ACTUARIAL ASSOCIATION OF EUROPE

Solvency II

Insurance Committee

Bratislava

Siegbert Baldauf

20 April 2023

Agenda

1) Process

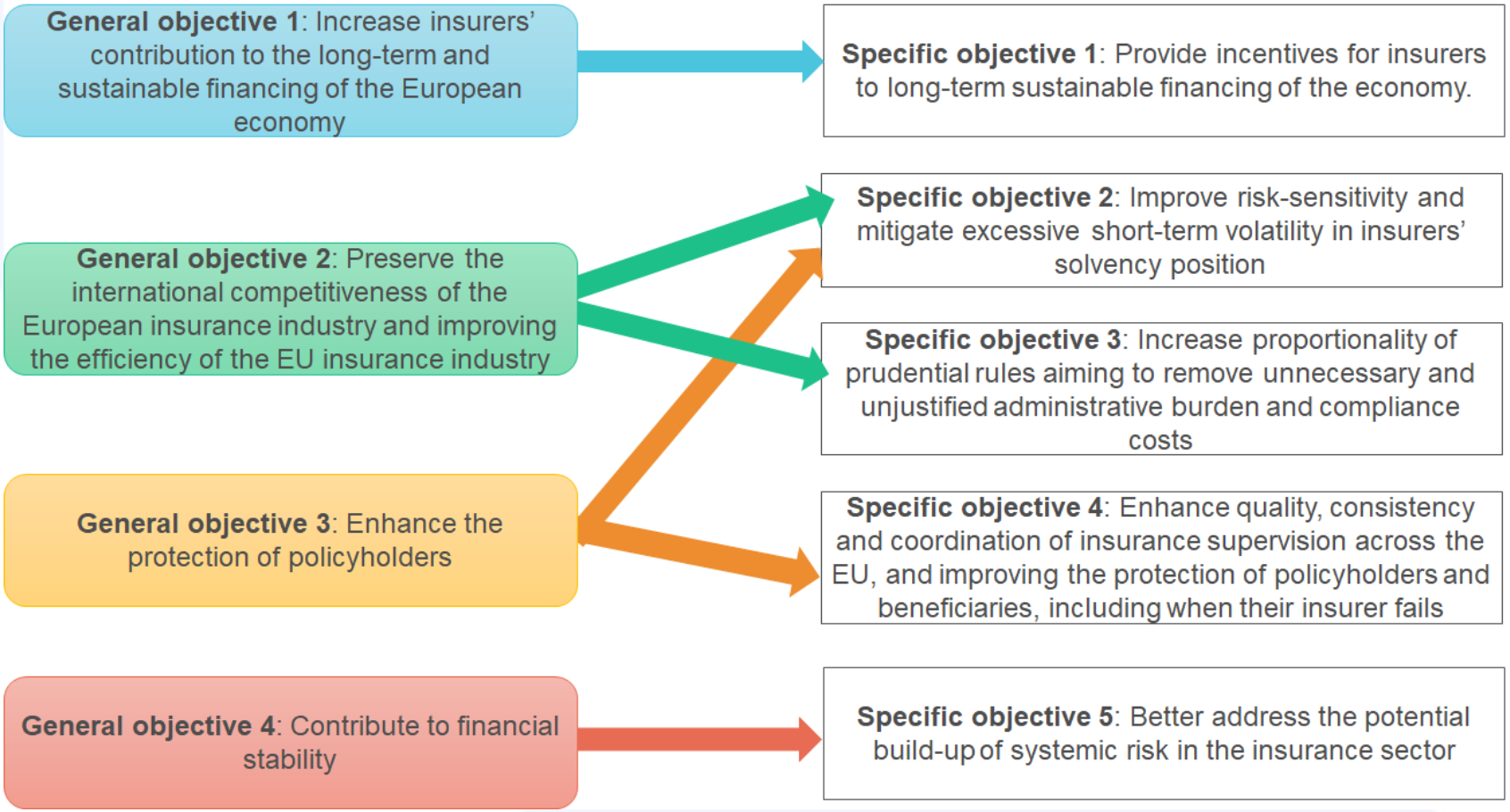
2) SII-Review: Impact of changed frame conditions?

3) IRRD: Short update

4) AAE position papers

Objectives of politics affect review

Figure 2: *links between general and specific objectives*



Source: Commission's impact assessment report Brussels, 22.9.2021 SWD(2021) 260 final

Solvency II review – the process

2019

- Commission's request for technical advice to EIOPA (11 February 2019)
- EIOPA was asked to provide advice by 30 June 2020

2020

- EIOPA: Opinion on the 2020 Solvency II review (17 December 2020) – considered results of previous consultation 2020
- Comprehensive background and impact analysis

2021

- Commission's proposal for amendments of SII Directive (17 September 2021)
- Proposal for an Insurance Recovery and Resolution Directive

Review: Preparation of trilogue parties

Commission (22 September 2021)

a) Proposals amending the Solvency II-Directive

b) Proposal to establish a new framework (Directive) for the recovery and resolution of insurance undertakings

EU-Council: Proposal for amendments to the SII-Directive (Compromise paper) 2 June 2022

Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL 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

Only minor changes of Commission's proposals

Parliament (ECON Committee): Draft report of the rapporteur with proposed amendments to

a) Commission's proposal to amend the SII Directive

August 2022: 805 amendments

b) Commission's proposal to establish a new Insurance recovery and resolution directive

August 2022: 195 amendments

Next procedural steps

Trilogue parties

Adaptations of a Directive have to be approved by the trilogue parties.

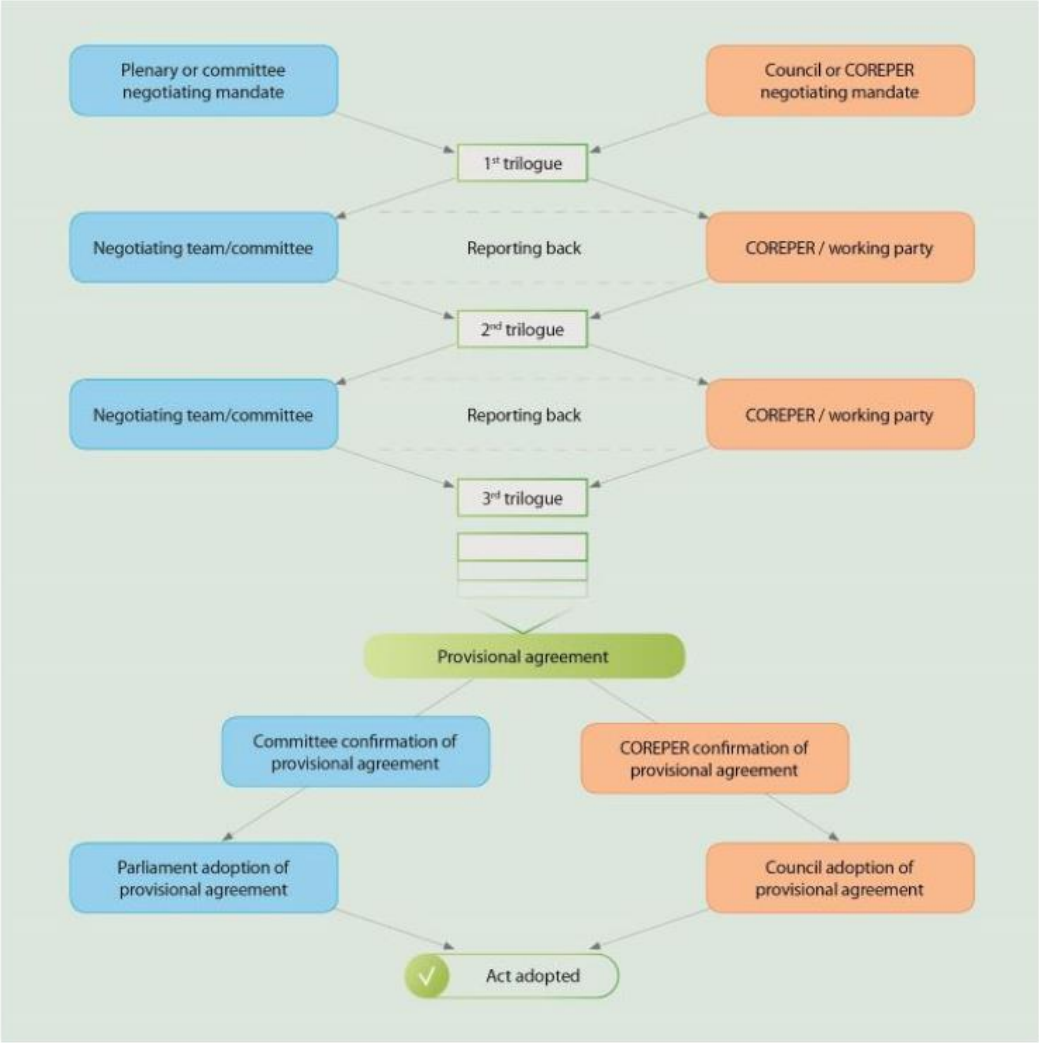
Transposition in national law in all countries within 18 months after approval.

European Commission: Proposal published December 2021
European Council: General compromise paper published June 2022
European Parliament: Approval of a compromise paper still missing

Entering into force of amended Directive in **2025(?) at the earliest**!

Directive and its Delegated Regulation are closely linked. Amendments of both are necessary to reach the objectives of the review.
ITS and RTS or Guidelines are subordinated. Adaptations might be needed as well.

Steps in the negotiation process



Trilogue negotiations involve, **on the Parliament side**, a negotiating team consisting of the Chair or a Vice-Chair of the responsible committee, the rapporteur and at least the shadow rapporteurs from each political group that wishes to participate and, **on the Council side**, representatives of the Presidency of the Council of Ministers.

The **Commission** is equally present and acts as mediator.

This process can last for several months, with up to three months between the three trilogues. It depends on the number of trilogues needed.

https://www.europarl.europa.eu/olp/en/interinstitutional-negotiations

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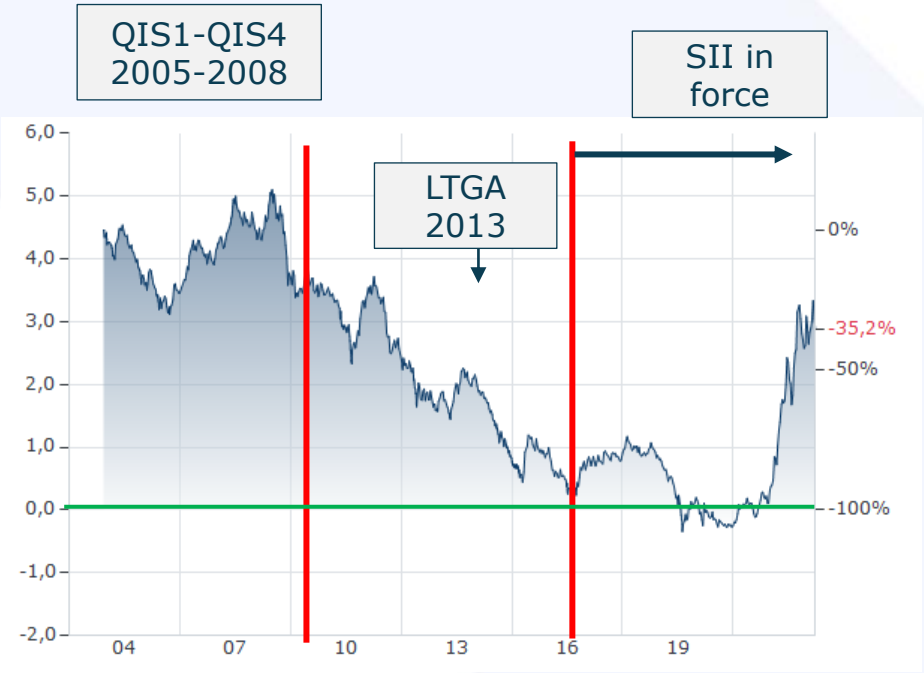
Repercussion of changed interest environment?

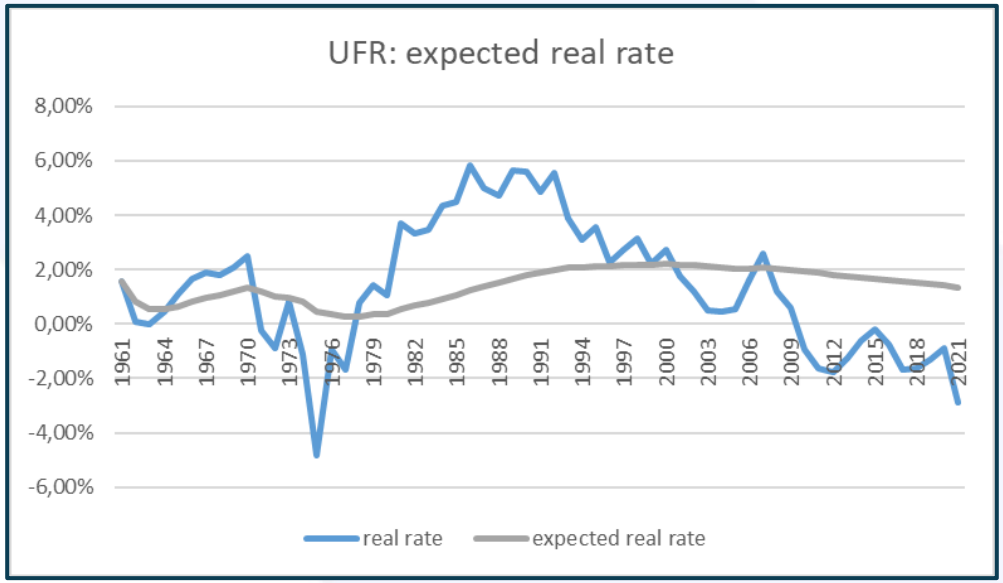


29 March 2023:
10 year CMS Swap rate

https://www.finanzen.net/zinsen/cms-swap-satz-eur

Review-phase dominated by low interest rates.
How to assess recent increase?

Significant changes since entering into force



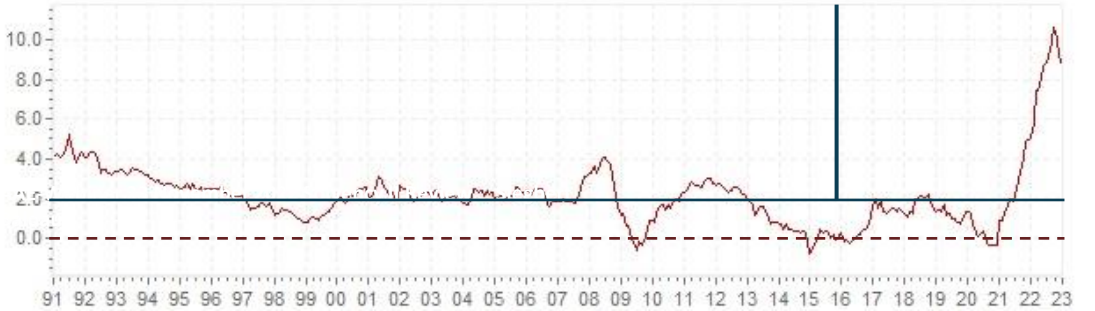
Year	UFR
2015	4.20%
2016	4.20%
2017	4.20%
2018	4.05%
2019	3.90%
2020	3.75%
2021	3.60%
2022	3.45%
2023	3.45%
2024	*3.30%*

2018: Change of methodology to determine expected real rate introduced.

UFR still calculated as expected inflation plus expected real rate.

Expected inflation rate: ECB's target rate 2% unchanged

Harmonised index of consumer prices (HICP)



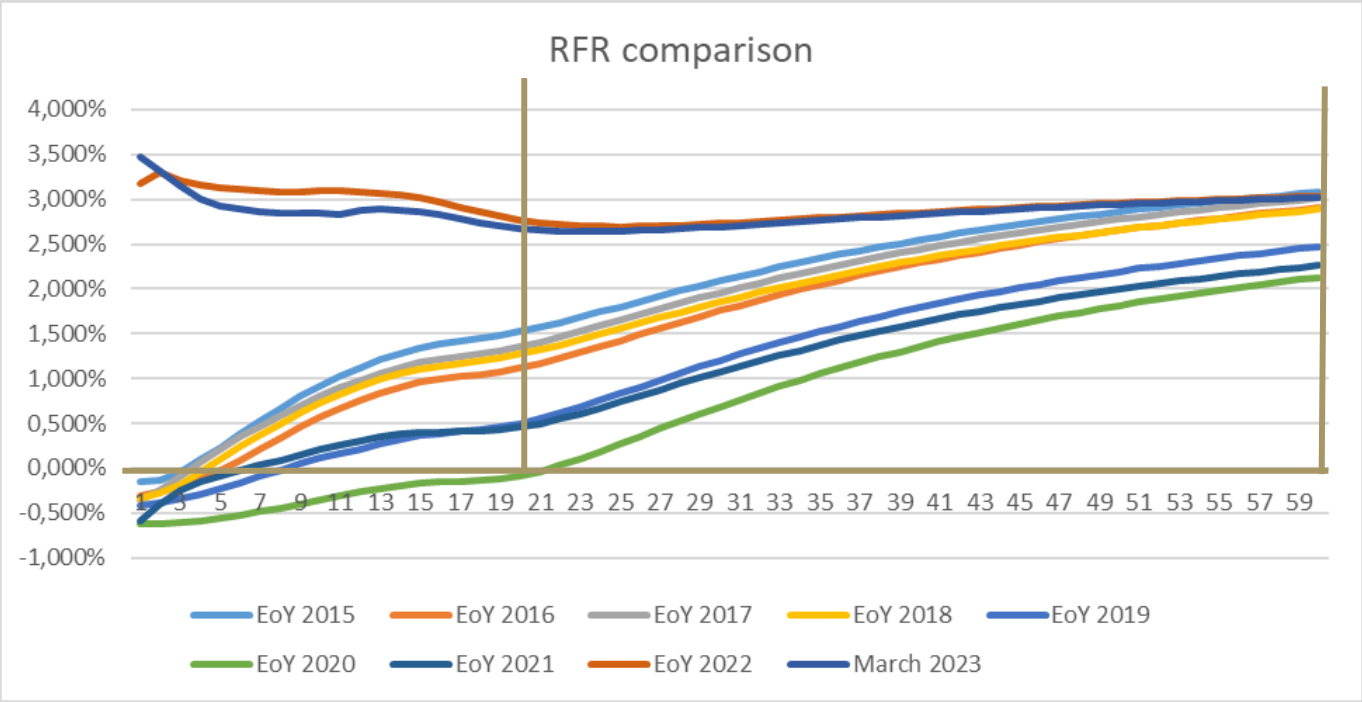
Sharp increase of inflation in Europe

Historic harmonised inflation Europe – HICP inflation

https://www.inflation.eu/en/inflation-rates/europe/historic-inflation/hicp-inflation-europe.aspx

Interest level impacts on RFR and SCR

End of low interest rate environment? Impact on current review process?	Ultimate forward rate



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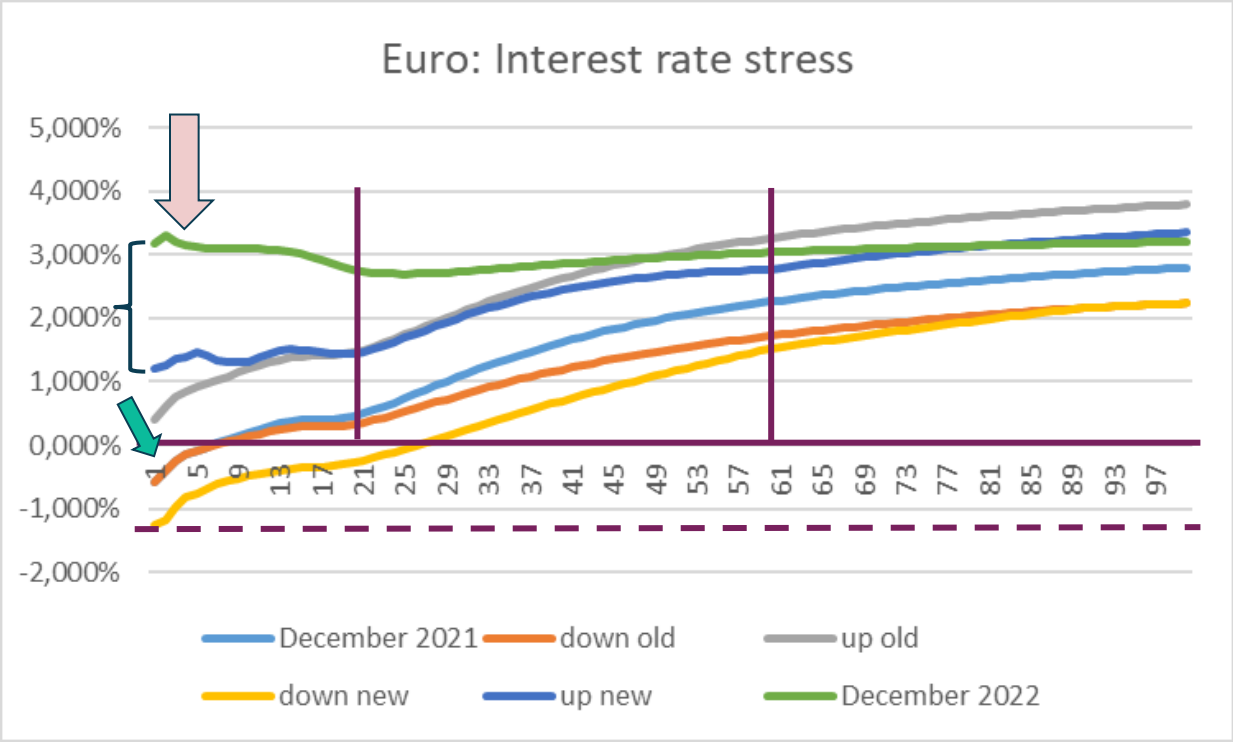
Recalibration of interest rate risk

Risk parameters are laid down in Delegated Regulation (Articles 166, 167).



Commission "considers" to build on EIOPA's advice, the shifted approach

But: First stress – then extrapolate!

Floor: **-1.25%;**

Phasing-in over 5 years.

UFR-Stress: Reduction 15 bps considered

Unchanged:

Risk of increase in RFR

Still appropriate?

How Solvency II develops in the meantime

Amended Directive will not be available before end of 2023

Transposition to national law will take another 18 month.

Implications for undertakings

Some risks are not or not appropriately considered in the current SII-framework

Nevertheless :

- Relevant risks even if not or not adequately addressed in the framework require immediate consideration in undertakings' risk assessment. (Pillar 2: especially in the ORSA)

Among these:

- calibration of interest rate risk sub-module,
- risk resulting from climate change,
- liquidity risk ...

In addition: Risks impairing statutory accounting.

Development of Solvency II in the meantime

EIOPA's activities:

EIOPA issued discussion paper or guidance notes concerning on some risks,e.g.

- Application guidance on climate change materiality assessments and climate change scenarios in ORSA (EIOPA-BoS-22/329 2 August 2022)
- Application guidance on running climate change materiality assessment and using climate change scenarios in the ORSA (EIOPA-BoS-22/329 2 August 2022)
- Discussion paper on Prudential Treatment of Sustainability Risk (EIOPA-BoS-22-527 29 November 2022).
- Discussion paper on methodological principles of insurance stress testing-cyber component (EIOPA-BoS-22/514 24 November 2022)
- EIOPA Staff paper on nature-related risks and impacts for insurance (EIOPA-23/247 29 March 2023)

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IRRD proposals

Recovery

Undertakings shall prepare and regularly update pre-emptive recovery plans (assessed by supervisory authority):

- Minimum market coverage: **80%**
- LRUs excluded
- Consideration of proportionality aspects
- Assessment against a set of scenarios
- Approval of the plan by AMSB

Plans should contain a framework of qualitative and quantitative indicators that identify the points at which remedial actions should be considered. Guidelines and RTS requested for further specification.

Resolution

Resolution authorities with harmonized set of powers to undertake all relevant preparatory and resolution actions.

Resolution authority shall prepare resolution plans setting out resolution actions:

- Minimum market coverage: **70%**
- LRUs excluded
- proportionality criteria, including the expected impact of their failure
- Specification of options for resolution should consider resolution scenarios
- Annual review

Guidelines and RTS requested for further specification.

Plans should not rely on extraordinary public financial assistance or expose taxpayers to the risk of loss.

Resolution: objectives and tools

Objectives of resolution (IRRD, Article 18)

(a) protecting policyholders, beneficiaries and claimants;

(b) maintaining financial stability, in particular, by preventing contagion and by maintaining market discipline;

(c) ensuring the continuity of critical functions;

(d) protecting public funds by minimising reliance on extraordinary public financial support.

The way to resolution: Supervisor's assessment will start the process if

1) an undertaking is assessed as likely to fail or in case of a failure
2) No reasonable prospect of recovery is identified

Resolution authority involved:

To decide: Liquidation of the undertaking or go into resolution

(To respect: "no creditor worse of off than under normal insolvency proceedings" principle)

Open question: resolution funding

IRRD: Resolution tools

Bail-in	• Write-down of liabilities or conversion to shares – policyholders cannot receive shares
Solvent run-off	• Withdrawal of authorisation and run-off
Sale of all or part of the business	• To third party / parties
Bridge undertaking	• Public controlled entity where assets and liability are temporarily managed
Asset and liability separation	• Impaired or problem assets and/or liabilities can be transferred to a management vehicle
Additional national tools and powers	• If consistent with framework

Member States: Ensure that resolution authorities have necessary powers to apply these tools.

Cross-border business: Resolution colleges required, EIOPA shall be invited to attend

Source: EIOPA's staff paper IRRD

IRRD: EIOPA's view

Basically, EIOPA supports the draft Directive proposed by the Commission.

Staff paper: *Overview of the proposal for an insurance recovery and resolution directive*, EIOPA-22/636, 6. July 2022

Follow-up document: *Staff paper on frequently asked questions about IRRD (10 November 2022),* Criticism: IRRD too close to banking regulation in the BRRD.

Further document: *Staff paper on comparing recovery and resolution frameworks in banking and insurance 10 Nov 2022*

Not in the IRRD – but requested by EIOPA and proposed in several amendments to the IRRD → Consideration of insurance guarantee schemes (IGS) – new Article 82 a proposed.

Existence of IGS for eligible policyholders or beneficials can affect the chosen resolution tool.

From a perspective of consumer protection, EIOPA deeply regrets that the minimum harmonisation of the Insurance Guarantee Schemes at EU level has not been considered.
Source: EIOPA's comment on Solvency II proposals from the European Commission Date: 01 Oct 2021

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AAE's position

The AAE had published a paper concerning the proposed amendments of the SII-framework:

Solvency II: Solvency II-review: main positions of the AAE

https://actuary.eu/wp-content/uploads/2023/02/20230208-AAE-position-on-SII_Review_FINAL.pdf

The focus is still on:

- Extrapolation
- Volatility adjustment
- Risk margin
- Long-term equity investment
- Sustainability, climate change

The progress will be monitored continuously. The position papers will be adapted to possible new aspects.

AAE's position

AAE published a position paper on insurance recovery and resolution

https://actuary.eu/wp-content/uploads/2023/02/20230208-position-IRRD-FINAL.pdf

Recovery: a risk management and not a legal process

- SII regime contains already powerful tools to monitor the risk position (ORSA) and to inform shareholder and supervisors about possible risks
- IRRD should not compete with Solvency II
- Formal requirement to provide recovery plans might be excluded

Resolution: harmonisation could be beneficial for policyholders

- Not agreed: Resolution Authorities should provide resolution plans based on a coverage percentage of the market. It should be based on risk factors (of failure, or the impact of failure)
- Some parts too close to BRRD
- Financial stability considerations should not override policyholder protection considerations
- Costs of resolution authority should be kept low
- IGS not included; funding of resolution process unclear

actuarial association of europe

Solvency II

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