ACTUARIAL ASSOCIATION OF EUROPE
ASSOCIATION ACTUARIELLE EUROPÉENNE

1 PLACE DU SAMEDI
B-1000 BRUSSELS, BELGIUM
(+32) 2 201 60 21
INFO@ACTUARY.EU
WWW.ACTUARY.EU

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MAIN POSITIONS CONCERNING THE SOLVENCY II 2020 REVIEW

We welcome the precondition not to change fundamental principles of the Solvency II framework, like confidence level underlying calibration of capital requirements and the market-consistent valuation of the balance sheet. Anyway, we acknowledge the need to adapt part of the regulation because of the current and prolonged low interest rate environment, the high-level needs for the insurance sector to better serve the long-term needs for European citizens and the experience learned during the 4 years of application of the current regime. Fostering this role as long-term investors requires an appropriate valuation of long-term business and a risk-adequate treatment of long-term investments as well.

Our concerns are mainly related to the following topics:

1. Inappropriate treatment of long-term business with guarantees
2. Fostering investments by requiring not risk-adequate capital (e.g. green supporting)
3. Extensions of the Solvency II framework by macroprudential elements

Ad 1[1]:
The availability of deep, liquid and transparent (DLT) markets is a precondition for the required market-consistent valuation in the current framework. An identified last liquid point (LLP) is the starting point for an extrapolation. Currently, for the EURO, this LLP is 20 years. EIOPA's DLT assessment has identified longer durations than 20 years only for swaps and not for bond related criteria (bond market, residual volume, matching criterion). Undertakings which need to invest in bonds can therefore not rely on DLT markets for durations longer than 20 years. For the Euro, the LLP of 20 years should not be changed. Any change in the definition of LLP has significant market impact which needs to be taken carefully into account.

Extrapolation method: The current Smith-Wilson method should not be changed. An essential criterion is the role of the UFR and the convergence requirement (for the EURO) to reach the UFR within a convergence period of 40 years with a prescribed tolerance. The UFR reflects a long-term expectation, annually determined by EIOPA in accordance with the method published in 2017.

The alternative extrapolation method discussed in the Consultation Paper and tested as part of the holistic impact assessment leads to a significant weakening of the role of the UFR caused by waiving the convergence requirements. The method carries distortions of capital markets (e.g. ECB-activities, Covid-19) forward to the entire RFR and increases volatility of capital position.

[1] The statements have already been among our comments on EIOPA's Consultation Paper on the Opinion on the 2020 review of Solvency II (EIOPA-BoS-19/465 15 October 2019). Comments are published on AAE's website.

E.g.: Although one cannot blame the ECB for declining or even negative interest rates, without ECB's asset purchase programs ten-year sovereign bond yields would have been 140 bp higher in 2018[2]. Besides immediate effects on attainable yields, long-term valuation can be seriously affected by non-appropriate valuation requirement. This might even prevent insurers from maintaining their long-term business model, holding long-term investments, offering products and ensuring that the liabilities to existing customers will be met. Long-term valuation requires a mean reversion assumption thus compensating this effect.

Convergence to the UFR is determined by the last liquid forward rate (LLFR) and a mean reversion factor alpha. The LLFR aims at taking into account information from DLT-markets post the LLP. It can be highly volatile (see Holistic impact assessment and Complementary Information Request) and affects the entire RFR. Convergence is modelled independent from capital markets by applying fixed factors depending solely on the mean reversion factor. In a low interest rate environment this is equivalent to a reduction of the UFR. Effects in a high interest rate environment are not considered (although being part of Commission's request).

Volatility adjustment needs reconsideration. The current proposal is still based on a reference portfolio calibrated at EU-level, although considering undertaking specific aspects. This will not remedy the identified deficiencies. Taking own assets as a basis should still be considered. We don't support the proposed introduction of additional own funds buffers for compressed spreads (a new proposal of ESRB and EIOPA). This would effectively increase complexity without adding additional benefit with regard to policyholder protection or financial stability. Undertakings using the VA already have to disclose the effect resulting from this measure. Furthermore liquidity plans are required in the risk management system.

Interest rate stress: We see the need for corrections of the current SCR interest rate risk calibration as currently negative interest rates are not stressed. The AAE had supported the calibration proposed in the Consultation paper. The since then protracted low interest rate environment gives reason to thoroughly examine the usability of data for this purpose. The risk parameters should only be applied to the liquid part of the curve. This stressed liquid part should be extrapolated. First stress – then extrapolate!

Risk margin: We welcome the attempt to reduce the risk margin by introducing a factor lambda to attenuate the impact of future SCR. The currently proposed floor should be omitted. We are still of the opinion that the margin needs further analysis (e.g. CoC for different lines of business), especially on the way it works for long-term insurance liabilities.

Ad 2:
Same risk same capital is a basic principle of SII. Therefore neither green supporting nor brown penalising factors should be introduced. Capital requirements should consider the quality of investments and the inherent risk. We support initiatives that contribute to an appropriate integration of climate risk in the Solvency II framework.

Ad 3:
SII is a risk based – although microprudential - framework which ensures already an extensive protection of policyholders.

[2] Philip R. Lane: The yield curve and monetary policy, Speech at University College London (UCL), London, 25 November 2019

EIOPA already acknowledged that risks for financial stability, liquidity risk, etc. in insurance are not comparable to those observed in banks. An extension of SII should be based on a thorough analysis of already available measures. The ORSA requires already the consideration of all kinds of risk the undertaking might be exposed to. An extension to cover possible macroprudential risk should consider proportionality.

With regard to recovery, resolution and IGS we currently see different treatment across Europe which might lead to flaws in policyholder protection. A harmonisation should consider already available solutions and proportionality aspects. Cross-border business might deserve particular attention.

Coherence of SII framework should be considered. Additional burden for the undertakings resulting from macroprudential measures to reduce risk should be considered in the prudential framework in order not to go beyond 99.5% VaR requirement.

Contact:

Monique Schuilenburg, Operations Manager, AAE moniques@actuary.eu **Twitter: @InfoAAE**
Siegbert Baldauf, Solvency II Project Manager, AAE SolvencyII@actuary.eu **Twitter: @InfoAAE**