Global and Solvency II insurance frameworks

The Chair stated that Europe is reviewing Solvency II and that the three pillars of the framework will be reviewed. At the global level the International Association of Insurance Supervisors (IAIS) is finalising the global capital standard for insurance. The UK is also working on its own review of the prudential framework. An additional aspect is the interrelation between European Solvency II, UK Solvency, and the Insurance Capital Standard (ICS) at a global level.

1. The Solvency II framework requires critical adjustments to remain faithful to its initial objectives and take on board emerging sustainability related risk

An industry representative stated that extensive discussions have already taken place on Solvency II. The main aspect for insurers is to provide security and trust to policyholders with good service. The secure and fair markets target sometimes may not imply security and/or best service to policyholders. The market should do well for consumers and citizens.

On the Solvency II review the expectations are for fitness to initial purpose and to address the new context, new environment and new risks. Realistic approaches in the proactive prudential framework are paramount and will only be achieved while remaining risk based. The two main threats in the risk-based valuations are sustainability issues and long-term guarantees that sometimes clash with short-term bias in the regulation. Care is needed to avoid disproportionate capital charges between asset classes. Sustainability issues are the second major threat.

Insurers need to be able to pursue managing their risks, with the monitoring of their exposures being the liabilities or the investment and observing the transition that occurs every day. There is a concrete aspect in sustainability with physical risks, but the transition could result in costly and inappropriate work that could bring new risks. The wish is for regulators, particularly supervisors, to strengthen the debate in quality. It would be welcome for supervisors to challenge and bring more science based evidence.

2. The review of the Solvency framework for insurance undertakings in the EU is expected to reinforce the role and efficiency of the sector in the economy, financial stability, and the cooperation among supervisors

2.1 European Parliament, Council and the European Commission are close to completing the review of Solvency II

An official stated that the Solvency II review is reaching a pivotal moment as the trialogue meetings are about to commence. The Council and the European Parliament are close and will hopefully converge with the European Commission by the end of 2023. The review is essential for the insurance sector and the European economy.

A regulator noted that Parliament had reached an agreement and there are now three stable texts. The hope is that the trialogues manage to conclude before the elections start. Solvency II is a robust fundament of the industry. A second point is to examine how often Solvency II is reviewed, as there is a significant time and cost from the industry in impact assessments. The hope is that the trialogues will result in an outcome that is planned in coordination with all the other regulatory files such as the Insurance Recovery and Resolution Directive (IRRD) and the Digital Operational Resilience Act (DORA).

The Chair agreed that stability of regulation and coordination with other workstreams are key.

A regulator added that the trialogues can further develop the enhancement of cross-border cooperation at a time when there is more home-host instead of group subsidiary. If there is an issue then a platform can be helpful, but care is needed if someone wants a platform for every home-host situation.

2.2 Critical reinforcements

An official stated that the review is a unique lever to better protect policyholders and adapt to emerging risks. It enhanced cross-border activity supervision, and increased collaboration between supervisors, which is vital in this regard. The review will enhance the counter-cyclical aspects of the framework, and the introduction of macroprudential instruments will contribute to increasing financial stability in Europe. The review will empower insurers to play a more significant role in financing European sustainable growth.

A regulator noted that what Solvency II has tried to achieve is also true in a different climate, because it is a market valuation based framework that takes on board what is happening in markets.

2.3 Climate related risk and biodiversity challenges

An official stated that the review will improve the insurance sector's consideration of climate risk through the Own Risk and Solvency Assessment (ORSA), stress tests, and the attention on biodiversity. The French position on environment, social and governance (ESG) is to aim high while being wary of consistency with existing cross-sectoral regulations.

A regulator noted that how sustainability is introduced can be meaningful in many ways. Elaborating on transition plans takes on board what information is already available to supervisors and what information has already been produced.

2.4 There is no need for further regulatory capital and for better enabled companies to invest in the economy

An official stated that the pandemic demonstrated that current capital requirements are at a sufficient level to ensure the sector's resilience. The compromise texts of the Council and of the European Parliament do not create additional requirements to give reasonable leeway to the insurance industry to increase its capacity to finance the European economy.

A regulator added that capital easing will take place so risk assessment and risk management will be important. Individual companies will need to be examined very carefully, and the publication of individual stress test results is welcomed. The easing is meant to benefit the green transition; EIOPA should monitor that the freed up capital is going to green investments, not to excessive dividends.

2.5 Attention needs to be paid on improving proportionality and levelling the global playing field

An official stated that a welcome feature of both compromise texts is the increased proportionality for small and non-complex companies. The competitiveness of the insurance industry is also at stake in the review. The Council's approach insists on an international, level playing field to make it clear that European prudential regulations are not being discussed from an 'ivory tower'. There should be mindfulness of the global context of a strong insurance industry to the benefit of European consumers.

The Chair noted that in December 2020 EIOPA issued its advice for the review of Solvency II, and the objectives of the revision were clearly stated.

A regulator added that the proposals recognising that low-risk undertakings can do less reporting are welcomed.

3. The insurance sector has navigated the low interest rate environment well, but new challenges dictate remaining prudent

A regulator stated that there is currently a robust insurance environment, and the industry has managed the low interest rate environment very well, but improvements had been needed in the system for long-term guarantees such as extrapolation, volatility adjustment and interest rate risk. There is a concern about the current environment, which is very challenging due to war and problems with growth. The resilience of the sector has to be maintained and everyone needs to have substantial capital in the system. The European Commission wants to reduce bureaucracy, but the current discussion is on transition plans for companies.

4. The UK insurance solvency framework shares similar adaptation objectives though focusing in UK insurance market specificities

An official stated that Solvency UK and Solvency II share the same underlying features and market adjusted valuation group consolidated frameworks. The review has been undertaken and led by the government, with the Prudential Regulation Authority (PRA) within the Bank of England playing an important role. Policyholder protection was one of the key objectives, along with sustainability, financing sustainable and productive investment, and competitiveness.

4.1 An accurate valuation of the balance sheets of life insurers is one of the objectives

An official explained that in November 2022 the UK government issued the high-level areas of the review, the vast majority of which were completely in line with the PRA's views. All elements to do with the valuation of the balance sheet of life insurers will be used to protect policyholders against any risks, including stress tests with individually published results. The PRA can also set fundamental spread add ons on the valuation.

4.2 UK insurance market specificities require attention

An official stated that in June 2023 the PRA published a consultation paper with the first package of reforms, and in the autumn the second paper will be published. Everything will have been implemented and be in the rules by the end of 2024. UK Solvency has a difference in focus; the UK focused on the matching adjustment portfolio, while EU colleagues focused on the volatility adjustments. The design of the risk margin reforms is the same in Solvency II and Solvency UK, but the calibration is different.

5. Solvency II enables a pan European organisation model, but engagement with all supervisors is needed

An industry representative stated that their company's current business in Europe is from an acquisition that took place in 2010. The bigger impacts for the company around Solvency II were around four pieces: the legal structure used in Europe, the regulatory engagement approach moved to, the risk management at a business level in terms of the products, and the strategy of the company's European subsidiary and its businesses around Europe. On integration, the company's decision based on the Solvency II framework was to reorganise in a hub-and-spoke model, having one subsidiary in one member state and then to convert all other subsidiaries around Europe into branches.

The company had needed to create something new and needed to maintain its legal structure. The business went around Europe talking to prudential supervisors and convincing them that it was fine to move prudential supervision away from them. Due to the legal structure, the regulatory approach and the risk management approach, the business is examined in a pan-European way. The business limits the volatility.

6. The definition of the ICS global Solvency minimum standard is at its final stage

6.1 The ICS will be launched at the end of 2024

An official stated that their organisation is at the final stage of delivering the ICS, which is a very well tested and well monitored standard. An essential step will be achieving a robust assessment of the comparability of the ICS and the US implementation of the ICS. A consultation paper was issued in June on the ICS as a candidate Prescribed Capital Requirement (PCR). A PCR is a Solvency standard, which is a minimum standard that international colleagues have to observe or be above. In March 2023 robust criteria were also agreed for a comparability assessment between the ICS and the US implementation of the ICS.

An official emphasized the importance of the comparability exercise to succeed in establishing an international level playing field. While recognizing the commendable work of the IAIS in designing the standard ICS, it was necessary to move to the next steps of the process only when conditions were fully met.

A regulator stated that the consultation document is a key moment for everyone involved, and the findings in the fourth monitoring exercise will be crucial for the final document. The world needs an international minimum standard, and a final ICS would currently not result in a need for a Solvency II review.

6.2 Focusing on the comparability of the outcomes is essential

An industry representative stated that the IAIS is doing the comparability study, and the focus has moved from equivalence to comparability. The focus is the outcomes, and focus is needed on the stress tests to see whether the same outcomes occur, and whether the same points of regulatory intervention appear for both regimes.

6.3 ICS should use internal models as a framework for internationally active insurance groups and should not lead them to implement two different standards

A regulator stated that their organisation has essentially introduced and implemented an ICS. It is very important that the ICS takes the internal models on board; all internationally active insurance groups have internal models, which will also be an element of the ICS.

An industry representative stated that it is not clear what prudential regulation will mean at a global level, as a minimum harmonised framework is not yet in practice for different regions. Solvency II is a fairly complete and advanced framework, and there should not be two prudential regulation standards and indicators.

The Chair expressed hope that the ICS will be finalised soon and as expected, because it will be an added value for the supervision and for the protection of policyholders globally. The insurance sector deserves to have a global capital standard, and the hope is that the ICS will be a catalyst for convergence of a prudential framework around the globe.