

## Insurance Europe comments on EIOPA's explanatory notes on variation analysis templates (August 2017)

### Summary

Insurance Europe welcomes the opportunity to provide comments on EIOPA's explanatory notes on the variation analysis templates.

Insurance Europe finds EIOPA's explanatory notes on the variation analysis templates a very useful document. However, Insurance Europe believes that the document could have provided more detailed explanations on several topics, eg on profit transfer, on the reporting of best estimate as presented in example 2A. The latter seems to be very complex especially for annuity provisions. It would be/have been also useful to include "Life" examples for completing S.29.03 and S.29.04, particularly for "unit-linked" and "other life" business.

In addition, the legal status of EIOPA's explanatory notes on the variation analysis templates has to be clarified; for example, whether it will be legally on the same footing as the log which is part of the ITS. Therefore, EIOPA should find a way to make sure that all the directions this document provides will be endorsed, adhered to, interpreted in the same way, and followed by all supervisors.

Insurance Europe proposes as a way forward that a Q&A process specific to the Variation Analysis templates be established by EIOPA as soon as possible, which will contain parts of the material of this document. The Q&A will also serve as the channel for clarifying and responding to the many other questions that will undoubtedly arise in the lead-up to the first Variation Analysis reporting by end 2017.

Insurance Europe's feedback should be read as follows:

1. Below, Insurance Europe puts forward a set of comments and clarifications sought
2. In addition, Insurance Europe submits, separately, specific text/language revisions proposed directly in the explanatory notes document

### General comments and outstanding clarifications sought on the explanatory notes

- **Allocation method** – is it acceptable to use an allocation method (a top down approach rather than a bottom up approach) for splitting out the information in S.29.03 by LoB, and featuring the same in S.29.04?
- **Order of calculation** – is an undertaking able to vary the order of calculation with respect to the discount part of the calculation, as suggested within the log file? The recent examples shared by EIOPA suggest the order is mandated; however, by changing the order of calculation, Insurance Europe believes it is possible to avoid extra calculation steps such as revaluation of year 'N' cash flows on both 1 year forward rates and year 'N' yield curve, without disrupting the purpose of the cells (see appendix "order of calculation" for one proposed approach).

The methodology used in Case 3 is an example of how to capture the various data cuts post the unwinding of discount for 'prior to the period' – such that all the cash flows post unwinding of discount (in R0210) from R220 to R240 must be discounted using the one year forward rate curve for the yield curve at the start of the year.

The suggested order of calculation is slightly different – ie R0250 is calculated before R0240. This implies that R0250 captures the impact of a change in yield curve from forward rate to the current year end yield curve on the 'N-1' cash flows, and then R0240 is calculated, which captures the difference between 'N' & 'N-1' cash flows discounted using the current year end yield curves.

Insurance Europe would like to know if the example given in Case 3 is a prescribed approach, or whether the order of calculation is open to interpretation as per the EIOPA log file.

■ **Cash flows** – from the log file and associated explanations, rows R220-R240 were interpreted as follows. Would this be correct?

- R220 – expected diagonal of payments (year 1 cash flow from the opening best estimate).
- R230 – almost actual\* vs expected for year 1 cash flow, where the almost actual\* reflects the difference in actual and expected payments made because of a speeding up or slowing down of payments (and not increases or decreases on settlement – these are for technical flows); hence the closing best estimate is impacted. If insufficient information is available to work this out, then the log summary and associated comments have been interpreted to suggest that a pure actual versus expected calculation can be used.

- R230 – on page 70 of EIOPA's explanatory notes, we would like to see more clarity around the signage (-/+ ) of the variation due to experience risks calculation. Is it [realised cash flows (paid/incurred new diagonal) – projected cash flows] OR [projected cash flows - realised cash flows (paid/incurred new diagonal)]?

- R240 – changes in best estimate that impact the future cash flows at the endpoint valuation (which are not inflation or yield curve driven). These would include new case information or revisions of IBNR due to non-economic assumption changes. Some of the wording around the inclusion of changes in RBNS and IBNR appears ambiguous (Please refer to the highlighted text in the appendix "RBNS and IBNR Ambiguity").

If inflation cannot be split out explicitly, R240 would seem the most appropriate place to put it – would this be acceptable? Alternatively, should it all (R230-R250) be put in R230? See EIOPA comment "For non-life (C0060/R0250), in case variation due to inflation cannot be discerned from changes due to experience, the whole amount would be reported under C0060/R0230".

- In this case, the 2 examples need clarity over the timing of the claims provision payments:
  - Example 1: claim provision of 100, paid 105 during the year.
  - Example 2: claim provision of 100, paid 50 during the year and review provision for 55 (5 more than initially).
- If, for example, in Example 2 one expected to pay the full claims provision of 100 in the past year, it would be expected that R220 shows -100, R230 shows +50 and R240 shows +5 (assuming non-economic). Without knowing the timing of the claims provision payments, it is hard to apply these examples to a situation involving these 3 cells. If the expected payment in the year was 50, then it would be expected to see row R220 as -50, R230 as 0 and R240 as +5.

■ **Technical flows**

- Insurance Europe's interpretation of the technical flows is as follows: actual values of cash flow realised over the calendar year, which cover both impacts that are seen in the variation in best estimate (e.g. faster/slower payment speeds) and other impacts (e.g. higher/lower payments than expected on settlement, which will not be seen in the closing provisions but impact the asset side of the balance sheet). Would this interpretation be correct?
- If R230 reflects full actual versus expected cash flows (see the previous point on the interpretation of R230), would one just expect to see the actual component of this in the technical flows? In which

case the claims provision (claims and expenses) component of the technical flows would be made up of R220+R230. Is this correct?

- Insurance Europe's understanding of S.29.03 guidance is that premium written during the period (R0310) relates to the amount of written premiums under Solvency II principles and not included in the Best Estimate, respectively for Life and non-Life.
- As per S.29.04 guidance, premiums earned/to be earned (R0080) relates to:
  1. C0030 – Corresponds to written premiums related to risk covered after the period (ie. premiums to be earned after the period)
  2. C0040 – Corresponds to part of premiums related to risks covered during the period (ie. earned premiums under Solvency II principles)

Is it expected that these two values in S.29.03 (R0310) and S.29.04 (R0080) respectively, should correspond to each other? Are there any EIOPA mandated crosscheck validations for technical flows with other QRTs?

- **Exceptional elements triggering restating of opening BE** are described as the model changes. Insurance Europe believes it should also include correction of errors (in assumptions, calculation or others) revealed after the reporting date as we do not see any other suitable item where this could be fitted. eg, if correction of parameters (parameters of product A used for product B by mistake) is shown as a parameter change, the conclusion and interpretation of the analysis would, in our view, be distorted. (As a way of comparison, in case of the MCEV analysis of change, there is usually a restatement of the opening value where such corrections would be reflected and the modelling changes step follows that. In the SII variation analysis, there is no such restatement item).

- **Variation analysis split in three cells**

Could you please confirm that the variation analysis, in fact, splits into three cells:

- In R0070 (can be R0220) the cash flows modelled in year N-1 for year N are excluded.
- R0310-R0330 includes the real cash flows from year N, which, however, do not have any impact on BEL as at the end of year N (this concerns e.g. the actual total claims from year N)
- R0080 (can be R0230) includes the difference between the real cash flows in year N and the cash flows modelled for year N (assuming a simplified view). So, should the equation "R0310-R0330" + R0080 (can be R0230) = R0070 (can be R0220) apply? In other words, it should include the impact of all real cash flows from year N on BEL as at the end of year N. Could you provide an example for life insurance (similarly to the one provided for non-life)?

- **S.29.01 and S.29.02: reporting of variation of investments**

- EIOPA's explanatory notes on variation analysis templates (EIOPA-17-403), paragraph 1.14 (page 3) state the following in relation to QRT 29.02:

*"1.14. This variation of Investments is not a "pure variation" as it should only capture the variation leading to an impact on the EoAoL, ie. should not capture any buying's or selling's but simply the variation of the valuation, including expenses/revenues (as said R0190 needs to capture all amounts reported in S.29.02). For example, when bonds are paid this might affect "Cash and cash equivalents" but is not affecting the EoAoL. "*

- It is not clear what is meant here by buying and selling - Does it meant that the proceeds should not be included? The payment of a bond (presumably on maturity), which is given as example, would also have an impact on the excess of assets over liabilities (EoAoL) due to the difference between the face value/principal repayment on maturity (proceeds) and the market value as at the last reporting period (previous year end). The clarification should be refined.

- In addition, the explanations in the log file to S.29.02 and the definition to cell C0010/R0010 (page 63) imply that that any sales/ divestiture and purchases of investments during the period should be considered (relevant text is shown in bold):

*"i. Movements in valuation with an impact on the Excess of Assets over Liabilities (e.g. **realized gains and losses from sales**, but also valuation differences);"*

*C0010/R0010 Valuation movements on investments, including:*

- *For those assets kept in the portfolio, the difference between Solvency II values at the end of the reporting period (N) and at the beginning of the Year (N–1);*
  - *For those investments **divested between the two reporting periods (including where an asset was acquired during the reporting period), the difference between the selling price and the Solvency II value as at the last reporting period (or, in case of investments acquired during the period, the acquisition cost value);***
  - *For those assets acquired during the reporting period and still held at the end of the reporting period, the difference between the closing Solvency II value and the acquisition cost/value.*
- ...".*

- EIOPA's explanatory notes on variation analysis templates (EIOPA-17-403), paragraphs 1.19 & 1.21 (page 6)

- In reference to 1.21 in comparison to 1.19:  
The term "Investments" is generally used for the balance sheet positions R0070 – R0210 of the Balance Sheet Template S.02.01. Therefore, introducing a new second term of "investments" including other additional balance sheet positions like "Deposits to cedants" is highly inconsistent.

If it is really requested to introduce the other balance sheet positions as described in 1.21, the expression "Valuation movements on investments" should be renamed and the general description on Template 29.02 should be adjusted with these additional positions, to get a consistent definition.

- Further, as we expect a lot more questions, ie also regarding Life business, we propose a Q&A process especially for variation analysis to be established by EIOPA.

#### ■ **S.29.01 and S.29.03: variations due to technical provisions and other variations**

- This concerns rows R0200 and R0250 in QRT S.29.01, and their correspondence with rows R0360 and R0370 in QRT S.29.03. Paragraph 1.12 states that the "Other variations" (R0250) should reflect the variation of the assets and liabilities related to "Index-linked and unit-linked contracts" (see  $BV508 = \{S.29.01, r0200, c0030\} = \{S.29.03, r0360, c0120\} + \{S.29.03, r0370, c0120\} + \{S.29.03, r0360, c0130\} + \{S.29.03, r0370, c0130\}$ ). The validation BV508 contradicts this statement by clearly indicating that the neutralised variation of the assets and liabilities for unit-linked contracts calculated in row R0360 in QRT S.29.03 will be reported in row R0200 in QRT S.29.01 and not R0250. This is also made clear when reading paragraphs 1.24 and 1.35.
- The sixth answer in the FAQ on S.29.03 (page 18) contains the same contradiction, where the first point of the answer seems to contradict the third point of the answer.
- The current draft does not provide information as to whether profit transfer should be reported under "dividend distribution" in S.29.01 R0240. If this is not the case, it would be necessary to report profit transfer in S.29.01 R0250 "other variations in excess of assets over Liabilities". Then a large amount would be reported in R0250. Therefore, we propose to clarify in the Log Files on S.29.01 R0240 that profit transfer should be reported in this cell as well.

■ **S.29.02 and S.29.03: claims and expenses**

In QRT S.29.03, items such as Claims and Expenses are to be reported as positive values; however, for investment expenses in row R0050 of QRT S.29.02 there is no clear guidance provided. Paragraph 1.23 of the explanatory note indicates that R0060 on S.29.02 should be the sum of R0010 to R0050, which would then suggest the number in R0050 needs to be reported as a negative amount to give the correct total value. We would suggest adding a validation around R0060, to ensure the sum of R0010 to R0050 is calculated correctly. In the meantime, would EIOPA be able to confirm that the investment expenses in row R0050 of QRT S.29.02 are to be reported as a negative amount?

■ **S.29.03: changing the variation bridge from one currency to another**

Where (for example) a branch is located in a different country from the main undertaking, could EIOPA confirm where it expects the FX differences to be placed, or does it not foresee there would be any? We have assumed that brought forward numbers will be at prior year rate, end of year numbers will be at current year closing rate, and movements will be at average rates, meaning there will be differences.

■ **FAQ on S.29.01 - Excess of Assets over Liabilities**

This concerns the FAQ at the bottom of page 4 of EIOPA's explanatory notes. Insurance Europe has interpreted this to mean the variation element of surplus funds to be included in R0210/C0030 should equal R0050/C0030. Given the movement on surplus funds is captured across several S.29.01 attributes, is it correct to assume that to avoid a double count and for the templates to reconcile, the total value included in R00210/C0030 (in relation to surplus funds) should be deducted from R0190/C0030?

If the total surplus fund variation is to be deducted from R0190/C0030, then R0190/C0030 in S.29.01.01.02 is not valid, unless the same adjustment is replicated in R0060/C0010 in S.29.02.01.01. If we were to replicate the adjustment, which attribute should it reflect?

■ **FAQ on S.29.04 - Excess of Assets over Liabilities - explained by technical provisions**

The reporting of best estimate is described in example 2A. This seems to be very complex as non-annuity provisions are collectively assessed, contrary to annuity provisions. Therefore, an individual valuation is not available at the beginning of the period.

■ **Annex 2: S.29.01 – Excess of Assets over Liabilities**

Clarification is requested for income tax, which has to be reported in S.29.01. Shall this be reported as shown in the Profit and Loss accounts (ie income tax expense) or shall it be income tax which has actually been paid during the financial year (ie income tax payable)?

## Insurance Europe comments on EIOPA's explanatory notes on variation analysis templates (August 2017)

### Appendix – Order of calculation

In the example 'Case 3' and explanatory notes, EIOPA have stated that all cash flows post the unwind of discount should be discounted on the basis of year 'N-1' forward yield rates. We believe that if we were to capture the 'Variation in economic assumption' (R0250) before variation in R0230 & R0240 then we can avoid revaluing the year 'N' cash flows on a 1 year forward rate basis. Instead, we only need to discount year 'N' cash flows on the basis of year 'N' yield curves, thereby avoiding an extra step of calculation while maintaining the purpose of the cells. Please refer to the comparison below for further details:

		LIFE	NON LIFE		
		Gross of reinsurance	Gross of reinsurance		
		C0050	C0060	EIOPA Approach	Proposed New Approach
Opening Best Estimate	R0150		96.0800	*Discounted BE at N-1	*Same as EIOPA
Exceptional elements triggering restating of opening Best Estimate	R0160		0.0000		
Changes in perimeter	R0170		0.0000		
Foreign exchange variation	R0180		0.0000		
Variation of Best Estimate on risk covered after the period	R0190		0.0000		
Variation of Best Estimate on risks covered during the period	R0200		0.0000		
Variation of Best Estimate due to unwinding of discount rate - risks covered prior to period	R0210		0.9608	*All cash flows for 'N-1' ie. t=0 discounted using 1 year forward rate - discounted using spot rate	*Same as EIOPA

Variation of Best Estimate due to year N projected in and out flows - risks covered prior to period	<b>R0220</b>		-60.0000	*Claims provision BE in cash flow year 1 for 'N-1' ie. t= 0	*Same as EIOPA
Variation of Best Estimate due to experience and other sources - risks covered prior to period	<b>R0230</b>		0.0000		
Variation of Best Estimate due to changes in non-economic assumptions - risks covered prior to period	<b>R0240</b>		13.2403	*Cash flows from CF year 1 for 'N' discounted using 'N-1' 1 year forward rate – Cash flows from CF year 2 for 'N-1' discounted using 'N-1' 1 year forward rates	*Cash flows from CF year 1 for 'N' discounted using current year yield curve - Cash flows from CF year 2 for 'N-1' discounted using current year yield curve
Variation of Best Estimate due to changes in economic environment - risks covered prior to period	<b>R0250</b>		1.4994	*Cash flows from CF year 1 for 'N' discounted using current year yield curve – Cash flows from CF year 1 for 'N' discounted using 'N-1' 1 year forward rate	*Cash flows from CF year 2 for 'N-1' discounted using current year yield curve – Cash flows from CF year 2 for 'N-1' discounted using 'N-1' 1 year forward rates
Other changes not elsewhere explained	<b>R0260</b>		0.0000		
Closing Best Estimate	<b>R0270</b>		51.7805		

## Appendix - RBNS and IBNR Ambiguity

Please refer to the highlighted text below. Is EIOPA referring to case by case revision of IBNR or RBNS? We presume that EIOPA is using the same definitions as used elsewhere in the QRTs, i.e. RBNS is pure case reserve and does not include any IBN(E)R.

### Extract from Page 12:

<p>Variation of Best Estimate due to changes in non-economic assumptions - risks accepted/covered prior to period (R0090/R0240)</p>	<p>It mainly refers to changes in RBNS not driven by realised technical flows (e.g. revision on a case by case basis of the amount of IBNR) and changes assumptions directly linked to insurance risks (ie. reserving methodology assumptions, assumptions on lapse rates, inflation, etc.), which can be referred to as non-economic assumptions.</p>	<p>This will provide the variation of Best Estimate strictly related to changes in these assumptions, e.g. lapse rates.</p>	<p>This will provide the variation of Best Estimate strictly related to changes in these assumptions. This may not capture the variation due to case-by-case revision of RBNS, which would thus have to be added if related to a change in assumptions. This amount could also be reported in R0230 depending on the rationale for the revision.</p> <p>In cases where these changes cannot be discerned separately from changes due to experience, report the total figure under C0060/R0230.</p> <p>Changes of BE due to new information in terms of a new diagonal in the claims paid/incurred triangle would be captured in the cell R0230, while changes due to new or updated actuarial assumptions (e.g use of different development factors, changes in the actuarial reserving method (e.g. from chain ladder to Loss-Development Method etc.) would be captured in R0240.</p>
---	--	---	---