insurance europe

Annual Report 2012–2013

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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.

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Foreword

As we look back over the work of the last year and ahead to the challenges of the next, two words in particular spring to mind: "interlinking" and "overlap".

Each year the sections of our Annual Report become harder to compartmentalise, as the interlinking grows between all the EU and global initiatives on which we work.

Structuring our Annual Report is, of course, a minor problem, but it does reflect a far more serious concern — that individual policy initiatives and regulatory reforms can no longer be viewed in isolation in our increasingly interconnected global economy and society. Even seemingly targeted reforms can have consequences that spread far beyond their original focus.

Alongside this interplay, increasing overlap between regulatory initiatives is another trend that is creating concerns for the insurance industry, as policymakers, regulators and supervisors around the world can often seek to address issues independently and in different ways.

There are numerous examples of both interlinking and overlap in the workstreams covered in this Annual Report. The implications for insurers and their customers in terms of compliance and direct or hidden costs and effects are significant.

Let us turn first to Solvency II (see p8), Europe's planned regulatory regime, which has been so long in the making. The original objectives of Solvency II were to introduce harmonised, risk-based regulation that ensures high levels of customer protection, encourages good risk management and underpins a strong and efficient European insurance industry. Europe's insurers have supported these objectives from the outset. However, some vital issues must be resolved before we can consider the Solvency II framework ready to implement to achieve those original objectives.

As currently proposed, the calculation of hypothetical shocks to the economic value of asset classes in the Solvency II capital requirements could disincentivise investment in certain asset classes. The current proposals also ignore the very significant difference between trading bonds and holding them to maturity — as insurers generally do — to ride out market volatility. These problems with the Solvency II proposals have now been widely recognised. We therefore remain optimistic that solutions can be found that will avoid the new regulation unintentionally harming insurers' role as long-term investors, distorting financial markets and damaging the wider economy.

The investment issues arising from Solvency II are just one of the areas covered in our new study "Funding the future: insurers' role as institutional investors" (see p12), which we hope will draw attention to these and other threats to the ability of insurers to continue to provide crucial long-term funding for the economy. Also covered in the report are the potentially harmful effects on insurers and their policyholders of a proposed financial transaction tax in 11 EU member states (see p19), which we believe could encourage high-risk, high-margin transactions. Likewise, we highlight the failure of the new EU regulation (EMIR) of over-the-counter derivatives to take account of the long-term nature of insurance business and insurers' use of derivatives as an important tool in good risk management (see p13).

Turning beyond investment issues, we see interconnections and overlaps in many other areas. There is concern that the International Association of Insurance Supervisors' framework for supervising global systemically important insurers (see p24) could be so broad that it overlaps with existing or future EU prudential regulation. Likewise, the possibility of a global solvency regime under the IAIS's ComFrame proposals (see p26) would force insurers to comply with costly additional reporting and compliance beyond local systems that already provide appropriate policyholder protection.

The muddle of legislative proposals related to consumer information and insurance distribution issues is outlined on p30. Already difficult to understand in their original form, proposed amendments in the European Parliament blur the boundaries between the three elements in the European Commission's so-called "retail package" and its review of the Markets in Financial Instruments Directive (MiFID 2). In this area, too, we are increasingly concerned about the risk of inconsistent rules, as EU legislators and several international organisations all work on these issues.

It is for these reasons — and others — that, as we look ahead, we urge policymakers to consider a thorough analysis of the wider implications of their proposals before new initiatives are launched.

The European insurance industry is already operating in a difficult economic environment, with low interest rates affecting investment returns and austerity affecting consumers' purchasing choices. The latest industry figures (see p6) show that European insurers nevertheless slightly increased the gross premiums they wrote in 2012 to an estimated €1 114bn. It would be regrettable if policymakers' well intentioned initiatives were to have the unintended effect of harming the industry in such a climate.

As this Annual Report shows, the European insurance federation has had a busy and challenging first full year under its new Insurance Europe name. Since October 2012, Insurance Europe is also providing the secretariat for the newly formed Global Federation of Insurance Associations (GFIA) for its first term. Insurance Europe is therefore ideally placed to contribute not just to the European debates that affect the insurance industry but also to the global ones, and to identify and challenge the interlinking and overlaps between them.

Sergio Balbinot

President

Michaela Koller

Director General

European insurance in figures

2012 premiums recover despite the recession

Macroeconomic conditions have a direct impact on the European insurance industry. Figures from the EU statistical office, Eurostat, indicate that real gross domestic product (GDP) in the EU, after moderate growth of 1.6% in 2011, contracted by 0.3% in 2012. This primarily reflects the worsening of the sovereign-debt crisis in the first half of the year.

EU capital markets, on the other hand, recovered in the second half of the year, triggered by the decision by European leaders in June 2012 to create a single supervisory mechanism as a first step towards a banking union, and by the European Central Bank's announcement in August of purchases in secondary sovereign bond markets, which contributed to removing doubts about the integrity and viability of the euro.

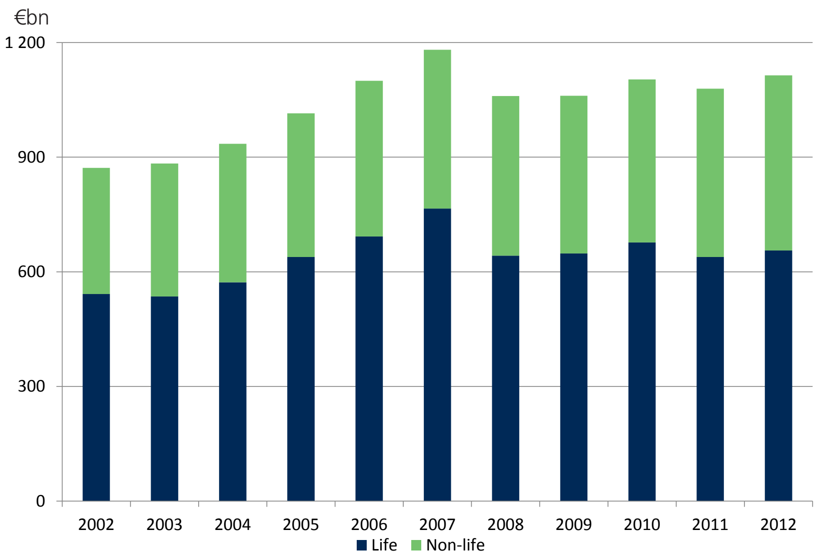
In these rather contrasting economic and financial conditions, the European insurance industry performed reasonably well, with preliminary figures for 2012 indicating a return to growth for total gross written premiums and a 9% increase in insurers' total assets under management.

Premiums up in both life and non-life

Early estimates show that after a more than 2% decline (at constant exchange rates) in 2011, total gross written premiums in Europe grew 1.6% in 2012 to €1 114bn. In life, which accounts for almost 60% of all premiums, the declining trend of 2011 was reversed, whereas in non-life a steady increase of almost 3% is estimated.

In order to strip out the effects of exchange rate changes and better reflect economic reality at the aggregate level, 2010/11 and 2011/12 growth rates have been calculated on the basis of 2012 exchange rates.

Total gross written premiums in Europe — 2002–2012 (€bn)



Note: 2012 figures are provisional

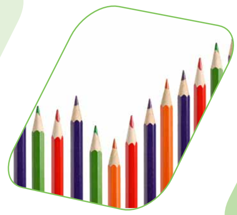
Life returns to positive growth

After a drop of around 6% in 2011, provisional data for 2012 life premiums in Europe indicate a small increase of nearly 1% (at constant exchange rates) to €656bn. The four largest markets continue to be the UK, France, Germany and Italy, which jointly account for around 70% of total life premiums in Europe. In the UK and Germany, positive growth of 10% and 0.6% respectively are expected (compared with +4% and -3.9% the previous year).

The estimated 10% growth in the UK is mainly explained by a rise in new single premium business and particularly by growth in individual pensions, whereas it is the regular business that primarily drives the moderate overall growth in Germany. In France and Italy, life premiums were down for the second consecutive year, respectively -8% and -5.5% (compared to -13% and -18% in 2011). In France, the key driver for the downward trend is still competition from other financial products. In Italy, the negative growth primarily reflects a decrease in traditional life insurance policies.

Non-life growth relatively stable

According to preliminary estimates, European non-life premiums totalled €459bn in 2012, compared to €441bn in 2011. Year-on-year, this corresponds to a rise of almost 3% (at constant exchange rates), which is very similar to the growth rate reported a year earlier. All three of the largest non-



life segments, ie motor, health, and property, reported an increase, with the strongest growth seen in property.

Within the non-life sector, motor insurance continues to be the largest business line, with 30% of the market. Provisional figures nevertheless point to a slowdown in the growth in premiums since — after an upturn of 6% in 2011 — a slight increase of nearly 2% at constant exchange rates is foreseen for 2012, to €135bn. Germany, the UK, Italy and France are the main players, representing together almost 65% of all Europe's motor premiums. Germany and France recorded growth rates of 5.4% and 3% respectively, while both the UK and Italy expect a decline of around 2%.

Health insurance remains the second largest non-life business line, with a market share of around 25% in terms of premiums. This sector is led by the Netherlands and Germany, which together account for more than two-thirds of the European market. It seems that the health sector experienced a slowdown in growth for the third consecutive year as — after increases of 5.8% and 3.2% in 2010 and 2011 — a rise of 2.5% at constant exchange rates is expected in 2012, with premiums amounting to €116bn.

Property insurance is the third largest non-life branch, accounting for nearly 20% of non-life premiums. According to early estimates, property premiums totalled €90bn in 2012. This corresponds to a rise of 4%, compared with growth of 1.6% in 2011. This acceleration is mainly driven by Germany and France which, with a market share of 19% each, report increases of 3.9% and 4.7% respectively. The UK, which accounts for about 20% of the European property market, expects premiums to have remained relatively stable in 2012.

Stock markets boost investment growth

Insurers are the largest institutional investors (see p12). Since the investment holdings of the life insurance industry account for about 80% of the total investment portfolio, insurers set their investment strategies with a long-term view, to meet long-term commitments. Logically, the value of their assets is strongly correlated to financial market conditions.

Following the recovery of capital markets in the second half of 2012, European insurers' total investment portfolio, estimated at market value, is expected to grow from almost €7 700bn in 2011 to almost €8 500bn in 2012. This corresponds to an increase of 9% at constant exchange rates, compared to +1.4% in 2011, mainly driven by expected increases of more than 10% for both France and Germany and almost 8% in the UK. Those three countries together account for about 60% of the total portfolio.

European insurance key figures and growth — 2010–2012 (€bn)

	2010	2011	2012	Nominal growth (at current exchange rates)		Nominal growth (at constant exchange rates)	
				2010/11	2011/12	2010/11	2011/12
Total gross written premiums (€bn)	1 104	1 079	1 114	-2.2%	3.2%	-2.4%	1.6%
Life	677	639	656	-5.6%	2.7%	-5.9%	0.8%
Non-life	427	441	459	3.2%	4.1%	3.0%	2.8%
Motor	124	131	135	5.7%	3.0%	5.9%	1.8%
Health	108	112	116	3.9%	3.0%	3.2%	2.5%
Property	84	86	90	2.1%	5.5%	1.6%	4.0%
Other non-life	111	111	117	0.8%	5.3%	0.7%	3.6%
Insurers' investment portolio	7 509	7 654	8 490	1.9%	10.9%	1.4%	9.0%

Note: 2012 figures are provisional

Prudential regulation

Vital decisions still to be made on Solvency II

Changes being made to Solvency II by the Omnibus II Directive will determine the success of the new EU framework for prudential supervision. The stakes are high given the important role the insurance industry plays not only for its customers but also for the growth and stability of the European economy as a whole.

The outcome of the trialogue discussions between the European Commission, Parliament and Council on the Omnibus II Directive will update the Solvency II Framework Directive, most importantly to address concerns over the way insurers' long-term liabilities and assets are treated.

From the outset, the European insurance industry has fully supported the original objectives of Solvency II. These were to introduce harmonised, risk-based regulation that ensures very high levels of customer protection, to encourage good risk management and to support a strong and efficient insurance industry.

However, there are some vital issues that must be resolved before the Solvency II framework is ready to implement and will achieve those objectives. Should the current framework be introduced without appropriate solutions, it could damage the insurance industry and have a negative effect not only on policyholders but also on the wider European economy.

Two particularly crucial issues remain. The first is to ensure that the long-term nature of the liabilities and assets held by many insurers is appropriately taken into account in the regulatory framework. The second is to finalise appropriate rules for assessing whether the regulatory frameworks of "third countries" are equivalent to Solvency II in order to accommodate groups based in the EU with operations outside and vice versa.

Finding solutions to the long-term guarantee and equivalence issues is vital if the European industry is to continue to compete internationally and remain one of Europe's success stories. Finding suitable solutions to both issues has, however, been challenging and has led to delays in finalising and implementing Solvency II.

Suggested solutions

During 2011 a package of measures to address the long-term guarantee issue was developed by a working group that was set up by the European Commission and that included Insurance Europe. During 2012 Insurance Europe worked in coordination with other insurance industry bodies to develop and test an industry version of these measures so that they would work as intended across all European markets and products, while creating the right risk measures and incentives for good product design, pricing and risk management.

The industry also highlighted to national finance ministries and others involved in the debates just how serious the potential risks to long-term investment and growth in Europe could be if Solvency II did not deal appropriately with long-term guarantees.

Testing the measures

In the absence of an agreement on the long-term guarantee element of Omnibus II in 2012, the trialogue parties decided to have the European Insurance and Occupational Pensions Authority (EIOPA) carry out an impact assessment to test how a number of variations of the package of proposed measures could address the issue.

Insurance Europe was pleased that the need for measures was recognised by the parties in the trialogues during 2012 and that the decision was taken to test measures before the Omnibus II Directive is finalised. A methodology close to the one developed by Insurance Europe was included in this impact assessment, alongside different, more restrictive versions.

EIOPA will publish the results of the impact assessment in June 2013 and they will be used as the basis for discussions on Omnibus II, with the aim of reaching agreement by the end of the year.

Preliminary feedback indicated that the assessment is likely to confirm fully that without additional measures Solvency II will not assess risks and volatility correctly and that the constraints placed on the measures included in the testing would prevent

Widespread concern over Solvency II's impact on long-term investment

The insurance industry is not alone in voicing worries over the impact of Solvency II on the long-term investment capacities of insurers. The Bank for International Settlements (BIS) was among the first to flag concerns. More recently, the Group of 30 consultative group on economic and monetary affairs highlighted the need to include counter-cyclical measures in Solvency II. The International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD) have come out with similar statements:

- "A related concern is whether life insurers and pension funds can maintain a long-term investor perspective ... [this] could alter the traditional role of life insurance companies and pension funds as global providers of long-term risk capital … could reduce the private and social benefits the sector generates through long-term investing, and the extent to which it mitigates the pro-cyclicality of the financial system."
  BIS: "Fixed income strategies of insurance companies and pension funds", July 2011

- "Care must be taken in the design and implementation of mark-to-market valuation principles and risk-based funding rules as they could incentivise pro-cyclical investment behaviour such as the fire-sale of assets in market downturns."
  OECD: "The effect of solvency regulations and accounting on long-term investing", December 2012

- "Initiatives like Solvency II for European insurance companies may push these institutions away from their traditional role of taking on longer-term risky assets, potentially dampening the positive impact of one class of "deep pocket" investors."
  IMF: "Global Financial Stability Report", September 2011

- "Furthermore, some form of countercyclical measures should be incorporated within the capital framework for insurance companies to avoid any unintended consequences that a market-consistent valuation approach might bring in times of distressed market conditions, such as worsening solvency positions triggering higher surrenders by policyholders or the forced sale of assets by insurers."
  Group of 30: "Long-term Finance and Economic Growth", February 2013

them from working as intended. The assessment is also likely to highlight that the package was not designed to cope with the current low interest rate environment and that other solutions will be needed to address this.

Preparing for Solvency II

In light of the delays to Solvency II, EIOPA published in March 2013 draft guidelines for interim measures with the aim of maintaining momentum, encouraging readiness for the new regulatory regime and achieving a harmonised approach to its introduction across jurisdictions.

The guidelines are due to be finalised by the end of 2013. Companies will be required to comply with them or to explain to supervisors why they cannot do so (the "comply or explain" approach). The aim is to introduce into local regulatory frameworks, in advance of Solvency II, some of its elements in the following areas:

- system of governance
- forward-looking assessment of the undertakings' own risks (based on ORSA — own risk and solvency assessment — principles)
- pre-application for internal models
- submission of information to national authorities (reporting)

The industry supports the introduction of high-level, principles-based guidelines on qualitative (Pillar 2) Solvency II requirements, provided they are all proportionate. It also supports interim guidelines on the pre-application of internal models that aim to ensure consistency in the approach and timing that is applied by the national supervisory authorities and in the readiness of insurers.

Because it is important not to pre-empt the outcome of the Omnibus II negotiations, Insurance Europe opposes the introduction of compulsory quantitative reporting or ORSA requirements based on Pillar 1. While the guidelines are based on the assumption that Omnibus II will be agreed at the end of 2013, decisions over what, if any, interim measures for reporting should be introduced can only be made once the outcome of Omnibus II is known. Ultimately, these guidelines will depend not only on when Omnibus II is finalised but also on what is decided and the timetable for implementation.

In all these interim measures, it is essential that regulators bear in mind the need to avoid unnecessary costs for insurers and their policyholders.

Issues remain for Level 2

Once Omnibus II is finalised, the focus will shift to the finalisation of the Level 2 implementing measures that flesh out the Solvency II Framework Directive.

Here, too, there is a number of important issues still to be fixed in areas such as: the calibration of capital requirements; the recognition of the benefits of risk diversification for groups; the extent to which future premiums from existing contracts can be taken into account; the exact features of financial debt instruments that can be used to cover capital requirements; and the way that Solvency II currently incentivises poor risk management, such as currency risk (as was explained in a briefing note published by Insurance Europe in March 2013).

The cost of implementing and complying with Solvency II is an area that also needs to be addressed. Solvency II needs to be workable for all; large companies need workable processes for receiving regulatory approval for the internal models that they will use for their calculations and smaller ones need the requirements placed on them to be proportionate.

The Level 2 measures and the Level 3 supervisory guidelines will need to strike the right balance between a regulation that is risk-sensitive enough but that is not unnecessarily detailed, complex or costly.

Reporting requirements …

There are two main Solvency II reporting requirements (Pillar 3): the Solvency and Financial Condition Report (SFCR) and the Regular Supervisory Report (RSR). The SFCR is a public disclosure, while the RSR, which expands on the SFCR, is a confidential report addressed to the supervisor. Some quantitative information required for both is to be reported quarterly and annually in quantitative reporting templates (QRTs).

EIOPA launched two public consultations on the proposed Solvency II reporting and disclosure requirements in November and December 2011 to which Insurance Europe provided significant and detailed feedback. The final report published by EIOPA in July 2012 contained substantial improvements on the original proposals, although important issues still remain.

The proposals require extensive qualitative and quantitative reporting, which overall remain extremely burdensome or costly for Europe's insurers. In particular, it is not known how the requirements will be tailored to make them proportionate to the complexity and risks of companies.

For example, given the stability of parts of insurers' balance sheets, some simplifications and approximations should be allowed in the quarterly reporting. Feedback suggests that EIOPA will further develop simplifications and Insurance Europe will assess such proposals when available.

The commercial sensitivity of items for public disclosure should also be considered and data reporting should not give rise to ambiguity. On the latter point, Insurance Europe welcomes the fact that disclosure, in a fixed format, of the group's risk concentration and the comparison of the Solvency II balance sheet with statutory accounting is no longer envisaged.

There remains a number of issues to do with the asset reporting

requirements, in particular the "look-through requirement" under which insurers would need to report details of every individual asset within all funds managed on their behalf by third parties. This requirement is problematic given that there can be multiple levels of third parties, for example in funds of funds arrangements. Achieving full look-through reporting would result in very significant additional costs and difficulties in meeting the reporting deadlines.

The QRT package requires the use of a development-year period of 15 years for reporting claims information for non-life (re)insurance, which means collecting information on a Solvency II basis before the new regime has in fact entered into force. 15 years is also excessive for short-tail business. On this point, few improvements were made.

EIOPA has not yet finalised its Level 3 guidelines on the two reports and the QRTs. Changes are still expected following finalisation of Omnibus II and the Level 2 implementing measures.

… and more reporting requirements

In 2011 the European Central Bank (ECB) announced its intention to adopt an ECB Regulation to enhance its statistics on insurance corporations. According to the ECB, such enhanced statistics would help it better to achieve its objectives in terms of financial stability, monetary policy and macroeconomic analysis.

The establishment of the European Systemic Risk Board (ESRB) in 2010, for which the ECB acts as secretariat and which is responsible for the macro-prudential oversight of the financial system, is one element explaining the ECB's desire to enhance its statistics in the field of insurance.

Following the ECB's announcement, Insurance Europe engaged in a dialogue with the ECB with two main objectives: ensuring that the ECB's new reporting requirements take sufficient account of the insurance business model; and avoiding as far as possible new requirements being imposed on top of what will be imposed by Solvency II. Achieving these two objectives should in turn mean that complying with the ECB's new statistical requirements would not result in excessive costs or an undue administrative burden on the industry.

On the first objective, Insurance Europe expressed the concern that some of the ECB's envisaged new statistical requirements may be based on the false premise that it is possible for the insurance sector to produce statistics that mirror precisely what is done in banking. This is, however, often not possible given the significant differences that exist between the two sectors.

One example here is timeliness and frequency of reporting: in insurance, certain items (such as technical provisions) involve actuarial estimates that take time to calculate and therefore cannot be reported within a very short period of time. Also, these estimates are unlikely to change significantly from one quarter to the next, meaning that such frequent reporting would not make sense. Reporting these items to the same deadlines and with the same frequency as in banking is therefore nearly impossible and is also not desirable.

A similar example is the breakdown of technical reserves by maturity and type of counterparty, which would be difficult and cumbersome to obtain.

Reporting duplication must be avoided

Insurance Europe highlighted the importance of avoiding overlaps with Solvency II. It welcomed the ECB's intention to use Solvency II wherever possible for its own reporting requirements and thus to avoid double reporting as far as possible. Ensuring a single reporting process for firms is also important. Europe's insurance industry is convinced that, given the detailed information that will be required under Solvency II, meeting most, if not all, of the objectives of the ECB on the basis of these reporting requirements should be possible.

In the coming months, the ECB intends to continue its work, leading to the possible adoption of an ECB Regulation on insurance corporations as early as 2014. As an immediate first step, the ECB will conduct a cost assessment, through which it will seek to get more clarity on the costs resulting from the new reporting requirements. This step is part of the "cost and merit" procedure followed by the ECB.

Investment issues

Insurers' role as long-term investors and the post-crisis regulatory agenda

Investments underpin the insurance business model. Over the last year, Insurance Europe has 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 help or hurt this role. It now sees those concerns echoed not only within Europe but also around the world (see box on p13).

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", the report was published in June 2013. In addition to explaining what drives and shapes insurers' investment decisions, the report also points to the significant interaction that exists between investment-related matters and other regulatory developments, such as Solvency II, tax changes and efforts to tackle systemic risk.

Insurers are a vital source of funding

The primary role of insurers is, of course, to provide risk protection and long-term saving and pension products. Nevertheless, as there can be many years between an insurer receiving premiums and paying related claims, investment returns are also a core component of insurance products. As the Insurance Europe report shows, insurance companies are the largest institutional investors in Europe with €7 700bn of assets under management, or more than half of all European assets (see chart) in 2011 and an estimated €8 500bn of assets in 2012 (see p6).

Banks, which are not considered institutional investors, have lending assets of around €46trn. However, new banking rules will force them to reduce their risks associated with maturity and liquidity transformation. Together with the amount needed to stimulate economic growth in Europe, this means an estimated funding gap of at least €4–5trn between now and 2016.

A significant portion of insurers' investments are long-term, to match the long-term maturity of liabilities. Insurers are therefore a vital source of the long-term funding the European economy desperately needs.

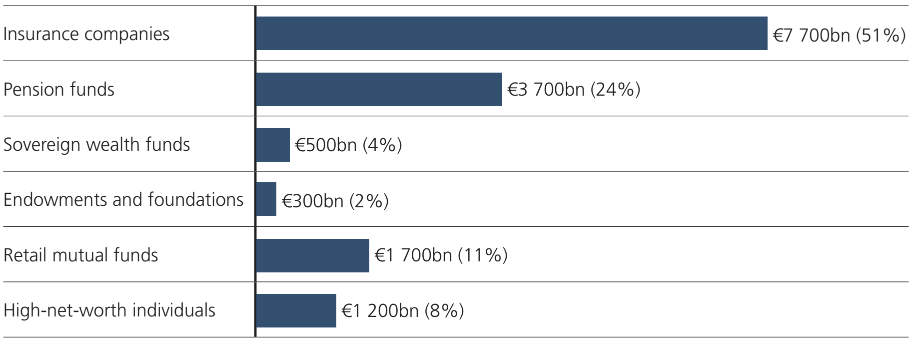
The investment capabilities of insurers have an additional characteristic that is particularly valuable in today's volatile markets. Because policyholders continue to pay premiums even in periods of market downturn, many insurers can remain a reliable source of liquidity and can buy assets when all other players in the market are selling. Insurers can therefore have a stabilising, counter-cyclical effect on the economy.

Real threats exist, however, to the ability of insurers to continue to provide this crucial long-term funding and stabilising role. Regulatory initiatives reinforced by the financial crisis — including changes in prudential regulation, accounting rules and tax law — could significantly affect insurers' investment behaviour by disincentivising investment in certain assets.

The new report sets out some of the policies that could inadvertently threaten insurers' long-term investments, such as aspects of the Solvency II regulatory regime's capital requirements (see p8), the proposed financial transaction tax (p19) and the reform of over-the-counter derivative trading (p13).

Insurance Europe hopes its report will help to increase understanding of how insurers invest and will make a useful contribution to addressing existing challenges and shaping future policies.

European assets under management — 31 December 2011



Source: "Funding the future: insurers' role as institutional investors", Insurance Europe and Oliver Wyman, June 2013

A European and global focus on long-term finance

Insurance Europe engaged in discussions with the European Commission in the preparation phase of the Green Paper that the EC issued in March 2013 on the long-term financing of the European economy. The purpose of the Green Paper is to initiate a broad debate about how to foster the supply of long-term financing and how to improve and diversify the system of financial intermediation for long-term investment.

Insurance Europe was pleased to see that the Paper has a wide scope, covering a range of factors that have the potential to affect both insurers' asset-allocation decisions and the flow of premiums to the insurance industry, which enables insurers to invest with a long-term perspective. In addition, Insurance Europe has encouraged the EC to assess whether framework conditions created by existing regulations and those under development are biased against long-term investment.

The Green Paper identifies insurers as suitable providers of long-term financing. It also recognises that institutional investors with long-term liabilities could fill the funding gap emerging from new banking rules "as long as the regulatory framework avoids an excessive focus on short-term volatility".

Globally, the importance of long-term investments and growth was acknowledged by the G-20 during the Mexican presidency of 2012, and long-term investments were defined as one of the priorities of the Russian presidency in 2013. In March 2013 Insurance Europe was part of a Global Federation of Insurance Associations delegation (see p60) that met the Russian G-20 presidency to highlight the significant role of the insurance sector in this area.

Insurance Europe has also been engaged in a project launched by the Organisation for Economic Co-operation and Development in February 2012, entitled "Institutional Investors and Long Term Investment", which aims to address market and regulatory challenges and to facilitate long-term investment. During the project workshops, Insurance Europe highlighted regulatory developments that have the potential to disincentivise the industry from investing in long-maturity and high-illiquidity products, such as infrastructure, or in small and medium-sized enterprises.

The post-crisis regulatory agenda

Meanwhile, the problems in financial markets have prompted policymakers within Europe and around the world to focus their attention on tightening and increasing the regulation of financial activities. In the last year, two of the most important of these initiatives have reached a near-final or a final stage: reform of the market for over-the-counter (OTC) derivatives and reform of the regulation of credit rating agencies in the EU.

Derivative reform and insurers' investment decisions

Derivatives are often a key part of insurers' risk management strategies, especially for long-term business where derivatives are used to hedge risk exposures by matching the profile of liabilities or securing a pay-off promise made to policyholders. Any additional costs incurred in derivative operations — such as those created by the OTC reforms outlined below — would thus translate into an extra cost in hedging risks and could discourage the provision of a range of insurance products for which derivatives are vital.

Back in 2009, the G-20 initiated a derivatives reform programme aimed at increasing the transparency, integrity and oversight of the market. The programme included compulsory central clearing of all standard derivatives, higher capital requirements for derivatives that would remain bilateral, and compulsory reporting of all derivatives to trade repositories. In 2011 the G-20 added margin requirements on non-centrally cleared derivatives to the programme and called on the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) to develop consistent global standards. At the same time, the G-20 mandated the Financial Stability Board to assess progress in implementing the reform and any unintended consequences for the provision of long-term finance.

The European initiative in response to the G-20 commitment was the European Market Infrastructure Regulation (EMIR) of August 2012. The Regulation is fleshed out by regulatory and implementing technical standards, a number of which entered into force in March 2013. Further technical standards for non-centrally cleared derivatives are still to be drafted by the European supervisory authorities, which are awaiting the final global standards from the BCBS and IOSCO to ensure there is consistency between the global and EU standards.

While EMIR recognises that pensions "typically minimise their allocation to cash in order to maximise the efficiency and the return for their policyholders", it fails to recognise that the same principle is also fully applicable to the long-term business of insurers. The insurance business model and the long-term illiquid profile of insurers' liabilities enable them to take a long-term view in their strategic asset allocation and hence to have a limited exposure to cash. At the same time, current practice indicates that central counterparties (CCPs) will only accept cash as collateral and there is no indication that they will expand the acceptable collateral to other highly liquid assets, as allowed by EMIR.

European insurers risk being forced either to hold unnecessary amounts of cash (to the detriment of long-term investments), to perform forced asset sales when cash is needed or to monetise assets via the repo market. The last two possibilities encourage pro-cyclicality and threaten the significant counter-cyclical role of insurers in periods of market stress. The ability to monetise assets to cover cash needs may be further challenged by proposed shadow-banking regulations (see p25), where the introduction of controls and limits on the use of cash generated via repos is foreseen.

Insurance Europe raised its concerns related to the emerging outcome of the OTC derivatives reform in its responses to the various consultations and made policymakers and regulatory authorites aware of the significant consequences for insurers' cash needs and liquidity positions.

As recognised by the EC's Green Paper on investment (see box on p13), the need for liquidity "may discourage investments in less liquid assets and hence block channels for long-term investment". While, traditionally, the continual flow of premiums and low liquidity needs enabled insurers to play a significant stabilising role in times of market stress, the emerging derivatives requirements seem to threaten this role. Insurance Europe considers it important that the rules recognise the true risks and do not prevent insurers from playing their traditional counter-cyclical role in times of market stress. At the same time, the aggregate effect of regulatory developments needs to be assessed and any unintended consequences prevented.

Challenges to implementing rating agency reform

In its November 2011 proposal for a Regulation on credit rating agencies, the EC sought to amend the existing EU rules to increase transparency and competition in the rating industry, as well as to reduce over-reliance on ratings by financial market participants.

Throughout the development of this legislation, Insurance Europe highlighted the main concerns of the insurance sector, which related principally to the requirement that companies rotate their use of rating agencies and to the rules proposed to reduce the reliance on agency ratings. Insurance Europe welcomed the agreement reached between the European Parliament, Council and Commission in November 2012 on the proposed revised Regulation, which addressed the main insurance industry concerns on these two issues.

Specifically, Insurance Europe welcomed the decision to apply the mandatory rotation principle to a limited range of financial instruments (ie structured finance products with underlying re-securitised assets), as well as the explicit mention that the mechanistic reliance on ratings should be reduced, while taking account of specific sectoral regulation. This is particularly important in insurance, where Solvency II allows insurance firms to make use of external ratings for prudential purposes in certain circumstances.

Nevertheless, the final provisions of the new Regulation regarding overreliance on external ratings remain quite general,

Insurers need access to a variety of assets

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.

An initiative on project bonds, which was launched by the European Commission and the European Investment Bank (EIB) in 2012, aims to foster investment in transport, energy and information technology infrastructure projects. At a meeting with the EIB in November 2012, Insurance Europe welcomed the initiative, which would enable small and medium-sized insurers in particular to invest in infrastructure assets with good maturity, performance and risk profiles. Nevertheless, Insurance Europe highlighted that the currently envisaged treatment of these assets under Solvency II would limit the ability of insurers to invest (see p8). The first issuance of project bonds is expected in the second half of 2013.

Alongside project bonds, securitisations can provide suitable and attractive investment profiles that satisfy the asset allocation objectives of insurers. Insurance Europe thus also welcomed a prime collateralised securities (PCS) initiative and a PCS label, an independent initiative designed to enhance and promote quality, transparency, simplicity and standardisation and to improve the depth and liquidity of the securitisation market. Insurance Europe is an observing member of the PCS initiative, alongside bodies such as the European Central Bank and the EIB. The PCS label will act as a recommendation and is intended to help the securitisation market regain its attractiveness to investors. This again could be affected by the disincentivising regulatory treatment that Insurance Europe has raised as a concern in the Solvency II discussions.

leaving room for interpretation by national authorities. For instance, it is not clear whether insurance companies will have to do their own internal risk assessment of all the securities in their portfolio, which would be impossible in practice given the significant capital and human resources required. It will therefore be of vital importance that the implementation of the Regulation is conducted carefully, with a strong focus on ensuring coherence with insurance regulatory developments and on avoiding unmanageable requirements regarding in-house models for the assessment of risk.

Balance required in bank recovery and resolution

Another regulatory initiative of relevance to insurers is the draft Directive on bank recovery and resolution published by the EC in June 2012. This aims to harmonise the way credit institutions and investment firms in financial distress are managed or wound-down.

Of particular interest to insurers as investors in debt instruments issued by such institutions is the proposed introduction of a "bail-in" mechanism that would see a bank's creditors participating in any recovery or resolution process. The proposal aims to minimise the losses to the wider public, in particular to taxpayers, from a failing bank and to avoid contagion in cases where a bank gets into difficulty. While insurers recognise the importance of avoiding the use of taxpayer money for resolving banks, it is important for the rules to be sufficiently clear and balanced so that incentives are maintained for insurers and others to invest in banks.

Against this background, Insurance Europe has argued that the proposed bail-in mechanism should be seen as a resolution and not a recovery tool. It has highlighted concerns over the substantial degree of discretion that would be granted to supervisors in determining when to exercise the trigger for bail-in instruments. Such discretion might enable the quick and smooth resolution of a bank but it would also create a risk that authorities would exercise the trigger before the point of non-viability is reached. The exercise of the bail-in mechanism should therefore be limited to instances where it is clearly evident to supervisors that a credit institution is beyond recovery.

Discussions are well advanced on the recovery and resolution proposal and there could be agreement by the end of 2013.

Ensuring adequate retirement saving

Insurers have a key role to play

Pensions are a cornerstone of the European economy. Europe's future competitiveness, standard of living and ability to evolve and grow depend in great part on its capacity to build up effective, affordable and sustainable pension systems, as these represent a significant portion of the public finances in all EU member states.

Achieving this objective will necessitate overcoming significant difficulties. One is demographic challenges, since Europeans are getting older. By 2060 the life expectancy at birth is projected to have increased by 7.9 years for men and by 6.5 years for women, compared to 2010 (according to the European Commission White Paper on Pensions, February 2012).

While scientific and medical developments should be celebrated for increasing longevity, an ageing population presents a major challenge to governments, industries and individuals. Not only are people living longer, but there is also a decline in fertility. The combination of longer life expectancy and lower birth rates is expected to have a significant impact on the dependency ratio — the ratio of people of working age to those aged over 65 — which is expected to move from 4:1 currently to 2:1 by 2060 (according to the EC Green Paper on Pensions, July 2010).

The current financial and economic crisis is also creating new difficulties, such as higher unemployment, which has an impact on the ability of governments to meet their pension commitments, and a low interest rate environment, which reduces the revenues provided by funded pension schemes.

These difficulties mean that innovative solutions need to be designed to ensure that all pension systems are able to deliver their pension promises and that these remain appropriate. Insurers are major providers of pension products and so have an important role to play.

Pensions adequacy and sustainability

The debate on pensions has two key questions at its core: how to maintain the adequacy of pension revenues and how to guarantee the sustainability of pension schemes.

Adequacy means ensuring that future retirees receive payments that are adequate for their needs. Currently there is an increasing concern that this will not be the case. This is especially true given that pensions are the main source of income for retirees and that public schemes — the main source of pension revenue in most EU member states — are under increasing pressure as a result of the different pension challenges.

Sustainability means ensuring that pension systems are sustainable in the long-term. Lower payroll tax revenues in a period of high unemployment, changing demographics and rising fiscal deficits in many economies are testing the sustainability of pay-as-you-go public pension schemes.

Achieving both objectives will require a progressive reorientation of national systems of retirement provision to take account of Europe's economic and demographic reality. The reforms undertaken in a number of member states — such as increasing the retirement age or linking minimum retirement age to developments in life expectancy — have to a certain degree avoided the projected increase in pension expenditure. However, this is likely to be insufficient, given the scale of the challenges ahead.

In addition, the ever closer integration of Europe's national economies means that the difficulties in one member state can spill over to other countries. For this reason, pensions — traditionally a national prerogative — are increasingly becoming a common EU concern, to which European responses are being developed.

Multi-pillar pension systems are best

Pension systems are traditionally organised in three pillars: pay-as-you-go; complementary; and private. No pillar on its own can respond to the challenges of the coming decades. For example, funded pension schemes can mitigate the risks of a lower dependency ratio, while unfunded schemes can mitigate the risks of a low interest rate environment, but no system can respond to every challenge.

A multi-pillar system has the advantage of diversifying risks,

Supplementary retirement systems

Insurance Europe strongly supports a more important role for supplementary pension systems in all EU states. Measures in the following areas are needed to develop these systems and their role:

- Appropriate prudential frameworks need to be in place to ensure that the providers of supplementary savings meet their promises, particularly on defined benefit contracts. The rules should be such that there is a level regulatory playing field for the different types of providers of complementary pensions (eg, insurance companies and pension funds).
- Pensioners and future pensioners should be provided with appropriate information about their future pensions entitlements so that they can make informed decisions and to raise awareness of the importance of saving for the future, especially among the younger generation.
- People should have access to occupational pension schemes, either organised by an employer/social partner or individually.
- Appropriate tax incentives to promote long-term savings are required.

since the factors that affect labour variables — and hence the first pillar — are not perfectly correlated with factors that affect financial variables, which determine the performance of second- and third-pillar retirement systems. Insurance Europe therefore welcomes the Commission's call to develop supplementary retirement savings, which remain under-developed in many EU member states. Another advantage of a multi-pillar system is that it makes it possible to distinguish between the goals of poverty reduction (typically the objective of the first pillar) and income replacement (better achieved through the second and third pillars).

Furthermore, pension reforms aimed at improving the sustainability of pension provision can result in lower future benefits for a given retirement age. In order to achieve replacement rates similar to those currently enjoyed by Europe's pensioners, individuals should have the opportunity to build supplementary entitlements through supplementary retirement savings.

An important role for insurers

The insurance sector is active in the provision of funded pensions in all three pillars, although the market share of the sector in the different pillars varies significantly between countries.

Insurers can offer more than just investment management. With long-standing actuarial experience, life insurers are well placed to provide protection against the risks that individuals face when planning their retirement, such as:

- longevity risk, by providing annuities
- the risk of premature death, by providing death cover
- inflation risk, by providing index-linked savings products
- interest rate risk, by providing minimum interest rate guarantees
- health care needs, by providing long-term care products

Given that insurers must shortly comply with the comprehensive solvency requirements of the new Solvency II regulatory regime (see p8) and are subject to strict supervision and regulation, they offer high levels of protection for future retirees.

Focus on employees' rights

Insurance companies are, like pension funds, important providers of occupational pensions. Both insurers and institutions for occupational retirement provision (IORPs) engage in long-term guarantees and concomitant long-term investments. Guaranteeing the application of the "same risk, same rules" principle should be one of the objectives of the European Commission's current review of the IORP Directive.

An important remaining issue in the new Solvency II regulatory regime is appropriate recognition and treatment of the long-term nature of some products offered by insurers, such as group insurance or individual pension schemes. One key aspect is to ensure that the ability of insurers to hold assets for the long term is appropriately recognised in the measurement of their exposure to market risk.

By holding bonds to maturity, the insurer is economically not exposed to asset-price volatility (generated by daily spread movements). At the same time, capital needed to protect against defaults is far lower than capital needs meant to protect against spread movements. Thus, a correct and appropriate measurement of the true risk (default versus credit spread risk) would prevent insurers from having to hold excessive amounts of capital.

Provided there are solutions in Solvency II to these issues, a similar approach could be followed in the IORP Directive, taking into account the specific characteristics of pension funds.

Insurance Europe is convinced that implementing an appropriately calibrated risk-based approach for insurance companies and IORPs alike would not lead to an undue burden or to a collapse of occupational pensions; rather the opposite. Such an approach would ensure transparency and security in pension provision, and would therefore benefit policyholders. Safeguarding employees´ rights to a secure retirement income should be the main objective of EU policymakers in Solvency II and the review of the IORP Directive.

Transparency is key

Providing high-quality information to future pensioners is of vital importance for a number of reasons.

First, transparency can contribute to a standard, high level of protection, irrespective of the provider. Specifically, any differences in providers or products should be made apparent in a clear and understandable way to the beneficiaries.

Providing high-quality information is also important to ensure that future retirees make informed decisions about their retirement plans. In order to achieve this objective, the information should be provided periodically and in a consistent way so that individuals can check whether they can meet their goals. This information should be aggregated to allow them to make these decisions with the full picture in mind, and without the need to add up the different schemes of which they have been members during their working life. Otherwise, some information might be overlooked or — due to differences in statements — be too complex for individuals to combine.

Some EU states have developed sophisticated tracking systems to inform citizens about their expected retirement income. Insurance Europe strongly believes that all states should be encouraged to develop these systems, which would enable individuals to have access to information on their entitlements and would help them take the right decisions about their future retirement plans.

Questions over Portability Directive scope

The transferability of occupational pensions is also under discussion. Given the broad diversity of pension systems across Europe, such transferability is difficult to achieve. Insurance Europe therefore welcomes the fact that the transferability of occupational pension rights is no longer one of the objectives of the EC's amended proposal for the so-called Portability Directive.

Rather than pursuing the objective of transferability, the priority should be the comparability between the different systems and providers, and the transparency of the financial situation of a provider. Without this, it is impossible for individuals to compare and make informed decisions about joining or changing pension schemes.

Insurance Europe is disappointed that the conditions relating to the acquisition and the preservation of pension rights have been retained in the proposal for a Portability Directive. It believes that these are most effectively dealt with by member states rather than at EU level, because increasing the possibility for worker mobility should not inadvertently undermine the development of pension systems in member states. Care should be taken to safeguard the development of occupational and supplementary pension provisions in member states, thus enhancing the social protection of citizens. Insurance Europe believes that any EU activity should complement actions at national level and should recognise the different approaches to pensions.

Taxation

Proposals have significant implications for insurers

The last year has seen Insurance Europe involved in a number of taxation issues with significant implications for the insurance sector. First and foremost, the discussions over a financial transaction tax (FTT) were revived, albeit this time for just 11 EU member states. In its present form, the FTT would have a huge impact on Europe's insurance firms and their customers.

Furthermore, Insurance Europe remains concerned about the lack of progress on a number of VAT-related questions, which should be addressed at European level as a matter of priority.

Moving to the other side of the Atlantic, now that the talks on the US Foreign Account Tax Compliance Act (FATCA) have come to an end, the focus for European countries will be on adopting bilateral agreements with the US, while for Europe's insurers the priority will be to comply with the new rules. Insurance Europe is also concerned about the proposed reintroduction of the affiliated reinsurance tax in the US, which could impose extra costs on European (re)insurers.

FTT would increase insurance costs

In February 2013 the EC presented a new proposal for a financial transaction tax (FTT) in 11 EU states. The new proposal is based on its original text of September 2011, which failed to secure unanimous support among EU members. As proposed, the FTT would be levied on nearly all transactions in financial instruments between financial institutions when at least one party is located in a participating EU state (residence principle) or when institutions are trading in financial instruments issued in participating states (issuance principle). The EC proposal covers (re)insurance undertakings, but it excludes the conclusion of insurance contracts. The Directive would enter into force on 1 January 2014.

Since it covers almost all transactions in most types of financial instruments, the proposed FTT would impose a significant cost on insurers and, ultimately, their policyholders through higher prices for products and services or lower returns on investment, thus reducing consumers' ability to buy the protection they need or to save adequately for their old age. The same conclusion was reached by the International Monetary Fund in its June 2010 report, "A fair and substantial contribution by the financial sector". Such effects would be particularly unwelcome in an environment of already low interest rates and low yields on the government and corporate bonds in which insurers invest substantially.

Furthermore, the real impact of the proposal would be much higher than the headline tax rate of 0.1%, given that the chain that lies behind most securities transactions usually involves various stages of trading and settling, including by market makers, brokers and clearing members, and that each stage would be subject to the FTT. This represents a very significant hidden cost increase for policyholders.

Insurance Europe is also concerned that by driving up the cost of all transactions equally, regardless of the underlying risks, the FTT would not meet the Commission's objective of limiting undesirable behaviour and contributing to the stabilisation of markets. The effect could actually be the opposite, as the FTT would render low-margin transactions unprofitable, which could encourage high-risk, high-margin transactions, thereby increasing risk in the markets. Also, by penalising the use of derivative instruments, which in insurance are mainly used only for hedging, the FTT would actually put at risk efficient asset management and investment strategies (see box on p20). In any event, it is Insurance Europe's firm view that specific undesirable behaviour made apparent by the financial crisis should be prevented not through taxation, but rather by appropriate regulation and supervision of all market participants.

The "enhanced cooperation" under which the Commission is proposing an FTT for 11 states allows a minimum of nine states to establish advanced integration or cooperation. Introducing an FTT in a limited number of EU countries would actually disrupt rather than enhance the EU internal market, since it would lead to a competitive advantage for jurisdictions not subject to the FTT. Also, financial institutions in a non-participating state would be liable to pay the tax on all their transactions with institutions in a participating state, which could discourage them from entering into transactions with the FTT-zone.

The general assumption underlying the FTT that the financial sector is under-taxed is also incorrect, particularly where insurance is concerned. The insurance industry makes a significant contribution to national budgets, most notably through premium taxes, but also through corporate taxes. Premium taxes are a consumption tax on insurance services that are VAT exempt. They clearly differentiate insurance from banking, where a comparable tax burden does not exist. Furthermore, European insurers bear the significant cost of irrevocable input VAT (see VAT section below).

The proposed FTT would result in a reduction of the taxable base. Certain activities that generate tax revenues, ie repo transactions, would be significantly reduced, as the tax would be higher than the average fee for a repurchase agreement. The loss of fee income on such activities would also, of course, result in the loss of corporate tax revenues on that income.

For all these reasons, Insurance Europe would encourage a thorough revision of the proposed Directive. One priority should be to not discourage EU citizens from saving for their retirement. This could be achieved by excluding retirement and other long-term insurance savings products from the Directive. Likewise, the FTT proposal must avoid multiple taxation of a single transaction. This could be achieved by exempting transactions with intermediaries.

Finally, the FTT should not be applied from 1 January 2014. Insurers have no existing systems for identifying and collecting the new tax, as other transaction taxes such as UK stamp duty and France's FTT have a narrower tax base and are paid via brokers and intermediaries. New reporting systems would have to be designed and developed and insurance companies would need to be given sufficient time to adapt.

Positive developments on FATCA

Insurance Europe has been engaged since the start in discussions on the development of a US Foreign Account Tax Compliance Act (FATCA), due to concerns over the onerous requirements it places on European insurers and the conflicts between those requirements and EU data protection rules.

The main aim of FATCA is to increase the ability of the US tax authorities to combat tax evasion by US persons with offshore accounts. The Act is due to come into force in January 2014, with European insurers required to file the information required for the first time in March 2015. European insurers would be obliged to enter into a legal agreement with the US Internal Revenue Service (IRS) and to report certain information on US customers holding life insurance and annuity contracts. Insurance Europe explained on numerous occasions to both the US authorities and the EC: that the FATCA requirements would surpass EU data protection legislation; that an insurer cannot change or cancel a long-term contract to compel the policyholder to assist it in complying with the new requirements of a foreign law; and that there is no legislative mechanism that allows European insurers to withhold 30% tax from policyholders, as required by FATCA.

FTT would affect insurers' risk management

In its financial transaction tax proposal (see main text), the European Commission suggests a tax of 0.01% on derivative transactions, calculated on the notional value underlying the contract. This would increase costs and threaten the liquidity of the derivatives market. As derivatives are an important tool in insurance companies' efficient asset and risk management, this would create additional costs for the industry.

As long-term investors, insurers cover their long-term liabilities by investing in long-term assets with the appropriate risk, return, maturity and liquidity characteristics. However, often the assets required to fully cover the liability exposure are not available and insurers therefore replicate these exposures by entering into derivative contracts, such as swaps.

Insurance Europe believes that the treatment of derivative instruments in the FTT proposal needs to be significantly amended in order to guarantee that insurers can continue to use such instruments for hedging and risk management purposes.

These hurdles led five EU countries — France, Germany, Italy, Spain and the UK — to reach agreement in July 2012 with the US on an alternative way to comply with FATCA. This Model Intergovernmental Agreement (IGA) is based on government-to-government information-sharing. Europe's insurance industry welcomed the Model IGA, which removes the barriers to compliance with FATCA by eliminating the requirement for financial institutions in a FATCA partner country to enter into a legal agreement with the IRS, as well as eliminating the requirement to withhold or to terminate the account of a recalcitrant account holder.

Insurance Europe is also pleased that the Model IGA substantially reduces the administrative burden. This is achieved through provisions such as the permission to use local anti-money laundering rules and the exclusion from FATCA's reporting obligations of pre-existing life insurance and annuity contracts with cash values of $250 000 or less and of entities and products that have a low risk of tax evasion.

The US Treasury issued the final FATCA Regulations in February 2013. In parallel, agreements based on the Model IGA are being negotiated between the US and all other EU states.

Rather than have the US unilaterally develop a reporting system for the FATCA Regulations and IGAs, the Organisation for Economic Co-operation and Development (OECD) set up a working group on FATCA reporting in which Insurance Europe participated in 2012 and 2013. Insurance Europe's main focus has been to ensure that the FATCA reporting requirements do not go beyond the existing reporting systems of European insurers. Insurance Europe welcomed the final version of the reporting system presented by the IRS in February 2013, since it requires insurers to report only data already captured by their existing systems and halves the amount of reporting compared to the first version in September 2012.

Debate on VAT stalled

The current EU VAT Directive exempts insurance services from value added tax. Although this may be perceived at first sight as providing fiscal advantages, this is far from being the case. In particular, because of the exemption, the industry cannot deduct the input VAT and, as a result, VAT neutrality is not ensured in the same way as for other sectors.

This is why the EC launched a proposal in 2007, widely supported by insurers, to address the issue of non-deductible VAT. The initiative comprised three measures: redefinition of the scope of exempt services; allowing banks and insurers to tax their services; and cost-sharing arrangements. Insurance Europe has closely followed developments, to ensure that the exemption covers the key functions of an insurance contract.

EU Council discussions have stalled under the Danish, Cypriot and Irish Presidencies of 2012 and 2013, seemingly due to opposition by some member states to any modification of the VAT exemption on financial and insurance services. Insurance Europe nevertheless believes that a change in legislation is needed to define clearly which insurance and financial services are exempt from VAT. Insurers urge the Council to resume the work started in 2007 to provide legal certainty.

Opposing affiliated reinsurance tax

Following the inclusion of a proposal on affiliated reinsurance tax in US President Obama's 2014 budget, Insurance Europe, in a coalition of 28 associations, consumer groups and companies, wrote to members of the US Senate and House of Representatives setting out, once again, opposition to such a proposal, which is similar to 2011 bills and legislation in Obama's 2013 budget proposal.

The objective is to close a supposed tax loophole, but the proposal would deny a tax deduction, on US reinsurance ceded by non-US companies to offshore affiliates, that is available to US insurers. It would therefore represent a punitive and discriminatory tax on foreign insurers in the US.

The proposal would have a negative effect on US consumers, as it would lead to reduced capacity and higher premiums, especially for natural catastrophe cover. Furthermore, the proposals would violate World Trade Organization commitments by the US. The proposal could become law in 2014, either as a revenue-raising amendment to a tax or spending bill or as part of corporate tax reform.

Financial reporting

Technical discussions with potentially far-reaching effects

Insurance Europe supports insurance accounting principles that create meaningful information in financial reports, reflecting the insurance business model. Principles that do not achieve this could have a significant impact on the industry due to their effect on the behaviour of users of financial statements, be they investors, supervisors or customers.

The past year has seen many regulatory developments related to accounting and audit from the International Accounting Standards Boards (IASB), the European Commission and the International Association of Insurance Supervisors (IAIS). The developments are prompted by an increasing recognition of the need for appropriate accounting measures for long-term investments, which are an integral part of insurance business.

In addition to responding to numerous consultations, Insurance Europe deepened its interactions with the three institutions, as well as with the European Financial Reporting Advisory Group (EFRAG), which provides technical advice to the Commission.

General developments

Insurance Europe's focus remains on the proposed international financial reporting standards (IFRS) for financial instruments (IFRS 9) and for insurance contracts (IFRS 4 Phase II). A key issue is the need for fuller recognition and acceptance by the IASB of the inherent link between assets and liabilities. Insurance Europe is pleased that the IASB has put the most significant amendments to both standards to another round of public consultation, which will be spread throughout 2013.

During 2012 it became apparent that efforts to reach convergence between US Generally Accepted Accounting Principles (US GAAP) and the two IFRS standards were not making progress. Although Insurance Europe recognises the advantages of convergence, it has always stressed that achieving an appropriate outcome is most important. With convergence now less of a priority, it is expected that the IASB will be able to conclude its deliberations in 2014 on the much needed replacement of IFRS 4.

IFRS 4: towards the finish line

Insurance Europe has been advocating important changes to IFRS 4 ever since the IASB published its first draft in 2010, including the introduction of mechanisms that would make it easier to compare the performance of insurance companies. These include: using other comprehensive income (OCI) to address short-term market impacts; changes to the discount rate to make it more principles-based; retrospective transition provisions with the use of practical expedients; unlocking of the residual margin; and a mirroring approach for participating contracts. In addition, Insurance Europe welcomed the three-year implementation period.

While there has been substantial progress towards adequately reflecting the insurance business model, the current tentative decisions for IFRS 4 Phase II do not yet achieve this. A number of critical areas require further development. The IASB consultation on the enhanced IFRS 4 Phase II proposals is due in June 2013 and is expected to focus on the five most important decisions, such as the mandatory OCI measurement category and the presentation and disclosure model.

IFRS 9: classification and measurement

In December 2012 the IASB published its IFRS 9 proposals to amend the accounting requirements for financial instruments, including a welcome recognition of the need to reduce mismatches between how insurers manage their business and how they report their financial performance. Particularly significant is the proposed ability to report on the short-term performance of simple debt security assets in the "fair value through other comprehensive income" (FVOCI) category. This third classification category was needed due to interaction with IFRS 4, which contains a requirement to present in OCI changes in the insurance contract liability arising from changes in the discount rate. Insurance Europe requested this change because otherwise the resulting accounting mismatches would create meaningless performance reporting.

Nevertheless, the proposals stop short of achieving a workable solution that captures the insurance business models, as Insurance Europe noted in its comments on the proposals in March 2013. This is because insurers often have long-term asset/liability management strategies, and may hold assets other than bonds, such as derivatives, equities and investment

IFRS 9 and 4: understanding the link between assets and liabilities

Most insurers manage a portfolio of assets based on their liabilities, which means that reporting rules on the asset side can have an impact on liabilities and vice versa. It is essential that the International Accounting Standards Board (IASB) recognises this link. To have a clear view of the appropriate principles for IFRS 4 and 9 (see main text), the proposals for both have to be assessed together and the focus must be on ensuring that changes in insurance liabilities and the associated backing assets are presented together, either in the income statement or in the OCI (other comprehensive income), otherwise performance reporting does not provide useful information.

A clear example is the proposed introduction in both IFRS 9 and 4 of the FVOCI (fair value through other comprehensive income) measurement category, which is intended to avoid accounting mismatches. The FVOCI concept is strongly supported by the industry but the way it is implemented in each standard can create problems. For example, FVOCI in IFRS 4 is currently proposed to be mandatory, which means all volatility relating to interest rates movements would pass through OCI. However, in IFRS 9 the current proposals would not allow derivatives, investment property or equities to be included in OCI. Although insurers often buy derivatives to reduce or eliminate interest risk, excluding derivatives from OCI in IFRS 9 while forcing the use of OCI for liabilities in IFRS 4 would lead to volatility appearing in the accounts which does not exist in reality. The industry is calling for the scope to be widened in IFRS 9 to allow other assets to be included and/or for the application of FVOCI in IFRS 4 not to be mandatory.

property, to back their liabilities. In these cases, management/reporting mismatches would still occur.

IFRS 9: impairment

The impairment proposals sparked by the financial crisis would require companies to take a forward-looking provisioning approach to identify expected credit losses on a more timely basis, whereas the current principles are based on recording these losses on an incurred basis. The proposals have, however, been delayed mainly due to efforts to reach a solution that is convergent with US GAAP. Insurance Europe supports the general IASB approach but will raise concerns that certain aspects create undue operational complexity.

Concern over EU reforms

Elsewhere, the EC's 2011 proposals for a new Regulation and a revised Directive on auditing raise concerns. They could lead to the mandatory rotation of audit firms, which would be time-consuming and costly, as well as prohibiting auditors from providing non-audit services. Insurance Europe has been engaged in this debate and strongly advocates that mandatory rotation of the key audit partner is a suitable alternative to mandatory rotation between firms. It also welcomed a number of changes, including the removal of the need to use pure audit companies (whose personnel often do not have expertise in non-audit services) and for joint audits. These requirements would have led to higher costs and a loss of auditors' acquired knowledge, which is particularly important for large insurers with complex internal structures.

The trialogue discussions between the European Parliament, Council and Commission on the legislation are expected to commence in mid-2013. Although the proposals for rotation of the audit firm are still in place, Insurance Europe is pleased to see that the Parliament has taken a step in the right direction by extending the period after which auditors have to be changed from the original 6-12 years to 25.

Insurance Europe also engaged in the EU reform that replaces the 4th and 7th Accounting Directives with a new Directive covering annual financial statements, consolidated financial statements and related reports of certain types of undertakings. A preliminary agreement was reached at April 2013 trialogue discussions. Insurance Europe was pleased that improvements included the re-introduction of options for EU states, such as in the use of fair-value accounting.

Systemic risk

Increased recognition of the differing risks posed by insurers and banks

The global insurance supervisory community, represented by the International Association of Insurance Supervisors (IAIS), has continued to work over the last 12 months on systemic risk in insurance, thereby contributing to the G-20 objective that no financial institution would be "too big to fail" and thus that taxpayers do not bear the costs of the resolution of any institution that does fail.

The IAIS's goal is to put forward a list of insurance entities regarded as systemically risky and to develop policy measures for them. Its work thus mirrors what was done in banking, where 29 "global systemically important banks" were identified at the end of 2011 and made subject to specific measures.

Fundamental differences between banks and insurers

Insurance Europe has over the past year been very active in this area, arguing that supervisors should develop an approach that meets the specificities of insurance. This means, in particular, refraining from excessively mirroring what was developed for banking in response to the financial crisis. Not only would the banking approach fail to meet the objective of enhanced financial stability — as it would not target the sources of systemic risk in insurance — but it would also be costly for policyholders, as it would probably result in higher premiums and fewer products.

Insurance Europe is pleased to observe seemingly increasing recognition beyond the insurance community of the fundamental differences between the potential systemic risks in banking and insurance. While the banking business model, with a high degree of interconnectedness and a maturity mismatch between assets and liabilities, is intrinsically systemically risky — since the failure of an institution can take place nearly instantly and spread to other firms — this is not the case in insurance. Insurers' assets and liabilities are typically matched and generally long-term, which avoids the risk of a run and makes interconnectedness very low, as firms do not rely on each other for short-term liquidity funding. This explains why certain characteristics that are an indicator of systemic risk in banking (such as the size of the entity) are not relevant in insurance. Likewise, in insurance only certain activities, under specific conditions, can generate systemic risk. The growing recognition of these differences is probably what has led to the IAIS being given more time to develop a framework that is not just a copy of the banking approach. Insurance Europe welcomes this decision.

Methodology must focus on activities

Over the past year, the IAIS has consulted on a methodology to identify global systemically important insurers (G-SIIs) and subsequently on possible policy measures for them.

Insurance Europe generally welcomed the IAIS's intention (made apparent in the two consultation documents and at meetings with the private sector) to focus on "non-traditional" and "non-insurance" activities. This is a step in the right direction, but the concern remains that the list of activities may still include activities that do not raise systemic risk concerns. This would mean that the framework would be so broad that it would overlap with existing prudential regulation. It would also lead to the identification of the wrong companies, ie companies engaged in traditional activities with no systemic risk implication. Also, it would mean that the policy measures would not be a targeted response to systemic risk concerns. Finally, a too lengthy list of activities would probably also result in insurers ceasing legitimate business activities and investments to avoid being determined systemically risky.

Insurance Europe has urged the IAIS to come up with an even

International framework as a local benchmark

The work of the International Association of Insurance Supervisors on systemic risk is primarily relevant to global players that may be designated as global systemically important insurers (G-SIIs). This does not mean, however, that others will not be affected. Rather, national or regional regulators may decide to use the international framework as a benchmark for designating entities perceived as presenting a risk locally. Likewise, the international measures could eventually be applied to locally designated companies. Getting the international framework right is therefore crucial for a wide range of European companies.

Shadow banking and systemic risk

In parallel to the work on systemic risk, initiatives are also being taken, notably by the Financial Stability Board (FSB), on "shadow banking". Insurance Europe maintains that insurers' lending activities are not shadow banking. It believes, however, that the FSB work could usefully contribute to the identification of activities that have the potential to raise systemic risk concerns. More specifically, Insurance Europe largely concurs with the FSB's recent assessment that maturity and liquidity transformation are characteristics of activities with the potential to generate systemic risk. Nevertheless, given the potential overlap between various global initiatives, it is important for the FSB to undertake an holistic review of them all to ensure that the measures developed to address concerns in one area do not overlap with measures in another, to avoid unnecessary duplication of regulation across both financial sectors and activities.

clearer focus on potentially systemically risky activities and to follow an approach consisting of the following steps:

- Firstly, activities that have the potential to generate systemic risk should be identified, based on their characteristics (such as maturity and liquidity transformation or the use of leverage). They should then be examined to determine whether they are undertaken by the insurer on a scale that is systemically relevant.
- Secondly, supervisors should assess whether an insurance group involved in such activities can adequately deal with the risks through its internal risk management frameworks, capital position and internal control processes.
- Finally, if necessary, measures should be envisaged. These should be applied in a graduated manner and be proportionate to the potential to generate systemic risk.

Tailor policy measures to insurance

Policy measures are a key component of the IAIS framework but it is vital to refrain from just applying banking solutions, which are unlikely to work in insurance and may have detrimental consequences. Specifically, Insurance Europe has urged the IAIS to envisage the separation of certain activities or a capital surcharge only as a last resort.

The separation of certain activities, if applied unduly, would make their operational management complex and costly and would introduce serious constraints on group capital management by limiting the fungibility of group capital and eliminating the benefits of diversification. It is also not clear that this would decrease the risks, as it would create a number of connected entities with no access to group resources to absorb shocks.

The envisaged capital surcharge (or HLA — higher loss absorbency) raises a number of fundamental concerns. For instance, it would introduce a distortion of competition between entities subject to an HLA and other entities that are engaged in the same activity but are not on the list of systemically important insurers. Also, imposing excessive capital requirements would affect the insurance industry (through lower returns), policyholders (through price increases resulting from companies' higher funding costs) and the economy as a whole, as insurers would have a more limited capacity to make long-term investments in the economy.

Insurance Europe welcomes the IAIS's intention to refrain from imposing a group-wide HLA, and to envisage it instead for very targeted activities. Nevertheless, even targeted HLA may overlap with similar national supervisory and regulatory tools. Targeted HLA should therefore be for those systemically important activities for which no similar national tools exist and should be directly linked to the potential to generate systemic risk.

The policy measures should be introduced gradually, allowing companies time to adapt to the new framework. The timetable proposed by the IAIS, under which measures would be introduced between one and five years after the adoption of the new rules, would to a large extent address this concern.

Insurance Europe welcomes the efforts of the IAIS to develop a framework that is a real response to concerns over perceived systemic risk in insurance. It believes, however, that further work is needed, as the key questions outlined above have not yet been answered satisfactorily.

Global standard-setting

ComFrame discussions dominate the international agenda

As a result of the financial crisis, commitments made by G-20 countries have led to a further substantial increase in global regulation. While each standard might, of itself, be justified, in combination they can have potentially negative consequences for the European insurance industry.

In addition to the work of the two main insurance standard-setters — the International Association of Insurance Supervisors (IAIS) for solvency and prudential standards and the International Accounting Standards Board (IASB) for financial reporting (see p22) — the International Organization of Securities Commissions (IOSCO), which sets investment standards (see p12), has grown in importance. The Financial Stability Board (FSB), which coordinates the work of national financial authorities and international standard-setting bodies, is also influencing the work of all these standard-setters.

Until recently, the IAIS's main focus was developing Insurance Core Principles (ICPs), which IAIS members use when developing their supervisory regimes. These are not expected to create any significant requirements for European companies beyond those set by the upcoming Solvency II regime (see p8). However, triggered by the financial crisis, the IAIS has dramatically broadened its activities, with initiatives focused on a small subset of the most complex and largest insurers.

Two new layers have been added to the IAIS's supervisory architecture, above the ICPs. At the top are measures applicable to global systemically important insurers (G-SIIs). Below that is ComFrame, a common framework for supervising international groups, which is also applicable to G-SIIs. It is these new, more prescriptive layers that have dominated IAIS discussions over the last year. Although the focus is large international insurers, the influence of the measures will likely be broader and, in many cases, they will eventually be applied to all insurers, regardless of the scale and nature of their activities.

ComFrame has now entered the third and final year of its development. The IAIS intends to complete the draft framework by the end of 2013, start two years of field testing and adopt the framework in 2018. Insurance Europe has engaged in the IAIS discussions over the last year; providing a comprehensive written submission in response to a mid-2012 consultation as well as participating in IAIS subcommittee meetings and the ComFrame Dialogues between the IAIS and the industry.

Two-stage approach needed

A theme that has run through Insurance Europe's comments is the need for ComFrame's development and implementation to be phased. This means focusing first on supervisory cooperation and coordination, the establishment of international colleges of supervisors and an improved understanding of group risks. Based on that practical experience, gaps should be identified, including where greater specification may be needed. This would allow ComFrame to identify regulatory best practice in group supervision, which should eventually dictate the direction of the project.

Despite only a few months being left for ComFrame's development and consultation on the final draft being delayed to mid-August 2013, the IAIS remains committed to having a completed framework ready for testing by the end of 2013. Of particular concern are the discussions on solvency and valuation, where industry requests for a principles-based approach aimed at facilitating supervisory understanding of local group solvency regimes seem to be gaining little traction.

Even supervisors remain divided on the quantitative aspects of ComFrame, as they seek to develop a quantitative group solvency figure to facilitate comparability between international groups. Key to this approach is the development of a ComFrame adjusted balance sheet (CAB). This applies accounting adjustments from an agreed list to a group's local reporting figures in order to derive a common valuation basis on which the group can be assessed and compared. Insurance Europe and its international counterparts have repeatedly questioned both the objective of the CAB and the need for quantitative balance-sheet comparability, emphasising instead that ComFrame should remain principles-based and focused on understanding local group supervision regimes through a mix of qualitative and quantitative approaches.

There is strong industry consensus that developing a global

Concerns over IAIS work on branches supervision

In late 2011 the International Association of Insurance Supervisors (IAIS) began to identify differences and similarities in the supervision of cross-border operations through third-country branches and to look at challenges in supervising such branches. Its issues paper is due to be adopted in October 2013. Insurance Europe is concerned that the current draft paper does not provide a sufficiently balanced view of the challenges and advantages of third-country branch operation and that it could compromise an insurer's flexibility to operate in the most appropriate way in local markets. Of particular concern are suggestions that operating through a subsidiary structure could be preferable, despite no evidence being provided, and the suggestion that "an international standard may be needed".

solvency regime for insurers is very ambitious and would take many years due to fundamentally different approaches in different markets. These varied approaches can provide appropriate policyholder protection in the markets for which they were designed, so the benefit of forcing companies and supervisors to comply with a costly additional global reporting and solvency system is questionable.

Module 3 improvements

On the group supervisory process (ComFrame Module 3), Insurance Europe welcomes improvements made to the version released in early March 2013; namely a clearer allocation of responsibilities between the group-wide supervisor and other supervisory college members, with the former taking a clearer leading role. However, Insurance Europe has highlighted the need for more information on how supervisors should cooperate and their responsibilities to each other.

The March draft also included significant material on recovery and resolution, with measures previously only seen in discussions in the banking sector or the systemic risk debate. The measures go far beyond those currently envisaged under Solvency II and look likely to influence the European Commission's work on non-bank recovery and resolution. Insurance Europe has raised concerns over the inclusion of measures designed to assist an expedited resolution process (crisis management groups, resolution plans, resolvability assessments) or to preserve a critical market function (supervisors' powers to improve resolvability, use of bridge institutions, bail-ins). It believes many of them are at best unnecessary and would place a significant burden on supervisors and the industry. At worst an insurer would run the risk of being resolved in a manner contrary to the long-term nature of its business, triggering firesales and immediate crystallisation of losses.

In parallel with the ComFrame discussions, a number of other workstreams look set to have a significant impact on the direction of the project. In particular, in January 2013 the IAIS established a small working group to examine the pros and cons of a global capital standard. Discussions are being held in closed sessions, so little is known so far.

EU and US dialogue makes progress

Elsewhere, discussions between EU and US policymakers are also likely to influence the international discussions, with many of the divisive areas in ComFrame identified as key workstreams; namely group supervision, professional secrecy, and solvency and capital requirements. 2012 saw a step change in these dialogues, with the establishment of a steering group and a report in December 2012 summarising the key commonalities and differences of the EU and US regimes, accompanied by objectives for the next five years.

Insurance Europe provided input in October 2012 to the report. It welcomed the increased transparency provided by the exercise and the efforts made by the policymakers to understand each other's regimes better. However, it emphasised the importance of taking an outcomes-based approach when comparing regulatory regimes, noting that otherwise differences in regulatory approach may delay meaningful progress and detract from the goal of gaining a better understanding of how different procedures achieve the same aims and sufficient levels of policyholder protection.

Global trade issues

New global federation strengthens insurers' voice on market access

Given the maturity of European markets, the greatest opportunities for Europe's insurers are increasingly overseas, particularly in Asian and Latin American markets where double-digit premium growth rates are not uncommon.

Dismantling barriers to free trade is a vital component of economic growth. Free trade also facilitates the global spreading of risk, which reduces risk concentrations in local markets, enhancing their financial stability. These values are recognised by the G-20, whose leaders committed not to introduce trade restrictions in the guise of regulatory reform at their Washington summit in 2008; a position that has been reinforced at every meeting since.

Despite the positive commitments of the G-20, protectionist measures remain on the increase in many markets and Insurance Europe continues to work on a number of challenging and long-running market access issues so that European insurers can operate with minimal frictional costs in overseas markets and on equal terms with local players.

India provides just one recent example, with its Insurance Regulatory and Development Authority (IRDA) adopting a new regulation in February 2013 to maximise risk retention within India through a combination of compulsory cessions, risk retention limits and reporting requirements for life insurers. Insurance Europe, under the auspices of the new Global Federation of Insurance Associations (GFIA), has raised with the IRDA its concerns that the new regulation will increase risk concentration in the local market, discourage investors and restrict the ability of foreign reinsurers to contribute to the development of the Indian insurance sector.

GFIA brings early benefits

The creation of the GFIA (see p60) in October 2012 has been a valuable development in facilitating Insurance Europe's closer coordination and greater synergies with other insurance associations around the world on trade issues. It has also made it easier to agree and communicate consistent messages to local policymakers around the globe.

Early successes include the GFIA's objection in December 2012 to foreign institutional investment rather than foreign direct investment (FDI) being the only acceptable form of new foreign equity in India, contributing to the Indian government's withdrawal of its proposed amendment to the draft Insurance Law Amendment Act. However, the bill itself, which not only includes an increase in the FDI limit from 26% to 49% but also allows foreign reinsurance branches to be established, continues to face significant local opposition, which has yet again delayed its introduction. The European Commission has been calling for a standstill in negotiations over a free trade agreement (FTA) between India and the EU if the FDI cap is not raised.

Likewise in the EU-Japan FTA negotiations, the EC has threatened not to continue negotiations if Japan Post, which

Insurance can facilitate post-catastrophe economic growth

In December 2012 the International Association of Insurance Supervisors, the Bank for International Settlements and the International Monetary Fund published a report which shows that, while natural catastrophes have a negative effect on economic growth, "it is mainly the uninsured losses that drive the subsequent macroeconomic cost", whereas sufficiently insured events are "inconsequential in terms of foregone output" and "even positive in the medium-term". These findings were based on data spanning 50 years, 203 countries and 2 476 major natural catastrophes.

The study is a valuable contribution to the debate on different forms of post-disaster spending. Its findings have important implications for policymakers when designing legislation and supervisory requirements. It is clear that they must remain flexible enough to support the development of market-driven initiatives and to encourage the take-up of insurance. The macroeconomic value of risk transfer to insurance markets is too important to be ignored. It is therefore particularly important that markets that lack adequate local (re)insurance capacity can freely access the global (re)insurance market.

has 40% of Japan's life insurance market and currently receives preferential regulatory treatment, is allowed to issue new products. Insurance Europe argues, in concert with its US counterparts, that Japan Post should not be allowed to issue new products until equal conditions of competition have been established for all market players.

Unfortunately Japan Post was "conditionally" given approval in November 2012 to offer educational endowment insurance. However, no new policies have yet been issued and its conditional approval is subject to a number of requirements in the Insurance Business Law, which to date it has not been able to meet. Japan's new liberal democrat government, elected in December 2012, appears more open to the arguments of the international insurance industry on this issue, taking a more cautious approach towards approving new Japan Post products. The new government is also keen to finalise an FTA with the EU and to become a member of the Trans-Pacific Partnership, both of which could be jeopardised by the Japan Post issue.

Positive multilateral developments

Alongside the bilateral discussions on market access with individual countries and despite the stalled Doha round of World Trade Organization (WTO) negotiations, there have been positive multilateral trade developments recently; namely the development of a Services Trade Restrictiveness Index (STRI) in insurance by the Organisation for Economic Co-operation and Development (OECD) and the establishment of multilateral services negotiations.

In November 2012 the OECD decided to expand its STRI to cover financial services, including insurance. The index comprises a database of regulatory policies affecting trade in services and a quantitative scoring of that information. It is hoped that the index will not only be used by trade negotiators as a reliable source of information on countries' market access but will also prove useful in putting the spotlight on countries with restrictive measures. Insurance Europe and fellow GFIA members provided input into the OECD's draft STRI in May 2013, seeking to ensure it covered health and pension products.

In December 2012 a framework for multilateral services negotiations was agreed by 21 WTO members, including the EU. The aim of this Trade in International Services Agreement (TISA) is to go beyond simply further opening up markets and to develop new rules for trade in services.

Negotiations only formally commenced in the second quarter of 2013 but Insurance Europe has already set out the market-access commitments the European insurance industry would like to see form the basis of the TISA.

Insurance Europe supports not only the binding of current levels of market access by participating countries but also a more ambitious minimum level of market access than currently provided for by the WTO General Agreement on Trade in Services (GATS). In particular, it would like the GATS "prudential carve-out" (which allows members to act for prudential reasons, such as protecting investors or ensuring the stability of the financial system, even if the measures do not conform with GATS rules) to be re-examined, its scope reduced and additional minimum market-access commitments in areas such as foreign equity caps or joint venture requirements included.

Although only a few developed countries are currently active in the TISA negotiations, once the basic framework is agreed it is intended that other countries will be invited to join.

Initiatives such as the OECD index and the TISA should help to fuel overseas opportunities for European insurers and to guard against the introduction of protectionist measures.

Looking beyond conventional market access barriers, the potential establishment of a Transatlantic Trade and Investment Partnership (TTIP) in 2013 could substantially change expectations of what can be achieved through trade negotiations. Not only is the TTIP expected to deal with conventional trade barriers, but the EC has also expressed a desire to include regulatory issues with potential implications for market access. This is a positive development that has the potential to push this and future trade negotiations beyond their traditional scope.

Consumer information and distribution

Seeking a consistent and coherent approach

In July 2012 the European Commission published its retail package, which consists of a proposal for a revised Insurance Mediation Directive (IMD 2), a Regulation on packaged retail investment products (PRIPs) and a proposal on Undertakings for Collective Investment in Transferable Securities (UCITS V). The Commission had already published its proposal for a review of the Markets in Financial Instruments Directive (MiFID 2) in October 2011.

Conduct of business rules for investment products are addressed in the MiFID 2 proposal, while the IMD 2 proposal contains conduct of business rules for insurance products, as well as a chapter containing enhanced standards that are applicable to insurance products with an investment element, or insurance PRIPs.

At the same time, discussions continue on the proposal for a Regulation on key information documents for investment products (the PRIPs Regulation), which contains the disclosure requirements for all investment products, including insurance PRIPs. Exactly what will be covered by the PRIPs Regulation remains an unresolved issue. However, this will have an important bearing not just on which products will have to have a "key information document" (KID) but also on which set of conduct of business rules certain insurance products will be subject to, depending on whether they are categorised as a PRIP or not.

MiFID adds confusion

To confuse matters further, in its discussions on MiFID 2, the Economic and Monetary Affairs Committee of the European Parliament has suggested including insurance undertakings within the scope of that directive, which would render the entire chapter on insurance PRIPs in IMD 2 redundant and subject insurance undertakings to the direct supervision of the European Securities and Markets Authority.

Insurance Europe has raised its opposition to such a proposal, as MiFID was designed to deal specifically with investment services and products; its provisions applying to investment firms and regulated markets. Insurance is already covered under numerous other directives, such as the IMD and Solvency II, with further rules to strengthen consumer protection contained in the PRIPs and IMD 2 proposals.

It is worth noting that it is only the European Parliament that has proposed such an approach; the Council of the EU currently supports the Commission's original proposal, which does not include insurance undertakings in the scope of investment legislation.

Blurred boundaries

Insurance Europe has been attentively monitoring developments in the European Parliament, where the current approach being taken is of great concern, as it blurs the boundaries between the different legislative proposals, which were already proving difficult to understand in their original form. For example, amendments have been proposed in the European Parliament to introduce into the PRIPs KID provisions covering sales rules that are already being debated, more appropriately, as part of the IMD 2 proposal.

In the case of provisions on cross-selling practices, ie where a financial product or service is offered together with another product or service in a package, Insurance Europe has been stressing the need to ensure these are addressed consistently across all EU financial services legislation.

From an insurance perspective, it is important to ensure that such practices are not treated more strictly under IMD 2 than under other legislation. Yet under the MiFID 2 provision, there is an obligation to inform the customer whether it is possible to buy the different components of the package separately. The IMD 2 provision, which requires the distributor to offer each of the different components separately, goes much further than MiFID 2, without any justification. In order to be consistent, the two texts need to be aligned, which is something that the European Commission has recently been advocating.

Ensuring a consistent and coherent approach across the different financial services legislative proposals at EU level is

proving to be a considerable challenge and it is a debate in which Insurance Europe continues to be closely involved.

A further example of the inconsistent approach can be seen in the differing treatment of conduct of business rules. The general conduct of business rules in IMD 2 apply to all insurance contracts. This means that the additional enhanced standards for the sale of insurance PRIPs would come on top of those general rules, creating cumulative sets of conduct of business rules for insurance PRIPs which would be stricter than those for other types of PRIPs regulated under MiFID 2. Such requirements would be onerous and duplicative, and would give rise to an unlevel regulatory playing field with investment products sold under MiFID 2.

Better information, not more

Insurance Europe supports improving the information provided to consumers to help them compare products. However, a prescriptive regulatory approach at EU level may have negative implications both for markets and consumers, particularly if too much pre-contractual information leads to information overload.

To highlight one particular example, a broker proposing a unit-linked life insurance contract at a distance (eg by phone, over the internet) currently has to deliver no fewer than 49 different sets of pre-contractual information under existing EU legislation (including the current IMD, Distance Marketing Directive, life directives, E-Commerce Directive, etc. — all of which are minimum harmonisation directives that allow member states discretion in how they achieve the directives' results). The number of sets of information would rise to more than 70 under the IMD 2 and PRIPs proposals.

Such an excessive amount of information would not help consumers to compare products and make an informed choice. The focus needs to be on better information, rather than more information. Only if there are clear and demonstrable benefits should there be any increase in the amount of pre-contractual information that is given to customers, not least because otherwise there is also an unnecessary and costly additional administrative and compliance burden placed on insurers.

IMD 2 — key issues

The best way to ensure a high level of protection for all consumers purchasing insurance products is for IMD 2 to recognise the diversity of insurance distribution markets across the EU, which results from consumers' differing demands and needs.

That this is the best approach is particularly evident in the debate over transparency in how those providing insurance are remunerated. Insurance Europe is in favour of transparency to help consumers make comparisons between products and it firmly believes that a requirement to disclose the source and form of remuneration would strike an appropriate balance.

The solution found should not confuse consumers by causing them to focus on unnecessarily detailed information on remuneration rather than the most important elements of a product, such as the insurance coverage, premium, exclusions or excesses. This was confirmed in a PricewaterhouseCoopers study on the impact of the IMD, which was carried out in 2011 on behalf of the Commission but whose findings were not taken into account in the Commission's proposal.

Key messages on the review of the Insurance Mediation Directive (IMD 2)

- The scope of IMD 2 should focus on insurance mediation activities
- Rules on conflicts of interest and remuneration must clearly benefit consumers and be risk-based
- Consumers should be able to purchase any insurance product without the need to obtain advice, if they so wish
- "Cumulative" conduct of business rules for insurance investment products (insurance PRIPs) must be avoided
- Cross-selling practices must be addressed consistently across EU financial services legislation

Rules on conflicts of interest and remuneration therefore need to be balanced and tailored to the channels concerned, proportionate to the level of complexity of the products being sold, and adapted to consumer needs.

In order to respect the existing diversity of distribution markets across the EU, IMD 2 should take a minimum harmonisation approach, allowing member states to maintain or adopt additional rules on conflicts of interest and remuneration, adjusted to the specific characteristics of their national markets, as many states have already found their own ways of dealing with remuneration in a manner appropriate to their markets. This further illustrates the diversity of markets across the EU.

Consumers should be able to purchase any insurance product without advice, if they so wish. In many cases, consumers do not need or want advice. This is especially true for basic, simple insurance products such as home and motor insurance.

Consumers are, of course, always free to seek advice, but it should not be imposed on them when it has been specifically declined. It is crucial to ensure that the possibility for sales without advice can continue, so as not to limit or interfere with consumer choice. Likewise it is important not to restrict the consumer's ability to access products as a result of advice being mandatory and the consumer not being in a position to afford it. Having to pay for advice each time could also deter consumers from shopping around. Regardless of whether the consumer opts for advice or not, all relevant information requirements will still be met, so consumers will always have the necessary information at their disposal.

PRIPs — key issues

Consumers cannot be expected to be experts in all fields; they require adequate information before purchasing investment products. Insurance Europe therefore supports the PRIPs initiative's aim to enhance comparability between different investment products through a pre-contractual, generic, product information document.

Insurance Europe is concerned, however, that the European Commission proposal is self-defeating, as PRIPs is considered to be a silver bullet for all consumer protection issues. Blurring the lines between standardised product information and other consumer protection matters, such as sales rules, will create a confusing legislative tangle that undermines the importance of pre-contractual information and fails to help consumers.

In response to the publication of the EC's PRIPs proposal, Insurance Europe published its key messages (see box opposite) and participated in dialogues with the European Insurance and Occupational Pensions Authority (EIOPA) and with European legislators in, for example, the European Parliament's Internal Market and Consumer Protection Committee.

Rethink needed on scope

Insurance Europe suggested that, above all, an in-depth reflection on the scope of PRIPs is required. If, for example, a unit-linked life insurance product and a company share both fell under PRIPs, it would become increasingly difficult for consumers to make valid product comparisons. Extending the scope of the proposed PRIPs regulation beyond packaged products would make the development of a simple information document less feasible, as far more information would be required to compare fundamentally different products.

Furthermore, under the current proposals, a consumer would receive more than 70 pre-contractual information items when purchasing a unit-linked life insurance product at a distance. That same consumer would also receive a number of information items twice but in different formats under Solvency II and PRIPs. That is why Insurance Europe suggests that pre-contractual information should focus on quality rather than quantity to reduce confusion and facilitate product comparability.

Industry-specific features are also important, since the key information document applies across financial sectors. For example, consumers should understand that, unlike

Key messages on the Packaged Retail Investment Products (PRIPs) Regulation

Insurance Europe recognises the importance of improving consumer information. The PRIPs Regulation should require better, not simply more, information.

- The Regulation should be focused on packaged investment products and therefore exclude products that have no characteristics of a packaged and/or investment product, such as all pension products and life insurance products where the risk is not borne by the policyholder.
- The key information document should highlight insurance-specific features to make it possible for consumers to adequately compare products across financial sectors and to provide useful disclosures tailored to the product or fund level.

other PRIPs, an insurance PRIP offers protection as well as investment. Denying consumers the disclosure of product-specific features stops them from adequately comparing products offered by different financial sectors.

It is important to ensure that the key information document offers consumers a better basis on which to compare investment products. This requires its scope to remain focused, ie on packaged investment products, including industry-specific features as well as disclosures that correspond to consumers' needs without overloading them.

An international patchwork

Insurance Europe has become increasingly concerned about the risk of inconsistent rules on point-of-sale disclosures, transparency and conduct of business given that — in addition to the EU legislators — several international organisations are working on these issues without sufficient coordination. At best, the different standard-setting bodies attend each other's meetings and/or exchange information on the progress of their work.

The Joint Forum of insurance, banking and securities supervisors will publish a consultation on cross-sectoral standards for point-of-sale disclosures, to which Insurance Europe intends to respond. At the Joint Forum's 2012 hearings, Insurance Europe questioned the timing of this exercise, in light of the European work on PRIPs and the potential conflicts between European and international rules. Insurance Europe was also concerned that the Joint Forum would copy rules designed for investment disclosures, without taking into account insurance-specific features and the consumer detriment that would result from such an approach.

Insurance Europe therefore urged the Joint Forum to ensure that the particular characteristics of insurance products that distinguish them from other products, such as biometric risk coverage, are duly considered in the report.

OECD at work too

Following high-level principles on consumer protection adopted by the G-20 in October 2011, the Organisation for Economic Co-operation and Development (OECD) established a taskforce that, among other things, focuses on transparency and responsible business conduct. It will be important for the OECD's work to be consistent with that of other bodies and for it to take the specific features of insurance products into consideration.

Insurance Europe called on the International Association of Insurance Supervisors (IAIS) to monitor the OECD work on consumer protection and to ensure alignment between its Insurance Core Principles and the Joint Forum work. The work of the IAIS market conduct subcommittee may also have an impact on conduct of business and pre-contractual information rules. Insurance Europe attended the subcommittee's meetings as an observer and tried to ensure alignment between the subcommittee's work and the developments at other international and European institutions.

Data protection

How to make EU reforms appropriate for insurers' risk management

Data processing is at the core of insurance activities. Insurers collect and process personal data so that they can assess the risks that consumers wish to cover and provide them with insurance products tailored to their needs and risk profiles.

Insurers also process data to evaluate consumers' claims, to pay compensation and benefits, as well as to prevent and detect insurance fraud. It is therefore vital to both insurers and their customers that proposed changes to European data protection legislation do not prevent insurers from collecting and processing personal data for these purposes.

In January 2012 the European Commission published proposals for the reform of the EU legal framework for data protection, consisting of two legislative instruments: a Directive on data processing for the purposes of prevention, investigation, detection or prosecution of criminal offences and a Regulation on the protection and free movement of data. Insurers will have to comply with the Regulation.

The proposed Regulation is a complex and cross-cutting piece of legislation that seeks to harmonise data protection legislation in the EU, strengthen individuals' rights and reduce the administrative burden on businesses. Its laudable aim of building up citizens' confidence in data protection while reflecting business realities and technological developments is fundamental for economic growth and innovation.

The Commission has designed the key provisions of its proposed Regulation to tackle issues stemming from social networking and the online environment. What it has not properly considered, however, is the impact of its proposals on businesses such as insurance.

As it stands, the EC's Regulation would restrict the ability of insurers to assess risk properly, reducing the availability and breadth of insurance products and increasing the cost of cover for customers. The prevention and detection of insurance fraud would also be seriously hampered.

The proposed Regulation also does not take account of the fact that insurers must comply with other pieces of European legislation, such as Solvency II and the Anti-Money Laundering Directive, with requirements imposed by supervisory authorities, as well as with the legal obligations placed on them by their contracts with consumers, which are in seeming contradiction to some provisions in the draft Regulation.

Insurance Europe has therefore monitored closely the discussions on the proposed Regulation in both the Council of the EU and the European Parliament, voicing its insurance-specific concerns and suggesting solutions (some of which are set out on the opposite page) in both.

Keeping the right balance

Any changes to EU data protection legislation should be relevant and proportionate, considering the individual's right to privacy and taking into account the way insurance works. It should explicitly recognise the need for insurers and reinsurers to process personal data in order to calculate fair premiums, and should respect the requirements of contract law. It should also enable insurers to verify the accuracy of information provided to them and to prevent fraud and financial crime. Finally, the Regulation must not overlap or be in conflict with other pieces of national or EU legislation.

Modernising the Council of Europe Convention

The proposed right of consumers to withdraw consent to processing of their data would produce unintended consequences to the detriment of both consumers and insurers. Insurance Europe is concerned that this right has also been introduced into the final text of the Council of Europe Convention for the protection of individuals with regard to automatic processing.

The 1981 Council of Europe Convention has been under review since 2011 and the revised proposals were finalised at the end of 2012. Insurance Europe is also concerned that the Convention's definition of genetic and biometric data would be incompatible with provisions in national and European legislation. On the other hand, Insurance Europe welcomes the provisions related to the deletion of a 24-hour data breach notification period and the limitation of the scope of the Convention.

Insurance-specific concerns and recommendations

The right to be forgotten

The European Commission suggests introducing a new "right to be forgotten", which would allow customers to require their insurance companies to erase all their personal data from their databases.

Concern This could result in insurers being unable to process consumers' data, preventing them from performing their contractual obligations and thus from offering their services to consumers. This could also force insurers to delete data that other regulations require them to retain or that they would need to process to detect and prevent fraudulent activities.

Recommendation The Regulation should clearly state that the right to be forgotten does not apply where there is a contractual relationship between an organisation and an individual. It should also not apply to data that the insurer is obliged to keep under other regulation or for the purposes of preventing and detecting fraud.

The right to withdraw consent

The proposed Regulation gives consumers the right to withdraw their consent to the processing of their personal data.

Concern Should consumers avail themselves of this right, insurers would no longer be able to keep and process that personal data. As above, this would mean that insurers would be unable to comply with anti-money laundering legislation and to process data for fraud prevention and detection purposes. As a consequence, honest consumers would pay higher premiums due to dishonest consumers' fraudulent behaviour, while insurers would not be able to deliver their services to them.

Recommendation The right to withdraw consent should not apply when there is a contractual relationship between an organisation and an individual and also when insurers need to comply with other legal or regulatory obligations.

Fraud detection and prevention

The Commission's proposed Regulation does not provide any clear legal basis on which insurers can process personal data and exchange information for the purposes of fraud detection and prevention.

Concern Preventing and detecting fraud is a key priority for insurers as detected and undetected fraud is estimated to represent up to 10% of all claims expenditure in Europe and exists in all lines of business. Insurers' activities in this area are in the interests of consumers as fraudulent claims and the cost of investigating suspected frauds lead to higher premiums for honest policyholders. Dedicating resources to investigating fraud also affects insurers' ability to deal with genuine claims quickly. In addition, evidence from recent studies by insurers suggests that insurance fraud funds and facilitates other serious crime.

Recommendation The Regulation must explicitly recognise the need for insurers to exchange information and process data for the purposes of fraud detection and prevention.

Profiling

The proposed Regulation includes a provision on profiling, which is primarily intended to prevent the creation of behaviour profiles based on internet activity. The provision allows profiling under certain strict conditions, none of them however permitting it explicitly to be carried out at the pre-contractual stage.

Concern As part of the underwriting process, insurers process personal data to assess the risk consumers wish to cover so that they can provide appropriate cover. There is a risk that this underwriting process and the assessment of an individual's risk at the pre-contractual stage would fall under the EC's proposed rules on profiling, with the consequence that consumers would have the right to object to any measures the insurers took to evaluate certain of their personal aspects when the measures are based solely on automated processing, without any human intervention. If this ability were prohibited or restricted, insurers would not be able to determine accurately the level of risk of each individual requesting cover. This could translate into higher prices, a decrease in insurance coverage and the inability to provide consumers with appropriate insurance.

Recommendation The Regulation should include a provision that allows insurers to carry out pre-contractual profiling.

Anti-money laundering action

Risk-based approach is key element in proposed EU Directive

The European Commission published its proposal for a fourth Anti-Money Laundering (AML) Directive in February 2013. Its aim is to transpose into EU law the revised Recommendations of the intergovernmental Financial Action Task Force (FATF) on combatting money laundering and the financing of terrorism, which were adopted in February 2012.

Insurance Europe contributed to the revision of the FATF Recommendations, and it continues its discussions with the FATF. As part of the Global Federation of Insurance Associations (see p60) it is contributing to an update of the FATF's risk-based guidance paper for the life insurance sector.

Likewise, Insurance Europe contributed to the Commission's consultation on its new AML proposal in June 2012 and spoke at the March 2013 public hearing that followed the proposal's publication. The Commission's decision to follow closely the FATF approach is welcome, particularly the Commission's recognition of insurance as a distinct business with its own product characteristics and risk profile, given that insurance products are at very limited risk of being used for money laundering. The clear acknowledgement that some terms have a different meaning in life insurance than they do in banking, for example, is a positive first step.

The proposal's definition of a financial institution appropriately only includes life insurance companies, thus excluding insurance products that do not accumulate cash or have a cash value and which therefore cannot be used for money laundering. A few European jurisdictions previously took a different approach, sweeping all types of insurance into their national AML requirements and resulting in a poor use of compliance resources with no benefit to the fight against money laundering

Measures should reflect risk

As in the FATF Recommendations, a key feature of the Commission's proposals is its risk-based approach. This tailors the anti-money laundering measures to the risk that has been identified. This approach is supported by the insurance industry, as life insurers will be able to allocate their resources efficiently to focus on those activities that pose a potential money-laundering threat and they will be able to adjust their approach depending on the perceived risks in the jurisdictions in which they operate.

For this risk-based approach to work in practice, however, it is important that European and national supervisors fully understand and embrace it. As some jurisdictions feel more comfortable with a more prescriptive approach, the Commission will need to ensure that the risk-based approach is appropriately translated into national law.

Consistency needed in implementation …

The ability to harmonise approaches to combatting money laundering across the EU, which would contribute to improving the functioning of the EU single market, will to a large extent depend on the guidelines that are developed by the European supervisory authorities. Unfortunately, some guidelines — such as those on customer due diligence — are only expected two years after the Directive is adopted, which is also the deadline for member states to transpose the Directive into national law. If harmonisation is to be achieved, it is vital that the guidelines are finalised sufficiently early in the transposition process.

… and in regulation

The envisaged AML regime can also only be effective with a consistent regulatory framework that allows entities to apply the provisions. Insurance Europe is concerned that this is not currently the case. For example, some of the provisions in the EU's proposed data protection framework (see p34) might be inconsistent with the AML obligations, including restrictions on intra-group information sharing, data retention and information gathering.

Insurance Europe also has concerns about the provisions covering the identification of persons that pose money laundering or terrorism financing risks, notably those relating to politically exposed persons and to beneficial ownership. It believes that the identification of such persons should not be the sole responsibility of insurers and others, but rather a joint responsibility with public authorities.

Gender-neutral insurance pricing

The aftermath of the ECJ Test-Achats ruling

Following a European Court of Justice (ECJ) ruling in a case brought by Test-Achats, a Belgian consumer association, EU insurers are no longer able to differentiate on the grounds of gender in their pricing.

While the judges' ruling related to the construction of the exemption granted to insurers in the EU's 2004 Gender Directive — and not to the way private insurance works — it has had the serious consequence of restricting insurers' ability to use gender-determined statistical data to establish economically efficient, risk-based pricing of their insurance products.

Although the ECJ ruling was published back in March 2011 and took effect in December 2012, Insurance Europe's work in this area has continued for a number of reasons. The European Commission will publish a report in 2014 on EU member states' implementation of the Gender Directive and of the ruling. In preparation, Insurance Europe has been calling for a period of stability — avoiding further legal changes — to allow consumers and insurers time to adapt to and to understand the new legal regime that has resulted from the ECJ's ruling.

Insurance Europe has also been underlining to European policymakers why and how insurance pricing that is based on accurate risk assessment benefits consumers. It has been warning of the detriment to consumers — in terms of the affordability and availability of insurance — if any additional restrictions were to be placed on insurers' use of relevant, evidence-based statistics in insurance pricing (see box overleaf).

Arguments voiced in Parliament

In mid-2012 Insurance Europe explained the possible negative impact of the ECJ's ruling on consumers at a hearing in the European Parliament organised by the Women's Rights and Gender Equality Committee in preparation for an own-initiative report (see below).

Insurance Europe outlined how insurance is based on actuarial calculations and the weighting of relevant risk factors and why insurers have therefore had to revise their pricing methods so that they can continue to reflect as accurately as possible the risk they assume in return for a premium, despite the ban on the use of gender as a risk factor in pricing.

It explained that the exclusion of gender as a pricing factor does not result in gender-neutral pricing converging at an arithmetical mean. Gender neutrality may result in higher premiums or less attractive benefits for some consumers. This is because insurers require higher margins to compensate for the lower predictability in the mix of future business. The impacts of the ruling are that there may be an increase in adverse selection, as the number of more risky consumers increases as a proportion of the pool of insureds, and an increase in moral hazard, as the risk-taking behaviour of consumers changes because they are insured.

Some consumers may therefore find that their insurance premiums increase as a result of the ECJ ruling. These groups include: young women drivers, despite statistics showing that they have safer driving habits than young men; men buying annuities, despite the fact that they do not live as long as women; and women seeking term life insurance, despite their greater longevity. The consequences can go even further, as consumers who had been able to afford a particular insurance cover might no longer be able to do so.

Positive Parliamentary report

The impact of the ECJ ruling was addressed in an own-initiative report, which was published in February 2013 by Hungarian socialist MEP Zita Gurmai on the implementation of the Gender Directive and of the ECJ ruling by member states. Some of the proposals contained in the initial draft of the report, such as significantly widening the scope of application of the ECJ ruling, would have had unforeseen negative consequences for insurers.

Proposals in the draft report to apply the ECJ ruling retroactively to all insurance contracts would likewise have had serious consequences for insurers' ability to offer insurance. And extending the scope of the ruling to cover second pillar occupational pensions would have exceeded the

Differentiation needed in insurance pricing

In March 2013 Insurance Europe responded to a consultation, commissioned by the European Parliament and conducted by consultancy Milieu, into the cost to small and medium-sized enterprises and public service providers of implementing a Directive on equal treatment. If adopted, the directive would potentially prevent insurers from differentiating between policyholders based on age and disability.

In its response to the consultation, Insurance Europe set out why information about age and disability is so important to insurers' assessment of risk when providing certain products.

Age is a fundamental determinant of mortality risk. Term life insurance therefore — where fixed payments are made for a fixed term — could not exist without taking account of age as a risk-rating factor.

Age is also a key factor in determining an insured's risk of becoming ill, disabled or unable to work, and is thus essential for calculating certain risks and premiums. This is particularly true for annuities for retirement, term life insurance, disability insurance, long-term care insurance and private medical insurance. Similarly, certain disabilities are relevant to the actuarial assessment of risks in term life, disability, long-term care and private medical insurance.

In light of the European Court of Justice (ECJ) ruling on the Gender Directive (see main text), it is important to ensure that the proposed EU Directive on equal treatment does not contain wording that could be legally challenged, in the way that led to the ECJ ruling modifying the Gender Directive, or that could otherwise lead to a ban on insurers' use of age and disability in their risk assessment and pricing.

Any potential future ban on the use of such fundamental risk-rating factors as age and disability in insurance pricing would be likely to have serious implications for certain products because of adverse selection (whereby low-risk groups are deterred from purchasing insurance and high-risk ones are attracted). This could limit the scope or availability of certain products or even lead to the end of the market for some.

Milieu is due to finalise a report for the European Parliament by September 2013.

legal scope of the ruling. These proposals were fortunately excluded from the final report.

The European Parliament adopted the report in mid-April 2013, calling on the European Commission to propose a new legislative text to bring the Gender Directive into line with the guidelines the EC produced after the ECJ ruling and to "closely follow" the insurance market to avoid "unjustified higher pricing" as a result of the ruling.

Insurance Europe continues to maintain that such a revision of the Gender Directive would mean an unwelcome period of legal uncertainty for both insurers and consumers; a point already acknowledged in the European Parliament's report in April. In particular, the report recognises that the ruling may have had an impact on member states' ability to implement the Gender Directive, since it has resulted in a period of uncertainty for both member states and insurers.

Insurance Europe understands that the Commission is monitoring the situation in member states to ensure that national legislation in the field of insurance complies with the ruling. The EC's findings on the implementation of the ECJ ruling in national law and in insurance practice will be included in its 2014 report on the implementation of the Gender Directive. That report is not, however, expected to consider the impact the ruling has had on the insurance industry.

Insurability

Mandatory insurance: a worrying regulatory pattern continues

Policymakers often view regulation as a means of encouraging insurance take-up. However, such regulation can restrict insurers' ability to freely negotiate policies with their customers and to develop a wide range of competitively priced products. Regulatory initiatives, however well intentioned, must take care not to impede the optimal functioning of the insurance market.

While the insurance industry supports EU initiatives to protect consumers and reduce risk, mandatory insurance systems tend to be overly restrictive by failing to distinguish between risk levels. For instance, some individuals and entities are required to purchase more cover than they need and face unnecessary costs, while those at high risk are not incentivised to purchase more than statutory cover and are thus under-insured.

EU remains focused on environmental liability

One of the most prominent examples of the debate over compulsory insurance relates to the EU's Environmental Liability Directive (ELD), "polluter pays" legislation adopted in 2004. While the ELD is now fully implemented, questions remain in relation to restoring damaged environment to its previous (or "baseline") condition and the role insurance should play.

In a February 2013 meeting with the European Commission, Insurance Europe stressed that the ELD remediation measures for damage to biodiversity, water and soil are highly complex and a flexible legislative framework is thus more suitable for the development of ELD insurance cover. As was seen at the Commission's ELD implementation workshop in January 2013, confusion remains over the threshold of "significant" damage for triggering an ELD claim and the "baseline" condition criteria. A voluntary system enables insurers to take a long-term approach by collecting risk data over many years in order to establish the baseline condition (eg the long-term effects of river pollution or contaminated soil), thus leading to effective and enduring insurance products.

As summarised in Insurance Europe's April 2013 comments on a study of ELD implementation commissioned by the EC from BioIS, the European insurance market has reacted to the ELD

Why funds are not the answer

Though policymakers sometimes look to national or EU funds to help compensate for public losses, such mechanisms often distort markets by reducing insurance demand and leading to the withdrawal of valuable insurance products.

For example, in a proposed EU Regulation on Clinical Trials to replace a 2001 directive, the European Commission suggested in July 2012 a "national indemnification mechanism" to compensate clinical trial participants for harm suffered during trials. The aim is to stimulate primarily academic trials that may lack financing for the currently mandatory cover. However, the consequential withdrawal of insurance products could prove detrimental to markets where the proposed mechanism fails by diminishing the valuable risk-assessment and claims-handling expertise of insurers. Perhaps more crucially, these mechanisms could have limited financial capacity due to difficulties gathering state revenue during the economic downturn. The European Parliament is due to adopt its report on the proposed Regulation in October 2013.

In another example, the Commission initiated a study into the feasibility of an EU-wide "risk-sharing scheme", financed by the industrial sector, to cover environmental damage as well as bodily injury, property damage or business interruption. At a Commission workshop in November 2012, it was suggested that this fund would work in parallel with the insurance market. However, Insurance Europe warned of a likely increase in moral hazard, with operators less likely to insure themselves if already obliged to pay into the scheme. It also outlined the vast skill of the insurance industry in covering complex environmental pollution risks in light of different national safety cultures.

Rather than turning to funds, the EU and its member states might better focus on increasing security and safety standards in order to minimise risk and, in turn, make risks more insurable.

with the continual growth of environmental liability pools, the introduction of non-binding insurance models for ELD cover and an increasing number of stand-alone environmental products.

The Commission's next evaluation of the ELD, in 2014, will re-examine the question of EU-wide mandatory insurance. The introduction of an EU-wide compulsory insurance system, however, would likely deter insurers from developing products if they could not meet the immediate demand. Mandating insurance at EU level would moreover result in government officials — rather than specialised insurance experts — determining what cover is appropriate. Insurance Europe will highlight these issues at the Commission's ELD Stakeholder Conference in June 2013.

Offshore oil spills added to environmental concerns

Insurance Europe discussed the complexity of the ELD during the European Parliament's 2012 debates on the Commission's proposed Regulation on offshore oil safety, which would extend the ELD to offshore marine regions and require financial security assessments for all offshore oil licensing applicants. Insurance Europe explained that extending the ELD would mean further confusion, as offshore environmental risks are complex and difficult to quantify. The energy insurance market that covers such risks consists of highly specialised experts and has only limited global capacity.

Damage to the offshore marine environment can take decades to rectify and, even then, it can be impossible to know if any damaged biodiversity has been fully restored. In a September 2012 meeting with policymakers, Insurance Europe stressed that the proposed Regulation should place more emphasis on risk management and safety standards, perhaps through licensing requirements. In February 2013 the European Parliament and Council agreed a provisional text that retained the extension of the ELD but transformed the draft legislation into a proposed Directive, which would allow member states more discretion to make financial security assessments.

A follow-up Commission study of offshore oil liability and financial security schemes, with a focus on insurance, will feed into its legislative proposal on offshore oil licensing, expected in the third quarter of 2013.

Questions over cross-border services

An EU focus on the freedom of movement between EU states has led policymakers to consider possible action over perceived obstacles posed by insurance.

The European Parliament has now dropped an amendment to a draft revised EU Directive on professional qualifications that would have required proof of insurance before commencing professional activities in another EU country. However, the European Commission in 2013 focused on cross-border insurance under the EU Services Directive.

A June 2012 Communication stated that some service providers seeking cross-border work were reportedly finding it difficult to obtain insurance and called for more adequate cover of cross-border services. The Commission has suggested possible industry-led actions, such as revised insurance renewal practices and national "help desks" to provide insurance information.

Insurance Europe supports work to facilitate a well-functioning internal EU market, but has maintained that any alleged problems with insurance must be clearly identified before industry-led solutions are proposed. Insurance Europe has explained that cross-border cover is generally available, though not feasible for all insurers to provide due to diverse languages, licensing requirements, tax regulations and liability legislation. As a member of the Commission's Forum on European liability and insurance organisation schemes (ELIOS Forum) and in view of the Commission's possible consultation on insurance for cross-border services, Insurance Europe will continue to explain how insurers work to best meet the needs of their insureds.

Sustainability

2013 becomes significant year for EU disaster insurance

In the face of the increasing frequency and severity of natural catastrophes occurring across Europe, the EU has taken particular interest in how the damages caused by such disasters can be minimised and be effectively covered by commercial insurance.

Risk awareness, accessible risk data, government and stakeholder cooperation, building planning and adaptation measures are all core areas that help increase overall insurability of natural catastrophe risks. In the light of possible EU action, Insurance Europe is stressing that a "principles-based" approach to disaster prevention and preparedness guidelines is more effective at minimising the devastating impact of natural catastrophes than a regulatory approach that introduces a "one size fits all" insurance solution for the whole of Europe.

EC questions adequacy and availability of insurance

In April 2013 the European Commission launched a consultation on its Green Paper on the insurance of natural and man-made disasters and whether EU action is needed to enhance the adequacy and availability of insurance.

The Green Paper recognises that insurers offer aid at every level of the risk-management cycle; from risk identification and risk modelling to risk transfer and recovery. However, the paper also notes that insurers will need to cover increasingly frequent and intense events due to changes in climate and population concentrations, growth in catastrophe-exposed areas and rising wealth and property values. It suggests that this could affect the availability and affordability of insurance, which could in turn leave society more vulnerable to disasters and governments more exposed to the financial costs arising from them.

Insurance Europe has been engaged in the EU discussions since they began at Council level in 2010, including regular meetings with the Commission to provide information about insurance market practices. In response to an invitation from the Commission, it submitted a list of elements the industry considered crucial for the Green Paper in November 2012. These included: forward-looking, multi-dimensional risk models; free and ready access to risk data; adoption of national adaptation and prevention policies; limited government intervention to encourage the uptake of insurance; and a flexible EU policy framework based on minimum harmonisation to preserve existing solutions in different markets.

Insurance Europe will participate in the Commission's public consultation on the Green Paper, which ends in June 2013. It also participated in the European Parliament's May 2013 debate about the Green Paper alongside representatives of the Commission and the International Finance Corporation of the World Bank.

Climate change adaptation linked to insurability

Since the Commission's White Paper on adaptation to climate change in 2009, Insurance Europe has maintained that adaptation is crucial for reducing the impact of the changing climate throughout Europe and, in turn, the insurability of natural catastrophe risks. For this reason, Insurance Europe has participated since 2010 in the Commission's Adaptation Steering Group, a body set up to feed input into the EU Strategy on adaptation to climate change.

The Commission launched its EU Strategy in April 2013, as part of a package with the Green Paper. A Commission conference, also in April, focused on how a more climate-resilient Europe might develop through adaptation policies (eg enforcement of building codes, flood defences and improvements to urban sewage structures), increased risk awareness and the sharing of risk and adaptation knowledge. Insurance Europe was pleased to see the conference highlight the need for more coordination between the government, public and private sectors and touch on the benefits of risk-based insurance pricing in encouraging adaptation measures. The EC remains concerned about the impact risk-based pricing could have on those living in high-risk zones (eg heavily flood-prone areas). Insurance Europe continues to argue that any potential solutions, such as public/private partnerships, would be best left to be designed by individual member states.

Insurance Europe remains closely engaged in EU work on adaptation, including participation in the European Climate Adaptation Platform, set up to share adaptation information, and in an EC study into the role of the insurance and banking sectors in making Europe more climate-resilient.

Attracting employees to insurance

The EU's social dialogue committee at work

Attracting and retaining talent is becoming significantly more important for insurers as their employees' median age increases and a growing number of workers reach retirement.

To help insurers address this challenge, Insurance Europe has over the past year led the very first pan-European project to help tackle demographic changes in the insurance sector. This has also been the first time that a project has taken a sector-wide approach to enhancing the attractiveness of insurance as a career and increasing the employability of individuals already working in the sector.

Insurance Europe carried out the project in cooperation with the employers' and employees' representatives on the European Insurance Sectoral Social Dialogue Committee (ISSDC), which discusses EU-level insurance issues. The project was sponsored by the European Commission.

Spreading good practice

The aim of the project was to promote and disseminate good practice implemented at company, national and EU levels, with a view to inspiring others and making insurance an even more dynamic and attractive sector in which to work.

The main outcome of the project was a booklet showcasing initiatives by the insurance industry to address the work/life balance, qualifications and life-long learning, and health and safety at work. The examples were chosen on the basis of their originality and effectiveness in tackling demographic changes.

The booklet features numerous examples of good ways to make the insurance sector more attractive and inclusive for women, young professionals and older employees. For older employees, the practices addressed, for instance, tailored working arrangements, employability issues, the transfer of knowledge, and the need to allow experienced and motivated older staff the possibility of continuing with their careers beyond the traditional retirement age.

The booklet is available in nine languages on Insurance Europe's website. It was launched at a conference organised by Insurance Europe in Brussels in June 2012 attended by employees' and employers' representatives, EU institutions and academics and civil society representatives, including Age Platform Europe and the European Women's Lobby.

The demographic challenge in the insurance sector was further discussed at a seminar in Prague in September 2012, which focused on developments and initiatives in the newest EU member states and possible follow-up actions.

The European Commission welcomed the project as a crucial contribution to the objectives of the EU's decade-long growth plan, the Europe 2020 Strategy, and of the 2012 European Year for Active Ageing and Solidarity between Generations.

A source of inspiration

The project was a major step in the follow-up to a joint statement on the demographic challenge in the sector that was adopted by the European insurance social partners in January 2010. It also marked a starting point, as its ultimate aim is to stimulate the emulation of its good practice examples.

Several companies and local social partners have shown a keen interest in taking inspiration from the booklet's examples in order to define either jointly or individually ways to address demographic changes. More insurers are eager to share their good practice initiatives should the booklet be updated.

The ISSDC has therefore started discussing follow-up initiatives. It is considering publishing an updated booklet online, taking into account new demographic changes affecting the European insurance sector and the latest practices initiated by insurers. The social partners also plan to launch a survey to assess developments at national and company levels following adoption of the joint statement of January 2010.

Furthermore, on the initiative of Insurance Europe, the social partners are developing a joint statement on teleworking in insurance. Today, information and communication technologies provide a wide range of opportunities for organising work in a more mobile and flexible way. Telework may offer advantages for employers and employees and could thus contribute to the sector's attractiveness.

- Member associations
- Events
- Publications
- Corporate governance
- Working bodies

Member associations

Austria		Versicherungsverband Österreich (VVO) President: Günter Geyer www.vvo.at tel: +43 171 15 62 00
Belgium		Assuralia President: Bart De Smet www.assuralia.be tel: +32 2 547 56 11
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Cyprus		Insurance Association of Cyprus Chairman: Polys Michaelides www.iac.org.cy tel: +357 22 45 29 90
Czech Republic		Česká asociace pojišťoven (ČAP) President: Martin Diviš www.cap.cz tel: +420 222 35 01 50
Denmark		Forsikring & Pension (F&P) President: Peter Damgaard Jensen www.forsikringogpension.dk tel: +45 41 91 91 91
Estonia		Eesti Kindlustusseltside Liit President: Artur Praun www.eksl.ee tel: +372 667 18 00
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Germany		Gesamtverband der Deutschen Versicherungswirtschaft (GDV) President: Alexander Erdland www.gdv.de tel: +49 302 020 50 00
Greece		Hellenic Association of Insurance Companies President: Alexandros Sarrigeorgiou www.eaee.gr tel: +30 2103 33 41 00
Hungary		Magyar Biztosítók Szövetsége (MABISZ) President: Anett Pandurics www.mabisz.hu tel: +36 1318 34 73
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Turkey	Türkiye Sigorta, Reasürans ve Emeklilik Şirketleri Birliği President: Recep Koçak www.tsb.org.tr tel: +90 2123241950

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Ukraine

The League of Insurance Organisations of Ukraine (LIOU)
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Events

4th International Conference, Amsterdam

Insurance Europe's annual conference has become an established part of the insurance calendar. This was demonstrated by the number of delegates and the calibre of speakers at its 4th International Conference on 1 June 2012.

Around 400 policymakers, regulators and insurers gathered in Amsterdam for the conference, entitled "Global market, global risks". Opened by HRH Princess Máxima of the Netherlands (now HM Queen Máxima), the event featured a keynote speech by Michel Barnier, the European Commissioner for the Internal Market and Services.

Welcoming delegates, Sergio Balbinot, president of Insurance Europe, talked about the difficult environment for insurers, noting the challenges in developed economies battling recession and financial instability and highlighting that 2011 was the most expensive natural disaster year ever recorded. "In spite of this difficult environment, the insurance industry has remained stable and secure," he stressed. He also emphasised that not only challenges, but also opportunities lay ahead for insurers.

Michel Barnier, European Commissioner for the Internal Market and Services

HRH Princess Máxima of the Netherlands

Insurance Europe president Sergio Balbinot

That in many cases the challenges the insurance industry faces can be turned into opportunities was demonstrated by HRH Princess Máxima in her address. She highlighted that improving access to financial products in developing countries and increasing the financial literacy of consumers in developed countries are both challenges and opportunities. She pointed to the 2.5bn people around the world who are without access to financial services and emphasised the role insurance can play in building stable, inclusive financial systems.

Conference exhibition: financial education

For the first time, Insurance Europe held an exhibition at its international conference. It showcased the wide variety of activities that are carried out by the world's insurance associations to promote financial education and awareness. Comprising interactive displays of teaching tools, audio-visual materials, consumer information documents and activities to promote retirement saving, the exhibition included Finland's award-winning Zaldo financial literacy campaign and the Netherlands' successful "Fix your risk" board game for schools. All the elements from the exhibition can now be viewed in the consumer information section of Insurance Europe's website.

HRH Princess Máxima and Insurance Europe president Sergio Balbinot are shown the financial education inititatives of the world's insurance associations

ISSDC conference: demographic challenges

On 14 June 2012 Insurance Europe hosted a conference in Brussels to discuss ways for the European insurance sector to address the challenges it faces as its workforce gets older. The event was in cooperation with the other employer and employee organisations that make up the EU's Insurance Sectoral Social Dialogue Committee (ISSDC) and was funded by the European Commission.

ISSDC vice-chair Elke Maes and chair Sebastian Hopfner

The conference, which was attended by 65 participants, enabled insurance employers, trade unions, EU institutions and civil society representatives to debate the best ways to increase the attractiveness of the insurance sector. A booklet showcasing initiatives that promote a good work/life balance, qualifications and lifelong learning, and health and safety at work was published at the conference.

Debating ways to increase the attractiveness of the insurance sector

Both the booklet and the conference form part of a project, called "Addressing the demographic challenge in the European insurance sector: a collection and dissemination of good practice", that resulted from a joint statement on demographic issues by the ISSDC in 2010. See p42 for more about Insurance Europe's work with the ISSDC.

Stable financial systems were also the focus of Commissioner Barnier's keynote speech. He stressed that insurers are natural long-term investors, playing a counter-cyclical and stabilising role in financial markets that is important for getting Europe back on track for sustainable growth. "Insurers and reinsurers are guardians of stability and continuity in the financial markets. In the current context, they are more important than ever," said Barnier.

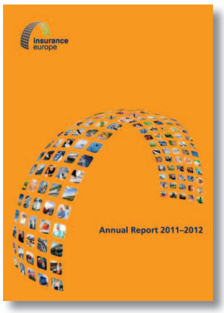
Transatlantic dialogue: John Huff, Missouri Director of Insurance (left), and Peter Skinner MEP compare the US and EU regulatory regimes

A packed hall of 400 delegates attended a full day of debates

The conference panels discussed problems and opportunities for insurers, covering everything from global regulation and retirement provision for ageing populations to sustainable responses to climate change. Audience votes provided a good snapshot of the industry's views. When asked about the biggest challenges, the difficult investment environment and coping with regulation were uppermost in delegates' minds.

Publications

All these Insurance Europe publications, and more, are available free to download at www.insuranceeurope.eu



Annual Report 2011–2012
(June 2012)

Indirect taxation on insurance contracts in Europe
(March 2013)

Funding the future: Insurers' role as institutional investors
(June 2013)

The impact of insurance fraud
(February 2013)

Briefing note: Currency risk
(March 2013)

Statistical publications

European Insurance Key Facts
(August 2012)

European Insurance in Figures
(January 2013)

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GLOBAL FEDERATION OF INSURANCE ASSOCIATIONS

- Launch
- Activities
- Members
- Executives

Global Federation of Insurance Associations

Launch

In 2012 Insurance Europe was one of the founding members of a worldwide federation of insurance associations. The Global Federation of Insurance Associations (GFIA) was established in October 2012 in Washington, DC to create one strong global voice for the insurance industry.

Launch of the GFIA in Washington, DC in October 2012

The GFIA has 32 member associations, representing insurers that account for around 88% of total insurance premiums worldwide. Formally incorporated in Switzerland, the federation's secretariat is being run for its first term by Insurance Europe. The federation works to increase the global insurance industry's effectiveness by submitting common positions to international regulatory groups, standard-setters and governments. By formalising contacts and cooperation among national and regional associations, it also facilitates dialogue within the industry on issues of common interest.

The GFIA has 10 working groups covering a diverse range of issues that are current priorities for the global industry: anti-money laundering; the ComFrame project of the International Association of Insurance Supervisors (IAIS) to create a framework for supervising international groups; corporate governance; financial inclusion; market conduct; natural catastrophes; research; systemic risk; taxation; and trade.

Significant activity so far

In its first eight months, the GFIA has been extremely active. Of particular note was a GFIA delegation to meet the Russian G-20 presidency in March, holding meetings with Russia's Deputy Minister of Finance and representatives from its Central Bank. Against the background of the Russian presidency's focus on strong, sustainable and balanced growth, the GFIA delegation highlighted the significant contribution of the insurance sector to long-term growth and its key role as an institutional investor. In making these points, the delegation highlighted the need for international regulatory bodies to be aware of the potentially unintended effects that regulatory changes can have on insurers' ability to invest long-term. In its meeting with the Central Bank, which was drafting the Russian presidency's conclusions on systemic risk, the GFIA delegation set out the industry's concerns about the bank-centric focus of the IAIS's work to identify global systemically important insurers and to develop measures targeted at them.

On many of the wide range of topics that the GFIA has already covered — such as the IAIS's work on third-country branch operations and the intergovernmental Financial Action Task Force's anti-money laundering recommendations — it has been the sole voice presenting the global industry's views.

The coordinating work behind the scenes — above and beyond its 13 submissions, position papers and letters so far — is perhaps where much of the GFIA's value lies. These discussions have helped to enrich the individual submissions made by GFIA members and have also facilitated global coordination of action. Work in the trade arena is probably the best example of this since, alongside the GFIA submissions, consistent messages have been disseminated to members' local trade representatives, companies and governments.

It is clear even at this early stage that the GFIA's broad membership enables it to respond to a wide range of policy initiatives and its creation has been welcomed by international bodies such as the IAIS. As the federation develops, its ability to represent the global industry will increase. In particular, work to create a research network is an exciting development that should add valuable weight to future GFIA positions.

GFIA members

Africa

Association for Savings and Investment of South Africa (ASISA)
South African Insurance Association (SAIA)

Americas

American Council of Life Insurers (ACLI)
American Insurance Association (AIA)
America's Health Insurance Plans (AHIP)
Association of Bermuda Insurers and Reinsurers (ABIR)
Brazilian Insurance Confederation (CNseg)
Canadian Life and Health Insurance Association (CLHIA)
Chilean Insurance Association (AACH)
Federación Interamericana de Empresas de Seguros (FIDES)
Insurance Bureau of Canada (IBC)
Property Casualty Insurers Association of America (PCI)
Reinsurance Association of America (RAA)

Asia

General Insurance Association of Japan (GIAJ)
Korea Life Insurance Association (KLIA)
Life Insurance Association of Japan (LIAJ)

Australia

Financial Services Council of Australia (FSC)
Insurance Council of Australia (ICA)

Europe

All Russian Insurance Association (ARIA)
Association of British Insurers (ABI)
Association of Mutual Insurers and Insurance Cooperatives in Europe (AMICE)
Association of Spanish Insurers (UNESPA)
Dublin International Insurance & Management Association (DIMA)
Dutch Association of Insurers (VVN)
French Federation of Insurance Companies (FFSA)
German Insurance Association (GDV)
Insurance Europe
International Underwriting Association of London (IUA)
Italian Association of Insurance Companies (ANIA)
Polish Insurance Association (PIU)
Portuguese Association of Insurers (APS)
Swiss Insurance Association (ASA/SVV)

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Membership
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