ACTUARIAL ASSOCIATION OF EUROPE

Item 11.1: Solvency II

Virtual meeting Insurance Committee

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31 March 2022

Agenda

1) Review process

2) Proposed amendments: Pillar 1

3) Proposed amendments: Others

Requirements and expectations

The framework needs to be consistent with the EU’s political priorities. In particular, the insurance sector should play a role

- In financing the **post COVID-19 economic recovery**,
- in completing the **Capital Markets Union** (CMU) and
- in achieving the targets of the **European Green Deal**.

More specifically, the sector will be instrumental to “re-equitisation” in the corporate sector and financing the transition to sustainability.

(Source: Commission’s proposal, p.1)

The participation of insurers in long-term investments, in particular equity, can be supported by ensuring that the prudential framework appropriately reflects the long-term nature of the insurance business and mitigates the impact of short-term market turmoil on insurers’ solvency

Action 4: The Commission will seek to remove regulatory obstacles for insurance companies to invest long-term, without harming financial stability and policyholder protection.

Source: https://ec.europa.eu/finance/docs/law/200924-capital-markets-union-action-plan_en.pdf

Solvency II review process

Directive Art. 77f: To review mandatory, amongst others:

- long-term guarantees (LTG) measures and measures on equity risk
- specific methods, assumptions and standard parameters used when calculating the Solvency Capital Requirement standard formula

To consider:

- Extension of the microprudential framework by macroprudential elements
- ESG-issues (Environmental, social and governance), sustainable finance

To answer the questions:

- Is Solvency II still fit for purpose?
- Is proportionality considered appropriately?
- Are there obstacles that impede the role of insurers as long-term investors?

Evolution not revolution!

- SII should remain risk-based
- Market consistent valuation
- 99.5% VaR of own funds within a one-year horizon

Starting date: 11 February 2019: Commission sent a request for technical advice on the Solvency II Directive to EIOPA (19 issues addressed)

Solvency II review process

EIOPA's Opinion (17 December 2020): Commission provided with the requested advice on the Solvency II-review – accompanied by extensive background analysis and an impact assessment

Commission submitted report and adapted impact studies to Parliament and Council (22 September 2021)

Proposal for a DIRECTIVE

"amending Directive 2009/138/EC as regards proportionality, quality of supervision, reporting, long-term guarantee measures, macro-prudential tools, sustainability risks, group and cross-border supervision"

Proposal for a DIRECTIVE

"establishing a framework for the recovery and resolution of insurance and reinsurance undertakings and amending Directives 2002/47/EC, 2004/25/EC, 2009/138/EC, (EU) 2017/1132 and Regulations (EU) No 1094/2010 and (EU) No 648/2012"

Complexity of SII-framework

Commission's proposals will lead to amendments of the Directive

Commission empowerments will lead to amendments of the Delegated acts

Level 1

Directive 2009/138/EG from 25 November 2009, amended by Omnibus II – Directive 2014/51/EU from 16 April 2014

Transposition into national law required

SII-Review 2020 !

Level 2

Delegated regulation 2015/35 from 10. October 2014 taking up these empowerments

Applicable without transposition into national law.

mandatory

SCR-Review 2018 ✓

Level 2,5

Implementing technical standards (ITS) and Regulatory Technical Standards (RTS)

Especially reporting issues

Applicable immediately

mandatory

Level 3

Guidelines for further clarification

Issued by EIOPA

Addressing NSAs

„Comply or explain"

Next procedural steps

European Parliament

European Council

European Commission

Trilogue parties

A Directive is a Level 1-document in the hierarchy of the framework.
Adaptations have to be approved by the trilogue parties.

After approval the Directive has to be transferred to national law in all member states within 18 months.

Members of the ECON-Committee are dealing with Commission's proposals.
A first hearing is planned end of March.
Approval by ECON and the European Parliament expected towards end of 2022.

Rapporteur for SII and IRRD: Markus Ferber (EPP)

Entering into force of the amended framework **2024 at the earliest**!

Delegated Regulation, Regulatory technical standards or Guidelines are subordinated. Adaptations have to consider the final outcome of the Directive.

Agenda

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3) Proposed amendments – Others

Long-term guarantee (LTG) measures

LTG-measures have been introduced via the Omnibus II – Directive.

Objective: Facilitate an adequate treatment of long-term business.

Article	**Name of the measure**
77a	Extrapolation of the risk-free interest rate
77b, 77c	Matching adjustment (MA)
77d	Volatility adjustment (VA)
106	Symmetric adjustment to equity capital charge
138(4)	Extension of the recovery period
304	Duration-based equity risk sub-module (DBER)
308c	Transitional measure on the risk-free interest rates
308d	Transitional measure on technical provisions

LTG-Report: Use of LTG measures

Annual LTG-Reports on the use of LTG-measures provided by EIOPA (2016 -2020)

Importance of LTG – measures differs significantly across Europe

VA and the transitional measure on technical provisions are of highest importance

LTG 2020: Number of undertakings using the measures							
Type of undertaking	Total number of undertakings	**VA**	**TTP**	**MA**	**TRFR**	**DBER**	**No measure**
Life	**444**	**236**	**84**	**2**	**2**		**196**
Non-Life	**1.322**	**193**	**10**	**0**	**3**	**1**	**1.127**
Both life and non-life	**387**	**178**	**42**	**12**	**2**	**0**	**203**
Reinsurance	**305**	**24**	**0**	**0**	**1**	**0**	**281**
Total	**2.458**	**631**	**136**	**14**	**8**	**1**	**1.807**
Number of countries		**21**	**11**	**1**	**4**	**1**	

Extrapolation of the RFR

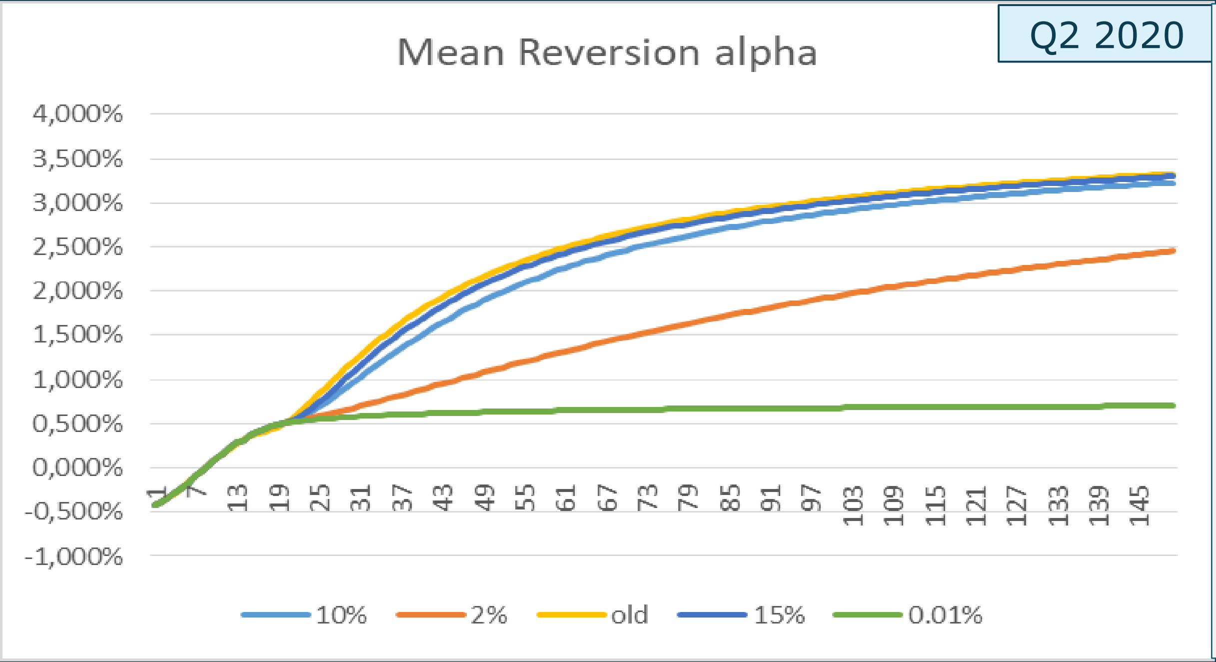
Current treatment	**Commission's proposal (Art. 77a)**
(for the Euro specified in the Omnibus II-Directive, **Recital 30**): – Last liquid point (LLP) = 20 – Convergence point = 60 years – Convergence tolerance = 3 bp (at convergence point: difference of extrapolated curve from effective UFR) <u>Chosen technique:</u> Smith-Wilson method	First smoothing point (FSP) is the starting point for the extrapolation FSP: DLT-character of markets considered and a sufficient availability of bonds with that maturity (residual volume criterion) Extrapolated part: shall take into account, information from financial instruments other than bonds where the markets for those financial instruments are DLT (by means of liquid forward rate - LLFR) Formula-based convergence towards UFR Phasing-in until 2032, steered by variation of the parameters in the formula. Details to be laid down in delegated acts.

<u>Objectives:</u> Use of information from all identified relevant DLT-markets
End the currency-specific treatment by adapting Art.77a

Alternative Extrapolation: Sensitivity Alpha

Shape of RFR and convergence to UFR strictly determined by alpha
Independent of starting value at FSP
Convergence process (period and tolerance not concretised)

Q2 2020



"No unequivocal evidence can be found in the economic empirical literature for the convergence factor and the existence of a convergence factor greater than zero is also often called into doubt."

Background document A.90

In addition: LLFR can change the starting value of the extrapolation

Extrapolation: transitional mechanism

Choice of parameters determining the speed of convergence:

Parameters determining the speed of the convergence of the forward rates towards the UFR of the extrapolation **may be chosen** such

that on first application date the RFR is sufficiently similar to the RFR in line with current extrapolation methodology one day before this date.

Those parameters of the extrapolation shall be decreased linearly at the beginning of each calendar year, during a transitional period. The final parameters of the extrapolation shall be applied as of 1 January 2032.

Thus, the RFR extrapolated by means of Smith-Wilson methodology will be approximated by choice of appropriate parameters used in the alternative extrapolation methodology.
Phasing-in independent of pre-defined market conditions (different from "mechanism" introduced in EIOPA's Opinion-paper to compensate for low interest rate environment).

Empowerment for Commission – Article 86

Article 86 empowers the Commission to adopt delegated acts laying down the methodologies, principles and techniques for the determination of the relevant RFR in particular:

i. the **formula for the extrapolation** including the parameters that determine the convergence speed of the extrapolation;

ii. the **method for the determination of the depth, liquidity and transparency** of bond markets;

iii. the **percentage** below which the share of bonds with maturities longer than or equal to a given maturity among all bonds shall be regarded as low

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AAE's view: Crucial requirements should be fixed in the Directive in a level 1-document

- Empowerment for the Commission to lay down relevant parameters in delegated acts should be accompanied by guardrails regarding
  - the convergence period and convergence tolerance
  - a parametrisation which is suitable to mitigate the impact of short-term market turmoil on insurers' solvency, thus superseding a transition period

Volatility adjustment (VA)

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EIOPA's advice:

Calculation of the VA for currency c:

$$VA_{perm} = GAR \cdot AR_4 \cdot AR_5 \cdot Scale_c \cdot RC\_S_c$$

Where:

- AR_4, to correct mismatches in fixed income assets and liabilities
- AR_5, to account for the illiquidity characteristic of liabilities
- GAR is the general application ratio → proposed ratio **85%**
- $Scale_c$ scaling-factor for currency c
- RC_S_c risk-corrected spread of the reference portfolio for currency c

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Commission's proposal

Calculation of the VA for currency cu:

$$VA_{cu} = 85\% \cdot CSSR_{cu} \cdot RCS_{cu}$$

where:

(a) VA_{cu} VA for currency cu;

(b) $CSSR_{cu}$ "credit spread sensitivity ratio" of an undertaking

(c) RCS_{cu} risk-corrected spread of reference portfolio

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A country-component (macro-component should be added)

$$VA = VA_{perm} + VA_{macro}$$

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A macro–component should be added for euro-countries with high spread

$$VA = VA_{cu} + VA_{Euro,macro}$$

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<td colspan="2">Approval by supervisors required for new applications of the VA</td>
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Empowerment for Commission - Article 86

The Commission shall adopt delegated acts laying down

(i) methods and assumptions for the calculation of the volatility adjustment referred to in Article 77d, including the following:

i. a formula for the ***calculation of the spread***

ii. a formula for the ***calculation of the credit spread sensitivity ratio****;*

iii. for each relevant asset class, the percentage of the spread that represents the portion attributable to a realistic assessment of expected losses or unexpected credit or other risks of the assets

iv. the ***transitional mechanism*** *as referred to in Article 77a(2);*

Re i. Spread still determined from a currency-specific reference portfolio

Re ii. Might be challenging for smaller undertakings – intended to reflect mismatch between fixed income assets and liabilities

Re iii. Consideration of current spread tends to increase volatility and reduce countercyclical capacity of VA

VA: Risk-Correction to the spread

Discussed by EIOPA in its background analysis (!):

Misestimating the risk correction of VA *(Para. 2.247)*

- ***Option 1:*** *no change*
- ***Option 2:*** *Amend the risk-correction to the spread so that it is decoupled from the fundamental spread, and instead calculated as a fixed percentage of the spread.*
- ***Option 3:*** *Amend risk-correction as in option 2, but allow for a higher impact of the VA when spreads are high*

2.252 ***The preferred option is option 3.*** *EIOPA has followed this option as part of its recommendation for a combined overall design of the VA.*

Option 1 (current treatment): calculated in the same manner as the fundamental spread (matching adjustment). Percentage of long-term average spread (LTAS) based on data relating to the last 30 years for government and for corporate bonds.

AAE's view: Empowerment for the Commission should concretise

- the method to calculate the risk-corrected spread based on a long-term average spread should not be affected by point-in-time considerations. This is necessary to ensure the function of the VA as a countercyclical element

Level 1-Regulation should ensure that such unintended developments are excluded.

VA – macro component (country specificities)

For the Euro, the VA shall be increased by a macro VA calculated as follows:

$$VA_{Euro,macro} = \mathbf{85\%} \cdot CSSR_{Euro} \cdot \mathbf{max}(RCS_{co} - \mathbf{1.3} \cdot RCS_{Euro}; \mathbf{0}) \cdot \omega_{co}$$

Where:

(a) $VA_{Euro,macro}$ is the macro VA for a country *co*;

(b) $CSSR_{Euro}$ is the credit spread sensitivity ratio of an undertaking for the euro;

(c) RCS_{co} is the risk-corrected spread for the country *co*;

(d) RCS_{Euro} is the risk-corrected spread for the euro;

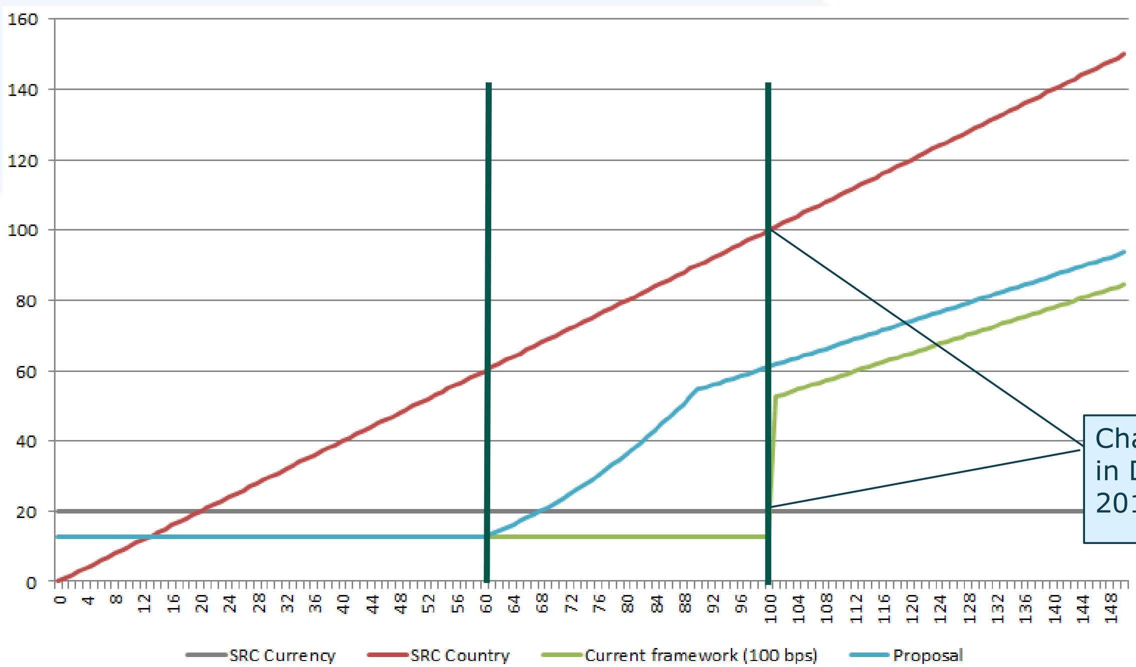
(e) ω_{co} is the country adjustment factor for country *co*.

The country adjustment factor shall be calculated as follows:

$$\omega_{co} = \mathbf{max}\left(\mathbf{min}\left(\frac{RCS_{co} - \mathbf{0.6\%}}{\mathbf{0.3\%}}; \mathbf{1}\right); \mathbf{0}\right)$$

Risk-corrected spread – macro-VA

Primary objective: Avoiding cliff-effects



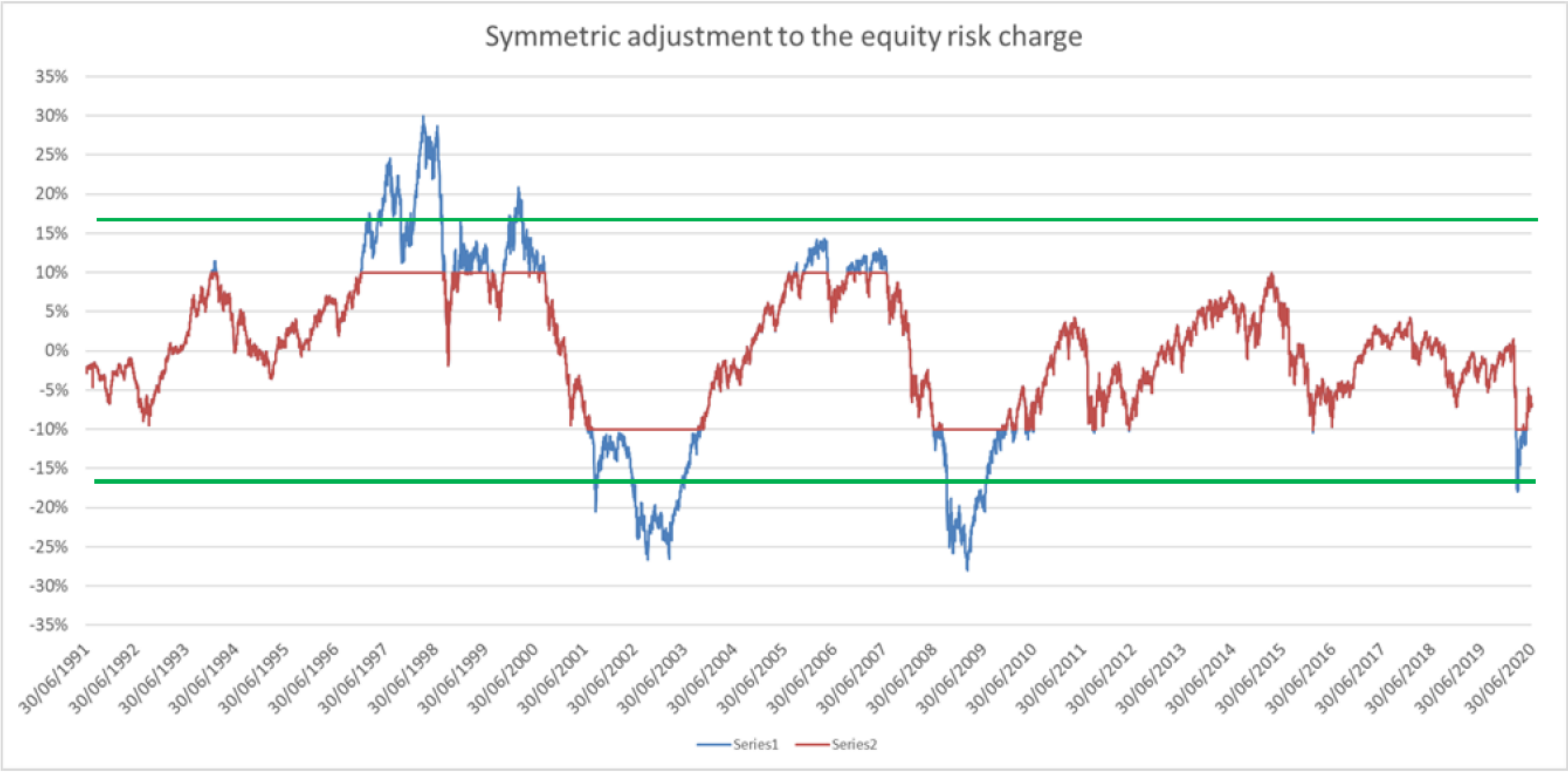
Risk corrected spreads under current regulation and proposal (cliff effect and its mitigation)

Changed already in December 2019 to 85bp

Source: **BACKGROUND DOCUMENT ON THE OPINION ON THE 2020 REVIEW OF SOLVENCY II** IMPACT ASSESSMENT A.335

Symmetric adjustment to equity risk charge

EIOPA advises **to widen the corridor to the symmetric adjustment** from currently +/- 10% to +/- 17% and to introduce a floor of 22% to the capital charge.



Extension of recovery period Article 138(4)

Current version	**Proposal: amendment of Article 138(4):**
In the event of exceptional adverse situations affecting insurance and reinsurance undertakings representing a significant share of the market or of the affected lines of business, as declared by EIOPA, **and where appropriate after consulting the ESRB**, the supervisory authority may extend, for affected undertakings, the period set out in the second subparagraph of paragraph 3 by a maximum period of seven years, taking into account all relevant factors including the average duration of the technical provisions.	In the event of exceptional adverse situations affecting insurance and reinsurance undertakings representing a significant share of the market or of the affected lines of business, as declared by EIOPA, the supervisory authority may extend, for affected undertakings, the period set out in paragraph 3, second subparagraph, by a maximum period of seven years, taking into account all relevant factors including the average duration of the technical provisions. (b) **in the second subparagraph, the first sentence is replaced by the following:**
Without prejudice to the powers of EIOPA under Article 18 of Regulation (EU) N° 1094/2010, for the purposes of this paragraph EIOPA shall, following a request by the supervisory authority concerned, declare the existence of exceptional adverse situations.	Without prejudice to the powers of EIOPA under Article 18 of Regulation (EU) No 1094/2010, for the purposes of this paragraph EIOPA shall, following a request by the supervisory authority concerned **and, where appropriate, after consulting the ESRB,** declare the existence of exceptional adverse situations.

Apparently no significant change → But to consider: the proposed introduction of an IRRD.
Article 141 Supervisory powers in deteriorating financial conditions changed by means of IRRD
Far-reaching extension of supervisory powers: pre-emptive recovery plans, resolution regime, etc.

Transitional measures – Article 308c, 308d

Approval to use the transitional measures only for undertakings

- falling for the first time in the scope of the Directive
- having accepted a portfolio transferred by an undertaking that applied these measures prior to the transfer

Disclosure

Within the part of the SFCR consisting of information addressed to other market participants referred to in Article 51(1b), publicly disclose all of the following:

(i) the fact that they apply the transitional measure;

(ii) the quantification of the impact of not applying the transitional on their financial position;

(iii) where the undertaking would comply with the SCR without application of this transitional measure, the reasons for the application of this measure;

(iv) an assessment of the dependency of the undertaking on this transitional measure and, where applicable, a description of the measures taken or planned by the undertaking to reduce or remove the dependency.

Correlation matrices

Correlation matrices play a significant role in the standard formula:

EIOPA advises to keep the two stage correlation structure in the standard formula unchanged:

- Correlation matrices within submodules
- Correlation matrix for the main risk modules

→ No direct correlation between market risk and life lapse risk introduced

<u>Within market risk module:</u>

Reduction of the correlation parameter for the spread risk and the interest rat risk (only downward scenario) from 0.5 to 0.25.

Risk margin: Modification of formula proposed

<u>EIOPA's proposed adaptation of the formula:</u>

The weight of future SCR is attenuated by application of a factor λ;

CoC-rate remains unchanged

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

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

This factor λ reduces the risk margin considerably.
The floor of 0.5 is reached for durations longer than 27 years.
Size of the factor λ justified by an analysis of the duration of the SCR(t)

The calculation of the Risk margin is not fixed in the Directive!

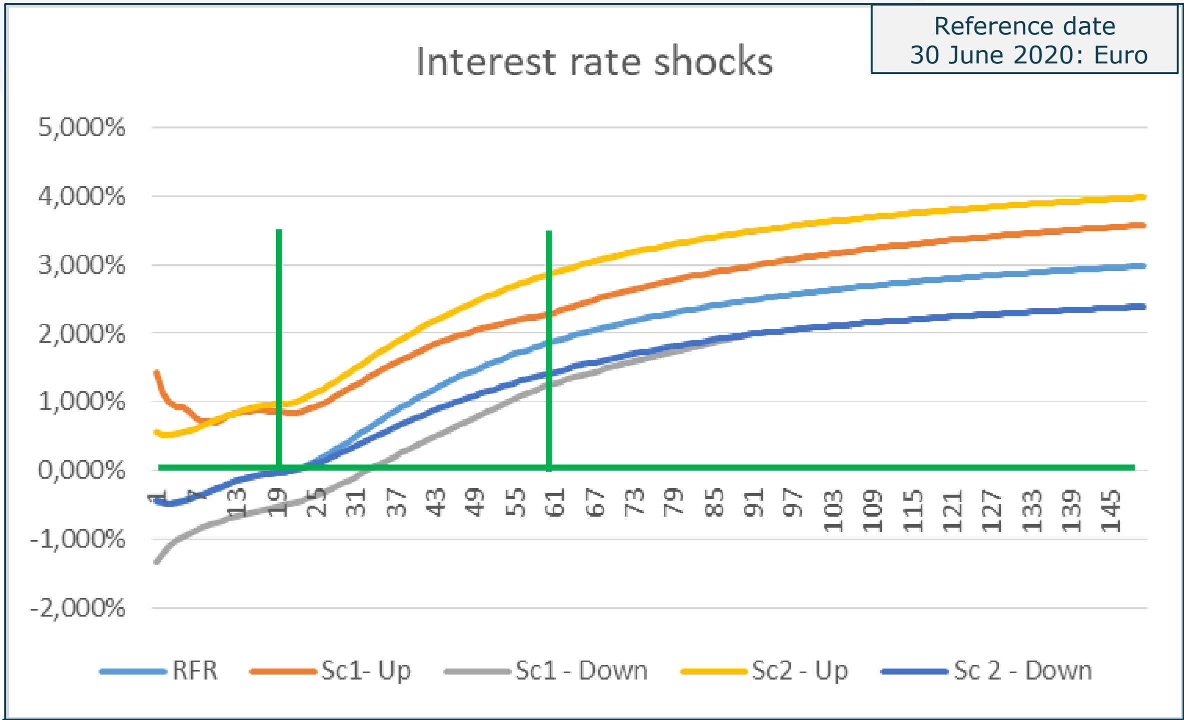
<u>**Commission**</u> <u>considers</u> to build on the λ-approach in upcoming delegated regulation, but

- Remove the floor of 0.5 (justification missed), and
- In addition, reduce the CoC to 5%.

→ Change is expected to contribute to the calculated capital relief (50 bln Euro)

https://ec.europa.eu/info/publications/210922-solvency-2-communication_en

Interest rate risk: EIOPA's advice



Proposed stress (basically the shift-approach had been proposed by actuaries during SCR -Review):

Proportional Stress
+
Additive component, linearly decreasing after FSP to 0 after 60 years.

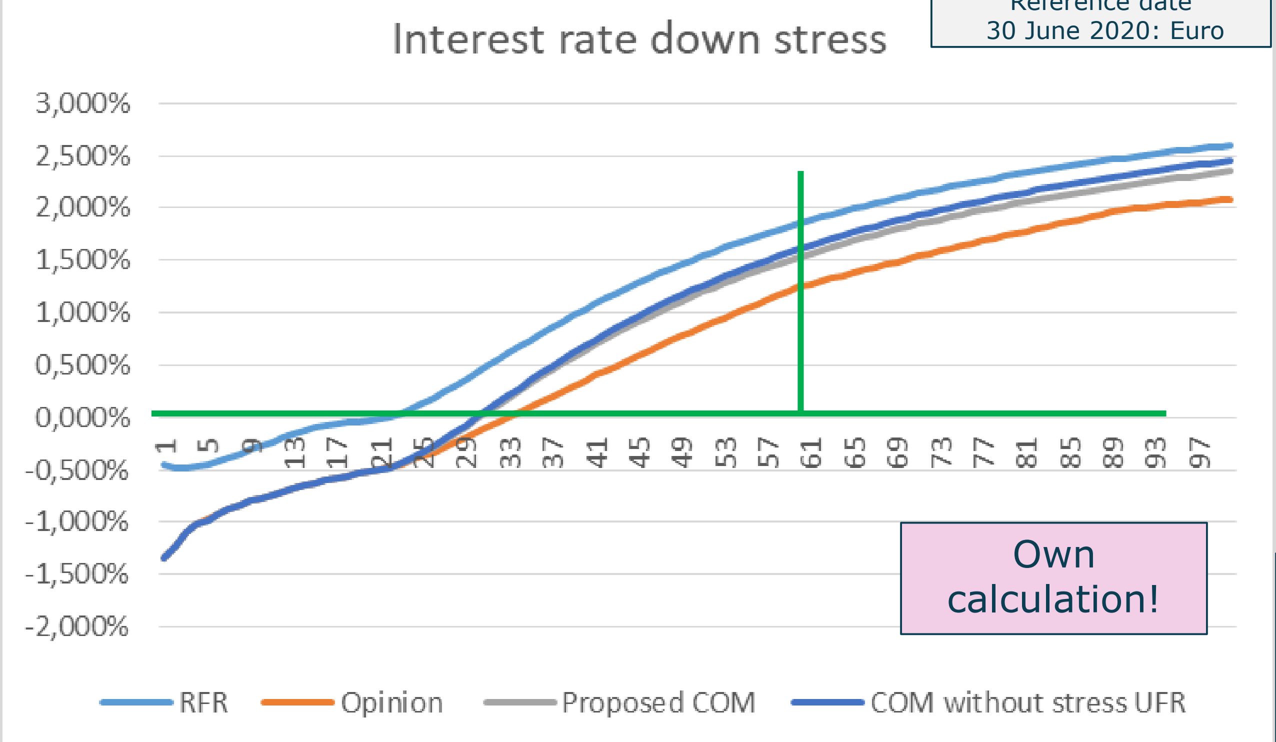
Lower bound of
-1.25%
for stressed interest rates

First extrapolate, than stress (not supported by AAE)

Gradual implementation for downward stress recommended: not lasting more than 5 years
Sc1: proposed stress, Sc2: current stress

Interest rate risk – COM’s “considerations”

Reference date
30 June 2020: Euro



Own calculation!

UFR-Stress: a reduction of the UFR by 15 bps considered

https://ec.europa.eu/info/publications/210922-solvency-2-communication_en

Commission considers to build on EIOPA’s advice.

But:

Stress only applies up to starting point of extrapolation.

Phasing-in over 5 years.

In line with change proposed by AAE:

“first stress – than extrapolate”

Commission's proposal – impact assessment

Two holistic impact assessments performed by EIOPA:
- Holistic impact assessment – HIA: reference date 31 December 2019
- Complementary Information Request – CIR: reference date 30 June 2020

Capital markets affected by Covid 19-pandemic in 2020.

Alternative extrapolation caused the highest impact on capital surplus. (Reduced mitigation of capital market turmoil)

Approximate impact on capital surplus		
Changes to	HIA	CIR
Volatility adjustment	+16 bn	+13 bn
Risk margin	+16 bn	+18 bn
Extrapolation	-34 bn	-61 bn
Correlations	+ 5 bn	+5 bn
Interest rate risk	-21 bn	-20 bn

The proposed transition period until 2032 helps short-term but does not remedy the weakness of the method.

Significant differences from HIA to CIR

Changes during first half year 2020:
- Significantly lower interest rates
- UFR reduced 3.90% to 3.75%

Alternative Extrapolation amplifies the effects.
Reduction of LLFR higher than reduction of RFR at FSP.
Indicating distortions in long-term swap market (post FSP).

	Solvency ratio							
	all		life		life and composite		non-life & reinsurer	
	HIA	CIR	HIA	CIR	HIA	CIR	HIA	CIR
Baseline	247%	226%	260%	228%	252%	223%	240%	229%
Scenario 1	234%	204%	229%	186%	228%	188%	242%	231%
Scenario 2	248%	216%	255%	204%	252%	206%	243%	231%
Scenario 2-Baseline	1%	-10%	-5%	-24%	0%	-17%	3%	2%
Scenario 1-Baseline	**-13%**	**-22%**	**-31%**	**-42%**	**-24%**	**-35%**	**2%**	**2%**

Source: **BACKGROUND DOCUMENT ON THE OPINION ON THE 2020 REVIEW OF SOLVENCY II** IMPACT ASSESSMENT

Commission's impact assessment

	Reference date end of 2019		Reference date mid-2020	
	Change in solvency ratio compared to under current rules	Change in excess own funds compared to current rules	Change in solvency ratio compared to under current rules	Change in excess own funds compared to current rules
Combined effect on quantitative rules of all recommendations by **EIOPA**	-13 percentage points (from 247% to 234%)	- EUR 15 billion(sample) -EUR 18 billion (whole market)	-22 percentage points (from 226% to 204%)	- EUR 40 billion(sample) -EUR 55 billion (whole market)
Combined effect on quantitative rules of all preferred options	-2 percentage points (from 247% to 245%)	**+EUR 16 billion(sample) +EUR 30 billion (whole market)**	-3 percentage points (from 226% to 223%)	**+EUR 8 billion(sample) +EUR 16 billion (whole market)**

Source: p.78. Commission staff working document impact assessment report, SWD(2021) 260 final PART 1/4

Expected result:

– Increase of up to **30 billion Euro** in capital surplus (depending on market conditions).
– Gradual implementation of changes over several years would also gradually affect solvency ratios of insurers.
– In the short term up to 90 billion Euro of capital could be released (and could be used to support the economic recovery).

points to figures from EIOPA's impact assessments

Commission‘s impact assessment

Following reasoning can be found in **footnote:**
- Negative impact *is <u>more significant for contracts with higher interest rates.</u>*
- *Such contracts are usually older – extinction over time will reduce long-term impact of changes on interest rates. This is not considered in the table.*

<u>Therefore:</u> The *overall impact is expected to be even more positive than what the table suggests.*

<u>Criticism</u>
- Impact assessment is based on EIOPA’s impact assessment.
- Only global message concerning overall effects on insurer’s own funds provided
- <u>Question:</u> How can impact be assessed with important parameters not specified?
- Granularity not sufficient: Exposure of countries or lines of business to the proposed changes differ
  - Highest capital relief resulting from risk margin → beneficial for all undertakings.
  - Increased capital need resulting from extrapolation → long-term business affected.

→ **robust and comprehensive impact assessment necessary!**

Parallel transitional periods possible

<u>Administrative and actuarial challenge</u>

Undertakings may have to cope with up tp three transition or phasing-in processes simultaneously:

1) Transitional measure on the technical provision or on the RFR
2) Transition process resulting from extrapolation

   Both until 2032

3) Phasing-in connection with the interest rate down stress

   for 5 years

Calculation and disclosure requirements can hardly be managed.

Agenda

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2) Proposed amendments: Pillar 1

3) Proposed amendments – Others

Risk management, ORSA

Several amendments to consider risk resulting from the use of the VA

Art. 44 (Risk management)

- Users of the VA: **Liquidity plans** shall take into account the use of the VA and assess whether liquidity constraints may arise which are not consistent with the use of the VA.
- The written policy on risk management shall take account of the VA;

As regards ALM, undertakings shall regularly assess

- the sensitivity of their technical provisions and eligible own funds to changes in the economic conditions that would affect the risk corrected spread;

Art. 45 (ORSA): The assessment shall include the significance with which the risk profile of the undertaking deviates from the assumptions underlying the VA.

The ORSA shall be performed annually, and without any delay following any significant change in their risk profile.(Proportionality: every two years)

Undertakings exempted from the annual ORSA shall nevertheless identify, measure, monitor, manage and report risks on a continuous basis

Risk management, ORSA

Macroprudential risks

Undertakings are required to consider and analyse

- the **macroeconomic situation**, and possible macroeconomic and financial markets' developments, and (upon request of supervisor) macroprudential concerns, that may affect
  - the specific risk profile,
  - the approved risk tolerance limits,
  - the business strategy,
  - the underwriting activities or
  - the investment decisions, and
  - the overall solvency needs
- **the activities** of the undertaking that may affect the macroeconomic and financial markets' developments, and have the potential to turn into sources of systemic risk

- The ORSA shall include the overall capacity of the undertaking to settle its financial obligations towards policyholders and other counterparties when those obligations fall due, even under stressed conditions.

Climate change, ORSA – New Article 45a

Climate change scenario analysis in the ORSA

1. the undertaking shall assess whether it has **any material exposure to climate change risks and** demonstrate the materiality to climate change risks in the ORSA.

2. where the undertaking has material exposure to climate change risks, it **shall specify at least two long-term climate change scenarios**, including the following:
   a) a long-term climate change scenario where the global temperature increase remains below two degrees Celsius;
   b) a long-term climate change scenario where the global temperature increase is equal to or higher than two degrees Celsius.

New structure of SFCR – Art. 51

The SFCR shall contain two separate parts.

The two parts shall be disclosed separately or jointly indicating clearly that the SFCR consists of both parts.

The first part shall consist of information addressed to policyholders and beneficiaries. It shall contain:

a) a description of the business and the performance; and
b) a brief description of the capital management and the risk profile.

The second part shall consist of information addressed to other market participants. It shall contain

a) a description of the system of governance;
b) a description, separately for assets, technical provisions, and other liabilities, of the bases and methods used for their valuation;
c) a description of the capital management and the risk profile, including at least …*list of details specified* → <u>more details depend on the final Level 1 document</u>

Audit requirements – Art. 51a

Article 51a **Audit requirements**

- For undertakings other than low-risk profile undertakings and captive insurance undertakings and captive reinsurance undertakings, **the balance sheet disclosed as part of the SFCR report or as part of the single SFCR shall be subject to an audit.**
- The audit shall be carried out by **a statutory auditor or an audit firm**
- **A separate report, including a description of the nature, and the results, of the audit, prepared by the statutory auditor or the audit firm shall be submitted together with the SFCR to the supervisory authority by undertakings.**

Long-term equity- Commission’s considerations

Revision of the current eligibility criteria for the long-term equity (LTE) asset class, introduced through Delegated Regulation (EU) 2019/931.

In particular: Simplifying the conditions under which equity investments, including via infrastructure funds, would be treated as “long-term”.

Assessment of amount of equity investments which could benefit from the preferential treatment as long-term based on a revised set of criteria:

> <u>Cautious scenario:</u> the reduction in capital requirements would reach approximately €10.5 billion for insurers using the standard formula. This money can be further invested in the economy.

Notwithstanding, the framework for LTE should remain prudentially robust. The review shall not harm policyholder protection and financial stability, in line with the new Action Plan for a CMU.

Source: https://ec.europa.eu/finance/docs/law/210922-communication-solvency-2_en.pdf

Sustainability risk – New Article 304a

Article 304a **Reviews as regards sustainability risk**

Contains two mandates to EIOPA concerning sustainability risks.

EIOPA is mandated

- to explore by 2023 a dedicated prudential treatment of exposures related to assets or activities associated substantially with environmental and/or social objectives (EIOPA shall submit a report on its findings to the Commission by **28 June 2023**) and
- to review regularly (at least every three years) the scope and the calibration of **parameters of the standard formula pertaining to natural catastrophe risk.**

The first review shall be completed three years after entering into force of the Directive.

Macroprudential tools – new Articles 144a, b, c

Article 144a **Liquidity risk management**

EIOPA shall develop draft **regulatory technical standards (RTS)** to further specify the content and the frequency of update of the liquidity risk management plan

Article 144b **Supervisory powers to remedy liquidity vulnerabilities in exceptional circumstances**

EIOPA shall, after consulting the ESRB, develop guidelines to:

a) provide further guidance on measures to address deficiencies in liquidity risk management and on the form, activation and calibration of powers that supervisory authorities may exercise to reinforce the liquidity position of undertakings when liquidity risks are identified and are not adequately remedied by these undertakings;

b) specify the existence of exceptional circumstances that may justify the temporary suspension of redemption rights;

c) specify the conditions for ensuring the consistent application of the temporary suspension of redemption rights across the Union and the aspects to consider for equally and adequately protecting policyholders in all home and host jurisdictions.

Article 144c **Supervisory measures to preserve the financial position of undertakings during exceptional market-wide shocks**

. EIOPA shall, after consulting the ESRB, develop **implementing technical standards (ITS)** to specify the existence of exceptional sector-wide shocks.

Proportionality and low risk profile undertakings

Proportionality is a high-ranked issue among the objectives of the SII-review. Extensively discussed in Commission’s proposal.

Proportionality: Higher thresholds could waive the mandatory application of SII for up to 186 insurers.

Proposed change (Article 1):

- Annual gross written premium not higher than **15 Mio. Euro** (old **5 Mio. Euro**)
- Technical provisions not higher than **50 Mio. Euro** (old **25 Mio. Euro**)

In addition: At least 249 insurers within the scope of SII would benefit from simpler and more proportionate rules (simplifications, reporting and disclosure).

New Articles 29a-29e: Category of **low risk profile undertakings (LRU)** introduced, amongst others with simplified rules for the valuation of financial options and guarantees (“prudent deterministic valuation” – based on a predefined set of scenarios) and reduced reporting requirements.

Guidelines concerning issues of SII-review

Interim activities of EIOPA (affecting Solvency II)**:**

1. **Consultation on Application guidance on running climate change materiality assessment and using climate change scenarios in the ORSA**
   EIOPA-BoS-21/567 Start date: 10 December 2021; End date: 10 February 2022

2. **Consultation on the revision of the Guidelines on valuation of technical provisions** EIOPA-BoS-21/302 Start date: 11 June 2021; End date: 12 November 2021
3. **Consultation paper on the revision of the Guidelines on Contract Boundaries** EIOPA-BoS-21/301 Start sate: 11 June 2021; End date: 12 November 2021

Next steps (for two 2. and 3.)**:**

EIOPA will consider the feedback received, publish a Final Report on the consultation and submit the Guidelines for adoption by its Board of Supervisors.

Applicable perhaps already in 2022

Solvency II

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