BNY | INVESTMENTS

SOLVENCY II REFORM: KEY CHANGES FOR ALLOCATORS

For Professional Clients only. In Switzerland for Qualified Investors only.

The 2025 amending directive to Solvency II — which goes live on 30 January 2027[1] — is the most significant update to European insurance regulation since the framework was established. Revisions are intended to stimulate the real economy by encouraging long-term investment, releasing an estimated €80 billion[2] in capital from European insurers as a result.

The changes include:

- Updated capital requirements for some asset classes
- Enhanced governance expectations by further embedding climate risk
- Expanded investment flexibility by simplifying requirements in certain areas
- Reduced regulatory requirements for smaller firms.

The updated guidance seeks to reflect the true economics and risks of a broader investable universe, which should help future-proof portfolios and increase the resilience of the insurance sector by broadening diversification. Asset classes that were previously uneconomic or less attractive because of their capital treatment may now become more viable for insurers.

A new regulatory landscape

Understanding what is changing and the potential benefits each change creates is the starting point for any insurer positioning its balance sheet and investment strategy ahead of January 2027. Revisions span each of the three pillars, the first of which delivers the most significant investment implications for insurers.

PILLAR I:

Capital and quantitative requirements

Risk margin

The risk margin is an additional buffer within an insurer's technical provisions designed to cover the cost of holding capital against risks that cannot be hedged, adjusted for the time value of money and the cost of holding that capital.

After January 2027, the **cost of capital** used in the risk margin calculation falls from 6% to 4.75%[3]. The reformed framework also introduces a **new lambda parameter,** the purpose of which is to reduce the weight given to very long-dated liabilities, making the risk margin less sensitive to interest-rate movements. Together, these changes are expected to lower technical provisions and release capital for many insurers, although a floor remains under discussion which may limit the benefit.

Which risks the margin covers: The risk margin is an additional buffer beyond best-estimate liabilities and covers underwriting, operational and market risks.

The insurers that will benefit most: The reforms are most relevant for insurers with very long-duration liabilities, including life insurers and writers of long-tail non-life business.

Interest-rate risk

Risk-free curve: Rather than relying primarily on extrapolation beyond 20 years, the new methodology incorporates additional long-dated market data and blends these rates with the Ultimate Forward Rate when constructing the discount curve. This is designed to better address the real risks facing insurers. As a result of using more market-based assumptions, liability values are likely to increase, but they should better reflect the behaviour of the long-term assets insurers use for hedging. This is intended to reduce asset-liability mismatches and improve the effectiveness of interest-rate hedging.

Solvency capital requirement (SCR) shocks: Under the revised framework, interest-rate stresses will be calculated using a combination of multiplicative and additive shocks, rather than relying solely on relative percentage shocks. This change is designed to better capture risk across different interest-rate environments, particularly when rates are low or negative. The revised framework also explicitly allows for negative-rate scenarios, resulting in more severe stress assumptions and potentially higher capital requirements for interest-rate risk. In practice, this is likely to increase the pressure to asset-liability match.

Volatility adjustment (VA)

The VA is designed as a counter-cyclical measure to mitigate the impact of day-to-day spread changes on an insurer's balance sheet. The original intention of the VA was to reduce the risk that short-term market volatility forces insurers to sell assets at the wrong time, which would thereby exacerbate market shocks.

The changes are intended to support that intention and better align the regulatory benefit with the actual economic exposure faced by individual insurers to avoid artificial volatility.

Application ratio: This determines the proportion of spread widening reflected in the VA, and increases from 65% to 85%[4], helping to reduce balance-sheet volatility during periods of market stress.

Credit spread sensitivity ratio (CSSR): The CSSR is introduced to mitigate the risk of compensation beyond actual investment losses from wider credit spreads. The new CSSR is designed to ensure the VA more accurately reflects genuine credit risk. It better reflects the actual holdings of the insurer and thereby reduces the risk of insurers receiving regulatory relief that exceeds the losses expected from widening credit spreads.

Removal of cliff edge: The current VA framework can produce abrupt changes in regulatory relief when certain conditions are met, creating “cliff-edge” effects in capital requirements. The revised framework replaces the country-specific component with a macroeconomic component for euro-denominated business, helping to smooth these transitions and better align capital outcomes with underlying market movements.

Symmetric adjustment mechanism (SAM)[5]

The SAM adjusts equity capital requirements according to market conditions, reducing charges after market falls and increasing them after periods of strong performance. It is designed to stop insurers being forced to act pro-cyclically when equity markets move sharply. When equities rise sharply, capital charges increase, and vice versa. The reforms allow greater flexibility in the SAM, increasing the range from +/-10% to +/-13%, helping to dampen the impact of temporary swings in equity markets on insurers’ capital requirements.

Long-term equity investments

Under Solvency II, insurers can receive more favourable capital treatment for equity holdings that they genuinely intend to own for the long term. However, the rules have been restrictive, significantly limiting the number of insurers that made use of it. The reforms remove the ring-fencing requirement, reduce the minimum holding period to five years, and replace narrow eligibility criteria with a diversification requirement. These changes should encourage greater use of long-term equity allocations.

Changes to securitised assets

Under Solvency II, securitisations are divided into four regulatory buckets, with capital requirements varying significantly between them. The framework distinguishes between ‘simple, transparent and standardised’ (STS) and non-STS securities, and then further differentiates each category by senior and non-senior tranches. In practice, the existing framework has imposed such high capital charges that only senior STS securitisations are common among standard formula insurers. The reforms reduce capital requirements across all four categories, but particularly for senior non-STS securities.

1. **Senior STS securities:** The reforms will bring capital charges for senior STS bonds closer to those applicable to equivalently rated covered bonds or corporate bonds, depending on credit quality. This will further improve the relative attractiveness for insurers.

2. **Senior non-STS securities:** The economics of senior structured credit will be fundamentally transformed for insurers from January 2027. For example, the current regulatory state requires a capital charge of 62.5% for a five-year AAA-rated collateralised loan obligation (CLO) tranche. Following the reform, the capital requirement falls to just 13.5%[6] for the same tranche.

PILLAR II:

Governance and risk management

Proportionality: The proportionality framework recognises that regulatory requirements should be proportionate to the nature, size and complexity of the risks an insurer takes. The reforms introduce a proportionality framework that allows smaller and less complex insurers to meet certain Solvency II requirements in a simpler way. This aims to reduce regulatory burden while maintaining policyholder protection.

Climate and liquidity risks: Climate and liquidity risks are more explicitly embedded as part of the reforms. Insurers are required to assess the materiality of climate risk and, where material, analyse long-term climate scenarios through own risk and solvency assessment (ORSA), while also maintaining proportionate liquidity risk management capabilities, including forward-looking liquidity planning and indicators to monitor stress.

PILLAR III:

Reporting and disclosure

Reporting taxonomy: Reporting moves to taxonomy 2.10.0, replacing 2.8.2 and aligning reporting with the revised Solvency II framework. The new regime introduces a streamlined reporting package, with some templates removed or revised, reduced requirements for smaller insurers, and more detailed reporting in targeted areas such as catastrophe risk, look-through exposures and counterparty data.

External audit: The revised framework introduces a targeted external audit requirement. By requiring the balance sheet disclosed in the Solvency and Financial Condition Report to be subject to independent assurance, the reform is intended to strengthen the reliability, credibility and consistency of publicly disclosed Solvency II information. It also supports greater supervisory and market confidence in the reported financial position of insurers.

What it means for your portfolio

Although investment-grade fixed income is expected to remain the core allocation, the range of suitable assets is likely to increase. The traditional approach had already been evolving before the Solvency II amendments, as insurers looked for more efficient ways to align asset portfolios with long-dated liabilities while managing capital constraints.

The revised framework creates broader scope to align portfolios with balance-sheet objectives. Lower capital charges on assets such as senior non-STS securitisations, together with reforms to long-term equity and fixed income investments, make a wider range of higher-yielding assets more capital-efficient for insurers.

The benefits will vary by insurer, depending on factors such as duration and type of liabilities, solvency, capital buffers and current asset mix. However, the reforms should enable portfolios to better align with long-term liabilities and capital objectives while reducing unnecessary volatility, supporting a more efficient investment strategy.

BNY works with insurers to assess how regulatory change interacts with balance-sheet structure, capital considerations and strategic asset allocation, and to translate those implications into practical portfolio decisions.

A final word

The 2027 Solvency II amendments do not rewrite the fundamentals of insurance investing, but they do change the efficiency with which insurers can position their asset portfolios. For firms prepared to reassess their balance sheets ahead of implementation, the reforms may create meaningful additional flexibility across capital, asset allocation and portfolio construction.

Endnotes

1. “Solvency II Updates: Technical Provisions & Own Funds”, Finalyse, 29 October 2025
2. “Solvency II Update Offers EU Insurers €80 Billion In Capital Relief”, S&P Global, 10 June 2024
3. “Solvency II review 2025”, Deloitte Luxembourg, 18 March 2025
4. “Solvency II review 2025”, Deloitte Luxembourg, 18 March 2025
5. “Equity Risk Stressing and the Symmetric Adjustment”, Ashurst Perkins Coie, 7 May 2026
6. “Solvency II reform broadens insurer access to global securitised”, Janus Henderson, 13 March 2026

The value of investments and the income received can fall as well as rise and investors may not get back the original amount invested.

Important information

BNY | INVESTMENTS