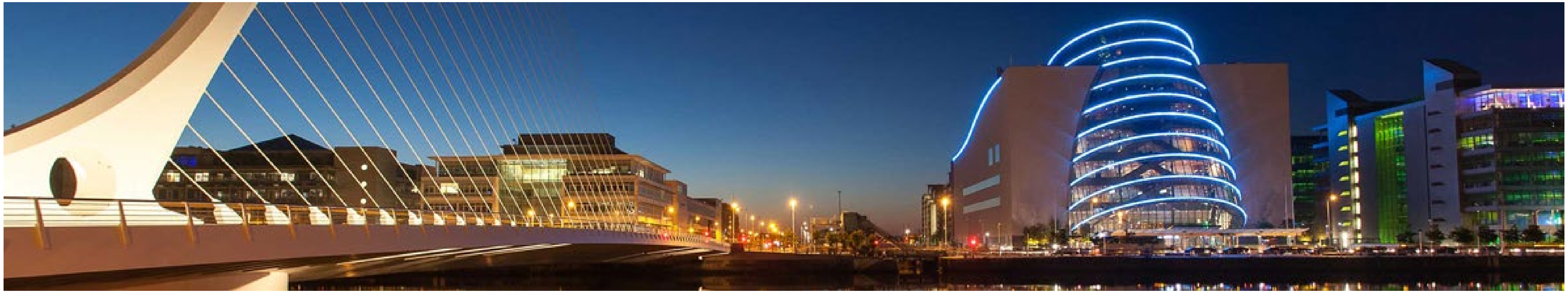
Welcome to Milliman's Lunchtime Webinar



Agenda

25 MARCH 2021

Topic	Presenter
Welcome and Regulatory Update	Andrew Kay
Solvency II 2020 Review	Aisling Barrett
Regulatory response to Climate Related Risk	Sinéad Clarke

Regulatory Update

Andrew Kay

25 MARCH 2021

EIOPA Risk Dashboard, January 2021

Risk Dashboard
January 2021

Risks	Level	Trend (past 3 months)	Outlook (next 12 months)
Macro risks	High	→	→
Credit risks	Medium	→	↗
Market risks	Medium	↘	↗
Liquidity and funding risks	Medium	→	→
Profitability and solvency	Medium	→	→
Interlinkages and imbalances	Medium	→	→
Insurance (underwriting) risks	Medium	→	↗
Market perceptions	Medium	↗	→

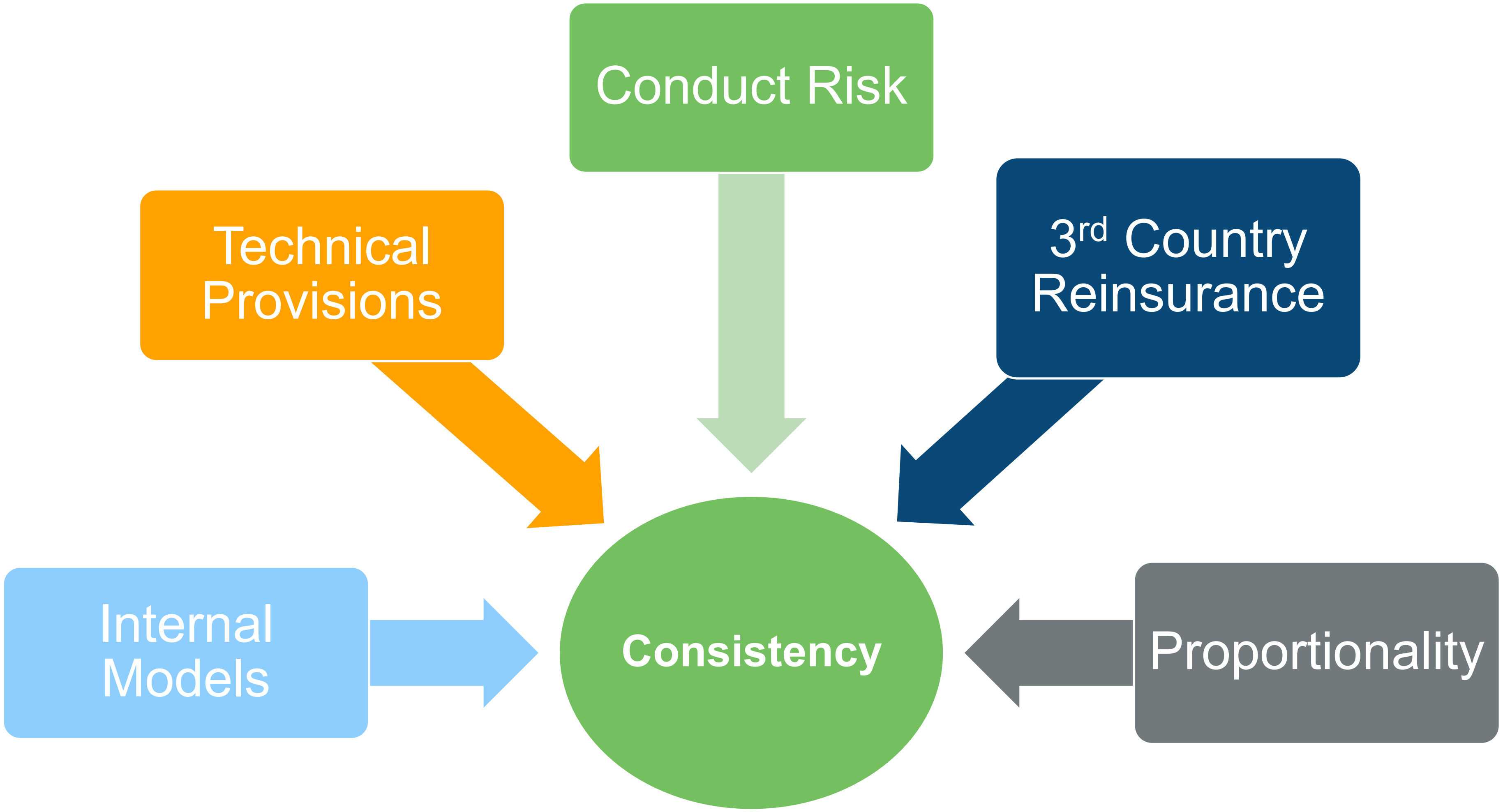
- **Covid 19**
- **Financial market volatility**
- **Profitability & Dividends**

Risk Management

and

Capital Management

Supervisory convergence themes



Thank you

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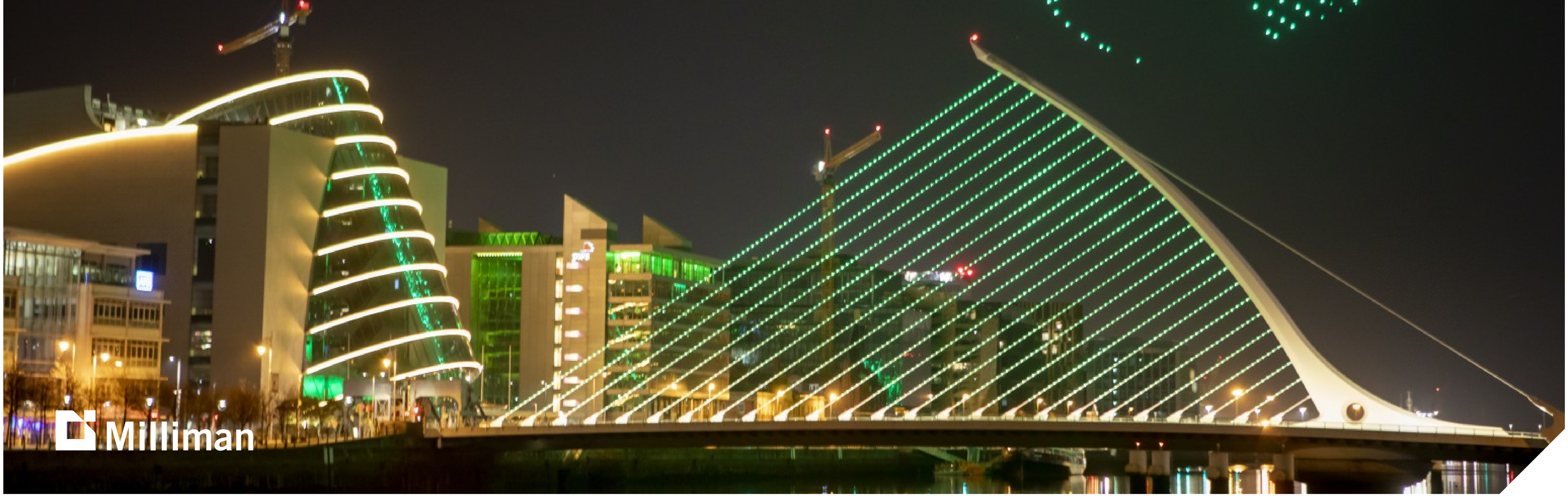
Solvency II 2020

EIOPA’s final opinion

25 MARCH 2021

AISLING BARRETT



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Poll 1: Do you plan to assess the impact of Solvency II 2020 changes this year:

1. **In the Actuarial Report on Technical Provisions**
2. **In the ORSA**
3. **Somewhere else**
4. **Not yet**

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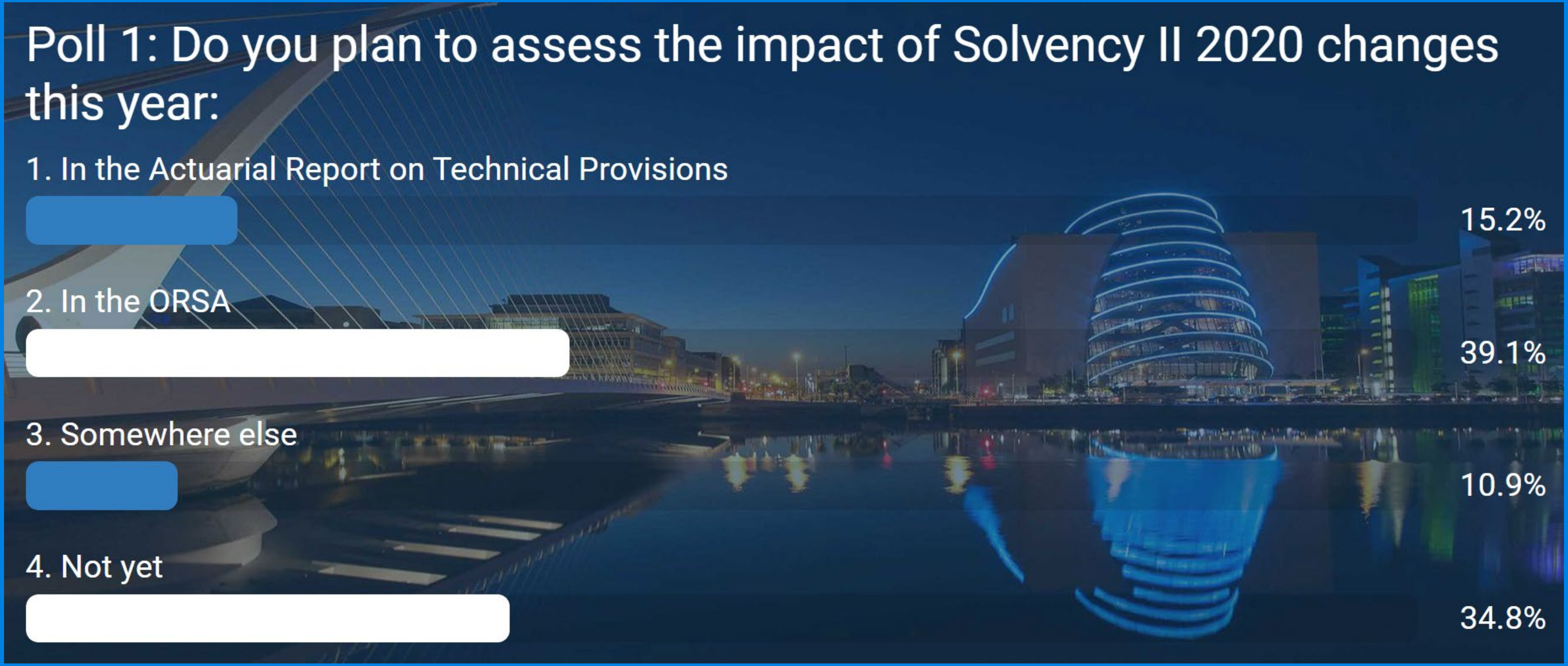
Poll 1 Results



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Key changes

Balance Sheet (Pillar 1)

The proposals with the most material impact on the solvency ratio across European insurers in aggregate are:

1. Extrapolation (-)
2. Interest rate risk capital requirement (-)
3. Risk margin (+)
4. Volatility adjustment (+)
5. Correlations (+)

(based on the impact assessments carried out by EIOPA)

Other items of note

- Proportionality measures
- Pillar 2 items:
  - Macroprudential policy
  - Liquidity risk management plans
  - Systemic risk management plans
  - Recovery & resolution
- Pillar 3: Reporting & disclosure

Pillar 1

Extrapolation

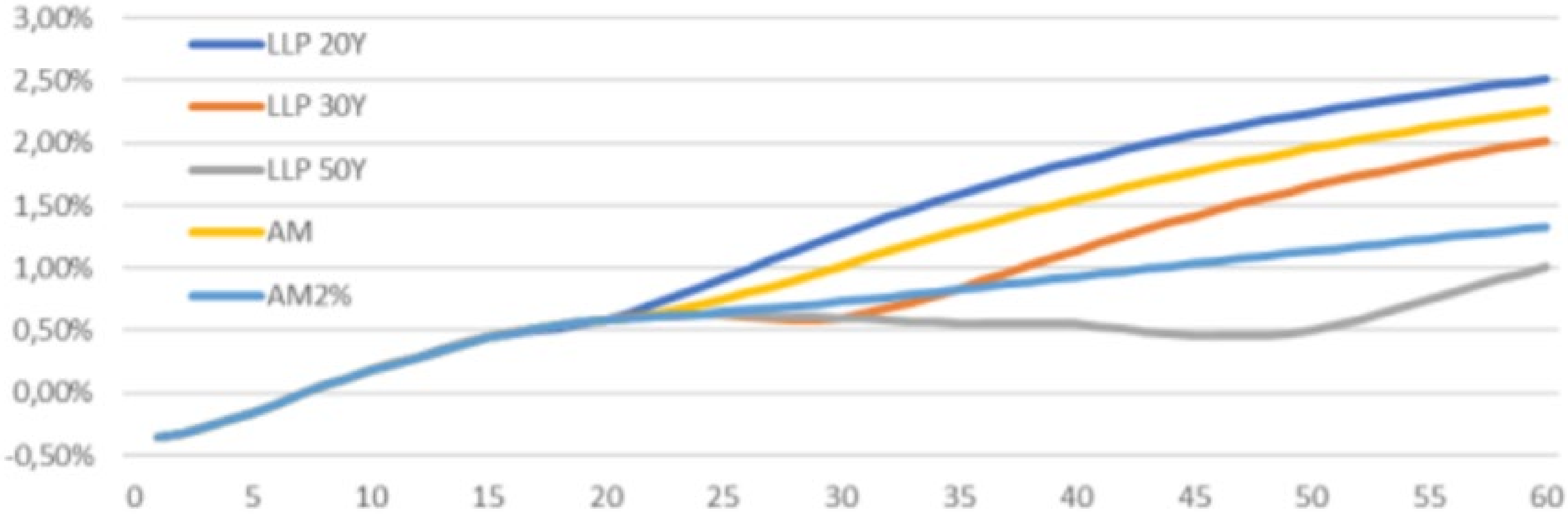
- EIOPA considered 5 options in the consultation for Euro:

1. No change
2. LLP stays at 20 years and safeguards introduced in Pillars 2 and 3
3. LLP increased to 30 years
4. LLP increased to 50 years
5. Alternative extrapolation method

- EIOPA is proposing option 5 which is seen as a compromise between including market info beyond LLP and limiting impact on valuation of long term liabilities

Extrapolation

EIOPA options considered based on year-end 2019 data



- LLP 20Y (current) is top line with increase to 30 and 50 years also shown
- AM is alternative extrapolation methodology using the parameters proposed in the holistic impact assessment – UFR of 3.9% and alpha (speed of convergence) of 10%
- AM2% is alternative extrapolation methodology with alpha of 2%
- EIOPA is now proposing a phase-in period with alpha depended on the level of the interest rate at 20 years

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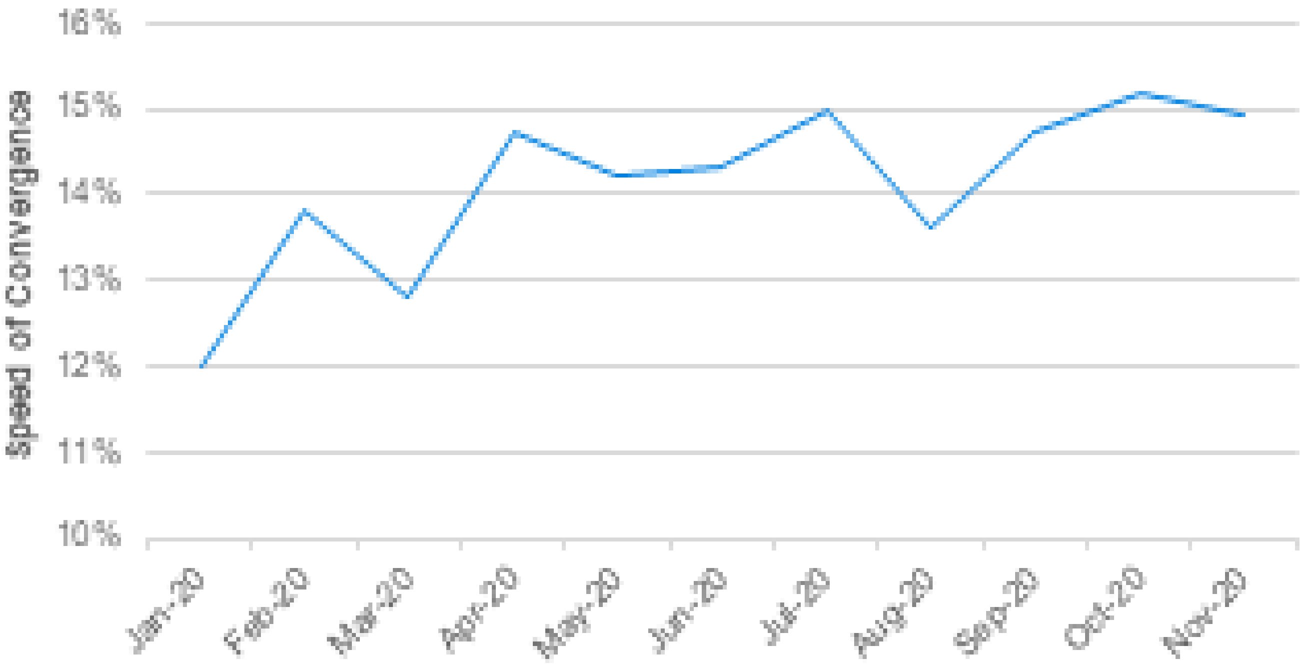
Extrapolation

Alpha – speed of convergence parameter



- Chart shows speed of convergence parameter calculated at each month in 2020
- Parameter is intended to smooth the transition and dampen the hit on solvency ratios
- However also introduces complexity and volatility

Other Long Term Guarantee (LTG) Measures

Matching Adjustment

- Removal of the limitation to **diversification benefits** in the standard formula SCR between matching adjustment portfolios and other portfolios.
- EIOPA is proposing additional requirements in relation to the eligibility of restructured assets in matching adjustment portfolios (introducing a **look through approach**)

Volatility Adjustment

- **Supervisory approval** required in all countries
- 65% increased to **85%**
- VA split into **permanent VA** and **macro-economic VA** (by country where products sold)
- **Application ratio** introduced to measure duration and volume **mismatch** between fixed income investments and insurance liabilities of the company
- **Another application ratio** introduced to take into account the **illiquidity** of the liabilities

Technical Provisions

Other Key Changes

Risk margin

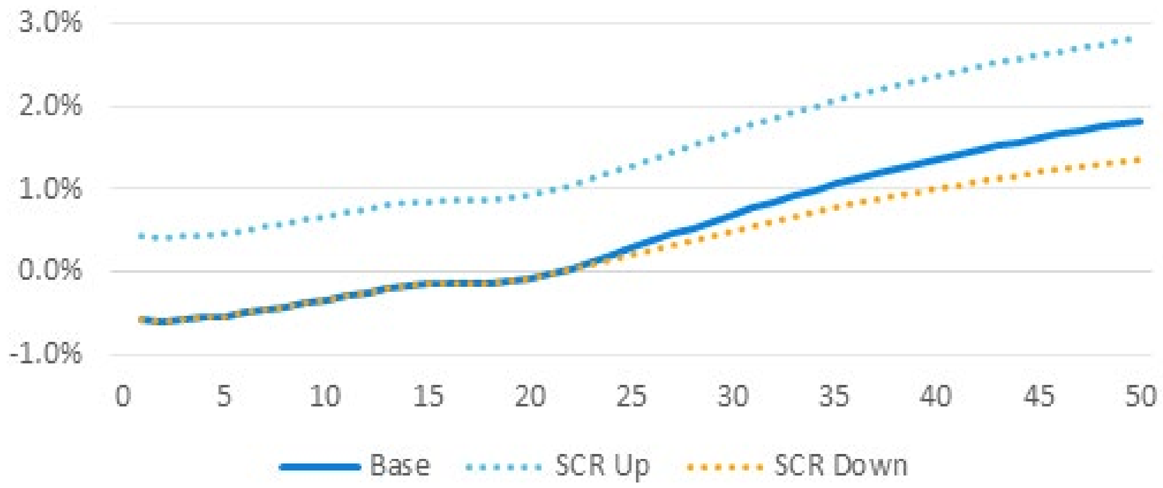
EIOPA is proposing a reduction to the **risk margin** calculated by applying a factor to the SCR projection.

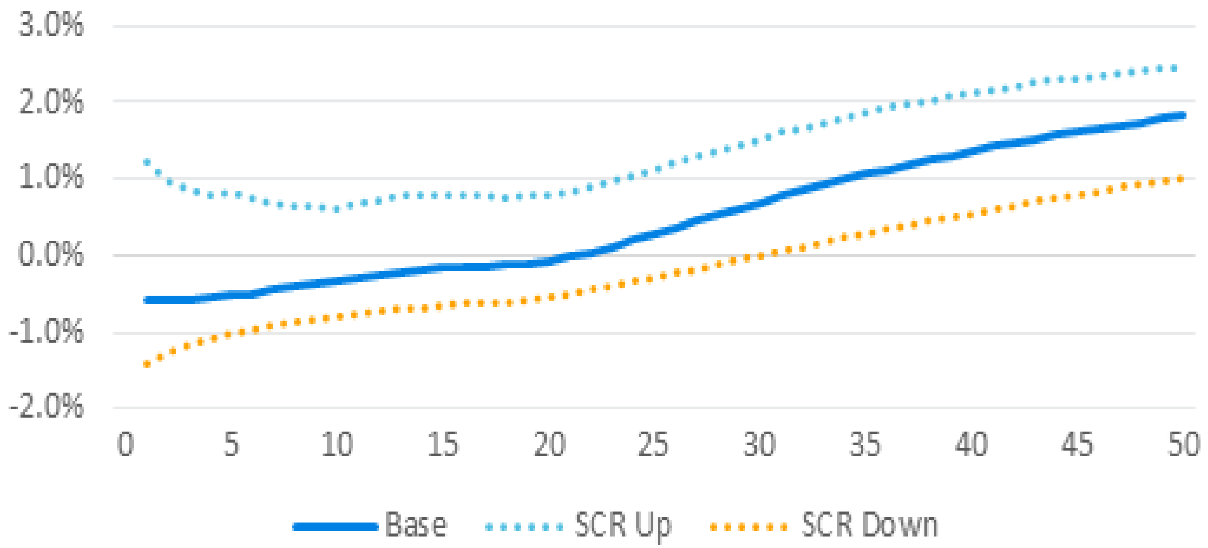
The factor starts at 97.5% at year 1 and reduces to 50% by year 28.

Other

- **Expenses** in the BEL should take into account Board decisions made in relation to writing new business. EIOPA states that assuming that new business will come when this is not the real expectation leads to a non-realistic valuation of the best estimate
- **Contract boundaries**
- **EPIFP**

SCR - interest rate risk





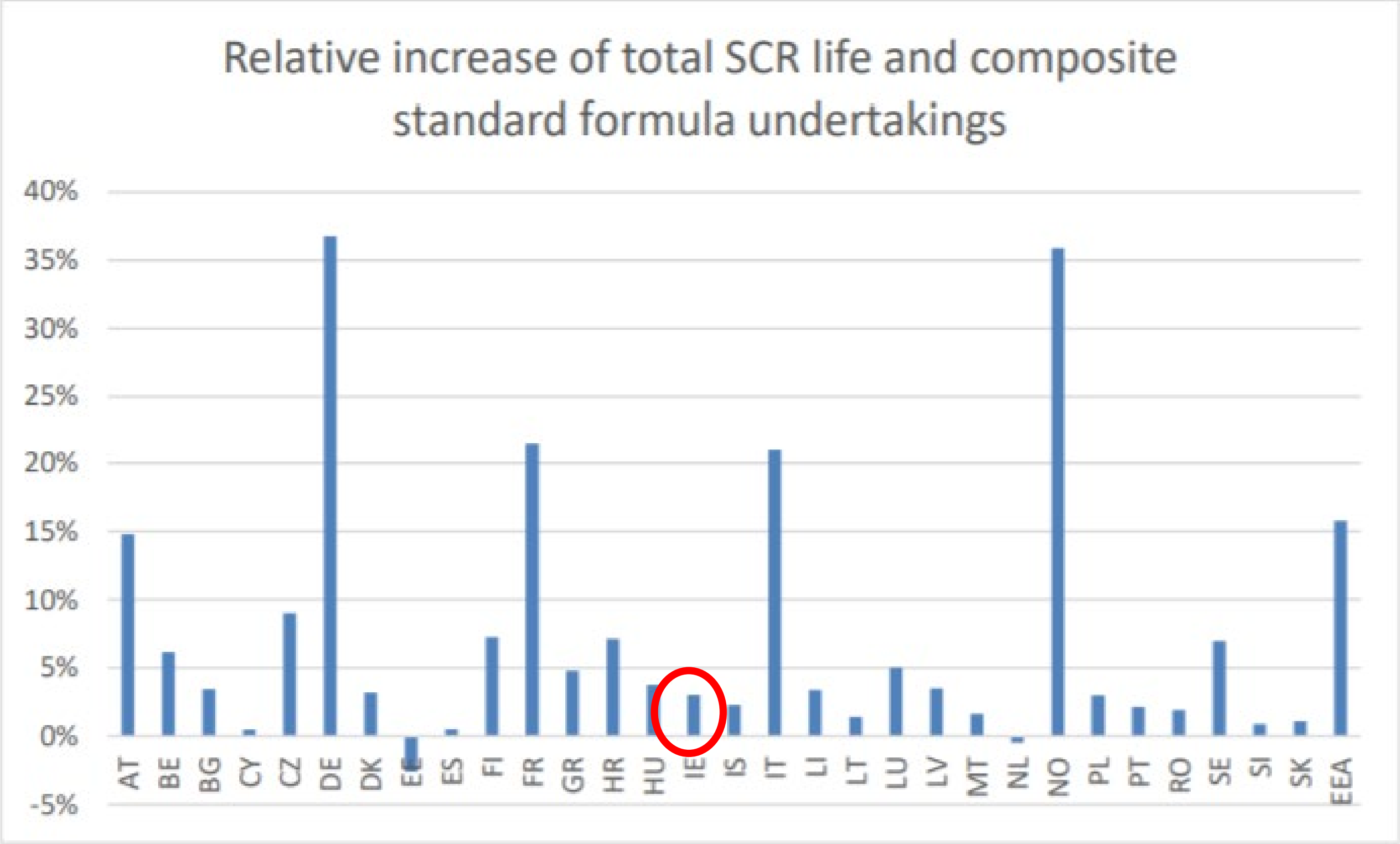
Interest rate risk standard formula SCR shocks under **current** approach at 30 September 2020

Interest rate risk standard formula SCR shocks under **proposed** approach at 30 September 2020

(consistent with that proposed in the consultation and with EIOPA's previous advice to the EC under the 2018 interim review that the EC chose not to implement at that time)

EIOPA is proposing that this change should be phased in over a period of 5 years

SCR interest rate risk - impact



- The increase of the overall SCR for life and composite undertakings in different markets is shown in the chart
- The **increase of the SCR** for all EEA **standard formula life and composite** undertakings is **17%**
- (The proposal has a negligible impact on non-life and reinsurance undertakings)

SCR – other changes

Correlations

- Correlation parameter between falling interest rates and spread risk reduced from 0.5 to 0.25.
- The impact assessment shows that the SCR reduces by 5% for EEA standard formula life undertakings as a result of this change.

Equity risk

- EIOPA is proposing widening the symmetric adjustment corridor for the equity risk capital charge from +/- 10% to +/- 17%

Counterparty default risk

- Simplified calculation of the risk-mitigating effect of derivatives, reinsurance, special purpose vehicles and insurance securitisations

Risk Mitigation Techniques

- Some amendments to the recognition of risk mitigation techniques

Proportionality

General

- Increase the **threshold** for exclusion:
  - Technical provisions of €25 million or less doubled to €50 million
  - Gross written premium of €5 million or less unchanged with member state option to increase up to €25 million
- Introduce concept of **low risk profile undertakings** that meet the following criteria:
  - No more than 5% of gross written premium outside **home country**
  - Accepted **reinsurance** no higher than 50% gross written premiums
  - Gross **TPs** no higher than €1 billion for life and €100 million for non-life
  - Gross SCR for interest rate risk / Gross TPs < 5% (life)
  - Investment returns > guaranteed rates (life) and combined ratio < 100% (non-life)
  - Marine, Aviation and transport or Credit and Suretyship lines of business < 30% gross written premiums
  - Non traditional investments < 20% total investments
- A **notification** should be provided by undertakings to supervisors if they believe they comply with the low risk criteria including an early identification of any of the proportionality measures it intends to apply (except for Pillar 1)
- For undertakings that are not low risk but wish to avail of proportionality measures, an **approval process** applies.

Proportionality

Pillar 1

No approval necessary, only ex post reporting:

- Prudent **deterministic** valuation allowed instead of stochastic for asymmetric options & guarantees if certain criteria are met including low risk profile undertakings criteria.
- Simplified calculation of immaterial **SCR modules** and submodules (excluding market risk) if < 5% BSCR. Calculated as undertaking specific volume measure by risk factor subject to a maximum of the last calculated value of that SCR component.

Pillar 2

For low risk profile undertakings or subject to supervisor's consent:

- Combinations of **key functions** are permitted (except the internal audit function) and combinations of key function holders and Board members are permitted
- A **regular ORSA** can be provided every two years (and following any significant change in risk profile) instead of every year
- **Written policies** may be reviewed at least every three years instead of every year
- The variable component of **remuneration** is not subject to the deferral requirement (if it is less than one third of total remuneration and doesn't exceed €50,000)

Pillar 3

- Amendments to the Quantitative Reporting Templates (**QRTs**) as follows:
  - Review **risk-based thresholds**
  - Simplify the **quarterly** submission
  - Delete and simplify some QRTs
- Allow for the exemption of **group reporting**, without the condition of exemption for all solo undertakings belonging to that group.
- (Note some additions to reporting also.)

Pillar 2

Pillar 2

Macroprudential policy

- Supervisors granted measures following sector-wide shocks, including restricting or suspending **dividend** payments.
- Supervisors given power to set **capital surcharge** to address systemic risk. EIOPA to draft guidelines on procedures to trigger, set, calculate and remove the capital surcharge for systemic risk.
- Undertakings should include macroprudential considerations and potential sources of systemic risk in the **ORSA**. Supervisors should use ORSAs to aggregate information on sources of systemic risk.
- **Prudent person principle** expanded to take into account macroprudential concerns (such as risk related to the credit cycle and economic downturn).

SRMP & LRMP

- Supervisors given power to require systemic risk management plans (**SMRPs**) from certain undertakings. EIOPA to issue guidelines to specify the undertakings in scope.
- EIOPA to issue guidelines on the operational details of a potential **liquidity risk framework**.
- All undertakings required to draft liquidity risk management plans (**LRMPs**) for identifying and addressing potential liquidity stresses. EIOPA to issue guidelines to specify when undertakings could be exempted.
- Supervisors given power to temporarily **freeze redemption rights** of policyholders of undertakings affected by a significant liquidity risk as a last resort measure in exceptional circumstances. EIOPA to issue guidelines to further specify “exceptional circumstances”.

Recovery & Resolution

- **Trigger for recovery** is non compliance with SCR
- **Pre-emptive recovery plans** required for a very significant share of market
- **Supervisors** given preventative measures:
  - Intensive dialogue and regular meetings
  - Additional or more frequent reporting
  - Specific timeframe to implement measures set out in the pre-emptive recovery plan
  - Limit variable remuneration and bonuses
- **Triggers for resolution** should be introduced at EU level and should include:
  - Undertaking is no longer viable or likely to be no longer viable and has no reasonable prospect of becoming so
  - Possible recovery measures have been exhausted
  - A resolution action is necessary in the public interest
- **Administrative resolution authority** to develop resolution plans and conduct resolvability assessments in a pre-emptive manner. Minimum set of **resolution powers** such as:
  - Withdraw authorisation
  - Sell / transfer shares / assets
  - Restrict / suspend policyholder rights
  - Prevent / recover variable remuneration

Pillar 3

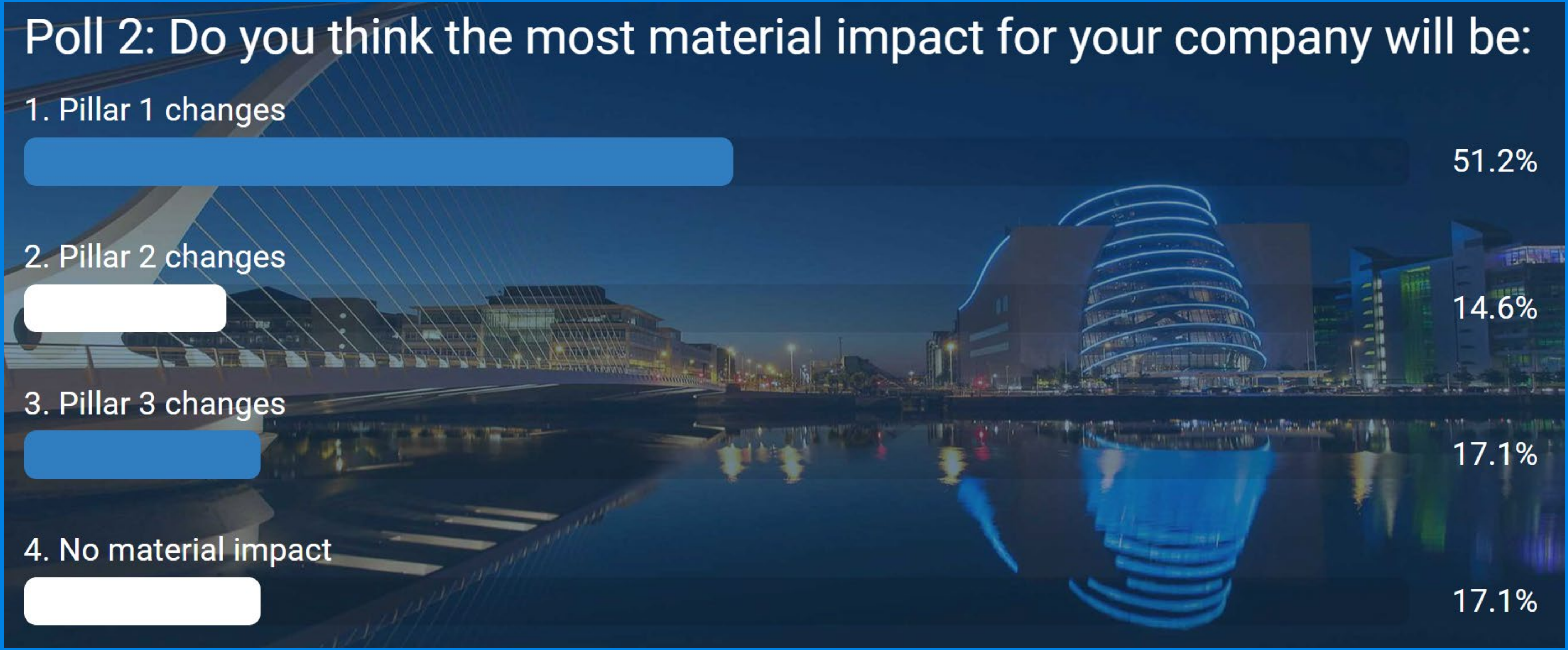
Reporting & Disclosure

- **External audit** of the SFCR covering the Solvency II balance sheet at a minimum, with the option for each member state's supervisor to also include the SCR and eligible own funds.
- Increase **deadline** for solo SFCR from 14 weeks to 18 weeks (to allow for new audit requirement). Increase deadline for group SFCR from 20 weeks to 24 weeks. (4 week extension increased from 2 weeks proposed in consultation)
- **Structure** split into 2 parts: one part addressed to policyholders (not required for reinsurers or captives) and the other part addressed to professional users
- Undertakings in scope for financial stability QRTs are required to include **sensitivities** in the SFCR as follows:
  - Equity markets +/- 25%
  - Risk free interest rates +/- 50 bps
  - Credit spreads of fixed-income investments +/- 50 bps
  - Property values+/- 25%
- **Additional information** on sustainability risks, environmental, social and governance factors and climate change issues, and LTG related information.
- Simplifications to the derivatives and technical provisions **templates**. New information in relation to cross-border business, cyber risk and product splits in S.14.

Poll 2: Do you think the most material impact for your company will be:

1. **Pillar 1 changes**
2. **Pillar 2 changes**
3. **Pillar 3 changes**
4. **No material impact**

Poll 2 Results



Other

Other proposals

Insurance Guarantee Scheme

- Minimum set of harmonised features
- **Home country** principle (pays EU level for EU LoBs & host tops up if necessary)
- Funded by **ex-ante contributions** by insurers, possibly complemented by ex-post funding arrangements in case of capital shortfalls
- Pay compensation and / or ensure **continuation** of insurance e.g. by portfolio transfer

Other

- FoS and FoE
- F&P
- Groups

Thank you

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Regulatory response to Climate Related Risk

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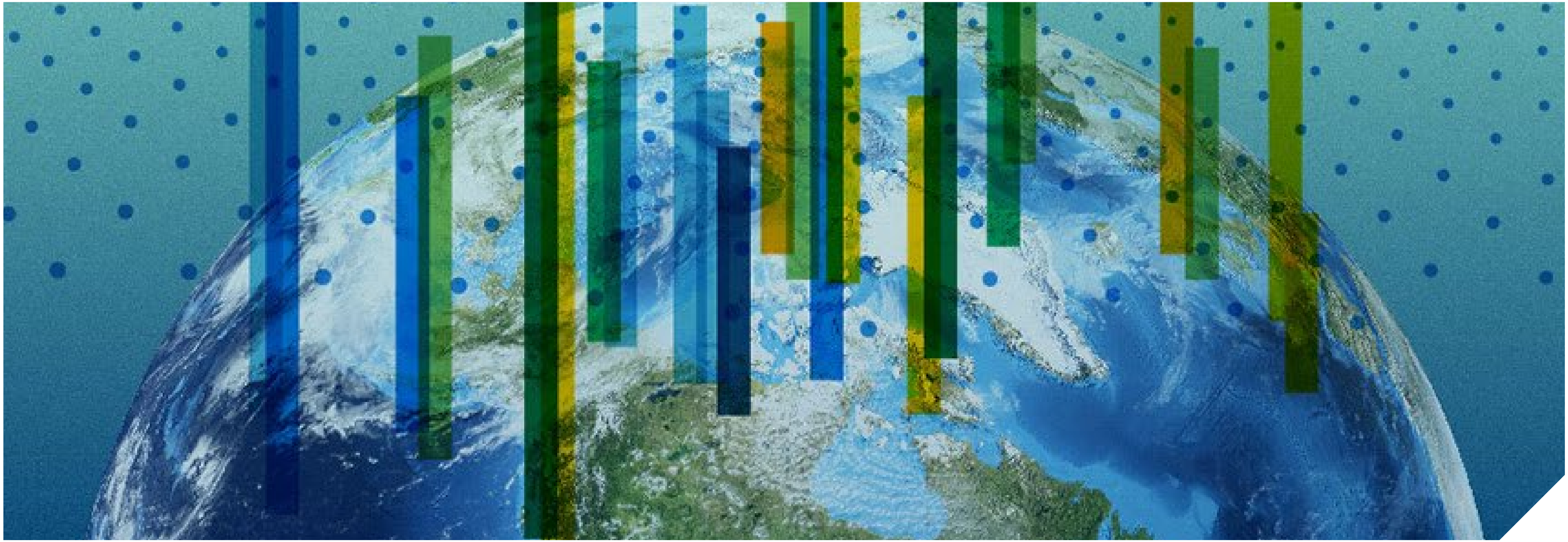
Sinéad Clarke

25 MARCH 2021



What is "climate-related risk"?

RISK	DEFINITION
Physical risk	Physical risks are risks associated with the **direct impact of climate change**. Physical risks can be divided into two further categories, **acute** and **chronic**. • Acute physical risks are event-driven, including increased severity of extreme weather events such as cyclones, hurricanes, or floods. • Chronic physical risks arise from longer-term shifts in climate patterns, e.g. sustained higher temperatures that may cause rising sea levels or heatwaves.
Transition risk	Transition risks arise from the **transition to a low-carbon, greener economy**. This transition could result in large changes in value of certain assets or higher costs of doing business. Regulation and reputation risks can also arise as a result of this transition.

Why is climate related risk different?

- **We can't look to the past to inform the future.**

  Historical data is rarely relevant: metrics must be forward-looking in order to capture the evolving nature of climate risks.

- **High level of uncertainty.**

  Huge uncertainty associated with probability and likelihood. Future development will more than likely be driven by political decisions.

- **Climate change is an emerging risk, where best practice is developing.**

  We might not be able to align risk exposure with risk tolerance immediately.

- **Time horizons matter.**

  Some risks may be long term in nature, but the political landscape and consumer sentiment can change suddenly.

Poll 1: How was climate-related risk treated in your company's ORSA in 2020?

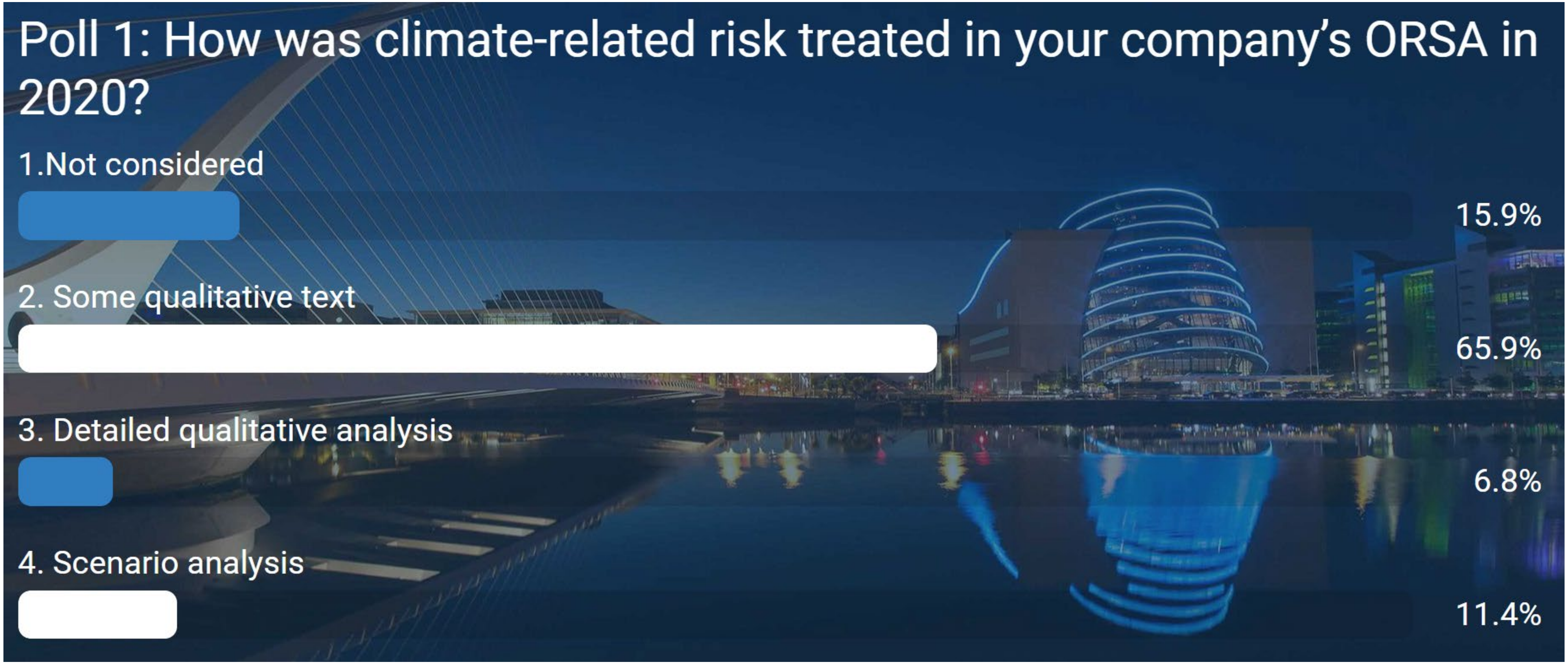
1. Not considered

2. Some qualitative text

3. Detailed qualitative analysis

4. Scenario analysis

Poll 1 Results



What is the regulatory response?

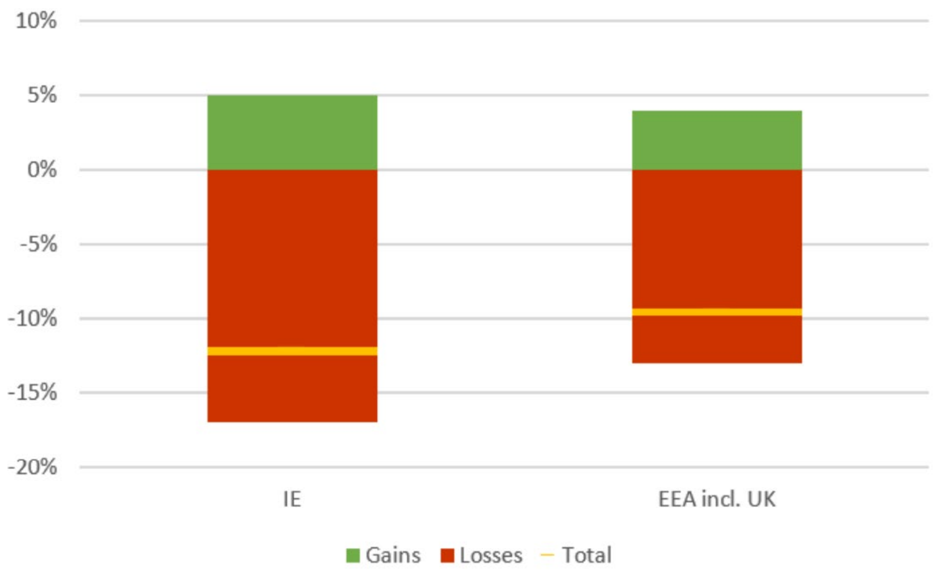
Central Bank of Ireland

Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

- February 2021, Ed Sibley, Institute of Directors:

  “You can expect the Central Bank to become increasingly active and intrusive in its approach to the supervision of climate change risks. Action is required by us all now."

- March 2021, Sustainable Insurance section of CBI’s Insurance Newsletter:
  - Provided some detail from EIOPA’s initial assessment of the sensitivity of the European Insurance Industry to transition risks.
  - Irish insurers have high exposure to potential gains (e.g. green energy exposures) and potential losses (e.g. oil production), with a net position below the European average.
- September 2020, the CBI issued a Climate & Emerging Risk Survey to the insurance sector.



Source: Insurance Newsletter - March 2021 (centralbank.ie)

What is the regulatory response?

Bank of England and the Prudential Regulation Authority

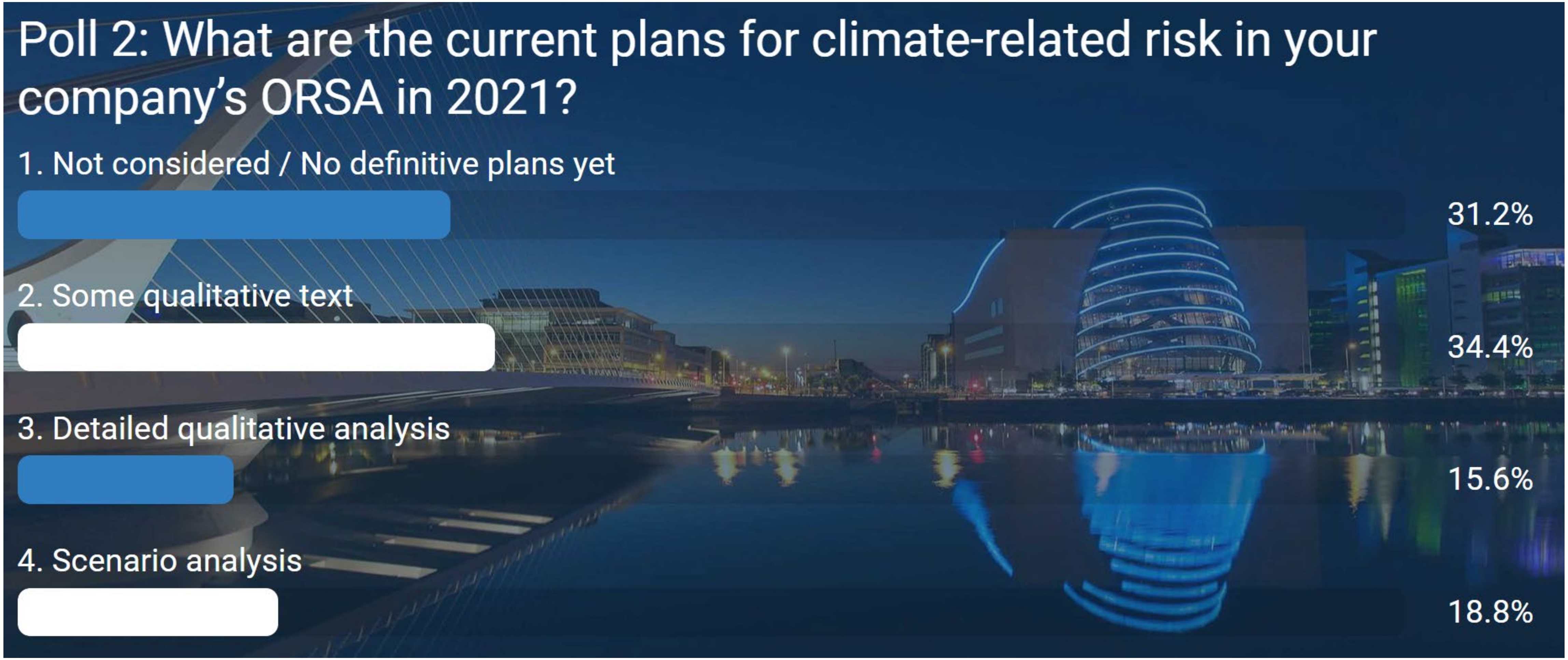
BANK OF ENGLAND

- March 2019, the PRA and Financial Conduct Authority hosted the first meeting of the jointly established Climate Financial Risk Forum (CFRF).
- The PRA issued Supervisory Statement in April 2019 (SS3/19), setting out the following expectations for insurance companies and banks:
  - Appoint a “Senior Manager” to take lead responsibility for climate change risks
  - Include climate change risks within their governance framework
  - Formally consider climate change within their risk management framework
  - Conduct regular scenario analysis covering a range of timescales
  - Disclose information about climate change risks
- The BoE’s biennial exploratory scenario (BES) to explore the financial risks posed by climate change will be launched in July 2021.

Poll 2: What are the current plans for climate-related risk in your company's ORSA in 2021?

1. Not considered / No definitive plans yet
2. Some qualitative text
3. Detailed qualitative analysis
4. Scenario analysis

Poll 2 Results



What is the regulatory response?

EIOPA

European Insurance and Occupational Pensions Authority

- Sustainable Finance Agenda – priority for 2021
  - Papers and consultations on inclusion of climate related risk in Solvency II framework

- Consultation paper on ORSA proposes that supervisors require (re)insurers:
  - To integrate climate change risks in their system of governance, risk-management system and ORSA
  - To assess climate change risk exposures in the short term
  - To also assess the longer-term risk of climate change, using forward-looking scenario analysis

- EIOPA papers provide guidance on how to develop climate risk scenarios for the ORSA

What to do next?

Education – learn about climate related risks and exposures.

Look at your balance sheet – where are the climate related risk exposures?

Begin to incorporate climate-related risks into risk management system.

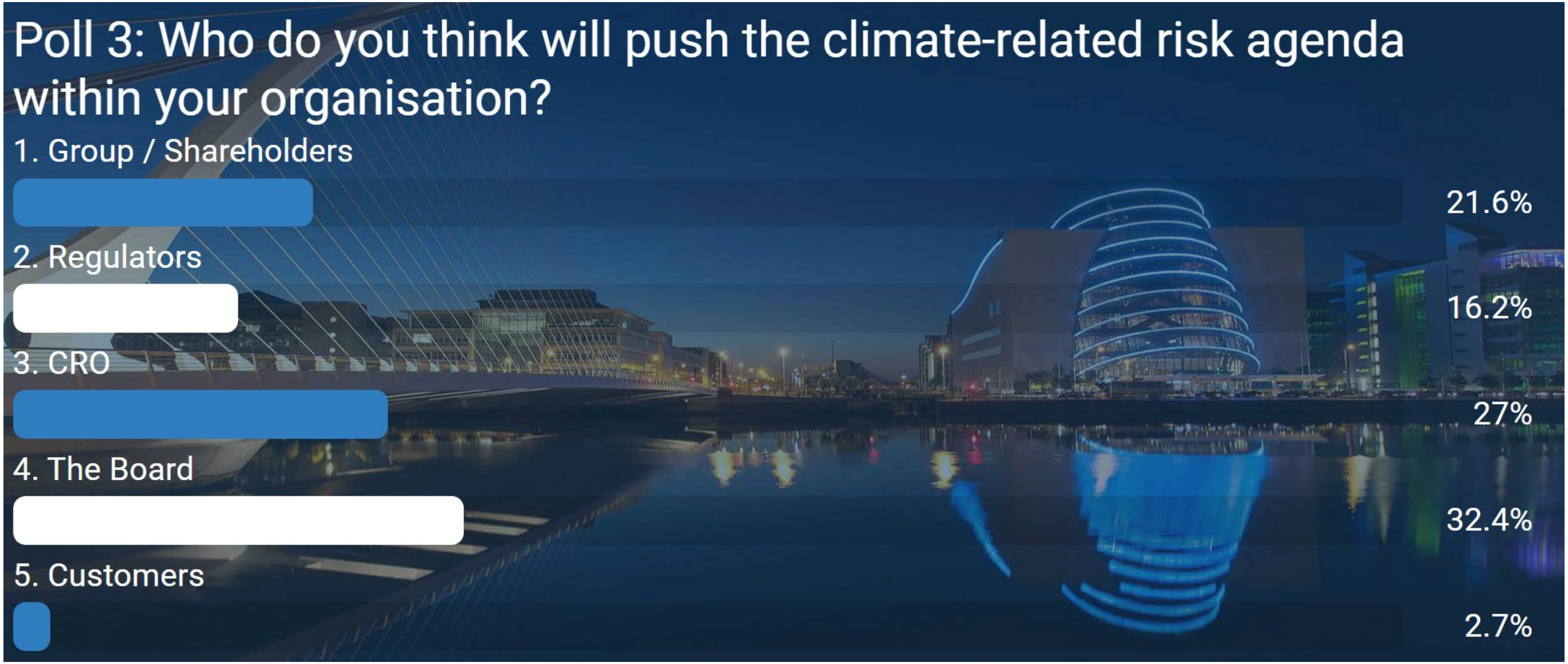
Develop appropriate climate related risk scenarios for ORSA.

What about the Prudent Person Principle (PPP) under Solvency II?

Poll 3: Who do you think will push the climate-related risk agenda within your organisation?

1. Group / Shareholders
2. Regulators
3. CRO
4. The Board
5. Customers

Poll 3 Results



“The thing about climate is that you can be overwhelmed by the complexity of the problem or fall in love with the creativity of the solutions”

Mary Heglar – Climate Justice Writer

Thank you

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