

CONTINUED CHANGE AND VOLATILITY IMPACTING SOLVENCY II REPORTING

The capital impacts of COVID-19 mean increased Solvency II monitoring and reporting challenges for insurers, against a backdrop of continued regulatory change. Faced with the evolving challenges of Solvency II, Refinitiv® highlights why insurers need reliable and flexible solutions from providers with proven expertise.

Solvency ratios impacted by coronavirus pandemic

Insurers are currently grappling with the unprecedented impacts of COVID-19. The global pandemic is placing significant pressure on the industry, with multiple pain points caused by high levels of asset and investment volatility; persisting low interest rates impacting returns and reserves; and escalating claims costs in lines of business such as business interruption, travel and event cancellation.

Lloyd's of London has estimated that the coronavirus pandemic will cost the insurance industry more than \$200bn in 2020. An estimated \$107bn of underwriting losses makes 2020 a record loss year, on a par with the devastating hurricanes of 2005 and 2017 that struck the US and Caribbean. Where 2020 differs from these previous major claims years is the "double hit" of financial market turmoil which is expected to lead to \$96bn of investment losses for the industry.

Insurers well placed to cope, but solvency ratios are suffering

Regulators and rating agencies are currently on high alert, particularly given the rapidly changing nature of market dynamics and considerable future uncertainties.

It's true that the European insurance industry was generally well-equipped going into this crisis, particularly the non-life and reinsurance sectors, given their lower asset leverage. While life and annuity insurers are more vulnerable, they are also largely expected to prove resilient. In March, the European Insurance and Occupational Pensions Authority (EIOPA) asserted that "the sector is well capitalized and able to withhold [sic] severe but plausible shocks to the system".

Yet, while the industry's favorable capital adequacy levels should allow the vast majority of insurers to weather the pandemic storm, the Q1 2020 results of major European insurers revealed declining solvency ratios for most providers. Major players like AXA, Allianz, Generali and Aviva have all seen significant drops, ranging from 16-28 percentage points. Q1 results have also shown that the use of hedging and/or derivatives to offset investment risks varies significantly by company and by country.

Volatility Adjustment helping to bolster ratios

Solvency II is known for its sensitivity to financial market volatility and movements in bond yields and credit spreads. The Volatility Adjustment (VA) is one of a series of Solvency II relief measures activated by EIOPA and is designed to cancel out the effects of short-term capital market volatility on insurer solvency positions.

Aegon's results highlight the extent to which the VA can help to stabilize ratios. The company's Solvency II ratio actually increased by seven percentage points in Q1 2020, aided by the application of the increased EIOPA VA to its Dutch portfolio. The firm disclosed that should EIOPA's VA reduce to a 15 basis point uplift to the Risk Free Rate (RFR), instead of 46bp, the Solvency II ratio for its business in the Netherlands would be 45 percentage points lower, at 194%.

Italian insurers are also applying country-specific VA. In March, the Italian government passed into law an EU Solvency II amendment that reduced the threshold for applying the country-specific VA to 85% from 100%. Italian insurer Solvency II ratios were therefore subject to these lower threshold requirements from the first quarter of 2020.

Increased frequency of solvency monitoring

Naturally, current volatility is leading to increased monitoring by regulators, with requests for weekly solvency ratio calculations by the Italian insurance supervisory authority, for example. Regulators at the country level will be keeping a close eye on capital levels and will continue to encourage or instruct insurers to conserve capital, following prudent dividend and other distribution policies, including variable remuneration.

In order to support insurers and reinsurers in more frequent monitoring of their solvency and financial positions, during April and May 2020 EIOPA carried out extraordinary calculations on a weekly or bi-weekly basis to monitor the evolution of the relevant RFR term structures and the symmetric adjustment to equity risk (EDA).

Solvency II facing a future of continued regulatory change

EIOPA 2020 review of Solvency II

While current market volatility poses immediate Solvency II monitoring and reporting challenges for insurers, this is occurring against a backdrop of continued regulatory evolution. EIOPA's proposed amendments to Solvency II mean that future change remains inevitable.

The regulator's consultation was launched in October 2019 in response to the identification of inconsistencies in the implementation of Solvency II, and its proposed amendments are aimed at ensuring more consistent application of the framework. The consultation contains wide-ranging proposals, covering deficiencies in the VA, reporting requirements, insurance guarantee schemes and Solvency Capital Requirements (SCR) standard formula changes.

The initial deadlines for the review have been pushed back to allow for a holistic assessment of the impact of COVID-19 on the industry. EIOPA will now deliver its advice on the Solvency II review to the European Commission at the end of December 2020, with the Commission expected to respond with legislative proposals for amendments in 2021.

Insurers have been requested to complete scenario-based returns to help EIOPA assess the impact of possible changes. The regulator has also sent a further data request with a reference date of 30th June 2020, so as to encompass a fuller impact assessment of the coronavirus pandemic.

Smaller changes also impacting Solvency II reporting

With such momentous global disruption and change it is also important to not overlook some of the smaller, but significant, changes affecting Solvency II reporting.

One such development is the introduction of a new version (V5) of the Solvency II Tripartite Template (TPT), which went live in March 2020. As an EU-wide standardized format for reporting the portfolio composition of funds, insurers require this information to meet their supervisory requirements (including SCR) and reporting obligations (such as the Quantitative Reporting Templates).

The new version contains changes in reporting which mark a step towards a stronger standardization of format and will have a significant impact on insurers and reporting service providers seeking to fulfill their TPT requirements.

How Refinitiv can help insurers

With current and future change looming large it is vital that Solvency II reporting teams are able to keep abreast of market movements. Refinitiv understands that compliance teams tasked with gathering, collating and managing specific reference data need robust, reliable and flexible ways of handling the complex data management challenges created by this evolving regulation.

Organizations must source and map data for reporting purposes; value and classify assets and liabilities; understand the constituents of potentially thousands of fund holdings; and create derived data inputs such as credit quality steps (CQS). Now more than ever, many insurers are grappling with the need to proactively manage these obligations, both globally and regionally.

The fundamental challenge these firms face is essentially one of managing Big Data at speed. Contacting each fund to obtain the required data relating to fund constituents and collating incoming non-standardized data in a timely fashion for quarterly submission to EIOPA can quickly become a significant headache; one that is only compounded by current market volatility.

Refinitiv manages the heavy lifting aspect of compliance by providing both the data and leading-edge technology to equip the insurance industry to meet the evolving challenges posed by Solvency II, enabling firms to meet both their Pillar I and Pillar III obligations. Its comprehensive data and tools empower industry participants to meet these obligations both efficiently and effectively.

Robust and reliable data

EIOPA's selection of Refinitiv as official data provider confirms the robustness and reliability of the firm's offering. Since January 2020, the regulator has used Refinitiv as its source for Risk-Free Rate (RFR) term structures. According to Russell Ironside, Proposition Manager at Refinitiv, "the increased frequency of EIOPA's publication of RFR data during this current period of market volatility is further validation of its decision to adopt Refinitiv for its market data needs."

He continues: “Our unmatched breadth and depth of regulatory-specific pricing and reference data – including CIC, LEI and branch level ratings – includes everything necessary to meet quarterly reporting obligations, and our professional services software capability combines full holdings data with pricing, reference and client proprietary data to populate the TPT report for submission to EIOPA.”

Refinitiv provides non-embargoed fund holdings, or fund look-through data, in a consolidated feed managed by a team of specialists to ensure that accurate fund constituents are sourced and aggregated for subscribers. Look-through enables insurers to gain valuable insights into their asset portfolios and boosts their ability to mitigate the risk exposure of their investments.

Its evaluated pricing team also covers illiquid and hard-to-price assets. This is particularly useful in light of the fact that additional capital requirements are usually imposed when asset valuations are not available.

Flexible solutions

Refinitiv’s end-to-end solution for Solvency II compliance is flexibly structured in separate components and enables insurers to confidently cover all their global and regional compliance needs. Moreover, its data solutions are highly adaptable and able to evolve alongside ever-changing requirements.

Ironside summarizes: “While managing regulatory change is no easy task, taking a proactive approach and employing the best holistic solutions – including robust data and leading-edge technology, backed by trusted human expertise – offers the most effective answer for forward-looking firms seeking a smooth and seamless response to ongoing regulatory developments.”

Refinitiv is one of the world’s largest providers of financial markets data and infrastructure, serving over 40,000 institutions in approximately 190 countries. It provides leading data and insights, trading platforms, and open data and technology platforms that connect a thriving global financial markets community – driving performance in trading, investment, wealth management, regulatory compliance, market data management, enterprise risk and fighting financial crime.

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