ACTUARIAL ASSOCIATION OF EUROPE

Solvency II
IC Spring Meeting in Sofia

Siegbert Baldauf

11 April 2019

Agenda

1) Solvency II SCR – Review / LTG - Review

2) Sustainability

3) Request for technical advice

4) Data Request

5) ICS

6) EIOPA work programme

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Status of SCR - Review

SCR – Review (due date was 31 December 2018)

- EIOPA had submitted their advice to the Commission (28 February 2018, ECON had proposed some adaptation (18 September 2018)
- Commission had published a draft of the Delegated Regulation (November 2018), including some of ECON’s proposal, others shifted to next review
- ECON asked Commission not to shift requested issues to the 2020/2021 – review. (e.g. Cost of capital rate, country component of the volatility adjustment, long-term equity,...)
- Commission adapted the initial text and adopted the Delegated Regulation on 8 March 2019
- If European Parliament and European Council don’t raise objections within a three months period, the Delegated regulation can enter into force.

Draft Delegated Regulation

Commission followed EIOPA’s proposals included in the first and second set of advice. Aadaptation of the Delegated Regulation published November 2018, including some of ECON’s proposal

Not included: Interest rate stress

A considerable number of Articles is amended or newly inserted. Most of the changes are in line with EIOPA’s proposals. Wording and sometimes structure is modified.

Not proposed by EIOPA:

> Commissions initiative: Significant extension of Article 43, concerning changes of the basic risk-free interest rate term structure.
>
> Proposed by ECON: Introduction of a new equity class: long-term equities (Article 169 extended, Article 171a inserted)

Draft Delegated Regulation: Long-term equity investment

Upon request of ECON the new asset class long-term equity investment has been introduced with reduced stress factor:

- Article 169 amended; Included: 22% decrease for long-term equity investment

- Article 171a inserted to describe the conditions that have to be met in order to meet the requirements. (duration more than 12 years, ring-fencing)

Upon request of ECON the preconditions have been weakened (duration more than 5 years, no ring fencing).

AAE comments on first draft (excerpt):

> *2) The proposed change of the Delegated Regulation has not been part of earlier consultations. A reliable assessment of the related risk resulting from this lowered stress is missing. An impact assessment is not available.*
> *3) We consider that a deviation from the required one-year period for the Value-at-risk calculation is not technically enabled by current regulation.*

Draft Delegated Regulation – Art. 43

Current Regulation	Draft version – significant extension
The rates of the basic risk-free interest rate term structure shall meet all of the following criteria: a) insurance and reinsurance undertakings are able to earn the rates in a risk-free manner in practice; (b) the rates are reliably determined based on financial instruments traded in a deep, liquid and transparent financial market. The rates of the relevant risk-free interest rate term structure shall be calculated separately for each currency and maturity, based on all information and data relevant for that currency and that maturity. They shall be determined in a transparent, prudent, reliable and objective manner that is consistent over time.	1. a), b) unchanged The rates of the relevant risk-free interest rate term structure shall be calculated separately for each currency and maturity, based on all information and data relevant for that currency and that maturity. 5. A technique, data specification or parameter, including the ultimate forward rate, the last maturity for which the basic risk-free interest rate term structure is not being extrapolated and the duration of its convergence towards the ultimate forward rate, shall be modified by EIOPA at the request of the Commission to ensure that the rates of the relevant risk-free interest rate term structure are determined in a transparent, prudent, reliable and objective manner that is consistent over time.

Risk margin

EU Commission call for advice text:

"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:

- 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 information;
- 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"

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Sustainable finance: Commissions request (1)

Formal request to EIOPA and ESMA for technical advices on potential amendments to, or introduction of, delegated acts under i.a Directive 2009/138/EC with regard to the integration of sustainability risks and sustainability factors (24 07 2018)

The Commission requests that EIOPA and ESMA deliver their respective advices by 30 April 2019.

4. Issues on which EIOPA and ESMA are invited to provide technical advices

4.1. Organisational requirements

4.2. Operating conditions

4.3. Risk management

4.4. Target market assessment

Consultation Paper on Technical Advice on the integration of sustainability risks and factors in the delegated acts under Solvency II and IDD (26 November 2018)

Proposed changes of Delegated Regulation (extract):

Organisational requirements:

- Extension of the task of risk management function (Article 269)

Operating conditions:

- Extension of prudent person principle (including new Article 275bis)
- Extension of the task of actuarial function (Article 272)

Risk management:

- Extension of Article 260 (risk management areas)
- Extension of Article 262 (Overall solvency needs)

Sustainable finance: Commissions request (2)

28 August 2018 **Request to EIOPA for an opinion on sustainability within Solvency II** EIOPA is asked to provide this opinion **by 30 September 2019** in order to allow the Commission to consider any follow-up actions including in the context of the review of Solvency II. **3.1 Impact of prudential rules on insurers' sustainable investments** **3.2 Considerations of sustainability factors with particular regard to climate in insurance and reinsurance undertakings' underwriting practice** **3.3 Miscellaneous**	**16 January 2019:** EIOPA published a **Public Call for Evidence for an Opinion on sustainability within Solvency II** (Deadline 8 March 2019) Market participants are asked to provide evidence on the integration of sustainability risks in investment and underwriting practices Next steps: Based on the feedback received, EIOPA will prepare the draft Opinion to the European Commission for consultation during the second half of 2019.

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Illiquid liabilities (1)

25 April 2018: REQUEST TO EIOPA FOR INFORMATION RELATED TO DIRECTIVE 2009/138/EC Deadline 16 December 2018 EIOPA is asked to provide detailed information on the liquidity of insurance undertakings' liabilities, taking into account at least the following: – Contractual options to (partially) redeem those liabilities before maturity; – The related contractual penalties; – The related tax incentives; – The coverage of biometrical risks; – Their average duration in practice.	29 October 2018: EIOPA published **Consultation paper: Request for feedback on methodological considerations regarding Illiquid Liabilities** Deadline for Comments: 7 December 2018 **35 questions to stakeholder** relating to Analysis of the illiquidity of insurance obligations. – terms and conditions of the contract – duration of insurance liabilities . – Measuring illiquidity based on the variation in cash flows under stresses Analysis of the investments of insurers – Analysis of the holding period of assets – Risks of bonds over longer horizons – Risk of equity investments

Illiquid liabilities (2)

25 April 2018: REQUEST TO EIOPA FOR INFORMATION RELATED TO DIRECTIVE 2009/138/EC .	Consultation paper: Request for feedback on methodological considerations regarding Illiquid Liabilities
3.1. Information on insurance liabilities 3.2. Information on asset management of insurers 3.3. Information on long-term guarantee measures 3.4. Information on the market valuation of insurance liabilities 3.4. Information on the market valuation of insurance liabilities	Based on the feedback received and further work, EIOPA will launch a request for information in early 2019 Activities: Done: 13 December 2018: EIOPA Stakeholder event in Frankfurt, **18 March 2019: Data request** According to EIOPA's plan: Q3: Integration in LTG –opinion

Reporting and Disclosure

EIOPA launched a

Call for input on the Solvency II reporting and disclosure review 2020 (19 December 2018) with deadline 21 February 2019)

Comments submitted before 31 March 2019 considered on a best effort basis

https://eiopa.europa.eu/Publications/Consultations/Call%20for%20input_reporting_disclosure%20review%202020.pdf

Goal: EIOPA want to assess if the requirements remain fit-for-purpose and in particular if the requirements allow a risk-based and proportionate approach.

The paper consists of a comprehensive questionnaire covering all aspects of supervisory reporting and public disclosure – content and timing as well.

The AAE has submitted comments on 28 March 2019

Commission’s request: Review country component

7 February 2019 Commission sent to EIOPA the

Request to review the methodology for the activation of the “country component” of the volatility adjustment under Solvency II

"The current methodology applied by EIOPA to derive the “country component” of the volatility adjustment does not work as intended, and does not allow properly mitigating country specific spread crises in the valuation of technical provisions. In particular, the recent data show that there are uncertainties regarding the activation of this component due to potential “cliff-edge effects”

This is part of the 2020 review but EC invites EIOPA to immediately start thinking of improving the functioning and efficiency of the country VA. Any technical proposal would be accompanied by an impact assessment

Underlying document can be found here: https://eiopa.europa.eu/Publications/Requests%20for%20advice/signed_letter_08_02_19.pdf

Commission’s call for technical advice to EIOPA

11 February 2019 **Call for Advice relating to LTG – measures and a number of other measures as well to EIOPA**.

Review requirements (minimum scope) provided by the Directive:

- LTG - measures and measures on equity risk;
- methods, assumptions and standard parameters used when calculating the SCR standard formula;
- Member States’ rules and supervisory authorities’ practices regarding the calculation of the MCR;
- group supervision and capital management within a group of insurance or reinsurance undertakings.

Others added, identified by stakeholder or Commission

EIOPA’s advice is expected by 30 June 2020.

Commission’s call for technical advice to EIOPA

Involvement of stakeholders:

The expected proceeding could be comparable to the SCR – Review process.

EIOPA’s advice: Consultation paper expected in October 2019

This will be the key document for our comments.

Preparatory discussion or consultation papers concerning parts of Commission’s planned earlier.

Additional data requests possible.

https://eiopa.europa.eu/Publications/Requests%20for%20advice/signed%20note.pdf
https://eiopa.europa.eu/Publications/Requests%20for%20advice/RH_SRAnnex%20-%20CfA%202020%20SII%20review.pdf

Request to EIOPA for technical advice

Principles that EIOPA should take into account (excerpt)

- Give detailed holistic impact assessment of all relevant effects, qualitative and quantitative, on European level and on each Member State
- Consult widely market participants in an open and transparent manner. Advice should take account of different opinions expressed by the market participants during the consultation and should provide a feedback statement on the consultation justifying its choice vis-à-vis the main arguments raised during the consultation.
- The principle of proportionality: the technical advice should not go beyond what is necessary to achieve the objectives of the Directive
- Provide sufficient factual data backing the analyses gathered during its assessment.
- Provide comprehensive technical analysis. Dara requests might be required
- The technical advice should not take the form of a legal text.

Request to EIOPA for technical advice

Solvency II – Review: Commission's Request for Advice

LTG / SCR – Review, partly mandatory

- 3.1. Extrapolation
- 3.2. MA / VA
- 3.3. Transitional
- 3.7. SCR Standard formula
- 3.17. Best estimate –report + …
- 3.6. Dynamic VA; int. Model
- 3.4. Risk Margin
- 3.5. CMU aspects- recalibration
- 3.8. Risk mitigation techniques
- 3.14. Group supervision
- 3.16. Proportionality, Thresholds
- 3.15. Reporting, Disclosure
- 3.16. Own Funds, solo, tiering
- 3.19.Relevance External ratings

Systemic risk

- 3.11. Recovery , Resolution
- 3.12. Ins. Guarantee schemes
- 3.10. Macroprudential issues

- 3.9. MCR - Report
- 3.13. Freedom services ….

Preparatory work has already started

Preparatory activities:

- Illiquid liabilities		
	Consultation 2018/2019,	
	Data request	(3.1., 3.2.)
- Extrapolation of risk-free rate curve		
	LTG – Report, Data request	(3.1.)
- Reporting and Disclosure	Call for Input	(3.15.)
- Recovery and resolution	Consultation 2017,	
	EIOPA's Opinion 2017	(3.11., 3.12.)
- Macroprudential policy	Discussion paper	(3.10.)

Not part of the Request for Technical Advice:

Sustainability risk	Consultation 2018/2019

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)

Supervisory practices on the supervision of TP

In Utrecht Thomas Béhar presented a survey:

Solvency II Benchmark: Observed practices for Standard Formula across Europe

The chair of the Supervisory Convergence team of EIOPA invited the AAE to share the results with the working group.

Matthias Pillaudin presented the study on 18 March 2019 in Frankfurt.

Supervisors had been interested especially in the treatment of

- Contract boundaries:
- Valuation of options and guarantees
- Management actions

In order to concretize the Benchmark study, additional details are needed. An additional survey prepared to collect this information.

Discussion paper on systemic risk

29 March 2019 EIOPA published a
Discussion Paper on Systemic Risk and Macroprudential Policy in Insurance (EIOPA-BoS-19/131)
Comments are requested by **30 April 2019**

> *EIOPA aims at turning the work done into a specific policy proposal for additional macroprudential tools or measures, where relevant and possible as part of the Solvency II Review.*

https://eiopa.europa.eu/Publications/Administrative/2019-03-29%20DiscussionPaperSystemicRiskMarcoprudentialPolicyInsurance.pdf

The questions asked in this paper are related to the three papers
Despite Commission’s closed list of four elements, all 13 elements proposed for further consideration in EIOPA’s third paper are put up for discussion

Discussion paper on systemic risk

29 March 2019: **Discussion Paper on Systemic Risk and Macroprudential Policy in Insurance (EIOPA-BoS-19/131)** Deadline: 30 April 2019 **!!!**

EIOPA had analysed in three papers the systemic risk resulting from insurance business

Question: Is macroprudential supervision needed, in order to avoid or mitigate systemic risk?

Discussion paper: Are macroprudential tools needed and should these be part of the Solvency II review? Thirteen potential tools listed in EIOPA's third paper.

Despite Commission's closed list of only four elements, all 13 elements proposed for further consideration in EIOPA's third paper are put up for discussion

https://eiopa.europa.eu/Publications/Administrative/2019-03-29%20DiscussionPaperSystemicRiskMarcoprudentialPolicyInsurance.pdf

Systemic risk in Insurance

EIOPA's papers published 2018

EIOPA had published three papers relating to this issue:

Systemic risk and macroprudential policy in insurance. (6 February 2018).
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

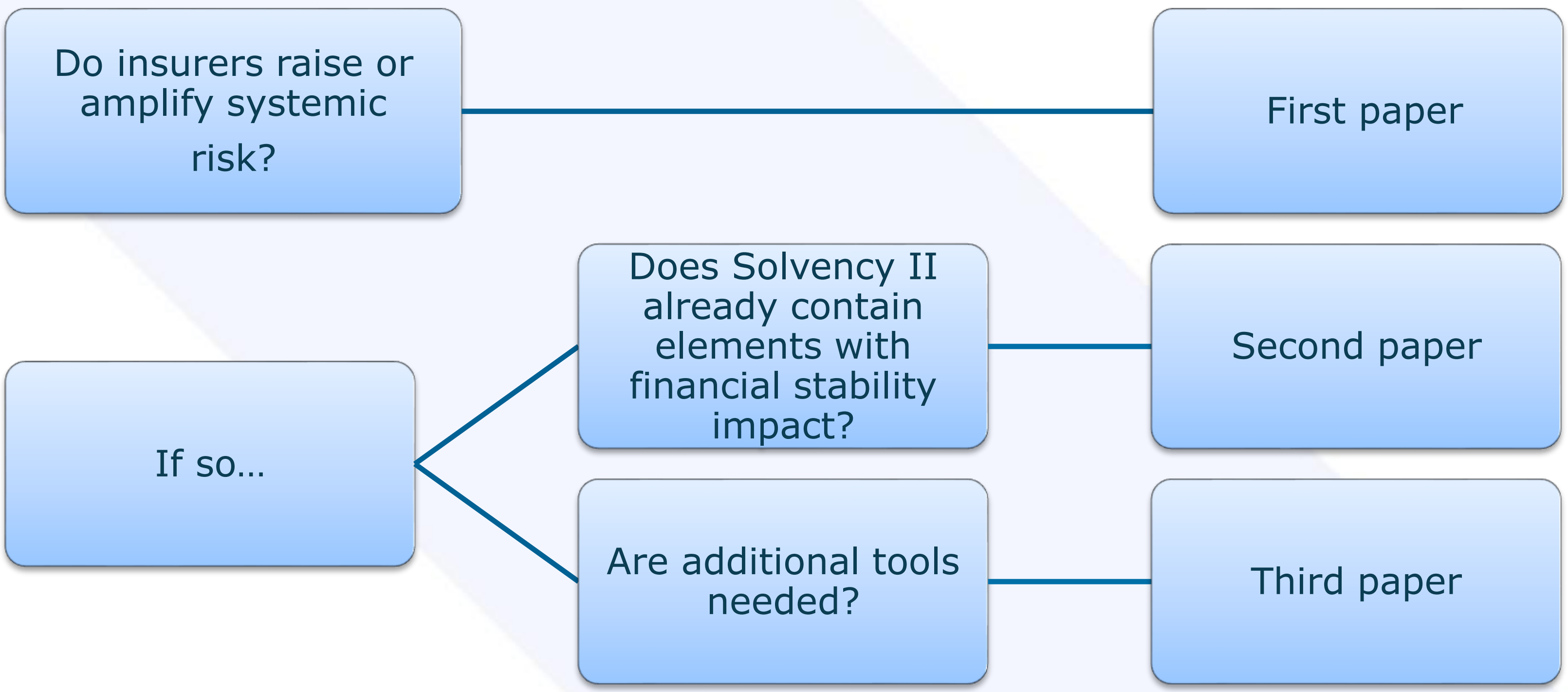
Mitigating systemic risk through Solvency II: EIOPA publishes the second paper of a series on systemic risk and macroprudential policy in the insurance sector. **(21 March 2018)**
The paper also includes a detailed annex on the macroprudential impact of some of the long-term guarantees measures under stress.

https://eiopa.europa.eu/Publications/Reports/Solvency%20II%20tools%20with%20macroprudential%20impact.pdf

Other potential macroprudential tools and measures to enhance the current framework **(31 July 2018)**
The paper focuses on whether a specific instrument should or should not be further considered. This is an important aspect in light of future work in the context of the Solvency II review.

https://eiopa.europa.eu/Publications/Reports/EIOPA%20Other%20potential%20macroprudential%20tools.pdf

Systemic risk in Insurance



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EIOPA’s data request

EIOPA announced the expected data request in the context of LTG – Review 2019 and the 2020 Solvency II Review at 18 March 2019

Undertakings are asked to provide the following information

- Information on the Long-Term Guarantees (LTG) measures
- Information on the dynamic volatility adjustment (DVA)
- Information on long-term illiquid liabilities

NSAs will contact a representative sample of undertakings regarding the provision of information for each information request.

Timeline:

17 May 2019: Deadline for the undertakings to submit results to NSAs

29 May 2019: Deadline for NSAs to report to EIOPA (except group data)

14 June 2019: Deadline for insurance groups (for the dynamic VA)

28 June 2019: Deadline for NSAs to report to EIOPA on groups

EIOPA’s data request: LTG measures

Information on the LTG measures

- Impact of the extrapolation of risk-free interest rates on the financial position of undertakings
- Losses due to bond defaults and downgrades of bonds in matching adjustment portfolios
- Assets in matching adjustment portfolios
- Diversification effects in the calculation of the Solvency Capital Requirement when the matching adjustment is used
- Overcompensation of the volatility adjustment

EIOPA’s data request: Extrapolation

Extrapolation

This tab is **only relevant** for the pre-selected life and composite undertakings from the euro area, from Bulgaria and from Denmark for which the materiality threshold for the impact of extrapolation as defined below is exceeded.

The materiality threshold is defined as follows:

$$\frac{\sum_{t>LLP} CF_t}{\sum_t CFt} \leq 10\%$$

materiality threshold not exceeded

$$\frac{\sum_{t>LLP} CF_t}{\sum_t CFt} > 10\%$$

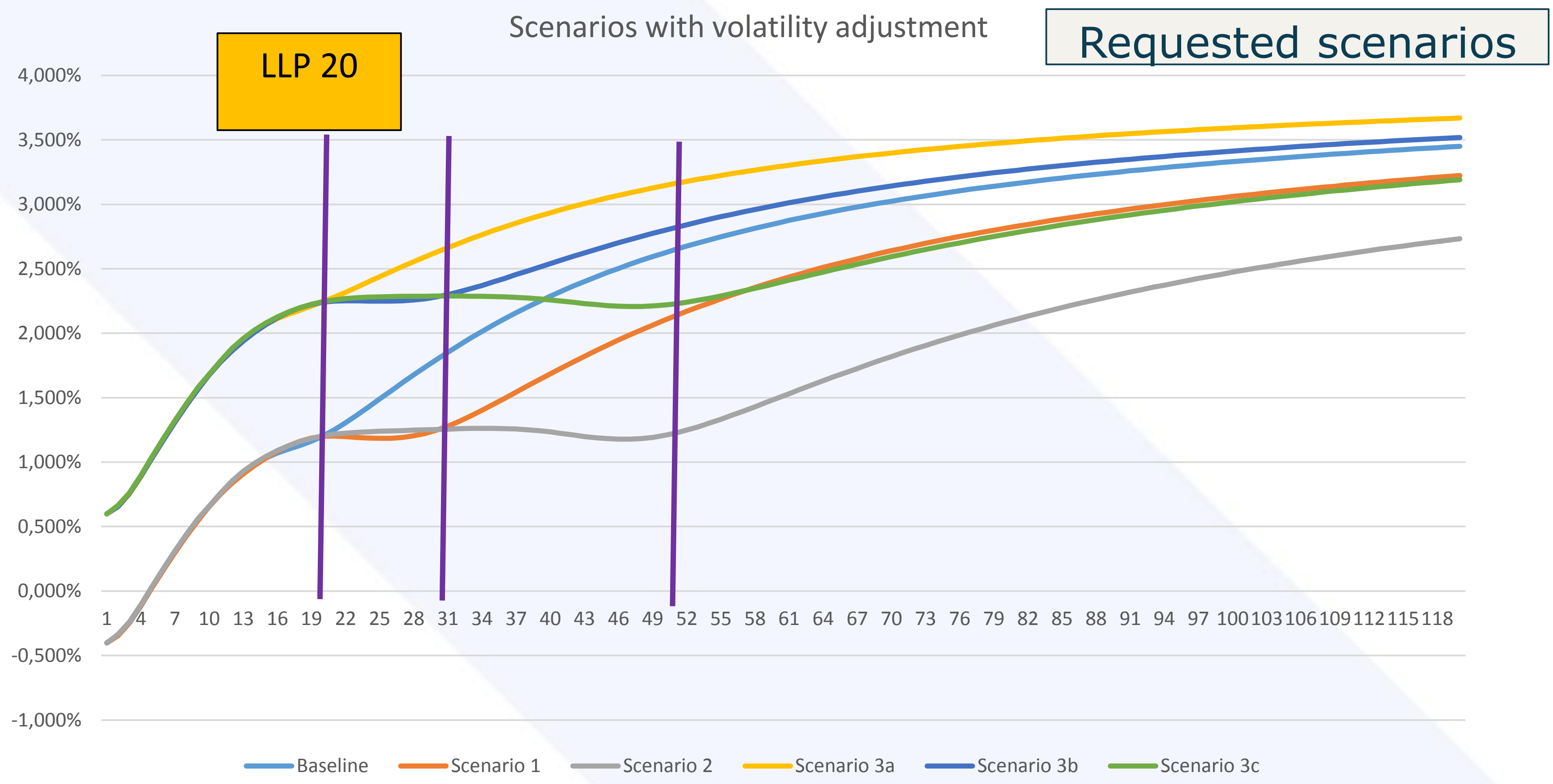
materiality threshold exceeded.

Where CF_t represent the best estimate cash flows *t* years from the reporting date

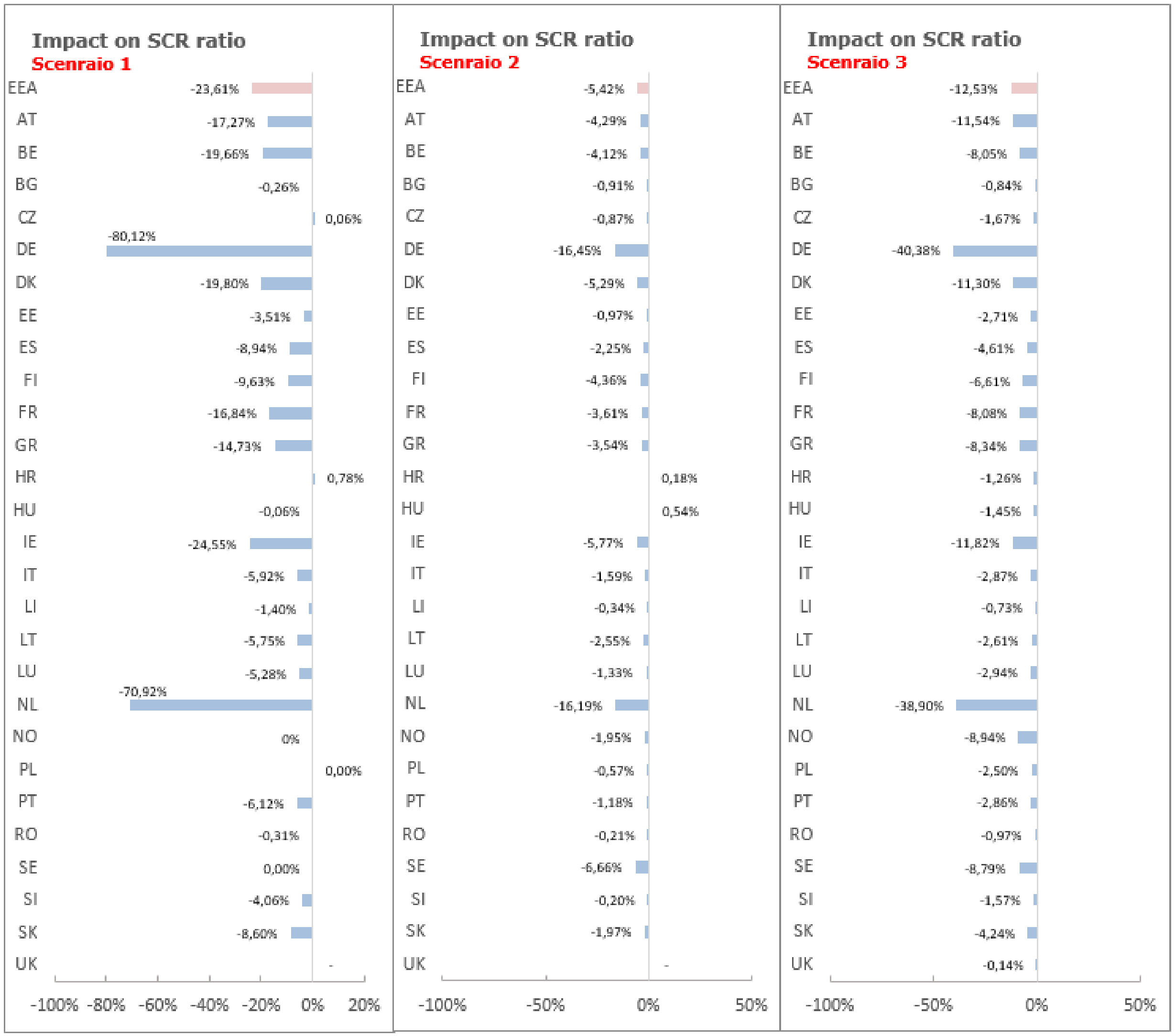
Requested scenarios

- Scenario 1: Increase of the LLP for the euro from 20 to 30 years. For all other currencies, the risk-free interest rates are unchanged.
- Scenario 2: Increase of the LLP for the euro, as well as for currencies pegged to the euro, from 20 to 50 years.
- Scenario 3: An increase of swap rates by 100 bps, combined with the following three settings for the LLP:
  - Scenario 3a: maintain an LLP of 20 years for the euro
  - Scenario 3b: Increase of the LLP for the euro from 20 to 30 years; and
  - Scenario 3c: Increase of the LLP for the euro from 20 to 50 years.

EIOPA's data request: Extrapolation



LTG–Report 2018:Three scenarios tested



<u>Scenario 1:</u> Increase of the LLP for the euro from 20 to 30 years.
<u>Scenario 2</u>: Increase of the minimum convergence point from 60 to 90 years
<u>Scenario 3:</u> Decrease of the UFR by 100 basis points

At EEA level, scenario 1 would result in a reduction of the SCR ratio by 24 percentage points, scenario 2 would result in a reduction of the SCR ratio by 5 percentage points and scenario 3 would result in a reduction of the SCR ratio by 13 percentage points. ***The average change in SCR ratios is the highest for undertakings in Germany, and Netherlands.***

EIOPA’s data request: Dynamic volatility adjustment

Information on the dynamic volatility adjustment

- Impact of the dynamic volatility adjustment in three economic scenarios, a base case and a spread widening and tightening scenario
- Impact of four configurations: no VA, constant VA, dynamic VA and exclusion of sovereign risk
- Overview of market value of fixed income portfolio in different dimensions
- Qualitative questions regarding investment and risk management and supporting the analysis of quantitative results

EIOPA’s data request: Illiquid liabilities

Information on long-term illiquid liabilities

- Characteristics and measurements of illiquidity of liabilities
- Asset management practices
- Exposure of assets to forced selling under stressed conditions

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International Capital Standards - update

Goal:

- a unified path to convergence of group capital standards
- a single ICS that achieves comparable outcomes across jurisdictions.

Implementation of ICS Version 2.0 in two phases:

- A five-year "monitoring period", ICS 2.0 used for confidential reporting
- Implementation of the ICS as a group-wide PCR.

DATE	MILESTONE
May 2018	Launch of 2018 Quantitative Field Testing
July 2018	Publication of ICS Version 2.0 CD and comprehensive ComFrame consultation
Sep 18	Field Testing submissions due
October 2018	Feedback on ICS Version 2.0 CD and comprehensive ComFrame consultation due
Apr 19	Launch of final round of ICS Field Testing
July 2019	Data due for 2019 Field Testing
IAIS 2019 General Meeting	Adoption of ComFrame, including ICS Version 2.0 for the monitoring period
Early-2020 to Late-2024	Five-year monitoring period
Nov 24	Adoption of the ICS Version 2.0 for implementation as a group-wide consolidated PCR

PCR= Prescribed Capital Requirement

Planned proceeding unchanged.
Launch of next (last) field test expected in April

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EIOPA’s work programme 2019

Strategic Objective 2: Leading convergence towards high-quality prudential supervision throughout the EU

EIOPA has the following priorities for 2019:

- Further development of the regulation and eventually authorisation of PEPP (Commissions legislative proposal)
- Preparing the ground for EIOPA’s Opinion due in 2020 on the LTG Measures - on the basis of robust evidence on their effectiveness, testing ideas for improvement and considering impact on existing regulation.
- Further refinement of the International Capital Standard (ICS) 2.0 as reference ICS and starting confidential reporting to international colleges
- Achieving proportionate and relevant application of IORP II throughout Europe

EIOPA’s work programme 2019

Planning priority for 2019: SII review context: Preparing the ground for EIOPA’s Opinion due in 2020 on the LTG Measures

ID	Products Due Date	Due date
2/1101	Review of Reporting and Disclosure Commission Implementing Regulations following amendment of Delegated Regulation and regulatory feedback loop	Q2 (2019 review) + (general review (2020))
2/1102	Long term guarantees review (thematic focus for 2019 to be specified): - Full Impact Assessment - EIOPA opinion to be delivered by 1/1/2021 at latest	 Q2 Q4
2/1103	Follow up as required to advice provided in 2018 on Solvency Capital Requirements standard formula including on health risk	Q1-Q4
2/1104	Ongoing work on wider environmental, social and governance issues as required and on natural catastrophes (“climate change”)	Q1-Q4
2/1105	Development/annual update of Risk Free Rate Methodology - in respect of representative portfolios, deep/ liquid transparent criteria, and ultimate forward rate	Q4
2/1106	Ongoing work stemming from Calls for Advice and Opinion on Sustainable Finance on the basis of corresponding EIOPA Action Plan	Q4
2/1107	Response to Commission Call for information on illiquid liabilities	Q3
2/1108	Potential additional Calls for Advice from the European Commission in the context of the wider Solvency II 2020 Review	Contingent on demand
2/1109	Solvency II Rule Book on website	Q4

Annex

Draft Delegated Regulation – Art. 43 new

2. The techniques, data specifications and parameters used for determining the technical information on the relevant risk-free interest rate term structure referred to in Article 77e(1) of Directive 2009/138/EC, including the ultimate forward rate, the last maturity for which the relevant risk-free interest rate term structure is not being extrapolated and the duration of its convergence towards the ultimate forward rate, <u>shall be transparent, prudent, reliable, objective and consistent over time.</u>

3. EIOPA shall inform the Commission of any substantial change in the data used for determining the technical information on the relevant risk-free interest term structure. A substantial change shall mean any change which renders the techniques, data specifications or parameters invalid, including the ultimate forward rate, the last maturity for which the basic risk-free interest rate term structure is not being extrapolated and the duration of its convergence towards the ultimate forward rate, .

Draft Delegated Regulation – Art. 43 new

4. In the event of a substantial change in the data as referred to in paragraph 3, EIOPA may submit to the Commission a proposal containing such modifications to the techniques, data specifications or parameters as are needed to address the invalidity and are proportionate to the substantial change in question. That proposal shall be accompanied by an assessment of the appropriateness and impact of those proposed modifications.

5. A technique, data specification or parameter, including the ultimate forward rate, the last maturity for which the basic risk-free interest rate term structure is not being extrapolated and the duration of its convergence towards the ultimate forward rate, shall be modified by EIOPA at the request of the Commission to ensure that the rates of the relevant risk-free interest rate term structure are determined in a transparent, prudent, reliable and objective manner that is consistent over time.