insurance europe

Memo for information

To: Solvency II Working Group
From: ECOFIN Team
cc:
Date: 28-09-2017
Reference: ECO-SLV-17-207

Subject: Summary of EIOPA roundtable 27 September

Comments

Members will find below highlights from the EIOPA roundtable on the Solvency II review organised on 27 September. The summary mainly focuses on comments and arguments made by supervisors in the meeting, and should be read in conjunction with the slides shared by EIOPA before the meeting. Members should also note that:

- Industry participation included Insurance Europe and some of its members (ABI, ANIA, DIA, FFA, GDV), as well as representatives from the CFO/CRO fora, AMICE, RAB, AAE.
- Supervisory participation included EIOPA, but also representatives from ACPR, PRA, IVASS, Bafin, DNB. In many cases, the discussion was actually led by supervisors.

Summary

The discussion followed the agenda shared by EIOPA ahead of the meeting (see ECO-SLV-17-202). Each topic started with a presentation by supervisors (on the basis of the slides shared – see ECO-SLV-17-203), was followed by comments from non-supervisory participants, and then continued with an exchange of views. This summary does not intend to repeat industry's comments (as these are already known to members) and rather focuses on points made by the supervisors, on top of the points in the presentation slides and often in response to industry's critique.

LAC DT (work led by DNB)

Comments made by supervisors:

- While EIOPA and supervisors are indeed working on some level of convergence, the objective is not to achieve a full convergence (as is the case for the SCR standard formula). The intention is not to fully remove supervisory judgement, but rather encourage both supervisors and undertakings to make similar judgements for similar issues. Some level of company own judgement will still remain in areas such as business plans, recapitalization plans.
- After facing significant push-back on the proposal to use risk-free returns on the basis of risk-neutral projections, DNB noted that supervisors need to reflect more on this issue and on the reference to Guideline 9.
- No future profits below MCR post-shock would be allowed as a breach of MCR would trigger a recovery period which, if unsuccessful, would lead to insurers losing their licenses with no chance to issue new business
- Allowance of reversals is not in line with a risk-neutral approach.
- Regarding recapitalization: there may be a difference between a company seeking recapitalization on the market (ie on its own) vs a company seeking recapitalization within a group (eg from the parent company). Supervisors seemed to suggest only recapitalization within a group would be acceptable.
- On the issue of recognition of risk margin, supervisors seem to believe the actual numeric impact is marginal. They asked the industry to provide examples on how this could be significant.

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The industry was aligned in raising concerns on EIOPA's proposals, across areas identified in the EIOPA presentation.

Risk margin (work led by ACPR and EIOPA)

Comments made by supervisors:

- The industry should not be surprised by the size of the RM; the formula of the RM was already known and it makes sense that a transfer value increases in a low interest rate risk environment. In addition, EIOPA believes that calculating the RM as a % of SCR is not an argument in itself that the RM should change.
- European supervisors see no economic justification for linking the CoC rate to the level of the risk-free rates.
- EIOPA is open to review the RM beyond the CoC, but the industry should put forward more proof. This may anyway only be in the scope of the 2020 review.
- EIOPA wants to be forward looking in the estimation of parameters for the CoC, however it believes that it needs to look at past data and reflect it in the calculations.
- ACPR noted that, in its view, the industry has not provided enough proof into the issue of volatility. Supervisors wish to review CoC on the basis of what was already done back in 2007.
- Supervisors are struggling to find data to assess whether the RM is indeed a reflection of the transfer costs.
- On whether the Solvency II work on the risk margin and ICS work on the margin over current estimate are linked, EIOPA answered that the two workstreams should be looked at in parallel and are not linked.
- EIOPA and supervisors have not yet decided whether they will only advise on a new CoC level, or on a CoC based on a formula and with provisions for review (like it has done for the UFR).

The industry was united in asking for a material review of the CoC, as well as for a solution that addresses volatility in the RM and goes beyond the CoC.

Premium and reserve risk (work led by ACPR)

EIOPA noted that it is not aiming to change the methodology, but it is only testing scenarios on the basis of new data vs what was done back in 2011.

Volume measure for premium risk (work led by the ACPR)

EIOPA indicated that work is in progress to review adjustment factors, in particular by investigating the data that was received from companies in September. EIOPA is looking at changes in own funds over 1y, and this explains why data is not calendar data but full 1y data. EIOPA has not yet decided whether its approach should be split between 1y and multi-year contracts. It also admitted that the exhibits presented in the presentation for the roundtable need to be further clarified/reviewed.

Interest rate risk (work led by Bafin)

Comments made by EIOPA and supervisors:

- EIOPA noted that reality of low interest rates cannot be ignored and, of all the changes in the scope of the review, this is the most "logical". It was also noted that this area attracts a high level of concern among supervisors in the EIOPA BoS.
- While supervisors recognize limited experience / data on low interest rate environments, they aim to work as much as possible on the basis of data that is available.
- On the issue of reviewing the correlations if interest rate calibrations are reviewed: supervisors noted that market risk recalibrations are not in the scope of the advice, so there is no intention to look into correlations.
- The EIOPA WG on this topic has not looked into linking data breaches to particular events, nor in the duration of data breaches.
- On the issue of whether method 2 and 3 lead to 99.5% confidence results, Bafin responded that in method 2 stress factors were calibrated at 99.5% and on this basis a min shock was derived, while in

method 3 floors were estimated from distributions of interest rate changes that captured the 99.5% quantile.
- On the issue of stressing the extrapolated curve, Bafin recognizes that extrapolating after stress may be more consistent with the valuation approach, however there are concerns that this approach may result in underestimation.
- EIOPA ruled out method 1 and will only consult on method 2 and 3.

Industry representatives argued for a delay to the review of the IR module to 2020 and also asked for method 1 to be reconsidered and not ruled out. A number of representatives challenged the EIOPA technical work.

Longevity/mortality

Comments made by EIOPA/supervisors:
- Work so far confirms that age dependent shocks may be justified.
- Focus of the work so far has been on the stress factors; the relevant WG will discuss in the near future whether USPs should also be included or not.
- DNB noted that a lot of effort has been put into the exercise, however it may turn out that 20% is in fact the average so shocks would be below and above 20%.

Insurance Europe welcomed that EIOPA is investigating the areas that were highlighted in the discussion paper, and noted that it will provide more comments once concrete proposals are made. Note: the Commission raised concerns bilaterally with Insurance Europe, indicating that, politically, an uplift of shocks above 20% for young people would not be in line with the EC objectives of increasing (private) pensions in Europe.

Look through (work led by IVASS)

Comments made by supervisors:
- A change in the 20% threshold is still being discussed, though supervisors do not appreciate the argument of aligning pillar 1 and pillar 3 requirements.
- The EIOPA WG acknowledged the lack of target asset allocation information and is considering proposing alternatives that are more workable in practice.

Insurance Europe welcomed that the EIOPA WG is looking into all the areas highlighted in the discussion paper and asked that more of the industry proposals be considered.

Counterparty default risk (work led by EIOPA)

Comments made by supervisors:
- The EIOPA WG is considering a review of the QIS5 simplification, in line with Insurance Europe's proposal.
- At least two options would be proposed for derivatives in the consultation.

Insurance Europe highlighted the need for an ambitious change in the measurement of derivatives' risk, to reflect the EMIR provisions that make centrally cleared derivatives almost risk-free.

Own funds

This area had not been listed on the agenda, so a high-level update was provided by EIOPA.
- It was noted that a full alignment to CRR is not being foreseen, however EIOPA would recommend some changes/refinements to the current approach. For example, circumstances in which full/partial write down would be triggered would be defined (eg if MCR breach or 75% of SCR breach then full write down).
- EIOPA would keep the current 20% limit of RT1 as eligible tier 1; if this was removed, criteria should be strengthened.
- PLAM should be strengthened, with a full write down.

Currency risk

This area had not been listed on the agenda, so a high-level update was provided by EIOPA.

- EIOPA is not convinced by the Insurance Europe proposals, which are deemed to be too complex.
- The DNB noted that, in practice, some companies seem to have found solutions to hedge currency at group level.
- EIOPA would also consider cases where a company has significant activity in non-home currency and may allow for group reporting in a different currency.

Next steps

- At EIOPA level:
    - EIOPA is working on the fall consultation document.
    - The draft consultation paper will be presented in the BoS of 26 October. Depending on how many comments supervisors make, EIOPA will aim to launch the consultation immediately after (ie may be as soon as 27 October or the week after in early November)
    - EIOPA will also launch a data collection exercise on interest rate risk and LAC DT, to be run in parallel to the consultation in November – December.

- At Insurance Europe level:
    - The secretariat proposes that the various areas of the meeting be discussed in the Solvency II WG meeting of 4 October, with a plan for next steps. The secretariat is in particular seeking members' feedback and views that could be put forward as counter-arguments to EIOPA's proposals.