



EIOPA-CP-14/054

27 November 2014

Consultation Paper

on

the proposal for draft Implementing

Technical Standards with regard to the

procedures for assessing external credit

assessments

Table Contents

Responding to this paper	3
Consultation Paper Overview & Next Steps.....	3
1. Draft Technical Standard	5
2. Annex I: Impact Assessment.....	9

Responding to this paper

EIOPA welcomes comments on the proposal for draft Implementing Technical Standards with regard to the procedures for assessing external credit assessments.

Comments are most helpful if they:

- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA in the provided Template for Comments, by email Consultation_Set2@eiopa.europa.eu, by 2 March 2015.

Contributions not provided in the template for comments, or sent to a different email address, or after the deadline will not be processed.

Publication of responses

Contributions received will be published on EIOPA's public website unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.

Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents and EIOPA's rules on public access to documents¹.

Contributions will be made available at the end of the public consultation period.

Data protection

Please note that personal contact details (such as name of individuals, email addresses and phone numbers) will not be published. They will only be used to request clarifications if necessary on the information supplied.

EIOPA, as a European Authority, will process any personal data in line with Regulation (EC) No 45/2001 on the protection of the individuals with regards to the processing of personal data by the Community institutions and bodies and on the free movement of such data. More information on data protection can be found at <https://eiopa.europa.eu/> under the heading 'Legal notice'.

¹ [https://eiopa.europa.eu/fileadmin/tx_dam/files/aboutceiops/Public-Access-\(EIOPA-MB-11-051\).pdf](https://eiopa.europa.eu/fileadmin/tx_dam/files/aboutceiops/Public-Access-(EIOPA-MB-11-051).pdf)

Consultation Paper Overview & Next Steps

EIOPA carries out consultations in the case of drafting Technical Standards in accordance to Articles 10 and 15 of the EIOPA Regulation.

This Consultation Paper presents the draft Technical Standards and a technical annex where relevant.

The analysis of the expected impact from the proposed policy is covered under Annex I Impact Assessment.

Next steps

EIOPA will consider the feedback received and expects to publish a Final Report on the consultation and to submit the Consultation Paper for adoption by the Board of Supervisors.

1. Draft Technical Standard



EUROPEAN COMMISSION

Brussels, 29.6.2011
C(20..) yyy final

COMMISSION DELEGATED REGULATION (EU) No .../..

of []

COMMISSION IMPLEMENTING REGULATION (EU) No .../.. laying down implementing technical standards with regard to the procedures for assessing external credit assessments according to Directive 2009/138/EC of the European Parliament and of the Council

of []

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2009/138/EC of 25 November 2009 of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)² and in particular Articles 41(3) and 44(4a) thereof,

Whereas:

- (1) This Regulation establishes the procedures for assessing the appropriateness of external credit assessments by insurance and reinsurance undertakings in the calculation of their technical provisions and the Solvency Capital Requirement.

² OJ L 335, 17.12.2009, p.1.

- (2) This Regulation ensures that insurance and reinsurance undertakings make additional assessments as part of their risk management wherever this is practicably possible in order to avoid any automatic dependence on external assessments, taking into account the nature, scale and complexity inherent in the business of the insurance and reinsurance undertakings.
- (3) A key measure to reduce market reliance on external credit ratings for insurance and reinsurance undertakings is to perform own credit assessments.
- (4) Outsourcing the performance of additional assessments should not undermine the aim of avoiding overreliance on external credit assessment institutions.
- (5) This Regulation is based on the draft implementing technical standards submitted by the European Insurance and Occupational Pensions Authority to the Commission.
- (6) The European Insurance and Occupational Pensions Authority has conducted open public consultations on the draft implementing technical standards on which this Regulation is based and analysed the potential related costs and benefits and requested the opinion of the Insurance and Reinsurance Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1094/2010.

HAS ADOPTED THIS REGULATION:

Article 1

Risk management policy

- (1) In view of assessing the appropriateness of external credit assessments, in their risk management policy insurance and reinsurance undertakings shall at least address:
 - (a) the scope and frequency of the additional assessments;
 - (b) the events likely to trigger changes in the additional assessments; and
 - (c) the manner in which additional assessments are to be performed.

Article 2

Role of risk management function

- (1) Insurance and reinsurance undertakings shall ensure that the risk management function verifies that:
 - (a) the additional assessments take place according to the risk management policy, as specified under Article 1; and
 - (b) the results of the additional assessments are taken into account in the calculation of the technical provisions and the Solvency Capital Requirements.

Article 3

Information used for the additional assessments

- (1) Insurance and reinsurance undertakings shall ensure that information used for the additional assessments is of sufficient quality and updated regularly.

Article 4

Regular review and update of additional assessments

- (1) Insurance and reinsurance undertakings shall regularly review their additional assessments.
- (2) In the case of a material change in the assumptions of the additional assessments, insurance and reinsurance undertakings shall update the additional assessments accordingly.

Article 5

Documentation

- (1) Insurance and reinsurance undertakings shall document:
 - (a) the manner in which the additional assessments are performed and the results of these assessments; and
 - (b) the extent to which the results of the additional assessments are taken into account in the

calculation of the technical provisions and the Solvency Capital Requirement.

Article 6

Outsourcing of additional assessments

- (1) When outsourcing the performance of additional assessments, insurance and reinsurance undertakings shall comply with the requirements applicable to the outsourcing of critical or important operational activities.

Article 7

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, []

*[For the Commission
The President]*

[On behalf of the President]

[Position]

2. Annex I: Impact Assessment

Section 1: Procedural issues and consultation of interested parties

According to article 15 of EIOPA Regulation No 1094/2010, EIOPA conducts analysis of costs and benefits when drafting implementing technical standards. The analysis of costs and benefits is undertaken according to an Impact Assessment methodology.

The draft ITS and its Impact Assessment are subject to public consultation.

Section 2: Problem definition

To avoid overreliance on external credit assessment institutions (hereinafter ECAIs) when insurance undertakings use external credit assessments (hereinafter ECAs) in the calculation of technical provisions and Solvency Capital Requirement, insurance and reinsurance undertakings shall assess the appropriateness of these ECAs as part of their risk management by using additional assessments wherever practicably possible. EIOPA shall develop draft Implementing Technical Standards on the procedures to be followed when assessing ECAs.

The absence of implementing measures might result in the following undesirable effects:

- (a) Lack of knowledge amongst undertakings in how the appropriateness of ECAs should be assessed and challenged;
- (b) Uncertainty amongst undertakings as to the procedures under which additional assessments shall be performed;
- (c) Over-dependence on the results of ECAs and the ECAIs that perform them.

Baseline

When analysing the impact from proposed policies, the Impact Assessment methodology foresees that a baseline scenario is applied as the basis for comparing policy options. This helps to identify the incremental impact of each policy option considered. The aim of the baseline scenario is to explain how the current situation would evolve without additional regulatory intervention.

The baseline is based on the current situation of EU insurance and reinsurance markets, taking account of the progress towards the implementation of the Solvency II framework achieved at this stage by insurance and reinsurance undertakings and supervisory authorities.

In particular the baseline will include:

- The content of Directive 2009/138/EC as amended by Directive 2014/51/EU.
- The relevant Implementing Measures.

Article 44 (4a) of the Solvency II Directive contains the legal requirement for EIOPA to develop draft implementing standards on the procedures for assessing the appropriateness external credit assessments.

Section 3: Objectives

Objective 1: To promote common understanding for undertakings on the need to assess ECAs in an objective and independent manner having regard to proportionality and other practical considerations.

Objective 2: To ensure that the procedures for assessing the appropriateness of ECAs become an integral part of undertakings' risk management commensurate with the nature, scale and complexity of the business.

These objectives correspond to the main objective of the Solvency II Directive to protect policyholders and beneficiaries and the implicit objective of enhancing risk management.

Section 4: Policy issues/options

With the intention to meet the objectives set out in the previous section, EIOPA has given consideration to the following issues:

- (1) how granular the procedures for additional assessments should be in articulating the methods by which ECAs shall be analysed, reviewed and updated;
- (2) the extent to which the procedures should be subject to a formalised internal governance process;
- (3) whether the outsourcing of additional assessments should be designated as a critical or important activity.

In this context, the following options have been analysed:

Policy issue 1: Granularity of additional assessments.

- Option 1.1: Highly detailed process;
- Option 1.2: Principles-based process.

Policy issue 2: Governance process.

- Option 2.1: Prescriptive solution;
- Option 2.2: Flexible solution.

Policy issue 3: Outsourcing of additional assessments.

- Option 3.1: Critical or important activity;
- Option 3.2: Non critical or important activity.

Section 5: Analysis of impacts

Policy issue 1. Granularity of additional assessments

Option 1.1 Highly detailed process

Making the procedure more granular by defining the components of additional assessments would help to harmonise the overall process and better inform undertakings on how the additional assessments should be conducted. This is an important consideration as the intention of the ITS is to ensure that undertakings do not over-rely on ECAs carried out by ECAIs. Thus undertakings would benefit by knowing how to test and assess the appropriateness of the current external credit assessments attached to their asset holdings in calculating technical provisions and the SCR, how frequently the data should be reviewed and, if necessary, updated. In turn, this would provide additional means by which to check that undertakings are able to validate the data being provided by ECAs, proving incentives for undertakings to carry out these assessments appropriately.

Option 1.2 Principles-based process

On the other hand, inserting components in a legally binding procedure reduces the discretion available to undertakings to structure and organise their risk management processes as they see fit. Undertakings should be able to develop their own procedures to test and validate external credit ratings which otherwise may be constrained by having to comply with requirements not suited to their internal operations. However, any procedure aimed at how additional assessments should be carried out is as yet untested and only practical experience will reveal the extent to which undertakings adopt a principles-based approach and whether any issues that need to be addressed will arise from it.

Other stakeholders interests

Other industry stakeholders and policyholders would not be directly affected by the process to be adopted for additional assessments other than the expectation that it was being organised and carried out in an efficient manner without subsequent detriment to their interests. Supervisory authorities would benefit from having greater certainty that additional assessments were being carried out in a standardised manner but any monitoring will be proportionate as primarily supervisory authorities would be more interested in the end-results.

Costs/benefits impact

No evidence is available to suggest that the costs of adopting a more granular approach would be any higher than a principles-based approach and vice versa. However, it is likely that a principles-based approach would provide greater scope for on-going administrative savings by enabling undertakings to carry out procedures tailored to the nature, scale and complexity of its business and avoid having to comply with imposed procedures. Any accrued or derived benefit, to policy holders or the undertaking itself, in respect of either approach would be considered marginal in relation to the business as a whole.

Policy issue 2. Governance process

Option 2.1 Prescriptive solution

Establishing and defining a governance procedure for additional assessments within the ITS could be achieved by documenting and embedding the governance process within the risk management policy, either as a stand-alone feature or in combination with other integral operations such as stress testing of assets. A governance procedure should identify at least that the persons and methodology used in carrying out additional assessments were both identified and documented with appropriate levels of sign-off of the subsequent outcomes.

Option 2.2 Flexible solution

Prescribing a specific governance procedure would cut across the flexibility that undertakings have to organise their risk management system in the most efficient manner and best suited to their own internal structure and organisation. Consequently, undertakings should be free to determine how best to conduct additional assessments taking account of present practice and management protocols.

Other stakeholders' interests

Other industry stakeholders and policyholders would not be directly affected by the adoption of a set governance process for additional assessments other than the expectation that it functioned in an efficient manner such as to avoid any potential risk of consumer detriment. Supervisory authorities would benefit from knowledge of a defined governance process for additional assessments but would not normally, as part of regulatory supervision, expect to be intrusive in such areas expecting only that undertakings followed good risk management principles in line with the directive.

Costs/benefits impact

There would be small, incremental costs arising from the adoption of either solution but there would appear scope for greater administrative savings in allowing for a flexible form of governance which is likely to be a more material factor than any marginal benefits that might accrue from either solution.

Policy issue 3. Designating outsourcing of additional assessments as critical or important

Initial consideration was given to whether to include a third option to assess the impact of removing references or requirements on outsourcing altogether. However, it was felt that such an option should not be developed as it had been accepted in drafting the ITS that additional assessments on ECAs be regarded as a critical or important activity, irrespective of whether outsourcing took place or not. Instead the previous two options examine the impact of outsourcing from a critical/important and non-critical/important perspective. A critical or important activity is "essential to the operation of the undertaking as it would be unable to deliver its services to policyholders without the function or activity". As the process of assessing the appropriateness of ECAs involves checking or re-validating data in the calculation of technical provisions and the SCR it is of sufficient substance to

justify it as a critical or important activity in safeguarding policy holder interests.

Option 3.1 Critical or important activity

In designating the additional assessments an important or critical activity should ensure that the outsourcing of it does not adversely affect or impair the operations of the undertaking itself. By carrying out due diligence tests on a potential outsourcer provides greater certainty that an additional assessment would be undertaken by an expert and qualified provider and ensure that there were no conflict of interests with the ECAI that conducted the original ECA. Designating it a critical or important activity would thus help maintain confidence that the additional assessment was being carried out in a professional and independent manner.

Option 3.2 Non-critical or important activity

One of the advantages of outsourcing services is that it frees up the internal resources of an undertaking from having to perform a service or activity that can be done more effectively or flexibly by an outside body or agency on its behalf. This can be a significant factor both for small or large undertakings as outsourcing has proved to be a common practice amongst insurance undertakings across the spectrum for a variety of services and activities. Thus outsourcing additional assessments without labelling it critical or important may help undertakings to organise it in the most propitious manner but this must be judged against the possibility that, after the event, the work performed by the service provider may be open to concerns of being of sufficient quality and independence.

Other stakeholders' interests

Other industry stakeholders and policyholders will take comfort in the knowledge that outsourcing of additional assessments is considered as an important or critical activity with a full and proper level of oversight. Equally, the supervisory authority would derive confidence that this outsourcing activity was at least, compliant with the requirements set out in the Solvency II Directive and Implementing Measures thus ensuring a proper performance of the service and would assist its own supervisory role by enabling it to have direct access to the service provider under the terms of the written agreement between the parties.

Cost/benefits impact

By not designating additional assessments as critical or important activities provides greater scope for costs savings by further reducing the level of on-going compliance and administrative costs for undertakings. Against that consideration has to be weighed the fact that the undertaking would have a greater level of control and surveillance if the task was rendered critical or important bringing derived benefit in terms of greater certainty and confidence in the end results.

Financial stability

Neither the ITS nor the options have any direct impact on financial stability considerations. However, allowing undertakings more freedom on how and whether to carry out additional assessments, in a way that contributed to over reliance on ECAS, may pose an indirect and potential systemic risk if it resulted in capital

requirements being generally and progressively under-stated.

Social impact

Neither the ITS nor the options have any social impacts.

Section 6: Comparing the policy options

Although there is an inter-relationship between the three policy issues the options attached to each of them have been analysed independently.

- On policy issue 1 (granularity of additional assessments), it is considered that option 1.1 (highly detailed process) would render it more granular, and adherence to it more costly, beyond that strictly required by Article 44(4a) of the directive, making option 1.2 (principles-based approach) the preferred option;
- On policy issue 2 (governance process) option 2.1 (prescriptive solution) risks undermining the ability of each undertaking to organise its risk management system in a manner best suited to its business. Thus option 2.2 (flexible solution) is the preferred option;
- On policy issue 3 (outsourcing), recognising outsourcing under option 3.1 (critical or important) might increase the outsourcing cost compared with Option 3.2 (non-critical or important activity) but this has to be weighed against the benefits of greater scrutiny and surveillance afforded by it being a critical or important activity. Considering these arguments, the preferred option is the first one.

Overall evaluation

As drafted, and after consideration of the various options, it is considered that the ITS sets out the procedure for carrying out additional assessments in a manner that should make compliance with it both effective and practicable. Further proof or validation must await the outcome of working experience at which point it might be appropriate to review the scope and content of the ITS.