



To: Mairead McGuinness
Commissioner for financial services, financial stability and Capital Markets Union
European Commission
Rue de la Loi/Wetstraat 200, 1049 Brussels

Our
reference: ECO-21-021

Subject: Insurance industry priorities and views on the Solvency II review

Brussels, 22 February 2021

Dear Commissioner McGuinness,

The global pandemic has increased pressure on governments, businesses (especially SMEs) and consumers. Already challenged by economic, demographic and environmental developments, EU decision-makers have launched several key initiatives (Green Deal, CMU, Next Generation EU) setting ambitious political objectives. The insurance industry stands ready to assist in overcoming the current challenges to create a more resilient society and a sustainable economy and address the protection gaps, e.g. in pension savings and the coverage of natural catastrophes.

The Solvency II review provides a crucial opportunity — through a limited number of targeted improvements — to enable insurers to play their role in delivering on the EU's political objectives. We appreciate that the review comes in the context of an ambitious EU political agenda, and we are keen to work with you to identify how the review can further enhance the ability of our industry to make a positive contribution to Europe, through our risk-taking and investment capacity.

On behalf of the European insurance industry, please find below our views on the Solvency II review and, more specifically, on key elements of the EIOPA advice.

EIOPA's advice — a missed opportunity

According to our analysis, **EIOPA's proposals would decrease our risk-taking capacity as an industry by around €60bn¹. They would also increase — not decrease — the volatility in the solvency measurement.**

If implemented, EIOPA's proposals would significantly reduce our ability to invest in the real economy. A €60bn capital impact would reduce the investment capacity by the equivalent of **around €170bn equity investments, or around €680bn of corporate bond investments**. Some of the unnecessary impact would inevitably be passed on to consumers.

None of these consequences are justified. If anything, the recent COVID-19 experience has confirmed the strength of our industry and proved its ability to withstand extreme market conditions.

We also note that EIOPA did not provide any evidence that the industry needs more capital – and yet has put forward proposals that would ultimately lead to significant increases in capital requirements. We believe such an outcome is in stark contrast to what policymakers expect from our industry, effectively more — not less — risk-

¹ €60bn is the estimated impact of the EIOPA's proposals at 30 June 2020 without the transitional measures. EIOPA adds even more complexity with new transitional measures in an attempt to mitigate its increases — however, these do not change the ultimate negative impact and they don't work for all countries. The estimate also does not include the potential impact of proposals on groups requirements or the costs of implementing new requirements in areas such as reporting, recovery and resolution.



taking capacity for the European economy and its consumers, especially in light of the need for a post-pandemic recovery. Indeed, with the appropriate fixes to the Solvency II framework, we can live up to these expectations and contribute to the EU growth and green transformation agenda more effectively.

Furthermore, EIOPA's proposals undermine the global competitiveness of the European industry. At international level, EIOPA in fact agreed to certain measures to address systemic risk, and yet for European insurers it proposes an unwarranted gold-plating of those measures. We believe that this review should, on the contrary, aim to strengthen Europe's leadership in the world.

We recognise that EIOPA's work was started before the European Commission had finalised its plan for the Green Deal and CMU and before the urgent need for recovery from the effects of the pandemic. Nevertheless, the EIOPA advice is a missed opportunity. If the advice is followed, Solvency II's conservativeness and measurement flaws would be further amplified, preventing the insurance industry from fully supporting the EU's ambitious goals.

Solvency II review — the priorities

As you know, Solvency II is strongly supported by the industry and has proved its value since it was first applied in January 2016.

However, Solvency II has a number of flaws which mean it does not correctly capture the long-term nature of our business nor fully reflect the interaction between assets and liabilities. As a result, too much capital is required and the solvency measurement is too volatile. Furthermore, it is operationally extremely burdensome. These issues should be the focus of the review.

We highlight below our four recommended priorities for the review and provide additional information in the annex to this letter.

Priority 1: Address flaws for long-term business

Insurers' capacity to invest over the long-term is based on their business model, including their ability to offer long-term products. Addressing related flaws will help avoid pro-cyclical behaviours and better reflect the long-term nature of the insurance business. It would therefore allow our industry to both: 1) continue offering long-term savings and guarantee products that consumers value and need; and 2) enhance our investments in the real economy, including in equities and assets that support the sustainable transition. In aggregate, the impact of all changes should **lead to a justified and needed reduction in capital and volatility**.

Priority 2: Do not gold-plate international agreement on systemic risk measures

The implementation of the holistic framework for addressing systemic risk should be done with proportionality in mind and should not gold-plate what was agreed internationally. Only measures referenced in the EC Call for Advice should be considered.

Priority 3: Address operational complexity and burden

This can be achieved by making sure proportionality works in practice and simplifying and streamlining reporting requirements. This will lead to a more diversified and efficient insurance market, which is directly beneficial for European consumers.

Priority 4: Focus on areas of proven need, avoid changing what works

The Solvency II review should focus any changes on areas where there is a proven issue and should avoid changes where there is no real need and especially avoid changes to areas that have proven their value.



Solvency II review — an opportunity to take

The European Commission presented its proposal for Solvency II 14 years ago. The idea was as ambitious as it was compelling: a harmonised three-pillar approach which went far beyond established frameworks (including those developed for banking) by introducing a comprehensive economic and risk-based approach.

Solvency II has not only revolutionised European insurance regulation. Its approach has been copied by many jurisdictions. In short, it has become the gold standard of insurance regulation worldwide. It is, however, noteworthy that the flaws in the European framework that we outline above have similarly been identified by other regional and indeed the global supervisory community as important to avoid.

Following EIOPA’s advice as presented would put pressure on European insurers to de-risk their balance sheets, and further shift risk away from the industry, ultimately putting more risk on consumers. It would also curb their investment capacity and put them at a competitive disadvantage globally.

We hope that the European Commission will instead take the opportunity to address those (few) flaws and priorities identified above, thereby:

- increasing our industry’s capacity to take risks from individuals and companies
- mobilising our industry’s investment capacity to support the Green Recovery and transition
- fostering the CMU
- ultimately helping European insurers to defend their industry’s leading global position.

We look forward to exchanging views with the European Commission on how the European insurance industry can bring its full risk-taking potential to its customers and its investment potential to support the green recovery and the CMU.

Yours sincerely,

(e-signed)

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President, Insurance Europe

(e-signed)

Delfin Rueda
Chairman, European Insurance CFO Forum

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About Insurance Europe

Insurance Europe is the European insurance and reinsurance federation. Through its 37 member bodies – the national insurance associations – it represents all types and sizes of insurance and reinsurance undertakings. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe’s economic growth and development. European insurers pay out almost €1 100bn annually – or €2.9bn a day – in claims, directly employ over 900 000 people and invest nearly €10 200bn in the economy.

About the Pan-European Insurance Forum (PEIF)

The Pan-European Insurance Forum (PEIF) is a forum for the CEOs of major European insurers (Aegon, Allianz, AVIVA, AXA, GENERALI, MAPFRE, Munich Re, RSA, Swiss Re, UNIQA and Zurich) to exchange and present views on policy and regulatory issues impacting the European insurance sector. PEIF aims to promote a better understanding and recognition of the role of the insurance business model in the European Union and to provide its Members with the opportunity to discuss major policy and strategic issues affecting the insurance business in Europe and worldwide.

About CFO Forum

The European Insurance CFO Forum ('CFO Forum') is a high-level discussion group formed and attended by the Chief Financial Officers of major European listed, and some non-listed, insurance companies. Its aim is to influence the development of financial reporting, value based reporting, and related regulatory developments for insurance enterprises on behalf of its members, who represent a significant part of the European insurance industry. The CFO Forum was created in 2002.

About CRO Forum

The CRO Forum, formed in 2004, aims to advance risk management practice in the insurance industry. The CRO Forum member companies are large multi-national insurance companies, headquartered across the world with a concentration in Europe. The CRO Forum’s Core Aims are: Championing best practice in risk management to advance business; Alignment of regulatory requirements with best practice in risk management; and Providing insights on emerging and long-term risks. They share their view on these topics through publications and papers. <https://www.thecroforum.org/>.

About AMICE

AMICE, the Association of Mutual Insurers and Insurance Cooperatives in Europe, was created in January 2008 and its prime purpose is to ensure that the voice of the mutual and cooperative insurance sector in Europe is heard and that the interests of its members are taken into account in securing a level playing field for all insurers in Europe regardless of their legal form. AMICE provides a platform for mutual and cooperative insurers of all sizes to combine resources and expertise, exchange experiences across national borders and discuss key issues and concerns relating to planned legislative and regulatory changes and developments. In the EU Members States, the mutual and cooperative sector has a market share of over 30% representing close to EUR 400 billion in insurance premiums. With close to 90 direct members and representing about 700 more insurers indirectly through 5 national associations, AMICE speaks for a significant part of the insurance sector.

Annex: Priorities and proposals for the Solvency II review

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Priority 1: Address flaws for long-term business.

Insurers' capacity to invest over the long-term is based on their business model, including their ability to offer long-term products. Addressing related flaws will help avoid pro-cyclical behaviours and better reflect the long-term nature of the insurance business. It would therefore allow our industry to both: 1) continue offering long-term savings and guarantee products that consumers value and need; and 2) enhance our investments in the real economy, including in equities and assets that support the sustainable transition.

Specifically:

- For the **risk margin**, EIOPA's proposal is not sufficient. Benefits could be achieved in mobilising investment capacity, if a sufficient reduction is pursued through an appropriate combination of reducing the cost of capital, re-calibration of the proposed lambda, and allowing for group diversification.
- For the **volatility adjustment (VA)**, we need a mechanism that appropriately mitigates artificial volatility and recognises the returns that insurers can earn by increasing the overall application level and improving its sensitivity to the reference portfolios spread volatility. This can be achieved by maintaining the currency reference portfolio approach and introducing the following changes based on EIOPA's proposals: increase in the general application ratio, an undiluted reference portfolio, improving the country component and inclusion of an overshooting ratio adjustment. For improvements to be effective and avoid unnecessary complexity, they must not include EIOPA's unjustified proposals to change the risk correction and add a liquidity adjustment factor. Indeed, these two elements would undermine other improvements and the ability of the VA to work as a counter-cyclical mechanism.
- There is no need to change the current **extrapolation methodology for risk-free rate curves**. They already include the low and negative rates. EIOPA's proposals add further complexity and are unnecessary because there are already mechanisms in place to ensure that, even if rates stay very low, insurers will hold enough assets for very long-term liabilities.
- We recognise the need to reflect **negative interest rates** in solvency capital requirements, however EIOPA's proposals need improving so there is an appropriate floor to how negative interest rates can go and the stressed rates are calculated in a way consistent with how rates would change in practice.
- The standard formula solvency capital requirements for investments need to better reflect the real long-term risks faced by insurers, and not only the short-term market movements. This includes:
 - For **equities**, improving EIOPA's proposals so the qualifying criteria for long-term equities work
 - For **corporate bonds and private debt**, introducing the Dynamic Volatility Adjustment (DVA), which permits the correct measurement of spread risk, into the standard formula and avoiding new requirements for internal model users
 - For **property**, the risk factor should be reduced significantly to reflect the real risk of these assets.

Overall, to mobilise the investment capacity of our industry, the improvements to the VA, risk margin and capital charges for investments – with the extrapolation remaining unchanged - should more than offset the increase in capital from incorporating negative interest rates, **leading to a justified and needed overall reduction in capital and volatility**.

Priority 2: Do not gold-plate international agreement on systemic risk measures

The implementation of the holistic framework for addressing systemic risk, including pre-emptive recovery and liquidity risk management plans, should be done with proportionality in mind and should not gold-plate what was agreed internationally. Only measures referenced in the EC Call for Advice should be considered.

- EIOPA's additional proposals on **capital surcharge for systemic risk, concentration thresholds, new triggers for preventive measures** and **dividend controls** should not be taken forward. Solvency II is already designed with early intervention powers for supervisors as soon as the SCR is breached, and this should not be changed.

Priority 3: Address operational complexity and burden

This can be achieved by making sure proportionality works in practice and simplifying and streamlining reporting requirements. This will lead to a more diversified and efficient insurance market, which is directly beneficial for European consumers.

- EIOPA's proposals on **proportionality** are a step the right direction but need improvements to work as intended.
- Its proposals on **reporting** (such as mandatory audit requirements on top of the existing supervisory review processes, additional and/or changed templates) increase rather than reduce the burden and the costs, and policyholders and other stakeholders would not benefit from the changes.

Priority 4: Focus on areas of proven need, avoid changing what works

The Solvency II review should focus any changes on areas where there is a proven issue and should avoid changes where there is no real need and especially avoid changes to areas that have proven their value. In particular:

- **Supervision of cross-border operations** is the only other area (beyond those listed above) where further changes are justified, for more coherence and convergence in the supervision of activities based on freedom of services/freedom of establishment and protection of consumers. We therefore welcome EIOPA's proposals to strengthen and enhance cooperation between home and host authorities.
- **IGS schemes should remain decided at national level.** A harmonisation project would create significant costs and involve complex challenges, for which there may not be acceptable solutions.
- No new requirements for **internal models** are warranted. **Internal models** are a key element of the framework allowing for a more tailored measurement of complex risks. Insurers' ability to reflect their own risks in their internal models, such as via the DVA, must be preserved. There are already extensive and rigorous supervisory approval and reporting processes and EIOPA's proposals for new requirements such as the Enhanced Prudency Principle for the DVA and additional reporting and disclosure requirements to conduct comparisons to the standard formula would be onerous and undermine their purpose.
- No changes are needed on **group supervision**, except for fixing the trigger inversion issue, where there is a clear flaw to address. Other EIOPA proposals (e.g. changes regarding the recognition of future profits and other changes on the availability assessment, new requirements for aggregation method 2, the addition of a notional SCR for holdings, transposing solo governance requirements to groups) would add additional complexity, costs and capital for Solvency II groups, further undermining the European industry's competitiveness globally.

We have highlighted above our key positions, and would greatly appreciate the opportunity to provide additional technical arguments and detail for the various areas under discussion and how EIOPA's proposals could be improved in a meaningful way.