

Mairead McGuinness
Commissioner for Financial Services, Financial Stability and Capital Markets Union
European Commission
Rue de la Loi / Wetstraat 200,
1049 Brussels

Munich, 3 April 2023

Dear Commissioner McGuinness,

The Members of the Pan-European Insurance Forum (PEIF) were delighted to have the opportunity to talk to you on 9 March about the Solvency II review and the Retail Investment Strategy. I am writing in my capacity as PEIF Chair in response to your request during the meeting for further input and concrete ideas from our Members for how to address the concerns raised.

Solvency II

We strongly support the risk-based approach of Solvency II. However, certain aspects of how available capital and required capital are currently measured do not reflect the long-term insurance business model. This leads to unwarranted artificial volatility in solvency ratios and excessive overall capital requirements as compared to the target calibration of Solvency II (i.e., 99.5% VaR over one year). Long-term products and long-term investments are particularly affected by artificial volatility, and this has several detrimental consequences for European customers and for the broader European economy.

- Firstly, it makes long-term products unnecessarily expensive for customers, and creates disincentives for insurers to offer them. Such long-term products are not only wanted and needed by many customers, but they provide insurers with the foundation to invest in long-term assets.
- Secondly, it becomes more difficult for insurers to justify investing in real assets (such as equity, corporate bonds and property), and reduces their capacity to do so. Insurers are pushed to invest in portfolios with low returns for policyholders, while limiting insurers' ability to invest in the assets needed to drive the sustainable transition.
- Thirdly, it worsens the competitive position of EU insurers – both globally and as long-term investors in the European economy. Non-European insurers generally have more capacity to deploy capital to pursue risk-taking, innovation and investment – both at the global level and within Europe. The erosion of (re)insurers' competitiveness will have a negative impact on the EU's leadership in the global (re)insurance industry, might substantially harm the attractiveness of the EU as base for global insurance, and discriminates against EU insurers' long-term investments within the European economy in comparison with foreign investors.



The European (re)insurance industry has become an international success story in recent decades. However, with the implementation of Solvency II and its market value and risk-based approach, more capital has been necessary. The framework has proved to be more volatile than regulatory regimes that are not built on the same basis, leading to competitive distortions between international groups that compete with each other in markets around the world. As a result, European (re)insurers have to hold more capital for the same business than other global (re)insurers, and are subject to greater regulatory pressure to act with a short-term instead of a long-term perspective.

The IAIS's Insurance Capital Standard (ICS) project, which is based on Solvency II, was intended to create a more level playing field for internationally active groups with a single standard. Although ICS test calculations show lower capital requirements than Solvency II, it is still considered as significantly too onerous and volatile by our global competitors and their supervisory authorities (e.g. US, Canada and Japan) to be applicable in their home market. Also, the current revisions to the UK Solvency II regime will imply material improvements for UK-based insurance groups.

The Commission's proposals for the Solvency II review are a step in the right direction. However, further improvements are needed and warranted in light of the issues described above. They would strengthen the sector's global competitiveness, while ensuring European customers remain extremely well protected. Specifically:

- **Risk margin:** The Commission has proposed some improvements which would lower the level and volatility of the risk margin by around 30%. However, it would be meaningful and justified to target a reduction of at least 50%, also taking diversification effects into account.
- **Volatility adjustment:** We generally welcome the Commission's proposals to improve the effectiveness of the volatility adjustment, with the exception of the Commission's intention to change the 'risk correction' parameter. This would increase procyclicality and artificial volatility of Solvency II, in particular in a crisis situation, and undermine the other improvements of the volatility adjustment. The current risk correction is already conservative, and there is no need for adjustment.
- **Extrapolation of risk-free rates:** The Commission has proposed a new extrapolation method. However, the proposed calibration would create a new source of volatility (by transferring short-term interest-rate volatility to the reflection of long-term interest rates in Solvency II), incentivise increased derivative usage, and exaggerate the valuation of liabilities when interest rates are low. This should be addressed by a more appropriate calibration of the convergence parameter to at least 15%.
- **Internal models:** These are an essential tool of the Solvency II framework and have already been exposed to increasing supervisory requirements in recent years. We believe they should now be preserved as they are, without any further requirements that would increase their cost or undermine their usefulness.

- **Currency risk:** the Commission proposes to require additional currency risk to be recognised in the group capital requirement with regard to the participation in a third-country insurance subsidiary that is included in group solvency by the deduction and aggregation method. This risk should instead be considered and addressed through the Own Risk and Solvency Assessment.
- **Solvency II provisional equivalence:** In order to avoid a deterioration of the existing competitive position of EU insurers in third countries, it is essential that the Delegated Acts on the provisional equivalence of third-country solvency regimes are prolonged beyond 2025. This becomes even more relevant in times of increasing national protectionism – for example, as signalled by recent US legislation (such as the Inflation Reduction Act).

All of the above suggestions would help to durably strengthen the competitiveness of European (re)insurers and substantially support the green transition of the European economy.

Retail Investment Strategy

We would also like to take this opportunity to follow-up on some of the most pertinent issues raised in relation to the upcoming Retail Investment Strategy (RIS).

We understand that the European Commission is still considering introducing an EU-wide ban on inducements. In our view, this would not be an effective way to move forward. There is no evidence that justifies the need for an EU-wide ban on inducements, or proof that it would benefit all types of consumers in all Member States. The authors of the European Commission external study by Kantar¹ have acknowledged an error in their calculations. Therefore, it should not be used to inform the Commission's decision or the public debate.

We would like to reiterate the experience of market developments in the Netherlands shared during the meeting to illustrate our concerns with an EU-wide ban. The Netherlands benefits from an extensive and robust second pension pillar – unparalleled in other Member States – while new sales of third-pillar products are negligible. Since the ban was introduced in the Netherlands in 2013, new business in insurance-based investment products (IBIPs) has virtually disappeared, with the remaining market now primarily consisting of run-off business in discontinued products. IBIPs offer specific features, including financial guarantees and insurance protection that meet the need for security and certainty of customers considering an investment, and which contribute to reducing the protection gap. Removing access to

¹ European Commission, Directorate-General for Financial Stability, Financial Services and Capital Markets Union, Uličná, D., Vincze, M., Mosoreanu, M., et al., *Disclosure, inducements, and suitability rules for retail investors study : final report*, Publications Office of the European Union, 2023, <https://data.europa.eu/doi/10.2874/459190>

this market is not in the interests of consumers, especially in Member States that cannot rely on the effectiveness and robustness of their first and second pillars.

We also would like to highlight that applying a full ban at a later stage (phased implementation) would not mitigate its negative effects, as there is no evidence that retail investors would be willing or able to pay from their own pocket to access advice, and they might invest without taking any advice at all.

Our Members think that the following *meaningful changes* to the Retail Investment Strategy would enhance consumer protection.

- A more explicit requirement in the Insurance Distribution Directive (IDD) to carry out an assessment of the value-for-money of a product at the product-design stage would ensure that no excessive costs – including in relation to distribution – are charged to consumers.
- An enhanced transparency requirement calibrated to mitigate conflicts of interest, will ensure that the inducements remuneration model is not detrimental to consumers and empowers them to take a well-informed decision.

The Pan-European Insurance Forum remains committed to working with you and your experts, as well as the relevant stakeholders, to identify the best options for Solvency II and the RIS.

Yours sincerely,



Joachim Wenning
Chair of the Pan-European Insurance Forum

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