Nordic Position on the Solvency II 2020 review

Since 1 January 2016, Europe's insurers have been governed by a set of rules called Solvency II. The rules aim to ensure that policyholders throughout the European Union enjoy the same level of protection, no matter where they buy insurance. Nordic insurers and other European insurers played a significant role in the development of these new rules and welcomed their aims. However, insurers also raised concerns that certain elements within Solvency II would produce unintended consequences that could ultimately harm both insurers and their policyholders. To ensure there was the opportunity to address these concerns, policymakers mandated two reviews of the legislation: the 2018 review of Solvency II's implementing measures and the 2020 review of the Solvency II Directive.

Top priorities for the Nordic markets in the 2020 review

Risk margin

Already in connection with the 2018 review, the European insurance industry expressed concern that the risk margin is disproportionately large and too volatile due to low interest rates and other factors. We therefore are delighted that the risk margin is one of the areas covered in the Commission's Call for Advice (CfA) for the 2020 review.

In line with what has previously been pointed out by e.g. Insurance Europe, we think that the current Cost of Capital (CoC) of 6 per cent is too high and should be recalibrated lower.[1] One viable option to achieve a more accurate risk margin is to conduct a study of insurance companies' purchases, portfolio transfers and similar transactions since Solvency II was introduced, analysing how the risk margin has been valued in these cases.

We also believe that there are reasons to exclude the mass lapse stress from the calculation of the solvency capital requirement that is included in the risk margin calculation – for example, when a high capital requirement for cancellation risk for unit-linked insurance depends on a high value of future profits and at the same time does not entail additional cost for an owner to hold the capital base. A related issue that also should be reviewed is the standard Solvency Capital Requirement formula, in which it should be possible to take into account the fact that the risk margin will change if the applied stresses occur.

LTG measures

Last liquid point (LLP): We believe that there should be no change of the last liquid point (LLP) in Euro, DKK, NOK and SEK. Changes in the design of the risk-free curve can have significant consequences for Nordic insurance companies. The review of the last liquid point (LLP), which is requested in CfA, must take into account the depth, liquidity and transparency of the Nordic fixed income market, the ability to match liability cash flows occurring prior to the LLP, and the cumulative value of bonds with maturity exceeding the LLP.

Our view is that the last liquid point for the currencies in all Nordic countries should remain unchanged. One of the reasons is that the Nordic fixed income markets show signs of lower liquidity and increased vulnerabilities due to the extraordinary monetary policy and new stricter regulations for banks, financial markets (e.g. Mifid II/Mifir), etc.

In addition, CfA stresses the importance of stability even in times of financial turmoil, which also points to an unchanged LLP for these currencies: historical experience in the Nordic countries suggests that liquidity and issuance volumes for longer maturities are negatively affected in times of financial turmoil. The interest rate benchmark reform should also be taken into account, because reference rates such as Euribor and Libor will probably be replaced by other reference rates. This reform will likely affect the swap market's liquidity and will probably also have consequences for the bond market. In the review of the risk-free curve,

[1] See e.g. Insurance Europe's response to EIOPA from January 2018 regarding the consultation on the 2018 review, pages 101–111 (https://www.insuranceeurope.eu/sites/default/files/attachments/Response%20to%20consultation%20on%20EIOPA%E2%80%99s%20second%20set%20of%20advice%20to%20EC%20on%20Solvency%20II%20review.pdf).

Finance Finland, Insurance Sweden, Insurance & Pension Denmark, Finance Norway and Icelandic Financial Services Association are the industry organisations of insurance companies in the Nordic countries. Together we are the voice of Nordic insurers in the European political debate, advocating the important role of insurers in the modern society resting on competition, a level playing field and the ability to assess risks.

the focus should therefore rather be on the change of the reference rates and on how it is implemented, instead of changing LLP.

Transitional measure for technical provisions (TMTP): The TMTP is one of the key elements in the Omnibus II agreement and of great importance to many markets. No changes are needed, and any national restrictions to the use of TMTP should be opposed.

Market risk SCR design and re-calibration

Interest rate risk: We do not believe any major changes to the current design or calibration of the SCR interest rate risk module are needed. Should any changes to this risk module be proposed, it is crucial that they are preceded by an extensive and thorough impact assessment and seen in relation to all other relevant parts of the Solvency II framework. The current framework is based on EUR and GBP data. We believe country-specific stress levels should be addressed in order to better match different currencies.

Equity: We welcome the fact that the Commission recognises the need to review capital requirements for investments that support European growth. We want to emphasise the need to be ambitious in this work, as well as the need to thoroughly investigate whether Solvency II appropriately measures the actual risks that insurers are exposed to when investing in assets such as equity, corporate bonds and real estate.

Property risk: In the current framework, calibration is based mostly on UK data, which most likely results in too high stresses for properties in the Nordic countries. Therefore, the property risk should be recalibrated with thoroughly analysed data from other property markets, including the Nordic markets.

Supervisory reporting and disclosure

We commend the EU Commission for initiating a review of the supervisory reporting with the aim to make the reporting more effective and at the same time less burdensome for insurance companies. On this note, we believe the following issues could significantly further reduce the reporting and disclosure burden for insurance companies:

- Detailed reporting for financial assets and investment funds with ISIN code should be limited. For these assets and funds, it is easy for EIOPA and the national supervisory authorities to get hold of the requested information in other ways.

- Double reporting should be reduced, for example, by allowing RSR, ORSA, etc. to refer to other reports (such as annual reports) to a greater extent.

- Changes in reporting templates (taxonomies) should only be implemented when reporting the first quarter (Q1) the following year, instead of in the fourth quarter (Q4) of the same year as the changes are decided.

- Validation rules in the reporting templates should allow for some minor deviations, e.g. deviations equivalent to €10 or less.

- There is a risk that the shorter reporting timelines will lead to reduced quality as well as significant and disproportionate administrative burden for insurance companies. Therefore, the timelines (deadlines) for 2018 should continue to apply in the future, both for supervisory reporting as well as for the Solvency and the Financial Condition Reports.

Proportionality

We welcome the Commission's evident ambition to improve the proportionality of Solvency II. For smaller insurance companies, the principle of proportionality should be more operational and easier to apply than it now is – for example, the requirements for applying the simplifications in the standard SCR should be made less complex. The reporting requirements are also disproportionately burdensome for smaller insurance companies, not least in view of the number of different reports required (annual reports, ORSA, SFCR and RSR) with partially overlapping information that must be adapted for each report due to their different purposes and requirements. Smaller insurance companies should therefore be given more flexibility to refer to other reports in order to keep the reporting burden to a level that is more in line with their limited resources and activities. Furthermore, companies must have the option to calculate less significant risks as a fixed amount, instead of always with the full calculation.