Key Positions on the Solvency II Review

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 a fundamental overhaul of the system. Instead, targeted improvements are needed. The resulting amendments should lead to a better reflection of insurers' real risk. In aggregate, the impact of all changes should **lead to a justified and needed reduction in capital requirements and volatility**.

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 in 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 risk 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.

EIOPA's advice of December 2020 is a missed opportunity

- EIOPA did not provide evidence that the industry needs more capital — and yet has put forward proposals that would ultimately lead to significant increases in capital requirements.
- EIOPA's proposals would decrease the risk-taking capacity of the industry by around €60bn. They would also increase — not decrease — the volatility in the solvency measurement.
- EIOPA's proposals would hinder rather than enhance insurers' ability to support the recovery, the Green Deal and the Capital Markets Union and undermine the global competitiveness of our industry.

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.

Address flaws for long-term business

General

DO

- Address existing flaws to better reflect the long-term nature of insurance business.
- Adjust EIOPA's proposals where necessary to reflect economic and market reality and the EU climate and investment needs.

DON'T

- Change elements that work well.

Volatility adjustment (VA)/ matching adjustment (MA)

DO

- **Make material improvements to the VA**: it does not work well enough and needs improving to appropriately mitigate artificial volatility and recognise the returns that insurers can earn by increasing the overall application level and improving its sensitivity to market spread volatility.

  This can be achieved through the following changes based on elements of EIOPA's proposals: increasing the general application ratio; using an undiluted European reference portfolio; improving the country component; and inclusion of an overshooting ratio adjustment.

  For improvements to be effective and avoid unnecessary complexity, they must not include EIOPA's unjustified proposals to change the risk correction and add a liquidity adjustment factor (see across).

- **Refine MA as proposed by EIOPA**: it works well and only limited refinements are needed.

DON'T

- **In the VA, do not change the risk correction or add a liquidity adjustment factor**.

  These elements of EIOPA's proposals are prudentially unnecessary and would undermine other improvements, inhibit the ability of the VA to work as a counter-cyclical mechanism and make it more complicated than necessary.

Risk margin

DO

- Pursue a **significant reduction** through an appropriate combination of reducing the cost of capital, recalibration of the proposed lambda, and allowing for group diversification. 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 €160bn, is another source of artificial volatility and should be significantly reduced.

Extrapolation of risk-free interest rates

DON'T

- **Do not change the current approach to the extrapolation of long-term risk-free rates.**

  The methodology already reflects the current very low rates, including negative rates when they occur. EIOPA's proposals add further complexity and are unnecessary because there are already mechanisms in place to ensure that, even if rates stay very low, insurers will hold enough assets for very long-term liabilities.

Interest rate risk SCR	DO	DON'T
	Allow for negative interest rates, using the shifted calibration approach with an appropriately calibrated floor. **Use the agreed Solvency II extrapolation methodology** to calculate the stresses for long-term interest rates, ensuring consistency with how rates would change in practice.	**Do not use EIOPA's floor and do not use factor-based shocks for long-term rates**, as these elements of EIOPA's proposals assume unreasonable scenarios, would result in procyclicality and overstate the risk for long-term products.

Spread risk SCR	DO
	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 flaw 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	DO
	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 do not work 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	DO
	Recalibrate the real estate asset category to 15% to better reflect the real risks of this asset class.

Sustainable investments	DON'T
	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.

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.

Do not gold-plate international agreement on systemic risk measures

Macro-prudential package/ recovery & resolution	DO	DON'T
	Only consider measures referenced in the EC call for advice. The implementation of the holistic framework for addressing systemic risk should be done with proportionality in mind and should go no further than what was agreed internationally.: • 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 in terms of reduction of material systemic risk at EU level. • 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 designed with early intervention powers for supervisors. 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. This should not be changed. **Do not take forward additional proposals on 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 and impact global competitiveness. Instead the focus should be on correcting the current measurement flaws so that they are not procyclical. **Do not take forward additional proposals on 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. **Do not take forward proposals for additional concentration thresholds**.

Address operational complexity and 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. EIOPA's proposals for automatic application of proportionality are welcome, but need some adjustments and must be supplemented by criteria to allow automatic application where the insurer's exposure to risks or activities is not material.
  - 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 (without a focus 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 and disclosure

DO

- **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).

DON'T

- **Do not make many changes to existing QRTs or add unnecessary templates** such as the disclosure of standard formula numbers by internal model users.
- **Introduce external audit requirements for the SFCR**, on top of the existing supervisory review processes.

Thresholds

DO

- **Double the premium threshold and allow member states to increase the technical provisions threshold at which Solvency II is applied, in line with EIOPA's proposal, but with a range of €10-25m rather than €5m- 25m**. Below this, local requirements apply.

Focus on areas of proven need, avoid changing what works

General

DON'T

- **Do not change elements that work well or where it is unclear that benefits will outweigh costs** All changes add costs, can add to the complexity of the framework and can distract focus from other key areas of the review. The review should only include areas where there is evidence of a real issue and the benefits of the changes would justify their cost.

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.

Internal models

DO

- 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.

DON'T

- **Do not impose new reporting and disclosure of standard formula figures for internal models**. 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.

Group supervision

DON'T

- **Do not make any changes to group supervision or capital calculations for groups** except for the trigger inversion issue, where there is a clear flaw to address. Other EIOPA proposals (eg changes to the recognition of future profits and other changes to the availability assessment, new requirements for aggregation method 2 and the addition of a notional SCR for holdings) are not needed.

  There are already sufficient supervisory convergence tools. It is important to avoid additional complexity, costs and capital charges in order to preserve:
  - the European industry's competitiveness globally; and,
  - the flexibility and supervisory dialogue to ensure national supervisory authorities can adapt to the various group structures and risk profiles.

Supervision of cross-border business

DO

- In line with EIOPA's proposals:
  - Strengthen and enhance cooperation between home and host authorities.
  - Improve coherence and convergence in the supervision of activities based on freedom of services/freedom of establishment and protection of consumers.