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Addressing shortcomings without departing from Solvency II principles

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In principle, the review of the Solvency II SCR standard formula is neither supposed to produce substantial amendments to the current design of the formula, nor to strengthen or relax the current capital requirements.

The declared main objectives of the review are to: i) reduce unnecessary complexity; ii) correct identified technical inconsistencies; iii) remove unjustified regulatory barriers to investments in certain financial instruments. For example, the focus now is on simplifying the calculation of capital requirements for counterparty risk and catastrophe risk, as well as the application of the look through approach. Also, the treatment of non-rated bonds and unlisted equities as well as the concept of strategic equity are under review to evaluate potential undue impediments to their spreading.

Improving a consistent application of Solvency II is a priority as well, focusing on specific elements where practical experience has highlighted different interpretations, such as the calculation of the Loss Absorbency Capacity of Deferred Taxes.

Solvency II is a solid and effective supervisory framework. However, as expected, it has shown certain shortcomings, which in my view mainly insist on three aspects: its complexity, the high sensitivity to the market volatility of its indicators, which could inflate procyclicality, and, finally, possible inconsistencies in the calibrating factors, which could determine undesired effects, especially in investment behavior.

The challenge will be to improve these aspects without departing from those principles.

Most of these aspects could be seen as natural downsides of the agreeable principles of Solvency II. In the ongoing review, therefore, the challenge will be to improve these aspects without departing from those principles: reducing excessive complexity without watering down its risk sensitivity; softening the effects of short-term, artificial volatility without reducing the capability of the system to produce early warnings; avoiding undesired behavioral consequences without departing from the agreed capital calibration criteria.

Also the objective of reducing excessive discretion should be pursued without transforming Solvency II into a rule-based regime, but rather by relying on EIOPA powers to enhance convergent supervisory practices.

Even though it is not formally part of the SCR review, it will be particularly critical in my view to improve the tools which influence the Solvency II balance sheet sensitivity to short-term volatility. In this context, EIOPA is also in the process of drawing up annual reports on the use of Long Term Guarantee measures, to be used as a technical basis for the review of the measures in 2021. Together and consistently with the SCR review, this will be key for the European insurance market.