MINISTRY OF ECONOMIC AND BUSINESS AFFAIRS
DENMARK

European Commission
DG Internal Market and Services
Insurance and Pensions Unit
Rue de Spa 2
B-1049 Brussels
Belgium

MINISTER FOR ECONOMIC
AND BUSINESS AFFAIRS

26 JAN. 2011

MINISTRY OF ECONOMIC
AND BUSINESS AFFAIRS
Slotsholmsgade 10-12
DK-1216 Copenhagen K

Tel. +45 33 92 33 50
Fax +45 33 12 37 78
CVR no. 10 09 24 85
oem@oem.dk
www.oem.dk

Consultation on the Level 2 implementing measures for Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)

To the European Commission

The Danish government welcomes the initiative of the European Commission to ensure more risk sensitive capital requirements for the European insurance sector. Further, the Danish government appreciates the European Commission's focus on governance and the introduction of the Own Risk and Solvency Assessment.

The Danish government would, however, urge the European Commission to await agreement on the Omnibus II-directive and the outcome of the QIS 5 impact assessment to make sure that the implementing measures reflect the state of play in the insurance sector. Further, the experience from the financial crisis should be adequately reflected in the Solvency II implementing measures.

It is essential that the capital requirements capture the actual risks involved. It is important to strike a balance which ensures that low risk products are not punished by unduly burdensome capital requirements and similarly that very risky products are subject to high capital requirements. Specifically, the empirically documented low risk of Danish mortgage bonds should be reflected in the capital requirements in relation to these types of assets.

In line with the European Commission's approach to financial conglomerates, the Danish government finds that there should be consistency between banking and insurance regulation to the extent feasible.

The Danish government is very supportive of the new European Supervisory structure, including the establishment of EIOPA. However, regarding Solvency II, the Danish government finds that it is important to strike a balance between the level of statistical modeling and the level of direct decision making of EIOPA on the capital requirements.

Europaudvalget 2007
KOM (2007) 0361 Bilag 3
Offentligt

Below, the Danish government would like to comment on three of the issues in the draft Solvency II measures which are of particular importance to the Danish financial system. The comments are supplementary to the ongoing discussions in the EU in which Denmark is actively involved.

The Danish mortgage-credit system

The Danish mortgage-credit system is of major significance to the entire Danish financial sector and thus also to financial stability in Denmark. From an investor's point of view mortgage-credit bonds are very secure products. The yield spread between government bonds and mortgage-credit bonds is very limited as the real property pledged as collateral gives mortgage-credit bonds a very high degree of security. Bond investors have priority in the event of failure and borrowers are personally liable for the loans.

Denmark has documented the low risk of the Danish mortgage-credit system during the preparatory phase on the Solvency II implementing measures.

The mortgage-credit bond holdings of insurance companies are low risk assets which should be treated accordingly under the Solvency II regime.

The Danish government therefore welcomes the specific treatment attached to covered bonds regarding the concentration risk and spread risk capital requirements. For the Danish mortgage system, it is essential that these requirements are not stricter than in the draft implementing measures.

The Danish government would like to comment on the treatment of AA rated covered bonds, though. In the draft implementing measures, no special treatment for AA rated covered bonds is available in the spread risk module. Recent analysis by the European Covered Bond Council shows that AA rated covered bonds should also be subject to a special treatment in the spread risk sub module. Since this analysis is in line with previous Danish studies the Danish government finds that the implementing measures should be adjusted accordingly. This would ensure that that the capital requirement for Danish mortgage-credit bonds is calibrated in a manner that better reflects the real risk of these investments.

Longevity risk

To ensure adequate capital requirements regarding the life insurance undertakings' unforeseen changes in longevity (mortality), a stress test should be applied.

For life insurance companies the draft implementing measures thus contain the requirement to stress test the longevity risk by applying a shock of a (permanent) 20 per cent decrease in mortality rates for each age and each policy where the payment of benefits (either lump sum or multiple

payments) is contingent on longevity risk. The background for this shock seems to be an analysis based on 5-8 years mortality improvements.

The Danish regime is based on the fact that the best estimate should include an estimated improvement in longevity, and that undertakings perform ongoing review of the best estimate.

The Danish government finds that the shock of 20 per cent in the draft implementing measures is overestimating the risk of unforeseen changes in mortality given the current Danish regime. The Danish government is aware that practices in member states might vary in this respect, i.e. how often the estimations are reviewed. However, when requiring an ongoing review, the shock should be set at a lower level.

During the preparatory phase of the implementing measures, Denmark has presented documentation that a shock of 10-15 per cent would correspond to a 99.5 per cent confidence level on a 1 year horizon which is in line with the confidence level in Solvency II. The analysis is based on expected mortality changes incorporated in the best estimate, i.e. this lower shock level is statistically valid and could be applied.

The Danish government would urge the European Commission to reconsider the structure of the longevity risk module in order to take into account different regimes. This could e.g. be done by introducing a possibility to use undertaking specific parameters (USP). The USP should be approved and supervised by the national supervisory authorities and the implication on the level of technical provisions and level of capital should be comparable to the level which could be estimated by assuming 5-8 yearly updates.

The interest rate curve

An essential component in the calculation of technical provisions is the relevant risk-free interest rate term structure applied to discount the future cash flows. The general definition of the relevant risk-free interest rate term structure is part of the Solvency II implementing measures.

The Danish government supports flexibility in the choice of the relevant risk-free interest rate term structure. The Danish government would like to stress that the choice of relevant risk-free interest rate term structure should be based on undertakings' ability to perform effective asset- and liability management (ALM).

The Danish government supports the inclusion of an illiquidity premium - a premium which is generally zero but which is to be applied when market situations with increased illiquidity occurs - based on observable market data as opposed to a method where the application of an illiquidity premium is to be determined at the discretion of EIOPA. The latter approach would not allow undertakings to perform effective ALM.

Concluding remarks
The Danish government welcomes the initiative of the European Commission to ensure more risk sensitive capital adequacy standards for the European insurance sector and would like again to express its support for the Solvency II approach.

Above, the Danish government has commented on three of the issues in the draft Solvency II measures which are of particular importance to the Danish financial system and which we are looking forward to engage in further dialogue with the European Commission to resolve in the near future.

Yours sincerely

Brian Mikkelsen