

RISK MARGIN CONSULTATION PROPOSALS

Workshop with stakeholders on Solvency II consultation papers

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CP ON INSTRUMENTS ON THE RISK MARGIN

Scope

- Consultation paper on the RTS on the simplified calculation of the risk margin
- Consultation paper on revised Guidelines on the valuation of technical provisions

Key changes

- RTS on the simplified calculation of the risk margin
 - Aligns Article 58 DR (simplified calculation of the risk margin) with new formula in Article 37(1) DR, introducing exponential time factor ("lambda factor")
- Revised Guidelines on the valuation of technical provisions
 - Lambda factor fully integrated into simplified methods 1 & 2; no explicit recognition of lambda factor for methods 3 & 4
 - Guideline 62 and Annex IV revised; Guidelines 61 and Annex VI deleted
 - 25% reduction in number of Guidelines on the risk margin

MOTIVATION OF THE CHANGES

- Introduction in the Directive (art. 77(5)) of the so called “lambda factor”, in order to account for the time dependency of risks and reduce the amount of the risk margin in particular for long-term liabilities, thereby reducing the sensitivity of the risk margin to interest rate changes
- The Delegated Regulation sets the value of the lambda parameter to **0.96** and caps the reduction resulting from the factor to **50%**
- This implies the following change of the formula of the RM (art. 37 DR):

$$RM = CoC \cdot \sum_{t \geq 0} \frac{SCR(t)}{(1+r(t+1))^{t+1}} \quad \longrightarrow \quad RM = CoC \cdot \sum_{t \geq 0} \frac{SCR(t) \cdot \max(0.96^t, 0.5)}{(1+r(t+1))^{t+1}}$$

where CoC is set to 4.75% (art. 39), in line with the value introduced by Directive 2025/2 and the terms SCR(t) denote the future SCR at time t *before the allowance for the time-dependency of risk*

CP ON THE RTS ON THE SIMPLIFIED CALCULATION OF THE RISK MARGIN

- Aligns Article 58 DR (simplified calculation of the risk margin) with new formula in Article 37(1) DR, introducing the lambda factor:

Article 58

Simplified calculation of the risk margin

Without prejudice to Article 56, insurance and reinsurance undertakings may use simplified methods when they calculate the risk margin, including one or more of the following:

- (a) methods which use approximations of the amounts denoted by the terms SCR(t) referred to in Article 37(1);
- (b) methods which approximate the ~~discounted sum of the amounts denoted by the terms SCR(t) as referred to~~ **included in the formula set out** in Article 37(1) without calculating ~~each of those amounts separately~~ **each of the summands of that sum.**

- Article 58 of the Delegated Regulation falls under Article 301b(1) of the Solvency II Directive, that establishes that since 25 May 2016 Article 58 can only be amended by means of RTS drafted by EIOPA (“sunrise provision”)

CP ON REVISED GUIDELINES ON THE VALUATION OF TECHNICAL PROVISIONS

- Integrates the lambda factor in GL 62 (“Hierarchy of methods for the calculation of the risk margin”)
- Lambda factor **fully integrated in methods 1 and 2**, before the allowance for the time-dependency of risk
- It is **not considered appropriate** to explicitly recognize the lambda factor in the calculation of the risk margin when using **methods 3 and 4**:
 - **Method 3** is derived from Method 2 under the assumptions of a flat discounting curve and deterministic cash flows, so that the concept of modified duration can be applied. Hence, this simplification does not allow an explicit estimation of future SCR values to which the lambda factor could be applied
 - **Method 4** does not give explicit consideration to the time dimension of the liabilities, therefore it is not appropriate to include the lambda factor when using method 4
 - The explicit inclusion of the lambda factor into these methods could amplify the error of the approximation and, consequently, lead to a misstatement of technical provisions, in contrast with principles that should drive the assessment of the proportionality of the method according to art. 56 DR

CP ON REVISED GUIDELINES ON THE VALUATION OF TECHNICAL PROVISIONS: SUMMARY OF THE CHANGES

- **Guideline 61** – Methods to calculate the risk margin **DELETED**
- **Guideline 62** – Hierarchy of methods for the calculation of the risk margin
+ **Technical Annex IV** – Hierarchy of simplifications for the risk margin
AMENDED to reflect the introduction of the lambda factor. Other changes relate to the need to shorten and simplify the GL and to the integration of relevant Q&As
- **Guideline 63** – Allocation of the overall risk margin **UNCHANGED**
- **Guideline 50** – Simplified calculation of technical provisions during the year
+ **Technical Annex VI** – Simplified calculation during the year for the risk margin
Annex VI DELETED, Guideline 50 AMENDED to take this deletion into account

As a result of the proposed changes the number of guidelines on risk margin is reduced by 25%, in line with EIOPA objective for shortening guidelines relevant for the insurance industry



THANK YOU!

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