

Briefing

# Solvency II Delegated Regulations

## A summary of changes

RISK | PENSIONS | INVESTMENT | **INSURANCE**

On 18 June 2019 the European Commission published final changes to the Solvency II Delegated Regulation which will come into effect from 8 July 2019 (with a few from 1 January 2020, in order to avoid disruptions to the non-life and health insurance market).

Insurance companies affected should review the changes, as a matter of course. However, as a quick summary, below are the key areas that will be impacted. (Please note, changes are effective from July 2019 unless otherwise stated).

### Counterparty default risk sub-module

1. It has been clarified that all derivatives should be treated as Type 1 exposures apart from credit derivatives which should be excluded. Netting is allowed where derivatives represent exposure to the same counterparty.
2. There is now a more granular set of calculations for different derivative exposures, including exposures to qualifying central counterparties (CCPs) and the introduction of a new category for exposures to CCPs.
3. Confirmation that any risk mitigating impact cannot be negative and an added allowance for mortgage guarantors on mortgage loan exposures.

### Treatment of risk-mitigation techniques

1. Changes to allowable rolling reinsurance arrangements subject to regular renewal.
2. There are amendments to treatment of reinsurers in breach of Solvency Capital Requirement (SCR) or Minimum Capital Requirement (MCR).

3. Setting out requirements for where several contractual arrangements are combined to reduce risk.
4. Amendments to financial risk mitigation and status of counterparties.

### Market risk module

1. There is a slight change in definition of closed-ended alternative investment funds that can be treated as Type 1 equity and the inclusion of qualifying unlisted equity portfolios as Type 1.
2. There has also been a change to the criteria of allocating alternative investment fund and unlisted equity assets between Type 1 and Type 2 equities.
3. A lower stress of 22% has been given to long-term equity investments where the firm can demonstrate that they have a long-term holding strategy, although this will require supervisory approval.

4. There have been changes to the treatment of unrated bonds and loans in the spread risk module, allowing firms to undertake their own credit assessment.
5. There is an extension of the preferential treatment in relation to bonds and loans backed by EU regional governments.
6. For consolidated Group SCRs, there is the added option to use the currency of material own funds or technical provisions, rather than the reporting currency of the consolidated accounts.

### Classification of own funds

1. There are changes to the eligibility requirements for certain own fund items under Solvency II.
2. For Tier 2 and Tier 3 own funds, there is some relaxation of the duration requirements in specific circumstances. For Tier 1 own funds there are additional constraints on paid in subordinated mutual member accounts, paid in preference shares and the related share premium account and paid in subordinated liabilities.

### Look-through approach

1. Easement in the look-through requirements, particularly for assets backing linked liabilities, to allow previously reported allocations (rather than current allocations) for collectives or target allocations for grouped exposures.
2. The changes also involve the removal of the 20% limit to look-through simplifications for unit-linked business where the policyholder bears the investment risk.
3. An extension of the look-through requirements to related undertakings whose main purpose is to hold/manage investments of the insurer.
4. The alignment of the look-through treatment for Group and Solo entities.

### Simplifications

A number of additional simplifications have been introduced, primarily for non-life risks and the treatment of reinsurance.

1. These include new simplifications for life and non-life lapse risk, natural catastrophe risk and fire risk.

2. New simplifications to the calculations of debt portfolios where some is unrated, loss given default (LGD) for reinsurance and risk mitigating effect on underwriting risk for non-life risks only.
3. Amendments to the calculation of mortality risk (life and health), grouping of singled name exposures, risk mitigating effect of reinsurance or securitisation and of proportional reinsurance.

### Non-life underwriting risk module

1. Amendments to the definition future premium for non-life premium and reserve risk, NSLT health premium and reserve risk, variables for aviation and fire risk, the replacement of the whole article for marine risk and changes to the natural catastrophe risk formulae.
2. Changes to standard parameters (in annexes) such as segmentation, catastrophe risk factors, geographical splits and non-life premium and reserve risk correlations, although changes in premium and reserve risk correlation and segmentation do not apply before 1 January 2020.

### Health underwriting risk module

There have been some amendments to the mass accident stress risk factors. This involves changes to annex parameters for disability (permanent and temporary) and also the removal of the category of disability that lasts ten years and is caused by an accident.

## Deferred Tax and Loss Absorbing Capacity of Deferred Tax (LACDT) - effective 1 January 2020

1. New limitations and criteria for the allowance of future profits within the LACDT.
2. An additional requirement to have a risk management policy of deferred tax assets and LACDT – an assessment of assumptions and any concerns carried out by the Actuarial or Risk is needed.
3. There will also be some additional disclosure requirements in the Solvency and Financial Condition Report (SFCR) and in the regular supervisory report (RSR) around any Deferred Tax Assets (DTA) and the LACDT.

## Other Provisions

1. The setting out of the legislative framework to enable ELOPA to change how risk-free rates are determined.
2. Treating stop-loss insurance consistently with excess of loss insurance for the purpose of undertaking specific parameters.
3. The updating of definitions to include qualifying CCPs.
4. Minor corrections to wording and data that must be reported by supervisors.

## Conclusion

For some firms, the impact of the above changes may be negligible. However, it would certainly be worth firms performing their own assessment of these changes and making preparations ahead of their next quarterly or year-end cycle.

Please contact your Barnett Waddingham consultant if you would like to discuss this topic in more detail. Alternatively get in touch via the following:

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