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Position Paper

Insurance Europe response to European Commission Call for Evidence on Financial Conglomerates Review

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Contact person:	Ecofin department	E-mail:	ecofin@insuranceeurope.eu
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Summary

The European (re)insurance industry recognises the need to revisit the current framework for Financial Conglomerates in the current regulatory and supervisory environment. For the (re)insurance industry, financial conglomerates legislation is currently based on Insurance Groups Directive (98/78/EC) which will be repealed upon entry into force of Solvency II.

Under Solvency II, (re)insurers will comply with strict Pillar I requirements built around two capital requirements and procedures for supervisory intervention upon any breach. Pillar II introduces three lines of defence in the system of governance and requires that undertakings perform an own risk and solvency assessment to align long term capital planning with their business strategy and risk profile. Pillar III requirements are extensive including both quantitative and narrative reporting with additional reporting upon pre-defined events. EIOPA has recently proposed additional Pillar III reporting in order to monitor and assess overall financial stability of the industry.

This system applies both to solo undertakings and groups.

In general, we consider the Solvency II regime to be sufficiently risk based and as such, additional requirements at financial conglomerate level should not result in duplicate or contradictory requirements.

Draft Response to JCFC – Call for advice no.4 (to be published mid 2012)

We recommend that only one supervisor is entitled to ask the information from the head of the conglomerate and that this supervisor acts as a single point of contact for the conglomerate. There are many problems with applying multiple layers of supervision. On the supervisor's side, it is unclear who would have ultimate decision making powers and on the side of industry, it would result in duplicating tasks which are both costly and unnecessary.

We believe that financial conglomerate supervision should be limited to the interconnectedness between sectoral activities. Solvency II is designed to look at the operational activities of (re)insurance groups and compliance is assessed by the supervisor who is responsible for granting authorisation. (Re)insurance business is based on a longer term outlook in comparison to the banking sector therefore for operational activities and supervision, sectoral legislation should prevail.

Insurance Europe aisbl • rue Montoyer 51, B-1000 Brussels
Tel: +32 2 894 30 00 • Fax: +32 2 894 30 01
E-mail: info@insuranceeurope.eu
www.insuranceeurope.eu

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2011/89/EU amends Solvency II to recognise Mixed Financial Holding Companies (MFHCs) as the ultimate parent of (re)insurance groups. This brings Solvency II in line with banking sector legislation. In practice it means that the same supervisor could be recognised as the ultimate parent of both banking and insurance groups. We support this initiative however it should not be the case that an ultimate parent should repeatedly perform duplicate tasks in order to comply with sectoral and supplementary conglomerate legislation.

We propose that supervisors of a financial conglomerate be part of a college to ensure the underlying sectors of the financial conglomerate are well understood. As with the Solvency II package, appropriate dispute resolution mechanisms should be in place with the roles and responsibilities of each supervisor clearly defined.

FICOD1's Review Clause

- **Insurance Europe supports the use of waivers which would allow Solvency II requirements to be deemed equivalent for financial conglomerate supervision.**

For (re)insurance groups, the upcoming Solvency II framework will provide for extensive regulation of insurance groups. Intra-group transactions (IGTs) and risk concentrations will be continuously monitored and reported in detail to supervisors. "Significant IGTs" will trigger more frequent reporting and deeper analysis of the solvency situation of a group.

2011/89/EU foresees that if sectoral legislation sufficiently covers supervision of IGTs and risk concentrations for financial conglomerates purposes then the supervisory requirements may be carried out only once. We fully believe that this will be the case under Solvency II.

We strongly support the use of waivers as it should be possible for supervisors and undertakings to perform these tasks once, it would be inefficient for the same task to be performed multiple times. Under a system of enhanced cooperation and information sharing, supervisors will be able to maintain a sufficient level of oversight at group level.

- **We believe that under Solvency II, non-regulated entities are adequately captured.**

It is our understanding that group risks arising from non-regulated entities/regulated under different sectoral legislation should adequately captured under the Solvency II framework.

One of the first steps in Solvency II reporting is to consider all entities within the (re)insurance group. A next step is to consider, to what extent these entities contribute to group capital requirements, detailed reporting on each of these entities will follow.

Also, Article 211 of Solvency II introduces requirements for SPVs which are expanded upon in the draft Level 2 text to cover requirements on authorisation, fit and proper assessments, internal control and risk management.

It should be noted that not all undertakings within the group will have a material impact on group risks, the initial assessment will ensure that focus is placed on these undertakings. In this sense, there should be a common understanding of materiality between Solvency II and financial conglomerates legislation.

- **Supplementary supervision of systemically relevant financial conglomerates**

We are concerned by a possible confusion combining the issues of systemic risk and the financial conglomerates directive as in our view, the two issues should be kept separate. Banking and insurance have a significantly different exposure to risk due to their very different business models. The International Association of Insurance Supervisors in particular noted in its report published in November 2011, entitled

'Insurance and Financial Stability', that "there is little evidence of traditional insurance either generating or amplifying risk within the financial system or in the real economy"[1].

We would therefore urge the European Commission to deal with any systemic risk related concern at sectoral level and limit the scope of the Financial Conglomerates Directive to the issues not properly covered by sectoral legislation – which in our view is not the case for the systemic risk issue. As previously mentioned, supervision of risks resulting from other activities are already captured under the Solvency II framework.

- **Mandatory stress tests are already excessive at sectoral level.**

Solvency II is a risk based regime and in itself, acts as a stress test of (re)insurers. Within Pillar I, internal models will stochastically test various different scenarios. Within Pillar II, an undertaking's ORSA will assess reactiveness to future risks/events which may or may not materialise. EIOPA recently unveiled proposals for annual stress testing of (re)insurers which are already viewed by the industry as excessive. EIOPA and the EBA coordinate on stress testing of their respective sectors both in terms of content and timing.

It is our view that (re)insurance undertakings are already overburdened with stress testing and additional requirements at the level of financial conglomerates would be problematic.

Joint Forum Principles

- ***Supervisory powers (Joint Forum principles 1-4)***

Under Solvency II, group supervision is enforced by the group supervisor who is appointed according to pre-determined criteria. The group supervisor will act as head of the college in which other supervisors can observe or actively participate with regards to supervision of the (re)insurance group. The group supervisor will be responsible for the (re)insurance group with the ultimate parent being the single point of contact.

It is our view that there should be one point of contact for financial conglomerates, this entity may/may not be an entity regulated under sectoral legislation. Requests should be limited to matters that relate only to group supervision. The rights and duties of the group supervisor should be consistent with the rights and duties that will be granted to the group supervisor pursuant to Article 248 of the Solvency II Directive.

- ***Supervisory responsibilities (Joint Forum principles 5-9)***

We would like to refer to the group supervision framework under Solvency II which outlines the rights and responsibilities of supervisors within the college. In the draft Level 2 text this is expanded upon to cover systematic exchange of information within the college and transparency and accountability requirements for supervisors overall.

It should however be noted that Articles 64 to 71 of Solvency II outlines requirements for supervisors on professional secrecy and confidentiality arrangements, this is an important consideration when determining mandatory requirements for supervisory responsibilities. It is our view that the ability for supervisors to securely share confidential information is an essential pre-requisite for better supervisory cooperation and coordination.

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[1] "Insurance and Financial Stability", IAIS, November 2011. http://www.iaisweb.org/__temp/Insurance_and_financial_stability.pdf

- ***Governance (Joint Forum principles 10-14)***

As a preliminary comment, the term "board" is not used under Solvency II. The alternative wording "Administrative, Management and Supervisory Body (AMSB)" provides legal certainty for both one and two tier board structures which are widely used across Europe today.

Under Solvency II, it is clear that the AMSB has fiduciary responsibility over the system of governance, which comprises of four key elements (risk management; internal control; internal audit; actuarial). The system of governance essentially offers three lines of defence in addition to Pillar I capital requirements. Firstly, to ensure that risks, and work of the operational functions, are fully identified and controlled. Secondly, are questioned and challenged in terms of completeness and accuracy and finally, reviewed by the internal audit function, which has operational independence from the other three elements.

The system of governance under Solvency II also requires undertakings to perform an Own Risk and Solvency Assessment (ORSA), which aims to align long term business planning/strategy with future capital needs. Supervisors will have the opportunity to apply capital add-ons if their assessments show any gaps in the system. Requirements for the system of governance are applicable mutatis mutandis at group level and solo level.

Insurance Europe has always advocated a 'principles based approach' towards governance requirements as there are many different frameworks which groups must currently comply with, for example listing requirements, corporate governance codes, company law, etc. It would be important that financial conglomerates reform does not add undue burden and potentially conflicting provisions to this already complex area.

- ***Capital Adequacy and liquidity (Joint Forum principles 15-20)***

Solvency II has two mandatory capital requirements at group level, a Solvency Capital Requirement and an aggregation of solo MCRs. This allows for a sufficient period of supervisory intervention during which a recovery from any breech can be monitored and the capital requirement reinstated. Supervisors can impose capital add-ons based on assessments of both Pillar I and II provisions. In this sense, we do not agree with the EC's wording that capital requirements are left to the discretion of undertakings. It is important to note that the equivalent to "internal capital policy" under Solvency II is ORSA, which focuses on future planning rather than immediate regulatory capital requirements.

We see that liquidity requirements are more of an issue for the banking sector, (re)insurance activities are related to long term obligations (including cash payments) whereas for the banking sector, this relates to a shorter period of time. The eventual review on financial conglomerates should take such differences into account.

- ***Risk Management (Joint Forum principles 21-29)***

Solvency II group risks are assessed via the ORSA, group narrative reporting to the supervisor, completion of group and group specific quantitative reporting templates (dealing with capital adequacy, intra-group transactions and risk concentrations). While admittedly the primary purpose is to assess overall solvency of (re)insurance groups, we believe that any assessments deriving from the (re)insurance sector will be sufficiently robust. Requirements arising from the financial conglomerates review should not contradict the risk management framework of (re)insurance undertaking's which will be embedded in the overall system of governance.

From our understanding, Solvency II is aligned with the EC's objectives on capturing a view of the corporate governance framework for both regulated and, using EC terminology, "non-regulated entities such as SPVs".

Insurance Europe

as at 1 March 2012

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 over €1 100bn, employ nearly one million people and invest almost €7 500bn in the economy.