Insurance Europe response to European Commission targeted consultation on assessing the adequacy of macroprudential policies for non-bank financial intermediation (NBFI)

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General comments

Insurance Europe welcomes the opportunity to provide input into the European Commission's assessment of the adequacy of macroprudential policies for the non-bank financial intermediation (NBFI) sector.

Insurance Europe agrees with the Commission's assessment of the limited systemic risk posed by the insurance sector and the existing and extensive microprudential and macroprudential tools available to assess and mitigate it.

In light of the above, Insurance Europe's responses to the consultation questions are focused. Our key views on the macroprudential framework relating to the insurance sector are summarised below:

- The NBFI categorisation and terminology is unhelpful and unconducive to policymaking. NBFI is an undifferentiated and misleading term that amalgamates anything but bank-regulated entities, from insurers and asset managers to hedge funds, money market funds, venture capitalists, the crypto-ecosystem and even microloan organisations. However, policymakers' concerns are typically centred around the lack of adequate regulation and supervisory oversight. As such, a differentiated approach to the individual financial sector activities (regulated vs unregulated) is required.

- The European insurance sector is well-regulated and supervised. The extensive prudential framework, Solvency II, provides the sector with a strong and well-recognised regulatory foundation.

- With the Solvency II review, the macroprudential framework for the European insurance industry has been strengthened further, introducing new macroprudential requirements for insurers and new macroprudential powers for supervisors. In addition, the reform of Solvency II includes enhanced powers for supervision of cross-border activities.

- Additionally, the Insurance Recovery and Resolution Directive (IRRD) is in the process of being introduced. The implementation of the Financial Stability Board (FSB) Key Attributes, and related International Association of Insurance Supervisors (IAIS) standards, provide for orderly resolution in

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the insurance sector. It will provide resolution powers for existing supervisory authorities, or newly created resolution authorities.

- The insurance sector is also subject to extensive macroprudential oversight through the IAIS Holistic Framework, with data contributions from both individual insurers and supervisors.
  The Holistic Framework is the key international regulatory tool for the assessment and mitigation of potential build-up of systemic risk in the insurance sector. It is supported by the industry and was endorsed by the FSB in December 2022. Through the Holistic Framework, the IAIS has developed one of the most comprehensive global oversight mechanisms.

- Liquidity risk in the insurance sector is well-managed and well-supervised, although it is rarely problematic due to the unique features of the insurance business model. These include: liabilities being generally illiquid (meaning claim payouts are triggered by events, not policyholder decisions); insurers generally matching the duration and liquidity of their assets with that of their liabilities; and companies being typically well-diversified, benefiting considerably from risk diversification across product lines and time.

As a result, Insurance Europe takes the view that the European Commission's work on NBFI should not lead to additional regulations applying to the 'NBFI' sector as a whole, keeping in mind the already existing regulations and supervision applying to the insurance sector.

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Detailed comments

Q3. *To what extent could the failure of an NBFI affect the provision of critical functions to the real economy or the financial system that cannot easily be replaced?*
Please explain in particular to which NBFI sector, part of the financial system and critical function you refer to, and if and how you believe such knock-on effect could be mitigated.

Insurers perform crucial functions for the real economy and financial system. However, there is little systemic risk from a failing insurer, because of the specific insurance business model and the extensive regulatory and supervisory system already established. In addition, most insurance products are characterised by high substitutability between insurance providers.

The concept of critical functions in the insurance sector is typically discussed in the context of the IRRD. In its proposals on the IRRD, the Commission did not elaborate on the concept and has delegated the responsibility of clarifying this concept to EIOPA.

Notwithstanding the lack of clarity on what a critical function means in the context of the insurance sector, one of the primary objectives of the IRRD is to ensure the continuity of critical functions. As such, any critical functions in the insurance sector should be preserved through the implementation of the IRRD, if an insurer providing these functions does fail.

Q4. *Where in the NBFI sectors could systemic liquidity risk most likely materialise and how? Which specific transmission channels of liquidity risk would be most relevant for NBFI? Please provide concrete examples.*

Insurance Europe agrees that due to structural changes, systemic liquidity risk has increased in importance. However, liquidity risk remains relatively limited in the insurance sector.

Liquidity risk is rarely problematic in insurance because:

- Insurance liabilities are generally illiquid. On most policies, especially non-life policies, claims are not paid out until an insured event occurs. Life products often contain redemption options, but the short-term volatility of policy surrender rates is generally quite low over business and financial cycles. Any risk of mass redemptions is limited by contract features (eg limited early redemption options for annuities), cancellation penalties and tax charges, or the loss of biometric risk cover, all of which disincentivise policyholders from surrendering policies early.

- Insurers generally match the duration and liquidity of their assets with that of their liabilities. In addition, insurers have access to a stable flow of cash (pure liquidity) originating from new premiums, maturing assets and investment income. In line with the liquidity risks they face, insurers hold a substantial amount of highly liquid assets. For those insurers that use derivatives, preparedness for margin calls is high (see answer to question 26). Insurers are generally diversified companies and benefit considerably from risk diversification across product lines and time. This limits the extent to which large, unexpected claims can occur and stabilises aggregate pay-outs. Large single claims usually have a longer, sometimes multi-year, pay-out period and also benefit from reinsurance coverage.

  Effective regulatory and supervisory provisions regarding potential liquidity risks are already in place. The heightened significance of liquidity risks has already led to a substantial enhancement in the surveillance of insurers' liquidity risks. For instance, in 2020 EIOPA established a quarterly monitoring exercise regarding the liquidity position and projections of insurers with a potentially vulnerable liquidity profile. Since 2021, a liquidity component has also been included in EIOPA's insurance stress test. Furthermore, the macroprudential reforms to be introduced with the Solvency II review are specifically

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aimed at addressing liquidity risk. All insurers, with the exemption of small and non-complex undertakings, will be required to draw up and keep up to date a liquidity risk management plan (LRMP) covering liquidity analysis projecting the incoming and outgoing cash flows in relation to their assets and liabilities. Further, new supervisory powers to address severe liquidity vulnerabilities are introduced, including temporary restrictions of dividend distributions and temporary suspensions of redemption rights of life insurance policyholders.

Q6. *Do you observe any systemic risks and vulnerabilities emerging from crypto assets trading and intermediaries in the EU?*

European insurers do not invest in crypto assets[1] and have not observed any systemic risks and/or vulnerabilities from crypto assets trading or intermediation in the insurance sector.

Q7. *Considering the role NBFIs have in providing greater access to finance for companies and in the context of the capital markets union project, how can macroprudential policies support NBFIs' ability to provide such funding opportunities to companies, in particular through capital markets? Please provide concrete examples.*

Compared to, for example, the US, the stronger reliance on banks for funding, and more generally, the relative lack of diversity in funding sources for EU businesses is a well-known issue and a key focus of the Capital Markets Union (CMU) project. At European level, there are increasing efforts to reduce bureaucratic hurdles and regulation (eg Mario Draghi's report on the future of European competitiveness).

There are various drivers for this situation, which prevent insurers from playing a bigger role. Below are examples of actions that can help diversify funding from an insurance perspective. In addition to prudential reforms, measures beyond macroprudential policy are also particularly important:

- **Improve prudential rules which are unnecessarily holding back insurers' investments**

Improvements targeted at improving capital requirements for listed equities are under discussion as part of the Solvency II review. However, other areas of the review aimed at reducing excessive overall capital requirements and volatility also have a major impact on the capacity of insurers to invest. It is therefore key that the Level 2 technical details of the Solvency II review are finalised taking into account the impact of the review on the fulfilment of the CMU objectives.

- **Increase insurers' access to SME equity, venture capital, SME debt and infrastructure**

There are examples at national level of funds being created, often with the involvement of insurers and governments, that include equity and debt from small and medium-sized enterprises (SMEs), venture capital or infrastructure assets. Such funds provide the scale and access for a wide range of insurers to invest in these asset classes. Actions should be taken to assess where and why such funds have been successful and how their use can be expanded to other EU markets. The potential for multinational or EU versions of such funds, along with the potential benefits of financial instruments like InvestEU, should be investigated.

- **Facilitate greater cross-border investment**

Increase trust and confidence in cross-border investment within the EU by making progress in the areas of insolvency law and increasing intra-EU investment protection. Harmonising creditor rights, along with the legal status and powers of insolvency administrators to trace assets belonging to the insolvency estate, would help ensure that the interests of creditors are appropriately considered, contributing to greater confidence in a fair

[1] According to EIOPA's Financial Stability Report of June 2024, insurers' "exposures to crypto assets are negligible, represent only 0.02% of total assets under management (AUM) of undertakings investing in crypto, as of September 2023."

liquidation and reorganisation process. To increase the intra-EU investment protection, a straightforward process for settling or deciding disputes between investors and Member States should be implemented.

Q26. *What are your views on the preparedness of NBFIs operating in the EU in meeting margin calls, and on the ways to improve preparedness, taking into account existing or recently agreed EU measures aimed at addressing this issue? Please specify the NBFI sector(s) you refer to in your answer?*

Regarding the insurance industry, European (re)insurers are well-prepared for meeting margin calls. European (re)insurers are subject to the Solvency II prudential regime, which includes liquidity risk management requirements. Furthermore, it provides extensive supervision and reporting. Solvency II restricts the use of derivatives. It is only permitted insofar as derivatives contribute to a reduction of risks or facilitate efficient portfolio management. The use of derivatives for speculative reasons is not permitted.

Additionally, the use of derivatives under Solvency II is governed by the prudent person principle which restricts investment to instruments which the insurer can properly identify, measure, monitor, manage, control and report.

Under Solvency II, (re)insurers have to include liquidity risk management and investments, specifically derivatives, in their risk management system. Additionally, if a (re)insurer uses the volatility adjustment or matching adjustment they are already required to set up a liquidity plan.

These liquidity provisions will be strengthened by extensive new macroprudential requirements, agreed on as part of the Solvency II review aimed at systemic liquidity risk. In particular, insurers will have to draw up and keep up to date a liquidity risk management plan (LRMP) and will also have to develop and keep up to date a set of liquidity risk indicators to identify, monitor and address potential liquidity stress. While the details of the LRMPs and the liquidity risk indicators are still to be determined, European (re)insurers expect that these will be sufficient to address any continued supervisory concerns about liquidity risk management, including the preparedness for margin and collateral calls.

With respect to a further mitigation of potential risks from margin calls, greater transparency from market participants could contribute to improve participants' liquidity preparedness. For example, more transparency around the way Central Counterparty Clearing Houses' (CCPs) collateral requirements are modelled and calculated would allow insurers to anticipate any unexpected surge in collateral needs, helping firms to better identify and contribute to mitigate potential systemic impacts.

NBFIs play a key role in promoting growth in their respective economies. The need to hold significant amounts of cash, for example to cover margin calls during periods of stress, prevents investment in productive assets. Insurance Europe supports further assessment of the feasibility of expanding the type of assets accepted as collateral from cash-only to some types of non-cash. A wider range of accepted collateral would also contribute to strengthen firms' liquidity positions, diminishing systemic risk.

Q27. *What are relevant risk metrics or tools that can be used to effectively monitor liquidity and margin preparedness across all NBFI entity types? Please provide examples specifying the sector you refer to.*

Management of liquidity risk is a requirement under Solvency II[2] (Art 44(2) and Art. 132) and at a microprudential level, liquidity risk management is already a fundamental part of insurers' wider risk management (see also answer to question 26). Many insurers also regularly report on their liquidity risks to supervisors.

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[2] See Article 44 (2) *Risk management* and Article 132 *Prudent Person Principle*

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Going forward, the Solvency II review will introduce additional requirements for insurers to prepare liquidity risk management plans. The specifications of the new plans are currently being developed by EIOPA.

At a macroprudential level, European and global supervisors have developed several comprehensive liquidity monitoring tools to identify and quantify liquidity risks arising from the insurance sector. EIOPA has developed EU-wide liquidity stress tests and the IAIS has developed five liquidity metrics at a global level which serve as ancillary indicators as part of its Holistic Framework.

EIOPA 2021 stress test exercise and liquidity risk analysis

EIOPA's 2021 EU-wide stress-testing exercise assessed the financial strength and liquidity of the European insurance sector. The results of this stress test clearly demonstrated that liquidity risk is not a significant issue for European insurers. This is because it is well managed, being an integral part of insurers' asset and liability management and risk management.

The EIOPA exercise tested a very extreme 1-in-1000-year scenario. The results showed that:

- Under the base case, insurers had positive liquidity (ie cash and equivalents) of €80bn AND liquid assets of €2.8trn.
- Under the very extreme stress-test scenario, the positive liquidity position moved to a small negative liquidity position of €10bn, but liquid assets of €2.2trn were still available. The aggregate liquidity coverage ratio after the extreme stress situation was therefore 2 200%.

In addition, that liquidity risk in the insurance industry remains moderate under the new interest rate environment was demonstrated in the liquidity risk analysis in EIOPA's Financial Stability Report of Dec. 2023: It presents the results of the liquidity monitoring carried out by EIOPA of 100 selected European insurers identified by the national supervisors on the basis of potential high exposure to liquidity risks. Overall, EIOPA concludes that the aggregate liquidity position of the insurers analysed does not give cause for concern.

Q53. *What are the benefits and costs of a regular EU system-wide stress test across NBFI and banking sectors? Are current reporting and data sharing arrangements sufficient to perform this task? Would it be possible to combine available NBFI data with banking data? If so, how?*

Because of the additional insights they provide, cross-sectoral stress tests can be a useful tool in macroprudential monitoring and are already used by supervisors, for example by the ECB (see ECB Occasional Paper No. 2024/348 "Advancements in Stress-Testing Methodologies for Financial Stability Applications", May 2024). The one-off Fit-for-55 climate risk scenario analysis currently under way in the EU is another example. With respect to the design of these stress tests – as with stress testing in general – it is crucial to balance the costs and the benefits of the exercise, and, in particular, fully consider the existing data and analyses, as well as the burdens on financial institutions and supervisors.

European insurers already report and disclose extensive information including on their products, asset portfolios, derivative positions, risks and sensitivities.

This information, which is already available to EIOPA, could be used to assess system-wide shocks which may affect the banking and NBFI sectors. This desktop approach would be an appropriate starting point for any broad financial sector stress tests.

EIOPA's approach to the Fit-for-55 climate risk scenario analysis provides a good template for any future cross-sectorial systemic risk stress tests. In this exercise, EIOPA has shown that it can effectively use the information already provided by insurers to assess cross-sectorial scenarios.

More granular stress tests which involve companies running additional scenarios and providing even more data should only be considered as a second step in any future stress testing and should only be considered after extensive cost/benefit analysis.

Insurers' experience of EIOPA EU-wide stress tests has shown that these often create additional operational burdens while only providing marginal benefits from a risk management perspective.

Q66. *What are the benefits and costs of gradually giving ESAs greater intervention powers to be triggered by systemic events, such as the possibility to introduce EU-wide trade halts or direct power to collect data from regulated entities? Please justify your answer and provide examples of powers that could be given to the ESAs during a systemic crisis.*

Article 18 of the EIOPA regulation already provides EIOPA with power to perform a facilitating and coordinating role in the event of adverse developments which may jeopardise financial stability.

At this stage, no evidence has been put forward of the need to extend these powers or of any potential benefits that would arise from the extension of these powers.

Insurance Europe is the European insurance and reinsurance federation. Through its 37 member bodies — the national insurance associations — it represents all types and sizes of insurance and reinsurance undertakings. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income.
Insurance makes a major contribution to Europe's economic growth and development. European insurers pay out over €1 000bn annually — or €2.8bn a day — in claims, directly employ more than 920 000 people and invest over €10.6trn in the economy.