**Date**: 7 December 2018
**Ref.**: EC delegated regulation proposal of 8/11/2018, Article 171a - Long-term equity investments)
**Link** to the regulation proposal:
https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2018-5720906_en

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# BETTER FINANCE FEEDBACK ON RULES FOR SOLVENCY OF INSURERS

BETTER FINANCE has been stressing for several years the crucial need for insurers to invest much more of their own risk assets into equities.

The own risk equity assets of Western European insurers had already gone down from 22% in 2001 to 8% in 2010[1].

In 2016, the own risk equity assets of EU insurers were only 3.8% of total own risk assets (direct equity only, excluding indirect own risk equity held via investment funds) according to Insurance Europe, the EU trade body.

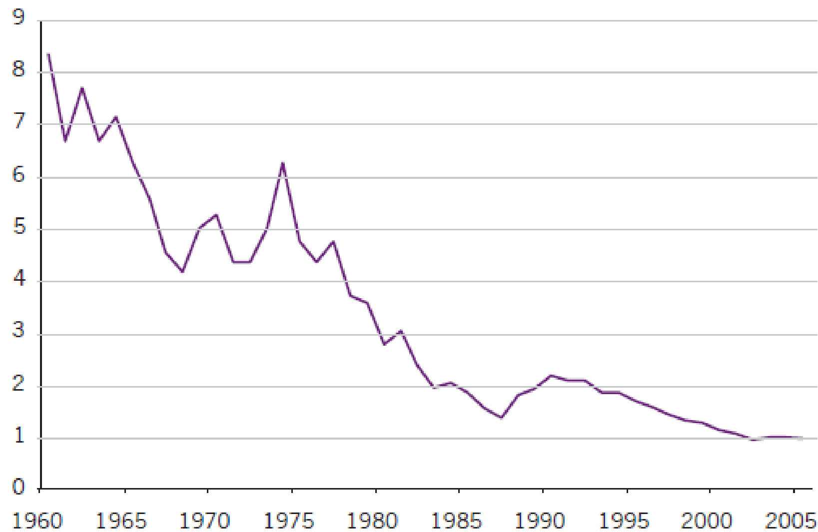
This significant increase in insurers' own risk equity assets would help:

1. The long term growth of the EU economy, by increasing the equity funding of the economy: this is one of the key objectives of the major EU "Capital Markets Union" (CMU) initiative;
2. EU long term and pension savers to get more decent real long term returns, as current fixed income performances are very low and often below inflation after fees (meaning negative real returns);
3. As major EU "institutional" investors on behalf of their policy holders, insurers must invest more for climate change and environmentally sustainable activities: "*A strong engagement on long-term issues, for example, towards longer equity holding periods and lower portfolio turnover, could reinforce their enabling role in financing sustainability*" (EU High-Level Group on Sustainable Finance Report).

In fact, BETTER FINANCE has already stressed the reverse correlation between the historical reduction of direct equity ownership by households in favor of equity holdings by funds and insurers on the one hand and the average holding period of equities as shown for example in the US market:

[1] BETTER FINANCE CMU Briefing Paper, April 2015 - http://betterfinance.eu/fileadmin/user_upload/documents/Research_Reports/en/CMU_Briefing_Paper_-_For_Print.pdf.

Average Holding Period for a Stock on the NYSE




*Source*: BETTER FINANCE CMU Briefing Paper 2015[2]

These three goals are vital for the EU economy and for EU citizens.

Therefore, BETTER FINANCE welcomes and strongly supports he EC initiative to lower the capital requirement for long term equity investments from 39% (listed equity in OECD countries) /49 % (other equity) to 22%.

However, the conditions spelled out in article 171a of the EC proposal are much to constraining for being implemented by EU insurers, and seem to apply only to direct equity portfolios, which is not reflecting the reality, in particular for mid- and small- size insurers who rely more on equity funds.

The proposal seems to mix two issues:

- The too low level of own risk direct and indirect (via equity funds) equity investments by insurers, and
- the too low holding period of each direct equity investment.

These are two different issues that should be in our view addressed separately. Given the dramatically low level of existing equity investments, the first issue – which addresses the first two goals listed above - should be prioritized and fixed as soon as possible.

First, BETTER FINANCE believes these long-term equity investments should not be ring-fenced. Article 304 of the Solvency II Directive should already allow insurers to ring fence equity investments covering pension liabilities, with the possible – and highly unfortunate – exception of personal pension ones. Further ring-fencing other equity investments will limit too much the ability of insurers to mutualize risks across their balance sheets, risk mutualisation being the core business of insurers. National competent authorities and

[2] Source: Bolton P. and Samama F. "Loyalty-Shares: Rewarding Long-term Investors" Journal of Applied Corporate Finance, Volume 25, page 75 (Summer 2013).

EIOPA should set up fewer constricting processes to identify the relevant equity investments, and to prevent their transfer.

Second, BETTER FINANCE has found that the turnover rate of active equity investment funds is often above 100% per annum, which means that – unlike individual shareholder portfolios – those funds hold any specific equity investment for less than a year, preventing their long term engagement as shareholders, and preventing them in particular to influence investee companies to invest more in sustainable activities. We could not find data on the turnover of the insurers' direct equity holdings, but there is a clear need to increase the average holding period of these investments as well to implement the third goal mentioned above. However, to require that each individual equity investment should be held at least twelve years by the insurer is not realistic and can be contrary to the fiduciary duties of the insurer towards the policy holders.

The first priority is to thoroughly increase the equity investments of insurers, the second is to make insurers become more engaged investors for long term sustainable growth.

As a first step, BETTER FINANCE recommends that insurers submit written policies to the public supervisors reflecting their commitment to hold the portfolio of equities for six to eight years, and that they report publicly every year on the turnover rate of these portfolios with the objective of lowering it progressively.

BETTER FINANCE also raises the issue of the capital requirements for indirect equity investment by insurers, as we fail to understand how the current terms of the EC proposal could fit them.

BETTER FINANCE is very concerned that without easing the requirements listed in the EC proposal and making them more realistic, insurers' equity investments and the average holding period of those will not thoroughly increase as they MUST to fund the sustainable long-term growth of the EU economy and to provide decent long term returns to EU policy holders.