Solvency II Review

Key asks ahead of the trilogues

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1 Introduction

Insurance Ireland welcomes the review of the prudential supervisory framework for insurance and reinsurance undertakings, Solvency II (hereafter: the Solvency II Review). The application of Solvency II in 2016 was a milestone. Solvency II presents the gold-standard worldwide in terms of prudential regulation.

Solvency II is a trademark for the EU insurance industry and a signal of trust globally. However, the discussions at international level on International Capital Standard (ICS)1 highlighted little or no appetite by other jurisdictions to follow the EU example to the extent of Solvency II. The result is that Solvency II, in its current form, creates a substantial competitive disadvantage for EU insurers, i.e., by the disproportionate capital requirements due to the risk margin.

The Solvency II Review is an opportunity to further integrate the Single Market for insurance. Particularly for Ireland, further integration would have a very positive impact. Removing barriers to cross-border service provision would enable Irish insurers to provide services to consumers and businesses in a more efficient manner across the Single Market. For Irish businesses and consumers, removing regulatory and administrative barriers can also result in more competition and consumer choice, potentially even attracting insurers to cover currently unserved market segments.

Unfortunately, the European Commission (EC) missed the opportunity to present proposals for the further integration of the Single Market. Instead, the EC condemns cross-border business in the Single Market as particularly risky, fortifying or even increasing regulatory and administrative barriers. Furthermore, the EC strengthened national discretions and a national market-focused approach.[2]

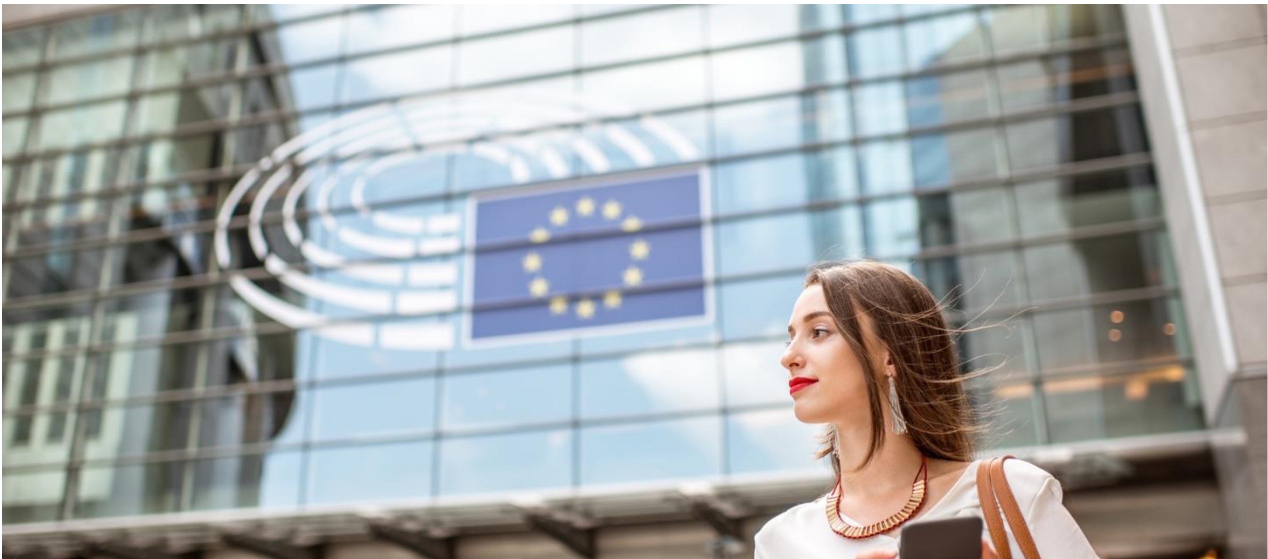
The EC linked great ambitions on the transition towards a more digital and sustainable future as well as the development of European capital markets to the Solvency II Review. The Irish insurance industry supports these ambitions. However, there seems to be a fundamental misunderstanding about the way to fully embrace the capacity of the industry. In its communications, the EC emphasised how it helps the industry to make substantial investments in the next years. While there is no doubt that some of the amendments will have that impact, it needs to be noted that the EC is only addressing existing flaws of the overly complex and

[1] Currently, the International Association of Insurance Supervisors (IAIS) tests the standards. More information can be found *here*.
[2] The European Commission proposals on a Insurance Recovery and Resolution Directive is even more extensive in this respect.

burdensome Solvency II. *"Rebalancing"* these necessary adjustments with other more onerous amendments will undermine the positive nature of the proposals.

Finally, it will be important to address the overall regulatory burden of Solvency II. While the EC's ambitions targeted to balance capital requirements over time, they ignored the impact of the overall significantly increasing regulatory burden. In this regard, the EC presented valuable proposals on a more proportionate application of Solvency II, i.e. for undertakings qualifying for a new low-risk class and captives, but did not consequently follow through with an overall reduction of the regulatory and administrative burden linked to the complexity of Solvency II.

The European Parliament and the Council made considerable efforts to amend the EC proposal in a meaningful and targeted manner. However, the resulting European Parliament Report (hereafter: ***the EP Report***) and the Council General Approach (hereafter: ***the CGA***) only address the flaws of the EC's proposal insufficiently. In this paper we will exlore the different positions on the table ahead of the inter-institutional negotiations *("trilogues"*) and define suggestions from the perspective of the Irish insurance industry.



2 Key asks of the Irish Insurance Industry

Overall, the Solvency II Review positions ahead of the trilogue (EP Report, EC proposal and CGA) do not live-up to the ambitions with which the process started. The proposed changes to the Solvency II Directive do not reduce the regulatory burden and even plans to limit its overall increase are not followed through. The competitive position of EU insurers globally is eroding if legislators can not deliver an outcome of the review which substantially reduces the regulatory requirements, both in capital and administration, and a further integration of the EU Single Market. Increasing barriers in the Single Market might protect national interest in the short term but will harm consumers, businesses and the insurance industry.

With regards to the upcoming trilogues, Insurance Ireland hopes that the EC and the Council re-evaluate their positions which had been established in September 2021 and June 2022 respectively and consider a greater push for a more competitive and more integrated European market for insurance to the benefit of businesses and consumers. Without a strong and competitive EU market, the aims of the open strategic autonomy cannot be achieved.

For the Irish insurance industry, the following 5 key aspects need to be addressed:

1. Include competition across the Single Market and the competitiveness of the EU insurance market globally in the objectives of Solvency II;
2. Ensure a targeted definition of *“significant cross-border activities”*, not a catch-all, exclude reinsurers, and establish digital supervisory platforms;
3. Reduce capital requirements in a meaningful way by reducing the risk margin by, at least, 50%;
4. Confirm the LRPU concept and acknowledge the captive business model;
5. Ensure a net-reduction of the regulatory burden at the end of the process and across all regulatory levels.

Insurance Ireland is strongly committed to supporting the improvement of Solvency II and stands ready to support.

3 The Priorities in Detail

3.1 Make competition an objective of Solvency II

Solvency II is the international gold-standard of prudential supervision of insurers worldwide. As such, the regime is a trademark for the EU insurance industry. It signals trust and certainty to consumers and investors. At the same time, Solvency II is the most complex and prudent regulatory regime. The currently tested ICS confirmed that there is only little or no willingness from the international regulatory community to follow the EU example all the way through to the Solvency II standards. As a result, the EU is very likely to diverge substantially from the future international standards, i.e. on capital requirements.

Notwithstanding the general impact of the overly complex and prudent design of the regime, the more onerous requirements of Solvency II lead to a competitive disadvantage for EU insurers at global level. An EU insurance industry which is able to compete at a global level is essential for both the success of the whole insurance industry and avoiding strategic dependency on external economies.

The credibility of the regime and a consistent consumer protection need to be maintained. Instead of benchmarking the EU against Asian or US standards, Insurance Ireland strongly supports a meaningful review of the standards to address the identified issues hereunder. In addition, Insurance Ireland believes that the competitiveness of the EU insurance sector needs to be considered when implementing and applying Solvency II.

Therefore, the Irish insurance industry suggests adding the competitiveness of the EU insurance sector to the objectives of Solvency II. Without prejudice to the main objectives of supervision and consumer protection as set out in the current Article 27 of Solvency II and the provisions to maintain financial stability, as set out in the current Article 28, Member States should ensure that, in the exercise of their general duties, National Competent Authorities (NCAs) shall have a duty to consider the potential impact of their decisions on the competitiveness of the EU insurance and reinsurance undertakings in the global market and fair competition across the Single Market.

MEPs said strong signs to enhance the competitiveness of EU insurers and remove regulatory barriers due to Solvency II. However, crucial elements of these proposal, like the amendment to Art. 28 to make competition a secondary objective of Solvency II were not adopted in the final EP Report. Nonetheless, the EP Report includes Recitals 5a and 5b supporting the proper functioning of the internal market and the competitiveness of the industry.

Further, Insurance Ireland considers the efforts by MEPs to adjust capital requirements and provide for an effective application of the proportionality principle as positively impacting the competitiveness of the EU insurance industry.

Overall, both the EP Report and CGA leave room for improvement to avoid the further erosion of the competitiveness of the EU insurance industry at global level and competition within the EU Single Market. Insurance Ireland suggests that the Council and the EC should re-evaluate its positions which they established in a different economic environment and focus on aspects impacting competition in the Single Market and the competitiveness of EU insurers globally.

3.2 Remove barriers to the Single Market

Further integration of the Single Market for insurance industry should be the main objective of this review. Regulatory and supervisory consistency and convergence form the basis of this integration process. Unfortunately, the EC's proposals are very limited in this regard and, where such proposals exist (e.g., on proportionality), the EC creates new and artificial barriers to the Single Market.

A specific area in this regard is the cross-border provision of services. In 2019, cross-border businesses in the EEA represented 11 % (173 bn Euros) of the overall gross-written premiums. The share of business conducted across the Single Market has increased steadily.[3]

Solvency II created the prudential regulatory framework for this development and enhanced consistent consumer protection across the EU. 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, Insurance Ireland believes that some of the cases, among the limited number of failures of undertakings operating under business models relying on the freedom to provide services and the freedom of establishment (FoS/FoE), 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 developments 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.

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

Assessing (near) failures in the EU insurance market since the application of Solvency II hints that some areas of cross-border business are a source for problems – medium-sized undertakings, operating out of specific jurisdictions and mainly targeting foreign national markets. The current Solvency II regime provides for two layers which proved to be strong, namely the group supervisory system and the (domestic) entity-based supervision. While the vast majority of FoS/FoE business across the EU is prudently supervised, there seems to be room for cases undermining the overall integrity of the market.

To address these challenges consistently, Insurance Ireland suggests implementing an additional layer formalising supervisory collaboration. The basis for the coordination of NCAs in cross-border supervision is a decision by EIOPA.[4] This decision and its annex provide for detailed procedures and practices for the supervision and collaboration of NCAs. In addition, the review of the regulation establishing EIOPA in 2019, led to changes to the Solvency II Directive introducing collaboration platforms. However, these platforms are only established if a negative impact is already anticipated.

Insurance Ireland suggests bringing these two elements together to further formalise and regularise supervisory convergence. The first step should be to digitalise platforms and create supervisory hubs accessible for all concerned NCAs under the administration of EIOPA and the lead of the NCA of the home Member State of the insurer. These hubs or digital supervisory platforms should be used for the regular provision of supervisory information (a) on the prudential supervision from the NCA of the home Member State; and (b) market and conduct supervision from the NCAs of the host Member States. Thereby, the transparency for NCAs from home and host Member States is substantially increased. In addition, additional information (pro-actively shared by NCAs or requested) can be shared through the platforms and to the attention of all concerned NCAs.

The new measures, proposed by the EC, like joined onsite inspections or individual requests could also be coordinated through these platforms to minimise the additional regulatory and administrative burden. Overall, this platform-based supervision should be proportionate to the nature, scale, and complexity of the risk inherent in the insurer's business. The consequences should be (a) the increase of transparency by facilitating the exchange between NCAs; and (b) the provision of regular available supervisory information.

With a more consistent approach to cross-border supervision and supervisory collaboration, Insurance Ireland believes that the stigmatisation of cross-border business as particularly risky should also be avoided.

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[4] *EIOPA BoS Decision on the Collaboration of the Insurance Supervisory Authorities of the Member States of the European Union, EIOPA-BoS-234, 10th June 2021*.

In order to make these changes, the new Article 33a should be amended to introduce the supervisory platforms as a standing mechanism for all cross-border operations. The EC and EIOPA should be mandated with identifying the necessary provisions of the EIOPA Decision which need to be further strengthened in the form of a delegated act to facilitate the operation of the platforms. The EIOPA should further identify which regularly available information should be shared through the platforms (prudential and market/conduct). In addition, EIOPA should be empowered to take action in cases where NCAs (home and host) do not fulfil their responsibilities with regards to the operation of the platforms. The proposed 5% threshold for the identification of "significant" cross-border business should be removed and replaced by a general provision emphasising a supervision proportionate to the nature, scale and complexity of risks inherent in the insurer's business. The 5% threshold sets a subjective hurdle as it is highly dependent on the size of the domestic market from which the insurer is exporting. An insurer passporting 5% of its business from a big Member State into a small Member State, like Ireland, can have a substantial impact in that market.

Finally, the existing and potential future provisions should be amended to create these platforms as exchange vehicles. The platforms should not only facilitate the exchange of information for the purpose of the Solvency II Directive, but also with regards to the future Insurance Recovery and Resolution Directive (IRRD).

The discussions among MEPs showed the particular interest of some Member States and their representatives to restrict cross-border service provision in the EU Single Market. At the same time, some MEPs stood-up to promote the Single Market and enhance its integration to the benefit of consumers and businesses. Despite the great ambitions expressed in Recital 5a, the proposed restrictive measures increase the regulatory burden for most, if not all, cross-border business have been maintained. What is determined as *"significant cross-border activities"* is catching nearly all such activity and exposing it to a higher burden. The definition established in the EP Report still reflects the positive intention by some. The EP Report states that cross-border activities are considered *"significant"* where the business of an insurers in a specific Member State exceeds 15% of the total business of the undertaking or 30 Million Euros of gross-written premiums (gwp) (Art. 13 (b) (10aa) of the EP Report). Insurance Ireland considers the first threshold as very valuable and huge improvement compared to the EC proposal (more than 5% of the business conducted cross-border, Art. 33 (3) (a(and Art. 159 (1) (a)) and the Council (more than 15 Million Euros gwp from cross-border or as per the host NCAs decision, Art. 33 (3) (a)). The second criterion established in the EP Report (30 Million Euros gwp in a host Member State) is inappropriate as it does neither reflect the risk inherent in the business nor its importance for the undertaking or the host market.

With a view to the trilogues, Insurance Ireland supports a combination of the positions established by the European Parliament and the Council avoiding the absolute trigger. In its opinion, the 15 % share of business conducted in a specific host market works well as

means of determining the importance for the undertaking. Insurance Ireland further suggest using the supervisory mandate given to the host NCA as per Article 33 (3) (b) of the CGA. The Council proposes to give mandate to EIOPA to ensure that uniform conditions are applied across Member States, which Insurance Ireland also supports. With regards to the further process subparagraphs 3 and 4 of Article 33 (3) (b) Insurance Ireland believes that the final decision should be taken by the responsible NCA (home NCA) to ensure sufficient safeguards. Where the host NCA does not agree with the home NCAs decision, EIOPA should be empowered to settle the disagreement.

In summary: *"significant cross-border activities"* should be determined as situations where the gwp underwritten in a specific host member State represents more than 15% of the total gwp of the insurer or where NCAs determine that the activities are *"significant"*. EIOPA should provide guidance for a uniform application. Host NCAs should have the power to request from home NCAs that the activities are determined *"significant"*. Where the home NCA and the host NCA disagree, EIOPA should be mandated to settle.

Overall, Insurance Ireland is concerned that the definition includes reinsurance undertakings. The nature of the reinsurance business is, per se, international and across-borders. The wider diversification of risk is one of the fundamental functions of the reinsurance business. Furthermore, reinsurers do not have an immediate consumer contact and, therefore, do not pose immediate consumer risk. Reinsurers as well as captive insurers and reinsurers should be automatically excluded from the definition. This flaw should be corrected in the interinstitutional negotiations.

Insurance Ireland considers it very positive that the EP Report introduces the concept of digital supervisory platforms to enhance transparency and accountability for supervisory processes and to limit the necessity for the use of the very burdensome ad-hoc measures which are triggered by the determination of an undertaking to carry-out *"significant cross-border activities"* (Recital 57 Article 152b of the EP Report). The CGA does not foresee such improvements to the collaboration platforms existing at the moment and Insurance Ireland strongly suggests following the EP in this regard. The digital supervisory platforms can substantially enhance supervisory collaboration in an effective and efficient manner, creating economies of scale for all involved NCAs and limit the need for additional requests. The mandate which the EP Report proposes to be given to EIOPA to oversee the operation of the platforms is considered and important and positive measure to ensure their functioning and uniform conditions.

Finally, Insurance Ireland highlights the emphasis which the EP gives to the fact that NCA collaboration is a two-way process. The EC proposal and the CGA solely focus on the home NCAs' duties to share information. The reciprocity that also the host NCAs shares all relevant information is extremely important as market information and important

developments close to the customer can enhance supervisory processes for home NCAs and can help the collaboration with the supervised undertaking.

3.3 Reduce the excessive risk margin

The risk margin is not determined at the level of the Solvency II Directive, but only in the Delegated Act. Therefore, the EC's intentions to amend the risk margin are only included in the Communications accompanying the proposal for a directive (pages 6-7). The EC defines the proposed changes to the risk margin as one of the central elements relieving the insurance industry of undue capital requirements. However, the positive impact of the risk margin proposal will be deprived by the additional capital requirements which the proposed amendments to the extrapolation methodology and the interest rate risk sub-module will trigger. In this regard, the risk margin is of even greater importance for the Irish market as most of the other measures balance the negative impact of the proposed amendments to the extrapolation methodology and the interest rate risk sub-module do only have limited impact on the Irish market (Volatility Adjustment) or no impact at all (Matching Adjustment).

If the package of measures is implemented as proposed by the EC, the likely impact on the Irish market is overall negative. Instead of addressing flaws consistently and freeing-up the capacity of the insurance industry to contribute to the sustainable and digital transformation of the EU, the capacity of Irish insurers would be further restricted. In addition, the different application of the proposed measures across Member States can create a competitive disadvantage for Ireland compared to other Member States. Due to the substantive impact and the very political nature of the topic, the EC should present draft Delegated Acts to the Co-legislators to allow for a fully reflected debate.

The EC's Communication widely follows the EIOPA's Advice to introduce a reviewed methodology to calculate the risk margin. In its 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%. In its Communication, the EC states that it will adopt a λ-parameter, but a floor is not mentioned. Furthermore, the EC reduces the rate for the Cost-of-Capital (CoC) from 6% to 5%. These two changes would have a positive impact reducing the excessive calibration of the risk margin substantially. However, the result is not sufficient. Insurance Ireland believes that, notwithstanding the used methodology, the recalibration of the risk margin should reduce its level by, at least, 50%.

A joined industry group delivered the following suggestion to address the three fundamental flaws of the existing risk margin methodology as well as EIOPA's proposal.

Derivation of CoC rate

There are a number of flaws in EIOPA's derivation of the CoC rate which means 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 CoC 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 shortcomings, the CoC 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 itself 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 it is also due to the high level of the floor of 0.5, which particularly impacts long-dated portfolios. The high λ-parameter and floor also limit the effectiveness of the λ-parameter to reduce inappropriate balance sheet volatility. For example, the insurance industry estimates 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 λ-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 addresses 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.

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.

Background on the 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 cases 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 CoC rate of 6%.

The risk margin has a very significant impact on the overall 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 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.

Insurance Ireland greatly appreciates that MEPs lifted this discussion to the political debate. The political and strategic dimension of the decision on determining the risk margin should not be left to the purely technical level. Insurance Ireland appreciated the EC's communication announcing that it aims to reduce the risk margin. However, these changes were far from being sufficient. The Council made no improvements. In addition to addressing the risk margin in the political process, the EP Report also makes substantial improvements to the determination of the risk margin. While the EP confirms the new structure of the calculation of a CoC and a λ-parameter. The EP also sets a positive sign by reducing the CoC at 4.5% and including the concept of the time-dependent λ-parameter in the Directive. The EP position should be confirmed in the trilogue.

To ensure that the reduction of the risk margin addresses the existing flaws of the risk margin the be e λ-parameter should be set at 0.925 at maximum.

3.4 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. It isa central element of the Solvency II framework, too. Earlier assessments by EIOPA and the industry showed that 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.

Insurance Ireland greatly appreciates that the EC picked-up on the ideas presented jointly by the Dutch and Irish insurance industries in 2019 suggesting the determination of Low-Risk Profile Undertakings (LRPU), and a predefined set of proportionality measures which these LRPUs can apply by default. The Irish insurance industry also strongly supports the ECs proposals recognising the specific nature of captive insurers and reinsurers in this respect.

With regards to the creation of the LRPU category, Insurance Ireland supports the majority of the suggested criteria. The main concern is the provision that a LRPU can conduct a maximum of 5% of its business cross-border. This provision unduly stigmatises cross-border business as riskier than covering the same risks at domestic level. However, the risk which

a customer presents is not dependent on the location of the headquarter of the insurer covering it.

The main difference is the competent authority in charge. Thereby, it may be assumed by the EC (and EIOPA, which suggested this criterion) that an NCA does not appropriately carry-out its supervisory duties if a customer is not resident in its own jurisdiction. While the EIOPA report might present evidence for limited quality of cross-border supervision for a few NCAs, the majority of NCAs carry out its duties consistently. The target should be the consistency of supervision across the EU and not penalising business which is conducted across the Single Market. Preventing insurers which carry out their business across the Single Market from qualifying as LRPU contradicts the objective of consistent and convergent regulation. Therefore, the criterion should be deleted (i.e., Articles 29a and 213a).

The second provision, which Insurance Ireland considers necessary to be reviewed is the reference to (partial) internal models. Undertakings fulfilling all LRPU criteria but use (partial) internal models are excluded from the LRPU category. While this is understandable for the application of proportionality measures which allow for diversion from standard formula calculations, it is not clear for the governance aspects of the proportionality measures. It should be clarified that undertakings using (partial) internal models can qualify as LRPU and use the proposed proportionality measures where they do not apply to areas covered by a (partial) internal model. It should be further clarified that undertakings which are part of a group which uses (partial) internal models should qualify for the full LRPU package if the specific undertaking does not make use of the (partial) internal model of the group.

Insurance Ireland believes that the EC proposals need to provide for an appropriate sensitivity for LRPUs with regards to the consolidation at group level. Where an LRPU is part of a group, which does not qualify as a low-risk group in line with Article 213a, and the impact of the LRPU or the consolidated impact of all LRPUs of that group is not significant, the proportionality measures should be recognised and safeguarded for the consolidation at group level.

With regards to the specific measures which LRPUs are allowed to apply automatically, Insurance Ireland supports the EC that the measures provided in the Solvency II proposals are a non-exhaustive list which should be further developed. Insurance Ireland also agrees that EIOPA should be mandated to develop such further tools.

Insurance Ireland would like to highlight two specific measures on the proportionate application of Solvency II: firstly, the exemption from quarterly reporting as per Article 35 and; secondly the use of the simplified calculations as per Article 109.

On the Article 35 exemption from quarterly reporting, the EC proposes to maintain the existing national discretion for exempting up to 20% of a national market from the quarterly reporting obligations. The amendments which the EC proposes suggest that LRPU should

be prioritised when applying the exemption. Insurance Ireland is of the strong opinion that quarterly reporting should only apply where nature, scale, and complexity of the risks inherent in an insurer's business require it and not the where the structure or size of the national market determine the scope for the provision. Insurance Ireland agrees that LRPUs should be exempted from the quarterly reporting requirements, however, based on their identification as LRPU as such. Article 35 should be amended accordingly. In addition, EIOPA found that the application of the exemptions is highly inconsistent across Member States, thereby, not contributing to regulatory convergence across the EU.

On the use of the simplified standard formula in accordance with Article 109, Insurance Ireland supports the measure allowing to use simplified methods for calculations of non-material risk (sub) modules. Insurance Ireland considers the proposal as a first step into the right direction. The respective Article 109 Solvency II and Article 88 of the according Delegated Act provide that an undertaking can use the simplified standard formula, given that the NCA approves its use.

Insurance Ireland believes that the simplified standard formula should be available more widely to ensure a proportionate application of Solvency II. It should be noted that the simplified method does not lead to a lower Solvency Capital Requirement (SCR) – rather than the opposite. However, using the simplified standard formula can substantially reduce the regulatory burden.

The EC proposal picks-up EIOPA's suggestion with regards to immaterial risk (sub) modules. Insurance Ireland supports this proposal, particularly as the application of the simplified method is linked to the criteria rather than *"just"* under the discretion of NCAs. However, the simplified standard formula should be available to undertakings more regularly, particularly for LRPUs, and the burden of proof should be reverted to the supervisor.

Insurance Ireland greatly appreciates that the EP, the Council and the EC followed its suggestion to enhance the consistency of the proportionate application of Solvency II by introducing the LRPU concept. The inclusion of a proportionality by default mechanism can substantially reduce the regulatory burden for undertakings with low risks and provide guidance for all other market participants which do not qualify for the category automatically.

With regards to the specific criteria laid down in Article 29a-29d and 213a, Insurance Ireland believes that the EP Report provides for the more comprehensive approach which should be favoured. Unfortunately, the overly broad definition of *"significant cross-border activities"* (see above) exclude an excessive number of low-risk undertakings from the LRPU category. A correction of the definition of *"significant cross-border activities"* (Art. 1 (10aa) EP Report and Art. 33 (3) (a) CGA Approach) would also address this problem.

Insurance Ireland greatly welcomes that captive insurers and reinsurers are considered LRPU by default in the EP Report (Art. 29a (1a)). The simplification compared to EC proposal and the Council GA increases proportionality and reduces the regulatory burden.

3.5 Ensure a net-reduction of the regulatory burden

3.5.1 Refine group supervision and recognise intra-group governance

Minimum consolidated group solvency capital requirement

In its proposal for the Solvency II Review, the EC proposed amendments to Article 230 Solvency II regarding the calculation of the minimum consolidated group solvency capital requirements. The amendments would prevent an existing problem that the group minimum capital requirement would be triggered before its solvency capital requirement is breached – thereby an inversion of the triggers for supervisory intervention. Insurance Ireland supports these amendments.

With regards to the specific wording of the new paragraphs 2 and 3 of Article 230 Solvency II, further clarification is necessary. The currently proposed wording might indicate that the *"false"* or *"old"* minimum SCR should still apply in addition to the adjusted and accurate minimum consolidated group solvency capital requirement.

Insurance Ireland believes that the determination of a proper group Minimum Capital Requirement (MCR), similar to the MCR at solo entity level should be defined encompassing the full scope of undertakings in the group (including non-EEA entities and holding entities).

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, Insurance Ireland agrees 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, which belongs to the 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 within the 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.

To ensure that the Solvency II provisions on outsourcing arrangements are applied proportionately to the limited risks and higher control in an intra-group set-up, Article 49 Solvency II should be amended to emphasise the necessity of a proportionate and differentiated approach between intra-group and external outsourcing. Article 38 should accordingly include the proportionate supervision of outsourced activities in an intra-group context.

The aspect of intra-group outsourcing is not considered in the review and should be included for further considerations after the conclusion of this process.

Regarding the determination of a group MCR in addition to the group SCR. The EC suggests that the currently existing group SCR and consolidated group SCR (which replaces a group MCR) would be amended to include a proper group MCR (Article 230). The proposal can ensure that the currently existing risk that this *"MCR"* exceeds the SCR for groups. The EP Report supports the EC proposal and does not make amendments to the text while the Council GA removes this positive adjustment. AT the same time, the Council GA recognises the issue of double counting. A combination of the EP/EC position and the Council GA should be considered as way ahead.

3.5.2 Ensure reporting & disclosure requirements fit for purpose

The EC proposes to split the Solvency and Financial Condition Report (SFCR) into a policyholder and beneficiary part and a professional user part Insurance Ireland appreciates the proposal as it will allow for a more targeted communication with the respective groups. It will further allow for a differentiation in the duties to present the respective parts of the

SFCR which are reflected in the proposed waiver for captives and reinsurers or the group SFCR.

The part addressed to policyholders and beneficiaries of the SFCR proposal seems to be reasonable and Insurance Ireland strongly supports that reinsurers and captives are excluded from the requirement to provide for that part of the SFCR. However, the current proposal of the respective Article 51 (5) is too vague with regards to reinsurers. The respective *“may not”* requirements should be changed to a *“shall not”* requirements to ensure a consistent application across the Single Market.

In contrast to this consumer-oriented part of the SFCR, the part focused on professional users leaves considerable room for improvement. Insurance Ireland strongly believes 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 Regular Supervisory Report (RSR) and the SFCR.

Insurance Ireland also has strong concerns with regards the proposal of a minimum audit of the SFCR. 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. Insurance Ireland believes that, instead of making this costly exercise a European mechanism, the EC 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.

The EC presents positive proposals to amend the requirements for the RSR. The EC picks-up on a clarification suggested by EIOPA that the RSR requirements should apply proportionately and allow NCAs to (only) require the report when necessary. The suggested minimum frequency of the RSR submission of 3 years seems reasonable. The suggestions towards a convergent minimum content and the aims to reduce the content of the RSR to material changes and minimise the duplications with the Own Risk and Solvency Assessment (ORSA) are also very welcomed.

Another positive change is the proposal of a single group RSR. While the provision of a single group RSR is greatly appreciated, Insurance Ireland is concerned that the governance requirements proposed to allow for the issuance of a single RSR is disproportionately 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.

Insurance Ireland sees its previously voiced concerns justified that substantial parts of the amendments to the reporting and disclosure requirements will be excluded from the review by Co-legislators and, instead, be carried forward by EIOPA (and the EC) in a pre-emptive and exclusive manner through amendments to the underlying Implementing Technical Standard (ITS). The already published ITS on reporting and disclosures bypassed Co-legislators and increase complexity and the overall regulatory burden resulting from Solvency II.

At level of the Solvency II Directive certain improvements have been proposed, i.e., with regards to reporting deadlines, or the split of the SFCR and the opportunity for the single RSR at group level. These proposals will need further work, e.g., as the reporting deadline for quarterly reporting has been left-out of the EC proposal or with regards to the content of the two parts of the SFCR.

Insurance Ireland would also like to highlight the existing methodology for the exemption of insurers from Article 35 quarterly reporting. The provision that 20% of the market can be excluded let to a highly inconsistent application across the Single Market. Insurance Ireland believes that the quarterly reporting requirement is subject to the general proportionate application of Solvency II, particularly with regards to low-risk undertakings.

Insurance Ireland welcomes the efforts which EIOPA makes in suggesting changes to the existing reporting and disclosure requirements (R&D) under Solvency II in order to reduce the regulatory burden. Insurance Ireland further appreciates 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 small and medium-sized insurers. Therefore, it is of utmost importance that the proposed changes are meaningful and justified, reduce the regulatory burden, and are sustainably applied.

Other proposals, like the one that internal module users should report standard formula are very concerning and should be avoided.

Despite the great ambitions announced with the publication of the proposal by the EC and during the negotiations in the EP and the Council, the impact of the changes are very limited. The envisaged reduction of the regulatory burden were not put to paper. Aspects like the external audit requirement for the SFCR or the excessive narrative part for the *"professional"* part of the SFCR are still existing. Against the background that the overall reporting burden for undertakings excessively increases, the overall assessment is

disappointing. Unfortunately, this is fully reflected in the reviewed Implementing Technical Standards (ITS) determining the QRTs.

The EP Report further strengthens national empowerments under Article 35 which would further enhance the inconsistency of the application of Solvency II.

3.5.3 Internal Models and standard formula reporting

The EC follows EIOPA's proposal that users of internal models should be required to report results of Solvency II standard formula calculation. 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 NCAs and the governance structure around the application of internal models ensures the consistency of this approach. The reporting of information generated through the use of an internal model should provide more precise information of an insurer than the use of the standard formula. The proposed amendment to Article 112 Solvency II should not be put forward.

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.

The EP Report proposes to delete the potential new provision requiring undertaking which use internal models to report standard formula results (Art. 112 of the EC proposal and the Council GA). Insurance Ireland strongly supports the EP's position.

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