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From:	European Economic and Social Committee (EESC)
On:	27 January 2022
To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
Subject:	Opinion of the European Economic and Social Committee (EESC) on the Solvency II Review

Delegations will find attached the opinion mentioned above.

Other language versions of the opinion will soon be available on the EESC's website :

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OPINION

European Economic and Social Committee

Solvency II Review

Proposal for a Directive of the European Parliament and of the Council 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 final – 2021/0295 (COD)]

Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of insurance and reinsurance undertakings and amending Directives 2002/47/EC, 2004/25/EC, 2009/138/EC, (EU) 2017/1132 and Regulations (EU) No 1094/2010 and (EU) No 648/2012
[COM(2021) 582 final – 2021/0296 (COD)]

ECO/566

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Referral	European Parliament, 22/11/2021 Council of the European Union, 26/11/2021
Legal basis	Articles 114 and 304 of the Treaty on the Functioning of the European Union
Section responsible	Economic and Monetary Union and Economic and Social Cohesion
Adopted in section	08/02/2022
Adopted at plenary	23/02/2022
Plenary session No	567
Outcome of vote (for/against/abstentions)	169/0/2

1. Conclusions and recommendations

1.1 The European Economic and Social Committee (EESC) agrees with the European Commission that the Solvency II rules, which are based on three pillars (quantitative capital requirements; organisational structure, supervision; reporting, transparency), have proved their worth. However, the experience of the sovereign debt crisis, the low interest rate policy, the initial impact of the COVID-19 pandemic, which is by no means over, and the knowledge that other crises will occur, mean that the regulatory framework should be adapted.

1.2 The EESC strongly welcomes the fact that the European Commission is addressing the issue of systemic risks in the insurance sector. The risk profile of insurers is changing. In view of the climate crisis, the insurance sector plays a particularly important role when it comes to insurance against the impact of climate change and new environmental risks (such as biodiversity). Insurers also face higher risks in their role as investors. In particular, material, liability and transition risks relating to climate change are not properly assessed.

1.3 The EESC supports the European Commission's objective of creating a regulatory framework in which the insurance sector plays an even greater role as an investor in financing the transition to a sustainable economy and in tackling the impact of COVID-19 and climate change. At the same time, the EESC stresses the considerable interest of civil society in ensuring the stability of the financial sector and calls for sound capital requirements and risk preparedness in the insurance sector. Instability in the insurance sector would significantly set back efforts to tackle the climate crisis and overcome the pandemic.

2. General comments

2.1 *The European Commission's approach*

2.1.1 The EESC agrees with the European Commission that the Solvency II rules, which are based on three pillars (quantitative capital requirements; organisational structure, supervision; reporting, transparency), have proved their worth. They have seen Europe's insurance sector through the turmoil of the sovereign debt crisis, the ongoing low interest rate policy and the initial impact of the COVID-19 pandemic, which is by no means over. The EESC considers it useful and necessary to draw the appropriate conclusions from the experience gained from applying the rules, particularly regarding proportionality issues and the capital and risk-preparedness requirements. It is these last points that are decisive for undertakings' capital needs and, therefore, for the role that insurance undertakings can play as product providers and investors in the economy.

2.2 *Consistency with other EU policies*

2.2.1 Implementing the European Green Deal and overcoming the consequences of the COVID-19 pandemic are top-priority policies, the implementation of which requires large sums of public and private capital. Europe's insurance sector, as a long-term investor with an investment portfolio of over EUR 10 trillion in 2020, could contribute much more than it currently does to funding the transition to a climate-neutral economy as well as infrastructure projects and

affordable housing. Its ability to do so is largely determined by the capital and risk-preparedness requirements in the Solvency II system.

2.2.2 The EESC supports the European Commission's objective of creating a regulatory framework in which the insurance sector plays an even greater role as an investor in financing the transition to a sustainable economy and in combatting the impact of COVID-19. At the same time, the EESC stresses the importance of not jeopardising the protection objectives of the Solvency II system, namely the protection of insured persons and beneficiaries and the preservation of financial stability. However, this could be threatened if, in order to support the European Green Deal, the strict risk assessment of insurers' investments is not firmly adhered to. The consumer protection rules of the Solvency II system should cover the insurance industry's investments and activities in sectors where insurers invest on the basis of requests by the authorities or government. These investments can then be rewarded or sanctioned accordingly. In any case, any investment under the European Green Deal or NextGenerationEU, for example, must be subject to the same risk assessment as any other investment. Sustainable insurance supervision requires a fact-based risk assessment and a calculation of capital based on that. The EESC fully backs the European Commission's approach of reviewing the existing rules on capital requirements to determine where they have led to inadequate requirements (excessive or insufficient). The European Commission's proposals show how much leeway can be created from this alone. However, where capital requirements are too low (for example, risks relating to climate change), they need to be increased to ensure the stability of the sector.

2.2.3 The EESC supports the European Commission's efforts to make another substantial contribution to the implementation of the Capital Markets Union. Building the internal market would make it easier to both finance ways out of the COVID-19 pandemic and fund the European Green Deal simply because consumers could see further progress towards creating a genuine single market in financial markets, although there are still many legal and real obstacles to establishing the Capital Markets Union.

2.2.4 The EESC welcomes the idea that the insurance sector should play a stronger role in financing the green transition. The insurance sector should also seek to mitigate all adverse environmental and social impacts of its investments and insurance activities. A link to the EU taxonomy is useful. The EESC calls for social sustainability objectives to be systematically taken into account. After all, failure to respect workers' and human rights can also lead to increased risk.

2.2.5 The proposals provide for streamlining of the complex Solvency II system in several places. This is to be welcomed. The idea that users of internal models now also have to submit reports – as if they were using the standard formula – does not make sense and should be rejected. Double reporting must be ruled out.

2.3 *Delegated acts*

2.3.1 The EESC is aware that the European Commission is entitled to adopt certain rules, in particular technical rules, by means of delegated acts. The Commission announces many proposals that it would like to implement through delegated acts. These proposals carry great weight and are of significant economic importance. Examples include volatility adjustment,

matching adjustment and extrapolation, as well as the very political decision as to the extent to which Green Deal funding should be facilitated and the limitations that should apply to investment risk assessments in this regard. Both here and elsewhere, the EESC calls for important economic matters to be dealt with in an ordinary legislative procedure involving the Parliament and consulting civil society, rather than through delegated acts. Before the adoption of the Solvency II package, the European Parliament, the European Commission and the EESC should have a clear picture of the content and impact of delegated acts.

2.4 *Evaluation of adjustments – Impact Assessments: Competitiveness*

2.4.1 The EESC proposes that a full evaluation of the thinking behind the Solvency II framework be carried out in the coming years. In the meantime, the framework conditions have changed in many ways and will continue to change, making evaluation absolutely essential. In this context, a competition check might be useful to determine the impact of the amended rules on the competitiveness of the European insurance sector on a world market basis.

3. Specific comments

3.1 *Proportionality and thresholds*

3.1.1 The EESC welcomes the European Commission's intention to strengthen the proportionality principle. Simplifying the very complex and burdensome regulatory framework is particularly important for smaller and less risk-exposed insurers, which are an important part of regional diversity. It is true that the Solvency II risk-management and reporting requirements should be reviewed and adjusted on the basis of rules. However, it is regrettable that it is still only the size of an undertaking that matters and that no comparison is made between the scope of the prudential requirements and an insurer's actual risks based on its business model.

3.1.2 A major strength of the European insurance market is the diversity of large and small insurers, of those that are active internationally and those that are strong at regional level, as well as the diversity of legal forms such as joint stock companies or cooperatives. This diversity should not be put at risk by overburdening insurers with excessive red tape.

3.2 *Long-term guarantee measures*

3.2.1 The EESC supports the European Commission's intention to enable the insurance sector to become more involved in financing the implementation of the European Green Deal, combatting climate change and its impact and tackling the consequences of the COVID-19 pandemic through more appropriate capital requirements. The implementation of the European Green Deal must not founder on the financing of the transition to a sustainable economy, and sustainability goals must not be jeopardised by insufficient capital requirements that artificially turn highly polluting activities into profitable investments. The revision of the rules on the necessary capital requirements will be the key to addressing these issues. The EESC thinks it essential to only modify the Solvency II rules to the extent that the prudential objectives of protecting insured persons and beneficiaries and the objective of financial stability are not jeopardised. The aim must be to strike the right balance between incentives for insurers to invest

in activities focused on social and environmental objectives, on the one hand, and prudential requirements, on the other. This has not yet been ensured.

3.2.2 The EESC supports the Commission's proposals to reduce volatility from long-term investments through the proposed volatility adjustment. At the same time, however, it is increasing volatility by switching to relative risk correction (percental deduction from spreads). This is counterproductive. It is not clear why the current risk correction should not be maintained.

3.2.3 The European Commission's proposals to modify the risk margin (for example, cost of capital rate of 5% and the non-consideration of the liquidity factor), the interest rate risk and the correlation between spread risk and interest rate risk are appropriate, without jeopardising Solvency II's protection objectives. However, particular attention must be paid to the level 2 texts, as the proposals leading to an overall improvement may also have detrimental effects on the investment portfolios of small and medium-sized insurers.

3.2.4 In principle, the EESC welcomes the European Commission's proposals to revise the eligibility criteria for long-term equity investments while at the same time ensuring financial stability. This will make it easier for insurance undertakings to benefit from preferential capital treatment when they provide long-term capital to the economy, provided that this capital is invested in line with social and environmental objectives. Overly complex rules must be avoided. Once again, a final assessment can only be made if the level 2 proposals are known.

3.2.5 The European Commission sets out its intention to present a new extrapolation method. Extrapolation is a calculation method that makes it possible to establish provisions for insurance policies whose terms run further into the future than reliable capital market information on risk-free interest rates. This method is a key factor in assessing provisions and therefore the need for own funds. Extrapolation is particularly important for life insurance, but not only in that case. The European Commission itself acknowledges in its Communication COM(2021) 580 final that the proposal that it will subsequently flesh out in a delegated act "will have a significant impact on insurers' capital resources in several markets". This significant impact will entail an additional capital requirement of more than 10% for non-life insurers compared to previous projections, thus completely counteracting the potential effects of releasing insurers' capital. The EESC believes that such far-reaching interventions should be decided in an ordinary legislative procedure.

3.3 *Climate scenario analysis and mandate to EIOPA[1] regarding sustainability risks*

3.3.1 The EESC fully supports the need for insurers to identify any material exposure to climate change risks and to assess the medium and long-term impact on their business. The EESC recommends extending this scenario analysis to all environmental risks and applying the concept of double materiality to these requirements. Insurers should also be required to assess and, where appropriate, mitigate the impact of their activities on climate change and the wider environment.

1 European Insurance and Occupational Pensions Authority (EIOPA).

3.3.2 The EESC welcomes the European Commission's proposal to mandate EIOPA to propose – after consulting the European Systemic Risk Board – possible adjustments to the capital requirements with regard to sustainability risks in a report by 28 June 2023. It is right to discuss such wide-ranging issues on an empirical basis. However, the EESC thinks that the deadline for submitting the report is not ambitious enough. Mitigating the effects of climate change requires swift action. The EESC would already like to point out that the lessons drawn from these proposals will affect fundamental issues relating to the financing of the European Green Deal. They will therefore be of a political rather than a technical nature and, in the EESC's view, must be dealt with in an ordinary legislative procedure involving the European Parliament.

3.4 *Group supervision*

3.4.1 Regulatory weaknesses have been revealed in group supervision in practice. The EESC supports the European Commission's proposals to bring insurance holding companies and mixed financial holding companies directly into the scope of the EU prudential framework. From the consumer's point of view, it is important to ensure that the external presentation of a group is transparent with regard to its liabilities.

3.5 *Role of insurance during pandemics and other large-scale disruptive events*

3.5.1 The EESC agrees with the European Commission's assessment that the pandemic has highlighted the need for clearer and simpler information on the terms of insurance cover and guarantees offered to consumers, especially as regards business interruption and travel insurance, and the need to constantly verify that insurance products continue to be in line with consumer needs. It is equally important that consumers be able to enforce their rights. Current product oversight has evidently not worked well enough. The EESC urges the Commission to ask EIOPA to put forward concrete proposals on how to solve the problem, which has already been known about for a long time.

3.5.2 The pandemic, the impact of climate change, which we are experiencing in Europe in the form of forest fires, drought, forest decline, heavy rainfall and flooding of unprecedented severity, as well as major new threats such as cyber risks, raise the question of the availability of insurance cover for such events, which will not continue to be one-off occurrences. The EESC strongly supports the European Commission's plan to set up a Climate Resilience Dialogue by 2022, bringing together insurers, reinsurers, public authorities and other relevant stakeholders. The EESC suggests involving civil society representatives in this dialogue from the outset.

3.6 *Insurance guarantee schemes (IGSs), recovery and resolution and new supervisory measures*

3.6.1 The European Commission does not present a proposal to harmonise the patchwork of IGSs in Europe. It omits this, even though IGSs provide significant last-resort protection to insured persons and beneficiaries. A Europe-wide system of IGSs, which at the same time takes account of the type of products and thus consumers' entitlement to protection, would significantly increase confidence in a single European insurance market. As EIOPA suggests, the EESC thinks there is an urgent need to at least harmonise a set of minimum principles for the IGSs. On the other hand, as the European Commission points out, the EESC also believes that this would

impose a significant financial burden on insurance markets in some Member States that do not yet have IGS systems, which they think is unreasonable at this stage of the recovery from the COVID-19 crisis. As a first step, the EESC calls on the European Commission to swiftly put forward a proposal for a minimum framework for IGSs to address the issue, with an appropriate transitional period, without overburdening the markets.

3.6.2 With its recovery and resolution proposal[2], the European Commission is expanding the supervisory tools which should enable supervisory authorities to act more quickly and more efficiently in the event of an economic crisis and, in particular, an emerging crisis. These tools also include measures such as pre-emptive recovery and resolution planning, including at group level. Resolution tools and powers are established. However, there is not a clear distinction between these and the existing Solvency II supervisory measures. In general, the tried and tested "intervention ladder" is called into question in many places as the new powers of intervention are intended to apply even before the Solvency Capital Requirement (SCR) is breached. The EESC considers it essential that the proposed measures be consistent with the rules of the intervention ladder. The resolution rules should facilitate a harmonised approach at group level, particularly in the case of mixed financial groups.

3.6.3 A counterargument against the proposals is that the COVID-19 pandemic, and in particular the low interest rate, has shown that the Solvency II toolbox has been good enough to cope with difficult situations. Even though this has largely been the case, the EESC does not agree with this line of reasoning. Based on experience from past financial crises, the EESC thinks there is an urgent need to begin taking phased crisis intervention measures at company level even before a failure to meet the minimum capital requirements, as long as there are clear signs the situation has worsened. The EESC points out that, when devising and implementing the rules in practice, it will be very important to clearly define and set the limits of EIOPA's and the national supervisory authorities' tasks.

Brussels, 23 February 2022

Christa SCHWENG
The president of the European Economic and Social Committee

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2 COM(2021) 582 final.