

To: Valdis Dombrovskis  
Vice-president for the Euro and Social Dialogue, Financial Stability, Financial Services and Capital Markets  
Union  
European Commission  
Rue de la Loi, 200  
1040 Brussels - Belgium

Our  
reference: EXCO-17-056

Subject: Insurance industry concerns over EIOPA's UFR changes and proposal to set up Solvency II Expert Group

Brussels, 26 April 2017

Dear Vice-President Dombrovskis,

I am writing to you to call on the Commission to prevent departure from the Ultimate Forward Rate (UFR) as set out in Solvency II.

As you know, the UFR is a key parameter to generate the long-term risk free rates and, as such, a crucial element of Solvency II. It was designed during the Omnibus II negotiations as a stable parameter to avoid artificial volatility, based on long-term historical data, and following recommendation by EIOPA was set at 4.2% for the euro. Parts of the Omnibus II agreement (eg the Long-Term Guarantee (LTG) package) might have been designed differently if it had been known that changes to the risk-free rate methodology could be made so quickly. As noted by the European Parliament Committee on Economic and Monetary Affairs, the review date of the LTG package by 1 January 2021 (the 2020 Review) *"was deliberately chosen to ensure a review based on market experience, to provide stability to market operators, and to ensure a coherent and consistent result."* This 2020 Review is the appropriate time to consider any changes relating to the LTG package. EIOPA's recent decision to apply changes to the UFR from January 2018 goes against the co-legislators' agreement on Solvency II.

#### **The current approach is already very conservative**

Setting the UFR at 4.2% does not mean that the industry discounts its liabilities at 4.2%. In fact, the discount rates remain far below 4.2%. For example, with the current UFR the risk-free discount rate for 10-year liabilities is below 0.6% and even for 60-year liabilities it is only 2.9%. Therefore, from a prudential point of view, there is no need for a rushed change because Solvency II's approach to interest rates is already conservative. Moreover, Solvency II assumes the current low rates are permanent and requires companies to hold capital for even lower permanent rates. Rates staying at their very low levels over the next 20 years is considered generally as an extreme scenario, but for Solvency II it is the base case. In addition, Solvency II has significant governance and reporting requirements, designed to ensure that company management acts early to address any problems such as interest rate mismatch and, should they not, provides supervisors with the information and powers to intervene early.

#### **EIOPA's powers should not be implicitly extended**

It was EIOPA's own initiative to prematurely suggest changes to the UFR. However, both Parliament and the Commission have raised concerns on the need for change at this early stage. The UFR is part of the risk-free rate term structure, and as such requires the endorsement of the Commission for it to be compulsory and apply across the Union. The Commission should avoid effectively extending EIOPA's powers and setting a precedent for further changes to the risk-free rates on EIOPA's own initiative. We would therefore encourage the



Commission to consider the overall effect of ceding power over elements such as the UFR to EIOPA and instead ask EIOPA to continue providing risk free curves with the current UFR.

**EC Expert Group to address concerns over Solvency II's impact on long-term products & investments**

EIOPA's decision sends the wrong signal to the industry by reinforcing the other problems Solvency II creates for long-term business. These problems have been highlighted by the industry since the Omnibus II discussions and, most recently, in the context of the EC call for evidence and the Capital Markets Union. They stem from Solvency II taking a short-term approach with a flawed underlying assumption that insurers need to be able to trade all assets and liabilities all the time. This puts at risk the industry's ability to provide long-term guarantees, pensions and savings products and to maintain and grow its role as a long-term stable investor, willing and able to invest in illiquid investments and avoid procyclical behaviour.

We are aware that this is an area that will be of focus in the 2020 Review and ask the Commission to consider already establishing an expert group in 2017 to assist in preparing the groundwork for this process. The expert group set up by the Commission during Omnibus II discussions to address the flaws in Solvency II provided recommendations which formed the basis of the LTG package without which Solvency II could not have been finalised. Bringing together recognised experts from regulators, academia and the industry, as well as EIOPA, is the best way to ensure suitable improvements are found and would be an appropriate part of the follow-up on the CMU call for evidence. It would provide a clear signal that the Commission takes issues around long-term investment seriously.

We thank you in advance for considering our comments and we would be happy to provide further details on the points raised above.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Balbinot".

Sergio Balbinot  
President