

# Questionnaire following EIOPA meeting with participants on Stress Test 2024 – excerpt from the Technical Specification document

## 4 Methodology

### 4.1 Capital component

#### Questions

**Q1:** Do you think that allowing a fully-fledged estimation according to the sectorial rules e.g., for banking participations, would be a feasible in the context of EIOPA stress test?

**Q2:** If yes, which additional information would be needed to run the fully-fledged estimation.

#### Response:

Insurance Europe generally supports the simplified approach, which is considered more practical and reasonable than a fully-fledged estimation in the majority of cases. This full estimation will significantly increase the burden and complexity of this test for most undertakings without enhancing accuracy.

However, for more significant participation, one approach could be for the underlying balance sheet of the participation to be stressed. As EIOPA uses an instantaneous stress scenario, the banking entities could apply the scenario and the narrative to their balance sheet. The valuation methodology, as required by the sectorial valuation, is still applied. If any of the valuation is based on the fair value or economic value, these values are changed according to the market stress scenario. Based on the narrative, the loan loss allowance, e.g. the probability of default, could be revised (this would require EIOPA to provide default probabilities). The banking entity would then have a revised weighted asset value and subsequent capital requirement following their SREP.

It is also noted that applying equity stress to the line item and neutralising the effect by a proportionate effect on the capital requirement will limit the effect on the Solvency ratio for the group and, thus, all related indicators. However, any indicator related to the Assets of Liabilities (AoL) will still be very negatively affected. These are typically the indicators being disclosed. This would, therefore, seriously negatively affect the Financial Conglomerates.

A simple equity stress on the value of the participation should reflect the underlying activities of this participation. A reduction of 40% (previous stress test), would require a significant impact on loans and mortgage loans. These changes would be so extreme that plausibility is seriously in doubt. A participant would have to explicitly mention the inappropriateness of this approach in any disclosure regarding the stress test.

### 4.3 Simplification and approximations

**Q3:** Do you have suggestions on alternative approaches to the calculation of the post-stress DTA/DTL which simplifies the process while preserving the level playing field of the exercise and the comparability of the results?

#### Response:

On change in the DTA/DTL is deemed to resemble a temporary shock and is simply the change in value times the enacted tax rate. An approximation would be to maintain your original recoverability analysis irrespective of the stress scenario.

## 4.4 Management Actions

**Q4:** In order to grant homogeneity in the application of the reactive management actions, do you have suggestions on how to more clearly identify metrics/thresholds to trigger RMAs?

**Q5:** Based on the common practices, can you suggest more precise location (e.g. risk management plan) where these metrics can be found?

### Response:

While recognising that the industry has previously supported the inclusion of management actions within the EIOPA stress test exercise, Insurance Europe is concerned that EIOPA's push for homogeneity in the application of Reactive Management Actions (RMA) is misplaced and could lead to inappropriate conclusions being drawn from the exercise.

The application of the RMAs in periods of stress is scenario-specific. Given the idiosyncratic and macroprudential nature of the ESRB/EIOPA stress test scenario, the application of RMAs in this scenario requires some additional considerations.

- There is a potential time differential between the application of these many of the RMAs and the effect on the balance sheets.
- Reactive actions like de-risking measures, cost adjustments, or premium changes are contingent on the specific circumstances and market conditions.
- EIOPA should include clear guidance on how the effects of the possible management actions are included in the capital component and the liquidity component. For example,
  - if an increase of premiums would be required, how would that be implemented in the own funds and the capital requirements
  - if a derisking would be made by selling equities, is that assumed to be at the reference rate, and can the participant assume a purchase of another investment type, or should the participant assume that the proceeds are only cash.
- On the quantification of the reactive management action: EIOPA mentioned that the effects of the RMA would be included in the stressed balance sheet instantaneously. This would not provide a good level playing field and would obscure differences between insurers.

For example, assume a RMA being increase in premiums

- An insurer who has all the insurance contracts with a yearly invoice at 1 January. The RMA would have only an effect in the year t+1
- An insurer who has all the insurance contracts throughout the year. The RMA would have an effect on the next batch of insurance contracts being renewed
- In EIOPA's approach, both insurers would have the same impact, while in practice, it wouldn't.

Given the different approaches taken by undertakings and supervisors to the development and supervision of risk management policies, any discussion on which RMAs should be applied in the constrained balance should be held between the company and relevant NSA. The NSAs will most likely already have this information available to them.

Attempting to identify specific documents which include the RMAs that all companies should apply in the constrained balance sheet does not appear to be a valuable approach.

In any case, the application of reactive RMAs should be completely at the discretion of the participating company. A severe stress impact will have and should have a detrimental effect on the

insurers SCR ratio – there should be no requirement or expectation for undertakings to have an SCR ratio above 100% after such a scenario.

## 5 Scenario, shocks and their application

### 5.1 Market shocks

#### Questions

**Q6:** Do you identify asset classes that are not properly covered in the section of market shocks?

**Q7:** Do you find the specifications on the application of the shocks sufficiently clear? If not, what information is missing?

#### Response:

Q6- On residential mortgage loans, the current approach based on RMBS is not working properly in some jurisdictions, such as Belgium or the Netherlands. Undertakings from these countries usually use residential mortgage loans to match liabilities' cash flows.

The current approach does not capture the low-risk profile of mortgage loans, which have historically performed well even during major economic crises.

The industry proposes the use of Loan-to-Value (LTV) ratio of mortgage loans to better reflect the risk associated with mortgage loans considered long-term investment strategy. Lower LTV values indicate lower risks. The current Standard Formula already considers the LTV in mortgage loans to address the risk of individual counterparty default.

### 5.2 Insurance specific shocks

#### Question

**Q8:** Do you have any views whether specific distribution channels were linked to higher surrender/lapses in the previous two years? If yes, please indicate the channels and the magnitude of impact.

#### Response:

We do not have any clear evidence that lapses are differentiated according to distribution channel.

**Q9:** Based on your experience, is there alternative proxy to use for claims inflation, consistent with allowing a level playing field and prevailing the comparability of the exercise?

#### Response:

With respect to the claims inflation, clear guidance should be given on how the expenses included in the best estimate are to be adjusted. EIOPA should clarify if the claims inflation is a one-off or a permanent shock.

The claims inflation should also acknowledge that existing contracts on costs (outsourcing expenses, etc.) are to be honoured and will not be opened. Thus, the claims inflation can only have an impact on the variable costs.

**Q10:** Based on your experience, is there alternative proxy to use for expense inflation, consistent with allowing a level playing field and prevailing the comparability of the exercise?

**Response:**

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## General remark

**Q11:** Please provide any other comments you deem appropriate in relation to the stress test package shared.

**Response:**

EIOPA question raised during the stakeholder event on 17 January

Q5- The validation impact of the shock to non-life cost....

**Response:** Insurance Europe prefers the baseline duration approach over the cash flow approach. The duration approach is generally available and provides a better balance between accuracy and practicality.

The cash flow approach could be more accurate for some undertakings, but for other undertakings, this approach could even reduce the accuracy due to potential difficulties in reflecting internal retrocessions accurately and the need for information from non-EEA entities, which may not be readily available. This alternative is also considered more burdensome than the duration approach.