SOLVENCY II

FEEDBACK STATEMENT ON CONSULTATION PAPERS 19/004, 19/005 AND 19/006

(Opinion on the 2020 review of Solvency II)

EIOPA-BoS-20/752
17 December 2020

European Insurance and Occupational Pensions Authority

Table of contents

1. Introduction 3
2. LTG measures and measures on equity risk 4
3. Technical provisions 34
4. Own funds 40
5. Solvency Capital Requirement standard formula 41
6. Minimum Capital Requirement 55
7. Reporting and disclosure 58
8. Proportionality 72
9. Group supervision 78
10. Freedom to provide services and freedom of establishment 107
11. Macroprudential policy 111
12. Recovery and resolution 116
13. IGS 120
14. Other topics of the review 124

1. Introduction

EIOPA would like to thank all the participants of the public consultation for their comments on the Consultation Paper on the Opinion on the 2020 review of Solvency II.

The input received provided important guidance for EIOPA to finalise the Opinion. All of the comments submitted were given careful consideration by EIOPA.

The individual comments received and EIOPA’s response to them are published as a separate document.

2. LTG measures and measures on equity risk

2.1 Extrapolation of risk-free interest rates

2.1.1 Determination of the LLP

Summary of comments

2.1 The vast amount of comments received from stakeholders on this topic underlines its importance for the review. Stakeholders underlined the core role of the RFR in product design, ALM etc. and outlined that changes to the underlying assumptions of the RFR determination can create very significant problems. An increase in the LLP would introduce additional volatility and be in conflict with a robust supervisory system. Business model sustainability was also seen as a major concern in case the LLP is increased.

2.2 On the **issue of underestimation of technical provisions**, stakeholders commented that the current discount rates (being determined based on the current risk-free interest rate term structure) were not too optimistic, outlining the impact of the ECBs intervention on interest rate levels and the limited robustness of long-term swap rates. They explained that capitalisation would increase as the UFR decreases and any underestimation was not evidenced.

2.3 On the issue of **risk management incentives**, stakeholders argued that hedging would not be possible/sensible in some markets so that an increase in the LLP would not set right incentives for hedging. They underlined that risk management was based on a number of perspectives such as ALM, risk appetite, rating, expectation on evolution of interest rates and would not only depend on Solvency II, so that the relevance of the risk free interest rate curve would be limited in that respect.

2.4 Stakeholders underlined the relevance of the term-structure for **financial stability**. Concerns were addressed that an extension of the LLP could have a procyclical effect where the increase of the LLP leads to additional volatility. They argued that derivatives cannot be freely used to extend the duration of the asset portfolio as this would for example have undesirable accounting consequences, would create other risks (such as liquidity risks on collateral) and would be challenging in particular for smaller undertakings. An increased use of derivatives would also increase the interrelation with banks and hedge funds or parties outside EU regulation and thus lead to systemic risk. Comments were also raised in respect of the current volume of the swap market which was seen as insufficient to cover all existing long-term liabilities. An increased demand could therefore lead to a further reduction in interest rates (example of Dutch market where LLP was changed, August 2019).

2.5 The ESRB underlined the need to adjust the interest rate term structure to better meet macroprudential considerations referring to the analysis performed in 2017. The ESRB proposed considering one or more of the following points: to shift the

LLP for the euro to 30 years, to extend the convergence period from 40 years to 100 years or to blend the extrapolated part of the curve partly with market data

2.6 Stakeholders raised criticism on EIOPA's DLT analysis, in particular in respect of the **market liquidity**, indicating that it has not changed in ways which would justify an LLP higher than 20 years and raising concerns on market liquidity of swaps for 30 and 50 years respectively. It was addressed that the analysis did not cover the depth of the market and an assessment on the structure of the market, that the time period of the analysis was too short and did not cover stressed situations. The relevance of the bond market for the determination of the LLP was highlighted by most of the stakeholders being the most typical asset class, addressing also the necessity to assess matching and residual volume criterion and putting further focus on the bond market liquidity. Stakeholders also raised concerns that interest rate markets are currently heavily influenced and **distorted by the ECB** so that interest rates do no longer represent fair market conditions.

2.7 Stakeholders were generally very concerned on the proposal put forth to give **powers to NSAs to limit capital distributions** based on a calculation without LTG and transitional measures and a variation of the extrapolation arguing that this would go beyond the agreed Solvency II confidence level and create a shadow SCR calculation and could raise the cost of funding. They also explained that distributions of profits include more than just the point in time SII situation, but sensitivities, multi year planning, additional profits, capital adequacy, ORSA and further so did not share concerns on undue dividend payments.

2.8 Specific comments were raised on the **alternative extrapolation methodology,** outlining the difficulty to set the alpha parameter, increasing complexity and intransparency of the method as well as burden for implementation.

2.9 In respect of the determination of the interest-rate curve**, a number of issues** were raised during the consultation which are not directly in scope of this topic. E.g. stakeholders expressed their view on the determination of the UFR, the relevance of a floor to the interest rate curve, the determination of the CRA and the consistency between risk measurement and valuation.

Assessment

2.10 EIOPA notes the relevance of the RFR for various areas including product design, ALM and last but not least the solvency position. This underlines the necessity to put particular focus on this area and assess whether the determination of the RFR has proven fit for purpose in the "early years" of Solvency II. While in the majority of countries no immediate negative implications have materialized yet, the current design of the extrapolation leads to a number of supervisory concerns, such as the potential underestimation of technical provisions, wrong incentives for risk management and negative implications on financial stability. Also, in one member state, negative implications could already be observed.

2.11 On the issue of underestimation of technical provisions, EIOPA still considers this to be one major risk. The low interest rate environment has been persisting for

several years and interest rates have even continued to decrease, reaching record lows in 2020. The monetary policy responses in the last couple of years – that were also put forth in the stakeholder comments - and those in response to the ongoing COVID-19 crisis entail an even longer low interest rate environment. Whereas the determination of the UFR already acknowledges for trends, this is not sufficient as the UFR only decreases slowly and will stay above current market rates. Therefore, information on long-term interest rates from current financial markets should not be completely disregarded.

2.12 On the issue of risk management incentives, EIOPA acknowledges that the RFR and the solvency position is not the only key figure when deciding on hedging strategies but more than one perspective is taken into account. However, where an insurer decides to match cash flows beyond the LLP, this increases the volatility of their Solvency II own funds which in turn leads to a conflict in objectives. Such conflicts could already be observed in practice in one member state and turned out to become relevant for the asset management.

2.13 On financial stability, EIOPA has carefully assessed the arguments and acknowledges that evidence in that area is limited. The reasoning on potential procyclical behaviour in case the RFR is changed are understood. On the other hand, taking into account further market information and thus providing for a potential risk also have positive implications on financial stability. EIOPA notes that any decision to change the RFR, in particular the LLP, needs to be taken with care.

2.14 EIOPA agrees that market liquidity conditions have not substantially changed in the last couple of years. For example, market data shows that the swap markets are liquid beyond the 20 years point – this observation also held for 2016. Also, bond market liquidity has not materially changed since then. EIOPAs focus on extrapolation is though not motivated by changing liquidity conditions but because of the issues identified which have become even more relevant in the current (and potentially future) lower interest rate environment.

2.15 The risk management provisions are intended to accompany the Pillar I requirements, certainly by reflecting the purpose and design of the individual measures. EIOPA considers that the power to limit capital distributions should be only applied in exceptional cases as a last resort measure when the supervisory authority has serious concerns that have not been properly addressed by the undertaking and there is a significant risk for policyholder protection. Due to the strong concerns raised by stakeholders, the advice has been amended and integrated into the existing requirements of Solvency II with the intent to provide further clarity on the provision and address the concerns on a "shadow SCR calculation". Objective is to make sure that RFR but also the VA and MA are actually earned, in comparison to the market risk free rates.

2.16 EIOPA acknowledges that a trade off has to be made between stability of the curve and full recognition of market information acknowledging the implications of a change of the RFR for various areas and the limitations and potential consequences raised (e.g. on actually performing hedging via derivatives and negative implications on product design and financial stability). For that reason, EIOPA suggests to implement the alternative extrapolation method, which strikes a good balance to address the issues identified with the current extrapolation.

2.17 The alternative extrapolation allows to take into account further market information but only to a certain extent reflecting market liquidity. Also, the bond market, bonds being the major asset category for backing liabilities, is explicitly taken into account. This confirms the relevance of the bond criterion. Also, the extrapolation method has turned out to be practicable and has been tested by EIOPA in the HIA and CIR. Transparency of the method will be ensured via EIOPAs publications of the RFR methodology. Further analysis during the COVID-19 crisis in 2020 did also not reveal any technical deficiencies or issues. EIOPA notes that the alpha parameter indeed is a decicive parameter which should be set with care and be stable over time to avoid overly volatility.

2.2 Matching adjustment

2.2.1 Diversification benefits

Summary of comments

2.18 Stakeholders support the removal of limits for diversification benefits among the MA portfolios and the remaining business of the undertaking, as it has been proposed by EIOPA.

Assessment

2.19 EIOPA advises to remove the limitations to the mentioned diversification benefits.

2.2.2 Asset eligibility criteria

Look through

Summary of comments

2.20 Some stakeholders consider that EIOPA's proposed look-through approach to assessing the suitability of restructured assets to be included in Matching Adjustment portfolios is unduly restrictive. They consider that EIOPA shold focus on the suitability and robustness of the cash flows associated with the securitisation structure, rather than on the securitisation structure and the nature of the underlying assets.

Assessment

2.21 EIOPA considers that it is imperative for undertakings to consider the nature of the underlying assets as it is unlikely that sufficient reliance could be placed on the cash flows where the restructure is attempting to transform substantially the nature of the underlying assets. The underlying rationale for applying the Matching Adjustment is the buy-to-hold principle as explained in Recital 31 of the Omnibus II Directive. Therefore, Section 2 Paragraph 182 (of the Consultation Paper) notes: "It would not be satisfactory... if the underlying assets were unsuitable for a buy-and-hold strategy and required frequent buying and selling or removing from the structure."

Yield to worst approach

Summary of comments

2.22 This approach is rejected by EIOPA. The stakeholders' comments can be summarized in 2 categories:

a) Some stakeholders consider that a external credit rating assessment for the assets is sufficient to consider fulfilled the MA requirements
b) Others stakeholders express their opinion about certain assets, considering them as apt for the MA (among others, the cash).

Assessment

2.12 EIOPA rejects the idea of sufficiency of credit ratings to be apt for the MA: all requirements required by art. 77b.1 of Solvency II Directive has to be fulfilled and ECAIs only assess the credit risk.

Regarding the suitability of certain complex assets, it is not the objective of the Consultation Paper to set up a catalogue of apt assets. This is something to do by the supervisors on a case by case basis; to this end, the Q&A process existing in EIOPA can be an adequate instrument for the harmonization. About cash, EIOPA can respond that this asset is apt for the MA.

2.3 Volatility adjustment

2.3.1 Technical improvements of VA calculation

Summary of comments

2.23 In this section, EIOPA sets out the following two proposals:

i. Where a "freezing" of assumptions on the representative portfolios used in the calculation of the VA is necessary, to change to a so-called "Cash-flow freeze" (CF-freeze) instead of the current so-called "Market value freeze" (MV-freeze)

ii. To allow for negative spreads in the aggregation of corporate and government bond spreads

2.24 With regard to the "freezing" issue, a number of stakeholders supported the EIOPA to switch to a "CF-Freeze" approach, as its assumption provides a more realistic reflection of the real economic situation of the insurance undertaking in times of economic crisis.

2.25 Some stakeholders expressed concerns on introducing a "CF-freeze" approach. These stakeholders acknowledged the technical points raised by EIOPA, but put the view that the difference between the CF-freeze approach and the MV-freeze approach presented in the consultation is only relevant in extreme cases and where low rated bonds (credit quality 5 and lower) are allocated a positive weight in the representative portfolio. They asserted that, for corporate bonds with better credit ratings, the impact should be minor.

2.26 Stakeholders that expressed concerns on the "CF-freeze" approach also pointed out that this approach does not take into acccount the impact of downgrades on

the VA at times of stress. They argued that, during times of stress, bonds that are downgraded would increase the weights of lower-rated buckets, offsetting any overshooting resulting from the current approach.

2.27 Some stakeholders also commented that a switch to the "CF-freeze" approach would lead to administrative costs and may make the calculation of the VA more complex.

2.28 There were hardly any comments on the proposal from EIOPA to allow for negative spreads in the aggregation of corporate and government bond spreads. One stakeholder pointed out that the impact of this proposal should be carefully assessed.

Assessment

2.29 With regard to the "freezing" issue, EIOPA considers that it is important that the framework for calculating the VA is reliable at all times, in particular in cases where there are strong changes in the level of spreads observed in the representative portfolio. In these cases, the proposed "CF freeze" method provides for a more robust and more realistic estimation of the aggregated spreads. Whilst differences between the "CF freeze" and the "MV freeze" approach are generally small, the stakeholder's comments do not refute the observation that the "MV freeze" mehod can lead to a mis-estimation of aggregated spreads in case of steep changes in the level of spreads that do not effect all bonds but are concentrated on specific "buckets" within the mix of fixed-income investments reflected in the representative portfolio. This is not necessarily confined to cases where bonds with credit quality five or lower are allocated a positive weight in the representative portfolio.

2.30 EIOPOA acknowledges that the "CF freeze" approach does not take into account a potential downgrades of bonds during the time period to which the "freezing" of assumptions on the representative portfolio applies. EIOPA underlines that, more widely, this applies also to changes of the mix of fixed income assets in insurer's investments during the "freezing" period. However, EIOPA considers that these effects are overall expected to be small since the VA is calculated on the basis of portfolios that are representative of the investments of insurers for a whole market or for all investments in a given currency. Moreover, EIOPA does not expect that these changes would lead to a systematic over- or underestimation of aggregated spreads under the "CF freeze" approach. For example, in cases where there is a sudden and steep widening of credit spreads, this could lead to "flight to quality" which would counteract a potential downgrade for specific asset classes.

2.31 Therefore, EIOPA upholds its proposal to use the "CF freeze" approach. EIOPA also upholds its proposal to allow for negative spreads in the aggregation of corporate and government bond spreads, noting that no comments were received that critizised such an approach. EIOPA points out that the impact of an allowance for negative spreads was implicitly tested in the Complementary Information Request (CIR), where the risk-corrected spreads for the calculation of the VA as set out in EIOPA's technical information for this information request were determined using such an approach.

2.3.2 Over- / undershooting

Summary of comments

2.32 Stakeholders acknowledge the possibility of overshooting caused mainly by the basis risk arising from mismatches between undertakings' own asset portfolios and the reference portfolio. However, overshooting is seen as an issue affecting a very limited number of undertakings across Europe. Most of them identify undershooting as the most serious problem affecting undertakings and this observation would be supported by the evidence provided by EIOPA in the consultation document. According to the comments, undershooting would be driven by: (a) low general application ratio (on this cf. section --); (b) duration/size mismatches of assets and liabilities; (c) basis risk with respect to the reference portfolio.

2.33 Stakeholders have mixed views on the introduction of an application ratio which mitigates overshooting issues. One aspect highly appreciated is the rescaling of the fixed income portion of the reference portfolio to 100% of the portfolio. Others highlight the complexity of the calculation and many of them oppose the cap to 1, which would fail to address undershooting issues, especially for non life insurers.

2.34 Indeed some stakeholders highlight that undershooting affects in particular non life insurers which would be affected by an artificial duration mismatch. Those stakeholders explain that the definition of contract boundaries in Solvency II fail to reflect the going concern horizon to which assets durations are linked. As the duration of assets is greater than the liabilities' duration, an undershooting effect of the VA would result. Some stakeholders suggest to include also the new business projections in the determination of the proposed application ratio on duration mismatch of the VA and/or removing the cap to 1 proposed in the consultation document.

2.35 Some stakeholders point that there should be a compensation also for the volatility of assets backing own funds, as own funds constitute a further buffer which could cover for the exaggeration of the spreads and undertakings earn a risk premium also on these assets.

2.36 Finally, other stakeholders mention the need to extend VA to equity and property assets and to exclude unit linked assets from the reference portfolio.

Assessment

2.37 EIOPA is of the view that overshooting is one of the main deficiencies of the current design of the VA that can potentially harm the objective of policyholder protection. It affects a significant portion of undertakings across Europe, as it is shown in the consultation document (see annex 2.21 in the analysis background document on the identification of overshooting effects of the VA during the pandemic, as well as annex 2.8 deficiency 1). The results provided in annex 2.21 on the identification of overshooting effects of the VA during the pandemic should be read taking into account that the VA should only adjust for exaggerations of bond spreads, not for the whole spreads: as such, not only a full but also a very high compensation of asset losses (as it is the case in several countries) can be considered as overcompensation. Moreover, it should be taken into account that

the test performed by EIOPA did not address credit quality mismatches which, in some cases, can contribute to overshooting.

2.38 EIOPA points out that the impact of the VA is highly dependant on the characteristics of the individual risk profile of the insurer, in particular with regard to its asset-liability management. Therefore EIOPA considers that it is crucial to address situations of overshooting by introducing asset-liability management aspects into the calculation of the VA. For this reason EIOPA advices to introduce an undertaking-specific application ratio capturing duration mismatches between assets and liabilities and allocation mismatches between holdings in fixed income assets and amount of insurance liabilities.

2.39 In order to ensure a high degree of policyholder protection, EIOPA considers that it is necessary to align the VA with the Solvency II framework and the economic balance sheet concept and, thus, does not support the proposal to include the new business projections when they go beyond the boundaries of the contracts underlying the insurer's insurance obligations in the calculation of the application ratio referred above.

2.40 EIOPA also disagrees with the proposal to remove the cap to 1 of this application ratio for non life insurers. Such a removal could result, in some cases, in a value of the VA which is higher than the corresponding risk corrected spread. This would lead to an overcompensation of the VA that would conflict with the objective of policyholder protection.

2.41 EIOPA notes that the proposed introduction of the application ratio on duration and allocation mismatches does not distinguish between assets backing technical provisions and assets backing own funds as all of them enter the calculation of the ratio. Thus the compensation for the volatility of the latter would not be an issue in the new framework.

2.42 EIOPA strongly disagrees with the proposal to extend the VA to equity and property assets. The measure is designed to tackle short-term spread volatility and a clear link between these asset classes and spread risk cannot be empirically found. With respect to spread sensitive assets, EIOPA proposes a rescaling of the fixed income portion of the reference portfolio to 100% of the portfolio, as long as duration and allocation mismatches are taken into account through the above mentioned application ratio. This proposed rescaling removes the issue on the inclusion of unit linked assets in the reference portfolio.

2.3.3 Inadequate reflection of illiquidity

Summary of comments

2.43 The feedback from stakeholders varies in this respect. There seems to be general agreement that for illiquid liabilities an additional illiquidity premium could be expected and recognised in the valuation of technical provisions under Solvency II. One stakeholder explains that the VA already reflects the liquidity characteristics as the reference portfolio as an aggregate market portfolio is based on undertakings perception of the illiquidity of their liabilities. Overall,

stakeholders support the conceptual idea of the illiquidity premium and its recognition as an objective of the VA.

2.44 While some stakeholders miss a reflection of the illiquidity of liabilities in the VA, the majority of stakeholders does not support an explicit recognition of the illiquidity of undertaking's liabilities in the determination of the VA for practicability and complexity reasons. Those stakeholders explained that the risk of forced sales is of predominant importance. In that respect, it is claimed that this risk should be – and would already sufficiently be - addressed in liquidity risk management and liquidity stress testing. They outline that these analysis would provide sufficient evidence that the VA can be earned. Also, stakeholders noted the interlink with the calibration of the GAR and outlined that the GAR was already considered to reflect an aggregate liquidity adjustment so where an explicit additional (undertaking-specific) application ratio was added to the VA, this would necessitate a recalibration of the GAR to avoid overly prudence.

2.45 On the choice of approaches to measure illiquidity (Approach A being the cashflow approach and Approach B being the bucketing approach), stakeholders supported the cashflow approach for technical reasons because it was seen as more informative.

2.46 There were split views on the introduction of a liquidity buffer: While a number of stakeholders broadly criticised it and considered that such a buffer would not be needed, others saw a benefit and a specific role on reporting a liquidity buffer for monitoring the use of the VA. Concerns were in particular raised in respect of any connection of the buffer with pillar I requirements: Stakeholders did not support its explicit recognition in the VA (e.g. as an application ratio) because the existing requirements in pillar II were considered sufficient as well as because of the reflection of liquidity issues in existing approval processes. Some stakeholders considered that such a buffer should have a prominent place in liquidity risk management, outlining that this would set right incentives there.

2.47 A number of additional comments were raised, e.g. that for the assessment of the risk of forced sales the own funds of the undertaking should be considered. Also, concerns were raised that the explicit reflection of the illiquidity of liabilities in the VA would lead to a double counting of risks and would introduce liquidity penalties.

Assessment

2.48 While the current VA may implicitly reflect the illiquidity of liabilities (as undertaking's investments do so), this only holds for the market as a whole. The illiquidity of the liabilities of an individual undertaking is currently not adequately reflected in the VA, since all undertakings may apply the VA independent of their illiquidity characteristics. EIOPA considers that the illiquidity of liabilities, which represents the degree of stability and predictability of its cash flows is undertaking specific and should be explicitly reflected in the VA as an application ratio.

2.49 EIOPA is of the view that the VA serves different targets including accounting for an additional illiquidity premium as well as mitigating spread exaggerations on the market. The advice forsees a final calibration of the application ratio for illiquidity that, in conjunction with the calibration of the GAR and compared to

the status quo, leads to a more favourable but prudent treatment of illiquid liabilities in the calculation of the VA. EIOPA considers that this does not lead to a double-counting issue: The VA allows to reflect an illiquidity premium in the valuation of liabilities depending on the illiquidity characteristics of the liabilities whereas the spread risk covers the variation in spread levels as part of the risk measurement.

2.50 EIOPA notes the advantages and disadvantages of both the cashflow and the bucketing approach and has tested the implementation of both during the review process. In view of the practicability of the approaches and the results received, EIOPA finally concluded that the bucketing approach should be followed.

2.51 EIOPA will take the recommendation of the introduction of an explicit application ratio capturing the illiquidity of liabilities into account in the final recommendation on the GAR.

2.52 EIOPA clarifies that the liquidity buffer was not intended to enter into the calculation of the volatility adjustment (e.g. as an explicit application ratio). EIOPA considers that the monitoring of the liquidity buffer should strengthen the requirement on liquidity risk management referred to in article 44(2) of the Solvency II Directive.

2.3.4 Misestimation of risk correction

Summary of comments

2.53 Most stakeholders strongly oppose EIOPA's assessment that the risk correction for the spread used in the calculation of the VA is misestimated. The following arguments are put forward in this regard:

1. The risk corrections should reflect the expected economic cost of downgrades and defaults over the long-term and should be based on long-term default statistics. It would therefore be appropriate that the risk corrections are largely insensitive to changes in credit spreads.
2. A risk adjustment that is proportional to the market credit spread would however not be reflecting long-term defaults, in particular not in times of a financial crisis, with substantial market exuberance. Such a risk adjustment woud therefoe unduly reduce the effectiveness of the volatility adjustment as an instrument to mitigate own fund losses in a crisis situation.
3. The objective of the VA to mitigate "exaggeration of bond spreads" requires a reference point to measure "exaggeration" in the context of the insurance business model. Assets backing insurance portfolios that result in stable cash outflows are not subject to forced selling and therefore all components of the spread, except for the spread relating to expected defaults, can be earned by the insurer in such cases. The asset loss compensation resulting from the VA for such portfolios should therefore include all spread components except the default component.
4. Unexpected credit risk, including unexpected default losses, is already covered by the SCR capital requirement. The EIOPA proposal would

therefore lead to double counting of risks between the valuation and capital requirements.

Assessment

2.54 EIOPA has assessed the implications of an approach to calculating the risk correction as suggested by a number of stakeholders. Under this approach, the risk correction would only capture the portion of the spread attributable to expected default, and no other components of the spread. In particular, the credit risk premium component of the spread would then be allocated to the risk corrected spread, and therefore increase the value of the VA.

2.55 This would imply that the interest rates used for the valuation of technical provisions, after adjusting for the VA, would no longer be risk-free, but contain credit risk. The use of a discount rate which is not risk-free for the valuation of technical provisions is in conflict with the basic principles of a market consistent valuation. The higher discount rates which result from adding part of the interest rate spread that carries credit risks lead to an underestimation of technical provisions which could put the protection of policyholders rights at risk.

2.56 Moreover, using discount rates which are not risk-free implies the assumption that the valuation of the technical provison can be done by using risky (i.e., not risk-free) bonds to replicate the insurance liability cash flows. Since these bonds contain a credit risk component, this non-hedgeable financial risk would have to be included in the risk margin. However, the risk margin calculated under the current regulation does not reflect any such financial risks. Hence under an approach where the current calculation of the risk margin is maintained, and that at the same time uses discount rates which are not risk free, the resulting value of technical provisions may materially underestimate the transfer value of the insurance liability, in contradicition to Article 77(3) of the Solvency II Directive.

2.57 Based on this assessment, EIOPA reaffirms its view that the the risk correction for the VA shall correspond to the portion of the spread that is attributable to a realistic assessment of expected losses or unexpected credit or other risk of the assets. This ensures that the risk-corrected spread, which serves as a basis for the calculation of the VA, corresponds to a portion of the spread which is free of asset risks.

2.58 EIOPA disagrees with the view put by some stakeholders that such an approach would lead to a double counting of risks, since the SCR already captures the spread risk of the fixed income assets of the undertaking. The risk correction of the spread ensures that the resulting risk-corrected spread, and therefore the portion of the spread that is attributable to the VA, can be regarded as free of asset risks. As set out above, this is necessary to ensure a coherent market-consistent valuation of technical provisions. The SCR has a different role – it measures, on basis of the market consistent valuation of assets and liabilities, the own funds that the undertakings requires to sustain a loss in own funds over a one year time horizon.

2.59 EIOPA disagrees with the view that the risk corrections should be based on long-term default statistics. Following such an approach, the value of the risk correction would be very stable and be largely insensitive to changes in credit spreads. This would only be appropriate if it can be assumed that the default risks

of fixed income assets do not significantly change over time, and stay the same throughout different market environments. However, such an assumption does not appear plausible.

2.60 Moreover, as past experience has shown, in periods where financial markets are distressed, and where this has led to a sharp increase in credit spreads in fixed income investments, a significant portion of this increase of spread is attributable to an increase of the credit risk component of the spread. This means that the risk correction of the spread, which includes the credit risk component, also needs to increase. It would therefore not be appropriate to design the risk correction such that is proportionate to long-term average of the spread.

2.61 EIOPA acknowledges that the determination of the portion of the spread which is attributable to either the expected default, the credit risk of the assets or to other asset risks poses methodological challenges. In the academic literature, a wide range of different models and approaches have been suggested that aim to decompose the spread into its various components. In view of this, EIOPA has opted for a simple and transparent calculation of the risk correction, which calculates the risk correction as a percentage of the prevailing spread.

2.62 EIOPA has carefully assessed the calibration of these percentage factors to ensure that the risk correction fulfils its role to capture the expected and unexpected credit risk components of the spread. EIOPA has found that, were a single average risk correction factor for corporate bonds is chosen, a risk correction of at least 50% seems required.

2.63 EIOPA acknowledges the concerns of stakeholders that the envisaged new design of the risk correction should not unduly reduce the effectiveness of the volatility adjustment as an instrument to mitigate own fund losses in a crisis situation. Therefore, EIOPA has amended its proposal such that the percentage factor that is applied to the spread decreases where the spread is in excess of the long term average spread. For corporate bonds, the amended design foresees that a reduced factor of 40% is applied to the excess of the spread above the long-term average of the spread. This has the effect that there is a stronger increase of the risk-corrected spread, and hence of the VA, in case of a sharp and steep increase of spreads in the market. EIOPA points out that a similar mechanism is suggested for government bonds, with corresponding factors of 30% and 20%, respectively.

2.64 In view of the findings above, EIOPA considers that these calibrations are already rather aggressive, i.e. they already represent a lower bound for the factors that could be regarded as commensurate with the conceptual target of the risk correction design. EIOPA considers that any further lowering of these factors is likely to impair the proper functioning of the risk correction, and could, in turn, lead to an underestimation of technical provisions.

2.65 EIOPA has also assessed the final VA, taking into account all changes foreseen for the new envisaged design of the VA. EIOPA considers that, if the risk-correction would be different than proposed or remain as under the current VA, then the (increased) general application ratio and the scaling factor would need to be reconsidered and/or recalibrated. The intention of the VA is to dampen the impact of exaggerated bond spreads. As such EIOPA considers it appropriate that the VA compensates a part of the losses on fixed income investments. With the

proposed VA, for undertakings with relatively highly illiquid liabilities this compensation is higher than under the current VA.

2.3.5 VA almost always positive

Summary of comments

2.66 The stakeholders who commented on the deficiency that the VA is almost always positive are not convinced that that characteristic is indeed a deficiency. They mainly hold the view that the VA should be negative because it corresponds to an illiquidity premium and consider the scenario of procyclical investment behaviour in times of compressed spreads as theoretical.

2.67 The ESRB recommends making the VA symmetric in order to ensure that insurers automatically build a buffer of own funds during times when risk premia on fixed income assets are excessively compressed and thereby build insurer resilience during times of exuberance.

Assessment

2.68 EIOPA analysed the option to allow national supervisors to impose own funds buffer during times of compressed spreads in order to increase the resilience of undertakings. Such a change is however not suggested because of possible interplay issues between the buffer and the VA and because of the risk of inconsistent application of the buffer across countries.

2.3.6 Underlying assumptions

Summary of comments

2.69 The deficiency on the unclarity of the underlying assumptions of the VA, that EIOPA identified, was generally accepted by stakeholders though – compared to the other deficiencies identified – not seen as of major importance.

2.70 There was split feedback on the objectives of the VA relevant for defining the underlying assumptions. While some stakeholders referred to the objectives of the VA as outlined in recital 32 of the Directive, others argued that the VA should also meet the objective of an illiquidity premium, representing the additional returns, above risk free rates, that insurers as long-term investors can and do earn.

2.71 Stakeholders generally supported a further clarification of the objectives of the VA in the Directive including both:

- The mitigation of artificial balance sheet volatility; and
- The reflection of additional returns that insurers as long-term investors can earn.

2.72 Individual stakeholders argued that the main issue with the underlying assumptions lies in the discrepancy between aggregate assumptions (e.g. for representative portfolio) and the undertaking's specificities. Effectiveness of pillar II would be improved where the VA would become more undertaking-specific. Stakeholders broadly mentioned that this deficiency would no longer be relevant

as EIOPA proposed to remove the sensitivity analysis in the risk management anyway.

Assessment

2.73 EIOPA considers that the objectives of the VA should be further clarified in the regulation to ensure a common understanding that allows a consistent application of the measure as well as effective supervision thereof. EIOPA considers that the underlying assumptions of the VA should be transparent, also to ensure a sound calibration.

2.3.7 Deficiencies in the methodology for the country specific increase

Summary of comments

2.74 On the deficiency related to potential cliff effects of country specific increase in the calculation of the VA, the industry tend to agree that there is an issue. In fact, the majority of the stakeholders agree that this deficiency is an area of concern (for some, the main one) in the design of the VA. The following comments were made in this regard:

- The activation mechanism does not work as expected.
- It creates undesirable cliff effects which introduce artificial balance sheet volatility.
- It leads to unwanted periods of activation and non-activation of the mechanism with consequent volatility of the own funds.
- It leads to under-shooting effects in the relevant countries for its lack of activation, failing to achieve its intended objective as a countercyclical measure (therefore the activation should increase).

2.75 There is in particular a suggestion that the application of the country-specific VA should depend on the on the liabilities composition and capital investments (i.e. the undertaking's actual exposure to bonds from that country) rather than the jurisdiction where the undertaking is established.

2.76 Some stakeholders refer that in the very recent Italian example, the mechanism has proved to be very volatile and inefficient.

2.77 Most of stakeholders welcome Option 7 as a good option within the list provided by EIOPA. However, some point out that:

- The proposal could be further enhanced through a lower/more sensitive activation component.
- The national component could be replaced by an entity-specific component or at least when either the currency or the country representative portfolios generates significant basis risk.
- The trade-off between accurate calculation and complexity should be considered.

2.78 There were only few responses on option 8. While one stakeholder agrees that a split would be sensible another one notes that a modification of the country VA would be sufficient.

Assessment

2.79 EIOPA agrees with that cliff effects of the mechanism for the country specific increase is an area of concern and that the design of the VA should be improved in order to overcome the problems identified. The activation mechanism should be more risk sensitive and incorporate a smoothing effect rather then a binary approach that alsos generates under-shooting situations.

2.80 Rather then replacing the national component by an entity-specific component, EIOPA considers that a balanced approach should be envisaged. The entity-specific view should be to some extent integrated in order to mitigate cases of overcompensation or under-shooting (by introducing appropriate application ratios in the design of the VA) but not completely, since then undersirable investment incentives could be created.

2.81 On the suggestion that the application of the country-specific VA should depend on the liabilities composition and capital investments, the comment could be relevant if in practise several undertakings had low exposure to bonds issued in their own country, however this does not seem to be the case. Additionally, considering all these factors would add a lot of complexity to the national component of the VA which would then be disproportionate.

2.82 EIOPA acknowledges the feedback received and has concluded that the split into a permanent and macro-economic VA should be maintained, while taking up the proposals to enhance the national component of the VA to avoid cliff edge effects when triggering.

2.3.8 General application ratio

Summary of comments

2.83 Stakeholders are all advocating for an increase of the general application ratio from 65% to 100%. Current GAR is considered as overly prudent. According to stakeholders keeping it at 65% would result in undershooting. Furthermore, the introduction of application ratios 4 and 5 is seen as extra layers of prudency which would justify to raise GAR.

Assessment

2.84 EIOPA acknowledges that changes in the design of the VA such as introduction of illiquidity and overcompensation application ratios involve a change in the general application. In particular, this allows EIOPA to increase GAR while keeping the level of prudency unchanged.

2.85 Nonetheless GAR is meant to deal with several risks among others:

- the risk of misstatement of the determination of the VA that occurs due to unavoidable estimation uncertainty with respect to the measurement of exaggerations of bond spreads and the identification of risk-free portions of these spreads.
- the limitation that the VA is applied equally to a wide range of liabilities, regardless of whether the undertaking is actually exposed to bond spread exaggerations and whether or not the liabilities are sufficient illiquid to

withstand forced sales and prevent realizing losses due to these bond spread exaggerations.

- The risk that undertakings cannot actually earn the VA;
- The mismatch between the representative portfolio and undertakings' own portfolio. Inspite of the introduction of two applications ratio, some of these mismatches will remain (for instance, quality overshooting).

2.86 Therefore EIOPA considers that increasing GAR to 100% would not be justified and advices increasing GAR from 65% to 85%.

2.3.9 Dynamic VA in the standard formula

Summary of comments

2.87 Apart from one stakeholder there was unanimous feedback from stakeholders in that they support the introduction of a dynamic VA in the standard formula, either in the form of a direct approach (recalculation of the VA in the spread risk module of the standard formula) or via a reduction of spread risk charges. Main reasons mentioned are the consistency of valuation and of risk measurement (total balance sheet approach), ensuring sound risk management and level playing field with internal models and with MA users.

2.88 Stakeholders specifically criticised the argument put forth during the consultation that the introduction of a dynamic VA in the standard formula could lead to unlevel playing field with internal model users where these also reflect the spread risk associated to government bonds. They argue that the DVA should not be used to target a compensation of government and corporate bond spread risks – the risks being undertaking specific depending on the exposure. They also explain that the undertakings applying the standard formula need to reflect on the spread risk of government bonds in the ORSA and thus also need to hold sufficient capital. Some mentioned that the spread risk of government bonds could also be explicitly reflected in the standard formula.

2.89 Some specifically mentioned that they consider the long-term spread risk as being overly conservative and that the dynamic VA for the standard formula would be a possibility to mitigate this for long-term investors. They consider that the long-term investors are exposed to default losses only and would thus not be exposed to other spread changes.

2.90 Stakeholders also disagreed that the introduction of the dynamic VA would lead to wrong investment incentives underlining the risk based SII framework – where risks are adequately reflected, this would not occur. They also mentioned that the complexity of the framework would not be materially impacted, though two stakeholders were concerned on potential additional complexity.

Assessment

2.91 EIOPA carefully assessed the option to have a dynamic VA in the standard formula, having reflected on the pros and cons in the consultation as well as including the dynamic VA in the standard formula as option within the holistic

impact assessment. After further careful consideration, EIOPA considers that a dynamic VA should not be introduced into the standard formula.

2.92 With respect to the pros and cons of the dynamic VA, EIOPA sees major disavantages, most notably an unlevel playing field in favour of standard formula users and the SCR no longer reflecting the full spread risk, reducing the level of policyholder protection.

2.3.10 Approval of VA

Summary of comments

2.93 The majority of stakeholders suggest that the question whether the VA should be subject to approval should be answered in the same way for all Member States.

2.94 Views on the need for approval differ. Some stakeholders consider the approval necessary provided the appropriateness of the VA application has to be justified, but not when the design is improved. Another view is that approval should be required, but no sensitivities on the VA impact. Another suggestion is to exempt undertakings that currently use the VA from the approval requirement.

Assessment

2.95 EIOPA confirms the view that the question whether the VA should be subject to approval should be answered in the same way for all Member States.

2.96 In view of the increased complexity of the proposed new design of the VA, it is recommended to subject the application of the VA to supervisory approval. In order to limit the costs for undertakings and supervisory authorities, it is proposed that the approval is only requested with respect to new VA users.

2.97 In addition, EIOPA advices to provide explicitly the supervisory power to request undertakings to stop using the VA when the processes or data for calculating the VA are not appropriate or when the underlying assumptions of the VA are not met. Consequently, current VA users in those Member States where supervisory approval is not requested could still be requested by the supervisory authority to stop using the VA when the use of the measure is not deemed appropriate anymore.

2.4 Dynamic volatility adjustment in internal models

Summary of comments

2.98 Industry stakeholders are supportive of the dynamic volatility adjustment (DVA) in internal models and consider the DVA to be consistent with Solvency II regulation and economic principles. Most comments were essentially related to the request to extend the DVA to the standard formula. Only few comments relate to potential measures if deficiencies in the VA would not be 'solved at source'. Those did not see a need for specific DVA measures but advocated that the internal models would have to forecast how the VA would and not how it should behave. One stakeholder would like to see the fair application as part of a supervisory convergence exercise, which is read as reference to the level playing field among DVA users.

2.99 The ESRB in its response stated that in internal models "the volatility adjustment should not affect the calculation of the solvency capital requirement since it already affects own funds". I.e. the ESRB opposes the use of a DVA in internal models and considers the DVA not to be an anti-procyclical measure.

Assessment

2.100 From industry stakeholders' perspective the EIOPA position to retain the DVA in internal models is supported and their comments indicated no change to this position. But as EIOPA's position on the DVA in internal models in the CP was conditional on the future design of the VA, stakeholders did not have the opportunity to comment on additional safeguards in the form of an 'enhanced DVA prudency principle' as now included in the advice and tested in the 'holistic impact assessment' (HIA) and the 'Complementary Information Request' (CIR). Some participants in their answers to the qualitative questions on the DVA in the CIR noted that the enhanced DVA prudency principle would fail to address undershooting and requested to base the VA calculation on the undertaking's own assets. This path is not followed for the VA and consistently not for the DVA because of the risk of incentives to move to riskier asset portfolios. Instead, such calculations in the enhanced DVA prudency principle are serving as floor for the SCR to address overshooting caused by a mismatch of credit spread sensitivity. Furthermore it is noted that full compensation of spread impacts is systematically not intended, with the purpose to reflect the remaining risks of the VA concept overall. Participants claimed this enhancement of the DVA prudency principle would cause a doubling of the calculation effort, as additionally to the 'direct DVA based on the reference portfolio' ('direct DVA(RefPF)') of the current prudency principle, also a 'direct DVA based on the undertaking's own asset portfolio' ('direct DVA(own PF)') would need to be calculated. EIOPA admits that effort indeed typically will increase, but considers it crucial to address overshooting as prerequisite for maintaining the DVA. But it might also not be necessary to perform such calculations every time a SCR is determined. As under the current DVA prudency principle, this might be the case if the 'striking floor' is sufficiently stable; for example if the undertaking uses a direct DVA on the reference portfolio and the corresponding SCR was evidenced to be higher than under 'direct DVA(own PF)' in the past and neither economic conditions nor risk profile materially changed.

2.101 Regarding the ESRB proposal, EIOPA is of the view that excluding the macro-economic VA from the DVA is an appropriate measure to avoid crisis-mechanisms to be anticipated in the SCR.

2.5 Transitionals measures on the risk-free interest rates and on technical provisions

2.5.1 Predominant application of the transitionals by undertakings without capital gap

Summary of comments

2.102 Industry stakeholders were unanimously critical on the restriction of the use of transitionals for undertakings applying the transitional by e.g. restricting the use or limiting the impact. Cappying the effect of the transitional to achieve an SCR ratio of 100% was considered difficult and arbitrary. Also, restricting or limiting the use was seen as contradicting the objective of the transitionals in providing undertakings sufficient time and planning safety to introduce in the new framework.

2.103 Also, additional reporting on the transitional measures was criticised by most stakeholders for not introducing added value as understanding requires deeper understanding of the business model. The information is also considered not to be considered relevant for policyholders and already available to supervisors as part of the RSR and approval process.

Assessment

2.104 EIOPA supports strengthening the disclosure on the transitionals. Additional information in the SFCR addressing other users than policyholders is considered sensible to allow stakeholders to better understand the role of the transitional and the measures undertakings intend to take. It thus adds transparency to better understand the current solvency situation of the undertaking.The quantitative information on the impact of the measures which is currently provided is not considered sufficient to allow for that.

2.5.2 Approval of transitionals after 1 January 2016

Summary of comments

2.105 Stakeholders criticised potential level playing field issues when undertakings are no longer able to apply for the transitionals (compared to undertakings that could apply for the use of the transitional). Also legal certainty and crisis management were put forth as key reasons for keeping open the possibility to apply for the transitionals.

Assessment

2.106 The transitionals were introduced into the framework to allow undertakings to smoothly transition into the new regulatory framework. Undertakings should actively manage the transition to foster compliance with SII regulation as soon as possible. Where undertakings required a transitional measure to enter into the new framework, they have applied to the transitionals as at the start of Solvency II or shortly after. EIOPA considers that those undertakings not yet having applied the transitionals should be able to manage their risks according to Solvency II. Any new applications should therefore be limited to individual cases where this is still deemed appropriate by NSAs.

2.5.3 Application of a capital add-on

Summary of comments

2.107 Stakeholders commented that the use of capital add ons should be restricted and only be applied as last resort as it was seen as counterproductive.

Assessment

2.108 Imposing capital add-ons is only considered in exceptional cases and in situations which have a temporary nature. However, capital add ons provide more flexibility to supervisors where otherwise only a rejection of the application of the transitional may be an option. Further clarification on when a capital add on should/could be imposed thus seems reasonable also to foster supervisory convergence. The measure of last resort is to revoke the approval for the application of the transitional measure in accordance with Article 308e of the Solvency II Directive.

2.6 Risk-management provisions on LTG measures

2.6.1 Role of liquidity plan for the VA

Summary of comments

2.109 The stakeholders support the change. Removal of a separate liquidity plan and integration into the wider liquidity risk management plan is endorsed. Some stakeholders commented that undertakings using the VA should not be obligated to submit a LRMP per default.

Assessment

2.110 It is not intended that undertakings using the VA should be obligated to submit a LRMP per default, but rather that their own internal liquidity planning should reflect the use of the VA. Apart from this clarification the advice can be kept as outlined in the consultation document.

2.6.2 Sensitivity analysis for the VA

Summary of comments

2.111 The stakeholders support the shift away from tests on the assumptions underlying the VA towards an analysis of economic sensitivities.

Assessment

2.112 As there are no dissenting comments, the advice can be kept as it is in the consultation document.

2.6.3 Forced sale of assets for the MA and VA

Summary of comments

2.113 The industry supports the deletion of the requirement to conduct analysis on the forced sale of assets.

Assessment

2.114 As there are no dissenting comments, the advice can be kept as it is in the consultation document. It should be noted that this is connected to the introduction of the requirement to calculate a combined scenario without VA/MA and with a more market consistent extrapolation. See 2.7.5 for comments on this issue.

2.6.4 Policy on risk management for the VA

Summary of comments

2.115 The stakeholders support the integration of the specific risk management policy on the use of the VA into the general risk management policy of the undertaking.

Assessment

2.116 As there are no dissenting comments, the advice can be kept as it is in the consultation document.

2.6.5 Analysis of measures restoring compliance for the MA and VA

Summary of comments

2.117 The stakeholders oppose the change. The calculation of a combined scenario without VA/MA and with a more market consistent extrapolation is criticised, but the strongest objections are voiced regarding the proposed NSA power to limit capital distribution based on this analysis.

2.118 The LTG-measures are seen as an integral part of the SCR calculation and are argued to be based on economically sound principles. It is argued that no SCR-coverages that disregard the measures should have to be calculated and reported.

2.119 Granting the NSAs the power to limit or block capital distributions when the SCR coverage with measures in place still exceeds 100%, is seen by stakeholders to undermine the 99,5th percentile confidence level of Solvency II. Furthermore it would lead to excessive capitalisation in the eyes of the industry.

2.120 The criteria and process which might lead to capital distribution limitations are not clearly enough defined in the view of the stakeholders. Some comments show an especially strong opposition to this, when allocated bonuses to policyholders might also be affected by the limitations.

Assessment

2.121 EIOPA considers that the power to limit capital distributions should be only applied in exceptional cases as a last resort measure when the supervisory authority has serious concerns that have not been properly addressed by the undertaking and there is a significant risk for policyholder protection.

2.122 Due to the strong concerns raised by stakeholders, the advice has been amended and integrated into the existing requirements of Solvency II with the

intent to provide further clarity on the provision and address the concerns on a "shadow SCR calculation". It is therefore suggested to connect the supervisory power to limit voluntary capital distributions with the identification of deteriorating financial conditions and the forward-looking assessment of the ORSA.

2.7 Disclosure on LTG measures

2.7.1 Disclosure of the impact of MA and VA set to zero

Summary of comments

2.123 Several stakeholders commented that the requirement to publicly disclose the impact of a MA/VA=zero scenario should be removed; in any case (both for policyholder and professional users) disclosures around the LTG measures (MA, VA) are disproportionate and inconsistent with those of other elements of the Solvency II framework.

2.124 The VA and MA are key elements of the framework at its highest level (Level-I Directive) and as such one of the fundamental elements of the framework. Requiring companies to disclose the impact of a scenario in which the MA or VA would not exist might convey the unintended message to the markets that the LTG measures might be a potentially movable or ancillary element of the framework that might at some point exist or not. The industry considers that such a message would be highly detrimental to all stakeholders.

2.125 In this sense, the MA=0 scenario may only have one coherent interpretation under Solvency II: the impact that the company might no longer be allowed by the relevant national supervisory authority to apply the MA, because of non-compliance and subsequent non-restoring of compliance in the relevant timeframe. The industry believes that this scenario would be more representative of operational risk than any other risk, whereas the messages conveyed could be misinterpreted as an economic/financial, rather than operational risk.

2.126 Information should only be presented including transitionals and LTG measures. More detailed analysis should be part of the ORSA.

Assessment

2.127 EIOPA supports that transparency regarding the impact of the measures should not be reduced. On the contrary, conclusions of EIOPA thematic focus in LTG report 2017 on public disclosure about the LTG measures reflected the stakeholders interest in more detailed and easily accessible quantitative information on the impact of the LTG measures and the SCR with and without the measures. However, EIOPA acknowledges that this information is mainly of interest for professional readers and not necessarily to policyholders, taking into to account the complexity of the measures. Therefore, EIOPA has reconsidered the need to prescribe minimum information on the impact of the measures in the section of the SFCR addressed to policyholders.

2.7.2 Requirement to disclose a sensitivity analysis of a 100 bps decrease in the UFR

Summary of comments

2.128 Several stakeholders expressed “strong” opposition to the introduction of a requirement to disclose a sensitivity analysis of a 100 bps decrease in the UFR in the SFCR.This stress scenario is beyond the boundaries of the SII framework, not in line with current UFR methodology where the maximum annual change is equal to 15 bps and therefore provides no value. Where relevant, a sensitivity on the impact of changing the UFR is already included in ORSA.

Assessment

2.129 In view of the proposed alternative extrapolation method, EIOPA considers that the reporting and disclosure requirement with respect to the sensitivity analysis on extrapolation should be limited to a change of the convergence parameter of the extrapolation method. The sensitivity analysis would contribute to address eventual wrong risk management incentives derived from the deviation of the interest rate term structure used for the valuation of technical provisions from observable market prices. This takes into account the conclusions of EIOPA thematic focus in LTG report 2017 on public disclosure about the LTG measures, where stakeholders expressed interest in more detailed and easily accessible quantitative information on the impact of the LTG measures as well as the impact of sensitivity calculations regarding extrapolation.

2.8 Long-term and strategic equity investments

General comments

2.130 Some stakeholders indicated that on the equity risk SCR, there is a need to ensure the new long-term equity category works in practice.

2.131 Another stakeholder indicated that the current restrictive criteria for inclusion as long-term equity could prevent its application to main parts of the life insurance market. The illiquidity of the liabilities is not reflected in an appropriate manner in the equity risk sub-module. A more precise definition of the applicable rules concerning the liquidity test as well as operational practices in accordance with local regulations is needed, in particular for the profit sharing mechanism.

2.132 Another stakeholder indicated that long-term and strategic investments - EIOPA’s advice should better account for the going concern perspective of insurance undertakings and their ability to avoid forced sales during adverse market situations and the realization of unexpected losses. The measure of risk should remain the 1-year horizon value at risk but account for the possibility to smooth market fluctuations over longer term because of the management actions in place. EIOPA’s proposal will create more complexity and unnecessary burden to undertakings with the approved use of the DBER.

General feedback

2.133 EIOPA supports stakeholder feedback that the new long-term equity category works in practice. The criteria for long-term equity shall ensure that undertakings and able and commit to hold their equity on the long term. Under such conditions, the long -term equity would benefit from the lower equity risk charge.

2.134 EIOPA therefore proposed several changes to the criteria for long-term equity investments. Those changes reinforce the reflection of liabilities characteristics of illiquidity, account for the specificities of life and non-life businesses and clarify the requirements.

2.135 Only one undertaking use DBER and we expect that the revised long-term equity should would apply instead.

2.8.1 Duration based equity risk - Phasing-out

Summary of comments

2.136 Few comments received raise all concerns about 1/ phasing out the DBER, 2/ replacing DBER by LTE.

Assessment

2.137 Only one undertaking is using DBER in Europe. Phasing out DBER would not prevent this undertaking from continuing using it. But, DBER could not be fully replaced by LTEI given that this undertaking has allocated all its equity to DBER. EIOPA recommends to allow this undertaking to continue using this disposal and create a grand-fathering from 31/12/2020.

2.8.2 Strategic Equity

2.8.2.1 Correlation of risk

Summary of comments

2.138 Most stakeholders answered no; the correlation of risks between the participation and the participating undertaking is of only theoretical use and cannot reasonably be measured in practice. It can thus not be taken into account. The multiple checks for strategic participations are already rather burdensome.

2.139 The preferred option would be to assume that there is no significant dependence; NSAs would only be given the legal basis to address the issue if there were significant indicators of high dependence.

2.140 Few stakeholders answered that allowing for a lower capital charge for a holding in an entity with performance that is highly correlated to its own is inappropriate.

Assessment

2.141 If the value of strategic equities significantly depend on, or are correlated with, the performance of the undertaking itself, there is a sort of encumbrance: a loss in own funds of the undertaking will subsequently also result in a loss of the strategic equity and this in turn will further decrease the own funds. One of the underlying assumptions for the applicability of the lower charges for strategic equity is that this is not the case. In cases where no correlation is available, a qualitative assessment of the dependence of the strategic equity on the performance of the undertaking would be required to rule out this sort of encumbrance.

2.142 Equity that is correlated with, or depends on, the performance of the undertaking is more risky and does not fit the lower capital charge for strategic equity. As part of undertaking's regular risk management it is required to know their risks; when risks are considered lower, undertakings should be able to demonstrate that. Equities that are significantly correlated with, or depend on, the performance of the undertaking are not less risky. If correlations or volatilities cannot be estimated from empirical data a qualitative assessment could suffice.

2.143 EIOPA assumes that the risk of significant dependence or correlation is addressed as part of undertaking's regular risk management. Therefore, EIOPA will not advice in this area.

2.8.2.2 Lower volatility

Summary of comments

2.144 Stakeholders oppose the inclusion of the beta method (options 3 and 4) to demonstrate the lower volatility of strategic equity, as it could lead to a de facto limitation by NSAs in the use of other methods (which some companies are today applying with the agreement of their NSAs). One of them sees the proposed method difficult to implement.

2.145 Some of the stakeholders are in favour of deleting the lower volatility criterion, as it does not consider that what makes participations strategic is not their own business, but the purpose of the participating undertaking. The latter deliberately decides that it will not give up the participation in case of stress, which justifies departing from the one year holding period. Hence, quantitative methods won't help to shed light on this issue. Rather, legislation must ensure that the declaration of a participation as strategic means a commitment from the participating undertaking.

Assessment

2.146 The lower capital requirement for strategic participation is justified if the risk is lower. In this regard, EIOPA advises to maintain the low volatility requirement. In addition, EIOPA recommends that the beta method be introduced as an optional method and considers that NSAs may use other methods.

2.8.2.3 Control threshold of 20% percent

Summary of comments

2.147 Stakeholders support option 4, i.e. a reduction of the control threshold to 10%, as it would improve the use of strategic equity. All respondents support the clarification that the requirement should be limited to participations in related undertakings, whether they are (re)insurers or not.

Assessment

2.148 Reasons to keep the threshold of 20% are: (i) The influence of the participating undertaking on a related undertaking can materially influence the volatility of the related undertakings' own funds and; (ii) the underlying idea of strategic equity investment as being investments of strategic nature. In addition, EIOPA takes note

of the support of respondents and advises to further explicit that the requirement applies to investment in related undertakings

2.8.3 Long-term equity

2.8.3.1 Empirical analysis

Summary of comments

2.149 EIOPA received comments about the following hypothesis of the empirical analysis.

a. Measure of risk and time horizon - One stakeholder argues that the analysis should take into account a 1-year time horizon "annualized" or "conditional" VAR. Moving to a longer time horizon would involve other risks, could involve the unwinding of the discounting of the best estimate liabilities together with the management actions that may affect unwinding.
b. Minimum dates, anniversary dates and overlapping window - Some stakeholders consider that the hypothesis of the minimum dates is too conservative. AAE recommends performing the analysis again with the same data based on overlapping daily returns to challenge current results based on minimum date (too conservative) and anniversary date (too aggressive).
c. Returns in excess of the risk-free rate - A stakeholder recommends to take the return in excess of the today's 10-years risk free rate plus calibrated equity premium. Other stakeholders reject the used of excess return.
d. Scope - One comment said that the analysis should take into account non-listed equity.

Assessment

2.150 The empirical VaR approach includes overlapping windows for the monthly data for a 10-year horizon based on observed data from January 1970 to April 2019.

2.151 Overlapping daily returns were considered as a source of data when performing the analysis. However, daily rates are not available for the early years (70's and 80's) so the use of monthly rates was decided as a more reasonable approach. Using the monthly rates will ensure consistency for all years and include all the available data.

2.152 The main challenges we face is that the data series is not independent. Allowing for overlapping daily rates will increase the amount of data but is not anticipated to provide significant additional information. In the analysis, all possible data are taken into account allowing for the inclusion of the different crisis noted during chosen time-period. To enhance this, the analysis was updated to include the data up to March 2020.

2.153 The choice to use excess returns based on minimum yearly values was adopted to eliminate the dependency in the chosen valuation date and to consider potential crisis occurring throughout the year. Whilst this does not necessarily properly account for long-term equity risks for the multi-year period and assumes that insurers will be forced to dispose of these investments at their lowest value every year it can provide a good indication of how the equity value could be impacted in adverse conditions.

2.154 In conclusion, the approach aims to assess the maximum loss possibly to be faced on a long term basis "annualized" to take into account the one year term

horizon and the analysis is limited only to listed equity due to lack of data for non-listed equity. EIOPA welcome the comments and after consideration, it was decided to extend the analysis to include the data up to May 2020. However, the updated analysis based on overlapping daily returns did not result in materially different outcome.

2.8.3.2 Diversification with other risks

Summary of comments

2.155 EIOPA received comments from several stakeholders. Feedback on the recognition of diversification of the long-term risk reflected in the LTE provisions of Art. 101a DR with the other short-term risks of the standard formula was mixed. While some stakeholders did not support additional complexity to the standard formula that could go along with a different treatment others acknowledged that long-term equity may require different treatment. There was split preferences on the options outlined by EIOPA in the consultation document as to whether diversification should be recognized between LTE and other risks. Some stakeholders included suggestions as to how this issue could be further analysed to come to a technically sound solution. Concrete evidence to support one of the options outlined by EIOPA was however not received.

Assessment

2.156 In view of the fact that no conclusive evidence was provided and is available to support any of the options outlined in the consultation document, EIOPA intends not to put specific advice in this area.

2.8.3.3 Diversification of the LTE portfolio

Summary of comments

2.157 One stakeholder answers that the prudent person principle of Solvency II already includes a diversification requirement. The industry suggests adding in the "Con" section the following "This additional criterion would increase the complexity of the sub-module".

Assessment

2.158 The LTE criterion that consists in a sub-set of equity that is well diversified is consistent with the prudent person principle of Solvency II. Thus, EIOPA does not considers that it adds burden.

2.8.3.4 Exclusion of the controlled intragroup equity

Summary of comments

2.159 No reason to exclude long-term intragroup equity investments from the scope of the LTE module as they may not pass the strategic equity criteria, but could pass the LTE criteria. And, more importantly, the nature of intragroup equity investments is usually long-term by definition.

Assessment

2.160 The value of the intragroup equity investments usually depends on, or is correlated with, the performance of the group and the undertaking itself. As such there is a sort of encumbrance: if there is a loss of own funds, the intragroup equity investment will also decrease in value and this will subsequently amplify the loss in own funds. The existence of such amplification does not justify a lower capital requirement as it is not less risky. Keep the advice.

2.8.3.5 Treatment of illiquidity

Summary of comments

2.161 Views of stakeholders are mixed, some consider that the illiquidity of liabilities is sufficiently reflected in the current equity risk sub-module, while others plead for a revision of the current LTE criteria. Among other stakeholders mentioned that the limit to the size of the portfolio should be deleted, LTE measure should include assets covering own funds, the geographical constraint should be expanded to the whole OECD rather than limiting to the sole EEE and the assessment of the ability to hold assets over a ten years period (point g.) should be clarified.

Assessment

2.162 EIOPA acknowledge that LTE measure deserve some amendment to improve its efficiency. Therefore, some of its requirements were changed to include a better assessment of the liquidity of liabilities. Furthermore, duration of the liabilities is set to 10 years and the limit to the size of the portfolio is removed.

2.8.4 Standard equity, Infrastructure equity and Unlisted equity

Summary of comments

2.163 EIOPA received 2 comments from stakeholders.

2.164 A first comment reflects the stakeholder's concern about the impact of the UK leaving the European Union on SCR calibration. EIOPA is therefore asked how the review the calibration in this context is planned.

2.165 The second comment is about the criteria requested to apply LTE and about strategic equity investments. As regards LTE, it regrets the current methodology as well as the proposed amendments (particularly 5 years holding period and the new criteria on diversification). For strategic equity, the lower volatility criterion should be removed, and the 20% minimum ownership / control threshold is seen too high. More qualitative criteria are put forward.

Assessment

2.166 Although the 2020 Solvency II Review was launched during the timing during which UK is leaving the EU, its purpose is not to recalibrate Solvency Capital Requirements in this context. For the scope of EIOPA's mandate, we are referring to the call for advice of the European Commission of 11 February 2019 on the 2020 review of Solvency II. The call for Advice does not make any reference to the UK leaving the EU. However, EIOPA did ad-hoc assessments on the potential impact on calibration of standard formula of UK leaving the EU. The holistic impact

assessment of the 2020 Solvency II Review will be based on a sample which do not include insurance undertakings from UK.

2.9 Symmetric adjustment to the equity risk charge

Summary of comments

2.167 Stakeholders generally support the suggestion in the consultation paper not to change the symmetric adjustment to the equity risk charge. One stakeholder suggested to extend the concept of symmetric adjustments to other market drivers, in particular to spread risk.

2.168 The ESRB recommended that internal model users should also be required to adapt the symmetric adjustment for equity risk to their models. More generally, the ESRB also saw merit in applying the symmetric adjustment to other non-fixed income assets, to increase resilience during times of exuberance.

2.169 One stakeholder suggested to exempt from the application of the symmetric adjustment savings-products without guarantees where the policyholder decides the asset allocation (e.g. unit-linked contracts).

Assessment

2.170 An extension of the symmetric adjustment to spread risk does not appear to be necessary because with the VA a powerful countercyclical measure on spread risk is already available. The extension of the symmetric adjustment to spread risk is an idea that could be explored, but data limitations do not allow us to do that at this stage.

2.171 Internal models are designed to better reflect the individual risk of the insurance and reinsurance undertakings. In addition, it is required that internal models are widely integrated into the risk management system. In order to ensure their appropriateness they are subject to strict requirements on e.g. their statistical quality, calibration, use test and validation. Introducing the symmetric adjustment to the equity charge to an internal model would distort the risk measurement. Such a modelling approach would usually not be compliant with the statistical quality, calibration, use test and validation standards anymore, especially as no particular method should be subscribed according to current legislation. Relaxing or abandoning these standards could lead to a general deterioration of the quality of the risk measurement system and to misestimating the solvency capital requirement. For these reasons EIOPA does not support the proposal to introduce the symmetric adjustment to internal models.

2.172 EIOPA acknowledges that the symmetric adjustment could, in specific situations, introduce more volatility into the solvency ratio. But in our view the countercyclical benefits of the adjustment, in particular increasing the resilience of undertakings during times of high equity prices and stabilising the solvency position in times of equity market turbulences, outweigh the issue of any such additional volatility in specific situations.

2.173 Symmetric adjustment has proven its efficiency in terms of contracyclicity. Since stakeholders are not reluctant to keep it the way it is, the current equity dampener can legitimately be maintained. Also, it is considered useful to widen the corridor in order to make the symmetric adjustment more effectif during times of crisis. Thus, EIOPA advices not to update the composition of the equity index for the symmetric adjustment, to keep the current functionning of the mechanism and to widen the corridor.

2.10 Extension of the recovery period - Role of the ESRB

Summary of comments

2.174 The main comment received is the one from the ESRB, which agrees with EIOPA's draft Advice on how to amend the first two paragraphs of Article 138(4) of the Directive. Given that the ESRB is responsible for the macroprudential oversight within the European Union, it would be more natural that the ESRB, where appropriate, was consulted by EIOPA before the declaration of an exceptional adverse situation. Criteria that need to be assessed before declaring an exceptional adverse situation can be of a macroprudential nature, such as the possible procyclical effects of re-establishing compliance with the SCR.

Assessment

2.175 In view of ESRB support and no objections from any stakeholder, EIOPA will maintain the draft proposed clarification as consulted.

3. Technical provisions

3.1 Best estimate

3.1.1 Future Management Actions topic

Summary of comments

3.1 The amendment proposed is welcomed. One comment raised some concerns that future management actions take into consideration new business, particularly when the projection period is long.

Assessment

3.2 New business can significantly interact with current business in some cases and therefore it should be considered to set appropriate future management assumptions. Further guidance from EIOPA will follow on this topic.

3.1.2 Expenses

Summary of comments

3.3 The amendments proposed are welcomed. One comment argued that investment expenses from assets covering the SCR are not required to pursue insurance business.

Assessment

3.4 According to current regulation, undertakings are required to have enough own funds to cover their SCR to pursue insurance business. Therefore, EIOPA considers that an amount of assets equivalent to the own funds required to cover the SCR is necessary to pursue insurance business. Further guidance from EIOPA will follow on this topic.

3.1.3 Economic Scenario Generators

Summary of comments

3.5 Stakeholders welcomed there is no amendments proposed on the topic and some of them also considered that no further guidance from EIOPA is needed. One comment suggested allowing standard calibrations under the proportionality principle

Assessment

3.6 The use of Economic Scenario Generators has been identified as a divergent practice across Member States. Therefore, EIOPA considers that further Guidance on the topic could foster a common understanding of the current principles and requirements set in the Solvency II regulation. Regarding proportionality, as discussed in chapter 8, EIOPA considers that simplified approaches may be applied while proportionate to nature, scale and complexity of the risks.

3.1.4 Policyholder Behaviour (valuation of options and guarantees)

Summary of comments

3.7 Some stakeholders were concerned that EIOPA may create new requirements regarding policyholder behaviour modelling. Other stakeholders suggested allowing static modelling as a simplified approach.

Assessment

3.8 EIOPA expects to issue further guidance on the topic not to create new requirements but to ensure a common understanding of common requirements. EIOPA also considers that simplified approaches for best estimate valuation, including modelling of policyholder behaviour, are already possible under the proportionality principle.

3.1.5 Contract Boundaries

Summary of comments

3.9 The clarification of Article 18(3) with regards to paid-in premiums raised mixed comments, the main concern focused on cases where options (e.g. maturity extension options) could have a different treatment than renewals.

3.10 The proposal to limit the exception of the third paragraph of Article 18(3) was moderately supported. The option to delete the exception, which has been disregarded by EIOPA, was clearly rejected.

3.11 Unbundling and discernible effect were identified as the two main divergent practices. EIOPA's assessment of unbundling would lead to splitting a significant amount of products and that approach raised mixed reactions, with some stakeholders considering it could lead to a significant burden for the undertakings. Stakeholders mainly considered that a 0% guarantee has a discernible effect or, at least, depends on the economic environment. One stakeholder suggested to extend the scope of the discernible effect assessment to the rights of article 18(3). Stakeholders in general welcomed the assessment on the frequency of the reassessment of the discernible effect.

3.12 One stakeholder suggested to clarify whether the prohibition to price contracts considering gender implies that a the premiums and benefits cannot be assessed at contract level for the purposes of article 18(3)(c).

Assessment

3.13 The comments received suggest that in most cases, even if the interpretation of the article may be slightly different, the cash flow projection is still consistent among undertakings. However, for some specific situations like maturity extension options there may exist minor divergent practices. For these reasons, TP PG considers that further guidance would be enough to clarify the interpretation of the article 18(3) and no amendment is required. Therefore, the proposal will be dropped. EIOPA is still assessing whether this is possible.

3.14 The exception of the third paragraph of article 18(3) exists on the basis that the situation at the date where the undertaking has the right to amend the premium or benefits is not equivalent to a new contract. The only difference that exists in such situation is the individual risk assessment performed at inception. Since the whole assessment of article 18(3) is based on the rights of the undertaking, EIOPA considers that any exception should also be based on legal/contractual rights as proposed in the EIOPA Opinion.

3.15 Unbundling has been identified as a source of divergent practices and the comments also point into that direction. EIOPA is working to provide further guidance on the assessment of contract boundaries to ensure a level playing field, in particular regarding unbundling and discernible effect.

3.16 EIOPA agrees on the need to clarify the consideration of gender for the purposes of article 18(3)(c).

3.1.6 EPIFP

Summary of comments

3.17 The amendment on EPIFP raised significant concerns. The split of loss-making and profit-making into different homogeneous risk groups. Several technical reasons were provided (e.g. profit sharing mechanisms). Some stakeholders questioned about the rationale to amend the definition of EPIFP so it better reflects the impact in the own funds.

3.18 Some stakeholders argued that the calculation of the impact of reinsurance on EPIFP could be burdensome and require additional assumptions, particularly for non-proportionate reinsurance. Other comments argued that with current data good proxies could be obtained.

3.19 Some stakeholders argued that the split of EPIFP by LoB business would also be significantly burdensome.

3.20 Some stakeholders question the usefulness of the future profits from servicing and management of funds or questioned the existence of similarities with EPIFP. Other stakeholders pointed out that the concept may partially overlap with EPIFP.

3.1.7 Contract Boundaries

Summary of comments

3.21 EIOPA agrees on the arguments provided by stakeholders on the split of loss-making and profit-making contracts into different homogeneous risk groups. Therefore, the proposed amendment will be dropped. However, EIOPA still plans to propose to allow for compensation of loss-making homogeneous risk groups with profit-making homogeneous risk groups so EPIFP is still closed to its impact on the own funds.

3.22 Article 70 of the Delegated Regulation states that EPIFP are included in the excess of assets over liabilities, which is included in the reconciliation reserve. Article 295 of the Delegated Regulation requires to include EPIFP while assessing liquidity risk. Therefore EIOPA considers that a definition of EPIFP closer to its

impact in the own funds including all future premiums would be more consistent with such articles.

3.23 EIOPA agrees with the arguments provided by the stakeholders and, even if still considers this as a relevant information, since it can be approximated from available data the amendment will be dropped.

3.24 Currently EPIFP should be calculated at homogeneous risk level. Therefore, EIOPA considers that identification of EPIFP by line of business would not be so burdensome for undertakings and the information will be valuable for supervisors.

3.25 Future profits from servicing and management of funds are, to some extent, similar to EPIFP. Both reflect profits from charges yet to be made to the policyholder. Therefore, EIOPA considers that, from a supervisory point of view, an estimate of such profits would be as useful as EPIFP. EIOPA agrees that, depending on the definition of EPIFP, there may exist some overlap with EPIFP. In any case, expected profits from servicing and management of funds are not expected to be added to EPIFP, but to provide complementary information.

3.1.8 IFRS 17 alignment

Summary of comments

3.26 Several stakeholders suggested to further align Solvency II technical provisions with IFRS 17, particularly regarding contract boundaries.

Assessment

3.27 EIOPA has considered the possibility to further align the framework. However, considering that both frameworks have different objectives it is reasonable that some differences exist. Besides, it should be noted that the IFRS 17 framework is still under revision.

3.2 Risk Margin

Summary of comments

3.28 Stakeholders expressed their disappointment by EIOPA's decision not to introduce changes to the calculation of the Risk Margin.

3.29 Comments focused on a range of suggestions for changes to the specification of the calculation of the Risk Margin:

a. Challenges to the assumptions underlying the calibration of the Cost of Capital (CoC) Rate, which should be modified leading to a substantial decrease;

b. The need to allow for diversification effects between the Life and Non-Life activities of undertakings as well as among undertakings which are part of a Group;

c. The need to reduce sensitivity of the Risk Margin to changes in interest rates;

d. The need to recognize the interdependence of future SCRs over time;

e. Requests for the consideration of certain underwriting risks as hedgeable and therefore excluding them from the calculation of the future SCRs.

3.30 The majority of stakeholders supported EIOPA's proposal not to allow for the Matching Adjustment or the Volatility Adjustment in the calculation of the Risk Margin (no change to the current approach).

3.31 A few stakeholders supported the current methodology including its calibration. A few stakeholders argued that the Risk Margin should be removed completely from Solvency II, whereas a few others suggested an alignment with the Insurance Capital Standard MOCE or the IFRS risk adjustment.

Assessment

3.32 EIOPA carried out a detailed analysis of the CoC rate calculation as part of the Second set of Advice to the European Commission on specific items in the Solvency II Delegated Regulation, published in 2018. This analysis concluded that a 6% CoC rate fixed for all undertakings continued to be appropriate.

3.33 In the context of the 2020 Review of Solvency II, this analysis was further expanded to cover other components of the Risk Margin calculation, given that in this context also the text of the Solvency II Directive is open for possible changes.

3.34 As part of this analysis, EIOPA did not find evidence supporting the adoption of some of the changes proposed by stakeholders, such as linking the CoC rate to the level of risk-free rates or the allowance for longevity as a hedgeable risk.

3.35 A change to a percentile MOCE was deemed to be outside of the scope of the review, as per the Call for Advice of the European Commission.

3.36 EIOPA considers that the calculation of future SCRs should allow for the dependency of risks over time. EIOPA proposes that a this dependency should be captured with the lambda approach.

3.37 Moreover, EIOPA analysis concluded for the existence of certain elements, such as the interest rate volatility of the Risk Margin, which justify the introduction of a lambda factor in the Risk Margin calculation. The effect of such change is a progressive reduction effect of the Risk Margin, which increases with duration of the liabilities.

3.38 According to EIOPA's analysis, the proposed calibration (lambda equal to 97,5% with a floor of 50%) adequately reflects the underlying technical elements which justify its introduction, as described. Such calibration means that future SCRs receive a 22.4% reduction at year 10 and 39.7% at year 20, reaching its maximum reduction of 50% at year 28. Further reducing the value of lambda and/or the value of the floor would weaken the robustness of the supervisory role of the Risk Margin in an unjustified manner, unduly reducing the protection of policyholders.

3.39 With regard to diversification for composite undertakings, the current calculation of the Risk Margin assumes diversification within Life and non-Life (re)insurance activities, at the same level which exists for the undertaking, but does not allow for diversification effects among these two aggregates. This is due to the

assumption that the entire block of life/non-life activities is transferred and the reference undertaking does not have any other (re)insurance activities.

3.40 EIOPA concluded that allowing for wider recognition of diversification benefits in such cases would be innapropriate. The current approach is deemed to provide an adequate degree of policyholder protection and is also in line with the economic reality of many transactions reported by NSAs.

3.41 Incorporating in the Risk Margin calculation expectations regarding the anticipation of an optimal degree of diversification benefits, which are impossible to foresee, would lead to an unjustified reduction of the Risk Margin and materially reduce the degree of policyholder protection.

4. Own funds

Summary of comments

4.1 Comparison with Banking Framework : Industry stakeholders agree with EIOPA's conclusion in relation to the differences between the Solvency II Own Funds categorisation system and the advice not to align the tiering structure to banking prudential regulation.

4.2 Potential Volatility : In relation to the potential undue volatility generated by the current tiering limits and the subsequent change of the calculation basis of the limit for rT1, industry stakeholders agree with the proposal not to change the calculation basis of the limit for rT1 and not to delete the 50% limit for lower Tiers.

4.3 Double Leverage : The majority of stakeholders disagree with EIOPA's examination of "excessive" double leverage (ratio above 100%). Stakeholders have the opinion that Solvency II would provide for the elimination in group solvency of the double use of eligible own funds and of the internal creation of capital.

4.4 EPIFPs : The majority of stakeholders agree with EIOPA's advice not to change the treatment of EPIFPs and are not supportive of further work on the topic. Stakeholders indicate that a positive value of EPIFP is useful and should not be weakened by limiting its eligibility or downgrading its tiering.

Assessment

4.5 EIOPA welcomes the stakeholders' support to the authority's conclusion on the differences between the Solvency II own funds categorisation system and the banking framework and the potential undue volatility generated by the current Tiering limits and the subsequent change of the calculation basis of the limit for rT1.

4.6 The issue of excessive double leverage should be addressed as part of the clarification of the use of other measures in accordance with Article 262 of the Directive.

4.7 EIOPA is working on guidelines to clarify the calculation of EPIFP.

5. Solvency Capital Requirement standard formula

5.1 Interest rate risk

Summary of comments

5.1 The stakeholders support the introduction of a relative shifted approach as a new interest rate risk model in the standard formula. They further support the gradual introduction of the new calibration via an appropriate transitional period, given the high impact this change would have on their solvency position.

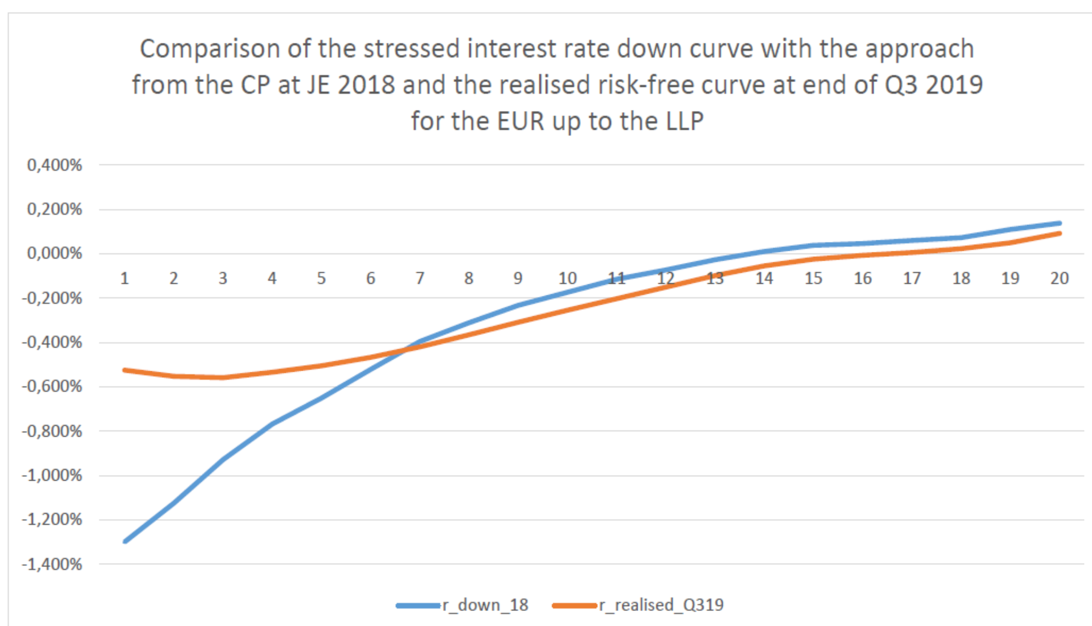
5.2 However, stakeholders disagree on the concrete calibration proposal of the relative shifted approach, arguing that:

a. the calibration is too sharp in the liquid part of the interest rate term structure and thus a floor needs to be introduced. They propose to either:
    i. lower the shift vector and introduce an implicit floor; or
    ii. to keep the proposed calibration but to amend it with an explicit floor. Specifically they propose to introduce a dynamic floor, which is derived from the minimum observed historical EUR risk-free rates and a slight prudence margin of 10 basis points.

b. the shocks for illiquid maturities need to be derived with the same extrapolation methodology which is applied for the derivation of the basic risk-free rates, where the extrapolation is performed after the last liquid point (first smoothing point) up to a shocked UFR of +-15 basis points. Only such an approach results in economically reasonable shocks for illiquid maturities. Moreover, an extrapolation approach ensures consistency with the valuation of liabilities and it is in line with the current UFR methodology. Finally, the extrapolation methodology takes currency specifics fully into account.

Assessment

5.3 **Lower the shift vector**
EIOPA disagrees with the statement that the calibration is too sharp in the liquid part of the interest rate term structure. A back testing exercise in 2019 (see figure below) clearly proves that at an overall level, the calibration is not too sharp. It is worthwhile noting that the calibration proposal even underestimates the realised interest rate movements in 2019 for many maturities. In the figure below, the blue curve corresponds to a shocked curve with a 99,5% calibration and it is actualy higher than the actual observed rates for medium terms maturities.



5.4 **Introduction of an explicit floor**

The calibration may be perceived to be too sharp especially for business lines where investment in short maturities is significant part of the portfolio. While, it is true that there is no empirical evidence to set such a floor at technical level, it is also true that we have never experienced such low interest rate levels to fully confirm the recalibration proposal. From that perspective, EIOPA acknowledges that a floor, which might become binding in the worst interest rate scenarios for shorter maturities, might be considered. In this respect a static floor, which is derived from the minimum observed interest rates for all currencies and a sufficient prudence margin, is more appropriate than a dynamic floor proposed by the industry. Such a static floor would significantly reduce the probability that the interest rate risk is underestimated and thus a frequent adjustment of the floor.

5.5 **Extrapolation and shocks for illiquid maturities**

Concerning the extrapolation proposals from the industry, EIOPA acknowledges that these would ensure consistency with the valuation of liabilities and the current UFR methodology and better take currency specifics into account. However, the main drawback of the proposal is that it might underestimate interest rate risk for longer maturities. Such an underestimation could particularly materialise if the market risk-free interest rate curve turns around at the FSP (takes the form of a hump-shaped curve) or the interest rate curve is underestimated at the maturities around the FSP (e.g. at the Q3 2019).

The most important objective for calibrating shocks for illiquid maturities is to measure interest rate risk appropriately, particularly to avoid an underestimation of interest rate risk. This objective is deemed more important than the objective to solely achieve consistency with the valuation and the UFR methodology.

Currently there is neither an indication that the interest rate risk with the simple linear interpolation approach systematically over nor that it underestimates the interest rate risk. Given that the consistency issues are deemed less relevant, EIOPA proposes to keep the simple linear interpolation approach for illiquid maturities.

5.2 Spread risk

Summary of comments

5.6 The views on the options can be grouped into three categories:

a. Two individual stakeholders expressed a preference for a long-term spread risk module;
b. Three associations expressed a preference for the Dynamic VA, but in their view also the long-term options could be given chance. However, they argued that the proposed conditions were too restrictive: ring-fencing, only EEA bonds and loans, conflicts with ALM. Moreover, InsuranceEurope/CFO Forum/CRO Forum were of the view that the long-term spread risk modules should benefit from the same reduction in spread charges as the matching adjustment;
c. Five stakeholders were in favour of the Dynamic VA, dismissing or being silent on the long-term spread risk options.

5.7 A couple of stakeholders argued for reconsidering/revisiting the spread risk treatment of specific asset classes: mortgage loans, private/unrated debt and (non-STS & STS) securitisations.

Assessment

5.8 The EIOPA view is to maintain the advice for no change (option1) of the SCR spread risk module.

5.9 In general the public consultation did not yield new information that would necessitate EIOPA to change its advice. In particular, there appears no broad support for the options on the long-term spread risk modules.

5.10 Revisiting/recalibrating the spread risk treatment of specific asset classes (mortgages, securitisations, private/unrated debt) is not within the scope of the Call for Advice. These issues were to a large extent covered by previous EIOPA advise included in the technical report calibration of certain long-term investments and the advice on specific items in the Solvency II delegated regulation.

5.3 Property risk

Summary of comments

5.11 Most stakeholders comment primarily on the calibration of property risk in the standard formula, arguing for a pan-European data-based approach most likely

resulting in a reduction of the shock to 15% on the basis of the results of the MSCI / INREV study which was published in 2017.

5.12 The ESRB argued against changes in the calibration on the basis of scarce and not comparable data as well as macroprudential considerations. Indeed, the ESRB identified vulnerabilities in both commercial real estate and residential real estate related to the level of household indebtedness, the growth of mortgage credit and signs of loosening of lending standards, house price growth and overvaluation of residential real estate.

Assessment

5.13 EIOPA focused its analysis on the further development of a single common property risk shock based on data from multiple countries. Despite the situation has improved compared with the original calibration work, EIOPA still encountered substantial data limitations which make it hard to justify an evidence-based recalibration of property risk, mainly:

- Limited length of the time series;
- Limited geographical coverage (evidence presented by stakeholders often leaves aside countries for which some evidence exists pointing to very high volatility);
- Strong mismatch between available calibration data (predominantly residential property) and actual exposures of European (re)insurers (largely commercial property).

5.14 The assessment of the current-COVID19 situation does not bring arguments implying that the property risk calibration is not appropriate. The impacts from COVID19 are yet to be seen in a property market and the forecasts that can be made are not in favour of a re-calibration.

5.15 Analysis of data from Internal Model users further suggests that the current calibration is appropriately reflecting the envisaged VaR 99,5% for 1-year time horizon.

5.4 Correlation matrices

5.4.1 Policy issue 1 - Overall structure of the market risk correlations

Summary of comments

5.16 The views of stakeholders on the need to change the correlation parameters of the market risk module and between that module and lapse risk differ. While some stakeholders support the current correlation parameters, other suggest changes, mainly as follows:

a. To reduce the correlation parameter between interest rate risk (downward scenario) and spread risk from 0.5 to zero, in particular because the

correlation between interest rates and spreads risk during the last year is lower than the current parameter.

b. To reduce the correlation parameter between market risk and life underwriting risk from 0.25 to zero in order to mitigate double counting effects, for example that after a mass lapse event a fall of equity markets would have less effects in absolute terms (and vice versa).

Assessment

5.17 EIOPA has carried out further analysis of the empirical dependency between interest rate risk (downward scenario) and spread risk. The results of the analysis support the reduction of the correlation parameter from 0.5 to 0.25. The results also show that a reduction to zero would not be justified. Stakeholders estimated a zero correlation for both risks. But the time series that the estimate is based on covered only one year and may therefore not fully reflect the dependence between the risks. Furthermore the estimates do not take into account tail dependence what is necessary for the correlation parameters in order to produce an aggregated SCR that corresponds to 99.5% VaR. The change of the correlation parameter between interest rate risk (downward scenario) and spread risk significantly reduces the probability of a material cliff effect. Apart from that, in order to assess the likeliness of cliff effects EIOPA has compared the capital requirements for the upward and downward interest rate scenario of insurance and reinsurance undertakings for the end of 2018. For 98.4% of the undertakings applying the standard formula the capital requirement for the non-relevant scenario was less than 80% of the capital requirement for the relevant scenario. For the vast majority of the remaining undertakings the capital requirement was small (less than EUR 10mn). This indicates that a material cliff effect is an exceptional event.

5.18 With regard to the correlation parameter between market risk and life underwriting risks it should be noted that there are relevant scenarios which show a material dependence between market risks and lapse risk. In particular, an increase of interest rates can cause an increase of lapse rates because the guaranteed rate of existing contracts become unattractive. A zero correlation parameter would therefore not be justified.

5.4.2 Policy issue 2 - Two-sided correlation parameter with interest rate risk

Summary of comments

5.19 Split views:

a. Some support of keeping a two-side correlation structure since the economic rationale is robust enough to support the assumptions related to the Interest Rate down side. Furthermore, in a market downturn scenario, an interest rate decrease could arise also from a reduction of Inflation. Given the lack of such dependency economic justification and robust

quantitative support for the Interest Rate Up side, keep a correlation equals to 0 seems to be reasonable.

b. To abandon two-sided correlation parameters, at least between interest rate risk and spread risk, in order to avoid cliff effects in the level of the SCR when the relevant interest rate risk scenario (upward or downward shift) changes.

Assessment

5.20 The proposed change in the context of Policy issue 1 (i.e. overall structure of the market risk correlations) to reduce the correlation parameter between interest rate risk (downward scenario) and spread risk significantly reduces the probability of a material cliff effect.

5.5 Counterparty default risk

5.5.1 Simplified calculation of the risk-mitigating effect of derivatives, reinsurance arrangements, special purpose vehicles and insurance securitisations

Summary of comments

5.21 Stakeholders support the proposed simplification.

Assessment

5.22 EIOPA confirms its proposal for the simplification.

5.5.2 Identification of the largest man-made exposures

Summary of comments

5.23 The views of stakeholders on the identification of the largest man-made exposures differ. While some stakeholders support the proposed change or no change, the majority of stakeholders suggest to base the counterparty default risk calculation on the largest risk concentration net of reinsurance. These stakeholders argue that this approach correctly captures the risk, is consistent with the calculation of the capital requirement for man-made risk and less burdensome than the consultation proposal.

Assessment

5.24 In view of the stakeholder comments received EIOPA proposes to base the counterparty default risk calculation on the largest risk concentration net of reinsurance. This approach is consistent with the calculation of the capital requirement for man-made catastrophe risk and therefore correctly captures the credit risk less burdensome than the consultation proposal.

5.5.3 Forborne and default loans

Summary of comments

5.25 Stakeholders disagree with capturing the risk of forborne and default loans in the counterparty default risk module instead of the spread risk sub-module and suggest to introduce instead a special treatment for these exposures in the spread risk sub-module.

Assessment

5.26 EIOPA believes forborne and default loans should be in the scope of the counterparty default risk module because it the approach of that module ensures a better risk measurement for these exposures and allows aligning the capital requirements between the insurance and banking regulation, thereby reducing the risk of cross-sectoral arbitrage.

5.5.4 Floor to loss-given-default of mortgage loans

Summary of comments

5.27 The ESRB suggests the introduction of a loss-given-default floor for residential mortgage loans which authorities can increase during times of exuberance. This would also correct the inconsistency in the microprudential capital requirements between the insurance and the banking frameworks, while taking into account the risk-bearing capacity of the insurance sector.

Assessment

5.28 EIOPA believes that the allowance for such a floor may result in inconsistent application across countries.

5.6 Calibration of underwriting risk

Summary of comments

5.29 Most stakeholders expressed the view that the mass[1] lapse scenario where the stressed discontinuance rate is currently set at 40% for all underwriting risks was too high and lacked proper justifications. The main arguments put forward against this scenario can be summarised as below:

a. The current calibration is not supported by evidence, e.g. results from models calibrated on representative data are lacking and thus no discussion on the validity of the assumptions chosen is possible.

    i. Some stakeholders therefore suggest to use the widespread Vasicek credit risk model calibrated on past lapse events to capture both systematic components of such events and idiosyncratic ones.

    ii. Other stakeholders pointed to an academic paper using the Extreme Value Theory to calibrate such extreme events. [2]

---

[1] The Delegated Regulation mentions ‘mass lapse’ for life and SLT underwriting risks, while only ‘lapse’ is used for non-life and NSLT health underwriting risks. Despite this difference in terminology, the stressed discontinuance rates are set at 40% in both situations.

[2] Biagini et al: Estimating Extreme Cancellation Rates In Life Insurance, 2019

b. Finally some stakeholders provided lapse data from national markets.

5.30 The assumption that the risk margin should be kept unchanged after the realisation of the scenario is not realistic: the risk margin would actually mechanically decrease, thus reducing the impact of the lapse scenario on the whole technical provisions. Therefore a pragmatic solution to account for this shortcoming would be to lower the stressed discontinuance rate.

5.31 Moreover, based on national observations, one stakeholder supported a lowering of the absolute ceiling in the permanent decrease of life lapse rates from 20 to 10 percentage points.

Assessment

Regarding mass lapse risk:

1. EIOPA looked at the models and resulting figures provided by stakeholders and observed the following:
   a. Having a single model for both "regular" lapses and extreme (or "mass") ones will most likely underestimate the extremes. Moreover, as any calibration approach based on past data, the past might not be representative of the future. Finally the random components in the Vasicek model assume a normal distribution whose tails are known to be too thin to appropriately represent the occurrence of extreme events.
   b. The Extreme Value Theory model was calibrated in an economic period of decreasing interest rates, therefore providing quite an incomplete range of variations from one of the main risk drivers, and eventually most likely underestimating the actual mass lapses if the model were to be applied in a context of increasing interest rates.
   c. The observations of past lapses occurred in some national markets and provided by some stakeholders were either not representative enough of the whole European market for the underlying risks or the time series were not long enough.
2. If the mass lapse scenario actually occurred, it would indeed decrease the risk margin. However EIOPA is of the opinion that in particular this phenomenon is sufficiently captured in the recently proposed new risk margin approach that keeps the complexity of the calculation at a reasonable level.

With regard to the change of the absolute ceiling in the permanent decrease of life lapse rates, EIOPA looked at the study provided by the stakeholder. Although this study is covering almost the entirety of the national market in question, from a general perspective it is not sufficient to envisage a change in the whole Standard Formula calibration supposed to fit (re)insurance undertaking across Europe "on average". Besides, even at national level, the observations considered are only covering 10 years during which the interest rates continually decreased, thus potentially underestimating lapse rates that would be observed in a continuously increasing interest rates environment.

Revision of specific pieces of advice in light of Covid-19 .

Lapse risk

5.32 For the consultation paper for the 2020 review of Solvency II EIOPA analysed lapse risk data for SLT health insurance that were provided by stakeholders. The conclusion of the analysis was that the data are not sufficient to advice for a change of the current risk factors for lapse risk.

5.33 In April 2018, the European Commission submitted a request to EIOPA to report on insurers' asset and liability management in relation to the illiquidity of their liabilities3. EIOPA also issued a questionnaire to national supervisory authorities on the areas of tax incentives and lapse rates. According to the relevant conclusions in the "Report on insurers' asset and liability management in relation to the illiquidity of their liabilities" (EIOPA-BoS-19-593, issued 16 December 2019), there is "no strong connection between surrender rates and the existence of disincentives to surrender" (see page 32).

5.34 EIOPA decided to re-collect data from the industry on the lapses from 2015 to Q2 2020 (separately for line of business and separately business that is subject to disincentives to lapse). The majority of respondents reported incomplete data; consequently it is not possible to aggregate the lapse rate across undertakings for large samples. A visual analysis of the time series of lapse rates provided did not identify a general pattern at the beginning of the pandemic in Q2 2020. In particular lapse rates did not generally increase in response to the outbreak of the pandemic.

5.35 **The results do not indicate that the current lapse calibration needs to be changed. In particular the data do not provide a basis to introduce distinctions in the lapse calibration between insurance businesses that is subject to disincentives to lapse and other business.**

Health insurance pandemic risk

5.36 The consultation paper did not cover the calibration of the pandemic risk sub-module.

5.37 In the complementary information request EIOPA collected data from (re)insurance undertakings applying the standard formula on the health insurance claims caused by the pandemic until the end of Q2 2020.

5.38 The sample of undertakings which reported data on pandemic risk consists of 97 undertakings (40 non-life, 31 composite, 22 life and 4 reinsurance undertakings), representing a market share of 37% (measured in terms of SCR for pandemic risk at the end of 2019). In the sample, the Covid-19 related claims correspond to 9% of the SCR for pandemic risk at the end of 2019.

5.39 **It should be noted that the data base covers only about three months since the outbreak of the pandemic. An analysis covering a longer period might come to a different result. A revision of the calibration of the pandemic risk SCR until December 2020 will not be possible.**

[3] EIOPA was specifically asked to provide detailed information on the liquidity of insurance undertakings' liabilities, taking into account, inter alia, (i) contractual options to (partially) redeem those liabilities before maturity;(ii) the related contractual penalties; (iii) the related tax incentives.

5.7 Catastrophe risk

Summary of comments

5.40 Most stakeholders call for greater transparency in the data and assumptions underlying the current parameters of the Standard Formula natural catastrophe risk sub-module in order to check its adequacy and make adjustments, where required. Some stakeholders express the need for undertaking-specific parameters to model these risks more appropriately. Stakeholders also stress the need for regular examination of the risk factors to ensure they are adequately calibrated.

5.41 Stakeholders support the publication of the average policy conditions collected through the information request by EIOPA. However they suggest to consider some of the collected figures with caution because of the amendments brought by EIOPA to the technical specifications in the course of the information request.

5.42 Some stakeholders argue that, compared to alternative generally accepted catastrophe models, the current parameters of the Standard Formula are overestimating the catastrophe risks they are specifically exposed to.

5.43 Other stakeholders ask for more transparency with regard to the members and work of the CAT risks expert network set up by EIOPA at the beginning of 2019, and express their wish of being represented in this network.

Assessment

5.44 Where possible, through this Opinion and future work of the EIOPA CAT risks expert network, EIOPA is willing to make the data and assumptions underlying the current and future parameters of the Standard Formula natural catastrophe risk sub-module more transparent. Regarding the use of undertaking-specific parameters to model these risks, EIOPA is of the opinion that, in the absence of a common modelling method, this is currently not feasible. In this respect EIOPA is not aware of proposals from stakeholders for such a common method. Moreover EIOPA is of the view that introducing undertaking-specific parameters to model this sub-risk, although better taking into account undertakings' specificities w.r.t. these risks, would add too much complexity to an already complex framework.

5.45 In light of the potential effects of climate change on natural catastrophes occurrence and intensity, EIOPA called in particular for regular recalibrations of this risk sub-module in its September 2019 Opinion on sustainability within Solvency II Pillar 1.

5.46 EIOPA is aware of some limitations in the collected data and has processed them accordingly.

5.47 Regarding the potential overestimation of the Standard Formula current risk parameters for some perils in some regions, EIOPA did not receive during this consultation any evidence and data supporting lower parameters. It is to be noted that the current calibration of the standard parameters for the natural catastrophe risk module of the standard formula does not explicitly include

climate change risks as stated in EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation (EIOPA-BoS-18/075). In consultation with the EIOPA CAT risks expert network, EIOPA is preparing a discussion paper on the methodology for the potential inclusion of climate change in the natural catastrophe risk module of the standard formula.

5.48 As regards the activity of and membership in the EIOPA CAT risks expert network, EIOPA selected the interested applicants at the end of a public call for interest launched in December 2018 on the basis of their expertise in the modelling and/or underwriting of catastrophe risks as well as in climate change risks. EIOPA was in particular seeking expertise from academia and the industry (brokers, reinsurers, model vendors and data analysts).

5.8 Risk mitigation technique

5.8.1 Non-proportional reinsurance

Summary of comments

5.49 Views are mixed. While some prefer to keep standard formula simple and do not support a change, others are of the view that some non-life lines of business might be amended to include factor for non-proportional reinsurance.

5.50 Four approaches were suggested by one stakeholder:

- the first is inspired by the South African prudential framework,
- the second is based on the methodology proposed by stakeholders in the 2018 review to recognise adverse development covers,
- the third consist in allowing USP for non-proportionate reinsurance factors,
- the fourth implies to extend the use of current non-proportionate reinsurance factors to all lines of business.

Assessment

5.51 EIOPA assessed the outcome of the HIA and the comments from stakeholders. EIOPA agrees that the SF should be simple and easy but also give recognition to proper risk mitigation from reinsurance. Based the outcome of the HIA EIOPA concluded that the proposal from the HIA is probably not simple enough to give good results. The assessment (of the comments and the numbers from the HIA) shows that there is little appetite to change the simple approach as currently in the regulation.

5.52 An earlier assessment of a combination between a simple approach and more risk-based approach (sort of USP-light) was put aside because of foreseen complications wrt the use of the 'regular USP'.

5.8.2 Recognition of adverse development covers

Summary of comments

5.53 Most of the answer claim that adverse development covers (ADC) should be recognised in the standard formula thanks to the solutions to extend recognition of non-proportional reinsurance.

Assessment

5.54 EIOPA reviewed the proposal by stakeholders on the recognition of ADC in the standard formula and also reviewed the EIOPA-advice from 2018 on the same topic.

5.55 Based on this re-assessment and supported by new information received from stakeholders, EIOPA prepared a new proposal on the recognition of Adverse development covers.

5.8.3 Recognition of finite reinsurance

Summary of comments

5.56 Views are split. Some support a change while other advocate for not recognizing finite reinsurance as a RMT in Solvency II. One ratio is suggested by some stakeholders to limit the amount of finite reinsurance to be recognized. It relies on a stress test approach aiming at assessing the absorbing loss capacity of finite reinsurance schemes.

Assessment

5.57 EIOPA maintains its advice for a non-recognition of finite reinsurance.

5.58 As acknowledge by stakeholders, finite reinsurance is of various type. EIOPA does not support a one-size fits all approach. The Allowance Ratio as proposed does not take into account specific features of instruments and introduces a one-size-feats-all approach that is inappropriate to deal with the vast variety of finite reinsurance schemes. Furthermore, the calculation of the Allowance Ratio would imply that undertakings define their own of 1/200 years stress scenario. This is contradictory to the standard formula assumptions.

5.8.4 Recognition of a financial risk-mitigation technique

Summary of comments

5.59 Regarding the treatment under standard formula (SF), no specific comment is raised on the proposed treatment.

5.60 Regarding the treatment of such instruments under internal models (IMs), the views of stakeholders differ.

5.61 Some stakeholders would be in favour of recognition under IMs. They consider that IMs provide flexibility to properly capture risk profile and recognize the economic impact of contingent instruments under close supervisory scrutiny.

5.62 On the other hand, some stakeholders would prefer a non-recognition under IMs to favour a consistent treatment between standard formula and internal model that would bring a better comparability of results between companies.

5.63 Regarding the proposal to clarify Article 101 not to include basic own fund increases (question 5.7 of the public consultation), some stakeholders welcome the clarification. On the opposite, some consider that the clarification would have the unintended consequence of restricting the interpretation of the 1-year VaR for internal models.

Assessment

5.64 EIOPA maintains its advice for a non-recognition of these instruments under standard formula.

5.65 A consistent treatment between standard formula and internal models would conduct to a non-recognition of those instruments. Furthermore, even if IMs provide flexibility to properly capture risk profile, the proper modelling of these instruments remains challenging for undertakings, especially in a stressed environment. Indeed, even if the counterparty risk is adequately taken into account (which is challenging considering the specificities of such instruments), it would still be necessary to properly assess the risk that the agreement would not be executed as theoretically intended in case of litigation (e.g. related to the definition of the triggers).

5.66 For those reasons, EIOPA recommends not to recognize such instruments under internal models.

5.9 Reducing reliance on external ratings

Summary of comments

5.67 Most stakeholders support the proposal to not to make a change at this stage with regard to the reduction of the reliance on external rating. In their view it would not be appropriate to extend the internal assessment approach introduced in Article 176a of the Delegated Regulation to rated debt. Before introducing new methods, experience with the new methods from the SCR review should be gained. The industry stakeholders highlight that the recent changes targeting internal assessments for unrated debt are very burdensome to apply in practice, not least because of the extensive criteria and the practical difficulties in assessing whether the criteria are met. Some comments stressed that, in order to reduce the reliance on external ratings, that internal ratings, that are considered by a (re)insurer as part of its approved internal model, should in general be eligible for use in the standard formula calculations of entities that belong to the same insurance group (irrespective whether the exposures are externally rated or unrated).

Assessment

5.68 Having regard to the remarks raised, EIOPA upholds its proposal not to make a change at this stage. Changes should be based on the know-how gained in the future by applying the previously introduced new methods. Particular attention could then also be put on the use of the approved internal models.

5.10 Transitionals on government bonds

Summary of comments

5.69 Most stakeholders supported the draft advice, proposing no change to the existing transitional, which expired at 01/01/2020.

Assessment

5.70 EIOPA performed an additional analysis focusing on the issue of cross-sectoral consistency. Such consistency has been disrupted by the introduction of a grandfathering provision in the banking framework, for similar exposures incurred before 12 December 2017.

5.71 This situation creates an un-level playing field, to the detriment of insurance undertakings. Such distortion in the competitive landscape should be addressed, given that both sectors usually compete in the market for attracting consumer long-term savings.

5.72 Taking all elements into consideration, namely the immateriality of the issue at EEA level, EIOPA advises the introduction of a grandfathering provision exempting exposures to Member States' central governments or central banks denominated and funded in the domestic currency of any other Member State, which were incurred before 31 December 2019, from the calculation of the concentration risk and spread risk sub-modules in accordance with the standard formula.

6. Minimum Capital Requirement

6.1 25%-45% corridor

Summary of comments

6.1 Regarding the use of the 25%-45% corridor, most stakeholders agreed with EIOPA not to change it for simplicity reasons. Other stakeholders reported that enlarging the corridor will improve the use of the calculated MCR and would be closer to the risk profile of the undertaking. A few other stakeholders advocated the use of a single value of 35% instead of a corridor for simplification purposes.

Assessment

6.2 Based on the input received, EIOPA considers that the current 25%-45% corridor strikes a balance between, on the one hand, the application of a simple, robust calculation with the linear MCR and, on the other hand, the risk-sensitivity of the MCR and the consistency between MCR and SCR.

6.2 Notional MCRs for life and non-life activities

Summary of comments

6.3 As regards the calculation of the notional MCRs for life and non-life activities, most stakeholders supported the deletion of the calculation of these MCRs for simplifications purposes.

Assessment

6.4 The deletion of the notional MCRs for life and non-life activities would simplify the MCR calculation for composite insurance undertaking. However it would not be in line with the separate management of life and non-life insurance and may contribute to an unlevel playing field between composite insurance undertakings and other insurance undertakings. In balance EIOPA suggests to keep the calculation of the notional MCRs.

6.3 Non-compliance with the Minimum Capital Requirement

Summary of comments

6.5 Most stakeholder support the need of direct reporting but do not see a need to further specify the requirement for the insurance undertaking under Article 139(1) of the Solvency II Directive to inform the NSA immediately if they observe a non-compliance with the MCR. Most stakeholder saw no need to inform the NSA on an estimated level of the breach of MCR if undertaking is unable to give an exact amount in a short timeframe.

Assessment

6.6 Within the current regulation convergence on when NSAs expect to be informed of a breach of the MCR should be achieved esepecially since the text states 'immediately'. Certainty on the exact level of the MCR of the insurance ndertaking and clear governance (AMSB to be involved) are of immenent importance but should not lead to a delay in informing the NSA oa a breach of the MCR. After carefull consideration of the above, EIOPA sees that the benefits of the proposed ammendement overcome the downside of issues presented by stakeholders and porpose no changes to the preferred policy option.

6.4 Qualification of risk of non-compliance

Summary of comments

6.7 Stakeholders support EIOPA's advice to bring more clarity to the requirement incorporated in Article 139 (1) of the Solvency II Directive stating NSA should be informed in case of a risk of non-compliance within the following three month.

Assessment

6.8 After carefull consideration of the above and taking into account that the proposal does not lead to a change in the Solvency II Directive the text has been deleted to shorten the advice.

6.5 Supervisory action taken in case of a likely non-compliance of MCR

Summary of comments

6.9 Several stakeholders do not support the introduction of a realistic finance scheme to be requiremed in case of a near breach of the MCR, either because they do not see the need or because the procedures for a breach of MCR and a near breach of MCR would then be the same and possibly confusing. One stakeholders supported the proposal another stakeholder supported further clarification on Level 2 and 3 of the Solvency II Reguations.

Assessment

6.10 After carefull consideration of the above and taking into account the importance of managing a near breach of MCR effectively with timely actions EIOPA sees that the benefit of the proposed ammendments and the clarifications at Level 2 and Level 3 of the Solvency II Regulations overcome the downside of requirements for more structured approach to handling a near breach of MCR.

6.6 Practises for restriction or prohibitions of the free disposal of assets

Summary of comments

6.11 Although one stakeholder supports the proposal to clarify the text of Article 139(3) of the Solvency II Directive several stakeholders state they see no need to clarify the conditions under which a restriction or prohibition of the disposal of the assets should be considered since the application of the Article does not lead to any difficulties in many Member States and might lead to less flexibility in Member States where the use of the article does not cause any challenges.

Assessment

6.12 After carefull consideration of the above, EIOPA sees that the benefits of the proposed amendment overcomes the downside of issues presented by stakeholders and proposes no change to the preferred policy option.

6.7 Withdrawal of license processes

Summary of comments

6.13 Most support the aim of the proposal to reach convergence, however there are also some concerns, that the procedure for setting conditions for a possible extention of the 3 month period to comply with the MCR requirement could lead to complicated procedures wich might at the same time lead to less convergence.

Assessment

6.14 After careful consideration of the above, EIOPA sees the downside of setting further criteria for extention of the 3 month period for the insurance undertaking to comply with the MCR and therefore decided to delete the proposal on setting conditions for an extention of the period.

6.8 Supervision by NSAs post withdrawal

Summary of comments

6.15 All stakeholder support the proposal to specify if and to what extend an undertaking whose authorisation has been withdrawn comes under supervision, while some at the same time recognising that not all parts of the Solvency II Regulation can still be fully applicable.

Assessment

6.16 After carefull consideration of the above EIOPA proposes to no change of the proposed policy option.

7. Reporting and disclosure

General issues – Summary of comments

7.1 Prior to the introduction of Solvency II, supervisory regular reporting requirements were based on Solvency I which derived from national GAAP. An analysis of these regular reporting requirements within the Member States showed a wide range of different levels of detail of information to be provided to NCAs.

7.2 With the introduction of Solvency II the regular supervisory reporting based on national GAAP was not harmonised and the (high) required depth and detail - in some Member States, e.g. Austria - remained unchanged. Therefore the insurance industry (especially in those Member States which kept the extensive and detailed regular reporting requirements to NCAs based on national GAAP unchanged) continues to be faced by a significant burden of regular reporting requirements which industry considers is no longer justified with the introduction of Solvency II.

7.3 To reduce the overall burden of regular reporting requirements to NCAs, industry recommends that all regular reporting requirements outside the scope of Solvency II should be required to be analysed by NCAs with a view to being discontinued unless there is clear rationale for retention.

Assessment

7.4 Supervisory reporting based on national GAAP is not within the scope of Solvency II. The Solvency II framework cannot impose requirements or limit reporting outside the scope of Solvency II. Hence, undertakings should address specific concerns to the relevant national NCAs. In any case EIOPA is aware of the concern and also recommends NCAs to consider industry comments and concerns and to keep the national specifc reporting requirements only if fit for purpose.

Quarterly reporting - Summary of comments

7.5 The supervisory reporting requirements include an annual reporting and the reporting of 4 quarters. The reference date of the Q4 coincides with the reference date of the annual reporting. Stakeholders, during the regular dialogue and as part of the Call for Input performed by EIOPA raised concerns regarding this duplication between Q4 and annual reporting and asked for deletion of the Q4 reporting. Considering that Q4 reporting is crucial for the supervisors risk assessment frameworks and the calculation of early warning indicators on a timely fashion, EIOPA proposed to keep Q4 reporting.

7.6 During the public consultations the stakeholders again raised their concerns and proposed deletion of Q4 reporting.

7.7 ECB strongly supported EIOPA's proposal highlighting that a complete set of quarterly data at the same deadlines for each quarter is a prerequisite for the "integrated reporting approach for supervisory and statistical data" to work. If the Q4 data were to be dropped for supervisory purposes, ECB would have to in any case collect all the necessary templates for ESCB statistical purposes for Q4.

Assessment

7.8 Quarter 4 data received within the quarterly reporting deadlines is crucial for the Supervisory Review Process. However, the scope of the quarterly reporting was revised and streamlined when possible without jeopardising the aim of reporting.

7.9 In addition Information is needed for ECB and if would be decided to be dropped for supervisory purposes, all necessary templates for ESCB statistical purposes for Q4 will still be collected for the relevant Member States.

Deadlines - Summary of comments

7.10 The industry welcomed EIOPA's proposal for extending the deadlines for annual reporting. While some of the stakeholders strongly supported keeping the deadlines to quarterly reporting to 5 weeks others requested to also increase the quarter deadlines from 5 weeks to 6 weeks. Other proposals were in introducing the deadlines in days instead of the weeks.

7.11 ECB highlighted that a high timeliness for quarterly reporting is a prerequisite for the "integrated reporting approach for supervisory and statistical data" to work and that Regulation ECB/2014/50 on statistical reporting requirements for insurance corporations even foresees an assessment of merits and costs of further reducing the transmission deadline by reporting agents to 4 weeks.

7.12 Some of the stakeholders also commented that the current legislative framework requires to send the narrative information (SFCR and the qualitative part of the RSR) and the quantitative information (annual QRTs) by the same deadline and suggest to allow the submission of the narrative information one month later than the submission of annual QRTs.

Assessment

7.13 The change from weeks to working days would create a material miss-alignment of the reporting deadlines not only between different Member States but as well within one unique Member State and is not seen as adequate.

7.14 Quarterly deadlines were kept but EIOPA proposes an extension of annual reporting deadlines. In addition, EIOPA considered that the quantitative and qualitative information could be reported/disclosed at different points, with narrative information being reported/disclosed 2 weeks after the annual QRT.

Currency of the contract instead of reporting currency - Summary of comments

7.15 Stakeholders welcomed the proposal to keep the *status quo* and the introduction of totals in reporting currency when only the original currency is reported. Only one stakeholder commented against the proposal of reporting totals in reporting currency saying that costs will exceed the benefit.

Assessment

7.16 EIOPA analysed the comments received and taking into account also the input received during the Call for input to the industry at the beginning of 2019 decided not to propose changes in this area taking into account the contradictory signs from stakeholders and in particular the burden of any change compared to keeping the *status quo*.

Captives insurance and captive reinsurance undertakings - Summary of comments

7.17 According to the stakeholders granting an automatic exemption from quarterly reporting to captives would be an appropriate risk-based application of proportionality as intended in the Solvency II Directive. It would ensure a harmonised approach to the supervision of SME-sized captives across the EU and would help to ease the supervisory reporting burden for captives and to allow industrial and financial groups in the EU to continue to rely on captives as a valuable and cost-effective tool for effectively and efficiently managing risk.

7.18 The industry highlights that captives are of no systemic importance for the financial system in its entirety. In some jurisdictions there are some positive examples of proportionality being applied to captives but there is a wide divergence among NCAs in the application of proportionality. Due to their risk profile, captives should be exempted from certain reporting requirements, e.g. the quarterly reporting and essential parts of the SFCR. The industry welcomes that EIOPA suggests an exemption from the newly proposed SFCR for policyholder.

7.19 In particular, the industry also proposes that any undertaking which meets the definition of a captive under Article 13 of the Solvency II Directive should be exempted from S.19.01. Recognising the significant costs that are involved in reporting this template, and the specific risk profile of captives as discussed above, this would be an appropriate application of proportionality in line with Article 29 of the Solvency II Directive, which takes into account the specific nature of captives, as intended per Recital 21 of the Directive.

Assessment

7.20 EIOPA believes that setting an automatic exemption from quarterly reporting for captives would limit the supervisory power of NCAs and would not provide the necessary information to monitor the risk profile of captive undertakings. EIOPA understands that the risk profile of a captive insurance or reinsurance undertaking is usually stable, but it also acknowledges that the risk profile can also be subject to material fluctuations that can only be monitored through the information captured via quarterly reporting, as for other entities. It should also be considered that EIOPA is proposing a new framework to implement proportionality principle which will also be applicable to captives.

7.21 However, recognising the specific risk profile EIOPA proposes a number of simplifications to be applicable for the quarterly and annually reporting, namely regarding item-by-item templates, split by currency in S.16 and S.19, simplification of S.27 and exemption from S.29.

Reinsurance undertakings - Summary of comments

7.22 Stakeholders welcomed the proposals.

Assessment

7.23 EIOPA kept its proposal as initially consulted.

Solvency and financial condition report - Structure, content, addresses and language - Summary of comments

7.24 The industry broadly welcomes EIOPA's conceptual idea to split the SFCR into a policyholder section and a professional section and of further streamlining the structure by putting together some parts of the report. Further support was given to the idea of specifying the trigger to the update of the SFCR and standardising tables in the report.

7.25 Industry is supportive of EIOPA's objective to remove the significant duplication between the SFCR and other sources of information, such as insurance companies' annual reports. Industry is also supportive of EIOPA's call to remove "padding" and generic statements and asks EIOPA to consider setting out guidelines on this.

7.26 Industry sees the introduction of two different and clearly defined stakeholders – the policyholder and the professional users - as an improvement.

7.27 EIOPA's proposals for a "concise, simple, objective, balanced and non-promotional" policyholder part are sensible. Industry asked EIOPA to confirm that this can be achieved within a two-page document and stressed that the improved format should not lead to increased workload.

7.28 At the same time however, the industry is disappointed by EIOPA's lack of ambition to make much needed changes requested by the industry. Specifically:

- The content of the section for professionals in the SFCR remains largely unchanged, the industry believes the professional section should be limited to quantitative templates only;
- There are many duplications between the SFCR and other reports, for example the annual report RSR, that should be addressed. Corporate governance, an area covered by other regulations on which information is publicly available, should not be required either in the SFCR or the RSR;
- It is noted that in industry opinion there will be no reduction in the reporting burden, as it appears that the items no longer required will be moved to the RSR. Industry also notes with concern EIOPA's intention to increase its prescription of how the SFCR should look, for example with the inclusion of more structured formats such as prescribed graphs and tables. Instead of requiring undertakings to include standard EIOPA text defining various terms, industry proposes that the SFCR should provide a link to an EIOPA web page where these definitions are provided.
- The industry is concerned by the lack of detail on EIOPA's proposed harmonised tables. It is not clear to what extent they will resemble what insurance undertakings already do, and what new information they will contain. In principle, insurers disagree with this level of prescription within the SFCR – companies should be able to provide the information they wish, as the requirement is to provide information as set out in the financial statements.

7.29 Regarding language requirements at group level, in general stakeholders welcome EIOPA's proposal to remove DR Art 360 (3), and as such no longer requiring the translation of the summary into the official language(s) of the Member State where any of the (re)insurance subsidiaries of the participating (re)insurance undertaking, IHC or MFHC has its head office.

7.30 Some stakeholders suggested that the language requirements for the Group SFCR that the summary must be available in the national language and more detailed information could be provided in English and only the executive summary should be translated in the national languages.

7.31 Other stakeholders commented that they would prefer all reports to be reported in their native language and in English to make cross border comparaisons easier and this to enhance the integration of the European financial market.

7.32 Regarding the language of the solo SFCR the industry commented that the choice of language is unclear in respect of companies with cross border activities and asked EIOPA to clarify how the requests from NSAs would work and whether there would be thresholds.

7.33 Regarding captives, Stakeholders proposed to evaluate the benefits of requiring an SFCR for captives as this causes significant additional costs and is a very time-consuming process during the already very labour-intensive year-end reporting period. Stakeholders also argue that the audit requirement would bring very little value to stakeholders but considerable strain to captive undertakings.

7.34 Further comments received proposed that the information for professional users should be in a language commonly used in financial markets. For the policyholder section, the language of the Member State where the insurance company is operating (via FoS/FoE).

Assessment

7.35 Following the comments received EIOPA kept the proposal for distinguishing the SFCR part addressed to policyholders from the part addressed to other users (e.g. professional public) and further streamlined the content of the two sections.

7.36 To address further the comments received from the stakeholders the structure of the report is now proposed to be amended from 5 to 4 sections (Business and performance, System of Governance, Valuation for solvency purposes and Capital management and Risk profile). Furthermore, the information requested is materially streamlined and shortened to avoid repetition with other documents.

7.37 Regarding comments on prescribed graphs or tables, EIOPA further proposes to specify these only in the future and via Guidelines, Supervisory Statements or other tool deemed adequate in order to improve readability and comparability (to be further discussed at that point).

7.38 Considering the comments on EIOPA's intention to further prescribe how SFCR should look like regarding the idea of including definitions in the policyholders section a basic text explaining SCR, MCR and own funds has been now developed and included in the opinion. The basic explanations aim helping policyholders in reading the policyholders section. Making policyholders to follow a link to understand a two-pager report is not adequate.

7.39 Regarding language requirements at group level EIOPA further proposes deletion of the summary in the other stakeholders part which automatically removes the requirement for language translation. The language requirements at solo level, in the cases of cross-border business are further clarified.

7.40 With regard to captives, EIOPA proposes further simplifications for the professional readers' part and proposes exemptions from the policyholders' part whenever

captive insurance undertakings are not performing business that involves natural persons and whenever captive reinsurance undertakings meet specific criteria. No audit requirement is proposed for captives' SFCR and the freedom to apply this requirement is left to the discretion of the National Supervisor.

Solvency and financial condition report – Gaps identified in the SFCR - Summary of comments

7.41 Regarding disclosure of sensitivities stakeholders commented that they do not see any need for a standardised approach, especially as the stresses on biometrical factors are highly company specific. Other comments are that:

- These are too many sensitivities and we cannot see a use of testing for positive circumstances, e.g. +25% in stock prices;
- While we appreciate the rationale for requiring SCR sensitivities, we consider it important that the definitions are set out very clearly, so that they are relevant, easily understood, and comparable;
- A mandatory calculation of some technical sensitivities should not be prescribed;
- Effects should be disclosed in reporting currency rather than in Euro;
- Disclosing sensitivities should remain a decision of the insurer;
- Captives should be excluded and should not disclose sensitivities;
- Some sensitivities (such as the real estate shocks) are too severe, and we consider that there are too many of them. For example, industry would question whether both up and down equity shocks of such a magnitude are necessary;
- It is unclear how the sensitivities should be reported for non-euro countries. The measures are presented in relation to changes in euros, but all other information is presented either on reporting or original currency. Against this background, the industry believes the currency should be the same, preferably the reporting or original currency;
- The industry also opposes the disclosure of changes in own funds as changes during the year on the position of OF can not easily be segregated.

7.42 Regarding disclosure of the OF change stakeholders commented that the proposed elements of the change appears to mimic the format of S.29, to split Own Funds into asset movements and TP movements. This is not how the Own Funds movements are assessed and managed for Life business, and movements in, for example, unit liabilities (which will be entirely offset by movements in underlying assets) could dwarf genuine movements in Own Funds and dramatically reduce the usefulness of the information. A better solution would be to publish additional guidance on how to show a genuine analysis of Own Funds, not split into component parts.

7.43 Further comments received focused on the disclosure of LTG measures and more specifically:

- Several stakeholders commented that the requirement to publicly disclose the impact of a MA/VA=zero scenario should be removed; in any case (both for policyholder and professional users) disclosures around the LTG measures (MA, VA) are disproportionate and inconsistent with those of other elements of the Solvency II framework;
- The VA and MA are key elements of the framework at its highest level (Level-I Directive) and as such one of the fundamental elements of the framework.

Requiring companies to disclose the impact of a scenario in which the MA or VA would not exist might convey the unintended message to the markets that the LTG measures might be a potentially movable or ancillary element of the framework that might at some point exist or not. The industry considers that such a message would be highly detrimental to all stakeholders;

- In this sense, the MA=0 scenario may only have one coherent interpretation under Solvency II: the impact that the company might no longer be allowed by the relevant national supervisory authority to apply the MA, because of non-compliance and subsequent non-restoring of compliance in the relevant timeframe. The industry believes that this scenario would be more representative of operational risk than any other risk, whereas the messages conveyed could be misinterpreted as an economic/financial, rather than operational risk;
- Information should only be presented including transitionals and LTG measures. More detailed analysis should be part of the ORSA.

7.44 Several stakeholders expressed "strong" opposition to the introduction of a requirement to disclose a sensitivity analysis of a 100 bps decrease in the UFR in the SFCR.This stress scenario is beyond the boundaries of the SII framework, not in line with current UFR methodology where the maximum annual change is equal to 15 bps and therefore provides no value. Where relevant, a sensitivity on the impact of changing the UFR is already included in ORSA.

7.45 Regarding the ESG and climate related risks disclosure the comments received mentioned:

- The proposed disclosure would be redundant with other legislative initiatives and disclosure being made in undertakings "sustainability reports";
- There is an absence of standardised criteria for such disclosure and such disclosure should only be defined when the taxonomy is finalised;
- Such disclosure should only be made if relevant for the social and financial conditions of the undertaking;
- There would be an important cost in collecting the relevant data, most likely via asset managers.

Assessment

7.46 EIOPA further considered the comments received and revised the proposal for disclosure of sensitivities by introducing a reference to proportionality, revising the content and clarifying the request. However it considers it as an important step towards comparability of information disclosed.

7.47 The content of the sensitivities has been revised leading to material reductions of sensitivities addressing economic assumptions but not including for now non-economic assumptions.

7.48 Following the comments received EIOPA decided not to propose a standardisation in the disclosure of variation of own funds. In fact, contrary to the sensitivities information, a best practice from the market regarding this disclosure was not identified and further work and dialogue with the market is needed before requesting such standardisation.

7.49 Regarding LTG measures EIOPA supports that transparency regarding the impact of the measures should not be reduced. On the contrary, conclusions of EIOPA thematic focus in LTG report 2017 on public disclosure about the LTG measures reflected the stakeholders' interest in more detailed and easily accessible

quantitative information on the impact of the LTG measures and the SCR with and without the measures. However, EIOPA acknowledges that this information is mainly of interest for professional readers and not necessarily to policyholders, taking into to account the complexity of the measures. Therefore, EIOPA has reconsidered the need to prescribe minimum information on the impact of the measures in the section of the SFCR addressed to policyholders.

7.50 In view of the proposed alternative extrapolation method, EIOPA considers that the reporting and disclosure requirement with respect to the sensitivity analysis on extrapolation should be limited to a change of the convergence parameter of the extrapolation method. The sensitivity analysis would contribute to addressing eventual wrong risk management incentives derived from the deviation of the interest rate term structure used for the valuation of technical provisions from observable market prices. This takes into account the conclusions of EIOPA thematic focus in the LTG report 2017 on public disclosure about the LTG measures, where stakeholders expressed interest in more detailed and easily accessible quantitative information on the impact of the LTG measures as well as the impact of sensitivity calculations regarding extrapolation. Nevertheless, in accordance with the proportionality principle, EIOPA proposes that the disclosure requirement is limited to those undertakings with long-term liabilities since those are the undertakings for which the results of the sensitivity analysis can be material.

7.51 Environmental risks pose prudential risks to the balance sheet of (re)insurers including physical risks, transition risks or liability risks.

7.52 The Taxonomy Regulation and Disclosure Regulation[4] establish disclosure requirements for insurers on likely impacts of sustainability risks on the return of financial products relating to investments for insurance based investment products (IBIPs). The non-binding Guidelines on reporting climate-related information promote disclosure for large companies (NFRD guidelines) of material financial risks caused by climate change on their balance sheet as well as of material environmental risk to which they re exposed through their investment and underwriting activity.

7.53 The Disclosure Regulation is however only applicable to life insurance undertakings, which make available IBIPs, IORPs and pension product providers (including PEPP) information, hence leaving out non-life insurers. The 2019 NFRD Guidelines cover financial risks on the asset and liability side, but in a non-binding manner.

7.54 In its consultation paper on supervisory reporting and disclosure for the SII 2020 review, EIOPA suggested to include in the SFCR (in the part addressing policyholders, in the section “business and performance”) a “statement regarding the consideration of ESG factors in the investment policy of the insurance or reinsurance undertaking”. In addition, in its Opinion on sustainability in Solvency II, para 4.47, EIOPA addressed briefly the need for prudential disclosure of ESG risks on the (re)insurers’ balance sheet.

[4] https://eur-lex.europa.eu/eli/reg/2019/2088/oj

7.55 Based on the gaps identified, EIOPA proposes that prudential disclosure on the financial impact of climate change on the assets and liabilities of (re)insurers is made mandatory.

7.56 This would secure harmonised disclosure of prudential risks, as any other risks, to policyholders and investors. To limit the burden on the insurers, information provided under other regulatory "sustainability" disclosures, to the extent these are relevant for a prudential risk assessment can be used (e.g. reference to disclosure of sustainability risks arising from the Disclosure Regulation or, other information which may be required as part of the future amended non-financial reporting directive).

Solvency and financial condition report – availability of the SFCR - Summary of comments

7.57 Most of the stakeholders supported the benefit of ensuring that the SFCR information is more accessible and in a machine readable format. However, with divergences on the specific ways or approaches to achieve it.

7.58 Most of the stakeholders were not in favour of the options presented by EIOPA to structure the SFCR and in particular on the means of XBRL.

7.59 One stakeholder suggested the creation of an European central repository of SFCR report similar to the one offered at national level by the Central Bank of Ireland.

7.60 Some of the stakeholders noted the lack of specific details that consultation included in regards the specific methods to prepare a machine readable SFCR.

7.61 Few stakeholder raised concerns regarding the submission within the regulatory reporting of the direct URL to the SFCR.

Assessment

7.62 Acknowledging the comments, EIOPA considers among the options reachability of SFCR reports the Option 1 to be the preferred one but without requesting the URL to the publication of SFCR report in XBRL format (as such publication will not be requested).

7.63 EIOPA notes that the suggested approach does not require any shortening of the deadline for SFCR publication, only the specific location in the website (URL link) should be determined in advance, however this does not mean that the report should be already available at this stage in the website.

7.64 EIOPA considered several options how to make the information from the SFCR reports easily reachable in a searchable format, while limiting the costs for the entities and assuring that especially the quantitative information from the SFCR, published in harmonised Quantitative Reporting Templates, is easily reachable and allow for efficient analysis of data.

7.65 Following comments received about the structuring of the SFCR reports and the specific case referred of the Central Bank of Ireland, the extraction and publication of the quantitative SFCR QRTs information subset after cross-checking it with the supervisory reporting seems to be the most advantageous from cost benefit perspective. For such, the publication of the SFCR in a searchable format is crucial.

Following this the impact analysis has included an option 1.6 considering this searchable format of the SFCR as a minor modification to the option 1 (Keep the current situation).

Solvency and financial condition report – Audit of the SFCR - Summary of comments

7.66 Some of the stakeholders supported EIOPA's proposal of introducing an auditing requirement in the Solvency II Directive saying that this would ensure that as a minimum the Solvency II Balance-Sheet is subject in all Member States to external auditing by a qualified auditor. They proposed to have as an output an audit opinion published together with the SFCR. Additional auditing requirements should be left to the discretion of the NCAs.

7.67 Other stakeholders commented that the proposed auditing requirement is actually already requested by some countries. Therefore it makes sense either to introduce the obligation for all countries or to remove it for all Member states.

7.68 There were also stakeholders who expressed the opinion that the limitation to the audit of the Solvency II balance sheet only should be temporary and in the future, EIOPA should consider extending the audit requirement to the other parts of the SFCR.

7.69 However, a number of stakeholders raised concerns that the introduction of an audit will lead to a big increase in their costs without really contributing to the improvement of the quality of the report and that the evidence showed on the value added was only judgmental and not based on facts.

7.70 Regarding captive undertakings a proposal was made to remove them from the scope of the requirement for an external audit of the Solvency II balance sheet as captive's Solvency II balance sheet and SFCR are of limited relevance to its policyholders or any other stakeholders (e.g. cedants to captives already receive the necessary assurance from the captives' audited financial statements).

7.71 There were also comments that auditing should be about promoting transparency and accuracy and therefore auditing requirements should not be subject to exemptions based on proportionality. If some insurers would and others would not let their SFCR or their Solvency II balance sheet be audited this would result in a two tier population with a decrease in transparancy and - at least by trend - also accuracy.

7.72 Some stakeholders raised concerns that all stakeholders deserve the same level of assurance about the completeness and correctness of the information disclosed. When NCAs apply different requirements, this goes against the harmonisation of the market and does not respect the principle of proportionality. In this sense they proposed that in case of an introduced audit requirement, it should be prescriptive in being limited to the Solvency II balance sheet alone to ensure consistency across all Member States.

Assessment

7.73 As part of its opinion EIOPA performed a cost/benefit survey to assess the cost impact of its proposal. The survey includes sample of 357 individual undertakings

from 29 EEA Member States who indicated that 73% of the undertakings taking part in the survey audit their SII Balance Sheet and 84% of them have a wider scope of the audit. The cost estimation provided during the cost survey indicated that the costs for undertakings auditing balance sheet only as a percentage of the total assets are around 0.004%.

7.74 Regarding different comments received arguing that NCAs different requirements should be limited EIOPA would like to clarify that the proposal is to set a minimum requirement but Member States have the right to request additional auditing and this right should not be limited.

7.75 Considering the comments received and the results from the cost/benefit analysis as well as the NCAs experience gained, EIOPA proposes to keep the minimum audit requirement of the SII balance sheet, keeping the requirement of auditing for captives insurance and captive reinsurance undertakings to the discretion of the Member State.

Solvency and financial condition report – Templates used in the SFCR – will be included in November BoS

Solvency and financial condition report – Deadlines of disclosing SFCR - Summary of comments

7.76 Most of the stakeholders welcomed an extension of the deadline of the solo SFCR by 2 weeks. However, they commented that this deadline extension needs to come in force in 2020 already. If it is introduced later, it would be step back in comparison to deadlines in the reporting year 2020. Furthermore, they said that this time is needed to fulfil the existing reporting requirements, independent of the external audit requirements EIOPA proposes.

7.77 Some further clarified that extending the deadline with 4 additional weeks would be the absolute minimum in case of an external audit requirement, as there will be a peak in the demand for qualified external auditors. The deadlines should take into account the correlation with other risk reports (i.e. ORSA Report), as well as the processes followed and timing for data closing.

7.78 There were also stakeholders who considered the 2 weeks extension as not enough pointing that the external audit reduces preparation time for the annual submission of data and reporting within the Solvency II deadlines by more than two weeks. These stakeholders request further insights as to how EIOPA has determined two weeks to be sufficient.

7.79 Further comments proposed the deadline of the single SFCR to be aligned with the deadlines of group SFCR. The proposal is justified as for groups reporting a 'single group SFCR', there will be a 6-week-cut in the reporting deadlines at the end of 2019. This implies that the deadline for the single group SFCR and the solo SFCR will be the same. While for annual QRT-reporting there will be 6-week delay for groups. Considering the external audit requirement for most of the SFCR, this will be quite burdensome especially for smaller groups.

7.80 Regarding single SFCR, the industry proposes that EIOPA establishes a single, 22-week deadline for production of a single SFCR, thereby avoiding the practical

difficulties associated with different deadlines for different parts of the same document.

Assessment

7.81 EIOPA further assessed the comments received and would like to clarify that there are in total 4 weeks of additional extension to the disclosure timeline, two weeks of extension of reporting of annual QRTs plus two weeks as EIOPA agrees that narrative information (RSR and SFCR) should be reported/disclosed two weeks after QRTs. This together with the streamlining of the SFCR should allow adequate amount of time for the industry while preserving the needed timeliness for the stakeholders using the information.

7.82 The single group SFCR should lead to a delay on the timing of access to information by the policyholders. Therefore the deadline for the publication of the policyholder section should not be different for groups using the possibility to disclose a single SFCR.

7.83 The final proposal of EIOPA is 18 weeks deadline for insurance and reinsurance undertakings and 24 weeks for the group SFCR.

Assess adequacy of receiving the Actuarial Report regularly- Summary of comments

7.84 During the public consultation stakeholders broadly supported EIOPA proposal to keep the Actuarial report internal. A minority of the stakeholders favoured the publication of the actuarial report in order to be able to assess whether technical provisions are adequate or not.

Assessment

7.85 EIOPA acknowledges the comments received. As the majority supported the proposal while a minority asked for the disclosure of the report EIOPA proposes to keep the status quo and keep the report internal.

Regular supervisory report – Structure and content - Summary of comments

7.86 During the public consultation the stakeholders welcomed EIOPA's proposals to improve the structure and content of the RSR but commented that the reporting requirements were not actually reduced, as some information was simply moved from the SFCR to the RSR. Stakeholders proposed that EIOPA should consider a simplification of the RSR without duplicating the information already presented in the SFCR report.

7.87 Further comments agreed that the RSR should be revised and its structure changed in a manner consistent with the proposals for the new SFCR structure while maintaining the same structures and content (but more in-depth in the RSR).

7.88 A few stakeholders considered providing additional information especially in the area of remuneration as critical (e.g. remuneration entitlements of members of the AMSB and key function holders), given the extremely sensitive nature of the data. Furthermore in order to avoid the potential risk of confidential information being spread or even getting public in the reporting process, which involves a multitude of people, they proposed an option of a separate reporting of this data to the national supervisor (i.e. outside of the RSR).

7.89 Other mentioned that following EIOPA's proposal some duplications with the ORSA report would be eliminated but according to the proposal information covered by the ORSA report will still be due if ORSA is submitted during a certain time window (more than 6 months before and not due in the 3 months after the RSR). This constraint may be a concern for undertakings that usually submit their ORSA within this time frame as they will either have to change their process and ORSA submission dates or include information from their previous ORSA anyway.

7.90 Regarding RSR language stakeholders proposed to include an option to have English as the language requirement, at least for the Group RSR, but preferably also for the Solo RSR as this would enable an international undertaking to have the option to submit the RSR only in English.

7.91 Regarding the single group RSR industry expressed its disappointment with EIOPA's advice not to allow a single group RSR. The industry noted that a well-structured document can address the concern of the document being too lengthy. Moreover, it would be at the discretion of the parent company to produce a single group RSR, and as such the insurer is aware that the information is shared with several supervisors.

Assessment

7.92 EIOPA noted the comments regarding the RSR structure and contend and further simplified and streamlined them while also removing all unecessary information thus avoiding any repetitive information with the SFCR and the ORSA-report. The timeframe of the last ORSA reported was eliminated to make it simple.

7.93 The language proposal was not changed as there is a difference between the addressees of the SFCR and RSR. As the RSR is addressed to the supervisors the language of the Member State of the NCAs should be used. In addition, in some countries documents submitted in other languages are not official and also it can not be required that all supervisors know English.

7.94 Regarding single RSR EIOPA considered industry's comments and proposes to introduce the possibility of a single RSR meeting predefined criteria.

Regular supervisory report – Frequency of the RSR - Summary of comments

7.95 Most of the stakeholders commented that a three-year RSR is sufficient and should become the standard, as opposed to simply being an option at the NSA's discretion. This would ensure clarity and a level playing field in the reporting requirements. During the other years no RSR reports should be requested, unless there have been material changes.

7.96 EIOPA's proposal for the possible mandatory assessment by NCAs and communication of the frequency of the RSR to undertakings is a positive development, as it promotes risk-oriented reporting and takes the individual situation of the insurer into consideration. However, it is not clear how it would work in practice.

7.97 Further, when the supervisor makes the assessment (as proposed by EIOPA) and obliges the insurer to report RSR more often than every three years, it is unclear whether there is still a possibility in the future to report an abbreviated report (as foreseen in DR Art 312 (3)), rather than a full RSR report.

7.98 For the group RSR report there is the problem for multinational companies. Some companies draft the report every year, in other companies every three years because there are different frequencies.

7.99 The same frequency in all countries ensure clarity and a level playing field in the reporting requirements.

Assessment

7.100 EIOPA keeps the proposal as initially consulted and proposes to introduce L3 tools for achieving supervisory convergence by keeping the minimum requirement for submission of full RSR once every 3 years. The application of this proportionality measure will follow the general approach discussed under the proportionality framework (see Chapter 8).

Article 254 of the Directive - Summary of comments

7.101 The industry welcomes the proposal to amend Art 254 of the Directive to allow for exemption of group QRT reporting without the condition of exemption of all solo insurance undertakings belonging to that group. Stakeholders proposed that EIOPA ensures that a practicable procedure is defined in order to exempt the groups over the long term.

Assessment

7.102 The proposal was kept.

8. Proportionality

8.1 Thresholds for exclusion from Solvency II

8.1 The industry in general supports EIOPA's advice to maintain the current methodology for the exclusion from the scope of Solvency II and proposes to improve further the application of the principle of proportionality.

8.2 Stakeholders further proposed EIOPA to also analyse Articles 3 to 10.

8.3 Regarding EIOPA proposal on thresholds stakeholders expressed different views as summarised below:

- In general, support the proposal as set by EIOPA;
- Agree with doubling the thresholds on TP but not with allowing Member-State to set the threshold for GWP as it would not ensure a level playing field throughout all Member States;
- Asked to consider having the range between 10ml – 25ml, i.e. doubling the entry point;
- Propose to introduce the number of contracts that are written by a reinsurance undertaking as a threshold for the application of SII; reinsurance companies that write up to 20 reinsurance contracts should be exempted from SII;
- Propose to have a methodology to define small and non-complex institution.

Assessment

8.4 EIOPA further analysed articles 3, 5, 6, 7, 8, 9 and 10 of Solvency II Directive to see whether those exceptions should still apply and where needed proposed further changes.

8.5 EIOPA believes the option initially proposed should be kept. Although recognising the cons no other feasible option to consider proportionality and revise article 4 was proposed.

8.6 EIOPA disagrees with the proposal of introducing the number of contracts an exclusion criterium for reinsurance undertakings as the number of contracts is not a good indication of the concrete exposure of the reinsurance undertaking and systemic relevance might indeed be at stake.

8.7 The proposal to define a methodology to define small and non-complex institution is not directly related to Article 4 and rather more relevant in the context of the application of proportionality. Please consider EIOPA's final Opinion where proportionality has been further enhanced.

8.2 Proportionality in pillar 1

Summary of comments

8.8 No advice was provided in the CD, but two options to change the status-quo: Option 2 (introduce a set of simplified calculation for immaterial risks) and Option 3 (introduce an integrated simplified calculation, 2 alternative methods provided). A specific question (Q8.2) was included in the CD to ask stakeholders their preferred option.

8.9 All stakeholders welcome the possibility to introduce new simplifications to the calculation of the SCR standard formula.

8.10 Most stakeholders support the introduction in the Regulation of a tool-box of non-exhaustive simplifications that can automatically be applied by companies when some predefined and risk-based criteria are met should be created

8.11 Some expressed their preference for a combination of both Option 2 and 3 considered not to be mutually exclusive, but if considered to be lacking In terms of transparency or comparability, they would prefer Option 3

8.12 Some suggested to allow undertakings to use their own simplifications, provided proportionality requirements are met

8.13 A number of stakeholders recommend that NSAs should bear the burden of proof for demonstrating that a simplification is not appropriate because it produces a lower outcome than the standard calculation (currently, undertakings have to show that the results of the simplified calculation do not materially diverge from the more standard calculation)

8.14 Some stakeholders support the removal of the non-life lapse risk from the standard formula because its size is small.

8.15 Regarding non-life CAT risks, some stakeholders consider the simplification consisting in not considering the risk-mitigating effect of reinsurance as too simplistic and very conservative in terms of capital requirements.

Assessment

8.16 EIOPA further developed Option 3 (i.e. integrated approach) because it would substantially reduce the calculation burden for undertakings. Moreover, this approach is consistent with the EIOPA Supervisory Statement - Application Proportionality Solvency Capital Requirement , but (i) making the approach more risk sensitive (SCR is not frozen in the application step, but updated over time in a simple way); (ii) providing a legal hook for a pragmatic approach that is missing in the SS.

8.17 The list of simplifications should stay a closed list in order to ensure the reliability and comparability of the SCRs.

8.18 EIOPA rejects the proposal to remove the burden of proof for the appropriateness of a simplification from the undertaking. The calculation of the SCR should remain the responsibility of the undertakings. Only they have the data to assess the whether a simplification is proportionate to the nature, scale and complexity of the undertaking's risks.

8.19 With regard to the complete removal of the non-life lapse risk supported by some stakeholders, EIOPA is of the view that this risk may grow in the future. For undertakings where the risk is immaterial the suggested simplifications for immaterial risks can be applied.

8.20 EIOPA acknowledges that the simplification consisting in not considering the risk-mitigating effect of reinsurance may a limited scope of application. Still it can be appropriate in several cases.

8.3 Proportionality in pillar 2

General comment

8.21 The industry welcomes the advice of EIOPA to improve the application of the proportionality principle to the Pillar 2 requirements. The application of such principle inter alia depends on the nature, scale and complexity of the risks inherent in the undertaking's business. These parameters do not eliminate the legal uncertainty and ultimately increase the differences between member states in the interpretation of Solvency II rules. Thus, level I & II measures should provide further details to avoid uncertainty and inconsistencies between member states. Providing "common flexible criteria for the definition of 'small/less complex undertakings' " at the level of guidelines is not sufficient in order to guarantee that the principle of proportionality will be enforced effectively.

Assessment

8.22 EIOPA aims to improve the scope and consistency of application of proportionality principle under the Solvency II framework in the SRP (Supervisory Review Process) proposing an appropriate combination of legislative (binding) amendments and non-legislative (supervisory convergence oriented) amendments to existing tools. This combined approach would allow to keep the necessary flexibility and supervisory judgment under the SRP. EIOPA will clarify the application of the proportionality principle in the Directive and introduce some general criteria on how to measure nature, scale and complexity. In particular, EIOPA has clarified that certain proportionality measures would be generally allowed for low risk profile undertakings (i.e. combination of key functions, biennial ORSA, less frequent review of written policies and exemption of the deferral of the variable remuneration); these measures could also be applicable to other undertakings in specific cases, subject to the consent of the supervisory authority.

Summary of comments on key functions combination: difference between person and body

8.23 Stakeholders welcomes EIOPA's advice to explicitly allow the combination of key functions. However some stakeholders commented that EIOPA should also be clear on the difference between a "person" and "a governance body" (e.g. the Board of Directors). This is to ensure the Board of Directors of a smaller or less complex entity is collectively assuming supervision of the key functions without the need for having a "person" individually nominated for the said key functions, obviously in line with Fit & Proper, Conflict of Interest, Outsourcing and Independence requirements.

Assessment

8.24 EIOPA considers that the nomination of a key function holder, as the person responsible for the key function and with specific expertise, should be always requested. Key functions should report to the AMSB, consequently the AMSB cannot collectively act as key function holder. Nevertheless, the combination of the role of key function holder with AMSB membership could be allowed provided that

the conditions prescribed are met, including proper management of conflicts of interest.

Summary of comments on key functions combination: burden of proof

8.25 With respect to the combination of key functions with other roles, stakeholders commented that although already broadly accepted by most NSAs, the current processes to apply this measure and the burden of proof are overly burdensome. It would be more proportionate to generally admit any of the combinations mentioned and to exclude them only on a case-by-case basis.

Assessment

8.26 EIOPA has revised the proposal to acknowledge that for low risk profile undertakings the combination of roles should be generally allowed, provided that certain conditions are met. For other undertakings, combinations should be the exception rather than the general rule in order to preserve the independence of the key functions. The conditions under which combination of functions could be allowed have been specified in EIOPA's advice; EIOPA consider that the conditions should be sufficiently flexible to allow a case by case assessment. The proposed draft does not request a formal authorisation process for undertakings to be able to combine key functions.

Summary of comments on key functions combination with AMSB membership

8.27 EIOPA suggestions is that the combination of Management Board member and key function holders should only be allowed when certain conditions are met. This will lead to avoidable discussions with the NCA and thus inefficiencies on both sides. Given the particular importance to ensure the availability of sufficient risk management knowledge at decision making level and to ensure a clear risk governance (including responsibilities and accountabilities). We would like to emphasize that a model where the CRO is key function holder and a Board member, is an appropriate and compliant model, provided the other management board members can effectively challenge the CRO.

Assessment

8.28 EIOPA considers that the combination of a key function with AMSB membership should be allowed when the conditions described are met, in particular for low risk profile undertakings; otherwise there is a high risk that the key function holder cannot performed its tasks in an effective and independent manner.

Summary of comments on possible exception to the requirement of an actuarial function

8.29 Some national industry associations propose that non-life insurers with a maximum of € 50 mn premium income, which do not insure risks class 10 (Motor vehicle liability), liability class 3 (Road transport liability), class 11 (Aircraft liability), class 12 (Liability for ships), class 13 (General liability), class 14 (credit) and class 15 (suretyship), unless these are ancillary risks, should only be required to have an actuarial function (either outsourced or in-house) if they sell insurance contracts with a duration of more than 4 years. Life insurers, however, should always have an actuarial function.

Assessment

8.30 The actuarial function is a fundamental element of the undertakings' system of governance according to Solvency II. While the actuarial function can be combined with other roles based on proportionality, there should be no exception to have an actuarial function; the tasks of the actuarial function with respect to the technical provisions and underwriting policy are essential in any insurance undertaking, irrespective of its type of business.

Summary of comments on ORSA simplified template

8.31 Some stakeholders expressed that EIOPA's advice to not reduce the minimum content of the ORSA is a missed opportunity to enhance the principle of proportionality. In fact, some good practice is already observed, for instance with the "Low/Medium Low ORSA Template" provided by the Bank of Ireland. Further simplifications could be built on that model in order to accommodate undertakings with a very simple risk profile.

Assessment

8.32 With respect to the requirement of an ORSA template for small/less risky undertakings, EIOPA considers that it could result in unintended restrictions. The current provisions in level 1 and level 2 are sufficiently flexible and allow for proportionate approaches, as the Irish template. Rather than including more prescriptive rules in the Directive or Regulation, EIOPA would support the consideration of such a "proportionate template" in a future revision of the level 3 guidelines on ORSA.

Summary of comments on ORSA frequency

8.33 Generally stakeholders welcomes EIOPA's advice to request an assessment of the deviation from the assumptions underlying the SCR in the ORSA only every two years; although some stakeholders consider that proposal neither necessary nor providing significant relief. Some stakeholders propose allowing this assessment to be performed every three or five years when justified by the risk profile. Other stakeholders would favour that for some undertakings, the ORSA should only be provided following any significant change in the risk profile of the undertaking.

Assessment

8.34 EIOPA has revised the initial proposal to allow low risk profile undertakings to perform the ORSA every two years, unless the supervisory authority concludes based on the specific circumstances of the undertaking that a more frequent assessment is needed. This measure would apply automatically to low risk profile undertakings but other undertakings could also apply it if the supervisory authority agrees to it, on a case by case basis. The exemption from the annual ORSA shall not prevent the undertaking from being able to identify, measure, monitor, manage and report risks on a continuous basis.

Summary of comments on written policies regular review

8.35 Stakeholders welcomes EIOPA's advice to provide the possibility to review the written policies up to every three years instead of annually, when proportionality justifies it. However, in order to ensure an effective application of this option, it

should be up to companies to set the periodicity of this review depending on the own assessment of their risk profile. NSAs could challenge this assessment without putting a significant burden of proof on undertakings. The frequency of three years should be an option by default, and a higher frequency should be justified by the risk profile. Not all written policies should be assigned a higher frequency, rather the approach should be tailored to the actual risks of an insurer. The less frequent review of written policies is a positive point but the wording “may be allowed” is confusing. A review every three to five years should be the norm, without a prior approval of the NSA. Insurance undertakings should be competent to assess by themselves if, regarding their own risk profile, they need to perform a more frequent review.

Assessment

8.36 EIOPA considers that an annual review of written policies should still be the general rule; a less frequent review should be justified by proportionality, in particular for low risk profile undertakings. Nevertheless, EIOPA agrees that the undertaking should decide on the adequate frequency of the review, with the possibility for the NSA to challenge it. Therefore, the draft proposal has been revised as follows: "written policies shall be reviewed annually. Low risk profile undertakings may be allowed to perform a less frequent review, up to three years, unless the supervisory authority concludes based on the specific circumstances. This measure could also be applicable to other undertakings in specific cases, subject to the consent of the supervisory authority.

Summary of comments on AMSB

8.37 Several stakeholders commented that ORSA process already requires an assessment of the governance system, board effectiveness as well as the regular reporting and disclosure cycle. It also implies that these elements are being assessed. Board effectiveness and the effectiveness of the system of governance are monitored on an ongoing basis within the organisation of any insurer, by the corporate bodies, the key functions, and to some extent the external auditor. It is not clear to us what value this additional requirement would add.

Assessment

8.38 EIOPA understands that undertakings already should assess the composition, effectiveness and internal governance of the AMSB as part of the evaluation of the system of governance. The proposal is intended to highlight that proportionality plays an important role in such assessment.

9. Group supervision

9.1 Definition of the Group, including issues of Dominant Influence ; and Scope of the Group Supervision

Summary of comments - Policy Issue 9.3.1 (1) Lack of clarity on the definition of group in Article 212 of the Solvency II Directive, regarding the definitions that support the identification of a group to capture undertakings, which, together, form a de facto group.

9.1 Some stakeholders are of the view that the issues faced do not deserve a change in the regulations as for them it is unclear how many cases are affected by it and how relevant those situations are. In general, their view is that it should be avoided to introduce new regulations for very specific cases.

9.2 Some stakeholders indicate that there should not be concerns that a particular undertaking does not fall under the definition of a group for the purpose of Solvency II if such undertakings are properly supervised at solo level. In their view the supervisory authority can include all "group-related elements" in the supervisory dialogue.

Assessment - Policy Issue 9.3.1 (1) Lack of clarity on the definition of group in Article 212 of the Solvency II Directive, regarding the definitions that support the identification of a group to capture undertakings, which, together, form a de facto group

9.3 EIOPA has taken consideration of the stakeholders comments, and also has appreciation for the challenges that supervisory authorities are currently facing with existing cases. The number of cases are significant for at least one supervisory authority, and less significant for other supervisory authorities but equally important. The regulatory amendment is important to ensure that undertakings linked to each other through a centralised coordination which is not directly imminent as it is not established through a contract, clear financial ties or otherwise directly visible ties but are nevertheless managed on a unified basis (by e.g. offering the same policies under the same conditions, following the same investment policies and investing in the same assets, sharing employees, using the same web-sites) while not coming directly under the group supervision, can also be identified as an insurance group. A dominant influence is not easy to establish in such a case as. Not putting these undertakings under group supervision could lead to an unlevel playing field and pose risks on policy holders.

9.4 Group Supervision has specific objectives, focussing on the managing the risks of the individual insurance undertakings being part of a group. Therefore solo supervision cannot replace group supervision.

9.5 After careful consideration of the above, EIOPA sees that the benefits of the proposed ammendments overcomes the downside of issues presented by stakeholders and proposes no change to the preferred policy option.

Summary of comments- Policy Issue 9.3.1 (2) Need to facilitate the application of group supervision under Article 213 of the Solvency II Directive in the case of horizontal groups groups with multiple points of entry in the EEA, and multiple groups held by the same individual or legal entity.

9.6 The key comment across several stakeholders is that the term 'centralised coordination' in Article 212(1) (c) of the Solvency II Directive is sufficiently clear, or suggest a reference to the IFRS standards for 'control' and 'dominant influence'. Many stakeholders provide the feedback that restructuring the group has a considerable impact on the group and is in principle a management decision and advice against the power of the supervisory authority to restructure the group. While no direct comments in favour, stakeholders are of the view that this power should be exercised under clear conditions. Several stakeholders therefore request the amount of cases in which this issue occurred to weight the costs and benefits of the proposal.

Assessment - Policy Issue 9.3.1 (2) Need to facilitate the application of group supervision under Article 213 of the Solvency II Directive in the case of horizontal groups groups with multiple points of entry in the EEA, and multiple groups held by the same individual or legal entity.

9.7 EIOPA agrees with the feedback from stakeholders that a restructuring of the group is in principle a management decision and has considerable impact on the group. The policy proposal therefore states that restructuring can only be requested when the current structure obstructs or jeopardises adequate group supervision as this would put the protection of policy holders at risk.

9.8 After considering the above, EIOPA sees that the benefits overcomes the downside of issues presented by stakeholders and proposes no change to the preferred policy option.

Summary of comments- Policy Issue 9.3.1 (3) Lack of clarity in other definitions to secure scope of a group subject to Solvency II

9.9 One stakeholder states that these defintitions to support group supervision should be adequately clear. One stakeholder suggests to refer also to the IFRS criteria. Other stakeholders suggest to use the look through approach which would result in all assets and liabilities to be part of the consolidated data. Some of these stakeholders indicate that the consequences of different interpretations of the definitions are severe also considering the influence on business decisions, and some of them see no need for clarifications. While one stakeholder states clarification would be welcome.

Assessment - Policy Issue 9.3.1 (3)) Lack of clarity in other definitions to secure scope of a group subject to Solvency II

9.10 The proposal does not aim to interfere with the accountancy standards used for identifying a group, the aim is clarification within the Solvency II framework regarding uncertainties that may arise when identifying a group for the purpose of group supervision. Some definitions should therefore be amended to clarify the scope of group supervison.

9.11 After considering the above, EIOPA sees that the benefits brought with clarification overcomes the different solutions presented by stakeholders and proposes no changes to the preferred policy option.

9.2 Definition of Insurance Holding Company and other challenges related to Insurance holding companies and Mixed financial holding companies

Summary of comments – Policy Issue 9.3.2 (1). Article 212 of the Solvency II Directive does not provide additional explanation of the meaning of 'exclusively or mainly' in the definition of IHC.

9.12 Stakeholders state that criteria for determinating an insurance holding should be clear, easily measurable and consistent with the other Euorpean Directives in the financial sector. There were also some suggestions from stakeholders regarding which criteria should be taken into account to identify a IHC or a MFHC. Some other stakeholders state the definition is widely used and no clarification is necessary.

Assessment – **Policy Issue 9.3.2 (1)** Article 212 of the Solvency II Directive does not provide additional explanation of the meaning of 'exclusively or mainly' in the definition of IHC.

9.13 The aim of the policy advice is indeed to have a clear measurable standard to identify an insurance holding company. This to ensure a level playing field and avoid any competitive disadvantages for certain groups depending on the interpretation made by the group supervisor and/or national transposition issues. EIOPA's policy advice regarding the term 'exclusively' or 'mainly' should be understood to a situation where more than 50% of the consolidated balance sheet of the holding company or another indicator such as solvency capital requirement, equity, personnel, etc, deemed relevant by the national competent authority, is derived from the insurance sector (including third country insurance undertakings).

9.14 After considering the above, EIOPA sees that the benefits of further defining the criteria will ensure clarity for the stakeholders and proposes no changes to the preferred policy option.

Summary of comments - Policy Issue 9.3.2 (2) Article 214(1) of the Solvency II Directive; and powers over insurance holding companies and mixed financial holding companies

9.15 Several stakeholders remarked that the powers towards holding companies are too far reaching and disproportionate in the context of group supervision as they are no authorised institutions. Other stakeholders state that it is up to the insurance group to decide which entity is responsible for assuring the compliance with group Solvency II requirements. Some stakeholders welcomed the changes proposed to Article 214(1) of the Solvency II Directive, but state the holding should not come under full solo-supervision

Assessment- Policy Issue 9.3.2 (2) Article 214(1) of the Solvency II Directive; and powers over insurance holding companies and mixed financial holding companies

9.16 EIOPA took into consideration the legislation on the banking sector (CRD V) regarding supervisory powers over holding companies . The policy option does not intend for the holding companies to be subject to full solo-supervision, the aim is for the supervisor to take adequate measures in relation to the holdings from a group perspective, and only when necessary . It is important for the group supervisory to make the decision on which entity is responsible to fulfil the requirements. This as it would be ineffective to request the group to decide which entity in the group is responsible for the application of the group requirements if the group delegates it to an undertaking that would not be in the position to effectively apply and enforce these requirements for the group. Facilitating such a choice as proposed by some stakeholders would also not be in line with other articles of the Solvency II Directive such as Article 216 and 235 of the Solvency II Directive.

9.17 After considering the above, EIOPA concludes that the benefits of clarity on the responsibilities of holding companies leads to more effective group supervision from which policholders will benefit. EIOPA therefore proposes no changes to the preferred policy option.

9.3 Exclusion from group supervision

Summary of comments – Policy Issue 9.3.3 (1) Exclusion of undertakings from the scope of group which can lead to complete absence of group supervision or application of group supervision at a lower / intermediate level in the group

9.18 One stakeholder fully welcomes the proposal, while several stakeholders, do not favour EIOPA's proposal for EIOPA to be informed if a supervisory authority considers complete exclusion from group supervision on the basis of Article 214 (2) of the Solvency II Directive or if the exclusion results in a capital relieve at consolidated level.

9.19 Some stakeholders state the importance of supervisory flexibility. Although some of these stakeholders see no need for further clarification of this article at level 1 but rather through supervisory guidance to ensure a level playing field, one stakeholder states that the principle of exclusion should be clear.

9.20 One Stakeholder states that the reference to group supervisors should not be plural, as in an decision on exclusion from the scope of group supervision only one supervisory authority is concerned as group supervisor.

9.21 Several stakeholders would like to know in how many cases there has been a complete exemption from group supervision.

9.22 Finally, at least half of the stakeholders support the proposal that the exclusion from the scope of the group should not lead to absence of group supervision.

Assessment - Policy Issue 9.3.3 (1) Exclusion of undertakings from the scope of group which can lead to complete absence of group supervision or application of group supervision at a lower / intermediate level in the group

9.23 There are clear supervisory cases where the outcome is different in similar situations as well as where the exclusion would lead to an absolute absence of group supervision. EIOPA believes it is important to be involved in the process in exceptional cases to ensure both level playing field and supervisory convergence as described in the identification of the issue and the policy analysis. The policy advice highlights that in very exceptional and justified cases, a waiver from group supervision could be allowed after consulting EIOPA and any relevant competent authority concerned and should be subject to continuous monitoring.

9.24 The reference to group supervisors in plural is not meant to refer to several group supervisors responsible for the same group. For clarification the wording has been adjusted in the advice. After considering the above, EIOPA sees that the benefits overcomes the downside of issues presented by stakeholders and proposes no change to the preferred policy option then the replacement of the term 'group supervisors' by supervisory authority.

Summary of comments - Policy Issue 9.3.3 (2) Negligible interest (Article 214(2)(b) of the Solvency II Directive) vs. achieving the objectives of group supervision..

9.25 Several stakeholders state the meaning of 'negligible interest' should be clear, but also consistent with other European legislation, especially the accountancy regulation. One stakeholder explicitly supports the policy proposal and requests alignment with the Financial conglomerates directive.

9.26 Another stakeholder underlines that the integration of immaterial third country undertakings from especially non-equivalent third countries in the scope of group supervision is costly and burdensome for the undertaking without direct 'added value'. The only other method currently possible is to deduct the book value of the undertaking under Article 229 of the Solvency II Directive. The stakeholder states a more fair and risk-sensitive approach would be to continue

the treatment at solo level (i.e. equity method and equity risk charge). It is the stakeholder's view that this corresponds to EIOPA's proposal in the section 9.3.7 that refers to Article 229 of the Solvency II Directive (Non-availability of information and undertakings not deemed as non-negligible. An alternative for a proxy Method to calculate group solvency requirements).

Assessment - Policy Issue 9.3.3 (2) Negligible interest (Article 214(2)(b) of the Solvency II Directive) vs. achieving the objectives of group supervision.

9.27 The policy proposal seeks to close the current regulatory gap by setting a clear criteria at the level of the legislation (either level one or two). This would be beneficial considering the impact it could have both on group supervision and group solvency. The criteria should take into account at least: the size of the entity potentially subject to exclusion when compared with the size of the group, the potential impact on group solvency, any relevant intragroup transactions or financing, whether the related undertaking (other than a subsidiary) belongs also to another group as a subsidiary and is included in the scope of group supervision exercised over the other group or whether encompassing by the group supervision .

9.28 The proposal under solvency II could be taken into consideration by the European Comission when reviewing the interlinkages with other regulations like the one that refers to Financial Conglomerates.

9.29 After considering the above, EIOPA proposes not to change the preferred policy option.

9.4 Supervision of IGTs and RCs

Summary of comments – Policy Issue 9.3.4(1) No inclusion in the current definition of IGTs of reference to IHC, MFHC, MAIHC[5], and third country (re)insurance undertakings as one of the possible counterparties of the IGTs

9.30 While one stakeholder welcomes the clarifications about the IHC and MFHC inclusion into the IGTs, others are of the opinion that existing reporting and disclosure requirements seem to be sufficient to provide all the information needed for IGT supervision. If needed, in their view, the supervisory authority can approach directly the group. Moreover, in their view, the inclusion of IGTs between non-insurance undertakings goes beyond the content of the recital 109 of the Solvency II Directive which allows for supervisory measures "at the level of the insurance or reinsurance undertaking where its solvency is being or may be jeopardised" since group supervision (under this rectial) is not an aim in itself, but supports the solo supervision by providing a better picture of an (EU) (re)insurer in the context of the group.

[5] MAIHCs reporting on IGTs is already provided for under Article 265 of the Solvency II Directive, however where the regulated entity from other financial sectors at the top of the group does not fall under national law in the definition of a MAIHC, Article 265 applies to those entities. Hence, MAIHCs are kept under the scope of the title of this policy option in conjunction with IHC, MFHC.

9.31 The policy advice is considered by some stakeholders to be burdensome for larger groups and in their view the inclusion of IGTs with banks further blurs the boundaries between sectoral and cross-sectoral (FICOD) supervision.

Assessment - Policy Issue 9.3.4(1). No inclusion in the current definition of IGTs of reference to IHC, MFHC, MAIHC, and third country (re)insurance undertakings as one of the possible counterparties of the IGTs

9.32 In order to have a common understanding of IGTs that could pose a threat to the financial position of the insurance or reinsurance undertakings belonging to a group, the definition of IGTs must be clear and as comprehensive as possible so that supervisors can adopt measures in a timely manner. Recital 108 and 109[6] of the Solvency II Directive should be read in conjunction with the directives given on adequate supervision of IGTs and risk concentrations (Articles 258 and 246(2) of the Solvency II Directive). Furthermore, group supervision is also an important objective of the Solvency II framework, and adequate supervision of IGTs contributes to the achievement of the objectives of group supervision and protection of policyholders.

9.33 The Directive requires that the group internal control mechanisms should cover sound reporting and accounting procedures to monitor and manage IGTs and risk concentrations, hence it is expected that the policy proposal should not cause excessive burden except if the analysis of specific interlinkages have not already been taken into consideration.

9.34 The policy proposal does not clash with existing FICOD regulations regarding the supervision of IGTs. Not all insurance groups with a parent credit institutions, investment firms and financial institutions are denominated as a conglomerate subject to FICOD, and for cases where the supplementary supervision is not applicable the policy proposal is of the utmost importance for the group and solo supervisors. As regards to the application of a proportionality principle, Article 213(3) of the Solvency II Directive allows group supervisors to waiver the reporting of IGTs and RC in order to avoid reporting under Solvency II and FICOD. Furthermore, the setting of thresholds also assists in the application of a risk based approach to supervision of IGTs.

9.35 The policy proposal acknowledges that where a regulated entity from other financial sectors at the top of the group does not fall under national law in the definition of a MAIHC under Article 212(1)(g) of the Solvency II Directive, Article 265 of the Solvency II Directive also applies to these entities.

9.36 In light of this, information about financing transactions, capital arrangements when one counterparty is a holding company (IHC, MFHC, MAIHC) or a third-country entity are deemed fundamental to understand the effects on the financial position of the (re) insurance undertaking. Therefore, EIOPA proposes no change to the preferred policy option. Nonetheless, wording amendments

[6] Recital 109 states that supervisory authorities should be able to exercise supervision over such risk concentrations and IGTs, taking into account the relationships between regulated entities as well as non-regulated entities, including (IHC) and (MAIHC)…and take appropriate measures”

both in the analysis and opinion section of the Advice are included as considered beneficial.

Summary of comments - **Policy Issue 9.3.4(2).** To amend Article 244(3) of the Solvency II Directive to allow the introduction of additional criteria.

9.37 Some stakeholders stated that they do not see an added benefit from setting a EU-wide threshold in order to achieve supervisory convergence. Some of these stakeholders suggest that supervisory convergence could be achieved through guidelines and/or improvement of relevant reporting templates) rather than changes in the legislation to ensure level playing field for such risk sensitive and specific definitions.

9.38 Other stakeholders are of the view that the current criteria are sufficient and clear enough; and should any criteria be added, that should have a clear relationship with the risks induced by the possible risk concentration and easily measureable i.e. quantitative.

Assessment - Policy Issue 9.3.4(2). To amend Article 244(3) of the Solvency II Directive to allow the introduction of additional criteria.

9.39 It should be noted that EIOPA's advice is not to set a threshold to be applied to all groups but to introduce into the regulation additional variables to the existent criteria for setting up thresholds (i.e. such as eligible own funds or a qualitative criterion, to these being of the SCR and/or technical provisions for the purpose of setting thresholds for IGTs and RCs reporting as deemed necessary by the group supervisor) in order to better take into account the specificities of the supervised group and enhance group supervision across Europe. This criteria as it is defined under a level 1 would require a change at the same level. After having the revised criteria in the legislation, there is a possibility to work on level 3 guidelines or supervisory notes.

9.40 After considering the above, EIOPA sees that the benefits overcome the downside of issues presented by stakeholders and proposes no change to the preferred policy option. Nonetheless, some wording has been amended to the analysis section of the Advice to provide some insights into the qualitative approach that could be considered by supervisory authorities.

9.5 Article 262 Solvency II Directive - Clarification

Summary of comments – Policy Issue 9.3.5(1) Further regulatory clarity needed on the application of Article 262 of the Solvency II Directive

9.41 One Stakeholder is supportive with the clarifications proposed for the proper application of the Article 262 of the Solvency II Directive and agrees that the group supervisor shoud document the application of one or several other methods. The same stakeholder stakeholder further comments that the possibility for the European group supervisor to require the group setting up a

EEA holding company in order to excercise group supervision should be limited to cases where other methods cannot be applied.

9.42 Some stakeholders state that policy proposal should not prevent supervisors from pursuing a proportionate approach, which may or may not involve the establishment of an EU holding company. Some of these stakeholders wonder if the cases listed in the advice where only theoretical or not.

Assessment – Policy Issue 9.3.5(1) Further regulatory clarity needed on the application of Article 262 of the Solvency II Directive

9.43 EIOPA is aware that some member states are facing the issues raised in the analysis of cases included in the opinion in supervising third country groups' European undertakings. Therefore, the policy issue presented is not a theoretical nature. EIOPA wishes also to recall the advice explicitly mention that the establishment of an EEA holding company is an option among the various other methods a group supervisor could consider to fulfil the objectives of group supervision, and the requirement for a holding should not be mandatory where the supervisors already applies "other methods" that allow them to achieve the objectives of Solvency II group supervision.

9.44 The policy proposal does not curtail supervisory judgment and the application of a risk based approach. The advice also emphasises on the need for the regulation to outline clear objectives to make use of 'other methods' in the case of no equivalence and parent undertakings registered in a third country.

9.45 After considering the above, EIOPA proposes no change to the preferred policy option except for wording amendments in the advice that emphasise the need to have clear objectives to make use of other methods under Article 262 of the Solvency II Directive.

9.6 Group Solvency -Treatment of Insurance Holding Companies (IHC), Mixed Financial Holding Companies (MFHC) [for the purpose of the Notional SCR and Own Funds]

Summary of comments - Policy Issue 9.3.6 (1) Need to clarify how a notional SCR should be calculated and how to treat the IHC and MFHC for the purpose of the group solvency calculation, in particular of a notional SCR and own funds for such undertakings

9.46 Some stakeholders support EIOPA's policy proposal, and some also indicate recommendations to ensure no double counting of risks. Some stakeholders recommend that intra-group transactions should be eliminated in the determination of notional solo-SCRs otherwise e.g. for IHC/MFHC which hold insurance subsidiaries, there would be a double-counting of risks of insurance subsidiaries which would cause deterioration of the allocation of contribution to Group SCR among insurance subsidiaries. Other stakeholders also confirm the above approach (no double counting of risks for participations) by stating that in the consolidated group SCR (method 1) any IHC/MFHC is only to be reflected on a consolidated basis .

9.47 One stakeholder makes reference to the effect of double counting of risks related to participations in relation to the use of notional SCR of IHC/MFHC in the calculation of the Minimum Consolidated Group SCR with the consequence of limiting the recognition of diversification benefits.

Assessment – **Policy Issue 9.3.6 (1)** Need to clarify how a notional SCR should be calculated and how to treat the IHC and MFHC for the purpose of the group solvency calculation, in particular of a notional SCR and own funds for such undertakings

9.48 In order to reduce the effect of double counting of the equity risks as highlighted by the stakeholders and to ensure a balanced treatment of all undertakings in the calculation both of the contribution to the group SCR, the following changes to the policy proposal have been considered:

- when determining the contribution of the related entities to the group SCR, the solvency requirement of the ultimate parent company (insurance or holding company) should be included in the calculation net of the equity risk related to the participations
- when combination of methods 1 and 2 is applied, the notional SCR and the notional OFs of the IHC/MFHC are added to the group solvency calculation but it would be expected that there is no double counting of equity risk in the SCR if the proposal under section 9.3.10 on combination of methods is adopte

9.49 After considering the above, EIOPA’s opinion remains for the preferred policy option. The analysis and the impact assessment have been updated to expand on the application of the policy proposal.

9.7 Article 229 of the Solvency II Directive –Non-availability of information and and other reasonable factors An alternative for a proxy Method to calculate group solvency requirements

Summary of comments – Policy Issue 9.3.7(1) Lack of clarity and consistency in the application of Article 229 of the Solvency II Directive in particular in cases where imposing Solvency II calculation is burdensome or impossible.

9.50 The proposal to increase proportionality and introduce a simplified calculation for the purpose of group solvency calculation of own funds and SCR as an alternative to the use of Article 229 of the Directive is supported by all stakeholders, however some of them (all except for Assicurazioni Generali) indicate some caveats as regards to the methodology

9.51 Two stakeholders consider that the right method should be the equity method (Article 13 (5) Delegated Regulation) based on IFRS shareholders' equity less goodwill and intangibles. One stakeholder also considers that the adjusted equity method implies valuing the participation (insurance company) with its proportionate Solvency II excess of assets over liabilities, which is unworkable.

9.52 Regarding the cap on own funds, two stakeholders are opposed to the idea of a cap of own funds. They consider that there is no justification for a cap, which results rather in a penalty for some groups. On the contrary, one stakeholder

considers that the cap is a valid incentive to provide more accurate data across groups.

9.53 Finally, one stakeholder highlights that under current provisions of Article 229 of the Solvency II Directive the application of the simplified calculation is not subject to approval by the group supervisor And it does not seem justified to require approval.

Assessment- Policy Issue 9.3.7(1) Lack of clarity and consistency in the application of Article 229 of the Solvency II Directive in particular in cases where imposing Solvency II calculation is burdensome or impossible.

9.54 Based from stakeholder's comments, it is understood that stakeholders welcome the idea of a simplified methodology that takes into account the accounting values, however there is no preference to set a cap on own funds. It is also noted that some groups are applying a proxy calculation as an alternative to the default approach set under Article 229 of the Solvency II Directive.

9.55 To address this, EIOPA proposes a new policy option where a simplified calculation is an exceptional and an alternative treatment to the default option of a deduction from of the own funds eligible for the group solvency calculation as provided in Article 229 of the Directive and should not apply to undertakings that represent a significant percentage of the investments in the group. For the application of a the alternative approach, the group should check with its supervisory authority that the undertakings belonging to the same group are both on an individual and on a collective basis considered as no material. When calculating the solvency capital requirements, the value of the undertaking is shocked for equity risk, currency risk and concentration risk. The output of the calculations cannot be lower than the proportion of local capital requirements ("the floor") for that undertaking. If the local capital requirements are not known, then the simplified approach would not be possible.

9.8 Scope of method 2 (where used exclusively/or in combination with method 1)

Summary of comments – Policy issue 9.3.8(1) Need to clarify the scope of application, and undertakings to be included under method 2 and their treatment to ensure a consistent treatment across methods (same scope of entities under all methods) and across EEA

9.56 Two stakeholders indicate that there is no need for further specifications. They consider that Article 328 of the Delegated Regulation already provides for specific elements to be considered regarding the choice of the method. They also indicate that their concern is that changes to the regulation could result in undertakings having to change their calculation methods.

9.57 Stakeholders also commented on the how the IHC/MFHC can be included under method 2. One stakeholder believes that the calculation of a notional SCR for

IHC/MFHC is already required as of today under Method 1. Two stakeholders consider that this notional SCR for holding companies should be net of risk charges for participations in related undertakings.

Assessment – Policy issue 9.3.8(1) Need to clarify the scope of application, and undertakings to be included under method 2 and their treatment to ensure a consistent treatment across methods (same scope of entities under all methods) and across EEA

9.58 The reading of Article 233 of the Solvency II Directive outlines that the method 2 should only apply to insurance/reinsurance companies, and no reference is made to IHC/MFHC and undertakings in the Other Financial Sectors. For that reason, EIOPA recommends to have a clarification.

9.59 The policy proposal is closing the regulatory gap to ensure clarity and transparency on the scope of application. Method 1 is the default method of application while Method 2 requires a particular assessment (e.g. not applicable in all cases). There would be no impact on the application for the other financial sector (e.g. results are expected to be the same under Method 1 and Method 2)

9.60 For holding companies if included under method 2 they should follow the policy recommendation on section 9.3.6 regarding computing a notional SCR and a notional MCR.

9.61 For undertakings in Other Financial Sectors (OFS), EIOPA recommends to clarify that Article 329 Delegated Regulation applies to them. Further details of that advice is available under section 9.3.16(1) of the Advice.

9.62 After considering the above, EIOPA proposes no change to the preferred policy option. However, wording amendments were incorporated to facilitate linkage with other policy issues.

9.9 Partial Internal Model (PIM) and Integration Techniques

Summary of comments- Policy Issue 9.3.9 - There is no specific provision about the application of integration techniques to partial internal models at group level

9.63 EIOPA received a limited number of comments on this issue. Stakeholders generally accepted the proposal for clarifying that mutatis mutandis approach from the solo level regarding the application of integration techniques to the partial internal model should not be applicable at the group level.

9.64 Two stakeholders in this context underlined their support for necessity of the concept of an alternative integration technique as included in the preferred policy option and advocated for the recognition of diversification effects between internal model entities and standard formula entities at the group level.

9.65 Two stakeholders focused mainly on the integration technique 1 and its appropriateness.

Assessment -Policy Issue 9.3.9 -There is no specific provision about the application of integration techniques to partial internal models at group level

9.66 EIOPA's examples illustrated in the analysis of the preferred policy option, as well as the stakeholders comments confirm that the integration of entities applying standard formula with the ones applying an approved internal model at group level should be treated in a different way from the treatment of integration techniques at solo level. This is due to the fact that the nature of risks' integration is different from the nature of entities' integration. A clear differentiation on the treatment will avoid errors/mis-representations when calculating the group solvency requirements.

9.67 Regarding diversification effects, EIOPA would like to underline that these could only be recognised under an alternative integration technique and that groups should explicitly show that this technique (not only regarding diversification effects) does not result in an underestimation of the overall risks the group is exposed to as part of the assessment required in Article 239 (5) (b) of the Delegated Regulation that the resulting Solvency Capital Requirement appropriately reflects the risk profile of the undertaking or group. This would imply to demonstrate that there is no recognition of diversification benefits that do not exist.

9.68 EIOPA proposes no change to the preferred policy option except for some wording amendments.

9.10 Group SCR calculation when using Combination of methods

Summary of comments – Policy issue 9.3.10(1) A need for clarification of principles to ensure appropriate coverage of risks in the group SCR under the combination of methods. This especially concerns equity risk for participations, currency risk and concentration risk.

9.69 Stakeholders in general are supportive to clarify that no double counting of equity risk should occur when using combination of methods, while one stakeholder agreed to eliminate any diversification benefit among entities included through method 2 both exclusively or in combination with Method 1 and stated that groups should only use the method 1 and method 2 in peculiar and residual cases.

9.70 Regarding currency and concentration risk, stakeholders agree that those risks might exist, but in general some stakeholders are not supportive of explicitly addressing these risks. Stakeholders are of the view that there are enough buffers in method 2 to ensure that the approach in overall would be still prudent and also indicated that the cost benefit is not aligned to the level of materiality of these risks. Finally, one stakeholder referred to the fact that method 1 is the preferred approach and prudency should be used to support the use of method 1.

Assessment – Policy issue 9.3.10(1) A need for clarification of principles to ensure appropriate coverage of risks in the group SCR under the combination of methods. This especially concerns equity risk for participations, currency risk and concentration risk.

9.71 EIOPA acknowledges the arguments brought forward by stakeholders and considers an explicit treatment of risks as preferable when dealing with combination of methods. This also against the background of discussions between supervisors and undertakings, which will benefit from a clarification and the data inputs from sampled groups, which confirm that impacts can be considered to be of limited materiality. The policy option presented on the one hand avoids a double counting of participation risk. On the other hand it requires an explicit treatment of currency and concentration risk, in line with the practice of some stakeholders. It is also intended that for standard formula users, requirements will leverage on established algorithms. Effort is considered to be generally limited. Furthermore, diversification will be allowed for and proportionality will allow to deal with cases of low materiality.

9.72 After considering the above, EIOPA sees that the benefits overcomes the downside of issues presented by stakeholders and proposes no change to the preferred policy option.

9.11 Group Solvency –Application when using combination of methods

Summary of comments – Policy Issue 9.3.11 (1) - Need for Article 233 of the Solvency II Directive to explicitly state that Method 2 (where used exclusively or in combination with Method 1) used to calculate the group solvency requirements applies to single undertakings (where used exclusively or in combination with Method 1).

9.73 Industry is of the view that there is no need for further clarification regarding the application of method 2, Some stakeholders disagree with EIOPA's proposal to allow the application of method 2 only to legal entities on a one by one basis (e.g. no sub-group consolidation). For example, they consider that if the sub-group is managed on a unified basis but is not a subsidiary of the parent undertaking, diversification between the entities in the sub-group should be allowed.

Assessment - Policy Issue 9.3.11 (1) - Need for Article 233 of the Solvency II Directive to explicitly state that Method 2 (where used exclusively or in combination with Method 1) used to calculate the group solvency requirements applies to single undertakings (where used exclusively or in combination with Method 1).

9.74 Method 2 is intended to apply as an exceptional method according to Articles 220 and 233 of the Solvency II Directive. Where method 2 is used exclusively, Article 233 of the Solvency II Directive is explicit about the solvency calculations being made on an entity by entity basis. Where Method 2 is used in combination with Method 1, there is less clarity on the regulations however the principle remains and this was clarified in the Q&A 1401 of July 2018.

9.75 The application of method 2 exclusively, or in combination with method 1 has its consequences due to the definition of the method. Diversification Benefits are not allowed under Method 2. As the method 2 allows for a simplified calculation (e.g. simple aggregation and no consolidation) and potentially to substantial gains, it was designed in a prudent manner that does not allow for diversification between undertakings (simple sum of solo SCRs) and encompasses potential multi counting of risks (when solo SCRs take into account exposures to related undertaking which SCRs are added up). Contrarily, applying Method 2 at a "sub-group" level would allow for diversification between undertakings that use Method 2 and re-treat potential multiple counting of risks via the consolidation process.

9.76 Method 1 is the default method to calculate the group solvency requirements, and groups wishing to avail of the benefits of applying only method 1 should revise if their current application of Method 2 (or a combination of methods) under Article 328 of the Delegated Regulation is no longer applicable to them and engage with their group supervisors.

9.77 After considering the above, EIOPA proposes no change to the preferred policy option of recommending clarity on the application of method 2 when used exclusively or in combination. EIOPA also recommends some specificities regarding the calculations of certain risks (see section 9.10 of this document; and section 9.310 of the Call for Advice) which are aligned with the need for clarity on the alternative method.

9.12 Classification of Own Funds

Summary of comments – Policy Issue 9.3.12(1) Classification of own funds at group level and the reliance on criteria for classification at solo level – issues with application of Article 330 (1)(d) of the Delegated Regulation level.

9.78 Some stakeholders agree with the advice to delete the paragraph (1)(d) of Article 330 of the Delegated Regulation, since own funds which do not meet the Tiering criteria of Article 332 Delegated Regulation cannot qualify as group own funds at all. One stakeholder welcomes the clarification in the scope of undertakings to be included under method 2 and their treatment to ensure a consistent treatment across methods.

9.79 Some other stakeholders however are of the opinion that there is no need to add additional requirements and the current sequence of requirements is clear.

9.80 Furthermore, these stakedholders considers that, if supervisory convergence is the issue, this should be dealt with by means of convergence tools at the disposal of EIOPA rather than by changes to the legislation

Assessment - Policy Issue 9.3.12(1) Classification of own funds at group level and the reliance on criteria for classification at solo level – issues with application of Article 330 (1)(d) of the Delegated Regulation.

9.81 The policy proposal would solve the issues encountered on the application of mutatis mutandis affecting the classification of own funds at group level by clarifing and confirming that in the case the provisions in Articles 331 to 333 (including the requirements in Articles 71/73/77) of the Delegated Regulation are not met, this would lead to the non-recognition of the full amount of that own-fund item at group level. It would also avoid that an own-fund item (under method 2) and not compliant with Articles 331 to 333 (including reference to Articles 71/73/77) of the Delegated Regulation could still be considered available at group level.

9.82 After considering the above, EIOPA sees that having clarity at regulatory level would provide benefits to all stakeholders. Therefore, EIOPA proposes no change to the preferred policy option.

Summary of comments – Policy Issue 9.3.12(2) Assessing "free from encumbrances" in particular in relation to own-fund items issued by an insurance holding company or mixed-financial holding company (recital 127 of the Delegated Regulation)

9.83 Majority of stakeholders are of the view that the clarification on the application of Recital 127 of the Delegated Regulation is not needed and existing winding-up practices are sufficient. In their view, when there is a breach of a SCR and a winding-up situation arises, there is normally an automatic suspension of any payments. Some stakeholders indicate that all EEA subsidiary (re-)insurers within the scope of that group must be captured by Recital 127, irrespective of the type, including ASUs. In that regard, some of the stakeholders would favour the policy option which extends on the scope of application which in their view would enhance the level playing field.

9.84 One stakeholder agrees with the need to clarifiy the purpose of recital 127 in the Delegated Regulation. Its view is that the scope of this provision should be the winding-up of any EEA (re)insurance related undertaking in the group and that the scope should be the same, regardless of the structure of the group (a group headed by a holding company or by an insurance or reinsurance undertaking) to ensure a level playing field.

Assessment - Policy Issue 9.3.12(2) Assessing "free from encumbrances" in particular in relation to own-fund items issued by an insurance holding company or mixed-financial holding company (recital 127 of the Delegated Regulation)

9.85 The policy proposal would solve the current uncertainty and challenges associated with the effective application of recital 127 of the Delegated Regulation. The clarification in the regulation should indicate that it would be sufficient to provide for the suspension of repayment/redemption of an own-fund item when there is a winding-up situation and EIOPA also advises that this is limited to winding-up situations of any EEA (re)insurance related undertaking of the group. The supervisory authority should still have the possibility to waive

the suspension of repayment or redemption of that item in exceptional circumstances, for example for non-material non-controlled participations. The advised policy will also confirm existing practises and ensure an enhanced level playing field.

9.86 After considering the above, EIOPA proposes no change to the preferred policy option. However, some wording adjustments incorporated on the analysis and the opinion.

9.13 Availability Assessment of Own Funds (Article 330 of the Delegated Regulation)

Summary of comments – **Policy Issue 9.313.(1)** Inclusion of own fund items to cover the solo contribution to the group SCR (Article 330(5) of the Delegated Regulation)

9.87 In general, stakeholders agree with EIOPA's proposal – no change of Article 330(5) of the Delegated Regulation. Some stakeholders consider that the no change is the right approach as the current process described in the aforementioned article ensures no components unable to absorb losses in the group are added to group own funds.

9.88 Other stakeholders indicate that no change is needed as they believe that every simplification has its vulnerabilities, and that tiering the availability limits would result in additional tiering limitations at group level. Also, they defend that such mentioned situations (in the advice) are not frequent.

Assessment – **Policy Issue 9.313.(1)** Inclusion of own fund items to cover the solo contribution to the group SCR (Article 330(5) of the Delegated Regulation)

9.89 EIOPA's policy advice is a no change to the current regulation. This is also supported by stakeholders. Therefore, EIOPA proposes not to change the preferred policy option.

Summary of comments - Policy Issue 9.313.(2) Formula for calculating of the contribution to group SCR- Need to clarify the inclusion of undertakings in the SCR Diversified.

9.90 Some stakeholders believe that the scope, as defined in Article 222 of the Solvency II Directive and in Article 330 of the Delegated Regulation, is sufficiently clear. Nevertheless they state the need to clarify some aspects such as no inclusion of parent company and no separate SCR for Ancillary Services Undertakings (ASU's).

9.91 Also, other stakeholders make reference to the need to clarify the double counting of equity risk and the IGT's treatment when including the IHC in the SCR Diversified.

Assessment – **Policy Issue 9.313.(2)** Formula for calculating of the contribution to group SCR- Need to clarify the inclusion of undertakings in the SCR Diversified.

9.92 The policy proposal seeks to ensure that all key risks derived from undertakings are captured in the diversified SCR calculation in a consistent manner, while still allowing a proportionate application where no added burden is posed by including ancilary service undertakings.

9.93 In particular, the proposal regarding treatment of IHC and MFHC has been amended in the advice in such a way that, when determining the contribution of the related entities to the group SCR, the solvency requirement of the ultimate parent company (insurance or holding company) may be included in the calculation net of the equity risk related to the participations in insurance undertakings. For further details, please refer to section 9.6 – Group Solvency – Treatment of Insurance Holding Companies (IHC), Mixed Financial Holding Companies (MFHC) for the purpose of notional SCR calculation.

9.94 After considering the above, namely the need for clarification regarding the consideration of specific entities in the diversified SCR, EIOPA proposes no change the the preferred policy option (clarification of the undertakings to be included in the contribution calculation).

Summary of comments – **Policy Issue 9.313.(3)** Availability assessment of specific items within the reconciliation reserve, the benefit from transitional measure on technical provisions or risk-free interest rates.

9.95 Some stakeholders refer to the initial purpose of the transitional measure, to facilitate the transition at both solo and group level, and therefore it should not be considered unavailable at group level.

9.96 Generally, stakeholders did not agree with the initial proposal to make the transitional measure on technical provisions subject to an availability assessment at group level, some stated that it was not a clarification but a change in the law.

Assessment – **Policy Issue 9.313.(3)** Availability assessment of specific items within the reconciliation reserve, the benefit from transitional measure on technical provisions or risk-free interest rates.

9.97 After considering the stakeholders comments, the difficulty in assesssing the transitional measure on technical provisions' availability at group level and it's impact on group solvency, a new policy option was developed. EIOPA advices to include in the regulations additional disclosures that would allow the group supervisor to take action if the group SCR coverage is significantly dependant on own funds stemming from the benefits on transitional measures.

Summary of comments - Policy Issue 9.313.(4) EPIFPs and the availability assessment of own funds under Article 330 of the Delegated Regulation

9.98 Some stakeholders strongly and fundamentally disagrees with the option that EPIFPs should be assumed to be not available by default at group level by default. Stakeholders argue that supervisors are also granted power to review the best estimate calculations, knowing that EPIFP are just an output of the economic value of insurance liabilities. They consider that non-availability by default of EPIFP would create legal uncertainty while undermining the fundamental principle of the market-consistent balance sheet.

9.99 Some stakeholders defend EPIFPs are a result of a valuation based on economic principles, calculated with principles suggesting transferability to a willing third party, resulting in the possibility to make EPIFPs available through transactions such as sale of legal entities, portfolio transfers, reinsurance arrangements and securitization. The timeframe for the completion of these transactions in 6 to 9 months is realistic. Furthermore, in substance, EPIFP is shareholder money which must for reasons of symmetry be reflected as also the pertaining risks are reflected.

Assessment - Policy Issue 9.313.(4) EPIFPs and the availability assessment of own funds under Article 330 of the Delegated Regulation

9.100 EIOPA analysed the comments received and recognized that assuming the non-availabilibity of EPIFPs is controversial and could raise other issues.

9.101 After considering the above, EIOPA sees that the benefits overcome the downsides of issues presented by stakeholders and proposes a revised policy option to the one consulted with stakeholders.This revised option advices that groups are asked to consider EPIFPs as part of the regular availability assessment (Article 330(1) of the Delegated Regulation). EPIFPs are not subject to a default assumption of non-availability, but the availability should be justified by groups. It should be noted in any case that, in accordance with Article 330(5) of the Delegated Regulation, non-available own funds can be taken into account in the group solvency up to the contribution of each company to the group SCR.

9.14 Minority Interest – Basis and Approach to calculation of Minority Interest to be deducted from the consolidated group own funds

Summary of comments: Policy Issue 9.3.14 (1) -Need for a clear basis and approach for the calculation of minority interest at a regulatory level (level 2).

9.102 Some stakeholders are of the view that the current EIOPA guidelines on treatment of minority interests are sufficient, but in general stakeholders agree with the need to further clarify the calculation of minority interest.

9.103 Regarding the minority interest's calculation, most of the stakeholders support that the calculations should be based on a solvency II valuation. Stakeholders also believe the calculation should be net of IGTs but there are some divergent views regarding the inclusion or not of external subordinated debt.

9.104 A stakeholder noted that whether external debts are to be included or not depend on the legal construction with the minority interest i.e. if they are equal (to their proportion) liable for the subordinated debt in a winding-up situation the external subordinated debt should be considered (situation 1c) otherwise 1a should apply. However, majority of highlight that the approach consulted under case 1.b and 1.c of the the consulted policy option are reasonable, and at least three stakeholders indicates a preference for case 1.c. (e.g. to exclude external subordinated debt).

Assessment: Policy Issue 9.3.14 (1) -Need for a clear basis and approach for the calculation of minority interest at a regulatory level (level 2).

9.105 Based on the analysis of inputs from stakeholders and other data available to EIOPA, it is confirmed that the output under case 1.b and policy advise would offer an alignment with the Article 330 of the Delegated Regulation and Guideline 14 of EIOPA's guidelines on group solvency while reducing the impact on the total deductions applied to eligible own funds and easing the calculations the groups will need to apply regarding minority interest. The outputs for the consulted case 1.c. will have a larger impact on the overall available own funds at group level as the minority interest is calculated separately from other non-available own funds. Hence, ignoring to some extent the fact, that the non-available own funds may be included up to the contribution of solo SCR to the group SCR. The Guideline 14 of EIOPA Guidelines on group solvency is adopted on the basis that paragraph 5 precedes paragraph 4 of Article 330 on the process of determining the availability at group level of eligible own funds of related undertakings. By not giving priority to non-available own fund items to cover the contribution as implied under case 1.c, this may lead to a lower amount of minority interest deducted from group own funds in principles, however it could also lead to other own fund deductions not analysed in detail in the consulted case.

9.106 Some stakeholders disagree with the inclusion of external subordinated debt in the minority interest calculation. The approach followed by the guideline on minority interest mainly aims at identifying the excess of available own funds over the contribution to the group SCR. To this end, it is necessary to include all own funds of the subsidiary concerned. Due to the structure of solo own funds, in general, there will be no deduction for minority interest applied to subordinated debt instruments – in alignment with the accounting approach. The only exception for deduction for minority interest on sub-ordinated debt would be in situations where a subordinated debt has been demonstrated to be available in accordance with Article 330 (3) of the Delegated Regulation (which is generally not the case as there is a default presumption of unavailability) and it is in excess of the contribution to the group SCR of the subsidiary. The overall spirit of Guideline 14 of EIOPA Guidelines on group solvency is still considered appropriate.

9.107 After considering the above, EIOPA proposes no change to the preferred policy option consulted with stakeholders, and confirms the approach to follow under

the preferred policy option is 1.b (e.g. it should also be net of intragroup transactions and include external subordinated debt)

9.15 Minimum Consolidated Group SCR

Summary of comments – **Policy Issue 9.315.(1)** Need to clarify and align the scope of the undertakings included in the minimum consolidated group SCR (Min.Cons.SCR) versus the undertakings included in the group SCR

9.108 Some stakeholders welcome the clarification of the scope of the minimum consolidated group SCR and are in favour of the inclusion of guideline 21b in the legislation. However, they are of the view that for groups with large parts of D&A and OFS entities, there will be a significant difference in the scope between the group SCR and the MCR. This different scope is justified in some of their views, as there is a cap on diversification. However, for any other reasons that are connected to the functions of a group MCR, a difference in the scope cannot be justified in the opinion of other stakeholders.

9.109 Other stakeholders disagree with an extension of the group of entities contributing to the minimum consolidated group SCR as they do not see any supervisory added value. In particular, the inclusion of holding companies is seen critical, as they do not write insurance business in general.

9.110 One stakeholder questions the inclusion of non-equivalent third country (re)insurers, as it is not assessed in the policy proposal. In case of equivalence, local rules may be applied for the inclusion in the group solvency calculation. In case of non-equivalence, the Solvency II legislation should be applied. However, the stakeholder further indicates that for certain elements the inclusion of non-equivalent third country subsidiaries in the group solvency calculation could result in an onerous and inappropriate treatment.

Assessment – **Policy Issue 9.3.15.(1)** Need to clarify and align the scope of the undertakings included in the minimum consolidated group SCR (Min.Cons.SCR) versus the undertakings included in the group SCR

9.111 Third countries (re)insurance undertakings should be considered in the Min.Consol.SCR since they contribute to the group SCR. In case the inclusion of non-equivalent third country subsidiaries in the group solvency calculation could result in an onerous and inappropriate treatment, a simplified calculation for the purpose of group solvency calculation as an alternative to the use of Article 229 of the Directive is proposed under section 9.3.7 of the advice.

9.112 The inclusion of IHC and MFHC in the calculation (taking into account that the notional SCR for such undertakings is necessary due to other prudential reasons – see section 9.3.6 of the Advice) could (partly) ensure that the changes in the group SCR will be reflected in the Min.Cons.SCR.

9.113 This inclusion has to be considered together with the new proposal of the advice for policy issue 9.3.15.(2), which differentiate the two dimensions of minimum consolidated group SCR as (i) a method to calculate a floor to the group SCR

(mechanism to safeguard that the group SCR is not lower than the sum of "solo" MCRs) and (ii) the trigger for the "mutatis mutandis" application at group level of the requirements related to solo MCR. After the proposed change in the scope of the calculation, the Min.Cons.SCR should not any longer trigger the same supervisory actions as at solo level.

9.114 After considering the above, EIOPA confirms the policy option consulted for this policy issue, and the need to clarify that the purpose of Min.Cons.SCR at group level is not the same as in the MCR for solo undertakings (policy issue 9.3.15 (2). EIOPA sees that the benefits overcomes the downside of issues presented by stakeholders and proposes no change to the preferred policy option consulted with stakeholder.

Summary of comments – **Policy Issue 9.3.15.(2**) Calculation method for the minimum consolidated group SCR (Min.Cons.SCR) and related mutatis mutandis issues

9.115 All stakeholders strongly disagree in keeping the current calculation of the minimum consolidated group SCR as it is. They see the proposal of calculating a notional SCR and the minimum capital requirement (MCR) on holding companies as a simplistic method that is not risk-based and therefore a disproportionate approach. For stakeholders a factor-based calculation does not seem to be justifiable under a risked-based system. In their view, the concept of a minimum consolidated group SCR (Min.Cons.SCR) should only be maintained for the floor of the consolidated group SCR.

9.116 Stakeholders also expressed strong concerns about leaving the calculation method unchanged as this is increasing the risk of a "trigger inversion", which is understood as a situation where the group SCR is breached before the minimum consolidated group SCR (Min.Cons.SCR). Stakeholders are also of the view that the fact of the Min.Cons.SCR is not having a corridor at goup level should be considered in the analysis. They also comment that a breach of the MCR at group level should not trigger the same consequences as at solo level.

9.117 Stakeholders also believe that the "trigger inversion" would be further increased when using a methodology that takes into account a multiple counting of risks and IGTs. In their view, such a double counting would lead to onerous outcomes which will be exclusively relevant for the issuers of subordinated debt. Furthermore, in their view, the increased possibility of a trigger inversion would appear to punish more complex groups in general, as well as groups with large contributions from D&A and Other Financial Sector entities.

9.118 Some stakeholders see some critical issues with the concept of the minimum consolidated group SCR that should firstly be solved. For instance, in their view, there could be unintended consequences from the interaction between the principal loss absorbency mechanism "PLAM" and the "Group MCR" that have to be reflected appropriately.

Assessment – **Policy Issue 9.315.(2)** Calculation method for the minimum consolidated group SCR (Min.Cons.SCR) and related mutatis mutandis issues.

9.119 EIOPA has considered the above and confirms a no change to the existing methodology of the Min.Cons.SCR calculation (i.e. a floor using a simple calculation and for which no diversification benefits are brought into the calculation).

9.120 The Min.Cons.SCR is the minimum floor for the entities that are included on a consolidated basis and is a mechanism to safeguard that the group SCR is not lower than the sum of MCRs solo. The Min.Cons.SCR "the floor" at group level should not any longer trigger the same supervisory actions as at solo level (e.g. all relevant elements from Article 139 of the Solvency II Directive).

9.121 EIOPA also proposes a new trigger metric that is directly calculated as a percentage on the total group SCR. This metric should be used for the application of mutatis mutandis issues at group level of the requirements related to solo MCR, and any supervisory actions regarding breaches, own fund triggers, etc. Therefore, the proposal of a new metric trigger should prevent the situation encountered by some groups regarding the issue of the "mutatis mutandis" application.

9.122 Finally, clarifications regarding the policy issue on the Notional SCR calculation and related issues (see policy issue 9.3.6 in the consultation paper), will also help groups realising that the amount of the Min.Cons.SCR would not be as high as some stakeholders have stated.

9.16 Inclusion of Other Financial Sectors (OFS)

Summary of comments – Policy Issue 9.3.16 (1) Lack of clarity on inclusion of undertakings in Other Financial Sectors (OFS) into Solvency II

9.123 All stakeholders are of the view that a clarification on the application of Article 329 of the Delegated Regulation is not necessary. In their view it is obvious that this article applies regardless of the calculation method used for the inclusion of related OFS undertakings in the group solvency calculation.

9.124 One stakeholder mentions that it would not make sense to have different treatment as no real consolidation occurs for undertakings in OFS at group level. Therefore it should only be one method to include such undertakings.

Assessment – Policy Issue 9.3.16 (1) Lack of clarity on inclusion of undertakings in Other Financial Sectors (OFS) into Solvency II

9.125 Stakeholders are in favour of not having any policy proposal since in their view the current wording is sufficient for their interpretation. However, EIOPA's view is that the policy proposal will clarify that Article 329 always applies when other financial sector entities are included in the solvency II group solvency calculation. It would also solve any uncertainties on the actual technique to include these undertakings and that the technique should be applied independently of the method used for the calculation of group solvency.

9.126 After considering the above, EIOPA proposes no change to the preferred policy option consulted with stakeholders, however some wording amendments were added to the analysis and the advice.

Summary of comments – Policy Issue 9.3.16 (2) Allocation of OFS own funds into relevant Solvency II tiers for the purpose of Solvency II calculations

9.127 The majority of the stakeholders disagree with the policy proposal and state that Solvency II regulation should not be forced to the own funds from OFS entities, and that own-fund items should be reported according to the tiering assigned by the sectoral rules. Some stakeholders underline that the benefits would be very limited as it can be very misleading if some own-fund items are reallocated into Solvency II tiers while others are not. Some of the stakeholders also mention that it would be burdensome for them to identify the own-fund items that would have to be reallocated according to Solvency II tiering.

9.128 Some stakeholders agree with the policy proposal to allocate on a high-level and only for specific own-fund items. At the same time, they mention that if own-fund items other than subordinated debt are refered to, it should be clarified how any differences in the balance sheet according to sectoral rules and the economic perspective of Solvency II is considered.

Assessment – Policy Issue 9.3.16 (2) Allocation of OFS own funds into relevant Solvency II tiers for the purpose of Solvency II calculations

9.129 Although the the proposal consulted does not imply any reclassification according to Solvency II rules for own-fund items from OFS entities, EIOPA is conscious that it would be challenging to implement this policy in particular as it would require supervisors and groups to be fully familiar with the regulations applied to other financial sectors, and in particular the rules across OFS may not be comparable to Solvency II.

9.130 After considering the above, the stakeholders' comments that this policy is for information purposes and that the current impact of own funds from Other Financial Sectors to the contribution to the group SCR is only significant for a few groups and some of them are on the same member state, EIOPA has changed its prefered policy option consulted, and it now recommends the policy option 1 of no change, and therefore the status quo would remain for this policy issue.

Summary of comments – Policy Issue 9.3.16 (3) Clarify the ability of excess of own funds from OFS to absorb losses in the insurance part of the group

9.131 Some of the stakeholders state strong concerns on the concept of availability assessment in general. Regarding the proposal to include an availability assessment of OFS, the majority of the stakeholders disagree with the preferred policy option, and one stakeholder agree with EIOPAs policy advice

9.132 Some of these stakeholders question why a requirement of a close cooperation with relevant supervisors of other sectors would help, while some stakeholders mention that if an assessment of the transferability of own funds items from other financial sectors was to be introduced, harmonisation with other sectors would have to be ensured. One stakeholder underline that it would be very burdensome to identify the own-fund items from OFS. However, if an availability assessment were to be introduced, some stakeholders indicate that the proposed assessment should at least be a closed list of own-fund items similar to Article 330 (3) in the Delegated Resolutions, and therefore delete the reference to any non-distributable reserve.

Assessment – Policy Issue 9.3.16 (3) Clarify the ability of excess of own funds from OFS to absorb losses in the insurance part of the group

9.133 An availability assessment of own funds at group level is a requirement of the Solvency II framework. This ensures that own funds can be both transferred and can be readily absorb losses wherever they arise in the group. It is expected that groups are compliant with Article 330 of the Delegated Regulation.

9.134 The policy proposal focuses mainly in ascertaining if the excess of own funds generated from other financial sectors (which are not directly mentioned under Article 330 of the Delegated Regulation) can be readily available to absorb losses in the insurance part of the group . This should not cause much burden on groups, if groups have already full clarity of the own funds that are contributing to the group own funds.

9.135 After considering the above, EIOPA proposes no change to the aim of the preferred policy option consulted with stakeholders, but will amend wording to capture comments from stakeholders. EIOPA will clarify that the objective of this policy option is to have sufficient assurance that the excess of own funds from the OFS can be effectively used to absorb losses in the insurance part of the group. This to avoid misinterpretation of the financial positon of the group.

Summary of comments – Policy Issue 9.3.16 (4) Lack of clarity on the inclusion of own funds and capital requirements subject to sectoral rules when OFS entities form a group

9.136 All stakeholders agree with the preferred policy option to include the group own funds and group capital requirements when OFS entities form a group that is subject to sectoral rules.

Assessment – Policy Issue 9.3.16 (4) Lack of clarity on the inclusion of own funds and capital requirements subject to sectoral rules when OFS entities form a group

9.137 After considering the above, EIOPA proposes no change to the preferred policy option consulted with stakeholders.

Summary of comments – Policy Issue 9.3.16 (5) Need to clarify which capital requirements for credit institutions, investment firms and financial institutions should be included in the group solvency.

9.138 The stakeholders' comments to policy issue 5 are twofold. Stakeholders do not oppose regarding the legal part of the advice: the importance of the issue justifies to upgrade the text of the Q&A to the legal text instead of having the clarification in a Q&A. However, on the merit for a regulatory change, the stakeholders presented divergent views. Two stakeholders are of the opinion that the answer from Q&A 1344 should be copied into Delegated Regulations. Other three stakeholders are of a different view. They refer to the fact that Q&A 1344 seems to focus to stand alone entities but when the capital requirements are calculated according to the sectoral rules, the additional buffers should not be included in the calculation for the Solvency II group solvency calculation. Moreover, they indicate that there is also a legal issue about what should be recognized as capital requirements (i.e. rather requirements which are published and comparable).

Assessment – Policy Issue 9.3.16 (5) Need to clarify which capital requirements for credit institutions, investment firms and financial institutions should be included in the group solvency.

9.139 After further investigation of the nature of the additional buffers in banking, EIOPA recognized also the difference in the nature of the Solvency II capital add-on (which is included into the solvency capital requirements) and buffers in banking or investment services sector (which are set above capital requirements and lack of covering them results in lack of allowance to pay dividend, no recovery plan is required). Therefore, taking into account the input from stakeholders, EIOPA's own assessment and the fact that answer to Q&A 1344 was provided by the European Comission, EIOPA is of the opinion that the European Commission should clarify in the Delegated regulation whether indeed the content of financial conglomerate regulation (RTS 342/2014 Article 9) should also be applicable to the Solvency II group calculation. Moreover the provision in Article 336(c) of the Delegated Regulation refers to capital requirements while the additional CRD buffers are not recognized as part of them.

9.140 Considering that upgrading the Q&A 1344 to a regulatory level would introduce more strict treatment of credit institutions, investment firms and financial institution from the group solvency calculation perspective than they are treated according to sectoral rules, EIOPA proposes to change the preferred policy option consulted with stakeholders, i.e. ask for the clarification in the legal text what should be taken into account as the "capital requirements" of the credit institution, investment firms and financial institution,

9.17 Application of Article 228 of the Solvency II Directive - Related credit institutions, investment firms, and financial institutions

Summary of comments –Policy Issue 9.3.17(1) Lack of clarity regarding the methods of inclusion of related credit institutions, investment firms and financial institutions in group solvency requirements calculation (Article 228 of the Solvency II Directive), and interaction with FICOD, and other articles of the Solvency II framework

9.141 Some stakeholders agree with the necessity of a harmonized approach and are in favour with the proposal to include the credit institutions, investment firms and financial institution entities with their sectoral rules in the group solvency calculation. However, they indicate that there should be a balance between a harmonized approach and a workable solution.

9.142 Some stakeholders see the proposal (to delete Article 228 of the Solvency II Directive) as an introduction of further complexity and state that the issue is presented in a minimalmanner by EIOPA. In their view, there are possible far reaching consequences that should be anticipated in a further in-depth analysis. These consequences are not fully described. In their view, by deleting Article 228 of the Solvency II Directive, FICOD groups would be required to calculate their group capital according to both the FICOD and Solvency II Directive, if the results of the calculations vary. A stakeholder is of the view that the policy proposal is forcing Solvency II rules into undertakings of other financial sectors and that legislative amendments should be avoided.

9.143 Most stakeholders describe their concern of an excessive reporting burden in case there will be no possibility to deviate from the Solvency II methods 1 or 2.

Assessment - Policy Issue 9.3.17(1) Lack of clarity regarding the methods of inclusion of related credit institutions, investment firms and financial institutions in group solvency requirements calculation (Article 228 of the Solvency II Directive), and interaction with FICOD, and other articles of the Solvency II framework

9.144 The lack of clarity regarding Article 228 of the Solvency II Directive as well as to the national transposition issues have brought concrete practical issues as described in the analysis of the advice. Removing the references to FICOD methods, will simplify matters to Solvency II groups and ensure a level playing field across member states.

9.145 The policy proposal is not creating new rules for including related credit financial institutions, investment firms and financial institutions undertakings in the group solvency calculation. Solvency II groups will therefore include these undertakings by applying sectoral rules but they can only be included in with Solvency II methods (see Section 9.3.16 of the Advice). Groups can still avail of the flexibility to deduct the participation in a credit financial institutions, investment firms and financial institutions undertakings from the own funds eligible at group level.

9.146 Based on the public reporting data available, it is evident that the issues identified limits comparability of data across Solvency II groups which are also denominated as financial conglomerates. Furthermore, the proposal is not interfering with the FICOD regulations, and based on the comments received it is hard to understand how such Solvency II groups will suffer additional burden in the context of FICOD supplementary supervision, in particular as they should be already applying full Solvency II rules to integrating such undertakings subject to Article 228 of the Solvency II Directive (including Guideline 11 of EIOPA Guidelines on Group Solvency on the treatment of specific related undertakings for group solvency calculation).

9.147 After considering the above, EIOPA sees a benefit rather than a downside for removing only Article 228 paragraph one from the Solvency II Directive. Therefore, EIOPA advises to amend the wording of the preferred policy option consulted with stakeholders, i.e. ask for the clarification in the legal text what should be taken into account as the "capital requirements" of the credit institution, investment firms and financial institution could only be included in the calculation of the group solvency using Solvency II methods.

9.18 Mutatis mutandis application of solo governance requirements to groups - Article 40 of the Solvency II Directive (definition of the AMSB for groups); and Article 246 of Solvency II Directive (supervision of the system of Governance)

Summary of comments – Policy issue 9.3.18 - Lack of clarity regarding the mutatis mutandis application of solo governance requirements to groups - Article 40 of the Solvency II Directive (definition of the AMSB for groups); and Mutatis Mutandis under Article 246 of Solvency II Directive

9.148 Some stakeholders are supportive about the need to clarify the group governance requirements set out in Article 246 of the Solvency II Directive while others state that is it not necessary to include Article 40 of the Solvency II Directive regarding the responsibility of the administrative, management or supervisory body (AMSB) under the scope of group governance requirements as in their view that will restrict flexibility in group governance organisation.

9.149 Some stakeholders also specify that the group supervisor must not be granted power to designate any entity as responsible for the implementation of group governance requirements when the identification of the ultimate parent undertaking is not obvious. Stakeholders' view is that this should be defined in cooperation with the group itself.

9.150 Some stakeholders consider unnecessary to take into account all the entities which are included in the scope of the group into the group system of governance. First, they consider unnecessary to include risks that arise from undertakings which are not subject to Solvency II because the large majority of such related undertakings only provide support activities. Secondly, their preference is also not to include non-controled participations under the scope of group governance requirements. Finally, some stakeholders indicate some

reservations on the practical implementation of the group governance requirements based on the proposed policy option.

Assessment – Policy issue 9.3.18- - Lack of clarity regarding the mutatis mutandis application of solo governance requirements to groups - Article 40 of the Solvency II Directive (definition of the AMSB for groups); and Mutatis Mutandis under Article 246 of Solvency II Directive

9.151 The advice seeks to clarify group governance legal requirements in order to guarantee an effective functioning of a group system of governance and to clearly identify the responsabilities within the group and to enhance the level playing field on group governance

9.152 The policy does not intend to reduce flexibility of (re)insurers to organise themselves in implementing group governance legal provisions. The main purpose of the advice is indeed not to define a specific group governance organisation or structure but to provide clarity on the mutatis mutandis of governance requirements at group level. In particular, to precise group governance expectations regarding (i) accumulation of key functions at the level of the parent undertaking and within the group, (ii) prevention of conflict of interests, (iii) fit and proper requirements of all key function holders at group level, (iv) consistency between written governance polices at group and solo undertaking level and (v) the scope of risk management system which should cover all activities conducted at group level, including non-insurance activities and the risks arising from non-insurance entities.

9.153 EIOPA appreciates that the policy advice regarding the possibility for the group supervisor to designate an entity within the group as responsible for AMSB and reporting could have an impact on the group structure. Hence, it is worth noting that the policy advice states that this power applies only where appropriate and exclusively, and subject to a dialogue with the group, to the cases noted in the advice in order to achieve the objectives of adequate governance at group level.

9.154 EIOPA considers that an effective group system of governance must take into account all the relevant risks that arise at group level, including those which are arise from non-regulated entities within the group, in order to identify and monitor them correctly. In order to facilitate such an effective group system of governance, all entities that are included in the group according to the Solvency provisions on group definition, must be subject to the group governance requirements; this means that non-controled participation are also subject to the governance requirements defined by the group and, in the case of joint-participations.

9.155 After considering the above, EIOPA proposes no change to the preferred policy option of clarifing the provisions regarding responsibility for governance requirements at group level, and setting principles to reduce SoG mutatis mutandis issues, however wording amendments were included to the policy analysis and advice where necessary.

10. Freedom to provide services and freedom of establishment

10.1. Efficient information gathering during the authoriation process

Summary of comments - Policy Issue 10.6 (1): Efficient information gathering during the authorisation process

10.1 Most stakeholders are of the view that the issues faced are effectively supported by an obligation to have a legal obligation in the Solvency II Directive to provide information on former rejections for authorisation to the to the supervisory authority where the request for authorisation is submitted.

10.2 Several stakeholders indicate that the obligation to inform the supervisory authority about informal authorisation requests and how such a request can be withdrawn can be difficult as to what is an 'informal' request. One stakeholder stated that intermediaries are not authorised but registered before they start their activity. Another stakeholder suggests to add a timeframe for the informal requests. The same stakeholder suggests to further refine the requirements for the scheme of operations to be submitted to the supervisory authority as part of the authorisation request. The stakeholder suggests to add to Article 23(1) (a) of the Solvency II Directive apart from the 'nature of the risks' information on the 'geographical focus of the business'.

Assessment - Policy Issue 1 (paragraph 10.6) efficient information gathering during the authorisation process

10.3 EIOPA has taken consideration of the stakeholders' comments;

10.4 Informal contacts between applicants and supervisory authorities to prepare a formal authorisation procedure are common practice in the EEA. The interaction with the applicant and the supervisory authority might contain valuable information for supervisory authorities approached by the applicant in another application process. Further clarifications in informal applications can be provided in Level 3. The text concerning Intermediaries in has been adapted accordingly, as they are registered and not authorised. The advice/opinion does not interfere with the registration process; it requests relevant information about the rejected registrations as an intermediary. The proposal for the adaptation of Article 23(1) (a) of the Solvency II Directive has been accepted however as part of policy Issue 2.

10.5 After careful consideration of the above, EIOPA sees that the benefits of the proposed amendment overcomes the downside of issues presented by stakeholders and proposes no change to the preferred policy option 1 and agres with the adaptation of policy issue 2 with the amendment of article 23(1)a of the Solvency II Directive.

10.2. Information exchange between home and host supervisors in case of Matearial changes in the FoS activities

Summary of comments - Policy Issue 2 (Paragraph 10.7) Information exchange between home and host supervisors in case of material changes in the FoS activities

10.6 Stakeholders supported Policy issue 2, which obliges the insurance undertaking to inform the supervisory authority in case of material changes in the FoS activities also in case where the nature of the risks or commitments does not change or might change as stated in the current text of Article 149 of the Solvency II Directive. One stakeholder states that the meaning of 'business pursued' is possibly not immediately apparent, however supports to proposal.

Assessment - Policy issue 2 (paragraph 10.7) Information exchange between home and host supervisors in case of material changes in the FoS activities.

10.7 EIOPA considered the stakeholders comments and concluded insurance undertakings are supposed to have a clear overview of the business they pursue.

10.8 After careful consideration of the above, EIOPA proposes no change to the preferred policy option 2 and the adaptation of policy issue 2 with the amendment of article 23(1)a of the Solvency II Directive.

10.3. Enhanced role for EIOPA in complex cross-border cases where NSAs fail to reach a common view in the cooperation platform

Summary of comments - Policy issue 3 (paragraph 10.8) Enhanced role for EIOPA in complex cross-border cases where NSAs fail to reach a common view in the cooperation platform.

10.9 Several stakeholders state the interference of EIOPA under Article 16 EIOPA Regulation would lead to a 'name and shame' mechanism for non-compliant supervisors. Another stakeholder raises concerns about a loss of clear competences for home and host supervisors as well as for EIOPA.

10.10 Several stakeholders made comments on the current wording of Article 152a (2) of the Solvency II Directive especially the use of the word 'consumer protection'.

Assessment - Policy issue 3 (Paragraph 10.8) Enhanced role for EIOPA in complex cross-border cases where NSAs fail to reach a common view in the cooperation platform.

10.11 EIOPA has taken consideration of the stakeholders' comments and would like to point out the proposed amendment of Article 152a of the Solvency II Directive refers to an already existing EIOPA task on the basis of Article 16 EIOPA Regulation. Furthermore the term 'consumer protection' is already part of the current text of Article 152a of the Solvency II Directive.

10.12 After careful consideration of the above, EIOPA sees that the benefits of the proposed amendment overcomes the downside of issues presented by stakeholders and proposes no change to the preferred policy issue 3.

10.4. Cooperation between home and host NSAs during ongoing supervision

Summary of comments - Policy issue 4 (Paragraph 10.9) Cooperation between home and host NSAs during ongoing supervision.

10.13 Most stakeholders who provided feedback underlined the importance of effective cooperation between home and host supervisors and welcomed the proposal as far as it would not interfere with the division of tasks and powers of the home and the host supervisors. One stakeholders requested the term 'material cross border business' to be further defined.

Assessment – Policy issue 4 (Paragraph 10.9) Cooperation between home and host NSAs during ongoing supervision.

10.14 EIOPA has taken consideration of the stakeholders' comments and would like to underline more effective exchange of information does not lead to a shift in supervisory responsibilities. Furthermore the term 'material cross border business' could be further defined on Level 3.

10.15 After careful consideration of the above, EIOPA sees that the benefits of the proposed amendment overcomes the downside of issues presented by stakeholders and proposes no change to the preferred policy issue 4 and will consider if material cross border business .

10.5. Explicit power of the host supervisor to request information in a timely manner

Summary of comments - Policy issue 5 (Paragraph 10.10) Explicit power of the host supervisor to request information in a timely manner.

10.16 Several stakeholders requested a further clarification of the term 'reasonable timeframe'. Several stakeholder requested to have information requests only to be referred to the home supervisory authority. One stakeholder requested the host NSA to only be allowed to approach the insurance undertaking on strictly predefined matters as otherwise information requests from host NSAs would possibly interfere with information requests from home NSAs. Another stakeholder stated only if the home NSA was unable to provide or gather the information.

Assessment – Policy issue 5 (Paragraph 10.10) Explicit power of the host supervisor to request information in a timely manner.

10.17 EIOPA has taken consideration of the stakeholders' comments and would like to underline the proposal does to aim for an increased request for information, the policy issue states legitimate information requests need to be answered in a timely manner, as currently this is not the case. Furthermore, the request for setting one timeframe for all different kind of information requests is not possible. Common sense should lead the setting of a timeframe.

10.18 After careful consideration of the above, EIOPA sees that the benefits of the proposed amendment overcomes the downside of issues presented by stakeholders and proposes no change to the preferred policy issue 5.

10.6. Enhanced reporting requirements and exchange of information

Summary of comments – Policy issue 6 (paragraph 10.11) Enhanced reporting requirements and exchange of information.

10.19 Several stakeholders support the enhanced facilitation of exchange of information. One stakeholder states the enhanced exchange of information via the EIOPA Hub should not lead to a change in the balance of powers between supervisory authorities.

Assessment - Policy Option 6 (paragraph 10.11) Enhanced reporting requirements and exchange of information.

10.20 EIOPA has taken consideration of the stakeholders' comments and would like to underline that enhanced information exchange supports national supervisory authorities to do their respective tasks as home and host supervisors.

10.21 After careful consideration of the above, EIOPA sees that the benefits of the proposed described developments and no need to change their view that the possibility of making more information available on e.g. products sold for home and host supervisors would lead to a better informed supervisor as stated in policy issue 6.

11. Macroprudential policy

11.1. Overall comments received and additional information

11.1 EIOPA received submissions from 34 different stakeholders, including industry associations and insurers, actuarial associations and supervisors. In total, 356 comments were received. In addition to that, the IRSG and the ESRB provided feedback by means of a letter covering all different items.

11.2 The macroprudential policy advice has been broaden as a result of the COVID-19 crisis. In particular, a new section with the additional measures to reinforce the insurer's financial position (restricting dividend distribution and the purchase of the insurer's own shares) is included. The section on liquidity risk has also been revised to encompass also a proposal for a liquidity risk framework which grants supervisors with mitigating measures if vulnerabilities are identified based on risk monitoring and stress testing.

11.2. General comments

Summary of comments

11.3 Many stakeholders consider that systemic risk in insurance is not sufficiently evidence-based and, therefore, question the need of a macroprudential approach in insurance.

11.4 Several industry participants consider that Solvency II already provides a good basis to address macroprudential concerns, and that sufficient tools are already in place. If, however, a macroprudential framework has to be developed, it should be restricted to the tools selected by the European Commission and should be aligned with the IAIS Holistic Framework for Systemic Risk in the Insurance Sector.

Assessment

11.5 EIOPA agrees that the potential systemic risk originating from the insurance sector is less prominent than in the banking sector. However, the approach developed suggests that there are indeed instances in which systemic risk can be originated in or amplified by the insurance sector. This is fully in line with the analysis carried out by other European and international institutions, such as the ESRB, the IMF or the IAIS. Furthermore, EIOPA has been actively engaged in the discussions held at the IAIS and ESRB and does not see fundamental differences.

11.6 EIOPA also agrees that significant progress has been made with the introduction of Solvency II. Solvency II includes several elements with direct and indirect macroprudential impact that are duly considered in EIOPA's work. However, EIOPA still believes that Solvency II does not cover all sources of systemic risk identified, leaving room for additional tools and measures. Furthermore, EIOPA's analysis suggests the need to go beyond the tools selected by the European Commission in the Call for Advice, also in view of the COVID-19 crisis. Moreover,

in EIOPA's view, the proposed tools and their operationalisation would contribute to further align Solvency II with the IAIS Holistic Framework.[7]

11.3. Capital surcharge for systemic risk

Summary of comments

11.7 The capital surcharge for systemic risk is the tool that raises more opposition by industry participants. Some stakeholders consider that it is not clear how such a tool could mitigate systemic risk. Others mention that Solvency II already gives supervisors the power to impose capital add-ons where risks are not adequately reflected.

Assessment

11.8 EIOPA agrees that a capital surcharge cannot be the default response to systemic risk, but should be considered as part of a broader toolkit of possible tools that may help to address macroprudential concerns. It can help mitigating some of the sources of systemic risk identified, e.g. depending on the trigger, the capital surcharge seeks to ensure sufficient loss absorbency capacity, discourage excessive involvement in certain products and activities, as well as discourage potential risky behaviours.

11.9 EIOPA considers that the capital surcharge for systemic risk is a useful supplement to the currently existing microprudential capital add-on, but that it should be set up as a separate Pillar 2 tool. Although the current capital add-on may indeed contribute to mitigate systemic risk indirectly, the tool is essentially microprudential in focus.

11.4. Concentration thresholds

Summary of comments

11.10 Some industry participants do not see appropriate to include a power for NSAs to define soft thresholds for action at market level if a certain exposure increases dramatically and/or reaches a significant level. Among the issues raised is the need to keep Solvency II as a principle-based framework, and the concern that a “soft threshold” actually becomes a “hard threshold”.

Assessment

11.11 EIOPA is of the view that the difference between “hard thresholds” (which cannot be breached) and “soft thresholds” (which can be breached, but would raise supervisory awareness) should properly be taken into account. In result,

---

[7] The IAIS Holistic Framework for Systemic Risk, in particular Insurance Core Principle (ICP) 10, includes measures to reinforce the insurer’s financial position, such as those requiring an increase in capital and those that reduce or mitigate risks (e.g. restricting exposures, through either hard or soft limits, to individual counterparties, sectors or asset classes) as part of the powers supervisors should have. According to this ICP, the supervisor toolkit should also include the power to temporarily delay or suspend, in whole or in part, the payments of the redemption values on insurance liabilities and the power to issue and enforce directions requiring the insurer to prepare a report describing actions it intends to undertake to address specific activities the supervisor has identified, through macroprudential surveillance, as potentially posing a threat to financial stability.

EIOPA considers that the definition of "soft thresholds" would not go against a principle-based framework like Solvency II and would provide NSAs with a useful tool to monitor market-wide concentrations.

11.5. Expansion in the use of the ORSA and the PPP

Summary of comments

11.12 Most comments on the proposal to expand the ORSA and the prudent person principle highlight that macroprudential concerns should already be covered in the current framework and that both elements should remain as tools of the insurer. Greater prescriptiveness should therefore be avoided.

Assessment

11.13 EIOPA agrees that ORSA and the prudent person principle cannot be very prescriptive. The proposal seeks to expand its use (in line with the experience in some countries) while keeping the necessary discretion of undertakings, given that they are both company-owned tools. Moreover, to the extent that macroprudential concerns are already included by undertakings, no fundamental change is to be expected.

11.6. Pre-emptive recovery and resolution planning

Comments to this topic are addressed as part of the section on Recovery and Resolution.

11.7. Systemic risk management plans

Summary of comments

11.14 Several stakeholders agree that systemic risk management plans might, in some cases, offer a useful way for insurers to take corrective action on systemic risk before supervisory measures are necessary, but should be subject to a clear rationale and proportionality.

11.15 Others make reference to specific concerns. They refer, in particular, to the additional administrative and reporting burden and the inability of undertakings to accurately assess their own systemic importance and systemic risk.

Assessment

11.16 EIOPA is of the view that the requirement to draft a systemic risk management plan should follow an "opt-in" approach, i.e. only specific insurers would be requested, following a justified decision by the supervisor. This should address the issue of proportionality. Moreover, such a plan would describe the actions to be taken by the undertaking to address the identified concerns and would be informed by the assessment of systemic risk which would be carried out by supervisors. Therefore, no significantly increased reporting burden for undertakings would be expected.

11.8. Liquidity risk management plans

Summary of comments

11.17 Many stakeholders argue that liquidity risk management is already included in the scope of Solvency II and is part of current risk management practices. There is also a general opposition to the definition of scope as proposed by EIOPA, with most stakeholders suggesting that undertakings should be selected (not waived) based on supervisor's discretion, and according to their exposure to liquidity risk and systemic relevance.

Assessment

11.18 EIOPA agrees that liquidity risk is indeed partially covered in Solvency II and, consequently, prudently managed undertakings should already have some kind of processes or procedures in place that are documented. Therefore, the opt-out approach (as a starting assumption, all companies should be within the scope in a proportionate way) should be maintained.

11.9. Temporary freeze on redemption rights

Summary of comments

11.19 The power of supervisors to temporarily freeze redemption rights is generally considered as a potentially useful tool in exceptional circumstances, as it could avoid the risk of an insurance run. The view is that it should be applied only as a last resort measure.

11.20 There is a general advice to handle the tool with care in order to avoid undesirable side effects on the economy and on the rights of policyholders. Most stakeholders warn against possible damage to the reputation of insurers and policyholders' confidence in the reliability of their contracts.

Assessment

11.21 EIOPA takes note of the overall support to its proposal and fully agrees with the need to use this tool only in exceptional circumstances. Moreover, EIOPA considers that the application of this tool should be linked to, or preceded by, the prohibition of distributing dividends, bonuses and other means of variable remuneration to management or shareholders.

11.10. ESRB comments

Summary of comments

11.22 The ESRB agrees with the high-level conclusion that Solvency II needs to be complemented with tools that reflect macroprudential considerations. This section focuses on two issues highlighted by the ESRB in its response:

- The liquidity tools for addressing liquidity risk arising from the assets and liability sides, and

- The horizontal tools for addressing risks stemming from the direct and indirect provision of credit to the economy.[8]

11.23 Regarding the liquidity tools, the ESRB proposes to amend the framework along the following lines: i) Better reporting and measurement;[9] ii) stress-testing requirements; and iii) Pillar 2 provisions for liquidity.

11.24 On the horizontal tools to address the provision of credit, in essence, the ESRB proposes three main tools or measures, i.e. a) capital-based tools (a loss-given-default floor for residential mortgage loans and a systemic risk buffer), b) borrower-based measures (e.g. loan to value or loan to income ratios), and c) public disclosure requirements.

Assessment

11.25 Regarding the ESRB's proposals on liquidity risk, it should be noted that the macroprudential policy advice has been broaden in light of the COVID-19 crisis and now includes an additional proposal on a liquidity risk framework, including potential tools to address identified risks. This approach is to a large extent similar to that proposed by the ESRB.

11.26 Regarding the horizontal tools to address the provision of credit,

- The ESRB's proposal to set up a sectoral systemic risk buffer is similar to EIOPA's proposal of a capital surcharge for systemic risk. While the ESRB's proposal appears to be narrower and focused on concentrations, EIOPA's capital surcharge is a more general tool, which could be used for similar purposes.
- EIOPA generally supports the ESRB's proposal of introducing borrower-based measures, such as loan to value or loan to income ratios. Given the cross-sectoral implications of the tool, the ESRB is better placed to further develop this proposal from an operational point of view.

[8] The remaining issues mentioned by the ESRB are addressed in other parts of the feedback statement.

[9] It should be noted that the industry participants do not believe that an enhancement in the reporting framework is needed.

12. Recovery and resolution

12.1 Overall comments received

12.1 In total 35 stakeholders, mostly industry and insurers' associations, provided comments on recovery and resolution. The number of comments and answers to specific questions amounted to 308. In addition to that, EIOPA's Insurance and Reinsurance Stakeholder Group (IRSG) and the ESRB provided feedback by means of a letter covering all different items.

12.2 General comments

Summary of comments

12.2 Some stakeholders do not see the need of introducing a harmonised EU framework for recovery and resolution, arguing that Solvency II is enough or that it may lead to additional costs and administrative burden.

Assessment

12.3 EIOPA is clearly in favour of introducing a minimum harmonised approach in the field of recovery and resolution, for the different reasons explained in the advice and in previous publications. While it is clear that Solvency II represents a major step forward, it should also be noted that it is not a zero-failure regime and, from that perspective, a minimum harmonised approach would ensure a set of common tools for preventive measures, common objectives and sufficient resolution tools to address the challenges posed by companies in distress. This is particularly important for cross-border cases.

12.4 Regarding the costs and potential administrative burden, EIOPA considers that this burden should be significantly reduced by a proportionate application of the framework.

12.3 Proportionality principle

Summary of comments

12.5 Most stakeholders argue that the application of the proportionality principle is essential. This refers to the whole framework, and particularly with regards to recovery and resolution planning. In this context, some oppose the proposal that the requirement to have pre-emptive recovery and resolution plans should capture a specific share of each national market at the EU.

Assessment

12.6 EIOPA fully shares the need to apply proportionality regarding the overall framework and, in particular, recovery and resolution planning. At the same time, however, pre-emptive planning is an essential tool that should be broadly requested in a proportionate way and based on a set of harmonised criteria.

12.7 The current approach of capturing a certain market share seeks to ensure a sufficiently high degree of consistency while leaving certain flexibility to NSAs to also consider national specific features.

12.8 Determining the scope of undertakings subject to pre-emptive planning would ensure a first layer of proportionality. Other means to apply proportionality refers to the content of the plan, e.g.: including simplified obligations, or the frequency of updating. The advice has provided additional information on how to ensure proportionality.

12.9 The existence of critical functions and other functions that are material for the financial system or the real economy at European or national level, should be taken into account for the consideration of the need for a proportionate resolution planning.

12.4 Application of the framework to reinsurers

Summary of comments

12.10 There are some concerns on the applicability of the framework to reinsurers for two main arguments, i.e. the fact reinsurance is a business-to-business activity with limited policyholder protection implications as well as the nature and type of risks and its limited contribution to systemic risk.

Assessment

12.11 EIOPA is of the view that the recovery and resolution measures proposed in the Advice should apply to both insurance and reinsurance companies. However, the Advice also considers that the specific features of the reinsurance market should be taken into account in the application of the proposed recovery and resolution measures and provides an indication of specific elements to be considered in the context of reinsurance (e.g. regarding pre-emptive recovery and resolution planning, resolvability assessment or resolution powers).

12.5 Preventive measures (previously called "early intervention powers")

Summary of comments

12.12 Stakeholders are critical to the proposed early intervention powers. The insurance industry is of the view that Solvency II was already designed to allow for early intervention. Hence, there should be no intervention points for supervisors as long as the SCR has not been breached.

Assessment

12.13 EIOPA considers that there is a need for a certain degree of minimum harmonisation in potential measures to be taken by NSAs where undertakings are still compliant with the capital requirements, but observe a progressive, structural and serious deterioration in their condition is still ongoing.

12.14 Based on the comments received, however, EIOPA has undertaken several changes in the originally proposed approach. First, the term used (early intervention powers) has been replaced by the term "preventive measures", which is more in line with the nature of the tools proposed and also with the terminology used in ICP10. The wording regarding some of the measures has been amended. The preventive measure of suspending or limiting the right of

policyholders to surrender their contracts on a temporary basis has been addressed separately, only as a macroprudential and resolution tool.

12.6 Resolution tools

Summary of comments

12.15 Some industry participants consider that run-offs and portfolio transfers should be sufficient to deal with the large majority of failures and, therefore, that more intrusive tools should be very cautiously considered.

Assessment

12.16 While EIOPA agrees that traditional tools such as portfolio transfer or run-off should be given priority when resolving an undertaking, other tools should also be available for complex, multiple failures or to preserve critical functions or other functions that are material for the financial system or the real economy, e.g. because of the material negative impact on a relevant number of policyholders (also in proportion to the national market) affected by the functions in case they are no longer provided. NSAs should assess the proportionate application of such powers on a case-by-case basis.

12.7 Power to remove impediments

Summary of comments

12.17 Some stakeholders have also raised concerns regarding the power to remove impediments for recovery and resolution purposes. They consider that it would interfere with the legal structure of the insurer, which may only be justified under exceptional circumstances.

Assessment

12.18 Removing material impediments is fundamental for an orderly and successful resolution of undertakings. At the same time, EIOPA agrees that such power should be exercised in exceptional circumstances and surrounded with safeguards and mechanisms by which undertakings can challenge the decision of the authority in charge of resolution.

12.8 ESRB comments

Summary of comments

12.19 The ESRB supports EIOPA's conclusion regarding the need for a minimum harmonised recovery and resolution framework across the European Union. The ESRB considers five fundamental points that such framework should include. In summary: 1) An evaluation of the existing frameworks and an enhancement and harmonisation at the EU level *if appropriate*; 2) An expansion of the current toolkit; 3) The need to cover the whole insurance sector, while allowing for proportionality; 4) A recognition of the financial stability objective; and 5) The consideration of how resolution should be funded without resorting to public funds.

Assessment

12.20 EIOPA agrees with the suggestions made by the ESRB. The current proposal aims at covering, among others, the issues raised. EIOPA wants to stress that - as stated in the advice - "the lack of a European framework for the recovery and resolution of (re)insurance undertakings has resulted in a fragmented landscape of national frameworks across the Member States". Indeed, "EIOPA Opinion (2017) showed that a majority of the Member States do not have an effective recovery and resolution framework in place, as defined by the FSB in the Key Attributes". From that perspective, EIOPA has already concluded on the appropriateness of establishing a minimum harmonised recovery and resolution framework to contribute to adequately protecting policyholders as well as maintaining financial stability in the EU.

13. IGS

13.1 Overall comments received

13.1 In total, 45 submissions were received to the separate consultation paper, with the industry and associations representing over 70% of the feedback received. The remaining submissions are from Ministries, IGSs, and consumer associations. Furthermore a few comments were sent separately to the overall CP on the Opinion of the Solvency II 2020 Review.

13.2 Minimum degree of harmonisation in the field of IGS

Summary of comments

13.2 Several stakeholders agree there should be a minimum degree of harmonisation, and the legal structure should be left to national discretion. However, other stakeholders (mostly from the industry) are against harmonisation in the field of IGSs of any form, and thus support the status quo. Some point at lack of harmonization of supervisory practice, and recovery and resolution frameworks too.

Assessment

13.3 EIOPA set out the pros and cons of more harmonisation in the field of IGSs, concluded and continues to endorse a minimum degree of harmonisation that would benefit policyholders, industry and financial stability as a whole.

13.3 Role and functioning of IGSs

Summary of comments

13.4 There are different views from stakeholders. Some agree with both roles (paying compensation swiftly to policyholders and beneficiaries for their losses when an insurer becomes insolvent and ensuring the continuation of insurance policies), whilst others prefer only one of the roles.

Assessment

13.5 The EIOPA's proposal concerning the roles is stated as "and/or" and therefore fits the minimum harmonisation principle. This is also in line with the feedback received. Other refinements have also been incorporated, providing further details on the concepts of "continuation" and "compensation".

13.4 Geographical coverage

Summary of comments

13.6 Most stakeholders seem to favour the home-country approach. This is in line with the EIOPA advice that the geographical coverage of national IGSs should be harmonised based on the home-country principle. The main reason indicated by stakeholders is that it ensures consistency with the approach with regard to prudential supervision and liquidation. In this regard, they highlight that the

quality of prudential supervision is key. Some other stakeholders, however, have strong views that the host-country should be preferred.

13.7 Other stakeholders point at the operational challenges that need to be taken into account. For the small markets the cost burden is likely to be higher than for those in larger markets. Furthermore, some stakeholders agree that the IGS of the host-country functions as a "front office" (e.g. for the identification of the affected policyholders). This would help reduce the inconvenience for policyholders. However, on this, other stakeholders prefer a mere administrative role as "contact point". Some stakeholders, which prefer the host-country principle, also find that the home-country model can only achieve the objective of ensuring proper consumer protection, if more harmonised rules are set in place, not only regarding the level of coverage of the national IGS's, but also regarding the insurance products covered by the IGS.

Assessment

13.8 The home approach is generally favoured by the stakeholders. Following the comments received, EIOPA has also provided further details on the operationalization of the home country approach, providing several options for operationalisating it and the related pros and cons, as well as references to the "front office/back office mechanism".

13.5 Eligible claimants

Summary of comments

13.9 Most stakeholders would like to include only consumers that are natural persons, for reasons of costs or for the reason that micro- and small-sized undertakings can better assess their chosen insurers' strength, seek professional advice and guide themselves by ratings. They argue it should be left at the discretion of Member States, in consultation with local stakeholders, to decide whether a wider scope is justified.

Assessment

13.10 EIOPA had argued that micro- and small sized entities are similar to natural persons. Most stakeholders are of the view that only natural persons are to be included. After analysing the comments received, EIOPA decided to consider only natural persons and micro-sized entities as eligible claimants, based on the European Commission's definitions. Where the policyholder is a company not covered by the schemes, its related beneficiaries or third parties should still have the right to claim for compensation to the IGS (e.g. accident at work).

13.6 Eligible policies

Summary of comments

13.11 Given that EIOPA did not include a specific list of policies, the comments of stakeholders are quite general. Several stakeholders emphasize the fact that there are key differences between life- and non-life insurance. Concerning the

criteria for selecting the policies, there are divergent opinions regarding the types of policies that could lead to “considerable financial or social hardship” in the event of insurance failure. Other stakeholders comment that most policies should be covered, but that reinsurance should be excluded.

Assessment

13.12 The advice has been expanded to provide more criteria on what social hardship means and include a proposal for policies for minimum harmonisation. EIOPA’s preferred option is to extend IGS coverage to specific life and specific non-life policies, based on the nature of the protection (be it contract-related or claims-related). EIOPA also agrees with the view that that there are key differences between life- and non-life insurance.

13.7 Coverage level

Summary of comments

13.13 The views are quite general and split. Some stakeholders mention that the minimum coverage level should reflect market conditions and customers’ need. Others state minimum coverage levels should be harmonized and cover at least a majority of policyholders’ losses. Also, a harmonized framework should provide for liability retentions and caps.

Assessment

13.14 The advice has been expanded to provide more criteria on the coverage level. EIOPA agrees that minimum coverage levels should be harmonised for certain eligible policies. EIOPA also generally agrees with the introduction of percentage caps and/or compensation limits, to guarantee appropriate consumer protection while ensuring the financial stability of the national IGS and mitigating dangers of moral hazard.

13.8 Funding

Summary of comments

13.15 With respect to funding, the industry favours ex-post funding. However, other stakeholders see the benefit of ex-ante funding. Some argue that the funding should be left to national discretion.

Assessment

13.16 It should be noted that EIOPA did not include a specific proposal, but only the view that IGSs should be funded on the basis of ex-ante contributions by insurers, possibly complemented by ex-post funding arrangements in case of capital shortfalls. Further work is needed in relation to specific situations where a pure ex-post funding model could potentially work, subject to adequate safeguards. Therefore, any comments and suggestions received may be considered during the follow-up work to the final Advice. The advice remains broadly unchanged.

13.9 Disclosure and cross-border cooperation

Summary of comments

13.17 Stakeholders agree with appropriate disclosure to consumers, but stress that it should not be used for marketing purposes.

13.18 Stakeholders also agree with the need for cross-border cooperation.

Assessment

13.19 On disclosure and cross-border cooperation, a number of refinements have been incorporated following the feedback received.

14. Other topics of the review - Fit and proper requirements

Summary of comments

14.1 Overall, the consumer organisations agreed with EIOPA's advice whilst the stakeholders from industry disagreed with the proposals to clarify and strengthen for NCAs to conduct ongoing supervision of the assessments. Those stakeholders are of the view that it is within the remit of the insurance undertakings to undertake ongoing assessment of AMSB members and qualifying shareholders and they expect the proposals will add to bureaucracy and the costs of supervision. In this view the NCA should only investigate further in case of doubt.

14.2 Stakeholders provided also suggestions for amendments as they viewed that the power to withdraw the authorisation in case of AMSB not being fit and proper should not be added as supervisory tool, because it is already contained in Article 144 (c) Solvency II Directive in case of a serious failure. Stakeholders suggested that NCAs should have the power to revoke the members of the AMSB that are not fit and proper. Furthermore they proposed that to include an obligation for the undertaking to notify the supervisory authority the undertaking's assessment has lead to a negative result.

14.3 Furthermore some stakeholders are of the view that joint assessments lead to inefficiencies and bureaucracies.

Assessment

14.4 The primary responsibility of the ongoing assessment of AMSB members and qualifying shareholders is and will stay with the company. Nothwithstanding, EIOPA will advise EC to continue to strengthen the ongoing assessment of AMSB members and qualifying shareholders in line with Article 42 ensuring that the condition is fulfilled at all times. It has been clarified that the ongoing assessment is not equal to the re-assessment of each and every AMSB member (i.e. qualifying shareholder) neither it is a replication of the assessment of the undertakings. This assessment should rather be carried out as part of the NCAs' supervisory activities i.e. offsite reviews or during onsite visits.

14.5 EIOPA will advise to EC to use some of the suggestions from the stakeholders from industry to further improve the advice on a selected number of points, i.e. as reflected in paragraph 14.54 on removal of AMSB members or key function holders (KFHs), on requiring undertakings to inform the supervisor in case an AMSB member/KFHs is not fit or proper anymore.

14.6 EIOPA also advises to keep the possibility for a joint assessment as it will increase the efficiency of assessments and improve the decisions by the Home supervisor following those assessments.

EIOPA

Westhafen Tower, Westhafenplatz 1
60327 Frankfurt – Germany
Tel. + 49 69-951119-20
info@eiopa.europa.eu
https://www.eiopa.europa.eu