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European Insurance Regulation in 2025: Investment Implications

We expect a transformation of the insurance regulatory landscape through 2025. Solvency UK reforms and the comprehensive review of the European Union's (EU) Solvency II regulation offer new perspectives on risk management and capital efficiency. In addition, sustainability frameworks are set to continue developing at a fast pace, requiring insurers to stay abreast of changes to reporting, fund-disclosure and transition-risk requirements. In this article, we survey some of the key developments ahead and note their investment implications.

Solvency UK and Matching Adjustments Reform

Solvency UK marks a pivotal moment for the UK insurance industry. The new UK prudential regime for insurers, necessitated by Brexit, includes restating relevant EU Solvency II rules and introducing major reforms in areas such as Matching Adjustments ("MA").

The new MA framework allows assets with highly predictable ("HP") cash flows in addition to assets with fixed cash flows. HP assets are capped at 10% of total MA assets, they require two additional matching tests and incur a minimum of 10 basis points of additional fundamental spread (FS), but their inclusion would still enhance insurers' flexibility to diversify their investment portfolio with structured products and private assets. Potentially eligible MA asset classes such as **Agency Residential Mortgage Backed Securities (RMBS), Collateralized Loan Obligations (CLO), Simple, Transparent and Standardized (STS-eligible) Asset Backed Securities (ABS),** and **private debt** would provide attractive spread and diversification benefits.

The new MA framework also removes the limit on the amount of MA that can be claimed from sub-investment grade investment. Though large sub-investment grade investments are unlikely, the removal of the existing "cliff edge" should provide more comfort for those investing in **BBB and especially BBB- assets.**

The EU's Solvency II Review

In the EU, the agreement on the Solvency II Directive review in 2024 marked an important milestone in a process that started in 2020. The European Insurance and Occupational Pensions Authority (EIOPA) technical standards and their implementation into national laws are still in progress, but it is possible to anticipate how key changes in the Directive might affect insurers' investment strategies.

Newly relaxed eligibility criteria for Long-Term Equity Investment ("LTEI") could encourage a significant increase in **private equity** and **infrastructure equity** allocations among European insurers.[1] LTEI has a capital charge of 22%, compared with 49%, with symmetric adjustments, for private equity that does not qualify. **LTEI-eligible European Long-Term Investment Funds ("ELTIFs")** and **"lower-risk" Alternative Investment Funds ("AIFs")** are appealing vehicles, as they are assigned eligibility at the fund level rather than on a more complex "look-through" basis.

In addition, the Volatility Adjustment to the risk-free interest rate term structure has been updated with new parameters that take duration matching into consideration and aim to better capture the idiosyncratic experience of the **government bonds** issued by the insurer's home country.

Sustainability Regulation and Transition Finance

The insurance industry faces challenges from evolving European and global sustainability frameworks in 2025. Most insurers will be in the process of preparing various sustainability reports amidst anticipated changes to fund disclosure rules and a heightened focus on transition finance.[2]

Sustainability Reporting. The debut of sustainability reports under new frameworks, including the International Sustainability Standards Board (ISSB) framework and the Corporate Sustainability Reporting Directive (CSRD), will provide insurers as investors with valuable insights into material risks and opportunities. However, insurers as reporting corporate entities will continue to face their own challenges due to insurance-specific discrepancies between the European Sustainability Reporting Standards (ESRS) and the ISSB standards.

Transition Finance. Regulators increasingly expect insurers to publish effective transition plans articulating a detailed strategy for achieving long-term emission reduction goals. Throughout the year, insurers should monitor the work of the United Nations-convened Forum for Insurance Transition to Net Zero (FIT), which is expected to publish guidance to assist the industry with transition planning.

Future Regulatory Changes to Monitor

Additional regulatory changes could affect the insurance industry.

The European Commission's consultation on EU securitisation rules includes a proposed reassessment of the capital treatment of **CLOs and other securitised products** under the Solvency II Standard Formula. Moves in this area could motivate insurers to invest more in securitised products for their diversification and yield advantages.

EIOPA has recommended additional capital requirements for fossil fuel assets on European insurers' balance sheets to reflect their higher risks.

Changes to the Sustainable Finance Disclosure Regulation (SFDR) are anticipated, with a potential new product categorization system to replace current Article 6, 8 and 9 requirements. The forthcoming consultation on labels for overseas funds under the UK's Sustainability Disclosure Requirements (SDR) will be a critical opportunity to harmonise EU and UK regulations.

A dual strategy to enhance insurance coverage for climate-related disasters proposed by the European Central Bank and EIOPA may be considered by the European Commission. It includes a public-private reinsurance mechanism and potentially an EU fund for reconstruction costs.

We believe the insurance industry must embrace a dynamic approach to navigating regulatory changes and seizing the related emerging opportunities in 2025. The new Solvency UK regime and the European Solvency II review present avenues for diversification into structured products and LTEI. Additionally, evolving sustainability frameworks require insurers to keep a close eye on next steps regarding transition planning, sustainability reporting and prudential requirements for fossil fuel assets.

[1] Flora Xu, "Long Term Equity: A Winner for Insurers?" (January 2025), at https://www.nb.com/en/gb/insights/insights-long-term-equity-a-winner-for-insurers.
[2] Argi Sampedro and Sarah Peasey, "Navigating 2025: The Intersection of Sustainability and Pragmatism" (January 2025), at https://www.nb.com/en/gb/insights/insights-navigating-2025-the-intersection-of-sustainability-and-pragmatism.

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