Solvency II background

The need for a consistent supervisory approach

Three generations of EU Directives applicable since the 1970s paved the way for an insurance market to operate on the basis of freedom of establishment and freedom to provide services within the European Union. Over time, the regulatory framework seemed increasingly ill-suited to supervise the industry.

Due to its simplicity, lack of an economic risk-based approach and differences in implementation across the European Union, the existing regulation needed revision.In 1999, the European Commission presented its paper on "The Review of the Overall Financial Position of an Insurance Undertaking". This initiated the discussion among the European institutions, regulators and supervisors on the modernisation of the prudential framework for the supervision of insurance and reinsurance undertakings.

The discussions took particular importance in the wake of the financial crisis erupting in 2007. Although the majority of troubled institutions were banks, several insurers were also affected by the crisis, attributable to inappropriate investment decisions by insurers which led to significant losses, the interconnectedness with banks or, in general, evidence of poor governance, a report issued by EIOPA in July 2018 stated.The crisis showed the importance of a harmonised understanding of the risks by all involved actors, and the need for considering wider implications for financial stability.

It crystallised the need for bringing the regulatory framework at the forefront of modern risk management, reflecting the reality of large groups operating on a cross-border basis. The crisis also showed that the EU was not sufficiently equipped to ensure effective cooperation and coordination between national financial supervisory bodies as well as a consistent application of the legal framework across all Member States.

In 2009, a report was issued by the High-Level Group on Financial Supervision in the EU, chaired by Jacques de Larosière, echoeing the weaknesses in the supervisory and regulatory regime that contributed to the financial crisis.

A risk-based regulatory framework

A three-pillar structure has been adopted for the Solvency II regulatory framework,: quantitative requirements (Pillar I), governance of the undertaking and supervisory activity (Pillar II) and supervisory reporting and public disclosure (Pillar III).

Taken together, the three pillars form a coherent approach to promoting the understanding and management of risks across the sector.

- Key determining features of the Solvency II regulatory framework are:Risk-based: Higher risks will lead to a higher capital requirement to cover for unexpected losses.
- Group supervision: supervisors shall increase coordination and exchange of information in colleges of supervisors to improve cross-border supervision of insurance and reinsurance groups
- Market consistent: assets and liabilities shall be valued at the amount for which they can be exchanged, transferred or settled in the market
- Proportionate: regulatory requirements shall be applied in a manner that is proportionate to the nature, scale and complexity of the risks inherent to the business of the insurance and reinsurance undertakings.