

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

**Deadline
5 January 2018
23:59 CET**

Name of Company:	Finance Norway	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ Do not change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇒ Leave the last column <u>empty</u>. ⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a paragraph or a cell, keep the row <u>empty</u>. ⇒ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. <p>Please send the completed template, <u>in Word Format</u>, to CP-17-006@eiopa.europa.eu</p> <p>Our IT tool does not allow processing of any other formats.</p> <p><u>The numbering of the reference refers to the sections</u> of the consultation paper on EIOPA's second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation. Please indicate to which paragraph(s) your comment refers to.</p>		
Reference	Comment	
General Comment	Finance Norway welcomes the opportunity to comment on EIOPA's draft advice to the European Commission. Finance Norway is a member of Insurance Europe, and fully supports the views expressed in their consultation response. In addition, we would like to elaborate on some of the aspect of EIOPA's proposal on interest rate risk in a more national context, see section 7.3 below.	
Introduction		

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7.3	<p>Paragraphs 440-449</p> <p>As Insurance Europe has pointed out in their response to this consultation, the following economic considerations must be inherent in the design of the interest-rate</p>	

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risk submodule:

- Lower capital requirements in a low yield environment to reflect the economic reality that there will be diminishing demand as interest rates decrease.
- The presence of a lower bound.
- The differing correlations of market risk in different market environments.

Furthermore, there needs to be recognition of the unprecedented combination of economic events which led to the current low interest rate environment; declining inflation following the 2008 and 2011 financial crises, an increased demand for long-term safe assets to satisfy new regulatory requirements along with additional demand from the ECB's (and other central banks) QE program have all contributed to current economic conditions.

In addition to this, economic conditions and public financial conditions differ between nations and supports a different optimal policy mix going forward. In this regard, nations with strong public finances and stable national currencies are more likely to use expansive budget measurer rather than expansive monetary policy in events of economic slowdown, making interest rates close to zero even more unlikely.

We argue that this would be the case for Norway, as explained in the following.

Backdrop

Zero was for a long time seen as the lower bound for central banks' policy rates. An important argument was that rates below zero would lead to increased demand for (interest free) cash. However, cost of transactions, transfers and storage is in practise limiting such effects, as long as the rate is not too negative. Another argument states that negative rates on excess reserves inflict costs on banks which they will pass on to their customers. Hence, loosening policy may have unintended consequences, cooling down the economy instead of stimulating it.

In 2018 negative interest rates are no longer an unusual observation. Several central banks have cut policy rates to levels below zero in recent years, to stimulate the economy and hence also reach their inflation targets. The rate levels differ. The Swiss

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National Bank (SNB) aims to keep the 3m LIBOR CHF between -0.75 and -1.25 percent. The Swedish Riksbanken has a deposit rate at -1.25 percent, and a repo rate at -0.50 percent. It is the latter that has the greatest impact on money market rates, and the 3m STIBOR is currently around -0.58 percent. The ECB has a deposit rate at -0.40 percent. Due to the asset purchasing programme, it is this rate that affects the money market rate. 3-month EURIBOR is currently at -0.33 percent.

So far, we do not see strong signs of adverse effects of negative rates, but the above mentioned rate levels seem to be close to a lower bound where the room for further cuts is limited. For instance, the [Swiss National Bank](#) voiced concerns in 2016:

«However, the low interest rate environment also presents several challenges for monetary policy. The possibility of holding cash limits the scope for monetary policy action. Persistently low interest rates can also have an adverse impact on financial stability and diminish the effectiveness of monetary policy. These side-effects are one reason why negative interest, or expansionary monetary policy more generally, is no panacea».

There are two main reasons why we see the probability of negative Norwegian rates as low:

- 1. The Norwegian Central Bank ("Norges Bank") is explicitly hesitant to cut rates further.** The Norwegian Central Bank's policy rate is currently very low, but positive, at 0.50 percent. The economy was not severely hit by the financial crisis, but a plunge in the oil price, starting in the autumn of 2014, triggered a downturn in the Norwegian economy which led the policy rate further down to its current level.

In the [Monetary Policy Report](#) (MPR) of March 2016, the Executive Board of the Norwegian Central Bank discussed the room for further manoeuvre (our underlining):

The experience of other countries suggests that the lower bound for the key policy rate is below zero, but it is difficult to provide a precise estimate of the

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limit. Lower interest rates could increase financial system vulnerabilities. As the key policy rate approaches a lower bound, the uncertainty surrounding the effects of monetary policy increases. This now suggests proceeding with greater caution in interest rate setting. Should the Norwegian economy be exposed to new major shocks, the Executive Board will, however, not exclude the possibility that the key policy rate may turn negative.

In the passage, the possibility of negative rates is not excluded, but the Board says it wants to proceed cautiously in a situation when the rate is already very low. The Norwegian Central Bank is internationally known to be a central bank that “leans against the wind”, i.e. that explicitly takes the consideration of monetary policy effects on financial stability into account when setting the policy, keeping the rates higher than it otherwise would have been to dampen build-up of financial imbalances¹. The Norwegian Central Bank has on several occasions stated that without this consideration, the policy rate would presently be lower than it is today. This stance stands in stark contrast with its Swedish peer, Riksbanken.

A recent example of the Norwegian Central Bank’s hesitance to cut policy rates further can be seen in the most recent [MPR](#) (December 2017). In an alternative risk scenario, with a pronounced downturn in housing prices and investments, the policy response would not be a cut in the policy rate, but rather that “the increase in the key policy rate will be deferred”.

2. Fiscal policy leeway is ample, with a large “oil fund” to counteract economic downturns. The saving of oil revenues in the Government Pension Fund over time has given the Norwegian government ample fiscal policy leeway. The Fund, which exclusively invests abroad, is currently valued to NOK 8619 bn. There is a broad political consensus, stated in the fiscal rule, that transfers from the Fund to the central government budget, over time, should follow the expected real return on the Fund (set to 3 percent).

¹ See for instance <https://www.bis.org/review/r161103b.pdf>

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It is important to note that the fiscal rule is countercyclical. In good economic times, politicians should use less than 3 percent in the budget, in bad times they should use more. In the recent oil-induced slowdown, strong fiscal stimuli was one of the main reasons why the economic downturn was very mild, despite an abrupt decline in petroleum investments. Hence, it was one of the reasons why the policy rate ended at 0.50 percent, and not in negative territory. If a negative shock hits the economy again, we expect fiscal policy to turn strongly expansionary again, rather than interest rates to turn negative.

Conclusion:

An interest rate risk module designed with a decline of 200 basis points from the current market rate level as an input as proposed by EIOPA, will imply strongly negative rates. Negative rates are no longer an unusual observation, but it is likely that the lower bound for rates is higher than the one implied by EIOPA. Moreover, we see a significantly lower probability of negative rates in Norway compared to its peers, as fiscal policy leeway is ample and as the central bank is explicitly not comfortable with an interest rate level that is too low.

As Insurance Europe has pointed out in their response to this consultation, the abovementioned unprecedented combination of economic events which led to the current low interest rate environment, are extremely unlikely to be repeated and calibrating the interest rate risk submodule without due regard to these facts will overstate the risk and would be contrary to the market consistency principle underlying the Solvency II framework.

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