Ania
Associazione Nazionale
fra le Imprese Assicuratrici

SOLVENCY II REVIEW

ANIA's response to the EC consultation on the review of prudential rules for insurance and reinsurance companies (Solvency II)

Key priorities for the Italian Insurance Industry

- *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 support closing the EU protection gap; 3) invest in a long-term, sustainable way, in the European economy and therefore support the EC objectives. The industry therefore calls for:*
  - ***An appropriate valuation of insurance liabilities, which requires:***
    - ✓ *Improving the Volatility Adjustment so that it better mitigates market volatility, fully recognises country specific spreads with the eurozone and better reflects the spread above the risk-free rate that insurers can and do earn.*
  - ***An appropriate, risk-based capital treatment of assets, which requires:***
    - ✓ *Fixing the design of the long-term equity asset category*
    - ✓ *Allowing for negative interest rates in the capital calculation with an appropriate floor*
  - ***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.*

Summary

ANIA welcomes the opportunity to contribute to the European Commission consultation on the Solvency II review.

Solvency II (SII) is strongly supported by the industry. Solvency II proved its value in practice since it was first applied in January 2016 and particularly during the most recent financial market turmoil due to the COVID-19 crisis. However, it is regarded as excessively conservative and has some measurement flaws and excessive operational burdens, which create unnecessary costs and barriers, in particular relating to the provision of long-term products and investments.

For the Italian Insurance industry, the review should particularly focus on addressing the areas where there are known and important problems to fix: we refer to the treatment of long-term business, and, in particular, to the functioning of the Volatility Adjustment (VA), the most widely used LTG measure.

On this specific issue, the Italian insurance industry underlines the fact that **the VA has not worked as intended over the last years** and that the most important deficiency has been recognized to be the **systematic failed activation of the country specific component**. This has happened despite national spread movements, which would have needed to be counterbalanced. In fact, designing country component activation conditions which have proven to be too conservative and which foresee only an on/off activation mode, produces the following detrimental effects:

- **undershooting effects**, which prevent the VA in achieving its intended objectives as a countercyclical measure;
- **undesirable cliff effects**, which introduce artificial volatility in the balance sheet.

More in general, the industry believes that **the review should lead to**:

- ✓ A more appropriate valuation of liabilities, by addressing the current technical flaws (eg in the Volatility Adjustment and in the Risk Margin).
- ✓ A more appropriate measurement of capital requirements in the standard formula (eg improving the criteria for long-term equity, 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

At the same time, the industry stresses that **the review should not**:

- ✓ lead to an increase in overall capital requirements – not least because Solvency II is already the most conservative regime in the world. 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.
- ✓ result in unnecessary changes (eg changing the risk correction in the VA) and complexity (eg the calculation of the illiquidity and the duration ratio).

- ✓ introduce systemic risk related measures (such as recovery and resolution) that go beyond those agreed at international level, but rather acknowledge the role and strength of the SCR and the MCR in the Solvency II framework.
- ✓ introduce non risk-based reductions in capital requirements as incentives to address climate change. Removing SII barriers will create strong enough incentives when combined with insurers' own natural interest and business model together with the EC's powerful regulatory initiatives (SFDR, Taxonomy, NFRD) and the wider EU Green Deal.
- ✓ introduce additional layers of regulation, on top of Solvency II, such as harmonised Insurance Guarantee Schemes. Solvency II, when implemented appropriately, offers sufficiently high protection. The focus should be on ensuring SII is calibrated and applied appropriately and on regulatory and cooperation and coordination between supervisory and/or resolution authorities.

The Italian insurance industry **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 support closing the EU protection gap; 3) invest in a long-term, sustainable way, in the European economy and therefore support the EC objectives. The industry therefore calls for:
  - **An appropriate valuation of insurance liabilities, which requires:**
    - ✓ Improving the Volatility Adjustment so that it better mitigates market volatility, fully recognises country specific spreads with the eurozone and better reflects the spread above the risk-free rate that insurers can and do earn
  - **An appropriate, risk-based capital treatment of assets, which requires:**
    - ✓ Fixing the design of the long-term equity asset category
    - ✓ Allowing for negative interest rates in the capital calculation with an appropriate floor
  - **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 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 and to avoid unnecessary burden and to prevent costs for insurance companies, costs which would be charged to the policyholder.
- In the macroprudential and cross-border supervision area, there is a limited need for additional tools, as SII already provides several safeguards.
- The requirements for and legal structure of Insurance Guarantee Schemes (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 and 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 foster 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.

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

Question 1: What could be the renewed objectives of European legislation for insurance companies?

On a scale from 1 to 9 (1 being "not important at all" and 9 being "of utmost importance"), please rate, and if possible rank, each of the following proposals.

	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								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		

If you identify other political objectives, please specify them and give a rating of their importance from 1 to 9 for each of them:

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

However, considering the overarching EU goals regarding sustainable growth and long-term financing, it makes sense for Solvency II to reflect these goals.

Apart from the additional potential objectives identified by the EC in the table above, another objective should be added, namely Solvency II should support the international competitiveness of the European industry, with an importance set at 8. While SII 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 support the global competitiveness of the European (re)insurance industry. This over-arching objective of the European Union to support European competitiveness in the global scene 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 long-term investment capacity of the industry. Therefore, the review of Solvency II should give the highest priority to insurers' ability to offer long-term guarantees.

Question 2: 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?

On a scale from 1 to 9 (1 being "low priority" and 9 being "very high priority")? Please rate, and if possible, rank each of the following proposals.

	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				X						
Preventing the build-up of systemic risk and ensuring financial stability				X						

If you identify other priorities, please specify them and give a rating from 1 to 9 to each of them:

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 expensive, to the detriment of policyholders' benefit. 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.

Question 3: Have the recent changes to the prudential framework regarding equity investments appropriately addressed potential obstacles to long term investments?

- 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:

ANIA 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. However, some of the application criteria are hard to fulfil and reduce the applicability of the sub-category. This has been evidenced in the EIOPA data collection exercises which have shown that very few companies expect to make use of the submodule.

The criteria for long-term equity (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.

ANIA 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, ANIA notes that:

- Criterion (b) to (d) of Art. 171a of the Delegated Regulation 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. The industry proposes to <u>remove such criteria</u>.
- 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 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, <u>the average holding period is not an optimal proxy</u> to assess a long-term investment strategy.
- Criterion (f) on EEA shares considerably restricts the investment universe. The industry proposes an <u>extension to OECD shares</u>.
- EIOPA's alternative criterion (g) 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 of very limited use in the whole UE. Beyond being overly restrictive, this criterion is incoherent with the liability structure of companies operating in most European countries needs to be <u>changed to avoid over-restrictions</u> to the use of the LTE submodule. 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 <u>to a maximum of 6-7 years</u>. Should this criterion be unchanged, then it will restrict the scope of application of the LTE submodule not only in Italy, being limited mostly to very few long-duration pension products.

Question 4: 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)?

Please indicate the statements with which you agree.
at least 1 choice(s)

- No, there should be a preferential treatment for long-term investments in bonds that are held close to maturity, with appropriate safeguards

Please specify your answer to question 4 (if needed):

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.

As it is stated by the European Commission on its recent Communication on the CMU, "the participation of insurers in long-term investments, in particular equity, can be supported by ensuring that the prudential framework appropriately reflects the long-term nature of the insurance business and mitigates the impact of short-term market turmoil on insurers' solvency".

For the specific case of long-term corporate debt, ANIA supports the argumentation that there should be a preferential treatment for long-term investments in bonds that are held close to maturity, with appropriate safeguards.

A regulatory initiative in this field could achieve two goals simultaneously: one the one hand, it would capture real risks to which insurers are exposed when investing; on the other hand, it could improve the industry capacity to contribute to the EU Action Plan through a risk-based solution.

Furthermore, 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.

Question 5: 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	

Please explain your reasoning for your answer to question 5 (if needed):

The actual treatment of SME's riskiness is too conservative limiting the investments without appropriately measure their underlying risks.

We do not support artificial incentives/disincentives on the basis of green/brown qualifications. Solvency II is, and should remain, a risk-based framework. Any differential treatment between green assets or brown assets, including a green supporting factor (GSF) or a brown penalising factor (BPF), should be based on the difference in underlying risks. Therefore, risk-based methods able to capture the different risks underlying "green" and "brown" business models should be the starting point of financial regulation in this field.

Question 6: Does Solvency II appropriately mitigate the impact of short-term market volatility on the solvency position of insurance companies?

- No

Please indicate how the framework could mitigate the volatility of:

- fixed-income assets
- stock markets

ANIA does not consider Solvency II to provide sufficient mitigation against artificial volatility of insurer's solvency position caused by short-term market volatility.

Artificial volatility in Solvency II 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 Volatility Adjustment is overall too low but, most importantly, does not sufficiently mitigate the impact of short-term market volatility. The VA will need to provide greater mitigation of artificial balance sheet volatility. There is a need for a general increase in the level of the VA and for a better triggering at its country component to adequately reflect the ability of insurers to earn higher returns at risk-free rates.

We strongly support focused improvements in order to make the VA more effective. The effectiveness of such improvements should be guaranteed against normal and stressed market conditions removing unintended artificial volatility in own funds, avoiding pro-cyclical investment behaviour and limiting forced sales of assets.

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. An "Own Assets" VA calculated with a sufficient level of granularity, would significantly reduce the basis risk inherent in the current design of the VA. It is therefore one possible approach to achieving the objective of an increased mitigation of artificial balance sheet volatility.

Under the Solvency II Review process, we believe that EIOPA has made a considerable effort to propose some corrections and refinements to the existing VA framework. In this context, some EIOPA proposals are welcome:

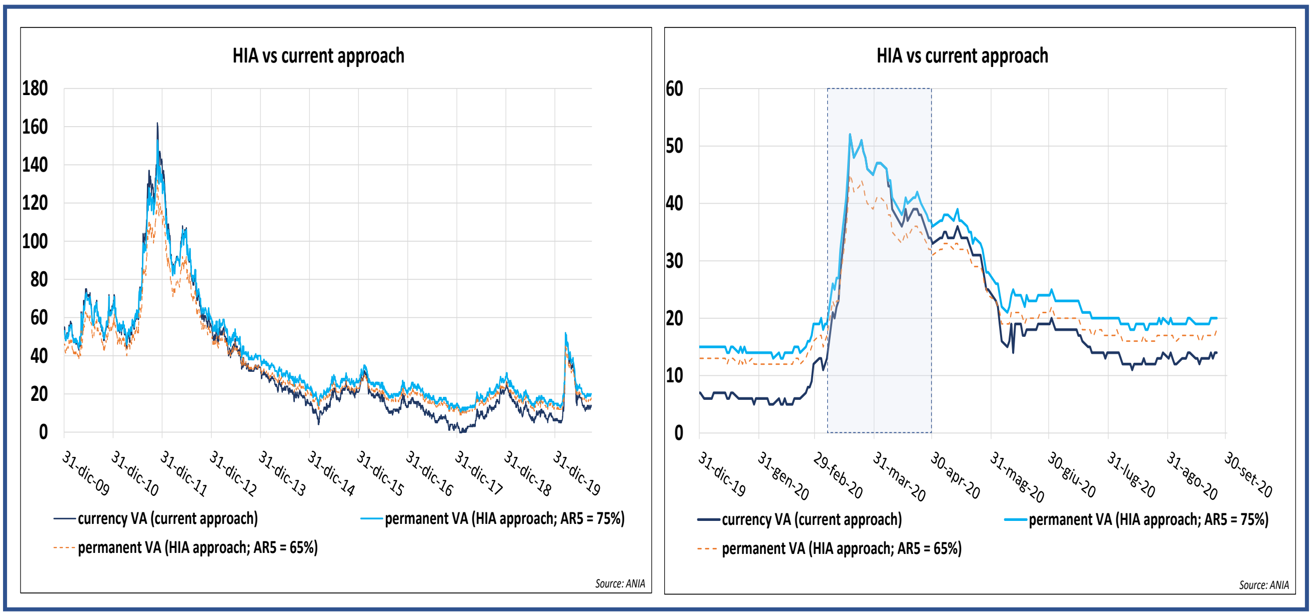
- improve the country component according to the EIOPA option 7 (even if an improved calibration of the application parameters should be considered in light of the recent crisis). The country component is particularly important for Italy, but hasn't worked properly especially when it has been needed the most, namely in case of extreme volatility at national level, due to temporary circumstances and deemed to be reabsorbed in the medium term; this situation exposes Italian insurer's balance sheet and solvency position to a high degree artificial volatility.

- increase the general application ratio from 65% to 85% (even if the general application ratio should be increased up to 100%): the 65% general application ratio is considered to be a technically unjustified 35% haircut to account for a range of unquantified risks which are already largely dealt with elsewhere in the framework;
- include the scale up factor for the asset weights: it would mitigate the wrong assumption according to which non-fixed income assets are currently being allocated a zero yield.

However, the EIOPA's design for reviewing the current Volatility Adjustment framework seems not fully appropriate as it would result in increased procyclicality and make the VA less effective in a crisis. This is essentially due to the following reasons:

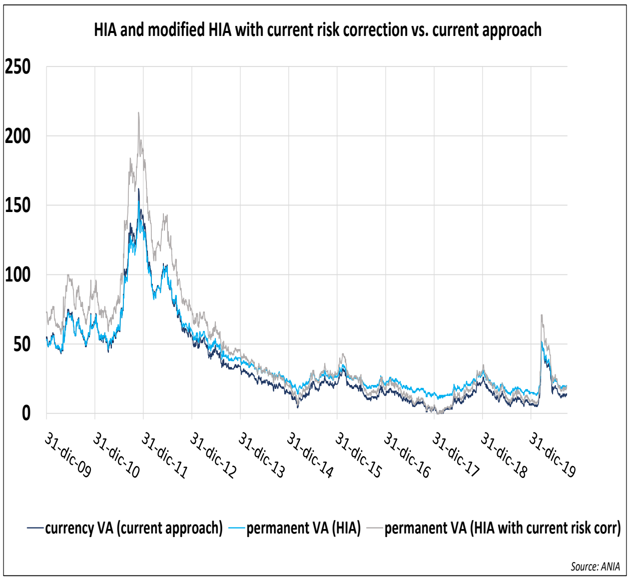
- changing the risk correction to be a % of prevailing spreads will paradoxically increase pro-cyclicality and will restrict the ability of the VA to compensate for spread shocks and embeds unjustified methodological assumptions; in order to avoid that, the risk correction should not depend on the prevailing spread level, as proposed by EIOPA, but on a longer time horizon as in the current method.
- there is not a prudential need to introduce liquidity penalties through the proposed "adjustment for illiquidity of liabilities".

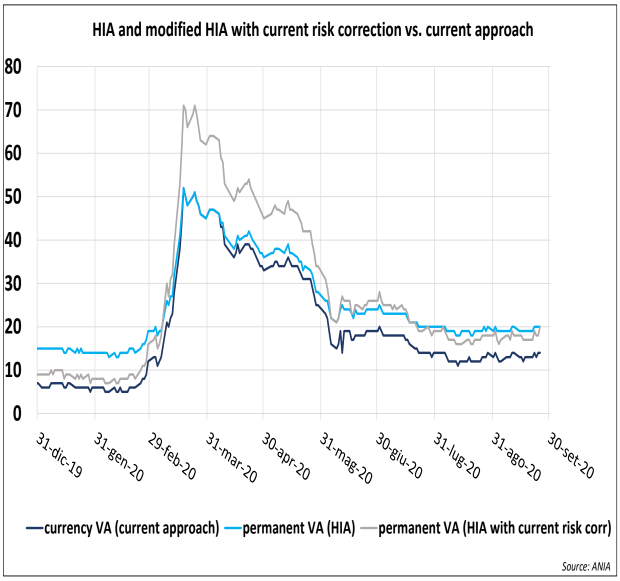
The graphs below show clearly the pro-cyclical nature of the new risk correction methodology, thus amplifying the delta between the current (blue line) and the proposed approach (HIA approach; light blue line) during times with lower spreads, and, on the other way round, reducing the same delta when spreads rise sharply. Applying also an adjustment for illiquid liabilities as in the proposed method, could exacerbate this effect and deliver new VA results which are even lower than the ones currently achievable in crisis situations (orange line). This is particularly evident during the initial weeks of the pandemic break-out.



We believe that a solution should be found to eliminate, or at least mitigate the negative effect of the proposed features highlighted above; if this should not be done, also useful solutions proposed by EIOPA, such as Option 7, would be heavily impacted, thus making improvements in that area much less effective.

The following graphs show how the proposed HIA approach would work without change in risk correction methodology (grey line).





The risk margin is another major 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 rate should be lowered to 3%, in line with evidence provided by the industry.

The symmetric adjustment to equity risk is noted to work fairly well. However, the lower and upper bounds should be increased. During crisis periods, such as Covid19, these bounds have proven to be inadequate.

Question 7: 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

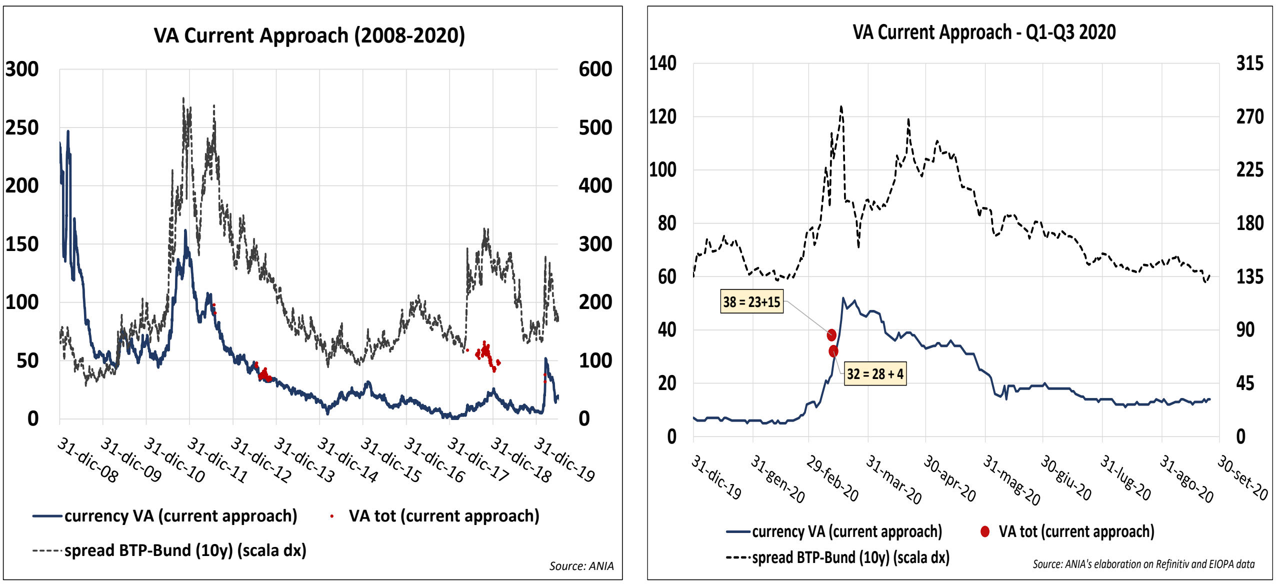
Please indicate how the framework could avoid procyclical behaviour by insurers:

Solvency II does not generally promote procyclical behaviours. It already contains a number of important instruments which counteract potential pro-cyclicality even in extreme market situations. However, there is room for improvement to make these instruments fully functional and further reduce potential procyclical effects from Solvency II.

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. Nevertheless, the Solvency II regime should not, because of measurement flaws, such as the ineffective volatility adjustment and the poorly designed risk margin, which do not currently reflect the real underlying risks and business model, create artificial incentives for insurers to act in a procyclical way and inhibit their ability to play a countercyclical role.

As noted above, 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 crisis. Similarly, significant spread widenings were witnessed in national markets in 2008, 2011 and 2018 but backtesting analysis shows that almost no relief was provided by the VA country component (red dots).



Red dots indicate total VA when country component activates (according to the current calculation methodology).

In the current review process, EIOPA is planning to change the risk correction to be a % of prevailing spreads; this will significantly restrict the ability of the VA to compensate for spread shocks and embeds unjustified methodological assumptions which end up in making the proposed risk correction highly procyclical. 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 method currently in force.

With regard to the interest rate risk submodule, ANIA recognises the need to make changes to better reflect the risk of a low and/or negative interest rate environment. However, it is imperative that its design and recalibration are carefully considered to 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 into the design of the submodule.

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.

Regarding the approach related to the extrapolation of the risk-free rates, no changes should be made to the current risk-free rate extrapolation as it is already effective in countering artificial solvency volatility.

Question 8: Some stakeholders claim that Solvency II has incentivised insurers to shift investment risk to policyholders. Do you agree with this statement?

- Yes, but it is not the most important driver

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. It is true, nevertheless, that the "low interest rate environment" can be regarded as a temporary driver, while Solvency II will represent a permanent driver, unless it is fixed accordingly.

Improving the SII framework in order to incentivize long-term business as described above (Q6), could help to counterbalance low rates and the shift of investment risk to policyholder.

Question 9: 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	

Please explain your reasoning for your answer to question 9 (if needed):

A combination of Solvency II rules and the prolonged low-interest rate environment has adversely affected the ability of insurers to provide products with long-term guarantees. Preserving the ability of the industry to provide long-term guarantees in the future should be a priority of the review. Long-term guarantee 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 current 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. Changes to Volatility Adjustment, for example, might better address the volatility of solvency ratio so far observed in insurance products offering guarantees.

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

The Insurance Industry priority should be to foster and support long term insurance products able to provide security and profits to both policyholders and Industry itself. Any disincentive in this sense should be avoided and instead support should be given to long term investments, not to be overcharged in a Solvency II assessment.

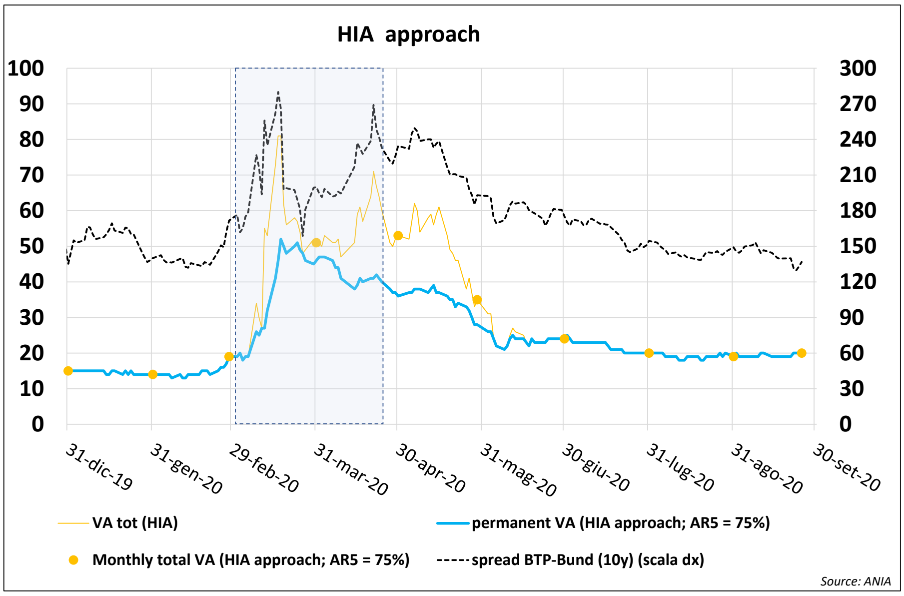
Question 10: In light of the Covid-19 crisis, have you identified any major issues in relation to prudential rules that you were unaware of or considered of lesser importance prior to the pandemic?

- No

Please elaborate your answer to Question 10:

The pandemic stressed the volatility of the current prudential rules but also how important elements concurring to it have not been properly addressed in the proposed VA solution. The Covid-19 crisis reinforced how using punctual daily data to calculate Solvency II metrics, especially the VA, could not be the correct solution to represent volatility patterns in financial markets, thus giving a wrong representation of the true risks to which insurers are exposed during a spread crisis.

The graph gives an example of such distortion, showing how during March and April 2020 the VA for Italian companies (yellow line when country component activates, light blue otherwise) would have registered much higher values than the official value registered at month-end (yellow dots).



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.

Other issues which emerge during COVID-19 crisis are the excessive size of the risk margin and its sensitivity to interest rates and the excessive capital requirements for long-term equity and bond investments.

Question 11: 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?

- Don't know/no opinion

Question 12: 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.

at least 1 choice(s)

- 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

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

There is very limited systemic risk within the insurance industry. 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, we strongly believe that only the macroprudential tools mentioned by the European Commission in its call for Advice (CfA) should be further considered in the context of the 2020 Solvency II review. There is currently no justification for major new measures that would create significant initial and/or ongoing costs. Equally important, no additional measures beyond those agreed in the international context as part of the holistic framework should be introduced. Introducing measures in Solvency II beyond the holistic framework is unnecessary and would create a strong competitive disadvantage for European market players, competing with non-European companies in Europe and internationally.

The interconnectedness with the broader financial sector is already taken into account when determining the capital requirement for market risk and counterparty default risk. Furthermore, the interconnectedness is mostly the result of derivative holdings and reinsurance. The former is regulated by EMIR and the latter by Solvency II.

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

Question 13: From the point of view of policyholders, should the scope of small insurance companies, which are not subject to Solvency II be extended?

- Yes

Please explain your reasoning for your answer to question 13 (if needed):

The regulatory system should be extended and simplified to smaller insurance companies to allow them to keep working in their environment. The same simplified regulatory system should be extended to medium sized companies as well to better address policyholders needs.

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.

Question 14: 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

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:

A risk-based approach linked to specific proportionate measures that can be applied automatically by Insurance companies would provide certainty in the scope of application and a much smoother implementation of the proportionality principle.

Question 15: Should the exemptions and limitations always be subject to the discretion of the public authorities? Please indicate the statements with which you agree.

at least 1 choice(s)

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

Please specify your answer to question 15 (if needed).

See question 14.

Question 16: 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)?

- No

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

We believe that a 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 specific characteristics of certain business models reduce the risk of the company, these should be properly accounted for.

Question 17: 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	

Question 18: 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? Please indicate the statement(s) with which you agree.

at least 1 choice(s)

- The information provided was in the right level of details

Question 19: 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?

The current level of information is deemed to be sufficient. Current contents of SFCR are well suited for its purpose

For the average policyholder, the length should be no more than two pages and the format should be simple and standardized across companies.

Question 20: 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?

- 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:

The Question is mainly for policyholders, anyway, 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, we believe there should be no additional requirements regarding the group SFCR.

Question 21: 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

Question 22: 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?

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

Please specify the purpose of such a disclosure in your view:

The requirement to calculate both internal model and standard formula figures is onerous and unnecessary. Should such a requirement be introduced, it would effectively undermine not only the internal models but also the suitable processes underlying their effective management and supervision. Internal models are designed to reflect a company’s specific risk profile when it is proven that the standard formula is not suitable. Therefore, a continuous comparison between the standard formula and internal model figures is meaningless. Performing high quality calculations would take away time from ordinary risk management activities, such as IM calculations and reporting. This is counterintuitive, given that IM models are implemented because SFs are deemed inadequate.

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

Question 23: 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?

- No

Please specify the additional powers needed:

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. However, cooperation between Home and Host Authorities should be improved. An enhanced role could be envisaged for EIOPA in complex cross-border cases where Home and Host authorities fail to reach a common view in the cooperation platform.

Question 24: Should the supervision of cross-border activities by insurers be exercised by national authorities or by a European authority?

- By national authorities, with European coordination where needed.

Please elaborate on your answer to question 24:

Only the single National Supervisory Authorities have all the competences and information to maintain a robust and fruitful supervision to the relevant insurers, taking properly into account the local specificities. Any review that could undermine the "Home country principle" should be avoided consequently.

Question 25: 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

Question 26: 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?

- No

Please explain your reasoning for your answer to question 26 (if needed):

We support that the legal structure of policyholder protection schemes should be left to the discretion of member states. More generally, we believe 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.

Solvency II requirements in some cases have rendered IGS protection redundant.

Question 27: Which of the following life insurance products should be protected by IGS?

- No life insurance products

ANIA supports that the requirements 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). However, we 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 would be 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.

Question 28: 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:

We support 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, we 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 only must 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.

Question 29: Should all mandatory insurance be covered by IGS?

- No

Please specify your answer for your answer to question (if needed):

We support 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).

However, we would like to highlight that while there is a logic to including compulsory non-life insurance in a national IGS, the reality is that the types of insurance that are compulsory vary greatly across member states. Therefore, including all compulsory non-life products under the scope of minimum harmonisation would lead to a lack of harmonisation. 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 be, however, up to member states to decide.

Question 30: If your insurer fails, what would you prefer?

- Don't know/no opinion

Question 31: 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?

- No

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

ANIA 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.

The legal structure of policyholder protection schemes should be left to the discretion of member states. More generally, ANIA 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. We therefore support the introduction of minimum requirements on caps and compensation limits, 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.

Question 32: 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.

at least 1 choice(s)

- 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

Question 33: 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)? Please indicate the statement with which you agree.

at least 1 choice(s)

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

Question 34: 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.

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

Although the current prudential regime already sets some specific powers of intervention by NSA, we consider that more discretion could be allowed to public authorities to temporarily modify specific solvency rules at sector level, provided it is necessary to preserve financial stability

The previously mentioned measures, on the other hand, should be applicable only where a single Insurer is in financial distress and massive redemption rush events occur due to deteriorated reputational risk, only where the National Supervisory Authority should believe that the actual conditions are more favourable for the policyholders than in the event of failure.

Question 35: In your view, should the framework provide for flexibility to alleviate certain regulatory requirements during exceptional adverse situations?

- Yes

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:

SII allows the extension of the recovery period up to seven years in the event of exceptional adverse situations but further flexibility interventions could be useful. Nevertheless, as of today, Solvency II is not appropriately calibrated for exceptional market circumstances, and the flaws were highlighted by the recent COVID-19 crisis, when Solvency II failed to appropriately address through the VA the issue of short-term market volatility. Until SII flaws are fixed in an effective way, and especially those regarding the country component in the VA, regulatory flexibility should represent a necessary attitude.

Section 4: New emerging risks and opportunities

Question 36: 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, but the calibration of capital requirements is not possible at this stage, as the data will only become available over the next years

Please elaborate your answer to question 36:

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, ANIA 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.

Question 37: 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?

- No

Question 38: 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?

- No

Question 39: Should Solvency II rules for insurers explicitly require climate scenario analyses as part of the qualitative rules ("Pillar 2")?

- Yes, and climate scenarios analyses are of medium importance

Question 40: In your view, does Solvency II contain rules that prevent the practice of impact underwriting by insurers?

- No

Question 41: 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?

No proposals

Question 42: 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")?

- No

Question 43: 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?

- No

Question 44: 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

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:

Lighter requirements when an activity is outsourced in a group should be part of the proportionality measures.

The requirements currently calibrated for extra-group outsourcing, contribute to creating redundant processes and controls for intra-group outsourcing.