

## ACTUARIAL ASSOCIATION OF EUROPE (AAE) INPUTS ITS COMMENTS ON EIOPA'S DISCUSSION PAPER ON METHODOLOGICAL PRINCIPLES OF INSURANCE STRESS TESTING

AAE agrees with the described stress test process and elements. An important issue is the scope of the stress test. With regard to macroprudential objectives, a thorough analysis should help to identify sources of risk that might have a material impact on financial stability. Focussing on microprudential objectives, requirements of the existing Solvency II framework should be considered. Undertakings are required under Solvency II to identify the risks which are most applicable to their undertaking; prescribed methodology might not therefore be helpful given the likelihood of different risks applying for different undertakings.

We consider that the same models and perimeters should be the preferred approach for baseline and stress scenarios in order to ensure consistency. We note that recalculation of the baseline scenario will result in extra burden and should be considered in line with the stress test purpose. Models used should not deviate significantly from those used for Solvency II calculations.

We consider that the effectiveness of a stress test is primarily a function of scenario design.

On time horizons, we consider a three year period to be the longest feasible and propose that specifications should allow for reasonable simplifications.

We consider that the impact of management actions should be included in stress tests. Though post-stress calculations with and without the impact of management actions would give useful insights, it will be difficult to design scenarios and give guidance for relevant management action in such a way that the results will be meaningful on an aggregate level. We suggest it could be more useful to disclose qualitative information on management actions incorporated and their impact.

We consider that combined scenarios, but allowing the identification of the single shocks in isolation, should be the preferred approach, and are in favour of the bucketing approach for market shocks.

We believe that care should be taken when undertaking stress tests on climate change given the evolving nature of the understanding of climate related risk. We note also that climate related risks manifest themselves in risk categories which are already considered.

Comments on specific shocks follow:

- We would expect a shock on sovereign bonds
- We consider that covered bonds provide a better proxy for mortgage loans than application of RMBS shocks

- For life insurance shock, we believe the provision should be more explicit whether a “cap approach” (i.e. only own funds decrease and which level) would apply for life shocks but also for stress testing purposes in general
- The standard formula approach seems to be ambitious (too much calculation and implementation needs) to be used within the EIOPA stress test scenarios. Implementation of the classification approach may be less complex.
- Disability shocks could be modelled and calibrated in general similarly to mortality shocks calibrated in line with the Solvency II approach.

We are supportive of the general approach to simplifications and the materiality criteria.

We support the additional considerations on the use of regression techniques included in the discussion paper.

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