Response to EIOPA's consultation paper on the criteria for the identification of exceptional sector-wide shocks

Our reference:	ECO-SLV-24-412	Date:	24-12-2024
Referring to:	Consultation on the criteria for the identification of exceptional sector-wide shocks - Solvency II Review		
Related documents:	Consultation paper		
Contact person:	Prudential Team	E-mail:	prudential@insuranceeurope.eu
Pages:	5	Transparency Register ID	33213703459-54

Introduction

Q1. *Do you have general comments on the consultation paper?*

Insurance Europe appreciates the opportunity to provide input on EIOPA's draft technical advice.

Given the resilience of the sector and the existing supervisory powers, Insurance Europe does not agree there is a need to introduce further supervisory powers to restrict insurers' distributions for macroprudential purposes. As such, the criteria for the identification of exceptional sector-wide shocks require a very careful and restrictive approach.

Context to the Regulatory Technical Standards (RTS)

The insurance industry has demonstrated resilience during past crises, supported by an effective regulatory and supervisory regime, which will now be enhanced with new macroprudential measures such as liquidity risk management plans and consideration of additional macroprudential aspects as part of the Own Risk Solvency Assessment (ORSA) and investment strategies.

Empirical evidence from recent crises (eg COVID-19, Ukraine conflict) shows no need for such measures to ensure insurance sector stability. EIOPA's stress tests have further confirmed the sector's resilience under severe stress scenarios.

Discretionary powers

Exceptional sector-wide shocks should not automatically trigger macroprudential measures by local supervisors. Instead, they prompt the identification of the most vulnerable companies based on agreed and common market criteria. Solvent companies without imminent and material Solvency Capital Requirement (SCR) breaches should not face restrictions on dividends, buy-backs or other capital distributions.

EIOPA's mandate is to define criteria for identifying exceptional shocks, but the draft RTS lacks clear differentiation between exceptional and non-exceptional shocks. EIOPA acknowledges that these criteria will remain broad due to uncertainty about future crises, leaving significant discretion to supervisors. This discretion must be applied cautiously to prevent overreaction, as the current draft risks increasing the cost of equity and subordinated debt for European (re)insurers (through increased spreads). It could also hinder capital-raising during stress periods, harm EU sector competitiveness, and exacerbate procyclicality.

Insurance Europe aisbl • rue Champ de Mars,23 B-1050 Brussels
Tel: +32 2 894 30 00 • E-mail: info@insuranceeurope.eu
www.insuranceeurope.eu

Consistency of application

Giving individual Member States' supervisory authorities a broad scope to declare a sector-wide shock raises concerns about consistency across Member States, especially because of the lack of precise definitions:

- ***Supervisory dialogue:***
  Insurance Europe proposes that the NSA should be obliged to engage in discussions before imposing measures, to avoid unilateral NSA decisions. To mitigate this, it is recommended that the NSA duly justifies their proposed use of supervisory powers.

- ***Supervisory convergence:***
  The draft does not address how discrepancies in national approaches might impact competitiveness or the functioning of groups reliant on intragroup dividends for capital and liquidity allocation, especially if the EU approach differs from other global jurisdictions. This is also critical for the functioning of groups which rely on intragroup dividends to allocate capital and liquidity appropriately.

Clarity of definitions

It would be helpful if the term "sector-wide" shocks is better defined in the RTS, giving both quantitative and qualitative criteria that clearly avoids overreaction from supervisors, unnecessary costs for the industry and counterproductive effects on systemic risk. It also should place emphasis on the systemic risk, impact of such a shock and the likelihood that the supervisors will determine that a majority, or at least a very large number, of (re)insurance undertakings would be deemed "vulnerable" per Article 144c of the Solvency II Directive.

Q2. *Do you have comments on the following sections in section 1 with background and rationale?*

In our understanding, Article 144c as part of the chapter "Macroprudential tools" is a purely macroprudential provision. Therefore, the industry agrees with EIOPA that regarding policyholder protection, only shocks that endanger a significant part of the insurance cover provided by the sector are relevant. Other shocks should be dealt with by use of the microprudential toolkit.

Amendments to the Solvency II Directive

Mandate for draft regulatory technical standards

Approach to the RTS

Q3. *Do you have any other comments on the background and rationale section?*

Q4. *Do you have comments on the following recitals?*

Recital 1

It should be added that overly strict criteria could lead to the identification of an exceptional sector-wide shock when not warranted by risks to financial stability and the use of the instrument without necessity, increasing its negative side-effects.

Recital 2

EIOPA's draft states that some exceptional sector-wide shocks may pose a risk to policyholder protection but not endanger financial stability, and therefore different criteria should be introduced for both objectives. However, in our understanding, Article 144c, as part of the chapter on macroprudential tools, seems to be solely aimed at ensuring financial stability. Therefore, policyholder protection is only a relevant objective of this instrument when financial stability is threatened. As far as only policyholder protection objectives are concerned, the microprudential toolkit should be used. This should be clarified.

The draft RTS should make clear "financial stability" refers specifically to the stability of financial systems concerned in the European Union, as outlined in Article 28 Solvency II Directive (and contrasted with the objective of protecting policyholders and beneficiaries pursuant to Article 27 Solvency II Directive). Without this distinction, the term "financial stability" could lead to narrower or more microprudential interpretations.

Recital 3

Recital 4

Recital 5

Q5. *Do you have comments on the following articles?*

Article 1 - Criteria for exceptional sector-wide shock

Paragraph 1 (a) is too broad. **"**The **Contribution"** of insurance undertakings to financial instability should be subject to a materiality qualifier. Otherwise, any individual instability (irrespective of SCR compliance) may be seen as part of an overall instability and, thus, contributing to it. Like paragraph 1(b), it should be restricted by the additional requirement "which represent a significant part of the insurance and reinsurance undertakings of the sector…". Not all instances of instability constitute an exceptional sector-wide shock. For example, situations where a few large insurers with specific business models contribute to instability should not trigger such measures if the broader sector remains stable.

The Solvency II Directive mandates EIOPA to specify clear criteria for identifying exceptional sector-wide shocks, yet the RTS remains vague and open to interpretation, offering supervisors excessive discretion.

- The Directive states:
  - "exceptional sector-wide shocks have the **potential to threaten** the financial position of the undertaking concerned or the stability of the financial system".
- The RTS states:
  - "Supervisory authorities shall consider one or more events to be an exceptional sector-wide shock if that event or those events significantly **increase one or both of the following risks:**
  - (a) insurance and reinsurance undertakings of a sector in their Member State cause or contribute to financial instability in one or more Member States; or
  - (b) insurance and reinsurance undertakings which represent a significant part of the insurance or reinsurance cover provided by a sector in their Member State are unable to meet their insurance or reinsurance obligations".

In practice, this means that the supervisor is given considerable freedom to declare exceptional sector-wide shocks, contrary to the intention of creating clear criteria via technical standards for consistent application. The RTS lacks guidance on the precise conditions under which supervisory powers in Article 144c would apply, paving the way for excessive discretion.

The identification of the exceptional sector-wide shock would only be appropriate if it is truly "sector-wide". This would require a high degree of confidence that the shock affects a majority or a substantial number of undertakings, leading to the identification of a large number of "individually vulnerable entities". Situations where only a limited number of companies are impacted should be handled by existing provisions in the Directive, without declaring a sector-wide shock.

The RTS wording which refers to events which "significantly increase" the risks of undertakings contributing to financial instability in one or more Member States is vague. The wording is similarly imprecise and open to interpretation as the Directive wording which states that exceptional sector-wide shocks have the potential to threaten the financial position of the undertaking concerned or the stability of the financial system. Against this background, the industry suggests that the wording of the RTS should be aligned with the Directive or removed.

Furthermore, the RTS would benefit from additional clarity:

- Article 1 refers to "a sector" and "the sector" multiple times. These terms need to be defined. The term "sector" should be understood as meaning the whole insurance sector. However, the draft RTS tries to define "sector" as a sub-set of the national insurance sector which is too narrow. For example, where Article 1 (1) a) speaks of "insurance and reinsurance undertakings of a sector" and Article 1 (1) b) of "insurance or reinsurance cover provided by a sector", this refers rather to insurance segments or even lines of business rather than the insurance sector as a whole.
- Article 1(1) speaks of "significantly increase". This should be "materially increase" to align better with terms used in the Solvency II body of rules; "materially" means a change that would change decisions of stakeholders.
- Article 1(1)(b) refers to a significant part of the (re)insurance cover in their Member State. In analogy with Article 1(1)(a), it seems logical to look not only at their own Member State but also at other Member States.
- Sector-wide shocks definition could include the following aspects:
    - *a majority of undertakings in the Member States concerned are likely to be assessed "vulnerable"*
    - *no reasonable prospect of a recovery within a short-term period of, eg, 3 months (enduring nature)*
    - *reinsurance mechanisms including their global dimension must be considered as mitigating the impacts on primary insurers*
    - *material contagion risks from one market to another as well as between sectors, from pro-cyclical behaviour in line with Article 28 of Directive 2009/138/EC*
    - *impact on competitiveness of insurers*

- The linguistic content of Article 1 (1) is unclear. For example, "one or both of the following risks" and "insurance and reinsurance undertakings of a sector".
- Furthermore, it may make sense to have a closer link between "**exceptional sector-wide shocks**", declared by national supervisory authorities, and "**exceptional adverse situations" pursuant to Article 138 (4) Solvency II Directive**, declared by EIOPA and allowing National Competent Authorities (NCAs) to give insurance undertakings more time to restore their solvency in case of SCR breach. Currently Article 1 (2) (d) only requires that the declaration pursuant to Article 138 (4) Solvency II Directive is one of several factors to be taken into consideration.

Article 2 - Entry into force

Q6. *Do you have any other comments on the draft technical standards?*

Q7. *Do you have comments on the analysis of policy issue A?*

While the industry finds the criteria included in the draft RTS too general to provide a reasonable level of legal certainty about what constitutes an exceptional sector-wide shock, quantitative criteria are not absolutely necessary to define the situation more clearly.

For example, the current Solvency II already includes quantitative criteria to evaluate the effect of event(s) on (re)insurance undertakings in the sector. Specifically, non-compliance with the SCR, as addressed in Article 137 of the Directive, serves as a relevant criterion. The expected impact on the solvency ratio or Minimum Capital Requirement (MCR) coverage ratio, by its nature, could be used to decide on the severity of sector-wide shocks. Using a quantitative criterion of an aggregated sector solvency ratio falling below 100% as a measure to identify such events would capture relevant aspects, considering the potential consequences for the industry, such as the inability to pay dividends.

Additionally, Article 144c in the amended Solvency II Directive already specifies: *"When exercising the power referred to in paragraph 2 of this Article, supervisory authorities shall duly take into account the proportionality criteria referred to in Article 29(3), and the existence of approved risk tolerance limits by the undertaking and thresholds in its risk management system",* which could provide a starting point for further definition of vulnerable risk profiles.

Q8. *Do you have any other comments on the impact assessment in Annex I?*

Q9. *Do you have any other comments on the consultation paper?*