Transition to the risk-based capital model in insurance: Special regulatory issues

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STATE INSURANCE SUPERVISION EFFICIENCY IN A FRAME OF A NEW SOLVENCY REGULATION

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Special regulatory issues

- Exclusion from the scope
  - due to the size
  - due to termination
- Understandable and unambiguous regulation
- Power of supervisory authority before new regulation enter into force
- Transitional measures guaranteed by
  - legislation
  - Supervisory Authority

Exclusion from the scope due to the size

Threshold

- 5 million EUR gross written premiums
- 25 million EUR gross technical provisions
- Not include activities covering
  - Liability risks
  - Credit and suretyship risks
- Reinsurance operations
  - 0,5 million EUR or 10% of gross written premiums
  - 2,5 million EUR or 10% of gross technical provisions

Exclusion from the scope due to the size

Legislation

- apply for undertakings
  - if threshold exceeded for three consecutive years
  - seeking authorisation for which threshold are expected to be exceeded within following five years
  - pursue activities due to right of establishment and freedom to provide service in the territory of another Member State

- cease to apply for undertakings
  - if threshold has not been exceeded for three consecutive years
  - none of the threshold is expected to be exceeded during following five years

Exclusion from the scope due to termination

Undertakings which by 1 January 2016 cease to conduct new (re)insurance contracts and exclusively administrate their existing portfolio in order to terminate their activities

- before 1 january 2019
- is in winding-up proceedings

Exclusion from the scope due to size or termination

2912 (re)insurance undertakings under the scope of supervision according to Solvency II in EEA insurance market

3700 approximately number of (re)insurance undertakings in EEA insurance market

Source:

- „Report on long-term guarantees measures and measures on equity risk 2018“, 18.12.2018
- EIOPA Registers, Register of Insurance Undertakings, https://eiopa.europa.eu/regulation-supervision/registers/register-of-insurance-undertakings

Understandable and unambiguous regulation

Quantitative Impact Studies

- 2005 Preparatory Field Study (2005 Summary report)
- 2005 Quantitative Impact Study 1 (31.12.2004)
- 2006 Quantitative Impact Study 2 (31.12.2005)
- 2007 Quantitative Impact Study 3 (31.12.2006 or 31.12.2005)
- 2008 Quantitative Impact Study 4 (31.12.2007)
- 2010 Quantitative Impact Study 5 (31.12.2009)
- 2012 Long-term guarantees assessment (31.12.2011)

Public hearing and meetings with Member States

Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of the Insurance and reinsurance (Solvency II)

December 17, 2009	Published in Official Journal of the European Union
April 1, 2015	Article 308a shall apply
January 1, 2016	Legislation came into force

Power of supervisory authority before new regulation enter into force

Phasing-in from April 1, 2015 for

- Approval of ancillary own funds
- Classification of own funds into tiers
- Undertaking specific parameters
- Internal models
- Establishing Special Purpose Vehicles
- Approval of use of Duration based equity risk sub-module
- Approval of use of Matching adjustment
- Approval of use of Volatility adjustment
- Transitional measures
- Scope of Group supervision, identify Group supervisors, establish College

Transitional measures - legislation

- Criteria for the classification of **basic own-fund items** to Tire 1 (or Tire 2) for up to 10 years after January 1, 2016 if:
  - issued before January 1, 2016 or prior to the date of entry into force of the Delegated Regulation
  - on December 31, 2015 could be used to meet the available solvency margin up to 50% (25%) of solvency margin according to previous legislation
- Requirements defined by Implementing Measures for **instruments based on repackaged loans** that were issued before January 1, 2011 shall apply only if new underlying exposures were added or substituted after December 31, 2014

Transitional measures - legislation

- Standard parameters used to calculate **concentration risk** sub-module and **spread risk** sub-module shall be until
    - December 31, 2017 **same** in relation to exposures to Member States‘ central governments or central banks dominated and funded in domestic currency of any Member State as the ones that would be applied to such exposures denominated and funded in their domestic currency
    - in year 2018 reduced by 80%
    - in year 2019 reduced by 50%
    - from January 1, 2020 shall not be reduced in relation to exposures to member State‘s central government or central banks denominated and funded in the domestic currency of any other member State

Transitional measures - legislation

- Standard parameters used to calculate **equity** risk sub-module for equities that the undertaking purchased on or before January 1, 2016 shall be calculated as weighted average of
  - Standard parameters equals to standard parameters for duration-based equity risk sub-module
  - Standard parameters equals to standard parameters for equity risk sub-module

$$SP_{Transit} = (1 - \propto) \cdot SP^{DurBased} + \propto \cdot SP^{Equity}$$

- The weight for parameters shall increase for 14,28% at the end of each year
  - Year 2016; (α = 0%)
  - Year 2017; (α = 14,28%)
  - Year 2018; (α = 28,57%)
  - …
  - Year 2022; (α = 85,71%)
  - Year 2023; (α = 100%)

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Transitional measures - legislation

- If (re)insurance undertaking **comply with required solvency margin** on December 31, 2016 but do not comply with SCR in the first year of application of new regulation the supervisory authority instead of required necessary measurements to achieve re-establishement of the level of eligible own funds covering SCR within six months they shall require (re)insurance undertaking to take necessary measures by December 31, 2017
- If Member State on May 23, 2014 **use provisions defined in legislation regulating activities of institutions for occupational retirement** (regarding rules relating to the solvency margin and to the guaranteed fund), they may use them until December 31, 2019.

Transitional provisions on the risk-free interest rate

- (Re)insurance undertaking may apply transitional adjustment to the relevant risk-free interest rate term structure to admissible (re)insurance activities subject to the Supervisory Authority approval
- Adjustment calculated as a portion of difference between
  - Interest rate used before new regulation enter into force
  - Annual effective rate

$$AER_{Adjusted} = AER + \propto \cdot (IR - AER)$$
$$AER_{Adjusted} = (1 - \alpha) \cdot AER + \propto \cdot IR$$

- The portion shall decreased for 6,25% at the end of the year
  - Year 2016; (α=100%)
  - Year 2017; (α=93,75%)
  - Year 2018; (α=87,50%)
  - …
  - Year 2031; (α=6,25%)
  - Year 2032; (α=0%)
- Admissible (re)insurance activities
  - Contracts were concluded before January 1, 2016 excluding contract renewals on or after that date

Transitional provisions on the risk-free interest rate

As on the year end 2017

- 7 undertakings in 5 countries use transitional provisions on the risk-free interest rate
- Market share in technical provisions is negligible at both EEA and national level except
  - in one member states where aggregate market share is approximately 20% of technical provisions
- -50 pts is the average impact of removing the use of transitional provisions on the risk-free interest rate on SCR ratio (from 206% with TRFR to 156% without TRFR) of undertakings using TRFR
- 5,3% is the average impact of removing the use of transitional provisions on the risk-free interest rate on the technical provisions of undertakings using TRFR
- 1,2 pp is the average adjustment to the risk free rate

Source:

➢ „Report on long-term guarantees measures and measures on equity risk 2018“, 18.12.2018

Transitional provisions on technical provisions

- (Re)insurance undertakings may apply transitional deduction to technical provisions subject to Supervisory Authority approval
- Transitional deduction calculated as a portion of the difference between
  - Net technical provisions in accordance with new regulation
  - Net technical provisions according to the previous regime

$$TP_{Transit} = TP_{SII} - \alpha \cdot (TP_{SII} - TP_{SI})$$
$$TP_{Transit} = (1 - \alpha) \cdot TP_{SII} + \alpha \cdot TP_{SI}$$

- The portion of the difference shall decreased for 6,25% at the end of the year
  - Year 2016; (α=100%)
  - Year 2017; (α=93,75%)
  - Year 2018; (α=87,50%)
  - …
  - Year 2031; (α=6,25%)
  - Year 2032; (α=0%)

Transitional provisions on technical provisions

As on the year end 2017

- 162 undertakings in 11 countries use transitional provisions on technical provisions
- 24% of the total amount of the technical provisions in EEA
- -75 pts is the average impact of removing the use of transitional provisions on technical provisions on SCR ratio (from 218% with TTR to 143% without TTP) of undertakings using TTP
- 5,4% is the average impact of removing the use of transitional provisions on technical provisions on the technical provisions of undertakings using TRFR

Source:

- „Report on long-term guarantees measures and measures on equity risk 2018“, 18.12.2018

Special regulatory issues

Thank you

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