

## Review of Solvency II *Key Positions of the Luxembourg (Re)Insurance Industry*

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### I. SUMMARY OF KEY ISSUES

Topic	Comments on proposed amendments
<b>Supervision of cross border business</b>	<ul style="list-style-type: none"> <li>Enhanced supervisory requirements for 'significant cross border business'.</li> <li>Host supervisor could request information directly from companies and request to join an on-site inspection.</li> </ul>
<b>System of Governance</b>	<ul style="list-style-type: none"> <li>The possibility for undertakings to appoint one person to hold more than one key function would in future be limited only to low-risk undertakings.</li> </ul>
<b>Reporting &amp; disclosure</b>	<ul style="list-style-type: none"> <li>For internal model users – estimate and regularly report the SCR according to the standard formula.</li> <li>Certain exemptions offered for low-risk undertakings &amp; captives.</li> <li>The SFCR would be split into 2 separate sections (addressed to policyholders &amp; analysts).</li> </ul>
<b>Proportionality</b>	<ul style="list-style-type: none"> <li>Certain exemptions would be permitted of low-risk undertakings &amp; captives.</li> <li>According to the criteria set for low-risk undertakings, we doubt that any Luxembourg (re)insurers would qualify.</li> </ul>
<b>Audit requirements</b>	<ul style="list-style-type: none"> <li>It is envisaged to require an audit of the Solvency II balance sheet.</li> </ul>
<b>Capital requirements</b>	<ul style="list-style-type: none"> <li>Relief on capital measures would be temporary as a move towards EIOPA's earlier proposals are phased in.</li> </ul>
<b>Macroprudential issues</b>	<ul style="list-style-type: none"> <li>New liquidity management measures at group &amp; solo level.</li> <li>Powers of the supervisor to suspend or restrict dividend payments.</li> </ul>
<b>Sustainable Finance</b>	<ul style="list-style-type: none"> <li>2 climate change scenario analysis would be mandated in the ORSA.</li> <li>EIOPA to investigate a dedicated prudential treatment for exposures related to assets and activities associated ESG criteria.</li> </ul>
<b>Group specific issues</b>	<ul style="list-style-type: none"> <li>Potential extension to the scope of the group.</li> <li>Proposed new indicators when identifying significant IGTs and Risk Concentrations.</li> <li>New minimum MCR floor, modelled on the solo MCR.</li> </ul>

### II. POSITIONS OF THE LUXEMBOURG (RE)INSURANCE INDUSTRY

#### A. Supervision of cross border business

ACA believes that the European Commission (EC) proposals regarding the supervision of 'significant' cross border activity are too simplistic, not risk-based and therefore inappropriate. [These proposals go beyond the mandate of enhancing supervisory cooperation and essentially introduce a new level of supervision](#) in relation to:

- Information to be exchanged between home and host supervisors, some of which goes beyond the requirements and objectives of the Solvency II prudential framework;

2. Direct control for the host supervisor and EIOPA, which would undermine the home country control principle.

The threshold of 5% GWP generated in a given member state, as a trigger for identification of significant cross border business is too simplistic. This measure essentially is used to 'catch all' cross border business under scope of the new requirements, which will place a large burden on supervisory authorities and possibly undermine the intended objective of enhanced supervisory cooperation. ACA fully supports enhanced supervisory cooperation as a way of protecting consumers.

The Solvency II [changes in cross border supervision should not result in discriminating against \(re\)insurers and Member States' markets whose business model is complemented by the opportunities provided by the single market](#) and the nature of the risks they underwrite. ACA members continue to discuss possible alternatives to the 5% threshold, in order to achieve a more targeted result. For example, basing the analysis on the percentage of the local market activity which the cross-border business represents etc.

**ACA believes that enhanced supervisory cooperation should not compromise the home country control principle.**

We understand the increasing focus on consumer protection related issues and the Luxembourg industry fully supports that policyholders shall have the possibility to choose from fair, competitive and [safe products](#). It is important however to note that many cases identified as being problematic in the cross-border sense, arise from situations of illegal or fraudulent activity, which do not fall under scope of the Solvency II prudential regime. The objective therefore should be to assist national supervisors and law enforcement agencies to tackle fraud and bring those responsible to justice. [Diluting the home country control principle could have a very disruptive effect, by slowing down or even preventing swift and effective intervention.](#)

**ACA do not agree with the EC proposal to allow host supervisors and EIOPA to address supervisory requests directly to (re)insurers. All information requests should be centralised and coordinated via the home supervisor.**

ACA appreciates this requirement arises out of situations where there are deteriorating financial conditions and severe non-cooperation by the home supervisor. We therefore believe that the legal text should better reflect those concerns and perhaps put in place a framework or process around such requests; after which a direct request could be made as a last resort. If companies start to receive direct and possibly conflicting requests from different authorities, this could severely distract from an orderly supervisory review process.

**Additionally, ACA believes that these provisions should not apply to cases where a supervisory college exists as it could undermine supervisory convergence by allowing for different supervisory approaches for different business structures**

Furthermore, the inclusion of reinsurance undertakings within the scope of these new requirements is incompatible with the nature of the reinsurance business. The Solvency II Directive defines reinsurance as the activity of accepting risks ceded by another (re)insurer.

By nature, reinsurance is a business-to-business activity that is intrinsically cross-border, we find that the current proposals fail to recognise the specificity of reinsurers' business models.

## B. Proportionality

ACA does not agree that the 5% threshold and concept of significant cross border business, should be linked in any way to the criteria for low-risk undertakings. Using this criterion implies that cross border business is per se 'high risk', whereas in fact it is the founding concept of the EU Single Market. We therefore propose that the significant cross border criterion is removed from this section. [In an environment of rising national protectionism, the principles underpinning the EU Single Market must be protected and preserved.](#)

We fully support the acknowledgment that captive undertakings have a particular risk profile in that they specifically cover risks associated with the industrial or commercial group to which they belong.

**ACA proposes that the EC goes further by allowing captives to be recognised as ‘low risk’ undertakings in general, rather than being considered according to a separate criterion.**

### C. System of Governance

The proposal to require that key functions such as risk management, actuarial, compliance and internal audit are carried out by different people, will be very harmful to the (re)insurance industry. In particular, it should not be the case that EU legislation prevents a member of the AMSB from performing a key function.

While we appreciate these proposals are made specifically in relation to the Solvency II key functions, ACA would like to note that overall, the number of key roles required by EU legislation continues to grow e.g. AML, GDPR, technology related roles. These new roles often require different skills sets and professional designations. Where the performance of key functions relies on employees requiring a specific professional designation, EU legislation should not prevent that companies could use those skills across complementary tasks, even if they fall under scope of a separate key function.

In the current environment of industry consolidation, it is increasingly important that the regulatory regime incentivises a diverse market with many players. This has a direct impact on the choice of the insurance offer to the European consumer. Market consolidation presents challenges for local economies in terms of the social impact of job losses arising out of streamlining exercises and the lack of original ideas, which can impact on competitiveness. All of which are in contradiction with the intended direction of EU policy.

We acknowledge there are certain EU countries which apply strict functional and hierarchical separation of all key functions, these countries are very few in number and for the large majority of countries that do allow for this practice, there is no evidence to suggest that it leads to a deterioration of governance standards.

**ACA considers that (re)insurers should be able to make use of all the skills that their employees have to offer**

### D. Audit Requirements

ACA appreciates that discussions on audit requirements of Solvency II materials have been ongoing for many years and some member states already require external auditing of the Solvency II Balance Sheet.

**ACA however considers that the member state discretion should remain so that national supervisors can request targeted external audit exercises on subjects which are of particular concern.**

Auditing of the Solvency II balance sheet requires the competence of qualified actuaries and auditors. The local regulator in Luxembourg employs many actuaries directly, we see that there is already a high level of professional competence within the Luxembourg regulatory system, which is reflected in the cost of supervision.

It is estimated that an audit of the Solvency II balance sheet could cost up to 150K EUR.

The Solvency II framework already provides for standardised formulas and presentation of information, which is strictly adhered to by companies, and verified by the supervisory community. Therefore, ACA sees this as an unnecessary burden with no material benefit.

**ACA is strongly against the proposal to introduce an annual requirement for the external audit of the Solvency II Balance Sheet.**

## E. Reporting & disclosure

Regarding the EIOPA supervisory reporting amendments package, [ACA disagrees that new QRTs should be introduced in advance of the Solvency II review](#). These initiatives are linked and the industry highlights that many of the topics covered by the EIOPA package are subject to discussions under the Solvency II review, and other regulatory initiatives e.g. the cross border business template, sustainable finance reporting etc.

Companies will need time for implementation which would be further complicated by numerous different requirements arising out of various related projects, according to different timelines. A focused and prioritised approach is essential.

**ACA is strongly against the requirement for undertakings using full and partial internal models to also report an SCR estimate based on a standard formula calculation.**

This is an arbitrary requirement introducing duplicate processes for reporting and calculation methodologies. It also disincentivises the use of internal models which are widely accepted to be very useful tools.

The proposal to split the SFCR between policyholder and analyst audiences, acknowledges that much of the Solvency II related information is too complex for policyholders. It will require some thought and reorganisation of the information, however the Luxembourg Insurance Industry is supportive of measures to improve the simplification of disclosure documentation to policyholders.

## F. Capital requirements

ACA appreciates the efforts of the EC to reduce capital requirements for EU (re)insurers thus supporting capital allocation to different projects and improving competitiveness at an international level. We note that the capital requirement measures will phase out over a period of time, eventually favouring a more prudent approach recommended by EIOPA.

With the numerous new regulatory requirements arising out of this regime, [it is unclear at this stage what will be the free levels of capital, following implementation of the various regulatory requirements and additional external checks](#).

We note that the EC introduces 3 new concepts with regard to capital requirements:

1. Significant breach of the SCR;
2. Risk of non-compliance with the MCR;
3. Minimum consolidated SCR floor.

In case of breach of the SCR, the supervisory ladder of intervention is enacted in order to ensure recapitalisation of the undertaking. [It is not clear for us what is the intended objective of responding to a 'significant SCR breach'](#) and how this would differ from an early warning of a possible MCR breach.

**ACA believes that in case of potential breach of the SCR, having too many points of intervention based on subjective assessments bears the risk to create conflicts of opinion within the supervisory system.**

## G. Macro-Prudential Measures & Sustainable Finance

ACA continues to analyse the new requirements for macro-prudential measures at group and solo levels. These requirements have the potential to be very burdensome and we are wary that there may be conflicting views between supervisors as to what constitutes a good macro-prudential result at group and at solo level. We have concerns about the direct supervisory intervention measures and the possibility of disagreement between supervisors, particularly in the context of liquidity management plans. It is important that Group Colleges are sufficiently prepared to work in a coordinated manner on this subject.

**ACA considers that supervisory intervention to the extent of freezing redemption of options on life policies and suspending or restricting dividends, goes too far.**

We note proposals to use the ORSA for carrying out new scenario analyses e.g. the two mandated climate change scenarios and the macroprudential assessments.

**ACA would like to enforce that the ORSA stays an undertaking driven tool, ACA sees it as problematic to require mandatory scenarios for regulatory purposes.**

## H. Group specific issues

ACA continues to analyse the EC proposals regarding the impacts on group supervision and the interaction with the various interconnecting legal frameworks.

**ACA would like to reiterate that the supervision of an insurance group or sub-group should always rest with an insurance supervisor.**

New arrangements regarding the structure and scope of group supervision should not inadvertently result in non-insurance supervision being directed from an ultimate parent of another financial sector, for example.

We also continue to consider the new proposal regarding a revised 'minimum consolidated SCR floor'. When treating inclusion of Mixed Financial Holding Companies, it should be clear that insurance groups should not be required to hold a notional capital amount for banking related activities, unless it is used to contribute to the insurance group SCR.

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