

To: Gabriel Bernardino
Chairman
EIOPA

Cc: Martin Merlin, Director for regulation and prudential supervision of financial institutions
Nathalie Berger, Head of unit insurance and pensions
European Commission

Our
reference: ECO-18-131

Subject: Comments on EIOPA's communication of the stress test results

Brussels, 20 December 2018

Dear Gabriel,

I am writing to you as a reaction to the EIOPA public statements on the results of the 2018 stress test exercise.

We are pleased to see that the 2018 stress test exercise confirms the strength and resilience of Europe's insurance industry. However, we are disappointed by how EIOPA chose to interpret and communicate on the stress test results.

From the perspective of the European insurance industry it is very important that the design, limitations and the results of the stress test exercise are appropriately communicated and well understood, especially given the potential for financial market impact. We also consider it in the interest of the general public to acknowledge strengths and strong capital positions whenever these are supported by data as is clearly the case here.

This stress test, as the one before, demonstrates that Solvency II continues to ensure that individual companies and the industry as a whole remain strong and resilient to micro as well as macro prudential risks. We believe your recent communication around the stress test was a missed opportunity to highlight that Solvency II is a comprehensive, complete and transparent framework which ensures individual company solvency and consumer protection. We are concerned that your public communication on the stress test exercise might ultimately result in raising the acceptable level of company capitalisation, beyond that agreed by the European co-legislators.

We would like to highlight the following specific areas of concern:

■ **The results of the stress test confirmed the strength and resilience of the industry and that there are no financial stability concerns. However, EIOPA's key message was that the test showed industry vulnerability and significant impacts.**

- The aggregate baseline SCR ratio of 202.4% was described by EIOPA as "adequate". We would argue that double the target SCR is in fact not just "adequate", but a very strong capital level.
- The overall *ratio* of Assets over Liabilities (AoL) fell at most by 2.8% after the scenarios and remained above 106.7%. The results raise no concern over insurers' ability to pay all claims and other liabilities. EIOPA chose to focus on reporting a fall in *excess* of AoL of up to 32%. This latter number, although not relevant in terms of assessing financial stability, can appear to the general public, and even financial journalists, as a big and concerning number. In fact, Politico misunderstood the results and reported in their headline that "EU insurers' assets-liabilities ratio drops 30 percent in stress test".
- EIOPA described falls in the excess of AoL (and SCR ratios) after the scenarios as evidence of insurers' vulnerability and focused strongly on reporting this. In fact, the results are evidence of strength, rather than vulnerability. The fact that capital falls after such scenarios is a sensitivity and this is entirely normal given that insurers take these risks on behalf of customers.

- **Despite EIOPA noting that it was not a pass-or-fail capital exercise, its press release, executive summary and video put significant and even primary focus on the post-stress SCR positions.**
 - Beyond the practical difficulties in calculating the post-stress SCR, including such a measure in the stress test is problematic, especially since it is not even the Solvency II framework that is being applied (given the requirement to exclude key elements such as transitional recalculation and management actions, as well as the use of an instantaneous change to the UFR).
 - Solvency II is already a stress test and covering the same risks. It is not appropriate to set any expectation that an insurer should be able to meet its SCR capital post-stress. To do so would mean a huge increase above the 1 in 200 level of prudence that was agreed by the co-legislators as a fundamental calibration of Solvency II.
 - Therefore, the post-stress SCR results, if included at all, should only be for NSAs' and EIOPA's use and not reported publicly – because as soon as they are reported, especially if reported on an individual basis, there will be pressure for companies to adjust their risk profile to ensure their SCR remains above 100% under all stress scenarios at all times.
 - The AoL ratio provides a better reflection of the health of the industry from a financial stability perspective and should be the central focus for public reporting.

- **EIOPA continues to refer to the scenarios as being “plausible”, which is misrepresenting their likelihood.**
 - We would argue that the chosen scenarios and the exercise specifications are very extreme, in particular due to the multiple negative scenarios included simultaneously in each of the stresses and predicted to happen at the same time instantaneously.
 - Specifically, a decrease in the UFR of over 2%, non-allowance of management actions and no recalculation of transitional measures do not reflect economic or regulatory reality.

- **EIOPA insists that individual public disclosure will increase market discipline, improve the level playing field and increase confidence in the exercise. However, it fails to acknowledge that Solvency II already provides stress test data and extremely high levels of transparency.**
 - The baseline situation together with low interest rate, asset shocks, longevity, natcat stress scenarios and many more are all part of Solvency II capital requirements and reported publicly on a company basis in the SFCR.
 - Given the financial stability focus, the complexity of the exercise and the need to avoid it becoming a capital raising exercise, we do not believe that the public disclosure of individual company results is necessary nor appropriate. The risk of misinterpretation, misunderstanding and inappropriately alarming headlines was demonstrated by the press reaction.
 - The long-term guarantee (LTG) measures are a fundamental, permanent and indissoluble part of the valuation framework of Solvency II. Therefore, the communication of the stress test results with and without the effect of the LTG measures can lead to an artificial interpretation of results.

We stand ready to discuss the points above and look forward to continuing our dialogue on the insurance industry stress test.

Sincerely,
Olav Jones

