Position Paper

of the German Insurance Association (GDV)
ID-number 6437280268-55

on Systemic Risks and the Macroprudential Framework in the Insurance Industry

Gesamtverband der Deutschen Versicherungswirtschaft e. V.

German Insurance Association

Wilhelmstraße 43 / 43 G, 10117 Berlin
Postfach 08 02 64, 10002 Berlin
Phone: +49 30 2020-5000
Fax: +49 30 2020-6000

51, rue Montoyer
B - 1000 Brüssel
Tel.: +32 2 28247-30
Fax: +49 30 2020-6140
ID-number 6437280268-55

Contact:
Economics, Financial Markets; Financial Regulation

E-Mail: economics@gdv.de

www.gdv.de

Executive Summary

Insurers' business activities depend crucially on financial stability. Therefore, the German insurance industry supports an effective macroprudential policy. We appreciate the current work aimed at further enhancing the macroprudential framework in the insurance industry and would like to contribute our experiences and views to the ongoing discussion.

When evaluating potential further measures, in our opinion, a holistic view is essential. Both, the potential sources of systemic risk and the macroprudential impact of the existing regulatory framework, should be taken into account. It is our view, that the framework currently in place for European insurers (e.g. macroprudential aspects of Solvency II, stress tests, regular risk dashboards and financial stability reports by EIOPA, macroprudential monitoring by the ESRB) already goes a very long way to effectively address potential systemic risks from the insurance sector.

In order to avoid restrictive and unnecessary new provisions that would negatively impact the economic capacity and the social role of the insurance industry, any enhancement of the macroprudential framework should be guided by the following overarching principles:

- A **comprehensive impact assessment** of any potential new macroprudential tool should routinely be performed, taking into account both expected benefits and direct as well as indirect costs arising from the new tool.
- Decisions on macroprudential tools should be based on the **actual relevance of theoretically possible systemic risks,** which are not yet sufficiently addressed by the existing framework.
- A strict application of the **principle of proportionality** is essential, based on the actual level of risks a business model or activity implies for the stability of the financial system.
- The work on macroprudential policy tools in Europe must be **in line with global developments**, thereby ensuring a level playing field across jurisdictions.

Taking these principles as guidelines, we have **substantial concerns** regarding the current discussion on potential additional tools, in particular:

- Assessment of relevant systemic risks **not sufficiently evidence-based** (e.g. liquidity risk);
- **Lack of full consideration of existing Solvency II measures** (e.g. capital buffers, recovery plans, payment restrictions, reporting templates);
- **Insufficient targeting and risk sensitivity** of potential tools (e.g. capital surcharges, leverage ratios and liquidity ratios);

- **Substantial operational implementation challenges** and cost considerations not fully taken into account (e.g. ORSA enhancement, additional reporting requirements or plans).

A detailed assessment of the tools under discussion is attached as **Annex** to this Position Paper.

In our view, the focus should be on reducing counterproductive effects in the current supervisory system. E.g. we strongly support an **improvement of the volatility adjustment** under Solvency II.

Finally, macroprudential policy is only one element in the **overarching task to ensure financial stability**. There is a wide range of opportunities for policymakers to strengthen financial stability, which promise in our view to be much more effective than additional macroprudential measures. For example, **completion of the European Capital Markets Union** would enhance cross-border capital flows, leading to decreased concentration risks and a better cushioning of exogenous shocks to the financial system and the economy.

Contents

1. Introduction

Following the experience of the global financial crisis of 2008, a key element of the G20's reform agenda was the development of a comprehensive macroprudential framework. Complementing microprudential policy with its focus on individual financial service providers, macroprudential regulators and supervisors aim at identifying and, where necessary, reducing systemic risks in order to strengthen the stability of the financial system and to mitigate the potential costs of financial crises.

As an important pillar of the financial system and provider of essential functions for the economy and the society at large, the insurance industry, as a matter of course, has been included in the new macroprudential framework from the beginning. For example, insurance industry developments are an integral part of the ongoing monitoring exercise of the new macroprudential supervisors (e.g. ESRB, German Financial Stability Committee), and insurers are included in the Financial Stability Board's regulation of globally systemically important financial institutions.

Currently, both on the global and the European level, there are initiatives to review the existing framework and to further strengthen macroprudential

supervision of the insurance industry. The IAIS is in the process of developing a holistic framework for systemic risk in the Insurance Sector.[1] EIOPA[2] and the ESRB[3] suggest reviewing the Solvency II framework from a macroprudential perspective. Both have identified a number of potential instruments and measures that could be examined further. In its request for advice on the Solvency II Review 2020[4] the European Commission asks EIOPA to assess whether the existing provisions of Solvency II allow for an appropriate macroprudential supervision. Should EIOPA identify a need for further action, it is asked to examine a closed list of potential instruments. In April 2019 EIOPA asked stakeholders for input on a discussion paper on systemic risk and macroprudential policy.[5]

Insurers' business activities depend crucially on financial stability and well-functioning financial markets. Therefore, the German insurance industry supports a comprehensive macroprudential framework. In general, it is our understanding that effective macroprudential supervision is already in place for insurers. However, as there has not yet been a fully comprehensive and consistent review of the macroprudential framework for the European insurance industry and the risk landscape is evolving, we appreciate the ongoing initiatives.

When examining the macroprudential framework and evaluating potential further measures, a holistic view that fully takes into account the macroprudential impact of the existing provisions is crucial. Any amendment of macroprudential regulation and supervision should be guided by the principles of better regulation. Furthermore, the role and the limitations of macroprudential policy should always be borne in mind.

As a contribution to the current discussion on the future macroprudential framework for the insurance industry, the German insurance industry provides its views on systemic risks and macroprudential policy in insurance in this Position Paper. In addition, a detailed assessment of potential additional instruments and measures under discussion is laid out in the Annex to the paper.

---

[1] IAIS (2018): Holistic framework for systemic risk in the insurance sector

[2] EIOPA (2018): Other potential macroprudential tools and measures to enhance the current framework

[3] ESRB (2018): Macroprudential provisions, measures and instruments for insurance

[4] European Commission (2019): Request to EIOPA for technical advice on the review of the Solvency II Directive

[5] EIOPA (2019): Discussion Paper on systemic risk and macroprudential policy in insurance

2. Current framework against systemic risks in the insurance sector

Irrespective of the exact sources of potential systemic risks there is a broad consensus that unidentified vulnerabilities and insufficient resilience of insurers towards unfavourable developments could be the leading cause for (collective) activities of insurers to contribute to systemic risks in the financial system. However, eliminating such vulnerabilities and ensuring a sufficient solvency position is already the aim of microprudential supervision. Therefore, an **effective microprudential supervisory system** addresses most risks from a macroprudential perspective as well: It works against all potential systemic risks from the insurance industry – from contagion risks (e.g. because of fire sales of assets) to a sudden withdrawal of insurance services (following, for instance, a phase of underpricing).

With Solvency II, there is already a highly sophisticated and effective insurance supervisory system in place that counters potential systemic risks in the insurance sector effectively, e.g. with risk-based capital requirements and high standards of insurer governance. Macroprudential aspects played a substantial role in the design of Solvency II. Examples are reporting requirements, transitional measures – which allow for a gradual introduction of some Solvency II features – and specific Solvency II tools that aim at preventing excessive procyclicality.[6]

What is more, early identification of potential systemic risks is ensured through a **comprehensive monitoring** of the European insurance market – e.g. on the basis of Solvency II data, surveys on specific issues and expert judgement of supervisory authorities. Important tools are EIOPA's biannual stress tests, the half-yearly financial stability reports and the quarterly risk dashboards of EIOPA, but also the regular monitoring exercises of central banks (ECB, National Central Banks) and macroprudential supervisors (e.g. ESRB, Financial Stability Committees at the national level).

To name examples of **regulation at the national level** here in Germany, the maximum technical interest rate in life insurance performs an important function in preventing under-reserving both from a micro- and a macroprudential perspective. In addition, the German insurance supervisor BaFin takes into account potential effects on financial stability and procyclicality when considered appropriate.

[6] See also EIOPA (2018): Solvency II tools with macroprudential impact.

3. Systemic risks in the insurance sector

While the focus of macroprudential regulation in the field of insurance initially was on the potential systemic impact of the failure of large, individually systemically relevant insurers, the discussion has broadened to include systemic risks originating in or being amplified by collective actions of insurers with similar business models or with specific activities and behaviours. This partly reflects changes in the environment of the insurance industry. In particular, the long-lasting phase of extremely low interest rates has caused substantial negative effects on many life insurers. In addition, digitalization and climate change also entail new risks that could potentially become systemic.

There is an ongoing debate regarding potential systemic risks in the insurance industry. As yet, **central issues are only partly resolved**, both regarding the nature and practical relevance of theoretically possible systemic risks and the effectiveness of the present regulatory framework and a possible need for further action. **Empirical evidence is still sparse**. Most of the empirical work on systemic risks in the European insurance sector focusses on systemic risks in the pre-Solvency II era. However, the introduction of Solvency II represents a fundamental regime change in insurance supervision that substantially changed (potential) systemic risks; and the impact of this regime shift will only become apparent over time. This means that empirical work based on past pre-Solvency II observations has very little value, if any, as a basis for assessing the need for additional macroprudential tools for the European insurance industry today. In particular, it does not take into account the substantial risk-mitigating impact the introduction of Solvency II has brought about. Hence, more conceptual and empirical work is needed.

However, there is a broad consensus that, compared to the banking sector or some highly systemically relevant markets like real estate, **systemic risks from the insurance industry** and the insurance markets are **quite limited** and that there is very little systemic risk in the insurers' core business. Because of the specific characteristics of the insurance business – long-term orientation, stable financing of liabilities, advance financing of insurance benefits through insurance premiums and the link of most insured events to external causes – the insurance industry does not only have lower systemic risks, it is often working as a stabilizing factor in the financial system. Moreover, it is important to note that compared to the banking industry contagion risks from insurers are much lower – both within the industry and from the industry to other sectors of the economy. Banks are heavily connected through the interbank market – which in the past often was the source of strain – while insurers operate much more on a stand-alone basis. Also, insurers are less integrated in the financial mar-

ket infrastructures since they are not an integral part of the payment or settlement systems.

We would also like to point out that in a free market economy the provision of insurance services and the limits of insurability naturally evolve over time, e.g. because of technological progress, changes in the risk landscape, the provision of alternative capital or competitive market dynamics. Therefore, a withdrawal of specific product types by insurers or a reduction in insurability for specific risks as a result of market forces is not the same as the manifestation of a systemic risk.

4. Principles for effective macroprudential policy

In order to ensure an effective and efficient macroprudential approach for the insurance industry, an appropriate design of any new provision is essential. One vital prerequisite is that macroprudential tools are **tailored to the characteristics of the insurance business** and the exact nature of the systemic risk they aim at. By no means should supervisory frameworks or instruments developed for other segments of the financial system simply be transferred to the insurance industry.

In addition, decisions on macroprudential tools should not be based on conceptual analysis and theoretically possible systemic risks only. Rather, the **actual relevance of systemic risks**, which are not yet sufficiently mitigated by the existing framework, should be central to the assessment. Macroprudential policy should always be **risk-based** and follow the **principle of proportionality**.

When evaluating potential new instruments and measures, a **comprehensive impact assessment** is always necessary, that besides the expected benefits also examines their direct and indirect costs. Cost-benefit analyses, ideally quantitative in nature, appear absolutely essential in order to prevent ineffective or inefficient regulation. Any new measures aimed at further reducing systemic risks impose financial costs on insurers which must be balanced by an adequate benefit – also in the overall view of the entire economy. Otherwise, too much or inappropriately designed regulation of the insurance sector could impair the economic function insurers provide. It could thereby even lead to higher systemic risks, e.g. if it negatively impacts insurers in their role as long-term investors or weakens their competitive position compared to other (less or unregulated) industries.

In this process, it is important to take into account that the assessment of any tool is complicated by substantial uncertainty. This reflects the highly

complex interconnections and the rapid pace of change in the financial system, but also the only partly resolved conceptual issues and the limited experience with the newly introduced Solvency II regime and the current macroprudential framework.

Last but not least, it should be ensured that EU-level work on macroprudential policy is **consistent with international developments** (in particular, IAIS's work on a holistic framework for systemic risk), thereby ensuring a level playing field across jurisdictions.

Against this backdrop, care should be taken to avoid premature measures and over-regulation so as not to impair the effectiveness of the insurance industry in its socially-essential roles of risk carrier and long-term-oriented investor.

5. Financial stability as an overarching task

Macroprudential policy, with its mandate to identify and mitigate systemic risks, has an important role in ensuring the stability of the financial system. At the same time, however, its limitations should also be borne in mind. Apart from **conceptual challenges** regarding the appropriate design of the macroprudential framework, it is important to take into account that macroprudential policy can only be **one element** in the safeguarding of financial stability. Other areas of policy and supervision also have manifold direct and indirect effects on the stability of the financial system and have to contribute to financial stability as well. Besides microprudential policy, **forward-looking and stability-oriented fiscal and economic policies are vital**. In addition, **monetary policy has an important role to play**.

The link between macroprudential supervision and other policy areas has become quite obvious over the last years. Unprecedented zero or even negative interest rates, including for longer maturities on the bond market, have become one of the most important systemic risks in Germany and Europe. The substantial negative impact of the low interest rate environment on life insurance is one of the causes for the intensified discussion on further macroprudential instruments for insurers. However, this extreme interest rate development did not result from fundamental developments like lower growth or inflation alone. Rather, the persistence of a highly expansionary, unconventional monetary policy does play an important role as well. Instead of trying to further strengthen the macroprudential framework to counteract all potential systemic risks caused by monetary policy, it would be more effective and efficient if central banks took the stability effects of their policies more strongly into account as well.

Regarding potential systemic risks emerging with fundamental social developments like demographic change, digitalization or climate change, macroprudential policy can only play a limited role. Primarily, a proactive and stability-oriented fiscal and economic policy is needed.

Instead of introducing ever more macroprudential tools, it can often be **more effective to strengthen financial stability by other measures**. For example, the completion of the European Capital Markets Union would be an important contribution. Cross-border investment conditions for institutional investors would be enhanced, resulting in more diversified investments and less concentration risk. In addition, this would contribute – as e.g. in the US – to the cushioning of exogenous shocks to the financial system and the economy.

We would also like to point out the example of a legal provision in the German insurance contract law that is counterproductive from a macroprudential perspective. In Germany, life insurance products typically grant policyholders a surrender option which allows the latter to terminate their policies at **predetermined guaranteed surrender values**. If interest rates were to increase sharply, surrender values would no longer be in line with market values, resulting in a potential risk of increased lapses. However, this risk is caused entirely by current regulation: Surrender options with guaranteed values are required by the German Insurance Contract Act (VVG, § 169). Guaranteed surrender values were introduced with the reform of the Insurance Contract Act in 2008. Between 1994 and 2008 insurers had the right to set surrender values in line with market developments. Thus, German life insurers have become less resistant to an upward interest rate shock as a result of a legislative provision with procyclical effects. Instead of new macroprudential measures to compensate for the increased risk potential from a positive interest shock, a more-targeted and efficient solution would be a **revision of the current German regulation on surrender values**.[7]

Therefore, ensuring financial stability as best as possible and mitigating the costs of future financial crises that will not be fully avoidable should be recognised as an overarching task and challenge. Overloading macroprudential policy should be avoided.

Berlin, 15 July, 2019

[7] See also the discussion in Deutsche Bundesbank (2018): Financial Stability Review 2018, p. 90.

Annex: Assessment of additional instruments and measures

1. Enhancement of ORSA and PPP

Potential tools

Potential extensions to the current framework under discussion are an **enhancement of the Own Risk and Solvency Assessment (ORSA)** and **an enhancement of the Prudent Person Principle (PPP)**. In a potential design developed by EIOPA[8], the relevant authority in charge of the macroprudential policy would **aggregate and analyse macroprudential information from all ORSA reports and all investment strategies**. On this basis, they would **provide input to insurance supervisors** who in turn would use this information for sector-wide analyses and for their input provided to undertakings. This can imply the **request of specific information** from undertakings for a certain source of systemic risk in terms of nature, scope, format and point in time, where justified by likelihood or impact of materialisation. Authorities should also seek to mitigate the potential source of systemic risk by influencing through moral suasion undertakings regarding their **risk and / or investment strategy**.

GDV position

Insurers are already required to **consider in the ORSA process all material risks** that may have an impact on their ability to meet obligations to policyholders. Hence, for insurance companies to provide a holistic view, they **must already take into account all observable systemic risks** which could have a material impact on their business. Examples in this respect are credit cycles, asset price bubbles or reduced market liquidity. In Solvency II, ORSA is the **central management tool** which helps the board to make sound strategic decisions and to manage all material risks for the company. Both the harmonisation of the structure and content of ORSA reports and the mandatory consideration of macroprudential risks at request of the supervisory authority as laid out by EIOPA are **in stark contrast with this fundamental principle of ORSA**. ORSA should not become the place to deal with supervisory enquiries. Instead, it should remain an instrument tailored to the specific management of individual insurance groups and companies. Supervisory measures are permitted in the supervisory review process (Art. 36 of the Solvency II Directive), taking into account proportionality (Art. 29 IV of the Solvency II Directive) and applying a risk-based approach (Art. 29 I of the Solvency II Directive).

[8] Cf. EIOPA (2018): Other potential macroprudential tools and measures to enhance the current framework, p. 45 (ORSA) and p. 51 (PPP).

The suggested **enhanced macroprudential PPP requirements also do not seem to be a step forward**. With the introduction of Solvency II hard regulatory investment limits guiding the asset allocation were replaced by the PPP as a principle-based approach. According to Article 132 SII-Directive insurers have to invest assets in a way that **security, quality, liquidity and profitability of the portfolio** are ensured. That means that already today **insurance companies have to consider potential risks to the integrity and stability of financial markets** in their investment strategies.

Besides, the aggregation and feedback process as outlined above appears difficult to implement in practice. Not least because of major conceptual and practical challenges, **we agree with the ESRB** that the **efficiency and effectiveness** of both potential enhancements **is not adequate**.[9] The German insurance industry strongly believes that the potential benefit of analysing thousands of ORSA reports and investment strategies put together under the PPP does not **justify the large additional costs this would imply** for both insurers and supervisors. Since ORSA reports are insurer-specific, a technical solution to aggregate these reports at reasonable costs cannot be expected in the near future. It would also be prone to technical errors. What is more, investment strategies tend to be **very diverse as a result of company-specific business models and insurance products**. Additional costs and conflicts of interest would be generated if insurers were expected to take decisions that were sub-optimal for their business because of macroprudential concerns.

As a result, we see a more proportionate and pragmatic approach in continuing to **assess the ORSA and the investment strategy on a standalone basis** and to discuss any macroprudential implications in the context of the **existing macroprudential surveillance framework** (e.g. EIOPA's regular financial stability reports or EIOPA's and the ESRB's risk dashboards).

2. Systemic risk management planning (SRMP)

Potential tool

A Systemic Risk Management Plan (SRMP) is a regulatory report that provides supervisors with information relating to the specific systemic risk that insurance companies may pose to the financial system. Selected insurance companies would be asked to **describe the measures they in-**

[9] Cf. ESRB (2018): Macroprudential provisions, measures and instruments for insurance.

tend to undertake in order to address specific systemic risks as identified by the supervisor. At present, a SRMP is requested **only from insurers classified as globally systemically important by the Financial Stability Board (FSB) (G-SIIs)**. This tool could, however, be extended to other insurers, e.g. covering also specific large insurers or financial conglomerates. By reviewing the potential contribution to systemic risks, the group wide supervisor would decide whether either some activities or factors (e.g. from the IAIS systemic risk drivers[10]) deserve to be comprehensively analysed by the insurer in the report, as they are deemed in some way to pose systemic risk on the domestic or global level.

GDV position

Monitoring and analysing potential systemic risks in the insurance sector is mainly the task of macroprudential supervisors at national and European level. Here, a comprehensive **macroprudential surveillance framework is already in place** (see section 2 p. 6). Considering the rather limited systemic risk originating from or being amplified by the insurance industry, we feel that a parsimonious approach to systemic risk management planning (SRMP) would be sufficient both in terms of companies involved and risks analysed.

Also, from a cross-sector perspective, it is not clear why this instrument has so far not been **established in the banking** sector, even though systemic risks have proven to be higher there. EIOPA considers costs for the implementation as not significant, especially for large insurers or conglomerates. However, more reports and information requirements would produce **significant administrative burdens and necessitate additional IT investments** at the expense of insurers and, ultimately, policyholders. Prior to adopting any extensions to the SRMP, a **comprehensive cost-benefit analysis** is required recognising already existing macroprudential information (like Quantitative Reporting Templates (QRT) and stress tests). Any request for SRMPs should be duly justified, be applied only to a **limited number of insurers** and should also be subject to the **proportionality principle**.

[10] Cf. EIOPA (2018): Systemic risk and macroprudential policy in insurance, p. 44.

3. Liquidity risk management plan and liquidity reporting

Potential tools

The purpose of the Liquidity Risk Management Planning (LRMP) is to strengthen the existing liquidity management framework. It seeks to comprehensively monitor liquidity risks and to prevent the mismanagement of liquidity. According to the IAIS, the LRMP should include a statement of policy containing the **liquidity risk tolerance** of the insurer, a **description of the corporate governance and management** that will establish the risk tolerance, manage the level of liquidity risk given that threshold, and monitor the effectiveness of that management. The liquidity management is also expected to include an assessment of the insurer's liquidity adequacy across various time horizons and **plausible stress scenarios** as well as a reporting by the insurance company on these activities.[11] Given that at present this plan is requested **only from G-SIIs**, the tool could potentially be extended **beyond the entities classified as globally systemically important** by the FSB. In the current discussion, financial conglomerates are not considered for providing LRMPs, given that for significant supervised banks there is already a requirement for the production of consolidated liquidity reports (i.e. ILAAP or Internal Liquidity Adequacy Assessment Process).

GDV position

GDV recognises the existence of liquidity risk in insurance companies. However, Solvency II already requires companies to effectively **manage all liquidity risks** (Art. 44 II lit d) Directive 2009/138/EG and Art. 260 I lit d) Delegated Regulation (EU) 2015/35). Insurance companies have already to consider both short-term and long-term liquidity risks when assessing the **appropriateness of their assets in terms of nature, duration and liquidity** in order to meet the undertaking's obligations as they fall due. Insurers have to plan how to deal with changes in expected cash inflows and outflows. Given the fact that insurance companies have various risk management tools already in place, **liquidity risk does not appear to be a major potential source for systemic risk** in traditional insurance business.

To supervise the robustness of liquidity risk management a **large amount of data is already available** to supervisors. Solvency II reporting templates (e.g. S.06.02, S.13.01, S.18.01) are already the basis for liquidity analyses, e.g. the "liquidity and funding risks" analysis in the EIOPA Risk Dashboard. In addition, the possibility of additional requests like EIOPA's

[11] Cf. IAIS (2014): Guidance on liquidity management and planning.

current request on Long-Term Guarantees and illiquidity already exists today. These instruments ensure a **sufficient supervision of insurers' (potential) liquidity risks**, especially in view of the **moderate liquidity risks** in traditional insurance business.

Insurers' business models **differ fundamentally from banks' business models**. In maturity and liquidity transformation, for instance, insurers and banks usually take offsetting positions. **Insurers provide liquidity to the markets** by transforming longer term and less liquid liabilities into shorter term and more liquid assets. In addition, in line with the stated investment principles which include liquidity, insurers' investments include a **substantial proportion of liquid assets**. And because of the required solvency capital (SCR), the **total investments clearly exceed the registered assets** used to cover the technical provisions (Art. 239 SII-Directive). Thus, the liquidity position in the insurance industry is generally more than sufficient to meet the payment obligations.

An **investigation of EIOPA** concerning leading causes of insurers' failures and near misses, which comprises a sample of 180 affected insurance undertakings in 31 European countries from 1999 to 2016, also confirms that insurers' liquidity risk is of very limited systemic relevance.[12] Herein, EIOPA concludes that the financial crisis 2008 put a substantial amount of insurance undertakings and groups under severe financial distress and several insurers were affected. But this was attributable mainly to asset price losses, the interconnectedness with banks or, in general, evidence of weak governance. **Liquidity shortfalls did not play a role** in the sector. In contrast, Central Banks had to massively provide liquidity to the banking sector via LTROs. Given the fact that liquidity risks did not play a role in the insurance industry during one of the largest financial crises in modern financial history it appears reasonable to assume that existing **liquidity risk management planning and liquidity reporting should generally be sufficient** to address what is generally characterized as a moderate level of liquidity risk.

Even in **scenarios of a sudden and unforeseen increase** in surrenders (mass lapses), Solvency II's risk-based nature and its **embedded capital buffers** ensure that sufficient assets are available to cover liabilities. Especially for the risk of mass lapses, the **Solvency II standard formula already takes into account a lapse rate of 40 % as stress**. For the German life insurance market, historical lapse data show that lapse rates tend to be very stable and hardly fluctuate in stressed market conditions such as the financial crisis in 2008. As far as there is some risk of substantially higher lapse rates in a scenario of abruptly rising interest rates in

[12] Cf. EIOPA (2018): Failures and near misses in insurance.

Germany, this is due to the current legal provision on guaranteed surrender values (see section 5, p. 9). Here, we suggest – in line with the Deutsche Bundesbank[13] and as already implemented in France – an adjustment of the **regulation of the guaranteed surrender values** for new business. In addition, supervisory or management actions regarding a **temporary freeze of redemption rights** – a further instrument currently under discussion – could be considered when faced with the manifestation of the tail risk mass surrender. However, such a strong tool has to be handled with great care in order to avoid undesirable side effects. Apart from the fact, that insurers benefit from the stability and long duration of their liability side in the sense that they are able to cope with a much higher degree of illiquidity on their asset side, in Germany, the supervisory authority already has the power to intervene in severe situations.

EIOPA considered costs for the implementation of additional reporting requirements as not significant, especially for large insurers. However, we believe that more information requirements and reports would result in **significantly higher administrative burdens and IT investments** to the detriment of insurers and, ultimately, policyholders. Prior to any extensions to the LRMP or the liquidity reporting a **comprehensive cost-benefit analysis** would be needed. This analysis should take into account existing Solvency II liquidity measures and macroprudential information already available. Additional regulatory requests in these fields should be on the basis of proven needs and they should only be applied in firm accordance with the **proportionality principle**.

4. Liquidity risk ratios

Potential tools

The purpose of liquidity risk ratios is to develop a set of **indicators to monitor and assess liquidity risk** both at the micro and macro level. The liquidity of the assets shall be evaluated together with the liquidity of the liabilities. **Several indicators** have been proposed, such as liquid assets vs. technical provisions, liquid assets vs. liquid liabilities, unencumbered assets vs. total assets, liquid assets ratio, and liquidity resources vs. liquidity needs, short-term liquidity resources vs. short-term liquidity needs, lapse ratio, and gross written premium vs. surrenders.

[13] Deutsche Bundesbank (2018): Financial Stability Review, p. 90.

GDV position

As stated previously (see Annex section 3), liquidity risks are of substantially lower **significance for insurers** compared to banks due to the insurance business model. Depending on their design, liquidity risk ratios may be in contradiction with the long-term nature of the insurance business as they may not adequately capture the complexity of cash flows in a (re)insurance group. The projected cash flows of a company are the result of a thorough asset-liability-management process. Liquidity ratios fully detached from this process **do not capture the true underlying liquidity needs**. Forcing entities to report the liquidity ratios under discussion would ultimately **limit the ability of the risk management function** to assess and monitor liquidity risks using appropriate existing tools. As a consequence, investment diversification as well as the ability to finance the real economy would deteriorate.

In addition, such ratios would **require a precise definition** of what exactly qualifies as “high quality unencumbered assets” or “liquid assets” within an insurance company’s balance sheet. If the definition is too narrow, new **concentration risks** may arise. In addition, there is a risk that companies may not be able to offer profitable products due to excessive liquidity deposits and the loss of the illiquidity premium. And finally, many of the discussed liquidity measures (particularly those that include premiums) are **not suitable for insurance companies that are closed for new written premiums**. Therefore, **insurers** should remain fully in charge to monitor their liquidity position within the existing regulatory framework.

5. Exposure limits and concentration thresholds on insurers’ assets

Potential tools

The possibility of **defining hard and soft concentration thresholds or exposure limits** on insurers’ assets has also been discussed as additional macroprudential tools. Concentration thresholds imply the definition of limits to certain types of exposures to avoid excessive direct and indirect concentrations. The design can be hard or soft: **Hard thresholds** are fully binding in nature. For example, if the exposure limit for a specific asset or asset class is set at a certain percentage of the investment portfolio, undertakings are simply not allowed to exceed this limit. In contrast, **soft thresholds** can be violated, but this would necessitate special awareness of authorities, who could take action in case of a perceived excessive contribution to systemic risk. Therefore soft thresholds have the character of a special monitoring tool.

GDV position

With the introduction of Solvency II hard regulatory investment limits were replaced by the Prudent Person Principle (PPP) as a principle-based approach. PPP requires insurers to invest their entire capital in a way that **security, quality, liquidity and profitability of the portfolio as a whole** are ensured. Since then, investment strategies employed across Europe have been very diverse and strongly dependant on the individual insurance business. Concentration thresholds or exposure limits go against one of the key intentions in the transition from Solvency I to Solvency II. Rather than applying strict allocation limits, insurers can decide over their strategic and tactical asset allocations within limits of own funds available.

Furthermore, the current Solvency II framework has a number of additional tools already in place to address concentration risk at a microprudential level. According to Article 44 II lit d) Directive 2009/138/EG and Article 260 I lit e) Delegated Regulation (EU) 2015/35 every insurer already has implemented a **concentration risk management** to identify relevant sources of concentration risk and to ensure that risk concentrations remain within established limits. In addition, the **capital adequacy requirements already take into account concentration risks** at entity level. Last but not least, the focus of ORSA on concentrations and relevant stress scenarios also contains external events and systemic risks. These tools are designed to address the risk of excessive concentrations and to encourage appropriate risk management and appropriate diversification.

Interventions via hard threshold values could lead to a **sustained disruption of the necessary balance between profitability, liquidity and security at the portfolio level** of the individual insurer. They would overly restrict insurers in their choice of investments. Besides, assets are managed in the framework of the undertaking-specific asset-liability management to ensure a match with the liability side. Hence, any exposure limit or concentration threshold would have to encompass asset-liability aspects. Otherwise, thresholds could have negative implications for insurers' overall asset return, matching abilities and funding role. It could also lead insurers to dispose of certain assets in anticipation of reaching the limits.

At financial market level, **selling pressure or forced sales** would have negative side-effects and are potentially destabilising. Setting thresholds could lead to herd behaviour and procyclical actions, rather than mitigating them. Even soft thresholds require insurers to take them into account in their investment strategy, reporting obligations and regulatory interactions. Therefore, customers and market participants might also focus on potential limit breaches. De facto, soft thresholds could also result in strict re-

quirements. Thus, any form of thresholds should be avoided. We strongly support fully maintaining the principle-based approach of the PPP.

From our point of view, a further mitigation of potential systemic concentration risks (e.g. regarding specific national markets) could better be achieved by **broadening the investment universe** for long-term investors like insurers, e.g. by **completing the Capital Markets Union at European level** (see section 5, p. 9).

6. Macroprudential enhancement of capital requirements

Potential tools

Strengthening the capital base to strengthen resilience to systemic risks is also being discussed. The idea is that **capital surcharges** could counter systemic risks from insurer failures (entity-based approach). In particular, they would improve incentives as insurers pay a price for engaging in activities with the potential to pose systemic risk (activity-based approach) or engage in risky behaviour (behaviour-based approach). Further, the concept of a **broad-based capital buffer that works anticyclically** (i.e. buffers are built up during upswings of the credit cycle and run down during periods of financial market stress) has been introduced in the banking sector and is now also debated for the insurance industry. The aim is to smooth the fallout from boom and bust phases. Moreover, to maintain a strong capital base, **dividend or other payments to shareholders and the purchase of the insurer's own shares may be restricted or suspended**. Finally, certain **leverage ratios** (e.g. own funds to total assets; insurance liabilities to own funds; non-insurance liabilities to own funds) are suggested for monitoring purposes.

GDV position

We disagree with the concept of applying capital surcharges to mitigate systemic risks in the insurance industry. Under Solvency II, the **SRC and MCR methodologies already ensure that companies have sufficient capital to cover most risks, including risks to financial stability**. The Solvency Capital Requirement obliges undertakings to hold a capital buffer at all times that enables it to survive a 200-year event. Even if the respective undertaking is in breach of the Solvency Capital Requirement, it still disposes of sufficient own funds to meet all its obligations. If the Solvency II capital buffers are threatened, **sufficient powers of intervention** are available (Articles 138 ff. SII-Directive). More early intervention powers for restriction or suspension of dividend or other payments based solely on macroprudential considerations should therefore be **limited to clearly**

defined special cases. In order to avoid inconsistencies they should be in line with existing German regulation. According to German law, no profits can be distributed to the shareholders if funds are needed to secure long-term guarantees.[14]

Moreover, insurers have to consider **material systemic risks within the ORSA framework** and to provide enough capital so that **potential systemic risks are covered within the overall solvency requirement**. In addition, other indicators and methods contribute to mitigating systemic risks. Therefore, we believe that **additional capital requirements are not necessary**. And even if in exceptional circumstances there should be a justification for additional capital, Article 37 SII-Directive already allows for **capital add-ons** if supervisors conclude that the risk profile of the insurer deviates significantly from the assumptions underlying SCR calculation, or its systems of governance deviate significantly from the standards set out. A significant size or certain systemic relevant activities or behaviour may **cause such a deviation and lead to a capital add-on**. Therefore, the Solvency II framework already allows for cases where risks are not adequately reflected and does not limit the nature of those risks. In line with the risk-based Solvency II approach, these capital add-ons are not permanent uplifts but have to be cancelled by the supervisor if the specific situation ends. If capital surcharges should apply they seem to be **less predictable and less effective** compared to other tools, especially if a high return can be expected from the systemic relevant activity. For **financial conglomerates**, it is important to consider how different buffers for banks, insurers etc. interact, otherwise these buffers for conglomerates can be unreasonably large.

Regarding the implementation of a **countercyclical capital tool, Solvency II already contains three permanent instruments[15] with a countercyclical impact**. These instruments are tailored to the specific conditions of the insurance industry.[16] **We share EIOPA's view** that an additional countercyclical capital buffer should not be considered further because of the risk of **unclear interferences with these permanents instruments and operational difficulties**. In addition, the insurance industry is not a major driver of the financial cycle. In particular, insurance companies are not closely linked with the credit cycle like banks are, and there is no sign of an excessive build-up of investment exposures or excessive risk-taking "in good times" which would have to be reserved in "bad times". Instead

---

[14] So-called Ausschüttungssperre in German insurance supervision law (§ 139 para 2 VAG).

[15] Volatility adjustment, matching adjustment and symmetric adjustment to the equity risk sub-module

[16] Cf. EIOPA (2018): Solvency II tools with macroprudential impact, p. 68.

we suggest **improving existing instruments** within the Review 2020, e.g. reflecting the stability and, hence, illiquidity of underwriting cash flows in a separate volatility adjustment ("illiquidity VA") and provide additionally an accurate and effective crisis instrument ("crisis VA") for all undertakings concerned.

Beside the existing SCR and MCR coverages further **leverage ratios** are in discussion. With regard to the potential contribution to systemic risks we believe that leverage ratios are of **little significance** for the insurance industry. In fact, there is even a **risk of misinterpretation**. In contrast to the banking sector, defining a **leverage ratio for the insurance industry is far more difficult** as it depends much more on the specific business model of the individual insurance company. EIOPA clearly points out the problems and limitations of the various possible definitions and stresses the need for further investigations.[17] Even if the leverage ratio were only used as a monitoring tool, in practice, insurers would still have to take the ratio into account in their reporting and regulatory interactions, affecting company steering, regardless of the formal status. In addition, customers and market participants will probably also focus on these measures. Unlike for banks, the **interpretation of leverage ratios in insurance would be very difficult** given the differences in business models and the different types of insurance. Therefore, these "monitoring tools" are not suitable for the insurance industry. From our point of view, the **SCR and MCR coverages should remain the relevant indicators**.

7. Measures against market-wide under-reserving

Potential tools

To avoid market-wide under-reserving or under-pricing, different regulatory requirements are in discussion. A proposal is, for instance, the **special monitoring of all life insurance companies** by collecting data at market level on the development of profits and losses and by decomposing them according to their sources (e.g. mortality component, lapse components, etc.). Likewise, **maximum interest rate guarantee levels for life insurance contracts** and **additional reserving requirements** for insurance companies with products that contribute to systemic risk are under discussion.

[17] Cf. EIOPA (2018) Other potential macroprudential tools and measures to enhance the current framework, p. 9 ff.

GDV position

The identification of under-reserving is a key concern of micro-prudential supervision and one of the main tasks of the actuarial function under Solvency II. With Solvency II the **best estimate calculation of the technical provision** has been introduced. To ensure the adequacy of technical provisions, insurers must **validate their entire calculation**. This includes the appropriateness, completeness and accuracy of relevant data, the adequacy of the assumptions and methods and the appropriateness of the level of the technical provisions with respect to all the obligations towards policyholders. The responsible actuarial function is required to be independent of the revenue-generating functions and kept free from the influence of the management board. The independent actuarial function also has to give an opinion on the underwriting policy, including an analysis of the sufficiency of premiums to cover future claims and expenses. Moreover, in many Member States, an **external auditor** has to audit the Solvency II balance sheet including technical provisions. And finally, the **risk margin provides an extra layer of security**.

Regarding a need for the reporting of additional data to the supervisory authorities for macroprudential monitoring purposes, we believe that companies already **provide sufficient information** on the adequacy of their reserves in the comprehensive **Quantitative Reporting Templates** (QRT) and the **Regular Supervisory Report** (RSR). Therefore, additional regular reporting requirements that make the reserving process more cumbersome do not appear necessary. Supervisors should establish internal exchange of information processes to use existing data for identification of any significant market-wide trend. Moreover, supervisory authorities already have sufficient powers for **tailor-made information requests or surveys**.[18]

Besides, the underwriting risk in life insurance shows that the sensitivity of insurance liabilities against additional indicators (like longevity, mortality, lapse, disability) is relatively low compared to market risk. Since these are quite small sources of potential under-reserving, deeper monitoring does not seem to be justified as it would substantially increase the administrative burden for insurers. Beyond that, the EIOPA study on “Failures and near misses in insurance” of 2018 does not indicate under-reserving as a significant cause for failure in life insurance.

Concerning a **maximum interest rate guarantee for life insurance**, it could be a sensible instrument to avoid under-pricing or under-reserving in excessively competitive market situations. In the German market with the

[18] E.g. EIOPA’s survey for understanding cyber insurance in 2018.

"Höchstrechnungszinssatz" a proven **instrument in the life insurance sector has already been implemented** quite some time ago.[19]

Moreover, an **additional reserving requirement** has also been implemented in the German life insurance market already.[20] Due to the long-term nature of the business it could make sense to build up required additional capital buffers at an early stage. In already critical situations, however, companies should not be overburdened. Therefore, the **design is decisive and needs comprehensive analyses** before implementation.

8. Restrictions on business

Potential tools

Discussions also include possible **restrictions on business activities** that may pose a systemic risk, e.g. measures like prohibiting the insurer from issuing new policies or specific types of products, or requiring it to alter its sales practices, restricting the transfer of assets, or restricting activities of a subsidiary.

GDV position

Before further restrictions are considered, a comprehensive analysis of existing regulations is required. Some product intervention powers due to financial stability concerns are already **implemented at European level** according to Article 9 para 5 of Regulation (EU) No. 1094/2010 and Articles 16, 17 Regulation (EU) No 1286/2014 (PRIIP-VO). Furthermore, with the IDD a new framework recently came into force, which also included **comprehensive requirements for product approval and product control**. In the IDD, the European legislator focuses rightly on the **protection of the customers**.

As the restriction or even prohibition of products is already possible in case of non-compliance of SCR and further deterioration of financial position of insurance companies, **we reject early product interventions** based solely on macroprudential concerns. Such product interventions seem **hardly justified** as they seriously **interfere in the business models** of the individual insurance companies and intervene in the **ownership rights of its shareholder.** Additionally we want to stress, that the impact

---

[19] Höchstrechnungszins (HRZ) according to § 2 para 1 DeckRV, HRZ was lowered step by step from the historical maximum value of 4 % to current 0.9 %.

[20] Zinszusatzreserve (ZZR) according to § 341f para 2 HGB i. V. m. § 5 para 3 DeckRV.

of product restrictions could **distort global competition and innovation**. Measures taken at European level should be weighed against impacts on the competitive positions of the European insurance sector globally.