Press release

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Rushed changes to UFR unnecessary and could threaten investment returns for policyholders

No need or justification for changing the UFR

Rushed changes to the ultimate forward rate (UFR) risk pushing insurers towards sub-optimal investment strategies, which could unnecessarily negatively impact policyholders' returns, according to Insurance Europe, the European insurance and reinsurance federation.

In addition, changing the UFR before the Solvency II review is unnecessary. This is because the current framework already has several additional layers of protection in place to ensure policyholder claims will be paid.

In its response to a European Insurance and Occupational Pensions Authority (EIOPA) consultation on possible changes to the methodology for calculating the UFR, Insurance Europe said there is no need to change it for either prudential or policyholder protection reasons.

Igotz Aubin, head of prudential regulation at Insurance Europe, commented: "Calls for hurried changes to the UFR appear to be based on a misunderstanding of its purpose and how it impacts Solvency II liability valuations. The UFR of 4.2% is not the risk free rate used for Solvency II valuations; rather it is a parameter used to generate them. The actual risk free rates are far lower. For example, the risk free rate for euros in June at year 10 was 0.32% and even at year 60 was 2.76%."

Insurance Europe believes that changing the UFR now could also cause unintended adverse consequences for both policyholders — by pushing insurers towards locking their products into long-term low returns — and for the European economy, by creating unnecessary difficulties and encouraging sub-optimal changes to investments at a time when insurers' capacity to invest and provide financial stability is especially important.

It should also be noted that the UFR is defined in Solvency II as a long-term, stable parameter and its current calibration was agreed at political level during the Omnibus II negotiations. Therefore, the current low interest rate environment does not constitute a change in long-term expectations for interest rates, especially given that the current low rates are linked to current European Central Bank policy, which is intended to be temporary.

Aubin added: "While low interest rates are creating real challenges for the industry, companies have been taking action — in some cases, for many years — to adapt their products, investment mix, hedges and capital levels. Solvency II makes this a requirement for all companies, creating multiple layers of buffers and protection, as well as introducing very detailed monitoring and powers to allow supervisors to ensure the necessary actions are being taken."

Insurance Europe also believes that when the UFR is eventually reviewed that — given its key role as an anchor for solvency liability calculations and the potential significant impact of any change — an impact analysis should be undertaken before any methodology and implementation planning is finalised. This analysis should include an assessment of:

- The impact on the overall level of prudence in the Solvency II framework, to avoid creating unintended and unnecessary burden.

- Potential pro-cyclical effects and other unintended consequences for policyholders and the wider economy, in particular regarding insurers' capacity to invest in long-term projects and distribute long-term savings retirement products.
- Back testing to ensure that the objectives of producing a stable long-term rate, and avoiding additional volatility in liability calculations, have been achieved.

- Ends-

Notes for editors

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2. You can also receive updates from Insurance Europe by signing up here or by following us on Twitter @InsuranceEurope.
3. Insurance Europe is the European insurance and reinsurance federation. Through its 34 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of almost €1 170bn, employ a little under one million people and invest nearly €9 600bn in the economy.