

To: Solvency II WG, Public Affairs & Communications Committee
From: Prudential Team
cc:
Date: 31-03-2022
Reference: ECO-SLV-22-155

Subject: Key messages ahead of EGBPI on 5 April

Summary

Ahead of the Expert Group on Banking, Payments and Insurance (EGBPI) meeting on 5 April ([Agenda](#)), the secretariat has prepared a summary of Insurance Europe's key positions on the topics tabled for discussion (ECO-SLV-22-153).

Members are encouraged to share the summary of Insurance Europe's key position with their EGBPI representatives.

Should members have any additional feedback on the proposals from the EC, please write to prudential@insuranceeurope.eu

Key industry positions on questions posed by Commission

Diversification benefits within the market risk module

- **Question 1** - The industry **supports the proposed reduction of the correlation parameter** between interest rate down risk and spread risk. However, there is justification for a further reduction to 0 and the removal of the two-sided correlation.
- **Question 2** - The industry **supports a thorough investigation of the correlation parameter** between equity risk and interest rate risk. There should be transparency on any analysis used to justify the calibration of the correlation matrix.

Rules governing RMT

- **Question 3**
 - The industry **supports the improvement of the recognition of risk mitigation techniques, in particular Adverse Development Covers (ADCs)**. However, **improvements to EIOPA's recommended approach are needed** to ensure the improvements are effective including extension of the proposal to multiple LoBs and removal of limitations to the attachment point. Improved recognition of ADCs will consequently reduce the volatility of small and medium-sized insurance companies, while protecting their back book of historical risks from distortions.
 - **The industry does not support equal treatment of contingent capital treatments in internal models and the standard formula**. A key feature of internal models is to provide flexibility to properly capture risk profile where standard formula cannot do so appropriately. Current regulation which allows the internal models to capture risk profile correctly and recognise the economic impact of contingent instruments under close supervisory scrutiny (via internal model approval processes) is appropriate and does not need to change.

- **The industry does not support EIOPA’s advice on the introduction of new safeguards to ensure effective transfer of risks in case of reinsurance treaties.** Following the presentation of its recommendations, EIOPA undertook further work on this topic and developed an Opinion on the use of Risk Mitigating Techniques. In particular, EIOPA agreed to clarify that a reinsurance arrangement may not pass the “commensurate” test where it creates “a significant deviation of the risk profile of the undertaking from the underlying assumptions of the SCR”. In other words, a reinsurance arrangement may not qualify for a SCR reduction if it renders the SF inappropriate to capture the risk profile of the ceding undertaking. Against this background, **any changes to Delegated Regulation in this area should reflect EIOPA’s Opinion on the use of RMT as well as its earlier advice.**

Rules on the prudential treatment of third-country reinsurance

- **Question 4 – The industry supports Option 1, no changes to the prudential treatment of third-country reinsurance.**
 - Europe should not follow the negative trend of market access barriers and should not impose restrictions on third country reinsurers. In particular, introducing barriers such as limitations on cession rates, collateral requirements, or local presence requirements to reinsurers from non-equivalent third countries would have knock-on effects on the EU based (re)insurers and should be avoided.
 - Solvency II already provides tools for supervisors to assess a cedant risk exposure including credit risk via the Counterparty Default Risk Module which already considers key elements such as the rating of a reinsurer and whether a reinsurer is from an equivalent or non-equivalent third country. In isolated cases where supervisors do not view the existing quantitative requirements as sufficient, supervisors already have the powers (Art. 37 Solvency II Directive) to impose additional capital requirements.
 - Qualitative requirements (eg Art. 210 and 235 SII Delegated Act) ensure reinsurance contracts provide effective coverage and risk management requirements (Art. 44 SII Directive, Art. 260 SII Delegated Act) ensure that reinsurance risk mitigating techniques are suitable for undertakings and that their credit risks are assessed. Should there be special circumstances or other risks beyond counterparty, Solvency II allows for such assessments to be embedded in a cedant’s ORSA and discussed in the supervisory dialogue.

SCR for mortgage loans

- **Question 11: The industry strongly supports Option 1 not to aim for further consistency with banking regulation. The current treatment of mortgage loans in Solvency II is appropriate and should be retained,** as it is already calibrated on a one-year 99.5% VaR as per Solvency II principles and reflects the long-term nature of the insurance sector.
- **Question 12: The introduction of arbitrary floors into Solvency II is unnecessary and would undermine its risk-based nature.** The Commission has not presented any evidence that the current capital requirements are not consistent with the Solvency II requirements, of any “*potential risks stemming from large-scale lending operations by firms outside the banking perimeter*” or of any regulatory arbitrage within European mortgage markets. Further, the analysis provided by the ESRB is very subjective and based on a number of assumptions (reflecting the difficulty of making a direct comparison between capital requirement for banks and insurers).

Other changes to counterparty default risk

- **Question 14 – The industry supports EIOPA advice on the treatment of partial guarantees on mortgage loans.**

Best estimate

- **Question 15 - Potential changes to best estimate not dependent on amendments to Level**
 - *Definitions* (changes proposed to Art 1):

- The industry **supports the introduction of a definition of Future Management Actions** in DA Art 1.
- The industry **does not support the introduction of a definition of gross expected future profit/loss** from servicing and management of funds in DA Art 1
- *Contract boundaries* (changes proposed to Art 18(3)):
 - The industry **disagrees with the proposed clarification** that the third subparagraph of Article 18(3) establishes an exception that only needs to be applied when the undertaking does not have the right to perform again an individual risk assessment, after the inception of the contract
- *Expenses* (changes proposed to Art 31(1)/(4)):
 - The industry **agrees with the clarification that the expenses shall take into account overhead expenses** to be incurred in servicing insurance and reinsurance obligations [i.e. undertakings should take into account assumptions on expected future expenses]
- *EPIFP* (changes proposed to Art 260(4)):
 - The industry **agrees with the clarification that Loss-making policies should be offset against profit-making policies within a homogeneous risk group for the purpose of the calculation of EPIFPs.**
- **Question 16** - To allow for proportionality, **the criteria for the use of a prudent deterministic valuation of the best estimate should be set so that also non-low risk profile undertakings would be able to continue to use it.** Stochastic modelling is burdensome and does not often lead to significant changes to the technical provisions. If required by default it will affect most insurers and involve a heavy workload, while according to EIOPA the impact on the best estimate of including the dynamic component usually ranges from 0.05% to 0.3% of the best estimate.

Reporting and disclosure

- **Question 18** - **The industry welcomes the split of the SFCR in two parts**, as proposed by the EC, however the current proposal would increase the operational burden and fails to streamline the SFCR. The industry highlights that the second part of the SFCR, dedicated to other participants should only consist of the set of public QRTs, without a mandatory narrative.

Group supervision

- **Question 20** - Potential changes directly related to changes to Level 1
 - The industry is concerned by the EC's extensive set of proposals to change the requirements on group supervision and to grant additional powers to the group supervisor in Solvency II — without clear justification of their need. These proposals go far beyond what is necessary to address group-related issues and could lead to unintended consequences.
 - It should be noted that a change in labelling to use the term 'Group MCR' instead of 'Minimum Consolidated Group SCR' does not address the issues highlighted by the industry. While the industry welcomes the addressing of the issue of trigger inversion, other issues should also be addressed.
 - The disclosure in the SFCR of solvency figures without the benefit of transitionals at group level is very concerning, because it would create confusion and undermine their purposes of giving insurers the necessary time to adjust under the new Solvency II framework. (DR Art 359/Art 372)
- **Question 20** - Potential changes not dependent to changes to Level 1
 - **The treatment of EPIFP at group level should remain unchanged, and not be included in the group's regular assessment.** Creating an availability assessment process specific to the EPIFP, on top of what is already required by Art.330, would only add burden and uncertainty in the group capital assessment for no purpose.

- EPIFPs are an important part of the Solvency II framework allowing the reflection of economic reality, with respect to the principle of going concern. As such, they are a useful element, notably to encourage the offer of long-term guarantees. The Delegated Regulation already provides for NSAs the power to challenge the availability of own funds items that are assumed available. Supervisors also have the power to review the best estimate calculations, knowing that EPIFPs are just an output of the economic value of insurance liabilities.
- **The industry highlights there is no need to specify the way of calculating non-available minority interests from insurance subsidiaries.** There are already specific guidelines on the treatment of minority interests.

Other topics

- **Question 24 – The industry strongly supports the EC’s proposed clarification on the calculation of the expense risk module (Art 140(a) and Art 157(a))**
 - Change is needed because, **as currently worded, the wording used in the Delegated Regulation deviates from a risk-based approach and leads to unnecessary and excessive capital.** In practice, it forces insurers to include expenses which cannot vary such as acquisition expenses.

The change would be to **Article 140 of the delegated regulation** on Life-expense risk sub-module. The issue can be solved by adding text along the lines the wording shown in red below to the existing article:

The capital requirement for life-expense risk referred to in Article 105(3)(d) of Directive 2009/138/EC shall be equal to the loss in basic own funds of insurance and reinsurance undertakings that would result from the combination of the following instantaneous permanent changes:

*(a) an increase of 10 % in the amount of expenses taken into account in the calculation of technical provisions; **Expenses which cannot vary materially or give rise to material adverse solvency development can be excluded (eg commission or investment management expenses which are contractually agreed and so cannot be unilaterally changed).***

(b) ...

A **similar change in wording for Article 157 of the Delegated Regulation** on Health-expense risk sub-module, is also appropriate.

- **Property risk: There should be a review of the property risk stress factor.** The standard formula property risk factor which was calibrated solely with exceptionally volatile UK data is clearly too high given the evidence in the EU. In addition, a revised capital requirement could foster insurers’ contribution to the financing needs of economic recovery, the Capital Markets Union and, particularly, the decarbonisation targeted by the European Green Deal.
- **Lapse risk:** There should be a review of the lapse risk submodule. The **risk factors for the life and health mass lapse scenarios are unreasonably high.** No evidence of the veracity of the calibrations has been provided by EIOPA whereas in reality, 37 even in extreme situations of individual life insurers, lapse rates of 40% (or 70%) have not occurred. The mass lapse risk factors for life and similar to life techniques health are only selectively applied to those contracts for which the changed lapse rates increase the obligations. In practice, however, movements in lapse rates are largely homogeneous over all contracts. Therefore, the assumed changes in option exercise rates should apply to all contracts in each scenario.