



Consultation on draft guidelines –
Discussion by Pillar 1 working sub-group
EIOPA IRSG – 24 June 2014



Preliminary discussion

- The Pillar 1 sub-group concentrates on guidelines and related explanatory text and impact analysis in respect of:
 - Pillar 1 matters generally
 - Use of internal models
- This amounts to over 600 pages of complex material which has not been reviewed in detail as yet. The sub-group envisages continuing to share comments and impressions prior to seeking IRSG approval for our full submission in late August.
- Today is about seeking IRSG endorsement for some themes.

Pillar 1

- **Own Funds**
- **Contract Boundaries**
- **Valuation of Technical Provisions**
- **Treatment of Market/Counterparty Risk Exposures in Standard Formula**
- **Basis Risk**
- **Look-through Approach**
- **The Adjustment for the Loss-Absorbing Capacity of Technical Provisions and Deferred Taxes Undertaking-Specific Parameters**
- **Application of the Life Underwriting Risk Module**
- **Application of the Health Catastrophe Risk Sub-Module**
- **Application of Outwards Reinsurance Arrangements to the Non-life Catastrophe Risk Sub-Module**
- **Allocation of Insurance Policies to Liability Risk Groups for the Man-Made Liability Catastrophe Risk Sub-Module**
- **Application of the Man-Made Liability Catastrophe Risk Sub-Module**
- **Group Solvency Calculation**



Headlines

- Let's walk before we try to run – for sake of timely implementation, guidelines should be only to give effect to directive/dda requirements – best practice exhortation is for explanatory text
- Learn from experience – gather data from undertakings and supervisors on lessons of Pillar 1 implementation and use these to update guidelines and explanations later.



Themes for IRSG discussion / comment

- In principle it is welcome for EIOPA to clarify or explain how it envisages the Solvency 2 framework is to be implemented as an aid to both supervisors and undertakings in achieving convergent implementation of that framework.
- However EIOPA guidelines, although not binding of themselves, are as we understand it to be put to NCA's on a 'comply or explain' basis and may therefore be effectively binding in practice. Given the considerable challenges of timely implementation of Solvency 2 in any event, guidelines should not introduce additional requirements.



Themes for IRSG discussion / comment

- The draft guidelines are quite heterogeneous, as is perhaps to be expected given that they have been drafted by different groups of people. Most are elaboration of a known requirement, but some are more reflective of desired good practice (e.g. in relation to valuation of technical provisions). Such matters would better be covered in explanatory text for the time being.
- The guidelines have been drafted in a vacuum - for this reason, EIOPA should pay very careful attention to feedback to the consultation on the guidelines, particularly where such feedback reflects practitioner experience.



Themes for IRSG discussion / comment

- It will be important for EIOPA to implement an approach whereby issues and questions arising in the context of implementation are exchanged between national supervisors and with EIOPA – this should form the basis of a future updating of the (explanatory text supporting the) guidelines.
- In relation to internal models the guidelines apparently implicitly assume that probably distribution functions are normally stationary and can be reliably estimated in the tail. These conditions often are not satisfied and it will be important for EIOPA to gather information such that the guidelines or explanatory text can be developed to embrace more the real world of non-stationary probabilities and sparse tail data.



Themes for IRSG discussion / comment

- Experience of past quantitative impact studies suggests that practitioner support needs are of at least two forms. First is expanded interpretation of Solvency II technical specifications – this is where the guidelines/explanation should be most helpful. The second and perhaps greater need is for interpretation support in the context of application in a particular national context (for example a particular policy type) and this may be where the guidelines – or more particularly the explanatory text - are capable of being improved in the fullness of time.



Themes for IRSG discussion / comment

- The distinction between more and less significant changes to internal models is expressed impractically – for example parameter changes are routine.
- The Guidelines attribute a large number of roles and responsibilities to the actuarial function. Many of these, however, do seem to be incompatible with the fundamentals of some common governance systems (such as those based on the three lines of defense model). This could be amended through making the Guidelines more principle-based and less rule-based.



Themes for IRSG discussion / comment

- Overall, the Guidelines tend to add detail to the Solvency II framework and the already very detailed dda. A (admittedly rather philosophical) issue for discussion is whether a regulatory regime is improved through either adding detail or strengthening the logic of the fundamentals. A ‘quality over quantity’ approach may be preferable.