

To: Solvency II WG, Public Affairs & Communications Committee, Economics & Finance Committee  
From: Insurance Europe Secretariat  
Date: 08-05-2024  
Reference: ECO-SLV-24-126

Subject: Updated High-level overview and key industry messages in response to EGBPI non-paper on Solvency II

## Summary

Based on members' feedback, the secretariat has updated a high-level overview and industry responses to the Commission non-paper on Solvency II (see [ECO-SLV-24-121](#)) prepared for the Expert Group on Banking, Payment and Insurance (EGBPI) meeting of 15 May.

For members' convenience, a track change version is provided (see ECO-SLV-24-126TC).

Members are requested to

1. Engage with their relevant national authorities and others involved in the discussions from their markets, based on the key messages below and the industry Do and Don'ts paper ([here](#))
2. Report on feedback from their contacts to the secretariat to enable us to decide on next steps.

## Scope of Level 2 work

The EC proposes a staggered approach where the so-called 'Core Level 2 review' elements would be given priority for technical discussions while the so called 'Extended Level 2 review' elements would be dealt with at a second stage, by the next EC.

Core Level 2 review elements include LTG, LTE, reporting and disclosure, governance, proportionality, group supervision and other topics previously discussed in EGBPI meetings e.g. risk-mitigating techniques in the SCR calculation, counterparty default risk and SCR for mortgage loans

Extended Level 2 review elements include work on sustainability risk (prudential treatment of sustainability risks, biodiversity report, natcat parameters)

### EC questions:

- What are experts' views on the outlined work programme for the review of the Solvency II Delegated Regulation? In particular, are there specific additional topics which the Commission should consider for the 'Core Level 2 review'?
- What is experts' view on the opportunity to investigate the introduction of a dedicated prudential treatment for crypto-assets?

### Messages:

- The Commission's work on Solvency II Level 2 should consider the wider EU policy objectives in particular:
  - the further development of the CMU and the Green Deal and how insurers can contribute to the crucial need for increasing investment.

- international competitiveness of the industry
- the Commission's commitment to reduce operational and reporting burdens by 25%.
- Key to the above are the reductions in excessive capital and volatility which were an objective of the Level 1 agreement – the Level 2 should follow through to enhance and certainly not undermine the Level 1 improvements.

### **Bundling of empowerments**

The EC reiterates the recital stating that the SII Delegated regulation should be kept in force and any change should be made via amendments to this regulation. Regarding this, the paper notes that any decision regarding the possible bundling of empowerments will have to be made under the next Commission.

#### **EC questions:**

- What are experts' views on the possible implementation of this recital as part of the Solvency II review? In particular, do experts consider that the 'Core Level 2 review' could be adopted through one amending act to the delegated regulation, or should it be divided into at least two amending acts?
- If the 'Core Level 2 review' was to be adopted through more than one amending act, a possible approach could be to distinguish the quantitative aspects directly arising from the Level 1 agreement (long-term guarantees [LTG], long-term equity, risk margin and interest rate risk) from the rest. Another approach could be to further split amendments related to the quantitative aspects directly arising from the Level 1 agreement into two acts – one dedicated to valuation rules (LTG measures and risk margin) and the other to capital requirements (long-term equity and interest rate risk). What are experts' views on such possible approaches?

#### **Messages:**

- The bundling of empowerments should be sufficiently granular to allow the EC's Level 2 proposal/set of proposals to be assessed on their own merits and for Council and EP to exercise their role.

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## **First discussions on certain items of the review**

### **1. Extrapolation of RFR curves**

**Convergence parameter:** Commission does not propose a calibration for the convergence parameter at this stage and just state that 11.975% is the minimum calibration implied by the co-legislators.

**Residual volume criterion:** The non-paper notes the DG FISMA's proposal to maintain the convergence parameter at 6% as this would have maintained the First Smoothing Point (FSP) at 20 years since 2011. The non-paper highlights that in 2022, the methodology and market conditions would have increased the EUR FSP to 24 years. Nevertheless, this outcome is considered temporary and does not result in a change in the FSP.

#### **Questions:**

- What are experts' views on the points outlined in this section?

#### **Messages:**

##### **Convergence parameter**

- **A higher than 10.975% calibration is needed to avoid reducing artificial balance sheet volatility introduced by the new methodology.**

- The industry supports a calibration of 15% for the EUR and 70% for SEK as these would achieve this and also reduce incentives for procyclical behaviour and excessive derivative usage.

**Residual volume criterion**

- **Stability of the extrapolation parameters, particularly the first smoothing point (FSP), is necessary to avoid introducing additional artificial volatility.**  
Revising the residual volume parameter upwards to above 6% would keep the FSP at 20 years for the Euro and would future proof the new extrapolation methodology against market volatility.

## 2. Risk margin

Based on the recital in the SII amended directive stating that “the introduction of the term-dependent factor should result in a reduction of the sensitivity of the risk margin to changes in interest rates”, the EC concludes that this **implies the reintroduction of a cap/ceiling/floor to the effect of the lambda**, as the recital would imply that the mitigating effect of the lambda for long-term maturities should not be higher than for short-term maturities.

**Questions:**

- What are experts’ views on the impact of the provisional Level 1 agreement (in relation to the cost-of-capital rate) on the setting of the exponential term-dependent factor? In particular, what should be the value of the term-dependent factor?
- What are experts’ views on the appropriate ceiling to the effect of the term-dependent parameter?

**Messages:**

- **The exponential time-dependent factor (i.e. the lambda parameter) should be set below a maximum of 0.975, without a floor/cap/ceiling.**
- The reduction in the, currently excessive, risk margin will increase the risk-taking capacity of the insurance industry and allow it to contribute to the EU’s political objectives including the CMU and the transition to a sustainable economy.
- It is also unclear how the EC can conclude that a ceiling is needed based on the recital. The exponential nature of the lambda factor is intended to have greater effect at longer duration.
- A reintroduction of a ceiling/floor undermines the political agreement made by the co-legislators on the basis of the previous EC communication (which supported removal of the floor). It would reduce the beneficial changes made to the risk margin to the benefit of long-term products.

## 3. Volatility adjustment

The EGBPI non-paper presents the following calibration for the risk correction parameters.

- $Risk\ correction\ Gov. = \min [30\% * \min(S^+, LTAS^+) + 20\% * \max\{0, \min(S^+ - LTAS^+, LTAS^+)\} + 15\% * \max\{0, S^+ - 2 * LTAS^+\}, 105\% * LTAS^+]$
- $Risk\ correction\ Cor. = \min [50\% * \min(S^+, LTAS^+) + 40\% * \max\{0, \min(S^+ - LTAS^+, LTAS^+)\} + 35\% * \max\{0, S^+ - 2 * LTAS^+\}, 195\% * LTAS^+]$

**Questions:**

- What is experts’ view on the possible approach to risk correction in light of the provisional agreement on the amending Directive?

**Messages:**

- **The Commission’s proposed approach to the risk correction is completely unacceptable as it would re-introduce volatility and procyclicality and undermine the other agreed improvements to the VA.**
- The EC proposals are technically unsubstantiated. No evidence has been put forward that this calibration meets the requirements, set out in the Directive.
- The caps were included in the risk correction formula agreed in the Level 1 text in order to avoid the new risk correction formula from introducing too much volatility and procyclicality, but the draft calibrations proposed by the Commission (195% of LTAS for corporate bonds and 105% of LTAS for government bonds) would have no impact, even in the most extreme market environments.
- It would therefore undermine the co-legislators’ agreement that the risk correction should be appropriately calibrated to ensure proper functioning of the volatility adjustment (VA), particularly during periods of market instability, when the VA is most needed.
- It is inconsistent with the existing and well-functioning requirements for capturing downgrade and default risk under the matching adjustment (MA). The proposal could mean insurers holding the same portfolio of assets would have very different requirements for the same risks depending on whether they apply the VA or MA.
- The calibration of the risk correction parameters must provide a realistic assessment of the default and downgrade risk associated with the reference portfolio and avoid creating volatility and procyclicality. It must be technically substantiated and deliver a framework which supports insurers as providers of long-term products and investors.

#### **4. Interest rate risk**

The non-paper implies that the introduction of a time-dependent floor to interest rates is optional and notes that EC notes has no data at this stage, to introduce such a floor.

It also outlines the requirements on potential phasing-in over a period up to 5 years and if introduced the phasing in is mandatory.

**Questions:**

- What is experts’ views on the opportunity to introduce a term-dependent floor in the standard formula interest rate risk sub-module?
- If experts agree with the introduction of a term-dependent floor, do they have data supporting the determination of such potential term-dependent floor, or do they recommend that FISMA seeks data and/or possible technical inputs from EIOPA to support discussions during one of the forthcoming EGBPI meetings?
- What is experts’ view on the need to introduce a phasing-in mechanism in the Delegated Regulation, bearing in mind that where introduced, such phasing-in becomes mandatory for all undertakings?

**Messages:**

- **According to the final compromise text on SII, there is a requirement to introduce a term dependent floor, it is not just ‘for the EC’s consideration’.**
- It is important to calibrate a realistic term-dependent floor to the down interest rate risk SCR scenario.
- The recent (i.e. in 2020) low point in the RFR curves provides a good data point for discussions on what a term-dependent floor to the IR submodule may look like.
- Industry does not support the introduction of a mandatory phasing-in of the updated interest rate risk scenarios.

## 5. Long-term equity investments

The non-paper notes that the criterion in Art 105a (1) second subparagraph - demonstration of the ability to avoid force selling - needs further specification. The Commission considers the previously discussed 'liquidity' test approach as a reasonable way forward, subject to further finetuning.

The EC will reflect on the type of collective investment undertakings which should be considered as presenting a lower risk and mentions a simplified approach for LTE recognition at group level, not requiring a group level assessment.

### Questions:

- Do experts identify the need to further specify other points of Article 105a paragraph 1, second subparagraph of the provisionally agreed Solvency II amending Directive?
- Do experts agree to investigate further the liquidity test approach?

### Messages:

- Regarding the criteria for further specification in L2, it is key to avoid introducing overly complicated or excessive conditions in the Delegated Acts which would restrict supervisors' ability to recognise equities as long-term, as such the criteria should enable those currently using LTE to be able to continue to do so.
- It is important to clarify that the criteria for equity collective investment undertakings are assessed at the level of the fund and not at the individual security level, and the criteria should not be too restrictive or overly complicated. This is consistent with the portfolio-level approach foreseen in the LTE criteria, i.e. (b), (d), and (f).

## 6. Matching adjustment

DG FISMA will consider amending rules governing the SCR calculation in order to allow undertakings using the MA to calculate their SCR on the basis of full diversification.

### Questions:

- Do experts have comments in relation to the possibility to allow undertakings using the matching adjustments to calculate their SCR on the basis of full diversification?

### Messages:

- **The industry welcomes the changes proposed in L1 allowing undertakings using the matching adjustment to calculate their SCR on the basis of full diversification.**

## 7. Direct exposures to central clearing counterparties (CCPs)

As part of the EMIR chapeau communication, the EC noted it "intends to address the disadvantageous prudential treatment insurers face if they become a direct clearing member". DG FISMA has sent a call for advice to EIOPA in order to implement the statement included in the EMIR.

### Questions:

- Do experts have comments or suggestions in relation to the prudential treatment of direct exposures to CCPs?

**Messages:**

- *No specific messages at this stage.*

## **8. Empowerments on proportionality**

The non-paper refers to DA specifying, next to eligibility criteria for SNCUs:

- methodology for classifying u/takings/groups as SNCU
- conditions for granting or withdrawing NSA approval for non-SNCUs

The EC notes that when conditions are set too light, NSAs could lack legal basis to oppose use of certain proportionality measures, to the detriment of policyholder protection. On the other hand, when conditions are set too strict, it may excessively limit non-SNCUs.

**Questions**

- Do experts have comments or suggestions in relation to the above-mentioned proportionality items?

**Messages:**

- It is very important to ensure that non-SNCUs will in practice also have access to proportionality without excessive burdens, therefore approval procedures for non-SNCUs to access proportionality measures should be simplified, with clear criteria and target market share.
- Enable effective application of proportionality measures for SNCUs within groups.