



# ACTUARIAL ASSOCIATION OF EUROPE

## **Solvency II – Review: Meeting Insurance Committee**

Siegbert Baldauf

3 April 2020

# Agenda

- 1) Review process and timeline
- 2) EIOPA's Opinion
- 3) Holistic impact assessment
- 4) ICS
- 5) Other topics

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# Timeline for 2nd step of SII - review

Solvency II Directive: Review of the **LTG-measures** required in Article 77f.  
Detailed prescription of process and timeline.

Due date: 1 January 2021 (relevant for the whole review process)

## Prescribed steps:

- Until 2020 EIOPA reports to European Parliament, European Commission and the Council annually on use and impact of the LTG –measures (Reports 2016, 2017, 2018, 2019 are available)
- EIOPA shall submit an **opinion** on the assessment of the application of the LTG –measures to Commission by **30 June 2020**
- Based on this opinion, Commission shall submit a report to the European Parliament and to the Council by 1 January 2021
- This report shall be accompanied, if necessary, by legislative proposals.

# Consultations related to SII - review

**1) Request for Feedback on Methodological Considerations regarding Illiquid Liabilities**

29 October 2018 – 7 December 2019

**2) Discussion Paper on Systemic Risk and Macroprudential policy in Insurance**

29 March 2019 – 30 April 2019

**3) Consultation Paper on proposals for Solvency II 2020 Review Package on Supervisory Reporting and Public Disclosure**

12.Juli 2019 – 18 October 2019

**4) Consultation Paper on proposals for Solvency II 2020 Review Harmonisation of National Insurance Guarantee Schemes**

12.Juli 2019 – 18 October 2019

**5) Consultation Paper on the Opinion on the 2020 review of Solvency II**

15 October 2019 – 15 January 2020

The AAE commented on these consultations

# Consultation on reporting and disclosure - Technical aspects

EIOPA-BoS-19-582 18 December 2019: **Consultation Paper  
on proposals for Solvency II 2020 Review.**

**Review of technical implementation means for the package on Solvency 2  
Supervisory Reporting and Public Disclosure**

Paper published January 2020; Deadline for comments: 20 April 2020

Review of the technical means in particular within:

- *The BoS governance process for XBRL taxonomies development and publication;*
- *The business and technical validations, including its definition and documentation, its deactivation process and its tolerance mechanism;*
- *Taxonomy architecture, EIOPA's taxonomy tooling and its deliverables;*
- *The improvement of the accessibility and reachability of the public disclosure data. Including its standardisation as machine readable and promoting the accessibility/reachability of the reports.*

SII – Working group recommended not to comment on these technical issues (XBRL, taxonomy).

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# Solvency II – 2020 Review

LTG – Report  
2016

LTG – Report  
2017

LTG – Report  
2018

LTG – Report  
2019

LTG – Report  
2020

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

Mitigating systemic risk through  
Solvency II (21 March 2018)

Other potential macroprudential  
tools and measures to enhance the  
current framework (31 July 2018)

Report on insurers' asset and liability  
management in relation to the illiquidity  
of their liabilities (16 December 2019)

Opinion on Sustainability within  
Solvency II (30 September 2019)

ESRB: Enhancing the  
macroprudential dimension of  
Solvency II (19 February 2020)

EIOPA: Financial  
stability report (bi-  
annual). E.g.  
December 2019

**Solvency II–review  
2020**

EIOPA Discussion Paper  
IBOR transitions (January 2020)

Supervisory statement on the impact  
of the ultra-low/negative interest rate  
environment (19 February 2020)

ICS (i.a.) Level 1 Document:  
ICS Version 2.0 for the monitoring  
period (14 November 2019)



# Solvency II: LTG - Report 2019

The inhomogeneity of insurance business across Europe is documented in EIOPA's annual LTG – reports:

Comments: The use of transitional measures needs approval by the NSA. The NSA control the activities needed to achieve compliance with Solvency II until end of the transitional period (Directive Art. 308(e)).

**We rejected EIOPA's proposal to disclose more details in the SFCR.**

Number of undertakings using the measures							
Type of undertaking	Total number of undertakings	VA	TTP	MA	TRFR	DBER	No measure
Life	555	255	105	19	3	1	271
Non-Life	1.593	203	10	0	0	0	1.331
Both life and non-life	395	177	43	14	2	0	210
Reinsurance	311	25	1	1	1	0	286
Total	2.797	660	159	34	6	1	2.098
Number of countries		22	11	2	4	1	

# Risk-free interest rate curve

**Change of volatility adjustment** several options discussed

Example:

- Split in permanent volatility adjustment and an extraordinary adjustment

## **Extrapolation of the risk-free rate**

Options concerning last liquid point (LLP) for the Euro

- unchanged
- LLP = 20, additional safeguards in Pillar2, Pillar3
- LLP = 30
- LLP = 50

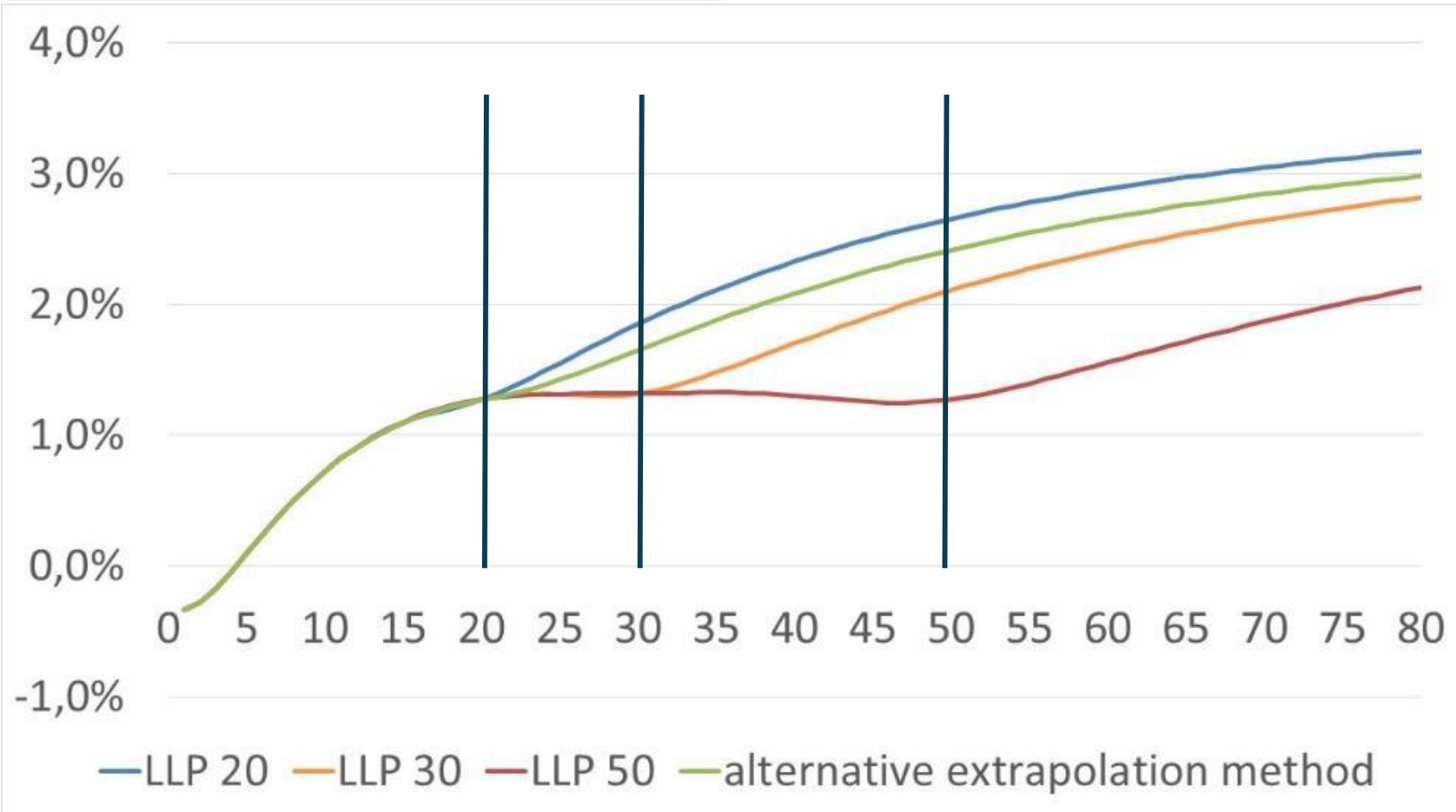
Concerning methodology

- Alternative: Considering liquid points beyond LLP  
replace Smith-Wilson

Comparable to the methodology proposed by UFR-Committee in the Netherlands for pension business

# Extrapolation – Impact of options considered

Rfr: Year end 2018

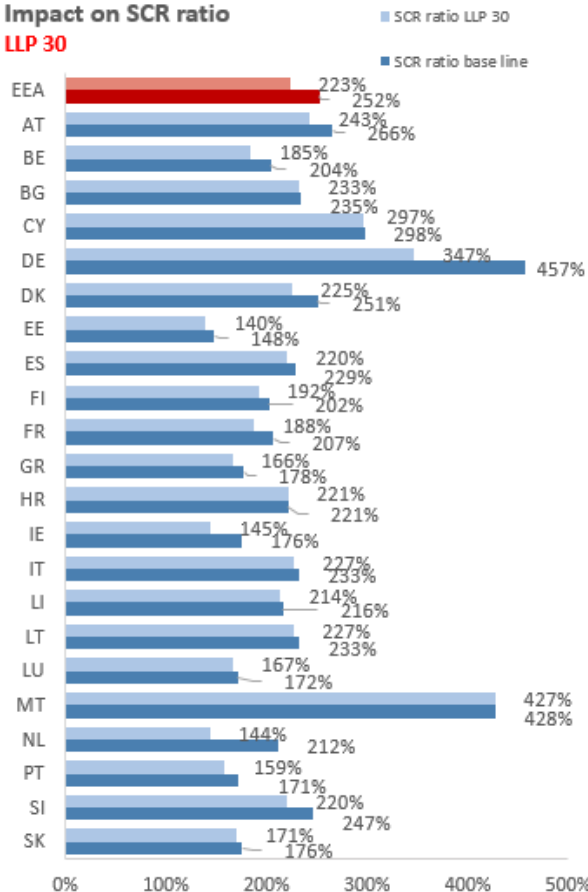


Source: Consultation paper p. 37

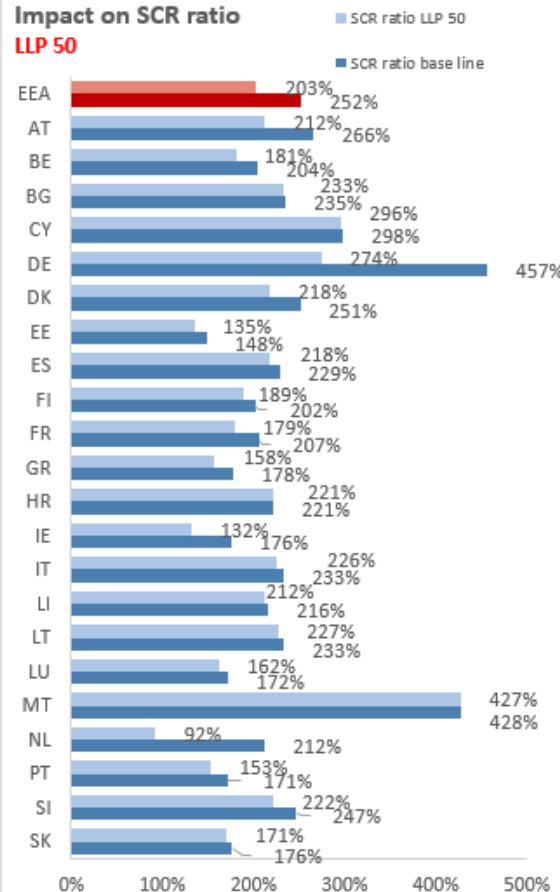
# Extrapolation – Impact of options considered

Rfr: Year end 2018

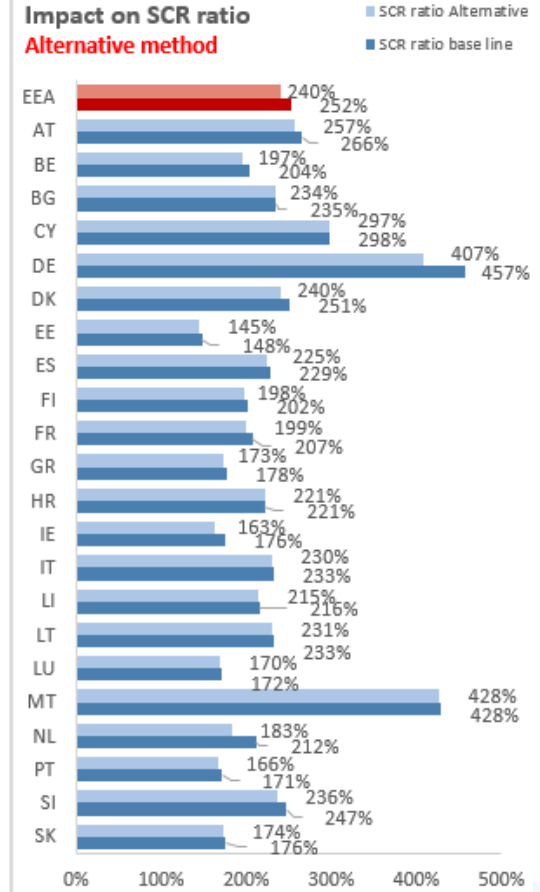
**Impact on SCR ratio**  
**LLP 30**



**Impact on SCR ratio**  
**LLP 50**



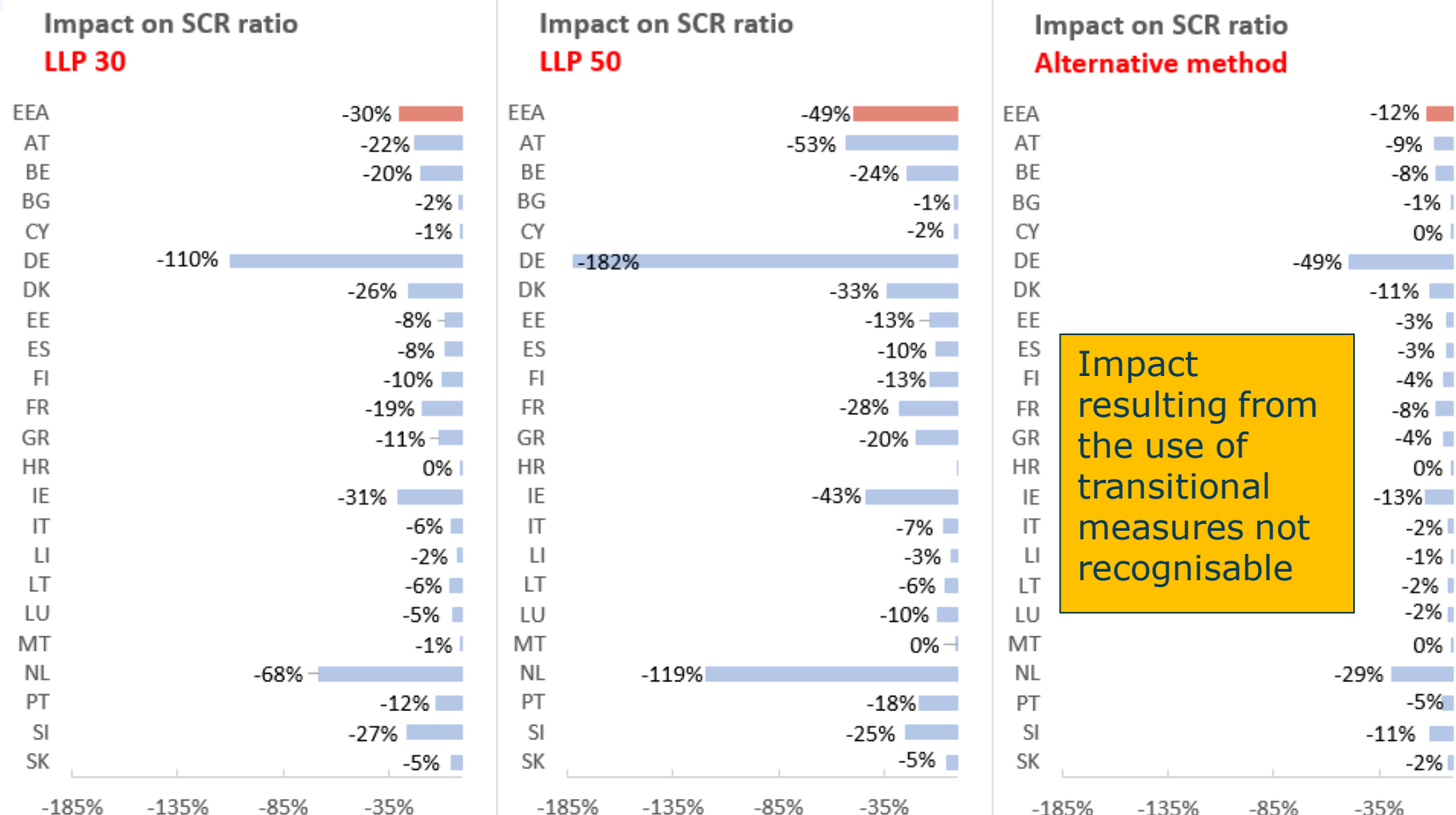
**Impact on SCR ratio**  
**Alternative method**



Source: Consultation paper p. 39

# Extrapolation – Impact of options considered

Rfr: Year end 2018



Source: Consultation paper p. 39

# Solvency II review: DLT – assessment

## **Commission's request:**

EU-Commission requested EIOPA to provide data evidence on criteria to determine the last liquid point (LLP).

The value of the LLP determined based on the criteria:

- the depth, liquidity and transparency of swap and bond markets
- the ability of insurance 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.

Provision of evidence at the very least for the time period 2016-2018, and ideally several years further in the past, including to the extent possible periods of market stresses and increased interest rates.

Data provided: Due to non-availability of data, EIOPA has not been able to meet these requirements. Especially no information on the effects of market stress and increased interest rates is provided.

# DLT–assessment for the Euro: EIOPA’s analysis

Swap markets analysed only for years 2016, 2017

Result: Swap market for the euro in these years is deep, liquid and transparent for maturities 1 to 15, 20, 25, 30, 40 and 50 years (not for other years)

Bond markets: no data delivered for the Euro-countries

Matching criterion: Analysed with and separately without unit-linked and index-linked business (value in brackets)

Maximum LLP: 2016: 10 years (10 years)

2017: 15 years (15 years)

probably not complete data: 2018: 15 years (23 years)

Residual volume criterion:

Resulting LLP: 2016: 22 years

2017: 22 years

2018: 21 years

EIOPA fails to substantiate a shift of the current LLP of 20 years for the Euro.

**The LLP of 20 years should not be changed**

The LLP depending on outstanding volumes of bond cashflows is calculated based on a threshold of 6%.

The IBOR transition might further affect the DLT characteristic of markets

# IBOR Transition: Discussion paper

**EIOPA Discussion Paper IBOR transitions** (EIOPA-BoS-20/009, January 2020)

Background: Manipulation of interest rate benchmarks LIBOR and EURIBOR necessitated a replacements of these benchmarks

Two rates possible:                      €STR: Euro Short Term Rate  
recalibrated EIONIA: €STR + 8.5 bp – available until end of 2021

Currently two types of benchmark rates:

- a) IBOR (Inter Bank Offered Rates): embedding credit risk (CRA applies)
- b) OIS (Over-night index average rates): risk-free

IBOR – based swap instruments might be replaced by OIS – based swap instruments in the near future.

Challenge: Managing the transition, use of CRA



# IBOR Transition: risk-free rate

IBOR transition affects the risk-free rate curve and thereby the valuation of insurance liabilities.

## Challenges:

- Identification of DLT – markets  
*Currently none of the new OIS based curves can be considered DLT according to EIOPA's criteria. (Discussion paper, para 23)*
- Transition to OIS: Change of the SII – Directive (Article 45: adjustment to swap rates for credit risk)

Discussion paper: EIOPA asked 8 questions relating to the process and the treatment of the Credit risk adjustment.

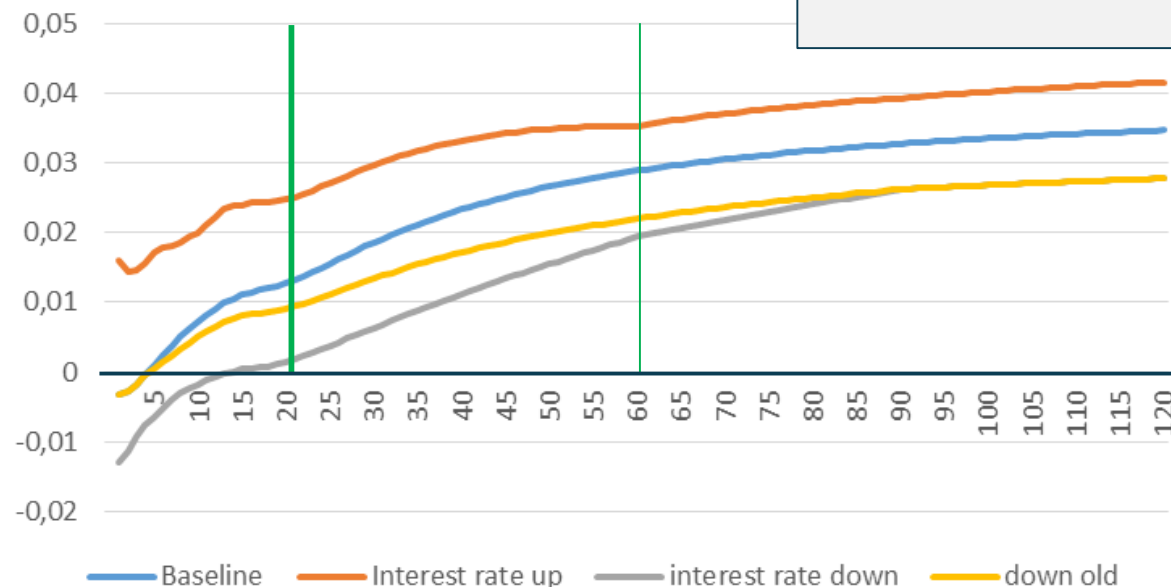
Taking account of the feedback, a consultation paper will be produced later with policy recommendations.

# Interest rate stress

Remainder from SCR – Review: EIOPA's proposed advice relating to interest rate stress unchanged. Estimated impact: Significant reduction of coverage ratio e.g. for Germany by 75%-points. (Source: Annex to EIOPA's second set of advice, 28 February 2018). EIOPA will review the proposed 3 years period for gradual implementation (considering the impact of all changes suggested for SII-review).

Interest rate stress

Term structures  
31 December 2018



Proposed stress:

Proportional stress  
+  
Additive component,  
after LLP linearly  
decreasing to 0 until  
year 60.

Our comment:

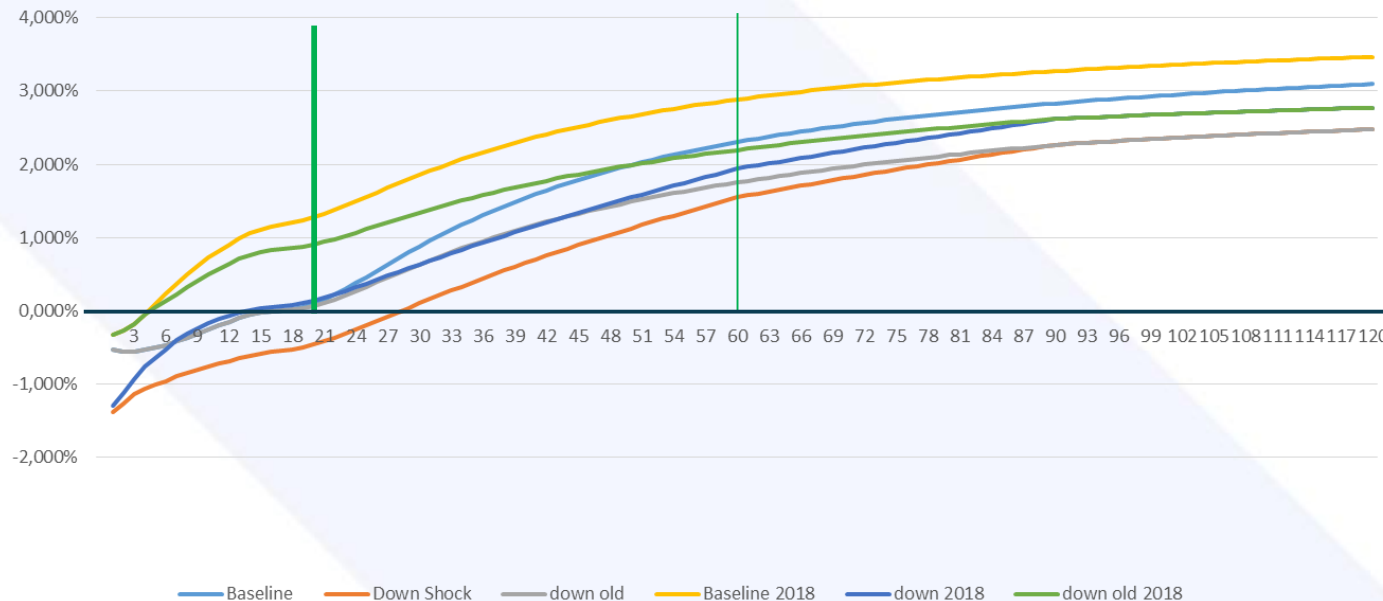
Stress should only be  
applied to the liquid  
part of the curve.

Possible changes of extrapolation methodology considered in the Consultation paper; especially changes of the LLP

# Interest rate stress – 2019 lower rfr

Term structures  
31 December 2019

31.12.2018 vs. 30. 9. 2019

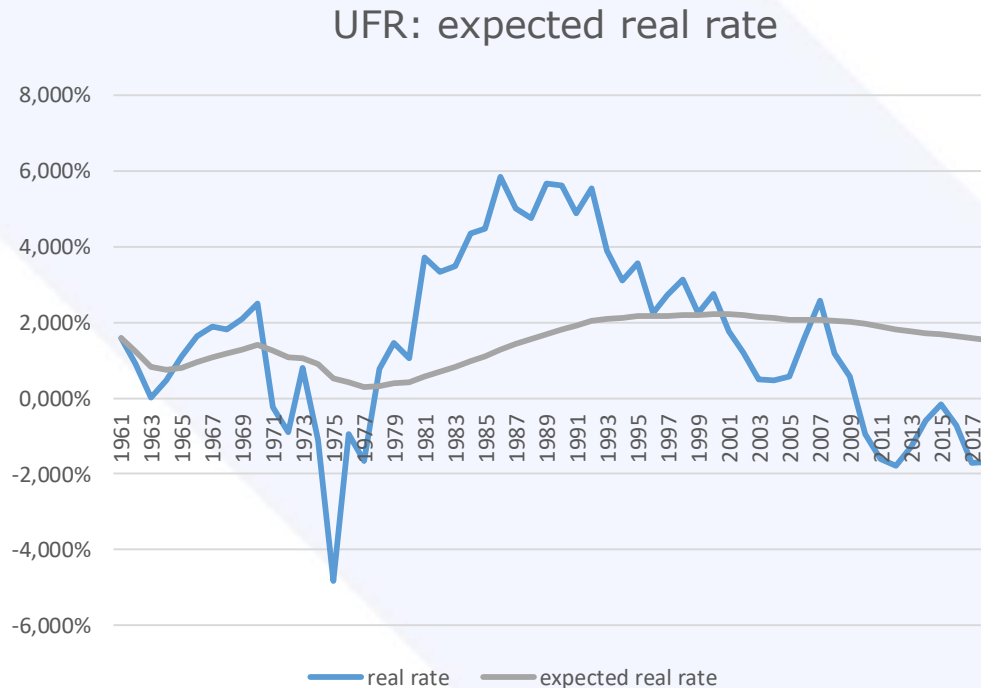


Proposed stress: Proportional stress + Additive component, after LLP linearly decreasing to 0 until year 60.

Interest rate down shock leads to negative interest rates in the first 25 years. Critics: Shock should only be applied to the liquid part.

# Ultimate Forward Rate (UFR)

## Smoothing over time



Solvency requires the valuation of risk over a one-year horizon.

Such a stress on the interest rate cannot change the UFR taking into account the new methodology.

**Stress should be limited to the liquid part of the risk-free interest rate curve.**

**Delegated regulation:** (56) The calibration of the interest rate risk at longer maturities should reflect that the ultimate forward rate towards which the risk-free interest rate term structure converges to is stable over time and only changes because of changes in long-term expectations.

# Ultimate Forward Rate (UFR): Methodology

## Backup

The UFR should reflect the long-term expectation concerning the interest rate.  
It was developed as sum of target inflation rate + real interest rate

For the Euro ECB's target inflation rate is 2.0%, the real rate was 2.2%.  
Solvency II started with a UFR of 4.2%. Change of inflation target would change the UFR, with significant impact on the Solvency ratios.

In 2017: New methodology to derive the UFR published by EIOPA:

The expected real rate calculated as the simple arithmetic mean of annual real rates for the past years since 1960 (widening window approach)

The resulting UFR in 2017 was 3.65%. Starting in 2018 this value should be reached in steps of 15 bp. For 2020 the UFR is 3.75%.

For the year 2020 the calculated expected real rate is already reduced to 1.55%.

Although being an average value for more than 58 years, this value will diminish significantly in a protracted low interest rate environment, counteracting the risk of underestimation.

# Volatility adjustment: current calculation

## Delegated regulation: Articles 49-51

*Article 49* **Reference portfolios**

*Article 50* **Formula to calculate the spread underlying the volatility adjustment**

*Article 51* **Risk-corrected spread**

$$S = w_{\text{gov}} * \max (S_{\text{gov}}, 0) + w_{\text{corp}} * \max (S_{\text{corp}}, 0)$$

Based on reference portfolio

**w<sub>gov</sub>**: ratio of the value of government bonds

**S<sub>gov</sub>**: average currency spread on government bonds

**w<sub>corp</sub>**: ratio of the value of bonds other than government bonds, loans and securitisations

**S<sub>corp</sub>**: average currency spread on bonds other than government bonds, loans and securitisations

## Directive, Article 77d:

3. The amount of the volatility adjustment to risk-free interest rates shall correspond to **65 % of the risk-corrected currency spread**.

# Volatility adjustment: Commission's request

Commission requested an assessment concerning the use of volatility adjustment.

The quantitative impact of two approaches should be provided.

- Approach 1: 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";
- Approach 2: 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.

In addition, EIOPA is asked to review the functioning of the country component given its purpose and suggest amendments to the measure where necessary.

EIOPA presented a comprehensive analysis of options in the Consultation paper that could serve as building blocks for the two approaches.  
No concrete advice provided.

AAE comments: Approach 2 should be chosen.

# Volatility adjustment: EIOPA's approach

Backup

Objectives attributed to the VA:

1. Prevent procyclical investment behaviour;
2. Mitigate the impact of exaggerations of bond spreads on own funds;  
and
3. Recognise illiquidity characteristics of liabilities in the valuation of technical provisions.

EIOPA identified seven deficiencies in the current determination of the VA

- 1) risk of over- or undershooting
- 2) illiquidity of liabilities not taken into account
- 3) cliff effect of country component
- 4) miss estimation of risk correction
- 5) VA not symmetric
- 6) underlying assumptions unclear
- 7) risk free rate with VA not market-consistent



# Volatility adjustment: options considered

Backup

- Option 1 – undertaking specific VA
- Option 2 – middle bucket approach
- Option 3 – asset driven approach
- Option 4 – Adjustment accounting for amount of fixed- income assets and asset-liability duration mismatch undertaking specific VA
- Option 5 – Adjustment accounting for the illiquidity of liabilities
- Option 6 – risk correction calculated as a percentage of the spread
- Option 7 – Amend the trigger and the calculation of country-specific increase of the VA
- Option 8 – Clearer split of the VA between its function as a crisis and a permanent tool

As requested by commission: two approaches consulted:

Approach 1: Options 4, 5, 6 + **8 for macro-economic VA**

Approach 2: Options 1, 4, 5 (macro-economic VA not needed)

To determine VA: GAR General application ratio – comparable to 65% (Art. 77d)  
AR Application Ratios (Option 4 and Option 5) required to reflect illiquidity of liabilities and mismatch

# Volatility adjustment: Risk management

Without consideration of the final outcome, EIOPA provided advice with regard to risk management requirements in case volatility adjustment is applied.

## EIOPA's advice

Regarding Article 44(2) of the Solvency II Directive (requirement on setting up a liquidity plan where the VA is applied) EIOPA advises to clarify and strengthen the requirement as follows:

- *undertakings applying the VA should fall under the requirement to establish a liquidity risk management plan,*
- *they should in their liquidity risk management plan take into account the use of the VA, in particular they should analyse whether the liquidity planning indicates any liquidity constraints which are not consistent with the use of the VA, for example where they result in forced sale of assets and thereby endanger that the VA can be earned.*

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# Holistic impact assessment

EIOPA-BoS-20/107 2 March 2020

## **Technical specification of the information request on the 2020 review of Solvency II Holistic impact assessment**

According to Commission's request

*The provided technical advice should contain a detailed holistic impact assessment of all relevant effects, qualitative and quantitative, on European level and on each Member State; the detailed impact assessment should be presented in easily understandable language respecting current legal terminology at European level.*

EIOPA's prepared one scenario to test tentative proposals to changes of the

- Extrapolation
- Volatility adjustment
- Interest rate down shock
- Risk margin

Deadline shifted  
to 1 June 2020  
(COVID-19)

Timeline information request	
2 March 2020	Launch of the information request
31 March 2020	Deadline for participants to submit results to their national supervisory authorities
1 to 16 April 2020	Validation of results by national supervisory authorities
16 April 2020	Deadline for reporting of information from national supervisory authorities to EIOPA

# Holistic impact assessment

## Disclaimers:

- Although consultation feedback and data received are considered in the proposals included in the technical specifications **EIOPA's position as reflected in this information request is not final**
- Only those proposals with expected material impact on the Solvency II calculation are considered in the information request

## Disclosure of results

- Anonymised results from the information request will be disclosed as part of its Opinion on the 2020 review of Solvency II in June 2020.

# Extrapolation of risk-free rate (Euro)

## Current methodology

Last liquid point (LLP) = 20

Convergence point = 60 years

Convergence tolerance = 1 bp

Credit risk adjustment = 10 bp

Ultimate forward rate = 3.9%

### Methodology:

Smith-Wilson method

Speed of convergence controlled by parameter alpha ( $\geq 0.05$ )

Alpha = 0,13281 (EoY 2019)

Source: Technical documentation of the methodology to derive EIOPA's risk-free interest rate term structures

## Alternative methodology

First smoothing point (FSP) = 20  
(residual bond criterion used)

Last liquid forward rate (LLFR) =  
weighted combination of forward  
rates pre and post FSP (0,705%)

Ultimate forward rate = 3,9%

### Methodology:

Forward rate after FSP: weighted  
average of LLFR and UFR

Vasiček model for interest rates

Convergence factor = 10%

No convergence tolerance prescribed

# Extrapolation of risk-free rate (Euro)

Backup

## Alternative methodology:

DLT swap rates for maturities 1-10, 12, 15, 20, 25, 30, 40, 50 considered

### Calculation of the LLFR:

$$LLFR = w_{20} * f_{15,20} + w_{25} * f_{20,25} + w_{30} * f_{20,30} + w_{40} * f_{20,40} + w_{50} * f_{20,50}$$

With  $f_{t1,t2}$  = forward rates between maturity t1 and t2 (one-year forward rate) and weighting factors  $w_x$  derived from average notional amount  $V_x$  traded for maturity x

$$w_{20} = \frac{V_{20}}{V_{20} + V_{25} + V_{30} + V_{40} + V_{50}}$$

### Extrapolation of forward rates

$$f_{20,20+h} = \ln(1+UFR) + (LLFR - \ln(1+UFR)) * B(a, h)$$

$$B(a, h) = (1 - e^{-ah}) / ah$$

- $h$  = maturity after FSP
- $a$  = convergence factor (10%)

### Zero-coupon rates post FSP extrapolated:

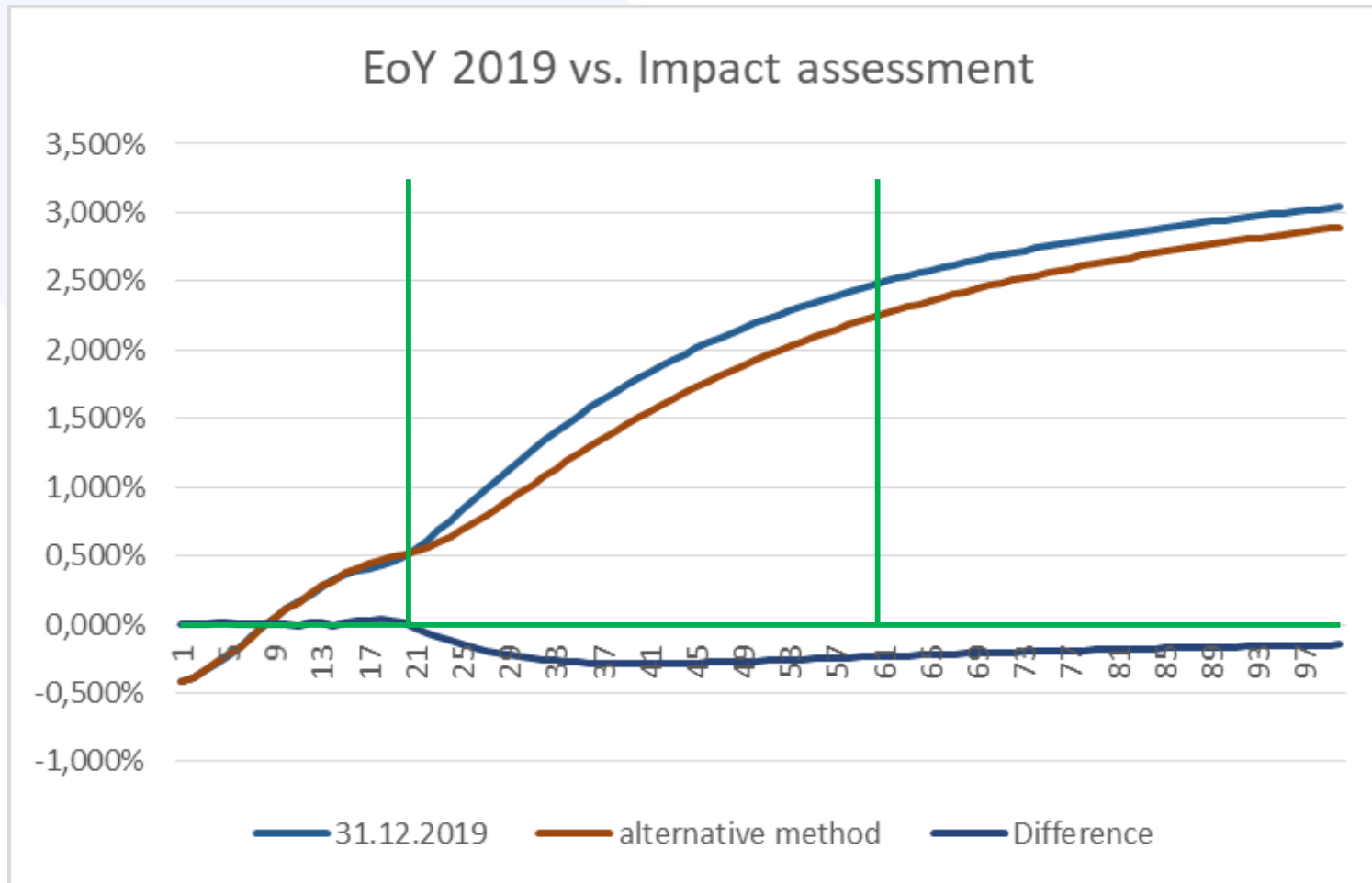
$$z_{20+h} = \exp \left( \frac{20 * z_{20} + h * f_{20,20+h}}{20+h} \right) - 1$$

*The alternative extrapolation method consists of two steps: First, zero coupon yields (up to and including the FSP) and forward rates (pre and post the FSP) are derived from the swap curve for maturities 1-10, 12, 15, 20, 25, 30, 40 and 50 years.*

*Second, zero-coupon yields beyond the FSP are derived using a weighted combination of the LLFR and the UFR.*

(Source: Consultation paper A.71)

# Alternative method affects rfr considerably



Convergence to UFR: Neither convergence point nor convergence tolerance prescribed!



# Volatility adjustment: Impact assessment

EIOPA's tentative proposal: VA will consist of a permanent VA and a macroeconomic (calculated as a country-specific VA). This conforms to approach 1 in Commission's request.

End of 2019: no trigger to activate macroeconomic VA

Calculation of application ratios (AR) required

AR<sub>4</sub>, to correct mismatches in fixed income assets and liabilities

AR<sub>5</sub>, to account for the illiquidity characteristic of liabilities

The permanent VA is calculated as

$$VA = GAR \cdot AR_4 \cdot AR_5 \cdot Scale_c \cdot RC\_S_c$$

where

- GAR is the general application ratio (set to 85%)
- $Scale_c$  scaling-factor for currency c (set to 141% for the EURO)
- $RC\_S_c$  risk-corrected spread of the representative portfolio for currency c (set to 0.167% for the EURO)

# Volatility adjustment: Considering mismatch

AR<sub>4</sub> aims at correcting mismatches between fixed income assets and liabilities

$$AR_4 = \min\{(PVBP(MV_{i,c}^{FI}) / PVBP(BEL_{i,c})); 1\}$$

where

- $MV_{i,c}^{FI}$  = the market value of undertaking's  $i$  investment in fixed income investments in currency  $c$  (fixed income investments identified on basis of their CIC)
- $PVBP(BEL_{i,c})$  equals the price value of a basis point of the best estimate of the liabilities of undertaking  $i$  in currency  $c$ ;
- $PVBP(MV_{i,c}^{FI})$  equals the price value of a basis point of the fixed income investments of undertaking  $i$  in currency  $c$ .

# Volatility adjustment: Considering mismatch

Backup

Calculation of the price value of a base point

$$PVBP(BEL_{i,c}) = \frac{(BEL_{i,c}(RFR_c) - BEL_{i,c}(RFR_c + GAR \cdot Scale_c \cdot RC_{Sc}))}{GAR \cdot Scale_c \cdot RC_{Sc}}$$

- $RFR_c$  = basic risk-free interest rate term structure for currency  $c$
- $RFR + GAR \cdot Scale_c \cdot RC_{Sc}$  denotes the basic risk-free interest rate term structure, to which a volatility adjustment of size  $GAR \cdot Scale_c \cdot RC_{Sc}$  is applied
- $RC_{Sc}$  denotes the risk corrected spread of the reference portfolio in currency  $c$  (calculated as a function of the credit spread CS up to the long-term average spread LTAS and as a function of the LTAS for the exceeding part)
- **GAR** denotes the general application ratio.
- $Scale_c$  is a scaling factor for the relevant currency reference portfolio bringing the weight of fixed income instruments to 1.

# Volatility adjustment: Considering mismatch

## Backup

Calculation of the price value of a base point of the fixed income investments of the undertaking.

Calculation based on the difference in their market value against current spreads and spreads would have increased by the part of the VA that does not depend on the undertaking specific application ratio, i.e.  $GAR \cdot Scale_c \cdot RC\_Sc$  :

$$PVBP(MV_{i,c}^{FI}) = \frac{MV_{i,cFI}(CS) - MV_{i,cFI}(CS + GAR \cdot Scale_c \cdot RC\_Sc)}{GAR \cdot Scale_c \cdot RC\_Sc}$$

$CS$  = current level of spreads.

# Volatility adjustment: Considering illiquidity

$AR_5$  is a weighted average of the application factors that are allocated to the different illiquidity categories:

$$AR_5 = \max \left( \min \left( \frac{BE_I \cdot AR_{5,I} + BE_{II} \cdot AR_{5,II} + BE_{III} \cdot AR_{5,III}}{BE_I + BE_{II} + BE_{III}}; 100\% \right); 60\% \right)$$

where

- $BE_I$  = best estimate of the category I liabilities
- $BE_{II}$  = best estimate of the category II liabilities
- $BE_{III}$  = best estimate of the category III liabilities

Calculated without VA and transitional measures. Basic risk-free rate based on the alternative extrapolation method.

# Volatility adjustment: Considering illiquidity

Determining the illiquidity category of liabilities according to the criteria in the table:

Illiquidity category	Criteria	Application factor
Category I – High illiquidity	<ul style="list-style-type: none"> <li>- No surrender/cancellation options or where the take up of the surrender option or the cancellation of the contract can never lead to a loss in own funds for the insurer</li> <li>- Low best estimate impact mortality risk</li> </ul>	100% ( $AR_{5,I}$ )
Category II – Medium illiquidity	<ul style="list-style-type: none"> <li>- Low best estimate impact of permanent increase in lapse rates</li> <li>- Low best estimate impact of mortality risk</li> </ul>	75% ( $AR_{5,II}$ )
Category III – Low illiquidity	Contracts that do not fall into category I or II	60% ( $AR_{5,III}$ )

# Dynamic volatility adjustment

Dynamic volatility adjustment can currently only be applied by users of an internal model.

It is not available for users of the standard formula.

Consultation paper: EIOPA advises not to change the SCR standard formula to allow for the dynamic volatility adjustment.

AAE-Comments: We advocated a change concerning this matter.

Holistic impact assessment:

As part of the holistic impact assessment, undertakings are requested to provide data on the impact of applying the dynamic volatility adjustment in the standard formula.

EIOPA will decide on its final advice.

## SII – Review: Risk margin

The risk margin is the discounted sum of current and future SCR multiplied by the Cost of Capital – Rate

$$RM = CoC \cdot \sum_{t \geq 0} \frac{SCR(t)}{(1+r(t+1))^{t+1}}$$

- SCR(t): SCR after t years;
- r(t+1): basic risk-free rate for the maturity of t+1 year
- CoC = 6%

The AAE has published a paper “A Review of the Design of the Solvency II Risk Margin”. This paper contains a broad discussion concerning all aspects of the risk margin-calculation, especially the CoC-rate.

The paper is assumed to serve as a basis for further analysis.

AAE-Comments: We advocated a change of Article 77 (5) of the Solvency II Directive. A differentiated CoC-rate should be possible, if substantiated adequately (e.g. for certain lines of business).



# Risk margin: Scenario in impact assessment

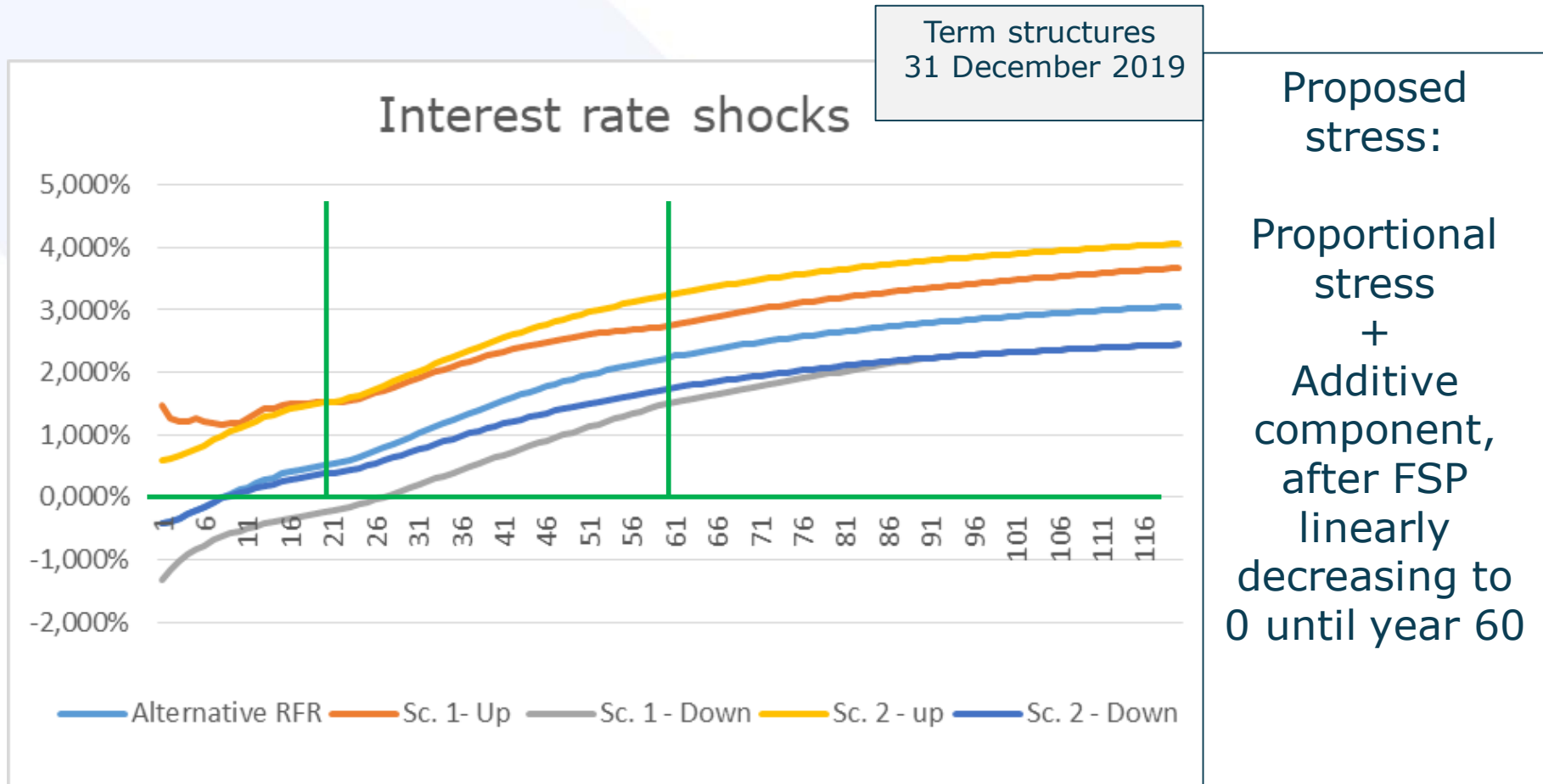
The weight of future SCR is attenuated by application of a factor  $\lambda$ ;  
CoC-rate remains unchanged

$$RM_{\text{scenario}} = CoC \cdot \sum_{t \geq 0} \frac{SCR(t)}{(1+r(t+1))^{t+1}} \times \max(\lambda^t, 0.5), \lambda = 0.975$$

- $SCR(t)$ : SCR after  $t$  years;
- $r(t+1)$ : basic risk-free rate for the maturity of  $t+1$  year
- $CoC = 6\%$

This factor  $\lambda$  reduces the risk margin considerably.  
Effect comparable to a significant reduction of the CoC –rate.  
No justification for the size of the factor  $\lambda$  is given.

# Interest rate stress: alternative methodology



Invitation to calculate SCR with a modified calibration of scenario:  
A floor of -1.25% to shocked interest rates.

# Correlation spread and interest rate risk

Delegated Regulation: According to Article 164 the correlation parameter between interest rate risk and spread risk is 0.5.

Commission requested advice, concerning the appropriateness of calibration of correlation parameters used in the SCR standard formula, especially within the market-risk module

**Consultation paper, para 5.155: Furthermore, EIOPA advises to keep the market risk correlations unchanged.**

Impact assessment: The correlation parameter for interest rate risk (downward shock) and spread risk should be set to 0.25. The parameter for interest rate risk (upward shock) and spread risk should stay at 0. All other correlation parameters remain unchanged.

# Agenda

- 1) Review process and timeline
- 2) EIOPA's Opinion
- 3) Holistic impact assessment
- 4) ICS**
- 5) Other topics

# Insurance Capital Standards (ICS)

14 November 2019: **IAIS adopts first global frameworks for supervision of internationally active insurance groups and mitigation of systemic risk in the insurance sector** <https://www.iaisweb.org>

The adopted reforms include:

- a) Common Framework (ComFrame)
- b) Insurance Capital Standard (ICS) version 2.0
- c) Holistic Framework for the assessment and mitigation of systemic risk in the insurance sector

ICS Version 2.0 used for 5-year monitoring period starting January 2020

- based on the results of 6 field tests in the years 2014 – 2019
- during monitoring period results only used for confidential reporting and discussion with supervisors
- Further refinement during monitoring period (detailed timeline and work-plan)
- Public consultation before implementing ICS as group-wide prescribed capital requirement (PCR)
- Adoption of ICS as PCR in Q4, 2024
- In the meantime, assessment if Aggregation Method (AM) developed i.a. by United States leads to comparable outcome, i.e. usable for calculation of PCR

# Insurance Capital Standards (ICS) - AM

## **About the Aggregation Method**

*Since the IAIS Annual Meeting in Kuala Lumpur in November 2017, US Members have indicated that their supervisory framework does not support a group-wide consolidated approach to a PCR, and hence the US and other interested jurisdictions are developing an Aggregation Method (AM) that follows a different approach than the ICS, but which they aim to use as their implementation of the ICS on an outcome-equivalent basis. (Statement from IAIS Secretary General Jonathan Dixon on the ICS Monitoring Period, 21 February 2020)*

<https://www.iaisweb.org/page/news/press-releases/file/88901/media-release-statement-by-iais-sg-jonathan-dixon-on-ics-monitoring-period>

## **Definition of comparable outcomes**

Comparable outcomes to the ICS means that the Aggregation Method (AM) would produce similar, but not necessarily identical, results over time that trigger supervisory action on group capital adequacy grounds.

IAIS developed 6 high-level principles and criteria to assess the comparability of ICS and AM.

*The high-level principles and criteria are developed in such a manner that the AM is neither precluded at the outset as an outcome equivalent approach to the ICS for measuring group capital, nor given a free pass.*

# Agenda

- 1) Review process and timeline
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- 5) Other topics**

# Insurance Stress Test: Methodological principles

EIOPA had published a **Discussion Paper on Methodological principles of insurance stress testing** on 22 July 2019. The AAE commented on this paper.

Follow-up: **Methodological Principals of insurance stress testing**

EIOPA-BoS-19/568 04 Dezember 2019 (published 3 March 2020)

The paper is “part of a general enhancement of EIOPA’s approach to stress testing”. Feedback on the Discussion paper is considered in this document.

Content of the paper (same as in Discussion paper)

- Introduction
- Stress test process and objectives
- Scope
- Scenario design
- Shocks and their application
- Data collection and validation

Discussed methodology can be considered e.g. in the context of ORSA.

Additional paper planned on stress test related issues like e.g. liquidity position, climate change



# SCR – Review: LAC DT

The new regulation concerning the loss-absorbing capacity of deferred taxes became effective as of January 2020.

Considering the effect on the Solvency position of the undertaking, the Delegated Regulation requires an intensified occupation with this topic.

*36) The loss-absorbing capacity of deferred taxes has a significant impact on the solvency position of insurance and reinsurance undertakings. The administrative, management or supervisory body of insurance or reinsurance undertakings should therefore adopt a **risk-management policy related to deferred taxes**, which takes into account the loss-absorbing capacity of those deferred taxes. In particular, that policy should set out the responsibilities for assessing the underlying assumptions applied to the projection of future taxable profits.*

Article 260 (1) (Risk management areas) includes now explicitly the treatment of deferred taxes as an additional risk management area. According to Article 41(3) of the Directive a written policy on risk management is required for this area.

A first observation: With regard to deferred taxes, the treatment required by NSAs seems to differ considerably between the countries.

EIOPA aims at a convergence of supervisory practise across Europe. It would be helpful to have an overview of the treatment by national supervisors.

Thank you very much for your attention!

## Solvency II review

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