Views on the EC's proposal for a Directive amending Solvency II

Our reference:	ECO-SLV-22-015	Date:	18 January 2022
Referring to:	https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12461-Insurance-&-reinsurance-firms-review-of-prudential-rules-Solvency-II-Directive- en		
Contact person:	Angus Scorgie, Head of prudential regulation & international affairs/reinsurance	E-mail:	scorgie@insuranceeurope.eu
Pages:	37	Transparency Register ID no.:	33213703459-54

Contents

Insurance Europe aisbl • rue Champ de Mars,23 B-1050 Brussels
Tel: +32 2 894 30 00 • Fax: +32 2 894 30 01
E-mail: info@insuranceeurope.eu
www.insuranceeurope.eu

1.1 Key industry messages

Solvency II (SII) has provided many of its intended benefits, including introducing a risk-based approach for solvency capital, setting very high standards for risk management and governance, extensive supervisory reporting and significant public reporting. As a result, the framework ensures very high levels of policyholder protection and a more level regulatory playing field across Europe.

However, the framework needs a number of improvements because it does not correctly reflect insurers' long-term business model, resulting in excessive capital burdens and solvency volatility for European insurers. It has also created a very significant, and in some cases unnecessary, operational burden for insurers.

These deficiencies result in negative impacts for consumers, both directly through increased costs and less optimal investments and indirectly due to reduced product availability and guarantees. They also constrain the insurance sector's ability to contribute to the EU's political priorities, including economic recovery from COVID-19, the Capital Markets Union (CMU) and the European Green Deal, as they reduce the sector's capacity to take risk. Finally, they undermine insurers' international competitiveness, their natural ability to take a long-term approach to products and investment and their ability to avoid procyclical behaviour during a crisis.

The SII review should not lead to a fundamental overhaul of the system. Instead, a limited number of focused changes are needed that will, in aggregate, lead to a justified and needed reduction in capital requirements and volatility. The right changes, as outlined below, will make the system more risk-based by better aligning it to the real risks faced by insurers. This will free up capacity for much needed investment, risk absorption and protection, while still keeping policyholders extremely safe. These corrections are necessary if the European insurance sector is to maintain its long-term business and product offering for the benefit of customers and financial stability, to play its full role in the transition to a sustainable economy and other EU political objectives, and to compete internationally.

It is important that appropriate changes are made to both Level 1 and Level 2 of the current SII framework, as both play a key role in determining insurers' capital and other requirements. In particular, elements that have a fundamental impact on capital requirements and resources should be specified in the Directive, for example the main extrapolation parameters.

Key industry recommendations for the SII Review and IRRD

Correct the treatment of long-term business to address excessive capital and volatility

The following key elements will help correct the excessive capital requirements and artificial volatility for long-term business by aligning the measurements with the real risks faced by insurers, while keeping customers very well protected.

On the balance sheet-related measures:

- **Extrapolation of risk-free rate curve: The EC's proposals for changing the extrapolation methodology need a significantly different calibration than the one proposed by EIOPA to avoid increasing the cost of providing long-term and guaranteed products to policyholders and increasing volatility.**

  The current extrapolation methodology already results in risk-free rates responding immediately to lowering interest rates, including when rates go negative. The current risk-free rate curves are already a conservative basis on which to value insurers' liabilities.

  EIOPA's recommended calibration of the new extrapolation methodology would significantly lower risk-free curves, resulting in a substantial increase in the cost of providing long-term products and guarantees, as well as increasing the sensitivity of the framework to interest rate movements, creating additional solvency volatility, particularly for long-term business. The EC has not provided evidence that significantly reducing the projected long-term interest rates is needed or would benefit policyholders. EIOPA's regular stress-testing exercises, on the other hand, provide a further

mechanism to assess low interest rate concerns and have confirmed that insurers can cope not just with the current low interest rates but even with much more extreme "low for long" interest-rate scenarios.

- **<u>Volatility adjustment (VA)</u>: The EC proposes a number of changes to the VA. With the exception of a proposed change to the "risk correction", these are supported by the industry because, in aggregate, they better reflect the real economics of insurers' balance sheets and increase the effectiveness of the VA in mitigating artificial volatility and procyclicality.**

  The EC's proposal to apply EIOPA's changes to the risk correction (one of the key elements of the VA calculation) should not be taken forward. The existing risk correction, based on sound economic principles, is already calibrated conservatively, and has proven to work well in ensuring the impact of defaults and downgrade is adequately covered. Evidence justifying a change has not been put forward. On the contrary, changing the risk correction in the way proposed by EIOPA would undermine the other improvements to the VA and reduce their effectiveness in reducing procyclicality. Therefore, there should be no change to the risk correction or EIOPA's proposal should be adjusted to minimise its adverse, procyclical effects.

  The current requirement to publicly report solvency figures with and without the VA (and matching adjustment (MA)) should be removed. The VA and MA are key to correctly capturing the real economics, and publishing both numbers creates confusion as to the valid solvency requirements.

- **<u>Risk margin</u>**: **The EC's proposals to introduce a lambda parameter and reduce the cost of capital are welcome and needed because they help reduce the unnecessarily high costs of long-term liabilities and reduce volatility. Further improvements would also be justified.**

  The risk margin is an amount over and above the conservative valuation of the amount needed by insurers to cover all future projected liabilities, taxes and associated costs. It totals €160bn for the industry and as well as significantly reducing risk absorption and investment capacity the current methodology introduces volatility because it is quite sensitive to interest rate changes. The changes proposed by the EC will help reduce the level and volatility, but further reductions would be economically justified, for instance to take more fully into account diversification or a lower cost of capital.

On the Solvency Capital Requirement-related measures:

- **Solvency Capital Requirement (SCR) for investment assets:** SII capital charges for insurers investing in real assets such as equity, company debt and property do not correctly reflect the real economic risks faced by insurers — in particular because the framework generally and wrongly assumes that insurers are fully exposed to short-term market price volatility (trading risk) when, in reality, they are exposed to the lower risk of long-term underperformance of their investments. The SII Review should address this.
  - **<u>For equity</u>: Improve the current criteria for long-term equity category so that it works in practice and enables a significant portion of insurers' portfolios to be eligible for the more appropriate 22% capital charge.** The symmetric adjustment should also be optional to avoid the EC proposals to widen the corridor for the adjustment, to create, rather than mitigate, solvency volatility.
  - **<u>For debt</u>: Define a dynamic volatility adjustment to be allowed for the standard formula spread risk capital module. No new requirements should be added for internal model users that can incorporate a dynamic volatility adjustment.**

- **<u>Interest rate risk</u>: The EC proposals to better recognise low and negative interest rates in the SCR calculations are welcomed by the industry because they are consistent with how long-term interest rates (beyond the liquid part of the curve) will change under extreme downward interest-rate scenarios. However, a change is needed to the methodology/calibration to avoid excessive impacts on the liquid part of the curve. This will result in justifiable and appropriate increases in capital.**

Improve proportionality and avoid increasing costs and operational burdens

Unnecessary operational costs and burdens created by SII ultimately impact customers through higher costs and/or insurers dedicating less time to product development and other services. With the texts defining the SII framework exceeding 3 500 pages, proportionality is vital to avoid unnecessary costs and burdens, but it is widely acknowledged that this is not working in practice. Furthermore, every reporting requirement — and in particular every change to reporting — creates the need for an IT project, data sourcing, validation and management processes by potentially thousands of insurers. The EC has recognised the significant operational burden of SII and has made some helpful proposals to reduce it, particularly for small insurers. However, these need to be improved if they are to work as intended and the EC makes other proposals that would create additional burdens. So, in aggregate, its proposals would lead to an overall increase in costs for the sector. Therefore improvements, including the following, are needed:

- **<u>Proportionality</u>: The industry fully supports the introduction of the automatic application of proportionality. However, some improvements are needed to the EC proposals including:**
  - to the **criteria for low risk-profile undertakings and groups** to avoid unnecessarily exclusions; and;
  - to the provisions for **applying automatic proportionality on the grounds of non-materiality** of risks/activities.

- **<u>Reporting</u>: Increases in reporting arising from the SII Review should be limited to those truly necessary and should be offset by improvements.** For example:
  - The changes to the Solvency & Financial Condition Report should reduce, not increase, the workload and lead to a report focused on relevant information for policyholders and a simple dataset for other market participants.
  - There should be no new external audit requirement set at European level.
  - Proposals to require internal model users to also report standard formula solvency positions are not necessary, create additional costs and risk undermining the purpose of the internal model.

- **<u>Group supervision</u>: The EC proposals are far too extensive and changes should be limited to those where there is evidence that there is a real need and that the benefits outweigh the costs.** The EC's proposals to change requirements on group supervision and grant additional powers to the group supervisor in SII go far beyond what is necessary.

- **<u>Recovery and resolution</u>: The industry supports a harmonised recovery and resolution framework, but the current proposals are unnecessarily wide-ranging and improvements are needed to:**
  - ensure the scope and requirements are appropriate and proportionate to the risks;
  - avoid unjustified new powers for EIOPA;
  - take fully into account the specific nature of insurers and avoid the simplistic application of banking requirements; and,
  - avoid gold-plating internationally agreed requirements.

Maintain the SCR as the starting point for the supervisory ladder of intervention

SII was designed with two clear capital levels: the Minimum Capital Requirement (MCR — about €220bn for the industry) and the much higher Solvency Capital Requirement (SCR — about €610bn). This was done to create an early intervention point at which, as soon as the SCR is breached, the company is required to provide a recovery plan and the supervisor can intervene with a ladder of intervention measures, such as restricting dividends and new business. If the MCR is breached, supervisors can fully take over the company to either recover it or resolve it through a sale or run-off process. Above the SCR, the normal and ongoing supervisory dialogue applies and supervisors always have the power to enter into additional discussions with companies if they have concerns.

The key intervention points of the existing supervisory ladder of intervention should be maintained. Creating powers for new, even earlier intervention points, before the SCR is breached, is unnecessary and will indirectly increase capital requirements, potentially significantly, because insurers, supervisors and the market can consider the new intervention point as the implicit new solvency requirement.

- **On macroprudential measures: The EC's proposals to introduce new powers for supervisors to intervene before the SCR is breached are strongly opposed by the industry. The specifics of these powers should also not be delegated to EIOPA to design and calibrate.** Other proposed macroprudential tools also go beyond what is necessary, given the limited level of systemic risk in the insurance industry, and will create an unnecessary regulatory burden.

- **On recovery and resolution: The intervention point for any resolution authority should be the MCR. If there is an insurance guarantee scheme, it should remain a protection of last resort, applying only once the point of insolvency has been reached and in accordance with its local statutes.**

Other issues: sustainable finance, cross-border supervision, internal models

- **Insurance Europe supports sustainability, including climate-related risks, being integrated into SII. While these risks are, to a very large extent, already covered by SII, Insurance Europe recognises the EC proposals in this area are necessary developments.**
  - Increasing the frequency of recalibration of climate related natural catastrophe risks.
  - Including climate stress testing within the ORSA.
  - Giving a mandate to EIOPA to assess by 2023 if there is a risk-based justification for dedicated prudential treatment of exposures associated with environmental and/or social objectives.

- **Insurance Europe welcomes proposals to strengthen the cooperation between home and host supervisors around the activities of businesses operating cross-border through the freedoms of services and establishment (FOS/FOE).** However, changes should not compromise the home-state principle and improvements are needed to the EC proposals to ensure that:
  - the changes are tailored to the specific problems they seek to solve and it is ultimately about ensuring that supervision is effective and the SII framework is fully applied; and,
  - the appropriate improvements will not result in overburdening or even discriminating against insurers whose business model integrates the opportunities created by the single market.

- **Internal models are a crucial feature of the SII framework and are already subject to very extensive approval requirements and processes by national supervisors. Care must be taken to avoid changes and new requirements that would increase the already high costs of developing and maintaining internal models or undermine their usefulness.**

1.2. Proportionality

Thresholds

While the EC proposals for thresholds are welcomed by the industry, some further improvements are needed to make these work for groups, reinsurance, and specific business lines.

- The industry welcomes the doubling of the threshold for exclusion from Solvency II related to technical provisions of individual insurers (from €25 million to €50 million) and the proposal to triple the threshold for exclusion from Solvency II based on gross written premiums (from €5 million to €15 million);
- The industry suggests the following further improvements to the thresholds in order to make these work for groups, reinsurance and specific business lines:
    - Raise the thresholds in Article 4.1.c to €50m of total technical provisions of the group where the undertaking belongs to a group (currently €25m).
    - Add thresholds in Article 4.1.d of the Directive for liability, credit, and surety ship: €0.5m of gross written premiums or €2.5m of technical provisions (currently no threshold).
    - Raise the threshold in Article 4.1.e regarding reinsurance business to €1m of the undertaking's gross written premium income or €5m of its technical provisions gross of the amounts recoverable from reinsurance contracts and special purpose vehicles; or more than 10 % of its gross written premium income or more than 10 % of its technical provisions gross of the amounts recoverable from reinsurance contracts and special purpose vehicles (currently €0.5m premium, €2.5m provisions and 10% of provisions).

Proportionality

The industry fully supports the introduction of the automatic application of proportionality for Low Risk Profile Undertakings (LRPUs) and LRPU groups. To ensure the proposals work for all markets some improvements are needed to the criteria, in particular in regard to size, cross border, non-life insurance classes and non-traditional investments. In addition, the simplifications for immaterial risks which are achievable for any company should not be temporary and should be allowed automatically.

It is important that the general principle of proportionality also remains beyond the LRPU and immateriality provisions. This means that any company should be able to use proportionality measures such as simplifications and combination of key functions.

1.2.1. Introduction of a new category of low-risk profile undertakings and general approach to proportionality for other insurers

- The following criteria, as currently proposed by the EC, are too restrictive and need changing in the final text:
    - The size criterion (currently set at for life max €1bn of technical provisions (TP), for non-life max gross written premiums (GWP) of €100m).
    - The cross-border criterion (currently set at max 5% of total annual GWP)
    - For non-life undertakings: The criterion on classes of insurance allowed up to 30 % of premiums
    - The non-traditional investments criterion (currently 20% of total investments)
- Proposed solution:
    - Default size criteria of €1bn and €100 millon, but member states can increase this from €1bn to max €5bn technical provisions and from €100m to €500m GWP, as long as this does not exceed 20% of market (optionally by number or market share).
    - 5% limit for cross border activity applies only where a member state makes use of the option to apply a threshold above €1bn and €100m. This will ensure a level-playing field.

In case the EC would decide to keep the size criterion unchanged, the cross border criterion should be addressed, as it is currently not risk-based.

- Motor insurance should not be part of the classes that are restricted to a limit of 30 % of premiums (class 3 should be removed from the criterion). This would keep the proposals in line with EIOPA's advice.
- The non-traditional investments criterion needs adjustment:
  - An increase in the 20% threshold is necessary.
  - Clarity also needs to be provided on how the criterion is exactly to be calculated.
  - In particular, it is not clear how to calculate the "*investments in non-traditional investments*" (NTI): (the numerator). And the EC is requested to confirm whether the following interpretation is correct.

    1) Given the wording that the criterion uses ("*investments*", "*property for own use*", etc), it would seem that it refers to the relevant figures in the S.02.01.02 quantative reporting template (QRT) (Balance Sheet).
       - If yes, then the NTI should only consist of the elements that are subordinate to the investments R0070 line and which are not "traditional investments" (not bonds, equities, cash, deposits). Hence the NTI should consist of R0080, R0090, R0180, R0190 and R0210.

    2) The NTI figure does not include other assets additional to the above (reinsurance recoverables/receivables, insurance/intermediaries receivables). If this would not be the case, very few if any companies will satisfy the criterion of NTI≤20%.

    3) For the total investments calculation (the denominator), it is understood that it involves taking the total assets from S.02.01.02 [R0500] and therefrom "…. excluding investments covering unit-index linked contracts, excluding property for own use, excluding plant and equipment for own use, excluding property under construction for own use".

- The exclusion of LRPU status of (re)insurers that calculate the solvency capital requirement (SCR) using an approved partial or full internal model is too restrictive. The use of an Internal Model does not mean the (re)insurer represents a high risk. It typically means that the characteristics of the (re)insurer's portfolio are not well enough captured by the standard formula. This can be due to several reasons: for example, the (re)insurer operating in a niche market.
  The industry proposes that entities of a group using an internal model should not be automatically excluded from being identified as an LRPU, as the banking regulation has text which avoids this problem (see below):
  The following insurance and reinsurance undertakings shall never be classified as low-risk profile undertakings:
  (a) undertakings using an approved partial or full internal model to calculate the Solvency Capital Requirement, in accordance with the requirements for full and partial internal models set out in Chapter VI, Section 4, Subsection 3; With the exception of the case where the undertaking does not use internal models to meet the prudential requirements in accordance with this Regulation except for subsidiaries using internal models developed at the group level.
  This change is proposed based on Article 4 (145)(g) of the Banking Regulation, describing the criteria a small and non-complex institution needs to adhere to.
- The industry welcomes the introduction of a list of the proportionality measures (new Article 29c(1)) which may be automatically used by LRPUs, and the fact that the proportionality measures can be further extended via the delegated acts (DA).

- The industry notes that national supervisory authoritires (NSAs) should duly justify any rejections for the use of any of the proportionality measures following the power that was granted to supervisors to

prevent the use of certain proportionality measures regarding low-risk profile undertakings in exceptional circumstances and when the supervisory authority has serious concerns in relation to the risk-profile of a low-risk profile insurer (new Article 29c(2)).

- The process for insurers that are not classified as low-risk undertakings (paragraph 13 and recital 12: new Article 29d) makes it difficult for insurers to use the proportionality measures, not least because an insurer must declare it does not plan any strategic change that would have an impact on the risk profile within the next three years. Such declaration is almost impossible to make.
  An alternative would be to not require such declaration in the application but to introduce a requirement to inform the NSA if such a strategic change is going to be made. The NSA could in such case reassess the approval to use proportionality measures and the approval can be amended or withdrawn if the insurer's risk profile has changed. This obligation for the insurer and possibility for the NSA to reassess and react should however only be triggered by significant strategic changes that would substantially increase the risk profile.
- The industry agrees with this provision requiring all undertakings using proportionality measures to report annually to their supervisory authority information on the proportionality measures used (Article 1, paragraph 13 and recital 13: new Article 29e (1)). However, the reporting obligation must be very precise on what measures insurers should report and care must be taken to ensure that this obligation does not hinder or make it difficult for insurers to apply the legislation in a proportionate manner.
- The industry notes that the transitional provision allowing undertakings applying proportionality measures in line with current Solvency II requirements without prior notification/approval for a maximum of four years after entry into force of the new directive (para 13: new Article 29e (2)) could imply that after four years, NSAs can intervene and decide to discontinue the use of the current simplifications. Insurers should be allowed to continue to use simplifications, except if there is a significant change in the risk profile.
- There seems to be a wrong cross-reference in the empowerments for the EC and for EIOPA with respect to low-risk profile undertakings (para 12 (b)). Insurance Europe's understanding is that the new paragraph 5 should point towards Article 29a(1), not Article 29a(1) points (e), (f) and (h).

1.2.2. Regular supervisory report (RSR)

- The industry strongly welcomes the proposal that LRPU should only submit an RSR every three years (Article 35 (5a)/para 16 (b));
- Captive (re)insurance undertakings should benefit from limited supervisory reporting requirements provided that they meet specific criteria that will be set out in the Delegated Act (Article 35 (9)/Para 16 (d));
- The industry welcomes the proposal to grant EIOPA empowerments regarding exemptions for captives (re)insurance undertakings meeting the criteria, from reporting certain supervisory reporting templates (Article 35 (10) para 16 (e));
- While the industry welcomes the proposal that supervisors should prioritise LRPU for the exemptions from and limitations to quantitative regular supervisory reporting granted by supervisory authorities, and that captives which meet specific criteria should be exempted from quarterly asset-by-asset reporting (New article 35a/para 17 and recital 18), the limitations and exemptions should be applied up to the 20% threshold, and not at the discretion of the NSA, as is currently proposed in the text. And, as proposed by the EC, LPRUs should be prioritised in obtaining these limitations and exemptions.

1.2.3. General governance requirements

- The industry welcomes the proposal that within the regular internal review of the system of governance, the assessment of the adequacy of the composition, effectiveness, and internal governance of the administrative management or supervisory board (AMSB) should take into account the nature, scale, and complexity of the risks inherent in the undertaking's business (Article 41(1)/paragrah 21(a));

- The industry takes note of the proposal to exempt LPRUs from the new requirement that the persons responsible for key functions may not perform other key functions or be a member of the AMSB provided that certain safeguards are in place (Article 41(2a)/paragraph 21(b)). It is however important that the general principle of proportionality also remains beyond the LRPU and immateriality provisions. This means that any company should be able to use proportionality measures such as simplifications and combination of key functions.
- The industry welcomes the proposal that LRPU should be allowed to carry out a less frequent reviews of the written governance policies: ie, at least every three years instead of annually, unless the supervisory authority concludes that a more frequent review is needed Article 41(3)/(paragraph 21(c)).

1.2.4. Own Risk & Solvency Assessment (ORSA)

The industry appreciates the intention to strengthen proportionality regarding the proposed requirement to conduct an outward assessment of systemic risk by exempting LRPU and undertakings having obtained prior supervisory approval (Article 45 (1b)/paragraph 24(b)). At the same time, however, **this exemption is insufficient to ensure a proportionate approach regarding macroprudential aspects in the ORSA.** Additional proportionality should be foreseen in the application of Art. 45, paragraph 1(e) (see also section 1.6.1).

- ORSA frequency for LPRU and captives should be every three years, aligned with the RSR frequency and with no NSA discretion, and not every two years as currently proposed(Article 45(5)/paragraph 24(d)).
- The industry welcomes the proposal not to require LPRU to specify climate change scenarios or to assess their impact on the business of the undertaking in the ORSA (Article 45a/paragraph 25 and recital 26).

1.2.5. SFCR

- The industry welcomes the proposal that captive (re)insurance undertakings which meet certain specific criteria should be exempted from disclosing in the SFCR the part addressed to policyholders and beneficiaries and should be allowed to disclose o n l y quantitative data in the part addressed to other market participants without further narrative disclosures (Article 51 (3)(4)/paragraph 26(e));
- The industry welcomes the proposal that exempts reinsurance undertakings from disclosing in the SFCR the part addressed to policyholders and beneficiaries (Article 51(5)/paragraph 26(e));
- While the industry takes note of the proposal that LRPU should only disclose certain quantitative data in the part of the SFCR addressed to other market participants, provided that they disclose a full report containing all the information required every three years (Article 51(6)/paragraph 26(e)), it highlights that the 'other market participants SFCR' should consist of the public QRTs with no mandatory narrative (for LRPUs and all other insurance companies).
- The industry welcomes the proposal LRPU should be exempted from the requirement to subject the solvency balance sheet disclosed in the SFCR to an audit (paragraph 27 and recital 31), but it highlights there is no support for any external audit requirement.
- The industry takes the view that there should be no mandatory auditing of the solvency balance sheet disclosed by captive (re)insurers. And therefore the proposed member state option to require an audit of the solvency balance sheet disclosed by captive (re)insurance undertakings in the SFCR (paragraph 27) should be removed.

1.2.6. Information for and reports from EIOPA on the use of proportionality and simplification measures.

- The industry welcomes the proposal to introduce a requirement for supervisory authorities to provide on an annual basis to EIOPA the number of low-risk profile undertakings and other undertakings, as well as the number of low-risk profile groups and other groups using simplifications or other

proportionality measures as well as the proportionality measures and simplifications used by each undertaking or group (Article 52(1)(e)(f)/paragraph 28(a) and (b));

- The industry welcomes the proposal obliging EIOPA to publicly disclose annually, for each member state, the number of (re)insurance undertakings and groups, divided by low-risk profile undertakings and others using simplifications or other proportionality measures and the simplifications and other proportionality measures used by each undertaking or group (Article 52(2)(f)/paragraph 28(b)).
- While the industry supports the proposal obliging EIOPA to provide a report on the degree of supervisory convergence in the use of capital add-ons and in the use of proportionality measures between supervisory authorities in the different member states (Article 52(3)/paragraph 28(c))the following needs to be integrated into the reporting process:
    - A channel for insurers to report to EIOPA disproportionate processes for information and monitoring purposes (Directive).
    - EIOPA should produce and keep up to date a searchable database of all proportionality measures that are spread across all levels of regulation
    - A requirement for NSAs to report the number of applications and refusals for proportionality measures – both related to LRPU and other proportionality measures. And for this information to be included in the publicly disclosed information.
    - For all kinds of insurers to be able to cope with the complex legal Solvency II landscape, it is necessary to uphold the basic proportionality principle that is underpinning EU legislation. For this reason, Articles 29(3) and (4) are essential. The proposals in the new Article 29a – 29d must not restrict this proportionality.
    - In addition to the proportionality measures mentioned in Article 29c and 29d, the Solvency II Directive and its complementing requirements have other provisions that explicitly take proportionality into account. Care should be taken to ensure that undertakings can apply these provisions in a proportionate way without being hindered by an unnecessary administrative reporting burden.
    - Against this background, the reporting on proportionality measures used should be restricted to what is described in Article 29c and 29d.

1.2.7. Calculation of technical provisions

- While the industry welcomes the proposal to introduce a proportionality measure accessible for LRPU (Article 77(7)/paragraph 36 and recital 33) and other insurers subject to prior supervisory approval (Article 29c new/paragraph 13 and recital 33), it highlights that also non-LRPU should be able to continue to apply a prudent deterministic valuation of best estimate of TP, thereby applying general proportionality. This would be in line with recital 33 stating that it should be ensured "*the methods for calculating technical provisions of contracts with options on guarantee are proportionate to the nature, scale and complexity of the risks faced by the insurer*". In addition, the proposed standard requirement (stochastic valuation) as worded in the proposal is considered too complicated since it requires undertakings to model also potential deviations of the actual outcome from the expected outcome.

  Furthermore, it should be noted that the amendments proposed in recital 33 and paragraph 36 adding Article 77(6) and (7) lead to a considerable expansion of dynamic policyholder modelling. In fact, this provision would mean that dynamic policyholder behaviour modelling would become the default method and only LRPU would be exempted. However, stochastic modelling is burdensome and does not lead to significant changes to the technical provisions. In particular, the consideration of the possible interaction between surrender level, the contract return and the return on the market will be very laborious to develop. Currently, less than 40% of the undertakings apply dynamic policyholder modelling. When dynamic modelling is required by default, it will affect most insurance companies and involve a heavy workload. It should be noted that, according to EIOPA, "*the impact on the best estimate of including the dynamic component usually ranges from 0.05% to 0.3% of the best*

estimate"[1]. So, even though the added workload is very significant, the impact on the best estimate is very limited.

- The industry welcomes the proposal empowering the EC to specify in the Delegated Act the prudent deterministic valuation of the best estimate as well as the conditions under which that valuation may be used (Article 86(1)(aa)/paragraph 40 (a)(i)).
- The industry welcomes the proposed empowerment for EIOPA to develop draft implementing technical standards specifying the set of scenarios to be used for the prudent deterministic valuation of the best estimate for life obligations (Article 86(2a)/paragraph 40(c)).

1.2.8. Liquidity risk management

- The industry welcomes the proposal allowing low-risk profile undertakings and (re)insurance undertakings that have obtained prior approval from the supervisory authority should not be required to draw up a liquidity risk management plan (Article 144a (4) new/paragraph 54). However, additional proportionality should also be foreseen in the application of Article 144a.

1.2.9. Use of proportionality measures at the level of the group

- The industry concerns about the LRPU criteria also applies for group LRPU criteria (size/cross border/ non-life classes/non-traditional investments) (Article 213a(1)/paragraph 63).
- (Article 213a (2)(a)(ii)) should be removed from the group LRPU criteria, as was the case for the solo criteria;
- The EC should be able to revise the group LRPU criteria via the Delegated Act (as is the case for solo criteria). However, this is understood to be omission from the EC, and it is expected that it will be corrected at a later stage.
- For what concerns the fact that 'similar process as at solo level for classification as low-risk profile groups, to be applied at the level of the ultimate parent (re)insurance undertaking, insurance holding company or mixed financial holding company (Article 1, paragraph 63: new Article 213a (2) referring to the new Article 29b)), as well as for the loss of the benefit of proportionality measures (Article 213a(6) pointing to Article 29c)' the industry refers to the solo comments. And, in any case, group consolidation should not prevent solo entities with LRPU status from using the proportionality measures foreseen.
- The industry welcomes the EC proposal introducing the same list of proportionality measures for low-risk profile groups as for solo undertakings (Article 1, paragraph 63: new Article 213a (6) referring to the new Article 29c).
- The industry welcomes the EC proposal introducing a requirement for groups using proportionality measures to report annually to their supervisory authority information on the proportionality measures used (new Article 213a (6) paragraph 63, referring to the new Article 29e).
- The industry welcomes the EC proposal that groups applying proportionality measures in accordance with the present Solvency II requirements should be allowed to continue doing so without prior notification or approval, as currently done for a period not exceeding four financial years after the entry into force of the new Directive (new Article 213a(6)/paragraph 63, with reference to Article 29e).
- The industry welcomes the EC proposal to have no requirement for low-risk profile groups and other groups which have obtained prior supervisory approval to draw up a liquidity risk management plan at the level of the group (new Article 246a (1)/ paragraph 80, with reference to Article 144a(4));

[1] Para. 3.91 EIOPA-BoS-20/750, 17 December 2020 EIOPA background document on the opinion on the 2020 review of Solvency II.

- The industry welcomes the EC proposal to have triennial frequency of the group regular supervisory report for low-risk profile groups and other groups with prior supervisory approval (new Article 256b (1)/paragraph 84, with reference to Article 35(5a));
- The industry welcomes the EC proposal to exempt LRPUs from the requirement to subject the consolidated solvency balance sheet disclosed in the group Solvency and financial condition report (SFCR) or as part of the single SFCR to an audit for low-risk profile groups (new Article 256c/para 84, with reference to Article 51a(1), new Article 213a/para 63, with reference to Articles 29c and 29d on proportionality measures).
- The industry agrees with the principle of the use of 'mutatis mutandis' references to the proportionality framework applicable at individual level to define the framework applicable for groups

1.2.10. Simplified calculations

- The industry welcomes the provision foreseeing that all (re)insurance undertakings may use a simplified calculation for a specific risk module or sub-module which is immaterial under the criteria set out in the new Article 109 (paragraph 45 and recital 42); and the empowerment for the EC to specify further in the Delegated Act the simplified calculation for immaterial risk modules and risk sub- modules set out in the new Article 109 (para 46).
  It is however highlighted that the simplifications for immaterial risks should:
  - Be permanent and not for only three years (where risk module is immaterial)
  - Cover both calculation and reporting
  - Be allowed automatically
- Please refer to the group supervision section for comments on the proposed simplification for immaterial related undertakings only, taking into account the nature, scale and complexity of the risks of the related undertaking or undertakings concerned; definition of the concept of "immateriality" to be expressed in percentage of the consolidated accounts; need to obtain prior supervisory approval; empowerment for the EC to specify in the Delegated Act the technical details for application of the simplified approach for the calculation of the group solvency to participations in related undertakings that are immaterial, as well as the criteria based on which supervisory authorities may approve the use of the simplified approach (Article 234/paragraph 76).

1.3. Quality of supervision

- The industry agrees with the EC proposal to amend Article 25 to clarify that each refusal of an authorisation, including the reason, shall be notified to EIOPA and recorded in a database which can be consulted by supervisory authorities.

1.4. Reporting

The EC's proposals to increase reporting requirements, including the amendments to the ITS on reporting and disclosure, should be limited to those really necessary and offset by improvements to the SFCR, which should be streamlined.

Reporting requirements involve every insurer in Europe undertaking IT projects, data processes, validation processes and management review. This ultimately impacts customers through higher costs and/or less time for product development and other services. The industry is concerned that despite the EC's previous recognition that the overall reporting burden was too high, the EC reporting proposals would significantly increase, rather than reduce the reporting burden and would lead to costs which are not justified by the benefits.

- The industry welcomes the proposal to require EIOPA to submit to the EC a report on potential measures to develop an integrated system of data collection to reduce areas of duplication and

inconsistencies between reporting frameworks and to improve data standardisation and efficient sharing and use of data already reported. EIOPA shall prioritise information on Collective Investment Undertakings (CIU) and derivatives reporting (Art 35 new para 12/para 16 (g))

- The industry notes the following regarding the 'modifications to Article 35 and the new Article 35a adapting the reporting requirements for LRPU, notably to facilitate the access to exemptions and limitations on reporting for these entities':
  - The modifications specifying that — in the information which insurance undertakings must submit to their NSA and which is necessary for the purposes of supervision, account must also be taken of general principles of supervision laid down in Article 29, including explicit references to proportionality — are welcomed.
  - While the industry welcomes the prioritisation of the LRPUs for limitations and exemptions in Article 35a, it notes that the granting of limitations and exemptions is not automated and is still at the discretion of the supervisor: as such the LRPU limitations and exemptions are not part of the "list of automatically applicable proportionality measures". Granting the limitations and exemptions should be automatic.
  - For comments on proportionality provisions foreseen for LRPUs and captives related to reporting requirements, please refer to the proportionality section.
  - In new Article 35a (6), where EIOPA is required to issue guidelines for a coherent and consistent application of the requirements, the industry welcomes the standardisation of the process for NSAs to inform insurers from limitations/exemptions they benefit from.
  - Insurance Europe proposes to modify Article 35 (1), in order to make clear that only adequate and relevant information should be requested from supervisory authorities in the course of reporting. Thereby the industry refers to the principle of data minimization pursuant to Article 5 of the General Data Protection Regulation (GDPR) supervisory authorities shall solely be allowed to request information that is adequate, relevant and limited to what is necessary for the purposes of supervision of insurance and reinsurance undertakings.

    Article 35(1) should be amended as follows (proposed changes in bold):
    - *Member States shall require insurance and reinsurance undertakings to submit to the supervisory authorities the **adequate and relevant** information **which is limited to what is** necessary for the purposes of supervision, taking into account the objectives of supervision laid down in Articles 27 and ,28 and 28a and the general principles of supervision laid down in Article 29. That information shall include at least the information necessary for the following when performing the process referred to in Article 36*
- The industry highlights the following regarding the new Article 35(5a) and the new Article 256b on the RSR by undertakings and groups laying down the principles and frequency for this narrative report.
  - The industry welcomes the clarification that by default, in a normal situation, the RSR would be requested 'at least' every three years, however, a provision should be added that NSAs should duly justify their request when asking for an RSR more frequently. Furthermore, such decisions by NSAs should be made timely, say no later than three to six months before the yearend, to allow insurers sufficient time to prepare a full RSR report.
  - It should also be clarified that a summarised/abbreviated report as required in Article 312 (3) will no longer be required for intermittent years between two full RSR submissions.
  - Given that timelines are now included in Art 256(1) and 256b(1), respectively, for the group SFCR and group RSR, for clarity the same timelines should also be stated in Article 256(2) and 256b(2) for the single group SFCR and RSR as a whole.
  - In addition, it should be clarified in Article 256 and 256b that the parent undertaking, if this undertaking is an insurance undertaking, also may include a section in the single SFCR and RSR relating to this entity, as only referring to "subsidiaries" in Article

256(2)(b) and 256b(2)(b) otherwise it risks excluding them from the scope of the single SFCR and RSR, as Articles 256(1), 256b(1), 256(2)(a), and 256b(2)(a) only deal with group reporting.

- The industry welcomes the EC's proposal to introduce the possibility to have a single group RSR, subject to certain criteria (new article Article 256b(2)/paragraph 84).
- The new Article 35b sets out reporting deadlines and introduces the possibility to change them where justified by extraordinary circumstances.
  While the industry welcomes the extension of deadlines for annual reporting (SFCR/RSR and QRTs - new Article 35b) it notes the quarterly reporting deadlines should also be extended: ie from five weeks to six weeks. In addition, the additional time granted for the SFCR will mostly be taken up by the new external audit requirement. The proposed extension of timelines should be granted in any case and should not depend on EIOPA's proposals for minimum external audit requirements and additional SFCR requirements.
- The industry highlights the following regarding the proposals to modify the structure of the SFCR by splitting its content into a part addressed to policyholders and a part addressed to other stakeholders (paragraphs 26 and 83 amend Article 51 and, respectively, Article 256).
  - While the industry takes note of the split of the SFCR in two parts, one for policyholders and one for other market participants, it highlights that the report addressed to other market participants should only consist of the mandatory public QRTs without a mandatory narrative. To this end a change to the newly proposed Article 51(1b) is needed to '*Insurance undertakings shall only be required to include in the part addressed to other market participants the quantitative data required by the implementing technical standard referred to in Article 56*', so that the SFCR for other market participants would only consist of the public QRTs, with no mandatory narrative or additional calculations solely for SFCR purposes. Otherwise, the changes will add significantly to the burden without achieving the aims of streamlining the burden. In addition, for the sake of understandability, the policyholder SFCR should be limited to a maximum of two pages.
  - The current proposal will in reality mean that insurance companies must have two separate SFCRs, one for consumers and one for others. In addition, insurance companies have well-functioning processes for SFCR that would need to be altered, which will require significant resources and additional costs.
    A narrative explanation is not considered necessary as the professional public has industry expert knowledge and additional information is available to them in the financial and other reports provided by the company.
  - Similar to Article 51(1)(b), Article 56 should be reviewed, to restrict EIOPA's legal empowerment and only retain legal empowerments necessary for the outline and the content of the SFCR as envisaged by the amendments to the Directive.
- The industry does not support any external audit requirement at European level (paragraphs 27 and 84/new Articles 51a and 256c). The EC's proposed Articles 51a and 256c should be deleted, to avoid the introduction of an external audit requirement for the balance sheet or any other part of the SFCR.
  The balance sheet forms the basis for a large part of the — usually very detailed — information that must be provided in the SFCR. This requirement will be very resource-intensive and entail significant costs for insurance companies, which will ultimately lead to higher premiums for the policyholders. In addition, the data to be audited is already subject to a significant safeguard mechanism through the supervisory process of regulatory authorities (see, inter alia, Article 36 of the Solvency II Directive). Therefore, the added value, such as additional protection for policyholders, can be questioned and the significant additional costs for companies this will entail must be taken into consideration as well. Should the external audit requirement be introduced, an audit with a limited level of assurance should be sufficient.
  The industry welcomes the extended deadline by four weeks for the SFCR. However, this would only to a limited extent ease the operational burden for insurers of the proposed requirement of external auditing of the SFCR. The external audit of the SFCR will have to be carried out at the same time as the external audit of the annual report, as certain data form the basis for both reports. Furthermore,

for companies with internal models (including those with partial internal models), the requirement for external audit of the balance sheet in the SFCR also means that the internal model must be audited. This is because the risk margin is based on the outcome of the internal models.

- Article 51(1b) (iii)/paragraph 26(c) should be deleted to avoid mandatory reporting of sensitivities for undertakings relevant for financial stability.
- The industry welcomes the proposal to introduce an obligation for supervisors to submit to EIOPA statistics on the use of proportionality measures and simplifications in their market (Article 52). These statistics should be made public.
- The industry strongly opposes the proposed amendments to Article 112 to require undertakings using an internal model to report standard formula data regularly to the supervisors:
    - The industry has strong concerns on this proposal and urges not to go ahead with these proposals. There should be no new standard formula reporting requirements for internal model users, as NSAs already have extensive tools to ensure that internal models continue to generate prudent SCR numbers, and they are responsible for the internal model approval, so it is unclear which additional insights the new templates would provide.
    - One of the main reasons insurance companies choose to have an internal model is because the standard formula does not capture the company's risks in an adequate manner. Also, for this reason, NSAs have the possibility to require an internal model. The comparison of standard formula figures is not meaningful for cases where internal models areused to solve this problem. As such, the requirement to report the standard formula for comparability between companies goes against one of the core reasons for having an internal model.
    - In addition to increasing the burden of reporting, this requirement can create uncertainty for the companies as to which financial position (SCR and MCR) the supervisory authority will use for supervisory purposes, either SCR/MCR based on the internal model or SCR/MCR based on the standard formula. This may lead to the situation that companies with an internal model may also start considering using the standard formula. Companies would therefore lose the advantage of having the same measure of capital management internally and externally.
      In addition, this requirement entails extra complexity and additional costs.
- Furthermore, any other potential future changes after the finalisation of the Solvency II 2020 review, notwithstanding the abovementioned remarks, should be carefully considered before their actual implementation. Most insurers have automated insurance processes, which makes implementing changes both operationally burdensome and expensive. In particular, changes to the structure of the reported information, for example modifying chapters and the narrative, should be carefully considered, and only implemented if duly necessary.
- Insurance Europe proposes to amend the deadline for annual group submission as stated in Article 254 (3) to 22 weeks after the undertaking's financial year end in order to maintain the existing extension of 6 weeks for group eporting compared to solo reporting. The current proposal on Article 254 (3) requires annual group submission within 20 weeks after the undertaking's financial year end. This reduces the time available for undertakings between submission of solo annual QRT and group annual QRT from 6 weeks to 4 weeks as the proposed submission deadline for solo annual submission is 16 weeks according to the proposed Article 35b (1). This shortening of the reporting deadline is probably unintended as recital 32 of the proposed directive states that "…annual reporting and disclosure deadlines for insurance and reinsurance undertakings and for insurance and reinsurance groups should be extended…".

1.5. Long-term guarantee measures

1.5.1. Extrapolation of RFR curves (Articles 77a, 51)

EIOPA's proposed calibration of the key "speed of convergence" parameter (10% and 40% for SEK) must be significantly increased to least 15% and to around 70% for SEK to avoid excessive increases in the valuation of long-term liabilities and magnification of the artificial volatility to interest rate movements.

In addition, Article 77a should be amended to specify the convergence parameter (exact value), the Deep, Liquid and Transparent (DLT) determination method and the residual volume criterion (ie the percentage value of 6%). These points are not secondary technical issues but the specifications that are crucial for the quantitative outcome of the review. Furthermore, the First smoothing Point (FSP) for the first day of application of the amending Directive should also be specified in the Directive (ie euro FSP=20 years).

The current extrapolation methodology already ensures that low and negative rates are incorporated into the risk-free rate curves and that the extrapolated part of the curve provides appropriate discounting rates.

While the industry does not see the need for a change, it recognises the EC's desire to refine the current extrapolation methodology and include more market data for some currencies.

However, the rationale for the extrapolation methodology was to ensure that the longer cash flows of the insurance liabilities would be less sensitive to short-term price fluctuations. By incorporating more market information and at the same time constraining the stabilizing effect of convergence, the EC's proposed methodology combined with EIOPA's proposed calibration of 10% and 40 % for SEK for the convergence parameter will result in higher volatility of risk-free rates and, thus, of solvency positions. This is contrary to the original objective of the extrapolation methodology.

EIOPA's proposed low "speed of convergence" parameters **would further erode insurer's ability to offer long-term products and guarantees and make the long-term investments that such products require and allow.** To avoid this detrimental result, the convergence parameter must be significantly higher.

1.5.2. Volatility Adjustment (Articles 77d, 86)

Insurance Europe welcomes the EC's proposals on the volatility adjustment (VA) with the exception of its stated intention to adopt EIOPA's proposed changes to the risk correction under level 2. This could undermine the beneficial impact of other improvements and would diminish the anticyclical qualities of the VA. The current risk correction methodology is already conservative and so either EIOPA's proposed change should therefore be dropped or adjusted to avoid procyclicality. All VA changes should be included in Article 77d.

Insurance Europe welcomes that the EC has proposed several important and necessary changes to the design and calibration of the volatility adjustment:

- Increasing the general application ratio to 85%.
- Changing the reference portfolio to be based solely on debt instruments.
- The Macro-VA proposal.
- Inclusion of the 'credit-spread sensitivity ratio' (CSSR) - subject to the definition of the CSSR being amended to ensure it measure the credit sensitivity and not the interest rate sensitivity of the liabilities.

However, **Insurance Europe strongly supports the retention of the current risk correction methodology or, alternatively, to improve the calibration of the methodology proposed by EIOPA and brought forward by the EC.** The EC's proposal to introduce a risk correction which is calculated as a percentage of the prevailing spread could undermine its proposed improvements, outlined above, during

periods of very high market volatility and exacerbate procyclicality. These are exactly the situations when the VA is most important.

The aim of the risk correction is to adjust for the possibility that insurers are not able to earn the spreads based on defaults of the counterparties embedded in the reference portfolio. The calculation of the VA is based on a normal environment and should be assessed as such.

The current risk correction methodology is already very prudent, ensures that insurers hold sufficient reserves to protect against default and downgrade risks, and protects against procyclicality.

Nevertheless, if the EC should decide to consider EIOPA's approach, it will be crucial to modify the design or calibration to mitigate the procyclical effect and ensure the VA continues to be an effective countercyclical tool.

In addition to maintaining the current risk correction, Insurance Europe supports other amendments to the VA framework:

- **The requirement to disclose solvency data without the VA (and matching adjustment (MA)) as well as the official solvency position should be removed**. This is important to avoid any confusion over publicly available Solvency II figures. This will be especially important during any significant market turbulence when multiple solvency data can exacerbate market irrationality.
- The proposed macro-VA mechanism could be further improved to ensure a gradual and smooth activation of the country component and mitigating the cliff effect. This could be achieved by taking into account the "scale parameter" in its activation.
- To determine corporate bond yield curves for currencies where there is little or no data available, Insurance Europe supports the continued use of euro corporate bond yield curves adjusted by 1.5 times the difference between the euro RFR and the local currency RFR.

Insurance Europe also notes that the EC's proposed amendments do not address the issue of artificial volatility arising from discrepancies between the composition of the euro reference portfolio and the composition of individual insurer portfolios. The basis risk leads to significant impact for some markets/companies.

1.5.3. Matching adjustment

Insurance Europe supports the changes to the MA framework proposed by the EC. To correctly implement those changes references to MA portfolios in the Delegated Regulation Articles 70, 81, 216, 217 and 234 should also be removed.

The requirement to disclose solvency data without the MA (and VA) as well as the official solvency position should be removed. In addition to the arguments outlined in section 1.5.2, the industry highlights the following considerations.

- The MA is a permanent measure under the Solvency II framework. Insurance undertakings that apply the MA to a portfolio of insurance obligations cannot revert back to an approach that does not include the MA. Therefore, the requirement to disclosure the impact of a scenario in which the MA would not apply (or would be set equal to zero) in the SFCR is inconsistent with its permanent nature.
- The MA is a key element of the framework at its highest level (Level I Directive) and as such one of the fundamental elements of the framework. Requiring companies to disclose the impact of a scenario in which the MA would not exist might convey the unintended message to the markets that the MA might be a potentially movable or an ancillary element of the framework that might at some point exist or not. The industry considers that such a message would be highly detrimental to all stakeholders.

1.5.4. Transitionals

Insurance Europe does not consider the EC's proposals to restrict the future application of transitional measures and the increased public disclosure on the use and impact of the transitional measures to be necessary. Also, there should be no gold plating of the transitional measures at national level.

1.5.5. Symmetric Adjustment for the Equity risk charge

The application of the symmetric adjustment for the equity risk charge should be made optional because for some insurers it can result in increased, rather than reduced solvency volatility.

The symmetric equity adjustment is intended to be an anticyclical tool which mitigates the impact of short-term volatility in the equity markets. However, it is calculated on the basis of a standard European portfolio of equities which can differ quite significantly from the actual holdings of individual insurers. The differences in the portfolios mean that for some insurers the impact of short-term equity market volatility on the insurer's solvency position is accentuated due to the application of the adjustment. This will be even more pronounced with EC's proposal to widen the corridor to ± 17 % and reinforces the need to make the symmetric adjustment optional.

1.6. Macro-prudential tools (Article 144a-c, Art. 45, 132)

The EC's proposals to implement macroprudential tools into the Solvency II framework go beyond what is necessary given the limited level of systemic risk in the insurance industry. This will create unnecessary regulatory burden. In particular, care should be taken not to undermine Solvency II and impair European insurers' international competitiveness: eg by indirectly increasing capital requirements with a potential supervisory intervention before the breach of the SCR, as proposed in Article 144c.

European insurers oppose amendments that would undermine the current order of intervention powers which are necessarily linked to verifiable thresholds. In principle, the **legal power of intervention by NSAs should be possible only in the case of an SCR breach**. A seamless integration of insurance-specific recovery and resolution framework and macroprudential tools into the existing supervisory ladder is essential.

The EC introduces proposals which give more power to the NSAs in times of liquidity stress and deterioration of the financial position in exceptional circumstances. The exceptional circumstances are not described and subject to future work. However, the powers granted to supervisors could also lead to a self-fulfilling prophecy and should be carefully scrutinised. For example, a liquidity measure could trigger fewer investors to be attracted to invest and therefore this could hinder the re-capitalisation.

The "exceptional circumstances" should be linked with a breach of SCR and directly related to "extension of the recovery period" (Article 138 (4)). If a measure in the context of the liquidity and/or financial situation is proposed, Article 138 (4) should be automatically triggered where there is a breach or where a breach is foreseen.

With respect to liquidity reporting and content of liquidity risk management and monitoring, it should be explicitly noted that the additional guidance should avoid being overly prescriptive (ie resemble the ORSA principles) and should be reflective of the insurance perspective rather than a copy of the banking perspective. There are fundamental differences.

1.6.1. Macroprudential concerns in the ORSA (Article 45)

It is unclear what the EC's expectation is regarding the requirement to consider and analyse the activities of the undertaking that may affect macroeconomic and financial markets' developments, which have the potential to turn into sources of systemic risk (proposed Article 45, 1 (e)).

This proposed requirement to have an outward assessment of systemic risk for each insurance company has the potential to be very far reaching and goes beyond the recommendations made by EIOPA. It is unclear how it could work in practice. Given the very limited systemic, if any, contribution of individual insurers' behaviour and the diverse range of strategies employed across Europe, the potential benefits of this requirement also seem limited and do not justify the substantial costs involved.

Undertakings and insurance groups should, therefore, not be required to analyse whether their activities have the potential to turn into sources of systemic risks. Instead, analysing potential sources of systemic risk should remain the task of the supervisory authorities as part of their macroprudential surveillance.

In addition, having defined parameters goes against the principles of the ORSAs being the undertakings' **own** risk assessments. The choice of scenarios and methodologies to assess relevant risks in the ORSA should be at the discretion of the undertakings. The defined parameters should, therefore, only be included in the ORSA when relevant and material for the undertaking's risk profile. The same applies for the input of macroprudential risks that supervisory authorities should provide to the undertakings in recital (22). When defined parameters and input is required by the undertakings, and thereby a standardised analysis of the risks, the industry takes the view that EIOPA's regular stress testing exercises are a more suitable supervisory tool than requiring it to be included in the undertaking's ORSAs.

1.6.2. Macroprudential concerns in the PPP (Article 132)

It is unclear what the EC's expectation is regarding the requirement to assess the extent to which an insurer's investment strategy may affect macroeconomic and financial market developments and have the potential to turn into sources of systemic risk (proposed Article 132, paragraph 6).

The proposed requirement to have an outward assessment on the potential for each insurer's investment strategy to have an impact on systemic risk has the potential to be very far reaching and goes beyond the recommendations made by EIOPA. It is unclear how it could work in practice. Given the very limited, if any, systemic contribution of individual insurers' behaviour and the diverse range of strategies employed across Europe, the potential benefits of this requirement appear limited and do not justify the substantial costs involved. In addition, this unclarity could have counterproductive effects: For example, it could lead to insurers avoiding certain investments that would have benefited policyholders, improved financial stability or contributed to the conversion to a green economy.

- The proposed paragraph 7 should read "For the purposes……. macroeconomic **and financial markets'** developments and macroprudential concerns shall have the same mean as in Article 45"

1.6.3. Liquidity risk management plans (LRMPs)– Article 144a

The requirement for all (re)insurers, except those classified as LRPU, to submit LRMPs is overly burdensome. A much more proportionate scope should be foreseen or at the minimum, the frequency for submitting a reduced LRMPs for those insurers who have low liquidity risk should be limited to every three to five years.

Liquidity risk plans and liquidity risk indicators should be designed and reflect (re)insurers' own assessment of their liquidity position, including under stress. Company-specific plans and indicators ensure that they result in useful and practical risk management tools rather than arbitrary metrics.

Therefore, Insurance Europe suggests removing the empowerment to EIOPA to standardise the content of the plans (delete Art.144a (6)). Article 144a (2) is sufficiently clear as to what is expected in the plan.

1.6.4. Supervisory power to remedy liquidity vulnerabilities in exceptional circumstances – Article 144b

Article 144b paragraph 2 proposes new powers for supervisors to intervene to reinforce the liquidity position of each undertaking when liquidity risks or deficiencies are identified. While the EC requests the form, activation, and calibration of these powers to be further specified in guidelines to be developed by EIOPA, further detail on what is foreseen by the EC is needed to make a complete assessment of this proposal, and this should be specified in Level 2 and not in guidelines.

The proposed powers for supervisors to intervene to reinforce the liquidity position can have negative consequences for the insurance companies as well as the policyholders, but also for financial stability if it increases procyclical behaviour. For example, if these powers are used to require insurers to reduce their investment in less liquid assets this could have negative consequences for pension savings, for example, as liquid assets often have lower returns. It is, therefore, very important that such powers are only considered in very rare and exceptional circumstances where large liquidity risks or deficiencies exist and can be clearly demonstrated. In addition, the powers must be proportionate to the severity of the liquidity risks and deficiencies.

The implementation of the proposed powers for NSAs to temporarily suspend redemption rights (paragraph 3) would, in the industry's view, result in EIOPA receiving "de facto competencies" with regards to supervisory measures because it would be tasked with defining the "exceptional circumstances" which may justify the suspension of redemption rights. This task, however, is for the legislator — at least to specify some basic details. This applies with respect to paragraph 4, which allows the suspension of redemption rights to all undertakings when exceptional circumstances affect the whole or a significant part of the market.

Insurance Europe proposes for the following considerations to be taken into account when further specifying these powers.

- Should the powers allow intervention against undertakings that do not have significant liquidity risks? Any such measure taken against healthy undertakings is not appropriate and therefore not justified.
- In case the reference to paragraph 3 in paragraph 4 is to be understood as reference to legal consequences the only condition for the material intervention to the whole market – including companies not affected directly – would be "exceptional circumstances", as defined by EIOPA Guidelines. As those are not material law, the industry doubts whether there is a sufficient legal basis for such an intervention. Consultation with the group supervisor with respect to restrictions of intra-group dividend distributions (Article 144c (6) 2nd sentence) may be helpful and could be foreseen.

1.6.5. Supervisory measures to preserve the financial position of undertakings during exceptional market-wide shocks (Article 144c)

The EC has proposed that supervisory authorities shall have the power to restrict or suspend dividend distributions to shareholders and other subordinated creditors for 'undertakings with a particularly vulnerable risk profile'.

This power is an extreme measure and the criteria mentioned in Article 144c are not sufficient. The criteria 'exceptional sector-wide shock' and foremost 'particularly vulnerable risk profile' need to be defined in more detail on Level 1 for such serious measures.

- First, the future relationship with the already existing automatic suspension of dividends (EC Delegated Regulation 2015/35/EU, Article 71 paragraph 1 lit l and m) must be clarified.

- Second, the notion of a "particularly vulnerable risk profile" must be clarified and aligned on Level 1 with the existing risk-based logic of a potential non-compliance with the SCR as the fundamental reference value.
- Third, under paragraph 5 these measures shall be limited (instead of reviewed) to three months and may be renewed (by another three months) to avoid any risk of creating a perpetual situation.
- Fourth, the individual, case-by-case assessment of the financial and solvency position of undertakings should be further accentuated to avoid any analogy that "sector-wide shocks" automatically result in "sector-wide suspensions of dividend distributions".
- Fifth, the application of the measures shall duly take into account the rights of shareholders and other subordinated creditors as well as potential effects on capital markets in case of listed undertakings.

While the exception for intra-group transactions makes sense, the reference to significant intra-group transaction is unduly restricting the ability to make intra group transactions at a level below the relevant significance thresholds. In the case of larger groups, the sum of dividends that on an individual basis are deemed non-significant can be significant on aggregate.

1.6.6. Macro-prudential tools at group level (Article 308b (reduction of own funds stemming from transitional measures)

The EC has proposed that, where an insurance group is using transitional measures on risk-free interest rates or technical provisions in subsidiaries, the group supervisor shall have the power to reduce the amounts of group own funds stemming from the use of these transitional measures, if the group materially relies on these transitional measures in such a manner that it misrepresents the actual solvency position of the group, even if the solvency ratio for the group without transitional measures is above 100%.

The only criteria required for this far reaching and extreme decision of the supervisory authority is 'misrepresentation of the solvency position'. There is no further definition of 'misrepresentation' in the amendment leaving the interpretation of this terminology solely to the supervisor without any concrete reference points for the insurance undertaking (group). This proposed amendment must be clearly formulated in detail with clear reference points for the insurance industry. There has been no prior consultation regarding criteria for such decisions by a supervisory authority.

1.7. Amendments related to the European Green Deal / Sustainable investments

Insurance Europe welcomes that the EC does not introduce artificial incentives or disincentives based on green or brown qualifications that are not risk appropriate.

The EC's mandate for EIOPA to explore by 2023 a dedicated prudential treatment of exposures related to assets or activities which are associated with environmental and/or social objectives is appropriate as long as the approach remains risk based, thereby preserving the risk-based nature of the Solvency II framework.

However, even if such a review is welcomed in principle, the risk exists that, due to lack of data, the review could produce results that are not representative. Against this background, the industry supports the repetition of this review at a later point in time — to be defined — on a much broader market basis: eg once the EU Green Bond Standard is in use and once the new Corporate Sustainability Reporting Directive (CSRD) feeds into the new EU database for sustainable company data.

The proposed inclusion of climate stress testing within the ORSA and the request for EIOPA to regularly review the natcat parameters to assess if they need to be adjusted in light of the impact of climate change are both recognised by the industry as necessary developments.

1.8. Group Supervision

The EC's proposals to change the requirements on group supervision and to grant additional powers to the group supervisor in Solvency II — without clear justification of their need — go far beyond what is necessary to address group-related issues. Care should be taken not to overburden groups through the creation of unnecessary new requirements and costs.

In particular, the following points must be considered:

- It is important that the scope of group supervision in Solvency II is consistent with International Financial Reporting Standards (IFRS) and that intermediate insurance holding companies are taken out of scope.
- It is unclear how the newly proposed Articles 144a–c shall or can be applied mutatis mutandis at group level. It is also unclear whether supervisory measures in consequence to Article 144a–c can or shall be taken at group level as well in cases where such measures are applied at solo entity level. As this would neither make sense nor would it be proportionate, therefore clarification should be provided.
- The power to require a group to restructure would go beyond what is necessary to supervise groups. Organisational freedom is essential, and changes might have a substantial impact on the group, including on, for example, resources and taxes. Supervisory authorities already have the necessary power to sufficiently supervise groups with complex organisational structures. Even if there are (few) cases in which this may be difficult, this should be solved at level of the supervising authority and does not justify such an extensive intervention.
- While Insurance Europe welcomes the creation of proper group minimum capital requirements (MCR), the text reads as if the previous minimum consolidated SCR will continue to exist as well, as such penalising the global presence of European groups
- There should also be no additional supervisory powers in the context of transitional measures within group own funds. The fact that supervisory actions could be taken would create de facto a level of intervention before the breach of group SCR which undermines the effectiveness of transitionals.
- Regarding group own funds, expected profits included in future premiums (EPIFP) should not be included in the group's regular availability assessment. EPIFP are the result of a valuation based on economic principles and part of the reconciliation reserve. They are fully recognised as unrestricted Tier 1 items, and there is no justification apparent for burdensome continuous assessment.
- The scope of groups and definitions of parent company and subsidiary should not be amended.

1.8.1. Definition of the group, including issues of dominant influence; and scope of the group supervision/ Definition of IHC

- The industry notes the following regarding the proposals to facilitate the identification of undertakings which form a group, in particular with respect to groups which are not in the scope of Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, and to horizontal groups (Article13/Article 212).
    - Definitions in Article 13 of "parent undertaking" and "subsidiary undertaking" should not be amended.
    - The widening of NSAs' mandate to establish new groups in Article 212 should not be introduced, but be aligned with financial reporting legislation. Having different group structures for different legislation (eg financial reporting, banking regulation, financial conglomerates) can create at the very least difficult governance issues.
      These proposals could be interpreted as requiring independent companies and groups of companies that co-operate to be included in group supervision, on the basis of such co-operation. Such co-operations can be fully in line with other legislations, such as competition law. In particular for mutuals it is quite common to have different kinds of

co-operation. If the proposal is intended to have such an impact, it would be very extensive and far-reaching, while achieving very litte benefits in practise. Furthermore, the proposals give supervisors too much discretion.

In addition, if a supervisor deems two or more companies to be a group (or the case where an existing group also should include one more company), these companies need time to adjust. Changing group scope may imply very extensive changes: eg to group calculations and reporting. This should be catered for in the Directive.

- The industry notes the following regarding the proposed amendments to bring insurance holding companies and mixed financial holding companies directly in the scope of the EU prudential framework. The new paragraph 3a requires appropriate internal governance and corporate structure for groups whose parent undertaking is a holding company, to allow for effective group supervision. Paragraphs 3b and 3c are inserted to ensure appropriate enforcement powers, including, as a last resort measure, the power to require the group to restructure (Art 213).
  - In some Member States financial conglomerates within the meaning of the Ficod Directive ((2002/87/EC), ie groups headed by a mixed financial holding company as the parent undertaking of both a banking sub-group and an insurance sub-group), play a very significant role in the domestic market, for example in Finland.
  - And in some Member States, a mixed financial company can also be, at the same time, a central body for the credit institutions affiliated to that central body within the meaning of Art. 21 of the CRD and Art. 10 of the CRR and ; in such cases the group consists of the central body and credit insitutions affiliated to it (together often referred to as a co-operative network) as the banking arm of the group and one or more insurance companies as the insurance arm of the group.
  - According to the proposed Art.212 (2) *" …the supervisory authorities shall also consider as a parent undertaking any undertaking which, in the opinion of the supervisory authorities, effectively exercises a dominant influence over another undertaking, including where this influence is exercised through centralised coordination, over the decisions of the other undertaking"*.
  - As such, the definition of insurance group on the basis of the provisions above could, if the scope of insurance group remains as proposed, result in including in insurance group supervision also the credit institutions (in practice small local banks) affiliated to the central body within the meaning of CRD Art. 21 and CRR Art.10. on the basis of the central body's statutory obligation to give instructions to the affiliated credit institutions.
  - In practice this would mean that the definition of an insurance group is not limited to insurance subsidiaries but covers all subsidiaries, including i.a. credit institutions and investment firms.
  - As a consequence, the supervision of insurance groups should be fully applied also to credit insitutions, the parent undertaking of which is a mixed financial holding company, unless adjustments are made to the proposed amendments of Solvency II.
  - Given that credit institutions and investment firms and groups they belong to are subject to requirements on their internal govenrance, risk management and resolution that are at least equal to the requirements for insurance companies, **the scope of insurance group supervision in groups headed by a mixed financial holding company should be limited to the subsidiary insurance companies headed by a mixed financial holding company, at least if the mixed holding company is subject to EU law.**
  - The current Proposal could be unduly interpreted as requiring co-operative networks to be included in the scope of insurance supervision on the basis of the central body's obligation to steer those networks and to draw up consolidated annual accounts at the level of the cooperative group.

  <u>Proposed changes to address this:</u>

The following new Article 213b is proposed to be added to the Directive:

Article 213b

Groups headed by a mixed financial holding company

3. Where the parent undertaking of a group is a mixed financial holding company, a group shall mean for the purpose of this Title, the part of a group, which consists of the mixed financial holding company and its subsidiaries and participations, which are insurance undertakings or reinsurance undertakings.

By derogation from this Title and the first sub-paragraph the Group solvency shall be calculated in accordance with the Directive 2002/87/EC.

Paragraphs 3 and 4 of the existing Article 213 should be deleted.

Alternatively, in case the newly suggested Art. 213b proposed above is not accepted, it is proposed to add the following paragraph to Article 212:

Article 212

Definitions

…

3. Where a central body within the meaning of Article 10 of the Regulation (EU) N:o 575/2013 is a mixed financial company at the head of a group, the central body and credit institutions affiliated to it shall not be considered to be related to each other within the meaning of this Article.

- Paragraphs 3a and 3b should not apply to intermediate insurance holding companies. In particular with respect to intermediate holding companies, without any steering role the increased obligations that are proposed are not justified, and are redundant to the obligations of the ultimate parent (re)insurance undertaking, insurance holding company or mixed financial holding company of the group.
- In any case, the power to require a group to restructure would go beyond what is necessary to supervise groups. Organisational freedom is essential, and changes might have a huge impact on the group, including, for example, resources and taxes. In the industry's view, supervisory authorities already have the necessary power to sufficiently supervise groups with complex organisational structures. Even if there are (a few) cases in which this may be difficult, this should be solved at level of the supervising authority and does not justify such an extensive intervention.

- **Article 214/paragraph 64** is amended to clarify when an undertaking can be excluded from the scope of group supervision, when group supervision can be waived or can be exercised at the level of an intermediate parent undertaking.
  - The clarification in Article 214 (1) that *'the exercise of group supervision in accordance with Article 213 shall not imply that the NSAs are required to play a supervisory role in relation to the third-country (re)insurance undertaking or the MFHC*' is welcomed.
  - The exclusion of undertakings from group supervision shall be assessed by national supervisors against a list of criteria. In line with the review's ambition to cover as much group situations as possible, the criteria should apply – as proposed in the EIOPA Opinion – in an alternative instead of a cumulative way.

1.8.2.
1.8.3. Supervision of Intragroup Transactions (IGTs) and Risk Concentration (RCs)

- The EC has proposed a review of the definition of 'IGT to be reported' so that group supervisors get the power to tailor the definition of 'intra-group transactions to be reported' so that it better fits the specificities of each group (Article 245/Article 265). This creates a risk that NSAs will implement and use this flexibility with significant variation over time and as compared to other NSAs. There is also a risk that it will result in different requirements compared to the related definitions in Financial

Conglomerate Directive (FICOD)-regulation, leading to an additional reporting burden for some groups.

1.8.4. Cap on minimum consolidated group SCR and Treatment of Insurance Holding Companies (IHC), Mixed Financial Holding Companies (MFHC), for the purpose of Notional SCR and Own Funds calculations

- Article 230 (2) was modified so that, similarly to individual insurance and reinsurance undertakings, the minimum consolidated group SCR is never higher than 45% of the consolidated group SCR.
  - The industry strongly welcomes the EC's efforts to address the trigger inversion issue and the proposal to consider the minimum of 45% of the group SCR and the existing Min.Cons.Group SCR as the relevant minimum consolidated SCR.
  - However, the wording of the new paragraphs 2 and 3 of Article 230 in the proposal would imply that the previous minimum should continue to exist, in addition to the new one. To address this, the second subparagraph of paragraph 2 could be adjusted as follows:

    2. The Solvency Capital Requirement at group level based on consolidated data (consolidated group Solvency Capital Requirement) shall be calculated on the basis of either the standard formula or an approved internal model, in a manner consistent with the general principles contained in Title I, Chapter VI, Section 4, Subsections 1 and 2 and Title I, Chapter VI, Section 4, Subsections 1 and 3, respectively.
    For the purpose of the calculation referred to in paragraph 3, point (b), of this Article, ~~the consolidated group Solvency Capital Requirement shall have as a minimum~~ the sum of the following item shall be used:
    (a) the Minimum Capital Requirement as referred to in Article 129 of the participating insurance or reinsurance undertaking;
    (b) the proportional share of the Minimum Capital Requirement of the related insurance and reinsurance undertakings;

    This would be sufficient to address the trigger inversion issue while still ensuring that the minimum reflects the full scope of undertakings in the group.
  - In addition, the EC proposal would require groups to include the (notional) MCR of third country (re)insurance, IHCs, third-country IHCs and MFHCs when calculating the new minimum consolidated group SCR (Article 230/233a). To avoid double-counting of risks depending on the structuration of groups, Insurance Europe would like the EC to clarify that intra-group transactions should not be taken into account in the calculation of minimum consolidated group SCR.

1.8.5. Group SCR calculation when using combination of methods

- In Article 233, the EC clarifies that, to avoid material increases in capital requirements, it should be clarified that, for the purpose of calculating the consolidated group SCR, no equity risk capital charge is to be applied to such holdings. For the same reason, currency risk charge should only be applied to the value of those holdings that is in excess of the SCR of those related undertakings.
  - In paragraph 75, the EC notes that participating (re)insurance undertakings should be allowed to take into account diversification between that currency risks and other risks underlying the calculation of the consolidated group SCR, however this does not seem to be reflected in the proposed amendments to the directive.
  - The EC proposes to introduce additional capital requirements for currency risk for participations for entities included in group solvency via Method 2 (ie the deduction and aggregation method). This would be detrimental to the principle of protecting all

policyholders of the group, to the level playing field principle and contrary to the principle of equivalence.

- The industry fails to see the benefits of this. It seems to mean that related insurance undertakings must be included in consolidated data, even though they are included in group own funds and SCR calculations using Method 2. This is unnecessarily complicated and not in line with a scenario where Method 2 would have been used exclusively. The industry suggests amending Article 233a(3) as follows:

(3) For the purposes of paragraph 1, point (a) (i), and paragraph 1, point (b)t (i) of this Article, holdings in related undertakings referred to in Article 220(3) to which method 2 is applied shall not be included in the consolidated data.

For the purposes of paragraph 1, point (b) (i), of this Article, the value of holdings in undertakings referred to in Article 220(3) to which method 2 is applied, in excess of their own Solvency Capital Requirement, shall be excluded when calculating the Solvency Capital Requirement at group level based on consolidated data. ~~in the consolidated data when calculating the sensitivity of assets and liabilities to changes in the level or in the volatility of currency exchange rates ('currency risk'). However, the value of those holdings shall not be assumed to be sensitive to changes in the level or in the volatility of market prices of equities ('equity risk').~~

1.8.6. Scope of Method 2 (where used exclusively/or in combination with Method 1)

- Article 220 aims to specify which undertakings may be included in the group solvency calculation through Method 2, thereby clarifying that such a method should only apply to (re)insurance and undertakings, 3rd (re)insurance undertakings, undertakings belonging to other financial sectors, MFHC, IHC, and other parent undertakings the main business of which is to acquire and hold participations in subsidiary undertakings, where those subsidiary undertakings are exclusively or mainly (re)insurance undertakings.
  - The industry proposes the following change in wording to the article, because this amendment intends to clarify that the combination of methods can be used to contribute to an international level playing field for European insurance groups (eg when local capital requirements are used in the group capital calculation, similar to local insurers and non-EU groups operating in these markets):
  - *Article 220(b) However, Member States shall allow their supervisory authorities, where they assume the role of group supervisor with regard to a particular group, to decide, after consulting the other supervisory authorities concerned and the group itself, to apply to that group method 2 in accordance with Articles 233 and 234, or, where the exclusive application of method 1 would not be appropriate, a combi-nation of methods 1 and 2 in accordance with Articles 233a and 234, **including in order to ensure an international level playing field;***

1.8.7. Own Funds requirements for groups

- **Article 230 paragraph 1** introduces minimum criteria to allow for the identification of cases where an own-fund item issued by a participating undertaking is clear of encumbrances.
  - This amendment should not be introduced, or at least restricted to own fund items issued by a participation insurance holding company or a mixed financial holding company. This seems to be what is intended (see recital 68).
  - The consequences of the proposal are unclear and potentially detrimental to insurance companies' access to capital markets. Would a subordinated liability in a parent undertaking be disqualified from own funds if there is not a condition in its terms that it

will be not repaid if any of its insurance subsidiaries/participations is being wound up? Will the capital market accept such instruments? Would the rule apply also to instruments already issued?

1.8.8. Application of Article 228 of the Solvency II directive - Inclusion of Other Financial Sectors

- Article 228 also states that "*the amount of own funds of each related undertaking corresponding to non-distributable reserves and other items identified by the group supervisor as having a reduced loss-absorbency capacity, as well as preference shares, subordinated mutual members account, subordinated liabilities, and deferred tax assets, that are included in the own funds in excess to the own fund requirements calculated in accordance with paragraph 3, shall not be taken into account, unless the participating insurance or reinsurance undertaking is able to justify, to the satisfaction of the group supervisor, that those items can be made available to cover the group SCR.*"
  - While the financial impact for companies may be limited, providing the proof would be a very costly and burdensome process.
  - Own funds from other financial sectors are already considered on the basis of the respective applicable sectoral rules. The proposed additional limitation for the recognition in the calculation of group own funds is too restrictive. It should be noted that in the previous version of EIOPA`s advice, the required analysis of the loss absorbing capacity was only needed in cases of material impact. This reference is missing in the actual version of the EC's proposal. In the specific case where the group does not hold the majority of the Other Financal Services (OFS) entity, it will be very problematic and burdensome to have access to all the relevant information. Additionally, the EC should provide more detailed information on how the cooperation with the group supervisor must be organized, respectively which criteria must be fulfilled in detail to fulfil the necessary requirement of availability to absorb losses. And finally, the aspect of immateriality needs to be addressed: eg if the impact of restrictions on the loss absorbing capacity is immaterial, no restriction needs to be applied.
  - Furthermore, it should be made clear that participating undertakings that head a group which is also identified as a financial conglomerate can use the same test of transferability of excess of own funds from other financial sectors than insurance as they already use under the financial conglomerate rules. These undertakings should not be required to perform this transferability test in a different way under Solvency II rules.

1.8.9. Article 229a – simplified calculations for determining group SCR

- Article 229a is inserted to grant the possibility, subject to supervisory approval, to use a simplified approach to the integration of non-material related undertakings in the group solvency calculation. Materiality thresholds are introduced. Insurers must assess materiality on a yearly basis and must disclose the size and a list of related undertakings using the simplified approach
  - The proposed percentage (between 0.2 and 0.5% on an aggregated basis) seems very low and makes the proposed solution not very meaningful. The proposed thresholds never have been a topic of discussion in the previous publications and even if the term "consolidated accounts" is interpreted as the sum of the group balance sheet (sum of assets), these thresholds are far below those already used and agreed with national authorities. If groups must enlarge their Solvency II calculation scope due to the introduction of these far too low thresholds, it will take a significant amount of time and resources to implement those companies with no added value. **The proposed thresholds should be reconsidered: eg a total sum of book values of 1% of total assets (consolidated accounts) would be reasonable.** The threshold for each individual related undertaking should be adjusted appropriately. Referring to the new Article 229a, the materiality thresholds are defined by 0,2% of the group`s consolidated

accounts per entity and by 0,5% of the consolidated accounts in total. To have a common understanding of the proposed thresholds, the term "consolidated accounts" must be clarified.

- Article 234 Delegated Acts

  Article 229a introduces concrete thresholds/criteria for the simplified approach to participations in related undertakings (Solvency II scope), but in the proposed amendment to Article 234, a future delegated act may further specify the criteria for the group supervisor approval. A further specification beyond concrete thresholds is not necessary or of use. This proposed passage regarding Article 229a is therefore of no added use and should be deleted.

1.8.10. MUTATIS MUTANDIS principle

- Responsibilities of AMSB of the head of the group extended to ensuring compliance with all group requirements. This principle is against a company law principle which states that each subsidiary with legal personality remains fully responsible for its own activities. To this end, Articles 246 and 257 are amended to clarify the application mutatis mutandis at group level of governance rules applicable to individual undertakings. Those amendments include the role of the AMSB of the parent undertaking and require that groups ensure consistency of the group written policies with those adopted by related undertakings. Finally, they clarify that the persons in charge of other key functions within IHC and MFHC should be fit and proper.
  - It is unclear how Article 144 a-c can or shall be applied mutatis mutandis at group level. Intervention powers must have a clear and certain legal basis, which is not the case where the "mutatis mutandis" leaves significant uncertainty as to the legal requirements for any such intervention against the participating undertaking: eg it is unclear:
    - In the case of Article 144b, whether the parent undertaking also needs to be a life insurance undertaking.
    - Whether any undertaking-related requirements must be met at the level of the participating undertaking and any market-related requirements for the market of the participating undertaking.

    Since the macroprudential measures are not motivated by the safeguard of the group's solvency or liquidity, the criteria of intervention at group level lacks consistency.
  - Article 257: Should not apply to intermediate insurance holding companies unless significant steering occurs in such a holding.

1.9. Supervision of cross-border insurance business

Insurance Europe welcomes proposals to strengthen the cooperation between home and host NSAs around the activities of businesses operating cross-border through the freedoms of services and establishment (FOS/FOE). However, this should not result in overburdening or even discriminating against (re)insurers whose business model integrates the opportunities created by the single market and/or the nature of the risks they underwrite. It is therefore important to ensure the solutions are tailored to the specific problems they seek to solve, which are ultimately about ensuring that supervision is effective and the SII framework is fully applied.

- Efficient information gathering during the authorisation process
  - Insurance Europe supports for the proposed new provisions under articles 18 and 23/25, requiring businesses to declare previous rejections of withdrawals of authorisations (whether formal or informal) and ensuring they also list the markets they intend to be active in. Indeed, it is essential to ensure that individuals who were not deemed fit and proper in one jurisdiction do not manage to get around this refusal by asking for the authorisation in another jurisdiction.

- Cooperation between home and host NSAs during ongoing supervision
  - Insurance Europe welcomes the proposed article 33a's emphasis on improved home and host NSAs cooperation in cross-border cases, while maintaining the home Member State principle. However, the definition of "significant cross-border activity" is too simplistic, not risk-based, and therefore should be improved. Cross-border business is not inherently riskier, which is what is implied by using the 5% threshold as the single criterion to separate businesses that should receive increased scrutiny. Insurance Europe calls for a more comprehensive risk-based approach not limited to the share of the annual GWP written through FOS/FOE, with criteria that truly capture those undertakings with unsustainable business models, as confirmed by EIOPA itself in its recent report on "Failures and near-misses".
  - Insurance Europe also notes that the concept of significant cross-border business is also coming up in other legislative proposals. It is therefore also important to ensure coherence, with one general clearly defined concept.
- Information exchange between home and host supervisors in case of material changes in the FoS activities
  - Insurance Europe supports the new article 149's aim to enhance the information exchange between home and host NSA in cases of material changes in the FOS activities, and the clearer definition of "material change". However, it may be necessary to better define when exactly this obligation is triggered on the undertaking's part.
- Extended obligation to notify
  - Insurance Europe is very supportive of the obligation found in the new article 152a for the home and host NSA to notify both EIOPA and other concerned NSAs if an FOS/FOE undertaking's financial condition is deteriorating or other risks emerge (including consumer protection concerns). Such proactive measures are very welcome.
- Mediation role for EIOPA in complex cross-border cases where NSAs fail to reach a common view in the collaboration platform
  - Whilst Insurance Europe welcomes the mediation role envisaged for EIOPA in the new article 152b, we regret the absence of proposal to upgrade supervisory platforms to facilitate exchange of information between home and host NSAs. The digitalisation of supervision should be taken advantage of to improve cross-border cooperation between NSAs and avoid waiting until the situation of an undertaking is deteriorating to increase the cooperation. Standing digital platforms would allow a permanent exchange of information between home and host NSAs and facilitate greatly the implementation of many of the Commission's proposals. They should be based on existing structures (supervisory colleges). In its digital strategy, EIOPA outlines ambitions to further facilitate the cooperation of NSAs through digital tools. Cross-border collaboration and the operation of these platforms should be a priority and the legal basis for this should be included in the Solvency II Review.
- Explicit power of the host supervisor to request information in a timely manner
  - The new article 153's suggested power for the host NSA to request information in a timely manner from the home NSA and the undertaking in the local language should be more strictly framed for the latter. In general, it should be noted that such local language requirements could impact on the ability to share information in a timely manner. There must not be information distortion between host and home NSAs, with the host NSA more up to date about an undertaking than its home NSA, and duplicated requests for information from undertakings should be avoided. The host NSA should only be authorised to approach the undertaking in exceptional cases, where the request for information addressed to the home NSA is urgent and was dismissed or not adequately complied with. The home principle should not be undermined in any way for example. The procedure regarding information requests, including timelines, should then be set out in the legal texts. There should be no uncertainty for undertakings as to who they should

respond to and by when. Additionally, provision of information should only be required in either the home supervisor language or in English. It should be noted that the aforementioned upgrade of supervisory platforms can facilitate the exchange of information and transparency between NSAs substantially and ensure that the same information is available for all concerned NSAs.

- Additional requirements related to significant cross-border activities
  - The new article 159a significantly increases the powers of the host NSA, which can be warranted in very specific cases. However, it should be properly framed so as not to undermine the home Member State principle. The process and timeline it sets out do not necessarily seem adequate given the urgency which is likely to be needed in cases where an undertaking will not meet the MCR.
  - Furthermore, this provision should apply in compliance with existing regulation, specifically in cases where a supervisory college exists. Indeed, the EC proposal could end up undermining supervisory convergence in the case of Groups with established colleges, by creating the possibility of having different supervisory approaches for Groups with different business structures.Existing structures such as those for supervisory colleges are already an existing example of information exchange and cooperation.
  - The inclusion of reinsurance and captive (re)insurance undertakings within the scope of these new requirements is incompatible with the nature of the reinsurance and captive (re)insurance business. The Solvency II Directive defines reinsurance as the activity consisting in accepting risks ceded by an insurance undertaking or third-country insurance undertaking, or by another reinsurance undertaking or third-country reinsurance undertaking. By nature, reinsurance is a business-to-business activity that is intrinsically cross-border. Captive (re)insurance undertakings only manage risks on behalf of undertaking belonging to the same economic group, an activity usually international and not exposing third-parties to any risk. Reinsurance and captive (re)insurance undertakings should therefore be excluded from the scope of article 159a, which fails to recognise the specificity of reinsurers' business models.

1.10. Internal models (articles 122 and 112)

There should be no new requirements on the use of the Dynamic Volatility Adjustment (DVA) for internal model users and no standard formula reporting requirements for internal model users.

NSAs already have extensive data from companies and tools to ensure that internal models continue to generate prudent SCR numbers, and they are responsible for the internal model approval, so it is unclear which additional insights the new templates would provide.

Regarding the proposed changes to the modelling of the DVA in internal models (Article 122), Insurance Europe highlights:

- The Solvency II Directive already contains several requirements and standards on internal models, including the Use Test, statistical quality standards, calibration standards, profit and loss attribution, validation standards and documentation standards (Articles 120-125). These ensure that internal models are appropriately calibrated and robust.
- The introduction of a standardised approach for a specific element of internal models goes against the principle of internal models and will undermine the internal consistency of these models by losing the congruence between the SCR and the balance sheet with subsequent negative impact on risk management.
- In addition, the requirement of requesting two separate SCR calculations and taking the highest outcome might run contrary to the fundamental principle to calibrate the capital requirement to a 1-year 99.5 value at risk (VaR), to which current internal model DVA models are already calibrated.

- The inclusion of the EC's new requirements would result in significantly increased operational burden for internal model firms who use the DVA without commensurate risk management or policyholder protection benefit.

Regarding the proposals for esko'srecital 44 is welcome, as it emphasises the objective of imposing no "limits" on Internal Models as a consequence of standard formula supervisory reporting.

1.11. Other issues

1.11.1. Governance

The added requirement in Article 41(1) third subparagraph, specifying that the internal review of the system of governance shall include an assessment of the administrative, management or supervisory body, **must be amended to align with company law**. The assessment of the administrative, management or supervisory body should not be performed by the staff but by, for example , a nomination committee appointed by the annual shareholders' meeting.

1.11.2. Legal certainty with regard to the "eternal cancellation right"

Article 186 of Solvency II is not in line with more recent legislation, such as the Consumer Rights Directive (CRD), as it does not provide for a time limit of the customers' cancellation right. Consequently, under Article 186, any error in the customer information may trigger an "eternal cancellation right". This allows customers to rescind the contract years or decades after its conclusion in order to retrospectively avoid the contractually agreed costs. Article 186 should be amended in accordance with the CRD, which stipulates a time limit of 12 months under any circumstances.

1.11.3. Market access of third country reinsurers

Absent regulation on the market access for third country reinsurers in Europe contributes to a fragmented regulatory environment in member states and creates an unlevel playing field for the (retro-)cession of insurance risks outside the EU. This has potential to put cedents (and their customers) at a competitive disadvantage and skew operation of the insurance markets as a result of reduced capacity and higher protection costs. Therefore, the review should tackle this issue and ensure a harmonized approach by enabling all EU cedents to benefit from unhindered access to international reinsurance markets on a cross-border basis.

1.11.4. Obstacle to legally effective netting agreements

Article 275 (1a) stipulates that the claims of the insured take priority over all other claims. The absence on an exception for netting agreements of derivatives makes it difficult for insurers to use this recognized risk mitigation technique which could help to reduce risk and to protect liquidity. Netting agreements are rightly privileged in the Capital Requirements Regulation and European Market Infrastructure Regulation and should also be possible under Solvency II.

2. Comments on EC communication

2.1. Equity investments

Insurance Europe welcomes the EC's stated intention to revise the eligibility criteria for the long-term assets class. However, the detail of any changes will be key to achieve the improvements needed so that a significant portion of standard formula insurer's equity holdings would qualify.

The insurance industry is Europe's largest institutional investor and, as such, it has a direct interest in long-term investment, especially given that most of these assets back long-term liabilities (eg pension and savings products).
The Solvency II framework should recognise these long-term investments with appropriate capital requirements that reflect their true long-term risks. In this respect, the industry appreciates the EC's work in this area so far and acknowledges the steps taken with the objective to improve the framework for long-term equity (LTE) in Article 171a of the Delegated Regulation.

However, the LTE sub-module must appropriately recognise the fundamentals of long-term investments. Long term-investing is not simply about maturity or duration of assets or about restricting individual assets to be held to maturity or for a certain number of years. Instead, it is about the nature of the liabilities and the overall risk and investment strategy, which allows the insurer to hold its investment portfolio over a long-term horizon. The ability and willingness to invest long-term is directly related to the nature of the liabilities of insurance companies and is not in contradiction with dynamic management of the investment portfolio in line with best risk management practices.

As it stands, some improvements are necessary for the LTE sub-module to fully capture the essence of long-term investments and to adjust the conservativeness of its application criteria, which seriously harm its usability. Specifically, some application criteria in the LTE are hard to fulfil and very burdensome, which is a deterrent to the use of the LTE sub-module. The practical difficulties to apply the sub-module deter companies from attempting to use it in the first place, de facto creating a situation similar to the Duration Based Equity Risk (DBER) sub-module, which is not used in the EEA.

A review of the specific criteria of Article 171a will also help deliver on the broader European objectives set out in the Green Deal and the Capital Markets Union (CMU), as well as support the EU investment plans towards the social and economic recovery of Europe.

Finally, the industry notes that the impact of using the LTE sub-module might be limited if the characteristics of long-term investments are not adequately considered irrespective of whether an insurer uses an internal model or standard formula. Adequate consideration of long-term investments will increase the ability of all insurers, including internal model users, to invest in equity, which is in line with the CMU objective to deepen the European financial markets.

2.2. Risk margin

Insurance Europe welcomes the EC's recognition that significant improvements are needed to the design and calibration of the risk margin. While the changes proposed by the EC will result in a justified reduction in the risk margin, it is important to highlight that even further reductions would be justified: eg by a combination of recognising diversification, a justified lower cost of capital, a lower lambda parameter.

At a minimum, the EC's proposed changes to the risk margin should be safeguarded in the Level 1 text by the inclusion of appropriate wording in Article 77. And, as previously highlighted by the industry further

adjustments would also be justified. These further improvements could be achieved through (an appropriate combination) of the following elements:

- A lower calibration for the currently proposed lambda of 0.975
- Recognition of diversification that exists between life and non-life business within the same entity, or between different entities within a group.
- A reduction in the Cost of Capital rate.

2.3. Diversification benefits

Insurance Europe welcomes the EC's proposed reduction in the correlation parameter between interest rate down risk and spread risk in the standard formula from 0.50 to 0.25. However, a correlation of 0.0 can also be justified and in line with the correlation between upward interest risk and spreak risk.

There is not sufficient evidence for complex two-sided correlations in the market risk module, in particular between interest rate risk and spread risk, at all.

2.4. Calculating the capital requirement for interest rate risk

Insurance Europe welcomes that the EC has recognised that the interest rate shock in the standard formula is consistent with the approach used to value those liabilities and have therefore applied an extrapolation methodology to construct the 1-in-200 year interest rate shocks.

However, the proposed methodology may result in unrealistically large decreases in the liquid part of the curve. This should be addressed by reflecting the reduced downside risk in the negative territory. One possible way to achieve could be to include a floor which reflects a realistic lower bound to interest rates. EIOPA's proposed floor would have no material impact and is not a suitable solution.
While the changes made to the interest rate risk submodule are needed to incorporate the risk of a low or negative interest rates, they should not however be unnecessarily excessive. This would undermine the ability of insurers to write long-term products and guarantees.

Insurance Europe further supports that the EC's proposed changes to the interest rate risk methodology should be safeguarded in the Level 1 text. Therefore, wording along the following lines should be added to Article 105 of the Directive to reflect these requirements: *Article 105b: The interest rate risk sub-module calculated in accordance with the standard formula shall be calculated in accordance with Article 77a and reflect a realistic lower bound for interest rate term structures.*

2.5. Further recognition of risk-mitigation techniques within the standard formula

Insurance Europe welcomes the fact that in the communication, the EC notes its intention to improve the treatment of non-proportional reinsurance in the standard formula, in line with EIOPA's advice. While this is a positive development as EIOPA recommends to improve the recognition of risk-mitigation techniques, – specifically adverse development covers (ADCs) under the reserve risk sub-module in the standard formula – it **is regrettable that it introduces limitations and therefore fails to completely address the issue**.

Insurance Europe supports the **extension of ADCs proposal to multiple lines of business.** The formula proposed by EIOPA should also apply to multiple lines of business and shouldn't have any limitation to the attachment point, as the economic effects of the attachment point are already recognised by the formula and thus doesn't exclude possible cases of underestimating risks (as is also an intention by the EC according to its communication referred to above).

The industry encourages the Commission to address this issue as improved recognition of ADCs will consequently reduce the volatility of small and medium-sized insurance companies, while protecting their back book of historical risks from distortions.

In addition, EIOPA advised to introduce new requirements for allowing standard formula users to have their reinsurance program recognised in Article 210 of the Delegated Regulation, on top of the existing safeguards in the regime. EIOPA's advice to the EC was based on the consultation document of September 2020 and not on the final EIOPA Opinion on the use of Risk Mitigation Techniques published in July 2021.

EIOPA agreed to review its position on reinsurance recognition after feedback from stakeholders, in particular, EIOPA agreed to clarify that a reinsurance arrangement may not pass the "commensurate" test where it creates "*a significant deviation of the risk profile of the undertaking from the underlying assumptions of the SCR*". In other words, a reinsurance arrangement may not qualify for a SCR reduction if it renders the SF inappropriate to capture the risk profile of the ceding undertaking.
Against this background, the EC is urged to read EIOPA's advice in conjunction with the final Opinion on the matter.

2.6. Mortgage loans

The current calibration of mortgage loans is justified by the real economics and risks faced by insurers investing in such loans. In its Solvency II Overview (here), the EC sets out compelling reasons why strict alignment of capital requirements in banks and insurance is not appropriate and why a direct comparison is misleading. It is therefore unclear why the EC now pursues some form of regulatory alignment of solely mortgage loans.

Regarding mortgage loans, it is crucial that the risk mitigation by the (risk-adjusted value of) mortgage continues to be adequately recognised. In particular, it should not be undermined by a floor for the loss given default of the mortgage loan (brought into discussion by the European Systemic Risk Board (ESRB)). Such a blind takeover from the completely different banking regulation would neither be risk-sensitive nor in line with Solvency II principles (99.5% VaR).

Furthermore, it is noted that the comparison between banks and insurance companies in the referenced ESRB paper is based on the Basel III and Solvency II standard formulas, while in practice banks usually run an internal model thus the actual capital requirements are not compared.

Also, banks and insurance companies have different business models. Banks are transforming short-term liabilities (current account and savings deposits) into long-term assets (mortgage loans), while insurance companies do have long-term liabilities (long-term life insurance) for which they need long-term assets (mortgage loans). As such, mortgage loans are often a good fit for asset liability management (ALM) purposes.

Mortgage loans are an important asset class with a plenty of small individual exposures with low risks and without short-run market value fluctuations. However, currently not all mortgage loans are subject to the counterparty default risk module but instead to the — inadequate — spread risk module. In particular, the limit of one million euros for mortgage loans subject to the counterparty default risk module neither accounts for the developments of the local property market nor is it risk sensitive. Therefore, it should be deleted or at least raised. Moreover, not only mortgage loans to natural persons but also to communal and cooperative housing societies should be eligible.

2.7. Dynamic volatility adjustment

The Directive should clearly specify that there should be a Dynamic Volatility Adjustment (DVA) available for standard formula users.

Although the DVA is already foreseen in the Directive (Article 105 (d)), it is currently ignored in the level 2 text. Therefore, in Article 105 wording along the following lines should be included: *The spread risk sub-module calculated in accordance with the standard formula shall take into account the effect of credit spread movements on the volatility adjustment calculated in accordance with Article 77d.*

Solvency capital requirements should be based on the real risks to which insurers are exposed. The inclusion of a DVA in the standard formula ensures that the capital requirements for investing in corporate bonds under the standard formula would be based on the long-term risks: ie the risk of default, rather than the short-term risks.

The Directive already foresees that the 1-in-200 scenarios used to calculate the SCR should be applied to both sides of the balance sheet: ie the value of the assets and liabilities should both be recalculated in accordance with the given scenario. This "total balance sheet" approach is a fundamental principle of the Solvency II system and is already applied to other key risks that consider to both assets and liabilities (ie interest rate risk and FX risk).

Insurance Europe has developed a proposal for the inclusion of a DVA in the standard formula, which is prudent, risk sensitive and easy to implement. Further information on this proposal can be found here.

2.8. Matching adjustment

To correctly implement those changes, references to MA portfolios in the Delegated Regulation (Articles 70, 81, 216, 217 and 234) should also be removed.

See also comments provided in section 1.5.3.

2.9. Treatment of EPIFP at group level

- The treatment of EPIFP at group level should remain unchanged, and not be included in the group's regular assessment. EPIFPs are an important part of the Solvency II framework allowing the reflection of economic reality, with respect to the principle of going concern. As such, they are a useful element, notably to encourage the offer of long-term guarantees. Furthermore, Article 330 of the DR already provides for NSAs the power to challenge the availability of own funds items that are assumed available. Supervisors also have the power to review the best estimate calculations, knowing that EPIFPs are just an output of the economic value of insurance liabilities. Creating an availability assessment process specific to the EPIFP, on top of what is already required by Art.330, would only add burden and uncertainty in the group capital assessment for no purpose.

2.10
2.11 Other topics

- **Property risk:** There should be a review of the property risk stress factor included in the proposals. The standard formula property risk factor which was calibrated solely with exceptionally volatile UK data is clearly too high given the evidence in the EU. In addition, a revised capital requirement could foster insurers' contribution to the financing needs of economic recovery, the Capital Markets Union and, particularly, the decarbonisation targeted by the European Green Deal.
- **Lapse risk:** There should be a review of the lapse risk submodule. In the life insurance lapse risk scenarios, the risk factors are currently only selectively applied to those contracts for which the changed lapse rates increase the obligations. In practice, however, movements in lapse rates are largely homogeneous over all contracts. Therefore, the assumed changes in option exercise rates should apply to all contracts in each scenario.
- Moreover, the risk factors for the life and health mass lapse scenarios appear to be unreasonably high. No evidence of the veracity of the calibrations has been provided by EIOPA whereas in reality,

even in extreme situations of individual life insurers, lapse rates of 40% (or 70%) have not occurred. The mass lapse risk factors for life and similar to life techniques health should therefore be recalibrated (or at least be re-placeable by an undertaking-specific parameter).

3. Comments on EC's Impact Assessment

The presented estimations suggest a more or less stable or slightly increased capital in excess of regulatory requirements (at the end of the transitional period). However, this neither holds for all national markets, nor for all market situations (regarding both interest rate level and spread level). This applies even more as the net effect of the proposal results from different positive and negative effects that are very much larger. Small changes (or uncertainties in the estimation) of these opposing effects may result in big changes of the (instable) net effect.

For an informed decision on the EC's proposals, more clarity on their impact should be provided regarding underlying assumptions, drivers, and their effects at member state level and not only for the EU as a whole.