Amundi
ASSET MANAGEMENT

2020 Review: EIOPA's Recommendations

Solvency II

EIOPA's response to the European Commission was published on 17 December after being delayed by six months to include an analysis of the impact of the public health crisis.

In its response, EIOPA recommends reviewing two key provisions of the "Long-term guarantees" measures: the method of extrapolating risk-free interest rates and the volatility adjustment (VA).

Calibrating the interest rate shock remains the most important point in the review of the standard formula applied for the solvency capital requirement (SCR) calculation. EIOPA maintains the specifications set out in the October 2019 consultation, leading to an increase in the capital requirement for certain insurance activities.

EIOPA suggests adjusting the article addressing "Long-term equity investments". The equity portfolios that apply a 22% capital charge are in fact quite rare because the criteria are difficult to meet. EIOPA wishes to establish more detailed criteria broken down according to the type of risks covered (life or non-life insurance).

EIOPA would like to revise several provisions of the long-term guarantees measures

Reminder of the current extrapolation method

The interest rates used to discount insurers' obligations are inferred from the prices of financial instruments traded on markets, but for very long maturities, there is no market that is deep, liquid, and transparent enough to assess interest rates in a meaningful way.

EIOPA has chosen the Smith-Wilson method to extrapolate risk-free rates past the **Last Liquid Point (LLP).**

For each currency, very long-term rates are extrapolated based on

- the rates or prices of liquid market instruments maturing before the LLP (for most currencies, these are 6-month fixed rate swaps),
- the **Ultimate Forward Rate (UFR)**, and
- a point of convergence where instant rates converge with the UFR. This point of convergence depends on the currency and is equal to the higher of 60 years or the LLP + 40 years. As the LLP for the euro curve is 20 years, the convergence point is set at 60 years.

Since 2017, the UFR has been determined every year, based on two components, the expected real rate and the expected inflation rate, while varying by no more than 15 basis points from year to year. Thus, for the euro, the UFR was set at 3.60% for 2021.

EIOPA recommends amending the method used to extrapolate risk-free rates

In an environment of low interest rates, the current extrapolation method underestimates the liabilities of insurers with very long-term euro-denominated liabilities. Although the UFR has dropped by 15 basis points each year since 2017, extrapolation using the Smith-Wilson method means applying discount rates substantially higher than the swap rates currently being observed for 20-to-50-year maturities.

Furthermore, the spread between the 15-year swap rate and 20-year swap rate (the last two market baselines used) substantially affects the measurement of very long-term liabilities. Thus, in some swap curve distortion configurations, hedging that is meant to improve the matching of assets and liabilities past 20 years is not necessarily effective at reducing variations in Solvency II net assets. The current extrapolation method therefore does not always encourage improvements in risk management.

After exploring several solutions to mitigate these drawbacks, including moving the LLP to 30 years or 50 years (for the euro curve), EIOPA finally recommends replacing the current Smith-Wilson method with a method that extrapolates forward rates using the UFR and the **Last Liquid Forward Rate** (LLFR)**.**

There are two different segments for building the yield curve:

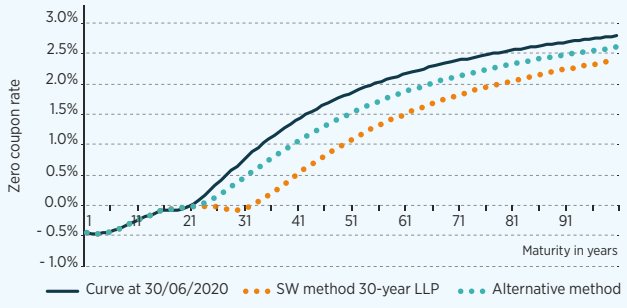
- Up to the first smoothing point (FSP), set at 20 years for the euro, "zero coupon" rates are calculated step by step, based on the swap rates observed on the market (bootstrapping method), and for swap maturities that do not meet the DLT criterion (deep, liquid, transparent market)[1], zero coupon rates are interpolated with the assumption of a constant forward rate between the two liquid maturities at the boundaries.

1. In 2019, the swap maturities meeting the DLT criterion were those up to and equal to 12 years then 15, 20, 25, 30, 40 and 50 years.

- Past the FSP, extrapolation is based on forward rates by a function that combines the UFR and LLFR. For the euro, the LLFR is a weighted average of five forward rates[2], with the weighting assigned to each rate reflecting the liquidity of the swap rate used to calculate it in relation to the liquidity of the swap rates of all five maturities. Zero coupon rates are then easily inferred from the forward rates.

The recommended extrapolation method leads to a decrease in the risk-free yield curve, but it is nonetheless much closer to the current curve than that obtained using the Smith-Wilson (SW) method with the LLP set at 30 years.

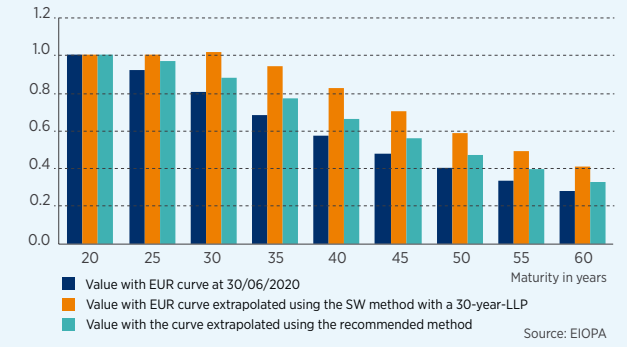
EUR curve at 30/06/2020 compared with a curve extrapolated with an LLP of 30 and a curve extrapolated using the recommended method



Source: EIOPA

With swap rates observed at end-June 2020 and a UFR of 3.75%, a flow of €100 in 40 years is currently valued at €58. With the LLP at 30 years this value is €82, and with the recommended extrapolation method it is €66.

Discounted value of a unit flow based on its maturity (EUR curve at 30/06/2020)



Source: EIOPA

The impact on the solvency ratio varies greatly by country. German and Dutch insurers would be the most negatively affected. With the accounting positions of end-2018, for the German market, applying the alternative method would lower the solvency ratio from 457% to 407%. For the Netherlands, the alternative method would reduce the ratio from 212% to 183%. For the European market as a whole, the impact would be lower, with the alternative method bringing the solvency ratio down from 252% to 240%[3].

EIOPA provides for a transition period ending in 2032. During this period, if the risk-free rate observed at the FSP is below 0.5%, the parameters of the forward rate extrapolation formula will be adjusted to mitigate the impact of the change in method.

EIOPA recommends transforming the volatility adjustment (VA) to incorporate the specific characteristics of each insurer

VA is an adjustment to the risk-free yield curve that seeks to partially offset the impact of the bond portfolio's volatility on the solvency ratio. Insurers can measure their obligations by adding part of the increase in spreads to the risk-free yield curve.

However, in its current definition, the VA has been widely criticised. It is considered insufficiently responsive and not adapted to the specific characteristics of the insurers that use it.

This part of the long-term guarantees package is widely used. At year-end 2019, 631 entities in 21 countries, whose technical provisions accounted for 79% of total EEA technical provisions, used the VA. Unlike the matching adjustment (MA), its use does not require strict asset-liability matching.

At the European level, the VA raises the solvency ratio of entities that use it by an average of 25 points, but there are considerable disparities between countries. The countries where the impact is greatest are the Netherlands (53-point fall in the solvency ratio without the VA) and Germany (35-point fall in the solvency ratio without the VA)[4].

In its current version, the VA for EMU member countries is calculated as follows:

$$VA = VA_{€} + VA_{Country}$$

$$VA_{€} = GAR * RCS_{€}$$

$$VA_{Country} = GAR * W_{Country} * max[0, RCS_{Country} - 2 * RCS_{€}]$$

Where

GAR = general application ratio, set at 65%

$RCS_{€}$ = risk-corrected spread of the reference portfolio set by EIOPA for the euro

$RCS_{Country}$ = risk-corrected spread of the reference portfolio set by EIOPA for the country

$W_{Country}$ = Country weighting. This is 1 if the risk-corrected spread on the country reference portfolio $RCS_{Country}$ is greater than 85bp, or 0 otherwise.

2. Forward rates assumed to be constant for each of the five periods: 15-20 years, 20-25 years, 20-30 years, 20-40 years and 20-50 years.
3. Figures provided by EIOPA in the consultation on the 2020 review following a request for information among 299 insurance and reinsurance undertakings in the first half of 2019.
4. Figures provided by EIOPA in its "Report on long-term guarantees measures and measures on equity risk 2020" published in December 2020.

The VA will continue to be calculated by currency, but EIOPA wishes to fundamentally change the approach used.
It recommends calculating VA as the sum of two components:

VA = VA Permanent + VA Macroeconomic VA

$$VA_{Permanent} = NewGAR * AR_{Mismatch} * AR_{illiquidity} * NewRCS_{€}$$

$$VA_{Macro} = NewGAR * AR_{Mismatch} * AR_{illiquidity} * NewW_{Country} * max[0, NewRCS_{Country} - 1.3 * NewRCS_{€}]$$

For each of these components, EIOPA recommends increasing the general application ratio (NewGAR) to 85%, and adjusting it by introducing two new factors specific to each insurer:

- the $AR_{Mismatch}$ factor, reflecting the duration and/or volume mismatch between fixed income investments and the technical provisions covered by these investments,
- the $AR_{illiquidity}$ factor, depending on the illiquidity of the undertaking's liabilities.

• Calculation of the mismatch application ratio ($AR_{Mismatch}$)

This ratio aims to avoid an insurer benefiting from a high VA (based on the average asset allocation of insurers in the EU) which would have a major impact on its best estimate provisions, while its asset portfolio has little exposure to spread fluctuations (because it contains a smaller proportion of fixed income assets than the reference portfolio and/or its duration is much lower than that of the reference portfolio).

It is defined as the ratio of the credit spreads sensitivity of fixed income investments to the sensitivity to the VA of best estimate liabilities. It is capped at 1.

• Calculation of the illiquidity application ratio ($AR_{illiquidity}$)

Liabilities are allocated to three baskets, each assigned a different weighting. The most illiquid liabilities such as annuities are weighted 1, medium illiquid liabilities have a 75% weighting and the least illiquid liabilities have a 60% weighting. The sum of these weighted liabilities divided by the total amount of liabilities is the "illiquidity" factor. This factor will be higher for undertakings whose activities involve long-term liabilities with no surrender option.

At 30 June 2020, among entities that responded to EIOPA's request for additional information, the mismatch factor comes out at an average of 92% and the illiquidity factor at 76%. Before applying the general application ratio, the coefficient arising from the combination of the two application ratios ranges between 43% and 80% in different countries. For France and Italy, the combination produces a coefficient of around 75%[5]. The holistic impact assessment performed at year-end 2019 showed very similar application ratios.

• Calculation of the risk-corrected spread of reference portfolios in € and by country ($NewRCS_{€}$ et $NewRCS_{Country}$)

The definition of the risk-corrected spread (RCS) is also reviewed. EIOPA recommends adjusting the risk correction calculation method used to define the RCS for each sub-category of assets.

EIOPA removes the probability of default and the cost of downgrading of the assets from calculations for corporate bonds. EIOPA instead proposes a set of fixed rates for each category - EEA government bonds and other fixed rate investments (now including government bonds issued by non-EEA countries). The new calculation formula only uses spreads by sub-category and the long-term averages of these spreads (a floor of 0 is systematically applied to the spreads used in calculations).

• The macroeconomic component of VA is an improvement on the current "country VA"

The macroeconomic VA is calculated by country and applies to policies sold in the country in question and denominated in the country's currency.

Like the permanent VA, it includes an application ratio equal to the product of the general application ratio of 85% and the two insurer-specific factors (mismatch factor and illiquidity factor).

EIOPA proposes adjusting the weight $NewW_{Country}$ to avoid the threshold effects arising with the current formula. The weighting proposed is designed to ensure the gradual and smooth application of the country component. It ranges from 0 to 1 and depends on the $NewRCS_{Country}$, the risk-corrected spread of the reference portfolio for the country in question[6].

To take into consideration a country's specific features, the macroeconomic VA is a function of the difference between the risk-corrected spread of the country reference portfolio $NewRCS_{Country}$ and 1.3 times (versus 2 times currently) the risk-corrected spread of the global reference portfolio $NewRCS_{€}$.

At 30 June 2020, applying the new calculation method would have slightly increased the VA for the euro, from 19 basis points to 23. The holistic impact assessment at year-end 2019 showed a bigger difference, because with the new method the VA for the euro would be 14 basis points instead of 7 basis points.

Overall, the change in method would not significantly change the solvency ratio for entities that responded to the request for additional information and which apply the standard formula. However, in the assessment performed at year-end 2019, the new method proved more favourable overall, with Italian, French and German insurers that apply the standard formula benefiting the most.

5. Figures provided by EIOPA in "Impact Assessment - Background document on the opinion on the 2020 review of Solvency II", dated 17 December 2020, based on an analysis of responses to the request for additional information between mid-July and September 2020 from 278 entities representing 68% of EEA life technical provisions and 45% of non-life written premiums and on the holistic impact assessment launched in March 2020.

6. This weighting is zero when the risk-corrected spread is below 60 bps and it increases linearly to a maximum of 1 when the risk-corrected spread is equal to or greater than 90 bps.

EIOPA recommends allowing the diversification of risks between portfolios that apply the matching adjustment (MA) and the insurer's other activities

The MA can only be applied to a portfolio of insurance obligations that is managed separately from other activities, and which is assigned a portfolio of assets whose cash flows match those of its liabilities. The MA makes it possible to use the fixed income investment rate of return to determine the discount rate applied to the insurance obligations.

Its use requires supervisory approval, and it was mostly applied in the United Kingdom. As of the end of 2019, the MA was only used by 14 undertakings, in Spain. These undertakings' technical provisions accounted for 59% of the Spanish market[7] and their solvency ratio would have decreased by an average of 19 points if they could not apply the MA.

Article 217 of Delegated Regulation (EU) 2015/35, which explains how to calculate SCR in the case of ring-fenced funds and matching adjustment portfolios, does not allow any risk diversification between ring-fenced funds or matching adjustment portfolios and the rest of the insurance undertaking.

EIOPA proposes eliminating this restriction for MA portfolios but does not recommend loosening the conditions for applying MA.

EIOPA maintains its recommendation to review the interest rate risk sub-module

EIOPA considers that the current calibration of the standard formula underestimates interest rate risk but accepts a five-year transition period to shift from the current calibration to its recommended calibration

Reminder of the stresses currently applied to yield curves to calculate interest rate SCR

The yield curve stress scenarios use relative variations:

- In the rising interest rate scenario, a declining relative shock by maturity, ranging from +70% for one-year maturities to +20% for the longest maturities, with **a minimum 1% increase applied to all maturities**.
- In the decreasing interest rate scenario, a declining relative shock by maturity, ranging from -75% for one-year maturities to -20% for the longest maturities, with **no variation applied to negative rates**.

In 2018, EIOPA recommended changing the calculation for the up and down curve stresses used to calculate the interest rate SCR. The proposals made were not adopted, because the review of the interest rate sub-module did not fall within the review scope specified by the Commission.

EIOPA maintains its recommendation to define interest rate stresses by combining **a relative shift and an additive shock**. The 1% minimum shock in the up scenario is deleted but, in particular, negative rates are stressed in the down scenario, though with a floor of -1.25% for stressed rates.

For insurers with long-term liabilities whose asset portfolio shows a much shorter duration, the recommended interest rate shocks have a much greater adverse effect than the current calibration. However, insurers will have an adjustment period as a five-year transition is provided for before the new definition is applied in full.

EIOPA recommendation for interest rate shocks

The Up curve is defined as:

$$r^{Up}(m) = r(m) * (1 + s(m)^{Up}) + b(m)^{Up}$$

The Down curve is defined as:

$$r^{Down}(m) = r(m) * (1 - s(m)^{Down}) - b(m)^{Down}$$

Where, for different maturities m (in years):

- r(m) = risk-free rate at maturity m,
- $r^{Up}(m)$ = rate at maturity m in the rising interest rate scenario
- $r^{Down}(m)$ = rate at maturity m in the declining interest rate scenario
- $s(m)^{Up}$, $b(m)^{Up}$, $s(m)^{Down}$, $b(m)^{Down}$ vectors shown in the table

The values of the **s vectors** are linearly interpolated between 20 and 90 years.
The values of the **b vectors** are zero beyond 60 years and are linearly interpolated between 20 and 60 years.

In the Down scenario, a lower limit of -1.25% is applied to the stressed interest rate.

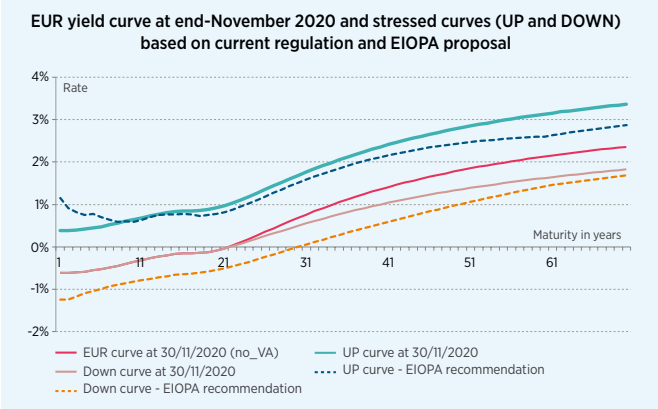
Maturity (m)	Vector s Up	Vector b Up	Vector s Down	Vector b Down
1	61%	2.14%	58%	1.16%
2	53%	1.86%	51%	0.99%
3	49%	1.72%	44%	0.83%
4	46%	1.61%	40%	0.74%
5	45%	1.58%	40%	0.71%
6	41%	1.44%	38%	0.67%
7	37%	1.30%	37%	0.63%
8	34%	1.19%	38%	0.62%
9	32%	1.12%	39%	0.61%
10	30%	1.05%	40%	0.61%
11	30%	1.05%	41%	0.60%
12	30%	1.05%	42%	0.60%
13	30%	1.05%	43%	0.59%
14	29%	1.02%	44%	0.58%
15	28%	0.98%	45%	0.57%
16	28%	0.98%	47%	0.56%
17	27%	0.95%	48%	0.55%
18	26%	0.91%	49%	0.54%
19	26%	0.91%	49%	0.52%
20	25%	0.88%	50%	0.50%
90	20%	0%	20%	0%

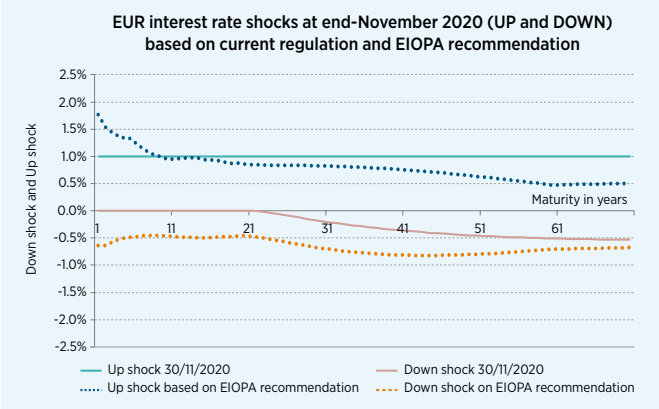
Source: EIOPA, Opinion on the 2020 review of Solvency II, 17 décembre 2020

7. Figures provided by EIOPA in its "Report on long-term guarantees measures and measures on equity risk 2020" published in December 2020.

Illustration in a low interest rate environment: EUR rates at end-November 2020

The left-hand chart shows the risk-free yield curve for the euro as at the end of November and the Up and Down stress scenarios determined by the current calibration and with the new calibration recommended by EIOPA. The right-hand chart shows the magnitude of the corresponding interest rate shocks.





Source: EIOPA, Amundi AM calculations, data as at 30/11/2020 - Information provided as an illustration only

The recommended calibration for the Down rate scenario increases the amplitude of shocks for all maturities. However, for the Up rate scenario, although the recommended formula leads to larger shocks for shorter maturities, the shocks are close to 1% (current minimal shock) for maturities between 8 and 16 years, and they continue to decline for longer maturities.

The following table shows how changing the stress calibrations impacts capital requirements in the low interest rate environment prevailing at the end of November 2020.

For example, for a flow of 100 in 20 years, in the Up stress scenario, the capital charge is reduced slightly, from 18% to 16% of the discounted value. For the Down stress scenario, the capital charge rises from zero to 10% of the discounted value.

Flow maturity	Discounting of 100 with the EUR curve at 30/11/2020	Ratio of interest rate SCR to discounted value for the upward rate scenario		Ratio of interest rate SCR to discounted value for the downward rate scenario	
		with current stress parameters	with the stress parameters recommented by EIOPA	with current stress parameters	with the stress parameters recommented by EIOPA
2 years	101	2%	3%	0%	1%
5 years	103	5%	6%	0%	2%
10 years	104	10%	9%	0%	5%
15 years	103	14%	13%	0%	8%
20 years	102	18%	16%	0%	10%
25 years	94	22%	19%	2%	15%
30 years	81	26%	22%	6%	23%

Source: EIOPA, Amundi AM calculations, data as at 30/11/2020 - Information provided as an illustration only

For life and composite undertakings, the new calibration would lead to a relative increase in the overall SCR of 17% or €22 billion. This would reduce the average solvency ratio recorded at end-2019 by around 36 points (from 267% to 231%).

The impact varies considerably between countries. German insurers would be the most affected, recording a relative increase in their overall SCR of 37%, representing €5 billion, and reducing their solvency ratio by around 100% (it is currently close to 400%)[8].

8. Figures provided by EIOPA in "Impact Assessment - Background document on the opinion on the 2020 review of Solvency II", dated 17 December 2020, based on the holistic impact assessment launched in March 2020.

Several changes are recommended for the capital requirement for equity risk

Enlarging the symmetric adjustment corridor for equity shocks

The symmetric adjustment (or dampener) is intended to have a contra-cyclical effect, mitigating the central equity market shock[9] by increasing the capital charge in an upward market and decreasing it when markets have fallen.

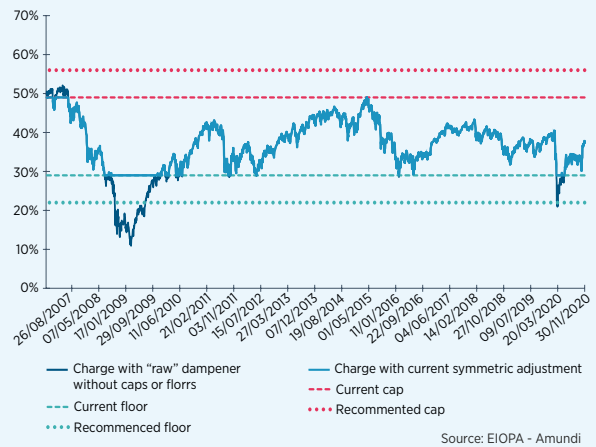
It is calculated using the difference between the level of a composite index on the date in question and the index's historical average over the past three years. Under current regulations, the symmetric adjustment can vary from -10% to +10%.

EIOPA wishes to make the symmetric adjustment to the equity capital charge more effective by enlarging its corridor to [-17%; +17%]. The charge for type 1 equities would fluctuate in a corridor of [22%; 56%] instead of [29%; 49%].

The composition of the index used to calculate the symmetric adjustment is not called into question.

The chart shows that in March 2020, the reduction in the equity charge was limited by the current floor and that in the absence of limits, the dampener would have taken the equity charge slightly below 22% for a short period.

Change in Type 1 equity capital charge with an enlarged dampener (-17% and +17%)



Source: EIOPA - Amundi

Scope of application of long-term equity investments

EIOPA redefines the criteria required to apply the "Long-term equity investments" sub-module.

The equity sub-module in question must be well diversified, but the geographical criterion is maintained. Only European Economic Area (EEA)-listed equities and unlisted equities from companies having their head office in an EEA country are eligible.

EIOPA wants strategic investments and intragroup investments to be excluded from the scope.

The equity sub-portfolio considered as Long-term equity investments (LTEI) must be clearly identified. It must be part of an asset portfolio assigned to clearly identified insurance businesses and the management policy must reflect the intention to keep the equities in the sub-portfolio for an average of more than five years.

EIOPA recommends replacing the general condition ensuring that the equity sub-portfolio is not subject to forced sales for at least ten years with specific criteria depending on whether the undertaking has life or non-life insurance obligations.

- For life insurance, LTEI must cover a homogenous risk group.
- The obligations must be shown to be illiquid (belonging to the highly illiquid or medium illiquid buckets determined for the VA application ratio) and their duration must be over ten years.
- For non-life insurance liabilities, an equity portfolio is only eligible as LTEI if the undertaking holds in addition high quality liquid assets (HQLA) that amount to more than best estimate liabilities net of reinsurance.

  EIOPA details the HQLA calculation, distinguishing between several asset categories and assigning some of them investment limits and haircuts.

  The HQLA can comprise up to 100% cash or European Union government bonds (or bonds issued by other entities with a zero credit SCR under the standard formula) and up to 40% investment grade bonds (or loans). Eligible assets in the category capped at 40% are divided into two sub-categories and a haircut of between 15% and 50% is applied depending on their CQS and the type of securities.

9. 39% for type 1 equities (listed in an EEA or OECD country) and 49% for equities listed in other countries or unlisted equities.
10. Representative of insurers' equity investments..

	Type of assets	Haircut	Maximum % of HQLA	
Level 1 assets	Cash and cash equivalent	0%	100%	
	Bonds and loans from: • The European Central Bank • EU Member States, denominated in their domestic currency • Multilateral development banks referred to in paragraph 2 of Article 117 of Regulation (EU) No 275/2013 • International organisations referred to in Article 118 of Regulation (EU) No 275/2013	0%		
Level 2A assets	Bonds and loans rated CQS 0 or 1, excluding those from financial institutions	15%	40%	40%
Level 2B assets	Covered bonds rated CQS 0 or 1, excluding those emitted by a bank which is part of the same group as the Insurer undertaking	25%	15%	
	Qualifying RMBS	50%		
	Bonds and loans rated CQS 2 or 3, excluding those from financial institutions	50%		

In all cases, risk management and the financial management policy must demonstrate the commitment to hold the equity investments.

The possibility of holding equities via an investment fund is unchanged. For social entrepreneurship funds[11], venture capital funds[12], European long-term investment fund s[13] and unleveraged closed-end alternative investment funds[14], the holding commitments may be considered at the level of the fund and not at the level of its underlying assets.

The irreversible nature of the designation of an equity portfolio as an LTEI is also reaffirmed. If an insurer is no longer able to keep the holding commitments required for a sub-portfolio identified as an LTEI, it will not be authorised to use this mechanism for the next three years.

Deleting the "Duration-based equity risk" sub-module

EIOPA recommends deleting the "Duration-based equity risk" sub-module, which is only used by one entity.

This sub-module concerns equities held to meet occupational retirement obligations. The insurance undertaking may apply an equity SCR of 22%, after receiving approval from its supervisory authority. The terms of application of this sub-module are extremely restrictive, for example the average duration of the undertaking's liabilities must exceed 12 years.

Overall, EIOPA considers that having this sub-module coexist alongside the "**Long-term equity investments**" sub-module generates unnecessary complexity.

Scope of application of strategic investments

EIOPA does not recommend loosening the criteria required for certain holdings to qualify as **strategic investments**, which can then apply a capital charge of 22%.

The criterion of lower volatility is retained; EIOPA proposes clarifying its assessment method. The 20% control requirement is also upheld, with a proposal to clarify the scope of application.

Infrastructure investments

The more favourable current calibrations for investments in infrastructure projects and equities of infrastructure companies are not being revised.

EIOPA wishes to change the correlation matrix used to calculate the market SCR

Regarding the aggregation of market risks, EIOPA approves the coexistence of two correlation matrices: one used when the insurer chooses to apply the upward interest rate risk scenario and the other used when the downward scenario is applied[15].

But EIOPA recommends **lowering the correlation coefficient between interest rate risk and credit risk from 50% to 25% when the downward scenario is applied.**

In cases where the insurer has to apply the rate up scenario, EIOPA upholds the zero correlation between interest rate risk and credit risk.

This change is overall positive for life insurers, as their long-term liabilities mean that they most often apply the interest rate down scenario.

11. Qualifying within the meaning of Article 3, point b), of Regulation (EU) 346/2013 of the European Parliament and of the Council.
12. Qualifying within the meaning of Article 3, point b), of Regulation (EU) 345/2013
13. Introduced by Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds.
14. Provided the fund manager is licenced in the EEA.
15. Insurers must use the scenario that gives rise to the highest capital requirement.

In the impact assessment, EIOPA mentions that this change to the correlation matrix would cause a (relative) decrease of 5% in the SCR for life insurers. This would lead to an increase in the capital surplus of €5.8 billion. German, Italian and French insurers would gain the most from reducing the correlation, recording an increase in their solvency ratios of between 11% (Germany) and 8% (France)[16].

The correlation matrix applied to calculate the basic SCR by aggregating market, counterparty, life underwriting, health underwriting, and non-life underwriting risks is also upheld by EIOPA.

EIOPA recommends simplifying quarterly reporting to the supervisory authorities and reviewing the Solvency and Financial Conditions Report

Quarterly quantitative reporting

EIOPA recommends some marginal changes to the reporting templates for financial assets (in particular the "List of assets" template S.06.02).

The prospect of the sharing of information between national and European supervisory authorities ofm different types of financial sector participants[17] means it is possible to consider discontinuing certain Solvency II disclosures by insurers, in particular information on derivatives and look-through reporting of collective investment undertakings.

Initially, EIOPA proposes simplifying reporting on "Open derivatives" (S.08.01) and deleting "Derivatives transactions" (S.08.02).

In its Consultation, EIOPA introduced a new template (S.06.04) containing item-by-item information on collective investment undertakings when the insurance undertaking has significant influence on the investment strategy or is aware of individual positions[18]. However, EIOPA acknowledges that within a few years, it should have access to information on investment funds collected by national central banks in the European System of Central Banks[19], thereby removing the need for eurozone funds to submit this statement. It therefore proposes reducing the scope of application to funds in EEA member countries that are not part of the eurozone and third countries.

For the reporting of "Securities lending and repos" (S.10.01) and "Assets held as collateral" (S.11.01), EIOPA is considering adjusting (introducing in the second case) the exemption threshold in the forthcoming review of technical standards.

However, EIOPA is not in favour of deleting Q4 quantitative reporting, which some consider redundant due to annual reporting. The quarterly reporting deadlines remain tight and are kept unchanged at five weeks for individual entities (16 weeks for the annual statements of individual entities).

Solvency and Financial Conditions Report

EIOPA proposes **separating the SFCR into two parts:** a first part for policyholders, which must provide an overview of risks, and a second part intended for professional users, with a structure similar to the current SFCR.

The part addressed to policyholders must contain summary information on the entity's activity, its performance and the material risks to which it is exposed, as well as the minimum capital requirement (MCR), SCR, amount of eligible own funds and coverage ratios.

In the part for professional users, the chapter on "System of governance" is simplified and the "Risk profile" and Capital management" chapters are merged. This merged section is, however, enhanced as it must include details of the sensitivity of the SCR, own funds and the coverage ratio to certain market fluctuations. The sensitivities must be measured applying each of the eight following scenarios:

	Down scenario	Up scenario
Equity market	-25%	+25%
Interest rates	-50 bps	+50 bps
Credit spreads	-50 bps	+50 bps
Real estate	-25%	+25%

The insurer can add other sensitivity analyses if it considers they are better suited to its risk profile.

The second notable change recommended by EIOPA is the introduction of an **auditing requirement for the Solvency II balance sheet.** This obligation would apply both at individual and group level[20].

Publication deadlines are extended. The deadline for publication of the SFCR by an individual entity is set at 18 weeks after the end of the financial year. For the group SFCR, or a single SFCR containing information on the group and its subsidiaries, the deadline is 24 weeks after the end of the financial year (except for the part addressed to policyholders, which must be published within 18 weeks).

EIOPA makes several recommendations to extend the principle of proportionality

EIOPA proposes **raising the thresholds set in the Solvency II Directive to exclude small undertakings** from its scope of application:

- Doubling technical provision thresholds,
- Allowing Member States to set the written premiums threshold between €5 and €25 million (by default the current level of €5 million will continue to apply).

16. Figures provided by EIOPA in "Impact Assessment - Background document on the opinion on the 2020 review of Solvency II", dated 17 December 2020, based on the holistic impact assessment launched in March 2020.
17. National central banks, national supervisors of banks, insurance undertakings and the financial markets, etc.
18. This statement must be submitted quarterly if funds account for more than 10% of total investments and without condition for annual reporting.
19. In accordance with Regulation (EU) 1073/2013 of the European Central Bank concerning statistics on the assets and liabilities of investment funds.
20. Insurance and reinsurance captives are exempt from this obligation.

EIOPA wishes to set criteria to identify undertakings with a **low risk profile.** Undertakings considering that they meet these criteria and wishing to benefit from the principle of proportionality must notify their supervisory authority. In such cases, they will be able to perform an Own Risk and Solvency Assessment (ORSA) every two years and review their written policies every three years (unless they undergo material change).

For the SCR calculation, a simplified approach is proposed to measure the capital requirement arising in respect of "non-material risks". This method includes adjusting the SCR in proportion to changes in the risk exposure. To be considered non-material, a risk must not represent more than 5% of the Basic SCR (BSCR) and the overall capital requirement for all non-material risks may not exceed 10% of the BSCR. However, the market risk module is excluded from this approach as market risk exposures can change rapidly and very significantly.

What next?

The next step will be the publication of the European Commission Proposal in 2021, but the review process will be far from complete...

Source: ACPR conference, 27 November 2020 – Amundi

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