EIOPA publishes advice on potential undue short-term pressures from financial markets

The European Insurance and Occupational Pensions Authority (EIOPA) has today published advice on the potential undue short-term pressure from financial markets on corporates.

EIOPA found no clear evidence of undue short-termism in insurance and institutions for occupational retirement provision (IORPs), although their investment practices are sensitive to macroeconomic circumstances such as the persistent low interest rate environment. More specifically, adaptation to macroeconomic circumstances may imply a shift in their role as long-term investors and insurance and pensions providers to their clients.

In its advice, EIOPA provides recommendations, including:

1. Developing a cross-sectorial framework with the aim of promoting long-term investments and supporting sustainable economic growth at European level.

  - General principles should guide the consistent implementation across the financial system of defined objectives in this matter and should help to assess performance against concrete targets as well as potential deviations at sectoral or sub sectoral level.
  - The promotion of long-term focus needs to be, respectful with the principle of freedom of investment, commensurate with the risks taken, always ensure the viability of individual business models, be compatible with an adequate level of protection for policyholders, members and beneficiaries, and be stable at a systemic level.

1. Facilitating the generation and publication of long-term performance benchmarks to increase the focus on long-term value creation rather than immediate shareholders’ interests or excessively short-term profitability objectives.

    - The availability of transparent and commonly understandable long-term benchmarks should benefit both providers and customers.

The advice is published in response to a request from the European Commission to all three European Supervisory Authorities (ESAs) to collect evidence and stakeholders’ views on this issue. Both the European Banking Authority and the European Securities and Markets Authority have also published their advice today.

Eiopa outlines key financial stability risks of the European insurance and pensions sector

- *Risk of a prolonged low yield environment has intensified over the last 6 months and remains the key challenge for European insurers and pension funds, putting pressure on both solvency positions and long-term profitability*
- *Combination of weakening economic outlook, concerns over debt sustainability and stretched valuations across financial markets could also give rise to a sudden reassessment of risk premia*
- *Emerging cyber and climate change related risks continue to demand attention from insurers, pension funds and supervisors*
- *Interconnectedness with banks and home-bias in investments remain high for European insurers and could lead to potential spillovers of risks from other sectors*

Frankfurt, 18 December 2019 – Today, the European Insurance and Occupational Pensions Authority (EIOPA) published its December 2019 Financial Stability Report of the (re)insurance and occupational pensions sectors in the European Economic Area.

The risk of a prolonged low yield environment has intensified over the last 6 months, as a combination of weakening economic outlook, growing trade tensions and increased downside risks have ushered in a new round of monetary policy easening by central banks, which has been accompanied by sharp decline in longer-term yields. The low yield environment remains the key risk for both the insurance and pension fund sector and continues to put pressure on solvency positions. While the European insurance sector remains overall well capitalized with a median Solvency ratio of 212%, significant disparities remain across undertakings and countries. Overall solvency positions have also deteriorated in the first half of 2019 and the low interest rate environment is expected to put further pressures on the capital positions going forward, in particular for life business. The low yield environment also has implications for long-term profitability, as it becomes increasingly difficult to meet promises and guarantees issued in the past. This could trigger further search for yield behaviour by insurers and pension funds, which could add to the build-up of vulnerabilities in the financial sector if not managed properly. Moreover, a combination of weakening economic outlook, concerns over debt sustainability and stretched valuations across financial markets could give rise to a sudden reassessment of risk, in particular for riskier assets, which could trigger losses in the investment porfolios of insurers and pension funds. EIOPA will therefore continue to monitor closely this risk to identify at an early stage any potential vulnerabilities.

Furthermore, cyber risk and climate change risks continue to demand attention from insurers, pension funds and supervisors, as insurers and pension funds are increasingly susceptible to cyber risks as the digital transformation continues, while also bringing new opportunities for insurers in the form of cyber underwriting. Regarding climate risk, insurers and pension funds can play a key role in the transition towards a low carbon economy as major institutional investors, but this transformation carries significant investment risks as well. It is therefore crucial that both insurers and pension funds actively incorporate climate change risks in their own risk management frameworks. At the same time, climate change can also have a significant impact on the liabilities of non-life insurers and reinsurers, as extreme weather related events become more frequent and severe. EIOPA has taken several initiatives to pro-actively tackle the climate challenge, by analysing potential climate-sensitive exposures in insurance investment portfolios, while the stress test for IORPs in 2019 also included an assessment of potential transition risks for pension funds. Furthermore, EIOPA published an Opinion on integrating sustainability and climate change risks into the Solvency II framework in September 2019. Going forward, EIOPA will continue to build on this work to assess both physical and transition risks for insurers and pension funds and assess potential misalignment with the Paris agreement climate goals.

The reinsurance industry has seen a relatively benign first half of 2019 in terms of catastrophic events, with global insurance losses significantly below long-term levels and the record losses observed in 2017 and 2018. Coupled with the overall positive stock market developments, this has benefited the profitability and solvency position of the reinsurance sector, although losses in the second of half of the year could still have significant impact. Growth in global reinsurance capital has been supported mostly by traditional capital, although outstanding alternative reinsurance capital has also continued to grow despite concerns related to the potential effect of climate change on the occurrence of natural disasters. The issuance of new ILS instruments appears to be more moderate in 2019 compared to the previous two years however.

Finally, the challenging economic environment has also taken its toll on the financial situation of the European occupational pension fund sector. The persistently low interest environment affects the current values of DB pension obligations and in almost all Member States, cover ratios (ratio of assets covering the pension obligations) decreased with the outlook continuing to look challenging in light of the slowdown in the global economy and the pressure on the interest rates. Asset values also impaired significantly towards the end of 2018, wiping off substantial values in equity investments which also affected the accumulated savings of members and beneficiaries in DC funds. Going forward, the improved reporting framework for the IORP sector will allow for an enhancement monitoring and assessment of potential vulnerabilities and financial stability implicatinos of European pension funds.

Gabriel Bernardino, Chairman of EIOPA said: *"Over the past six months, we have seen the risks for a prolonged low yield environment intensify. A combination of a weakening economic outlook, increased downside risks and ongoing uncertainties about trade disputes and Brexit have ushered in a new round of monetary easing by central banks, which has been accompanied by a sharp decline in longer-term yields. In this regard, we continue to see the clear benefits of Solvency II, as the market-consistent and risk-based regulatory framework has helped price in the risk of low interest rates, build resilience and enhance the risk management practices of insurers. At the same time, it is important that the regulatory framework continues to remain robust in the future and adequately reflects the risks faced by insurers in a low for long environment. As such, it is crucial that these elements are addressed in the currently ongoing Solvency II review to ensure that promises can continue to be met in the future."*

This Financial Stability Report also includes two thematic articles, focusing on i) a climate risk assessment of the sovereign bond portfolio of European insurers and ii) the impact of variation margining on EU insurers' liquidity.

EIOPA's Financial Stability Report – December 2019 is available via this link.

Notes for Editors

The **European Insurance and Occupational Pensions Authority (EIOPA)** was established on 1 January 2011 as a result of the reforms to the structure of supervision of the financial sector in the European Union. EIOPA is part of the European System of Financial Supervision consisting of three European Supervisory Authorities, the National Supervisory Authorities and the European Systemic Risk Board. It is an independent advisory body to the European Commission, the European Parliament and the Council of the European Union. EIOPA's core responsibilities are to support the stability of the financial system, transparency of markets and financial products as well as the protection of insurance policyholders, pension scheme members and beneficiaries.

ESMA proposes strengthened rules to address undue short-termism in securities markets

Recommendations

ESMA, in its Report, makes recommendations to the EC for action in key areas, such as:

1. disclosure of Environmental, Social and Governance (ESG) factors including:
   - amending the Non-Financial Reporting Directive (NFRD);
   - promoting a single set of international ESG disclosure standards;
   - requiring the inclusion of non-financial statements in annual financial reports; and
2. institutional investor engagement including:
   - a review of the *White List* under the Takeover Bids Directive*;*
   - a potential shareholder vote on the non-financial statement; and
   - monitoring the application of the Shareholder Rights Directive (SRD II).

Disclosure of ESG factors

ESMA, based on the evidence collected, recommends improvements in issuers' ESG disclosures which should respect a minimum level of comparability, relevance and reliability. ESMA recommends that the EC considers appropriate amendments to the NFRD to establish principles for high quality non-financial information along with a limited set of specific disclosure requirements.

In parallel, ESMA also recommends that the EC assesses the feasibility of achieving international convergence and consolidation of relevant disclosure frameworks with the objective of promoting, in the medium term, the adoption of a single set of international standards for ESG disclosures.

ESMA also proposes including the non-financial statement in issuers' annual financial reports and mandating assurance on its content and consistency with other information in the annual financial report. It also recommends establishing consistency between the NFRD and the Transparency Directive, a key element to improve reliability of ESG disclosures.

Institutional investor engagement

In order to further facilitate engagement taking into account long-term objectives, ESMA recommends that the EC mandates a review of the *White List*, namely ESMA's public statement on shareholder cooperation and acting in concert under the Takeover Bids Directive.

ESMA suggests that the EC considers the effectiveness of a shareholder vote on the non-financial statement to allow investors to express their views on how investee companies address sustainability risks.

In addition, ESMA suggests monitoring the application of the revised SRD II in order to assess whether it effectively encourages long-term engagement.

Next steps

ESMA's report has been sent to the EC which will decide whether to initiate legislative changes to address the Report's recommendations and monitor the effect of certain legislative acts to assess whether there is a need for further action.

Background

ESMA collected evidence in various ways. In addition to a review of relevant financial literature, ESMA conducted a public survey and hosted a stakeholder workshop, while it also sought the input of the Securities and Markets Stakeholder Group (SMSG).

ESMA's work on undue short-term pressures forms part of its work on sustainable finance and relates to the European Commission's Action Plan on 'Financing Sustainable Growth'.

Press release – Bees: MEPs call for reduction in use of pesticides to save Europe's bees

In a resolution adopted on Wednesday, Parliament welcomes the EU Pollinators Initiative, but highlights that, as it stands, it fails to protect bees and other pollinators from some of the many causes of their decline, including intensive farming, pesticides, climate change, land-use changes, loss of habitat and invasive species.

As pollinators are essential for biodiversity, agriculture and reproduction in many plant species, MEPs urge the Commission to present a full-scale action programme with sufficient resources.

Pesticide reductions necessary

To help further decrease pesticide residues in bee habitats, reducing the use of pesticides must become a key objective of the future Common Agricultural Policy (CAP), MEPs say.

They also call for EU-wide mandatory reduction targets to be included in the upcoming revision of the Directive on the sustainable use of pesticides.

Parliament finally demands more funds to support research into the causes of bee decline to protect the diversity of pollinator species.

The resolution was adopted by show of hands.

Background

In April 2018, the EU agreed to fully ban the outdoor use of imidacloprid, clothianidin and thiamethoxam, known as neonicotinoids. However, several member states notified emergency exemptions regarding their use on their territory.

After calls from Parliament and Council for action to protect bees and other pollinators, the Commission presented its Communication on the EU Pollinators Initiative on 1 June 2018.

According to the Commission, around 84 % of crop species and 78 % of wild flower species in the EU alone depend, at least in part, on animal pollination. Up to almost EUR 15 billion of the EU’s annual agricultural output is directly attributed to insect pollinators.

Press release – Parliament keeps up pressure to tax digital economy more fairly

As international talks at OECD level on taxation systems for the digital economy entered a new phase in October, MEPs quizzed the Commission on its strategy on [Monday](#) and adopted a resolution on Wednesday with 479 votes in favour, 141 against and 69 abstentions.

If international negotiations fail, the EU should go it alone

In the resolution, MEPs express their concern that there is no common approach at EU level on the ongoing international negotiations and call on the Commission and member states to agree on a joint and ambitious EU position, while making their own positions publicly known. The Parliament supports Commission President Ursula von der Leyen's commitment to propose an EU solution, should an international deal not be reached by the end of 2020.

MEPs say that at international level, the EU's position should aim to ensure that the Single Market functions smoothly, notably by safeguarding a level playing field for all types of firms. They demand that firms pay a fair share of tax where the actual economic activity and value creation take place and that the income from taxes is fairly distributed across all the member states.

Background

Following the financial crisis, the G20 addressed tax evasion, tax avoidance and money laundering through the Base Erosion and Profit Shifting (BEPS) project, leading to the BEPS action plan. This action plan, however, did not address the detrimental practices existing in the digitalised economy and this led to further work being set up under BEPS in 2015 (BEPS Action 1 Report). In October and November 2019, the OECD launched two separate public consultations on the matter, aiming to find consensus on a way forward.

In 2018/2019, the EU came close to adopting its own set of rules (legislation on a digital services tax, and legislation defining a significant digital presence), however, the need for unanimity within the Council meant that a few member states were able to prevent a deal being reached.