

Q&A

QUESTION ID:

1841

REGULATION REFERENCE:

(EU) No 2015/35 - supplementing Dir 2009/138/EC - taking up & pursuit of the business of Insurance and Reinsurance (SII)

TOPIC:

Solvency Capital Requirement (SCR)

ARTICLE:

Article 142

PARAGRAPH:

6

STATUS:

Rejected

DATE OF SUBMISSION

29 Jan 2019

BACKGROUND OF THE QUESTION:

The following text is observed in the SF correlation calibration paper

<https://eiopa.europa.eu/CEIOPS-Archive/Documents/Advices/CEIOPS-L2-Advice-Correlation-Parameters.pdf>:

“Expense risk 3.82. Some insurance events like lapse, disability and revision can lead to additional expenses for the undertaking. For example, in case of a mass lapse event the number of transactions increases drastically and the internal processes of the undertaking would need to be adjusted accordingly. Moreover, a revision of the economies for scale in relation to the future expenses would need to be made. In case of an increased probability of disability events or annuity revisions, the expenses for the assessment and management of these events will rise. 3.83. In order to allow for this causal connection, similar to QIS4, a medium correlation factor of 0.5 for lapse, disability and revision risk in relation to expense risk seems to be appropriate.” The text provides the evidence that the Standard Formula intends to cover the potential loss of economies of scale within the expense risk rather than the mass lapse risk. Hence not revising the per policy expense assumptions within the mass lapse risk would be in line with the advice paper.

Question

In calculating the SCR using the Standard Formula approach, each risk is assessed individually and risks are then aggregated using defined correlation assumptions. The expense risk applies a combined instantaneous permanent increase of 10% to the expense assumptions and 1 percentage point to the expense inflation rate. The mass lapse stress applies a 40% immediate shock to the in-force policies that would result in capital strains to the business. A correlation factor of 0.5 is used in aggregating the expense risk and mass lapse risk.

A Solvency II advice paper “CEIOPS’ Advice for Level 2 Implementing Measures on Solvency II: SCR STANDARD FORMULA Article 111(d) Correlations (CEIOPS-DOC-70/10 dated on 29 January 2010)”

(<https://eiopa.europa.eu/CEIOPS-Archive/Documents/Advices/CEIOPS-L2-Advic.>

..) states that the SF correlation factor between the expense risk and the lapse risk reflects the potential loss of economies from the mass lapse event. This advice suggests that the standalone expense risk already includes the risk of potential increase of the expense assumption from a mass lapse event. Hence wouldn't the practice of capturing this risk again within the mass lapse risk, as suggested in the response to Q&A number 1678, constitute double counting of losses arising from an 1-in-200 year event under the Standard Formula?

Background of the question

The following text is observed in the SF correlation calibration paper <https://eiopa.europa.eu/CEIOPS-Archive/Documents/Advices/CEIOPS-L2-Advice-Correlation-Parameters.pdf>: "Expense risk 3.82. Some insurance events like lapse, disability and revision can lead to additional expenses for the undertaking. For example, in case of a mass lapse event the number of transactions increases drastically and the internal processes of the undertaking would need to be adjusted accordingly. Moreover, a revision of the economies for scale in relation to the future expenses would need to be made. In case of an increased probability of disability events or annuity revisions, the expenses for the assessment and management of these events will rise. 3.83. In order to allow for this causal connection, similar to QIS4, a medium correlation factor of 0.5 for lapse, disability and revision risk in relation to expense risk seems to be appropriate." The text provides the evidence that the Standard Formula intends to cover the potential loss of economies of scale within the expense risk rather than the mass lapse risk. Hence not revising the per policy expense assumptions within the mass lapse risk would be in line with the advice paper.

EIOPA answer

This question has been rejected because the matter it refers to has been answered in Q&A 1678 , which remains valid. Using the assumption of constant per policy expense for determining the capital requirements for mass lapse risk may in many cases be too optimistic with respect to the possibility to reduce costs. Also, the reason behind the retained correlation factor depends on the legislator intention.