Solvency II Amendments

The original Solvency II directive was published in 2009 and entered into force on 1 January 2016. Solvency II outlines the key requirements for insurers, reinsurers, and captives established in the EU. Solvency II consists of three pillars: quantitative requirements (capital requirements), qualitative requirements (governance), and transparency and reporting requirements. As such, it is vitally important for the insurance sector and contributes to the strengthening of the EU financial system and the resilience of insurance and reinsurance companies.

The anticipated changes to the Solvency II regulations are set to take effect from 30 January 2027 and introduce several significant changes across its three pillars and proportionality measures, primarily aimed at enhancing the resilience of the insurance sector, improving risk management, and reducing regulatory burdens for smaller entities. Here is a summary of the key changes:

Pillar I: Strengthening the Capital Framework

- **Volatility Adjustment:** The volatility adjustment (VA) framework now requires supervisory approval, with the application ratio increasing from 65% to 85%, necessitating closer monitoring of credit spreads.
- **Risk Margin:** The cost of capital rate for the risk margin decreases from 6% to 4.75%, easing capital burdens for insurers.
- **Symmetric Adjustment:** The symmetric adjustment to the standard equity capital charge, which addresses risks from fluctuations in equity prices, now includes an expanded adjustment corridor from 10% to 13%, enhancing sensitivity to equity shocks.
- **Extrapolation of Risk-Free Interest Rates:** A new phased approach to adjusting the convergence to the ultimate forward rate (UFR) will take place until 2032, enabling insurers to better reflect market rates in their long-term liabilities.
- **Long-Term Equity Investments:** The criteria for classifying long-term equity investments have been relaxed by allowing for more flexibility in the types of investments that can be included.

Pillar II: Strengthening Governance and Risk Oversight

- **Own Risk and Solvency Assessment (ORSA):** The ORSA now includes the analysis of macroeconomic conditions that affect the firm's risk profile.
- **Governance and Fit and Proper Requirements:** Insurance and reinsurance undertakings must notify the supervisory authority of any changes in key personnel, including providing reasons for these changes. Additionally, supervisory authorities are empowered to require the removal of individuals who do not meet the fit and proper requirements.
- **Operational and Sustainability Risk Management:** There is now a requirement for insurance and reinsurance undertakings to ensure as part of their risk management, to have strategies, policies, processes, and systems in place to identify, measure, manage, and monitor sustainability risks over the short, medium, and long term.
- **Macroprudential Tools:** Supervisory authorities have the authority to require companies to strengthen their liquidity position if significant liquidity risks or weaknesses are detected.

Pillar III: Enhancing Transparency and Reporting

- **Solvency and Financial Condition Report (SFCR):** The SFCR is now divided into sections for different stakeholders, enhancing clarity for policyholders and market professionals.
- **Audit Requirements:** Balance sheets in the SFCR are now subject to audits, increasing transparency.
- **Reporting Deadlines:**
  - **Annual QRTs**: Extended from 14 weeks to 16 weeks.
  - **Regular Supervisory Report (RSR) and SFCR**: Extended from 14 weeks to 18 weeks.
  - **Group SFCR**: Extended from 20 weeks to 22 weeks.
- **Proportionality Measures for Smaller Entities:**
  - **Simplified Calculations**: Small and non-complex undertakings (SNCUs) can use deterministic valuation for calculating technical provisions.
  - **Exemptions**: SNCUs and captives are exempt from certain liquidity risk management requirements and may have reduced reporting obligations.
  - **Governance Flexibility**: Key function holders in SNCUs can perform multiple roles, simplifying governance structures.

Crisis Management and Resolvability Enhancements

- **Crisis Plans and Resolution:** The directive now ensures that resolution plans include comprehensive measures for addressing operational continuity and mitigating potential disruptions.
- **Judicial Oversight:** Member States may require ex-ante judicial approval for crisis management measures and establish a right to appeal against such decisions.

These changes reflect a more balanced regulatory environment aimed at promoting long-term investment, enhancing supervisory practices, and reducing unnecessary burdens on smaller (re)insurers.

Looking ahead: ongoing discussions & considerations

Apart from the agreed changes to the Solvency II (SII) directive, there are other proposed amendments reflecting ongoing discussions and considerations in the insurance regulatory space. These potential changes are being explored to address various aspects such as resolvability, sustainability risks, macroprudential concerns, and group supervision. These consultations aim to gather feedback and refine guidelines and technical standards, but they have not yet been formally approved or implemented. Stakeholder engagement through these consultations is crucial in shaping the final decisions and regulatory pathways. A summary of these potential changes is included below:

- **Resolvability and Resolution Planning:** Proposals emphasize the assessment of resolvability and stress the need for tailored guidelines. These aim to ensure insurance firms can be effectively resolved in crisis situations, minimizing impact on policyholders and maintaining financial stability.
- **Critical Functions Identification:** The guidelines propose criteria for identifying functions that are crucial for the economy and individual livelihoods, suggesting that a deeper understanding of these functions can aid in the preparation for potential disruptions.
- **Recovery Planning:** Regulatory Technical Standards (RTS) are introduced to guide pre-emptive recovery planning and enhance market stability. This includes metrics to assess insurance market share and substitutability.
- **Sustainability Risks:** There is a focus on integrating sustainability risks into insurance operations, underscoring the importance of sustainability in financial risk management and planning.
- **Group Supervision:** Amendments address the exclusions from group supervision and underscore the importance of assessing intra-group transactions for ongoing appropriateness.
- **Market and Counterparty Risk Management:** Revisions propose streamlined guidelines for managing market and counterparty risk exposures in the standard formula, aiming to ensure robust risk assessment and management practices.

Overall, these amendments and proposals aim to refine the Solvency II framework to account for emerging risks, improve recovery and resolution capabilities, and enhance sustainability considerations in the insurance sector. The intention is to bolster market stability, protect policyholders, and adapt to evolving market conditions and regulatory requirements.

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