

To: Solvency II Working Group
From: Prudential Team

Date: 16 July 2021
Reference: ECO-SLV-21-206

Subject: EIOPA opinion on the use of risk mitigation techniques by insurance undertakings

Summary

On 12 July, EIOPA published its [Opinion on the use of risk mitigation techniques by insurance undertaking](#).

The Opinion addresses the use of risk mitigation techniques and includes a set of recommendations addressed to NSAs to ensure convergent supervision.

In response to the industry feedback ([ECO-SLV-20-270](#)), EIOPA has made a number of important changes including explicitly recognising the importance of RMT, removing the RMT "blacklist" in the annex and improving the wording in a number of areas. However, the secretariat considers that the Opinion is still unnecessary, likely to disincentivise the use of RMT and to create additional operational burdens for insurers who do use RMT.

It is also worthwhile to note that although EIOPA consulted on this topic on the basis of a draft supervisory statement, it has published its views as an Opinion. However, this is not expected to make a practical difference to its application.

The secretariat's full assessment can be found below. If members have any additional comments, please write to prudential@insuranceeurope.eu.

Assessment

In terms of content, according to the Opinion:

- Risk mitigation techniques and, in particular reinsurance, are efficient tools for (re)insurance undertakings to manage their risks. It is also an important tool for capital management improving risk diversification.
- Reinsurance is a tool that can be used to optimise market participants' capital position within Solvency II.
- Prudency and effective risk transfer are considered by supervisory authorities when assessing compliance of recognition of risk mitigation techniques in SCR calculation. Where there is a calculated capital relief, a commensurate risk transfer is also expected.
- The use of mitigation techniques can have a significant impact on the SCR and therefore supervisory authorities should give appropriate attention to this subject.
- To recognise a risk mitigation technique in the SCR calculation there should be a proper balance between the effective risk transfer and the SCR relief.
- The transfer of risk might create basis risk and introduce other risks.
- Reinsurance structures tailored to standard formula scenarios or other reinsurance structures with complex interactions with the standard formula may endanger the adequacy of the standard formula measuring the risk-mitigating effect of the reinsurance structure. A case-by-case analysis is necessary to ensure adequate consideration of the specificities of the reinsurance structure.
- Supervisory authorities should also apply this opinion to (re)insurance undertakings making use of internal model.

On the positive side, EIOPA made some changes to the recognised the beneficial and necessary role of reinsurance and RMT in the insurance market and clarified some statements in order to avoid misinterpretation.

- + In line with the industry position, EIOPA has clarified that **reinsurance is an essential risk mitigation technique**. EIOPA has revised the introductory text to strengthen this consideration and avoid negative implications highlighted by some stakeholders.
- + EIOPA deleted the Annex of examples where it was proposed that there was a need for reinforced supervisory dialogue.
- + EIOPA specified that the actuarial functions should be proportionate to the **materiality** and complexity of the transaction (see paragraph 12, blue box).
- + EIOPA amended the text ‘...the complexity of the reinsurance contract might be hiding the absence of real risk transfer..’ into ‘...the complexity of the reinsurance contract leads to a specific interaction with the SCR...’ clarifying that reinsurance contracts do not hide features and they do not have to be disincentivised (see paragraph 14).
- + In paragraph 16 (blue box) EIOPA took on board the wording suggested by Insurance Europe “*Insurance and reinsurance undertakings should **provide, when requested**, the technical details of the risk mitigation techniques and the related contracts and **information on** any links or combinations with other existing or newly implemented contracts, appendixes or side letters to the supervisory authority that.....*”
- + In paragraph 18 EIOPA amended ‘non-traditional’ with ‘most complex in order to **not disincentivise some types of contracts** and do not harm reinsurance innovation.

On the negative side:

- EIOPA’s continues to suggest that the use of some RMT can endanger the adequacy of the standard formula. The provisions in the Opinion suggest that risk and risk mitigation should be measured on different bases.
- EIOPA fails to clarify the extent of the issue it seeks to address with the Opinion and instead refers to “new” structures as the motivation for its work in this area.
- EIOPA still applies the analysis of the risk profile of the undertaking at the **level of individual reinsurance arrangements**. Insurance Europe requested that this was specified to only be necessary if an individual reinsurance arrangement is significant for the overall assessment of the risk profile deviation of the undertaking (see paragraph 13, blue box).
- EIOPA did not clarify its concerns about the treatment of risk mitigation techniques within **internal models** (see paragraph 11).