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Ministry of Finance

Unit of Insurance and Financial Reporting

Department of Insurance and Investment Funds

Financial Stability Department
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European Commission
Internal Markets and Services DG
Financial Institutions

Markt-Consultations@ec.europa.eu

Swedish response to the Commission consultation on the Level 2 implementing measures for Solvency 2 jointly by the Ministry of Finance, Financial Supervisory Authority and the Riksbank

Dear Sir/Madame,

We are very pleased to submit to you our comments on the Commission consultation on the Level 2 implementing measures for Solvency 2. Should further clarifications be needed we stand ready to assist you.

Yours Sincerely,

Ministry of Finance	**Finansinspektionen**	**Sveriges Riksbank**
Sonja Daltung	**Malin Björkmo**	**Mattias Persson**
Head of Unit	**Head of Department**	**Head of Department**

2. Policy Issues

1. Technical provisions – best estimate – risk-free interest rate curve

Question 1: Do you agree that the Commission Services' suggested approach would be the most efficient and effective in order to achieve the objectives of:

- harmonising the calculation of technical provisions;
- introducing proportionate requirements for small undertakings;
- introducing risk-sensitive harmonised solvency standards; and
- promoting compatibility of valuation and reporting rules with the international
- accounting standards elaborated by the IASB.

SE: We agree with the Commission Services approach in that the best base for the risk-free interest rate curve used when calculating the technical provisions is the swap curve. This is

the case because swaps, in general, are more stable and closer to being considered truly risk-free than government bonds. In addition, swaps offer a wider range of observable liquid points.

However, when the risk-free rate is derived from the swap curve, it should be adjusted for credit risk, since there is credit risk in swap contracts. On the other hand, swaps will be more regulated and in a future the credit risk may be sufficiently close to zero so that we at some point do not need an adjustment of the risk-free rate curve. But as there is still credit risk for swaps, the credit risk adjustment should be calculated for different regions or currencies, updated over time (annually or more often if needed, for example under periods of financial turmoil) and also take into consideration the durations for the specific swap contracts used to derive the risk free rate curve.

If an illiquidity premium under stressed liquidity scenarios will be introduced, it is our strong view that the calculation of the illiquidity premium must be transparent, predictable and free from arbitrariness. In order to achieve transparency, predictability and to avoid arbitrariness regarding the illiquidity premium, there has to be explicit criteria set up how this premium is derived. Therefore, we strongly suggest that the way the illiquidity premium is calculated is described in the level 2 text, preferably with an explicit formula.

Additionally, we are also strongly in favour of that the risk-free rate term structure are published by EIOPA either on a daily basis or by publishing a tool where a user can produce the same interest rate curves at any point in time. This tool will need access to a database where the underlying swap rates can be retrieved. In order to be able to produce the risk-free rate term structure with such periodicity, all parameters used must be set by explicit criteria. Therefore it is not possible in our opinion that any part of the calculation process can be left to expert judgment or political decisions.

Furthermore, for currencies like SEK with a liquid market only up to about ten years, we want to stress the importance of having a macro-economic extrapolation model, like the one tested in QIS 5 (Smith-Wilson). In order to reach stability over time in the long term discount rates, the implementation must be done with great care. The details of the extrapolation method could be developed at level 3.

2A. Technical provisions – risk margin – Cost-of-Capital rate

Question 2: … the objectives of:

- harmonising the calculation of technical provisions;
- introducing proportionate requirements for small undertakings
- introducing risk-sensitive harmonised solvency standards; and
- promoting compatibility of valuation and reporting rules with the international accounting standards elaborated by the IASB.

SE: We agree that the suggested approach is a good way to reach the objectives of harmonization, proportionality, risk-sensitivity and compatibility with the IASB accounting standards.

Question 3: Do you agree that a 6% Cost-of-Capital rate would closely reflect the cost of providing an amount of eligible own funds equal to the SCR necessary to support the insurance obligations over the life time thereof? (Please provide reasons)

SE: The issue of calibrating the Cost-of-Capital rate has proven to be extremely complicated and it is difficult to say what is the correct rate. Our belief is that 6 % is reasonable.

2B. Technical provisions – risk margin – diversification

Question 4: …the objectives of:

- harmonising the calculation of technical provisions;
- introducing proportionate requirements for small undertakings;
- introducing risk-sensitive harmonised solvency standards; and
- promoting compatibility of valuation and reporting rules with the international accounting standards elaborated by the IASB.

SE: The risk margin is supposed to correspond to the costs for the reference undertaking to provide eligible own funds corresponding to the SCR calculated for the transmitted insurance portfolio. Option 1 assumes that this company is well diversified, Option 2 that it has the same degree of diversification as the company for which the calculation is made and Option 3 that it has no diversification across lines of business. Option 2 represents a compromise between the two extreme assumptions, and we would support that.

3. Own funds – quantitative limits for SCR and MCR

Question 5: …the objectives of:

- introducing proportionate requirements for small undertakings;
- introducing risk-sensitive harmonised solvency standards;
- promoting compatibility of prudential supervision of insurance and banking; and
- promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA.

SE: We agree with the Commission to follow option 5 (the option tested in QIS5).
In our opinion there should not be any proportionality requirements concerning the quality of own funds linked to the size of the company.

Question 6: In your view, what impacts would the Commission Services' suggested approach have on the following:

- cost of own funds
- capital raising or capital reduction

SE: There is a need of raising additional capital in relation to the tested requirements in QIS5. This will most certainly have an impact on the cost of capital and in the long run the additional cost will be paid by policyholders. It is of utmost importance that the final calibration of the SCR will be performed with care. The basic idea of the insurance business model must be kept in order for consumers to have access to cost effective risk transfer of their individual risks. QIS 5 indicates in certain areas that the calibration is too conservative.

4. Procyclicality – Pillar II dampener

Question 7: …the objectives of:
- introducing risk-sensitive harmonised solvency standards;
- harmonising supervisory powers, methods and tools;
- promoting compatibility of prudential supervision of insurance and banking; and
- promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA.

SE: We agree with the suggested approach, of an extension period of total 30 months.(In normal circumstances 6+3 months plus up to another 21 months extension in case of an exceptional fall in financial markets).

Question 8: Should the list of factors to be taken into account by supervisory authorities when deciding whether to grant such a decision be left open? (Please provide reasons)

SE: The list should be open because of the difficulty to foresee how serious problems in the financial markets will emerge. Before granting a decision for extension of the recovery period, EIOPA should be consulted.

5. Supervisory reporting – content, form and modalities

Question 9: …the objectives of:
- introducing proportionate requirements for small undertakings;
- harmonizing supervisory reporting;
- promoting compatibility of valuation and reporting rules with the international accounting standards elaborated by the IASB; and
- ensuring efficient supervision of insurance groups and financial conglomerates.

SE: Solvency 2 is a risk based regulation focusing on the undertakings own assessments of risks and on their internal governance systems and risk management systems. The calculations of solvency capital requirements according to pillar 1 combined with the important and up to date governance rules in pillar 2 should result in a large shift in supervision, towards increased qualitative assessment of internal processes within undertakings. The Solvency 2 regulation is extensive, but it renders the undertakings a certain degree of freedom to act within the framework. Imposing a too large burden of detailed reporting could be a risk to the successful implementation of Solvency 2.

We agree with the Commission Services that scenario 3 is best to meet the objectives. But we disagree that the supervisory reporting should be based on the information publicly disclosed.

Reporting to the supervisory authorities should only include information that the supervisory authorities needs for their supervisory activities as stated in the Commission Regulation, Recital 93. It must be clarified that certain information will not be subject to periodic review by supervisors, but admitted primarily because of statistics or macro prudential reasons.

The reporting templates should concentrate on aggregated risks rather than on details. When undertakings report details of risks it will be up to the supervisor to aggregate the risks. This responsibility can never be on the supervisors but on the undertakings. Examples of were this

very detailed reporting could be found is within the area of assets, technical provisions and reinsurance.

Therefore we believe that there is an urgent need for a control mechanism in the regulation process in order to limit the amount of information requested by the supervisory authorities in order to reach an “optimal” amount of reporting, balancing the needs of the public and supervisors and the cost imposed. Such control mechanisms must be provided by the Commission at level 2. Mandatory, comprehensive impact assessments would be at least a part of the solution.

The reporting of the list of assets is a specific issue. The question is what EIOPA or ESRB need and what the national supervisors need. The COM is therefore asked to provide clarity on the objective(s) of the reporting package.

It is important to bear in mind that it is not information on asset holdings per se that is of interest to the supervisors, but the risk exposure implied by those holdings. Supervisors have to be in possession of systems capable of calculating the exposures implied by the mix of derivates and direct holdings in a portfolio. This might not be the kind of systems that supervisors have today. Large investments in IT systems would be needed. The gains of being able to calculate the exposures within the authority should be compared to the IT development cost for portfolio analysis systems. (That comparison should take into account that the risk exposure is already captured in the SCR calculation and that undertakings also will be required to perform additional stress/scenario testing in the ORSA).

The logic approach would be for the supervisor to take on the more qualitative methodology while supervising the prudent person principle, i.e. focus on investment processes and policies/instructions within the undertakings. We believe that the latter would be more in line with the ideas of Solvency 2.

We suggest in line with the proportionality principle that the quantitative reporting on an annual basis also should be reduced for smaller and medium-sized undertakings with a less complex risk profile, e.g. with adjusted templates for this group of undertakings.

Question 10: The Commission Services are currently of the view that, in line with the proportionality principle, the level 2 implementing measures should only require material and/ or relevant information to be provided. Do you agree with this approach? (Please provide reasons, including specific suggestions on how to implement the proportionality principle with respect to reporting requirements, how and who should determine what information is material and/ or relevant)

SE: Yes we agree. If a template is not applicable to a certain undertaking due to the fact that there is nothing to report because this undertaking does not write that line of business, this is not proportionality. We refer to the answer on Question 9.

Question 11: Do you have any suggestions on which specific quantitative data should be subject to external audit? (Please provide reasons)

SE: We agree with CEIOPS position.

Question 12: Do you have background information or evidence that groups are approaching the reporting requirements from a centralised, top-down group perspective? (Please also provide views on whether groups should be encouraged to adopt this approach)

SE: It is our informed opinion that groups are approaching many fields from a centralised top-down perspective, logically this would also be the case for the field of reporting.

6. Public disclosure – content, form and modalities

Question 13: …the objectives of:

- introducing proportionate requirements for small undertakings;
- harmonizing supervisory reporting;
- promoting compatibility of valuation and reporting rules with the international accounting standards elaborated by the IASB; and
- ensuring efficient supervision of insurance groups and financial conglomerates.

SE: We are in favour of high transparency. However, our belief is that this can only be achieved through disclosure of relevant information rather than a lot of details. More information does not necessarily lead to higher transparency. It is essential to find an acceptable balance between appropriate transparency and the amount of information.

Questions 14: The current approach favoured by the Commission Services would be to list a number of items which would need to be put in the public domain. Some stakeholders argue that the SFCR should contain much less information, so that it is understandable by policy holders, while others support disclosure of information directed at a much wider audience. Do you have views on:
a) what stakeholders should be addressed?
b) what are the areas on which stakeholders need information?
c) how detailed has it to be?

SE: The most important stakeholder from a supervisory perspective is the policy holder. Their main interests would be the undertakings financial and solvency situation to day and in the future, the undertakings ability to control their risks and the robustness of the governance system. The information should not be too complex and detailed. See also the above answer to supervisory reporting.

Questions 15: Solvency II will be based on an economic valuation of all assets and liabilities. The current approach favoured by the Commission Services would be to require public disclosure of a number of aggregated key figures arising from solvency valuation and their material differences with the accounting valuation. Do you support that approach?

SE: Yes we support this approach It will help stakeholders to compare undertakings.

7. Treatment of holdings in participations and subsidiaries

Question 16: …the objectives of:

- introducing proportionate requirements for small undertakings;
- introducing risk-sensitive harmonised solvency standards;

- promoting compatibility of prudential supervision of insurance and banking; and
- ensuring efficient supervision of insurance groups and financial conglomerates.

SE: With respect to proportionality our opinion is that general principles for proportionality should be applied and there is no need for specific guidance here.

We agree that an approach that combines the options is appropriate. However we are not in favour of a differentiated equity stress for strategic participations, since the criteria to determine if participations are strategic or not will be ambiguous and require judgement that might not be applied equally by undertakings. Therefore we do not see the rationale for a differentiated stress.

With regards to equity stress for non-strategic and strategic participations, our opinion is that undertakings should have an option to determine the equity stress based on the risk profile in each participation, i.e. valuation in accordance with SII-principles and the SII- methodology for calculation of SCR (look through principle). If undertakings do not apply that option the equity stress for other (non-listed) equities should be applied.

Furthermore our opinion is to maintain the QIS 5-methodology for financial and credit institutions and undertakings excluded from the group.

Also a NIL valuation for undertakings excluded from the group could be applied in order to limit the burden for undertakings with respect to valuation of a participation that should be stressed to 100 %. We would like to highlight that valuation to NIL will have a deferred tax impact that need to be considered.

Question 17: Do you agree with Deloitte's conclusion that the choice of policy option may cause some undertakings to change their corporate structure?

SE: Yes we agree, this would be inevitable if there is a possibility for arbitrage.

Question 18: In terms of alternative approaches for holdings in certain regulated related undertakings (financial and credit institutions and insurance and reinsurance undertakings), would you support an approach which makes use of the additional information available about these holdings to determine their contribution to the overall risk profile of the undertaking? (Please give suggestions of possible approaches)

SE: For Financial and Credit institutions see above. Our view is that compatibility with the banking industry should be obtained when possible.

For Insurance undertakings, an approach to consider the contribution to the overall risk profile is appropriate and also required in the level 1 text in the ORSA and pillar 2 requirements. (see also response to question 16 above)

8. SCR standard formula – equity risk – Pillar I dampener

Question 19: …the objectives of:

- introducing risk-sensitive harmonised solvency standards;
- harmonising supervisory powers, methods and tools;

- promoting compatibility of prudential supervision of insurance and banking; and promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA.

SE: For now we do not have an opinion about which time period the symmetric adjustment, i.e., the Pillar 1 dampener, should be based on. The reason is that we think that the length of time of the Pillar 1 dampener should be chosen at the same time the final formula for calculating this adjustment is chosen. We see some major problems (discussed below) with the currently proposed formula.

We have identified three major problems with the proposed way to calculate the pillar I dampener:

1. when longer time periods are chosen, this measure is most of the time either +10 % or –10 %.
2. the same index is chosen for all undertakings, i.e., MSCI Developed index (USD, independent of their holdings
3. even though the undertaking holds equities that exactly follow (replicate) MSCI Developed index, an increase in the index will at certain levels of adjustment term actually lower the solvency ratio (own funds / SCR)

These problems are thoroughly discussed and some suggestions to reduce the problems are given in the *appendix* to this document.

We look forward to take part of and discuss future proposals on the formula and time period that shall be used to calculate the symmetric adjustment.

9. SCR standard formula – loss-absorbing capacity of technical provisions

Question 20: …the objectives of:
- introducing risk-sensitive harmonised solvency standards;
- introducing proportionate requirements for small undertakings.
- harmonising supervisory powers, methods and tools; and
- promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA.

SE: We agree with the rationale behind option 2, which, includes all relevant risk areas that impacts loss absorbing capacity. We have noticed, in QIS 5, that option 3 is too complex and do not provide more accurateness than option 2.

10A. SCR standard formula – diversification effects – correlation parameters

Question 21: …the objectives of:
- introducing risk-sensitive harmonised solvency standards;
- introducing proportionate requirements for small undertakings.
- promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA; and
- ensuring efficient supervision of insurance groups and financial conglomerates.

SE: The correlation parameters are difficult to estimate, since they are supposed to measure dependence between extreme outcomes of different risks. We support the present values, but must be prepared to change them when more information becomes available.

10B. SCR standard formula – diversification effects – geographical diversification

Question 22: …the objectives of:

- introducing risk-sensitive harmonised solvency standards;
- introducing proportionate requirements for small undertakings.
- promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA; and
- ensuring efficient supervision of insurance groups and financial conglomerates.

SE: We support Option 2: a less granular subdivision of European regions and that the calculation of the adjustment factor should be optional for the companies.

11. SCR internal models – integration of partial internal models

Question 23: …the objectives of:

- introducing risk-sensitive harmonised solvency standards;
- introducing proportionate requirements for small undertakings;
- harmonising supervisory powers, methods and tools; and
- ensuring efficient supervision of insurance groups and financial conglomerates.

SE: We support the Commission's proposal on integration techniques unless the undertaking shows the inappropriateness of such prescribed techniques. The allowed default integration techniques should be prescribed by EIOPA, not locally.

Fulfilment of Commission's objectives:

- *Introducing risk-sensitive harmonised solvency standards* – Different local supervisory authorities cannot be allowed to prescribe different techniques if the objective of a harmonized regulatory framework shall be possible to achieve.
- *Introducing proportionate requirements for small undertakings* – Some proportionality achieved because the firms are allowed to develop and use their own techniques, but can save time and resources by choosing to rely on the techniques prescribed by the supervisor, without investigating the appropriateness of the technique. There is however a small risk that undertakings use prescribed techniques that are inappropriate for their risk profile.
- *Harmonising supervisory powers, methods and tools* – Different local regulatory authorities cannot be allowed to prescribe different techniques if the objective of a harmonized regulatory framework, including tools and methods, shall be achieved.
- *Ensuring efficient supervision of insurance groups and financial conglomerates* – That the same techniques and tools are used by all the regulatory authorities is a requirement for performing the exercise of group supervision via a 'lead regulator' effectively.

12A. SCR standard formula – underwriting risk (other than catastrophe risk) arising from non-life insurance obligations

Question 24: …the objectives of:
- introducing risk-sensitive harmonised solvency standards;
- introducing proportionate requirements for small undertakings; and
- harmonising supervisory powers, methods and tools.

SE: Sweden supports the suggested approach, Option 2 followed with an adjustment factor as in QIS5. A pre-defined shock, i.e. a scenario based method, might better reflect the risk situation of the undertaking but is close to an internal model and probably difficult to apply.

Question 25: …the objectives of:
- introducing risk-sensitive harmonised solvency standards;
- introducing proportionate requirements for small undertakings; and
- harmonising supervisory powers, methods and tools.

SE: The scenario model is more risk sensitive, and we support it.

12B. SCR standard formula – underwriting risk (other than catastrophe risk) arising from life insurance obligations

Question 26: …the objectives of:
- introducing risk-sensitive harmonised solvency standards;
- introducing proportionate requirements for small undertakings; and
- harmonising supervisory powers, methods and tools.

SE: The scenario model is more risk sensitive, and we support it.

13. SCR internal models – use test

Question 27: …the objectives of:
- introducing risk-sensitive harmonised solvency standards; and
- harmonising supervisory powers, methods and tools.

SE supports the Commission's proposal for a definition of the use test - to require the internal model to be used on all organizational levels of an undertaking or an insurance group. A high degree of coordination and sharing of experience between regulators is needed to ensure that the use test requirements are harmonized.

A single list of processes/areas to cover in the use test for all supervised entities would require the undertakings to follow a common organizational structure, something that is not in line with the directive.

14. SCR internal models – statistical quality standards

Question 28: …the objectives of:
- introducing risk-sensitive harmonised solvency standards; and
- harmonising supervisory powers, methods and tools.

SE supports the Commission's proposal to require an undertaking's use of expert judgement and data sources to be described in a data policy. Common European principles of supervision for the contents of such data policies should be developed.

Fulfilment of Commission's objectives:

- *Introducing risk-sensitive harmonised solvency standards* – Not obvious that harmonized standards for risk-sensitive measurement and control are a consequence of the choice of option 2, rather a consequence of the requirements for data quality and internal control. None of the other options would be a better choice to meet this objective.
- *Harmonising supervisory powers, methods and tools* – Common principles of supervision for the contents of such data policies should be developed. Otherwise, there is no guarantee that a harmonized supervision is achieved.

15. Capital add-ons

Question 29: …the objectives of:

- introducing risk-sensitive harmonised solvency standards;
- harmonising supervisory powers, methods and tools; and
- introducing proportionate requirements for small undertakings.

SE: We understand that there is a need to assure that the capital-add on is not used very differently by supervisors. We therefore suggest that the setting of an add-on follow a due process and that decisions to use add-ons is monitored by EIOPA.

We are of the opinion that a deviation should be rather obvious (significant) and are hesitant to the percentages suggested in terms of deviations from the standard formula SCR. The reason for this is that the SCR standard formula is in itself quite robust and is per definition not aligned to the individual undertakings risk profile.

For internal models the case is somewhat different. An approved IM should in principle be aligned with the risk profile of the undertaking. Furthermore the approval of an IM requires a process for keeping the model up to date with the risk profile.

Question 30: Should supervisors be able to exercise judgment, according to pre-defined criteria, in relation to each of the following:

1) in the case of risk-profile capital add-ons, significant deviations from the SCR that are below 15%

SE: The threshold as suggested here is not a relevant tool as we are of the opinion that a deviation should be rather obvious (significant) and are hesitant to the percentages suggested by EU COM. The reason for this is that the SCR SF is in itself quite robust and per definition not aligned to the individual undertakings risk profile. Hence, there is a risk that supervisors can easily find deviations and then would the capital add-on measure not be very exceptional and this would not be in line with the level 1 text.

2) for the purposes of determining when a governance capital add-on may be applied, the timeframe to be regarded as an appropriate for having allowed other remedial measures to have been exhausted, subject to a maximum period of 6 months
3) the methodology used to determine the capital add-on.

SE: Enough harmonisation for the methodology and timeframes could and should be achieved through level 3.

16. Actuarial function

Question 31: …the objectives of:
- introducing proportionate requirements for small undertakings;
- harmonising supervisory powers, methods and tools;
- promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA; and
- ensuring efficient supervision of insurance groups and financial conglomerates.

SE: Technical guidelines would serve as an important tool for setting a minimum standard for the quality of the work performed by the actuarial function. However the standards should take into account the proportionality principle and be non-binding as undertakings should be free to develop and justify their own standards.

Question 32: Do you agree that requiring EIOPA to adopt (non-binding) guidelines at Level 3 would be the most appropriate solution in terms of practicability and level-playing-field considerations? (Please provide reasons)

SE: Yes, see answer to question 31.

Question 33: Should actuarial guidelines solely relate to technical issues or should they be extended to include professional and ethical guidelines? (Please provide reasons)

SE: Actuarial guidelines should not include professional and ethical guidelines. Professional and ethical requirements (e. g. "fit and proper") already follows from other texts in the directive. We find no reasons to develop further guidelines on top of these texts particularly for the actuarial function.

17. Supervisory co-operation and co-ordination

Question 34: …the objectives of:
- harmonising supervisory powers, methods and tools;
- promoting compatibility of prudential supervision of insurance and banking;
- promoting compatibility of the prudential regime for EU insurers with the work of the IAIS and IAA; and
- ensuring efficient supervision of insurance groups and financial conglomerates.

SE: We agree with option 2 on the participation of branch supervisors in colleges, only indicative threshold should be set on level 2. Option 1 is not recommendable as binding thresholds would not take into account trends, emerging risks or particular products on national markets provided through branches.

As a minimum frequency of college meeting is already established on level 1 there is no need for that on level 2. What is important is to have the optimal number of meetings for the college in order to ensure efficient supervision of the insurance group. In some cases this means no physical meeting but telcos and in other cases there will be a very obvious need for 2-4 physical meetings per year. Option 2 would be more appropriate.

Question 35: Do you share the view that provisions on colleges should not be set in level 2 implementing measures? (Please provide reasons for your response and, where relevant, suggestions on the provisions which you think should be included at level 2).

SE: No new additional provisions need be set on level 2.

Question 36: What are your views on the need for supervisors in the college to systematically exchange information? What information would be the most efficient and useful to be exchanged taking into account the potential burden for supervisors?

SE: This depends on the risk profile and the risk assessment for each group but there will be a need for systemically exchange .f information. The information available in the supervisory reporting package should be used as a basis.

3. Impact on Insurance markets and products

1. Impacts on products

Question 37: Do you anticipate that the Commission Services' suggested approach for level 2 implementing measures would result in an increase or decrease in insurance prices? (Please provide details of the types of product or groups of policy holders affected, the magnitude of the increase or decrease expected and whether the change results from change in the value of technical provisions or capital requirements)

SE: In general we agree with the Deloitte Study conclusions for impact on markets and products. Below we high-light some observations.

For unit-linked long term savings business there is already quite heavy competition on pricing in Sweden. Otherwise this would be an area where one could expect to see a Solvency 2 impact. However the final interpretation of ‘contract boundaries’ will have an effect, we will se whether the impact would be increased or decreased insurance prices. If the definition of contract boundaries turns out to be too narrow, it will be impossible for undertakings to offer unit-linked insurance savings on the market, since the SCR is based on a stress on an MCEV-type measurement, while the own funds only contain parts of that underlying capital. Especially, it will be impossible to start new unit-linked type business, due to own funds’ constraints.

Question 38: Would the Commission Services' suggested approach for level 2 implementing measures result in a reduction of cross-subsidisation between different lines of business or groups of policy holders? (Please provide details of which lines of business or groups of policy holders will be most affected and the reasons for this)

Question 39: Would the Commission Services' suggested approach for level 2 implementing measures stimulate product innovation? (Please provide examples of the type of product innovation that is expected and details of the lines of business that this product innovation will relate to)

SE: We agree with the Deloitte Study conclusions, depending on the calibration of the SCR there will be a drive in product development towards less risk-carrying products, especially

for life and long term savings products with guarantees. This will lead to more or less transfer of longevity risk and financial risk to policyholders/consumers.

Clearly a life-long pension benefits an individual. If expensive to buy (which may be the absolutely right pricing due to risk contents and capital requirements) fewer individuals will afford to buy the product in the future, and this may influence selection in the insured portfolio regarding longevity.

There would also be impacts for different types of guarantees or product lines with a large content of collectively financed risks. If insurance risks and financial risks are smoothed over time and over a bigger insured portfolio, this can be beneficial for the individual policyholders. Therefore it is important that the Solvency 2 calibration takes this into account.

Question 40: Would the Commission Services' suggested approach for level 2 implementing measures result in a withdrawal of certain products from the market? (Please provide reasons and examples of products that may be withdrawn)

SE: Due to quite protracted low interest rates, long term yield guarantees has been reduced for new products. Recently, some companies tried to persuade customers to voluntarily move from products where returns are guaranteed to products in which no guarantee exist or is severely curtailed. Customers upside – according to undertakings – is that the undertaking can invest much more freely without the guarantees and thereby achieve a higher return on investment than the guarantee would provide over time. The capital requirements in Solvency 2 may cause the supply of such traditional savings products with guarantees to be further reduced/limited.

One example in the Swedish market where a product might be withdrawn from the market is the collectively agreed ‘occupational group-life’ – a group-life solution where all employed are insured, regardless of age, health conditions etc. If an individual dies, a lump sum is paid to his/her family. If the employer had not paid the premiums still the lump-sum is paid and the ex-gratia costs are shared by the insurers according to a co-insuring agreement. This is clearly beneficial for the public – individuals are protected. Of course this type of set-up could still exist on a Solvency 2-regulated market, but it is not obvious how to mirror the risks in this product in the standard model. If an internal model is necessary, the product’s impact on SCR would be far too expensive for the undertakings and the product would be faced out.

When discussing product design and risk-carrying, one should consider the risks connected to adverse selection and for products only attracting few customers and therefore making undertakings suffer from the risk of not obtaining a critical mass. This may be highly relevant for new businesses and companies under start-up.

2. Impacts on markets

Question 41: Would the Commission Services' suggested approach for level 2 implementing measures promote particular types of insurance business model (e.g. specialisation vs. diversification, joint-stock companies vs. mutuals, branches vs. subsidiaries, groups vs. single legal entities)? (Please provide reasons and examples)
Question 42: Would the Commission Services' suggested approach for level 2 implementing measures affect competition across undertakings in the EU and/or the functioning of the internal market? (Please provide reasons and examples)

Question 43: What would the impact be of the Commission Services' suggested approach for level 2 implementing measures on small or medium-size enterprises as buyers of insurance?
Question 44: What impacts would the Commission Services' suggested approach for level 2 implementing measures have on the captive market? (Please provide examples)

Answers to question 41-44:
SE: We see mergers and restructurings in front of us. We support the conclusions drawn by Deloitte on impacts on markets and the degree of the impact will in the end depend on the final calibration of Solvency 2.

Below is an expanded answer to question 41
Effect of the contract boundary definition on recurring single premiums
In Swedish life insurance it is quite common to sign occupational- and private pension insurance contracts with recurring single premiums instead of true regular premiums. The recurring single premiums are for occupational pension contracts quite stable concerning charge levels and predictability in payments. In order to make a change of charges or to terminate the contract for occupational pensions with recurring single premiums there always has to be a negotiation with the policyholder and the labour union.

For recurring single premium contracts, the charge levels for future premiums are not formally set (or restricted) by the insurance contract or legislation and can then according to the suggested level 2 definition of the contract boundaries not be included in the best estimate calculation. However, the majority of the costs (acquisition and administrative) occur close to the first premium. Since the majority of the costs occur in the beginning of the contract and no future charges are taken into account, setting up new contracts of this type leads to an extremely severe solvency 2 balance-sheet situation.

In our opinion, should at the very least, Occupational pensions and Insurance Contracts with recurring single premium be treated as true regular premiums for the period in which there is an agreement under the Collective agreement between the employers and employees.
(It is not decided yet whether occupational pensions in Sweden will be regulated under the Solvency 2 directive or the IORP directive. Until this is decided we assume that Solvency 2 will apply to occupational pensions contracts.)

4. Social and economic impacts

Question 46: What social, environmental or economic knock-on effects could occur as a result of changes to the design, pricing and availability of insurance products? (Please provide examples)

SE: One cannot deem the Solvency 2 regulation to be neither only beneficial nor only bad for society, for undertakings or for policyholders, there are aspects of both good and bad for all stakeholders.

Question 47: Would the Commission Services' suggested approach for level 2 implementing measures27 make it easier or more difficult to obtain insurance for certain risks or groups of policy holders, and will there be a transfer of risk from insurers to consumers.

SE: See the reasoning in response to question 40.

Question 48: Would the Commission Services' suggested approach for level 2 implementing measures have significant consequences for the financial situation of individuals/ households, both immediately and in the long run? (Please provide examples)

SE: No specific opinion, see also previous answers.

Question 49: What is the impact on the social inclusion and protection of particular groups? (Please provide examples of the specific groups of individuals affected (e.g. firms, localities, the most vulnerable, the most at risk of poverty, the elderly)

SE: See answers to questions 40.

Question 50: Would the Commission Services' suggested approach for level 2 implementing measures affect some categories of consumers more than others (e.g. elderly people vs. younger people; low income consumers vs. high income; people collectively insured vs. people individually insured)?

SE: See answers to questions 40. In this area maybe some time also should be spent upon comparing the impacts of Solvency 2 with the principles stated in the Council Directive 2004/113/EC of 13 December 2004 implementing the principle of equal treatment between women and men in the access to and supply of goods and services, and the way the different states have implemented that directive.

1B: Social impacts - health

Question 51: What is the impact on the access to, and effects on, social protection and health systems?

Question 52: Would the Commission Services' suggested approach for level 2 implementing measures impact more heavily specific types of health insurance products (e.g. disability insurance, long term care insurance)?

Question 53: Would the Commission Services' suggested approach for level 2 implementing measures have significant effects in certain Member State and/or regions due to the specific role played by the private insurance in those Member States /regions (e.g. primary and complementary health insurance)?

SE: Answer to question 51-53

In principle we agree with the impacts and conclusions as described in the external Study by Deloitte for the Impact Assessment of Solvency 2 (level 2). In our opinion the effects are logically stronger with the QIS 5 calibration than QIS 4 which should be taken into account for the final calibration.

1C: Economic impacts

Question 54: What is the impact on specific economic sectors (both financial and non-financial)?

Question 55: Would the Commission Services' suggested approach for level 2 implementing measures impact the investment policy of insurers? (Please provide reasons and examples)

Question 56: Does it contribute to improving the conditions for investment and for the proper functioning of capital markets? (Please provide reasons and examples)

Question 57: Would the Commission Services' suggested approach for level 2 implementing measures contribute to financial stability? (Please provide reasons and examples)

Answer to question 54–57

SE: We thoroughly analyse the impacts of Solvency II and the level 2 implementing measures have on the financial and non-financial sectors in Sweden. This as the Swedish insurance sector is important for the functioning of the financial and capital markets. For that reason, it is also important to analyse if the level 2 implementing measures affect the financial stability.

These are the major issues we focus on when we do our analyses of the proposed level 2 implementing measures regarding this questions:

- If the proposed level 2 implementing measures have an impact of the undertakings investment policy that lead to a change in their holdings of and demand for different financial assets: For example, the markets for covered bonds by Swedish mortgage institutions and bonds issued by Swedish banks are of great of importance for the financial stability in Sweden. Currently, Swedish undertakings hold around 25 % of these covered bonds and 10 % of other bonds issued by banks. If Solvency 2 results in the Swedish undertakings drastically reducing their holding of these bonds, it can have a large impact on the functioning of these markets as well as on the financial stability. Also the effects on portfolio allocations regarding equity and corporate bonds are of interest, as they provide important funding sources for Swedish non-financial corporations.
- If the proposed level 2 implementing measures imply pro-cyclical behavior of the undertakings: On one hand, in Solvency 2 there are proposals, e.g., the Pillar 1 and Pillar 2 dampener, which will reduce this kind of behavior. On the other hand, as discussed in our answer to question 19 about the Pillar 1 dampener, some of the current proposed methods could instead amplify the pro-cyclical behavior of the insurance sector.
- If the proposed level 2 implementing measures cause undertakings to transfer risks to other financial intuitions, e.g., banks and hedge funds, by issuing, for example, catastrophic bonds and longevity swaps, then the insurance sector will be more systematically important as it will be more integrated with the rest of the financial sector. Increased usage of derivatives to efficiently manage risk could also be an effect
- If the proposed level 2 implementing measures will lead to arbitrage: On this issue, we also have concerns that the credit risk and credit rating for some sovereign bonds is not taken in consideration, i.e. independent of their risk/rating they are considered to be risk-free and, thereby, have a spread risk of 0 % when the solvency capital requirement is calculated. This might lead undertakings to invest in sovereign bonds with a high credit risk and a low credit rating, as these bonds will offer higher yields.

Other issues:

Governance

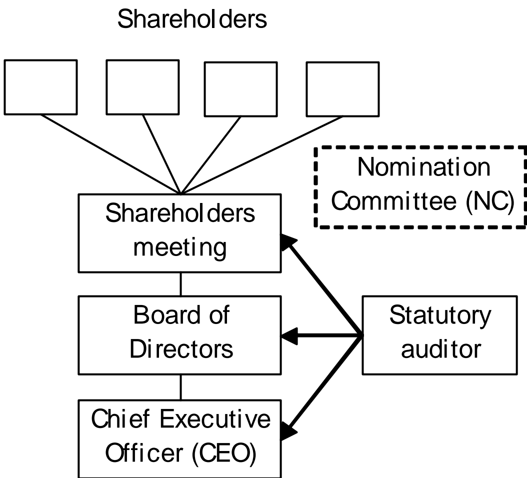
There are different systems of corporate governance in Europe. The Swedish corporate governance system offers a third alternative to the so-called one-tier system and the two-tier system although it is more like the one-tier system. See below for the illustration of the Swedish governance model.

Given the specific feature of the Swedish governance structure, we see a need to clarify the text under the governance section in order to make the implementation of the governance provisions smoothly and workable at the national level for different governance systems. In particular, the text should be clear so that it is not obligatory for the key functions to operate under the oversight of the board in the Swedish governance model. That is hardly workable because the board in the Swedish governance model is a rather small body consisting of around 15 members.

Swedish corporate governance model

The Swedish model, for instance, is distinct from both the one-tier Anglo-American model and the two-tier Continental European governance model. It is characterised by the three mandatory decision-making bodies (in hierarchical order the shareholders meeting, board of directors and the CEO) and a controlling body (the statutory auditor) appointed by the shareholders meeting. The board of directors has a unitary structure and is made up predominantly by non-executive directors. Furthermore, in accordance with the Swedish Banking and Financing Business Act the role of the chairman and the CEO cannot be combined, separating the roles and responsibilities of the two.

Figure 1: The Swedish Governance Model



In the listed Swedish companies, the shareholders' decisions on election of the board of directors (as well as the remuneration) are prepared by a specific nomination committee (NC), with at least three members. In line with the Swedish Code of Corporate Governance, a majority of the members should be independent of the institution in question and at least one of the members should be independent with regard to the largest owner. The NC (appointed by the shareholders) plays a central role in the Swedish model and is tasked with specifying the duties and profile of the directors (including the chairman) in accordance with the

company’s operations, articles of association and the shareholders’ interests. Another distinct feature of the Swedish governance model is the strong shareholder power through the annual shareholders’ meeting where shareholders have the right to place any item (within the decision competence) on the agenda. The corporate governance system in Sweden consists of both statutory provisions and Swedish Code of Corporate Governance with generally accepted practices. The system is considered to be well functioning with a strong component of self regulation, based on strong shareholder power.

Appendix to question 19.

Here follows a discussion about the proposed formula for the symmetric adjustment, i.e. Pillar 1 dampener, and some suggestions on how to reduce these problems:

The formula proposed how the symmetric adjustment term shall be calculated is the formula presented in the QIS 5 Technical specifications and CEIOPS calibration paper. That is, the adjustment term for day t, X_t, shall be calculated as

$$X_t = \frac{I_t - \frac{1}{n}\sum_{s=t-1}^{t-n} I_s}{\frac{1}{n}\sum_{s=t-1}^{t-n} I_s} \qquad (1)$$

where the adjusted capital stress, X_t, is subject to a band of ±10% either side of the standard capital stress. Further, when calculating the adjustment term, I_t is the value of the MSCI Developed index (USD) at time t. It shall be noted that CEIOPS in their calibration paper, propose other ways to calculate this term. However, as this is the way it is calculated in QIS5 technical specification, the following discussion will refer to this formula. Also note that the Commission Service propose that n = 36 months (= 780 days of trading).

The first problem with the proposed way to calculate the symmetric adjustment is that when longer time periods are chosen, this measure is most of the time either +10 % or –10 %. For example, when evaluating 36 months from January 1, 2000 up until December 7, 2010, more than 75 percent of the time the adjustment term is those values (+10 % or –10 %).[1] By using a somewhat shorter time period, for example a year, then this has fallen to around 40 %. But on the other hand, the adjustment term is only constant and unchanged around 35 % of the days when the time period is one year, in comparison to above 75 % when the time period is 36 months.

Our suggestion to reduce this problem is to have shorter time periods, to get a little more variability between the values, i.e., not only +10 % or –10 %. However, we support that the Pillar 1 dampener and symmetric adjustment mechanism is constructed in such way so that the volatility of it is reduced. One way to reduce the variability that arises when using shorter time periods is to decide that the symmetric adjustment can only be some specified values, for example -10 %, - 7,5 %, - 5 % etc (this is done, by, for example, still use formula (1,) but rounding off to the closest specified value). By using a shorter time period and that the equity dampener can only be certain values, we think that the Pillar 1 dampener will better fulfill its objectives, which is to avoid unintended pro-cyclical effects and at the same time undertakings not having to adjust their risk profile frequently solely as a result of movements in the equity capital charge.

The second issue (problem) originate from that the same index is chosen for all undertakings, i.e., MSCI Developed index (USD). Thereby, the holdings of the different undertakings are not at all considered. For example, if an undertaking just holds national equities and that stock market has a low correlation with the specified index, then the solvency capital charge for equities can increase without the price/value have gone up for the undertaking's equities. And

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[1] 43 % of the evaluated period the symmetric adjustment term is + 10 % and 34 %of the period it is – 10 %.

due to the way the symmetric adjustment is calculated there could be very drastic increases. For example, for the period 1 January 2000 – 7 December 2010 the symmetric adjustment increased by around 5 percentage points in a day and above 12 percentage points over 10 days, independent of the used time period (n). Thus, the capital charge for equities has from one day to next or during a fortnight increased with 5 and 12 percentage points, respectively. That corresponds to a change in the capital charge for equities by around 15 % and 40 %, respectively. This drastic increase in the capital charge, which could happen without an increase in the value of the undertaking's equities, could mean that the equity charge rise in the middle of a crisis for the undertaking. And as this drastic increase happens so quickly, it will not allow sufficient time for undertakings to rebalance their profile in a stressed scenario. This in turn can lead to that the undertaking has to conduct fire sales of their holdings and, thus, pro-cyclical behavior of the undertakings that can have major impact on the financial markets and the financial stability.

Due to the fact that the solvency capital charge for currency and that it is hard to hedge against the exposure to currency risk, Solvency II might lead to that the undertakings invest more in equities in the same currency as the undertaking. For that reason we propose that the adjustment term should be calculated for more indices than the MSCI Developed index (USD). Which indices that the undertaking should use when calculating the symmetric adjustment term should depend on their holdings. So that means that an undertaking if investing in stocks/equities in different currencies has to use different indices to calculate the symmetric adjustment term. And as many different indices will be used, the time period used for calculating the pillar 1 dampener have to be evaluated for all different indices. Of course, this will make the calculations of this dampener a little bit more complex, but the alternative, i.e., to use only one index for all undertakings, is in our view not an option.

The third problem is that even though the undertaking holds equities that exactly follow (replicate) MSCI Developed index, an increase in the index will at certain levels of adjustment term actually lower the solvency ratio (own funds / SCR). For example, when the adjustment is around 0 %, then the adjustment term will change from one day (t) to the next (t+1) by $(I_{t+1} – I_t)/ I_t$ percentage points. Thus, if adjustment term for day t X_t = 0 %, then for the next day, $X_{t+1} = (I_{t+1} – I_t)/ I_t$ (see below for an explanation).

Here follows an example of why this is a problem. For simplification, we assume an undertaking, which assets constitute of 50 units of equities and 50 units of government bonds. The technical provision is 70 units and the SCR only depends on the risk for the equities, i.e., SCR = 50 * 0.39 = 19.5 units when the adjustment term, X_t, is zero (here it is assumed that all equities fulfill the requirement for Global equities and no currency risk). This means that the undertaking has 10.5 units of own funds in excess of SCR or a solvency ratio of 30/19.5 = 154 %. Then we assume that the index goes up by 10 % (= $(I_{t+1} – I_t)/ I_t$), thus the undertaking after this increase has 55 units of equities (everything else is unchanged). At the same time the capital charge has increased by 10 percentage points, i.e., the capital charge is 49 % (this follows from that $X_{t+1} = (I_{t+1} – I_t)/ I_t$ when X_t=0%). This means that SCR is now 55 * 0.49 =26.95 units. Thus, the own funds excess over SCR has decreased to 8 units and the solvency ratio to 130 %. Of course, this is somewhat simplified example, but it stills shows that something is fundamentally wrong with the proposed way to calculate the pillar 1 dampener, i.e., with formula (1).

The problem here steams from the fact that the proposed equity charge is too sensitive. To get rid of this problem a lot of different alterations of the formula can be used, for example by

using some kind of moving average (e.g., take the average of the last ten days of the adjustment term as calculated in (1)) or divide the value in (1) with a value of 2 or above (which is much higher than the beta proposed in CEIOPS calibration paper). And by using a moving average or divide by a figure above 2 some of the other problems listed above will also be reduced.

Here follows a short explanation of why the dampener (adjustment term) sometimes increases by the return on the index.

If the adjustment term, X_t, is zero then

$$0 = \frac{I_t - \frac{1}{n}\sum_{s=t-1}^{t-n} I_s}{\frac{1}{n}\sum_{s=t-1}^{t-n} I_s} \Rightarrow I_t = \frac{1}{n}\sum_{s=t-1}^{t-n} I_s$$

That means that the adjustment term the next day, X_{t+1}, must be

$$X_{t+1} = \frac{I_{t+1} - \frac{1}{n}\sum_{s=t-1}^{t-n} I_s}{\frac{1}{n}\sum_{s=t-1}^{t-n} I_s} \approx \frac{I_{t+1} - I_t}{I_t}$$

The reason why it is approximately equal (≈) is that one day has been excluded and a new day included when we go from t to t+1 in $\sum_{s=t-1}^{t-n} I_s$. But if the adjustment term is calculated using a long time period, then it is just a very small change. So that is why the adjustment term for day t+1 is $(I_{t+1} - I_t)/ I_t$, when the adjustment term is 0 % on day t. It shall also be pointed out that there other ways to show this and that it is not necessary that the adjustment term is exactly 0 % on day t to have this effect/outcome.