
Hot Topic

EIOPA consults on draft interim measures for Solvency II preparation

FS Regulatory Centre of Excellence

28 March 2013

Summary

On 27 March 2013 EIOPA published its consultation on *guidelines for the preparation of Solvency II* (“the guidelines”). The draft guidelines follow EIOPA’s concern expressed in its December 2012 *Opinion* that there should be consistency in the preparations for Solvency II across Europe to ensure the industry does not lose momentum and is better placed to comply with Solvency II when it becomes effective.

The draft guidelines comprise of four consultations (“the consultations”) that include proposed interim measures in the following areas:

- System of governance – CP 13/008
- Forward looking assessment of the insurer’s own risks (based on ORSA principles) – CP 13/009
- Reporting to regulators – CP 13/010
- Pre-application for internal models – CP 13/011

The interim measures are intended to encourage national regulators to adopt consistent approaches in their preparations for Solvency II implementation. This paper sets out the key features of the proposed interim measures and the implications for the insurance industry. The consultations are open for comments until 19 June 2013.

EIOPA expect to publish final guidelines in the autumn of 2013 leaving a few months for regulators to implement them by 2014.

What do the draft Guidelines mean for the industry?

The draft guidelines are addressed to national regulators across the EU and aim to promote consistency in the preparation for Solvency II implementation. Upon adoption, national regulators must 'make every effort to comply' with EIOPA guidelines in accordance with European legislation. This in practice means that national regulators should comply unless it is beyond their powers to do so.

EIOPA is clear that it is for each national regulator to determine how to comply with EIOPA's guidelines in an appropriate manner. The Danish FSA has already taken the first steps in developing interim measures for Solvency II (letter to insurers January 2013), and has expressed considerations of implementing the outcome of the process in EIOPA. It is not clear at this stage how exactly the Danish FSA will incorporate these draft requirements into the DK supervisory framework.

Once the guidelines are approved (expected in autumn 2013) national regulators will have a period of two months to implement them into their national supervisory frameworks. EIOPA expect the Interim Measures to be effective from January 2014.

EIOPA's proposed approach to implementing the draft guidelines

EIOPA highlight that the draft guidelines should be applied in a manner that is proportionate in the context of preparations to Solvency II. It also allows for some flexibility of application through the use of thresholds and 'phasing-in' of some of the measures.

Fixed thresholds for application could create uncertainty for some companies close to the cut off boundary. It would be advisable for companies to engage with their

supervisors early in order to determine whether the final guidelines are intended for them.

More importantly, EIOPA clarified that the Interim Measures would not require national regulators to take supervisory action in the case of a company's non-compliance. Ultimately this means that while some companies will be expected to complete a parallel run of some Solvency II elements, they cannot be held in breach of any Solvency II requirements before the framework full enters into force.

The Danish FSA will determine how it applies the principle of proportionality and the use of thresholds in applying the interim measures. This will be a key piece of information for small-sized insurers that might be unsure as to whether they fall within the thresholds proposed. This information is likely to become available at some point in Q4 of 2013.

In the letter to insurers on January 2013, the Danish FSA made it clear that (partial) internal models can be approved for preparing the Individual Solvency Requirement. The Danish FSA referred to EIOPA's work on interim measures in the letter. It is not clear at this stage how the Danish FSA will embed its ISB regime with the proposed interim measures from 2014.

Overall Guidelines content

The interim measures focus on the parts of Solvency II which are either considered stable in terms of content or where early supervisory cooperation is required to support use of Solvency II tools upon day 1, such as internal models. The consultations cover the following areas:

- Internal model pre-application
- System of governance
- ORSA – forward looking
- Supervisory reporting and public disclosure

The table below sets out key features of the Interim Measures, including their proposed scope, dates of application and deadlines.

| Pillar | Policy area | Background and proposed approach | Scope of application | Date of application / Deadlines |
|-----------------|---------------------------------------|---|----------------------|--|
| Pillar 1 | Internal model pre-application | <p>Although not a formal requirement of the Solvency II directive, many supervisors have established pre-application processes to help insurers through the journey to submission of a final internal model application. EIOPA's draft guidelines aim to formalise this process in response to pressure from the industry and to increase convergence of supervisory practices across the EU.</p> <p>The draft guidelines cover a number of areas which national regulators should review during the pre-application such as the use test; assumption setting; use of expert judgement; calibration; validation; documentation. Pre-application does not insinuate pre-approval however the Danish FSA has indicated (under the ISB regime) that it may be possible for some companies to use their Solvency II models under the current regime.</p> | Internal model firms | Guidelines effective by 1 January 2014 |
| Pillar 2 | System of governance | <p>National regulators would have to ensure that companies take appropriate steps to build an effective system of governance.</p> <p>The draft guidelines do not differ significantly from previous versions circulated by EIOPA however, some areas of change include:</p> <ul style="list-style-type: none"> - Decisions taken at AMSB level should be documented including description on how information from the risk management system has been taken into account. - Considerable extension to application of the prudent person principle including assessment of non-routine investment activities, unit linked and index linked contracts, assets not traded on a regulated market, derivatives, securitised products. - New section dealing with classification and eligibility of own funds in context of capital and medium term capital management policies. Similar to EIOPA's requirements for ORSA in their final report published summer 2012. - Outlines new tasks expected of the Actuarial Function in assessing data quality; testing against experience; arrangements on underwriting policy and reinsurance. - New guidelines on governance and risk management at group level, including reference to internal model pre-application. | All firms and groups | Guidelines effective by 1 January 2014 |

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|-----------------|--|---|---|---|
| Pillar 2 | Own Risk and Solvency Assessment (ORSA) forward-looking | <p>The draft guidelines are broadly based on EIOPA's Final Report on ORSA published in July 2012.</p> <p>EIOPA target only the forward looking aspect of assessing own risks however this assessment is linked to all the major components of ORSA:</p> <ul style="list-style-type: none"> - Continuous compliance with regulatory requirements (capital; technical provisions; own funds) - Overall solvency (non-financial risks) and link to business plan/beyond 1 year horizon - Deviations from assumptions underlying the SCR - Group specific requirements (information per legal entity must be easily identifiable) | Regulators to obtain 80% coverage of national market | <p>Guidelines effective by 1 January 2014</p> <p>Companies to submit their supervisory report within two weeks of completing their ORSA</p> |
| Pillar 3 | Supervisory reporting | <p>The draft guidelines contain a sub-set of the Reporting package published by EIOPA in July 2012. For more detail see Dialog Article: Getting to grips with Pillar 3¹.</p> <p>Under the interim measures, companies would have to report annual and quarterly information during 2015. EIOPA are working on the basis that Omnibus II will be adopted by then and Solvency II Pillar 1 requirements would be known.</p> <p>EIOPA clarifies that the main objective of preparatory reporting is to ensure companies are embedding and testing the necessary systems to support systematic reporting.</p> <p>The annual and quarterly requirements for solo and group insurers will be subject to different thresholds of application which are explained in more detail below.</p> <p>Market share for non-life is to be assessed according to gross written premium; Life to be assessed according to technical provisions. Companies required to report information would be notified 11 months in advance of the first reporting date.</p> | | |
| | | <p>- Solo annual quantitative reporting</p> <p>Templates from the following categories are targeted: balance sheet; assets; technical provisions; own funds, SCR and MCR.</p> | Firms representing at least 80% of national market share. | Reference date: 31 Dec 2014 ² Deadline: 20 weeks after y/e |
| | | <p>- Solo quarterly quantitative reporting</p> <p>Templates from the following categories are targeted: balance sheet; assets; technical provisions; own funds and MCR.</p> | Firms representing at least 50% of national market share. | Reference date: 30 Sept 2015 Deadline: 8 weeks after q/e |
| | | <p>- Group annual & quarterly quantitative reporting</p> | Groups with asset | Groups apply |

¹ <http://www.pwc.dk/da/nyt/finance/pillar3rapportering.jhtml>

² EIOPA assumes Solvency II will be effective from 1 January 2016 – if this date moves the dates for interim reporting will also be adjusted accordingly. This is to reflect the objective that firms will report the annual package at least once before Solvency II becomes effective (and quarterly reporting will happen twice).

EIOPA proposes interim measures for Solvency II preparation

| Pillar | Policy area | Background and proposed approach | Scope of application | Date of application / Deadlines |
|--------|-------------|---|--|---|
| | | Templates from the following categories are targeted: balance sheet, assets, technical provisions; own funds; SCR; group specific information (composition of group capital; intra-group transactions; risk concentrations) | holdings of/exceeding 12bn€ (financial stability groups) | same reference dates as solos Groups add 6 weeks to solo deadlines |
| | | <p>- Narrative reporting</p> <p>Shorter than EIOPA's last available draft guidelines. Covers information on the System of Governance; Capital Management; Valuation for Solvency purposes; Reporting Policy.</p> | Solo and group annual thresholds apply (80% of national market share and groups with/over 12bn€ assets holdings) | Annual reporting reference dates and deadlines apply |

What's next?

The consultations are open until 19 June 2013 and all interested stakeholders are invited to comment. On 12 March 2013 Insurance Europe wrote to EIOPA outlining their view that they support EIOPA broad objectives for Interim Measures however quantitative information derived from Solvency II Pillar 1 calculations should not be required on the grounds that these are still not final and could create unnecessary compliance costs to the industry.

EIOPA plans to publish final guidelines in the areas covered by the consultations in the autumn of 2013. It is expected this will allow national supervisors enough time for the measures to be implemented early in 2014.

Contacts

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What do I need to do?

EIOPA's proposed interim measures are likely to bring Solvency II preparations back to life. First, insurers might wish to become familiar with the proposals and consider responding to the consultation. There is still opportunity to influence the debate and the final shape of the interim requirements.

Secondly, firms might wish to assess their level of preparedness against the proposals. As explained before, although most of the proposals relate to Pillar 2 and 3 requirements, the preparation of this information presupposes calculation of key Pillar 1 information which might not yet be readily available. This coupled with the fact that some of the requirements will kick in as early as 2014 will bring a sense of urgency to those who had put their Solvency II programmes on hold.

The biggest challenge for most insurers will be the requirement to produce a forward-looking ORSA and quantitative reporting to the regulator ahead of the Solvency II implementation. Finance functions may need to re-think their target operating model to enable this reporting in parallel with current reporting requirements and enhanced integration with actuarial, risk and other departments.

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