

# AMICE Response to EIOPAs Consultation Paper on Valuation of Technical Provisions

## INTRODUCTION

### 1. General comments

We support the objective of the guidelines to improve implementation and ensure a convergent application of the Directive and Delegated Regulation. However, the proposed amendments should not be used to tighten the provisions laid down in the Solvency II Directive and the Delegated Regulation.

The key issues are summarised below:

#### Expert judgement

It is not proportionate to request the application of the guidelines on internal models to the calculation of the best estimate of technical provisions. This would lead to an undue complexity as it refers to guidelines which are not directly applicable for not users of internal models. Therefore, there is a need to review whether the guidelines on expert judgement for internal models are fully applicable to the best estimate calculation.

#### Investment management expenses

We disagree with the proposed new guideline as it is not in line with the related articles of the Solvency II Directive and Delegated Acts. The investment management expenses should be taken into account only to the extent the insurance and reinsurance contracts require to settle and serve the insurance and reinsurance obligations over the lifetime.

#### Use of stochastic valuation

The EIOPA's requirement to use stochastic calculation for contracts '*whose cash flows depend on future event and developments*' should be softened so that it is justified also against the materiality towards the customer end protection, i.e. whether there would be a material impact on the undertaking's solvency position if stochastic calculation is not used.

#### Transitional period

Due to the significant number of proposed changes and the impact that they may have on insurance firms, some implementation time is needed when introducing new guidelines or amendments to existing guidelines. A transitional period should be looked at against the average needed time for implementation.

## GUIDELINES

### *Expert judgement*

#### **2. Guideline 24a (NEW) - Materiality in assumptions setting**

We appreciate the introduction of this guideline on materiality; however, it is not proportionate to request the application of the guidelines on internal models for the calculation of the best estimate of technical provisions. This would lead to an undue complexity as it refers to guidelines which are not directly applicable for not users of internal models. Therefore, there is a need to review whether the guidelines on expert judgement for internal models are fully applicable to the best estimate calculation.

We also disagree with EIOPA's main reason for the introduction of these new guidelines, that there was only a reference to the guidelines on expert judgement vis-à-vis internal models and that implicitly it was assumed that companies had to follow internal model guidelines.

#### **3. Guideline 24b (NEW) - Governance of assumptions setting**

It is important to have flexibility in the assumption setting process based on expert judgement. We propose to amend the text to focus on material assumption setting and not all assumptions setting. It is mentioned in guideline 24a (NEW) that the insurance undertakings should take into consideration the materiality of the impact of using expert judgement; In order to be consistent, this Guideline should follow the same materiality principle.

#### **4. Guideline 24c (NEW) - Communication and uncertainty in assumptions setting**

The requirement of an establishment of a formal and documented feedback process between the providers and the users of material expert judgement and of the resulting assumptions might be extremely burdensome for undertakings.

#### **5. Guideline 24d (NEW) - Documentation of assumptions setting**

We have concerns over the level of process and documentation which we consider excessive and too prescriptive. It is too burdensome to document the "rationale for the opinion".

#### **6. Guideline 24e (NEW) - Validation of assumptions setting**

It should be clarified how the materiality of the assumptions in the validation of assumption setting is taken into account.

### *Biometric risk factors*

#### **7. Guideline 24e (AMENDED) - Modelling biometric risk factors**

We do not believe that there is a need to amend the explanatory text of this guideline.

### *Expense allocation*

#### **8. Guideline 28a (NEW) - Investment management expenses**

In this new guideline 28a, EIOPA states that insurers should take into account all expenses to be incurred in servicing insurance and reinsurance obligations plus the SCR. It is unclear what

kind of SCR EIOPA is referring to (i.e pre-shock SCR, post shock SCR, de-risked SCR etc.). Additionally, investment expenses pertaining to an SCR scenario situation should be included in the SCR capital requirement only, not in the best estimate of liabilities as the Best estimate does not correspond to a 99.5 VAR situation and this would lead to double counting.

We also disagree with the proposed new guideline as it is not in line with the related articles of the Solvency II Directive and Delegated Acts (see below). The investment management expenses should be taken into account only to the extent the insurance and reinsurance contracts require to settle and serve the insurance and reinsurance obligations over the lifetime.

Lastly, there should not be prudence in the best estimate calculation and therefore using the sentence 'at least' is misleading as it seems to imply that insurers would be free to calculate the expenses at a much large scale.

### **Solvency II Directive and Delegated Acts articles related to the contractual cash flows**

#### **Solvency II Directive**

- Article 77.2 ... The calculation of the best estimate shall be based ... and realistic assumptions ...

*The cash-flow projection used in the calculation of the best estimate shall take account of all the cash ... flows required to settle the insurance ... obligations*

- Article 77.4 where ... obligations can be replicated reliably using financial instruments ..., the value of technical provisions ... shall be determined on the basis of the market value of those financial instruments.

- Article 78. In addition to Article 77, when calculating technical provisions, insurance ... undertakings shall take account of the following:

(1) all expenses that will be incurred in servicing insurance ... obligations;

#### **Solvency II Delegated Acts**

- Article 22.1 Assumptions shall only be considered to be realistic for the purposes of Article 77(2) of Directive ... where

(c) .... the assumptions are based on the characteristics of the portfolio of insurance ... obligations, where possible regardless of the insurance ... undertaking holding the portfolio;

- Article 28 ... the calculation of the best estimate shall include all of the following cash flows, to the extent that these cash flows relate to existing insurance ... contracts ...

(c) payments of expenses as referred to in point (1) of Article 78 of Directive

- Article 31.1 [cash flows] shall take into account ... expenses ... which are referred to in point (1) of Article 78 of Directive ...

(b) investment management expenses;

### **Solvency II Directive and Delegated Acts articles related to the realistic assumptions**

#### **Solvency II Directive**

- Article 77.2 ... The calculation of the best estimate shall be based ... and realistic assumptions ...

*The cash-flow projection used in the calculation of the best estimate shall take account of all the cash ... flows required to settle the insurance ... obligations*

### **Solvency II Delegated Acts**

- *Article 23.1. ... future management actions shall only be considered to be realistic for the purposes of Article 77(2) of Directive ... where they meet all of the following conditions: ... (b) assumed future management actions are consistent with the insurance ... undertaking's current business practice and business strategy ...;*

### **9. Guideline 30 (AMENDED) - Apportionment of expenses**

Further guidance is needed as to whether EIOPA is putting forward, as a result of the proposed change (i.e the removal of overhead term in the guideline), a change to the related article of the Delegated Regulation.

### **10. Guideline 33 (AMENDED) - Changes in expenses**

The reference to inflation seems to suggest that the focus of this guideline is on cost increase. However, the best estimate should also include an allowance for a decrease in the expected future cost.

### **Treatment of financial guarantees and contractual options**

### **11. Guideline 37a (NEW) - Dynamic policyholder behaviour**

This is a highly ambitious requirement that over-complicates the processes and models for insurers. Therefore, it should be either removed or amended so that it is only required provided there is clear evidence that only dynamic policyholder behavior models can capture the accurate best estimate and its risk profile and there is sufficient data behind it; And this should be justified against policyholder end protection.

### **12. Guideline 37b (NEW) - Bidirectional assumptions**

No comments.

### **13. Guideline 37c (NEW) - Option to pay additional or different premiums**

No comments.

### **Future management actions**

### **14. Guideline 40a (NEW) - Comprehensive management plan**

EIOPA provides a clarification in the guidelines on the way future management plans shall be documented. We understand that EIOPA is trying to impose some homogeneity regarding the type of documents that are part of the management plan. Reference to the proportionality principle should be added to this guideline.

### **15. Guideline 40b (NEW) - Consideration of new business in setting future management actions**

Future management actions need to be as realistic as possible but this sets out the need for the

cashflows from both new business and future premiums to be counted in. Some flexibility in the application of this guideline is needed as the EIOPA's proposal might trigger additional technical work for insurers.

### *Methodologies for the valuation of contractual options and financial guarantees*

#### **16. Guideline 53a (NEW) - Use of stochastic valuation**

The guidelines appear to promote the use of stochastic models for the valuation of contractual options and financial guarantees, when in fact, some of these options and guarantees are simple enough to be modelled via a deterministic approach.

The EIOPA's requirement to use stochastic calculation for contracts '*whose cash flows depend on future event and developments*' should be softened so that it is justified also against the materiality towards the customer end protection, i.e. whether there would be a material impact on solvency position if stochastic calculation is not used.

The proposed amendment to this guideline is also related to the 2020 Solvency II review proposals; EIOPA put forward a prudent deterministic valuation approach under the proportionality principle to be applied by low risk profile undertakings with medium or low time value of options and guarantees (TVOG). We also suggest that the proposed amendment is put on hold until the review of the Solvency II package enters into force.

### *Economic Scenario Generator*

#### **17. Guideline 57a (NEW) - Market risk factors needed to deliver appropriate results**

The integration of credit and spread modelling in the best estimate calculation would be very burdensome for undertakings. We propose to amend the text so that it is clarified that firms do not need to model spread or credit risk but rather the need to consider it. If not material, it can be ignored.

### *Expected Profits in Future Premiums ("EPIFP")*

#### **18. Guideline 77 (AMENDED) - Assumptions used to calculate EPIFP**

No comments

#### **19. Guideline 78 (NEW) - Alternative approach to calculate EPIFP**

No comments

## EXPLANATORY TEXT

### *Expert judgement*

#### **20. Explanatory text on Guideline 24a (NEW) - Materiality in assumptions setting**

As stated in our comments to Guideline 24a, it is not proportionate to request the application of the guidelines on internal models the calculation of the best estimate of technical provisions. This would lead to an undue complexity as it refers to guidelines which are not directly applicable for not users of internal models.

### *Biometric risk factors*

#### **21. Explanatory text on Guideline 25(AMENDED) - Modelling biometric risk factors**

There is a typo and the reference should be to Guideline 25 and not to Guideline 24e. In any case the explanatory text has not been amended.

### *Expense allocation*

#### **22. Explanatory text on Guideline 28a (NEW) - Investment management expenses**

EIOPA states in paragraph 3.6 that the calculation of the exact amount of expenses of technical provisions may require burdensome calculations because of the circular reference to the technical provisions. Can EIOPA explain why this calculation is circular? Is it because the technical provisions include financial guarantees? Or is it because Investment management expenses are related to the level of future technical provisions?

#### **23. Explanatory text on Guideline 30 (AMENDED) - Apportionment of expenses**

EIOPA states in paragraph 3.9 that the process of apportionment of expenses between the existing and the future business should be done in realistic and objective manner. Further clarification is needed as to whether this means that companies will have to allocate their current expenses between existing and future business. In any case, the real management expenses incurred in a year are not split between existing and future business and it will be extremely difficult to do so.

#### **24. Explanatory text on Guideline 33 (AMENDED) - Changes in expenses**

The reference to inflation seems to suggest that the focus of this guideline is on cost increase. However, the best estimate should also include an allowance for a decrease in the expected future cost.

### *Treatment of financial guarantees and contractual options*

#### **25. Explanatory text on Guideline 37a (NEW) - Dynamic policyholder behaviour**

We do not support EIOPA's proposal by which insurance undertakings shall consider a dynamic modelling of policyholder behaviour by default and a lack of data is not sufficient to justify a static modelling. Further explanation is needed as to whether static modelling is not appropriate for valuing best estimate.

### *Future management actions*

#### **26. Explanatory text on Guideline 40a (NEW) - Comprehensive management plan**

As stated in our comment to Guideline 40a, reference to the proportionality principle should be added to the explanatory text of this guideline.

#### **27. Explanatory text on Guideline 40b (NEW) - Consideration of new business in setting future management actions**

As stated in our comment to Guideline 40b, reference to the proportionality principle should be added to this guideline.

### *Methodologies for the valuation of contractual options and financial guarantees*

#### **28. Explanatory text on Guideline 53a (NEW) - Use of stochastic valuation**

We would like to reiterate that some of these options and guarantees are simple enough to be modelled via a deterministic approach.

### *Expected Profits in Future Premiums ("EPIFP")*

#### **29. Explanatory text on Guideline 77 (AMENDED) - Assumptions used to calculate EPIFP**

No comments.

### **IMPACT ASSESSMENT**

#### **30. Section 4.1. Procedural issues and consultation of interested parties**

No comments.

#### **31. Section 4.2. Problem definition**

No comments.

#### **32. Section 4.3. Objectives pursued**

No comments.

#### **Section 4.4. Policy Options**

##### **33. Section 4.4.1. Policy issue 1: Introduction of additional Guidelines vs status quo**

We support Policy option 1.2: Keeping the status quo of the current Guidelines.

##### **34. Section 4.4.2. Policy issue 2: Consistent approach regarding use of expert judgments for both technical provisions and internal model**

We support Policy option 2.3: Reference to the guidelines on Expert judgement for internal model purposes in the recitals (current situation).

##### **35. Section 4.4.3. Policy issue 3: Proportion of investment management expenses to be considered**

We support Policy option 3.4: Expenses relating to investments backing Solvency II Best Estimate.

##### **36. Section 4.4.4. Policy issue 4: Management of expenses that the fund manager reimburses to the undertaking**

We support Policy option 4.1: Reimbursement should be considered as decrease of expenses.

##### **37. Section 4.4.5. Policy issue 5: Detailed guidance on the calculation of EPIFP**

We support Policy option 5.2: No further clarification,

## *Section 4.5. Analysis and impact of policy options*

### *Section 4.5.1. Policy issue 1: Introduction of new Guidelines vs status quo*

**38. Policy option 1.1: Introduction of additional EIOPA Guidelines to provide clarity on how the calculation of technical provisions shall be applied by insurance and reinsurance undertakings.**

We oppose this policy option 1.1.

**39. Policy option 1.2: Keeping the status quo of the current Guidelines.**

We favour this option of keeping the status quo.

### *Section 4.5.2. Policy issue 2: Consistent approach regarding the use of expert judgments for both technical provisions and internal model*

**40. Policy option 2.1: Introduction of a full set of guidelines on Expert judgment for the valuation of technical provisions**

We oppose this policy option 2.1.

**41. Policy option 2.2: Introduction of a reference to the guidelines on Expert judgment for internal model purposes in a specific guideline**

We oppose this policy option 2.2.

**42. Policy option 2.3: Reference to guidelines on Expert judgement for internal model purposes in the recitals (current situation)**

We favor this option of keeping the current situation.

### *Section 4.5.3. Policy issue 3: Proportion of investment management expenses to be considered*

**43. Policy issue 3: Proportion of investment management expenses to be considered**

We oppose the policy option 3.1.

### *Section 4.5.4. Policy issue 4: Management of expenses that the fund manager reimburses to the undertaking*

**44. Policy issue 4: Management of expenses that the fund manager reimburses to the undertaking**

We favour option 4.1: Reimbursement should be considered as decrease of investments.

#### **Section 4.5.5. Policy issue 5: Detailed guidance on the calculation of EPIFP**

##### **45. Policy option 5.1: Clarification on the assumptions to be used to calculate EPIFP**

We oppose the policy option 5.1: Clarification on the assumptions to be used to calculate EPIFP.

##### **46. Policy option 5.2: No further clarification**

We favour this option where no further clarification is needed.

#### **Section 4.6. Comparison of Options**

##### **47. Section 4.6.1: Policy issue 1: Introduction of new Guidelines vs status quo**

We support Option 1.2: Keeping the status quo of the current Guidelines.

##### **48. Section 4.6.2: Policy issue 2: Consistent approach regarding the use of expert judgments for both technical provisions and internal model**

We support Option 2.3: Reference to guidelines on Expert judgement for internal model purposes in the recitals (current situation).

##### **49. Section 4.6.3: Policy issue 3: Proportion of investment management expenses to be considered**

We do not support Option 3.2: Investments backing Solvency II technical provisions and the solvency capital requirement. We support Option 3.4: Investments backing Solvency II best estimates.

##### **50. Section 4.6.4: Policy issue 4: Management of expenses that the fund manager reimburses to the undertaking**

We do not support Option 4.2: Reimbursement should be considered as other cash inflow. We support Option 4.1: Reimbursement should be considered as decrease of expenses.

##### **51. Section 4.6.5: Policy issue 5: Detailed guidance on the calculation of EPIFP**

We do not support Option 5.1: Clarification on the assumptions to be used to calculate EPIFP. We support Option 5.2: No further clarification.

#### **ADDITIONAL COMMENTS**

##### **52. Please insert here any general comment not covered in the sections above.**

No comments.