
Hot Topic

Publication of final EIOPA guidelines signals renewed effort towards Solvency II finalisation

FS Regulatory Centre of
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Summary

On 27 September 2013 EIOPA published its final *guidelines for the preparation of Solvency II* ("the guidelines"). The guidelines cover the following four areas:

- System of governance
- Forward looking assessment of own risks (based on the ORSA principles)
- Submission of information to National Competent Authorities
- Pre-application for internal models

The guidelines apply from 1 January 2014; although in some areas they foresee a gradual application over 2014 and 2015.

The guidelines are addressed to national regulators who must decide how best to incorporate them into their local supervisory framework. Therefore, whilst the direction of travel across member states should be consistent, there may be differences as to how the guidelines are implemented in practice. Regulators have two months from issuance to report to EIOPA about their intentions to comply with the guidelines.

The guidelines have been finalised following a public consultation earlier in the year. EIOPA has summarised how stakeholders' comments have been addressed. However, the changes made are largely points of detail or clarifications. In a number of areas EIOPA has not been convinced of arguments that the guidelines are unduly burdensome and therefore would require fundamental change.

The guidelines have been prepared on the working assumption that Solvency II will be applicable from 1 January 2016. The achievement of this implementation date will be dependent on a successful conclusion to the ongoing 'trilogue' discussions regarding the treatment of long-term guarantees¹ leading to the approval of the Omnibus II Directive. A vote on Omnibus II is currently scheduled for February 2014.

The publication of these guidelines is a key milestone towards Solvency II's implementation. Insurers now have a clearer idea of what will be expected of them in the period leading up to Solvency II's implementation and should be acting now to ensure they are well placed to respond to the implementation of the guidelines by their local regulators.

¹ See our Hot Topic at <http://www.pwc.co.uk/insurance/publications/eiopa-publishes-findings-on-long-term-assessment.jhtml>

What do the guidelines mean for the industry?

The guidelines are addressed to national regulators across the EU and aim to promote consistency in the preparation for Solvency II implementation. National regulators (referred to in the guidelines as National Competent Authorities or 'NCAs') must 'make every effort to comply' with EIOPA guidelines in accordance with European legislation. This in practice means that national regulators should comply (some may feel they already do comply) unless it is beyond their powers to do so.

EIOPA is also clear that it is for each national regulator to determine how to comply with EIOPA's guidelines in an appropriate manner.

Once the guidelines are published in all official EU languages (expected on 31 October 2013) national regulators will have a period of two months to report to EIOPA on whether, and how, they plan to apply them. The guidelines take effect from 1 January 2014, although in some areas there is a gradual application through a phasing in approach over the two years leading up to Solvency II's assumed implementation on 1 January 2016.

EIOPA's approach to implementing the guidelines

In their response to the consultations stakeholders have made it clear that they want to see a 'principles based' approach for the preparatory guidelines. As a result, the approach taken by EIOPA is that the guidelines do not seek to describe how the requirements are to be applied on a case-by-case basis, but instead are drafted with the intention of being applicable to all circumstances.

To take account of the principle of proportionality and to provide flexibility in the preparatory stage, in some areas the guidelines make provisions for 'phasing-in' (so that expectations for 2015 differ from those for 2014). In addition, in some areas thresholds apply so that the guidelines will not be applicable to all insurers. However,

to a large extent the way that the guidelines impact insurers will depend on how national regulators seek to implement them. In this regard, EIOPA expects national regulators to take into account the nature, scale and complexity inherent to each insurer's business.

Many stakeholders asked EIOPA to clarify that any failure to comply with the guidelines in the preparatory period should not lead to any enforcement action. However, the guidelines remain silent on this point as the means by which the guidelines are incorporated into the local regulatory framework is considered to be a matter for national regulators. EIOPA does note that a failure to meet Solvency II's capital requirements in the preparatory period would not, in itself, be expected to lead to supervisory action. However, EIOPA indicates that supervisory action could arise if the quality of information submitted under the guidelines is deficient or if appropriate consideration is not given to matters arising from the application of the guidelines on system of governance or the Forward Looking Assessment of Own Risks (FLAOR).

EIOPA has clarified that the explanatory text accompanying the guidelines is intended to provide illustrations of how the guidelines work in practice without creating any new obligations. As such national regulators are not subject to a 'comply or explain' obligation in respect of the explanatory text.

For each of the guidelines EIOPA discusses how it has addressed stakeholders' comments in finalising the guidelines and a detailed appendix is provided setting out EIOPA's resolution of all the comments received.

Overall guidelines content

The guidelines 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 one, such as internal models.

The Appendix sets out key features of the guidelines, including their scope, dates of application and deadlines.

What's next?

EIOPA plans to issue the guidelines in all official EU languages on 31 October 2013. National regulators will then have two months to report to EIOPA about their intention to comply, prior to the guidelines taking effect on 1 January 2014.

EIOPA has indicated it will review the proposed submission dates for regulatory reporting at the end of 2013 in light of developments towards the finalisation of Omnibus II.

National regulators are required to submit a progress report to EIOPA on the guidelines' implementation in February 2015.

Omnibus II trilogy discussions continue in the lead up to the key vote scheduled for February 2014. If Omnibus II is approved to this timetable then EIOPA's assumed date of 1 January 2016 for full Solvency II implementation may be achievable.

Contacts

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What do I need to do?

The publication of EIOPA's guidelines should reinvigorate insurers' Solvency II preparations.

Firms should be assessing their level of preparedness against the guidelines whilst at the same time paying close attention to the degree to which their national supervisors will adopt these guidelines. Whilst most of the proposals relate to Pillar 2 and 3 requirements, the preparation of this information presupposes calculation of key Pillar 1 information. This coupled with the fact that some of the requirements will kick in at the beginning of 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 assessment of own risks 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.

EIOPA is working to an assumed Solvency II implementation date of 2016. With the trilogy discussions currently progressing, and with a vote on Omnibus II set for early next year, it appears clear that the policy makers remain convinced that this is an achievable (if challenging) target date. Firms should be taking stock as to whether they are on track to move to a fully live Solvency II environment in 2016.

Appendix – Key Features of Solvency II guidelines

| 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 regulators have established pre-application processes to help insurers through the journey to submission of a final internal model application. EIOPA's guidelines aim to formalise this process to achieve a consistent and convergent approach across the EU.</p> <p>The guidelines apply to applications to use either full or partial internal models to calculate the SCR at either a solo or a group level.</p> <p>The guidelines cover a number of areas which national regulators will consider during the pre-application process and are divided into 12 Chapters as follows:</p> <ul style="list-style-type: none"> • Chapter 1 – General (guidelines 1 – 4) • Chapter 2 – Model changes (guidelines 5 – 8) • Chapter 3 – Use test (guidelines 9 – 17) • Chapter 4 – Assumption setting and expert judgement (guidelines 18 – 22) • Chapter 5 – Methodological consistency (guidelines 23 – 25) • Chapter 6 – Probability distribution forecast (guidelines 26 – 29) • Chapter 7 – Calibration – approximations (guidelines 30 – 35) • Chapter 8 – Profit and loss attribution (guidelines 36 – 38) • Chapter 9 – Validation (guidelines 39 -50) • Chapter 10 – Documentation (guidelines 51 – 57) • Chapter 11 – External models and data (guidelines 58 – 65) • Chapter 12 – Functioning of the colleges during the pre-application process for internal models for groups (guidelines 66 – 70) <p>Paragraphs 3.32 – 3.84 set out how EIOPA has responded to stakeholders' comments on the previous draft guidelines, including areas in which amendments have been made. In general the changes made by EIOPA constitute clarifications rather than widescale changes.</p> | Internal model firms. | Guidelines effective on 1 January 2014. |
| | | | <h3>In Denmark</h3> <p>As a part of the Danish administrative order “Bekendtgørelse om solvens og driftsplaner for forsikringsselskaber” (administrative order on solvency and programmes of operation for insurance companies, hereinafter the “Administrative order”) implemented 1 January 2014, companies are allowed to use user-specific parameters in their calculations of solvency demands by the standard model if they send a letter (around five pages) to the FSA.</p> <p>As a part of the Administrative order, companies are allowed to use partial or full internal models in their calculations of solvency demands if they send a letter (around ten pages) to the FSA. Companies must be able to document the design and operational details of the internal model.</p> | |
| Pillar 2 | System of governance | <p>During the preparatory phase, national regulators are expected to ensure that companies take active steps towards implementing an effective system of governance compliant with Solvency II's requirements. National supervisors are in turn expected to review and evaluate the quality of the information provided to them in this area and to discuss the progress being made.</p> <p>The guidelines themselves apply from 1 January 2014 and do not generally contain any specific phasing in requirements. In practice regulators will not be in a position ‘to ensure that’ all insurers that they regulate comply with all aspects of the guidelines at this date. It will therefore be for national supervisors to determine how to apply the guidelines practically over the period building up to implementation.</p> | All firms and groups. | Guidelines effective on 1 January 2014. |

| Pillar | Policy area | Background and proposed approach | Scope of application | Date of application / Deadlines |
|----------|--|---|--|--|
| | | <p>In many areas the guidelines are directly sourced from the systems and control requirements of the Solvency II level 1 directive. The guidelines are divided into sections and chapters as follows:</p> <ul style="list-style-type: none"> • Section I – General Provisions for preparatory Guidelines (guidelines 1 – 2) • Section II – System of Governance <ul style="list-style-type: none"> – Chapter I – General governance requirements (guidelines 3 – 10) – Chapter II – Fit and Proper (guidelines 11 – 14) – Chapter III – Risk Management (guidelines 15 – 24) – Chapter IV – The “prudent person” principle and the system of governance (guidelines 25 – 30) – Chapter V – Own fund requirements and the system of governance (guidelines 31 – 32) – Chapter VI – Internal controls (guidelines 33 – 34) – Chapter VII – Internal audit function (guidelines 35 – 37) – Chapter VIII – Actuarial function (guidelines 38 – 47) • Section III – Group specific governance requirements (guidelines 48 – 52) <p>Paragraphs 3.48 – 3.105 set out how EIOPA has responded to stakeholders’ comments on the previous guidelines, including areas in which amendments have been made. In general the changes made by EIOPA constitute clarifications rather than widescale changes. In many areas EIOPA did not agree with stakeholder concerns; for example EIOPA did not agree with the suggestion that the guidelines in some areas (e.g. risk management) were too detailed and that guidelines in other areas (e.g. the prudent person principle) were inappropriate.</p> | | |
| | | | | <p><i>In Denmark</i></p> <p>The FSA is revising the Danish executive order on management “ledelsesbekendtgørelsen” in connection with the Insurance Core Principles (ICP)</p> |
| Pillar 2 | Forward-looking assessment of own risk (FLAOR) | <p>EIOPA’s guidelines deal with the Forward Looking Assessment of Own Risks (FLAOR). This assessment is linked to all the major components of ORSA (see EIOPA’s Final Report on ORSA published in July 2012) including:</p> <ul style="list-style-type: none"> • Continuous compliance with regulatory requirements (capital; technical provisions; own funds) • Quantity and quality of own funds over the whole of the business planning period • Deviations from assumptions underlying the SCR • Group specific requirements <p>There are a number of elements to the FLAOR and, in terms of timing and frequency of reporting, EIOPA has clarified that:</p> <ul style="list-style-type: none"> • The assessment of overall solvency needs should be performed by all firms at least twice during the preparatory phase, once at any time during 2014 and once in 2015. This will remain the case irrespective of the progress on Omnibus II. | <p>All firms and groups.</p> <p>However, only 80% market coverage required in respect of assessment of continuing compliance with capital requirements and the requirements on technical provisions.</p> | <p>Guidelines effective on 1 January 2014</p> <p>Assessment of continuing compliance with capital requirements and the requirements on technical provisions deferred until 2015.</p> <p>Companies to submit their supervisory report within two weeks of completion of assessment.</p> |

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| | | <ul style="list-style-type: none"> The need to perform an assessment of continuing compliance with the capital requirements and the requirements on technical provisions have been deferred and now only need to be performed in 2015 by those firms within scope. <p>The guidelines are divided into sections as follows:</p> <ul style="list-style-type: none"> Section I – General Provisions for preparatory Guidelines (guidelines 1 – 3) Section II – Forward Looking Assessment of Own Risks (guidelines 4 -10) Section III – Specific features regarding the performance of the forward looking assessment of own risks (based on the ORSA principles) (guidelines 11 – 18) Section IV – Specificities of the Group in the forward looking assessment of own risks (based on the ORSA principles) (guidelines 19 -25) <p>Paragraphs 3.48 – 3.107 set out how EIOPA has responded to stakeholders’ comments on the previous guidelines, including areas in which amendments have been made. As noted above certain requirements have been deferred until 2015. However, EIOPA rejected stakeholder views that guidelines on FLAOR were unduly burdensome and also did not accept arguments that firms applying for internal model approval should not have to consider the SCR. However, EIOPA acknowledges that the first reports will not ‘necessarily already be perfect’.</p> | | |
| Pillar 3 | Supervisory reporting | <p>The guidelines require reporting based on a sub-set of the Reporting package published by EIOPA in July 2012. For more detail see our Hot Topic: Getting ready for Solvency II reporting. An Appendix highlights changes that have been made to the versions published in July 2012.</p> <p>The guidelines are designed to ensure that insurers and groups build systems and structures to deliver high quality information for supervisory purposes and to allow regulators to review and evaluate the quality of information and the progress made.</p> <p>Under the guidelines, companies have to report annual information as at 31 December 2014 within 22 weeks (an extension of 2 weeks from what was originally proposed) and quarterly information as at 30 September 2015 within eight weeks. Groups have to report as at the same dates but have an extra six weeks to make their submissions.</p> <p>These deadlines have been set based on the assumption that Solvency II will be implemented on 1 January 2016. EIOPA plans to revisit this assumption at the end of 2013 based on Omnibus II’s progress.</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. Companies / groups required to report information must be notified 11 months in advance of the first submission reference date.</p> <p>The thresholds for solo insurers are based on market share. Market share for non-life business is to be assessed according to gross written premium. Market share for life business is to be assessed according to gross technical provisions. The thresholds for groups are based on total assets in the consolidated balance</p> | | |

In Denmark

As a part of the Administrative order implemented 1 January 2014, companies are expected to regard risks with a going-concern view in a short and long term perspective.

In Denmark

As a part of the Administrative order implemented 1 January 2014, companies are expected to report their results for the first time in Q1 2014. The reporting is expected to be an extract of EIOPA’s Quarterly Reporting templates (which is necessary for the FSA concerning ISB).

| Pillar | Policy area | Background and proposed approach | Scope of application | Date of application / Deadlines |
|--------|-------------|--|---|--|
| | | <p>sheet. The assessments are to be performed based on 2012 data.</p> <p>Paragraphs 3.48 – 3.123 set out how EIOPA has responded to stakeholders' comments on the previous guidelines, including areas in which amendments have been made. EIOPA acknowledged stakeholder concerns regarding the burden imposed by the reporting guidelines but has concluded that pre-implementation reporting is a crucial part of Solvency II preparation (although national regulators may now exempt captives from the requirements).</p> | | |
| | | <p>Solo annual quantitative reporting</p> <p>Templates in the following areas are required: balance sheet; assets and liabilities; open derivatives; technical provisions; own funds, SCR and MCR.</p> | Firms representing at least 80% of national market share. | Reference date: 31 Dec 2014 Deadline: 22 weeks after y/e. |
| | | <p>Solo quarterly quantitative reporting</p> <p>Templates in the following areas are required: balance sheet; assets; open derivatives; 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 quantitative reporting</p> <p>Templates in the following areas are required: balance sheet; assets; open derivatives; technical provisions; own funds; SCR; group specific information (undertakings within group; insurers' individual requirements).</p> | Groups with asset holdings exceeding 12bn€ (financial stability groups). | Groups apply same reference dates as solos. Groups add 6 weeks to solo deadlines. |
| | | <p>Group quarterly quantitative reporting</p> <p>Templates in the following areas are required: balance sheet; assets; open derivatives; own funds.</p> | Groups with asset holdings exceeding 12bn€ (financial stability groups). | Groups apply same reference dates as solos. Groups add 6 weeks to solo deadlines. |
| | | <p>Narrative reporting</p> <p>Covers information on the System of Governance; Capital Management; Valuation for Solvency purposes.</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. |

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