

2020 review of Solvency II

Proportionality

Any views provided in this document are tentative views at working group level and should not be understood as EIOPA positions.

8.1. New framework for the application of the proportionality principle

8.1.1 Extract from the call for advice

3.16. Proportionality and thresholds

EIOPA is asked to assess whether proportionality in the application of the Solvency II framework could be enhanced, ...

8.1.2 Relevant legal provisions

1. The most relevant provisions with respect to the general application of principle of proportionality in the Solvency II framework are the following:
 - Recital 18
 - Recital 19
 - Recital 20
 - Recital 21
 - Article 29 - General principles of supervision
 - Article 34 - General supervisory powers
2. The reference to the relevant provisions with regard to the use of the principle of proportionality for the different pillars of Solvency II is reported in the relevant sections of this advice.

8.1.3 Identification of the issue

3. Stakeholders raised to EIOPA the little or no application of proportionality under Solvency II in practice and the lack of convergence in the cases where it is applied.

4. Considering the available information (e.g. annual report on the use of limitation/exemptions from reporting, the result of the peer review of key functions, etc.), EIOPA agreed that there is room for improvement in the application of proportionality and further work was carried out after the public consultation of the draft advice. A dedicated meeting with stakeholders was organized on 28 February 2020 to kick-off the work.
5. The proposed framework for improving the principle of proportionality is based on the following pillars:
 - Introduce in the legal framework clear guidelines to identify insurance/reinsurance whose nature, scale and complexity of risks justify the use of the proportionality principle (section 8.1.4.1);
 - Introduce a new process for the application of the proportionality principle (section 8.1.4.2);
 - Clarify the role of supervisors with regard to the application/supervision of proportionality measures not specifically mentioned in the legal framework (section 8.1.4.3);
 - Introduce a new transparency and monitoring tool to report on a regular basis the use of proportionality measures in the EU (section 8.1.4.4).
6. The specific proportionality measures with regard to the different pillars of Solvency II are described in the relevant sections of this advice.

8.1.3.1 Criteria for identifying low risk undertakings and the role of the supervisory authorities

7. According to stakeholders, one of the main obstacle to apply proportionality is that the pre-condition of the nature/scare/complexity of the risks is too wide, highly judgemental and lead to very uncertain outcomes on the concrete possibility to apply proportionality, which in the end discourage undertakings to initiate a process with their Supervisors.
8. Another point of criticism is that the proof of burden for the application of the principle of proportionality is entirely on the undertakings.
9. In order to achieve the final outcome of making the application of the proportionality principle more automatic, providing more predictability and certainty to the market, while at the same time keeping it risk-based, some more detailed and clear criteria which identify low risk could be introduced in the legal framework undertakings (LRU).
10. Low risk undertakings complying with the new predefined criteria will have the reasonable assurance to be entitled to apply the proportionality principle.
11. In other words, the criteria for identifying low risk undertakings aims at implementing in a simple and harmonised way the measurement of the nature, scale and complexity of undertaking' risks.

8.1.3.2 New process for the application of the proportionality principle

12. EIOPA proposes to amend the Solvency II framework in order to introduce a new process for applying the principle of proportionality by undertakings and for its supervision by NCAs could be introduced in the Solvency II framework.
13. The proposed process is different, depending on whether the applicant undertaking complies or does not comply with the new criteria for defining low risk profile undertakings (see par. 8.1.4.1).

8.1.3.3 The role of the supervisory authorities with regard to the use of proportionality measures not specifically identified in the Solvency II framework

14. There are different interpretations if the current Solvency II application of the principle of proportionality might lead to the use of additional proportionality measures, not explicitly mentioned in the legal framework.
15. This was clearly experienced in the work who led to the EIOPA Supervisory Statement on the application of the proportionality principle in the supervision of the Solvency Capital Requirement (SCR) calculated in accordance with the standard formula.

8.1.3.4 EIOPA's report on the use of proportionality measures by Member States

16. Currently EIOPA publishes an annual report on the use of proportionality measure for the purpose of limiting/exempting undertakings from reporting requirements.
17. Some stakeholders asked EIOPA to publish an annual report on the application of the proportionality principle per Member State and make propositions on how to improve its effectiveness and consistency

8.1.4 Analysis

8.1.4.1 Criteria for identifying low risk undertakings and the role of the Supervisory authorities

18. Since there is no a single best approach to measure the risk profile of insurance/reinsurance undertakings, the criteria for identifying low risk undertakings should be calibrated by striking a fair balance between predictability/convergence in

the application of the new framework, on the one hand, and allowing for supervisory judgement/risk-based supervision on the other hand.¹

19. The above mentioned trade-off between simplicity/predictability for the market and use of supervisory judgement/risk-based supervision by Supervisors leads to the conclusion that new criteria should be considered as a harmonized framework that is expected to fit a good number of cases. However, even if more predictable in comparison with the current framework (where no guidance exists at all), the proposed new framework is not meant to be a fully automatic approach in every case.
20. Indeed, NCAs always have (and should have) the power/responsibility to:
 - Challenge the application of proportionality principle and object its application to undertakings complying with the criteria for low risk undertakings (i.e. override the result of the test of LRU);
 - Confirm the result of the application of the criteria for identifying low risk undertakings (i.e. endorse the result of the test of LRU).
21. In the cases where Supervisors deems it is not appropriate to allow the concerned undertaking to apply the proportionality principle, the burden of the proof is reversed and Supervisors will give some justification on this regard.
22. Following the same rationale, Supervisors have also the power/responsibility to allow the application of proportionality to some undertakings not complying with the above mentioned criteria, when they don't fit their specific risk profile.
23. Eligible undertakings to be considered low risk undertakings are all insurance and reinsurance undertakings, meeting the criteria reported in the next paragraph, who are not pure reinsurers, don't calculate the Solvency Capital Requirements using (partial or full) internal model and undertakings who are not at the head a group (related undertakings, not at the head of the group, can be considered low risk undertakings).
24. Low risk undertakings are eligible undertakings, as defined in the previous paragraph, who fulfil all the following criteria:
 - (a) Risks from technical provisions: [placeholder – issue to be re-discussed]
 - (b) Stability of undertaking's underwriting and investment performance: [placeholder – issue to be re-discussed]
 - (c) Immateriality of the cross-border business: undertakings not underwriting more than [0.5%/1%] of annual gross written premiums outside of its home jurisdiction
 - (d) Size: in case of life-undertakings the gross technical provision not higher than [500 mln/1bn] EUR, in the case of non-life undertakings the gross written premiums (GWP) not higher than EUR 100 million. Undertakings pursuing both life and non-life insurance activities are required to fulfil both the above mentioned criteria;

¹ Indeed, a high predictable and convergent framework (*pros*) based on hard quantitative thresholds which will not leave room for risk-based supervision and use of supervisory judgement (*cons*). On the other hand, a high flexible and risk-based framework (*pros*) would lead to case-by-case decision by Supervisors, with no predictability by undertakings and potentially unlevel playing field and non-convergent approach at the EU level (*cons*).

- (e) Immateriality of large risks: [non-life undertakings not underwriting Marine, Aviation and transport or Credit and Suretyship] or [non-life undertakings not underwriting more than 50% of the annual gross written premiums in Marine, Aviation and transport or Credit and Suretyship line of business]
- (f) Traditional investments: underwriting not investing more than [10%/20%] of their total assets (excluding investments covering unit-index linked contracts, Property (for own use), Plant and equipment (for own use) Property (under construction for own use) and including derivatives) in non-traditional investments, where traditional investments are considered bonds, equities, cash and cash equivalents and deposits;
- (g) No material reinsurance business accepted: accepted reinsurance, measured by gross written premiums, not higher than [50]%.

25. In order to achieve some stability in the application of the new framework, it is proposed to require undertakings to fulfil all the criteria for two consecutive financial years.

26. Similarly, undertakings will lose the status of LRU if they don't comply with at least one of the required criteria for two consecutive financial years. This means that, once entered in the sample of low risk undertakings, the concerned undertaking is entitled to use the proportionality measure for at least two consecutive financial years.

27. However, even in case an undertaking doesn't comply with at least one of the required criteria for two consecutive financial years and it can no longer be considered as a low risk undertaking for the following year, it is proposed to follow a case-by-case approach and entering in a dialogue with the concerned undertaking to assess whether it should be entitled to continue using (all or only some) proportionality measures or not, taking into consideration the impact on the organisation of undertakings and the change of its risk profile.

28. Finally, in order to keep the description of the criteria relatively short and simple, it is considered necessary to provide additional operational guidance with the release of some EIOPA Guidelines.

8.1.4.2 New process for the application of the proportionality principle

29. The following two steps approach, based on a combination of the above options, should be introduced in the legal framework:

- ex-ante notification (not an approval or administrative process) from undertakings who believe to comply with the criteria for low-risk undertaking reported in section 8.1.4.1, and,
- once such a classification has not been challenged by the NCA (i.e. Supervisors didn't react to the ex-ante notification), an ex-post reporting (deadline and form to be discussed) of the proportionality measure(s) used by all undertakings (i.e. low risk undertakings and not).

30. As previously mentioned, it is worth reminding that Supervisors will have the possibility to challenge the use of any proportionality measures even if the classification of low risk undertakings has not been challenged after the early notification.

31. The ex-ante notification of the own classification as “low-risk profile” is considered to be a minimum burden as it is envisaged to happen only once and revised only in case material changes occur to the risk profile of the undertakings and is justified by the increased number of proportionality measures to become available to those undertakings, some of them without any specific criteria.²

32. [to be further discussed the notice period for the notification and the information to be reported in the notification, for instance early identification of the proportionality measures to be used]

33. The criteria for defining low risk profile undertakings are designed as benchmark, expected to work in several cases but not necessary in every single circumstance.

34. Generally speaking, there might be three cases where some undertakings will not comply with the new criteria for low risk profile undertakings, but at the same it application of the principle of proportionality shouldn't be excluded a priori, namely:

1) Undertakings with a very specific risk profile, not captured by the criteria identifying low risk profile undertakings;

2) Undertakings willing to apply simplifications for pillar I requirements, where Solvency II framework refers to the specific risks falling within the SCR or TP, while the criteria for identifying low risk undertakings are designed considering the overall risk profile of undertakings (which is the reference for applying the proportionality principle in pillar II and III requirements);

3) Medium-high risk undertakings, by default not complying with the criteria for low risk undertakings, willing to use a proportionality measure with regard to an immaterial specific risk or specific part of the portfolio.

35. In these cases, the application of the proportionality principle shouldn't be excluded *a priori*, because the compliance with criteria for low risk profile undertakings is not met. It should be rather introduced a different process for assessing the compliance with the (different) conditions to apply the principle of proportionality

36. In the first case the undertaking should notify the supervisor, following the process defined for undertakings complying with the criteria, but adding to the notification a detailed description of the risk profile and the reasons why they believe the status of 'low risk undertaking' should also apply to them. The notification process defined above applies *mutatis mutantis* in this case.

37. In the second case, if undertakings comply with the specific requirements³ required by SII framework, the undertaking can apply the measure(s) and *only ex-*

² The ex-ante notification is not intended to change the notification requirement required by SII to persons who effectively run the undertaking or are responsible for other key functions.

³ For instance:

- on SCR: article 109 (Simplifications in the standard formula) of the Directive, as complemented by article 88 (Proportionality) of Delegated Regulation, allows undertakings to use simplified calculation when the nature, scale and complexity of the risks of the undertaking falling within the relevant module or sub-module justify it;

- on TP: article 56 (Proportionality) of Delegated Regulation require undertakings to use methods to calculate TP which are proportionate to the nature/scale/complexity of the risks underlying their insurance and reinsurance obligations.

post reporting applies. This will also be the case for undertakings eligible as 'low risk profile undertakings' that wish to apply only those simplifications.

38. In the third case the use of the specific proportionality measure by those undertakings needs to be approved by the NCA. Such an approval process...

39. Further work in the future, from a supervisory convergence perspective, should be considered once these cases (above all the first and third case) arise, to promote a convergent application of the process.

8.1.4.3 The role of the supervisory authorities with regard to the use of proportionality measures not specifically identified in the Solvency II framework

40. EIOPA discussed whether the existing proportionality measures together with the new proportionality measures, to be introduced in the Delegated Regulation, should be considered as a "close list" of all possible measures or alternatively whether Supervisors (should) have the power to apply the principle of proportionality in the Supervisory Review Process (SRP), allowing undertakings to apply additional proportionality measures, not explicitly mentioned in the Solvency II framework.

41. The additional proportionality measures, allowed by Supervisors, shouldn't be considered as "new" proportionality measures introduced by Supervisors, referring to a policy-making activity. They should be rather seen as the application of the principle of proportionality in supervision, which is defined by the Insurance Core Principles of the IAIS as the use of "a variety of supervisory techniques and practices which are tailored to the insurer to achieve the outcomes of the Insurance Core Principles (ICPs). Such techniques and practices should not go beyond what is necessary in order to achieve their purpose".⁴

42. The SII framework should be amended to clarify that similar situations in the future would be fully in line with the Solvency II framework as long as it is in line with Solvency II principles and rules as it was the case for that Supervisory Statement.

43. The benefits of such an approach would be:

- To apply the proportionality principle in the SRP;
- To allow for use of future proportionality measures, currently not envisaged, which can be fully justified and compliant with the nature/scale/complexity requirement.

44. The mentioned power by Supervisors shall be exercised under certain "safeguards", i.e. it should not lead to a complete exemption from requirements and the proportionality measures should be in line with the general and overarching principle of Solvency II.

8.1.4.4 EIOPA's report on the use of proportionality measures by Member States

⁴ IAIS, Insurance Core Principles: Introduction and Assessment Methodology.

45. Following up a proposal from some stakeholders, the scope of the current EIOPA report on exemptions/limitations of reporting should be extended by considering the use of the principle of proportionality for all the three pillars of Solvency II in order to have a complete picture.
46. The public report on the overall use of proportionality measures is expected to bring many the benefits (e.g. increase the awareness of Supervisor's community and undertakings on the use of proportionality measures in different Member States, facilitate the process of future revision of the Solvency II requirements or trigger the use of some other supervisory).
47. It should be noted that the Report as such should not be overly burdensome (it should also pass the cost-benefits analysis test).
48. In order to feed the preparation of the report, it is proposed to introduce a new structured reporting through a simple template, which will be part of the QRT, with annual frequency. This new and more quantitative reporting requirement will replace the current Solvency II requirement to report, in qualitative way, some proportionality measures in the RSR (unless there is the need/appetite to provide some qualitative note, in addition to the new quantitative template).

8.2. Proportionality in pillar 1

8.2.1 Technical provisions

8.2.1.1 Extract from the call for advice

3.16. Proportionality and thresholds

EIOPA is asked to assess whether proportionality in the application of the Solvency II framework could be enhanced, and in particular in the following areas:

- *the appropriateness of the thresholds for the exclusion from the scope of Solvency II, as defined in Article 4 of Directive 2009/138/EC;*
- *the possibility to waive certain requirements relating to any of three Pillars of the framework based on size thresholds or the nature of the undertaking or of its risks;*
- *rules for the simplified calculation of sub-modules that form an immaterial part of the Solvency Capital Requirement of an individual insurance or reinsurance undertaking.*

8.2.1.2 Relevant legal provisions

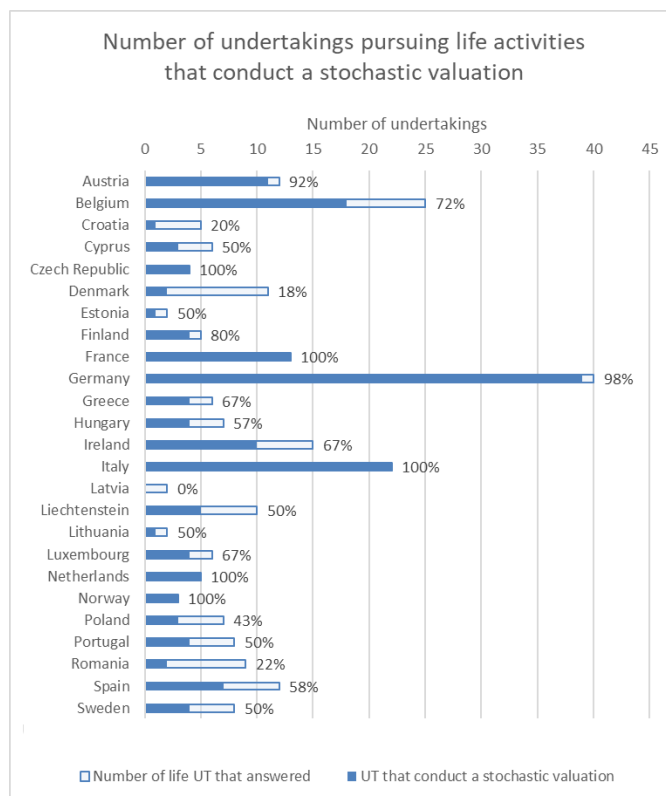
49. Article 34 of the Delegated Regulation 2015/35

50. Recital 15 of the Delegated Regulation 2015/35

8.2.1.3 Identification of the issue

51. Regarding stochastic valuation, there is room for further proportionality. The use of stochastic valuation is significantly uneven across jurisdictions within the EEA. The

information request performed for the 2020 review showed significant differences, with a penetration of stochastic valuation ranging from 0% to 100%. Even if this extreme variability may be due to the size of the sample, it is clear that stochastic valuation is the default approach in some markets while in others is the exception. Indeed, even for those undertakings using stochastic valuation, the scope within their portfolio significantly varies among jurisdictions.



52. The impact of stochastic valuation may be seen as low compared to the Best Estimate since it is below 1% in two thirds of the cases and does not usually go beyond 5% for the rest of them. However, considering that the ratio best estimate over own funds for life undertakings an impact of 1% on the best estimate could be translated into an impact of 10% of the own funds and even more in some cases.

53. The current framework is considered sufficiently clear regarding the need to perform stochastic valuation where cash flows depend on the economic environment, e.g. for contract with options and guarantees that are not immaterial. However, to facilitate a smooth the path between deterministic and stochastic valuation for undertakings with less resources, an intermediate approach could be defined under the proportionality principle.

8.2.1.4 Analysis

54. Stochastic valuation is the most accurate alternative for the valuation of contracts with options and guarantees and, indeed, deterministic valuation tends to underestimate the best estimate of such contracts since it does not consider the time value of options and guarantees (TVOG). However, stochastic valuation is significantly complex and costly to implement, since it requires an economic scenario generator and a valuation platform that allows stochastic valuation. For this reason, proportionality on stochastic valuation would lead to further convergence, allowing

undertakings to depart from pure deterministic valuation without being required to implement full stochastic valuation.

55. Therefore, a prudent deterministic valuation under the proportionality principle to be applied by low risk profile undertakings with medium or low time value of options and guarantees (TVOG) could be introduced. This would leave three valuation methods:

- a. *Immaterial O&G*: Deterministic valuation
- b. *Proportionality*: Prudent deterministic valuation
- c. *Default approach*: Stochastic valuation

56. Undertakings would be allowed to apply such prudent deterministic valuation when they meet two conditions:

- d. They meet all the criteria for low risk profile undertakings (LRU)
- e. The TVOG of the contracts with options and guarantees is below 10%⁵ of the SCR

57. This threshold would cover LRU undertakings with a significant amount of contracts with non-material options and guarantees, i.e. low TVOG, and also LRU undertakings with a low amount of contracts with material options and guarantees.

58. However, measuring the TVOG can be significantly burdensome, since it requires to perform both a stochastic and a deterministic valuation. For this reason, EIOPA would publish a prudent harmonised reduced set of scenarios (PHRSS) that the undertakings would be allowed to use to assess the TVOG criterion. This PHRSS would consist in approximately 10 scenarios that would allow undertakings to make a rough estimate of the stochastic value of their best estimate without requiring them to invest in an economic scenario generator.

59. Since such a reduced set of scenarios might not be accurate enough in some specific cases, the calibration of the scenarios by EIOPA would include additional prudence in the form of slightly increased volatility.

60. Regarding valuation, the prudent deterministic valuation would be equal to the regular deterministic valuation plus a stochastic supplement. This stochastic supplement to be added to the best estimate would be equal to the threshold used as criterion, i.e. 10% of the SCR. However, undertakings would be allowed to demonstrate that a different stochastic supplement would better reflect their risk profile. This would allow undertaking to always have an option that can be applied by default (stochastic supplement added to best estimate equal to 10% of the SCR), but in case they want to use a more accurate, complex and probably lower estimate of the stochastic supplement they would still be allowed to do so if properly justified.

8.3. Proportionality in pillar 2

⁵ This threshold, 10% of the SCR, is still under calibration.

61. In the Consultation Paper on the Opinion on the 2020 review of Solvency II published in October 2019, EIOPA presented several proposals to enhance the application of proportionality on the following areas: key functions, ORSA, written policies, administrative, management or supervisory body (AMSB) and remuneration.
62. Following the stakeholders' comments EIOPA has considered two main changes to revise its advice:
- a. Make explicit that certain proportionality measures are generally admissible with respect to low risk profile undertakings (see section 8.1.4.2 regarding new process for the application of the proportionality principle), and
 - b. Modify the advice on frequency of the ORSA, allowing low risk undertakings to perform the ORSA (not only the assessment of deviation of the risk profile from the assumptions of SCR calculation) every two years instead of annually.

8.3.1 Biennial ORSA

63. EIOPA considers that a biennial ORSA could be allowed for low risk profile undertakings. This option allows to generally relieve the burden for low risk profile undertakings by reducing the frequency of the assessment in Article 45(1) of the Solvency II Directive. As a general rule, for low risk profile undertakings an annual assessment is not deemed strictly necessary; an assessment every two years could be sufficient, provided that there is no significant change in the undertaking's risk profile. However, taking into account the role of the ORSA, as an integral part of the business strategy to be taken into account in the on-going management of the undertaking, the supervisory authority should still have the power to request an annual ORSA in view of the undertaking's specific circumstances (e.g. where the undertaking presents a weak solvency position). Conversely, the supervisory authority could agree on exceptional cases that undertakings not falling under the definition of "low risk profile undertaking" benefit from this measure.

8.4. Proportionality in pillar 3

8.4.1 Identification of the issues

64. EIOPA published in July 2019 a consultation paper setting out technical advice on the reporting and disclosure requirements of Solvency II.⁶ Proportionality of the requirements was one of the focus of the review. The proposed changes include proposals on the following areas:

- Amend Article 35 of the Solvency II Directive adapting it to the new proportionality framework proposed under Section 8.2.;
- Review the existing risk-based thresholds and create new ones in the quantitative reporting templates;

⁶ See <https://eiopa.europa.eu/Pages/News/Consultation-on-supervisory-reporting-and-public-disclosure.aspx>.

- Simplification of the quarterly submission;
- Deletion of several quantitative reporting templates and the simplification of a number of other quarterly and annual templates;
- Amend the RSR frequency adapting it to the new proportionality framework proposed under Section 8.2..

8.4.2 Analysis

Quantitative Reporting templates (QRTs):

Article 35

65. Amendments to this article have been extensively discussed. The conclusion was that any change could jeopardise a proper supervisory review process, including and especially for low risk profile undertakings.

66. Indeed, there is support to keep article 35 of Solvency II as currently, i.e. keeping the reference to maximum 20% market share for financial stability purposes, and keeping the “may” as it should be a risk-based approach. The approach currently being proposed for the application of proportionality principle is a balance between a risk-based approach and the need to have simple and clear criteria to define low risk profile undertakings and provide more legal certainty.

67. This implies the need for a minimum on-going monitoring of the risk-profile of the undertakings. The submission of quarterly reporting is the tool that allows a regular, less intrusive and more automatised monitoring of the risk-profile which allows supervisors to be confident with undertakings using an extensive number of proportionality measures. The further reduction of the quarterly reporting would endanger such monitoring and jeopardise the protection of policyholders. On the contrary, keeping quarterly reporting would actually support a proportionate approach in the supervisory review process because high-level and automatised monitoring can be sufficient for low risk undertakings and would not require further actions (which would be needed if quarterly reporting is not available).

68. On the other side, the paragraph, with a “may”, creates expectations on the use of such possibility by NCAs. In fact the article implies an assessment of the criteria defined in article 35(8) by the NCAs to decide on such limitations/exemptions. The use of a different set of criteria in article 35 is difficult to justify and adds complexity to proportionality framework. EIOPA believes that considering the importance of reporting in the comments submitted by stakeholders regarding proportionality a different option should be discussed together with the PG proposal, while recognising the importance of quarterly reporting.

Option 1:

69. Keep the “may” and to promote an increased use and convergent approach of this proportionality measure an indirect link to the definition of the “low risk profile” undertakings to such a limitation/exemption is proposed by identifying this classification as one of the features to have into consideration when NSAs are assessing the possibility of limitations or exemptions.

70. In this discussion it was also taken into account the simplifications being proposed for the quarterly reporting (see below) together with the already existing risk-based thresholds as evidenced in EIOPA Reports on Limitation and Exemption of Reporting (LER):
71. As an example the look-through reporting is carried out only by 57% of the undertakings that hold CIUs in unit-linked contracts, which corresponds to 78% of the investments in CIUs held in unit-linked and index-linked contracts (Table 1.3). This means that 43% of the undertakings that hold CIUs in unit-linked and index-linked contracts do not need to carry out look-through reporting on a quarterly basis. These undertakings have 22% of investments in CIUs in unit-linked contracts.
72. In terms of number of templates to be submitted, in Q1 2019, large undertakings had to fill in on average nine templates and were hence required to fill in nearly twice as many templates as small insurance undertakings in this quarter. In total, small undertakings had to fill in only five templates on average.
73. In fact, it was in the annual package that the need for more proportionality was identified, which is being addressed by additional risk-based thresholds and revision of existing risk-based thresholds.
74. To ensure supervisory convergence it is proposed to enlarge the scope of EIOPA Guidelines on the market share to include as well the NCAs process to inform the undertakings on the limitations and exemptions.

Option 2:

75. Amend the "may" into a "shall" and exempt automatically the undertakings classified as 'low risk undertakings' from quarterly reporting. Those undertakings should still be required to report annually. The annual reporting would allow NCAs to monitor the risk profile of the undertakings. This would represent a huge improvement in the automatic application of the proportionality principle.
76. However, it is recognised that such an approach should also take into account the materiality of the information received quarterly in different contexts of supervision. For this reason such an automatic approach should be limited to small percentage of the market share. In fact, using EU figures (national level impact will be different) the application of a "shall" quarterly exemption to a limit of 5% of the market share in life and non-life would allow the application to all 'low risk profile undertakings' in most scenarios described above.
77. The 95% coverage would also allow the ECB to continue to rely on Solvency II data and no additional requirements to undertakings to be exempted from this reporting under Solvency II.

Quarterly reporting:

78. The proposals under section 7.2.2 were assessed from a proportionality perspective. EIOPA concluded that no additional proportionality measures are needed in addition to the changes proposed to article 35, considering:
- Quarterly package is already proposed to be simplified;
 - Quarterly reporting is a crucial piece of the monitoring of undertakings risk profile undertakings under the SRP;

- Article 35 amendments.

79. The possibility to include the MCR template in the quarterly exemption and replace it by an alternative monitoring method for the MCR was discussed and the following is noted:

- Any exemption if allowed should be clear that it is a reporting exemption, not a calculation exemption. The quarterly MCR calculation should be kept;
- Should not be automatic as many Members believe the quarterly reporting of MCR is crucial and is not considered burdensome;
- Overall no support for complete exemption.

80. Based on the discussion and acknowledging that in fact the template currently in use for the MCR reporting goes beyond the reporting requirement under article 129, an amendment is proposed to article 35 to clarify that the information regarding the results of the Minimum Capital Requirement shall always be submitted using the QRTs as defined in the ITS.

Annual reporting:

Regular Supervisory Report (RSR)

81. The proposals under the Section 7.6.1. were assessed from a proportionality perspective. EIOPA concluded that no additional proportionality measures are needed in addition to the changes proposed.

82. There was support for a better and more consistent implementation of the lower frequency of the RSR for low risk profile undertakings. The option considered in the Consultation Paper was supported ("Introduce L3 tools for achieving supervisory convergence by keeping the minimum requirement for submission of full RSR once every 3 years but ask mandatory assessment by NCAs and communication of the frequency of the RSR"), however, this option needed to be put in the context of the new proportionality framework under development, e.g. convergence is to be achieved through the definition of "low risk profile" and not only by Level 3 tools. Undertakings complying with the low profile criteria should by default be allowed to report the RSR every 3 years unless formally communicated otherwise by the NSA. The frequency of every 2 years would be kept more flexible and convergence under Level 3 tools should be considered.

83. The allowance of a single RSR should not impact the requirement at solo level in any way, i.e. if a solo RSR is not required that undertaking specific information should not be part of the single RSR; if a group RSR is not required but a solo RSR is required, then a solo RSR should be submitted to the NSA or a single RSR (if allowed) including only the information from the relevant undertakings. In case undertakings belong to a group and lower frequency than annual is applied to any subsidiary or to the parent the college should agree as much as possible on aligning the requirements in case the group applies for a single RSR.

84. Currently the frequency of the RSR is defined in Level 2. For consistency with the remaining reporting framework the frequency and the link to the low risk profile

undertakings is proposed to be included in Level 1, but keeping it in Level 2 could also be an option.

Solvency and Financial Condition Report (SFCR)

85. The proposals under the Section 7.3. were assessed from a proportionality perspective. EIOPA concluded that no additional proportionality measures are needed in addition to the changes proposed. The following reasons were identified:

- SFCR is an important tool regarding market discipline and the reports are used by stakeholders (this was in fact confirmed with the comments received in the public consultation);
- Insurance undertakings are considered as a "Public Interest Entity" and therefore it is difficult to argue that stakeholders are not interested in the information from insurance undertakings, and this interest cannot be linked to the risk profile;

86. To consider such exemption on the basis of the risk profile would create uncertainty regarding the publication of the SFCR and the fact that an undertaking previously exempted that starts publishing the SFCR would be interpreted as an increase in the risk of such undertaking.

87. It should also be noted that a simplification of the SFCR is being proposed and the SFCR has embedded proportionality and it is observed that the SFCR from small undertakings is much simpler than the one from bigger undertakings.

88. The only exemption of the above is the captives due to its specific nature.

Article 254 – quarterly reporting at group level

89. In the area of proportionality applicable to group reporting the options considered by EIOPA were the following:

- 1) Don't change Article 254 or Article 35 (6) and (7) of SII Directive;
- 2) Improve proportionality under Articles 35 (6), 35 (7) and article 254 of SII Directive.

90. The lack of consistency in the application of the proportionality principle at solo level leads to situations where undertakings belonging to a group are exempted by one NSAs while other less relevant solos are not exempted by different NSAs. As a result, according to the current articles, the group cannot be exempted unless all solo undertakings are exempted.

91. EIOPA understands the national specificities associated to the different application of proportionality principle that gives origin to this situation but believes that it leads to non-proportionate outcomes at the level of some groups. Thus, it proposes to mitigate the situation by allowing the group to be exempted even if not all undertakings belonging to the group are exempted.

92. The following amendments in the Solvency II Directive are considered:

- Amend Article 35 of the Solvency II Directive adapting it to the new proportionality framework proposed under **Section 8.1.;**

93. EIOPA proposes the following amendments in the Solvency II Delegated Regulation:

- Amend the RSR frequency so that undertakings complying with the low profile criteria should by default be allowed to report the RSR every 3 years unless formally communicated otherwise by the NSA.

94. The following amendments in the ITS on reporting are considered:

- Review the existing risk-based thresholds and create new ones in the quantitative reporting templates;
- Simplify the quarterly submission;
- Delete several quantitative reporting templates and simplify number of other quarterly and annual templates;

95. **In** addition, in the area of groups it is considered to amend Article 254 of the Solvency II Directive to allow for exemption of groups reporting without the condition of exemption of all solo insurance undertakings belonging to that group.

8.5. Proportionality for specific business models

Background

96. The nature of captive (re)insurance undertakings is different from the nature of a "standard" (re)insurance undertaking writing a balanced portfolio of diversified risks in different Lines of Business covering a multitude of policyholders in the market.

97. Captive (re)insurance undertakings typically write a limited number of Lines of Business, for risks which are linked to the industrial/financial group to which they belong, with stability with regard to the type of risks underwritten over time. Furthermore, captive (re)insurance undertakings have, in most of the cases, limited or no own staff and rely heavily on outsourcing to external service providers or to the industrial/financial group to which they belong.

98. Whilst the business model and often also the risk profile of captive (re)insurance undertakings diverge from the ones of a "standard" European (re)insurance undertaking subject to the Solvency II framework, the development of an USP/Internal Model is, in most of the cases, not proportional considering the bureaucratic burden associated with the request for approval and therefore not an efficient option for those undertakings.

99. EIOPA has identified, following discussions on supervisory convergence regarding the supervision of captive (re)insurance undertakings and the analysis of the comments and arguments received during the first and second wave of consultation regarding the Solvency II 2020 review, proportionality on pillar II requirements and a set of exemptions and limitations on reporting and disclosure that should be applicable to (re)insurance captives, in light of their particular business model, meeting a set of conditions.

100. EIOPA also proposes that, provided that certain criteria are met, further proportionality measures shall apply to captive reinsurance undertakings on top of

the above mentioned proportionality for Pillar II and exemptions and limitations with regard to Pillar III requirements.

101. EIOPA highlights the importance of keeping captive (re)insurance undertakings under the remit of the Solvency II Directive, and that any exemption based on the type of business model should be avoided. However, special proportionality can be introduced based on the specific nature of the business pursued.
102. EIOPA proposals reflect the specific business model of captives and ensures supervisors keep the necessary tools and information to supervise these entities.
103. The proposals set out below shall apply to captive (re)insurance undertakings which fall within the definition as set out in Article 13 (2) and (5) of the Solvency II Directive (which are kept as currently drafted) and meet specific criteria. Captive (re)insurance undertakings do not need to be classified as a 'low risk undertaking' to benefit from the specific proportionality measures proposed in this section. On the other way, if captive (re)insurance undertakings comply in addition with the 'low risk undertakings' criteria they can also benefit from additional proportionality measures not covered in this specific section.

Scope of application

104. With regard to the requirements to be met, EIOPA proposes the following amendments to the Solvency II framework which aim at enlarging the scope of the proportionality measures applicable for captive insurance and reinsurance undertakings.

Proportionality measures for captives

ORSA

105. With regard to proposals related to the frequency of the ORSA, EIOPA proposes that the full ORSA is performed and, consequently, the ORSA Report submitted to the local supervisor every 2 years or without any delay when a change in the risk profile is expected or following any significant change in the risk profile.
106. No amendment shall be needed to legislative text in the Solvency II Directive or in the delegated Regulation as currently the ORSA frequency is dealt with in the EIOPA Guidelines on ORSA.
107. In particular, a change in the risk profile is expected when:
 - major changes in the underwriting program or the reinsurance program are foreseen during the next 12 months (such as start-up of new lines of business, major changes in business volume, major changes in risk tolerance limits);
 - major changes in the allocation of the investments are foreseen over the next 12 months;
 - unusual transaction incur over the following 12 months (such as portfolio transfers in or out, or a material change in one of the major ultimate shareholders).
108. With regard to proposals related to the content of the ORSA, EIOPA proposes overall guidance on the minimum expected content without limiting the possibility for the captive (re)insurance undertaking to add additional items in the ORSA or, in exceptional circumstances, for the NCAs to request additional information.
109. To implement this, EIOPA proposes to add a new paragraph in Article 45 of the Solvency II Directive specifying that only letters a), b) and c) of Paragraph 1 apply to captive insurance and reinsurance undertakings meeting a specific set of criteria.
110. The aforementioned criteria shall be mentioned in a new paragraph of Article 50 of the Delegated Regulation and should be then defined in a separate article as follows:

111. Captive insurance undertakings and captive reinsurance undertakings as defined in points (2) and (5) of Article 13 of the Solvency II Directive may use the proportionality requirements if all of the following requirements are met:
- in relation to the insurance obligations of the captive insurance undertaking or captive reinsurance undertaking, all insured persons and beneficiaries are legal entities of the group or natural persons eligible to be covered under the group insurance policies of which the captive insurance or captive reinsurance undertaking is part, as long as the business covering natural persons eligible to be covered under the group insurance policies remains immaterial;
 - in relation to the reinsurance obligations of the captive insurance or captive reinsurance undertaking, all insured persons and beneficiaries of the insurance contracts underlying the reinsurance obligations are legal entities of the group of which the captive insurance or captive reinsurance undertaking is part;
 - the insurance obligations and the insurance contracts underlying the reinsurance obligations of the captive insurance or captive reinsurance undertaking do not relate to any compulsory third party liability insurance.

112. The minimum expected content of the ORSA shall include at least the information indicated below.

With regard to Article 45 (1) (a) of the Solvency II Directive:

- Summary of Lines of Business written, with indication of maximum limit per claim and per UW year, gross and net of reinsurance, and information on historical loss ratios gross and net of reinsurance
- Indication of the risk appetite, including (but not necessarily limited to) an indication of an SCR coverage ratio, provided that lower limits are respected. If not, clarification to the local supervisor has to be provided
- Indication of asset allocation and loss ratios assumptions used in the projections
- A minimum of 3 year financial projections of profit and loss and Solvency II Balance sheet, in a base case scenario and for each of stressed scenarios (one at least). In any case, the scenario projection should be large enough to show the recovery from the stress.
- Impact on SCR coverage ratio over the projection horizon for each of the stressed scenarios
- Conclusions and measures taken by the captive (re)insurance undertaking following the outcome of the stress-tests. In any case, those conclusions should consider the year after the stress.

With regard to Article 45 (1)(b) of the Solvency II Directive:

- Continuous compliance with capital requirements will be covered implicitly in the stressed 3 or more year projections of the profit and loss and balance sheet under Article 45 (1)(a), and corresponding SCR coverage ratio evolution.

113. More specifically, with regard to the aspect of continuous compliance with requirements on calculation of technical provisions, for the premium provision, the ORSA report should include at least a qualitative statement of the assumptions used for the interplay of rules regarding contract boundaries, the calculation of the SCR CAT risks and contractual limits anchored in the (re)insurance contracts accepted and (retro)ceded.

With regard to Article 45.1.(c) of the Solvency II Directive:

- Qualitative assessment if there is any indication that the standard formula should not be adequate.

114. EIOPA proposes to implement the above specific content as follows: Introduce article 306a with the minimum content requirements set out above and, when deemed necessary for specific items, develop specific Guidelines in the EIOPA Guidelines on ORSA in relation to the expected content described above.

115. With regard to already existing simplifications applicable to Technical Provisions and Solvency Capital Requirement calculations, EIOPA proposes to keep the current legislative text.

Reporting and public disclosure

116. EIOPA proposes to implement the reporting exemptions and limitations explained below in the ITS as a follow-up of the amendment proposed to Article 35 of the Solvency II Directive and amendment of relevant articles of the Delegated Regulation.

117. Specific exemptions and limitations on supervisory reporting public and disclosure applicable to captive insurance and reinsurance undertakings

118. With regard to reporting, EIOPA proposes to introduce the following limitations and exemptions (on top of the limitations/exemptions given to captives under Article 35 of the Solvency II Directive following a risk-based approach):

Quarterly reporting:

- Limitation from reporting on investments and derivatives (i.e. S.06.02 and S.08.01 not to be reported)

Annual reporting:

- Exemption from S.02.02
- Elimination of the currency split from S.16 template
- Elimination of the currency split from S.19 template
- Reduction of template S.27 on cat risks only to the general table without breakdown in the tables for single risks
- Exemption from S.29s template on variation analysis

119. EIOPA will include details on concrete templates limited/exempted in the ITS, however amendments in Article 35 of the Solvency II Directive will be needed (see section on article 35).

120. With regard to public disclosure, EIOPA proposes to introduce the following specific exemptions into the public disclosure:

- SFCR for professional readers: only QRTs to be provided. No narrative part.
- SFCR for policyholders: to be provided only if the business pursued with regard to policyholders and beneficiaries involves natural persons.

Specific exemptions and limitations on supervisory reporting public and disclosure applicable to captive reinsurance undertakings meeting specific criteria

121. Captive reinsurance undertakings have a business strategy oriented to optimisation of insurable risk financing of the parent company and to find optimal reinsurance solutions (especially non-proportional ones). Dividend payments and profits from capital investments are minor figures in the balance sheets.

122. Furthermore the business strategy of captive reinsurance undertakings is atypical in the sense that it doesn't pursue market share gain and keeps the business rather static across the years and therefore strategic risks tend to be close to zero. Furthermore captives tend to face decreasing probabilities of

insolvency over time as profits are normally collected over time and redirected to capital.

123. The static nature of the business allows to calculate the worst case in a deterministic way by adding up the limits of the underwritten contracts.
124. As a feedback to the Public Consultation, EIOPA proposes further proportionality measures applicable only to captive reinsurance undertakings meeting the criteria mentioned in Article 50 of the Delegated Regulation based on the following conditions:
- The policyholders of the reinsurance contracts are legal entities of the group (i.e. the Parent company or other entities of the industrial group to which the captive belongs);
 - Loans in place with the Parent or any group company do not exceed 20% of total assets held by the captive, groups cashpools included;
 - The maximum loss resulting from the exposures can be deterministically assessed without use of stochastic methods (i.e. limits to losses covered are included in the reinsurance contracts in place).
125. It is important to highlight that for all reinsurance captives not meeting the criteria above, only the general provisions applicable to captive (re)insurance undertakings included in the previous section shall apply.
126. Provided that the previous conditions are met, EIOPA proposes to apply the following additional proportionality measures to captive reinsurance undertakings:
- No SFCR for policyholders
 - The annual reporting package shall include only the QRTs disclosed in the SFCR

Regarding captives the following changes are considered :

127. To introduce the following limitations and exemptions into the supervisory reporting (on top of the limitations/exemptions given to captive insurance and reinsurance undertakings under article 35 following a risk-based approach):
128. Limitation from reporting on investments and derivatives (i.e. S.06.02 and S.08.01 not to be reported)
129. Limitation from reporting assets and liabilities by currency (i.e. S.02.02 not to be reported);
130. Limitation from reporting Information on annuities stemming from Non-Life Insurance obligations (i.e. no currency split applicable to S.16 templates);
131. Limitation from reporting Information on annuities stemming from Non-Life Insurance obligations (i.e. no currency split applicable to S.19 templates);
132. Limitation from reporting on Solvency Capital Requirement - Non-life and Health catastrophe risk (i.e. only summary table to be reported for S.27 template);
133. Limitation from reporting on variation analysis (i.e. variation analysis not to be reported in S.29s templates)
134. To introduce, for a reduced set of reinsurance captives undertakings that meet specific criteria, the following limitations and exemptions into the supervisory reporting (on top of the limitations/exemptions given to captive

insurance and reinsurance undertakings under article 35 following a risk-based approach and of the ones listed in 8.6):

135. The reporting package shall include only the QRTs disclosed in the SFCR
136. With regard to SFCR, to introduce the following specific exemptions into the public disclosure for captive insurance undertakings:
SFCR for professional readers: only QRTs to be provided. No narrative part.
SFCR for policyholders: to be provided only if the business pursued with regard to policyholders and beneficiaries involves natural persons which can still be considered as risks of the industrial group to which the captive belongs). No audit requirement shall be applicable to SFCR for captives.
137. With regard to SFCR, to introduce the following specific exemptions into the public disclosure for captive reinsurance undertakings:
SFCR for professional readers: only QRTs to be provided. No narrative part.
No SFCR for policyholders shall be required;
With regard to ORSA, the proposal is two-fold:
With regard to proposals related to the frequency of the ORSA, that the full ORSA is performed and, consequently, the ORSA Report submitted to the local supervisor every 2 years or without any delay when a change in the risk profile is expected or following any significant change in the risk profile.
138. With regard to proposals related to the content of the ORSA, overall guidance on the minimum expected content without limiting the possibility for the captive (re)insurance undertaking to add additional items in the ORSA or, in exceptional circumstances, for the NCAs to request additional information.
139. Captive insurance undertakings and captive reinsurance undertakings as defined in points (2) and (5) of Article 13 of the Solvency II Directive may use the proportionality requirements listed above if all of the following requirements are met:
140. in relation to the insurance obligations of the captive insurance undertaking or captive reinsurance undertaking, all insured persons and beneficiaries are legal entities of the group or natural persons eligible to be covered under the group insurance policies of which the captive insurance or captive reinsurance undertaking is part, as long as the business covering natural persons eligible to be covered under the group insurance policies remains immaterial;
141. in relation to the reinsurance obligations of the captive insurance or captive reinsurance undertaking, all insured persons and beneficiaries of the insurance contracts underlying the reinsurance obligations are legal entities of the group of which the captive insurance or captive reinsurance undertaking is part;
142. the insurance obligations and the insurance contracts underlying the reinsurance obligations of the captive insurance or captive reinsurance undertaking do not relate to any compulsory third party liability insurance.
143. With regard to further proportionality measures applicable to reinsurance undertakings only, captive reinsurance undertakings meeting the criteria

mentioned in Article 50 of the Delegated Regulation based on the following conditions:

144. The policyholders of the reinsurance contracts are legal entities of the group (i.e. the Parent company or other entities of the industrial group to which the captive belongs);
145. Loans in place with the Parent or any group company do not exceed 20% of total assets held by the captive, groups cashpools included;
146. The maximum loss resulting from the exposures can be deterministically assessed without use of stochastic methods (i.e. limits to losses covered are included in the reinsurance contracts in place).