European Commission - DG FISMA, July 2020

Consultation document: Review of prudential rules for insurance and reinsurance companies (Solvency II)

BdV comments for Better Finance, Brussels, in December 2020

Weblink to EC Consultation Document:
https://ec.europa.eu/info/files/2020-solvency-2-review-consultation-document_en

Q1. 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.
BdV: all 9 (only ESG 6)

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? 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.
BdV: all 9 (only ESG 6)

Q3. Have the recent changes to the prudential framework regarding equity investments appropriately addressed potential obstacles to long term investments?
BdV: YES

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)? Please indicate the statements with which you agree *(at least 1 choice).*
BdV: YES

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

- Less costly for SMEs: agree
- Less costly for ESG: disagree
- more costly for brown investments: agree

Comment: We fully support EIOPA's fundamental approach of preventing as well from "green-washing" as from "green bubbles". ESG-conform investments must be submitted to the same unequivocal risk assessment procedures (ORSA) as any other investment by insurers.

Q6. Does Solvency II appropriately mitigate the impact of short-term market volatility on the solvency position of insurance companies?
BdV: YES

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?
BdV: No

Q8. Some stakeholders claim that Solvency II has incentivised insurers to shift investment risk to policyholders. Do you agree with this statement?
BdV: YES, but it is not the most important driver.

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?
BdV: Policyholders: NO; financial stability: YES
Comment: It is quite obvious that under the ongoing conditions of the low, or even zero and negative interest rate period classical concepts of capital return guarantees of life insurers do not make any sense anymore. Product innovations are strongly necessary which offer reduced or even no capital guarantees under the fundamental condition that full participation at any surplus is guaranteed and performance scenarios and cost charges are reliable and transparently outlined to potential customers.

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?
BdV: NO
Comment: Although the Covid-19 crisis may surely be considered as a major disruptive event ("black swan event"), it does not create any fundamentally new systemic risks. It enhanced all those systemic risks which had occured already before. All these aspects have clearly been reported by many EU analysis like ESAs Joint Committee Report on Risks and Vulnerabilities in the EU Financial System (September 2020), EIOPA's Financial Stability Report (July 2020), EiOPA's Studies on the Impact of ultra low yields on the insurance sector, including first effects of Covid-!9 crisis (July and February 2020), as well as EIOPA's regular Stress Tests and Risk Dashboards.
On the national level, for example in Germany, this has been reflected by the "Committee of Financial Stability" to which representatives of the Bundesbank, of the NCA (BaFin) and of the Federal Ministry of Finance belong. This Committee publishes its annual report for the Federal Parliament usually in June/July (in 2020 already the seventh report: "Ausschuss für

Finanzstabilität: Siebter Bericht an den Deutschen Bundestag zur Finanzstabilität", Juli 2020 - with special reference to Solvency II in chapter 2.3).

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?
BdV: No

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 statement(s) with which you agree *(at least 1 choice)*.
BdV: YES (number of gaps)
Comment: In its recent "Financial Stability Report" of October 2020 the Bundesbank has clearly pointed out that due to the negative effects of the corona-lockdown of the real economy there is a largely growing risk of downgrading of company loans and debts and any securities linked to them. This could have strongly negative impacts on the asset allocations of insurers as well in 2021 and later. So ORSA of insurers and ORA of IORPs must be on "high alert" by analysing these interdependencies, but this requirement should in fact be obvious for any professional risk-management.

Q13. From the point of view of policyholders, should the scope of small insurance companies, which are not subject to Solvency II be extended?
BdV: No

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?
BdV: No

Q15. Should the exemptions and limitations always be subject to the discretion of the public authorities? Please indicate the statement(s) with which you agree *(at least 1 choice)***.**
BdV: The current system of exemptions and limitations is satisfactory.

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)?
BdV: No

Q17. How can the framework facilitate policyholders' and other stakeholders' access to the SFCRs?
BdV:
- current framework sufficient: disagree
- publication on website easily accessible: agree

- sent regularly to each policyholder: agree
- sent to policyholder on demand: agree

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? Please indicate the statement(s) with which you agree *(at least 1 choice)***.**
BdV: The reading was not insightful
Comment: It is obvious that there are strong differences with regard to the data quality, transparency and understandability of SCFRs published by the life insurers. BdV in cooperation with the independant analyst Carsten Zielke has published since 2017 each year an extensive evaluation on the transparency and understandability of SCFRs of German life insurers. These analyses are all published on BdV's website.

For 2020: https://www.bundderversicherten.de/presse-und-oeffentlichkeitsarbeit/pressemitteilungen/explodierende-zinszusatzreserve-zehrt-solvenz-der-lebensversicherer-weiter-aus

BaFin as well had strictly required quality improvements of these reports:

https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Fachartikel/2018/fa_bj_1809_SolvencyII_en.html

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? [
BdV:
Comment: We fully support EIOPA's proposal of a new short section in the SFCR with information specifically aimed at policyholders. This new section (a two-pages document) should obligatorily be sent to policyholders in common with the annual pension benefit statements.
Therefore we agree with EIOPA's proposal (cf. Consultation Paper EIOPA-BoS-19-309 of 25 June 2019) to introduce a standardized information in the SCFR addressing other users than policyholders following to page 11 and 12 of the CP (impacts on SCR coverage ratio and on the amount of Own Funds following to the proposed key sensitivity tests). As this information shall be shown via a template, we propose to add it either in section E (Capital Management) or in section C.2 (Business Risk) of the SFCR (following to the current SCFR sections).

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?
BdV: YES:
Comment: Group SFCRs should be sent on demand (cf. Q 17).

Q21. Should all insurers publish a SFCR on a yearly basis?
BdV: YES, all insurers should publish a SFCR on a yearly basis.

Comment: The SFCRs constitue the only official Solvency II document which has to be published by the insurers addressed to the general public (retail and professional investors, analysts, journalists etc.) and not exclusively to the supervisors. All other information on Solvency II figures are accessible only for the insurers themselves and the supervisory authorities. That is why we consider any attempt to reduce the importance of SFCR or even to abolish them must clearly be rejected (for ex. due to apparently low online click rates).
For consumer organisations like Better Finance or BdV the SFCRs constitute the essential basic information tool for an additional analysis of capital and solvency requirements which we make publish by an independent insurance analyst - at least for the German life insurance market - once a year (in 2017, 2018, 2019 and 2020). That is why we are able to confirm: our website is an important tool for multiplication / proliferation of information contained in the SFCRs to a wider 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?
BdV: No, but calculation and report to public authorities.

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?
BdV: YES
Comment: If the host authority considers that the home authority does not take the necessary measures in order to prevent from customer's detriment, the latter has to inform and urge EIOPA for mitigating this conflict.

Q24. Should the supervision of cross-border activities by insurers be exercised by national authorities or by a European authority?
BdV: Other answer.
Comment: By national authorities, with mandatory European coordination and oversight.

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?
BdV: No
Comment: We continue to support EIOPA's objective to develop principles of a minimum degree of harmonisation in the field of insurance guarantee schemes (cf. BdV's comments on EIOPA's consultations on IGS in February 2017, October 2018 and October 2019). This objective is clearly consistent with the objectives which are already implemented in other sectors of the

financial industry (BRRD, FSB Key Attributes etc.). Therefore minimum harmonisation should entail the definition of a common approach to the fundamental elements of recovery and resolution (e.g. objectives for resolution and resolution powers, common set of early intervention powers) which the national frameworks should contain, while leaving room for Member States to adopt additional measures at the national level if needed to better address the specificities of their national markets, subject to these measures being compatible with the principles and objectives set at the EU level.
The ongoing and even enhanced “low for long” interest rate phase constitute a tremendous challenge for life insurers and their long-term liabilities and will continue to have a severe, more risky impact on their search for yield behavior. The increasing number of run-offs shows at the same that not all life insurers are willing or even able to cope with this situation.
Obviously recovery and resolution and IGS are very closely linked. An EU-framework of RRPs, i.e. a kind of common “toolkit” available to all NCAs, constitutes the necessary complementary element to the proposed harmonisaton of national IGS - due to the two current main macroeconomic drivers, “low for long” interest rate phase and enhanced cross-border offers of financial services (like PEPP), which call for a more equal and effective protection of policy-holders.

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?
BdV: YES
Comment: We acknowledge that, due to very different supervisory pre-conditions at the national level (home of global companies or not, existence of an Insurance Guarantee Scheme or not, existence of pre-emptive Recovery and Resolution Plans or not, etc.), it appears to be appropriate that the legal structure of policyholder protection schemes should be left to the discretion of Member States. As EIOPA has shown, IGS already exist in more than half of the EU Member States. But based on these examples and combined with a minimum degree of EU harmonisation the obligation for setting up an IGS on the national level should be introduced.
In the long run any potential harmonised approach towards IGS should not only trigger a principle-based harmonisation of national insolvency regimes, but a minimum harmonisation with clear qualitative criteria and quantitative thresholds aiming at establishing a more equal protection of policyholders.

Q27. Which of the following life insurance products should be protected by IGS?
BdV: All life insurance products

Q28. Which of the following non-life insurance products should be protected by IGS?
BdV: Accident
Comment: All mandatory insurances like motor insurances should be covered at minimum. The German model of health insurances based on the calculation of life insurances is a special feature which - as far as we know - does not exist in any other EU member state. That is why the

model of the national IGS for health insurances “Medicator” cannot be generalized, but it is necessary for Germany.

Q29. Should all mandatory insurance be covered by IGS?
BdV: YES
Comment: At a minimum all mandatory insurance liabilities should be covered by the IGSs at national level. If there are any limits, the amounts covered for these liabilities should correspond to the highest level of amounts already fixed in each of the member states.

Q30. If your insurer fails, what would you prefer?
BdV: it depends on the type of insurance policy.
Comment: No generalized answer is possible. Providing compensation to policyholders for their losses in case of a liquidation of an insurer is the worst case scenario and will surely not work – at least not for life insurers. Effective protection of policyholders must therefore already start by ensuring the continuation of insurance policies. In Germany this has been the case in 2003 with “Mannheimer Lebensversicherung” and the take over of its portfolio by the national IGS “Protektor”. Therefor for each insurance class a separate solution has to be found. For life insurances the continuation of contracts is prevalent as outlined. For motor insurances the compensation of occurred indemnity claims is prevalent.

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?
BdV: YES
Comment: Unfortunately in the EU strong differences of living standards and therefore of insurance premiums (and in consequence their level of coverage) continue to subsist among the Member States. Therefore a minimum coverage level should be determined at each national level. But of course a minimum coverage level at EU level should be a long-term objective to be elaborated by EIOPA (based on the experience of motor insurances for example).

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 *(at least 1 choice)***.**
BdV: YES, …insurer in financial distress…
Comment: In Germany the national IGS (“Protektor”) is entitled to reduce the guaranteed sums of life insurance contracts up to 5%, if its accumulated assets are not sufficient in order to fulfil its long-term pay-out liabilities. This provision seems to be appropriate (cf. article 314 of national insurance supervisory law - VAG).

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)? Please indicate the statement(s) with which you agree *(at least 1 choice)***.**

BdV: YES, as a last resort…

Comment: In Germany the national IGS ("Protektor") is entitled to reduce the guaranteed sums of life insurance contracts up to 5%, if its accumulated assets are not sufficient in order to fulfil its long-term pay-out liabilities. This provision seems to be appropriate (cf. article 314 of national insurance supervisory law - VAG).

Q34. Please specify whether other exceptional measures than those mentioned in Q32 and Q33 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.

BdV: No dividends to shareholders in exceptional adverse market conditions.

Q35. In your view, should the framework provide for flexibility to alleviate certain regulatory requirements during exceptional adverse situations?

BdV: YES

Comment: In 2020 due to the Covid-19 crisis the supervisory authorities on the European and national level provided for flexibility with regard to short term capital requirements and reporting obligations by insurers and pension funds. This seemes to be an appropriate example how to react during exceptional adverse situations.

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)?

BdV: YES, and sufficient data is available…

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?

BdV: Yes, with medium 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?

BdV: Yes, with medium importance

Q39. Should Solvency II rules for insurers explicitly require climate scenario analyses as part of the qualitative rules ("Pillar 2")?

BdV: Yes, with medium importance

Q40. In your view, does Solvency II contain rules that prevent the practice of impact underwriting by insurers?
BdV: Don't know

Q41. Do you have proposals for changes others than those provided in your answers to [Q5] and [Q36] to [Q40] that would make Solvency II a more conducive framework for sustainable activities by insurance and reinsurance companies?
BdV: ---

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")?
BdV: YES
Comment: Very recently, the German NCA BaFin has published in its monthly Journal (october 2020) the resultats of the first supervisory examination of IT-structures of insurers and pension funds. This examination was based on BaFin's circular on "Supervisory Requirements with regard to IT" ("VAIT") of July 2018 (stressing cyber risk analysis, management responsibilities, user identidy controls, cloud services, external service providers etc.). BaFin now clearly states that the requirements outlined in this circular have NOT been fulfilled by the vast majority of the insurers, pensionsfunds ("Pensionskassen") and even reinsurers. Therefore BaFin urges the insurers for enhanced efforts of strong improvements of their own IT structures and internal control mecanisms. Detailed supervisory examinations will be continued during the next two years.

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?
BdV: YES for business B2B contracts, NO for private customers.

Q44. Should the legislation differentiate intragroup and extra-group outsourcing, and introduce “lighter” requirement in the former case?
BdV: No