Matheson

EIOPA Consultation on the new Proportionality Framework under Solvency II

Overview

In August this year, the European Insurance and Occupational Pensions Authority ("**EIOPA**") published a public consultation ("**Consultation**") on the new proportionality framework proposed in the Provisional Agreement on amendments to the Solvency II Directive ("**Provisional Agreement**").

The proposed proportionality framework aims to address concerns relating to the limited and inconsistent application of proportionality, as identified by EIOPA's 2020 Review of Solvency II, by introducing a clear legal framework and process for applying and supervising the principle of proportionality for:

(i) small and non-complex undertakings ("**SNCUs**") and groups ("**SNCGs**"); and

(ii) undertakings and groups not classified as small and non-complex, which are permitted to avail of certain proportionality measures.

As part of the Consultation, EIOPA has set out its opinion that the proposed methodology for the classification of SNCUs and SNCGs detailed in the Provisional Agreement is clear and comprehensive. In addition, it has proposed a set of conditions for determining the use of proportionality measures for undertakings and groups not classified as small and non-complex.

Stakeholders have the opportunity to respond to the Consultation before 25 October 2024, after which EIOPA will prepare its final advice for submission to the European Commission by 31 January 2025.

Key Takeaways

The new proposed proportionality framework is expected to simplify application of the proportionality measures under Solvency II.

SNCUs and SNCGs that meet specified eligibility criteria will automatically be permitted to avail of the proportionality measures once they have complied with the two month notification process proposed under the Provisional Agreement and no objections have been raised by the competent supervisory authority.

It is, however, important to be aware that insurance undertakings within a group could meet the criteria for SNUCs on a standalone basis, but the group may not meet the criteria for SNCGs on a consolidated basis. Therefore, practical challenges may arise for SNCUs that are required to comply with group reporting requirements, notwithstanding any proportionality measures applied at entity level.

Undertakings and groups that do not meet the small and non-complex eligibility criteria can apply for approval to use certain proportionality measures, but will be required to demonstrate that the proportionality measures are justified based on their risk profile. The qualitative and quantitative conditions proposed by EIOPA should provide non-SNCUs and non-SNCGs with greater clarity as to the regulatory criteria to be met to avail of certain proportionality measures.

Firms which can avail of proportionality measures under Solvency II will benefit from reduced regulatory obligations in areas such as reporting, disclosure, governance, revision of written policies, calculation of technical provisions, own-risk and solvency assessments and liquidity risk management plans. This may lead to reduced costs and operational efficiencies.

Overall, we consider the proposed proportionality framework to be a welcome development which should provide greater clarity and predictability in the application of proportionality under Solvency II.

It is also proposed that EIOPA will report annually on the utilisation of proportionality measures by insurance companies / groups in each Member State, which should provide visibility and accountability on whether supervisory authorities are giving effect to the new proportionality framework.

Small and Non-complex Undertakings and Groups

The Provisional Agreement sets out criteria for **classifying undertakings as SNCUs**, which includes the following:

Interest Rate Risk	No higher than 5% of the technical provisions, gross of the amount recoverable from reinsurance contracts and special purpose vehicles;
Cross-Border Activities	Business conducted on a cross-border basis in another Member State is less than €20 million or 10% of its total annual gross written premium;
Investments	Non – traditional investments do not represent more than 20% of total investments;
Reinsurance	Re-insurance operations do not constitute more than 50% of its total annual gross written premium income;
Non-life Activities	The average combined ratio for non-life activities net of reinsurance of the last three years is less than 100 % and the annual gross written premium income from non-life activities is not higher than €100 million; and
Life Activities	The technical provisions from life activities are no more than €1 billion from life activities, gross of the amount recoverable from reinsurance contracts and special purpose vehicles

Once an undertaking meets the criteria and complies with its solvency capital requirement, it can avail of a simplified notification process under Solvency II for classification as a SNCU by providing:

(i) evidence of compliance with the SNCU criteria over the last two consecutive financial years;

(ii) a declaration that the undertaking does not plan any strategic change that would lead to non-compliance with any of the SNCU criteria within the next three years, and

(iii) an identification of the proportionality measures the undertaking expects to implement.

Provided no objection is raised by the supervisory authority within two months of receipt of a complete notification, the undertaking will automatically be deemed a SNCU and can avail of the related proportionality measures.

The Provisional Agreement sets out further criteria for the **classification of an insurance group as SNCGs** for the purposes of group supervision rules, with related proportionality measures applying. However, as noted above, insurance undertakings within a group could meet the criteria for SNUCs on a standalone basis, but not meet the criteria for a SNCG on a consolidated basis. Therefore, practical challenges may arise for SNCUs that are required to comply with group reporting requirements notwithstanding any proportionality measures applied at entity level.

Insurance groups including SNCUs should carefully consider the proposed proportionality framework and, where necessary, make submissions in response to the Consultation to ensure there is no impediment on the ability of SNCUs within the group to fully avail of proportionality measures.

Under the Consultation, respondents are asked to consider whether any aspect of the methodology for classifying undertakings and groups as small and non-complex would require further specification. If so, respondents are asked to describe which ones, the reasons why and propose further guidance.

Undertakings and Groups not classified as Small and Non-Complex

The Provisional Agreement provides for non-SNCUs and non-SNCGs to seek prior approval from the competent supervisory authority to avail of some or all of the following proportionality measures, where justified relative to the nature, scale and complexity of their risk profile:

1. Regular supervisory report at least every three years instead of annually or bi-annually;
2. Combination of key functions;
3. Written policies updated every five years instead of annually;
4. Waiver from macroprudential analysis in the ORSA;
5. ORSA every two years instead of annually;
6. Prudent deterministic valuation of the best estimate for immaterial obligations with options and guarantees in the calculation of technical provisions;
7. Exemption from liquidity risk management plan; and
8. Exemption from the remuneration requirement to defer a significant portion of the variable remuneration.

EIOPA has proposed a set of conditions based on both qualitative and quantitative measures to assist supervisory authorities in assessing whether to grant or withdraw the use of any of the above proportionality measures for non-SNCUs and non-SNCGs. It is expected that the conditions will be reflected in delegated acts to Solvency II.

EIOPA considers that the proposed conditions offer a fair balance between predictability / convergence in the application of the new proportionally framework, on the one hand, while allowing for supervisory judgement / risk - based supervision on the other hand.

A high level overview of the conditions proposed by EIOPA for authorising the use of proportionality measures for non-SNCUs and non-SNCGs are as follows:

1. **Risk resilience of the undertaking:**	The supervisory authorities expect that the undertaking is resilient to any current or future risks and does not require a further supervisory assessment. The supervisory authorities also expect that the undertaking is not subject to on – going supervisory measures to restore material non – compliance with Solvency II;
2. **Non-complex Business Model:**	The undertaking must not have a complex business model, must be aware of the complexity of its products or hold any complex investments and must maintain a stable business model;
3. **Solvency Capital Requirement:**	The undertaking's Solvency Capital Requirement is surpassed by an appropriate margin, considering the solvency position of the undertaking. This is inclusive of the medium term capital management plan;
4. **Market presence of the undertaking:**	The undertaking's: - technical provisions from life activities must be no higher than €15,000,000,000; - annual gross written premium income from non – life activities is no higher than €2,000,000,000; and - does not represent more than 5% of the life market or, where applicable, non - life market of the home Member State of the undertaking.
5. **System of governance:**	The supervisory authority has not raised concern resulting from the system of governance of the undertaking in the previous three financial years;
6. **Regular Supervisory Reports**	There were no concerns raised in the last three Regular Supervisory Reports which contained high – quality and complete information;

7. **Organisational structure:**	There were no concerns relating to the decision making procedures and the organisational structure of the undertaking in the last three financial years;
8. **Relevant qualifications:**	The individual responsible for the key functions of risk management, actuarial and compliance, have the relevant knowledge, skills and experience to effectively carry out activities in relation to the different functions;
9. **Separate functioning costs:**	The costs relating to maintaining separate functions must be disproportionate with respect to the total administrative expenses, along with the total number of employees of the undertaking;
10. **Written policy requirements:**	All required written policies as part of the system of governance are in alignment with each other and the business strategy and approved by the administrative management or supervisory body;
11. **Risk and solvency assessments:**	The information included in the previous three risk and solvency assessments by the undertaking is appropriate to its risk profile;
12. **Impact of the ORSA:**	The supervisory authorities have no concerns that the reduced frequency of the own risk and solvency assessment ("ORSA") impacts the effectiveness of the management system of the undertaking, and the undertaking implements an effective process to supervise circumstances that require an ad hoc ORSA as well as sufficient resources to provide an ad hoc ORSA, when required;
13. **Prudent deterministic valuation:**	The applicant is not using a stochastic valuation of the best estimate in relation to the requirements for which the undertaking is looking to apply to a prudent deterministic valuation;
14. **Time value of the option:**	The time value of the options and the guarantees of the contracts where the prudent deterministic valuation is applied is below 5% of the Solvency Capital Requirement;
15. **Exposure to liquidity risk:**	There are no material exposures to liquidity risk from asset and liability sides of the balance sheet considering the possible effect of policyholders' behaviour on the liquidity of insurance contracts, taking into account the potential impact of policyholders' behaviour on the liquidity position of the undertaking and the exposure to off-balance sheet items;

16. **Counterparty exposures:**	There is no significant focus on counterparty exposures to reinsurance undertakings;
17. **Liquidity position of undertaking**	There are no concerns in liquidity position of undertakings resulting from economic or macroeconomic market trend or the amount and quality of own funds items;
18. **Fungibility and availability of liquid funds:**	For groups only, there are no concerns related to the fungibility and availability of liquid funds throughout the group, including the ability to transfer liquidity across the group's undertakings; and
19. **Annual variable remuneration :**	The annual variable remuneration of the staff member shall not exceed EUR 50,000 and represents less than 1/3 of that staff member's total annual remuneration.

Application of the above conditions will be dependent on the particular proportionality measure which the SNCU or SNCG is seeking to avail of. The applicant undertaking or group will be required to fulfil all relevant conditions to avail of each proportionality measure as indicated in the Consultation.

Under the Consultation, stakeholders are asked to consider whether any additional specific conditions would be needed for insurance groups that are not classified as small and non-complex. If so, stakeholders are asked to describe which ones and the reasons why.

Should you have any queries in relation to the Consultation or in preparing a response to the Consultation, please contact Darren Maher, Grainne Callanan, Elaine Long or your usual Matheson contact.

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