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WORKING DOCUMENT

From:	Presidency
To:	Working Party on Financial Services and the Banking Union (Insurance)
Subject:	Solvency II review - Cover letter of a third global compromise

Solvency II review
Cover letter of a third global compromise
May 18, 2022

On the basis of the discussions held during the six working parties that took place during the first quarter of 2022, and building on the achievements of the Slovenian Presidency, the French Presidency drafted a number of targeted compromise text proposals modifying the provisions introduced by the European Commission's proposal amending the Solvency II Directive 2009/138/EC and taking into account both oral contributions and written submissions from Member States. Bearing in mind the objective of establishing a general approach of the Council in Ecofin by June 2022, two consecutive global compromises have been brought forward to Member States on April 11th and May 11th. This third compromise text has been amended on the basis of new written submissions from Member States.

This non-paper highlights the main changes introduced in this third compromise. In order to ease their identification, the new amendments appear in bold blue letter in the compromise text, while former amendments appear in bold black letter. Some provisions seem to require further in-depth discussions and hence are put into brackets in the attached compromise proposal.

The Presidency's intention is to build upon this third compromise to reach an agreement within the Council on the text. After this working party, the Presidency will therefore assess whether the compromise text has sufficient support by Member States to be brought to COREPER.

Main changes entailed in this compromise text

1) Long term guarantee measures

Member States were overall supportive of the second compromise proposal on long term guarantee measures, even though some adjustments were still requested to clarify the new provisions inserted in the second compromise:

(a) 'Quality overshooting' ratio: A new **recital 36a** is introduced and **Article 77d** is amended, both in case of an overshooting of the VA caused by a difference in the composition of bonds portfolio held by an undertaking, compared to the currency representative portfolio. In this case, the undertaking should be able to apply a modified VA that better takes into account the specificities of its investments in debt instruments in order to correct the overshooting effect.

This instrument is calculated as the ratio of the risk corrected spread calculated based on the undertaking's portfolio of investments in debt instruments over the risk corrected spread. The formula of the risk corrected spread used for this purpose has been simplified and shall be calculated in the same manner as the risk corrected spread based on the reference portfolio for the relevant currency, but using undertaking-specific data on the weights and average duration of the relevant sub-classes of investments within the undertaking's portfolio of debt instruments for the relevant currency.

Article 77d(1c) is also amended to clarify the relationship between the use of the specific adjustment to the risk-corrected spread as introduced in the previous paragraph, and the **macro VA**. These two measures pursue opposite objectives and shall not be activated simultaneously: the specific adjustment to the risk-corrected spread curbs the undershooting whereas the macro VA address undershooting issues.

For an undertaking using **an internal model**, the SCR is the higher between a notional SCR calculated with a VA based on the reference portfolio for the relevant currency and a notional SCR calculated with a VA based on the own portfolio of the undertaking (enhanced prudence principle). **Article 122** already takes into account that this prudence principle cannot be consistent with the use of a macro VA. It is therefore also amended to specify that the VA used for internal models (**dynamic VA**) should not be calculated based on the undertaking-specific adjustment of the risk corrected spread, as introduced in paragraph 1c in Article 77d.

(b) CSSR for pegged currencies: both **recital 39** and **Article 77d** had been amended in the second compromise text in order to ensure that the new credit spread sensitivity ratio (CSSR) calculation would take into account pegged exchange rate regimes in the delegated act. Some Member States were concerned about the comparative advantage for insurers from countries with pegged exchange rate regime running cross-border business in euro-zone countries. This provision has been reworded to make clear that it only aims at allowing undertaking authorized in countries that comply with the Exchange Rate Mechanism (ERM II) to use a single CSSR, and not a single VA, to calculate the best estimate of their liabilities.

2) Group supervision

Member States were overall supportive of the second compromise proposal, even though some adjustments were still requested. The following amendments are proposed in the third compromise text:

(a) Horizontal groups

- **Proportional share in horizontal groups:** in response to a demand of some member states, Article 221, the discretionary power of the supervisory authority is enlarged to cater for the case of horizontal groups characterised by weak capital ties. A new point (d) aims at allowing the application of the power given to the supervisor to determine the proportional share held by the participating undertaking (Article 221(2)) to horizontal groups “managed on a unified basis” according to the “opinion of the supervisor” pursuant to article 212 (3), and not pursuant to Directive 2013/34/EU.
- **Definition of ‘parent’ and ‘subsidiary’ undertakings:** Article 13(15) and (16) are amended to include in the definitions of “*parent undertaking*” and “*subsidiary undertaking*” the cases of undertakings designated as such by the supervisory authority pursuant to Articles 212 and 214. This amendment ensures an equal treatment of “*parent undertakings*”, whether they fall under the definition of Directive 2013/34/EU or are designated as “*parent undertakings*”. Consequently, the explicit references to “*designated parent undertakings*” in articles related to group supervision (e.g. Article 246) are removed.

(b) Banking buffers: the exclusion of capital buffers from the calculation of the group solvency capital was not supported by a majority of Member States. In order to address the concern expressed some member states, a mandate is therefore given to EIOPA in Article 304b to monitor for five years the contribution of combined buffers of credit institutions to insurance groups’ SCR and report any findings.

Other minor changes have been made to for the sake of consistency or clarity. In Article 212(1)(f), point (d) adds holding companies of third-country insurance and reinsurance undertakings to the list of subsidiaries to be taken into account when assessing whether 50 % of the point’s various indicators are “insurance” or not to classify the entity as insurance holding company.

In paragraph 72, point (b)(ii) has been further amended to ease the application of supervisory measures in case of “trigger inversion”. Article 230 clarifies that supervisory measures equivalent to a breach of SCR should be applied in case of a breach of the minimum consolidated group SCR, no matter if the group still complies with its SCR. In that case, articles usually applied in case of breach of SCR must be read by replacing “*Solvency Capital Requirement*” with “*Minimum Consolidated Group Solvency Capital Requirement*”.

In Article 256c(1) on SFCR audit requirements, the word “*consolidated*” is replaced by the word “*group*” to cater for the needs of horizontal groups that do not provide a consolidated balance sheet according to accounting standards, and clarify that only the prudential group balance sheet has to be audited.

3) *Proportionality*

The main changes made by the Presidency are the following:

- **Criteria for classification of undertakings as small and non-complex:** in a spirit of compromise, the criterion of cross-border activity is maintained at the same level as in the previous compromise (EUR 15 million or 5 % of cross-border activity). In return, EIOPA's reporting on small and non-complex undertakings operating outside of their home state is detailed (additional paragraph in **Article 52**) and a monitoring power regarding the appropriateness and soundness of the criteria is conferred on it. The latter shall be submitted 3 years after the entry into application of the updated Directive.
- **Use of proportionality measures:** the Presidency proposes to maintain the principle of an automatic classification as SNC, while slightly amending **Article 29c(2)** by removing the adjective "severe" in the definition of "severe deficiencies in the functioning of the undertaking's system of governance", in order to avoid redundancies with the "serious" concerns these deficiencies of governance can arouse.
- **Proportionality at group level:** some Member States voiced concerns on the exclusion of some entities using method 2 in the calculation of proportionality criteria at group level pursuant to Article 213a. Therefore, a safeguard preventing groups with significant subsidiaries using method 2 from being wrongly considered as SNC is introduced.

Other minor changes further clarify the compromise. Article 29a removes the reference to "insurance", thus harmonizing the wording with the compromise reached on this article. The reference to insurance only could be misleading as for the reinsurance activities operated by captive entities. Article 29a(b) rewords the cross-border criteria as "lower" instead of "not higher than" in order to align the drafting with other occurrences of this criterion.

4) *Supervision of cross-border insurance business*

Article 33a on *Supervisory cooperation between home and host supervisory authorities* and article 159a on *Additional requirements related to significant cross-border activities* contain identical provisions regarding the definition of *significant cross-border* activities and the disagreement settlement applicable to such activities. In order to avoid redundancy and ensure consistency, the wording of article 159a has been modified to replace these detailed provisions by a reference to article 33a.

5) *Macro-prudential tools*

Article 144 (b) paragraph 4 has stirred debate on the conditions and the extent of the power given to a macroprudential authority to **suspend redemption rights** of policyholders in the event of exceptional circumstances and liquidity risks affecting whole or a significant part of the market. Some Member States argue that policyholder protection is paramount and that this authority should conduct a case-by-case analysis of liquidity vulnerabilities of undertakings concerned, while others regard that the value of this power lies in the ability to use it collectively in order to act swiftly in case of exceptional circumstances. In the spirit of compromise, two modifications are contemplated:

- The first subparagraph is reworded to clarify that the macroprudential power should only be used if all the conditions laid down under paragraph 3 (microprudential level) are fulfilled. In other words, conditions listed in paragraphs 3 and 4 are cumulative to collectively suspend redemption rights pursuant to paragraph 4.
- Member States are invited to share their views on the collective nature of this macroprudential power, which some member states are still discussing. The word 'collectively', which is put into brackets in the compromise text, clarifies that this macroprudential power is not a power to be exercised towards individual undertakings. However, even if the word were to be deleted, it would remain that according to this provision the power is to be exercised "in relation to all undertakings directly concerned". Thus, this deletion would not change the nature of this power, which is intended to be exercised towards several or all undertakings, but it would give more national discretion when transposing it into national law.

In order to ensure consistency between **article 132** on the Prudent Person Principle and article 45 on ORSA, article 132 is amended to specify that supervisory authorities shall consider whether any of the analyses referred to in paragraph 6 (effect of investment strategy on macroeconomic and financial markets' developments) is already performed at a higher-level of consolidation when deciding to request it at solo level.

New **Article 254(4)** has been amended to better circumscribe the delays and period in which the group supervisor can extend the deadlines applicable to the group for the submission of the information referred to in Article 254, in case of an operations-disrupting event declared as exceptional by EIOPA.

6) Reporting

Article 51(7), which aims at better circumscribing the possibility of extending reporting delays, has been further amended to ensure that, in case the undertaking benefitting from the extension is part of a group subject to group supervision, the supervisory authorities inform immediately the group supervisor of the aforementioned extension.

Article 256b has been amended to enable the group supervisor to extend, in case of an operations-disrupting event declared as exceptional by EIOPA, the deadlines applicable to the group for the submission of reporting information, consistently with the existing provisions at the solo level.