Solvency II consultation – closing 21/10/2020:

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.

1 2 3 4 5 6 7 8 9 Don’t know / No opinion

A. Ensuring that insurers remain solvent
B. Ensuring that insurers' obligations to the policyholders continue to be fulfilled even in the event that they fail
C. 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
D. 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
E. Facilitating insurers’ ability to offer (sufficiently) high returns to policyholders, even if this implies taking more risks
F. Facilitating insurers’ ability to offer products with long-term guarantees
G. Ensuring that insurers do not face liquidity issues (i.e. that they have sufficiently liquid assets8) to meet at all times short-term obligations
H. Preventing the build-up of systemic risk and ensuring financial stability

	1	2	3	4	5	6	7	8	9	Don’t know
A								■		
B								■		
C							■			
D							■			
E						■				
F							■			
G								■		
H									■	

If you identify other priorities, please specify them and give a rating from 1 to 9 to each of them. [Insert text box]

Facilitating credit (re)insurers ability to offer efficient credit protection to banks – Rating: 7

Prudentially regulated **private credit insurers** provide credit protection in respect of bank loans by underwriting credit insurance (from their liability side).

Private credit insurers (PCIs) that provide **trade credit insurance** play a critical role in supporting the real economy, including through the Covid-19 crisis, facilitating access to short term liquidity and longer-term growth capital. They are active partners to banks in risk transfer across a **range of asset classes**, including corporate and SME lending, trade finance, project and infrastructure financing, asset backed lending and mortgage lending. They have worked closely with banks in supporting them throughout economic cycles for more than two decades.

- PCIs have an increasingly important role (particularly in Europe) in the non-trade business of banks by underwriting **non-payment insurance on individual loans**, enabling banks to manage credit risk, counterparty limits and capital for further lending.
    - Here, **it is important that banks prudential regulations recognize the super senior status of non-payment insurance policies versus lending**, which is not the case now.
- Credit insurers are very supportive of the HLF's CMU recommendations for growth in balance sheet synthetic securitisations. They are already long-term risk sharing partners with the banking sector, as they provide credit protection through **balance sheet synthetic securitisations** in the form of a **financial guarantee or an insurance policy**. It is important, therefore, that the proposed regulatory changes do not prevent credit insurers from playing their role and, on the contrary, help them to further support the real economy.
    - Here, a key issue for the insurance industry regarding the STS framework is insurers not being recognised as eligible guarantors under any proposed STS framework at this date. This creates an economic disincentive for banks to select against insurers when seeking to structure credit protection as they won't get the preferential risk weighting on senior retained tranches. To appeal to the widest range of appropriate investors, the **'funded' requirement should be dropped in STS proposal if unfunded credit protection is provided by a Solvency II regulated entity.**
- The unfunded credit protection providers active in providing credit protection are multi-line (re) insurers with diversified business and limited correlation to the credit risk. They are well established and experienced in assuming and underwriting credit risk of the type originated by banks. They should not be assimilated with monoline credit insurance companies which are subject to different regulatory requirements, only underwrite financial risk and have very different asset, liability and overall risk profiles to the multi-line credit (re) insurers active in synthetic securitisations and credit insurance to date.

We fully recognise that the two issues raised above don't necessarily fit with Solvency II only but with the bridge between Solvency II and CRR/CRD for banks.

However, **the absence of regulatory response on these questions will limit a growing and sustainable form of private protection in these transaction from institutions that represent important partners to banks for the distribution of credit risk, notably in SME finance.**

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).

☐ Yes, and the framework provides the right incentives
☐ No, investments in long-maturity bonds (more than 15 years) should be less costly for insurers, regardless of whether they hold their investments for the long term
☐ No, there should be a preferential treatment for long-term investments in bonds that are held close to maturity, with appropriate safeguards
☐ No, and in order to effectively reduce the cost of investment in bonds, Solvency II should allow all insurers to apply the dynamic modelling of the volatility adjustment
X No, and I have another proposal to address this issue
☐ Don't know/no opinion

Please specify your answer (if needed). [Insert text box]

Insurers can facilitate real economy financing by providing **credit insurance** protection in respect of bank loans (from their liability side – question 2), or by **investing** in credit assets (from their asset side), both allowing banks to increase their lending capacity.

To foster real economy finance on insurers' **investment** side, current regulatory disincentives could be safely removed to foster insurers' appetite for **STS securitisations**, both true sale and funded synthetic. This could be achieved by providing regulatory capital benefits to insurers and reviewing the current inadequate Solvency II rules, notably in the following areas:

- the difference between senior and non-senior tranches of STS securitisations;
- the difference between STS and non-STS securitisations;
- the difference between pools of mortgages loans and senior RMBS (investing in senior RMBS is more capital intensive than investing in the underlying pools whereas the risk of loss is necessarily lower); and
- the limitations regarding EIF/EIB compared to other government guarantees to obtain a 0% risk weight.

Such a review, recommended by the High Level Forum, is particularly important in the context of the future **Capital Markets Union**, because the European Commission Action Plan (September 24, 2020) specifically aims at

– **increasing the role of insurers in real economy financ**e:

  "*Action 4: The Commission will seek to remove regulatory obstacles for insurance companies to invest long-term, without harming financial stability and policyholder protection*", and

– **leverage securitisation to transfer bank loans** - and specifically SMEs loans - to non-bank investors:

"Action 6: In order to scale-up the securitisation market in the EU, the Commission will review the current regulatory framework for securitisation to enhance banks' credit provision to EU companies, in particular SMEs"

Given the urgency of the current Covid-19 context, it is imperative that a fair and safe regulatory treatment of both true sale and synthetic securitisations is in place in 2021, especially since both types of securitisations will soon hopefully benefit from a STS framework. Depending on their asset allocation, insurers can invest in senior, mezzanine or junior tranches of STS and non-STS securitisations, and thereby increase lending capacity for banks by releasing capital or credit limits.

Waiting up to the end of the comprehensive review of the EU framework for both STS and non-STS securitisation would postpone an opportunity that sufficiently broad sources of recovery finance are available.