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The Solvency II review: a "risky" business

Covid-19 has had a huge impact on the insurance industry: financial dislocation across investment classes increased exposure in certain lines of business, such as business interruption, and life and pension products with guarantees. However, the full impact of the pandemic is not yet entirely clear, and so far, it can be said that the EU insurance industry has weathered the pandemic storm rather well and that most EU insurers and reinsurers remain well-capitalized.

This is an important lesson for the Solvency II review: demonstrating that there is no reason to fundamentally change a regime that appears to work well, even in a crisis situation. However, this does not mean that Solvency II cannot be improved. The regulatory framework must be strengthened in order to ensure that the insurance industry is capable of meeting future challenges. The pandemic has shown that black swans may well appear on the horizon more frequently than predicted in existing models. The solvency framework must also reflect the changing economic climate.

The insurance industry plays a critical role in the management of risk. In its capacity as a risk carrier and investor, it is in a unique position to understand the pricing of risks. In their risk assessment, insurers must be vigilant in an ever-changing environment of risk and keep abreast of new emerging risks. The regulatory framework must support insurers in better managing risk by rewarding good risk management, and also by avoiding unnecessary and too complex rules and procedures. More importance must be attached to risk prevention and risk mitigation.

Supervisors must assist insurers in their drive for better risk management. They can do so by increasing the frequency of supervisory reviews, by making analyses more granular, and by regular stress testing. Supervisors must also be aware that risks, such as those related to climate change, can have on financial stability. By assisting insurers in the identification, monitoring, and assessment of these risks and by contributing to the mitigation of these risks, supervisory authorities can help to protect policyholders and to ensure financial stability.

Although sustainability is not specifically part of the Solvency II review, as it was not included in the European Commission's call for evidence, the importance of the sustainability agenda is such that this issue must receive proper attention in the review.

Finally, the pandemic has shown that proper customer information is crucial to make the insurance market work efficiently. Policyholders need to know which risks are covered under insurance policies and why certain risks are excluded from coverage. The exclusion from coverage may not be such that new protection gaps are created or that already existing gaps are increased, and this should be clarified at the onset. It is important that the insurance industry fulfills its socio-economic role by reducing the many protection gaps that still remain, in areas such as pandemics, natural catastrophes, pensions, health care, etc. **The Solvency II review must proactively help insurers to reduce the insurance protection gap.**

If necessary a public/private partnership should be built in order to deal with risks which the private sector cannot bear on its own.