



Solvency II : **Fixing the flaws & keeping policyholders safe**



Solvency II review — focused correction of flaws required



Press release | 22 September 2021 | Brussels

Reviewing EU insurance rules: encouraging insurers to invest in Europe's future



European Commission's ambition for the review of Solvency II is to **encourage insurers to invest in Europe's future**



Industry's corrections would make the system more **risk-based and free up capacity, while keeping policyholders safe**

Solvency II works well overall but ...

It does not properly capture the long-term nature of insurance

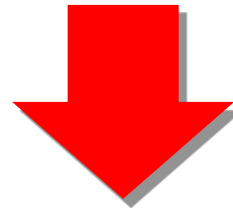
Proportionality is not working in practice



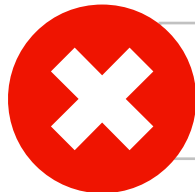
So capital is too high &

too volatile

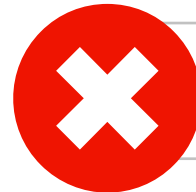
Too burdensome



Negative impact on insurers' ability to:



offer long-term/guaranteed products



invest in the wider economy

The flaws are therefore creating problems for customers

Lower benefits for pensions & other products

Higher premiums

Unnecessary costs

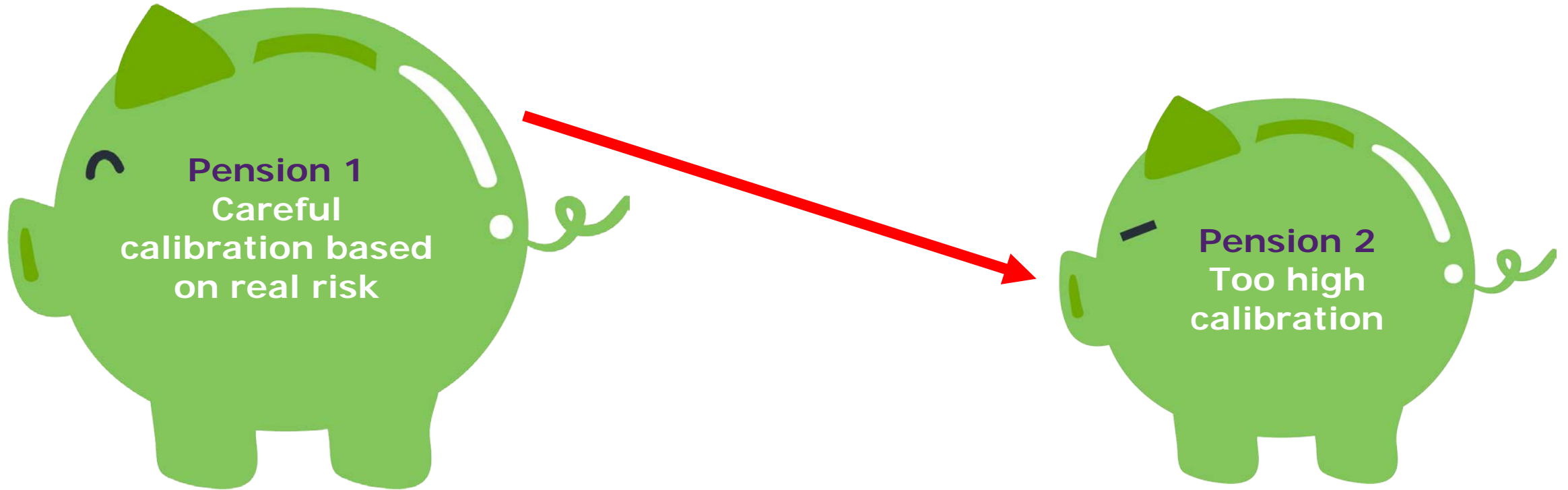
Less long-term investment

Fewer products available



Consumers suffer if capital requirements are too high

High capital leads to high costs or less investment in better performing assets



After the corrections, consumers would remain extremely well protected



Solvency II is very comprehensive, with many safeguards



Supervisors already have extensive powers to intervene if the SCR is breached



Stress tests have consistently shown the industry's ability to withstand severe stresses

Solvency II is very comprehensive with many safeguards



Very prudent **discounting** is used to calculate the value of policyholders' claims



A **risk margin** protects policyholders in the case insurer failure/insolvency



Capital requirements are calculated to **cover 28 different risks**



Extensive requirements for strong governance and risk management including to consider their own risk profile in the Own Risk and Solvency Assessment (**ORSA**)

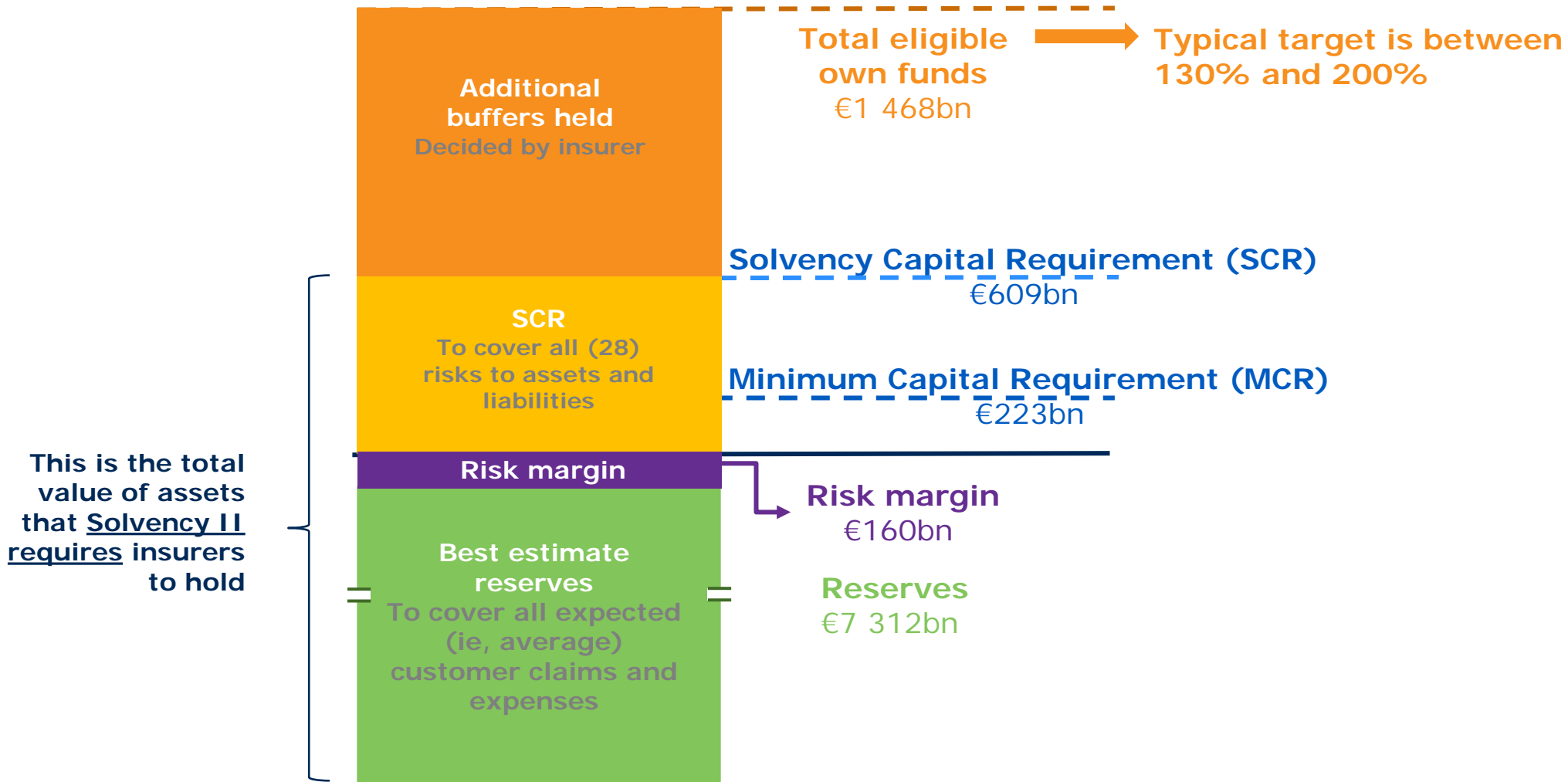


Strong supervisory powers: Two solvency levels, **MCR/SCR**, with a ladder of intervention



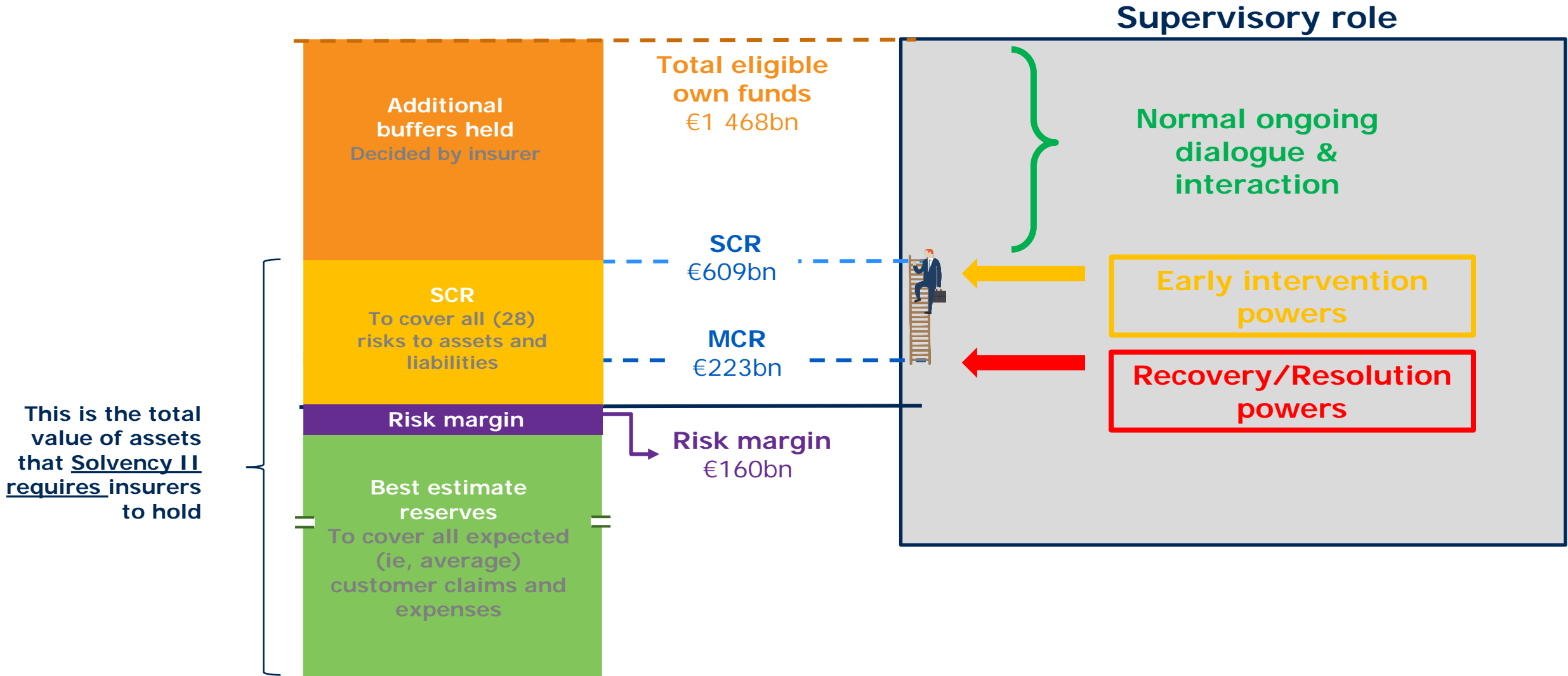
Capital add-ons can be applied by NSAs under certain circumstances

Solvency II – multiple levels of capital protect customer



* Not to scale
EIOPA Q2 2020 figures

Solvency II – supervisory powers are already strong



Solvency II – supervisory powers are already strong

Normal dialogue & interaction



Powers include to conduct on-site investigations whenever there are significant concerns

Early intervention powers



“Ladder of intervention gives power to take administrative or financial measures against a company or their management if the SCR is breached

Example: blocking dividends, very close monitoring, additional reporting, limits on new business

Recovery/Resolution powers



When a company’s solvency position is deteriorating below the MCR: the power to take all measures necessary to safeguard the interests of policyholders

Example: replacing management, putting into run-off

Stress tests are used by SII to set the capital requirements and in additional exercises to increase understanding of specific events

In all stress tests, including for cars, a decision is made on the severity of the scenario

Euro NCAP tests different scenarios, mostly at speeds of 50km/h

Frontal Impact



Lateral Impact



Rear Impact

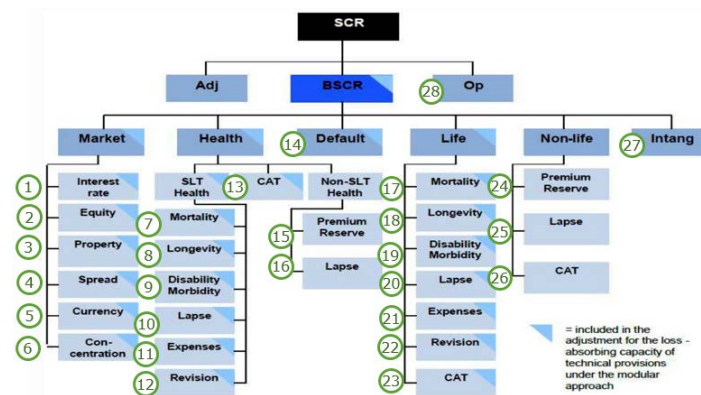


Rescue and Extrication



More severe crash tests with faster speeds could have been chosen, but there is a recognition that there is a **trade-off between safety and the cost/usability of a car for consumers**

Solvency II is also based on a stress test type approach



28 different risks with the capital needed to protect customers determined for each risk based on a **standard 1 in 200 year type scenario event**

The **stress test exercises** are not to set capital requirements, but to understand the impact of specific events and even more extreme scenarios

Examples:

- **Even lower interest rate scenarios than SII tests**
- **Pandemic scenarios**
- **Climate change scenarios**

Typically based on specific scenarios/events – sometimes extremely unlikely e.g. **1 in 1000+ year**

A stress test for insurers is similar to car crash tests

The crumple zone will be damaged, but the focus is on whether passengers are protected

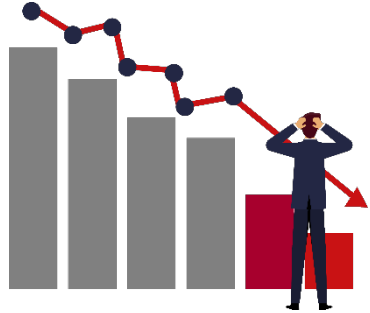


Best estimate reserves = passengers

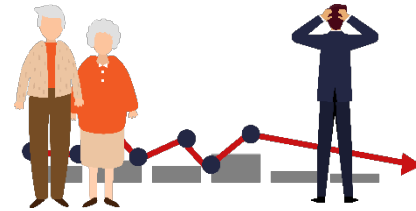
Capital + Risk margin = Total crumple zone

SCR + Risk margin = SII required crumple zone

A lot of interest in how specific scenarios would impact the industry



Market crashes



“Low for long”
interest rates



Natcat & climate change



Liquidity

Solvency II already covers these risks to a large extent

The additional stress test exercises can provide even more information to help to understand the impact of these risks on the industry

Regular and ad hoc stress test exercises are used to assess these concerns

Extreme scenarios used to understand impact of events beyond those already in SII



Regular Insurance Stress Test

2014, 2016, 2018, 2021



Click to add text
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Sensitivity analysis of
climate-change related
transition risks

December 2020



Impact of climate change on the financial stability of the insurance sector

September 2021



EIOPA's 2021 stress test exercise tested some very extreme scenarios

Scenarios were estimated by ESRB to be up to 1-in-1000+ year scenarios

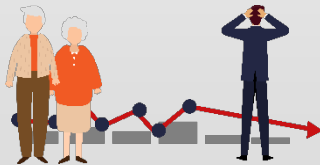
Severe market crash scenario

- Equity: -40%
- Sovereign bonds: up to -25%
- Property: up to -30%
- Increasing interest rates
- Coupled with 20% customer lapse and increased claims inflation



"Extreme low for long" scenario

- Insurer's investment returns below 1% per year until 2030 and less than 2% per year after 2030
- Significant increase in life expectancy



Natcat scenario

In quick succession:

- 2 earthquakes
- 2 floods
- 4 windstorms



Combined multiple event "COVID-19" scenario

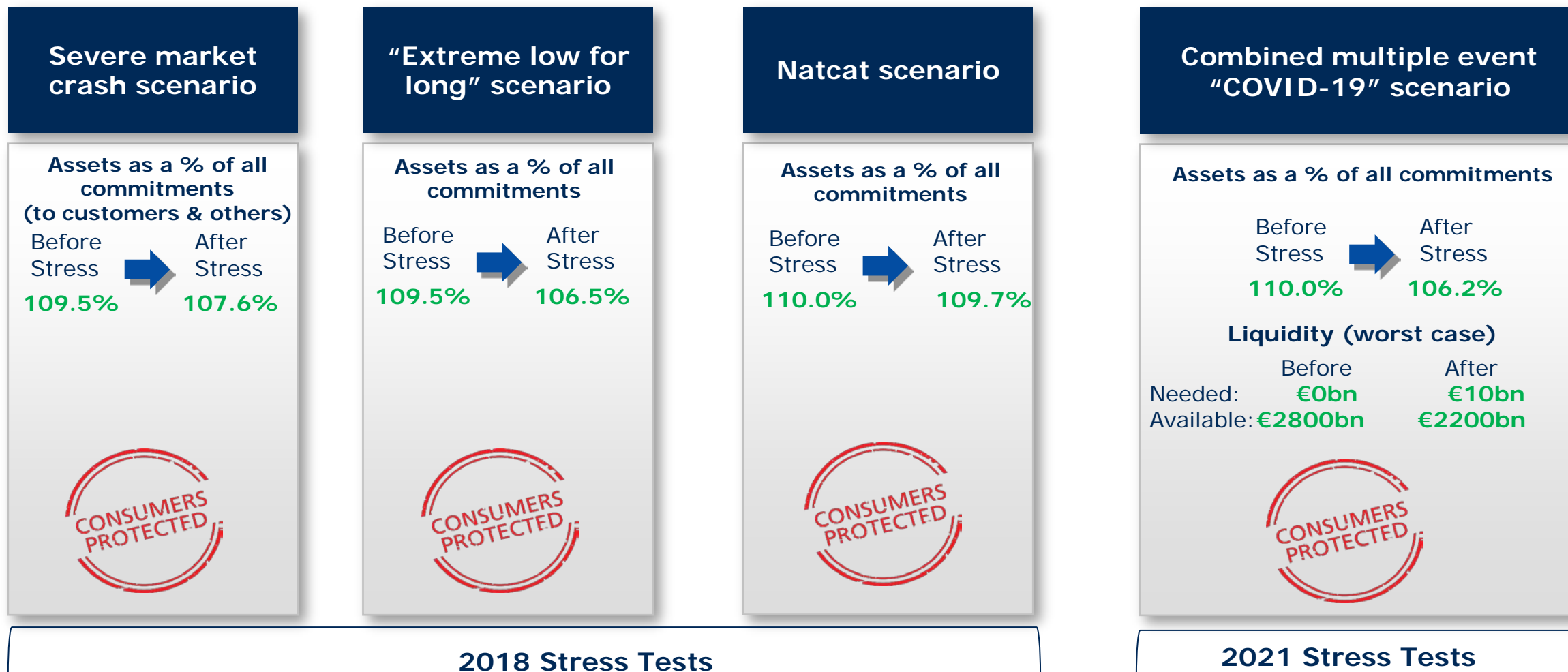
- Interest rates fall below -1% until 2030
- Equity: -45%
- Property: up to -20%
- Falls in bond markets
- 20% customer lapse and increased claims inflation

2018 Stress Tests

2021 Stress Tests

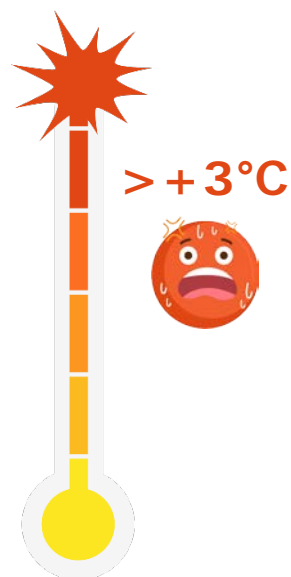
...and continue to confirm there is more than enough capital & liquidity

Also showing that correcting Solvency II flaws to increase capacity would not put customers or financial stability at risk



In Europe and beyond risks of “stranded assets” have also been tested

IAIS worst-case scenario: “Too little, too late” is very extreme



➔ **Temperature increase of more than 3°C**



➔ **Current implemented policies are maintained, so no further policy action taken**



➔ **Deteriorating living conditions, such as a 10x increase in exposure to natural hazards**



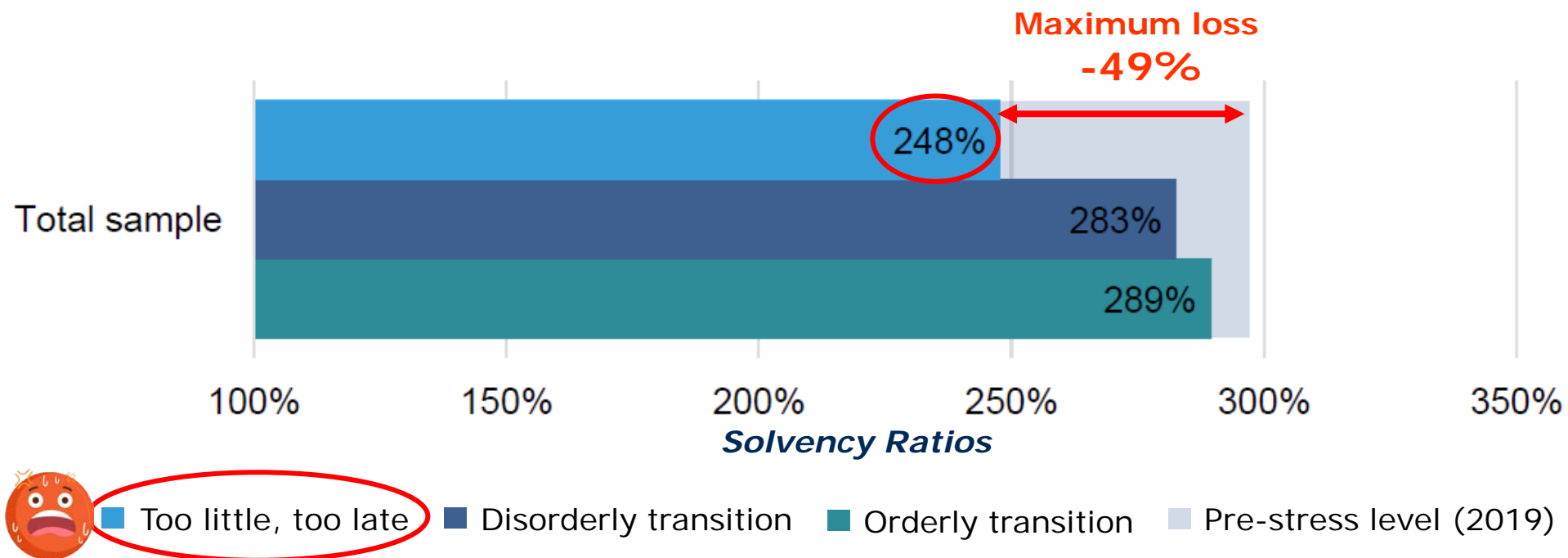
➔ **Severe and irreversible impacts, such as rising sea levels and disruptions to ecosystems**



➔ **Macroeconomic disruptions, such as disruptions to infrastructure, supply chains and health, & other transition risks**

The IAIS assessment indicates that consumers would remain protected

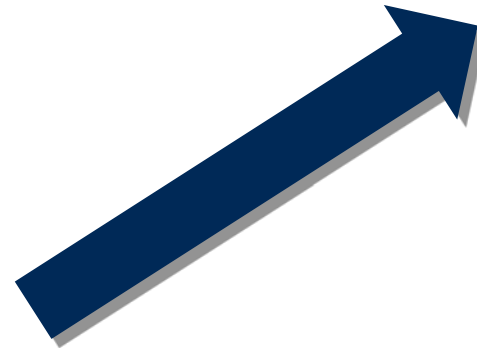
Even under the very extreme scenario, the solvency ratio remained very strong



EIOPA's December 2020 report* also found European insurers' exposure relatively limited and risks "manageable"

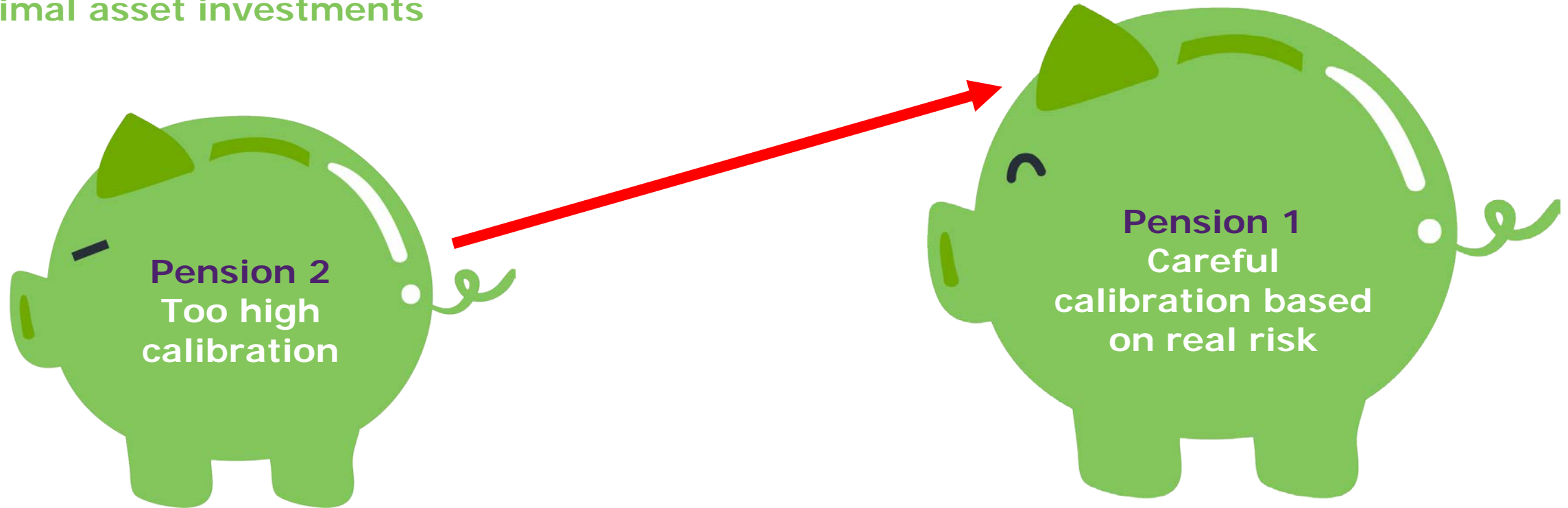
Some of the benefits of getting the capital right ...

Allow insurers to take more of the risk for consumers, which is currently increasingly pushed on to them



Some of the benefits of getting the capital right ...

Better returns over the long-term from more optimal asset investments



Some of the benefits of getting the capital right ...

Every €1 additional capital capacity would support ...



€1.70 in equity investments

€3 if the capital charge for long-term equity is properly corrected



€6 investment in green bonds

€9 if the dynamic volatility adjustment is extended to the standard formula in combination with existing spread risk charges



€1000 in windstorm protection

Conclusions



The corrections needed in the Solvency II Review would increase capacity by

- better aligning to the real risks and long-term nature of insurance
- leading to a justified, significant and permanent reduction in capital requirements and volatility



And so would provide benefits to policyholders and the wider economy by

- Avoiding unnecessary costs and allow for more real investments
- Removing barriers to guaranteed products
- Allowing insurers to play their full role on climate change and sustainability
- Helping European insurers to be internationally competitive



At the same time, policyholders would remain very well protected