Associazione Nazionale
fra le Imprese Assicuratrici

Solvency II e trasferimento dei rischi, il nuovo ruolo delle compagnie riassicurative

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«17° ANNUAL ASSICURAZIONI»

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Agenda

➢ **Solvency II**

- **Where we are**

- **Open issues**

- **A long-term view**

Solvency II: Where we are

Solvency II : where we are

- 1st January 2016: entry into force
- Amended draft Delegated Act published on 30th September 2015
- 2nd set of EIOPA Guidelines published in national languages on 14th September → NSAs have two months to comply or explain
- Around 30 Regulations being currently consulted by IVASS. Some of them to be finalized only after 31st December 2015

Solvency II: Open issues

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- Is Solvency II able to promote insurers' long-term investments? (Infrastructures, Securitisations, Equity)

- Does Solvency II allow to properly cope with short-term market volatility? (Risk-free rate and adjustments)

Solvency II: Open issues

➢ Infrastructures

- CMU Action Plan includes draft amendments to Solvency II Delegated Regulation (2015/35):
  - ✓ a new asset category is introduced ("Qualifying in infrastructure investments");
  - ✓ specific treatment for SCR calculation (reduced shocks for both equity- and bond-type investments);
  - ✓ requirements in term of risk management.

- EC asked EIOPA for further advice on infrastructure corporates
- Investments in infrastructures are crucial to economic recovery in Europe (also via the Juncker Plan and EFSI)

Solvency II: Open issues

➢ Securitisations

- Solvency II Delegated Regulation (2015/35) introduced some significant improvements
  - ✓ i.e **reduced calibration for «high quality» (Type I) securitisations**
- EC Proposal for simple, transparent and standardised (STS) securitisations contains a number of further positive elements
  - ✓ e.g. **junior tranches included in the scope of STS**
- Need for further reduction of the current Solvency II calibrations in order to better reflect the true risks on the insurers that do not represent a barrier to investment
  - ✓ e.g. **capital charges for securitisations of residential loans to be capped at the level of charge applied to the underlying pool of residential loans**

Solvency II: Open issues

- **Equity**

  Å CMU Action Plan contains draft amendments to Solvency II Delegated Regulation (2015/35):

  - ✓ investments in ELTIFs and Equities traded on Multilateral Trading Facilities (MTFs): same capital charges as equities traded on regulated markets (Type 1)
  - ✓ transitional measure for equity investment extended to Type 2 equities (equity shock starting from 22% in 2016 and reaching 39% or 49% in 7 years). Simplifications in case of equity held within collective investment funds (improvements needed)

Solvency II: Open issues

➢ Risk-free rate and its adjustments

- MA, VA, extrapolation: introduced to reduce artificial volatility in insurers' balance sheets
- Do the adjustments work properly in case of stress? No back-testing has been done
- Ultimate Forward Rate (UFR): EIOPA methodology review in 2016.

Solvency II: Open issues

➢ The National framework

- Ring Fenced Funds
  - ✓ no indication from IVASS whether RFFs exist in Italy or not
- Deferred taxes
  - ✓ it seems that the case of a «fiscal unit» is not envisaged in the proposed Regulation. This raises problem as to the application of the «recovery test» of transferred tax losses with sufficient future profits
- External audit
  - ✓ a requirement for an external audit of Solvency II data – particularly for QRTs data - would be burdensome and expensive
- Subgroup supervision
  - ✓ not clear yet whether IVASS will apply supervision to Italian subgroups belonging to foreign groups

Solvency II: A long-term view

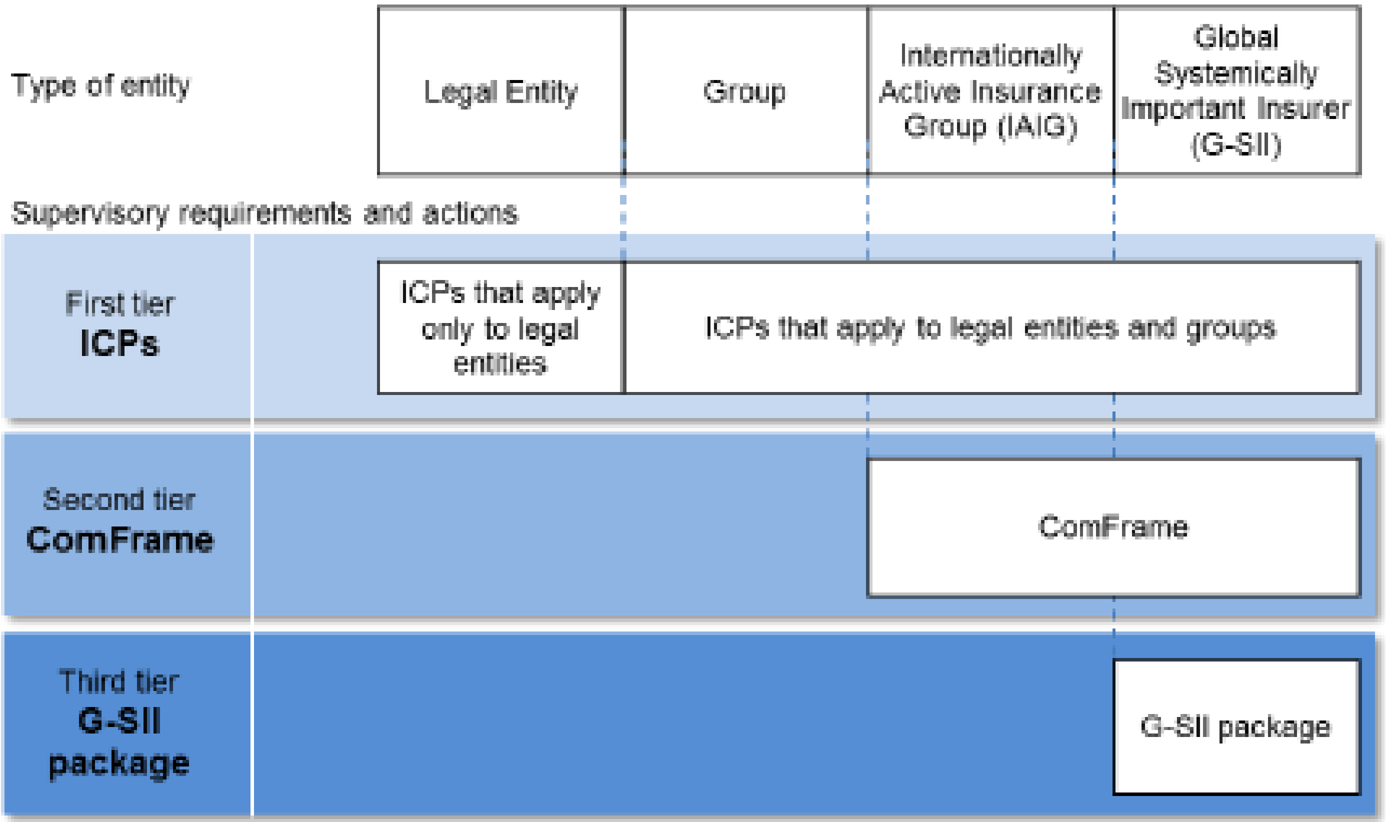
Solvency II: A long-term view

➢ Solvency II reviews and updates

- **by end of 2017:** how the application of Group supervision is performed
- **by end of 2018**: assessment of the benefits of enhancing group supervision and capital management within a group
- **by end of 2018**: review of the Standard Formula
- **by end of 2020**: wider review of the Standard Formula
- **by end of 2021**: EIOPA to assess the impact of Long-Term Guarantee (LTG) Measures

Solvency II: A long-term view

Architecture of IAIS international supervisory requirements



Solvency II: A long-term view

IAIS global capital standards

- **Basic capital Requirement (BCR)**
  - Foundation for higher loss absorbency for G-SIIs

- **Higher Loss Absorbency (HLA)**
  - Development additional capacity requirements for G-SIIs

- **Insurance Capital Standard (ICS)**
  - Risk-based global insurance capital standard
  - Apply to IAIGs (including all G-SIIs)
  - Included in ComFrame

Solvency II: A long-term view

IAIS work program

	Adopt	Confid. Report Annual Review	Apply	Apply to
BCR	2014	2015 ->	2019 ->	G-SII
HLA	2015	2016 ->	2019 ->	G-SII
ICS 1.0	2017	2017 ->	n/a	IAIG (G-SII)
ComFrame Incl ICS 2.0	2019	n/a	2020 ->	IAIG (G-SII)

- **BCR: FSB/G20 endorsement October/November 2014**
- **HLA: FSB endorsed. IAIS formal adoption at GM November 2015**

  G-20 endorsement anticipated November 2015
- **Development and refinement informed by Field Testing**

Source: IAIS, 2015

Solvency II: A long-term view

- **Using market values may exaggerate the true exposure of the balance sheet to temporary market volatility** and therefore force the company to hold significant extra capital buffers to cope with the large volatility
  - The "market consistent" value of liabilities is obtained by discounting future cash flow with risk-free rates (proxied by euro swap rates). During periods characterized by high volatility in financial markets, average asset values tend to decrease while "safe" assets will benefit from "flight to quality" effects, which will cause their market value to increase considerably
    - ✓ Thus, the capital position of insurers might deteriorate even if the adjustment of interest rates is only temporary and liabilities are due in a distant future (recent examples: 2008 corporate bond and 2011 government bond crisis)
- **Using a 1 year VAR for assets which can be held long-term may exaggerate the exposure to market movements** and lead to capital requirements being set too high than required, at least for specific asset classes
  - (Mladina, 2014) "equity returns show more volatility and tail risk at short horizons than at long horizons"
  - (Persaud, 2015) "to a life insurer, what matters is not the price of an asset or the risk of holding it tomorrow or at the end of the year but the risk at the point of maturity of the policy"

Solvency II: A long-term view

- **Adjustments were made to the market consistent approach to better reflect the long-term nature of the business** and allow insurers to continue to offer long-term guarantees backed by long-term investments:
  - For example, on the balance sheet measurement, adjustments have been introduced to the discount rate used to value liabilities (e.g. the "Matching Adjustment", "Volatility Adjustment")
  - Transitional measures envisaged for the calibration of equity risk
- **<u>Concerns remain over the effectiveness of the adjustments as these are regarded to be very conservative in their calibration and restrictive where they can be applied</u>**
- Rather than seen as legitimate improvements to better reflect the true risks and economics of the business these adjustments are seen by some as aberrations from the pure and correct market approach (Ayadi et al., 2012)
- Research is needed on this topic
  - The Solvency II review, planned for 2018, should find proper solutions to these issues in order to preserve the insurance business model (in particular, Life)

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