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

Cc: Valdis Dombrovskis
Executive Vice-President
European Commission

Our reference: ECO-20-075

Subject: Views of the insurance industry on the review of Solvency II

Brussels, 29 October 2020

Dear Commissioner McGuinness,

We would like to take this opportunity to follow up on the recent European Commission consultation on the review of the Solvency II prudential framework.

First, we would like to acknowledge the ambitious Commission objectives for the financing of sustainable EU economic growth, the transition to a zero-carbon economy, the creation of a greener, more sustainable and resilient Europe and building a capital markets union (CMU). Not only does our industry fully support these objectives, but we can play a major role in achieving them.

Today, our industry provides protection to individuals and businesses. It invests on behalf of policyholders and has over €10 trillion of assets under management, which support the European economy. In the future, this can be further enhanced to help finance European recovery, growth and the transition to a sustainable economy.

Solvency II, the framework governing our industry since 2016, has a significant impact on our ability to offer (long-term) products to consumers and make (long-term) investments in the economy. Solvency II is a milestone in the integration of the EU single market for insurance and our industry continues to strongly support it. However, the framework — as it is today — creates unnecessary costs and barriers, in particular in relation to our long-term business. In concrete terms, it has a number of measurement flaws that result in excessive capital requirements and volatility, and it is extremely burdensome from an operational point of view.

At a time when we are increasingly called on to support the EU economic recovery and a sustainable path for Europe, we must emphasise that we can contribute to our full capacity only if the Solvency II review produces the right results. This requires a limited but important set of improvements (set out in the Annex). The current crisis has demonstrated that our industry is sufficiently capitalised — in fact, the current levels of required capital are already excessive. The appropriate improvements will lead to a justified reduction in capital requirements and will also address the artificial volatility that Solvency II creates today. These improvements are not only needed to enable the industry to support the EU ambitions of a green recovery and growth and its delivery of the CMU objectives. They are also indispensable to allow our industry to compete internationally with non-EU players, whose regimes are significantly less burdensome.

Embedding a greater capital burden and new requirements in the framework — as suggested by EIOPA and the ESRB — is not justified. Instead, a more efficient and effective framework is necessary.

EIOPA set as an objective for its advice a so-called "balanced outcome" at year-end 2019. However, EIOPA's current proposals will not result in a "balanced outcome". Instead, they will lead to a significant increase in capital requirements, especially as EIOPA appears to leave out the impact of some of its most negative proposals. Its proposals will also make solvency ratios even more volatile, especially during periods of crisis and will trigger more pro-cyclical behaviour. It is fundamentally wrong to base technical advice on such an objective because it:

- ignores evidence that current requirements are too high and are creating unnecessary barriers;
- does not allow for a proper assessment of evidence or appropriate improvements;
- does not consider the impact of the proposals at other points in time;
- focuses on the impact at overall European level rather than at member-state level;
- does not distinguish between types of undertakings; and,
- completely ignores the EC, Parliament and Council objectives for the review.

Last, but not least, we are aware of recent proposals made by the ESRB (the governance of which EIOPA forms part) for new tools and measures aimed at "filling in the gaps in the framework" from a macroprudential perspective. The ESRB recognises that long-term financing and sustainable investment should be an objective of Solvency II and lack of such investment may itself create risks to financial stability. However, its proposals would achieve the opposite of this. In fact, we note that the ESRB proposals appear to be largely inspired by banking and their overarching theme seems to simply be to add more capital, more intervention powers and more regulatory layers on top of Solvency II on the grounds of financial stability. We would highlight that too much capital, which ultimately prevents us from offering valuable long-term products and making long-term investments, can be as damaging as too little capital for the European economy and consumers.

Solvency II already contains a number of provisions supporting macroprudential supervision. Financial stability is already an objective of the extensive and sophisticated Solvency II framework and there is no new evidence (from COVID-19 or elsewhere) that justifies considering any new measures beyond the limited number in the EC Call for Advice to EIOPA. Indeed, the COVID-19 crisis has demonstrated the strength of the Solvency II regime and the significant benefits it brought in terms of risk management, as well as the financial resilience of our sector.

To conclude, we believe the review of Solvency II should focus on improving existing instruments to fully reflect insurers' long-term business model, to mitigate artificial volatility and to reduce the unnecessary operational burden. This is a key opportunity for the Commission to make improvements that will help deliver on its objectives set out in the EU Green Deal and the CMU.

We look forward to engaging with you on this important review.

Yours sincerely,

(e-signed)

Andreas Brandstetter
President, Insurance Europe

(e-signed)

Mario Greco
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(e-signed)

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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 PEIF is a forum for the CEOs of major European headquartered international (re)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 AMICE

The Association of Mutual Insurers and Insurance Cooperatives in Europe aisbl (AMICE) is the voice of the mutual and cooperative insurance sector in Europe. Its primary remit is to advocate for appropriate and fair treatment of all mutual and cooperative insurers in Europe. It also 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. Mutual and cooperative insurance is characterised by customer-membership and democratic governance; such insurers are typically owned by their policyholders. They follow the principles of solidarity and sustainability. More than half of all insurance undertakings in the EU are mutual and cooperative insurers, accounting for a market share of more than 32%. They provide cover for more than 400 million members/policyholders and employ nearly 440,000 people.

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.

About CRO Forum

The CRO Forum is a group of professional risk managers from the insurance industry that focuses on developing and promoting industry best practices in risk management. The Forum consists of Chief Risk Officers from large multi-national insurance companies. It aims to represent the members' views on key risk management topics, including emerging risks.

Annex**:** Key positions of the European insurance industry on the Solvency II review

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KEY POSITIONS FOR THE 2020 REVIEW OF SOLVENCY II

Solvency II is strongly supported by the insurance industry. The economic, risk-based framework has proved its value since it was first applied in January 2016. However, the framework is excessively conservative, contains some measurement flaws and places excessive operational burdens on companies, which create unnecessary costs and barriers to the provision of — in particular — long-term products and investments.

The Solvency II review should not lead to an increase in overall capital requirements. For certain products, a better reflection of their real risk should lead to a justified reduction in capital requirements.

The industry believes that the review should lead to:

- A **more appropriate valuation of liabilities** by addressing the current technical flaws (in the volatility adjustment (VA) and risk margin) and maintaining what works (current extrapolation methodology, matching adjustment).
- A **more appropriate measurement of capital requirements** in the standard formula (eg, including the dynamic VA into the spread-risk assessment, improving the criteria for long-term equity, correcting the calibration of property risk, allowing for negative rates in the interest rate calculation).
- An **overall increase in insurers' capacity to invest and take on risks** due to reductions in capital requirements as a result of addressing the technical flaws in the framework. This will support insurers in:
  - maintaining their role as providers of long-term savings/pension products, which are key for the long-term well-being of European citizens, especially in light of ageing populations, the savings gap and strained national budgets;
  - providing protection to individuals and businesses, and working with governments to close the protection gap, which is more important than ever, given the challenges posed by climate change; and,
  - investing in the European economy, supporting the post-COVID-19 recover and the transition to a sustainable economy.
- A **less burdensome framework** by simplifying and streamlining reporting requirements.
- A **more diversified and efficient insurance market** by enhancing the application of proportionality.
- An **enhancement of the risk-based nature of the framework** by more appropriately capturing insurers' true business model and actual risks. This will:
  - maintain a very high level of policyholder protection; and,
  - strengthen financial stability.
- **EU companies better able to compete** with foreign firms in domestic and foreign markets.

The review of Solvency II is a key opportunity for policymakers to:

- Deliver on the important European objectives set out in the Green Deal and the Capital Markets Union, as well as support the Next Generation EU plans for the social and economic recovery of Europe.
- Support the competitiveness of the European industry on the global stage, and thus deliver on the EC ambition to strengthen Europe's leadership in the world.

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LONG-TERM BUSINESS

General	DO
	Ensure the link between assets and liabilities is recognised throughout the framework, both in the valuation and the solvency capital requirement (SCR). Ensure real, not theoretical, risk exposures are measured.

Volatility adjustment (VA)/ matching adjustment (MA)	DO	DON'T
	Make material improvements to the VA: it does not work well enough and needs improving to better mitigate market volatility and to be higher to better reflect what insurers can and do earn. Although EIOPA's draft proposals include some good ideas, other elements override them and would make the VA worse (see across). **Refine MA as proposed by EIOPA**: it works well and only limited refinements are needed.	**In the VA, do not change the risk correction or add a liquidity adjustment factor**. These elements of EIOPA's draft proposals are prudentially unnecessary and would make the VA more procyclical, worse at mitigating artificial volatility and neutralise improvements from the "option 7" country component, making the VA more complicated than necessary.

Risk margin	DO
	Review the design and calibration of the risk margin to lower the current excessive level and volatility. The risk margin is a purely theoretical amount added over and above the real reserves needed to pay all future expected claims and expenses. It currently reduces the risk-taking capacity of the industry by up to €190bn, is another source of artificial volatility and should be significantly reduced.

Risk-free interest rates	DON'T
	Do not change the current approach to the calculation of the risk-free rates. The methodology already reflects the current very low rates, including negative rates when they occur. EIOPA's draft proposal to change the method for extrapolating beyond the last liquid point is unnecessary, would create another source of artificial volatility and would make it even harder for insurers to maintain long-term business and therefore also impact long-term investment.

Interest rate risk SCR	DO	DON'T
	Allow for negative interest rates, using the shifted calibration approach.	**Do not use EIOPA's floor and do not apply the shock beyond the last liquid point**, as these elements of EIOPA's proposals assume unreasonable scenarios and would result in procyclicality.

	DO	DON'T
Spread risk SCR	**Maintain the current dynamic VA for internal model users**, without changes and new limitations such as those proposed in EIOPA's enhanced prudency principle. Applying the dynamic VA is an effective way to address the flaws in the measurement of spread risk and recognise the actual risk exposure when investing in corporate bonds. **Allow the dynamic VA to apply in combination with the existing spread risk charges for standard formula users**.	
Equity risk SCR	**Improve the criteria for the long-term equity category**. Much of insurers' equity investment is generally exposed to the risk of long-term under-performance and not to short-term market price movements. This equity category was created in the 2018 review in recognition of this, but the current qualifying criteria are poorly designed and almost no equity qualifies in practice. The criteria need to be improved so that a significant amount of equity investments qualify as long-term, thus removing a barrier to greater investment by insurers.	
Real estate	**Recalibrate the real estate asset category to 15%** to better reflect the real risks of this asset class.	
Sustainable investments		**Do not introduce artificial incentives or disincentives to hold assets on the basis of green or brown qualifications**. Appropriate improvements in the review, combined with the EC's powerful green finance strategy (eg SFDR and taxonomy) will provide strong incentives for insurers to accelerate their transition to sustainable investments.
Internal models	**Preserve (re)insurers' ability to reflect their own assessments of risks through the use of internal models**. There are already extensive and rigorous supervisory approval processes in place.	**Do not impose new reporting and disclosure of standard formula figures for internal model**. This would be onerous and undermine their purpose. **Do not seek standardisation of the design of internal models**. The purpose of internal models is to capture different and complex risks. **Do not add unnecessary limitations to internal models**, such as those proposed by EIOPA in the enhanced prudency principle on the DVA.

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Other	DO	DON'T
	Remove the requirement to publicly report solvency with and without the long-term measures. The long-term measures are there to reflect the true economics and the real risks. Requiring public reporting of solvency with and without them creates confusion and undermines their purpose, especially during periods of market volatility when they are most needed.	Do not change transitional measures — they should be left in place until they expire.

REDUCING THE BURDEN

Proportionality	DO
	Amend legislation to ensure proportionality works in practice. This should include: • Making clear that not only are NSAs legally able to allow insurers to apply proportionality, but they have a legal obligation to facilitate this. • Creating a non-exhaustive toolbox of proportionality measures with pre-defined, risk-based criteria for their automatic application. • Making clear that proportionality can go beyond the toolbox and apply to all, based on the nature, scale and complexity of the risks and activities (and not only on the size of the company). • An annual report assessing the application of proportionality, including proposals for how to improve its effectiveness and consistency.

Reporting	DO	DON'T
	Reduce the compulsory Quantitative Reporting Templates (QRTs). **Simplify the Solvency and Financial Condition Report (SFCR)** by allowing a short (eg , 2-page) summary together with a simple extract of QRT data (with no mandatory narrative).	**Do not make many changes to existing QRTs or add unnecessary templates such as the disclosure of standard formula numbers by internal model users.**

Thresholds	DO
	Allow member states to increase the thresholds at which Solvency II is applied, in line with EIOPA's draft proposals. Below this, local requirements apply.

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FURTHER ISSUES

Macro-prudential package/ recovery & resolution	DO	DON'T
	Only consider measures referenced in the EC call for advice. The extremely limited systemic risk presented by insurers and the comprehensive nature of Solvency II mean there is no justification for significant further supervisory tools. The EC measures should be applied in a proportionate way, if at all: • Empower supervisors to be able to temporarily prohibit redemption of policies in specific circumstances. • Consider pre-emptive recovery planning for insurers only where it would provide a tangible benefit, as determined by the supervisory authority. • Employ resolution only as a last resort, once all recovery options have been exhausted. Resolution plans should exclusively address the rare situation that an insurer ends up at a point of non-viability. • Recognise the importance of cross-border cooperation and coordination between supervisory and/or resolution authorities within the European Economic Area and in third countries, as well as the mutual recognition of resolution actions.	**Do not introduce new intervention powers before the SCR is breached**. Solvency II is already very comprehensive. With its two levels of capital — the MCR and significantly higher SCR — the framework was already designed for early intervention, which starts as soon as the SCR is breached. There is no need for new powers for even earlier intervention. **Do not introduce counter-cyclical capital buffers or capital surcharges for systemic risk**. Solvency II is already too conservative, adding even more buffers is unnecessary and would increase the barriers to long-term products and investments. Instead the focus should be on correcting the current measurement flaws so that they are not procyclical. **Do not introduce concentration limits**. **Do not introduce new powers for controlling dividends**. Solvency II already provides a strong basis and safeguards the framework for dividend distributions, including in the ORSA and risk appetite limits approved by Boards. The current case-by-case approach is appropriate. Blanket bans can have damaging effects, such as disruption of income flows for investors (eg, pension funds) that rely on regular dividends.

Group supervision	DON'T
	Do not make any significant changes to group supervision or capital calculations for groups. There are already sufficient supervisory convergence tools. It is important to preserve flexibility and supervisory dialogue to ensure national supervisory authorities can adapt to the various group structures and risk profiles.

Insurance guarantee schemes (IGS)	DON'T
	Do not introduce minimum harmonisation of IGS. Solvency II, when implemented appropriately, offers sufficiently high protection. The focus should be on ensuring Solvency II is calibrated and applied appropriately and on cooperation and coordination between supervisory and/or resolution authorities. The IGS currently in place vary significantly across Europe but generally work well in their local context and laws. The requirements and legal structures of IGS should continue to be decided by member states.

Non-proportional reinsurance	DO
	Improve the treatment of non-proportional reinsurance.