

To: Solvency II Working Group
From: Prudential Team

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Subject: For information - summary EIOPA workshop on the 2020 Review of Solvency II

Summary

On 5 and 6 June, the secretariat attended a workshop organised by EIOPA on a number of topics covered by the 2020 review of Solvency II.

The event provided an opportunity for Insurance Europe, along with other industry representatives - including AMICE, the CFO Forum, the Actuarial association of Europe to provide input, feedback and discussion with EIOPA and some of the NSA staff involved in EIOPA's working groups.

On the **first day** stakeholders shared views on the long-term guarantee (LTG) measures, volatility adjustment (VA) and matching adjustment (MA), as well as the extrapolation of risk-free rates, equity risk, transitionals and other aspects of the LTG measures.

On the **second day** potential macro-economic measures, recovery and resolution requirements and insurance guarantee schemes were discussed.

As EIOPA went through the slides for each topic, the summary focuses on the discussions held during the workshop. The slides can be found [here](#), for the agenda see [here](#).

Background

Day 1

1. Introduction

- Comments made by the industry
 - Risk margin is not on the agenda.
 - The industry asked how the impact assessment will be approached
 - Reducing reliance on external ratings will be publicly consulted, and is not discussed in a workshop
- Comments made by EIOPA
 - EIOPA plans to organise 3rd workshop in the first half of December on the technical advice (topics still to be defined)
 - EIOPA noted that CoC was already included in SCR 2018 review. Risk Margin may be included in the 3rd workshop. Insurance Europe pointed out that RM should be wider reviewed (as suggested in 2018 review). EIOPA highlighted that it has no intention to do further work on the risk margin.
 - Impact assessment will be holistically approached (requested by EC). There will be the need to ask information to the industry. Request will likely take place in the first half of 2020. The global/overall impact of all the proposals will be tested
 - Proportionality will be included in the consultation of July, but only limited to reporting

2. Design of the VA (BaFin)

- Similar debates are taking place internally on improving the VA it is important to:
 - to solve the artificial volatility issue
 - Industry asked that changes improvements need to be done within the current VA/MA framework.
 - Tendency to double count, in particular when talking about illiquidity testing/ratios, one source of concern could be lapses, but SII already has a lapse shock.
 - Fundamental spread: EIOPA notes it does not include unexpected credit risk, however SII has a credit risk charge
- EIOPA noted that the Fundamental spread captures unexpected credit risk. EIOPA notes it is looking at a component of the technical provision with a time horizon longer than 1 year. There is the intention to capture both expected and unexpected credit risk.
- EIOPA said on double counting: The SCR does not is not aiming to address the liquidity issue. EIOPA looks at it from a different perspective, while the SCR reflects the instantaneous loss, without considering the gap in future years, the application ratio approach for example would create a measure of the illiquidity of the liabilities. This approach would to look at all the cash flow streams and look where distortions are.
- To get a good understanding of all the proposals it would be useful to have some examples.
 - EIOPA noted it will consider the option to have examples
- What is EIOPA's view? Are these proposals a collection? Does this include EIOPA's own view/position?
 - EIOPA is putting options together and assess feasibility and appropriateness.
- Stating in the deficiencies that the VA is always positive seems introducing a countercyclical buffer
 - EIOPA commented that it is a list of potential deficiencies and they are caught from a macro prudential perspective
- Underlying assumptions of the VA are unclear – are you also implying the 65% application ratio?
 - EIOPA said that the current VA tries to embrace all different objectives in one approach and it makes it difficult to address all objectives and EIOPA needs a clear rationale for all components
- The industry highlighted that best estimate should not be confused with stress testing valuation
 - EIOPA noted it does not see it as a penalisation but as a way to take into account the liability specificities. Because it may make sense to consider to which extent you are exposed to the exaggeration of bond spreads, based on liability characteristics. As if you have very liquid liabilities you may be more exposed to the bond spreads movements on the short term.
- Does EIOPA have a better idea where under and overshooting takes place, as you already put forward proposals to solve it?
 - EIOPA notes it is making the analysis, based on the data received, and a first item was already analysed in the LTG last year
- On the undertaking specific approach – when just changing the weights, did EIOPA check whether it solves the over/undershooting and the country specific issue? Or would EIOPA also need to introduce more granular in the indices to solve this issue?
 - EIOPA has clear picture on exact effects. Point is clearly noted. Regarding option 1, one needs to carefully consider how to do the split and which indices to use.
- It is important to verify if option 1 could be applied consistently with IFRS 17, which allows for top down approach and allows insurers to have a risk-free curve related with their own portfolio
 - EIOPA is aware of the link with IFRS 17, but did not yet investigate.
- The definition of illiquidity is not completely clear; how can we approach it?
 - EIOPA proposed a definition in the request for feedback document: liabilities that are predictable in time and amount also under stressed conditions.
- Is the crisis VA going to substitute the country VA or is it an approach to deal with extreme situations - ie meaning of crisis VA is not clear, unless it is just the transformation of the country VA?
 - EIOPA said it looks at the country risk corrected spreads, and looking at the current framework, where the basis VA is European VA, an reacts only slowly, there is the situation that the country

spread can deviate significantly. There the idea is that a certain threshold is needed, to define a point where the country spreads deviates so significantly from the basis spread that you should consider as a national crisis situation where you need to have an effect. If you would have undertaking specific VA, one could say a crisis VA is not needed, because you are already looking at the undertaking specific situation.

- On the bucketing approach, the industry is concerned about remaining bucket. What would be the deficiency and potential solution for the remaining bucket? Would this come in addition to VA, and does this imply there are 4 buckets.
 - One could just use for remaining the current VA, and indeed EIOPA still needs to think about addressing the deficiencies of the current VA. Or you could under this approach also combine the current VA with one of the options.
- Are the two application ratios (one based on illiquidity features and the other one to solve over/under shooting) combinable?
 - EIOPA noted that nothing prevents them to combine them, and it could make sense.

3. DVA (BaFin)

- The industry noted that the reason why internal model companies are using this is because it better reflects their risk profile. DVA is needed to capture the correct risks. And if not allowed, the impact may be detrimental. There should be an extension to the standard formula companies, as the same reasoning applies.
 - EIOPA notes it is aware of the industry appetite to introduce DVA for standard formula users
- The industry voiced its surprise about the fact that the DVA is questioned, as it is a natural component from SII Framework (DVA is also in EIOPA stress test, it is recognised). And specifically on the question what are your risk management incentives, the industry does not see any incentives to increase the mismatch between assets and liabilities, by doing so companies will hit their risk appetite limit, and it will also affect the SCR. So the industry does not observe the wrong incentives to move its ALM to unrealistic strategies.
 - EIOPA noted that some of the VA deficiencies will be spilled over to DVA, and level playing field is important. They will strongly cooperate with the VA working group, in particular from the internal model point of view.
- The DVA slides are stating that when using the DVA, the internal outcome should at least be at the same level of the EIOPA methodology. This could be a risk, because why would an internal model replicate an EIOPA methodology that is also flawed (VA has deficiencies as earlier discussed).

4. Spread risk (ACPR)

- EIOPA commented it does not expect changes in the spread risk stresses, other than addressing the long-term nature as presented on slide 7
- Options to be chosen is the DVA, the other options EIOPA put forward do not work.
 - EIOPA replied that the DVA option is not reported here, in the VA discussions EIOPA considers also the impact of the options on the spread risk, and this could be imported into the discussions.
- The industry noted that in the degree of illiquidity of liabilities, EIOPA does not consider own funds, they are liabilities and they are long term and predictable.
 - EIOPA noted that if own funds would be included, some kind of procyclicality would be observed.
- The industry highlighted that the issue is not about the holding period of assets, it is about whether one is a forced seller. Capital is one aspect, but there are also other aspects on the degree of forced sales where you one is exposed to that should be taken into account. For example, the ability to change your portfolio or not.
 - EIOPA noted that measuring the illiquidity of liabilities is measured separate from everything else. When considering the forced selling approach EIOPA always encounter the procyclicality problem. EIOPA notes that its approach is conceptually not that different, and if the industry has a way to avoid the procyclicality when using the forced sales concept please put it forward

5. Extrapolation of the RFR (BaFin)

- EIOPA noted that the focus will be on Euro, because this dominated the discussions until now.
- The industry noted that the current method includes looking at the liquidity of the bond market, and asked what the rationale is for abandoning this? In addition, EIOPA mentioned that liabilities can be underestimated, but they can also be overestimated, and this can be detrimental for investments and consumers
 - The representative of the working group said that a lot of points have been discussed already in the working group. The representative ensured that they are aware of these points and noted that it is not easy to come up with a good solution. And on bond criteria there is a doubt on the criteria.
- The industry noted that there are safeguards already, eg sensitivities that were reported to supervisors for information, or there are stress tests. No new safeguards are needed, but the existing ones could be formalised. In addition, these results are relevant for supervisors but not for public disclosure.
 - EIOPA acknowledged there are safeguards
- The industry said that not everything should be sold via valuation, Solvency II has 3 pillars and it has a lot of options to solve issues, let's use these wide possibilities
- The industry also noted that with 20 years the market consistent limits are reached, also the safeguards that are available in the products should be used.

6. MA (Spanish Supervisor/PRA)

- The industry agreed that allowing for diversification is the way forward, this corresponds to economic reality. Both proposals presented by the PRA warrant addressing
- In Spain there is no legal ring fencing, and MA is applied for 20 years, without any problems, there is no rationale not to allow for full diversification (eg mortality risk and longevity risk, cannot benefit from diversification today) and there is no rationale not to allow for full diversification between all the assets of the company.
- Both proposals do not create the possibility for more portfolios to be eligible for the use of the MA.
- The industry asked whether EIOPA also considered to do anything on the criteria? And the CfA asked to look for improvements, and not doing anything would actually not be an improvement

7. Equity risk

- The industry provided the following practical feedback on the criteria applicable to be eligible for the 22% long-term equity charges:
 - **The portfolio is assessed to cover the best estimate** and most undertakings have mutualised assets, and these assets back both liabilities and own funds. So both liabilities and own funds are important to support the long-term investments.
 - **Segregation** – do not know how to deal with it, assets are mutualised, segregation is made at group level, having several entities (life/non-life). And inside a solo undertaking we do not know how to address this segregation as it currently does not exist in the balance sheet. It needs to be seen how this can be put into practice.
 - **Average holding period** – it has no impact on individual holding of the assets. Undertakings have an active asset management, so arbitration can be made between equity assets or even for driving financial results and for participating contracts. It is possible that a specific asset is sold and re-bought immediately, only to have the surplus value realised, and to be able to distribute it to the policyholders. So it is questioned how this requirement is compatible with the active management.
 - Initial condition was 12 years, now 5 years, we need a quantitative impact, to be sure it fits with the business model.
 - SII is already having to mix 1 year with multiyear, and is finding its way around it. (For example Longevity risk and cost is also a multiyear risk). The problem is that these criteria create clashes with good risk management.
 - Issue is not the holding period, but the issue whether one is exposed to short term price volatility, and whether one is exposed to forced selling.

- The requirements could be simplified so they do not clash with good risk management. And that recognises that when one is not exposed to forced selling then the risk is a long-term underperformance, and for that the 22% calibration is a logical one.
- The industry is surprised by the results/data EIOPA presented on slide 7– the results show that the market in Europe dropped 62% after 10 years. Surprised it is so large, as during the crisis the worst fall was around 40%. The industry highlighted there is literature on financial data (for US market) and the results are completely different, and this should be reconciled.

8. Transitionals

- The industry asked what the review means, companies are using transitionals because they trusted that it was a part of Solvency II. Revoking transitionals could endanger financial stability.
 - EIOPA highlighted that it was asked to assess the ongoing appropriateness, and not to check which transitionals should be deleted. This also means EIOPA should assess whether it is useful to prolong any transitionals, in particular the transitional on government bonds.
- The industry voiced its concern regarding EIOPA's idea that high SCR ratios should be capped. Because this will undermine smooth transition and lead to market disruption
- Some of the transitionals were developed for the short term, others for the long term. The longer term transitionals are linked with long term portfolios. And the rationale for having the transitionals is still there.
- The industry highlighted that the fact that a company has a high SCR Ratio does not mean that a company does not need a transitional anymore. As sometimes companies can be very sensitive to changes.
- According to the industry, there is no unlevel playing field, all undertakings were allowed to apply the transitionals.
 - EIOPA noted it makes a comparison between SII and SI and this determines how much benefit one gets from the transitional. And as SI was not a harmonised system, depending on national market and Solvency I implementation, a company could benefit more or less from the transitional. So there is competition that should be harmonised
- In the industry's view the article in directive on 'Phasing in of transitionals' applies to all companies, and not only companies with an SCR under 100%.
 - EIOPA has a different interpretation, and will look into this.

9. Other Aspects of LTG measures

- It should be assessed what should be reported to supervisor and what should be publicly disclosed. The focus after the 2020 review should be on valuation based on the discount rate. And the appropriate improvements to the methodology to determine the discount rate should be defined but need for separating them has passed. By separating them you send the wrong message to the public.
- To the question why no impact of VA on liquidity plans exists, the industry replied that the liquidity plan is based on undiscounted cash flows, so it is not possible for the VA to have an impact?
- SFCRs are hardly read and then other information are required in addition? We would like to review what the SFCR is, as expectations are not met.
 - EIOPA said that before the publication of the LTG, EIOPA had a meeting with analysts, journalists and other parties, and actually these stakeholders asked for more information

Day 2

1. Macroprudential

- Which problem are you addressing?
 - EIOPA noted that there is some possibility of systemic risk, everyone agrees on this, so if it exists we can't just wait for it to materialise and do nothing.

- So far not even limited evidence of systemic risk was seen, the proof is lacking. Without a good understanding of what systemic risk is, it is hard to impose a new measure. So this is why there is scepticism.
 - There is a potential for impact on financial stability. Let's not deny the discussion, it will take place anyway, better that it takes place here.
- The industry noted that it is good that you recognise differences with banking, but it does think it would be good to have practical examples of how systemic risk could materialise. Now there isn't any, but this could change in the future. The starting point is different now and the process should therefore be about monitoring future systemic potential. Also, introducing thresholds, they will turn into limits that tempt supervisors and change nature of monitoring. ORSA with macroprudential elements seems fine, we have always supported temporary freezes, let's look at how it's used in other countries and see if this can be expanded.
 - In the recent crisis, there was public money used for insurers. Activity-based approach is the good one. Potential impact on financial stability is important, so we need to recognise it fully and act accordingly.
 - EIOPA has a conceptual approach, which is very theoretical. But even if the industry does not like that approach, facts are: public intervention existed, activities have proven systemic in the past. We can debate as much as we want, but facts are clear.
 - On the thresholds, it is a valid concern, but in reality why would you think supervisors are not doing this already; does it mean these are hard thresholds? No.
- The industry expressed concern that some tools are not aligned with SII, eg investment limits.
- The industry struggles with capital surcharge, because that is talking about leveraging on companies, whereas activities are much more relevant sector-wide. What are the sources and what are the transmission channels? If you don't know that, how do you apply tools? If you applied a capital surcharge to AIG, would they have fared better?
- There are already surcharges in SII, but there are concerns with those - ban on activities could be more effective than surcharges.
- Insurance is also a risk mitigator at macro level, clear difference with banks there. Good to align with IAIS, but we see deviation when it comes to behaviour-based sources.
 - EIOPA is aware that capital surcharge is the most sensitive topic, the challenge is timing, not conceptual; solution is to go for counter-cyclical buffers, but we find this unfit for insurance, hence the surcharge. Activities vs entities: prohibition of activities sounds good but can't be easily done.
 - Difference with banking: if 40% of direct lending is through insurance, insurers will be treated like banks.
 - EIOPA doesn't share the view that we need nothing more than SII. EIOPA's macroprudential framework is a principles-based approach and we don't want to change this.
 - IAIS doesn't cover behaviour explicitly, but it does cover it. IAIS also considers capital add-ons and we believe that a surcharge for exceptional circumstances is justified.
- To understand surcharges, could you give us a situation where a surcharge would be justified? If it remains theoretical, we don't know what you mean by that.
 - EIOPA cannot say now as it would look like consensus view, but in the paper EIOPA makes clear that there are three triggers: low interest rate environment, disincentivising certain activities, if supervisor think failure would be impactful, like a D-SII.

2. Recovery & Resolution

- The industry enquired about proportionality for SMEs
 - EIOPA has done further work on that, giving more guidance on proportionality when they talk of preventive planning.
- The industry reminded that there is the SCR, nothing should be done to introduce a threshold above it. Early intervention, when? That is more normal supervisory relationship; are companies refusing dialogue now? Point of non-viability is somewhere below MCR, not sure you can pre-define it, as you would have full intervention powers anyway. Pre-emptive plans, important to ensure proportionality.

- EIOPA noted triggers in SII are appropriate for early intervention. Is there a need to harmonise this? NSAs do engage now, but EIOPA has seen that there are different practices and intervention triggers from NSAs. Some soft triggers, some use hard triggers above SCR. EIOPA believes it should try to harmonise this.
- If some supervisors use hard triggers, then harmonisation would remove hard triggers above SCR, but provide some criteria for early intervention, right?
 - EIOPA did not provide a clear response here.
- The industry is very concerned that the SCR becomes new MCR, when you say that action is needed to avoid dropping under SCR. Everything should be done to avoid changing the ladder of supervision.
 - Nothing will be added that doesn't already happen today, we just need to formulate some guidelines for pre-emptive measures.
- Perception is everything, calibration was done with SCR, MCR etc. Exercise care to not implicitly suggest buffers above SCR.
 - EIOPA highlighted that in crisis management groups, the biggest trouble is discussing how to resolve cross-border groups because of different resolution regimes or no resolution regimes nationally, this is why some harmonisation is needed.
- It is good not to have hard triggers for R&R, good internal risk management processes are important and already exist.
- The Austrian supervisor requires 150% to allow dividend payments. And it was suggested not to reinforce this type of behaviour in what EIOPA would decide to do.
- The frameworks in the Netherlands and France are dissimilar, it would not be good if all frameworks end up looking differently, as this would lead to fragmentation.
- European situation far from harmonised, the industry noted it sees a relationship with systemic risk.
 - EIOPA said there is indeed added value from recovery planning, and it sees added value from R&R in macroprudential.
- The industry said that planning should not pre-empt solutions that can be found during crisis times. It suggested to leave plans generic, as the industry's impression is that supervisors are good at resolving national crisis situations when they have to.
 - EIOPA said it will do something in the middle, and there will be some flexibility built in.

3. Insurance Guarantee Schemes

- EIOPA said that the home-country principle is preferable, to be in line with supervision home-country control. Ex-ante funding is preferred because an IGS should be credible. A consultation in July is foreseen because it is a difficult topic, in some areas EIOPA will pose open questions and EIOPA really wants and needs concrete proposals.
- The industry noted that harmonisation has worked in the US with 53 states and regimes. We use host rather than home. Funding is ex-post. It is a missed opportunity if IGS not allowed to develop resolution plans or to participate in CMGs, because they have essential know-how.
- Need for an IGS depends on legal situation of policyholder, in the Netherlands, the policyholder has strong position, above tax authorities. Strong position lessens the need for IGS protection.
- Any funding should be risk-based SII; the term cash box is sensitive. Cash boxes create wishes and desires. There should be a total ban on marketing. Premium not a good standard for calculating contributions, look at what is actually guaranteed.
- Adequately-funded doesn't mean cash in the bank, just have a good mechanism for funding.