EC Review of Prudential Rules for Insurance and Reinsurance Companies (Solvency II)

20 October 2020

PUBLIC CONSULTATION DOCUMENT

Introduction

Insurance companies play an important economic and social role. Indeed, insurance is provided for many events of human life (sickness, car accidents, fire damage, death, etc.) but also for potential liabilities as regards third parties such as medical liability. Insurers also play an important role in non-bank intermediation, for instance by channelling household savings into the financial markets and into the real economy.

The core business model of insurance companies is very specific. Insurers collect premiums from clients (referred to as “policyholders”) up-front but are only obliged to make payments if a predefined adverse event occurs at a later stage. The insurance sector is also prone to information asymmetry. In general, policyholders are less aware than the insurance company about the own ability of the latter to fulfil the terms of the contract (solvency) or the risks underlying the contract (conduct of business).

Insurance companies perform a key function in the economy, and their failure could have very detrimental consequences for its functioning. Intervention of public authorities is therefore needed, in particular to guarantee that insurance companies are able to honour insurance contracts (i.e. that they are “solvent”). For this reason, there is regulation as regards the solvency of insurance companies and for minimisation of the disruption and losses for policyholders in case of insurance failure (so-called “prudential supervision”).

Since the 1970s, the European Union (EU) has adopted a series of legislative acts (so-called “Solvency I”) aiming at facilitating the development of a Single Market in insurance services, whilst securing an appropriate level of policyholder protection. However, this framework was characterised by a number of structural weaknesses. In particular, it ignored key risks faced by insurers (for instance, risks of negative downturns in financial markets) and did not guarantee an equivalent level of protection for all citizens in Europe.

Solvency II which entered into application in 2016, introduces for the first time a harmonised, sound and robust prudential framework for insurance firms in the EU. It is based on the risk profile of each individual insurance company but still ensures comparability, transparency and competitiveness. The Solvency II framework consists of three ‘pillars’:

- quantitative requirements, including the rules to value assets and liabilities (in particular, technical provisions – liabilities towards policyholders), to calculate capital requirements and to identify eligible own funds to cover those requirements (referred to as “Pillar 1”);
- requirements for risk management, good governance, as well as the details of the supervisory process with competent authorities (“Pillar 2”);
- requirements on transparency, reporting to supervisory authorities and disclosure to the public (“Pillar 3”).

The same approach is being applied for insurance groups as for individual insurers, so that groups are recognised and managed as economic entities.

As confirmed by stakeholders’ statements at the recent conference organised by the European Commission on the review of Solvency II on 29 January 2020, the general perception is that the European framework as a whole functions well. At the same time, the experience gained from the first years of application of the Solvency II framework and the feedback received from industry stakeholders
and public authorities have identified a number of areas, which could deserve a review. Furthermore, the framework also needs to take into account the political priorities of the European Union (notably the European Green Deal, the completion of the Capital Markets Union, and the strengthening of the single market) and should also be flexible enough to cope with any economic and financial developments (including the unprecedented protracted low – and even negative – interest rate environment).

Following a formal request for advice that was sent by the European Commission to the European Insurance and Occupational Pensions Authority (EIOPA) in February 2019, EIOPA conducted three technical consultations covering the 19 topics of the Solvency II review that were identified by the European Commission.

In parallel to EIOPA’s work on the review, the European Commission intends to collect feedback from a wider audience, including policyholders, consumer associations, and financial market stakeholders other than insurers, by conducting its own consultation on the review. This more general consultation will cover four main areas:

1. long-termism and sustainability of insurers’ activities and priorities of the European framework;
2. proportionality of the European framework and transparency towards the public;
3. possibilities to improve citizens’ trust, to deepen the single market in insurance services and to enhance policyholder protection and financial stability;
4. new emerging risks and opportunities (e.g. sustainability, technological developments, etc.) that may need to be addressed by the European framework.

The results of the present consultation will complement the one resulting from EIOPA’s technical consultations. They will all feed into the European Commission review process of the Solvency II framework.

1. Long-termism and sustainability of insurers’ activities and priorities of the European framework

The main objective of Solvency II is the protection of policyholders.

The protection of policyholders requires that insurance companies are subject to effective solvency requirements based on the actual risks they are facing. Such a framework provides incentives for insurance companies to appropriately measure and manage their risks. The framework is defined in such a way that the risk of an insurance failure, even though not null, is of very low probability, as an insurer complying with its requirements is supposed to be able to cope with an extreme adverse event whose probability of occurrence is only 1 in every 200 years.

At the same time, it is important to ensure that insurers are not hindered from providing long-term funding to the European economy in line with the European Commission’s political priorities such as:

- the European Green Deal, which should make Europe the world’s first climate-neutral continent by 2050. To achieve this ambition, there are significant investment needs as well as opportunities. Their magnitude requires mobilising both the public and private sectors, including insurance companies;
- the completion of the Capital Markets Union (CMU), which aims to mobilise financial resources in Europe and channel them to all companies, including small and medium-sized enterprises (SMEs), and in infrastructure projects that Europe needs to expand and create jobs.

Solvency II includes a series of provisions aiming to ensure that the framework does not unduly prevent insurers from providing financing to the economy and to offer life insurance products with guaranteed returns (or capital guarantee). However, according to some stakeholders, European legislation has incentivised insurance companies to retrench from more long-term and thus illiquid assets (e.g.
infrastructure projects). This may negatively affect European economic growth, and result in lower expected returns for life insurance policyholders.

Moreover, the current heightened equity and credit spreads volatility and the significant stock market contraction stemming from the Covid-19 crisis, as well as the vulnerabilities in the real estate sector must be taken into account when reviewing the existing rules. The prudential framework should provide the right incentives for robust risk management while avoiding excessive risk-taking, and limiting financial stability implications. At the same time, it should avoid procyclical behaviour and not unduly prevent insurers from contributing to the long-term financing of the economic recovery of the European Union in the aftermaths of the current crisis.

In addition, while insurers’ investments are exposed to risks related to climate change and reputational risk, European legislation may not appropriately reflect those risks, hence not providing the right incentives. The European Central Bank recently showed that climate change-related risks have the potential to become systemic for the euro area through possible significant exposures to climate risk, which are currently not included in the prudential framework.

Finally, over the recent years, insurers have faced an unprecedented environment of low interest rates, which is progressively deteriorating their profitability. This can raise several concerns. First, despite the prudential framework, it can incentivise insurers to “search for yield” by taking more risks and investing in more complex securities, as pointed out by the European Central Bank in November 2019. Second, the low interest rate environment can also materially affect the life insurance landscape, and the ability of insurers to offer insurance products with guarantees. The current trend of risk shifting to policyholders can result in new challenges, depending on customers’ risk tolerance and financial literacy.

Objectives of the framework and priorities of the review

According to the current European legislation, “the main objective of insurance and reinsurance regulation and supervision is the adequate protection of policy holders and beneficiaries. (...) Financial stability and fair and stable markets are other objectives of insurance and reinsurance regulation and supervision which should also be taken into account but should not undermine the main objective”.

Q1. What could be the renewed objectives of European legislation for insurance companies? On a scale from 1 to 9 (1 being “not important at all” and 9 being “of utmost importance”), please rate, and if possible rank, each of the following proposals.

<table>
<thead>
<tr>
<th>Proposal</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>Don’t know / No opinion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policyholder protection</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Financial stability</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Fostering investments in environmentally-sustainable economic activities which will be defined in the EU taxonomy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Fostering long-term investments in the real economy and providing long-term financing to European companies, including SMEs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Ensuring a fair and stable single market</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>5</td>
<td></td>
</tr>
</tbody>
</table>
Q2. In light of market developments over the recent years, in particular the low or even negative interest rates environment and the Covid-19 crisis, what should be the priorities of the review of the European legislation for insurance companies? On a scale from 1 to 9 (1 being “low priority” and 9 being “very high priority”)? Please rate, and if possible, rank each of the following proposals.

<table>
<thead>
<tr>
<th>Proposal</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>Don’t know/No opinion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ensuring that insurers remain solvent</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>8</td>
</tr>
<tr>
<td>Ensuring that insurers’ obligations to the policyholders continue to be fulfilled even in the event that they fail</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>4</td>
<td></td>
<td>4</td>
</tr>
<tr>
<td>Ensuring that there are no obstacles for insurance companies to contribute to the investment needs of the European Green Deal, i.e. fostering insurers’ investments that help the transition to carbon neutrality by 2050</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3</td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>Ensuring that there are no obstacles for insurance companies to invest in accordance with the objectives of the Capital Markets Union, i.e. fostering insurers’ long-term financing of the European economy, including SMEs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2</td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>Facilitating insurers’ ability to offer (sufficiently) high returns to policyholders, even if this implies taking more risks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Facilitating insurers’ ability to offer products with long-term guarantees</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>6</td>
<td></td>
<td>6</td>
</tr>
<tr>
<td>Ensuring that insurers do not face liquidity issues (i.e. that they have sufficiently liquid assets⁹) to meet at all times short-term obligations</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>7</td>
<td></td>
<td>7</td>
</tr>
<tr>
<td>Preventing the build-up of systemic risk and ensuring financial stability</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>5</td>
<td></td>
<td>5</td>
</tr>
</tbody>
</table>

Capital requirements for investments in SMEs (both in equity and debt), for long-term investments and for sustainable investments

Q3. Have the recent changes to the prudential framework regarding equity investments appropriately addressed potential obstacles to long term investments?

No opinion

Q4. Does the prudential framework set the right incentives for insurers to provide long-term debt financing to private companies, including SMEs (i.e. to invest for the long-term in long-maturity debt instruments)? Please indicate the statements with which you agree (at least 1 choice).⁹

No opinion
Insurers’ contribution to the objective of a sustainable economic growth and policyholder protection

Solvency II is a risk-based and evidence-based framework. This implies in particular that the quantitative rules governing capital requirements for insurers’ investments are supported by quantitative evidence. This entails a need for sufficient and robust data to support changes to Solvency II, which could further incentivise insurers to contribute to the long-term and sustainable financing of the European economy, while preserving the necessary level of policyholder protection embedded in the framework.

In particular, there is a need for sufficient evidence that the risk of investment in SMEs or in environmentally sustainable economic activities and associated assets is lower than what the current prudential rules would imply.

Q5. Do you agree or disagree with each of the following proposed change to quantitative rules in Solvency II?

<table>
<thead>
<tr>
<th></th>
<th>Agree</th>
<th>Disagree</th>
<th>Don’t know / no opinion</th>
</tr>
</thead>
<tbody>
<tr>
<td>We should make it less costly for insurers to invest in SMEs</td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>We should make it less costly for insurers to invest in environmentally-sustainable economic activities and associated assets (so-called “green supporting factor”)</td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>We should make it more costly for insurers (and therefore provide disincentives) to invest in activities and associated assets that are detrimental to the objective of a climate-neutral continent (so-called “brown penalising factor”)</td>
<td></td>
<td>x</td>
<td></td>
</tr>
</tbody>
</table>

Please explain your reasoning:

Solvency II is a risk-based and evidence-based framework. Appropriate changes to Solvency II will allow insurers to contribute to the long-term and sustainable financing of the European economy, while preserving the necessary level of policyholder protection embedded in the framework. The quantitative rules should not be used to introduce ESG-related considerations to either incentivise or disincentivise insurer’s investments. Such an approach could result in simplistic “buy green, sell brown” incentives which penalise insurers that invest in real estate with a view to redevelop assets while incorporating sustainability improvements.

Ensuring that the Solvency II framework does not create disincentives to address climate and environmental risks and opportunities in insurers’ investment policies is important in the review of Solvency II. Together with other long-term institutional investors, life insurers have spearheaded the UNEP initiative to move towards a more sustainable future over the past fifteen years. The demands of
such investors have transformed the built environment and will greatly assist in delivering on the
commitsments made in the Paris Agreement.

Creating a sustainable future for Europe’s urban ecosystems requires a viable economy to be equitable
and accessible to the society it serves, and for both to have a positive impact on the environment, in
turn improving well-being, society and the economy.

Furthermore, like infrastructure, real estate is a source of employment that reaches far beyond its
construction phase, which combined with the physical assets represents a long-term investment in
viable and sustainable communities throughout Europe.

A more accurate measure of the real risk of property investment through a re-calibration of the standard
model SCR for property based on better data will lead to a release of capital, which is necessary for
insurers to support their role in the recovery, sustainable growth and transformation to a net-zero
carbon economy without compromising policy holder protection.

**Short-term volatility, procyclicality, and insurance products with long-term guarantees**

The current Covid-19 crisis, characterised by heightened volatility in financial markets, drops in stock
markets, rises in spreads and a series of rating downgrades by credit rating agencies, has resulted in
more volatility of insurers’ solvency positions over the last months, according to industry stakeholders
and public authorities. This requires assessing the effectiveness of the mechanisms embedded in the
Solvency II framework (in particular, the so-called “long-term guarantee measures and the measures on
equity risk”) aiming at mitigating volatility of insurers’ solvency and at avoiding procyclical behaviours. If
this volatility becomes excessive, it may hinder their ability to offer products with long-term guarantees
and may incentivize them to largely shift the risk to policyholders (via the distribution of unit-linked or
index-linked products). This could question the sustainability of the traditional life insurance business.

Q6. Does Solvency II appropriately mitigate the impact of short-term market volatility on the
solvency position of insurance companies?

Yes

Q7. Does Solvency II promote procyclical behaviours by insurers (e.g. common behaviour of
selling of assets whose market value is plunging or whose credit quality is decreased), which
could generate financial instability?

Yes. Short-term market volatility has very little real impact on real estate, which as an illiquid asset, is
naturally a long-term investment that is not used to support the short-term solvency position of
insurance companies.

The regulatory assumption underlying Solvency II that illiquid assets such as long-term real estate
investments will be used to satisfy insurers’ liquidity needs is incorrect. At the same time, Solvency II’s
SCRs for property based on mark-to-market accounting applied to fluctuations in real estate valuations
are pro-cyclical by encouraging the sale of long-term assets in down markets, regardless of the
measure of volatility used to determine the SCRs, even when those assets yield long-term, stable
income flows through rents.

Over the recent years, in some countries, insurers have favoured the supply of insurance products
where the investment risk is shifted to policyholders (i.e. higher risk for policyholders, but also
prospects of potential higher returns over the long run), instead of traditional life insurance products
with guarantees.
In a recent report\textsuperscript{10}, the International Monetary Fund recommended public authorities to consider “policies serving as a disincentive to new life insurance products offering guaranteed returns”.

**Q8. Some stakeholders claim that Solvency II has incentivised insurers to shift investment risk to policyholders. Do you agree with this statement?**

*No opinion*

**Q9. Do you agree with the International Monetary Fund that public authorities should aim to provide disincentives to the selling of new life insurance products offering guaranteed returns?**

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
<th>Don’t know / no opinion</th>
</tr>
</thead>
<tbody>
<tr>
<td>From the point of view of a policyholder</td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>In terms of financial stability</td>
<td></td>
<td></td>
<td>x</td>
</tr>
</tbody>
</table>

**Prudential rules and Covid-19**

The Covid-19 outbreak allows assessing the robustness of the regulatory framework under a crisis situation. As Solvency II requires insurers to set aside capital to absorb losses stemming from extreme events – including sanitary crises such as a pandemic – that occur once in two hundred years, the insurance sector proved to be in general well-prepared to cope with the current adverse financial and economic conditions\textsuperscript{11}.

**Q10. In light of the Covid-19 crisis, have you identified any major issues in relation to prudential rules that you were unaware of or considered of lesser importance prior to the pandemic?**

*No*

**Other issues**

Some insurance companies are subsidiaries of (and therefore belong to) wider insurance groups. The European legislation identifies such insurance groups as integrated “economic entities”, which are therefore subject to Solvency II rules on a consolidated basis. However, under current rules, public authorities focus on ensuring that both the solo entities of the group and the group as a whole have enough capital to cover their risks.

Some stakeholders are of the view that it might be sufficient for public authorities to supervise the solvency position of insurance groups only (and not of individual insurers), and to ensure that they are sufficiently well-capitalised to support all funding needs of insurance subsidiaries. This would imply that individual insurers belonging to a group could be left under-capitalised, provided that the group as a whole is well-integrated and has sufficient available capital to cover all risks to which insurance companies within the group are exposed, and therefore to meet each subsidiary’s financing needs on demand.
Q11. From the point of view of policyholders, would it be acceptable to waive Solvency II requirements to insurance companies that belong to a group, if the group as a whole is subject to “strengthened” supervision?

No opinion

Some stakeholders claim that Solvency II focuses too exclusively on the monitoring of individual insurers without taking into account their exposure to and interconnectedness with other insurers, the broader financial sector and the real economy.

Q12. Should the European legislation be amended to better take into account insurers’ exposure to and interconnectedness with the broader financial sector and the real economy? Please indicate the statement(s) with which you agree (at least 1 choice).

No opinion

2. Proportionality of the European framework and transparency towards the public

Scope of Solvency II

Solvency II is a sophisticated while often complex prudential framework. Applying it appropriately is a costly exercise.

Therefore, certain companies that provide insurance services are not covered by the European framework due to their size, their legal status, their nature – as being closely linked to public insurance systems – or the specific services they offer. In practice, Solvency II does not apply to very small insurance companies (it is worth mentioning that the exclusion from Solvency II also prevents the insurers concerned from doing business on a cross-border basis). However, the quantitative thresholds of exclusion have not been reviewed since the entry into force of the Directive in 2009.

Increasing the quantitative thresholds of exclusion of Solvency II would result in an increase in the number of insurance companies which are not in the scope of the European framework. This increase could be justified by the objective of further alleviating undue regulatory burden for small insurers and might result in lower premiums to be paid by policyholders of those small firms with (possibly) higher fixed costs.

On the other hand, for policyholders of those firms, which would be excluded from the scope of Solvency II, there is no guarantee that the level of protection introduced at national level would be as high as the one stemming from Solvency II rules. In addition, from a European perspective, it might be argued that new exclusions from the scope of Solvency II would go against the objectives of integration of the Single Market for insurance services and of level-playing field within the European Union.

Q13. From the point of view of policyholders, should the scope of small insurance companies, which are not subject to Solvency II be extended?

No opinion
Proportionality in the application of Solvency II

Solvency II aims at limiting the burden for small and medium-sized insurance companies within its scope. One of the tools by which to achieve that objective is the application of the proportionality principle. In other words, the requirements should be adapted and simpler when such an approach is justified by the nature, scale and complexity of the risks. That principle should apply both to the requirements imposed on insurance companies and to the exercise of powers by public authorities.

As Solvency II is a “principle-based” framework, its implementation by public authorities heavily relies on supervisory judgement by public authorities. In particular, as regards proportionality, there are only broad principles regarding the way of assessing whether a given insurer may be allowed to implement certain requirements in a more proportionate and flexible way.

In practice, this high level of supervisory discretionary power may have limited the effective implementation of the proportionality principle, and the effective possibilities for small insurers with a low risk profile to implement the framework in a simplified way.

For this reason, some stakeholders claim that Solvency II should be more “rules-based” regarding the implementation of the proportionality principle, which would require setting clear and unambiguous criteria in the legislation - for automatic allowance for simplified rules when those criteria are met. However, it may be challenging in practice to define appropriate criteria, which would take into account the actual risks faced by each insurer.

Q14. Should public authorities have less discretion when deciding whether insurers may apply simplified approaches and/or implement Solvency II rules in a more proportionate and flexible way?

No opinion

Scope of reporting obligations

The European framework requires insurance companies to regularly submit to public authorities the information which is necessary for the purpose of prudential supervision. However, it also contains some exemptions and limitations that national authorities can grant if the companies concerned do not represent more than 20% of a Member State’s insurance market.

Q15. Should the exemptions and limitations always be subject to the discretion of the public authorities? Please indicate the statement(s) with which you agree.

No opinion

Specificities of not-for-profit insurers

Most Solvency II rules apply uniformly to all insurers regardless of their legal form or corporate structure. This is in particular the case for governance requirements (e.g. requirements for directors and board members to have appropriate knowledge and experience).

The European legislation has required changing and strengthening the governance of mutual companies (i.e. not-for-profit companies, which are collectively owned by their members who are at the same time their clients) and paritarian institutions (i.e. not-for-profit institutions that are jointly managed by the social partners).
Q16. Should the European framework take into account the specific features of not-for-profit insurance companies (e.g. democratic governance, exclusive use of the surplus for the benefit of the members, no dividend paid to outside shareholders)?

No opinion

Transparency towards the general public

The European framework has substantially improved transparency towards the public. Indeed, each insurer subject to Solvency II has to disclose – that is to say make it available to the public in either printed or electronic form free of charge – at least on a yearly basis, a report comprising information on its business strategy, financial and solvency situation, and risk management (so-called “Solvency and Financial Conditions Report” – SFCR).

Some insurers claim that this report is burdensome to produce and is not fit for purpose, as it may appear too complex and too detailed for current or prospective customers. On the other hand, other stakeholders in the financial industry (e.g. investors) are requesting further transparency on solvency data.

Please note that the European Commission is also reviewing the rules concerning non-financial reporting for public interest entities, including insurance companies. One of the aims of this review is to improve publicly available information about how non-financial issues, and sustainability issues in particular, impact companies, and about how companies themselves impact society and the environment. As part of this review, the European Commission launched a separate public consultation between 20 February and 11 June 2020.

Q17. How can the framework facilitate policyholders’ and other stakeholders’ access to the SFCRs?

<table>
<thead>
<tr>
<th></th>
<th>Agree</th>
<th>Disagree</th>
<th>Don’t know / no opinion</th>
</tr>
</thead>
<tbody>
<tr>
<td>The current framework is sufficient, as it already requires insurers to publish their SFCR on their website if they own one</td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>The framework should clearly require that insurers’ publication on their website is easily accessible for the public</td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Insurers should be required to send (electronically or by mail) on a regular basis a summary of the SFCR to each policyholder</td>
<td></td>
<td></td>
<td>x</td>
</tr>
</tbody>
</table>
Q18. If you have already consulted a SFCR, did you find the reading insightful and helpful, in particular for your decision making on purchasing (or renewing) insurance, or investing in/rating an insurance company? Please indicate the statement(s) with which you agree.

No opinion

Q19. Which information should be provided to policyholders on insurers’ financial strength, business strategies and risk management activities? What should be the ideal format and length of the SFCR?

No opinion

Q20. Some insurers belong to wider insurance groups, which also have to publish a Solvency and Financial Conditions Report at group level (so-called “group SFCR”). Do policyholders (current or prospective) need to have access to information from group SFCRs?

No opinion

Q21. Should all insurers publish a SFCR on a yearly basis?

No opinion

Q22. Some insurers use their own internal models to calculate their solvency requirements, after approval and ongoing supervision by public authorities, and not the prescribed standard approach defined by the legislation. For those insurers that use an internal model, should European legislation require them to also calculate their solvency position using standard methods for information purposes, and to disclose it to the public?

No; insurers that use their own internal model should not be required to calculate their solvency position using standard methods, at least for the property investments, as the standard model SCR for property as currently calculated bears no resemblance to their real risk.
Improving trust and deepening the single market in insurance services

Supervision of cross-border business

The rationale for the EU insurance legislation is to facilitate the development of a Single Market in insurance services, whilst securing an adequate level of policyholder protection.

Insurers that have obtained a licence to operate in a Member State under Solvency II rules are allowed to operate in any other Member State of the Union (so-called “EU passporting” system). The harmonised requirements under Solvency II aim to ensure uniform levels of policyholder protection throughout the Union.

The supervision of insurance activities (including cross-border) is the responsibility of the national public authority that granted the licence to the insurer (the “Home” authority), and not the public authorities of the other Member States where the insurer operates (the “Host” authorities). However, a European Supervisory Authority (the European Insurance and Occupational Pensions Authority) is in charge of ensuring supervisory convergence and contributes to the coordination of the supervision of cross-border activities.

Some insurers operating cross-border have failed over the recent years, with negative impacts on policyholders. Such cases may have unduly affected public trust in the Single Market for insurance services.

Q23. When the Home authority does not take the necessary measures to prevent excessive risk-taking or non-compliance with the European rules by an insurer for its cross-border activities, should the Host authority be provided with additional powers of intervention, in order to protect policyholders?

No opinion

Q24. Should the supervision of cross-border activities by insurers be exercised by national authorities or by a European authority?

No opinion

Preventing and addressing insurance failures

Policyholders across the EU have different levels of protection in the event of their insurer’s failure. National public authorities have different sets of powers to deal with an insurer whose financial position is deteriorating or that is failing.

Solvency II already provides authorities with a general power to take any measures, which they deem necessary to safeguard the interests of policyholders. It further requires firms to set up a recovery plan (“ex-post”) when they do not comply with their quantitative solvency requirements. However, some Member States require insurers to also draft and maintain pre-emptive recovery plans setting out possible measures to deal with crisis scenarios. Resolution regimes, which aim to address the fall-out of an insurance failure in an orderly manner and to prepare authorities for such events with resolution plans and resolvability assessments, are mostly incomplete and uncoordinated. The lack of availability for national authorities of the right tools to deal with failures, leads to different levels of policyholder protection and affects public authorities’ ability to safeguard financial stability.

In addition, a majority of Member States have introduced national Insurance Guarantee Schemes (IGS) that provide last-resort protection to policyholders. When insurers are unable to fulfil their contractual commitments, IGS offer protection against the consequences of a failure of an insurance company. These IGS are generally funded by the insurance industry. An IGS can offer protection by paying
compensation to policyholders or by ensuring the continuation of insurance contracts.

However, not all Member States have created such a safety net for the protection of policyholders and the geographical scope, the coverage and powers of the current IGS differ. This implies that policyholders of insurers located within some Member States would not benefit from the same IGS protection in the event of an insurance failure as in other Member States. This situation leads to gaps and overlaps in IGS protection.

Note that the protection of victims of motor accidents in the case of the insolvency of an insurer is already covered by the proposal amending the Motor Insurance Directive, which is currently negotiated by the European Parliament and the Council of the European Union.\(^\text{14}\)

Q25. Do you consider that insurers and public authorities are sufficiently prepared for a significant deterioration of the financial position or the failure of an insurer and that they have the necessary tools and powers to address such situations, in particular in a cross-border context?

No opinion

Q26. Should it become compulsory for all Member States to set up an IGS, in order to ensure that a minimum level of policyholder protection is provided across the EU?

No opinion

Q27. Which of the following life insurance products should be protected by IGS?

No opinion

Q28. Which of the following non-life insurance products should be protected by IGS?

<table>
<thead>
<tr>
<th>Insurance Product</th>
<th>Should be covered</th>
<th>Should not be covered</th>
<th>Don’t know / No opinion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health</td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Workers’ compensation</td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Insurance against Fire and other damage to property</td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>General liability</td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Accident (such as damage to the driver)</td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Suretyship for home building projects</td>
<td></td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Q29. Should all mandatory insurance be covered by IGS?
No opinion

Q30. If your insurer fails, what would you prefer?
No opinion

Q31. The coverage level of IGS determines the level of protection provided to policyholders. Should the European legislation set a minimum coverage level at EU level?
No opinion

Preventing financial stability risks and ensuring policyholder protection

Q32. In order to limit the risk of insurance failures and protect financial stability, should public authorities have the power to temporarily prohibit redemptions of life insurance policies? Please indicate the statement(s) with which you agree.
No opinion

Q33. In order to limit the risk of insurance failures and protect financial stability, should public authorities have the power to reduce entitlements of a life insurer’s clients (e.g. reducing the right for bonuses that policyholders were initially entitled to receive)? Please indicate the statement(s) with which you agree.
No opinion

Flexibility of the framework under crisis situations

Solvency II provides that when exceptional adverse situations are identified by the European Insurance and Occupational Pensions Authority, national authorities may give more time for insurers to restore compliance with quantitative requirements (from six months to up to seven years). Still, there is a need to evaluate whether the Solvency II framework is sufficiently flexible and reactive to crisis situations (such as the current Covid-19 pandemic), in order to preserve insurers’ solvency and financial stability, but also to restrict the regulatory burden stemming from reporting and disclosure requirements.

Q34. Please specify whether other exceptional measures than those mentioned in Q32 and Q33 should be introduced in order for public authorities aiming to preserve insurers’ solvency and financial stability to intervene timely and in an efficient manner during exceptional adverse situations. Please also clarify if those measures should apply at the level of individual insurers or widely to the whole sector.
No opinion

Q35. In your view, should the framework provide for flexibility to alleviate certain regulatory requirements during exceptional adverse situations?
No opinion
4. New emerging risks and opportunities

A. European Green Deal and sustainability risks

The European Commission recently unveiled its European Green Deal for the EU and its citizens, with the aim for Europe to become the world’s first climate-neutral continent by 2050. The European Green Deal is a new growth strategy that aims to transform the EU into a fair and prosperous society, with a modern, resource-efficient and competitive economy where there are no net emissions of greenhouse gases in 2050 and where economic growth is decoupled from resource use. To achieve the ambition set by the European Green Deal, there are significant investment needs. These also represent opportunities for sustainable investment.

Insurance companies can contribute to these investment needs and can benefit from new opportunities arising from the green transition. Their underwriting activities can also help increase the Union’s resilience to sustainability risks, in particular when it comes to damage arising from natural catastrophes. However, insurers are exposed to climate change, both through their investment and underwriting activities. The European Insurance and Occupational Pensions Authority (EIOPA) indicated in a recent opinion that the European legislation may currently not appropriately reflect those risks, hence not provide the right incentives. Insurance companies are also exposed to the transition risks.

While this consultation serves to prepare the review of Solvency II, it has to be noted that the European Commission is also preparing a renewed sustainable finance strategy for the 3rd quarter of this year and an upgraded EU Adaptation Strategy for the 4th quarter of this year, with dedicated public consultations.

Perils of the natural catastrophe module

The Solvency II standard approach for the calculation of capital requirements for natural catastrophes covers the most common types of natural catastrophes, namely windstorm, flood, hail, earthquake and subsidence. Where an insurance company uses an approved internal model for the calculation of the capital requirements, either on own initiative or on request by the national authority, additional types of natural catastrophes can be covered in the calculation of capital requirements. However, a large number of insurance companies, in particular most small and medium-sized ones, are currently not using an internal model for the calculation of natural catastrophe risk.

Q36. Are there additional types of natural catastrophes that might become relevant to the broader insurance sector in the next years and therefore warrant an inclusion in the standard approach for the calculation of capital requirements (e.g. drought or wildfire)?

No opinion

Use of historical data

Solvency II sets out several requirements on the use of data in the valuation of liabilities to policyholders. Notably, the data should contain “sufficient historical information” and “appropriately reflect the risks” to which the insurance company is exposed. In business lines materially affected by climate change, historical data may not capture sufficiently the trends caused by accelerated climate change. EIOPA therefore recommends that insurers combine historical data with knowledge gained from recent scientific research and, where appropriate, the output of forward-looking models when valuing their liabilities towards policyholders.
Q37. Beyond the general rules on the use of data, should Solvency II rules explicitly require insurers to assess whether the data used in the valuation of liabilities to policyholders captures sufficiently trends caused by climate change?

No opinion

Solvency II allows insurance companies to use internal models for the calculation of capital requirements after approval by the supervisory authority. For that purpose, the insurer has to forecast the probability distributions for the relevant risks. Similar rules apply to the data used in the probability distribution forecast in the context of internal models as for the valuation of liabilities towards policyholders.18

Q38. Beyond the general rules on the use of data, should Solvency II rules explicitly require insurers to assess whether the data used in an internal model captures sufficiently trends caused by climate change?

No opinion

Scenario analyses

Scenario analyses are common practice for insurers’ risk management to challenge the plausibility of balance sheet valuation and the level of capital requirements. EIOPA also recently recommended that insurers should conduct analyses of climate scenarios as part of their risk management.

Q39. Should Solvency II rules for insurers explicitly require climate scenario analyses as part of the qualitative rules (“Pillar 2”)?

No opinion

Impact underwriting

EIOPA recently suggested that insurers engage in ‘impact underwriting’, whereby insurers develop new insurance products, design and price products with the aim to contribute to adaptation to and mitigation of climate change without disregard for actuarial risk-based principles of risk selection and pricing.

Q40. In your view, does Solvency II contain rules that prevent the practice of impact underwriting by insurers?

No opinion

Q41. Do you have proposals for changes others than those provided in your answers to [Q5] and [Q36] to [Q40] that would make Solvency II a more conducive framework for sustainable activities by insurance and reinsurance companies?

No. Insurers are already helping to address climate change in a number of important ways and are at the forefront of long-term sustainable financing of the economy; however, their ability to do this through real estate investments is in part limited by the excessively high standard model SCR for property that does not reflect the real risk of real estate investment.

The review of Solvency II should not be used to specifically incentivise the green transition but should instead ensure that its design and calibration do not impede insurers’ key role in it. If the standard model SCR for property is re-calibrated to reflect the real risk, insurers’ own interests and business models, combined with regulatory initiatives such as the SFDR, the SP Taxonomy and the Green Deal will ensure that this process continues without compromising policy holder protection.
B. Challenges arising from digitalisation and other issues

While this consultation serves to prepare the review of Solvency II, the European Commission organised between 19 December 2019 and 19 March 2020 a consultation on the need for legislative improvements to make the financial sector more secure and resilient against cyberattacks.\(^{19}\)

In addition, the European Commission is also preparing a new Digital Finance Strategy for Europe that sets out strategic objectives that should guide public policy in the coming five years. This new strategy planned for the third quarter of 2020 will build on the work carried out previously, in particular in the context of the FinTech Action Plan. It will take into consideration all the recent market and technological developments that are likely to impact the financial sector in the near future. A separate public consultation\(^ {20}\) took place between 3 April 2020 and 26 June 2020.

Insurance companies increasingly rely on Big Data analysis in order to set prices and customise insurance product offering for policyholders. While such innovations could provide some potential benefits to policyholders, they also raise questions about privacy, discrimination, fairness and exclusion.

In the context of the digitalisation of the economy, cyber risk has gained increasing relevance as one of the main – if not the top – operational risks faced by organisations. The increasing frequency and sophistication of cyber-attacks and the continued digital transformation and use of new technologies also make insurers increasingly exposed to cyber threats. In addition, there is a rising demand by businesses and individuals for insurance protection against internet-based risks, for instance to cover losses from data or network security breaches, and theft of intellectual property (so-called “cyber-insurance”). While insurers have to be granted authorisation for conducting business in various “classes” of insurance, there is no specific authorisation process (or dedicated reporting requirements) for cyber-insurance products.

Q42. Should the European legislation introduce enhanced requirements for insurers to monitor and manage information and communication technology (ICT) risks, including cyber-risks as part of their risk management practices (“Pillar 2”)?

No opinion

Q43. Should the European legislation consider that cyber-insurance is a distinct class of insurance, which would need to be subject to its own authorisation process by public authorities?

No opinion

Insurance companies may decide to conclude an agreement with another entity (for instance a FinTech company), by which the latter performs certain activities, which would otherwise be performed by the insurance company itself (for instance, in relation to IT services).

Insurance companies can also outsource these activities to another entity belonging to the same insurance group. Solvency II does not differentiate intra-group and extra-group outsourcing, in terms of requirements. Some stakeholders claim that intra-group outsourcing, in particular in the area of digital services, should be “lighter”, as insurance groups are treated and managed as integrated economic entities and are subject to all Solvency II requirements on a consolidated basis.

Q44. Should the legislation differentiate intragroup and extra-group outsourcing, and introduce “lighter” requirement in the former case?

No opinion
5. Additional information

INREV strongly supports the Commission’s review of Solvency II. While we fully support Solvency II’s goals of providing adequate protection of policy holders and beneficiaries, and to ensure the financial stability of the Union and fair and stable markets, the role that European Commission policy can play in facilitating insurers’ financing of the real economy is also extremely important. As we have frequently argued, the current Solvency II prudential rules hinder insurers’ ability to contribute to the long-term funding of the economy in the EU, which is now an especially important point as the EU tries to recover from the economic impact of the Covid-19 outbreak and simultaneously address urgent climate change challenges.

Data sources that would better calibrate property risk

The availability of data that can be used to measure the volatility of real estate in all property markets in the EU over a very long time is a fundamental challenge. As EIOPA has noted, “the main specificities of real estate as an asset class are its illiquidity (infrequent and irregular trading, no central market place where prices can be easily observed) and its heterogeneity (in terms of characteristics influencing the value of the asset – e.g., location, size and other physical characteristics of the building).”

While many of INREV’s life insurer members that developed internal models indicated to us that they were able to use a variety of data sources that match the specificities of their own portfolio composition, a single data source that perfectly measures volatility of real estate across all EU markets over a very long time series, sufficient to definitely establish the downside tail risk of a one-in-two-hundred-year event, does not exist. However, there is indisputably much better data available now than there was when the initial calibration for real estate was adopted. At the time, the UK was deemed to be the only source of deep and sufficiently frequent data and the IPD monthly UK Index, comprised primarily of London office and retail properties, was used.

As EIOPA correctly points out, the value of real estate assets can only be observed on two occasions: when valuations are performed and when property is sold. It is also correct that value stemming from actual transactions are too infrequent to form the basis of reliable indices. Real estate is typically a very long-term investment that institutional investors such as life insurers use to meet their long-term liabilities (we note in this regard that the 16 December 2019 EIOPA ‘Report on insurers’ asset and liability management in relation to the illiquidity of their liabilities’ showed that insurers hold property-related investments for 14 years on average, the longest of any asset class discussed, p.69). In addition, the high transaction costs incurred in buying and selling real estate make it highly unattractive as a short-term investment. Furthermore, as long-term investors, they do not normally sell their real estate investments during downturns in the market; they hold them and ride out the downturn while the real estate investments continue to deliver relatively stable income returns, which accounts for the lack of real estate transaction data in economic crises. It is important to note, however, that a lack of real estate transaction data does not support a conclusion of high volatility.

Valuation data, although subject to some smoothing, lagging and subjectivity, are available from much more reliable sources than tax assessments, which are indeed an unreliable basis for measuring value across all European property markets. In contrast, the valuations performed for institutional investors and fund managers are much more standardised and professional, which is understandable considering that the infrequent trading makes institutional investors keen to closely monitor the value of their investment portfolios through professionally conducted independent third-party valuations applying industry-wide standards. In almost all EU countries, valuers are trained and certified, for example by RICS, and follow valuation guidelines consistent with the International Valuation Standards Council (IVSC) standards. The wide application of these standards across Europe by trained, professional valuers makes missing physical characteristics of any property highly unlikely. These factors also provide much more consistency and, as a result, reliability, than some assume.

Valuations performed for institutional investors such as pension funds and insurance companies are the basis of all the direct real estate indexes computed and published by MSCI. They also constitute the baseline market reference points for its Transaction Linked Indexes (TLIs). However, the central purpose of the TLIs is to identify the additional impacts of actual trading activity, specifically upon the measurable volatility of intrinsically lumpy, heterogeneous and illiquid real estate investment markets. This is achieved by regressing all achieved sale prices in each period upon the preceding valuations of the sold assets so that the potential risks of transacting in complex real estate markets are fully and
EIOPA have invested much time and effort in understanding the data challenges related to measuring real estate volatility and have noted that, as with every regression, the robustness of the estimated parameters depends on the number of underlying transactions in each bucket and that, for some markets, they are scarce. Accepting that there are fewer transactions in many markets than would ideally have taken place to support a highly robust transaction linked index, the MSCI TLI (from the publicly available MSCI Real Estate Solvency II 2017 Update Report - see link here) gives a much better picture of volatility across the EU than making the unwarranted assumption that data from the UK alone, and then primarily the highly volatile London office and retail property market which completely exclude the residential market, are representative of the entire EU commercial property investment market.

The MSCI TLI is based on a three-step approach, first based on a full 15-year quarterly valuation based indexes for each of the 17 European markets it covers, then estimating any additional trading volatility using TLI methods for key national markets and all relevant pan-European composites, then using these new series to establish better grounded value at risk estimates using EIOPA defined methodologies to identify worst case 12-month negative return sequences.

In its most recent Solvency II consultation, EIOPA identified three policy options based on data made available to it. Option one of maintaining the status quo is simply not acceptable. First, the UK commercial property market is not representative of the entire EU commercial property investment market. Second, more and better data and analysis are now available. And third, the current measure of property volatility based on UK data only does not recognise how diversification of insurers’ portfolios by geography and sectors lowers the volatility of their real estate portfolios. Insurers typically diversify their real estate investments in order to spread risk and therefore lower volatility while generating the returns needed to meet their obligations to policy holders.

The growth of non-listed real estate funds in Europe can, in fact, be attributed to a great degree to institutional investors such as life insurers seeking diversification outside their domestic markets. Even relatively small institutional investors can and do pool capital and therefore gain access to investments that lower their risk-adjusted returns, sourced and managed by managers with local knowledge and access to deal flow. There is some irony to EIOPA comments that small insurers often holding property only in their own country, because in a chicken-and-egg situation, many experts see the current excessively high standard model SCR for real estate and associated return drag as creating a disincentive to those insurers making such investments, even though they could help lower their real estate portfolio volatility and concentration risk.

Between the policy options raised by EIOPA in its most recent consultation of calibrating a single common shock with data from more countries than just the UK and creating two different shocks, one for some countries and another for the rest, INREV strongly supports a single common shock. Adopting different shocks within Europe would depart from the Solvency II pan-European approach that has been used to date for all standard formula modules and sub-modules and would likely exacerbate the distortive effect of property SCRs by creating winner and loser commercial property investment markets for insurers.

A further question arises, however; why should data from the UK even be considered in the volatility analysis given that UK insurers will soon fall outside the direct scope of Solvency II? Should UK insurers’ heavily domestic property portfolios even be included in the EU property investment market weightings? Given the fact that insurers in the remaining-27 EU Member States invest in UK property at much lower levels than UK insurers do, should the 27% market weighting of the UK be lowered? This would indisputably lead to a lower measure of the volatility of property investments in Europe.

In fact, MSCI’s comprehensive scan for the most extreme current evidence of European tail values at risk indicates that the most appropriate shock factors to use for determining real estate SCRs would not exceed 15% for all of Europe if the UK is fully included, or 12% for European composites that exclude the UK. We strongly urge the Commission to consider these findings and the data underlying them in supporting a potential EIOPA recommendation for a property shock for standard model users across the EU.

With regard to modelling property risk in internal models, a number of our insurer members provided us with information regarding the approach they used to. Almost all indicated that they use a combination
of TLI series and VBI series or some other city/sector specific assessment of value at risk, while one used risk factors to estimate the underlying systemic risk. The data underlying the TLI and VBI series came from a variety of sources and were generally supplemented by other data sources where appropriate to provide additional sector or geographic insights into historical volatility of their specific real estate portfolios. No series potentially broadly representative of property markets in Europe and very few narrower series extended significantly further back in time than the MSCI TLI from the MSCI Real Estate Solvency II 2017 Update Report.

Getting the standard model SCR for property right is extremely important. An SCR based on better data that more accurately reflects the real risk of property investment would lead to a release of capital that could be used by insurers to make further long-term investments that support recovery, sustainable growth and the transformation to a net-zero carbon economy without compromising policy holder protection.

**Real estate as a long-term investment**

Long-term investment is critically important to the European economy and society. Life insurers, like other institutional investors such as pension funds, are the source of much of the long-term investment in Europe as they seek out investments that deliver long-term, stable income streams and thereby enable them to meet their long-term liabilities to policyholders.

Real estate makes up an important part of the investment portfolios of almost all life insurers. Real estate investment, whether made directly by purchasing buildings or indirectly by investing collectively through real estate funds or other indirect vehicles, helps insurers meet their obligations while, at the same time, makes a vital contribution to the wider economy, society and the environment.

Long-term real estate investment strategies are distinguished from shorter-term strategies by the underlying investment intentions and by the reliability of income returns. Holding periods are an identifying characteristic and it is noteworthy that in a survey conducted by EIOPA, insurers identified real estate holding periods as the longest of all asset classes.

Life insurance companies are attracted to real estate’s diversification benefits, its income generating qualities and its relatively attractive risk return profile. Their long-term real estate holdings are concentrated in low-risk core assets, which account for over 89.6% of their real estate investments by value. These assets offer longer-term, steady and often inflation-hedged income streams that can be used in the overall liability matching.

A review by EIOPA of insurers’ average holding periods for the assets identified as long-term holdings are considerably higher than for the total portfolio, with real estate (including funds) having the longest average holding period of 14 years, which is even longer than infrastructure.

Importantly, real estate does not function as a liquidity buffer within life insurers’ portfolios and is held through periods of stress; it is held for its diversification benefits and the income it generates by way of rental cashflows. Life insurers’ real estate investments are focused on acquiring a long-term, certain income stream and sustaining capital value, rather than capital appreciation. The asset class can also offer valuable diversification benefits in a portfolio due to its lower correlation with other financial assets. Insurers typically invest in real estate across different sectors and geographies, which offers further diversification within the real estate allocation itself, a point that has been consistently underappreciated in the Solvency II regulation. Core real estate investing focuses on stabilised income streams which are often structured to offer strong inflation hedging characteristics, with contracted income commonly linked to CPI or a similar pricing index. This is especially beneficial for matching investment assets to insurers’ future liabilities to policyholders.

Unlike owner-occupied housing, institutional real estate is acquired as a financial asset, not as a consumer good or personal utility. The institutional real estate market comprises assets that are of institutional quality and held in third party ownership. This invested market is made up of commercial real estate in Europe’s major cities, including offices, retail and industrial/logistics premises. In addition, residential is an important sector, represented by portfolios of professionally managed private rented sector (PRS) multi-family assets as well as social housing portfolios.
The rationale for undertaking long-term investing is that it can provide superior returns through exploiting liquidity and/or market risk premia. As long-term investors, insurers have the capacity to invest counter-cyclically, thereby amplifying this enhanced return. Such long-term counter-cyclical strategies provide a floor for real estate markets during downturns as well as for the real economy and economic value growth. Importantly for addressing the current Covid-19 triggered economic challenges, the counter-cyclical nature of long-term investing greatly assists the stabilisation of financial markets during downturns.

While many of these points regarding the benefits of long-term investment have been tacitly acknowledged in the preferential treatment accorded to both infrastructure and long-term equities in order to remove barriers to insurers investing in the real economy in follow-on amendments to Solvency II, how they also apply to insurers’ investment in real estate directly and through funds and other indirect investment vehicles should be actively considered in the current review. The logical conclusion could arguably be to extend preferential treatment to property as well.

There are many arguments to support such an approach. For example, policies designed to incentivise long-term investment should logically not subject long-term asset classes such as real estate to solvency requirements based on arguably irrelevant one-year downside volatility in capital values, given that the assets deliver relatively stable income returns. Rather, illiquid assets that cannot easily be disposed of in the short-term should be subject to a longer downside volatility period. In addition, mark-to-market valuation of illiquid long-term investments creates artificial balance sheet volatility. Combined with a short-term downside volatility timeframe, this promotes pro-cyclical behaviour by pressuring investors to sell some long-term relatively stable income-producing assets in periods of short-term downside volatility, thereby exacerbating market cycles.

**Real estate and Infrastructure**

In recent years, life insurers have increasingly looked beyond traditional core retail, office and industrial buildings to invest in ‘social infrastructure’ projects such as affordable housing, student accommodation, leisure and sports facilities, healthcare facilities and care homes for the elderly. Because they can deliver stable, long-term income in the same way as traditional commercial property, they increasingly attract long-term capital to meet long-term liabilities. Under Solvency II, they are generally treated as property and are subject to the property module solvency capital requirements.

Infrastructure and real estate investments are often mutually dependent, with one not being possible without the other. For instance, real estate assets, as social infrastructure, may not be sustainable in certain areas unless appropriate transport and utilities infrastructure is put in place – while those infrastructure enhancements are unlikely to be financially viable in the absence of substantial investment in the built environment.

Given their similarities as long-term asset classes, mutual dependencies and increasing overlap between different types of infrastructure and commercial real estate investment, both should be seen in view of their vitally important contribution to strengthening European economy, growth and job creation and the contribution they make to insurers’ long-term investment portfolios.

**Sustainable real estate investment**

Ensuring that the Solvency II framework also provides appropriate incentives to address climate and environmental risks and opportunities in insurers’ investment policies is another important area of consideration in the holistic review of Solvency II. Together with other long-term institutional investors, life insurers have spearheaded the UNEP initiative to move towards a more sustainable future over the past fifteen years. The demands of such investors have transformed the built environment and will greatly assist in delivering on the commitments made in the Paris Agreement.

Creating a sustainable future for Europe’s urban ecosystems requires a viable economy to be equitable and accessible to the society it serves, and for both to have a positive impact on the environment, in turn improving well-being, society and the economy. Real estate, in tandem with infrastructure, is the scaffold for delivering a sustainable future. These benefits are natural externalities of long-term investment.

Furthermore, like infrastructure, real estate is an important source of employment that reaches far beyond its construction phase, which combined with the physical assets represents a long-term investment in viable and sustainable communities throughout Europe.
Endnotes

1 Note that throughout this consultation document, unless explicitly stated otherwise, the term “insurance” encompasses both insurance and reinsurance.

2 For instance, a house fire, a car accident causing damages to the policyholder’s car or physical injuries, the death of the insured triggering the payment of accumulated capital to pre-determined beneficiaries in the case of a life insurance contract, etc.

3 The recording of the conference is available here: https://webcast.ec.europa.eu/conference-on-review-of-thesolvency-ii.

4 See for instance, ESRB’s warnings and recommendations on medium-term residential real estate sector vulnerabilities.

5 See the special feature “Climate change and financial stability” published in May 2019 as part of the European Central Bank’s Financial Stability Review.


7 The taxonomy is a clear and detailed EU classification system for sustainable and environmentally- sustainable activities, which is currently under development. It is aimed to become a “common language” for all actors in the financial system.

8 i.e. cash or other highly marketable securities.

9 Skipped [note in comment instruction]

10 See the Global Financial Stability Report: Lower for longer (October 2019), and in particular page 47.

11 By the end of 2019, insurers held on average an amount of capital which was more than twice as high as the one required by the legislation.

12 Skipped [note in comment instruction]

13 More information on the review of the rules concerning non-financial reporting for public interest entities, including insurance companies is available at the following link: https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2020-580716_en.


15 The questions in this section address similar issues as the questions in section 3.5. (Improving resilience to adverse climate and environmental impacts) of the consultation on the renewed EU Sustainable Finance strategy which was launched on 8 April 2020. Stakeholders that submit responses to both consultations do not need to reiterate the comments already made in responses to the questions of the consultation on the renewed EU Sustainable Finance strategy.


INREV is the European Association for Investors in Non-Listed Real Estate Vehicles. We provide guidance, research and information related to the development and harmonisation of professional standards, reporting guidelines and corporate governance within the non-listed property funds industry across Europe. INREV currently has 461 members. Our member base includes institutional investors from around the globe including pension funds, insurance companies and sovereign wealth funds, as well as investment banks, fund managers, fund of funds managers and advisors representing all facets of investing into non-listed real estate vehicles in the UK and the rest of Europe. Our fund manager members manage more than 500 non-listed real estate investment funds, as well as joint ventures, club deals and separate accounts for institutional investors.

A full report on this topic that contains many of the points raised in this submission can be found at: https://www.inrev.org/system/files/2020-04/INREV-Long-term-investment-for-Europes-future-2020-Report.pdf

See: https://www.eiopa.europa.eu/content/insurers-asset-and-liability-management-relation-illiquidity-their-liabilities_en