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FINANCIAL SECTOR ASSESSMENT PROGRAM

July 3, 2025

TECHNICAL NOTE

INSURANCE MICRO AND MACROPRUDENTIAL SUPERVISION

Prepared By
Monetary and Capital Markets Department, IMF

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program (FSAP) in the euro area. The note contains the technical analysis and detailed information underpinning the FSAP findings and recommendations. Further information on the FSAP program can be found at http://www.imf.org/external/np/fsap/fssa.aspx.

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Glossary

BSCR	Basic Solvency Capital Requirement
CTTP	Critical Third-Party Providers
DORA	Digital Operational Resilience Act
EA	Euro Area
EBA	European Banking Authority
EC	European Commission
EEA	European Economic Area
EFPITP	Expected Future Profits in Technical Provisions
EIOPA	European Insurance and Occupational Pensions Authority
ESA	European Supervisory Authorities
ESFS	European System of Financial Supervision
ESG	Environmental, Social and Governance
ESMA	European Securities and Markets Authority
EU	European Union
EU-SCICF	European Systemic Cyber Incident Coordination Framework
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSP	First Smoothing Point
FSR	Financial Stability Report
FTE	Full-Time Equivalent
GME	Global Monitoring Exercise (IAIS)
IAIS	International Association of Insurance Supervisors
ICP	Insurance Core Principles
ICT	Information and Communications Technology
IDD	Insurance Distribution Directive
IGS	Insurance Guarantee Scheme
IMF	International Monetary Fund
IRRD	Insurance Recovery and Resolution Directive
LACDT	Loss-Absorbing Capacity of Deferred Taxes
LTE	Long-term Equities
MCR	Minimum Capital Requirement
MS	Member States
NCA	National Competent Authority
ORSA	Own Risk and Solvency Assessment
POG	Product Oversight and Governance
PPP	Prudent Person Principle
QRT	Quantitative Reporting Template
RDB	Insurance Risk Dashboard
RIS	Retail Investment Strategy
RTS	Regulatory Technical Standards
SCR	Solvency Capital Requirement
SFCR	Solvency and Financial Condition Report

SFDR	Taxonomy Regulation, the Sustainable Finance Disclosure Regulation
SRAF	European Systemic Risk Assessment Framework
TN	Technical Note
UFR	Ultimate Forward Rate
VA	Volatility Adjustment

EXECUTIVE SUMMARY[1]

Over the past five years, the institutional structure for insurance regulation and supervision in the euro area (EA) has evolved incrementally, and at the time of the FSAP important legislative processes were in development. Insurance supervision remains a national responsibility, but the European Insurance and Occupational Pensions Authority (EIOPA) is assuming a growing, central role. This includes EIOPA's responsibilities under the Digital Operational Resilience Act (DORA), which establishes an oversight framework for critical Information and Communications Technology (ICT), along with the Insurance Recovery and Resolution Directive (IRRD), which gives EIOPA new roles and responsibilities, including the establishment of a resolution committee and other more permanent tasks (such as participating in the resolution colleges). In addition, at the time of the FSAP, important legislative review processes were in course, such as the Solvency II Review and the Retail Investment Strategy (RIS) proposal.

Solvency II is a sophisticated, risk-based solvency regime that has worked well over time, and the ongoing legislative review should ensure that safety and soundness objectives are not compromised. EA insurance groups are generally well capitalized. Solvency Capital Requirement (SCR) ratios have been stable during market turmoil and the pandemic, even as interest rates increased quite quickly. The European Commission's (EC's) objective for the Solvency II Review was to provide incentives to the insurance and reinsurance sector to invest in long-term capital, aligning with the typical long-term horizon of insurance liabilities and pension products, while ensuring resilience. Throughout the legislative process, however, there have been proposed changes to the Pillar 1 requirements, that will likely lead to material increases in insurer's surplus capital over the current SCR. Solvency requirements should be developed on a total-balance sheet approach recognizing the interdependence between assets, liabilities, regulatory capital requirements and capital resources. Adjustments to quantitative requirements in Solvency II should be considered in line with the calibration of 99.5 percent value at risk over a one-year period. The legislation should also make clear that while there may be multiple objectives to the Solvency II review, the prudential objective should be the primary objective and other objectives should be secondary.

The finalization of the IRRD's legislative process is a welcome development, which should be buttressed by harmonizing Insurance Guarantee Schemes (IGS). Prior to IRRD, there was a fragmented landscape regarding recovery and resolution which depended on national law. The IRRD allows Member States (MS) certain flexibility during transposition. IGS do not exist in all MS, and where they do, significant differences in their design may pose challenges in failures of cross-border insurers. Establishing a minimum common framework for IGS would significantly enhance the protection of policyholders and foster greater trust in the single market.

[1] This Technical Note has been prepared by Peter Windsor (IMF, Monetary and Capital Markets Department). The on-site work supporting the findings was conducted during November 2024. The information in this note is current as of November 18, 2024. The FSAP thanks the authorities for the constructive dialogue and the many insights that they have shared.

The Retail Investment Strategy (RIS) proposal seeks to strengthen the legislative framework to enable retail investors to make more informed decisions, but some proposed amendments can potentially weaken the framework. The RIS proposed to provide adequate protection to retail investors, as well as enhance trust and increase retail investor participation. The EC proposals should bring about positive changes, such as European value for money benchmarks, clearer information for consumers fit for digital distribution, and more information on the progress of investments along with new tools to enhance consumer choice when investing. It also introduces stronger rules to protect consumers against misleading marketing communications and misleading advice from "finfluencers". However, the amendments proposed by the EP and Council have the potential to weaken some of these proposed changes, as emphasized by EIOPA and ESMA in a recent letter.[2]

To ensure resources are focused on implementation, the EC should consider a temporary pause to legislative reform after RIS is completed and IGS are harmonized, and a high bar should be set in determining the need for any further reforms. There is a sense of regulatory fatigue among stakeholders. There have been multiple changes to the Solvency II Directive in the past years. The Solvency II Review is a major project, ongoing for more than five years, and the IRRD has been developed at the same time. Horizontal legislation applicable to a wide range of financial markets actors also impact insurance and have been enacted in the last five years, such as DORA, the Artificial Intelligence Act, the Taxonomy Regulation, the Sustainable Finance Disclosure Regulation (SFDR), and the Corporate Sustainability Reporting Directive. In addition, large insurers have dealt with the most significant accounting change for insurers in many decades, with the introduction of IFRS 17 and IFRS 9 from the beginning of 2023. There should be a period of legislative stability to enable full implementation of these reforms by insurers, EIOPA and the National Competent Authorities (NCAs).

EIOPA's resources are stretched and should be buttressed. There are no additional resources planned for EIOPA's new tasks once the regulatory reforms are implemented. Over the last 5 years, EIOPA has had to deprioritize and scale down activities to accommodate the heavier workload from new regulations. EIOPA is also not recruiting to the full extent of its existing resource envelope. EIOPA relies to some extent on Seconded National Experts (SNEs) for staffing and has been unable to fill these positions due to similar resource pressures at NCAs. In addition, EIOPA is operating in a competitive environment for staff and skills and faces challenges in attracting and retaining specialized expertise in areas such as digitalization, sustainability, and financial supervision. EIOPA should explore additional and new ways to recruit a full complement of staff to work on its heavy regulatory and supervisory agenda and NCA's should ensure SNE positions at EIOPA are filled. EIOPA's budget and staff establishment plan should be reviewed in light of the significant new tasks it has been given through legislative reform. In view of the increasing budgetary challenges for both EIOPA and the NCAs, other funding mechanisms should be explored.

[2] https://www.eiopa.europa.eu/publications/eiopa-and-esma-letter-european-commission-regarding-retail-investment-strategy_en - see also further content of this letter on pages 24-26 below.

EIOPA's efforts in supervisory convergence are crucial, but it faces challenges in cross-border operations and market conduct supervision. Despite using various tools like guidelines and peer reviews, cooperation between home and host supervisors remains problematic. Difficult cases have highlighted that EIOPA and the EC lack sufficient authority to protect policyholders when NCAs do not fulfill their Solvency II obligations. The Solvency II Review is a step towards strengthening EIOPA's role in cross-border supervision, but further enhancements are needed. Some RIS proposals aim to empower EIOPA, although suggested changes by the Council might weaken its role in these cases. Additionally, EIOPA could benefit from improved access to key supervisory documents, such as ORSA reports. There should be consideration for granting EIOPA emergency powers to make binding decisions when home NCAs fail to act, ensuring policyholder protection in cross-border activities, which may require a fundamental reform of the relationship between EU authorities and member states. Regarding conduct risk, EIOPA should be provided with more direct ability to identify, analyze and assess risks for policyholders which are relevant to multiple MS**.**

EIOPA should obtain more resources and be given stronger powers related to internal models. Insurers representing more than 50 percent of the European insurance market use an internal model to calculate the solvency capital requirement (SCR). Comparisons between SCRs calculated using internal models and SCRs calculated on the standard formula show a wide variety of results for insurers of the same type. While EIOPA undertakes several activities to foster convergence in internal model supervision, it faces barriers to being more effective. EIOPA should be provided with more resources for country visits, enhance participation in colleges, and provide more benchmarking or technical assistance as needed. EIOPA should also have stronger powers with regard to supervisory decisions related to internal models. There should be discussions on the application of a floor to address some aspects of internal model SCR calculations either as a standard or on a case-by-case basis (e.g., outliers) beyond the limited corrections under circumstances described in the Solvency II Review. It is notable that a similar approach has been taken by the BCBS with regard to internal model usage by banks.

EIOPA should continue to develop its European Systemic Risk Assessment Framework (SRAF). The SRAF is closely aligned with the International Association of Insurance Supervisors' (IAIS) Global Monitoring Exercise (GME) but lacks a systemic risk score for individual insurers similar to the Individual Insurer Monitoring component of the GME. Also, there is no outward looking dimension to systemic risk surveillance. EIOPA should enhance the SRAF beyond the sector-wide aggregate perspective to add a scoring methodology that would more clearly enable monitoring of the risk of individual insurers over time, from a systemic risk perspective. EIOPA should continue working with ESAs, ESRB and ECB to determine if or how insurers may have a systemic impact on the EA financial system and consider enhancing this dimension in its macroprudential framework. In addition, individual insurer results of stress test exercises should be published.

Solvency II data collection should be centralized at EIOPA. Currently, Solvency II data is received by NCAs and then shared with EIOPA for the central database. The fact that the key data is owned by NCAs can be constraining in terms of the ability to share data with other members of the ESFS for systemic risk monitoring. Changes should be made to the responsibilities of NCAs and EIOPA, such that EIOPA is the recipient of data from insurers and groups and enables NCAs to access that

data. EIOPA should be provided with adequate resources for this new responsibility. Individual insurance level data should be made available to the public, either as an EIOPA initiative or as part of wider initiatives such as the European Single Access Point (ESAP).

Table 1. Euro Area: Recommendations on Insurance Micro and Macroprudential Supervision

Recommendations	Timing[1]	Authorities
Implement a formal profitability assessment with a special focus on large groups using IFRS based on further analysis of similarities and differences between Solvency II valuation principles and IFRS.	ST	NCAs and EIOPA
Develop a more systematic approach on how the capital add-on can be used in a more targeted way to address vulnerabilities under Pillar 2 such as from internal control functions, risk management practices and governance processes.	MT	EIOPA and NCAs
If adjustments are introduced to quantitative requirements in Solvency II, changes should be considered in line with the calibration of 99.5 percent value at risk over a one-year period.	MT	EC, EIOPA
Ensure that while there may be multiple objectives to the Solvency II review, the prudential objective should be the primary objective and other objectives should be secondary.	I	EC
Implement a minimum harmonization framework for IGS across MS to protect policyholders, particularly those who buy insurance products on a cross-border basis and foster greater trust in the single market.	MT	EC, EIOPA
Include in the RIS implementation any additional reforms pertaining to the design and distribution of insurance products envisaged to enhance EU savings and investments.	MT	EC, Co-legislators
Consider a temporary pause in further regulatory reforms once Solvency II review, IRRD, minimum harmonization of IGS and RIS implementation are complete, and a high bar should be set in determining the need for any further reforms.	I	EC
Explore additional and new ways to recruit a full complement of staff to work on its heavy regulatory and supervisory agenda should	I	EIOPA
Ensure national seconded expert positions at EIOPA are filled	I	NCAs
Review EIOPA's budget and staff establishment plan in light of the significant permanent tasks it has been given through legislative reform. In view of the increasing budgetary challenges for both the Authority and the NCAs, other funding mechanisms should be explored	I	EC, EIOPA
Agree to exchange the ORSA Report with EIOPA on a regular basis	ST	NCAs
Consider endowing EIOPA with emergency powers to take binding decisions when home NCAs are unwilling or unable to act and policyholder protection is at risk in the context of cross border activities, noting this may require more fundamental reform of the relationship between EU authorities and MS	MT	EC
Obtain more resources so that EIOPA can improve convergence of internal model supervision, by undertaking more country visits regarding internal models, enhancing the participation in colleges, and providing more comparative studies, benchmarking or technical assistance.	ST	EC, EIOPA

Table 1. Euro Area: Recommendations on Insurance Micro and Macroprudential Supervision (Concluded)		
Give stronger powers to EIOPA on supervisory decisions related to internal models.	ST	EC
Introduce a mechanism to allow a binding technical review to resolve differences of opinion between EIOPA staff and NCAs on internal model supervision	ST	EC, EIOPA
Enter into a discussion on the application of a floor to address some aspects of the internal model SCR calculation either as a standard or on a case-by-case basis.	ST	Co-Legislators, EC, EIOPA
Provide EIOPA with more direct ability to identify, analyze and assess risks for policyholders which are relevant to multiple member states	ST	EC
In light of EIOPA's advice on the prudential treatment of sustainability risk, ensure that prudential policy continues to be anchored in risk-based analysis ensuring the primacy of prudential policy objectives where they may conflict with other policy objectives	I	EC, Co-Legislators
If additional risk charges for fossil fuel-related assets are adopted in the standard formula, supervisory review processes must ensure that internal model users have recognized such differences in the capital required in relation to those assets	MT	EIOPA, NCAs
Once the reassessment of natural catastrophe risks in the Pillar 1 standard formula is completed, conduct a review of how internal model users are calibrating natural catastrophe risks to ensure they consider at least the same risks as the standard formula	MT	EIOPA, NCAs
Enhance the SRAF with a scoring methodology that would more clearly enable monitoring individual insurers over time from a systemic risk perspective and develop an approach to considering outward risks posed by insurers to other parts of the financial system.	MT	EIOPA
Changes should be made to the responsibilities of NCAs and EIOPA, such that EIOPA is the recipient of data from insurers and groups and enables NCAs to access that data and EIOPA should be provided with adequate resources to undertake this new responsibility	ST	EC
Individual insurance level data should be made available to the public, either as EIOPA initiative or as part of wider initiatives such as the European Single Access Point (ESAP)	ST	EIOPA, NCAs
Align the EIOPA regulation (1094/2010) to the provisions on the power to publish individual results of sectorial stress test included in the EBA regulation (1093/2010. Article 22(1a)).	ST	EC
EIOPA and NCAs should operationalize processes to enable the publication of the individual insurer results of stress test exercises according to the applicable regulation(s) both at National and EU level.	ST	EIOPA, NCAs
[1] Immediate (within 1 year); ST Short Term (within 1-2 years); MT Medium Term (within 3–5 years).		

INTRODUCTION

1. This Technical Note (TN) provides an analysis of the main elements of the regulatory and supervisory framework governing insurance companies in the EA. This analysis is based on the existing regulatory framework and the supervisory practices that were in effect as of November 2024. The analysis is specifically informed by a comprehensive review of regulations, market analyses, and discussions with both European and national authorities. Furthermore, the FSAP team met with representatives from insurance companies and industry associations.

2. While recommendations are based on the applicable international standards, this TN does not assess observance of the Insurance Core Principles. Insurance supervision is primarily a national responsibility, with the European Union (EU) bodies focused on establishing regulation and promoting convergence in supervisory practices across MS. In this context, the TN considers significant EU-wide issues in prudential and market conduct regulation and supervision. The TN also discusses macroprudential tools and crisis management within the insurance sector[3] and provides an update on the current risks and vulnerabilities faced by the insurance sector in the EA. The impact of these risks varies among insurance companies, depending on the design of their products and their investment exposures. Moreover, differences in accounting, taxation, social security laws, and supervisory practices at the national level complicate the ability to draw aggregated conclusions.

MARKET STRUCTURE AND RISKS

A. Market Structure

3. Insurance penetration[4] is high in the EA at 9.9 percent in 2023. The level of penetration varies considerably between MS, indicating various levels of development of insurance markets. See Figure 1. Overall penetration in the EA compares favorably to the United States, which Swiss Re Sigma reports to be at 10 percent. While penetration has increased since 2021, there has been a steady decline in the number of insurers in the EA, across all types of insurers (see Figure 1). When measuring the balance sheet growth of insurance groups, the results are impacted by market value changes due to the significant increase in interest rates; as a result, both asset and liability values declined in 2023 (see Figure 2). The valuation approach in Solvency II,[5] particularly the long-term guaranteed measures such as the volatility adjustment (VA), appear to be working well in the changed environment. Asset and liability values have moved in similar ways and the SCR has been relatively stable (see Figure 2). Changed bond portfolio valuations have largely driven the changes in

[3] This TN focuses on EU-wide issues as regulation is at the EU-level and is applicable in the European Economic Area (EEA), which includes the 27 EU MS along with Iceland, Liechtenstein, and Norway. The EA covers the 20 countries within the EU that use the Euro.

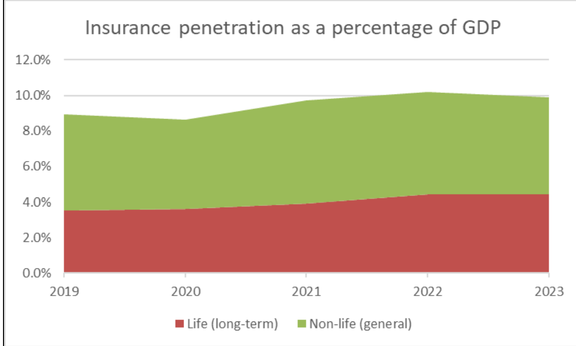
[4] Insurance penetration measures the development of the insurance sector. It is the ratio of total insurance premium to gross domestic product.

[5] Not all European insurers are subject to Solvency II, as exemptions exist for smaller undertakings. However, the combined market share of these exempted insurers is minimal.

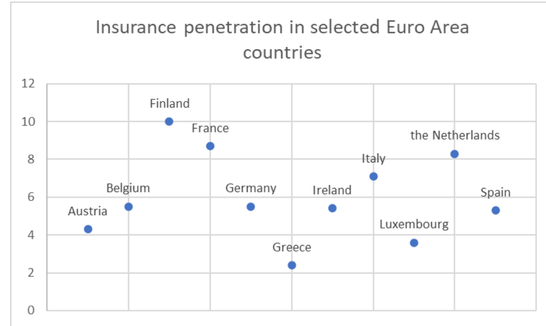
total asset values observed. Within those bond portfolios, government bond values have reacted the most to the changed interest rate environment (see Figure 2).

Figure 1. Euro Area: Insurance Penetration and Number of Undertakings

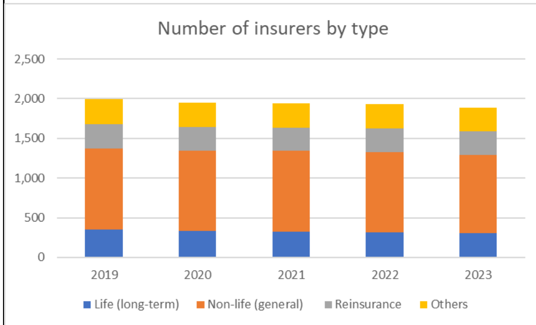
Insurance penetration has increased in recent years …



However, insurance penetration varies significantly by country

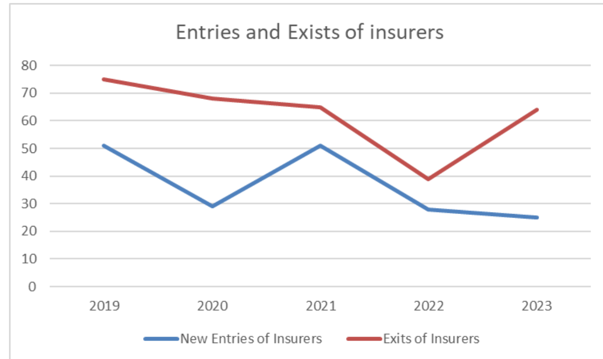


The number of insurers has been steadily declining…



Source: Panels 1, 3 and 4: EIOPA and IMF Staff Calculations;

Exits from the market have consistently exceeded entries to the market



Panel 2: Swiss Re Sigma

Figure 2. Euro Area: Selected Statistics for Insurance Groups

Values of assets and liabilities move in similar ways, likely driven by the prevailing interest rate environment to a large extent ….

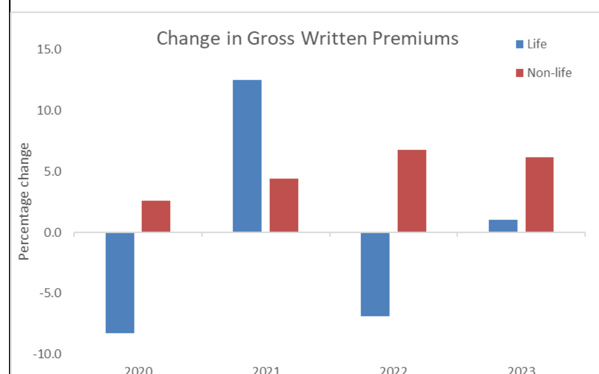
…so, SCR coverage ratios have been quite stable despite changing monetary policy.

Source: EIOPA and IMF Staff Calculations

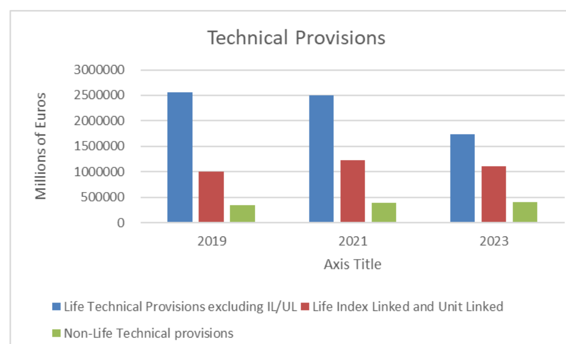
4. **Life insurance is an important form of savings for EA citizens, while non-life insurance has demonstrated consistent growth.** Gross written premiums (GWP) for life insurance have demonstrated some volatility in terms of growth (see Figure 3). Life Technical Provisions are significantly higher than for non-life insurance due to the long-term nature of life insurance and the accumulation of savings they represent. Index-Linked and Unit-Linked (IL/UL) life insurance technical provisions, which typically do not have long-term interest rate guarantees, have not been as affected by changes in interest rates as technical provisions for life insurance excluding IL-UL have. Changes in interest rates have a much larger impact on long-term liabilities. Non-life GWP has been increasing steadily and this is reflected in the increasing technical provisions. Non-life insurers typically have much lower technical provisions because of the short-term nature of the business.

Figure 3. Euro Area: Insurer Growth

Non-life GWP have been consistently growing but Life GWP growth has been volatile ….



Life insurance technical provisions are substantially greater than non-life but have decreased due to increased interest rates

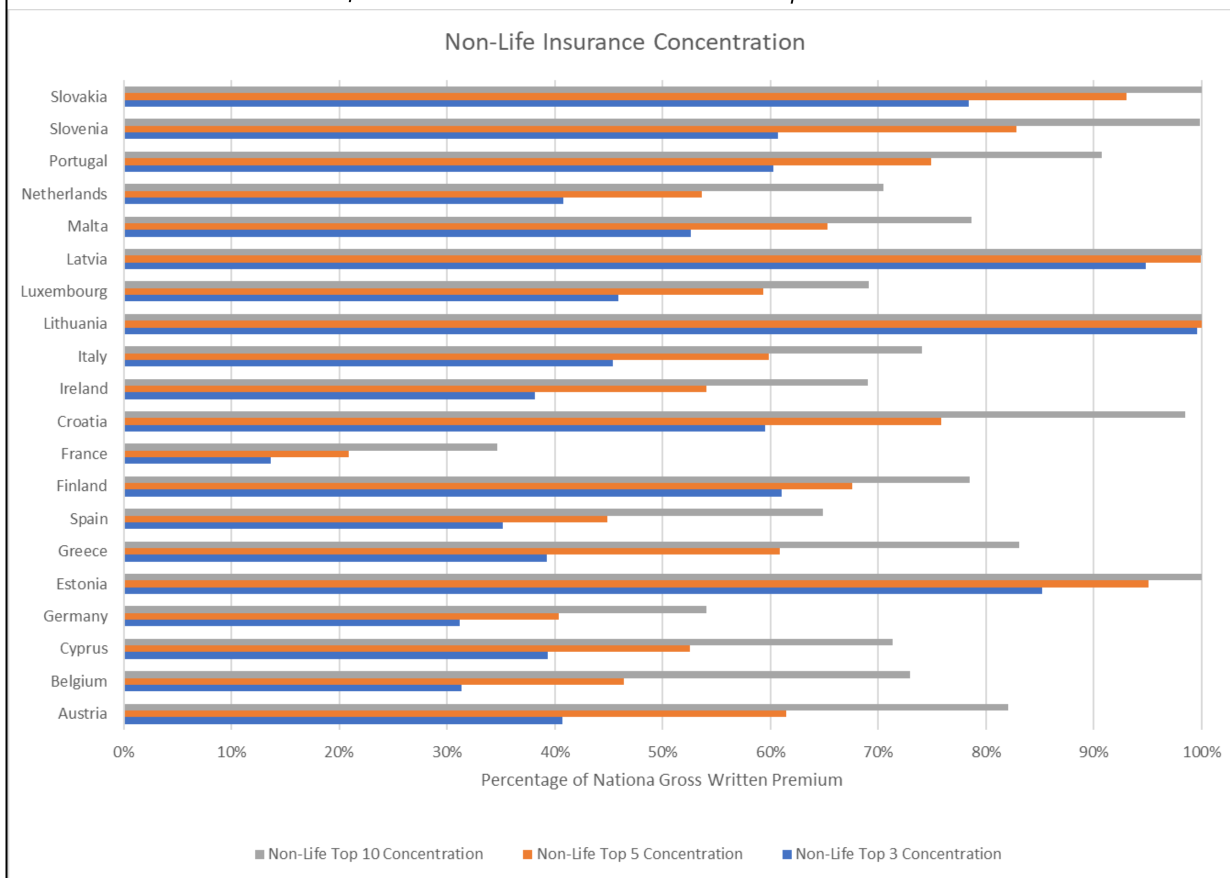


Source: EIOPA and IMF Staff Calculations

5. **Neither the life insurance sector nor the non-life insurance sector is particularly concentrated at the EA level**. The top 10 life insurance groups account for 46 percent of the life insurance market. The top 10 non-life insurers account for 35.8 percent of the non-life insurance market. No insurance group has more than a 10 percent share of its relevant market at the EA level. However, within EA countries, some markets exhibit high concentration levels as can be seen in Figures 4 and 5. Outside of France and Germany, market concentration of the top 5 life insurers within EA MS is significant. 14 of the EA MS have highly concentrated markets with top 5 market share above 60 percent.

Figure 4. Euro Area: Non-Life Insurance Concentration

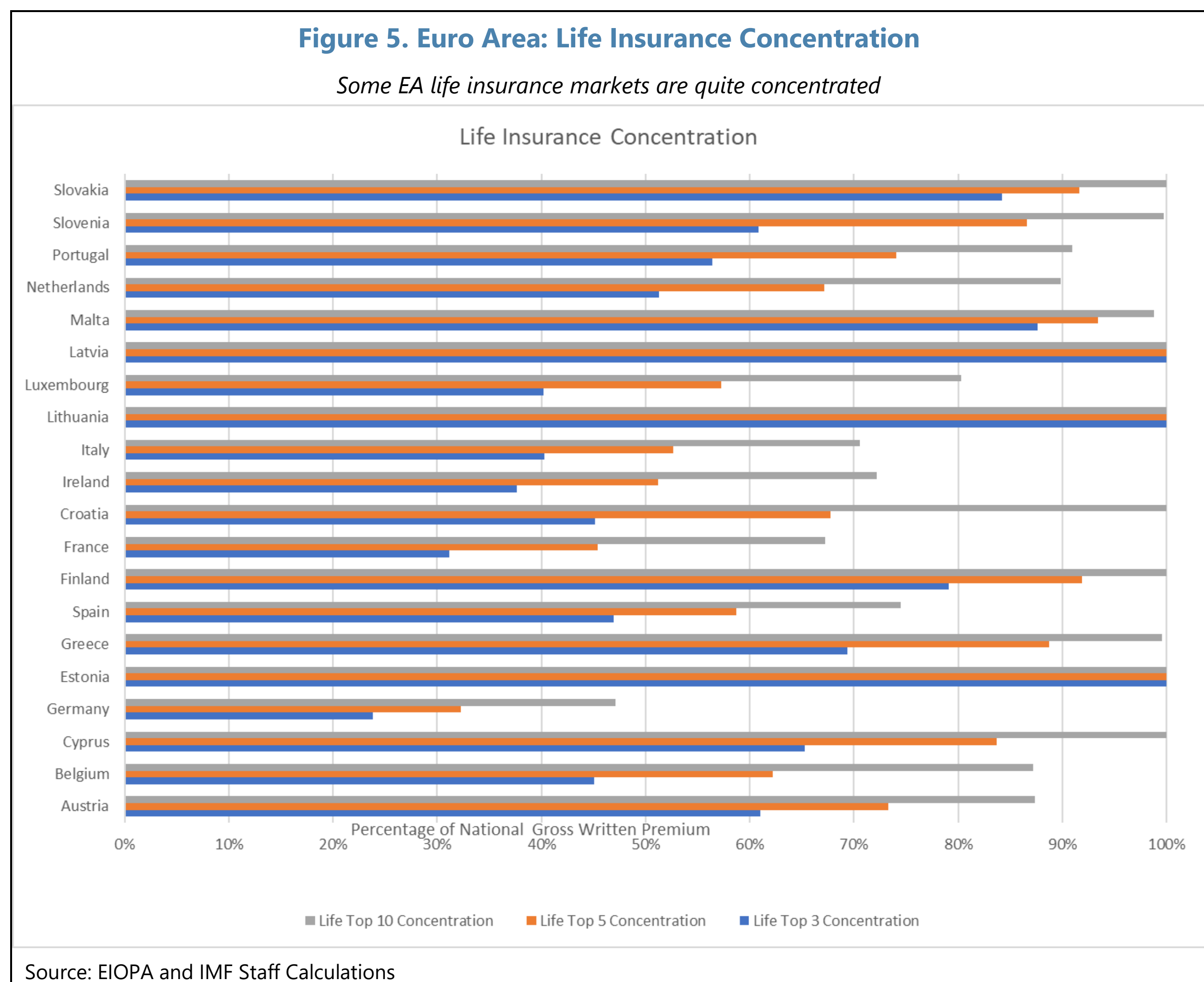
Some life insurance markets in the Euro zone are quite concentrated



Source: EIOPA and IMF Staff Calculations

Figure 5. Euro Area: Life Insurance Concentration

Some EA life insurance markets are quite concentrated

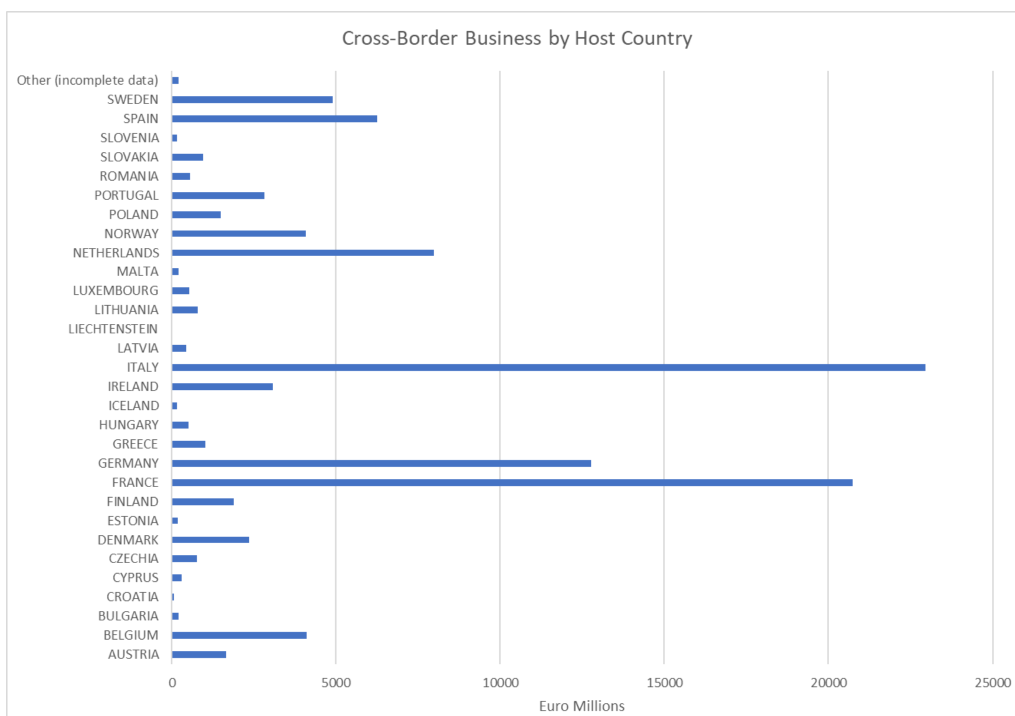


Source: EIOPA and IMF Staff Calculations

6. Cross Border business is significant within the EEA. Total direct (i.e. excl. reinsurance) cross-border business reported was Euro 104.1 billion. In terms of host countries (where the products are sold), the most significant markets for cross-border business are Italy, France, and Germany (see Figure 6). All countries in the EEA are hosts to some cross-border business. In terms of home countries (where the insurers reside), Ireland and Luxembourg dominate (see Figure 7). Figure 8 shows that cross-border business can be very significant in terms of the overall insurance market in some EEA countries.

Figure 6. Euro Area: Direct Cross-Border Premiums in the EEA by Host Country

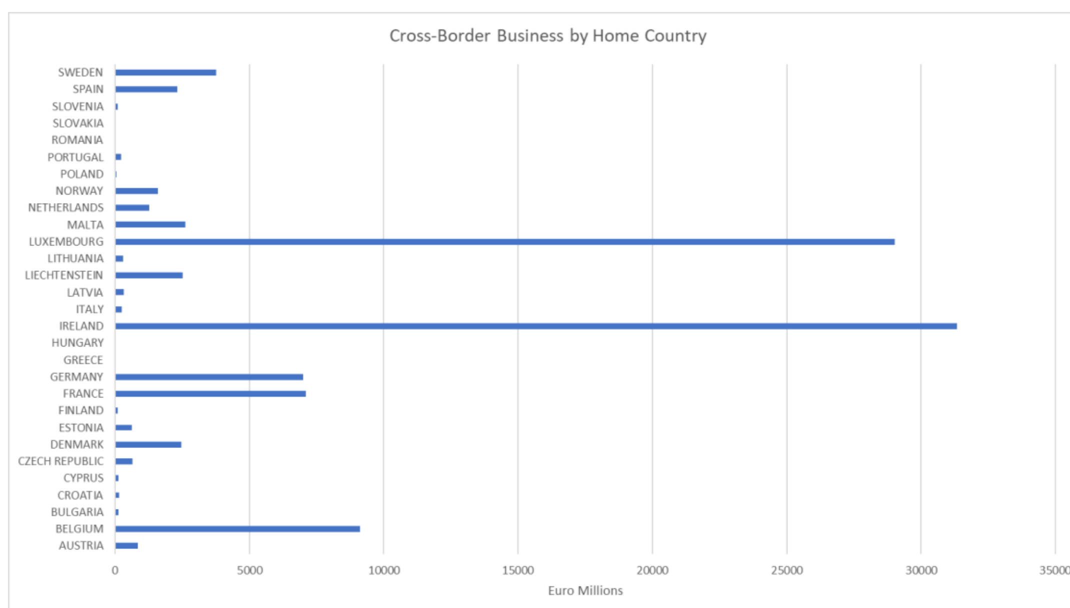
Direct cross border business can be more significant in some host countries in the EEA



Source: EIOPA and IMF Staff Calculations

Figure 7. Euro Area: Direct Cross-Border Premiums by Home Country

Direct cross-border business is dominated by only a few home countries

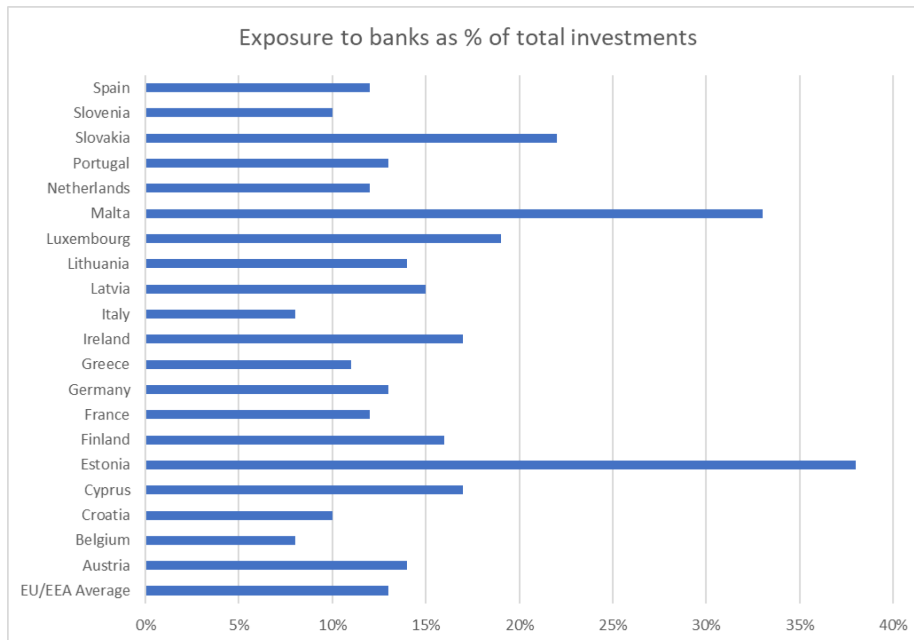


Source: EIOPA and IMF Staff Calculations

7. Insurers' investments in the banking sector remain material The average exposure of insurers to banks was 13 percent of total investments in 2023 but this varies considerably by country with Estonia and Malta at the highest level of exposure to banking assets in the EA. See Figure 9.

Figure 9. Euro Area: Investments interconnectedness with Banks

Exposures to bank investments considerably vary by countries in the EA with some significantly above the EU/EEA average



Source: EIOPA

B. Risks and Vulnerabilities of the Insurance Sector

8. Much can be learned about risks and vulnerabilities in the EU Insurance Sector by referencing EIOPAs publications. See Macroprudential section for an explanation of these products. EIOPA's quarterly insurance risk dashboard is a good starting point (see Figure 10). The semi-annual EIOPA Financial Stability Report (FSR) provides a good understanding of risks affecting the insurance sector over the short to medium term. EIOPA conducts on a quarterly basis a qualitative survey on relevant risks for insurers among NCAs, publishing the results in the FSR. The highest risk identified by NCAs in the Spring 2024's survey, published in the June 2024 FSR, was macroeconomic risks due to uncertainty around the outlook for inflation and growth, and these factors were linked to geopolitical instability. Market risks, mainly related to interest rate risk due to the large bond portfolios of insurers, was the second in the list of most material risks. The third most material risk referred to digitalization and cyber risks. Cyber incidents were noted as increasing in most MS. It was further noted that the insurance sector was adapting business models to the digital environment with new technologies across underwriting, claims and operational management. However, some insurers were failing to adapt their business and risked losing premium income in the future.

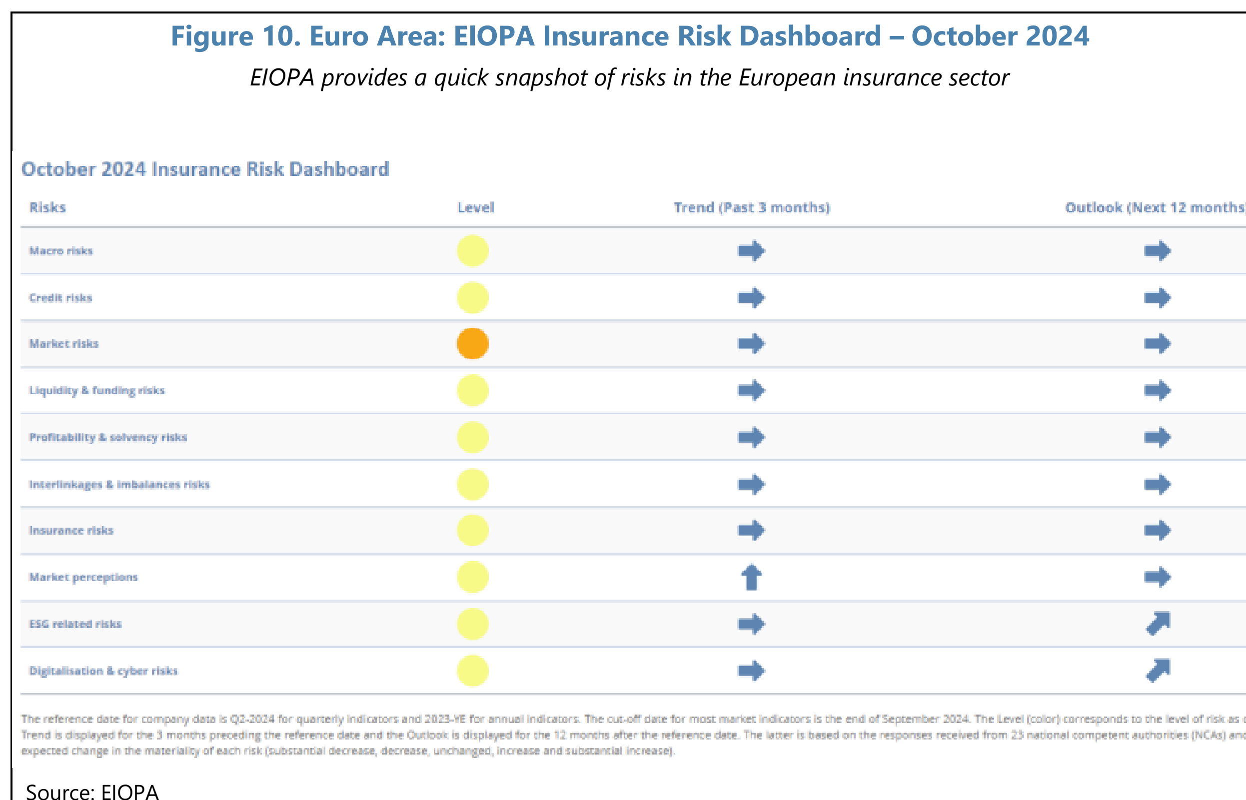


Figure 10. Euro Area: EIOPA Insurance Risk Dashboard – October 2024

EIOPA provides a quick snapshot of risks in the European insurance sector

October 2024 Insurance Risk Dashboard

Risks	Level	Trend (Past 3 months)	Outlook (Next 12 months)
Macro risks	●	→	→
Credit risks	●	→	→
Market risks	●	→	→
Liquidity & funding risks	●	→	→
Profitability & solvency risks	●	→	→
Interlinkages & imbalances risks	●	→	→
Insurance risks	●	→	→
Market perceptions	●	↑	→
ESG related risks	●	→	↗
Digitalisation & cyber risks	●	→	↗

The reference date for company data is Q2-2024 for quarterly indicators and 2023-YE for annual indicators. The cut-off date for most market indicators is the end of September 2024. The Level (color) corresponds to the level of risk as o
Trend is displayed for the 3 months preceding the reference date and the Outlook is displayed for the 12 months after the reference date. The latter is based on the responses received from 23 national competent authorities (NCAs) and
expected change in the materiality of each risk (substantial decrease, decrease, unchanged, increase and substantial increase).

Source: EIOPA

9. EIOPA's insurance risk dashboard is updated quarterly and provides a more real time understanding of risks as determined by EIOPA and NCAs. See Figure 10 for EIOPA's October 2024 Insurance Risk Dashboard. The risk level is represented by a 4-level scale of colors linked to quantitative scores that aggregate the set of risk indicators encompassed in each risk category. The risk trend reports the quarter-on-quarter variation of the risk score, while the outlook is displayed

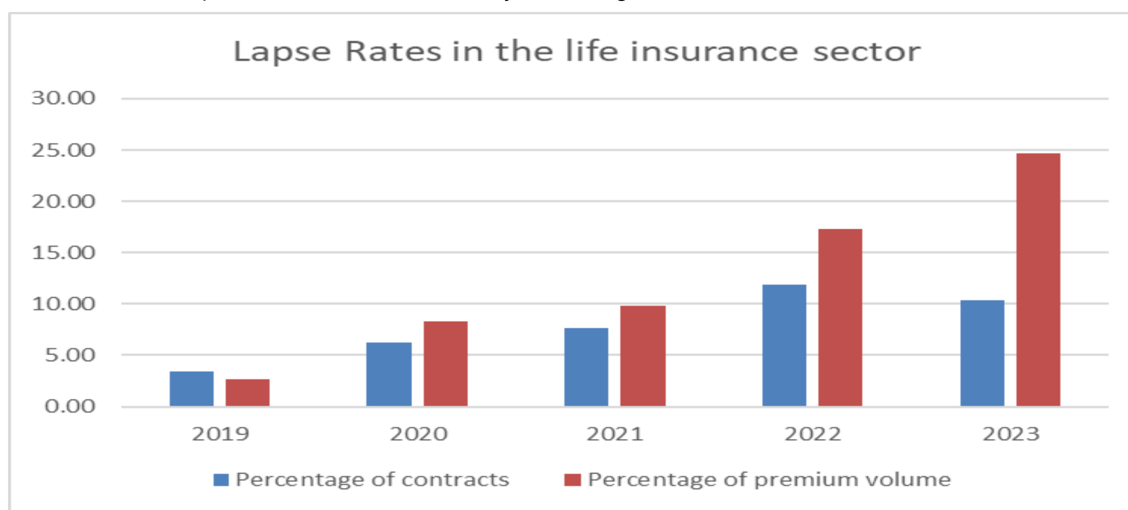
for the 12 months after the reference date based on qualitative responses received from NCAs and ranked according to the expected change in the materiality of each risk. The yellow level means medium risk and the orange level means high risk. Unused levels in this quarter's risk dashboard are green which means low risk and red which means very high risk. In terms of the trend and outlook, an arrow pointing right means EIOPA's view is that the risk is holding constant. The arrow pointing directly up means a substantial increase and the arrows pointing up and to the right mean an increasing trend.

10. The one risk identified as a high risk is market risk. Risk premia repricing seems to be the main uncertainty ahead. Credit spreads seem tight given the generic economic and monetary environment: it is also linked to growth evolution and hence uncertainty remains high. Falling interest rates are a double-edged sword for insurers. Falling interest rates mean asset values tend to increase (although the same will occur to insurer's liabilities). However, reducing returns will negatively impact the life sector in the medium to long-term. Interest rate hedging through derivatives may be a source of liquidity risk if interest rates move unexpectedly, triggering margin calls on derivative portfolios. Market perceptions risk, which relates to perception of investors towards insurers, has substantially increased over the last year. During 2023, insurance stocks underperformed relative to the market as a whole but that turned around for Quarter 3, 2024. Price to earnings ratios remained stable but with increased dispersion within those results. Insurer credit default swap spreads are declining.

11. In terms of non-life insurance, natural catastrophe risks remain a top consideration particularly in light of notable European flooding events in the last year. This is a concern from two perspectives. First, it is a concern in terms of the impacts on European insurers, and second it raises concerns about the affordability and availability of insurance coverage in some areas of Europe. Claims inflation remains a concern, although lower headline consumer inflation is removing some pressure. However, claims inflation is not the same as CPI, as insurance claims can be affected by inflation related to e.g., automotive parts and building materials remains high.

Figure 11. Euro Area: Lapse rates

Lapse rates have been materially increasing in the EA life insurance sector

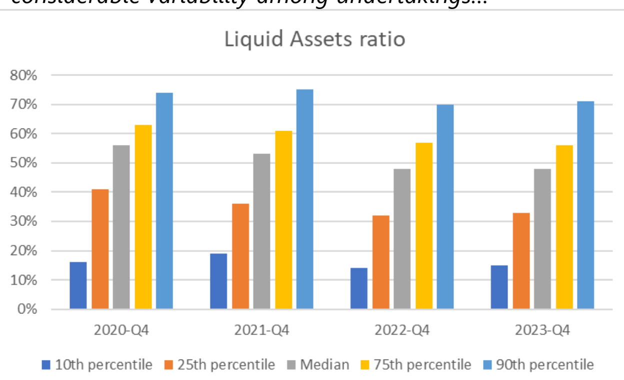


Sources: EIOPA and IMF Staff Calculations

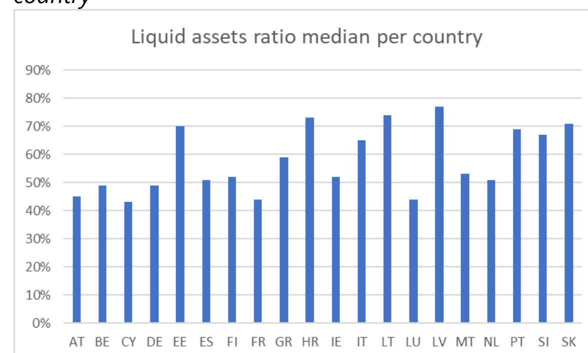
12. Policy lapses remain a risk for the life insurance sector and have been rising. Relatively easy financial conditions provide a variety of options for policyholders to reinvest elsewhere, and lapse rates have accordingly been increasing (see Figure 11) with capital and liquidity implications. From a capital perspective it shows up as higher lapse risk (e.g., mass lapse risk) within regulatory capital requirements (EIOPA recently finalized the public consultation of a paper which provides guidance on the treatment of mass-lapse reinsurance with the aim of achieving greater supervisory convergence across Europe). Policy lapse levels are heterogenous across countries since features of the policies sold are distinct, as are distribution models (e.g., distribution by banks seems to be correlated with higher lapse rates) along with differing fiscal and tax treatment. From a liquidity perspective, the liquidity of the asset portfolio is important, especially in cases that the allocation was shifted to private credit and other illiquid assets. However, it appears insurers have sufficient cash flow from premiums and sufficient liquid assets to be able to sustain the higher lapse rates seen recently. The liquid assets ratio of insurance undertakings in the EEA slightly declined since 2020, with the weighted median value at 48 percent at end 2023. The liquid assets ratio varies considerably across EA countries (see Figure 12).

Figure 12. Euro Area: Liquid Assets

Liquid asset ratios have been declining over time and there is considerable variability among undertakings…



And median liquid asset ratios vary considerably by EA country



Source: EIOPA and IMF staff calculations

13. Real estate related investments have increased consistently since the introduction of Solvency II and alternative assets are material. Total exposures to real estate investments were reported at 10.3 percent of total investments at the end of 2023, compared to 7.3 percent at the end of 2016. However, the figure would likely be higher other than for the reduction in real estate values over the past year. The exposure to real estate requires ongoing monitoring according to the ESRB.[6] Alternative assets are material to the investments of the EEA insurance sector, at 16 percent of assets at end 2023.[7] EIOPA includes real estate exposures in its definition of alternative assets, and this is the most significant among alternative assets. Life insurers have the largest exposure to alternative assets with an allocation of 23.6 percent of their investments, and 10.5 percent of investments on real estate.

14. Since the introduction of Solvency II, there have been transitional measures on the valuation of technical provisions, which also impact the interest rate risk calculation. These transitional measures are not that material in business-as-usual times but can be significant in stress. As at the end of 2023, the cumulative SCR ratio of insurers using transitional measures on technical provisions was 263 percent. Without the transitional measures, the SCR ratio for these insurers would be 249 percent.

15. The impact of the VA is much more significant and will become even more so when the Solvency II review is implemented. For insurers using the VA, SCR ratios were 263 percent as

[6] 2022 Report on commercial real estate and the follow-up report on vulnerabilities in residential real estate in 2024.

[7] In absence of a commonly accepted definition of alternative assets, EIOPA defines them according to risk-based characteristics which include illiquidity, difficulty in valuation, and complex structures. The asset classes considered as alternative are exposures to: real estate, private debt, infrastructure investments, private equity, and others (e.g., structured notes, alternative funds collateralised securities). For a detailed CIC mapping based on SII reporting refer to EIOPA (2024) June Financial Stability Report – Figure 5.41. Available at: EIOPA FINANCIAL STABILITY REPORT.

at the end of 2023, but if the VA was set to zero the SCR ratio would be 245 percent. In stressed markets, the VA is more significant. The VA has been successful in reducing volatility in SCR ratios.

16. Solvency II reporting includes limited information on the income statement of insurers. Nevertheless, insurers report information on premiums, claims and expenses, and on income/gains and losses as part of the prudential reporting, and a breakdown of the profit & loss is reported in the financial stability templates. Based on these figures, EIOPA reports profitability in its insurance risk dashboard on the basis of return on assets, return on investments, return on equity (using excess of assets over liabilities as a proxy), and return to premiums. According to the latest risk dashboard, the weighted median return on assets of the sector was 0.8% in the second half of 2023, up from 0.6% in the second half of the previous year. However, this reporting likely varies depending on the accounting methodology used. Those insurance groups applying IFRS 17 for consolidated group reporting are likely to have very different profit emergence than groups and solo insurers using country-specific generally accepted accounting principles.

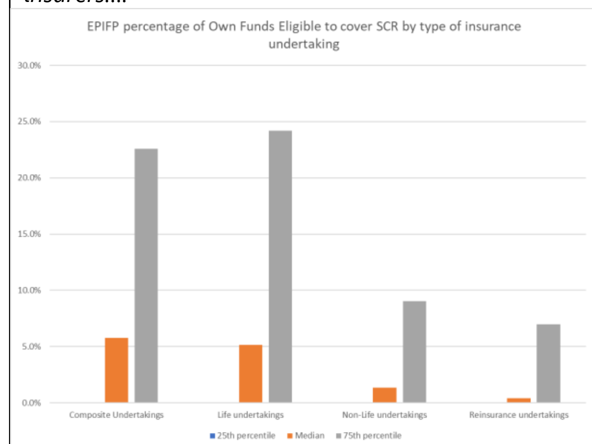
Recommendation

- NCAs and EIOPA should consider requiring groups applying IFRS to report an income statement to enable analysis about profitability to be conducted.

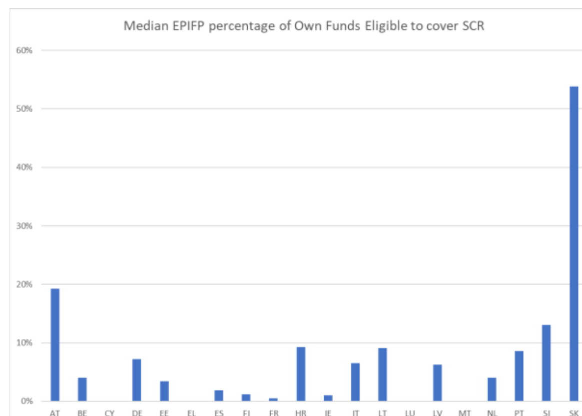
17. European insurers maintain high quality capital, but attention is needed in relation to the expected profits included in future premiums (EPIFP) At the end of 2023, 91 percent of Eligible capital to meet the SCR was made up of Tier 1 unrestricted capital. However, EPIFP can be significant and differs across countries (See Figure 13). The SCR calculation seeks to account for circumstances in which those future profits will not be realized. Future profits impact Tier 1 unrestricted capital through a reduction in technical provisions and therefore higher recognized Tier 1 capital Where high levels of future profits embedded in technical provisions are seen, scrutiny is needed regarding the cash flow assumptions being used in the calculation of those technical provisions.

Figure 13. Euro Area: Materiality of EPIFP and LACDT

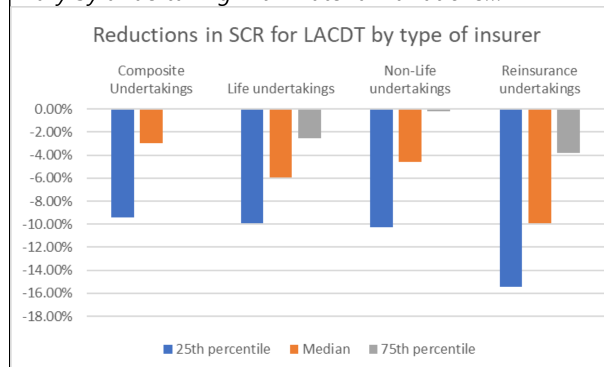
EPIFP can be material compared to own funds for some insurers….



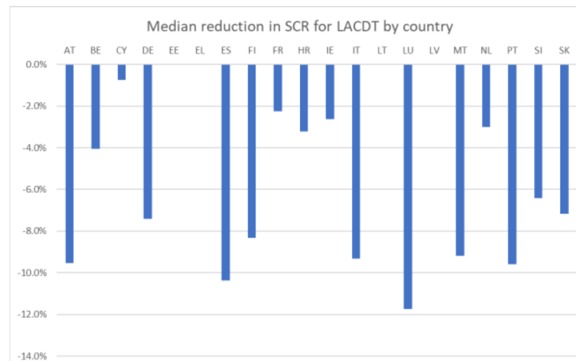
EPIFP can be more significant in some EA MS….



Reductions in SCR for LACDT vary by insurer but also vary by undertaking with material variations…



Variations among countries can be significant too.



Source: EIOPA

18. **The Loss-absorbing Capacity of Deferred Taxes (LACDT) is open to significant interpretation in the SCR calculation.** LACDT is a Solvency II adjustment that accounts for the creation of new deferred tax assets if an insurance company experiences unexpected losses as calculated by the Basic Solvency Capital Requirement (BSCR). Effectively, the SCR is reduced by the amount of new deferred taxes that could be recognized. There is uncertainty in the value of deferred taxes as it requires future profits to realize their value, although the key concept and process (including the probability of future taxable profit) is commonly used in IFRS (IAS 12) in general-purpose financial statement. New eligibility rules were introduced in 2018 limiting the circumstances in which LACDT could be recognized and specific guidance was developed by EIOPA in its supervisory handbook. The changes were aimed at ensuring insurers were not being overly optimistic in setting their assumptions when projecting future taxable profits. As can be seen in Figure 12, LACDT can lead to material reductions in SCR and varies significantly across EA countries. Higher levels of LACDT require increased scrutiny.

INSURANCE SECTOR REGULATION

A. EU Insurance Regulation Architecture

19. Over the past five years, the institutional structure for insurance regulation and supervision has evolved. Insurance supervision remains a national responsibility, but EU bodies took a greater role after the global financial crisis. EIOPA is part of the ESFS which includes three ESAs—the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA), and EIOPA—along with the ESRB. EIOPA serves as an independent advisory body to the EC, the European Parliament, and the Council. It performs specific legal, technical, and scientific tasks and provides evidence-based advice to help inform policies and laws at the EU level. EIOPA's scope includes insurers and reinsurers, financial conglomerates, institutions for occupational retirement provision, and insurance intermediaries. EIOPA has legal personality, administrative and financial autonomy, and is accountable to the European Parliament and the Council of the EU. To fulfill its mission, EIOPA works closely with the NCAs. While NCAs continue to supervise individual financial institutions within their MS, EIOPA and the other ESAs aim to enhance the functioning of the internal market.

20. Regulation of insurance at the EU level is complex and is supplemented by MS level regulation and legal frameworks. From a prudential perspective, the key piece of legislation for insurers is the Solvency II Directive (Directive 2009/138/EC) which sets out the prudential regulation and supervision requirements for insurers. The Insurance Distribution Directive (IDD) regulates the design and distribution of insurance products in the EU and there is a growing recognition of the interaction among prudential and market conduct risks. Soon to be applicable is the IRRD which will establish a framework for recovery and resolution of insurers.

21. EIOPA's mission provides a clear focus for its activities. The mission statement reads: "EIOPA seeks to protect the public interest by contributing to the short-, medium- and long-term stability, effectiveness and sustainability of the financial system for the Union's economy, citizens and businesses." EIOPA further states: "This mission is pursued by promoting a sound regulatory framework and consistent supervisory practices in order to protect the rights of policyholders, pension scheme members and beneficiaries and contribute to public confidence in the EU's insurance and occupational pensions sectors."[8] EIOPA's mandate makes no reference to matters alien to safety, soundness and financial stability, such as competitiveness, or supplemental objectives like increasing investment in the green economy. EIOPA's provides advice on regulatory initiatives and also in response to the specifications of calls for advice from the EC. EIOPA undertakes activities in five broad categories of tasks:

- Consumer Protection: EIOPA promotes transparency, simplicity and fairness in the market for consumer financial products and services across the EU.

[8] https://www.eiopa.europa.eu/about/mission-and-tasks_en.

- Regulatory Framework: EIOPA contributes to a sound regulatory framework and consistent supervisory practices to protect the rights of policyholders, and pension scheme beneficiaries.

- Financial Stability: EIOPA fosters financial stability and confidence in the insurance and pensions markets.

- Advisory Role: EIOPA acts as an independent advisory body to the EC, European Parliament and the Council of the European Union (co-legislators), providing evidence-based advice to shape informed policies and laws.

- Supervisory convergence: EIOPA promotes a common supervisory culture and consistent supervisory practices across the EU to ensure strong, effective and harmonized processes.

22. Since the last FSAP, in addition to the developments set out below, other regulations have come into force that affect insurers, including some that are applicable to a wide range of EU companies. For example, in June 2019, the Pan-European Personal Pension (PEPP) Regulation came into effect. The PEPP is a voluntary personal pension scheme which can be offered also by insurers. In addition, the General Data Protection Regulation (GPDR) (Regulation (EU) 2016/679) sets out requirements for processing and storage of personal data ensuring privacy is maintained. Soon to come into application, in January 2025, is DORA, that aims to strengthen the digital resilience of the financial sector. There is also the Artificial Intelligence Act, that focuses on safety to promote trustworthy AI adoption while aiming to protect health, safety and fundamental rights. In the realm of sustainability, there are the SFDR, and the Corporate Sustainability Reporting Directive. Beyond the EU-level regulation and legislation, the insurance sector also must comply with national requirements not yet harmonized across the EU. Differences exist in national accounting rules, taxation, and social security laws. These in part explain the diversity and differences in products offered by insurers and demanded by consumers across the EU MS.

23. Into this already complex matrix of regulatory requirements, significant and important regulatory reforms have been launched on a number of fronts. Set out below are the most material developments for insurers and groups. There is no doubt that these initiatives seek to address problems, issues, and regulatory gaps for the insurance sector. However, the cumulative impact of regulatory reform must not be underestimated.

Solvency II

24. Solvency II is a sophisticated, modern risk-based solvency regime, relying on a broadly market-consistent valuation of assets and liabilities. Solvency II is structured around three pillars:

- Quantitative Requirements: includes the valuation of assets and liabilities different from accounting standards (with some reliance on IFRS), capital requirements—the SCR and Minimum Capital Requirement (MCR), and own funds.

- Governance, including risk management and internal control systems, and the supervisory review process.

- Supervisory Reporting and Public Disclosure: reporting requirements to supervisory authorities and public disclosure.

25. The SCR is typically calculated using the standard formula, though insurers can opt for a full or partial internal model, subject to supervisory approval. The standard formula employs a modular approach, calculating a capital charge for each risk separately before aggregating these charges to determine the overall SCR. Both the individual risk charges and the aggregated SCR are calibrated to a 99.5 percent value at risk over a one-year period. This means that Solvency II does not aim for zero failure but requires insurers to hold enough capital to withstand unexpected losses that could occur once in 200 years. The SCR must be covered by eligible own funds. The SCR ratio, which is the ratio of eligible own funds to SCR, should be at least 100 percent. In addition to the SCR, insurers must also comply with the MCR. The MCR, which is not risk-based, typically ranges between 25 and 45 percent of the SCR, subject to an absolute minimum amount. If an insurer or reinsurer fails to meet the SCR, it must take measures (such as increasing capital or reducing risk) to comply again within six months. A breach of the MCR could lead to a withdrawal of authorization unless it is rectified within three months.

26. The second pillar of Solvency II prescribes sound governance, including internal control and risk management systems but is rarely used to require additional capital. Insurers are required to document their risks in the ORSA report which is also submitted to the NCAs. The ORSA report represents a key instrument for supervisors. For those insurers where the standard formula is not considered appropriate, the NCA can decide to prescribe a capital add-on (CAO), which can also be requested in case of weak governance.[9] At this stage, the use of capital add-on to address pilar II risks is very limited. As at the end of 2023, total CAOs were only 13 (9 member states) for a total of EUR 297mn, equivalent to less than one percent of the SCR. EIOPA reports[10] that of the 13 CAOs, eight were due to differences in the insurers risk profile compared with standard formula SCR underlying assumptions, one was due to deviation in the insurer's risk profile compared to internal model SCR underlying assumptions, and four were due to weak governance.

27. The third pillar prescribes reporting and disclosure requirements. These include quantitative reporting templates (QRT) and narrative reporting being submitted to the NCA, and various disclosures to the public, including the Solvency and Financial Condition Report (SFCR) which each undertaking has to publish annually. The SFCR serves two purposes: the main part is targeted towards market analysts, while the summary part is required to be drafted in a way that it could be understood by policyholders. SFCRs must be accompanied by certain QRTs.

[9] Article 37 of the Solvency II Directive.

[10] https://www.eiopa.europa.eu/assets/insurance-statistics/Statistical_update_on_the_use_of_capital_add-ons_2023.xlsx

Recommendation

- EIOPA and NCA's should develop a more systematic approach on how the CAOs can be used in a more targeted way to address vulnerabilities under Pillar 2 such as from internal control functions, risk management practices and governance processes.

B. Solvency II Review

28. In addition to the Solvency II Review, there have been other changes to the Solvency II framework since the previous EA FSAP. Directive (EU) 2019/2177 strengthened the information exchange and cooperation between supervisory authorities in relation to cross-border insurance activities, with the key new requirement that EIOPA sets up and coordinates collaboration platforms. The Commission Delegated Regulation (EU) 2018/1221 revised the standard formula capital requirements for investments in securitizations, in particular introducing specific capital requirements for simple, transparent, and standardized securitizations. The Commission Delegated Regulation (EU) 2019/981 of 8 March 2019 introduced several changes to the own funds and capital requirements, including a specific treatment for long-term equity investments. The Commission Delegated Regulation (EU) 2021/1256 introduced requirements to integrate sustainability risks in the governance of insurance and reinsurers.

29. All stakeholders interviewed during this FSAP reported that Solvency II is operating well. They point to the market shocks related to COVID-19 and how insurers were able maintain strong balance sheets through that period. It is important to point this out as no stakeholders have any issues with Solvency II in its pre-review form's fitness for purpose as a prudential framework for insurers. All stakeholders expressed the view that only incremental change was needed.

30. The EC's objective for the Solvency II Review was to give better incentives to the insurance and reinsurance sector to invest in long-term capital, while ensuring the resilience of the sectors. These incentives were to be in line with the Capital Markets Union objectives, as well as contribute to the green and digital transition, while ensuring the insurance and reinsurance sectors remained safe and sound in difficult economic times and protective of consumers' interests**.** In detail, the EC's objectives were: (1) provide incentives for insurers to contribute to the long-term sustainable financing of the economy; (2) improve risk-sensitivity; (3) mitigate excessive short-term volatility in insurers' solvency positions; (4) enhance quality, consistency and coordination of insurance supervision across the EU, and improve protection of policyholders and beneficiaries, including when their insurer fails; and (5) better address the potential build-up of systemic risk in the insurance sector.

31. The Solvency II Review begun with a Call for Advice to EIOPA from the EC in February 2019. The main agreed changes to the Solvency II Review are summarized in Annex 3. EIOPA provided its Opinion on the Solvency II Review in December 2020. EIOPA conducted two public consultations—one focused on reporting and disclosure, in July 2019, and the other on the remainder of the Opinion in October 2019. In September 2021, the European Commission tabled a proposal for a directive that would amend Solvency II. It stated that the overall aim of the

comprehensive review package was to ensure insurers and reinsurers in the EU keep investing and supporting the political priorities of the EU, in particular financing the post-Covid recovery, completing the capital markets union, and channeling funds into the European green deal. The description of the package points out that the review also fills gaps in the current rules and makes the insurance and reinsurance sector more resilient. The EC published a related impact assessment report, in which various measures were subject to an analysis comparing efficiency (or cost-effectiveness) to benefits or detriments to key measures of effectiveness on: (1) long-term and green financing; (2) risk sensitivity and volatility; (3) proportionality; (4) financial stability; (5) international competitiveness.

32. Significant changes to the Solvency II Directive have been agreed, departing from EIOPA's opinion, which may result in relaxation of prudential requirements and potential impact on financial resilience. Impact figures are not available for the final compromise reached by the Co-legislators. However, estimates were made during the negotiations of the impact of the EC's proposal and the ECON Committee of the European Parliament's Proposal. Cumulatively, the ECON changes would add over EUR 120 billion to the surplus capital over SCR for the EEA insurers compared to EIOPA's opinion based on year end 2019 figures (to maintain the same base as EIOPA's original advice). The EC's initial proposal following EIOPA's opinion would have created an addition of EUR 56 billion to the surplus (figures based on EIOPA analysis of proposals). This compares to approximately EUR 972 billion in surplus and EUR 606 billion in SCR as at the end of 2019 and represents a significant relaxation of the original proposals. The changes that have been negotiated apply to extrapolation of the risk-free yield curve, the VA, the risk margin in technical provisions, and the long-term equity capital requirements.

33. There have been no impact assessments on whether the proposed deviations to EIOPA's advice would compromise the calibration of the SCR. The calibration of 99.5 percent value at risk over a one-year period requires many choices, including calibration techniques, the data series and length of data series to use. While the specified calibration may appear quite precise, choices made in that calibration can be material to the outcome. The most material changes affected the valuation of liabilities and while not directly related to calibration of the SCR, were material enough to cause concerns that the SCR calibration was not carried out in light of the stated valuation approaches. Solvency requirements should be developed on a total-balance sheet approach recognizing the interdependence between assets, liabilities, regulatory capital requirements and capital resources.

34. Subsequent to the November mission, the directive that introduces amendments to Solvency II (the Amending Directive) was published in the Official Journal of the European Union on January 8, 2025. The Amending Directive entered into force on January 28, 2025. MS have two years to incorporate the Amending Directive into legislation.

Recommendation

- If adjustments are introduced to quantitative requirements in Solvency II, changes should be considered in line with the calibration of 99.5 percent value at risk over a one-year period.

- The EC should ensure that while there may be multiple objectives to the Solvency II review, the prudential objective should be the primary objective and other objectives should be secondary.

C. Insurance Recovery and Resolution Directive (IRRD)

35. At the time of the mission, the recovery and resolution framework for insurance companies was regulated only by national laws, but subsequently this has been replaced by the IRRD (see below). This has led to considerable variations in both substantive and procedural laws among EU MS. This is a significant concern because failures and near failures (termed 'near misses' by EIOPA) are not rare. As of August 2024, EIOPA's database of failures and near misses[11] contains a total of 261 cases, which include failures, near misses, and ongoing cases where it remains uncertain whether they will ultimately result in a failure or a near miss. In the past decade, specifically from 2013 to 2023, 146 cases have been reported, of which 47 were failures, 78 were near misses, and 21 are still ongoing. Like all regulatory regimes, Solvency II is not designed as a zero-failure regime. The disorderly failure of an insurer or a group of insurers can present risks to financial stability and affect policyholders. Insurance companies play a crucial role in delivering essential services to many sectors, including households (policyholders), non-financial corporations and other parts of the financial sector.

36. Elements of international requirements on resolution are often absent in various MS. EIOPA's analysis revealed several gaps across different EU MS. The Financial Stability Board's (FSB's) Key Attributes and the IAIS' ICP 12 (Exit from the Market and Resolution) outline essential core elements, including legal powers, funding arrangements, resolution tools, and requirements for planning and cross-border cooperation, all aimed at enabling the effective resolution of any financial institution that could be deemed systemically important.

37. The European Parliament adopted the IRRD in April 2024 and a corrigendum in October 2024. In November 2024, the European Council also approved it. The IRRD was published in the Official Journal of the European Union on January 8, 2025, and entered into force on January 28, 2025. Following this, MS will have a two-year period to incorporate the Directive into their national legislation. The IRRD is a minimum harmonization directive, allowing MS certain flexibility in its transposition. It's important to note that prior to the introduction of the IRRD, three MS—France, Romania, and the Netherlands—had established dedicated legislative frameworks for the recovery and resolution of insurers. Additionally, some MS possess specific powers in their national laws that are aligned with provisions in the IRRD. Key features of the IRRD are summarized in Annex 4.

38. Minimum harmonization of IGS was not included in the IRRD. A comprehensive proposal for a minimum harmonization framework for IGS was made in the context of EIOPA´s Opinion on the 2020 Solvency II Review. This was finally not proposed together with the IRRD. The IRRD acknowledges the role of IGS, for example:

[11] For further detail consult Chapter 3 of the 2018 report Failures and near misses in insurance – Overview of causes and early identification.

- allows for the use of IGS as a contributor to resolution schemes;[12]
- availability of IGS for funding can be taken into account for resolution planning;
- Member states may provide that an appropriate insurance guarantee scheme is assigned with the duties and rights of a bridge undertaking provided that certain conditions are met; and
- the potential use of an IGS can be taken into account when the authorities decide whether to bring a failing undertaking into resolution or wind it up under a national insolvency proceedings.

39. In 2021, the EC acknowledged that establishing a minimum common framework for IGS would significantly enhance the protection of policyholders throughout the EU and foster greater trust in the single market. However, given the estimated implementation costs and the economic uncertainty stemming from the COVID-19 pandemic, the European Commission deemed it inappropriate to proceed with IGS harmonization at that time but indicated that it would revisit the appropriateness and timing of harmonization in the future. The IRRD includes a requirement for the EC to submit a report within 24 months of its entry into force, after consulting with EIOPA, to assess the suitability of IGS harmonization. The lack of IGS in several MS, and where they exist, the fragmentation in the design of IGS, pose challenges in cases of failures involving cross-border operations. Some policyholders might find themselves unprotected if there is no IGS in place, or they may experience varying levels of protection depending on coverage of different IGS:

- Under the host-country principle, an IGS covers all domestic policies issued by local insurers, as well as policies sold by foreign insurers into the country through freedom of services (FoS) or freedom of establishment (FoE) (inward). However, it does not extend coverage to policies sold abroad via FoS or FoE (outward). This results in an undesirable situation where policyholders insured by the same failed insurer may be treated differently solely based on their residence, even if they possess identical policies from the same insurer.
- In contrast, when an IGS operates under the home-country principle, it covers policies issued by domestic insurers both within the country and abroad via FoS or FoE (outward). However, this principle does not provide coverage for policies sold by foreign insurers into the country through FoS or FoE (inward). Consequently, policyholders within the same MS may be supported by different national IGSs and receive varying levels of protection.

According to information gathered by EIOPA, nine IGSs follow the host-country principle, seven adhere to the home-country principle, and eight employ a combined approach.

40. The IRRD requires EIOPA to develop 19 instruments, which include 12 technical standards, 6 guidelines, and a framework for cooperation agreements. For illustrative purposes, these instruments can be categorized into five main groups: 1) Recovery planning, 2) Operational

[12] Resolution schemes are tools and processes to manage the failure of an insurer in an orderly manner in the public interest and to ensure continuity of essential services.

issues, 3) Valuation, 4) Resolution plans and resolvability, and 5) Legal issues. The technical materials will be produced with varying deadlines of 18, 24, and 30 months following the IRRD's entry into force. EIOPA has established the necessary dedicated project group to ensure timely delivery of these instruments, organizing them into three batches. The batches are not fully aligned with the delivery deadlines, as some instruments have important linkages to other instruments. Currently, the first batch of technical materials is being developed by EIOPA. It is notable that the majority of the instruments that EIOPA has to produce will only be available either just before the IRRD's application date or approximately 6 months after. This process, which is somewhat dependent on resources available to EIOPA, means there will be some uncertainty as to the detailed requirements that need to be implemented by MS, which may compromise the timeliness of practical implementation of the IRRD. However, there has been prioritization of Level 2 and Level 3 measures to enable preparation of pre-emptive recovery and resolution plans.

Recommendation

- A minimum harmonization framework for IGS should be implemented across MS to protect EU policyholders, particularly those who buy insurance products on a cross-border basis and foster greater trust in the single market.

D. Proposal for EU Retail Investment Strategy (RIS)

41. The RIS has been developed by the EC based on EIOPA's and ESMA's advice, which was developed with the NCA members of both organizations. EIOPA also issued its advice to the EC for public consultation. The EC also carried out its own studies and assessment including a market wide mystery shopping exercise. The objectives of the RIS are to strengthen the legislative framework to enable retail investors to make more informed decisions and provide adequate protection to retail investors as well as enhance trust and increase retail investor participation. Proposals to enhance retail investor protection include to:

- Improve disclosures and protect from misleading marketing communications;
- Introduce clear pricing process into product oversight governance by enhancing the existing value for money assessment including through mandatory EU benchmarks;
- Address conflicts of interest in distribution process and introduce a partial ban on inducements for execution-only trades;
- Encourage wider range of cost-effective products to be sold including a 'best interest test' for payment/receipt of inducements;
- Uphold high standards of professional qualification for financial advisors;
- Member states to implement measures to support financial literacy; and
- Enhance supervisory cooperation to ensure rules are applied in a coherent manner across EU.

42. The legislative process has moved swiftly since the Commission's legislative proposal was published in May 2023. The proposal is currently at the stage where the European Parliament agreed on its negotiating mandate on the regulation amending PRIIPs on 11 April 2024 and on the Omnibus directive on 23 April 2024, and the Council of the European Union agreed its negotiating mandate on 12 June 2024. The co-legislators have so far proposed to remove the partial inducement ban, instead focusing more on transparency of conflicts of interest,[13] and have also proposed to downgrade the mandatory EU-wide value for money benchmarks proposed by the Commission to a supervisory tool. In addition, the possibility for national benchmarks for insurance-based investment products, in limited cases, have also been proposed. A concurrent peer group product assessment was introduced by both the European Parliament and Council which, under the Council's negotiating mandate, would need to be supported by a non-public EIOPA/ESMA database.[14]

43. In their joint letter, EIOPA and ESMA[15] have expressed their concerns that the "establishment of such a database as a tool only for a certain group of market participants would not constitute an efficient use of ESMA's and EIOPA's resources". EIOPA additionally indicated during the mission their concerns about the adequacy of resources foreseen in relation to the creation of the database, which will be costly for the two ESAs. It is important that the final list of deliverables expected of the ESAs is matched by adequate human and budgetary resources. Depending on the outcome of the negotiations, EIOPA may also have to develop an online comparison tool for PRIIPs as well as conducting ongoing consumer testing of the PRIIPs KID — both resource-intensive activities. EIOPA and ESMA also underline in their letter, "the importance of ensuring an adequate and efficient supervisory framework allowing for timely and effective supervision of cross-border business" and that they are "concerned about potential additional hurdles introduced in the Council's position, whereby the request by at least two member states would be needed to establish supervisory collaboration platforms". Such hurdles would limit the effectiveness of the consumer protection measures with respect to cross-border business.

44. Implementation of RIS will result in a significant amount of work for EIOPA and ESMA for which sufficient resources need to be available. In addition to the database and online comparison tool which have been introduced as a result of changes proposed by the European Parliament and Council, the Commission has proposed that EIOPA and ESMA develop a number of different pieces of implementing legislation such as RTSs, implementing technical standards, value for money benchmarks and guidelines. In addition, EIOPA and ESMA will need to supervise and promote convergence on the new requirements. There will need to be consultation processes for these developments as well as consumer testing. There is also the potential risk that the final

[13] "Retail investment package: Council agrees on its position": https://www.consilium.europa.eu/en/press/press-releases/2024/06/12/retail-investment-package-council-agrees-on-its-position/

[14] See Council press release: https://www.consilium.europa.eu/en/press/press-releases/2024/06/12/retail-investment-package-council-agrees-on-its-position/

[15] https://www.eiopa.europa.eu/document/download/3407888a-1a58-40df-929e-1de57fcac8dd_en?filename=ESMA24-450544452-2484 percent20ESMA- percent20EIOPA percent20letter percent20on percent20RIS.pdf

outcome of the legislative process might not necessarily lead to significant strengthening of existing or newly proposed provisions, in all the areas that were originally proposed.

E. Digital Operational Resilience Act

45. DORA came into effect in January 2023 and will apply from January 2025. It aims to harmonize the operational resilience regulations across the financial sector, covering 21 distinct types of financial entities. Three of these entities fall under EIOPA's jurisdiction: (i) insurance and reinsurance undertakings that are part of the Solvency II framework; (ii) institutions for occupational retirement provisions with more than 15 members; and (iii) insurance and reinsurance intermediaries, including ancillary insurance intermediaries that exceed the size of small and medium enterprises. RTSs for DORA have been developed by the ESAs and submitted to the European Commission according to the legislative deadlines in January and July 2024. At the date of the mission, six out of ten technical standards had been adopted by the European Commission with three of those published in the Official Journal of the European Union. DORA harmonizes the rules concerning ICT risk management and resilience for 21 different types of financial entities. DORA introduces six main elements of ICT risk supervision among EU financial entities: (i) harmonized cross-sectoral requirements; (ii) a level playing field among all competent authorities with respect to measures to supervise ICT risk supervisory powers; (iii) a definition of the concept of ICT third party service provider in a much broader sense than ICT outsourcing; (iv) an oversight framework for the critical ICT third-party service providers at EU level; (v) mandatory threat led penetration testing at EU level; and (vi) legal precedence for DORA for financial entities (so called *lex specialis*) over the generally applicable requirements of the Network for Information Systems Directive and Critical Entities Resilience Directive. It creates a digital operational resilience rulebook covering:

- *ICT Risk Management:* Financial entities must implement strong governance and controls for managing ICT risks. This includes policies, monitoring, and regular assessments of their systems.

- *Incident Reporting:* Financial entities must report major ICT incidents to national authorities within tight timeframes including the nature, cause, and impact of the disruption.

- *Operational Resilience Testing*: Entities must perform regular testing of their ICT systems, especially for critical functions, to ensure they can withstand and recover from cyber incidents or operational disruptions.

- *Third-Party Risk Management*: Financial entities must ensure that ICT third-party service providers (especially cloud and IT services) comply with stringent ICT security and resilience standards. Contracts with these providers should reflect the institution's regulatory obligations.

- *Oversight of CTTPs*: DORA designates "critical ICT third-party service providers" (CTTPs, e.g., major cloud services) to be overseen by the ESAs.

- *Information Sharing:* DORA encourages financial entities to collaborate and share information on cyber incidents and threats.

46. EIOPA, in collaboration with other ESAs, will commence oversight of the CTPPs to foster convergence and enhance the digital operational resilience of financial entities that depend on CTPPs for their operational functions. This initiative aims to contribute to the stability of Europe's financial system. The three ESAs have created a joint Directorate in charge of oversight activities for CTTPs established by DORA. Such a joint directorate is a European first. There is a Director who oversees these oversight activities across the three ESAs.[16] Once it is up and running, there will be a coordinated oversight process involving the three ESAs, 60 NCAs across the three sectors, and the ECB. The oversight activities will start from January 17, 2025.

47. A critical issue not yet fully worked out is, practically, how oversight activities, including on-site inspections, can be undertaken at CTPPs in third countries. This is particularly relevant to cloud service providers. There is a requirement in DORA that CTPPs will need to have a European subsidiary established within 1 year of designation as a CTPP. However, there will also likely need to be coordination with third country authorities which will undoubtedly be a complex matter. The ESAs have already started the process of engaging with (prioritized) third country authorities.

48. Additionally, EIOPA will assist in implementing the EU-SCICF.[17] This was an outcome from a recommendation by the ESRB in December 2021. This framework is designed to facilitate an effective and coordinated response at the EU level in the event of a significant cross-border cyber incident that could impact the stability of the Union's financial sector. Article 49 of DORA has enabled creation cross-sectoral ICT incident reporting. It is important to note that this is a coordination body not a decision-making body. The EU-SCIF will be set up on a step-by-step basis starting on 17 January 2025, but the full set-up of EU-SCICF is subject to the outcome of a Report to be drafted by the EC, so the details of full implementation were not known at the date of the mission. The EU-SCICF will involve national authorities, European-level authorities including the three ESAs, macroprudential and resolution authorities. Participating members will be notified and will exchange information regarding potential systemic cyber incidents or threats. When a systemic risk arises, the EU-SCICF will function as a forum for relevant authorities to communicate and coordinate necessary actions, as well as to utilize tools aimed at mitigating the crisis from a macroprudential standpoint.

49. In 2022, the ESAs in collaboration with the relevant competent authorities, conducted a joint high-level analysis aimed at gaining a preliminary understanding of how ICT services are provided to EU financial entities by ICT third-party service providers (TPPs). The high-level findings from this analysis offer an initial overview of ICT TPPs within the financial sector, detailing the services they provide to the sampled financial entities. The ESAs identified approximately 15,000 ICT TPPs directly serving entities in the financial sector across the EU. Furthermore, the results indicate that frequently utilized ICT TPPs play a crucial role in supporting many critical or important

[16] https://www.eiopa.europa.eu/esas-appoint-director-lead-their-dora-joint-oversight-2024-10-01_en.

[17] https://www.eiopa.europa.eu/document/download/40bae754-ea17-47d4-9227-74d2365a81b6_en?filename=ESAs percent20Factsheet percent20on percent20the percent20EU percent20SCICF.pdf.

functions and offer a wide array of services. Furthermore, in instances where financial entities rely on services for critical or important functions, or where service continuity is essential, most of these services are found to be non-substitutable. This work is informing the implementation of DORA.

F. Overall Impact of Reforms

50. The legislative reform process detailed in sections B to E above, constitutes an extraordinary level of change across many facets of insurers' business models as well as a significant workload for EIOPA and NCAs to implement the reforms. All of these legislative reforms will need time to be fully bedded down into insurer operations. EIOPA has a very high workload of producing instruments and guidelines to enable technical implementation of the new requirements. This is already diverting scarce resources from other relevant work. EIOPA and the NCAs will later have additional significant work to incorporate the new requirements into supervisory processes to ensure the objectives of the reforms are met. Finally, discussions around further measures to improve the effectiveness of EU capital markets provide indications of possible further legislative reforms. The specter of further incremental reforms will add to the regulatory fatigue experienced by the insurance sector in the EU, EIOPA and the NCAs. The swift pace of the RIS legislative process could be slowed down in order to incorporate any further reforms that are needed and allow more time for all stakeholders to prepare for the reforms.

Recommendation

- The EC and European Legislators should include in the RIS implementation any additional reforms pertaining to the design and distribution of insurance products envisaged to enhance EU savings and investments.
- There should be a temporary pause in further regulatory reforms for the insurance sector once Solvency II review, IRRD, minimum harmonization of IGS and RIS implementation are complete, and a high bar should be set in determining the need for any further reforms.

INSURANCE MICROPRUDENTIAL SUPERVISION

A. Role of EIOPA and NCAs

51. Insurance supervision remains fundamentally a national responsibility, through NCAs. The EIOPA is part of the ESFS, which includes three ESAs: the EBA, ESMA, along with the European Systemic Risk Board (ESRB). EIOPA collaborates closely with NCAs as, in line with Article 6 of EIOPA's Regulation, the Board of Supervisors, which is formed by 27 NCAs, is the main decision body. While NCAs continue to supervise individual financial institutions in their MS, EIOPA and the other ESAs aim to enhance the functioning of the single market.

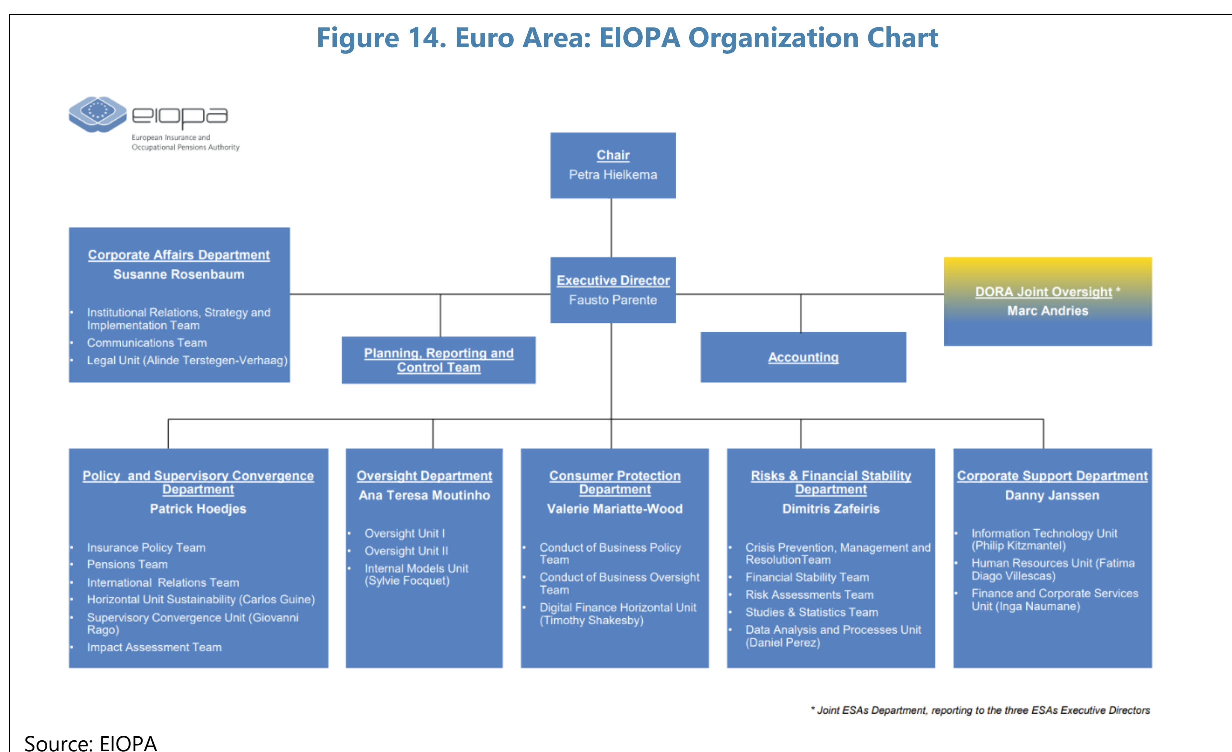
52. EIOPA serves as an independent advisory body to the EC, the European Parliament, and the Council. It performs specific legal, technical, and scientific tasks and provides evidence-

based advice to help shape informed policies and laws at the EU level. EIOPA's scope includes insurance undertakings, reinsurers, financial conglomerates, institutions for occupational retirement provision, and insurance intermediaries. EIOPA has legal personality, administrative and financial autonomy, and is accountable to the European Parliament and the Council of the EU. To fulfill its mission, EIOPA collaborates closely with NCAs.

B. EIOPA Supervisory Resources and Capacity

53. EIOPA has 4 functional departments along with support departments. See Figure 14, all functional department names are largely descriptive of their roles. There is the Policy and Supervisory Convergence Department, the Oversight Department, the Consumer Protection Department and the Risks and Financial Stability Department.

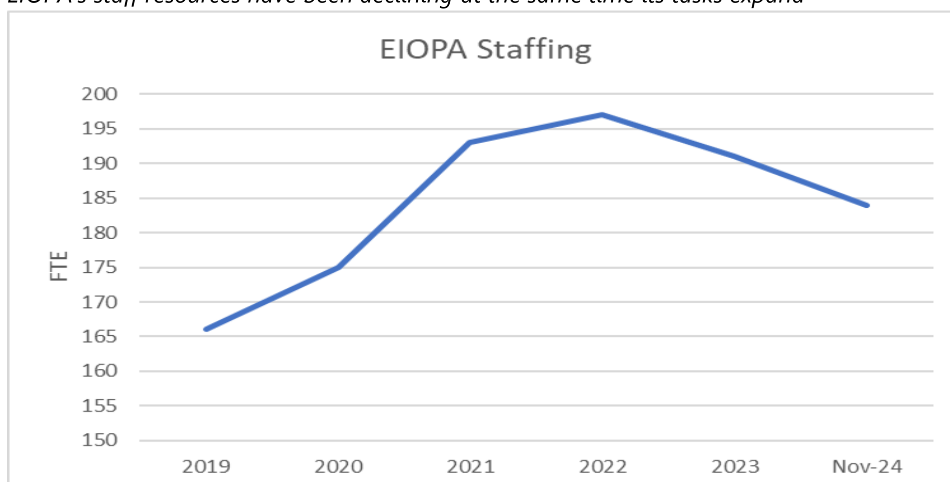
Figure 14. Euro Area: EIOPA Organization Chart



Source: EIOPA

Figure 15. Euro Area: EIOPA Staffing

EIOPA's staff resources have been declining at the same time its tasks expand



Source: EIOPA and IMF Staff Calculations

54. Since 2019, EIOPA's resources have gradually increased, but not sufficiently to meet the growing demands of its expanding regulatory responsibilities (Figure 15). The ESAs have a specific funding model where NCAs contribute 60 percent and the EU 40 percent to the ESAs' budget. Accordingly, EIOPA's funding requires substantial contributions from the NCAs, putting pressure on them, especially when new mandates or tasks arise, necessitating additional resources, budget, and staff. This situation has become increasingly challenging in recent years for all parties, particularly for smaller NCAs and for EIOPA. EIOPA's annual budget has increased by about 2 percent annually, and staffing has grown moderately. Key areas such as the Solvency II review, IRRD, DORA development and implementation, and the proposal for the EU RIS will add material additional workloads. These require a significant focus on digital resilience, consumer protection, and crisis management, stretching existing resources and necessitating strategic reallocations.

55. The 2019 review of the ESAs added more staff positions, but this expansion has not kept pace with the surge in new regulatory initiatives. As part of the Solvency II review, EIOPA will draft and review RTS and guidelines as needed, and monitor their implementation. This also includes new permanent tasks related to the Solvency Capital Requirement, collaboration with NCAs, proportionality, and macroprudential tools. EIOPA is preparing for the implementation of the IRRD, which will introduce new responsibilities, including developing technical standards and guidelines, establishing a resolution committee, and participating in resolution colleges. Depending on the final legislative texts, EIOPA will work on the Retail Investment Strategy, which may include providing technical advice, developing technical standards and guidelines, and creating tools such as databases and online comparison tools related to the PRIIPs Regulation and the IDD. This might also involve assessing EIOPA's ongoing Value for Money work to draw lessons and inform any new mandates under the RIS. Regulatory initiatives on the SFDR, the Corporate Sustainability Reporting Directive, and the Corporate Sustainability Due Diligence Directive, will begin to take effect. The

integration of other sustainability risks, including biodiversity and social risks and opportunities, will also become more prominent.

56. EIOPA will contribute to the implementation of the European Single Access Point (ESAP), which aims to provide a centralized access point to information about financial services, capital markets, and sustainability that entities and competent authorities must make public. In this context, both EIOPA and NCAs will act as data collectors for the insurance and pension sectors. EIOPA will also contribute to the implementation of the Supervisory Data Strategy, which aims to ensure accurate, consistent, and timely data collection by supervisory authorities while reducing the reporting burden on financial institutions. Furthermore, EIOPA will support discussions on the proposed Regulation on Financial Data Access (FIDA), particularly from a consumer protection standpoint, and under any mandates that might be agreed upon under that Regulation.

57. To address supervision of CTPPs under DORA, the three ESAs will each receive 10 full time equivalent positions. However, even though DORA will be applicable from 17 January 2025, the collection of fees and recruitment for relevant positions is scheduled to begin only in October 2025. Consequently, the preparatory work for this significant regulation has been carried out primarily using existing resources. Additionally, EIOPA will support the implementation of the European Systemic Risk Board (ESRB) Recommendation of December 2021, which calls for the establishment of the EU-SCICF to ensure an effective and coordinated response at the EU level in the event of a major cross-border cyber incident with potential systemic impact on the Union's financial sector. Additionally, EIOPA, together with the other ESAs, will follow up on the Artificial Intelligence (AI) Act, which aims to address risks associated with specific uses of AI and promote trust and excellence in AI within the sector.

58. In addition to the heavy regulatory agenda significantly increasing EIOPA's workload, EIOPA's supervisory convergence activities have also intensified due to a rise in cross-border cases (as set out in the section below on cross-border business). This has stretched EIOPA's resources, necessitating careful prioritization to effectively manage both new regulatory demands and growing supervisory convergence responsibilities. Over the last 5 years, EIOPA has deprioritized activities related to less critical supervisory convergence due to conflicting priorities. Additionally, non-core supervisory convergence activities were scaled down to accommodate the heavier workload from new regulations.

59. EIOPA has been assigned new mandates and tasks for market conduct supervision, but these have not been matched by adequate resources. New mandates include those related to sustainability and conduct, such as greenwashing and the SFDR. The recent RIS proposal may build on this resourcing issue as it includes several tasks for EIOPA to be better identified at the end of the legislative process. Based on the he EC Legislative Financial Statement (LFS) on RIS EIOPA is concerned that allocated resourcing would not meet the demands placed on it. It is acknowledged that the details of the changes are not yet finalized, however EIOPA's concerns about the proposed new mandates versus proposed resources indicates that there is a risk of accentuating the trend of further straining EIOPA's depleted resources.

60. However, EIOPA is also not deploying the full extent of the resources allocated to it. It has an establishment of 220 FTEs, but it currently employs only 184 FTEs. Since 2022, EIOPA's employed FTEs have been declining (see Figure 14). One significant reason for this is that EIOPA relies on Seconded National Experts (SNEs) for some staffing and EIOPA has not been able to fill these positions due to resources pressures at NCAs, with 29 SNEs in EIOPA's establishment but only 13 of those positions are filled. EIOPA is operating in a competitive environment for staff and skills and that has posed challenges for EIOPA. EIOPA must attract and retain talent with specialized expertise in areas such as digitalization, sustainability, and financial supervision. The demand for skills in emerging fields like cybersecurity and operational resilience, driven by regulations like DORA, has heightened competition with private sector firms and other regulatory bodies. Limited financial resources further compound this challenge, as EIOPA must offer competitive packages and career development opportunities to remain an attractive employer in the talent market.

61. This competitive environment also pressures EIOPA to continuously develop its staff's expertise through training and internal programs, ensuring that key projects and regulations are not delayed due to talent shortages. Balancing long-term skill-building with immediate regulatory needs remains an ongoing priority.

Recommendations

- EIOPA should increase its efforts to recruit a full complement of staff to work on its heavy regulatory and supervisory agenda and NCA's should ensure national seconded expert positions at EIOPA are filled.
- EIOPA's budget and staff establishment plan should be reviewed in light of the significant permanent tasks it has been given through legislative reform. In view of the increasing budgetary challenges for both the Authority and the NCAs, other funding mechanisms should be explored.

C. Supervisory Convergence

62. The 2018 FSAP recommended EIOPA intensify work on supervisory convergence and EIOPA has undertaken a significant number of activities with respect to their tools for convergence. EIOPA's tools amongst others include guidelines, recommendations, opinions, supervisory statements, EIOPA's supervisory handbook, Q&As and peer reviews.

63. Guidelines, also known as level 3 measures, are issued under Article 16 of the EIOPA Regulation to NCAs or financial institutions to establish consistent, efficient, and effective supervisory practices. These guidelines are considered 'soft law' measures, meaning they are not legally binding, but competent authorities and financial market participants are required to "make every effort" to comply with them. Specifically, for Solvency II, there are more than 30 sets of guidelines, leading to over 700 individual guidelines across all three pillars of Solvency II. Currently, some of these are being reviewed or will be reviewed according to a prioritization plan to align their content with the Solvency II review. EIOPA is also fine-tuning the process for issuing guidelines,

assessing the comply-or-explain declarations by NCAs, and monitoring their effective implementation over time.

64. Opinions are public documents addressed to NCAs issued by EIOPA, under Article29(1)(a) of EIOPA Regulation, when there is a lack of convergence in supervisory practices due to different interpretations of the regulatory framework. These opinions are drafted by a dedicated Project Group, consisting of NCA experts and EIOPA staff, and are steered by the Supervisory Steering Committee (SSC). EIOPA has published 16 Opinions since 2015 covering Solvency II (9 Opinions), IORPs (6 Opinions) and SFDR / IDD (1 Opinion). Examples of opinions published under Article 29 in recent years, following a consultation phase, include the Consultation on mass-lapse reinsurance (Annex to the Opinion on reinsurance) on 8 November 2024, the Opinion on supervision of captives undertakings in July 2024, the Opinion on sustainability claims and greenwashing in the insurance and pensions sectors in May 2024, the Opinion on the use of risk mitigation techniques by insurance undertakings in July 2021, the Opinion on the supervision of the use of climate change risk scenarios in ORSA in April 2021 (with ongoing monitoring), the Opinion on the supervision of remuneration principles in the insurance and reinsurance sector in April 2020, the Opinion on implementation of the common framework for risk assessment and transparency of institutions for occupational retirement provisions in July 2019, and the Opinion on non-life cross-border business of long-term nature in December 2018.

65. Supervisory Statements are public documents addressed to NCAs issued by EIOPA, under Article29(1)(a) of EIOPA Regulation, when divergences in supervisory practices are primarily driven by different supervisory approaches. These statements are drafted by a dedicated Project Group, which includes NCA experts and EIOPA staff, and are steered by the Supervisory Steering Committee (SSC). EIOPA has published 15 Supervisory statements since 2017 covering Solvency II (10 supervisory statements), IDD (3), IORPS (1) and SFDR (1). Examples of Supervisory Statements published in recent years include the Supervisory Statement on the deduction on foreseeable dividends from own funds (February 2025), the Supervisory Statement on supervision of reinsurance concluded with third-country reinsurers in April 2024, the Supervisory Statement on differential pricing practices in non-life insurance lines of business in March 2023, and the Supervisory Statement on the supervision of run-off undertakings in April 2020. Currently EIOPA is gathering information from NCAs on recent authorizations and rejections regarding the acquisition of control in insurers by private equity firms. The aim is to publish a draft supervisory statement that provides guidance to NCAs for addressing risks associated with this particular business model, such as the short-termism of the shareholders (which conflicts with the typical long-term nature of insurance business), shifts towards riskier assets, excessive leverage, and regulatory arbitrage.

66. An explicit task of creating a Supervisory Handbook was assigned to EIOPA in 2020 as part of the ESAs review, although EIOPA had already begun working on it in 2014. There are three handbooks available for NCAs only, covering prudential supervision under Solvency II, conduct of business supervision, and supervision of institutions for occupational retirement provisions. In December 2020, EIOPA released the Supervisory Handbook Tool (a digital handbook), providing

individual access to supervisors from NCAs, with the objective to modernize the supervisory process, facilitate and expand the user base among NCAs and EIOPA, and promote the exchange of views.

67. EIOPA performed 12 peer reviews since 2013 and developed a new framework in 2022. Since 2013, EIOPA has conducted 12 peer reviews[18] covering mainly insurance topics, with 1 peer review on pension supervision. With the new governance framework for the peer reviews, which tasked EIOPA staff to lead peer reviews, EIOPA has completed three peer reviews: one on outsourcing in 2022, one on Product Oversight Governance in 2023, and one on the Prudent Person Principle (PPP) in 2024. Furthermore, EIOPA recently finalized a peer review of the supervision of the stochastic approach in the calculation of technical provisions (March2025). Additionally, in line with the peer review methodology, EIOPA has conducted follow-up reviews with respect to: the peer review on key functions (2021), the propriety of Administrative, Management, or Supervisory Body, and qualifying shareholders in 2022, the application of the PPR[19] for IORPs in 2023 and one on EIOPA decision on collaboration of NCAs in 2024. More recently EIOPA has implemented some targeted improvements in the peer review process to reduce the scope of the assessment (including the participating NCAs) and to follow a more risk-based approach in recommending areas of improvements to NCAs. The follow-up phase typically reveals that not all recommended actions are implemented by NCAs, increasing the need for further monitoring.

Cross-border Business

68. The provision of cross-border insurance services has approximately doubled since the introduction of Solvency II in 2016. The growth has been based on both the basis of Freedom of Service (FoS) and Freedom of Establishment (FoE) (branches). Sales of insurance through FoS is expected to grow due to digitalization. This means that collaboration between NCAs that are home supervisors (where the insurer is based) and NCAs that are host supervisors (where policyholders and risks insured are located) will become more important. EIOPA has improved the exchange of information between supervisory authorities by building a Cross Border Notification tool that was put in place in February 2023. The Cross Border Notification tool is used by all NCAs to perform notifications related to cross-border business, replacing previous e-mail communication.

69. In order to enhance supervisory collaboration, collaboration platforms were developed in 2017 as an oversight tool to achieve stronger and timely cooperation between home NCA and host NCAs. The role of collaboration platforms was enshrined in the Solvency II Directive in 2019. There are different type of collaboration platform giving different roles to EIOPA. Where there are concerns about an insurer operating on a cross-border basis, EIOPA will be the coordinator (a so-called Type 1 platform). In other instances where greater collaboration is needed but without concerns, NCAs can create a collaboration platform (Type 2) without EIOPA's direct involvement. Since 2017, 21 Type 1 collaboration platforms and five Type 2 collaboration platforms have been created. Type 1 collaboration platforms deal with both prudential issues and market conduct issues.

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[18] Covering Solvency II aspects related to pillar I (Pre-application of internal models, technical provisions), many pillar II issues etc.

[19] Prudent Person Rules

EIOPA and can request the establishment of collaboration platforms and participate in the activities of the collaboration platforms, including on-site inspections, carried out jointly by two or more NCAs. EIOPA also can request information to allow for the proper functioning of the collaboration platform, while supervision and enforcement decisions remain within the competence of NCAs.

70. Currently, EIOPA lacks powers to deal with a home supervisor which is unwilling or unable to take necessary supervisory actions. This can lead to consumer detriment and may undermine trust in the Single Market. Many of EIOPA's tools have limitations in different situations. Furthermore, EIOPA and the NCAs can and are facing legal actions for attempting to address issues with insurers taking on cross-border business. In addition, EIOPA, NCAs and the EC have received similar Access to Documents requests, which have led in some instances to further legal challenges. In one case, both EIOPA and the EC are reaching the end of their legal powers. This started with a formal recommendation to the NCA, under Article 16 of the EIOPA Regulation, leading to a notice of non-compliance. EIOPA then investigated a potential breach of Union Law by the NCA in relation to obligations under Solvency II and issued a recommendation under Article 17(3) of the EIOPA Regulation. This was followed by the EC issuing a formal opinion under Article 17(4) of the EIOPA Regulation. The NCA withdrew the authorization of the company on June 5, 2023, and therefore lost powers under local law in relation to the company, and at the time of the mission no liquidator had yet been appointed under local law. The EC initiated an infringement procedure, and the MS concerned responded to that infringement procedure. This procedure is still ongoing. Despite all this EU level regulatory action, while the company cannot sell new business it continues to accept premiums from existing policyholders based inside and outside the home MS.

71. The Solvency II review will introduce new rules and roles for EIOPA to enhance supervisory cooperation and information exchange between home and host supervisors for significant-cross-border activities. The definition of significant-cross-border activities is linked to the activities carried out under FoS and FoE in the host MS and is based on either the total cross-border gross written premium in the host MS exceeding EUR 15 million, or cross-border activities which are considered by the host supervisor as being of relevance with respect to the host MS's market which is to be further defined by EIOPA in an RTS. From 2027, EIOPA will have a formal mediation role where NCAs in a collaboration platform disagree about the actions to be taken or if an NCA does not carry out agreed actions in a situation where there are serious concerns about negative effects on policyholders. Where NCAs in a collaboration platform face a disagreement about information sharing, EIOPA will be able to publish information on findings, recommendations or measures stemming from supervisory work for the purposes of policyholder protection or financial stability including potentially the undertaking's name unless there are good reasons not to do so. These new powers are welcome but in highly challenging cases, it remains to be seen if these powers would be sufficient. Colleges of supervisors are also an important tool for the supervision of cross-border business (when performed through international groups instead of through FoE and FoS). Also, in colleges of supervisors steps can be taken to improve EIOPA's ability to contribute to good group supervision, in particular the regular exchange with EIOPA of the ORSA Report. In the longer-term consideration could be given to endowing EIOPA with emergency powers to take binding decisions when home NCAs are unwilling or unable to act and policyholder protection is at

risk. However, this may require more fundamental reform of the relationship between EU authorities and MS.[20]

Recommendations

- NCAs are recommended to agree to exchange the ORSA Report with EIOPA on a regular basis (see also section on Internal models and Sustainability)
- Consider endowing EIOPA with emergency powers to take binding decisions when home NCAs are unwilling or unable to act and policyholder protection is at risk in the context of cross border activities, noting this. may require more fundamental reform of the relationship between EU authorities and MS.

Internal Models

72. **The 2018 EA FSAP TN contained a recommendation that European legislators endow EIOPA with the necessary powers and resources to promote further convergence in supervisory practices.** As at year end 2023, there were four insurance groups and 82 solo insurance undertakings using approved full internal models. In addition, there were 27 insurance groups and 66 solo insurers using a partial internal model.[21] Insurers representing more than 50 percent of the European insurance market in terms of gross written premiums use an internal model. The 2018 EA FSAP TN made a recommendation for greater convergence of the supervision of internal models, particularly focusing on the use of the dynamic VA. In November 2017, EIOPA issued an opinion on the supervisory assessment of internal models including a dynamic VA, and in that promised to undertake further monitoring in cooperation with NCAs. An update to this opinion is a work in progress at the time of the mission.

73. **The Solvency II Review includes an amendment to require internal model users to submit their SCR calculated on the basis of the standard formula every two years.** This is for the purpose of comparisons with the SCR based on the internal model, and for comparisons among internal model users. It will also enable supervisors to make comparisons over time for individual undertakings, and be useful to monitor model drift over time.[22] In addition, in the last revision of the ITS (applicable for end 2023) new QRTs have been introduced to capture data by risk module to further enable better monitoring of internal models.

74. **Internal models generally produce SCRs which are lower than SCRs produced from the standard formula.** EIOPA and NCAs have been comparing the results of internal model calculated SCRs and standard formula SCRs for a stable sample of insurance groups that have been using

[20] Co-legislators would need to deem it necessary to exercise such powers directly at the supranational level (subsidiarity) even for non-systemic insurance undertakings.

[21] Partial internal models cover one or more risk modules, or submodules, of the basic solvency capital requirement or one or more entities part of the group but not the group as whole.

[22] Model drift is where an internal model gradually diverges from the actual risk profile of the firm over time due to e.g., changes in the underlying risk environment, updates to the model, or shifts in the firm's business activities.

approved internal models since 2018, even before the amendment mentioned above was made. EIOPA published the Non-Life Underwriting Risk Comparative Study in Internal Models (Non-Life Study") in January 2024.[23] EIOPA plans to conclude as similar analysis for life insurers during 2025. The benefits of using an internal model, in terms of lowering SCR, vary by business model. It is noted that lowering the SCR is not the sole reason for using an internal model, there are significant benefits in risk management, capital management and dialogue with the supervisor about those topics. In the Non-Life Study, it was found that for premium and reserve risk the internal model users operate on a more favorable capital intensity level, volatility and distribution type compared to the standard formula. Furthermore, significant variation was observed in diversification benefits between premium risk and reserve risk with internal model users demonstrating generally higher diversification benefits compared to the prescribed diversification benefits in the standard formula.

75. Results of comparisons between SCRs calculated using internal models and SCRs calculated for the same insurers under the standard formula show a wide variety of results for insurers of the same type. These range from small increases in SCRs under internal models to very large discounts from using internal models compared to the standard formula SCR. It is the mission's view that in the case of reinsurers, large differences (either reductions or additions) may be justified as the standard formula often is not appropriately calibrated to a reinsurer's business model. Direct underwriters can also claim the same thing to a certain extent and an internal model is inherently better tailored to the business model of a particular insurance group. However, EIOPA and NCAs should consider how much of a reduction from standard formula SCR calculations is reasonable considering the business models of the relevant insurance groups. While results for non-life and composite insurers remained relatively stable over time, some significant variability in the comparison to standard formula SCR can be observed for life insurance groups.

76. Limitations of a simple comparison between internal model calculated SCR and standard formula SCR are acknowledged. The suitability of the standard formula SCR to the business models of insurance groups does vary. Additional metrics would also be helpful in monitoring internal model usage. However, the comparison provides a useful benchmark and a way of identifying insurance groups using internal models that require greater scrutiny. The benchmark is also useful in identifying model drift.

77. In the Solvency II review, the power to apply a floor to the SCR has been included but only in limited, specific circumstances of reflecting the effect of credit spread movements on the volatility adjustment. This will be possible where supervisory authorities allow insurance and reinsurers to use a dynamic VA in their internal model, at a level below which benefits on the SCR in excess of a mitigation of exaggerated bond spreads are expected to occur. This provides a very specific circumstance where a floor could be used for an internal model calculated SCR. Outlier results for internal model calculated SCRs may be addressed through supervisory convergence processes, but should be supported by a floor to the standard SCR applicable in a wider set of circumstances. Supervisory convergence processes should be supported by the existence of a floor

[23] https://www.eiopa.europa.eu/eiopa-analyses-internal-models-non-life-underwriting-risk-2024-01-04_en

on internal model results to address some aspects of internal model SCR calculations compared to the standard formula SCR. There will be strong arguments against such a proposal because of the link between internal models and risk management, which a floor may be seen as disrupting. However, for the credibility of internal model calculations of SCR, a floor calibrated to address the more extreme outliers as compared to the standard formula SCR would be useful to address some aspects of internal model SCR calculations. A similar approach has been taken in banking regulation, with an output floor agreed. The output floor in Basel III sets a lower limit on the risk-weighted assets (RWAs) calculated by banks using their internal models. Specifically, it ensures that the RWAs computed using internal models cannot fall below 72.5% of the RWAs calculated using the standardized approach. It is notable that one of the justifications for this measure is the aim to restore the credibility of internal models by providing a backstop and ensuring that banks maintain sufficient capital buffers.

78. EIOPA undertakes a number of activities to foster supervisory convergence in the supervision of internal models. EIOPA also conducts country field visits in relation to internal model supervision. There are 19 NCAs which supervise insurance groups or insurers using internal models, and EIOPA undertakes country visits to two NCAs per year in average (1 in 2020, 3 in 2021, 3 in 2022, 2 in 2023 and 2 in 2024). At such a rate, it will take nearly ten years to visit all NCAs. This is a sign of EIOPA's resource constraints and given the materiality of internal models this is an area that should be further resourced. Comparative studies are undertaken and this informs country visits and technical assistance. NCAs with smaller markets and less resources do request technical assistance from EIOPA and EIOPA has provided technical assistance to three NCAs since the inception of Solvency II, as at the time of this mission.

79. While EIOPA performs much valuable work in improving convergence of internal model supervision, it faces structural barriers to being more effective. Internal models and risk management are necessarily intertwined. However, EIOPA's access to insurer-specific information is quite limited, often depending on the goodwill of NCAs. EIOPA does not, for example, have automatic access to ORSA reports which would be useful in understanding internal models in use. In addition, EIOPA is not considered a concerned supervisor in supervisory teams considering internal models. If there is a disagreement between two concerned supervisors, they can escalate the issue to EIOPA for an opinion. However, if EIOPA has a different opinion from NCAs, there is no current way of resolving this issue. One way to improve EIOPA's role, would be for EIOPA to be considered a full member of the supervisory team and therefore have an equal say on issues related to internal models with the concerned NCAs. However, there is still no mechanism for the resolution of differences of opinion between EIOPA staff and NCAs.

80. It is clear from the above analysis that EIOPA needs more resources devoted to internal model convergence. There can be a debate about whether this is through internal reallocation (which then requires a discussion of what to deprioritize), allocation of SNEs, part of an increased overall resourcing envelope for EIOPA, or the enhanced ability to attract and compensate the necessary technical staff to assess internal models. Addressing some or all of these resourcing issues will assist in EIOPA's internal model convergence role. In addition, EIOPA's role needs to be

formalized when it comes to supervisory decisions about internal models. Such formalization would be of limited use if EIOPA is restrained from having access to necessary information. In particular, EIOPA should have timely access to all documents available to the supervisory authorities concerned (including the ORSA).

Recommendations

- EIOPA should obtain more resources to improve convergence of internal model supervision: In particular, more resources should be provided to undertake country visits regarding internal models. In addition, there should be an increase of resources to enhance participation in colleges and the work on comparative studies, benchmarking, or technical assistance.

- EIOPA should be given stronger powers on supervisory decisions related to internal models. If EIOPA could be considered a full member of the supervisory team and therefore have an equal say with NCAs on issues related to internal model supervision, this would foster supervisory convergence.

- A mechanism should be introduced to allow a binding technical review to resolve differences of opinion between EIOPA staff and NCAs on internal model supervision. EIOPA can be and is a center of excellence on internal model supervision. That role can be strengthened if EIOPA's opinion on controversial matters can be addressed by a technical review process such as a review panel with the necessary technical knowledge. Their decision should be binding on relevant NCAs.

- EIOPA, NCAs and the EC should discuss whether the introduction of a floor to address some aspects of the internal model SCR calculation is needed, either as a standard or on a case-by-case basis.

D. Supervision of Market Conduct Risks

81. The IDD regulates the design and distribution of insurance products within the EU. Its primary goals are to harmonize the insurance market across the EU and to enhance consumer protection standards. Key aspects of the IDD include: accountability of insurers for ensuring products they manufacture and distribute meet consumer needs, accountability of distributors for consumer outcomes; imposition of conduct of business and transparency rules on insurance distributors including a standardized insurance product information document for non-life insurance products; clarification of procedures and rules for cross-border insurance distribution to facilitate a more integrated EU insurance market; establishment of the principle that MS shall ensure NCAs have sufficient powers and resources for the supervision and sanctioning of insurance distributors who do not comply with the directive. The IDD, in most areas, is a minimum harmonizing directive, meaning it sets baseline standards but allows MS to introduce more stringent provisions if they choose.

Connection between Market Conduct Risks and Prudential Risks

82. Poor market conduct outcomes can be symptoms of poor governance at insurers and may lead to prudential problems due to the need for consumer redress. Beyond the linkage between poor conduct and poor governance, which in EIOPA's supervisory experience, can also have prudential implications, poor conduct and bad consumer outcomes can lead to broader issues in the insurance sector as seen in past scandals in the UK (Payment Protection Insurance) and the Netherlands (mis-selling of unit linked policies).

83. EIOPA has found overall poor conduct can limit trust and thus limit a deepening of the financial sector. For example, according to the latest Eurobarometer results from July 2024, 8 percent of EU consumers do not have any non-life insurance products with this percentage varying from 2 percent in Sweden to 24 percent in Bulgaria, with the majority of EU consumers only having motor and household insurance. Lack of trust in insurance products, social norms and issues around perceptions of cost all lead to consumers choosing not to buy insurance products. EIOPA's Eurobarometer survey from 2024 shows that 41 percent of EU consumers still do not trust insurers to ensure good consumer outcomes. Previous experience with insurance undertakings or existing negative perceptions in the community impact the level of trust. Limited clarity in coverage can also impact consumers' willingness to buy insurance: EIOPA's 2022 Eurobarometer data results show that in the event of a natural catastrophe, 22 percent of consumers would not know if they were covered or were not sure about the exact coverage/exclusions that may apply. In the same survey administered in 2023, 19 percent of EU consumers were unsure of the exclusions that may apply when faced with a natural catastrophe event. For these reasons EIOPA in recent years has increased focus and resources into market conduct supervision, even though resources in this area remain limited due to the overall resourcing constraints faced by EIOPA.

Product Oversight and Governance (POG)

84. The adequate application of POG requirements should mitigate cases of consumer detriment. The POG Delegated Regulation requires products to be compatible with the needs, characteristics and objectives of a defined target market which requires insurers to give prime importance to customers' interests during product design and throughout the lifecycle of a product. EIOPA's initial work on POG focused on supervisory convergence. It produced a chapter of the EIOPA supervisory handbook in April 2020 and set out EIOPA's approach to the supervision of POG in September 2020. Additional work focused on ensuring that NCAs adequately supervise POG requirements and the correct application of POG requirements by the industry, EIOPA issued supervisory statements covering: POG requirements in the context of COVID-19 in July 2020, assessment of value for money of unit-linked insurance products under POG in November 2021, exclusions in insurance products related to risks arising from systemic events in September 2022 and on differential pricing practices in non-life insurance lines of business in March 2023.

85. EIOPA conducted a peer review on POG which showed that most NCAs did not have in place an adequate framework for POG for insurance-based investment products. The peer review aimed at assessing how NCAs supervise POG requirements in relation to insurance-based

investment products, which are an important saving product for European consumers. POG requirements identify certain stages in POG development—target market assessment, product testing and product monitoring and review phase. EIOPA issued its final report in July 2023.[24] The reference period of the peer review was Q1-2008 to Q1-2022 and the final report was published in July 2023. Overall, EIOPA issued a total of 110 final recommended actions to the 30 participating NCAs. Of these, 18 NCAs were found to have met few expectations on POG supervision and received four or five recommended actions each. The recommended actions focused on broad conduct aspects linked to supervisory approaches and practices adopted by NCAs: (i) organization and resources of POG supervision; (ii) risk-based approach; (iii) setting and communicating supervisory expectations; (iv) supervisory processes; and (v) supervisory activities.

Risk Identification

86. Due to the lack of conduct reporting, EIOPA has developed retail risk indicators by using selected data under Solvency II report to primarily focus on identifying market conduct risks. EIOPA developed these indicators based on Solvency II data. They allow monitoring of trends and identify possible risks. The key indicators used are the claims ratio, claims rejected ratio and commission rate. The indicators found that income protection, miscellaneous financial loss and legal expenses lines of business have the highest commission rates and lowest claims ratio.

87. Beyond the retail risk indicators, EIOPA also used a number of other tools. EIOPA also has launched its first coordinated a mystery shopping exercise with eight NCAs. This covered the sale of insurance-based investment products. The exercise uncovered instances of poor disclosure and possible mis-selling. No decision has yet been made to publish the results and next steps are yet to be decided.

Country Visits and Thematic Review

88. Since June 2018 EIOPA carried out 18 conduct country visits and undertook two thematic reviews. The country visits aim at discussion NCAs' conduct supervisory practices and found differing approaches to conduct supervision with some NCAs dedicating limited attention and resources to conduct including some mostly doing complaints handling. EIOPA carried out two thematic reviews with the most recent focusing on credit protection insurance in 2020. The review identified problematic issues such as high commissions, low claims ratios, problematic business models, cross-subsidization of loans' profitability with banks, increasing potential prudential risks through the risk of the need for redress.

89. Limited follow up to thematic reviews and country visits remains a challenge. Following the credit protection insurance thematic review EIOPA issued a warning identifying a number of issues and actions to be carried out. However, it is difficult for EIOPA to ensure enforcement of the warning and adequate follow up. In particular, there is not enough traction on possible prudential implications and colleges are not paying full attention to the issues limiting actions to address

[24] https://www.eiopa.europa.eu/publications/peer-review-product-oversight-and-governance-pog_en

conflicts of interests and governance issues. Similarly, follow up to country visits is difficult, as EIOPA's feedback is not binding, with divergent follow-up actions. NCAs face challenges in resourcing conduct supervision and in being able to enforce requirements due to legal risks.

Recommendations

- Provide EIOPA with more direct ability to identify, analyze and assess risks for policyholders which are relevant to multiple member states

E. Climate Risk Supervision and Regulation

Sustainability Unit

90. Sustainable Finance is a key strategic priority for EIOPA. From an organizational standpoint, EIOPA has established a dedicated Sustainability Unit that operates horizontally across the organization. This unit is tasked with the ongoing development and implementation of EIOPA's overarching strategy concerning sustainable finance. To enhance its coordination efforts, the staffing of the unit reflects the interdisciplinary nature of the subject, with relevant projects being pursued across all core business areas, including prudential and conduct policy, prudential and conduct supervision, and financial stability. It is important to note the unit's role is coordination, it does not undertake all sustainability work, but it needs to be aware of all sustainability-related activities within EIOPA. The unit is staffed by a combination of five full-time experts and part-time specialists from other departments. The unit also considers the sustainability of EIOPA's own operations, and its mandate goes beyond climate risks, incorporating wider environmental issues such as biodiversity, social risks and governance issues. The unit has created more structured, regular exchanges about sustainability issues among EIOPA management and staff.

EIOPA's Opinion on the Use of Climate Change Risk Scenarios in ORSA

91. A key document in the supervision of climate risk was EIOPA's opinion on the use of climate change risk scenarios in ORSA. The opinion is addressed to NCAs and aims to build a common supervisory culture and consistent practices across the EU. It seeks to integrate climate change risk scenarios into the ORSA to ensure undertakings consider both short and long-term climate risks. The opinion makes it clear that insurers are expected to integrate climate change risks into their governance, risk management and ORSA, including both physical risks and transition risks. Insurers should perform qualitative and quantitative analyses of climate change risks covering short, medium, and long-term horizons. They should assess the materiality of climate change risks to their business by evaluating the potential impact on their solvency and financial position. The opinion requires NCAs to review the integration of climate change scenarios in ORSA during supervisory activities. They should ensure insurers are adequately considering climate risks and taking appropriate actions. At the time of the mission, EIOPA is carrying out a monitoring exercise to assess how the supervisory expectations have been implemented. It is surveying both NCAs and insurers, aiming to cover 80 percent of the market. These requirements will now become part of the Solvency II framework, and this work should feed into the development of RTS on Sustainability Risk

Management Plans. EIOPA has been coordinating discussions about climate change risk scenarios in ORSA in some supervisory colleges, focusing on how individual insurance groups have gone about conducting the scenario analysis and incorporating that into their ORSA.

Incorporating Climate Risks into Pillar I Requirements

92. EIOPA worked on the incorporation of climate risks into Pillar I requirements in the context of the Solvency II Review. This work was based on a mandate initially proposed by the EC[25] in its proposal for the Solvency II amending directive in 2021. The Solvency II Review mandates that EIOPA assesses whether a dedicated prudential treatment of exposures related to assets or activities associated substantially with environmental or social objectives would be justified, including in relation to fossil fuel related assets. In December 2023, EIOPA published a consultation paper on Prudential Treatment of Sustainability Risks followed by a report in November 2024. The analysis relied on both historical data and forward-looking analysis. EIOPA considered that historical data may not sufficiently reflect the emerging changes in risk patterns that are related to climate change. Transition risks are not well-represented in historical data and are often intertwined with other market risk drivers, such as inflation.[26] An important point made by the ESRB is that prudential policy should be anchored in risk-based analysis and should not be used to achieve broader policy objectives related to sustainability. The EC will now consider EIOPA's advice in determining measures to include in Level 2 Delegated Acts of the Solvency II Directive.

93. EIOPA's analysis considered equity and spread risk on stocks and corporate bonds for climate policy relevant sectors. EIOPA's analysis for equity risk relied on considering the Value-at-Risk on historical data and forward-looking analysis using projected equity shocks based on eight published scenarios.[27] Consistently with the Solvency II calibration methodology, for the historical analysis of spread risk on corporate bonds, the metric used was the 99.5 percent 12-month Value-at-Risk, calculated on the series of annual spread changes and measured in basis points. The transition return shocks for corporate bonds for the different economic activities are derived from the same disorderly transition scenarios as for equity risk. EIOPA's backward- and forward-looking analysis demonstrated a differentiated and elevated loss potential of fossil fuel-related stocks and corporate bonds compared to other economic activities.

94. Based on this analysis, the key recommendation in EIOPA's report is the one on additional capital requirements for exposures to fossil fuel -related equity and corporate bonds. The additional capital requirements are intended to mitigate the financial risks associated with fossil fuel investments, which may become stranded assets as the world shifts towards greener energy sources. EIOPA provided three options for both fossil fuel related equities and corporate bonds. For both asset classes, an option of maintaining the status quo for Pillar 1 requirements was provided. A second option of differentiating based on existing frameworks—for equity treating fossil

[25] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0581

[26] Taking a forward-looking approach is in line with advice from ESRB to EIOPA.

[27] Published scenarios by ACPR, ESRB/ECB, DNB and IAIS.

fuel-related stocks as Type II equity (i.e., a capital charge of 49 percent rather than 39 percent for Type I equities and for bonds a rating downgrade of bonds related to fossil fuel activities). The third option was a dedicated supplementary capital requirement for fossil fuel-related equities of 17 percentage points added to existing equity related capital requirements and for fossil fuel-related bonds a 40 percent increase in the spread risk charge.[28] EIOPA's impact assessment indicates that the proposed policy options have a minimal effect on the aggregated solvency ratio of insurance undertakings in the EEA, primarily because they are well diversified and have limited direct exposure to fossil fuel-related assets.

95. EIOPA also considered other differentiation for climate risk affected assets. It considered the impact of energy efficiency on property risk but did not recommend a differentiated capital treatment; the quantitative findings from backward- and forward-looking perspectives demonstrated mixed evidence. It also considered the impact of inclusion of climate adaptation measures on non-life underwriting risk (i.e., impact underwriting) but did not find compelling quantitative evidence to justify differentiated treatment where adaptation measures are in place. EIOPA suggested repeating the analysis, provided that further market developments resulted in improved availability of data. A future extension of the analysis of solvency capital requirements for non-life natural catastrophe risk was also suggested by EIOPA. It also considered social risks and impacts from a prudential perspective but did not advise on a dedicated Pillar I prudential treatment at this stage due to a lack of corresponding data and risk models without ruling this out as a future development.

96. The same considerations about risk should be taken into account for insurers which have approved internal models for Pillar 1 requirements. Internal model users account for over 50 percent of the European insurance market. There is some history of internal model users taking into account risks that are not addressed in the standard formula. For example, internal models typically take into account the risks of sovereign bonds that are excluded from the standard formula. However, it is unclear how NCAs or EIOPA will ensure that equivalent risk assessments are included in internal models compared to the proposed changes to the standard formula if these were to be written into law.

Recommendations

- It is recommended, in light of EIOPA's advice on the prudential treatment of sustainability risk, that the EC and European Legislators ensure that prudential policy continues to be anchored in risk-based analysis ensuring the primacy of prudential policy objectives where they may conflict with other policy objectives.

[28] An example quoted by EIOPA is a low-risk bond with a duration of 7 years and a credit quality step of zero would be subject to a shock of 7.7 percent instead of 5.5 percent under the proposal.

- If additional risk charges for fossil fuel-related assets are adopted in the standard formula, supervisory review processes must ensure that internal model users have recognized such differences in the capital required in relation to those assets.

Natural Catastrophe Risk Reassessments in the Solvency II Pillar 1 Standard Formula

97. In April 2024, EIOPA consulted[29] on a reassessment of catastrophe risks in the Solvency II Pillar 1 standard formula. The context of the reassessment is that natural catastrophes are becoming more frequent and more severe across Europe due to climate change. The consultation contains EIOPA's analysis of natural catastrophe parameters in the standard formula to see if current parameters needed recalibrating in light of new evidence considering also the impact of climate change, and to assess whether new peril or regions should be included. Pursuant to the Solvency II Review, EIOPA is mandated to review,[30] at least every five years, the scope and the calibration of the standard parameters of the non-life catastrophe sub-module of the Pillar 1 SCR with respect to natural catastrophe risk.

98. EIOPA is proposing new risk factors for 25 perils/regions across all five perils (flood, hail, earthquake, windstorm, subsidence) included in the standard formula. EIOPA recommends including natural catastrophe risks for more countries in the standard formula which were not previously covered. In relation to flood risk, nine countries including the Netherlands, Ireland and Finland are recommended to be added to the natural catastrophe risks. EIOPA is considering additions to the five perils already included in the standard formula natural catastrophe module. Perils considered to be added in the future include wildfire, coastal flood and drought. The EIOPA consultation paper, notes that some of the evidence relied on for recalibrating natural catastrophe risk comes from undertakings using internal models for Pillar 1. The focus of the paper was on the standard formula, but no further information was provided about how internal model users are calibrating these risks. As internal model users account for over 50 percent of the European insurance market, their calibration of these risks is also important.

Recommendation

- Once EIOPA has completed its reassessment of natural catastrophe risks in the Pillar 1 standard formula, it should review with NCAs how internal model users are calibrating natural catastrophe risks to ensure they are considering at least the same risks as the standard formula.

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[29] https://www.eiopa.europa.eu/consultations/consultation-20232024-reassessment-natural-catastrophe-risk-standard-formula_en

[30] EC included this mandate in its in its proposal for the Solvency II amending directive in 2021 - https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0581

Greenwashing

99. In June 2024, EIOPA issued[31] its final advice to the EC on greenwashing risks and the supervision of sustainable finance policies and issued a related Opinion on the supervision of sustainability claims. This final advice was based on the request for input from the EC in May 2022, which requested input on the areas of greenwashing and its supervision from all three ESAs. The request asked for a report on the scale and frequency of greenwashing, supervisory experience in dealing with greenwashing in order to identify good supervisory practices which are effective at identifying, monitoring and mitigating potential greenwashing risks as well as gaps in those practices and proposals for improvements to the current regulatory framework. The report complements EIOPA's Progress Report on greenwashing published in June 2023. The report addressed both insurance and pension providers. As part of its analysis to produce the report, EIOPA coordinated a survey among 16 national supervisors covering 99 insurance and pension providers. EIOPA found that providers were generally complying with sustainability-related requirements, while identifying areas for improvement particularly in relation to SFDR product-level website disclosure and consideration of sustainability-related objectives in the product manufacturing process. EIOPA included in the advice the need to take a more consumer-centric approach for sustainability preferences as part of advice process and simplify consumer-facing sustainability disclosures. In relation to non-life insurance products, EIOPA identified examples of non-life products with sustainability features, for example non-life products that provide rewards to consumers when they adopt sustainable behaviors. Based on the findings of this final advice, EIOPA issued an Opinion setting out a common EU approach to the supervision of greenwashing and sustainability claims.

100. EIOPA identified an increase in supervisory attention by NCAs around sustainability-related requirements, even though the focus remains limited. In 2024, more NCAs reported occurrences of greenwashing or potential greenwashing, up from 8 in 2023. NCAs also reported more supervisory activities around greenwashing with 21 reporting such activities in 2024 compared to 15 in 2023 along with more resources dedicated to greenwashing supervision. Challenges identified in the supervision of greenwashing were resource constraints, lack of sustainability-related data and lack of a common approach to supervising greenwashing.

Insurance Protection Gap for Natural Catastrophes (Nat Cat Protection Gap)

101. The impact of natural catastrophes varies significantly across Europe. It is estimated that more than EUR 900 billion in direct economic losses were caused by natural catastrophes in the EEA between 1980 and 2023. Almost a fifth of the losses over this 43-year period occurred in the last three years. Only approximately 25 percent of these losses were insured.[32] The losses that are not

[31] https://www.eiopa.europa.eu/publications/eiopas-final-report-and-opinion-greenwashing-advice-european-commission_en

[32] CATDAT (Risklayer GmbH - Europe Climate related impact Analysis Project) and EIOPA's Dashboard on insurance protection gap for natural catastrophes - European Union (europa.eu).

insured are referred to as the Nat Cat insurance protection gap. The ECB and EIOPA have identified[33] channels for natural catastrophe risk to impact on financial stability. Firstly, physical damage to assets can result in decreased collateral values and significant repricing of loans and securities for financial institutions in high-risk areas. Secondly, physical risks can disrupt supply chains, leading to substantial losses for the real economy and impacting financial institutions' balance sheets. In both scenarios, a high concentration of key economic activities in high-risk areas can magnify these losses, giving local events broader significance. This can lead to a reduced provision of credit in high-risk areas and for lower-income borrowers.

102. In the EEA, in addition to private insurance, there are national schemes that complement private insurance cover for natural catastrophes. These aim to ensure societal resilience against disasters increasing insurance penetration, improving risk awareness and prevention and increasing insurance capacity through more affordable (re)insurance. There is also the EU Solidarity Fund that provides EU-state backed funding for disaster relief, but this should not be considered as an insurance product. The objective of the EU Solidarity Fund is to grant financial assistance to eligible states in the event of a major or regional natural disaster or a major public health emergency with serious repercussions on living conditions, the natural environment, or the economy.

103. The Nat Cat protection gap is driven by both demand side and supply side issues. EIOPA research[34] on the demand side identifies issues that impact on the willingness of consumers and business to buy Nat Cat insurance along with potential solutions. The demand side barriers and drivers include income levels and perceptions of unaffordability of coverage; the perception that the process of buying insurance can be demanding; a lack of clarity in the terms and conditions in insurance policies; previous negative experiences with insurance claims; misperceptions of the risks of a Nat Cat event; and high expectations about government intervention in case of a catastrophe. EIOPA has identified potential solutions to the identified demand side issues. Measures include increasing risk awareness among citizens and businesses; simpler, consumer-friendly purchasing processes; better comparison and greater standardization of products around coverage, exclusions and pricing structures.

104. The Climate Resilience Dialogue Final Report, initiated by the European Commission, addresses the growing climate protection gap in Europe.[35] It highlights the increasing frequency and severity of climate-related hazards such as floods, wildfires, heatwaves, droughts, and storms. The report identifies key factors contributing to this protection gap, including low risk awareness, insufficient data for risk assessment, and affordability issues. It emphasizes the need for multi-stakeholder collaboration, improved risk reduction measures, and innovative insurance solutions.

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[33] https://www.eiopa.europa.eu/document/download/f472de85-ec4c-4dfe-b62f-841b43b38965_en?filename=ecb.policyoptions_EIOPA~c0adae58b7.en_.pdf.

[34] https://www.eiopa.europa.eu/publications/revised-staff-paper-measures-address-demand-side-aspects-natcat-protection-gap_en.

[35] https://climate.ec.europa.eu/document/download/4df5c2fe-80f9-4ddc-8199-37eee83e04e4_en?filename=policy_adaptation_climate_resilience_dialogue_report_en.pdf

The report also proposes actions for public authorities, the insurance industry, and other stakeholders to enhance climate resilience and narrow the protection gap.

105. As a result of the different impacts of natural catastrophes on MS and national specificities in natural catastrophe schemes to provide coverage, protection gaps vary significantly across the EU. EIOPA created its dashboard on insurance protection gap for natural catastrophes[36] (Nat Cat Dashboard) to monitor risks related to the insurance protection gap in Europe. At the request of the EC,[37] EIOPA created this dashboard because both the EC and EIOPA are concerned that affordability of insurance coverage for natural catastrophes and insurability of those risks are likely to come under pressure due to climate change. The dashboard assists in understanding the Nat Cat protection gap and what drives it in each country in the EEA. This will enable measures to decrease society's losses in the event of natural catastrophe to be identified. There are four different views in the dashboard. The current view indicates the current protection gap for each of the five perils tracked in the dashboard. The historical view (see Box1) presents the actual historical protection gap per peril since 1980. Then there is the country view which presents additional information on the current and historical protection gaps for each country. Finally, there is the country insurance view that shows how natural catastrophes are covered by country.

106. EIOPA is continuing work on addressing the demand side issues for Nat Cat insurance coverage. EIOPA issued a Supervisory Statement on exclusions in insurance products related to risks arising from systemic events,[38] the objective of which is to promote supervisory convergence in the assessment of the treatment of exclusions as part of the product design and drafting of terms and conditions. The statement highlights that exclusions should be clearly presented to consumers. EIOPA is undertaking a small survey in eight MS on contract exclusions related to natural catastrophe to assess clarity of coverage and exclusions in insurance product information documents compared to the target market's needs, objectives, and characteristics. The survey also assesses whether an add-on Nat Cat coverage is offered when the standard wording of the policy excludes those Nat Cats. The survey is also intended to identify different initiatives in each market aimed at increasing consumers' awareness about the availability of Nat Cat coverage.

107. EIOPA also identified the need for sharing expertise and data on catastrophe risks. EIOPA has established a "Centre of excellence for catastrophe modeling and data",[39], and is providing European supervisors and insurers with expertise, studies, tools and data to enable them to effectively assess, monitor and supervise these risks. The Centre of excellence allows national and

[36] Dashboard on insurance protection gap for natural catastrophes - EIOPA

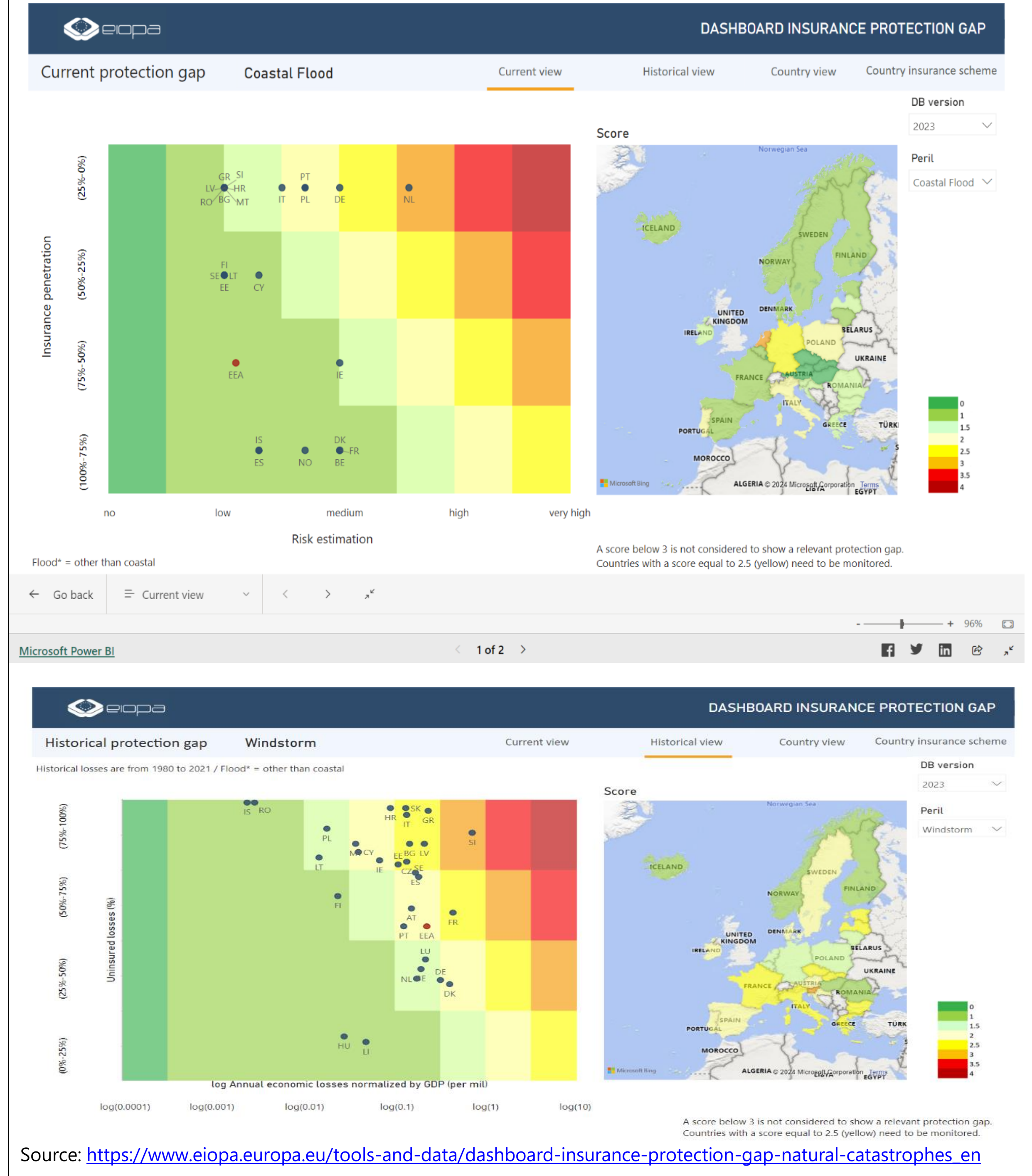
[37] The EC requested EIOPA undertake this work as part of the Strategy on Financing the Transition to a Sustainable Economy (https://finance.ec.europa.eu/publications/strategy-financing-transition-sustainable-economy_en) and the EU Strategy on Adaption to Climate Change (https://climate.ec.europa.eu/eu-action/adaptation-climate-change/eu-adaptation-strategy_en)

[38] Supervisory statement on exclusions in insurance products related to risks arihttps://www.eiopa.europa.eu/publications/supervisory-statement-exclusions-insurance-products-related-risks-arising-systemic-events_ensing from systemic events - EIOPA

[39] https://www.eiopa.europa.eu/tools-and-data/centre-excellence-catastrophe-modelling-and-data_en

European public authorities to gain a common understanding of catastrophe risks, take preventive measures and address the insurance protection gap. Lastly, it helps improve public awareness of risks related to catastrophes. EIOPA is also working on the development of solutions for the collection and dissemination of uniform and comprehensive catastrophe risk and loss data.

Box 1. Euro Area: EIOPA Protection Gaps Dashboard—Current and Historical Views



Source: https://www.eiopa.europa.eu/tools-and-data/dashboard-insurance-protection-gap-natural-catastrophes_en

MACROPRUDENTIAL SUPERVISION[40]

A. Systemic Risk Assessment

108. EIOPA has developed the SRAF which is highly aligned with the IAIS GME. This assessment is undertaken annually using 73 indicators grouped into the same categories as the IAIS GME. The SRAF indicators were developed considering the IAIS sector-wide monitoring, the EIOPA insurance risk dashboard, and the EIOPA supervisory handbook. The scope of the SRAF is on EEA and country-level aggregate developments. The goals of the SRAF are to facilitate an analysis of the potential emergence of systemic risk in the European insurance sector and support European members' participation in the collective discussions on systemic risk, which take place in September each year and are part of the IAIS Holistic Framework for Systemic Risk in the Insurance Sector.[41] The analysis is based on annual Solvency II data as at the end of the previous year and macroeconomic or other external data up to the end of July in the year of analysis.

109. Unlike the IAIS GME, there is no systemic risk score calculated to identify particular insurance groups for further discussion. The SRAF indicators are presented in the form of a heatmap covering both the EEA aggregate and individual jurisdictions. Whenever particular developments or outliers are identified at country or European level, a more detailed analysis based on individual insurer data can be carried out on an ad-hoc basis for selected indicators. Each indicator is classified into a risk bucket based on the historical distribution or on economic theory/regulation, but these scores are not yet aggregated at the level of the risk category. The SRAF results are discussed at EIOPA's Risks and Financial Stability Committee and Board of Supervisors and NCAs also provide written comments. While the approach is sophisticated and highly aligned with the IAIS sector-wide monitoring in terms of categories and risks monitored, it does not appear to be as systematic as using an approach to blend the indicators into a score. While the IAIS Application paper on Macroprudential Supervision[42] does not specifically recommend a score it does set out ways to calculate a score for individual insurers. The benefit of such a systemic risk score is that it facilitates identification of insurers that are increasing their systemic risk footprint from year to year.

110. There is no outward looking dimension to systemic risk surveillance. There has been research done including by EIOPA staff [43] and the ECB that in March 2020, insurers did play a role in

[40] ICP 24: The supervisor identifies, monitors and analyses market and financial developments and other environmental factors that may impact insurers and the insurance sector, uses this information to identify vulnerabilities and address, where necessary, the build-up and transmission of systemic risk at the individual insurer and at the sector-wide level.

[41] https://www.iaisweb.org/uploads/2022/01/191114-Holistic-Framework-for-Systemic-Risk.pdf

[42] https://www.iaisweb.org/uploads/2022/01/210830-Application-Paper-on-Macroprudential-Supervision.pdf (¶106).

[43] de Jong, Alexandra, Draghiciu, Alin, Fache, Rousová, Linda, Fontana, Alessandro, Letizia, Elisa *Thematic Review on the Impact of Variation Margining on the Stability and Functioning of the Financial System*. December 2019. https://www.eiopa.europa.eu/system/files/2020-01/eiopa_dec2019_fsr_thematic_review_impact_variation_margining.pdf

stressing the liquidity of money market funds after making withdrawals in order to settle margin calls on derivatives. There is also the potential for fire sales of assets as a result of either liquidity or solvency pressures at insurers which may have transmission channels to the banking sector.[44] The perspective that insurers can, albeit in limited circumstances, have impacts on other financial sectors to which they are interconnected needs more attention. EIOPA should pay more attention to financial sector counterparties to identify high levels of concentrations of activities or exposures that may lead to correlated behavior. While the ESRB highlights that exposures of insurers to non-MMF investment funds remain high, EIOPA is not focusing enough on these interlinkages and imbalances and indicators of investment exposure to other financial institutions appear to be too broad. These observations also apply to the Insurance Risk Dashboard discussed below. Cross sectorial assessments and potential second round effects stemming from direct impacts on insurers and other financial sectors are discussed at ESAs Joint Committee and at ESRB level, where EIOPA is engaged at work-group level and as a member of the General Board, Steering Committee and Advisory Technical Committee. With specific reference to the Joint Committee activities on risks assessment, since 2024 the frequency of the joint risk report has been reduced to annually.

Recommendation

- EIOPA should enhance the SRAF with a scoring methodology that would more clearly enable monitoring of the risk of individual insurers over time from a systemic risk perspective and develop an approach to considering outward risks posed by insurers to other parts of the financial system.

B. Insurance Risk Dashboard

111. EIOPA maintains the insurance RDB which is designed to evaluate financial stability risks within the European insurance sector. RDB results are produced quarterly by EIOPA and published on its website. The RDB combines quantitative, mostly backward-looking indicators derived from supervisory and market data, with qualitative, forward-looking inputs from the NCAs, gathered through quarterly insurance bottom-up surveys. It is based mainly on supervisory data from the Solvency II QRTs. It also incorporates data from other internal and external sources, especially for indicators related to emerging risks and economic or financial markets trends. The RDB monitors the following risk categories: macro risks, market risks, credit risks, risks related to solvency and profitability, liquidity risks, interconnectedness risks, insurance (underwriting) risks, market perceptions, environmental, social and governance (ESG) related risks, digital and cyber related risks. For each indicator included in the RDB, a weighted distribution is calculated based on the relative importance (e.g., size) of entities in the sample. Risk scores are then assigned to each indicator based on a pre-defined calibration which can be based either on the historical distribution or on economic theory/regulation. The indicator risk scores are aggregated at the category level

[44] https://www.bostonfed.org/-/media/Documents/Workingpapers/PDF/2023/sra2301.pdf

through a weighting approach resulting in a final risk level for the category (low, medium, high, and very high).

C. Coordination of Macroprudential Surveillance

112. Currently, Solvency II data is received by NCAs and then shared with EIOPA for the central database, with NCAs maintaining ownership of the data. This can be constraining in terms of the ability to share data at the European level for systemic risk monitoring. For example, EIOPA could only share aggregate country level data for the recent system-wide liquidity stress test coordinated by the ESRB. If the current arrangement of decentralized data submission is maintained , every instance in which data needs to be shared will involve a negotiation with NCAs with an uncertain outcome. In a crisis, the ability to share data quickly and analyze vulnerability on a cross-sectoral basis will be crucial and the current decentralized approach does not provide sufficient assurance that the data could be shared on a timely basis.

113. Only aggregated insurance statistics are currently published by EIOPA. Individual insurers are required to publish certain QRTs with SFCRs so there is already some Solvency II reporting data for individual insurers in the public domain, but it is not accessible in one place. This may be addressed by the implementation of the European Single Access Point but only from 2030 onwards. It would be better for market discipline for individual insurer data to be published in one place and for the published data to be more granular data than the QRTs published with the SFCR.

Recommendation

- Changes should be made to the responsibilities of NCAs and EIOPA, such that EIOPA is the recipient of data from insurers and groups and enables NCAs to access that data and EIOPA should be provided with adequate resources to undertake this new responsibility.
- Individual insurer level data should be made available to the public, either as EIOPA initiative or as part of wider initiatives such as the European Single Access Point (ESAP)

D. EU-Wide Stress Tests

114. EIOPA carries out regular insurance stress tests to assess how well the European insurance industry is able to cope with severe but plausible adverse developments of financial and economic conditions. Stress test results help supervisors identify the vulnerabilities of the insurance industry and find ways to improve its resilience. The stress tests are carried out every three years, with an exercise underway in 2024 at the time of the mission. The previous stress test was carried out in 2021 and the one before it in 2018.[45]

115. EIOPA's stress test is not designed to be a pass/fail exercise. The objective of the stress test is to allow EIOPA to make recommendations to the industry and enable supervisors to discuss

[45] 2024 is the 6th exercise. EIOPA ran Insurance Stress Test exercises in 2011, 2014, 2016, 2018, and 2021.

with insurance undertakings remedial actions as necessary in order to improve their resilience. Therefore, the focus is primarily microprudential. The microprudential assessment is complemented by the estimation of potential spillover from the insurance sector to other parts of the financial system triggered by reactions to the prescribed shocks.

116. The 2024 stress test exercise focuses on economic consequences of a re-intensification or prolongation of geopolitical tensions. It evaluates the impact of such a scenario on the capital and liquidity position of European insurers. The scenario, developed in cooperation with the European Systemic Risk Board (ESRB), envisages a widespread resurgence of supply chain disruptions, leading to lower growth and higher inflation. Second-round effects stemming from a wage-price spiral would further exacerbate inflationary pressures, ultimately leading to a re-appraisal of market expectations of interest rates across tenors and currencies. Concerns about the persistent effects of severe adverse shocks are reflected in a larger increase of expected market rates at the short end of the yield curve than at the long end. This contributes to a further inversion of the yield curve. Despite expectations of decreasing inflationary pressures over time, growth will continue to be adversely affected. The resulting tightening of financing conditions would heterogeneously increase government bond rates and would weigh on corporate profitability, widen credit spreads and have a negative impact across other asset classes. Market and insurance specific shocks derived from the narrative are calibrated to be severe but plausible and affect both the asset and liability side of the balance sheet of insurers as well as their liquidity in- and out-flows.[46]

117. The 2024 Stress Test exercise is designed to assess the resilience of the European insurance industry from both capital and liquidity perspectives. Insurers participating in the stress test are requested to estimate their position under two assumptions: (i) fixed balance sheet, where only embedded management actions are allowed; and (ii) constrained balance sheet, where a set of identified reactive management actions are allowed. The 2024 Stress Test exercise encompasses 48 undertakings registered in 20 European jurisdictions. The sample covers 75 percent of the EU-wide market based on total assets. The current regulatory framework does not grant EIOPA with the power to publish stress test results at an individual level. To enhance the transparency of the exercise, EIOPA pursued the publication of individual results in 2018 and 2021 requesting to each participant the consent to disclose their individual information. The objection to the publication of individual results reiterated by large part of the industry, and the lack of progress made through the dialogue, forced EIOPA to formally ask for the powers to disclose the individual

[46] The overall probability of materialization of the market risk shocks included in the scenario depends on several factors, including the probabilities of the triggering events and their level of correlation. The overall likelihood of the scenario for affected variables can be gauged by the probabilities of the shocks simulated for each response variable jointly with the historical (sample-dependent) probability of the trigger events. These joint probabilities vary across the different categories of financial assets, ranging between 0.03% and 0.5%. ESRB (2024) Adverse scenario for the 2024 European Insurance and Occupational Pensions Authority's insurance sector stress test exercise. available at: https://www.eiopa.europa.eu/document/download/5a66259b-130d-4862-8a6c-216c64162f46_en?filename=Adverse%20scenario%20of%202024%20EIOPA%20insurance%20stress%20test%20exercise.pdf.

results of stress test through the issuance of an Opinion on the subject on April 12, 2022.[47] The Opinion was reflected in the recently approved Solvency II review[48] without triggering changes to the EIOPA regulation. The 2024 stress test exercise is conducted under the in-force regulation. Therefore, EIOPA has to keep pursuing the disclosure of individual results upon explicit consent expressed by the participants.

Recommendation

- Align the EIOPA regulation (1094/2010) to the provisions on the power to publish individual results of sectorial stress test included in the EBA regulation (1093/2010. Article 22(1a)).
- EIOPA and NCAs to operationalize processes to enable the publication of the individual insurer results of stress test exercises according to the applicable regulation(s) both at National and EU level.

E. Solvency II Review – Macroprudential Toolkit

118. The Solvency II review introduces a macroprudential toolkit. Insurers will need to incorporate macroprudential considerations into their ORSA and the PPP, as directed by their supervisors. Additionally, they must develop forward-looking liquidity risk management plans. Details of how these new requirements will be addressed still needs to be fleshed out in RTSs.

119. Short-term liquidity analyses will be mandatory for larger insurers. Small and non-complex insurers, or those with prior supervisory approval, will be exempt. Mid- and long-term analyses will be at the discretion of the supervisors. The macroprudential toolkit also grants new supervisory powers to national supervisors. Under certain conditions, supervisors can temporarily freeze surrender rights to counter systemic liquidity shocks and impose early restrictions or suspensions on capital distributions and variable remunerations to prevent insolvency risks.

120. These enhancements should bring about significant improvements to understanding macroprudential risk in the insurance sector and promote better management of macroprudential risk. However, details are yet to be fleshed out and so by the time of the next euro area FSAP, the extent of the improvement from implemented practices will be able to be assessed.

[47] EIOPA (2022) Opinion to institutions of the European Union on individual disclosures in the context of EU-wide stress test exercises. Available at: Opinion to institutions of the European Union.

[48] The reviewed directive adds an additional (fourth) paragraph to Article 64[2] as follows: "*The first three paragraphs of this Article shall not prevent the supervisory authorities from publishing the outcome of stress tests carried out in accordance with Article 34(4) of this Directive or Article 32 of Regulation (EU) No 1094/2010 or from transmitting the outcome of stress tests to EIOPA for the purpose of the publication by EIOPA of the results of Union-wide stress tests*."

Annex I. 2018 FSAP Recommendations

Table 1. Euro Area: Recommendations for Insurance Supervision and Regulation

Recommendations	Time[1]	Update
Strengthen EIOPA's powers and resources to achieve supervisory convergence (EU*)	I	This has been achieved to some extent through embedding collaboration platforms into Solvency II with EIOPA's role spelled out. Also, the Solvency II Review will confer additional powers on EIOPA. However, as this TN points out strengthening is still needed in relation to internal models.
Intensify work on supervisory convergence, esp. on internal models, quality of capital, the loss-absorbing capacity of deferred taxes, and the supervision of cross-border risks (EIOPA)	ST	Work has intensified at EIOPA as set out in this note on internal models and supervision of cross-border risks. Not written in the note but checked during the mission, additional supervisory convergence work on the quality of capital has occurred.
Support the insurance sector's preparation for Brexit by providing guidance and further clarifying supervisory expectations, especially on service continuity (EIOPA)	I	Brexit has occurred and as it is not a current issue, as such the mission did not focus on following up on this recommendation.
Improve transparency by disclosing more market data publicly and by making more EU-wide data accessible to NCAs and other authorities such as the ESRB and the ECB (EIOPA)	ST	More market data has been disclosed over time at an aggregated level. More EU-wide data is available through FSRs as well. However, EIOPA is still constrained in fully participating in systemic risk assessments at the EU-level due to restrictions on sharing individual insurer and insurance group data.
Intensify work on cyber risks (including good practices for supervising cyber risk underwriting) (EIOPA)	ST	The implementation of DORA will be a step change in the supervision of cyber risks.

[1] Immediate (within 1 year); ST Short Term (within 1-2 years); MT Medium Term (within 3–5 years).

Annex II. List of NCAs for Insurance Supervision

	Name of organization	Supervisory role in the insurance sector
Austria	FMA - Finanzmarktaufsicht (Financial Market Authority)	Prudential & market conduct
Belgium	NBB - Nationale Bank van België (National Bank of Belgium)	Prudential supervision. The Financial Services and Markets Authority (FSMA) is responsible for the market conduct supervision
Croatia	Croatian Financial Services Supervisory Agency	Prudential & market conduct
Cyprus	Αρμοδιότητα της Υπηρεσίας Ελέγχου Ασφαλιστικών Εταιρειών (Cyprus Insurance Companies Control)	Prudential & market conduct
Estonia	Finantsinspektsioon (Estonia Financial Supervision Authority)	Prudential & market conduct
Finland	FIN-FSA - Finanssivalvonta (Finnish Financial Supervisory Authority)	Prudential & market conduct
France	ACPR - Autorité de Contrôle Prudentiel et de Résolution (Prudential Control Authority)	Prudential & market conduct
Germany	BaFin - Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Financial Supervisory Authority)	Prudential & market conduct
Greece	Τράπεζα της Ελλάδος (Bank of Greece - Department of Private Insurance Supervision)	Prudential & market conduct
Ireland	Central Bank of Ireland	Prudential & market conduct
Italy	IVASS - Istituto per la Vigilanza sulle assicurazioni	Prudential & market conduct
Latvia	Latvijas Banka	Prudential & market conduct
Lithuania	Lietuvos Bankas (Bank of Lithuania)	Prudential & market conduct
Luxembourg	Commissariat aux Assurances	Prudential & market conduct
Malta	Prudential & market conduct	Prudential & market conduct
The Netherlands	DNB - De Nederlandsche Bank (National Bank of Netherlands)	Prudential supervision. The Autoriteit Financiële Markten (AFM) is responsible for the market conduct supervision
Portugal	AUTORIDADE DE SUPERVISAO DE SEGUROS E DE FUNDOS DE PENSOES	Prudential & market conduct
Slovakia	NBS - Narodna Banka Slovenska (National Bank of Slovakia)	Prudential & market conduct
Slovenia	AZN - Agencija za Zavarovalni Nadzor (Insurance Supervision Agency)	Prudential & market conduct
Spain	Dirección General de Seguros y Fondos de Pensiones	Prudential & market conduct

Annex III. Key Changes in the Solvency II Review

Long-Term Guarantees

1. Improvements have been made to the so-called "long-term guarantee measures" to ensure that risks in low interest rate environments are adequately addressed, while also preventing undue volatility in capital requirements.

Volatility Adjustment[1]

2. The VA framework has been significantly revised. Supervisory approval will now be required in all countries before applying the VA. Additionally, the mechanism underlying the VA is subject to a substantial overhaul. The general application ratio has increased from 65 percent to 85 percent. The country component of the VA is replaced with a macroeconomic VA for MS, based on the country-specific reference portfolio and with a gradual and smooth activation to avoid a "cliff-edge" effect. Introduction of an undertaking-specific credit spread sensitivity ratio with a value between zero and one to account for volume and duration mismatches between fixed income investments and insurance liabilities. Insurance and reinsurance undertakings may, subject to prior supervisory approval, apply an additional undertaking specific adjustment on the risk-corrected spread of the currency, to account for the undertaking's fixed income portfolio composition. This additional adjustment is capped at 105 percent and may not be higher than 100 percent for two consecutive quarters. The weights used to weigh the spreads for government bonds and non-government bonds should sum to 100 percent. The risk-correction deducted from spreads shall be calculated as a percentage of spreads but is capped by reference to a percentage of the long-term average spreads. In the context of extrapolation of risk-free interest rates, the VA also applies to the last liquid forward rate.

Risk Margin

3. The cost-of-capital rate is set at 4.75 percent for the risk margin (down from 6 percent currently). Additionally, the EC is authorized to adjust this cost-of-capital rate in the Solvency II Delegated Regulation, but not earlier than five years from the date the amending Directive takes effect. Furthermore, the EC can only reset the cost-of-capital rate within a range of 4 to 5 percent.

4. An exponential, time-dependent element, known as the "lambda factor," is introduced to account for the time dependency of risks and reduce the risk margin. The detailed requirements for implementing this element will be specified in the Delegated Acts.

[1] The VA in Solvency II is a mechanism that allows insurers to adjust the discount rate used to value their liabilities, mitigating the impact of short-term market volatility on their balance sheets and provides a spread over the risk-free rate reflecting a percentage of the risk-corrected spread on a reference portfolio.

Extrapolation of the Risk-free Yield Curve

5. Technical changes were introduced to the extrapolation of the risk-free yield curve. A new methodology for the extrapolation of risk-free interest rates has been agreed upon. The extrapolation will begin at the first smoothing point (FSP), which is the duration at which bond markets are no longer considered deep, liquid, or transparent. From this point, the extrapolation will be based on forward rates that smoothly converge from the applicable forward rate at the FSP to an ultimate forward rate (UFR). The extrapolated forward rates will be a maturity-dependent weighted average of the UFR and a liquid forward rate, incorporating information on longer-term interest rates from various financial instruments other than bonds that are observable in a deep, liquid, and transparent market. While the detailed parameters, including exact formulas and weightings, are yet to be specified in the Delegated Acts, two important parameters have already been established in the Directive: (i) at its entry into force, the FSP for the euro shall be at a maturity of 20 years; (ii) at 40 years past the FSP, the UFR weight should have increased to at least 77.5 percent. This condition effectively floors the convergence parameter (alpha) at roughly 11 percent in the extrapolation formula proposed earlier by EIOPA (EIOPA proposed 10 percent)

Provisions related* to *equity investments

6. The corridor for the symmetric adjustment has been widened to a value of 13 percent. This aims to modulate capital requirements for equity investments countercyclically, based on the state of stock markets. For long-term equities (LTE), eligibility criteria will be established at Level 1. To promote investments in long-term projects, the LTE regime sets capital requirements for specific long-term equity investments at 22 percent (Level 1). Previously, rules restricted LTE to investments within the EEA, but the agreement expands this to include other OECD countries. The EC is also empowered to adopt delegated acts to specify these criteria further.

Proportionality

7. The Solvency II review has introduced a new proportionality framework. Insurers that meet specific eligibility criteria based on their size, activities, and riskiness will benefit from lighter requirements. These undertakings will be classified as small and non-complex. Furthermore, insurers that do not meet all eligibility criteria for small and non-complex undertakings may still access certain predefined proportionality measures in the Solvency II Directive with supervisory approval.

Macroprudential Supervision

8. The Solvency II review introduces a macroprudential toolkit. Insurers must incorporate macroprudential considerations into their ORSA and the PPP, at the discretion of the supervisor. Additionally, insurers will be required to develop forward-looking liquidity risk management plans. Short-term liquidity analyses will be mandatory for a defined group of insurers (excluding those classified as small and non-complex or those that have received prior supervisory approval for exemption), while mid- and long-term analyses will be subject to supervisory discretion.

The macroprudential toolkit also grants national supervisors’ new powers, allowing them to temporarily freeze surrender rights to address systemic liquidity shocks and impose early restrictions or suspensions on capital distributions and variable remuneration to mitigate insolvency risks in exceptional circumstances.

Sustainability

9. Insurance entities will need to create specific plans addressing financial risks associated with sustainability factors, including those arising from the transition. If a plan is required at the group level, subsidiaries included in the group plan will be exempt from developing individual plans. The content, supervisory approaches, and disclosure elements related to these plans, including quantifiable targets, will be further defined in RTS. Moreover, insurers must disclose certain information concerning their sustainability risks in the SFCR, including whether the undertaking discloses plans outlined in the Corporate Sustainability Reporting Directive and whether it is materially exposed to climate change risks, along with actions taken to address these risks.

Annex IV. Key Features of the IRRD

National Insurance Resolution Authorities

1. MS will appoint one or more authorities with the authority to implement resolution tools and develop, where deemed necessary in line with the IRRD provisions, resolution plans. A supervisory or other authority may also serve as the resolution authority, provided that structural arrangements, including distinct staff and reporting lines, are in place to guarantee effective operational independence.

Recovery Plans

2. At least 60 percent of a MS's life and non-life insurance market respectively is subject to pre-emptive recovery planning. Market share is calculated based on gross technical provisions for life insurance and gross written premiums for non-life business. Pre-emptive recovery planning is to be carried out at the group level, and solo undertaking as part of a group generally do not need to undertake their own recovery planning. Solo undertakings, if they are selected by the supervisory authority on the basis of risk, will also be subject to recovery planning.

Resolution Plans

3. Resolution authorities are required to develop a resolution plan for insurers and groups the resolution of which would relatively be more likely to be in the public interest or that have critical functions. These undertakings should account for at least 40 percent of a MS's life and non-life insurance market respectively using the same basis of calculation as for the threshold for pre-emptive recovery plans. Resolution planning should typically be conducted at the group level, and must be updated at least every two years.

Addressing Substantive Impediments to Resolution

4. If a resolution authority determines that significant impediments to the resolvability of an insurer or group exist, it will inform them accordingly. Should the authority find that the measures proposed by the undertaking, or the group, do not sufficiently address or resolve these impediments, it will have the power to implement alternative actions to enhance their resolvability. For examples, the authority may require the undertaking or group to limit its maximum exposures; divest certain assets; restructure liabilities; restrict or suspend the development of new or existing business lines or products; or make changes to its legal or operational structures.

Proportionality

5. Small and non-complex undertakings are not required to create separate pre-emptive recovery plans and are exempt from resolution planning, unless a supervisory or resolution authority determines that a specific undertaking poses a risk at the national or regional level. Supervisory and resolution authorities may also opt to implement simplified obligations for certain undertakings regarding the content, details, and frequency of updates to pre-emptive recovery

plans and resolution plans, as well as the level of detail required. The criteria for assessing whether simplified obligations are applicable include the undertaking's risk profile, size, interconnectedness with other entities or the financial market, and the complexity of its operations.

Resolution Tools and Powers

- *Solvent run-off:* This gives resolution authorities the power to prohibit an undertaking under resolution from entering into new insurance or reinsurance contracts but enables the use of existing assets to meet obligations of current policyholders eventually winding-up under normal insolvency procedures once policyholder obligations are met.

- *The asset and liability tool:* This empowers the resolution authority to transfer assets, rights, or liabilities of an undertaking under resolution, or a bridge undertaking, to one or more asset and liability management vehicles. The primary purpose of this tool is to enable a portfolio transfer during the resolution process.

- *Sale of business tool:* This tool is intended to enable resolution authorities to conduct a sale of the insurer or part of its operations to one or more purchasers (other than a bridge undertaking) without the consent of shareholders.

- *Bridge undertaking tool:* This tool enables resolution authorities to transfer shares or other ownership instruments, or any assets, rights, or liabilities of one or more undertakings under resolution, to a bridge undertaking. A bridge undertaking is an entity that is wholly or partially owned by public authorities or an IGS and is established to fulfill the resolution objectives outlined in the IRRD. Additionally, a resolution authority may also assign IGS with the duties and powers of a bridge undertaking.

- *Write down or conversion tool:* This tool will allow the resolution authority to write down or convert capital instruments, debt instruments, and other eligible liabilities to establish an internal mechanism for absorbing losses. There are mandatory and optional exclusions for certain types of liabilities and insurance claims (e.g. health insurance).

Resolution Conditions

6. Before resolution authorities can initiate actions regarding an insurer and/or group, several conditions must be satisfied. These include an assessment by the resolution authority indicating that no reasonable prospects exist for alternative private sector measures or supervisory actions (including preventive and corrective measures) to prevent the failure of the undertaking or group within a reasonable timeframe. Additionally, the resolution must be deemed necessary for the public interest. An undertaking will be considered as failing or likely to fail if it broadly meets any of the following criteria: (i) it no longer meets the MCR under Solvency II, (ii) it no longer meets authorization requirements or is significantly deficient in its legal obligations, (iii) it is unable to settle debts or other liabilities, (iv) it requires extraordinary public financial support, or (v) its liabilities exceed its assets.

Financing Arrangements

7. IRRD provides for financing arrangements to be implemented by MS. These should ensure that the resolution authority has adequate funds at its own disposal to, at least, pay any 'No Creditor Worse-Off' claims through ex ante or ex post contributions, or a mix thereof, from the country's insurers.

EIOPA's Coordinating Role

8. EIOPA has an important coordinating role in the IRRD. For example, EIOPA should contribute to promoting efficient, effective and consistent functioning of resolution colleges and convergence across them. Additionally, EIOPA will establish a Resolution Committee that includes representation from all national resolution authorities. In addition, EIOPA has a role in developing technical standards and guidelines.