



EIOPA-BoS-19/131

29 March 2019

**Discussion Paper on
Systemic Risk and Macroprudential Policy in
Insurance**

Contents

Responding to this paper	3
Executive summary	4
1. Introduction	7
2. European Commissions' Call for Advice	10
3. Systemic risk and macroprudential policy in insurance	11
3.1 Where do we stand in insurance?.....	11
3.2 Systemic risk in insurance.....	12
3.3 A macroprudential framework for insurance	15
4. Solvency II tools with macroprudential impact	17
4.1 Introduction	17
4.2 Preliminary analysis of the macroprudential impact of Solvency II.....	17
5. Other potential macroprudential tools and measures to enhance the current framework	19
5.1 Introduction	19
5.2 Leverage ratio	20
5.3 Enhanced monitoring against market-wide under-reserving.....	21
5.4 Capital surcharge for systemic risk.....	24
5.5 Additional reporting on liquidity risk [Included in COM's CfA].....	27
5.6 Liquidity risk ratios.....	31
5.7 Temporary freeze on redemption rights	32
5.8 Concentration thresholds – Monitoring exposures.....	33
5.9 Enhancement of the ORSA [Included in COM's CfA].....	35
5.10 Enhancement of the Prudent Person Principle [Included in COM's CfA].....	37
5.11 Request of recovery plans [Included in COM's CfA].....	38
5.12 Development of resolution plans [Included in COM's CfA].....	39
5.13 Request of systemic risk management plans [Included in COM's CfA]	40
5.14 Request of liquidity risk management plans [Included in COM's CfA]	41
References	44
Annex – Discarded tools	45
A.1 Counter-cyclical capital buffers (time-varying capital tools)	45
A.2 Liquidity requirements.....	46

Responding to this paper

EIOPA welcomes comments on the “Discussion paper on systemic risk and macroprudential policy in insurance”.

Comments are most helpful if they:

- respond to the question stated, where applicable;
- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA in the provided Template for Comments, by email CP-19-001@eiopa.europa.eu by **30 April 2019**.

Contributions not provided in the template for comments, or sent to a different email address, or after the deadline will not be considered.

• Publication of responses

Contributions received will be published on EIOPA’s public website unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.

Please note that EIOPA is subject to Regulation (EC) No 1049/2001 regarding public access to documents¹ and EIOPA’s rules on public access to documents.²

Contributions will be made available at the end of the public consultation period.

• Data protection

Please note that personal contact details (such as name of individuals, email addresses and phone numbers) will not be published. They will only be used to request clarifications if necessary on the information supplied. EIOPA, as a European Authority, will process any personal data in line with Regulation (EU) 2018/1725³ on the protection of the individuals with regards to the processing of personal data by the Union institutions and bodies and on the free movement of such data. More information on data protection can be found at <https://eiopa.europa.eu/> under the heading ‘Legal notice’.

¹ Regulation (EC) No 1049/2001 of the European Parliament and of the Council of 30 May 2001 regarding public access to European Parliament, Council and Commission documents (OJ L 145, 31.5.2001, p. 43).

² Public Access to Documents (See link: [https://eiopa.europa.eu/Pages/SearchResults.aspx?k=filename:Public-Access-\(EIOPA-MB-11-051\).pdf](https://eiopa.europa.eu/Pages/SearchResults.aspx?k=filename:Public-Access-(EIOPA-MB-11-051).pdf)).

³ Regulation (EU) 2018/1725 of the European Parliament and of the Council of 23 October 2018 on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data, and repealing Regulation (EC) No 45/2001 and Decision No 1247/2002/EC (OJ L 295, 21.11.2018, p. 39).

Executive summary

1. This Discussion paper is based on a series of three papers previously published by EIOPA.⁴ They aimed at contributing to the debate on systemic risk and macroprudential policy in insurance while ensuring that any extension of this debate to the insurance sector reflects the specific nature of the insurance business.
2. In its work, EIOPA followed a step-by-step approach seeking to address the following questions in a sequential way:
 1. Does insurance create or amplify systemic risk?
 2. If yes, what are the tools already existing in the Solvency II framework, and how do they contribute to mitigate the sources of systemic risk?
 3. Are other tools needed and, if yes, which ones could be promoted?
3. Each paper published addresses one of the questions above. The publication of the three EIOPA papers on systemic risk and macroprudential policy in insurance has constituted an important milestone by which EIOPA has defined its policy stance and laid down its initial ideas on several relevant topics.
4. This work should now be turned into a specific policy proposal for additional macroprudential tools or measures where relevant and possible as part of the review of Directive 2009/138/EC (the 'Solvency II⁵ Review'). For this purpose, and in order to gather the views of stakeholders, EIOPA is publishing this Discussion Paper on systemic risk and macroprudential policy in insurance, which focuses primarily on the third paper, i.e. on potential new tools and measures. Special attention is devoted to the four tools and measures specifically highlighted in the recent European Commission's Call for Advice to EIOPA.
5. Table 1 puts together and summarises the main findings of the work done by EIOPA, by linking sources of systemic risk and operational objectives (EIOPA, 2018a), tools already available in the Solvency II framework (EIOPA, 2018b) and other potential tools and measures to be further considered (EIOPA, 2018c).

Table 1: Sources of systemic risk, operational objectives and macroprudential tools and measures

Source of systemic risk	Operational objectives	Solvency II tools with direct impact	Other potential tools and measures for further consideration
Entity-based related sources – Direct sources			
Deterioration of the solvency position leading to:	➤ Ensure sufficient loss-absorbency	[Note: As a comprehensive microprudential tool,	➤ Leverage ratio

⁴ See EIOPA's publications "Systemic risk and macroprudential policy in insurance", "Solvency II tools with macroprudential impact", and "Other potential macroprudential tools and measures to enhance the current framework". All three papers can be found in <https://eiopa.europa.eu/financial-stability-crisis-prevention/crisis-prevention>.

⁵ 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 Insurance and Reinsurance (Solvency II) (OJ L 335, 17.12.2009, p. 1).

<ul style="list-style-type: none"> • Failure of a Global Systemically Important Insurers (G-SII) or Domestic Systemically Important Insurers (D-SII) • Collective failures of non-systemically important institutions as a result of exposures to common shocks 	capacity and reserving	<i>Solvency II is designed to address this operational objective]</i>	<ul style="list-style-type: none"> ➢ Enhanced monitoring against market-wide under-reserving ➢ Capital surcharge for systemic risk ➢ Enhancement of ORSA ➢ Request of recovery plans ➢ Request of resolution plans
Activity-based related sources – Indirect sources (i)⁶			
Involvement in certain activities or products with greater potential to pose systemic risk	<ul style="list-style-type: none"> ➢ Discourage excessive involvement in certain products and activities 	<ul style="list-style-type: none"> ➢ Prohibit or restrict certain types of financial activities(*) 	<ul style="list-style-type: none"> ➢ Capital surcharge for systemic risk ➢ Enhancement of PPP
Potentially dangerous interconnections	<ul style="list-style-type: none"> ➢ Discourage excessive levels of direct and indirect exposure concentrations 		<ul style="list-style-type: none"> ➢ Additional reporting on liquidity ➢ Liquidity risk ratios ➢ Concentration thresholds ➢ Request of LRMP ➢ Request of SRMP
Behaviour-based related sources – Indirect sources (ii)			
Collective behaviour by insurers that may exacerbate market price movements (e.g. fire-sales or herding behaviour)	<ul style="list-style-type: none"> ➢ Limit procyclicality ➢ Ensure sufficient loss-absorbency capacity and reserving 	<ul style="list-style-type: none"> ➢ Symmetric adjustment in the equity risk module. ➢ Volatility adjustment ➢ Matching adjustment ➢ Extension of the recovery period ➢ Transitional measure on technical provisions 	<ul style="list-style-type: none"> ➢ Additional reporting on liquidity ➢ Liquidity risk ratios ➢ Temporary freeze on redemption rights
Excessive risk-taking by insurance companies (e.g. 'search for yield' and the 'too-big-too fail' problem)	<ul style="list-style-type: none"> ➢ Discourage risky behaviour ➢ Ensure sufficient loss-absorbency capacity and reserving 	<ul style="list-style-type: none"> ➢ Prohibit or restrict certain types of financial activities(*) 	<ul style="list-style-type: none"> ➢ Capital surcharge for systemic risk
Excessive concentrations	<ul style="list-style-type: none"> ➢ Discourage excessive levels of direct and indirect exposure concentrations 		<ul style="list-style-type: none"> ➢ Concentration thresholds ➢ Enhancement of ORSA ➢ Enhancement of PPP
Inappropriate exposures on the liabilities side (e.g. as a result of competitive dynamics)	<ul style="list-style-type: none"> ➢ Ensure sufficient loss-absorbency capacity and reserving 		<ul style="list-style-type: none"> ➢ Enhanced monitoring against market-wide under-reserving ➢ Capital surcharge for systemic risk

(*) This measure, which is not part of Solvency II, is however included because it pursues similar objectives and also applies EU-wide.

6. The questions to stakeholders revolve around all aspect of the table above, putting special attention on the potential new tools and measures. Special

⁶ Section 3.3.2. in EIOPA (2018a) considers several insurance products and activities that, because of their intrinsic features, may act as systemic risk drivers.

attention is devoted to those tools that are part of the European Commission's Call for Advice. Stakeholders are invited to provide their views on all questions asked by sending an email to CP-19-001@eiopa.europa.eu by **30 April 2019.**

Stakeholder question(s):

Q1) Do you have any preliminary remark or general comment regarding the topic of systemic risk and macroprudential policy in insurance?

1. Introduction

• Legal basis

7. EIOPA is competent to issue this Discussion paper on systemic risk and macroprudential policy in insurance in relation to its responsibilities under the EIOPA Regulation⁷, in particular:
 - The third sub-paragraph of Article 1(6) thereof, requiring from EIOPA in the context of the exercise of its powers to pay particular attention to any potential systemic risk posed by financial institutions, the failure of which may impair the operation of the financial system or the real economy;
 - Article 8(1)(i) thereof, providing among other things for EIOPA's task to contribute to "the monitoring, assessment and measurement of systemic risk";
 - Article 18(1) thereof, requiring from EIOPA to actively facilitate and, where deemed necessary, coordinate any actions undertaken by the relevant national competent supervisory authorities in the case of adverse developments which may seriously jeopardise the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union;
 - Article 22(1) thereof, seeking from EIOPA to consider and address any systemic risk and risk of disruption in financial services;
 - Article 23 thereof, providing that EIOPA has to, in consultation with the ESRB, develop criteria for the identification and measurement of systemic risk.
8. EIOPA issues this Discussion paper with the aim of gathering the views of all interested stakeholders.

• Background and scope of the Discussion paper

9. The financial crisis has shown the need to further consider the way in which systemic risk is created and/or amplified, as well as the need to have proper policies in place to address those risks. So far, most of the discussions on macroprudential policy have focused on the banking sector due to its prominent role in the recent financial crisis.
10. Given the relevance of the topic, EIOPA initiated the publication of a series of three papers on systemic risk and macroprudential policy in insurance with the aim of contributing to the debate and ensuring that any extension of this debate to the insurance sector reflects the specific nature of the insurance business.
11. EIOPA followed a step-by-step approach, seeking to address the following questions:
 - *Does insurance create or amplify systemic risk?* In the first paper entitled 'Systemic risk and macroprudential policy in insurance', EIOPA identified and analysed the sources of systemic risk in insurance and proposed a specific macroprudential framework for the sector.

⁷ Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48).

- *If yes, what are the tools already existing in the current framework, and how do they contribute to mitigate the sources of systemic risk?* In the second paper, 'Solvency II tools with macroprudential impact', EIOPA identified, classified and provided a preliminary assessment of the tools or measures already existing within the Solvency II framework, which could mitigate any of the systemic risk sources that were previously identified.
 - *Are other tools needed and, if yes, which ones could be promoted?* The third paper carried out an initial assessment of other potential tools or measures to be included in a macroprudential framework designed for insurers. EIOPA focused on four categories of tools (capital and reserving-based tools, liquidity-based tools, exposure-based tools and pre-emptive planning). The paper focuses on whether a specific instrument should or should not be further considered. This is an important aspect in light of future work in the context of the Solvency II review.
12. The publication of the three EIOPA papers on systemic risk and macroprudential policy in insurance constitutes an important milestone by which EIOPA has defined its policy stance and laid down its initial ideas on several relevant topics. It should be noted that the ESRB (2018) has also identified a shortlist of options for additional provisions, measures and instruments, which reaches broadly similar conclusions as EIOPA.
 13. EIOPA's work should now be turned into a specific policy proposal for additional macroprudential tools or measures where relevant and possible as part of the Solvency II Review. For this purpose, and in order to gather the views of stakeholders, EIOPA is publishing this Discussion Paper on systemic risk and macroprudential policy in insurance.
 14. This Discussion paper is based on the three papers previously published. They therefore back its content. Interested readers are recommended to consult them for further information or details. Relevant references are included in each of the sections.
 15. EIOPA has included questions on all three papers. The majority of the questions, however, revolve around the third paper on additional tools or measures, which is more relevant in light of the Solvency II review.
 16. The Discussion paper primarily focuses on the "principles" of each tool, trying to explain their rationale. As such, it does not address the operational aspects/challenges of each tool (e.g. calibration, thresholds, etc.) in a comprehensive manner. Similar to the approach followed with other legislative initiatives, the technical details could be addressed by means of technical standards, guidelines or recommendations, once the relevant legal instrument has been enacted.
- **Definitions**
17. EIOPA provided all relevant definitions in EIOPA (2018a). It has to be noted, however, that there is usually no unique or universal definition for all these concepts. EIOPA's work did not seek to fill this gap. Instead, working definitions are put forward in order to set the scene and should therefore be considered in the context of this paper only.

- *Financial stability* and systemic risk are two strongly related concepts. Financial stability can be defined as a state whereby the build-up of systemic risk is prevented.⁸
 - *Systemic risk* means a risk of disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy.⁹
 - *Macroprudential policy* should be understood as a framework that aims at mitigating systemic risk (or the build-up thereof), thereby contributing to the ultimate objective of the stability of the financial system and, as a result, the broader implications for economic growth.
 - *Macroprudential instruments* are qualitative or quantitative tools or measures with system-wide impact that relevant competent authorities (i.e. authorities in charge of preserving the stability of the financial system) put in place with the aim of achieving financial stability. In the context of this paper, these concepts (i.e. tools, instruments and measures) are used as synonyms.
18. The macroprudential policy approach contributes to the stability of the financial system — together with other policies (e.g. monetary and fiscal) as well as with microprudential policies. Whereas microprudential policies primarily focus on individual entities, the macroprudential approach focuses on the financial system as a whole.
 19. It should be taken into account that, in some cases, the borders between microprudential policies and macroprudential consequences are blurring. That means, for example, that instruments that may have been designed as microprudential instrument may also have macroprudential consequences.
 20. There are different institutional models for the implementation of macroprudential policies across EU, in some cases involving different parties (e.g. ministries, supervisors, etc.). This paper adopts a neutral approach by referring to the generic concept of the 'relevant authority in charge of the macroprudential policy', which should encompass the different institutional models existing across jurisdictions. Sometimes a simplified term such as 'the authorities' or 'the competent authorities' is used.

⁸ <https://www.ecb.europa.eu/ecb/tasks/stability/html/index.en.html>

⁹ Article 22 of EIOPA Regulation defines 'systemic risk' by reference to Article 2(c) Regulation (EU) No 1092/2010.

2. European Commissions' Call for Advice

21. The European Commission (COM) will review components of the Solvency II Directive by the end of 2020 and has initiated a Call for Advice (CfA) to EIOPA.¹⁰ Section 3.10 refers specifically to macroprudential issues. The request is drafted as shown below.

EIOPA is asked to assess whether the existing provisions of the Solvency II framework allow for an appropriate macro-prudential supervision. Where EIOPA concludes that it is not the case, EIOPA is asked to advise on how to improve the following closed list of items:

- the own-risk and solvency assessment;
- the drafting of a systemic risk management plan;
- liquidity risk management planning and liquidity reporting;
- the prudent person principle.

This assessment should be based on strong supporting evidence, also assessing the possible impact of such additional specifications of insurers' behaviour and possible interactions with other Solvency II instruments.

22. EIOPA is looking for feedback from stakeholders to all tools and measures contained in its third publication (EIOPA, 2018c). In addition, special attention is devoted to those four items specifically highlighted in the CfA. Each relevant section covering these items is highlighted with the reference *[Included in COM's CfA]* to allow stakeholders an easy identification. Comments should be based, to the extent possible, on supporting evidence.

¹⁰ https://ec.europa.eu/info/files/190211-request-eiopa-technical-advice-review-solvency-2_en

3. Systemic risk and macroprudential policy in insurance

3.1 Where do we stand in insurance?

[¹⁰ EIOPA (2018a) – Section 1]

23. The 2007-2008 financial crisis highlighted the need of a new set of policies aimed at avoiding contagion and contributing to financial stability. Most of the initiatives developed in the aftermath of this crisis are targeted to the banking sector, which was at the epicentre of the financial crisis. Although the insurance sector differs substantially from the banking sector, some of the lessons from the banking experience could also be useful for insurance. Box 1 provides an overview of some of the lessons learned.

Box 1: Main lessons learned from the crisis

- Microprudential policy should be supplemented with a macroprudential approach. Potential conflicts between the two approaches should be avoided to the extent possible.
- Sources of systemic risk need to be identified.
- A sound macroprudential strategy that links objectives and instruments should be in place. Sufficient macroprudential tools need to be available.
- Systemic risk can originate from both entity-based and activity-based sources.
- Macroprudential policy may require supranational coordination.
- Macroprudential policies pose several challenges (time dimension, spill over effects, etc.) that need due consideration. Overall, macroprudential policy seems to contribute effectively to the mitigation of systemic risk.

24. Topics around systemic risk and macroprudential policy are less developed in insurance, in comparison with the banking sector. Box 2 shows the status of the discussion in insurance. To some extent, it takes stocks of the basic assumptions that are generally accepted also in this Discussion paper.

Box 2: Status of the discussion in insurance

- It is widely acknowledged that the traditional insurance activities are generally less systemically important than banking.
- However, insurance can also potentially create or amplify systemic risk. Therefore, a macroprudential approach seems justified beyond banking, including insurance.
- Macroprudential policies for insurance could also have the benefit of crisis prevention. They should, however, be tailored to insurance.
- A balance between the entity-based and activity-based approaches also needs to be struck in insurance. Special attention should be devoted to the systemic risk arising from certain activities or products.¹¹
- Sufficient tools need to be in place to address the sources of systemic risk.

¹¹ As will be explained in Section 3.2, EIOPA distinguishes three sources of systemic risk, i.e. entity-based, activity-based and behaviour-based sources of systemic risk.

- There could be a risk of regulatory arbitrage if insurance is not included within the wider macroprudential framework.

3.2 Systemic risk in insurance

[~~EF~~ EIOPA (2018a) – Section 3]

25. While a common understanding of the systemic relevance of the banking sector has been reached, the issue is still debated in the case of the insurance sector.¹² In order to contribute to this debate, EIOPA developed a conceptual approach to illustrate the dynamics in which systemic risk in insurance can be created or amplified. Box 3 summarises the main elements of EIOPA's approach.

Box 3: Main elements of EIOPA's conceptual approach to systemic risk

- *Triggering event*: Exogenous event that has an impact on one or several insurance companies and may initiate the whole process of systemic risk creation. Examples are macroeconomic factors (e.g. raising unemployment), financial factors (e.g. yield movements) or non-financial factors (e.g. demographic changes or cyber-attacks).
- *Company risk profile*: The result of the collection of activities performed by the insurance company. The activities will determine: a) the specific features of the company reflecting the strategic and operational decisions taken; and b) the risk factors that the company is exposed to, i.e. the potential vulnerabilities of the company.
- *Systemic risk drivers*: Elements that may enable the generation of negative spill-overs from one or more company-specific stresses into a systemic effect, i.e. they may turn a company specific-stress into a system wide stress.
- *Transmission channels*. Contagion channels that explain the process by which the sources of systemic risk may affect financial stability and/or the real economy. EIOPA distinguishes five main transmission channels: a) Exposure channel; b) Asset liquidation channel; c) Lack of supply of insurance products; d) Bank-like channel; and c) Expectations and information asymmetries
- *Sources of systemic risk*: they result from the systemic risk drivers and their transmission channels. They are direct or indirect externalities whereby insurance imposes a systemic threat to the wider system. These direct and indirect externalities lead to three potential sources' categories of systemic risks which are not mutually exclusive, i.e. entity-based related source, activity-based related source and behaviour-based related source.

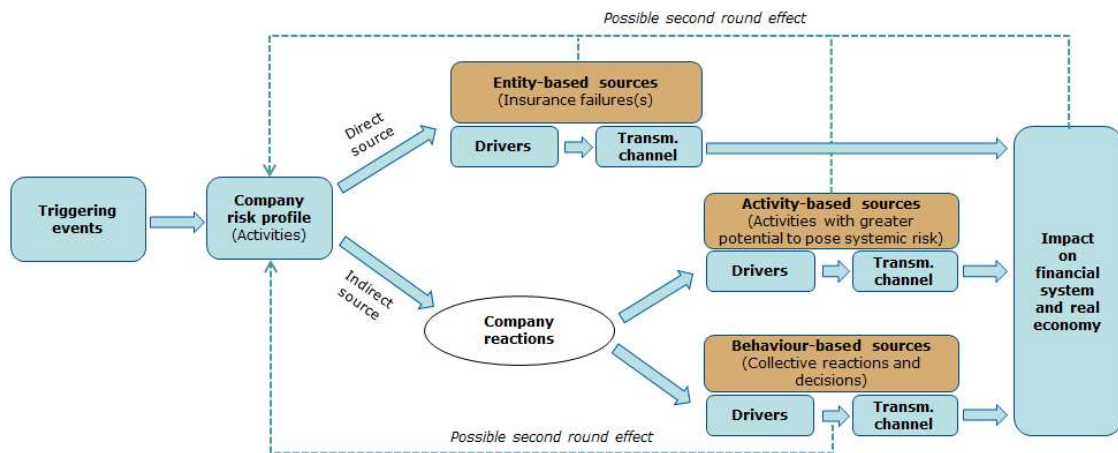
26. In essence and as depicted in Figure 1, the approach developed by EIOPA considers that a 'triggering event' initially has an impact at entity level, affecting one or more insurers through their 'risk profile'. Potential individual or collective distresses may generate systemic implications, the relevance of which is determined by the presence of different 'systemic risk drivers' embedded in the insurance companies.

27. In EIOPA's view, systemic events could be generated in two ways.

¹² EIOPA (2018a), Box 3, provides an overview of the difference between banking and insurance and the implications in terms of systemic risk.

- i. The 'direct' effect, originated by the failure of a systemically relevant insurer or the collective failure of several insurers generating a cascade effect. This systemic source is defined as 'entity-based'.
- ii. The 'indirect' effect, in which possible externalities are enhanced by engagement in potentially systemic activities (*activity-based sources*)¹³ or the widespread common reactions of insurers to exogenous shocks (*behaviour-based source*).

Figure 1: An approach to systemic risk in insurance



28. Potential externalities generated via direct and indirect sources are transferred to the rest of the financial system and to the real economy via specific channels (i.e. the transmission channel) and could induce changes in the risk profile of insurers, eventually generating potential second-round effects.
29. Table 2 provides an overview of possible examples of triggering events, risk profile, systemic risk drivers and transmission channels. It should therefore not be considered as a comprehensive list of elements.

¹³ The idea is not to label specific products or activities as intrinsically systemic. Instead, the focus is put on the design and management by insurance undertakings.

Table 2: Direct and indirect impact of macroprudential policy

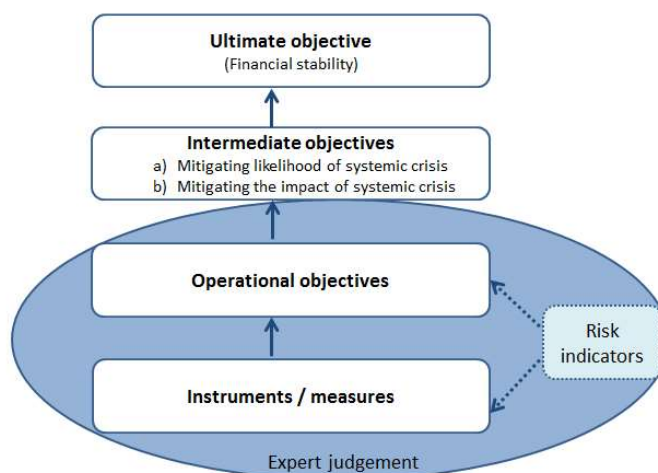
Triggering events (Examples)	Risk profile of the company	Potential systemic risk drivers	Main transmission channels
<ul style="list-style-type: none"> • Macroeconomic factors <ul style="list-style-type: none"> ○ Unemployment ○ Inflation ○ Bubbles (e.g. housing) ○ Others • Financial factors <ul style="list-style-type: none"> ○ Yield movements ○ Market prices (equity, fixed income, etc.) ○ State of the banking system ○ Financial innovation ○ Others • Non-financial factors <ul style="list-style-type: none"> ○ Demographic changes (mortality/longevity) ○ Natural catastrophes ○ Legislative changes ○ Political changes ○ Technological changes ○ Consumer/policyholder behaviour (e.g. mass lapses, etc.) ○ Cyber attack ○ Others 	<ul style="list-style-type: none"> • Market risks <ul style="list-style-type: none"> ○ Interest rate ○ Equity ○ Property ○ Etc. • Health risks <ul style="list-style-type: none"> ○ Mortality ○ Longevity ○ Lapse ○ Etc. • Default risks • Life risks <ul style="list-style-type: none"> ○ Technical provision ○ Mortality ○ Longevity ○ Lapse ○ CAT ○ Etc. • Non-life risks <ul style="list-style-type: none"> ○ Premium reserve ○ Lapse ○ CAT • Operational risk (incl. fraud) • Model risk 	Entity-based related sources – Direct sources	
		<ul style="list-style-type: none"> ➤ Deterioration of the solvency position leading to: <ul style="list-style-type: none"> a) Failure of a G-SII, D-SII b) Collective failures of non-systemically important institutions as a result of exposures to common shocks 	<ul style="list-style-type: none"> • Exposure channel • Lack of supply of certain products • Expectations and information asymmetries • Asset liquidation
		Activity-based related sources – Indirect sources (i)	
		<ul style="list-style-type: none"> ➤ Involvement in certain activities or products with greater potential to pose systemic risk ➤ Potentially dangerous interconnections <ul style="list-style-type: none"> • Derivative trading (non-hedging) • Financial guarantees (incl. monolines) • Asset lending (e.g. securities lending) and management activities • Direct lending • Lapsable products and products that entail maturity transformation • Guaranteed products • Variable annuities 	<ul style="list-style-type: none"> • Exposure channel • Asset liquidation channel • Bank-like activities channel (maturity transformation and leverage)
		Behaviour-based related sources – Indirect sources (ii)	
		<ul style="list-style-type: none"> ➤ Collective behaviour by insurers that may exacerbate market price movements (e.g. fire-sales or herding behaviour) ➤ Excessive risk-taking by insurance companies ➤ Excessive concentrations ➤ Inappropriate provisioning (e.g. under-pricing as a result of competitive dynamics) <ul style="list-style-type: none"> • Concentrations in certain asset classes and common exposures on the asset side • Excessive risk taking <ul style="list-style-type: none"> ○ 'Search for yield' ○ Too-big-to-fail/moral hazard problems • Heightened competition potentially leading to insufficient technical provisions or premiums 	<ul style="list-style-type: none"> • Exposure channel • Asset liquidation channel

3.3 A macroprudential framework for insurance

[E IOPA (2018a) – Section 4]

30. A macroprudential framework should lay down the essential elements of the macroprudential strategy, allowing for a coherent decision-making process. EIOPA proposed a framework fully focusing on the insurance sector, which is shown in Figure 2.

Figure 2: EIOPA’s macroprudential strategy



31. The main elements of EIOPA’s framework are the following:

- The consideration of three layers of objectives: (1) the ultimate objective, i.e. to ensure financial stability; (2) the intermediate objective in which the ultimate objective is split, i.e. mitigating the *likelihood* and the *impact* of systemic crises; and (3) the operational objectives, which should be pursued by authorities.
- A set of instruments to be used by the relevant authorities in charge of the macroprudential policy to achieve the operational objective. These instruments could either be available in the current regulatory framework or be new.
- Other relevant elements that complete the framework, such as risk indicators and the need to leave room for expert judgement.

32. The operational objectives — a cornerstone of the framework — should be defined to specifically address the sources of systemic risk in insurance that have been previously identified. Table 3 provides an overview of the sources of systemic risk and the operational objectives proposed.

Table 3: Sources of systemic risk and operational objectives

Sources of systemic risk	Operational objectives
Entity-based related sources – Direct sources	➤ Ensure sufficient loss-absorbency capacity and reserving
<ul style="list-style-type: none"> • Deterioration of the solvency position leading to insurance failure(s) of G-SII, D-SII or collective failures, the latter as a result of exposures to common shocks 	
Activity-based related sources – Indirect sources (i)	

<ul style="list-style-type: none"> • Involvement in certain activities or products with greater potential to pose systemic risk 	<ul style="list-style-type: none"> ➤ Discourage excessive involvement in certain products and activities
<ul style="list-style-type: none"> • Potentially dangerous interconnections 	
Behaviour-based related sources – Indirect sources (ii)	
<ul style="list-style-type: none"> • Collective behaviour by insurers that may exacerbate market price movements (e.g. fire-sales or herding behaviour) 	<ul style="list-style-type: none"> ➤ Discourage excessive levels of direct and indirect exposure concentrations
<ul style="list-style-type: none"> • Excessive risk-taking by insurance companies (e.g. 'search for yield' and the 'too-big-too fail' problem) 	
<ul style="list-style-type: none"> • Excessive concentrations 	<ul style="list-style-type: none"> ➤ Limit procyclicality
<ul style="list-style-type: none"> • Inappropriate exposures on the liabilities side (e.g. as a result of competitive dynamics) 	<ul style="list-style-type: none"> ➤ Discourage risky behaviour

33. Once the theoretical framework has been adequately identified, there is a need to consider those elements that make it operational, such as the need to develop the capacity to assess and monitor systemic risk, the identification of data needs or how to better communicate with the public and markets.

Stakeholder question(s):

Q2) Do you have any further considerations on the conceptual approach to systemic risk and the macroprudential framework proposed?

4. Solvency II tools with macroprudential impact

4.1 Introduction

34. Following EIOPA's step-by-step approach, after defining the sources of systemic risk, the next step to be taken should be assessing the tools and measures already in place in the current framework to mitigate them. EIOPA (2018b) identified, classified and provided a preliminary assessment of the tools or measures already existing within the Solvency II framework.
35. Although Solvency II is not a macroprudential framework, it contains several elements that may have financial stability impact. The impact of these elements should be taken into account when determining whether additional tools, or changes to the existing ones, are warranted for macroprudential purposes (EIOPA 2016).

4.2 Preliminary analysis of the macroprudential impact of Solvency II

[~~18~~ EIOPA (2018b) – Section 1]

36. The macroprudential impact of Solvency II originates in three different ways:
 - The design of the framework itself. Solvency II is a comprehensive microprudential regime for the EU insurance sector. Capital is held against market risk, credit risk, underwriting risk and operational risk. In itself, this regime is designed to ensure sufficient loss absorbency capacity and reserving, one of the operational objectives identified in Section 2 as relevant for insurance. Furthermore, significant emphasis in Solvency II is also put on the identification, measurement and proactive management of risks, providing ground also on the operational objectives linked to discouraging risky behaviour and discouraging excessive levels of direct and indirect exposure concentrations.
 - Some elements in the framework with indirect macroprudential impact. Solvency II has some additional elements with indirect macroprudential impact that should not be ignored. These instruments, which were not primarily designed as instruments to mitigate systemic risk, could nevertheless contribute to a certain extent to different operational objectives when considered at an aggregated level. The main ones are the prudent person principle (PPP), the own risk and solvency assessment (ORSA) and the capital add-on under specific circumstances.
 - The elements with direct macroprudential impact. The tools with macroprudential impact that were identified and further analysed in EIOPA (2018b) are essentially the long-term guarantees measures and measures on equity risk introduced in the Solvency II directive, the design of which has a direct macroprudential impact. In short, these tools are the ones shown in Table 4.¹⁴
37. In addition to that, another measure allowing authorities to prohibit or restrict certain types of financial activities was also considered. This measure, which

¹⁴ Given that Solvency II entered into force in 2016, there is not an extensive amount of experience. This analysis should only be considered as a first step. Further work might be needed at a later stage, once more information and data are available.

is not part of Solvency II, is however included because it pursues similar objectives and applies EU-wide.

38. The preliminary assessment carried out in EIOPA (2018b) shows that the tools with direct macroprudential impact contained in Solvency II essentially contribute to limiting procyclicality (Table 4). Indeed, these tools seek to address the risk of collective behaviour by insurers that may exacerbate market price movements. In addition to that, prohibiting or restricting certain types of financial activities is linked to the operational objectives of discouraging excessive involvement in certain products and activities as well as discouraging risky behaviours.

Table 4: Solvency II tools with macroprudential impact

Tools with direct macroprudential impact	Sources of systemic risk addressed	Operational objectives
<ul style="list-style-type: none"> ➤ Symmetric adjustment [¹⁸ EIOPA (2018b) – Section 2] ➤ Volatility adjustment [¹⁸ EIOPA (2018b) – Section 3] ➤ Matching adjustment [¹⁸ EIOPA (2018b) – Section 4] ➤ Extension of the recovery period [¹⁸ EIOPA (2018b) – Section 5] ➤ Transitional measure on technical provisions [¹⁸ EIOPA (2018b) – Section 6] 	<ul style="list-style-type: none"> • Collective behaviour by insurers that may exacerbate market price movements 	<ul style="list-style-type: none"> • Limit procyclicality
<ul style="list-style-type: none"> ➤ Prohibit or restrict certain types of financial activities [¹⁸ EIOPA (2018b) – Section 7] 	<ul style="list-style-type: none"> • Involvement in certain activities or products with greater potential to pose systemic risk • Excessive risk-taking by insurance companies 	<ul style="list-style-type: none"> • Discouraging excessive involvement in certain products and activities • Discourage risky behaviours

39. It should be mentioned that the tools considered may have limitations from a macroprudential perspective as well. Furthermore, several sources of systemic risk do not seem to be sufficiently addressed with the existing tools. As a result, while some measures of Solvency II can be considered to contribute to the mitigation of systemic risk, there is still room for considering additional tools and measures in order to improve the current framework.

Stakeholder question(s):

- Q3) What are your views on how the Solvency II tools outlined above deliver against the operational objectives defined?
- Q4) Is there any other existing Solvency II tool with *direct* macroprudential impact that is relevant? If yes, please: 1) describe the tool; 2) explain which source of systemic risk it would be targeting (see Table 3); and 3) explain the transmission channels through which it may propagate to the result of the financial sector, if relevant.

5. Other potential macroprudential tools and measures to enhance the current framework

5.1 Introduction

40. In its third paper, EIOPA (2018c) carried out an analysis focusing on four categories of tools: a) Capital and reserving-based tools; b) Liquidity-based tools; c) Exposure-based tools; and d) Pre-emptive planning. EIOPA also considers whether the tools should be used for enhanced reporting and monitoring or as intervention power. Following this preliminary analysis, EIOPA concluded the following (Table 5):

Table 5: Additional tools and measures under consideration

Tool	Type of tool	Proposed for further consideration?
Enhanced reporting and monitoring		
Leverage ratio	Capital and reserving-based	Yes
Enhanced monitoring against market-wide under-reserving	Capital and reserving-based	Yes
Additional reporting on liquidity risk (*)	Liquidity-based	Yes
Liquidity risk ratios	Liquidity-based	Yes
Enhancement of Prudent Person Principle (PPP) (*)	Exposure-based	Yes
Enhancement of own risk and solvency assessment (ORSA) (*)	Exposure-based	Yes
Recovery plans (*)	Pre-emptive planning	Yes
Resolution plans (*)	Pre-emptive planning	Yes
Systemic Risk Management Plans (SRMP) (*)	Pre-emptive planning	Yes
Liquidity Risk Management Plans (LRMP) (*)	Pre-emptive planning	Yes
Intervention powers		
Counter-cyclical capital buffer	Capital and reserving-based	No
Capital surcharge for systemic risk	Capital and reserving-based	Yes
Liquidity requirements	Liquidity-based	No
Temporary freeze on redemption rights	Liquidity-based	Yes
Concentration thresholds	Exposure-based	Yes

(*) Considered specifically in the European Commission's Call for Advice (See Section 2).

41. Discussion on potential tools to be considered is an important aspect in light of future work in the context of the Solvency II review.

Stakeholder question(s):

Q5) Do you agree with the list of tools to be further considered?

Q6) What should be the overarching principles to be considered by authorities for these tools and measures?

Q7) Is there any other relevant macroprudential tool or measure that should be considered for the insurance sector? If yes, please: 1) describe the tool or measure; 2) explain which source of systemic risk it would be targeting

(see Table 3); and 3) explain the transmission channels through which it may propagate to the result of the financial sector, if relevant.

5.2 Leverage ratio

[~~EU~~ EIOPA (2018c) – Section 2.1]

• Introduction

42. Description. Leverage ratios aim at identifying the build-up of leverage so that action can be taken before a stress occurs and the entities carry out destabilising deleveraging processes.
43. Potential contribution to mitigate systemic risk. This tool would mainly address two sources of systemic risk.

Capital and reserving-based tools	Main source(s) of systemic risk	Operational objective(s)
Leverage ratio	<ul style="list-style-type: none"> • Deterioration of the solvency position leading to: <ul style="list-style-type: none"> ○ Failure of a G-SII, D-SII ○ Collective failures of non-systemically important institutions as a result of exposures to common shocks • Involvement in certain activities or products with greater potential to pose systemic risk 	<ul style="list-style-type: none"> ➢ Ensuring sufficient loss absorbency capacity and reserving ➢ Discourage excessive involvement in certain products and activities

44. Proposal. This measure is proposed for further consideration as a tool for monitoring purposes, i.e. not as a hard requirement.
45. Operational aspects. EIOPA proposes two ways of defining the leverage ratio in insurance:
- i. The first definition uses a balance sheet proxy for the own funds (excess of assets over liabilities and subordinated liabilities) in relation to total assets (excluding assets held for index and unit linked contracts). This is typically used in the banking sector and *a priori* may appear to have utility as a non-risk based leverage measure.

$$\text{Leverage ratio 1} = \frac{\text{Excess of Assets over Liabilities} + \text{Subordinated liabilities}}{\text{Total assets (excl. assets held for index and unit linked contracts)}}$$

- ii. A second definition of leverage ratio is the ratio of non-insurance liabilities to the proxy for the own funds. The ratio would include the following items:¹⁵

$$\text{Leverage ratio 2} = \frac{\text{Subordinated liabilities} + \text{Debts owed to credit institutions} + \text{Financial liabilities other than debts owed to credit institutions}}{\text{Excess of Assets over Liabilities} + \text{Subordinated liabilities}}$$

46. In both cases, the effects of all transitional measures could be removed from the excess of assets over liabilities to provide a more accurate view of the proxy for the own funds. On the second ratio, off-balance sheet items may also be added to the numerator.

• Issues for consideration

¹⁵ In this case, “subordinated liabilities” appears both as part of “non-insurance liabilities” as well as “own funds”, in accordance with the definition followed.

47. In insurance, the concept of the leverage ratio differs from that in banking. This is due to i) the inverted production cycle, and ii) the fact that there is not a common definition of leverage in insurance, and therefore, there is not a simple non-risk weighted ratio that can be used for the same purpose. Also, the business model is substantially different, and size is not automatically considered as a source of systemic risk but is to some extent necessary in order to be able to apply the law of large numbers.
48. Given the different nature of the business models of insurers and banks, establishing a minimum leverage ratio requirement for insurers similar to the one used in banking raises several conceptual questions and makes it rather inappropriate for insurance.
49. Notwithstanding the above, considering the relation between own funds and total assets as well as its evolution over time just (i.e. the first ratio proposed) for monitoring purposes could provide a first and rough overview of the sector's loss absorption capacity to cope with potential asset-side shocks. In addition, an excessive level of non-insurance liabilities (as defined in the second ratio proposed) might increase the build-up of systemic risk and should therefore be closely monitored by authorities. This explains why this tool was included for further consideration.

Stakeholder question(s):

- Q8) What are your views on the first definition of leverage ratio considered?
- Q9) What are your views on the second definition of leverage ratio considered? Are there any non-insurance liabilities missing?
- Q10) Is there any other relevant definition of leverage ratio in insurance that should be considered? If yes, please explain.

5.3 Enhanced monitoring against market-wide under-reserving

[~~EU~~ EIOPA (2018c) – Section 2.2]

• **Introduction**

50. Description. Enhanced monitoring against market-wide under-reserving is intended to identify potential deviations of the assumptions from the actual experience in the calculation of the technical provisions to foster effective and harmonised actuarial methodologies throughout the European Union.
51. Potential contribution to mitigate systemic risk. This tool would mainly address two sources of systemic risk.

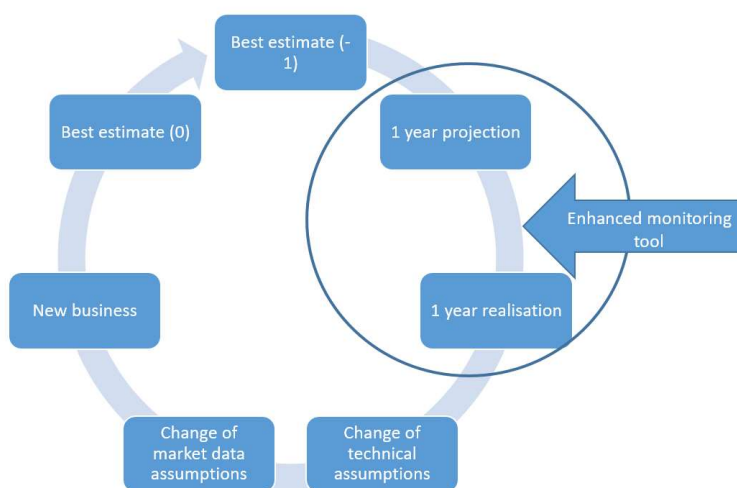
Capital and reserving-based tools	Main source(s) of systemic risk	Operational objective(s)
Enhanced monitoring against market-wide under-reserving	<ul style="list-style-type: none"> • Deterioration of the solvency position leading to: <ul style="list-style-type: none"> ○ Failure of a G-SII, D-SII ○ Collective failures of non-systemically important institutions as a result of exposures to common shocks • Inappropriate exposures on the liabilities side (e.g. as a result of competitive dynamics) 	<ul style="list-style-type: none"> ➢ Ensuring sufficient loss absorbency capacity and reserving

52. Proposal. This measure is proposed for further consideration as a tool for enhanced reporting and monitoring. The focus will be put essentially on the life business,

given that there seems to be already some relevant information available on the non-life business and they are long-term contracts. At this stage, however, it is not fully clear if the information is sufficient. This aspect should be further explored before considering any other additional information.

53. Operational aspects. In order to address the macroprudential risk of under-reserving, the comparison of assumptions to actual experience is required. Figure 3 shows the variation analysis of the change of the best estimate from one year to the next one. In this analysis the projection vs. the realisation is considered only on an aggregate level. The tool for enhanced monitoring would propose to add a more detailed analysis of the change of the best estimate by providing not only more granular data on the changes of the assumptions but also by analysing the profits/losses due to the actual experience.
54. In order to compare the incomes needed to cover the actual expenses, they should be compared to the actual expenses as well as the changes of the assumptions in question. In particular, the earned interest should be compared with the interest rate according to the risk-free rate and the changes of the best estimate due to the change of the risk-free rate from one year to another.

Figure 3: Variation analysis of the change of the best estimate from one year to the next one



- **Issues for consideration**

55. It should be stressed that the actuarial function already has to determine these deviations in order to assess the assumptions made in the best estimate of the technical provisions.
56. The information in the variation analysis (VA) templates is currently not granular enough to allow supervisors to detect problematic reserving, where it occurs. The quantitative reporting templates (QRT) of the variation analysis (VA QRT 29.03 and 29.04) would serve as the starting point as they aim at explaining the changes in the balance sheet from one year to the other.
 - QRT 29.03 provides an explanation by technical provision of the excess of assets over liabilities. It explains the differences between the opening and closing best estimates focusing on certain items such as foreign exchange variations, unwinding of discount rates, changes non-economic assumptions and changes in the economic environment.
 - QRT 29.04 provides a detailed analysis of the technical flows versus the technical provisions. It covers the written premiums during the period, claims

and benefits, expenses, variations of best estimate, variation of technical provisions as a whole and net variation for index-linked and unit-linked business.

57. Both templates could be enhanced to enable the identification of market-wide under-reserving. Table 6 provides a high-level overview of the reporting gaps. Additional information should be collected on the profit or losses that result from deviations of assumptions to actual experience from one year to another with regards to interest rate; longevity/mortality; lapse; disability; reinsurance, cost charges; and currencies.

Table 6: Potential deviations, available information and reporting gaps

Potential deviations	Available information -Template(s) and brief description-	Proposal for new reporting
Interest rate	Limited information. The interests to be earned in order to cover the TP in the next year (i.e. the one-year forward + impact(change of RFR)) is unknown. The same is true for the interest earned: S0901 does not inform about the interest earned during the period. ¹⁶	To be considered. Comparison of interest needed to cover the growth of the TP with the interest earned
Longevity/mortality	Not available	To be considered. Comparison of expected mortality/longevity claims with actual ones
Lapse	Not available	To be considered. Comparison of actual lapse benefits with expected ones and the TP of these contracts including all incomes and costs for lapsation (e.g. reclaims of acquisition costs).
Disability	Not available	To be considered. Comparison of the expected cases of disability (technical provisions and benefits) with the actual occurring disabilities within the year
Reinsurance	Not available	To be considered. Comparison of incoming and outgoing cash-flows due to reinsurance contracts
Cost charges	Not available	To be considered. Comparison of expected vs. actual cost cash-flows
Currencies	Limited information. In the current template the cell 'foreign exchange variation' is related only to contracts in foreign currencies – but not to contracts in the own currency covered by assets in a foreign currency (see Q&A on the VA templates).	To be considered. Measurement of the impact of changes of currency rates

58. In order to fill in the reporting gaps identified, the relevant templates might have to be amended. This proposal will be considered as part of the overall review on reporting, which will take place in light of the Solvency II review. EIOPA has launched a public call for input to gather also the stakeholders' views.¹⁷

Stakeholder question(s):

¹⁶ For example, the interest indicated there contains the coupons of bonds – regardless to which extent they were already taken into account in the balance sheet at the begin of the period. Usually, the assets of the previous year + premiums-benefits-costs + interest = assets of current date. This equation does not hold if interest is taken from S0901.

¹⁷ [Call for Input on Solvency II Reporting and Disclosure Review 2020](#).

Q11) What are your views on the usefulness and mechanics of the tool? Do you identify other elements that would need to be reported for an appropriate monitoring?
Q12) Please describe the available data and robust methods within an insurance undertaking on the deviation of the best estimate assumptions from the actual experience that could be used to monitor against under-reserving.
Q13) What would you estimate as the benefit/positive impact of the implementation of the measure, where applicable, for the industry, for policyholders and/or for supervisors?
Q14) What would you estimate as the costs/negative impact of the implementation of the measure? Can you please: a) Describe the main cost drivers or negative impact, where applicable, for the industry, for policyholders and/or for supervisors; b) Split between one-off and ongoing costs; and c) Consider possible options to mitigate those costs.

5.4 Capital surcharge for systemic risk

[¹⁸ EIOPA (2018c) – Section 2.4]

• Introduction

59. Description. A capital surcharge tool aims at creating an additional buffer to withstand shocks, therefore avoiding the deterioration of the solvency position of undertakings potentially leading to insurance failure(s).
60. Potential contribution to mitigate systemic risk. This tool could serve to mitigate four sources of systemic risk identified.

Capital and reserving-based tools	Main source(s) of systemic risk	Operational objective(s)
Capital surcharge for systemic risk	<ul style="list-style-type: none"> • Deterioration of the solvency position leading to: <ul style="list-style-type: none"> ◦ Failure of a G-SII, D-SII ◦ Collective failures of non-systemically important institutions as a result of exposures to common shocks • Involvement in certain activities or products • Excessive risk-taking by insurance companies (e.g. 'search for yield' and the 'too-big-too fail' problem) • Inappropriate exposures on the liabilities side (e.g. as a result of competitive dynamics) 	<ul style="list-style-type: none"> ➢ Ensuring sufficient loss absorbency capacity and reserving ➢ Discourage excessive involvement in certain products and activities ➢ Discourage risky behaviour

61. Proposal. This measure is proposed for further consideration as an intervention measure.
62. Operational aspects. Authorities would have the power to increase the capital requirement to address the sources of systemic risk identified, i.e. entity-, activity- and behavioural-based sources. Table 7 summarises the main elements of the proposal as well as the main operational challenges identified.

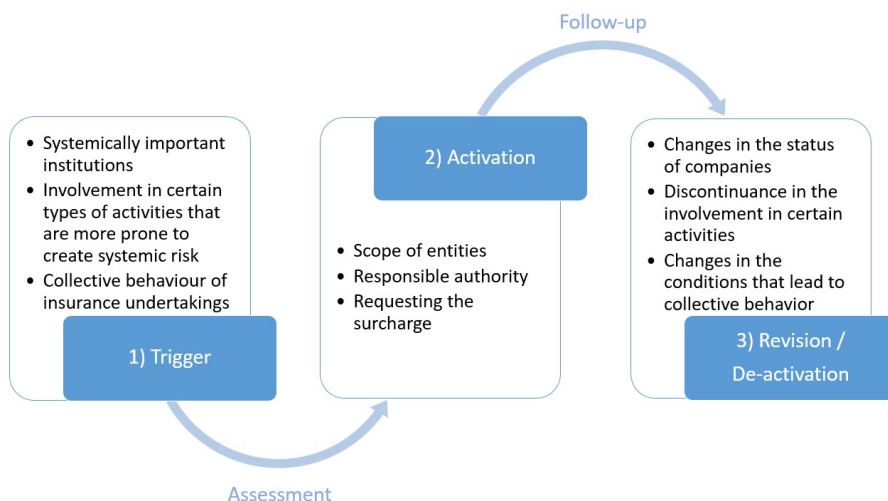
Table 7: EIOPA proposal and main challenges

EIOPA proposal according to the trigger	Scope of institutions	Responsibility	Main challenges
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Possibility of authorities to apply a surcharge to systemically important insurers	• G-SIIs ¹⁸	• FSB	<ul style="list-style-type: none"> • Not clear if the designation will continue in the future. Current consultation paper of IAIS proposes to suspend it. EIOPA is closely monitoring the developments in this field.
	• D-SIIs	• NSAs	<ul style="list-style-type: none"> • Guidance needed to ensure level playing field at EU level • Level and calibration of the surcharge is to be defined
Possibility of authorities to apply a surcharge based on the involvement of undertakings in certain types of activities that are more prone to create systemic risk	• Those involved in the specific activities	• NSAs	<ul style="list-style-type: none"> • Agreement at EU level on the activities that should be subject to such measure. Some kind of threshold might also have to be defined, which poses several challenges • Level and calibration of the surcharge is to be defined by NSAs
Possibility of authorities to apply a surcharge based on the collective behaviour of insurance undertakings	• Those subject to a domestic shock	• NSAs	<ul style="list-style-type: none"> • Identification of common macroprudential shocks • Point in time in which this tool would be activated/de-activated • Level of the surcharge
	• Those subject to an EU shock	• EIOPA	<ul style="list-style-type: none"> • Distinction between domestic and EU shocks, which would activate EIOPA's coordinating role

63. The dynamics of the capital surcharge would take three steps, as shown in Figure 4. Despite the transitory nature of a capital surcharge for systemic risk, the specific source (entity-, activity- and behaviour) that trigger the surcharge will determine the length of the uplift. In this context, ensuring proportionality in terms of the undertakings subject to this tool as well as the level of the surcharge is a fundamental element.

Figure 4: Process for the capital surcharge



64. Given the difficulties of identifying macroprudential shock that trigger “common behaviour” and, therefore, to activate the surcharge in a pre-emptive way, a

¹⁸ SII stands for Systemically Important Insurer, whereas G stands for Globally and D for Domestically (or nationally).

capital surcharge might not be the most appropriate measure to address behaviour-based sources of systemic risk.

- **Issues for consideration**

65. There are three fundamental issues to make this tool operational, i.e., the methodology to determine the capital surcharge, its integration in Solvency II and the need of being consistent with the global developments.
66. In terms of the methodology to determine the capital surcharge, a similar approach to the existing capital add-on (Article 37 of the Solvency II Directive) could be considered, i.e. the SCR calculated via a (partial) internal model or the standard formula would be increased to reflect macroprudential risks regardless of the amount of eligible own funds. In case of need, alternatives to meet the new capital requirements would essentially be raising capital or restricting the distribution of dividends.
67. A macroprudential capital surcharge as the one being considered could be integrated both in Pillar I (calculation of capital reserves) and Pillar II (management of risks and governance) of Solvency II. Pillar I provides for the rules to determine a market consistent balance-sheet, as well as for a risk-based calculation of capital requirements. Pillar II, in turn, is about enhanced governance. Neither of them seems to be the ideal place to introduce a capital surcharge for systemic risk. The reason is that Solvency II was not conceived as a framework to explicitly cover macroprudential concerns.
68. In addition, a macroprudential capital surcharge should also take into account developments at level of the International Association of Insurance Supervisors (IAIS). This refers, in particular, to the Holistic Framework for Systemic Risk that is being considered (Box 4).

Box 4: IAIS references to capital surcharge

(Source: IAIS, 2018, p. 38)

“Requiring an increase in capital, for instance via capital add-ons, may be a useful tool for supervisors in mitigating identified systemic risk. It is a measure to improve resiliency and eventually reduce the risk of a potentially systemic event materialising. As such, it is considered an intervention tool to address risks that supervisors have identified through their monitoring activities. The supervisor should clearly document the rationale for the add-on, including the specific risk it is intended to mitigate or to protect against. Such an increase is not intended to be a permanent uplift. In the event that a supervisor applies a capital add-on to a particular exposure or activity, it would be expected that the capital add-on would return to zero at the end of a pre-determined fixed period (for example, 12 months) from the date that the add-on amount is announced to the firm(s) unless the supervisor announces, to the insurer(s), a decision to maintain the add-on amount or adjust it again before the expiration of the fixed period. An add-on may also help incentivise insurers to reconsider the engagement in these potentially systemically risky activities. For instance, if the supervisor identifies that, in the current economic environment, a product exposes the insurer or a group of insurers to excessive macroeconomic exposure or that the insurer or a group of insurers is overexposed to assets where values are not justified by fundamentals, they may require those insurers to hold additional capital against the risks from these exposures”.

Stakeholder question(s):

Q15) Do you consider that the capital surcharge can effectively contribute to the mitigation of systemic risk? If not, please explain why.

- Q16) What would you estimate as the benefit/positive impact of the implementation of the measure, where applicable, for the industry, for policyholders and/or for supervisors?
- Q17) What would you estimate as the costs/negative impact of the implementation of the measure? Can you please: a) Describe the main cost drivers or negative impact, where applicable, for the industry, for policyholders and/or for supervisors; b) Split between one-off and ongoing costs; and c) Consider possible options to mitigate those costs.
- Q18) On which basis would a capital surcharge for systemically important insurers, for certain types of activities and for collective behaviour be triggered?
- Q19) What would be the challenges if the surcharge would be calculated similar to the SCR via a (partial) internal model or the standard formula?
- Q20) What do you see as possible interactions with other Solvency II instruments? What is the best way to integrate such a tool in Solvency II? As a new tool or by broadening the scope of the current capital add-on?
- Q21) What could be the possible impact of this tool on the insurers' behaviour (if any)?

5.5 Additional reporting on liquidity risk **[Included in COM's CfA]**

[¹⁸ EIOPA (2018c) – Section 3.1]

69. Preliminary notes: EIOPA considers a sequential approach to liquidity risk comprising three steps: 1) Enhancing the reporting framework; 2) Improve the monitoring of liquidity risk; and 3) Considering liquidity requirements. While the first and second steps are addressed in section 5.5 and 5.6 respectively, the power to impose liquidity requirements is included in the annex A.2 of this document. The reason is that it was not proposed for further consideration at this stage. Indeed, there is no evidence yet of material liquidity risk at macro level that would justify the development and implementation of binding liquidity requirements for insurers. However, the tool is included in the Annex for the sake of completeness.
70. In addition, it should be mentioned that a dedicated EIOPA Project Group on Illiquid Liabilities (IL PG) was set up in 2018.¹⁹ One of the objectives of the IL PG is to achieve a common understanding of potential illiquidity characteristics of insurance liabilities and to measure insurers' ability to decide on the timing of buying and selling and to invest over a long term. This work is complementary to the work on the liquidity-based tools established to mitigate liquidity systemic risk.

• Introduction

71. Description. A prerequisite to any kind of micro or macro tool is the availability of a comprehensive and reliable set of indicators that will serve to underpin and guide the decisions on the design, calibration and activation of a tool. The existing QRTs seem to have gaps in data for identifying and monitoring liquidity risk.²⁰

¹⁹ <https://eiopa.europa.eu/Pages/Review-of-Illiquid-liabilities-and-analysis-of-potential-implications-Information-Request-.aspx>.

²⁰ Given that the reporting on the asset side is quite comprehensive, the focus of this proposal is on the liability side and, in particular, on the contractual features that may explain the risk of mass or increased surrenders by policyholders. Parts of the risk are already covered in the mass laps risk module of the SCR calculation. This does not preclude, however, that certain improvements might also be needed on the asset side. For example, there could be a need to get a better overview of transactions that take place within the reporting period, which are not open at the reporting date. This is the case of certain derivative transactions.

72. Potential contribution to mitigate systemic risk. Enhancing the reporting framework with regards to liquidity would contribute to mitigating two main sources of systemic risk.

Liquidity-based tools	Main source(s) of systemic risk	Operational objective(s)
Additional reporting on liquidity risk	<ul style="list-style-type: none"> • Involvement in certain activities or products with greater potential to pose systemic risk • Collective behaviour by insurers that may exacerbate market price movements (e.g. fire-sales or herding behaviour) 	<ul style="list-style-type: none"> > Discourage excessive involvement in certain products and activities > Limit procyclicality

73. Proposal. This measure is proposed for further consideration for enhanced monitoring and reporting purposes.

74. Operational aspects. Elements to look at, which could affect the liquidity of a contract (and thus the technical provisions) are linked to the following:

- The existence of surrender options and the time to maturity of the contract,
- The contractual incentives (guarantees included or profit sharing), and
- The economic impact of early termination for policyholders (e.g. exit fees or taxation related issues).

• **Issues for consideration**

75. Although the Solvency II reporting already includes valuable information regarding some of these elements, there are gaps that would need to be filled-in. From a macroprudential point of view, the main reporting gap refers to some of the elements that would allow authorities to identify the potential systemic risk triggered by massive surrender decisions.

76. As considered by the IAIS, product features allowing for payments that are not triggered by the occurrence of an insurable event (such as surrenders or other withdrawals) entail higher systemic risk potential stemming from substantial liquidity risk.²¹ In line with EIOPA (2018a), this could lead to two specific sources of systemic risk:

- Risk of insurance failure(s). Generally, liquidity issues and solvency issues go hand in hand. However, insurance companies may fail because of a liquidity stress, or because the liquidity stress turns into a solvency problem (i.e. entity-based related source); and
- Collective behaviour by insurers that may exacerbate market price movements, such as fire-sales (i.e. behaviour-based related source).

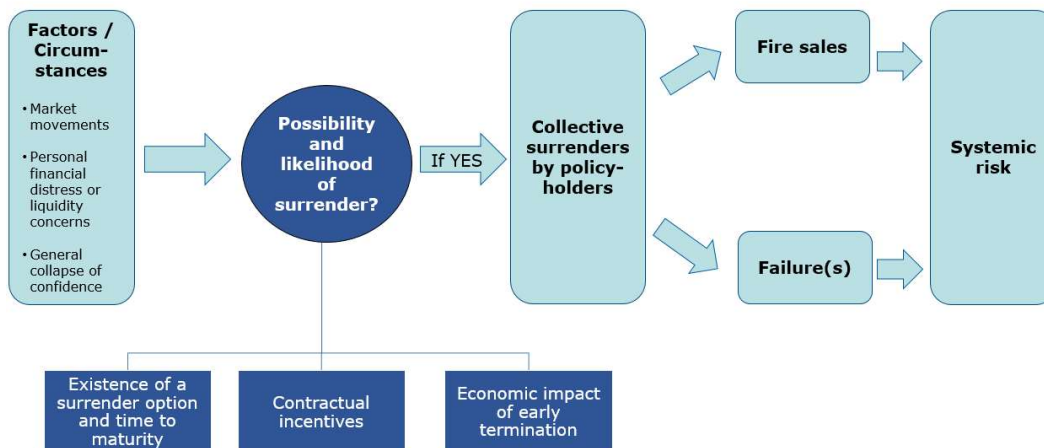
77. The main aspect, therefore, relates to the incentives that would lead to mass surrenders and, eventually, runs on the insurers, which – in line with the IAIS - depends on several factors (or circumstances) such as:

- 1) “Market movements (higher external returns, either spikes in interest rates or stock returns could lead to higher lapse rates, while higher internal returns, such as surplus participation, could lead to lower lapse rates);
- 2) Personal financial distress or liquidity concerns; and

²¹ IAIS (2016)

3) A general collapse of confidence in a company, product or industry.”²²

Figure 5: Potential systemic risk triggered by massive surrender decisions



78. In practical terms, the elements that may create incentives or disincentives to policyholders if the above factors or circumstances materialise are linked to the type of product and the existence of certain contractual features,²³ as well as the economic environment and consequences for policyholders in case of early termination. These are the existence of a surrender option and the time to maturity, the contractual incentives (e.g. guarantees included or profit sharing provisions) and the economic impact of early termination, affected by exit fees or taxation issues.
79. Although the Solvency II reporting already includes valuable information regarding some of these elements, there are gaps that would need to be filled. This information is summarised in the table below.
80. The most relevant template for this topic in the current Solvency II reporting is S.14.01 “Life obligations”. This template includes information about life insurance contracts (direct business and accepted reinsurance) and also includes annuities stemming from non-life contracts. Within the template the information is broken down by line of business, homogenous risk group and an undertaking specific contract.²⁴ In case of products unbundled, the different parts of the product are reported in different lines of business.

Table 8: Risk factors, available information and reporting gaps

Liquidity risk elements	Available information	Proposal for consideration
Existence of a surrender option	Yes, by homogenous risk group within each line of business. S.14.01 “Information on Homogeneous risk	No additional information seems to be needed , if S.14.01 C0200 “Surrender value” is

²² Factors 2 and 3 are typically linked to a crisis situation or adverse events.

²³ As stated by the IAIS (2016), policies offering protection to holders serve for different purpose than products used as a vehicle for saving and, therefore, are less likely be subject to surrender.

²⁴ Solvency II Directive, Article 80 (Segmentation): “Insurance and reinsurance undertakings shall segment their insurance and reinsurance obligations into homogeneous risk groups, and as a minimum by lines of business, when calculating their technical provisions”. Level 2 sets in addition for life the flowing requirements: “(a) there are no significant differences in the nature and complexity of the risks underlying the policies that belong to the same group; (b) the grouping of policies does not misrepresent the risk underlying the policies and does not misstate their expenses; and (c) the grouping of policies is likely to give approximately the same results for the best estimate calculation as a calculation on a per policy basis, in particular in relation to financial guarantees and contractual options included in the policies”.

	groups" – item C0200 "Surrender value". The surrender value by line of business is as well reported in S.12.01.	reported as homogenous risk group of contracts has a surrender value. Some potential enhancements in terms of reporting frequency or specific contracts (e.g. contracts that could be transferred to another insurer) might be worth considering.
Time to maturity and/or duration	For life: Template S.13.01 "Projection of future gross cash flows" includes per line of business and per year the projection of undiscounted expected cash-(in and out)flows: Other relevant templates might be: - S.16.01 – Average duration of obligation (R0020) - S.22.04.01.02 – Average duration of insurance and reinsurance obligations (C0030) - SR.22.03.01.01 – Duration of liabilities (R0170) ("Information on the matching adjustment calculation)	Additional information could be considered. If needed on a more granular level that information could be added to the S.14.01 to receive the duration or information on the maturity per homogenous risk group or product ID.
Guarantees included	Yes, by homogenous risk group within each line of business. S.14.01, "Information on Homogeneous risk groups" – item C0260 "Annualised guaranteed rate (over average duration of guarantee)". Average guaranteed rate to the policy holder over the remaining life time of the contract. Only applicable where a guaranteed rate is provided in the contract. Not applicable for unit linked contracts.	No additional information seems to be needed, if S.14.01 C0260 "Annualised guaranteed rate" is reported as homogenous risk group of contracts has a guarantee included.
Profit sharing (policy)	Not available	Additional information could be considered. General information on existence of a specific form of profit sharing on the level of homogenous risk groups or product IDs can potentially be added to S.14.
Exit fee and/or market value adjustment upon surrender	Not available	Additional information could be considered. Information on the existence of an exit fee of homogenous risk groups or product IDs can potentially be added to S.14.
Taxation	Tax deductibility of the premium	Not available
	Exemption of withholding tax upon surrender	
		Additional information could be considered. A "Yes/No" type of information on the existence of a specific form of taxation on the level of homogenous risk groups or product IDs can potentially be added to S.14. More granular information on income tax seems to be more difficult, given that it may vary depending on many factors and also during the life of the different products. However, given that the taxation element has proven to be a key driver for lapses in some countries, the fiscal treatment of the products is deemed very relevant.

81. In order to fill in the reporting gaps identified, the relevant templates might have to be amended. This proposal will be considered as part of the overall review on reporting, which will take place in light of the Solvency II review. As stressed before, EIOPA has launched a public call for input to gather also the stakeholders' views.

Stakeholder question(s):

- Q22) Are there any other elements to be included in the reporting requirement in order to identify potential system-wide liquidity stresses?
- Q23) What would you estimate as the benefit/positive impact of the implementation of the measure, where applicable, for the industry, for policyholders and/or for supervisors?
- Q24) What would you estimate as the costs/negative impact of the implementation of the measure? Can you please: a) Describe the main cost drivers or negative impact, where applicable, for the industry, for policyholders and/or for supervisors; b) Split between one-off and ongoing costs; and c) Consider possible options to mitigate those costs.

5.6 Liquidity risk ratios

[~~EU~~ EIOPA (2018c) – Section 3.2]

• **Introduction**

- 82. Description. The purpose is to develop a comprehensive and meaningful set of indicators to monitor and assess liquidity risk both at micro and macro level.
- 83. Potential contribution to mitigate systemic risk. The development of such indicators would contribute to mitigate two of the sources of systemic risk identified.

Liquidity-based tools	Main source(s) of systemic risk	Operational objective(s)
Liquidity risk ratio	<ul style="list-style-type: none"> • Involvement in certain activities or products with greater potential to pose systemic risk • Collective behaviour by insurers that may exacerbate market price movements (e.g. fire-sales or herding behaviour) 	<ul style="list-style-type: none"> ➢ Discourage excessive involvement in certain products and activities ➢ Limit procyclicality

- 84. Proposal. This measure is proposed for further consideration as an enhanced reporting and monitoring tool for competent authorities.
- 85. Operational aspects. The liquidity of the assets shall be evaluated together with the liquidity of the liabilities, namely the time to maturity of the outstanding portfolio and the presence of product characteristics (e.g. penalties) that might limit the incentives of policyholder to lapse. Several indicators have been proposed, such as:
 - Liquid assets/technical provisions
 - Liquid assets/liquid liabilities
 - Unencumbered assets/total assets
 - Liquid assets ratio
 - Liquidity resources/liquidity needs
 - Short term liquidity resources/short term liquidity needs
 - Lapse ratio
 - Gross written premium/surrenders

• **Issues for consideration**

86. Solvency II is a risk-based framework, which does not include specific quantitative (Pillar I) requirements for liquidity risk. According to the Solvency II Directive, ORSA (Pillar II) has to cover liquidity risk and hence it has to be seen as a valuable source of information. In the same vein, the PPP includes the liquidity aspects of investments and has to be respected by the insurers.
87. However, the principle-based nature of this requirement and the lack of clear definitions and indicators on liquidity make it a challenging task for the supervisor to verify the compliance of insurers with these requirements. This explains why this tool is proposed for further consideration.

Stakeholder question(s):

Q25) Are there any other relevant indicators that could be considered to detect potential systemic liquidity stresses?

5.7 Temporary freeze on redemption rights

[~~EF~~ EIOPA (2018c) – Section 3.4]

• **Introduction**

88. Description. This tool provides authorities with the power to temporary forbid or limit lapses in *exceptional circumstances*, which could be applied to the whole or part of the market, or to systemically important institutions, in order to give the vulnerable entity or entities some time to implement necessary measures to reduce their liquidity risks.
89. Potential contribution to mitigate systemic risk. Temporary freezing redemption rights might positively contribute to limiting procyclical behaviours.

Liquidity-based tools	Main source(s) of systemic risk	Operational objective(s)
Temporary freeze on redemption rights	<ul style="list-style-type: none"> Collective behaviour by insurers that may exacerbate market price movements (e.g. fire-sales or herding behaviour) 	<ul style="list-style-type: none"> ➤ Limit procyclicality

90. Proposal. This measure is proposed for further consideration as in intervention power for authorities.
91. Operational aspects. Some measures could be considered, according to the severity of the observed situation, such as the establishment of a kind of gate²⁵ or temporary suspending the redemption rights for the whole market in exceptional circumstances, considering the financial stability implications.

• **Issues for consideration**

92. This tool temporarily freezes the rights of policyholders to surrender, which should be carefully considered by authorities, before implementing it for the whole market. Indeed, it will deprive to a certain extent policyholders of their savings, at least on the short term. One underlying reason for such a measure is a higher level playing field among policyholders in case of crisis. This is due to the fact that the better informed ones will surrender first and have their money back, whereas the latest to surrender would be the only one to support the failure of the insurers.

²⁵ In the Asset Management sector, in case of exceptional circumstances, and in order to preserve the public interest, assets managers are allowed to level off the surrender rate, for a limited period of time. When the surrender rate reaches a predetermined threshold, the assets manager caps the surrenders, applying a fairness principle to every investor. A similar mechanism could be implemented for life insurers.

93. As a result, it should be applied only in very exceptional circumstances and for a limited period of time, to prevent risks representing a strong threat for the financial health of the whole insurance market or for the financial system.

Stakeholder question(s):

- Q26) Do you consider that a temporary freeze on redemption rights in exceptional circumstance can effectively contribute to the mitigation of systemic risk? If not, please explain.
- Q27) How could the term “exceptional circumstances” be understood, i.e. what should be the trigger(s) to activate this tool?
- Q28) What should be the optimal period of freeze or limitation of redemption rights?
- Q29) In case of limiting the redemption rights, what could be the relevant criteria for such a limitation (absolute threshold or percentage)?
- Q30) What would you estimate as the benefit/positive impact of the implementation of the measure, where applicable, for the industry, for policyholders and/or for supervisors?
- Q31) What would you estimate as the costs/negative impact of the implementation of the measure? Can you please: a) Describe the main cost drivers or negative impact, where applicable, for the industry, for policyholders and/or for supervisors; b) Split between one-off and ongoing costs; and c) Consider possible options to mitigate those costs.
- Q32) What could be the possible impact of this tool on the insurers’ behaviour (if any)?
- Q33) What do you see as possible interactions with other Solvency II instruments (if any)?

5.8 Concentration thresholds – Monitoring exposures

[[E](#) EIOPA (2018c) – Section 4.1]

• Introduction

94. Description. This tool considers the definition of some benchmark on (the growth of) certain types of exposures that are being identified, in order to understand, monitor and eventually avoid excessive (direct and indirect) concentrations.
95. Potential contribution to mitigate systemic risk. This tool should contribute to the operational objective of discouraging excessive levels of direct and indirect exposure concentrations.

Exposure-based tools	Main source(s) of systemic risk	Operational objective(s)
Concentration thresholds	• Excessive concentrations	➢ Discourage excessive levels of direct and indirect exposure concentrations

96. Proposal. This measure is proposed for further consideration. However, for an adequate implementation of the tool, a sequential approach should be followed. In a first step, potential concentrations should be identified and monitored. The possibility of establishing certain “soft thresholds” (as defined below) for action at market level by national authorities if a certain exposure increases dramatically and/or reaches a significant “risky level”, should be further considered only at a later stage, after a good overview of the potential risks is available. Specific

instruments would only be considered at the end of the process if deemed necessary.

97. In line with the first step, EIOPA has carried out some internal research to identify relevant exposure concentrations, define specific indicators to be considered, and provide an initial overview of the main exposures at country level. The following exposures were considered:

- Exposures to certain asset classes:
 - Government and corporate bonds;
 - Equity;
 - Real estate, for example through mortgages and loans;
- Exposures to assets issued by companies (or governments) in emerging markets
- Exposures to certain sectors, in particular, the banking sector;
- Derivatives:
 - Exposure to banks
 - Counterparty concentration
 - Intragroup transactions on derivatives
- Cross-country exposures

98. From this initial analysis, it can be confirmed that, as expected, there are relevant differences across countries, reflecting historical developments, habits and trends at national level. The analysis carried out in this first step, supports the rationale for a flexible approach on any potential threshold to be defined in a second step.²⁶ As stated in EIOPA (2018c), flexibility at jurisdictional level could better grasp national specificities, such as significant differences in asset allocation amongst insurers in different jurisdictions or different tax regimes. Nonetheless, the analysis carried out allowed observing circumstances where higher overall levels of exposure (at country aggregates) are combined with a more concentrated profile of such exposures. Both aspects are being assessed on a relative basis, and do not provide, *per se*, a definitive conclusion of undesirable levels of exposure.

99. Operational aspects. The proposal only refers to the potential establishment of “soft thresholds”, as opposed to “hard thresholds”,²⁷ as the latter are not deemed adequate for the insurance industry in a Solvency II environment. Soft thresholds or benchmarks are meant for monitoring purposes. This implies the identification of benchmark to refer to when examining the concentration; they can be exceeded, but would raise special awareness of authorities, who would take action as appropriate where they believe there is a macroprudential risk. This would provide for a flexible approach.

- **Issues for consideration**

100. In line with the current Solvency II approach, the emphasis should be put on enhancing risk management practices and, in general, accurate application of PPP, appropriate implementation of own risk assessment functions by the companies so

²⁶ Particular differences could also exist between Euro area and Non-Euro area countries. In the latter, some concentrations might be explained by the fact that financial institutions seek to avoid significant currency mismatch and FX risk, focusing largely on local-denominated assets.

²⁷ Hard thresholds are limits that should not be breached. For example, if the exposure limit to a specific asset class is set at a certain percentage of the investment portfolio, undertakings are simply not allowed to exceed this limit.

to foster proper diversification and avoiding unintended implications at market level (fire sales, pro-cyclical behavior) especially in time of stress. Completing the current framework by setting soft thresholds and granting some kind of flexibility in the form of guided discretion at national level to take action in case exposure goes beyond certain level (i.e. if certain exposure increases dramatically and/or reaches a significant level) seems, however, a good supplement to the Solvency II approach.

101. In order not to depart excessively from the principles of Solvency II, the criteria and conditions to be met would be fixed at EU level, while taking into account the conditions in the different markets.

Stakeholder question(s):

Q34) Do you miss any relevant type of concentration?

Q35) Which elements should be considered to ensure that the required national flexibility to address the national specificities of the markets does not compromise the level playing field in the EU?

Q36) What could be the possible impact of this tool on the insurers' behaviour (if any)?

5.9 Enhancement of the ORSA [Included in COM's CfA]

[¹⁸ EIOPA (2018c) – Section 4.2]

• **Introduction**

102. Description. In an ORSA, an insurer is required to consider all material risks that may have an impact on its ability to meet its obligations to policyholders. In doing this a forward looking perspective is also required. Although conceived at first as a microprudential tool, this tool could be enhanced to take the macroprudential perspective also into account.

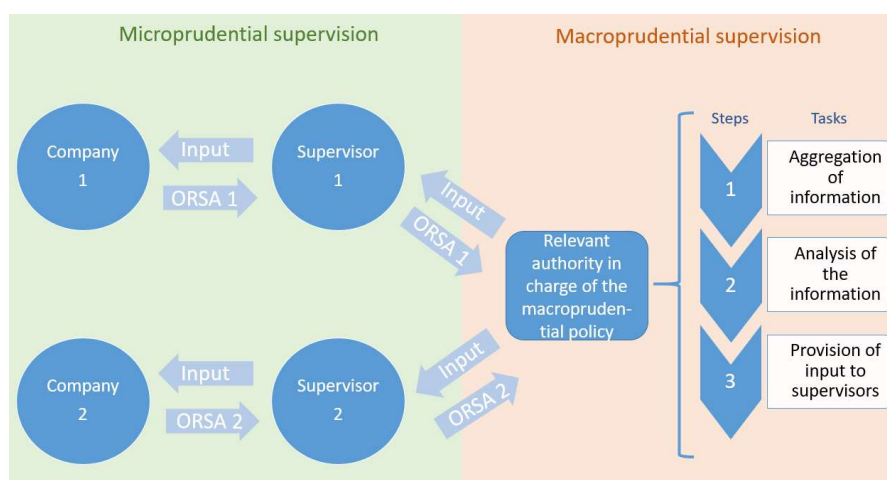
103. Potential contribution to mitigate systemic risk. The enhancement of ORSA could help in mitigating two of the sources of systemic risk identified.

Exposure-based tools	Main source(s) of systemic risk	Operational objective(s)
Enhancement of ORSA	<ul style="list-style-type: none"> • Excessive concentrations • Deterioration of the solvency position leading to: <ul style="list-style-type: none"> ○ Failure of a G-SII, D-SII ○ Collective failures of non-systemically important institutions as a result of exposures to common shocks 	<ul style="list-style-type: none"> ➢ Discourage excessive levels of direct and indirect exposure concentrations ➢ Ensure sufficient loss-absorbency capacity and reserving

104. Proposal. This measure is proposed for further consideration for enhanced reporting and monitoring purposes.

105. Operational aspects. A description of all relevant operational aspects is carried out in EIOPA (2018c). In essence, the idea is to supplement the microprudential approach by assigning certain roles and responsibilities to the relevant authority in charge of the macroprudential policy (see Figure 6). This authority could carry out three different tasks: 1) Aggregation of information; 2) Analysis of the information; and 3) Provision of certain information or parameters to supervisors to channel macroprudential concerns. Supervisors would then request undertakings to include in their ORSAs particular macroprudential risks.

Figure 6: Incorporating the macroprudential perspective into ORSA



- **Issues for consideration**

106. In order to make the ORSA operational from a macroprudential point of view, the following would be needed:

- A clarification of the role of the risk management function in order to include macroprudential concerns.
- The inclusion of a new paragraph in Article 45 of the Solvency II directive explicitly referring to the macroprudential dimension and the need to consider the macroeconomic situation and potential sources of systemic risk as follow-up of their assessment on whether the company complies on a continuous basis with the Solvency II regulatory capital requirements.
- Clarification that a follow-up is expected after input from supervisors, namely from authorities in charge of the macroprudential policy. On a risk-based approach this might imply the request of specific information in terms of nature, scope, format and point in time, where justified by likelihood or impact of materialisation of a certain source of systemic risk.

107. Furthermore, a certain level of harmonisation of the structure and content of the ORSA report would be needed, which would enable the identification of the relevant sections by the authorities in charge of macroprudential policies. This, however, would mean a change in the current approach followed with regard to the ORSA.

Stakeholder question(s):

Q37) How could the ORSA be enhanced to also include macroprudential considerations? Please provide a detailed suggestion.

Q38) What would you estimate as the benefit/positive impact of the implementation of the measure, where applicable, for the industry, for policyholders and/or for supervisors?

Q39) What would you estimate as the costs/negative impact of the implementation of the measure? Can you please: a) Describe the main cost drivers or negative impact, where applicable, for the industry, for policyholders and/or for supervisors; b) Split between one-off and ongoing costs; and c) Consider possible options to mitigate those costs.

Q40) What could be the possible impact of this tool on the insurers' behaviour (if any)?

Q41) What do you see as possible interactions with other Solvency II instruments (if any)?

5.10 Enhancement of the Prudent Person Principle **[Included in COM's CfA]**

[~~EF~~ EIOPA (2018c) – Section 4.3]

• Introduction

108. Description. The PPP prescribes that undertakings shall only invest in assets and instruments whose risks the undertaking concerned can properly identify, measure, monitor, manage, control and report, and appropriately take into account in the assessment of its overall solvency needs. It is a microprudential tool in essence, but it could be enhanced to also cover macroprudential concerns.

109. Potential contribution to mitigate systemic risk. The enhancement of the PPP could help in mitigating two of the sources of systemic risk identified.

Exposure-based tools	Main source(s) of systemic risk	Operational objective(s)
Enhancement of PPP	<ul style="list-style-type: none"> • Excessive concentrations • Involvement in certain activities or products with greater potential to pose systemic risk 	<ul style="list-style-type: none"> ➢ Discourage excessive levels of direct and indirect exposure concentrations ➢ Discourage excessive involvement in certain products and activities

110. Proposal. This measure is proposed for further consideration as a tool for enhanced reporting and monitoring.

111. Operational aspects. The PPP could be enhanced to cope with macroprudential concerns. The relevant authority in charge of the macroprudential policy would seek to extract relevant information on the investment strategy of undertakings, analyse it together with other relevant information that might be available and provide input to supervisors on potential macroprudential risks. The potential impact of the PPP would work *ex-ante* and *ex-post*:

- *Ex-ante*, to the extent that insurers take into consideration macroprudential concerns when deciding on the investment strategy of insurers.
- *Ex-post* if it is considered as a soft tool with corrective power. Supervisors are expected to assess these risks at company level.

• Issues for consideration

112. The PPP tool could be enhanced with the aim of making it more suitable for macroprudential purposes. For example:

- Specific requirements could be introduced to consider in the chosen investment strategies in addition to excessive concentrations at sector level, covering other macroprudential risks, such as credit cycle downturns, or reduced market liquidity.
- Specific requirements could be introduced to consider the investment strategies that could lead to procyclical behavior, including any relevant management actions the insurer has identified that it would rely on to manage their solvency position.

Stakeholder question(s):

- Q42) How could the prudent person principle be enhanced to also include macroprudential considerations? Please provide a detailed explanation.
- Q43) *Ex-ante* impact: How could be ensured that insurers take into consideration the macroprudential concerns (e.g. a questionnaire or template)?
- Q44) *Ex-post* analysis: In your view, what would be relevant to consider in order to make sure that supervisors can aggregate and analyse the information?
- Q45) What would you estimate as the benefit/positive impact of the implementation of the measure, where applicable, for the industry, for policyholders and/or for supervisors?
- Q46) What would you estimate as the costs/negative impact of the implementation of the measure? Can you please: a) Describe the main cost drivers or negative impact, where applicable, for the industry, for policyholders and/or for supervisors; b) Split between one-off and ongoing costs; and c) Consider possible options to mitigate those costs.
- Q47) What could be the possible impact of this tool on the insurers' behaviour (if any)?
- Q48) What do you see as possible interactions with other Solvency II instruments (if any)?

5.11 Request of recovery plans **[Included in COM's CfA]**

[²⁸ EIOPA (2018c) – Section 5.1]

• Introduction

113. Description. In a pre-emptive recovery plan, an insurer describes the possible measures it would adopt to restore its financial position following a significant deterioration caused by potential scenarios of stress. This plan is drafted by companies in normal times.
114. Potential contribution to mitigate systemic risk. The main objective of broadening the scope of companies subjects to recovery planning is ensuring sufficient loss absorbency capacity and reserving.

Pre-emptive planning	Main source(s) of systemic risk	Operational objective(s)
Request of recovery plans	<ul style="list-style-type: none"> • Deterioration of the solvency position leading to: <ul style="list-style-type: none"> ○ Failure of a G-SII, D-SII ○ Collective failures of non-systemically important institutions as a result of exposures to common shocks 	<ul style="list-style-type: none"> ➤ Ensuring sufficient loss absorbency capacity and reserving

115. Proposal. This measure is proposed for further consideration as an enhanced reporting and monitoring tool for a scope of companies beyond the designated G-SIIs. This approach is consistent with EIOPA's Opinion on Recovery and Resolution for insurers.²⁸
116. Operational aspects. The key operational aspect is broadening the scope to cover a sufficiently large number of companies. By broadening the scope of companies subject to recovery planning beyond G-SIIs, the sector would benefit from a

²⁸ See EIOPA (2017). In this Opinion, EIOPA considers that the requirement of recovery and resolution planning should apply to all (re)insurers subject to the proportionality principle, i.e. including the possibility to waive certain companies or to apply simplified obligations.

decrease in the likelihood of insurance failures. Companies would be requested to prepare recovery plans in normal times.

- **Issues for consideration**

117. A key aspect of this measure is the concept of proportionality, as stated in EIOPA’s Opinion (2017), which applies to all four pre-emptive plans considered in this Discussion paper. This issue refers to the scope of application, i.e. which companies should be subject to recovery planning, but also to the possibility of including simplified obligations for certain companies.
118. Another issue for consideration is the relationship between these pre-emptive recovery plans (drafted in normal times) and the Solvency II recovery plans, which – according to Article 138 of the Solvency II Directive (2009/138/EC) – are requested within two months from the observation of non-compliance with the SCR.

Stakeholder question(s):
Q49) How could proportionality in the recovery plans be ensured? Please provide a detailed answer.
Q50) What would you estimate as the benefit/positive impact of the implementation of the measure, where applicable, for the industry, for policyholders and/or for supervisors?
Q51) What would you estimate as the costs/negative impact of the implementation of the measure? Can you please: a) Describe the main cost drivers or negative impact, where applicable, for the industry, for policyholders and/or for supervisors; b) Split between one-off and ongoing costs; and c) Consider possible options to mitigate those costs.
Q52) What could be the possible impact of this tool on the insurers’ behaviour (if any)?
Q53) What do you see as possible interactions with other Solvency II instruments (if any)?

5.12 Development of resolution plans **[Included in COM’s CfA]**

[¹⁸ EIOPA (2018c) – Section 5.2]

- **Introduction**

119. Description. The measure consists on the development by competent authorities of resolution plans in a pre-emptive manner (i.e. in normal times) with the intention of making the resolution of companies feasible without severe systemic disruption and without exposing taxpayers to loss.
120. Potential contribution to mitigate systemic risk. The focus is on operationalising the strategies to achieve an orderly process of resolution or liquidation, ensuring that the undertakings have sufficient loss absorbency capacity and avoiding reliance on public funds.

Pre-emptive planning	Main source(s) of systemic risk	Operational objective(s)
Request of resolution plans	<ul style="list-style-type: none"> • Deterioration of the solvency position leading to: <ul style="list-style-type: none"> ◦ Failure of a G-SII, D-SII 	<ul style="list-style-type: none"> ➤ Ensuring sufficient loss absorbency capacity and reserving

o Collective failures of non-systemically important institutions as a result of exposures to common shocks

121. Proposal. This measure is proposed for further consideration to be applied to a scope of companies beyond the designated G-SIIs.
122. Operational aspects. The key operational aspect is broadening the scope to cover a sufficiently large number of companies. By broadening the scope of companies subject to resolution planning beyond G-SIIs, the sector would benefit from a minimisation or reduction of any systemic risks arising from an insurer's failure, including also collective failures, particularly relevant when companies are operating in fragile environments.

• **Issues for consideration**

123. As with recovery planning, a key aspect of this measure is the concept of proportionality. To avoid excessive burdens to competent authorities, the measure should in general be directed towards insurers, which might have a direct or indirect impact on policyholders, pose systemic risks or result in the discontinuance of services that could harm the financial stability and/or real economy.

Stakeholder question(s):
Q54) How could proportionality in the resolution plans be ensured? Please provide a detailed answer.
Q55) What would you estimate as the benefit/positive impact of the implementation of the measure, where applicable, for the industry, for policyholders and/or for supervisors?
Q56) What would you estimate as the costs/negative impact of the implementation of the measure? Can you please: a) Describe the main cost drivers or negative impact, where applicable, for the industry, for policyholders and/or for supervisors; b) Split between one-off and ongoing costs; and c) Consider possible options to mitigate those costs.
Q57) What do you see as possible interactions with other Solvency II instruments (if any)?

5.13 Request of systemic risk management plans [Included in COM's CfA]

[¹⁸ EIOPA (2018c) – Section 5.3]

• **Introduction**

124. Description. The measure consists in requesting insurers to draft SRMPs in which they present all applicable measures they intend to undertake to address the systemic risk that the institution may pose in the financial system.
125. Potential contribution to mitigate systemic risk. Requesting SRMPs should contribute to mitigate two of the sources of systemic risk identified.

Pre-emptive planning	Main source(s) of systemic risk	Operational objective(s)
Request of SRMP	<ul style="list-style-type: none"> • Involvement in certain activities or products with greater potential to pose systemic risk • Potentially dangerous interconnections 	<ul style="list-style-type: none"> ➢ Discourage excessive involvement in certain products and activities

126. Proposal. This measure is proposed for further consideration as an enhanced reporting and monitoring tool for a scope of companies beyond the designated G-SIIs.
127. Operational aspects. The key operational aspect is broadening the scope to cover a sufficiently large number of companies. By broadening the scope of companies subject to SRMPs, the sector would benefit from a macroprudential perspective. Firstly, by means of ensuring that the institutions are monitoring and managing more effectively the activities, which could lead to posing systemic risk. Secondly, to make this actually effective in practice, insurers should seek to take concrete actions to better manage, reduce or separate their systemically risky activities.

• **Issues for consideration**

128. A key aspect refers to the scope of application of this measure, i.e. the companies that should be requested to draft SRMPs. This links to the issue of proportionality. Given that at present this plan is requested only to G-SIIs, the aim is to potentially go beyond the systemic entities identified, e.g. covering also specific large insurers (e.g. D-SIIs), that might pose systemic risk. Financial conglomerates should also be considered, even in the event that they are not insurer-led conglomerates.

Stakeholder question(s):

- Q58) Do you consider that systemic risk management plans can effectively contribute to the mitigation of systemic risk? If yes, what are the key elements that should be considered? If not, please explain why.
- Q59) Which companies should be included within the scope of the systemic risk management plans? What should be the criteria to be considered?
- Q60) What would you estimate as the benefit/positive impact of the implementation of the measure, where applicable, for the industry, for policyholders and/or for supervisors?
- Q61) What would you estimate as the costs/negative impact of the implementation of the measure? Can you please: a) Describe the main cost drivers or negative impact, where applicable, for the industry, for policyholders and/or for supervisors; b) Split between one-off and ongoing costs; and c) Consider possible options to mitigate those costs.
- Q62) What could be the possible impact of this tool on the insurers' behaviour (if any)?
- Q63) What do you see as possible interactions with other Solvency II instruments (if any)?

5.14 Request of liquidity risk management plans [Included in COM's CfA]

[¹⁸ EIOPA (2018c) – Section 5.4]

• **Introduction**

129. Description. This measure consists in requesting LRMPs to insurers, in order for them to assess the framework and arrangements that they have in place to manage, mitigate or reduce liquidity risk.

130. Potential contribution to mitigate systemic risk. This measure should help mitigating two of the sources of systemic risk identified.

Pre-emptive planning	Main source(s) of systemic risk	Operational objective(s)
Request of LRMP	<ul style="list-style-type: none"> • Involvement in certain activities or products with greater potential to pose systemic risk • Potentially dangerous interconnections 	<ul style="list-style-type: none"> ➢ Discourage excessive involvement in certain products and activities ➢ Discourage excessive levels of direct and indirect exposure concentrations

131. Proposal. This measure is proposed for further consideration as an enhanced reporting and monitoring tool for a scope of companies beyond the designated G-SIIs.

132. Operational aspects. As with the other plans, the key operational aspect is broadening the scope to cover a sufficiently large number of companies. By broadening the scope of companies subject to LRMPs, the sector would benefit from a macroprudential perspective. The LRMP can increase awareness of potential liquidity risks and improve the company’s ability to recover from liquidity stresses, hereby reducing (to some degree) their risk of failure, as well as contributing to the operational objective of ensuring sufficient loss absorbency capacity (from a liquidity point of view).

• **Issues for consideration**

133. As with the other plans, a key aspect refers to the scope of application of this measure, i.e. the companies that should be requested to draft LRMPs. Given that at present this plan is requested only to G-SIIs, the aim is to potentially go beyond the systemic entities identified, e.g. covering also specific large insurers (e.g. D-SIIs), that might pose systemic risk. Financial conglomerates are not considered for the purposes of requesting LRMPs, given that for significant supervised banks there is already a requirement for the production of consolidated liquidity reports (i.e. ILAAP or Internal Liquidity Adequacy Assessment Process).

134. Solvency II requires insurance or reinsurance undertakings applying the matching adjustment or the volatility adjustment to set up a liquidity plan projecting the incoming and outgoing cash flows in relation to the assets and liabilities subject to those adjustments. Synergies with the LRMP should be sought to the extent possible.

Stakeholder question(s):
Q64) Do you consider that liquidity risk management plans can effectively contribute to the mitigation of systemic risk? If yes, what are the key elements that should be considered? If not, please explain why.
Q65) Which companies should be included within the scope of the liquidity risk management plans? What should be the criteria to be considered?
Q66) What would you estimate as the benefit/positive impact of the implementation of the measure, where applicable, for the industry, for policyholders and/or for supervisors?
Q67) What would you estimate as the costs/negative impact of the implementation of the measure? Can you please: a) Describe the main cost drivers or negative impact, where applicable, for the industry, for policyholders and/or for supervisors; b) Split between one-off and ongoing costs; and c) Consider possible options to mitigate those costs.

- Q68) What could be the possible impact of this tool on the insurers' behaviour (if any)?
- Q69) What do you see as possible interactions with other Solvency II instruments (if any)?

References

- EIOPA (2016): [*A potential macroprudential approach to the low interest rate environment in the Solvency II context*](#), EIOPA-BoS-15/202, 23 March 2016.
- (2017): [*Opinion to Institutions of the European Union on the Harmonisation of Recovery and Resolution Frameworks for \(Re\)insurers across the Member States*](#), EIOPA-BoS/17-148, July 2017.
- (2018a): [*Systemic risk and macroprudential policy in insurance*](#), EIOPA, first paper on macroprudential policy in insurance.
- (2018b): [*Solvency II tools with macroprudential impact*](#), EIOPA, second paper on macroprudential policy in insurance.
- (2018c): [*Other potential macroprudential tools and measures to enhance the current framework*](#), EIOPA, third paper on macroprudential policy in insurance.
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Annex – Discarded tools

A.1 Counter-cyclical capital buffers (time-varying capital tools)

[~~135~~ EIOPA (2018c) – Section 2.3]

135. Description. Broad-based capital buffer are designed to work anticyclically (i.e. buffers are built up during upswings of the credit cycle and run down during periods of financial market stress).
136. Potential contribution to mitigate systemic risk. The objective of time-varying capital tools is to contribute to one of the operational objectives identified.

Capital and reserving-based tools	Main source(s) of systemic risk	Operational objective(s)
Time-varying capital tools such as the counter-cyclical capital buffer (CCyB)	<ul style="list-style-type: none"> • Deterioration of the solvency position leading to: <ul style="list-style-type: none"> ○ Failure of a G-SII, D-SII ○ Collective failures of non-systemically important institutions as a result of exposures to common shocks 	<ul style="list-style-type: none"> ➤ Ensuring sufficient loss absorbency capacity and reserving

137. Reasons for not considering this tool further:

- This tool is typically designed for the banking sector to ensure that credit institutions build up capital in an upturn of the credit cycle so that in a downturn the buffer can be released and the institution is not incentivized to reduce lending in order to improve their capital ratio. Although the insurance sector is also vulnerable to boom and bust, it is not in the same way as banks because of the different business model.
- Insurers' vulnerability to these shocks also depends on their asset holdings, which vary substantially across the EU, as well as the type of insurance liabilities they hold and whether they offer fixed or variable returns. That points to an automated, broad-based capital tool such as the CCyB in banking may be inappropriate for insurance.
- The use of multiple targeted tools through the long term guarantee measures allows the Solvency II calculation to respond to the different 'cycles' that insurers are exposed to in a way a single broad-based capital adjustment like the CCyB would not.
- Linked to the previous, several important operational issues and challenges of such a tool raise some doubt as to how it would work in practice (e.g. how to calibrate it).
- Given the risk of overlaps with work of current countercyclical features of Solvency II, and the operational difficulties, a broad-based countercyclical capital buffer is not further considered in this Discussion paper. A more targeted capital tool could be appropriate for targeting the cyclical nature of specific exposures.

A.2 Liquidity requirements

[¹⁸ EIOPA (2018c) – Section 3.3]

138. Description. This tool aims at reducing liquidity risk by introducing formal constraints to be respected by the insurers. They can be of a micro- or macroprudential nature depending on the scope of the measure.
139. Potential contribution to mitigate systemic risk. The main sources of systemic risk addressed and the operational objectives pursued coincide with the other liquidity tools.

Liquidity-based tools	Main source(s) of systemic risk	Operational objective(s)
Liquidity requirements	<ul style="list-style-type: none"> • Involvement in certain activities or products with greater potential to pose systemic risk • Collective behaviour by insurers that may exacerbate market price movements (e.g. fire-sales or herding behaviour) 	<ul style="list-style-type: none"> ➢ Discourage excessive involvement in certain products and activities ➢ Limit procyclicality

140. Reasons for not considering this tool further:

- There is no evidence yet of material liquidity risk at macro level that would justify the development and implementation of binding liquidity requirements for insurers.
- Liquidity-based instruments are more complex to develop and more difficult to operationalise for insurers and are therefore costlier to implement than the other liquidity measures.
- Several potential side effects of such requirements were considered. For example:
 - How they affect the long-term investment strategy of insurers and have an impact on their asset-liability management (ALM) approach.
 - Whether they lead to further increase of exposure toward high quality liquid assets which could lead to excessive concentration on certain asset classes or geographical regions.
 - What would be their effect on the asset allocation by insurers and other holders of relevant assets.
- EIOPA proposes a step-by-step approach to liquidity risk in the absence of strong evidence of material liquidity risk at macroprudential level: the potential development of minimum liquidity requirements might be considered more in-depth only as a final step, once reporting requirements have been enhanced and a risk assessment framework has been put in place.