**FERMA response to the EIOPA Consultation Paper on the Opinion on the 2020 review of Solvency II**

**15 January 2020**

Introduction

FERMA thanks EIOPA for the invitation to comment on the 2nd Consultation Paper on the Opinion on the 2020 review of Solvency II. FERMA brings together 21 national risk management associations in 20 European countries. They represent nearly 5.000 risk and insurance managers throughout Europe, of which 37% are European captive insurance users.

FERMA has developed a proposal for a harmonised approach in the application of the proportionality principle by the supervisors. FERMA’s conceptual approach has been introduced in its “Response to the EIOPA Consultation Paper on reporting and disclosure in the context of the Solvency II revision”, dated 18th October 2019, and is aimed at outlining a methodology to assess the overall risk profile of any given (re)insurance undertaking and subsequently ensure that proportionality is applied by EU national supervisors in a harmonized way.

FERMA’s proposal is aimed at supporting EIOPA and National Competent Authorities (NCA) in determining which criteria and elements should be taken into account for assessing how any given (re)insurance undertaking can benefit from the Principle of Proportionality (PoP) and to what extent.

FERMA believes its suggested harmonised approach would allow national supervisory authorities to appropriately screen any insurance undertakings’ nature, scale and complexity against the core objectives of Solvency II, which are policyholder protection, market discipline and financial stability.

At this stage, FERMA’s proposal can be seen as a proof of concept encompassing a set of preliminary tools, list of proportionality measures, rationale for the matrix as well as proportionality criteria and regulation objectives. Assessed altogether, these elements, supported by operational examples, could indicate how and to what extent proportionality measures can be applied.

FERMA’s proposal is aimed at outlining the underlying rationale supporting a potential methodology and as such we would warmly invite EIOPA to cooperate further and complete the proposed approach, notably in designing, finetuning and finalising its practical features.

Structure of FERMA’s Response

The present response to EIOPA Consultation Paper is therefore structured around two main angles:

1. A short reminder about the overall rationale supporting FERMA’s proposed methodology.
2. A tentative list of open items/questions that should be addressed together by EIOPA and FERMA to round off the approach and make it applicable.

1- Reminder: FERMA’s suggested approach to a consistent Principle of Proportionality (PoP) methodology

The full extent of FERMA’s proposal can be found in its *Response to EIOPA Consultation* Paper from 18th October 2019.

**Underlying Principles**

* The objective of the FERMA approach is to ensure that proportionality is evaluated consistently by EU national supervisors, while keeping a flexibility in the intensity of the proportionality measures
* Proportionality criteria (nature, scale and complexity) should not be regarded as separated but assessed altogether as a whole, i.e. as defining a (re)insurance undertaking’s overall risk profile.
* The ultimate objectives of Solvency II (i.e. financial stability, consumer protection and market discipline) are intrinsically part of the overall risk profile assessment.
* The link between proportionality criteria and ultimate objectives is not assessed in two steps but in one single step, allowing for the risk profile and the related proportionality decision to be addressed holistically.

Our proposed approach is innovating since it considers the objectives of Solvency II (financial stability, market discipline and policyholder protection) as a starting point. It does not only focus on the specific risks within the undertaking but makes a link between the impact of the business model and related risk profile of an insurance undertaking with the policy objectives of Solvency II.

**Our Starting Point: Three Fundamental Questions and Four Steps**

FERMA’s methodology has been structured as a potential answer to the following three questions:

1. How can we link proportionality criteria (size, scale and complexity) into one single risk profile for any given (re)insurance undertaking?
2. How can we link the said risk profile to the ultimate objectives of the regulation (policyholder protection, financial stability and market discipline)?
3. How can we link that final result to concrete proportionality measures?

Considering that “proportionality is lost if it is defined”, FERMA’s approach focuses on the methodological way to assess how and to what extent proportionality should be applied to any given (re)insurance undertaking according to its overall risk profile, and does so through a four steps methodology:

* **STEP 1: Overall Risk Profile Matrix,** combining the proportionality criteria and the regulation objectives
* **STEP 2: Defining Four Levels of Applicable Proportionality**
* **STEP 3: Listing Applicable and/or potential Proportionality Measures**
* **STEP 4: Linking Risk Profile and Concrete Proportionality Measures**.

2- Open items/questions to complete FERMA’s approach

**STEP 1: Overall Risk Profile Matrix**

The Risk Profile Matrix is based on a scoring to be attributed to the (re)insurance undertaking based on a predefined assessment rule.

FERMA has developed a first set of assessment rules which aims at positioning the (re)insurance undertaking level of exposure considering a given proportionality criteria on one hand and a given regulation objective on the other hand.

**In order to move the methodology forward, a dialogue with EIOPA should be started to ensure appropriate and finetuned definitions for all 27 combinations of the risk matrix (3 levels for 3 proportionality criteria relating to 3 regulatory objectives).**

**STEP 2: Defining Four Levels of Applicable Proportionality**

FERMA has pre-defined examples of differentiated Levels of Proportionality.

**In order to move the methodology forward, a dialogue with EIOPA should be started to ensure appropriate and finetuned definitions for those differentiated levels of proportionality are achieved in a consistent way, allowing the practical implementation of the methodology.**

**STEP 3: Listing Applicable and/or potential Proportionality Measures**

Deploying the PoP more would require to complete a review of existing as well as potential proportionality measures that could be applied to (re)insurance undertakings meeting those proportionality risk profiles.

Understanding what proportionality measures could be applied for specific overall risk profile would be the concrete bridge between the objectives of Solvency II and the actual business model and risk profile of (re)insurance undertakings.

**The methodology will be efficient only if it leads to proportionality measures that are concrete and operational.**

**An open dialogue with EIOPA should start to list and define such proportionality measures.**

**STEP 4: Linking Risk Profile and Concrete Proportionality Measures.**

In order to be efficient, the methodology should connect the various proportionality measures to the risk profile assessed through the proportionality matrix.

**As such a dialogue should start with EIOPA to ensure an appropriate definition of rating criteria allowing a clear and consistent connection to the practical proportionality measures.**

CONCLUSION

The challenges to be achieved to successfully deliver a workable methodology are twofold:

1. Cooperating with EIOPA for completing in a consistent and practical way the design, definition and finetuning of the methodology’s components as described here above.
2. Finding the right balance between a consistent, methodological and more predictable evaluation of proportionality for (re)insurance undertakings whilst keeping an open dialogue with EU national supervisors around practical application of proportionality measures and allowing them to keep control about how and to what extent the said measures can be applied.

FERMA would welcome the opportunity to cooperate with EIOPA in moving that concept further through the following concrete actions:

* Kick-off workshop with NCA representatives to introduce the approach and agree its framework;
* List key risk drivers against each Solvency II objective in terms of nature, scale, and complexity;
* Finalise scoring matrix;
* Collect proportionality measures already in use by NCAs across 3 pillars;
* Add proposed additional proportionality measures;
* Determine when each proportionality measure could be granted based on scoring matrix;
* Perform sample testing by NCAs on approx. 20 undertakings to finalise calibration of framework;
* Develop tooling and methodology note for the use by NCAs.

We hope that we can cooperate with EIOPA and NCAs to investigate the practicality of our methodology and contribute to improve and strengthen the way proportionality is applied within the (re)insurance industry. It would represent a real progress for the Solvency II framework and would ensure that the proportionality principle fully benefits to all stakeholders, both supervisors, (re)insurance undertakings and end consumers.

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FERMA - The Federation of European Risk Management Associations brings together 21 national risk management associations in 20 European countries. FERMA represents the interests of more than 4800 risk and insurance managers in Europe active in a wide range of business sectors from major industrial and commercial companies to financial institutions and local government bodies. More information can be found at [www.ferma.eu](http://www.ferma.eu)