reinsurance advisory board

RAB Key views on the Solvency II level 2 texts

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To maintain Europe's leadership in the reinsurance sector, the Solvency II Review needs to achieve an optimal balance between the prudence embedded in the supervisory framework and the availability of capital to protect and invest in societies.

The RAB welcomes the recently agreed changes to the Solvency II Directive, particularly the justified reduction of the risk margin. The RAB highlights, however, that the Solvency II Review will markedly increase complexity and the cost of compliance for most Solvency II authorised groups, thus missing the target of bringing more proportionality into the framework. It is also contrary to the European Commission's objective of reducing burdens associated with reporting requirements by 25%[1].

The next phase of the Solvency II Review should be focused on aligning the details of the Level 1 political agreement with the wider EU objectives in terms of sustainability, resilience and competitiveness by:

- Increasing the capacity of EU reinsurers' balance sheets to take on more long, complex and large risks via a lambda factor that, combined with the agreed 4.75% Cost of Capital rate, would significantly reduce the size and volatility of the risk margin.
- Maintaining a truly risk-based framework for globally active companies. This means reinsurers using an approved internal model report their standard formula estimate through a process agreed with their respective supervisors, capital calculations and specifically the group capital calculations, are free from double-counting and the standard formula reflects geographical diversification appropriately.
- Avoiding "one-size-fits-all" solutions that are inadequate for reinsurers. The definition of significant cross-border activity and the scope of macroprudential provisions in Solvency II need to include a carve-out recognising the fact that reinsurance is a business-to-business activity and that there is no evidence of reinsurance contributing to systemic risk or financial instability.
- Ensuring that any new reporting requirements agreed in Level 1 are implemented pragmatically and efficiently, without undue burden, to aid the international competitiveness of well-regulated European companies.

The RAB sets out below the key changes that are needed in the development of the Level 2 texts to ensure the Solvency II review delivers from a reinsurance perspective.

- Treatment of non-proportional reinsurance: Introduce a dedicated treatment for Adverse Development Covers, based on an improved version of EIOPA's proposal which applies to multiple lines of business and to the reserving risk.
- Risk Margin: Adopt a 0.925 lambda parameter (without a floor) and appropriately recognise group diversification in the group risk margin.
- Group minimum SCR calculation: Clarify that local requirements of third country undertakings do not have to be factored in, if the related risks are already part of the balance sheets of European companies, to the satisfaction of supervisory authorities.
- Basis risk: Changes to the basis risk regime should not be addressed in the level 2 but should instead be done in a future review of the EIOPA guidelines.
- Standard formula reporting:
  - The content and process for reporting the standard formula estimate for internal model users should be individually determined between the internal model users and their respective NCAs.
  - The market risk, life underwriting risk and the health underwriting risk modules should be reviewed to appropriately reflect geographical diversification for standard formula users as well as for internal model users providing estimates.
- Lean and efficient reporting requirements: Ensure that new reporting requirements arising from the Level 1 changes, e.g. Liquidity Risk Management Plans (LRMPs) and Sustainability Risk plans (Art 44), are lean, reliant on (re)insurers' own risk management framework, and free of duplication with similar requirements arising from other cross-sectoral regulations.

Further information on the RAB's views on each of these topics is outlined below.

1 Factsheet_CWP_Burdens_10.pdf (europa.eu)

Treatment of non-proportional reinsurance

Non-proportional (NP) reinsurance is an important risk mitigation instrument for the non-life sector and a crucial tool for smaller and medium sized companies to manage peak risk.

The RAB has always advocated for a more risk-sensitive treatment of non-proportional reinsurance in the standard formula and has engaged with EIOPA for many years to provide credible ideas and workable solutions.

The current standard formula approach provides for a flat 20% reduction on the volatility factor for premium risk for three lines of business. This reduction does not depend on the actual existence of reinsurance, does not vary with the extent of reinsurance, and is not available neither for other lines of business, nor for reserving risk, which is clearly not risk sensitive as it fails to incentivise good risk management practices.

Recommendation

The RAB supports EIOPA's proposal to better recognise Adverse Development Covers in the Delegated Regulation, through an amendment to Article 117. However, the RAB recommends improving EIOPA's proposal through the following adjustments:

- The formula proposed by EIOPA should also apply to structures covering multiple lines of business and should not have any limitation in the attachment point. Since the economic effects of the attachment point are already recognised by the formula, there is no risk of underestimation (as intended by the Commission). Limits to the attachment point would be inconsistent with the treatment of NP reinsurance in the Cat submodule of the Life SCR, where no such restriction applies.
- The ADC proposal should be extended to multiple lines of business and to the reserving risk. Improved recognition of ADCs could reduce the volatility of small and medium-sized insurance companies, while protecting their back book of historical risks from distortions.
- The better recognition of reinsurance in the standard formula should not be defeated by the introduction, in parallel, of new "safeguards" which would disincentivise the use of proper risk mitigation techniques.

Risk margin

The RAB welcomes the changes made by the co-legislators to the risk margin to introduce a time dependent element (i.e. a lambda parameter) to reduce the excessive volatility of the risk margin associated with long-term business.

Recommendation — Articles 33a, 152a, 159a

The RAB considers that a reduction of the risk margin by at least 50% is technically justified, as evidenced by Insurance Europe (here). It should be noted that the PRA has provided support to the 70% reduction of the risk margin for long-term business in the UK which came into effect in 2024.

The RAB recommends the Commission to calibrate the lambda at 0.925 without a floor to reach a level, which would be more in line with market evidence.

In addition, counter-intuitively, diversification between risks at group level is not permitted when calculating the risk margin. This contrasts with other areas of the Solvency II regulation (SCR, risk margin at solo level) and practical experience – where there are many examples where groups have transferred policies as a whole. By not allowing for diversification between different entities within a group, the current approach to calculating the risk margin has the effect of artificially increasing the projected SCRs at group-level and hence leads to an overinflated risk margin.

Group minimum SCR

The group supervision of (re)insurers should self-evidently be free from double-counting of third-country risks to prevent an undue expansion of the group SCR floor, which would threaten the management of internationally active EU reinsurers.

Given the significance of the business written in third countries by reinsurers, the RAB is extremely concerned that the co-legislators did not fully eradicate the double counting in the calculation of the minimum of the consolidated Group SCR in their amendments to Article 230.

Recommendation

The RAB recommends amending the calculation of the Group minimum SCR based on the recommendations provided in the French Treasury non-paper on the issue. In practice, it is suggested that the European Commission creates an Article 341a as follows on the basis of Article 234 of the Solvency II Directive:

Article 341a (Delegated Regulation)
Where applicable, the minimum consolidated group Solvency Capital Requirement determined in accordance with the requirements set out in the second subparagraph of Article 230(2) of Directive 2009/138/EC shall be the sum of amounts referred to in points (a), (b) and (c), unless the participating undertaking can demonstrate to the satisfaction of the supervisory authority that the risks borne by these related third-country insurance and reinsurance undertakings are already taken into account in the contribution of another insurance and reinsurance undertaking established in the EEA for an equivalent amount in (a) or (b).

Standard formula reporting for internal model users

The RAB does not support the reporting of standard formula results for internal model users and considers that the new requirements undermine the purpose of internal models. Internal models are used in situations where both companies and regulators agree that the standard formula, which is predominantly designed and calibrated on the basis of direct insurance business, would not appropriately capture the undertaking's risk profile.

Recommendation

The RAB considers that the reporting of a standard formula estimate should be done by (re)insurers using an internal model in a manner that addresses the individual needs of their respective NCAs and reflects the fact that NCAs, in their approval processes of the IM, recognise the limitations of the standard formula to assess the company's actual risks. Therefore, the format and content should be agreed directly between the NCA and the undertaking, independently from the RSR and Solvency II QRTs processes.

Article 311
Capital management
2.The regular supervisory report shall include all of the following information regarding the Solvency Capital Requirement and the Minimum Capital Requirement of the insurance or reinsurance undertaking:
(c) an estimate of the undertaking's Solvency Capital Requirement determined in accordance with the standard formula, where the supervisory authority requires the undertaking to provide that estimate pursuant to Article 112(7) of Directive 2009/138/EC.
Instead, the reporting referred to in article 112(7) of the Directive should be addressed in a new Article 88a in the subsection on proportionality and simplification in the standard formula.

Article 88a
1. Where a simplified calculation is used to determine the estimate of the undertaking's Solvency Capital Requirement in accordance with the standard formula pursuant to Article 112(7) of Directive 2009/138/EC, the undertaking concerned shall inform the national competent authority.
2. The estimate of the undertaking's Solvency Capital Requirement referred to in the first paragraph shall be provided in a format agreed with the national competent authority.

Risk mitigation techniques

Clarification and improvement of the current rules on basis risk in the context of risk-mitigation techniques (RMT) in the standard formula would be welcome. Indeed, the current approach takes an "all or nothing" view of material basis risk, which creates significant uncertainty for both insurers and reinsurers and is not consistent with a risk-based approach.

In its advice on the 2020 Review, EIOPA ignored all the industry's feedback and proposals on basis risk and advised transforming EIOPA Guidelines 1, 2 and 3 on basis risk into legislation in the Delegated Regulation.

In addition, contingent capital is an instrument used as an efficient and innovative capital management tool to protect reinsurers against e.g. extreme NATCAT losses. Its economic value as a capital shield can be properly modelled in internal models. EIOPA suggestion to derecognise contingent capital in internal models' economic scenarios to align with the more static standard formula is not risk-based.

Recommendation

The Commission should not incorporate Guidelines 1,2 and 3 on basis risk into the Delegated Regulation. This would only exacerbate the issues currently faced and encourages the instead encourages that any issues arising from basis risk are addressed in a future review of the EIOPA Guidelines.

The Commission should not change the Level 2 with respect to contingent capital in internal models.

Lean and efficient reporting requirements

Many of the Level 1 amendments will increase the reporting burdens for reinsurers, at odds with the European Commission's commitment and efforts to streamline and reduce reporting requirements by 25%. To prevent a further increase in reporting requirements, it is essential to draft Level 2 texts appropriately to ensure they are principle-based and not overly prescriptive.

Recommendation

New reporting requirements arising from the Level 1 changes, e.g. Liquidity Risk Management Plans (LRMPs) and Sustainability Risk plans (Art 44), should be based on the insurer's risk management framework.

The Commission should enable NCAs to exempt reinsurers from reporting or allow for simplifications in the reporting based on their risk profile (e.g. for macroprudential concerns in the ORSA or medium- and long-term liquidity analysis).

The Commission should also avoid unnecessary duplication in Solvency II reporting by:

- avoiding redundancy with existing reporting requirements arising from cross-sectoral EU legislations and allowing cross-referencing,
- fostering group-wide reporting instead of individual legal entity reporting,
- allowing integration of new reports into existing reports (e.g. the ORSA), and
- allowing English to be the sole reporting language of international groups.

Insurance Europe's Reinsurance Advisory Board (RAB) is a specialist representative body for the European reinsurance industry. It is represented at chairman and chief executive officer (CEO) level by the seven largest European reinsurance firms: Gen Re, Hannover Re, Lloyd's, Munich Re, PartnerRe, SCOR and Swiss Re, with Insurance Europe providing the secretariat.

Through its member bodies, the RAB represents more than 50% of total worldwide reinsurance premium income. The RAB promotes a stable, innovative and competitive market environment. It further promotes a regulatory and trading framework that facilitates global risk transfer through reinsurance and other insurance-linked capital solutions.