



Jonathan Faull  
Director-General  
DG Internal Market and Services  
EUROPEAN COMMISSION  
Rue de Spa 2 - 02/056  
B-1049 Brussels

Gabriel Rodrigo R. Tavares Bernardino  
Chairman of EIOPA

Frankfurt, 14 March 2011

**Subject:** EIOPA QIS5 Report

Dear Mr. Faull, *Dear Jonathan,*

With the publication of the report on the fifth quantitative impact study (QIS5), EIOPA has successfully carried out a fully comprehensive assessment on the functioning of the upcoming Solvency II regulatory framework and its implications, in particular by providing the Commission with the requested quantitative input to the finalisation of its proposal on level 2 implementing measures.

QIS5 has been the most exhaustive test for Solvency II, with an **impressive participation** rate of 68%, surpassing the very ambitious target that your Services set in your letter dated 5<sup>th</sup> July, 2010. Furthermore, all 30 EU and EEA countries have participated, with a quantum leap in terms of participation of SMEs, more than doubling the level of QIS4. Such a successful outcome has been only possible thanks to the good cooperation of Industry and Supervisors.

QIS5 will also be the **last fully comprehensive test** to take place before the implementation of Solvency II. Additional testing to further improve the framework will take place through ad hoc work dealing with the specific areas for improvement to be assessed. It has at the same time been the first QIS led by EIOPA.

The outcome of the study provides with a clear indicator of the **general support** to the **design** of the system, and the role that the two levels of intervention settled, a trigger level named the Solvency Capital Requirement (SCR), and a hard target level, the Minimum Capital Requirement (MCR), have to play. Volatility has been underlined as an issue by stakeholders, and EIOPA fully acknowledges its relevance both with regards to technical provisions and SCR. While pillar 1 and 2 dampeners embedded in the legislation, together with the flexibility in terms of supervisory response provided by the ladder of intervention, with enhanced disclosure and transparency on top, provide with a sound and consistent approach towards the issue, EIOPA will further examine this issue and its implications.

1

Your letter underlined, and EIOPA is fully committed towards, the importance of a feasible system, that can be applied by all undertakings affected. QIS5 has been an excellent basis to identify areas where **complexity** should be reduced. EIOPA has reflected them in the report, and is looking forward to work to enhance practicability and **feasibility** of the framework, in particular with regards to SMEs. There is work pending in this area, that should start without delay.

QIS5, based on data of year end 2009, clearly shows that the insurance industry has **sustained well the crisis**, yet has suffered from it, with a decrease of the surplus (Solvency I data) close to 20% when compared to year end 2007. Solvency buffers built in have allowed the insurance industry to remain in general in a compliant solvency position after a severe financial crisis. This factual information supports the **need of risk-based supervision**.

The study also confirms that the sector, under Solvency II-tested rules, remains **well capitalised**, with €395bn of eligible elements above the SCR and €676bn above the MCR. Regardless of this, and in line with what happened in QIS3 and QIS4, there are a number of undertakings that show a solvency ratio below the SCR and the MCR.

At the same time, QIS5 results show a reduction of the existing surplus under Solvency I rules that, taking into account necessary adjustments to allow for the comparison, accounts for 15% of the existing surplus at the solo level. At the group level, two main aspects need to be underlined: firstly, for third country operations, the difference between applying the deduction-aggregation method using local rules vs. the accounting-consolidation method; secondly, the sample of groups using internal models would display a surplus under Solvency II, which is higher than the current one under Solvency I.

You asked us to collect evidence that would help improve the **calibration**, to ensure meeting the confidence level of 99.5% set in the level 1 Framework Directive. QIS5 shows that, while the calibrations in the system are in general accepted as appropriate by supervisors and industry, additional work needs to be carried out in particular in the areas of non-life and catastrophe modules to improve the calibrations. May I inform you that EIOPA, together with the industry, is already actively working in the two aforementioned areas and the outcome of such work will follow shortly, in time to improve the level 2 work.

The incentives embedded in the Solvency II framework to enhance **diversification** work well in practice, accounting for €466bn (more than 35% of the sum of SCR modelled risks). This is also the case when it comes to group diversification, with an additional benefit of 20% as weighted average on top of the sum of the solo SCRs.

Among the main objectives of Solvency II, your Services have always referred to the enhanced **consistency and comparability** that it will bring to the European insurance sector. EIOPA fully supports that approach and the benefits of it, and considers that further work has to continue in order to ensure it. In particular, additional work with regards to the definition of contract boundaries and the relevant developments in IFRS 4, or the way to value deferred taxes is paramount to come with a system that allows for comparable technical provisions.

The call for advice indicated some areas where information had to be collected in order to assess different approaches tested:

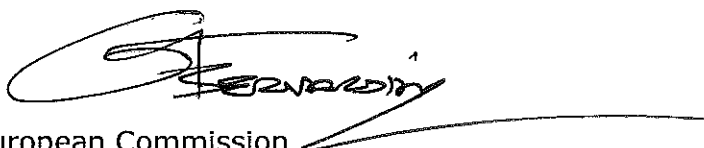
- **Illiquidity premium:** the impact of it, tested for the first time in QIS5, accounts for 1% of the overall technical provisions (equivalent, in life, to half of the total risk margin). At the same time, EIOPA considers appropriate to provide with guidance with regards to how to allocate products in the buckets, or get back to the proposal of a binary approach 0%/100%.
- **Risk Margin:** this is one of the areas where the full approach tested has demonstrated to be overly complex. EIOPA considers that further work to ensure consistency is needed with regards to the simplifications tested.
- **Expected profits included in future premiums (EPIFP):** The QIS5 specification as proposed by the Commission sought a quantification of this item as a separately identified element of Tier 1. The QIS5 results underline the fact that EPIFP could be a material component with significant impact on an insurer's solvency contribution. There are differing views on this, but we propose that further work be led by EIOPA in cooperation with industry and European Commission to see if a balanced and workable position could be identified which permits recognition to a prudent degree of EPIFP in Tier 1, taking into account relevant developments in the definition of contract boundaries.

QIS5 has also provided with very useful information with regards to the **transition** from Solvency I to Solvency II: transition should aim at facilitating the implementation of risk-based supervision and avoiding to disrupt the functioning of insurers and the viability of business. Three areas have been identified where it makes full sense to introduce transitionals, namely equivalence with third countries, treatment of hybrid capital and subordinated liabilities and discount rates on technical provisions. But we need not only to provide with transitionals, we also need to do it for the right amount of time. Too little time will not help achieving the aforementioned objectives, but too much time will strongly disincentivise the shift towards Solvency II and risk-based supervision.

I would like to end by indicating that EIOPA is committed to further work in the field of Solvency II, and will do so actively, not only in the areas listed by your Services, but also based upon own initiative identification of areas that can be improved.

Yours sincerely,

Gabriel Bernardino,  
EIOPA Chair



Cc Mr. Karel van Hulle, European Commission  
Ms. Sharon Bowles, Chairwoman ECON, European Parliament  
Mr. Peter Skinner, Rapporteur on Solvency II, European Parliament  
Mr. Csaba Zsarnoczi, European Council, Hungarian Presidency