Top 9.2: Status of Solvency II

Siegbert Baldauf

12 April 2018

Lisbon, IC meeting

Agenda

1) Solvency Review Process
   a) SCR Review
   b) LTG review
2) SFCR
3) Insurance stress test
4) Systemic risk and macroprudential policy

Agenda

1) Solvency Review Process
    a) SCR Review
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1) SFCR
2) Insurance stress test
3) Systemic risk and macroprudential policy

Process SCR - Review

End of a long process - but only a stopover in the whole Solvency II review

Review Solvency II Delegated Regulation		
Process step	Commission's request to EIOPA 18 July 2016	
Discussion paper	8 December 2016 - 3 March 2017	
	1. set of advice	**2. set of advice**
Roundtable with stakeholders	23 May 2017 8 June 2017	27 September 2017
Advice to Commission	**31 October 2017**	**28 February 2018**
Consultation paper	4 July 2017	5 November 2017
End of Consultation	31 August 2017	5 January 2018

EIOPA’s advice to Commission

EIOPA’s has sent the required advice in two sets to the Commission:

EIOPA-BoS-17/280 30 October 2017

EIOPA’s first set of advice to the European Commission on specific items in the Solvency II Delegated Regulation

EIOPA-BoS-18/075 28 February 2018

EIOPA’s second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation

- Several changes of Delegated Regulation proposed.

LAC DT leads to several new articles in the Delegated regulation. Extension of the task of the Actuarial Function proposed. (7a) added to article 272:

Article 272 – Actuarial Function

7a. Assess and validate the underlying assumptions applied for the projection of future profits for the purpose of Article 15 and Article 207.

The administrative, management or supervisory body may delegate this task to the risk management function.

SCR – Review

Some of EIOPA’s proposals (overview):

a) Mortality / Longevity: Mortality 15%, longevity also unchanged
b) Risk margin: COC unchanged, discussion of methodology for postponed to LTG – review
c) Catastrophe risk: some changes proposed
d) Volume measure for premium risk: changes for one-year and multi-year contracts
e) LAC DT: considerable changes of Delegated Regulation proposed,
f) Interest rate risk: Shift approach now proposed

SCR - Review – EIOPA's advice

a) Mortality / Longevity: Mortality 15%, longevity also unchanged

<u>Consultation paper:</u> EIOPA had proposed to increase mortality stress from 15% to 25% based on the presented methodology. Methodology confirms the calibration of longevity risk.

<u>Our comments:</u> Let mortality stress unchanged (Paper of the Spanish actuaries)

<u>EIOPA's proposal:</u> maintain 15% mortality stress, 20% longevity stress, no improvement of granularity

SCR - Review – EIOPA's proposals

b) Risk margin: COC unchanged, discussion of methodology for postponed to LTG – review

Consultation paper: EIOPA had proposed to maintain Cost of capital rate of 6%. Methodological issue not considered.

Our comments: 6% to high, not adequate in consideration of the nature of the business, methodology to calculate the risk margin requires change

EIOPA's proposal:

- 6% still adequate, despite low interest rate environment.
- Based on the analysis of equity price risk.
- Review of other aspects should be done as part of the forthcoming LTG review.

SCR - Review – EIOPA's proposals

b) Risk Margin – some comments and ideas from working group

Even though EIOPA postponed the discussion on the actual methodology around risk margin, it might be worthwhile to prepare ourselves and start to re-think the concept of risk margin. This gives us also better ability to react towards EIOPA (or EC) if help is asked. Some basic ideas that could be listed:

What is the purpose of risk margin?
What should it cover?
In what circumstances RM could be used and if it would be used what then? Would the SII requirements still be same for that company?
How RM needs to be funded, e.g. could MCR be used as part of the funding?

A lot of good ideas were sent to EIOPA in the 2017 responses to SCR review. Besides this there has been different papers/discussion regarding this topic. Currently RM is one of the hot topics in the 'SII Brexit review' in UK, there might be good ideas coming out of this also.

SCR - Review – EIOPA's advice

c) Catastrophe risk

<u>Consultation Paper:</u> EIOPA proposed some simplifications and changes for Man-Made and Nat Cat Risks.

<u>Our Comments:</u>

- Support development of simplified methods, especially for smaller entities.
- Generally supportive of the individual proposals.

<u>EIOPA's Proposal:</u> EIOPA advises simplifications for

- 10 year disability scenario for health risk;
- identification of largest concentration for Fire Risk; and
- mapping non-allocated exposures for Nat-Cat, and changes including
  - definition of "vessel" for marine risk;
  - identification of largest man-made Cat exposures net rather than gross of RI;
  - recalibration of some Nat-Cat parameters; and
  - new ex-post adjustment to capture policy specific limits and deductibles.

SCR - Review – EIOPA's advice

d) Volume measure for premium risk

Consultation Paper: EIOPA proposed two options, no change; or

remove "gap" in definition of FP_{FUTURE}, and reduce volume measure for FP_{FUTURE} by 70%

Our Comments: We agreed more with the second option but

- noted the significant impact on one-year contracts and proposed also a reduction in the volume measure for $FP_{EXISTING}$ to reduce this adverse impact;
- noted the additional inter-year volatility that would be introduced and proposed a method to counteract volatility (example method from DAV)
- proposed a more risk-based volume measure (e.g. premiums net of commissions or risk premiums) rather than gross premiums.

EIOPA's Proposal: EIOPA now advises

- One-Year Contracts: no change (therefore avoiding much of the additional volatility); and
- Multi-Year Contracts : remove "gap" reduce volume measure for FP_{FUTURE} by 70%
- EIOPA did not take up the AAE proposal on a more risk-based volume measure.

SCR - Review – EIOPA's proposals

e) LAC DT

EIOPA's intention is, to implement 9 key principles to achieve a harmonization.

These key principles are about:

I. The financial and solvency position of the undertaking – role of compliance with the MCR and SCR after shock loss
II. Future profits stemming from new business – projection assumptions
III. Future profits stemming from new business – projection horizon of future profits stemming from new business
IV. Future profits stemming from new business – projection horizon of new business sales
V. Future profits stemming from return on assets
VI. Future profits stemming from return on assets in excess of technical provisions – projection horizon
VII. Future Management Actions
VIII. Role of system of governance
IX. Supervisory reporting and disclosure

LAC DT

To achieve this treatment of LAC DT, EIOPA advises to integrate several new articles in the Delegated Regulation.

Requirements for SFCR and RSR are amended (Articles 297, 311).
Article 260 on risk management areas amended by

h. Loss-absorbing capacity of deferred taxes

In addition, the tasks of the Actuarial Function are extended:

Article 272 – Actuarial Function

7a. Assess and validate the underlying assumptions applied for the projection of future profits for the purpose of Article 15 and Article 207.
The administrative, management or supervisory body may delegate this task to the risk management function.

SCR - Review – EIOPA's proposals

LAC DT

Working group's assessment

EIOPA's proposal all-in-all was a good effort to the right direction

The 5-year limit for new sales seems not to make the future profits calculation any better → could be pointed out to leave this restriction out. It maybe should be left to the market to come up with their own views. The part of new business related to more than 5 years seems limited so far. Level playing field is created by regulatory convergence on how is looked at LAC DT

Level playing field – it seems to take time for insurers to go through the evolution in LAC DT calculation – might not be good idea to push too much. Anyway important that supervisors do understand the concept and can give the need guidance locally

SCR - Review – EIOPA's advice

f) Interest rate risk down

Consultation paper: EIOPA had proposed two option:

A) Symmetric 200 basis point (bp) minimum shock with a static interest rate floor (-2% maturity one year to -1% maturity 20 year)

B) Combined approach – proposal A combined with affine stress

Our comments: preferred a shift of yield curve, criticized a methodological error that led to a wrong back-testing result and the exclusion of the shifted approach.

EIOPA's proposal:

- EIOPA advices to implement a relative shift approach.
- And a phasing–in over the next three years

More details discussed below!

Assessment of overall impact missing - observations

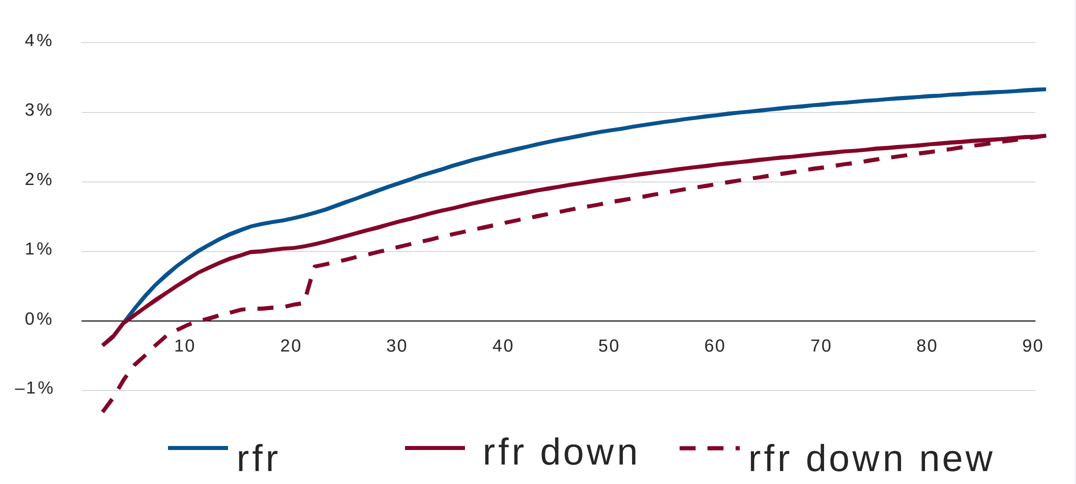
1) EIOPA published impacts as an average value. Disclosure of national specificities not satisfactory and sufficient to allow an informed decision.
2) EIOPA did not publish the observed variances together with the average value.
3) EIOPA has developed a new methodology to calculate the UFR. Nevertheless the instantaneous interest rate risk shock is also applied to the UFR.
4) EIOPA did not transparently disclose the limitation and the full background of the published particular change. Impact assessment is based on the current risk-free rate with the current UFR.
5) EIOPA did not publish an encompassing impact assessment considering all proposed changes.
6) Interest rate risk: Impact resulting from decreasing UFR not considered (§ 2461).

2464. The impact is expected to be most material from the 2nd to the 3rd year. This is because for the first year, where the decrease is less material, different buffers such as specific reserves or unrealised gains could be used to compensate for the lower amount of distributed profits. After a certain step, this compensation is not sufficient. (§ 2464)

Interest rate risk – to be considered

SCR review

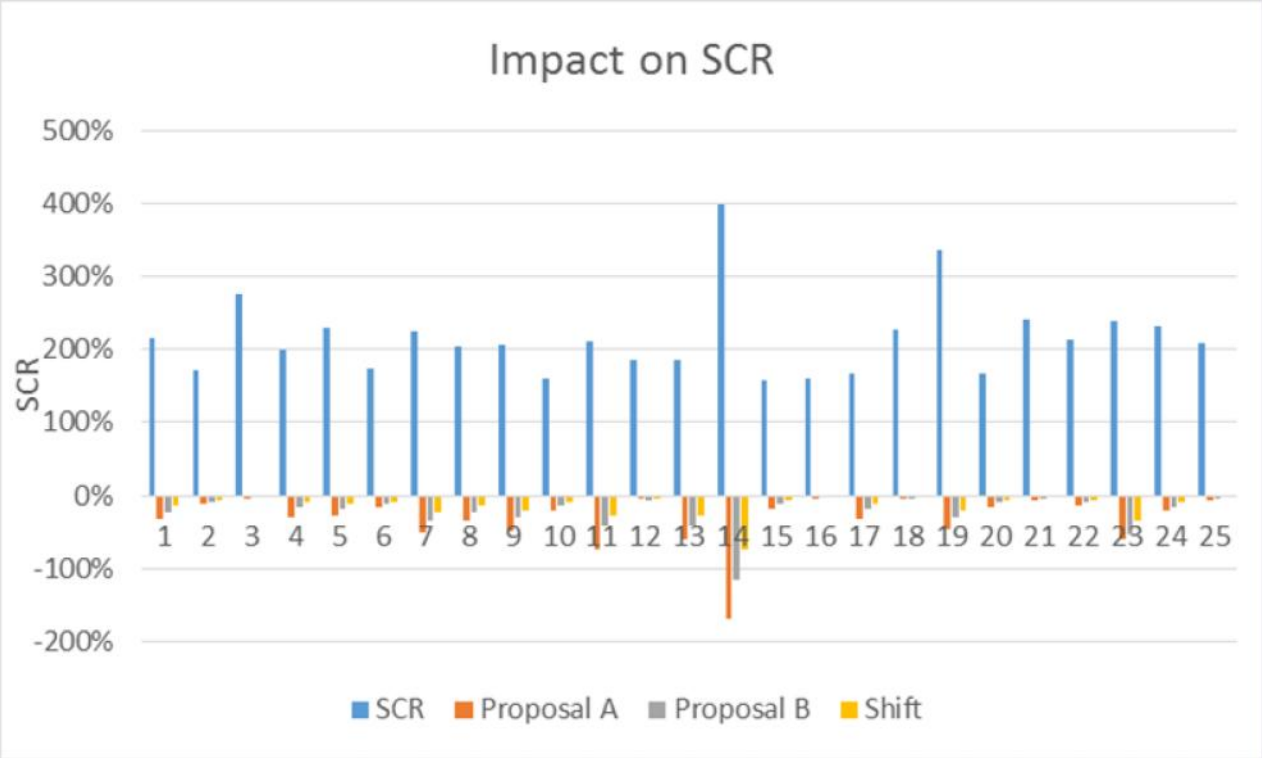
Proposed interest rate shock: Requires in addition a higher stress after LLP (rfr data: February 2018)



- UFR methodology has not been available in the past. It is effective since 2018. The UFR is now derived based on a long history of real rates (widening window).
- An instantaneous shock would not change the past but only affect the time series now. This would hardly result in a decrease of rfr to such an extent.
- Applying additional stress after the LLP seems to be not consistent with the new methodology.
- To be considered: As a macroprudential element, such changes might at the most be part of the ORSA

EIOPA's impact assessment

"…, the average impact on the solvency ratio is estimated being around 14 percentage points (from a solvency ratio of 216% to a solvency ratio of 202%)."



Criticism
EIOPA has added more details in the Annex, but

1) Countries cannot be identified
2) Average SCR is calculated as mean value without weights
3) It is an average of national average value
4) Extreme effects are visible in the text
5) Effects from transitionals not clear

Commission’s position

Valdis Dombrovskis

Many insurance companies are concerned about the impact that Solvency II may have on their long-term business, and the Commission takes this concern seriously. On this, we are open-minded and it goes without saying that any major reform would need to be well justified. In any case, this topic will be for the review on this directive, in 2020. We will shortly ask EIOPA to collect additional information over the next years on the impact of Solvency II on long-term investments.

https://ec.europa.eu/commission/commissioners/2014-2019/dombrovskis/announcements/public-hearing-solvency-ii-opening-keynote-speech-vice-president-valdis-dombrovskis_en

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If divine help is needed ...

In ancient Roman religion and myth, Janus (/ˈdʒeɪnəs/; Latin: IANVS (Iānus), pronounced [ˈjaː.nus]) is the god of beginnings, gates, transitions, time, duality, doorways,[1] passages, and endings. He is usually depicted as having two faces, since he looks to the future and to the past.

https://en.wikipedia.org/wiki/Janus

LTG Review already started

According to Article 77f (2) of the Directive, EIOPA provides an opinion on the assessment of the application of the LTG measures and the measures on equity risk to the Commission.

Commission shall submit a report to the European Parliament and to the Council by 1 January 2021, or, where appropriate, earlier. Report shall be accompanied, if necessary, by legislative proposals.

Although LTG Review is required by 1 January 2021, preparatory activities of EIOPA can be observed:

- first preparations for the assessment and
- already apparent changes

concerning the risk-free interest rate term structure:

1)	UFR:	change of methodology
2)	Interest rate risk:	new calibration in SCR – review
3)	Extrapolation:	different scenarios tested

LTG measures

LTG measures were introduced through Omnibus II Directive in order to ensure an appropriate treatment of insurance products that include long-term guarantees.

Articles	**Name of the measure**
➢ 77a	Extrapolation of the risk-free interest rates
➢ 77b, 77c	Matching adjustment
➢ 77d	Volatilty adjustment
➢ 106	Symmetric adjustment mechanism to the equity risk charge
➢ 138(4)	Extension of the recovery period
➢ 304	Duration-based equity risk sub-module
➢ 308c	Transitional on the risk-free rate TRFR
➢ 308d	Transitional on technical provisions

Risk-free interest rates term structure

Economic value of assets (including capital investments)

Available Solvency Margin

Buffer

Solvency Capital Requirement (SCR)

Technical provisions

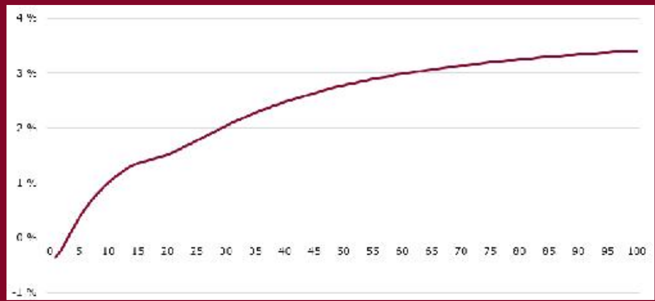
Risk margin

Best estimate of discounted future cash flows (including options and guarantees)

Economic value of other liabilities

Solvency II balance sheet

Risk-free interest rate term structure used for interest rate shocks in SCR calculation



Risk-free interest rate term structure used for discounting the cash flows

The risk-free rate interest term structure is a core parameter for the valuation of liabilities under Solvency II!

LTG Report: Extended focus

Like in the previous report: EIOPA describe the effects resulting from the use of LTG measures across the countries.

New: short assessment of the quality of SFCR

But: Report no longer restricted to stock-taking.

EIOPA had put forward an information request including scenario calculations varying the UFR, the LLP and the convergence speed.

- Scenario 1: Increase of the LLP for the euro from 20 to 30 years. For currencies other than the euro the risk-free interest rates are unchanged.
- Scenario 2: Increase of the minimum convergence point from 60 to 90 years for all currencies except the Swedish krona.13 For the Swedish krona the convergence point changes from 20 years to 50 years
- Scenario 3: Decrease of the UFR for all currencies by 100 basis points

The results are contained in the report.

EIOPA-BoS-17/334 20 December 2017

Report on long-term guarantees measures and measures on equity risk 2017

Risk-free rate term structure affected gradually

Risk-free rate term structure is a core parameter for the valuation of liabilities. Affected selectively by several activities

SII: Directive and Delegated Regulation inforce since January 2016
Treatment of standard formula, LTG to be reviewed
until 2018 resp. 2021

2017: EIOPA developed a methodology to define the UFR leading to a stepwise reduction by 0.15% starting 2018

2018: SCR – Review: Recalibration of interest rate risk module in standard formula (EIOPA’s own initiative)

2020: Review of LTG measures and transitionals
Extrapolation already treated in EIOPA’s LTG report

2018: EIOPA publish a series of papers on systemic risk in insurance.
Goal: Enhancement of the solvency regime by embedding the appropriate macro prudential tools into it

Solvency II review –
a piecemeal procedure

actuarial association of europe

2016 | 2017 | 2018 | 2019 | 2020

1 January 2016

Solvency II enacted

Parameters for standard formula and
long-term guarantee (LTG) measures are fixed

1 January 2018

UFR methodology changed

Resulting target UFR is 3.6%. Until 2017 UFR has been 4.2%. Stepwise reduction by 0.15% is agreed.

31 December 2018

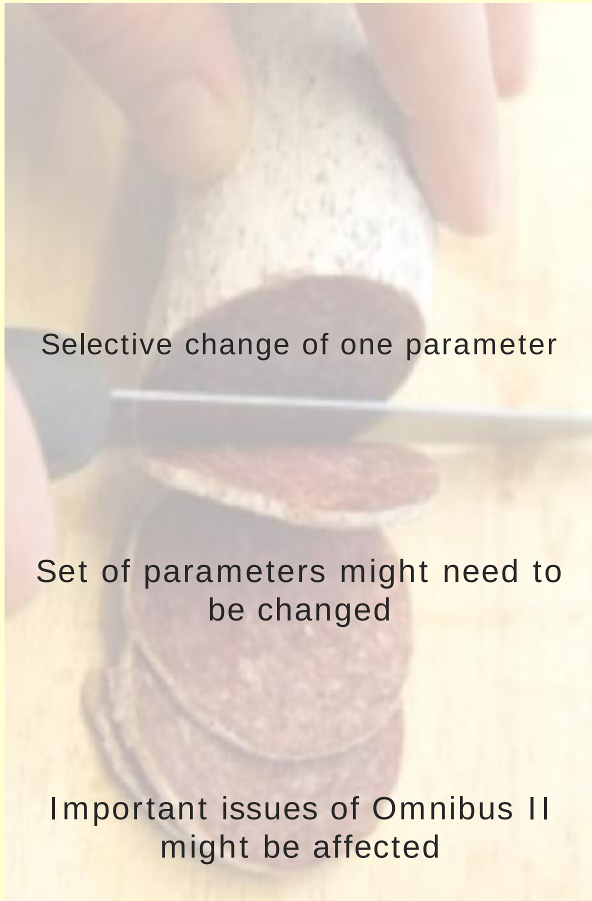
Review of Solvency Capital Requirement (SCR)

Interest rate risk module in standard formula is recalibrated (EIOPA's own initiative)

31 December 2020

Review of long-term guarantee (LTG) measures

Extrapolation already treated in EIOPA's LTG report

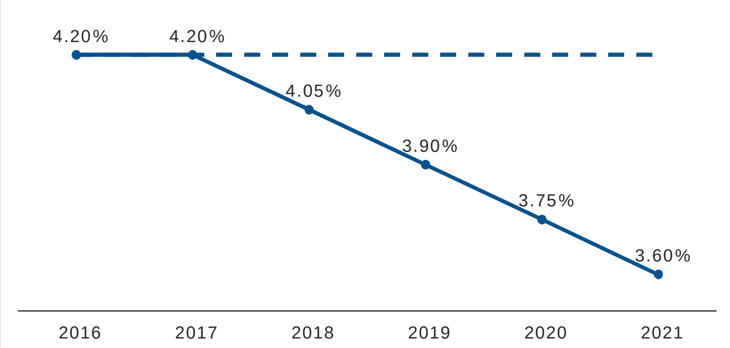


Changes of RFR: Adaptations in force or proposed

Ultimate forward rate

In force since 2018

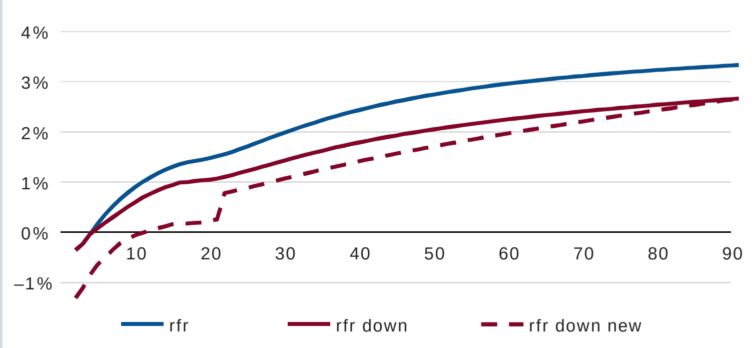
New methodology leads to a stepwise UFR reduction by 0.15% (until 2017: UFR = 4.2%)



SCR review

Proposed modification

Proposed interest rate shock: Requires in addition a higher stress after LLP (rfr data: February 2018)



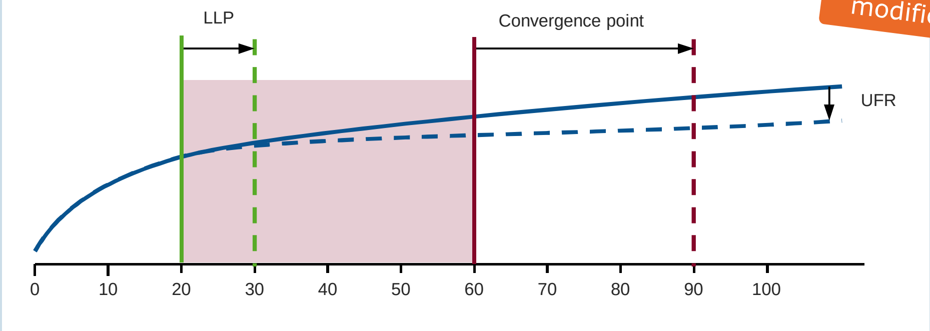
LTG review

Potential modification

Already tested for LTG report 2017:

- LLP: 30 years (instead of 20 years)
- Convergence period: 60 years (instead of 40 years)
- UFR: 3.2% (instead of 4.2%)

Scenarios proposed by ESRB



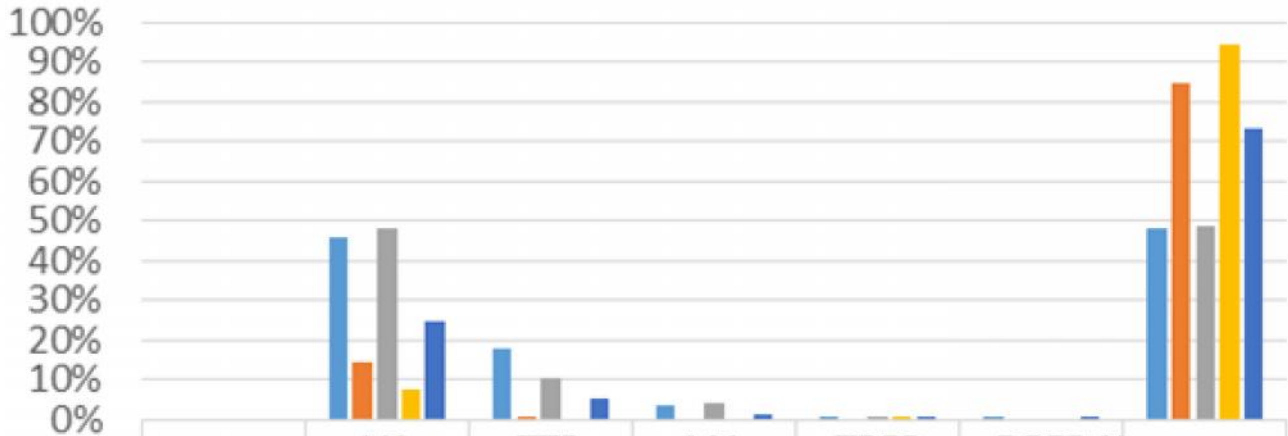
LTG Report:
LTG measures broadly used

Number of undertakings using the measures							
Type of undertaking	Total number of undertakings	VA	TTP	MA	TRFR	DBER	No measure
Life	**601**	**276**	**109**	**22**	**2**	**1**	**288**
Non-life	**1.614**	**236**	**13**	**0**	**0**	**0**	**1.368**
Both life and non-life	**399**	**192**	**41**	**16**	**3**	**0**	**194**
Reinsurance	**331**	**26**	**0**	**0**	**1**	**0**	**312**
Total	**2.945**	**730**	**163**	**38**	**6**	**1**	**2.162**
Number of countries		**23**	**11**	**2**	**4**	**1**	

Technical provisions in EUR billions		
Type of undertaking	Undertakings not applying any of the measures	Undertakings applying at least one measure
Life	1.792 (22.3%)	6.233 (77.7%)
Non-life	472 (63.4%)	272 (36.6%)
Total	2.264 (25.8%)	6.505 (74.2%)

LTG Report:
LTG measures broadly used

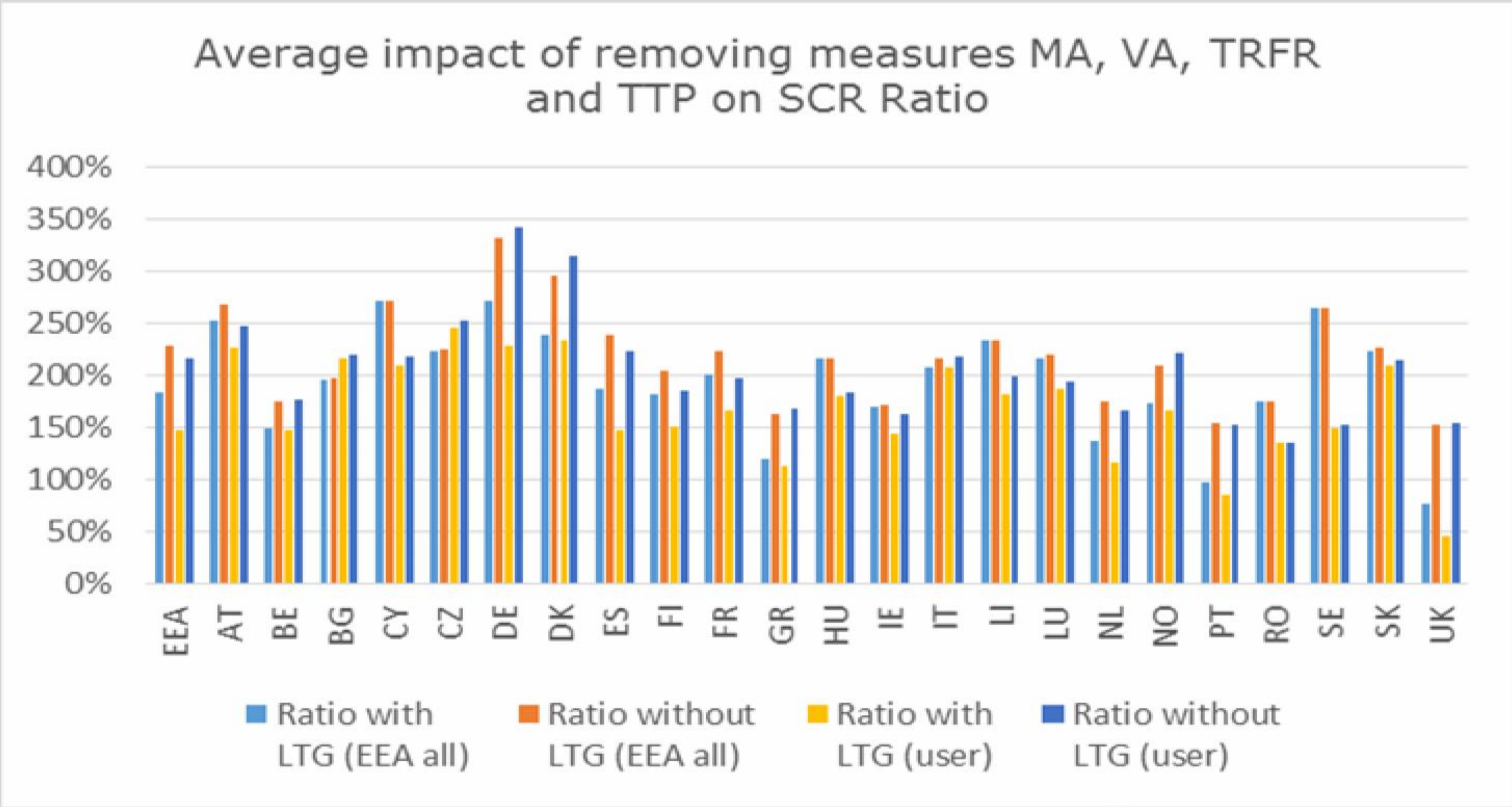
Proportion of undertakings using each measure



	VA	TTP	MA	TRFR	DBER	No measure
Life	45,9%	18,1%	3,7%	0,3%	0,2%	47,9%
Non-life	14,6%	0,8%	0,0%	0,0%	0,0%	84,8%
Both life and non-life	48,1%	10,3%	4,0%	0,8%	0,0%	48,6%
Reinsurance	7,9%	0,0%	0,0%	0,3%	0,0%	94,3%
Total	24,8%	5,5%	1,3%	0,2%	0,0%	73,4%

Life   Non-life   Both life and non-life   Reinsurance   Total

LTG Report: Measures have significant impact on SCR



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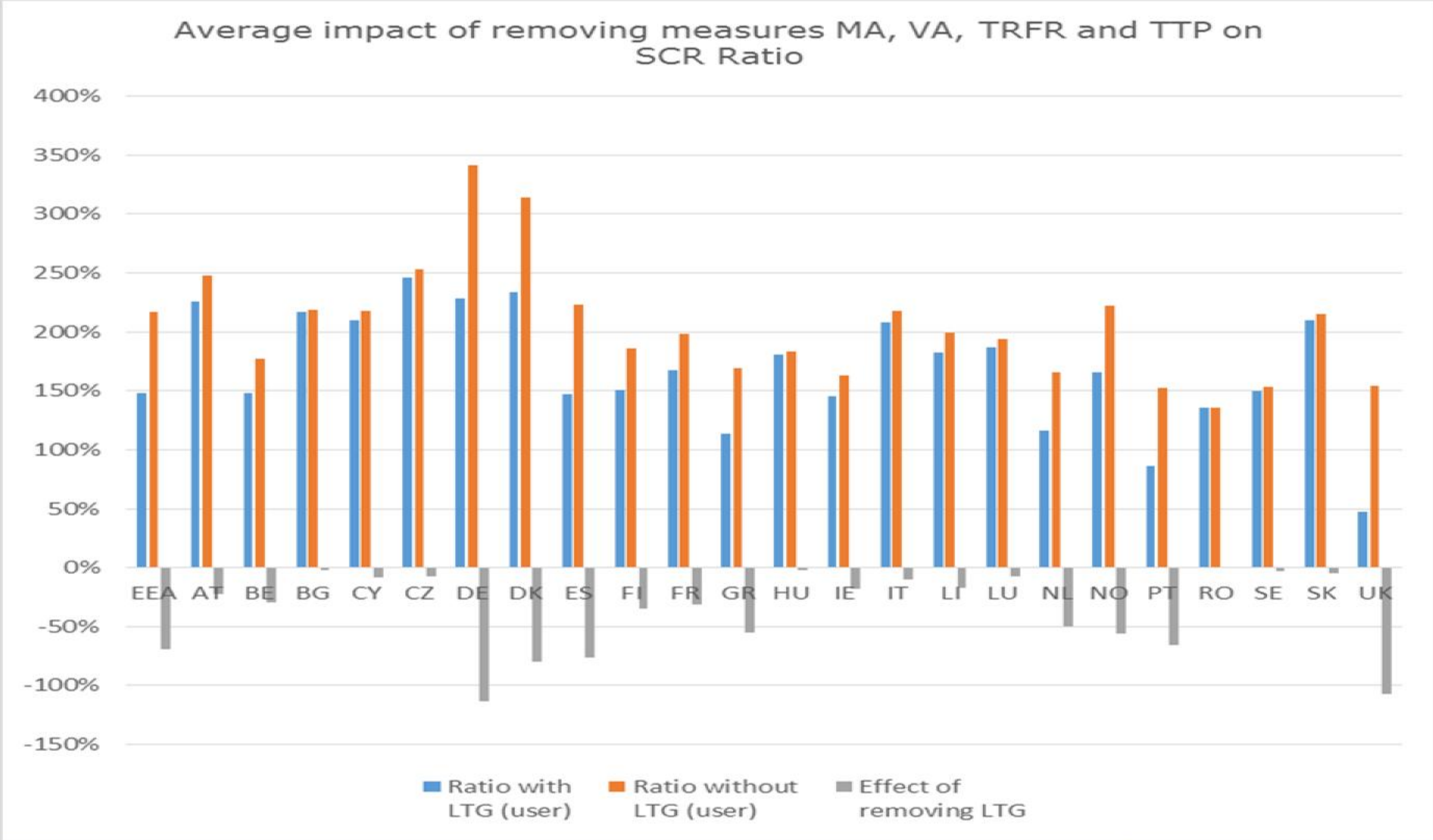
LTG Report: LTG measures have significant impact on SCR

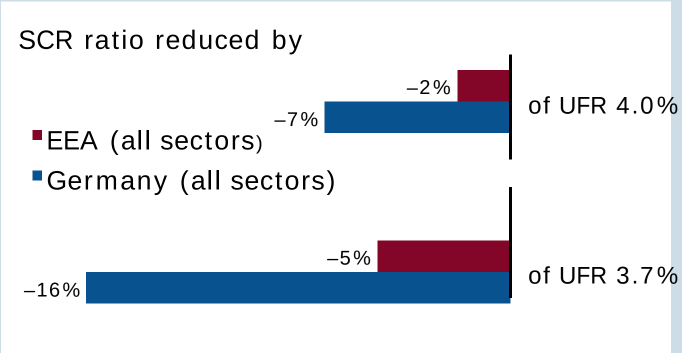


Impact on SCR ratios – Average vs. particular country

Example Germany

Based on UFR of 4.2% under consideration of transitionals!

Ultimate forward rate – impact assessment



Source: Results of the impact analysis of changes to the UFR, EIOPA-BoS-17/072, 30 March 2017

SCR review

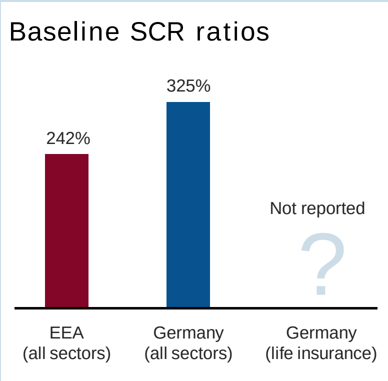
"The impact of the new methodology has been analysed on the basis of a specific information request. The impact of the methodology is material, in particular for those undertakings where the liability cash-flows depend on the level of interest rates. For life undertakings that are exposed to the low-yield environment, the average impact on the solvency ratio is estimated being around 14 percentage points (from a solvency ratio of 216% to a solvency ratio of 202%)."

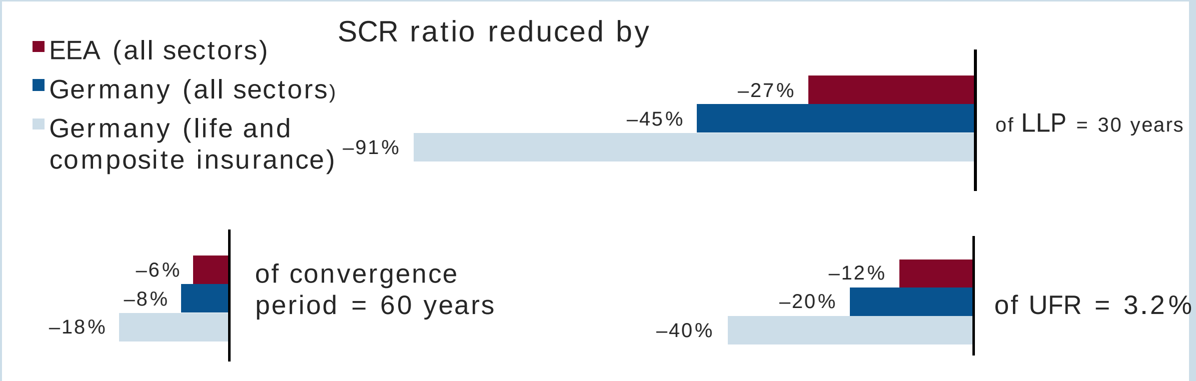
Proposed method has not been tested.

Average value is not particularly significant.

Source: EIOPA's second set advice on specific items in the Solvency II Delegated Regulation, EIOPA-BoS-18/075, 28 February 2017

LTG review

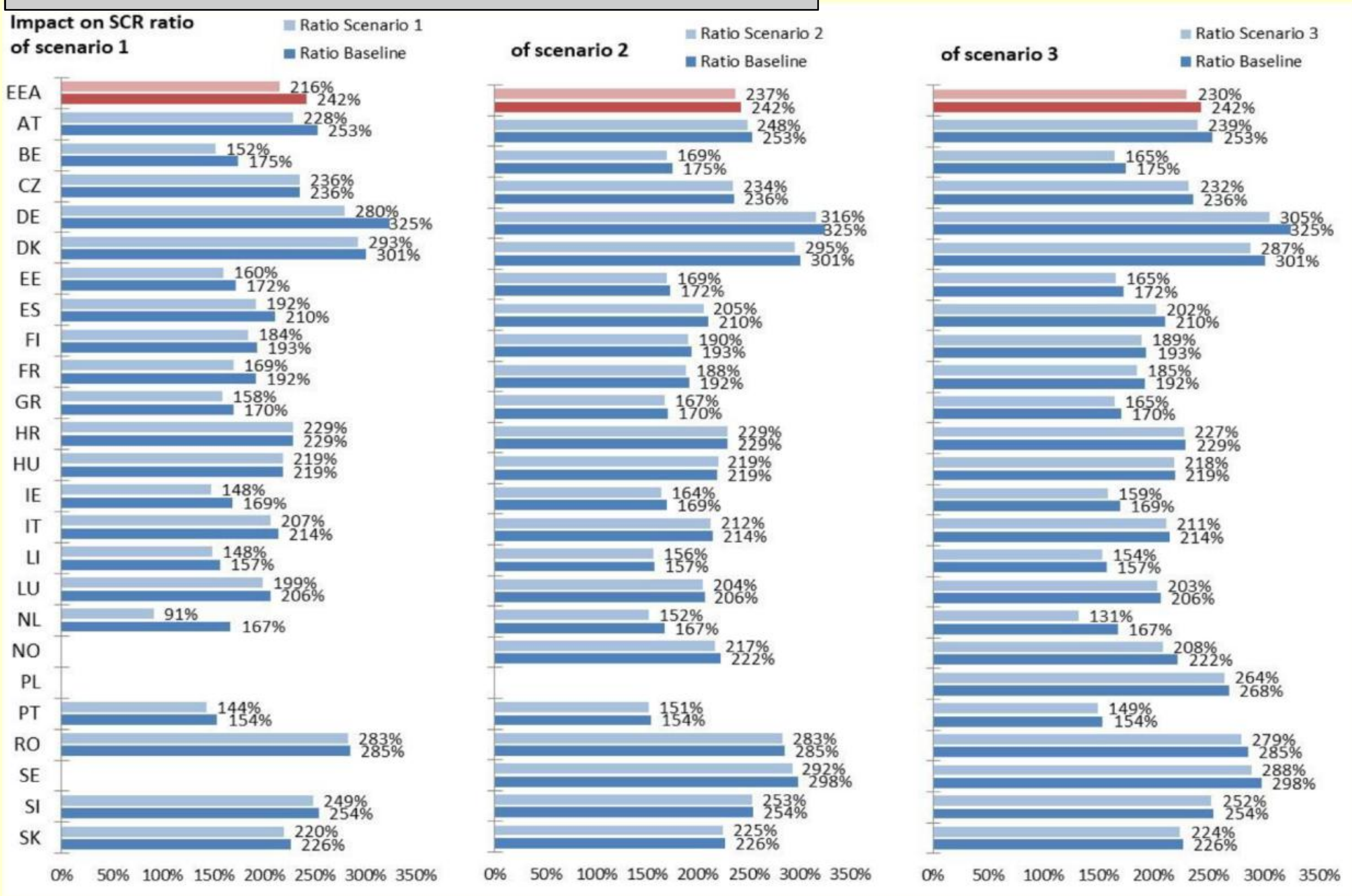




Source: Report on long-term guarantees measures and measures on equity risk, EIOPA-BoS-17/334, 20 December 2017

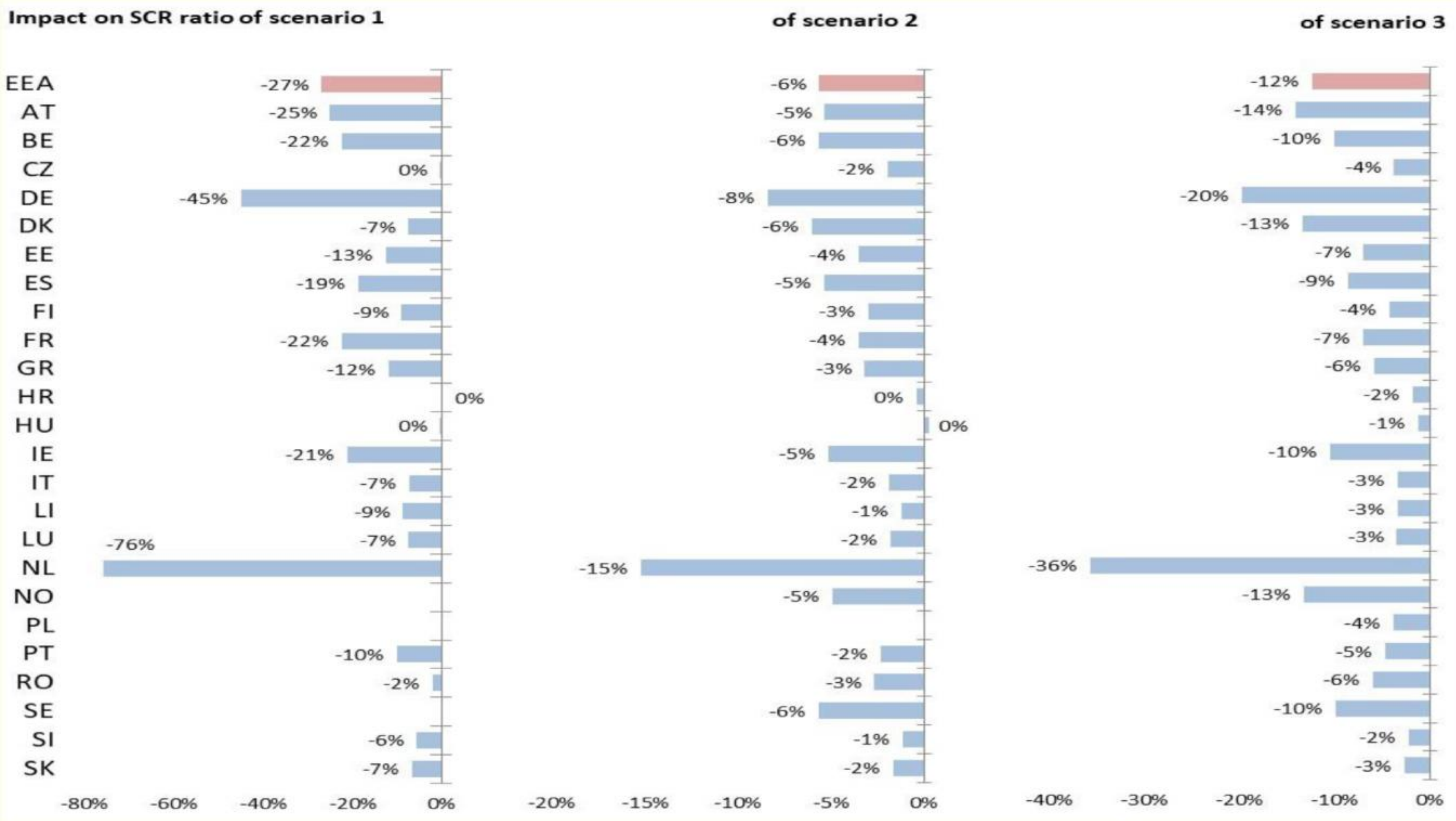
LTG Report: Observed Sensitivities of extrapolation

All undertakings



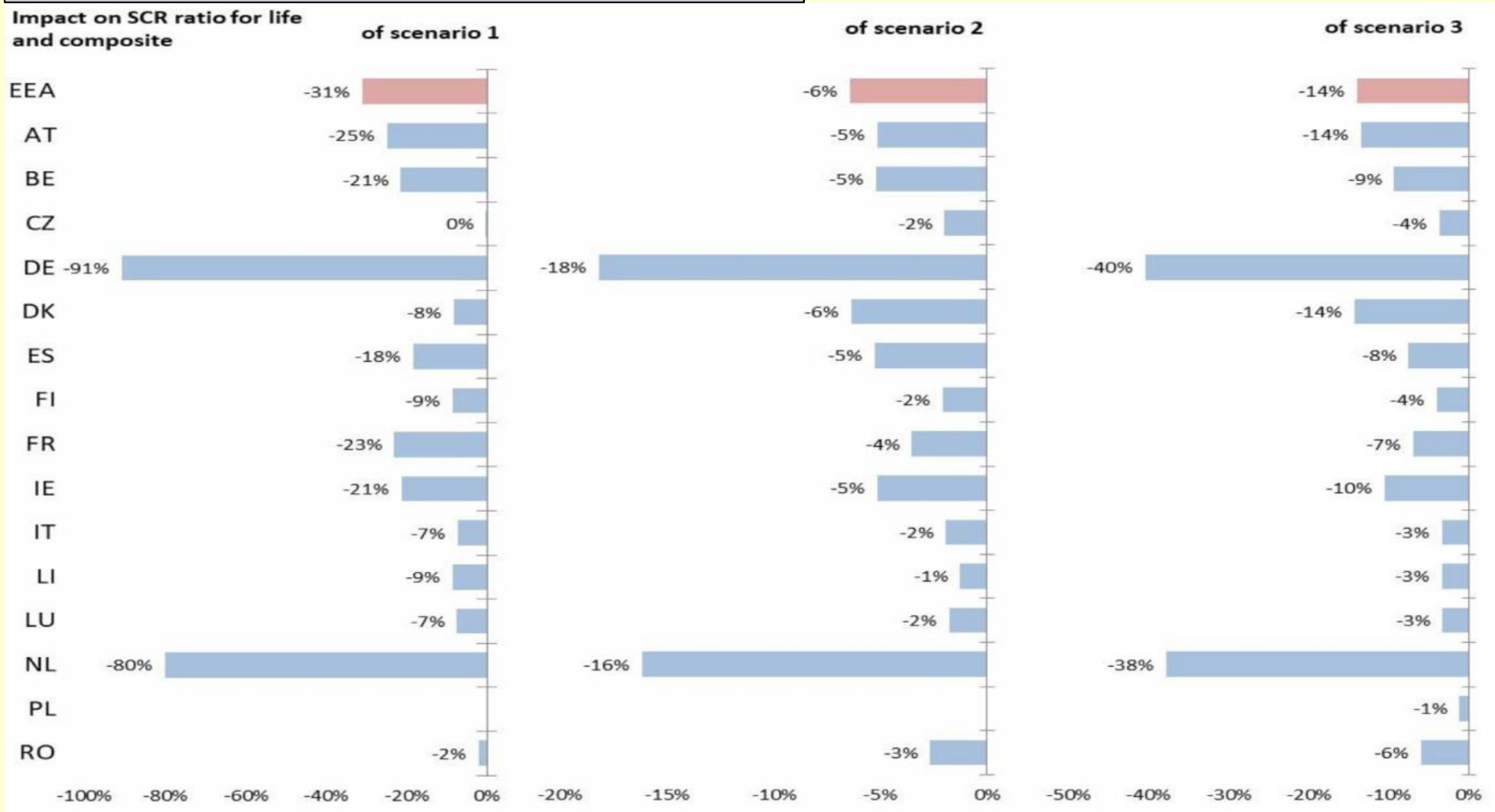
LTG Report: Observed Sensitivities of extrapolation

All undertakings



LTG Report: Observed Sensitivities of extrapolation differ between LoBs

Life and Composite



LTG Report: Observed Sensitivities of extrapolation

Critics

Scenarios are evaluated separately – no overall result published

- Most graphics depict results for all insurance undertakings together
- Average effects shown are not a reliable basis for an country- or undertaking-specific assessment
- Must not be a prejudice for results of the LTG review

High importance for LTG-review

Especially important in this context: ESRB – Report from August 2017 Regulatory risk-free yield curve properties and macroprudential consequences, https://www.esrb.europa.eu/pub/pdf/reports/esrb.reports170817_regulatoryriskfreeyieltcurveproperties.en.pdf

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SFCR - EIOPA's assessment

EIOPA-BoS/17-310 18 December 2017 EIOPA's Supervisory Statement
Solvency II: Solvency and Financial Condition Report

In next year's SFCR undertakings/groups should also include comparative information in certain areas of the SFCR.

2.10 Need for a more consistent and fit-for-purpose SFCR Summary

2.12 EIOPA expects the SFCR Summary to at least include:

- The key elements and drivers of the undertaking's business model and business strategy;
- Main indicators for the undertaking's underwriting performance and investment performance including material lines of business and material geographical areas where the business is carried;
- Any significant business or other events with material impact on the solvency and financial condition that have occurred over the reporting period;
- The key elements of the system of governance;
- Information about the undertaking/group key risks;

https://eiopa.europa.eu/Publications/Supervisory%20Statements/EIOPA-BoS-17-310-SFCR%20Supervisory%20Statement.pdf

SFCR - EIOPA's assessment

2.12 EIOPA expects the SFCR Summary to at least include: (continued)

- Solvency ratio with and without volatility or matching adjustment;
- The approach towards the use of transitional arrangements, including the solvency ratio without the transitional adjustment to the relevant risk-free interest rate term structure or without transitional measure on technical provisions;
- The amount of the Solvency Capital Requirement (SCR) and the eligible amount of own funds to cover the SCR, classified by tiers;
- The amount of the Minimum Capital Requirement (MCR) and the eligible amount of basic own funds to cover the MCR, classified by tiers;
- Information about any non-compliance with the MCR or significant non-compliance with the SCR over the last reporting period.

2.17 Information on ORSA under the SFCR is by its very nature undertaking/group specific. This means that undertaking/group specific information needs to be included, even when referring only to the process and not to the outcome.

SFCR - EIOPA's assessment

2.19 The information on the risk sensitivity to different scenarios or stresses, including the sensitivity of the SCR of the undertaking/group, should be better structured and more comprehensive.

2.31 It is important to clarify the expectations regarding the forthcoming first-time provision of mandatory comparative information in 2017 concerning certain SFCR areas.

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Insurance stress test 2018

Dimitris Zafeiris

This year, EIOPA is running its third European Union-wide insurance sector stress test exercise. The exercise targets globally active European (re)insurance groups selected by EIOPA in cooperation with national competent authorities based on the total assets, gross written premium and technical provisions.

It focuses on the evolution of liquidity and capital positions against a set of scenarios encompassing a wide range of market and insurance specific shocks selected among the risks that are deemed as the most relevant for the insurance sector vis-à-vis the reported Solvency II values as per year-end 2017.

https://eiopa.europa.eu/Publications/Interviews/InterviewDimitris%20ZafeirisInsiderGR.pdf

Insurance stress test 2018

To be tested:

Narrative and calibration to be developed before final proposal in April

Three scenarios:

- Yield curve up shock combined with lapse and provisions deficiency stress
- Low yield scenario combined with longevity stress
- Nat-Cat scenario

Timetable (not final)

- Beginning of May 2018 - launching of the exercise
- Mid-July - submission of groups' results to NCAs
- End-September – finalisation of
  - -Quality assurance process - national and central EIOPA
  - -Collection of final consent for individual disclosure of results
- December 2018 - the publication of results

More details after

EIOPA Workshop 16 April 2018

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Agenda

1) Solvency Review Process
    a) SCR Review
    b) LTG review
2) SFCR
3) Insurance stress test
4) Systemic risk and macroprudential policy

Systemic Risk and macroprudential policy (1)

EIOPA published the first paper in a series of three on systemic risk and macroprudential policy in insurance (6 February 2018).

Press release:

Today, the European Insurance and Occupational Pensions Authority (EIOPA) published the first in a series of papers with the aim of contributing to the debate on systemic risk and macroprudential policy. Until now, the debate has mainly focused on the banking sector due to its prominent role in the recent financial crisis. Through this series of papers, EIOPA will ensure that any further extension of the debate to the insurance sector fully reflects the industry's specific nature.

This first paper outlines the lessons learnt from the financial crisis and the banking sector affecting the insurance sector, as well as the current status of debate within the sector. The paper identifies and analyses the sources of systemic risk in insurance outlining three potential sources: entity-based, activity-based and behaviour-based.

The paper also includes a proposal for a macroprudential framework for insurance and defines specific operational objectives based on the previously-identified sources of systemic risk.

https://eiopa.europa.eu/Publications/Reports/Systemic%20risk%20and%20macroprudential%20policy%20in%20insurance.pdf

Systemic Risk and macroprudential policy (2)

Second paper published 21 March 2018. Press release:

Mitigating systemic risk through Solvency II: EIOPA publishes the second paper of a series on systemic risk and macroprudential policy in the insurance sector

Today, the European Insurance and Occupational Pensions Authority (EIOPA) published the second in a series of papers with the aim of contributing to the debate on systemic risk and macroprudential policy. Until now, the debate has mainly focused on the banking sector due to its prominent role in the recent financial crisis. Through this series of papers, EIOPA will ensure that any further extension of the debate to the insurance sector fully reflects the industry's specific nature.

This second paper identifies, classifies and provides a preliminary assessment of the tools or measures already existing within the Solvency II framework, which could mitigate any of the systemic risk sources that were identified in the EIOPA's first paper 'Systemic risk and macroprudential policy in insurance' published in February this year. The paper also includes a detained annex on the macroprudential impact of some of the long-term guarantees measures under stress.

https://eiopa.europa.eu/Pages/News/Mitigating-systemic-risk-through-Solvency-II-EIOPA-publishes-the-second-paper-of-a-series-on-systemic-risk-and-macroprudent.aspx

Systemic Risk and macroprudential policy

EIOPA’s macroprudential strategy

EIOPA considered three layers of objectives with the existence of a set of instruments.

Ultimate objective
Financial stability

Intermediate objectives
a) Mitigating likelihood of systemic crisis
b) Mitigating the impact of systemic crisis Expert judgement

Operational objectives
Instruments / measures

Risk indicators and
Expert judgement required

Essential information is provided by risk indicators. The use of indicators should, however, be supplemented with expert judgement, particularly when it comes to the use and calibration of the instruments and measures.

Systemic Risk and macroprudential policy

<table>
<tr><th>Source of systemic risk</th><th>Operational objectives</th></tr>
<tr><td>Deterioration of the solvency position leading to:
➢ Failure of a G-SII, D-SII.
➢ Collective failures of non-systemically important institutions as a result of exposures to common shocks.
[Liability side (own funds)]</td><td>Ensure sufficient loss-absorbency capacity and reserving</td></tr>
<tr><td>Involvement in certain activities or products with greater potential to pose systemic risk
[Liability side (technical provisions)]</td><td rowspan="2">➢ Discourage excessive involvement in certain products and activities
➢ Discourage excessive levels of direct and indirect exposure concentrations
➢ Limit procyclicality
➢ Ensure sufficient loss-absorbency capacity and reserving</td></tr>
<tr><td>Potentially dangerous interconnections
[Asset and liability sides]</td></tr>
<tr><td>Inappropriate exposures on the liabilities side (e.g. as a result of competitive dynamics)
[Liability side (technical provisions)]</td><td>Ensure sufficient loss-absorbency capacity and reserving</td></tr>
</table>

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Systemic Risk and macroprudential policy

Source of systemic risk	Operational objectives
Excessive risk-taking by insurance companies (e.g. 'search for yield' and the 'too-big-too fail' problem) [Asset side (investment)]	➢ Discourage risky behaviour ➢ Ensure sufficient loss-absorbency capacity and reserving
Excessive concentrations [Asset side (investment)]	Discourage excessive levels of direct and indirect exposure concentrations
Potentially dangerous interconnections [Asset and liability sides]	

"It should be acknowledged that the implementation of Solvency II reporting requirements has improved the quantity and quality of data and as a consequence the ability to monitor systemic risk compared to previous data collections. However, a need may still arise either for new types of data or for an improvement in existing data i.e. the granularity and frequency of data."
Footnote 43, p. 68

Systemic Risk and macroprudential policy

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Executive summary of second paper:

The purpose of the present paper is to identify, classify and provide a preliminary assessment of the tools or measures already existing within the Solvency II framework, which could mitigate any of the systemic risk sources that were identified in the EIOPA's paper 'Systemic risk and macroprudential policy in insurance' (EIOPA, 2018).

These tools are the following:

- Symmetric adjustment in the equity risk module.
- Volatility adjustment.
- Matching adjustment.
- Extension of the recovery period.
- Transitional measure on technical provisions.

These are the LTG – measures to be reviewed until 2020. The further analysis might influence the result of the LTG – review.

It is acknowledged:

Given that Solvency II entered into force in 2016, there is not an extensive amount of experience. This analysis should only be considered as a first step. Further work might be needed at a later stage, once more information and data are available.

Systemic Risk and macroprudential policy

Macroprudential methods should be chosen specific for insurance business

Actuaries should carefully watch the proceeding and try to influence or support the implementation!

Solvency II contains already macroprudential elements. These could be used as indicators for the purpose of a macroprudential supervision.

<u>As announced:</u>

- Second paper in this series focusses on these elements.
- They might be used as starting points for the shape of macroprudential instruments and amendment of Solvency II.
- National approaches shall also be used.

Possible outcome: Considerable additional burden (financial and operative) for undertakings possible.

Macroprudential framework EIOPA's planning for 2018

Backup

Planning priority for 2018:
Strategic Objective 3: to strengthen the financial stability of the insurance and occupational pensions sectors
3.0 Identify, assess, monitor, report and mitigate risks and threats to the financial stability of the European insurance and pensions sectors

- Macro prudential discussion in insurance – EIOPA will continue developing a stance on macro prudential frameworks for the insurance sector to strengthen the Authority's capability to contribute to macro prudential discussions, and in particular, ensure that the revision of Solvency II benefits from insights from the macro prudential level.

  More generally risks to financial stability will create a degree of uncertainty that could impact on regulatory developments and may need to be considered within the framework of the review of Solvency II, leading the discussions on how to enhance the solvency regime by embedding the appropriate macroprudential tools into it.

European Insurance and Occupational Pensions Authority Revised Single Programming Document 2017-2019 (AWP 2018)

Appendix: Legal framework for Solvency review

Review: Legal basis (1)

Review of long-term guarantee measures

Article 111 (3) of the Solvency II Directive:

> By 31 December 2020, the Commission shall make an assessment of the appropriateness of the methods, assumptions and standard parameters used when calculating the Solvency Capital Requirement standard formula. [...] The Commission shall present a report to the European Parliament and to the Council, accompanied, where appropriate, by proposals for the amendment of this Directive, or of delegated or implementing acts adopted pursuant hereto.

Article 77f (2), (3) of the Solvency II Directive:

> (2) EIOPA, where appropriate after consulting the ESRB and conducting a public consultation, shall submit to the Commission an opinion on the assessment of the application of Articles 77a to 77e and 106, Article 138(4), and Articles 304, 308c and 308d, including the delegated or implementing acts adopted pursuant thereto. That assessment shall be made in relation to the availability of long-term guarantees in insurance products, the behaviour of insurance and reinsurance undertakings as long-term investors and, more generally, financial stability.
>
> (3) Based on the opinion submitted by EIOPA [...], the Commission shall submit a report to the European Parliament and to the Council by 1 January 2021, or, where appropriate, earlier.

Review: Legal basis (2)

Review of solvency capital requirement – Recital 150 of the Solvency II Delegated Regulation:

In order to ensure that the standard formula continues to meet the requirements [...] on an ongoing basis, the Commission will review the methods, assumptions and standard parameters used when calculating the Solvency Capital Requirement with the standard formula [...]. This review should make use of the experience gained by insurance and insurance undertakings during the transitional period and the first years of application of these delegated acts, and be performed before December 2018.

Review of ultimate forward rate – Article 47 of the Solvency Delegated Regulation:

For each currency, the ultimate forward rate [...] shall be stable over time and shall only change as a result of changes in long-term expectations. The methodology to derive the ultimate forward rate shall be clearly specified in order to ensure the performance of scenario calculations by insurance and reinsurance undertakings. It shall be determined in a transparent, prudent, reliable and objective manner that is consistent over time.

Review of cost-of-capital rate – Article 77 (5) of the Solvency II Directive:

The rate used in the determination of the cost of providing that amount of eligible own funds (Cost-of-Capital rate) shall be the same for all insurance and reinsurance undertakings and shall be reviewed periodically.