	Comments Template on Discussion Paper on the review of specific items in the Solvency II Delegated Regulation	**Deadline 3 March 2017 23:59 CET**
Name of Company:	Allianz SE	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
	Please follow the following instructions for filling in the template: ⇨ 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 empty. ⇨ Please fill in your comment in the relevant row. If you have no comment on a paragraph or a cell, keep the row empty. ⇨ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. **Please send the completed template, in Word Format, to CP-16-008@eiopa.europa.eu** **Our IT tool does not allow processing of any other formats.** The numbering of the questions refers to the discussion paper on the review of specific items in the Solvency II Delegated Regulation.	
Reference	**Comment**	
General Comment	We appreciate the opportunity to provide feedback on the discussion paper on specific items of the Solvency II Delegated Regulation. In general we support the observations made in the feedback of the CRO Forum, Insurance Europe and the German Association of Insurers (GdV). In the following, we provide additional comments on selected specific issues.	
Q1.1		
Q1.2		
Q1.3	Yes it is a relevant factor, especially for insurance groups or companies writing international business.	

Q1.4		
Q1.5		
Q1.6	We agree with the opinion given by Insurance Europe and GDV that this sub-module is immaterial for PC and that it should be considered to be removed.	
Q1.7	The shock for lapse mass risk is unrealistically high in comparison to our internal analysis; there is no historical evidence (in Germany) to support a scenario where in excess of 40% of the portfolio lapses within one year.	
Q1.8		
Q1.9	The regulations should include lump-sum as part of the lapse risk module and describe how standard surrender and lump-sum shock can be combined into one.	
Q1.10		
Q1.11	Yes it is a relevant factor, especially for insurance groups or companies writing international business.	
Q1.12		
Q1.13	We agree with the opinion given by Insurance Europe and GDV that this sub-module is immaterial for PC and that it should be considered to be removed.	
Q1.14		
Q1.15	Regarding segmentation of insurance contracts covering disability (“Berufsunfähigkeit”), a simplified approach on how to distribute the risks among the health and life sub-modules could be very helpful. Moreover, if the unbundling of such insurance contracts is below materiality threshold or technically not feasible, a simplified approach to include all risks within the life module should be possible.	
Q1.16		
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Q1.18		
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Q1.20		

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Q1.24		
Q1.25		
Q1.26	There should be a possibility for undertakings to increase the SCR by an additional buffer in order to reflect residual risks / business not captured by the standard model without having to apply for a (partial) internal model. Absolute or relative thresholds may be set to prevent misuse.	
Q2.1	We are in favor of rewording Article 4, allowing for the use of internal rating models, which are acknowledged by local regulators for calculating regulatory capital requirements (e.g. acknowledged for SII internal modelling purposes), for the calculation of the SCR according to the standard formula. However, the usage of external ratings must not be restricted or impeded and the usage of internal ratings should not be mandatory.	
Q2.2		
Q2.3		
Q2.4	We are in favor of rewording Article 4, allowing for the use of internal rating models, which are acknowledged by local regulators for calculating regulatory capital requirements (e.g. acknowledged for SII internal modelling purposes), for the calculation of the SCR according to the standard formula. However, the usage of external ratings must not be restricted or impeded and the usage of internal ratings should not be mandatory.	
Q2.5		
Q2.6		
Q2.7		
Q2.8		

	Comments Template on Discussion Paper on the review of specific items in the Solvency II Delegated Regulation	Deadline 3 March 2017 23:59 CET
Q2.9		
Q2.10		
Q3.1		
Q3.2		
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Q3.9		
Q3.10		
Q3.11		
Q3.12		
Q4.1		
Q4.2	From our perspective, especially one aspect of Delegated Regulation (EU) 2015/35 with regards to the use of financial derivatives as risk-mitigation technique under the standard formula warrants adjustments to market practice: The requirement that the replacement of the risk-mitigation technique shall not take place more often than every three months, see Article 209(3) regarding rolling hedge arrangements, can run contrary to market practice. For example, FX hedging strategies usually use derivatives with shorter than three months original maturity and/or can also require a more frequent rebalancing based on market movements of the hedged exposure. Given an appropriate back- and stresstesting of such rolling hedge arrangements, we see no reason not to take into account effective rolling hedges with derivatives of shorter original maturities and/or with more frequent rebalancing when calculating the Solvency Capital Requirement under the standard formula. This should be reflected in an updated version of Article 209(3).	

	In addition, we suggest to make the reasoning of the pro rata temporis approach stipulated in Article 209(2) for the risk-mitigation effect of derivatives with shorter than 12 months maturity outside of rolling hedge arrangements according to Article 209(3) more transparent: While the negative market value change of e.g. a three month equity future long position fully enters the Solvency Capital Requirements the positive market value change of a three month equity future short position is only partially recognized. Given the instantaneous shocks assumed in the standard formula, see recital (72) of Delegated Regulation (EU) 2015/35, this asymmetric treatment should be further detailed.	
Q5.1	In general we agree with the Insurance Europe opinion not to change the definition. Changing the definition in such a way would extend the volume measure for one year contracts beyond the 1-year horizon. This would not be in line with the calibration objective of Solvency II (article 101(3)). Nevertheless for multiyear contracts the gap is questionable as some parts of the future premiums are excluded. The correctness of this approach is dependent on the underlying calibration of the market parameters. Furthermore it is difficult for PC companies to select the “initial recognition date” (IRD) from data systems. The definition of the IRD should be enhanced and possible approximations such as contract commencement date (CCD) set equal to the IRD should be explicitly allowed. This approximation would also be favorable to one-year contracts in combination with the FP definition (consider an automatically renewed 1-yr contract in year N+1 where IRD doesn’t equal CCD, the exclusion of “premium to be earned during the 12 month after the IRD” would lead to only partial exclusion of the premium earned in N+2).	
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Q6.1		
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Q7.9	In general a clear documentation on the calibration of the risk factors is required to understand the impact of single factors such as contractual limits. The Czech regulator has published its opinion in which it has forbidden to apply the recital (54) of DA that sum insured should be adjusted for contractual limits for Nat Cat. The sum insured without any adjustment should be used instead as the exposure. The main argument was that the contractual limits are already incorporated in the calibration of the Standard formula for Czech. We support a recalibration of the Czech Nat Cat sub-modules which would allow for applying the recital (54) of DA and also publishing detailed information how the calibration was carried out.	
Q7.10	Years with significant clustering component were 1990 and 1999. Those are already implicitly included in the SM calibration.	
Q7.11		
Q7.12	No. We performed a study that showed an immaterial European-wide impact on risk capital. It is expected that the effect is already implicitly accounted for through the country windstorm estimations and cross-country correlations.	
Q7.13		
Q8.1		
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Q9.1		
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Q9.5		
Q10.1	The Lee-Carter methodology has become the standard stochastic model for projecting the future mortality both in the actuarial literature and in the insurance industry. The Lee-Carter method is regarded as the simplest and the most robust currently available and has been successfully applied in the internal model of Allianz.	
Q10.2	The calculated capital requirements are clearly dependent on the choice of the model. The advantages, limitations and key assumptions of the Lee-Carter model are well understood which allows for a better understanding of the model and parameter risk. Furthermore, the model chosen is practical, transparent, flexible and more realistic than the current model.	
Q10.3	Generally, adding additional assumptions may increase the complexity and uncertainty of the model. The calibration should be processed based on the available data. Nevertheless, the scientific development in demographic research should be carefully analyzed. Furthermore, additional assumptions can be included in the existing data. For instance in the Best Estimate mortality table published by the German actuarial association (DAV 2004R) an assumption on the future mortality has already been included.	
Q10.4	The two sources of mortality data mentioned in the paper are of good quality. Additionally, the data from national statistical offices could be included in the process, since it might be of greater	

	granularity and hence might increase the understanding of the data from the proposed sources.	
Q10.5	The best solution would be to calibrate the model to the specific portfolio in question. In practice, the industry data (see DAV 2004R in Germany) may be considered together with modifications taking into account the specific portfolio. When calibrating to population data a basic risk might be considered for which additional risk capital could be necessary.	
Q10.6	The granularity of the model should be consistent with the Best Estimate assumption. Again, a greater granularity leads to higher complexity of the model. The materiality of the possible misestimate could be controlled by calculating sensitivities with respect to different choices of granularity.	
Q10.7	The current calibration of the longevity/mortality risk stress factors is considered to be in line with the 99.5% VaR and a one-year time horizon. The same assumption would hold for the approach described in the paper for the longevity/mortality risk. Moreover, the Lee-Carter model provides the full distribution of life expectations.	
Q10.8	The proposed calibration process still produces the shocked mortality table to calculate the longevity risk in the standard model. The cash flow model behind the calculation of the SCR remains unchanged and is independent of the choice of the mortality table.	
Q10.9	The cross effect between longevity and interest rates can be very important dependent on the local contractual specifics and should then be considered in the model. It could be captured in terms of correlation included in the risk aggregation process.	
Q10.10	Again, the current stress factors used to estimate the longevity/mortality risk in the standard model are considered to be in line with the 99.5% VaR and a one-year time horizon. The same would hold true for the discussed approach. The cash flow model used for the determination of the SCR for the longevity risk should be seen as a monotonic transformation of the mortality distribution from the Lee-Carter method into the own funds loss distribution.	
Q11.1		
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Q11.5		
Q11.6		
Q11.7	We agree with the GDV opinion that calculating GSP based on aggregated data is not appropriate for groups.	
Q11.8	An alternative method would be to calculate GSP as a weighted average of USPs.	
Q11.9		
Q12.1		
Q12.2	**Variance of the loss distribution** Art. 201 (2) of Commission Delegated regulation (EU) 2015/35 provides the formula for calculating V_{inter}. Paragraph 2a says that "the sum covers all possible combinations (j,k) of different probabilities of default on single name exposures in accordance with Article 199". In Art. 201 (2a) it is not fully clear whether summands j=k should be excluded from the sum (i.e. the sum is only over different (j,k) probabilities, meaning all fields in a matrix except the diagonal), because of the word "different" in front of "probabilities of default". In our view, the word "different" intends to make clear that identical PDs that apply to different single name exposures are only considered once for purposes of the sum, which is also consistent with Art. 201 (3) (a) where the term "different probabilities of default" is used as well. This is also in line with the counterparty default risk helper tab provided by EIOPA for the Long Term Guarantee Assessment (LTGA) run, which showed an implementation of the formula in Art. 201 (2) that included the summands with j=k. Suggestions: It should be made clear that the sum in Art. 201 (2) also includes the summands where j=k.	
Q12.3	The classification of mortgages in CDR in §191 is too complex. It should be simplified.	

	Tax receivables Art. 199 (8) of Commission Delegated Regulation (EU) 2015/35 states that "[type 1] exposures to counterparties referred to in points (a) to (d) of Art. 180 (2) [on exposures receiving a 0% risk factor in the spread risk sub-module] shall be assigned a probability of default equal to 0%", which effectively results in a counterparty default risk charge of zero for type 1 exposures to Member States' central governments. Exempting such type 1 exposures from a capital charge in the counterparty default risk module is obviously in line with the treatment in the spread risk and concentration risk sub-modules. However, tax receivables due from Member States' central governments currently cannot be classified as type 1 exposures in the counterparty default risk module, since such exposures are not referred to in the closed list of type 1 exposures in Art. 189 (2).Therefore, when following the regulation literally tax receivables due from Member States' central governments need to be classified as type 2 exposures according to Art. 189 (3), which states that "type 2 exposures shall consist of all credit exposures which are not covered in the spread risk sub-module and which are not type 1 exposures". Once classified as type 2 exposures a capital charge of 15% applies to the exposures concerned (see Art. 202). We have the opinion that when following the regulation literally tax receivables due from Member States' central governments are disproportionately penalized compared to type 1 exposures towards such counterparties, which receive a capital charge of zero. Therefore, we suggest clarifying the treatment of tax receivables. Suggestions: Tax receivables should either be included in the list of type 1 exposures in Art. 189 (2) or the regulation should explicitly exempt from a capital charge type 2 exposures that are tax receivables due from Member States' central governments.	
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Q14.1	DA 2015/35 Art. 184 (2) (b) states that exposures to a counterparty which belongs to the same group shall be excluded, provided that the conditions as outlined in DA 2015/35 Art. 184 (2) (b) are met. Condition (v) ("there is no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities from the counterparty to the insurance or reinsurance undertaking") should be either removed or simplified and clarified. The assumption should be that in general this condition is always met since a literal interpretation would e.g. require that the calculating (re)insurer has to be able to withdraw its entire equity investment in a subsidiary (re)insurer within a short time frame, which is highly unrealistic.	
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Q15.1		
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Q15.4	The prohibition of netting out negative and positive risks is very conservative and unrealistic, for both, solo and group levels.	
Q16.1		
Q16.2		
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Q16.6	We like to stress that the look-through approach is a concern not only for investments backing unit-linked business and the discussion triggered by this paper should generally address the topic and should not be limited to unit-linked business.	
Q16.7	We support the opinion of GDV that additional guidance is needed on the application of the look-through approach in different cases. In the current strict wording of Article 84 the application of the look-through approach is excessively burdensome and in many cases insurers are only left with the alternative of the type 2 equity sub-module which is not appropriate.	
Q16.8	We support the opinion of GDV that Article 84 of the Delegated Acts should be amended to allow for additional simplifications of the look-through approach.	
Q16.9	We like to question the only alternative modelling of investment funds as type 2 equity exposures. Here, the shock level is calibrated by application of the symmetric adjustment which is created to offset equity market movements. There is no evidence to support the application of the symmetric adjustment for investment funds (especially fixed income funds).	
Q17.1	We would like to point out two inconsistencies between the valuation methodology and the SCR calculation which should be addressed in the review of the interest rate risk sub-module:	

	1) Valuation is done using market rates until last liquid point and then extrapolating to the UFR. The interest rate risk calculation should be consistent with the valuation methodology so that extrapolation to the UFR also applies under shock scenarios. 2) Given the fact of negative risk free rates it does not seem to be appropriate to exclude shocks on negative rates as required by Article 167 (2) DA.	
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Q17.16		
Q18.1	The calculation of deferred tax liabilities (DTL) and deferred tax assets (DTA) in the SII balance sheet is a straightforward application of the principles contained in IAS 12. The following topics should be considered for LAC DT calculation: - Automatic reversal of DTA: In case DTA's underlying deductible temporary differences reverse in the future without negatively impacting future taxable income, no taxable income is necessary to prove the recoverability of automatically reversing deductible	

	temporary differences. For example it can be assumed that DTA on risk margin or on losses related to HTM assets will reverse automatically with the ending of the insurance contract or with the repayment of the bond at due date. - Sources of taxable income: For DTA recoverability testing all sources of taxable income can be taken into account: o Tax groups or other tax specialties allowing taxable income consolidation and transfer of taxable income between the members of a tax group/consolidation vehicle have to be considered when analysing existence of future taxable income. o Taxable income can be sourced by business in force and new business	
Q18.2	The assumptions on the returns on assets and liabilities should be realistic and reasonable. Available market information and experiences from the past should be taken into account when assessing the return on assets. A general assumption that return on assets have to be calculated based on a risk neutral assumptions is not in line with reality.	
Q18.3	The uncertainty in the returns of assets in the calculation of the LAC DT is already considered in the market consistent valuation of assets at the calculation date. The return on assets over the duration of the existing business is stable and certain and there is no need to make any adjustment for uncertainty. Over time, economic taxable profits will be realised, which can be used to recover notional deferred taxes. These future profits are expected from earning an investment margin on invested assets over and above the discount rate included in the Solvency II balance sheet and funding costs. We do not consider that it would be appropriate to limit the expected return to the shocked risk free rates.	
Q18.4	As a principle, the recoverability testing of DTA has to be based on the future taxable income calculated in compliance with the company's applicable tax code and taking into account the reversals of existing temporary differences. According to IAS 12, the future taxable income has to be adjusted (increased) by deductible temporary differences which reverse and therefore reduce taxable income. Additionally, future	

	taxable income leading to new deductible temporary differences has to be eliminated . In order to assess, which existing deductible temporary differences reverse and which new deductible temporary differences arise assumptions of how tax and economic income will develop in time and impact the reversal of temporary differences need to be made. To avoid an assumption based approach it is possible to offset the gross DTA which have to be proven to be recoverable (not the ones which will reverse automatically without impacting taxable income) with existing DTL. For the potentially remaining net DTA it is sufficient to take into account as future taxable income the future economic profits from new business adjusted by permanent differences.. When calculating future taxable economic profits stemming from new business, it is possible to take economic new business values instead of economic P&L's. This is in line with the valuation principles and in consequence with the calculation of DT in the MVBS (base case). When calculating the LAC DT itself not all losses from the shock will materialize in tax losses. Depending from the respective local tax regulation, some shock losses will trigger real tax losses, some will only trigger deductible temporary differences. With respect to emerging deductible temporary differences there are some which will trigger real tax losses in the future upon reversal and some which will not trigger real tax losses in the future (e.g. risk margin, HTM assets, see point 18.1). Nevertheless, all DTA resulting from the shock loss, either resulting in DTA on tax loss or in DTA on temporary differences result in LAC DT based on the balance sheet approach underlying IAS 12.	
Q18.5	Taxable income stemming from new business, which is not yet reflected in the MVBS/stressed MVBS has to be considered because even after a shock new business and in consequence taxable income will be available based on going concern assumptions. In order to reflect the impact of the shock on new business, new business prospects should take into account the impact that the stressed environment has on the sale volume and returns of new products. E.g. the return of P&C products are less affected by interest rate volatility, and there may even be an increase in premium rates and profitability following large P&C loss events. For life business the impact of revised product design on returns need to be assessed at is likely that loss experience will be	

	compensated by the design of new products. In addition, when taking account of new business in the calculation of the LAC DT, a fundamental consideration is the extent to which the relevant business would be able to recoup the shock loss and hence be able to write new business. This requires consideration of the basis on which the business in question can take management actions to improve its capital position (including whether it can be recapitalised). We expect that the European insurance businesses would take appropriate management actions (including if necessary recapitalisation) following a shock loss. We do not consider that it would be appropriate to assume that the whole of the European insurance industry would go into run-off and be unable to write any new business. There is empirical evidence available to demonstrate that following large losses, insurance capacity is reduced resulting in increasing premium rates and hence a recovery in insurance profitability. Some level of new business must therefore be assumed, based on appropriate management actions (including recapitalisation). Consideration of profitability levels post SCR event can be based where possible on historic experience (e.g. industry reaction to past CAT events).	

Q18.6	- New business projections before shock as basis for taxable income
	- New business projections after shock for taxable income
	    o Going concern assumptions
	    o Impact of shock per risk source
	    o Recovery patterns (e.g. premium increases after a loss event, reversal of market shocks)
	    o Appropriate Management reactions (product change and corresponding profitability, cost reduction, etc.)	

Q18.7	An arbitrary time limit on the time horizon should not be imposed as this does not reflect reality. In addition, the time horizon must also reflect the local tax regulations in the relevant jurisdiction. For example, in certain jurisdictions losses may expire, but in other jurisdictions the tax deduction arising from a loss may be delayed (for example until payments are required to be made to	

	policyholders). The time horizon used must be that one required by the local tax regulations in the relevant jurisdiction.	
Q18.8	Please refer to Question 18.7.	
Q18.9	Although limiting the LAC DT to the amount of net DTL is a conservative and simplified approach which should be allowed, the following points are not taken into account: 1) Going concern is not taken into account. . Setting the LAC DT to the amount of the net DTL effectively assumes that no future returns on assets and liabilities would be earned, and no future new business would be written by the business in question (and by extension the whole of the European/EU industry 2) The net DTL does not necessarily reflect the true future taxable income against which the shock loss can be offset. The net DTL may reflect DTAs that will reverse in the future without negatively impacting future taxable income (e.g. reversal of risk margin and spreads).	
Q18.10	Please refer to Question 18.9. No other issues should be considered.	
Q18.11	To calculate a post-shock Solvency II Balance sheet can be insightful in determining the effect of shocks on the carrying amount of assets and liabilities and tiering limits and in showing which part of the LAC DT will result in instantaneous taxable losses and which part is still deferred post-shock. It will help in assessing the recovery measures to be taken (to reach again 100% SCR post-shock) and assessing their effects and in determining the basis for the sources of future taxable results. However, as there are many uncertainties surrounding a post-shock Solvency II Balance sheet (for instance how to determine a post-shock SCR and how to distribute shocks to certain assets and liabilities in internal models) and the insights as described above can also be gathered differently, the creation of a post-shock Solvency II Balance sheet should not be prescribed.	
Q18.12	Please refer to Question 18.13.	
Q18.13	Recapitalization (after breaching SCR or MCR) can be relevant to support future earning capacity to support the LACDT.	

	For example through assumptions of excess earnings on assets (recapitalization will generate excess return). Also this should prevent the need of other measures (like derisking) which would undermine the pull to par argument for the (larger part of the) spread shock. The possibility to make use of recapitalization should be in line with the recovery plan. In addition, we would promote an approach that, when planning the profits (post SCR event), there is consideration of the fact that there is potentially a longer period of SCR recovery allowed by the regulator, when it comes to industry wide events (Article 138 of S II Directive). A blended approach to determining the SCR recovery period could be applied taking into account whether company specific events of industry events are driving the SCR. We would welcome a standardized approach to this assumption on the deemed recovery period to SCR for industry wide events.	
Q18.14	No additional regulation, guidance or simplification is required.	
Q18.15	We do not promote a number of mandatory simplifications in the required tax modelling across the EEA. As the types of losses incurred will vary across firms and the fiscal regimes are country specific, an overly uniform approach could inevitably lead to unrealistic outcomes. The tax model and assumptions presented by individual firms should take into account such specificities and member state regulators should review if the proposed modelling fits for the individual firm, given its circumstances.	
Q18.16	The calculation of the LAC DT introduces significant elements of procyclicality because of the volatility of the differences between market value of assets and liabilities and the corresponding values that are recognized for tax purposes and that are more often linked to historical/acquisition or amortized cost. To limit its effect, it is important to avoid introducing methodologies or requirements characterized by rigidity or artificial restrictions that would amplify the procyclical effect.	
Q19.1		
Q19.2		
Q19.3		

Q19.4		
Q20.1	While the analysis of the different regulatory texts is thorough, it should be put into context of the broader regulation. Hence, the following important aspects should also be noted: ▪ *<u>There is a significant risk that the insurance Principal Loss Absorbency Mechanism ("PLAM") leads to a reduction of the SCR ratio</u>.* The insurance PLAM may not cure the trigger breach**.** In fact, both write-down and conversion can even lead to a **reduction** of the SCR ratio under certain circumstances. Please refer to the answer to Q20.4 for a more detailed explanation. ▪ *<u>Bank regulators increasingly understand the importance of the hierarchy of capital:</u>* Bank regulators appreciate that not only equity, but also bank Additional Tier 1 ("AT1") are sensitive instruments that signal strength or weakness to investors. While bank regulators want to ensure early loss absorbency, they want to do it constructively by e.g. considering the hierarchy of capital with respect to distributions (AT1 coupons are to be preferred to equity dividends). With this in mind, we believe that a desirable insurance PLAM not only achieves loss absorbency, but respects the hierarchy of capital, and does not worsen the SCR ratio. ▪ *<u>Insolvency</u>***:** The Delegated Regulation ("DR") effectively stipulates significantly tighter insolvency triggers than the Capital Requirements Regulation ("CRR"). For example, the DR requires that all of Restricted Tier 1 ("RT1"), Tier 2 ("T2") and Tier 3 ("T3") contain a mandatory coupon deferral (T2, T3) or cancellation (RT1) trigger as well as a mandatory redemption deferral (or prohibition of early calls) to avoid insolvency due to illiquidity or breach of the asset-liability test (where applicable). The CRR does not require any such triggers for Tier 2 or AT1, and only requires AT1 to be treated as equity for purposes of the asset-liability test. ▪ *<u>Absence of a meaningful and systematic definition of "loss"</u>*: While principal and coupon "loss absorbency" are key requirements for Solvency II own funds instruments, there is no explicit definition of "loss". A "loss" that triggers PLAM, for example, occurs when capital requirements exceed own funds. However, this may occur at a time when no loss in its classical sense (e.g. under local GAAP or IFRS) has occurred. Similarly, it cannot be ruled out that such accounting profits coincide with a breach of the SCR/MCR ratio. Solvency II does not provide for a "market based" profit and loss account (only a Market Value Balance Sheet	

	(“MVBS”)), and a “loss” derived from such a profit and loss statement would not be a sufficient “loss” concept either as it only explains a reduction of own funds, while own funds may fall even though the ratio increases (via an over-compensating reduction of the SCR/MCR). Accounting losses do play a role for RT1 coupon cancellation (available distributable items) and the write-up. In case of write-up, there is a clear asymmetry to the write-down which solely depends on a Solvency II ratio breach. We question that a sensible PLAM can be designed in the absence of a clear concept of “loss” – as well as a clear view on what “loss absorbency” really aims to achieve. In this context there should be a clarification that the concept of “loss absorbency” does not refer to accounting losses but undercapitalisation. ▪ *Temporary relief from Tiering limits to prevent cliff effects:* The current limit of RT1 at 20% of eligible Tier 1 can have adverse amplification effects for insurers which can be meaningful due to the combination of significant investment portfolios and a substantially mark-to-market regulatory regime. Resulting problems can be resolved by (i) raising the RT1 limit, and/or (ii) explicitly allowing the limit to be breached during periods of elevated market volatility as such periods can impact insurers’ own funds, and consequently the RT1 allowance, negatively. This would be in line with recent recommendations from the EBA with respect to the increased market volatility introduced by the new minimum requirements for own funds and liabilities eligible for bail-in (MREL). The comments in the final MREL Report regarding potentially negative consequences of coupon suspension also strongly support our view that the SII coupon suspension trigger should not be raised.	
Q20.2	▪ *Insurance own funds instruments are characterised by contractual provisions which add considerable cost and risk of adverse unintended consequences for little regulatory benefit*. Examples include the following: o ***Prohibition of extraordinary call rights in years 1-5 without replacement:*** all early calls require prior regulatory approval. It does not make sense to generally prohibit calls without replacement in cases where both regulator and issuer agree that a replacement is not necessary. See our answer to question 20.7-20.9 for further information. o ***First Call right - appropriate margin (RT1 – DR Art. 71 (1) (g)):*** The age of an	

	instrument should be irrelevant for the decision whether or not it is appropriate to call it. Art. 71 (1) (g) DR should be replaced with more generally applicable approval EIOPA (Level 3) guidelines for regulators which could reference the respective issuer's level of the solvency ratio as well as its capital policy and plans. ▪ *We also suggest improved wording of some clauses in Art. 71, 73:* o Redundancy of the redemption waiver in Art. 71 (1) (k) (and identical provisions for Tier 2 and Tier 3) in view of Art. 71 (2). o The wording of Art. 73 (4) (step-up), even though it is based on the UK's Genpru rulebook, is unnecessarily complicated and lengthy. o Unclear terms / clauses such as *repurchase, redemption, and repayment* should not be used synonymously as they have differing economic consequences for the insurer. The terms should be clearly differentiated and be defined in a consistent and clear way without changing the regulatory intent of the relevant articles in the DR.	
Q20.3	▪ Extraordinary call rights should in principle be possible for RT1, T2 and T3 without replacement at all times (incl. first five years), subject to prior regulatory approval. Where necessary, issuers may obtain approval to call only based on the condition of prior replacement (of course with own funds of appropriate – potentially even higher – quality) ▪ Art. 71 (1) (g) DR should be replaced with more generally applicable EIOPA (Level 3) guidelines based on which regulators should grant approvals.	
Q20.4	▪ **PLAM is not required by Basel 3 for equity accounted bank AT1:** While the CRR requires PLAM for European bank AT1, PLAM is not required in many non-European jurisdictions, notably the USA. The original Basel 3 paper only requires PLAM for IFRS debt accounted AT1 instruments (Basel Committee on Banking Supervision, "Strengthening the resilience of the banking sector", No. 89, criterion 11, December 2009). ▪ **The banking and insurance PLAM are actually identical:** The bank and insurance PLAM mechanics as defined by the CRR and DR both allow (or do not prohibit) a choice between temporary or permanent write-down and conversion. Both should lead to the same consequences (see Art. 54 No. 1(d) CRR which requires the reduction of (i) distributions, (ii) claim in liquidation and (iii) redemption amount for the banking PLAM). However, in practice,	

bank and insurance PLAM lead to rather different consequences.

- **The consequence of bank and insurance PLAM are different due to a combination of factors:** Despite identical mechanisms the PLAM impacts bank solvency ratios very differently to insurance ratios. This is mainly due to the following reasons:
  - *Scope of trigger – justifiable difference, but need to consider consequences for the insurance PLAM therefrom:*
    Banking uses a Core Equity Tier 1 (“CET1”) trigger (CET1 / Risk Weighted Assets (“RWA”)), insurance uses a total capital trigger ((Unrestricted Tier 1 (“UT1”) + RT1 + T2 + T3) / SCR). The bank (CET1) trigger ratio will always improve due to the PLAM. In insurance, the PLAM will always increase the amount of UT1 capital, too. In insurance, however, the key regulatory ratio is the SCR (total capital) ratio. Therefore, the insurance PLAM trigger is rightly based on the SCR (total capital) ratio. However, this trigger ratio can either improve, remain unchanged **or even fall** upon application of the PLAM (which we will explain further below). Bank AT1 allows the **mathematical limitation of the write-down** amount to the amount needed to cure the trigger breach. This is not possible in insurance. The need for multiple (group and solo, SCR and MCR) triggers makes it possible that the PLAM does improve one or more of the trigger ratios, but actually leads to the deterioration of one or more of the other trigger ratios at the same time, thus possibly even **leading to an additional trigger breach**.
    The differing scope of triggers in banking and insurance is justified by the different business models and the consequently differing regulatory regimes. However, it cannot be justified that, as a result of applying the bank PLAM without adjustments, the insurance PLAM may not lead to a cure of the trigger ratio, may therefore be unlimited and may even result in the breach of other ratios defined by the trigger.
  - *Role of DTA – justifiable difference, but need to consider consequences for the insurance PLAM therefrom*: Both known PLAM mechanisms (write-down and conversion) can lead to adverse tax effects, i.e. profits from PLAM can lead to (i) a reduction of DTA (and reduction of UT1/CET1), (ii) an increase of DTL (and reduction of UT1/CET1), or (iii) (least likely) an immediate tax expense (and reduction of

	UT1/CET1). Both bank and insurance regulation require the deduction of net DTA from the highest quality of own funds (i.e. from CET1 or UT1 respectively).The difference is that in insurance, net DTA can be added back to own funds as Tier 3, subject to a limit (15% of the SCR). o The MVBS requires that all balance sheet line items are marked-to-market. Consequently, the MVBS is very sensitive to such market changes, and therefore the inclusion of DTA as Tier 3 own funds (up to a limit) is both important and sensible. Net DTAs are a welcome volatility dampener of insurance solvency ratios, which are nevertheless significantly more volatile than those of banks. **The different treatment of DTA in banking and insurance is justified, in our eyes.**However, the different role of DTAs (T3) in the banking and insurance regimes does mean that the impact of PLAM differs, too. Assume that a PLAM results in a fall of DTA (and thus in an identical reduction of the insurer's reconciliation reserve or – in case of a bank – retained earnings). The reduction of the reconciliation reserves or retained earnings that results from tax on PLAM "profits" does not impact the amount of *eligible* UT1 and *eligible* CET1 since the amount of DTA that needs to be deducted from UT1/CET1 has also fallen. Therefore, if the tax on the profit resulting from the application of the PLAM "only" reduces DTA, the PLAM cannot lead to a reduction of a bank total capital ratio. Contrary to this, in insurance a PLAM that reduces DTA may result in a reduction of *eligible* Tier 3, thus leading to a **fall** of the total capital ratio. **It cannot be justified that the insurance PLAM can result in unintended consequences for the key Solvency II ratio, whereas the key solvency ratio for banks (CET1) always increases due to the bank PLAM. The difference in how and to what extend the DTA is recognised as capital, and what implications this has, including as regards the PLAM, should be further assessed. As a general point, the allowance for DTA as capital may be somewhat higher under Solvency II - however it is only admitted within the lowest quality of capital for insurers whereas it may be recognised as the highest quality of capital for banks. In contrast, the fundamental role for DTA is arguably much greater for insurers compared to banks.** *Level of Trigger – difference not justifiable*: Coupon cancellation for bank AT1 is triggered upon breach of the so-called	

	combined buffer, i.e. typically when the CET1 ratio falls below ca. 10%. Even this AT1 coupon cancellation trigger is considered more like a gone-concern trigger (i.e. within the lowest quartile of the buffer). In insurance, the DR foresees cancellation of equity dividends at the same time as cancellation of RT1 coupons (SCR breach), whereas in banking the prioritisation of AT1 coupons is now foreseen by the draft CRR. We also note that bank Tier 2 is non-deferrable at all, whereas insurance Tier 2 requires deferral upon the same trigger level as RT1 coupon cancellation. The bank PLAM trigger is breached when the CET1 ratio falls below 5.125% and is therefore generally considered a "gone concern" trigger. Even before a bank's CET1 capital ratio falls below the trigger ratio, it will be perceived to be non-viable. The corresponding "gone concern" trigger of insurers would arguably be the MCR rather than the SCR. Instead, the insurance PLAM is essentially triggered simultaneously with RT1 coupon cancellation (and even Tier 2 coupon deferral), leaving aside the three months cure period for the PLAM trigger. **There is no reason why the insurance PLAM should apply so much earlier than the banking PLAM.** ○ *Regulation on the Minimum Policyholders' Dividend:* A specific regulation for German life insurers on minimum policyholders' dividends (Mindestzuführungsverordnung) could even further reduce the total capital ratio and increase the volatility of the SCR ratio of life insurers. In case of trigger breach, the write down would result in other income that has to be distributed 50:50 to the company and policyholders. The portion for policyholders is either attributed to a fixed reserve for premium refunds (Rückstellung für Beitragsrückerstattung, RfB) or to a free part of these reserves that can be assumed only partly as own funds (paragraph 93 section 1 VAG). The allocation to the free or fixed part of RfB is company specific and can change from one year to the other. As a consequence of the allocation to RfB the total capital ratio would not only decrease further for life insurers as a result of the write down but the volatility would also increase significantly. Hence, the write down instrument may not be feasible for German life insurers at all.	
Q20.5	Full consistency between insurance and banking regulations is not a goal in itself as differences in business models between insurance and banking exist and should be adequately reflected	

	justifying in our view some differences in respective regulatory regimes. ▪ We refer to our extensive answer to Q20.4, and summarise as follows: o We view the (i) different scope of triggers and (ii) the different role of DTA as justifiable. o However, these differences mean that copying the bank PLAM to insurance regulation does lead to unintended consequences (potential **reduction** of SCR ratio), which should certainly be avoided. o The different trigger levels are not justifiable. ▪ We understand that some stakeholders prefer a full (100%) write-down or conversion for insurance RT1 even though this is neither required for bank AT1, nor justified by the impact on the Solvency II ratio. While full consistency is not a goal in itself, we think that such a difference between bank and insurance PLAM cannot be justified. The fact that the trigger level itself is arguably higher in Solvency II than is the case for AT1 adds to the argument that the triggering mechanism (i.e. full vs limited write-down) should not (also) be more conservative. Further, we note that this would maximise the potential reduction of the SCR ratio in many jurisdictions described in our answer to Q20.4 above. Finally, it would turn the hierarchy of capital upside down (PLAM benefits equity investors at the expense of RT1 investors) even though the insurer could still be viewed as “going concern” – in addition to the problems with respect to investor hierarchy already present in Solvency II, in isolation as well as relative to AT1. Bank regulation increasingly reflects the importance of maintaining the hierarchy of capital, and insurance regulation should not explicitly disregard the hierarchy of capital either. ▪ **The insurance PLAM may malfunction at the currently foreseen trigger levels – issuing a PLAM with an even higher trigger hurdle as suggested by the question only increases this risk.**	
Q20.6	▪ Insurance PLAM applies much earlier and has a much higher risk of worsening a crisis than its bank counterpart. Insurance regulation should avoid the flaws of both the current banking and insurance PLAM. ▪ **We suggest to follow the lead of non-European bank regulators to delete the PLAM**	

requirement altogether. PLAM may well lead to unintended consequences and is not necessary, as even 100% loss absorbency could be achieved without it.

- We note that the deletion of the PLAM is a **long term solution,** which is unlikely to be implemented in the near future given the outlined timeframe for reviewing Solvency II. Below, we therefore provide **two short term solutions** that aim to minimise the risk of unintended consequences of the insurance PLAM. **Also**, we suggest an alternative loss absorbency mechanism other than PLAM that could be implemented **in the long term**.
- First, though, we deem it important to highlight some additional points and weaknesses of the current system:
  - *PLAM is not necessary for instruments to absorb losses*: Its strong resemblance of equity allows RT1 to impose 100% losses on investors without application of the PLAM: RT1 allows issuers to impose a stop on (i) any repayment of the principal amount (RT1 criterion perpetuity) and (ii) any coupon payments (RT1 criterion full coupon discretion). The value of the instrument for investors falls to zero (100% loss absorbency) upon such an announcement. Regulators have all means necessary to force issuers to make use of these rights.
  - *Principal loss absorbency is complex, error prone and can lead to unintended consequences*: It is not straightforward to design loss absorbency mechanisms that (i) work under all conceivable scenarios and (ii) treat investors fairly. In particular M&A scenarios may imply that PLAM does not work as intended (e.g. what happens if an issuer with conversion instruments is merged into another issuer that does not have listed shares). For perpetual instruments, it is unlikely that the terms and conditions can foresee all potential scenarios over the life of the instrument. Equally, the hierarchy of capital should not be undermined by the PLAM. Contrary to equity, RT1 does not provide any upside for its investors as the maximum coupon is contractually fixed, while equity dividends are not. The issuer call right at par limits the upside of market value. To compensate for this, investors in RT1 must therefore be protected in the downside scenario (equity must be "wiped out" before RT1). However, in case of write-down instruments, the hierarchy of capital is typically turned upside down as the profit resulting from the write-down benefits equity investors (increase in

retained earnings), whereas RT1 investors lose out. Therefore, in banking, the solution to such weaknesses of the PLAM is that the PLAM only applies in a gone concern scenario

- *Short term solutions (minimising the risk of unintended consequences from current PLAM)*:
  - **Where a write-down *reduces* a relevant ratio (e.g. the group SCR ratio), the write-down should be limited to the absolute possible minimum.** In order to meet the formal requirement of a PLAM in the current DR, only a limited write-down of e.g. [5-10%] of the nominal amount should be required. Where the write-down does not improve the trigger ratio, it would improve the UT1 ratio at the expense of the RT1 ratio. However, as mentioned above, the bank mechanism to mathematically limit the write-down amount would not work (no cure of trigger breach possible). In view of the hierarchy of capital a 100% write-down would not be justified either. We therefore suggest to equally limit the write-down in this case by a specific percentage (e.g. [5-10%]). There is no straightforward comparable solution for conversion RT1, as typically 100% of the principal amount is converted. In jurisdictions where conversion can lead to a reduction of the SCR ratio, conversion therefore maximises the risk of an SCR reduction.
  - **PLAM as well as the cancellation trigger could be set at much lower levels (margin to MCR) rather than at the SCR.** This would not change the fundamental concerns with the PLAM, but would reduce the risk of unintended consequences. It would thereby also bring the insurance regulation closer in line with that of banking.
- *Long term solutions (deleting PLAM and using other LAMs to avoid unintended consequences)*:
  - An alternative to PLAM that would (i) avoid a reduction of the SCR ratio, (ii) impose losses on investors, and (iii) be very simple would be to **automatically require the cancellation of e.g. [2-3] years' worth of coupons upon trigger breach.** As a rule of thumb, for an assumed coupon level of 6%-7% this mechanism would imply a permanent loss to investors worth ca. [15% to 20%] of the original principal amount – a meaningful, substantial and true amount of "loss absorbency" by investors. It would mean that Art. 71 (7) would have to be abolished as it would focus on loss imposition via coupon cancellation. It would, however, appreciate that coupon cancellation (and

	prohibition of repayment) is the simplest way to impose even a complete (100%) loss on investors in perpetual instruments – and without any of the negative consequences of the current insurance or bank PLAM. It would further appreciate that RT1 investors incur losses in a way that shareholders never do as equity dividends cannot economically be cancelled (only deferred). We see such coupon cancellation as a sensible and much simpler regulation than that for banking. ▪ Designing a sensible PLAM or an alternative to it is very complex. The discussion would greatly benefit from an exchange of views with all relevant stakeholders including lawyers and banks with in-depth structuring and market experience.	
Q20.7	▪ Insurance - prohibition of extraordinary call rights in years 1-5 without replacement: All calls require prior regulatory approval. It does not make sense to generally prohibit early calls without replacement – there may well be cases where both regulator and issuer agree that a replacement is not necessary. This prohibition may mean that a costly and inefficient instrument must be kept for years (i.e. until the five year period has expired) even in cases where total own funds are high). While an open market repurchase may still be allowed (subject to prior approval), it is typically more costly than the exercise of a call right, and repurchases (unlike calls) very rarely allow the issuer to extinguish the entire principal amount. Equity can be reduced at all times, in some jurisdictions even without prior regulatory approval. Equity is viewed as "permanent" nevertheless, simply because there is never an obligation to repurchase equity. Similarly, call rights do not create an obligation to make use of this right – early call rights will only be used when it is economically preferable to do so. We therefore see no reason why exercising a call right should be prohibited without prior replacement particularly when regulators have to approve it in any case. ▪ Banking – tax and regulatory calls: Call rights should not be limited to tax and regulatory calls. Extraordinary call rights are rarely used, are always subject to prior approval and essentially are a risk that investors bear (calls take place at contractually pre-agreed (low) prices, typically par). There is no reason why regulation should "protect" investors by limiting such call rights for insurers.	
Q20.8	▪ The difference in call rights is not justified by the different business models of banks and	

	insurers. ▪ The limitations in both regimes are generally viewed as a burden that – given the obligation to obtain prior regulatory approval for any call – adds no regulatory benefit, but may cause unnecessary costs to insurers or banks.	
Q20.9	▪ Given the similar market environment, banks and insurers are facing, consistency is generally desirable. However, banks and insurers are different in many aspects and hence it is more important that specific rules are adequate. The regulation regarding early calls has weaknesses in both current regimes which can be addressed in both regimes as follows: o All early call rights should be subject to prior regulatory approval. A categorical but temporary prohibition to call without replacement is not sensible and should be deleted. o Non-binding guidelines that support regulators when assessing the merits of calls requiring higher minimum limits (so called margins) in case of no replacement may be helpful. o A limitation of call rights is not necessary. In fact we cannot see a reason why regulation should protect investor rights in this respect. o We think that so-called “make whole” prices for early calls (make whole is typically the higher of par and the remaining cash flows discounted with a contractually agreed discount rate) could be prohibited. All early calls should be priced at par (plus accrued interest).	
Q21.1	▪ RT1 is of weaker quality than UT1 and should therefore remain limited. A removal of the limit would make the term “Restricted” Tier 1 meaningless. We are questioning the practicability of “improving” the quality of “R”T1 as implied by question 21.4. Adding more onerous requirements is likely to effectively prohibit most insurers from issuing Tier 1 in the form of subordinated debt (market acceptance). At least, it would increase the cost of such instruments. ▪ We assume that EIOPA is fully aware that no new transitional RT1 can be issued today, and hence the question for a “restriction” of transitional RT1 is aimed to limit the amount of transitional RT1 within eligible own funds rather than to “restrict” issuance of further	

	transitional RT1. ▪ With that in mind, we do not see how – after removal of the 20% limit – transitional RT1 could be "restricted" without alternative quantitative limits, which – according to the wording of the question – may not be the "preferred" approach. If the 20% limit was to be removed, transitional RT1 would arguably have to be reclassified as (transitional) Tier 2, which would cause significant challenges for a number of insurers. ▪ **There is a high risk that an unqualified removal of quanitative limits for transitional "R"T1 would imply an additional An dsignificant ex post subsidy to those insurers that have large amounts of transitional RT1 outstanding, which would undermine the level playing field concept.**	
Q21.2	▪ No, a removal of the 20% limit would not have any impact on the amount of eligible transitional RT1 of our group.	
Q21.3	▪ No, a removal of the 20% limit would not have any impact on the total own funds coverage of our group. ▪ For the removal of the 20% limit to have an impact on the total capital ratios of insurers, more than the entire headroom for RT1 (20% of total Tier 1 and thus (implicitly) 25% of UT1), and T2+T3 (50% of the SCR) would have to be utilised today. This is unlikely in the case of groups, and would be rather unusual for individual members of a group, too.	
Q21.4	▪ **We oppose a removal of the 20% limit**. ▪ We are sceptical about the ability to define sensible features to make Tier 1 in the form of subordinated debt even more akin to equity. RT1 as currently foreseen is already more risky than equity in several aspects as a consequence of the inversion of the hierarchy of capital. ▪ We are questioning the practicability of "improving" the quality of RT1. The proposed "improvements" only make the occurrence of unintended consequences more likely. Also, these consequences will occur at an earlier stage of a crisis, and arguably will make it even more difficult – if not impossible - for all but the strongest insurers to issue Tier 1 in the form of subordinated debt in the capital market.	
Q21.5	▪ A limit for RT1 is sensible regulation in our eyes. We cannot see good reasons for removing it and cannot see a sensible way to "improve" the quality of RT1 further via additional	

	(contractually fixed) requirements. ▪ Retaining the 20% limit looks more sensible since: (i) the combination of the complexity / volatility of Solvency II Pillar 1 and (ii) the existing required features to qualify as Restricted Tier1 having prevented the insurance sector to launch a Euro benchmark Restricted Tier1 in the capital markets. Strengthening the RT1 features would make market-access even more challenging – even though market access is virtually non-existent in the first place. Strenghtening RT1 features is therefore not desirable.	
Q21.6	▪ Given the absence of meaningful amounts of issuance of RT1 based on current criteria it is not possible to make any reliable statements on the potential marketability (or market cost) of "R"T1 instruments after the contemplated criteria changes. ▪ These changes would make the occurrence of unintended consequences likely to happen at an even earlier stage as the PLAM – and the potential **reduction** of the SCR ratio therefrom – would apply already at higher capital ratios. ▪ The market for restricted Tier 1 instruments is virtually non-existent. The increase of the trigger level significantly above non-compliance with the SCR would i) entail an additional cost for the issuer while ii) increasing the risk of unintended consequences (worsening of the SCR ratio) and thus arguably reducing the quality of its own funds. It would also further reduce the number of insurers that actually can access this market for capital, as only the best rated insurers would arguably find sufficient demand.	
Q21.7	▪ Setting the call right further from the issuance date **reduces** the quality of this own funds item as it reduces the instrument's flexibility. ▪ The permanence of RT1 is perpetual as there is never an obligation to repay, and since incentives to redeem are prohibited. Prohibiting call rights after 5 years and allowing them only after 10 years therefore does not increase RT1s permanence in any sense. ▪ The RT1 call right is certainly not an obligation to call. The call right allows insurers to replace the instrument with an otherwise identical, but lower cost, instrument – preventing such a replacement for 10 years rather than only 5 cannot be viewed an "improvement" of the instrument's quality. ▪ In this context, we reiterate that all call rights are contingent on the prior approval from the	

	regulator. ▪ In addition, extending the first call date beyond five years would create a unjustifiable difference to bank AT1, where ordinary calls are allowed after five years. In any caseall calls are subject to the approval of the supervisory authority. It therefore does not seem appropriate to extend this first date of call. Furthermore, if the first call for repayment or redemption were set further 5 or 10 years after the date for issuance, the issue of this type of capital items would be hardly feasible in practice. ▪ **We point out that the DR requires regulators to make certain decisions such as the approval of calls. Own funds instruments are market sensitive. Given the great degree of complexity of such instruments as well as market sensitivities, we would welcome an intense dialogue between regulators and insurers on the functioning of such instruments. Also, EIOPA could provide a helpful platform for exchange between national supervisors.**	