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Long-Term Equity: A Winner for Insurers?

Insurance companies must hold capital in proportion to their risk. While that burden eased in 2019 when the European Commission introduced the Long-Term Equity Investments (LTEI) category, reducing the capital charge on eligible investments to 22%, the stringent and sometimes ambiguous LTEI eligibility rules have dampened insurers' appetite for longer-term equity holdings.

That is, until 2024, when the EU Commission Council and Parliament finalised the Solvency II review, which relaxed LTEI eligibility criteria to try to incentivise insurers to invest longer-term equity capital and thereby drive broader economic growth. Highlights[1] include:

- Contractual ring-fencing requirements have been removed, broadening eligibility by decoupling LTEI assets from corresponding pools of insurance obligations.
- Ambiguous stress tests to ensure "no forced sale" of LTEI assets within a decade have been replaced by a commitment to retain the investments for more than five years on average.
- European Long-Term Investment Funds (ELTIFs) and "lower-risk" Alternative Investment Funds (AIFs) can be assessed at the fund level instead of looking through to the underlying assets.
- Eligible investments include listed and unlisted companies headquartered in both EEA and OECD countries.

[1] *Final Compromised Text* (January 2024) at https://data.consilium.europa.eu/doc/document/ST-5481-2024-INIT/en/pdf.

In our view, these changes could significantly broaden the adoption of LTEI among European insurers and potentially reshape their asset allocation strategies. Even with the widening of the symmetric adjustment (SA) corridor from ± 10% to ± 13%, we believe the 22% capital charge for LTEI could appear more appealing compared with other equity classifications.[2]

For example, insurers might choose to reclassify some equity investments as LTEI, thereby opening the possibility of adding private equity to their portfolios via ELTIFs and AIFs.

And considering that the 22% LTEI capital charge is similar to the requirement for holding long-term BBB bonds, we think private equity—when paired with interest rate swaps to mitigate interest rate risk (because LTEI does not provide any duration benefit)—could be a more capital-efficient solution than long-term corporate bonds.

While loosening LTEI eligibility requirements could steer insurers toward longer-term equity investments, we believe this results in a paradoxical outcome: Long-term debt—generally considered a more prudent liability-backing option—becomes relatively more capital-intensive than LTEI.

[2] Capital charges for other classifications: 39% + SA for Type 1 equity (listed EEA/OECD equities), 49% + SA for Type II equity (unlisted equities, non-EEA/OECD listed equities), 30% + SA for qualifying infrastructure, and 36% + SA for qualifying infrastructure corporates.

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