

REQUEST TO EIOPA FOR TECHNICAL ADVICE ON THE REVIEW OF SPECIFIC ITEMS IN THE SOLVENCY II
DELEGATED REGULATION AS REGARDS UNJUSTIFIED CONSTRAINTS TO FINANCING (Regulation (EU) 2015/35)

With this mandate to EIOPA, the Commission seeks EIOPA's technical advice on the review of specific items in the Solvency II Delegated Regulation (Regulation (EU) 2015/35).

The mandate follows the Communication from the Commission to the European Parliament and the Council – Implementation of Article 290 of the Treaty on the Functioning of the European Union (the "**290 Communication**")¹, the Regulation of the European Parliament and of the Council establishing a European Insurance and Occupational Pensions Authority (**the EIOPA Regulation**)², the Framework Agreement on Relations between the European Parliament and the European Commission (the "**Framework Agreement**")³ and the inter-institutional agreement on better law-making⁴.

The Commission has expressed its intention to review the methods, assumptions and standard parameters used when calculating the Solvency Capital Requirement with the standard formula before December 2018. This review should make use of the experience gained by insurance and reinsurance undertakings during the transitional period and the first years of application of Solvency II. EIOPA is invited to provide technical advice on specific items that the Commission has identified for the scope of this review.

This technical advice shall be delivered by 28 February 2018.

1. Context

1.1 Scope

On 18 January 2015, Commission Delegated Regulation (EU) 2015/35 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) entered into force. In this Regulation, the Commission executed 76 empowerments set out in Directive 2009/138/EC. When that Regulation was adopted, the Commission expressed its intention to review specific items of the Solvency II standard formula before December 2018⁵.

In 2016, notably on the basis of the results of call for evidence on the EU regulatory framework for financial services, three areas which merit further reflection were identified: proportionate and simplified application of the requirements (area 1), removal of unintended technical inconsistencies (area 2) and removal of unjustified constraints to financing (area 3). In July 2016, a first request for technical advice was sent to EIOPA, covering areas 1 and 2.

Within the context of Capital Markets Union, it is of utmost importance that any investment supporting jobs and growth is appropriately treated in insurers' prudential requirements. Therefore, this additional request for technical advice as regards unjustified constraints to financing (area 3) is sent to EIOPA, in view of removing

¹ Communication of 9.12.2009. COM(2009) 673 final.

² 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), OJ L 331, 15.12.2010, p. 48–83.

³ The Framework Agreement on relations between the European Parliament and the European Commission, OJ L304/47, 20.11.2010, p.47.

⁴ Inter-institutional agreement between the European Parliament, the Council of the European Union and the European Commission of 13 April 2016 on Better Law-Making, OJ L 123, 12.5.2016, p.1.

⁵ Recital 150 of Commission Delegated Regulation (EU) 2015/35.

barriers to investments in unrated bonds and loans and in unlisted equity, in order to improve insurers' ability to invest in private placement offerings and in private equity.

1.2 Principles that EIOPA should take into account

In providing its technical advice, EIOPA is invited to take account of the following principles:

- It should respect the requirements of the EIOPA Regulation and is invited to widely consult market participants in an open and transparent manner. EIOPA should provide advice which takes account of different opinions expressed by the market participants during the consultation and should provide a feedback statement on the consultation justifying its choice vis-à-vis the main arguments raised during the consultation.
- The principle of proportionality: the technical advice should not go beyond what is necessary to achieve the objectives of the European Union and provide for the proportionate application of the Solvency II Directive, in particular in relation to small insurance undertakings, and avoid creating excessive administrative or procedural burdens for (re)insurers.
- EIOPA will determine its own working methods depending on the content of the issues being dealt with. Nevertheless, horizontal questions should be dealt with in such a way as to ensure coherence between different standards of work being carried out.
- While preparing its advice, EIOPA should seek coherence within the regulatory framework of the Union, and in particular Directive 2009/138/EC.
- The provided technical advice should contain sufficient and detailed explanations for the assessment done, and be presented in easily understandable language respecting current legal terminology at European level.
- EIOPA should justify its advice by identifying, where relevant, a range of technical options and by undertaking evidence-based assessment of the costs and benefits of each. The results of this assessment should be submitted alongside the advice to the Commission. Where administrative burdens and compliance costs on the side of the industry could be significant, EIOPA should where possible quantify these costs.
- EIOPA should provide sufficient factual data backing the analyses gathered during its assessment. To meet the objectives of this mandate, it is important that the presentation of the advice produced by EIOPA makes maximum use of the data gathered and enables all stakeholders to understand the overall impact of the options presented by EIOPA.
- EIOPA should provide comprehensive technical analysis on the subject matters described below covered by the delegated powers of the Commission included in the relevant provision of the Solvency II Directive and its recitals.
- The technical advice given by EIOPA should not take the form of a legal text.
- EIOPA should address to the Commission any question it might have concerning the clarification of the text of the legislative act, which it should consider of relevance to the preparation of its technical advice.

2. Procedure

The Commission requests the technical advice of EIOPA in preparation of the review of the Solvency II Delegated Regulation which is expected to be carried out in 2018 regarding the questions referred to in section 3 of this formal mandate.

The Commission reserves the right to revise and/or supplement this formal mandate. The technical advice received on the basis of this mandate will not prejudice the Commission's final decision in any way.

In accordance with the established practice, the Commission may continue to consult experts appointed by the Member States to prepare amendments to the Solvency II Delegated Regulation.

The Commission has duly informed the European Parliament and the Council about the final version of this mandate. Should the Commission adopt delegated acts, it will notify them simultaneously to the European Parliament and the Council.

3. EIOPA is invited to provide technical advice on the issues:

3.1. Methods and assumptions to be used when assessing the credit risk in calculating the spread risk submodule, with respect to criteria that could be used to identify certain unrated bonds and loans (under the empowerments in Articles 111(1)(c) and 135(1)(a) of Directive 2009/138/EC).

Delegated Regulation (EU) 2015/35 sets out specific risks factors for bonds and loans for which a credit assessment by a nominated external credit assessment institution (ECAI) is not publicly available. These risk factors stand currently at a level between risks factors applicable to bonds and loans with credit quality step 4 and risk factors applicable to bonds and loans with credit quality step 3. Except where the debtor has posted collateral and except for infrastructure investments, these risks factors are independent from the precise characteristics of the instrument and of the debtor.

Reducing mechanistic reliance on external ratings is one of the objectives for the Commission in accordance with the G20's commitments, and EIOPA was already asked in July 2016 to further develop the framework for the use of alternative credit assessment in the Solvency II standard formula. In this context, the discussion paper issued in December 2016⁶ gathers possible methodology to assess the credit quality of exposures.

A first step in reducing reliance on external credit ratings for regulatory purposes is to provide alternative criteria through which investments with a better risk profile can be identified. In particular, the Solvency II framework could be improved by ensuring that bonds and loans benefit from a risk-based treatment, without limiting this benefit to instruments for which a credit assessment by a nominated ECAI is available. More precisely, the risk factors already applicable to bonds and loans with an available credit quality step could be applied to other bonds and loans for which no credit assessment by a nominated ECAI is available, provided that they satisfy certain qualifying criteria.

Consequently, EIOPA is asked to provide clear and conclusive criteria applicable to bonds and loans for which no credit assessment by a nominated ECAI is available, in order to identify certain instruments, which would then be allowed to receive the calibration associated with credit quality step 2. Where EIOPA identifies alternative criteria which would identify instruments with a better or a lower risk profile, these two types of criteria should also be provided. The corresponding instruments would then be allowed to receive the calibration associated with credit quality step 1 and 3 respectively.

Such criteria can be related to the financial state of the debtor, in particular on the basis of its financial statements.

Such criteria can also be related to the features of the instrument concerned, in particular to its position in the credit hierarchy in case of default and to the transparency offered to investors as regards the debtor.

⁶ EIOPA-CP-16/008 - Discussion Paper on the Review of Specific Items in the Solvency II Delegated Regulation.

In addition to features potentially considered by ECAIs when providing a credit assessment, such criteria can also be related to the insurer's own risk management system, to ensure their ability to manage properly risks related to investments in bonds and loans for which no credit assessment by a nominated ECAI is available.

The criteria related to the debtor and to the instrument concerned should be designed to ensure that sufficient risk-sensitivity is introduced, given that no credit assessment by a nominated ECAI is available, and considering that the criteria related to the risk management would result in reinforced risk management by insurance undertakings compared to investments in bonds and loans for which a credit assessment by a nominated ECAI is available.

3.2. Methods and assumptions to be used when calculating the equity risk submodule, with respect to criteria that could be used to identify certain portfolios of unlisted equity (under the empowerments in Articles 111(1)(c) and 135(1)(a) of Directive 2009/138/EC).

Delegated Regulation (EU) 2015/35 sets at 49% the risk factor applicable to equity which are not listed, except for strategic equity investments, for infrastructure investments and for investments in ELTIF, EuVECA and EuSEF.

Within the context of Capital Markets Union, any barriers to investments creating jobs and growth should be removed. In particular, the Solvency II framework could be improved by increasing the risk sensitivity of investments in unlisted equity. More precisely, a lower risk factor could be extended to certain portfolios of unlisted equity, provided that they satisfy certain criteria.

Consequently, EIOPA is asked to provide clear and conclusive criteria applicable to portfolios of equity from the European Economic Area (EEA) which are not listed, in order to identify those instruments which could benefit from the same risk factor as listed equity.

Such criteria can be related to the characteristics of the portfolio, in particular the diversification achieved, either directly or through funds, and the transparency offered to the investor on the company in question, either by the fund manager or by the company itself. The consideration taken for environmental, social and governance aspects could also be taken into account.

Such criteria can also be related to the asset management skills and strategy and to the insurer's own risk management system, to ensure their ability to pursue investments in unlisted equity and to manage properly risks related to them, either directly or through funds.

These criteria should ensure that insurers have the ability to finance the development of companies in the EEA, regardless of their size or of the range of products offered, where they decide to dedicate sufficient resources to pursue and manage these investments and where these investments offer sufficient transparency.

3.3. Methods and assumptions to be used when calculating the equity risk submodule with respect to strategic equity investments (under the empowerment in Article 111(1)(c) of Directive 2009/138/EC).

Delegated Regulation (EU) 2015/35 sets specific risk factors for strategic equity investments, provided they satisfy certain criteria. This reduced calibration should already ensure that insurers are able to conduct long-term investments under the form of equity, by reflecting the likely reduction in the volatility of their value arising from their strategic nature and the influence exercised by the participating undertaking on those related undertakings.

In order to inform the Commission about the effect of this provision within the context of Capital Markets Union, EIOPA is asked to provide information on the current application of this provision. More precisely,

EIOPA is asked to provide information on the application of the criteria by insurance and reinsurance undertakings as well as by the National Supervisory Authorities. EIOPA is in particular asked to provide information on the investments currently covered by this asset class and by each Member State, notably in terms of size and sector of the underlying corporates, the purpose for the insurance undertaking of the investments, and in terms of size and type of the share and of holding period by the insurance or reinsurance undertaking.