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TRENDS – Solvency

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In a nutshell…

***Discussions are ongoing in the European Parliament** to reach compromises on the different positions on the proposed amendments of the **Solvency II Directive** and the proposed **Insurance Recovery and Resolution Directive**.*

***Solvency II**: **A further meeting** between the rapporteur and shadow rapporteurs **will be held in mid-April** in order to be able to reach an agreement on the different positions, projecting discussions towards the **last phase of negotiations** to be held with the Council and the Commission **in the second half of 2023**.*

***IRRD: Parliament is negotiating final compromises**; the intention is to put the text to a vote in the same meeting as the Solvency II file.*

***New consultations** include: i) **IAIS Public Consultation on Climate Risk in Insurance**.*

***EIOPA has published the new and modified representative portfolios** to be used as a basis **for the calculation of the Volatility Adjustment**.*

***IVASS published a Letter to the Market regarding** the timing and operational modalities for **the reporting of supervisory information**.*

*We provide an **update of the latest works by the Bank of England regarding the review of the newly established prudential framework** (stemming from Solvency II).*

***The CRO Forum published a Paper on ORSA** stress tests and scenario testing.*

*Our **focus section** provides additional analysis regarding the **treatment of Nat cat risk in Solvency II**, also considering the recent Call for evidence to review standard formula parameters by EIOPA.*

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Highlights

Review 2020: Recent Developments

a) Solvency II Directive.

On March 9, rapporteur Markus Ferber proposed **new compromises on sustainability and LTG issues**, which are now being negotiated with the other shadow rapporteurs. There will be another shadow meeting in April, while the vote in the ECON Commission, which was originally scheduled for the end of November, could take place in May. According to this scenario, the plenary vote would take place at the end of June and the Trilogue should thus begin under the Spanish Presidency.

b) Insurance Recovery and Resolution Directive (IRRD).

Work **continues in the European Parliament on negotiating the latest compromises**; the vote on the report is expected to take place together with the Solvency II vote.

c) Developments in ITS Reporting and Taxonomy 2.8.0.

On **March 17**, EIOPA released the **final Taxonomy 2.8.0**, which includes the "business package" containing changes to the Implementing Technical Standards and the Solvency II Reporting Guidelines.

New consultations

IAIS: Public Consultation on Climate Risk in the Insurance Industry

Last **March 16**, the **International Association of Insurance Supervisors** (IAIS) published a **Climate Risk Consultation Paper** ("Climate Risk Supervisory Guidance"), which is the first in a "package" of three consultation papers **aimed at promoting a global-scale supervisory approach to better address climate-related risks in the insurance industry**.

The Consultation **follows up on the work begun with the publication of the Application Paper on Climate Change-Related Risks in May 2021** and the subsequent gap analysis carried out in 2022 with regard to existing supervisory material to define how climate risk is captured and to identify possible further supervisory standard-setting interventions.

The paper **consults on some changes to the guidance on various ICPs** (Insurance Core Principles) on the following aspects: i) changes to the introduction of the ICP that positions **climate risk in the context of the overall insurance supervisory framework**; i) discussion on the need for changes to the existing supporting material related to **governance, risk management and internal controls** (ICPs 7 and 8); iii) questions that require feedback from stakeholders on climate-related operations, for what relates to **supervisory guidance**.

Other reports

EIOPA: New representative portfolios for the Volatility Adjustment calculation

Last **March 9**, EIOPA published the new representative portfolios (in a new version with some revisions from what was published in December) that will be used **for the Volatility Adjustment (VA) calculation**.

EIOPA will begin using the new representative portfolios as of March 31, 2023. The next update of the representative portfolios is scheduled for the end of 2023.

IVASS: Letter to the market on timeline and operational arrangements for supervisory reporting for 2023

On **March 1**, **IVASS** published a Letter to the Market regarding the timing and operational modalities for the reporting of supervisory information.

In the Letter, the Institute summarizes the **main requirements for the submission of supervisory disclosures with a reference date of 2023**, or to be transmitted during 2023 through the Infostat infrastructure, including the operational modalities for transmission and related deadlines.

The fulfillments referred to in the Letter concern: i) **Solvency II reporting** and information for **Financial Stability** purposes; ii) national supervisory and **statistical disclosures**; iii) **natural catastrophe and sustainability** risk disclosures; iv) claims disclosures; v) **channel AML disclosures** - life and non-life premiums by intermediary; vi) **health insurance liability** disclosures; and vii) **IFRS 17 consolidated financial statements**.

Bank of England: Developments in the supervisory regulatory framework in the United Kingdom

Last **March 13**, the Bank of England, as **the Prudent Regulation Authority (PRA)** for the UK insurance industry, released a Report describing the **latest developments in its work on climate-related risks and the capital rules framework**.

The Report identifies as **potential areas for future development**: i) removing uncertainties created by **climate risk detection** limits in the current supervisory regime; ii) **strengthening risk management controls** to improve the identification, measurement, and management of climate risks; and iii) **assessing possible "regime gaps"** in the macroprudential framework and **calibrating macroprudential tools**.

With regard to the **revision of the prudential framework**, the Bank of England recently published the text of a speech by Sam Woods (Deputy Governor for Prudential Regulation and Chief Executive Officer of the Prudential Regulation Authority) **on the topic of revising Solvency II according to more "UK-friendly" criteria**.

Among the **topics addressed**, of particular relevance to the UK is the **approach for calculating the Fundamental Spread within the Matching Adjustment**, for which no changes are deemed necessary, and the revision of the way **Risk Margin** is calculated, for which instead a change in favor of its substantial reduction is deemed necessary.

Other issues the Authority intends to focus on include: (i) the removal of **reporting requirements** deemed unnecessary for the U.K. market; (ii) the streamlining of **rules for the approval of internal models**; (iii) the expansion of the range of **assets eligible for Matching Adjustment** and, more generally, of eligibility requirements; (iv) raising the **threshold for access to the Solvency UK regime** for smaller firms or new market entrants; (v) greater flexibility in the calculation of group capital requirements; and (vi) taking steps in parallel with the Solvency II review to simplify and clarify expectations for the **UK ISPV regime**.

CRO Forum: Paper on ORSA Stress Test and scenario testing

The **CRO Forum** (the Association of Europe's Leading Chief Risk Officers) has recently published a Paper gathering the **views** of Forum members **on the development of ORSA** and the purpose and role of **stress testing and scenario analysis** in this area.

The Paper builds on an earlier paper developed in 2013 and contains guidance on some principles that can be used by insurance companies to develop an appropriate set of scenarios and stress tests as part of their risk management frameworks; moreover, it **includes insights into companies' current practices regarding the definitions, number, severity and probability of the scenarios chosen**.

In more detail, the paper addresses the following topics: i) **objectives and role of scenario analysis and stress testing in ORSA**; ii) **characteristics of scenarios**; iii) definition, principles, and characteristics of **long-term risk analysis and stress scenarios**; and iv) role of **management actions** in ORSA.

Nat-cat risk in Solvency II and the review of SF parameters in light of the effect of climate change

In February, **EIOPA launched a Call for evidence on the revision of the Nat-Cat parameters** of the standard formula (with deadline on March 31), following the European Commission request.

In its mandate, **the Commission asked EIOPA to review**, at least every three years, **the scope and calibration of the standard parameters of the natural catastrophe risk sub-module for non-life companies**. In light of the growing significance of climate-related risks, the Commission also asked the Authority to take into account, for the purpose of this review, the latest available evidence in terms of scientific studies and risks underwritten by companies using the standard formula for calculating the catastrophe submodule of the solvency capital requirement.

*The Solvency II framework requires that the **Solvency Capital Requirement** (SCR) be **determined by considering the main types of risks** (market and technical) **to which an insurance company is typically exposed** in the conduct of its business.*

***Technical risks include** non-life underwriting risk and, within that, **catastrophe risk**.*

The Call for Evidence aims, therefore, to gather empirical evidence that complements the analyses initiated in the *Methodological paper on the potential inclusion of climate change in the Nat Cat standard formula* published on July 8, 2021, in order to be able to assess whether or not any recalibration of the parameters involved is necessary in light of climate change risks as well.

*The **natural catastrophe risk** (so-called nat-cat risk module) - one of the sub-modules included in the catastrophe risk module for non-life lines of business - quantifies the risk of loss or unfavorable change in the value of insurance liabilities **arising from non-life insurance obligation due to significant uncertainty of assumptions about premiums and reserves referring to** extreme or exceptional events identifiable as **"natural catastrophes"**.*

Article 120 of the Delegated Acts states that the calculation of the **Nat-cat risk submodule** shall be **based on five types of natural disasters** (*perils*): i) **earthquake**, ii) **windstorm**, iii) **flood**, iv) **hail**, and v) **subsidence**.

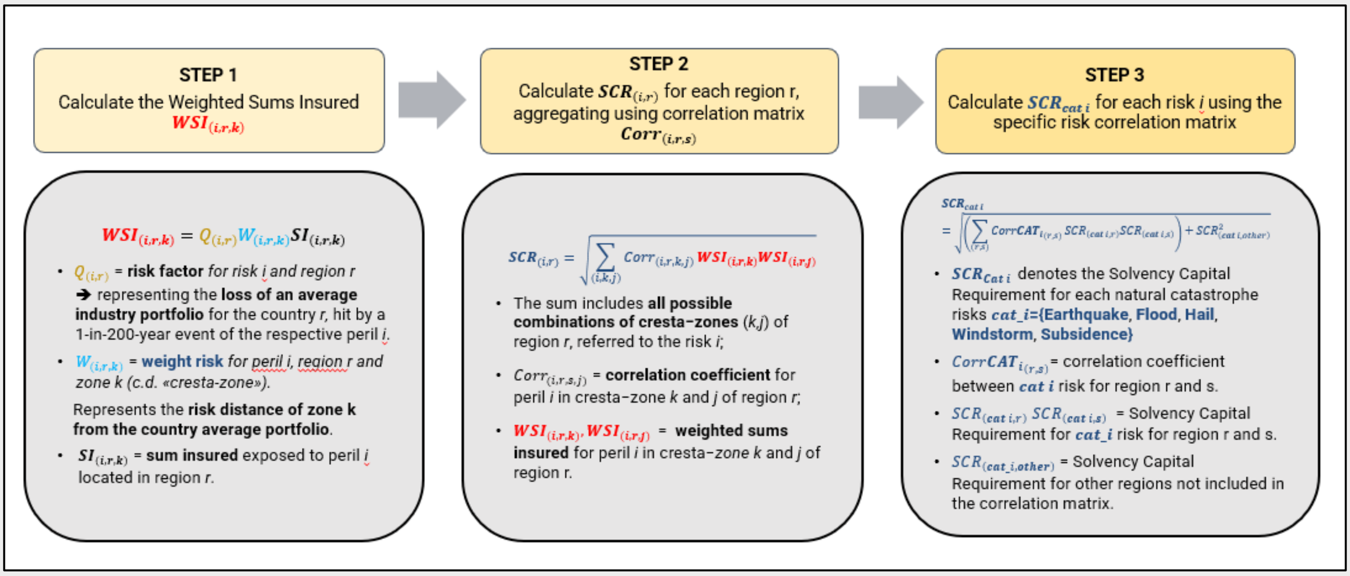
Peril	Type of disaster	Descpription
Earthquake	Geophysical	Includes ground motions not resulting from tsunamis or fires.
Flood	Hydrological	Includes river and rain floods (caused by rainfall), not including storm surges.
Windstorm	Meteorological	Includes cyclonic storms (extra-tropical and tropical cyclones) and excludes convective storms.
Hail	Meteorological	Includes hail as the dominant sub-peril.
Subsidence	Geophysical	Refers to the swelling or shrinkage of clay soils (characteristic of French and neighboring territories).

The Nat-cat SCR is, therefore, calculated by taking into account all risks to which the company is exposed based on the country/geographical region (so-called *region*) and the province/administrative area (so-called *CRESTA zone*/risk zone) in which the risk is located.

For each of the risks, the **capital requirement is calculated based on the sums insured** by the following steps:

Calculation of Weighted Sum Insured (WSI) for each country and risk zone, obtained by multiplying the sums insured by: a **risk factor** $Q_{i,r}$ specific to each risk/country combination (representing the loss of a an average portfolio of policies affected by an adverse event with probability of occurrence 1/200) and a **weighting factor** $W_{(i,r,k)}$ specific to each risk/country/risk zone combination (measuring the risk distance of risk zone k with respect to the region under consideration).

1. **Calculation of the capital requirement for each country,** equal to the **loss of basic Own Funds** that would result **from an instantaneous loss of an amount calculated by** (i) **aggregating the insured sums** calculated in the previous step through risk-zone correlation matrices **and** (ii) **taking into account specific scenarios** defined by the Delegated Regulation.
2. **Calculation of the capital requirement for each peril**, obtained by aggregating the values derived from the previous step using cross-country correlation matrices.



In the Call for Evidence EIOPA then requires to: (i) i**ndicate the risks/regions for which recalibration is deemed necessary**, providing supporting evidence and data; (ii) indicate any **changes in terms of crest zones or correlation matrices** (with attached rationale justifying the change); (iii) produce **data on insured and economic losses related to specific events** (to facilitate the evaluation of any recalibration of risks already in the standard formula or to gather information on "emerging" risks); and (iv) **provide any other comments** or suggestions on the topic, if any.

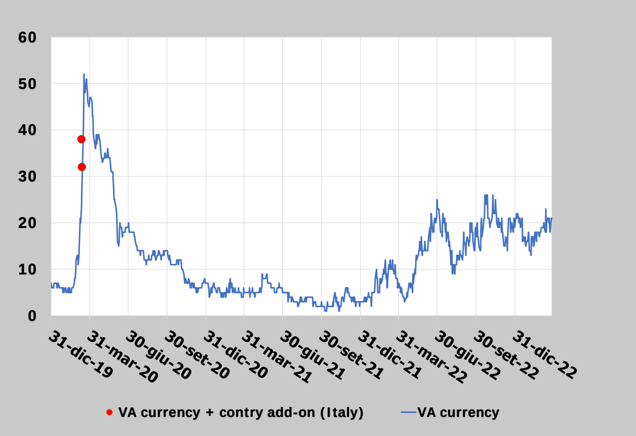
The previous review phase took place with the Review 2018 and decided for an increase in the country risk factor for flood risk (from 0.10% to 0.15%) and a reduction for earthquake risk factor (from 0.80% to 0.77%). For hail risk, the previous calibrations dating back to 2010 are still used (0.03%).

*The Nat-cat perils to which **Italy** is exposed, based on the most recent calibrations, are: **earthquake, flood and hail.***

In contributing to the European response to the Authority's request (through the Insurance Europe working groups), **some important elements to be taken into account to ensure adequate calibration of the risks under consideration were pointed, including**: (i) the **need to consider the evolution of the scientific literature in this area and the new catastrophe models available** for some specific risks, as well as the most recent data on insured losses; (ii) **critical issues related to the use of insured sums as a basis for calculation** and the need to adequately reflect, in the parameterization of the formula, the different national practices in terms of loss limits.

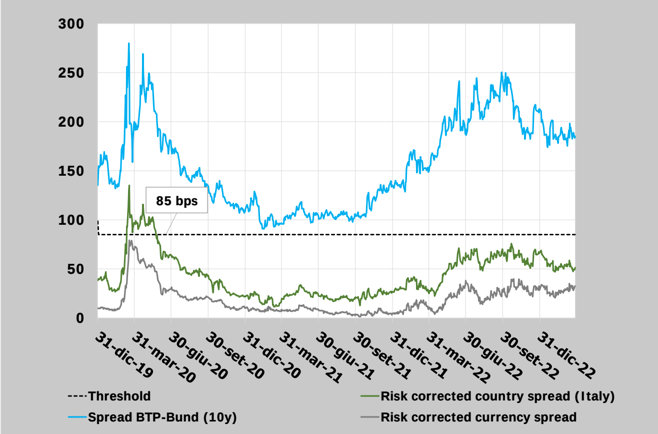
Appendix

Volatility Adjustment for Italy (bps)



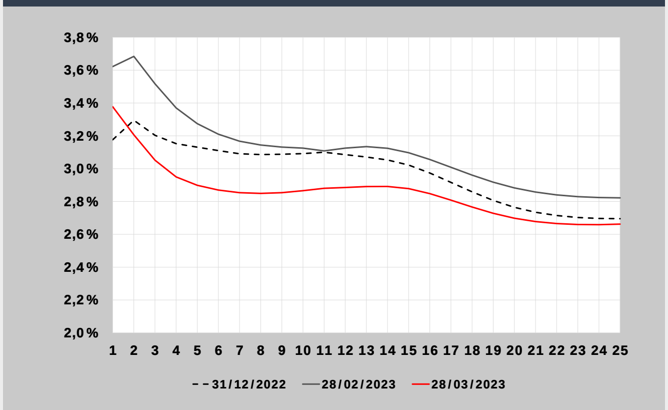
Source: ANIA elaborations on EIOPA and Refinitiv data.

VA components vs. BTP-Bund spread (10y)



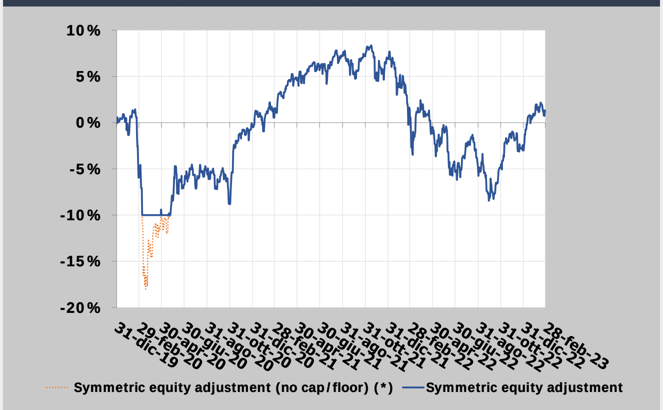
Source: ANIA elaborations on EIOPA and Refinitiv data.

Risk-free rate curve (without VA)



Source: ANIA elaborations on EIOPA and Refinitiv data.

Symmetric Equity Adjustment



Source: EIOPA. (*) SA without -10%/+10% floor/cap.

Volatility Adjustment (*) vs. 10y-Risk-Free Rate

year	month	VA TOTAL (bps)	VA currency (bps)	VA country-Italy (bps)	10y Risk-Free Interest Rates (%)	10y Risk-Free Interest Rates + VA (%)
2023	28 Mar.(**)	21	21	0	2,87	3,08
	28 Feb.	18	18	0	3,01	3,19
	26 Jan.	17	17	0	2,76	2,93
2022	31 Dec.	19	19	0	3,09	3,28
	30 Sep.	18	18	0	2,99	3,17
	30 Jun.	25	25	0	2,09	2,34
	31 Mar	6	6	0	1,11	1,17
2021	*31 Dec.*	*3*	*3*	*0*	*0,21*	*0,24*
2020	*31 Dec.*	*7*	*7*	*0*	*-0,37*	*-0,30*

(*) Correction to the EIOPA risk-free rate curve. Source: EIOPA; (**) ANIA estimate.

Symmetric Equity Adjustment (*) to the Equity capital charge (%)

31 Jul. 2022	31 Aug. 2022	30 Sep. 2022	31 Oct. 2022	30 Nov. 2022	31 Dec. 2022	31 Jan. 2023	28 Feb. 2023
-2,2	-4,9	-8,1	-4,8	-1,2	-3,0	0,9	1,3

(*) Correction to the capital charge applied to equity instruments, based on a basket of equity indices defined by EIOPA. Source: EIOPA.

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