	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:	**UNIPOL GRUPPO S.p.A. (Unipol Group)**	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
	Please follow the following instructions for filling in the template: ⇨ Do **not** change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇨ Leave the last column empty. ⇨ Please fill in your comment in the relevant row. If you have no comment on a paragraph or a cell, keep the row empty. ⇨ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. **Please send the completed template, in Word Format, to CP-17-006@eiopa.europa.eu** **Our IT tool does not allow processing of any other formats.** **The numbering of the reference refers to the sections** of the consultation paper on EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation. Please indicate to which paragraph(s) your comment refers to.	
Reference	**Comment**	
General Comment	Unipol Group is pleased to have the opportunity to provide its contribution to the draft of the EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation. More precisely, Unipol Group would like to comment on the following areas in relation to which, under this section, it would like to highlight some key messages:	

- **Volume measure for premium risk**: with regard to the gap that exists in the definition of one of the components of the volume measure, *FP(future,s)*, Unipol Group is of the opinion that no change to *FP(future,s)* is a more suitable approach;
- **Natural catastrophe risk**: as already stated several times in other comments related to the calibration of the Nat Cat risk in the standard formula approach, Unipol Group would like to reiterate that the Italian Earthquake risk is still miscalibrated due to the reasons better explained below;
- **Interest rate risk**: Unipol Group believes that the existing scenario characterized by a low yeld environment with negative interest rates is already a very stressed scenario. Hence, Unipol Group is of the opinion that the Proposals A and B suggested by EIOPA appear to be not in line with the current economic and financial empirical conditions in the Euro area;
- **Simplification of the counterparty default risk**: Unipol Group suggests that an effective simplification of the Standard Formula with the aim of reducing the burden to assess the 60% condition in the loss-given default (LGD) calculation for reinsurance arrangements should be based on the Solvency Ratio or Credit Rating of the counterparties;
- **Loss-absorbing capacity of deferred taxes (LAC DT)**: as a general comment, Unipol Group highlights that the additional conditions, both quantitative and qualitative, that are discussed in Chapter 17 of the Consultation Paper, go beyond the rules (IAS 12) that have been set out in the Solvency II Delegated Regulation in relation to the accounting for deferred taxes in Solvency II balance sheet and consequently, in an

	indirect way, in the LAC DT.	
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2.4.3	With respect to the options suggested by EIOPA to cope with the gap that exists in the definition of one of the components of the volume measure, *FP(future,s)*, Unipol Group would like to highlight that: ▪ Following the rationale behind the use of a weighting factor for the *FP(future)* and considering that – as stated in the Consultation Paper – the same reasoning applyes to the *FP(existing)*, the exclusion of any form of weighting for the latter aggregate should be supported by statistical evidence in addition to the qualitative motivations reported in the Consultation Paper; ▪ According to the analysis of the risk drivers affecting the different components of the volume measure, the calibration of *Alpha* factors should take into account the effective impact of “*unexpected risk 1*” on the FP addends (both existing and future) and should be based on statistical evidence; ▪ It would be appropriate to calibrate a specific *Alpha* factor for each line of business. In light of the aforementioned issues, Unipol Group is of the opinion that Option 2 in its current form would not be an appropriate methodology to take into account the gap in the volume measure. For this reason, it should be preferable to stick with Option 1.	
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6.3.3.2	Since there could be some difficulties in spatially allocating a certain kind of exposures (for example, pipelines, electric lines, railways,…) to risk zones, EIOPA assessed that, in these cases, the undertaking should allocate the exposures to the CRESTA zone with the highest risk weight in the region (Option 5). The choice of this Option would not allow to properly reflect the natural catastrophe risk of this kind of exposure that is often spread over the entire territory of a single country. In the case of Italy Earthquake, for example, the entire "Terna S.P.A" (the Italian electric energy transmission system operator) exposure would be allocated to the L'Aquila CRESTA Zone. By taking into account this single exposure, the earthquake risk capital calculated according to Option 5 would be about ten times the earthquake risk capital calculated with the actual approach (i.e. Option 6) used by the Group. In light of the above, Unipol Group is of the opinion that Option 6 is a more suitable approach.	
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6.4.3.3	After the EIOPA recalibration, the Italy Earthquake risk factor has changed from 0,8% to 0,77%. Unipol Group is of the opinion that the calibration of the Standard Formula	

	Italy Earthquake still does not incorporate adequately 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 specialized software (RMS, AIR) on the market show strong miscalibration of Standard Formula risk calculation (a greater value of about 250% in relation to gross losses). Moreover, the market of reinsurance and CAT Bond reflect, through the quotes, an implicit risk assessment which is inconsistent with that expressed by the Standard Formula.	
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6.5.3.3	Recital 54 of the Solvency II Delegated Regulation states: "*In order to capture the actual risk exposure of the undertaking in the calculation of the capital requirement for natural catastrophe risk in the standard formula, the sum insured should be determined in a manner that takes into account of contractual limits for the compensation for catastrophe events*". To take into account this recital, EIOPA introduced an "ex-post adjustment " to the end results. Even though the average indemnity limit for the UnipolSai flood and earthquake portfolio is 30% of the sum insured, the proposed adjustment doesn't change any of the CRESTA Zone results. Unipol Group is of the opinion that there are two possible ways to consider the recital: a change in the input data or a change of the country risk factor (better calibrated to take into account the policy conditions effect).	
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7.4.3	Unipol Group is of the opinion that the EIOPA advice to adjust the current interest rate risk module according to either Proposal A or B does not represent an economically sound approach. The existing scenario characterized by a low yeld environment with negative interest rates is indeed already a very stressed scenario. Hence, the proposal of taking into account very low and negative interest rates of about -1% is excessively rigorous and it appears not in line with the current economic and financial empirical conditions in the Euro area, mainly due to the following reasons: ▪ **Monetary policy decisions of central banks within the EU**. A number of major central banks in Europe have set key policy rates at negative levels in order to further encourage lending by making it costly for banks to hold excess reserves at their central banks. Nominal yelds on some bonds of highly-rated European governments have also dropped below zero, leaving no discretion to manage potential additional negative shocks. ▪ **Interest rates can be subject to progressive decreases, theoretically without lower bounds.** Several economic studies clearly show how the continue decrease of interest rates have a potentially significant negative impact on certain economic sectors, such as the insurance and the banking sectors, with consequent adverse social effects. Some illustrative calculations carried out by the Bank of England (2013) suggested that such substitution from reserves to cash might begin to occur if central bank deposit rates were persistently -0.5% or lower. So the true floor is probably somewhere in that	

region[1];

- **Effects on money market funds.** In addition to the above, the reduction of interest rates to deeply negative levels would risk to jeopardize also monetary funds, which are important players in the global financial system. Moreover, a search-for-yeld and a carry-trade behaviour would be incentivized while exhacerbating the risk taking of economic actors.
- **Deposit facility.** ECB (European Central Bank) data on deposit facility show that, since the sovereign debt crisis, stocks have notably increased. The reduction of interest levels below -0,5% could justifiy the creation of physical structures (caveau) to avoid this huge cost for the deposit of such significant amounts of money.
- **Financial time series analysis on negative interest rates:**

	1M	3M	6M	1Y	3Y	5Y
Negative interest rate frequency	19.04%	17.37%	11.70%	12.18%	10.67%	4.60%
Minimum	-0.37%	-0.32%	-0.22%	-0.23%	-0.25%	-0.18%

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[1] Bank of England (2013), Letter to Andrew Tyrie, Chairman of Treasury Committee, 16 May (available at https://www.bankofengland.co.uk/-/media/boe/files/letter/2013/charles-bean-letter-to-andrew-tyrie-160513).

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13.4.3	**Paragraph 1058 - Simplified calculation of Article 192(2) of the Solvency II Delegated Regulation** Unipol Group agrees that the 60% condition in the loss-given default (LGD) calculation for reinsurance arrangements (Art.192(2) of the Delegated Regulation) is difficult to assess. Moreover, Unipol Group welcomes EIOPA’s proposal to introduce an optional simplification with the aim of reducing the burden to assess the 60% condition, but the proposed approach of adopting the most conservative LGD for all reinsurance arrangements does not allow to capture the effective riskiness of the reinsurer. Unipol Group suggests that an effective simplification should be based on the Solvency Ratio or Credit Rating of the counterparties.	
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17.4.2	**General comment** From a general standpoint, Unipol Group would like firstly to point out that the additional conditions, both quantitative and qualitative, that are discussed in Chapter 17 of the Consultation Paper exceed the rules (IAS 12) that have been set out in the Solvency II Delegated Regulation in relation to the accounting for deferred taxes in	

Solvency II balance sheet and consequently, in an indirect way, in the LAC DT.

IAS 12 is also the same accounting principle used by several undertakings for the preparation of their individual and/or consolidated financial statements.

For the purpose of recognition of deferred tax assets (DTA), IAS 12 sets clear requirements stating that DTA should be recognized if *"it is probable that taxable profit will be available against which the deductible temporary difference or unused tax credits can be utilized"*.

In relation to the key principles regarding the projection of likely future profits mentioned under pararagraph 1294 of the Consultation Paper, Unipol Group would like to highlight that several restrictions have been added, particularly with regard to:

- The expected profitability of new business (for example, by setting it to a value equal to the 50% of pre-shock levels);
- The extension of the period over which taxable profit could be estimated;
- The introduction of "prudential" haircuts to taxable profits.

Such restrictions are not consistent with the "probability" requirement set by the IAS 12 itself and by the common application of these requirements by entities which prepare their audited financial statements based on IAS/IFRS principles. In other words, assuming that the "possible implementations" of the key principles are in place, and that the recognition and valuation criteria used for other assets and liabilities different from the deferred taxes are the same for IAS/IFRS and Solvency II purposes, the amount of DTA recognized in post shock Solvency II balance sheet for LAC DT calculation would be almost certainly lower than those recognised in an IFRS balance sheet, when for both balance sheets the same IAS 12 is applied.

Such potential difference is due to both the "possible implementations" of key principles mentioned above and to other relevant factors which are taken into account under IAS 12. For example, when assessing the likelihood of future taxable profits, the administrative, management or supervisory body of the undertaking (AMSB) takes into account other elements such as:

- Past history of generation of fiscal profits with special reference to fiscal profits generated after a significant non recurring f tax loss;
- Whether the potential deferred tax assets arising from unused tax lossess are resulted from identifiable causes which are unlikely to recur (lke bSCR*).

Key principle 1: Role of compliance with the MCR and SCR after shock loss

Under paragraph 1297, it is stated that "*EIOPA does not expect undertakings using the standard formula to explicitly determine the compliance with their MCR and SCR after the bSCR* shock loss. However, EIOPA does expect that all undertakings reflect the extent of compliance with their MCR and SCR in their assumptions used for their projections of future profits*".

Unipol Group is of the opinion that asking for an additional check of compliance with SCR and MCR, even after the bSCR* shock loss, in order to assess the LAC DT which is a portion of SCR itself, is:

i) **not consistent** with paragraph 207 of Solvency II Delegated Regulation that states that, for the purpose of calculating LAC DT, each undertaking should take "*into account the magnituted of the loss referred to paragraph 1 ant its impact on undertaking's current and future* ***financial*** *position*" (i.e. the Delegated Regulation refers to the financial and not to the solvency position);

ii) **overly prudent** if applied consistently with the formula proposed in paragraph 1300 as it was assumed that SCR = bSCR* implying a LAC DT of 0. On the other hand, if "actual" SCR (including LAC DT) has to be taken into account, the calculation could lead to a significant increase in complexity and, in some circumstances, to a "circular reference" in the calculation as LAC DT and solvency position after shock do influence each other .

As a consequence, in line with the Solvency II Delegated Regulation, the likelihood of an undertaking being able to utilise nDTA should be assessed in light of the financial ability of the entity to meet its future obligation to its policyholders with the available financial assets or with other reasonable debt or capital management actions.

Key principle 2, 3, 4, 5 and 6: Future profits stemming from new business and future profits stemming from return on assets

Unipol Group would like to refer to the general observations better illustrated above with respect to the overly prudence underlying the possible implementation of these key principles and the consequent related inconsistency with IAS 12.

In addition, Unipol Group would like to underline that the proposed implementation of the key principles seems not to take fully into account the difference existing between fiscal profits and economic profis calculated in line with Solvency II rules.

More specifically:

- Fiscal profits are calculated on the basis of tax rules that are normally derived from accounting principles underlying entities' financial statements and that are estimated based on "real world" assumptions;
- Economic profits are calculated according to Solvency II valuation principles which have been set for prudential purposes.

Fiscal profits includes, for example, the following amounts which are excluded from the "Economic profits"' perimeter:

- Income on financial assets (both underlying technical provision and own funds) for the amount gained under "real world" hypothesis exceeding the "risk free" rates that are in place for prudential purposes. Such portion of income on financial assets are included in business plans approved by AMSB (mentioned in paragraph 1323), which are based on "real world" assumptions and that are normally the basis also for the recognition of DTA in financial statements;
- Differences between economic profits and fiscal profits due to non relevance for tax purposes of certain portion of economic profits or lossess (i.e. non temporary/permanent differences between tax base and carrying amount of certain assets or liabilities). For example, profit stemming from the sale of a specific insurance product could be partially or in full excluded from current or future taxable income due to specific exemption as per relevant tax law.

As a consequence:

i) The projection of profits for LAC DT calculation shoud take into account post-shock "real world" estimate of future profits as only "real world" figures are the basis for the actual calculation of future taxable income;

ii) The model proposed under the standard formula should allow undertaking, at least on a voluntary basis, to increase complexity in order to gather a more relevant estimate of future profits for LAC DT calculation.

Key principle 7 - Future Management Actions (FMA)

Unipol Group disagrees with the statement included in paragraph 1348 that "*the valuation on the Solvency II balance sheet already reflects the transfer price of such unprofitable portfolio and no gain from a sale is to be expected*".

The market value of a portfolio of insurance contracts cannot normally be approximated by Solvency II values of underlying assets and liabilities, since the market value differs from Solvency II value at least for:

- The new business value of such portfolio outside Solvency II contract boundaries;
- The difference in interest rates used to discount liabilities in a market transaction and in the Solvency II framework.

As a consequence, if a realistic and prudential market value of a portfolio is available and if the sale of such portfolio is realistic, Unipol Group is of the opinion that such management actions can be taken in account as a post-shock management actions.

Key principle 8 – Role of system of governance

Unipol Group believes that the additional requirements proposed under paragraph 1364 are extremely burdensome, as they imply several calculations of the pre and post shock business plan and fiscal profits. Unipol Group, instead, is of the opinion that a qualitative assessment of the most significant hypothesis underlying projections, together with the quantitative impact of halving LAC DT or setting it to zero, could represent a reasonable solution with this respect.

The other information requested, if relevant, could be included in Regular Supervisory Reporting (RSR).

Key principle 9 – Supervisory reporting and disclosure

Unipol Group is of the opinion that also the additional requirements proposed under paragraph 1368 appear to be extremely burdensome because they potentially further increase the effort in the preparation of the Solvency and Financial Condition Report (SFCR) and of the Regular Supervisory Report (RSR) and, for some items, such efforts seem not be balanced by a corresponding increase in useful disclosure to the NSA or

	to the public. Furthermore public disclosure of assumptions underlying the calculation of LAC DT with particular reference to future profits could determine misunderstandying by investors and difficulties to compare results. More specifically: ▪ With regard to the part of own funds generated by deferred tax assets, both in the pre-stress and post-shock situations, Unipol Group would like to point out that the own funds generated by DTA in pre-stress situation are already included in QRT S.23.01. The preparation of post shock own funds projections, including relevant DTA would imply to double the effort in the preparation of "best estimate" ORSA projections, without a significant increase in the information provided to the supervisory authority. ▪ With respect to a summary of the sensitivity analysis carried out regarding the assumptions used to demonstrate likely utilisation of both deferred tax assets in the pre-stress situation and LAC DT, Unipol Group would like to refer to comments illustrated in relation to the key principle 8.	
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