

Viewpoint: The Right Balance: Solvency II and Capital Requirements

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10 July 2025

Discussions on the Level 2 implementation of Solvency II are an opportunity to reflect on progress made in the Solvency II review.

In doing so, it is worthwhile revisiting the objectives of the review and EIOPA's approach.

The review was an opportunity to reflect and check whether the framework functions as intended and remains fit for purpose, as well as to apply lessons learned from supervisory experience to refine the framework.

Our experience told us that Solvency II has proved itself as a solid foundation, withstanding a number of bumps in the road, such as COVID-19, and more recent high inflation.

The approach therefore was one of 'evolution not revolution,' with one of the main objectives to keep overall changes to Solvency II balanced, reflecting the fact that the framework continues to work well.

Overall, EIOPA is happy with the direction that the review has taken and welcomes the revisions. Many of the amendments undoubtedly enhance the framework's effectiveness and reflect well EIOPA's opinion.

While Solvency II has withstood bumps in the road in the past, we need it to continue to do so – especially as those bumps are getting more frequent and more substantial.

Geopolitical tensions, the climate crisis, cyber attacks. In Europe (and indeed around the world), politicians, business and citizens are living with these issues on a daily basis. At the same time, the EU needs to boost economic growth and competitiveness to survive such a changing world.

One response in Europe is a call for greater investment in infrastructure, technology, defence and green projects that will help Europe overcome these challenges.

The insurance sector is well-placed to answer this call, given their position as long-term investors with considerable sums at their disposal. In fact, EIOPA recognised this in its opinion on the review, indicating that some lowering of capital requirements for long term investments would be appropriate.

Yet there are voices pushing to lower the capital requirement further, with some arguing that this would prompt more investment in these critical areas.

EIOPA is not convinced that this is the right approach.

Will well capitalised insurers really use these newly-released funds to invest in the right areas of the European economy? Perhaps.

Investment decisions are driven by many factors, with the capital requirement being just one.

We know from our data that insurers today are overall well capitalised, with buffers above the capital required.

Insurers can already use these buffers to invest in the green and digital transformation. Are they doing so? Again, perhaps.

Or, will well capitalised insurers choose to use the released capital to pay higher dividends or buy back shares? For the third time, perhaps.

Three times 'perhaps' gives us some cause for concern.

The current level of capital requirement is there for a reason. It protects consumers, the sector, society, and the EU economy helping them to withstand turbulence (the balanced approach). Our view is that if the capital requirement is lowered, the resilience of the sector risks being eroded. This is concerning, particularly given today's volatile environment.

If changes result in creating stronger incentives for risk-taking while simultaneously lowering the capital in the system, then this should be transparent and made clear to policyholders and society that risks are up. Furthermore, it would be relevant to monitor that the policy goals of more investments in the EU economy are met.

As we come close to the final steps of the Solvency II review, let's not lose sight of the principles behind the review and, above all, the balanced approach.