



EIOPA-CP-14/011
1 April 2014

**Cover note for the Consultation
On Implementing Technical Standards
for
Solvency II**

1. Introduction

- 1.1. EIOPA invites comments from stakeholders on the first set of Implementing Technical Standards for Solvency II. EIOPA is exercising the power to draft these standards according to its establishing Regulation¹ and based on the empowerments introduced by the Omnibus II Directive, amending the Solvency II Directive.²
- 1.2. Comments are due by 30 June 2014, using the template provided on EIOPA's website.
- 1.3. The ITS define the procedures for the approval processes of the Matching Adjustment, Ancillary Own Funds, Undertaking-Specific Parameters, Internal Models and Special Purpose Vehicles, as well as the joint decision process on Group Internal Models. The ITS contribute to the preparation by undertakings and supervisors for the approval processes, which are due to start on 1 April 2015.
- 1.4. EIOPA will submit the ITS to the European Commission by 31 October 2015 for final endorsement.
- 1.5. The Commission's Delegated Acts containing the implementing measures are not public; where reference is being made to draft articles of the implementing measures, an annex accompanies the consultation listing the relevant articles. This annex is not subject to the consultation.

2. Nature of implementing technical standards

- 2.1 Implementing Technical Standards (ITS) are regulatory tools drafted by EIOPA in accordance with Article 15 of the Regulation establishing EIOPA.³
- 2.2 Generally, technical standards are drafted based on a specific delegation or empowerment from the Commission in the relevant legislative act (for example, the OMDII Directive modifying the existing Solvency II Directive). This empowerment often includes a deadline by when EIOPA shall have the technical standard finalised.
- 2.3 Technical Standards are meant to be technical, not to imply strategic decisions or policy choices and their scope and content shall be limited by

¹ Regulation (EU) no 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority).

² Council Presidency compromise of 25 November 2013, consolidation the final compromise text on Omnibus II.

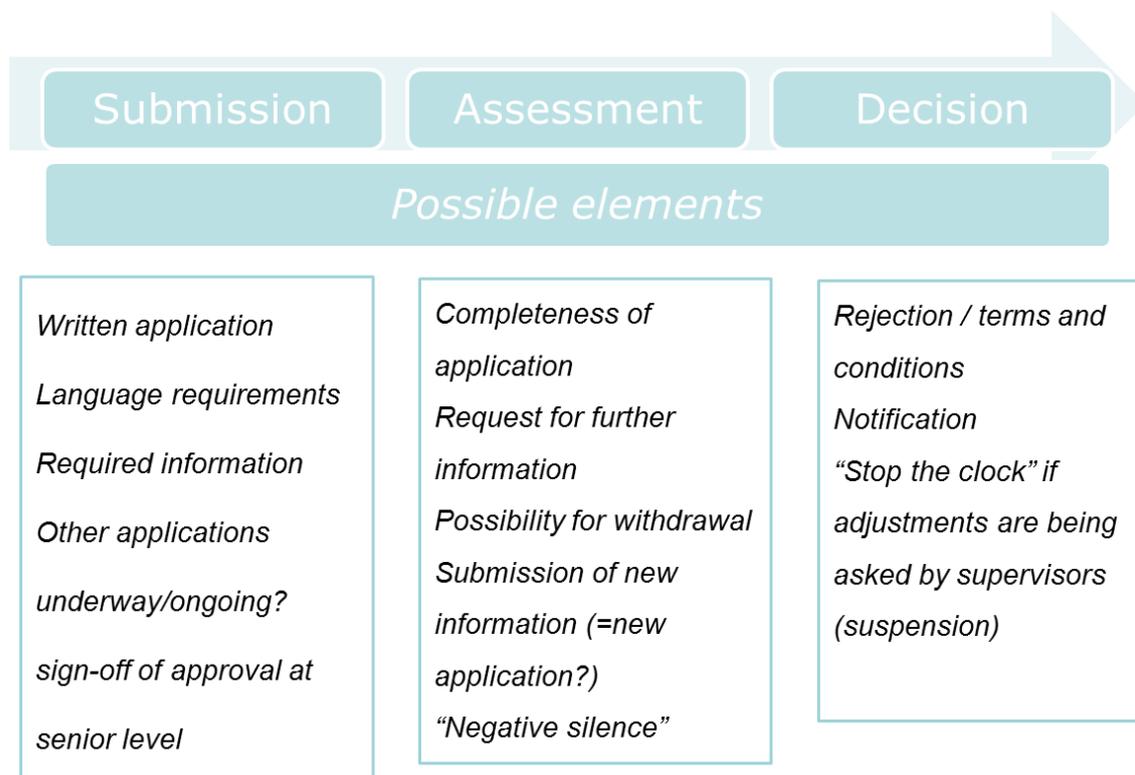
³ Regulation (EU) no 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority).

the specific empowerment. Implementing technical standards will mostly aim at defining the forms, templates and procedures for specific areas under regulation. The technical standards shall be in line with the empowering regulation and delegated acts.

- 2.4 As for any regulatory tool EIOPA will conduct a public consultation, perform a cost and benefit analysis (Impact Assessment) and consult the relevant Stakeholder Group for their opinion.
- 2.5 The final draft implementing technical standard shall be endorsed by the Commission, who informs European Parliament and Council. The Commission has the ability amend or reject the proposed ITS, within a period of 3 months. EIOPA can submit a new draft within a deadline of 6 weeks following the feedback from the Commission.
- 2.6 Once the technical standard is endorsed by the Commission, the Commission will translate and publish the TS. The implementing technical standard will be part of the implementing measures and become binding legislation.

3. Nature of supervisory approval processes

- 3.1. The approval processes lay down the process requirements for undertakings to obtain the approval by their supervisor of (the application of) particular elements of the prudential framework. It also contains the process requirements for the supervisors to ensure that where all requirements are met, an effective legally certain and prudentially sound approval can be given.
- 3.2. Approval processes aim at ensuring, through the prior scrutiny by the supervisor, the quality and admissibility of certain important, complex or “non-standard” parameters.
- 3.3. The approval process is broadly divided into three major steps, which can contain the following key features:



4. Papers under consultation – summary of key features

1. ITS on the approval process for matching adjustment

What is a matching adjustment?

Where the cash-flows of assets and liabilities have similar characteristics to maturity, so these assets are not exposed to spread risks in short-term (cash-flow matching), the matching adjustment can be used to adjust the relevant risk-free interest rate term structure for the calculation of the best estimate of technical provisions.

The aim of this adjustment is to avoid that changes of assets spreads impact the amount of own funds of these undertaking. In doing so, the adjustment aims at mitigating short-term volatility of the Solvency II balance sheet in view of the long term nature of the commitments of insurers.

The matching adjustment applies to certain undertaking's portfolios that are managed separately from the rest. In practice, the liability cash-flows shall be hedged by asset cash-flows with similar characteristics, e.g. duration, timing and amount.

Key features of the ITS

The ITS sets out the process to be followed in seeking for the approval of the MA, focusing on how the undertaking shall demonstrate that the criteria related to the asset and liability cash-flows, and the cash-flow matching are fulfilled. In line with the Directive, the ITS particularly sets out provisions to ensure

- that asset cash-flows and liability cash-flows are matched and assets can only be replaced for the purpose of retaining the matching where the expected cash-flows have materially changed such as in the case of the downgrade or default of a bond;
- that the insurance undertakings can hold their assets to maturity;
- adequate transparency through public disclosure of the impact of the matching adjustment on the undertakings' financial position

2. ITS on the approval process for internal models, major changes to the internal model and changes to the policy for changing internal models

What are internal models and why should there be a policy (and approval process) for changing the internal model?

An internal model is a tool, which as part of risk management allows the insurer to analyse the overall risk position, to quantify risks and to determine the capital required to meet those risks. The purpose of an internal model is to fully integrate processes of risk and capital management within the insurer.

It is the responsibility of undertakings to update their internal models in order to keep the model and its methodologies accurate and up-to-date. Supervisors shall approve major changes to the internal model and be satisfied that the model still complies with the test and standards for model approval after any changes have been applied. The Directive requires that a policy for changes shall be approved as part of the initial model approval; changes to the policy itself shall also be approved by supervisors.

Key features of the ITS

In relation to the approval of internal models, the ITS includes provisions on:

- The content of the application package submitted by the undertaking containing evidence that the internal model meets the criteria set out in the Directive and Delegated Acts;
- conditions for the approval of the policy for changing the internal model (PCM);
- criteria for the assessment of the application by supervisors;

- the content of decision by supervisors; and
- specificities on the transitional plan to extend the scope of the model

In relation to the approval of major changes and changes to the PCM, the ITS stipulates that the process to follow is the same as the initial approval of internal models with specific considerations that need to be taken into account in relation to major changes and changes to the PCM.

3. ITS on the joint decision process for group internal models:

What is a group internal model?

A group internal model is an internal model, which is used by a group to calculate both the Group Consolidated SCR and the solo SCR of at least one related undertaking

Key features of the ITS

This ITS sets out the necessary provisions to ensure uniform joint decision process by supervisors concerned in the college, with a view to facilitating joint decisions on the application of a group internal model to the entities of the group.

4. ITS on the approval process for undertaking-specific parameters

What are undertaking-specific parameters?

The USP approach for calculating the capital requirements under Solvency II is a formula-based approach allowing for the use of undertaking-specific data to better reflect an undertaking's underwriting risk profile.

Key features of the ITS

The ITS sets out the process for

- The undertaking to demonstrate that the requirements related to data quality and the undertakings' risk profile are satisfied. This includes requests for justification on the choice of the parameters, segments and methods to calculate the parameters, as well as the assessment of how the criteria for completeness, accuracy, and appropriateness of the data are fulfilled.

- The reversion to standard formula parameters, which are subject to the approval of the supervisory authorities and shall be duly justified
- The supervisor to require the use of undertaking-specific parameters by the undertaking

5. ITS on the approval process for ancillary own funds

What are ancillary own funds?

Ancillary own funds are items other than basic own funds that can be called up to absorb losses. Examples are: unpaid share capital or initial fund that has not been called up; letters of credit and guarantees; any other legally binding commitments received by insurance and reinsurance undertakings (future claims for mutual insurance undertakings).

The amounts of ancillary own fund items are subject to prior supervisory approval. Ancillary own funds can cover part of the solvency capital requirement, but not the minimum capital requirement. Where an ancillary own fund item has been paid in or called up, it is treated as an asset and ceases to form part of ancillary own fund items.

Key features of the ITS

The ITS sets out the process for

- structure of the application and the nature of the information that will need to be provided by the undertaking to allow the supervisory authority to assess if the undertaking meets the relevant criteria in the Directive and delegated acts; and
- how the process envisaged for the assessment of the application will function, including for example the timescales, the ability for supervisory authorities to request additional information, and how changes to the application will be treated.

6. ITS on special purpose vehicles (SPVs)

What are SPV's?

SPVs are independent legal entities that are established by one or more sponsors. In an insurance environment SPVs would assume risks from insurance or reinsurance undertakings. The establishment of separate legal entities shall create an independent third party to which insurance risks and assets can be transferred. After the establishment and the transfer of assets, portfolios or insurance risk, the sponsor will not have any control over the SPV and the SPV

will not have any rights against the sponsor. The structure of the SPV has to accommodate that this risk transfer is effective.

Key features of the ITS

The ITS focuses on:

- Measures to ensure the effectiveness of the risk transfer and policyholder protection through the process for the analysis of the transfer itself and the structure, i.e. independence, of the SPV, timelines and minimum documentation requirements and details on the fully funded requirement
- The process for the cooperation and exchange of information between supervisory authorities regarding SPVs and the design of formats and templates for accounting, prudential and statistical information to be reported by SPVs

5. Common approaches to the ITS

Consistency

- 5.1. Within each step of the approval process, EIOPA has aimed to compare the requirements put across in the different ITS. This should ensure differences between the processes should be duly justified by the nature of the process and the element subject to approval. The consistency of the ITS shall ensure that the administrative burden on undertakings and supervisors is limited to the extent possible: the basics of the approval process should be the same, irrespective of the element to which the process applies.
- 5.2. In particular, the different steps of the approval processes are aligned.
 - Submission of the application: language requirements, signature, definition of requirement information for the submission of the application, confirmation of receipt by the supervisor, declaration on applications ongoing and foreseen.
 - Assessment by the supervisor: period for assessing the completeness of the application, deadlines for decision-making, the consequence of an absence of decision by the supervisor within the time period, possibility for the supervisor to request further information or changes as well as the possibility for the undertaking

to submit further information, suspend the time for decision by the supervisor and for withdrawal of the application.

- Decision by the supervisor: rejection basis and language of the notification.
- 5.3. Different treatments shall be justified in particular by the specific nature of the element subject to approval or the scope of empowerment given in the Directive. Naturally, the content of the requirements will be adapted to the element under consideration.
- 5.4. In particular, where the ITS for SPVs differs from other ITS, this is due to the fact that the empowerment for the ITS on granting supervisory approval to establish SPVs needs to be considered as part of the general authorisation procedures for undertakings, set out in Articles 14 to 26 of the Solvency II Directive.
- 5.5. Further information on the policy choices made in the ITS can be found in the accompanying impact assessments.

Proportionality

- 5.6. The Solvency II Directive stipulates that its provisions should be applied in a manner that is proportionate to the nature, scale and complexity of the business of insurance and reinsurance undertakings.⁴ In doing so, EIOPA has considered if more specific or additional criteria to nature, scale and complexity are appropriate within a particular context to ensure a proportionate application of the requirements.⁵ EIOPA has also considered where it may be appropriate to differentiate the requirements imposed to smaller insurance undertakings.⁶
- 5.7. Nevertheless, in particular within the context of the ITS, it is important to underline that
- The principle of proportionality applies even where not explicitly mentioned: the application of the rules by supervisors must be carried out in a proportionate way at all times.
 - The application of the proportionality principle should not be equated with a reduction or disapplication of the regulatory requirements. The application of the principle can equally demand that more stringent or detailed requirements are necessary with regard to particular risks or complexities.

⁴ Numerous references are made in the Directive to proportionality, in particular in Article 29(3).

⁵ For example this could be achieved by the use of the terms 'significant' or 'material' to indicate that requirements do not have to be met in all circumstances.

⁶ For example through the use of a threshold.

- The empowerment for the ITS may not permit EIOPA to propose specific measures or treatments, for example for different types of undertakings as this may be inconsistent with the treatment specified in the Directive or Delegated Acts.
- 5.8. The proportionality analysis is undertaken in the framework of the policy development process and as part of the impact assessment, where the expected impact on the relevant stakeholders for the proposed policy is analysed. A specific section in the impact assessment annex for each ITS documents the analysis.
- 5.9. Generally, in the development of the ITS, proportionality is implicit in the processes and the requirements, therefore very few explicit measures are included to create a particular treatment in view of particular risk profiles – processes have to be applied by all undertakings who apply for the use of the element and by the supervisors that have to assess the application. Therefore, the proportionality lies mostly in the nature and complexity of the particular element at hand and would result in less or more documentation requirements or information requests, all within the scope of the process.

For example,

- in the approval process of MA, the proportionality considerations in this ITS are related to the complexity of the portfolios for which the insurance or reinsurance undertaking is seeking the application of the matching adjustment. Less evidence will be needed for the application approval process to demonstrate that threshold is met where there is no mortality risk involved in the liability cash-flows.
- in the approval process of USP, the more simple the undertaking's risk profile is, the easier it will be in the approval process to demonstrate that data requirements are fulfilled. Also naturally, the more segments and parameters an undertaking or reinsurance undertaking is applying for the use of USP, the more documents will have to be submitted; however, the supervisor will still have to decide within six months.
- in the approval process of ancillary own funds, the application of the principle of proportionality is linked to the complexity of the ancillary own-fund item for which approval is sought, which will affect the nature of the information that will need to be provided to the supervisor authority.
- in the process for the joint decision for group internal models the process is potentially complex: several supervisors may be involved and the procedure has to make sure that a decision is taken in the

tight timeframe foreseen in the Directive. The proportionality aspect is relevant in how in practice by each individual college applies the process: for instance the different steps of the process and the timeline for these steps to be followed by the NSAs concerned can be smoother for less complex colleges or group internal models.

- in the approval process of internal models, major policy changes and changes to the policy for changing the internal model, for less complex models, the undertaking may need to provide less evidence in its application about the compliance with the different requirements (notwithstanding that evidence needs to be provided about the compliance with each of the internal models requirements), and the supervisors may not need to perform so deep reviews of the model as compared to more complex models.
- in the approval process for SPVs the proposed requirements translate the procedures for the authorisation and withdrawal of authorisation for insurance and reinsurance undertakings in procedures that are fit for the purposes of a SPV - which acts as a reinsurer without writing business. In particular, for the approval of multi-arrangement SPVs, the requirements are fully in line with and reflecting the treatment of single-arrangement and single sponsor SPVs, ensuring that the requirements are not too burdensome.