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Position Paper

Insurance Europe comments on the Green Paper on long-term financing of the European economy

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Insurance Europe welcomes the European Commission's Green Paper on long-term financing of the European economy and the opportunity to contribute to it.

Part I: Key messages of the insurance industry

Insurers' primary role is to provide protection, as well as long-term savings and pension products

- The primary role of the insurance industry is to provide protection, risk transfer and management of savings for retirement. Insurance promotes economic activity by giving policyholders risk coverage and implicit confidence to make investments or engage in business that they might otherwise deem too risky. Insurers are important suppliers of long-term savings and pension products which provide people with an income in retirement. These products are of increasing importance as state pension schemes come under strain from ageing populations.

Provision of long-term financing is not insurers' main objective, but a consequence of their primary role as providers of long-term products

- Insurers must invest the premiums they collect from policyholders to pay claims and benefits on their policies and to cover their operating and capital costs.
- While insurers can help support economic growth, policymakers should be aware of the fact that insurers' investment in long-term assets is a natural consequence of their liabilities, ie investing in assets is not an aim *per se*, but a consequence of insurers' primary role of providing protection and managing policyholders' savings.
- Insurers are the largest institutional investors in Europe (with €8.5trn assets under management at the end of 2012, up from €7.7trn at the end of 2011).

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Insurance Europe upholds that the intention and the capacity to hold assets over the long-term are the key features of any definition of long-term investment

- Insurance Europe appreciates the wide scope of the definition of long-term investing proposed in the Commission staff working document. Having the capacity to hold assets over the longer term is a key characteristic of long-term investors.
- It is important to recognise that long-term investment is not only about infrastructure, but also covers a range of other assets including, potentially, sovereign bonds, corporate bonds, equity, venture capital, property, covered bonds and securitisations.

Insurers' capacity to channel premiums towards long-term finance could be threatened by a range of framework conditions

- As the Green Paper recognises, a range of regulatory developments have the potential to affect insurers' ability to continue providing long-term funding to the economy. These concerns arise in a range of areas of policy, such as: prudential regulation, taxation, collateral requirements for derivatives, accounting rules and principles, macroeconomic policy, etc.

Regulatory initiatives should aim to create the best regulatory environment and framework conditions for market mechanisms to function correctly

- Any regulatory change and/or initiative should recognise that market mechanisms are unbeatable in allocating capital most efficiently.
- The availability of long-term investments is crucial for the insurance industry, as it is needed for matching liabilities and for enabling efficient risk management. This ultimately benefits policyholders.

Insurance Europe strongly supports the Green Paper assessment that, alongside institutional investors, well-functioning and deep capital markets and infrastructure are needed

- Stable, deep and liquid capital markets are essential for long term finance.
- Policymakers need to continue to support the development of corporate bond and equity markets across the EU.

In future, impact assessments should consider both the individual effect of regulatory developments and the cumulative impact of regulatory changes within and across sectors

- Ongoing regulatory reforms and changes should be continuously monitored and reassessed in order to address and limit any adverse impact on long-term investments.

The need to ensure financial and regulatory stability across EU member states

- Regulatory consistency and stability across member states would foster an environment in which those with capital would be more inclined to invest with a long-term perspective.

The European insurance industry greatly welcomes the EC's Green Paper on long-term financing of the European economy and will continue to support efforts to ensure that regulation and other framework conditions work as intended. Insurance Europe stands ready to continue the dialogue on these matters so that current impediments to long-term financing are removed in an appropriate way.

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Part II: Responses to specific questions raised in the consultation

Over recent years, Insurance Europe highlighted the important role that insurers play as long-term investors in the economy and has raised a number of concerns about the extent to which regulatory developments can hurt this role. Such concerns are now being echoed not only within Europe but also around the world (by the G-20 or the Group of Thirty). These concerns prompted Insurance Europe to produce — together with consultancy Oliver Wyman — a report on the role of insurers as institutional investors. Entitled "Funding the future: Insurers' role as institutional investors"[1], the report was published in June 2013.

1. ***Do you agree with the analysis above regarding the supply and characteristics of long-term financing?***

Broadly, yes.

Insurance Europe agrees that governments and corporates are key players in long-term investments. However, the ability of governments to provide long-term financing in the future is in our view limited. Public debt in the euro area increased substantially after the global banking and economic crisis. The high level of public debt represents a burden for many governments restricting their long-term policy options already significantly and, instead, making it necessary for governments to consolidate their budgets. Therefore, from our point of view, households as well as financial intermediaries gain increasing importance in long-term financing, and will increasingly take on the role of providing both the corporate and the public sector with appropriate funding.

We agree with the view stated in the Commission's staff working paper that it should be recognised that long-term investment needs to be defined by the combination of the nature of long-term investors as well as the nature of the actual investment. For example, equity investments, which play a major role in funding businesses, can be long-term or short-term. For these investments it is the nature and behaviour of the investor that make them long-term.

For markets to function effectively, to provide stability and to allow companies and governments to plan for the long-term, it is important that, in addition to investors with short-term trading horizons, there are long-term investors willing and able to buy and hold assets based on long-term prospects.

It is also important to recognise that long-term investment is not only about infrastructure, but also covers a range of other assets including, potentially, sovereign bonds, corporate bonds, equity, venture capital, property, covered bonds and securitisations. A stable regulatory framework, an appropriate supply of funding and investors with long horizons are needed for all these assets to enable long-term planning which is part of capital investment, whether in the private or public sector. In addition, it should be noted that significant infrastructure investments are also made by corporates, such as, for example, utility companies (where investments in infrastructure would be funded through raising of debt or equity). It is important that the understandable focus on ensuring that regulation (such as Solvency II) does not unnecessarily penalise direct infrastructure investment should not result in concerns about inappropriate calibration of other investments being left unaddressed (e.g. relating to corporate bonds, securitisations, covered bonds, property, etc.).

Furthermore, while we understand that the focus of the debate is naturally on long-term productive investments, it is not clear to us how a distinction between "productive" and "financial" capital could be made either in theory or in practice. In addition, we consider that the statements in the Green Paper referring to households which "generally prefer liquidity and easy redemption" and to the fact that "stability is preferred

[1] http://www.insuranceeurope.eu/uploads/Modules/Publications/funding-the-future.pdf

and risk-aversion is now widespread" are only a temporary consequence of the financial context of recent years and not necessarily a defining behaviour of households in general. Empirically, households are often ready to forego liquidity for long-term riskier assets which provide income and capital appreciation in the long-run.

2. Do you have a view on the most appropriate definition of long-term financing?

We broadly agree with the approach to defining long-term investment and investors provided in the Commission staff working paper. We have used the following similar definitions in our report "Funding the future":

- *Long-term investment* is the provision of long-dated funds that pay for capital-intensive activities that have a multiyear development and payback period. Such long-dated funds could be provided in various forms, including a very wide range of assets and asset classes. For example, they can include liquid assets with defined maturity dates (such as corporate bonds), liquid assets without a specific maturity date (such as listed equities), as well as highly illiquid assets (such as infrastructure or private equity investments).
- *Long-term investors* are investors that have the ability, the willingness and the patience to hold assets for a long period of time or until maturity. They are also able to withstand short-term volatility and continue to hold the asset through periods of low value when their analysis indicates such periods are temporary. Long-term investors whose asset profiles are meant to match their liability profiles are generally not faced with forced sales of assets, although they may still decide to sell assets for other reasons, such as to match changes in their liability profile or where their analysis indicates long-term performance is likely to deviate substantially from initial expectations.

3. Given the evolving nature of the banking sector, going forward, what role do you see for banks in the channelling of finance to long-term investments

The role of banks is different from, as well as complementary to the role of insurers. Banks have a long-standing role and experience in intermediation, which is useful and should be conserved. Banks will maintain a key role in channelling finance to long-term investments. However, as banks (re)build capital post crisis and adjust to new liquidity constraints, their ability to fund long-term investment is likely to diminish. Directly or indirectly, insurers could play an increasing role in filling this emerging funding gap.

Insurers already help fund banks' provision of long-term financing in various ways - through securitisations, covered bonds, co-funding and through their funding of bank debt and equity. It is therefore important that the framework conditions ensure that insurers are in a position to continue and potentially develop this role. In addition, where insurers increase direct financing of long-term projects, banks could become important partners by taking on parts of the credit process such as origination, structuring, intermediary services, administration or liquidation.

However, in order to avoid unintended cross-sectoral dependencies, we suggest that the Commission considers a dedicated impact assessment of the overall framework conditions in the banking and insurance area.

4. How could the role of national and multinational development banks best support the financing of long-term investment? Is there scope for greater coordination between these banks in the pursuit of EU policy goals? How could financial instruments under the EU budget better support the financing of long-term investment in sustainable growth?

Any public intervention must be balanced against market mechanisms in a way that does not distort the functioning of the markets. Generally, financing of long-term investments should remain at the level of private counterparties within existing credit markets in order to ensure an effective and efficient allocation of resources. This way a level-playing field is maintained and new credit bubbles cannot be generated as a result of a distortion of the pricing mechanisms. Where appropriate, public initiatives could provide opportunities for private sector participation in long-term investment projects such as infrastructure and other relevant projects via, for instance, public-private partnerships or initiatives such as the EIB project bonds. Any such structures should at the same time be supported by a transparent and sound monitoring, accountability and regulatory framework.

Development banks, with their key expertise and specific public objectives, can channel and catalyse private capital to kick-start funding and create liquidity for specific projects which would have significant and clear difficulties gathering finance via the capital markets directly. Such instruments and initiatives can support asset/liability management by institutional investors and can complement insurers' long-term investment portfolios. Governments may consider providing risk mitigation to long-term investment projects where it would result in a more appropriate allocation of risks. Such risk mitigation mechanisms may include credit and risk guarantees, first-loss provisions, public subsidies and the provision of bridge financing via direct loans.

However, public intervention in long-term investment projects should be optimised by identifying any market failures, carrying out appropriate cost-benefit analyses of such interventions and ensuring that any public support is appropriately priced and subject to fiscal considerations.

In this respect, Insurance Europe welcomed the Europe 2020 Project Bonds Initiative, which would enable small and medium-sized insurers in particular to invest in infrastructure assets with good maturity, performance and risk profiles. Similar projects are welcomed by the European insurance industry. However, every effort should be made to ensure that regulatory conditions do not disincentivise the investments in such assets.

5. ***Are there other public policy tools and frameworks that can support the financing of long-term investment?***

A favourable business and investment environment stemming from an appropriate regulatory framework and the effective observance of the rule of law are essential for long-term investment. Policymakers should create transparent, fair and reliable business regulation, supervision and administrative procedures.

In order to limit uncertainty and to safeguard a stable environment for long-term investments, policymakers should take into account the impact of possible changes to the regulatory frameworks on both past and future investment decisions. This implies that changes to regulatory regimes should have no retroactive effects on the existing investment portfolios of investors. This does not mean that regulatory frameworks should always have to be frozen in their current state for existing *and* future investments. Governments must be able to readjust their policy and maintain flexibility in order to take account of changing technological, social or environmental conditions. It is, however, vital to distinguish between the frameworks for future projects for which capital has not yet been committed, and the ones for existing investments, not least by considering the impact of changes to the existing investments. At this point in time, we believe it is crucial for the member states of the EU and EEA to reinforce investors' trust and confidence in the financial system. If successful, this could represent a not easily imitable competitive advantage for the region, helping it to embark on a relatively higher growth path.

Ongoing regulatory reforms and changes should be continuously monitored and reassessed in order to address and limit any adverse impact on long-term investments. Impact assessments should be carried out before the

formal proposals are presented. Impact assessments should consider both the individual effect, as well as the cumulative impact of regulatory changes and developments.

6. To what extent and how can institutional investors play a greater role in the changing landscape of long-term financing?

Insurers have traditionally played a significant role in funding the European economy.

Insurers' liability profiles enable them to take a long-term investment view, which can be achieved through a wide range of instruments, including equity investment, venture capital, property and securitisations, on top of more obvious forms such as loans, mortgages, covered, corporate, sovereign and infrastructure bonds. The exact mix of assets and their risk-return profiles is highly dependent on the type of products/liabilities that insurers write, which often differ from company to company and/or from country to country.

At the end of 2011, European insurers held:

- 21% of European corporate bonds
- 18% of European equity
- 25% of European government debt
- 11% of euro area bank debt
- At least €400bn supporting other long-term investments via: covered bonds (mortgages), infrastructure, private equity, securitisations, loans

At the same time, a number of regulatory proposals can have an impact on insurers' investment decisions and have the potential to "encourage" sub-optimal allocations to specific assets and/or asset classes.

Developing complementary pension systems throughout the EU would also contribute to enhancing the availability of long-term funding, given that pension products are (by definition) of a long-term nature and predictable, and therefore require long-term assets. To date, complementary schemes remain under-developed in many EU member states, despite the benefits of having mutually reinforcing pillars for pensions. Specifically, a multi-pillar system has the advantage of diversifying risks, since the factors that affect labour variables, and hence the first pensions pillar ("pay as you go"), are not perfectly correlated with factors that affect financial variables, ie variables which determine the performance of second and third pillar retirement systems. Developing complementary pension schemes throughout the EU was outlined as one important objective in the Commission's White Paper on pensions, which Insurance Europe welcomes.

Going forward, safeguarded by a proper framework where challenges and disincentives are addressed, pure market mechanisms will define the "natural" landscape of long-term financing.

7. How can prudential objectives and the desire to support long-term financing best be balanced in the design and implementation of the respective prudential rules for insurers, reinsurers and pension funds, such as IORPs?

Good regulation is important for a healthy industry and the move to modern, risk-based regulation is strongly supported by European insurers.

Insurance Europe believes that there is a need for a proportionate prudential regulatory framework which takes account of the risks faced by providers of occupational and personal pension schemes, but which also facilitates (or, at least, does not hurt) investment in instruments which support long-term financing of the EU economy. Ensuring a level playing field between the different providers of long-term pension products on the basis of the "same risks, same rules" principle, irrespective of the type of provider, is also an important

objective. Such an approach would contribute to guaranteeing a similar level of protection to all beneficiaries and members of pension schemes, irrespective of the type of provider.

Insurers' ability to invest in long-term assets is derived from their business model of providing policyholders with long-term savings and insurance products. In order to ensure that long-term assets remain part of insurers' investment strategies, the prudential framework must reflect the risks faced by insurers offering these products to the policyholder and not force them to hold disproportionate levels of capital.

Among the remaining issues to address in Solvency II, many stakeholders have voiced the importance of ensuring appropriate treatment of the long-term nature of the products that insurers offer. The Solvency II framework as currently envisaged may create disincentives for long-term investing from a range of perspectives[2]:

- Correct measurement of risk

It is vital for the Solvency II framework to adopt a correct measurement of risks to which insurers are exposed. More precisely, where insurers buy long-term assets in order to cover long-term and illiquid liabilities, they have the ability to hold these assets long-term or until maturity and are economically not exposed to interim price changes. As highlighted in the Commission staff working document, "investors engaged in long-term financing are generally expected to hold onto the assets for a long time and are less concerned about interim changes in asset prices, focused instead on long-term income growth and/or capital appreciation".

However, the currently envisaged Solvency II rules fail to recognise this ability and induce excessive and irrelevant (or artificial) volatility on insurers' balance-sheets, which is very expensive for insurers to cope with. In addition, the longer the investment the higher the volatility, so the greater the disincentive to invest.

Without appropriate measures, balance-sheet volatility will be artificially high, resulting in more expensive products or fewer resources to provide income to pensioners. In addition to this being bad for policyholders, it would be bad for the wider economy as the long-term nature of the business is what enables the significant role that insurers play in funding long-term economic growth, while also acting as a stabiliser during periods of market stress.

- Appropriate capital charges which do not over-state risks and over-penalise investments

The Solvency II capital regime sets capital requirements for each asset class based on hypothetical shocks to their economic value. This encourages insurers to invest only in assets that are still attractive when capital requirements are accounted for. From this perspective, the currently envisaged capital requirements for a wide range of long-term products in which insurers invest (such as public equity, real estate, private equity, infrastructure) are highly punitive.

The consequences of miscalibrations go far beyond reducing investment in long-term instruments, such as longer-dated corporate bonds or infrastructure bonds. In addition to the direct impact on long-term investments and the potential impact on growth in Europe, miscalibration restricts the investment choices for insurers which can result in lower long-term returns for policyholders and less diversification. Moreover, capital requirements should be able to capture the distinctive characteristics of various investments, such as infrastructure, which carry lower default and higher recovery rates compared to other investments in corporates and prudential rules should be able to appropriately reflect that.

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[2] Addition details and insight regarding the challenges posed by Solvency II are highlighted in the report on "Funding the future: Insurers role as institutional investors"

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Insurance Europe welcomed the European Commission letter to EIOPA of September 2012 requesting EIOPA to examine whether current economic conditions require that the regulatory capital for insurers' long-term investments under the envisaged Solvency II regime be reduced (without jeopardising the prudential nature of the regime)[3].

EIOPA's preliminary response unfortunately focused on a very limited range of assets and failed to investigate the link between appropriate design and calibration of SCR and the ongoing discussions about how best to recognise the long-term nature of the business in balance-sheet valuation. However, we understand that EIOPA is currently addressing some of these points in parallel and we look forward to further discussions.

- Avoidance of barriers which limit the channelling of investments towards SMEs

Any proposal that requires insurers to hold only bonds above a certain credit rating limits the funding provided to entities with a credit rating close to the threshold. Such credit quality restrictions will basically reduce access to funding for all but the largest companies, as SMEs are generally not eligible for high credit ratings (due to a range of constraints, such as their size). Furthermore, credit quality restrictions may result in cliff-edge effects.

If the long-term nature of the insurance business model is not properly dealt with, then insurance companies risk being forced away from long-term guarantees products which will implicitly affect their long-term investments or will mean lower pension pay-outs.

The concerns affecting the provision of long-term products apply equally to pension funds and insurance companies. Insurance Europe is convinced that once an appropriate solution is found under the Solvency II framework, a similar approach could be followed in the review of the IORP, provided the specific characteristics of IORPs are taken into account. This would avoid regulatory arbitrage between the different providers of pension products and will ensure equal protection for members and beneficiaries irrespective of the provider.

In addition, similar prudential rules should apply to both pension funds and insurers when providing similar pension products. Insurance Europe does not agree with the claims that any revision or strengthening of the capital requirements would create a disincentive to the provision of occupational pension schemes by IORPs. Such unfounded claims do not justify not developing new risk-based capital requirements for pension funds.

European insurers are also faced with increasing regulatory requirements with regards to stress tests, which are widely employed in insurers' risk management practice and also represent an important tool for supervisors when assessing the sensitivity of investment portfolios with respect to external shocks on capital markets. While we recognise that stress tests are a useful risk management as well as a supervisory tool, we also consider that an exaggeration of risk scenarios must be avoided, as it can potentially mislead policyholders, investors and supervisors in their interpretation of the risk-bearing abilities of insurers, with potentially negative consequences for the financial stability of insurers and the market as a whole. Exaggeration of risk scenarios (especially in relation to long-term risk-taking) can potentially create a short-term investment bias.

8. ***What are the barriers to create pooled investment vehicles? Could platforms be developed at the EU level?***

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[3] http://ec.europa.eu/internal_market/insurance/docs/solvency/20120926-letter-faull_en.pdf. In April 2013 EIOPA published its initial position regarding the concerns highlighted by the European Commission ("Discussion Paper on Standard Formula Design and Calibration for Certain Long-Term Investments")

The availability of assets is crucial to the significant investment role that insurers play in the economy. Insurers need access to a wide range of assets that enable them to match their liability needs and that allow for portfolio diversification. Therefore, the long-term investment funds (LTIF) initiative is greatly welcomed by the insurance industry as an instrument which could provide access to a broad range of assets pooled together in an investment vehicle. However, when defining and designing such instruments, policy makers should make every effort to assess any potential challenges that could prevent insurers (and other investors) from investing. Such challenges could arise in a range of areas such as: prudential rules limiting or disincentivising long-term investments, taxation rules, national legislation and restrictions, etc.

9. ***What other options and instruments could be considered to enhance the capacity of banks and institutional investors to channel long-term finance?***

The capacity of insurers to channel long-term finance can be enhanced by encouraging the flow of premiums which will generate the funds to be invested. More importantly, policy developments should make sure that funding needed to finance the economy is not wasted through, for example, unnecessarily high capital requirements. At the same time, the tax environment and policies should not create any impediment to long-term investment.

While we consider that all efforts should be made to address any weakness and barriers embedded in already existing frameworks and investment vehicles, as mentioned above we also believe that a long-term investment fund vehicle could potentially facilitate the raising of capital. Any such framework should allow a wide range of long-term assets and investments, able to provide long-term investors with portfolio diversification, as well as appropriate and attractive risk/return profile. As previously stated, Insurance Europe welcomes the project bonds initiative.

10. ***Are there any cumulative impacts of current and planned prudential reforms on the level and cyclicality of aggregate long-term investment and how significant are they? How could any impact be addressed?***

Insurance Europe strongly believes that the impact of specific regulatory initiatives should not be assessed on an isolated basis, but rather cumulative impact studies within and across the financial sectors should be conducted.

The OTC derivatives reform (ie EMIR) is an important example of a concern highlighted by the Green Paper, that is: "the simultaneous introduction of liquidity requirements for different financial market players" which "may discourage investments in less liquid assets and hence block several possible financing channels for long-term investment at the same time". More precisely, the rules emerging from the OTC derivatives reform seem to indicate that insurers will need to hold significant amounts of cash to cover derivative collateral needs. Insurers will therefore have to either: 1) hold suboptimal amounts of cash; 2) monetise assets in order to get cash; 3) perform forced sale of assets when cash is needed. Especially in the case of insurers writing traditional life business, with long-term illiquid liabilities, the exposure to cash is limited. While the continual flow of premiums and the low liquidity needs have traditionally enabled insurers to play a counter-cyclical role in periods of market downturn, the new OTC derivative rules risk threatening this role. In addition, regulatory developments in other fields (such as the new rules on UCITS funds[4], the financial transaction tax or the ongoing discussions in the FSB work on shadow banking) risk further amplifying the concerns by limiting the ability to monetise assets for covering collateral needs.

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[4] http://www.esma.europa.eu/system/files/2013-314.pdf

As described in our answer to Question 7 above, there are a range of concerns around the Solvency II framework which, if left unaddressed, can significantly impact insurers' investment behaviour and asset allocation, especially in relation to long-term assets. In that sense, appropriate and optional transitional provisions should be specified in order to ensure protection of the existing insurance contracts.

In future, the combined effects of different regulatory initiatives under way need to be analysed in order to ensure more joined up thinking.

11. How could capital market financing of long-term investment be improved in Europe?

Policymakers should not only promote the development of long-term savings, but also create an environment that ensures trust and stability for those willing to invest in long-term products. They should also promote an effective framework for fair competition and corporate governance.

In addition, policymakers should ensure appropriate protection of investors' rights and not just shareholders' rights.

12. How can capital market help fill the equity gap in Europe? What should change in the way market-based intermediation operates to ensure that the financing can better flow to long-term investments, better support the financing of long-term investment in economically, socially and environmentally sustainable growth and ensuring adequate protection for investor and consumers?

Capital markets complement the traditional and central role of banks as credit intermediaries and lending entities. Without deep capital markets, long-term investment in many EU countries relies on a narrow set of financial instruments and particularly banks, which are capital constrained. Taking steps to expand and encourage the range of capital market instruments across all European countries is therefore vital.

A good example of why it is important that financial intermediation evolves would be the case of infrastructure. In Europe, banks have traditionally played a major role in funding infrastructure, particularly in the riskier construction phases. There is, however, a significant reduction in the capacity of the banking sector to fund such large projects. Since infrastructure represents a major opportunity for the European economy given the numerous existing proposals for new transport, energy and communications networks, it is important to revitalise capital markets and improve their capacity to lend to the real economy in the new funding environment.

In addition, Insurance Europe concurs with the assessment that "government policies and regulations need to be as neutral as possible, with respect to private agents' choices between equity and debt financing".

13. What are the pros and cons of developing a more harmonised framework for covered bonds? What elements could compose the framework?

Investments in covered bonds vary significantly across Europe. There are a range of reasons for this; for example, in some jurisdictions this can be due to:

- lack of an appropriate legal framework for such investments or
- local investment rules restricting insurers' investments in such assets

Therefore, in order to support investments in covered bonds, initiatives which ensure that frameworks for covered bonds exist across all markets could increase the availability of such assets to interested investors.

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Extending the range of eligible assets to cover the bonds could also be useful for increasing the availability of funds for the financing of infrastructure, for example.

In principle, the harmonisation of frameworks across Europe could potentially make it easier for institutional investors to diversify portfolios by investing in various covered bond markets. However, given the significant differences that exist across regimes in Europe, the exact implementation of a harmonised regime would be very difficult to achieve. In addition, care should be taken to make sure that any regulatory changes in the covered bonds area do not create any deterioration of already established high standards in core covered bond markets. The disadvantages of potentially lower overall covered bond standards would outweigh the advantages of a harmonised framework.

14. How could the securitization market in the EU be revived in order to achieve the right balance between financial stability and the need to improve maturity transformation by the financial system?

Securitisation has acquired a bad reputation and new issuance has declined dramatically after securitisation was blamed, at least in part, for the credit crisis. This reputation is largely unjustified in the case of securitisation conducted in Europe. For example, a Fitch Ratings report (April 2012), showed that total losses for products in Fitch's ratings portfolio at end-July 2007 were 6.5% for their triple-A-rated US residential mortgage-backed securities, but only 0.8% for triple-A European, Middle Eastern and African securities.

While insurers are currently invested in a range of securitisations, the most common types are ABS and MBS. Insurers tend to invest in the least risky tranches of these pools of assets, which have the potential for additional returns without significantly increasing the riskiness of their portfolio.

Some market commentators are optimistic that the securitisation market will start to grow again. For example, the Prime Collateralised Securities (PCS) labelling scheme may help grow the market by promoting quality, transparency, simplicity and standardisation of securitisations. It is essential that European policymakers encourage the securitisation market. For example and to this end, it would be helpful if private initiatives such as the PCS label would be considered as a criteria for risk assessment and implicitly taken into account in a risk-based capital charge framework as soon as they prove effective outcomes.

We would like to highlight the fact that Solvency II represents a significant barrier to investing in securitisations and this is mainly due to what Insurance Europe regards as unnecessarily high capital requirements. For example, based on the Standard Formula, the capital required for a triple-A ABS with 6-year duration is 42%.

15. What are the merits of various models for a specific savings account available within the EU level? Could an EU model be designed?

We are generally cautious about the introduction of new savings vehicles, which would enhance complexity and could encourage short-term investment behaviours. Such an involvment in the allocation of capital should only be considered in cases of demonstrated market failure. The first priority of governments should be to address funding challenges by improving already existing channels and mechanisms, such as:

- Ensuring that banks continue to be in a position to do financial intermediation and to channel investment, with the support of capital markets / institutional investors
- Increase the flow of savings from individuals, which can be achieved through:
    - Education (increased awareness among the population of saving for old age and the promotion of financial literacy)
    - Financial inclusion policies

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- Encouraging and incentivising 2nd and 3rd pillar pensions (ie by appropriate tax incentives, collective agreements, automatic enrollment)

Specific savings accounts are intended to serve special savings objectives of the population such as retirement income or individual home ownership. Regulatory frameworks across the EU ensure that those individual objectives may be achieved by a diversity of product providers and that they do not require specific investment strategy choices by individuals. The design of the products should reflect the traditions of the EU member states and the preferences of retail investors. An artificial EU-wide model product should be avoided as it would impede product innovation, limit diversity and undermine competition.

16. What types of CIT reforms could improve investment conditions by removing distortions between debt and equity?

Insurance Europe would like to highlight that debt and equity can be both long and short-term investments. Generally, Insurance Europe believes that tax neutrality towards different forms of financing should be promoted or, at least, tax rules should not act in a way that influences investors' choice of debt or equity.

17. What considerations should be taken into account for setting the right incentives at national level for long-term saving? In particular, how should tax incentives be used to encourage long-term savings in a balanced way?

Taxation laws can encourage individuals and investors to adopt a long-term investment philosophy. Specifically, tax incentives encourage individuals to plan for retirement, locking their savings in for the long-term. For the economy, such an approach results in a flow of premiums, that insurers can invest in assets with a long-term perspective, thus helping to fund economic growth.

Insurance Europe is concerned that despite the importance of ensuring a flow of funds with a long-term perspective, and the important role appropriate tax incentives play in achieving this objective, many European governments are responding to their fiscal problems by removing these tax incentives. This short-term approach could not only restrict the availability of long-term funding for Europe's businesses, but also worsen governments' fiscal situation as it will reduce economic growth and, hence, the tax base. In addition, such an approach reduces the ability of citizens to save for their old age.

18. Which types of corporate tax incentives are beneficial? What measures could be used to deal with the risks of arbitrage when exemptions/incentives are granted for specific activities?

As there is a significant risk of misallocation of capital, any tax incentives for certain long-term investments products have to be carefully considered.

19. Would deeper tax coordination in the EU support the financing of long-term investments?

One of the most important preconditions for long-term investments is to have a stable and reliable tax framework, but also one that does not act against long-term investment. Insurance Europe is concerned that the recent European Commission proposal on an FTT could have such a consequence that is could adversely impact long-term investments.

- In particular, Insurance Europe is concerned by the very wide scope of application proposed, ie most markets, financial instruments and financial actors. This means that transactions conducted when

pursuing a long-term strategy would be as directly affected as transactions with a speculative purpose. This contradicts the Commission's objective of reducing speculation in the markets.

- In addition, a series of features of the FTT proposal would increase companies' cost of funding. For instance, the proposal to impose a tax on all transactions on bonds in the secondary markets would significantly reduce the liquidity in such markets, and as a result make it more difficult and expensive for companies and governments alike to raise money.
- Imposing the FTT to transactions in the repo/securities lending market has the potential to threat the ability of insurers to monetise their long-term assets (backing long-term liabilities) for covering short-term liquidity/cash needs. As highlighted in our response to Question 10, any limitation in insurers' ability to monetise assets will force insurers to hold sub-optimal amounts of short-term and highly liquid assets (such as cash), to the detriment of long-term ones.
- Insurance Europe is also concerned by the fact that the Commission proposal would result in significantly lower returns on the investment made by individuals in view of their pension, be it through occupational or personal pension products. Consequently, we believe that the flow of funds invested by individuals in such products would go down, which in turn would reduce the long-term funding opportunities of corporates and governments.

For these main reasons, Insurance Europe opposes the introduction of the financial transaction tax as defined by the Commission[5].

20. To what extent do you consider that the use of fair value accounting principles has led to short-termism in investor behaviour? What alternatives or other ways to compensate for such effects could be suggested?

Insurers' business models are such that the liability' profile is the main driver of insurers' investment behaviour. Insurance liabilities are to a large extent long-term and predictable, with stable cash flow profiles. Therefore, insurers are substantially able to match long-term liability profiles with investments held long-term. Because most insurance policies create predictable and long-term liabilities for insurers, they can invest in long-term and illiquid assets.

Asset/liability management (ALM) for insurers means that insurers manage assets according to the liability profile in order to meet obligations to policyholders. Because of the variety in insurance products, an insurer can have different business models and thus follow different ALM strategies. This implies that insurers should be able to apply different measurement and presentation provisions depending on the characteristics of their insurance portfolio.

Insurers typically tend to hold their investments (such as debt or equity instruments) long-term or until maturity (in the case of bonds). The selling and buying activities which insurers have to undertake have the main common objective of rebalancing the portfolio of assets backing insurance liabilities on a regular basis to ensure that the contractual cash flows from the financial assets are sufficient to settle the insurance liabilities. However, it is important to note that, in contrast to some other businesses, insurers should not be considered as traders. As insurers have low liquidity risks, their investment strategies usually stabilise the financial system.

Insurance Europe believes that the importance of accounting should not be underestimated and it creates an important source of information for investors. The necessity of appropriate reporting requirements has been acknowledged by the International Accounting Standards Board (IASB), in charge of setting the International Financial Reporting Standards (IFRS) principles. As such, the Board decided to introduce a mixed

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[5] For additional details, please see [Insurance Europe position paper regarding the introduction of the financial transaction tax]

measurement model in IFRS 9 (i.e. full fair value, amortised cost, fair value through other comprehensive income). We support this decision, which recognises the diversity of business models and reflects users'/investors' needs.

In addition, insurers acknowledge that current measurement of assets and insurance liabilities may present useful information to investors and shareholders. Presenting a balance-sheet based on current values is in fact a cornerstone of IFRS 4 "insurance contracts", as is the inclusion of most financial assets categories at fair value under IFRS 9. However, fine-tuning is needed to allow for a transparent and proper reflection of the long-term nature of the different insurance business models. As ALM is the fundamental core of an insurer's business, the challenge is to find appropriate solutions able to recognise the interaction between all assets (especially debt instruments offering stable cash flows able to match liability' cash flows) and the related insurance liabilities. In the context of the requirement of the IASB to measure insurance liabilities at current value, the current measurement of assets reflects a consistent measurement on both sides of the balance-sheet. However, it does not solve the critical issue of appropriately reflecting the presentation of current value changes in performance reporting given the nature of the various insurance business models. For insurers, the appropriate presentation of the performance in the profit and loss is critical in order to make the insurers' financial position and performance comprehensible to investors. This should reduce insurers' cost of capital and so facilitate their support of long-term investment in Europe.

As mentioned earlier, insurance companies are predominantly long-term investors and therefore it is important to reflect meaningful performance in their earnings. Depending on the nature of the insurance products/liabilities and the related assets, there is a clear need for different classification possibilities including "amortised cost", "fair value through other comprehensive income" and "fair value through profit and loss".

21. What kind of incentives could help promote better long-term shareholder engagement?

Insurance Europe believes that as long as framework conditions are not biased against long-term investments, creating unnecessary and inappropriate disincentives, there is no specific need for or benefit from creating additional incentives. Furthermore, incentives to promote shareholders' engagement would often be difficult and challenging to implement in practice. Insurers strongly believe that long-term commitment in investment strategies is key in delivering performance and beneficial to investors and the economy as a whole. Therefore, a self-commitment to exercise voting rights is preferable. In addition, the possibility of exercising voting rights in a cross-border context should be improved.

22. How can the mandates and incentives given to asset managers be developed to support long-term investment strategies and relationships?

Investment mandates and incentives should be aligned with the owner's (e.g. the policyholders') investment objectives (eg investment horizon, risk aversion, targeted sensitivity of assets portfolio, etc.) and should not artificially bias indications towards long or short-term investment horizons.

The best way to encourage long-term investment is, as indicated in other responses, to:

a) Seek ways to encourage owners to be willing to invest long-term
b) Ensure there are no unnecessary framework biases against long-term investment

Best practice guidelines helping smaller insurance companies and other investors with long-term horizons to design investment mandates and incentive schemes which ensure asset managers are aligned with their objectives could be of help. For example, appropriate use of contractual elements such as claw-back provisions, high watermarks or long-term performance measures can be used by asset owners when defining asset managers' investment mandates.

In the insurance sector, there are extensive regulatory requirements placed on investments which cover the relationship between investors and asset managers. These requirements ensure the interests of investors and asset managers are aligned. Therefore, Insurance Europe considers that further regulatory measures are not needed in the area of monitoring and regulating asset managers.

23. Is there a need to revisit the definition of fiduciary duty in the context of long-term financing?

No.

Fiduciary duty is currently defined across European jurisdictions in different ways, but with common elements regarding trust, confidence and good faith. The definition of fiduciary duty should not deviate from the objective of aligning the interests of financial managers and customers by introducing a specific focus on short-term vs. long-term fiduciary duty.

25. Is there a need to develop specific long-term benchmarks?

No.

However, we note that guaranteed products automatically create a long-term benchmark as, once a payoff promise has been made, the investment objective becomes outperformance against a guarantee rather than outperformance against current market performance. This has the benefits of allowing/requiring insurers to take a long-term view in their investment approach.

30. In addition to the analysis and potential measures set out in the Green Paper, what else could contribute to the long-term financing of the European economy?

Regulatory consistency and stability across the member states would foster an environment in which those with capital would be more inclined to invest. Member states should thus not only promote long-term investments but also create an environment that ensures trust and stability for those willing to invest in long-term financial commitments.

Insurance Europe is the European insurance and reinsurance federation. Through its 34 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe’s economic growth and development. European insurers generate premium income of more than €1 100bn, employ almost one million people and invest around €8 500bn in the economy.