Solvency II review

Summary of EIOPA’s opinion on the 2020 review of Solvency II

On 17 December 2020, the European Insurance and Occupational Pensions Authority (EIOPA) published a paper reflecting its opinion on the 2020 Solvency II review (the “Opinion”) that the European Commission will be conducting in 2021.

Initially expected by the end of June 2020, the Opinion’s publication was delayed due to the COVID-19 crisis. Stakeholder contributions to a consultation paper issued in October 2019 helped EIOPA finalize the technical advice for the Solvency II Directive review.

The Opinion is one of the key elements that the European Commission will consider when developing the package of changes it will present for adoption during 2021.

The European Commission should present its proposal on the review around Q3 2021, but, as mentioned by EIOPA: “any implementation of changes resulting from EIOPA’s advice is likely to be closer to 2025 than to 2020”.

Related links

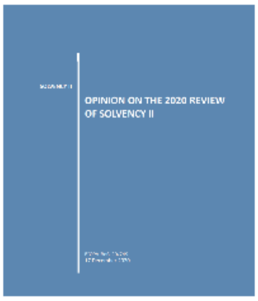
Opinion on the 2020 review of Solvency II | EIOPA (europa.eu)

Consultation Paper on the Opinion on the 2020 review of Solvency II | EIOPA (europa.eu)

Structure of EIOPA publications

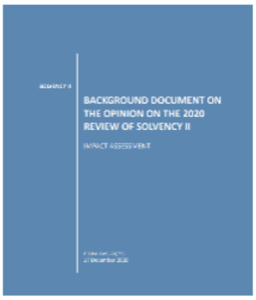
Factsheet

The two-page Factsheet summarizes the main changes proposed in the Opinion.



Opinion

The Opinion is the main document issued by EIOPA. It summarizes the key decisions made based on the Background document's analyses and impact assessment.

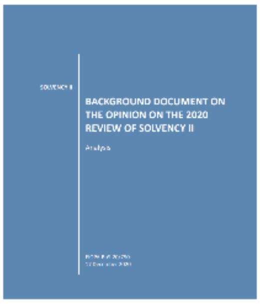


Background impact assessment

The Background “impact assessment” document focuses on the effects of the changes put forward in the Opinion.

It is in two parts:

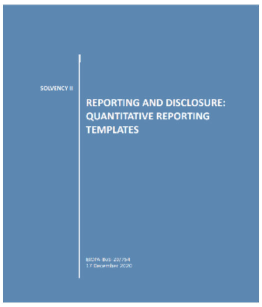
- **Part 1** describes the combined impact of all changes across all areas covered in the Opinion.
- **Part 2** is subdivided into several sections, with each section corresponding to an area covered in the Opinion. It summarizes the impact of the options considered in the consultation paper (2019).



Background analysis

The Background “analysis” document details the extensive analysis behind EIOPA's proposals to the European Commission regarding its 2020 review of Solvency II.

This extensive document spans more than 1'000 pages and provides detailed explanations on the subjects covered in the Opinion.



Reporting and disclosure: Quantitative Reporting Templates

This document is provided in addition to the Opinion. It covers the individual Quantitative Reporting Templates (QRTs) at solo and group level, including Financial Stability Reporting, and aims to provide stakeholders the full view of the future reporting and disclosure requirements, as a complement of the legislative proposals in this area covered by the Opinion.

Additional changes to the QRTs may come also from other areas of the review of Solvency II; however, they would need to be implemented later in the Implementing Technical Standards (ITS) (after the legislative amendments).

Main changes proposed by EIOPA

This document aims to summarize the key topics of the Opinion published on 17 December 2020.

This document is not an analysis of the Opinion and is not exhaustive. Only topics relevant to the Luxembourgish markets have been outlined and summarised hereafter.

Topic:	*Expected impact:*
Long-term guarantee (LTG) measures and equity risk measures	**Life (++), non-life (+)**

Extrapolation of risk-free interest rates

- EIOPA proposes a new method other than Smith-Wilson for the extrapolation of risk-free interest rates (which considers **liquid swap rates with maturities longer than 20 years**) to better reflect market rates. While the maturity from which the extrapolation starts is still 20 years, this new method produces lower interest rates for maturities longer than 20 years.

Volatility adjustment (VA)

- EIOPA proposes a new VA calculation method, splitting the VA into a **permanent part and a macroeconomic part** to better align it with the EIOPA's objectives. This should better capture the specificities of (re)insurers' own investment portfolios (in its current form, the VA is computed per currency and per market).
- With this new method, application ratios should be introduced to capture the mismatch between assets and liabilities durations and to consider the degree of liabilities' illiquidity.
- In addition, EIOPA recommends increasing the general application ratio from 65% to 85% and that the Solvency Capital Requirement (SCR) standard formula should not be changed to allow for the dynamic VA (DVA).

Equity risk

- EIOPA recommends changing the eligibility criteria for **long-term equity investments**.
- Regarding the **symmetric adjustment** to the equity risk charge, EIOPA recommends widening the corridor to the symmetric adjustment from currently +/- 10% to +/- 17%, and to introduce a floor of 22% to the capital charge.

Topic:	*Expected impact:*
Technical provisions	**Life (++), non-life (+)**

Risk margin

- EIOPA suggests adjusting the risk margin calculation formula to account for the **time dependency of risk** by introducing a floored, exponential and time-dependent element. This change of methodology, with an introduction of a parameter λ of 0.975, could reduce the risk margin by around 15%, depending mainly on the portfolio's duration.

Expenses

- **New business expenses**: EIOPA suggests amending Article 31(4) to "Expenses shall be projected taking into account the decisions of the administrative, management or supervisory body of the undertaking with regard to writing new business."
- **Administrative expenses and acquisition expenses**: EIOPA proposes amending the second paragraph of Article 31(1) to "[Administrative expenses and acquisition expenses] shall take into account overhead expenses ~~incurred~~ to be incurred in servicing insurance and reinsurance obligations."

Expected profit in future fees for servicing and management of funds

- EIOPA proposes adding the following notion of expected profits in future fees: "the expected profit in future fees for servicing and management of funds' means for index-linked and unit-linked insurance the difference between technical provisions without a risk margin calculated in accordance with Article 77 of Directive 2009/138/EC and technical provisions without a risk margin under the assumption that the future fees for servicing and management of funds that are expected to be received in the future are not received for any reason other than the insured event having occurred, regardless of the contractual rights of the policyholder to discontinue the policy."

Dynamic policyholder behavior

- EIOPA considers the same level of harmonization could be achieved under the current Delegated Regulation's provisions with the EIOPA's **additional guidance on the calibration of dynamic models**, instead of having a common simplification or waiving the requirement to model dynamic policyholder behavior. This guidance should also clarify that the lack of data for extreme scenarios is not a reason in itself to not model dynamic policyholder behavior.

Topic:	*Expected impact:*
SCR standard formula	**Life (++), non-life (++)**

Interest rate risk

- According to EIOPA, the current shocks in the Delegated Regulation for interest rate risk do not meet the requirements of Article 101(3) of the Solvency II Directive and the current calibration severely underestimates the risk.
- EIOPA suggests modeling interest rate risk in the standard formula using a **"relative shift" approach,** the parameters of which vary in function of the maturity. In addition, the shocked interest rates in the downward scenario should not be less than -1.25%.
- The change to the interest rate risk calibration should be **phased in over five years**, as this change could increase the SCR for life and composite undertakings by 17% on average, depending on each market (5% in Luxembourg).

Counterparty default risk

- EIOPA proposes a simplified calculation of the **risk-mitigating effect** of derivatives, reinsurance arrangements, special purpose vehicles and insurance securitizations.

Recognition of adverse development covers and finite insurance covers

- EIOPA suggests recognizing adverse development covers by adding the following to Article 117 of the Delegated Regulation: "For all segments set out in Annex II, the **standard deviation for non-life reserve risk** of a particular segment shall be equal to the product of the standard deviation for non-life gross reserve risk of the segment set out in Annex II and the **adjustment factor for non-proportional reinsurance** [new definition]."

Topic:	*Expected impact:*
Minimum Capital Requirement (MCR)	**Non-life (+)**

EIOPA recommends changing the risk factors (both for technical provisions and premiums written) for the calculation of the MCR set out in Annex XIX of the Delegated Regulation.

Topic:	*Expected impact:*
Reporting and disclosure	**All undertakings**

Reporting deadlines

- **Solo Solvency and Financial Condition Reports (SFCRs) and solo Regular Supervisory Reports (RSRs)**: EIOPA recommends amending the requirements for undertakings to disclose their SFCRs no later than 18 weeks after the undertaking's financial year-end (currently 14 weeks), which automatically extends the deadlines for the disclosure of group SFCRs to no later than 24 weeks. This also accommodates the audit proposal of the Solvency II Balance sheet (see below).
- **QRTs**: EIOPA suggests amending the annual supervisory reporting deadlines in line with the reporting deadlines that apply during 2019, but to keep the reference to weeks and not working days, i.e., 16 weeks for annual individual supervisory reporting (currently 14 weeks) and five weeks for quarterly individual reporting (unchanged).

Structure amendment

- **SFCRs for policyholders**: EIOPA proposes various amendments, including distinguishing the SFCR part addressed to policyholders from the part addressed to other users.
- **SFCR content**: EIOPA suggests reducing the report's structure from five sections to four (business and performance, system of governance, valuation for solvency purposes, and capital management and risk profile), streamlining the required information to be disclosed, and clarifying the specific requirements that apply to captives insurance and captives reinsurance undertakings.
- **RSR content**: EIOPA's recommendations regarding RSR content and structure include: clarify the RSR elements to be included when the report is being submitted for the first time (i.e., new companies or after several material changes) and on an ongoing basis; further simplify the report by focusing on material changes, reducing duplication with ORSA and

delete information that is fully or partially covered by QRTs; amend the structure of the report from five sections to four in line with the SFCR amendments proposed; and streamline the information required to be reported.

Audit of the SFCR

- Regarding the SFCR audits, EIOPA proposes introducing **minimum audit or similar requirements** in the Solvency II Directive.
- This should ensure that **as a minimum the Solvency II Balance Sheet** is subject to a similar level of assurance in all Member States. This should enhance confidence that the balance sheet's financial information complies with the respective rules and regulations, regardless of the undertaking's size or risk profile.
- For captive insurance and captive reinsurance undertakings, Member States should be allowed to decide if audit requirements should apply.
- The proposal is applicable for solo, group and single SFCRs.

General supervisory reporting and public disclosure issues

- Regarding the quarterly reporting, EIOPA suggests keeping the Q4 publication requirement to **reduce the quarterly templates' scope** (to be implemented in future ITS).
- In particular, EIOPA suggests deleting the following: the template on derivatives transactions (S.08.02); the information on transitionals in the templates on life and non-life technical provisions (S.12.01 and S.17.01); some cells in the template on open derivatives (S.08.01); and template S.08.02 on derivatives transactions.
- In addition, EIOPA advises that the reporting of S.16.01 on life technical provisions should not be required for reinsurance undertakings, and proposes introducing an information request in S.01.02 to identify undertakings running a run-off business and captives insurance and reinsurance undertakings.

Topic:	*Expected impact:*
Proportionality	**Captives**

Proportionality for captives

Regarding captives that meet specific criteria, EIOPA proposes:

- Introducing several additional limitations and exemptions into the **supervisory reporting**, including that S.02.02, S.06.02 and S.08.01 should not be reported; that no currency split applies to S.16 and S.19 templates; that only the summary table should be reported for the S.27 template; and that variation analysis should not be reported in S.29 templates.
- The reporting package shall include **only the QRTs disclosed in the SFCR** for a reduced set of reinsurance captive undertakings that meet specific criteria.
- With regards to **SFCRs**:
  - For professional readers, only the QRTs are required (no narrative part) for both captive insurance and reinsurance undertakings.
  - In case of captive insurance undertakings, SFCRs for policyholders are only required if the business pursued with regard to policyholders and beneficiaries involves natural persons that can still be considered as risks of the industrial group to which the captive belongs.
  - No SFCRs for policyholders are required in case of captive reinsurance undertakings.
- **ORSA**:
  - Regarding **frequency**: EIOPA proposes performing the full ORSA and, consequently, submitting the ORSA report to the national supervisory authority (NSA) every two years, or without delay when a change in the risk profile is expected or following any significant change in the risk profile.
  - Regarding **content**: EIOPA proposes overall guidance on the minimum expected content without limiting the captive (re)insurance undertaking to add additional items in the ORSA or, in exceptional circumstances, for the supervisory authority to request additional information.

Topic:	*Expected impact:*
Others	**All undertakings, NSA and insurance market**

Group supervision

- EIOPA suggests clarifying the **group supervision** of subsidiaries, the calculation of **group solvency**, the appropriateness of minimum consolidated group SCR, and uncertainties or gaps of **governance** requirements at the group level.

Freedom to provide services and freedom of establishment

- For cross-border business, EIOPA proposes one amendment to the Solvency II Directive to improve the efficiency of information gathering during the **authorization process** and two other amendments to facilitate the information exchange in case of **material changes in freedom of service (FoS) activities**.
- EIOPA also recommends that its role in the cooperation platforms supporting the supervision of complex cross-border business be enhanced where NSAs fail to reach a common view.
- EIOPA suggests facilitating the **cooperation between home and host NSAs** during ongoing supervision. In particular, this cooperation should at least cover the system of governance, including the head office management’s ability to understand the cross-border market specificities, risk management tools, internal controls in place and compliance procedures for the cross-border business; the outsourcing arrangements and distribution partners; the business strategy and claims handling; and the consumer protection.

Finally, EIOPA proposes changing Article 153 of the Solvency II Directive regarding the explicit power of the host supervisor to request information in a particular timeframe and language.

Macroprudential policy

- EIOPA is of the view that the macroprudential perspective should be incorporated into the current prudential Solvency II framework to supplement the current microprudential approach in a consistent and coherent way.
- This policy should define **additional tools and measures** to broaden supervisory authorities’ current toolkit of macroprudential measures, including:
  1. Capital surcharge for **systemic risk** and systemic risk management plans (SRMP);
  2. **Liquidity risk** framework and liquidity risk management plans;
  3. Additional measures to **reinforce the insurer’s financial position;**
  4. Definition of **concentration** thresholds;
  5. A temporary freeze on **redemption rights**; and
  6. Pre-emptive **recovery and resolution** planning.
- EIOPA also advises to expand the use of the **ORSA** to include the macroprudential perspective and the **prudent person principle** to take into account macroprudential concerns.

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