XAVIER LARNAUDIE-EIFFEL

Deputy General Manager, CNP Assurances

The combined risk of ultra-low interest rates and too restrictive (future) regulation for life insurers:the economy needs a balanced Solvency 2 review

Life insurers manage their balance sheet over the long term with savings and retirement products representing several trillions of commitments in euros on a European scale. Consumers have shown interest in these offers, especially with the growing aging of the population in Europe. Insurers are therefore committed and continue this management to meet the needs of European citizens over several decades.

Based on this time horizon, very low rates are still recent for insurers. This paradigm shift occurred with the Quantitative Easing of the ECB in 2015 and now the Covid19 crisis reinforces the scenario of low interest rates for long. It seems likely that an accommodative monetary policy will be necessary to overcome this unprecedented crisis further while at the same time it is a challenge for the insurance industry. Ultra low or even negative rates weaken insurers and medium-term profitability as of now solvency is undermined. The 2020 results showed substantial declines in solvency for life insurers, until several dozen points lost over the year due to the decrease in interest rates.

Insurers must adapt and transform their business models to survive. They can no longer offer long-term products combining security, liquidity and yield. It would take time to adapt the offers and its success with customers. In the meantime and under pressure from low interest rates, insurers have already implemented measures in order to seek yield, such as adjusting asset allocation by focusing on riskier and sometimes less liquid assets.

In the medium term, the risk of low interest rates could increase with the 2020 review of Solvency 2. Initially, the calibration of capital requirement in the standard formula did not foresee a risk of negative rates. There is no doubt about the reality of negative rates and the formula has to be adjusted in particular in the computation of the interest rate SCR submodule within the standard formula. However, other items in the calculation should be adapted in order to achieve a balanced review that does not result in a substantial increase in capital requirements. Maintaining the very accommodating monetary policy helps reorient insurers' investments towards equities, unlisted investments or real estate. This movement is favorable to the economic recovery at the end of the pandemic crisis. In these conditions, it is necessary that the Solvency 2 review does not penalize this movement. In current EIOPA advice on 2020 Solvency 2 review, there are positive adjustments such as slight reduction of risk margin or simplification of criteria for long-term equities investment qualification. However, these propositions are not sufficient to compensate other very penalizing propositions as interest rate SCR recalibration and the change of methodology for the extrapolation the interest rate used for technical provisions valuations. A balanced review of the prudential framework is essential so that insurers can continue to offer long-term products and be actors in the economic recovery, by promoting the investment of amounts entrusted by policyholders in the economy.

A sudden and disorderly rise in rates after a long period of low rates would also constitute a risk. Large capital losses would expose insurers who may then be unable to meet demand for redemptions, especially since the differential in return to market assets would induce policyholders to invest outside of life insurance. However, there is an opportunity in case of a controlled rise to slight positive levels, stimulating for savings and investment and not dissuasive for its financing.