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EU Review of Solvency II

Presentation to Financial Markets Law Committee
(Insurance and Pensions Scoping Forum)

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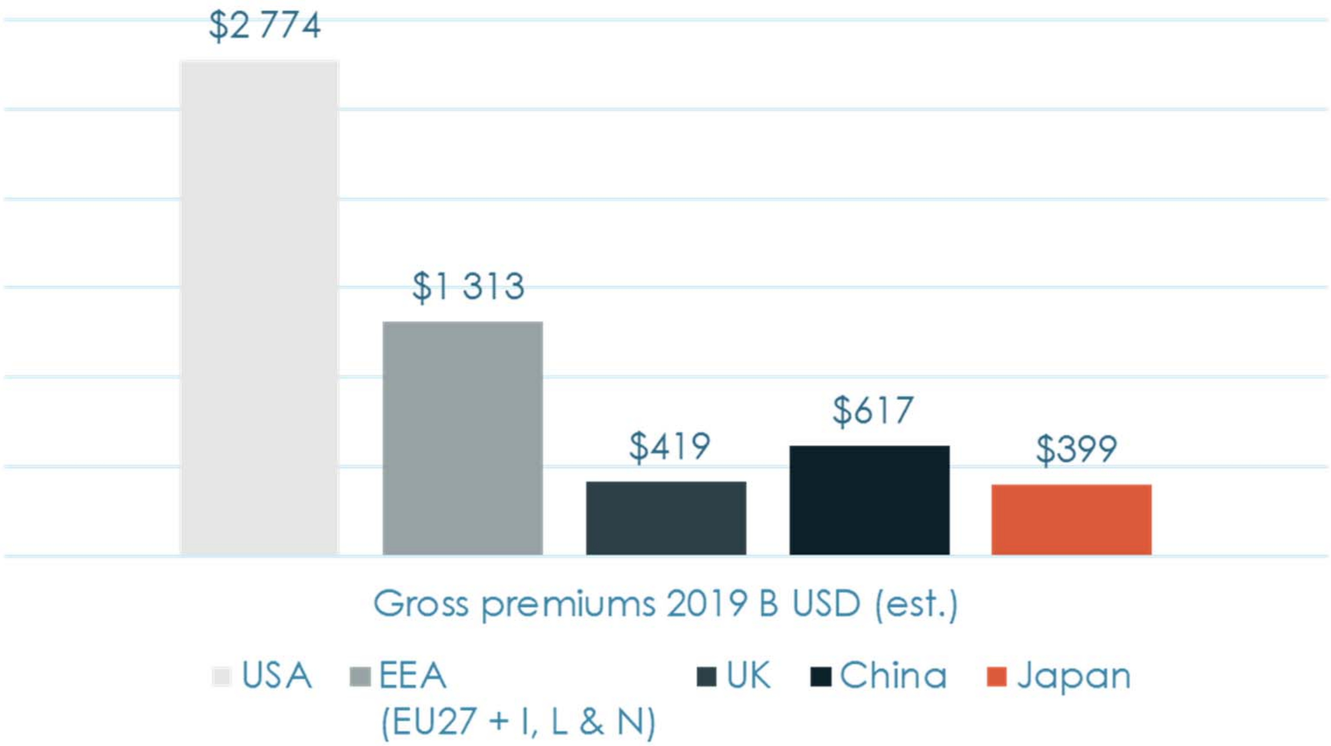
Context

- Texts
  - Directive 2009/138/EC ("Solvency II Directive" or "SII"), amended by Directive 2014/51/EU, effective 01.01.2016
  - Delegated Regulation (EU) 2015/35 amended by Delegated Regulation (EU) 2019/981
- Objectives: policyholder protection, financial stability and fair/stable market
- Principles: total balance sheet approach, market-consistent valuation, use of internal models
- Three "pillars":
  1. capital required in view of underwriting, market, credit and operational risks
  2. effective risk management system
  3. disclosure and reporting
- Impact: improved alignment of capital to risks, strengthened governance and risk management, harmonized templates for supervisory reporting on solvency (but not market conduct)

What is at stake

- Sets of norms



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Review process

- Mandated by SII: measures re long-term guarantee products (LTG) and equity risk (art. 77f(3) and art. 304(2)); Solvency Capital Requirement (SCR) standard formula methods, assumptions and standard parameters (art. 111(3)); Minimum Capital Requirements (art. 77f(3)); group supervision and capital management (art. 242)
- EIOPA consultations and information requests (2019-2021), Consultation Paper 15.10.2019 (878 pages, 19 topics)
- European Commission consultation 01.07.2020-21.10.2020, summary report 01.02.2021
- EIOPA Opinion on the 2020 Review of SII + Background Documents (Analysis, Impact Assessment + Feedback Statement) 17.12.2020 (≈ 1200 pages)
- EC proposed revision of SII expected July 2021 for adoption Q3 2021
- European Parliament and Council to review, modify and adopt in 2022?

Criticisms expressed

- Excessive volatility results from market-consistent balance sheet (Volatility Adjustment)
- Disincentives for long-term investments (corporate bonds and long-term loans)
- Excessive reporting
- Limited application of proportionality principle
- “Solvency II is certainly the most sophisticated prudential framework in the world, but it is also the most conservative, creating unnecessary costs and barriers, which have a significant impact on insurers’ ability to make long-term investments in the economy and offer long-term products, already challenged by a negative interest rate environment.” (FFA)

EIOPA Opinion 17 December 2020

Some proposed modifications to SII:

- Balanced updating of the regulatory framework, including re proportionality
- Recognition of the economic situation
  - LTG measures and equity risk
  - Increase capital requirement in respect of interest rates
- Regulatory toolbox completion, including
  - Macro-prudential tools: supplement micro-prudential framework, equip national supervisory authorities to address "all sources of systemic risk"
  - Recovery and resolution measures: minimum harmonized and comprehensive recovery and resolution framework
  - Insurance guarantee schemes: introduce EU network of schemes or alternative mechanisms

Expected elements of the Commission’s proposal (1/2)

- Increase long-term/low-carbon investment by insurers
  - “re-equitisation”
  - Different capital requirements for green/brown assets? Amend risk management requirements?
- Mitigate excessive volatility while enhancing risk-sensitivity
  - Volatility Assessment modification; reflect illiquidity of liabilities; fix “risk correction” deficiencies; symmetric adjustment; risk margin component of liabilitiies
  - Interest rates: impact of negative rates, 100 yr vs 65 yr spot rate

Expected elements of the Commission's proposal (2/2)

- Better application of proportionality (i.e. some relief for smaller insurers); principle announced but application not specified; revise exclusion thresholds (set in 2009)
- Improve supervision (including for cross-border activities) and protection against insurer failure
  - "shortcomings in the quality/consistency of supervision and in cooperation between authorities" → mitigate regulatory arbitrage?
  - Insolvency procedures subject to limited harmonization (not subject to Insolvency Regulation 2015/848)
  - No harmonization of guarantee schemes?
- Increase contribution to financial stability in face of systemic risks (macro-prudential vs micro-prudential supervision)

Questions?

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