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Solvency II 2020 Review - Update

12th April 2021

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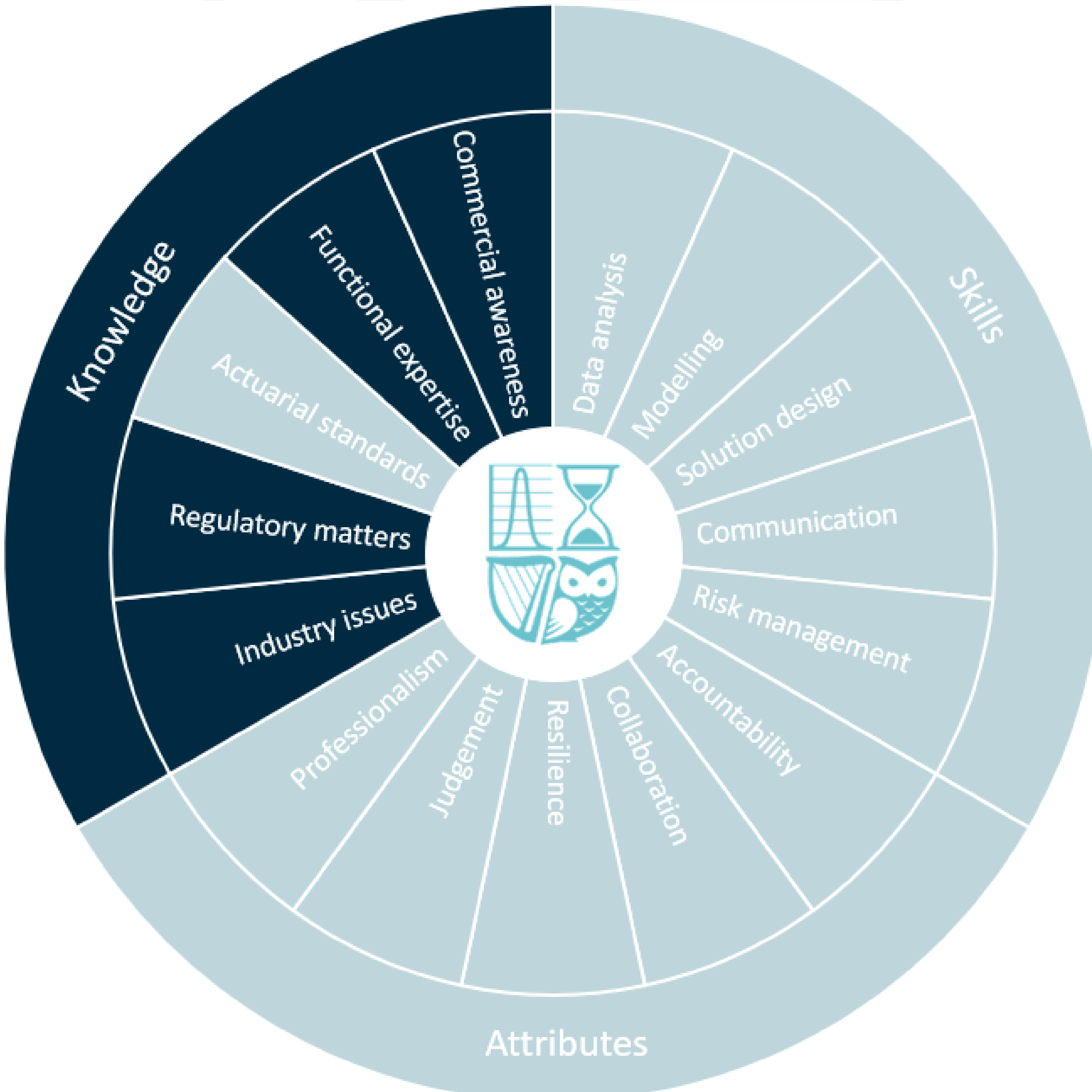
Competencies Covered



Questions

Please click on the ‘Raise Hand’ icon

to ask a question

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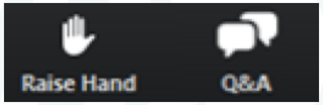
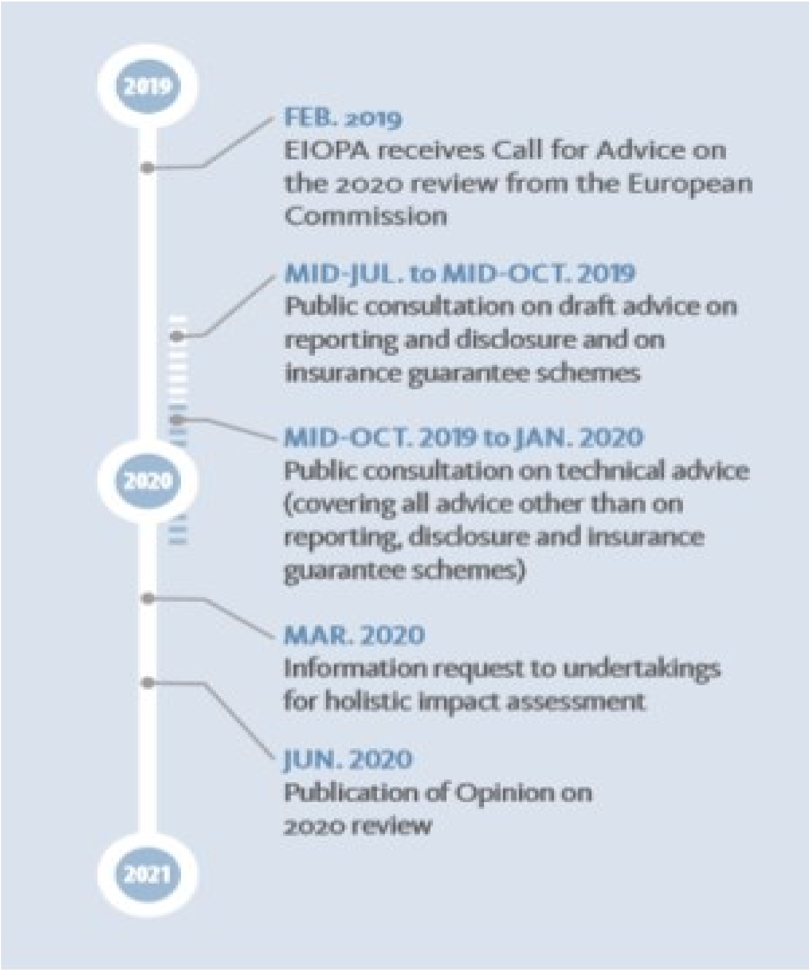
wait to be unmuted

or

Use the Q&A function





Source: EIOPA Fact sheet on the 2020 review of Solvency II

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Solvency II 2020

EIOPA's final opinion

Aisling Barrett

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TIMELINE

2019 **2020**

February
EIOPA receives a call for advice on the 2020 review from the European Commission

Mid-July to mid-October
Public consultation on draft advice on reporting & disclosure and on insurance guarantee schemes

Mid-October to January 2020
Public consultation on draft advice (on all advice other than on reporting & disclosure and insurance guarantee schemes)

March to June
Information request to undertakings for holistic impact assessment

July to September 2020
Complementary information request to take into account impact of Covid-19 pandemic

December
Final advice submitted to EC and published

Q3 2021
European Commission proposal on the review

In its opinion, EIOPA notes that the implementation date for any changes is likely to be closer to **2025** than 2020.

Source: https://www.eiopa.europa.eu/sites/default/files/solvency_ii/solvency2-factsheet.pdf

Key Changes

Balance Sheet (Pillar 1)

The proposals with the most material impact on the solvency ratio across European insurers in aggregate are:

1. Extrapolation (-)
2. Interest rate risk capital requirement (-)
3. Risk margin (+)
4. Volatility adjustment (+)
5. Correlations (+)

(based on the impact assessments carried out by EIOPA)

Other items of note

- Proportionality measures
- Pillar 2 items:
  - Macroprudential policy
  - Liquidity risk management plans
  - Systemic risk management plans
  - Recovery & resolution
- Pillar 3: Reporting & disclosure

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Pillar 1

Extrapolation

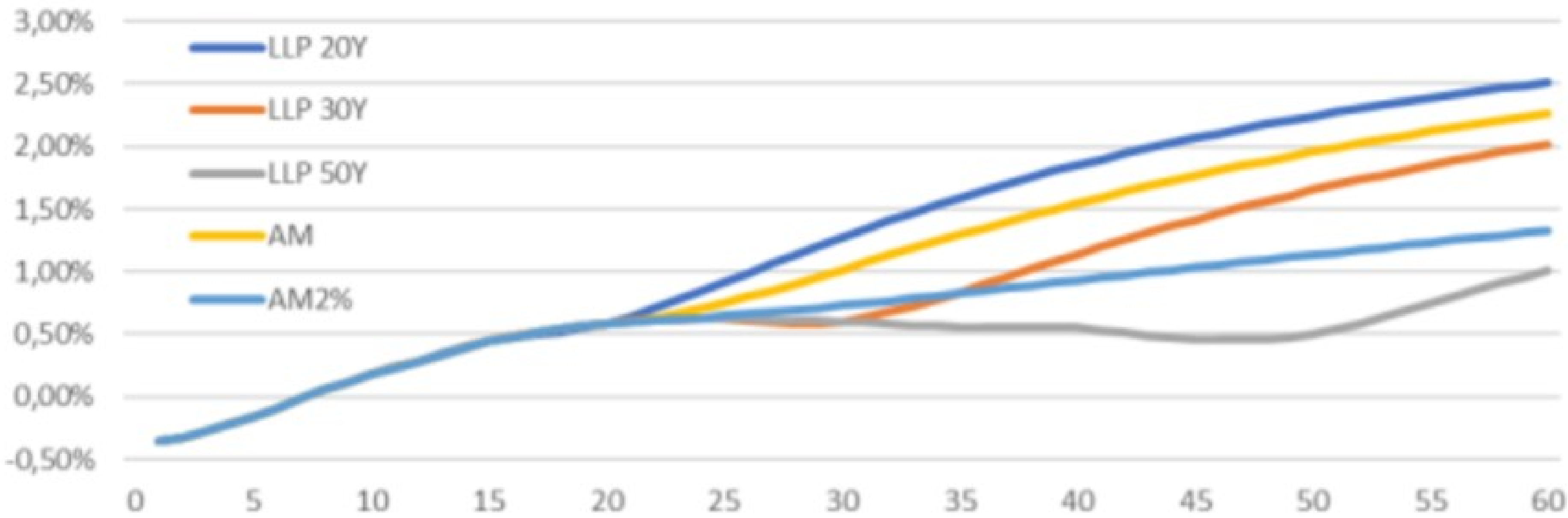
- EIOPA considered 5 options in the consultation for Euro:

1. No change
2. LLP stays at 20 years and safeguards introduced in Pillars 2 and 3
3. LLP increased to 30 years
4. LLP increased to 50 years
5. Alternative extrapolation method

- EIOPA is proposing option 5 which is seen as a compromise between including market info beyond LLP and limiting impact on valuation of long term liabilities

Extrapolation

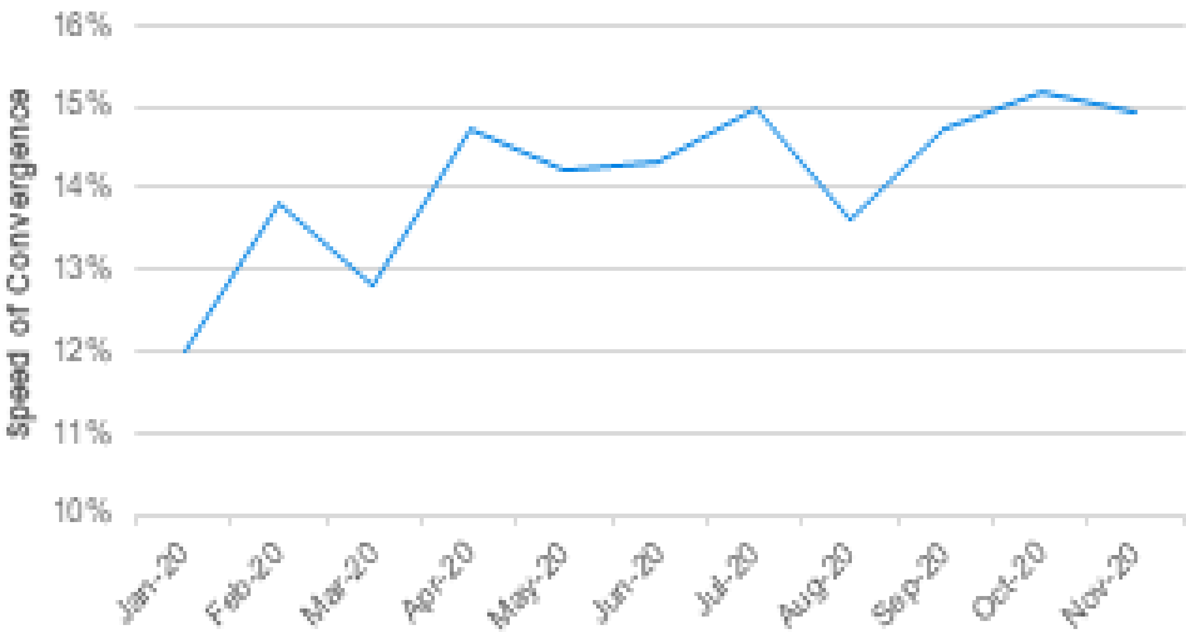
EIOPA options considered based on year-end 2019 data



- LLP 20Y (current) is top line with increase to 30 and 50 years also shown
- AM is alternative extrapolation methodology using the parameters proposed in the holistic impact assessment – UFR of 3.9% and alpha (speed of convergence) of 10%
- AM2% is alternative extrapolation methodology with alpha of 2%
- EIOPA is now proposing a phase-in period with alpha depended on the level of the interest rate at 20 years

Extrapolation

Alpha – speed of convergence parameter



- Chart shows speed of convergence parameter calculated at each month in 2020
- Parameter is intended to smooth the transition and dampen the hit on solvency ratios
- However also introduces complexity and volatility

Other Long-Term Guarantee (LTG) Measures

Matching Adjustment

- Removal of the limitation to **diversification benefits** in the standard formula SCR between matching adjustment portfolios and other portfolios.
- EIOPA is proposing additional requirements in relation to the eligibility of restructured assets in matching adjustment portfolios (introducing a **look through approach**)

Volatility Adjustment

- **Supervisory approval** required in all countries
- 65% increased to **85%**
- VA split into **permanent VA** and **macro-economic VA** (by country where products sold)
- **Application ratio** introduced to measure duration and volume **mismatch** between fixed income investments and insurance liabilities of the company
- **Another application ratio** introduced to take into account the **illiquidity** of the liabilities

Technical Provisions

Other Key Changes

Risk Margin

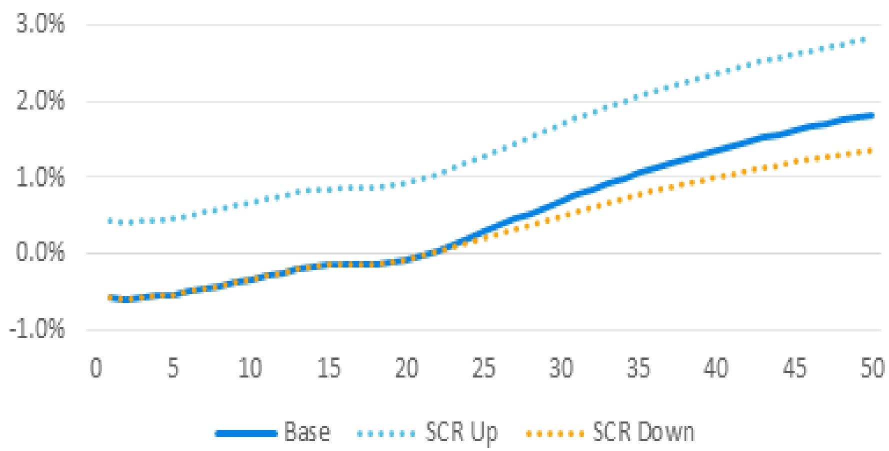
- EIOPA is proposing a reduction to the **risk margin** calculated by applying a factor to the SCR projection.

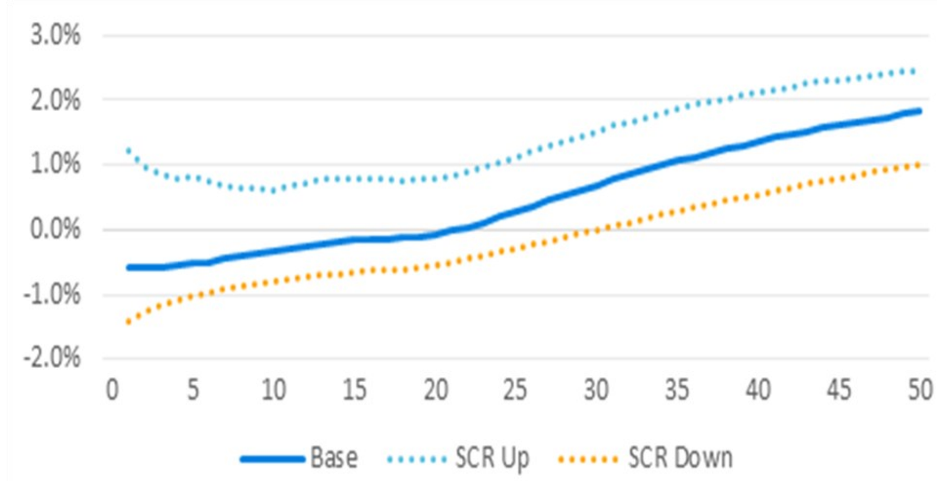
- The factor starts at 97.5% at year 1 and reduces to 50% by year 28.

Other

- **Expenses** in the BEL should take into account Board decisions made in relation to writing new business. EIOPA states that assuming that new business will come when this is not the real expectation leads to a non-realistic valuation of the best estimate
- **Contract boundaries**
- **EPIFP**

SCR - interest rate risk





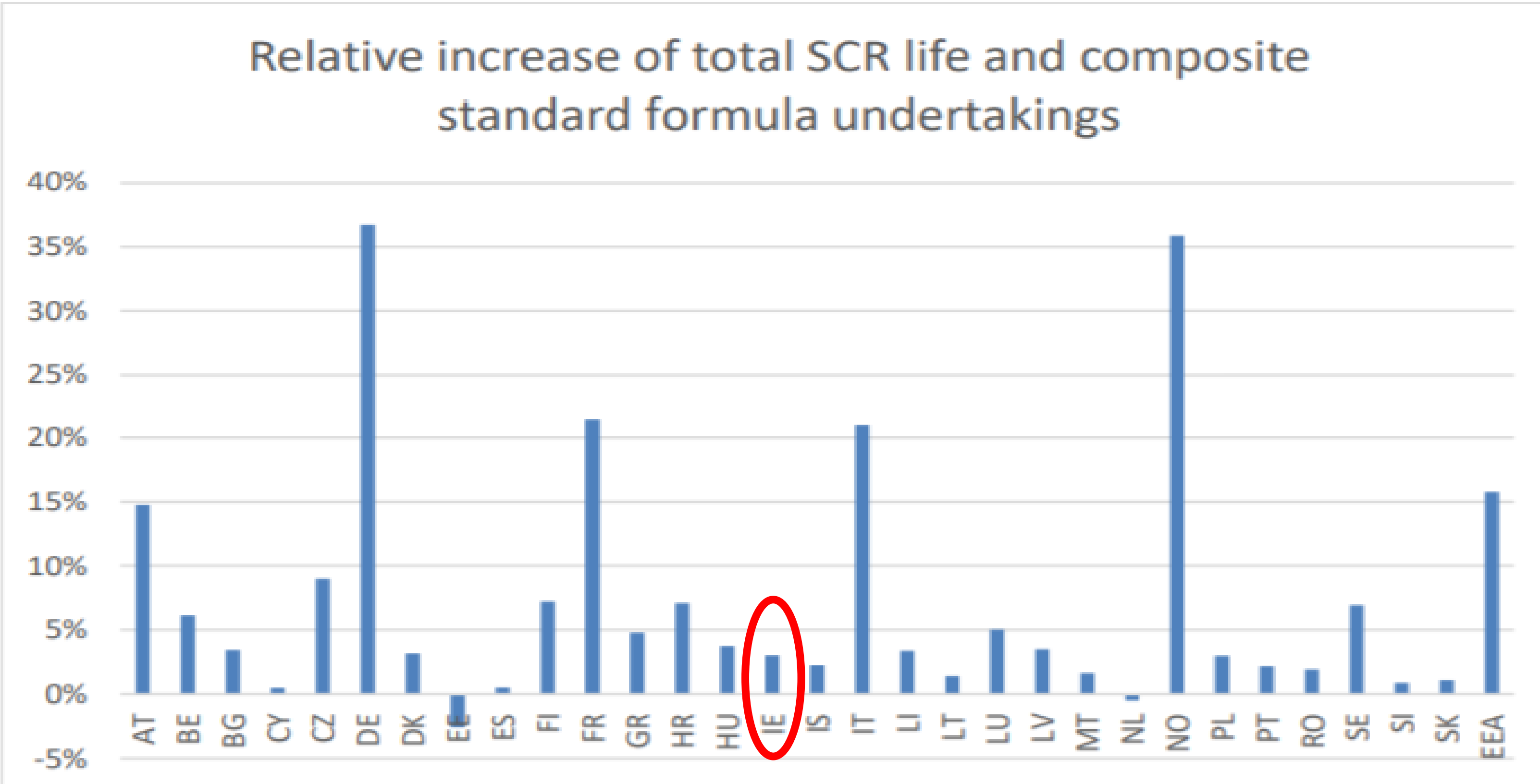
Interest rate risk standard formula SCR shocks under **current** approach at 30 September 2020

Interest rate risk standard formula SCR shocks under **proposed** approach at 30 September 2020

(consistent with that proposed in the consultation and with EIOPA's previous advice to the EC under the 2018 [interim review] that the EC chose not to implement at that time)

EIOPA is proposing that this change should be phased in over a period of 5 years

SCR interest rate risk - impact



- The increase of the overall SCR for life and composite undertakings in different markets is shown in the chart
- The **increase of the SCR** for all EEA **standard formula life and composite** undertakings is **17%**
- (The proposal has a negligible impact on non-life and reinsurance undertakings)

SCR – other changes

Correlations

- Correlation parameter between falling interest rates and spread risk reduced from 0.5 to 0.25.
- The impact assessment shows that the SCR reduces by 5% for EEA standard formula life undertakings as a result of this change.

Equity risk

- EIOPA is proposing widening the symmetric adjustment corridor for the equity risk capital charge from +/- 10% to +/- 17%

Counterparty default risk

- Simplified calculation of the risk-mitigating effect of derivatives, reinsurance, special purpose vehicles and insurance securitisations

Risk Mitigation Techniques

- Some amendments to the recognition of risk mitigation techniques

Proportionality

General

- Increase the **threshold** for exclusion:
  - Technical provisions of €25 million or less doubled to €50 million
  - Gross written premium of €5 million or less unchanged with member state option to increase up to €25 million
- Introduce concept of **low risk profile undertakings** that meet the following criteria:
  - No more than 5% of gross written premium outside **home country**
  - Accepted **reinsurance** no higher than 50% gross written premiums
  - Gross **TPs** no higher than €1 billion for life and €100 million for non-life
  - Gross SCR for interest rate risk / Gross TPs < 5% (life)
  - Investment returns > guaranteed rates (life) and combined ratio < 100% (non-life); Marine, Aviation and transport or Credit and Suretyship lines of business < 30% gross written premiums; Non traditional investments < 20% total investments
- A **notification** should be provided by undertakings to supervisors if they believe they comply with the low risk criteria including an early identification of any of the proportionality measures it intends to apply (except for Pillar 1)
- For undertakings that are not low risk but wish to avail of proportionality measures, an **approval process** applies.

Proportionality

Pillar 1

No approval necessary, only ex post reporting:

- Prudent **deterministic** valuation allowed instead of stochastic for asymmetric options & guarantees if certain criteria are met including low risk profile undertakings criteria.
- Simplified calculation of immaterial **SCR modules** and submodules (excluding market risk) if < 5% BSCR. Calculated as undertaking specific volume measure by risk factor subject to a maximum of the last calculated value of that SCR component.

Pillar 2

For low risk profile undertakings or subject to supervisor's consent:

- Combinations of **key functions** are permitted (except the internal audit function) and combinations of key function holders and Board members are permitted
- A **regular ORSA** can be provided every two years (and following any significant change in risk profile) instead of every year
- **Written policies** may be reviewed at least every three years instead of every year
- The variable component of **remuneration** is not subject to the deferral requirement (if it is less than one third of total remuneration and doesn't exceed €50,000)

Pillar 3

- Amendments to the Quantitative Reporting Templates (**QRTs**) as follows:
  - Review **risk-based thresholds**
  - Simplify the **quarterly** submission
  - Delete and simplify some QRTs
- Allow for the exemption of **group reporting**, without the condition of exemption for all solo undertakings belonging to that group.
- (Note some additions to reporting also.)

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Pillar 2

Pillar 2

Macroprudential policy

- Supervisors granted measures following sector-wide shocks, including restricting or suspending **dividend** payments.
- Supervisors given power to set **capital surcharge** to address systemic risk. EIOPA to draft guidelines on procedures to trigger, set, calculate and remove the capital surcharge for systemic risk.
- Undertakings should include macroprudential considerations and potential sources of systemic risk in the **ORSA**. Supervisors should use ORSAs to aggregate information on sources of systemic risk.
- **Prudent person principle** expanded to take into account macroprudential concerns (such as risk related to the credit cycle and economic downturn).

SRMP & LRMP

- Supervisors given power to require systemic risk management plans (**SMRPs**) from certain undertakings. EIOPA to issue guidelines to specify the undertakings in scope.
- EIOPA to issue guidelines on the operational details of a potential **liquidity risk framework**.
- All undertakings required to draft liquidity risk management plans (**LRMPs**) for identifying and addressing potential liquidity stresses. EIOPA to issue guidelines to specify when undertakings could be exempted.
- Supervisors given power to temporarily **freeze redemption rights** of policyholders of undertakings affected by a significant liquidity risk as a last resort measure in exceptional circumstances. EIOPA to issue guidelines to further specify “exceptional circumstances”.

Recovery & Resolution

- **Trigger for recovery** is non compliance with SCR
- **Pre-emptive recovery plans** required for a very significant share of market
- **Supervisors** given preventative measures:
  - Intensive dialogue and regular meetings
  - Additional or more frequent reporting
  - Specific timeframe to implement measures set out in the pre-emptive recovery plan
  - Limit variable remuneration and bonuses
- **Triggers for resolution** should be introduced at EU level and should include:
  - Undertaking is no longer viable or likely to be no longer viable and has no reasonable prospect of becoming so
  - Possible recovery measures have been exhausted
  - A resolution action is necessary in the public interest
- **Administrative resolution authority** to develop resolution plans and conduct resolvability assessments in a pre-emptive manner. Minimum set of **resolution powers** such as:
  - Withdraw authorisation
  - Sell / transfer shares / assets
  - Restrict / suspend policyholder rights
  - Prevent / recover variable remuneration

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Pillar 3

Reporting & Disclosure

- **External audit** of the SFCR covering the Solvency II balance sheet at a minimum, with the option for each member state's supervisor to also include the SCR and eligible own funds.
- Increase **deadline** for solo SFCR from 14 weeks to 18 weeks (to allow for new audit requirement). Increase deadline for group SFCR from 20 weeks to 24 weeks. (4 week extension increased from 2 weeks proposed in consultation)
- **Structure** split into 2 parts: one part addressed to policyholders (not required for reinsurers or captives) and the other part addressed to professional users
- Undertakings in scope for financial stability QRTs are required to include **sensitivities** in the SFCR as follows:
  - Equity markets +/- 25%
  - Risk free interest rates +/- 50 bps
  - Credit spreads of fixed-income investments +/- 50 bps
  - Property values+/- 25%
- **Additional information** on sustainability risks, environmental, social and governance factors and climate change issues, and LTG related information.
- Simplifications to the derivatives and technical provisions **templates**. New information in relation to cross-border business, cyber risk and product splits in S.14.

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Other

Other proposals

Insurance Guarantee Scheme

- Minimum set of harmonised features
- **Home country** principle (pays EU level for EU LoBs & host tops up if necessary)
- Funded by **ex-ante contributions** by insurers, possibly complemented by ex-post funding arrangements in case of capital shortfalls
- Pay compensation and / or ensure **continuation** of insurance e.g. by portfolio transfer

Other

- FoS and FoE
- F&P
- Groups

Thank You!

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2020 Review of Solvency II

Joseph Collins

Content

- Solvency II 2020 review – recommendations
- CBI insights
- Next steps – EU
- Next steps – Iri

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Recap - What has EIOPA

EIOPA's approach to the Solvency II review is to address three areas where improvements are needed:

Balanced updating of the regulatory framework
EIOPA proposes changes in several areas but with balanced overall impact on insurers. This reflects the fact that Solvency II is overall working well.

Recognition of the economic situation
In particular the persistence of low interest rates. EIOPA recommends proper provisions for the risk of interest rate changes.

Regulatory toolbox completion
Including better protection of policyholders via macro-prudential tools, recovery and resolution measures and insurance guarantee schemes.

The CBI is a member of EIOPA – we voted for the overall package

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Figure 24 – Average relative change of best estimate at the end of Q2 2020

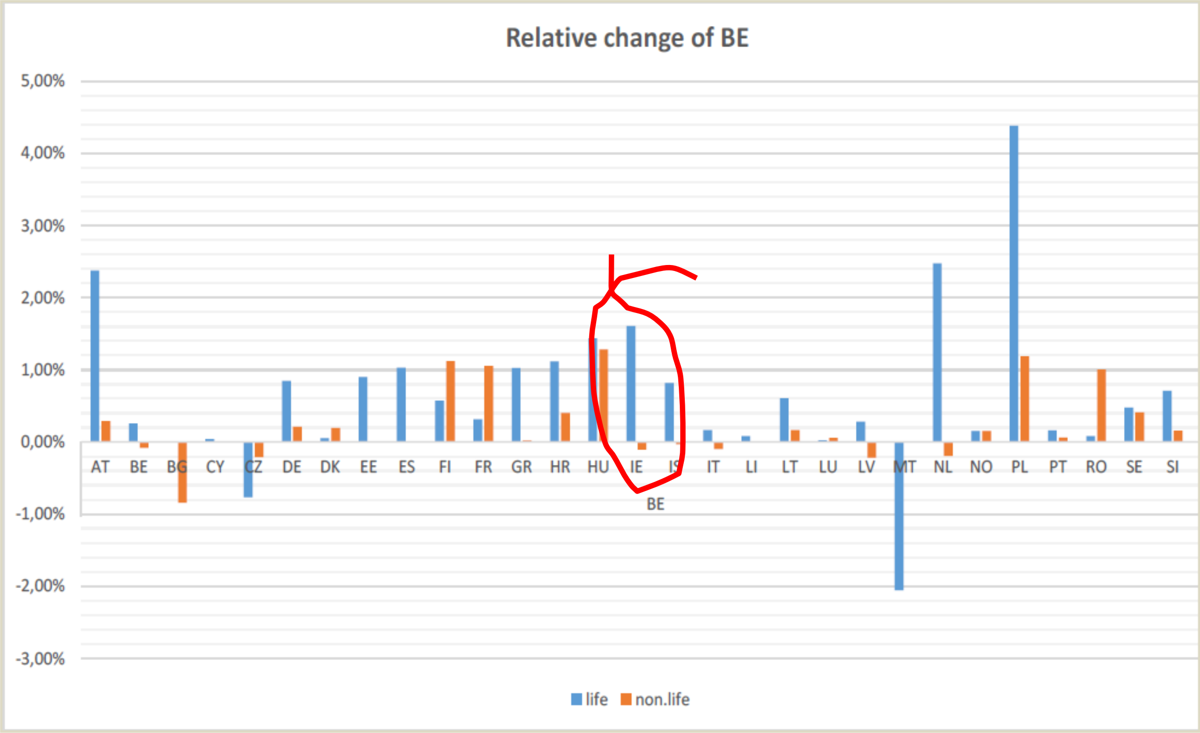

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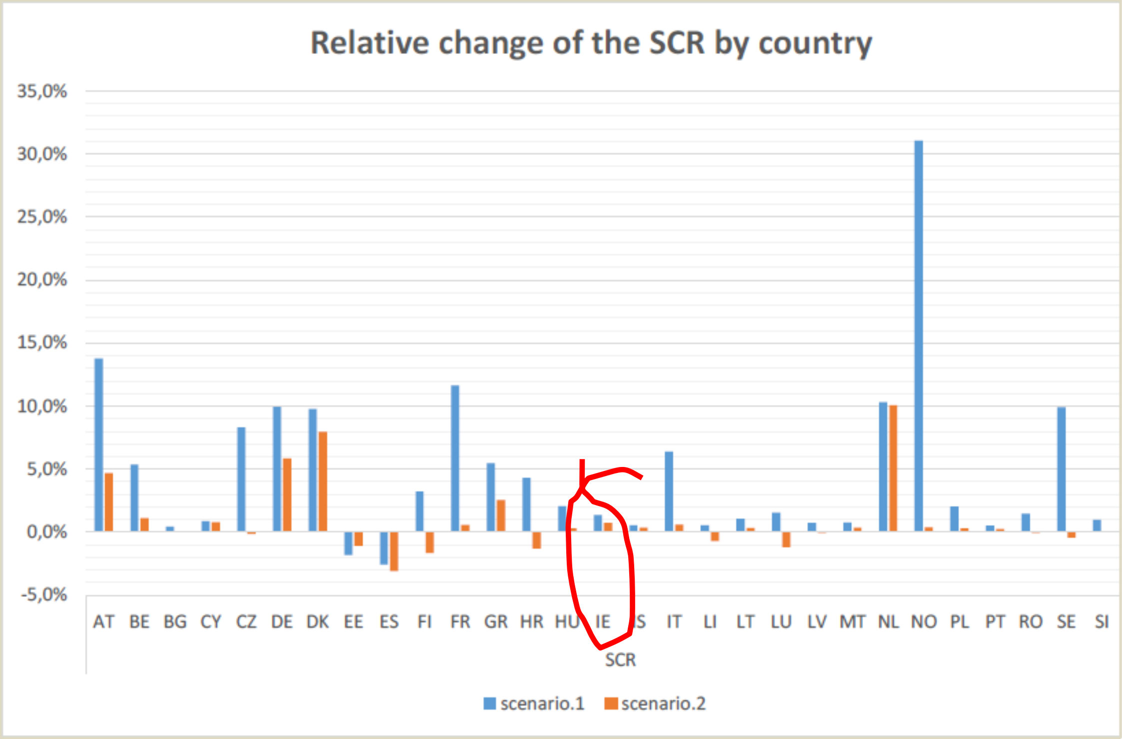
Figure 22 – Relative change of the SCR by country at end of Q2 2020



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Solvency II 2020 review – CBI insights

Proper recognition of the economic context

- Low / negative interest rates are obviously being experienced right now, and the framework needed to recognise that

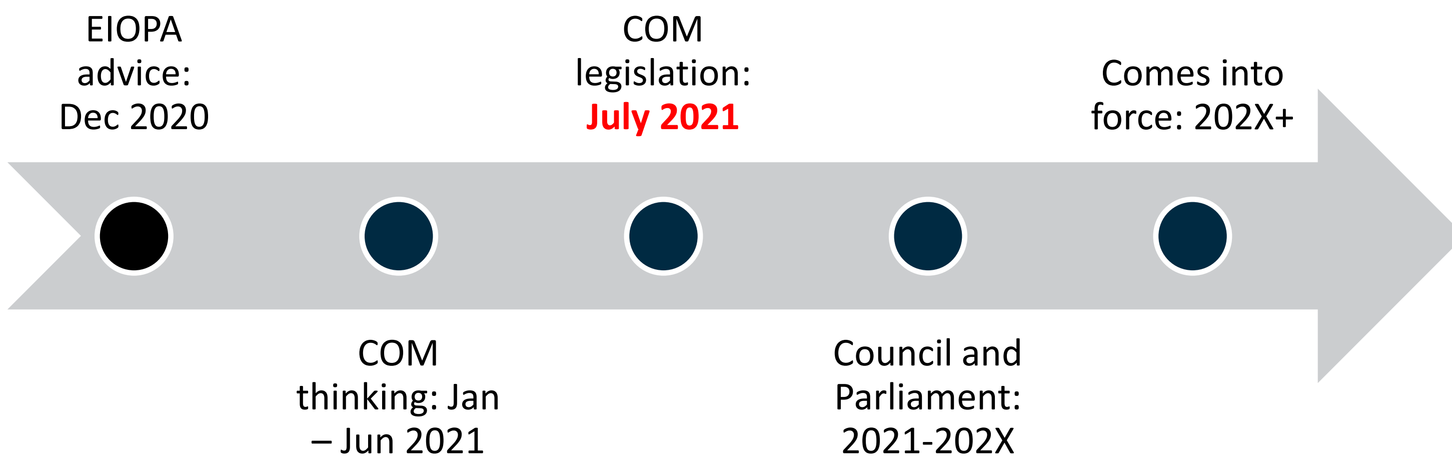
Balance update to regulatory framework

- Agree with the concept of a balanced approach
- Important to look at the recommendation as a package of changes

Complete the regulatory toolbox

- Additional tools are cautiously welcomed – with great power comes great responsibility
- Harmonisation is warmly welcomed – we already have an IGS - and more harmony would be even more warmly welcomed

Solvency II 2020 review – next steps



This timeline is for Level 1 Directive – Level 2 Regulations and Level 3 Guidelines will also change

- *Some Guidelines may change in advance of the legislation being finalised*
- *Level 2 changes likely to follow Level 1 changes*

Solvency II 2020 review – “level” diagram

Level 1: Directive

- Changes adopted by Parliament and Council

Level 2: Regulations

- Changes adopted by Commission

Level 3: Guidelines

- Changes adopted by EIOPA

What you should do

- Pay attention to what gets published in (probably) July
- No impact in the short term, other items will have an impact before these changes come into force
- Think about the possible impacts of the July proposals in the medium term
- Talk to your friendly regulator if you have any concerns