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EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY

SCR Standard Formula Review

EIOPA Insurance and Reinsurance Stakeholder Group meeting
Frankfurt, 7 June 2017

Introduction

- Why is the topic on the agenda?
  - EIOPA will be consulting on its draft advice during the summer on several items of the COM call for advice
  - An information request will be sent during the summer

- What is expected from IRSG?
  - This presentation provides IRSG with an overview of the next milestones and welcomes any feedback

- Next steps
  - A workshop on 8 June 2017 on unrated debt and unlisted equity
  - Public consultation and information request

Update on the process – 1/2

- Roundtable with stakeholders (IRSG invited) on 23 May on the first set of advice

- Information received from NCAs and the industry
  - Non-life triangles, guarantees and RGLA, CAT risks, LAC DT practices

- CAT WS met for two times
  - Balanced and adequate composition: NCAs, IE, AMICE, IRSG, academics, model vendors, reinsurers, brokers
  - Requested to clearly document the new calibrations

- Workshop on 8 June on unrated debt and unlisted equity

Update on the process – 2/2
Overview of time table of SCR review consultations

For July-August consultation:

- Simplified calculations, look-through for investment related vehicles, reliance on ECAI, treatment of guarantees and RGLA, risk mitigation techniques, some USPs and information on LAC DT

For November-December consultation:

- Risk margin, own funds, policy options on LAC DT, CAT risks, premium and reserve risks, mortality and longevity risks, counterparty default risk, currency risk at group level, interest rate risk, simplifying look-through and unrated debt, unlisted equity and strategic participations

Agenda

1. 1st set of advice for consultation
2. Information requests
3. Second call for advice

1. First set of advice

Topic	Publication during summer
Simplified calculations	Yes
Look-through approach	Part about related investment vehicles ready Part on simplifications for Oct. BoS
Reliance on external credit ratings	Yes
Treatment of guarantees and RGLA	Yes
Risk-mitigation techniques	Yes
Undertaking specific parameters	Some USPs only
Loss-absorbing capacity of deferred taxes	Information can be sent to COM Policy options for 2nd set of advice
Risk margin	Postponed to 2nd set of advice
Own funds	Postponed to 2nd set of advice

2. Information requests during summer - 1/2

- Information request on strategic participations to NCAs and undertakings
  - Requested by call for advice
  - Focuses on qualitative information since some quantitative information will be accessible via annual reporting
  - Questions to be sent mainly to NCAs
  - But also to undertakings
  - Questions on
    - characteristics of these investments
    - methods and criteria to qualify as strategic investments

2. Information requests during summer – 2/2

- Information request on volume measure for premium risk
  - Approach may be changed
  - Need for an impact assessment
  - Not sufficient granular information to assess impact in QRTs
  - Proposal to ask NCAs to gather undertakings data

- Information request on interest rate risk in the future
  - Approach may be changed and there will be a need to assess the impact
  - Methodology not ready to be tested yet

3. Second call for advice

- Scope unrated debt and unlisted equities
- Call for evidence ended in May
- Workshop with stakeholders on June 8
- Consultation of proposals in November
- Open questions on debt:
  - Appropriate scope
  - How to combine simplicity with risk sensitiveness
  - How to account for limitations of internal assessments

BACKGROUND

1. First set of advice

- Simplified calculations
  - Framework of article 88 that undertakings need to assess the error introduced does not prevent them to apply simplified calculations
  - We would have at least a thousand of risks calculated with simplified calculations
  - New simplified calculations on non-life lapse risk, life lapse risk, mortality risk
  - Interest rate risk simplified calculation to be confirmed

2. First set of advice

- Reduce reliance on external credit ratings
  - o Internal credit assessment:
    - Required for larger or more complex exposure and can only lead to higher capital charges
    - Stakeholders requested more flexibility: lower capital charges possible, approval of internal credit assessment framework by NCA
    - Proposal:
      - Regulation proposed not be changed
      - EIOPA would develop guidance after SCR review to help undertakings perform internal credit assessment
      - In a few years, EIOPA could assess if these internal assessments are more widely and appropriately used
  - o Use of third party models – approved by supervisors – will be further assessed in the context of the work on unrated debt

3. First set of advice

- Reduce reliance on external credit ratings
  - Simplified approach:
    - Undertakings need to nominate at least one ECAI
    - Problem for small undertakings: often 1 ECAI is not sufficient to cover the whole portfolio
    - Is it proportionate to nominate a second ECAI for a small part of the portfolio? → increases fees
    - Under the framework of article 88 of DR, where it is not proportionate to obtain a second ECAI, calculate your spread and market risk concentration as if all investments would be of credit quality step 3
    - To be applied only for assets that produce fixed cash-flows
    - Not to be applied where there are insurance liabilities with mechanism of profit participations or unit/index-linked business
    - Materiality assessment on-going

4. First set of advice

- Look-through approach for investment related vehicles
  - Proposal to extend look-through to investment related undertakings
  - A definition of these vehicles would be provided. Elements being considered:
    - Need to have an investment mandate
    - Holding assets on behalf of parent undertaking
    - Not running insurance business
  - Other discussion points:
    - Do they need to be controlled by the insurance undertaking?
    - Should the look-through be optional or an obligation?

5. First set of advice

- Exposure guaranteed and to RGLA
  - o 75% of value guaranteed is provided by central governments and RGLA
  - o On guarantees, proposal to be consistent with banking framework and within Solvency II:
    - Align treatment of guarantees issued by RGLA in the market risk module to the treatment of guarantees issued by central governments
    - Recognise partial guarantees by central governments and RGLA
    - Extend the recognition to type 2 exposures

6. First set of advice

- Exposure guaranteed and to RGLA
  - On RGLA:
    - Insurance and banking regulations have different lists of RGLA which risk profile is similar to central governments
      - Sources of differences come from the absence of an intermediate treatment in the Solvency II Regulation and of risk assessments done in different point in time
    - Introducing an intermediate treatment makes the Standard Formula more complex: a materiality assessment is on-going

7. First set of advice

- Undertaking specific parameters:
  - Proposal to extend USP for reinsurance non-proportional factor
  - Currently only for excess of loss, extension to stop-loss
  - Proposals received on USP for premium risks, but it would add complexity without clear benefits
  - USP on mortality and longevity risks and on lapse risk to be analysed by Oct. 2017 for the 2nd set of advice
  - USP on Nat Cat may be investigated by CAT WS once the work on simplifications and recalibrations is finished

8. First set of advice

- Risk-mitigation techniques
  - Rolling hedges: Allow adjustments for changes in the exposures while avoiding unnecessary complexity and renewal risk
  - Recognition of reinsurance contract when SCR breached:
    - Difficult to prove for insurers that a reinsurer which breached its SCR provided a realistic recovery plan and will restore compliance in six months
    - Considering whether there could be simpler options
  - Longevity risk transfer and finite reinsurance are sufficiently covered by the current framework
  - Adverse development covers: assessing whether it would be possible to further recognise them

9. First set of advice

- LAC DT
  - Information gathered on different practices. Divergences come from:
    - Different tax regime
    - Different starting point in the balance sheet (DTA-DTL)
    - Different supervisory practices in assessing the likelihood of future profits for the utilization of net DTA after the shock loss
      - Assumptions on new business, time horizon of projection, compliance with SCR after the shock
  - These information will be sent to COM, i.e. planned for June BoS for public consultation
  - Further work on-going on converging on these issues and assessing whether there would be simpler way to calculate/ justify/ supervise LAC DT