



ACTUARIAL ASSOCIATION OF EUROPE

Solvency II Working Group IC Spring Meeting in Sofia

Siegbert Baldauf

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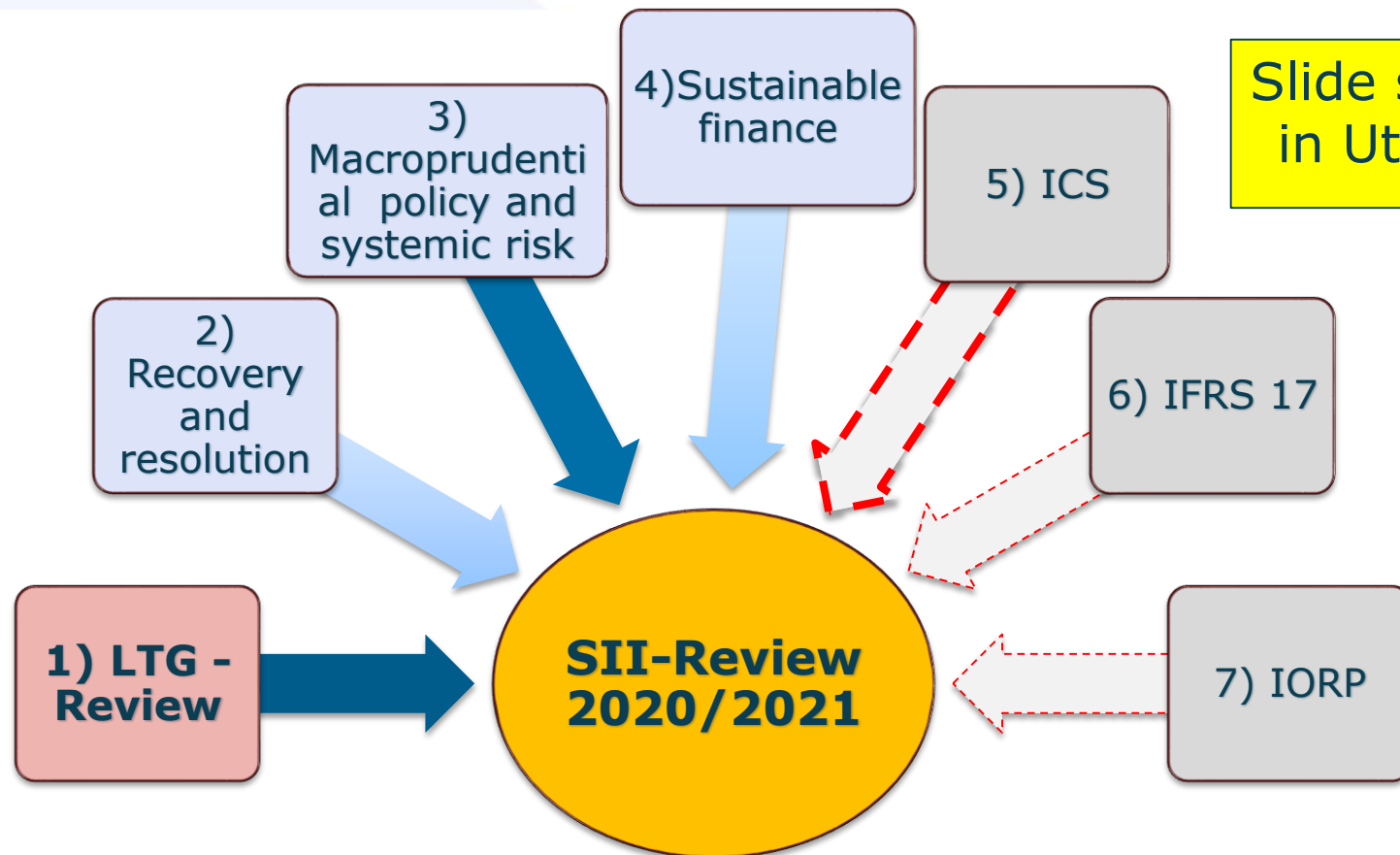
Solvency II Working Group

Solvency II Working Group

Current list of members

Chair:	Siegbert Baldauf
Vice Chair:	Daphné de Leval
Members:	Lauri Saraste
	Declan Lavelle
	Nils Dennstedt
	Matthias Pillaudin
	Frank Schiller
	Debbie Ramdien-Sonai

Solvency II 2020/2021 – Potential impact



Gabriel Bernardino: *A second and more comprehensive revision is due in 2020-21. In that revision, we will look at the whole regime **and among other things, review long-term liabilities.***

5. Juni 2018: **Interview with Gabriel Bernardino with Pensioner & Förmåner and Dagens Industri**

S II Working Group: Tasks and Capacity

First assessment of tasks for the Solvency II Working Group

- 1) Remainders from SCR – Review ✓
- 2) LTG – Review ✓
- 3) Systemic risk and macroprudential tools ✓
- 4) Recovery and resolution – funding of insurance guarantee schemes (✓)
- 5) Sustainable Finance (✓)
- 6) International Capital Standards (ICS) (✓)

✓: Recognised as task

(✓): to be considered

S II Working Group: Tasks and Capacity

Prior to the expected consultation documents, the Solvency II Working Group had established three task forces (Objective: proactive occupation):

- | | |
|------------------------------|------------------|
| a) Interest rate down stress | Lauri Saraste |
| b) Risk Margin | Malcolm Kemp |
| c) Macroprudential tools | Siegbert Baldauf |

LTG – measures: Request for Advice of the Commission expected

Solvency II Working Group still needs now

- members and
- experts for particular issues, to be called upon

Members should be highly committed to the tasks

Request to EIOPA for technical advice

3.1. Extrapolation of the Risk-Free Interest Rate term structure (Art. 77a)

3.2. Matching adjustment (Art. 77b, 77c) and volatility adjustment (Art. 77d)

3.3. Transitional measures

3.4. Risk margin

3.5. Capital Markets Union aspects

3.6. Dynamic modelling of the Volatility adjustment

3.7. Solvency Capital Requirement standard formula

3.8. Risk-mitigation techniques and other techniques used to reduce SCR

3.9. MCR

Exemplary:

3.1.-3.3. LTG – Review

3.4. Appropriateness of risk margin

3.5. Market risk: under consideration of long-term nature of insurance business, in particular equity risk and spread risk (Illiquidity!)

3.7. open issues from SCR- Review: interest rate risk

Calibration of underwriting risk

CAT risks in standard formula

3.8. Reinsurance non-life underwriting

3.9. member-states' rules and practises, e.g. use of cap und floor

Request to EIOPA for technical advice

<p>3.10. Macro-prudential issues</p> <p>3.11. Recovery and resolution</p> <p>3.12. Insurance guarantee schemes (IGS)</p> <p>3.13. Freedom to provide services and freedom of establishment</p> <p>3.14. Group supervision</p> <p>3.15. Reporting and disclosure</p> <p>3.16. Proportionality and thresholds</p> <p>3.17. Best estimate</p> <p>3.18. Own funds at solo level</p> <p>3.19. Reducing reliance on external ratings</p>	<p>Exemplary:</p> <p>3.10. "closed list" of items: Advice on improvement of</p> <ul style="list-style-type: none"> ▪ ORSA; ▪ systemic risk management plan; ▪ liquidity risk management planning and liquidity reporting; ▪ prudent person principle. <p>3.11., 3.12. Assessment SII rules on Recovery; Need for harmonisation of resolution; Trigger „early intervention“</p> <p>3.15 Appropriateness of volume and frequency</p> <p>3.17. Supervisory practises with regard to calculation of the best estimate</p> <p>Use of ESG, Management actions, options and guarantees</p> <p>3.18. Tiering banking vs. insurance</p>
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Preparatory work has already started

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|--|-------------------------------------|
| - Illiquid liabilities | Consultation, Data request |
| - Extrapolation of risk-free rate curve | |
| | LTG – Report, Data request |
| - Reporting and Disclosure | Call for Input |
| - Recovery and resolution | Consultation, EIOPA's Opinion paper |
| - Systemic risk and macroprudential policy | |
| | Discussion paper |

Not part of the Request for Technical Advice:

Sustainability risk

Consultation

Relevance for the Solvency II working group

Preliminary assessment (might change depending on EIOPA's consultation paper)

a) no occupation

To discuss

- 3.6 Dynamic modelling of Volatility adjustment
- 3.8 Risk-mitigation techniques and other techniques used to reduce SCR
- 3.9. MCR
- 3.11 Recovery and resolution
- 3.12 Insurance Guarantee schemes
- 3.13 Freedom to provide services and freedom of establishment
- 3.14 Group supervision
- 3.16 Proportionality and thresholds
- 3.17 Best estimate*
- 3.18 Own funds at solo level
- 3.19 Reducing reliance on external ratings

* If flaws or significant supervisory divergences are identified, EIOPA is asked to advise on how these could be remedied.
→ Occupation required

Relevance for the Solvency II working group

To discuss

Preliminary assessment (might change depending on EIOPA's consultation paper)

b) actuarial skills and knowledge required

- 3.1 **Extrapolation**
- 3.2 Matching adjustment (Art. 77b, 77c) and
 volatility adjustment (Art. 77d)
- 3.3 Transitional measures
- 3.4 Risk margin
- 3.5 Capital Markets Union aspects
- 3.7 Solvency Capital Requirements and Standard formula
- 3.10 Macro-prudential issues
- 3.15 Reporting and Disclosure

Relevance for the Solvency II working group

To discuss

Item	Topic	Priority
3.1	Extrapolation	high
3.2	Matching adjustment (Art. 77b, 77c) and volatility adjustment (Art. 77d)	high
3.3	Transitional measures	medium
3.4	Risk margin	high
3.5	Capital Markets Union aspects	high
3.7	Solvency Capital Requirements and Standard formula	high
3.10	Macro-prudential issues	medium
3.15	Reporting and Disclosure	medium

To consider

Interdependencies

The role of insurers as long-term investor (illiquidity of liabilities!) plays a role in several issues listed in this Request:

- Volatility Adjustment, Matching Adjustment
- Spread risk
- Equity risk
 - Duration based equity risk sub module
 - Long-term equity investments
 - Symmetric adjustments
- Risk margin
- Interest rate risk (in SCR – Review)

Annex

Excerpt of Request – 3.1

Extrapolation of the Risk-Free Interest Rate term structure (Art. 77a)	<p>As a minimum, evidence should be provided on the value of the last liquid point in accordance with the following criteria:</p> <ul style="list-style-type: none">-the depth, liquidity and transparency of swap and bond markets in a currency;- the ability of insurance and reinsurance undertakings to match with bonds the cash-flows which are discounted with non-extrapolated interest rates in a currency;- for all relevant maturities, the cumulative value of bonds with maturities larger than or equal to the relevant maturity in relation to the volume of bonds in the market.
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Excerpt of Request – 3.2

Matching adjustment (Art. 77b, 77c) and volatility adjustment (Art. 77d)	<p>EIOPA is asked to provide an assessment of the quantitative impact on the calculation of the best estimate and the solvency position of insurance undertakings the following approaches for the calculation/application of the volatility adjustment:</p> <p>Approach 1: the application of an adjustment that takes into account the illiquidity features and/or duration of insurers' liabilities, while maintaining the current concept of representative portfolios. That adjustment may rely on different "application ratios";</p> <p>Approach 2: the application of an adjustment that takes into account the weights of own assets holdings of each insurer; that adjustment may rely on different "application ratios" depending on the level of cash-flow matching of insurance liabilities portfolios. When applying this approach, EIOPA should specify the assumptions regarding diversification benefits in the calculation of the Solvency Capital Requirement.</p>
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Excerpt of Request – 3.3

Transitional measures	<p>EIOPA is asked to assess the ongoing appropriateness of the transitional provisions in terms of policyholder protection and level-playing field. This assessment should, where applicable, also assess whether the ongoing possibility for companies to newly apply for the transitional measures should continue. EIOPA may prioritise its work on the different transitional measures, provided that the advice states the reason for doing so. However, EIOPA's assessment should cover at least the transitional measures referred to in Articles 308b (12) and (13), Article 308c and Article 308d of the Solvency II Directive.</p>
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Excerpt of Request – 3.4

<p>Risk margin</p>	<p>EIOPA is asked to assess the appropriateness of the design of the risk margin, without challenging the approach based on the cost-of-capital. In particular, EIOPA should assess the ongoing appropriateness of:</p> <ul style="list-style-type: none"> - the design of the risk margin, in light of the work currently undertaken by EIOPA on the transfer value of liabilities, in the context of the Commission’s Call for information¹⁰; - the assumptions regarding the asset mix of the receiving undertaking, in particular with regard to the assumption of risk-free investments. This assessment should take into account the potential interactions between the recognition of market risk and the use of the volatility adjustment and the matching adjustment in the risk margin calculation; - the use of a fixed cost-of-capital rate for all insurance and reinsurance undertakings; - the assumptions used to derive the cost of capital rate, including the absence of leverage and the derivation of the equity risk premium. <p>EIOPA is asked to collect information on the actual transfer of insurance liabilities between insurance and reinsurance undertakings. In particular, EIOPA is asked to compare the transfer values with the valuation of the transferred liabilities and assets, if any, under the Solvency II framework.</p>
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Excerpt of Request – 3.5

Capital Markets Union aspects

EIOPA is asked to continue its analysis on the treatment of long-term investments under Solvency II. In particular, EIOPA is asked to assess whether the methods, assumptions and standard parameters underlying the calculation of the market risk module with the standard formula appropriately reflect the long-term nature of the insurance business, in particular equity risk and spread risk. To this end, EIOPA is asked to

- identify the characteristics of insurance business and liabilities that enable insurers to hold their investments for the long term; and
- where appropriate, advise on revised methods, assumptions and standard parameters for the purpose of calculating the market risk module, reflecting insurers' behaviour as long-term investors.

With regard to equity, EIOPA is also asked to conduct a comprehensive review of the equity risk sub-module, and in particular to assess the appropriateness of the design and calibration of the duration-based equity risk sub-module, of strategic equity investments, of long-term equity investments and of the symmetric adjustment.

Excerpt of Request – 3.7

Solvency Capital Requirement standard formula

a) Interest rate risk

EIOPA is asked to assess whether the calibration of the interest rate risk sub-module with the standard formula adequately reflects the risks faced by insurers, taking into account the low interest rates environment, and in case this analysis points towards flaws, to advise on how these could be remedied. When making recommendations, EIOPA should ensure that any new calibration is appropriate for all currencies in the EEA, and should take into account the potential interactions with the parameters of the risk-free interest rate term structure.

d) Calibration of underwriting risk

Where stakeholders provide material data of sufficient quality, EIOPA is asked to assess whether that would form a more representative basis for the calibration of underwriting stresses than the calibration on which the current factors are based.

e) CAT risks in the Standard Formula

In its second set of advice on specific items in the Solvency II Delegated Regulation (EIOPA-BoS-18/075), EIOPA had advised a method to capture specific insurance policy conditions (in particular contractual limits or sub-limits) that deviate significantly from the national market average conditions in the standard formula natural catastrophe calculation. In order to facilitate the application of that approach, EIOPA is asked to provide the national market average conditions that underlie the calibration of the natural catastrophe risk submodule.

Excerpt of Request – 3.10

Macro-prudential issues

EIOPA is asked to assess whether the existing provisions of the Solvency II framework allow for an appropriate macro-prudential supervision.

Where EIOPA concludes that it is not the case, EIOPA is asked to advise on how to improve the following closed list of items:

- the own-risk and solvency assessment;
- the drafting of a systemic risk management plan;
- liquidity risk management planning and liquidity reporting;
- the prudent person principle.

This assessment should be based on strong supporting evidence, also assessing the possible impact of such additional specifications of insurers' behaviour and possible interactions with other Solvency II instruments.

Excerpt of Request – 3.15

Reporting and disclosure	<p>EIOPA is asked to assess, taking into account stakeholders' feedback to the Commission public consultation on fitness check on supervisory reporting:</p> <ul style="list-style-type: none">- the ongoing appropriateness of the requirements related to reporting and disclosure, in light of supervisors' and other stakeholders' experience;- whether the volume, frequency and deadlines of supervisory reporting and public disclosure are appropriate and proportionate, and whether the existing exemption requirements are sufficient to ensure proportionate application to small undertakings.
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Excerpt of Request – 3.17

EIOPA is asked **to report** on divergent supervisory practices with regard to the calculation of the best estimate, and to provide quantitative information on their impacts, in particular with regard to the following items:

- the use of the use of economic scenario generators for the purpose of calculating the best estimate of life obligations;
- the application of the definition of contract boundaries;
- the application of future management actions including those in the context of highly profitable scenarios and those linked to "lapses/surrenders";
- the treatment and evaluation of expenses, investment costs and the valuation of options and guarantees.

Where this analysis would point towards the identification of flaws or significant supervisory divergences, EIOPA is asked to advise on how these could be remedied.

Best estimate