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From:	General Secretariat of the Council
To:	Financial Services Committee
Subject:	FSC 20.01.21 Item 3: Solvency II Presentation by EIOPA

EIOPA's Opinion on Solvency II Review

Financial Services Committee
20 January 2021

Review of Solvency II – Main themes

EIOPA's approach to the Solvency II review is to address three areas where improvements are needed:



Balanced updating of the regulatory framework

EIOPA proposes changes in several areas but with balanced overall impact on insurers. This reflects the fact that Solvency II is overall working well.



Recognition of the economic situation

In particular the persistence of low interest rates. EIOPA recommends proper provisions for the risk of interest rate changes.



Regulatory toolbox completion

Including better protection of policyholders via macro-prudential tools, recovery and resolution measures and insurance guarantee schemes.

The balanced updating covers a broad range of topics. The presentation focusses on key topics, including long-term guarantees measures, equity risk measures and proportionality.

Review of Solvency II – Key topics

Long-term guarantees measures and equity risk measures

- *Discount rates for insurance liabilities* → change the method of extrapolating discount rates to better reflect market rates. Method includes “emergency brake” that mitigates impact when market rate levels are extremely low.
- *Volatility adjustment to discount rates* → better align the design of the adjustment to its objectives, in particular reward insurers for holding illiquid liabilities.
- *Risk margin* → recognise diversification over time thereby reducing size and volatility of the margin, especially for long-term liabilities.
- *Equity risk* → revise the criteria for the ability to hold equity long-term, by making a link with long-term illiquid liabilities.

Overall European impact of changes will be balanced.

Review of Solvency II – Key topics

Proportionality

- The current approach on proportionality can benefit from more explicit guidelines on when the principle can be applied by (re)insurers and on the role of supervisors. With the increase in the use of proportionality, EIOPA aims at reducing the compliance cost for small/less risky undertakings.
- EIOPA proposes a new framework on proportionality based on four pillars:
 - 1) Introduce a new process for applying and supervising the principle of proportionality, based on 7 explicit and objective criteria to identify low risk undertakings eligible for applying proportionality measures. Expected benefits: clarity, predictability, risk sensitiveness, supervisory dialogue and reversal of the burden of proof (from undertakings to supervisors);
 - 2) Increase the proportionality measure across the three pillars of Solvency II, especially regarding low risk undertakings;
 - 3) Increase the effectiveness of proportionality embedded in the supervisory review process, clarifying the role of supervisors and their room for manoeuvre (e.g. in case of measure not mentioned in SII);
 - 4) Increase the transparency on the use of proportionality measures across the three pillars of Solvency II.

Review of Solvency II – Key topics

Interest rate risk

- Change calculation of capital requirements for interest rate risk in order to reflect the steep fall of interest rates experienced during the last years and the existence of negative interest rates.
- Current capital requirement underestimates the risk. It therefore provides wrong risk management incentives and inadequate policyholder protection.
- Increased capital requirements will incentivise matching long-term liabilities with long-term bonds.

The proposed change will have significant impact on the solvency position of some life insurers. It should therefore be phased in over 5 years.

Review of Solvency II – Key topics

Macroprudential policy

- Supplement the current microprudential framework in the Solvency II Directive with a macroprudential perspective.
- Introduce tools and measures to equip national supervisory authorities with sufficient powers to address all sources of systemic risk, including in particular:
 - Capital surcharge for systemic risk
 - Systemic Risk Management Plans
 - Liquidity Risk Management Plans
 - Temporary freeze on redemption rights

Review of Solvency II – Key topics

Recovery and resolution

- EIOPA calls for a **minimum harmonised and comprehensive recovery and resolution framework** for (re)insurers to deliver increased policyholder protection and financial stability in the EU (which in our view outweigh the potential costs of harmonisation), also by reducing current fragmentation and facilitating cross-border cooperation.
- Recovery measures: Solvency II should be further developed with the introduction of
 - a requirement for undertakings to develop and maintain pre-emptive recovery planning and resolution planning, incl. resolvability assessment.
 - preventive measures for supervisors to be used before the breach of the capital requirements.
- Resolution measures/ Liquidation process:
 - Designation of a resolution authority → Exercise of resolution powers (e.g. transfer powers without prior consent; power to stay the rights on financial/reinsurance contracts; power to restructure liabilities) subject to strong safeguards (e.g. no creditor worse off than in liquidation)
 - Clear resolution objectives

Review of Solvency II – Key topics

Insurance Guarantee Schemes (IGSs) – national IGSs to be harmonised, for the benefit of policyholders and financial stability as a whole (harmonisation to be seen within the broader context of recovery and resolution), on the following principles:

- Role and functioning: compensation to policyholders and beneficiaries and/or continuation of contracts
- Geographical coverage: home-country principle
- Eligible policies: selection of life and non-life policies associated to “considerable financial or social hardship for policyholders”
- Eligible claimants: natural persons and micro-sized firms
- Coverage level: minimum harmonised coverage level for claimants
- Funding: ex-ante funded (contributions by insurers), if needed complemented by ex-post funding
- Disclosure: adequate, clear and comprehensive disclosure to consumers
- Cross-border cooperation and coordination

To ensure a certain degree of flexibility to the Member States, EIOPA should assess the compliance of all the harmonised principles at the end of a transitional phase and should report the result of this assessment to the Commission.

Review of Solvency II – Timeline

When	What
February 2019	EIOPA receives request for technical advice from the European Commission
October 2019	EIOPA consults on Solvency II review
December 2019	EIOPA holds stakeholder workshop on Solvency II review (and, in October 2020, on impact of Covid-19 situation on review)
December 2020	EIOPA submits technical advice to the European Commission
Third quarter 2021	European Commission issues the proposal to review Solvency II

Application of changes are not expected to apply before 2024.



THANK YOU!

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