Insurance Ireland's
Priorities
on

The Review of the Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast)

Considering the Opinion of the European Insurance and Occupational Pensions Authority (EIOPA) of 17th December 2020

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Insurance Ireland members are progressive, innovative and inclusive, providing competitive and sustainable products and services to customers and businesses across the Life and Pensions, General, Health and Reinsurance sectors in Ireland and across the globe.

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1. Introduction

In February 2019, the European Commission called on the European Insurance and Occupational Pensions Authority (EIOPA) to deliver technical advice in preparation for the review of the European prudential supervisory regime for insurers, Solvency II. After nearly two years of extensive consultations and numerous workshops and meetings, EIOPA presented its final advice on 17th December 2020 (hereafter: *The Advice*).

The review cannot only look at the regime itself and focus on an internal EU or a Member State perspective. Instead, the review must have clear objectives to further integratation of the EU Single Market for insurance and to ensure the global competitiveness of the European insurance industry.

In this broader picture, the Solvency II review can be an essential element of the ambitious plans of the European Commission and Co-legislators to pursue a sustainable recovery of the EU economy and society from the Covid-19 crisis, the Next Generation EU initiative. Addressing the shortcomings of the framework, namely its over-complexity and existing miscalibrations (e.g. of the risk margin), can unlock significant potential in the industry to provide the cover and the investments which are indispensable for economic and social recovery.

The same holds true for the EU Green Deal. The ability of insurers to make the necessary investments in sustainable projects and to close protection gaps for climate-related risks can be enhanced or hampered by Solvency II depending on the outcome of this review. Only on the day before the publication of the technical advice, EIOPA presented its great ambitions on sustainability to stakeholders. Despite this ambitious approach, EIOPA's Advice includes a number of aspects limiting the industry's ability to facilitate the transition towards a more sustainable EU economy and society in the future.

Finally, we would also like to highlight the importance of Solvency II for the objectives of the European Commission's Capital Markets Union (CMU) Action Plan. The CMU explicitly refers to the treatment of long-term equity. Nonetheless, if the main flaws of the Solvency II calibration (e.g. the risk margin) are not solved, the capacity of the insurance industry to contribute to strengthening the EU capital market will be limited.

The Advice has to be assessed against this background.

Already in 2019, the Irish insurance industry defined its own priorities for the review of the Solvency II Directive. This paper aims at evaluating the Advice against these priorities. As the Advice takes a broader approach than the initial Call for Advice by the European Commission, additional aspects, e.g. the newly proposed macro-prudential tools, are considered in this paper as well.

2. Priorities of the Irish insurance industry

a. Integrate the Single Market for insurance, prevent discrimination and protectionism

The freedom to provide services (FoS) and the freedom of establishment (FoE) are fundamental freedoms of the EU and were essential for the creation of the Single Market. In 2019, cross-border businesses in the EEA represented 11 % (173 billion Euros) of the overall gross-written premiums. The share of business conducted across the Single Market increases steadily.[1]

[1] EIOPA Peer Review on EIOPA's Decision on the collaboration of the insurance supervisory authorities, 2nd December 2020.

Solvency II creates the prudential regulatory framework for this development and enhanced consistent consumer protection across the Union. Insurance Ireland and its members strongly support a Solvency II review which further integrates the Single Market and fosters regulatory and supervisory consistency and convergence.

Solvency II is not and should not be a zero-failure regime. However, we believe that some of the cases among the limited number of failures of undertakings operating under FoS/FoE business models unveiled shortcomings of the current regime and its consistent application. While the overall impact on the EU market for insurance was minimal, individual consumer detriment, potential hardship and misdevelopments in some jurisdictions should be addressed. More consistency on both sides, meaning limiting opportunities for regulatory arbitrage and national gold-plating should be the aim of the Solvency II review.

We appreciate that EIOPA comes to the same conclusions in its Advice. We also support the conclusions and lessons learned which EIOPA draws. Proposals, like an improved exchange of supervisory data or transparency about ongoing and failed application authorisation procedures[2], are very welcome.

However, we miss a stringent path in EIOPA's Advice on the issue. Rather than consequently assessing regulatory and supervisory inconsistencies across all areas of the Directive, EIOPA only focuses on a limited number of issues. A fundamental, but important, improvement to the cross-border supervision would be the transition of cross-border supervisory platforms from ad-hoc mechanisms to permanent supervisory tools. Rather than making a distinction between material and non-material cross-border business, a proportionate approach should be foreseen which also allows for adjusting the intensity of interaction to the risk inherent in the business model. The basis for such a permanent platform structure is the provision of already available information on digital cross-border platforms. This step would not require substantial additional efforts by NCAs. However, it can significantly contribute to the effective, efficient and transparent supervision of the Single Market for insurance. The basis for this enhanced governance and function of supervisory platforms should be included in the Solvency II Directive and also be reflected by avoiding potentially discriminatory provisions, like materiality thresholds. In the Advice, EIOPA refers to an improved use of data and technology (para. 7.1 of the Advice). We believe that this approach is the way ahead and enables transparent and consistent supervision not only, but particularly, in cross-border cases.

EIOPA emphasises the need for more effective supervisory cooperation and transparency. In this respect, we strongly support EIOPA's idea of an improved information exchange (Chapters 10.2 and 10.4 of the Advice) and a mandate for EIOPA to intervene where NCAs fail to fulfil their roles (Chapter 10.3 of the Advice). However, EIOPA's proposals focus on the home supervisor. In the background note to the Advice, EIOPA states:

> *"[…] undertaking might not have a clear understanding of the risks that it faces, or may face, in the host territories. Also the home supervisor might face some challenges relating to: the need for local market knowledge, an understanding of the specific local insurance products, relevant laws and requirements, knowledge of local claims environment, awards and court systems, and knowledge of local intermediaries used to distribute the products."*[3]

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[2] EIOPA advises to include intermediaries into the scope of Article 18 Solvency II. While intermediaries are subject to the existing provisions of EIOPA's Decision on supervisory collaboration (para. 2.5.1), they are not subject to Solvency II. That should be maintained.
[3] Para. 10.36, EIOPA Background document on the Opinion on the 2020 Review of Solvency II, 17th December 2020.

We are convinced that the vast majority of insurers will be fully aware of the market it will engage in. Nonetheless, we strongly support the idea that the cooperation of NCAs is essential for an effective and efficient supervision of cross-border business. In contrast to EIOPA which solely looks at the home supervisor, we suggest that the improved governance for the cross-border cooperation of NCAs ties relevant NCAs closer to each other. In addition to the situational cooperation, host supervisors should provide relevant information for the effective supervision of insurance undertakings, e.g. on market trends, conduct supervision or regulatory changes, through the cooperation platform as well.

Furthermore, we believe that some of EIOPA's measures are imbalanced towards insurers operating across the Single Market and might open room for protectionist policies. One particular example is the proposed mandate for host supervisors to request information from undertakings directly and in its own language in a timely manner (para. 10.7 of the Advice). We believe that this provision allows for substantial inefficiencies and might lead to a significant administrative burden for undertakings. Insurers provide information to the NCA in charge – the home supervisor. The home supervisor shares this information with the other concerned NCAs. We are convinced that this information channel should be maintained as a single point of contact. Information requested by one NCA might be of relevance for others. Multiple similar requests might increase the bureaucratic burden without any added value and the interaction between NCAs might already solve some of the issues in question. With regards to the language requirement, we consider it an unnecessary burden to request the information in local language. Insurers operating across borders are already required to provide certain information in local language (i.e. where it is relevant for consumers). For other issues, English as the working language of EIOPA should be sufficient to ensure an efficient and timely provision of information.

Notwithstanding the concrete tools which might be envisaged to improve the cross-border supervision of insurers, it is important that Solvency II is applied consistently, focus is on the Single Market and provisions do not harm particular markets or business models.

Unfortunately, the Advice contains a number of proposals which do counter the further integration process and the continuous shift from national to Single Market. A particular example in this respect is the EIOPA proposal to leave the scope of the Directive to Member States by a Member State option to set the application threshold for Solvency II (para. 8.3 of the Advice). A less significant, but still viable example for an exaggerated focus on national markets are the newly proposed measures on Recovery & Resolution (R&R) measures (Chapter 12 of the Advice). In its proposal EIOPA suggests that certain new measures cover "a very significant share of each national market in the EU"[4]. While we fundamentally disagree with EIOPA's approach to these specific measures, we also suggest focussing on the underlying risk and market. In this case, it is not necessary that each national market looks at itself if measures are implemented consistently. Again, supervisory cooperation and trust among NCAs will be the determining factor for the effectiveness of supervision. However, the burden to compensate a lack thereof should not be placed on the industry.

Box 1: The implementation of the EIOPA statement on the ban on dividends

A very specific example with regards to consistent supervision is the implementation and application of the EIOPA statement on the distribution of dividends and similar transactions[5]. The detrimental impact of this statement and the according proposal to introduce an empowerment for NCAs/EIOPA to issue such statements in a binding manner are deeply concerning.

[4] Para. 12.4 of the Advice.

[5] EIOPA statement on dividends distribution and variable remuneration policies in the context of COVID-19, 2nd April 2020.

The detrimental impact of the most recent factual ban on dividends and similar transactions should provide evidence to prevent any further ambition towards this direction. Its significantly damaging impact for the credibility of Solvency II and the Single Market can be best illustrated for cases of groups operating across borders. In these cases, the prohibition of intra-group transactions is a vital threat to the freedom of capital – yet another fundamental freedom of the EU. While we understand and support the individual powers assigned to NCAs to block the distribution of dividends in cases where an individual insurer is at risk, we do not see any value in a market-wide policy. EIOPA failed to provide the basis for a consistent application of its own statement which might have been possible by providing clarity about the potential risk-scenarios and calculations to be tested by undertakings and supervisors. Therefore, we believe that EIOPA should rather focus on its mandate to provide the information necessary for a consistent application of existing powers rather than striving for additional powers for themselves or NCAs.

Overall, the recent case proves that such measures are rather more detrimental than supportive in terms of consumer protection or financial stability. In contrast, the policy led to severe uncertainty for insurers and supervisors and to arbitrary/disadvantageous situations for markets ignoring/applying the ban, particularly for different entities within the same group. As the necessary powers to prohibit critical payments already exist for NCAs, we consider the justification for EIOPA's and the later ESRB's statement requiring additional powers as a sign of the lack of cooperation and agreement between authorities.

One of the achievements of Solvency II is the change from an isolated solo-entity approach to a comprehensive group approach in supervision. Therefore, it needs to be ensured that decisions on distributions are taken consistently across groups. Solvency II already provides for the governance structure of efficient and effective group supervision. In cases where a ban on distribution covered intra-group transactions, such a wide-ranging decision must not be taken at a supervisory level without a duly justified case-by-case decision based on transparent and clear criteria. Otherwise, undertakings might also face a risk of arbitrary decision-making. In this context the different approaches of EIOPA in its Advice and its reaction to the Covid-19 market disruption are duly noted. While EIOPA considers a 13 % drop in solvency ratio for the whole market (as it would be triggered by its own advice) as "manageable", a 17% drop triggered by the Covid-19 market reaction led to the statements on distribution bans. EIOPA's inconsistent and asymmetric treatment highlights the potential for arbitrary decision-making when soft powers are used outside of the clear metrics and triggers of the Solvency II regime.

	Impact on the solvency ratio in p.p.	Comment
EIOPA proposal for the SII review	• whole market: -13%[6] (scenario 1) • Life market: -24%[7]	EIOPA: "*The impact of the advice, including the interest rate risk recalibration, appears manageable for the insurance industry*"[8]
Impact of Covid-19 at Q1 2020	• Whole market: -17%[9] • Life market: -16% (-18% when incl. composite)[10]	EIOPA and the ESRB requested an EU-wide distribution ban[11]

[6] EIOPA figures resulting from the holistic impact assessment at year end 2019.
[7] As above
[8] EIOPA's communication on the result of the HIA
[9] Solvency ratio from year end 2019 to Q1 2020, based on EIOPA's own funds quarterly data
[10] As above
[11] As per the statements issued by EIOPA in April and the ESRB in May 2020

b. Apply Solvency II proportionality and reduce the burden of proof

The proportionate application of Solvency II is essential for an effective, efficient and appropriate regulation to the benefit of EU businesses and consumers and a central element of the Solvency II framework. The assessments conducted by EIOPA and the industry showed that particularly the proportionate application of the regime is insufficient and highly inconsistent. Therefore, a comprehensive European approach to the proportionate application of Solvency II is imperative for the ongoing review.

In 2019, the Dutch and the Irish insurance industry presented a joint comprehensive proposal on how to improve the proportionate application of Solvency II across the Single Market. We appreciate that the fundamental principles of this approach have been adopted by EIOPA, namely the development of concrete tools with risk-based thresholds and the creation of a category of low-risk undertakings (LRU, Chapter 8 of the Advice). However, more work is necessary to fill these principles with life and make the (risk-) proportionate application of Solvency II the norm (as required by the Directive) rather than the exemption. In particular the creation of an EU-wide category of LRU should not lead to an empty bucket. The heterogeneity of the EU Single Market for insurance is essential for the stability of the market, the availability of cover and consumer choice. It is important that the standards for a proportionate application of Solvency II are consistent and reliable for undertakings and supervisors across the Single Market.

In this regard, it is particularly incomprehensible why EIOPA suggests that the EU-wide approach towards the proportionate application of Solvency II should not apply to insurers operating across the Single Market (para. 8.8 (3) of the Advice). In addition to the general absurdity of this approach, such a provision would particularly harm new market entrants (such as InsurTechs) and providers of niche products. Thereby, the provision also harms other initiatives such as the Pan-European Personal Pension Product (PEPP), where a market participant seeking to provide the PEPP across borders (as it is the general purpose of PEPP) would not be eligible as an LRU under EIOPA's conditions).

Furthermore, it is important that the tools to improve the proportionate application of Solvency II are sufficiently concrete and ensure a consistent approach. Rather than principles, defined measures need to be foreseen. The EIOPA advice includes a number of valuable suggestions (e.g. on reporting and disclosure) but falls short on essential areas such as the ORSA or the pillar 1 calculations.

Finally, it will be important for the further success of the Solvency II process that the proportionate application focusses on the risk inherent in an insurance business rather than its size (as required by the Solvency II Directive). EIOPA's focus is too narrow in this respect. In addition to the definition of a LRU category and the development of a set of tools for the eligible undertakings, EIOPA should broaden the scope of its approach and develop thresholds for each of the tools as well.

The Irish insurance industry noted the consideration of specific measures applicable to the captives and reinsurance business models. We appreciate that EIOPA followed-up on its commitment which the Authority already announced at its annual conference in 2018 to specifically look into the application of Solvency II to these business models.

Together with other industry bodies, Insurance Ireland developed a comprehensive proposal for a proportionality toolbox (Box 2) and for the definition of LRU (Box 3). The creation of the toolbox and the LRU should be embedded in the Solvency II Directive. For the definition of the low-risk category, it will be important that its creation is reliable, easily assessable and predictable for insurers and NCAs alike. Therefore, it will be essential that it forms part of the future Solvency II Directive and that additional criteria are defined for the qualification for the category and the transfer out of the category.

However, the tools and criteria for the application of the tools should be laid down in subordinated regulation to ensure the necessary flexibility.

Box 3: A proportionality toolbox

The proportionality toolbox consists of two interlinked components and provides a useful mechanism for the automatization of the proportionate application of Solvency II. The first component is a non-exhaustive list of proportionality measures (tools). The second component is a set of pre-defined criteria (conditions) that are linked to a single or multiple proportionality measures. If companies comply with these criteria, they are allowed to apply the respective measures automatically. In addition, the tools provide examples and best practices for insurance companies, which do not fulfil the explicit criteria. These companies should still be able to use this tool, if they can demonstrate that the application is proportionate to its individual risk profile.

(1) The definition of the proportionality measures (tools) is the first part of the toolbox. It is essential to improve the common understanding of a proportionate application of Solvency II across markets. It creates legal certainty for insurance companies and supervisors, while it also relieves the significant burden on undertakings to develop tools on an individual basis and file an application to their respective NCA. Examples for such tools already exist in some Member States. Scaling them across the Single Market will benefit convergence and consistency.

The list of proportionality measures (tools) shall not be exhaustive, because it cannot reflect the optimal proportionate application of Solvency II to each individual insurer. Therefore, it is important that the current approach of insurers applying for the proportionate application of specific requirements and approved by the NCA is maintained in parallel. Supervisory dialogue can discover new, innovative proportionality measures that should be added to the toolbox in future.

(2) Defining and linking pre-defined criteria to each proportionality measure establishes a mechanism for automatic application that increases legal certainty and reduces the burden to justify the application. We propose to link criteria and measures for each of the defined tools, there should be clear pre-defined criteria or thresholds for the automated (default) application of that tool.

The definition of a category such as LRU is not new. Multiple Member States and their respective NCAs have similar categories in place. However, the definition at Member State level has led to fragmentation and inconsistency with regard to the criteria and the number of insurers eligible and benefits of the tools in such a category. The definition of a common EU LRU category would foster consistency of the proportionate application of Solvency II and create a reliable standard across the EU.

The proportionate application of Solvency II should also be recognised at group level. We therefore oppose that element in EIOPA's proposal (para 8.7 of the EIOPA advice). Where entities qualify for either the LRU or specific tools, the entity should be entitled to apply the tools. In order to avoid that the accumulation at group level requires these entities to apply Solvency II disproportionate to its risk, the use of the results of the tools or proxies should be eligible for the consolidation at group level. However, such a requirement must not lead to undue incentives to split a group into multiple entities and a risk-concentration in single parts of the group. Therefore, thresholds should determine the eligibility of the use of tools for the accumulation at group level.

A list of concrete proposals can be found in ANNEX I of this paper.

Box 4: Creating an LRU category

The definition of a category such as LRU is not new. Multiple Member States and their respective NCAs have similar categories in place. However, the definition at Member State level has led to fragmentation and inconsistency with regard to the criteria and the number of insurers eligible and benefits of the tools in such a category. The definition of a common EU LRU category would foster consistency of the proportionate application of Solvency II and create a reliable standard across the EU.

Insurers qualifying as LRU should be allowed to apply a substantial package of proportionality measures on a reversed burden-of-proof. Notwithstanding the concrete definition of LRU or the thresholds for specific tools, NCAs should maintain their independence and should challenge the use of a tool where such a challenge is duly justified.

The EIOPA approach

We appreciate that EIOPA creates a category of LRUs for which a set of proportionality tools apply by default. With regards to the eligibility criteria for the qualification as a LRU, we have serious concerns that the identified parameters reflect are sound and sensitive to contribute to a risk-based, consistent and EU-wide application of the principle of proportionality.

EIOPA suggests 7 different criteria which all have to be fulfilled for the eligibility of an undertaking as an LRU (5 of 7 in case of a captive).

The most critical criterion is the requirement that an insurer is only qualifying as an LRU if the insurer has no more than 5% premium income from cross-border business (para. 8.8 (3) of the Advice). We believe that this criterion contradicts the fundamentals of the EU Single Market. Furthermore, it is not evident that cross-border business is per se more risky than domestic business. The recent examples of certain NCAs to not supervise cross-border business appropriately must not lead to a discrimination of such business models. Furthermore, such a criterion will significantly undermine the ability of new market entrants to scale their business in fair competition with domestic incumbents of similar risk profiles as well as it discriminates the providers of niche solutions across the Single Market.

EIOPA advises that life undertakings, gross technical provisions may not be higher than € 1 billion and for non-life undertakings, gross written premium may not be higher than € 100 million to qualify as an LRU (EIOPA advice, para. 8.8 (4) of the Advice). We believe the size of the insurer does not determine its level of risk as much as the nature of the risks it insures.

We believe that EIOPA itself suggests a better criterion in paragraph 8.8 (5) of the Advice. It determines that premium written in the Marine, Aviation and Transport and / or Credit and Suretyship business lines should not be higher than 30% of total annual written premiums of the non-life business.

In paragraph 8.8 (7) of the Advice, EIOPA suggests that “accepted reinsurance gross annual written premiums are not higher than 50% of the total annual written premium” of an insurance undertaking to qualify as an LRU. Solvency II foresees a sophisticated governance around reinsurance agreements, including the opportunity for NCAs to intervene. If reinsurance contracts are accepted/acceptable to the NCA, we do not see why they will make an undertaking high risk if they go above 50%. Either a reinsurance contracts is acceptable because it removes risks from the balance sheet, or it is not.

Finally, we are not sure about the impact of the criterion described in paragraph 8.8 (2) of Advice. EIOPA refers to "Life undertakings, excluding the index/unit linked business […]". If the criterion Is to be understood in a way that the criterion only applies to life other than index/unit linked business, it is considered appropriate. If the wording implies that insurers offering index/unit linked business cannot be considered LRUs, we doubt the suitability of the criterion. Index/unit linked businesses are per definition less risky than traditional life insurance as a substantial share of the investment risk is not covered by the insurer.

In addition to the criteria for the LRU category, EIOPA suggests a number of further provisions on the LRU status and the application of the proportionality tools.

Among these EIOPA describes the process of application of the toolbox (para. 8.12-8.16 of the Advice). EIOPA proposes that the insurer notifies the NCA, which then has one month to object. We consider this approach appropriate. However, it must be ensured that the requirements for the notification (para. 8.14 of the Advice) remain simple and do not create an additional administrative burden.

EIOPA also describes the important process for companies which do not comply with the eligibility criteria of LRUs (para. 8.17-8.20 of the Advice). EIOPA allows insurers which do not comply with to argue that they should be eligible. While this is an important provision, we believe that there should also be specific criteria proportionality measures reflecting the particular risk perception of the application of the measure. That enables other insurers with a more specific risk profile (e.g. larger insurers or insurers with specific exposures) to apply Solvency II more proportionality.

Two proposals which are very concerning from an industry perspective are not subject to the EIOPA advice itself but included in the background analysis in which EIOPA suggests legal amendments. In general, EIOPA suggests amendments to Article 6 of the Delegated Regulation. Articles 6a-6c describe the above-mentioned establishment of the toolbox. In the following Article 6d EIOPA limits the use of the toolbox to two years. This is incomprehensible. There is no factual or reasonable basis why an insurance undertaking, which does not have a material change in its risk profile or misses to comply with the eligibility criteria of the LRU category for any other reason, should not use the proportionality measure on a permanent basis.

Along the same lines and also not reflected in the EIOPA advice is Article 6f of the EIOPA proposal. This Article allows NCAs to withdraw eligibility for any (not just material) changes in the risk profile. While we believe that the monitoring of the risk profile of the insurer which is also proposed in the Article is a general supervisory function, we believe that the withdrawal of the eligibility needs to be duly justified and based on an ongoing incompliance with the criteria set-out in the Solvency II Directive.

A simple set of reliable criteria

With regards to the criteria to define LRUs, it is important that the criteria are simple and that their assessment is possible without creating an additional regulatory burden to avoid repeating the current dilemma on the application of the principle of proportionality under Solvency II.

In addition, the criteria should focus on the risk inherent in an insurer's business and not its size as determined by the Solvency II Directive itself.

In consequence, we propose a set of the following 5 criteria:

1. LRUs should provide for a stable solvency position. Solvency II defines an appropriate solvency position with the compliance with a company's individual SCR (SCR ≥ 100). In order to ensure an appropriate level of confidence, we believe that the volatility of the SCR compliance should be taken into account. Therefore, we suggest that the volatility of the SCR is taken into account for an SCR between 100% and 130%.
2. LRUs should be well capitalised. Therefore, we suggest that the ratio of eligible own funds relative to the total balance sheet of the insurer should be sufficiently high to reduce the risk of failure. We consider a ratio of minimum 20 % appropriate in this respect.
3. LRUs exposure to particularly risky lines of business (LoB) should be limited to a non-substantive share. Certain LoB and products present particular risks to the insurance company, e.g. liability cover, aviation, marine or credit. Companies offering these products should not be excluded from the LRU per se, but the share which these businesses have in the total business of the insurer should not be substantial. Therefore, we propose that the share of these LoBs and products should be limited to a maximum of 20%.
4. A central element of Solvency II is (partial) internal models with which companies can determine their individual risk profile more appropriately than with the standard formula. While we believe that Solvency II should apply proportionately to insurers using (partial) internal models, we believe that the use of such models should require undertakings to review the tools separately, rather than through the default approach of the LRU category.
5. LRU should not be of systemic relevance. The International Association of Insurance Supervisory (IAIS) defines Internationally Active Insurance Groups (IAIG). The IAIS considers IAIGs to be of particular importance for the global insurance market. As for the use of (partial) internal models, we believe that companies which are considered IAIGs should be exempted from the default approach of the LRU category.

These criteria should apply, notwithstanding the legal form of a company. Tools, specifically tailored to business models (i.e. mutuals, reinsurers and captives) should be foreseen, independently from the qualification of an insurer as an LRU.

An overview of the criteria can be found in ANNEX II of this paper.

c. Avoid unnecessary capital requirements due to an excessive risk margin

The risk margin is a conceptual approach to adjust the system to the general principles of Solvency II. It expresses the capital equivalent which would be necessary to sell the portfolio of a failing insurer to another insurance undertaking. Thereby it can be interpreted as the “price” of portfolio continuity in the 1 in 200 case of failure of an insurer.

Following this logic, the risk margin is the “surcharge” for non-hedgeable risks and the additional solvency capital necessary for the insurer taking-over the portfolio from the failing insurer. In its current form, the risk margin is applied as a cost-of-capital (CoC) rate of 6 percent.

The risk margin has a very significant impact on the overall solvency capital requirement (SCR) of insurers. Due to its concept, its impact is higher for insurers offering products with long durations, i.e. life insurances and some long-tail non-life business. Looking into the dynamics of the insurance market and the functioning of the long-term business, this has a detrimental effect. For some long-term exposures, the risk margin can overshoot the effective SCR. This leads to a tremendous miscalibration and consequently limits insurers' ability to efficiently provide protection to customers and invest long-term.

A huge impact factor on the current risk margin is the inclusion of mass lapse. For many products (i.e. unit-linked products), the existence of a large mass lapse risk is closely linked to a large part of the own funds being “financed” by the value of future profits. Contrary to sources of own funds corresponding to shareholders ́ equity, undertakings are usually not applying a return requirement on the value of future profits in the business. Actually, it could be argued that if the insurer, that acquires the portfolio, receives a portfolio dominated by mass lapse risks, it takes over a profitable portfolio with a large value of future profits. In such a situation, it is very unlikely to end up in a situation with solvency problems triggering the transfer of the portfolio.

Insurance Ireland believes that the risk margin should be significantly lower. The over-reliance on some risk factors (i.e. mass lapse) and the excessive estimated CoC rate stand against the fundamental aim of the long-term insurance business model, affecting both risk-taking capacity and investments.

In its Advice, EIOPA presents a reviewed methodology to calculate the risk margin (para. 3.8 of the Advice). EIOPA explains that the approach taken should lead to an exponential and time dependent methodology. The result are a λ-parameter (=0,975) and the implementation of a floor of 50%. The resulting calibration adjustment to the risk margin is insufficient. Rather than a sound and sensible review of the level of the risk margin, the approach taken by EIOPA rather seems to be an attempt to fulfil its own goal of a capital-neutral Advice (plus the additional own funds requirements due to the interest rate risk calibration, see Chapter 2. d of this paper).

Insurance Ireland and its members consider this approach inacceptable as it neither solves the fundamental miscalibration of the risk margin nor does it empower insurers to provide their full risk-taking and investment capacity to the EU economy and society.

Therefore, we strongly support the work of a joined industry group which aims to address the three fundamental flaws of the existing risk margin methodology as well as EIOPA’s proposal:

- The derivation of CoC rate,
- The introduced lambda parameter and floor,
- Recognition of diversification at group level.

Derivation of CoC rate

There are a number of flaws in EIOPA’s derivation of the CoC rate which mean that it is too high and inconsistent with Solvency II specifications. For example, the current calibration does not reflect the capital structure of insurance undertakings (assuming only equity funding and ignoring bond financing) and, therefore, wrongly reflects a cost of equity and not a weighted average cost of capital. In addition, the current calibration incorrectly captures asset risk and, therefore, reflects more than pure insurance risks, as required by Solvency II regulations. Furthermore, the estimation of the important beta parameter in the calibration was significantly distorted by a massive overweighting of large companies (which exhibit stronger co-movement with major indices).

Finally, the methodology for deriving the cost-of-capital rate is backward-looking and hence is biased upwards, since backward- looking estimates include a survivorship bias (i.e. firms that fail are removed from the index and are therefore not captured) – forward-looking estimates are more consistent with Solvency II and would result in a material reduction in the CoC rate.

Based on an analysis that avoids these multiple short-comings, the cost-of-capital rate should be set to 3%.

The newly introduced lambda parameter and floor

While the λ-parameter is an acknowledgement that the risk margin is too high and volatile, particularly for long-term business, the proposed level of 0.975 is not justified. Unfortunately, the proposal undermines itself for some long-dated portfolios. The equally introduced changes to the extrapolation methodology for interest rates more than offsets the impact from the introduction of the λ-parameter in combination with the proposed floor – resulting in a net increase in the risk margin.

This is in part due to the high level of lambda but is also due to the high level of the floor of 0.5, which particularly impacts long-dated portfolios, and whose introduction and level. The high λ-parameter and floor also limit the effectiveness of the λ-parameter to reduce inappropriate balance sheet volatility. For example, we estimate that for a 30-year product, EIOPA's parameterisations would only result in a 20% reduction in volatility relative to the current risk margin regulations. A λ-parameter of 0.9 with a floor of 0.25 would result in nearer a 50% reduction in volatility relative to the current risk margin. And a λ-parameter of 0.8 with no floor would result in a 75% reduction in volatility relative to the current risk margin. Other combinations would also have a significant impact, e.g. a λ-parameter of 0.9 with a floor of 0.5 would result in nearer a 40% reduction in volatility relative to the current risk margin and a -parameter of 0.9 with no floor would result in a 55% reduction.

Any action taken by EIOPA to improve the proposal would, therefore, be more effective if it addressed both areas. The industry called on EIOPA to review the calibration throughout the process, however, the parameters remained unchanged.

If the λ-parameter and floor are set appropriately, they will recognise the risk dependence over time inherent in insurance products. For example, in the case of lapses (see below), exposure significantly reduces after a lapse stress while for some multi-year general insurance products maximum pay-out clauses would reduce future SCRs following the occurrence of an insured event.

Recognition of diversification at group level

The current risk margin calculation does not allow for diversification at group level. This exclusion contradicts a fundamental principle of insurance business and effective risk management. Diversification is allowed for in the calculation of group capital requirements and in the calculation of local entity risk margins, so not permitting for this in the calculation of the group risk margin is both unclear and counter intuitive. It is also counter to practical experience where there are many examples where groups have transferred policies as a whole. Therefore, the amended methodology to determine the risk margin should recognise the impact of diversification within a group.

d. Take a reasonable approach towards interest rate risk

Interest rates have a significant impact on the solvency position of insurers. Decreasing interest rates lower the potential return on assets in the event of a sale. Furthermore, lower interest rates lead to a lower expected discount rate with which the liabilities of an insurer are valued. Therefore, changes in the interest rate hit insurers not only in the real world but even more strongly in the Solvency II model environment. The reason is that the Solvency II model implies that the assets and liabilities would be realised at the moment of their valuation. That means that insurers would be forced to sell assets and re-invest their returns even in none-preferential interest rate scenarios. Consequently, it has to be noted that the basis of the design of the interest rate risk as part of the Solvency II standard formula does not properly reflect reality, i.e. the long-term nature of the insurance business model and the resulting investment strategy.

This problem gains importance with the calculation of the interest rate risk. In accordance with the confidence level of Solvency II – a 99.5 percent Vale at Risk (VaR) assumption – a situation which theoretically appears in 1 out 200 events are anticipated (positive and negative change). Together with the aforementioned assumption of the need of an insurer to sell all assets at this extreme scenario and re-invest all available funds at this catastrophic rate, this scenario appears even less likely. The general concept as well as the underlying assumptions are very conservative and lead to a considerable own fund requirement for insurance undertaking.

Notwithstanding this general observation, EIOPA proposed in 2018 to amend the current assumptions and anticipate an even more extreme downturn. The proposed changes would raise the necessary own funds of insurers to cover their SCR significantly – making compliance even more "expensive". We do not challenge EIOPA's view that the current low interest rate deserves additional observation and potential adaptions. However, we strongly believe that the proposed extreme changes to the current methodology are not sensible and significantly harm insurers ability to provide cover and invest. Maintain and increasing both core functions of the industry are particularly important in light of the extensive efforts to boost economic and social recovery post Covid-19.

Together with other industry bodies, we support a change to the design and calibration of the interest rate risk sub-module that meets all the following criteria:

- It contains a floor which properly reflects the extent to which yield curves can go negative and the true risk in a low and negative yield environment;
- The illiquid part of the stressed yield curve is derived using standard extrapolation parameters and methodology;
- Is appropriate for all currencies to which it is applied.

In its Advice, EIOPA presents a reviewed version of its previous approach (Chapter 5.1 of the Advice). While it reflects some of the industry concerns in theory, e.g. the inclusion of a floor (para. 5.10 of the Advice), the suggested calibration does still maintain the flaws of the previous versions.

One of the central elements of the determination of the interest rate risk is the derivation of the respective rates – the illiquid part of the stressed interest rate term structure. In contrast to the methodology used for the extrapolation of the illiquid part of the Risk-Free Interest Rate (RFR) – the Smith-Wilson method – the methodology used for the interest rate risk sub-module is based on factors (para. 5.8 and 5.9 of the Advice).

EIOPA is aware of the significant and detrimental impact which the change of the methodology would have. Therefore, the Authority suggests a five-year lead-in period (para. 5.11 of the Advice). While this idea is generally appreciated, we would rather suggest developing a more sensitive methodology for the interest rate term structure, than the slow phase-in of such a radical approach.

e. Adjust the lapse risk calibration to market experience

The lapse risk (the risk that policyholders surrender their policies) is a crucial element of the solvency capital requirement, particularly for life insurers. Due to the long-term focus of the products and the investment element of most life insurance contracts, the impact is bigger on life insurance contracts than on non-life contracts with usual contract durations of less than 5 years. The surrender of an exceptionally high number of policyholders might be a challenge to life insurers as investments, which are usually matched to the policyholder's contract duration, would have to be realised and expected future premium income will no longer be available.

However, a large number of policyholders surrendering their policies at a certain moment or over a short period is very unlikely. First, policyholders usually buy life insurance products not only for investment purposes but also for protection – against old-age poverty or of family members in case of their own death. Second, policyholders very rarely follow capital market developments of the underlying assets of their insurance policy regularly and acquire the information to make the economically (not socially) rational decision to surrender a policy in a moment where the present value of a product exceeds the value of the best estimate.

Notwithstanding the aforementioned, Insurance Ireland and its members agree that the lapse risk can be a threat and should therefore be subject to the calculation of the Solvency II capital requirement. But the current design and level of the lapse risk sub-module under Solvency II need to be reviewed. The delegated regulation specifying the SCR calculation describes the lapse risk as the largest of the following:

- capital requirement for the risk of a permanent increase in lapse rates,
- the capital requirement for the risk of a permanent decrease in lapse rates or
- the capital requirement for mass lapse risk.

The permanent increase/decrease of lapse rates are set to 50 percent. The mass lapse is defined as an instantaneous discontinuance of 70 percent in case of insured pension schemes and 40 percent in other cases. Particularly the design of the lapse risk overshoots the data monitored in markets. For European markets the surrender rate for life insurance products is between 15 and 20 percent. Following the logic of the increase/decrease assumptions in the delegated regulation, the resulting calibration of the lapse risk would be significantly lower than the calibrated mass lapse (22.5 – 30 percent).

In addition to the calibration of the lapse risk factor, concerns remain regarding the calculation basis of the lapse risk. Currently, the lapse risk factor is applied on a contract-by-contract basis. Consistent with the aforementioned, that would mean that each individual will make a fully informed decision about his/her preference regarding a surrender at the same time. While his might be a theoretically fair assumption, it is very unlikely in reality. Therefore, we support the position that the lapse risk should be calculated on a portfolio basis.

Furthermore, Insurance Ireland is concerned that only the best estimate is considered as a diminishing factor. As the lapse risk only materialises in cases of surrender, the risk margin would need to be taken into consideration as well. Based on the aforementioned impact of the risk margin, i.e. on long-term business, the exclusion of the risk margin from the calculation of the SCR due to lapse risk is enormous.

Despite these strong concerns and an intense discussion of the actuarial profession with EIOPA, EIOPA suggests no changes to the mass lapse risk calibration in its Advice (para. 5.26 of the Advice).

f. Reflect risk mitigation techniques in the standard formula

Basis Risk

Insurance Ireland shares the opinion of EIOPA that the current definition and application of "basis risk" across the EU Single Market leads to an inconsistent approach by NCAs in their assessment of risk mitigation techniques. The result can be an ineffective risk management as certain risk mitigation techniques might be excluded from an insurance undertakings' risk management toolkit due to the applied NCA policy on basis risk. Thereby the undertaking is limited in its ability to effectively and efficiently transfer risk to reinsurers. In such a situation insurer retain risks which would in a functional

system be transferred. That can lead to inefficient exposure to risks and unfavourable allocation of own funds.

While we agree with EIOPA's general statement that improving the convergence and consistency of the interpretation and application of basis risk by NCAs and insurers is desirable, we disagree with the current content of and suggested changes to the Guidelines.

In paragraph 5.3.2 EIOPA suggests that a drafting proposal which the EIOPA predecessor, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), made for the Implementation Measures on Solvency II is now added to Article 210 Solvency II. This suggestion was ruled-out in the initial development of the implementing measures (European Commission Delegated Regulation (EU) 2015/35).

The suggestion to add this wording is concerning. Already in its reply to EIOPA's consultation on the use of risk mitigation techniques[12], Insurance Ireland emphasised that the effectiveness and efficiency of risk mitigation does not depend on the relation between reinsurance agreement and the Solvency II standard formula, but the relation between the reinsurance agreement and the real exposure to risk. Making the acceptance of a reinsurance agreement conditional to the appropriateness of the standard formula to the real risk profile of an insurance undertaking will limit effective and efficient risk transfers.

The second proposal of EIOPA (para. 5.3.3 of the Advice) is to "upgrade" the EIOPA guidelines 1, 2 and 3 of the EIOPA Guidelines on basis risk[13] to the delegated regulation under Solvency II~~. is, generally, supported.~~ Again, we share the opinion that such an "upgrade" can facilitate convergence and consistency, however, a fundamental review of the EIOPA Guidelines is a prerequisite for the legal adaptation of the Guidelines as delegated acts.

Particularly the following adjustments are indispensable to ensure a sound reflection of basis risk and reinsurance for standard formula users:

- Adjust the scope of the guidelines before the upgrade;
- Include cover thresholds in the basis risk assessment;
- Reflect material basis risk in capital relief for risk mitigation techniques;
- Contemplate the new delegated acts with explanatory examples – extension of the existing explanatory text – in the form of supervisory guidance.

The current wording of Guideline 1, paragraph 1.4 is misleading as it suggests that the guidelines solely focus on market-risk. If the Guidelines are transposed into delegated regulation, it should be clarified that the provisions support undertakings in calculating their capital requirements under Solvency II (as such) and not just for the market risk.

Paragraph 1.12 of Guideline 2 recognises cover caps for the assessment of the materiality of basis risk. However, the Guidelines do not recognise thresholds which enforce a risk mitigation technique. In order to ensure an appropriate reflection of agreements foreseeing such a threshold, the thresholds should be reflected in the assessment of the basis risk as well.

In general, the existence of material basis risk should not disqualify the benefit of the risk mitigation as such. Where an insurer can demonstrate the materiality and the extent of the basis risk, the insurer

[12] https://www.insuranceireland.eu/news-and-publications/eiopa-s-consultation-on-the-use-of-risk-mitigation-techniques-by-insurance-and-reinsurance-undertakings

[13] https://www.eiopa.europa.eu/sites/default/files/publications/eiopa_guidelines/br_final_document_en.pdf

should be allowed to subtract the extent of the material basis risk from the overall benefit of the use of a risk mitigation technique. The remaining benefit should be recognised, nonetheless. If included in the delegated acts, an according provision should be added to the Guidelines.

In addition, it will be important to provide more substance supporting the consistent applications of the Guidelines – then delegated act. Therefore, we suggest that the current explanatory note to the guidelines is improved with further examples illustrating the basis risk assessment and converted into supervisory guidance.

With regards to the Delegated Regulation, we also believe that the existing provisions under Article 86 of the Delegated Regulation. First, it is not clear why the delegated regulation refers to currency mismatch in particular rather to the basis risk as such. The reference should be deleted. Second, the addition to the Guidelines that the remaining benefits from the use of risk-mitigation techniques can be recognised, after the subtraction of the material basis risk, should be added to the article.

Non-proportionate reinsurance

Overall non-proportional (NP) reinsurance is the predominant risk mitigation instrument for the non-life sector and is a particularly crucial tool for smaller and medium-sized companies to manage peak risk. While the Solvency II standard formula recognizes the impact of NP reinsurance in the catastrophe sub-module of the non-life underwriting risk module, it fails to do so in the premium and reserve risk sub-modules. We consider this to be a technical inconsistency of the standard formula.

This treatment under Solvency II represents a real barrier to the further development of the market for adverse development covers. Due to this mistreatment, NP reinsurances is sought mainly by internal model users. As such recognising NP reinsurance under the Solvency II standard formula would particularly support SMEs.

The current approach does not reward undertakings that have sought to reduce their risks through NP reinsurance. The only alternative to internal models which allows for a proper consideration of NP reinsurance are undertaking-specific parameters (USP). In practice this does not provide for a viable solution, i.e. for SMEs. The process of designing and approving a USP is highly burdensome, time-consuming and requires significant efforts. Furthermore, uncertainty will remain about the compatibility of the resulting data requirements on company experience and the nature of some of the covers, including adverse development covers (ADCs).

Insurance Ireland and its members support an approach whereby the recognition of non-life NP reinsurance would be based on allowing undertakings to determine the appropriate adjustment factors for NP reinsurance arrangements in force. This would reflect actual risk-mitigating behaviour of the insurer and allow for a sound, sensitive and practicable approach, correcting current inconsistencies, reinforce the risk-based nature of the framework and make it more proportionate for standard formula users.

We support EIOPA's proposals to change NP reinsurance on reserve risk and are disappointed that no proposals on premium risk have been made (para. 5.27 of the Advice). We, therefore, call on the European Commission and Co-Legislators to propose the necessary amendments to the Solvency II framework.

g. Acknowledge group governance powers in intra-group outsourcing

Solvency II provides for a sophisticated and complex system of requirements regarding the outsourcing of certain functions and services. The general idea is that the outsourcing insurer ensures that the company, which the insurer employs to fulfil the function or service, complies with the high standards of Solvency II. Despite the general level of the regulatory burden of Solvency II, we agree to an approach which ensures that the outsourcing of an activity does not undermine the credibility of Solvency II or allow for regulatory arbitrage.

The Solvency II outsourcing requirements apply to each outsourcing agreement irrespective of whether the receiving company is controlled by the group of the insurer or a fully external service provider. Insurance Ireland believes that the same treatment of intra-group and external outsourcing is not justified. The service provider, as part of a group, is part of the regulated organisation which is responsible for the implementation and execution of the internal control and management functions across the group.

As a result of this situation, the potential risks associated with the outsourcing of a function or a service differs significantly between intra-group outsourcing and the outsourcing to external partners. Solvency II already provides for strict requirements for the internal control, risk management and reporting for the regulated group. The group-wide systems are applied consistently across the group – including internal service providers and the outsourcing company. The group-wide application of a group-wide management system includes aspects which are in focus of the Solvency II outsourcing requirements, e.g. IT security, data protection, etc. Automatically, this leads to a consistent data protection or contingency planning. By principle, the strategy of the outsourcing company and the service provider are subject to the same coordinated strategic approach across the group. As a result, unilateral arbitrary behaviour and the associated risk of such behaviour are eliminated.

Finally, the supervision of the group by the competent authority leads to a consistent supervision of both the outsourcing entity and the service provider. The consistent group supervision under direct Solvency II supervision, or Solvency II equivalence, ensures regulatory compliance with the standards of Solvency II. This lowers the risk associated with an outsourced activity even further as not only the outsourcing entity's compliance with the outsourcing requirements but also the service provider is included in the Solvency II group supervision.

EIOPA does not recognise the specific control and limited risk of intra-group outsourcing arrangements. Rather than acknowledging the control and, therefore, common interest between the outsourcing undertaking and the servicing entity, EIOPA increases the regulatory burden for such arrangements. In its Advice EIOPA suggests that information about material intra-group outsourcing arrangements should be included in the RSR (para. 7.27 of the Advice).

h. Propose reporting & disclosure requirements fit for purpose

Insurance Ireland and its members welcome the efforts EIOPA makes in suggesting changes to the existing reporting & disclosure requirements (R&D) under Solvency II in order to reduce the regulatory burden. We further appreciate the intention of EIOPA to develop measures which ensure a more consistent application of the R&D requirements. It must be noted that the implementation of the Solvency II R&D was very burdensome and costly for the industry, in particular for SMEs. It is, therefore, of utmost importance that the proposed changes are meaningful and justified, reduce the regulatory burden and are sustainably applied.

Reporting deadlines

A crucial element to the massive burden which Solvency II creates are the tight R&D deadlines under which the R&D requirements have been fulfilled. Solvency II foresees a transitional period during which the reporting deadlines are gradually reduced to reach the final target in 2019. Experiences show that the initial deadlines were already considerably tight and that insurers are significantly challenged by the shortened periods. EIOPA acknowledged this experience and suggests freezing the deadlines at the current stage and to not make the "last step", thereby extending the deadlines initially fixed in the Directive (para. 7.3 of the Advice). Insurance Ireland appreciates this proposal and suggests granting undertakings even more time. The current deadline does not only have to cover the efforts necessary to comply with the R&D requirements but all other necessary steps, e.g. audit. Two additional weeks to cater for these measures would be very welcome. In addition, EIOPA's suggested extension of the deadlines does not apply to the submission of quarterly reporting. This needs to be adjusted as well.

Reducing the regulatory burden

In line with our ask on proportionality, Insurance Ireland and its members strongly advocate for a more consistent and proportionate application of the Solvency II R&D requirements. In this regard, we are disappointed that EIOPA decided to recommend maintaining the empowerments for NCAs in Art. 35 (6) and (8) Solvency II. In contrast to relying on national measures, we consider an ambitious and stronger approach towards the definition of risk-based thresholds important. We therefore appreciate that EIOPA announces the review and further development of such thresholds (Chapter 8.5 of the Advice). However, EIOPA did not yet deliver on a more consistent approach.

Furthermore, EIOPA started its review of the reporting requirements with an exercise to identify core and non-core Quantitative Reporting Templates (QRTs). This approach was welcomed but seems to have not gone very far. In its Advice EIOPA suggests a very limited number of simplifications and deletions (para. 7.2 of the Advice), but rather introduces new and additional information requirements (para. 7.9 and 7.10 of the Advice). In addition, EIOPA suggests maintaining the obsolete requirement for undertakings to report Q4 data in addition to annual reports.

Newly introduced QRTs

Some of the new requirements, like the product-by-product reporting for non-life insurers (para. 7.9 of the Advice) have to be met by a clear added value. The sole purpose of gaining additional information for NCAs cannot justify the efforts. From our assessment EIOPA fails to show an equal added value to the efforts necessary to reflect the increased granularity of requested information (e.g. on QRTs S.14.01), the additional templates (e.g. cyber or internal models) or the regrouping of QRTs (e.g. for the cross-border reporting).

One example: EIOPA proposes the reporting of more granular data on QRT S.14.01 on life insurance and the introduction of a comparable QRT for non-life. In its consultation, EIOPA justified this idea with the possibilities which the use of RegTech and SupTech offer when analysing the data. However, EIOPA fails to show which other R&D requirements become obsolete due to the analysis of the more granular data and which benefits the use of the tech and data analysis offer. The explanation of paragraph 7.1 (a) of the Advice is insufficient in this respect. An assessment should have been carried-out prior to the issuance of the advice to the European Commission and the resulting changes need to be made prior to the entry into force of the revised reporting requirements. Requiring the industry to adjust systems and acquire new R&D services to fulfil the proposed amendments is too costly to justify a "test-run" of tech solutions by supervisors.

Insurance Ireland and its members agree with EIOPA that there is a rationale for including cyber risks in the R&D under Solvency II (para. 7.9 of the Advice). In its prior consultation EIOPA was inconsistent between its explanatory note which suggested a holistic approach and the actually requested information in the new QRT. Unfortunately, EIOPA followed the approach of the QRT. Instead of a broader approach looking into the different products (i.e. standalone cyber, property, casualty, PI, D&O, etc.), the proposed templates are requesting contract-by-contract information with an atypical allocation of information (e.g. physical injury to third parties). This requirement is not reflecting the approach taken in the business and would require additional efforts to provide the information. We consider reporting system which follows the structure of the business more efficient and better to reflect the identified reporting purpose.

EIOPA suggests the introduction of a specific cross-border template. In general, Insurance Ireland supports the idea as increasing transparency of cross-border business might assist supervisors across the Union to improve the consistent supervision of insurers. The approach to consolidate already available data in a specific template S.04.03 might increase transparency while keeping additional efforts reasonable and facilitate the aims expressed in Chapter 2.a. of this paper. However, the requested information goes beyond the information which has to be reported in other QRTs and beyond the one required in the QRTs S.05.02, S.12.02 and S.17.02 which EIOPA suggests deleting. Instead of reducing the regulatory burden, the EIOPA proposal actually increase the compliance efforts necessary. Also, the additional information requested is not usually available and might be difficult to be generated (e.g. the number of insureds and number of contracts by line of business and location). As a result, the regulatory burden is increasing substantially.

Internal Model users reporting standard formula results

In its advice, EIOPA proposes a requirement that users of internal models should be required to report results of Solvency II standard formula calculation (para. 7.10 of the Advice). Internal Models under Solvency II have the purpose of reflecting the risks inherent to an insurers risk better and more precisely than the standard formula. Internal models are of particular value where the standard formula does not reflect the insurer's risk exposure appropriately. The regulatory approval by the NCA and the governance structure around the application of internal models ensure the consistency of the approach. The reporting of information generated through the use of an internal model should provide more precise information on an insurer than the use of the standard formula.

Insurance Ireland believes that the requirement to calculate both internal model and standard formula would be misleading for stakeholders. It would also lead to suboptimal decisions being taken by insurers using internal models to the detriment of consumers and shareholders. There is neither a benefit for policyholder protection nor financial stability as the core objectives of Solvency II. In contrast, the additional regulatory requirements can harm the competitiveness of insurers.

Internal models are designed and calibrated to reflect an insurer's specific risk profile and to meet supervisory expectation to ensure policyholder protection. Any changes to internal models are subject to supervisory monitoring or approval.

The standard formula is designed for a hypothetical average insurer. Where an insurer applies for the use of an internal model, deviations have two well-founded sources: i) the adaptation to individual risk profile; ii) the on-going revision of the appropriateness of the internal model against the latest usable science and dataset.

Internal models are fully integrated in the decision-making of firms and their risk management, as per the use test prescribed in Article 120 of the Solvency II Directive. A requirement to disclose standard

formula figures might deteriorate from the most appropriate decision-basis, the internal model figures.

Based on the aforementioned, we consider the requirement to disclose standard formula users to be irrelevant for stakeholders. In accordance with Recital 115 of the Solvency II Delegated Regulation, insurers should be protected from such irrelevant information requests, unless there is a specific and justified supervisory request in accordance with the proportionate application of standard formula reporting of Article 112 Solvency II Directive.

The preservation of internal models in Solvency II is important to ensure the global competitiveness of EU insurers. Undermining internal models will require AMSB to reconsider their strategic and business plans in a way that may limit the provision of insurance cover and investing long-term.

Against this background, Insurance Ireland cannot follow the reasoning of EIOPA proposing that internal model users should report standard formula results. The proposal would create significant additional efforts necessary and increase the regulatory burden. Due to the specific nature of each internal model, there is no or very limited comparability of results. Any comparison between internal model results and standard formula calculations should focus on specific issues and be requested by the supervisor in charge. In terms of an EU-wide assessment, EIOPA has its benchmarking exercise at hand. Therefore, Insurance Ireland suggests abandoning the newly proposed requirements.

Solvency and Financial Condition Report

Already in the consultation phase prior to the Advice, EIOPA set a positive sign by suggesting a split of the Solvency and Financial Condition Report (SFCR) into a policyholder part and a professional user part. We appreciate that this idea is included in the Advice (para. 7.11 of the Advice) as it will allow a more targeted communication with the respective groups. It further allows for a differentiation in the duties to present the respective parts of the SFCR which is reflected in the proposed waiver for captives and reinsurers or the group SFCR.

While the consumer-oriented part of the SFCR proposal seems to be reasonable, there is considerable room for improvement for the part focused on professional users. We strongly believe that there is a chance to reduce the regulatory burden significantly.

With the sole audience of professional users, the SFCR should focus on disclosing figures rather than narrative and explanatory information. In addition, the amount of information to be provided can be significantly reduced (e.g. required sensitivities) and should focus on material changes – a full SFCR should only be required on a less frequent basis. Furthermore, attention should be paid to non-duplication of information required for the RSR and the SFCR. EIOPA's proposals partially reflect the need for a more stringent and less burdensome SFCR. Aspects, like the suggestion that reference to other publicly available sources are possible or the deletion of the summary from the professional part of the SFCR, are appreciated (para. 7.13 of the Advice for solo and 7.14 of the Advice for groups). In general, the professional users' section should solely be of a numerical nature as a baseline allowing, but not requiring, insurers to provide additional narrative. We also understand that EIOPA considers the inclusion of sustainability risks important (para. 7.13 of the Advice). Nonetheless, an efficient approach is necessary.

In addition to the existing requirements, EIOPA suggests the standardisation of the information on sensitivities (para. 7.17 of the Advice). We believe that the definition of this minimum is not required. A crucial parameter for the impact which the standardised sensitivities will have is the determination of the scope. In the Advice EIOPA refers to "groups/undertakings relevant for financial stability

purposes". Similar to the newly introduced pre-emptive tools on R&R it will be important what this means in practice. In our opinion, only groups/undertakings which might destabilise the financial stability as such should be required. Also, the provision that the benchmark should be the Single Market or the Eurozone rather than single Member States.

We have strong concerns with regards to EIOPA's proposal of a minimum audit of the SFCR (para. 7.11, 7.21 and 7.22 of the Advice). A mandatory external audit of Solvency II reports had been subject to the initial discussion on Solvency II. Back then, the proposal to require an audit was rejected at EU-level. However, some Member States (including Ireland) made an external audit mandatory. We believe that, instead of making this costly exercise a European mechanism, EIOPA should encourage Member States to drop the requirement consistently. The supervision of the content of the SFCR is a NCA mandate and should not be "outsourced" to auditors. Neither does the audit provide any assurance to policyholders.

Overall, we believe that the EIOPA proposals fail to fulfil the aim of a material reduction of the regulatory burden. Despite some positive ideas, we expect the overall burden to increase.

Regular Supervisory Reporting

EIOPA's proposals to amend the requirements for the Regular Supervisory Report (RSR) are considered positive. EIOPA clarifies that the RSR requirements should apply proportionately and allow NCAs to (only) require the report when adequate (para. 7.24 of the Advice). The suggested minimum frequency of the RSR submission of 3 years (para. 7.25 and 8.54 of the Advice) seems reasonable. EIOPA's suggestions towards a convergent minimum content and aims to reduce the content of the RSR to material changes and minimise the duplications with the ORSA are also very welcomed (para. 7.26 of the Advice).

Another positive change is the suggestion of a single group RSR (para. 7.29 of the Advice). While the provision of a single RSR is greatly appreciated, we are concerned that the governance structure which EIOPA suggests creating around its issuance might be burdensome. Where the insurance group decides to present a single RSR, the NCAs should have the powers to challenge the decision through the college of supervisors and by a common decision in the college. The proposed structure which foresees the approval of the issuance of a single RSR by the college first in coexistence with the individual NCAs powers to request solo RSRs might create an uncertainty which outweighs the potential benefit of the single RSR.

i. Develop an EU system of Insurance Guarantee Schemes as measures of last resort

Insurance Guarantee Schemes (IGS) are a valuable measure of last resort of policyholder protection in cases of insolvency. The Irish Insurance Compensation Fund (ICF) was recently reviewed and adapted to best reflect the needs of the Irish market. We understand and support the initiative of EIOPA to ensure that EU citizens are appropriately covered by guarantee schemes (para. 13.1 of the Advice). We support the EIOPA in its opinion that IGS are not an isolated issue, but closely linked to the newly proposed R&R mechanisms (para. 13.3 of the Advice). The distinction between some existing IGS mechanisms (e.g. the German Protector AG) and resolution mechanisms like the empowerment of the Dutch resolution authority to create bridge or run-off institutions, is difficult. Therefore, we consider it important that the discussion on both issues will be linked.

The focus of IGS is on the consumer. We believe that the most sensible way for an EU measure would also be to focus on the consumer. In contrast to the recommendation from EIOPA to use the "home-country principle" (para. 13.5 of the Advice), this would result in a "host-approach". This approach

provides that every policyholder is covered by the guarantee scheme of his/her Member State of residence. Accordingly, insurers, irrespective of the location of their headquarters, contribute to this scheme in an equitable manner. This approach ensures that the consumer is appropriately covered in accordance with the social and economic circumstances of the country of his/her residence.

However, as EIOPA and several Member States push for a home-approach, we will discuss the issue. The home-country principle requires insurers to contribute to the insurance guarantee scheme in the country where they are located. To allow for a reliable and sustainable fund and risk management, that automatically means that the compensation of policyholders in case of an insolvency can only be the one applicable in the home jurisdiction of the insurer. If not harmonised to a certain minimum, that might leave the policyholder with insufficient compensation. Furthermore, it could only apply to policies which are covered by the home guarantee scheme of the insurer. In addition to the consumer protection aspect, there might be a competitive issue about the home-country principle. An inconsistent system of national guarantee schemes might create regulatory arbitrage. Undertakings, i.e. those with unsound financial positions, might be incentivised to search for the "cheapest" system. To avoid such a situation and create a certain consistency in this safety-net for consumers, a minimum harmonisation is indispensable.

The features of this minimum harmonisation should, at least, cover the following:

- Products and policyholders in scope,
- Minimum maximum compensation levels,
- Funding mechanism and minimum contribution.

In this regard, we appreciate that EIOPA is making an attempt towards this direction. However, the approach falls short as EIOPA takes a too national centrist approach when it comes to the cross-border impact. While we generally agree that the definition of the products in the scope of an IGS should be compulsory (non-life) consumer products, the determination of compulsory products across Member States differs significantly. Therefore, Insurance Ireland recommends to primarily focus on those products which are required consistently across all EU Member States, with Motor Third-Party Liability, being the prime example.

Most **Non-life insurance** products (except for health insurance) are short-term contracts and the underlying risk does not depend on the personal condition of the insured (health status, age, etc.). For these products, replacement is, usually, simple. The compensation through an IGS can, therefore, focus on current claimants in line with paragraph 13.8 (i) of the Advice. This makes the determination of eligible people to be covered by the IGS simpler. The scope should further be limited to natural persons for the purpose of the minimum harmonisation. Natural persons are, usually, most vulnerable. Even smallest companies can usually acquire specialised consultancy services and should be excluded, in contrast to paragraph 13.10 of the Advice.

In order to ensure, that people are appropriately compensated notwithstanding where they are domiciled in the European Union, a minimum level for the maximum cover should be mandatory for all national guarantee schemes. Prices, costs of living and replacement costs differ significantly across the Union. A policyholder residing in a Member State with higher costs of living should not face financial hardship due to the location of the head offices of the insurer. EIOPA does reflect this issue in its Advice and suggests a certain minimum guarantee by Member States, e.g. of 100,000 Euros, (para. 13.14 of the Advice). We believe that this guarantee should be subject to further discussion and assessment. Nonetheless, we do not see a need for the differentiated approach taken by EIOPA in paragraphs 13.14 and 13.15 of the Advice. The percentage cap can be applied together with a certain guarantee as well.

A fundamental factor for fair competition of insurers across the Union is the funding mechanism and the funding level of the IGS. In order to not distort competition and ensure swift payments to consumers a certain minimum level of pre-funding might be defined as ex-ante funding as reflected in paragraph 13.20 of the Advice. In addition, a certain minimum contribution as share of the business written or be some other risk-based contribution by and insurer might be defined. At the same time the definition of a maximum contribution is advisable to ensure that no single insurer is overly burdened in line with paragraph 13.22 of the Advice. These three factors will ensure that incentives for forum shopping and regulatory arbitrage are limited. Therefore, we greatly appreciate that EIOPA advises to foresee two of the three aspects in its minimum harmonised approach. However, EIOPA does not make any concrete proposals on what the according parameters could be.

For life insurance products, Insurance Ireland and its members agree to the EIOPA assessment that contract continuity is crucial. We further agree with the idea that mechanisms to continue insurance policies might be more beneficial than simple compensation mechanism. However, we do not agree that an IGS is the right form. In contrast to the EIOPA advice (para. 13.8 (ii) of the Advice), we believe that a practicable and efficient resolution mechanism is more appropriate (see Chapter 2.j of this paper).

j. Focus an EU-wide Recovery & Resolution measures on macro risks

In the Advice, EIOPA suggests a set of measures on the R&R of insurance undertakings (Chapter 12 of the Advice). Insurance Ireland agrees with EIOPA that a comprehensive framework of R&R and IGS should be envisaged and (minimum) harmonised across the EU (para. 12.1 of the Advice). In line with our position on IGS (see Chapter 2. i of this paper), we believe that certain parameters of R&R mechanisms should be harmonised to ensure market stability, consumer protection and fair competition as also stated by EIOPA in paragraph 12.2 of the Advice. It will be essential that the resulting provisions will be outcome focused and do not deteriorate competition in the EU insurance market.

The measures suggested by EIOPA can broadly be summarised as pre-emptive recovery measures in addition to the existing recovery measures under Solvency II and a new framework for the resolution of insurance undertakings. In this regard, EIOPA refers to the link between the suggested new measures on R&R and the newly proposed macroprudential tools (Chapter 11.6 of the Advice). We share EIOPA's views that the new macroprudential tools and the R&R measures are closely linked. However, we believe that it is important to differentiate the different tools in accordance with their intended purpose and adjust their scope accordingly.

The suggested early intervention tools (Chapters 12.1.1 and 12.2.3 in the Advice) are of particular concern. These measures will create a significant additional administrative burden without an appropriate added value for the vast majority of insurers and, notwithstanding EIOPA's statement in paragraph 12.28 of the Advice, implicitly increase the SCR above the fundamental eligibility standard of Solvency II the 99.5% Value-at-Risk. EIOPA acknowledges the need for the proportionate application of some of the new tools (para. 12.15 and 12.16 of the Advice). Nonetheless, EIOPA fails to include consistent and concrete proposals on the proportionate application of the measures in its Advice (Chapter 8 of the Advice). A practical approach will be particularly important as EIOPA suggests that *"a very significant share of each national market in the EU"* should be covered. In case of the macroprudential value of the tools, by nature, macroprudential policy focuses on the market-wide perspective. It is, therefore, not clear why a (very) *"significant share of each market"* should be targeted instead of an approach clearly targeted at macro risks.

In contrast to the EIOPA approach, we believe it is absolutely essential that the macroprudential tools are applied in a risk-proportionate way and in relation to macroeconomic risk inherent in an insurance

business. Thereby, it becomes obvious that the starting point of the approach should not be at national markets and single entity level, but at an EU-wide and group focus. Single entities should only be subject to the new provisions where they are essential for the overall exposure of their group. The perspective at national market level should be abandoned as such. Where NCAs consider that insurers, which are not part of a group already subject to the measures, need to be included in the scope, it should be duly justified. An example in this respect could be insurance undertakings with a dominant market position in a country with a currency other than the Euro.

For all insurers where the application of the new measures cannot be duly justified, the existing regular supervisory powers are considered sufficient to allow NCAs to assess the solvency condition and inherent risk of an insurer. A risk-proportionate closer monitoring of the insurer or deeper assessments are not prohibited under Solvency II. Rather than applying a new set of tools, forcing NCAs into action and increasing the regulatory burden on NCAs and insurers, NCAs should be reassured of their operational freedom of carrying-out their duties. We strongly believe that the consistent application of the existing measures is more important than creating an additional layer of requirements.

In line with that approach, we are concerned about EIOPA's thoughts on national empowerments and the potential expansion of new measures at national markets and beyond groups. Solvency II should be the determining standard of what is regulated at EU level – not a regulatory race to the top based on NCA gold-plating and national initiative. Therefore, we believe that there should be a common standard which insurers have to comply with, also with regards to new R&R provisions. For the purpose of market integrity, the existence of group plans and schemes should be automatically taken into account across Member States, particularly for the determination of market coverage.

From our perspective, additional requirements might only be justified where the failure of the insurer would lead to deteriorated or disrupted market – national or cross-border. It needs to be avoided that the additional provisions lead to overlaps or duplications of parts of the existing provisions.

<u>Pre-emptive recovery planning</u>

In its Advice, EIOPA does not acknowledge the existence and functioning of the provisions which already exist under Solvency II. In its recent statement on the application of the supervisory ladder[14], EIOPA describes the functioning and application of the measures. In line with this statement, we consider the existing Solvency II recovery measures for insurance undertakings which are likely to breach or in breach with their SCR as sufficient. If an additional layer of regulation might be foreseen, it needs to be very targeted and duly justified.

The new measures must create material added value to justify the effort necessary for compliance. The pre-emptive recovery measures must not just present an additional compliance burden or an implicit increase of capital requirements, namely for pre-emptive recovery planning for SCRs > 100. Given the different measures already in place, i.e. the ordinary supervisory review, ORSA and the existing Solvency II recovery plans (in breach of the SCR), this will have to be assessed carefully.

With regards to the scope of the pre-emptive recovery tools, we would like to highlight the importance of a group-wide approach. It is one of the great achievements of Solvency II compared to Solvency I that the supervisory focus shifted from entity to group. This should also be recognised in R&R mechanism and would also reflect the discussion at international level. In its Advice, EIOPA suggests a set of

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[14] EIOPA statement on supervisory practices and expectations in case of breach of the Solvency Capital requirement, published for consultation on 25th November 2020.

criteria for the definition of the scope of the new measures (para. 12.15 of the Advice in conjunction with Table 12.4 of the background analysis).

EIOPA defines harmonised criteria for assessing if an insurer should be subject to the newly suggested measures (Table 12.4 of the Background Analysis). EIOPA suggests that cross-border business per se justifies the application of pre-emptive recovery measures – implicating that it presents a particular risk. Again, we would like to emphasise that the common EU-wide insurance framework should not penalise or hinder the provision of services across the Single Market. EIOPA undermines fair competition and the integrity of the Single Market based on the location of the headquarter of an insurer rather than its risks or its market impact. In addition to the specific criteria on cross-border activity, EIOPA also includes cross-border business in its thoughts on "interconnectedness". As part of the assessment, EIOPA asks "Does the undertaking have cross-border activity or a dominant market share in a country other than its home country?". While we agree that a dominant market share can be considered a source of market risk (subject to definition what dominant means), we strongly oppose that cross-border activity is an indicator for risks stemming from the interconnectedness of an insurer.

Resolution mechanism

Insurance Ireland supports the measures on resolution mechanisms and IGS to complement the existing provisions on recovery under Solvency II. We would like to emphasise the importance of the interplay between functioning resolution mechanisms and IGS which is also highlighted by EIOPA (para. 13.3 of the Advice). Particularly where the cover/compensation of consumers is considered to be more appropriate based on portfolio-continuity, resolution schemes are important. In consequence, Insurance Ireland strongly believes that the appropriate measure for protecting life insurance policyholders is a well-functioning resolution mechanism rather than an IGS.

We further agree to the EIOPA proposals that a minimum harmonisation of key elements (e.g. resolution powers, funding models and scope) is necessary to avoid consumer detriment and competitive disruption (para. 12.1 of the Advice). We also believe that a minimum harmonisation of the criteria under which insurers become subject to a resolution framework must be harmonised as well (para. 12.3.3 of the Advice).

Regarding the functionality of resolution mechanisms in cross-border cases, we agree to EIOPA that the respective fora (i.e. college of supervisors and supervisory platform) need to be in a position to exchange information and come to joint conclusions on the resolvability or liquidation of an insurer. The minimum harmonisation is the basis for this common understanding and we believe that our proposal on an improved governance for supervisory platforms would also enhance the functionality of resolution frameworks, if implemented.

Looking at national examples to benchmark the EU initiative against, we would like to highlight the recently implemented Dutch resolution mechanism as it seems to provide for a practicable and balanced approach[15]. The guiding principle of the resolution mechanism is that no creditor is worse off with the resolution than with an ordinary liquidation procedure. We appreciate that this principle is also reflected in EIOPA's Advice (para. 12.20 of the Advice). In contrast to an IGS or the Bank resolution schemes, the Dutch system is focused on the continuity of policies. In order to ensure this continuity, the Dutch National Bank (DNB) has four major tools: a bail-in tool, the sale of business, installation of bridge institutions and asset separation (the latest only when applying one of the other tools). These

[15] Wet van 28 november 2018 tot wijziging van de Wet op het financieel toezicht en enige andere wetten in verband met de herziening van het kader voor herstel en afwikkeling van verzekeraars (Wet herstel en afwikkeling van verzekeraars)

powers are reflected in the EIOPA Advice (Chapter 12.2.4 of the Advice), but EIOPA goes beyond the principles of the Dutch resolution mechanism.

The overarching aim of the contract continuity is reflected in the policies under which the resolution mechanism applies. The fundamental condition for the application of the resolution mechanism is that a public interest test is passed. The mechanism applies if it protects policyholders and prevents severe social disruption together with either preventing significant adverse effects on financial markets and the real economy or preventing the use of public funds. In the cases where the resolution mechanism applies the DNB will apply the tools described above to remove potential impediments for the transfer of business and improve the resolvability of the insurer. We appreciate that these considerations form the basis of EIOPA's Advice with regards to the objectives of the resolution mechanism (para. 12.11 of the Advice).

With regards to the scope of the resolution mechanism, Insurance Ireland supports the approach taken by the DNB. Only undertakings which are likely to pass the underlying public interest test in case of failure are required to fulfil pre-emptive obligations. In order to keep processes efficient, we believe that the potential requirements should be based on the existing provisions without unnecessary duplicating them. While the EIOPA Advice considers this aim (box 12.4 of the background document), the provisions outlined for the assessment might go beyond the fundamental principle of "public interest". As mentioned above, the definition of "materiality" in this context will be of extraordinarily importance and requires a consistent solution at EU level.

This efficiency needs to be reflected in the funding of the mechanism as well. The Dutch system is slim and efficient. The system foresees an ex-post funding arrangement which explicitly does not cover recapitalisation or absorb losses of the insurer under resolution – unlike IGS.

Instead, the funds are collected to cover the administrative costs of the operation, potential operative costs due to the establishment of a bridge institution or compensation where the no creditor is worse off requirement is not met. This approach keeps the running administration costs for the resolution mechanism low and ensures avoids additional costs due to the management of the fund.

With regards to the specific additional powers for NCAs, Insurance Ireland generally agrees with the list of powers suggested by EIOPA (Chapter 12.2.4 of the Advice) but would rather suggest keeping the list more focused to allow for a harmonised approach and do not risk unnecessary conflicts with national transposition. In our opinion, it is important to ensure the following mandate is available to the competent authority in charge:

- Control, manage and operate the insurer or bridge institution. In a situation where the insurer is no longer viable, the power to continue to carry on some of the insurer's business, for example making payments to annuitants would be consistent with policyholder protection. However, the aim should be to establish appropriate adjustments in value, where required, as soon as practicable so as to prevent conflicts of interests arising between different policyholder groups.
- With regards to control, management and operational powers the establishment of a bridge institution might be another potentially more efficient way to undertake a portfolio transfer.
- Restructure, limit or write down liabilities, including insurance and reinsurance liabilities, and allocate losses to creditors and policyholders, where applicable and in a manner consistent with statutory creditor hierarchy and jurisdiction's legal framework: Buyers of insurance purchase protection against financial losses that are incurred by the occurrence of the insured risk. Insureds pay a premium to mitigate risk, whereas investors take risk to earn a premium. Therefore, insureds are entitled to higher protection in resolution (and liquidation) than investors.

- Stay the rights of reinsurers of a cedent insurer to terminate or not reinstate coverage on the sole ground of the cedent's entry in recovery or resolution: We considers that this resolution power may be appropriate where the cedent enters resolution. It is however important to introduce adequate safeguards. Reinsurers should not be made liable to pay for losses beyond those covered by contracts existing at the time of the loss. Any reinstatement of coverage must be carried out at market prices. In the absence of comparable market prices, the reinsurer should be able to use its existing pricing mechanisms. Reinsurers can provide valuable capacity in off-loading risk. Where the implementation of such a framework creates legal uncertainty or moral hazard risks in the case of recovery this could limit reinsurers' willingness to get involved when firms are in financial difficulty.
- Stay the early termination rights associated with derivatives and securities lending transactions. Great care must be taken with regard to the possible effects on the assets or investments, including existing contracts. In addition, a comparison with the existing regulations at the European level is absolutely necessary. Otherwise, there could be contradictory regulations.
- Ensure continuity of essential services (e.g. IT) and functions by requiring other entities in the same group to continue to provide essential services to the undertaking in resolution, any successor or an acquiring entity. Contagion effects may be expected from other group entities if they continue to have to provide services for the insurer in resolution and may not receive adequate payments for these services.

With regards to the triggers to enter into resolution, we agree with EIOPA's Advice as outlined in Chapter 12.3.3.

A specific approach will be necessary for reinsurance and captive undertakings. Reinsurers and captives should not be subject to IGS or R&R regimes. Box 4, below, provides further information in this respect.

Box 4: R&R and IGS of Reinsurers and Captives

With a view to the specific case of reinsurance and captives, we would like to emphasise our previously expressed position that the focus on exposure to consumers and primary markets for R&R measures and IGS is important.

With regards to reinsurance, the following should be taken into account:

- Reinsurance is a business-to-business activity, with limited policyholder protection implications, and there is no evidence or history of it contributing to systemic risk or financial instability. The application of regulation to reinsurance needs to be proportionate.
- Regarding entity-based systemic risk, the 3 biggest reinsurers in the EU combined total assets represent 0.1% of the total financial assets in the world (as computed by the Financial Stability Board in the 2018 Global monitoring report on Non-Bank Financial Institutions). The 10 biggest global reinsurance groups represent no more than 0.3% of the total financial assets in the world.
- Regarding activity-based systemic risk, reinsurance is primarily about property, casualty and biometric risks. Those risks are not linked to the financial cycle and therefore traditional reinsurance activities are not subject to "bank-run" or risk of fire sales. Climate change does not either create systemic risk for the (re)insurance sector insofar as the related risks will fully materialize over the longer term, thus allowing (re)insurers to manage their exposure to transition risk and to adjust the pricing of their policies to the changing cost of risk in a timely manner.

- Regarding behaviour-based systemic risk, reinsurance activity covers in particular long tail risks and thus, from an Asset-Liability-Management perspective, reinsurers invest through the cycle and are not prone to herding behaviour.

With regards to captives, the following has to be considered:

- The nature of captives differs significantly from "standard" insurers writing a balanced portfolio of diversified risks in different Lines of Business covering a multitude of policyholders in the market.
- Captives usually write a limited number of Lines of Business, for risks which are linked to the industrial/financial group to which they belong, with stability with regard to the type of risks underwritten over time.
- Captives have limited or no own staff and rely heavily on outsourcing to external service providers or to the industrial/financial group to which they belong.
- Captives have a business strategy oriented to optimisation of insurable risk financing of the parent company and to find optimal reinsurance solutions.
- The business strategy of a captive does, usually, not pursue market share gain and keeps the business
- rather static across the years and therefore strategic risks tend to be close to zero.
- Captives tend to face decreasing probabilities of insolvency over time as profits are normally collected over time and redirected to capital.
- The static nature of the business allows to calculate the worst case in a deterministic way by adding up the limits of the underwritten contracts.

Based on these considerations, we believe that reinsurers and captives should be exempted from the new R&R provisions and IGS.

k. Ensure a sensitive approach to additional macroprudential tools

With its proposals on macroprudential supervisory tools, EIOPA creates a new and additional layer of regulatory provisions to the already complex Solvency II (Chapter 11 of the Advice). The tools can cause significant additional efforts for undertakings and, if at all, should be used in a very sensible manner. The wide-ranging impact of these tools can further deteriorate the international competitive position of EU insurers. As for the already mentioned pre-emptive recovery planning, adding layer on layer of regulation, explicitly or implicitly increases the capital and regulatory burden and, thereby, deviate from the fundamentals of the current Solvency II regime.

Maintaining fair competition and avoiding a disproportionate burden on insurers should be guiding principles for the potential implementation of additional macroprudential tools. Insurance Ireland believes that a sensible approach is an adaptation of the Holistic Framework for Systemic Risk of the International Association of Insurance Supervisors (IAIS)[16]. Unfortunately, EIOPA's proposals go beyond this framework, particularly with regards to the proposed capital surcharges (Chapter 11.1 of the Advice) and concentration thresholds (Chapter 11.3 of the Advice).

We are concerned about the lack of definition of the scope of the macroprudential tools. EIOPA leaves the application of the tools widely to NCAs. In line with our position on the pre-emptive recovery planning (see Chapter 2.j. of this paper), which EIOPA also includes among the macroprudential tools (Chapter 11.6 of the Advice), we believe that a very targeted and proportionate approach is necessary. Rather than focusing on the question "who to exempt?" from the provisions, we believe that the

[16] https://www.iaisweb.org/page/supervisory-material/financial-stability/file/87109/holistic-framework-for-systemic-risk

sensible question is rather “who must be included and to which extent?” to reach the objective to prevent market-wide disruption. Also in line with our position, we are suggesting changing the scope from a very nationalistic perspective to the Single Market perspective.

As already highlighted in Box 1 of this paper, we do not believe that the declaration of systemic crisis and effects should be left to the discretion of supervisory authorities. We understand and support that, if such measures are enforced, they need to apply consistently across the EU and not at national market level. The only exemption to this provision might be the new tools on concentration risk (Chapter 11.3. of the Advice), however, it will have to be proved that a shortfall in a national market cannot be compensated by the EU Single Market.

Also in Box 1 of this paper we highlighted the detrimental impact which the EIOPA statement on the ban of dividends and similar payments had on the EU insurance and capital markets. Therefore, we are very concerned about EIOPA’s proposal to introduce general powers to ban such payments (Chapter 11.2 of the Advice). We believe that the existing powers for supervisors to prohibit the distribution of these payments where they might impact the ability of an insurer to comply with its SCR as absolutely sufficient. Furthermore, we are convinced that only the application on a case-by-case basis and by assessing the individual capital and risk position of an undertaking should be the determining factor for a decision on prohibiting discretionary payments. Rather than the empowerment for market-wide action, EIOPA and NCAs should define common standards on how to assess insurers’ capital and risk positions in exceptional circumstances (like the Covid-19 crisis). Despite the general opposition towards the new measure, we noted that EIOPA exempted intra-group payments from its Advice on the new measure (para. 11.9 of the Advice). We consider this difference in comparison to the EIOPA statement as acknowledgment of the detrimental impact of this action and its fatal effect of the freedom of capital.

3. Conclusion

At a recent event held by Insurance Ireland on Solvency II, the aims of the review were described as optimising the regulatory framework. If this is the benchmark, there is significant room for improvement for the European Commission before presenting its legislative proposal in the second half of 2021.

Overall, the Advice is a missed opportunity to make the next step towards an integrated EU Single Market for insurance, consistent consumer protection and the competitiveness of the sector. The Advice does not show a clear path to reduce the regulatory and administrative burden or the complexity of the regime. If implemented, the Advice creates a significant challenge to the global competitiveness of the EU insurance industry and the heterogeneity of the internal market. It will also make it more difficult for new market entrants (e.g. InsurTechs) to grow their business across the Single Market. There is a strong need for the European Commission to step-up, remove existing barriers to the Single Market and ensure that the barriers proposed by EIOPA are not included in the future Solvency II framework.

In contrast to creating the crucial link between policy and technicality, EIOPA published an inconsistent set of proposals. In general, most of the suggested improvements are outweighed by additional requirements or are not going far enough by itself. Throughout the process, EIOPA explained that it takes “a balanced approach”. However, our view is that the improvement of a system or its optimisation must not identify a “balance” as its target.

Maintaining or even increasing the regulatory burden on insurers will create a significant push-back for the ability of insurers to facilitate economic recovery and the twin-transition towards a more

sustainable and digital EU Single Market. Based on an analysis conducted by the European insurance association, Insurance Europe, implementing the suggestions of EIOPA is expected to lead to increasing product prices by 8-16 bn Euros, 225 bn Euros less invested in equity (or 900 bn Euros less invested in private or corporate debt (BBB rated) or simply the withdrawal of certain products. In contrast, adjusting the calibrations in a sound and sensitive manner might lead to significant benefits for the economy and society – a Euro saved in capital might transform into 1.70 Euros in equity investments, 6 Euros in Green Bonds or 1000 Euros in windstorm coverage.

One of the core asks of the European Commission’s call for advice is the consistent application of the principle of proportionality across the EU. It is positive that EIOPA is drawing from a discussion paper which the Dutch and Irish insurance associations published in 2019 in its advice. The aim of the approach is to reduce the governance burden on the application of the principle by 1) identifying concrete tools for the proportionate application of Solvency II and 2) amend the application process for the use of the tools. The acknowledgment of this fundamental idea is a milestone. However, the criteria which EIOPA defines to determine if an undertaking can apply the tools are likely to create challenges. Even more importantly, EIOPA significantly undermines the integrity of the Single Market with defining that an insurer which is carrying-out its business across the Single Market poses a bigger risk than an insurer only active in a single Member State. Such an approach must not be expected.

With regards to the supervision of cross-border insurance, EIOPA suggests amendments which reflect the positive signals of EIOPA’s recent statement specifically on cross-border supervision. The idea of the identification of core information to be shared between National Competent Authorities (NCA), a first careful step to improve the governance of cooperation (platforms), is positive. EIOPA also repeats some of its positions which it already expressed during the review of its establishing regulation in 2018. While we support a mandate for EIOPA to intervene where NCAs fail to fulfil their tasks appropriately, some of its proposals remain to be harmful for the integration process, i.e. a materiality threshold for the information sharing and an empowerment allowing host NCAs to directly request information from insurers rather than using the prescribed process. Despite these improvements, Insurance Ireland believes that further improvements would have been possible. Particularly with regards to the function and governance of cross-border supervisory platforms. Transforming the platforms from ad-hoc to standing formats and formalising its governance would mean a substantial step for supervisory cooperation and coordination.

Closely linked to the further integration of the market are the proposals on R&R and Insurance Guarantee Schemes. EIOPA suggest a minimum harmonisation and a consistent approach on both aspects. The Irish insurance industry welcomes and supports these suggestions. With regards to the concrete proposals, it will be important that none of these measures are an opportunity to compromise fair competition in the EU Single Market needs.

In consequence, it will be on Co-legislators to take EIOPA’s opinion into account when delivering on a review which optimises the supervisory regime and allows insurers to play their role in the EU economy and society. A central element of this work will be to converge the technical piecemeal into a meaningful and consistent review to the benefit of the EU Single Market, its consumers and industry.

The Irish insurance industry stands ready to support this process.

Brussels/Dublin, February 2021

ANNEX I: Practical tools for the proportionate application of Solvency II

The definition of a concrete set of tools for the proportionate application of Solvency II can be an essential driver for the consistent application of the principle of proportionality across EU Member States. The tools should form a toolbox covering all three pillars of Solvency II. A first set of measures should at least comprise the following:

Proportionality Measures	Pre-defined criteria for automatic application	Further description & thresholds
Pillar 1		
Conservative estimation or simple update for sub-modules	**By default for all companies**	
Simplified Standard Formula Use of simplified standard formula allowed	**By default for all companies**	Optional without preconditional for all, because it leads to a higher capital requirement anyway.
Simplified calculations of technical provisions - Quarterly calculations: allow simplified update - allow greater aggregation regarding the granularity of technical cash flows: Allow use of the same external model, for example, an Economic Scenario Generator (ESG), across multiple companies by having supervisor validate it once	**LRU status** or **no material change in risk profile**	
Simplified calculation of own funds: - Amounts recoverable from insurance: no adjustment for the expected default of the reinsurer Deferred taxes: possibility to use IFRS approach, simplifications should be explicitly allowed	**LRU status**	
Pillar 2		
ORSA - three-year frequency; synchronized with RSR - simplified ORSA template (such as the simplified template developed by the Bank of Ireland) - no appropriateness assessment of standard formula in the ORSA Use of last valuation (quarter or annual, instead of full recalculation) for non-material component in the ORSA	**LRU status or** **no material change in risk profile**	
Key Functions - Combination of several key functions	**tailor made assessment; reverse burden of proof**	

- Key function holders can hold the responsibility for several entities Risk management: only periodic (every three years) re-evaluation of non-material		
Actuarial key function not required	**Non-Life +** - **Contracts not longer than 4 years + not liability insurance**	
Regular Review of the Governance System Depth and recurrence of the regular review of the governance system tailored to the risk exposure of the business	**LRU status**	
Written policies - Simplified or standardised written policies - No minimum content Review every three years is sufficient (currently annual review necessary)	**LRU status**	
Administrative, management or supervisory body (AMSB) - Regular assessment on the adequacy of the composition, effectiveness and internal governance of the AMBS considering proportionality	**LRU status**	
Remuneration No time-shifted pay outs necessary	**Non-material scale and share of variable remuneration:** Variable renumeration less than 50.000 EUR and less than 1/3 of total annual renumeration	This proposal originates differs from EIOPA's first draft of the advice. This measure should not be limited to LRU for automatic application.
Pillar 3		
RSR - three-year frequency; synchronized with ORSA - Simplified scenario analysis section should be filled only when significant changes	**LRU status or** **SCR 100% plus 1.5 times maximum volatility**	
External audits No application of the external audit of solvency II disclosure	**LRU status**	
SFCR One report – one addressee: The SFCR should be divided into a short report for policyholders ("Two-Pager") and a separate, purely quantitative report for the professional public.	**By default, for all companies**	The SFCR in its current form, addressing user groups with completely differing requirements at the same time, is not expedient. We propose to follow the EIOPA's draft proposal to split the SFCR into a concise, easily understandable narrative report

		for policyholders (so called "Two-Pager") and a purely quantitative report for the professional public containing only relevant data. These data should only be based on the already published QRT. The publication of additional quantitative data as well as a narrative explanation should not be required, as the professional public possesses the necessary expert knowledge to draw relevant information directly from raw data
SFCR Professional SFCR only if insurer has issued financial instruments on capital markets (equity or fixed income)	**Mutual insurance companies that have not issued equity or bonds**	Mutuals typically do not do that. If they lend money from a bank, the bank can ask for any information it wants; the same goes if the mutual insurer takes out reinsurance. Also, if a distributor wants the information, he can ask the insurer. In all these cases it is not proportionate to require this information as a standard. Although we do not know yet what should be in the policyholder SFCR exactly, we do not want any exceptions to this obligation.
SFCR Consumer-focused SFCR only if the captive or reinsurer has direct consumer exposure	**Captives and Reinsurance Undertakings**	Captives and Reinsurers serve professional clients or counterparts belonging to the same group. Insurance solutions provided by captives and reinsurers are usually not "off-the-shelf" and are tailored solutions – based on individual negotiations of professional counterparts.
QRT Reporting no quarterly and annual QRTs required	**LRU status**	
Horizontal		
Across all three pillars Use of simplified results, proxies or extrapolation methods for the accumulation at group level	**LRU status or other eligibility** **&** **Non-material part of the group (≤ 3% of total gwp) AND accumulated share of all LRU/eligible entities non-material (≤ 10 % of gwp)**	

ANNEX II: Defining low-risk undertakings

Risk-based criteria	Thresholds	Description
1. Solvency Situation (= solvency ratio minus maximum of volatility of the SCR)	100% + 1.5 maximal volatility of SCR	Significant level of confidence that the SCR is over 100% over the next 5 years, also in cases of severe economic crisis.
2. Capitalization (= ratio of eligible own funds to balance sheet total)	20%	Eligible own funds divided by balance sheet total.
3. Systemic relevance (= balance sheet total)	<12 billion balance sheet total	Source: IAIS definition of internationally active insurance groups.
4. Internal model to calculate SCR	No use of internal models	The use of internal models should require undertakings to review the tools separately, rather than through the default approach of the LRU category.
5. Weight of risky products on total company's business (= marginal share of liability business)	30% marginal share	