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Mr Gabriel Bernardino
Chair
European Insurance and
Occupational Pensions Authority
Westhafenplatz 1
60327 Frankfurt am Main
Germany

~~Dear Mr Bernardino,~~ Dear Gabriel,

The financial crisis has had a major impact on the capacity of European businesses and governments to finance investment and innovation projects. In the current economic environment, it is essential to put in place measures to stabilize the financial markets, in particular a regulatory environment that ensures effective, secure financial markets.

It is against this background that the European Council of June 2012 expressed its determination to stimulate smart, sustainable, inclusive, resource-efficient and job-creating growth, in the context of the Europe 2020 Strategy, and initiated Compact for Growth and Jobs. This action to be taken by the Member States and the European Union aims at relaunching growth, investment and employment as well as making Europe more competitive.

Investment in the drivers of growth, productivity and competitiveness generally requires finance over an extended time horizon, in particular to satisfy the on-going capital investment needs associated with them. This type of finance is generally referred to as 'long-term finance'.

The financial sector plays an essential role in providing and channelling this investment. Beyond providing short-term finance for businesses' day-to-day operations and other temporary money requirements, financial institutions, markets and instruments should provide also long-term finance, given their key role in intermediating between providers and end-users of capital; their ability to engage in liquidity and maturity transformation; and, their ability to manage complex risk profiles.

European insurers are a potentially powerful financing channel for long-term investment in growth- and job-enhancing areas: at the end of 2010 they had assets worth EUR 7,400 billion which is more than 50% of European GDP. However, regulatory capital requirements are one of the determinants as regards institutions' financing decisions of long-term physical investment even though they alone do not determine the investment behaviour of insurers. Nonetheless, investment incentives are influenced, to a substantial extent, also by the design and calibration of the regulatory capital requirements.

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While it is true that Solvency II had been conceived in very different economic circumstances from those we experienced in recent years, I assume that the Framework Directive adopted in 2009 is sufficiently flexible to allow insurers to adapt to the current state of the economy.

In that context, I would be grateful to EIOPA for examining whether the calibration and design of capital requirements for investments in certain assets under the envisaged Solvency II regime necessitates any adjustment or reduction under the current economic conditions, without jeopardising the prudential nature of the regime.

The analysis will be based on the non-public working document "draft implementing measures Solvency II" sent to you on 3 November 2011. This non-public document already reflects past CEIOPS advice and lessons drawn from the fifth Quantitative Impact Study (QIS5).

I am conscious that the capital requirement for an investment in a given asset depends on whether the insurer underwrites long term or short term insurance contracts. The matching between assets and liabilities is different in the two cases and the capital requirements are reflective of this fact (through a capital requirement for interest rate risk). This component of the capital requirements however remains frequently disregarded in the studies on Solvency II incentives, although it may have a significant impact. Thus I would be grateful if the analysis would give due regard to this component too.

Of course, the issue does not appear only in the area of insurance, but also in the area of other financial institutions, including pension funds, providing finance to aforementioned physical assets.

Furthermore, considering that insurers and banks may finance the same type of assets bearing the same risks, it is also important to gauge whether capital requirement rules under CRD-IV and Solvency II are consistent and are providing a competitive "level playing field", so as to forestall any hazardous regulatory arbitrage between the banking and the insurance sector. Because of the dynamics of the legislation making and the different external constraints, it would be very helpful if you could coordinate your efforts with both EBA and ESMA.

The scrutiny should focus mainly on 'long-term finance' and should include at least the following assets:

- infrastructure financing and other long-term financing through project bonds, other types of debt and equity;
- SME financing through debt and equity;
- socially responsible investments and social business financing through debt and equity;
- long-term financing of the real economy through securitisation of debt serving the above mentioned purposes.

There is no official definition of 'long-term investment'. The Commission will come forward later this year with a Green Paper on long-term finance in the EU that will elaborate on that definition. As a starting point, EIOPA should focus on finance over a time horizon that expands over the economic business cycle, such as 10 years.

It would be highly appreciated if your efforts in this exercise could be coordinated as much as possible, with EBA and/or ESMA. Considering the importance and the urgency both of the growth agenda and of the completion of the implementing measures, I would appreciate to receiving your feedback before 1 February 2013.

I would like to conclude by thanking you again for your active involvement in the development of Solvency II and more generally in supporting the EU in its policies. I copy my letter to the Chairs of EBA and ESMA.

Yours sincerely,

Jonathan Faull

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