A&O SHEARMAN

20 MAY 2025

Solvency II: *Assessing the implications of the EU's Amending Directive for the insurance sector*

In January 2025, an amending directive (Directive (EU) 2025/2, the **Amending Directive**) was passed that will result in some important changes to the Solvency II Directive (Directive (EU) 2009/13/EU) taking effect across EU member states on 30 January 2027. The Amending Directive contains far-reaching changes on topics as varied as long term equity investments, valuation of insurance liabilities, proportionality and reporting, reflecting insurers' valuable role in responding to the challenges of our times: green transition and COVID recovery.

However, the Amending Directive also contains significant changes to rules on group supervision, and, in that regard and others, reflects supervisory lessons learned since the implementation of Solvency II in 2016. Below, we shed some light on these changes.

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WHAT ARE THE KEY CHANGES AROUND INSURANCE GROUPS?

There are seven main buckets of changes relating to insurance groups:

- The introduction of a quantitative test with respect to identification of insurance holding companies.
- The introduction of an additional "anti-avoidance" power for supervisory authorities to designate as a "parent" any undertaking which, in the opinion of the supervisory authority, exercises a dominant influence over another undertaking. This allows for insurance groups to be created by supervisory powers in circumstances where the tests for consolidation would otherwise not have been satisfied.
- The extension of supervisory powers to insurance holding companies and mixed financial holding companies. While it remains the case that insurance holding companies and mixed financial holding companies are not required to comply with notional capital requirements at an individual level, these entities will, following the implementation of the Amending Directive, be within the scope of supervisory powers.
- The extension of supervisory powers (including at the level of insurance holding companies and mixed financial holding companies) to address circumstances where there is an impediment to effective group supervision.
- A more rigorous approach to the rules relating to the supervisory approach used where insurance groups are headquartered outside of the EU.
- The introduction of explicit proportionality measures at group level.
- Technical changes that address gaps in the Solvency II Directive.

WHAT ARE THE IMPLICATIONS OF THE CHANGES ON THE SCOPE OF INSURANCE GROUPS?

In broad terms, the Amending Directive introduces greater certainty for borderline cases where the existence of an insurance holding company is doubtful. The definition of "insurance holding company" will be aligned with the equivalent definition in the banking sector, and—in broad terms—an insurance holding company will be defined as a parent undertaking the "insurance" subsidiaries of which contribute 50% or more to any one or more of the following indicators on a "steady basis":

a) the undertaking's equity on the basis of its consolidated position;

b) the undertaking's assets on the basis of its consolidated position;

c) the undertaking's revenues on the basis of its consolidated position; or

d) the undertaking's personnel on the basis of its consolidated position.

For the purposes of determining whether the threshold above is met in relation to any of the indicators, insurers, reinsurers, insurance holding companies, mixed financial holding companies (and service companies for the same) in the group will be taken into account. While there is still scope for supervisory discretion (since the list of indicators is non-exhaustive), this change brings welcome clarity when compared to the current "exclusively or mainly" test, which is variably implemented across member states.

The Amending Directive introduces scope, however, for supervisory authorities to intervene to designate a "parent" and "group" where the more typical consolidation tests are not met (thereby potentially substantially expanding the scope of the insurance group where the discretion is applied, with all that that implies for group solvency and governance). In particular, as an additional "anti-avoidance" power, the Amending Directive will allow supervisory authorities to identify a "parent" or "group" where it finds "two or more undertakings which, in the opinion of the supervisory authorities, are managed on a unified basis". Relevant factors for this assessment include:

a) de facto control, or influence over decision making, including representation in decision making bodies;

b) strong reliance due to material financial or non-financial transactions/operations;

c) evidence of co-ordination; and

d) evidence of co-ordinated and consistent strategies, operations or processes, including brand and marketing.

This will be of particular interest to horizontal groups (i.e., groups in which insurance undertakings are structured as siblings with no capital links between insurance undertakings), which may not have met the tests for group supervision as previously expressed. While, from our vantage point, the possibility of capture of a horizontal group within the group supervisory net was present in the Solvency II Directive prior to amendment, the clarifications reflected in the Amending Directive may result in a more liberal application of the supervisory discretions. It is notable that while the Amending Directive clarifies that "groups which are already subject to group supervision will continue being subject to such supervision", there is no equivalent statement that groups not currently subject to group supervision will, absent changes, remain outside the scope of group supervision.

NEW SUPERVISORY POWERS OVER INSURANCE HOLDING COMPANIES AND MIXED FINANCIAL HOLDING COMPANIES

Associated with the supervisory discretion (explained above) to designate an insurance group absent the satisfaction of strict criteria, the Amending Directive also requires EU member states to have powers to require mandatory group restructuring in order to facilitate effective group supervision, for example by:

a) requiring an insurance holding company or mixed financial holding company to implement changes to the structure of its group in order to facilitate effective group supervision;

b) requiring an insurance holding company or mixed financial holding company (or another entity exercising dominant influence over the (re)insurers in the group) to be established in an EU member state.

These powers are capable of being exercised where the structure of a group obstructs or prevents effective group supervision. Situations where it is appropriate to use these powers are acknowledged to be rare and will involve EIOPA oversight.

In cases where the organisation of a group is not effective to (i) coordinate all the subsidiary undertakings of the insurance holding company or mixed financial holding company; (ii) prevent or manage intra-group conflicts; and (iii) enforce the group-wide policies set by the insurance holding company or mixed financial holding company throughout the group, then EU member states will have the power to require changes to its internal arrangements and distribution of tasks.

In addition, the Amending Directive introduces a requirement for EU member states to have at their disposal certain (minimum) regulatory powers which can be used against insurance holding companies and mixed financial holding companies in cases where the continuity and integrity of group supervision is not maintained, or the group supervision rules are otherwise breached. These regulatory powers must include at least an ability to:

a) suspend the exercise of voting rights attached to the shares of the subsidiary insurance or reinsurance undertaking held by the insurance holding company or mixed financial holding company;

b) issue injunctions, sanctions or penalties against the insurance holding company, the mixed financial holding company or the members of the administrative, management or supervisory body of those companies;

c) give instructions or directions to the insurance holding company or mixed financial holding company to transfer to its shareholders the participations in its subsidiary insurance and reinsurance undertaking;

d) designate on a temporary basis another insurance holding company, mixed financial holding company or insurance or reinsurance undertaking within the group as responsible for ensuring compliance with the group supervision requirements;

e) restrict or prohibit distributions or interest payments to shareholders;

f) require insurance holding companies or mixed financial holding companies to divest from or reduce holdings in insurance or reinsurance undertakings or other related undertakings; and

g) require insurance holding companies or mixed financial holding companies to submit a plan on return, without delay, to compliance.

While supervisory powers over insurance holding companies have existed in a patchwork across EU member states for some time, the suite of powers described in the Amending Directive will, for many EU member states, require a significant enhancement to the regulatory arsenal and, in locations where the existing regulatory toolkit is less well developed, may raise questions for investors and other stakeholders in insurance groups.

THIRD COUNTRY INSURANCE HOLDING COMPANIES/MIXED FINANCIAL HOLDING COMPANIES AND "OTHER METHODS"

The Solvency II treatment of insurance holding companies/mixed financial holding companies located outside the EU and in non-equivalent jurisdictions has been a contentious issue since the introduction of the regime, with a high degree of discretion available to EU supervisory authorities to apply what the Solvency II directive ambiguously describes as "other methods" to ensure effective group supervision. The Amending Directive introduces a list of these "other methods", including:

a) designating one insurance or reinsurance undertaking that shall be responsible for compliance with group supervision requirements;

b) requiring the establishment of an insurance holding company or a mixed financial holding company within the EU;

c) where several insurance and reinsurance undertakings form a subgroup, applying group supervision at the level of the subgroup, in combination with enhanced supervision of intragroup transactions and risk concentrations;

d) requiring board independence from the ultimate parent undertaking outside the EU;

e) prohibiting, limiting, restricting, monitoring or requiring prior notification of transactions, including the payment of dividends and coupons, where there are concerns regarding the solvency of EU (re)insurers in the group and where the relevant transactions involve group entities outside the EU;

f) requiring information on the solvency and financial position, the risk profile, and the risk tolerance limits of non-EU parent undertakings, including, where applicable, reports on topics which are discussed at the level of the non-EU parent undertaking board.

The Amending Directive will, of course, continue to permit supervisory discretion. But it should produce more uniform supervisory practice across the EU, and act to re-focus supervisory minds on the purpose of "other methods" (in particular, towards bolstering the EU supervisory perimeter in relation to insurance groups).

PROPORTIONALITY

The Amending Directive provides greater clarity on the application of the proportionality principle at both the level of individual undertakings, but also insurance groups. The proportionality principle (which has been a feature of Solvency II since its original implementation in 2016) has been criticised as being uncertain in both its scope and supervisory effect. The Amending Directive introduces specific criteria which will be used to identify "small and non-complex" insurance groups, which will benefit from certain relaxations of the Solvency II regime. Supervisory authorities will remain empowered to apply these relaxations to undertakings which do not meet the "small and non-complex" criteria, or to apply the more stringent rules in certain circumstances even where those criteria are met.

In overview terms, the "small and non-complex" criteria:

a) are determined based on technical provisions for groups containing life insurers and gross written premium for groups containing non-life insurers;

b) require the absence of certain adverse indicators (e.g., significant cross-border business; factors indicating a higher risk profile (such as a three-year average combined ratio for non-life insurers of over 100%).

Insurance groups (i.e., those which meet the "small and non-complex" criteria) can benefit from the "proportionality measures" in the Amending Regulation, including:

a) reduced frequency of regular supervisory reporting (required only every five years);

b) reduced frequency of ORSA reporting (required only every two years);

c) exemption from climate change analysis requirements;

d) exemption from requirement to prepare a liquidity risk management plan;

e) reduced calculation of technical provisions;

f) reduced governance burden. In particular, key function holders will be permitted to take on multiple roles, provided certain conditions are met.