European Parliament

Proposal amending the Solvency II Directive

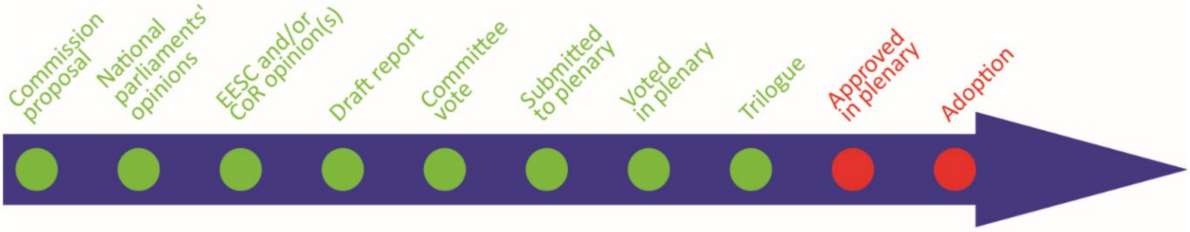
OVERVIEW

Directive 2009/138/EC – also known as Solvency II – sets out the prudential regulatory framework for the insurance sector in the EU. The framework aims to establish the single market for insurance services further, while strengthening policyholders' protection.

On 22 September 2021, the European Commission tabled a proposal for a directive that would amend Solvency II in essentially three ways: i) lowering regulatory obligations on small and low-risk profile insurance companies, ii) taking into account long-term and climate change risks, and iii) enhancing group-level and cross-border supervision.

In the European Parliament, the Committee on Economic and Monetary Affairs (ECON) was assigned the file on 22 November 2021, with Markus Ferber (EPP, Germany) as rapporteur. After Council and Parliament reached a provisional agreement on the text in December 2023, the ECON committee approved it on 29 January 2024. Parliament is set to vote on the adoption of the text at its April II plenary session, and the Council will put the text to the vote as well. Once adopted, the text will be signed by the co-legislators and published in the Official Journal.

Directive amending Directive 2009/138/EC as regards proportionality, quality of supervision, reporting, long-term guarantee measures, macro-prudential tools, sustainability risks, group and cross-border supervision		
Committee responsible: *Rapporteur:* *Shadow rapporteurs:*	Economic and Monetary Affairs (ECON) Markus Ferber (EPP, Germany) Eero Heinäluoma (S&D, Finland) Stéphanie Yon-Courtin (Renew, France) Henrike Hahn (Greens, Germany) Johan van Overtveldt (ECR, Belgium) Marco Zanni (ID, Italy) Chris MacManus (The Left, Ireland)	COM(2021) 581 22.9.2021 2021/0295(COD) Ordinary legislative procedure (COD) (Parliament and Council on equal footing – formerly 'co-decision')
Next steps expected:	Submitted to plenary	



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Introduction

In July 2020, the European Commission initiated a review of Directive 2009/138/EC on the taking-up and pursuit of the business of insurance and reinsurance, also known as the **Solvency II** Directive, or Solvency II. The review focuses on the rules regarding long-term guarantee measures, solvency capital requirement, minimum capital requirement, and supervision of insurance companies operating in different EU Member States.

As a result of the review, on 22 September 2021, the Commission tabled a proposal for a directive amending Solvency II (the '**amending proposal**', COM(2021) 581). The amending proposal is accompanied by another proposal for a directive establishing a framework for recovery and resolution of insurance companies (the '**IRRD** proposal', COM(2021) 582), also part of the results of the Solvency II Directive's review. The two proposals are separate yet connected: the amending proposal would regulate insurance companies before they fall into financial distress, while the IRRD proposal would establish an EU-level harmonised framework to cope with failing insurance companies.

Existing situation

The Solvency II Directive came into force in 2016, replacing 14 directives formerly known as Solvency I. Solvency II is built on three pillars:

- Pillar I sets the quantitative requirements, i.e. the assets and liabilities valuation and capital requirements;
- Pillar II sets the qualitative requirements, including governance and risk management of the undertakings and the own risk and solvency assessment (ORSA);
- Pillar III sets the supervisory reporting and public disclosure.

Solvency II implements the principle of market valuation of assets and liabilities of insurance companies and risk-based capital requirements. Nevertheless, Solvency II integrates the principle of proportionality in ensuring that the regulatory requirements take into account the nature, scale and complexity of the risks inherent in an insurance company, since they may constitute unnecessary burden for some insurance companies. Finally, Solvency II requires national supervisors to increase coordination and exchange of information in colleges of supervisors for the benefit of cross-border supervision.

The previous review conducted by the European Supervisory Authorities (**ESAs**) in 2019 led to amending Regulation (EU) 2019/2175 (the '**ESA review**'), which brought changes to existing convergence tools and governance provisions. Moreover, where cross-border insurance activities are significant for the host Member State's market and require close collaboration between EU Member States' supervisory authorities, the European Insurance and Occupational Pensions Authority (EIOPA) has a mandate to set up and coordinate collaboration platforms.[1]

Preparation of the proposal

The amending proposal is accompanied by an impact assessment (SWD(2021) 260),[2] which concludes that, while the Solvency II framework overall functions effectively, certain elements need to be improved. In particular:

1) *Long-term risk exposure* assessment can be improved so that Solvency II no longer creates disincentives to long-term investment in equity, and would better capture long-run sustainability risks;
2) *Riskiness* assessment needs to be revised so that Solvency II reflects the low interest rate environment appropriately, and avoids high volatility in solvency ratios being unduly generated;

3) *Proportionality* in Solvency II can also be improved so that smaller and less risky insurance companies benefit from a simplified framework;

4) Recent failures of insurance companies with cross-border operations highlighted shortcomings in supervision and confirmed that policyholders are not protected consistently across the EU in the event of financial distress;

5) The supervisory toolkit to prevent systemic risks may prove to be insufficient.

Table 1 provides an overview of the policy options assessed by the Commission's impact assessment for each of the problems, with the preferred options highlighted in blue.

Table 1 – Policy options assessed by the Commission and preferred options (blue)

(1) Long-term green financing	(2) Risk sensitivity and volatility	(3) Proportionality	(4) Supervision protection	(5) Financial stability
BASELINE: Do nothing	BASELINE: Do nothing	BASELINE: Do nothing	BASELINE: Do nothing	BASELINE: Do nothing
Facilitate long-term investment in equity	Fix all technical flaws in relation to risk sensitivity and volatility	Exclude a significant number of firms from Solvency II and enhance the proportionality principle within Solvency II	Improve quality of supervision, in particular cross-border supervision	Make targeted amendments to prevent financial stability risks (i.e. incorporate targeted macro-prudential considerations into the framework)
Reduce capital requirements on all equity investments	Address issues of risk sensitivity and volatility while balancing the cumulative effect of the changes	Prioritise enhancing the proportionality principle within Solvency II and make a smaller change to the exclusion thresholds	Introduce rules to avert/manage failures	Introduce an extensive macro-prudential framework
Strengthen 'Pillar 2' requirements in relation to climate risks			Introduce rules to protect policyholders when insurers fail	
Integrate climate risks in both 'Pillar 2' and quantitative rules				

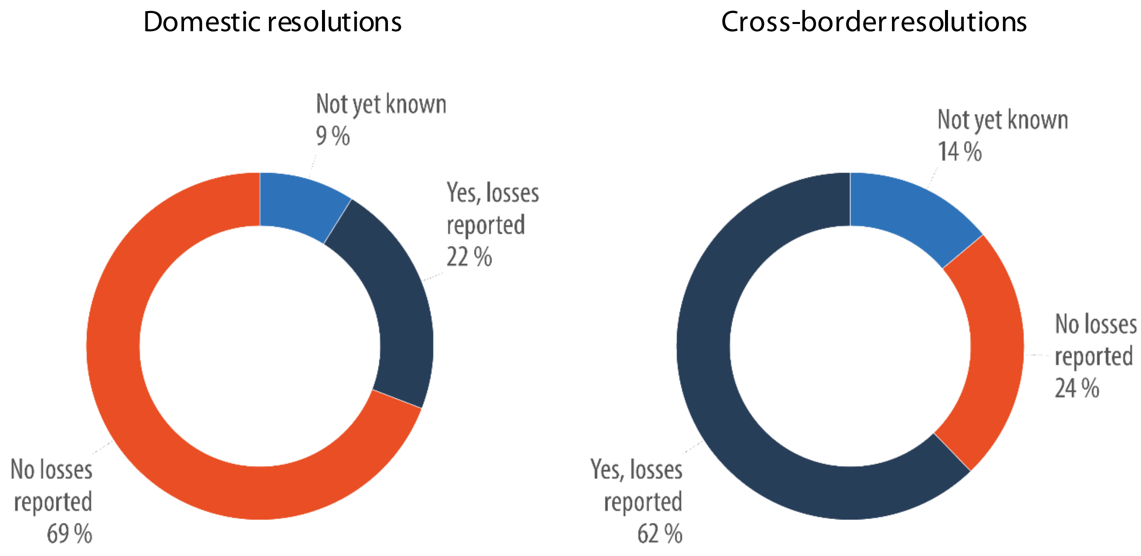
Source: V. Girard, Solvency II review, initial appraisal of a European Commission impact assessment, EPRS, European Parliament, April 2022; compilation based on the impact assessment, pp. 19-76.

The changes brought about by the amending proposal are expected to raise funding potentials for the real economy of up to €90 billion.[3] Moreover, insurers will have to assess their risk exposure to climate change and the impact of climate change on their activities in the long run. The consumers holding policies in other Member States would be better protected as they seem penalised in the current situation (Figure 1); they would also receive more detailed and complete information about the financial situation of their insurer. This implies the strengthening of cross-border cooperation between supervisory authorities within the EU to prevent financial issues and enhance policyholders' protection.

This cooperation should include more information coming from the supervisory authority of the home Member State, in particular regarding the outcome of the supervisory review process relating to the cross-border activity.

Supervisory authorities should have the necessary powers to preserve the solvency position of specific insurance or reinsurance undertakings during exceptional situations such as adverse economic or market events affecting a large part or the totality of the insurance and reinsurance market in order to protect policyholders and preserve financial stability. Those powers should include the possibility of restricting or suspending dividend distributions to shareholders and other subordinated lenders of a given insurance or reinsurance undertaking before an actual breach of the solvency capital requirement occurs.

Figure 1 – Policyholders' losses in resolution cases



Data source: EIOPA, Failures and near misses in insurance, 8 October 2021.

The changes the amending proposal would bring

The amending proposal would in particular modify the chapters of Solvency II on capital requirements and valuation of insurance liabilities towards policyholders and on cross-border supervision. It also introduces necessary clarifications and changes to provisions implementing the proportionality principle. These changes aim to improve the functioning of the regulatory framework for insurers and attain the objectives of Solvency II.

The proposal builds on six main areas: proportionality, reporting, long-term guarantee measures, the European Green Deal, supervision, and macro-prudential tools.[4] The proposed changes include the following.

Proportionality. The amendment of Article 4 Solvency II would increase the thresholds in size for the exclusions from the scope of Solvency II, thereby excluding smaller firms. It also clarifies Article 29 Solvency II, which sets out the applicability of the proportionality principle with respect to delegated and implementing acts, by introducing the new concept of low-risk profile undertakings, and new criteria to identify low-risk insurance companies (paragraph 13 of the proposal).[5] It also sets out reporting obligations specific to low-risk profile insurance companies.

Reporting. The amending proposal would adapt the reporting requirements for low-risk profile undertakings. It also modifies the structure of the solvency and financial condition report (SFCR) in Article 51 Solvency II, splitting its content into a part addressed to policyholders and a part addressed to other stakeholders, and introducing auditing requirements for the prudential balance sheet. Using internal models, insurance companies would report regularly to the supervisors an estimation of the solvency capital requirement.

Long-term guarantee measures. The amending proposal would control for the long-term interest and volatility risks.[6] The volatility adjustment would also become subject to supervisory authorisation in some more cases. In addition, the internal model would take into account the effect of credit spread movements on the volatility adjustment ('dynamic volatility adjustment'). Finally, it would be EIOPA, and not national supervisory authorities, that would consult the European Systemic Risk Board (ESRB) before declaring an exceptional adverse situation.[7]

Macro-prudential tools. The own risk and solvency assessment (ORSA) by insurers would integrate macroeconomic considerations, whereby insurers assess the impact of plausible macroeconomic and financial market developments, with inputs required from supervisory authorities. Investment strategies would also have to consider plausible macroeconomic and financial market developments, and assess the extent to which their investments may have an impact on systemic risk. The amendments also introduce requirements on liquidity management and planning to ensure the ability to settle financial obligations towards policyholders, and develop liquidity risk indicators.

European Green Deal. Amendments introduce a new article 45a on climate scenario analysis, whereby insurers would have to identify any material exposure to climate change risks and assess the impact of long-term climate change scenarios on their business.[8] The proposal would mandate EIOPA to explore a dedicated prudential treatment of exposures related to assets or activities associated substantially with environmental and/or social objectives, and to review regularly the scope and calibration of parameters of the standard formula pertaining to natural catastrophe risk.

Supervision. The amending proposal would ensure that each refusal of an authorisation envisaged by Article 25 Solvency II – not only authorisation granted, as set out by Article 25a – is notified to EIOPA and recorded in a database that can be consulted by supervisory authorities. The amendment would also introduce the option to conduct a joint assessment of an application for authorisation on request of one of the supervisory authorities.

The amending proposal also would modify Article 212 Solvency II (definitions) to facilitate the identification of entities that form a group, and 'insurance holding companies' would be defined more specifically.[9] The supervisory authorities would be empowered to require the group's restructuring. The risk assessment would take into account the structure of the group more effectively, and a revised 'minimum consolidated group solvency capital requirement' would be introduced, consistent with the rules on minimum capital requirement at individual level.

Furthermore, requirements to provide information on previous rejections or withdrawals of authorisation in other Member States would be introduced, and supervisory authorities would be informed about intended cross-border business. Mandatory exchange of information between the supervisory authorities in home and host Member States would be introduced. EIOPA's role in complex cross-border cases would be enhanced where the supervisory authorities involved fail to reach a common view in a cooperation platform, and EIOPA would receive a complying mandate in resolving disagreements between supervisory authorities.

Advisory committees

In its opinion, adopted on 23 February 2022, the European Economic and Social Committee (**EESC**) states that recent events such as the low interest rate policy and the COVID-19 pandemic, serve as reminders that the regulatory framework should be adapted. The EESC strongly welcomes that the proposal takes into account the change in the risk profile of insurers, and points out that the insurance sector plays a significant role when it comes to insurance against the impact of climate change and environmental risks. It supports the proposal's objective of establishing a regulatory framework in which the insurance sector is assigned a greater role in financing the transition to a sustainable economy and tackling the impact of COVID-19 and climate change.

National parliaments

The deadline for the submission of reasoned opinions on the grounds of subsidiarity was 4 February 2022. No subsidiarity concerns were raised.

Stakeholder views[10]

In its opinion of January 2022, Insurance Europe – the European insurance and reinsurance federation – agrees that, although Solvency II has delivered many of its intended objectives, it needs to be modified in a way that reflects the long-term business model of insurance companies and avoids 'excessive capital burdens and solvency volatility'. This would benefit not only consumers but also the industry's potential to finance the real economy. Insurance Europe therefore welcomes the Commission proposal while suggesting changes. For instance, Insurance Europe argues that further reduction in the design and calibration of the risk margin would be justified, and that a correlation parameter of zero between interest rate down risk and spread risk in the standard formula could also be justified. Moreover, it notes that the amendment requiring the internal review of the governance system to include an assessment of the administrative, management or supervisory body needs to be amended to align it with company law.

According to the summary report of the Commission consultation, respondents from non-governmental organisations (NGOs), consumers, citizens and public authorities ranked as their highest priorities the solvency of firms, the protection of policyholders against an insurer's failure, and the prevention of systemic risk. They also largely supported the view that climate scenario analyses should be required as part of the rules on risk management and governance requirements. As for the macro-prudential tools, the stakeholder group supported providing authorities with the power to prohibit redemptions temporarily only when an insurer is in financial distress. Conversely, NGOs, consumers, citizens and public authorities were the group rallying least behind the view that the framework should provide regulatory flexibility in adverse events.

Legislative process

European Parliament

The committee referral was announced in plenary on 22 November 2021. The Committee on Economic and Monetary Affairs (**ECON**) was appointed as the lead committee and Markus Ferber (EPP, Germany) as rapporteur. The Committees on the Environment, Public Health and Food Safety (ENVI) and on Legal Affairs (JURI) were asked to give opinions but decided not to. The rapporteur presented his draft report on 6 June 2022;[11] 805 amendments were tabled.

The ECON committee adopted the final report on 27 July 2023, by 55 to 3 votes (1 abstention).[12] The report proposes that the members of the administrative, management and supervisory bodies of insurance companies should, at all times, be of 'good repute and possess collectively sufficient knowledge, skills and experience to perform their duties'. For this, they should not have been convicted for offences relating to 'money laundering or terrorist financing or other offences that would question their good repute'. Insurance companies should also establish and effective system of governance. Moreover, insurers should 'explicitly' take into account environmental and social risks. For this, supervisory authorities should ensure that insurers develop the necessary tools to measure, manage and monitor these risks, and develop specific plans and quantifiable targets to address them.

As regards proportionality and reporting complexity by small and medium-sized insurance companies, the report envisages that they may limit their sustainability reporting to i) a brief description of the business model and strategy; ii) the policies in relation to sustainability matters; iii) the adverse impacts on sustainability matters, and actions taken; and iv) the principal risks to the insurer related to sustainability matters and how the undertaking manages those risks.

The report also supports enhanced cooperation between supervisory authorities to improve policyholder protection and stability in the financial sector. Strengthened cooperation would i) safeguard consumer rights and strengthen policyholder protection, and ii) increase transparency and the regular exchange of information. Information exchange should in particular include the 'outcome of the supervisory review process related to the cross-border activity, the financial condition of the undertaking, and market conditions which might impact the provision of services'.

Finally, the report proposes the assignment of additional tasks to EIOPA, including the preparation of a report on the assessment of biodiversity and climate change risks. EIOPA would also define consistent guidelines for national rules for the assessment of macro-prudential risks, and would set up and coordinate a collaboration platform between supervisory authorities.

The ECON committee decision to enter into interinstitutional negotiations was confirmed by Parliament's plenary on 13 September 2023.

Council

The Council agreed its general approach on 17 June 2022. It acknowledges that the amendments would ensure a balanced review of the prudential framework while improving policyholder protection and financial stability. In its position, the Council considered the 'specificities of national insurance industries' and sought to 'strike the right balance when reducing the administrative burden on insurers, especially on small and non-complex companies'. It also considered that EIPOA should be assigned additional tasks. On the one hand, consistently with the EU's environmental objectives, EIOPA should prepare a report on the assessment of environmental risks – biodiversity loss, natural disasters and climate related risks. On the other, EIOPA should define 'consistent guidelines for national rules' followed by insurers when assessing their macro-prudential risks.

Provisional agreement

Council and Parliament reached a provisional agreement on 14 December 2023, The agreed text revises the long-term guarantee measures to make them more risk sensitive and to improve the resilience of the insurance industry. The agreement also introduces a new macro-prudential dimension in the regime and gives sustainability greater prominence.

Simplified and proportionate rules will apply. First, the agreement[13] maintains the size of the threshold for exclusion from the scope of Solvency II set by the proposal, namely a) the annual gross written premium should not exceed €15 million (up from the €5 million currently set by the directive); and b) the total technical provisions should not exceed €50 million (up from the €25 million currently set by the directive). It also replaces the phrase 'low-risk profile' used for describing undertakings, with the phrase 'small and non-complex', and specifies that its defining criterion – 'investments in non-traditional investments' – is the sum of three components.[14]

The agreed text retains the proposal's rules on macro-prudential reporting that is to be included in the ORSA, but unlike the proposal, stipulates that the impact of the undertaking on the macroeconomic and financial markets' developments would only be included the ORSA if the supervisory authority makes a reasoned request for this.[15] Regarding liquidity risk management, the agreed text maintains the obligation of the (re)insurance undertaking to draw up and maintain liquidity management plans. However, it specifies that, upon the supervisory authority's request, (re)insurance undertakings would extend the liquidity risk management plan to also cover the medium- and long-term liquidity analysis. The measures required by the supervisory authorities to reinforce the liquidity position are to be reviewed at least 'once every six months' – as opposed to 'once a year', as envisaged in the proposal. Furthermore, the evidence is to be shared with EIOPA. Additionally, the agreed text empowers the supervisory authority to act when the lack of compliance may cause a 'severe and imminent' threat to the protection of policyholders or to the stability of the financial system. These actions include suspending the distribution of dividends or other payments to shareholders, including through buybacks, as well as bonuses. Supervisors may also suspend redemption rights of life insurance policyholders.[16]

As regards climate change and the European Green Deal, the agreed text retains Article 45a, as inserted by the proposal, but specifies that when reviewing the long-term climate change scenarios, (re)insurance undertakings would have to take into account the performance of tools and principles used in previous climate change scenarios. Moreover, the agreed text explicitly names fossil fuel-related assets among those to be assessed by EIOPA for their potential to pose sustainability risks. EIOPA will also assess whether and to what extent the ORSA should include the material exposure of (re)insurance undertakings to biodiversity-related risks and assess actions to be taken.[17]

Finally, the agreed text maintains the enhancement of coordination among national supervisory authorities regarding (re)insurers' cross-border activities.

Next steps

The text of the provisional agreement was approved by Parliament's ECON committee on 29 January 2024 by a large majority (32 to 1). The next steps include the adoption of the text by Parliament in plenary (indicatively on 22 April 2024) and by the Council. If adopted, the final text will be signed by the Council and Parliament and published in the *Official Journal of the EU*.

EUROPEAN PARLIAMENT SUPPORTING ANALYSIS

Girard V., Solvency II review, initial appraisal of a European Commission impact assessment, EPRS, European Parliament, April 2022.

Policy Department for Economic, Scientific and Quality of Life Policies, Solvency II: Prudential treatment of equity, European Parliament, September 2022.

OTHER SOURCES

European Parliament, Amendments to the Solvency II Directive, Legislative Observatory (OEIL).

European Commission, Proposal for a Directive amending Directive 2009/138/EC as regards proportionality, quality of supervision, reporting, long-term guarantee measures, macro-prudential tools, sustainability risks, group and cross-border supervision, COM(2021) 581, 22 September 2021.

ENDNOTES

1 A cooperation platform is set up when EIOPA and relevant national supervisory authorities see the merit in strengthening cooperation in the event of material cross-border business to ensure the functioning of the internal market. Through the platforms, insurers' home national supervisory authorities make use of home supervisors' expertise and knowledge of local market specificities. The Commission's report on the ESAs' operations (COM(2022) 228) provides further details on the implementation of Solvency II and the amended chapters on supervision.

2 See also the executive summary of the impact assessment report, SWD(2021) 261.

3 See also the Commission's impact assessment, p. 45.

4 Other areas include 'transition measures introduced by Directive 2014/51/EU' and 'minor updates and fixes'.

5 For instance, one criterion for life insurance undertakings is that the value of the technical provisions is not higher than €1 billion. The criteria can be supplemented in delegated acts.

6 The risk-free interest rate term structure would be required to take into account the information from financial markets for maturities where the term structure is extrapolated.

7 The ESRB is responsible for the macro-prudential oversight of the EU financial system to prevent and reduce systemic risks. It covers banks, insurers, asset managers, shadow banks, financial market infrastructures and other financial institutions and market. Its members include the president and vice president of the ECB, the governors of national central banks, a representative of the European Commission, and the chairs of the three supervisory authorities.

8 Identified low-risk insurers would be exempted from the climate change scenario analyses.

9 The proposed definition is inspired by the Capital Requirements Directive (CRD, Directive 2013/36/EU) on credit institutions.

[10] This section aims to provide a flavour of the debate and is not intended to be an exhaustive account of all different views on the proposal. Additional information can be found under the Section on 'European Parliament supporting analysis'.

[11] In his draft report, the rapporteur considers the proportionality envisaged by the amending proposal to be a 'step in the right direction'. The draft report proposes to widen the range of insurance companies to be excluded from the scope of Solvency II by increasing thresholds in size and risk level, replacing *absolute* thresholds with *relative* ones, to account for market size. On cross-border supervision, the amendments proposed in the draft report would make collaboration and information exchange between home and host supervisors mandatory. Moreover, the draft report finds the status quo of how long-term guarantees (LTG) are determined – i.e. by means of delegated acts – unsatisfactory, since these LTGs are still being discussed. Furthermore, the draft report supports the view that firmer liquidity planning by insurers is required, but suggests to link this to general risk management requirements and not to macro-prudential supervision, since – unlike with banks – liquidity problems of insurance companies hardly cause any systemic concerns. Finally, the draft report takes the view that sustainability risks are already and sufficiently considered in the Solvency II prudential framework.

[12] See also the summary of the report.

[13] See also the Milliman briefing note for further comparison.

[14] Criterion iv) requires that the sum of the following elements is not higher than 20 % of total investments:

- the gross market risk module referred to in Article 105(5) (the only item cited in Parliament's report);
- the part of the counterparty default risk module referred to in Article 105(6), which corresponds to exposures to securitisations, derivatives, receivables from intermediaries and other investment assets not covered in the spread risk sub-module;
- any capital requirement that is applicable to investments in intangible assets that are not covered by the market risk and the counterparty default risk modules.

[15] This change was not included in Parliament's report.

[16] All these amendments to the agreement were included in the Parliament's report.

[17] These two amendments to the rules on the EIOPA assessment were included in Parliament's report.

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