insurance europe

Press press release

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Insurance Europe raises concerns over misunderstanding of UFR

Any changes to UFR should wait until Solvency II review

There seems to be a misunderstanding over how Solvency II liabilities are currently calculated, including the discount rates, according to Insurance Europe, the European insurance and reinsurance federation.

Some observers appear to believe that the Ultimate Forward Rate (UFR) is the discount rate. However, the UFR is, in reality, an input needed to generate interest rate curves which go out to 130 years. The actual discount rates used to value liabilities for Solvency II are, in fact, far lower than the UFR of 4.2%.

For example, the rates that EIOPA published for curves in March 2016 were 0.46% for a 10 year liability, and still only 2.81% for 60 year liabilities. This means that these risk-free rates are already very low and, even though investment returns are also currently relatively low, they are still higher than these rates. Therefore, Solvency II already has a level of conservativeness built into it.

Olav Jones, deputy director general at Insurance Europe, commented: "Companies also have to hold extra assets within their provisions to cover other elements of Solvency II, which are not actually needed to pay claims; such as the risk margin. This is all, of course, in addition to the solvency capital which ensures insurers can cope with a very wide range of extreme adverse events, including significantly lower interest rates."

The Solvency II Delegated Acts require the UFR to be stable over time and say it should only be adjusted due to changes in long-term expectations. This is because changes to the UFR can have a very significant impact, such as creating artificial volatility in insurers' balance sheets, bringing uncertainty and negating the stated purpose of the UFR to provide stability for long-term liability valuations.

In response to the publication of the European Insurance and Occupational Pensions Authority's (EIOPA) consultation on the UFR, the federation said that stability is essential and that the UFR should continue to be aligned with the outcome of the Long-term Guarantee Assessment and Omnibus II, as already agreed by co-legislators.

While low interest rates are creating real challenges for the industry, companies have been taking action — in some cases, for many years — to adapt their products, investment mix, hedges and capital levels. Solvency II makes this a requirement for all companies, creating the need for multiple layers of buffers and protection, as well as introducing very detailed monitoring to allow supervisors to ensure the necessary actions are being taken.

Jones added: "With this in mind, Insurance Europe finds the focus on the UFR somewhat out of context and any short-term changes to be inappropriate. Given the large amount of work involved in Solvency II and additional pressure from low interest rates, insurers should be able to focus on implementation and adapting their business models without unnecessary uncertainty in key underlying parameters used in the valuation."

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Notes for editors

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2. You can also receive updates from Insurance Europe, sign-up here or by following us on Twitter @InsuranceEurope.
3. Insurance Europe is the European insurance and reinsurance federation. Through its 34 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of almost €1 170bn, employ over one million people and invest nearly €9 900bn in the economy.