

**Comments Template on
Consultation Paper on EIOPA's second set of advice to the European
Commission on specific items in the Solvency II Delegated Regulation**

**Deadline
5 January 2018
23:59 CET**

Name of Company:	Royal Dutch Actuarial Association	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ Do not change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇒ Leave the last column <u>empty</u>. ⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a paragraph or a cell, keep the row <u>empty</u>. ⇒ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. <p>Please send the completed template, <u>in Word Format</u>, to CP-17-006@eiopa.europa.eu</p> <p>Our IT tool does not allow processing of any other formats.</p> <p><u>The numbering of the reference refers to the sections</u> of the consultation paper on EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation. Please indicate to which paragraph(s) your comment refers to.</p>		
Reference	Comment	
General Comment	<p>Two general queries regarding any changes to the Standard Formula:</p> <ul style="list-style-type: none"> • Will there a time / transition period to adapt to the changes? • How should companies to prepare for the new factors in advance of their official adoption date, for example should they anticipate the changes in the ORSA? 	
Introduction		

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1.1	<p>Our comments on the proposed changes to the calibration of premium and reserve risk are given under section 1.4. Here we pose two wider comments on the calibration of Premium and Reserve Risk</p> <ul style="list-style-type: none"> We question whether it is appropriate to apply the same factors across the whole of Europe. It may be possible to apply country specific factors when several years of Solvency II Reporting data becomes available. <p>A key weakness of the Premium Volume measure is that it is applied to premiums gross of commissions. It should be possible to adapt the volatility factors so that they apply to premiums net of commissions. This is a particular problem in the Miscellaneous Financial Loss line of business which comprises a very heterogeneous mix of risks.</p>	
1.1.1	Par. 20: We suggest to formulate criteria for when a recalibration is necessary. In this case, we do not understand why EIOPA has chosen less than 100 valid data points from undertakings or less than 20 countries as leading for a necessary recalibration of parameters.	
1.2.1		
1.2.2	Par 29. It is not clear when the data is not considered to be sufficiently reliable. Providing details on this may help in communicating the results of the recalibration.	
1.2.3		
1.2.4	Par 44. In 1.2.3 it is shown that the new sample is better than the 2011 JWG sample. However the gross-to-net ratio of JWG is considered to derive a final figure. We do not understand why JWG is considered sufficient for the use of this ratio. It is also not clear why the gross-to-net ratio only impacts the groups HME and HWC.	
1.3		
1.3.1		
1.3.2	Par 52. The automated elimination of outliers leads to less volatility in the outcomes. Especially given the 3 times automated elimination. We think it is good to disclose how many outliers were eliminated per group.	

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1.3.3		
1.3.4		
1.3.5		
1.4	<p>We welcome the updated calibration for these five lines of business but we note that it will cause “step-changes” in capital requirements in some cases.</p> <p>Our main comments are around how the proposed recalibrations will be implemented in practice? For example:</p> <ul style="list-style-type: none"> • Will there a time / transition period to adapt to the changes? • How should companies to prepare for the new factors in advance of their official adoption date, for example should they anticipate the changes in the ORSA? <p>What will happen in case of companies using USPs which may now – after application of new factors – end up with higher (USP-based) capital requirements as compared to Sctandard Formula results based on the new calibration?</p>	
1.4.1		
1.4.2		
2.1		
2.2	Recital (45) – A further explanation of the difference between ‘future earned premiums’ and ‘expected premiums’ could be helpful.	
2.3	<p>(84) We agree that the gap is existing and that it should be – for consistency reasons – corrected. A drawback could be seen in a potentially slightly increased complexity in case of one-year contracts. This can nevertheless be addressed by a simplified estimation of FP(future) – e.g. by averaging out a one year’s expected premium income.</p> <p>(90) We also share the view that future business should be reflected in the SCR calculation in line with the requirements of the Solvency II Directive. In doing so, a potential diversification/</p>	

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	<p>correlation between the underlying risks in due course of time should be taken into account.</p> <p>(98) We agree that there is no feasible and less complex methodology which would reduce the dependency on the pricing strategy / level of an insurance undertaking, which would not in turn change the SCR calculation approach significantly. We would like to point out that other means of Solvency II (like ORSA and the assessment of the actuarial function wrt. the undertaking's pricing strategy) are more appropriate safeguards to address under-pricing.</p> <p>It could be considered though to align the treatment of commissions, esp. for companies writing business net of commissions (where distributors add the commissions). In this case an average commission rate (given by the market NSA, for simplicity) or individual commission levels could be added in order to used guarantee a level playing field on applied premiums.</p>	
2.4.1		
2.4.2	<p>We agree on the approach to recognise different types of risk in the different components of the volume measure for premium risk.</p> <p>In paragraph 128 three components are specified for the volume measure. The first is P(s). It is not clear how in the components a and b of 128.1 also the 'premiums not yet received but that are part of the existing contracts' is captured. To our view expected premiums of existing contracts that are not yet paid are not considered in the current description. So to our view 128.1.a should be extended with premiums not yet received under existing contracts to the extend they fall in year t+1.</p> <p>In paragraph 138 two options are described considering the 2 elements: (1) the GAP and (2) the adjustment factor Alpha. To our view these are two different elements that need to be considered separately rather than discussing either one of the two:</p> <ul style="list-style-type: none"> • The GAP relates to the discussion to what extend the correct volume measure is taken • The Alpha relates to the discussion if the correct level of risk parameter is selected. 	

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We agree that for different components as described in 131 there are different risks and thus agree on the justification of the factor Alpha. But we think one could also decide not to close the GAP and still introduce Alpha parameter for FP future as well. This would particularly make sense for multi year contracts.

Related to the option with closing the GAP we understand the discussion but recognise that it will also lead to an increase of the capital requirement specifically for one year contracts. If the GAP is closed with suggested option 2 than FP(future) will not be zero anymore but a capital charge using the adjustment factor Alpha. Selecting this option however we think one should also decrease the risk factor applied for P(s) of existing contracts based on the description of risks included in the different components (paragraph 131) accounting for the issue that for the group Ps(existing business) as specified in par131 the Expected risk has already been recognised in the best estimate valuation and as such is not a risk component anymore.

The identified gap contains either expected risk and unexpected risk 1&2 or expected risk and unexpected risk 1. The introduction and calibration of an Alpha is adding complexity as well as parameter uncertainty. Could the introduction of a separate variable e.g. FP (future < 12 months, s) align the gap and keep the one year view in a more appropriate way?

2.4.3

Option 1 could make sense for one year contracts for simplicity reasons. However, for multi year contracts the introduction of Alpha, even if the GAP is not closed, would be advisable.

Option 2 could be considered an appropriate alternative to capture the premium risk but has some drawbacks

- 1) Increased complexity for one year contracts (most of business) and increased capital charge for these.
- 2) Increases volume for the SCR for one year contracts and is then not in line with current P(s): To our view Ps(Existing business) is then overstated. In this approach an Alpha would not only be needed for FP future but also for P(s) to account for the fact that Expected risk as specified in par131 is already included in the technical provisions and should not be accounted for in the SCR.

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	<p>3) The method will introduce more volatility on the volume measure during the year and can increase undesirable movements in the SCR quarter by quarter.</p> <p>Option 2 would be preferable above option 1, if no other options are to be considered.</p>	
3.1		
3.2		
3.3	<p>We agree that the Lee-Carter and Cairns-Blake-Dowd models are common in the market. We would like to add to this that multi-population models are getting increasingly common. As such we would have liked to see these included in the analysis as well. We agree on the use of the HMD as a source of mortality data. We would have liked to see an effort by EIOPA to collect portfolio-specific data as well.</p> <p>We believe that a more granular approach is preferable for both mortality risk and longevity risk, especially an age-dependent stress scenario would be an improvement.</p>	
3.4.1		
3.4.2	<ul style="list-style-type: none"> • We deem the selection of countries and historical years to be sufficient for the analysis. • We consider the proposed new mortality risk stress scenario of 25% to be on the high end. This shock is calibrated taking into account all mortality rates until the insured person dies, and therefore the shock is higher for lower ages (in the long run both the Lee-Carter and the CBD model produce volatile results). This shock will however also be applied to term life insurance contracts, while these are expected to have a much shorter duration (than upon death of the insured person). It would therefore be more logical to either produce a separate shock for these short run contracts, or to lower the general shock. Taking into account the shorter duration will lead to lower shocks, since the volatility produced by the Lee-Carter and CBD model in the short run is limited. • The results of the analysis show that an age-dependent stress scenario would not be constant. This holds for both longevity risk and mortality risk. We therefore would have liked to see an age-dependent stress scenario, which would have been a more accurate reflection of the underlying risk. We deem this improved accuracy preferable over the argument that the current approach prevents implementation costs and reduces complexity. 	

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	<ul style="list-style-type: none"> In case EIOPA is in favour of using a single shock for all ages, we would expect an argumentation of selecting the shock corresponding to an age of 60 years. Now, it is unclear why the shock related to this age is selected. 	
3.4.3	We consider the proposed 25% stress scenario for mortality risk to be on the high end and would like to see an age-dependent stress scenario for both mortality risk and longevity risk. We do not think that this would lead to substantial implementation costs or complexity, since most insurers already make use of a mortality table by age/gender for their best estimate calculations.	
4.1	In 258 it is stated that the 10 year scenario is "deleted". However, "moved to the 1 year and permanent scenario" would be a better description as the calibrated percentage for the 1 year scenario increases from 5% to 16.5% and the permanent disability from 1.5% to 3.5%.	
4.2		
4.3		
4.4		
4.5.1		
4.5.2	In 273 it is stated that the 10 year scenario is "deleted". However, "moved to the 1 year and permanent scenario" would be a better description as the calibrated percentage for the 1 year scenario increases from 5% to 16.5% and the permanent disability from 1.5% to 3.5%.	
4.5.3	<p>In 282 and 283 it is stated that the 10 year scenario is "deleted". However, "moved to the 1 year and permanent scenario" would be a better description as the calibrated percentage for the 1 year scenario increases from 5% to 16.5% and the permanent disability from 1.5% to 3.5%.</p> <ul style="list-style-type: none"> - In 283, 2nd bullet, it is stated "retain 3.5 % for the permanent disability scenario". We would suggest to replace "retain" by "increase" as the percentage increases from 1.5%. - What is the rationale behind the increase to 3.5%? Now it is in line (and even higher than) the WTC percentage, but in the former calibration a deviation from WTC was not needed? <p>We agree on the suggested deletion of the temporary disability component in the scenario (par 273) for the mass accident concentration.</p>	

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	<p>As a result, we understand the increase in the permanent disability scenario, because there also the 10 year disability is taken into effect. The increase from the 1.5% to 3.5% seems reasonable. However, the increase of the 1 year from 13.5% to 16.5% is to our view not reasonable and leads to an unwanted increase in SCR. For this we have looked at the following:</p> <ul style="list-style-type: none"> - 1000 policies in portfolio; - Yearly benefit when disabled is 100; - Average age is 40, end age is 65. So average of 25 years of maximum benefit; - In the old texts this leads to: <ul style="list-style-type: none"> o 25 years * 100 * 1000 * 1,5% = 37.500 o 10 years * 100 * 1000 * 5% = 50.000 o 1 year * 100 * 1000 * 13.5% = 13.500 o Total = 101.000 - Proposal scenario: <ul style="list-style-type: none"> o 25 years * 100 * 1000 * 3,5% = 87.500 o 1 year * 100 * 1000 * 16.5% = 16.500 o Total = 104.000 - In our view the one year should stay equal to the 13.5% it is now: <ul style="list-style-type: none"> o 25 years * 100 * 1000 * 3,5% = 87.500 o 1 year * 100 * 1000 * 16.5% = 13.500 o Total = 101.000 <p>Thus removing the 10 years disability scenario, increasing the permanent one to 3.5% and retaining the 13.5% for the one year scenario.</p>	
5.1	We think that Cyber risk is a risk that should be included in the module for Man-made catastrophe risk.	
5.2		
5.3		
5.4.1		

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5.4.2		
5.4.2.1		
5.4.2.2		
5.4.2.3	We support the advice to allow for a simplified approach. We would recommend to provide additional guidance on how to apply the proposed simplification. At this moment, it is not clear how to derive the potential loss from the top-5 exposure for each risk type. Do only these need to be considered?	
5.5.1		
5.5.2.1		
5.5.2.2		
5.5.2.3	We agree with the proposed change.	
5.6.1		
5.7.1		
5.7.2.1		
5.7.2.2		
5.7.2.3	We agree with the proposed change.	
6.1		
6.2		
6.3.1	When the simplified approach leads to a higher SCR than the SCR calculated with the standard calculation, the simplified approach is considered to be proportionate. This is a contradiction with the rules that are defined around the fit of the standard model.	
6.3.2		
6.3.3.1		
6.3.3.2		
6.3.3.3	Agree with option 5, in favour of formulation 1	
6.4.1		

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6.4.2		
6.4.3.1		
6.4.3.2	We support the approach to investigate the calibrations of the risk zone weights and the new country specific scenario's.	
6.4.3.3		
6.5.1		
6.5.2	We agree that a complete re-design of the SF approach to take into account differences in contractual limits would make the calculation disproportionately complicated.	
6.5.3.1		
6.5.3.2		
6.5.3.3		
7.1		
7.2		
7.3	<p>EIOPA comments on the suggestion of using extrapolation with the Smith-Wilson methodology after the LLP to improve the consistency with the valuation of the basic own funds. We think the counter arguments are not clear and as such not convincing. It is important that both the upward and the downward shock for long durations are appropriate and we can't conclude this from 455.</p> <p>"EIOPA has performed simulations with different UFR values indicating that the maximum annual change at the 90Y tenor point is at most 19 %" How are the UFR values simulated?</p> <p>"extrapolation would introduce additional complexity". We don't think that adding additional complexity should be an argument by itself, but we think that a clear trade-off should be made between adding complexity and added value of extrapolation.</p> <p>"there would also be a risk of not taking into account the changes in forward rates observed before the extrapolation that have a significant impact on the risk-free rates and hence</p>	

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	underestimating the changes" Why 'before' the extrapolation?	
7.4.1		
7.4.2	<p>Upward shocks It seems that the focus of the analysis has been on a good performance of the model in interest rate down scenarios, while it is of importance that the model produces plausible interest rate up and down shocks. After all, some insurance companies will be interest rate up exposed due to the fact that their liabilities (including UFR) are less sensitive for interest rate risk movements than their assets.</p> <p>We suggest to focus on the plausibility of both the interest rate up and down shocks. Both proposal A and B both seem to produce overly prudent interest rate up scenarios in a low yield environment, while the current (relative) model and the shifted approach lead to interest rate up scenarios which are smaller but still plausible. Therefore, we suggest to analyse the shifted approach in more detail by using a maturity-dependent shift vector. To our understanding this model can be calibrated such that at the same time it produces plausible interest rate risk down and interest rate up shocks in a low yield environment.</p> <p>Also, we suggest to back test the model based on an interest rate risk time series with a longer history.</p> <p>Non-parallel shock scenarios Currently the capital charge for interest rate risk is based on the maximum loss in two scenarios: an up and a down shock. This does not account for risk exposures to non-parallel shocks such as where part of the curve shifts up, while part of the curve shifts down. If a company is mainly exposed to these types of non-parallel interest rate shocks, the current approach could lead to an SCR that does not fully reflect its interest rate risk profile. We suggest to add these types of scenarios to this calculation.</p>	
7.4.3		

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10.4.2.5		
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13.3	<p>Collateral In the DA it is stated that the loss-given-default shall be net of the liabilities towards counterparties belonging to the single name exposure. However, it is not clear from the text how this netting should be applied (before or after adjustment for collateral). Suggestion to add the liability exposure to the formulas within Article 192(1).</p> <p>There are situations in which there is a tripartite agreement, in which an exposure towards a counterparty can be netted against a liability towards a third party (in the Netherlands: <i>spaarhypotheken</i> is such an arrangement). This situation can comply with Article 209 and 210 of the DA. However, Article 192(1) does not allow for this risk mitigation. The same holds for certain specific spread risk exposures that can be netted against a specific liability, complying with all the necessary requirements for risk mitigation.</p> <p>Adjustment for market risk The way the adjustment for market risk is defined for collateral exposures in Article 197(5) and for mortgages in Article 198(3) introduces ambiguity:</p> <ul style="list-style-type: none"> • The adjustment for market risk includes diversification benefits within the market risk module. This means that there will be a difference between the risk-adjusted value of collateral/mortgage for the solo and group entity reporting within the same group. It is 	

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not clear why this is considered appropriate from a risk perspective.

- The counterparty default risk on reinsurance counterparties should be included in the risk margin. As the risk margin *should be based on the assumption that the whole portfolio of insurance and reinsurance obligations is transferred to another insurance or reinsurance undertaking*, it is unclear which (hypothetical) diversification benefits within the market risk module should be taken into account in determining the counterparty default risk to be included in the risk margin.
- The delegated acts only prescribe a correction for market risk. However, there are situations in which the collateral itself is subject to counterparty default risk (e.g. cash or swaps as collateral for a reinsurance contract). It is unclear how to incorporate the counterparty default risk on the cash/swaps within the risk-adjusted value of collateral.
- The definition of the adjustment for market risk is based on two 'hypothetical' capital requirements for market risk. The definition in Article 197(5)(a) uses the word 'hypothetical', however, the wording suggests that the definition in article 197(5)(a) prescribes the *actual* market risk calculations of the company. Suggest to rephrase this article.
- The way the two hypothetical capital requirements for market risk are defined, suggest that Article 197(5)(b) defines a situation in which the (reinsurance) counterparty is in default (that's the reason the collateral assets are on the insurers' balance sheet). The wording in definition in Article 197(5)(b) suggest that both the collateral assets and the recoverable from the reinsurance contract should be included in the market (interest rate) risk calculations. This is a situation that will never occur, as in default the reinsurance recoverable will not be on the balance sheet anymore. Suggestion to exclude the applicable counterparty default risk exposure (for which the risk-adjusted value of collateral is determined) from the hypothetical market risk calculations as described in Article 197(5)(b).

Condition on the 60 % of the counterparty's assets subject to collateral in Article 192(2) of the Delegated Regulation

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	Agree with the observation that it is hard to determine the 60%. The all-or-nothing option <60% vs. >60% undesirable. A change from 59% of collateralized assets to 61% can have a huge capital impact which does not reflect the actual risk. Suggestion to introduce an additional step or some sort of sliding scale. The all-or-nothing option introduces difficulty in correctly projecting the SCR for risk margin purposes.	
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17.1		
17.2		
17.3		
17.4.1	<p><u>Key principle 1: role of compliance with MCR/SCR after shock</u> Compliance with MCR/SCR within the SII timelines is interpreted differently by some NSAs (NL for instance). They see compliance to SCR/MCR level to be important when projecting future cash flows after shock. EIOPA however does not go this far but just asks to take the SCR/MCR level after shock into account in the assumption setting for future profits. This needs to be in line at all NSAs, resulting in convergent practices in member states.</p> <p>Referring to paragraph 1300, in the 2nd formula does EIOPA mean by NewBus Future Profits?</p> <p><u>Key principle 2: Future profits stemming from New Business – projection assumptions</u> The ENBV is introduced, assuming this to be in line with the VNB under MCEV (but using SII assumptions). Under MCEV, VNB can have a horizon depending on the duration of a contract, long tail life business may have a long horizon. Comparison needs to be made to the fiscal carry forward rules for recovering profits.</p> <p><u>Key principle 3: projection horizon of future profits from new business – projection horizon of future profits from NB</u> It is up to the individual insurer/industry to come up with a horizon they believe is suitable to project NB sales and then for NSAs to challenge. This is in line with the principle based SII framework in stead of rules based implementation.</p> <p>In the possible implementation of key principle 3 (b) EIOPA refers to the CRO forum paper (the 3 years and then a reduction). This is however just an example and also CRO forum refer to a P&C business. EIOPA seems to assume all insurance companies to have the same planning period and equally for life/nonlife or health insurers the same level of uncertainty after the same amount of</p>	

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years. The question is whether this is feasible

Key principle 4: projection horizon of future profits from new business- projection horizon of NB sales

In the possible implementation (b) EIOPA suggests to limit the sales period to 5 years irrespective of the companies business planning period. We deem it is up to the insurer to plan their business ahead. If a company has done extensive field work and explained in the ORSA ways to create NB sales for a longer period, this should be taken into account. A company should receive credit for coming up with their own planning period and adequate substantiation. This is in line with the principle based foundation.

Key principle 5: Future profits from returns on assets

Possible implementation

Prescribing to use after shock risk free rates for the assets in excess of TP is not in line with the principle based framework. As such, it is up to insurers to substantiate the after shock returns based on their economic views, assets in portfolio and projection of the insurance portfolio. Being on the most prudent side of the spectrum (fully complying and not broadly complying with guideline 9) leaves no room for entrepreneurship.

1334: It does not seem to be a problem if companies change their hedging strategy assuring interest rate up risk to be highest if they cannot create enough future profits based on the interest rate after shock when down would be the highest. If there are incentives to do so, then this should be rewarded.

Key principle 6: future profits from return on assets in excess of TP - projection horizon

1338: the sales planning period should be considered separately from profits from assets on the balance sheet. Profits from these assets ought to be considered in conjunction with the long term investment strategy and nature (maturity, duration) of the assets under consideration.

Key principle 7: Future management actions

1344: reading this text, contractual agreements with third parties (agreements when in shocked

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	<p>situation) are deemed to be less certain or probably than FMAs that are at full discretion of the company. This needs more substantiation. There may be situations in which this is the other way around.</p> <p>1349: can EIOPA please elaborate on the wording 'common understanding'?</p> <p>1351: shock-loss situation differs completely to pre-stress situation. Therefore, the FMAs to be taken into account may differ and/or be more rigorous in post stress. For instance lowering guarantees in certain products (in a low interest rate situation, like banks do) in situations in which otherwise all policy holders protection is required may be a good management decision post stress but not pre stress. Also, for example there may be incentives to lower expenses post stress should policy holders otherwise be affected. Pre stress there may not be such an incentive.</p> <p><u>Key principle 8</u> No comments</p> <p><u>Key principle 9</u> No comments</p> <p><u>Simplified method</u> 1370: it needs to be made clear whether or not the taxable profit in the year of the shock is part of the TaxableEconomicProfits</p>	
17.4.2		
17.4.3		
18.1		
18.2		
18.3	<p>In the assessment of the first stakeholders proposal (The CoC rate should be fixed at the level that corresponds to current market conditions) it is argued that this proposal does not ensure that the risk margin is sufficient where liabilities run off over a longer time period that includes market condition different from current conditions. Although we can agree with that statement, we are</p>	

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	not convinced the current and final proposed methodology will ensure this. In other words, would this argument not apply to the current en final proposed methodology as well?	
18.4.1		
18.4.2		
18.4.3	<p>It is argued that there should be one Beta for the complete insurance sector. However, life and non-life insurance business can be regarded as different in terms of profit and growth potential, as well as risks. It might be considered whether a insurance sector specific Beta would be more appropriate.</p> <p>EIOPA's advice to calculate the ERP is to use historic return models. This is mainly based on the argument that forward looking models, such as dividend discount models have volatile results that heaviliy depend on assumptions made. Although we acknowledge these shortcomings of forward looking models, solely basing ERP on historic returns has limited forward-looking value. We suggest considering to incorporate both outcomes (in the form of some sort of weighted average) to include forward looking elements, but limit the volatility and assumption dependence of forward looking models.</p> <p>It is not clear how the CoC rates of 6.7% to 7,8% can result in an advice of 6%.</p> <p>More in general, it might be considered to formalize the process of calculating the CoC, so that the outcome is reperformable and predictable. For this, a clear set of rules regarding input, methodologies, rounding, update frequencies, etc needs to be determined. Furthermore, to prevent too sudden changes in the level of the risk margin (and thus cause undesired volatility in financial statements) it might be considered to also incorporate a set of rules that capture maximum movements in CoC rates per update.</p>	
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19.4.3	In paragraph 1477 it is stated that further write down should be required upon worsening of the SCR ratio. We ask EIOPA to develop advice regarding the situation in which the SCR ratio improves.	
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