EIOPA-BOS-19-306
25 June 2019

Consultation Paper on proposals for Solvency II 2020 Review

Package on Supervisory Reporting and Public Disclosure

3. Financial Stability Reporting

Background

1. In 2015 when the ITS on reporting was discussed, the need for more timely information for Financial Stability reporting was identified. This information was then discussed from a scope and timing perspective with the final outcome reflected in the EIOPA GL for FS reporting.

2. This information is currently received from ~95 groups and 22 solo undertakings, domiciled across 16 different European countries. FS reporting refers to the Quarterly and Annual financial stability reporting for Solos (AFS, QFS), Groups (AFG, QFG) & Third-Country Branches (AFB, QFB).

3. This information is used for analysis and in several EIOPA products; it is regularly used in the FSR as well as being the primary data source for EIOPA's Risk Dashboard and an important component of the preliminary analysis underlying the insurance stress tests. From experience gained since the implementation of the Solvency II regulatory regime EIOPA has identified some gaps in the scope of the information but also information/entry points which could be removed to reduce the reporting burden on industry.

4. The primary gaps identified in the collection of financial stability reporting data can be summarised as follows:

   - Lack of supplementary statutory account based information;
   - In S.38.01 - Duration of technical provisions, the template contains only information on Macaulay Duration which does not allow comparability with modified duration of assets reported in S.06.02 List of assets;
   - The Macaulay duration and the modified duration assume a fixed cash-flow structure, which might be a reasonable assumption for the majority of non-life

business but fails to take into account some features of traditional life business, e.g. when discretionary benefits exist. For this reason the use of effective duration was also discussed and EIOPA asks stakeholders to give input to the feasibility of using the effective duration;
- In S.05.01 Premiums, claims and expenses there is no information on net premiums earned preventing the calculation of the net combined ratio based on quarterly financial stability reporting;
- In S.39.01 Profit and loss – there is no high level P&L information.

5. Industry representatives, during the regular dialogue and as part of the Call for Input performed by EIOPA raised concerns regarding financial stability reporting:
   - Financial stability reporting is more or less duplication of the regular Solvency II-reporting, including the ECB-reporting. This duplication of reporting can be avoided by having the same timelines for the Financial Stability reporting as for the Solvency II-reporting;
   - Remove the solo Financial Stability reporting as the quarterly information arrives before, it does not provide any advance information or information additional to that provided by the quarterly SII submission.

Options considered

6. Considering the above background the proposals considered by EIOPA were the following:
   1) Keep the scope and deadlines of Financial Stability as of today;
   2) Improve the scope of information with the missing gaps identified;
   3) Reduce the reporting burden;
   4) Aligning timelines of FS reporting with those of standard reporting.

7. In order to harmonise the type of duration reported on the asset and liability side; three options were considered:
   1) Request Macaulay duration on the asset side to align with the currently reported liability durations.
   2) Request Modified duration on the liability side to align with currently reported asset durations.
   3) Request the Effective duration for both assets and liabilities.

8. EIOPA's preferred option is to request modified duration for the liabilities. However, requesting effective duration as an additional metric is also being considered. Further information on the differences between each Duration measure can be found in Annex I.

EIOPA Proposal

9. Deadlines of Financial Stability reporting need to be kept as they are today. Quarterly financial stability reporting is key to the timely production of the Risk Dashboard quarterly; changing quarterly deadlines to be in line with prudential package would delay the Risk Dashboard production by at least 2 months. Compared with other ESAs, EIOPA's Risk Dashboard is already published with some delay.

10. In terms of scope of the information collected, some changes are proposed in order to both collect additional information on the identified gaps and reduce the entry points thereby reducing the reporting burden for the industry. These changes are listed below and illustrated in Figure 1.

Figure 1 – Illustration of proposed changes to FS reporting

		afs .10	qfs .11	afg .12	qfg .13	afb .14	qfb .15
		Annual Financial Stability reporting Solo	Quarterly Financial Stability reporting Solo	Annual Financial Stability reporting Group	Quarterly Financial Stability reporting Group	Annual Financial Stability Third country branches	Quarterly Financial Stability Third country branches
Template code	Template title	d	c	i	h	x	v
S.01.01	Content of the submission	S.01.01.10	S.01.01.11	S.01.01.12	S.01.01.13	S.01.01.14	S.01.01.15
S.01.02	Basic Information - General	S.01.02.01	S.01.02.01	S.01.02.04	S.01.02.04	S.01.02.07	S.01.02.07
S.02.01	Balance sheet	X	X	X	S.02.01.02	X	X
S.05.01	Premiums, claims and expenses b	X	X	X	S.05.01.13	X	X
S.06.02	List of assets	X	X	X	S.06.02.04	X	X
S.14.01	Life obligations analysis	S.14.01.10	X	S.14.01.10	X	S.14.01.10	X
S.23.01	Own funds	X	X	X	S.23.01.13	X	X
S.25.04	Solvency Capital Requirement [Fi	X	S.25.04.11	X	S.25.04.13	X	S.25.04.11
S.38.01	Duration of technical provisions	S.38.01.10	X	S.38.01.10	X	S.38.01.10	X
S.39.01	Profit and Loss	X	S.39.01.11	X	S.39.01.11	X	S.39.01.11
S.40.01	Profit or Loss sharing	S.40.01.10	X	S.40.01.10	X	S.40.01.10	X
S.41.01	Lapses	X	S.41.01.11	X	S.41.01.11	X	S.41.01.11

		afs .10	qfs .11	afg .12	qfg .13	afb .14	qfb .15
		Annual Financial Stability reporting Solo	Quarterly Financial Stability reporting Solo	Annual Financial Stability reporting Group	Quarterly Financial Stability reporting Group	Annual Financial Stability Third country branches	Quarterly Financial Stability Third country branches
Template code	Template title	d	c	i	h	x	v
S.01.01	Content of the submission	~~S.01.01.10~~	S.01.01.11	~~S.01.01.12~~	S.01.01.13	~~S.01.01.14~~	S.01.01.15
S.01.02	Basic Information - General	~~S.01.02.01~~	S.01.02.01	~~S.01.02.04~~	S.01.02.04	~~S.01.02.07~~	S.01.02.07
S.02.01	Balance sheet	~~X~~	X	~~X~~	S.02.01.02	~~X~~	X
S.05.01	Premiums, claims and expenses b	~~X~~	X	~~X~~	S.05.01.13	~~X~~	X
S.06.02	List of assets	~~X~~	X	~~X~~	S.06.02.04	~~X~~	X
S.14.01	Life obligations analysis	~~S.14.01.10~~	X	~~S.14.01.10~~	X	~~S.14.01.10~~	X
S.23.01	Own funds	~~X~~	S.23.02	~~X~~	s.23.02	~~X~~	X
S.25.04	Solvency Capital Requirement [Fi	~~X~~	S.25.04.11	~~X~~	S.25.04.13	~~X~~	S.25.04.11
S.38.01	Duration of technical provisions	~~S.38.01.10~~	S.38.01.10	~~S.38.01.10~~	s.38.01.10	~~S.38.01.10~~	S.38.01.10
S.39.01	Profit and Loss	~~X~~	S.39.01.11	~~X~~	S.39.01.11	~~X~~	S.39.01.11
S.40.01	Profit or Loss sharing	~~S.40.01.10~~	X	~~S.40.01.10~~	X	~~S.40.01.10~~	X
S.41.01	Lapses	~~X~~	S.41.01.11	~~X~~	S.41.01.11	~~X~~	S.41.01.11

EIOPA proposes the following amendments to the Guidelines:

Add:

- New table being proposed in S.23.02 to the Financial Stability entry points (semi-annual frequency). Please see proposal in document "Individual Quantitative Reporting Templates (EIOPA-BoS-019-305)";
- In S.38.01.10 (Duration of technical provisions) request the "modified duration" in order to be directly comparable with the reported asset durations and make the template a quarterly template instead of annual;
- In S.05.01.13 (Premiums, claims and expenses) request net premiums earned (R0300), in order to allow the calculation of the net combined ratio quarterly;
- In S.39 (Profit and loss) – in addition to Profit and Loss figure, the figures of technical and non-technical account result, other income and other expenses, taxes, dividends and others (semi-annually frequency);
- Request the S.02.01 annual entry point (with statutory accounts value) in a semi-annual frequency.

Reduce:

- In S.38.01.10 (Duration of technical provisions) delete "Macaulay duration" cell;
- Delete S.14 (Life obligations analysis) from Financial Stability entry points;
- Delete S.40 (Profit or loss sharing) from Financial Stability entry points;
- This results in the overall deletion of Annual FS reporting.

Open Question to stakeholders:

Would requesting the effective duration (as set out in Annex I) of both assets and liabilities in addition to modified duration be feasible for groups/undertakings?

Analysis

11. In the development of the advice regarding Financial Stability reporting, EIOPA has considered the policy issues driving the need for a new approach. These are presented in the table below.

Policy issues	Options
1. Reporting deadlines	1.1 No change (preferred) 1.2 Aligning deadlines of FS reporting with those of prudential reporting
2. Content of FS reporting package	2.1. No change 2.2. Simplification of FS reporting package 2.3. Simplification of reporting package and introduction of new information (preferred)

Analysis of impacts

12. The following table summarises the costs and benefits for the main options considered in order to remedy the policy issues above.

Policy issue 1: Reporting deadlines		
Option 1.1: No change		
Costs	Policyholders	No material costs are expected
	Industry	Procedures are already in place, no expected costs
	Supervisors	No material costs are expected
	Other	-
Benefits	Policyholders	Earlier identification of relevant risks compared to option 1.2 benefits policyholder protection
	Industry	No extra costs, no need to adapt internal processes.
	Supervisors	Existing EIOPA products developed with Financial stability information are kept within the deadlines required by the users.
	Other	-
Option 1.2: Aligning deadlines of FS reporting with those of prudential reporting		
Costs	Policyholders	Delayed receipt of Financial Stability information by supervisors might impair timely identification of relevant risks
	Industry	Processes already in place would become obsolete, even if more time could release some pressure for timely data
	Supervisors	Limitations in the information available in order to identify FS risks. Impact on EIOPA product publication timelines and delayed identification of risks
	Other	-
Benefits	Policyholders	No material benefits are expected
	Industry	Longer time to prepare Financial Stability returns and alignment with regular supervisory reporting
	Supervisors	No material benefits are expected
	Other	-

Policy issue 2: Content of FS reporting package		
Option 2.1: No change		
Costs	Policyholders	No material costs are expected
	Industry	Reporting requirements stay as-is, no additional costs but no simplification either
	Supervisors	Limitations in the information available in order to identify Financial Stability risks. Information identified as needed over the last 3 years would continue not to be available
	Other	-
Benefits	Policyholders	No material benefits are expected
	Industry	Reporting requirements stay as-is: additional burden is avoided
	Supervisors	No material benefits are expected
	Other	-
Option 2.2: <u>Simplification of FS reporting package</u>		
Costs	Policyholders	Less complete financial stability oversight (possible non-identification of relevant risks)
	Industry	Processes for financial stability reporting would need to be kept
	Supervisors	Limitations in the information available in order to identify Financial Stability risks. Information identified as needed over the last 3 years would continue not to be available. Minimal: Implementing amended FS taxonomy
	Other	-
Benefits	Policyholders	No material benefits are expected
	Industry	Reduce the scope of the reporting for financial stability would reduce the reporting burden for undertakings
	Supervisors	No material benefits are expected
	Other	-
Option 2.3: <u>Simplification of reporting package and introduction of new information</u>		
Costs	Policyholders	No material costs are expected
	Industry	Removal of entry points should results in a net benefit in terms of reporting requirements but increase in information to be reported would balance the simplification. Costs however offset by proposed reductions as information requested should be available to undertakings within the scope of financial stability reporting.
	Supervisors	Minimal: Implementing amended FS taxonomy
	Other	-
Benefits	Policyholders	Timely identification of relevant risks

	Industry	More accurate assessment of Financial Stability risks should also benefit industry Reduction in entry points, streamlining the financial stability package, decreasing the reporting burden
	Supervisors	Enhanced information gathered thereby increasing analysis areas and oversight by NCA as well as enhanced oversight for EIOPA as well as EIOPA products benefitting from additional information. Streamlining the financial stability package while keeping the relevant needed information.
	Other	-

Comparison of options

Policy issue 1

13. The preferred option for this policy issue is to keep the current deadlines. The option to align the financial stability reporting deadlines with prudential supervisory group reporting (option 1.2) has been disregarded as it is considered that the potential costs for supervisors (including EIOPA) and policyholders related to delayed identification of risks largely outweigh the benefit for the industry.

Policy issue 2

14. The preferred option for this policy issue is the simplification in reporting requirements through the removal of entry points combined with the introduction of new relevant information (option 2.3).

15. It is considered that the removal of entry points should result in a net benefit for the industry in terms of reporting requirements. Costs to supervisors and EIOPA are considered to be minimal and related to the need for a change in FS reporting taxonomy. Improvement the scope of the information collected through Financial Stability reporting will be beneficial to supervisors and regulators by increasing the key information gathered from Financial Stability reporting entities, ultimately benefitting the protection of policyholders through more complete assessment of risks stemming from the insurance industry. It is considered that the benefits outweigh the costs of an increased reporting burden and amendment of Financial Stability reporting taxonomy for the industry and supervisors (including EIOPA).

Proportionality

16. There are no changes to the proportionality in the requirement for Financial Stability reporting from undertakings. It is considered that the additional information requested does not translate into an increased reporting burden on the groups in combination with the reduction of entry points.

17. It should be noted that the scope of Financial Stability Reporting is reduced, aiming the groups and undertakings with the highest impact: information is currently received from ~95 groups and 22 solo undertakings, domiciled across 16 different European countries.

Effectiveness & efficiency

18. The comparison of the options against the baseline scenario has been based on their contribution to achieving the following objectives: i) Effective and efficient supervision of (re)insurance undertakings and groups; ii) Improving proportionality, in particular by limiting the burden for (re)insurance undertakings with simple and low risks; iii) Financial Stability. The effectiveness and efficiency of each option to achieving the former three objectives has been illustrated in the table below.

19. Effectiveness measures the degree to which the different policy options meet the relevant objectives.

20. Efficiency measures the way in which resources are used to achieve the objectives. The extent to which objectives can be achieved for a given level of resources/at least cost (cost-effectiveness).

21. In the table below "0" covers both cases where the option does not increase the effectiveness/efficiency in achieving the objectives and cases where the option decrease the effectiveness/efficiency compared to the baseline. Consequently, it should be noted that option 1.2 (aligning the deadlines) and option 2.2 (simplifications in the reporting requirements) are deemed to have a negative impact with respect to the objective of and effective and efficient supervision of (re)insurance undertakings and groups as well as the financial stability objective.

Policy issue 1: Reporting deadlines						
	Effectiveness (0/+/++)			**Efficiency (0/+/++)**		
Options	Objective 1 Effective and efficient supervision of (re)insurance undertakings and groups	Objective 2: Improving proportionality, in particular by limiting the burden for (re)insurance undertakings with simple and low risks	Objective 3: Financial Stability	Objective 1: Effective and efficient supervision of (re)insurance undertakings and groups	Objective 2: Improving proportionality, in particular by limiting the burden for (re)insurance undertakings with simple and low risks	Objective 3: Financial Stability
Option 1.1: No change	0	0	0	0	0	0
Option 1.2: Aligning deadlines	0	0	0	0	+	0
Policy issue 2: Content of FS reporting package						
	Effectiveness (0/+/++)			**Efficiency (0/+/++)**		
Options	Objective 1 Effective and efficient supervision of (re)insurance undertakings and groups	Objective 2: Improving proportionality, in particular by limiting the burden for (re)insurance undertakings	Objective 3: Financial Stability	Objective 1: Effective and efficient supervision of (re)insurance undertakings and groups	Objective 2: Improving proportionality, in particular by limiting the burden for (re)insurance undertakings	Objective 3: Financial Stability

		with simple and low risks			with simple and low risks	
Option 2.1: No change	0	0	0	0	0	0
Option 2.2: Simplifications in reporting requirements	0	++	0	0	+	0
Option 2.3: Simplifications and improvements in reporting requirements	+	+	++	+	+	++

Annex I

Duration

1. Macaulay duration
   Macaulay duration is currently requested for liabilities. It can be defined as follows:
   $$\text{MacaulayDuration} = \frac{\sum_{t=1}^{n} \frac{t * C}{(1+y)^t} + \frac{n * M}{(1+y)^n}}{\text{Current Bond Price}}$$
   Where *t* is the time period, *C* is the coupon payment, *y* is the periodic yield, *n* is the number of periods, *M* is the maturity value and *Current Bond Price* is the present value of cash flows
2. Modified duration
   Modified duration is currently available for the asset side. . It can be defined as follows:
   $$\text{Modified Duration} = \left[\frac{\text{Macauley Duration}}{\left(1+\frac{\text{YTM}}{n}\right)}\right]$$
   Where *YTM* is yield to maturity and *n* is number of coupons per year.

3. Effective duration
   Effective duration is conceptually able to take into account the variability of cash-flows under changing economic environments. This concept is based on a full revaluation of the balance sheet positions in scope and therefore considers both aspects: **1)** change in discount rates and **2)** change of cash flows. More concretely, the effective duration for Technical Provisions would be calculated as follows:
   $$D_{TP}^{eff} = \frac{TP_{IRdown} - TP_{IRup}}{2 \cdot \Delta y \cdot TP_{base}}$$
   Where $TP_{(\cdot)}$ is the market-consistent value of Technical Provisions in the respective scenario at the reference date. Accordingly, TP_{base} refers to the baseline scenario while TP_{IRup} and TP_{IRdown} to the scenarios with parallel interest rate movements up and down, respectively. Both scenarios IR up and IR down are described by an absolute parallel shift of $\pm\Delta y$ of the underlying market curve at the valuation date (e.g. swap or government yield curve). The yield curve shift would be a parallel shift of the whole term structure and shift level 100 basis points. Whether the same yield curve shift would be applied simultaneously to both assets and liabilities or, alternatively, whether elements of the RFR mechanism like extrapolation should be taken into account for the liability side is subject of further discussions. Please note that the concept of effective duration is based on a full revaluation of Technical Provisions and for Life insurance therefore usually requires two additional runs of stochastic life cash-flow models.