

Final draft comments on EIOPA stakeholder event on the SII 2020 review

1. General comments

The industry welcomes the opportunity to provide comments following the EIOPA stakeholder event, thereby highlighting the following:

■ **Insurance Europe has strong concerns on EIOPA's approach for a balanced outcome**

EIOPA set as an objective for its advice a so-called "balanced outcome" at year-end 2019. However, EIOPA's current proposals will not result in a "balanced outcome". Instead, they will lead to a significant increase in capital requirements, especially as EIOPA appears to leave out the impact of some of its most negative proposals. Its proposals will also make solvency ratios even more volatile, especially during periods of crisis and will trigger more pro-cyclical behaviour. It is fundamentally wrong to base technical advice on such an objective because it:

- ignores evidence that current requirements are too high and are creating unnecessary barriers;
- does not allow for a proper assessment of evidence or appropriate improvements;
- does not consider the impact of the proposals at other points in time;
- focuses on the impact at overall European level rather than at member-state level;
- does not distinguish between types of undertakings; and,
- completely ignores the EC, Parliament and Council objectives for the review.

■ **Solvency II should not create artificial volatility of solvency positions**

The solvency position of insurers should be sufficiently stable and present a meaningful picture of future prospects. For this, solvency ratios must not be distorted by heavy short-term fluctuations. Artificial volatility of solvency positions forces insurers to hold higher than otherwise necessary levels of capital and could force insurers to behave in a more procyclical manner and with a short-term orientation, contrary to the insurance business model with its long-term illiquid liabilities. Generally, excessive artificial volatility could hinder insurers both from offering products with long-term guarantees for the sake of consumers and from contributing to the long-term funding of the European economy. These multiple adverse effects need to be avoided, in particular by maintaining the stabilising effect of the current extrapolation, improving the VA mechanism and reducing the size and procyclicality of the risk margin.

■ **Capital requirements should be risk based**

Capital requirements should be risk based, an over/underestimation of risks could lead to wrong incentives and, in the consequence, to wrong risk management which could endanger the security and the benefit of policyholders. Overestimation of risks can lead to higher than necessary costs for customers and as well as insurers no longer offering certain products and from investing in certain asset classes at all. Regulation that is overshooting from a risk perspective should be corrected or not be introduced in the first place. Key aspects in this respect are extrapolation, volatility adjustment and interest rate risk.

The industry is concerned that the EIOPA advice, if implemented, will maintain the existing flaws of Solvency II, not appropriately address the identified need for improvement and further deteriorate the competitiveness of the European insurance industry.

Finally, the proposals would significantly limit the industry's ability to provide its full risk-taking and investment capacity to the detriment of the EU economy and society. By that, the EIOPA proposals undermine the aims set by the EU institutions for a sustainable recovery of the EU economy, the further integration of the EU single market for financial services and insurance (as subject to the CMU) and the EU Green Deal.

In consequence, the EIOPA advice will have a substantial impact which goes far beyond the technical advice which the Authority was tasked to carry-out by the European Commission.

2. EIOPA first batch doc ([ECO-SLV-20-218.pdf](#) - COVID-19 revision of advice – First batch)

Own funds buffer for compressed spreads

Insurance Europe strongly rejects EIOPA's proposed Own Funds buffer.

The hypothesis that additional capital is needed to build resilience of the sector against compressed spreads is flawed. Importing the banking countercyclical capital buffer (CCyB) concept into insurance regulation is inappropriate as there is no evidence of any material link between the insurance business and the private debt cycle. Yet, as clearly set out by the Basel Committee, the CCyB '*primary objective is to use a buffer of capital to achieve the broader macroprudential goal of protecting the banking sector from periods of excess aggregate credit growth (...). [It] may also help to lean against the build-up phase of the credit cycle in the first place. In downturns, the regime should help to reduce the risk that the supply of credit will be constrained by regulatory capital requirements (...).*' As a result, the foundations for imposing a CCyB in the insurance sector on top of the SCR are missing. Improvements to the VA mechanism is the right way to mitigate the impact of short-term market spread volatility.

EIOPA's proposed design of the Own Funds buffer is also inappropriate and inconsistent with its proposal on the volatility adjustment (VA); its VA proposals would create additional own funds in periods of compressed spreads which could then subsequently be deemed ineligible by the Own Funds buffer mechanism.

- EIOPA's assertion that the Own Funds Buffer would symmetrically complement the volatility adjustment is incorrect. The purpose of the VA is not to create undue or arbitrary relief in bad times.
- Insurance Europe agrees with the flaws and drawbacks of the proposal which EIOPA has itself set out the document;
 - It would result in double counting of the risk of compressed spreads as it would be accounted for in both the SCR and the Own Funds buffer
 - It would distort the agreed 1-in-200 protection provided by Solvency II
 - It could create an unlevel playing field
 - It increases complexity and reduces comparability

In addition, EIOPA's document suggests that the Own Funds buffer is a step towards mandatory VA. Insurance Europe highlights that it opposes the mandatory application of the VA mechanism.

Symmetric adjustment

Insurance Europe does not support the widening of the corridor of the symmetric equity adjustment.

While recognising the potential merits of such an approach in mitigating equity market volatility, increasing the corridor could actually lead to higher volatility in the capital requirement for equities that will, among others, result in unwarranted disincentives to equity holdings as well as negative implications for the policyholders. For example, this can be the case for insurance companies with large holdings of equities where there is significant basis risk to the EIOPA Equity index.

Instead of widening of the corridor, the application of the symmetric equity adjustment should be made optional, especially for undertakings for whom it does cause significant basis risk.

Transitionals on RFR

Insurance Europe supports the continued application of the transitional measures as foreseen as in the Directive.

- The transition to Solvency II was expected to and has shown to take time for some companies, particularly in life insurance where the contracts are long-term. Not to have the possibility to use the transitional measures if necessary, could turn out to be very disadvantageous, especially for customers, e.g. in terms of profit sharing.
- Prematurely terminating the possibility for new transitional applications would impair the level playing field.
- EIOPA has previously correctly acknowledged the macroprudential role of transitionals, which can mitigate systemic risk. This means that the possibility to newly apply for the transitional could also be helpful in crisis situations. There is no reason to limit such an effect to existing applicants.

3. EIOPA's second batch document ([ECO-SLV-20-220.pdf](#) - COVID-19 revision of advice - Second batch EIOPA's)

Extrapolation

Insurance Europe supports the retention of the existing Smith Wilson extrapolation approach and parameters.

EIOPA's analysis of the impact of its proposals, sourced from the holistic impact assessments, show that its proposals would

- 1) unnecessarily increase liability valuations for long-term liabilities; and
- 2) increase artificial volatility and procyclicality within the framework.

EIOPA has not presented any new evidence of the need to change the extrapolation methodology and Insurance Europe continues to consider the issues of underreserving, risk management incentives and financial stability raised by EIOPA to be significantly overstated. These do not justify the significant and disruptive reductions in, and increased volatility of, available own funds which would be the result of these changes.

Insurance Europe firmly believes that the existing criteria governing the LLP (ie the bond criterion) must be maintained. EIOPA's updated analyses of the three criteria fail to present any justification for changing the last liquid point for the Euro from 20 years.

- EIOPA do not provide a DLT assessment of the bond markets, nor the matching criterion.
- EIOPA's analysis of the residual volume criterion continues to support an 20 year LLP for the Euro.

Currently, bond and swap markets both have to be deep and liquid. For non-extrapolated maturities, insurers must be able to match their obligations with bonds. The main reference to the bond market best reflects reality and must be maintained.

Solely looking at swap markets would be inappropriate. The current net volume of the swap market is far too low to cover the long-term European insurance obligations.

Looking at the bond market, liquidity has not increased since the specification of the LLP for the euro in the Omnibus II Directive (bid-ask spreads, trading volumes, and trading book inventories point to a stable or even decreased liquidity). EIOPA's analysis of the matching criterion showed an LLP of 15 years although it implicitly assumed that insurers are the only buyers of bonds. The ratio of bonds available on the market (excluding the volume permanently withdrawn by the ECB) to technical provisions in Europe has significantly fallen. The residual volume criterion also confirms a lower LLP. Hence, the established criteria clearly rule out an increase of the LLP and suggest a reduction instead.

If extrapolation – contrary to the criteria – nevertheless starts later, non-meaningful data from markets that are not sufficiently deep and liquid can lead to distorted long-term valuations and artificial volatility of solvency positions. If interest rates used for the calculation are doubtful or volatile, the present value of insurance payments that will be due decades in the future gets doubtful and very volatile, too. This could lead to strong fluctuations of technical provisions, own funds and capital requirements. Even if these results didn't provide robust information, procyclical reactions of undertakings or supervisors might be triggered. Therefore, the LLP for the euro should not be increased.

The proven Smith-Wilson extrapolation method should also be maintained. Changing the method is unnecessary and would require a completely new balance of requirements and parameters (in particular regarding liquidity criteria and convergence speed).

Insurance Europe further highlights the need to assess the impact on non-euro currencies which may also be severely affected by EIOPA's proposals.

Finally, it should be noted that there are already a number of elements in place to cover the risk that interest rates stay low for a very long-term and ensure that companies and supervisors are well equipped to manage such an eventuality:

- The current risk-free rates are applied until the last liquid point
- The updated UFR methodology provides a mechanism which if applied for the coming years will lower the extrapolated rates every year
- There is an interest rate down shock SCR (which will be increased to allow for negative rates and) which means that capital is held for even lower rates
- Low for long stress tests are done regularly (every three years now) and provide information to ensure the impact of such scenarios can be understood

MA

Insurance Europe supports EIOPA's proposal to remove the restrictions on diversification between MA and non-MA portfolios in the standard formula.

- It agrees that the analysis presented by EIOPA does not justify a change in the fundamental spread and, if anything, demonstrates the high level of prudence inherent in the fundamental spread methodology.

VA

Insurance Europe supports improvements to the VA that result in the following necessary outcomes:

- A. There is a general increase in the level of the VA to properly reflect the ability of insurers to earn returns above risk-free rates.**
- B. The VA provides increased mitigation of artificial balance sheet volatility.**

While EIOPA's proposal on the VA does contain a number of important improvements, these are offset by its detrimental proposals on the risk correction and liquidity application ratio.

EIOPA's proposals on the option 7 country component, the inclusion of a rescale parameter and the recognition that the GAR should be increased are welcomed. The inclusion of these improvements would go a long way to achieving the necessary outcomes detailed above.

However, Insurance Europe continues to reject the proposed change to the risk correction because it would increase the procyclicality of the framework and make the VA less effective,

- The current design of the risk correction prudently addresses the expected downgrade and default risks of holding fixed income investments for long-term liability driven investors.
 - Unexpected default losses are covered by capital requirements for spread risk module and must not be double counted.
- EIOPA's analysis of the fundamental spread in the MA section (consistent with its previous analysis in the LTG Reports) supports the industry view that the risk correction is sufficiently prudent to address downgrade and default risks.
 - Academia does not support EIOPA's hypothesis that the level of the spread is linked to the default rate. EIOPA's references to academic literature are misleading in this respect.

EIOPA's proposed liquidity application ratio is also ill conceived and detrimental to the justified mitigation of artificial spread volatility.

- The VA is used to value the best-estimate of the liabilities. The inclusion of a liquidity application ratio introduces an element of stress valuation into the BEL which is unjustified and creates double counting of the risk (as it is already accounted for in the SCR eg. for lapse risk).
- The existing VA provisions require companies to prepare a liquidity plan and to demonstrate they are not exposed to forced sales. These provide sufficient evidence that the liquidity profile allows the VA to be earned. The COVID experience has evidenced this to be the case.
- Any liquidity assessment should be done as part of Pillar 2 and 3 and cannot in any case only include assessment of the liability features but is only meaningful if it includes mitigating factors and sources of liquidity as EIOPA's own paper on liquidity stress testing makes clear.

Furthermore, the arbitrary 65% haircut should be abolished.

Insurance Europe welcomes EIOPA's back testing of the VA during different market conditions and supports similar analysis to ensure that policy proposals do work as intended during different economic environments. It provides the following observations.

- The analysis demonstrates that EIOPA's proposed VA is less effective in a period of extreme corporate bond stress (eg 2008/2009) unless an undertaking has a 100% liquidity and 100% duration ratio.
- The improvements deriving from the Option 7 country component are diminished when the liquidity adjustment is imposed and are only relevant for non-euro currencies in any case.
- Insurance Europe analysis shows that the impact of the proposed risk correction also reduces the benefits of the Option 7 country component and other improvements.

DVA

Insurance Europe supports maintaining the current dynamic VA for internal model users, without changes, and allowing the dynamic VA to apply in combination with the existing spread risk charges for standard formula users.

The dynamic VA should apply in combination with the existing spread risk charges for standard formula users. Applying the dynamic VA is fully in line Solvency II's fundamental principle that all scenarios should be applied to both assets and liabilities and is an effective way to address the flaw in the measurement of spread risk and recognise the actual risk exposure when investing in corporate bonds.

Internal model users are currently able to apply the dynamic VA subject to supervisory approval – this should continue without changes. EIOPA's proposed enhanced prudency principle has no other purpose than adding prudence on both the VA and internal models (which already are calibrated to a 99.5th confidence level), and in the process provides a disincentive for investing in good quality sovereign and corporate bonds.

Introducing the enhanced prudency principle could also result in an inappropriate deviation of the risk profile of the insurer which is contrary to the objectives of the internal model. The internal models for market risk are based on the risk profile and investment mix of internal model users. Based on (local) requirements different exposures are included in the determination of market risk. By introducing the enhanced prudency principle, EIOPA would disregard the uniqueness of the internal model approaches, the calibration approaches and methodologies.

Further restrictions, in addition to the benchmark studies and other requirements on internal model users could even deter insurers from using the internal models as the benefits will not outweigh the cost of using internal models. This is an unsatisfactory development.

Risk Margin

A review of the design and calibration of the risk margin to lower the current excessive level and volatility is necessary.

The current risk margin is far too high and volatile. It ties up around €190bn of insurers' capital and significantly reduces insurers' capacity to take on risks and invest in the economy. It is also a significant and inappropriate source of balance sheet volatility. While EIOPA's proposed changes are a step in the right direction, they do not go far enough to address the flaws and concerns around the risk margin. In particular, the derivation of the cost-of-capital rate is flawed, the lambda parameter and floor are set too high to be effective, and diversification is not recognised at group level.

The industry supports the following changes the risk margin:

- a 3% Cost of Capital rate
- a lambda value of between 0.8 and 0.9 with a floor between 0 and 0.33
- recognition of diversification at group level

■ **The derivation of the cost-of-capital rate**

There are a number of flaws in EIOPA's derivation of the cost-of-capital rate which mean that it is too high and inconsistent with Solvency II specifications. For example, the current calibration does not reflect the capital structure of insurance companies (assuming only equity funding and ignoring bond financing), and therefore wrongly reflects a cost of equity and not a weighted average cost of capital. In addition, the current calibration incorrectly captures asset risk and therefore reflects more than pure insurance risks, as required by SII regulations (in particular, risky assets and new business risks, both of which are ruled out by the SII regulations on the reference undertaking). Furthermore, the estimation of the important beta parameter in the calibration was significantly distorted by a massive overweighting of large companies (which exhibit stronger co-movement with major indices). Finally, the methodology for deriving the cost-of-capital rate is backward-looking and hence is biased upwards, since backward-looking estimates include a survivorship bias (i.e. firms that fail are removed from the index and are therefore not captured) – forward-looking estimates are more consistent with both SII regulations and a range of expert studies, and would result in a material reduction in the cost-of-capital rate. Based on an analysis that avoids these multiple short-comings, the cost-of-capital rate should be set to 3%.

■ **The lambda parameter and floor are too high**

If the cost-of-capital rate is not significantly lowered, it is even more important to achieve an improvement of the risk margin with a suitable lambda. While EIOPA's introduction of the lambda parameter and acknowledgement that the risk margin is too high and volatile, particularly for long-term business, is a welcome development, the proposed level for lambda of 0.975 has not been justified. For some long-dated portfolios the impact on the risk margin alone due to changes introduced to the extrapolation methodology for interest rates more than offsets the impact from the introduction of the lambda parameter with the floor - resulting in a net increase in the risk margin.

This is in part due to the high level of lambda but is also due to the high level of the floor of 0.5, which particularly impacts long-dated portfolios, and whose introduction and level have not been justified by EIOPA. The high lambda and floor also limit the effectiveness of the lambda parameter to reduce inappropriate balance sheet volatility. For example, we estimate that for a 30-year product, EIOPA's parameterisations (lambda of 0.975 and a floor of 0.5) would only result in a c.20% reduction in volatility relative to the current risk margin regulations. On the other hand, a lambda of 0.9 with a floor of 0.25 would result in nearer a c. 50% reduction in volatility relative to the current risk margin, while a lambda of 0.8 with no floor would result in a c. 75% reduction in volatility relative to the current risk margin. On the other hand, a lambda of 0.9 with a floor of 0.5 would result in nearer a c. 40% reduction in volatility relative to the current risk margin and a lambda of 0.9 with no floor would result in a c. 55% reduction in volatility relative to the current risk margin, while a lambda of 0.8 with no floor would result in a c. 75% reduction in volatility relative to the current risk margin. Any action taken by EIOPA to improve the proposal would therefore be more effective if it addressed both areas.

If the lambda parameter and floor are set inappropriately, they will not recognise the risk dependence over time inherent in insurance products. For example, in the case of lapses, exposure significantly reduces after a lapse stress while for some multi-year general insurance products maximum pay-out clauses would reduce future SCRs following the occurrence of an insured event. Another way of looking at the lambda parameter is that it introduces a time-dependent forward cost-of-capital rate that converges to a long-term value. For insurance risks, one would expect that this would tend towards zero as the market beta of insurance risk is close to zero, and any asymmetric information, requiring a premium, would dissipate over time.

■ **Diversification is not recognised at group level**

The current risk margin calculation does not allow for diversification at group level, contradicting a fundamental principle of insurance business. Diversification is allowed for in the calculation of group capital requirements and in the calculation of local entity risk margins, so not permitting for this in the calculation of the group risk margin is both unclear and counter-intuitive. It is also counter to practical experience where there are many examples where groups have transferred policies as a whole.

Interest rate risk

Insurance Europe supports a change to the design and calibration of the interest rate risk submodule that meets all the following criteria:

1. It contains a floor which properly reflects the extent to which yield curves can go negative and the true risk in a low and negative yield environment.
2. The illiquid part of the stressed yield curve is derived using standard extrapolation parameters and methodology.
3. Is appropriate for all currencies to which it is applied.

In the latest document, EIOPA has provided a recalibration of the model it proposed in its earlier advice. However, the inclusion of additional data points does not address the flaws in design of the model, namely

- the lack of a credible and economically justifiable floor; and
- the use of factors to derive the illiquid part of the stressed curve.

Economically justified floor to the model

EIOPA's purely data driven approach to the calibration is flawed as it fails to recognise that experiences with interest rate changes in times of positive rates cannot be transferred unlimitedly to periods with substantially negative rates. If interest rates were to fall too far and/or too long below zero, insurers would have to retreat from fixed income investments and switch to a combination of investing more in real assets and hoarding large amounts of cash.

Extrapolation of the illiquid part of the stressed curve

Interest rate risk refers to change of the risk-free interest rate term structure which is based on market data up to the LLP and is extrapolated afterwards. Solvency capital requirements for market risks must reflect the risk of changing capital markets, not of changing regulation (which provides for extrapolation). Therefore, the modelling of interest rate risk should follow the same two-step logic: risk factors should only be applied to the part of the curve that is based on market data. The resulting stressed curve should then be extrapolated with the usual algorithm.

This is the only way to obtain consistent, risk-sensitive and economically sound stressed yield curves and to calculate the true loss of basic own funds that would occur in the stress scenario. Moreover, this delivers appropriate results for all currencies which generally have different LLPs. Doing it the other way around, i.e. stressing the already extrapolated curve, systematically leads to incorrect results.

Non-euro currencies

EIOPA's analysis is concentrated on the euro and no backtesting (in Annex 12) is performed on any non-euro currencies. Any new calibration of the interest rate risk must be appropriate for all currencies to which it is applied, thus, before EIOPA propose any new calibration it must be thoroughly analysed, including backtesting etc, for more currencies than the euro.

Included in the annex to this document is analysis of EIOPA's proposals on the NOK interest rate scenarios which clearly demonstrates that EIOPA's proposals are not appropriate for that market.

Downgrades of corporate bonds

- No comments

Correlations

Insurance Europe supports the reduction of the correlation parameter between interest rate down risk and spread risk as a step in the right direction.

- The evidence presented by EIOPA does not justify the two-sided correlation between interest rate risk and spread risk. The correlation parameter should generally be zero, no matter whether up- or downward interest rate risk is decisive.
- The current dependency of the correlation parameter on the interest rates can lead to undesirable cliff effects.

Lapse risk

Insurance Europe supports both a recalibration of the lapse risk parameters for both life and non-life insurance as well as the extension of the USP framework to cover lapse risk.

- Insurance Europe is disappointed that EIOPA has not considered other methods to calibrate the mass lapse risk model, for example, the Vasicek Credit Loan Portfolio Model that was proposed by the industry in the response to EIOPA's opinion on the 2020 review of Solvency II (January 2020).
- For the life lapse risk scenarios, the change in option exercise rates should apply to all contracts. Currently, the risks factors of the life lapse scenarios are only selectively applied to those contracts for which the increased or reduced lapse increases the obligations for the insurance company. In practice, however, it can be observed that the movements in lapse rates and decreases are largely homogeneous across all portfolios.
- Currently, the lapse risk factor is applied on a contract-by-contract basis. Consistent with the aforementioned, that would mean that each individual will make a fully informed decision about his/her preference regarding a surrender at the same time. Therefore, the lapse risk should be calculated on a portfolio basis.
- Concerns remain that only the best estimate is considered as a diminishing factor. As the lapse risk only materialises in cases of surrender, the risk margin would need to be taken into consideration as well.
- The risk factors for the life and health mass lapse scenarios are unreasonably high and should be lowered. As an alternative, the restrictive provision in Article 218 (1) of the Delegated Regulation, which almost eliminates the possibility of undertaking-specific parameters (USP) for life and SLT health underwriting risks provided for in Article 104 (7) of the Directive, should be abolished.

Health insurance pandemic risk

- No comments

Macroprudential tools

- There is no need for burdensome new macroprudential tools as the current framework already effectively addresses most potential systemic risks in the insurance industry.
- During the COVID-19 crisis the European insurance industry has proved stable, and the supervisory regime has in general performed well. This has been evidenced across the industry.
 - For example, in Germany:
 - There is no indication that the solvency capital before the crisis was insufficient. For instance, the available option to newly apply for transitional measures was only taken up by two European undertakings.
 - No measures of last resort, as already foreseen in the SII Directive such as Art. 138, were applied.
 - Insurers have benefited from a stable liquidity situation.
 - The regulatory framework has supported the supply of insurance products during the crisis very effectively.
 - Regarding investments, in its recent Financial Stability Report, Deutsche Bundesbank comes to the conclusion that during the time of strained financial markets in the first quarter of 2020 German insurers tended to invest in a countercyclical way and thereby helped to stabilise financial markets.
 - For other countries, such as Sweden, statistics show that the insurers made no major changes to their investments in either equities, bonds or investment funds during Q1 2020 and increased their holdings of equities during Q2 2020.
- **Restrictions on distribution:** For the insurance industry, a blanket ban on distributions is not a suitable macroprudential instrument. Such an extensive intervention is disproportionate in principle. Blanket dividend suspension regardless of individual undertakings' situation, are also harmful to the insurance sector, undermine the credibility of prudential regulation and has a range of adverse consequences including:
 - disruption of income flows for those investors (eg pension funds) which rely heavily on regular cash remittance,
 - disruption to capital and liquidity management within insurance groups, compromising their ability to effectively manage the solvency of their entities
 - increase the cost of capital and damage the ability of the insurance sector to raise further capital by creating market uncertainty and calling into question the underlying investment rationale and appeal of a regular consistent dividends.

Solvency II already provides a strong basis and governance framework for dividend distributions, already governed by multiple safeguards and constraints including:

- continued and forward-looking solvency coverage requirement after subtraction of planned dividends in the ORSA
- risk tolerance limits which are formal commitments embedded within the undertaking's governance and limit their ability to reduce the solvency position in times of stress.
- boards' responsibilities towards ongoing viability and ultimately shareholder approvals

Therefore, on the individual level, such measures should not be considered before the SCR has been breached. Under the current framework, supervisors have already extensive powers to intervene unilaterally after the SCR has been breached as part of the ladder of intervention.

Further, one of the achievements of Solvency II is the change from an isolated solo-entity approach to a comprehensive group approach in supervision. Therefore, it needs to be ensured that decisions on distributions as crucial elements of the prudential supervision are taken consistently across

groups. Solvency II already provides for the governance structure of efficient and effective group supervision.

In cases where the blanket ban on distribution covered intra-group transactions, its application presents a severe damage to the fundamental freedoms of the EU – the freedom of capital. Such a wide-ranging decision must not be taken at a supervisory level without a duly justified case-by-case decision based on transparent and clear criteria. Otherwise, company’s might also face a risk of arbitrary decision-making.

In this context, the different approaches of EIOPA to its own draft advice on the Solvency II and the impact of Covid-19 market disruption are concerning. While EIOPA considers a 13 % drop in solvency ratio for the whole market (as it would be triggered by its own advice) as “manageable”; a 17% drop triggered by the COVID-19 market reaction led to the statements on distribution bans. EIOPA’s inconsistent and asymmetric treatment highlights the potential for arbitrary decision when soft powers are used outside of the clear metrics and triggers of the Solvency II regime.

	Impact on the solvency ratio	EIOPA consideration
EIOPA draft advice for the SII review	<ul style="list-style-type: none"> whole market: -13%¹ (scenario 1) Life market: -24%² 	EIOPA: “ <i>The impact of the advice, including the interest rate risk recalibration, appears manageable for the insurance industry</i> ” ³
Impact of COVID-19 at Q1 2020	<ul style="list-style-type: none"> Whole market: -17%⁴ Life market: -16% (-18% when incl. composite)⁵ 	EIOPA and the ESRB requested an EU-wide distribution ban ⁶

- **Liquidity risk framework:** for the insurance industry, liquidity risks are moderate and mostly already addressed by existing provisions. Therefore, additional requirements should only be considered if it can be demonstrated by the supervisor that an insurer is subject to elevated liquidity risks.
- Any **additional reporting requirements** must balance the costs against the benefits. A large amount of data is already available to supervisors (eg S.06.02, S.13.01, S.18.01). The current EIOPA advice regarding the 2020 Review already proposes Liquidity Risk Management Plans (LRMPs). More reporting/information requirements would produce significant administrative burdens and necessitate additional IT investments at the expense of insurers and, ultimately, policyholders. In any case a strong limitation of the scope of these reporting requirements would be required.
- Regarding the objective to further strengthen financial stability, the industry believes that **instead of considering new instruments and measures, the focus should be on enhancing the effectiveness of LTG measures** to fully reflect insurers’ long-term oriented business model, and to mitigate artificial volatility and potential incentives for procyclical behaviour in extreme market situations.

¹ EIOPA figures resulting from the holistic impact assessment at year end 2019.

² As above

³ EIOPA’s communication on the result of the HIA

⁴ Solvency ratio from year end 2019 to Q1 2020, based on EIOPA’s own funds quarterly data

⁵ As above

⁶ As per the statements issued by EIOPA in April and the ESRB in May 2020

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4. Document on Equity risk ([ECO-SLV-20-221.pdf](#))

Insurance Europe supports the development of a functional and accessible long-term equity risk submodule. It strongly disagrees with EIOPA's assessment that there is no economic justification for a reduced capital charge.

It welcomes EIOPA's work in this area which represent improvements on previous iterations of its proposals. However, these still do not go far enough to address the industry's concerns that the LTE submodule will become akin to the Duration-Based Equity submodule with extremely limited practical usage.

Insurance Europe provides the following feedback on EIOPA's revised criteria:

- (1)(b): Remains unnecessarily restrictive.
- (1)(c): EIOPA does not identify any sound reason for this condition (which overlaps with (a)). Very problematic is the "quasi ring-fencing" requirement, which can only be implemented in some EU legal systems with corresponding balance sheet structures, so that a level playing field is not given. We therefore welcome the deletion of two of the most problematic criteria: that the assets are organised separately and that they cannot be used to cover losses from elsewhere. However, it is unclear what the remaining criterion of being "separately managed" means exactly: To require a specific investment strategy/policy would be comprehensible – to require any kind of separation that goes in the direction of being separately organised would be unnecessary and could still prevent application. Therefore, this requirement should also be dropped to allow for an application in all member states.
- (1)(d): Insurance Europe welcomes the deletion of criterion (d).
- (1)(e): EIOPA's efforts to improve this criterion are welcome. However, the commitment to hold for a period over 5 years on average should not act as a limit to active management. Transactions would still need to be done, which can endanger the min average holding period. Therefore, this criterion could be simplified in line with the portfolio concept and improved to be applicable also to portfolios that do not yet have the required average holding period, but which are intended to be held for more than five years.
- (1)(f): Insurance Europe proposes an extension to OECD shares
- (1) (g): EIOPA's proposed extension of life liabilities to those in liquidity bucket I and II is welcome. This removes one decisive restriction (only allowing for bucket I) for a broad application. However, the requirement for 10-year duration remains a significant barrier. It should be relaxed to reflect the lower durations of more typical life insurance portfolios.
- (2) The criterion on the proportion of equity backing life technical provisions should be removed. This would be particularly disadvantageous where a small portion of the liabilities are eligible.

- (3): Assessment at the fund level should not be dedicated to specific funds only (as indicated under Art. 168). This condition excludes a look-through approach for conventional funds, de facto strongly limiting the applicability of the submodule.
- (4): The requirements here mean that, from a strategic point of view, there is risk of the portfolio of long term equities becoming non-compliant and creating a one-off and sudden increase in SCR. This sanction is likely to deter the use of the LTE submodule due to the possibility of increased volatility of the Solvency ratio.
- (5): The criterion to exclude controlled intra-group investments from the scope of LTE is not an adequate measure to ensure LTE investments are actually held over the long term. This is because LTE investments can be represented by intra-group investments and can often be directly linked to a source of return for policyholders. Intra-group investments are often compliant with the criteria of Art. 171a, but it is more difficult for them to qualify under the strategic equity submodule (Art 171), largely because the condition of lower forward-looking short-term volatility is difficult to demonstrate. The industry proposes not to exclude intra-group investments from the scope of Art. 171a unless the volatility criterion in Art. 171 is removed to allow for proper use of the strategic participation category.

5. Document on Non-proportional reinsurance ([ECO-SLV-20-222.pdf](#))

Insurance Europe tentatively welcomes the proposal on the inclusion of adverse development covers subject to further assessment of the restrictions and impact of the proposal.

6. Proportionality and reporting ([ECO-SLV-20-232](#))

The industry **highly welcomes the general approach proposed by EIOPA to improve the application of proportionality** including:

- The identification of low risk undertakings
- A clear process for the application
- Clarifying the role of the supervisors
- Introducing a transparency and monitoring tool to report about application of proportionality

However, the proposed framework – as it stands now – will not strengthen a consistent and proportionate application of Solvency II.

The criteria to identify low risk undertakings (LRU) are unnecessarily and overly restrictive, undermine the integrity of the single market approach and are likely to result in the creation of an empty bucket.

Moreover, restricting the automatic application of proportionality measures only to some “low-risk undertakings” is not satisfactory. As proposed by the industry, automatic criteria based on activities – eg a small/low risk business line in a more complex company. For example, it is regrettable that EIOPA does not propose the inclusion of its own supervisory statement on proportionality in SCR calculations in the regulation as an automatic measure.

In the industry view, these deficits of the proposed framework are rooted in a serious misunderstanding about proportionality. Applying proportionality does not mean to discharge undertakings from a severe

supervision nor to take away responsibilities from NCAs. On the contrary, NCAs can increase their legitimacy and the quality of their work, if they rethink proportionality as a tool to focus their resources based on actual risks.

While the industry understands the time constraint to finalise EIOPA's advice, one way forward could be to investigate the opportunity to provide more automatic measures based on activities at level 3, for example via ITS/RTS or guidelines.

■ **Technical assessment of the identification of low risk undertakings (section 8.1.4.1)**

The industry welcomes the definition of low risk undertakings as a first step to introduce automatic proportionality measures. However, EIOPA's proposed criteria for "low risk" insurers that are almost prohibitive (§24).

In the definition of "low risk" EIOPA suggests that cross border business needs to be immaterial, although a low risk profile should not be tied to the absence of cross-border activities, keeping in mind that one main objective is to foster the single market. We also object to the condition of "no material reinsurance". Also, EIOPA proposes an absolute size criterion, which is not risk based.

§24.c Immateriality of cross border business

- The industry proposes to delete this criterion
- This criterion is not appropriate to assess the risks of a particular undertaking. In fact, companies can diversify risks by operating in more than one market. Also, introducing this criterion will undermine political goal of creating a European capital market union.
- The systematic discrimination of cross-border business is not acceptable. Conducting business across the single market must not be a risk-determining factor per se. During the stakeholder event, EIOPA argued that the insurer is not aware of the risks in other jurisdictions. The supervisory approval process and the regular supervisory oversight/review should ensure that an insurer is capable of managing its business and the associated risks appropriately – domestic and cross-border. Proportionality should not depend on the location of headquarters or the home of the policyholders, because insurers who operate in other markets than the jurisdiction where they are established, must in any case prove to their NCA that they hold the necessary expertise. In cases where the supervisor does not feel that it can fully assess the appropriateness, supervisory cooperation and the coordination of EIOPA should fill the gap, not regulatory protectionism and barriers for the single market.
- While this is a good criteria to prohibit the exclusion if SII, since cross-border business should fall under the scope of our common EU supervisory framework; there is no reason why the proportionate application of this framework should be limited to insurers only operating in their domestic market. The risk inherent in an insurer's business model is not affected by cross-border operations per se.

§24.d Size

- The industry proposes to delete this criterion
- This criterion is not appropriate to assess the risks of a particular undertaking. In fact, this criterion will exclude many companies with a simple business models and low risk profile particularly in some bigger markets.

§24.g No material reinsurance business accepted

- The industry proposes to delete this criterion

- This criterion is not appropriate, because reinsurance business does not yield high risks per se. As a matter of fact, there are reinsurance undertakings with very high solvency ratios that can be considered low risk undertakings.

§23. Excluding criteria

- The industry proposes to delete this criterion
- The general exclusion of pure reinsurance undertakings and the status of head of a group should not mean an exclusion of automatic proportionality measures. Similarly, the use of partial or full internal model should not lead to systematic exclusion of any proportionality measures.

Some substitute risk-based criteria could be considered, such as solvency ratio, volatility of solvency ratio or ratio of eligible own funds to balance sheet total.

Moreover, it should be specified that once the new regulation enters into force, the criteria will be assessed immediately (§24 & 25). Companies that meet the LRU criteria should not have to wait for two years to be able to apply proportionality.

■ **Technical assessment of the new process for the application of the proportionality principle (section 8.1.4.2)**

The industry welcomes most of the proposed changes including in §33 and 34. The changes proposed by us shall be considered as contribution to establish simple and clear procedures.

However, as the process is not completely described at this stage, it is hard to make a full assessment. The industry would like to stress that **very bureaucratic processes must necessarily be avoided, as it would offset the benefits of proportionality** – and even discourage its application as it is currently the case in many occurrences. Processes must also be proportionate, having in mind that the aim is to avoid disproportionate measures for companies or activities with low risk and/or low scale.

§30. NCAs can challenge the status of LRU any time:

While the industry acknowledges that supervisors should always have the power to challenge undertakings, NCAs should have to justify their preliminary decision thoroughly towards the affected company. The company should be allowed to respond to NCA's preliminary decision. As a result of the dialogue, the NCA should communicate their final decision. This simple process will improve the quality and legitimacy of NCAs' decisions and gives companies a fair possibility to justify their risk profile.

■ **Technical assessment of the role of the supervisory authorities with regard to the use of proportionality measures not specifically identified in the Solvency II framework (section 8.1.4.3)**

§41. **The industry welcomes the proposal that proportionality measures defined in the delegated regulation are considered a non-exhaustive list of possible measures.** This enables supervisors and undertakings to be innovative and to find new and better to apply proportionality.

In contrast, the industry **disagrees with the assessment that that proportionality measures should not lead to a complete exemption from some requirements** (§44.1). In fact, this rule may prevent some fair and appropriate proportionality solutions. A complete exemption from a specific requirement should be allowed and may benefit policy holders where the requirement does not provide any added value for the supervision while producing costs for the affected company and consuming resources of the NCA.

In consequence, the second rule stating that proportionality measures should be in line with the general and overarching principle of Solvency II (§44.2) is sufficient.

Against this backdrop, the industry is of the view that the proposal in §44.1 should be deleted.

■ **Technical assessment of EIOPA's report on the use of proportionality measures by Member States (section 8.1.4.4)**

The industry welcomes the proposed changes. A good data base will improve the quality of discussions and supports the identification of new challenges regarding the application of proportionality. The industry would like to stress that, to avoid offsetting the benefits of a reduced burden, **the reporting on proportionality will have to be very simple and quick to fill**. Burdensome reporting requirements such as the documentation and reporting of every proportionality assessment (eg in the governance system) must not be required.

§48. At the current state, the introduction of a new template can't be assessed. We generally welcome EIOPA's intention to keep QRTs simple, to eliminate double reporting and to reduce the amount of qualitative reporting in the RSR.

■ **Technical assessment of proportionality in pillar 1 (section 8.2)**

The industry welcomes that EIOPA worked on a simplified approach for stochastic valuation. It is indeed very burdensome for undertakings to implement and maintain the procedures for stochastic valuation. **However, it is important that this new approach does not question present stochastic valuation approaches.** From the industry perspective, the approach could be applied under the proportionality principle of Art. 56 of the Delegated Acts. However, the application should be at the discretion of the individual undertaking.

Unfortunately, EIOPA does not present further details of the approach:

- How exactly would the TVOG estimated from the PHRSS?
- How are the PHRSS calibrated and generated?
- What input data is required?
- How is the interaction with the SCR calculation (eg loss absorbing capacity of technical provisions)?

Against this background, a more thorough assessment of the proposal is not possible.

The industry would like to note that at least one NSA has already stated, although not officially, that life companies will be systematically excluded from applying simplified approach for stochastic valuation, regardless of their risk profile. This kind of unilateral initiatives to not adopt the measures proposed at EU level undermine the level playing field and should be avoided at all cost.

■ **Technical assessment of proportionality in pillar 2 (section 8.3)**

Proportionality is key in making governance requirements appropriate and to avoid excessive burden on companies. The approach presented by EIOPA has its advantages as it for low risk undertakings becomes clearer that they can make use of some less burdensome measures.

§61. The industry **welcomes the proposed changes in the following areas: key functions, ORSA, written policies, administrative, management or supervisory body (AMSB) and remuneration.**

§62. Also, the industry highly appreciates that EIOPA takes into account stakeholder comments and proposes that that (§62a) certain proportionality measures are generally admissible with respect to low risk profile undertakings. In particular, the advice to **modify of the frequency (§62b) of the ORSA is step into the right direction, but it goes not far enough.**

- Biennial ORSA (section 8.3.1)

§63. **The proposal of a less frequent ORSA for LRU is welcome.**

However, it would make sense to allow LRU – without additional conditions – to conduct the ORSA only every third year, instead of a biennial ORSA. Conducting the ORSA every third is appropriate for LRU as they will already fulfil several risk-based criteria.

This would allow to synchronise the frequency of the ORSA and the RSR and effectively reduce the burden on LRU.

Moreover, the proposed “additional conditions” are not necessary and should be deleted.

First, the condition “significant change in the undertakings risk profile” is already covered through the general supervision of the target undertaking. Second, we are glad that EIOPA considers a stable solvency position as a useful criterion to assess the risk profile of an undertaking. Hence, we propose to use the solvency position as an important risk-based criterion to define LRU. In consequence, it would be not necessary to introduce it as an additional condition for modifying the frequency of the ORSA.

The following two conditions are also not necessary, because they are already covered by general rules regarding the application of proportionality:

- The “power to request an annual ORSA” is covered by the general rule in §30
- The “supervisory authority could agree on exceptional cases that undertakings not falling under the definition of “low risk profile undertaking” benefit from these measures” is covered by the general rule in §34.

■ **Other proposals**

Several other ideas from the industry have not been considered, such as leaving the choice between simplified formulas for risk modules and default formulas up to the insurer. Another one excluding low risk insurers up to a certain level from the definition of Public Interest Entities (PIEs).

Proportionality in Pillar 3

■ **Technical assessment of proportionality in pillar 3 (section 8.4)**

- The industry is disappointed by the lack of ambition shown in this proposal leading to just a few constructive changes regarding proportionality and reporting.

- On article 35 – The industry disagrees with the proposed change to Article 35 (option 2 in para 75–77), in particular reducing the **threshold for limitations and exemptions** from 20% to 5% market share due to an automatic exemption. When basing the exemption on risk-based criteria, there is no reason why any threshold should be set, even less a threshold lower than the current level. It would particularly affect markets where this measure is already broadly applied up to the current threshold, and reduce the application of proportionality rather than improving it.

- EIOPA concludes that no additional proportionality measures regarding the **SFCR** are needed in addition to the changes proposed (§85). In order to increase its impact, the SFCR should be split in two sections, with clearly defined target stakeholders, namely a policyholder section and a professional section, containing the following information:
 - A brief narrative report for policyholders, comparable to the executive summary of maximum two pages, which would enable the average policyholder to acquire an overview of an insurer's key information.
 - A detailed quantitative report without mandatory narrative explanations for the professional public consisting of the set of public QRTs, disclosed already.
- Analysis has shown that the use of the **SFCR** by stakeholders is very limited. The SFCR in its current form, addressing user groups with completely differing requirements at the same time, is not expedient. The costs for compiling this extensive narrative and quantitative report outweigh by far the documented benefit – for example, as a GDV study has shown, only 0.03% of German households downloaded SFCRs in 2018. The publication of additional quantitative data as well as a narrative explanation should not be mandatory, as the professional public possesses the necessary expert knowledge to draw relevant information directly from raw data.
- Furthermore, while the industry appreciates that the differences in business models are considered in EIOPA's approach, it is unacceptable that the proposed simplifications in pillar 3 are proposed exclusively for captives (§88). Those simplifications, especially the QRT-based **SFCR** for the professional public, should be applied as regular procedure for all entities. The ability of the professional public to evaluate quantitative data does not depend on the entity's risk profile or its business model. To apply proportionality adequately and consistently simplifications in reporting measures should be granted based on a risk assessment, which may include but should not be limited to the nature of the undertaking. Moreover, further clarification is necessary on the definition of "beneficiaries" in the context of captives to allow for a full assessment of the impact of the proposals.
- The industry welcomes the proposal for a frequency of the **RSR** only every 3 years for low risk insurers.
- For internal model users, EIOPA proposal to add extremely regular reporting templates and/or to require standard formula reporting would defy the purpose of making Solvency II more proportionate through the review. It is reminded that the proportionality principle protects firms from requirements "to submit any information which would not be relevant to their business" (recital 115 of the Delegated Regulation). Yet, standard formula is by design irrelevant to internal model firms' business as internal models are fully integrated in the decision-making of those firms and their risk management per the use test of Article 120 of the Solvency II Directive.
- Similarly, any requirement relating to an external audit of the SFCR would defy the purpose of making Solvency II more proportionate through the review. While only leading to limited benefits, and clearly duplicating work in the remit of supervisors, the proposals would have significant additional burden and costs across the industry.

7. Other issues

The industry highlights that **it is key that the property risk factor reflects property risk in the European Union**. An obvious case of long-term investments that need a more appropriate capital requirement is property. The current 25% risk factor for property risk in the standard formula is solely based on data from the UK commercial property market which is exceptionally volatile and not representative for a typical European insurer's real estate investment. An appropriate risk factor for the entire European property market would have been 15% at most. A risk factor that reflects property risk in the post-Brexit Union should not even exceed 12%

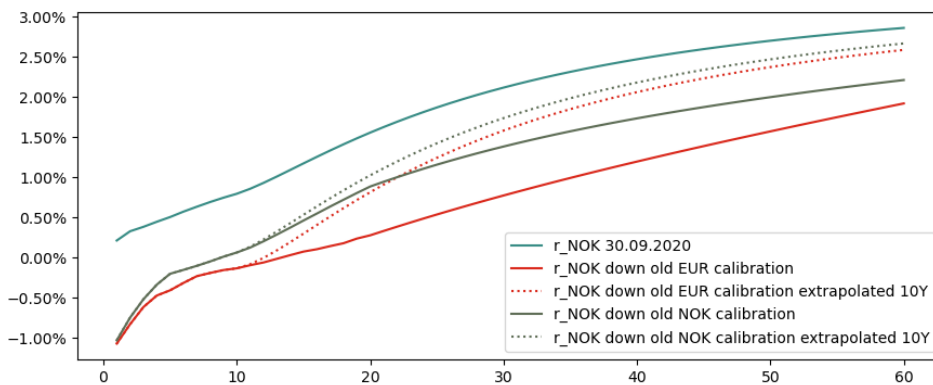
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Annex – Impact on NOK interest rate risk scenarios

The analysis below shows that EIOPA’s proposals for the interest rate scenarios is inappropriate for the NOK. Similar results are expected from other non-euro currencies.

Extrapolation

The effect of extrapolating the stressed curve (dotted) instead of stressing the entire curve with an extrapolated stress (solid) is displayed below. For NOK the LLP is 10Y, thus the stressed curve is extrapolated with Smith Wilson methodology after 10Y.



The dashed lines illustrate the differences discussed in "Extrapolation of the illiquid part of the stressed curve". The difference between the dashed gray and the solid red illustrated the difference between the real life marked consistent risk calibrated on NOK and regulation-based risk calibrated on EUR.

Calibration of stress parameters

To supplement the analysis, a calibration of the stress parameters for the NOK only is included below. These are included for illustrative purposes and should not be considered as an industry proposal for the calibrations.

Using the same methodology as for EUR to calibrate the rate stress for NOK and data up to 30.09.2020 gives a lower stress compared to the EUR stress for all tenors. Thus, it can be assessed that an unadjusted EUR-calibration is not appropriate for NOK. The down stresses are illustrated in the figure below.

