Position Paper

Views on EIOPA's opinion on the 2020 review

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1. General comments

1.1 Introduction

Solvency II is strongly supported by the insurance industry. The economic, risk-based framework has proved its value since it was first applied in January 2016.

Solvency II has a significant impact on the industry's ability to offer (long-term) products to consumers and make (long-term) investments in the economy. Solvency II is a milestone in the integration of the EU single market for insurance. However, the framework — as it is today — creates unnecessary costs and barriers, in particular in relation to long-term business. In concrete terms, it has a number of measurement flaws that result in excessive capital requirements and volatility, and it is extremely burdensome from an operational point of view.

At a time when the insurance industry is increasingly called on to support EU economic recovery and a sustainable path for Europe, it must emphasise that it can only contribute to its full capacity if the Solvency II review produces the right results. This requires a limited but important set of improvements. The recent crisis has demonstrated that the industry is sufficiently capitalised — in fact, the current levels of required capital are already excessive. The appropriate improvements will lead to a justified reduction in capital requirements and will also address the artificial volatility that Solvency II creates today. These improvements are not only needed to enable the industry to support the EU ambitions of a green recovery and growth and its delivery of the CMU objectives. They are also indispensable to allow the industry to compete internationally with non-EU players, whose regimes are significantly less burdensome.

The Solvency II review should not lead to a fundamental overhaul of the system. Instead, targeted improvements are needed. Embedding a greater capital burden and new requirements in the framework — as suggested by EIOPA — is not justified. Instead, a more efficient and effective framework is necessary.

1.2 Comments on EIOPA's advice to the European Commission

EIOPA's advice from December 2020 is a missed opportunity to appropriately address the existing flaws in the framework, in a way that also supports the EU's overarching objectives set out in the Green Deal and the CMU.

According to industry analysis, **EIOPA's proposals would decrease the risk-taking capacity of the industry by around €60bn[1]. This can mean lower capacity for the industry to take (long-term) risk on both product offering (ie, insurance solutions to customers) and investment in the economy. EIOPA's proposals would also increase — not decrease — the volatility in the solvency measurement**.

A €60bn capital impact would reduce investment capacity by the equivalent of **around €170bn of equity investments or around €680bn of corporate bond investments.** Some of the unnecessary impact would inevitably be passed on to consumers. Such an outcome is in stark contrast to what policymakers expect from the industry; effectively more — not less — risk-taking capacity for the benefit of Europe's economy and its consumers, especially in light of the need for post-pandemic recovery.

EIOPA did not provide evidence that the industry needs more capital overall. If anything, the recent COVID-19 experience has confirmed the strength of the industry and proved its ability to withstand extreme market conditions.

With respect to the EIOPA impact assessment:

- It does not consider the impact of the proposals at other points in time.

[1] €60bn is the estimated impact of the EIOPA's proposals at 30 June 2020 without the transitional measures. EIOPA adds even more complexity with new transitional measures in an attempt to mitigate its increases. However, these do not change the ultimate negative impact and they do not work for all countries. The estimate also does not include the potential impact of proposals on group requirements or the costs of implementing new requirements in areas such as reporting, recovery and resolution.

- It focuses on the impact at European level rather than at member-state level.
- It does not assess the proposals against the broader European objectives of growth, recovery and the green transformation agenda.

Similarly, many elements of the EIOPA advice increase the complexity of the framework and would lead to significant additional burdens and costs.

To conclude, if the EIOPA advice is followed without changes, Solvency II's conservativeness and measurement flaws would be further amplified, preventing the insurance industry from fully supporting the EU's ambitious goals.

1.3 The industry priorities for the review

Highlighted below are the industry's four recommended priorities for the review. An overview of the industry positions on the full EIOPA advice is provided in the later chapters of this paper.

Priority 1: Address flaws for long-term business

Insurers' capacity to invest over the long-term is based on their business model, including their ability to offer long-term products. Addressing related flaws will help avoid pro-cyclical behaviour and better reflect the long-term nature of insurance business. This would allow the industry to both: 1) continue offering long-term savings and guarantee products that consumers value and need; and 2) enhance its investments in the real economy, including in equities and assets that support the sustainable transition.

Specifically:

- There is no need to change the current **extrapolation methodology for risk-free rate curves**. They already include low and negative rates. EIOPA's proposals add further complexity and are unnecessary because there are already mechanisms in place to ensure that, even if rates stay very low, insurers will hold enough assets for very long-term liabilities.
- For the **risk margin**, EIOPA's proposal is not sufficient. Greater investment capacity could be mobilised if a sufficient reduction is pursued through an appropriate combination of reducing the cost of capital, recalibration of the proposed lambda, and allowing for group diversification.
- For the **volatility adjustment (VA)**, a mechanism is needed that appropriately mitigates artificial volatility and recognises the returns that insurers can earn by increasing the overall application level and improving its sensitivity to the reference portfolios spread volatility. This can be achieved by maintaining the currency reference portfolio approach and introducing the following changes based on EIOPA's proposals: increase in the general application ratio, an undiluted reference portfolio, improving the country component and inclusion of an overshooting ratio adjustment. For improvements to be effective and avoid unnecessary complexity and procyclicality, they must not include EIOPA's unjustified proposals to change the risk correction and add a liquidity adjustment factor. Indeed, these two elements would undermine other improvements and the ability of the VA to work as a counter-cyclical mechanism.
- The industry recognises the need to reflect **negative interest rates** in solvency capital requirements, however EIOPA's proposals need to be improved so that there is an appropriate floor to how negative interest rates can go and the stressed rates are calculated in a way consistent with how rates would change in practice.
- The standard formula solvency capital requirements for investments need to better reflect the real long-term risks faced by insurers, not only the short-term market movements by:
    - **For equities**, improving EIOPA's proposals so the qualifying criteria for long-term equities work.
    - **For corporate bonds and private debt**, introducing the dynamic volatility adjustment (DVA), which permits the correct measurement of spread risk, into the standard formula and avoiding new requirements for users of internal model.

- **For property**, the risk factor should be reduced significantly to reflect the real risk of these assets.

Overall, to mobilise the investment capacity of the industry, the improvements to the VA, risk margin and capital charges for investments — with the extrapolation remaining unchanged — should more than offset the increase in capital from incorporating negative interest rates, leading to a justified and needed overall reduction in capital and volatility.

Priority 2: Do not gold-plate international agreement on systemic risk measures

The implementation of the holistic framework for addressing systemic risk, including pre-emptive recovery and liquidity risk management plans, should be done with proportionality in mind and should not gold-plate what was agreed internationally. Only measures referenced in the EC Call for Advice should be considered.

- EIOPA's additional proposals on **capital surcharge for systemic risk, concentration thresholds, new triggers for preventive measures** and **dividend controls** should not be taken forward. Solvency II is already designed with early intervention powers for supervisors as soon as the SCR is breached, and this should not be changed.

Priority 3: Address operational complexity and burden

This can be achieved by making sure proportionality works in practice and simplifying and streamlining reporting requirements. It will lead to a more diversified and efficient insurance market, which is directly beneficial for European consumers.

- EIOPA's proposals on **proportionality** are a step in the right direction but need improvements to work as intended.
- Its proposals on **reporting** (such as mandatory audit requirements on top of the existing supervisory review processes, additional and/or changed templates) increase rather than reduce the burden and the costs, and policyholders and other stakeholders would not benefit from the changes.

Priority 4: Focus on areas of proven need, avoid changing what works

The Solvency II review should focus any changes on areas where there is a proven issue, should avoid changes where there is no real need, and should especially avoid changes to areas that have proven their value. In particular:

- **Supervision of cross-border operations** is the only other area (beyond those listed above) in which further changes are justified to create more coherence and convergence in the supervision of activities based on freedom of services/freedom of establishment and the protection of consumers. The industry therefore welcomes EIOPA's proposals to strengthen and enhance cooperation between home and host authorities.
- **IGS schemes should remain at national level.** A harmonisation project would create significant costs and involve complex challenges, for which there may not be acceptable solutions. The focus and priority should instead be on ensuring that Solvency II is applied appropriately in all member states and that Solvency II supervision is effective and national supervisory authorities act in a coordinated manner.
- No new requirements for **internal models** are warranted. **Internal models** are a key element of the framework, allowing for a more tailored measurement of complex risks. Insurers' ability to reflect their own risks in their internal models, such as via the DVA, must be preserved. There are already extensive and rigorous supervisory approval and reporting processes and EIOPA's proposals for new requirements such as the Enhanced Prudency Principle for the DVA and additional reporting and disclosure requirements to conduct comparisons with the standard formula would be onerous and undermine the models' purpose.
- No changes are needed on **group supervision,** except for fixing the trigger inversion issue, where there is a clear flaw to address. Other EIOPA proposals (eg, changes to the recognition of future profits and other changes to the availability assessment, new requirements for aggregation method 2, the addition of a notional SCR for holdings, transposing solo governance requirements to groups) would add more complexity, costs and capital for Solvency II groups, further undermining the European industry's competitiveness globally.

2. LTG measures and measures on equity risk

Section 2.1 Extrapolation of risk-free interest rates

A. Industry proposals for the review

Insurance Europe does not support any change to the current approach. The existing Smith-Wilson extrapolation methodology and parameters should be maintained. Additional complexity is not necessary and additional volatility must be avoided.

If, notwithstanding our strong objections, the alternative extrapolation method is introduced, Insurance Europe is ready to work with the European Commission and other stakeholders to change EIOPA's proposals to minimise the most problematic elements and reduce unintended consequences. This would need an improved calibration of the model which:

- ensures appropriate levels of stability for the valuation of long-term liabilities are achieved through an increased convergence parameter.
- continues to use the matching criterion to determine the first smoothing point (FSP).
- incorporates a transparent, understandable and predictable tool to contribute to financial stability. This should be developed based on EIOPA's proposed implementation mechanism and should be applicable for all currencies.
- considers the consequences for all currencies.

B. Comments on EIOPA's opinion

EIOPA's proposals to change the extrapolation of the RFR curve are based on the perception that the current approach results in under-reserving, risk management disincentives and issues of financial stability. Insurance Europe considers these issues to be significantly overstated by EIOPA. They do not justify the significant and disruptive reductions in, and increased volatility of, available own funds which would be the result of EIOPA's proposals.

EIOPA's analysis, sourced from the HIA and CIR, show that its alternative extrapolation methodology would:

1) unnecessarily increase liability valuations for long-term liabilities; and
2) increase artificial volatility and procyclicality within the framework.

No need to change the extrapolation method

To counteract the negative impacts of its proposals, EIOPA has developed an implementation mechanism which would mitigate the impact of its proposals a little (depending on the market situation and country) up until 2032.

While it seems that the proposed implementation mechanism would provide some necessary implementation time for long-term businesses to absorb the extreme impacts of the changes (note that affected insurers would still bear a significant impact in the first year), on further assessment it raises a number of important questions about the whole proposal to change the extrapolation methodology.

1) **Why no change to the current extrapolation method is needed.**
   - The current extrapolation method has proven its worth: it contributed significantly to a stabilisation of SII results in 2020 and has proven to be anti-cyclical. EIOPA does not provide evidence that its proposed alternative extrapolation method has the same desirable features.
   - The framework already captures long-term interest rate risks and the resulting discount rates used to calculate liabilities are very low already, it thus sets proper risk management incentives for new business.
   - In view of the possibility of rates remaining low for a long time, the UFR methodology was changed in 2017 to ensure that this will result in lower levels in the extrapolated risk-free curve.
   - Beyond this, the interest rate risk SCR module already ensures that insurers hold capital in case rates are even lower in the future. The level of capital required will increase for standard formula

users after amendments are made to incorporate negative rates into the IRR sub-module as part of this review (see section 5.1 for further comments on this interest rate risk).

- The alternative extrapolation methodology would impact existing Euro denominated liabilities which are at least 20 years in the future. But by 2032, the proportion of 20+ year liabilities will decrease due to the runoff of these portfolios. However, insurers with a higher remaining volume could still be significantly impacted.
- Insurance Europe supports the use of a consistent extrapolation method for all markets. Changing the extrapolation will have consequences for all currencies. EIOPA has failed to duly consider the impacts for non-Euro currencies in its assessment of the issue and in its proposals.

2) **Why introduce additional and unwarranted complexity and reporting burdens into the framework?**
   - The changes proposed by EIOPA add extra complexity to the methodology for setting risk free rates.
   - It will also increase the operational burden as insurers could have to make three sets of calculations, with extrapolations based on a convergence parameter of 10% (40 % for Sweden), 5% and X% (where X is set by the implementation mechanism). Having to calculate the impact of the implementation mechanism will result in a significant burden and cost for the companies as the SCR, technical provisions and own funds (eg. the full economic balance sheet) would have to be calculated multiple times.
   - The high number of sensitivities which are required to be calculated and disclosed will set unclear risk management incentives.
   - Similarly, certain features of the alternative extrapolation method create perverse risk management incentives. For example, insurers in the eurozone will have the (wrong) incentive to decrease 25y swap positions in favour of 30y swap positions because of the weightings which have been used in the model for the euro.
   - The forward rates under the alternative extrapolation approach are not continuous which means that no arbitrage-free valuation is possible. This complicates the risk-neutral valuation of embedded interest options.

3) **If the implementation mechanism is to be an integral aspect of the new methodology, why is there a requirement for supervisory reporting and public disclosure of the insurer's solvency position without it?**
   - Public disclosure of the solvency position without the impact of the implementation mechanism undermines the proposal and effectively creates a shadow solvency requirement and an additional supervisory intervention point above the SCR.
   - EIOPA proposes that undertakings disclose a sensitivity analysis with a convergence parameter, a, of 5% which itself undermines the 10% convergence parameter of its proposed alternative extrapolation methodology. It is also particularly problematic for the Swedish Krona for which EIOPA has proposed a normal convergence parameter of 40%.

Drawbacks of EIOPA's proposed alternative extrapolation methodology

- **It increases balance sheet volatility.** EIOPA's proposed calibration of the alternative extrapolation methodology could result in additional volatility of the value of liabilities and Own funds. This volatility can be mitigated (to a certain extent) by extensive use of derivatives. However, as noted below, this can be very costly and could create additional systemic and liquidity risks.
- **It increases the link and interactions with derivative markets**. Replacing a significant part of insurers' bond investments with receiver swaps means that banks acting as counterparties will have to enter into huge amounts of payer swaps. Even if banks were able to hedge most of this exposure, this may increase the interdependency between insurers and banks and thus increase systemic risk. The margining and collateral requirements for swap contracts can also create significant liquidity requirements across the industry during stress periods. Further consequences may arise if European CCPs have insufficient capacity to meet additional demand.**For some currencies, it uses market data**

of very long-term instruments (up to 50 years), which might have poor liquidity and might therefore be volatile.

- **It ignores the Matching Criterion** which mandates that insurers should be able to match their liabilities cashflows with bond cashflows. It is not feasible for all insurers to match their risk reflected in the solvency risk balance sheet using derivatives. For some undertakings, hedging by means of derivatives is only possible to a limited extent. In addition, hedging with derivatives is not straightforward (especially for smaller insurers) and requires expertise and an adequate (and costly) infrastructure. Furthermore, there may be legal obstacles to overcome to use derivatives.
- **It sets a strong procyclical incentive in an environment of historically low yields**. Life insurers and pension funds hold long-term bonds to maturity to match liability cashflows. The higher the maturity, the higher the proportion of buy and hold exposures. When rates fall, more and more investors start to chase the few bonds which are available. This change will amplify the incentive for insurers to buy more bonds which will arise from the proposed changes in the interest rate risk module.
- **It has been designed with a focus only on the euro without enough consideration of the consequences for non-euro currencies.** In addition, the impact on non-euro currencies is not analysed nor considered in the opinion or the background document even though it will lead to significant lower risk-free rates for some non-euro currencies as well.

It should also be noted that there are already a number of elements in place to cover the risk that interest rates stay low for a very long term and ensure that companies and supervisors are well equipped to manage such an eventuality:

- The updated UFR methodology provides a mechanism which if applied for the coming years will lower the extrapolated rates every year.
- There is an interest rate down shock SCR (which will be increased to allow for already negative rates to fall even further) which means that capital is held for even lower rates.
- Low for long stress tests are done regularly (every three years) and provide information to ensure the impact of such scenarios can be understood.
- The ORSA and the undertakings overall solvency needs typically include low for long scenarios for long-term business and hence developments with lower interest rate are already considered in decisions about capital distributions.

C. Conclusion

EIOPA's advice to change the extrapolation methodology should be rejected and any specific supervisory concerns addressed via supervisory dialogue and existing Pillar II provisions, such as the ORSA.

If, not notwithstanding the industry's strong objections, the alternative extrapolation methodology is implemented, then the calibration of the model must be changed. In addition, a transparent, understandable and predictable tool to aid financial stability, based on EIOPA's proposed implementation mechanism, should be developed which is applicable for all currencies.

Based on the industry's preliminary analysis, increasing the convergence parameter, a, to 20% for the Euro and 70% for the SEK would balance EIOPA's aims to include additional market data beyond the current last liquid point for the Euro and maintaining the anti-cyclical qualities of the existing method. The final calibration of any changes to the risk-free curve methodology would require careful consideration and Insurance Europe stands ready to work with the European Commission to minimise the most problematic elements and reduce unintended consequences.

Finally, all model parameters, especially the convergence parameter a, and criteria used to determine the first smoothing point should be fixed in the legal texts.

Section 2.2 Matching Adjustment

A. Industry proposals for the review

Insurance Europe supports the improved recognition of diversification between MA and non-MA portfolios in the standard formula and confirmation that restructured assets are MA-eligible.

B. Comments on EIOPA's opinion

The industry supports EIOPA's proposal to remove the restrictions on diversification between MA and non-MA portfolios in the standard formula.

C. Conclusion

The proposed changes to the Matching Adjustment represent an improvement to the framework and should be included.

Section 2.3 Volatility Adjustment

A. Industry proposals for the review

The industry supports improvements to the volatility adjustment (VA) that result in the following necessary outcomes:

A. There is a general increase in the level of the VA to properly reflect the ability of insurers to earn returns above risk-free rates.
B. The VA provides increased mitigation of artificial balance sheet volatility.

Achieving these outcomes would result in a VA which would remove barriers to the provision of long-term products as well as mitigate procyclicality in the Solvency II framework.

The outcomes listed above can be achieved through the following focused and economically justified changes to the existing VA-mechanism.

1. Unjustified and arbitrary deductions and dilutions should be removed from the VA calculations. Concretely,
    a. The 35% haircut due to the General Application Ratio
    b. The allocations to equity and property in the reference portfolios.
2. The country component which mitigates against localised market volatility should be more effective and its activation should be smoothed to avoid cliff-edges.
3. Recognising valid supervisory concerns, Insurance Europe also considers that a mechanism to mitigate against overshooting should be implemented.

B. Comments on EIOPA's opinion

While EIOPA's proposed changes to the VA do contain a number of important improvements, these are offset by its detrimental proposals on the risk correction and liquidity application ratio.

In its impact assessment, EIOPA notes that the introduction of its proposed VA would result in an average increase in the level of the VA. However, it is important to note that the improvement is very small and only occurs because spreads are very low. In periods of high corporate spreads, its proposals will result in a lower VA. Any potential benefit is country and company specific and dependent on prevailing market conditions. For example, at YE2019 and Q2 2020, Danish companies were on average worse off under EIOPA's proposals.

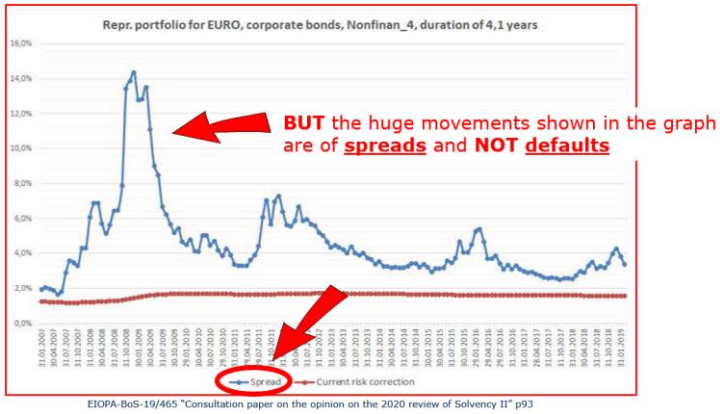
Risk correction

Insurance Europe strongly opposes EIOPA's hypothesis that the risk correction is misestimated and strongly opposes the option to calculate the risk correction as a percentage of the prevailing spread. Its proposal would severely restrict the ability of the VA to offset artificial spread volatility, making the VA less effective during a crisis, thereby undermining the anti-cyclical effect of the VA.

EIOPA's assessment that the risk correction is misestimated is based on a number of flawed arguments.

Firstly, EIOPA makes a comparison between the historical spread movements and the risk correction during that period and asserts that this is evidence that the risk correction is not sufficiently sensitive to spread movements. EIOPA's chart is included below.

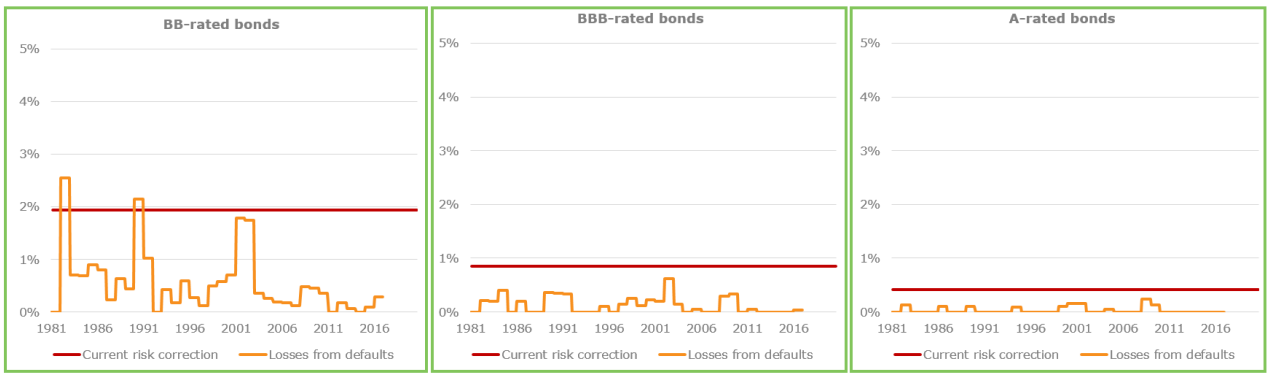
Flawed comparison of spread movements and risk correction for BB-rated bonds



Source: EIOPA

However, the correct comparison which should be made to assess the effectiveness of the risk correction is between the risk correction and the losses which occur due to defaults. Insurance Europe's analysis, shown in the charts below, shows that the risk correction would have provided sufficient protection against losses from defaults over the past 40 years.

Comparison of risk correction vs losses from defaults



Source: S&P, EIOPA, Insurance Europe calculations

EIOPA has made similar analysis of the efficacy of the risk correction in its assessment of the Matching Adjustment in its LTG reports which draws the same conclusion with real insurer portfolios and defaults albeit over a shorter period.

It is also worthwhile to note that EIOPA's assessment is based on BB-rated bonds which make up less than 1% of VA users' portfolios.

Secondly, EIOPA asserts that its proposed changes to the risk correction are unanimously supported by academic literature. Insurance Europe does not agree that academia supports EIOPA's hypothesis that the level of the spread is linked to the default rate and considers EIOPA's references to academic literature to be misleading in this respect. For example:

- According to Amato and Remolona (2003)[3], for corporate bonds, expected loss accounts for only a small fraction of spreads across all rating categories and maturities. They also state that "In general, spreads magnify expected losses, but the relationship is not one of simple proportions" and that "a more relevant feature of the relationship between spreads and expected losses is that the difference between them increases in absolute terms as the credit rating declines."
- Alexopoulou et al. (2009)[4] decompose the observed credit spreads into the expected losses and the risk premium. They proxy the market's perceived default risk by one-year-ahead expected default frequencies (EDF) provided by Moody's. By assuming a 40% recovery value (a standard assumption in literature) they derive the risk premium as the absolute difference between the observed level of CDS spreads and the expected loss.
- Fischer and Stolper (2019)[6], using data for the 2004-2016 period, find empirical evidence for corporate bond prices to be primarily driven by credit risk and interest rate risk during quiet market conditions. During more anxious and volatile markets, however, the impact of these two factors abates, whereas liquidity risk becomes the salient issue. While representing a negligible factor during calm phases, market-wide illiquidity shocks appear to result in substantial and long-lived increases in risk premia on the corporate bond market when a bearish sentiment prevails. This considerable impact of illiquidity on corporate bond spreads has not been reported previously by similar empirical studies based on simpler models. The results – which are shown to be robust against various modifications of the model setup – suggest that in highly unstable times - like the global financial crisis - liquidity risk may supersede credit risk as the most important determinant of corporate bond spreads.

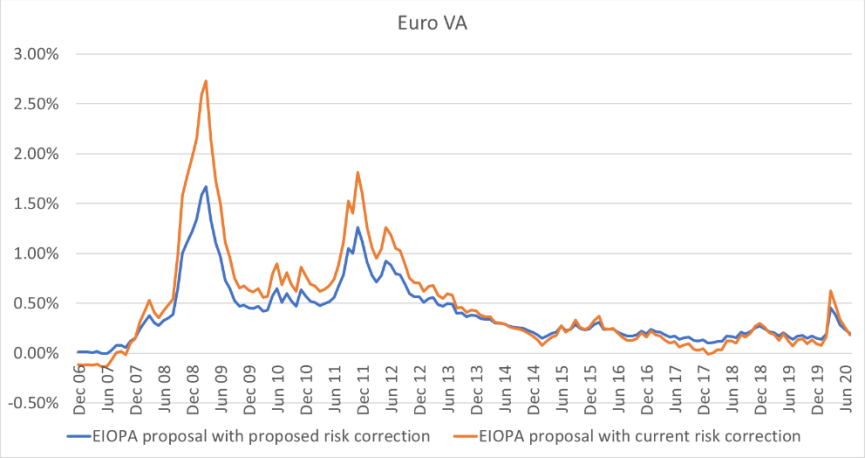
Impact of proposed risk correction

As noted above, EIOPA's proposed changes would severely restrict the ability of the VA to offset artificial spread volatility. This is illustrated in the chart below which shows a simulation of EIOPA's proposals[2] over the past 14 years. The orange line shows the EIOPA proposal with the current risk correction and the blue line shows the EIOPA proposal with its proposed risk correction.

As it can clearly be seen, the VA with EIOPA's proposed risk correction severely restricts the level of the VA during crisis periods (ie 2008 and 2011) when the measure is most needed. Instead, it provides additional relief when credit spreads are compressed.

All else being equal, a higher and more responsive VA will provide additional protection to insurers' balance sheets. Reduced protection during periods of stress and increased protection during normal periods would clearly increase procyclicality in the framework and transfer volatility to the Own Funds; this is at odds with EIOPA's stated intentions of increasing financial stability and reducing artificial volatility.

[2] Simulation is based on 2020 EIOPA Reference Portfolio, Liquidity application ratio (AR5) = 75% and overshooting ratio (AR4) =100%.



Source: Insurance Europe calculations, Refinitiv and EIOPA data

Ideally, the risk correction should reflect the expected cost of default and downgrade ie be a realistic assessment of the costs incurred by holding a diversified portfolio of bonds over the long-term. As such, this should be based on historical average default statistics, as it currently is.

The following should also be considered when assessing the risk correction methodology:

- The current methodology already contains a margin for prudence relative to the true expected default costs for corporate bonds due to the long-term average spread underpin.
- EIOPA's proposal would lead to double counting of risk because unexpected credit risk is already included in the SCR for spread risk. References to unexpected credit risk should be removed from Article 77d of the Solvency II Directive.
- Changing the risk correction from an absolute deduction on spread levels to one that is proportional to the current spread level will remove the counter cyclical effect of the VA and will transfer volatility to the Own Funds, which is unlikely to be desirable from a macro-economic point of view.

In light of the arguments reported above, it is also worth to highlight that EIOPA's risk correction proposal is contrary to the European Commission's request to assess the efficient functioning of the VA as a mechanism to prevent pro-cyclical behaviour on financial markets and to mitigate the effect of exaggerations of bond spreads.

EIOPA's proposal to change the risk correction would undermine its proposed improvements to the VA, make capital levels even more volatile and reduce the efficacy of the VA as a countercyclical tool. If, notwithstanding our strong objections, EIOPA's proposal was considered further, then material changes to its proposed methodology would be needed to ensure the VA's ability to continue as an effective countercyclical tool.

Liquidity application ratio

EIOPA's proposed liquidity application ratio is also ill-conceived and detrimental to the justified mitigation of artificial spread volatility.

As EIOPA has noted in its recent report on liquidity stress testing[3], a proper assessment of the liquidity position of an insurance undertaking needs to account for the full range of liquidity sources and liquidity needs in a holistic perspective. However, in its proposal for the VA, EIOPA has restricted its assessment of liquidity to a very simplified bucketing of liabilities, based on the existence and potential impact of lapse features and mortality shocks. It ignores sources of available liquidity which insurers can use to cover liquidity needs.

The VA is used to value the best-estimate of the liabilities (BEL). The inclusion of a liquidity application ratio introduces an element of stressed valuation into the BEL creating a double counting of the risk (as it is already

[3] Methodological Principles of Insurance Stress Testing – Liquidity Component

accounted for in the SCR eg. for lapse risk). It is therefore not needed and also adds unnecessary complexity to the VA framework.

The existing VA provisions require companies to prepare a liquidity plan and to demonstrate they are not exposed to forced sales. These provide sufficient evidence that the liquidity profile allows the VA to be earned. The COVID experience has evidenced this to be the case.

Macro-VA
The revised implementation mechanism proposed for the Macro-VA is supported because it will remove the cliff-edge application of the existing country component.

The proposed mechanism could be further improved by more properly taking into account the *Scale* parameter in the activation of the macro-VA, as the component ω - designed to ensure a gradual and smooth activation of the country component and mitigating the cliff effect - is based on non-rescaled risk corrected spreads.

Increasing risk sensitivity of the VA mechanism
EIOPA have proposed a number of changes which will increase the risk-sensitivity of the VA mechanism.

- The proposed *Scale* parameter removes the reference portfolios' allocation to non-fixed income assets in the VA calculations.
- The inclusion of an overshooting application ratio will adjust the VA benefit to better fit the size and duration of the insurer's fixed income portfolio.

These adjustments will result in a VA which provides a more tailored and fully justified benefit for each insurer.

General Application Ratio (GAR)
EIOPA's proposed increase of the GAR from 65% to 85% is a welcome change and rightly recognises that the current 65% level is overly prudent; however, 85% remains much more prudent than is necessary.

EIOPA references its original proposal of a 20% GAR (for the original Volatility Balancer idea) as a reason why the GAR should not increase beyond 85%. It is worthwhile highlighting that the 20% level would have resulted in a completely ineffective VA mechanism and has no economic basis.

Supervisory approval
It is unclear what benefit would be derived from the proposal for a mandatory application process for new VA-users. The proposal appears to be somewhat at odds with requests to limit the burden on supervisors and the existing extensive usage of the VA and expected time delay between EIOPA proposals and implementation of revised legislation.

Other
Insurance Europe also supports the retention of the approach to use euro corporate bond yield curves adjusted by 1.5 times the difference between the euro RFR and the local currency RFR to determine corporate bond yield curves for currencies where there is little or no data available.

C. Conclusion

The VA was intended to mitigate the impact of short-term fluctuations in bond spreads which create artificial balance sheet volatility for insurers and to represent the returns that insurers can and do earn above the risk-free rate.

In its advice, EIOPA has made a number of proposed improvements to address some of the agreed shortcomings of the existing VA design. However, it has also made two very damaging proposals which will reduce its effectiveness, namely the proposal to change the risk correction and the liquidity application ratio. These proposed modifications on the VA design will also increase the complexity of its use, which will result in an increased operational burden for the undertakings and disincentivise its use.

To achieve an effective VA mechanism, the following changes should be applied to the current reference portfolio approach:

- using an undiluted European reference portfolio (ie inclusion of the *Scale* parameter);
- increasing the general application ratio to 100%;
- improving the country component; and
- inclusion of an overshooting ratio adjustment.

These can be based on elements of EIOPA's proposals. However, for improvements to be effective and avoid unnecessary complexity, they must not include EIOPA's proposals to change the risk correction and to add a liquidity adjustment factor.

Section 2.4 Dynamic volatility adjustment in internal models

A. Industry proposals for the review

Insurance Europe supports maintaining the current dynamic VA for internal model users, without changes, and allowing the dynamic VA to apply in combination with the existing spread risk charges for standard formula users (see comments to section 5.2 for further details).

B. Comments on EIOPA's opinion

EIOPA's proposed enhanced prudency principle (EPP) has no other purpose than adding prudence on both the VA and internal models which already are calibrated to a 99.5th confidence level.

Introducing the enhanced prudency principle could also result in an inappropriate deviation of the risk profile of the insurer which is contrary to the objectives of the internal model. The internal models for market risk are based on the risk profile and investment mix of internal model users. Based on (local) requirements, different exposures other than those in the standard formula are included in the determination of market risk. By introducing the EPP, EIOPA would disregard the uniqueness of the internal model methodological and calibration approaches.

Introducing the EPP also requires internal model insurers to recalculate the SCR three times. This increases the administrative burden. Together with the proposals of the extrapolation and VA requirements currently in force, it would result in 7 calculations of the capital position.

Further restrictions, in addition to the benchmark studies and other requirements on internal model users, could even deter insurers from using the internal models or developing them further as the benefits will not outweigh the cost of using internal models. This is an unsatisfactory development.

C. Conclusion

Any supervisory concerns about the individual DVA modelling approaches can be addressed via existing supervisory processes and dialogue. No additional regulation nor specification of the approach to modelling the DVA in internal models is needed and EIOPA's proposal to include the enhanced prudency principle in the Solvency II Directive should be disregarded.

Section 2.5 Transitional measures on the risk-free interest rates and on technical provisions

A. Industry proposals for the review

Insurance Europe supports the continued application of the transitional measures as foreseen in the Directive.

The transitional measures have proven to work well to date and should remain stable during the run-off period to avoid any negative consequences on long-term business, eg negative impact on profit-sharing. No changes are needed, and there should be no national restrictions on the use of the measures.

B. Comments on EIOPA's opinion

EIOPA's advice to restrict the future application of transitional measures on risk-free rates (TRFR) and transitional measure on technical provisions (TMTP) is unjustified and would inhibit the level-playing field in Europe. There are multiple existing safeguards on the use of both TRFR and TMTP, such as supervisory approval and the availability of capital add-ons, which provide the necessary regulatory safeguards. Furthermore, abolishing the possibility of first-time applications could trigger a run on precautionary applications beforehand.

Similarly, its advice to require additional public disclosure on the use of and reliance on transitional measures is unnecessary and would only serve to undermine the transitional measures which are an agreed part of the Solvency II framework.

From a practical perspective, it is not clear what benefits, and to whom, these proposals would bring when they would be introduced over halfway through the transition period.

C. Conclusion

The transitional measures should remain as initially foreseen in the Omnibus II Directive. EIOPA's advice should be disregarded.

Section 2.6 Risk-management provisions on LTG measures

A. Industry proposals for the review

Insurance Europe supports some minor changes to the risk management provisions on LTG measures detailed in Article 44 of the Directive.

- Removal of the requirement to create a separate liquidity plan when using the VA.
- Clarifying the requirement on sensitivity analysis of the VA to variable economic conditions rather than variable assumptions but to retain this analysis in the RSR.
- Deletion of the requirement to test for forced sales.

B. Comments on EIOPA's opinion

EIOPA advises to make some improvements to the risk management provisions on LTG measures which are welcome and consistent with the industry views detailed above. These represent sensible improvements with credible benefits from a risk management perspective.

However, the industry strongly opposes its advice on dividends. EIOPA proposes to give NSAs power to suspend capital distributions if there is a "progressive and structural deterioration" of an insurer's financial position, with burden placed on the undertaking to demonstrate at the satisfaction of the NSA that distribution "does not increase the risk of further breach". This would:

- hamper global competitiveness of the EU sector on capital markets compared to third country insurers for which distributions are not highly regulated.
- deter capital allocation strategies and liquidity management of groups.

- deprive of income and liquidity other institutional investors such as pension funds relying on dividend payments from their investments in listed equity. Up to one third of their investments is allocated to other financial institutions such as the insurance sector[4].
- place a disproportionate burden on insurers and would lead to shadow reporting "to the satisfaction of NSAs".
- give an intrusive responsibility to NSAs to conduct a subjective assessment and lead to new capital requirements well above 100% SCR ratio (as an example, the Belgian supervisor is currently requiring 150% SCR ratio to consider **any** distribution, with additional conditions when SCR ratio is above 150%).
- In addition, it is unclear what would be included in "planned voluntary capital distributions". If it includes the ability to allocate bonuses to policyholders, this proposal would also have very large effects for eg mutual insurers' policyholders.

EIOPA's proposed required assessment in the ORSA of the risk-free interest rate is a step towards undermining the purpose and role of the ORSA. The ORSA is the company's own analysis and should remain so.

C. Conclusion

The EC should not propose new measures that would deter international competitiveness of the sector such as early intervention powers to restrict dividends distributions. In fact, NSAs already have at their disposal the power to prohibit distributions based on individual financial situation when the SCR is breached, or when such distribution would lead to a breach.

Section 2.7 Disclosure on LTG measures

A. Industry proposals for the review

The requirement to publicly disclose solvency figures with and without the VA/MA should be removed. The LTG measures are a fundamental part of Solvency II and the continued requirement to publicly disclose their impacts is both unnecessary and misleading.

B. Comments on EIOPA's opinion

EIOPA's advice to report only the solvency figures with the LTG measures in the policyholder version of the SFCR is welcomed. This approach should likewise be extended to the "other stakeholders" version of the SFCR.

However, its advice to require the disclosure of a sensitivity analysis of the extrapolation methodology is unjustified. As noted previously, Insurance Europe does not support the alternative extrapolation methodology but, if a change is implemented, there should be no requirement to publicly disclose the impact of altering the convergence parameter to 5%.

Publicly disclosing this requirement would effectively create a secondary solvency requirement which would be significantly in excess of the agreed 1-in-200-year confidence interval.

C. Conclusion

EIOPA's advice to require only the public disclosure of the solvency positions with the VA/MA in the policyholder version of the SFCR should be extended to the "other stakeholder" version. This would also require the removal of template S.22.01 from the list of QRT templates required to be disclosed publicly.

A consistent approach should be taken for the extrapolation of the RFR whereby only the solvency information relating to the agreed Solvency II approach (ie Smith Wilson extrapolation) should be publicly disclosed.

[4] (Source: European Commission (DG FISMA): Study on the drivers of investments in equity by insurers and pension funds, December 2019, p. 165ff).

Section 2.8 Long-term and strategic equity investments

A. Industry proposals for the review

The insurance industry is Europe's largest institutional investor and, as such, it has a direct interest in long-term investment, especially because 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 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 needs to 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 (see Action 4 on removing regulatory obstacles for insurance companies to invest long-term), 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.

B. Comments on EIOPA's opinion

EIOPA's proposal is a step in the right direction because it attempts to improve the usability of the sub-module and improve the applicability of the criteria. However, the chosen approach is still very conservative and will restrict its usability in practice.

In general, as recognised by EIOPA, the set of current criteria (a) to (d), if applicable at all, are difficult to fulfil because most insurers set their ALM strategies and manage their investments on a holistic basis, where liabilities are covered by a pool of investments with no allocation of individual investments to individual liabilities. As a consequence, these criteria cannot be implemented in some EU legal systems with profit-sharing mechanisms and uniform asset portfolios. Specifically:

- **Criterion (a):** The identification of the holding period of each equity investment is hardly implementable in practice. Such criterion should not restrict individual assets to be held for a certain time, as there are valid instances for selling assets, especially in consideration of insurers' duty towards their customers and shareholders. Therefore, the change proposed by EIOPA is welcome: it allows good

risk management practices, such as portfolio rebalancing, and active management strategies, which can provide better risk-adjusted returns.

- **Criterion (b):** The current requirement that the undertaking maintains the assignment of the sub-set of equity investment "over the lifetime of the obligations" is problematic because in practice, as noted by EIOPA, assets are often held longer than what is recognised in technical provisions (eg for renewed 1-year contracts). In this respect, the focus of this requirement should be on the fact that the equity investments are assigned to cover the best estimate as well as the risk margin and own funds. This is because own funds and risk margin are instrumental to a long-term investment strategy.
- **Criterion (c):** the current requirement is a key concern in terms of the usability of the sub-module, especially due to the wording "and the assigned portfolio of assets cannot be used to cover losses arising from other activities of the undertaking". As it stands, this creates a quasi-ring-fencing requirement which makes the sub-module not applicable in practice. EIOPA's proposal to modify this requirement is welcome as in many cases liabilities are covered generally by a pool of investments, with no allocation of individual investments to individual liabilities. This considered, Insurance Europe:
  - Supports EIOPA's proposals to modify the wording of the criterion and to clarify that a strict separation of teams managing the assets is not necessary.
  - Sees no merit in a separate management of the assigned portfolio. The identification requirement is considered sufficient. Any kind of separation that goes in the direction of being separately organised would be unnecessary and could still prevent application.
- **Criterion (d):** the sector supports EIOPA's proposal to modify the criterion under new paragraph (2) as this will achieve a wider use of LTE.

With respect to the other criteria, the industry has the following comments:

- **Criterion (e)**: the current criterion effectively mandates a passive asset management strategy for insurers' equity portfolios without regard to actual risks and performance potential. Beyond implying that no share is to be sold before the average retention period of five years is reached, the criterion is also based on the average holding period which is a wrong proxy for long-term investing. Under this perspective, EIOPA's proposal substantially improves the criterion by capturing that a LTE portfolio must have a long investment horizon overall, whereby insurers must be free to manage the assets dynamically (namely they are able to sell individual securities to optimise the risk/return ratio in relation to customer needs, the insurer's risk tolerance, market information and the assessment of the long-term prospects of the respective investments).
- **Criterion (f):** While the current requirement is not operationally unfeasible, EIOPA fails to improve it. Specifically, its scope should be widened as much as possible so that the insurers' investment universe is not unnecessarily restricted. This would be in line with the global nature of insurers' portfolios and would allow for important diversification benefits.
- **Criterion (g):** As acknowledged by EIOPA, the current requirement is operationally burdensome and, in some instances, it might be hard to prove the ability to avoid forced-selling for 10 years, which in turn negatively affects the applicability of the sub-module. While the current criterion needs to be improved, the industry considers that the criterion should still allow an insurer to demonstrate its capacity to avoid forced sales of the equity portfolio over a given time horizon.

  With respect to EIOPA's proposal, the industry acknowledges EIOPA's improvements and appreciates that it tailors the requirement to life and non-life liabilities separately. However, the criterion strongly departs from the original economic rationale to avoid forced sales. In addition, introducing the criteria on liabilities could entail some potential cliff effects in the use of the sub-module. In combination with the interdiction to use the sub-module for three years in case of non-compliance with the criteria, the use of the requirement in criterion g) could be a barrier to the use of the sub-module, as it could lead to a significant increase in capital charges without any significant change in the risk profile or the investment strategy of the insurer.
  Therefore, both current and proposed criteria require improvements to enhance the usability of the sub-module and avoid that the LTE module ends up being an "empty bucket", similar to the DBER. For these reasons, amendments to the proposed criterion should consider:

- **in subpoint i)**, the features of countries with life liabilities characterised by lower durations. The requirement to have a Macaulay duration of the liabilities in homogeneous risk groups exceeding 10 years can only be met by few long-duration pension products. This would not be achievable in countries where business is characterised by lower durations such as Italy, where durations are settling around 6-7 years according to data supported by the Italian insurance supervisory authority but also taking in account the latest market trends in that market. The eligibility of Category II liabilities, as suggested by EIOPA, is an important improvement to allow life insurance undertakings to classify equity as LTE.
- **in subpoint ii)**, the asset liability management (ALM) practices of non-life insurers. The proposed ratio $HQLA/BE\_portfolio$ could completely prevent the application for many non-life insurers because it would require non-life entities to cover all their best estimate liabilities with high-quality liquid assets (HQLA) as defined by banking regulation (ie the liquidity coverage ratio). This requirement introduces an element of stressed valuation which is unjustified and creates double counting of the risk (as it is already accounted for in the SCR, eg for lapse risk). Therefore, it should be reviewed so that an insurer is not required to cover all its liabilities with liquid assets, as a sound ALM invests in liquid assets to cover the cash flows of the first years of the liabilities and on more illiquid assets on a longer term. In addition, the scope of liquid assets needs to be widened – it excluded bonds of financial institutions and listed equity – and the applied liquidity haircut changed to avoid exaggerate the liquidity conditions of insurers, which are treated as banks. The reference to a bucketing of the liabilities also appears simplistic and should be refined to better reflect the liquidity risk for insurers.
- a **new subpoint iii)**, based on the original criterion g), on the ability to avoid forced sales. Some improvements can make this criterion less operationally burdensome and, in conjunction with a change in the time horizon, they have the potential to lead to a wider use of the LTE sub-module. This would allow its applicability also in jurisdictions where it might be hard to prove the ability to avoid forced-selling over a 10-year time horizon.

- **Criterion (h)**: While this requirement can be fulfilled, it comes with higher documentation requirements and significant complexity, which should be carefully considered.
- **Criterion (i):** The industry finds this principle appropriate as it captures a diversification element that is already a requirement of the Solvency II prudent person principle.

- **Paragraph (2):** This requirement on the proportion of equity backing life technical provisions is considered reasonable, but this should not be disadvantageous in cases where a small portion of the liabilities is eligible.

- **Paragraph (3):** The ability to assess the criteria under paragraph 1 at the level of the funds and not of the underlying assets can substantially decrease the complexity of the sub-module. Therefore, it should be clear that the assessment of the criteria is always possible at the portfolio level, not only for specific funds (ie EuSEF, EuVECA, ELTIF and specific closed-ended alternative investment funds, eg without leverage). This will facilitate the application of the LTE sub-module.

- **Paragraph (4):** The requirements imply that there is a risk of the portfolio of LTE becoming non-compliant and creating a one-off and sudden increase in SCR. This harshness of the sanction, jointly with the burden of other requirements, is likely to deter the use of the LTE sub-module due to the possibility of increased volatility of the Solvency ratio and should therefore be reviewed.

- **Paragraph (5):** EIOPA's proposal to exclude participations from the scope of LTE is not an adequate measure to ensure LTE investments are actually held over the long term. This is because LTE investments can be represented by intra-group investments and can often be directly linked to a source of return for policyholders. Intra-group investments are often compliant with the criteria of Art. 171a, but it is more difficult for them to qualify under the strategic equity sub-module (Art 171), largely because the condition of lower forward-looking short-term volatility is difficult to demonstrate. Should

the Commission intend to exclude controlled intra-group investments from the scope of the LTE module, only strategic participations should be excluded.

C. Conclusion

The criteria for LTE in the Delegated Regulation and EIOPA's proposals make it very difficult or even impossible for insurers to apply this sub-module to their LTE portfolio. In order to achieve the political objectives for which this specific provision on LTE module was introduced and to ensure the existence of a level playing field, the application criteria must be changed. Only feasible criteria which ensure that equities can be held for a long term should be maintained.

The following table includes proposed wording necessary for the LTE module to improve the usability of the sub-module (black colour represent the current wording of Article 171a, red colour indicates EIOPA's proposals and green colour indicates proposed changes by the industry). A more detailed explanation on the proposed wording is available below.

Insurance Europe proposal for Article 171a
1. For the purpose of this Regulation, a sub-set of equity investments may be treated as long-term equity investments if the insurance or reinsurance undertaking demonstrates, to the satisfaction of the supervisory authority, that all of the following conditions are met:
a) the sub-set of equity investments ~~as well as the holding period of each equity investment within the sub-set are~~ is clearly identified;
b) the sub-set of equity investment is included within a portfolio of assets which is assigned to cover the best estimate, its risk margin and share of the own funds of a portfolio of insurance or reinsurance obligations corresponding to one or several clearly identified businesses~~, and the undertaking maintains that assignment over the lifetime of the obligations~~;
c) ~~the portfolio of insurance or reinsurance obligations, and~~ the assigned portfolio of assets referred to in point (b) are identified~~, managed and organised~~ separately from the other activities of the undertaking~~, and the assigned portfolio of assets cannot be used to cover losses arising from other activities of the undertaking;~~
~~d) the technical provisions within the portfolio of insurance or reinsurance obligations referred to in point (b) only represent a part of the total technical provisions of the insurance or reinsurance undertaking;~~ [Replaced by new number (2)]
e) ~~the average holding period of equity investments in the sub-set exceeds 5 years, or where the average holding period of the sub-set is lower than 5 years, the insurance or reinsurance undertaking does not sell any equity investments within the sub-set until the average holding period exceeds 5 years;~~ a policy for long term investment management is set up for each long-term equity portfolio and reflects undertaking's strategic asset allocation to hold the global exposure to equity in the sub-set of equity investment for a period that exceeds 5 years on average. The AMSB of the undertaking has signed off this strategic asset allocation in the investment management policies and these policies are frequently reviewed against the actual management of the portfolios.
f) the sub-set of equity investments consists only of equities that are listed in the EEA or in the OECD or of unlisted equities of companies that have their head offices in countries that are members of the EEA or of the OECD;
g) where undertakings can demonstrate that either i. particular homogeneous risk groups of the life insurance and reinsurance liabilities belongs to categories I or II as defined for the purpose of the calculation of the VA and the Macaulay duration of the liabilities in this HRG exceeds ~~10~~ 6 years or ii. a sufficient liquidity buffer is in place for the portfolio of non-life insurance and reinsurance liabilities and the assigned portfolio of assets~~;~~ or iii. the solvency and liquidity position of the insurance or reinsurance undertaking, as well as its strategies, processes and reporting procedures with respect to asset-liability management, are such as to ensure, on an ongoing basis and under stressed conditions, that it is able to avoid

forced sales of ~~each equity investments within~~ the sub-set of long-term equity investments for at least ~~10~~ 5 years;
h) the risk management, asset-liability management and investment policies of the insurance or reinsurance undertaking reflects the undertaking's intention to hold the sub-set of equity investments for a period that is compatible with the requirement of point (e) and its ability to meet the requirement of point (g). Those elements are reported in the ORSA of the undertakings.
i) the sub-set of equity investments shall be properly diversified in such a way as to avoid excessive reliance on any particular issuer or group of undertakings and excessive accumulation of risk in the portfolio as a whole.
2. The proportion of equity backing life technical provisions that is assigned to the long term equity investment category does not exceed the proportion of life technical provisions compliant with the criteria specified in paragraph 1 on the total life technical provisions of the insurance or reinsurance undertaking;
~~2~~ 3. Where equities are held within collective investment undertakings or within alternative investment funds or within investments in related undertakings ~~referred to in points (a) to (d) of Article 168(6)~~, the conditions set out in paragraph 1 of this Article may be assessed at the level of the funds and not of the underlying assets held within those funds.
~~3~~ 4. Insurance or reinsurance undertakings that treat a sub-set of equity investments as long- term equity investments in accordance with paragraph 1 shall not revert to an approach that does not include long-term equity investments. Where an insurance or reinsurance undertaking that treats a sub-set of equity investments as long-term equity investments is no longer able to comply with the conditions set out in paragraph 1, it shall immediately inform the supervisory authority. The supervisory authority can ~~and shall~~ cease to allow the company to apply Article 169(1)(b), (2)(b), (3)(b) and (4)(b) to any of its sub-set equity investments for a period of ~~36~~ 12 months.;
~~5. Participations shall be excluded from the sub-set of equity investments~~

The following table outlines the industry's proposed changes (indicated in green) to EIOPA's proposal on the liquidity buffer used for the purpose of criteria g) subpoint ii.

Proposed changes to EIOPA's proposal on criterion (g)
The liquidity buffer used for the purpose of criteria g) ii should be tested on the level of the whole non-life insurance and reinsurance liabilities. The liquidity buffer should be calculated on the basis of the assets backing the undertaking's non-life insurance and reinsurance obligations. Where the liquidity buffer as outlined in the following paragraph is bigger or equal than 1, all equity backing the non-life insurance and reinsurance obligations fall under the scope of the provisions of Article 171a can apply a risk charge of 22% (provided that the other criteria set out above are met). Where the liquidity buffer is smaller than 1, a limited amount of ~~no~~ equity falls under the scope of Article 171a. The liquidity buffer for the purpose of criteria g) is to be calculated as follows: $HQLA/BE\_portfolio$ ▪ where the numerator is high-quality liquid assets (HQLA) backing the non-life liabilities, applying a liquidity haircut as defined below; ▪ the denominator is the non-life best estimate liabilities net of reinsurance. Where the liquidity buffer is less than 1, the portion of equity which is in scope of Article 171a is given by max(0,(equity- $BE\_portfolio$+HQLA)/equity), where equity is value of the equity portfolio. HQLA is comprised of two categories of assets: "Level 1" and "Level 2" assets. Level 1 assets can be included without limit, while a haircut is applied to Level 2 assets which can comprise up to 40% of the stock of HQLA. Level 2 assets are further split into Level 2A and Level 2B. Level 2B assets cannot represent more than 15% of the stock of HQLA. Level 1 and Level 2 assets can be considered as HQLA assets for the purpose of the buffer also when they are comprised within collective investment undertakings or within alternative investment funds.

The determination of the HQLA follows a two-step process: Firstly, the haircut outlined in the following paragraph is applied. Secondly, the before mentioned limitations apply.

HQLA Item	Eligible	Haircut
Level 1 assets	Cash and cash equivalent	0%
	Bonds and loans from: - The European Central Bank - EU Member States' central government and central banks denominated and funded in the domestic currency of that central government and the central bank - Multilateral development banks referred to in paragraph 2 of Article 117 of Regulation (EU) No 275/2013 - International organisations referred to in Article 118 of Regulation (EU) No 275/2013	0%
Level 2A assets	Bonds and loans rated CQS 0 or 1~~, excluding those from financial institutions~~	15%
	Covered bonds rated CQS 0 or 1, excluding those emitted by a bank which is part of the same group	15%
Level 2B assets	~~Covered bonds rated CQS 0 or 1, excluding those emitted by a bank which is part of the same group~~	~~25%~~
	Qualifying RMBS	50%
	Receivables / amounts ceded to insurers / other liquidity sources	50%
	Bonds and loans rated CQS 2 or 3~~, excluding those from financial institutions~~	50%

Additional explanations on proposed wording for Article 171a

The industry calls for the following improvements to enhance the applicability of the sub-module in practice (see table below for the proposals):

- **Criterion (a)**: EIOPA's changes are supported.
- **Criterion (b)**: EIOPA's changes are supported. In addition, to enhance the usability of the module, the industry also proposes that:
  - It should be clear that a portfolio of assets which covers the best estimate will also cover the risk margin and the share of own funds associated with the best estimate. This is necessary for consistency with criteria g) which requires non-life undertakings to hold enough HQLA to cover the best-estimate.
  - The wording "maintaining the assignment" is deleted because its practical meaning is unclear, which leads to unnecessary burden to use the module.
- **Criterion (c)**: EIOPA's changes are supported. In addition, the requirement of "separate management of the portfolio" should be deleted to remove uncertainty and allow for an application of the sub-module in all member states.
- **Criterion (d)**: The sector supports EIOPA's proposal to delete the criterion (d) and replace it with the criterion under new paragraph (2).
- **Criterion (e)**: The industry proposes to improve this criterion with a strategy-to-hold approach, which would be applicable also to portfolios that do not yet have the required average holding period, but which are intended to be held for more than five years. In any case, the strategic allocation to hold for a period over 5 years on average should not act as a limit to active management: transactions would still need to be done, which can endanger the minimum average holding period. Therefore, this criterion could be simplified in line with the portfolio concept and improved so that the average holding period can be satisfied:
  - Ex ante for a portfolio with an average holding period of more than 5 years.
  - Ex post for a portfolio without the required average holding period but intended to be held for more than 5 years.

- **Criterion (f)**: The industry proposes an extension to OECD shares, consistent with the approach for type 1 equities and infrastructure investments.
- **Criterion (g)**: The industry proposes to adjust the original wording of criterion g) on forced sales for the sub-set of LTE investments for at least 5 years. At the same time, it suggests also making it possible to use EIOPA's proposals amended as follows:
    - For life insurance:
        - EIOPA's extension of life liabilities to those in liquidity bucket I and II is welcome.
        - The 10-year duration requirement should be lowered to 6 years to reflect the lower durations of more typical life insurance portfolios in European countries.
    - For non-life insurance, the calculation of the liquidity buffer should be based on the demonstration that the insurer is not exposed to forced sales as part of Pillar II liquidity assessment. In practice, this means that:
        - The high-quality liquid assets (HQLA) numerator should be reviewed to include bonds of financial institutions.
        - A partial application of Article 171a should be possible based on the proportion of best estimate portfolio covered by HQLA
- **Criterion (h):** The industry agrees with this criterion but suggests clarification in order to minimise the reporting burden and improve the applicability of the sub-module.
- **Criterion (i):** The industry supports this criterion, provided it does not increase the sub-module complexity.
- **Paragraph (2):** EIOPA's proposal to replace criterion (d) with this paragraph is welcome, but further guidance might be necessary to ensure correct interpretation at national level.
- **Paragraph (3)**: The industry asks that assessment at fund level of the criteria under paragraph 1 is possible for all kind of UCITS and AIF funds, and it should be clarified that a look-through approach for conventional funds is still possible. This will avoid limiting the applicability of the sub-module.
- **Paragraph (4):** In order not to deter the use of the LTE sub-module, the industry proposes that discretion is left to the supervisory authority. Should this not be possible, then the sanction period should be reduced to 12 months or, as an alternative, the industry suggests considering the limitation of this sanction only to the identified sub-portion of equity investments rather than applying it to any of its equity investments.
- **Paragraph (5)**: The industry proposes not to exclude participation from the scope of Art. 171a. Should strategic participations be excluded, then the volatility criterion in Art. 171 should be removed to allow for proper use of the strategic participation category.

Finally, some uncertainty remains regarding the scope of application and the criteria to be satisfied under the LTE sub-category. It is key that guidance and dialogue at the level of NSAs ensure that the application of the LTE investments sub-category is duly considered and works in practice. As in other cases, the "burden of proof" for the criteria should not always lie with the undertakings, but also with the NSAs, and efforts to make the LTE sub-category work should be shared.

Section 2.9 Symmetric adjustment to the equity risk charge

A. Industry proposals for the review

The industry notes that the symmetric adjustment to the equity risk charge was designed to reflect the long-term nature of insurance and to help avoid excessive transmission of equity market volatility to insurers' balance sheets. This was therefore designed to reduce the risk that Solvency II measurement encourages, otherwise unnecessary, procyclical behaviour during stressed events.

Unfortunately, while recognising the potential merits of such an approach in mitigating equity market volatility, the equity symmetric adjustment is not functioning as it was supposed to as it is causing increased solvency volatility for some companies. Therefore, the adjustment should be optional to apply.

B. Comments on EIOPA's opinion

The industry does not support EIOPA's proposal to widen the corridor of the symmetric equity adjustment. Increasing the corridor could actually lead to higher volatility in the capital requirements for equities that will, among others, result in unwarranted disincentives to invest in equity as well as negative implications for the policyholders. For example, this can be the case for insurance companies with large holdings of equities where there is significant basis risk to the EIOPA Equity index.

The consequences of EIOPA's proposals will probably be worse when the majority of the equity holdings, including eg holdings belonging to unit-linked policies, are denominated in non-euro currencies due to the composition of the reference index.

For these reasons, it is necessary to envisage a solution that allows a degree of own professional judgment when applying the symmetric equity adjustment.

C. Conclusion

The industry proposes that the application of the symmetric equity adjustment is made optional, especially for undertakings for whom it does cause significant basis risk. In practice, this means that:

- companies should be able to choose whether to use the symmetric adjustment to the equity risk charge, and
- if they decide to do so, they should be able to decide whether to use either the +/-10% corridor or the +/-17% corridor depending on their situation and the composition of their equity investment portfolios.
- Additionally, companies should be allowed to remove the floor of 10% in case of severe financial circumstances and market volatility.

3. Technical provisions

Section 3.1 Best Estimate

A. Industry proposals for the review

Insurance Europe did not propose any changes or new definitions in relation to the Solvency II provisions regarding contract boundaries, EPIFP, future management actions and expenses.

B. Comments on EIOPA's opinion

Contract boundaries
Regarding the amendment of the third paragraph of DA Art 18(3) (ie the exception allowing an extension of contract boundaries for contracts where an individual risk assessment was performed at inception):

The industry disagrees with EIOPA's proposal to allow applying the exception that provides for contract boundaries to be extended for contracts where an individual risk assessment was performed at inception, only when the undertaking does not have the right legally/contractually to perform the assessment again. This proposal would substantially limit the possibility to extend the contract boundaries.

At the same time, the clarification that it is a *right* and *not an obligation* for insurers to perform an assessment at the level of individual contracts is helpful.

EPIFP
The industry acknowledges the modifications made to DA Art 260(4), thereby welcoming EIOPA's clarification that both profit- and loss-making policies within an HRG are allowed, as such avoiding burdensome calculations for undertakings without added value.

However, the introduction of a definition of gross expected future profit/loss from servicing and management of funds in DA Art 1 is not appropriate, because the definition is not accurate and leads to double counting. Indeed, EIOPA acknowledges, as also highlighted by the industry in its comments to the draft Opinion, that should the new definition not exclude the part included in future premiums, there would be an overlap with EPIFP. However, EIOPA believes that excluding this part of the profits would make the calculation more complex. And as such simply advises to implement the definition because the information provided is deemed to be 'very valuable'.

In addition, in its assessment EIOPA ignores the cost of servicing and managing. This cost should also be included in the calculation and, if this was the case, it is possible that this issue may not be material anymore.

Future management actions
The industry supports the introduction of a definition of Future Management Actions in DA Art 1.

Expenses
The industry takes note of EIOPA's clarification on expenses proposed in DA Art 31(1). At the same time, the industry is concerned by the change proposed to DA Art 31(4), as it would lead to new obligations for the AMSB.

C. Conclusion

The industry highlights it did not propose any changes or new definitions in relation to the Solvency II provisions regarding contract boundaries, EPIFP, future management actions and expenses. In relation to EIOPA's proposals:

- The industry disagrees with:
  - the proposal to allow the application of the exception that allows the extension of contract boundaries for contracts where an individual risk assessment has been performed at inception, only when the undertaking does not have the right legally/contractually to perform the assessment again, .
  - the introduction of a definition of gross expected future profit/loss from servicing and management of funds in DA Art 1
  - EIOPA's clarification on expenses in DA Art 31(4).

- The industry agrees with:
  - the clarification that it is a right and not an obligation for insurers to perform an assessment at the level of individual contracts (exception Art 18(3)).
  - the modifications made to DA Art 260(4) regarding EPIFP, clarifying that both profit- and loss-making policies within an HRG are allowed.
  - the introduction of a definition of Future Management Actions in DA Art 1.
  - EIOPA's clarification on expenses in DA Art 31(1).

Section 3.2 Risk margin

A. Industry proposals for the review

The current risk margin remains far too high and volatile. It reduces insurers' capital by about €160bn[5] and so significantly reduces insurers' capacity to take on risks and invest in the economy. It is also a significant source of artificial balance sheet volatility.

Improving the risk margin can be achieved through an appropriate combination of the following elements – each of which provides strong economic grounds to reduce the Risk Margin:

- An appropriate recalibration of the currently proposed lambda parameter, as well as removal or lowering of the floor currently suggested, to better reflect the impact of risk dependence over time.

[5] 160bn, excl UK, based on EIOPA Solo statistics of Q3 2020

- 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.

An appropriate risk margin can be achieved in several ways, for example, a reduction of at least 50% could be achieved by:

- reducing the cost of capital to 3%
- re-calibrating the **lambda** to **0.85** without a **floor** (or substantially lowering EIOPA's proposed floor)
- recognising the diversification benefit (in combination with the above).

In addition, the industry also put forward the proposal that mass lapse risk can be excluded under specific conditions. Indeed, to the extent that it can be shown that the amount of mass lapse risk corresponds to a positive value of future profits in own funds, mass lapse risk should not be part of the risks leading to a cost of capital for the assumed reference undertaking in Art 38-39 of the DA (namely mass lapse risk should in those cases be reduced or excluded from the risk margin calculation).

B. Comments on EIOPA's opinion

While EIOPA's proposed changes are a step in the right direction, they do not go far enough to address the flaws and concerns around the risk margin. In particular, the derivation of the cost-of-capital rate is flawed, the lambda parameter and floor are set too high to be effective, the proposals on the extrapolation of risk free rates massively increase the risk margin and its volatility, and diversification is not recognised between life and non-life business within the same entity, or between different entities within a group.

- The lambda parameter and floor are too high

While EIOPA's introduction of the lambda parameter and acknowledgement that the risk margin is too high and volatile, particularly for long-term business, is a welcome development, the proposed level for lambda of 0.975 is set too prudent. For some long-dated portfolios the impact on the risk margin alone due to changes introduced to the extrapolation methodology for interest rates more than offsets the impact from the introduction of the lambda parameter with the floor - resulting in a net increase in the risk margin. This is in part due to the high level of lambda, but is also due to the high level of the floor of 0.5, which particularly impacts long-dated portfolios, and whose introduction and level have only been justified by EIOPA as being 'prudent'.

The high lambda and floor also limit the effectiveness of the lambda parameter to reduce inappropriate balance sheet volatility. Any action taken by the EC to improve EIOPA's current proposal would therefore be more effective if it addressed both areas.

If the lambda parameter and floor are set inappropriately, they will not recognise the risk dependence over time inherent in insurance products. For example, in the case of lapses, exposure significantly reduces after a lapse stress while for some multi-year general insurance products maximum pay-out clauses would reduce future SCRs following the occurrence of an insured event.

- Diversification is not recognised at group level and across business lines

The current risk margin calculation does not allow for diversification at group level, contradicting a fundamental principle of insurance business. Diversification is allowed for in the calculation of group capital requirements and in the calculation of local entity risk margins, so not permitting this in the calculation of the group risk margin is both unclear and counter-intuitive. It is also counter to practical experience where there are many examples where groups have transferred policies as a whole.

Furthermore, for legal entities pursuing both life and non-life insurance activities, when calculating the risk margin for composite firms, an assumption is made that the life and non-life (re)insurance obligations are taken

over by two separate reference undertakings (Art 38.1(b) of the Delegated Regulation). This implies that no diversification benefit can be assumed between life and non-life insurance portfolios.

- Impact of lambda is counteracted by interaction with the extrapolation of risk free rates

The risk margin calculation is based on the discount value of future projected components of the SCR. For long-term products, these projections often include maturities of several decades. The EIOPA proposals on the extrapolation method will not only have an effect on the discounting but also on SCR components. By this double-effect, those proposals will counteract the proposed introduction of the lambda-parameter to a large extent.

- There is substantial evidence for decreasing the cost-of-capital rate

In line with previously provided evidence, the industry reiterates that there are a number of flaws in EIOPA's derivation of the cost-of-capital rate – presented in EIOPA's advice on the 2018 Solvency II review - which means that it is too high and inconsistent with Solvency II specifications.

For example, the current calibration does not reflect the capital structure of insurance companies (assuming only equity funding and ignoring bond financing), and therefore wrongly reflects a cost of equity and not a weighted average cost of capital. In addition, the current calibration incorrectly captures asset risk and therefore reflects more than pure insurance risks, as required by Solvency II regulations (in particular, risky assets and new business risks, both of which are ruled out by the Solvency II regulations on the reference undertaking).

Furthermore, the estimation of the important beta parameter in the calibration was significantly distorted by a massive overweighting of large companies (which exhibit stronger co-movement with major indices).

Finally, the methodology for deriving the cost-of-capital rate is backward-looking and hence is biased upwards, since backward-looking estimates include a survivorship bias (ie firms that fail are removed from the index and are therefore not captured). Forward-looking estimates are more consistent with both Solvency II regulations and a range of expert studies, and would result in a material reduction in the cost-of-capital rate.

Based on an analysis that avoids these multiple shortcomings, there is evidence for a cost-of-capital rate should of 3%.

C. Conclusion

While the industry welcomes the fact that EIOPA took on board the industry proposal to introduce a lambda, and as such allows to reflect risk dependence over time, EIOPA's proposal is not sufficient, and will, together with the EIOPA proposals on extrapolation, have a very limited effect on the final risk margin. Benefits could be achieved in mobilising investment capacity, if a sufficient reduction is pursued through an appropriate combination of reducing the cost of capital, re-calibrating the proposed lambda, and allowing for group diversification.

Against this background, Insurance Europe believes that an appropriate risk margin can be achieved in several ways, for example, a reduction of at least 50% could be achieved by:

- reducing the cost of capital to 3%
- re-calibrating the lambda to 0.85 without a floor (or by substantially lowering EIOPA's proposed floor)
- recognising diversification benefit plus a combination of the above.

4. Own funds

A. Industry proposals for the review

The industry is of the view that no fundamental changes are needed in the area of own funds.

However, the 2020 review is the occasion to fix minor flaws, such as the recognition of particular own funds elements of mutuals in Tier 1:

Article 69 Delegated Regulation on the list of own-fund items for Tier 1 capital provides that ie paid-in initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type undertakings (ii) and paid-in subordinated mutual member accounts (iii) *"shall be deemed to substantially possess the characteristics set out in Article 93(1)(a) and (b) of Directive 2009/138/EC, taking into consideration the features set out in Article 93(2) of that Directive, and shall be classified as Tier 1, where those items display all of the features set out in Article 71".*

However, the last part of the sentence, *"where those items display all of the features set out in Article 71"* goes against the level 1 provision, as the Solvency II Directive (in particular Article 93 and 94) does not allow for this restriction. Article 94 of the Solvency II Directive states that an item may be classified as Tier 1 when it *"substantially possesses"* the characteristics required for that Tier. The essential criteria for qualifying as Tier 1 capital are set out in article 93 of the Solvency II Directive as (a) permanently available; (b) subordinated; (c) sufficient duration; (d) no incentives to redeem; (e) no mandatory servicing costs; and (f) no encumbrances.

If there are doubts about the question whether the participants/member account of an individual (mutual) insurer meets the requirements, this should be assessed on an individual basis and not categorically for all mutual insurers at once[6].

For some items, eg membership accounts in the Netherlands, the individual participant cannot take its funds out of the participants account if the SCR is below 100% or if it would become so due to the withdrawal. Therefore, if the mutual insurer has enacted in its articles of incorporation the rule that participants funds may not be paid back when and as long as the SCR ratio is at or below 100%, the funds *"substantially possess"*, the requirements for Tier 1 and the participants funds should be allowed to count fully as Tier 1 capital. Article 69 of the Delegated Regulation should be amended to reflect this condition in the articles of incorporation accordingly.

B. Comments on EIOPA's opinion

EIOPA's proposal to maintain the status quo is welcome.

One area of concern regards the classification of expected profits in future premiums (EPIFPs). The industry concurs with EIOPA's proposal to maintain the classification of EPIFPs in Tier 1. However, the perspective of potential future changes at level 3, out of the legislative process and without proper scrutiny by co-legislators, is very worrisome. These would likely have a very significant impact and could unduly de facto degrade the status of EPIFPs. 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. EIOPA seems to regard a positive value of EPIFPs as something negative that should be limited, which is a conservative approach and is contrary to the Solvency II principle of going concern.

Further, the industry rejects EIOPA's analysis of the concept of "double leverage" and notes that Solvency II already provides for the elimination of the double use of eligible own funds and of the internal creation of capital in group solvency (see section 9 on group supervision).

C. Conclusion

EIOPA's advice to make no changes in the area of own funds is appropriate.

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6 This discussion on the tiering of the participant account in a mutual insurer, was left open when Solvency II entered into effect on January 1, 2016. By way of background we refer to the letter by the European Parliament to the European Commission of December 19, 2014 (D(2014)62142), the reply by the European Commission of January 27, 2015 (PD/rv((205)161889), a reply to that Commission letter by the European Parliament of April 1 2015 (306043) and a further letter by the European Commission of May 11, 2015 (AV/rv(2015)1779031).

Moreover, to ensure that no changes that would deter the eligibility of EPIFPs as own funds are introduced at a later stage by EIOPA out of the legislative process, the EC should consider proposing additional safeguards in the regulation.

5. Solvency Capital Requirement standard formula

Section 5.1 Interest rate risk

A. Industry proposals for the review

Insurance Europe recognises that the interest rate risk sub-module needs to be recalibrated to reflect the low and negative yield environment.

A relative shifted approach model could be used as an alternative to the current approach to capture the risk of negative yields.

However, any updated interest rate risk model must be calibrated and designed to:

1. **Extrapolate the illiquid part of the yield curve using standard extrapolation parameters and methodology.**
2. **Contain a floor which properly reflects the extent to which yield curves can go negative and the true risk in a low and negative yield environment.**
3. **Be appropriate for all currencies to which it is applied.**

Furthermore, any change will have a significant impact on solvency ratios, therefore potential impacts must be carefully assessed and phased in over time.

Extrapolation of the illiquid part of the stressed curve
Interest rate risk refers to the change of the risk-free interest rate term structure which is based on market data up to the LLP and is extrapolated afterwards. Solvency capital requirements for market risks must reflect the risk of changing capital markets, not of changing regulation (which provides for extrapolation). Therefore, the modelling of interest rate risk should follow the same two-step logic: risk factors should only be applied to the part of the curve that is based on market data. The resulting stressed curve should then be extrapolated with the usual algorithm.

This is the only way to obtain consistent, risk-sensitive and economically sound stressed yield curves and to calculate the true loss of basic own funds that would occur in the stress scenario. Moreover, this delivers appropriate results for all currencies which generally have different LLPs.

Economically justified floor to the model
EIOPA's purely data driven approach to the calibration is flawed as it fails to recognise that experiences with interest rate changes in times of positive rates cannot be transferred unlimitedly to periods with substantially negatives rates. If interest rates were to fall too far and/or for too long below zero, insurers would have to retreat from fixed income investments and switch to a combination of investing more in real assets and/or holding more cash.

Insurance Europe proposes that the explicit floor to be included in the IRR model is based on the lowest recorded monthly Euro RFR curve less a prudency margin of 10 basis points. If rates were to fall further in future, the floor should be updated to reflect this so that there is always a capital requirement for interest rate risk.

B. Comments on EIOPA's opinion

EIOPA's advice on changes to the interest rate risk sub-module reflects a small improvement on previous iterations of its proposals. However, it will continue to result in exaggerated capital charges for many undertakings with long-term liabilities and will penalise insurers in some non-Euro markets, such as Norway and Sweden.

EIOPA's proposal for a relative shift approach is, for some currencies such as NOK and SEK, based on a too narrow and simplistic assessment, leading to a too conservative calibration. EIOPA's proposed interest rate seems to overestimate the likelihood of low interest rates for the full range of maturities.

Insurance Europe welcomes that EIOPA recognises that an explicit floor to interest rate risk is a justified part of the model and proposes to phase-in the impact over a 5-year period. However, introducing a phase-in mechanism is not sufficient to alleviate the increase in capital requirements due to the IRR methodology change. Furthermore, it is not clear that EIOPA's proposed phase-in mechanism is economically justified given that rates change over time and taking 1/5th of difference between the current stressed curve and the new stressed curve can have very different impact depending on when the impact is calculated.

Determination of the illiquid part of the stressed curve

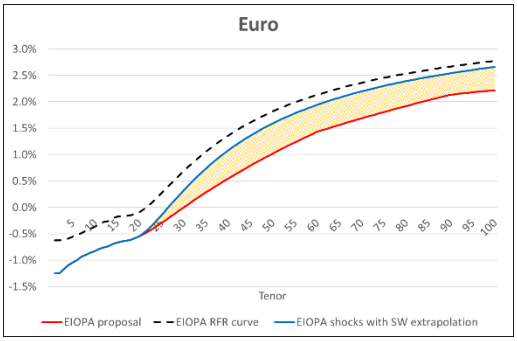
EIOPA's model uses factor-based stresses for the extrapolated part of the interest rate term structure. This is economically incorrect and creates an inconsistency with the calculation of the liabilities; should the prescribed 1-in-200-year stress materialise, only the liquid part of the curve would be affected, the illiquid part of the curve would then be derived using the extrapolation methodology. Therefore, the stress scenario proposed by EIOPA to determine capital requirements is inconsistent with the valuation framework.

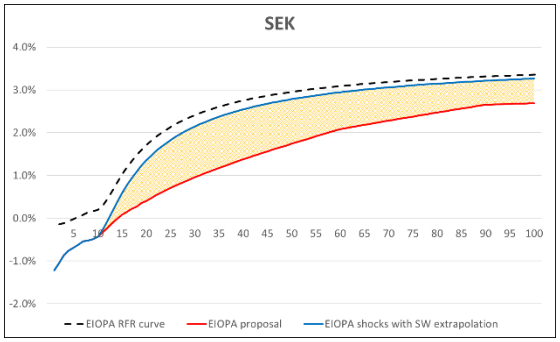
To Insurance Europe's best knowledge, despite its extensive analysis of the IRR shock issue, EIOPA has never provided a reason why the illiquid part of the stressed curve should not be derived using the standard extrapolation approach. Neither has it justified its preferred approach of linearly diminishing the 20-year shock up to the 90-year point.

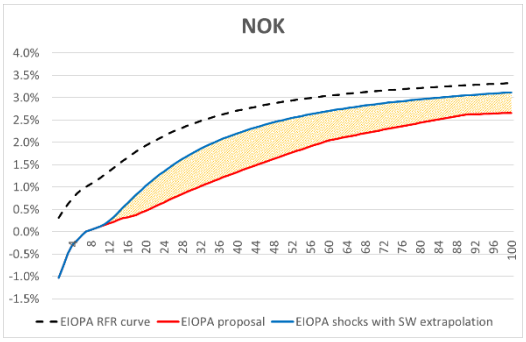
The charts below show the impact of this flaw on the stressed curves for the Euro, SEK and NOK at year-end 2020.

- The black dotted line was the EIOPA RFR curve as at 31 December 2020.
- The red line shows the IRR down curve (ie the stressed curve) under EIOPA's proposal.
- The blue line shows the IRR down curve under EIOPA's proposal but with the illiquid part of the curve determined under the S-W extrapolation approach.

It is important to highlight that if EIOPA's calculated stresses did materialise in practice, the blue line represents the EIOPA RFR curve after that shock. **The yellow shaded therefore shows that overestimation of long-term interest rate risk** which is structurally inherent in EIOPA's proposal.







As shown in the charts above, deriving the illiquid part of the stressed curve using the standard Smith-Wilson extrapolation approach would significantly alleviate the over-exaggeration of EIOPA's proposal for long-term business as well as addressing the issues for non-Euro currencies with a LLP shorter than 20 years. This is because stressing and extrapolating in the logical correct order also has the important advantage that the interest rate risk module fits automatically to all different values of the LLP. Thus, there is no need for different proposals depending on the LLP and the use of a single calibration of risk factors is more reasonable.

In the HIA, EIOPA tested an alternative approach for these non-Euro currencies which showed that reflecting currency-specifics within the model would "significantly reduce the SCR" for SEK, NOK and PLN. This is because the current model overstates the risk in the illiquid part of the curve. However, EIOPA appears to have rejected this approach based on undisclosed "level-playing field" issues (page 247 in the Background document). But by not having an appropriate interest rate risk sub-module for all currencies, EIOPA's proposal in fact may introduce level-playing field issues.

A model which correctly extrapolates the illiquid part of the stressed curve would avoid these possible "level-playing field" issues and make the proposal more fit-for-purpose.

Economically justified floor to the model

Following stakeholders' feedback, EIOPA has recognised that the model should have an explicit floor to "*prevent a possible overestimation of interest rate risk".* However, EIOPA has erroneously calibrated the floor based on historical interest rates in the Swiss Franc market. The Swiss market is not sufficiently representative of the EEA-markets as a whole to provide an appropriate floor. Indeed, according to EIOPA's analysis, only 0.16% of the liabilities in the EEA are denominated in Swiss Francs.

Insurance Europe considers that the explicit floor to the interest rate risk sub-module should instead be primarily based on Euro interest rates. To ensure that the floor is appropriate for longer-term rates as well, the explicit floor to interest rates should also be term-dependent, as is the implicit-floor. EIOPA itself observes in the second set of advice on the 2018 Review that the introduction of maturity-dependent shift parameters for the downward shock is "justified economically speaking" (par. 758).

Insurance Europe proposes that the explicit floor to be included in the IRR model is based on the lowest recorded monthly Euro RFR curve less a prudency margin of 10 basis points. If rates were to fall further in future, the floor should be updated to reflect this so that there is always a capital requirement for interest rate risk.

C. Conclusion

Three very important changes to EIOPA's proposals are still needed to ensure that the revised interest rate risk sub-module correctly captures the interest rate risk.

1. The illiquid part of the stressed curve must be derived using the standard extrapolation approach.

2. The explicit floor used in the model must be term-dependent and reflect the characteristics of the EEA-markets to which it is to be applied, and not solely the Swiss market.

Insurance Europe proposes that the explicit floor to be included in the IRR model is based on the lowest recorded monthly Euro RFR curve less a prudency margin of 10 basis points. If rates were to fall further in future, the floor should be updated to reflect this so that there is always a capital requirement for interest rate risk.

3. Be appropriate for all currencies to which it is applied, including SEK and NOK.

Section 5.2 Spread risk

A. Industry proposals for the review

The industry supports the extension of the DVA to the standard formula to resolve the incorrect treatment of corporate bonds within Solvency II.

This approach is already implemented by many internal model firms who model market risk and could be easily implemented for standard formula users by adjusting the SCR spread shock scenario. This will ensure that the capital requirements for corporate bond exposures for all VA-users are more reflective of the true economic risks. The industry notes that the introduction of the dynamic VA in the standard formula would not and should not impact the 0% risk weighting for Member State sovereign debt.

The dynamic volatility adjustment does not change the risk measurement of the asset side but ensures that the total balance sheet approach of Solvency II is obeyed, ie that assumed spread changes are adequately reflected in the risk measurement of liabilities as well the assets. This is consistent with the standard formula calculations for interest rate and currency risk where the off-setting effects between assets and liabilities are modelled.

B. Comments on EIOPA's opinion

Disappointingly, EIOPA has advised that no changes are made to the standard formula's spread risk sub-module to reflect insurers' long-term holdings of corporate bonds and loans.

In its assessment, EIOPA refers to the fundamental principle of Solvency II that the SCR should ensure the market value of assets exceeds the market value of liabilities with 99.5% certainty within one year. However, it fails to recognise that in a spread stress scenario, the market value of the liabilities will decrease for VA-users due to increases in the volatility adjustment. Therefore, restricting the assessment of the impact of the scenario to only the assets overstates the risk.

The VA was included in the Solvency II framework to recognise that insurers, as long-term liability driven investors, are not fully exposed to short-term losses arising from changes in credit spreads. This is due to their asset-liability management, the predictability of liability cashflows and the insurer's ability to avoid forced asset sales.

Using the VA within the calculation of the liabilities but ignoring it in the determination of the capital requirements makes no economic sense. Solvency capital requirements for market risks must reflect the risk of changing capital markets, not of changing regulation (ie that the VA would remain unchanged in stress).

C. Conclusion

Insurance Europe proposes to adjust the current spread risk SCR sub-module so that the DVA is incorporated **in a way that is prudent, risk-sensitive and easy to implement**. Standard formula insurers using the VA would multiply the existing spread risk SCR charges by a DVA Reduction Factor before applying them:

$$\textbf{stress}_i\textbf{(with DVA)} = \textbf{stress}_i * \textbf{DVA Reduction Factor}_i$$

The DVA Reduction Factor is based on the economic effect that applying a DVA would have on the insurer's balance sheet under the 1-in-200 stress scenario. There is a floor included in the formula so that there is a minimum level set for each rating category (credit step) which would limit how much the spread risk can be reduced by the inclusion of the DVA. The floor is proposed to be set using the "reduction factors" already used by matching adjustment portfolios in Solvency II.

The proposed approach is risk-based, prudent and consistent with the economic principles of the Solvency II:

- It applies the total balance-sheet approach.
- It is prudent because the floor is sufficiently conservative.
- It is consistent with the matching adjustment.

Insurance Europe further proposes to change the reduction factor applicable to unrated debt to 82.5% (it is currently 100%). The 82.5% reduction factor is consistent with the existing spread charges, set out in Article 176.

Details on the proposed changes to the standard formula

The stress factors for spread risk, set out in Article 176, are adjusted for those undertakings which use the volatility adjustment as follows:

$$\textbf{stress}_i\textbf{(with DVA)} = \textbf{stress}_i * \textbf{DVA Reduction Factor}_i$$

$$\textbf{DVA Reduction Factor}_i = \max\left(\left(1 - \min\left(\frac{\text{PVBP(BELj,c)}}{\text{PVBP(MVj,cFI)}}, 1\right)\right), \textbf{RF}_{\textbf{CQS}}\right)$$

- Stress_i = standard formula stress factors for spread risk for instrument i
- $\text{PVBP}(\text{BELj}, c)$ equals the value change in the best estimate arising from a basis point increase in credit spreads of undertaking j in currency c.
- $\text{PVBP}(MV_{j,cFI})$ equals the value change arising from a basis point increase in credit spreads of the corporate bonds and loans of undertaking j in currency c.
- RF_{CQS} = Reduction factors from dynamic-MA modelling (article 181), as noted in the table below (subject to a change in the reduction factors for unrated debt).

PVBP terms are already defined and used within the volatility adjustment as they are needed to calculate the overshooting ratio (AR4). However, it is necessary to define separate terms $\text{PVBP}(\text{BELj}, c)$ and $\text{PVBP}(MV_{j,cFI})$, which reflect the sensitivity of the insurer's liabilities and corporate bonds and loans to change in their spreads (and does not reflect the sensitivity of any fixed income instruments which are not in scope of the spread risk sub-module eg. some mortgage loans and EEA sovereign bonds).

Reduction factors from Article 181.

	0	1	2	3	4 and higher
RF_{CQS}	45%	50%	60%	75%	100%

The above reduction factors are consistent with the existing regulation. However, Insurance Europe supports a change to the reduction factor applicable to unrated debt to 82.5% (it is currently 100%). The 82.5% reduction factor is consistent with the existing spread charges, set out in Article 176.

It is also worthwhile to highlight that the reduction factors are already extremely prudent, and no evidence has been provided to support such extreme calibrations.

Further information on the details of this proposal, please see Insurance Europe's paper, *Implementation of a dynamic volatility adjustment in the standard formula for spread risk SCR*.

Section 5.3 Property risk

A. Industry proposals for the review

Insurance Europe supports a recalibration of the property risk sub-module charge to better reflect the underlying risk based on pan-European data and to avoid unnecessarily impairing this kind of long-term investments. The recalibration with appropriate data from various European property markets will ensure that the property risk does not result in too high stresses for properties in some countries.

The industry notes that in the current framework, the calibration is based only on the UK commercial property market, which is exceptionally volatile and not representative of a typical European insurer's real estate investment. In addition, available data for the pan-European real estate market shows that the calibration should be at 15% at most. Insurance Europe therefore considers this evidence sufficient for recalibrating the standard formula property risk factor, in line with the EU objective of the CMU and of the European Green Deal.

B. Comments on EIOPA's opinion

EIOPA's conservative approach fails to deliver a definitive advice to the European Commission.

EIOPA's advice that no change should be made to the property risk sub-module is also somewhat contradictory. On one hand, it claims that there is not enough data available from the two largest available data providers, MSCI and ECB, to perform a recalibration. On the other hand, it claims internal model calibrations which are likely calibrated on a similar-sized, or indeed smaller data set and are based on the insurer's own portfolio, are suitable justification for retaining the existing factor.

An analysis of EIOPA's Comparative Study on Market and Credit Risk Modelling Report also shows that internal model undertakings with higher exposures, ie those which are most likely to allocate resources to modelling the risk, generally have lower calibrations than the standard formula.

C. Conclusion

The property risk charge should be reduced to 15% in line with the industry's analysis, provided by MSCI.

Section 5.4 Correlation matrices

A. Industry proposals for the review

Insurance Europe supports a reduction in the correlation parameter between interest rate down risk and spread risk to 0.

B. Comments on EIOPA's opinion

EIOPA's proposed reduction of the correlation parameter between interest rate down risk and spread risk to 0.25 is a step in the right direction. However,

- The evidence presented by EIOPA does not justify the two-sided correlation between interest rate risk and spread risk. The correlation parameter should generally be zero, no matter whether up- or downward interest rate risk is decisive.
- The current dependency of the correlation parameter on the interest rates can lead to undesirable cliff effects.

C. Conclusion

EIOPA's proposal to reduce the correlation parameter between interest rate down risk and spread risk is welcomed but it should be further enhanced by reducing it to 0.

Section 5.5 Counterparty default risk (CDR)

A. Industry proposals for the review

Insurance Europe supports the following changes to the CDR sub-module.

- The introduction of additional simplifications to the counterparty default risk sub-module.
- The extension of partial guarantees on mortgage loans.
- The calculation of the hypothetical SCR for fire, marine and aviation risk should be based on the largest net risk concentration.
- No change of the recognition of default and forborne loans to the CDR sub-module.

B. Comments on EIOPA's opinion

EIOPA's proposed simplifications for the risk-mitigating effect of derivatives, reinsurance arrangements, SPV and insurance securitisations will provide some relief to undertakings.

Similarly, its advice to extend the effective recognition of partial guarantees on mortgage loans and on the calculation methodology for the fire, marine and aviation risk sub-modules are important clarifications.

However, its proposal to include default and forborne loans in the CDR is unnecessary.

C. Conclusion

EIOPA's advice on the CDR sub-module is broadly welcomed by Insurance Europe except for its proposal to reclassify the treatment of default and forborne loans which should be rejected.

Section 5.6 Calibration of underwriting risk

A. Industry proposals for the review

Insurance Europe supports both a recalibration of the lapse risk parameters for both life and non-life insurance and the extension of the USP framework to cover lapse risk. Furthermore, in the life lapse risk scenarios the change in option exercise rates should apply to all contracts.

- Currently, the risks factors of the life lapse scenarios are only selectively applied to those contracts for which the increased or reduced lapse increases the obligations for the insurance company. In practice, however, it can be observed that the movements in lapse rates and decreases are largely homogeneous across all portfolios.
- Concerns remain that only the best estimate is considered as a diminishing factor. As the lapse risk only materialises in cases of surrender, the risk margin would need to be taken into consideration as well.
- The risk factors for the life and health mass lapse scenarios are unreasonably high and should be lowered. As an alternative, the restrictive provision in Article 218 (1) of the Delegated Regulation, which almost eliminates the possibility of undertaking-specific parameters (USP) for life and SLT health underwriting risks provided for in Article 104 (7) of the Directive, should be abolished.

B. Comments on EIOPA's opinion

Insurance Europe is disappointed that EIOPA has not undertaken further analysis of the mass lapse calibration.

In particular, it is disappointing to note that EIOPA failed to assess an alternative method to calibrate the mass lapse risk model using the the Vasicek Credit Loan Portfolio Model that was proposed by the industry in the response to EIOPA's opinion on the 2020 review of Solvency II (January 2020).

The lapse risk sub-module (the risk that policyholders surrender their policies) is a crucial element of the solvency capital requirement, particularly for life insurers.

A large number of policyholders surrendering their policies at a certain moment or over a short period is very unlikely. Policyholders usually buy life insurance products not only for investment purposes but also for protection – against old-age poverty or of family members in case of their own death.

When calculating the capital requirement for mass lapse risk, any changes in the risk margin are excluded. This means that in a mass lapse scenario it is assumed that the cost of holding capital for future mass lapse risk remains unchanged, despite the loss of customer-base (and future profit). It would be more correct to re-calculate the risk margin when calculating the capital requirement for mass lapse risk, thus reducing the mass lapse stress accordingly.

The calibration particularly exaggerates the lapse risk for profitable unit-linked products resulting in a high-risk margin. This is especially the case for products that will be charged 70 %.

In addition to the calibration of the lapse risk factor, concerns remain regarding the calculation basis of the lapse risk. Currently, the lapse risk factor is applied on a contract-by-contract basis which would mean that each individual will make a fully informed decision about his/her preference regarding a surrender at the same time. While this might be a theoretically fair assumption, it is very unlikely in reality.

Despite these strong concerns and an intense discussion of the actuarial profession with EIOPA, EIOPA suggests no changes to the mass lapse risk calibration in its Advice (para. 5.26 of the Advice).

C. Conclusion

The calibration of the lapse risk sub-module remains a source of significant concern for the industry. The methodology and calibration result in very high SCR requirements which have not been justified through empirical evidence. The issue is further compounded by the restrictions placed on the use of USPs which mean that insurers cannot refine the calibrations to reflect their own risk profile, as was originally foreseen in the Directive.

Further evidence of this issue was discussed in the EIOPA's recent Consultation on draft Supervisory Statement on the use of risk mitigation techniques by (re)insurance undertakings which notes that most common mass lapse reinsurance structures used an attachment point of around 20%. The appealing cost vs. capital benefit is an indicator that the reinsurance market in many cases considers mass lapse stress levels above 20% as extremely unlikely, and thereby attractive to reinsure.

A re-evaluation of the mass lapse calibration and methodology is therefore necessary.

Section 5.7 Risk mitigation techniques

A. Industry proposals for the review

While Insurance Europe supports EIOPA's proposal to further improve the recognition of non-proportional reinsurance in the standard formula, specifically by introducing a proposal for recognition of Adverse Development Covers (ADCs) under the reserve risk sub-module, it believes that the EIOPA proposal lacks ambition given its limitations and thus fails to completely address the issue.

To improve the guidelines for treatment of basis risk, Insurance Europe made a number of proposals aimed at improving harmonisation, risk management and overall efficiency in the insurance market.

Similarly, concrete proposals to improve the recognition of finite reinsurance in the standard formula were also included in the joint industry response to EIOPA's consultation on the 2020 Review.

Finally, Insurance Europe does not support consistent treatment of contingent capital treatments in internal models and the standard formula. A key feature of internal models is to provide flexibility to properly capture risk profile where standard formula cannot do so appropriately. Current regulation which allows the internal models to capture risk profile correctly and recognise the economic impact of contingent instruments under close supervisory scrutiny (via internal model approval processes) is appropriate and does not need to change.

B. Comments on EIOPA's opinion

Insurance Europe welcomes the work that EIOPA has done with the insurance industry and notably the members of the RAB to develop a workable proposal for the recognition of ADCs in the standard formula. Insurance Europe believes that the formula proposed by EIOPA should also apply to multiple lines of business and that it shouldn't have any limitation to the attachment point, as the economic effects of the attachment point are already recognised by the formula.

However, all of EIOPA's other proposals for risk mitigation techniques are disappointing and remain suboptimal. Industry feedback has broadly been ignored and disregarded without appropriate assessment or explanation.

- Only cursory assessment of industry proposals on the recognition of finite reinsurance in the standard formula appears to have been made.
- No mention of industry feedback on the guidelines for basis risk has been included in the advice.

C. Conclusion

Insurance Europe would encourage the European Commission to address the issues identified above on EIOPA's proposals on ADCs. Improved recognition of ADCs will consequently reduce the volatility of small and medium insurance companies, while protecting their back book of historical risks from distortions.

Further consideration of the industry feedback on finite reinsurance and basis risk should be made prior to acceptance of EIOPA's advice. "Upgrading" these guidelines to the Delegated Regulation, as suggested by EIOPA, should only be considered if flaws and shortfalls of the current guidelines are appropriately reflected.

Furthermore, its proposals on the recognition of contingent capital in internal models should be disregarded.

Section 5.8 Reducing reliance on external ratings

Insurance Europe supports EIOPA's proposals for investigation of the success of the Article 176a by analysing the extent to which insurers make use of these provisions for unrated bonds in practice and, if they don't, why this is the case.

Insurance Europe also supports an impact assessment of future potential new methods for rated bonds and looks forward to future engagement on this topic with EIOPA and the EC.

Section 5.9 Transitional on government bonds

Insurance Europe welcomes EIOPA's proposed grandfathering provisions exempting exposures to Member States' central governments or central banks denominated and funded in the domestic currency of any other Member State.

6. Minimum Capital Requirement

A. Industry proposals for the review

The industry is of the view that no significant changes are needed in the area of solo MCR.

B. Comments on EIOPA's opinion

Insurance Europe welcomes EIOPA's proposal not to change the calculation of the MCR corridor.

The industry welcomes changes aiming at improving convergence of supervisory action in case of non-compliance with the MCR. However, the addition of specific requirements already in case of risk of breach of the MCR leads to a forward shift of the supervisory ladder as well as to further uncertainties as the risk of a breach of the MCR depends on the scenarios and forecasts chosen. Besides, the industry notes that the eventual lack of flexibility in NSA action that may arise was not identified as a potential "cost" in EIOPA's impact assessment.

C. Conclusion

The EC should follow EIOPA's advice to make no changes to the solo MCR calculation method and provide clarification to improve convergence of supervisory action in case of breach of the MCR.

7. Reporting and disclosure

A. Industry proposals for the review

In the area of reporting the industry has put forward the following proposals:

- General
  - The industry proposed an alternative approach for S.06.04 - on detailed funds look through - to satisfy supervisory information needs and at the same time avoid additional reporting burden.
- Reporting deadlines
  - The industry proposed to revert to the timetable related to 2018 data.
- QRTs
  - The industry proposed to have a set of core (basic) QRTs reported by all undertakings, containing the key figures needed to assess the risks and solvency situation of an undertaking and a set of additional, non-core, QRTs templates for which companies would be exempt from reporting unless the NSA required the company to report specific templates based on justification related to their risk profile/activities.
  - The industry noted that EIOPA should wait for the conclusion of the 2020 review (including full scrutiny by the EU institutions) before making any changes to its QRTs and reporting requirements. The industry understands that EIOPA only needs the Commission approval

for ITS amendments. The industry does not believe EIOPA should act on any of its proposals before proper Level 1 and Level 2 strategic consideration of the issues.

- SFCR
  - The SFCRs should be simplified so that they consist of only a very short simple policyholder section and a simple data extraction of the public QRTs data without a mandatory narrative for the section for other stakeholders.
  - For the Single Group SFCR a 6-week extension of deadlines should be maintained.

- RSR
  - A three-year RSR is sufficient and should become the standard, as opposed to simply being an option at the NSA's discretion.
  - Groups should have the option to report their RSR under the form of a single group RSR.

B. Comments on EIOPA's Opinion

General Points

The industry **supports** EIOPA's advice to the EC to continue implementation of the Digital Finance Strategy and development of the announced Supervisory Data Collection Strategy, including potential legislative changes that **would clarify/facilitate use of already reported data within other EU reporting frameworks**, with CIU data as a priority, which would reduce the reporting burden of S.06.04. The industry furthermore acknowledges EIOPA's advice to the EC to promote **the identification of other areas of duplications and inconsistencies between the reporting frameworks across** the sectors of the financial industry and continue to work on the foundation of data standardisation, critical for an efficient data-sharing framework, in cooperation with relevant supervisory and regulatory authorities.

Reporting Deadlines

While the industry **welcomes the 2-week extension in timelines for annual QRTs**, it is of the opinion that **an extension** of the timelines **should also be granted for quarterly QRT reporting, ie from 5 weeks to 6 weeks**.

While the industry **welcomes the proposed 4-week increase in reporting timeline of the SFCRs**, ie from 14 weeks to 18 weeks for Solo SFCRs and from 20 weeks to 24 weeks for Group SFCRs, it notes that most if not all of this time will be taken up by the newly introduced requirements such as the minimum external audit, the references to sustainability risks, ESG and climate change related issues etc. **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 **appreciates EIOPA's proposal to amend the deadline for the single SFCR**, thereby addressing an industry concern, and to bring the deadline to 18 weeks for the policyholder section and 24 weeks for the professional section.

The **4-week increase in the RSR timeline** is welcomed.

QRTs

The industry is genuinely disappointed that EIOPA decided to maintain its proposal for standard formula reporting requirements for internal model companies. **EIOPA's proposed requirement to calculate both (partial) internal model and standard formula figures is onerous and unnecessary**, with long-lasting consequences. The introduction of such a requirement would effectively undermine not only the internal models but also the suitable processes underlying their effective management and supervision.

Internal models are the critical part of the Solvency II framework, and they were designed to reflect a company's specific risk profile when the standard formula is not appropriate. Therefore, it is incorrect to attempt the comparison of standard formula figures with internal model figures. Undertakings using Solvency II internal models do so because the standard formula does not reflect their risk profiles well enough, making any

comparison between standard formula figures meaningless. In addition, the requirement would create significant additional costs and challenge the real value of internal models. In fact, internal models facilitate a risk-sensitive approach to supervisors' and insurers' assessments of capital adequacy, by considering insurers' distinctive risk profiles. As such, transparent insights into the risk management practices of insurers with specific risk profiles are provided, which is the most valuable information for supervisors.

Further, NSAs are responsible for the approval of the internal models in their jurisdictions, and in addition they approve any major changes to the internal models and they need to be notified regularly of all other changes. During these processes, NSAs receive the standard formula figures as part of the mandatory information required for the authorisation. As such, supervisors have an extensive suite of tools available to them to ensure that internal models continue to generate appropriate SCR numbers.

With respect to limitations and exemptions, while **Art 35 was changed to become more risk based** (applying in priority on the basis of risk based criteria - which we have deemed too restrictive - for LRU rather than a priority given to "small" companies), EIOPA proposes two options, **option 1** where it was **not made mandatory for NSAs to use waivers up to 20% threshold and option 2** where it was **made mandatory** for NSAs to use waivers **up to a 5% threshold**. The industry clearly prefers option 1. It is however disappointed that EIOPA has not proposed to make it mandatory to grant waivers up to the 20% threshold. To make the mandatory exemptions up to 20% meaningful, some further changes are needed, in particular a pragmatic solution for group reporting is needed, as it would not make sense to exempt a single entity while the group still would have to report the information. Further, there should be legal certainty (exemption for at least 3 to 5 years and not on an annual basis as at present). Moreover, the criteria to identify LRU are not appropriate (see section 8 on Proportionality).

The industry also welcomes that in the area of groups EIOPA proposes to amend Article 254 of the Solvency II Directive to allow for exemption of groups reporting without the condition of exemption of all solo insurance undertakings belonging to that group. However, it notes that EIOPA did not propose concrete drafting changes to Art 254 of the Directive in its 'background analysis' document related to the Opinion on the SII 2020 review. Additionally, **Q4 reporting should be eliminated**, as it has limited added value, but takes up much needed resources, which could be used more efficiently during an extremely busy reporting period.

EIOPA proposed **additional reporting requirements and/or reviewed templates** for cross border business (S.04), cyber risk, product by product information for life and non-life (S.14) And although we recognise justification for additional reporting for eg cyber, this has not been compensated by other reductions and the currently proposed cyber template is too granular.

Furthermore, the industry notes that beyond all the extensive changes proposed by EIOPA to the reporting package, further changes, in particular to the QRTs, are not included in this opinion and are still to be expected under the form of amendments proposed to the ITSs on reporting and disclosure. The ITS amendments will include some welcome deletions of rarely used QRTs, but many changes to a large number of existing QRTs are still expected, which would be costly - as Solvency II reporting usually involves automated processes - and not justified by the supervisory benefits. Against this background the industry highlights the following:

- the number of mandatory QRTs should be reduced
- the industry disagrees with the proposed changes to a large number of existing QRTs, which would be costly and not justified by the supervisory benefits
- any change concerning QRTs - even in case of simplifications – should allow for sufficient time to implement all these changes, as these will have a huge impact on resources, IT systems and company processes.
- EIOPA should wait for the conclusion of the 2020 review (including full scrutiny by the EU institutions) before making any changes to its QRTs and reporting requirements. The industry understands that EIOPA only needs the Commission approval for ITS amendments. EIOPA should not act on any of its proposals before proper Level 1 and Level 2 strategic consideration of the issues.

SFCR

While the industry takes note of the concept of splitting the report in 2 parts, a section for policyholders and a section for other stakeholders, **it believes that the current SFCR proposal fails to achieve the aim of simplifying and streamlining the SFCR.** The policyholder section will likely go beyond a two-pager and the section for other stakeholders is deemed to be very extensive and would lead to substantial costs, which would materially increase if/when the external audit requirement becomes applicable. **The industry reiterates that the SFCR for policyholders should be kept very short and simple while the SFCR for other stakeholders should be a data extraction of the public QRTs data without any set requirements for a narrative, besides this no further changes to the SFCR are needed.**

The appropriate content for the policyholder section could for example be tested by means of a consumer analysis (eg it could be tested whether consumers understand the document and whether they interpret it correctly).

Furthermore, the industry strongly rejects the **external audit or similar requirement of at least the balance sheet disclosed as part of the SFCR as this would represent an unnecessary and substantial additional cost for undertakings**, disproportionate to the very limited number of readers of the SFCR and the added value will be minimal. Furthermore, the supervisory review obligation is already the responsibility of the national authority. In addition, it is highly likely that these additional costs will be ultimately borne by policyholders.

The industry appreciates that the differences in business models are considered in EIPOA's approach ie for captives. However**, it is inacceptable that the proposed simplifications in pillar 3 only apply to a very limited number of specified entities** (*para 88 proportionality*). Those simplifications, especially the QRT-based SFCR for the professional public, should be applied as regular procedure for all entities. The ability of the professional public to evaluate quantitative data does not depend on the entity's risk profile or its business model. To apply proportionality adequately and consistently, simplifications in reporting measures should be granted based on a risk assessment, which may include but should not be limited to the nature of the undertaking. Moreover, further clarification is necessary on the definition of "beneficiaries" in the context of captives to allow for a full assessment of the impact of the proposals.

The **numerous additions and changes that EIOPA proposes to the SFCR would make the report even more extensive, burdensome and costly than it already is today.** EIOPA proposes to add/change:

- **References to sustainability risks/ESG and climate change related issues**. The industry highlights that numerous and further changes to the Delegated Regulation with regard to sustainability should be avoided, especially because amendments to the Delegated Regulation with respect to sustainability are expected to be made shortly and the impact of these changes is not visible yet. As there is a need for stability and legal certainty in this area, proposals for further changes should be duly considered as well as their interaction with ongoing policy developments, eg Sustainable Finance Disclosure Regulation (SFDR) and proposals on sustainability corporate governance.
    - Delegated Regulation Art 293 - *Part addressed to other stakeholders - Business and performance - 2a. The SFCR shall include qualitative and quantitative information regarding the consideration of Environmental, Social, and Governance (ESG) factors in the underwriting policy of the insurance or reinsurance undertaking, and any activities related to the development of products and services which reduce sustainability risks and have a positive impact on ESG issues.*

      The industry disagrees with EIOPA's proposal and with its timing as the Commission should first finalise the amendments on the integration of sustainability risks/factors to the Delegated Regulation under Solvency II (hereafter, "the sustainability amendments to the Delegated Regulation") on which it has been working for the last 2 years. This is key as these amendments contain elements, for example a definition of sustainability factors, without which it is even harder to understand what is intended with these proposed changes. In addition, **the requirement is not clear** (eg what quantitative

information should be reported on ESG factors and whether this would be consistent with the definitions and requirements of the SFDR.)

- Delegated Regulation Art 293 - *Part addressed to other stakeholders - Business and performance –7 information on the investment policy, including qualitative and quantitative information regarding the consideration of Environmental, Social, and Governance factors in the investment policy of the undertaking and any stewardship activities related to the investees on account of Environmental, Social, and Governance issues.*

  The industry disagrees with EIOPA's proposal. As noted above, the Commission should first finalise the sustainability amendments to the Delegated Regulation on which it has been working for the last 2 years. This is key as these changes contain for example a definition of sustainability factors, without which it is even harder to understand what is intended with these changes.
- Delegated Regulation Art 293 - *Part addressed to other stakeholders - Business and performance – 7 The SFCR shall describe, where applicable, compliance of the insurance activity with the criteria for substantial contribution to climate change adaptation in accordance with Article 3 of Regulation (EU) 2020/852.*

  The industry disagrees with EIOPA's proposal and its timing. Once again, the wording is vague and the proposal is wrongly timed, eg with respect to ongoing development in the SFDR and the Taxonomy Regulation.
- Delegated Regulation Art 294 - *Part addressed to other stakeholders - System of governance - 1. The SFCR shall include all of the following information regarding the system of governance of the insurance or reinsurance undertaking: (b) (i)…how the remuneration policy is consistent with the integration of sustainability risks;*

  The industry agrees with this extension as it is consistent with the SFDR text and the nature of the proposed sustainability amendments to the Delegated Regulation under Solvency II.
- Delegated Regulation Art 296 - *Part addressed to other stakeholders - Valuation for solvency purposes*

  1. The SFCR shall include separately for each material class of assets, following the classification as set out in the solvency balance sheet, the value of the assets, as well as a description of the bases, methods and main assumptions used for valuation for solvency purposes, including, where relevant, the consideration of sustainability risks and factors in the valuation methods

  2. The SFCR shall include all of the following information regarding the valuation of the technical provisions of the insurance or reinsurance undertaking for solvency purposes

  (a) separately for each material line of business the value of technical provisions, including the amount of the best estimate and the risk margin, as well as a description of the bases, methods and main assumptions used for its valuation for solvency purposes, including, where relevant, the consideration of sustainability risks and factors in the valuation methods;

  The industry agrees with this extension, as the article specifies "where relevant" and the requirement is risk-based.
- Delegated Regulation Art. 297 - Part addressed to other stakeholders - *Capital management and risk profile - 2. The SFCR shall include all of the following information regarding the SCR and the MCR of the insurance or reinsurance undertaking: (j)Actions taken by the undertaking to ensure that sustainability risks are taken into consideration in the risk management areas set out in **Article 260**;*

  The industry takes note of this inclusion, but suggests ensuring this will not amount to a duplication with respect to the sustainability amendments to the Delegated Regulation.
- Delegated Regulation Art. 297 - *Part addressed to other stakeholders - Capital management and risk profile*

  9. SFCR shall include information on how the undertaking has determined its own solvency needs given its risk profile, including the effect of sustainability risks, and how its capital management activities and its risk management system interact with each other.

The industry agrees with this proposal, as it consistent with proposals in EC Delegated Regulation for Article 269 (paragraph 1a – new). At the same time, there should be a materiality consideration in the wording, by adding "where relevant".

- LTG related information: EIOPA's advice to report only the solvency figures with the LTG measures in the policyholder version of the SFCR is welcomed. This approach should likewise be extended to the "other stakeholders" version of the SFCR.
- Reporting on use of transitionals for interest rates and technical provisions: The industry rejects EIOPA's advice to require additional public disclosure on the use of and reliance on the transitional measures. This is unnecessary and would only serve to undermine the transitional measures which are an agreed part of the Solvency II framework. From a practical perspective, it is not clear what benefits, and to whom, these proposals would bring when they would be introduced over halfway through the transition period.
- On the standardisation of the sensitivity of SCR ratio, SCR amount and Eligible Own Funds to cover the SCR amount: The industry takes note of EIOPA's effort to reduce the minimum number of sensitivities (minimum: equity markets/RFR/credit spreads of fixed income investments/property values) and the fact that the sensitivities only need to be disclosed by groups/undertakings relevant for financial stability purposes. However, the industry is concerned by the fact that the specific guidelines to determine these undertakings relevant for financial stability purposes still need to be provided by EIOPA, and as such the extent of this requirement is unclear. And by the prescriptive set of pro forma sensitivities applicable, when the use of such data should depend on the risk profile of the undertaking, and what makes sense in illustrating what is essentially company specific sensitivities, and not universal or EU specific risks. Against this background, the industry believes that the disclosure of sensitivities of SCR coverage in percentage, SCR, Eligible Own Funds should be at the discretion of the company only.
- Impact of changes to the convergence parameter of the alternative extrapolation method on financial position: EIOPA's advice to require the disclosure of a sensitivity analysis of the extrapolation methodology is unjustified. As noted previously, Insurance Europe does not support the alternative extrapolation methodology but if a change was implemented, there should be no requirement to publicly disclose the impact of altering the alpha parameter to 5%.
- The approach to merge certain parts of the reports – ie Capital management and Risk profile would be a costly one-off change.

Against this background, the industry reiterates its proposal that the SFCR for policyholders should be kept very short and simple while the SFCR for other stakeholders should be a data extraction of the public QRTs data without any set requirements for a narrative, beside this no further changes to the SFCR are needed.

At the same time, the industry does welcome:

- EIOPA's proposal not asking for a policyholder section of the group SFCR.
- The clarification regarding languages in Delegated Regulation Art 298 bis, specifying that in case of a contract concluded with a policyholder in another MS under FoS/FoE, the policyholder has the right to ask for a translation of the SFCR part for the policyholder in the official language or one of the official languages of that MS, as chosen by the policyholder.
- The suggestion to require the SFCR/RSR in a specific technical format, allowing for application of search function.
- The reporting (via QRT) of the exact location of SFCR/Public QRTs on the website to NSA.
- The suggestion that SFCR data may be used by NSAs/EIOPA to collect/extract/analyse/publicly disclose the information of SFCRs/QRTs.

RSR

The industry **welcomes** EIOPA's proposal to introduce the **possibility to have a single group RSR**, subject to certain criteria (new article Directive Art 256a).

The industry acknowledges EIOPA's effort to reduce the reporting burden by reducing the **frequency** for LRUs to a 3-year RSR. However, for other undertakings the RSR frequency is still at the discretion of the supervisor, with the additional requirement specified in Art 312 (2) of the Delegated Regulation that the supervisor needs to duly justify this request, which is appreciated by the industry. At the same time, the industry highlights that it is important that further guidance is developed for supervisors, on how they should justify this request.

In addition, the industry also **appreciates EIOPA's efforts to streamline the RSR**, in particular the introduced distinction between static and dynamic information as well as the reduction of the overlap between ORSA and RSR and with information that is already reflected in QRTs.

The industry takes note of EIOPA's **clarification on** what should be understood as **material changes** (Delegated Regulation Art 304 (b))

Furthermore, the industry welcomes the increase in RSR deadline as proposed by EIOPA.

The industry disagrees with the fact that EIOPA does not recognise the specific control and limited risk of intra-group outsourcing arrangements. Rather than acknowledging the control and, therefore, common interest between the outsourcing undertaking and the servicing entity, EIOPA increases the regulatory burden for such arrangements, bysuggesting that information about material intra-group outsourcing arrangements should be included in the RSR (para. 7.27 of the Advice).

C. Conclusion

General
The industry welcomes EIOPA's advice to the EC to improve institutional data exchange with CIU data as a priority (S.06.04) and to limit as such the duplication of reporting, which would help reduce the burden of reporting.

Reporting deadlines
While the industry welcomes the extension of deadlines for annual reporting (SFCR/RSR and QRTs) it notes the quarterly reporting deadlines should also be extended, ie from 5 weeks to 6 weeks. In addition, the industry highlights that 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.

SFCR
While the industry takes note of EIOPA's suggestion to split the SFCR in two parts, it believes the SFCR part for other stakeholders should be a simple data extraction of the public QRTs data without a mandatory requirement for a narrative. The industry highlights that the part for policyholders, as currently proposed, will go beyond a two-pager, while it should be kept very short and simple. In addition, the industry does not support the addition of various reporting and disclosure proposals.

Furthermore, it is key that the introduction of a minimum external audit requirement for the SFCR is removed.

In addition, the many additions proposed will only lengthen the report, and should be removed or at least substantially reconsidered.

- Numerous and further changes to the Delegated Regulation with regard to sustainability should be avoided, because amendments to the Delegated Regulation with respect to sustainability are expected to be made shortly and the impact of these changes is not visible yet.
- The disclosure of sensitivities of SCR ratio, SCR amount and Eligible Own Funds to cover the SCR amount should be at the discretion of the company only.
- The SFCR should include only data including the VA/MA – the current requirement to include the impact of VA/MA separately should be removed.

QRTs
The standard formula reporting requirement for internal model companies, as proposed by EIOPA should not be considered by the Commission as it is both onerous and unnecessary.

The granting of waivers as foreseen in Art 35 of the Directive should be made mandatory up to the 20% threshold. To make the mandatory exemptions up to 20% meaningful, some further changes are needed, in particular a pragmatic solution for group reporting is needed, as it would not make sense to exempt a single entity while the group still would have to report the information. Further, there should be legal certainty (exemption for at least 3 to 5 years and not on an annual basis as at present).

Furthermore, the industry notes that EIOPA proposed additional reporting requirements and/or reviewed templates for cross border business (S.04), cyber risk, product by product information for life and non-life (S.14), and many other changes, which are not part of these – already extensive – proposals in the area of reporting. Against this background the industry highlights the following:

- the number of mandatory QRTs should be reduced
- the industry disagrees with the proposed changes to a large number of existing QRTs, which would be costly and not justified by the supervisory benefits
- any change concerning QRTs - even in case of simplifications – should allow for sufficient time to implement all these changes, as these will have a huge impact on resources, IT systems and company processes.
- EIOPA should wait for the conclusion of the 2020 review (including full scrutiny by the EU institutions) before making any changes to its QRTs and reporting requirements. The industry understands that EIOPA only needs Commission approval for ITS amendments. The industry does not believe EIOPA should act on any of its proposals before proper Level 1 and Level 2 strategic consideration of the issues.

8. Proportionality (and thresholds)

8.1 Thresholds

A. Industry proposals for the review

The industry is of the view that the thresholds for exclusion from Solvency II should be raised. This would ensure that very small undertakings are exempted from the Directive's requirements, and more appropriately regulated and supervised under a more appropriate framework at national level.

B. Comments on EIOPA's opinion

Insurance Europe broadly welcomes EIOPA's proposal on thresholds, ie the raise of the technical provisions thresholds to €50m and the option for member states to raise the premium income threshold up to €25m. However, the premium income threshold to be used by default should be €10m instead of €5m, in order to guarantee that very small undertakings are exempted and avoid a conservative approach from NSAs. This would also take into account inflation since the entry into force of Solvency II.

In addition, EIOPA's analysis as to how many undertakings would be exempted based on the two main thresholds – premium income and technical provisions – does not take into account the companies that would not benefit from this raise, due to the other thresholds that are kept at the current low level. The reinsurance business threshold and the thresholds concerning companies belonging to a group should adjusted accordingly, while EIOPA is proposing no changes.

C. Conclusion

The EC should broadly follow EIOPA's advice to raise the thresholds of Article 4 on the Solvency II Directive.

However, the EC should further adjust the level of other thresholds as follows:

- Raise the minimum threshold in Article 4.a regarding premium income to €10m instead of EIOPA's proposed to keep the minimum at €5m.
- 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).

Finally, a revision clause for inflation should be clearly provided in the text.

8.2 Proportionality

A. Industry proposals for the review

The industry welcomes the Commission's ambition to improve the application of proportionality in Solvency II. Changes are necessary to ensure that any insurer can avoid, based on the scale, nature and complexity of its activities, unnecessary costs which ultimately would have to be borne by policyholders.

Applying proportionality does not mean to discharge undertakings from a severe supervision nor to take away responsibilities from NSAs. On the contrary, NSAs can increase their legitimacy and the quality of their work, if they rethink proportionality as a tool to focus their resources based on actual risks.

The industry is of the view that the application of the principle of proportionality can be effectively improved by:

1- **Making clear in the Directive that the application of proportionality is a duty for NSAs and that NSAs are allowed to deviate from the detailed requirements in the regulation for proportionality reasons**

The current lack of application and convergence of proportionately across the Union creates regulatory and supervisory inconsistencies.
In some countries, NSAs do not feel legally able to deviate from the Level 1 and 2 regulation for proportionality reasons, so it needs to be clear that this is allowed.
Moreover, the principle of proportionality is embedded into Solvency II, which is a very sophisticated framework, and as such needs to be applied with a risk-based approach to avoid overly burdensome requirements and costs.

2- **Creating a proportionality toolbox: a list of measures with risk-based criteria for automatic application**

This means that the proportionality measures can be automatically applied on the basis of pre-defined risk-based criteria:

- Concerning the company as a whole and its risk profile (LRU), or
- Specifically designed for each proportionality measure of the toolbox for non-LRU.

3- Allowing insurers to apply measures listed and not listed in the toolbox: with justification, a simple ex-ante approval process and a reasonable timeframe for NSAs to object.

The burden of proof must be reverted to ensure that the process is not more burdensome than the regulatory requirement itself. Companies that do not qualify for automatic application must have access to an ex-ante approval process where they would explain the proportionality measures they wish to apply, whether part of the toolbox or not, and justify why they believe this is proportionate.

NSAs should object within a reasonable timeframe, two months for measures defined in the toolbox, and three months for other measures, in order to have a timeframe that is reasonable both for the insurer and for the NSA to perform its analysis. In the absence of objection, the insurer would be allowed to use the measure.

4- Providing in the regulation that EIPOA produces an annual report on proportionality

Similar to the one on exemptions and limitations in reporting, EIOPA would assess the progress made across the EEA and per member state and identify good practice.

B. Comments on EIOPA's opinion

In 2019, the insurance industry presented a comprehensive proposal on how to improve the proportionate application of Solvency II across the single market. EIOPA's great efforts to embrace the fundamental principles of this approach in its opinion are appreciated. However, some improvements are necessary to ensure that the new proposed framework works in practice and significantly improves the application of proportionality.

1- NSAs duties and empowerment to deviate from the legal texts for proportionality reasons

The drafting proposed in Articles 29.3 and 29.4 is welcome, **to ensure that NSAs are legally able to allow proportionality measures**, and the fact that they cannot refuse the automatic application as provided in the new framework (see 2- Proportionality toolbox) is welcome.

However, EIOPA's proposal does not state clearly that **NSAs have a general duty and power to enforce the principle of proportionality to a large extent** and not only where the regulation makes it explicitly mandatory.

Finally, the industry disagrees with the proposed provision in Article 29.5 that proportionality measures should not lead to a complete exemption from some requirement. In fact, this rule may prevent some fair and appropriate proportionality solutions. A complete exemption from a specific requirement should be allowed and may benefit policyholders where the requirement does not provide any added value for the supervision while producing costs for the affected company and consuming resources of the NSA. Moreover, some waivers are already allowed in the area of reporting. It is necessary to include into the text certain provisions that a complete exemption of a certain specific requirement is possible for reasons of proportionality.

2- Proportionality toolbox

EIOPA heard the industry's call to introduce some automaticity to reduce the burden of administrative processes, and to increase legal certainty and convergence in the area of proportionality. Following the industry approach, EIOPA is proposing to create a toolbox of proportionality measures to be applied automatically.

- Overall, the proposed framework for low risk undertakings (LRU) is welcome. Unfortunately, its design is partially flawed because it only applies as a package to insurers identified as LRU, and there is no

possibility to apply individual proportionality measures based on some criteria specifically designed for this simplification.

- The proposal for Article 6a.5 introducing some flexibility for NSAs to categorise additional insurers that do not meet all the criteria but believe they should belong to the LRU category is also welcome. However, the criteria are too restrictive and some of them are not risk based. Specifically:

    - Size of the company

This criterion is not appropriate to assess the risks of a particular undertaking. In fact, this criterion will exclude many companies with a simple business model and low risk profile particularly in some bigger markets. Moreover, just because of differences in the general cost of living across member states, a criterion based on the absolute size of a company in € (premiums or technical provisions) cannot be an objective measure of the size of a company.

    - Immateriality of cross-border business:

This criterion is not appropriate to assess the risks of a particular undertaking. In fact, companies get better geographical diversification of risks by operating in more than one market. Also, introducing this criterion will undermine the political goal of creating a European capital market union and miss the opportunity to strengthen the security of policyholders by improving the cooperation among NSAs.

The systematic discrimination of cross-border business is not acceptable. Conducting business across the single market must not be a risk-determining factor per se. During its stakeholder event, EIOPA argued that the insurer is not aware of the risks in other jurisdictions. This is concerning, as the supervisory approval process and the regular supervisory oversight/review should ensure that an insurer is capable of managing its business and the associated risks appropriately – domestic and cross-border.

Proportionality should not depend on the location of headquarters or the home of the policyholders, because insurers who operate in other markets than the jurisdiction where they are established must in any case prove to their NSA that they hold the necessary expertise. In cases where the supervisor does not feel like it has sufficient expertise or resources to conduct its assessment, supervisory cooperation and the coordination of EIOPA should fill the gap, not regulatory protectionism and barriers to the single market.

    - Property being included in the "non-traditional investments" under one of EIOPA's criteria

Due to structural differences of investment portfolios across member states, this would result in excluding all companies from the LRU category in some countries.

    - Criterion of combined ratio

The industry understands that the criterion on life insurance "excluding index/unit-linked" means that these products are not taken into account in the limit. Should the criterion mean that index- and unit-linked providers should be excluded from the LRU status, this criterion would not be acceptable. Some clarification would be welcome.

Moreover, when developing guidelines to clarify how the combined ratio is calculated, EIOPA should specify that the combined ratio of non-life insurance companies should be calculated including financial income and the ratio considered should be an average over two years in a rolling five-year period.

    - Criterion on Marine, Aviation and transport or Credit and Suretyship line of business

NSAs are strongly invited to take into consideration local specificities to extend the scope of LRU (eg in Denmark, several of the smallest insurance companies are mutual fishing vessels insurance).

- Finally, the measures in the toolbox should also concern Pillar 1.

The industry welcomes the drafting of Article 6e regarding the application process for non-LRU.

Both the process and the timeframe of two months for the NSA to respond, as proposed by the industry, seem appropriate.

However, safeguards are needed in Article 6e.3 to avoid that NSAs request a disproportionate amount of additional documentation and render the process more burdensome than the regulatory requirement itself. The industry proposes at this stage to introduce a notification process to EIOPA (see 4- EIOPA report on proportionality).

3- Additional proportionality measures needed

Approval process
The industry appreciates the design of a clear, transparent and harmonised process for NSA approval of the use of proportionality measures, whether these are in the toolbox or not.

Pillar 1 measures
It is welcome that EIOPA has, as suggested by the industry, proposed the inclusion of its own supervisory statement on proportionality in SCR calculations in the regulation as an automatic measure. However, it is regrettable that market risk has been excluded from this measure. Indeed, market risk is the module in which insurers are the most likely to have non-significant sub-modules. Moreover, this exclusion had not been put forward in the supervisory statement published in April 2019.

In article 36.2a and 36.2b, EIOPA proposes that NSAs are allowed to grant proportionality measures that are not listed in the Directive or in the Delegated Regulation with respect to Pillar 2 only. For Pillar 1, only measures listed in EOIPA's convergence tools would be allowed. Multiple proportionality simplifications are spread across many texts at level 1, 2 and 3, and the purpose of proportionality is precisely to avoid unnecessary administrative burden. Therefore, for such an approach to be workable, EIOPA would need to draft a comprehensive list of measures and simplifications in one single centralised tool such as a guideline.

Currently, Solvency II allows usage of a **simplified calculations for the SCR**, when the insurer meets certain conditions (Article 109, Solvency II). The conditions for the various risk modules of the SCR are provided in Articles 88 to 112 of the Delegated Regulation. In this context, it has to be noted that the simplified standard formula does not lead to lower SCRs. As it is based on rather conservative assumptions, and leaves out deductions that are in the standard formula, it is likely that the simplified standard formula results in a more conservative SCR.

Article 109 of the Solvency II Directive reads: "*Insurance and reinsurance undertakings may use a simplified calculation for a specific sub-module or risk module where the nature, scale and complexity of the risks they face justifies it and where it would be disproportionate to require all insurance and reinsurance undertakings to apply the standardised calculation. Simplified calculations shall be calibrated in accordance with Article 101(3).*"

Article 88(1), Delegated Regulation, says: "*For the purposes of Article 109, insurance and reinsurance undertakings shall determine whether the simplified calculation is proportionate to the nature, scale and complexity of the risks by carrying out an assessment (…) of (1) an assessment of the nature, scale and complexity of the risks of the undertaking falling within the relevant module or sub-module and (2) the difference between the two calculations.*"

Article 88 means that National Competent Authorities (NCAs) require the insurer to demonstrate that they fulfil the conditions for applying the simplified formula. Articles 91 to 112 Delegated Regulation provide the simplified formulas for the various SCR risk modules.

The current approach presents a severe risk for the undertaking that the supervisor does not allow for simplifications, causing unnecessary uncertainty and resulting in additional compliance burdens. The result is a dilemma, that undertakings refrain from applying the simplified, yet proportionate, version of the standard formula, due to the regulatory uncertainty, only to end up with a more conservative requirement anyway.

The simplified formula leads to more conservative results because certain elements that would reduce a company's SCR under the regular standard formula are removed from the calculation. The trade-off between less complexity and a lower capital requirement should be the choice of the insurer. Therefore, the use of the simplified standard formula should be at the discretion of the insurer. At a minimum, it should apply automatically for LRU and for other companies when pre-defined criteria are met.

Taking away the general power to challenge the use of the simplified standard formula must not result in cutting NSAs' ability to fulfil their tasks and ensure a risk-appropriate supervision. Rather than challenging the choice of the insurer to use the simplified standard formula as such, we suggest that the NSA can require insurers to use the regular standard formula for specific risk modules and only where it is duly justified. As such, the NSA should demonstrate that the choice of the simplified standard formula leads to a materially lower SCR than the SCR calculated with the general standard formula.

The same approach should be implemented notwithstanding the legal form of the undertaking, including captives (Article 89, Delegated Regulation).

The proposed approach to the use of the simplified standard formula would be more proportionate and efficient. Thereby, it could particularly support smaller insurers and new market entrants (eg InsurTechs) with lower budgets. Moreover, it would employ resources for insurers of all sizes more efficiently. In addition, the use of the simplified standard formula would also reduce the complexity for the assessments by investors of start-ups.

Finally, the industry welcomes that EIOPA worked on a **simplified approach for stochastic valuation**. It is indeed very burdensome for undertakings to implement and maintain the procedures for stochastic valuation. However, it is important that this new approach does not question present stochastic valuation approaches. From the industry perspective, the approach could be applied under the proportionality principle of Art. 56 of the Delegated Regulation. However, the application should be at the discretion of the individual undertaking.

Combinations of key functions to be judged on case-by-case basis

The industry welcomes EIOPA's clarification that combinations of key functions are allowed, and stresses that although pre-defining risk-based criteria would be challenging, a case-by-case assessment must always be considered by NSAs and should not be systematically dismissed.

Guided ORSA in lower frequency

The Own-Risk and Solvency Assessment (ORSA) is at the very heart of the Solvency II framework and essential for an effective supervision of the risk management of a company. However, the ORSA also requires enormous efforts by undertakings and is linked to substantial uncertainties.

While it is important that the fundamental principle of the ORSA – the own reflection of an undertaking on its risk and solvency position – is maintained, when there is no material change to the risk profile it should be allowed to conduct the ORSA only every three years.

Also, guidance on the structure and substance of the ORSA would ensure a more proportionate and consistent approach. In this regard, the Central Bank of Ireland (CBI) provides a targeted set of questions for the ORSA of insurers qualifying for the CBI's low/medium low risk categorisation. This approach should be the basis for a proportionate approach to the ORSA at EU level.

The questions which the CBI asks are standardised, but the answers are (obviously) not. The questionnaire does not take the responsibility for the assessment away from the undertakings, but it helps to guide these insurers to create a high quality, yet proportionate ORSA. An approach similar to the one of the CBI is considered a valuable tool for the proportionate application of Solvency II at EU level. Companies should be free to choose, if they want to follow such a pre-defined set of questions.

Moreover, it is important that the possibility of a less frequent ORSA also applies to non-LRUs, reflecting the individual risk profile of an undertaking.

Macroprudential measures

In its technical advice, EIOPA presents a number of proposals for new macroprudential and recovery and resolution tools. If implemented, these measures would present a significant regulatory burden to insurance undertakings. Although EIOPA acknowledges the need for the proportionate application of some of the new tools, it fails to include consistent and concrete proposals in its advice on the proportionate application of Solvency II.

Concretely, EIOPA states that the new measures should cover a "very significant share of each national market". Disconnected from entities' risks, these would not be applied proportionately. By nature, macroprudential policy focuses on the market-wide perspective. It is, therefore, not clear why a "very significant share of each market" should be targeted instead of an approach clearly targeted at macroprudential risks (also see comments in the section Macroprudential policy).

Finally, the focus to determine the scope of macro measures should not be at national and single entity level, but at an EU-wide and group focus. Single entities part of a group should only be subject to the new provisions where they are essential for the overall exposure of their group, and the perspective of a national market level should be abandoned to focus on the single market level (see detailed comments in "Macroprudential policy").

Captives
The recognition of the specific business modem of captives is welcome.

Companies belonging to a group
The industry notes that companies within a group should be treated equal to solo companies. Currently, proportionality cannot be applied for small entities within a group when it comes to reporting, because information is required at group level even when the entity is non-significant. EIOPA has proposed a change in this respect, however there is no corresponding drafting proposal for a new legal provision.

The proportionate application of Solvency II should also be recognised at group level. Where entities qualify for either the LRU or specific criteria for each measure, the entity should be entitled to apply the tools.

Moreover, in order to avoid that the accumulation at group level requires these entities to apply Solvency II disproportionate to their risks, the use of the results of the tools or proxies should be eligible for consolidation at group level. However, such a requirement must not lead to undue incentives to split a group into multiple entities and a risk concentration in single parts of the group. Therefore, some thresholds of materiality as proposed in the toolbox could determine the eligibility for the use of tools.

Transitional period
The transitional measure proposed in Article 6g is welcome and crucial to not deter the existing proportionality measures already approved in the context of supervisory dialogue.

Outsourcing within a group
The Solvency II outsourcing requirements apply to each outsourcing agreement irrespective of whether the receiving company is controlled by the group of the insurer or a fully external service provider. Insurance Europe believes that the same treatment of intra-group and external outsourcing is not justified. The service provider, as part of a group, is part of the regulated organisation which is responsible for the implementation and execution of the internal control and management functions across the group.

As a result of this situation, the potential risks associated with the outsourcing of a function or a service differ significantly between intra-group outsourcing and the outsourcing to external partners. Solvency II already provides strict requirements for the internal control, risk management and reporting for the regulated group.

The group-wide systems are applied consistently across the group – including internal service providers and the outsourcing company. The supervision of the group by the competent authority leads to a consistent supervision of both the outsourcing entity and the service provider. The consistent group supervision under direct Solvency II supervision, or Solvency II equivalence, ensures regulatory compliance with the standards of Solvency II. This lowers the risk associated with an outsourced activity even further as both the outsourcing entity's compliance with the outsourcing requirements and the service provider are included in the Solvency II group supervision.
(Also see comments in the reporting section)

The service provider, as part of a group, is part of the regulated organisation which is responsible for the implementation and execution of the internal control and management functions across the group. As a result, the potential risks associated with the outsourcing of a function or a service differs significantly between intra-group outsourcing and the outsourcing to external partners. Solvency II provides for strict requirements for the internal control, risk management and reporting for the regulated group. The group-wide systems are applied consistently across the group – including internal service providers and the outsourcing company. The group-wide application of a group-wide management system includes aspects which are in focus of the existing outsourcing requirements, eg IT security, data protection, etc. Consequently, this leads to a consistent data protection or contingency planning. By principle, the strategy of the outsourcing company and the service provider are subject to the same coordinated strategy across the group. As a result, unilateral arbitrary behaviour and the associated risk of such behaviour are eliminated.

Requirements that should be waived when differentiating intra-group outsourcing include:

- the detailed cost/risk/benefit assessment currently required prior any outsourcing
- the notification to supervisors
- the AMSB approval

Solvency II insurers and Public Interest Entities under the Accounting Directives

All Solvency II insurers are considered Public Interest Entities (PIEs), simply because they fall under the scope of Solvency II[7]. This has led to sharply increased costs of external auditors since the rules on PIEs came into effect on June 17, 2016.

Qualifying all Solvency II insurers as PIEs is debatable: this label is reserved under the EU accounting directive for organisations with a "*significant public relevance […], which arises from the scale and complexity of their business or from the nature of their business*".

The PIE status requires involvement of external auditors with special qualifications, which are rare and therefore more expensive. The scarcity of such external auditors leads to a capacity issue and a cost issue. Removal of the PIE status would mean that these insurers would still be audited by external auditors, and supervised by their national supervisor or regulator, under exactly the same reporting rules (IFRS or national GAAP).

It is important to note that the content of the annual report and any other public documentation by the organisation is the same whether the organisation is a PIE or not.

While this may not require a change in the Solvency II Directive or Delegated regulation, we propose to amend Directive 2006/43/EC and Directive 2014/56/EU accordingly as part of the Solvency II Review.

LRU and insurers with a total balance sheet size of €1bn or less, or a total premium income of €1bn or less should be excluded of the definition of PIEs in the accounting Directives.

4- EIOPA report on proportionality

[7] Public interest entities are defined in directive 2006/43/EC as amended by directive 2014/56/EU article 2, point (13).

The proposed drafting in Article 52 is very much welcome. A public disclosure of statistics on measures applied in each member state is a great transparency and monitoring tool to encourage proportionality, and to help EIOPA fulfil its mandate of supervisory convergence in the area of proportionality.

Moreover, NSAs should have to report to EIOPA on the applications received, whether approved or rejected, including if the file was deemed incomplete. Similarly, NSAs should also report to EIOPA when an insurer decides to not pursue its application after a complementary information request. This would discourage situations where an NSA requests an unreasonable amount of documentation or level of details, and deems the file incomplete in the meantime. In both cases, EIOPA should not have the power to overrule the NSA's decision, but would use the information to monitor the application of proportionality measures across member states within the remit of its mandate of supervisory convergence.

A channel for insurers to report disproportionate requirements to EIOPA, whether it concerns individual approvals or national implementing standards (list of documentation requested from insurers) would be of great value, and the number of signalisations could be part of EIOPA's annual report.

C. Conclusion

The EC should ensure that its proposal for the 2020 review results in tangible benefits with respect to the application of proportionality. In particular, when designing the new framework, extreme care must be taken to ensure that regulatory burden is not traded for administrative burden.

The EC proposal should be broadly based on EIOPA's opinion, but the following improvements are vital in order to achieve significant improvements in the application of proportionality:

- **It needs to be clarified in the Directive, not only that NSAs are able to deviate from requirements on the basis of proportionality, but that they have a duty to do so**
  - Providing that proportionality may result in a complete exemption from a specific requirement (Article 29.5 of the Directive)
  - Adding an explicit statement in Article 29 of the Directive that an efficient and effective application of proportionality is an NSA duty

- **Improvements needed to the definition of Low Risk Undertaking (LRU)**
  - The criterion related to the size of companies is not appropriate and very restrictive. It would exclude many small and medium-sized companies that have simple business models yielding low risks. Hence, it should be deleted.
  - The requirement for no material cross-border business should be removed – it is unnecessary and will hamper cross-border activity and international competitiveness
  - The criteria relating to non-traditional investment with respect to property (new Article 6a of the Delegated Regulation) need to be changed – in its current form it would mean that in certain countries no companies would be LRUs. The industry wonders whether it might have been unintentional as it is unclear why property should be excluded.

- **Size alone must not exclude companies from automatic application of proportionality - larger companies must also be able to qualify for automatic application of certain proportionality measures where they do not have material exposure to a risk or activity.**
  - For non-LRU, criteria based on materiality needed to be added for certain proportionality measures so that they can be applied automatically for larger companies who meet these criteria (Delegated Regulation)
  - It should be made clear that companies are not denied access to proportionality for the sole reason that they belong to a group (Article 254 of the Directive)
- **Additional proportionality measures should be included along with those already proposed by EIOPA**

- As proposed above, and listed in the toolbox in appendix.

- **Other improvements needed**
  - Allowing the recalculation of immaterial sub-modules only every three years instead of annually, but without excluding market risk (Delegated Regulation)
  - Providing that EIOPA produces and keeps up to date a listing all of proportionality measures that are spread across all levels of regulation
  - Adding in NSAs reporting to EIOPA the list of applications received, approved, rejected, or deemed incomplete (Article 52 of the Directive)
  - Providing a channel for insurers to report to EIOPA disproportionate processes for information and monitoring purposes (Directive).
  - Run off undertakings should also be able to apply for LRU status
  - Concrete proposals are necessary for applying the proportionality principle effectively to entities belonging to a group. This should include the definition of when an entity is "non-significant".
  - Exclude LRU and medium-sized insurers from the definition of PIEs

See appendix for more detail on specific industry proposals on how to apply the improvements listed above.

9. Group supervision

A. Industry proposals for the review

The industry is of the view that no changes to the Solvency II Directive or Delegated Regulation are needed in the area of group supervision, unless a specified issue such as the trigger inversion has been confirmed. While the EC explicitly asked EIOPA's advice on the main issues identified[8], the solutions for an eventual lack of convergence do not have to always imply regulatory changes. These would be more appropriately addressed through convergence tools already at EIOPA's disposal.

Changes to the legislation imply compliance costs and come with the risk of unwanted effects, such as a lack of flexibility to adapt to various structures and risk profiles of groups in the context of group supervision. On the contrary, supervisory convergence tools foster dialogue between NSAs, and between EIOPA and NSAs, and result in a better understanding as to why and how in some cases divergent practices are justified by the specificities of particular groups.

However, measures aiming at enhancing proportionality are also welcome for groups. In this respect, the industry strongly rejects the idea that proportionality would "work both ways" and justify additional requirements on top of all the requirements of the Solvency II framework. Proportionality aims at reducing unnecessary burden, not at creating new requirements for groups.

Finally, the industry reiterates its concerns on new overly conservative measures such as restrictions of dividends distributions, which deter capital and liquidity allocation strategies within groups. The regulation already provides such bans in case of breach of SCR or if such distribution would lead to a breach. Moreover, groups also have to demonstrate compliance with the SCR over the horizon of the business plan.

B. Comments on EIOPA's opinion

[8] in the EC's 2019 report on group supervision https://ec.europa.eu/transparency/regdoc/rep/1/2019/EN/COM-2019-292-F1-EN-MAIN-PART-1.PDF – based on EIOPA's 2018 report https://www.eiopa.europa.eu/sites/default/files/publications/pdfs/report_on_article_242_com_request_final_14_dec_2018_0.pdf

The industry is surprised to see that many changes proposed to the Solvency II Directive or Delegated Regulation are maintained in EIOPA's final opinion, and broadly disagrees with EIOPA's numerous proposals for changes in the area of group supervision.

Most of these measures aim at improving convergence of supervisory practices. While there may be a need for improvement in this respect, this should be achieved by making full use of EIOPA's convergence tools (supervisory handbook, workshops, colleges of supervisors, etc).

Moreover, EIOPA decided to exclude its proposals on group supervision from its holistic impact assessment, and the document "background impact assessment" provided together with EIOPA's opinion provides a very superficial analysis of the costs and benefits of all the proposed measures. For example, many proposals are justified by vague benefits such as "*Increase of policyholders protection through enhanced group supervision*"; "*Ensures a level playing field through sufficiently harmonised rules. More clarity, less uncertainty of the scope of group supervision*"; "*More clarity, enhanced group supervision*". Some proposals may entail a significant impact on the solvency position of groups or have other unintended consequences. In view of the proposed amendments regarding group own funds and group solvency, the potential effects of these amendments are considered together with the effects of amendments at solo level have not been assessed.

The industry is in particular concerned by:

- The broadening the scope of the minimum consolidated SCR (to include holdings)
- The addition of currency and concentration charges on undertakings aggregated with method 2 (D&A)
- Additional NSA powers to restructure a group
- Responsibilities of AMSB of the head of the group extended to ensuring compliance with all group requirements
- The extension of the scope of items to be included in the regular availability assessment, especially EPIFPs and transitional measure on technical provisions or risk-free interest rates

Many other small changes intended to "clarify" definitions and framework have no clear benefits and no clear view on the impact. In fact, several proposed changes identified as a "clarification" are actually a change of the regulation.

EIOPA states that the quantitative impact of some proposals being difficult to assess, "*cost and benefits of requesting data from supervisory authorities and Groups was carefully weighted throughout the process of developing the advice*". The industry notes that it is in NSAs' mandate and duty to provide information they have at their disposal to EIOPA where it is justified and this should not constitute an obstacle to weighting the cost and benefits of the proposed measures that may have a detrimental on many groups across Europe.

Finally, the scope of a group and the definitions should not be changed in a way that would deviate from other regulations, such as regulations on financial conglomerates and financial reporting**.** Any such deviation comes with administrative costs and corporate governance issues if different group structures would occur for different regulations.

Definition of the group, including issues of dominant influence; and scope of the group supervision

- EIOPA proposes to further "clarify" Article 212 of SII Directive in the Delegated Regulation regarding the definitions of "centralised coordination" to identify a group to capture undertakings, which, together, form a de facto group upon supervisory powers.
    - EIOPA does not highlight how this is related to policyholders' interest. Moreover, due to the vague justification that there "can" be insurers which "can" fulfil some conditions, it is still unclear whether this problem is theoretical, anecdotic, or a real issue.
    - EIOPA and NSAs should not try to create additional groups where it is not necessary.

- Moreover, EIOPA's proposal to include a "non-exhaustive list of examples" does not seem appropriate in the Delegated Regulation, but rather for level 3 guidance. A non-exhaustive list of examples even in binding regulation would not solve eventual issues of convergence.

- EIOPA proposes changes under Article 213 of the Directive aiming to give NSAs the power to restructure groups in the case of horizontal groups, groups with multiple points of entry in the EEA, and multiple groups held by the same individual or legal entity.
  - EIOPA should not have additional powers to intervene in group structures, as this should remain the sole responsibility of the AMSB and ultimately of the shareholders where applicable. The structure of a group and the related parties is already defined by either the SII legislation or by accounting rules (national GAAP or IFRS). EIOPA could assess the principles as laid down in the IFRS standards with respect to control or significant influence. An alignment would result in similar consolidation circles between accounting and Solvency II.
  - The option proposed is not proportionate to the scale of the issue mentioned. The creation of an EU holding entity would require many resources and create ambiguity as it would not reflect the real functioning of the group.
  - Article 212(1)(c)(ii) provides sufficient possibilities to include entities as part of a group in exceptional cases. Moreover, EIOPA notes that some criteria are listed in its guidelines, highlighting an issue of lack of use of convergence tools rather than gaps in the regulation.
  - EIOPA did not highlight to what extent this poses a policy issue despite the industry call, and does not justify why this would lead to "*Risks to policyholder protection due to lack (or poor) group supervision*" and "*Cost deriving from uncertainties and divergent practices*" in its "background impact assessment".

- EIOPA proposes changes to "clarify" the definitions of subsidiary, parent undertaking, control, participation and the definition of groups to "secure the scope of a group" subject to Solvency II.
  - EIOPA's proposal is not a clarification, but in fact a change of the regulation. While compliance costs associated to any change are certain, the benefit of this change is unclear.

Definition of Insurance Holding Company and other challenges related to Insurance holding companies and Mixed financial holding companies

- EIOPA proposes changes to Article 212 of the Solvency II Directive to provide additional explanation of the meaning of 'exclusively or mainly' in the definition of IHC.
  - EIOPA specifies that, based on data, the issue occurred for 5 of 28 supervisors. However, the number of occurrences is not specified, and it does not highlight to what extent a change to the regulation, which always entails compliance costs, is justified.
  - EIOPA notes that those responsible for group supervision have either implemented national regulation to address the regulatory gap and/or introduced a supervisory criterion for the assessment. If anything, it shows that EIOPA failed to centralise such initiatives and to be proactive enough in providing guidance at EU level as soon as the first interpretation occurred.

- EIOPA notes that NSAs reported a lack of powers over insurance holding companies and mixed financial holding companies and proposes changes to Article 214(1) of the Solvency II Directive.
  - In fact, Article 258 of the Solvency II Directive already provides NSAs, notably the group supervisor, with the necessary powers to enforce group supervision at IHC/MFHC-level. Therefore, Insurance Europe does not understand why several supervisory authorities reported that they have no supervisory powers at all towards top holdings of insurance groups. It is also hard to comprehend that one supervisory authority reported that according to their national law the insurance group decides which entity in the groups can be approached and is responsible for the group requirements. Inadequate implementation of the Directive should not be compensated by legal action at European level.

- In addition, the proposed powers are too far reaching and disproportionate.

Exclusion from group supervision

- EIOPA proposed to introduce a principle in the Solvency II Directive stating the exclusion should not "normally" result in complete absence of group supervision.
  - Disagreements between NSAs or between NSAs and EIOPA should not result in changes to the regulation. It is unclear what the issue is. The exclusion from the scope of group supervision being at the discretion of the supervisor, the NSA should simply not grant a specific exemption if an exclusion would result in a problematic situation. There is no need for further specifications.

- Negligible interest (Article 214(2)(b) of the Solvency II Directive) vs. achieving the objectives of group supervision. EIOPA said several cases were reported by supervisory authorities
  - There is no need for further specifications. It is important to allow for supervisory flexibility to account for differences between groups across the EU.

Supervision of IGTs and RCs

- EIOPA proposes to amend the wording of Article 13(19) to include in the current definition of IGTs a reference to IHC, MFHC, and third country (re)insurance undertakings as one of the possible counterparties of the IGTs
  - It is unclear whether EIOPA has in effect encountered the problem where the group supervisor was unable to retrieve the information as requested with respect to IGTs, and in how many cases a group deliberately excluded IGT information, considered by EIOPA as a "gap". Moreover, having different thresholds for different entities would be disproportionately burdensome.
  - The decision to replace Solvency II IGT with FICOD IGT should remain a decision amongst competent supervisors. Changing the legislation is not an appropriate means to solve disagreements between supervisors.

- EIOPA deems necessary to provide clearer criteria on the application of thresholds for IGTs and RCs
  - Supervisory convergence should not be achieved by changes to the legislation. Guidance could be added to the guidelines rather than amending legislation.
  - Thresholds for the reporting of IGT/RC should always be based on the risk profile and specific circumstances of any group concerned. If needed, guidance could be added in the guidelines rather than amending legislation – which would most likely not even be able to cover all possible scenarios, group structures and characteristics. If appropriate, EIOPA could revise Chapter II of the guidelines on governance which deals with group governance aspects (guideline 69).
  - A QRT is only one tool for understanding the risk concentration. An insurer will more broadly embed concentration risk management and will describe this where relevant in the RSR/ORSA. The thresholds are set by the NSA based on the particularities of the Member State, the interconnectedness of risks and other characteristics. An EU-wide threshold would have many flaws as any threshold will be too high in one Member State and too low in another, whether relative or absolute. A too low threshold will see too many entries and a too high threshold, too few. This should be left at the discretion of NSAs.
  - Overall, there is no need for additional criteria, as the current Solvency II legislation provides sufficient opportunities for the group supervisor to obtain the information and assessments needed.

Article 262 Solvency II Directive – third countries

- EIOPA opposes changes to add "further regulatory clarity" on the application of Article 262 of the Solvency II Directive, including that that the establishment of an EEA holding company can be required as an "other method" under Article 262(2).
    - It is unclear whether this is a practical or theoretical issue.
    - Also see comment on restructuration powers above.

- Other issues identified in the application of current provisions on third countries: consistency and clarity of language
    - Solvency II applies to any insurance company with a presence in the EEA or any insurance entity willing to sell insurance products to consumers in the EEA. Solvency II also provides requirements for insurers in equivalent and non-equivalent third countries within a group. Where equivalence is granted, the local rules may apply and be included in the solvency position of the group. However, if a third country is deemed to be non-equivalent, the group has to apply Solvency II to undertakings in that jurisdiction.
    - The impact of EIOPA's proposal is not intuitive, provides incorrect management incentives and also has a very negative impact on the willingness of groups investing outside the EEA in non-equivalent third countries and/or countries which have a temporary equivalence.

Treatment of Insurance Holding Companies (IHC), Mixed Financial Holding Companies (MFHC), for the purpose of Notional SCR and Own Funds calculations

- EIOPA proposes to clarify how a notional SCR should be calculated and how to treat the IHC and MFHC for the purpose of the group solvency calculation, in particular of a notional SCR and own funds for such undertakings.
    - In principle, there is no need for an additional clarification. In practice, no issues were seen or reported. It is important to recognise that all related undertakings are actually included as an equity investment and stressed as such. In the notional SCR a significant share of the capital requirement is related to intra-group transactions.
    - The industry provided concerns on the 2019 draft opinion that the definition of notional SCR would imply problematic double counting of equity risk for some of the applications above, in particular for the Min.Cons.SCR calculation. EIOPA refers to this risk of "double counting" in paragraph 9.198 of the "background analysis document". It seems EIOPA writes this in the context of availability assessments while it seems that the observation of double counting of equity charges is especially relevant for the Min.Cons.SCR calculation. Concretely, the risk could be that there are several intermediate holding companies in a group structure. One holding company will hold (let's assume 100%) of a related insurance undertaking. That holding company, under the notional SCR proposal of paragraphs 9.28 and 9.29 of the final opinion, will include an equity charge on the related insurance company. A second (eg regional level holding company) will again calculate equity risk on the NAV of the first holding company (and as such indirectly again on the insurance undertaking). At the same time, the insurance undertaking contributes to the Min.Cons.SCR based on its own solo MCR, while under the EIOPA proposals (paragraph 9.80 of the final opinion) the intermediate holding companies start contributing to the Min.Cons.SCR based on 35% of the Notional SCR. But via the 35% of the notional SCR, the insurance undertaking is also contributing the Min.Cons.SCR via the equity charges on the (indirect) holdings held by the intermediate holding companies. So there is a risk of (significant) multiple contributions to the Min.Cons.SCR when intermediate holding companies need to include equity risks on their equity holdings in the notional SCR. As such, paragraph 9.198 of the "background analysis document" should state that the notional SCR for all intermediate holding companies should be net of equity risk (or at least net of (indirect) exposure to (re)insurance undertakings).
    - Another example where the double counting of equity risk is evident is for the calculation of the contribution to the group SCR, needed for the availability assessments of non-available OF.

- EIOPA says in paragraph 9.197 of the background analysis document: *"However, as the inclusion of the notional SCR of the holding companies in the group SCR calculation would also reduce the contribution to group SCR of each entity of the group (including insurance undertakings), the final impact on group own funds depends on the distribution of non-available own funds in the group between (re)insurance undertakings and holding companies."* The industry assumes that EIOPA refers to the fact that the denominator (sum of SCR solo) will be extended with the notional SCRs of holding companies. Also, here this means that the contribution to the group SCR for (re)insurance undertakings will be impacted (getting lower) on an unjustified basis via that double counting of equity risk on the same exposure(s) in the intermediate holding companies.

Article 229 of the Solvency II Directive – A proxy Method to calculate group solvency requirements.

- EIOPA proposes a revised simplified approach to address a lack of clarity and consistency in the application of Article 229 of Solvency II Directive, in particular in cases where imposing Solvency II is burdensome or impossible.
  - The proposed percentage (between 0.1 and 0.3% on an aggregated basis) seems very low and makes the proposed solution not very meaningful. This proposal is not appropriate.

Scope of method 2 (where used exclusively/or in combination with method 1)

- EIOPA proposes to "clarify" the scope of undertakings to be included under method 2 and their treatment to ensure a consistent treatment across methods – same scope of entities under all methods – and across the EEA.
  - Article 328 of the Delegated Regulation already provides for specific elements to be considered within the choice of the method. Additional regulation could result in undertakings having to change their calculation methods, while no specific issue was reported.

Partial Internal Model (PIM) and Integration Techniques

- EIOPA proposed to add a specific provision about the application of integration techniques to partial internal models at group level.
  - There is no need for additional requirements. The current listed approaches and structuring by the group supervisor are sufficient.
  - As each group is unique in its form and internal models are reflecting the risk profile of the insurance entities and the group, each integration should be assessed on a case-by-case basis and supervised as such.
  - The group supervisor has such a task and has to include the fellow members of the college of supervisors.

Group SCR calculation when using Combination of methods

- EIOPA proposes to introduce additional capital requirements for currency, market risk concentration and equity risk for participations for entities included in group solvency via method 2 (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.
- With respect to the currency risk, group supervision under Solvency II extends to the protection of policyholders and beneficiaries, wherever they are located, not specifically EU policyholders:
  - *"Own funds should be appropriately distributed within the group and available to protect policyholders and beneficiaries where needed." (recital 106 of the Directive).*
  - *"The solvency of – inter alia – third country insurance undertakings can be affected by the financial resources of the group and supervisory authorities should therefore be provided with the means of exercising group supervision and of taking appropriate measures at the*

level of the insurance or reinsurance undertaking where its solvency is being or may be jeopardized." (recital 108 of the Directive).

- The excess own funds available in method 2 entities do not serve exclusively as additional capital above the required own funds in Method 1, but rather are intended to be available across the group. While method 1 policyholders are potentially 'exposed' to currency risk on excess own funds of the method 2 entities, method 2 entities are likewise 'exposed' to currency risk on excess own funds of the method 1 countries.
- To impose an additional group capital requirement reflecting the exposure of method 1 entities to the impact of currency translation fluctuations of excess capital in method 2 entities due to currency movements is nonsensical in the group context where all policyholders need to be protected equally.
- With respect to all other risk types we note that under the current application of method 2, several prudency buffers are already in place, both as a result of Solvency II itself and through the local (equivalent) regimes:
  - Based on discussion and examples as given in EIOPA's opinion on Group Solvency Calculation in the context of equivalence in practice prudent deductions in own funds (eg from an availability perspective) and incremental factors on SCR are applicable.
  - By construction of method 2, there is no allowance for diversification between entities included under method 2 and with entities included under method 1.
  - Local regimes may already take into account such risks in the local regime.
- The EIOPA proposals could as such easily lead to double counting of risks, and would have a substantial capital impact on groups. They will pose a threat for the establishment of financial conglomerates or significant groups (reporting under SII) in the EEA with significant exposure to equivalent regimes. As such, EIOPA's proposals seem onerous and should not be pursued, including for mutuals added to solvency calculations with method 2.
- The EIOPA "background impact assessment" document mentions that at individual group level this consideration would not give rise to impacts of more than 5% point on the ratio. However, this underestimates the impact, which is expected, in individual cases to be significantly higher. In the impact assessment that covers some aspects of group supervision (data call submitted in January 2020), groups used qualitative fields to argue they are strongly against the introduction of these charges and did not necessarily submit the actual material financial impact it would have. As such the impact assessment does not appear to reflect the actual impact in reality.
- In line with the discussion above, the proposals should be rejected in full. Nevertheless, in the current high level non-nuanced proposal as given in paragraph 9.50 of the final opinion, some of the details would require additional attention:
  - The reference to Article 13 of the SII Delegated Regulation (valuation of related undertakings) seems wrong. This would practically draw in SII adjusted equity valuation of D&A entities. The most likely approach seems to be to use the local equivalent regime value (as included in group OF) as a basis for the value of the exposure that needs to flow into the standard formula (SF) risk modules.
  - The SF market risk concentration module is referred to in the proposals by referring to the full range of articles 182 to 187 of the SII Delegated Regulation. Note that article 182 paragraph 1 requires exposures that belong to the same corporate group to be treated as one single name exposure. As such, it is unclear whether all D&A entities should form one big single exposure, or whether the market risk concentration should be applied on an entity by entity basis. This can have material impact on the outcome as on an entity by entity basis, the threshold for the market risk concentrations SCR calculation may lead to single entities not contributing to that calculation. It is assumed that an entity by entity assessment would need to be applied, however that would thus require the deactivation of article 182 paragraph 1 for this specific calculation at group level.

- Further, the industry has highlighted for a number of years that the current group currency risk methodology over-estimates currency mismatches because it wrongly generates a capital charge when a company, very appropriately, holds assets in local currency to back a local currency solvency requirement.
- Article 188 (1) of the Solvency II Delegated Regulation defines capital requirement for currency risk as the sum of the capital requirements for currency risk for each foreign currency. For each foreign currency, the capital requirement for currency risk is determined by the loss in basic own funds arising from a stress of 25% to the value of foreign currency against local currency (see Article 188 (2)). Where the consolidated group SCR is calculated on the basis of the standard formula, the local currency is the currency used for the preparation of the consolidated accounts, as per Article 337 of the Solvency II Delegated Regulation.
- For a group with exposure to multiple currencies, the standard formula can give a poor representation of the currency risk. By forcing a group to hold capital against currency risk at group level even though currency risk is perfectly well handled at solo level, the design of the currency risk calculation will distort the incentives for good risk management practice at group level. For a group with exposure to multiple currencies the standard formula can give a poor representation of the currency risk.

Group Solvency – Application when using combination of methods

- EIOPA proposes changes to Article 233 of the Solvency II Directive, to explicitly state that Method 2 (where used exclusively or in combination with Method 1) used to calculate the group solvency requirements applies to single undertakings and not to sub-groups.
  - The industry strongly opposes this proposal. If, for example, the sub-group is managed on a unified basis but is not a subsidiary of the parent undertaking, diversification between the entities in the sub-group should be allowed, irrespective of whether the consolidation method can be used for the whole group.
  - Moreover, this proposal is not a "clarification", but a change of the regulation, that would have a great impact on groups currently allowed to apply the method at sub-group level.
  - If there are issues with equivalence in third countries as regards rules on diversification, those issues should be addressed rather than introducing rules that can create unfair competitive disadvantages to groups operating only within EU/EEA.

Own Funds requirements for groups

- Regarding the assessment "free from encumbrances," in particular in relation to own-fund item issued by an insurance holding company or mixed-financial holding company, EIOPA proposes to amend the Delegated Regulation to include a provision based on recital 127 concerning IHC/MFHC in the group.
  - The industry is of the opinion that there is no need to have additional requirements. The sequence of requirements is clear. If supervisory convergence is the issue, this should be dealt with by means of convergence tools at the disposal of EIOPA rather than by changes to the legislation.
  - Normally, any winding-up situation exists when there is a breach of the SCR. In that case there is an automatic suspension of any payments. If 75% SCR is breached, debt instruments convert to the highest quality of capital.
  - Documentation of subordinated debt is diverse, reflecting the specificities of each group's situation. For instance, conditions to redemption on the debt may often be conditioned to the parent's undertaking and/or the group breach of capital requirements and to the absence of any insolvent insurance affiliate winding-up, whereas the subordination clause may apply only to the claims of the issuing entity (parent company). But there will be some (implicit or explicit) commitment of the mother entity to cover losses where they arise in the group (sometimes it can also be materialised in formal parental guarantees which will subordinate the repayment to affiliates claims if the affiliate is unable to pay). It is not

appropriate to provide for the repayment/redemption of an own fund item when there is a winding-up situation of any EEA (re)insurance undertaking of the group. Existing practices are sufficient. In case of a small undertaking of the group, the group will be able to cover the losses and, in any case, this should not lead to stop the repayment of the debt of the group. If an entity is large, the stress will impact the parent entity and the group. It would also be difficult to justify that the change is limited only to EEA undertakings – but in any case, the enlargement of the subordination would create unnecessary complexities and be difficult or impossible to enforce in a cross-border context.

Availability Assessment of Own Funds (Article 330 of the Delegated Regulation)

- EIOPA proposes no change with regard to the availability assessment under Article 330(5) of the Delegated Regulation, ie on own funds items to cover the solo contribution to group SCR
  - The industry agrees that no changes are needed, and welcomes that EIOPA recognised that it is a balanced approach between the spirit of recognising own funds as available up to the coverage of the solo SCR diversified, and the need to take into account the diversification benefits and to limit the transferability over the contribution to the group SCR.

- EIOPA advises to clarify the inclusion of all undertakings taken into account in the SCR diversified for the purposes of calculating the group SCR where the related undertaking is included with Method 1.
  - The contribution formula cannot be expanded as suggested.
  - The group has to calculate the solvency ratio as being one economic entity. Based on this notion the economic balance sheet is determined. Subsequently the SCR is calculated based on this consolidated data. The next step is determining the available own funds and the eligible own funds. In this latest step, the availability and fungibility is assessed from all components of the own funds. Own funds of underlying entities deemed unavailable at group level are only taken into consideration up to the diversified contribution to the group SCR. This process still ensures no components are included which cannot be used to absorb losses elsewhere in the group. This process should be sufficient, and no change is needed.
  - The inclusion of the notional SCR (net of equity) could have a negative impact on the group Solvency ratio as the solo contribution of insurance entities in the group SCR will be lower. In all calculations where this factor is used, there will be an impact.
  - The industry further refers to its response to EIOPA's consultation on its draft opinion for more examples and figures.

- EIOPA proposes to include in the regulations that the group solvency position without availability of the benefit from these transitionals should be disclosed, and that supervisory action can be taken.
  - The disclosure of solvency figures without the benefit of transitionals at group level is very concerning, because it would create confusion and undermine their purposes of giving insurers the necessary time to adjust under the new Solvency II framework. The fact that supervisory actions could be taken would create de facto a level of intervention before the breach of group SCR.

- Regarding the recognition of EPIFPs at group level, EIOPA advises to add them to the regular availability assessment under Article 330(1) of the Delegated Regulation.
  - Although the industry notes that EIOPA has slightly changed the text of its proposal, in practice the result is the same: there would be no formal pre-approval process for the admissibility in Tier 1, but a continuous assessment and demonstration to NSA's satisfaction which would be overly burdensome.
  - There is no economic argument to go beyond the already high level of conservativeness included in Solvency II. EPIFPs are the result of a valuation based on economic principles. They are fully recognised as unrestricted tier 1 items, and there is no justification for any extremely burdensome continuous assessment.

- From an economic standpoint, the recognition of equity capital associated with future premiums on in-force business at group level is the natural consequence of their inclusion in the technical provisions and the build-up of an SCR to account for the associated risks. EPIFPs are an output of the economic valuation of the BEL (ie the present value of expected future cash flows) and the level of EPIFP depends on each undertaking's risk profile. Uncertainties relating to future cash-flows are modelled in the best estimate and thus reflected in the amount of EPIFP. The best estimate is calculated based on an exit value notion. This suggests that the insurance contracts are transferred to a willing third party. The transfer includes all rights and liabilities of the relationship between policyholder and insurer. The third party will also assume the future premiums as part of the cash flows transferred. EPIFPs can be made available via several transactions.

Minority Interest

- EIOPA advises to further clarify the basis and approach to be followed for the calculation of the item minority interest in the Solvency II Delegated Regulation.
  - There are already specific guidelines on the treatment of minority interests.

Minimum Consolidated Group SCR

- EIOPA proposes changes to broaden the scope of the minimum consolidated SCR to include insurance holding companies and mixed financial holding companies.
  - The industry opposes EIOPA's suggestions to extend the scope of the existing min.cons.group SCR.
  - Overall, EIOPA's proposal to broaden the scope is disproportionate, especially as the IHC or MFCH do not bear (re)insurance risks. The notional SCR determined for IHC or MFHC can include a lot of IGT, especially with respect to the subsidiaries and so the subsequent group SCR can encompass duplications. By not addressing the issue of IGTs, the notional SCR/MCR can be largely overestimated.
  - EIOPA fails to explain how to apply tiering when a combination of methods is applied. In particular whether tiering needs to be applied separately in relation to method 1 and method 2 entities. The actual views of EIOPA in respect of tier limits relative to the SCR are provided in EIOPA's opinion on the application of a combination of methods to the group solvency calculation. Such cases do not seem to have been considered.
  - In addition, the combination of EIOPA's proposals (in paragraphs 9.83 and 9.84 of its opinion may be confusing. In paragraph 9.83 EIOPA uses the word 'group SCR' (ie the whole group, including D&A) in the following sentence: […] mechanism to safeguard that the group SCR is not lower than the sum of MCRs solo". It seems that EIOPA actually intends to refer to the SCR for consolidated data as calculated under article 336(a) of the SII Delegated Regulation. The wording 'sum of MCRs solo' is confusing, as the min.cons.group SCR would not be based anymore on solo (re)insurance undertakings only, but in addition on 35% of the notional SCRs of intermediate holding companies.

- EIOPA proposes no change to the calculation method for minimum consolidated group SCR, but a clarification of its purpose and the introduction of a new trigger metric for the application at group level of the requirements related to solo MCR. The new metric would be the smaller of 45% of group SCR and the Min.Cons.SCR.
  - The industry strongly welcomes EIOPA'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 supervisory metric for groups.
  - However, the EIOPA proposal should be complemented by an optional waiver of the very burdensome and complicated calculation of the minimum consolidated SCR. Applying this simplification could only lead to an identical or a more conservative outcome.

- Moreover, the current floor (for method 1) is clearly linked to trigger levels, ie MCR at solo level. By extending the scope of entities contributing to the floor with entities that do not have a solo MCR this metric becomes random and thereby meaningless for groups including such entities.
- In addition, this paragraph 9.83 might be stating that the new (extended) Min.Cons.SCR is actually to replace the SCR under article 336.a if the Min.Cons.SCR is higher, which again brings the risk of double counting of equity charges. Moreover, it would not make sense anymore in the context of the new metric introduced in paragraph 9.84.
- Finally, EIOPA fails to explain how to apply tiering when a combination of methods is applied.

Inclusion of Other Financial Sectors (OFS)

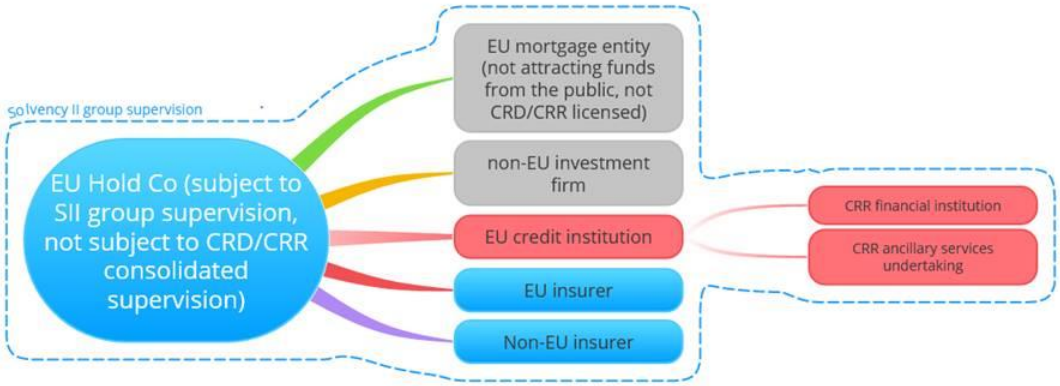
- With respect to the inclusion of related undertakings, EIOPA advises to clarify that Article 329 of the Delegated Regulation is always applicable when other financial sector entities are included in the Solvency II group solvency calculations, and that the own funds and capital requirements for these undertakings are aggregated to the total group own funds and to the total group SCR respectively.
    - When extending group supervisory requirements in any way, there is a risk of legal inconsistencies across financial sectors. It is important that regulation regarding groups is consistent with the legal framework of financial conglomerates and with its equivalence in banking regulation. In this context, specific rules for the inclusion of OFS entities which deviate from sectoral requirements should be avoided.

- With respect to the allocation of own funds from Other Financial Sectors into relevant Solvency II tiers for the purpose of Solvency II calculations, EIOPA recommends no change.
    - The industry agrees that no change is needed. OFS undertakings should be considered via sectoral rules, and Solvency II regulations should not be forced onto the sectoral rules to avoid unnecessary burden.

- To clarify the ability of excess of own funds from OFS to absorb losses in the insurance part of the group, EIOPA proposes to require an analysis of the loss-absorbing capacity of own-fund items from OFS similar to that required under FICOD.
    - The industry opposes to extend this concept to OFS entities. EIOPA itself admits that the proposed policy option is not material given the insignificant contribution of the excess from OFS to the excess of the total group own funds.
    - If an availability test for the excess of own funds from other financial sectors was to be introduced, it should be allowed to use FICOD-based rules to perform it, so that groups that need to fulfil both Solvency II rules and FICOD rules can use the same result as regards availability in both those solvency tests.

- EIOPA advises the Commission to clarify in Articles 329, 335 and 336 of the Delegated Regulation that when related undertakings in OFS form a group subject to sectoral group supervision, group own funds and group capital requirements that are calculated according to sectoral rules should contribute to the group solvency calculation instead of the sum of the capital requirement and own funds of each individual undertaking
    - Insurance Europe fails to see significant benefits on convergence and level playing field as different approaches are not reported in the background analysis.

- EIOPA notes that the Delegated Regulation should state clearly what should be considered as capital requirement for credit institutions, investment firms and financial institutions that belong to a group subject to Solvency II by transposing its response to Q&A 1344 into the regulation.
    - Taking as example the following hypothetical group structure:



- The dotted line indicates the scope of Solvency II group supervision, the boxes in red are the entities in scope of CRD consolidated supervision. Without going into detail, it is possible to have CRD consolidated supervision only at this level and not at the highest level in the group, as this would lead to multiple types of group supervision (SII, CRD and potentially FCD supervision). The two entities in the grey boxes are not included in CRD consolidated supervision. These entities are not required to calculate Pillar II capital at solo level (neither the non-EEA investment firm nor the EEA mortgage entity is subject to CRD) but they are included in the group Solvency II calculation (and in scope of the Group ORSA, which should ensure risks related to these entities are covered at group level).
- The EU mortgage entity is a 'non-regulated undertaking carrying out financial activities' as mentioned in article 336(c) of the Delegated Regulation for which notional capital requirements should be calculated. Strictly speaking Q&A 1344 applies to institutions, financial institutions and investment firms only but a similar reasoning could be applied to non-regulated undertakings carrying out financial activities.
- Although this is not 100% clear it seems that the investment firms, credit institutions etc. in article 336 (c) only refer to entities subject to the EU rules, so not to eg non-EEA investment firms, but should notional capital requirements be applied to such entities, CRD or (going forward) the EU Investment Firm Regime could be the regime that needs to be applied in the context of the Group Solvency II calculation.
- It makes sense to only apply simple capital requirements to the entities in grey, given that they are not subject to capital requirements at solo level and risks at group level should be captured anyway in the group ORSA.

Application of Article 228 of the Solvency II Directive – Related credit institutions, investment firms, and financial institutions

- To address a potential lack of clarity in Article 228 Directive regarding the methods of inclusion of related credit institutions, investment firms and financial institutions in the group solvency calculation, the interaction with FICOD and other articles of the Solvency II framework, EIOPA proposes to delete the first paragraph of Article 228.
    - This proposal is concerning, even when deleting only the first paragraph of Article 228. For insurance companies in a financial conglomerate not being able to use the same methods in Solvency II as that used for the conglomerate could of course lead to governance issues.

Mutatis mutandis application of solo governance requirements to groups - Article 40 of the Solvency II Directive (definition of the AMSB for groups); and Article 246 of Solvency II Directive (supervision of the system of Governance)

- EIOPA's advice is to amend the Solvency II Directive to ensure that Article 40 of the Solvency II Directive also explicitly applies to insurance groups.
    - The industry disagrees with EIOPA's advice, notably the proposal to state clearly that the AMSB of the parent undertaking at top of the group would be responsible for the compliance with all group requirements.
    - More broadly, although there are similarities between group and solo governance, the governance of a group is not the same as the governance of a solo insurance undertaking, so flexibility through the mutatis mutandis principle is necessary. For example, group key functions have a different role than solo-undertakings key functions of. The impact of this proposal may not necessarily be large, but could lead to additional difficulties in the application in practice and seems conceptually wrong.
    - Moreover, EIOA did not provide any evidence of issues, it is impossible to make an informed assessment on EIOPA's proposal due to the absence of details about the extent of the alleged issues.

C. Conclusion

The EC should avoid making numerous changes in the area of group supervision that would result in deterring flexibility.

Due to the various and unique complex structure of groups, and the diverging legal forms of companies in the EEA, the EC should ensure that Solvency II remains principles-based in this area. Supervisory convergence tools are more appropriate to address the current challenges without the risk of creating problems in the future.

The EIOPA proposal to address the trigger inversion issue is welcome, however groups should have the possibility to decide to choose the new simple metric as a conservative approach to avoid a burdensome calculation of the minimum consolidated group SCR, and some clarifications are needed to address all cases.

Moreover, the extension of the regular availability assessment, notably to include EPIFPs, is concerning and would add significant undue burden.

As EIOPA failed to deliver an appropriate impact assessment of its other proposals, there is no satisfactory evidence that the cost/benefit ratio of these proposed changes is acceptable.

10. Freedom to provide services and freedom of establishment

A. Industry proposals for the review

The industry makes the following recommendations, including:

- Allow EIOPA to share the recommendation made to an NSA in a complex cross-border case where no common view emerged in the cooperation platform with the board of supervisors, rather than making it public.
- Better frame the power of the host NSA to request information from a FOS/FOE undertaking (only in clearly defined urgent cases) and remove the local language provision.
- Upgrade the existing cross-border supervisory platforms to standing digital platforms for the exchange of information between home and host NSAs.

B. Comments on EIOPA's opinion

The cooperation between home and host NSAs in the host country is essential (especially in sector-specific business lines, such as construction). Insurance Europe therefore supports many of the recommendations found in EIOPA's opinion in this respect, and the principles underlying them:

- Carefully framed additional powers for the host NSA, in full respect of the home Member State principle
- Early cooperation between NSAs before an undertaking finds itself in a difficult situation
- EIOPA's involvement as soon as it is clear that the necessary actions are not being taken by the relevant NSAs.

Efficient information gathering during the authorisation process

The industry supports EIOPA's recommendation to require an undertaking applying for authorisation to disclose any refusal/withdrawal of *any* request for authorisation it may have submitted in another MS, whether formal or informal, and the reasons for it.

Information exchange between home and host supervisors in case of material changes in the FoS activities

The industry supports the principle underpinning this recommendation, to enhance the information exchange between home and host NSA in cases of material changes in the FOS activities. However, the term "material change" should be clarified, including the criteria which would trigger this obligation on the undertaking's part, especially as Art 149 of the Directive already requires any change in the nature of the risks or commitments to be subject to the notification procedure between home and host NSAs.

Enhanced role for EIOPA in complex cross-border cases where NSAs fail to reach a common view in the cooperation platform

While the industry supports an enhanced role for EIOPA in complex cross-border cases where NSAs fail to reach a common view in the cooperation platform, the power given to EIOPA to make the recommendation public (as well as the NSA's failure to comply) should not result in the publication of confidential information or a "name and shame" policy which could ultimately weaken an NSA's power in its jurisdiction, and therefore weaken supervision there instead of reinforcing it. The pressuring power found in this proposal could be better framed by simply sharing the recommendation with the board of supervisors, which in itself already has a strong dissuasive effect and ensures other NSAs take note. Furthermore, the home Member State principle should be fully respected and home and host NSAs should be allowed to explore any issues in full in the cooperation platform before EIOPA steps in.

The industry is very supportive of the obligation for the home NSA to notify both EIOPA and the host NSA if an FOS/FOE undertaking's financial condition is deteriorating or other risks emerge (including consumer protection concerns). Such proactive measures are very welcome.

Cooperation between home and host NSAs during ongoing supervision

The industry sees the cooperation between home and host NSAs during ongoing supervision as an essential factor for a healthy cross-border market. However, this should not deviate from the 'home Member State principle', which remains the rule even where there is significant cross-border business. In any event, the concept of "material cross-border insurance business" should be clarified, especially the threshold making a cross-border business "material".

Upgrade supervisory platforms to facilitate exchange of information between home and host NSAs

So far, supervisory platforms have only been foreseen once the (economic) condition of an undertaking is seen to be deteriorating. The digitalisation of supervision should be taken advantage of to improve cross-border cooperation between NSAs. Standing digital platforms could be used for a permanent exchange of information between home and host NSAs (both ways).

Explicit power of the host supervisor to request information in a timely manner

The 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 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.

C. Conclusion

The EC should follow EIOPA's recommendations to enhance the supervision of insurance companies operating cross-border through the freedom to provide services (FOS) and the freedom of establishment (FOE), in order to prevent their failures and properly assess the fit and proper requirements.

In particular, the efforts to strengthen cooperation between home and host NSAs by increasing obligations for both and increasing home NSAs' responsibility in respect of their insurers' cross-border activities are welcome. The suggested means, which will give EIOPA the necessary tools to intervene where cooperation between NSAs is not sufficient (or where it fails) are also welcome. It is essential for the level of control to be the same across Members States, whether business is done in the home market or in another market via the FOS/FOE, while ensuring the "home Member State" principle is not diluted in any way.

11. Macroprudential policy

A. Industry proposals for the review

The industry believes that with regards to macroprudential policy the internationally agreed holistic framework for addressing systemic risk should not be gold-plated.

Should the measures referenced in the EC Call for Advice be considered, then:

- the proportionality aspect should be strongly taken into account
- the measures should be introduced only when the existing Solvency II framework can be shown to be insufficient to tackle identified material systemic risks and
- it should be clearly demonstrated that the benefits of applying these new measures outweigh the costs.

It is essential that macroprudential tools are applied in a risk-proportionate way and in relation to macroprudential risk inherent in an insurance business.

The starting point of such a macroprudential approach should be primarily activity-based, and EU-wide inconsistencies should be avoided. The approach should not be taken at single entity level, but at (EU-wide) group level. In general, single entities should only be subject to the new provisions where they are essential for the systematic risk of their group.

NSAs should duly justify when companies which are not part of a group already subject to the measures need to be included in the scope (eg insurance companies with a dominant market position in a country with a currency other than the Euro).

Regarding the objective to further strengthen financial stability, instead of considering new macroprudential instruments and measures, the focus should be on enhancing the effectiveness of LTG measures to fully reflect insurers' long-term oriented business model, and to mitigate artificial volatility and potential incentives for procyclical behaviour in extreme market situations. In light of EIOPA's proposals on the alternative extrapolation mechanism, Insurance Europe proposes that if the alternative extrapolation method is introduced, a transparent, understandable and predictable tool, based on EIOPA's proposed implementation mechanism, should be developed which is applicable for all currencies.

B. Comments on EIOPA's opinion

The industry views favourably EIOPA's references to proportionality.

It further welcomes the proposal to introduce a power for NSAs to temporarily freeze redemption rights in extreme circumstances. Such power would be a potentially useful tool of last resort because it would address the (extremely remote, but potentially severe) risk of mass surrender, preserving value and potentially

preventing the need to use more drastic measures within the resolution toolkit. It could also prevent the unequal treatment of customers who surrender their policy in a crisis and those who do not. In addition, this tool has proven its effectiveness in the few cases when it was used. As EIOPA mentioned in its opinion, the only potential circumstance in which such a tool could be justified is when there is a real and imminent risk of an insurance run (mass lapse). As these events are extremely unlikely in practice, such powers would create an absolute limit to insurers' exposure to very significant forced "fire sales" of assets and contagion. However, insurers caution to handle the power with great care, to avoid undesirable side effects, as it may also present operational challenges.

With respect to proportionality, a consistent application is crucial. For instance, regarding the moderate liquidity risk most insurers face, EIOPA's proposal to require liquidity risk management plans (LRMPs) from almost all insurers does not seem proportionate.

There are however a number of other elements in the opinion which cannot be supported, in light of the limited systemic risks of the insurance industry and the already existing extensive macroprudential framework (eg macroprudential elements of Solvency II like the volatility adjustment, stress tests, risk dashboards and financial stability reports).

Generally speaking, for instance, EIOPA's proposal to issue guidelines to further specify procedures or the scope of application of the measures creates uncertainty about their implementation and could potentially add significant administrative burdens and costs whose impact should be carefully evaluated. If anything, measures in the Solvency II Directive should be further clarified to avoid the unnecessary introduction of excessive powers via guidelines. Should these options be considered, additional guidance should be very strict in order to limit any potential undesired effects or excessive concentration of powers in the hands of NSAs.

More specifically with regards to other issues:

- **Capital surcharge for systemic risk**

The industry strongly rejects a separate capital surcharge tool for systemic risk, as capital cannot be the default response to systemic risk. Instead, where real systemic risk exists, other mechanisms, such as ensuring supervisory oversight and good internal controls and risk management, are essential and effective. Given the comprehensive nature of Solvency II, risks which could lead to systemic concerns (such as losses in asset portfolios or increased customer policy surrenders), are already covered. Therefore, it is unclear why there would be need for additional capital and in fact, such additional capital surcharges are more likely to aggravate issues than address them.

- **Systemic risk management plans (SRMPs)**

In addition to the criteria outlined in the EIOPA Opinion (global activity, the interconnectedness with the financial system, potential substitutability concerns as well as the nature of exposures, scale, and complexity of the undertaking's activities) the criterion "diversification benefits" should be included. As diversification effects are considered for internal models, they should be considered for systemic risk assessments. In particular insurance groups operating in various countries benefit from balancing effects of their group subsidiaries that need to be duly taken into account.

- **Restrictions on distribution**

Insurers strongly hold the view that a restriction on distributions is not a suitable macroprudential instrument for the insurance sector and reiterate the opposition to any kind of sector-wide dividend ban, be it on national or European level. The current approach on Solvency II (which is based on individual assessment) shall be maintained. While a blanket ban represents an extensive intervention and is disproportionate in principle, on the individual level, such measures should not be considered before the SCR has been breached. Under the current framework, supervisors already have extensive powers to intervene unilaterally after the SCR has been breached as part of the ladder of intervention.

In particular, the industry believes that blanket dividend suspension regardless of individual undertakings' situation, are also harmful to the insurance sector and the wider financial system, undermine the credibility of

prudential regulation and has a range of adverse consequences (eg the disruption of income flows for institutional investors which rely heavily on regular cash remittance, disruption to capital and liquidity management within insurance groups).

Solvency II already provides a strong basis and governance framework for dividend distributions, already governed by multiple safeguards and constraints including

- continued and forward-looking solvency coverage requirement after subtraction of planned dividends in the ORSA,
- risk tolerance limits which are formal commitments embedded within the undertaking's governance and limit their ability to reduce the solvency position in times of stress and
- boards' responsibilities towards ongoing viability and ultimately shareholder approvals.

Insurance Europe highlights that one of the achievements of Solvency II is the change from an isolated solo-entity approach to a comprehensive group approach in supervision. Therefore, it needs to be ensured that decisions on distributions as crucial elements of the prudential supervision are taken consistently across groups. Solvency II already provides for the governance structure of efficient and effective group supervision.

In cases where the blanket ban on distribution covered intra-group transactions, its application presents a severe damage to one of the fundamental freedoms of the EU – the freedom of capital. Such a wide-ranging decision must not be taken at a supervisory level without a duly justified case-by-case decision based on transparent and clear criteria. Otherwise, companies might also face a risk of arbitrary decision-making.

- **Concentration thresholds**

The industry does not agree that soft thresholds for action at market level would be helpful given the varied nature of insurers' business models, resulting in unpredictable implications if any supervisory decisions were based on it.

Concentration thresholds or exposure limits go against one of the key intentions in the transition from Solvency I to Solvency II. Rather than applying allocation limits, insurers can decide over their strategic and tactical asset allocations within limits of own funds available. Even "soft" supervisory concentration thresholds could lead to a distortion of the necessary balance between profitability, liquidity and security at the portfolio level of the individual insurer. They could restrict insurers in their choice of investments and could lead to herd behaviour and pro-cyclical actions rather than mitigating them. Besides, assets are managed in the framework of the undertaking specific ALM to ensure a match with the liability side. "Soft" thresholds could also result in insurers disposing of certain assets in anticipation of reaching the limits. At financial market level, selling pressure or forced sales would have negative side-effects and could potentially be destabilising. Thus, any form of thresholds should be avoided, especially in a sophisticated risk-based framework such as Solvency II.

- **Liquidity risk framework**

The industry does not agree with EIOPA that the COVID crisis has stressed the need for an extensive liquidity risk framework (see page 608 in the "Background document"). Instead, this crisis has shown that liquidity risks are well managed within the industry in the current regulatory framework. In addition, measures that require insurers to reduce their investment in less liquid assets will have negative consequences for eg pension savings as liquid assets often have lower returns. Therefore, additional measures should only be considered in very exceptional circumstances where large liquidity risk vulnerabilities exist and can be clearly demonstrated.

- **Expand the use of ORSA to include the macroprudential perspective**

The industry believes that any changes to the ORSA should not undermine its purpose and role. As with any risk an insurer is exposed to, the ORSA can already be used as a suitable place for insurers to report on any material exposure and how it is monitored and managed. Insurance Europe would caution against prescriptiveness in the ORSA processes, which are already assessed by the relevant supervisory authorities. The ORSA is the company's own analysis and should remain so.

C. Conclusion

In light of the above, there are some positive aspects to be considered, such as the implementation of the IAIS holistic framework, the references to proportionality and the introduction of the power to temporarily freeze redemption rights, to be used in very limited and specific circumstances.

Nevertheless, the industry cannot support EIOPA's proposals, specifically in relation to capital surcharge for systemic risk, restrictions in distribution and concentration thresholds.

Insurers would also like to highlight once more that the multiple references to the issuance of Guidelines that would further specify the procedures or the scope of application of the proposed measures may add burdens and costs on companies and generate uncertainty in regard to the implementation of the proposals.

As a way to further enhance financial stability, if the alternative extrapolation methodology is implemented, a transparent, understandable and predictable tool, based on EIOPA's proposed implementation mechanism, should be developed which is applicable for all currencies.

12. Recovery and resolution

A. Industry proposals for the review

With respect to recovery and resolution measures, the industry believes that a risk-based approach and proportionality are essential.

In particular on pre-emptive recovery planning, it is important to ensure that the requirement is only applied to companies where planning would create a tangible benefit in terms of reduction of material systemic risk at EU level, not least because Solvency II already requires recovery planning from all companies when the SCR is breached.

With respect to resolution measures, there is no justification for going beyond the global holistic framework.

Run-offs and portfolio transfers are sufficient to deal with the large majority of insurance failures and should be the preferred tools. More drastic measures should be considered with caution and clearly justified.

There is no need for supervisory intervention in the day-to-day operations of healthy companies, in particular the removal of impediments for recovery and resolution and early intervention rights.

B. Comments on EIOPA's opinion

Insurance Europe sees some merits in a few proposals included in EIOPA's opinion. For instance, the proposal to equip with some acceptable powers, such as the ability to withdraw the authorisation granted to an undertaking and put all or part of the insurance business contracts into run-off and to temporarily prohibit redemption of policies in specific circumstances, eg when such measures are necessary to address major threats to the insurance sector, as long as policyholders would be better off than in the event of the insurer's failure.

Having said that, the industry maintains that resolution should be a measure of last resort, which should only be employed once all recovery options have been exhausted. Resolution powers need to be well-defined and targeted, to avoid forcing resolution authorities into taking sub-optimal actions. They should be based on circumstances and changing macroeconomic factors and should focus on reducing systemic risks.

Insurers agree that traditional resolution tools, such as run-offs and portfolio transfers are sufficient to deal with the large majority of insurance failures. These should be the preferred tools and authorities should clearly justify the need for more intrusive tools and why they are not sufficient to meet the objectives of resolution.

It should be noted that failures take longer in insurance and therefore rapid intervention will not prove a good reason for the choice of resolution tools, especially because fire-sales of assets or the crystallisation of their value could result in unnecessary value destruction.

Insurance Europe supports powers for public authorities to temporarily prohibit redemption of policies in specific circumstances, for instance when such measures are necessary to address major threats to the insurance sector, as long as policyholders would be better off than in the event of the insurer's failure. Nevertheless, the industry does not consider a prohibition on distributions a suitable macroprudential instrument and believes it should be handled with great care.

Cross-border cooperation and coordination between supervisory and/or resolution authorities within the EEA and third countries, as well as the mutual recognition of resolution actions is important for the insurance industry. However, Insurance Europe is of the view that EIOPA has enough existing powers to play a leading role in ensuring the consistent and coherent functioning of these cross-border arrangements across the EU. This should allow for the swift recognition and implementation of decisions of resolution authorities outside their jurisdictions thereby increasing their chances of success. A shift of competencies from national supervisors to EIOPA should be avoided.

EIOPA's opinion does not cover the resolution of financial conglomerates nor in that context, the interaction between the insurance resolution framework and the BRRD/SRM framework.

As it is a complex subject, it requires appropriate attention, to ensure effective cooperation between supervisory and resolution authorities on a cross-sectoral basis, alignment of triggers and resolution tools and to avoid the possibility that the resolution of one part of the conglomerate negatively impacts the other part of the conglomerate and the just and equal treatment of all clients and creditors in the conglomerate. In addition, the opinion does not take in consideration that the EU insurance sector consists, to a significant degree, of mutual insurance companies and other cooperatives, which may differ to other insurers in regards of recovery and resolution.

The industry also agrees, in regard to triggers, that non-compliance with SCR (in accordance with Article 138 of the Directive when the SCR ratio is below 100%, and not before) is an appropriate trigger for entry into recovery. The SCR is already a preventive measure (or early intervention as they were called in previous publications) trigger and it should be noted that if an undertaking is in breach of the SCR, it can still have sufficient own funds to meet all its obligations. We do not see the need to supplement the existing SCR-trigger by further pre-emptive triggers. Furthermore, the recovery period for the SCR should be extended from 6 months to two years to allow insurers to implement appropriate measures within an adequate timeframe.

The industry believes that **it is important to avoid disrupting the ladder of supervision** already provided by Solvency II. Therefore, insurance companies agree that rigid pre-defined triggers (which represent an absolute obligation for the authority to intervene when a specific situation arises) for entry into resolution are not appropriate, as an assessment of when an insurer's liabilities exceeds its assets requires significant judgment on the part of the resolution authority (this is because asset values fluctuate and so do liabilities, which are merely best estimates of expected claims/maturities rather than certain amounts).

While a few of the proposals mayrepresent a step in the right direction, there are several other measures whose extent is unclear or negative for the insurance industry.

The proposal for member states to **officially designate an administrative resolution authority** is inconsistent with FSB guidance for effective resolution regimes. For the latter, references to a 'resolution authority' include more than one authority so that multiple authorities can be responsible for exercising resolution powers under the resolution regime.

In regard to the proposal of **establishing a minimum harmonisation of a recovery and resolution framework**, the industry believes that it could only be principle-based. In many cases, in fact, there are justifiable reasons as to why different approaches are taken in different jurisdictions.

The existence of diverging approaches in member states should not be a valid reason for introducing a very burdensome EU-framework on recovery and resolution for insurers. Insurance regulation is an appropriate route to achieve harmonisation of company law, which at a national level may include tools to achieve resolution of insurance companies. Member states should determine the appropriate approach for their own market.

In EIOPA's Opinion, the scope of pre-emptive recovery planning points to the coverage of a very significant share of the national market. Insurance Europe does not agree with this criterion. In fact, it is important to ensure that only companies where planning would create a tangible benefit in terms of reduction of material systemic risk at EU level should be required to draw a pre-emptive recovery plan, for two reasons.

Firstly, recovery planning is required from all companies when the SCR is breached (in accordance with Article 138 of the Directive when the SCR ratio is below 100%, and not before).

Secondly, introducing requirements of national coverage will lead to a situation in which many other insurers, some quite small, would be required to have pre-emptive recovery plans to satisfy market coverage criteria. In addition, requirements of coverage conflict with the proportionality principle and the possibility to waive undertakings from the requirement of pre-emptive recovery planning. Therefore, there should be no requirement regarding recovery based on the coverage of the market share of the national market.

With regards to the **introduction of new powers for NSAs**, on extensive supervisory dialogue and additional or more frequent reporting, the industry believes that there is no need for supervisory intervention in the day-to-day operations of healthy companies, in particular the removal of impediments for recovery and resolution and early intervention rights. Otherwise, Solvency II would be undermined under the guise of recovery and resolution requirements. Insurance Europe maintains that the ladder of supervisory intervention provided by Solvency II already enables supervisors to step in when there is an imminent risk that capital requirements are breached, and includes certain requirements in terms of recovery: recovery plan in case of non-compliance with the SCR, finance scheme in case of non-compliance with the MCR and supervisory powers in deteriorating financial conditions.

The SCR ensures a high level of capital buffer, calibrated to ensure a firm will remain able to meet all obligations to policyholders even after a 1-in-200-year loss event. The supervisory ladder of intervention in Solvency II allows supervisors to begin taking actions when the SCR is breached and to fully take over the company if the MCR is breached – an early point at which an insurance company still has significant assets in excess of those needed to meet its obligations to policyholders.

There are in fact several safeguards embedded in the three pillars of Solvency II:

- Insurers are required to have a risk appetite, a statement regarding the own buffer needed considering the risk profile, risks and volatility of the current position and development of these in the future. Based on these considerations, insurers will have formulated a capital adequacy policy, including an own ladder of intervention. This is communicated to the supervisory authorities.
- Insurers are required to calculate or estimate their solvency position at regular intervals, and in any case annually. They are also required to communicate directly to the supervisory authorities any breach of the SCR or a projected breach in the coming three months.
- On a quarterly basis, insurers are required to submit various QRTs providing current data to the supervisory authorities.

Therefore, NSAs can assess the development of the solvency position of individual insurers and are also able to prioritise their supervisory actions, including through the supervisory review process (see also EIOPA guidelines). More measures (such as additional or more frequent reporting) may represent an additional administrative burden and increase in costs for undertakings.

Insurers also believe that the **power to limit variable remuneration and bonuses** should be implemented in the event of recovery and foremost on the basis of management decisions and not in the context of preventive measures.

In the EIOPA opinion, when listing the **criteria for pre-emptive recovery and resolution planning**, cross border businesses are considered both as interconnectedness and per se, effectively doubling the risk factor that they may represent. With regards to the consideration of cross-border activity as a risk-criterion per se, the industry reiterates the concern expressed on the proportionate application of Solvency II. Cross-border activity is not a suitable risk criterion for macroprudential considerations either.

In line with the industry's considerations expressed for market coverage requirement in order to prepare recovery plans, Insurance Europe does not think that there is a benefit to developing a pre-emptive resolution plan for an apparently healthy insurance company.

In general, it would make sense that resolution authorities develop a generic overview of resolution options with their pros and cons, in order to facilitate the assessment of the situation and the drafting of a recovery plan in case a company breaches the SCR. Having requirements of national coverage will lead to a situation in which many insurers, will be required to have recovery plan to satisfy market coverage criteria. In addition, requirements of coverage would need further work to be determined and are in conflict with the proportionality principle and the possibility to waive undertakings from the requirement of pre-emptive recovery planning.
The industry is therefore strongly against such proposal to have a recovery plan that should capture some specific share of each national market in the EU.

Furthermore, the need to issue **future guidelines** for the identification of critical functions and others which are material for the financial system adds a layer of uncertainty to the preparation that would be required by insurance undertakings.

As already stated, the industry maintains that run-offs and portfolio transfers are sufficient to deal with the large majority of insurance failures. Therefore, these should be the most preferred tools and authorities should clearly justify the need for more intrusive tools and why run-off or portfolio transfers are not sufficient to meet the objectives of resolution. Since failures take longer in insurance, rapid intervention will not prove a good reason for the choice of resolution tools, especially because fire-sales of assets or the crystallisation of their value could result in unnecessary value destruction.

Resolution should be a measure of last resort which should only be employed once all recovery options have been exhausted. Entry into resolution should not occur before the insurer has reached the point of non-viability. Resolution powers need to be well-defined and targeted, to avoid forcing resolution authorities into taking sub-optimal actions. They should be based on circumstances and changing macroeconomic factors and should focus on reducing systemic risks. As mentioned before, run-offs and portfolio transfers are sufficient to deal with the large majority of insurance failures. These should be the most preferred tools and authorities should clearly justify why they are not sufficient to meet the objectives of resolution and the need for more intrusive tools .

While in specific instances (eg when it is necessary to address major threats to the insurance sector as long as policyholders would be better off than in the event of the insurer's failure) insurers would support powers for public authorities to temporary prohibit redemption of policies, the industry does not consider a prohibition on distributions a suitable macroprudential instrument and it should be handled with great care.

With respect to some of the **resolution powers listed**, the industry has the following comments:

- **Create and operate a bridge institution to which the assets and liabilities of the undertaking in resolution is transferred.**
    - In a situation where the insurer is no longer viable, the power to continue to carry on some of the insurer's business, for example making payments to annuitants would be consistent with policyholder protection. However, the aim should be to establish appropriate

adjustments in value, where required, as soon as practicable so as to prevent conflicts of interests arising between different policyholder groups. The industry agrees that control, management and operational powers are necessary, but would point out that in insurance, establishing a bridge institution is another means to undertake a portfolio transfer.

- **Stay the early termination rights associated with derivatives and securities lending transactions**.
  - Great care must be taken about the possible effects on assets or investments, including existing contracts. In addition, a comparison with the existing regulations at European level is absolutely necessary. Otherwise there could be contradictory regulations. It is also important to point out that this resolution power will most likely lead to higher costs for insurers to use derivatives to manage and mitigate their risk. Ensure continuity of essential services (eg IT) and functions by requiring other entities in the same group to continue to provide essential services to the undertaking in resolution, any successor or an acquiring entity. Contagion effects may be expected from other group companies if they have to continue to provide services for the insurance company in resolution and may not receive adequate payments for these services.
- **Restructure, limit or write down liabilities, including (re)insurance liabilities, and allocate losses to shareholders, creditors and policyholders.**
  - Buyers of insurance purchase protection against financial losses that are incurred by the occurrence of the insured risk. Insureds pay a premium to mitigate risk, whereas investors take risk to earn a premium. Therefore, insureds are entitled to higher protection in resolution (and liquidation) than investors.

Finally, **there is no need for triggers for preventive measures** as Solvency II already provides for a supervisory ladder of intervention, and a breach of the SCR should not be seen as a trigger for the application of supervisory intervention measures. Solvency II is by design a risk-based and forward-looking framework. Consequently, there is no need for preventive measures as the framework implies sufficient time to react in case of an SCR breach.

EIOPA's proposal of triggers for resolution include a situation in which an undertaking is "likely" to be no longer viable. Such wording should be removed as it introduces uncertainty and triggers should be clear for all stakeholders. The condition should be aligned to the Solvency II ladder of supervisory intervention, and therefore should refer to an irrecoverable breach of the MCR.

C. Conclusion

In conclusion, while there are a few positive aspects among the suggestions made by EIOPA in its Opinion, the insurance industry's outlook on the Recovery and Resolution proposals is negative, as they do not seem to be risk-based and also not proportionate.

The scope of pre-emptive recovery and resolution plan should not be based on the coverage of national markets and EIOPA's proposals for the introduction of some unnecessary and overly intrusive powers for NSAs, as well as resolution measures that go beyond the global holistic framework, are not appropriate.

13. Insurance guarantee schemes

A. Industry proposals for the review

Insurance Europe supports the status quo and opposes an EU initiative on IGS.

The IGS currently in place vary significantly across Europe but generally work well in their local context and laws and predominantly stem from pre-SII times.

Solvency II already provides very high levels of policyholder protection and safeguards that need to be duly considered. The Solvency Capital Requirement (SCR) ensures a high level of capital buffer, calibrated to ensure a firm will remain able to meet all obligations to policyholders even after a 1-in-200-year loss event. The real risk of failure is significantly lower than this because:

- Companies set internal target capital above the SCR requirement
- Pillar II which requires management monitor risks and to take action in the case risks materialise to prevent a failure.
- Pillar II and Pillar III which ensure supervisor monitoring and intervention powers to provide even more protection and external monitoring through public reporting.

An insurer is considered to have failed if it has breached its Minimum Capital Requirement. Currently (Q3 2020), the average MCR-ratio across the industry is above 600% and the aggregate MCR amounts to about €222bn – 36% of the total SCR. In addition to this, there is the extra capital provided by the risk margin which is held over and above the funds that Solvency II requires through strict reserving requirements to hold to cover all liabilities including claims, costs and taxes. This means that in most cases, when an insurer fails there are still assets covering technical provisions fully, and there will also be some remaining additional capital buffer above this. Furthermore, existing regulations, including national insolvency systems, can be designed to give policyholders priority over other creditors in the insolvency process, ie the policyholders have preferential rights.

Therefore, in the rare case a company fails and cannot recover, the overall Solvency II and the preferential rights aim to ensure that there are enough funds to allow an orderly run-off or transfer without any loss to policyholders.

An IGS adds even more capital requirements and so should only be in place where considered really needed on a national basis. An IGS harmonisation project would create significant costs and involve complex challenges for which there may not be acceptable solutions.

Solvency II was designed with very high level of customer protection in mind. If the overall framework had included IGS from the start then it would have been designed differently, with lower capital requirements. There are examples internationally where IGS form part of the overall framework and in such examples we see lower capital requirements and a much higher expectation and tolerance of insurance failures. Adding mandatory IGS as yet another layer of capital to the framework is not appropriate.

IGS bears the danger of moral hazard as it cannot be excluded that IGS encourage less responsible conduct. With IGS in place, policyholders might be inclined to pay less attention to the insurance company's financial solidity and choose their insurer solely on the basis of the lowest premium. Equally, insurance intermediaries might not necessarily offer their clients the products of a financially sound insurer, but rather those which come at the lowest price irrespective of the soundness of their risk management and solvency position.

B. Comments on EIOPA's opinion

The industry disagrees with EIOPA's proposal to make it mandatory for all Member States to have a national IGS in place. IGSs currently in place vary significantly across Europe but work generally well within their local context and laws. Some Member States currently have arrangements equivalent to an IGS that protects policyholders in the same way, whereas other Member States do not have an IGS but consider that policyholder protection is nevertheless sufficient. As well as creating significant costs and new capital requirements where no IGS is currently in place, even a minimum harmonisation would also inevitably lead to extra costs for some existing IGS or their equivalent which are already in place and working.

On potential scope, insurers oppose EIOPA's proposal that mandatory IGS should cover life and non-life policies – the product scope should be decided at national level. There are significant differences across the EU on what specific insurance products cover (bank deposits on the other hand are much more similar among the Member States). For example, in some countries home insurance also covers legal protection, liability and travel insurance while in others it does not. Thus, the relative importance of different types of insurance for policyholders differs between member states. This is precisely why there are significant differences in this

respect between current IGS in EU member states. This creates significant challenges for a minimum harmonisation regulation to specify that certain products should have an IGS cover. In addition, it can have damaging and unwarranted consequences for Member States' insurance market as well as for the national social welfare systems, including the national pension systems. For example, EIOPAs proposal that occupational pensions covered under Solvency II shall be included in the IGS can create level playing field issues with IORPs in some Member States. Occupational pensions should therefore not be covered regardless type of provider. Therefore, any minimum harmonisation would have to avoid specifying products and leave a large degree of national flexibility to ensure that an appropriate solution could be found for each market.

Insurers oppose the proposed scope of eligible claimants to include micro-sized legal entities - minimum coverage should not go beyond consumers (natural persons). It should be for member states to decide, in consultation with local stakeholders, whether a wider scope is justified.

On funding, insurers oppose the proposed harmonisation to mandatory ex-ante funding. Insurers believe that ex-ante funding should not be imposed, any minimum harmonisation should leave IGS funding (ex-ante or ex-post) to be decided at Member States' level. In cases where ex-ante funding is considered appropriate at national level, decentralised funds should also be allowed by the member state where each company holds the assets allocated for IGS funding on its own balance sheet.

EIOPA also fails to address the contagion risks - absolute caps on insurers' contributions to an IGS would be needed to avoid that the IGS itself creates other failures. In many European insurance markets, there is a high concentration, ie the Top 4 insurers having 70-80% of market share. In the rare case of one large company collapsing and not having enough resources to pay all claims, there would be a risk that an IGS could create interconnectedness and vulnerabilities in the financial position of otherwise healthy insurers. Therefore, caps on contributions would be needed to avoid this contagion risk.

On home vs host roles, while European insurers agree with EIOPA that the geographical coverage of national IGSs should be based on the home-country principle, EIOPA fails to recognise that the host country should play a role in providing the "front office" customer communication and interface. The home country principle is supported because this aligns national supervision of an insurer with the IGS that would have to cover the costs if that insurer would fail. This can help ensure supervisors treat their supervisory responsibilities for insurers in their jurisdiction who sell to cross-border customers as seriously as they do for those selling to local customers.

On compensation vs continuation, EIOPA indicates these having equal status, however the industry considers that it is important that in the rare case of failure, policies are wherever possible, continued through a run-off or transfer instead of immediate compensation to ensure the optimal outcome for policyholders while avoiding unnecessary calls on IGS funds. This should however remain a decision taken at Member State level, as compensation may be more beneficial to the customer in some cases or at least not disadvantageous compared to continuation, eg in non-life.

C. Conclusion

The Commission should refrain from implementing minimum harmonisation of IGS schemes.

The IGS currently in place vary significantly across Europe but generally work well in their local context and laws. The requirements and legal structures of IGS should continue to be decided by member states. Attempts at harmonisation would create significant costs and involve complex challenges for which there may not be acceptable solutions. Solvency II, when implemented appropriately, offers sufficiently high protection. The focus should be on ensuring Solvency II is calibrated and applied appropriately and on cooperation and coordination between supervisory and/or resolution authorities. In any case, before considering any further action, the Commission allows for time to learn from the extension of motor guarantee funds' competences to insolvencies, as proposed under the ongoing revision of the MID.

14. Other topics of the review (transitionals, fit & proper)

The industry supports no changes in the areas of other transitionals.

In relation to fit and proper requirements, the CfA was intended to solve cross-border issues. In any case, the regulation already provides what is needed to ensure ongoing appropriateness, and the pursued goal of these changes is unclear.