

To: Mr Olivier Guersent  
Director General  
DG Financial Stability, Financial Services and Capital Markets Union  
European Commission

CC: John Berrigan, Deputy Director General  
Nathalie Berger, Head of the Insurance Unit

Your  
reference:  
Our  
reference: ECO-19-026

Subject: Views of the insurance industry on the EC request for technical advice on the Solvency II Directive review

Brussels, 22 March 2019

Dear Mr. Guersent,

On behalf of the European insurance industry, we would like to share Insurance Europe's first views on the European Commission's recent formal request to EIOPA on the review of the Solvency II Directive. At this early stage, we have identified a number of issues that we wish to raise with you and that impact EIOPA's work. Our intention is to write to you again in the near future on a broader set of elements of the review.

Firstly, we would like to emphasise the importance of this review for the insurance industry. It is a key opportunity to **improve the design and calibration** of the framework. Solvency II is today the most sophisticated risk-based regime in the world and we remain fully committed to the risk-sensitive nature of the framework. However, improvements are needed to address its overall excessive conservativeness and the particular areas that do not work as intended or have given rise to unintended consequences in areas such as the products insurers offer and investment.

Improvements are needed to **support and enhance European insurers' role in Europe's society and economy and our competitiveness internationally**. We welcome the increasing recognition that the Commission has given in recent years to the industry's role in the society. This includes the protection of citizens, businesses and organisations, the provision of long-term savings and pensions, as well as significant investment capacity that supports the European economy and its long-term and sustainable growth. The nature of insurers' business model also allows us to contribute to financial stability during a crisis, rather than to amplify risk.

Against this background, **the review should definitely not lead to an increase in the capital burden placed on the European industry**.

Secondly, we wish to highlight five key areas that require your attention at this stage:

1. Volatility and matching adjustment

**We strongly support substantial improvements in the volatility adjustment mechanism and enhancements to the matching adjustment mechanism. We do not believe that a single adjustment mechanism would be achievable in a way that reflects the variety of product design and risk management strategies in EU member states – both adjustments have a critical role to play.**

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Improvements should focus on 1) better reflecting insurers' actual ability to earn meaningful risk premiums above risk-free rates and 2) avoiding artificial balance sheet volatility. The effectiveness of improvements should be tested against normal and stressed market conditions in all currencies and member states.

2. Determination of the risk-free interest rate term structure

**We do not believe any major changes are needed to the current design or calibration of the risk-free interest rate structure.** In light of the Commission's call for advice, the insurance industry notes that 1) it is important that EIOPA's testing of alternative levels for the last liquid point involve both an increase (eg 30 year for EUR) and a decrease (eg 15 year for EUR) in this parameter, to ensure the full range of market situations is covered and 2) the appropriateness and impact of the methodology to derive the UFR should also be assessed.

3. Dynamic volatility adjustment

We believe the dynamic volatility adjustment is a key mechanism that permits the correct measurement of the real economic impact of credit/spread risk. We trust that the Commission will investigate and test this claim and ask EIOPA to consider an **extension of the dynamic volatility adjustment to standard formula users as one of the potential ways forward.**

4. Risk margin

**Beyond the current scope of the call for advice, work on the risk margin should also review its rationale and purpose. We welcome the fact that the review will cover both the design of the risk margin and the calibration of the cost of capital,** and that the call for advice has reflected some of the technical concerns raised by the industry in the 2018 review.

5. Investments in assets supporting the Capital Markets Union

We welcome recognition of the need to review the capital requirements for investments that support European growth. **We want to emphasise the need to be ambitious in this work** and to thoroughly investigate whether Solvency II appropriately measures the actual risks that insurers are exposed to when investing in assets such as equity, corporate bonds and real estate.

While this letter focuses on five, specific areas of the call for advice, we would also highlight the importance and relevance of other areas, including the proportionality and appropriateness of reporting requirements, as well as the need to thoroughly consider all the potential drawbacks of macro-prudential tools, recovery and resolution measures and insurance guarantee schemes.

We are committed to offering our technical expertise, experience and evidence to support the discussions on the 2020 review and look forward to constructive engagement with you and your team.

Yours sincerely,



Olav Jones  
Deputy Director General



Matthew Rider,  
Chairman European Insurance CFO Forum