KEY POSITIONS FOR THE 2020 REVIEW OF SOLVENCY II

Solvency II is strongly supported by the insurance industry. The economic, risk-based framework has proved its value since it was first applied in January 2016. However, the framework is excessively conservative, contains some measurement flaws and places excessive operational burdens on companies, which create unnecessary costs and barriers to the provision of — in particular — long-term products and investments.

The Solvency II review should not lead to an increase in overall capital requirements. For certain products, a better reflection of their real risk should lead to a justified reduction in capital requirements.

The industry believes that the review should lead to:

- A **more appropriate valuation of liabilities** by addressing the current technical flaws (in the volatility adjustment (VA) and risk margin) and maintaining what works (current extrapolation methodology, matching adjustment).
- A **more appropriate measurement of capital requirements** in the standard formula (eg, including the dynamic VA into the spread-risk assessment, improving the criteria for long-term equity, correcting the calibration of property risk, allowing for negative rates in the interest rate calculation).
- An **overall increase in insurers' capacity to invest and take on risks** due to reductions in capital requirements as a result of addressing the technical flaws in the framework. This will support insurers in:
  - maintaining their role as providers of long-term savings/pension products, which are key for the long-term well-being of European citizens, especially in light of ageing populations, the savings gap and strained national budgets;
  - providing protection to individuals and businesses, and working with governments to close the protection gap, which is more important than ever, given the challenges posed by climate change; and,
  - investing in the European economy, supporting the post-COVID-19 recover and the transition to a sustainable economy.
- A **less burdensome framework** by simplifying and streamlining reporting requirements.
- A **more diversified and efficient insurance market** by enhancing the application of proportionality.
- An **enhancement of the risk-based nature of the framework** by more appropriately capturing insurers' true business model and actual risks. This will:
  - maintain a very high level of policyholder protection; and,
  - strengthen financial stability.
- **EU companies better able to compete** with foreign firms in domestic and foreign markets.

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

- Deliver on the important European objectives set out in the Green Deal and the Capital Markets Union, as well as support the Next Generation EU plans for the social and economic recovery of Europe.
- Support the competitiveness of the European industry on the global stage, and thus deliver on the EC ambition to strengthen Europe's leadership in the world.

LONG-TERM BUSINESS

General

DO

- **Ensure the link between assets and liabilities is recognised throughout the framework**, both in the valuation and the solvency capital requirement (SCR).
- Ensure real, not theoretical, risk exposures are measured.

Volatility adjustment (VA)/ matching adjustment (MA)

DO

- **Make material improvements to the VA**: it does not work well enough and needs improving to better mitigate market volatility and to be higher to better reflect what insurers can and do earn.

  Although EIOPA's draft proposals include some good ideas, other elements override them and would make the VA worse (see across).

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

DON'T

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

  These elements of EIOPA's draft proposals are prudentially unnecessary and would make the VA more procyclical, worse at mitigating artificial volatility and neutralise improvements from the "option 7" country component, making the VA more complicated than necessary.

Risk margin

DO

- **Review the design and calibration of the risk margin to lower the current excessive level and volatility**.

  The risk margin is a purely theoretical amount added over and above the real reserves needed to pay all future expected claims and expenses. It currently reduces the risk-taking capacity of the industry by up to €190bn, is another source of artificial volatility and should be significantly reduced.

Risk-free interest rates

DON'T

- **Do not change the current approach to the calculation of the risk-free rates**.

  The methodology already reflects the current very low rates, including negative rates when they occur. EIOPA's draft proposal to change the method for extrapolating beyond the last liquid point is unnecessary, would create another source of artificial volatility and would make it even harder for insurers to maintain long-term business and therefore also impact long-term investment.

Interest rate risk SCR

DO

- **Allow for negative interest rates**, using the shifted calibration approach.

DON'T

- **Do not use EIOPA's floor and do not apply the shock beyond the last liquid point**, as these elements of EIOPA's proposals assume unreasonable scenarios and would result in procyclicality.

Spread risk SCR	DO
	Maintain the current dynamic VA for internal model users, without changes, and **allow 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.

Equity risk SCR	DO
	Improve the criteria for the long-term equity category. Much of insurers' equity investment is generally exposed to the risk of long-term under-performance and not to short-term market price movements. This equity category was created in the 2018 review in recognition of this, but the current qualifying criteria are poorly designed and almost no equity qualifies in practice. The criteria need to be improved so that a significant amount of equity investments qualify as long-term, thus removing a barrier to greater investment by insurers.

Real estate	DO
	Recalibrate the real estate asset category to 15% to better reflect the real risks of this asset class.

Sustainable investments	DON'T
	Do not introduce artificial incentives or disincentives to hold assets on the basis of green or brown qualifications. Appropriate improvements in the review, combined with the EC's powerful green finance strategy (eg SFDR and taxonomy) will provide strong incentives for insurers to accelerate their transition to sustainable investments.

Other	DO	DON'T
	Remove the requirement to publicly report solvency with and without the long-term measures. The long-term measures are there to reflect the true economics and the real risks. Requiring public reporting of solvency with and without them creates confusion and undermines their purpose, especially during periods of market volatility when they are most needed.	**Do not change transitional measures** — they should be left in place until they expire.

REDUCING THE BURDEN

Proportionality

DO

- **Amend legislation to ensure proportionality works in practice**. This should include:
  - Making clear that not only are NSAs legally able to allow insurers to apply proportionality, but they have a legal obligation to facilitate this.
  - Creating a non-exhaustive toolbox of proportionality measures with pre-defined, risk-based criteria for their automatic application.
  - Making clear that proportionality can go beyond the toolbox and apply to all, based on the nature, scale and complexity of the risks and activities (and not only on the size of the company).
  - An annual report assessing the application of proportionality, including proposals for how to improve its effectiveness and consistency.

Reporting

DO

- **Reduce the compulsory Quantitative Reporting Templates (QRTs)**.
- **Simplify the Solvency and Financial Condition Report (SFCR)** by allowing a short (eg , 2-page) summary together with a simple extract of QRT data (with no mandatory narrative).

DON'T

- **Do not make many changes to existing QRTs or add unnecessary templates such as the disclosure of standard formula numbers by internal model users**.

Thresholds

DO

- **Allow member states to increase the thresholds at which Solvency II is applied, in line with EIOPA's draft proposals.** Below this, local requirements apply.

FURTHER ISSUES

Macro-prudential package/ recovery & resolution

DO

- **Only consider measures referenced in the EC call for advice**. The extremely limited systemic risk presented by insurers and the comprehensive nature of Solvency II mean there is no justification for significant further supervisory tools. The EC measures should be applied in a proportionate way, if at all:
  - Empower supervisors to be able to temporarily prohibit redemption of policies in specific circumstances.
  - Consider pre-emptive recovery planning for insurers only where it would provide a tangible benefit, as determined by the supervisory authority.
  - Employ resolution only as a last resort, once all recovery options have been exhausted. Resolution plans should exclusively address the rare situation that an insurer ends up at a point of non-viability.
  - Recognise the importance of cross-border cooperation and coordination between supervisory and/or resolution authorities within the European Economic Area and in third countries, as well as the mutual recognition of resolution actions.

DON'T

- **Do not introduce new intervention powers before the SCR is breached**. Solvency II is already very comprehensive. With its two levels of capital — the MCR and significantly higher SCR — the framework was already designed for early intervention, which starts as soon as the SCR is breached. There is no need for new powers for even earlier intervention.
- **Do not introduce counter-cyclical capital buffers or capital surcharges for systemic risk**. Solvency II is already too conservative, adding even more buffers is unnecessary and would increase the barriers to long-term products and investments. Instead the focus should be on correcting the current measurement flaws so that they are not procyclical.
- **Do not introduce concentration limits**.
- **Do not introduce new powers for controlling dividends**. Solvency II already provides a strong basis and safeguards the framework for dividend distributions, including in the ORSA and risk appetite limits approved by Boards. The current case-by-case approach is appropriate. Blanket bans can have damaging effects, such as disruption of income flows for investors (eg, pension funds) that rely on regular dividends.

Group supervision

DON'T

- **Do not make any significant changes to group supervision or capital calculations for groups**. There are already sufficient supervisory convergence tools. It is important to preserve flexibility and supervisory dialogue to ensure national supervisory authorities can adapt to the various group structures and risk profiles.

Insurance guarantee schemes (IGS)

DON'T

- **Do not introduce minimum harmonisation of IGS**. Solvency II, when implemented appropriately, offers sufficiently high protection. The focus should be on ensuring Solvency II is calibrated and applied appropriately and on cooperation and coordination between supervisory and/or resolution authorities. The IGS currently in place vary significantly across Europe but generally work well in their local context and laws. The requirements and legal structures of IGS should continue to be decided by member states.

Non-proportional reinsurance

DO

- **Improve the treatment of non-proportional reinsurance**.