



## Proposals for making proportionality work in Solvency II

Insurance Europe and AMICE welcome that the Commission's has requested EIOPA, in its call for advice on the Solvency II 2020 Review, to assess whether proportionality in the application of the Solvency II framework could be enhanced.

The principle of proportionality, one of the overarching principles of the Treaty on European Union, is a vital element of the Solvency II Directive. It should allow national supervisory authorities to adjust the application of regulatory requirements in relation to the nature, scale and complexity of an insurer's activity.

However, the industry reports little or no application of proportionality in practice. Preventing overly burdensome and costly requirements is essential to avoid unnecessary complexity and costs which ultimately must be borne by customers and to preserve a diversified market.

The industry has therefore developed concrete proposals for changes that would help ensure that proportionality works in practice as originally intended.

*Insurance Europe is the European insurance and reinsurance federation. Through its 37 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of more than €1 200bn, directly employ over 950 000 people and invest over €10 200bn in the economy.*

*AMICE (the Association of Mutual Insurers and Insurance Cooperatives in Europe) is the representative organisation for the mutual and cooperative insurance sector and represents members in 21 countries across Europe. The mutual and cooperative insurance sector plays a significant role in the economy of the EU and within the insurance industry as a whole. Approximately half the insurance firms in Europe are mutuals or cooperatives [or their subsidiaries] and they represent close to 400 million members-policyholders writing approximately €400 billion in insurance premiums. Mutual and cooperative insurers are also significant employers with more than 430,000 people employed in Europe. AMICE provides a platform for members of all sizes to combine resources and expertise, exchange experiences across national borders and discuss planned legislative and regulatory developments.*

## Solvency II 2020 review

### Making proportionality work in practice

#### 1. Introduction

The principle of proportionality is embedded in the Solvency II Directive, reflecting its core status within the EU Treaties. Proportionality is a vital element of all EU legislation, even more so within a framework as sophisticated and extensive as Solvency II.

**Proportionality should protect insurers from unnecessary costs**, which ultimately have to be borne by their customers. It specifically should tackle the risk of smaller insurers being driven out of business due to regulatory requirements which are excessive relative to their nature, scale and complexity. **However, national supervisory authorities (NSAs) often perceive themselves as legally restrained from permitting companies to apply it.** As a result, in practice, proportionality is very rarely applied at present.

**Changes are therefore needed to ensure that the principle of proportionality works in practice and is applied effectively and consistently across all Member States and across all three pillars of Solvency II.** Insurance Europe welcomes that, in its call for advice to EIOPA, the European Commission asked for an assessment of whether proportionality can be enhanced in the application of the Solvency II framework.

Some NSAs appear to focus on whether an insurer can afford the costs of complying with a requirement. This is not an appropriate method by which to consider proportionality. The overriding concern should be whether the nature, scale and complexity of the insurer justify a simplified application of the requirement, or even a non-application, without any significant impact on the overall measurement of solvency or on policyholder protection. This fits in with Solvency II's guiding principles-based approach and should thus apply to all requirements of Solvency II (Pillars I, II and III) and to the exercise of supervisory powers across the EU<sup>1</sup>.

It is very clear that Solvency II creates many obligations for insurers. It also creates obligations for supervisors and **it must be clear that one of the obligations for NSAs is to allow and facilitate the application of the proportionality principle.** For all insurance companies, the application needs to be more operational, straightforward and pragmatic, for example, by simplifying and clarifying the requirements for applying proportionality.

A better application of the principle of proportionality would not only reduce the unnecessary burden placed on insurers, but would also **allow supervisors to better focus and allocate resources to fulfil their objectives** of consumer protection and financial stability. Insurers and their customers across the European Union would benefit from a proportionate and strong Solvency II framework.

EIOPA recognised the need for improvement in its supervisory statement, "Solvency II: Application of the proportionality principle in the supervision of the Solvency Capital Requirement", in which it highlights the need for a consistent implementation of the proportionality principle. However, this statement is limited in scope and is not sufficient to ensure proportionality works in practice.

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<sup>1</sup> Solvency II Directive, recital 19; "That principle should apply both to the requirements imposed on the insurance and reinsurance undertakings and to the exercise of supervisory powers"

Concrete steps are required to ensure the principle of proportionality is **fully adopted by Member States and NSAs and applied in a practical, harmonised and consistent way across the European Union**

## 2. Recommendations

Insurance Europe has identified the following changes needed to ensure the principle of proportionality works in practice:

- **In the Directive, additional text is needed to make clear that:**
  - **NSAs are not only legally able, but have an obligation, to allow companies to deviate from – or to not apply some – specific requirements set out in the Directive, the Delegated Acts and/or the implementing texts in order to apply proportionality.** For example, by amending Article 29 of the Directive “General principles of supervision”.
  - **Proportionality can be applied by groups and large companies as well as small companies.** The references to nature, scale and complexity should clearly refer to the relevant risk, activity or product and not the overall size of the company/group. Currently, some subsidiaries are excluded from applying any proportionality measures because they are part of a group. Equal treatment should be applied whether or not the company belongs to a group. For that purpose, proportionality at solo level must be reflected directly at group level.
- **In the Delegated Acts, create a proportionality “tool-box” – a non-exhaustive list of predefined specific proportionality measures.** This list of simplifications and waivers is needed to ensure proportionality relief can be available for all companies where some requirements are overly burdensome compared to the risks.
- **Reduce the burden on companies** seeking to apply proportionality measures (whether one of the predefined tools or other simplification/waiver) **and improve the consistency of the application of the principle of proportionality by:**
  - **adjusting existing requirements** (articles 56 and 88 of the Solvency II Directive) and **introducing clear risk-based specific criteria for the automatic application of measures of the tool-box** which would allow companies meeting those criteria to apply the tool automatically without further documentation and without the explicit approval of their NSA.
  - **requiring EIOPA to develop these clear risk-based criteria** aiming at assisting NSAs in their assessment of the nature, scale and complexity of risks and increase transparency in the application process of the principle.
  - **detailing in the regulation that individual measures of the tool-box can be applied by all insurers**, even when they do not fulfil the predefined criteria for automatic application, in the context of the supervisory dialogue, on condition that they properly document the justifications for so doing.
- **EIOPA should publish an annual report on proportionality including proposals on how to improve its effectiveness and consistency.** The report would evaluate the application of the proportionality principle per Member State and make propositions on how to improve its effectiveness and consistency (similar to the EIOPA report on the use of limitations and exemptions from reporting). This report, and any follow-up, should be overseen by the new proportionality committee<sup>2</sup> which is required to be set up by the ESA review.

These changes would ensure that all insurers have practical and efficient access to applicable proportionality measures. This would help companies of all sizes to not be subject to excessive costs and burdens of applying

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<sup>2</sup> Addition to Article 1 of Regulation (EU) No 1094/2010: “The Authority shall establish, as an integral part of the Authority, a Committee advising the Authority as to how, in full compliance with applicable rules, measures should take account of specific differences prevailing in the sector, pertaining to the nature, scale and complexity of risks, to business models and practice as well as to the size of financial institutions and markets to the extent that such factors are relevant under the rules considered.”

proportionality which currently create an imbalance against any benefits. These changes would be of particular help for companies with non-complex business which may meet the criteria for automatic application of the proportionality toolbox.

### 3. The need for changes to the Directive

At present, there is very little application of the proportionality principle. Some NSAs consider any simplification or deviation from legal texts as not permitted if they are not explicitly mentioned in the regulation. However, **the purpose of the proportionality principle is precisely to be able to over-ride some specific detailed requirements when they are disproportionate in relation to the objective sought**. It should be made clear in the legal texts that supervisors are required to consider and allow, and in fact facilitate, deviations from the specific texts based on the application of the proportionality principle, when justified by the insurer's scale, nature and/or complexity. **This should include clarification that the non-application of some requirements is allowed on the grounds of proportionality.**

Concrete steps are needed to ensure the principle of proportionality is **fully adopted by Member States and NSAs, and applied in a consistent way across the European Union**. Supervisors should apply proportionality by considering questions such as: *"Does this deviation from the specific requirements have any significant impact on overall solvency or policy holder protection?"*. Where the answer is no, they should not object to the company's approach.

To effectively reduce the supervisory burden for companies with a less complex risk exposure, proportionality must start with the question: *"Is an implementation necessary?"* If the answer is yes, a second step is required to assess how proportionality can be used in the process of implementation, i.e. how the requirement needs to be implemented. This should be made clear in the legal text, for example in Article 29 "General principles of supervision".

### 4. The proportionality toolbox

**In order to make proportionality effective and to increase the harmonisation of its application across Member States, EIOPA should seek to design a comprehensive non-exhaustive set of simplifications and waivers.**

***Automatic simplifications apply to companies meeting the predefined scale, nature and complexity criteria (i.e. "low risk companies")***

- The legal texts should provide a non-exhaustive **list of simplifications and waivers applying automatically to "low risk companies"**. It should be mandatory for EIOPA and/or NSAs to **predefine objective criteria to identify low risk companies, based on their overall scale, nature and complexity**. The concerned **companies would be automatically entitled to apply a list of simplifications and waivers, without any additional burden of proof and without objection from the NSA.**

***The simplifications and waivers can be considered for all, in the context of supervisory dialogue***

- **Proportionality applies also for more complex insurers on non-material risks and lines of business (LoB):**
  - The simplifications and waivers listed for low risk companies shall apply on non-significant LoBs and activities for more complex insurers
  - Although proportionality should be widely applied through the three pillars of Solvency II and should not be reduced to a list of simplifications, it appears that some examples need to be provided in the

regulation to clarify to NSAs that they have the right to deviate from the general requirements for non-significant activities.

- There should be **no application process and no significant burden of proof for the insurer**. The company should **duly notify the NSA** where it intends to apply simplifications, and should document its reasons for applying the simplification, unless it is a “low risk company”, but **should not have to go through an application process**.
  - The application of proportionality should not be compromised or discouraged by making it costlier than fulfilling the requirement in itself. Therefore, a short explanation from the company as to why it believes proportionality applies should be required, but there should be no significant burden of proof.
- When an insurer informs an NSA of its intention to apply proportionality, **the NSA should have a short and defined reaction time at its disposal to decide whether it wishes to object, with justification, to the use of simplifications in this specific context**. The NSA cannot object in the case of a “low risk company” applying the simplification.
  - This will allow an effective and efficient application of proportionality and prevent some current situations observed in some Member States, where an NSA remains silent and so blocks the application of proportionality.

## 5. Reducing the burden for companies to comply including criteria for automatic application

The current status of the application of the simplifications mentioned in article 109 of the Directive is as follows:

- for the calculation of technical provisions, listed in articles 57 to 61 of the Delegated Acts
- for the calculation of the SCR, listed in articles 90 to 112 are subject to the provisions of article 56 and 88 of the Delegated Acts.

Article 56.2 and 88.1 provide that the evaluation can be qualitative. However, in practice, companies are most often required by their NSA to conduct a quantitative evaluation of the deviation.

This places an important burden of proof on the company to demonstrate that it can apply simplifications in the calculation of the SCR and technical provisions. For smaller insurers, in practice, it is not worth the cost and effort of hiring an actuary and a lawyer to build their case for applying a simplification, particularly when there is a limited chance of having their request accepted by their NSA.

## 6. Toolbox example

The table below is provided as an illustrative example of how the proportionality toolbox could be designed:

*Note: criteria below are illustrative and further work would be needed between nsas and eiopa to define criteria taking into account scale, nature and complexity*

	<i>Proportionality measure open to any company subject to scale, nature, complexity. Self-assessment within the context of supervisory dialogue.</i>	<i><u>Automatic</u> proportionality measure for any company meeting the predefined criteria of scale, nature and complexity.</i>
PROCESS	Company required to notify NSA with explanation - <u>NSA can object within justification within [X] months.</u>	Company required to send a simple notification to NSA - <u>no power to object since the criteria are predefined.</u>
<b>Pillar 1</b>		
Simplifications for the calculation of technical provisions listed in articles 57 to 61	Individual supervisory dialogue	Scale: to be defined Nature: [ex: no credit, liability, surety ship...] Complexity: ...
Simplifications for the calculation of the SCR listed in articles 90 to 112		Scale: to be defined Nature: [ex: no credit, liability, surety ship...] Complexity: ...
No calculations for negligible exposures: report zero for the SCR component		Ex: [SCR component <1% total SCR Market share of the company <[10]%]
Conservative estimate for small but not negligible exposure in the SCR		Ex: [SCR component <5% total SCR Market share of the company <[10]%]
No calculations for negligible components of the balance sheet: report zero in the balance sheet		Ex: [BS component <[1]% total BS Market share of the company <[10]%]
Conservative estimate for small but not negligible component of the balance sheet		Ex: [SCR component <5% total SCR Market share of the company <[10]%]
Estimating the future BEL of non-significant portfolio (annually or quarterly) by applying the ratio between the current BEL and the mathematical provision of a portfolio with similar characteristics		Ex: [Portfolio weight <[5]% LoB Market share of the company <[10]%]
Estimating risk Margin for quarterly valuation by using the percentage of the BEL calculated at the annual reporting		[Criteria to be defined]
Simplification x		[Criteria to be defined]
...		
<b>Pillar 2</b>		
Actuarial key function not required	Individual supervisory dialogue	Ex: [No duration > 2 years Scale: <€[x]m premium income]...
Simplified ORSA template sufficient <sup>3</sup>		Scale: to be defined Nature: [ex: no credit, liability, surety ship...] Complexity: ...

<sup>3</sup> The Central Bank of Ireland offers the possibility for "Low and Medium Low undertakings" to fill a predefined template for the ORSA

Use of last valuation (quarter or annual, instead of full recalculation) for non-material component in the ORSA		Ex: [SCR or BS component <[5]% total SCR or BS Market share of the company <[10]%]
Key function holders can hold the responsibility for several entities		Ex: [Group includes companies below €[x]m premium income <[y] employees companies concerned are in the same country/group of predefined countries ...]
Lower requirements for intra-group outsourced activities		[Criteria to be defined]
Risk management limited to periodic re-evaluation for non-material risks		All companies
Depth and recurrence of the regular review of the governance system tailored to the risk exposure of the business		All companies
No deferral of the payment of variable remuneration for very small amounts (Currently even a €1 bonus requires payment deferral which is not practical and burdensome)		All companies Ex: [variable remuneration <[x]€ ]
Simplification y		[Criteria to be defined]
...		
<b>Pillar 3</b>		
RSR: sections should be filled only when significant change	Individual supervisory dialogue	Scale: to be defined Nature: [ex: no credit, liability, surety ship...] Complexity: ...
SFCR only every 3 years		Scale: to be defined Nature: [ex: no credit, liability, surety ship...] Complexity: ...
Only basic QRTs to be reported (please refer to Insurance Europe's response to EIOPA's consultation on reporting)		Scale: to be defined Nature: [ex: no credit, liability, surety ship...] Complexity: ...
Exemptions from participating in EIOPA reviews and requests for information through NSAs		Scale: to be defined Nature: [ex: no credit, liability, surety ship...] Complexity: ...
Companies in run-off with a few outstanding claims: exempted from most of reporting, eg by way of a single short report		
Groups: solo companies within a group accounting for a negligible proportion of the entire group to be included in the group report [via, for example, roll-over methods or even be omitted entirely]		[Criteria to be defined]
Groups: QRTs only on a biannual or annual basis instead of quarterly		Ex: [Scale of the group: <€[x]m premium income] ...
Small entities part of a group: in quarterly reporting, report only very limited data [to be defined]		Ex: [Company scale <€[x]m premium income, or company weight <x% of the group technical provisions/income...] ...
Look-through approach: revision of the limits for obligation of the look-through approach		
Simplification z		[Criteria to be defined]
...		
<b>Other</b>		
Company not identified under public interest entity (PIE) under the accounting Directives		Scale: to be defined Nature: [ex: no credit, liability, surety ship...] Complexity: ...
...		

## **APPENDIX**

### **Existing relevant texts**

#### **Directive**

##### Article 29:

###### General principles of supervision

1. Supervision shall be based on a prospective and risk-based approach. It shall include the verification on a continuous basis of the proper operation of the insurance or reinsurance business and of the compliance with supervisory provisions by insurance and reinsurance undertakings.
2. Supervision of insurance and reinsurance undertakings shall comprise an appropriate combination of off-site activities and on-site inspections.
3. Member States shall ensure that the requirements laid down in this Directive are applied in a manner which is proportionate to the nature, scale and complexity of the risks inherent in the business of an insurance or reinsurance undertaking.
4. The delegated acts and the regulatory and implementing technical standards adopted by the Commission shall take into account the principle of proportionality, thus ensuring the proportionate application of this Directive, in particular in relation to small insurance undertakings.

The draft regulatory technical standards submitted by EIOPA in accordance with Article 10 to 14 of Regulation (EU) No 1094/2010, the draft implementing technical standards submitted in accordance with Article 15 thereof and the guidelines and recommendations issued in accordance with Article 16 thereof, shall take into account the principle of proportionality, thus ensuring the proportionate application of this Directive, in particular in relation to small insurance undertakings.

#### **Delegated Acts**

##### Article 56:

###### Proportionality

1. Insurance and reinsurance undertakings shall use methods to calculate technical provisions which are proportionate to the nature, scale and complexity of the risks underlying their insurance and reinsurance obligations.
2. In determining whether a method of calculating technical provisions is proportionate, insurance and reinsurance undertakings shall carry out an assessment which includes:
  - (a) an assessment of the nature, scale and complexity of the risks underlying their insurance and reinsurance obligations;
  - (b) **an evaluation in qualitative or quantitative terms** of the error introduced in the results of the method due to any deviation between the following:
    - (i) the assumptions underlying the method in relation to the risks;
    - (ii) the results of the assessment referred to in point (a).
3. The assessment referred to in point (a) of paragraph 2 shall include all risks which affect the amount, timing or value of the cash in- and out-flows required to settle the insurance and reinsurance obligations over their lifetime. For the purpose of the calculation of the risk margin, the assessment shall include all risks referred to in Article 38 paragraph 1(i) over the lifetime of the underlying insurance and reinsurance obligations. The assessment shall be restricted to the risks that are relevant to that part of the calculation of technical provisions to which the method is applied.
4. A method shall be considered to be disproportionate to the nature, scale and complexity of the risks if the error referred to in point (b) of paragraph 2 leads to a misstatement of technical provisions or their components that could influence the decisions-making or judgment of the intended user of the information relating to the value of technical provisions, unless one of the following conditions are met:
  - (a) no other method with a smaller error is available and the method is not likely to result in an underestimation of the amount of technical provisions;
  - (b) the method leads to an amount of technical provisions of the insurance or reinsurance undertaking that is higher than the amount that would result from using a proportionate method and the method



does not lead to an underestimation of the risk inherent in the insurance and reinsurance obligations that it is applied to.

Article 88:

Proportionality

1. For the purposes of Article 109, insurance and reinsurance undertakings shall determine whether the simplified calculation is proportionate to the nature, scale and complexity of the risks by carrying out an assessment which shall include all of the following:

(a) an assessment of the nature, scale and complexity of the risks of the undertaking falling within the relevant module or sub-module;

(b) **an evaluation in qualitative or quantitative terms**, as appropriate, of the error introduced in the results of the simplified calculation due to any deviation between the following:

(i) the assumptions underlying the simplified calculation in relation to the risk;

(ii) the results of the assessment referred to in point (a).

2. A simplified calculation shall not be considered to be proportionate to the nature, scale and complexity of the risks where the error referred to in point (b) of paragraph 2 leads to a misstatement of the Solvency Capital Requirement that could influence the decision-making or the judgement of the user of the information relating to the Solvency Capital Requirement, unless the simplified calculation leads to a Solvency Capital Requirement which exceeds the Solvency Capital Requirement that results from the standard calculation.