

# Milliman Breakfast Briefing

19<sup>th</sup> June 2019



# Solvency II 2020 Review

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19 JUNE 2019

# Trailers

- Coming to an insurer near you in 2020.....
  - Solvency II Directive requires certain areas to be reviewed by the European Commission by end of 2020.
  - Commission has written to EIOPA requesting its advice by 30 June 2020 on items that it has identified as deserving a reassessment.
- Solvency III?

# Starring

- Minimum Scope (Directive)
  - Long term guarantees measures and measures on equity risk
  - Methods, assumptions and parameters used when calculating the standard formula SCR
  - Member States' rules and supervisory authorities' practices regarding the calculation of the MCR
  - Group supervision and capital management

# Also Featuring

- A number of other areas have also been selected for review
  - Risk margin
  - Capital Markets Union aspects
  - Macro prudential issues
  - Recovery and resolution
  - Insurance guarantee schemes
  - FoS/FoE supervisory powers
  - Reporting and disclosure
  - Proportionality and thresholds
  - Best estimate
  - Own funds
  - Reliance on external ratings

# EIOPA timetable



## Timeline

April 2018	EIOPA receives Call for Information on asset-liability management from the European Commission
Nov 2018	Publication of LTG report 2018
Feb 2019	EIOPA receives Call for Advice on the 2020 review from the European Commission
<b>Mid-July to mid-Oct 2019</b>	<b>Public consultation on draft advice on reporting and disclosure</b>
<b>Nov 2019 to Jan 2020</b>	<b>Public consultation on draft Opinion (covering all advice other than on reporting and disclosure)</b>
<b>Nov to Dec 2019</b>	<b>Information request to undertakings for holistic impact assessment</b>
<b>Dec 2019</b>	<b>Publication of LTG report 2019</b> <b>EIOPA response to Call for Information on asset-liability management</b>
<b>June 2020</b>	<b>Publication of Opinion on 2020 review</b>
<b>December 2020</b>	<b>Publication of LTG report 2020</b>

Experts are currently assessing the need for further information requests in 2019.

Source: [https://eiopa.europa.eu/Publications/Meetings/06.\\_EIOPA-IRSG-19-12\\_Slides%202020%20review.pdf](https://eiopa.europa.eu/Publications/Meetings/06._EIOPA-IRSG-19-12_Slides%202020%20review.pdf)

# Specific Areas of Interest

## Long Term Guarantees

- Last Liquid Point
  - Currently set to 20 years for Euro
  - But, 2017 ESRB report suggested increase to 30 years
  - EIOPA 2018 LTG Report examined impact of such a change
    - Average reduction in SCR coverage ratio across EEA of 24 percentage points
    - Similar impact for Ireland
  
- Convergence
  - ESRB also suggested extending convergence period from 40 to 100 years
  - LTG Report examined impact of change in period from 40 years to 70 years
    - Average reduction in SCR coverage ratio across EEA of 5 percentage points
    - Similar impact for Ireland

# Specific Areas of Interest

## Risk Margin

- Can be quite sizeable for companies with long term liabilities
  - Cost of capital of 6% deemed too high by some
  - Can't use VA or MA
- What could change
  - Cost of capital approach is not up for discussion
  - Design
    - EIOPA asked to consider actual transfer values vs Solvency II valuation
  - Assumptions regarding asset mix
    - Consider VA and MA but then also recognition of market risk
  - Use of a fixed cost of capital for all undertakings
  - Assumptions used to derive cost of capital (including absence of leverage)
- But, EIOPA resisted changing CoC in 2018 interim review and pushed back on other feedback

# Specific Areas of Interest

## SCR

- Interest Rate SCR
  - As part of 2018 review, EIOPA proposed changes to better reflect low interest rate environment
  - Relative shift approach proposed  $R_{up} = R * (1 + A) + B$  or  $R_{down} = R * (1 - A) - B$
  - Average impact on the solvency ratio estimated as ca. 14 percentage points
  - But, Commission noted that *“...a revision of the calibration of interest rate risk would more appropriately be considered in the context of the review of the Solvency II Directive itself planned in 2020....”*
  - Expect this topic to emerge again
  - But likely to be lost of push back from industry

# Specific Areas of Interest

## SCR

- Market Risk SCR
  - Request framed in context of treatment of long-term investments under Solvency II
  - Could we see a reduction in the Equity SCR stress in certain cases???
  - Spread SCR also mentioned in the same section of call for advice so possible changes here too
- Counterparty Default SCR
  - EIOPA asked to consider proportionality and advice for a simpler approach (where appropriate)
- Underwriting SCR
  - EIOPA asked to consider calibration of stresses if stakeholders provide data to support changes
  - Mortality and Longevity calibrations considered as part of 2018 review but no changes proposed

# Specific Areas of Interest

Best estimate

- EIOPA asked to report on divergent supervisory practices and their impacts
  - ESGs
  - Contract Boundaries
  - Management Actions
  - Treatment of expenses
  - Valuation of options and guarantees

# Specific Areas of Interest

## Other Areas

- Macro-prudential issues
  - EIOPA asked to consider improvements in
    - ORSA
    - Drafting of a systemic risk management plan
    - Liquidity risk management planning and liquidity reporting
    - Prudent person principle
- Recovery and resolution
  - Consider development of Solvency II rules
  - Consider need for minimum harmonisation rules for resolution

# Specific Areas of Interest

## Other Areas

- Insurance Guarantee schemes
  - Consider need for minimum harmonisation rules
- Reporting and disclosure
  - Assess ongoing appropriateness of requirements in light of experience
  - Volume, frequency and deadlines of supervisory reporting and public disclosure
  - EIOPA has already issued a call for input (now closed)
  - Public consultation on planned advice to take place soon
  - Note previous LTG reports have commented on level of detail on LTG measures in reporting/disclosure

# Next Steps - Stakeholder Involvement

- Industry is likely to be heavily involved in review



Society of Actuaries in Ireland

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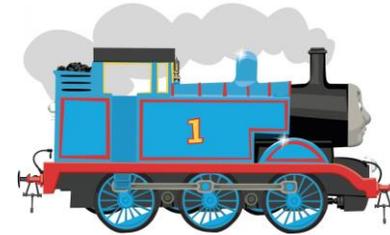
# Focus on Outsourcing

Patrick Meghen

19 JUNE 2019



# CBI Activity on outsourcing



1.

On site inspections & cross sector survey



2.

Discussion Paper –  
19<sup>th</sup> November 2018



3.

Industry Event on  
Outsourcing on  
30 April 2019



4.

Where next?

# No new requirements...

## But a broad range of existing requirements

- **Solvency II**
  - Directive
  - Delegated Regulations
  - EIOPA Guidelines on System of Governance
- **CBI Notification Process for (Re)Insurance Undertakings when Outsourcing Critical or Important Functions or Activities** under Solvency II
- Cross Industry Guidance in respect of **Information Technology and Cybersecurity Risks**
- Central Bank of Ireland Guidance on **Fitness and Probity Standards 2018**
- Central Bank of Ireland Guidance for (Re) Insurance Undertakings on the Fitness and Probity Amendments 2015

Relevant Regulation, Guidance and Reports
<b>Legislation</b>
Central Bank of Ireland AIF Rulebook
Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1))(Investment Firms) Regulations 2017 – S.I. No 604/2017.
Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Undertakings for Collective Investment in Transferable Securities) Regulations - S.I. No. 420 of 2015, S.I. No 307 of 2016, S.I. No. 344 of 2017
Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive
European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 – S.I. No 352/2011.
European Union (Alternative Investment Fund Managers) Regulations – S.I. No. 257/2013, S.I. No. 379/2014
European Union (Markets in Financial Instruments) Regulations 2017 – S.I. No. 375/2017.
European Union (Undertakings for Collective Investment in Transferable Securities) (Amendment) Regulations 2016
European Union (Insurance and Reinsurance) Regulations 2015 (Solvency II Regulations)
Central Bank of Ireland Consumer Protection Code 2012
European Union (Payment Services) Regulations 2018
Companies Act 2014
Central Bank of Ireland Fitness and Probity Standards 2014
<b>Regulatory Requirements, Guidance and Reports</b>
Basel Committee on Banking Supervision Principles for the Sound Management of Operational Risk 2011
Central Bank of Ireland Fund Administrators Guidance 2017
Central Bank of Ireland Fund Management Companies - Guidance 2016
Central Bank of Ireland Investment Firms Questions and Answers 5 <sup>th</sup> Edition 2018
Committee of European Banking Supervisors (CEBS) <sup>11</sup> Guidelines on Outsourcing 2006
European Banking Authority Guidelines on Internal Governance under Directive 2013/36/EU 2017
European Banking Authority Recommendations on Outsourcing to Cloud Service Providers 2017
Financial Stability Board Principles for an Effective Risk Appetite Framework 2013
European Insurance and Occupational Pensions Authority Guidelines on Systems of Governance 2016
Central Bank of Ireland Credit Union Handbook 2018
Central Bank of Ireland Cross Industry Guidance in respect of Information Technology and Cybersecurity Risks 2016
Central Bank of Ireland Guidance on Fitness and Probity Standards 2018
Central Bank of Ireland Report on Anti-Money Laundering/Countering the Financing of Terrorism and Financial Sanctions Compliance - Life Insurance Sector 2016, Irish Funds Sector 2015, Banking Sector 2015

# CBI – Key Message

**1** The CBI views the management of outsourcing risk as key from both a Conduct and Prudential perspective.

**2** The CBI are trying to raise awareness and encourage discussion regarding outsourcing and what is required/expected of companies

**3** It was clear from their statements that they felt that there was a gap between their expectations and the levels observed in surveys / inspections.

## CBI – Key Message

“While the review found some good practices, overall the results were disappointing. To put it bluntly, we found significant risk management deficiencies on a widespread basis. More broadly, we concluded that, when it comes to outsourcing arrangements, governance and risk management standards are emphatically not where they need to be”



- Derville Rowland – [Central Bank Conference on Outsourcing](#), 30 April 2019

# Outsourcing Key Topics

Governance

Risk Management



Outsourcing  
Expectations

Business Continuity

Other  
Considerations

# Governance



- Board Awareness and Control
  - Ultimate responsibility remains with the Board
  - Should be informed of major instances



- Contractual Arrangements
  - Should be in place for all arrangements.
  - Action got legal to check if all required items included



- Responsibility & Oversight
  - Must have visibility of outsourced activities.
  - You can't outsource the responsibility
  - Responsibility lies with the 1<sup>st</sup> line – not just a task for 2<sup>nd</sup> and 3<sup>rd</sup> lines
  - Should have a register of outsourced providers



- Outsourcing Strategy & Policy
  - Policy should be a “living document”
  - Active throughout “lifecycle” of the arrangement
  - Update your policy and don't leave it sitting on the shelf

# Risk Management



- Risk Assessment
  - Both initial and ongoing assessment required. **Create a schedule and conduct**



- Due Diligence
  - Initial assessment and due diligence are very important – very difficult to change at a later stage



- Retained Skills & Knowledge
  - Important to **retain this knowledge**, particularly for oversight
  - But this isn't always practically possible (e.g. small company)



- Definitions
  - Breadth of what falls within “outsourcing”
  - More consensus needed on what falls within the “critical” definition
  - **Review definitions in policies**

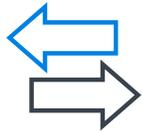


- Monitoring and Management
  - Gerry Cross (CBI) at the conference noted a mismatch between regulatory expectations compared with industry regarding what level of oversight / governance is required
  - **Design a reporting framework / KRIs**

# Business Continuity



- Business Continuity Testing
  - Focus a lot on operational resilience. Assume disruption rather than just focusing on prevention – what is plan B.
  - Update your BCP plans and tests.



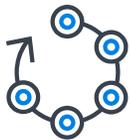
- Exit Strategies
  - Consider options of going to another 3<sup>rd</sup> party or bringing it in house
  - Allow for this when enter contracts
  - Have exit strategies drafted.



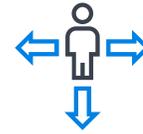
# Other Observations



- Increased use
  - Growth of use – but for expertise and access rather than cost savings and efficiency
  - Increasingly viewed as a way of "ceding operational risk" to companies that have greater operational expertise.



- Intra Group
  - Can offer benefits and make sense, but governance is key. Same level of diligence should apply
  - Remember you are regulated at a local level and this is where responsibilities lie



- Concentration of suppliers
  - CBI noted they have seen a concentration across particular providers (TPA, Actuarial services)



- Offshoring
  - Especially important if outside the EEA
  - Include in contracts what can / can't happen



- Scale of Activity
  - Large volume of providers/actions
  - Practical challenge of managing this

## Quote of the day

“You wouldn't allow your babysitter to outsource the babysitting”

# Case Study – babysitting (1)

## Outsourcing Governance

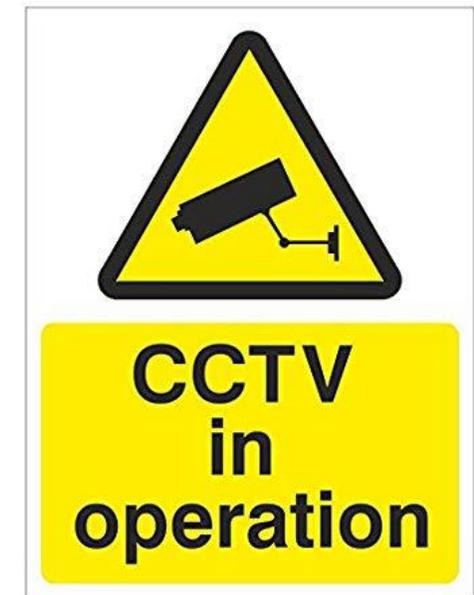
- Definition
  - Is this “Outsourcing”
  - Critical / Important?
- Due Diligence / Initial Assessment



# Case Study – babysitting (2)

## Outsourcing Governance

- Notification
  - Not a PCF role
- Contract
  - Rights, Responsibilities, Exit Clause, Remediation
  - Remuneration (none)
- Service Level Agreement
  - KRI's – number of children lost/injured, achievement of target bed time
- Monitoring
  - Phone Call, arrive home early
  - Web cams (X)



# Case Study – babysitting (3)

## Outsourcing Governance

- Business Continuity
  - Replacement, off-site facility
- Data / GDPR / IT due diligence
- Intra-Group
  - Using a relation - same level of rigour should be applied
- Exit Strategy
  - Retain knowledge in house



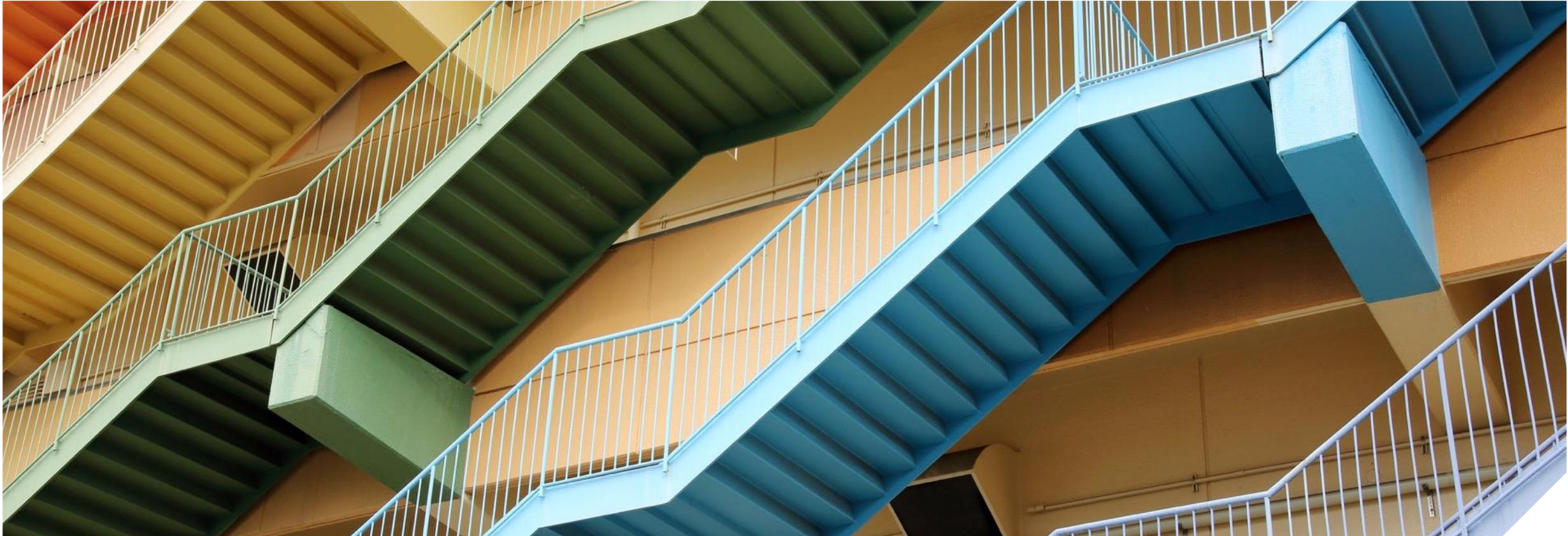
# Insurer investment strategies

Ireland and Europe



Sinéad Clarke

19 JUNE 2019

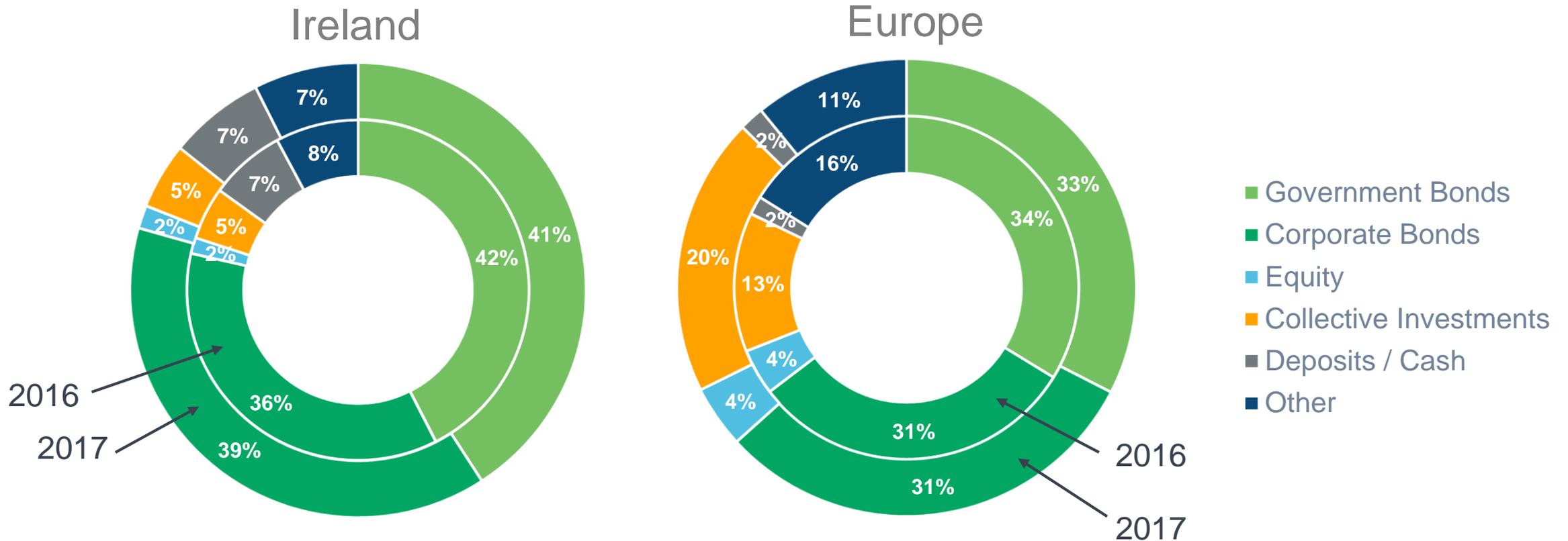


# Background

- Low interest rate environment
- Recent comments from the CBI
- Changes since introduction of Solvency II
- Solvency II 2018 Review
- EIOPA request for ALM information

# Split of financial investments

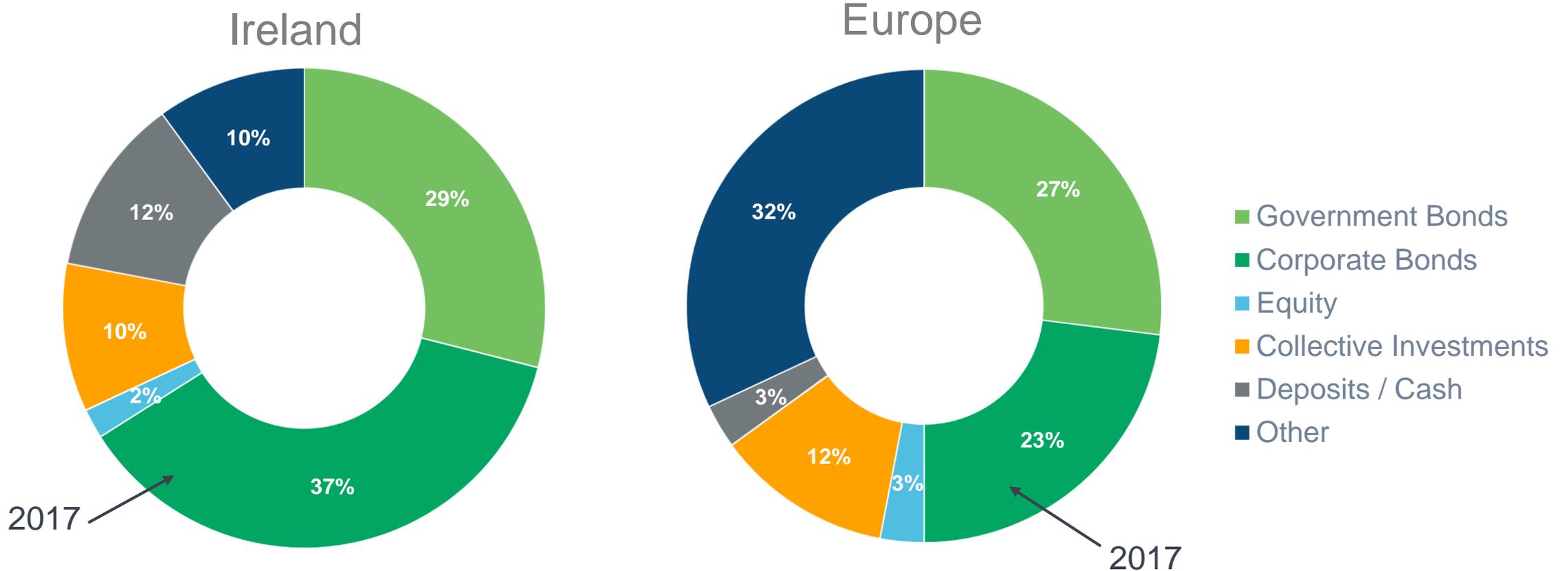
Life insurers and reinsurers



Source: Split of Assets Investments (other than assets held for index-linked and unit-linked contracts), Solvency II Wire SFCR data

# Split of financial investments

Non-life insurers and reinsurers

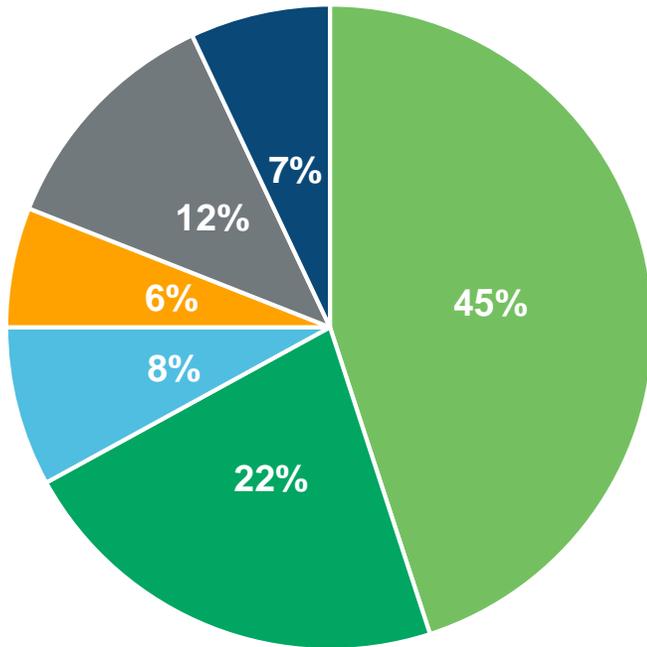


Source: Split of Assets Investments (other than assets held for index-linked and unit-linked contracts), Solvency II Wire SFCR data

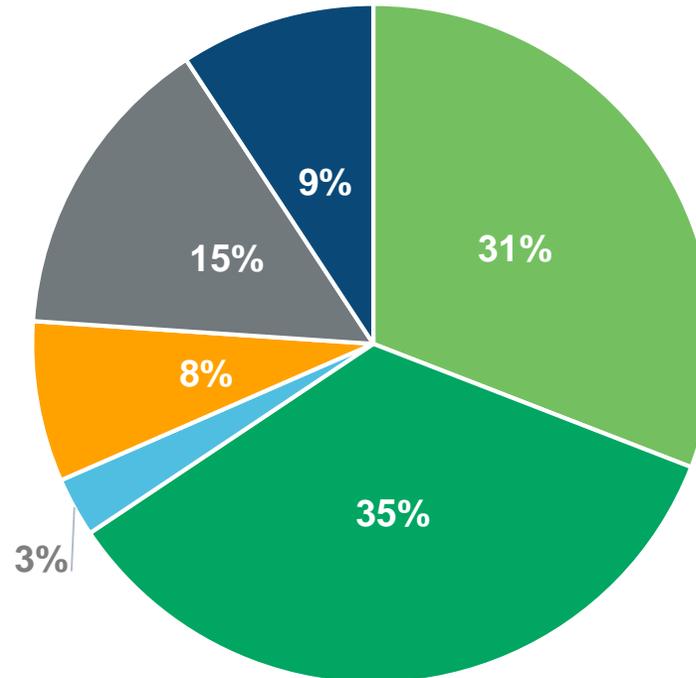
# Split of financial investments - 2017

## Irish Insurers

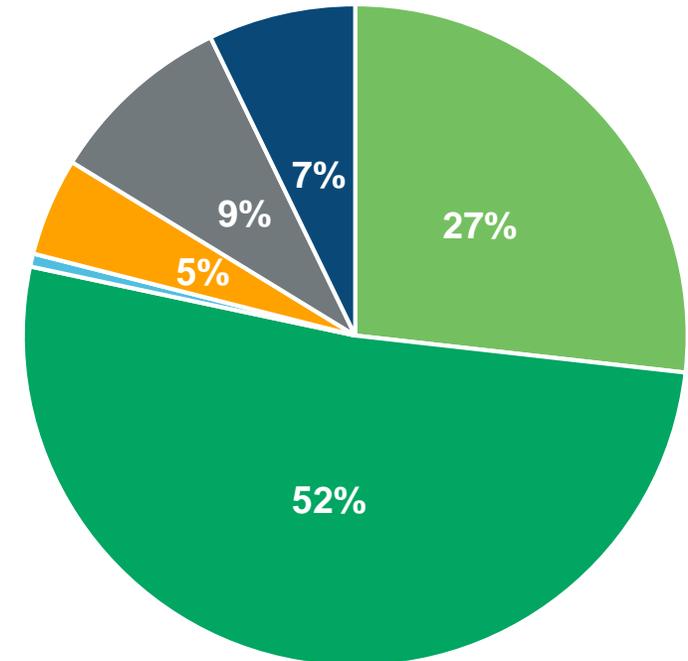
Life Direct Writers



Non-Life Direct Writers



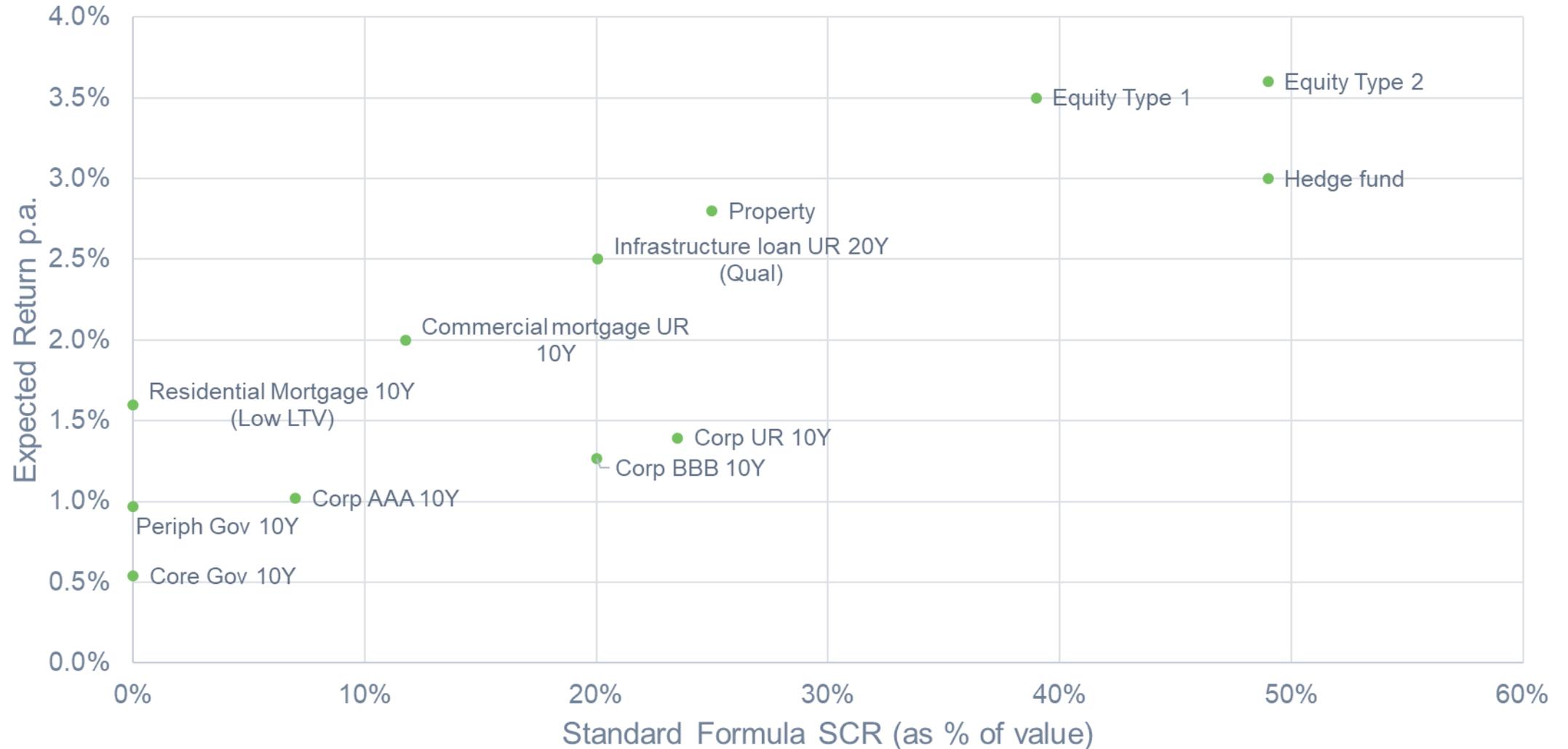
Reinsurers



■ Government Bonds ■ Corporate Bonds ■ Equity ■ Collective Investments ■ Deposits / Cash ■ Other

Source: Split of Assets Investments (other than assets held for index-linked and unit-linked contracts), CBI 2017 SFCR Repository

# Return versus Capital



Further reading: <http://ie.milliman.com/insight/2018/Investment-strategy-under-Solvency-II/>

# SII 2018 Review - Changes to Delegated Regulations

Asset Category	Change
Infrastructure	Reduced capital requirements for “qualifying infrastructure investment” or “qualifying infrastructure corporate investment”
Securitisation	Change of treatment to reflect simple, transparent and standardised (STS) securitisations
Unrated Debt	Reduction in the capital charge for unrated debt where it can be treated as Credit Quality Step 2 or 3 depending on the insurer’s internal capital assessment.
Unlisted Equity (direct investment)	“Qualifying unlisted equity” can be treated as type 1 equity under the Standard Formula if it meets some specific rules e.g. company is based in EEA, investment is unlisted ordinary shares, etc.
Long-term Equity Investment	Significant reduction in equity capital charge if specific criteria is met e.g. company is based in the EEA, equity investment is used for ALM, portfolio has an average duration of 5 years, etc.

Further reading: <http://ie.milliman.com/insight/2019/Solvency-II-under-review/>

# Issues to think about

- Capital optimisation
- Prudent Person Principle / Risk appetite
- ORSA / Pillar II capital requirements
- Standard Formula Appropriateness
- Liquidity