

**Comments Template on
Consultation Paper on EIOPA's first set of advice to the European
Commission on specific items in the Solvency II Delegated Regulation**

**Deadline
31 August 2017
23:59 CET**

Name of Company:	AAE - Actuarial Association of Europe	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ Do not change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇒ Leave the last column <u>empty</u>. ⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a paragraph or a cell, keep the row <u>empty</u>. ⇒ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. <p>Please send the completed template, <u>in Word Format</u>, to CP-17-004@eiopa.europa.eu</p> <p>Our IT tool does not allow processing of any other formats.</p> <p><u>The numbering of the reference refers to the sections</u> of the consultation paper on EIOPA's first set of advice to the European Commission on specific items in the Solvency II Delegated Regulation. Please indicate to which paragraph(s) your comment refers to.</p>		
Reference	Comment	
General Comment	<p>As indicated in paragraph 11 it is highly recommendable to make use of the annual reporting templates to be send to EIOPA by July 2017 the latest.</p> <p><u>LAC DT</u>: Only Day One reporting is considered in the paper. It is indispensable – especially for LAC DT – to repeat the calculations with the data of the business year 2016.</p> <p><u>Simplifications</u>: According to paragraph 48, to obtain a full overview concerning the use of simplification the annual QRT are necessary. This limits the informative value of this issue</p>	

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	<p>performed for this Consultation Paper.</p> <p><u>Selective broadening of the request relating to LAC-DT:</u></p> <p>EIOPA announce to go beyond what is requested by the Commission's call for advice in case of LAC DT:</p> <p><i>457. In this first response to the Call for Advice EIOPA will only address the request for information from the European Commission and will not yet come up with any advice on possible changes in the Delegated Regulation. EIOPA will continue working on supervisory convergence and, if deemed necessary, <u>may advise changes in the Delegated Regulation in its second response to the Call for Advice.</u></i></p> <p>In case of mass lapse they came to a different decision:</p> <p><i>30. The difficulties faced when calculating the capital requirements for lapse risk are understood and proposals for simplified calculations are described below. The <u>appropriateness of the level of the mass lapse risk is not in the scope of the call for advice of the European Commission. The materiality of this risk could be assessed at a later stage with the help of the annual QRTs.</u></i></p> <p>Referring to the need for supervisory convergence to extend the scope of this call for advice for LAC DT while strictly sticking to the consultation for mass lapse risk is not consistent. Supervisory convergence should primarily lead to a comparable assessment of the solvency of an undertaking considering the risk and the national specifics (fiscal, legal, contractual obligations). Lapse risk is as well affected by national specifics and should be therefore be covered in this consultation in line with EIOPA general objective of supervisory convergence and level playing field.</p>	
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2.2		
2.3	<p>Non-Life lapse risk Explanations given under the analysis section in paragraph 27 say that there is room to have a simplification for the lapse risk calculations. Furthermore, an application of the shock referred to in Articles 118(1) and 150(1) by homogeneous risk groups is described as a “could be” simplification. Later in the document, the calculation on homogeneous risk groups is advised as the only simplification. Is there still room for further / additional simplified methods.</p> <p>Simplifications (22): We understand EIOPA's concern that non-listed simplifications still need to be correctly calibrated. Nevertheless, we do not agree that non-listed simplification are in general close to an internal model and we would like to highlight that ruling out non-listed simplifications in general is in strong contrast to the objective to simplify the calculations for (re)insurance undertakings either. We therefore recommend allowing for non-listed simplifications as long as they fulfill certain qualitative requirements. One example would be to allow for non-listed simplification that use the methodology prescribed by the Standard Formula as a basis. There already exist such qualitative requirements within the Delegated Regulation (c.f. simplification for V_prem in Article 116 4 a) and b)). These requirements could be generalized for non-listed simplification to address the calibration topic raised. This would be in line with the principle-based approach of Solvency II.</p> <p>Simplifications (23): In particular, when setting values to a conservative value the comparison to an internal model is ambiguous. There are plenty of examples where a conservative value can be chosen without a model discussion, e.g. the maximum value of the diversification factors in the Non-Life Natural Catastrophe Module (Div_ws, Div_EQ, Div_hail, Div_flood) is 1. So setting these values to 1 is conservative and avoids additional calculations. Another example is the simplification for V_prem in Article 116 4 as mentioned above (22).</p> <p>These examples show that the regulation is set up to allow for conservative assessments already</p>	

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	and conservative values can be obtained in line with existing methods. Therefore, in order to further simplify the calculations in line with the objective of this CP, we suggest allowing explicitly the use of conservative values. As described for non-listed simplifications this might be subject to qualitative requirements.	
2.4		
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2.4.2	<p>Non-Life lapse risk (simplified formula approaches): While under paragraph 59 it is stated that difficulties encountered for the calculation of non-life lapse risk are similar to life lapse risk, the definition of simplifications should take into account the relation of these risk with the non-life lapse risk tending to have a very low materiality compared to life.</p> <p>The introduction of a simplified calculation of this risk on homogeneous risk groups is appreciated. In addition to this we would recommend to take the following into account as well: The risk reflects impacts on the premium provision in shocked events and there highly depends on the methods used to determine these provisions. There are many companies in the market where the premium provision is calculated on homogeneous risk groups or simply LoBs by applying simplified methods (e.g. formula based approaches based on Combined Ratios). These methods can be developed further to directly determine the lapse risks allowing a simplified calculation (e.g. formula based further developing the Combined Ratios based approaches).</p> <p>An example for such approaches is highly propagated by Gesamtverband der Deutschen Versicherungswirtschaft e.V. (GDV). The GDV provided a formula for the premium provision and derived a direct formula for the SCR of the lapse risk. Reference is made to their comments on CP-16-008 Q1.6.</p> <p>Why haven't such approaches been further stated, explained and followed in CP-17-004?</p>	

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2.4.3

Agree with the proposed modification of the formula for simplified calculation of the life mortality risk and health mortality risk. In this case, Article 91 of the Delegated Regulation needs to be adapted.

The item CAR_k is not defined. It might not be easy to calculate this value.

Caveat: There is an item CAR_i defined in Article 96. This is different and must not be mixed up!

Currently Article 91 contains the following definition for the Capital at risk for this purpose

(a) CAR denotes the total capital at risk, meaning the sum over all contracts of the higher of zero and the difference between the following amounts:

(i) the sum of:

- *the amount that the insurance or reinsurance undertaking would currently pay in the event of the death of the persons insured under the contract after deduction of the amounts recoverable from reinsurance contracts and special purpose vehicles;*
- *the expected present value of amounts not covered in the previous indent that the undertaking would pay in the future in the event of the immediate death of the persons insured under the contract after deduction of the amounts recoverable from reinsurance contracts and special purpose vehicles;*

(ii) the best estimate of the corresponding obligations after deduction of the amounts recoverable from reinsurance contracts and special purpose vehicles;

Non-life lapse risk sub-module

27/62: We support the introduction of a simplified calculation for non-life lapse risk, but the requirement to demonstrate that there are no material compensations between policies needs clarification.

In non-life insurance, there are usually material compensations between policies being affected by claims and those, which are not within a homogeneous risk group, which is a fundamental concept in non-life insurance. It needs to be clarified that these types of compensation do not fall within the requirement.

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	<p>Lapse risk sub-module:</p> <p>We welcome the proposed additional simplifications that now allows companies to use homogeneous risk groups to calculate the lapse stress (as opposed to policy-by-policy calculations). This is</p> <p>(a) more representative of what is actually likely to happen in a stress scenario and</p> <p>(b) should lead to less burdensome calculations.</p> <p>It will be important for companies to be able to demonstrate that a simplified approach does not give rise to material offsetting (between policies in the same group) within the lapse risk calculations.</p>	
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3.4.2	<p>Paragraph 129: we would recommend adding whether this assessment should be performed one point in time or be revised depending a.o. on the modified duration of unrated bonds or under extreme predefined conditions.</p>	
3.4.3	<p>Paragraph 146: it is too restrictive to exclude as a whole (re)insurance undertakings who provide profit sharing or conduct unit-linked business. A more appropriate approach would be to work at Line of Business level while evidencing the assets covering the liabilities in line with the ALM policy.</p> <p>Typo in paragraph 147: approaches as at this stage.</p> <p>Paragraph 146: Invitation for comments</p>	
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4.4.2	<p>We do not feel comfortable with the justifications in paragraph 202. Do the CQSs always properly reflect the risk mitigating effect of partial guarantee?</p> <p>Paragraph 203: the current insignificant proportion of partial guarantee in other assets than type 2 mortgage loans is not an appropriate argument for not revising the SCR concentration sub-module. An alignment of the approaches between SCR spread and concentration is more acceptable.</p>	
4.4.3		
4.4.4	<p>Paragraph 226: we would recommend making clear that the requirement w.r.t. to fully coverage we refer to is the one under article 215 (f) only. So "The guarantee referred to in point (c) should be recognised provided it complies with the requirements of Articles 209 to 214, except for the requirement that it "fully covers..." <i>as stated in Article 215 (f).</i></p> <p>We would also recommend further guidance on the valuation of partial guarantees, including those listed in paragraph 167.</p>	
5.1		
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5.3	<p>Risk Mitigation Effects:</p> <p>Scenarios Methods (255/267, 269ff.):</p> <p>To achieve the objective to ensure a technically consistent supervisory regime (3) reinsurance should be taken into account in the premium and reserve risk calculations in a meaningful way. We understand that EIOPA does not want to completely overhaul the design of this module nevertheless introducing a scenario approach could still reflect the risk more appropriately without increasing complexity (268). This issue could be addressed by using the same approach as</p>	

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	<p>for the non-life natural catastrophe risk module. Here the loss before reinsurance is calculated based on a factor approach while reinsurance is taken into account using the scenarios A and B (e.g. Article 121 1 to 4 for Windstorm of the Delegated Regulation). With this combined method, the concerns raised in 269 to 271 and 274 to 275 could be addressed at least for non-finite reinsurance. Without reinsurance, the results for the factor approach and the combined approach are identical. This addresses the argument raised in 272.</p> <p>Furthermore, we do not see the risk of wrong incentives (276) with the combined approach as undertakings would have to comment on their reinsurance in the ORSA Report and the Actuarial Function Report anyway. Therefore, they would have no incentive to buy reinsurance for the sole purpose of optimizing the Standard Formula. In fact, the current approach actually stipulates wrong incentives as not buying any reinsurance regardless of the own risk profile is promoted. Therefore, this issue should be fixed.</p> <p>Adverse Development covers (“ADC”) We want to raise the following objection concerning EIOPA’s assessment: Adverse development covers (paragraphs 249-264) – these effectively cap reserve risk. EIOPA have reviewed the proposal for how the standard formula could be adjusted to take account of an ADC and rejected it. They suggest that insurers allow for ADCs by applying for a USP instead. The issue is that the process for applying for a USP can be prohibitively expensive for some, particularly smaller, insurers.</p> <p>ADCs are becoming quite common and there should be an allowance within the SCR to allow for this change. It would not need to be perfect – for example, it could stipulate that the ADC should apply to all reserves within one SII line of business. However, as it stands, smaller insurers who are not equipped to apply for a USP are at a disadvantage, as they are required to hold capital against reserve risk, which, in reality, they are not exposed to.</p>	
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5.4.2	With rolling hedges it’s important to end up to such a clear legal text with a level of guidance that	

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	<p>also companies that do not use the hedges 'in day-to-day business' would have the possibility to do the needed actions if needed. It's important that insurers do have the capability to have a level of understanding of the hedging that the hedging program set in motion (in case of solvency ratio declining) is eligible in a way that the impact on the SCR requirement can be achieved.</p> <p>Regarding the realistic recovery plan and the reduction factor referred in 324 seems still to leave a question mark on the process but also might cause pro-cyclicality in case of a SCR breach as re-insurance market is quite widely linked in EU. This might have unexpected consequences to the solvency positions of insurers in times of stressed market conditions.</p>	
5.4.3	<p>Article 211(3) of the Delegated Regulation ("realistic recovery plan") The introduction of a partial recognition period with a maximum of 6 months implies a recalculation of the SCR after this period with no or full recognition of the risk mitigation provided by the reinsurance undertaking concerned. This probably leads to a recalculation need during the year instead of at year-end, which rather adds complexity and raises new questions. Shortening the recognition period even below the 6 months as mentioned in paragraph 329 could further stress the situation especially when the period ends close to quarterly reporting cycles. Entities could tend to avoid a partial recognition from the beginning to avoid the recalculation cycles and might add some impact analysis into the ORSA. We would therefore recommend revisiting the paragraphs 324 and 329 from a process and methodology perspective.</p>	
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6.4.2	<p>We would expect the LAC DT to be consistently applied, which is not currently explicitly mentioned in the text. This is particularly relevant in case of different tax rates on Equity investment.</p>	

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	We would also recommend defining the hierarchy of the rules applicable in case of eligibility for the Duration Based Equity.	
6.4.3	Under the current rules the lack of look-through in respect of investment related undertakings generally means the SCR is significantly higher than if it was allowed to look-through (as equity shock is applied to the value of such a participation). Insurers seem to prefer the option to apply the look-through approach to investments in 'Investment Related Undertakings' (see para. 349 of Section 6.3). EIOPA however, seems to offer all or nothing: look-through can be either mandatory or not allowed at all (see Section 6.4.3). A compromise solution would be to require insurers to apply the look-through approach to investments in 'Investment Related Undertaking' unless they can demonstrate to NSAs that such approach is not appropriate (e.g. when the related undertaking is highly leveraged).	
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7.3	<p>USPs: 387 We agree that adding new methods for USPs for Premium and Reserve Risk would bear the risk of resubmitting already existing USP application, which should be avoided in any case. Therefore, we suggest focusing on simplifying the validation requirements instead of introducing new methods and documentation requirements.</p> <p>Paragraph 407: EIOPA had asked stakeholders to provide other methodologies on lapse risk that would solve the issues explained.</p> <p><u>Life Lapse risk submodule</u></p> <p>Permanent increase/decrease in lapse risk</p> <p>Current Approach according to EIOPA-14-322 "The underlying assumptions in the standard formula for the Solvency Capital Requirement calculation"</p> <ul style="list-style-type: none"> • In the current approach for lapse risk the calibration of the shock of the decrease of lapse 	

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rates was mainly based on a study of the UK with-profit life insurance market in 2003 performed by order of the British FSA [Financial Services Authority "Calibration of the Enhanced Capital Requirement for with-profits life insurers", 2004; short: FSA04].

- The shock of the increase of lapse rates has been assumed symmetrical.

Impact of lapse risk

Lapse risk is one of the major underwriting risks in life insurance especially if surrender values are guaranteed. The German supervisory report published in 2016 analysing day one reporting shows that prior to diversification life risk makes up 29% of the BSCR requirement, the second most important risk after market risk (78% of BSCR). QIS5 data reveals for a market with guaranteed surrender values that lapse risk drives the life risk module even stronger than longevity risk (43% of life risk is attributed to lapse and just 40% to longevity on the German market).

In addition, lapse risk has a high impact on the time value of financial options and guarantees. Finally, lapse rates are of particular significance for business models with guaranteed surrender values. Here, a precise reflection of risk is needed in contrast to business models where surrender values reflect current market conditions or do not contain any guarantees.

Data quality

Insurance undertakings generally perform analyses on specific parameters, which affect their risk profile and contribute to solvency capital requirements materially. One of these parameters is lapse. Especially, undertakings can differentiate between lapse rates by product line. Furthermore, additional differentiations are often possible: time to maturity or elapsed time since issue as well as other determining parameters e.g. sales channel. Time series exist over longer periods, so that undertakings can monitor on the one hand the trend in lapse behaviour, on the other hand this also allows for quantile analysis over time. Of course, size and complexity of the insurer needs to be taken into account by the principle of proportionality. However, data should be readily available and it is usually of a better quality and reliability than data for other underwriting risks. Naturally, data quality has to be checked and proven by the Actuarial Function in line with other data quality validation and is of course subject to further checks by supervisors.

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Lapse rates in the German market

The lapse rates in the German market vary widely. We can identify the following main drivers

- Product mix, since e.g. savings business often has a higher lapse experience than protection business
- Sales channels
- Maturity of the inforce business

The heterogeneous picture with regard to lapse rates is confirmed by data from the German BaFin which contains quantiles of relative lapse rates and shows a high volatility in time and among companies:

	2011	2012	2013	2014	2015
95% quantile	8.33%	7.68%	7.64%	7.42%	6.94%
75% quantile	5.48%	5.27%	5.19%	4.77%	4.61%
median	4.18%	4.11%	4.01%	3.78%	3.39%
mean	4.70%	4.53%	4.47%	4.10%	3.76%
25% quantile	3.39%	3.33%	3.39%	2.95%	2.70%
5% quantile	1.93%	1.84%	1.80%	1.77%	1.63%

In addition, with general market data available (1975 – 2014) quantiles have been evaluated to review lapse up and down shock. Data shows quantiles of 99.5% at 10.59% and 0.5% at -11.38%. From our perspective, this indicates that the absolute shock parameters currently used in the standard formula might be too high and are certainly not appropriate for a large group of insurance companies.

Overall Solvency Needs

Assessing the overall solvency needs, life insurance companies calibrate the lapse risk according to their specific risk profile. Market experience in Germany tells us that the company specific calibrated lapse risk is usually much lower than the one used in the standard formula.

Conclusion

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Given

- the substantial impact of lapse risk in the European life insurance market,
- the highly company specific characteristics in terms of lapse level and volatility in e.g. Germany,
- the fact that lapse is monitored closely especially in life and health insurance business,
- the experience companies gained calibrating lapse risk when calculating the overall solvency needs and
- the results of the overall solvency needs calculation that suggest that the parameters of the standard formula do not necessarily fit

we recommend introducing the possibility of USP for lapse risk.

Permanent increase/decrease in lapse risk

We consider data concerning lapses as readily available and of very good quality, as lapse and lapse risk are usually subject to a close monitoring in life and health insurance.

Input data and method-specific data requirements

The data for carrying out the undertaking-specific stress calibration shall consist of the following:

- a) data consist of number of lapses and number of total policies potentially differentiated by line of business;
- b) the data are representative for the lapse risk that the insurance or reinsurance undertaking is exposed to;
- c) the data are adjusted for any mass lapse occurrences or outliers to the extent that these risks are reflected in the mass lapse risk;
- d) in case a significant drift in lapse rates over time can be observed, a de-trending is carried out following [FSA04 recital 7.35]
- e) data are available for at least ten reporting years;

Method specification

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In order to calculate the USP for lapse risk we would like to propose the following method. The method is consistent with the shock calibration based on a study of the UK with-profit life insurance market in 2003 performed by the order of the British FSA. The objective is to derive a permanent and maturity-independent shock.

- a) Focus on lapse rates: According to Article 142 of the Delegated Acts, the lapse risk sub-module covers (a) all legal or contractual policyholder rights to fully or partly terminate, surrender, decrease, restrict or suspend insurance cover or permit the insurance policy to lapse and (b) all legal or contractual policyholder rights to fully or partially establish, renew, increase, extend or resume the insurance or reinsurance cover. However, due to the lack of historic data on the use of each policyholder option, the following calibration covers only the pure policy lapses for which data are available. This approach is in line with [FSA04] and [CEIOPS-DOC-42/09, recital C.4].
- b) Data collection following [FSA04, recital 7.34]: Collect crude lapse rate data for at least the last ten years, potentially differentiated by line of business.
- c) Lapse ratio calculation following [FSA04, recital 7.34]: Derive the baseline assumptions using the ratio of the lapse rate in a given year to the corresponding lapse rate recorded in the previous year (short: lapse ratio).
- d) Fit distribution following [FSA04, recital 7.35]: Assume a log-normal distribution with parameters μ and σ^2 for the lapse ratio. Accordingly, we can estimate the parameters by using moment estimators, i.e. calculating the statistical mean and the statistical standard deviation of the logarithm of the lapse ratio.
- e) Validate the fitted distribution using a statistical test like the Q-Q-plot. Calculate the 0.5% and 99.5% quantile.
- f) The quantiles derived in step e) will be used to derive the USP lapse stress by calculating the absolute differences to 100% and using the greater difference for both the up and down shock in order to obtain a symmetrical stress.

Remark following [FSA04, recital 7.36]: Using the historical year on year lapse changes will tend to overstate the variability and thus the standard deviation in the fitted log-normal distribution.

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	<p>According to [CEIOPS-DOC-42/09, recital 3.147] the Polish supervisor used the same approach and documented the same caveat: Quantiles based on an annual deviation overestimate the shock of a permanent change.</p> <p>As the chosen approach is rather conservative, we regard it as appropriate for the derivation of lapse rate USP.</p> <p>For lapse risk, one can consider that the derived shocks are in general suited to calculate the corresponding quantiles of the distribution of the liabilities. [FSA04, recital 8.7-8.9] shows the necessary monotony: The more extreme the capital requirement percentile, the higher the "translated" lapse stress in absolute terms. When calculating USP for lapse risk, companies are supposed to calculate a set of sensitivities that refer to different lapse rate percentiles. The resulting liabilities are supposed to show the necessary monotony.</p>	
7.4		
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7.4.2	<p>Stop Loss USP (paragraphs 438) The section includes a new proposed USPs for stop loss reinsurance. We welcome this, as stop loss covers are becoming quite common. We have not analysed the proposed methodology at this stage but would make the same point as above that applying for a USP is an onerous process and many insurers are not in a position to do so (see 5.3). Again, larger internal model companies are at an advantage.</p>	
7.4.3	Paragraph 451: Typo: should be paragraph 453	
7.4.4		
8.1	<p>See general remarks</p> <p><i>457. In this first response to the Call for Advice EIOPA will only address the request for information from the European Commission and will not yet come up with any advice on possible changes in</i></p>	

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the Delegated Regulation.

EIOPA will continue working on supervisory convergence and, if deemed necessary, may advise changes in the Delegated Regulation in its second response to the Call for Advice.

Regarding the aim of EIOPA:s work and efforts, which was stated in point 457, *we keep it highly important that the following topics should be kept in focus in the future work of EIOPA:*

Level playing field:

We acknowledge that supervisory convergence is of utmost importance to achieve a level playing field for undertakings. This must not lead to an equal treatment that ignores national specifics. It might be recommendable to identify some principles that can help NSAs to consistently assess the adequacy of the application in their particular country.

As every EU member state has its own specialties in their taxation framework and also as the LAC-DT has been interpreted in quite various ways by different NSA's and insurance companies there seems to be a unawareness amongst insurers of the different features and principles of LAC DT. This brings the need of the better clarification of LAC DT to ensure the level playing field. We find several topics where EIOPA could concentrate in their future work with LAC DT to ensure the level playing field. Some of these are already partly covered in this consultation paper:

- Whether a country or company is in a DTA position or DTL position seems to matter a lot
- Having adequate DTL for maximum LAC DT tends to lead to less pressure on LAC DT from future profits (relatively obvious), and only required to show the SII ratio will be back above 100% within 3 to 6 months and recoverability of loss can be shown. Not for LAC DT level as such;
- Different loss carry forward rules have an impact on LAC DT, depending on the maturity these should be taken into account. {
- The meaning of "level playing field" might need to be opened to better understand the issue. Solvency II is a post-tax system and local tax rules have to be applied as they are under IFRS. As this holds true for the valuation (i.e. own funds) as well as for the stressed

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case (LAC DT), there will be different starting positions for companies, which might or might not be an level playing field issue. Furthermore being a post-tax supervision framework means that all fiscal differences must be fairly reflected. This can be quite a burden.

- There seems to be a broad consensus that LAC DT up to the amount of net DTL (t=0) is acceptable (as long as netting DTL and DTA is admissible of course)
- What are (if any) the potential sources of future profits to support DTA (essentially the same in base case as in stressed case)

Complexity:

We find the open questions relating to LAC DT keeping this issue complex. In the future work and analysis, EIOPA could aim at a clarification of the principles behind LAC DT, taking into consideration the unchangeable national frame conditions. A harmonization of the calculation could help to reduce the complexity and take away uncertainty. Complexity is a serious cost-issue, requiring significant key resources, for both regulators and insurers. This will also have an impact on how those insurers with limited resources can comply with the legislation.

Agree on the underlying causes of the LAC DT:

We find that it is utmost important to understand and agree on what is the phenomenon causing LAC DT. The underlying causes of the LAC DT and their subsequent allocation towards the stressed balance sheet results in additional differences between the fiscal valuation and the economic valuation. For instance when there's a change in netDTA it can be caused by :

- temporary differences which will recycle back as long as the balance sheet exposure is maintained on the Economic Balance Sheet,
- actual losses due to effect of the underlying scenarios (for example defaults or lapses) and
- results, which are mandatory, recognised into the period in which they materialise.

The various causes will require a different approach in the recoverability assessment based on the going concern assumption. Whether an insurer recognised all three causes depends on the actual fiscal legislation and treatment of changes in valuation, which might differ per Member State.

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Commission on specific items in the Solvency II Delegated Regulation**

**Deadline
31 August 2017
23:59 CET**

	<p><u>Agree on a common language:</u> It seems that EIOPA have already started their work by opening up several of the different features. Anyway, any misleading approaches to describe the phenomenon need to be corrected. This would also help stakeholders to be better prepared to discuss and understand the issues around LAC DT:</p> <ul style="list-style-type: none"> - It should be avoided to use "LAC DT from future profits" as also LAC DT supported only by DTL is supported by future profits, but essentially future profits exist in the SII metric already at t=0. The crucial point with DTA is, that one has to prove that it is probable that future taxable profit will be available, against which the deferred tax asset can be utilized. It could rather write as "LAC DT from DTA" (or something similar). - Losses. As LAC DT is not about the tax authority physically transferring money to the insurer, it seems fairer to describe these losses as opportunity losses. They are relative 'losses', compared to a fictive 'gross shock' situation in which the insurer would pay more taxes. <p><u>Technicalities behind the calculation of future profits:</u> Already highlighted by EIOPA but should be recognized even more. The overall principles behind the valuation of future profits and the rationale when, how and in which circumstances this calculation should be explained in insurers' solvency report. In addition, principles behind some specific details, e.g. what kind of management actions, needs to be commonly agreed.</p>	
8.2		
8.2.1		
8.2.2		
8.2.3		
8.2.4	<p>It is not clear why a stand-alone comparison with the treatment of DTA in banking (stress tests) is relevant. Stress tests cannot be assessed purely on the methodology of computing the results, but also on the nature of the business, the size of the stresses and the criteria used in assessing the results. Indeed, these are jointly determined and are interrelated.</p>	

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8.3	<p>Assessing the term instantaneous one would assume that the shock occurs at the reference date in order to account for incurring the loss in the own funds. The question then arises whether, for intra-year reference points, the already accumulated tax results are to be included in the recoverability assessment. Because the result for the year up to the reference point is already recognised after which the shock scenario is applied. Otherwise, the scenario exceeds the 1-200 requirement.</p> <p>In the guidelines of EIOPA, reference is made to fiscal unity (guideline 9). However, the statements made do not actually align with the concept of fiscal unity in the various Member States (esp. 1.28). For example if not, losses are transferred, but actually, profits are transferred ensuring the non-payment or reduced payment of taxes within a fiscal unity. A group is able to transfer profits to that entity within the fiscal unity that allows an optimisation of the tax payments. Due to the guidelines of EIOPA, the concept of fiscal unity is not recognised which is contrary to the fiscal legislation.</p>	
8.4	<p>Considering the large number of undertakings across the countries, it might be an approach to start with an analysis of correlations. It cannot be assumed to be sufficient if these correlations are derived from one the Day One templates only. At least a validation using the annual QRT 2016 is indispensable.</p> <p>Besides this, an identified correlation is not necessarily an indicator for causality. A careful analysis of the data is necessary.</p> <p><i>According to paragraph 478 EIOPA hypothesises that five factors may influence the amount of LAC DT; the applicable tax rate, other elements of the tax regime, the net DTL on the balance sheet, the size of the undertaking and the solvency ratio. Other elements of the tax regime are the carry-back and carry-forward possibilities. There may be even more elements of the tax regimes that imply differences in LAC DT across the EEA, but these are left out of this analysis as data on these other characteristics are not readily available.</i></p> <p>EIOPA acknowledges that differences in LAC DT can be implied by more elements. As these elements are not readily available, they are left out. This affects significantly the quality of the analysis. Especially lines of business offered by the undertaking, the requirement of policyholder</p>	

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	<p>participation, and the existence of surplus funds and similar can be of relevance in this context.</p> <p>One interesting remark is that the LAC DT % exceeds the Tax Rate % for Luxembourg. What is the rationale behind this?</p>	
8.4.1	When assessing the tax regimes an overview how results are recognised under fiscal legislation would also provide a valuable insight in the development of the nDTA on the economic balance sheets.	
8.4.2		
8.4.3	<p>The heading of Figure 10 suggests that it captures net DTL / LAC DT in Table 8. However, there are no negative numbers for net DTL / LAC DT in Table 8. What is the reason?</p> <p>Why is Figure 10 presented at the country level and Figures in 8.4.4 / 8.4.5 at the entity level? The correlations mentioned in 490 refer to entity level. A figure on the entity level might be interesting.</p>	
8.4.4	<p>Regarding 492, the correlations contradict the hypothesis. The 'possible explanation' makes intuitively sense, but we do not see how it relates to the contradiction.</p> <p>Regarding 493, Figure 11 is presumably a typo. Shouldn't this be Figure 12?</p>	
8.4.5	<p>We read section 8.4.5 and the size coefficient in 8.4.6 as indicating that smaller companies need more time (have more difficulties) coming to terms with LAC DT.</p> <p>496: Typoto influence of the amount....</p>	
8.4.6	Regarding 507, rather than do a more detailed study on these data, it may be more useful to include data for a year later, and analyse changes.	
8.5		
8.5.1		
8.5.2	Regarding 513, we agree that information about the role of carry-back would be helpful for comparative purposes.	
8.5.3	Regarding non-life business, future profit is only allowed for the part included in premium reserve	

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	calculation. There is no DTL in the balance sheet for 1-year non-life insurance.	
8.5.3.1		
8.5.3.2	New business is identified as a possible source to demonstrate the likelihood of future profits post a shock event, which seems appropriate. However, paragraph 534 suggests that premiums received beyond the contract boundary (as defined for technical provisions) would not be eligible for recognition in the LACDT calculation. This seems inconsistent - premiums received outside contract boundary should be considered as well as new business. In many instances, the contract boundary is immediate based on the SII rules but premiums would be expected to be received beyond the boundary (based on experience analyses) and in many cases this is more certain than new business. In addition, it should be noted that in IAS 12 new business is allowed which might have a link to this also.	
8.5.3.3	Ad i. To handle uncertainty about future returns, the concept of the Risk Margin can perhaps be expanded. It could include a cost of capital for the uncertainty of future returns. Alternatively, the concept of LAC DT can be expanded with a Risk Margin like term. Ad ii. The concept of 'pull-to-par' seems analogous to 'dynamic VA'. If an internal model has been approved with such characteristics, pull-to-par is a given. Ad iv. It seems like an UFR drag and a VA drag are inconsistent with current EIOPA valuations. Ad vi. The release of the Risk Margin (a risk premium on the liability side) seems to be treated differently from risk premiums on the asset side. There is no double counting of the risk margin. The risk margin is initially taken out of equity / included in technical liabilities.	
8.6		
8.6.1	When judging whether compliance with MCR / SCR should affect the calculation some simple measures should be allowed to mimic the way companies' recovery systems work on possible Allowance of capital inflows, risk mitigation framework, management action plans and capital tiering rules.	

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