FESE Reaction to the Commission consultation on Solvency II

21st October 2020

Introduction

Institutional investors, in particular insurers, fulfil a critical role in the economy, channelling the savings of millions of people into investable assets[1]. They play a key role in the development of financial markets as they:

- represent the largest source of equity capital;
- contribute to both efficiency and modernisation of the allocative mechanisms of a financial system; and
- often support improvements in corporate governance practices by monitoring firms' management.

However, while institutional investors have traditionally been long-term equity investors in capital markets, equity investments by insurance companies are decreasing. European insurance companies invest less in equity compared to third country insurers and to EU pension funds, partially due to current regulatory and fiscal arrangements in place that act as a barrier to the development of public capital markets in Europe.

The CMU HLF stated in its report that insurers underinvest in equity. The HLF recommends that the Commission proposes some necessary, prudentially sound amendments to encourage significantly higher investment particularly in equity, including in SMEs, by carrying out a targeted review of Solvency II. In parallel, the EU High-Level Expert Group on Sustainable Finance included in its final report recommendations that policy makers should investigate how the Solvency II framework can be improved to facilitate long-term investment.

FESE strongly supports the need for further incentives to promote the further development of a deep and liquid European Capital Market. Therefore, **a review of the regulatory framework is needed to address the barriers for achieving greater long-term investments, in particular equity capital charges under Solvency II should be a clear priority in order to remove one of the important biases against equity investment.** Under the regime, insurers must, in most cases, hold a 39% capital charge to own shares in listed companies. The equity category, called "long-term equity" has a lower capital charge of 22% (compared to the standard charge of 39%) to reflect long-term underperformance rather than forced selling risk. While this can be potentially very helpful in ensuring more appropriate capital charges for equity investments, the criteria for qualifying as "long-term

[1] Committee on the Global Financial System, "Establishing Viable Capital Markets," 2019.

equity" have proven not to work well in practice as it is estimated that only about 2% of all insurers' equity investment could qualify[2].

FESE Key messages:

- Exchanges support insurers in maintaining their role as providers of long-term savings/pension products, as this supports the well-being of European citizens, especially in light of an ageing society, the savings gap and strained national budgets.
- The Solvency II review should lead to an overall increase in insurers' capacity to invest in areas where a reduction in capital requirements is justified by addressing the technical flaws of the framework.
- An appropriate and ambitious review is also necessary to ensure insurers can contribute to the growth of the European economy, supporting the recovery and the transition to a sustainable economy.
- The review of Solvency II is a key opportunity for policymakers to deliver on broader European objectives set out in the Green Deal and the Capital Markets Union as well as supporting the Next Generation EU plans for the social and economic recovery of Europe.

Question that FESE would answer

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

☐ Yes

☒ No, the recent changes will not have a material impact on insurers' ability to invest for the long term

☐ Don't know/no opinion

Please specify what the remaining obstacles are, and how to address them while preserving the necessary prudential safeguards to ensure policyholder protection:

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[2] CMU HLF report, 2020.

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About FESE

The Federation of European Securities Exchanges (FESE) represents 36 exchanges in equities, bonds, derivatives and commodities through 18 Full Members from 30 countries, as well as 1 Affiliate Member and 1 Observer Member.

At the end of September 2020, FESE members had 8,419 companies listed on their markets, of which 14% are foreign companies contributing towards European integration and providing broad and liquid access to Europe's capital markets. Many of our members also organise specialised markets that allow small and medium sized companies across Europe to access capital markets; companies were 1,162 listed in these specialised markets/segments in equity, increasing choice for investors and issuers. Through their RM and MTF operations, FESE members are keen to support the European Commission's objective of creating a Capital Markets Union.

FESE is registered in the European Union Transparency Register: 71488206456-23.

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