



AAE

ACTUARIAL
ASSOCIATION
OF EUROPE

SII-review: Practical questions for EU Actuaries

Webinar

Daphné de Leval

6 December 2024



Agenda

- 1) Pillar 1 calculations
- 2) Sustainability
- 3) Auditing SII EBS



Pillar 1 calculations (1/2)

Topic	Objective	Solution	Analyses
Extrapolation	Do not underestimate technical provisions by considering market data above 20 years	Alternative extrapolation method where, as from 20 years (FSP), forward rates are a weighted average between the LT forward rate (UFR) and forward rates derived from LT swaps (LLFR)	<ul style="list-style-type: none">Increased sensitivity to financial market conditionsRisk of excessive use of derivativesInsurance industry tends to support a higher convergence rate to UFRTo be defined: LLFR, transition mechanism
Volatility Adjustment	Reduce the overshooting effect of the VA	Revised formula: asset-liability duration gap (CSSR), increased General Application Ratio (GAR from 65% to 85%) and revised Risk Correction (RC). Introduction of an optional ratio for basis risk	<ul style="list-style-type: none">Better representation of the asset-liability sensitivity to spreadImportance of Own VA (ORSA)To be defined: scaling factor and RC
SCR interest	Increase the shock on low interest rates, shock negative interest rates	Relative shifted method where rates are first shifted before being subject to a proportional shock before being shifted back	<ul style="list-style-type: none">Method focused on low interest rates without consideration for inflationTo be defined: floor, UFR shock and transition phase



Pillar 1 calculations (2/2)

Topic	Objective	Solution	Analyses
Symmetric Adjustment	Increase the corridor to improve countercyclicality	Corridor increased from +/-10% to +/-13%	<ul style="list-style-type: none">Basis risk with EU index to be considered (ORSA)
Long Term Equity	Relax conditions to support Capital Market Unions	Reduced shock of 22% under the following conditions <ul style="list-style-type: none">Subset of equity investments clearly identified and managed separately (OCDE)Global equity exposure for an average period of more than 5 years on average (policy, ORSA) also in case of stressed situation (liquidity test)Possibility to qualify funds as LTE	<ul style="list-style-type: none">Increased importance of liquidity risk managementTo be defined: liquidity test, analysis at fund level
Risk Margin	Reduce RM and sensitivity to interest rates	Revised formula: Coc reduced from 6% to 4.75%, introduction of a λ factor to project SCR	<ul style="list-style-type: none">CoC is actually undertaking specific (to note MOCE in ICS = 5%)To be defined: λ value and eventual floor (to note EIOPA: $\lambda = 0,975$ and floor = 0,5)

Agenda

- 1) Pillar 1 calculations
- 2) Sustainability
- 3) Auditing SII EBS



Sustainable Finance in SII

Authorities mandates

ESAs to develop guidelines on ESG stress test and how S&G risks could be included

EIOPA to

- review CAT NAT calibration in SF (at least every 5 years)
- report on whether Green/Brown Supporting Factor can be justified on a risk basis on assets and liabilities, incl. fossil-fuel related assets **(submitted on Nov 7th, 24)**
- assess and report extent to which biodiversity risks are to be considered in ORSA

Risk Management

- Climate ORSA climate change scenario analyses to be performed by insurers (except SNCU) for material exposures at least every 3 years (scenario $< 2^{\circ}\text{C}$ and considerably $> 2^{\circ}\text{C}$)
- Consider previous analysis in climate ORSA (climate change scenarios, tools performance and underlying principles)
- Prudent Person Principle includes explicit reference to LT impact of investment decisions on ESG factors

Sustainability risk plans

- Sustainability risk planning requirements introduced:: targets, process and actions shall be proportionate, quantifiable targets disclosed annually, no solo plan needed if captured at group level
- SNCUs are exempted

SFCR Disclosures

- SFCR disclosure requirement for climate change analysis
- Description of the implementation of the sustainability risk plan in the SFCR, incl. targets/milestones

Governance

- AMSB members should have good reputation
- Undertakings shall have an effective RMS considering ST/MT/LT ESG risks
- NSAs to ensure that ESG risks are considered over appropriate time horizons

To be defined at L2: sustainability risk plans with min standards for methodologies, elements of the plan, supervisory approaches, elements to be disclosed
CP issued on Dec 4th, 24



Sustainability risk plan – link with CSRD

Article 44 Para 2b)	Analyses
<p>Member States shall ensure that insurance and reinsurance undertakings develop and monitor the implementation of specific plans that include quantifiable targets and processes to monitor and address the financial risks arising in the short, medium, and long term from sustainability factors, including those arising from the process of adjustment and from transition trends in the context of the relevant Union and Member State regulatory objectives and legal acts in relation to sustainability factors, in particular those set out in Regulation (EU) 2021/1119 of the European Parliament and of the Council (EU Climate Law)</p>	<ul style="list-style-type: none">- Insurers will be required to elaborate plans to address financial risks from ESG factors (with a focus on the transition), set-up [risk] targets and processes- Is it correct that these risk plans/targets should not be confused with « net-zero transition plans » as required by CSRD but should be consistent?- In practice it is still unclear how these two plans (i.e. prudential and non-prudential) will co-exist and be integrated in financial institutions existing processes (efficiently and avoiding overlaps)

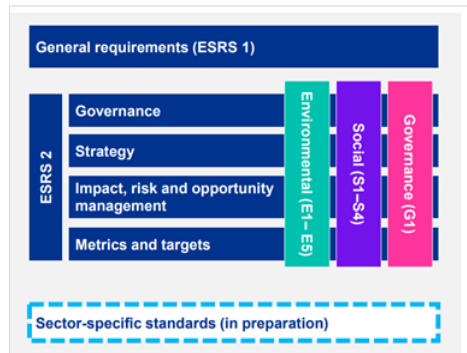


CSRD at a glance



STANDARDS

- EFRAG issued new final draft reporting standards for CSRD called **ESRS**¹.



- It is composed of **ESRS 1 & 2** explaining generic DRs² and **10 topic-specific standards**



ASSURANCE

- Mandatory – limited level of assurance on sustainability reporting



SCOPE

New concepts to consider:

- Full ESG coverage
- Double materiality assessment
- Strategies, targets & transition plans with related progress
- Value chain to be considered
- Aligned with EU regulation & International standards



Eligibility and timeline

As of 2024: EU Entities already subject to NFRD and other listed entities with more than 500 employees (e.g. non-EU)

As of 2025: All large companies (listed or not) complying with at least 2 of the following criteria: > 250 employees and/or > €50M Turnover and/or > €25M Total Assets

As of 2026: Listed SME's³

As of 2028: Non-EU parent companies with a combined group turnover in the EU of more than EUR 150 million



REPORT

- Now fully part of the **Management Report** (with director liability implications)
- Submitted in **electronic format and digital tagging (ESEF/ESAP)**
- Consolidation and exemption regimes in place

¹ ESRS : EU sustainability reporting standards

² DRs: Disclosure Requirements

³ Micro-undertakings are companies that do not exceed two of the following three criteria (including subsidiaries): 10 employees, net turnover of EUR 700,000 or total assets of EUR 350,000



CSRD – ESRS1 General principles

01

Characteristics of information quality

- **Relevance** – influence on the assessments and decisions of users of sustainability reports under a double materiality approach
- **Faithful representation** – complete, neutral, and accurate in describing the reality they represent
- **Comparability** – consistent over time and, to the greatest extent possible, presented in a way that enables comparisons between undertakings (across sectors and within a specific sector).
- **Verifiability** – provable
- **Understandability** – clear and concise

02

Double materiality

An undertaking **must report** on those **issues** that are **considered material**, either from the perspective of Financial Materiality, or Impact Materiality, or from both perspectives:

- **Impact Materiality:** impact of the undertaking on key sustainability issues (*inside-out* perspective)
- **Financial Materiality:** impact of sustainability issues on the undertaking's performance and positioning (*outside-in* perspective)

03

Reporting boundaries and value chain

- The undertaking **reporting boundary** for its sustainability reporting is the one retained for its financial statements, expanded to its upstream and downstream value chain
- The undertaking reporting **boundary** can be extended if this provides a greater understanding of the impacts of the enterprise
- The level of detail in the disclosure should be based on **relevant facts and circumstances, consistent with the industry**

04

Time horizon

- Reporting period must be **consistent** with the one retained for its **financial statements**
- Link **retrospective and forward-looking information**
- Report progress against **base year**
- Companies should consider the following time intervals in reporting:
 - **short term** = one year
 - **medium term** = two to five years
 - **long term** = more than five years

05

Due diligence

Undertakings will need to **embed due diligence in their governance and organization**, engaging with relevant stakeholders, in order to identify and assess **adverse impacts** on the environment or people, and **take actions** to address those adverse impacts, tracking and communicating their **effectiveness**

Agenda

- 1) Pillar 1 calculations
- 2) Sustainability
- 3) Auditing SII EBS



Audit requirement – Economic Balance Sheet

Article 51 a)

1 - For insurance and reinsurance undertakings other than small and non-complex undertakings and captive insurance undertakings and captive reinsurance undertakings, **the balance sheet disclosed as part of the solvency and financial condition report** in accordance with Article 51(1) or the balance sheet disclosed as part of the single solvency and financial condition report in accordance with Article 256(2), point (b), **shall be subject to an audit.**

2 -By way of derogation from Article 29c, **Member States may extend** the requirement laid down in paragraph 1 of this Article to undertakings classified as **small and noncomplex undertakings**, captive insurance undertakings and captive reinsurance undertakings.

3. Member States may **extend the scope** of the audit requirement referred to in paragraph 1 to other elements of the solvency and financial condition report.

4. The audit shall be carried out by a **statutory auditor or an audit firm**, in accordance with the auditing standards applicable pursuant to Article 26 of Directive 2006/43/EC

Experience

- Better understand the products and best estimate assumptions
- Identify sources of profitability and risk
- Reconcile SII figures with local GAAP and eventually IFRS17
- Identify areas of divergence/perform benchmark
- Improve quality of processes and information following audit requirements
- Challenges in terms of deadlines in case of insufficient quality
- Foster interactions with Actuarial Function and Supervisor
- Allow supervisor to prioritise inspection



SII-review: Practical questions for EU Actuaries

Thank you!

Daphné de Leval

Mobile (+32) 478230231

Daphne.deleval@gmail.com