European Commission’s Better Regulation Consultation:

“Review of measures on taking up and pursuit of the insurance and reinsurance business (Solvency II)”

AMICE, the Association of Mutual Insurers and Insurance Cooperatives in Europe, represents a specific sector of the European insurance industry. Our members are characterised by their central focus on their policyholders, who are generally the owners of their insurers rather than the external investment community. The products, services and benefits derived from our members’ activities are conceived and applied for the best interests of their policyholders, with a long-term perspective at the core of the relationship between the mutual/cooperative insurer and the policyholder. Mutual/cooperative insurers represent approximately one-third of all insurance business in Europe, and range from some of the smallest insurance entities to some of the largest in the region.

AMICE would like to thank the European Commission for the quality of the work conducted since EIOPA’s final advice roll-out and for the legislative package released on 22 September 2021 aiming at accommodating key issues. Several major concerns of the industry have been taken into account and we are grateful for the care and efforts made to address them.

While the amendments to the Directive are now plainly worded and fully readable, the amendments to the Delegated Regulation are yet to be formulated and this leaves room for speculation and uncertainty with regards the full achievement of the key improvements and targets that the review is expected to bring into the Solvency II framework in the policyholders’ interests. Fine tuning the adequate valuation and calibration of risks in the context of long-term business models remains paramount.

Therefore, our concerns and focus now are very much on the technicalities of very specific points, namely the severity of the interest rate shock on the liquid part of the curve, the risk correction in the VA and, last but not least, the completion of adequate eligibility criteria for the long-term equity risk.

On the elaboration of the risk-free rate curve and the extrapolated part, we reaffirm the usefulness of a yield curve constructed with a long-term anchor that limits the volatility of the best estimates and maintains a balanced view towards all possible prospects without enforcing a too strong bias towards the current financial environment which would also prove useful if interest rates rise again. The manner in which the risk-free curve including the extrapolated part is constructed should avoid incentives for short-termism. The calibration of the parameters of the extrapolated part should refrain from embedding more sensitivity on the longer cash flows to short-term price fluctuations. The current proposals are unsatisfactory in this respect and result in additional volatility and incentives for short-termism (see Section 2 in Annex).

By incorporating more market information and at the same time constraining the stabilising effect of convergence, the European Commission’s proposed methodology combined with EIOPA’s
the proposed lowering of the convergence parameters will result in higher volatility of risk-free rates and, thus, of solvency positions and sensitivity to short-term price fluctuations. This is contrary to the original objective of the extrapolation methodology for solvency purposes. A careful assessment of the calibration would therefore have to be conducted. Where required, the calibration of the alternative extrapolation method as submitted by EIOPA should be changed to meet all of the above stipulated original requirements of the extrapolation methodology.

In addition, Article 77(a) of the Solvency II Directive should be amended to specify the convergence parameter, the deep, liquid and transparent (DLT) determination method and the residual volume criterion. These points are not secondary technical issues but are crucial elements for the quantitative outcome of the review.

Remaining concerns on unsolved issues:

1. While we support the preliminary need to correct the existing interest rate risk calculation for the non-extrapolated part of the curve, we insist on simplifying and making EIOPA’s proposal more tailored by removing the lower limit of -1.25% and bringing in a constant risk factor of -30bps when rates are negative. This would be reflective of the current empirical evidence that in the low interest rate environment and since rates have become negative, volatility has dramatically dropped, leading to a much more limited absolute downward shift for an interest rate downward movement.

On the extrapolated part of the curve, the method for stressing the ultimate forward rate (UFR) should be more consistent with how the UFR would change in a stressed scenario, under the agreed UFR methodology developed by EIOPA, and therefore not always lead to a reduction as a result of applying 15 basis points, as in the current proposal.

2. Regarding the Volatility Adjustment, AMICE appreciates the European Commission’s proposals to strengthen its effectiveness. Yet, we still very much challenge the exaggerated conservatism and high procyclicality introduced by the new formula for calculating the risk-corrected spreads.

On the one hand, the default risk that the risk correction seeks to represent can only be soundly calibrated with the help of sufficiently deep historical data. The behaviour of spreads at a single point in time is not an adequate estimate of defaults, especially during a crisis. Overlooking these facts in the new design of the risk correction is leading to higher procyclicality during periods of exploded spreads at a time when market disfunction is much more related to liquidity and other problems than to default (based on the representative portfolio holding only few non-investment grade fixed income assets). On the other hand, the level of the risk adjustment has been increased very significantly, far beyond what historical experience shows.

We believe a compromise is needed between the overcalibrated and highly penalising risk correction proposed, and the expectations to reflect the actual level of the credit risk and compensate for artificial volatility based on historical data. Counter-proposals are being
developed by the industry and AMICE is supporting an approach that we believe would strike the awaited balance.

3 On long-term investments (LTEI), we appreciate the significant progress introduced by EIOPA in its final opinion which now correctly reflects how long-term equity investment strategies are implemented, which improves the eligibility criteria in Article 171a. The new criteria rightly focus on the risk appetite and governance framework that the insurance undertaking must have in place to allocate equities to the reduced shock of long-term portfolios and move from requiring an \textit{ex-post} holding average to an \textit{ex-ante} long commitment.

In general, the specifications relating to long-term equity investments must be as streamlined and efficient as possible to facilitate a workable and broad implementation and possibly allowing the inclusion of certain types of participations.

We are aware that the current \textit{g}) criteria maybe be subject to interpretations and insufficient harmonised approaches because its key components maybe insufficiently completed, enumerated and described. Hence, we have worked on a detailed proposal (see section 4 in Annex) that we believe achieves a high level of security in interpretation and comfort in robustness and application.

We stand strongly against moving away from liquidity stress tests as a meaningful demonstration of the application of the enforcement of the long-term equity investment strategy. EIOPA’s final advice criteria would move away from the undisputable evidence of the absence of liquidity risk and fire sales through the monitoring and adequate management of future cash flow gaps to, on the one hand, rather disconnected requirements based on a minimum duration of best estimates for life portfolios (threshold effect, disconnection with the real risk of forced sales), and on the other hand, a very punitive “liquidity” ratio for non-life portfolios, which does really address liquidity issues and horizons and harbours a number of contradictions.

\textbf{Criteria \textit{g}) should remain as it is in the current Delegated Regulation, i.e. is a liquidity test based on a cash flow approach dedicated to liquidity issues even under stressed circumstances.}

Finally, it still remains that long-term equity investments are outside the scope of eligibility to the reduced shock where these assets are backing own funds. We believe this is inconsistent and unjustified and that it does not do justice to the long-term aspect and resilience of own funds and it does not encourage good risk management. \textbf{Equity portfolios backing own funds should not be out of the scope of Article 171a.}

We also request the European parties to reconsider the scope of this paragraph and allow internal model users to use the same approach, providing a level playing field with respect to the LTE and the objectives of the LTE module.
Other concerns:

4 We do not see a need to introduce EIOPA’s proposed changes on Group Supervision. The current hierarchy of supervision works appropriately. The European Commission’s proposals to change the requirements on group supervision and to grant additional powers to the group supervisor in Solvency II go far beyond what is necessary to address group-related issues. It is often hard to assess why changes are deemed necessary, as there is often a lack of clear justification or sometimes the justification seems to be based on spurious anecdotal evidence or extreme or singular cases which do not justify new legislation.

Additionally, the proposals to amend Articles 13, 212 and 213 of the Solvency II Directive are intended to facilitate the identification of undertakings which form a group, in particular with respect to groups which are not in the scope of Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, and to horizontal groups. We do not support these changes and believe that the current definitions should continue to be harmonised with those used in other relevant legislations, including those for financial reporting and other relevant sectoral prudential regulation. Having different parameters for different legislative purposes (e.g. financial reporting, banking regulation, financial conglomerates) can create, at the very least, difficult governance issues (see Section 5 in Annex).

5 The reporting requirements should be streamlined. The European Commission’s proposal to keep the SFCR as one report and two audiences is an improvement compared to the current situation and we welcome this proposal. However, this proposal should only be introduced if the purpose of reducing the reporting burden can be achieved. The European Commission’s proposals together with EIOPA’s proposals in its final opinion, which provided some insights as to the amendments envisaged to the Delegated Regulation, seem to indicate that this would not be the case; the proposal should therefore not be introduced and instead limited changes should be incorporated to the summary of the SFCR to ensure it achieves the Commission’s goals of making it more policyholder-friendly. In addition, we would encourage policymakers to be more ambitious and allow SMEs/mutuals to publish the SFCR addressed to policyholders only, since there is little or no institutional investment interest.

The European Commission’s proposal to request an external audit of the Solvency II balance sheet information included in the SFCR should be removed as it is extremely costly, and thus will be particularly burdensome for SMEs. The requirement also risks duplicating safeguard mechanisms that are already in place in the Solvency II Directive to ensure quality of the solvency reporting, i.e. those present through the supervisory review process (see Section 6 in Annex).

6 Proportionality: AMICE members appreciate that more predictable, general criteria to apply proportionality are included in the Solvency II Directive. However, the proposed
framework for low-risk undertakings (LRU) is restrictive and some improvements are needed in the criteria. Additionally, the proposal for new simplifications is a step in the right direction but they do not go far enough in some areas, particularly on reporting. Reducing the burden for smaller and low-risk insurers, particularly in terms of reporting, is a key priority for AMICE members.

At the same time, it is important that the general principle of proportionality remains beyond the LRU and immateriality provisions. This means that any insurer should be able to use proportionality measures such as simplifications. The LRU provisions should therefore not introduce unnecessary impediments. In particular, we query how the amendments proposed would impact on undertakings applying a prudent deterministic valuation of best estimate of technical provisions. Furthermore, additional proportionality measures should be introduced in Pillar III reporting in order to lessen the burden for insurance undertakings (see Section 7 in Annex).

7 Macroprudential tools: Solvency II is a balanced framework for prudential supervision enhancing good risk management and disclosure. The existing Solvency II microprudential regulation is an excellent framework for prudent risk management and covers many macroprudential issues as well; therefore, current instruments should be used as much as possible. Furthermore, insurance is typically non-systemic and liquidity issues are well under control, as the recent 2021 European Stress Tests have clearly demonstrated. We warn against too much duplication from banking supervision, as the two business models together with their respective risk profiles are very different.

Regarding the consideration of macroprudential and sustainability risks in the ORSA, we do not support the proposal of introducing defined parameters, which goes against the principles of ORSAs being the undertakings’ own risk assessments. The choice of scenarios and methodologies to assess relevant risks in the ORSA should be at the discretion of the undertakings. Therefore, the analysis associated with the assessment of sustainability risks should only be included in the ORSA when relevant and material for the undertaking’s risk profile. The same applies for the input of macroprudential risks that supervisory authorities should provide to undertakings in Recital 22. When defined parameters and input are required from undertakings, and thereby a standardised analysis of the risks, AMICE believes that other more suitable supervisory tools and provisions exist, rather than requiring such analysis to be performed and included in the undertakings’ ORSAs (see Section 8 in Annex).
Annex

1. Interest Rate Risk

Rationale for changes to EIOPA’s proposal in a nutshell

The European Commission referred to EIOPA’s proposal in its communication regarding the revision of the interest rate risk sub-module in the Standard Formula. The only exception is the extrapolation of the illiquid part of the stressed curve as curves will be derived with the same extrapolation methodology as per the liquid part (i.e. the illiquid part of the yield curve will be extrapolated using the standard extrapolation parameters and methodology). The European Commission’s proposal regarding the extrapolated part is a step in the right direction, but we would like to stress that further improvements are needed for the liquid part so that the market evolutions of interest rates in recent years are taken into account and the Solvency II regulation is adapted to the wider economic and financial environment. In its opinion published in December 2020, EIOPA introduced a new model and parameters which resulted in a too severe interest rate downward shock amidst an environment of low and negative interest rates. The severity of the calibration was limited by setting a floor at -1.25% beyond which interest rates cannot drop further for all maturities.

There is no doubt that Europe has experienced a significant change in the interest rate levels during the last decade. However, since interest rates have turned negative, the historical volatility has also decreased substantially.

AMICE finds that EIOPA’s proposal to review the interest rate risk needs several improvements. We therefore propose the following changes:

• to delete the absolute and artificial floor of -1.25% to bring in the fact that there always is a risk for rates to decrease.

• when interest rates are negative only a constant risk factor should be used reflecting that there is no such historical series that can reliably support EIOPA’s combination of factors affecting interest rates. We find a constant of -30bps to be a good proxy for a downward interest rate risk shock. This would be in line with observations from Euro Swap during the negative yield period (2015-2021) and also the Japanese market (JPY SWAP) where rates have stayed low for many decades.

• we strongly suggest that EIOPA’s model be used so that these changes are brought in and the parameter $b^{down}$ is replaced by a constant $b_{neg}$ (Chart 1.1)
As stated above, AMICE aligns with the European Commission's proposal that the interest rate shocks beyond the last liquid point (LLP) are a function of the earliest maturity points consistent with the methodology applied to determine the risk-free rate term structure (i.e., first stress market data, then extrapolate based on the Basic-risk free rate extrapolation methodology). On the extrapolated part of the curve, the method for stressing the ultimate forward rate (UFR) should, however, be more consistent with how the UFR would actually change in a stressed scenario under the agreed UFR methodology developed by EIOPA. Under such circumstances, the UFR methodology would not always lead to a reduction as a result of applying 15 basis points, as in the current consideration as expressed by the Commission in its communication on Level 2 amendments.

We strongly highlight that the interest rate risk also needs to work well for other relevant currencies.

**Background evidence on historical and negative Euro Swaps risk profile**

**Interest rate downward risk in negative yield territory – the 1-year changes have decreased substantially**

As it can be found in Chart 2.1, the volatility seems to have decreased significantly after the
yields turn negative, despite the fact that the data is very narrow and especially during the latest period of negative yields.

Both the 1Y and 2Y Euro Swap rates have had ‘1-in-200 year’ (VaR 99.5) one-year changes as high as -390 bps in history but have decreased to lower than one-tenth of that after rates have dropped into negative territory, resulting in an empirical VaR 99.5 of -30bps. For the 10Y Euro Swap rates the same applies, but not that significantly as the extremes in history have been a lot lower (i.e. -150 bps); however, during times after yields have dropped below zero, the extreme events have been on similar levels to the 1- and 2-year rates.

It is important to keep in mind that even the total 20+ years of euro-swap is not enough to make proper quantitative analyses of the extreme events. Expected changes in the economic environment and the way ECB could influence the rates should be considered in a more qualitative way. This was studied in more detail in EIOPA IRSG’s publication 6/2020.
AMICE’s proposal – how would the results look in comparison to EIOPA’s

The year-end 2020 showed a Euro-swap curve below zero until the 22-year maturity. The new interest rate risk shock introduced by EIOPA already hit the lower limit on the two first-year maturities. The simplified alternative model proposed by AMICE with a -30bps constant downward shock applied when rates are negative is in line with EIOPA’s proposal but is not affected by the lower limit.

Chart 3.1 shows a comparison between AMICE’s and EIOPA’s proposals at different points in time:
As with any new proposal, some sensitivity analysis is needed to assess how it operates in a changed situation.

In Chart 3.2, impacts are provided for sensitivities of +150bps and -50bps to the Solvency II basic risk-free rate at 30/6/2020. The -50bps parallel shock to the Euro Swap rates at 30/06/2020 shows how AMICE’s simplified alternative corrects the problems with the lower bound.

In the case of high interest rates, AMICE’s simplified alternative model allows for an interest rate downward risk which remains well aligned with EIOPA’s proposal but the parameters $s^{down}$ could also be recalibrated to meet EIOPA’s model more closely if such a need is identified.
Back-testing of both EIOPA’s and AMICE’s proposals

Both EIOPA’s and AMICE’s proposals can be back-tested on how well they would have worked with historical data. This can be done by looking at every quarter-end how that swap rate has been changing in the following 1-year period and then how both EIOPA’s and AMICE’s proposals have been able to capture the risk.

From Chart 3.3, one can observe that for the 1-year rate, no breaches have been observed and
that EIOPA’s model seems to be calibrated too prudently, with the realised change in swap rates a lot lower. On the 10Y swap rate there have been two significant changes that have led to breaches:

(1) 2013 EU debt crisis when the ECB lowered its deposit and marginal lending facilities; and
(2) 2019 long swap rates decreasing below zero which resulted in EIOPA’s proposal also breaching.

The back-testing can also be performed by using a different risk measure, i.e. how the best estimate liability changes in different time steps. In Chart 3.5, a 10-year duration liability cashflow has been valued on every quarter by how much rates have been changing in the following 1-year period and then these results are compared on both the EIOPA and AMICE proposals to identify how well these have been able to capture the risk. One can observe that the same two breaches can be found in the previous analysis. By looking at the Best Estimate liability, one can conclude that the present value captures well the whole rate curve change and already gives a good insight into the matter. In any case, by taking the asset value changes (which reduce the risk), the risk margin (which increase the risk) and correlations (which reduce the risk), a more holistic understanding could even be achieved.

![Chart 3.3](image-url)
Chart 3.4

10-year EUR swap rate

- Euro Swap rate at the previous year
- Observed Euro Swap rate
- EIOPA proposal2
- AMICE proposal3

Chart 3.5

Interest rate risk for a 10y-duration BE liability present value - realized change vs. proposals

- Euro Swap rate one year movement (Q-to-Q)
- EIOPA proposal
- AMICE proposal
Interest rate downward risk – case study from Japanese markets

Europe has been experiencing low interest rates for a while now but the Japanese market has a much longer experience of low interest rates. In Chart 3.6 one can observe from the rich data set of the Japanese swap market how risk-free rates have been changing over time. As from the early 1990s, the Japanese swaps and especially 1Y swaps have always been below 1.5% and even below 0.5% after 2010. They fell in a negative territory after 2016.

Concerning the 10Y swap rates, the levels have been substantially higher in the 1990s but after that they stayed below 2% and became negative as from 2016.

The 1Y JPY swap rates ‘1-200-year’ (VaR 99.5) one-year changes are not lower than -50bps even when taking the entire historical data series into account. When restricting the data series and looking at the period after the 1Y rate hits zero, i.e. 2016 onwards, the VaR 99.5 decreases to -25bps.

For the 10Y swap rates, the findings are even more differentiated as the rates have been a lot higher. Therefore, the all-history VaR 99.5 is roughly -175bps but drops to -68bps when looking only at the low rates as from 2016 onwards. The VaR 99.5 can be measured through different methods described in the academic literature; here, the empirical VaR one-year change is a reasonably good proxy for this risk measure.
Chart 3.6

For the 1Y JPY SWAP, VaR 99.5% for the entire history (1995 onwards) is -50 bps and for the period rates hit negative, only -25 bps.

For the 10Y JPY SWAP, VaR 99.5% for the entire history (1990 onwards) is about -175 bps and for the period rates hit negative, only -68 bps.
2. Extrapolation

AMICE does not see the need for a change in the extrapolation method as proposed by the European Commission. This is because the current extrapolation methodology already ensures that low and negative rates are incorporated into the risk-free rate curves and that the extrapolated part of the curve provides appropriate discounting rates. While we recognise the European Commission’s aim to refine the current extrapolation methodology and include more market data for some currencies, we note that the alternative approach proposed will not achieve this goal for most non-euro currencies. We believe nonetheless that an alternative method should not be introduced, particularly because that method has dramatic negative consequences in the solvency position of the insurers concerned and increases the sensitivity of the longer cash flows to short-term price fluctuations.

In its advice to the European Commission, EIOPA did not elaborate on the evidence and arguments for the proposed calibration. This will make it difficult in the future to re-assess the approach and amend it if and when needed. Furthermore, the European Commission has not provided any clarification as to whether the “matching criterion” had to be removed. The ALM aspect for insurers is still a key element of managing the balance sheet going forward and serve the interests of the policyholders.

We believe that any change in the extrapolation method should adhere to the original principles of the Solvency II framework, as agreed by the European co-legislators, namely:

- The extrapolation methodology should result in the longer cashflows to be less receptive to short-term price fluctuations. This was always the aim of the methodology introduced following the agreement between the Council, the European Parliament and the European Commission of the Omnibus II Directive (Recital 30);

- The principles of the UFR should be respected. The extrapolated part of the discount rate for the euro should reach the UFR 40 years after the LLP (or the first smoothing point). Within the alternative extrapolation method this could be obtained by a re-calibration of the alpha parameter – see below;

- The methodology should also work for other non-euro currencies in an appropriate manner. For such currencies, in line with Recital 30, the characteristics of the local bond and swap markets should be taken into account when determining the starting point for the extrapolation of risk-free interest rates and the appropriate convergence period to the ultimate forward rate. For example, for SEK, this has meant in practice that the LLP/FSP is 10 years and that the extrapolated part of the discount rate for the SEK should reach the UFR 10 years after the LLP;

- The risk-free interest rate (RFR) should be able to be replicated by the stakeholders.
By incorporating more market information and at the same time constraining the stabilising effect of convergence, the European Commission’s proposed methodology combined with EIOPA’s proposed lowering of the convergence parameters will result in higher volatility of risk-free rates and, thus, of solvency positions. This is contrary to the original objective of the extrapolation methodology for solvency purposes.

Notwithstanding these strong arguments and objections to the proposed change, if the alternative extrapolation were to be introduced as proposed by the European Commission, a careful assessment of the calibration would have to be conducted. Where required, the calibration of the alternative extrapolation method as submitted by EIOPA should be amended to meet all of the above stipulated original requirements of the extrapolation methodology for solvency purposes. Amongst such concerns, EIOPA’s proposed calibration of the convergence parameter of 10% for the euro and 40% for SEK will result in a higher volatility of the risk-free rates and thus of the solvency positions. We believe that the convergence parameter put forward by EIOPA needs to be significantly increased to at least 15% for the euro and to around 70% for SEK to avoid excessive increases in the valuation of long-term liabilities and magnification of the artificial volatility to interest rate movements. Reflecting the above amendments and to ensure initial stability upon implementation, the calibration of the alternative extrapolation method for all currencies for the first day of application of the amending Directive should also be specified in the Level 1 text (including the starting point for the extrapolation of risk-free interest rates and the appropriate convergence period to the ultimate forward rate). This should be reflective of the fact, given the importance of setting the relevant risk-free interest rate term structure appropriately, that subsequent reviews of the calibration of all currencies, euro as well as non-euro currencies, should be conducted at the appropriate level.

In addition, Article 77(a) of the Solvency II Directive should be amended to specify the convergence parameter, the Deep, Liquid and Transparent (DLT) determination method and the residual volume criterion (i.e. the percentage value of 6%). These points are not secondary technical issues, but the specifications that are crucial for the quantitative outcome of the Solvency II review.

3. Volatility Adjustment

The volatility adjustment has been established in order to limit the excessive and undue impact of the financial market-driven volatility in fixed income instruments on the solvency position of undertakings. During market turmoil, spreads may increase sharply and decrease the market value of fixed income assets to levels that are not justified by tangible default risk. This loss in market value may induce a decrease of the net asset values and solvency positions beyond true economic levels and spur non-desirable pro-cyclical investment behaviours.

Such will be the case where the net asset value results from assets and liabilities valuations that are not consistent. The VA mechanism was introduced to improve the consistency of the
valuation of the best estimates with the dynamics of fixed income assets which were marked to market so that the net asset value remains meaningful and avoids undue volatility. For that, the volatility adjustment should adequately mitigate the effect of exaggerations of bond spreads. The VA should achieve the above prescribed goal of neutralising market volatility when not linked to credit risk and in relation to bond portfolios with long-term management strategies (i.e. “hold to maturity” approaches that do not cash in the temporary market losses or gains).

Special care should also be given to the effective volumes of fixed income assets held in the balance sheet with long-term strategy approaches in order to make sure they are all accounted for to avoid an undershooting impact of the VA because of the application of the RFR curve to discount BE only.

General Comments

We welcome the improvement of the functioning of the VA both as a countercyclical and permanent tool. We acknowledge the progress, primarily with regards to the country layer where we welcome the new approach.

However, several strong issues remain for the currency layer to work appropriately in all circumstances.

Scaling adjustment factor (CSSR_{CU})

We regret that all assets backing own funds are still not fully accounted for. The scaling factor is a good step in the right direction but may still be too small for very well-capitalised undertakings. It remains absolutely key that the VA reaches its goal of compensating the artificial volatility of the entire fixed income portfolio, not just the one homothetically backing technical provisions. The building of own funds should not be discouraged nor distorted or unrecognised at its true levels of resilience for proper transparency and comparability as well as sound policyholder protection. It is instrumental to reclaim own funds and their long-term stance.

Undershooting might also be sourced from positive duration mismatches where the duration of the fixed income portfolio is greater than the duration of the best estimates cash flows. This can often happen in the prudential balance sheets of non-life insurers. This is because the duration of the liabilities is truncated since all future premiums cash inflows are excluded from the scope of best estimates as well as own funds. This does a bad job of reflecting the long-term stable resources that can support longer-term investments.

CSSR_{CU} should be de-capped so that a symmetric scaling adjustment may apply in case of undershooting which needs to be fully addressed.

Risk correction

There is a concern that the risk correction is insensitive to changes in credit spreads which may lead to underestimating the risk in times of spreads increases.

AMICE reiterates its reaction to the claim that historical evidence linking spreads increases with defaults increases. That statement is in contradiction with the paper quoted by EIOPA (K.
Giesecke et al.) where the authors find that **there is little or no evidence that credit spreads respond to current or lagged default rates**. The authors conclude that: “Taken together, these counterintuitive results support the view that **corporate credit spreads are driven largely by factors such as illiquidity**.”

Moreover, it had been stated that “**the risk correction is everything that is not liquidity premium**” without enough substantiation. For instance, prices are also driven by market features such as supply and demand beyond sole liquidity or risk issues. In addition, institutional investors buying long-term bonds to back their liabilities also pay for a “term premium”. Even risk may be related to various factors, not all of them being of importance in this context, namely downgrade risk not associated with default.

**Current spreads cannot be used for the determination of the risk correction of investment grade fixed income assets.**

We oppose the move from a risk correction based on long-term averages of spreads and defaults to a risk correction based on current spreads. Under the new approach, the higher the spread, the higher the risk correction and the lesser the portion of spreads that can be translated into the VA.

We would like to refer to another context where AMICE proposed to replace external ratings by spreads during the 2018 review discussions. EIOPA (see EIOPA-BoS-17/280) argued against it and stated that "**a proposal to use spread as a risk indicator instead of ECAI’s mapping may increase pro-cyclicality and incentivise (re)insurance undertakings to focus on the short-term credit risk**”. We would raise the same concern in the matter of risk correction. A risk correction determined as a crude proportion of spot spreads would be subject to exaggerated market movements and would strongly and unduly penalise undertakings by limiting the amount of artificial volatility captured by the VA, introducing pro-cyclicality as well as massively overstating the risk.

The change in the risk calibration proposed by EIOPA is only relevant where increases in spreads may be correlated to increases in risks. In times of distress, we found evidence that such a link exists for high yield instruments only, and not in the case of investment grade instruments that yet represent the essential composition (98% for the euro currency) of the reference portfolios underlying the computations of the VA.

**Research**

We have performed in-house research on the statistical link between spreads (BofAML indices) and defaults (S&P rates) over the last two decades. Our analysis has performed a split between investment grade and high yield bonds data.
This contrasted link between spreads and defaults behaviours for high yield and investment grade instruments indicates that spreads respond to different market drivers. While spreads are linked to the default levels for high yield bonds, spreads for investment grade are driven by other factors such as liquidity, monetary policies, supply and demand, wider financial context, etc.

For investment grade which represent 98% of the reference portfolio, current spreads are not a suitable driver on which to base the calibration of the risk correction.

**Cost of downgrade**

It is also pointed out that cost of downgrade is unnecessarily reflected in the VA. While this may be justified in the MA, where undertakings are required to replace assets, there is no such requirement in the VA. We support this statement that supports better the initial objective of the VA to reflect the portion of the spreads that can really be earned by insurers holding their asset instruments until redemption.

AMICE would also like to point to the original proposal made by AMICE in the
consultation of the European Commission on the use of the VA which would basically eliminate any significant under- or overshooting.

Notwithstanding our original proposals, we think a compromise is needed between the over calibrated and very penalising risk correction proposed and the expectations to reflect the actual level of the credit risk and compensate for artificial volatility based on historical data (see above). Counter-proposals are being developed by the industry and AMICE is supporting an approach that would strike the awaited balance.

4. Long-term equity investments (LTEI)

Some of EIOPA’s proposals to amend Article 171a are most welcome and adequate in their recognition of the governance and ALM and investment policies needed in place to enable allocations to equities managed with long-term strategies. The move from an ex-post holding average towards an ex-ante intention of holding is key and reflective of the actual operational context conducive to and supportive of long-term investments.

The removal of the requirement to identify a separate portfolio of liabilities (criteria c) is also welcome since forcing artificial ring-fencing works against the long-term investment strategies of diversified equity portfolios and is not reflective of the asset and liability management in place for such strategies.

However, the newly proposed approach under revised criteria g) is a step back and is not effective to demonstrate the absence of potential exposure to forced sales.

Lastly, we think it is vital that own funds, in particular when of the strongest quality, may be recognised for their long durations and resilience and empowered to invest in long-term equities.

Criteria g): Life

For life entities, liabilities should have a duration in excess of 10 years. Such an approach is bringing a cliff-edge effect on top of being arbitrary and too conservative in the number of years retained for setting a liquidity criterion. Additionally, and even more importantly, no duration alone can evidence the absence of cash flow gaps and accordingly the absence of a risk of forced sales. Only the asset and liability management in place can demonstrate the absence of risk of forced sales (according to the requirements under criteria g) as defined under the current Delegated Regulation). Such a demonstration is based on the amounts of existing and expected highly probable cash inflows not submitted to any market risk at a loss available to cover the foreseen cash outflows including a secured margin for deviations.

Criteria g): Non-life

For non-life entities, insurers are required to cover all of their best estimate liabilities by Quality Liquid Assets.
The above requirement is excessive. An insurer cannot be required to cover all its liabilities by liquid assets as, on a going concern, a sound ALM shall invest in liquid assets to cover the cash flows of the first years of the liabilities and on more illiquid assets on a longer term. It also highly depends on the definition that is given to liquid assets.

The scope of liquid assets is very severely restricted when excluding bonds of financial institutions and listed equity (it should even be noted that selling equities at a gain where significant unrealised gains exist should not be deemed to be problem). Finally, the binary application (i.e. if the insurers meet the HQLA test or not) is also key to lead to a restricted application. With regards to equities, one should be reminded that they have a secondary market much more alive than fixed income instruments, at least for the constituents of the main equity indices. An appropriate haircut could be set in order to account for the volatility of these investments but without discarding them completely.

Moreover, haircuts level may be deemed to be very conservative, especially for level 2A bonds and covered bonds with CQS 0 or 1, whose quality is very high.

On the denominator side, the scope is not delineated according to liquidity issues but rather accounts for the whole amount of best estimates. Liquidity issues represent a risk that needs to be appreciated on a horizon usually of one year maximum. On the specific topic of non-exposure to forced sales of long-term equity portfolios, liquidity issues could be explored on the horizon of the intention of holding as a maximum which is set to 5 years.

The capacity to address outflows on longer horizons than 1 year or 5 years for long-term equity portfolios is not a liquidity but rather an ALM concern or a solvency concern addressed through the solvency requirements.

The liquidity adequation should remain in line with its objective of assessing liquidity risk which is commonly an issue of the following days or months and that can be extended to 5 years in the case of the long-term equity portfolios eligible in Article 171a.

We propose to maintain an approach under criterias g) based on a liquidity stress test by which insurers should comply on their whole balance sheet at solo level, relying on forward-looking scenarios with a time horizon of five years. The liquidity test should consider as asset cash flows the cash balance and cash financial instruments, recurrent revenues rising from assets (e.g. coupons, property rents, dividends), outcome cash flows coming from debt items on the asset side (e.g. existing repurchase agreements) and cash flows from the sales of equities and funds not included in the long-term equity submodule, as long as those sales comply with the risk management, asset-liability management and investment policies of the insurers. The income cash flows rising from the reinvestment of the previous cash flows should be excluded and the cash flows of the long-term equity submodule should be limited to dividends.

The liability cash flows include the outcome cash flows arising from claims, the income cash flows arising from future premiums of in force contracts including renewals for the next 5 years, the outcome cash flows arising from expenses and taxes, and the outcome cash flows arising from insurance or reinsurance undertaking funding (e.g. distributed dividends, debt interest and
Own funds (and risk margin)

Equities backing own funds are excluded from the reduced equity shock. Long-term equities backing the risk margin are also excluded as reference is only made towards “best estimates”.

We would like to reiterate that own funds are best placed for long-term investment strategies. Own funds have durations much longer than best estimates and may be very stable. Own funds are instrumental to the global long-term stance of the whole balance sheet.

The risk margin works together with best estimates and forms technical provisions which invested assets should be treated on an equal footing as those backing best estimates, strictly speaking.

Both life and non-life entities should be able to apply the LTE capital charge on their equity investments backing both technical provisions and own funds where they have a sound ALM enabling them to gather enough cash flows to cope with short term liquidity needs, longer-term needs being addressed by solvency requirement.

The non-exposure to forced sales underpinning the liquid risk analysis should be demonstrated in a similar manner than described above for the long-term equity portfolios backing life and non-life insurance best estimates.

This should be authorised to avoid impeding long-term investments within insurance undertakings, in particular primarily for free assets.

5. Group Supervision

Many of the proposals aim at dealing with supervisory convergence issues. These should not be solved by new detailed legislation but within the remits of EIOPA.

Supervisory authorities already have the necessary powers to sufficiently supervise groups with complex organisational structures. Even if there are (a few) cases in which this may be difficult, this should be solved at level of the supervising authority and does not justify such an extensive intervention. We believe that supervisory convergence across Europe provides the means of effective group supervision without the need to introduce new legislation. Care should therefore be taken not to overburden groups through the creation of unnecessary new requirements and costs.

The proposals will have a negative effect on the international competitiveness of the insurance groups, increase the administrative burden and introduce new restrictions on the management of insurance undertakings.

Powers to restructure a group

There is no need to grant additional powers to supervisors to be able to restructure a group; we believe the proposed additional powers for NSAs to restructure a group, or to choose which
company would be designated as responsible for horizontal groups are overly intrusive and too far-reaching compared to the (theoretical) benefits. Supervision needs to adapt to the variety of business models and strategies and not the contrary.

The European Commission's proposals to Articles 13, 212 and 213 of the Solvency II Directive are intended to facilitate the identification of undertakings which form a group, in particular with respect to groups which are not in the scope of Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, and to horizontal groups. We do not support these changes, but believe that the definitions used for group supervision should continue to be harmonised with those used in other relevant legislations, including those for financial reporting and other relevant sectoral prudential regulations. Having different group structures for different legislative purposes (e.g. financial reporting, banking regulation, financial conglomerates) can create, at the very least, difficult governance issues.

In this regard, AMICE is of the view that:

- Definitions in Article 13 of “parent undertaking” and “subsidiary undertaking” and the Group as set out in Article 212 should not be amended;
- Similarly, the widening of NSAs’ mandate to establish new groups as set out in the amended Articles 212 and 213 should not be introduced.

The empowerments given to supervisors to require a group to restructure would go beyond what is necessary to supervise groups. Organisational freedom is essential, and changes may have a huge impact on the group, including, for example, resources and taxes.

On mutual insurers in particular, we believe that the current proposal could be unduly interpreted as requiring independent mutual companies and groups of mutual companies that cooperate to be included in the scope of insurance group supervision, on the basis of said cooperation. Such cooperations can be fully in line with other legislation, such as competition law. In particular for mutuals, it is quite common to have different kinds of cooperation.

If the European Commission decides to keep the amendments as proposed despite the concerns raised, then it should at least be possible to require that all criteria in unison or at least criterion number one (a) in paragraph 5 of Article 212 is made mandatory. The first criterion concerns natural and legal persons and is clearly the most important. Groups generally consist of different degrees of ownership in other companies. A treatment could be that ownership could be replaced by the criteria as in (a). The proposals appear to include groups that are “orchestrated” by the same owners/people, so this must be a fundamental prerequisite. Therefore, the first criterion should be made mandatory and the other two as proof that the “group” is really controlled by the same people.

The number of persons must also be limited. The NSA should present facts that these persons genuinely have influence and power over the undertakings in question. There must be a relevant causation between these persons’ powers and the groups acting as mentioned in (b).
and (c) of paragraph 5 of Article 212. Two independent undertakings that cooperate should never be enough for putting group supervision in place. Therefore, an assessment of the independence of the undertakings should be included as a contra-indicator for group supervision.

The supervisory authority should not be able to decide this on its own initiative but should turn to a court or other external legal expert to evaluate if the cooperation legally can be regarded as a group. This would significantly increase legal certainty and at the same time give the designated group time to adapt its activities.

Lastly as modifying the scope of a group may imply that very extensive changes are necessary mainly to the group calculations and reporting, adequate time is therefore needed when a group is required to put into force such adjustments. This should also be properly catered for in the Solvency II Directive.

Regardless of the proposals made above, the assessment of the entity’s independence should therefore never lead to incorporating mutual undertakings’ cooperation in the scope. Group supervision on mutuals that are independent could in reality dilute or extinguish the owners’ powers over the mutual entity. A mutual that is directly owned by their policyholders cannot be “given” a parent undertaking since it has commitments solely towards the policyholders.

The impact of the proposals on group supervision in these circumstances would lead to the loss of diversification and of many small, local and sustainable mutual undertakings. Not least for reasons of sustainability and proportionality, SME independent companies should be allowed to continue to cooperate in non-group structures.

Governance

We do not agree with the proposal to amend Article 40 of the Solvency II Directive to ensure that it applies to insurance groups: a statement indicating that the AMSB of the parent (re)insurance undertaking at the top of the group would be responsible for the compliance with all group requirements would not be an issue. However, if the group supervisor is granted the power to designate a different company of the group or a specific company in the case of a horizontal group (where the parent company is not clearly identifiable), this should explicitly be done in cooperation with the group itself. The outcome should be to mutual consent.

6. Reporting

Solvency and Financial Condition Report

While AMICE takes note of the split of the SFCR in two parts, one for policyholders and one for other market participants, and believes that the European Commission’s proposal could be an improvement compared to the current situation and thus in principle welcomes this proposal, we believe it should only be introduced if the stated purpose of reducing the reporting burden can be really achieved. The European Commission’s proposal together with EIOPA’s Final Opinion published in December 2020, which provide some insights as to amendments envisaged in the
Delegated Regulation, seem to indicate that this would not be the case.

Therefore, limited changes should instead be introduced to the summary of the SFCR to ensure it achieves the Commission’s goals of making it more policyholder friendly. Without this, the changes will add significant burden without achieving the aims of streamlining the reports. A likely outcome would then be that despite the good intentions, the current proposals mean that in reality the insurance companies will have to maintain two separate SFCRs, one for policyholders and one for other market participants. This outcome should be avoided as insurance companies have well-functioning processes in place for the SFCR that would then need to be altered and which will require significant resources and additional costs, to little benefit and avail.

For the reasons mentioned above:

- For the sake of understandability, the SFCR addressed to policyholders should be limited to a maximum of two pages; while
- The SFCR report addressed to other market participants should only consist of the mandatory public QRTs with no narrative or additional calculations solely for SFCR purposes. A narrative explanation is not considered necessary as the professional public has industry expert knowledge and additional information is available to them in the financial and other reports provided by the company.

To this end, a change is needed to Article 51(1a) to ensure that the section of the SFCR addressed to policyholders is simple in structure and content and to the newly proposed Article 51(1b and 1c) so that insurance undertakings are only required to include in the part addressed to other market participants the quantitative data required by the implementing technical standard referred to in Article 56. In a similar vein to what is said of Article 51(1a, b and c), Article 56 should also be reviewed and only maintain legal empowerments necessary for the outline/content of the SFCR as suggested by the above amendments to the proposals introduced to the Directive, for the SFCR addressed to policyholders and the SFCR report addressed to other market participants, respectively.

Solvency and Financial Condition Report for SMEs

AMICE would like to encourage the institutions to be more ambitious and allow SMEs/mutuals to publish the SFCR addressed to policyholders only: an SME or mutual insurer, which has not been rated by a rating agency and has not issued subordinated debt and operates locally, has different stakeholders than a large financial conglomerate. SME mutuals’ main stakeholders are solely their policyholders.

The European Commission’s proposal for the policyholder part of the SFCR requires information on the undertaking’s business and performance, the undertaking’s system of governance and quantitative information about the solvency position of the insurer. This information is already comprehensive enough and sufficient for most policyholders. For the average policyholder, the information required in the professional users’ part of the SFCR is too detailed. The
policyholders’ main concern is to know whether their mutual insurer is able to pay out its claims and benefits when due, but this information would be provided already in the policyholders’ part of the SFCR.

**Frequency of the RSR report and SFCR/RSR single report timelines**

Given the changes laying down the principles and frequency for the RSR narrative report as proposed in the new Articles 35(5a) and 256b on the Regular Supervisory Report (RSR) for solo undertakings and groups, AMICE welcomes the clarification that, by default in a normal situation, the RSR would be requested ‘at least’ every three years. However, for sake of clarity, a provision should be added so that NSAs should duly justify their request when asking for an RSR more frequently. Furthermore, such decisions made by NSAs should be made timely, say no later than three to six months before the year-end to allow insurers sufficient time to prepare a full RSR report. The legal provisions should also clarify that a summarised/abbreviated report as required in the Article 312(3) of the Delegated Regulation will no longer be required for intermittent years between two full RSR submissions.

Furthermore, AMICE welcomes the European Commission’s proposal to introduce the possibility to have a single group RSR, subject to certain criteria as stated in the new Article 256b (2)/paragraph 84 of the Solvency II Directive. Given that the timelines are now included in Articles 256(1) and 256b(1) of the Solvency II Directive, respectively, for the group SFCR and RSR, for the sake of clarity, the same timelines should also be stated in Article 256(2) and 256b(2) of the Solvency II Directive for the single group SFCR and RSR. In addition, it should be clarified in Article 256 and 256b of the Solvency II Directive that the parent undertaking, if this undertaking is an insurance undertaking, may also include a section in the single SFCR and RSR relating to this entity, as only referring to “subsidiaries” in Article 256(2)(b) and 256b(2)(b) risks otherwise excluding them from the scope of the single SFCR and RSR (Articles 256(1), 256b(1), 256(2)(a) and 256b(2)(a) only deal with Group reporting).

**Reporting Deadlines**

**Extended deadlines**

We welcome the extended deadlines but the external audit reduces preparation time for the annual submission of data and reporting within the Solvency II deadlines by more than the proposed weeks. The extended deadlines will, however, only alleviate the operational problems associated with introducing the requirement of external auditing of the SFCR. This is because in many cases, the external audit of the SFCR will have to be carried out at the same time as the external audit of the annual report, as certain data form the basis for both reports.

Furthermore, the Q4 submission to the regulatory authorities, which would contain most of the same data as the annual solvency balance sheet included in the SFCR, would not receive the same extended deadlines. The European Commission’s proposed extension of the annual reporting deadlines is therefore not enough. As a consequence, we believe that an extension of the timelines should be granted in any case and should not depend on EIOPA’s proposals for
minimum external audit requirements and additional SFCR requirements, to which AMICE is opposed (please see next section). Also, some consideration should be taken for the extension of quarterly submission timelines.

**External Audit**

AMICE members have strong concerns regarding the European Commission’s proposal to request an external audit of the Solvency II Balance Sheet information included in the SFCR. The implementation of audit requirements in some Member States in recent years has proven that the role of external auditor overlaps with the duties of the supervisory authorities when conducting the Supervisory Review Process (SRP; see, *inter alia*, Article 36 of the Solvency II Directive). Given this, data to be audited is already subject to a significant safeguard mechanism through the supervisory process of regulatory authorities.

In addition, a mandatory audit is extremely costly for undertakings, particularly for small and medium-sized undertakings. The cost of the audit can be significant, but often a lot more when actuarial work is involved. Therefore, the added value, such as additional protection for policyholders can be questioned and the significant additional costs for companies that will entail should be taken into consideration as well. We therefore reject any proposal to impose a mandatory audit requirement on any type of Solvency II information, be that information made public or information regularly submitted by undertakings to the authorities. We would like to reiterate that any sort of external scrutiny and audit should be a choice for the undertakings and not an obligation. Should the external audit requirement nonetheless be introduced as a mandatory requirement, an audit with a limited level of assurance should be sufficient.

7. **Proportionality**

**Low risk undertakings (LRU)**

Proportionality is a key aspect of the regulatory infrastructure, which should reflect the nature, scale and complexity of the insurance entity when applying regulatory requirements. AMICE members appreciate that more predictable, general criteria to apply proportionality are included in the Delegated Regulation. However, the proposed framework for low-risk undertakings (LRU) is restrictive and some improvements are needed in the criteria. It is important that the general principle of proportionality also remains beyond the LRU and immateriality provisions. This means that any company should be able to use proportionality measures such as simplifications and combination of key functions.

**Immaterial gross SCR interest rate risk**

The criteria by which life undertakings should have a ratio of the gross SCR for interest rate risk submodule over the gross technical provisions not higher than 5% will be insufficient once the review of the interest rate risk comes into force. We propose that the threshold is reviewed upwards and is increased to 10%.
Cross-border business

The criteria by which undertakings should not underwrite more than 5% of annual gross written premiums outside of its home jurisdiction would penalise cross-border business. We propose to increase the threshold to 10% of gross written premiums.

Specialised non-life undertakings

The criteria by which non-life and composite undertakings should not underwrite more than 30% of the annual gross written premiums in Marine, Aviation and Transport or Credit and Suretyship line of business will penalise specialised insurers which operate on a few lines of business. We propose that the threshold is increased to 40%.

Combined ratio non-life undertakings

The criteria by which insurers’ average combined ratio net of reinsurance of the last three years should be less than 100%. It is not appropriate for mutual companies which do not need to produce surplus for shareholders and owners. Mutual companies can afford a combined ratio in excess of 100% in periods of good financial income. We propose this criterion to be removed.

Motor insurance

EIOPA’s advice to the European Commission for the 2020 review states that a maximum of 30% of premium income may relate to Marine, Aviation and Transport or Credit or Suretyship business (please see comment above). The Commission’s proposal is that “the sum of the annual gross written premiums in classes 3 to 7, 14 and 15 of Section A of Annex I is not higher than 30% of total annual written premiums of non-life business.” It therefore appears that EIOPA’s proposal means that motor insurance is not included in the activities to be accommodated within 30%, while the Commission’s proposal means that motor insurance should be included. We believe that the EIOPA proposal should be followed. Motor vehicle insurance has been recognised by the regulations as less risky and it therefore seems strange to include in the criteria. The standard formula in the SCR calculation show that motor vehicle insurance is considered to be less risky than the other included classes. Unlike the other classes included in the Commission's proposal, motor insurance largely consists of consumer insurance where insurance claims are relatively low and claims are settled relatively quickly. Thus we do not view the risk in class 3 as comparable to that of the classes 4-7, 14 and 15.

Undertakings not classified as Low risk undertakings (LRU)

We disagree with the European Commission proposal by which some of the proportionality measures should only be granted to other insurers following an approval process by national supervisory authorities.

Transitional on proportionality measures

The new framework for low-risk profile undertakings may be a step back for some companies currently applying simplifications but that do not fulfil the new LRU criteria as they will be requested to obtain prior approval for using simplifications. We therefore welcome the
transition period of existing simplifications for those companies which are not eligible to the LRU definition, facilitating the fulfilment of the proportionality requirements in the future and giving the industry some time to adapt to the new standards.

New proportionality measures proposed

**Proportionality in Pillar I**

**Simplification best estimate non-life - Non-life lapse risk**

The new simplification by homogeneous risk groups (HRG) for non-life lapse risk introduced in 2018 would have to be amended to take into account the fact that insurance risks are not monitored on a policy-by-policy basis but rather on a portfolio basis. Simplifications for non-life lapse risk over HRG are currently misaligned with the unbundling of insurance contracts. Non-life contracts have different guarantees which are split across different HRGs and when the policy lapses the different guarantees lapse as well, those which are profitable and those which are onerous. It is therefore meaningless to compute the non-life lapse risk sub-module at homogeneous risk group level. We reiterate the need to apply this shock at the best estimate level. The potential slight underestimation of this approach should be compensated by the high level of calibration of this risk (i.e. 40% shock).

**Applying a prudent deterministic valuation of best estimate of technical provisions**

While we welcome the proposal to introduce a proportionality measure accessible for LRUs (Article 77(7) paragraph 36 and recital 33) and other insurers subject to prior supervisory approval (Article 29c new/paragraph 13 and recital 33) we also believe that non-LRUs should be able to continue to apply a prudent deterministic valuation of best estimate of technical provisions, thereby applying general proportionality. This would be in line with the new proposed Recital 33 stating that it should be ensured “the methods for calculating technical provisions of contracts with options on guarantee are proportionate to the nature, scale and complexity of the risks faced by the insurer”.

In addition, the proposed standard requirement (stochastic valuation) as worded in the proposal is considered too complicated since it requires undertakings to also model potential deviations of the actual outcome from the expected outcome.

**Method for risk mitigation, diversification and adjustments**

The largest risk exposures within the marine, fire and aviation risk sub-modules have to be identified on a net of reinsurance basis. For fire risk, this means that all possible combinations within a radius of 200m have to be assessed on a net basis. Those insurers whose reinsurance covers would not change the outcome of the fire risk sub-module should be allowed to carry out the calculation on a gross basis in application of the proportionality principle.

**Natural catastrophe risk - Grouping method**

Some amendments are needed on the new simplification introduced in 2018 and which allowed insurers not to allocate the sum insured across the different Cresta zones. The option selected by which firms had to allocate the undertaking’s exposure to the Cresta zone with the highest risk weight in the region is very conservative and is not used by undertakings. We propose that
insurers are allowed to apply the risk factor for the region without considering the risk zones, and that a prudence factor for the undertaking’s exposure is added.

**Proportionality in Pillar II**

We appreciate the European Commission’s proposals that offer more flexibility to adapt the governance of small and medium sized companies to their sizes and risk profiles. However, we believe that some additional measures could be introduced:

**Combination of the internal audit function with operational tasks**

EIOPA’s peer review on key functions shows that combinations of the internal audit function holder with operational tasks are observed in eight countries. We propose that a similar approach is introduced provided the appropriate mitigation measures are in place to avoid potential conflicts of interest.

**Annual reports on the key functions**

The risk management function, actuarial function, compliance function and internal audit function produce annual reports to the AMSB. NCAs should be allowed to reduce the frequency of submission of the reports of the key functions, taking into account proportionality considerations.

**Outsourcing intra-group level**

We believe that the same treatment of intra-group and external outsourcing is not justified. The requirements should be significantly simplified.

**Proportionality in Pillar III**

The European Commission’s proposals on proportionality are a step in the right direction but they do not go far enough in some areas, particularly on reporting. Reducing the burden for smaller and low-risk insurers particularly in terms of reporting is a key priority for AMICE members. In order to lessen the burden for insurance undertakings, additional proportionality measures should be introduced in Pillar III reporting.

**Article 35 Solvency II Directive**

The proposed changes to make Article 35 of the Solvency II Directive more risk-based are welcome, however we still believe that the AMICE’s proposal to replace “may” in Article 35 (6) and (7) of the Solvency Directive by a “shall” should be considered. Most national supervisors have not granted the waivers as foreseen in this article in terms of the market share covered, and only a handful of Member States apply the exemption.

**8. Macroprudential tools and related concerns with sustainability**

We disagree with the statement that gaps are to be found in the new framework on macroprudential supervision. Insurance is typically non-systemic and liquidity issues are well
under control.

AMICE does not see the need for such an elaborate set of new measures and powers. We warn against too much duplication from banking supervision as the business models and risk profiles are very different.

The European Commission’s proposal to grant the individual NSAs the possibility to invoke the suggested measures will distort the level playing field and result in some of the political agreements to be reversed, based on supervisory discretion. Furthermore, the new instruments and tools will also have a negative effect on the international competitiveness of the insurers, increase the administrative burden and introduce new restrictions on the management of insurers.

We would like to reiterate that the regular European-wide stress tests are the appropriate tool to assess the macroprudential issues, especially when future management actions following a stress scenario are allowed. AMICE disagrees that the macroprudential perspective should be considered in the ORSA and Prudent Person Principle. We reiterate that the ORSA is the core risk management tool of an insurance undertaking and as such is shaped by the drivers of risks, granularity and horizons commensurate with its risk profile, strategies and risk appetite, its risk measures, and business planification horizon. In this context, it is unclear what the European Commission’s expectation is regarding the requirement to consider and analyse the activities of the undertaking that may affect macroeconomic and financial markets’ developments, which have the potential to turn into sources of systemic risk (as proposed in Article 45 (1) (e)).

This proposed requirement to have an outward assessment of systemic risk for each insurance company has the potential to be very far-reaching and goes beyond the recommendations made by EIOPA. It is also unclear how it could work in practice. Given the very limited – if any - systemic contribution of individual insurers’ behaviour and the diverse range of strategies employed across Europe, the potential benefits of this requirement also seem limited and do not justify the substantial costs involved. Undertakings and insurance groups should, therefore, not be required to analyse whether their activities have the potential to turn into sources of systemic risk. Instead, analysing potential sources of systemic risk should remain the task of the supervisory authorities as part of their macroprudential surveillance.

The ORSA should be meaningful for micromonitoring and micro-supervision, and a macroprudential dimension would not be compatible with and be detrimental to the initial objectives of the ORSA. Setting out defined parameters goes against the principles of the ORSAs being the undertakings’ own risk assessment. The choice of scenarios and methodologies to assess relevant risks in the ORSA should be at the discretion of the undertakings. The defined parameters should, therefore, only be included in the ORSA when relevant and material for the undertaking’s risk profile. The same applies for the input of macroprudential risks that supervisory authorities should provide to the undertakings (cf. Recital 22). When defined parameters and input are required by the undertakings, and thereby a standardised analysis of the risks, the industry believes that EIOPA’s regular stress testing
exercises would be a more suitable supervisory tool than requiring it to be included in the undertakings' ORSAs.

With respect to **Liquidity Reporting**, the approaches considered should be tailor-made for the insurance industry and not merely a duplication from the banking sector. The fundamental aspects of the business models differ too much for the banking regime to provide meaningful outcomes. Moreover, the results of the 2021 European Insurance Stress Test demonstrate that liquidity is less of a concern for the insurance sector.

**Sustainability considerations in the ORSA**

Similar to what stated previously about introducing a macroprudential perspective into the ORSA and while AMICE is generally supportive of Article 45(a)(1), having defined parameters set out as proposed in Article 45(a), paragraphs 2-4 go against the principles of the ORSAs being the undertakings' own risk assessments. The choice of scenarios and methodologies to assess relevant risks in the ORSA should be at the discretion of the undertakings.

Defined parameters should, therefore, only be included in the ORSA when relevant and material for the undertaking's risk profile. When defined parameters and input are required by the undertakings, and thereby a standardised analysis of the risks, AMICE is of the view that industry-wide ad hoc and regular reviews performed by EIOPA, the IAIS and similar industry bodies provide a more suitable supervisory tool than requiring it to be included in the undertakings’ ORSAs. With this in mind, Article 45(a), paragraphs 2-4 should be altered to read as follows:

*Where the undertaking concerned has material exposure to climate change risks, the undertaking shall duly ensure it includes suitable analysis of the impact of long-term climate change on the business of the undertaking in its assessment.*

At regular intervals, the assessment referred to in Article 45(1) shall contain an analysis of the impact on the business of the undertaking of the long-term climate change specified pursuant to paragraph 2 of this Article. Those intervals shall be proportionate to the nature, scale and complexity of the climate change risks inherent in the business of the undertaking, but be no longer than three years.

The analysis of long-term climate change referred to in the paragraph 2 shall be reviewed, at least every three years, and updated where necessary.

9. **Application of the symmetric adjustment for the equity risk charge**

The proposal to widen the corridor for the symmetric adjustment to the equity risk charge by amending Article 106 (3) may impact unduly between different jurisdictions in the EEA and contribute rather than lessen solvency volatility. AMICE is therefore supportive of the view that the symmetric adjustment should remain as it is calibrated in the current Delegated Regulation. An increased corridor to ± 17 percentage points will lead to higher volatility in the capital requirement for equities that may result in unwarranted disincentives to equity holdings.
The symmetric adjustment is intended to be an anticyclical tool which mitigates the impact of short-term volatility in the equity markets. However, it is calculated on the basis of a standard European portfolio of equities which can differ quite significantly from the actual holdings of individual insurers. The differences in the portfolios mean that for some insurers the impact of short-term equity market volatility on the insurer’s solvency position is accentuated due to the application of the adjustment. This will be even more pronounced with the European Commission’s proposal to widen the corridor to ± 17%. For the reasons mentioned above, AMICE believes that the symmetric adjustment should remain unchanged. Alternatively, the application of the symmetric adjustment for the equity risk charge should be made optional to apply. It is worth remembering that the market value of equity is the basis on which the equity SCR stress factor applies. In case of financial market turmoil, the drop in market values is attracting a commensurate drop in the capital requirement. Alleviating the factor of the stress is adding to the reduction of the capital charge in a way that may exceed the drop in the numerator of the solvency ratio.