# Review of the Solvency II Delegated Act

## Focus on “Other topics”

*EGBPI meeting - 5 April 2022*

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European Commission

# Background

- During the EGBPI meeting held on 8 November 2021 many delegations asked for more clarity about Commission's intentions on the related topics included in the Commission Delegated Regulation (EU) 2015/35.

- This document aims at collecting experts' feedback on the key areas for amendments to that Delegated Regulation on **topics other than long-term guarantees measures and long term investments**, as outlined in the Communication from the Commission on the Solvency II review and the Commission services' non-paper of 8 November 2021.

# Background

- This document touches upon the following topics:
  - Diversification benefits within the market risk module
  - Rules governing risk-mitigation techniques, including as regards third-country reinsurance
  - Equity risk
  - Possible recognition of state reinsurance and state guarantees as risk-mitigating techniques in the SCR calculation
  - SCR for mortgage loans
  - Other changes to counterparty default risk
  - Best estimate
  - Proportionality and Remuneration
  - Reporting and disclosure
  - Group supervision
  - Other topics (Minimum Capital Requirement, Green deal items, Expense risk)

# Agenda

- Market risks, Risk mitigation techniques
- State guarantees and state reinsurance
- Conterparty default risk
- Best estimate, Remuneration, Reporting and Disclosure
- Group supervision
- Other topics (MCR, Green deal items, Expense risk)

European Commission

# Diversification benefits within the market risk module

# Diversification benefits within the market risk module of the standard formula

## Correlation between spread risk and interest rate risk

- This concerns Article 164 of the Delegated Regulation
- In line with EIOPA's Opinion, as indicated in the Communication, it is intended to keep the two-sided correlation structure within the market risk module and to reduce the correlation parameter between spread risk and interest rate risk (in the downward scenario) to 0,25.

## Correlation between equity risk and interest rate risk

- Not covered by EIOPA's Opinion
- A national insurance association provided an analysis hinting to elements that would justify, in its view, a reduced correlation parameter between equity and interest rate risks (i.e. from 0,5 to 0) in a downward scenario for interest rates
- Recently, EIOPA has made further analysis (based on tail correlations and the «implied correlation» methodology) that confirms that current correlation parameters are appropriate - *preliminary*

# Questions to experts

- **Question 1:** Regarding the correlation between spread risk and IRR, do experts have any objections to amend the Delegated Regulation following EIOPA's Advice? **Yes/No**

  - Keep the two-sided correlation
  - Reduce the correlation parameter between spread risk and interest rate risk (in the downward scenario) to 0.25.

- **Question 2:** In view of EIOPA's analysis, do experts have any objections not to amend correlation parameters between interest rate risks and equity risk within the standard formula? **Yes/No**

# Rules governing risk-mitigation techniques, including as regards third-country reinsurance

# Risk Mitigation Techniques (RMTs) (1/2)

## Non proportional reinsurance: recognition of Adverse Development Covers as RMTs

- EIOPA advised to amend Article 117 of the Delegated Regulation in order to recognize adverse development covers that are applied to insurance policies with similar risk characteristics as risk mitigation techniques in the standard formula capital requirements.
- Furthermore, EIOPA advised “no change” to the adjustment factors for the recognition of non-proportional reinsurance in the premium risk calculation (Article 117(3)) or the rules governing finite reinsurance in the standard formula Solvency Capital Requirement.

## Non-recognition of contingent capital instruments and convertible bonds as RMTs

- EIOPA advised to clarify in the regulation that financial risk-mitigation techniques and other financial instruments which include contingent capital instruments that trigger a purchase of insurer’s new shares or convertible bonds that convert into insurer’s new shares held then by the counterparty at a specific price set mechanism upon the occurrence of a specific event, both elements being pre-defined in the contract, cannot be used to reduce the SCR, both in the standard formula and in internal models.

# Risk Mitigation Techniques (RMTs) (2/2)

**New safeguards to ensure effective transfer of risks in case of reinsurance treaties**

• Following EIOPA's Advice, it is intended to amend article 210 of the Delegated Regulation to add provisions to specify that insurers must prove the extent of an effective transfer of risk in order to ensure that any reduction in the SCR - or increase in available capital resulting - from its risk transfer arrangements is commensurate with the change in risk that the undertaking is exposed to.

**Add new rules on the prudential treatment of third country reinsurance, including on cases where risks are retroceded**

- Following discussion in the CWP of 18 March, some delegations pointed to the need of exploring further targeted rules and supervisory safeguards on the treatments of complex reinsurance treaties provided by third country reinsurers
- Some delegations also mentioned the case of retrocession of risks as possibly increasing lack of transparency regarding the enforcement and effectiveness of treaties in the EU
- Commission services are open to consider tightening the criteria for recognition of RMTs for non equivalent third country reinsurers (possibly including requirements for an insurer to prove to the supervisory authority the enforceability of the contract and\or the level of risk transfer and\or report about the possible retrocession of risks).

# Questions to experts (1/2)

**<u>Question 3</u>:**

Do experts have any concerns with amending the Delegated Regulation following EIOPA's Advice in relation to **Non-proportional reinsurance** and **Adverse Development Covers**, **Contingent capital instruments** and **Convertible bonds**, and the **safeguards to ensure effective transfer of risks** in the case of reinsurance treaties? **Yes/No**

# Questions to experts (2/2)

- **Question 4:** Should the criteria for the recognition of risk mitigation techniques using reinsurance contracts be further tightened for the case of **non-equivalent third country reinsurance**?

Option 1: No further change

Option 2: Specify in Article 210 (*Effective transfer of risk*) that only contractual arrangements which are irrevocably effective and enforceable in the concerned EU Member States and whose fulfillment are directly controlled by the ceding insurer can be recognized as Risk Mitigation Techniques.

Option 3: Amend article 211 (*Risk Mitigation techniques using reinsurance contracts or special purpose vehicles*) to introduce further conditions for the allowance of non-equivalent third country reinsurers (currently limited to those with a credit quality step 3 or better). If yes, how?

Option 4: Introduce a new requirement for the ceding insurer to report (to its supervisor) further detailed information about its reinsurance plan and the extent to which this relies on non-equivalent third country reinsurers and their retrocession of risks. Eventually introduce a requirement for the ceding insurer to obtain sufficient information to monitor the impact of retrocession on its effectiveness on an ongoing basis

Option 5: Combination of some of the above options or others. Please specify

# Recognition of State reinsurance/guarantees as risk-mitigation techniques

# Background

## Reinsurance

- During the Covid-19 crisis, under the 'Temporary Framework for State aid measure to support the economy in the current Covid 19 outbreak' adopted by the Commission, some Member States implemented temporary transfers of credit insurance business to Member States acting as 'reinsurers'
- Solvency II does not explicitly recognize such transfers as risk-mitigation techniques and EIOPA adopted a Supervisory Statement recommending NSAs to have a 'flexible' reading of Solvency II for such schemes

## State Guarantees

- Currently, in the calculation of the SCR, (State) guarantees can only be recognised where explicitly referred to in the Delegated Regulation
  - Exposures in the form of bonds and loans that are fully, unconditionally and irrevocably guaranteed (spread risk)
  - Exposures that are fully, unconditionally and irrevocably guaranteed by a Member State (concentration risk)
  - Exposures included in counterparty default risk module that are fully secured by a guarantee from a State.
- No recognition of partial State Guarantees on bonds and loans, no recognition of Guarantees on equity investments (where in line with DG COMP framework)

# State reinsurance

European Commission

# Background

- In July 2020, EIOPA recommended competent authorities to **temporary allow** insurers and reinsurers to consider **schemes that transfer insurance risk to a Member State's government based on the Temporary Frameworks** as having the same consequences as reinsurance as defined in Solvency II.

- In its supervisory statement, EIOPA specified that:

  - such treatment may have led the assets recognized by insurers and reinsurers under the scheme to be considered linked to reinsurance (e.g. reinsurance recoverables or reinsurance receivables) for Solvency II purposes.

  - to recognise such schemes as risk-mitigation technique for SCR calculation, they would have had to comply with the relevant requirements of Articles 209-215 of Commission Delegated Regulation (EU) 2015/35.

- As announced in the non-paper circulated for the EGBPI held on 8 March 2011, we intend to specify that insurers and reinsurers should be allowed to recognize reinsurance schemes that transfer insurance risk to a Member State's government as having the same consequences as risk mitigation techniques using reinsurance contracts

# Questions to experts

- **Question 5**: Do experts have any concerns with amending the list of counterparties in case of reinsurance contracts of Article 211 in a way that those schemes can be recognized as Risk Mitigation Techniques? **Yes/No**

- **Question 6**: Do experts have any concerns with allowing that such schemes should lead the assets recognized by insurers and reinsurers under those schemes to be considered “reinsurance recoverables”? **Yes/No**

- **Question 7**: Should such schemes also lead to other changes concerning the relevant requirements of Articles 209-215 for the recognition of RMTs in the SCR calculation? *If Yes, please specify what changes you would suggest*

# State guarantees

European Commission

# Possible amendments

**Partial (but irrevocable) State guarantees on individual bonds and loans in the scope of spread risk and market risk concentration**

- E.g. if a bond with a value of 100 is irrevocably guaranteed by the State for 70% of its principal, a possible approach could be that spread risk capital charge would only apply to 30% of the bond value

**Partial (but irrevocable) guarantees on a pool of bonds or loans in the scope of spread risk**

- E.g. A pool of 3 loans worth 20 (BBB), 35 (A) and 45 (AA) [Total 100] is guaranteed by the State at 30%. The State therefore guarantees 30.
- A possible approach could consist in considering that the riskier loans are given priority when assessing which loans are guaranteed for the purpose of calculating capital requirement. Therefore, Spread risk charge could not be applied to the BBB-rated loan (20) and to 10 of A-loan. Only 25 of A-rated loan and 45 of AA-rated loan could be subject to spread risk

**Other assets in the scope of market risks**

- Guarantees on investments in equities or real estate?
- Guarantees on currency risk?

# Questions to experts

- **Question 8:** What is experts' view on the treatment of bonds and loans subject to spread risk?
  - Option 1: No change – only fully and irrevocably guarantees by States should be recognized
  - Option 2: Individual bonds/loans partly but irrevocably guaranteed should benefit from a 'preferential' treatment
    - Please specify if a 'minimum' % of State guarantee should still be required (e.g. at least 50%)
    - Please specify whether you agree with the possible concrete approach described in the previous slide
  - Option 3: In addition to Option 2, recognize partial guarantees on a pool of loans and bonds
    - If so, please specify whether additional conditions shoud apply
    - If so, please specify whether you agree with the possible approach described in the previous slide or whether you would expect a more 'conservative' approach?

- **Question 9:** What is experts' view regarding the potential full and/or partial State guarantees on other asset classes should be recognized (e.g. equity, real estate, etc.)?

- **Questions 10**: What is experts' view regarding the potential recognition of State guarantees on other 'risks' (e.g. currency risk)?


# Treatment of mortgage loans

# Consistency of insurance and banking rules

European Commission

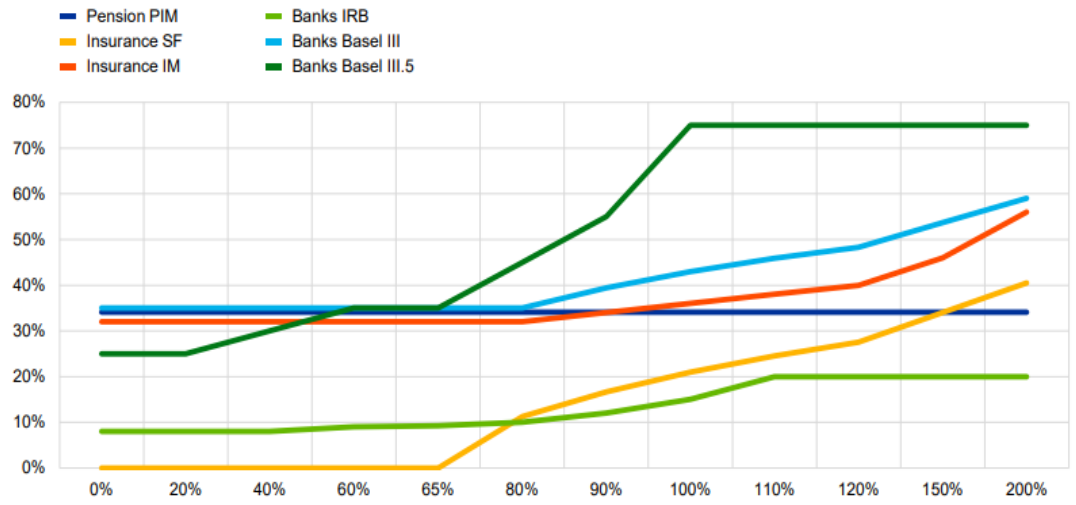
# Background (1/2)

- In its Communication on the Digital Action Plan Strategy, the European Commission indicated that it was "*considering the need for legislative proposals to address potential risks stemming from potential large-scale lending operations by firms outside the banking perimeter, which may entail both micro- and macro- prudential risks*".

- According to ESRB's paper on 'Enhancing the macroprudential dimension of Solvency II': "*The way in which the direct and indirect provision of credit is treated in Solvency II can create incentives for regulatory arbitrage and reduce the effectiveness of macroprudential measures*".

**Comparison of risk weights across sectors**

*(percentage risk weights (y-axis) according to LTV ratio (x axis))*




*Source: De Nederlandsche Bank (2016), "**Loan markets in motion**", November.*
*Notes: The risk weight percentages vary according to the LTV ratio, which is also expressed as a percentage. Assumptions need to be made for diversification benefits and loss-absorbing capacities to calculate equivalent risk weights for the insurance and pension sectors. The chart provides a comparison of the risk weights obtained for pension funds (Pension PIM), for (re)insurers under the standard formula (Insurance SF), for (re)insurers using an internal model (Insurance IM), for credit institutions using the internal ratings-based approach (Banks IRB) and for credit institutions under the standardised approach (Banks Basel III and Banks Basel III.5).*

# Background (2/2)

## ESRB's recommendations

- "The treatment of credit provision should be enhanced through capital-based (…) and by bringing (re)insurers within the scope of borrower-based tools".
- For capital-based tools, the ESRB notably recommends to introduce a **LGD floor for mortgages** to correct inconsistency in microprudential capital requirements between banks and insurers.
- Authorities should also have the power to increase this floor during times of excessive price gains in the residential real estate sector, as is the case in the banking sector.

## Argument raised by the expert from one MS (against ESRB's recommendation)

- Valuation rules are different and depending on the level of interest rates, values of mortgage loans may be higher or lower in IFRS than in Solvency II

## Why a focus on mortgage loans only?

- Contrary to other loans, mortgage loans are under the counterparty default risk module in Solvency II.
- Comparison with credit risk (i.e. exposure to default) under CRR is therefore more 'legitimate' than for other loans which are in the scope of 'spread risk' (i.e. reflecting insurers' exposures to fluctuations in market values due to changes in spreads)

# Comparison of insurance and banking rules

- Like in insurance, capital requirements for mortgage loans can be calculated under different approaches (standard approach, internal rating based (IRB) approach

**Insurance**

- **Standard formula**: Article 192(4) introduces a formula for calculating loss-given default. The LGD can be nil where the amount of the loan is smaller than 80% of the risk-adjusted value of the collateral.
- **Internal models**: no specific provisions for mortgage loans

**Banks**

- **Standard approach**: risk weighting of exposure values (multiple cases), but the capital requirement can never be nil (see Art. 124 to 126a CRR)
- **IRB approaches**: there are "floors" or "inputs values" for the LGD for retails exposures:
  - Under the A-IRB: "**LGD floor**" of **10%** (Art 164(4) CRR 2) → "**LGD floor**" of **5%** (Art 164(4a) CRR 3 proposal)…*which can be increased for macroprudential considerations in accordance with Art. 458 CRR*
  - Under the F-IRB: "**input LGD value"** for exposures secured by residential property (meeting certain criteria) is 35% (Article 230 of CRR 2) → under CRR 3 proposal, the LGD value for the part of the senior exposure secured by residential property would be 20 % (Article 230 of CRR 3 proposal)

# Challenges and limitations

**An 'alignment' is probably undesirable**

- No intention to challenge the fundamental principles of Solvency 2, notably the market-consistent valuation
- Banking rules on mortgage loans are very sophisticated with many different cases → Replicating them in Solvency II may not be justified for an activity which is not supposed to represent a major share of an insurer's business
- Finding the appropriate basis for comparison is not straightforward
  - For insurance: should it be assessed before or after diversification benefits? If after diversification, which assumption to choose?
  - For banks: how to translate the ratio OF/RWA into a 'Solvency II' metric (OF / capital requirements). This would imply making a disputable assumption on the own fund requirement of the bank

**An approach to floors to LGD, as proposed by the ESRB may be more 'targeted' and reasonable, but…**

- Which scope? Standard formula or internal models?
- Standard approach in CRR does not rely on LGD values (direct risk-weighting), therefore It does not seem possible to use standard approach as an input for standard formula…
  - So only the LGD input values or floors of the IRB approach may be used
  - Applying such LGD values or floors as floors for insurers, including for standard formula, would have the advantage of being less impactful, as IRB approaches tend to be less conservative than the standard approach

# Illustrative examples – impact of different floors to LGD values on the capital treatment of mortgage loans under Solvency II

*Real Estate value: 100*
*Haircut 20%, guarantee 0%*

| Loan | Real estate (corrected) | L\V | LGD | LGD% | LGD with floor 5% | 10% | 15% | 20% |
|---|---|---|---|---|---|---|---|---|
| 130 | 80 | 130% | 66 | 51% | 66 | 66 | 66 | 66 |
| 120 | 80 | 120% | 56 | 47% | 56 | 56 | 56 | 56 |
| 110 | 80 | 110% | 46 | 42% | 46 | 46 | 46 | 46 |
| 100 | 80 | 100% | 36 | 36% | 36 | 36 | 36 | 36 |
| 90 | 80 | 90% | 26 | 29% | 26 | 26 | 26 | 26 |
| 80 | 80 | 80% | 16 | 20% | 16 | 16 | 16 | 16 |
| 70 | 80 | 70% | 6 | 9% | 6 | 7 | 10,5 | 14 |
| 60 | 80 | 60% | 0 | 0% | 3 | 6 | 9 | 12 |
| 50 | 80 | 50% | 0 | 0% | 2,5 | 5 | 7,5 | 10 |
| 40 | 80 | 40% | 0 | 0% | 2 | 4 | 6 | 8 |
| 30 | 80 | 30% | 0 | 0% | 1,5 | 3 | 4,5 | 6 |
| 20 | 80 | 20% | 0 | 0% | 1 | 2 | 3 | 4 |
| 10 | 80 | 10% | 0 | 0% | 0,5 | 1 | 1,5 | 2 |

*Real Estate value: 100*
*Haircut 40%, guarantee 0%*

| Loan | Real estate (corrected) | L\V | LGD | LGD% | LGD with floor 5% | 10% | 15% | 20% |
|---|---|---|---|---|---|---|---|---|
| 130 | 60 | 130% | 82 | 63% | 82 | 82 | 82 | 82 |
| 120 | 60 | 120% | 72 | 60% | 72 | 72 | 72 | 72 |
| 110 | 60 | 110% | 62 | 56% | 62 | 62 | 62 | 62 |
| 100 | 60 | 100% | 52 | 52% | 52 | 52 | 52 | 52 |
| 90 | 60 | 90% | 42 | 47% | 42 | 42 | 42 | 42 |
| 80 | 60 | 80% | 32 | 40% | 32 | 32 | 32 | 32 |
| 70 | 60 | 70% | 22 | 31% | 22 | 22 | 22 | 22 |
| 60 | 60 | 60% | 12 | 20% | 12 | 12 | 12 | 12 |
| 50 | 60 | 50% | 2 | 4% | 2,5 | 5 | 7,5 | 10 |
| 40 | 60 | 40% | 0 | 0% | 2 | 4 | 6 | 8 |
| 30 | 60 | 30% | 0 | 0% | 1,5 | 3 | 4,5 | 6 |
| 20 | 60 | 20% | 0 | 0% | 1 | 2 | 3 | 4 |
| 10 | 60 | 10% | 0 | 0% | 0,5 | 1 | 1,5 | 2 |

- Article 191 of the Delegated Regulation specifies that the LGD on a mortgage loan must be equal to **max(Loan – (80 % × Mortgage + Guarantee); 0),** where “mortgage” denotes the risk-adjusted value of the collateral.
- In the examples, the “haircut” reflects the adjustment for market risks applied to the residential property. To estimate the adjustment for market risks an assumption about the diversification benefits is necessary
- It can be seen that the floor has an effect for mortgages with a loan to value ratio up to a 70% in the first case, up to 50% in the second case
- According to EIOPA’s analysis, the impact of a 10 % floor for the LGD seems moderate. For a mortgage portfolio that represents 20 % of all insurer’s assets, the result would be an increase in the SCR around 0.5 %.

# Questions to experts

- **Question 11:** What is experts' preferred approach to investigate amendments aiming at closing significant loopholes between insurance and banking regulation in relation to capital requirements (not valuation) on mortgage loans?
  - Option 1: the Commission should not aim to achieve further consistency with banking regulation
  - Option 2: the Commission should investigate, but only for the standard formiula
  - Option 3: the Commission should investigate for both the standard formula and internal models

- **Question 12:** Do experts have any concerns with using LGD floors of CRR as a way to achieve further alignment between banking and insurance?
  - If yes, please specify any alternative approach.

- **Question 13:** Assuming the LGD floor approach is followed, what is experts' preferred option:
  - Option **1a**: the LGD floor of the A-IRB approach as currently applicable (Art. 164(4) CRR): **10%***
  - Option **1b**: the LGD floor of the A-IRB approach as proposed to be amended (Art. 164(4a) of CRR3): **5%***
  - Option **2a**: the LGD value of the F-IRB approach as currently applicable (Art. 230 CRR –secured exposure) : **35%**
  - Option **2b**: the LGD value of the F-IRB approach as currently applicable (Art. 230 CRR – senior secured exposure) : **20%**
  - Option **3**: Other

* unless a higher LGD value is imposed for the banking sector in accordance with Art. 458 CRR in national market

*NB: Options 1b and 2b would require monitoring CRR3 negotiations to ensure consistency with the final values retained in CRR the banking sector*

# Other changes to Counterparty Default Risk

# Counterparty default risk

## Default and forborne loans

- Linked to Article 178 of Regulation (EU) No 575/2013 (CRR) and par. 163 of Annex V, Part II of Commission Implementing Regulation (EU) 2015/227
- In line with EIOPA's Opinion, the intention would be **to include the default and forborne loans in the type 2 exposures of the counterparty default risk module**
- According to EIOPA, the use of the spread and interest rate shocks for estimating the capital absorption of low quality loans may underestimate the level of potential losses the undertaking may face on the related exposures.
- Implementing EIOPA's proposed formula for loss-given default would also allow avoiding arbitrages against the banking regulation and would require the following amendment:
  *LGD = 6.67 * max (Loan – Recoverables; 36%* Loan)*
- Consistency with the Commission's proposal on the review of the CRR

## Consistency of treatment of partial guarantees on mortgage loans with banking rules

- Concerns Article 192(4) of the Delegated Regulation
- In line with EIOPA's Opinion, **such amendment would imply that a requirement for the recognition of partial guarantees could be that the guarantor requires the insurance or reinsurance undertaking to first pursue the obligor itself** (compared to the situation where the guarantor directly pays out the guaranteed amount).
- Consistency with the Commission's proposal on the review of the CRR

# Questions to experts

**<u>Question 14</u>:**

- Regarding the **prudential treatment of default and foreborne bonds and** the **treatment of partial guarantees on mortgage loans**, do experts have any concerns with amending the Delegated Regulation following EIOPA's Advice?

# Best estimate

# Potential changes which are dependant on amendments to Level 1

- In the Commission's proposal, the **Commission would have to adopt delegated acts** '*laying down the **prudent deterministic valuation** referred to in Article 77(7) as well as the **conditions** under which that valuation may be used to value the best estimate of technical provisions with options and guarantees*'.

**Condition (as proposed by EIOPA)**

- An insurer may only use the prudent deterministic valuation where the time value of options and guarantees, measures based on a prudent harmonised reduced set of scenarios (PHRSS) to be set out in ITS, of the contracts concerned is below 5% of the SCR

**Method (as proposed by EIOPA)**

- the undertaking adds to its best estimate a stochastic supplement either equal to 5% of the SCR, or where the undertaking can calibrate a stochastic supplement using the PHRSS that accurately reflects the firm's risk profile, equal to that ad-hoc stochastic supplement;
- the loss-absorbing capacity of technical provisions is independent from the stochastic supplement;

**EIOPA would develop draft ITS specifying the set of scenarios** to be used for the prudent deterministic valuation of the best estimate for life obligations

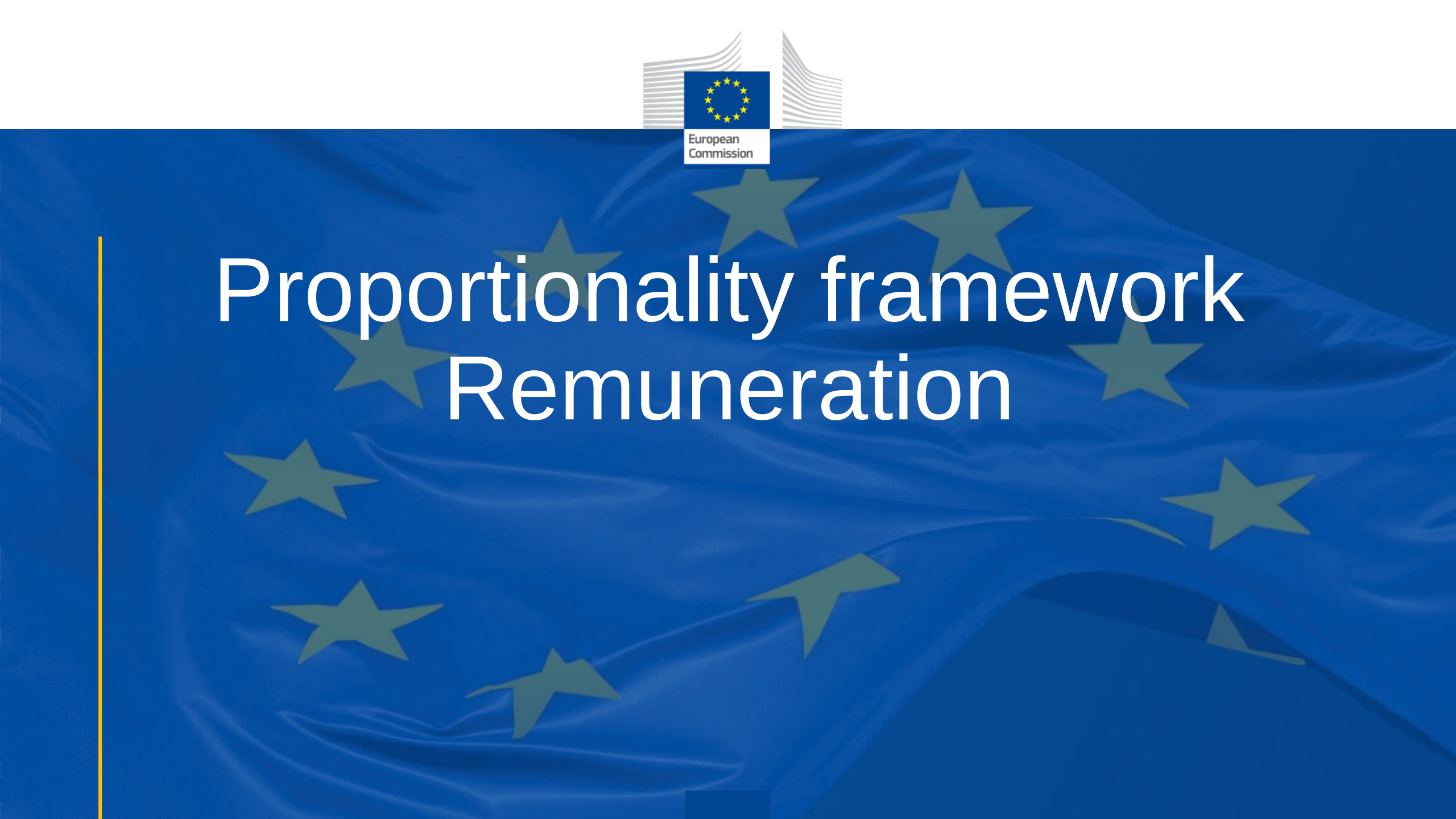
- Approximately 10 scenarios

# Potential changes which are not dependant on amendments to Level 1

| Article | Topic | EIOPA's recommendations |
|---|---|---|
| 1 | Definitions | - Introducing a definition of 'future management action' : any action that the AMSB of an insurance or reinsurance undertaking may expect to carry out under specific future circumstances<br>- Introducing the concept of 'expected profits in future fees for servicing and management of funds'. Those future profits are quite similar in nature to expected profits included in future premiums (EPIFPs) and can have a significant impact on technical provisions of unit- and index- linked products and on own funds. |
| 18(3) | Contract boundaries | Clarifying 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 |
| 31 | Expenses | - (paragraph 1) clarifying 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]<br>- (paragraph 4) Clarifying that for the purpose of calculating expenses, new business should not be assumed in all cases, but only under realistic assumptions. |
| 260(4) | Expected profits included in future premiums (EPIFPs) | Clarifying that:<br>- Loss-making policies should be offset against profit-making policies within a homogeneous risk group for the purpose of the calculation of EPIFPs<br>- If a homogeneous risk group is loss-making in total, it should not be set to zero, but it should be included in EPIFPs |

# Questions to experts

- **Question 15**: do experts have any concerns with the proposed amendments to the Delegated Regulation which are not dependent on amendments to the Level 1?
- **Question 16**: do experts have any concerns with the proposed amendments to the Delegated Regulation which are dependent on amendments to the Level 1?




# Proportionality framework Remuneration

# Waiver of the deferral of variable remuneration (1/2)

- **EIOPA recommends that the scope of the mandatory deferral of a substantial portion of the variable remuneration component in Article 275(2)(c) of the Delegated Regulation may be limited, taking into account the absolute and relative amount of variable remuneration received by the staff member.**
  - The limited scope would be in line with Article 94 of CRD, as amended by Directive (EU) 2019/878.
  - However, the thresholds in the banking sector would have to be adapted to the characteristics of the insurance market
- **More concretely, EIOPA recommends that the mandatory deferral would not apply when both of the following criteria are met:**
  - The undertaking is a low-risk profile undertaking, or the supervisory authority approves the use of the proportionality measure in accordance with Article 29d of the Directive
  - The variable portion of the staff member's remuneration does not exceed both of the following:
    - 50.000 euros
    - One third of the total remuneration.

# Waiver of the deferral of variable remuneration (2/2)

- Directive (EU) 2019/878 introduced derogations to the waiver: *Member State may decide that staff captured under the criteria shall not be subject to the exemption 'because of national market specificities in terms of remuneration practices or because of the nature of the responsibilities and job profile of those staff members'.*
- Two experts' written feedbacks asked to introduce the same flexibility in Solvency II.
- However, it seems challenging to introduce a MS option in a Delegated Regulation.
- In addition, one can note that:
  - Article 29c(2) of the COM proposal introduces a 'safeguard' power on the use of proportionality measures by LRP firms
  - Article 29d of the COM proposal allows supervisors to grant proportionality measures to non-LRP insurers with terms and conditions. Such terms and conditions can leverage on the banking criteria for derogations to the waivers.

# Questions to experts

- **Question 17:** what is experts' view on the exemption to the deferral on variable remuneration?
  - Option 0: No change to the rules on remuneration
  - Option 1: Follow EIOPA's Opinion
  - Option 2: Follow EIOPA's Opinion but set lower thresholds (*please specify*)


# Reporting and Disclosure

# Potential changes which are directly related to changes to Level 1

- **Proposed Way forward:** Potential changes largely follow EIOPA's proposal

| DIRECTIVE | DELEGATED REGULATION |
|---|---|
| Article 35 (9) | Amend Articles 304 – 314 (Solo) and Articles 372 – 375 (Groups) to define criteria for limited supervisory reporting for captive insurance and reinsurance captive undertakings |
| Article 56 (1) | Amend Articles 290 – 303 to integrate the new structure of the SFCR and specify the required information (that needs to be disclosed) accordingly. (Solo) |
| Article 256 (4) | Amend Articles 359 – 371 to integrate the new structure of the SFCR and specify the required information (that needs to be disclosed) accordingly. (Group) |
| Article 256b (6) | New article to specify the information which shall be reported in the Group Regular Supervisory Report. |

# Questions to experts

- **Question 18**: Do experts have any concerns with regard to the potential amendments described in the previous slide? *NB COM's intention is to deal with issues regarding ESG disclosures by insurers in the context of the CSRD*

- **Question 19:** Do experts have any concerns with the proposed way forward regarding disclosures of sustainability risks, ESG and climate change?


# Group supervision

# Potential changes which are directly related to changes to Level 1 (1/2)

| DIRECTIVE | DELEGATED REGULATION |
| --- | --- |
| Article 92 | Amend Article 68(3) to align the condition for non-deduction of own funds from credit or financial institutions |
| Article 226 | Add references to 'holding companies of third-country insurance and reinsurance undertakings in Articles 335(1), points (a), (c) and (d) |
| Article 228 | • Amend (streamline or delete) Article 329 as most rules would now be specified in the Directive<br>• Adjust references to entities from other financial sectors in Articles 335 and 336 as the Directive would specify that the total group SCR is the sum of the 'consolidated group SCR' and of the contribution from other financial sector entities |
| Article 229a | New article to specify the simplified approach (use of equity method for valuation, treat the item as an investment subject to the floor specified in the Article 229a(2) of the Directive), largely in line with EIOPA's Opinion |

# Potential changes which are directly related to changes to Level 1 (2/2)

| DIRECTIVE | DELEGATED REGULATION |
|---|---|
| Article 230* | • Add references to 'holding companies of third-country insurance and reinsurance undertakings in Articles 335(1), points (a), (c) and (d)<br>• If change in labelling is confirmed by co-legislators, use the term 'Group MCR' instead of 'Minimum Consolidated Group SCR' throughout the Delegated Regulation<br>• Amend Art. 331 to 333 to reflect updated rules on 'encumbrance' |
| Article 233a | • Amend Article 341 of the Delegated Regulation to align with the proposed specification on the Minimum Consolidated Group SCR (group MCR in PCY's compromise), e.g. to further specify own funds eligibility where appropriate<br>• Possible new article to further specify rules governing group solvency calculation where a combination of methods is used |
| Article 308b(17) | • Amend Article 359 so that SFCR includes an assessment of the impact on insurers' solvency of assuming that own funds stemming from transitional measures are unavailable at group level<br>• Amend 372 for the reporting of such assessment |

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* NB: part of Art. 230 on encumbrance is suggested to be moved to Art. 222(6) in the French PCY's draft compromise

# Potential changes which are not dependent on changes to Level (1/2)

| Topic | Envisaged change | Article in Level 2 |
|---|---|---|
| **Treatment of joint ventures / joint operations** | There is an inconsistency between prudential treatment and accounting (IFRS) one in relation to joint ventures / joint operations where some undertakings which should be consolidated on a proportional basis under Solvency II are included through equity method under IFRS. This can raise technical issues. The Delegated Regulation could allow for a more consistent approach and/or foresee more proportionality in the application of Solvency II rules in such cases. | 335(1)(c) |
| **Treatment of holding companies** | Clarifying that a notional SCR has to be calculated for the purpose of availability assessment and/or where the deduction and aggregation method is used for an insurance holding company or a mixed financial holding company. **In line with EIOPA's Opinion** | 330(5), 330(6) + and possibly new article |
| **Availability of group own funds** | • Clarifying that expected profits included in future premiums should be included in the insurance group's regular availability assessment processes. **In line with EIOPA's Opinion.**<br>• Deleting paragraph Article 330(1)(d), as this is a criterion for classification as own fund, not for availability. **In line with EIOPA's Opinion** | 330(1) |
| | • Complementing the list of non-available own funds to align with Article 222(2) of the Solvency II Directive. **In line with EIOPA's Opinion**<br>• Specifying the way of calculating non-available minority interests from insurance subsidiaries. **In line with EIOPA's Opinion.** | 330(4) and possibly new paragraph 330(4a) |
| | Introducing the following relief: for the purpose of the availability assessment, groups may reduce the contribution of the ultimate parent company to the group SCR by discarding equity risk stemming from holding insurance participations. Such a change would improve group solvency, by allowing more non-available own funds from subsidiaries to be taken into account at group level. **In line with EIOPA's Opinion.** | 330(6) |

# Potential changes which are not dependent on changes to Level (2/2)

| Topic | Envisaged change | Article in Level 2 |
|---|---|---|
| **Classification of group own funds** | • Amending the title of Art. 331-333 to clarify that classification requirements also apply to participating undertakings (and not only related undertakings) – aim is to reflect the content of those articles which actually refer to both participating and related undertakings. **In line with EIOPA's advice** | Art 331 to 333 |
| **Partial internal models** | • Specifying the conditions under which the partial integration technique n°1 referred to in Annex XVIII may be used to include undertakings outside the scope of the internal model;<br>• Specifying the requirements for using the other integration techniques listed in Annex XVIII;<br>• Specifying the linkages between the assessment of the appropriateness of the partial integration technique n°1 and the deduction and aggregation method.<br>**In line with EIOPA's advice** | Art. 328, Art. 343 and Annex XVIII |
| **Transparency & accountability** | • Disclosure of the number of groups where Article 214 has been used to either waive group supervision or to exclude the top parent company | Annex XXI |

# Questions to experts

- **Question 20**: Do experts have any concerns with regard to the potential amendments described in the previous slides, notably those which are not dependent on changes to Level 1?

Currently, in order to be classified as group own funds, any own fund item issued by a subsidiary has to refer to the group SCR as a trigger for deferral/suspension of distributions and of repayment. One EU group has highlighted to the Commission services that this may deter acquisitions and consolidation in the insurance sector, as own funds issued by a target acquirer before the acquisition takes place would obviously not refer to the SCR of the acquiring group, and would therefore not meet the Solvency II group classification criteria.

- **Question 21**: Although there is no equivalent provision in CRR, do experts consider that Commission services should investigate possible amendments which would ensure that own funds issued by an acquirer before the acquisition takes place to be temporarily classified as (non-available) group own funds (i.e. temporary derogation from the principle of requiring reference to group SCR to be classified as group own funds)?
    - If so, do experts have suggestions in relation to the duration of this temporary derogation?


# Other topics

# Minimum Capital Requirement

- Regarding the use and the level of the cap and the floor, EIOPA advised not to change the current 25%-45% corridor
- In relation to the risk factors ("alpha" for technical provisions and "beta" for written premiums) for the calculation of the Minimum Capital Requirement (MCR) set out in Annex XIX of the Delegated Regulation, EIOPA advised the following changes:

| Segment | LoB | factor alpha | factor alpha _NEW | factor beta | factor beta_NEW |
|---|---|---|---|---|---|
| **Medical expense insurance** | **1 and 13** | **4,7%** | **5,4%** | 4,7% | 4,7% |
| **Income protection insurance** | **2 and 14** | 13,1% | 13,1% | **8,5%** | **8,0%** |
| **Workers' compensation insurance** | **3 and 15** | **10,7%** | **10,3%** | **7,5%** | **9,0%** |
| **Credit and suretyship insurance and proportional reinsurance** | **9 and 21** | **17,7%** | **16,0%** | **11,3%** | **17,7%** |
| **Legal expenses insurance and proportional reinsurance** | **10 and 22** | **11,3%** | **5,2%** | **6,6%** | **7,8%** |
| **Assistance and its proportional reinsurance** | **11 and 23** | **18,6%** | **20,3%** | **8,5%** | **6,0%** |
| **Non-proportional health reinsurance** | **25** | **18,6%** | **15,9%** | 15,9% | 15,9% |

- **Question 22**: Do experts have any concerns with amending the Delegated Regulation following EIOPA's Advice?

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# Remaining Green Deal items

- Background: sole reliance on historical data may lead to underestimation of risks affected by climate change

**Best Estimate**

- Concerns Article 20 (Limitations of data)
- A clarification could be introduced to state that insurers' internal procedures should ensure avoidance of overreliance on data from past events with respect to climate change-related risks

**Internal models**

- Concerns Article 231 (Data used in the internal model)
- A clarification could be introduced to state that insurers' internal procedures should ensure avoidance of overreliance on data from past events with respect to climate change-related risks

# Questions to experts

- **Question 23**:

Do experts have any concerns with regard to the potential amendments described in the previous slide?

# Raised during EIOPA's Q&A process: SCR for expense risk

- Art. 140, point (a) and 157, point (a) on life and health SLT expense risk could be clarified such that expenses that are contractually fixed and cannot change would not be subject to the scenario set out in those articles.

- **Question 24**:

Do experts have any concerns with regard to such clarifications on the calculation of the expense risk module?

# Less substantial alignments with changes at the Level of the Directive (work in progress)

Pending the agreement on amendments to Directive, a number of aligning changes to the delegated regulation would be required:

- Art. 271 [internal audit function]: in light of the amendments to Article 41 of the Directive (new paragrapgh 2a), the paragraphs 1 and 2 should be deleted; likewise point (d) in Art. 308(6) should be deleted;
- Art. 278(2) [capital add-on in relation to VA can only be imposed where deviations from underlying assumptions to not justify revoking supervisory approval]: current text is written under the assumption that not all MS require approval for the VA; the text should reflect that all MS will require supervisory approval; the rest of the substance in this paragraph would be maintained

# Other changes - ORSA

- In the context of the ORSA, EIOPA's view is that the rules on the overall solvency needs set out in Article 262(2) of the Delegated Regulation should be clarified.
- More specifically, the overall solvency needs would include the result of stress tests and scenario analysis that are proportionate to the nature, scale and complexity of the risks inherent in the undertaking's business.
- However, Article 262 can only be amended under the empowerment for RTS set out in Article 50(3) of the Solvency II Directive. This empowerment would not be modified under the Commission's proposal for amendments to the Directive.
- Against this background, EIOPA has stated the intention to develop draft RTS.
- When submitted by EIOPA, the Commission could consider such draft RTS for adoption under an initiative separate from the other amendments to the Delegated Regulation.

# Other issues

**Property risk**

- Technical analysis conducted by EIOPA concluded that there is **no technical justification for a downward re-calibration of the property risk sub-module** of the standard formula despite the UK departure from the EU.
- This is in line with ESRB's assessment that property risk should not be weakened at the current juncture, as there are vulnerabilities in both commercial and residential real estate sectors which are important for financial stability.

**Strategic equity investments**

- The Commission proposal suggests amending the empowerment in Article 111(1)(m) of the Solvency II Directive to replace the reference to 'related undertakings' by a reference to 'qualifying holdings'.
- However, based on current assessment by EIOPA**, it is not envisaged to amend Article 171 of the Delegated Regulation on strategic equity investments to reflect this change in empowerment**.

**Underwriting risk**

- In line with EIOPA's advice, there is **no technical justification to revise the current calibration of the underwriting risks stress factors** of the standard formula, unless convincing evidence of flaws will emerge in the coming months.

# Thank you



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