insurance europe

Position Paper

Response to EC consultation on review of Solvency II

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Introduction

Insurance Europe welcomes the opportunity to contribute to the European Commission's consultation on the review of Solvency II.

Solvency II is strongly supported by the industry. Solvency II has proved its value in practice since it was first applied in January 2016. However, it is excessively conservative and has some measurement flaws and excessive operational burdens, which create unnecessary costs and barriers, in particular in relation to the provision of long-term products and investments.

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, 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 spread risk assessment, improving the criteria for long-term equity, correcting the calibration of property risk and allowing for negative rates into the interest rate calculation).
- **An overall increase in insurers' capacity to take investment and other risks** due to reductions in capital requirements in areas where this is justified when addressing the technical flaws of the framework.
- A **less burdensome and operationally heavy framework**, by simplifying and streamlining reporting requirements.
- A more **diversified and efficient insurance market**, by enhancing the practical application of proportionality.
- Allowing EU companies to be competitive with foreign firms in domestic and foreign markets.

All the above targeted outcomes will ultimately 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 an ageing society, the savings gap and strained national budgets. They will also support insurers in providing protection to individuals, businesses, and society at large, and in working together with governments to close the protection gap, which is more important than ever, given the challenges posed by climate change.

Improvements in Solvency II should maintain, and even enhance the risk-based nature of the framework, by more appropriately capturing insurers' business model and the actual risks that the industry is exposed to. This way, the level of policyholder protection will remain very high and financial stability will be strengthened.

An appropriate and ambitious review is also necessary to ensure insurers' can continue to play their role as major investors in the European economy, support the recovery and the transition to a sustainable economy.

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

- Deliver on broader European objectives set out in the Green Deal and the Capital Markets Union, (especially in relation to Action 4 on removing regulatory obstacles for insurance companies to invest long-term), as well as supporting the Next Generation EU plans for the social and economic recovery of Europe.
- Supporting 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.

At the same time, the industry stresses that the review **<u>must</u>**:

- **Not lead to an increase in overall capital requirements**, not least because Solvency II is already the most conservative regime in the world. Even more conservativeness would seriously harm not only insurers' ability to invest and offer valuable products to European policyholders, but also their competitiveness at an international level.
- **Not result in unnecessary changes and complexity** in technical areas that remain appropriate (eg extrapolation and last liquid point (LLP)).
- **Not introduce systemic risk related measures**, (such as recovery and resolution,) that go beyond those agreed at international level. Instead it should , but rather acknowledge the macroprudential aspects already inherent in Solvency II and the role and strength of the solvency capital requirement (SCR) and the minimum capital requirement (MCR) in the Solvency II framework.
- **Not introduce reductions in capital requirements that are not risk-based,** as incentives to address climate change. Removing unjustified Solvency II barriers will create strong enough incentives when combined with insurers' own natural interest and business model together with the EC's powerful regulatory initiatives (eg the Sustainable Finance Disclosure Regulation (SFDR), Taxonomy and the Non-Financial Reporting Directive (NFRD)) and the wider EU Green Deal.
- **Not introduce additional layers of regulation**, on top of Solvency II, such as harmonised insurance guarantee schemes (IGS). Solvency II, when implemented appropriately, offers sufficiently high protection. The focus should be on ensuring Solvency II is calibrated and applied appropriately, on regulatory and supervisory convergence, and on cooperation and coordination between supervisory and/or resolution authorities.

Regarding the **objectives of the Solvency II framework**, the insurance industry continues to strongly support the main objectives of policyholder protection and financial stability. In addition to these, the industry believes that the following objectives should be added, in line with the overarching priorities of the European Commission:

- Solvency II should support, and not hamper, long-term sustainable investments by the insurance sector.
- Solvency II should support, and not hamper, the competitiveness of European (re)insurers in Europe and internationally.

Regarding the **objectives for the review**, the industry believes that the following are key:

- The review should address the existing flaws of the Solvency II framework, in order to remove obstacles to insurers' investments in long-term and sustainable assets.
- The review should focus on facilitating and removing existing regulatory barriers to the offering of long-term savings and pension products, including guarantees. Allowing insurers to continue offering these products not only brings value to policyholders but is also a key pre-requisite for their ability to invest long-term in the European economy.
- The review should reduce the unnecessary burdens and costs of the regulation by making proportionality work in practice; simplifying & streamlining reporting requirements; and improving regulatory and supervisory convergence.

The industry's **key priorities** for the review are as follows:

- **Fixing the treatment of long-term business** is key, to allow insurers to: 1) offer long-term savings and pension products, including guarantees; 2) offer valuable protection products for citizens and businesses, and to support closing the EU protection gap; 3) invest in a long-term, sustainable manner in the European economy and therefore support the EC's objectives. The industry therefore calls for:

- An appropriate **valuation of insurance liabilities**, which requires:
    - Improving the **Volatility Adjustment (VA)** so that it better mitigates market volatility, appropriately recognises country specific spreads within the eurozone and better reflects the spread above the risk-free rate that insurers can and do earn almost risk-free, too.
    - Improvements to the VA are key for most markets, but they will not address all volatility issues for cases where portfolios differ significantly from the reference one (for example, the Netherlands where the level of mortgage assets has a significant impact). For these countries, it is even more important that the dynamic VA is maintained without change for internal model users and allowed to be used in combination with the existing spread risk charges for standard formula users.
    - Making targeted refinements to the **Matching Adjustment (MA).**
    - Maintaining the current approach to the **extrapolation of the risk-free rates.**
- An **appropriate, risk-based capital treatment of assets**, which requires:
    - Fixing the design of **the long-term equity** asset category.
    - Maintaining **the current dynamic VA for internal model users,** without changes, and **allowing the dynamic VA to apply in combination with the existing spread risk charges for standard formula users**. 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. Internal model users are currently able to apply the dynamic VA subject to supervisory approval – this should continue without changes. The dynamic VA should further be allowed to be applied in combination with the existing spread risk charges by standard formula users.
    - Recalibrating the **real estate** asset category.
    - Allowing for **negative interest rates** in the capital calculation with an appropriate floor and by first stressing the liquid part of the curve and then extrapolating the illiquid part accordingly.
    - No artificial incentives/disincentives for **green/brown assets.**
- A review of the design and calibration of the **risk margin** to lower the current excessive level and volatility.

- **Making proportionality work in practice** is key to avoid unnecessary costs which ultimately would have to be borne by policyholders. The industry therefore welcomes the Commission's ambition to improve the application of proportionality in Solvency II. Changes are necessary to ensure that any insurer can avoid overly burdensome requirements, based on the scale, nature and complexity of its activities.
- Streamlining of **reporting requirements** is vital to ensure the reporting package remains fit for purpose, to avoid unnecessary burdens and to prevent costs for insurance companies, which would be passed on to policyholders.
- In the **macroprudential and cross-border supervision area**, there is a limited need for additional tools, as Solvency II already provides several safeguards.
    - Only **measures referenced in the EC's call for advice** justify consideration and should only be introduced if the Solvency II framework can be shown to be insufficient, if benefits outweigh costs and by fully taking into account proportionality. There is therefore **no need for more drastic measures such as those proposed by the European Insurance and Occupational Pensions Authority (EIOPA) or the European Systemic Risk Board (ESRB) in the past.** For example, there is no need for supervisory intervention before an SCR breach, counter-cyclical capital buffers, capital surcharge for systemic risk or concentration limits.
    - Pre-emptive recovery planning should only be considered for insurers where it would provide a tangible benefit for financial stability within the EU, as determined by the relevant supervisory authority.
    - Resolution should be a measure of last resort, which should only be employed once all recovery options have been exhausted. Resolution plans should exclusively address the remote situation that the insurer eventually ends up at the point of non-viability.
    - Insurance Europe supports powers for public authorities to temporary prohibit redemption of policies in specific circumstances.
    - Cross-border cooperation and coordination between supervisory and/or resolution authorities within the EEA and third countries, as well as the mutual recognition of resolution actions is important.

- The requirements for a legal structure of **IGS** should be left to the discretion of individual member states and therefore there should be no minimum harmonisation.
- **Internal models** are and should remain a core element of Solvency II. Introducing standard formula reporting requirements for internal model users should be avoided, as they are onerous, unnecessary, misleading and would undermine the integrity of internal models.
- In the area of **group supervision, flexibility and supervisory dialogue should be preserved**, to ensure NSAs can adapt to the various structures and risk profiles of groups. Concerns that only target a very small number of groups should not be addressed by changes to the legislation, but should more appropriately be achieved through the use of supervisory convergence tools, which help to foster a better understanding as to why and how in some cases divergent practices are justified by the specificities of particular groups. With respect to capital calculations for groups, the industry is of the view that **no significant changes in capital calculations** should be made.

Contents

Section 1: Long-termism and sustainability of insurers' activities, and priorities of the European framework

Q1. *What could be the renewed objectives of European legislation for insurance companies?*

	1	2	3	4	5	6	7	8	9	Don't know/ no opinion
Policyholder protection									x	
Financial stability								x		
Fostering investments in environmentally-sustainable economic activities which will be defined in the EU taxonomy[7]								x		
Fostering long-term investments in the real economy and providing long-term financing to European companies, including SMEs								x		
Ensuring a fair and stable single market								x		

Summary:
The main objectives of insurance regulation should remain policyholder protection and financial stability.

However, considering the EU's overarching goals regarding sustainable growth and global competitiveness, it makes sense for Solvency II to reflect these goals too.

Apart from the additional potential objectives identified by the EC in the table above, another objective should be added: namely that Solvency II should **support the international competitiveness of the European insurance industry, with an importance set at 8**. While Solvency II is the most sophisticated risk-based regime in the world, it is also the most conservative. The industry strongly supports a risk-based regime that ensures a high-level of policyholder protection and supports financial stability. At the same time, the regime should not hamper, but instead support the global competitiveness of the European (re)insurance industry, which is the most international industry in the world, and a success story for Europe. This over-arching objective of the European Union to support European competitiveness at a global level should become an objective of Solvency II itself, and should be added under Art 28 of the Directive.

At the same time, it is key to understand that what generates insurers' ability to invest with a long-term perspective is the flow of premiums that they receive from policyholders for their long-term savings/pension products. Removing barriers to long-term investments is key, but equally key is removing barriers to the offering of long-term products, including long-term guarantees, which are the generators of the industry's long-term investment capacity. Therefore, the review of Solvency II should give the highest priority to insurers' ability to offer long-term guarantees. (see Q2)

Further comments:
The industry notes that long term guarantees (LTG) can refer to both the amount and duration of the future claim (in some markets insurers can provide a pension for as long as you live).

Q2. *In light of market developments over the recent years, in particular the low or even negative interest rates environment and the Covid-19 crisis, what should be the priorities of the review of the European legislation for insurance companies?*

	1	2	3	4	5	6	7	8	9	Don't know /no opinion
Ensuring that insurers remain solvent		x								
Ensuring that insurers' obligations to the policyholders continue to be fulfilled even in the event that they fail		x								
Ensuring that there are no obstacles for insurance companies to contribute to the investment needs of the European Green Deal, i.e. fostering insurers' investments that help the transition to carbon neutrality by 2050									x	
Ensuring that there are no obstacles for insurance companies to invest in accordance with the objectives of the Capital Markets Union, i.e. fostering insurers' long-term financing of the European economy, including SMEs									x	
Facilitating insurers' ability to offer (sufficiently) high returns to policyholders, even if this implies taking more risks									x	
Facilitating insurers' ability to offer products with long-term guarantees									x	
Ensuring that insurers do not face liquidity issues (i.e. that they have sufficiently liquid assets) to meet at all times short-term obligations[8]		x								
Preventing the build-up of systemic risk and ensuring financial stability		x								

Summary:
Insurance Europe understands that this question is not about the general importance of certain objectives, but rather about whether and how/where the existing regulatory framework needs to be improved in order to achieve these objectives.

- **Reducing the unnecessary burdens and costs of the regulation** should be one objective of the review, with an importance set at **9**. The overly high costs and strains of Solvency II make long-term guarantee products very capital intensive, to the detriment of policyholders. Increasing operational efficiency can be achieved by:
  - Making proportionality work in practice.
  - Simplifying & streamlining reporting requirements, in line with the EC's fitness check of supervisory reporting requirements.
  - Improving regulatory and supervisory convergence to avoid additional regulatory burden due to additional layers and diverging regulation, avoid gold-plating and ensure a level-playing field.

Further comments:
Insurance Europe understands that this question is about the focus of the Solvency II review to achieve the objectives of the regulation, and therefore highlights the following regarding the scores given in the table:

Ensuring that insurers remain solvent

Solvency II already sets high standards for insurers – eg they must hold enough capital to withstand a 1 in 200 event – and includes extensive Pillar 2 and Pillar 3 requirements. This already ensures a high level of solvency for the insurance sector. As such, it should not be a strong objective of the review to enhance requirements in this respect. Instead, the review should focus on ensuring that measurements are right and do not create unintended consequences.

Ensuring that insurers' obligations to the policyholders continue to be fulfilled even in the event that they fail

As stated above, Solvency II provides a very high level of protection to policyholders. In fact, even in a pre-Solvency II environment, EIOPA's assessment of insurers' failures and near misses concluded that few occurred, and that few policyholders have been adversely affected since Solvency II came into force.

The focus should therefore not be so much on the isolated and limited likely cases of failure, but rather on making sure that the current flaws in Solvency II are fixed, that the framework works as intended, and supports the EU overarching goals.

Ensuring that there are no obstacles for insurance companies to contribute to the investment needs of the European Green Deal, ie fostering insurers' investments that help the transition to carbon neutrality by 2050

The review should be focused on removing barriers and allow insurers to invest with a sustainable approach. Proposals for improvement of the framework should remain risk-based and be assessed also in terms of their impact on long-term sustainable investing by the insurance industry: it is key that the review better reflects the long-term nature of the business, which will also benefit sustainable investment.

Ensuring that there are no obstacles for insurance companies to invest in accordance with the objectives of the Capital Markets Union, i.e. fostering insurers' long-term financing of the European economy, including SMEs

Same comment above.

Facilitating insurers' ability to offer (sufficiently) high returns to policyholders, even if this implies taking more risks

The returns insurers can offer to their policyholders very much depend on the macroeconomic environment and financial market conditions. The ultra-low interest rate environment inevitably reduces potential returns for long-term products. This makes it even more important that the regulatory framework is risk-based, efficient and does not create unjustified capital burdens. The industry has highlighted many times that the current capital charges are preventing insurers from investing in assets with good returns for policyholders. Fixing the flaws in Solvency II would allow a fair treatment of investments which would:

- Remove unduly high capital charges, hence lower costs for the guarantees offered to policyholders.
- Allow insurers to invest in assets with higher possibility of return, also to the benefit of policyholders.

Facilitating insurers' ability to offer products with long-term guarantees

Long-term products with guarantees are highly valued by policyholders and play a fundamental role in the provision of occupational and personal pensions in a number of EU countries. They are key in addressing the challenges of an ageing society, the savings gap and strained national budgets. In addition, these long-term products, alongside other savings and pension products, facilitate insurers' ability to make long-term investments (see Q1).

Solvency II should not create unnecessary and unjustified barriers to the provision of long-term products. The review should therefore ensure that the LTG measures are improved to ensure that they are effective and capital charges for long-term investments reflect the long-term risks that insurers are exposed to.

Ensuring that insurers do not face liquidity issues (i.e. that they have sufficiently liquid assets) to meet at all times short-term obligations

Liquidity risk is not a major issue for insurers, because the business model already limits the exposure and because insurers actively assess and manage liquidity as needed. The existing regulatory requirements are sufficient to provide the assurances needed that insurer will not face liquidity issues.

Preventing the build-up of systemic risk and ensuring financial stability
In light of the limited systemic risk posed by the insurance sector, and the comprehensive protection already provided by Solvency II, the review should not focus on creating new macroprudential tools. Instead, financial stability could be further supported by enhancing the effectiveness of LTG measures (which prevent procyclical behaviour).
The industry recognises that there is now an international framework for addressing systemic risk, and that the EC call for advice reflects this framework to a large extent.

Q3. *Have the recent changes to the prudential framework regarding equity investments appropriately addressed potential obstacles to long term investments?*
Yes / No, the recent changes will not have a material impact on insurers' ability to invest for the long term / Don't know/no opinion

- No, the recent changes will not have a material impact on insurers' ability to invest for the long term

Please specify what the remaining obstacles are, and how to address them while preserving the necessary prudential safeguards to ensure policyholder protection:

Summary:
The industry appreciates the EC's previous work in this area and acknowledges the steps taken with the objective to improve the framework for long-term equity (LTE) in Art 171a of the Delegated Regulation. However, some application criteria are hard to fulfil and reduce the applicability of the sub-category, as evidenced in the EIOPA data collection exercises.

The criteria for LTE in the Delegated Act are too strict, making it very difficult or even impossible for insurers to apply this sub-module to their LTE portfolio. The recent alternative criteria proposed by EIOPA as part of its Holistic Impact Assessment are also inadequate because the LTE would only qualify for the reduced risk factor under prohibitive conditions.

The industry therefore calls for a review of the LTE submodule to address the problems raised by the current and EIOPA's proposed criteria and enhance the applicability of the submodule in practice.

With respect to the specific criteria:
- Criterion (b) to (d) of Art. 171a can be problematic for some markets as they can only be implemented in EU legal systems with corresponding balance sheet structures.
  - The industry proposes to remove such criteria.
- Criterion (e) on the average holding period effectively mandates a buy and hold strategy for insurers' equity portfolios with little or no flexibility for ongoing management.
  - The industry proposes to substitute this criterion with a commitment-to-hold approach.
- Criterion (f) on EEA shares considerably restricts the investment universe.
  - The industry proposes an extension to OECD shares.
- Criterion (g) of Art. 171a is hardly implementable. EIOPA's alternative criterion is also a step back to a very conservative approach.
  - The industry considers that criterion (g) should be relaxed and the threshold lowered. Should the EC consider EIOPA's proposal, it should account for the features of countries with business characterised by lower durations and asset liability management (ALM) practices of non-life insurers.

Further comments:
Insurance Europe appreciates the EC's previous work in this area and acknowledges the steps taken with the objective of improving the framework for LTE in Art 171a of the Delegated Regulation. However, some of the application criteria are hard to fulfil and reduce the applicability of the submodule. This has been evidenced in the EIOPA data collection exercises which have shown that very few companies expect to make use it.

In order to achieve the political objectives for which this specific provision on LTE was introduced and to ensure the existence of a level playing field, the application criteria must be changed. The industry therefore calls for a review of the LTE submodule, aimed at addressing the problems raised by the current, and EIOPA's proposed, criteria and enhancing the likelihood that it would be applied in practice. Only feasible criteria which ensure that equities can be held for a long term should be maintained.

With respect to the criteria, the sector notes that:

- **Criterion (b) to (d)** of Art. 171a can be problematic for some markets as they can only be implemented in EU legal systems with corresponding balance sheet structures. This implies that a "level playing field" does not exist. **Criterion (c)** is also not applicable in practice as in many cases liabilities are covered generally by a cover pool of investments, with no allocation of individual investments to individual liabilities.
    - The industry proposes to remove these criteria.
- **Criterion (e)** of Art. 171a on the average holding period effectively mandates a buy and hold strategy for insurers' equity portfolios with little or no flexibility for ongoing management, and without regard to actual risks and performance potential. The current delegated act implies that no share is allowed to be sold until an average retention period of five years has been reached. In this respect, the average holding period is not an optimal proxy to assess a long-term investment strategy.
    - The industry proposes to substitute this criterion with a commitment-to-hold approach at portfolio level, which would be applicable also to portfolios that do not yet have the required average holding period, but which are intended to be held for more than five years. Therefore, the average holding period could be satisfied:
        1. Ex ante for a portfolio with an average holding period of more than five years.
        2. Ex post for a portfolio without the required average holding period but intended to be held for more than five years.
    - As an alternative to the commitment-to-hold approach, the criterion could be simplified in line with the portfolio concept. Specifically, the criterion could set upper limits for a turnover rate associated with the desired long-term holding period, eg a target average holding period of five years could lead to a one-sided turnover rate of 20% pa.
- **Criterion (f)** of Art. 171a on EEA shares considerably restricts the investment universe.
    - The industry proposes an extension to OECD shares, consistent with the approach for type 1 equities.
- **Criterion (g)** of Art. 171a is hardly implementable in practice and is inappropriate in view of the long average holding period of long-term investments of insurers, which has been proven and also determined by EIOPA. EIOPA's alternative criterion (g) also undermines the overall LTE submodule and is a step back to a very conservative approach, similar to the Duration Based Equity Risk submodule, which is applied by one single undertaking in the whole EU. Beyond being overly restrictive, this criterion is incoherent with the liability structure of companies operating in most European countries, and needs to be changed to avoid over-restrictions to the use of the LTE submodule.
    - The industry considers that criterion (g) of Art. 171a should be relaxed and that its ten-year threshold should be lowered to be in line with the average durations of most European countries' businesses (ie 6-7 years).
    - Should the EC consider EIOPA's proposal, then the criterion should be modified. Specifically:
        - For life insurance:
            - The duration requirement should reflect the average duration of most European countries' businesses (ie 6-7 years) which reflects the long-term time horizon for these businesses.
            - The requirement for liabilities to be in category I under EIOPA's VA liquidity assessment condition should be replaced by the demonstration by the insurer that they are not exposed to forced sales as part of their Pillar II liquidity assessment.
        - For non-life insurance, the calculation of the liquidity buffer should be based on the demonstration by the insurer that they are not exposed to forced sales as part of their Pillar II liquidity assessment.
- **Criterion (i)** proposed by EIOPA as part of its Holistic Impact Assessment captures a diversification element that is already a requirement of the Solvency II prudent person principle.

- The industry agrees with this criterion, provided it does not increase the submodule complexity.
- **Point (2)** of Art. 171a decreases the complexity of the submodule by allowing insurers to assess conditions in paragraph 1 at the level of the funds rather than at the level of the underlying assets. Assessment at the fund level should not be dedicated to specific funds only, as this will harm the application of the LTE submodule to other potentially qualifying portfolios.
  - The industry asks that point (2) is extended to all LTE portfolios.
- **Point (4)** proposed by EIOPA to exclude controlled intra-group investments from the scope of LTE is not an adequate measure to ensure LTE investments are actually held over the long term. This is because LTE investments can be represented by intra-group investments and can often be directly linked to a source of return for policyholders. Intra-group investments are often compliant with the criteria of Art. 171a, but it is more difficult for them to qualify under the strategic equity submodule (Art 171), largely because the condition of lower forward-looking short-term volatility is difficult to demonstrate.
  - The industry proposes not to exclude intra-group investments from the scope of Art. 171a unless the volatility criterion in Art. 171 is removed to allow for proper use of the strategic participation category.

Finally, some uncertainty remains regarding the scope of application and the criteria to be satisfied under the LTE sub-category. It is key that guidance and dialogue at the level of national supervisory authorities (NSA) ensure that the application of the LTE investments sub-category is duly considered and works in practice. As in other cases, the "burden of proof" for the criteria should not always lie with the undertakings, but also with the NSAs, and efforts to make the LTE sub-category work should be shared.

Additional observations
The following points illustrate in more detail the reasons why the current criteria make it very difficult or even impossible for insurers to apply this sub-module to their LTE portfolio.

- **Criterion (b) to (d)**, if applicable at all, are difficult to fulfil because most insurers set their ALM strategies and manage their investments on a holistic basis where liabilities are covered by a pool of investments with no allocation of individual investments to individual liabilities. For the submodule to be usable in practice, the "quasi ring-fencing" requirements from Art. 171a should be deleted, as also outlined in the recent Holistic Impact Assessment of EIOPA.
  - As an example, these criteria restrict insurer's ability to fulfill its obligation to optimise the portfolio, while limiting the possibilities for diversification and increasing investment costs. Moreover, they are in contradiction with the profit-sharing mechanism and the uniform asset portfolio which are in place in some jurisdictions.
- **Criterion (e)** of the current delegated act implies that no share is allowed to be sold until an average retention period of five years has been reached. Criterion (e) is therefore contrary to good risk management practices, such as portfolio rebalancing, and precludes active management strategies which can provide better risk adjusted returns. A portfolio classified as LTE should have a correspondingly long investment horizon overall, whereby insurers must be free to manage the assets dynamically: ie they are able to sell individual securities to optimise the risk/return ratio in relation to customer needs, the insurer's risk tolerance, market information and the assessment of the long-term prospects of the respective investments. The industry notes that:
  - An absolute ban on the sale of shares does not fit in a sound investment policy. As concluded by EIOPA, it is the long-term strategy that matters, not the retention period of individual shares (see Chapter 2.3 p. 74 & 78 EIOPA, Report on insurer's asset and liability management in relation to the illiquidity of their liabilities, 16 December 2019, EIOPA-BoS-19/593).
  - Insurance companies invest indirectly in long-term shares: eg via funds to which the look-through approach is applied. Even if these funds may take a long-term view, for the above reasons, funds cannot promise not to sell any shares. As a result, companies that have not yet reached an average holding period of five years (ex post) cannot invest through a fund because once the fund sells a share, the company would no longer meet the conditions for long-term shares with severe penalties and unstable SCR as a result.
  - Companies should retain the possibility to change their investment policy without losing sight of the long-term vision. For example, firms may redirect their exposure in response to a new

investment strategy (eg the phasing out of carbon-intensive and polluting stocks) or in response to changing fundamental market conditions. The industry agrees with EIOPA's approach in its holistic impact assessment that for these ex post portfolios, it would be more logical to use a commitment-to-hold approach until the average holding period of five years is reached, as EIOPA proposes. (see Nr. 91 e) European Insurance and Occupational Pensions Authority (EIOPA), *Technical specification of the information request on the 2020 review of Solvency II,* 2 March 2020, EIOPA-BoS-20/107)

- Regarding **criterion (g)** proposed by EIOPA as part of its holistic impact assessment, the industry notes that:
  - The requirement to have a Macaulay duration of the liabilities in homogeneous risk groups exceeding 12 years would not be possible in countries where business is characterised by lower durations. Should this requirement be kept, it needs to be modified to a maximum of 6-7 years. Should this criterion be unchanged, then it will restrict the scope of application of the LTE submodule, being limited mostly to few long-duration pension products.
  - The requirement for non-life entities to cover all its best estimate liabilities with high-quality liquid assets (HQLA) as defined by banking regulation (ie the Liquidity coverage ratio) is also inappropriate as, on a going concern basis, an insurer should not be required to cover all its liabilities with liquid assets as a sound ALM shall invest in liquid assets to cover the cash flows of the first years of the liabilities and on more illiquid assets on a longer term. In addition, the scope of liquid assets is extremely restricted – it excluded bonds of financial institutions and listed equity – and the proposed liquidity test might also lead to restrictions in the application, especially considering it is not tailored to insurers, but for banks.

Q4: ***Does the prudential framework set the right incentives for insurers to provide long-term debt financing to private companies, including SMEs (i.e. to invest for the long-term in long-maturity debt instruments)?***
Yes, the framework provides the right incentives
No, investments in long-maturity bonds (more than 15 years) should be less costly for insurers, regardless of whether they hold their investments for the long term
No, there should be a preferential treatment for long-term investments in bonds that are held close to maturity, with appropriate safeguards
No, and in order to effectively reduce the cost of investment in bonds,
Solvency II should allow all insurers to apply the dynamic modelling of the volatility adjustment
No, and I have another proposal to address this issue
Don't know/no opinion

- No, and in order to effectively reduce the cost of investment in bonds, Solvency II should allow all insurers to apply the dynamic modelling of the volatility adjustment

Summary:
First, it is important to note that the industry is not seeking incentives to long-term investment but only to remove unjustified disincentives. Solvency II is a risk-based framework and should remain this way. Concretely, this means that the treatment of long-term investment should be improved by better measurement of the true long-term risk of these exposures.

The dynamic volatility adjustment (DVA) is a tool which enables insurers to partially reflect their risk-bearing capacity as long-term liability driven investors in their capital calculations. It creates a more realistic assessment of the credit risks to which they are exposed and should be available for all insurers.

Internal model users are currently able to apply the DVA make the correct adjustments subject to supervisory approval - this should continue without changes. No new restrictions should be introduced.

For the specific case of corporate debt, Insurance Europe supports the extension of the DVA to the standard formula.

The current standard formula risk charges for corporate bonds are based on the incorrect assumption that insurers may have to sell all their corporate bonds at depressed prices during a crisis. However, insurers typically invest in a specific portfolio of corporate bonds which is tailored to provide income to match their expected claims and expenses. If there is no significant change in the expected claims and expenses, then there is no need for insurers to sell their bonds during crisis period. In these circumstances, because the insurer does not have to sell the bonds, the short-term price fluctuations are irrelevant as the expected cashflows remain the same. Therefore, the true risk to the insurer in this case is default risk as defaults will change the cashflow pattern.

As a final remark, the industry notes that the introduction of the DVA for corporate debt in the standard formula would not impact the 0% risk weighting for member state sovereign debt.

Further comments:
DVA modelling is already a widely accepted part of many internal models which model market risk and could easily be implemented in the standard formula by adjusting the SCR spread shock scenario. Solvency II also already permits the dynamic modelling of the matching adjustment within the standard formula (Art. 181 of the Delegated Regulation).

In order to ensure that the DVA is effective, it is crucial that other important features of the VA are improved, too, in order to capture artificial volatility in insurer's balance sheets (see Q6).

In general, insurers have very stable balance sheets, based on long-term and predictable liabilities, which enables them to take a long-term approach to investment. Given this long-term perspective, they are generally not exposed to short-term market volatility and can play a countercyclical role in the financial markets. The Solvency II regime should not, because of measurement flaws, such as the poorly designed risk margin and ineffective volatility adjustment, which do not currently reflect the real underlying risks and business model, inhibit insurers' ability to play a countercyclical role.

Q5: ***Do you agree or disagree with each of the following proposed change to quantitative rules in Solvency II?***

	Agree	Disagree	Don't know /no opinion
We should make it less costly for insurers to invest in SMEs	x		
We should make it less costly for insurers to invest in environmentally-sustainable economic activities and associated assets (so-called "green supporting factor")		x	
We should make it more costly for insurers (and therefore provide disincentives) to invest in activities and associated assets that are detrimental to the objective of a climate-neutral continent (so-called "brown penalizing factor")		x	

Summary:
The industry is not seeking incentives to long-term investment, including SMEs, but to remove unjustified disincentives that limit insurer's willingness and ability to invest long-term. Solvency II is a risk-based framework and should remain this way. It is key to seek ways to improve the treatment of long-term investment under Solvency II by precisely better reflecting a risk-based measurement of the exposures.
On **investment in SMEs**:

- The current capital requirements for some SMEs investments are excessively high compared to the actual risk exposure. They should be reduced in a risk-based manner.

- Insurers invest in SME in various ways: eg via listed/unlisted equity, debt, funds, securitisation, covered bonds. Improving the treatment of equity and debt under Solvency II will implicitly support investment in SMEs.
- At the same time, insurers' investment capacity in SMEs (and other assets) would be enhanced by addressing other flaws of the framework, such as the VA and the RM (see Q6).

On **green/brown factors**:
The industry does not support artificial incentives/disincentives based on green/brown qualifications. Solvency II is, and should remain, a risk-based framework. Any differential treatment between green or brown assets, including a green supporting factor (GSF) or a brown penalising factor (BPF), should be based on the difference in underlying risks.

The priority should be on ensuring that the outcome of the Solvency II 2020 review results in focused changes that help, and do not hinder, insurers in fulfilling their key role in supporting Europe's need for investment to achieve carbon neutrality and economic growth. This means a reviewed Solvency II framework that adequately reflects transition risk, and appropriately measures the risks of long-term business without exaggerating long-term liabilities or the risks of long-term assets that back them (including sustainable investments). This is also key to avoid disincentives to offering long-term products to customers (see Q41).

Further comments:
The insurance industry is uniquely positioned to contribute to sustainability. It stands ready to support the transformation to a more sustainable economy and to play a role in incentivising other corporate entities to participate. In the coming years, key sustainable projects are expected to be financed via equity, long-term corporate bonds and loans. Excessive capital requirements for long-term and sustainable investments significantly limit insurers' ability to invest in such options. Therefore, prudential requirements need to be adjusted in the context of the 2020 Solvency II review to allow insurance companies to contribute meaningfully to the financing of sustainable projects and SMEs.

The following key elements are needed to optimise the industry potential to contribute:
- **More sustainable investments** - currently, the demand for attractive sustainable assets is not matched by the availability of such assets. Given the lack of suitable sustainable investment opportunities, the right incentives are needed to stimulate a sustainable transformation leading to increases in the volume of such investments in the economy.
- The right outcomes for the **various EC sustainability-related legislative initiatives**, in particular adequate changes to Solvency II to **create the right conditions for sustainable investing**.

The industry does not support arbitrarily changing prudential requirements (either via a GSF or a BPF) without risk-based justification. Such actions would create distortions which create artificial risk/return trade-offs, undermine good risk management and lead to valuation bubbles. Capital requirements should not be adapted in a way that disproportionally promotes green/sustainable projects disregarding their risks, or in a way that penalises other less sustainable projects without robust risk considerations. Capital requirements should reflect a risk-based approach and consider the actual risks associated with the investments. Only if the risks related to sustainable investment projects are significantly lower (or higher), the capital requirements should reflect this in a fair and transparent way.

There are flaws in Solvency II which create unnecessary disincentives related to a) how available capital is measured and b) how capital charges for assets (including bond investments) are measured. These flaws need to be addressed so that their correction will bring about justified, risk-based capital requirements. The improvements needed to rectify the flaws include:

- Reducing the risk margin significantly (see answer to Q6).
- Making meaningful improvements to the calibration and design of the VA (see answer to Q6).
- Incorporating the DVA into the standard formula for the corporate bond spread risk SCR calculation (see answer to Q4).
- Ensuring that internal model companies can continue to use dynamic VA as they currently do.

- Addressing the excessive capital requirements for long-term equity and bonds, as well as property investments, in particular reviewing the LTE submodule to enhance the likelihood that it would be applied in practice (see answer to Q3 and Q4) and recalibrate the property risk submodule with pan-European data.

The industry highlights that removing unjustified constraints to long-term property investments through a lower capital charge could unlock capital investments in less liquid assets. This can contribute towards financing the EC's planned "Renovation Wave" initiative, which forms a part of the European Green Deal. Today, buildings account for 40% of energy consumed. Almost 80% of today's EU building stock will still be in use in 2050. According to the EC, the current renovation rate will need at least to double in order to make the EU the world's first climate neutral continent by 2050.

Q6: ***Does Solvency II appropriately mitigate the impact of short-term market volatility on the solvency position of insurance companies?***
Yes/No/Don't know/no opinion

- No

Please indicate how the framework could mitigate the volatility of:
- fixed-income assets
- stock markets

Summary:
Solvency II does not provide sufficient mitigation against **artificial** volatility of insurers' solvency position caused by short-term market volatility.

Artificial volatility in Solvency II generally arises where the market consistent approach and 1-year time horizon used to quantify the insurer's solvency position have not been properly adapted to deal with long-term insurance business. The result of these inconsistencies is that small risks for an insurer are often reflected as big changes in the solvency position, typically experienced during periods of market turbulence. As a result, Solvency II can provide incorrect signals on the solvency position during these periods.

There are already mechanisms in Solvency II which aim to improve the recognition of long-term business. Some provide good mitigation against artificial volatility. However, targeted but important improvements are still needed:
- The level of the **VA** should be increased and its ability to mitigate artificial balance sheet volatility arising from short-term fluctuations in both European and national fixed income markets should be improved.
  - EIOPA's proposed risk correction and liquidity adjustment factor should be rejected as these would make the VA less effective.
- No changes should be made to the current **risk-free rate extrapolation** as it is already effective in countering artificial volatility. The matching and residual volume criteria are necessary and justified elements and must be retained.
- The **MA** is also effective in removing artificial solvency volatility. EIOPA's proposals to remove the restriction on diversification between MA and non-MA portfolios are welcomed.

The **risk margin** is a source of artificial volatility because of its high sensitivity to interest rates. To address this and its excessive size, an appropriate lambda parameter should be introduced, there should be increased recognition of diversification and the cost of capital (CoC) rate should be lowered to 3%.

Further comments:
The VA is overall too low and does not sufficiently mitigate artificial volatility. Therefore, necessary outcomes which should result from any changes to the VA are:
- **In order to avoid increased pro-cyclicality**, the risk correction should not depend on the prevailing spread level, as proposed by EIOPA, but on a longer time horizon as in the current method.

- **Liquidity should be dealt with under Pillar 2 & 3** in order to achieve a correct valuation of the liabilities and avoid double counting. There is no prudential need to introduce liquidity penalties through EIOPA's proposed "adjustment for illiquidity of liabilities", which should be rejected.
- **A general increase in the level of the VA** to properly reflect the ability of insurers to earn returns above risk-free rates. Currently, the level of the VA is too low because of numerous unjustified reductions which are made to the reference market data used as a basis for the calculation, including:
  - Non-fixed income assets being allocated a zero yield.
  - A technically unjustified 35% haircut to account for a range of unquantified risks which are already largely dealt with elsewhere in the framework.
  - An ineffective country component due to unjustified restrictions in the activation criteria.
- **Increased mitigation of artificial balance sheet volatility**. The VA should fully recognise the country specific spread with the eurozone which helps mitigate the impact of localised spread volatility for countries which use the euro. This additional volatility occurs because of the differences between the portfolios used to calculate the euro VA which is based on an average European insurer and the portfolios of insurers individual countries. Currently, extraordinary national market fluctuations, for example, are almost never captured whenever they occur.
  - The result are important levels of under- and overshooting of the 'European currency VA' leading to incorrect solvency ratios for Belgian and Dutch insurers in both normal and stress market circumstances.
  - Another issue related to the use of a reference portfolio to calculate the VA is that some investments, such as mortgages and covered bonds, are poorly represented. This is especially important for some markets, such as the Netherlands.
  - Improvements to the VA are key for most markets, but they will not address all volatility issues for cases where portfolios differ significantly from the reference one (for example Netherlands where the level of mortgage assets has a significant impact as noted above). For these countries, it is even more important that the dynamic VA is maintained without change for internal model users and allowed to be used in combination with the existing spread risk charges for standard formula users.

Furthermore, to determine corporate bond yield curves for currencies where there is little or no data available, the current approach to use euro corporate bond yield curves adjusted by 1.5 times the difference between the euro RFR and the local currency RFR should be maintained.

The risk margin is excessively large, especially for long-term business, and excessively sensitive to interest rates is another source of artificial volatility. These issues are particularly problematic for long-term products. There are a range of technical arguments which, taken together, support a significant reduction in the risk margin. The following issues should be addressed:
- The risk margin does not appropriately reflect risk interdependence over time. This is why an appropriate scalar should be introduced into the calculation.
- The calculation of the risk margin does not allow for diversification between life and non-life business within the same entity, or between different entities within a group.
- The CoC is exaggerated and should be reduced to an appropriate level. A 3% CoC is deemed appropriate, in line with evidence previously provided by industry.

The **current extrapolation parameters and methodology are appropriate and should not be changed**. As part of the consultation paper on the 2020 review, EIOPA carried out an analysis of the residual volume criterion and the matching criterion which demonstrate that market conditions have not changed sufficiently to justify a later extrapolation start (higher LLP).

The industry firmly believes that the existing criterion governing the LLP (ie the bond criterion) must be maintained. Solely relying on the swap market is inappropriate and dangerous. For some undertakings hedging using derivatives is only possible to a limited extent for legal reasons. Furthermore, it is questionable if a significant part of insurers' liabilities could actually be hedged by swaps at the market. Moreover, the cancellation of the bond criterion would increase the volatility of provisions and therefore the procyclicality of life insurance business.

The **MA** has proven to be a very powerful and valuable tool which has provided many benefits for policyholders, and insurers. It has also benefitted the wider financial system through ensuring the supply of long-term capital and mitigating systemic risks.

The MA framework provides good risk management incentives that eliminate or substantially mitigate some market risks (interest rate risk, reinvestment risk, spread risk and liquidity risk) and promote robust ALM processes. The MA mechanism ensures that the impact of these risk management and ALM processes are well reflected in the insurer's solvency position, thereby avoiding artificial solvency volatility.

Solvency II requires the economic balance sheet and the Solvency Capital Requirement to be calculated based on the assumption of **"going concern**". This implies that the insurer is not only an insurer today but will also sell insurance products and/or act as an insurer going forward. However, it also explicitly asks supervisors to protect the interest of the current policyholders which they do by assessing the current level of economic capital and whether that exceeds the SCR, which implicitly gives them a "gone concern" perspective. Re-orientating the supervisory perspective to align with a going concern approach would help to foster a more long-term perspective within insurance supervision.

Q7: ***Does Solvency II promote procyclical behaviours by insurers (e.g. common behaviour of selling of assets whose market value is plunging or whose credit quality is decreased), which could generate financial instability?***
Yes/No/Don't know/no opinion

- No

Please indicate how the framework could avoid procyclical behaviour by insurers:

Summary:
Solvency II does not generally promote procyclical behaviours. It already contains a number of important instruments, eg the MA, which counteract potential procyclicality. However, there is room for improvement to make these instruments fully functional and further reduce potential procyclical effects.

The effectiveness of the VA, a tool to mitigate the artificial impact of volatility in fixed income markets, could be significantly improved. The extent to which a working and robust VA is needed has not been fully witnessed since the implementation of Solvency II. While some spread widening was experienced during the COVID-19 crisis, this was nowhere near the magnitude of 2008 or 2011 crises. Significant spread widenings were also experienced in national markets in 2008, 2011 and 2018 but back testing shows that almost no relief was provided by the VA country component.

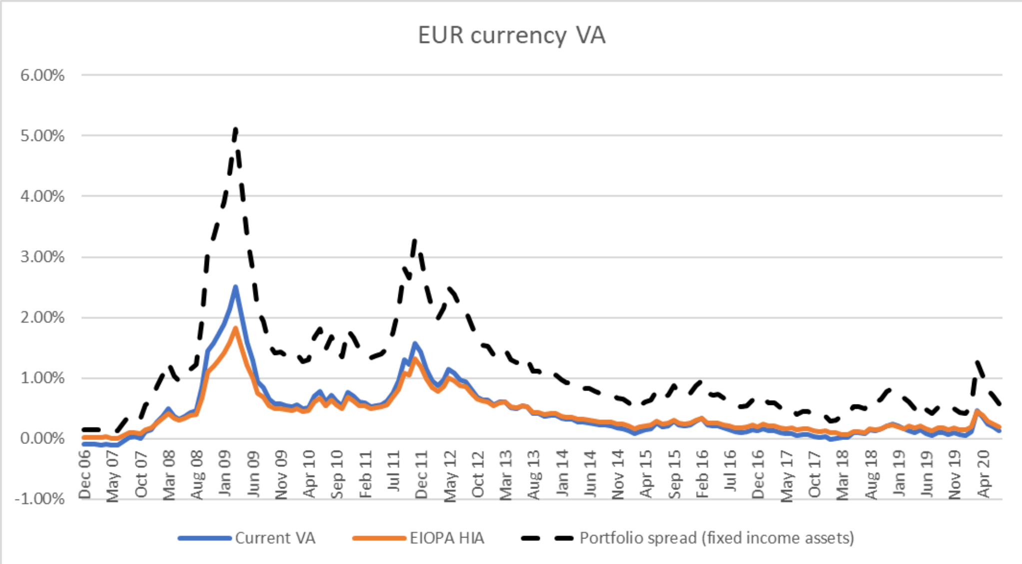
EIOPA's proposed change to the extrapolation methodology could also create additional procyclicality. This is because insurers would be incentivised to increase allocations to ultra-long dated bonds or swaps to improve the asset liability matching. The additional demand for these instruments is likely to further lower the risk-free-rate (RFR) curves and increase demand further.

With regard to the **interest rate risk submodule,** there is a need to better reflect the risk of a low and/or negative interest rate environment. However, it is imperative that its design and recalibration avoid a significant and detrimental impact on financial stability, as such a change will have a significant impact on solvency ratios. This can be achieved by introducing an appropriate floor and extrapolating the illiquid part of the curve.

Under its current design the **risk margin**, as noted in recent Bank of England Financial stability reports, can encourage insurance companies to reinforce falls (rises) in risk-free interest rates by switching into (out of) low-risk assets.

Further comments:

The chart below illustrates how the **current VA** and EIOPA's proposed VA would work during these periods of extreme stress. It is clear from this chart that any VA proposals should be tested under stress circumstances.



With regard to the **extrapolation of the RFR curves**, it is noted that starting the extrapolation at a higher maturity will lead to a more volatile discounting curve which itself could cause stronger fluctuations in insurers' own funds and therefore in solvency ratios. As most insurers have internal limits on solvency ratios, this will lead to more frequent breaches of the internal level. Insurers are then likely to de-risk (for example by selling assets) in order to improve solvency levels. As periods of equity market turbulence often happen simultaneously with low interest rates, this amplifies procyclical effects.

Any changes to **the interest rate risk submodule** will have a profound and significant effect on many insurers. Insurance Europe supports an updated interest rate risk model which is calibrated and designed to:

- Contain a floor which properly reflects the extent to which yield curves can go negative and the true risk in a low and negative yield environment.
- Extrapolate the illiquid part of the yield curve using standard extrapolation parameters and methodology.
- Be appropriate for all currencies to which it is applied.

Limiting the sensitivity of the **risk margin** to changes in risk-free interest rates would have macro-prudential benefits. Therefore, much needed changes to the risk margin, as set out in response to Q6 need to be made.

Q8*: Some stakeholders claim that Solvency II has incentivised insurers to shift investment risk to policyholders. Do you agree with this statement?*
Yes/Yes, but it is not the most important driver/No/Don't know/no opinion

- Yes, but it is not the most important driver

Comments:

Solvency II is one important driver in the shift of investment risks to policyholders. However, the main driver has been the low interest rate environment in most European countries.

Although in the short term, the low interest rate environment is the main driver in most countries, this should not be seen as a reason not to improve Solvency II. The underlying and long-term main driver is Solvency II, and the framework should not exacerbate the consequences of the low interest rate environment. Improving the Solvency II framework in order to incentivise long-term business as described above (Q6) could help to counterbalance the effects of low rates and the shift of investment risk to policyholder.

Q9: *Do you agree with the International Monetary Fund that public authorities should aim to provide disincentives to the selling of new life insurance products offering guaranteed returns?*

	Yes	No	Don't know/ no opinion
From the point of view of a policyholder		x	
In terms of financial stability		x	

Summary:
A combination of Solvency II rules and the prolonged low-interest rate environment has adversely affected the ability of insurers to provide products with LTG. Preserving the ability of the industry to provide LTG should be a priority of the review. LTG can refer to both the amount and duration of the future claim (in some markets insurers can provide a pension for as long as you live).

The calibrations of Solvency II however overstate long-term liabilities and exaggerate balance-sheet volatility, resulting in capital requirements and buffers that are too high. Consequently, Solvency II unnecessarily and adversely affects the cost of offering long-term products.

Refining Solvency II would help insurers play an even bigger role in the provision of safe, long-term savings products, for example by addressing the exaggerated volatility of solvency ratios by fixing the VA flaws.

The demand for guaranteed saving products varies across Europe and depends on personal circumstances and national differences, although it remains very high on average. A recent Insurance Europe pension survey, interviewing 10 000 citizens across ten countries, clearly confirmed a strong appetite for certain features typically offered by insurers including guarantees:

- The highest priority was security of the money invested (60% respondents).
- Respondents overwhelmingly chose investment safety over performance of investments (73%).
- Information about guarantees was deemed the most important one (67%).

It is therefore crucial that regulatory obstacles are avoided so that pension and long-term investment policies enable insurers to meet the demand for guarantees and allow them to fulfil their role in tackling the pension savings gap and more generally in channelling more private savings into capital markets. Given the potential for life insurance products to provide savers with simple and less risky access to an appropriate asset mix, policymakers should support industry efforts to make wider use of these products.

Q10*: In light of the Covid-19 crisis, have you identified any major issues in relation to prudential rules that you were unaware of or considered of lesser importance prior to the pandemic?*
Yes /No/Don't know/no opinion

- No

Comments:
The financial market turbulence caused by COVID-19 has shown that it is even more important than previously thought to have effective stabilising elements in the solvency regime. The solvency position of insurers should present a robust picture of their future prospects and must not be distorted by short-term fluctuations which might provoke pro-cyclical reactions that further fuel a crisis. Apart from that, the crisis did not highlight any major issues.

However, it did reaffirm several of the issues which are under the scope of the Solvency II review and need to be addressed. These include the ineffectiveness of the volatility adjustment at mitigating artificial balance sheet volatility (see question 6 and 7), the excessive size of the risk margin and its sensitivity to interest rates (see questions 6 and 7) and the excessive capital requirements for long-term equity and bond investments (see question 3 and 4 respectively).

Furthermore, the COVID-19 crisis reaffirmed that the current extrapolation methodology and matching adjustment, provide justified stability in the discounting curves and are appropriate.

Finally, it is noted that the impact of the COVID-19 pandemic may also provide additional data to verify/recalibrate the pandemic risk submodule and associated correlations.

Q11: *From the point of view of policyholders, would it be acceptable to waive Solvency II requirements to insurance companies that belong to a group, if the group as a whole is subject to "strengthened" supervision?*
Yes, it is sufficient for the insurer to rely on the group's wealth/ No, it is not sufficient for the insurer to rely on the group's wealth/ Don't know/no opinion

- Don't know/no opinion

Comments:
The industry has no strong views at this stage on this particular question as the exact meaning of "strengthened" supervision and a reliance "on the group's wealth" is not clear. In general, the industry does not see any need for changes in this area. Rather than removing capital requirements at solo level, it is vitally important to allow groups to manage economic capital at group level in practice.

However, the industry does have a strong position on the broader topic of group supervision, and would like to highlight the importance of the recognition of the role of groups within Solvency II, which is a very valuable feature of the framework.

Groups play an important role in the global competitiveness of the EU insurance industry. They also foster Solvency II objectives of policyholder protection and financial stability, thanks to the capacity to better access financial markets and a greater risk diversification, both geographically and between lines of business. **An efficient group supervision framework is therefore important to meet the goals set out by the CMU**.

While some supervisory convergence concerns have been highlighted in this area, the industry believes that the convergence tools at the disposal of EIOPA and NSAs – eg colleges of supervisors, cooperation platforms, peer reviews, etc – are sufficient. These tools encourage dialogue between NSAs, and between EIOPA and NSAs, and help understanding why and how, in some cases, divergent approaches are justified by the features of particular groups. The existing flexibility in the regulation is much needed to ensure NSAs can adapt to the various structures and risk profiles of groups. It is important to keep in mind that supervisory convergence aims at **harmonising supervisory practices** while keeping a risk-based and proportionate approach, **and not applying one-size-fits-all requirements to all groups**.

Moreover, any changes to the regulation imply a cost of compliance, and may result in some unexpected detrimental effects, due to the specific features and structures of groups. Therefore, before considering any changes, **the existing tools should be used to their full extent**. Finally, **an essential part of the group supervision framework is the recognition of the economic capital management at group level**. Although not part of this consultation, the industry would like to voice some strong concerns about some proposals made by EIOPA, notably regarding the derecognition of expected profits in future premiums (EPIFPs) at group level by default. This would result in ring-fencing own funds at local level, and would therefore be incompatible with the objectives of the CMU.

Q12: ***Should the European legislation be amended to better take into account insurers' exposure to and interconnectedness with the broader financial sector and the real economy? Please indicate the statements with which you agree.***
Yes, in targeted areas of the framework/ Yes, a number of gaps in the framework need to be addressed in areas other than those mentioned in the previous answer (for instance, insurers' significant exposure to specific types of assets)/ No/ Don't know/no opinion

- Yes, in targeted areas of the framework

Please specify the additional instruments that you would consider, and the type of systemic/financial stability risks that those instruments would aim to address:

Summary:
Insurance Europe reiterates that the current macroprudential framework is effective and already provides significant ongoing assurance that systemic risk remains limited in the European financial system. In light of the limited need for additional macroprudential measures, Insurance Europe strongly believes that only the macroprudential tools mentioned by the EC in its call for advice should be further considered. There is currently no justification for major new measures that would create significant initial and/or ongoing costs. Introducing measures in Solvency II beyond those in the holistic framework is unnecessary and would create a strong competitive disadvantage for European insurers competing with non-European companies.

There is broad consensus that unidentified vulnerabilities and insufficient resilience of insurers towards unfavourable developments are the leading cause for (collective) activities of insurers to contribute to systemic risk in the financial system. However, the aim of microprudential supervision is ensuring vulnerabilities are identified and managed and ensuring a sufficient solvency position and risk-bearing capacity. An effective microprudential supervisory system can counteract all potential systemic risks from the insurance industry (eg contagion risks due to fire sales of assets, sudden withdrawal of insurance services following a phase of under-pricing or massive cyber risks). Improvements in the workings of Solvency II can substantially contribute to supporting financial stability and may have a larger positive effect than new, explicitly macroprudential, measures. The interconnectedness with the broader financial sector is already considered when determining the capital requirement for market risk and counterparty default risk. Furthermore, a significant part of the interconnectedness is the result of derivative holdings and reinsurance. The former is regulated by the European market infrastructure regulation (EMIR) and the latter by Solvency II.

Further comments:
Insurance Europe maintains that there is very limited systemic risk within the insurance industry and no additional measures beyond those agreed in an international context as part of the holistic framework should be introduced.

Regarding the tools mentioned by the EC in its call for advice, changes should be envisaged carefully and subject to a full cost-benefit analysis:

- **Own Risk and Solvency Assessment (ORSA):** Any changes to the ORSA should not undermine its purpose and role. As with any risk an insurer is exposed to, the ORSA can already be used as a suitable place for insurers to report on any material exposure and how it is monitored and managed. Insurance Europe would caution against prescriptiveness in the ORSA processes, which are already assessed by the relevant supervisory authorities. The ORSA is the company's own analysis and should remain this way.
- **Prudent Person Principle (PPP):** Insurance Europe strongly supports the PPP. Any changes that would result in investment rules and restrictions should be avoided.
- **Liquidity risk management & reporting:** Given the insurance business model, it is generally accepted that liquidity risk is limited and already managed and is not therefore a primary concern. There are already a number of existing Solvency II requirements relating to liquidity risk management and reporting. These include Article 44 (Risk Management), Article 77 (use of MA and VA) and Article 132 (Prudent Person Principle) of the Solvency II Directive and Article 260 (Risk Management) and Article 295 (SFCR requirements) of the Delegated Acts. Insurers also already submit a significant amount of

data to EIOPA via the quarterly reporting templates (QRTs) which should provide the majority of the data required to monitor systemic liquidity risk.

- As noted above, Insurance Europe is of the view that the current regulatory requirements already address the – usually quite moderate - liquidity risks of insurers. However, it recognises that some additional appropriate and proportionate Pillar II and III requirements could provide clearer assurance that this is the case. For example, the following could be considered in case of special liquidity risks:
    - including an explicit assessment of liquidity as part of the ORSA
    - the proportionate introduction of liquidity risk management plans (LRMPs).
- It is vital that any liquidity assessment, like solvency, is done on a holistic basis with any stress tests and reporting taking into account the liquidity of both assets and liabilities, the interaction between these and all sources of liquidity. Elements such as penalties, taxes and powers to prevent mass lapses must also be taken into account in the assessment of any liquidity needs.
- **Systemic risk management & planning (SRMP)** – This may, in some cases, offer a useful way for insurers to take corrective action on systemic risk before supervisory measures are necessary, but these need to be justified by clearly quantified and articulated evidence of material systemic risk in advance, with a clear commitment to proportionality. Therefore, SRMP should be seen as a reserve tool, and its use should be contingent on the identification of material levels of systemic risk and evidence of a clear transmission channel into the wider economy from the identified activity.
- Where it is believed that the application of tools is justified, their application **must be proportionate and determined by nature scale and complexity of the risks inherent in an insurer's business** (see also section 2 of this consultation) and should be applied targeted: eg by focussing recovery measures at group level and exclude local entities from such measures where there is compliance at group level.

Section 2: Proportionality of the European framework and transparency towards the public

Q13: ***From the point of view of policyholders, should the scope of small insurance companies, which are not subject to Solvency II be extended?***
Yes/No/ Don't know/no opinion

- Yes

<u>Summary</u>:
Exempting very small companies from costly and overly complex regulation is necessary to maintain a diversified market, by avoiding unnecessary burden. As such, very small companies should be excluded of the scope of Solvency II.

The companies out of the scope of Solvency II remain under the supervision of national supervisory authorities, in a more appropriate regulatory regime created by national regulators.

Consequently, the industry supports an increase of the thresholds for the application of Solvency II. The thresholds set in Article 4.1.a and 4.1.b of the Solvency II Directive should therefore be changed as follows and as proposed by EIOPA:

- €10m for the undertaking's annual gross written premium income [currently €5m] with the option for member states to increase the thresholds to €25m.
- €50m for the total of the undertaking's technical provisions [currently €25m].

<u>Further comments:</u>
Additionally, thresholds set in Article 4.1.c of the Solvency II Directive should be changed as follows:

- €50m for the total of the technical provisions of the group, where the undertaking belongs to a group [currently €25m].

- €0.5m of gross written premiums or €2.5m of technical provisions for liability, credit and surety ship [currently no threshold; Article 4.1.d of the Directive].
- €1m of the undertaking's gross written premium income or €5m of its technical provisions gross of the amounts recoverable from reinsurance contracts and special purpose vehicles, or more than 10 % of its gross written premium income or more than 10 % of its technical provisions gross of the amounts recoverable from reinsurance contracts and special purpose vehicles [currently €0.5m premium, €2.5m provisions and 10% of provisions; Article 4.1.e].

No changes are needed to Article 4.4 of the Solvency II Directive, which foresees that exclusion from the Solvency II scope due to size shall not apply when a company makes use of the right of establishment or the freedom to provide services.

Q14: *Should public authorities have less discretion when deciding whether insurers may apply simplified approaches and/or implement Solvency II rules in a more proportionate and flexible way? Please explain your reasoning (if needed).*
Yes/No/ Don't know/no opinion

- Yes

Please specify the criteria that should be introduced in the European legislation, in order for an insurer which meets them to be automatically granted the use of simplified approaches and/or a more proportionate and flexible application of the rules:

Summary:
While Insurance Europe is of the view that some mandatory aspects in the application of proportionality should be introduced – in the view to ensure a minimum application of proportionality in all markets – the discretion of NSAs and the supervisory dialogue with companies should not be deterred. Instead, changes in the regulation are needed to improve the NSAs' ability to largely apply proportionality.

The Insurance Europe proposal (detailed in the attached document) is based on the following:
- Making clear that applying proportionality is a duty for NSAs and allow them to comfortably consider proportionality more broadly.
- Making clear that proportionality can apply to all, and is based on the nature, scale and complexity of the risks.
- Creating a toolbox of proportionality measures with pre-defined risk-based criteria for their automatic application.
- Giving to the newly created EIOPA committee on proportionality the responsibility to publish an annual report on proportionality including proposals on how to improve its effectiveness and consistency.

Further comments:
Insurance Europe has identified the following changes needed to ensure the principle of proportionality works in practice:
- In the Directive, additional text is needed to make clear that:
  - **NSAs are not only legally able, but have an obligation**, to allow companies to deviate from – or to not apply some – specific requirements set out in the Directive, the Delegated Acts and/or the implementing texts in order to apply proportionality. For example, by amending Article 29 of the Directive "General principles of supervision".
  - **Proportionality can be applied by groups and large companies as well as small companies**. The references to nature, scale and complexity should clearly refer to the relevant risk, activity or product and not the overall size of the company/group. Moreover, proportionality at solo level must be reflected directly at group level.

- In the Delegated Acts, **a proportionality "tool-box" – a non-exhaustive list of predefined specific proportionality measures – should be created**. This list of simplifications and waivers is needed to ensure proportionality relief can be available for all companies where some requirements are overly burdensome compared to the risks. The industry emphasises that this list would be non-exhaustive, and **would not prevent NSAs to consider further measures developed by insurers**.
  - Article 88 of the delegated regulation defines whether an insurer is able to use simplifications, which relates to the concept of proportionality. However, the article does not define whether the assessment is to scrutinised by the supervisor before or after as part of the supervisory review process. The industry is of the view that the governance process of the insurer has assessed the use of proportionality to be appropriate and the supervisor should challenge this *a posteriori*, reversing the burden of proof, while maintaining supervisory dialogue.
  - Furthermore, the proposal made by EIOPA in its "Supervisory Statement Solvency II: Application of the proportionality principle in the supervision of the Solvency Capital Requirement" should be embedded in the Solvency II legislation as an approach which is allowed to be used by the insurers.

- The burden on companies seeking to apply proportionality measures should be reduced (whether one of the predefined tools or other simplification/waiver) and the consistency of the application of the principle of proportionality improved, by:
  - **Introducing clear risk-based specific criteria for the automatic application of measures of the tool-box** which would allow companies meeting those criteria to apply the tool automatically without further documentation and without the explicit approval of their NSA. While some tools may have the same criteria, it is important that the tools can be applied individually since the risks associated to simplifications may differ. In addition, NSAs should not take into account whether a company can afford to fulfil a requirement, but whether application of the proportionality could materially underestimate risks or over-estimate solvency level.
  - **Requiring EIOPA to develop these clear risk-based criteria** aiming at assisting NSAs in their assessment of the nature, scale and complexity of risks and increase transparency in the application process of the principle. The advantages are higher legal certainty, fostering the harmonisation across member states, reducing the burden for insurers and NSAs and promoting the security of policy holders.
  - **Detailing in the regulation that individual measures of the tool-box can be applied by all insurers**, even when they do not fulfil the predefined criteria for automatic application, in the context of the supervisory dialogue, on condition that they properly document the justifications for so doing.

- **EIOPA should publish an annual report on proportionality including proposals on how to improve its effectiveness and consistency**. The report would evaluate the application of the proportionality principle per member state and make propositions on how to improve its effectiveness and consistency (similar to the EIOPA report on the use of limitations and exemptions from reporting). This report, and any follow-up, should be overseen by the new proportionality committee which is required to be set up by the ESA review.

In general, the following aspects are important to successfully reform proportionality in Solvency II:
- Understanding the reasons for proportionality – public authorities need a clear understanding of the advantages of proportionality for consumer, companies and for themselves.
- Providing incentives for a consistent and appropriate application – public authorities need a clear obligation to apply proportionality and a regular monitoring.
- Supporting administrative practice – public authorities need useful guidelines and mechanisms.

Also, strengthening discussion formats will further drive the reform process:
- Public peer reviews can assess the actual performance of NSAs and provide useful recommendations.
- Non-public peer advice groups can initiate organisational learning, because public authorities are more likely to discuss controversial issue in non-public fora.
- Supervisory dialogue and becoming more accountably towards companies are likely to increase the quality and legitimacy of supervisory practice.

A risk-based approach and the automatic application of key measures are mandatory to make proportionality work. Furthermore, industry proposes to organise the automatic application through a "proportionality toolbox" that links risk-based criteria to specific proportionate measures.

Some examples of criteria that could trigger automatic application of proportionality and which could be used for a number of the tools are:

- A conservative estimate or simple update of a former evaluation should be allowed if:
  - The item represents less than 5% of own funds/basic SCR (BSCR).
  - The cumulative simplified items cannot exceed 10% of Own Funds/BSCR.

- No calculations for negligible exposures, namely reporting zero for the SCR or own funds component should be allowed if:
  - The item represents less than 1% of own funds/BSCR.
  - Cumulative items reported to zero do not exceed 2% of BSCR.
  - The market share of the company <10% of national market.

The examples of criteria already proposed by EIOPA in the supervisory statement "Application Proportionality Solvency Capital Requirement" could be used as the basis for setting the automatic criteria.

Q15*: Should the exemptions and limitations always be subject to the discretion of the public authorities?* *The current system of exemptions and limitations is satisfactory/ The framework should also include some clear criteria for automatic exemption and limitation/ The 20% limit should be increased/ The 20% limit should be reduced/ There should be no discretion at all/ I have another answer/ Don't know/no opinion*

- The framework should also include some clear criteria for automatic exemption and limitation

<u>Summary</u>:
The application of proportionate measures should be a duty for NSAs, and at the same time it needs to consider the specific characteristics of the national markets. While the industry supports the use of waivers up to the current 20% level of this threshold, the industry strongly highlights that the automation of risk-based proportionate measures yields huge potential for insurance companies and policy holders.

The industry supports the use of the waivers foreseen in Art 35(6) (7), and believes that the application of waivers up to the current level of 20% of the market by NSAs should be made mandatory instead of optional. At the same time, the application of these proportionate measures should remain a choice on the insurer's side: companies exempted should still be able to report data voluntarily.

The limitations and exemptions set out in Article 35 of the Solvency II Directive are a concrete proportionality measure in reporting requirements (see EIOPA reports on the use of limitations and exemptions from reporting). This measure is an additional tool and should in no way not prevent application of other simplifications under the cover on proportionality (see answer to Q14).

<u>Further comments:</u>
The industry believes that one way of expanding the use of waivers and simplifying the process, would be to make these exemptions and limitations mandatory, and as such limiting discretionarily by NSAs.

Currently, these waivers are used in an inconsistent and limited way across member states – EIOPA's report on the use of limitations and exemptions from reporting 2019 shows that only 13 member states make use of them. EIOPA also acknowledged in its "consultation on proposals for Solvency II 2020 Review Package on Supervisory Reporting and Public Disclosure" (wave 1) that the process is "rather cumbersome" and "does not foster efficient forms for proportionality in Pillar 3".

Furthermore, even where they are granted by NCAs, lack of certainty over whether the waivers will also be granted for subsequent reporting periods creates a significant disincentive for companies to use them.

In order to guarantee some certainty for insurers that are on the edge of the threshold for exemptions and limitations, it could be considered to apply the same process as for the thresholds for exclusion of the scope of Solvency II, ie to grant/remove the authorisation only after three years of being above/under the threshold.

In particular, if you think that there should be clear criteria for automatic exemption and limitation, please specify those criteria:

Summary:
As per other proportionality measures (see answer to question 14), this measure should be automatically allowed when the insurer is below the predefined threshold.

Q16: ***Should the European framework take into account the specific features of not-for-profit insurance companies (e.g. democratic governance, exclusive use of the surplus for the benefit of the members, no dividend paid to outside shareholders)?***
Yes/ No/ Don't know/no opinion

- No

Please specify the areas of the framework, which should be adapted (quantitative requirements? governance requirements? etc.):

Further comments:
Insurance Europe believes that proportionate supervision under Solvency II should be risk-based, and not structure-based. Some profit-generating companies may have a low-risk profile and a stable governance with more scrutiny, while some complex not-for-profit insurers may have a higher risk profile. As such, the legal form of a company does not appear as an appropriate criterion on which to base adapted requirements.

However, if any particular feature of a non-for-profit company results in a lower risk profile, impacts the need for capital or justifies a proportionate approach, this should be taken into account in accordance with a risk-based approach .

Q17: ***How can the framework facilitate policyholders' and other stakeholders' access to the SFCRs?***

	Agree	Disagree	Don't know/ no opinion
The current framework is sufficient, as it already requires insurers to publish their SFCR on their website if they own one	x		
The framework should clearly require that insurers' publication on their website is easily accessible for the public		x	
Insurers should be required to send (electronically or by mail) on a regular basis a summary of the SFCR to each policyholder		x	
Insurers should be required to send (electronically or by mail) the SFCR to each policyholder who explicitly requests for it	x		
Other options	x		

Summary:

The industry agrees with the current provisions specified in Art 301 and believes these are appropriate. As such the industry agrees with the statement that '*the current framework is sufficient, as it already requires insurers to publish their SFCR on their website if they own one'*.

However, undertakings already have to publish the SFCR on their website if they own one. Most undertakings provide the SFCR on their website in an easily accessible manner, often on the same page as annual reports/similar publications. As such there is no need to require a change in legislation that '*insurers' publication of the SFCR on their website is easily accessible for the public*'.

The sector disagrees with the suggestion to require insurers by default to send (electronically/by mail) a summary of the SFCR to each policyholder, as this would trigger costs, be environmentally unfriendly and put more administrative burden on insurers, with little or no benefit for the policyholder. Indeed, the policyholder can easily access the SFCR on the website of the insurer. Furthermore, the industry highlights that policyholders already receive numerous documents and information when concluding an insurance policy.

Regarding the statement that '*Insurers should be required to send (electronically or by mail) the SFCR to each policyholder who explicitly requests for it'*, the industry notes that Art 301(5) already requires insurers to send a printed copy of the SFCR to each policyholder who explicitly requests it within two years of the disclosure date, as such the industry believes there is no need to modify the existing article. However, the existing requirement could be amended to include electronic copies.

Regarding other options, the industry would support the idea to request insurers to provide the direct links to the SFCRs in the regulatory reporting and to have these SFCR-links published on the websites of EIOPA/NCAs, as this would be helpful for finding the reports.

Further comments:
Analysis has shown that the use of the SFCR by stakeholders is very limited. Interested stakeholders can find all necessary information on insurance companies' websites. Hence, access to information is not the problem, and stakeholders do not seem to be interested in the information provided in the SFCR. A short narrative report for policyholders, comparable to the executive summary of maximum two pages is expected to be more attractive for stakeholders than extensive reports requiring time and effort to examine. There is room to improve the SFCR by making it more efficient both for insurance companies (in the development) and their stakeholders (when consulting the document) (see Q19 for more detail).

Q18: ***If you have already consulted a SFCR, did you find the reading insightful and helpful, in particular for your decision making on purchasing (or renewing) insurance, or investing in/rating an insurance company?***
The reading was insightful/ The information provided was in the right level of details/ The information provided was too detailed/ The information provided was redundant with what can be found in other public reports by insurers/ No, the reading was not insightful I have never consulted a SFCR/ Don't know/no opinion.

- Don't know/no opinion.

Summary:
Insurance Europe has not answered this question as it is clearly addressed to policyholders and/or investors. At the same time, it highlights the industry proposals on the SFCR as set out in Q19.

Q19: ***Which information should be provided to policyholders on insurers' financial strength, business strategies and risk management activities? What should be the ideal format and length of the SFCR?***

Summary:

The low level of public interest in the SFCR is significantly surpassed by the enormous effort put into preparing the information. Indeed, the level of detail of the current SFCR is excessive and is not helpful in understanding the actual financial strength of the insurer for the normal policyholder.

Therefore, the industry believes that, in order to increase its impact, the SFCR should be split in two sections, with clearly defined target stakeholders, namely a policyholder section and a professional section, containing the following information:

- **A brief narrative report for policyholders,** comparable to the executive summary of maximum two pages, which would enable the average policyholder to acquire an overview of an insurer's key information. It should be standardised and include an overview of an insurer's risk appetite, key risks and solvency and financial situation and it should not require expert knowledge to fully understand the information provided.
- **A detailed quantitative report without narrative explanations for the professional public consisting of the set of public QRTs, disclosed already**. Limiting the SFCR for professionals to quantitative information would facilitate report comparison, and would also enable cross-border analysis, which is currently complicated due to the language barriers arising from the narrative content. Additional narrative explanation should be possible, at the discretion of the reporting company.

Furthermore, it should be noted that insurers are not supportive of the addition of various reporting disclosure proposals from EIOPA (eg on VA, risk management/disclosure provisions on LTG measures, best estimate and extrapolation) suggested by EIOPA in the context of the consultation on the Solvency II review. The industry also has strong objections against the new auditing requirements, as proposed by EIOPA. While only leading to limited benefits, and clearly duplicating work in the remit of supervisors, the proposals would have significant additional burden and costs across the industry.

Q20: Some insurers belong to wider insurance groups, which also have to publish a Solvency and Financial Conditions Report at group level (so-called "group SFCR"). Do policyholders (current or prospective) need to have access to information from group SFCRs?
Yes/ No/ Don't know/no opinion

- No

Please specify the format and content of the information that should be disclosed to policyholders in group SFCRs, and what would be the appropriate frequency of publication of such reports:

Summary:
Insurers, including insurance groups, are required to make their SFCRs available on their websites. As such, policyholders wishing to access a group SFCR are able to do so. Against this background, the industry believes there should be no additional requirements regarding the group SFCR.

Furthermore, in the solo SFCR any relationship and/or interdependency with the group, etc. is already disclosed. As such, there is no need for additional information, which would only lead to an information overload.

Q21: ***Should all insurers publish a SFCR on a yearly basis? Please indicate if you agree or disagree with the following statements.***
Yes, all insurers should publish a SFCR on a yearly basis/ Yes, but some insurers should only be required to publish a summary of their SFCR on a yearly basis/ No, a yearly publication of the SFCR should not be required for some insurers/ No, a yearly publication of the SFCR should not be required for any insurer/ Don't know/no opinion

- Yes, all insurers should publish a SFCR on a yearly basis

Please indicate what you consider the appropriate frequency of publication of the SFCR (or of its summary) and whether all insurers or only some types should publish them (if the latter, please specify which types):

Summary:
While the industry is of the view that the current yearly frequency of the SFCR is appropriate, it highlights that the low level of public interest in the SFCR is significantly outweighed by the substantial effort put into preparing the required information. Against this background, the industry believes that the SFCR should be simplified, as set out in the response to question 19.

However, more important than the frequency is the format of the report (division into a brief narrative report for policyholders ("two-pager") and a quantitative report for the professional public.

Q22: ***Some insurers use their own internal models to calculate their solvency requirements, after approval and ongoing supervision by public authorities, and not the prescribed standard approach defined by the legislation. For those insurers that use an internal model, should European legislation require them to also calculate their solvency position using standard methods for information purposes, and to disclose it to the public?***
Yes/ No, insurers that use their own internal models should not be required to publicly disclose their solvency position using standard methods, although they should be required to calculate it and to report it to public authorities/ No, insurers that use their own internal model should not be required to calculate their solvency position using standard methods/ Don't know/no opinion

- No, insurers that use their own internal model should not be required to calculate their solvency position using standard methods

Summary:
The requirement to calculate both (partial) internal model (IM) and standard formula (SF) figures is onerous and unnecessary, with long-lasting consequences. Should such a requirement be introduced, it would effectively undermine not only the IMs but also the suitable processes underlying their effective management and supervision.

IMs are designed to reflect a company's specific risk profile when it is proven that the standard formula is not suitable, as such IMs are the critical part of the Solvency II framework for many (re)insurers. It is important to recognise that that true comparability of outcomes should mean that regulatory capital is aligned to the actual risk profile of insurers. Therefore, a continuous comparison between the SF and IM figures with public disclosure would only to confusion and wrong conclusions.

In fact, IMs facilitate a risk-sensitive approach to supervisors' and insurers' assessments of capital adequacy, by considering insurers' idiosyncratic risk profiles. As such, transparent insights into the risk management practices of insurers with specific risk profiles are provided, which is the most valuable information for supervisors. Supervisors might even require firms to use an IM (Art. 119 Directive) when a company's risk profile deviates significantly from the underlying assumptions of the SF. It would hardly make sense, from a policyholder protection perspective, to ask firms required to use an IM by supervisors to disclose SF results.

Further, supervisors are responsible for the original IM approval, they approve any major changes to the IM and they will be notified regularly of all other changes. During these processes, NSAs receive the SF figures as part of the mandatory information required for the authorisation. As such, supervisors have an extensive suite of tools available to them to ensure that IMs continue to generate appropriate SCR numbers.

Further comments:
In fact, it is normal that IMs deviate from the standard formula. Deviations have two well-founded sources:
- The adaptation to individual risk profile.
- The on-going revision of the appropriateness of the IMs against the latest usable science and dataset.

Given that standard formula results are not reflective of risks for IM users, comparisons between companies would lead to a false sense of comparability, and as such be meaningless. Comparing companies on a measure that does not reflect individual risk characteristics would provide an invalid view of companies' solvency positions and their relative financial strength, which could be higher or lower than that determined by the standard formula.

Furthermore, there is today an extensive governance around IMs, involving multiple supervisors in colleges, extensive supervisory dialogue and analysis behind every approval of every calculation. IMs are fully integrated in the decision-making of firms and their risk management, as per the use test prescribed in Article 120 of the Directive. While standard formula calculation requirements for IM users would create significant additional costs and challenge the real value of IMs, it would serve no useful purpose. Performing high quality standard formula calculations on a regular basis would take away time from other important risk management activities, such as IM calculations and reporting. This is counterintuitive, given that IM are implemented precisely to appropriately reflect an insurer's risk profile. The industry does not see any benefit in the calculation of standard formula numbers of IM users – but only costs and risks of misinterpretation due to approximations inevitably needed.

In allowing for IM, the Solvency II framework recognises that the standard formula is designed and calibrated to capture the risk profile of the average insurance undertaking, and cannot be made appropriate for all types of insurance business and structure. The more the risk profiles of undertakings deviate from the average risk profile assumed in the standard formula, the more inappropriate the standard formula will be for such undertakings.

It must be noted that, while additional reporting is requested in some jurisdictions, it tends to be more flexible and undertakings are able to tailor their data in discussion with their supervisors. This reflects the fact that models do vary, and by definition will not always easily align with the standard formula calculation, making reporting the results on such a detailed standardised template not appropriate and in instances even incorrect. To be proportionate, SF reporting for IM users should be based on exceptional and entity-specific supervisory requests, as per Article 112.7 of the Directive.

Finally, it should be noted that SF reporting/disclosure for IM users would not improve the protection of policyholders. The administrative management or supervisory board (AMSB) will have no choice but to make decisions based on the standard formula if it is publicly disclosed, which could lead to suboptimal strategic and business decisions. In addition, the preservation of IMs in Solvency II is a matter of global competitiveness.

Section 3: Improving trust and deepening the single market in insurance services

Q23*: When the Home authority does not take the necessary measures to prevent excessive risk taking or non-compliance with the European rules by an insurer for its cross-border activities, should the Host authority be provided with additional powers of intervention, in order to protect policyholders?*
Yes/ No/ Don't know/no opinion

- No

Comments:
Rather than additional powers for the host authority which would undermine the "home country" principle, the focus should be on ensuring the home authority actually carries out its supervisory duties diligently when dealing with the cross-border activities of the insurers within its jurisdiction. When this is not the case, the involvement of EIOPA may be helpful (see next question) but this is distinct from providing new powers to host authorities over companies based outside their jurisdictions.

The priority should be enhancing information exchange and cooperation between home and host authorities and with EIOPA (as has been done in the ESAs Review (Directive (EU) 2019/2177) articles 152a and 152b of Solvency II Directive) at every step of the insurance operating chain, from before the authorisation to after a potential winding up, along those examples:

- Extending the mandatory notification mechanism by home to host authorities found in art. 148 Solvency II Directive to EIOPA too, in the context of its extended powers under art. 31 of the ESAs Review.
- Submitting changes in the nature of the risks or commitments to the notification procedure between Home and Host authorities (art. 149 of Solvency II).
- Obliging the home authority to notify both EIOPA and the host authority for example if the financial conditions of an insurer operating under freedom of services/freedom of establishment (FOS/FOE) undertaking's is deteriorating or other risks emerge (including consumer protection concerns), as is the case in Art. 152a. 2 Solvency II-Directive.
- Ensuring home and host authorities share up-to-date list of general good provisions with each other and with EIOPA.
- Strengthening cooperation between national supervisory authorities through formalised and compulsory mechanisms for mutual information on the specificities of national regulations or markets.

Q24: *Should the supervision of cross-border activities by insurers be exercised by national authorities or by a European authority?*
By national authorities only/ By a European authority only/ By national authorities, with European coordination where needed/ Other answer/ Don't know/no opinion

- By national authorities, with European coordination where needed.

Summary:
As stated above, the "home country principle" should remain the rule, and it should in no way be undermined. Home authorities should therefore be the ones supervising all activities of the insurers based in their jurisdictions, including the cross-border activities. An enhanced role could nonetheless be envisaged for EIOPA in complex cross-border cases where home and host authorities fail to reach a common view in the cooperation platform.

EIOPA could have/offer a number of powers or services which could assist the authorities in the supervision of the cross-border activities of the insurers within their jurisdiction:

- An early warning system with a list of elements calling for closer scrutiny, such as candidates which were refused fit and proper credentials in another member state.

- Ensuring the register of insurers active in the EU clearly indicates which markets they are operating in.
- A register of compulsory insurance schemes (as defined in art. 179 of the Solvency II Directive) and related requirements in force in member states.
- NCAs (home and host) to be required to share up-to-date list of general good provisions with each other and with EIOPA.
- EIOPA to ensure that its register of general good provisions is up to date.
- Providing governance for the operation of digital supervisory platforms.
- Developing key information (indicators) to be shared on company and market.
- EIOPA to monitor and ensure compliance of NCAs with the requirements.

Q25: ***Do you consider that insurers and public authorities are sufficiently prepared for a significant deterioration of the financial position or the failure of an insurer and that they have the necessary tools and powers to address such situations, in particular in a cross-border context?***
Yes/ No/ Don't know/no opinion

- Yes

Please specify the instruments or harmonised powers that are needed at each stage of preparation (i.e. recovery planning, resolution planning, resolvability assessment) and at various stages of intervention (i.e. during early intervention, recovery or resolution):

Further comments:
Solvency II (through the ladder of supervisory intervention) already enables supervisors to step in when there is an imminent risk that capital requirements are breached, and includes certain requirements in terms of recovery: recovery plan in case of non-compliance with the SCR, finance scheme in case of non-compliance with the MCR and supervisory powers in deteriorating financial conditions.

The SCR ensures a high level of capital buffer, calibrated to ensure a firm will remain able to meet all obligations to policyholders even after a 1-in-200 year loss event. The supervisory ladder of intervention in Solvency II allows supervisors to begin taking actions when the SCR is breached and to fully take over the company if the MCR is breached – a point at which an insurance company still has significant assets in excess of those needed to meet its obligations to policyholders.
There are in fact a number of safeguards embedded in the three pillars of Solvency II:

- Insurers are required to have a risk appetite, a statement regarding the own buffer needed taking into account the risk profile, risks and volatility of the current position and development of these in the future. Based on these considerations, insurers will have formulated a capital adequacy policy, including an own ladder of intervention. This is communicated to the supervisory authorities.
- Insurers are required to calculate or estimate their solvency position at regular intervals, and in any case annually. They are also required to communicate directly to the supervisory authorities any breach of the SCR or a projected breach in the coming three months.
- On a quarterly basis, insurers are required to submit various QRTs providing current data to the supervisory authorities.
- Therefore, NSAs are able to assess the development of the solvency position of individual insurers and are also able to prioritise their supervisory actions, including through the supervisory review process (see also EIOPA guidelines).

Any need for additional tools should only be considered once there is an assessment of the existing tools in Solvency II and how these are implemented. The existing tools already provide a list of possible measures enabling a recovery and apparent weaknesses.

Therefore, question 25 should focus on the situation in which there is a sudden/immediate deterioration of the solvency position of an insurer and for which no real recovery is possible. In all other instances, the supervisory review process should be sufficient to anticipate any deterioration of the solvency position which would endanger the interests of policyholders. In fact, even a deterioration of the level of the MCR still protects policyholders for

any unanticipated events with a confidence level of 85% over a 12 months horizon and also the risk margin still exists enabling the transfer of the insurance portfolio to other parties.
In terms of **recovery and resolution tools for insurers**, Solvency II already provides several safeguards, and it includes provisions for the winding-up of insurers together with national insolvency laws to complement these. Pre-emptive recovery planning should only be applied to companies where planning would create a tangible benefit in terms of reduction of material systemic risk at EU level, not least because Solvency II already requires recovery planning from all companies when the SCR is breached. There should be no requirement regarding recovery and resolution plans based on the coverage of the market share of the national market.

Regarding **recovery**, further discussion should focus on supervisory measures that can support effective recovery, rather than on new powers of intervention by the supervisory authority.

According to Article 138 para 3 of the Solvency II Directive the supervisory authority shall require the insurer to take the necessary measures to ensure compliance with the SCR within six months from the observation of non-compliance with the SCR. The supervisory authority may, if appropriate, extend that period by three months to a total of nine months. The short recovery period creates enormous pressure to act and lead to companies having to take premature and disadvantageous measures (eg fire sales of certain assets). **We consider a recovery period of at least two years to be appropriate**. This is particularly adequate in the light of the provision in para 4, which allows for an extension of the recovery period of up to seven years in case of exceptional adverse situations.

In cases of crises, especially in the case of an SCR breach, the provision of additional capital by shareholders is key to support recovery. This should be acknowledged and supported, rather than disincentivised, by European regulatory measures in the area of recovery. At national level today, an example of a disincentive to shareholder support is still the case of profit-sharing regulations in Germany, where the additional capital provided by shareholders in cases of crisis may become in fact not repayable to shareholders.

Notwithstanding the level of engagement, regulatory consistency, convergence and a proportionate application are crucial where additional measures might be foreseen. For example, local entities should not be required to provide for recovery plans where an EU parent group plan exists or, at the very least, fully acknowledge the group recovery plan and not requiring additional assessments.

Resolution should be a measure of last resort, which should only be employed once all recovery options have been exhausted. Entry into resolution should not occur before the insurer has reached the point of non-viability. Resolution powers need to be well-defined and targeted, to avoid forcing resolution authorities into taking sub-optimal actions. They should be based on circumstances and changing macroeconomic factors and should focus on reducing systemic risks. Run-offs and portfolio transfers are sufficient to deal with the large majority of insurance failures. These should be the most preferred tools and authorities should clearly justify the need for more intrusive tools and why they are not sufficient to meet the objectives of resolution.

Insurance Europe understands that the resolvability assessment is a necessary element of developing or verifying resolution plans. It should consider how, in the unlikely situation in which an unpredictable event has led an insurer to a point of non-viability that it cannot recover from, policyholders' interests can be best protected. The resolvability assessment should be discussed with the insurer.

Since failures take longer in insurance, rapid intervention is unnecessary, especially because fire-sales of assets or the crystallisation of their value could result in unnecessary value destruction. Insurance Europe favours stay and suspension powers, because they preserve value and can very often prevent the need to use more drastic measures within the resolution toolkit (see also Q33).

Cross-border cooperation and coordination between supervisory and/or resolution authorities within the EEA and third countries, as well as the mutual recognition of resolution actions is important. Unilateral decisions should be explicitly discouraged, as they risk producing sub-optimal outcomes. EIOPA has sufficient existing powers to play their key role in facilitating cooperation and coordination between supervisors. This should allow for the swift recognition and implementation of decisions of resolution authorities outside their jurisdictions thereby increasing their chances of success. Any cross-border cooperation must be defined in accordance with the rule of law.

Q26: Should it become compulsory for all Member States to set up an IGS, in order to ensure that a minimum level of policyholder protection is provided across the EU?
Yes/ No/ Don't know/no opinion

- No

Summary:
IGS currently in place vary significantly across Europe but work generally well within their local context and laws. In fact, IGS often predate Solvency II requirements, which in some cases have rendered IGS protection redundant. Some member states currently have arrangements equivalent to an IGS that protect policyholders in the same way, whereas other member states do not have an IGS, but consider that policyholder protection is nevertheless sufficient.

Insurance Europe takes the view that the legal structure of policyholder protection schemes should be left to the discretion of individual member states. More generally, Insurance Europe believes that national authorities should be allowed significant flexibility to choose the IGS features that best suit their market, to reflect that there are important differences between member states regarding social welfare systems, winding-up process for insurers and insurance product lines.

Insurance Europe notes that Solvency II was designed to take into account analysis of past insurance failures and was calibrated to provide an adequate level of policyholder protection, without there being harmonised IGSs across the EU.

Subsequent analyses of insurance failures by EIOPA have substantially come to the same conclusions as the initial analysis, and therefore does not indicate there is an issue with the design of Solvency II in this respect.

There are already substantial existing layers of prudence built into the Solvency II framework – such as the SCR, the MCR and the risk margin – all of which sit above the best estimate of the liabilities. If additional layers of prudence were to be added to Solvency II through a harmonised IGS, which was not considered when determining its original calibration, then the calibration of the overall framework would need to be reviewed to ensure that the overall cost of the regime (which ultimately falls to customers) is still appropriate (in particular the risk margin).

Further comments:
Insurance Europe would also caution against comparing IGSs with deposit guarantee schemes of the banking industry. Bank runs and bank failures cause immediate and severe liquidity stress, which is highly contagious. Insurance failures could deteriorate future rights to some extent but will never cause liquidity stress.

In addition, an IGS would introduce the danger of "moral hazard" as the losses of any failing insurer will be absorbed by other parties than the insurer or supervisory authorities concerned, which would render the concept of the ladder of intervention obsolete. This could even lead to more risky business being written as there is no downside risk. Any losses will be passed on to other insurers while the benefits will flow to the underwriting party.

Should the Commission decide to propose a minimum harmonisation of IGS regimes, Insurance Europe's preference would be for a home approach combined with host elements, in which:

- The home country provides all the funding, because this ensures alignment with the model of the EU supervision already established in Solvency II. The home country would be responsible for deciding on how the IGS is funded (eg ex-ante/ex-post funding, how contributions are allocated to each insurer in their market, contribution caps, etc).

- The host country provides the "front office" customer interface to facilitate customer, policy and claim identification, as well as communication in local language.

Q27: ***Which of the following life insurance products should be protected by IGS?*** *All life insurance products/ Some life insurance products/ No life insurance products/ Don't know/no opinion*

- No life insurance products

Please specify which life insurance products should not be covered and explain why:

Summary:
Insurance Europe takes the view that the requirements and legal structure of policyholder protection schemes should be left to the discretion of individual member states and therefore does not endorse a minimum harmonisation on any type of product (life and non-life). However, it would like to highlight the following:

Life insurance contracts are long-term by nature and may have social security implications to a broad cross-section of the population. However, the role of life insurance may be very different across member states, and significant differences between types of life insurance products have to be taken into consideration.

For example, the risks differ significantly between unit-linked products without guarantees and (traditional) life insurance products with guarantees. In unit-linked life insurance without guarantees, the investment risk is borne by the policyholder and the insurance company does not provide any guarantee. Moreover, even if the insurance company is confronted with financial problems, the units invested in by the policyholder cannot be used for the liquidation of the insurance company, but remain with the policyholder. For this reason, even under minimum harmonisation, **unit-linked life insurance without guarantees should be excluded from IGS**.

If an EU wide IGS would be introduced, national specific circumstances must be taken into consideration when selecting which policies should be covered by IGS, to avoid damaging and unwarranted consequences for both insurance markets and social welfare systems, including national pension systems. In particular, the diverging structures of the occupational pension markets and the varying types of schemes existing in different member states must be respected.

Further comments:
If an EU wide IGS would be introduced for occupational pension insurance, it is essential – from a level playing field perspective – that an appropriate IGS is also put in place for similar occupational pensions schemes offered by other providers such as pension funds (IORPs). Since pension funds (IORPs) are not subject to comparable prudential regulation (Solvency II), the IORP guarantee scheme should be separated from the insurance guarantee scheme.

Q28: *Which of the following non-life insurance products should be protected by IGS?*

	Should be covered	Should not be covered	Don't know/ no opinion
Health		**X**	
Workers' compensation		**X**	
Insurance against Fire and other damage to property		**X**	
General liability		**X**	
Accident (such as damage to the driver)		**X**	
Suretyship for home building projects		**X**	
Other		**X**	

Please elaborate your answer to question 28. In particular, if you consider that other non-life insurance products should be protected please specify which products:

Summary:
Insurance Europe takes the view that the legal structure of policyholder protection schemes should be left to the discretion of individual member states and therefore does not endorse a minimum harmonisation on any type of product (life and non-life). However, Insurance Europe would like to highlight the following:

In contrast to life insurance, non-life insurance is generally characterised by a short contract duration (often a one-year policy) and lacks a savings element. In the case of insolvency of a non-life insurance undertaking, the consumer can easily switch from the insolvent insurer to another insurer since, in contrast to life insurance, there is no deterioration of the insured risk with time. Unlike in the case of bank deposits or investments, compensation must only be paid if the insured event occurred and the policyholder's claim is justified. Consequently, the affected number of policyholders is considerably smaller in relation to the total insured portfolio.

Including compulsory non-life products under the scope of minimum harmonisation would be also problematic because types of insurance that are compulsory vary greatly across member states. Moreover, since life and non-life insurance contracts differ significantly and are handled differently in the event of insolvency, it could be preferable that life and non-life insurance are treated and administered by separate IGS entities. This should, however, be up to member states to decide.

Q29: ***Should all mandatory insurance be covered by IGS?***
Yes/ No/ Don't know/no opinion

- No

Summary:
Insurance Europe takes the view that the requirement for and legal structure of policyholder protection schemes should be left to the discretion of individual member states and therefore does not endorse a minimum harmonisation on any type of product (life and non-life).

Including compulsory non-life products under the scope of minimum harmonisation would be also problematic because types of insurance that are compulsory vary greatly across member states. Moreover, since life and non-life insurance contracts differ significantly and are handled differently in the event of insolvency, it could be preferable that life and non-life insurance are treated and administered by separate IGS entities. This should, however, be up to member states to decide.

Q30: ***If your insurer fails, what would you prefer?***
Receiving compensation from the IGS/ That the IGS ensures that your insurance policy continues, for example by transferring it to another insurer/ It depends on the type of insurance policy/ Don't know/no opinion

- Don't know/no opinion

Comments:
Insurance Europe has not answered this question because the question is clearly addressed to policyholders.

Q31: *The coverage level of IGS determines the level of protection provided to policyholders. Should the European legislation set a minimum coverage level at EU level?*
Yes/ No/ Don't know/no opinion

- No

Please specify up to which amount claims should be fully guaranteed as a minimum:

Summary:
Insurance Europe supports the status quo and **opposes an EU initiative on IGS**. This is because the IGS currently in place vary significantly across Europe but work generally well within their local context and laws. Some member states currently have arrangements equivalent to an IGS that protect policyholders in the same way, whereas other member states do not have an IGS but consider that policyholder protection is nevertheless sufficient. Even a minimum level of harmonisation would create significant costs and involve complex challenges for which there may not be acceptable solutions.

Insurance Europe takes the view that the **legal structure of policyholder protection schemes should be left to the discretion of member states.** More generally, Insurance Europe believes that national authorities should be allowed significant flexibility to choose the IGS features that best suit their market, to reflect that there are important differences between member states regarding social welfare systems, winding-up process for insurers and insurance product lines.

The compensation paid in the case of a life insurer's insolvency is normally limited to the guaranteed sums and main commitments of the life insurance contract, whereas non-life insurance normally concentrates on outstanding claims and excludes the repayment of pre-paid premiums. Insurance Europe therefore supports the introduction of minimum requirements on caps and compensation limits within any national arrangements, to guarantee appropriate consumer protection while ensuring the financial stability of the national IGS and mitigating dangers of moral hazard. Member states should decide which compensation limits are adequate for the sustainability of their national IGS.

Further comments:
If an EU wide IGS would be introduced, member states should decide which compensation limits are adequate for the sustainability of their national IGS and may provide for: a *de minimis* rule (minimum threshold for IGS intervention) which avoids a disproportionate, excessive administrative burden that has only a very minor advantage for the consumer; a maximum limit for IGS intervention; within the maximum limit, a maximum percentage of the insurance claim covered by the IGS; absolute caps on total contributions are needed to avoid that the obligation to fund an IGS exposes the other remaining insurers in the market and their customers at a risk that would not have existed otherwise.

Insurance Europe would also like to highlight that the statement in the question that the coverage level determines the level of protection provided to policyholders is only *true* if everything else is equal. There are many other factors, eg type of products, insurers' governance and the financial strength, that are at least equally important for policyholder protection.

Q32: *In order to limit the risk of insurance failures and protect financial stability, should public authorities have the power to temporarily prohibit redemptions of life insurance policies? Please indicate the statement(s) with which you agree.*
Yes, at sectoral level, to the extent that such a measure is absolutely necessary to address major threats to the insurance sector/ Yes, in cases where a specific insurer is in a weak financial position/ Yes, in cases where a specific insurer is in financial distress, and as long as policyholders would be better off than in the event of the insurer's failure/ No/ Don't know/no opinion

- Yes, at sectoral level, to the extent that such a measure is absolutely necessary to address major threats to the insurance sector

- Yes, in cases where a specific insurer is in financial distress, and as long as policyholders would be better off than in the event of the insurer's failure

Q33: ***In order to limit the risk of insurance failures and protect financial stability, should public authorities have the power to reduce entitlements of a life insurer's clients (e.g. reducing the right for bonuses that policyholders were initially entitled to receive)?***
Yes, if the insurer is in deteriorated financial position/ Yes, as a last resort measure, and as long as policyholders would be better off than in the event of a failure/ No/ Don't know/no opinion

- Yes, as a last resort measure, and as long as policyholders would be better off than in the event of a failure

Q34: ***Please specify whether other exceptional measures than those mentioned in Question 32 and Question 33 should be introduced in order for public authorities aiming to preserve insurers' solvency and financial stability to intervene timely and in an efficient manner during exceptional adverse situations.***

Summary:
The industry believes that no further exceptional measures are needed if the shortcomings of the framework are addressed, making it fit for purpose to overcome crisis situations.

Indeed, while the Solvency II framework works well overall, it does not correctly capture the real economics and risks of insurers' long-term business. This leads to an underestimation of solvency strength and excessive volatility in the solvency measures. This is of particular relevance in times of stress since, during periods of high market volatility, these flaws can push insurers into unnecessary procyclical behaviour. The industry has highlighted the need for the Solvency II review to result in focused improvements, including increasing the volatility adjustment and significantly reducing the risk margin, while keeping the risk-free rate calibration and methods unchanged for the euro as well as for other currencies.

Additionally, the possibility to provide an extension of the recovery period allows for flexibility in times of exceptional adverse situations.

Please also clarify if those measures should apply at the level of individual insurers or widely to the whole sector:

N/A

Q35: ***In your view, should the framework provide for flexibility to alleviate certain regulatory requirements during exceptional adverse situations?***
Yes/ No/ Don't know/no opinion

- No

Please specify which additional provisions/measures would provide for sufficient flexibility of the framework, and which regulatory requirements would need to be alleviated during exceptional adverse situations:

Comments:
The framework already allows for some necessary flexibility, and this was seen in the COVID-19 crisis where EIOPA proposed a welcome delay in the reporting requirements. Similarly, Solvency II already allows the extension of the recovery period up to seven years in case of exceptional adverse situations, and NSAs already

have great powers of intervention when the SCR is breached. In any case, flexibility should especially not mean that NSAs can decide to apply measures outside the Solvency II supervisory ladder (especially before the SCR is breached).

What is key is that the Solvency II review fixes the flaws of the framework, and any solutions for such flaws should be tested against normal and stress market conditions, so that Solvency II works as intended in exceptional adverse situations. Today, Solvency II is not appropriately calibrated, and these flaws were highlighted by the recent COVID-19 crisis, when Solvency II failed to appropriately address the issue of short-term market volatility. Until these flaws are fixed in an effective way (see answers in section 1), regulatory flexibility could represent a necessary precondition.

Section 4: New emerging risks and opportunities

Q36: ***Are there additional types of natural catastrophes that might become relevant to the broader insurance sector in the next years and therefore warrant an inclusion in the standard approach for the calculation of capital requirements (e.g. drought or wildfire)?***
Yes, and sufficient data is available for the calibration of capital requirements for the additional types of natural catastrophes/ Yes, but the calibration of capital requirements is not possible at this stage, as the data will only become available over the next years/ No, additional types of natural catastrophes will continue to have lesser relevance for insurers, and they can be addressed by internal models and qualitative requirements ("Pillar 2")/ Don't know/no opinion

- Yes, but the calibration of capital requirements is not possible at this stage, as the data will only become available over the next years

Please indicate the source of available data:

N/A

Summary:
The Solvency II standard formula is not intended to, and should not be changed to, quantify every risk. Although no evidence has yet been presented to support the inclusion of new risks in the standard formula, Insurance Europe recognises that the materiality of risks may change in the future and that there may be justification for the future inclusion of new risks, as data will become available over time. For example, there is a more consistent impact of atmospheric events such as wind, rain, lightning: such events, considered altogether, even if not referable to a single catastrophe event, are becoming more relevant. It is to be noted that a sufficiently long period of time would be necessary for any data signals to be distinguishable from random variation.

The justification for the future inclusion of any risks needs to be assessed with respect to 1) the significant operational challenges of sourcing data and calibrating the natural catastrophe risks parameters for the standard formula, 2) the materiality of other peak perils in a given country and 3) the existing Solvency II provisions for dealing with idiosyncratic risks (eg internal models and Pillar II requirements).

The 2018 review of Solvency II included the revision of a number of natural catastrophe parameters. This was carried out by the EIOPA CAT working group which consisted of EIOPA, nat cat modellers, brokers as well as supervisory and industry representatives. The process demonstrated that there is often limited data available to calibrate these parameters.

Insurance Europe further highlights that the materiality and calibration of several of the existing standard formula natural catastrophe risk parameters remains questionable. These include the Italian earthquake risk and Greece earthquake risk country factors.

Q37: ***Beyond the general rules on the use of data, should Solvency II rules explicitly require insurers to assess whether the data used in the valuation of liabilities to policyholders captures sufficiently trends caused by climate change?***
Yes, and requiring this assessment is of high importance/ Yes, and requiring this assessment is of medium importance/ Yes, but requiring this assessment is of low importance/ No/ Don't know/no opinion

- Yes, but requiring this assessment is of low importance

Q38: ***Beyond the general rules on the use of data, should Solvency II rules explicitly require insurers to assess whether the data used in an internal model captures sufficiently trends caused by climate change?***
Yes, and requiring this assessment is of high importance / Yes, and requiring this assessment is of medium importance/ Yes, but requiring this assessment is of low importance/ No/ Don't know/no opinion

- Yes, but requiring this assessment is of low importance

Comments:
Europe's insurers remain as committed as ever to tackling climate change and to contributing towards making the EU economy sustainable. In its role of provider of insurance, the industry continues to embed sustainability in its business model.

When it comes to taking into account climate change risk, insurers are already required by Solvency II to use up-to-date data in the valuation of liabilities, including, where appropriate, changes that can impact the current liabilities.

It is worth noting that, given current data availability and models, specific rules on climate change trends in data are unlikely to achieve the desired outcome to capture overall impact of climate change on the valuation of liabilities. Life insurance already explicitly considers mortality and morbidity trends when making provisions. While such trends could change in the coming decades because of climate change, the impact will become clear slowly and likely only in retrospect. This means that the extent to which climate change will affect the valuation of liabilities is not clear, and positive effects for some insurers are also possible.

For non-life insurance data trends might not matter as singular weather events cannot be linked to specific trends. Instead, changes in frequency and severity of certain events – not captured by historical trends – can be more relevant especially because insurers tend to sell yearly guarantees for which pricing and conditions can be adjusted yearly.

Similarly, internal model design and calibrations do not prevent internal model undertakings accounting for climate change. Insurers generally take into account the climate-related evolutions via their effect on other variables included in the internal models.

Q39: ***Should Solvency II rules for insurers explicitly require climate scenario analyses as part of the qualitative rules ("Pillar 2")?***
Yes, and climate scenario analyses are of high importance/ Yes, and climate scenarios analyses are of medium importance/ Yes, but climate change scenario analyses are of low importance / No/ Don't know/no opinion

- Yes, but climate change scenario analyses are of low importance

Please explain what opportunities and challenges you foresee for the insurance industry when it comes to climate scenario analyses including, for example, whether standardisation of these scenarios would be useful:

Summary:

The **European stress testing exercise and the overall solvency needs assessment (in the ORSA) can** be helpful for certain insurers to assess their exposures to climate change risk. With respect to the ORSA, it is important that scenarios remain relevant for each company's risk profile. Insurance companies that do not identify significant climate risks in their risk profile should not be forced to consider climate scenarios.

For insurers with significant climate risk, the development of a standardised set of quantitative scenarios to be included in the ORSA should be avoided, as it creates a number of issues including the lack of consensus among experts regarding the choice of scenarios and their evolution in the future. Defining a standardised set of quantitative scenarios for all countries across the EU is even more challenging (see the existing modules for natural catastrophe risk).

It is important to note that:

- It is unclear how to separate the various effects of climate change risk from other factors.
- While historical data is not enough to predict climate change risks, forward-looking company data (pathways) is not available in a systematic manner and is not of sufficiently high quality.
- There are no agreed scenario assumptions and methodologies to project key variables, including insurance uptake/exposures and vulnerabilities into the future, eg for a period 2030-2040.
- Undertakings need to have full flexibility to reflect differences in time horizons (climate change has a longer time horizon compared to that of long-term scenario analysis in risk management, governance and ORSA) and company specificities (the measurement and quantification of these risks is necessary only when these effects are financially material for the undertaking, which depends on company-specific strategy).

Further comments:

There are a number of tools that can be used to assess climate change risks in a forward-looking manner, such as scenario analysis and stress testing.

On one hand, the **European stress testing exercise** may be helpful to this end.

On the other hand, the **ORSA also represents an adequate tool** to consider financially material sustainability risks; given the key role of **overall solvency needs assessment** in undertakings' risk management, the forward-looking and long-term aspect, and the need to ensure cross-sectoral consistency.

As finding a meaningful standardised set of quantitative scenarios would be challenging, the insurance sector suggests that EIOPA focuses on the development of non-binding qualitative principles, rather than a prescribed set of quantitative scenarios.

In general, the insurance industry notes that, given the long-term horizon of sustainability risks, a qualitative approach is equally valuable for their analysis, particularly while the development of EU-wide climate stress testing is in its infancy. While financially material sustainability risks can be considered both from a qualitative and quantitative view, the undertaking should decide which quantitative or qualitative tools are most appropriate to consider sustainability risks, including those related to climate change.

Please explain your answer to Question 39:

Summary:

It is important that Solvency II does not explicitly require climate scenario analyses as part of the qualitative rules ("Pillar 2"). The preferred approach would be to leave **flexibility to insurers on the choice of the most adequate tools to deal with sustainability risks, including climate change**.

It should be considered that:

- Recent EC amendments to the Solvency II framework already put a strong focus on the integration of sustainability risks. Sustainability risks are already incorporated into the current framework, through an undertaking's risk management, governance and the ORSA.

- There are a number of technical issues associated with the development of scenarios (see above), including differences in resources and exposures across undertakings. EIOPA should focus only on providing guidance, eg via the development of non-binding qualitative principles.

While sustainability risks, and in particular climate change risks, should be considered in a forward-looking manner, the insurance industry notes that:

- Undertakings should maintain sufficient flexibility to reflect and integrate sustainability risks in line with their specific business model. This will allow them to effectively integrate material sustainability risks in their internal processes.
- Proportionality needs to be explicitly considered: small insurers with simple risk profiles should not prepare scenario analyses at all. A qualitative assessment, with the possibility to use scenario analysis, should be sufficient in this case.

In this respect, Insurance Europe notes that the European stress testing exercise may be helpful to explicitly require incorporation of a forward-looking approach towards climate change. The industry stands ready to collaborate with EIOPA on its triennial European stress testing exercise, to ensure that its design and the calibration of the scenarios are appropriate.

Q40: ***In your view, does Solvency II contain rules that prevent the practice of impact underwriting by insurers?***
Yes/ No/ Don't know/no opinion

- No

Please specify which rules (ideally with legal references) and rate their importance (high, medium, low):

Summary:
The industry believes there are currently no rules preventing the practice of impact underwriting by insurers, as long as considerations which are only based on or related to risk are taken into account, as part of the underwriting process.

It should be highlighted however that the response to the question whether or not Solvency II is preventing the practice of impact underwriting, also depends on the definition of 'impact underwriting'. For example, EIOPA recently defined 'impact underwriting' in light of climate change as follows:

"Consistently with actuarial risk-based principles, insurers, as risk managers and underwriters, can contribute to climate change adaptation (reduce impact of climate change) and mitigation (reduce GHG emissions) by applying their data, expertise and risk assessment capacity to
a. incentivise policyholders to mitigate insured risks via risk-based pricing and contractual terms and
b. consider in their underwriting strategy measures that contribute to climate change adaptation or mitigation."

It should be noted that this definition is not compatible with the regulatory requirements from Solvency II, since it ultimately makes non-risk parameters part of the risk-based pricing. Risk-based pricing of all risks independent from the area they stem is a core insurance principle. Therefore, the assessment and pricing of any risk that the insurer is requested to cover must be exclusively risk-based at all times. Should this not be the case, the crucial balance between risk-based premium income and claims payments as a foundation for financial market stability would be severely jeopardised. Other, non-risk-based aspects regarding sustainability should be taken into account before or after the underwriting process.

Q41: ***Do you have proposals for changes others than those provided in your answers to Question 5 and Questions 36 to 40 that would make Solvency II a more conducive framework for sustainable activities by insurance and reinsurance companies?***

Summary:
The EC focus should be on fixing the treatment of the long-term business and assets. Any regulatory barrier to long-term investing by the insurance industry will also be a barrier to sustainable investment. While not all long-term assets are sustainable, improving the design and calibration of regulations to better reflect the long-term nature of the business will therefore implicitly benefit sustainable investment.

The EC should investigate how Solvency II could be adapted to facilitate further long-term investment while maintaining its strong risk-based nature. In this respect, it is essential that Solvency II remains risk-based and does not attempt to artificially support green assets or penalise brown ones via artificially adjusted capital requirements.

Apart from Solvency II, a uniform European company database could be useful to broaden the investor base for SMEs through more accessible company information.

Q42: ***Should the European legislation introduce enhanced requirements for insurers to monitor and manage information and communication technology (ICT) risks, including cyber-risks as part of their risk management practices ("Pillar 2")?***
Yes/ No/ Don't know/no opinion

- No

Summary:
Rather than introducing further enhanced requirements, Insurance Europe instead stresses the need for alignment between all existing and ongoing initiatives in the area of ICT risk management, so as to avoid regulatory overload.

ICT risks are already part of the integrated risk management system of all Solvency II regulated insurers, as a component of operational risks (see Article 13 of the Solvency II Directive). As such, ICT risks are taken into account in capital requirements, governance and reporting. Insurers are also subject to ICT risk management requirements under the network and information security Directive (NIS) Directive in member states where they have been classified as Operators of Essential Services.

There are also other ongoing EU initiatives in the area of ICT risk management that will impact on insurers, notably the EC proposal on a digital operational resilience framework for financial services, which seeks to legislate in the areas of ICT and security requirements, incident response, stress testing, risk transfer mechanisms and information sharing. European supervisors are also active in this area, with forthcoming EIOPA guidelines on ICT security and governance, as well as national supervisors' initiatives on information security.

Q43: ***Should the European legislation consider that cyber-insurance is a distinct class of insurance, which would need to be subject to its own authorisation process by public authorities?***
Yes/ No/ Don't know/no opinion

- **No**

Summary:
The industry is opposed to a standardisation of cyber cover, which would be the result of considering cyber-insurance as a distinct class of insurance subject to its own authorisation process.

The cyber insurance market has and continues to evolve to meet the changing landscape of risks and consumer demands. Given the evolving nature of the risk, standards would inevitably become quickly outdated and would not provide adequate guidance for businesses. Product – or even coverage – standardisation at this stage would negatively impact both policyholders and insurers:

- Policyholders forced to buy standardised products are more likely to purchase cover that is not tailored to their needs and/or to buy either more or less coverage than they actually need.
- Insurers need the flexibility to tailor the policies to their clients' risks, and policy language is still evolving to reflect changing threats.

In order to meet this changing landscape of risks and consumer demands, it is important that insurers are able to maintain their ability to develop a wide range of innovative cyber products, which can vary from standalone cyber products to aspects of a broader insurance policy (eg under property insurance, directors' and officers' (D&O) liability insurance, or general liability policies). The type and extent of the cover varies greatly depending on the needs of the buyer, the type of cyber risks they are exposed to, their size, business model, and level of digitalisation.

Insurance Europe is therefore of the view that, given the nature of the risk and the resulting variety of consumer needs, the European legislation should *not* consider that cyber-insurance is a distinct class of insurance, that should be subject to its own authorisation process by public authorities.

Further comments:

For further information, please consult Insurance Europe publication on cyber insurance: https://insuranceeurope.eu/sites/default/files/attachments/Insurers%E2%80%99%20role%20in%20EU%20cyber%20resilience.pdf

Q44: *Should the legislation differentiate intragroup and extra-group outsourcing, and introduce "lighter" requirement in the former case?*

Yes, but the lighter requirements should be conditioned to the satisfaction of some criteria at the level of the group, for instance appropriate centralised risk management processes and internal control mechanisms of the group/ Yes, and those lighter requirements should not be conditioned to any additional criterion/ No/ Don't know/no opinion

- Yes, and those lighter requirements should not be conditioned to any additional criterion

Please specify which requirements should be alleviated in the case of intra- group outsourcing, and the criteria to be satisfied at the level of the group to benefit from the "lighter" requirements:

Summary:

The industry believes that lighter requirements when an activity is outsourced in a group should be part of the proportionality measures in the "toolbox". The service provider belonging to the same group, whether it is a regulated entity or not, should be the criterion for the relaxation of outsourcing requirements. The intra-group service provider is per se part of the regulated organisation which is responsible for the implementation and execution of the internal control and management functions across the group. This means that group-wide systems are applied consistently across the insurance group including the intra-group service providers company as well as the intra-group outsourcing company.

Therefore, there is no reason to require such extensive requirements when the activity is outsourced within the group, as the insurer knows well the service provider with which it has common interests, and the risks are inherently different, and lower, than when the activity is outsourced to an external third party.

The Solvency II framework already provides governance requirements such as ensuring risk management and internal controls at group level, as such the industry sees no objection in including these in the risk-based criteria. The same relaxation could be considered for third country groups which are based in countries with equivalent supervisory regimes. The "lighter" requirements for intra-group outsourcing should be clearly identified and fully harmonised in the European legal text in order to foster convergence.

Please specify which requirements should be alleviated in the case of intra- group outsourcing:

Summary:
The following criteria should be simplified for intra-group service providers:
- During the selection/tender of service provider.
- During the ongoing cooperation/collaboration between the involved insurance entities.

Selection/tender of service providers for services to be outsourced:
- Simplified examination of the service provider (Art 274.3.a of the Delegated Acts).
- Simplified examination of the same provisions of the safety and confidentially of information (Art 274.3.f DA).
- Simplified terms and conditions of the outsourcing agreement (Art 274.3.d DA).

Ongoing cooperation/collaboration between involved intra-group entities for outsourced services:
- Simplified right to issue general guidelines and individual instructions to service provider (Art 274.4.f and 274.4.j DA).
- Simplified reporting and disclosure obligations of the service provider (Art 274.4.c, 274.4.h and 274.4.j DA).
- Simplified compliance of the service provider's risk and internal control system (Art 274.5.a DA).
- Simplified monitoring of the service provider by the outsourcing insurance undertaking (Art 274.1 DA).
- Simplified coordination of contingency plans of the service provider by the outsourcing insurance undertaking (Art 274.5.d DA).

In particular, the designation of a person within the undertaking with overall responsibility for the outsourced key function – as required by EIOPA – should be dispensable. The same applies to the exhaustive requirements on selecting an adequate service provider.

Section 5. Additional input

As the consultation document invites stakeholders to provide further inputs, the industry would like to highlight additional concerns.

Market access of third country (re)insurance undertakings which exclusively conduct reinsurance activities

Articles 162–171 of Directive 2009/138/EG do not address the market access of third country (re)insurance undertakings which exclusively conduct reinsurance activities. This leads to a fragmented and inconsistent regulatory landscape, as some member states impose a local presence requirement on such undertakings while others don't. As a result, insurance and reinsurance undertakings are confronted with an unlevel playing field if they consider ceding (re)insurance risks to undertakings located outside the European Union on a cross-border basis.

Therefore, the market access of third country (re)insurers which only operate reinsurance business should be harmonised in accordance with international standards. Insurance Core Principle 13.4 of the International Association of Insurance Supervisors (IAIS) emphasises the cross-border nature of reinsurance transactions and the market sophistication of the parties involved. This should be translated into a regulation which requires member states to grant market access if the third country (re)insurer is authorised to conduct reinsurance business in its jurisdiction and national competent authorities deem the supervision performed by and the cooperation with their third country counterparts as adequate. Such an approach would also be in line with the equivalence concept for third country reinsurers pursued by Article 172 of Directive 2009/138/EG as it applies to the treatment of reinsurance contracts for solvency purposes only.

Regarding **strategic equity investments** (Art 171), the industry believes that:

- The lower volatility criterion should be removed.
- A prescribed beta-method for the volatility criterion in the regulation is not needed, neither as an optional nor as a compulsory method.
- The 20% minimum ownership and control threshold is too high. This should be reduced to 10%.

Netting agreements (currently hampered by Article 275)

Article 275 (1a) of the Directive should be supplemented to the extent that absolute priority does not apply with regard to netting agreements and a corresponding exception at national level does not violate the Directive.

Netting of derivatives is standard as a recognised risk mitigation technique for financial transactions in Europe, and netting agreements are privileged in the European capital requirements regulation (CRR) and EMIR regulations. Insurers also use netting to reduce risk and protect their liquidity. However, Article 275 (1a) of the Solvency II Directive makes it difficult to conclude netting agreements by stipulating that the claims of the insured have priority over all other claims. This priority over claims by third parties without exception, which was implemented at national level by an absolute ban on offsetting, is contrary to the conclusion of netting agreements.

Definition of insurance business

Insurance Europe agrees with recommendation 24 of the final report of EC's Expert Group on Regulatory Obstacles to Financial Innovation, which proposes that the impact of existing activities restrictions for financial institutions' non-core business should be reviewed to determine whether these restrictions remain proportionate. According to the expert group, particular attention should be paid to cross-sectoral considerations in order to ensure a level playing field between different types of actor in the financial sector, including BigTech.

In the insurance sector, limitations and restrictions may result from Art. 18. 1 (a) and (b) of the Directive, requiring (re)insurance undertakings to limit their objects to the business of insurance and operations arising directly therefrom, to the exclusion of all other commercial business. While we acknowledge the rationale of this restriction, it could prove to be detrimental to align and optimise the business models of insurers – in particular for the digital era – as new activities – inter alia – arising from the development in the area of digitalisation may be classified as non-insurance business. Consequently, they would not be permissible for insurance companies. Insurance Europe takes the view that this runs counter to the level playing field idea, as it puts insurance companies at an unjustified disadvantage relative to other participants in the digital economy.

Insurance Europe takes the view that the current understanding of "business of insurance" should be adapted in a way that better reflects the ongoing development in the insurance sector. Insurers should be encouraged to explore innovative ideas and utilise the potential of digitalisation without jeopardising the interests of policyholders.

Consequently, it may be clarified that non-insurance activities shall be allowed if:

- They are either not associated with increased financial risks for the insurance company.
- If these risks are already sufficiently addressed, eg within the company's (internal) model.
- If services are provided by insurance companies for other regulated parties.

Proposal to address the procyclicality created by the current Tier 3 approach

The industry wishes to put forward the following proposal to address the procyclicality created by the current Tier 3 approach: an option for consideration might be to temporarily remove the 15% restriction applicable for Tier 3 own funds items.

In adverse situations, eg market wide stresses (definition to be discussed), net deferred tax assets (net DTA) – a Tier 3 own fund item - will increase because of lower economic values of investments or through increases in the technical provisions. The increase of the net DTA could lead to the situation that the net DTA cannot be used to its full extent as a Tier 3 item, when the 15% limit would be breached. Even though several elements of the net DTA are of a temporary nature. By maintaining the exposure on the economic balance sheet, for example a bond, the net DTA will recycle back through unrealised gains.

Alternatively, instead of the temporary removal of the 15% restriction, the DTA related to these type of exposures (where the DTA will simply disappear by maintaining the assets on the economic balance sheet) could be exempted from the tier 3 calculation. This measure would substantially limit the current procyclical nature of the sub Tier 3 limit, in particular in the going concern.