Memo for action

To: Solvency II WG, Public Affairs & Communications Committee
From: Prudential Team
cc:
Date: 26-04-2022
Reference: ECO-SLV-22-188

Subject: Key messages ahead of EGBPI on 5 May

Summary

Ahead of the Expert Group on Banking, Payments and Insurance (EGBPI) meeting on 5 May (Agenda), the secretariat has prepared a summary of Insurance Europe's key positions on the topics tabled for discussion.

Members are encouraged to share Insurance Europe's key positions with their EGBPI representatives ahead of the meeting.

Should members have any additional feedback on the proposals from the EC, please write to prudential@insuranceeurope.eu

Key industry positions on VA, Extrapolation and Long-Term Equity criteria

Volatility Adjustment (VA)

- **Risk correction:**
  - The industry welcomes the Commission's proposal to amend EIOPA's flawed risk correction by reducing the impact of the risk correction in periods of extreme spread widening.
  - **However, an improved calibration of the risk correction is needed to ensure the effectiveness of the VA mechanism**, particularly during periods of extreme stress when the VA is most needed.
  - Insurance Europe analysis shows the following calibrations to be effective in reducing the increased procyclicality (see page 3 of Insurance Europe paper for Commission's proposals).

Government bonds issued by member states

$$RC = 30\% * \min(S^+, LTAS^+) + 15\% * \max[0, \min(S^+ - LTAS^+, LTAS^+)] + 7.5\% * \max(0, S^+ - 2 * LTAS^+)$$

Other bonds, loans and securitisations

$$RC = 50\% * \min(S^+, LTAS^+) + 25\% * \max[0, \min(S^+ - LTAS^+, LTAS^+)] + 12.5\% * \max(0, S^+ - 2 * LTAS^+)$$

See ECO-SLV-22-080 for more details.

- **Quality overshooting ratio**:
  - Industry does not support the inclusion of a quality overshooting ratio.
  - The introduction of a quality overshooting ratio would result in significantly increased complexity and it is very difficult to assess the benefit of this proposed measure.
  - No proposals on important measures such as the VA should be included in the Solvency II review without being fully back tested to ensure they do not cause unintended consequences and actually work in all market conditions, including during the 2007-2009 global financial crisis.

- **Calculation of Credit Spread Sensitivity Ratio:**
    - For countries whose currency is pegged to the Euro**, the CSSR should be calculated jointly for the Euro and the currencies pegged to the Euro**.
    - The calculation of the CSSR **should be done an annual basis** except where there is significant changes to the insurers' investment portfolio. This is necessary to reduce the operational burden associated with implementing a CSSR.

Extrapolation of RFR

- **The EC's proposals for changing the extrapolation methodology need a significantly different calibration than the one proposed by EIOPA** to avoid increasing the cost of providing long-term and guaranteed products to policyholders and increasing volatility.

- **The key "speed of convergence" parameter must be significantly increased to least 15% for the EURO and to around 70% for SEK** to avoid excessive increases in the valuation of long-term liabilities and magnification of the artificial volatility to interest rate movements.

- **The main extrapolation parameters including the convergence parameter, should be included in the Directive.**

- **Unjustified changes to the risk-free rate curves should not be introduced,** as they would increase the cost of long-term products and increase volatility.

Long-term Equity

- **Insurance Europe welcomes the EC's stated intention to revise the eligibility criteria** for the LTE asset class.
- **The key aspects** which need to be addressed are:
    - Removal of quasi ring-fencing requirements
    - Extension of the application to OECD equities
    - Extension of application to all investment funds
    - Providing the appropriate options for insurers to demonstrate that they have the ability to avoid being forced to sell their long-term equity holdings – this should include the options put forward by EIOPA as well as a liquidity test approach.

See ECO-SLV-22-077 for more details.

Insurance Europe views on other topics

Interest Rate Risk

- The EC proposal to use the agreed Solvency II extrapolation approach to determine the illiquid part of the shocked interest rate curve is necessary and welcome. However, a change is needed to EIOPA's proposed methodology/calibration to avoid excessive impacts on the liquid part of the curve in very low interest rate environments.

Matching Adjustment

- The EC proposal to remove the limitations on diversification of matching adjustment portfolios is welcomed by the industry.

Symmetric Adjustment to Equity risk

- The industry supports the exclusion of unit-linked assets from the application of the symmetric equity adjustment if the application corridor is to be widened to +/-17%.

Risk Margin

The industry welcomes the EC's proposals to introduce a lambda parameter and reduce the cost of capital, and would support further, justified, improvements.