association of the
luxembourg fund industry

Luxembourg, 05 January 2018

Comments to *EIOPA's second set of Advice to the European Commission on specific items in the Solvency II Delegated Regulation*

Introduction

The Association of the Luxembourg Fund Industry (ALFI) is the representative body of the Luxembourg investment fund community. Created in 1988, the Association today represents over 1,400 Luxembourg domiciled investment funds, asset management companies and a wide range of service providers such as depositary banks, fund administrators, transfer agents, distributors, legal firms, consultants, tax experts, auditors and accountants, specialist IT providers and communication companies. The Luxembourg Fund Industry is the largest fund domicile in Europe and a worldwide leader in cross-border distribution of funds. Luxembourg-domiciled investment structures are distributed in more than 70 countries around the world.

Comments in response to the second set of advice

ALFI would like to take this opportunity to provide high level comments on the second set of advice on specific items in the Solvency II Delegated Regulation, focusing in particular on the Risk Margin and its impact on the insurance world and thereby the impact on the asset management world. ALFI has undertaken substantial work with the investment fund community to prepare for the implementation of the Solvency II Directive on 1 January 2016, among others by contributing to and raising awareness to initiatives such as the Tripartite Solvency II Reporting Template (TPT) for asset managers. ALFI has continued with great interest to closely follow the developments as regards the Solvency delegated acts and more recently the Solvency II review.

As the European Commission outlined earlier in 2017, alongside the Capital Markets Union mid-term review, it unveiled measures to encourage long-term investment through a review of prudential calibration for investments in infrastructure corporates. The European Commission proposed reducing the amount of capital that insurance companies need to hold when they invest in infrastructure corporates, as it had previously done for Qualifying Infrastructure Investments and ELTIF. These targeted changes to the Solvency II Delegated Regulation were further intended to support long term investment and investment in infrastructure.

Strengthening the flow of private capital to growing businesses, infrastructure investment, energy transition and other projects to underpin sustainable growth are at the heart of what the European Commission seeks to achieve. It is precisely by removing obstacles that one will create better investment opportunities for pension funds and institutional and retail investors saving for the long-term.

Insurance companies, being natural long term investors, with the support of the asset management industry, play a central role in channelling the flow of capital into European infrastructure investments and various other projects that underpin sustainable growth. Through the Capital Markets Union, the European Commission has recognised the constraints that Solvency II has placed on insurers and the

Association of the
Luxembourg Fund Industry
a.s.b.l.

12, rue Erasme
L-1468 Luxembourg
B.P. 206
L - 2012 Luxembourg

Tel: +352 22 30 26 - 1
Fax: +352 22 30 93
info@alfi.lu
www.alfi.lu

TVA LU 23710105
R.C.S. F4428

industry has welcomed the lowering risk charges for eligible infrastructure projects and for infrastructure corporates. These amendments have been welcome but do not obviate the need to continue to identify and address unnecessary constraints to financing under Solvency II.

In respect of **X. Unrated Debt**, ALFI would like to point to the high complexity of EIOPA’s proposal for modelling the credit rating of unrated debt through internal models and for enabling unlisted equities to receive the capital charge of listed equities. Complexity may arguably dry up long term investment flows to issuers, while not necessarily improving risk assessment of such asset classes. Within the spirit of recent initiatives, it is necessary to improve the treatment of unlisted companies, all the more when investments are achieved through investment funds, which in turn provide diversification.

In respect of the **XV. Simplification of the look-through approach**, ALFI welcomes the opportunity to exclude unit-linked funds from the 20% threshold established by Article 84(3) when they are invested on behalf of clients as far as the final risk is not supported by the insurer.

Finally, as regards **XVIII. Risk Margin**, ALFI believes that the approach taken in this review is a missed opportunity to thoroughly examine the risk margin and the extent to which it is undermining the investment potential of European insurers and thereby asset managers.

We would like to point out that the risk margin is highly sensitive to interest rates and it is arguable that its impact on insurers was not anticipated by policymakers when it was designed, prior to the low interest rate era. The risk margin is calculated by multiplying the net present value of future capital requirements by the rate of cost of capital. Since low interest rates will increase the net present value of future capital requirements, the overall risk margin calculation is disproportionately affected by interest rates. Long term business is most sensitive to the risk margin, causing it to be a key barrier to insurers fulfilling their role as long-term investors in the economy.

In Q3 of 2016 EIOPA estimated that the total risk margin in the EU amounted to €210bn. Having discussed this with the asset management community we were made to understand the unnecessary strain on insurers’ resources, which could otherwise be freed to channel investment into the European Union. Consequently, we believe that EIOPA should consider how to alleviate such constraints on investment in the European economy.