Comments Template on Consultation Paper on EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation		Deadline 5 January 2018 23:59 CET
Name of Company:	Insurance Europe	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
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Reference	**Comment**	
General Comment	Insurance Europe welcomes the opportunity to comment on EIOPA's draft advice and provide technical input on the various areas under consultation. This introductory section of the response is aimed at providing a set of high-level comments on the advice, as well as a summary of views on each of the areas.	

Template comments

General Comments

EIOPA should not provide own-initiative advice on issues closely related to risk-free rates, which will be a key focus of the Solvency II 2020 review

EIOPA has chosen to provide own-initiative advice on potential recalibration of the interest rate risk SCR. This issue is however very closely related to the risk-free rate and the valuation approach, which were the subject of significant debate and controversy during the development of Solvency II and will be a key focus for the Solvency II 2020 review. It is therefore inappropriate to review the interest rate issue now, in isolation. In fact, Insurance Europe believes that the Commission did not include it in its call for advice for good reasons. All changes relating to interest rates should be considered together and as part of the 2020 review.

The insurance industry stresses its commitment to policyholders enjoying comprehensive protection against the risks inherent in insurance. However, Solvency II already takes a conservative approach to interest rates and the existing valuation approach, capital requirements, stress testing and reporting obligations are powerful tools to ensure that companies and supervisors can deal with the low interest rate environment. The stress tests, in particular, provide and have been used as a mechanism to allow supervisors and companies to understand the impact of stresses more extreme than the Solvency II calibration. There is, therefore, no prudential urgency to make changes to the interest rate risk calibrations now.

Insurance Europe also notes that this area of the draft advice is one of the largest (covering 22 pages) and includes some of the most complex and extensive methodology discussions. It has also resulted in additional data requests to insurers which are an extra burden in a period of the year when companies are extremely busy with annual closing. In addition, the time spent on this issue would have left less time and resource available on other issues. The industry would argue that such efforts would have been better placed on areas that are under the scope of the EC call for advice.

EIOPA should avoid an overly theoretical approach and should not ignore the real economic meaning and implications of its advice

In a number of areas of its advice EIOPA appears to not have considered the implications and economic meaning of the figures it has put forward. However, taking a step back and considering the practical implications is vital to arriving at appropriate advice and a prudential framework that achieves its intended outcomes in the real world. For example, EIOPA reported in some of its analysis that the current risk margin calibration and methodology leads to an aggregate risk margin of €210bn for the industry and about 45% of the total life insurance industry SCR. Industry analysis

provided to EIOPA shows that the risk margin for some long-term products can equal or even exceed the SCR for those products. The risk margin represents the cost of transferring the non-hedgeable risks to a third party in the event of a company failing. It does not seem possible that the cost of transferring a subset of risks can be such a high proportion of the SCR let alone equal or exceeding it. EIOPA does not seem to have even considered if such levels are reasonable or even possible, and in line with the intended purpose of the risk margin concept. Such an analysis, which should in fact be a key element of the discussion, is missing. If the outcome of the risk margin calibrations, including the cost of capital and methodology do not achieve the intended purpose of the risk margin, then this supports advice to lower the cost of capital and/or make other changes to achieve more appropriate risk margins.

The proposals for the interest rate SCR are also an example of an overly theoretical approach not matching economic reality. Specifically, one of EIOPA's proposals is to have a floor between negative 2% and negative 1% in the interest rate shocks. This is the equivalent of assuming that if interest rates dropped to these levels all insurance companies would sell all their assets and re-invest at these low rates and remain invested while their liabilities run off. Ignoring if such interest rates are even possible, this is totally unrealistic and would very likely go against principles of good asset liability matching, risk management and prudent person that are also required by Solvency II. Therefore in practice companies would not invest in such negative rates.

Convergence does not mean all supervisors applying the most prudent and restrictive approach
Care needs to be taken to avoid that convergence is interpreted as all supervisors taking the same action, irrespective of local market specificities, conditions and risks. This is a particular danger for LAC DT, where EIOPA appears to favour simplistic and arbitrary limits on all insurance companies across markets, instead of encouraging appropriate supervisory judgement and dialogue. Insurance Europe understands that the key driver for EIOPA going beyond the mandate foreseen by the EC is its desire to support convergence. In principle, Insurance Europe supports the high level of convergence and harmonisation already provided by the Solvency II framework. However, Insurance Europe is deeply concerned by cases where an extremely conservative approach from a specific jurisdiction is extrapolated beyond that jurisdiction for the sake of convergence. Such an approach defeats the risk-based nature of the framework and risks making the framework significantly more conservative than it already is.

EIOPA should consider, in developing its advice, the impacts and unintended consequences of changes
EIOPA, in giving its advice, should conduct an overall impact assessment of its proposals, as opposed to a solo assessment per area of review. Assessing the various proposals on an isolated/individual level cannot represent a reliable basis for assessing if and how the overall impact would support the objectives of Solvency II, the balance between simplicity and risk-sensitivity, the overall burden and costs on the industry. All these elements of impact were

in fact requested by the EC in its call for advice. Over the past two years the industry raised significant concerns on the impact that some of the elements in the review (eg the risk margin) can have on insurers' ability to provide long-term products and investment. These concerns have so far not been addressed. The industry would in fact argue that its concerns have implications for Europe's long-term growth and the EC should be appropriately informed and advised by EIOPA in such areas. Insurance Europe therefore believes that EIOPA should be interested in concerns on the ability of the industry to provide long-term products and invest long-term, and EIOPA should and make this part of its advice to the Commission.

Simplicity is an aim, but it should not be more important than appropriate risk measurement

The current draft advice fails to balance simplicity vs risk-sensitivity in a consistent way. EIOPA's arguments are not consistent, and the industry is concerned that EIOPA is prioritising risk-sensitivity and simplicity on the basis of how the conservatism of the framework is impacted. Specifically, EIOPA proposes on own-initiative rather complex methods, while it argues that some of the industry proposals, though economically justified, are too complex.

Comments on the areas under review

Please find below a summary of key comments for each area of the draft advice:

1. **Recalibration of standard parameters of premium and reserve risks**

Insurance Europe welcomes the request in the call for advice from the Commission to assess which standard parameters for non-life premium and reserve risk need to be changed, and to update the standard parameters for medical expense risk. However, Insurance Europe does not support the recalibration for the following reasons:

- the disproportionate weighting by country leads to overall calibrations that are dominated by a few countries.
- the general approach for assessing non-life premium risk should be based around differences between the expected and actual levels of aggregate losses in each year rather than a method that assumes variation about a constant level.

2. **Volume measure for premium risk**

Insurance Europe welcomes the request to reassess the definition of the volume measure for premium risk for continued appropriateness in the EC call for advice.

Insurance Europe appreciates the analysis and clarifications provided by EIOPA in the Consultation Paper with regard to the exposures to the different components of the non-life underwriting premium risk, notably with respect to unexpected risk 1, and ‚unexpected risk 2'. However, Insurance Europe highlights that both options put forward by EIOPA are unsatisfactory as they maintain an unjustified excessive calibration and spurious volatility over time and across undertakings and markets, as well as an unfair treatment between one year and multiyear contracts.

Based on the clarifications provided by EIOPA in the consultation paper, Insurance Europe proposes the following formula to appropriately capture the exposures to non-life underwriting premium risk:

$$V_{PREM,s} = Max[P_{(s)}; P_{(last,\ s)}] + Adjust_Factor\ x[FP_{(existing,\ s)} + BETA\ x\ FP_{(future,s)}]$$

With FP(existing,s) and FP(future,s) set to zero for one year duration insurance contracts
Adjust_Factor set to 30% as a maximum and BETA equals 50%.

Insurance Europe notes that basing the recognition date for new business on notification periods is not appropriate as it may be both very counter-effective providing wrong risk incentives and it may induce a strong volatility. In addition, Insurance Europe highlights it is distorting the reality of the risk exposures in the different years.

3. Recalibration of mortality and longevity risks

Insurance Europe welcomes the Commission's request for EIOPA to investigate the appropriateness of the standard parameters for mortality and longevity risks in the life and health underwriting risk modules.

As EIOPA itself highlights, there are numerous limitations to the methodology it followed for the recalibration exercise on longevity and mortality risks. Given the limitations of the recalibration methodologies, Insurance Europe believes that no changes are justified at this stage for either longevity or mortality risk factors.

4. Health catastrophe risk

Insurance Europe welcomes the Commission's request for EIOPA to propose methods and criteria for simplifications for

the Health Catastrophe risk submodule and, where appropriate, to develop a simpler structure for this this submodule. It appreciates the work done by the CAT WS to investigate and develop simplifications for the Health Catastrophe risk submodule and supports the proposals in this area.

5. Man-made catastrophe risk

Insurance Europe welcomes the Commission's request for EIOPA to propose methods and criteria for simplifications for the Man-made Catastrophe risk submodule and, where appropriate, to develop a simpler structure for this this submodule. It appreciates the work done by the CAT WS to investigate and develop simplifications for the Man-made Catastrophe risk submodule and broadly supports the proposals in this area.

6. Natural catastrophe risk

Insurance Europe welcomes the Commission's request for EIOPA to propose methods and criteria for simplifications for the Natural Catastrophe risk submodule and, where appropriate, to develop a simpler structure for this this submodule. It also appreciates the work done by the CAT WS to investigate and develop simplifications for the Natural Catastrophe risk submodule and for its work on the recalibrations.

Insurance Europe supports the proposed simplification for all Natural Catastrophe risk submodules as a pragmatic approach to mitigating some of the calculation burden for residual exposures.

While Insurance Europe welcomes EIOPA's recalibration initiative, it believes that a number of the proposed recalibrations put forward by the CAT WS contain excessive and unjustified prudency margins. Several of the proposals do not fully reflect the scientific data provided as input by the various modelling companies.

Insurance Europe supports EIOPA's follow up initiative to undertake holistic recalibrations of the windstorm and flood perils. This should improve consistency within the Natural Catastrophe risk submodule.

7. Interest rate risk

Insurance Europe does not support EIOPA's own initiative proposal to alter the structure and calibration of the interest rate risk submodule. The current calibration, while not perfect, should not give rise to prudential concerns due to the

overall conservative nature of the Solvency II framework. Key features of the existing methodology were designed in conjunction with other aspects of the framework and should not be considered in isolation or without impact assessment, and definitely not before the 2020 Solvency II review.

Insurance Europe reiterates that it is imperative that any changes to an important part of the Solvency II framework, such as the interest rate risk submodule, are fully considered, calibrated, tested and consulted upon.

Insurance Europe notes that, on own initiative, EIOPA has investigated several possible alterations to the interest rate risk submodule. It does not believe that EIOPA's Proposal A (200 bps symmetric adjustment) or Proposal B (combined approach) are suitable alternatives to the existing approach to modelling interest rate risk. These provide an overly conservative estimate of the interest rate risk, particularly in the low yield environment, and introduce unwarranted complexity.

Given EIOPA's investigations, Insurance Europe is disappointed that EIOPA has not investigated the "shifted approach" model further. This approach has several advantages relative to the other approaches which were tested. Insurance Europe cannot replicate EIOPA's insufficient backtesting results. Compliance with the 99.5% confidence level is inherent in the calibration of the relative shifted approach.

Irrespective of the different modelling approaches, Insurance Europe believes that to reflect economic reality, the incorporation of a suitable lower bound is vital. This should be based on the cost of holding cash and not on the assumption that insurers would invest in and hold a significant portion of their assets at negative yields over the long term.

Insurance Europe also firmly believes that risk factors should only be applied to the liquid part of the term structure. Afterwards, the shocked curves should be extrapolated in the same way as the best estimate curve. This is essential to achieve consistency with the valuation methodology, reduce complexity of interest rate risk hedging and provide a more economically realistic framework. Only with correctly extrapolated shocked curves the true loss of own funds can be calculated which impends in case of changed market interest rates.

8. Market risk concentration

Insurance Europe supports EIOPA providing clarifications on the issue of identifying the single name exposure and the presence of a credit assessment. These clarifications should not be envisaged in the Delegated Regulation, but rather via

other legal tools (eg guidelines). Furthermore, Insurance Europe continues to believe that all entities in a group, strategic participations and investment related undertakings, should be excluded from the scope of market risk concentration.

9. Currency risk at group level

Insurance Europe welcomes the Commission's request for EIOPA to investigate whether the existing approach taken to group currency risk is adequate and to suggest modifications where appropriate.

It is disappointing that EIOPA's assessment of currency risk does not address the issues identified by the Commission and stakeholders. The technical inconsistency inherent in the treatment of currency at group level has not been fully investigated nor addressed by EIOPA. Its assessment also does not appear to consider the incentives given to the group's risk management, as required by the Commission's call for advice.

Insurance Europe continues to believe its proposal provides an economic and justifiable alternative to the existing currency risk submodule which would align the regulatory framework with risk management practices and provides incentives for good risk management for all undertakings. EIOPA's proposal will alleviate the capital burden for a small and select group of insurers and does not go far enough to remedy the technical inconsistencies or provide incentives for good risk management.

10. Unrated debt

Insurance Europe welcomes the EC request for advice on how unrated debt could receive, as a proxy, the credit rating of rated debt should a set of criteria be met. Unrated debt represents not only an important investment asset for the industry, but also a key source of funding for SMEs in Europe.

Insurance Europe broadly supports the internal assessment approach, which is viewed as overall adequate and not overly complex. Insurance Europe highlights the need for an extension of the scope to CQS 3 and CQS 4, to allow for a wider coverage across member states. However, Insurance Europe believes that the internal model approach, as proposed, is not reflective of market reality, is overly restrictive and will not work in practice.

Insurance Europe notes that there are concerns in markets investing in unrated debt though funds that they may not be able to benefit from this improvement in the capital requirement assessment because the costs of obtaining the

information needed may outweigh the benefits.

While the objective of the call for advice is to proxy capital charges of unrated debt to those of rated debt, Insurance Europe believes that, in the medium-run, Solvency II should address the key question of whether it measures the right risks. Specifically, in the case of debt, where insurers are not exposed to forced sales, risk of default should be measured instead of risk of changes in spreads. This issue should be addressed thoroughly in the 2020 Solvency II review.

11. Unlisted equity

Insurance Europe welcomes the EC request for advice on how unlisted equity could receive, as a proxy, the capital charge of listed equity should a set of criteria be met.

While the objective of the call for advice is to proxy capital charges of unlisted equity to those of listed equity, Insurance Europe believes that, in the medium-run, Solvency II should address the key question of whether it measures the right risks. Specifically, in the case of equity, EIOPA should investigate how long-term exposure to equity and absence of forced sales risk impact insurers‘ actual risk exposures. Insurance Europe believes that this issue should be addressed thoroughly in the 2020 Solvency II review.

Insurance Europe is concerned by the high level of complexity of the proposals, and believes that the burden and cost of application may not be justified by the limited reduction in capital requirements.

In addition, Insurance Europe proposes the creation of an additional risk sub-module for Type 3 equities, which should be contingent on the weighted average duration of the liabilities exceeding an average of 6 years. The capital requirement for type 3 equity should follow an approach similar to the duration-based approach of Solvency II.

12. Strategic equity investments

Insurance Europe welcomes the EC request for information on strategic participations and on how the related qualifying criteria are applied in practice. As the EIOPA analysis confirms, the current criteria for strategic participations are difficult to validate in practice, and this may be one of the reasons why the estimated allocation by the industry to this asset class (ie €155bn) is likely below the actual exposure.

In terms of criteria for the identification of strategic participations, Insurance Europe proposes:

- the removal of the forward-looking short-term volatility criterion, which is not only very difficult to test in practice, but it also fails to be a good proxy for the actual risks of such assets for insurers who take a long-term strategic view.
- The change of the ownership & control threshold from 20% to 10%.

13. Simplification of counterparty default risk

Insurance Europe welcome the EC request for EIOPA to assess if the complexity of the counterparty default risk submodule is proportionate to the nature, scale and complexity of these risks and to develop a simpler structure, where appropriate.

Insurance Europe believes that EIOPA should have considered a more fundamental simplification of the structure of the submodule. The evidence put forward by EIOPA supports such an evaluation. Insurance Europe further believes that changes to the derivatives markets and, in particular, the introduction of EMIR substantiates this proposal.

However, Insurance Europe acknowledges EIOPA's efforts in the development of a number of optional and prudent simplifications as well as clarifications on the existing criteria within submodules. These proposals should reduce the calculation burden for some undertakings but Insurance Europe notes that the inclusion of excessive prudence may discourage their widespread usage.

14. Treatment of exposures to CCPs and changes resulting from EMIR

Insurance Europe welcomes EIOPA's work aimed at better reflecting the post-EMIR derivatives regulatory environment in the calibration of the Solvency II capital requirements for derivative exposures.

Insurance Europe supports EIOPA's proposal to align the Solvency II approach to the CRR one by considering the capital requirement for cleared derivatives as being 0.4% of the capital requirement for OTC derivatives. In addition, Insurance Europe believes it is important that EIOPA investigates whether the current assumptions for the OTC environment, in particular the 10% recovery rate, are indeed reflective of the post-EMIR environment. This is an issue worth further work, not least because EIOPA takes the OTC capital requirement as a starting point for reviewing the capital requirement of cleared derivatives.

15. Simplification of the look-through approach

Insurance Europe supports EIOPA's proposals on simplifications, in particular:

- the carve-out of assets for unit/index linked products from the 20% limit
- the possibility to use the last reported asset allocation of the collective investment undertaking or fund to calculate the SCR and
- the permission to use groupings of exposures when the target asset allocation is not available at the level of granularity necessary.

Insurance Europe appreciates that the reference to Article 88 of the Delegated Regulation, which refers to proportionality and simplifications, was made by EIOPA as a means to ensure a consistent and prudent approach across simplifications. However, Insurance Europe notes that, in the case of the proposed look-through simplifications, there are already safeguards for prudence, namely the 20% threshold and the requirement for testing the asset allocation criterion. Therefore, the reference to Article 88 on proportionality comes as an additional and unnecessary layer of burden, which should be avoided.

16. Look-through approach at group level

Insurance Europe appreciates EIOPA's initiative to consider - on request of some stakeholders - the application of the look-though approach at group level.

Insurance Europe supports EIOPA's proposal to mirror the approach at group level for solo level and vice-versa. Specifically, Insurance Europe agrees that, if there is a look-through at solo level, there should be look-through at group level and where there is no look-through at solo level, then there should be no look-through at group level. While Insurance Europe believes that both options put forward by EIOPA would result in the same approach, it prefers the option of reviewing the Delegated Regulation by specifying that related undertakings should be treated at group level in the same way as they are treated at solo level.

17. Loss-absorbing capacity of deferred taxes

Insurance Europe understands that EIOPA was asked by the EC to report on the various methods currently applied

across the EEA on LAC DT, and on their impact. Insurance Europe therefore believes that, by submitting its analysis, EIOPA has already fully delivered on its mandate.

While data presented in the past by EIOPA on LAC DT does confirm differences, it should be noted that **one of the key drivers of the differences is the fact that, across jurisdictions, supervisors have defined requirements on top of the Solvency II framework in the LAC DT calculations**. These requirements vary across jurisdictions, in particular in terms of their level of conservativeness. The varying supervisory responses are proof that there is no single right answer to potential prudential concerns on LAC DT. In fact, a number of considerations impact decisions on LAC DT, including the nature of the business, the profile of undertakings, the tax regimes, etc.

Against this background, Insurance Europe strongly believes that **the current framework already provides significant guidance on the issue of LAC DT, and any supervisory concerns should be addressed via appropriate supervisory dialogue, with appropriate knowledge of and respect for undertaking's specific business models. EIOPA should allow and encourage supervisory judgement and dialogue, and not limit it.**

At the same time, **Insurance Europe appreciates EIOPA's attempt to provide structure to the supervisory dialogue** on LAC DT. From this perspective, issues such as: the role of compliance with MCR/SCR post-shock, projection of and assumptions for new business, future management actions are all valid concepts that should be part of the supervisory dialogue. Any arbitrary/numbered limitations beyond these guiding principles should be avoided. Insurance Europe therefore believes that **the most appropriate way forward is for EIOPA to provide an opinion with guiding principles for the supervisory dialogues**. Such an opinion should be based on principles, and avoid arbitrary limits that would be agnostic to company/jurisdiction-specific circumstances. In fact, in such an opinion EIOPA should not avoid raising criticism on too conservative/unjustified approaches, which are in fact and unfortunately a reality in some member states.

Regarding the comments and proposals put forward by EIOPA in this consultation paper, Insurance Europe notes that:

- The total impact of future profits in LAC DT is, according to EIOPA, €25bn. This represents less than 1.7% of the 2016 total own funds. Insurance Europe is of the view that the issue is not material enough to justify an extremely conservative approach to harmonisation.
- The current differences are also explained by the limited experience of Solvency II application. These differences are likely to gradually reduce as undertakings will have to explain their approaches to the various stakeholders and align the assumptions across issues such as LAC DT, dividend policies, ORSA, budgets, financial statements, and mid-term capital planning. Experience of supervisory review process (SRP) is at this stage limited to a single closing exercise, ie end-2016. It is likely that this exercise in itself will lead to

inappropriate methodologies or assumptions being addressed. The involvement of senior management, the alignment with other processes, and the SRP will, in the short-term already, support a proper calculation and evidence of the LAC DT, which should be based on the unique characteristics of undertakings (governance, risk profile/appetite and various policies), and factor in the differences of the tax regimes and the consequences thereof.

18. Risk margin

Insurance Europe welcomes the EC call for advice requesting EIOPA to assess if the methods and assumptions applied in the calculation of the risk margin continue to be appropriate, in view of a changed market environment.

The current level of the risk margin, ie €210bn across the industry, is an enormous amount of capital locked out of productive use, with no proof that this level meets its intended objectives. This results in a waste of scarce capital and limits the capacity of insurers to take risks and grow. An excessive risk margin also has a major impact on the costs and availability of certain products, particularly long-term products, to the detriment of policyholders, and could trigger otherwise unnecessary and harmful actions for insurers under pressure from low interest rates.

Insurance Europe does not support EIOPA's decisions to 1) conduct a very narrowly focussed review, only considering the cost of capital rate and 2) propose no changes. Equally, Insurance Europe is concerned by EIOPA dismissing the extensive industry input and arguments, on the basis of weak justifications from EIOPA and a clear intention to preserve the status quo.

The current 6% calibration of the cost of capital is much higher than necessary and is a major reason why the risk margin is excessive. **Insurance Europe reiterates that, based on evidence, a 3% cost-of-capital rate is appropriate and justified**. Additionally, Insurance Europe notes the current design of the risk margin is flawed, and results in a disproportionate and unjustified allocation to certain long-term products.

At a broader policy objective level, EIOPA seems to ignore industry's concerns on the excessive size and volatility of the risk margin and fails to provide any proof that the current level of the risk margin indeed reflects its intended purpose, ie to reflect the cost of transferring liabilities to a third party (in line with Article 77(3) of the Directive). Insurance Europe believes that assessing the extent to which the risk margin actually meets its intended objectives across products should be part of EIOPA's work, and part of its advice to the Commission.

Specifically on EIOPA's proposal for the calculation of the cost of capital rate, Insurance Europe notes the following flaws: the use of a levered beta in combination with the assumption of undertakings being funded uniquely with equity,

	and a backward looking equity risk premium. Correcting these appropriately would result in a significantly lower cost of capital rate. **19. Comparison of own funds in insurance and banking sectors** Insurance Europe welcomes the Commission's request for EIOPA to assess differences in classification for those eligible items that are comparable between the banking framework and the Delegated Regulation, and, as a next step, to assess for each of the differences identified whether they are justified by differences in the business model, by diverging elements in the determination of own fund requirements or on other grounds. Insurance Europe welcomes the following proposals in EIOPA's draft advice: • The possibility to have a partial write-down under certain conditions. • Providing supervisory authorities with the ability to consider an exceptional waiver on write-down, in cases where the solvency position of the issuer would most likely be significantly weakened as a consequence of the write-down. While Insurance Europe acknowledges EIOPA's efforts in finding a practicable solution for issuance of RT1 instruments, it believes that the current proposals create a number of challenges and concerns, given the complexity of the functioning of these RT1 instruments across jurisdictions and in particular under certain stress conditions. **20. Capital instruments only eligible as tier 1 up to 20% of total tier 1** Insurance Europe acknowledges that EIOPA was asked in the EC call for advice to assess how eligibility criteria could be modified if the 20% limit on restricted Tier 1 own funds were to be removed. Insurance Europe welcomes EIOPA's assessment that the status quo should be preserved in this area as the strengthening of the related criteria would only result in prohibiting most insurers from issuing Tier 1 instruments in the form of subordinated debt.	
Introduction		
1.1	Insurance Europe welcomes the request in the call for advice from the Commission to assess which standard parameters for non-life premium and reserve risk need to be changed, and to update the standard parameters for medical expense risk. However, Insurance Europe does not support the recalibration for the following reasons:	

- the disproportionate weighting by country leads to overall calibrations that are dominated by a few countries.
- the general approach for assessing non-life premium risk should be based around differences between the expected and actual levels of aggregate losses in each year rather than a method that assumes variation about a constant level.

Additionally, Insurance Europe notes that for medical expense there are significant differences in the delivery of health services across countries, leading to very different insurance products characteristics per country. Therefore, Insurance Europe proposes to introduce a country factor based on the utilisation percentage of the health care system, which would cap the possible increase in costs to a certain maximum.

Paragraph 14

Appropriateness of the approach for medical expense

Insurance Europe believes that for medical expense the formula is inappropriate, as a cost is only incurred when medical treatment is actually provided to the policyholder. If there is no medical treatment, there are no costs and consequently there is no loss. However, the current formula does not reflect this.

For example, within the 12-month time horizon, a fully operational hospital cannot be built, and for various countries across Europe, medical care utilisation almost reached its maximum capacity. Also for certain medical expense contracts limits are specified for claim amounts, or the price per medical treatment is fixed or there is a maximum number of treatments allowed. Therefore, the approach of using the volume factor for premium risk and reserve risk is not appropriate. To remedy this situation Insurance Europe proposes **to introduce a country factor based on the utilisation percentage of the health care system, which would cap the possible increase in costs to a certain maximum**.

Insurance Europe notes that for health catastrophe risk, Solvency II also introduced country factors (see Annex XVI).

On top of the inappropriateness of the formula, Insurance Europe highlights that EIOPA has treated medical expense - in accordance with all other lines of business for which EIOPA has proposed recalibrations - as being similar across Europe. EIOPA has aggregated the various claim triangles, statistically processed these, which resulted in the proposed calibration. However, especially for medical expense, the underlying calibration is very different across Europe, and any suggestion for one standard parameter for medical expense will imply a deviation from reality for most health insurers. While USPs or the development of an internal model could be possible solutions, Insurance Europe notes that it is very burdensome for many health insurers and this would distort the level playing field.

Supplementary health is also different across Europe. Many member states have systems in which only certain

	treatments - limited in number - are covered and for which mostly pricing is fixed during the accident year. This also implies that the actual loss incurred due to either premium- or reserve risk is limited to the maximum per policy. This type of restrictions in the increase of the volume factor should be acknowledged.	
1.1.1		
1.2.1		
1.2.2		
1.2.3		
1.2.4		
1.3	Insurance Europe highlights that EIOPA maintained the same method as applied in 2011. Whereas insurers are required to frequently reassess whether the methodology applied is still appropriate. Insurance Europe would expect the same practice from EIOPA. However, the consultation document is lacking an assessment as to whether the method used: • is still valid for the various lines of business • continues to provide appropriate capital requirements taking into account the applicable legislation and characteristics of the individual markets across Europe, while maintaining a level playing field in the method.	
1.3.1	Insurance Europe believes that the general approach for assessing non-life premium risk should be based around differences between the expected and actual levels of aggregate losses in each year rather than a method that assumes variation about a constant level. Insurance Europe notes that this was an earlier consideration by the Joint Working Group (JWG) in the 2011 calibration exercise or in the development of the USP methodology.	
1.3.2		
1.3.3	Insurance Europe notes that when the calibration is done regardless of size of the portfolio (kappa factor), this could generate a bias. It would be expected that a large portfolio would have more diversification effects, and as such outliers would generally have a lower impact. However, in the current approach this effect is disregarded.	
1.3.4	*Considerations on pan-European factors* While Insurance Europe appreciates the simplicity of the pan-European factors, it is important to remain conscious that	

| | the **disproportionate weighting by country in method 2 will mean that the overall calibrations are dominated by a few countries**. Differing product designs and local characteristics can influence the underlying risk and thus the risk is not the same for all countries across Europe.

For example, significant differences in the delivery of health services across countries and the impact this has on the nature of medical expenses insurance products. Section 25 (Annex to chapter 1 – weights used in the method 2) shows that for HME premium risk the exposure is dominated by NL (47.8%) and FR (31.7%).

Insurance Europe notes that the JWG's initial work in 2011 recognised in paragraphs 104-108 heterogeneity across markets, and even drew out as specific examples the differences in health systems. Also, size variations were discussed in the subsequent paragraphs, and in particular in paragraph 109 it is stated that "the JWG was mandated to derive single factors for each of the individual lines of business". While that latter comment is in respect of portfolio size, paragraph 110 talks about the link between country and size, and thus Insurance Europe believes is equally applicable to the heterogeneity arising from country differences. It is unclear why there is a single pan-European approach (ie how the JWG combined the heterogeneous data) when some parts of the standard formula – for example catastrophe risk – do allow for regional differences.

The table below highlights the main countries that dominate the exposures of the recalibrated five lines of business. | |

Lines of business	Premium Risk weighting	Reserve Risk weighting
AS	DK: 17.1 % FR: 27.2 %	DK: 20.9% FR: 29.3%
CS	DE 18.8 % ES: 14.8 % IE: 15.6 % UK: 18.3%	DE: 25.0% FR: 21.0% IE: 16.3%
HME	FR: 31.7 % NL: 47.8%	FR: 18.7% NL:62.8 %
HWC	BE: 30.0 % FI: 20.6 % PT: 21.7 %	BE: 17.2% FI: 14.4 % NO: 31.5 %
LE	AT: 19.3% DE: 43.4% FR: 16.3%	DE: 57.9%

Based on these weights, the appropriateness of country-specific factors can be questioned. However, Insurance Europe notes that it is not clear whether data available would enable a country to effectively perform regional specific calibration. Insurance Europe would support further work in this aspect, particularly for classes where the data is predominantly from a few countries.

	Alternative Method Insurance Europe notes that a possible alternative to address the problem of the calibrations being based on a few specific countries would be to **allow for a country-specific parameter based on a similar methodology but reflecting the characteristics of the markets** instead of having one parameter per line of business by aggregating all jurisdictions in the end. Insurance Europe believes that a level playing field does not necessarily imply "one size fits all", a level playing field should ensure that all insurers willing to do business in a jurisdiction will have the same approach for the calculation of the solvency capital requirement.	
1.3.5		
1.4		
1.4.1	Insurance Europe does not support the updated calibrations because of the fact that overall calibrations are dominated by a few countries, and it believes the risk should be based around differences between the expected and actual levels of aggregate losses in each year rather than a method that assumes variation about a constant level. Insurance Europe observed that the overall direction across the lines of business is to increase capital requirements and believes further analysis is necessary as this could potentially lead to restructuring products and/or increased applications to move away from the standard formula. Insurance Europe notes that for credit and suretyship the premium calibration increases by around 50% (see paragraph 24), which coincides with a material reduction in volumes used in the 2017 exercise. Insurance Europe believes it would be beneficial if EIOPA could provide an explanation of the underlying reasons, and in particular if there is a material change in the type of products within the class between the periods. Insurance Europe has doubts on whether the data is representative of the industry as a whole, and it is not clear whether there is likely to be significant variation between companies as a result of different mix of business.	
1.4.2	Insurance Europe does not support the updated calibrations for the reasons set out in the previous paragraph. Insurance Europe notes that for legal expense and credit and suretyship, there is an increase in the premium calibration and a reduction in the reserving. However, there is no specific mention of this in the consultation. Insurance Europe believes it would be beneficial if EIOPA could provide insights in the underlying reasons of these movements.	
2.1	Insurance Europe welcomes the request to reassess the definition of the volume measure for premium risk for continued appropriateness in the EC call for advice.	

	Insurance Europe appreciates the analysis and clarifications provided by EIOPA in the Consultation Paper with regard to the exposures to the different components of the non-life underwriting premium risk, notably with respect to 'unexpected risk 1' and 'unexpected risk 2'. However, Insurance Europe highlights that both options put forward by EIOPA are unsatisfactory as they maintain an unjustified excessive calibration and spurious volatility over time and across undertakings and markets, as well as an unfair treatment between one-year and multiyear contracts. Based on the clarifications provided by EIOPA in the consultation paper, Insurance Europe proposes the following formula to appropriately capture the exposures to non-life underwriting premium risk: **Appropriate adjustment factors applied to FP_{future} and $FP_{existing}$** $V_{PREM,s} = Max[P_{(s)}; P_{(last, s)}] + Adjust_Factor \times [FP_{(existing, s)} + BETA \times FP_{(future,s)}]$ With FP(existing,s) and FP(future,s) set to zero for one year duration insurance contracts Adjust_Factor set to 30% as a maximum and BETA equals 50%. Insurance Europe notes that basing the recognition date for new business on notification periods is not appropriate as it may be both very counter-effective providing wrong risk incentives and it may induce a strong volatility. In addition, Insurance Europe highlights it is distorting the reality of the risk exposures in the different years.	
2.2		
2.3	***Paragraph 113*** Note to EIOPA: There seems to be a mistake in the following sentence, minimum should be replaced by maximum: *"to be earned by the undertaking during the following 12 months (P_s) instead of the maximum ~~minimum~~ of the estimate of the premiums to be earned by the undertaking during the following 12 months (P_s) and the earned premiums during the last 12 months ($P_{last,s}$) "* Insurance Europe highlights that EIOPA advocates that undertakings should inform the supervisor and demonstrate effectiveness of control about any increase of cession including new reinsurance as a requirement for recognition of the risk mitigating impact. This would be the consequence if the application of Articles 116(4) or 147 (4) becomes the standard way for the recognition of new reinsurance. Insurance Europe believes that this is disproportionate and might	

	not be the intention of these articles. It is Insurance Europe’s understanding that Articles 116(4) and 147(4) refer to situations where undertakings make a significant change in their business plan. In this case, demonstrating control around the implementation of the business plan and informing the supervisor might make sense, eg to avoid wrong incentives for overly frequent changes to the plan. However, for reinsurance which complies with Article 209 of the Delegated Regulation, eg is effective for the following 12 months, Insurance Europe believes that there is no need to require any additional controls as asked for in Art. 116(4) and 147(4). Additional requirements would be also disproportionate because Solvency II in general does not require undertakings to notify supervisors before concluding reinsurance. Insurance Europe believes the following observations are addressing EIOPA's concern about Insurance Europe’s proposal to allow undertakings to replace (under certain conditions) last year's NEP figure with a recalculated figure, ie last year's gross earned premium adjusted for the impact of the new reinsurance structure: • First, the proposal is prudent as it prevents incentives for an overly conservative estimation of earned premiums for the forthcoming years. • Second, the method is simple and transparent. It can be verified based on gross premium figures and detailed information on each reinsurance contract as included in Solvency II reporting. ***Paragraph 124*** The actual definition of volume measure for premium risk depends on commissions included in the written premiums. However, commissions are not associated to both ’expected‘ and ’unexpected‘ losses described in Paragraph 124 of Consultation Paper. For this reason, Insurance Europe believes that commissions should not be included in the volume measure for premium risk.	
2.4.1		
2.4.2	***Paragraph 137*** Insurance Europe notes that for option 2 an adjustment factor should also be applied to $FP_{existing}$ in order to obtain an appropriate premium volume measure.	

Paragraph 149

Insurance Europe notes it is not clear how the "alpha" is calculated, in particular regarding the proportion of multi-year contracts versus the one-year contracts. A recalculation of the SCR in one jurisdiction for the medical expense line of business (with only annual contracts starting the insurance cover on 1 January) indicated that the impact would be an increase of the SCR by 15% (€1bn).

Paragraph 151

Insurance Europe notes that for an adjustment factor of 30%, on average the volume measure seems to decrease, however, when considering the impact per line of business, there is an increase in volume measure for 12 out of 15 lines of business.

Paragraph 158-164

Recognition date

Insurance Europe **does not agree** with EIOPA's proposed clarification and definition of the initial recognition date for new business for N+1[1] where reference is made to the definition in article 17 of the Delegated Regulation for the reasons set out in this paragraph.

- Insurance Europe highlights that requiring an **extension of the volume factor to the pre-insurance cover period in line with Article 17** (initial recognition date) **would lead to a double counting of risks in the calculation of the capital requirement**. As during this pre-insurance cover period, the insurer only runs a risk related to a rise in claims handling costs. However, the calibration of the premium risk is based on claims triangles and makes no distinction between the period before the start of the insurance cover and the period of the actual insurance cover.
- In addition, Insurance Europe believes that **EIOPA's approach is not in line with the December 2011 calibration of the JWG of premium risk volatility factors**, which was carried out on the volatility of loss ratios by accident year taking the earned premiums on that accident year as the denominator. Defining a volume measure for premium risk different from earned premiums leads to inconsistency with the initial

[1] new business for N+1 represents contracts where the initial recognition date falls in the following 12 months as from the reference date (31/12/N) ie the date at which non-life underwriting premium risk is computed.

calibration and ultimately overestimates premium risk.

- The **reference to a recognition date based on article 17 of the Delegated Regulation for the identification of premium risk exposures is contradictory with an earlier position of EIOPA** as in 2014 Q&A where by FP_{future} should be zero for annual contracts and reported below:

Standard_SCR	SCR.9.2. NLpr Non-life premium & reserve risk	9.9	If a company writes annual or shorter duration policies is our understanding that the company would enter zero premium into FP future correct?	Yes, this is correct understanding.

- **Insurance Europe believes that premium risk should be compliant with recital 43 of the Delegated Regulation and that economic substance should prevail over legal form when deriving risk exposures**. Notification periods are legal features that do not appropriately reflect the risk exposures and sensitivity. Having two different amounts of SCR for an identical risk exposure period is not acceptable, as this could lead to an unjustified volatility of non-life underwriting premium risk between insurers. This is also illustrated in the example below.
- Additionally, **basing new business recognition dates on notification periods is both strongly counter-effective and leading to huge volatility in the certain cases.** Indeed, in some markets a notification period only exists when the insurer decides to review the tariff, ie to change the premium rates as from the renewal date. In the absence of a tariff revision, there is no notification period. This means that an insurer would experience major changes in the premium dates from one closing date to the other depending on the change in tariffs practice. Worse still, premium risk would increase in times when the insurer decides to increase the tariff and be on the safe side with regards unexpected risk 1 and conversely, would go down when the insurer does not review the tariff while actually facing more risks. This situation is inexplicable from an economic point of view and illustrates the fact that EIOPA's approach is clearly in contradiction with the principle of favoring economic substance over legal form (recital 43 of the Delegated Regulation).
- Insurance Europe highlights that under both options proposed by EIOPA in the Consultation Paper, **the reference to notification periods to define the recognition date of new business would lead to major increases in premium risk in markets that were not considering this feature so far**.

- By determining new business initial recognition dates on notification periods, EIOPA aims at increasing the consistency between the prudential balance sheet and premium risk approaches. While Insurance Europe believes this consistency makes sense as far as FPexisting is concerned, this is not the case or FPfuture. Indeed, these contracts generate a capital charge for the premium risk that is not compensated by future profits in the balance sheet.

However, future profits from these future contracts will ultimately be integrated in the prudential balance sheet at closure date (N+1) and will affect the distribution of the Net Asset Value at (N+1) closure date. The SCR amount, that theoretically corresponds 99.5th quantile of variation in Net Asset Value between (N) and (N+1), hence depends on the expected profitability accounted in the (N+1) balance sheet. But the current approach does not take this into account and as such premium risk is overestimated.

Against this background, Insurance Europe believes that **the recognition date should be aligned with the start of the insurance cover**.

Example on the volume measure of premium risk for two companies with different delays of notification but exposed to the same risk period

The example below illustrates that basing the recognition date for new business on notification periods is not appropriate as it may induce a strong volatility.

The example shows a theoretical case for two tacit renewal contracts, yearly renewed on 1 March for two different cases (ie case 1- with a delay of notification of 2 months and case 2 - with a delay of notification of 2 months - 1 day). The results below are presented for options 1 and 2 as proposed by EIOPA, and for annual or multi-year contracts (2 years).

Insurance Europe notes that the approach taken leads to very significant differences and is clearly in contradiction with the principle of economic substance over legal form (recital 43 of the Delegated Acts). Insurance Europe notes that basing the recognition date for new business on notification periods is not appropriate as it it may induce a strong volatility.

	Vprem	
annual	option 1	option 2
notice = 2 months - 1 day	14 months	12,6 months
notice = 2 months	16 months	17,6 months

The above table shows that there is a 2 month difference for Option 1 between the two cases and a 5-month difference for Option 2.

Multi-year (2 years)	Vprem	
	option 1	option 2
notice = 2 months - 1 day	14 months	14 months
notice = 2 months	28 months	21,2 months

The difference is even larger in case of multi-year contracts with an increase of 14 months for option 1 and about 7 months for option 2.

Insurance Europe notes that the approach taken leads to very significant differences and is clearly in contradiction with the principle of economic substance over legal form (recital 43 of the Delegated Regulation). Insurance Europe notes that basing the recognition date for new business on notification periods is not appropriate as it it may induce a strong volatility.

2.4.3

Paragraph 176

Insurance Europe welcomes the analysis and clarifications provided by EIOPA in the Consultation Paper with regard to the exposures to the different components of the non-life underwriting premium risk notably with respect to ‚unexpected risk 1' and unexpected risk 2‚.

EIOPA proposals:

However, Insurance Europe believes that these conclusions are incomplete and incorrect, as both options put forward by EIOPA maintain an unjustified over-calibration:

- **Option 1** the assessment of the 99.5% quantile on a one-year time horizon basis[2] of the non-life underwriting premium risk may imply premium exposures on several time periods beyond N+1. These exposures referred to

[2] See SCR definition in article 101-3 of Directive 2009/138/EC

as $FP_{existing}$ and FP_{future} in article 116 of the Delegated Regulation should be handled with care to avoid over-calibration and should adequately reflect diversification effects over time. Hence, the split between unexpected risk 1 and unexpected risk 2 should be appropriately reflected for these exposures, which is not the case in option 1.

- **Option 2** still overestimates the non-life underwriting premium risk for premium exposures beyond N+1. Unexpected risk 1 is overestimated for FP_{future} exposures notably because undertakings have the ability to mitigate unexpected risk 1 by repricing the new business. There is also a significant overestimation of non-life underwriting premium risk for multi-year contracts with respect to $FP_{existing}$ exposures.

Insurance Europe notes that the inclusion of risk in the volume factor should be consistent with the calibration exercise of the premium risk.

Insurance Europe believes the previously mentioned shortcomings can be addressed, therefore, **Insurance Europe puts forward the following proposal:**

Proposal - Appropriate adjustment factors applied to FP_{future} and $FP_{existing}$

$$V_{PREM,s} = Max[P_{(s)}; P_{(last,\, s)}] + Adjust_Factor \times [FP_{(existing,\, s)} + BETA \times FP_{(future,s)}]$$

With $FP_{(existing,s)}$ and $FP_{(future,s)}$ set to zero for one year duration insurance contracts

And Adjust_Factor set to 30% as a maximum and BETA to 50%.

Based on the clarifications provided by EIOPA in its Consultation Paper, Insurance Europe has elaborated a comprehensive reasoning set out in the following paragraph, based on which a proposal was developed to define the exposures of non-life insurance contracts for premium risk in an appropriate way.

Insurance Europe **agrees** with EIOPA's conclusions that:

1. Unexpected risk 2 does not apply to premium exposures beyond N+1. This indeed addresses a strong concern the industry raised in the response to the consultation in March, regarding the over-calibration the Delegated Regulation formula of premium risk is leading to, going beyond the one-year horizon underlying the SCR definition.
2. Unexpected risk 2 is the main source of the volatility targeted by non-life underwriting premium risk, in

particular for short term contracts. Unexpected risk 1 tends to have a different impact on the volatility, depending on the duration of the contract.

3. Unexpected risk 1 should only apply to premium exposures earned beyond N+1, against this background an adjustment should be defined, which has to be applied to exposure components referring to premiums earned beyond N+1 in order to capture the proportion of unexpected risk 1.

Insurance Europe **does not agree** with EIOPA on:

1. The method adopted to calibrate the adjustment factor, where EIOPA aims to maintain the premium risk value at the same level as it is under the current definition in the Delegated Regulation.
2. The proposal to limit the application of the adjustment factor to FP_{future}, while it should also be applied to $FP_{existing}$. As illustrated in figure 2.1 (paragraph 129) of the Consultation Paper, $FP_{existing}$ may only be exposed to unexpected risk 1 in order to comply with the SCR overarching time horizon definition.
   It is equally important to adequately recognize both the unexpected risk 1 and unexpected risk 2 components to which the different premium exposures are subjected. Because from the moment the exposures are derived from underlying contracts, these are aggregated according to their coverage period, independent of whether they are sourced from annual or multi-year contracts. In addition, Insurance Europe notes that it is key to have a fair treatment of all types of contracts as mentioned in recital 43 '*to avoid restructuring long-term contracts as short-term renewable contracts'*. Indeed, multi-year contracts satisfy a policyholder need and undertakings delivering these contracts should not be charged beyond the risk they bear.

Against this background Insurance Europe proposes the following steps leading to the appropriate formula:

Step 1: apply adjustment factor to FP_{future} and $FP_{existing}$ for the fact they only represent unexpected risk 1

Step 2: apply adjustment factor beta to FP_{future} as unexpected risk 1 can be mitigated by repricing

Insurance Europe believes that insurance undertakings are able to mitigate to a large extent the exposure to unexpected risk 1 with regard to FP_{future} , via a new tariff applicable to N+1 new business. This is the case for the time period between the reference date (31/12/N) and the date of issue of the N+1 new business. Additionally, unexpected risk 1 type events can be considered as market shocks, which are always known enough in advance to insurance undertakings (eg change in Ogden rate in UK, withdrawal of FGAO in annuities

revaluations in case of personal injuries linked to motor insurance in France, possible disengagement of the government in healthcare cost, ...). In addition, consequences of this kind of events are having a quite homogeneous impact on the whole market, new business price increase should not cause competition issues for insurers, and should therefore be rather easy to decide and manage.

Against this background Insurance Europe believes insurance undertakings are able to reprice (at renewal date for annual contracts and at the initial contract date for multi-year contracts) or to define other management actiosn, which should lead to an additional adjustment (ie reduction) of the FP_{future} factor in comparison to $FP_{existing}$.

Step 3: FP_{future} equals 0 for annual renewable contracts

Insurance Europe believes that for annual contracts, FP_{future} should be equal to zero. As unexpected risk 2 is not applicable to FP_{future} and unexpected risk 1 can be mitigated by repricing the N+1 new business.

Insurance Europe believes FP_{future} can always be considered negligible (ie max 4.2% of one-year of earned premiums) even when making abstraction of the insurer's ability to reprice new business for the predicable events linked to unexpected risk 1.

To illustrate this:

Assume that on the European non-life insurance market contracts are on average issued/renewed on 1 March. It can then be considered that companies are on average exposed to 10/12 of unexpected risk 1 or 83% (indeed the first two months of unexpected risk 1 of N+1 are accomodated by new business tariffs as January N+1 and February N+1 are past events from 1 March N+1 onwards). The amount of FP_{future} at exposure is equal to 2 months (ie January and February N+2). Taking into account EIOPA's conservative adjustment alpha factor set to 30% the exposure to the non-life volatility factors calibrated by the JWG in December 2011 can be estimated as: 10/12*2/12*30% = 4.2% of one year of earned premiums.

However, as pointed out earlier, insurers are able to reprice the tariffs for new business for unexpected risk 1 events. Insurance Europe believes that the extreme cases for which no anticipation could be made may represent 10% of the unexpected risk 1 events, which would lead to 0.4% of one year of earned premiums that could not be repriced, which is neglegible.

Insurance Europe notes that the illustration remains valid, irrespective of the actual date at which the yearly

	renewal takes place. *Step 4: „adjust_factor*FP$_{existing}$"should be equal to zero* **However, for annual contracts " $Adjust_factor \cdot FP_{(existing,s)}$" would be negligible, leading to a volume measure for premium risks of $max(P_s; P_{(last,s)})$for annual renewable contracts.** Against this background, the volume measure for premium risk for one year renewable contracts would equal one year of earned premiums, which is in line with the underlying calibration of the Joint Working Group in 2011 and reflected in the sigmas of the current premium underwriting risk factors in the Delegated Regulation. Insurance Europe proposes the following **method for determining the volume measure for premium risk** based on the abovementioned reasoning: Annual renewable contracts: $V_{(prem,s)} = max(P_s; P_{(last,s)})$ Multi-year contracts: $V_{PREM,s}$ = Max[$P_{(s)}$; $P_{(last,s)}$] + Adjust_Factor x[$FP_{(existing, s)}$ + BETA x $FP_{(future,s)}$] Where '*Adjust_factor*' equals the proportion of unexpected risk 1 within the underwriting premium risk factor sigma. And with '*BETA*' being an adjustment factor to reflect the ability mitigate unexpected risk 1 in the new tariff of N+1 new business. Insurance Europe proposes to set ‚Adjust_Factor' to 30% as a maximum and ‚BETA' to 50%.	
3.1	Insurance Europe welcomes the Commission's request for EIOPA to investigate the appropriateness of the standard parameters for mortality and longevity risks in the life and health underwriting risk modules. As EIOPA highlights in paragraph 235, there are numerous limitations to the methodology it followed for the recalibration exercise on longevity and mortality risks. Given the limitations of the recalibration methodologies, Insurance Europe believes that no changes are justified for either longevity or mortality risk factors. Insurance Europe remarks that EIOPA uses an equivalent point, ie age 60, for both stresses. This seems counter-intuitive as one would assume that mortality exposures would generally be lower for the younger ages than longevity	

	exposures. Insurance Europe notes that the proposed increase in the mortality shock (from 15% to 25%) could have an impact not only on the SCR, but also on the matching adjustment. Specifically, as noted in article 77b (f) of the Solvency II Directive: *"where the underwriting risk connected to the portfolio of insurance or reinsurance obligations includes mortality risk, the best estimate of the portfolio of insurance or reinsurance obligations does not increase by more than 5 % under a mortality risk stress that is calibrated in accordance with Article 101(2) to (5);"* An increase in the mortality shock could therefore lead to some undertakings no longer fulfilling this condition to apply the MA which could be an unintended consequence of EIOPA's recommendation.	
3.2		
3.3		
3.4.1		

3.4.2	***Paragraphs 194***
	
	Insurance Europe believes that this is a crucial, incorrect and untested assumption:
	
	• *Crucial:* In the underlying model, the size of the error term is independent of age, and independent of time. The only real 'model' therefore (which completely drives the results) is that risk (of all products for any one client) is one-to-one related to life expectancy.
	• *Incorrect:* The sensitivity of liability valuation to age does not go through life expectancies: see also a recent UNESPA paper which demonstrate that this approach is incorrect.
	  ○ Each possible future age is presumed to contribute equally to the risk of a product of a particular client. This may be meaningful for longevity products (from a certain age onwards), but not for mortality products (that often end at, say, age 65).
	  ○ This leads to systematic biases. For the portfolio as a whole, this approach puts far too much weight on mortality risks at very high ages, since it is incorrectly deemed to apply to all products at all ages. In this case, Insurance Europe is concerned that it leads to exaggerated mortality risks.
	• *Untested:* This assumption should have been tested. How do liability valuation risks depend on age? If changing mortality tables result in different Best Estimates, which ages are most affected?
	
	Paragraphs 208 & 209	

There is an important assumption that the error terms are independent and identically distributed (iid) over time. This assumption should be made explicit.

In addition, Insurance Europe has the following remarks:

1. One-year longevity risk largely arises from the fact that mortality trends are stochastic. Here, Θ is regarded as fixed, ie non-stochastic. Risk therefore appears in the form of parameter risk. This model is not by itself suited to capture longevity risk. One needs time-series of realistic estimates of Θ (given some estimation period). Indeed, there is a dependency between the BE estimation period and the risk estimation period. If the BE is driven by short-term histories, risk will be relatively large.
2. EIOPA was asked to examine granular approaches to estimate risk. This can hardly be done with a model where the size of the error term is independent of age, and independent of time. The assumption in paragraph 194 is crucial.
3. There is a whole (t.x) matrix of η terms to be explained, but one a line-item ('t') of error-terms? Insurance Europe's guess is that you need another error term dimension.
4. A crucial assumption relates to the fact that the size of the risk term is independent of the logit level. Did EIOPA check that assumption? Insurance Europe's guess is that higher logits lead to higher absolute risks (except perhaps at the highest levels).

In paragraph 209, Insurance Europe understands the negative correlation between mortality risk and longevity risk to be related to the stochasticity of k2. However, it remains unclear how would EIOPA create a correlation between two trends with stochastic error terms. Was it also on the basis of a single age, 60?

Paragraphs 217 to 220

It is not clear how the parameters are estimated. As indicated above, the choice of estimation period is crucial for the results. Also, it is not clear why the parameters are only estimated once, rather than repeatedly over time.

In addition, the risk dimension in this figure (downward sloping with age) is driven by the use of remaining life expectancies (downward sloping with age), and by a square-root of time formula for iid distributed mortality changes over time (here downward sloping, because young people have longer remaining life expectancies). Younger people have longer life expectancies, and hence have more iid terms added.

Paragraphs 221

	Figure 3.2 relies on the use of life expectancies as a measure of risk. Insurance Europe assumes that the difference between the proposal and the current Standard Formula is largely driven by an (untested) assumption about the relationship between the size of the shocks and mortality rates. It seems useful to at least test this assumption. ***Paragraphs 237*** In Insurance Europe's view, the life expectancy approach suggested here should lead to a mortality stress calibrated at an age lower than that of the longevity stress, since the average age at exposure is lower.	
3.4.3	***Paragraphs 244 to 246*** As the mortality table plays an important role in the determination of the mortality risk and longevity risk and in the best estimate, a consistent approach is needed. However, in several member states the underlying characteristics are not the same. In some jurisdictions the mortality table in the best estimate already includes some future projections of mortality improvements, which could therefore be part of the shock if compared to those jurisdictions where the mortality table does not include such future projections. Therefore, the shock should have accommodated this difference in order to avoid under/over statement of the risks.	
4.1	Insurance Europe welcomes the Commission's request for EIOPA to propose methods and criteria for simplifications for the Health Catastrophe risk submodule and, where appropriate, to develop a simpler structure for this this submodule. It also appreciates the work done by the CAT WS to investigate and develop simplifications for the Health Catastrophe risk submodule. Insurance Europe welcomes the proposal to remove the "Disability that lasts 10 years caused by an accident" scenario from the list of events which are parameters in the Mass Accident risk and Accident Concentration risk submodules (see Annex XVI). This was an unrealistic parameter within the standard formula. Further comment on the advice is provided in the following sections.	
4.2		
4.3		
4.4		
4.5.1		
4.5.2	**<u>Mass accident risk</u>** Insurance Europe supports the removal of the 10-year scenario and the recalibration of the remaining scenarios (1-year	

	temporary disability and permanent disability). This will reduce complexity of the calculation and increases uniformity of assumptions across the industry without the loss of risk sensitivity. However, it will remain challenging to estimate the benefits payable under events, particularly where these benefits are recurring. **<u>Accident concentration risk</u>** Insurance Europe acknowledges the counterexamples put forward by EIOPA in response to the two proposed simplifications for the Accident concentration risk submodule. However, it highlights the continued difficulty for undertakings to identify their largest accident risk concentration, as defined in Article 162 of the Delegated Regulation. Insurance Europe believes that both simplifications discussed will be an appropriate simplification in many cases. Undertakings should, therefore, be able to use these approaches when determining their largest concentration risk, subject to appropriate assessment and documentation. Insurance Europe believes that NSAs should recognise the challenges inherent in this submodule and should provide sufficient flexibility for undertakings to make an appropriate judgement of a suitable proxy exposure. **<u>Pandemic risk</u>** Insurance Europe recognises and agrees that a pan-European assessment of drivers of maximal unit claim costs is neither appropriate, nor risk sensitive. It welcomes the proposal for NSAs to provide this information at a national level on a non-obligatory basis. However, Insurance Europe notes that EIOPA do not discuss at which periodicity this information should be provided, but expects it to be on a regular basis. Insurance Europe expects the provision of this information to be especially useful for smaller and medium sized undertakings. However, undertakings who are able to make a tailored assessment of their claim costs should not be obliged to use any industry-wide averages.	
4.5.3	Insurance Europe welcomes EIOPA's advice with regard to the Mass Accident risk submodule. The removal of the 10-year scenario and the recalibration of the remaining scenarios (1-year temporary disability and permanent disability) will reduce complexity of the calculation and increase uniformity of assumptions across the industry without the loss of risk sensitivity.	
5.1	Insurance Europe welcomes the Commission's request for EIOPA to propose methods and criteria for simplifications for the Man-made Catastrophe risk submodule and, where appropriate, to develop a simpler structure for this this submodule. It also appreciates the work done by the CAT WS to investigate and develop simplifications for the Man-	

	made Catastrophe risk submodule. Insurance Europe welcomes EIOPA's advice in a number of areas. It believes the proposals will alleviate calculation burden arising from some submodules, eg Fire risk while improving risk sensitivity in other areas eg Marine risk submodule. However, Insurance Europe would like to highlight there will be limitations to any standard formula and that a balance must be struck between risk sensitivity and complexity. A standard formula will not, and should not strive to, be able to account for every conceivable scenario and risk. Further comment on the advice is provided in the following sections.	
5.2		
5.3		
5.4.1	Insurance Europe regrets that EIOPA does not investigate the use of Possible Maximum Loss/Estimated Maximum Loss measures. It believes that the use of Possible Maximum Loss/Estimated Maximum Loss measures would arguably improve the risk sensitivity of the calculation as they are derived with consideration to construction material, the use of firewalls and other preventative measures. Furthermore, these measures are used extensively as part of the underwriting and risk management processes and are generally readily available. While Insurance Europe recognises the subjectivity inherent in these measures and notes that their use would require careful recalibration, clear definition and an appropriate supervisory process, it still believes it is an approach worth exploring.	
5.4.2		
5.4.2.1		
5.4.2.2	Insurance Europe agrees with EIOPA that the calibration of the fire risk submodule remains appropriate ie 100% total loss within a 200m radius circle. Increased risk sensitivity could arguably be achieved through the introduction of multi-level damage zones (eg 100% loss within 100m, 50% loss between 100m and 200m, 25% loss between 200m and 300m) but this would result in unjustified complexity in the standard formula.	
5.4.2.3	Insurance Europe welcomes EIOPA's proposal to introduce a simplification for the Fire risk submodule. It agrees that the existing approach is optimal from a risk sensitivity perspective and welcomes a simplification which	

	fits within the existing structure of the submodule but which will reduce the calculation burden for undertakings. Insurance Europe expects the simplification to broadly maintain the current level of risk-sensitivity. It believes that requiring the assessment of the largest exposures per risk type and the introduction of an underpin for residential-only portfolios strikes an appropriate balance between complexity and risk-sensitivity. Insurance Europe notes that it is possible that the simplification could result in a lower capital requirement than the existing standard formula approach when insurers have a homogenous set of insured values, such that the "true" highest exposure in a 200m radius is driven by an accumulation of risks, rather than the largest individual risks. This is recognised for purely residential line insurers through use of an underpin, but it is worth noting that this can also occur for insurers writing small commercial business, and those writing larger business but relying on per risk policies to level the net loss across risks. However, Insurance Europe also notes that the existing provisions for the use of simplified calculations, as detailed in Article 88 of the Delegated Regulation, should ensure that the proposed simplification is used only where it is appropriate to do so.	
5.5.1		
5.5.2.1		
5.5.2.2	Insurance Europe acknowledges the issue raised by stakeholders in their request for the inclusion of vessels other than tankers and platforms in the Marine risk submodule. However, it cautions against the inclusion of every foreseeable scenario into the standard formula. A standard formula cannot, and should not strive to, account for every conceivable scenario. A balance must be struck between risk sensitivity and complexity. Insurance Europe further notes that there are the other parts of the Solvency II framework which are designed to address the non-uniform nature of risk profiles across the industry eg the ORSA.	
5.5.2.3	Insurance Europe supports the extension of the existing "tanker" scenario to include the risks to other vessels rather than the introduction of a new scenario. This represents a pragmatic approach to resolving the issue which will not unduly penalise firms who have both tanker and other vessel exposures. However, the proposed threshold of EUR 100,000 could be considered to be too low, considering what a small private boat costs and what appears be the aim of this extension, as illustrated by the example of Costa Concordia in paragraph 316. A threshold of EUR 1,000,000 or EUR 500,000 would be more appropriate as otherwise there is a risk of double counting, since smaller boats are usually included in the premium and reserve risks submodule.	
5.6.1	Insurance Europe supports the clarification of the application of the Motor vehicle liability risk submodule through	

	EIOPA's Q&A process. Stakeholders' confusion over the correct application of the calculation within the motor vehicle liability risk submodule illustrates the importance of full, correct and transparent documentation by EIOPA. This is necessary to enable consistent application of the framework across all jurisdictions.	
5.7.1		
5.7.2.1		
5.7.2.2		
5.7.2.3	Insurance Europe welcomes the proposal to alter the identification of the largest risk exposures for the Marine, Fire and Aviation (MFA) submodules from gross to "net of reinsurance where that reinsurance cover alters the relative ranking of the exposure within the undertaking's portfolio, based on the size of the exposure". It further welcomes the proposal for undertakings to document and assess cases where the distortion persists, despite the proposed change, through the ORSA and subsequent discussion with their NSA. It agrees that this strikes an appropriate balance between increased risk sensitivity and complexity and will remove the distortion identified in the majority of cases. Insurance Europe further believes that where an insurer has the capability and resource to make the assessment of its largest exposure, net of all reinsurance, it should be entitled to do so. The ability of an undertaking to make the assessment of the largest exposure on a net of all reinsurance basis will depend on its portfolio, reinsurance programme structure, internal resources and modelling software amongst other aspects. Due to the complexity of the resulting calculation Insurance Europe believes that NSAs should adopt a pragmatic approach to supervising the calculation as proposed by EIOPA. Finally, Insurance Europe would welcome further clarification from EIOPA on the impact this proposal has on other submodules, in particular, the counterparty default risk (CDR) submodule. As outlined in Article 196 of the Delegated Regulation, the calculation of the risk-mitigating effect of a reinsurance arrangement requires the calculation of the hypothetical capital requirement under the assumption that the reinsurance arrangement does not exist. If this assumption results in a change in the largest "net" exposure then a CDR capital charge will be incurred for that specific reinsurance cover. The following example provides illustration of this issue. Insurance Europe does not believe that this is an intentional consequence of the proposal and expects that a simple	

clarification would resolve this issue.

Fire risk				
Risk	A	B	C	D
Gross exposure	100	90	90	40
Facultative cover	75	70	60	0
Counterparty	c1	c2	c3	
CQS	1	1	1	
Net exposure	25	20	30	40

Existing solvency 2			
Fire risk SCR	25		
Counterparty risk SCR	c1	c2	c3
Recoverables	0	0	0
Risk mitigating effect	75		
LGD	18,75		
Vinter	0,01		
Vintra	0,02		
V	0,04		
Sigma	0,19		
SCR	0,56		

Proposal to alter to identification of largest risk on a net basis			
Fire risk SCR	40		
Counterparty risk SCR	c1	c2	c3
Recoverables	0	0	0
Risk mitigating effect	60	50	50
LGD	15	12,5	12,5
Vinter	0,06		
Vintra	0,03		
V	0,10		
Sigma	0,31		
SCR	0,93		

Insurance Europe:
In the calculation of the hypothetical SCR, risk A becomes the largest net risk as the facultative cover is assumed not to exist

Insurance Europe:
In the calculation of the hypothetical SCR, risk B becomes the largest net risk as the facultative cover is assumed not to exist

Insurance Europe:
In the calculation of the hypothetical SCR, risk C becomes the largest net risk as the facultative cover is assumed not to exist

6.1

Insurance Europe welcomes the Commission's request for EIOPA to propose methods and criteria for simplifications for the Natural Catastrophe risk submodule and, where appropriate, to develop a simpler structure for this submodule. It also appreciates the work done by the CAT WS to investigate and develop simplifications for the Natural Catastrophe risk submodule and for its work on the recalibrations.

Insurance Europe welcomes the proposed simplification for all natural catastrophe risk submodules and that the final simplification is an optional (not mandatory) simplification under the framework of Article 88 of the Delegated Regulation, rather than a replacement of the current standard formula approach. It supports the second formulation of

	the proposal which provides additional risk sensitivity and flexibility for undertakings. Insurance Europe welcomes EIOPA's recalibration initiative. However, it believes that a number of the proposals put forward by the CAT WS contain excessive and unjustified prudency margins. Several of the proposals do not reflect the scientific data provided as input by the various modelling companies. The proposals in many cases are anchored to the existing calibrations which are undocumented, unjustified and have been identified by EIOPA as being "materially inappropriate". Insurance Europe does not believe that EIOPA's proposed ex-post adjustment to account for restrictive policy conditions (indemnity limits and deductibles) in certain scenarios will have any meaningful impact. However, Insurance Europe does recognise the difficulty in incorporating these into the standard formula.	
6.2		
6.3.1		
6.3.2	Insurance Europe agrees that the introduction of an optional simplification is preferable to the alteration of the existing structure. A lot of resource has been invested in the development of systems and processes to geocode exposures and calculate the Natural Catastrophe risk capital requirements. Changing the structure will likely lead to additional cost without commensurate benefit.	
6.3.3.1		
6.3.3.2	Insurance Europe believes that option 5 and option 6 are both suitable approaches to providing a simplification for unallocated natcat exposures. However, as evidenced by the testing of the options in section 28, Annex to Chapter 6, option 5 can result in unjustifiable levels of prudence where undertakings have a large proportion of multi-zonal exposures. For example, in the case of Italy Earthquake, the entire "Terna S.P.A" exposure (Italian Electrical Lines) would be allocated to the L'Aquila CRESTA Zone. Considering this single exposure, the earthquake risk capital calculated according to option 5 would be about ten times the current earthquake risk capital which is calculated based on a pro-rata approach.	
6.3.3.3	Insurance Europe supports the inclusion of a simplification for the natural catastrophe risk submodules which enables undertakings to easily deal with unallocated or small amounts of unallocatable (ie moving) exposures. Insurance Europe believes that the second formulation of the option 5 proposal is preferable for the following reasons: 1. It will result in greater risk sensitivity; 2. It will not unduly penalise undertakings with "moving" exposures;	

	3. It recognises the best-endeavours of undertakings to geocode their exposures; 4. It will be prudent but will avoid some of the excessive prudency inherent in the first formulation (as illustrated in the analysis in section 28, Annex to Chapter 6).	
6.4.1		
6.4.2		
6.4.3.1		
6.4.3.2	Insurance Europe welcomes the request for the CAT WS to provide a holistic recalibration of the Windstorm and Flood perils which was provided by EIOPA subsequent to the publication of the consultation. To address the issue of cross-border consistency, Insurance Europe believes the only viable proposal is for EIOPA to recalibrate all relevant scenarios. A full, European-wide recalibration of the Windstorm and Flood scenarios would provide a consistent and justifiable calibration for these risks. Altering the recalibrations proposed by the CAT WS, which are already conservative relative to the scientific data, would undermine the work of the CAT WS. Insurance Europe, further, notes that the issue of cross-border consistency was discussed within the CAT WS and, to an extent, already informed its recommendations. The existing calibrations are undocumented, unjustified and have been identified by EIOPA as being materially inappropriate. Altering the proposals put forward by the CAT WS would, in effect, be anchoring any future calibrations to the existing calibrations. As the country factor proposals put forward by the CAT WS for the Windstorm and Flood perils will be reassessed, Insurance Europe notes that the majority of the proposals detailed in the paper can now be considered to be provisional. However, please see the next section for Insurance Europe's comments on these recalibration proposals.	
6.4.3.3	Through its assessment of the material inappropriateness of the current calibration EIOPA, identified a number of parameters which were considered to require recalibration. Insurance Europe welcomes the work done carried out by the CAT WS on the recalibration of the identified scenarios and recognises the challenges faced by the CAT WS including, but not limited to, the high variance between model estimates, the difficulty of reconciling different model parameters, data inputs and coverage levels. However, Insurance Europe believes that many of the proposed scenarios contain excessive levels of unjustified	

prudence relative to the model input that was provided. For example:

- The proposed Finnish Windstorm scenario country factor has a 140% prudency margin above the highest model estimate and a 190% prudency margin above the mean model estimate.
- The proposed Hungarian Flood scenario country factor has a 33% prudency margin above the highest model estimate and a 50% prudency margin above the mean model estimate

This is due, in part, to the design of the "mini-delphi" process, the high-level of supervisory representation on the CAT WS and the anchoring of expectations to the existing calibrations.

Insurance Europe notes that the input provided by the various modellers was requested to be calibrated to the required level of prudence of the Solvency II framework ie a 1-in-200 year event. While there are justifiable reasons for the CAT WS's recommendation to be outwith the range of input provided by the models, it does not agree that additional prudence should be introduced in to the proposals, especially for scenarios where there is significant data, modelling exposure and expertise.

Insurance Europe believes it is imperative that EIOPA publishes all documentation supporting the CAT WS recommendations. This is required to substantiate the recommendations of the CAT WS and to enable undertakings to make an assessment of the divergence of their risk profile from the industry profile assumed in the calibrations.

Insurance Europe provides specific comments on the various recalibrations below:

Slovakia Earthquake	The proposed change of 0.01% represents spurious accuracy. Insurance Europe supports the recalibration of the zonal factors and in particular the normalisation of the scenario which the industry believes reflects the risk of this scenario more accurately.
Greek Earthquake	Insurance Europe believes the proposed country factor for Greek Earthquake risk is unjustifiably conservative.
Italian Earthquake	Insurance Europe believes the proposed country factor for Italian Earthquake risk is unjustifiably conservative. Insurance Europe does not believe that the recalibration adequately incorporates the presence of policy conditions (sub-limits and deductibles) on Italian risk portfolios (average of the Italian portfolio is limited to under 30%).

	The evidence relating to the losses suffered on historical events as well as the results of evaluations carried out by the internal model or by main specialist software (RMS, AIR) on the market show strong miscalibration of risk calculation.	
Finland Windstorm	Insurance Europe believes the proposed country factor of 0.06% is too conservative. The high degree of expert judgement inherent in this proposal, arising from the omission of forestry data in the modelling input, should be validated through the assessment of modelling including forestry data. Insurance Europe supports the proposal to provide a zonal calibration across 19 zones.	
Sweden Windstorm	The proposed change in zonal weights is unwarrantably high for some of counties in the provisional recalibration. In particular, historical data show that the two counties with the highest zonal weights (13 Halland and 9. Gotland) are not the ones with the highest losses. In addition, some zone correlations are illogical from a geographical perspective (notwithstanding them being aggregation matrices), eg 03 Uppsala and 12 Skåne have a correlation coefficient of 0.25 even though they are not geographically close In addition, there is some ambiguity/error in the Solvency II Delegated Regulation, Annex IX, as to what consitutes the risk zones for Sweden which should be recitified. Insurance Europe would appreciate if it can be clarified that the 21 risk weights that are presented in Annex X (page L 12/251), correspond to the 21 counties in Sweden.	
Hungary Windstorm	This scenario is not significant and should be disregarded.	
Spanish Windstorm	Insurance Europe strongly supports the recalibration proposal for windstorm risk in Spain, since the Spanish insurance sector has worked intensively, in coordination with the Spanish supervisor, in the recalibration of this scenario, coinciding with both parties in developing a proposal which is more precisely adjusted to the characteristics of the Spanish market.	
Czech Hail	Insurance Europe notes that the country factor of 0.045% is at the upper end of the calibration range put forward by the modellers. Based on the first version of calibrated zonal factors, the estimated losses appear to be overstated compared to the results of a third-party catastrophe model.	

	In addition, Insurance Europe raises two related points 1. It reiterates that EIOPA should address the arbitrary scaling factors for the Motor LoB for the Flood and Hail scenarios. 2. The provision of an updated CAT helper tab with the finalised parameters would be welcome.	
6.5.1		
6.5.2		
6.5.3.1		
6.5.3.2		
6.5.3.3	Insurance Europe acknowledges the difficulty of incorporating the presence of individual undertakings' contractual limits into the volume measure of the catastrophe risk submodules. However, it does not believe that EIOPA's proposed ex-post adjustment will sufficiently address the issue. For the majority of catastrophe scenarios, severe restrictions would need to apply before any benefit was provided. For example, testing of the proposal by one insurer shows that even though the average indemnity limit for its flood and earthquake portfolio is 30% of the sum insured, the proposed adjustment doesn't change any of the CRESTA Zone results. Insurance Europe further highlights that the proposed adjustment applies at the level of the risk zones which reduces its ability to capture individual policy limits. For example, any contracts without restrictive contractual limits in a given risk zone would, in effect, be averaging out those contracts with restrictive contractual limits.	
7.1	Insurance Europe believes that the interest rate risk methodology within the existing Solvency II framework remains appropriate. The current calibrations, while not perfect, should not give rise to prudential concerns, because the overall conservative design of Solvency II, compared to realistic cash flows, ensures insurers hold capital for extreme interest rate scenarios. In addition, key features of the methodology were designed in conjunction with other aspects of the framework and should not be considered in isolation or without impact assessment, and definitely not before the 2020 Solvency II review. Preliminary assessment shows that EIOPA's proposals could result in a major impact on solvency ratios. Solvency II entered in force only two years ago and has only begun to be considered by financial analysts as a relevant and efficient	

	framework which brings transparency to the public and the market. Significant changes to important parameters which would result in the volatility of the solvency position could be detrimental to the image of the Solvency II regime. Insurance Europe notes that, on own initiative, EIOPA is working on investigating changes to the interest rate risk charge methodology. It disagrees with EIOPA that Proposal A and Proposal B are simple and appropriate adjustments to the current methodology. As proposed, both models result in an overly conservative estimate of interest rate risk. Given EIOPA's investigations, Insurance Europe is disappointed that EIOPA has not investigated the "shifted approach" further. By not including it in the data collection exercise, EIOPA has restricted the scope of its assessment and has, to all intents and purposes, presented a fait accompli. The potential impact of changes in the design and calibration of the interest rate risk submodule should not be underestimated. Further investigation of the models proposed by EIOPA is required and, in particular, a more comprehensive consideration of their interaction with other parts of the framework over a longer time horizon is needed.	
7.2		
7.3	**Paragraphs 436-439** Insurance Europe reiterates that the original design and calibration of the interest rate risk submodule were conducted in conjunction with other, interconnected, parts of the Solvency II framework, namely the RFR methodology, including the UFR, and the LTG measures. Any changes to the interest rate risk submodule will alter the balance provided by these different parts of the framework and should, therefore, not be made in isolation. The issue of changing market risk correlations, acknowledged by EIOPA, further substantiates this position. Indeed, Insurance Europe believes it is strange that EIOPA has decided that the market risk correlations are out of scope when it was EIOPA, itself, who decided the scope of its work in this area. **Insurance Europe does not believe that EIOPA's analysis has fully addressed stakeholders' concerns and does not agree that a change to the interest rate risk submodule is necessary at present. The appropriate time to assess whether the interest rate risk submodule has to be changed and – if so - its calibration is during the review of the LTG measures in 2020.** **Paragraph 440-449** Insurance Europe reiterates the following economic considerations which must be inherent in the design of the interest-	

rate risk submodule

- Lower capital requirements in a low yield environment to reflect the economic reality that there will be diminishing demand as interest rates decrease.
- The presence of a lower bound.
- The differing correlations of market risk in different market environments.

Furthermore, Insurance Europe believes that there needs to be recognition of the unprecedented combination of economic events which led to the current low interest rate environment; declining inflation following the 2008 and 2011 financial crises, an increased demand for long-term safe assets to satisfy new regulatory requirements along with additional demand from the ECB's (and other central banks) QE programme have all contributed to current economic conditions. In addition to this, economic conditions and public financial conditions differ between nations and supports a different optimal policy mix going forward. In this regard, countries with strong public finances and stable national currencies are more likely to use budget measures rather than expansive monetary policy in events of economic slowdown, making interest rates close to zero even more unlikely.

These events are extremely unlikely to be repeated and calibrating the interest rate risk submodule without due regard to these facts will overstate the risk and would be contrary to the market consistency principle underlying the Solvency II framework.

It is also worthwhile highlighting that the low yield environment had already developed and was at historical low when the EC's call for advice was prepared and issued, yet the EC chose not to include this as part of the specific advice requested from EIOPA.

Paragraph 450-455

Insurance Europe firmly believes that the calibration and application of interest rate shocks should only cover the liquid part of the term structure. The extrapolation of the curve after the last liquid point (LLP) should be carried out subsequent to the application of the shock. This is essential to achieve consistency with the valuation methodology, reduce complexity of interest rate risk hedging and provide a more economically realistic framework.

Only a correct extrapolation can yield the right changes beyond the LLP. If interest rates until the LLP drop significantly, the extrapolation also results in a marked drop of extrapolated rates. Thus, the given example of a 19% decrease as well as any other big or small change are automatically modelled in the right way. In contrast, to apply a factor in the

	extrapolation area which is based on a maximal change would overstate the risk in almost all situations. Insurance Europe provides comments to EIOPA's counterarguments to changing the interest rate risk submodule structure in this way, as outlined in paragraph 455. • Firstly, EIOPA states that it has performed simulations with differing UFR values which indicate that the maximum change at 90Y tenor point is 19%. Insurance Europe notes that the UFR is currently a fixed parameter of 4.2% (for the Euro) and no decision has, as yet, been taken by the Commission to alter this. In any case, changes to the extrapolated part of the curve arise primarily from changes in the liquid part of the curve. Extrapolation of the shocked curves therefore yields the correct modelling of the entire curve. It guarantees that the risks are neither underestimated nor overestimated. The use of a rough shock factor for the extrapolated part of the curve is not necessary, in contract, Insurance Europe believes it is inappropriate. • Secondly, Insurance Europe does not agree that extrapolation of the shocked curves increases complexity; there is no change in the Smith-Wilson extrapolation methodology, it is only applied to shocked input data. EIOPA notes that a change to the Directive would be required for it to be empowered to publish the stressed, extrapolated curves. Insurance Europe disagrees, noting that EIOPA calculates and publishes shocked curves at the moment and provides a mathematical tool for calculating the extrapolated curves. Nevertheless, if EIOPA feels legally unable to provide the information or a tool for undertakings to calculate the shocked curves then Insurance Europe believes that this substantiates its argument that the interest rate risk submodule should only be altered in the 2020 review when changes to the Directive are foreseen. This option would be preferable to the industry which expects any changes to the Solvency II framework to be properly developed, calibrated and justified, rather than being short-term and ad-hoc. • Thirdly, EIOPA notes the risk of not taking into account pre-extrapolation forward rates. In fact, this risk is precisely avoided by extrapolation of the shocked curves. Insurance Europe reiterates that a thoroughly considered, well-designed, properly calibrated and justified change to the interest rate risk submodule would be possible for the 2020 review. In summary, the extrapolation must be done after the liquid part of the curve is shocked. This is required to generate scenarios which are in line with the requirements of the Directive.	
7.4.1		

7.4.2	As noted above, Insurance Europe does not believe a change to the interest rate risk submodule is justified in the 2018 limited review of the standard formula and should be instead considered as part of the 2020 review. **Insurance Europe does not believe that either Proposal A (2% minimum shock) or Proposal B (the "combined" approach) are appropriate alternatives to the existing approach for modelling interest rate risk** for the following reasons; • They provide an overly conservative estimate of the interest rate risk, particularly in a low yield environment. • They are based upon unjustifiable economic assumptions. • They may encourage procyclical behaviour. • They are more complex than is required. • They result in erratic forward rate profiles which present technical modelling challenges. Given the investigations already made by EIOPA on this issue, Insurance Europe notes that EIOPA's proposal on the shifted approach could be the most appropriate of the three approaches investigated. While the exact specifications of this approach require further analysis, calibration and a wide impact assessment, Insurance Europe believes that this could be an economically sensitive and appropriate way to model interest rate risk within the standard formula. Insurance Europe reiterates that care needs to be taken in an area that is of such importance for insurers. The regulatory risk-free yield curve and the design of the interest rate risk submodule are central to the management of interest rate risk. The objective of the design therefore needs to be a simple and robust solution. Detailed comments on all approaches assessed by EIOPA are provided below. **Paragraphs 467 – 477 – The shifted approach** Insurance Europe supports EIOPA's assessment that the shifted approach has many advantages compared EIOPA's Proposal A and Proposal B: • It respects the main empirical fact that shocks in times of low interest rates are smaller. • It works well with low and negative interest rates. • It is a simple and transparent approach. • It is as close as possible to the previous relative approach. • It is easy to calibrate to the required 99.5% quantile. • It is quite robust in terms of the shift parameter.	

- It is data-driven.

In its assessment of the shifted approach, EIOPA has included the results of its testing of one calibration of the relative shifted approach which it suggests does not meet the calibration objectives. It is not clear how EIOPA have carried out the calibration of this model and Insurance Europe have been unable to replicate the analysis.

Indeed, Insurance Europe is surprised that EIOPA's backtesting of the shifted approach model does not demonstrate an appropriate level of calibration. The 99.5% confidence level should be inherent in the calibration of the model. For example, in the case of the relative shift approach without PCA, the 99.5% quantile of annual changes in the data should determine the shock factor. Therefore, by construction, the backtesting of a model against the data set it was calibrated on should always be passed.

In summary, the shifted approach could have decisive advantages. Insurance Europe does not believe that EIOPA's analyses are sufficient to discard it. At the very least, further analyses are required to assess if an appropriate calibration can be achieved which would meet the objectives of the Solvency II framework.

Paragraphs 478-486 – Proposal A – A symmetric 200 bps shock with floor

Insurance Europe does not believe that the introduction of a 2% minimum shock is appropriate, particularly in a low-yield environment.

While there is evidence that interest rates have experienced downward shifts greater than 2% in the past, it is economically unviable for interest rates to experience a parallel downward shift of 2% in the current market environment. In reviewing interest rate movements over the last 20 years this type of shock is beyond the 1 in 500 year point in the distribution of rate changes for the 5 year tenor. This is true for several currencies including the USD and EUR curves.

Based on EIOPA's risk-free rates as at 31 October 2017, applying this downward stress would result in a yield curve which was negative beyond the 25-year tenor point; purchasing and holding to maturity a 20-year zero-coupon swap at these levels would result in c.13% nominal capital loss.

Insurance Europe believes this to be wholly unrealistic. In such an environment, long-term investors would hold their assets in cash rather than continue to invest in negative yielding securities which guaranteed the destruction of capital. Furthermore, Insurance Europe does not believe it to be conceivable that a market as large as the Euro interest rate market could achieve such low rates, not least because this would have fundamental adverse consequences for the financial system and broader society.

Historical evidence supports this claim. For example, the Japanese government bond market has endured a low interest rate environment for over 20 years and despite continued and aggressive monetary stimulus it has never experienced negative rates of the magnitude provided by this model.

The introduction of negative stresses into the interest rate risk submodule could also result in additional costs being passed to the consumer if insurers decide to hedge the SCR exposure in the rates down scenario. One way to do this would be to buy a series of the swaptions with strike 0%, corresponding to the current floor on the rate stress. The cost is quantified by estimating an approximate cost of 0% strike swaptions at different maturities for a €1.000 million notional (November 29, 2017).

Swaption	Notional	ATM	Strike	Cost
5y10y	€1.000 m	1,84	0%	€21,1 m
10y30y	€1.000 m	1,75	0%	€4,4 m

Although the exact cost of hedging the risk in this way would greatly depend on the insurer's particular portfolio, it is clear from the quotes provided above that it will not be immaterial. Under the assumption that an insurer bought both swaptions detailed above to hedge its regulatory risk, it would add a cost of €25,6m for a notional portfolio of €2.000 million or 1,28% of the asset value. If interest rates remain positive as expected over the next 10 years, these contracts would expire worthless and would have created a 0.13% drag on the performance of the asset portfolio, a cost which would ultimately be passed on to the consumer.

To mitigate the impact of these extreme minimum shocks, EIOPA has proposed an interest rate floor, based upon the minima reached for the Swiss Franc interest rate curve, as at an unspecified date. While Insurance Europe does believe an (implicit or explicit) interest rate floor is a requisite for a sensible interest model, it contends that EIOPA's proposed floor is overly prudent and the result of questionable assumptions;

- To determine the model's floor, EIOPA has subtracted around 1% from the minima reached by the Swiss franc curve. In a negative interest rate environment, this represents an excessive and unjustified margin of prudence.
- The Swiss franc market is small in comparison to the Euro and GBP markets and the idiosyncrasies which drive the market cannot be realistically extrapolated to larger markets.

The level of any interest rate floor should be determined based on the cost of storing cash as this is the most likely alternative for insurers who were investing in a market which had enduring negative interest rates.

In summary, Insurance Europe believes that proposal A is based on questionable assumptions, is unjustifiable in the current market conditions and would result in a material over-estimation of the interest rate risk. In particular, the empirical fact that interest rate changes are smaller in a low yield environment must be obeyed. This proposal, however, cuts across the observed data pattern and massively overstates the risk in the low yield environment.

Furthermore, Insurance Europe notes that in its assessment of Proposal B, EIOPA itself notes that Proposal A can be considered to be overly prudent. A comparison of this model with ERSB projections provides a similarly prudent assessment of the model (see analysis below).

Paragraphs 478-521 – Proposal B – A combined approach

Insurance Europe notes that the model proposed under the combined approach is significantly more complex than the existing model. It is the combination of a total of three different models: 1) the existing relative model, 2) the 2% minimum shock ie Proposal A and 3) the affine model.

EIOPA's affine model is calibrated based on the observations from five currencies, over a c.6-year period. Insurance Europe does not believe that calibration of the model on such a limited data set is robust and notes that there is not enough history of negative rates in the key currencies at present to support a defensible calibration.

Insurance Europe highlights additional drawbacks of the affine model:

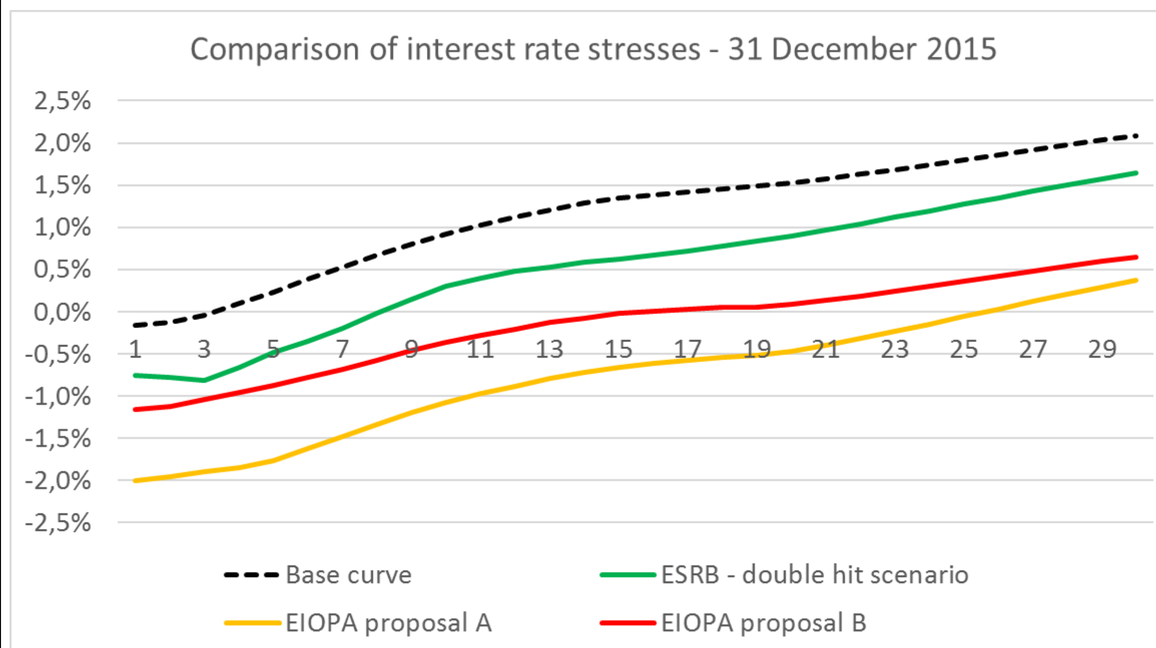
- It does not recognise the existence of a lower bound. Instead, it assumes that the lower bound is 1% lower than the existing interest rate which, by definition, is not a lower bound.
- The calibration of the additive component is based on the 0.995 (0.005) quantile of annual movements of multiple tenors across five markets. Applying this as a parallel shock results in two layers of prudency: firstly, the prudency arising from the cross-market assessment and secondly from the cross-tenor assessment.

The "combined approach" seeks to provide a changing interest rate model for different interest rate environments through the addition of a 2% minimum shock and an affine model to the existing approach. The result is an over-engineered and complex model which overstates the true interest rate risk, particularly in a low yield environment.

Comparison with ESRB analysis

The ESRB provide market-related input to EIOPA as part of the design of the stress test exercises. In 2016, the ERSB's Double Hit scenario, based on 31 December 2015 market conditions, provided a stress on swap rates with an "*estimated marginal probability of…0.5%*". Insurance Europe highlights that these shocks are significantly less extreme than those provided by either Proposal A or Proposal B models.

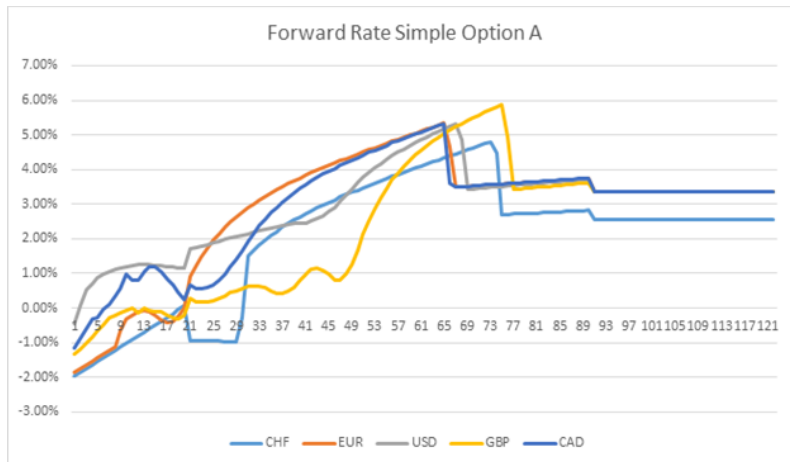
The chart below illustrates a comparison between the ESRB's 1-in-200-year shock and the shocks provided by EIOPA's proposal A and B as at 31 December 2015.

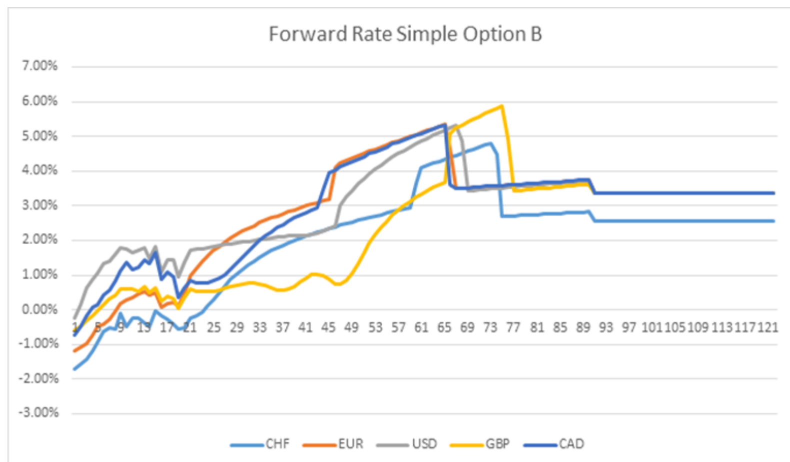


Forward rates

Insurance Europe highlights that the forward rate structures of the curves generated under Proposal A and Proposal B display erratic profiles with several jumps due to min/max operators, semi-static floor and semi-static minimum shock.

These are economically unrealistic as they do not provide credible forward rate profiles. They also present technical challenges as it becomes very difficult during the ESG calibration to have a good fit and acceptable validation test results. This is for a limited part due to the magnitude of proposed shock, but not solely. The largest part comes from

| | the forward rates pattern as a result of the to min/max operators, semi-static floor and semi-static minimum shock.



 | |

7.4.3	Insurance Europe reiterates that **the appropriate time to reassess this submodule is during the 2020 review under the framework of a wide stakeholder consultation. It is imperative that any changes to an important part of the Solvency II framework, such as the interest rate risk submodule, are fully considered, calibrated, tested and consulted upon.** Insurance Europe believes both Proposal A and Proposal B **should be discarded because they overstate the interest rate risk in a low yield environment and do not respect the empirical fact that shocks decrease in magnitude as interest rates decrease. In contrast, the shifted approach could have decisive advantages and warrants further analysis to determine an appropriate calibration and assessment.** Insurance Europe also supports the extrapolation of the interest rate curve following shocks being applied to the liquid part of the curve. This is the only way to generate scenarios which are in line with the requirements of the Directive.	
8.1	Insurance Europe welcomes the EC call for information on the current approach and assumptions in the market risk concentration sub-module. While EIOPA was not explicitly asked to provide an advice to the Commission, Insurance Europe appreciates that EIOPA has been looking into potential clarifications aimed at addressing the specific issue of "mixed exposures", which Insurance Europe believes provide appropriate background information to the Commission.	
8.2		
8.3	Insurance Europe believes that EIOPA should include in its analysis to the Commission the following proposals made by the industry: • Removing the restrictions in Article 184 (2)(b) (i) (ii) & (iv), in order to allow for all entities in a group to be excluded from a concentration capital requirement. • Listing strategic participations, as well as related investment undertakings (emerging from the first advice to the EC) as an exclusion under Article 184 (2). • Allowing for the recognition in Article 187(3) of a 0% risk factor for all member states' central government and central bank debt, independent of whether the debt is issued in domestic or foreign currency. This would support a consistent approach across European currencies.	
8.4.1		
8.4.2	Insurance Europe has no specific preference regarding the two options as applied to the investment portfolio, however highlights that it is key to be able to rely on the issuer rating in cases where there is no issue rating.	

8.4.3	Insurance Europe supports EIOPA providing clarifications on the issue of identifying the single name exposure and the presence of a credit assessment. It further believes that clarifications should not be envisaged in the Delegated Regulation, but rather via other legal tools (eg guidelines). **Paragraph 573** Insurance Europe supports the proposed approach to map changes to the market risk concentration to Article 199(4) to (7) of the Delegated Regulation.	
9.1	Insurance Europe welcomes the Commission's request for EIOPA to investigate whether the existing approach taken to group currency risk is adequate and to suggest modifications where appropriate. Insurance Europe is disappointed that EIOPA's assessment of currency risk does not address the issues identified by the Commission and stakeholders. The technical inconsistency inherent in the treatment of currency at group level has not been fully investigated nor addressed by EIOPA. Its assessment also does not appear to consider the incentives given to the group's risk management, as required by the Commission's call for advice. EIOPA's proposal to enable groups to nominate a reporting currency (subject to as yet undefined criteria) for the purposes of the currency risk submodule goes some way to illustrating EIOPA's acceptance that the concept of reporting currency in the context of group currency risk is artificial. This proposal will alleviate the issue for certain international groups but does not go far enough to address the wider inconsistencies in the framework. Insurance Europe reiterates its position and comments upon EIOPA's specific advice below.	
9.2		
9.3	Insurance Europe agrees with the comments received to CP-16-008 that the current treatment encourages groups to hold capital in the reporting currency, and that the current methodology incentivises hedging currency risk at the group level even though the firm may be backing local liabilities with local currency at the solo level. Insurance Europe firmly believes that the true currency risk for an undertaking arises from the denomination of its exposures and not from its reporting currency. In this regard, Insurance Europe believes that both solo and group undertakings should not have to hold capital against sensible risk management strategies which are designed to hedge the surplus position or the SCR ratio against currency risk. To achieve this, the regulatory framework should not apply a capital charge for groups who have a requirement to hold a foreign currency subsidiary SCR/local capital requirement or for solo undertakings who have allocated a pro-rata	

portion of their surplus to a currency in which they have foreign liabilities.

Insurance Europe's proposal, outlined below, provides an adjustment to the currency risk submodule which enables this change.

Capital requirement for the risk of an increase/decrease in the value of the foreign currency against the group reporting currency shall be equal to

25% * [Max(0,(Expfi-LFXmaxfi))+Max(0,(LFXminfi-Expfi))]

Where

Expfi is the value of the aggregate asset exposure for foreign currency i

LFXminfi = local Minimum Foreign Currency requirement = local liabilities + any local SCR

LFXmaxfi =local Maximum Foreign Currency requirement = Total assets*{LFXminfi/$\sum_{i=1}^{n} LFXminf_i$}

The definition of the local SCR could be the level of capital at which the local supervisors would intervene. (ie similar to SCR for Solvency II)

Paragraphs 580-582

EIOPA's concerns about the requirements of the Prudent Person Principle noted in paragraph 581 reaffirm the approach of most groups and solo entities, as reflected in responses to the Discussion Paper. However, it means that (re)insurers find themselves in a "catch 22 situation": holding assets locally satisfies the Prudent Person Principle, but means that they incur a currency risk capital obligation; holding assets centrally means that they can avoid the currency risk capital obligation but means that they may be in breach of the Prudent Person Principle.

Insurance Europe reiterates the flaws with the existing currency risk charge for groups through the following simplified example:

Consider a group with a foreign currency subsidiary which has a local (foreign currency) SCR requirement. There are three choices for the currency management of the local SCR requirement.

1. It holds the assets backing the local SCR in the local currency and attracts a capital charge at group level.
2. It holds the assets backing the local SCR in the group reporting currency and attracts a capital charge at subsidiary level.
3. It holds the assets backing the local SCR in the local currency but currency hedges the exposure at group level.

This attracts no capital charge but leaves the group unnecessarily exposed to currency fluctuations.

The only way to no receive a capital charge is to choose option 3. Insurance Europe acknowledges that the hedging of the foreign currency exposure at group level can mitigate capital requirements. **However, it does not agree with EIOPA that this is solely a commercial decision**. Entering into a currency hedging arrangement at group level to address technical inconsistencies in the SII framework effectively means the group has entered an unmatched currency position which can impact solvency position of the group.

Consider the following simplified example which clearly demonstrates that currency hedging at group level is not simply a commercial decision based on the cost of hedging.

All figures in €	€ subsidiary	£ subsidiary	€ Group
Liabilities	150	220	370
Assets	165	250	415
SCR	**10**	**28**	**38**
Own funds	**15**	**30**	**45**
SCR ratio	**150%**	**107%**	**118%**

After 25% appreciation in £, compare the impact on the group of hedging the UK-based subsidiary SCR exposure (ie hedging €28 of sterling exposure).

All figures in €	€ subsidiary	£ subsidiary	€ Group – no hedge	€ Group – FX hedge
Liabilities	150	275	425	425
Assets	165	312.5	477.5	470.5*
SCR	**10**	**35**	**45**	**45**
Own funds	**15**	**37.5**	**52.5**	**45.5**

SCR ratio	150%	107%	117%	101%

*Calculated either as 477.5- (28*0.25)=470.5 or alternatively, 165 + ((250-28)*1.25)+28 = 470.5

Another way to view the inconsistency in the regulatory framework is to consider the artificial nature of the "reporting currency" in the context of currency risk management. The reporting currency does not reflect the economic risks to which an undertaking is exposed. To illustrate this, consider the following example:

Two separate but near-identical entities A and B, which have 100% correlated risks, no foreign current exposure at subsidiary level but with different currencies (and all assets and liabilities are localised).

- separately these entities A & B would not have to hold capital for currency risk
- however, a Group owning only A & B would have to hold currency capital for currency risk in addition, irrespective of the choice of "reporting currency"

Insurance Europe's proposal provides a solution which can be used for both groups and solo entities. It enables the application of economically sensible and justifiable risk management strategies which theoretically allows undertakings to protect either their surplus position or SCR ratio against changes in currency.

Paragraph 583

EIOPA has rejected the Insurance Europe proposal, claiming it is overstates the diversification benefit. However, Insurance Europe does not believe that EIOPA have analysed the formula correctly.

- The *Max(0,(LFXminfi-Expfi))* term sets the capital requirement, for a given currency, for undertakings which have a negative currency position ie the undertaking does not hold enough assets in that currency to meet their liabilities plus local SCR.
- The *Max(0,(Expfi-LFXmaxfi))* terms sets the capital requirement, for a given currency, for undertakings which have a positive currency position ie the undertaking holds foreign currency assets in excess of the liabilities plus pro-rata share of the surplus.

The proposal does makes a currency charge for foreign currency assets but only where these are in excess of the pro-rated share of the surplus. The pro-rating of the surplus is proposed to be based upon the foreign currency exposures and subsidiary level SCRs. However, the resulting proportion is applied to the group total assets. Insurance Europe continues to believe that this provides an appropriate assessment of the true currency risk and does not warrant restrictions on capital fungibility.

	Insurance Europe understands that EIOPA is concerned that the deduction of the pro-rated surplus will overstate the diversification benefits because 1) the diversification effects between different currencies is implicit in the 25% stress factor and 2) the correlations for market risk would be required to change. Insurance Europe does not agree with this EIOPA's analysis and notes that an equivalent position could be created in the existing framework by entering in to currency forward contracts which do not generate a requirement to recalibrate the 25% stress factor or the market risk correlation matrix.	
9.4.1	Insurance Europe notes that the analysis provided by EIOPA relates to the distribution of all assets by currency, not the group own funds. This information does not provide sufficient insight into the impact of currency risk submodule at group level to be useful in assessing its appropriateness. The current standard formula approach for currency risk incentivises groups to hold capital in the reporting currency. This increases risk, which may remain an issue even when the reporting currency is changed, as proposed by EIOPA. As noted by EIOPA, a change of reporting currency would only benefit groups with a significant exposure to one particular currency but use a different currency to prepare consolidated financial statements. For the remaining groups, applying the current standard formula approach continues to result in poor risk management incentives, as well as an excessive level of capital being held due to: a) Translation risk being applied to unstressed own funds – Insurance Europe believes it should be assessed against the residual local Own Funds after the application of other stresses; b) The implied correlations between different FX rates (being 100% correlated in the most onerous direction for each currency); and c) The positive correlations between translation risks and other (market) risks are overstated.	
9.4.2	Insurance Europe does not believe that EIOPA's proposal remedies the technical inconsistencies which are to be found in the treatment of currency risk at group level, described in section 9.3. As noted, similar issues are can also be found in the treatment of currency risk for solo entities which write foreign currency business through branches. Insurance Europe does not agree that the current standard formula approach can be viewed as an appropriate trade off between simplicity and risk sensitivity. EIOPA's advice also fails to consider the risk management incentives arising from the standard formula. Insurance Europe believes that EIOPA should fully investigate the issue, as mandated to do so by the Commission, conduct robust analysis and develop a more appropriate solution. Insurance Europe stands ready to assist EIOPA with	

	the further development of its proposal to meet the all stakeholders' needs.	
10.1	Insurance Europe welcomes the EC request for advice on how unrated debt could receive, as a proxy, the credit rating of rated debt should a set of criteria be met. Unrated debt represents not only an important investment asset for the industry, but also a key source of funding for SMEs in Europe. Looking into the current challenge of unnecessarily high capital requirements for such debt supports the CMU objectives of addressing barriers to long-term financing. Insurance Europe welcomes EIOPA's proposals, in particular the advice on the internal assessment approach, which is viewed as overall adequate and not overly complex. Insurance Europe is however concerned by a number of proposals under the approved internal models approach, which it believes are not reflective of current market practice and will not be applicable in practice. In addition, Insurance Europe notes that there are concerns that some markets, namely those investing in unrated debt through funds, may not be able to benefit from this improvement because the costs of obtaining the information needed may outweigh the benefits. While the objective of the call for advice is to proxy capital charges of unrated debt to those of rated debt, Insurance Europe believes that, in the medium-run, Solvency II should address the key question of whether Solvency II measures the right risks. Specifically, in the case of debt, where insurers are not exposed to forced sales, risk of default should be measured instead of risk of changes in spreads. Insurance Europe believes that this issue should be addressed thoroughly in the 2020 Solvency II review.	
10.2		
10.3	Insurance Europe welcomes alternative approaches for use in the standard formula. It however notes that these alternatives should not limit insurers' ability to use external credit ratings. Insurance Europe highlights the increasing investment by the industry in residential mortgage loans, which are an appropriate asset to match insurers' liabilities profile, bringing yield and diversification to insurers' portfolios. In order to address existing unjustified and constraining requirements and capital charges, Insurance Europe reiterates its support for a change in Article 191(4). The current limitation of €1m prevents a significant number of residential loans from being treated under the counterparty default risk module, and these loans are heavily penalised in terms of capital under the spread risk module. The threshold should be either completely removed (as not key and not fully relevant) or reviewed to a higher level. Arguments supporting this change include: • The level of a loan (eg slightly below or slightly above the €1m threshold) does not impact the insurer risk	

	management approach to the loan itself. The same requirements apply to the credit assessment, including the requirement of the value assessment of Directive 2014/17/EU. Similarly, the covenants and the credit hierarchy do not differ as mortgage loans are generally senior loans. • Furthermore, there is an unequal treatment of similar consumer loans in the case where a borrower is financing two assets that in sum exceed the €1m threshold. • The price dynamics of real estate markets, especially in agglomeration centres in Europe, have seen significant increases over recent years, making the €1m level no longer relevant. • Further, the requirement of article 191 para 7 (the risk of the borrower may not materially depend upon the performance of the underlying property) is already met for all consumer mortgage loans due to the requirement of the Directive 2014/17/EU. In addition, Insurance Europe believes that mortgage loans to communal and cooperative housing societies should be treated as residential property, as de facto such loans provide individuals with adequate and affordable housing.	
10.4.1	Insurance Europe supports EIOPA's proposal regarding the internal assessment approach. However, it notes that there are concerns that, in some markets, those investing in unrated debt through funds may not be able to benefit from this improvement because the costs of obtaining the information needed may outweigh the benefits. Insurance Europe is concerned by a number of proposals under the approved internal models approach, which it believes are not reflective of current market practice and will not be applicable in practice.	
10.4.2.1	Insurance Europe supports the scope of EIOPA's analysis, including: • Focus on debt issued by corporates • Coverage of all industry sectors and exclusion of corporates from financial sectors (for which a financial ratio approach would anyway not work) • Focus on senior exposures • Focus on both bonds and loans However, Insurance Europe does not support focus solely on CQS 2 and would in fact argue for extension of the scope to CQS 3 and CQS 4, to allow for a wider market coverage. This could be achieved by reviewing the thresholds for the indicators to levels corresponding to CQS 3 and 4. Such an extension of scope is particularly key for a number of European markets which would otherwise not benefit from EIOPA's work as the existing assets would not meet the criteria for CQS 2.	

10.4.2.2		
10.4.2.3	Insurance Europe largely supports EIOPA's approach, including criteria based on selected financial ratios and requirements on the internal credit assessment process. Regarding **financial ratios**, Insurance Europe supports: • The financial ratios chosen by EIOPA, which are in line with key financial ratios used by major CRAs in their rating processes. The list is extensive and adequately reflecting main drivers for credit risk. • The qualitative factors, which are generally in line with what financial analysts usually look at in practice. • One single set of criteria applicable to all industry sectors. • Consideration of the average of ratios over a number of years (as opposed to current set of financial ratios). • The calculation of probabilities of default using the Bloomberg function DRSK. However, EIOPA should be mindful of how such an explicit reference to Bloomberg services could generate unavoidable costs for the industry (similarly to the experience with CRAs). However, Insurance Europe notes that: • The use of the quick ratio is indeed counter-intuitive and EIOPA should look into this, as holding of cash appears to be unnecessarily penalised. For example, if a borrower's total equity/total assets ratio is equal to 10% and if the net debt/total equity ratio is equal to 1.5 (in line with EIOPA's thresholds), then its cash will be equal to 75% of assets. This is not consistent with a quick ratio capped to 0.65. (note: Net debt = debt - cash = 1.5 * equity and equity =0.10 * assets. So, Debt - cash = 1.5 * 10 * assets = 0.15 equity. Considering that short term debt is nil, debt = assets – equity. Reminding that equity =0.10 * assets, then 0,90 * assets – cash = 0,15 * assets, which is equivalent to cash = 0,75 *assets) Regarding the **yield criterion**: • The yield element of the analysis should be considered as a useful reference, rather than a rigid criterion. • While Insurance Europe understands that yields are in fact used in practice by companies in their assessment of investment opportunities, Insurance Europe does not believe that a pure/simplistic comparison of yields between unrated vs rated debt should in itself be a criterion, not least because the yield on unrated debt often	

	includes an illiquidity spread that may make the market behaviour of unrated debt diverge from that of rated debt. There are in fact several reasons why the yield of a privately traded instrument could differ from that of a publicly-traded bond, including the presence of a premium for illiquidity, or a premium reflecting the borrower's preference for a private transaction. There were periods during the recent banking crisis in which the yield for unrated debt increased compared to rated debt, without an actual risk increase in the unrated debt. • Insurance Europe notes that in unrated debt markets one can observe, in some member states, illiquidity premiums of 200 bps for CQS 2 debts. Thus, the calibration of EIOPA is too low. ***Paragraph 768*** Insurance Europe notes that the yield on other similar debt that the borrower issued in the previous three years is not public information. While investors can derive a proxy, they cannot guarantee that this proxy reflects the exact yield. **Regarding other requirements:** • While Insurance Europe appreciates that additional risk management elements may be necessary for unrated debt, it also notes that such elements may already exist under the implementation of the prudent person principle. Therefore, EIOPA should not automatically require additional processes to be set up, but should rather encourage a review of whether existing internal processes and requirements are already enough. • Insurance Europe notes that it should be clarified that insurers following an internal model approach with already well proven internal processes and existing functioning credit assessment systems would meet the objectives of "other requirements". • The proposed definition of "senior debt" is too simple to cover the wide array of structure types. For example, there may be bilateral loans secured against specific assets and the whole company which could be regarded as "more senior". Insurance Europe would suggest replacing the wording with *"The item and other pari passu instruments senior to substantially all other claims ~~except for statutory claims~~ with the exception of: 1) an immaterial amount (eg less than 5% of senior debt) of other debt that is more senior in the right of payment under certain circumstances", 2) trustees and 3) derivatives counterparties*."	
10.4.2.4	Insurance Europe believes that EIOPA should recognise the value of and accept approved IRB models, for which a mapping to ECAIs should be allowed. In the case of internal model users who already develop an internal credit rating assessment, this should be recognised and accepted with an appropriate mapping to CQS in Solvency II.	

	Insurance Europe does not support EIOPA's proposals for the internal model approach, which are excessively restrictive, intrusive, not reflective of current market reality, and will not work in practice. Should EIOPA wish to make this approach workable, it is key that: • the scope becomes bonds and loans, and not just loans • requirements are revised significantly, to reflect the current market practice regarding conditions of the relationship between banks and insurers Concerns on EIOPA's proposals in the approved internal models approach include: • Concerns on breach of banking secrecy, by for example requesting communication of a loan internal rating to a third party, especially in cases where the borrowers themselves don't have access to this information. Similarly, banking secrecy may be breached by a requirement to provide “data on all loan applications (ie also those rejected)”. • The criterion requiring that “The bank retains an exposure of at least 50 % of the nominal value of the loans” does not match with market practices. Generally, banks retain an exposure of 5 to 10%. • As EIOPA itself highlights, banks are very reluctant to communicate on their internal processes (see Criteria on transparency regarding the functioning of the model) to insurers. This in itself is a clear barrier to making this approach work As a more general comment, Insurance Europe strongly believes that EIOPA should review the treatment of unrated debt to better reflect the actual risks that insurers are exposed to when investing in these assets, which is credit risk and not market spread risk.	
10.4.2.5		
10.4.3		
11.1	Insurance Europe welcomes the EC request for advice on how unlisted equity could receive, as a proxy, the capital charge of listed equity should a set of criteria be met. While the objective of the call for advice is to proxy capital charges of unlisted equity to those of listed equity, Insurance Europe believes that, in the medium-run, Solvency II should address the key question of whether it measures the right	

	risks. Specifically, in the case of equity, EIOPA should investigate how long-term exposure to equity and absence of forced sales risk impact insurers' actual risk exposure. Insurance Europe believes that this issue should be addressed thoroughly in the 2020 Solvency II review. While Insurance Europe appreciates the EC request for "clear and conclusive" criteria, it urges EIOPA to also consider the ease with which the criteria can be applied. Specifically, Insurance Europe would like to refer, as an anecdote, to the recent work done in the area of infrastructure project finance and corporates. As previously highlighted, the industry very much welcomed the identification of infrastructure as a separate asset class with a tailored prudential treatment. Unfortunately, the practical application of the identification criteria is proving to be extremely challenging in practice, due to their extensive and often ambiguous nature. In fact, a number of investors have indicated that the burden of checking projects against the long list of eligibility criteria is sometimes not justified by the reduction in capital requirement. When considering the eligibility criteria for unlisted equity, EIOPA must avoid a long list of criteria that makes the framework difficult to apply in practice. Insurance Europe welcomes in the call for advice the requirement for consideration of the environmental, social and governance aspects, but EIOPA does not seem to have considered these aspects in its final advice.	
11.2		
11.3	***Paragraph 770*** Insurance Europe disagrees with EIOPA's assessment that the specificities of different types of equity investment are not relevant for risk measurement under Solvency II. For private equity, it is important to differentiate between buyout investments, ie mature companies with solid business models, often EBITDA generating, vs. venture capital investments that are young and may not have proven business models yet. This is creating a large difference in risk. Default rate for the venture category is much higher, but the return from successful investments can be high.	
11.4.1		
11.4.2		
11.4.3	Insurance Europe broadly supports the current proposals for identifying unlisted equity that has a similar risk profile to listed equity. Regarding the two proposed approaches, Insurance Europe is concerned by the high level of complexity of the proposals, and believes that the burden and cost of application may not be justified by the limited reduction in capital requirements.	

With regards to the requirement on PE to have at least 25 funds managers, Insurance Europe notes that this should be relaxed as it does not reflect the current market reality. Insurance Europe received indications that 5-7 fund managers would be closer to current market practice.

Insurance Europe would like to put forward a **proposal for amendements to the criteria for long-term investment strategies in Article 171 of the Solvency II Delegated Regulation**

The long-term holding capacity of insurers in relation to equity investments should be taken into account in Solvency II. One way to achieve that is to create a specific risk module with specific treatment based on objective conditions ensuring long term holding and management of these assets, as proposed above.

An additional risk sub-module for Type 3 equities should be added in Article 168 of the Delegated Regulation.

Qualification for Type 3 equity treatment should be contingent on the weighted average duration of the liabilities exceeding an average of 6 years. This treatment is based on the same methodology introduced in the Solvency II Directive for the duration- based approach.

Type 3 equities shall refer to an equity holding or portfolio, held directly or indirectly, for which an insurer can demonstrate its willingness and ability to manage and hold it over the long-term.

- The undertaking's long-term holding capacity in relation to the equity portfolio shall be demonstrated by a prospective liquidity analysis.
- The demonstration can be based on criteria of ability of holding the equity portfolio over the long term are met even in stressed market conditions and described in the Own Risk and Solvency Assessment (ORSA)
- This is envisioned as a comparison between a deterministic scenario, projecting future financial flows under normal operating conditions and a stressed scenario, with shocks applied to the following variables: mortality, decrease in premiums and financial income, increase in incurred costs and an increase in lapse rate (ie discontinuance of a large portion of insurance policies).

The undertaking shall provide the following information to the competent authority to further demonstrate the long-term nature of the equity investment strategy:

- Investment policy, investment rules and arrangements with asset manager

- Asset-liability management policy
- Description of the internal process and procedures in place to ensure the long-term nature of the equity portfolio

The capital requirement for type 3 equities shall be equal to the loss in the basic own funds that would result from an instantaneous decrease in the value of type 3 equities. This instantaneous decrease shall be based on the following formula:

$$Inst_Decrease\ \ (incl\ sym_adj) = (39\% + sym_adj) - \frac{(39\% + sym_adj) - 22\%}{6} \times (average_duration\ - 6)$$

12.1

Insurance Europe welcomes the EC request for information on strategic participations and on how the related qualifying criteria are applied in practice.

While the Commission has not asked EIOPA to propose changes to the current Solvency II criteria for strategic participations, Insurance Europe would like to take the opportunity to make the following suggestions which, in its view, would improve the framework.

Proposal for amendments to the criteria for strategic participations in Article 171 of the Solvency II Delegated Regulation

Insurance Europe highlights that the approach of evaluating strategic participations on the basis of lower volatility and a high holding threshold is not appropriate. A lower forward-looking short-term volatility is not a valid criterion as it does not reflect the actual risks of such assets for insurers who take a long-term strategic view, and is extremely difficult to demonstrate in practice – as the EIOPA analysis confirms.

Instead, Insurance Europe believes that the qualifying criteria should be built on the strong links between the insurer and the investee company. Emphasis should be put on the long-term holding capacity of the insurer and its commitment to the activity of the investee company.

Insurance Europe suggests that Article 171 of the Solvency II Delegated Regulation should be reviewed as follows:

- **The minimum ownership & control threshold for an investment to qualify as a strategic participation should be reduced from 20% to 10%**. This could be done by applying the criteria for 'qualifying holding' as

defined in Article 13 (21) of the Solvency II Directive, rather than the criteria for 'participation' (as defined in Article 13 (20)).

- **The criterion in Article 171 (a), requiring the demonstration of lower volatility in the next 12 months after acquisition, should be removed**. As the EIOPA analysis shows, this criterion is very difficult to be applied in practice. In addition, Insurance Europe believes that the criterion comes into contradiction with the long-term horizon associated with the nature of strategic participations. The investor's willingness to hold over the long term cannot be tested via the one-year volatility metric. Therefore, Insurance Europe believes that a criterion aimed at testing the commitment of the (re)insurer to the activity of the investee should be added.

The following **redrafting** is suggested for Article 171 of the Delegated Regulation:

[...] equity investments of a strategic nature shall mean equity investments for which the ~~participating~~ insurance or reinsurance undertaking that owns a qualifying holding in another undertaking demonstrates the following:

~~(a) that the value of the equity investment is likely to be materially less volatile for the following 12 months than the value of other equities over the same period as a result of both the nature of the investment and the influence exercised by the participating undertaking in the related undertaking;~~

(b) the nature of the investment is strategic, considering all relevant factors, including:

(i) the existence of a clear decisive strategy to continue holding the qualifying holding for long period;
(ii) the consistency of the strategy referred to) with the main policies guiding or limiting the actions of the undertaking;
(iii) the ~~participating~~ undertaking's ability to continue holding the ~~participation~~ qualifying holding in the related undertaking for long period;
(iv) the existence of a durable link;
(v) the commitment of the insurance or reinsurance undertaking in the company's activities where a qualifying holding is held
(vi) where the insurance or reinsurance ~~participating~~ company that owns the qualifying holding is part of a group, the consistency of such strategy with the main policies guiding or limiting the actions of the group.

12.2		
12.3	Insurance Europe welcomes the investigation made by EIOPA into how the criteria for strategic participations are applied in practice. Emerging feedback from NSAs confirms in fact some of the difficulties that undertakings face in practice	

	when it comes to validating the "strategic participation" status of an asset holding against the prescribed criteria. As previously highlighted, Insurance Europe believes that the qualifying holding criteria for the strategic participations introduced in Solvency II are restrictive and inconsistent with market reality and the nature of these assets. (Please refer to comments above on how the framework can be improved by adjusting the criteria.)	
12.3.1	The experience of NSAs confirms the difficulty that the industry faces in assessing their assets against the criteria for the "strategic participation" status. The challenge is significant, in particular in the case of investments that are less traditional and less well-understood by the NSAs.	
12.3.2	As highlighted in 12.1 above, Insurance Europe believes that the volatility criterion should be removed. A lower forward-looking short-term volatility is not a valid criterion as it does not reflect the actual risks of such assets for insurers who take a long-term strategic view, and is extremely difficult to demonstrate in practice – as the EIOPA analysis confirms.	
12.3.3	Insurance Europe welcomes recognition of the strong link between the investment amount and the holding period. With respect to the relatively limited amount of such assets on insurers' balance sheets (ie €155bn), Insurance Europe notes that the number is likely underestimated mainly because of the difficulty in validating the criteria. At the same time, Insurance Europe notes that amending the criteria to make it more workable in practice would not only help improve identification of strategic participations, but would also help support increasing allocation to such assets, which are, as noted above, linked to long-term holding strategies that support the CMU objectives.	
13.1	Insurance Europe welcomes the Commission's request for EIOPA to assess if the complexity of the counterparty default risk submodule is proportionate to the nature, scale and complexity of these risks and to develop a simpler structure, where appropriate. Insurance Europe believes that EIOPA should have considered a more fundamental simplification of the structure of the submodule. The evidence put forward by EIOPA (eg the extensive use of simplifications, EIOPA's assertion that "counterparty default risk is not a major risk") supports a more thorough evaluation of the structure of the submodule. Insurance Europe believes that changes to the derivatives markets and, in particular, the introduction of EMIR further substantiates this such a change. However, Insurance Europe acknowledges EIOPA's efforts in the development of a number of optional and prudent simplifications as well as clarifications on the existing criteria within the submodule. These proposals should reduce the calculation burden for some undertakings but Insurance Europe notes that the inclusion of excessive prudence may	

	discourage their widespread usage. Further comments on EIOPA's advice are provided below.	
13.2		
13.3	***Paragraphs 935-938*** Insurance Europe would welcome further clarification on the application of the simplification detailed in Article 110 of the Delegated Regulation. ***Paragraphs 939-940*** Insurance Europe welcomes EIOPA's proposal to introduce an optional simplification to address the difficulties encountered in assessing whether a reinsurance counterparty has more than 60% of its assets pledged as collateral. However, it notes that EIOPA has not provided justification for the increased prudency inherent in the proposed simplification due to the change in the LGD factor from 50% to 90%. It believes that the simplification should be based on qualitative factors, such as the credit rating of the reinsurer, rather than effectively assuming all reinsurers have over 60% of their assets pledged as collateral. ***Paragraphs 941-944*** Insurance Europe believes that the requirements for the counterparty default risk for cash at bank provides an overly burdensome calculation and an excessive capital charge. Insurance Europe reiterates that the identification of bank counterparties required as part of Article 192 can be difficult to obtain when applying a look through to a UCITS fund and that obtaining this information requires additional time and cost with marginal impact on the overall SCR. Furthermore, Article 192 (6) of the Delegated Regulation prescribes that the loss-given-default on cash at bank to be equal to its value. The recovery rate for deposits and treasury is therefore 0% which is arbitrary and unjustified. In most studies, the average recovery rate for certain corporate debt tends to be 30% - 40% and therefore for cash at bank assets should be at least similar. For example, in Spain as of today (and except just one counterparty), there were no losses recorded for deposits and treasury. ***Paragraphs 945-950*** Insurance Europe welcomes clarification on the assumptions that should be used in the calculation of the hypothetical	

	SCR. In particular, it would welcome additional clarification on: 1. how the life, health and non-life submodules should be aggregated and whether correlation factors are to be used. 2. how undertakings should assess the impact of the "change in sign" within the interest rate risk and resulting change in correlation matrix if this is not consistent with the actual interest rate scenario. For example, when the larger capital requirement for interest rate risk is derived from the interest rate up scenario but the interest rate risk in the hypothetical SCR calculation for a given type 1 exposure is derived from the interest rate down scenario. ***Paragraphs 951-953 & paragraphs 1022-1027*** Insurance Europe welcomes the inclusion of a closed-form optional simplification for the calculation of the risk-mitigating effect of reinsurance arrangements. ***Paragraphs 954-962*** Insurance Europe welcomes the inclusion of an optional simplification to address the issue of the step-change which arises when the standard deviation of type 1 exposures exceeds 7%. This would provide continuity of the calculation for undertakings which exhibit standard deviation of type 1 exposures of around 7%. However, to remove the discontinuity, the proposed simplification merely assumes the higher, 5x factor applies to the lower volatility sector (S≤0.07·T) as well as the mid-sector (0.2T≥S>0.07·T). EIOPA doesn't provide any argument for choosing the more prudent approach. Insurance Europe believes a reformulation of the calculation would have been preferable to remove the discontinuity. Changes in counterparty exposures, eg the implementation of EMIR for derivatives, and the additional information available to EIOPA since the formulation of this submodule support further investigation of this issue.	
13.4.1		
13.4.2	***Paragraph 968-982*** In Insurance Europe's opinion, EIOPA's analysis shows that the complexity of the counterparty default risk module is not proportionate to the nature, scale and complexity of these risks. The analysis clearly shows that the counterparty default risk is not a key driver of the SCR for the majority of undertakings but, as noted by EIOPA, the counterparty default risk submodule is considered to be the most burdensome module compared to the level of the capital requirements it	

	generates. Insurance Europe agrees with EIOPA that the findings of its analysis underline the complexity of the submodule. ***Paragraph 983-1010*** Insurance Europe welcomes EIOPA's analysis of the use of derivatives and the recognition that it is valid for undertakings to use both long and short positions to hedge their exposures. It supports EIOPA's proposal to define a "risk-mitigating derivative" as a derivative which is part of a well-defined hedging strategy because it provides a more accurate representation of economic reality. Insurance Europe does not agree that all derivatives should be classified as type 1 exposures within the counterparty default risk submodule. This will result in the increasing capital requirements for derivatives which are under the scope of the spread risk submodule. If EIOPA does intend for all derivatives to be in scope of the counterparty default risk submodule then it should make very explicit that these are not in scope of the spread risk or market concentration risk submodule to avoid duplications of capital requirements. ***Paragraph 1011-1021*** Insurance Europe agrees with EIOPA that the counterparty default risk submodule should be refined to take into consideration any contractual netting arrangements. The proposal to calculate the LGD and risk-mitigating effect on single name exposures and not on each individual derivative appears to be a sensible approach. Insurance Europe welcomes further detail on the specificities of this proposal.	
13.4.3	Insurance Europe notes that EIOPA compares the relative importance of the size of the SCR for the counterparty default risk with those analysed under QIS4. This is a flawed analysis. The earlier QIS exercises tested alternative approaches and the calibration. Since the QIS4 calculations many elements have changed in the Solvency II legislation. The QIS exercises were also very much biased towards bigger companies as smaller companies generally not participated in the studies. Therefore, this comparison is not appropriate. The counterparty default risk also depends on the development on the economic balance sheet and can also be considered to be volatile. This will have an impact on the relative size of the risk compared to the BSCR. Detailed comment on EIOPA's proposals has been included in the previous section, please refer to these for supporting comments to the summary below.	

Paragraph 1030-1034

Insurance Europe reiterates that the complexity of the counterparty default risk submodule is not proportionate to the nature, scale and complexity of the risks. EIOPA's analysis supports this assessment.

Paragraph 1042-1043

Insurance Europe does not agree that all derivatives should be classified as Type 1 exposures in the counterparty default risk submodule. This would result in double counting of capital requirements for derivatives within scope of the spread risk submodule.

Paragraph 1044-1048

Insurance Europe welcomes EIOPA's proposal to define a risk-mitigating technique as a hedging strategy where it would be sufficient for the hedging strategy as a whole to meet the requirements of a risk-mitigating technique rather than each individual derivative. Insurance Europe would further welcome pragmatic documentation requirements of the hedging strategy to enable full application of this proposal.

Paragraph 1049-1056

Insurance Europe supports the recognition of contractual netting arrangements and the proposal to alter calculation to reflect the economic reality of the contractual netting arrangements**.** Insurance Europe welcomes this simplification which is furthermore consistent with usual practices.

Paragraph 1057

Insurance Europe would welcome clarification on the intended calculation of the hypothetical SCR.

Paragraph 1058-1066

Insurance Europe welcomes simplifications to the counterparty default risk submodule to reduce the calculation burden but notes that the inclusion of high margins of prudence inherent in these calculations may discourage their widespread usage. In particular, it does not believe that the margins of prudence within the proposed simplifications for the calculations in Article 192 (2) and Article 200 are justified.

Paragraph 1068

Insurance Europe welcomes additional clarification on the existing simplified calculation, detailed in Article 110 of the Delegated Regulation.

	Finally, Insurance Europe would welcome further clarification of the reasoning behind the inconsistent treatment of pool exposures of type B and C and pool exposures of type A/external reinsurance arrangements. In particular, the risk mitigating effect in Article 192 (RM) is included only to 50 %, whereas in Article 194 and 195, the full risk mitigating effect (ΔRM) is included.	
14.1	Insurance Europe welcomes the EC request for advice on the treatment of derivatives in Solvency II, to allow for the reflection of the post-EMIR derivatives regulatory environment. While the Commission asks EIOPA to propose changes for cleared derivatives, the call for advice itself does not imply that the current treatment of non-cleared, ie OTC derivatives, is correct. Insurance Europe strongly believes that the current assumptions for the OTC environment, in particular the 10% recovery rate, are not reflective of the post-EMIR environment, which imposes strong collateralisation requirements on both OTC and centrally cleared derivatives. EIOPA itself has not presented any research/reports that prove the 10% recovery rate is accurate. It is important that EIOPA investigates this, in particular as EIOPA takes the OTC capital requirement as a starting point for reviewing the capital requirement of cleared derivatives. Insurance Europe therefore believes that EIOPA's analysis is missing an investigation of whether the current parameters for OTC derivatives are correct. Once this analysis is done and an appropriate calibration is justified, the OTC derivatives capital charges can be used as a starting point for deriving the capital charges for cleared derivatives.	
14.2		
14.3	***Paragraph 1079*** Insurance Europe appreciates EIOPA's concern of having weaker requirements for insurers vs banks. However, more tailored requirements, aimed at making the framework more fit for purpose, would not necessarily mean weaker. Insurance Europe therefore believes that, while consistency between banking and insurance is welcome, it should not prevent EIOPA from adjusting requirements where adjustments would make the framework more appropriate and applicable. Concretely, Insurance Europe notes that some adjustments to the CRR criteria in Article 305 are needed to make the approach workable for insurers. In fact, EIOPA itself argues that comparability of capital levels is not aimed at because of the structural differences in frameworks and business models. Insurance Europe believes that the same argument could be used to justify lack of full consistency in the identification of criteria (ie Article 305 of CRR).	
14.4.1		

| 14.4.2 | **14.4.2 Analysis**
Paragraphs 1117 and 1118
Insurance Europe notes that EIOPA introduces prudence in the framework by taking a 4% reference value for CCP vs OTC credit charges, given that, in the banking case, the ratio is always lower than 4%. This margin of prudence should not be ignored, for example when considering potential adjustments to the criteria.
Paragraph 1120
Insurance Europe strongly believes that the current assumptions for the OTC environment, in particular the 10% recovery rate, are not reflective of the post-EMIR environment, which imposes strong collateralisation requirements. EIOPA itself has not presented any research/reports that prove the 10% recovery rate is accurate. It is important that EIOPA investigates this, in particular as EIOPA takes the OTC capital requirement as a starting point for reviewing the capital requirement of cleared derivatives.
Paragraph 1122
While Insurance Europe appreciates that, mathematically, there are a number of combinations of possible levels for the recovery rate and the probability of default that would lead to the targeted 4%, it believes that EIOPA should emphasise the economic meaning of the parameters. For example, it makes economic sense that the recovery rate is adjusted significantly above the current 10%, which is an extremely low rate that ultimately questions whether the OTC derivatives reform has achieved its objective of making the derivatives market safer.
Paragraph 1126
As already noted in the response to the Discussion Paper in early 2017, Insurance Europe believes that some adjustments to Article 305 of CRR are necessary to make the framework workable for the insurance sector. Specifically:
• Regarding Article 305 (2) (c) CRR, Insurance Europe would like to point out that, at this stage, insurers do not usually obtain independent legal opinions on consequences of CCP default. In fact, a recent EBA and ESMA report on the implementation of CRR (in relation to EMIR) points out that the concept of "legal opinion" did not work properly in the past and adjustments to Article 305 CRR are required.
• The current proposal by the European Commission for an adaptation to Article 305 CRR ("CRR II") would still pose significant challenges to small and medium sized insurers. Even though the proposed amendments lower the "legal opinion" requirement, instead making a "legal review" sufficient, it remains burdensome and cost- | |

	intensive to provide such reviews.	
14.4.3	Insurance Europe believes the following key issues should be addressed before EIOPA delivers its final advice to the Commission: • Article 305 of the CRR requires tailoring for the insurance sector to make the framework workable in practice • EIOPA should investigate whether the current capital requirement for OTC derivatives, used as starting point for cleared derivatives, is appropriate Insurance Europe supports option 1, ie no changes to the LGD formula, as it finds option 2 to be adding unnecessary complexity to the framework.	
15.1	Insurance Europe welcomes the Commission's request for EIOPA to review the simplification provided for the look-through approach, and it supports EIOPA's further proposals on simplifications, in particular: • the carve-out of assets for unit/index linked products from the 20% limit • the possibility to use the last reported asset allocation of the collective investment undertaking or fund to calculate the SCR and • the permission to use groupings of exposures also when the target asset allocation is not available at the level of granularity necessary. Insurance Europe notes that the requirement to *strictly* manage according to the target asset allocation or the latest reported asset allocation could lead to misinterpretation. To address this, Insurance Europe proposes to replace „strictly" with „consistent" in Art 84 (3) and Art 84(3)(b). Insurance Europe appreciates that the reference to Article 88 of the Delegated Regulation, which refers to proportionality and simplifications, was made by EIOPA as a means to ensure a consistent and prudent approach across simplifications. However, Insurance Europe notes that, in the case of the proposed look-through simplifications, there are already safeguards for prudence, namely the 20% threshold and the requirement for testing the asset allocation criterion. Therefore, the reference to Article 88 on proportionality comes as an additional and unnecessary layer of burden, which should be avoided.	
15.2		
15.3		
15.4.1		

15.4.2		
15.4.3	***Paragraph 1217 – 1219*** Insurance Europe welcomes the fact EIOPA reflected in its draft advice a number of simplifications put forward by Insurance Europe. In particular the carve-out of assets for unit/index linked products from the 20% limit, the possibility to use the last reported asset allocation of the collective investment undertaking or fund to calculate the SCR and the permission to use groupings of exposures also when the target asset allocation is not available at the level of granularity necessary. ***Paragraph 1218*** Insurance Europe highlights that the condition on managing underlying assets strictly according to the target allocation or to the last reported asset allocation could lead to misinterpretation (Please refer to the response in section 15.4.4) Insurance Europe is supportive of the proposed simplifications and the proposed amendments to Article 84(3). However, Insurance Europe highlights that the last reported asset allocation of the fund may be appropriate for a passive fund vehicle or ETF that has little drift in investment strategy but may not be suitable for hedge funds where exposures and risk can vary materially over a short period of time.	
15.4.4	Insurance Europe notes that, while it understands the rationale of conditioning the simplification on the management of underlying assets, it notes that reference to a "strict" allocation may in practice lead to cases of overly-restrictive interpretation of the provision. In practice, while target asset allocations are key references for asset managers, there are often in practice provisions on the discretion that the asset manager has to rebalance portfolios to their targets. Insurance Europe **proposes to replace the word "strictly" with "consistent"** in Art 84(3) and 84(3)(b) of the Delegated Regulation. Such a rewording would still fulfil the intended aim of the change. The proposed text would be as follows: • Art 84(3) *Where the look-through approach cannot be applied to collective investment undertakings or investments packaged as funds, the Solvency Capital Requirement may be calculated on the basis of the target underlying asset allocation or the last reported asset allocation of the collective investment undertaking or fund, provided such a target allocation is available to the undertaking at the level of granularity necessary for calculating all relevant submodules and scenarios of the standard formula, and the underlying assets are managed* ~~*strictly*~~ ***consistent with*** ~~*according to*~~ *the target allocation or* ~~*to*~~ ***with*** *the last reported asset allocation…* • Art 84(3)(b) *Notwithstanding Article 84(3), where the look-through approach cannot be applied to*	

	investments in collective investment undertakings or investments packaged as funds which back unit- and index linked obligations (for which the market risk is borne by policyholders), the Solvency Capital Requirement may be calculated on the basis of the target underlying asset allocation or the last reported asset allocation of the collective investment undertaking or fund, provided such a target allocation is available to the undertaking and the underlying assets are managed ~~strictly~~ ***consistent with*** *~~according to~~ this target allocation or ~~to~~* ***with*** *the last reported asset allocation…* Insurance Europe appreciates that the reference to Article 88 of the Delegated Regulation, which refers to proportionality and simplifications, was made by EIOPA as a means to ensure a consistent and prudent approach across simplifications. However, Insurance Europe notes that, in the case of the proposed look-through simplifications, there are already safeguards for prudence, namely the 20% threshold and the requirement for testing the asset allocation criterion. Therefore, the reference to Article 88 on proportionality comes as an additional and unnecessary layer of burden, which should be avoided.	
16.1	Insurance Europe appreciates EIOPA's initiative to consider - on request of some stakeholders - the application of the look-though approach at group level. Insurance Europe supports EIOPA's proposal to mirror the approach at group level for solo level and vice-versa. Specifically, Insurance Europe agrees that, if there is a look-through at solo level, there should be look-through at group level and where there is no look-through at solo level, then there should be no look-through at group level. While Insurance Europe believes that both options put forward by EIOPA would result in the same approach, it prefers the option of reviewing the Delegated Regulation by specifying that related undertakings should be treated at group level in the same way as they are treated at solo level.	
16.2		
16.3.1		
16.3.2		
16.3.3	***Paragraph 1251-1255*** Insurance Europe supports EIOPA's suggestion that, if there is a look-through at solo level, there should be look-through at group level and where there is no look-through at solo level, then there should be no look-through at group level. While Insurance Europe believes that both options put forward by EIOPA would result in the same approach, it prefers option 2 which is simple and straightforward.	
17.1	Insurance Europe understands that EIOPA was asked by the EC to report on the various methods currently applied	

across the EEA on LAC DT, and on their impact. Insurance Europe therefore believes that, by submitting its analysis, EIOPA has already fully delivered on its mandate.

Insurance Europe understands that the key driver for EIOPA going beyond the mandate foreseen by the EC is its desire to support convergence. In principle, Insurance Europe supports the high level of convergence and harmonisation already provided by the Solvency II framework. However, **Insurance Europe is deeply concerned by cases where an extremely conservative approach from a specific jurisdiction is extrapolated beyond that jurisdiction for the sake of convergence.** Such an approach defeats the risk-based nature of the framework and risks making the framework significantly more conservative than it already is.

While data presented in the past by EIOPA on LAC DT does confirm differences, it should be noted that **one of the key drivers of the differences is the fact that, across jurisdictions, supervisors have defined requirements on top of the Solvency II framework in the LAC DT calculations**. These requirements vary across jurisdictions, in particular in terms of their level of conservativeness. The varying supervisory responses are proof that there is no single right answer to potential prudential concerns on LAC DT. In fact, a number of considerations impact decisions on LAC DT, including the nature of the business, the profile of undertakings, the tax regimes, etc.

Against this background, Insurance Europe strongly believes that **the current framework already provides significant guidance on the issue of LAC DT, and any supervisory concerns should be addressed via appropriate supervisory dialogue, with appropriate knowledge of and respect for undertaking's specific business models. EIOPA should allow and encourage supervisory judgement and dialogue, and not limit it.**

At the same time, **Insurance Europe appreciates EIOPA's attempt to provide structure to the supervisory dialogue** on LAC DT. From this perspective, issues such as: the role of compliance with MCR/SCR post-shock, projection of and assumptions for new business, future management actions are all valid concepts that should be part of the supervisory dialogue. Any arbitrary/numbered limitations beyond these guiding principles should be avoided. Insurance Europe therefore believes that **the most appropriate way forward is for EIOPA to provide an opinion with guiding principles for the supervisory dialogues**. Such an opinion should be based on principles, and avoid arbitrary limits that would be agnostic to company/jurisdiction-specific circumstances. In fact, in such an opinion EIOPA should not avoid raising criticism on too conservative/unjustified approaches, which are in fact and unfortunately a reality in some member states.

Regarding the comments and proposals put forward by EIOPA in this consultation paper, Insurance Europe notes that:

- The total impact of future profits in LAC DT is, according to EIOPA, EUR 25bn. This represents less than 1.7% of

	the 2016 total own funds. Insurance Europe is of the view that the issue is not material enough to justify an extremely conservative approach to harmonisation. • The current differences are also explained by the limited experience of Solvency II application. These differences are likely to gradually reduce as undertakings will have to explain their approaches to the various stakeholders and align the assumptions across issues such as LAC DT, dividend policies, ORSA, budgets, financial statements, and mid-term capital planning. Experience of the supervisory review process (SRP) is at this stage limited to a single closing exercise, ie end-2016. It is likely that this exercise in itself will lead to inappropriate methodologies or assumptions being addressed. The involvement of senior management, the alignment with other processes, and the SRP will, in the short-term already, support a proper calculation and evidence of the LAC DT, which should be based on the unique characteristics of undertakings (governance, risk profile/appetite and various policies), and factor in the differences of the tax regimes and the consequences thereof.	
17.2		
17.3		
17.4.1		
17.4.2	***Paragraphs 1294 & 1295*** Insurance Europe appreciates that the key principles proposed by EIOPA are indeed relevant for the supervisory dialogue on LAC DT. Implementation of the principles should however remain part of the supervisory dialogue and appropriately reflect company-specific issues. **Key principle 1: Role of compliance with the MCR and SCR after the shock loss** **Insurance Europe generally agrees that the level of capital should play a role in the determination of LACDT, and should be part of the supervisory dialogue. Further, Insurance Europe believes that the assessment of compliance should be made after having taken into account the recovery measures put in place by the undertaking. Insurance Europe strongly disagrees with the prescribed formulaic approach for implementing this principle, which is an approach agnostic to the importance of company specificities and the value of supervisory dialogue.** ***Paragraph 1296*** EIOPA describes the role of compliance with the MCR and the possible consequence of a breach of the MCR. Insurance	

Europe agrees that an undertaking that does not meet the MCR and/or the SCR after a shock event, should demonstrate how the going concern is maintained. In other words, the undertaking should demonstrate if and which recovery measures within the set periods are required and what is the impact of these measures on future taxable profits. However, this substantiation should be done fully in accordance with the articles 138 and 139 of the Directive 2009/138/EC.

Paragraph 1297

Insurance Europe welcomes EIOPA's confirmation that standard formula undertakings are not expected to explicitly determine their compliance with the MCR/SCR after a shock loss – such second order calculations are not a general requirement of the Solvency II standard formula.

Paragraphs 1298 & 1299

Insurance Europe is of the view that EIOPA's position assumes a priori that companies will not have a viable recovery plan, which EIOPA cannot pre-judge. In addition, a situation of an undertaking being close to an MCR breach is different from effectively breaching the MCR. Very concretely, a breach of the MCR will result in no possibility to write new business, while being close to the MCR breach will not.

Furthermore, with an adequate recovery plan, even if a firm is closed to new business, it may still be possible to make future profits from in-force business.

Insurance Europe points out that EIOPA's assumption that an SCR breach would result in increased lapses is a non-evidenced assumption. The LAC DT shock is based on the underlying scenarios ensuing from the risk profile of the undertaking (based on the relative importance in the BSCR*). For example, for a well-diversified undertaking, the underlying lapse scenario is not the most damaging scenario.

Paragraph 1300

Insurance Europe strongly disagrees with the prescribed formulaic approach for implementing this principle, which is an approach agnostic to the importance of company specificities and the value of supervisory dialogue. Insurance Europe generally agrees that compliance with MCR and SCR should play a role in the determination of LACDT. However, the assessment thereof should be part of the supervisory dialogue. EIOPA's a priori view that there will be no future profits after an MCR shock is not reasonable as firms can demonstrate to their supervisors that they can recapitalise or de-risk, enabling thereby the undertaking to comply with the Solvency II requirements again and for example be able to use tax

loss carry-forwards. This is part of the undertaking's assessment of the utilisation of notional DTA.

Key principle 2: Future profits stemming from new business-projection assumptions

Insurance Europe disagrees that the projection assumptions of future profits stemming from new business should be more prudent than those of the calculation of technical provisions. In Insurance Europe's opinion, the projection assumptions should be consistent with the underlying scenarios causing the shock. Insurance Europe does not support arbitrary and automatic cut-offs; however it appreciates that a number of elements in the new business projection assumptions deserve appropriate supervisory dialogue.

Paragraphs 1305 & 1307

EIOPA provides statements regarding "optimistic" and "pessimistic" views and characterised these as non- justified following risk profile and risk appetite. It is totally unclear how EIOPA comes to these statements based on the information provided. Furthermore, this statement is based on only one data point.

Paragraphs 1308 - 1313

In considering new business, EIOPA should distinguish between new business from consumers and new business from renewals. The uncertainty of both will differ. The undertaking first has to assess the impact of the underlying lapse scenario and will project future renewals based on the post-shock policyholder base. The future lapse assumptions should be consistent with the lapse assumptions made within the best estimate. Any resulting business horizon for renewals should be consistent. Therefore, renewals of existing policies from should not be treated in the same way as new business from new customers.

Paragraph 1310

EIOPA assumes that the calculations of future new business profit should be based on economic profits whereas most countries do not calculate tax based on economic profits. This is not an appropriate basis for calculating taxable profits, and demonstrates a fundamental misunderstanding of tax principles.

Key principle 3: Future profits stemming from new business-projection horizon of taxable profits

Insurance Europe does not support provision of limits defined as cut-off points in number of years. Instead,

the projection horizon of taxable profits should be an area of discussion in the supervisory review process (SRP).

Paragraphs 1314 - 1325

As mentioned in key principle 2, when considering new business, EIOPA should distinguish between new business from consumers and new business from renewals. The uncertainty of both will differ. The undertaking first has to assess the impact of the underlying lapse scenario and will project future renewals based on the post-shock policyholder base. The future lapse assumptions should be consistent with the lapse assumptions made within the best estimate. Any resulting business horizon for renewals should be consistent. Therefore, renewals of existing policies should not be treated in the same way as new business from new customers. The provision of limits in the projection of future profits should be part of the supervisory dialogue and not be a priori. Several insurance products sold by insurers are directly related to existing legislations in a member state. For example, a policyholder who owns a car will have to have motor insurance; in several jurisdictions, fire insurance is mandatory if a house is owned, etc. Therefore, even in more severe shock scenarios, these insurances are still being sold as seen in the past (for example following the 9/11 event, impact following the 2008-2010 credit/euro crisis).

Paragraph 1315

EIOPA uses the consequence of the Lapse shock as an example of the impact of the shocks on other assumptions of the projection which should be considered as well. However, following the LAC DT shock, the full impact of the lapse scenario is already felt in the Economic Balance Sheet and Own Funds. The impact on cost loadings and future earnings over the remaining contract duration is already calculated and incurred. Furthermore, EIOPA should consider the Lapse scenario following the underlying scenario eg the relative importance of the Lapse scenario in the BSCR*.

Paragraphs 1316 & 1319

Insurance Europe does not support EIOPA's proposal to cap the total future profits stemming from new business after the shock loss as an arbitrary proportion of past profits and profits assumed in the business plan. The proposed cap will increase procyclicality as a negative cycle is prolonged in the LAC DT-calculations. Also, and as previously mentioned, EIOPA should differentiate real new business from new policyholders and renewals.

Paragraph 1319

Insurance Europe does not support provision of limits defined as cut-off points in number of years; For example, a long-

term business that goes into run-off would continue to earn a return from net assets as the book runs off (and not just for 5 years). Instead, the projection horizon of taxable profits should be an area of discussion in the supervisory review process (SRP).

Insurance Europe points out furthermore, that enforcing a limited projection horizon within which profits for a given new business will emerge could result in an approach similar to capping the LAC DT at, for example, the net deferred tax liability (DTL). This approach could lead to procyclicality.

Key principle 4: Future profits stemming from new business-projection horizon of new business sales

Insurance Europe strongly disagrees with using a business plan horizon as a general principle for determining taxable profits. The horizon should be an element of discussion between the undertaking and its supervisor in the context of the supervisory review process (SRP).

Paragraphs 1321 & 1325

EIOPA proposes in 4a to limit this to the business planning horizon. However, new sales are also part of the mid-term capital plan (part of the ORSA), which requires a longer horizon than 3 years. New business (sales) is also a feature within the IFRS Impairment testing of Goodwill (if appropriate and recognised on the accounting balance sheet) where longer business horizons are used (normally up to 10 years).

If an undertaking is willing to use a longer duration for the new business, this assumption is to be part of the supervisory review process. The use of 5 years of new business (as opposed to renewals) is a rebuttable presumption.

Key principle 5: Future profits stemming from return on assets

Insurance Europe believes that limiting returns to the risk-free rate does not make sense in a taxation context and reiterates its call for a full recognition of future profits stemming from assets on a realistic basis.

Paragraph 1331 & 1332

Insurance Europe strongly disagrees that the way to deal with uncertainties is to reduce the excess returns to the forward rates. Undertakings should be able to evidence the excess returns in the post-shock area. Historic evidence

shows that also after extreme events the excess returns are higher than the forward rates. In a going concern, setting the excess returns at the forward rates is too extreme and not reflective of the actual economic circumstances (based on the underlying scenarios). Many firms who have an internal model for market risk have reflected the long data series and the derived total returns in their assumption setting within that internal model. Reducing uncertainty is to require consistency of this assumption setting with other processes within the firm and ask for a well-designed governance procedure and transparency towards the supervisor.

Furthermore, Insurance Europe believes that limiting returns to the risk-free rate does not make sense in a taxation context and reiterates its call for a full recognition of future profits stemming from assets on a realistic basis. The Solvency II balance sheet is calculated on a market consistent basis. Over time, economic taxable profits will be realised, which can be used to recover notional deferred taxes. These future profits are expected to earn an investment margin on invested assets over and above the discount rate included in the Solvency II balance sheet and funding costs. To add to this, if everything was risk-neutral within the Solvency II framework, there would not be a market risk module in the SCR calculation.

Another point worth mentioning and recognised by EIOPA is that the existence of various tax regimes in the European market does not allow for a homogeneous approach to the LAC DT calculation. Therefore, Insurance Europe believes that the future profit projection in the after-shock scenario should be valued coherently with the local GAAP approach applied for tax calculation.

All the arguments above put aside, Insurance Europe is surprised that EIOPA's proposal does not even include the possibility of using the LTG adjustments (volatility adjustment and matching adjustment) in establishing assets return rates.

Paragraph 1333

Insurance Europe believes that pull-to-par and additional returns from recovery of equity markets should be allowed. There is no justification in restricting the post-shock returns on assets in excess of technical provisions to the risk-free rate as previously explained. Reference to the risk-free rate is not appropriate in the context of calculating the SCR which has to be computed in the real world where companies earn real returns.

In addition, the reference to guideline 9 of the EIOPA" Guidelines on the recognition and valuation of assets and liabilities other than technical provisions" is inappropriate in this context. The reason is that the LAC DT straddles both

the economic world and the fiscal world and companies pay taxes based on the real returns they make.

Further, pull-to-par is in accordance with IAS 12, which states (paragraph 29A) *"The estimate of probable future taxable profits may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this"*.

Key principle 6: Future profits stemming from return on assets in excess of technical provisions-projection horizon

Insurance Europe believes that there should be no arbitrary limit set for the projection horizon of future profits stemming from return on assets in excess of technical provisions. Rather, Insurance Europe is of the opinion that the features of each tax regime should be taken into account to set the projection limit which is best achieved through a discussion between the company and its supervisor in the context of the supervisory review process (SRP).

Paragraphs 1338

Insurance Europe considers that the time horizons used in calculating the LAC DT should be based on the time horizon appropriate to the underlying business in question and this should be part of the supervisory dialogue. Insurance Europe does not consider that it would be appropriate to impose an arbitrary limit on the time horizon used, as this could cause a systematic distortion of the results, contrary to the requirements of the Directive

Paragraphs 1340

Insurance Europe is of the opinion that the alternative approach that allows for the reflection of future returns on own funds over a projection horizon that is related to the technical provisions is more appropriate as it reflects uncertainty in an entity-specific way and is applicable in a similar manner to undertakings that have different characteristics. However, Insurance Europe sees a conceptual weakness in this approach since one cannot assume that the "duration" of own-fund is equivalent to the duration of the liabilities.

In Insurance Europe's opinion, a firm should be allowed to have a different horizon based on the arguments and evidence presented in the supervisory review process. In addition, post-shock run-off patterns of technical provisions, related levels of own funds and investments, and LAC DT should be aligned.

It is also important to realise that instantaneous shock losses under Solvency II are different from the actual emergence

of losses under the relevant tax regime in a jurisdiction. The time horizons under fiscal regimes are in many cases much longer.

Key principle 7: Future management actions

Insurance Europe disagrees with EIOPA's a priori disqualification of a range of management actions, that can in fact be valuable tools for undertakings to use in case of shock. Future management actions should be allowed, and their relevance and reliability should be part of the supervisory dialogue, and accepted as long as the undertaking can successfully demonstrate to the supervisor their impact on generating future profits.

Paragraphs 1343-1351

Insurance Europe strongly disagrees with EIOPA's proposal that disqualifies FMA. Some FMA could be applied as a direct consequence of the stressed scenario, according to a previous notification to the board disclosed in the FMA plan. Insurance Europe understands that any increase of uncertainty from incorporating potential management actions is undesirable. However, as part of the supervisory review process, the undertaking should be able to demonstrate how uncertainties have been dealt with. If the evidence provided is unsatisfactory or unconvincing the supervisor could as part of the supervisory review process apply a haircut to the expected results of the FMA

Paragraph 1344, 1346 & 1347

Insurance Europe does not believe that it is appropriate for EIOPA to limit the use of management actions to the extent it is proposing. The European insurance industry would be expected to survive stress losses, as it demonstrated following the 9/11 terrorist attacks and the 2008 financial crisis. It can be anticipated that European insurance businesses would be able to take appropriate management actions following a shock loss, including if necessary recapitalisation from within the group (which should be relatively straightforward) or from the capital markets. Recapitalisation from external sources should remain available to be used as one of the measures for recovery, provided the undertaking can demonstrate an appropriate level of realism based on financial reputation, market position, historical evidence and/or other suitable substantiation or the availability of contractual agreements. The recapitalisation should be assessed in the light of the underlying scenarios and the impact on the capital market. Experience proves that there is virtually always a market for debt, even after a shock resulting in a credit rating downgrade.

Paragraph 1345

Insurance Europe notes that the requirements set out in Article 23 of the Delegated Regulation are solely meant for

management actions in the calculation of technical provisions. Insurance Europe does not agree that these should also apply to future management actions integrated into the calculation of LAC DT.

Paragraph 1349

In paragraph 1349, EIOPA disqualifies de-risking. However, Insurance Europe is of the opinion that de-risking is a relevant measure and should remain a possible measure. The de-risking measures should not be read in conjunction with the formulaic approach taken by EIOPA in key prinicple 1 (see also earlier remarks). In this instance EIOPA tries to mitigate the linear effects of applying such a formula by restricting measures which normally are a valid option. For non-listed solo entities, de-risking is one of the more potent measures to be taken to recover. Naturally, de-risking should be reflected in the projection of the future earnings.

Key principle 8: Role of the system of governance

Insurance Europe agrees that there should be a robust system of governance and supports an enhanced role of the AMSB in the calculation of LAC DT. However, regarding the validation of the assumptions and calculations, Insurance Europe disagrees that it should be specifically the Actuarial Function that plays that role as this could also be fulfilled by the Risk Management Function or the Internal Audit Function

Paragraphs 1352 to 1364

Insurance Europe notes that with regards to capital management, DTA are classified as Tier 3 capital the percentage of which to cover the SCR is capped.

Key principle 9: Reporting and disclosure

Insurance Europe is concerned that EIOPA's proposals to strengthen the RSR and the SFCR with regards to LAC DT will increase (as opposed to decrease) the reporting burden of undertakings. Furthermore, Insurance Europe disagrees with the disclosure of competitive information in the SFCR.

Paragraphs 1365 to 1368

EIOPA is proposing to require both the supervisory reporting and the public disclosure of the deferred tax assets in the

	pre-stress balance sheet and the LAC DT calculation, including possibly a detailed sensitivity analysis. This will constitute a significant increase in the reporting burden which goes against the expected direction of travel in this respect. In particular, Insurance Europe disagrees with the disclosure of such commercially sensitive/competitive information (ie confidential information about planning assumptions) in the SFCR. In addition, the public disclosure in the SFCR could be misunderstood by the market. **Possible simplified calculation** **Insurance Europe is of the opinion that the proposed simplification in could be helpful. However, this simplification should only be applied optionally and never as an obligation.** ***Paragraphs 1369 to 1378*** Insurance Europe welcomes that the proportionality principle is explicitly being evoked in the context of LAC DT calculation. However, in addition to some shortcomings described below, EIOPA's proposal represents a mechanical, formulaic approach to calculating LAC DT, which essentially eliminates any form of judgement. Insurance Europe therefore strongly suggests that the simplification introduced will only be applied optionally and never as an obligation. Regarding the workings of the simplification, Insurance Europe understands that the main factor determining the horizon for future taxable profits to be factored in is the number of years during which carry-forward of taxable losses is possible under local tax law. However, this term is far shorter than the term during which Life Insurance entities recognize taxable losses stemming from the BSCR shock loss according to corporate income tax law in certain Member States. This could lead to artificial capping of both the taxable loss component that can be taken into account and the profits that are realistically available. Another prohibitive shortcoming in the formula proposed is that the excess of real world asset returns above the risk-free rate forms a relevant source of taxable profits for most insurers. However, this component is completely neglected.	
17.4.3	***Paragraph 1383*** Insurance Europe understands that the issue that EIOPA tries to address is an issue of current practice and supervisory approaches. Insurance Europe therefore believes that these issues should be tackled via supervisory tools that EIOPA has at its disposal.	

	Given the differences in tax regimes, and effect of different regulatory practices or Member state options (including, for example, extent and treatment of transitional measures), diverging practices on the inclusion and level of scrutiny of future profits are to be expected, and should be allowed for. Insurance Europe therefore believes that a principles-based approach is preferable. In particular, Insurance Europe agrees that proportionality is an important principle that needs to be applied when considering the calculation of LAC DT. However, Insurance Europe considers that the detailed comments and proposals suggested by EIOPA in applying the key principles do not allow for proportionality, and do not follow a principles-based approach. As stated above, the proposals represent a mechanical, formulaic approach to calculating LAC DT. Convergence in itself should not be the overriding goal, rather the goal should be a convergent principles-based process for assessing LAC DT.	
18.1	Insurance Europe welcomes the EC call for advice requesting EIOPA to assess if the methods and assumptions applied in the calculation of the risk margin continue to be appropriate, in view of a changed market environment. The current level of the risk margin, ie €210bn across the industry, is an enormous amount of capital locked out of productive use, with no proof that this level meets its intended objectives. This results in a waste of scarce capital and limits the capacity of insurers to take risks and grow. An excessive risk margin also has a major impact on the costs and availability of certain products, particularly long-term products, to the detriment of policyholders, and could trigger otherwise unnecessary and harmful actions for insurers under pressure from low interest rates. Insurance Europe does not support EIOPA's decisions to 1) conduct a very narrowly focussed review, only considering the cost of capital rate and 2) propose no changes. Equally, Insurance Europe is concerned by EIOPA dismissing the extensive industry input and arguments, on the basis of weak justifications and a clear intention to preserve the status quo. The current 6% calibration of the cost of capital is much higher than necessary and is a major reason why the risk margin is excessive. **Insurance Europe reiterates that, based on evidence, a 3% cost-of-capital rate is appropriate and justified**. Additionally, Insurance Europe notes the current design of the risk margin is flawed, and results in a disproportionate and unjustified allocation to certain long-term products. At a broader policy objective level, EIOPA seems to ignore industry's concerns on the excessive size and volatility of the risk margin and fails to provide any proof that the current level of the risk margin indeed reflects its intended purpose, ie to reflect the cost of transferring liabilities to a third party (in line with Article 77(3) of the Directive). Insurance Europe believes that assessing the extent to which the risk margin actually meets its intended objectives across products should be part of EIOPA's work, and part of its advice to the Commission.	

	Specifically on EIOPA's proposal, for the calculation of the CoC rate, Insurance Europe notes the following flaws: the use of a levered beta in combination with the assumption of undertakings being funded uniquely with equity, and a backward looking equity risk premium. Correcting these appropriately would result in a lower CoC rate.	
18.2	***Paragraph 1389-1392*** Insurance Europe believes that the current approach adopted in calculating the risk margin results in insurers holding technical provisions for insurance risks that enable an insurer to raise sufficient capital to withstand a scenario that corresponds to a loss exceeding the maximum possible ultimate loss (eg for annuities in which mortality rates fall to zero over the lifetime of the insurance obligations, or for lapses a lapse rate of more than 100%). Please refer to comments to section 18.3 for more detail. This contravenes Article 77(3), as no insurance undertaking would expect such level of protection to take over and meet the insurance obligations. In addition, Insurance Europe notes it could harm the financial stability objectives of regulators, as it effectively forces insurers to transfer insurance risks to off-shore jurisdictions and results in the creation of a highly material, artificial, interest rate risk sensitive balance sheet item. One of the key reasons the current risk margin design leads to an unrealistically high value of technical provisions for insurance risks, exceeding the requirement stipulated by Article 77(3), is the fact that it does not take account of risk dependence over time, and therefore overstates the total capital-at-risk. The current legal text allows insurers to take account of risk dependence over time when calculating a set of SCR(t)s in Article 37(1) and (2) of the Level 2 Delegated Regulation. Insurance Europe believes the set of projected SCRs that fully meet the Level 1 requirements should be consistent with an extreme but plausible lifetime shock. In order to also allow insurance undertakings using the standard formula to take risk dependency over time into account and to remain compliant with the Level 1 and Level 2 requirements, reasonable approximations and simplifications could be used for longevity risk. The approaches described would result in a more realistic run off profile for future capital requirements, and a more realistic calculation of the NPV as a consequence. Insurance Europe believes that this NPV value (and hence the risk margin itself) could be materially reduced while remaining reasonable and prudent.	
18.3	***'Calculation of the risk margin'***	

According to EIOPA some stakeholders propose to adjust the formula as set out above, where the CoC rate is allowed to vary according to a weighted average of risk-free interest rates for different currencies.

Insurance Europe does not agree with EIOPA's assessment, as risk-free rates across terms and currencies are highly correlated. Against this background, Insurance Europe believes that the proposal on varying the CoC rate with the RFR will therefore inevitably lead to lower volatility compared to the current CoC rate calibration.

According to EIOPA some stakeholders argue the reference undertaking should be allowed to use the MA and the VA

Insurance Europe is disappointed EIOPA has decided to consider this proposal only in the 2020 review of the long-term guarantee package. The VA and MA are permanent, core parts of the Solvency II framework and should be allowed to be taken into account in so far as the reference undertaking, to whom the liabilities are transferred, could also benefit from a Matching Adjustment and/or a Volatility Adjustment.

Insurance Europe believes that this proposal is consistent with other assumptions made about the reference undertaking having similar characteristics to the transferring insurer, as well as the assumption that the best estimate does not change.

Insurance Europe notes that firms with Matching Adjustment and/or Volatility Adjustment approval should use the respective measure in the calculation of the Non-Hedgeable Solvency Capital Requirement only, as inclusion of the Matching Adjustment in the rate used to then discount the Non-Hedgeable SCR would require a change to Article 37(1) of the Delegated Regulations.

According to EIOPA some stakeholders argue more diversification should be allowed for in the reference undertaking

Insurance Europe does not agree with EIOPA's assertion that the current Solvency II framework makes sufficient allowance for diversification between risks within insurance companies.

Currently an assumption is made that the life and non-life insurance obligations are taken over by two separate reference undertakings. This implies that no diversification benefit can be assumed between life and non-life insurance portfolios. Insurance Europe proposes to remove this arbitrary separation of obligations in order to enable insurance undertakings to properly take into account insurance risk diversification effects when calculating the risk margin.

Additionally, Insurance Europe believes that the current calculation of the risk margin at group level should also reflect diversification benefits. This is currently not the case as the risk margin of an insurance group is calculated as the sum

of the risk margins of the undertakings of the group. Insurance Europe proposes that this arbitrary separation of obligations is removed from the calculation.

Insurance Europe highlights that these proposed changes are consistent with the reality of how insurance groups are managed in practice and the SCR treatment of diversification. The excessively onerous Solvency II approach creates unintended incentives for the industry to restructure their organisations in order to enable appropriate diversification and overcome artificial constraints.

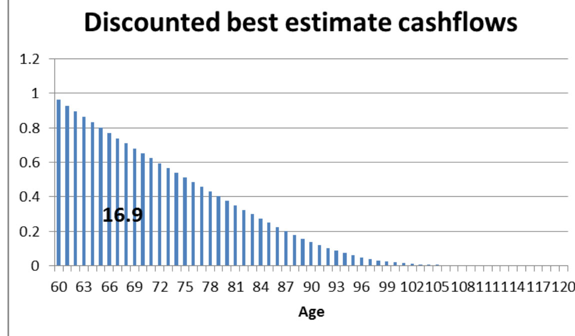
According to EIOPA "some stakeholders propose to use a time scaling factor to reduce SCR"

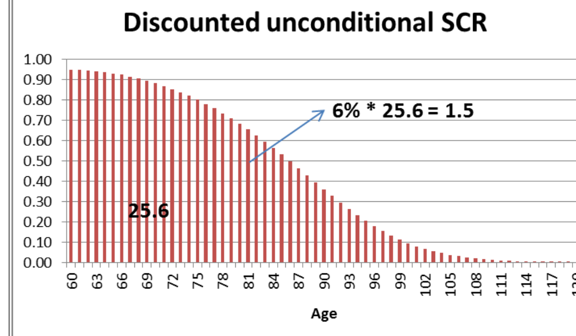
Insurance Europe acknowledges EIOPA's assessment that it may be difficult to assess the materiality of risk diversification over time, however Insurance Europe deems the impact can be material, and should be accounted for, as by not taking into account risk dependency over time, the current approach **overstates the ultimate risk and hence overstates the risk margin**.

Insurance Europe believes SCR capital requirements are not independent (eg a risk may be nonrepeatable, if it crystallises in one time period it could not reoccur, affecting forward SCR capital requirements), meaning it is not appropriate to value these as independent payments, which is the assumption implicitly made in the current Solvency II framework (Art 37(1) of the Delegated Regulation).

Insurance Europe notes that when setting the compensation required to finance a liability (ie the level of payment required, in the form of a risk margin, to take on that risk), an investor will consider the distribution of outcomes at maturity of the liability being financed. In other words, when providing this capital an investor will necessarily consider the ultimate risk when assessing the compensation required to provide that capital. By reflecting risk dependency, the ultimate loss that an investor can experience on any particular risk will be limited. Indeed, if a risk cannot occur twice, it should not be charged twice.

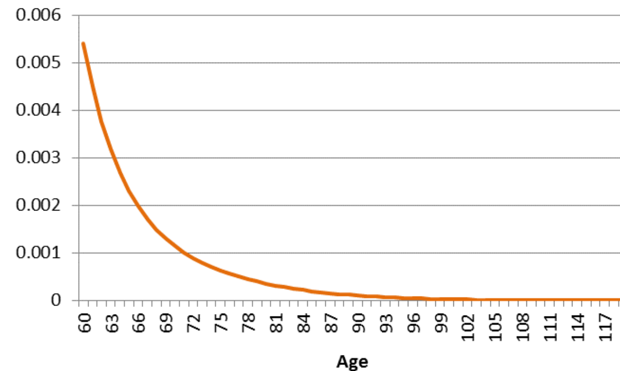
Current risk margin funds too much capital. This can be illustrated with a simple illustrative annuity example – a policyholder aged 60 with the IML00 base mortality table, a constant mortality improvement assumption of 1.8%, and a constant interest rate of 3%. This produces a best estimate annuity value of 16.9 (arbitrary units) and a risk margin of 1.5 (assuming Standard Formula stresses):





The risk margin is based on an SCR over the lifetime of this policyholder of 25.6 (ie sum of discounted unconditional SCRs). However, if this policyholder were to live forever, the total cost would be 33.3 (ie a perpetual bond whose value is 1/0.03 = 33.3), leading to a maximum possible loss of 16.4 (ie 33.3-16.9 = 16.4). This means that the current risk margin would be calculated based on an SCR of 25.6, while the worst case scenario of this policyholder living forever could only result in a maximum loss of 16.4, which is clearly wrong. In fact, the worst possible case for the investor corresponds to a 1-in-200 shock in each and every year, which yields a lower loss than 16.4. Therefore, any capital raised above this level the investor will receive back *with certainty* – and hence will not charge a premium above risk-free for this (ie **this component of the total capital raised requires a corresponding risk margin of zero**).

The current approach assumes that the future SCR being funded is based on unconditional 1-in-200 shocks. However, a significant proportion of insurance risks are non-repeatable – this is the case for longevity risk (eg cancer can only be cured once). Considering longevity risk further, ignoring such risk dependency over time results in implausible mortality rates – for example, for the 60 year-old policyholder, this would lead to mortality rates which are zero after the age of 90 if the Standard Formula stress of a 20% reduction in mortality rates every year is applied:



Historically, mortality rates have always increased with age. Therefore, the resulting mortality rates from applying the same unconditional shock year after year are completely implausible when viewed from a historic context and clearly not realistic – this is something that the use of a conditional stress (ie allowing for time dependency) would address.

The same reasoning can also be applied to other insurance risks. In the case of lapses, the current application of the risk margin formula will result in total lapse rates exceeding 100% (for example, for a five-year product with constant exposure, applying the Standard Formula stress of 40% each year implies that the risk margin should fund enough capital corresponding to a total lapse rate of 200%, or every policyholder lapsing twice).

Insurance Europe proposes that internal model firms are allowed to model risk dependence over time in their SCR projections in the risk margin calculation. Therefore, undertakings should be allowed to use a tapering parameter λ^t to derive the projected SCR in the risk margin formula provided in Article 37(1) of the Delegated Regulation, ie:

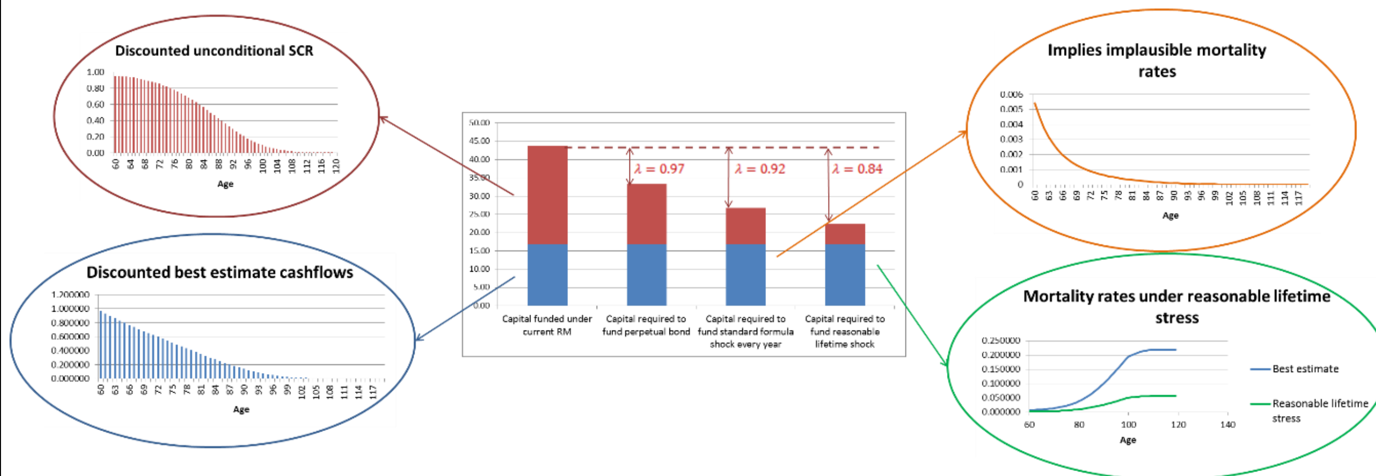
$$RM = CoC \sum_{t\geq 0} \frac{SCR(t)}{\left(1 + r(t+1)\right)^{t+1}}$$

where $SCR(t) = \lambda^t SCR'(t)$ and $SCR'(t)$ denotes the unconditional SCR at time t.

In this context, λ represents an estimate of the degree to which the ultimate risk reduces relative to a series of independent risks, and is linked to the reduction in size of future 1-in-200 risks following a 1-in-200 loss in previous

periods. This could be based on targeting an appropriate extreme lifetime shock to mortality rates. For example, for annuities, if an ultimate mortality rate of 5% at age 100 is targetted, in this example this would result in a λ of 0.84.

The diagram below demonstrates the impact on best estimate cash flows and notional SCR for the simple annuity product discussed above for (from left to right): (1) capital funded under the current risk margin (λ = 1); (2) capital required to fund a perpetual bond (λ = 0.97); (3) capital required to fund a standard formula shock every year (λ = 0.92); and (4) capital required to fund a reasonable lifetime shock (λ = 0.84):



Insurance Europe highlights that the tapering approach is one possible way to reflect the allowance for risk dependence over time and hence take into account the ultimate risk to the investor. Alternatively, firms could be allowed to use their internal models to achieve this by projecting forward SCRs using their internal model in a way that is consistent with their own view of the ultimate risk.

Paragraph 1396

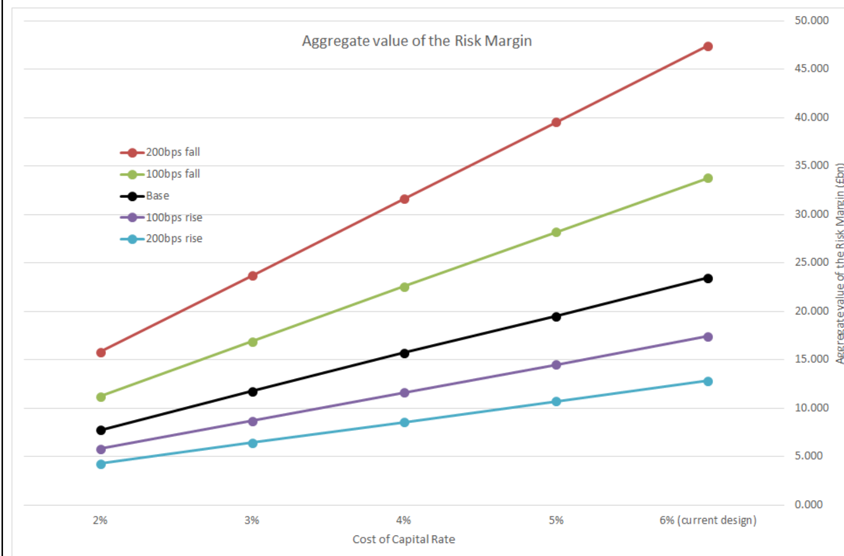
Insurance Europe is disappointed by EIOPA's lack of ambition and it regrets that more attention was not given to the proposals, arguments and evidence put forward by industry. EIOPA's updated analysis of the previous CEIOPS advice neither addresses the excessive level of the risk margin, nor the disproportionately large allocation for certain long-term

	products and the volatility of the risk margin.	
18.4.1		
18.4.2	***Size of the risk margin*** As a new and theoretical concept, a methodology and calibrations for the risk margin had to be invented during the development of Solvency II. The risk margin was never expected to have a very significant impact on a life insurer’s balance sheet, but its current level is unexpectedly extremely high. For the entire European industry, according to EIOPA figures, the total risk margin was €210bn in Q3 2016, out of which €150bn stemmed from life and composite insurance undertakings, representing about 45% of the life insurance industry SCR. For certain long-term products the risk margin can be especially extreme; such products include pensions paid out in lifelong annuities, whole life insurance and funeral insurance products. €210bn is an enormous amount of capital consumed by the risk margin and as such is locked out of productive use. Excessive levels result in a waste of scarce capital and limit the capacity of insurers to take risks and grow. Excessive risk margin will also have a major impact on the costs and availability of certain products, particularly long-term products, to the detriment of policyholders, and could trigger otherwise unnecessary and harmful actions for insurers under pressure from low interest rates. The excessive size of the risk margin represents a pan-European issue, of importance to (re)insurance undertakings across EEA jurisdictions. For example, EIOPA’s Q3 2016 data for Life business shows very clearly that the risk margin is higher than 50% of SCR in 4 EEA jurisdictions (Czech Republic, Germany, Netherlands and Norway) and between 40-50% in 10 EEA jurisdictions (Estonia, Greece, Ireland, Liechtenstein, Lithuania, Luxembourg, Poland, Slovakia, Spain and UK). Empirical evidence provided by a large annuity writer shows that there is a significant discrepancy between retaining vs reinsuring longevity risk, driven by the risk margin. In fact, based on the current conditions, economic neutrality between retaining and externally reinsuring longevity risk would be possible if the risk margin was reduced by around 75% to 85%. This shows clearly how distorted the risk margin is from an economic, risk-neutral approach. ***Sensitivity of the risk margin to interest rates*** **Insurance Europe believes that the risk margin is overly sensitive to changes in risk-free rates, regardless of the level of CoC** Although a reduction in the CoC rate reduces proportionally the absolute size of the risk margin, there is no mitigation of	

the sensitivity of the risk margin to interest rate movements. The risk margin remains volatile to changes in interest rates. For example, a survey[3] gauging the impact of the risk margin on the Solvency II balance sheet demonstrated how, for several levels of the CoC, the risk margin would be affected by movements of ±100 bps and ±200 bps in the risk-free rate (see figure 1 below). Specifically:

- If risk-free rates decrease by 100bps, the RM would increase by more than 40%
- If risk-free rates decrease by 200bps, the size of the RM would more than double

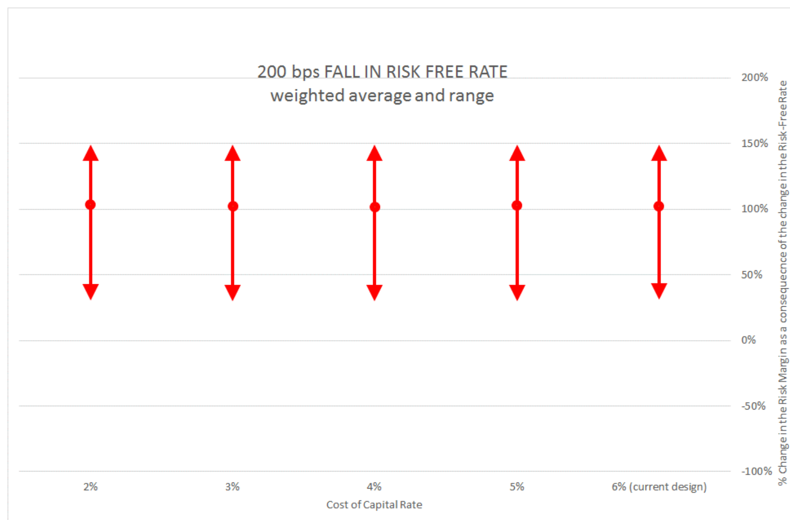
Figure 1: Aggregate size of the risk margin as a function of the CoC rate, including ±100bps and ±200bps changes in risk-free rate.



[3] Survey ran by the ABI on 14 companies, representing 75% of the aggregate UK Life risk margin, on data from year end 2016.

The same survey showed that the impact of changes in risk-free rates and the consequent risk margin volatility vary from company to company, but are on average very significant. For example, Figure 2 below shows that a 200bps downward shock on the risk-free rates can lead to a 150% increase in RM, at all CoC rates. **This emphasises the fact EIOPA's decision to review only the CoC ignored the significant volatility in the risk margin.**

Figure 2: Range and average of risk margin changes for 200bps decrease in risk-free rates



Paragraph 1399

Insurance Europe notes the data presenting an overview of the ratios RM/BEL, RM/OF, RM/SCR on a European level. However, Insurance Europe believes the table should have been shown for life and non-life undertakings separately on a European level, as the risk margin is substantially higher for life undertakings.

Insurance Europe notes that according to EIOPA solo balance sheet statistics, the risk margin amounted to €179bn for Q3 2016 and equalled €161bn end of 2016. While EIOPA's background note for the 23 of May 2017 roundtable on SCR

review showed a risk margin of €210bn for Q3 2016, which probably includes groups, and out of which €150bn stems from life and composite insurance undertakings.

General approach to the review of the CoC rate

While Insurance Europe recognises EIOPA's efforts in updating the calibration of the CoC rate, it highlights that the sources and information to determine CoC are upwardly biased. In addition, the parameters EIOPA has selected are very conservative. The estimation of each of the parameters should be based on realistic assumptions and ranges, as the CoC rate should reflect the economic reality and should not be a prudence margin.

To illustrate this, the formula EIOPA is using for determining the CoC rate is the following:

CoC rate = (1-x)β.[Equity risk premium]

The table below shows for each parameter the minimum and maximum value quoted by EIOPA. The application of these parameters leads to a possible CoC rate range between 1.7% and 10%. However, it is clear that EIOPA was very conservative in choosing the values for the respective parameters, leading to a very conservative CoC range.

	EIOPA's minimum value	EIOPA's maximum value	EIOPA selected value
Equity risk premium	2.3%	10.0%[4]	7.02%-8.09%
beta	0.9	1.25	1.2
adjustment	0.8	0.8	0.8
CoC	**1.7%**	**10.0%**	**6.7%-7.8%**

[4]In paragraph 1433 EIOPA refers to a current Bloomberg estimate of the ERP for the Eurostoxx 600 of 10%, without further explanations. While, in the table ('implied ERPs from dividend discount models) EIOPA refers to a range of ERP estimates from models from 2.3% to 8.2% (note that the 8.7% stated in the consultation is not correct, and should be 8.2%, in line with the table shown).

Paragraph 1410

Insurance Europe does not agree with the EIOPA's reasoning set out in this paragraph for the reasons explained below. **Insurance Europe recommends lowering the CoC rate calibration derived from the CAPM methodology in order to reflect that insurers are not funded uniquely with equity.**

- Insurance Europe highlights that the average share of eligible debt instruments in eligible own funds (EOF) in the EEA is not a comprehensive indicator for estimating the share of debt financing for deriving the CoC rate with a WACC approach. Indeed, the EEA average reflects a situation which is biased as it includes all entities, also insurance mutual companies, which do not rely highly on external financing. In addition, important disparities exist between Member States in terms of the use of subordinated debt by insurance companies.
- Insurance Europe believes that the reference to the QIS 4 exercise is out of date, as in the meantime Solvency II has entered into force and the contribution of debt financing on the CoC rate is clearly underestimated. The figures in the table show that for large insurance groups subordinated liabilities represent on average 25% of the total eligible own funds and it is mostly these larger insurance groups that hold the most significant amounts of risk margin.

  Note that using the proportion of debt instruments of total eligible own funds – and not of SCR – is prudent when estimating the potential impact of debt financing on the CoC rate for the risk margin (as the risk margin is the cost of providing capital for covering the SCR, and the share of debt financing is substantially higher if expressed as a percentage of the SCR).

Share of debt instruments in eligible own funds for significant EEA (re)insurance groups

Share of debt instruments in eligible own funds (excluding others sectors and D&A) for some significant EEA (re)insurance groups			
AEGON N.V.	39%	Mapfre, S.A.	8%
Ageas SA/NV	29%	NN Group N.V.	24%
Allianz SE	21%	Old Mutual plc	46%
Assicurazioni Generali S.p.A.	23%	Phoenix Group Holdings	9%
Aviva plc	34%	Prudential plc	24%
AXA SA	36%	RSA Insurance Group plc	40%

CNP Assurances SA	29%	Talanx AG	11%
Delta Lloyd NV	46%	Unipol Gruppo Finanziario S.p.A.	32%
Legal & General Group Plc	20%	Vienna Insurance Group AG	16%
Average Total of debt instruments in EOF / total EOF for these 18 groups			*25%*

Source : SFCR reports YE 2016

- Insurance Europe notes that the actual downward impact of the use of debt financing on the CoC rate depends on the relative cost of debt to the cost of equity and on the tax rate, which determines the tax deductibility of interest payments. Generally equity funding is more expensive than debt funding, and tax relief contributes to reducing further the effective cost of debt-financing compared to equity-financing. Even though the average corporate tax rates in the EU have shown a decreasing trend, it continues to be rather high (around 22%). Insurance Europe highlights that the current cost of debt financing is very low (around 250bps over the risk-free rate) and is usually materially lower than the cost of equity (eg around 200bps lower or more since 2012). equity funding is the most expensive form of capital and in practice insurers use also other capital instruments (and are authorized to use subordinated liabilities to finance up to 70% of their eligible capital, depending on the structure by tiers of their capital). Consequently, assuming 100% equity funding will overestimate the level of the CoC rate. Against this background, it seems arbitrary to impose a calibration based on only one type of financing where regulation explicitly allows another type of financing and insurers use it in practice.
- Insurance Europe notes that no undertaking will leverage its balance sheet when the debt financing cost would be higher than the cost of equity.

Equity risk premium (paragraph 1415-1435)

Appropriate equity risk premium

Insurance Europe notes EIOPA's analysis, however it believes **a forward-looking ERP is the most appropriate**. A forward-looking ERP is reasonable, as the CoC is the compensation forward-looking investors require for bearing the future risk of the company. However, often a backward-looking ERP is used for practical reasons. When this is the case, an adjustment should be applied to rectify the effects of using a backward looking ERP rather than a forward-looking ERP.

Insurance Europe believes that a backward-looking assessment of the risk premium for a diversified world equity portfolio would be between 5%-7%. However this ERP should be corrected for the following:

- The fact that a global diversified portfolio required for deriving an ERP also would contain assets other than equity (eg bonds, which have lower risk premiums).
- Backward-looking risk premiums contain a strong survivorship bias, and they depend strongly on the time period chosen.

Based on studies Insurance Europe believes that **a minimum downward adjustment of 2% is reasonable**, leading to a prudent range for ERP between 4%-5%. Insurance Europe **proposes an ERP of 5%** which is consistent with the average estimates of forward-looking ERPs from the Thomson Reuters data stream.

Comments on EIOPA's analysis of the ‚historical return model' and ‚dividend discount model'

Insurance Europe sets out its remarks on EIOPA's analysis of the historical return model and the dividend model in the paragraphs below. Insurance Europe notes that the comparison of the pros and cons of the historical return model and dividend discount model presented by EIOPA is very one-sided.

Historical return model (paragraph 1420-1424)

- The backward-looking ERP is extremely volatile and estimates have a very wide confidence margin. There is no evidence that dividend models are more volatile.
- EIOPA's backward looking ERP range [7.02% - 8.09%] is too narrow and too prudent and Insurance Europe believes these are not realistic.
    - The datasets and time periods seem to be selected to support the range, and in particular the use of the Eurostoxx 600 – containing the most successful and largest European listed companies – is erroneous.
    - Going too far back in time to calibrate the equity risk premium, ie 1926 for US, tends to increase it artificially.
    - EIOPA justifiably points out that '*the inclusion of the World War II period and the following economic recovery in the US time series may be considered questionable, because that economic situation is not comparable with today*'. Similarly, Insurance Europe believes that a data set starting in 1975, when economic environment and growth perspectives were different, for the determination of the EU ERP might lead to an upward bias, on top of the upward bias already introduced by using the backward-looking approach.
- The approach of calculating the country risk premiums by adding an adjusted sovereign spread is the most

conservative of all possible options presented in the Damodaran paper.

- EIOPA validates their ERP results based on the Damodaran approach set out in paragraph 1423. Insurance Europe believes it would be more appropriate to consider independent academic views on the equity risk premium.
    - Dimson, Marsh and Staunton conducted a benchmark study of ERPs in their 2003 paper[5] which analyses historical equity risk premiums and concluded that[6] "*when developing forecasts for the future, investors and managers should adjust historical risk premiums downward for the impact of these factors. This suggests that a plausible, forward-looking risk premium for the world's major markets would be on the order of 3% on a geometric mean basis, while the corresponding arithmetic mean risk premium would be around 5%. These estimates are lower than the historical premiums quoted in most textbooks or cited in surveys of finance academics. They represent our best estimate of the equity risk premium for corporate capital budgeting and valuation applications*."
    - In a 2011 update[7] they conclude that they "*infer that investors expect a long-run equity premium (relative to bills) of around 3%–3½% on a geometric mean basis and, by implication, an arithmetic mean premium for the world index of approximately 4½%–5%. From a long-term historical and global perspective, the equity premium is smaller than was once thought.*"
    - Damodaran shows a range of historic ERPs from 2.3% to 7.96% depending on the choices made (see table 4) and a range for Europe of 3.1% to 5.1% and 3.2% to 5.6% for the world (table 6)[8]. The consultation is therefore very selective when retaining a figure of 6.05% based on table 1 on page 11 of the Damodaran report.
    - The Norges bank note "The equity risk premium" (2016) concludes that "*The average World ERP based on data from 1970 to 2015 is 6.4 percent. Adjusting the average for repricing over the period lowers the average to 3.9 percent*".

[5] Dimson, Elroy and Marsh, Paul and Staunton, Mike, Global Evidence on the Equity Risk Premium (August 1, 2003). Journal of Applied Corporate Finance, Vol 15, No 4, pages 27–34; https://ssrn.com/abstract=431901.

[6] "*More fundamentally, however, we have argued that **past returns have been advantaged** by a re-rating due to a general decline in the risk faced by investors as the scope for diversification has increased. We have illustrated one approach that can be used to obtain an estimate of the amount by which the required rate of return has fallen. In addition, we have argued that **past returns have also been inflated by the impact of good luck**. Since the middle of the last century, equity cash flows have almost certainly exceeded expectations. Stock markets have therefore risen for reasons that are unlikely to be repeated.*"

[7] Dimson, Elroy and Marsh, Paul and Staunton, Mike, Equity Premia Around the World (October 7, 2011). https://ssrn.com/abstract=1940165.

[8] Damodaran, Aswath, "Equity Risk Premiums (ERP): Determinants, Estimation and Implication"s – The 2017 Edition (March 27, 2017). https://ssrn.com/abstract=2947861.

Dividend discount model (paragraph 1425-1433)

Note to EIOPA: In the table in paragraph 1433 EIOPA mentions the ERPs estimated by the models analysed range from 2.3% to 8.7%, however Insurance Europe notes that for Europe the maximum ERP equals 8.2%.

- EIOPA indicates that for the risk-free rate the retained ten years include a period where the ERP increases abnormally, possibly because of the latest financial crisis. Therefore, it is not sufficient to average the point-in-time results over a 10-year period and Insurance Europe believes that either the impact of the crisis should be taken into account, or a more appropriate period should be selected.
- Insurance Europe believes that the 5.5% dividend growth assumption is likely too high, especially in combination with the 143% uplift factor applied to dividends to reflect share buybacks.
  - The 10-year average dividend growth of the Eurostoxx 600 was 0%, which confirms that the assumption is highly sensitive to the time period chosen. Insurance Europe highlights that a more thorough analysis would be required, as it is performed in the Damodaran report. Against this background, the ERP for a given year should be based on specific estimates for the dividend growth potential provided by analysts rather than historic figures.
  - The Damodaran report derives (p83 and further) the forward-looking equity risk premiums based on the S&P 500 from 2008 to 2017, including the contribution of share buy-backs (EIOPA used S&P figures to derive the historical return ERP and as such it is also consistent to use it to derive the forward-looking ERP). The average of the ERPs calculated for this 10-year period is around 5%.

ERPs calculated by Damodaran based on S&P 500 figures[9]

2008	4,46%	2013	5,78%
2009	6,43%	2014	4,96%
2010	4,36%	2015	5,78%
2011	5,20%	2016	5,16%

[9] Note that the 2016 FL ERP calculated by Damodaran in its 2017 report (5,16%, pages 91-92) revises the figure presented in its 2016 report (6,12%) which appears in the consultation paper on page 282 in the extract from the Damodaran paper.

2012	6,01%	2017	4,50%

- The Norges bank publication 'The equity risk premium' (2016) indicates that '*The average World ERP estimate from various dividend discount models is 5.9%. These estimates may be affected by recent data bias. Cash flow growth has been exceptionally large since the end of the Global Financial Crisis in 2009, which in turn may bias upward expectations of future cash flow growth when extrapolated from historical data. In a below-average cash flow growth scenario, the estimated World ERP is 3.7%. Estimates of the expected ERP are also affected by the choice of proxy for the future risk-free rate. The current near-zero short-term interest rates may be a poor proxy for future short-term rates if the market expects rate increases in the future. The* ***expected World ERP from the discount models may be closer to 4% if expectations of interest rate normalisation are taken into account. Estimates from cross-sectional and time-series models also suggest an expected World ERP of 3 to 4 %.****'*
- **Insurance Europe believes that [4 – 6%] is a realistic range for the forward-looking world ERP.** As mentioned previously from a theoretical perspective the forward-looking ERP is the most suitable for the CAPM. Therefore, it is necessary to correct the upward bias of backward looking ERPs when these are used to derive the CoC rate.

Beta factor (paragraph 1436-1440)

Insurance Europe believes EIOPA's estimate for the beta is too high. The estimation of the beta for the insurance sector should reflect the fact that traditional insurance risk is not highly correlated to the evolution of financial markets. Insurance Europe believes the estimation of beta should reflect the unlevered beta of the insurance sector, which is consistent with CEIOPS' assumption that firms are 100% funded by equity and adds a layer of prudence to the calibration of the CoC rate. Not using an unlevered beta in this context would result in an inappropriately high cost-of-capital. Insurance Europe deems that [0.7- 1.0] would be an appropriate range for the unlevered beta, and **Insurance Europe recommends to use a beta of 0.85 subject to further adjustments for asset and franchise risk**.

Insurance Europe has the following comments on EIOPA's analysis and determination of beta:

Insurance Europe notes

- EIOPA determined beta incorrectly in basing it on a weighted average of betas for the 66 listed EEA undertakings, regressed against the Eurostoxx 600; Insurance Europe believes the beta should be calculated with respect to the global market, because an investor can diversify away European-specific risks by investing outside of the EU.
- The European insurance beta determined by Damodaran is significantly higher than the global and US

insurance beta. The difference stems from the higher life insurance betas in Europe, however, life insurance betas are most likely related to asset risks, correlated to the market, and as such not relevant in deriving the CoC rate for pure insurance risks. (eg beta for non-life is 40% lower than life beta).

Insurance betas calculated by Damodaran

	Insurance beta (Levered
Europe	**1,12**
World	**0,71**
US	**0,9**

- In paragraph 1438 (g) EIOPA notes that '*data from companies is aggregated using a weighted average in order to reflect different company sizes and to arrive at an estimate that is sufficient to transfer half of the insurance liabilities in the market',* ie the weights are based on market capitalisation. First of all it is not clear how EIOPA has performed the estimation and secondly, Insurance Europe believe the weighted average approach based on market capitalisation is not justified, as it creates distortion. The larger undertakings can have a larger correlation with the market while the risk margin is intended to finance capital for the run off of pure insurance risks which are not correlated with the market.
- EIOPA does not substantiate the choice for a beta of 1.2, while the range proposed is [0.9 – 1.25], which is clearly conservative.

Further Adjustments (Paragraph 1441 – 1442)

Insurance Europe notes that CEIOPS considered the need for a downward adjustment but that reliable quantitative results concerning the size of this adjustment were lacking. However, CEIOPS itself introduces an adjustment when deriving the CoC rate from the CAPM. Applying this adjustment brings the CoC from an initial range of [7,5% -10%] to the final CoC rate of 6%. The adjustment corresponds to an implicit adjustment of around 20% for Non-Life and 40% for Life.

Insurance Europe acknowledges that determining the adjustment may be complex, however it believes the 20% adjustment of the CAPM currently put forward by EIOPA is clearly too low. In particular when considered in the context of the risk profiles of life insurers who carry large amounts of asset risk. For example the results of the 2016 EIOPA stress testing exercise in section 2.3.1 on SCR –MCR profile notes that "Market risk accounts for 64% of the net solvency capital requirement before diversification benefits for standard formula users". Insurance Europe highlights that significant adjustment - reflecting asset risk and franchise risk - needs to be applied when deriving the CoC rate from

	the Equity Risk Premium calculated based on the CAPM total return approach. **Insurance Europe believes that a 30 % adjustment is appropriate.**	
18.4.3	Insurance Europe does not agree with EIOPA's conclusion that the CoC rate would be in the range from 6% to 8%. Insurance Europe believes that **3% is a prudent estimate for the CoC** based on the arguments and analysis set out in the previous paragraphs. Given the formula put forward by EIOPA to calculate the CoC rate **CoC rate = (1-x)β.[Equity risk premium]** Insurance Europe believes the following parameter estimates are reasonable: ERP ~ 5% in a range of [4%-5%] Unlevered Beta ~ in a range of [0.65-0.8] X ~ 30% Taking into account these estimates leads to a CoC rate between 1.82% and 2.8%, **therefore Insurance Europe believes 3% is an appropriate and sufficiently prudent CoC rate**. In addition, Insurance Europe notes that the RM is excessively large for unit linked products, regardless of the level of CoC. The risk margin is based on a cost of capital approach for non-hedgeable risks, which currently includes the mass lapse risk. In case of companies with predominantly unit-linked business, the existence of a large mass lapse risk is usually closely linked to a large part of own funds being "financed" by the value of future profits. Contrary to equity, however, companies do not usually apply a return requirement on the value of future profits. It can therefore be argued that the current construction of the risk margin tends to overestimate the value of the risk margin for such companies. Not only is it unlikely that the reference company, as referred to in Article 38 of the Delegated Regulation, would receive a portfolio with a large value of future profits – and thus a large mass lapse risk – since such a portfolio would be unlikely to end up in a situation with solvency problems in the first place. It can also be argued that such a portfolio, where the required own funds are to a large extent covered by the value of future profits, would not need an additional	

	return requirement, as is implicitly assumed by the current design of the risk margin. As a possible solution for this problem, Insurance Europe suggest the following: to the extent that it can be shown that the amount of mass lapse risk corresponds to a positive value of future profits in own funds, mass lapse risk should not be part of the risks leading to a cost of capital for the assumed reference undertaking in Article 38. In other words, the mass lapse risk should in those cases be excluded from the risk margin calculation.	
19.1	Insurance Europe welcome the Commission's request for EIOPA to assess differences in classification for those eligible items that are comparable between the banking framework and the Delegated Regulation, and, as a next step, to assess for each of the differences identified whether they are justified by differences in the business model, by diverging elements in the determination of own fund requirements or on other grounds. Insurance Europe welcomes the following proposals in EIOPA's draft advice: • The possibility to have a partial write-down under certain conditions. • Providing supervisory authorities with the ability to consider an exceptional waiver on write-down, in cases where the solvency position of the issuer would most likely be significantly weakened as a consequence of the write-down. While Insurance Europe acknowledges EIOPA's efforts in finding a practicable solution for issuance of RT1 instruments, it creates a number of challenges and concerns, given the complexity of the functioning of these RT1 instruments across jurisdictions and in particular under certain stress conditions.	
19.2		

19.2.1	**SCR is a _going concern_ solvency level – Bank AT1 PLAM is effectively applicable in gone concern**
	
	• The **_going concern nature_** of the SCR is well documented by Solvency II Directive Art 138:
	  ○ If own funds fall below the SCR, insurers must restore compliance with the SCR within ***6 months*** (or 9 months if such extension is considered appropriate by the regulator)
	  ○ In case of an industry wide crisis, the time to SCR restoration can be extended to ***7 years.***
	  ○ If own funds are lower than the SCR, the insurer can continue as a ***going concern*** (subject to a sufficiently high MCR coverage).
	• EIOPA's analysis for bank versus insurance should appreciate that bank regulation does not know a	

differentiation of SCR (going concern) and MCR (gone concern).

- Originally, bank AT1 PLAM was intended as a going concern loss absorbency trigger – just like RT1. However, bank regulation has moved on, and the bank AT1 trigger levels of 5.125% (or, where applicable 7%) are no longer considered going concern triggers – investors expect that bail-in will apply at much higher CET1 ratios and thus way ahead of PLAM.
- Bank PLAM is therefore considered a ***gone concern*** trigger by many market participants.

On group level, the MCR can be breached while the Group SCR ratio still exceeds 100%

- In this response, "**Group MCR**" is used to describe the "minimum consolidated Group SCR" (Solvency II Directive Art. 230(2)).
- The Group MCR is the simple ***sum of solo MCRs***, the MCR Tiering Limits (min 80% T1, max 20% T2, no T3, no ancillary own funds) also apply to the Group MCR (Solvency II Directive Art. 230(2) refers to Art. 98(4) of the same Directive; see also the EIOPA Guideline 16 on Group Supervision (No. 1.47(c)).
- The solo MCRs are factor based charges based on technical provisions, premiums and capital at risk, subject to an absolute EUR amount floor.
- Adding up solo MCRs ignores diversification between subsidiaries. The Group MCR is higher for the more complex group with many subsidiaries than for another group with only few large operating entities.
- The tiering limit rules for MCR coverage are stricter than for SCR coverage (both solo and group).
- Nevertheless, on solo level, the regulatory ladder of intervention ensures that the SCR is always breached ahead of the MCR. The reason is that T1 must exceed 50% of the SCR, whereas the MCR is capped at max. 45% of the SCR. Despite the stricter Tiering limits for SCR-coverage, a MCR ratio of less than 100% must always coincide with an SCR ratio of below 100%.
- On group level, however, there is no cap for the Group MCR relative to the Group SCR. In fact, there are several cases where the Group MCR exceeds 80% of the Group SCR. **As a consequence, the Group MCR can be breached even though the Group SCR is still above 100%.**
- In this response, a Group MCR breach with the Group SCR above 75% is referred to as "**trigger inversion".** Trigger inversion is used both for cases where the Group MCR trigger is breached, and the Group SCR Ratio is between 100% and 75% (ie the Group MCR PLAM trigger is breached ahead of the 75% SCR trigger), but also for the even

more critical case where the Group MCR is breached, but the Group SCR is still above 100%.

Trigger inversion is a realistic risk for many large insurance groups

- Insurance Europe has looked at 15 large Solvency II-regulated groups (including all current and former GSII) that together are responsible for a large proportion of currently outstanding group *externally* placed subordinated debt.
- The high-risk nature of RT1 from an investor perspective makes it very likely that this group of 15 will be responsible for the majority of group external RT1 outstanding in the future, given their relative credit standing and experience as issuers.
- For these insurance groups, the loss was calculated, defined here as the reduction in UT1 which would be "required" to reduce eligible own funds to exactly 100% of the Group MCR, leaving the MCR unchanged (but considering tiering limits, which are much more restrictive for MCR coverage purposes than for SCR coverage).
- Next, the impact of this loss (UT1 reduction) on the respective Group SCR ratio was calculated. The scope of the Group MCR differs from that of the Group SCR – only the latter contains other financial sectors and equivalent insurers. For sake of simplicity, all components of the Group SCR ratio other than UT1 were left unchanged – including the Group SCR and even T3 (DTA, which would be expected to increase in many loss scenarios).
- On average, the Group SCR is around 96% when Group MCR is breached (and 107% assuming full use of remaining T3 headroom). For 5 groups, the resulting Group SCR ratio is still above 100% (trigger inversion for all three triggers, ie cancellation/deferral, redemption and PLAM; 8 groups would be affected if you allow for the full use of the remaining T3 headroom). For only two out of the 15 groups the resulting Group SCR is lower than 75% at Group MCR breach, and it is only for these two groups where PLAM would be triggered by the 75% SCR trigger rather than the Group MCR trigger.

Why trigger inversion should be avoided

- **Trigger inversion is an issue that also extends to any discussion around resolution and/or bail-in for insurers:**
    - More important than its effects on a functioning framework for RT1, T2 and T3 that are explained below,

trigger inversion is highly relevant in the context of resolution and/or bail-in for insurers.

  - A logically consistent system with a regulatory ladder of intervention should ensure that the Group SCR (100%) is always breached ahead of the Group MCR.

- **RT1:** The consequences of trigger inversion for PLAM (RT1) are as follows:

  - DR Art. 71(8) specifies that PLAM should apply upon a "*significant non-compliance with the* <u>*SCR*</u>". Instead, on group level, PLAM would typically apply with full force (eg 100% write-off) when the group SCR is only marginally breached – or possibly not even breached at all.
  - The 75% SCR ratio trigger would be meaningless for most of the large groups.
  - There would be no 3-months cure period for many of the big groups even though the Group SCR ratio might still exceed 90%.
  - In effect, trigger inversion would imply that "partial" loss absorbency or the waiver for PLAM suggested by EIOPA to avoid adverse tax effects is unlikely to apply in practice
  - Effectively, trigger inversion implies that PLAM can be triggered when the group is still very much in a going concern state, ie **potentially while own funds are still sufficient to withstand *another* "1-in-200-year event".**

- **T2, T3:** The consequences for T2 and T3 are also unintentional:

  - The coupon deferral triggers for T2 can apply simultaneously with RT1 PLAM and RT1 coupon cancellation, and even T3 deferral may apply at the same time, too (depending on the trigger inversion issue).

- Contrary to this, bank regulation foresees a logical and clear ***hierarchy of capital***:

  - First step: RT1 coupon cancellation *may* apply (breach of MDA buffer, CET1 ratio >=10%), although banks may be able to prioritise AT1 coupons while "inside" the buffer.
  - Second step: PLAM at a CET1 ratio <=5.125%, in several cases <= 7%.
  - Last step: T2 is not subject to any triggers for coupons or principal. It is only subject to the ultimate risk of bail-in.

- Insurance Europe would like to point out that - **in today's market** - trigger inversion is only marginally meaningful for the marketability and pricing of <u>***RT1 (or T2, T3) at issuance***</u>. RT1 can only be sold to investors when investors view a trigger breach as highly unlikely at issuance. However, trigger inversion does matter in crisis, when regulatory capital instruments should function as intended and when any additional (unintended) negative surprises

	for regulators and investors should be avoided. **What could be done to avoid trigger inversion?** ▪ A systematic re-design of the Group MCR would require changes to the Solvency II Directive. ▪ A potential "quick-fix" would be to amend the Group Supervision Guideline 16 No. 1.47(d) so as to allow the Group MCR to be met with 50% T2 and 50% T1 (ie the maximum T2 tolerance that Insurance Europe believes to be allowable according to the Solvency II Directive). ▪ ***In the absence of any changes to the Group MCR concept, PLAM as well as the cancellation / deferral triggers for T2 and T3 deferral should not reference the Group MCR to avoid unintended consequences. As a minimum, the proposed waiver for PLAM (write-down) should also be possible in case of a Group MCR breach.***	
19.2.2		
19.2.3	**Legal certainty is also required for write-up** ▪ PLAM for Bank AT1 is both partial and temporary. Write-up provisions are reasonably clearly defined (although complicated). ▪ Insurance Europe strongly supports the possibility of a write-up, unless PLAM truly only applies in winding up (gone concern) of the group. ▪ Insurance Europe would therefore welcome EIOPA to make a transparent statement on write-up and clarify what exactly EIOPA would deem as a hindrance to recapitalisation. ▪ Without write-up, conversion instruments could be significantly less costly for issuers as investors could at least profit from the upside in the shares held post conversion – in the case of fixed price conversion (eg RSA's instruments issued in 2017), there is a non-negligible chance of RT1 investors even making profits upon conversion. In case of permanent write-down (ie if write-up were prohibited), the entire nominal could be written off potentially at rather high group SCR ratios. It is not clear why write-down instruments should be disadvantaged in this way. If no legal certainty is achieved on write-up, the non-listed insurers would find it difficult to issue RT1 instruments at reasonable prices. Conversion instruments are not available for non-listed insurers. In particular insurers in the legal form of a mutual, cooperative or public-sector company are dependent on the marketability of a write-down instrument	

	for RT1 issuance.	
19.2.4		
19.2.5		
19.2.6		
19.3	**The differences between PLAM for bank AT1 and insurance RT1 are substantial – even when considering the suggested EIOPA changes:** ▪ Bank PLAM is triggered in ***gone concern.*** Insurance PLAM is potentially triggered at ***going concern*** SCR levels – and it can be triggered simultaneously with mandatory deferral on T2 (and in case of trigger inversion even simultaneously with mandatory deferral on T3). Whereas bank T2 does not require deferral at all. ▪ Insurance Europe highlights the following two points on bank AT1 as a clarification, they refer to the intended functioning of write-down as originally foreseen in formal Basel 3 regulation, ie the statements ignore that bank regulations ignore that bank regulation has moved on and evolved since then, insofar as for practical purposes a write-down will not materialise in bank AT1 since bank PLAM is now generally expected to only apply in a gone concern scenario. In insurance, PLAM as currently envisaged may apply in a going concern situation, hence the formal functioning of write-down for bank AT1 as originally foreseen is still a relevant comparison. o Bank PLAM via write-down can be ***temporary***. Write-down is explicitly allowed for bank AT1. EIOPA so far has not commented on write-down, there seems to be a risk that regulators would prefer write-down to be permanent. o Bank PLAM via write-down can be ***partial*** – insurance PLAM is likely to be full, potentially even where the group SCR is not or only marginally breached (trigger inversion). **Other important differences between bank and insurance own funds regulation include the following:** ▪ **Limit system**: o In some jurisdictions, Insurance Europe notes there is a 'cliff effect' on eligible capital once T1 falls to less than 50% of the SCR, as existing T2 and T3 then no longer counts as eligible own funds. In these jurisdictions, the SCR ratio could fall from 101% (with T1 at 51%) to 49% due to a 2% reduction of T1 to 49%. In such a case, EIOPA's suggested linear approach to write-down is not applicable. Insurance Europe	

is not aware of any similar effects in banking.

- There is also a "cliff effect" related to RT1, since its limit is implicitly based on UT1 (the RT1 limit of 20% of total Tier 1 implies that RT1 is limited to 25% of UT1). If UT1 falls by 100, the maximum eligible amount of RT1 falls by 25. If the T2/T3 headroom is fully exhausted, a loss of 100 would reduce total eligible own funds by 125. There is no such cliff effect with respect to bank AT1.
- PLAM in insurance can only lead to an improvement of the key regulatory metric (SCR ratio) if it leads to a reversal of a prior cliff effect. In banking, PLAM always increases the key regulatory metric, the CET1 ratio.

19.4.1

Paragraph 1454 & 1456

a) The quality of RT1 is *formally* at least as good as that of equity.

b) PLAM does *not* increase the quality of own funds in a meaningful way.

c) PLAM may reduce the quality of RT1 as it can have adverse effects on the *financial stability* of the undertaking.

d) Even without PLAM, RT1 would be much riskier for investors than T2 or T3.

a) The quality of RT1 is formally at least as good as that of equity

- Permanence: RT1 is as good as equity
  - RT1 is perpetual. Since incentives to redeem are prohibited, market participants regard RT1 as so-called "True Perpetuals".
  - In contrast, perpetuals with a coupon step-up (incentive to redeem) are expected to be called at the step-up date, unless the issuer is in a severe crisis.
  - For True Perpetuals like RT1, investors expect a call only when it makes economic sense for the issuer to do so, ie when the old bond can be replaced at lower cost (or when RT1 exceeds the 20% limit). ***Importantly, Insurance Europe refers to its comment on EIOPA's observations in section 20.3 (paragraph 1525).*** Market data does demonstrate that investors price True Perpetuals like bank AT1 and RT1 to the next *expected* call date. Given the considerable spread tightening in recent months, the expected call date for many True Perpetuals is actually the next call date. However, this is only true because investors assume that the issuer can, and will, call the old AT1 bond and issue a new ***cheaper cost replacement AT1***. For

those bonds where it is not economically attractive to call, investors price the bonds on a "to-perpetuity" basis, ie assuming that the instrument will never be called (at least not in the near future).

- From a regulatory perspective, the quality (permanence) of RT1 is additionally protected as calls are always subject to prior regulatory approval. Note that it is understood that a repurchase of equity is not subject to prior regulatory approval in some EEA jurisdictions.
- Against this background **Insurance Europe believes that the quality of RT1 is as at least as good as equity in terms of permanence.**

- Loss absorbency with respect to distributions: RT1 is of higher quality than equity
  - RT1 distributions (coupons) are fully discretionary. In particular, dividend pushers and dividend stoppers are prohibited by EIOPA Guidelines.
  - *As a result,* ***RT1 investors can be subordinated (!) to equity investors:***
    - An issuer can decide to cancel all RT1 coupons in eternity, irrespective of the issuer's financial health (solvency). The issuer can nonetheless continue to pay equity dividends, or even do share buybacks etc. Solvency II allows issuers to subordinate RT1 investors to equity investors – note that PLAM is not required for this.
    - Importantly though, equity dividends can be seen as effectively ***cumulative***, whereas RT1 distributions are explicitly ***non-cumulative*** (without compensation or other "upside"). Equity dividends can be cancelled, but equity investors can be compensated with higher dividends in the future, and/or recovery/future upside in the shares.
  - ***In terms of loss absorbency via cancellation of distributions, RT1 is of higher quality than equity.***
  - The same is true for bank AT1. Both bank AT1 and insurance RT1 are high-risk products for investors – only where issuers have an incentive to treat RT1/AT1 investors fairly – ie not worse than equity investors - will investors be prepared to invest in such products (the need of an issuer to access the RT1/AT1 bond market in the future is such an incentive to treat RT1/AT1 investors fairly today).
  - The current demand for RT1/AT1 is strong despite these risks for RT1 investors. Note that many market observers are not sure whether this favourable demand situation will also prevail in a more normal yield

environment.

- Loss absorbency (and subordination) with respect to the principal: RT1 is at least as good as equity
    - Both equity and RT1 add to the stack of capital that does not count as a liability in insolvency – they both count as (anti-insolvency) "equity" for purposes of the asset-liability test.
    - The sum of RT1 and equity ("anti-insolvency equity") helps an issuer to withstand unexpected losses as it helps to avoid insolvency due to over-indebtedness (where such a test is relevant under national insolvency law). All RT1 and equity payments are discretionary, as such cannot cause insolvency due to illiquidity either.
    - Ignoring PLAM, losses do not reduce the accounting value of RT1, only that of equity. While the absence of a reduction of its accounting value does not signal that RT1 is of higher quality than equity, it certainly does not mean that RT1 quality would be lower either.
    - PLAM does *not* change the relative quality of equity and RT1 from a ***policyholder perspective*** either, as it leaves the stack of "anti-insolvency equity" unchanged – any increase in equity due to write-down or conversion is compensated by a fall in RT1 (ignoring any potentially adverse tax effect of PLAM).
    - Insurance PLAM occurs before equity is 'wiped out', leaving future upside for equity investors, including reduced future coupon expenses, for shareholders.
    - RT1 can contractually rank senior to equity in insolvency. However, when liabilities exceed assets, the providers of "anti-insolvency equity" cannot receive a liquidation consideration – ie effectively, RT1 and equity investors rank pari passu in liquidation.
    - ***In terms of loss absorbency (and subordination) via the principal amount, RT1 can indeed be junior to equity in circumstances that are not entirely unrealistic, causing a "value transfer" from (supposedly) more senior to (supposedly) more junior claimants.***
- Consequently, RT1 investors are - formally - exposed to more risk than equity investors in realistic scenarios.

b) PLAM does not increase the quality of own funds in a meaningful way

- PLAM does increase UT1, but only at the expense of falling RT1. PLAM therefore does not increase the amount of capital. Moreover, it also does not *formally* increase the quality of capital:
    - Both UT1 and RT1 allow cancelation of distribution.
    - Both UT1 and RT1 are truly perpetual (maximum permanence).
    - Both UT1 and RT1 add to "anti-insolvency" equity, which for purposes of the asset-liability test does not count as a liability.
- There is no meaningful benefit from PLAM for policyholders, *formally* RT1 is of equal or even higher quality than equity.
- It is true that RT1 creates different investor expectations than equity. RT1 can only be sold to investors if there is a reasonable certainty that RT1 investors will not be subordinated to equity investors. Rather, in practice RT1 investors expect to be treated preferentially to equity investors ***unless the issuer experiences a severe crisis.***
- To understand what this means for the relative quality of equity and RT1, note that reputational issues and signalling considerations can also impact the "quality" of equity as well. Some insurers may pay equity dividends in order to signal strength, even though prudence would suggest otherwise. However, please also note that insurers are typically much less dependent on capital markets financing than banks are - reputational pressures that may prohibit issuers from cancelling RT1 coupons (or equity dividends) are significantly lower than for banks, where short term refinancing requirements are substantial.
- At the margin, it is still to be expected that cash flows to RT1 investors in forms of distributions will be stopped at a later stage than equity dividends.
- Therefore, and despite the formally very high quality of RT1, Insurance Europe agrees with EIOPA that RT1 should be limited (more reasons to limit RT1 are provided in the comment on **20.4.3** below).
- The important point to note here is, however, that – ***once a crisis is indeed severe***, ie most definitely at times of a PLAM trigger breach – RT1 gives issuers (and, indirectly, regulators) a lot of power to impose losses on investors (through coupon cancellation, and noting that RT1 is also perpetual) and maintain all funds within the insurer for as long as is deemed necessary. In times of crisis, the quality of RT1 is at least pari passu to equity (if not better as coupons are cancelled vs. dividends that are effectively only deferred (cumulative)).

c) PLAM may reduce the quality of RT1 as it can have adverse effects on the financial stability of the undertaking

- Paragraph 1456 states that the primary objective of PLAM is to support ***financial stability*** at times of stress. Insurance Europe believes that there is a risk that PLAM will rather harm financial stability than support it:
  - Financial stability is not supported when PLAM results in the issuance of a potentially large number of shares without increasing own funds by a single Euro. Since the market value of conversion RT1 can be expected to match the value of the delivery shares at the time of conversion, there is – in theory – at least an offset to the share issuance in the sense that liabilities of equal market value are cancelled via conversion. However, to restore a healthy SCR coverage, an additional large scale capital increase may be required, and any additional supply of shares resulting from PLAM is not helpful for this additional capital raising. Insurance Europe is convinced that RT1 offers all necessary rights to impose extensive losses on RT1 investors without share issuance – and as such without this potential challenge to recapitalisation.
  - As outlined above, PLAM is a contractual subordination of RT1 investors to equity investors. At issuance, RT1 investors effectively ignore this subordination risk as a trigger event is deemed extremely remote. However, when a PLAM trigger event becomes more likely, the inversion of the hierarchy of capital will manifest itself, and investors in conversion RT1 may try to short-sell shares in anticipation of the imminent trigger breach. Such uncoordinated sales will certainly not contribute to orderly trading in the issuer's shares and thus potentially complicate a recapitalisation effort.
  - Financial stability may be harmed in the worst-case scenario where eligible own funds could even fall in case of adverse tax effects from PLAM in a severe crisis.

d) Even without PLAM, RT1 would be much riskier for investors than T2 or T3

- The combination of true perpetuity and discretionary cancellation makes RT1 significantly riskier than T2 (which can be dated, and does not even require discretionary *deferral*, let alone cancellation).
- Even without PLAM, RT1 allows the insurer to stop all cash flows to RT1 investors and effectively wipe out the investors' claims – while being able to pay equity dividends at the same time. T2 and T3 do not allow this.
- RT1 contains "vulture fund risk" – if a "vulture fund" were to own a small insurer with no need to re-access the capital markets for additional RT1, the vulture fund could stop all payments to RT1 investors in eternity.

- T2 and T3 do not pose anywhere near comparable risks for investors.

Some regulators (like APRA/Australia) do not require going concern insurance PLAM

Insurance Europe notes that Australian (APRA) rules for subordinated insurance Tier 1 require PLAM (conversion) only at Point of Non-Viability ('PONV'). At PONV the relevant insurer has gone into a **gone concern**. To Insurance Europe's knowledge, PONV is not defined by a particular solvency ratio, but is rather determined by the relevant regulatory bodies. Depending on when PONV occurs, PLAM may of course be justifiable and sensible. Insurance Europe highlights that, PLAM at PONV does not have unintended consequences, assuming that both equity and insurance RT1 are "wiped-out" simultaneously (or shareholders before RT1-holders – but not in the inverse sequence). Additionally, Insurance Europe notes that Basel 3 rules do not require PLAM for equity accounted bank AT1. While European regulation requires PLAM for any European bank AT1, other important regulators (eg US) do not. APRA does require PLAM for Australian bank AT1 at the PONV (ie as determined by the relevant regulatory body) and a CET1 ratio of 5.125%, whereas insurance RT1 requires PLAM only at PONV. At the time of drafting bank AT1 rules, a CET1 ratio of 5.125% was viewed as a going concern trigger level (the Basel 3 Pillar 1 minimum for CET1 is 4.5%). Today, however, PONV is generally expected to be reached at much higher CET1 ratios, and consequently the PLAM of European bank AT1 is generally expected to be triggered only in a gone concern situation.

Paragraph 1455

It is conceivable that PLAM leads to an increase in the SCR ratio

- A trigger breach most likely coincides with a significant fall of UT1.
- Assuming meaningful issuance of RT1, the fall in UT1 can lead to **'cliff effects'** (please refer to comments on section 19.3). 'Cliff effects' imply that certain capital items are available, but not eligible due to tiering limit restrictions.
- PLAM increases UT1, which in turn can reverse a prior cliff effect. As a consequence, PLAM may potentially lead to an increase in *eligible* own funds.

However, there is no guarantee that this happens. Of course, the currently envisaged criteria do – at the margin – incentivise high levels of T2/T3 as well as RT1, with lower UT1 levels as a likely consequence. Insurance Europe believes

	this cannot be intended. Also, these instruments are of perpetual nature. Scenarios that may seem remote today might become very real in the potentially very long life of the instruments.	
19.4.2	***Paragraph 1460*** Insurance Europe supports EIOPA's position that there is a strong case not to align the Principal Loss Absorption Mechanism with the banking regime. Insurance Europe highlights that a UT1 trigger would not solve the fundamental weakness of the insurance PLAM, ie that it typically does not lead to an increase – and may even lead to a decrease – of the key solvency metric for insurers, the SCR ratio. Also, Insurance PLAM does not increase the quality of capital in crisis, because of the very high quality of RT1 (as outlined in the comments on section 19.4.1) which is independent of PLAM coming to full force in times of crisis. This position is also backed by the underlying differences between Bank and Insurance Tier 2 capital securities. In Insurance Europe's view there is a higher degree of difference in quality of regulatory capital permanence between Bank Tier 2 and Additional Tier 1 than there is between Insurance Tier 2 and Restricted Tier 1. Hence from a prudential oversight perspective it makes much more sense to arrange for PLAM triggers specifically linked to Tier 1 coverage of risk weighted assets in bank oversight than it does in relation to the Tier 1 quantum in the capitalization of an insurance undertaking compared to its capital requirement.	
19.4.3	**Insurance Europe would welcome clarity regarding write-down** Insurance Europe would appreciate further guidance on how EIOPA views partial write-down to be implemented. However, Insurance Europe notes that the fact that the consultation paper is silent on write-down is a missed opportunity to provide additional clarity to regulators and to the market for capital securities. **Insurance Europe welcomes the introduction of the permission for a partial write-down** ▪ The waiver can help to avoid the most glaring of the unintended consequences that PLAM may have, namely a reduction of the SCR ratio. However, the way it is currently worded limits its applicability in practice ▪ Given the risk of trigger inversion (see comment on 19.2.1), there is a reasonable chance that the Group MCR will be breached even though the Group SCR is not. The waiver must not be granted if the group MCR is breached. It can be shown that in this case, the write-down may cure the breach of the Group MCR, but may at the same time results in a breach of the Group SCR. Insurance Europe believes this cannot be an intended consequence of the insurance PLAM. **Ideally, the concept of the Group MCR would be amended, but this would require**	

changes to the Solvency II Directive. In the meantime, a breach of the Group MCR in case of trigger inversion should not trigger PLAM. Therefore, Insurance Europe believes the waiver should be amended accordingly.

- In some jurisdictions, conversion can equally lead to taxable profits and a fall in the SCR ratio (via a reduction in T3 (DTA) or via an increase in tax liabilities and a fall in UT1). **A waiver should therefore equally be possible for conversion or any alternative PLAM.**

Recalculation of SCR and calculation of subsequent write-downs

- Because of its adverse impact on investors, the application of PLAM requires legal certainty. The same is true for mandatory cancellation of RT1 coupons, albeit to a lesser extent, since the overriding risk for investors is the contractual right to cancel coupons on a fully discretionary and non-cumulative basis.
- For PLAM, to avoid litigation risk all trigger ratios (group and/or solo SCR/MCR) must be properly calculated, which requires a fully consolidated MVBS to determine own funds to be used as a basis for the SCR/MCR calculation.
- Even the for large insurance groups, the consolidated MVBS is only established on a quarterly basis, and typically audited only annually. Small and medium sized insurers may prepare a fully-fledged MVBS only once a year, suggesting more flexible re-calculation periods may be sensible.
- ***In practice, a trigger breach can therefore be "determined" at best on a quarterly basis in a legally sound way.*** In addition, the result will typically be known only 3-5 weeks after the quarter-end date. More frequent assessments are good approximations only, but arguably not reliable enough from a legal perspective to effect PLAM thereon.
- ***Since all cash flows can be stopped on RT1 at any time, there is no particular need for a fast PLAM anyway.***
- Most importantly, this means that a meaningful three months cure period as foreseen by DR Art. 71(8)(c) would need to work as follows:
    - Assume for example that the issuer announces in May-2027 that the SCR ratio as per Q1-2027 has fallen to, eg 90%.
    - From this date on, the issuer knows with certainty that a capital increase is required within a short

timeframe (3 months) – this could be very little time left in case an equity prospectus needs to be prepared for the capital increase mentioned, and given any holiday season or black-out periods (no issuance window).

- Assume the issuer is fast and raises capital in July 2027. This will only impact the SCR ratio as per Q3-2027, the ratio as per Q2-2027 may still be insufficient.
- **In order for the 3-months cure period to be appropriate, a breach of the SCR should be possible for the 6 months period between the two relevant accounting dates (from Q1-2027 to Q3-2027).**

Other than the original 6 months period, Insurance Europe believes there is no reason why further write-downs should not be assessed on a quarter-by-quarter basis thereafter. However, any capital increase that occurs after the relevant accounting date, but before the figures for the last quarter have been established and published, should reduce (or eliminate) the need for such subsequent write-downs.

Paragraph 1479

Insurance Europe does not agree with EIOPA's statement that terms and conditions specifying partial conversion into equity will be challenging from a legal perspective. Insurance Europe proposes to apply partial conversion using the approach EIOPA has set out in option b in paragraph 1474.

Paragraph 1481

Insurance Europe believes partial conversion should be allowed for;

19.4.4

- The proposed Art. 71 5bis(a) requires a limitation of a write-down in full rather than allowing partial write-down when the Group MCR is breached
  - Breach of the Group MCR is intended to reflect an extreme situation where the group may need to be wound down. In such (supposedly) severe circumstances, equity investors should have been effectively wiped out, and RT1 investors should sustain a maximum loss, too (100% "loss absorbency" from an investor perspective).
  - Given the possibility of trigger inversion, the intuitive sounding prohibition of partial write-down at breach of the Group MCR may not make sense. However own funds may still be sufficient to cover a "1-in-200" year event, ie equity would still be valuable, and wiping-out RT1 bondholders would inverse the hierarchy of

	capital. o In case of trigger inversion, it is also possible that a 100% write-down may cure the Group MCR breach, but eg because of a reduction of T3 (DTA) may simultaneously lead to a breach of the Group SCR (waiver in Art. 70bis must not be granted if the Group MCR is breached according to the statement in paragraph 1495). Insurance Europe highlights that this cannot be intended either. ▪ The proposed Art. 71 5bis(a) prohibits a limitation of write-down when Group SCR falls below 75% o Similarly, for large insurance groups are expected to issue the majority of total outstanding RT1, the 75% SCR trigger level is likely to be breached long after the Group MCR has been breached (see trigger inversion comments in 19.2.1. above). This significantly reduces the applicability of the linear write-down mechanism. At the same time, the statement in paragraph 1495 implies that the waiver in Art 70bis cannot be granted even if the PLAM would further reduce the SCR ratio at that time. Insurance Europe believes that further reductions of the SCR ratio due to PLAM are not sensible, irrespective of the SCR ratio PLAM. The sole exception to this is an insurer that has gone into gone concern, in this situation tax effects do no longer matter and 100% write-down is arguably always justifiable. o Please see also comments made on cliff effects in section 19.3 "Limit system" that are not known to exist in banking. Please clarify the timing of subsequent write-down in view of the comments made in 19.4.3. (Recalculation of SCR and calculation of subsequent write-downs) ***Paragraph 1482*** *Note to EIOPA: Insurance Europe believes that the last sentence of article 5 ter should refer to 'Article 5 bis (b) (i)', whereas it is currently referring to 'Article 5 bis (i)'.*	
19.5.1	Insurance Europe clarifies that PLAM can reduce own funds not only because it can, in some jurisdictions, create a tax liability, but also because it can lead to a reduction of DTA (T3): in case of a trigger breach, the issuer may be subject to high tax losses carried forward, which in turn can be mirrored in a DTA (T3). The profit from PLAM can reduce T3 own funds, for other issuers the profit from PLAM may lead to a tax liability, thereby reducing UT1.	
19.5.2	***Paragraph 1485*** **The fact that Bank AT1 PLAM is indeed triggered at a very low (gone concern) level and thus later than**	

	insurance PLAM is not just an assumption. As explained in the comment in section 19.2.1, AT1 PLAM is triggered at a level that – for all practical purposes – must be considered gone concern. RT1, however, is triggered at a level that – within the Solvency II framework – must be considered a going concern level. There is no reason why the insurance PLAM should apply so much earlier than the banking PLAM.	
19.5.3	***Paragraph 1495*** Insurance Europe agrees with EIOPA's recommendation not to align with banking and insurance regime. In addition, Insurance Europe highlights there is no experience with waivers of this kind, and therefore recommends not to prescribe specific deadlines today. And in case a waiver were to become relevant, the respective regulator would need to decide in reasonably short time to avoid market uncertainty.	
19.5.4	▪ The waiver as worded in Art 70bis is also possible in case of 75% SCR breach or in case of MCR breach. **Insurance Europe believes this is sensible, as there is no level of SCR where it would be beneficial in any sense to policyholders to further reduce the SCR ratio.** However, Insurance Europe notes the drafting of Art 70bis (in paragraph 1496) is not in line with EIOPA's statement in paragraph 1495. ▪ The waiver should also be granted for conversion where necessary (depending on tax jurisdiction). ▪ A waiver should also be possible if the SCR ratio is less than 75% (or less than 100% for longer than three months), and, given trigger inversion, also when the Group MCR is breached. **There is no level of the SCR where it would be beneficial to policyholders to further reduce the SCR ratio.** ▪ Importantly, the SCR ratio may decrease because of a reduction of DTA (via lower tax losses carried forward). Insurance Europe believes the waiver is too narrow as the wording of Art. 70bis (b)(i) only refers to tax liabilities.	
19.6.1		
19.6.2		
19.6.3	***Paragraph 1504*** Insurance Europe notes that this paragraph is not necessarily correct with regard to regulatory calls. If a regulatory call is exercised because an instrument is no longer recognised as regulatory capital, the exercise of the call does not reduce regulatory capital.	

19.6.4	▪ Insurance Europe appreciates that tax and regulatory calls may no longer *automatically* require equivalent replacement irrespective of the issuer's solvency ratio. ▪ Regulators are expected to approve a call without replacement *only* if the post call solvency ratio is sufficiently high, ie if there is an 'appropriate margin' between the post-call solvency and 100% SCR/MCR. For this, it is irrelevant how old the instrument is – the same regulatory decision is expected for a tax call after three years, or an ordinary call after 15 years – post-call solvency ratios always matter. ▪ At the same time, it is not clear why only tax and regulatory calls should be possible without replacement in the first five years if the issuer's solvency is strong. ▪ **To summarize, all calls are subject to prior approval, and approval to call without replacement can in any case (including 10+ years post issuance) only be granted if the post call solvency is sufficiently high (ie appropriate margin *concept* should apply at all times). At the same time, *all* extraordinary calls should be possible without replacement at any times as long as solvency remains sufficiently high after a call.** It should be ensured that necessary grandfathering rules are implemented to further allow considering outstanding Solvency II RT1 / T2 bonds as own funds. Insurance Europe notes that Art 71(2)(i) possibly could put regulators in a position of conflict. As the regulator will probably first implement the new interpretation of the regulation that has potentially triggered the regulatory call to arise. And subsequently, the regulator needs to make an assessment under this clause to confirm the regulatory event has occurred. Therefore Insurance Europe proposes to leave the assessment to the issuer.	
19.7	***Paragraph 1509 - 1511*** Please refer to the comments made in section 19.2.1 on trigger inversion, why it should be avoided, and what could be done about it. ***Paragraph 1513*** Please refer to comments made in section 19.4.3 (sub-header: Recalculation of SCR and calculation of subsequent write-downs). ***Paragraph 1514***	

	Insurance Europe is doubting the usefulness of "partial conversion" ▪ Partial conversion does make intuitive sense when it is sufficient to restore the SCR. ▪ It should be noted that the impact of conversion on the SCR ratio may be better (or less bad) with partial instead of full conversion – the same holds for write-down. The "optimal write-down or conversion amount" can be lower than 100%, depending on the tax jurisdiction and tiering limit effects. ▪ However, partial conversion is complex, and there is very little (if any) experience with partial conversion in practice. ▪ Instead of adding even more complexity (and room for contractual errors) via partial conversion, ***Insurance Europe believes that it would be more sensible to (i) let PLAM only apply in a true gone concern (when there should be 100% conversion or write-down) and (ii) at a minimum extend the waiver for write-down to conversion in order to avoid the worst-case outcome from conversion – a further reduction of solvency ratios.*** ***Paragraph 1516*** Please refer to comments made in section 19.4.3. The waiver should also be applicable for conversion instruments, as well in case of a Group MCR breach. **Write-down** Please refer to comments made in section 19.2.3.	
20.1	Insurance Europe acknowledges that EIOPA was asked in the EC call for advice to assess how eligibility criteria could be modified if the 20% limit on restricted Tier 1 own funds were to be removed. Insurance Europe welcomes EIOPA's assessment that the status quo should be preserved in this area as the strengthening of the related criteria would only result in prohibiting most insurers from issuing Tier 1 instruments in the form of subordinated debt.	
20.2		
20.3	***Paragraph 1525*** **There is no inconsistency between (i) the observation that an AT1 with a first call after 10 years typically requires a higher coupon (is "more expensive") than an AT1 with a call date after 5 years, and (ii) the view that the of RT1 and AT1 are "truly perpetual" – ie the combination of perpetuity and absence of any**	

incentives to redeem – and therefore, provide utmost permanence.

A higher coupon does not automatically imply lower "permanence"

Consider two instruments, both with a term of five years and no call rights. By definition, the permanence of the two instruments is identical. Assume that the only difference is that instrument A has a fixed rate coupon, and instrument B has a floating rate coupon (3-months Euribor plus spread). If – as is typically the case – Euribor (fixed for 3-months) is lower than the risk-free rate (fixed for 5 years), the initial coupon of instrument B will be lower than that of instrument A. However, arbitrage ensures that the expected present value of both instruments is identical – the 3-months Euribor is expected to increase over time, which would increase the future coupon of instrument B after the initial 3-months period for which Euribor was fixed. Some market participants will call instrument A **"more expensive"** than instrument B nonetheless, after all, the initial coupon of the fixed rate bond will be higher, and an issuer may have a different expectation with respect to the expected future EURIBOR rates that the market. **Importantly, though the "permanence" of both instruments is identical by assumption, namely 5 years**.

Analysing market data – AT1 and RT1 trade to the _expected_ call date, which can be "never" (true perpetuity), but may be the _next_ call date

Based on market data, Insurance Europe is not sure why EIOPA concludes that investors tend to price instruments to the "next call" date. EIOPA's conclusion is only correct for instruments with step-up (incentive to redeem) which cannot qualify as RT1. For True Perpetuals like AT1 and RT1, it is only correct to extent that investors are convinced that issuing replacement AT1 at the next call date would be cheaper for the relevant issuer than leaving the existing AT1 bond outstanding instead.

Insurance Europe views permanence as a quality criterion for capital as meaningful only to the extent it protects the issuers' solvency. Where an issuer call right enables the issuer to save money by calling and replacing an existing instrument with an equivalent lower cost instrument, permanence is not negatively impacted despite the potential call/replacement. To be meaningfully supportive for the issuer, permanence requires that there is absolutely no need or obligation for the issuer to call an instrument when it would be very expensive or impossible to issue a replacement instrument. Given the impressive tightening of AT1 spreads in recent quarters, the expected reset coupons of existing AT1 (= risk free rate plus original credit spread) that will apply from the next call date look high compared to the new coupon that the same issuers would have to pay today for

a replacement AT1 (risk free rate plus lower current spread). Many AT1 bonds will therefore trade on a "to-call" basis, but only because a call and replacement allows the issuer to save money. **Importantly though, if credit spreads were to increase significantly from today, many of these bonds will start to trade on a "to-perpetuity basis" instead of a "to-next-call" basis, ie investors would no longer expect the bonds to be called.**

Market observation – simultaneously launched dual-tranche AT1 trades

The vast majority of bank AT1 and RT1 are issued with a so-called fixed/fixed reset coupon structure which works as in the following example:

- Perpetual bond with issuer call rights every 7 years ("PerpNC7"; "NC7" means not callable for the first seven 7 years).
- Coupon
  - Until first call date / first seven years: fixed at the 7-year risk free rate at issuance plus "original" credit spread.
  - Thereafter: reset every 7 years to the *then-prevailing* 7-year risk free rate plus "*original*" credit spread.
- Note the following difference:
  - The interest rate risk is limited to *7 years*, because the "risk free rate" component of the bond will be readjusted to the market rate every 7 years.
  - The credit spread is not re-adjusted. It is effectively a premium for "*perpetual* credit risk".

It is challenging to determine whether a particular existing AT1 with fixed/fixed reset coupon is likely to be called at the next call date, or not. You need to know the fixed credit spread of the existing AT1 bond (this spread is generally available), and you must compare it with the "current market spread" that the same issuer would have to pay today if it wanted to issue an equivalent new AT1 (not directly observable). If the current market spread is lower than the existing spread, the issuer will be expected to call the instrument at the next possible call date. If not, the assumption is that the bond is "truly perpetual" and will not be called.

An easier way to test whether bonds are truly priced to expected call rather than always priced to the first/next call is to compare the credit spread of two otherwise identical AT1 trades issued by the same issuer on the same date, where

only the time to first call differs. A "perpetual" credit spread would imply that the spreads are identical or not materially different for a non-call period of, say, 10 years and a non-call period of, say, 5 years. If, instead, it can be deemed very likely that issuers will always call the bond at the first call date, the spread should be lower in case of shorter non-call periods.

From the table below, you can see that credit spreads are broadly identical for simultaneously launched tranches, irrespective of the non-call period. The spread for a shorter non-call period can be even higher than that of a longer one, because the option to call is an "issuer option", and having call rights from year 5 on (rather than only from year 10) puts investors at greater risk (issuer call when the old bond's spread is higher than the market spread, so the issuer takes away upside from investors).

USDAT1

Issue Date	Issuer	Curr	Amount	Maturity	Call Date	Structure	Coupon until first call	Coupon thereafter	PLAM type	ISIN
23/09/2014	NORDEA BANK AB	USD	1,000	Perpetual	23/09/2019	PerpNC5	5.500	Swap +356.3bps	TWD	US65557DAM39
23/09/2014	NORDEA BANK AB	USD	500	Perpetual	23/09/2024	PerpNC10	6.125	Swap +338.8bps	TWD	US65557DAL55
17/09/2014	HSBC HOLDINGS PLC	USD	1,500	Perpetual	17/01/2020	PerpNC6	5.625	Swap +362.6bps	EC	US404280AR04
17/09/2014	HSBC HOLDINGS PLC	USD	2,250	Perpetual	17/09/2024	PerpNC10	6.375	Swap +370.5bps	EC	US404280AS86
16/04/2015	ING GROEP NV	USD	1,000	Perpetual	16/04/2020	PerpNC5	6.000	Swap +444.5bps	EC	US456837AE31
16/04/2015	ING GROEP NV	USD	1,250	Perpetual	16/04/2025	PerpNC10	6.500	Swap+ 444.6bps	EC	US456837AF06
10/08/2015	ROYAL BK SCOTLND GRP PLC	USD	2,000	Perpetual	10/08/2020	PerpNC5	7.500	Swap +580bps	EC	US780099CJ48
10/08/2015	ROYAL BK SCOTLND GRP PLC	USD	1,150	Perpetual	10/08/2025	PerpNC10	8.000	Swap +572bps	EC	US780099CK11

Market observation – insurance bonds

Very few RT1 bonds have been issued to date. However, EIOPA may want to look into the trading performance of the Tier 2 style US$ denominated True Perpetuals issued by several insurers in Q3-2016 (Allianz- ISIN: XS1485742438; Axa - ISIN: XS1489814340; Prudential- ISIN XS1488414464) and Zurich - ISIN: XS1449950663). These bonds were issued in fixed-for-life coupon format, a small niche market that is only rarely accessible. These bonds are very sensitive to changes in interest rates, given the absence of a reset. When US$ interest rates increased significantly from mid-September onwards, the prices of these bonds fell dramatically because it "suddenly" looked highly unlikely to investors that these bonds would be called. It can be shown that these bonds where then traded on a "yield-to-perpetuity" basis, and not on a yield-to-call" basis any longer. **The trading performance of these bonds is strong evidence for the "truly perpetual" nature of these bonds – investors did no longer expect that these bonds would be called**

	on their first call date. ***Paragraphs 1522 and 1526*** The transitional arrangements in Art. 308b of the Solvency II Directive apply to instruments issued prior to the publication of the Delegated Regulation (January 2015). For the RT1 instruments issued in 2016 and thereafter, and for any further transactions issued between today and the implementation date of changes to RT1 criteria (eg higher trigger levels), ***transitional arrangements are required for these instruments to continue to qualify as intended*** (risk of relegation into T2 or disqualification from own funds). This is also true in case the contemplated changes to the Delegated Regulation with respect to early calls would lead to a disqualification (not expected), in which case, Insurance Europe is of the opinion that transitional arrangements would be warranted too.	
20.4.1		
20.4.2	***Paragraph 1531*** Insurance Europe fully agrees with EIOPA that no strengthening of the features required for restricted Tier 1 instruments would exactly mitigate the effect on Tier 1 own funds of removing the 20% limit. In fact, restricted Tier 1 instruments as currently foreseen are already riskier than equity in several aspects because of the inversion of the hierarchy of capital, which in addition, makes the instruments more expensive. Therefore, any strengthening of criteria will render Restricted Tier 1 instruments even less attractive, making it impossible for all but the strongest insurers to issue Tier 1 in the form of subordinated debt in the capital market. Insurance Europe also refers to its extensive comments provided on section 19.4.1. which explain why Restricted Tier 1 is at least of the same quality as equity. These comments explain also that, in practice, insurers will treat Restricted Tier 1 investors senior to equity investors as long as the insurer is healthy, and hence payments to Restricted Tier 1 investors will stop at a later stage than payments to equity investors. While this is a voluntary decision by issuers, which can be prohibited by regulators, Insurance Europe believes that Restricted Tier 1 should be limited. The following reasons support limiting RT1 despite its very high quality: • Equity investors are the owners of the insurer, only equity investors have voting rights. In case of a crisis, existing equity investors typically play a crucial role in a recapitalisation exercise. Contrary to this, restricted Tier 1 investors are passive providers of capital. They take no part in decision making and invest on the premise that the risk of a crisis is highly remote. It is unlikely that restricted Tier 1 investors would play the same role	

as equity investors in any recapitalisation – irrespective of whether or not they become equity investors via PLAM.

- Equity benefits from a well-established statutory legal framework, whereas restricted Tier 1 and bank AT1 are largely contractually defined.
- Equity is tried and tested in crises. Contrary to this, there is only limited experience with bank AT1 and insurance restricted Tier 1 yet. In their current form, these instruments have only been issued during the last 5-6 years, and absent Banco Popular, no real "test in crisis" has been made with respect to a write-off or conversion of publicly placed benchmark AT1.

Paragraph 1532

Insurance Europe would disagree with such measures.

Firstly, improving the permanence of restricted Tier 1 instruments by increasing the first call date to 10 years would not be desirable for insurers. The restricted Tier 1 call is not an obligation but a right. The call right allows insurers to replace the instrument with an otherwise identical, but lower cost, instrument. Furthermore, the improvement in the capital quality of restricted Tier 1 instruments through a longer first call date is highly questionable. For starter, any redemption is already subject to regulatory approval, which should ensure that the capital position of the issuer is maintained at an appropriate level. Also, the fact that 5-year call dates do not reduce the permanence of capital instruments without step-ups is demonstrated by the actual history of numerous perpetual instruments with 5-year call dates ("perpNC5") issued into the USD markets, for which perpNC5 is the standard format, particularly for non-domestic USD. No behavioural expectation attaches to the 5-year first call dates, and many of these instruments have remained outstanding many years beyond their first call dates without any market reaction. Hence, setting the call right further from the issuance date reduces the quality of the instrument in the sense that it reduces its flexibility for the insurer.

In addition, increasing the non-call period from 5 to 10 years would reduce the quality of capital at the margin.

- Insurance Europe refers to its comment provided on 19.4.1 (Permanence: RT1 is as good as equity) and 20.3 (paragraph. 1525).
- RT1s are True Perpetuals, issuers are expected to call the instruments only when they can save money by doing so – either because an equivalent replacement can reduce financing costs, or when there is unnecessary excess RT1 capital.

- Increasing the non-call period reduces the ability of the issuer to save money. An open market repurchase can be attempted, but only at the then prevailing market price, plus a buyback premium which needs to be significant in order to repatriate 90%+ of the bond. More flexibility with respect to calls allows issuers to optimize their liability duration and provides more flexibility – it does not increase the risk of calls at a time when solvency is weak, as weak solvency implies high new issuance costs for new RT1. In any event, a call must be approved by the regulator, which the regulator would not be expected to grant, if there were concerns about the issuer's solvency.
- Increasing the 75% SCR trigger to 80% does not improve the quality of RT1. Insurance Europe refers to comments on 19.2.1 (Trigger inversion) and 19.4.1. (quality of RT1).

Finally, extending the first call date beyond five years would create an unjustifiable difference to the bank AT1.
While restricted Tier 1 instruments would not be suitable for all current investors in this market, it would be suitable for a sufficient part of the investor base (current buyers of bank AT1 which permits 5-year calls) to make this market a very interesting potential source of restricted Tier 1 capital.

Therefore, in the event Option 2 were chosen, Insurance Europe disagrees with the proposal to lengthen the minimum period of the first call from 5 to 10 years. Not only would this take away option value and financial flexibility from the issuer, it would also risk the loss of an investor base which consists of willing buyers of truly perpetual but callable instruments.

Insurance Europe also disagrees with the proposal in Option 2 not to permit any call dates. There are no legal mechanisms to eliminate this capital (unlike equity), and therefore, a perpetual instrument without call rights would reduce the issuer's financial flexibility to an unacceptable extent.

Paragraph 1535

Insurance Europe notes that EIOPA's analysis of the distribution of Restricted Tier 1 instruments across the industry shows that based on the current criteria, there is no meaningful amounts of restricted Tier 1 instruments issuance. Hence, strengthening the loss absorbency of these instruments by changing the mandatory triggers will imply more limited market access for a number of issuers, for a market which is already virtually nonexistent.

In addition, Insurance Europe notes thatthe SCR already includes a substantial buffer over the MCR to cover a "1 in 200 years" shock. Therefore, raising the trigger materially above the current level would make a breach proportionally more likely, at a level of capitalisation which might still be comfortable (eg as at H1 2016, the range of published SCR ratios

	was very wide, from 126% to 196%). Finally, Insurance Europe believes that increasing the 75% SCR trigger to 80% does not improve the quality of restricted Tier 1 – please refer to comments provided in sections 19.2.1 (Trigger inversion) and 19.4.1. (quality of RT1). In conclusion, Insurance Europe strongly urges EIOPA against this recommendation. ***Paragraph 1536*** Insurance Europe would not agree with a blanket measure to withdraw altogether the ability for hybrid instruments to be recognised as tier 1 capital. There may be some hybrid capital instruments and subordinated liabilities that meet the tier 1 characteristics and as such these should be permitted to be included in tier 1. ***Paragraph 1538*** Insurance Europe welcomes and supports EIOPA not recommending a blanket measure to withdraw altogether the ability for hybrid instruments to be recognised as tier 1 capital.	
20.4.3	Insurance Europe welcomes and supports EIOPA's option 1 recommendation which advises the status quo (retaining the 20% limit). However, Insurance Europe notes that EIOPA proposes a fallback option 2 – which provides additional criteria to strengthen the quality of hybrid instruments – in case option 1 is not accepted. However, Insurance Europe disagrees with option 2, as any strengthening of criteria will render restricted Tier 1 instruments even less attractive, making it impossible for all but the strongest insurers to issue Tier 1 in the form of subordinated debt in the capital market. Insurance Europe is also concerned about the suggestion in Option 2 that restricted Tier 1 instruments should not have any call dates. The legal framework for bonds is different from that of ordinary shares, and there would be no possibility ever to eliminate perpetual instruments without call rights if – for example – the regulatory requirements for own funds items changed in the future, or the circumstances of the issuer changed. In Insurance Europe's view, such a requirement would restrict the financial flexibility of the issuer to an unacceptable degree, and would be a serious disincentive for the issue of restricted Tier 1 instruments. ***Paragraph 1539, 1540, & 1541*** Insurance Europe welcomes and supports EIOPA's option 1 recommendation which advises the status quo (retaining the 20% limit).	

	Insurance Europe does not support Option 2. As noted above, the extension of the first call date would restrict the financial flexibility of the insurer and eliminate a good source of restricted Tier 1 capital as 5-year first calls are standard (particularly in the non-domestic USD market) for perpetual instruments. Although no behavioural expectations attach to these call dates, and numerous perpetual instruments have remained outstanding for many years beyond their first call dates without any adverse market reaction, Insurance Europe considers that a deviation from the standard terms would impair the marketability of restricted Tier 1 instruments – long-standing practice has a strong influence in these markets. In Option 2, EIOPA proposes to change the mandatory triggers. Insurance Europe is concerned by these proposals and note the following: • The SCR already includes a substantial buffer over the MCR to cover a 1 in 200-year shock. • Therefore, raising the trigger materially above the current level would make a breach proportionally more likely, at a level of capitalisation which might still be comfortable (eg as at H1 2016, the range of published SCR ratios was very wide, from 126% to 196%). Regarding paragraphs 1541 b, it is not clear whether EIOPA implies that if the instrument is not called before year 20, the instrument can never be redeemed which would be an unprecedented term for a debt security. As for paragraphs 1541 c, it is not clear whether the disallowance for partial write-down is to be applied mutatis mutandis to conversion instruments. (ie the full conversion is also proposed with this clause).	
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