

Comments to the 2021 Stress Test draft technical specifications

Providing feedback to the document

The 2021 Stress Test draft technical specifications will be presented and discussed during the meeting planned on 28 January 2021. For the sake of efficiency and effectiveness EIOPA welcomes comments on the document in advance to the meeting.

Comments are most helpful if they:

- respond to the question stated, where applicable;
- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA in the provided Template for Comments, by email to <eiopa.stress.test@eiopa.europa.eu> by **25 January 2021**.

Provided comments will not prevent any discussion during the teleconference and will not be disclosed.

Reference

Name of the Stakeholder	Insurance Europe
Contact Person	Angus Scorgie
Email address	scorgie@insuranc europe.eu
Phone number	+32 2 896 48 36

#	Question	Answer
Q.1.	In case of liquidity managed at solo level, between the top-down and bottom-up approach in the selection of the entities, what is in your opinion the most viable solution?	<p>General comment</p> <p>Insurance Europe provides the comments below on a provisional basis. These are intended to provide input for technical discussion. They do not necessarily represent our official views on the stress test exercise and are subject to change.</p> <p>We would welcome further exchange with EIOPA on the draft technical specifications, and in particular a consultation of draft calibration of the stress scenarios.</p> <p>Response to Q1</p> <p>Insurance Europe supports the Bottom-up approach. This should ensure that the solo entities which most influence the liquidity risk at group level are captured in the analysis and more importantly, those that do not influence the group liquidity do not need to be included in the analysis to avoid unnecessary burden.</p> <p>Insurance Europe supports the principle of “assessing the risk where it is managed” and welcomes EIOPA’s proposal to include flexibility in the exercise to allow insurers to model the liquidity risk at group or solo level.</p> <p>In case of liquidity managed at solo level (bucket b), the sources of liquidity on group level should also be applicable. This has also been an observation from the EIOPA liquidity monitoring.</p>
Q.2.	Please provide your view on the proposed criteria for the identification of the solos	<p>The identified threshold of 80% could be lowered to account for well diversified groups with several small entities. In these groups, entities with non-relevant liquidity risk would also have to be included in the scope.</p> <p>We support the removal of non-EEA parts of the groups in the total assets coverage ratio as they are not within scope ie. the denominator should be <i>“the total assets of EEA solos in the group.”</i></p>

<p>Q.3.</p>	<p>Do you have suggestions on alternative approaches to the calculation of the post-stress DTA/DTL which simplify the process and at the same time preserve the level playing field of the exercise and the comparability of the results?</p>	<p>The most burdensome elements of calculating the DTA/DTL is the classification of the DTA based on the enacted tax regime and to assess the changed recoverability of any netDTA.</p> <p>With respect to the classification according the tax regime: one can assume that all impacts which relates to cash outflows on the economic balance sheet are directly transferred into income tax payable and receivable, while all other elements are transferred to deferred tax assets or liabilities.</p> <p>For the recoverability, the insurers could use their analysis as used for calculating the LACDT. If they can demonstrate that on average the stresses used are less than the 1:200, the conclusions from the LACDT can apply. As one addition, any fiscal unity considerations should be allowed as these are not allowed for the LACDT.</p>
<p>Q.4.</p>	<p>Do you agree to apply the mortality shocks also in the Health Similar to Life business also in consideration of the additional burden?</p>	<p>On first assessment, the additional operational burden of applying the mortality stress on Health SLT business appears to be disproportionate to the impact. Normally, disability/morbidity is the most dominant risk driver.</p> <p>In some cases (i.e. LTC Long Term Care products), mortality shocks could result in benefit for the entity from both Capital and Liquidity perspective.</p>
<p>Q.5.</p>	<p>Based on your experience, is the General liability insurance materially affected by the current crisis?</p>	<p>Members that provided feedback have not reported, based on current data, that the general liability insurance has been significantly affected as a whole. However, they recognise that this situation may evolve in the future.</p> <p>This could possibly be driven by positive judgemental outcome for claimants, in particular for policies covering employer's liability or business interruptions. If an employee contracts COVID-19 through work or through travel related to work and claims that the infection is a result of the employer's negligence, the employer may be sued as the employer may be considered responsible for the infection. Similar case could happen for policies covering corporate responsibility against customers (e.g. medical responsibility) and in general for policies covering individuals.</p> <p>It is also highlighted that the current crisis results in an increase of claim severity of some lines of business, but a decrease for other lines of business due to the lock down measures.</p>

		<p>This is not reflected in the stress test scenario and appears a disadvantage for insurers with a diversified set of lines of business within their portfolio. For more information, please see the NBB's Covid-19 reporting - High-level results (updated 11/12/2020) is added.</p> <p>Source: https://www.nbb.be/doc/cp/eng/2020/nbb_covid19reporting.pdf</p>
<p>Q.6.</p>	<p>On the application of the shock to frequency, what is your preferred option between additive and multiplicative?</p>	<p>On initial assessment, the multiplicative application seems more appropriate for claims frequency.</p>
<p>Q.7.</p>	<p>Please provide any relevant feedback to the content of the document and more in general to the structure of the 2021 Stress Test exercise.</p>	<p>Insurance Europe welcomes several improvements to the stress testing exercise consistent with the feedback it provided to the two consultation papers on the Methodological principles of insurance stress testing. For example, we appreciate that the baseline position does not need to be recalculated, the idea of synthetic groups has been disregarded and templates for the capital component will rely to the maximum extent to the regular QRT reporting.</p> <p>However, we continue to highlight the following aspects of the draft technical specifications which raise concern for the industry:</p> <ul style="list-style-type: none"> • Based on the experience from the 2018 stress test, we are still not convinced that the calculation of the Post-stress SCR is neither necessary nor appropriate. <p>The analysis of stress after stress increases the processing effort and severely restricts the comparability of the results. At a minimum, we request that the methodologies applied in the 2018 exercise for the calculation of the post-stress SCR can be applied again to the largest extent.</p> <ul style="list-style-type: none"> • Individual public disclosure of the results of the exercise are not necessary to achieve EIOPA's objectives. "Voluntary" company-level disclosures change the nature of the exercise from a vulnerability test to a capital exercise and results should continue, as in previous years, to only be published at aggregate level.

		<p>Any voluntary disclosure of results should remain at an undertaking's own volition. EIOPA should not have a role to play in the co-ordination of voluntary disclosures. Besides, from a macroprudential perspective, company-level disclosure can be counterproductive.</p> <ul style="list-style-type: none"> • We appreciate that embedded management actions will be applicable. This measure is essential to produce adequate results about the resilience of the undertakings under the severe scenario, and in this way a realistic and comparable picture will be obtained. • With regard to reactive management actions being modelled in the "constrained balance sheet": Certain "natural" reactive management action such as the cut of dividends should always be admissible even if they are not included in the future management action plan. • The LTG measures should be set to be consistent with the current Solvency II regulation. The UFR should be modelled as per the existing EIOPA methodology and not as the last forward rate derived from the liquid part of the RFR curve, • EIOPA's early interaction with stakeholders via this consultation is welcomed. However, additional time should be foreseen for insurers to plan and complete the exercise. <p>For example, the start date could be advanced to April with the final submission date extended to September. Insurance Europe notes the following considerations with regard to the timeline.</p> <ul style="list-style-type: none"> ○ The first part of the period will be occupied with the pre-validation of the supervisors ○ Most participating groups will also be busy with completing the IAIS IIM data collection (starts in May) ○ Participating groups with an internal model will finalise their second phase of the diversification benchmark exercise ○ There could be increased demand for staff to have time off following the
--	--	--

		<p>lockdowns/travel restrictions</p> <ul style="list-style-type: none"> ○ Most groups will have to publish Q2 results end of July/mid-August • The stress test should be designed in accordance with the principle of proportionality. Any changes included in the upcoming stress test must be closely discussed with the stakeholders and developed in line with the current regime Solvency II. Excessive burden and unnecessary reporting requirements must be avoided. <p>Additional comments (paragraph number provided for reference)</p> <p>10: In paragraph 10 EIOPA states "...consequent erosion of savings (if available),...". Currently, which is also evidence by the various European statistical agencies that the savings quote increased during the recent lock down periods. How does this fact relate to your comment on the savings?</p> <p>13: Health claims have opposite effects which are not mentioned by EIOPA. COVID-19 did defer a lot of health care treatments resulting is less claims. As health care is provided by health care professionals not all deferred claims will lead to additional treatments unless the capacity of the health care systems is expanded.</p> <p>In the current crisis (2020) there has not been signals of increased lapses. In certain LoBs there could be a change in policyholder behaviour with respect to renewals and/or new business.</p> <p>As many of the events have been cancelled, all the (possible) claims with respect to business interruption are known. Naturally, based on legal challenges several dismissed claims could be reversed and total claim damages could increase.</p> <p>18: EIOPA states: „</p> <p>Additionally, liquidity risk might become an issue in case the level of claims and surrenders of the business lines more affected by the crisis overcome the expectations while the written premia shrinks due to the contraction of the economy.”</p> <p>This becomes only a risk if the insurer has too many illiquid assets. Liquidity risk and ALM</p>
--	--	--

		<p>risk should not be confused.</p> <p>71: The explanation of the timings should be enhanced for clarity. Currently, it could be misunderstood to be a multi-period stress.</p> <p>73: We assume the look through approach should also be applied for Investment related Undertakings ie. basically the stresses have to be applied to the economic balance sheet applied to determine the capital requirements rather than the balance sheet as disclosed in QRT S02?</p> <p>74: EIOPA proposed approach is not consistent with the manner in which the SCR is calculated. By stressing the value of the participation, a wrong risk profile is stressed.</p> <p>Also stressing the CRD-entities based on the equity stresses is wrong compared to the risk profile. The value of the participation is based on the sectoral requirements. A stress of the equity value will assume a too onerous deterioration of the business of these entities. For example for a mortgage bank, this would assume an massive default of residential mortgage loans. This is not the scenario assumed nor is it evidenced based on past crises.</p> <p>We would propose the asset value of the participations remains unchanged.</p> <p>86: Corporate bonds issued by financial institutions should be included in the table. The prescribed scenario does not justify an exclusion of these assets for the liquidity stress tests.</p> <p>86: EIOPA lists various assets on the balance sheet. EIOPA does not mention several other assets which would provide liquidity for the insurer such as "receivables" and "amounts ceded to reinsurers".</p> <p>86: EIOPA lists various assets on the balance sheet. In the list property is not included. EIOPA should be explicit with respect to indirect property included in investment funds. Also, property which provides rental income should not be disregarded as a source of liquidity.</p> <p>89: EIOPA presents a flow for Life insurers. It would be also useful to present an example for non-life insurance.</p> <p>94: does the classification of the life best estimate liabilities in terms of surrender</p>
--	--	--

		<p>value/penalties include fiscal penalties?</p> <p>110: For materiality considerations, EIOPA should refer to their statement regarding materiality and proportionality. In that statement, EIOPA applies percentages of 5%.</p> <p>117: EIOPA uses “defiantly” but should it be “differently”?</p> <p>125/146: We consider that covered bonds constitute a better proxy for mortgage loans. Applying RMBS shocks for Loans and Mortgages will overestimate the risks for mortgage loans.</p> <p>126: The UFR should be set to be consistent with the current Solvency II regulation. It should not be modelled as the last forward rate derived from the liquid part of the RFR curve,</p> <p>137: We assume that the shocks on claim severity should be applied comparable to the 2018 stress test. Is this assumption correct? How should the shock factors on claims frequency be implemented in the calculations?</p> <p>142: EIOPA states “Own shares (held directly) and holdings in related undertakings, included participations should be treated as listed equities.”. This stress assumes that underlying business is deteriorated significantly which is in most instances absolutely not the case.</p> <p>In our opinion the ancillary service entities should not be stressed. The underlying adjusted equity value should only be reconsidered based on the changes in the discount rate.</p> <p>As much as possible, EIOPA should ask the look through to be applied ie. the economic balance sheet should be used which is used as input for calculation of the capital requirements rather than by referring to the balance sheet as presented within the QRT S02.</p> <p>144: The economic value of “property, plant and equipment held for own use” is mostly based on the value of contractual arrangements. What is the rationale for a stress on these balance sheet items as the underlying, for example rental payments, are not changed? If the value of these items would change, changes in expense assumptions in the best</p>
--	--	---

		<p>estimate could also be made accordingly as the allocated costs are less.</p> <p>146: This approach leads to unrealistic stresses which undermine the appropriateness of the stress scenario for insurers having portfolios or mortgage loans. Mortgage loans do not have similar characteristics as RMBS as assumed by EIOPA (and the ERSB). See Insurance Europe feedback to the first of EIOPA’s Methodological Principles of Insurance Stress Testing Discussion Paper</p> <p>159: In considering the mass lapse stresses, EIOPA assumes that policyholders would understand based on the instantaneous other stresses to lapse their policies if they can benefit from the lapse ie. a rational behaviour. This assumption is not evidenced in the current and past crises.</p> <p>163: The increase in the mortality parameter will also have an opposite effect on the longevity risk if both risk are covered and related to the same policyholder.</p> <p>172: In what sense does EIOPA assume the deferral of medical care and thus expense to be included in the scenario. The health systems are not able to cope with the current envisaged health care and the increase due to the Covid-19 pandemic. This is also currently seen in practice ie. planned health care is suspended and/or deferred.</p> <p>176: EIOPA should understand that there is a natural boundary to the possibility of increases in health care. This fact is disregarded by EIOPA and therefore the execution of this scenario to the LoB medical expense will not provide realistic outcomes and will undermine the credibility of the stress test for those groups having significant portfolios of health products.</p> <p>178: The impact of the pandemic has also shown the decrease of claims in several LoBs. EIOPA assumes only increases. Also see comments to question 5.</p> <p>8.1: In the questionnaire, EIOPA should take care in not duplicating asking for conclusions and arguments. The insurer should only be required to include additional information if it is not already included in previous answers. For example, questions 2, 3 and 4 will have many overlaps. The same is the case for 2, 6, 7 and 8.</p>
--	--	--