EIOPA's response to EU COM Consultation Paper on "Assessing the adequacy of macroprudential policies for Non-Bank Financial Intermediation (NBFI)"

1. Introduction

The perimeter of the NBFI encompasses multiple activities undertaken by entities of different sectors. Common activities conducted in the same markets, exposes entities to the same set of risks generating risk profiles that might, to some extent be comparable. In addition, activities undertaken by NBFI entities can also overlap and might, as a consequence increase interconnectedness among financial sectors.

The depicted conditions advise for a concerted approach when it comes to macroprudential supervision. However, in the identification of such a shared approach the following should be acknowledged:

i. the heterogeneity in the sectors and business models requires generalizations and simplifications to define a common framework.
ii. the different level of maturity/complexity of the Sectorial micro- and macroprudential regulation where in place.

European insurers operate under a well-established and robust micro-prudential capital regime which includes also macroprudential measures. Solvency II includes since its inception in its Pillars quantitative and qualitative elements with macroprudential implications to address potential procyclicality effects of long-term investors such as insurers (the so called, LTG measures). Additionally, the review of the Solvency II framework adopted by the Council on 5th of November 2024[1] further elements with macroprudential objective to the one in place.

[1] Solvency II and IRRD: Council signs off new rules for the insurance sector - Consilium

Handling instructions for documents with security markings: https://www.eiopa.europa.eu/sites/default/files/publications/other_documents/summary_eiopa_information.pdf

The specificities of the sectorial regulatory regimes shall be considered in designing a macro-prudential regime for NBFIs in order to avoid duplication, double-counting, or worst, conflicting measures.

2. Background

Non-bank financial intermediation (NBFI) covers very diverse sectors, including asset management companies and investment funds, non-bank investment firms, family offices, supply chain finance companies, pension funds, insurance companies, and other non-bank financial entities.

As pointed out by the European Commission[2], NBFI is an integral part of the EU's financial system. Non-bank financial intermediaries (NBFIs) account for roughly €42.9 trillion assets in 2023, representing 41% of the EU financial sector's assets. Capital markets are also a key component of NBFI and have grown considerably over the past few years. On the other hand, banks are connected to non-bank financial intermediation (NBFI) sector entities via loans, securities and derivatives exposures, as well as funding dependencies. Linkages with the NBFI sector expose banks to liquidity, market and credit risks.

It is worth noting that banks are subject to macroprudential measures of quantitative nature e.g., Systemic risk buffer (Article 133 of the CRD directive - 2013/36/EU[3]) countercyclical capital buffers (Article 135 of the CRD directive - 2013/36/EU). EIOPA in its Opinion on the 2020 review of the Solvency II, stated its view that supervisory authorities should be granted with the power to require a capital surcharge for systemic risk, to impose additional measures to reinforce the insurer's financial position (such as restricting or suspending dividend or other payments to shareholders), to define soft concentration thresholds, to expand the Own Risk and Solvency Assessment and the prudent person principle to take into account macroprudential concerns, to draft pre-emptive plans (recovery and resolution plans, as well as systemic risk and liquidity risk management plans), to grant NSAs with additional mitigating measures for liquidity risk in case vulnerabilities have been identified and to impose a temporarily freeze on redemption rights in exceptional circumstances.[4] Specific RTSs are in the drafting process.[5]

NBFIs play a pivotal role in fostering financial diversity and reducing dependency on bank financing, especially in the context of the capital markets union and the development of a robust single market. Nonetheless, a rapid expansion of NBFI can also generate new challenges and risks to financial stability.

At the international level, the Financial Stability Board, the International Organization of Securities Commission, and the International Association of Insurance Supervisors have progressively focused on

---

[2] Macroprudential policies for non-bank financial intermediation (NBFI) - European Commission (europa.eu)

[3] "Each Member State may introduce a systemic risk buffer of Common Equity Tier 1 capital for the financial sector or one or more subsets of that sector, in order to prevent and mitigate long term non-cyclical systemic or macroprudential risks […]"

[4] EIOPA (2020) Opinion on the 2020 review of Solvency II. Available at: https://www.eiopa.europa.eu/document/download/3c7759d5-a97a-4bc4-bfae-875c5d460d56_en?filename=Opinion%20on%20the%202020%20review%20of%20Solvency%20II.pdf

[5] Proposal for the Review of the Solvency II Directive. Available at: https://data.consilium.europa.eu/doc/document/ST-5481-2024-INIT/en/pdf

EIOPA | Westhafen Tower, Westhafenplatz 1 | 60327 Frankfurt | Germany
Tel: +49 69-951119-20
info@eiopa.europa.eu | https://www.eiopa.europa.eu

developing macroprudential analyses and tools that aim to mitigate systemic risks related to NBFIs. This work has gained even more traction in recent years, after various episodes of market turmoil (e.g., the 'dash for cash' during the COVID pandemic in March 2020 and the UK gilt market crisis in September 2022) and financial mismanagement (e.g., Archegos or Greensill Capital), which revealed the impact that the build-up of systemic risk and vulnerabilities of NBFIs can have on the whole economy.

The increasing systemic importance of NBFIs is reflected also in policy discussion at international level where, the FSB, the UK and the US have put forward consultations on assessing gaps in the macroprudential framework for NBFIs or have announced upcoming reforms in various NBFI sectors (e.g. money market funds). On 28 September 2023, the Bank of England announced the plan to create a new liquidity tool for NBFIs, which will initially cover insurance and pension funds and may potentially be extended to all NBFI entities that meet certain eligibility (ex-ante resilience) requirements. The FSB is considering reviewing the 2013 Recommendations on oversight and regulation of NBFIs and it has already advanced work on leverage, margin preparedness and vulnerabilities for open-ended funds. IOSCO also consulted on anti-dilution Liquidity Management Tools (LMTs) and is progressing work in the area of private finance. The Central Bank of Ireland has published a consultation paper on a holistic approach to macroprudential policies in the investment funds sector[6], while the ESRB also conducted work on the area and issued several papers[7]

The consultation has been launched as a follow-up to the previous policy-making actions undertaken by COM, which include as main milestones:

- September 2021 – Legislative proposal on Solvency II review and Insurance Recovery and resolution[8];
- January 2024 – Commission report on the macroprudential review[9];
- February 2024 – Capital Markets Union (CMU) political agreement between the European Parliament and the Council[10].

[6] Discussion Paper, An approach to macroprudential policy for investment funds, Central Bank of Ireland

[7] https://www.esrb.europa.eu/pub/pdf/reports/esrb.issuesnotepolicyoptionsrisksinvestmentfunds202309~cf3985b4e2.en.pdf?3e766fb7a0fabe49a83cff9ef1930dbf

https://www.esrb.europa.eu/pub/pdf/reports/esrb.cryptoassetsanddecentralisedfinance202305~9792140acd.en.pdf?f45cc2219ff3ea0545d9ecb9b5e8de71

https://www.esrb.europa.eu/pub/pdf/reports/esrb.issuesnoteonmacroprudentialaspectstradecreditinsurance202208~eaa8c9c764.en.pdf?c502ded6c6fc9ff0cc2d55d187ce98d9

[8] https://finance.ec.europa.eu/publications/insurance-rules-review-encouraging-solid-and-reliable-insurers-invest-europes-recovery_en

[9] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52024DC0021

[10] https://finance.ec.europa.eu/news/commission-welcomes-political-agreement-clearing-package-boost-capital-markets-union-2024-02-07_en

EIOPA | Westhafen Tower, Westhafenplatz 1 | 60327 Frankfurt | Germany
Tel: +49 69-951119-20
info@eiopa.europa.eu | https://www.eiopa.europa.eu

The objective of the consultation is to seek public authorities' and stakeholders' view on the adequacy of the macroprudential framework for NBFI with the intent not to revisit recent legislative agreements. The consultation aims to identify the vulnerabilities and risks of NBFIs and map the existing macroprudential framework for NBFIs. Second, it seeks to gather feedback on the current challenges to macroprudential supervision and discuss areas for further improvement.

Based on the Commission's recent report on the macroprudential review for banks and NBFIs, this consultation paper identifies the following key vulnerabilities stemming from NBFIs:

a. unmitigated liquidity mismatches;
b. the build-up of excessive leverage;
c. interconnectedness among NBFI sectors and between NBFI and banks.

As a lack of consistency and coordination among macroprudential frameworks across the EU can exacerbate the negative impact of such vulnerabilities, leading to unaddressed systemic risks. Commission services will use the information gathered in this consultation to inform the policy planning of the upcoming 2024-2029 College of Commissioners.

The European Commission hosted on 22 May 2024 a technical workshop to launch a targeted consultation on macroprudential policies for non-bank financial intermediation (NBFI)[11] constituted by a total of 68 questions, with the objective to gather further insight into the markets and business models of NBFI, and the interconnectedness among them and with banks.

The consultation format is a targeted consultation, and its outcome will be used to feed into the EU contribution to the international debate on macroprudential policies for NBFI, with a focus on the financial stability in the EU and how to ensure effective monitoring and risk management for investments funds.

3. Providing feedback to the consultation

EIOPA's feedback to the consultation is based on a tailored participation with focus on providing replies and feedback to insurance/pensions-related questions and a set of other questions indirectly related to insurance and pensions for a total of 13 questions (3 insurance/pensions-related questions, plus 10 questions indirectly related to insurance and pensions).

- ***Question 1.*** *Are there other sources of systemic risks or vulnerabilities stemming from NBFIs' activities and their interconnectedness, including activity through capital markets, that have not been identified in this paper?*

Answer: The perimeter of NBFI encompasses multiple activities and entities. The heterogeneity therein requires generalizations and simplifications to define a common framework. Recent developments and financial stability risks in insurance are monitored by applying both an "entity-based" and an "activity-

[11] https://finance.ec.europa.eu/regulation-and-supervision/consultations-0/targeted-consultation-assessing-adequacy-macroprudential-policies-non-bank-financial-intermediation_en

EIOPA | Westhafen Tower, Westhafenplatz 1 | 60327 Frankfurt | Germany
Tel: +49 69-951119-20
info@eiopa.europa.eu | https://www.eiopa.europa.eu

based" mapping approach. Whereas the entity-based approach focuses on the characteristics of individual insurers (e.g., nature, size, and complexity), the activity-based approach targets these activities undertaken by the individual insurers and by the sector in aggregate which generate exposures deemed as systemically relevant (e.g., liquidity, interconnectedness, substitutability) to capture risks that cut across different types of entities within the insurance industry and the financial markets in general.

The approach elaborates on the concept that systemic risk may stem from either an individual financial institution or a group of institutions. It expands the former concept of systemically important financial institutions, whose distress or failure could cause or amplify significant disruption to the wider financial system and real economy, with the systemic implications originated or amplified by group of institutions. The focus is in this case on collective actions or distress of institutions that operate in the same markets or engaged in similar activities, and thus are jointly exposed to certain risks.

While EIOPA agrees with the proposed general classification, we would remark to refer to the classification(s) specifically used for the insurance sector which takes into account:

- International developments, more specifically the IAIS holistic framework[12];
- EIOPA's paper on macroprudential supervision[13], and the subsequent
- EIOPA opinion on the 2020 review of Solvency II[14]

Additionally, the sectorial micro- and macroprudential regulation in place should be considered in progressing on the discussion on macroprudential framework for NBFI.

Since inception, Solvency II, included in its Pillars quantitative and qualitative elements with macroprudential implications to address potential procyclicality effects of long term investors such as insurers (the so called, LTG measures).[15]

More specifically, Solvency II contains several elements that support financial stability impact. The tools with macroprudential impact that the Solvency II framework embeds are essentially the long-term guarantees measures and measures on equity risk capital surcharge introduced in the Solvency II directive, the design of which has a direct macroprudential impact and include:

- Symmetric adjustment in the equity risk module;
- Volatility adjustment;
- Matching adjustment;

[12] IAIS (2019) Holistic Framework for Systemic Risk in the Insurance Sector. Available at: 191114-Holistic-Framework-for-Systemic-Risk.pdf (iaisweb.org)

[13] EIOPA (2017) Systemic risk and macroprudential policy in insurance. Available at: Systemic risk and macroprudential policy in insurance (europa.eu)

[14] EIOPA (2020) Opinion on the 2020 review of Solvency II. Available at: https://www.eiopa.europa.eu/document/download/3c7759d5-a97a-4bc4-bfae-875c5d460d56_en?filename=Opinion%20on%20the%202020%20review%20of%20Solvency%20II.pdf

[15] The set of measures are labelled Long Term Guarantees measures. A report on the use of LTG is available at: Report on long-term guarantees measures and measures on equity risk 2020 - European Union (europa.eu).

- Extension of the recovery period;
- Transitional measures on technical provisions.

In addition to ensuring sufficient loss absorbency capacity and reserving, the above mentioned tools contribute to another operational objective, namely, limiting procyclicality. Indeed, these tools address the risk of collective behaviour by insurers that may exacerbate market price movements.

In terms of latest developments, the Solvency II 2020 review, which is at the date of the submission of this feedback (November 2024) still undergoing the legislative process for adoption, introduced an additional set of tools and powers with macroprudential implications to address the specificities of the insurance sector:

- Expansion of ORSA to consider macroprudential concerns (exposures area);
- Integration of macroeconomic concern in the Prudent Person Principle (exposures area);
- Requirements on Liquidity Risk Management Plans (LRMP) (liquidity area);
- Powers to require undertakings to reinforce their liquidity position (liquidity area);
- Suspension of redemption rights of life insurance policy holders (liquidity area);
- Restriction or suspension of dividend distributions or payments to shareholders and other subordinated creditors (liquidity area)
- Additional measure to reinforce the insures' financial position (capital area);
- Pre-emptive recovery and resolution plans (pre-emptive area).

The current framework review, in its approval process, aims to cover additional macroprudential related items. Specifically, it includes macroprudential considerations in the ORSA and PPP, requirements for short/mid/long terms liquidity plans, and additional specifications on the circumstances under which competent authorities shall take actions upon macroprudential concerns.[16] Improvements on the quantitative reporting templates, introduced since YE2023 reporting, enhance the monitoring of liquidity.

EIOPA has been advocating for a broadening of Solvency II to incorporate tools with macroprudential implications and measures for several years with a comprehensive set of advice provided in the 2020 Review of Solvency II. We welcome that a good number of the tools with macroprudential implication proposed by EIOPA were taken on board in the initial proposal of the Commission and eventually made in the agreement reached in December of the last year.

EIOPA believes that the tools included in the last version provide a good combination in terms of variety of instruments and the agreement reached on the tools with macroprudential implications represents a good improvement.

[16] Draft process of a set of new Regulatory Technical Standards (RTS) is ongoing. Relevant for the issue at stake: "RTS on applicability criteria for macroprudential analysis in own risk and solvency assessment and prudent person principle", the "RTS to specify the criteria for the identification of exceptional sector-wide shocks" and the "RTS on liquidity risk management plans" are directly related to a specific package of additional tools with macroprudential implications.

However, work on the matter is still ongoing. EIOPA is already working in cooperation with its Members, and, where needed in consultation with the European Systemic Risk Board, on the drafting of guidelines and technical standards to ensure a consistent application the tools in the EU.

Further to the developments mentioned in the context of the review of the Solvency II Directive, it is worth mentioning that, as explained by the European Commission[17], in the context of the Insurance Recovery and Resolution Directive, the requirement for (re)insurers to formulate pre-emptive recovery plans is meant to facilitate prompt remedial action and ensure that entities are prepared should problems arise. These plans will improve the insurer's understanding of its vulnerabilities and its realistic options in stress scenarios, and can be integrated as part of an undertaking's system of governance. It also grants national authorities' powers to guarantee an orderly resolution of failing (re)insurers by ensuring as far as possible the continuity of the insurance coverage. This improves the outcome for consumers and limits recourse to taxpayers' money.

Finally, powers are also provided by the PRIIPS regulation to EIOPA and the relevant competent authorities or EIOPA to prohibit or restrict the marketing, distribution and sale of insurance-based investment products giving rise to serious concerns regarding investor protection, orderly functioning and integrity of financial markets, or the stability of the whole or part of the financial system.

- ***Question 3.*** *To what extent could the failure of an NBFI affect the provision of critical functions to the real economy or the financial system that cannot easily be replaced? Please explain in particular to which NBFI sector, part of the financial system and critical function you refer to, and if and how you believe such knock-on effect could be mitigated.*

Answer: Insurers' role in the economy is to provide protection and long-term funding. Wide-spread reactions of insurers to market movements might generate footprints in the market and hinder their ability to fuel the economy. Interconnectedness could possibly increase detrimental effects. Substitutability and concentration of service provision might pose issues to the real economy in case of stress scenarios (e.g. during the COVID pandemic some monoline insurers, such as those working on credit insurance, were included in the general package of fiscal support deployed by Member States). The Insurance Recovery and Resolution Directive (IRRD) recognises insurers as positioned to provide specific services to the economy. Those activities go under the term of critical functions and 'critical functions' means in this context activities, services or operations performed by an insurance or reinsurance undertaking for third parties that cannot be substituted within a reasonable time or at a reasonable cost, and where the inability of the insurance and reinsurance undertaking to perform the activities, services or operations would be likely to have a significant impact on the financial system and the real economy in one or more Member States, including by affecting the social welfare of a large number of policy holders, beneficiaries or injured parties or by giving rise to systemic disruption or by undermining general confidence in the provision of insurance services;

[17] Insurance rules' review: encouraging solid and reliable insurers to invest in Europe's recovery - European Commission (europa.eu)

EIOPA | Westhafen Tower, Westhafenplatz 1 | 60327 Frankfurt | Germany
Tel: +49 69-951119-20
info@eiopa.europa.eu | https://www.eiopa.europa.eu

Coordinated sensitivity analyses and stress test exercises among Supervisory Authorities would be beneficial to identify spillovers form the financial sector to the real economy and promote convergent practices to ensure the least propagation possible of knock-off effects.

The recent nat-cat events highlighted the example of how natural catastrophe insurance can play an important role in mitigating the negative macroeconomic, financial stability or fiscal implications of disasters[18].

In that context, the failure of the (re)insurance sector to provide coverage for climate-related catastrophe losses can:

- amplify the economic costs of climate-related events by limiting economies' ability to bounce back, hence delaying the recovery and resulting in inefficient burden-sharing;[19]
- cause systemic risks by increasing the exposure of banks to physical risk and reduce the value of collateral, potentially increasing the exposure of banks to credit risk;
- increase fiscal pressure for countries, esp. those with high physical risk, who would need to carry the cost of recovery and reconstruction post-disaster.

With climate change, as losses from natural disasters are rising[20], insurance becomes even more valuable from a macroeconomic and societal perspective.

However, only about 20 % of losses related to weather- and climate-related extremes are insured today in Europe[21].

As losses increase, insurance becomes more costly, leading to availability and affordability issues causing the insurance protection gap to widen, and amplifying the economic costs, systemic risks and fiscal pressure on governments.

To mitigate these costs and risks, additional risk-sharing solutions at national or European level may be needed.

For that purpose, the establishment of public-private partnerships involving the insurance industry, regulators, supervisors and governments can

- enhance risk identification (through the sharing of data and models);

---

[18] Policy options to reduce the climate insurance protection gap (europa.eu) (EIOPA-ECB 2023).

[19] Empirical evidence confirms that the impact of disasters on GDP growth also depends on insurance coverage. For example, a large-scale disaster causing over 0.1% of GDP worth of direct losses can reduce GDP growth by around 0.5 percentage points in the quarter of impact if the share of insured losses is low, i.e. below 35% of the total. However, if a high share of damages is covered by insurance, the indirect impact on GDP growth may be significantly reduced. (EIOPA-ECB, 2023).

[20] Swiss Re Sigma report 1/2024: Relative to GDP, 'the insurance loss burden from catastrophes has more than doubled over the last 30 years. And, extrapolating our estimated long-term trend rate of 5-7%, we estimate that today's burden could double over the coming decade.'

[21] European Environment Agency, European Climate Risk Assessment, 2024. Between 1980 and 2022, weather- and climate-related extremes caused EUR 650 billion in economic losses in the EU Member States (in 2022 euros), of which only 19.5% were insured. See for protection gaps for EU Member States: The EIOPA Dashboard on insurance protection gap for natural catastrophes - European Union (europa.eu).

EIOPA | Westhafen Tower, Westhafenplatz 1 | 60327 Frankfurt | Germany
Tel: +49 69-951119-20
info@eiopa.europa.eu | https://www.eiopa.europa.eu

- promote coordination on risk adaptation measures through investments in resilient infrastructure, or through premium reductions for the implementation of prevention measures;
- improve risk diversification across perils and geographies (through insurance pooling).

To ensure that insurers are in the position of keep offering services and coverages related to natural catastrophes, the sector should remain robust and properly capitalised also under adverse circumstances and not to act as generator or amplifier of systemic events via procyclical assets liquidation, exposures to counterparty risks, and interruption of services.

The actual macroprudential elements of Solvency II (refer to question 1) and the ongoing review covers these aspects. In the context of the Solvency II review, and in specifically in the new Regulatory Technical Standards under development, the concept of substitutability and risks thereof are considered (e.g., RTS on applicability criteria for macroprudential analysis in own risk and solvency assessment and prudent person principle).

- ***Question 4.*** *Where in the NBFI sectors could systemic liquidity risk most likely materialise and how? Which specific transmission channels of liquidity risk would be most relevant for NBFI? Please provide concrete examples.*

Answer: Given the characteristics of insurers' traditional business model, liquidity risk is not deemed a top concern in the insurance sector due to the inversion of the production cycle and the availability of liquid assets in their balance sheet[22].

Liquidity strains in the insurance sector stems from policyholder behaviour (i.e., lapses), off-balance sheet exposures (i.e., hedging strategies and related potential margin calls), balance sheet exposures (e.g., claims inflation, swift repricing of risk premia), exposures to insurable events (e.g., nat-cat), funding (e.g., deterioration of credit worthiness), and other sources (e.g., fungibility of liquid assets).[23]

EIOPA is devoting attention to the liquidity risk in the insurance sector through monitoring activities and policy actions. In the EIOPA December 2023 Financial Stability Report[24], EIOPA has highlighted that insurers, particularly in the life sector, often employ interest rate swaps to mitigate interest rate risks. In these swaps they normally pay floating rates and receive fixed rates which helps them to align their asset and liability durations. But these transactions can put a strain on the liquidity position of insurers when interest rates increase, and insurers must post additional variation margin. These margin calls require daily settlements, typically in cash or equivalents. The resulting liquidity needs depend on the extent to which insurers utilize derivatives. Some markets rely more heavily on derivatives to manage

[22] Insurance is characterised by an inverted production cycle. While premiums are paid up-front, claim payments are generally only settled in case the insured event occurs. The inverted production cycle generates a stable cash flow to insurers and makes the traditional insurance business less dependent on short-term funding.

[23] For an extensive discussion on the liquidity risk exposures refer to EIOPA (2021) Methodological principles of insurance stress testing – liquidity component. Available at: [Methodological principles of insurance stress testing - liquidity component - European Union (europa.eu)](#).

[24] [EIOPA December 2023 Financial Stability Report (europa.eu)](#)

EIOPA | Westhafen Tower, Westhafenplatz 1 | 60327 Frankfurt | Germany
Tel: +49 69-951119-20
info@eiopa.europa.eu | https://www.eiopa.europa.eu

asset-liability mismatch risks, while others predominantly use bonds.

EIOPA, in cooperation with its members, is regularly assessing and monitoring the liquidity position of insurance undertakings via an ad-hoc data collection. Additionally, since 2021 liquidity is part of the EIOPA EU-wide bottom-up stress test exercise.

In the context of the Solvency II 2020 review, in terms of macroprudential policy, several tools and measures have been introduced; these comprise capital-, liquidity-, exposure-, and pre-emptive based tools and measures that aim at broadening the current toolkit of macroprudential measures at the disposal of supervisory authorities. In addition, the newly introduced tools with macroprudential implications and measures also supplement certain provisions that already have a certain macroprudential impact (e.g. those that refer to the long-term guarantees measures). the implementation of these new tools and measures takes form in the mandates assigned to EIOPA to draft a set of Regulatory Technical Standards (RTS). In this context, the principles included in the new draft RTS on liquidity risk management plans (art. 144a and 144d) is a good starting point to identify triggering events (e.g. mass lapse, claims/expense inflation, and margin calls on derivative exposures) and follow-up actions.

Following the UK gilt crisis in the fall of 2022, EIOPA considered the adequacy of EU regulation in relation to IORPs' liquidity risk management in its advice for the review of the IORP II Directive[25]. EIOPA concluded in its advice that it will issue guidance to national competent authorities on the supervision of liquidity risk in relation to IORPs with material liquidity risk. A consultation paper on a draft opinion on the supervision of IORP liquidity risk management has been published in September 2024[26].

Moreover, EIOPA provided an overview of the use of derivatives by IORPs in both its June 2023 Financial Stability Report[27] and December 2023 Financial Stability Report[28].

Lastly, EIOPA will be running a Stress Test in 2025, which will be focused on a liquidity scenario.

More details on the IORPs policy related aspects are included in Questions 28 and 42.

- ***Question 5.*** *Where in the NBFI sectors do you see build-up of excessive leverage, and why? Which NBFIs could be most vulnerable? Please provide concrete examples.*

Answer: As highlighted on many occasions by the European Systemic Risk Board (ESRB) in its regular NBFI monitor[29], excessive leverage in the financial system is a key vulnerability and contributes to amplifying liquidity risks.

[25] Technical advice for the review of the IORP II Directive - EIOPA (europa.eu)

[26] Consultation on supervising the liquidity risk management of IORPs - EIOPA (europa.eu)

[27] EIOPA June 2023 Financial Stability Report (europa.eu)

[28] EIOPA December 2023 Financial Stability Report (europa.eu)

[29] ESRB (2024) NBFI Monitor. Available at: https://www.esrb.europa.eu/pub/reports/nbfi_monitor/html/index.en.html

EIOPA | Westhafen Tower, Westhafenplatz 1 | 60327 Frankfurt | Germany
Tel: +49 69-951119-20
info@eiopa.europa.eu | https://www.eiopa.europa.eu

The traditional business model of insurers based on the inverted production cycle is not characterised by an extensive use of leverage. However, it is worth distinguishing between financial and synthetic leverage and the risks therein.

While financial leverage includes financing transactions and borrowing, synthetic leverage emerges when the mechanism is applied through the use of derivatives or investments in leveraged funds (e.g. LDI funds that combine investments in fixed-income instruments with repurchase agreements and derivatives) and not through direct borrowing from counterparties. The use of derivatives, as noted in answer to Question 4, can trigger margin or collateral requests when there are adverse price movements in the underlying securities, ultimately causing an increase in liquidity demands and risks. Liquidity strains can be generated also by the need of procyclical liquidation of exposures in LDI funds.

Unlike financial leverage, for which some evidence can be derived from the insurers' balance sheets, synthetic leverage cannot be directly observed in the Solvency II regulatory reporting given the fact that derivatives are reported at market value. An enhancement of the reporting framework to facilitate supervisors' detection of synthetic leverage would be beneficial (e.g. similarly to what has been done for the mandatory Alternative Investment Fund Managers Directive (AIFMD) reporting for leveraged funds).

Considering that financial leverage is not a material source of concern for insurers[30], EIOPA is mainly focusing on synthetic leverage. In the context of the new RTS on Liquidity Risk Management Plans, EIOPA included synthetic leverage in the additional risk-based criteria to be considered for those undertakings required to provide plans for the medium to long term.

When it comes to building the adequate indicators, as pointed out in EIOPA's paper on "Other macroprudential tools and measures to enhance the current framework"[31] the concept of the leverage ratio in insurance varies much more than in banking.

The differences characterizing the insurance sector are mainly due to:

- the inverted production cycle; and
- the fact that there is not a common definition of leverage in insurance, and therefore, there is not a simple non-risk weighted ratio that can be used for the same purpose.

EIOPA has identified three different ways in which leverage in insurance could be measured[32]:

- Own funds to total assets;

[30] While the Prudent Person Principle ought to dissuade any synthetic leverage in Insurance Undertakings, it mainly has microprudential impact in the sense that it drives the investment behaviour of one insurer but cannot prevent the cumulation of risks in the sector through common behaviour

[31] Other potential macroprudential tools and measures to enhance the current framework (europa.eu)

[32] In addition to the listed stock based measures, the market also relies on some hybrid stock / flow measures such as the premiums written ratio and its net liability ratio. Net leverage is calculated as (net premiums written / (Total Assets – Technical provisions)) + (net liabilities / (Total Assets – Technical provisions)). The evidence that the main source of funding for insurers are the written premiums serves as a rationale for those indicators that estimate the ability of an insurer to sustain its business via premiums

- Insurance liabilities to own funds; and
- Non-insurance liabilities to own funds. The term 'own funds' includes not only excess of assets over liabilities.

In particular, the Own Funds to Total Assets ratio can provide a first and rough overview of the sector's loss absorption capacity to cope with potential asset-side shocks.

As a general consideration for the insurance sector, establishing a bounded leverage ratio requirement for insurers like the one used in banking raises several conceptual questions and makes it rather inappropriate for insurance. The above-mentioned indicators should rather only be considered as monitoring tool within a range of other indicators.

An additional area of improvement for the assessment of the synthetic leverage in the insurance and IORP sector is the reporting, with specific reference to asset holdings, look-through and indication of leveraged funds (e.g. LDI funds). Currently, Solvency II reporting does not allow to structurally single out leveraged funds (e.g. LDI funds) from funds of other nature potentially leading to misestimation of the exposures. More in general the lack of look-trough hamper the ability of identifying concentration in specific assets/securities stemming from the cumulation of direct investments and investments through funds.

More look through possibilities are needed for the identification of leveraged funds (e.g. LDI funds) can provide value added for the supervision of investment strategies, notwithstanding the existing regulatory framework for investment funds, the reduction of the reporting burden and the need to enhance proportionality which are clear goals for EIOPA; in general, reliance on a structured taxonomy for the identification of leveraged funds (e.g. LDI funds) can provide value added for the supervision of investment strategies. Further details on the reporting are provided in question 46.

- ***Question 26.*** *What are your views on the preparedness of NBFIs operating in the EU in meeting margin calls, and on the ways to improve preparedness, taking into account existing or recently agreed EU measures aimed at addressing this issue? Please specify the NBFI sector(s) you refer to in your answer?*

Answer: Insurance is a liability driven business where investment strategies are designed to match liabilities by a duration / return perspective. Life insurers usually operate with a negative duration gap due to the long nature of their liabilities. The general approach to manage the duration gap and minimising liability risk is to deploy investment strategies that match liabilities in terms of duration and returns. Specifically, changes in interest rates can be hedged by *i*) direct investments in fixed-income securities (primarily long-term government bonds), *ii*) synthetic exposures (through interest rate derivatives); or *iii*) investments in leveraged funds (e.g. LDI funds) that combine investments in fixed-income instruments with repurchase agreements and derivatives.

Interest rate swaps are mandatorily cleared via CCPs exposing insurers to margin calls[33]. The transition from low- to increasing interest rates generated large losses on the outstanding interest rate portfolios of insurers. These losses were realized/immediately effective in the form of variation margin calls which were covered by the sector with the liquidity at their disposal without signs of liquidity strains and / or signs of spillover to other markets. Assessments on the reaction of the insurance sector and specific sensitivity analyses have been published by EIOPA in ad-hoc publications and in its financial stability reports (see also BCBS-CPMI-IOSCO consultative report[34]).[35] Similar analyses, within the limitation of the IORPs reporting, has been conducted on the IORPS sector.[36]

EIOPA believes that the work done in the context of the Solvency II 2020 review and the related draft RTS on liquidity risk management plans (art. 144d) and the higher frequency of reporting for liquidity monitoring is considered as a helpful tool for supervisory work. In practical terms, the requirements relating to the liquidity risk management framework included in the Solvency II review will be considerably strengthened thanks to the RTS under consultation until January 2025. In particular, the liquidity risk management plan embeds the liquidity risk management governance, the establishment of risk indicators, the elaboration of stress scenarios, the identification of contingency measures, etc. The liquidity risk management framework will have to cover all sources of liquidity risks and the risks arising from the use of derivatives and margin calls are clearly identified.

Enhancements on management of the derivative exposures of IORPs is included in a specific consultation paper (refer to question 28).

- ***Question 27.*** *What are relevant risk metrics or tools that can be used to effectively monitor liquidity and margin preparedness across all NBFI entity types? Please provide examples specifying the sector you refer to.*

Answer: EIOPA runs regular liquidity monitoring exercises and included in its 2021 and 2024 Stress Test exercises a dedicated liquidity assessment perspective when testing the resilience of the European insurance industry to the proposed shocks.[37]

---

[33] So far, insurance undertakings operate through indirect clearing of their positions in CCPs. Recent evolutions in the market triggered on 30 April 2024 a call for advice, from the Commission to EIOPA on the standard formula capital requirements for direct exposures to qualifying central clearing counterparties. In preparation to the advice, EIOPA issued a specific consultation paper. EIOPA consults on the capital treatment of insurers' direct exposure to central clearing counterparties in the standard formula - EIOPA (europa.eu)

[34] See Basel Committee on Banking Supervision (BCBS),Committee on Payments and Market Infrastructures (CPMI), Board of the International Organization of Securities Commissions (IOSCO), (2024), "Consultative report on Transparency and responsiveness of initial margin in centrally cleared markets – review and policy proposals" and the accompanying press release

[35] EIOPA (2023) Impact of inflation on the insurance sector. Available at: Impact of inflation on the insurance sector (europa.eu)
EIOPA (2023) Financial Stability report – June. Available at: FINANCIAL STABILITY REPORT (europa.eu)
EIOPA (2022) Financial Stability report – December. Available at: FINANCIAL STABILITY REPORT (europa.eu)

[36] EIOPA (2023) Financial Stability report - December. Available at: FINANCIAL STABILITY REPORT (europa.eu)

[37] EIOPA (2021) 2021 Insurance stress test report. Available at: 2021 Insurance Stress Test (europa.eu)

EIOPA (2024) 2024 Insurance stress test – technical specifications. Available at: INSURANCE STRESS TEST 2024 TECHNICAL SPECIFICATIONS (europa.eu)

As part of the effort to onboard the industry in deeply understanding liquidity risks, EIOPA published in 2021 a set of methodological principles on insurance stress testing, with a dedicated focus on the liquidity component with the inclusion of specific liquidity metrics based on: liquidity stock, liquidity flow and sustainability of the liquidity position[38].

Furthermore, in the context of the Solvency II 2020 review, EIOPA delivered an RTS on Liquidity Risk Management Plans, with the aim of ensuring that insurance and reinsurance undertakings maintain adequate liquidity to settle their financial obligation towards policyholders and other counterparties when they fall due, even under stressed conditions.

In the context of the draft RTS, EIOPA took a principle-based approach, aiming for an appropriate balance between ensuring a consistent application of the liquidity risk management plan, also from cross-sectoral point of view, and acknowledging the heterogeneity of the business models and liquidity risk exposures of insurance and reinsurance undertakings and groups.

Insurance and reinsurance undertakings and groups will have to submit the liquidity risk management plan to the supervisory authorities as part of the information to be provided for supervisory purposes. This will contribute to the monitoring of the liquidity position of the undertakings and groups by supervisory authorities. Furthermore, supervisors are now granted new powers to remedy liquidity vulnerabilities in exceptional circumstances in Article 144b.

Regarding the IORPs sector, effective monitoring by IORPs and NCAs of liquidity risk entails:

- Regular stress testing / sensitivity analysis of incoming and outgoing cash flows with respect to derivative positions and other material sources of liquidity risk. This stress testing / sensitivity analysis should be based on “severe, but plausible” adverse scenarios, which can be standardised (NCAs) or pension funds’ own scenarios (IORPs). E.g. for IORPs using derivatives to hedge interest rate and foreign exchange risk: a severe market stress of rising interest rates and appreciation of foreign currencies;
- Comparing the stressed net cash outflows of IORPs with the availability of high-quality liquid assets, which means these assets should be unencumbered, of high credit quality and readily marketable;
- In this respect, commonly used and relevant liquidity risk metrics are the liquidity coverage ratio (liquid assets divided by net stressed cash outflows) and the excess liquidity metric (liquid assets minus net stressed cash outflows).

- ***[Pensions’-specific] Question 28.*** *How can current reporting by pension funds be improved to improve the supervision of liquidity risks (e.g. stemming from exposure to LDI funds, other funds or derivatives), while minimising the reporting burden? What can be done to ensure*

[38] EIOPA (2021) Methodological principles of insurance stress testing – liquidity component. Available at: Methodological principles of insurance stress testing - liquidity component

EIOPA | Westhafen Tower, Westhafenplatz 1 | 60327 Frankfurt | Germany
Tel: +49 69-951119-20
info@eiopa.europa.eu | https://www.eiopa.europa.eu

effective look-through capability and the ability to measure the impact of unexpected margin calls? Please provide examples also for other NBFI sectors.

According to the IORP II directive the use of derivatives shall be possible insofar as they contribute to a reduction in investment risks or facilitate efficient portfolio management. They must be valued on a prudent basis, taking into account the underlying asset, and included in the valuation of an IORP's assets. IORPs shall also avoid excessive risk exposure to a single counterparty and to other derivative operations.

IORPs using derivatives make up the majority of the IORP market in terms of assets, but the current reporting framework entails little information about actual notional amounts. In a survey conducted by EIOPA among NCAs, 40% of NCAs indicated not to collect derivative data from IORPs or only the market value of derivatives in the IORPs' balance sheet. Where NCAs collect relevant derivative data, like type of derivatives and notional amounts, this is often only true for direct derivative holdings and not indirect derivative holdings through investment funds. This makes it difficult for NCAs to assess the liquidity risks that IORPs are facing, as required by the IORP II Directive. However, IORPs also report in EMIR derivative transactions and this could be considered as a good starting point from where all the necessary micro and macro information can be derived.

EIOPA, provided the limitations of its mandate, is not in the position of offering an holistic overview on pensions schemes different from IORPs (e.g. Pillar I-bis and Pillar III).

The submission of line-by-line derivative information to EIOPA in the IORP reporting framework is currently voluntary. However, as from 2025, NCAs will have to report item-by-item derivative data to EIOPA in relation to IORPs' direct derivative holdings. To improve the supervision of liquidity risks stemming from indirect derivative exposures, NCAs could, as a first option, collect data on indirect derivative holdings directly from their IORPs, which are expected to already dispose of these look-through data. As a second option, derivative data could possibly be used that is already reported by investment funds to their competent authorities or to derivative trade repositories, as required by EMIR. Notwithstanding the different level of granularity of the Solvency II reporting, similar consideration should be extended to insurers offering pensions products.

In 2023 EIOPA issued an advice on the review of the IORP II Directive (September 2023)[39]. EIOPA has also issued a consultation paper on the draft opinion on the supervision of liquidity risk management of IORPs.[40]

Lastly, EIOPA will be conducting in 2025 a Stress Test exercise on liquidity, which goes hand-in-hand with the need to improve the supervision of liquidity risks.

[39] Technical advice for the review of the IORP II Directive - EIOPA

[40] Consultation on supervising the liquidity risk management of IORPs - EIOPA (europa.eu)

EIOPA | Westhafen Tower, Westhafenplatz 1 | 60327 Frankfurt | Germany
Tel: +49 69-951119-20
info@eiopa.europa.eu | https://www.eiopa.europa.eu

- ***[Pensions'-specific] Question 29.*** *What would be the benefits and costs of a regular EU-wide liquidity stress test for pension funds and with what frequency? What should be the role of EU authorities in the preparation and execution of such liquidity stress tests?*

Answer: The reference to stress testing already exists in European Regulation. EU Authorities role is defined in ESAs Regulation. Specifically, *EIOPA shall, in cooperation with the ESRB, initiate and coordinate Union-wide assessments* of the resilience of financial institutions to adverse market developments[41]

The regulation covers both the insurance and the IORP sectors and does not specify the type of risks to be covered and the frequency of the exercise.

Given the stronger emphasis on liquidity risk in the recent years, liquidity is since 2021 a key component of the Insurance stress test exercise.

For pension funds, the 2025 exercise will focus on liquidity stress test.

In terms of frequency EIOPA runs its EU-wide bottom-up (collecting data from the industry) stress test every 3 years (based on a dedicated BoS decision) whereas it conducts ad-hoc desktop sensitivity analyses (using regular reporting data). Specifically, on IORPs:

- it is also worth noting that the IORP Directive is a minimum harmonisation regime where EIOPA's role is configured in being able to provide a common framework to make results comparable across Member States.
- The benefits of the past stress test exercises run by EIOPA include the provision of insights into the vulnerabilities and exposures of the IORP sector in terms of current investments and investment behaviour – as well as into the potential effects on security mechanisms and the potential gravity of cuts to members and beneficiaries' retirement income. The findings highlight the need for supervisory monitoring and the available supervisory tools to be capable of detecting adverse market trends and market developments that can have long-term negative effects.

Based on the above, we see no added benefit of introducing additional legislation for liquidity stress testing of IORPs as it will be repetitive, causing unnecessary burden to participants.

EIOPA published a Consultation paper on the supervision of IORPs liquidity risk covering the management of all sources of material liquidity risks faced by IORPs.[42]

Regarding the frequency, EIOPA sees the 3 years frequency adopted so far for Stress Tests as a good compromise between the effort needed from the industry side and the preparatory and follow-up phases to be coordinated by EIOPA and its NCAs.

[41] Art. 21 (2) b and 32 (2) EIOPA Regulation (EU) No. 1094/2010 Available at: Regulation - 1094/2010 - EN - EUR-Lex (europa.eu)

[42] Consultation on supervising the liquidity risk management of IORPs - EIOPA (europa.eu)

EIOPA | Westhafen Tower, Westhafenplatz 1 | 60327 Frankfurt | Germany
Tel: +49 69-951119-20
info@eiopa.europa.eu | https://www.eiopa.europa.eu

- ***Question 42.*** *To what extent do you see emerging liquidity risks or market functioning issues that can affect liquidity in other markets? Can you provide concrete examples?*

Answer: As highlighted in our June 2024 Financial Stability Report[43], in response to a prolonged low interest rate environment, many life insurers sought higher yielding investments, leading to a greater allocation towards assets exhibiting higher illiquidity and more complex structures. Termed as "alternative assets" or "alternative investments," these assets lack a globally recognized definition but generally serve as alternatives to traditional investments like stocks, bonds, real estate, and mortgages. With different supervisors holding varying perspectives, alternative assets often feature intricate structures and cater to a more limited investor base, resulting in reduced liquidity.

Given that the term "alternative assets" lacks a universally accepted definition, with jurisdictions often defining them by exclusion—it usually includes assets not included in traditional listings, such as corporate bonds, sovereigns, or certain mortgages. While some jurisdictions classify equity funds or real estate as non-traditional assets, there is no uniformity across all asset classes. Consequently, specific rules or guidelines for alternative assets are lacking in most jurisdictions, although overall disclosure and management requirements for factors like illiquidity and duration management still apply. The proliferation of alternative assets among insurers has raised potential financial stability concerns, primarily stemming from lower credit quality and higher leverage inherent in such investments, which could exacerbate returns during downturns. Despite insurers typically adopting a "buy and hold" strategy, the illiquid nature of alternative assets poses challenges, especially in severe stress scenarios where insurers may seek to liquidate these holdings. This difficulty in divestment is compounded by the complexity and opacity of certain alternative instruments, such as private equity funds, as well as structured products, making effective risk management a daunting task for insurers. EIOPA expects these undertakings to manage this liquidity risk appropriately.

While hedging proved to reduce the volatility of the solvency position of insurance undertakings, amid market movements, derivative exposures might be source of liquidity strains. Interest rate swaps under Solvency II since June 2019 need to be cleared through Central Clearing Parties (CCPs). Clearing requires posting to the CCP initial margins to enter these contracts and variation margins on a daily basis in the form of cash to reflect losses in the market value of their position. These calls might be significant in case of swift and persistent trends in the interest rate markets exposing insurers, according to the materiality of their exposure and their position in the transaction.

An additional element to be considered is how insurers are accessing CCPs. Direct clearing implies being a member of the CCP providing initial and variation margins to the transactions and default fund contributions (prefunded and unfunded). Indirect clearing can be done as a client through the intermediation of a clearing member. In this case only initial and variation margins shall be provided by the insurers, whereas the default contribution lays on the member.

So far, EEA insurance and reinsurance undertakings have engaged with CCPs indirectly as clients, through the intermediation of a clearing member. Several CCPs are offering a mixed form of access for

[43] EIOPA (2024) Financial Stability Report. Available at: EIOPA June 2024 Financial Stability Report (europa.eu)

EIOPA | Westhafen Tower, Westhafenplatz 1 | 60327 Frankfurt | Germany
Tel: +49 69-951119-20
info@eiopa.europa.eu | https://www.eiopa.europa.eu

NBFIs, so-called sponsored access models, whereby NBFIs are connected directly to the CCPs but are exempted from default management obligations.[44]

In case insurers aims at clearing directly to CCPs, i.e., becoming a member, their risk profiles may change significantly as they might be exposed to additional liquidity risk as well as credit risk for counterparties that they do not transact with directly. This is a consequence of the loss mutualization of CCPs' default management processes.

Since 2018, Solvency II has included a specific treatment for indirect clearing for derivatives but not for direct clearing. As a result, direct clearing would still be treated as a bilateral exposure and therefore would result in higher capital requirements than indirect clearing. EIOPA has published in 2024 a consultation paper on the standard formula capital requirements for direct exposures to qualifying central clearing counterparties[34]., in response to the request for Advice issued by the European Commission on 30 April 2024[45] and due by 30 June 2025

At present, no EEA insurance or reinsurance undertaking has been identified as being a traditional clearing member with direct exposure to a CCP. Most insurance and reinsurance undertakings currently use clearing service providers rather than becoming direct clearing members. BIS has noted that national law often prohibits insurance undertakings from direct clearing due to restrictions on contributing to loss mutualisation mechanisms such as the CCP default fund contributions.

- ***Question 46.*** *How can leverage through certain investment strategies (e.g. when funds invest in other funds based in third countries) be better detected?*

Answer: More look through possibilities are needed also leveraging on the existing regulatory framework for investment funds and, in general, reliance on a structured taxonomy for the identification of leveraged funds (e.g. LDI funds) can provide value added for the supervision of investment strategies. Possible access to shared data hubs among supervisors could also enhance look through possibilities and would give supervisors the opportunity to make use of data received through multiples reporting systems across the financial sector more efficient (e.g. providing the possibility to dig deeper in the underlying assets), without creating an excessive burden for reporting entities. For now, the only structured information on funds' types is only derivable for EIOPA from the funds description field in the QRTs.

Typically, with the needed data at hand, supervisors could investigate further in the underlying assets behind of insurers' and IORPs investment strategy.

- ***[Insurance/Pensions'-specific] Question 49.*** *[To NCAs and EU bodies:] Are you able to timely identify (financial and synthetic) leverage pockets of other NBFIs (such as pension funds, insurance companies and so on), especially when they are taken via third parties or complex*

[44] See CPMI-IOSCO (2022), Client clearing: access and portability.

[45] REQUEST TO EIOPA FOR TECHNICAL ADVICE ON THE REVIEW OF SPECIFIC ITEMS IN THE SOLVENCY II DELEGATED REGULATION (DELEGATED REGULATION (EU) 2015/35

EIOPA | Westhafen Tower, Westhafenplatz 1 | 60327 Frankfurt | Germany
Tel: +49 69-951119-20
info@eiopa.europa.eu | https://www.eiopa.europa.eu

derivative transactions? Please elaborate on how this timely detection of leverage could be obtained?

Answer: Insurance is, in its traditional form, a liability driven business where investments are a function of the coverage / return promised to policyholders at the inception of the contract. The pure unit and index linked business represent an exception where the market risk is fully transferred to the policyholder. Nevertheless, insurers are, in their traditional portfolios, predominantly liability driven investors. European IORPs managing Defined Benefit schemes have as well strong incentives to apply LDI strategies in their investments (Defined Contribution schemes, in comparison, have less)[46].

It is worth noting that, despite the availability of data on repurchasing agreement transactions in QRT S.10.01, the exposures to leveraged funds (e.g. LDI funds) might be underestimated due to the lack of specific attributes on the leverage on leveraged funds (e.g. LDI funds). Moreover, a structural lag exists between the reported figures and the reporting timeliness due to reporting deadlines.

The identified gaps might lead to an underestimation of the exposures and of the related risks and hence, an enhancement of reporting requirements in this direction could support supervisors in their regular monitoring activities.

The same considerations can be applied to insurers' and IORPs exposures to loans and mortgages (direct and indirect), where the current reporting does not provide sufficient information (e.g., loan to value) for a thorough assessment of the underlying risks. Potential improvements on the reporting should be considered in light of the concentration/size of exposures, notwithstanding the need to assess the benefits and costs brought by the enhanced set of information.

- ***Question 54.*** *Is there a need for arrangements between NBFI supervisors and bank supervisors to ensure timely and comprehensive sharing of data for the conduct of an EU-wide financial system stress tests? Please elaborate.*

EIOPA endorses the need for an improved data sharing between authorities as one of the objectives of the Strategy on supervisory data in EU financial services. Our common goal is to reduce regulatory burden by ensuring the efficient reuse of reported data and avoid duplicative data requests to financial institutions.

EIOPA collects Solvency II and IORPs-related supervisory data from National Competent Authorities (NCA) and could also benefit from receiving, appropriately aggregated, additional data sets from other relevant sectors. However, we believe that data sharing should be aligned to the authorities' specific

[46] The general approach to liability-driven investment consists of managing and/or minimizing liability risk by generating matching assets in terms of duration and returns. Specifically, changes in interest rates can be hedged by i) direct investments in fixed-income securities (primarily long-term government bonds), ii) synthetic exposures (through interest rate derivatives); or iii) investments in leveraged funds (LDI funds) that combine investments in fixed-income instruments with repurchase agreements and derivatives. The latter were extensively used by UK pension funds. While mitigating interest rate risks, LDI strategies based on unfunded positions expose undertakings to counterparty and liquidity risks. The reduction of counterparty risks through the posting and collecting of margins, increases the liquidity risk.

Liability driven investment strategies applied by European insurers are mainly based on direct holdings of derivatives and repurchase agreements backed by government bonds. Overall, the synthetic leverage of the industry is limited. However, exposures are concentrated in the large players. Based on the available information, European IORPs have direct exposures to derivatives on their balance sheet. In addition, there can be further exposures through holdings in investment funds which make use of derivatives. Among exposures to funds, EIOPA was able to identify only a limited number of smaller entities has exposures to identified LDI funds.

mandate. It should also respect the ownership of individual and granular supervisory data as well as comply with all applicable data protection, intellectual property and professional secrecy rules.

Consistent with the goal of avoiding double reporting and overburdening financial institutions, EIOPA believes that this exchange of information should be based on the mandates of each authority and refers to cases where the respective authorities would be entitled to obtain this information directly from the financial institutions.

Focusing on the cross-sectorial stress testing, EIOPA highlights the following aspects.

EU-wide financial system stress tests and sectorial stress tests cannot be considered as substitutes, rather as complements. Sectorial stress tests have in general the objective to assess the resilience of individual entities, in the EIOPA case insurers and IORPs, against adverse developments of economy and markets and to infer potential vulnerabilities of the sectors by aggregating the impacts on each entity. Consideration on potential spillover to other sectors can be gauged by the potential reactive management actions deployed by the sectors against the prescribed shocks. The contained scope allows to tailor scenarios, shocks and approaches to the specificity of the targeted sector. System wide exercises requires more high-level specifications which are suitable for assessing macro impacts and second round effects. However, these general assumptions are not accurate enough to capture the specificities of the sectors and to assess impacts at micro level.

Operational and governance aspects of system wide exercises represent an additional challenge. The organization of such exercises requires expertise from each sector which can pose administrative and resource constraints. The governance of the processes which involves several authorities is also a challenge. Relying on existing structures, e.g., using the ESRB as the platform of cooperation, is a logical proposal as all EU supervisors are a member of the governance.

- ***Question 66.*** *What are the benefits and costs of gradually giving ESAs greater intervention powers to be triggered by systemic events, such as the possibility to introduce EU-wide trade halts or direct power to collect data from regulated entities? Please justify your answer and provide examples of powers that could be given to the ESAs during a systemic crisis.*

Systemic events are, by definition, characterised by spillover effects. Impacts can spread across sectors and across countries. While NCAs in crisis period should focused on local micro- and macro-prudential priorities, ESAs are better positioned to deal with systemic EU-wide events.

With large financial groups operating cross-border and with the increased interconnectedness of the financial sector, the ESAs can operate at EU level to consistently assess the resilience of relevant entities under adverse market/economic developments, estimate the potential impacts, and limit potential propagation / amplifications effects. ESAs are also properly positioned to ensure an effective coordination with the ESRB on the management of potential systemic events.

In the development of a crisis, time is always a key factor, and a timely assessments and reactions are necessary to limit its propagation. A consistent, effective, and more efficient data collection to support analysis and decision making at EU level under crisis situation can be achieved through the definition

EIOPA | Westhafen Tower, Westhafenplatz 1 | 60327 Frankfurt | Germany
Tel: +49 69-951119-20
info@eiopa.europa.eu | https://www.eiopa.europa.eu

of ad-hoc processes in cooperation with National Competent Authorities relying on their knowledge of the characteristics of the entities under their supervision, the available national reporting tools and channels, and the reporting data already available at the national level.

4. Documents and sources

- COM page on NBFI: Macroprudential policies for non-bank financial intermediation (NBFI) - European Commission (europa.eu)
- Link to the Public Consultation: Commission launches consultation on macroprudential policies for Non-Bank Financial Intermediation - European Commission (europa.eu)

EIOPA | Westhafen Tower, Westhafenplatz 1 | 60327 Frankfurt | Germany
Tel: +49 69-951119-20
info@eiopa.europa.eu | https://www.eiopa.europa.eu