reinsurance advisory board

Position Paper

Comments on EC inception impact assessment: Review of measures on taking up and pursuit of the insurance and reinsurance business (Solvency II)

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Summary

The Insurance Europe Reinsurance Advisory Board (RAB) strongly supports the Solvency II framework and its underlying, risk-based, market-consistent approach.

The RAB's view is that the current Solvency II framework broadly works as intended. However, the Solvency II review needs to strike the right balance between stability and prudence on the one hand and efficiency and growth on the other. Therefore, the review should focus on fine-tuning existing deficiencies rather than a complete overhaul of the framework.

Given that the purposes of the review are to mitigate the impact of short-term volatility and support the long-term financing of the economy (objective #1) and ensure an effective application of the proportionality principle (objective #2), the RAB identified some deficiencies as well as some areas that are essential to reinsurers.

Some changes are needed to achieve the objectives of effective proportionality and mitigating volatility. In relation to the former, the recognition of non-proportional non-life reinsurance for ceding companies should be improved in the standard formula. Moreover, basis risk should be more appropriately defined so that it does not unduly hinder the use, scope and efficiency of risk mitigation via reinsurance. Concerning the mitigation of volatility, the group risk margin calculation should recognise the diversification of risks across the reinsurance group to reflect the reinsurance business model.

Furthermore, in order not to jeopardise objectives #1 (mitigating volatility), #2 (effective proportionality) and #3 (enhanced policyholder protection), the following should be considered: consistency in the treatment of future premiums at group level should be adopted since premiums have been included in the technical provisions and SCR, and it should be recognised that standard formula results are meaningless for benchmarking against internal model results in the area of reinsurance. Moreover, a macroprudential capital surcharge for reinsurers would duplicate the aim of existing requirements without a clear benefit for policyholders or financial stability, as reinsurance is a competitive B2B activity. Similar comments apply with respect to a blanket application of recovery and resolution planning to reinsurers.

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An additional objective of the review should be to preserve the international competitiveness of the European reinsurance sector. A justified reduction in overall capital requirements for EU reinsurers should be evaluated in light of this objective. In addition, Solvency II should not create market access restrictions for reinsurance.

Detailed comments

Overall, the RAB's view is that the current Solvency II framework works as intended, as has been demonstrated during the COVID-19 crisis. Therefore, the review should focus on fine-tuning existing deficiencies rather than a complete overhaul of the framework.

In particular, the RAB would like to highlight the following deficiencies, which it considers need to be addressed through the review. These relate to the stated purposes of the review to mitigate the impact of short-term volatility and support the long-term financing of the economy (objective #1) and ensure an effective application of the proportionality principle (objective #2).

- **Effective proportionality:** The recognition of non-proportional non-life reinsurance for ceding companies should be improved in the standard formula. A risk-based regime should foster appropriate risk management incentives for smaller and less complex insurers via an economic recognition of risk mitigation techniques including non-proportional reinsurance.

- **Effective proportionality:** Basis risk should be more appropriately defined so that it does not unduly hinder the use, scope and efficiency of risk mitigation via reinsurance. The current rules result in an "all or nothing" approach and changes are needed to allow for material basis risk to be adjusted for in the capital relief provided.

- **Mitigating volatility:** The design of the risk margin has implications for the competitiveness of EU reinsurers compared to non-EU jurisdictions that do not require a risk margin of local (re)insurers. The group risk margin calculation should recognise the diversification of risks across the reinsurance group to reflect the reinsurance business model. The RAB, as well as several other representative bodies, have shared evidence that supports a cost of capital below the current 6% level with the Commission.

A number of areas of Solvency II have proven to work well and are essential to reinsurers. In particular, any change in the following could jeopardise objectives #1 (mitigating volatility), #2 (effective proportionality) and #3 (enhanced policyholder protection).

- **Mitigating volatility:** Economic recognition of future premiums (and corresponding claims) at group level is the logical consequence of their inclusion in the technical provisions and SCR. The own funds item is fully available to absorb losses, and tools exist to make future profits available at a group level should the need arise. Consistency in the treatment of future premiums at group level is an important topic for reinsurers, as they are providers of long-term protection contracts.

- **Mitigating volatility and effective proportionality:** The standard formula does not capture reinsurance risks and their diversification appropriately in most cases and reporting or disclosure on a standard formula basis should not be required of reinsurers using internal models. It should be recognised that benchmarking standard formula results against internal model results is meaningless, particularly in the area of reinsurance. Additional proposed reporting with respect to internal models and the external audit of Solvency II balance sheets would significantly increase the regulatory reporting burden without bringing tangible benefits. Such reporting would duplicate work already done by national supervisors.

- **Enhanced policyholder protection:** A macroprudential capital surcharge would duplicate the aim of existing requirements, given the risk-sensitivity and the holistic nature of Solvency II, without clear benefits for policyholders or financial stability, as reinsurance is a competitive B2B activity. Similar comments apply with respect to a blanket application of recovery and resolution planning to reinsurers.

An additional objective of the review should be envisioned to preserve the international competitiveness of the European reinsurance sector. A justified reduction in overall capital requirements for the European reinsurance sector is essential if it is to remain competitive in a global environment in which European firms are leaders.

Similarly, Solvency II should not create market access restrictions for reinsurance. In this context, the reinsurance equivalence regime should be reviewed for ongoing appropriateness.

The RAB strongly supports the Solvency II framework and its underlying risk-based, market-consistent approach. The Solvency II review needs to strike the right balance between stability and prudence on the one hand and efficiency and growth on the other. Getting Solvency II right is vital not only for the competitiveness of the European reinsurance industry but also for its capacity to provide cover for the changing risk landscape, to contribute to reducing the protection gap and to make long-term investments that support sustainable European growth.

Insurance Europe's Reinsurance Advisory Board (RAB) is a specialist representative body for the European reinsurance industry. It is represented at chief executive officer (CEO) level by the seven largest European reinsurance firms: Gen Re, Hannover Re, Lloyd's, Munich Re, PartnerRe, SCOR and Swiss Re, with Insurance Europe providing the secretariat. Through its member bodies, the RAB represents around 60% of total worldwide reinsurance premium income. The RAB promotes a stable, innovative and competitive market environment. It further promotes a regulatory and trading framework that facilitates global risk transfer through reinsurance and other insurance-linked capital solutions.