ISTITUTO PER LA VIGILANZA
SULLE ASSICURAZIONI
IVASS

Supervisory Regulations and Policies Directorate

Rome 3 August 2015

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Encl. No.

To insurance and reinsurance undertakings whose head offices are located in Italy
TO THEIR PREMISES

To their ultimate parent undertakings
TO THEIR PREMISES

To the branches in Italy of insurance and reinsurance undertakings with head office in a non EEA country
TO THEIR PREMISES

Solvency II: calculation of the solvency capital requirement using the standard formula – adjustment for the loss-absorbing capacity of deferred taxes

Foreword

1. Pursuant to article 103 of Directive 2009/138/EC, the *Basic Solvency Capital Requirement (BSCR)*, obtained by the aggregation of the capital requirements for Standard Formula macro-risks is corrected by adjustment for the loss-absorbing capacity of deferred taxes.

2. The calculation of the adjustment in question is governed by article 207 of the Delegated Regulation (EU) 2015/35 of the European Commission.

3. On 2 February 2015, EIOPA published on its website the "Guidelines on the loss-absorbing capacity of technical provisions and deferred taxes" (hereinafter "Guidelines") with the aim of ensuring the common, uniform and consistent application of the rules on the subject.

Regulatory framework

4. The valuation of deferred taxes in *Solvency II* takes place in accordance with article 15 of Delegated Regulation (EU) 2015/35, which requires that undertakings recognise and value deferred taxes in relation to all assets and liabilities, including the technical provisions which are recognised for tax purposes or for solvency purposes in accordance with article 9 of that Regulation.

5. Said article 9 provides that undertakings shall evaluate assets and liabilities of solvency financial statements in accordance with the international accounting standards adopted

by the Commission pursuant to Regulation (EC) No. 1606/2002, provided that those standards include valuation methods that are consistent with the valuation approach set out in article 75 of Directive 2009/138/EC.

6. The guidelines, issued by EIOPA pursuant to art. 16 of EU Regulation No. 1094/2010 (the so-called EIOPA Regulation), contain application recommendations on the approaches to be followed for the calculation of the adjustment, with reference both to individual undertakings and insurance groups.

7. To calculate the adjustment, undertakings must measure the change in value of deferred taxes that would result from the instantaneous loss referred to in article 207 of Delegated Regulation (EU) 2015/35 of the European Commission.

8. The EIOPA guidelines make clear that undertakings using the Standard Formula must allocate that loss to its causes with a level of granularity that, for the purposes of the calculation of deferred taxes, is defined according to current tax systems and must determine their impact on the value of deferred tax assets recognised in the solvency balance sheet.

9. The guidelines provide, in fact, that in determining the level of granularity, undertakings may use one or more average tax rates provided that they reflect applicable tax regulations and that the approach used does not result in significant errors in the calculation of the adjustment.

10. Notional deferred tax assets, i.e. the possible increase in deferred tax assets or the possible decrease of deferred tax liabilities that would be generated as a result of the loss referred to in article 207 of the Regulation, cannot be used for the adjustment, unless undertakings are able to demonstrate the probable existence of sufficiently ample future taxable profits.

11. To this end, the EIOPA guidelines provide for the prohibition of "double gearing": future taxable profit amounts that are "used" to demonstrate the recognition of deferred tax assets on the *Solvency II (before stress)* balance sheet cannot be "used" for the purpose of demonstrating the existence of future taxable profits in the *after-stress* situation.

12. A first step in testing for the existence of taxable profits in the *after-stress* situation, and therefore the eligibility of the adjustment, is to verify the capacity of the net deferred tax liabilities in the of *Solvency II (before stress*) balance sheet.

13. An undertaking may admit the existence of an adjustment beyond the condition mentioned in paragraph 12 if it demonstrates convincingly of having, in an *after-stress* situation, ample and suitable alternative future taxable profits.

Request for information

14. Taking into account: i) the complexity of the evaluations underlying the calculation of the adjustment; ii) the high degree of discretion in the definition of assumptions and calculation approaches; iii) the heterogeneity in the adjustment amounts submitted by the Italian undertakings in previous impact studies conducted by EIOPA, the following information must be submitted to IVASS in support of the adjustment data for the loss-

absorbing capacity of deferred taxes submitted to IVASS in response to the letters to the market of 4 December 2014 and 30 March 2015:

a. the value of the notional deferred tax assets at 31 December 2014 and the description of the method used for calculating them;

b. the description of the mechanism used for the allocation of the loss referred to in article 207 of Delegated Regulation (EU) 2015/35 to its causes (items or capital requirements for modules/sub-modules of the solvency balance sheet);

c. an indication of relevant tax rates applied and, in the case of use of one or more average tax rates, the criteria by which they were determined;

d. the existence of any arrangements for the transfer of profits or losses that determine changes in the valuation of notional deferred taxes;

e. valuations that demonstrate the eligibility of the part of *notional deferred tax assets* that determines the adjustment for the loss-absorbing capacity of deferred taxes as at 31 December 2014. In detail:

   i. the documented evidence of any offset against deferred tax liabilities recognised in the solvency balance sheet (before stress);

   ii. where an approach is used based on future taxable profit estimates other than the amounts referred to in point i), the documented evidence of methodological approaches, time horizon and macroeconomic assumptions used for the projection, defined in accordance with the underlying loss scenario.

f. evidence of possible methodological differences compared with the approach used for the recognition of deferred tax assets in the solvency balance sheet (before stress).

g. when relevant, the evidence of the calculation methods and approaches used for calculating the adjustment at group level.

Analysing the information will allow an evaluation of the need for the possible extension of the rules in this field.

15. The above information is required to be submitted to IVASS by 30 September 2015, by e-mail to DATILAC@ivass.it, using the special annexed table

Regards

by Delegation of the Joint Directorate
Director