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WORKING PAPER

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From:	General Secretariat of the Council
To:	Financial Services Committee
Subject:	Informal videoconference of the members of the Financial Services Committee - Informal videoconference of the members of the Financial Services Committee

Update: 2020 Review of Solvency II

Financial Services Committee
7 October 2020

2020 review of Solvency II – Objectives

- Balanced update of the current regulatory framework based on supervisory experience with the application of Solvency II provisions since 2016, including first lessons from the Covid-19 pandemic. Initial assessment confirms combined impact of the proposals at EU level to be very small.
- Proper recognition of the economic context (i.e. calibration of interest rate risk to reflect economic reality)
- Completion of the regulatory toolbox
 - Introduce macroprudential tools to Solvency II
 - Minimum harmonised recovery and resolution framework
 - Minimum harmonisation of insurance guarantee schemes

2020 review of Solvency II

Call for Advice by the European Commission

Advice requested on three areas...

- Reducing complexity and ensuring proportionality of the requirements
- Correct technical inconsistencies
- Capital Markets Union and financing the economy

... which translates, more specifically, into work on

- Long-term guarantees measures
- Transitional measures
- Risk margin
- Dynamic volatility adjustment
- SCR standard formula
- Risk-mitigation techniques
- Minimum capital requirement (MCR)
- Macro-prudential issues
- Recovery and resolution
- Insurance guarantee schemes
- Freedom to Provide Services (FoS) and Freedom of Establishment (FoE) insurance
- Group supervision
- Reporting and disclosure
- Proportionality
- Best estimate
- Own funds
- Reducing reliance on external ratings

2020 review of Solvency II

Call for Advice by the European Commission

EIOPA deliverables for 2020 review:

- EIOPA reports annually, since 2016, on the impact of the application of the **long-term guarantees (LTG) measures and the measures on equity risk** to the European Parliament, the Council and the European Commission. Based on EIOPA's opinion, the European Commission submits a report on the impact of the LTG measures and the measures on equity risk to the European Parliament and to the Council. The report is accompanied, if necessary, by legislative proposals.
- Response to European Commission's **Call for Information on asset-liability management** in relation to the illiquidity of their liabilities (December 2019) - this analysis supplements information provided in EIOPA's annual reports on LTG measures and feeds into the Opinion on the 2020 Review of Solvency II.
- **Opinion on 2020 review of Solvency II.**

2020 review of Solvency II

Impact of Covid-19 crisis on EIOPA's technical advice

- EIOPA's advice for the review of Solvency II delayed **from June 2020 to December 2020**, in order to
 - Take into account first lessons from the Covid-19 pandemic
 - Grant insurance industry more time to provide data for the review (until 1 June 2020)
 - Update impact assessment for the advice, taking into account data until 30 June 2020
- The advice developed before the pandemic is generally confirmed (principle of “evolution, not revolution”).
- Yet, following own assessment, EIOPA is revising specific pieces of advice which may be affected by the Covid-19 crisis, including long-term guarantee measures, potentially affected SCR risk parameters, and macro-prudential tools.

2020 review of Solvency II – Key topics

Discount rates for long-term liabilities

- Insurers' liabilities towards policyholders are discounted to take into account the time value of money.
- Insurers' liabilities are currently underestimated because discount rates for long-term liabilities are significantly different from market rates.
- The new methodology under discussion to derive discount rates strikes a balance between moving discount rates closer to market rates and stability objective.
- Proposal would increase the value of liabilities for insurance products that include long-term guarantees.

2020 review of Solvency II – Key topics

Volatility adjustment

- Discount rates for insurance liabilities include a volatility adjustment to prevent countercyclical investment behaviour when bond spreads widen.
- Technical refinements of the volatility adjustment discussed in order to:
 - Avoid that the adjustment overcompensates insurers' asset losses
 - More realistic allowance for credit risk in the adjustment while maintaining the effectiveness of the adjustment in extreme market situations
 - Improve the triggering of the country-specific increase to the adjustment
 - Ensure that the adjustment is economically justified by linking it to the illiquidity of insurance liabilities
- At the end of 2019 the refined volatility adjustment for the euro would be on average be 14 instead of 7 basis points.

2020 review of Solvency II – Key topics

Equity risk

- Solvency II includes lower capital requirements for “long-term equity investments” (22% instead of 39% or 49% for other types of equity), in order to reward lower risk and incentivise long-term investments. The introduction of this asset class recognised the role of insurance companies as long-term equity investors.
- Criteria for “long-term equity investments” now under revision to make them prudentially sound.
- Significant portion of insurers’ equity investments should be eligible for the application of the new “long-term equity investments” criteria.

2020 review of Solvency II – Key topics

Risk margin

- Insurance liabilities include a risk margin to reflect the uncertainty of insurance claims.
- Industry criticises that sensitivity of risk margin to interest rate changes increases volatility of insurers' capital position.
- Proposal to modify calculation of risk margin discussed. Proposal would reduce sensitivity of risk margin and recognise risk diversification over time.
- Proposal would reduce risk margins for long-term liabilities. On average risk margins are expected to decrease by 15%.

2020 review of Solvency II – Holistic impact assessment

Combined impact of advice on solvency position of undertakings

- Apart from the effect of the change on the capital requirement for interest rate risk, EIOPA's advice would have little impact on the average solvency position of the EEA insurance industry at the end of 2019.
- Test of new capital requirement for interest rate risk shows that current capital requirements are EUR 23 bn too low. Increase of the capital requirement will have to be phased-in so that the insurance industry can manage the change.
- Change of interest rate risk will affect primarily life insurers and composite insurers with long-term liabilities.
- EIOPA will revise the combined impact of the advice in light of the most recent data collected (Q2 2020), taking into account also first Covid-19 effects.

2020 review of Solvency II – Timeline

When	What
October	Review of advice based on data from complementary information request <u>23 October</u> : Event on the 2020 review of Solvency II with EIOPA's Insurance and Reinsurance Stakeholder Group
November	Draft final advice reviewed based on comments by EIOPA's Board of Supervisors
First half of December	Approval of final advice by EIOPA's Board of Supervisors
Mid-December	Publication of final advice



THANK YOU!

Fausto Parente
Executive Director
EIOPA