

1. Solvency II: a positive impetus

Solvency II directive will substitute for EU insurers a genuine risk based solvency framework to the current ill-adapted and national-based safety rules. This new prudential regime seeks to seize the whole range of risks borne by an insurance company and encourages and rewards risk assessment and management practices.

Often described as the most advanced prudential regime at global level, the Solvency II framework gives to the European insurance single market a cost efficient prudential approach that favours resilience and further integration. It also gives Europe the opportunity to be at the forefront of international discussions on a new architecture of a worldwide supervision in the Insurance sector.

The industry was and still remains supportive of an economic, risk-based and holistic approach that grounded the Level 1 consensus.

In the context of an increasing variety of risks – natural risks, pensions, etc. - the solvency margin set by the regulation is intended to combine a reasonable risk of the insurer's insolvency with reasonable economic cost for providing the guarantees given to consumers and businesses. For a given amount of fixed capital, it therefore increases businesses' ability to cover themselves against risks at optimum cost.

2. It is reasonable that policy-makers and supervisors draw the lessons from the financial crisis.

It is understandable that, in the wake of the crisis, on some specific risks focused increases of capital requirements were deemed appropriate.

However, there is no evidence of a need of a general increase of solvency margins and one should not lose sight of the fundamentals:

- The financial crisis did not originate from market failure, negligence or a lack of regulation in the European insurance sector;
- The business model of insurers is fundamentally different from that of banks. Whereas failing banks could put the whole financial system at risk, with grave consequences for European economies, if an insurer were for any reason to fail, this could be managed in an orderly fashion.

Capital requirements are part of the framework, when appropriate. But adjusting the level of capital requirements upwards cannot be the sole and systematic response to everything. Regulators have to be empowered to leverage a largely principle-based regime. This risk-based economic approach is delivering an appropriate regulatory framework that incentivises the best risk management practices.

3. The insurance sector withstood the crisis noticeably well

The likely overall capital requirement suggested by the current QIS 5 might significantly exceed QIS 4. Some anticipate requirements increased by about 45%. Yet the insurance sector, as a whole, weathered the crisis with no need

for extra capital, be it public or private. Therefore, there is no reason why Solvency II would ultimately lead to a global increase of capital requirements for the sector

The consequences of going down this avenue would be devastating for EU economy and citizens:

- Insurance products more costly for the consumer as the increased cost of regulatory requirements leads to price increase;
- As a result of huge asset reallocations induced by the regulation, potential large scale asset sales, longer term capital diversion from European industry and projects and lost of investment opportunities at the global
- European insurance industry competitiveness jeopardised outside the EU. It is worth bearing in mind that out of the top 10 global insurance companies, eight are European based.

4. The European industry is threatened to experience a massive increase of its capital needs.

In the aftermath of the crisis, capital is a scarce and costly resource facing competitive needs to fulfil: public deficits financing, investments or financial institutions recapitalisation. At a time when businesses are beginning to invest again and with banks highly cautious in their lending, the last thing they need is to dry up or reduce the alternative source provided by insurers

Moreover insurers have historically always been financiers of industry due to the long-term horizon of their resources. Today, with the practical aspects of the new prudential regime for insurers currently being defined, this role is under threat. If this direction were to be confirmed, it would have a significant impact on investment, growth and employment..

Last changing the solvency rules for insurers influences their investment strategy freezing innovation to the detriment the hedging of emerging risks, impacting the price and the level of their services and reducing their genuine role as institutional investors. Preference could be given to overly conservative investment strategies. In non-life insurance, insurers' ability to offer low prices and propose innovative products would be reduced. In life insurance, expected financial returns for policyholders would be lower in particular from long-term retirement savings plans. On a macroeconomic level, consumers could make up for this reduction in returns by increasing their propensity to save to the detriment of the volume of consumer spending on goods and services.

5. We must work together urgently to bring Solvency II back on track.

It is vital to adopt both a comprehensive and a balanced approach aimed at promoting financial stability, ensuring consumer protection and providing the insurance industry with the necessary conditions for it to continue to play its roles as a risk absorber and as an important long-term investor for the economy in order to foster growth and create jobs.

Failing to put the Solvency II project back on track, i.e. its economic approach as adopted by the EU lawmaker, would make the market more uncertain, rather than more stable and, ultimately, policyholders poorer, not safer.

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6. On technical issues:

6.1. 'In-force cash flows' (or 'expected future profits' for CEIOPS)

There are two sets of issues:

- In the current drafting of QIS 5, the recognition and the tiering of these 'In-force cash flows' related to premiums from existing contracts to be received in the future (recurring premiums) are questioned. There is an issue of boundaries (pertaining to the future premiums related to in-force contracts in the computation of technical provisions) with large stakes on the amount of Own Funds.
- On top of that, CEIOPS and certain Member States do not recognize these 'In force cash flows' related to premiums to be received (vs. premiums already cashed in) as the best quality of Own Funds and propose these to be 'down-tiered' into Tier3. The industry adamantly disagrees with that analysis. It claims that a split of in-force cash flows would be contrary to its business model and valuation approaches, distort the total balance sheet approach, and lead to double-counting of risk and, finally, it is very difficult to assess the split.

6.2. Diversification in the risk margin

According to the Article 77 in the framework directive, the risk margin shall be such as to ensure that the value of the technical provisions is equivalent to the amount insurance and reinsurance undertakings would be expected to

require taking over and meeting the insurance and reinsurance obligations. CEIOPS and certain member states propose to exclude most diversification benefit from the liability valuation, when the industry is of the view that it reflects the reality of insurance business: the assumption of no diversification between lines of business but also geographical diversification between entities at group level - based on the interpretation that each line of business is transferred individually to the reference undertaking – does not reflect how insurance liabilities are transferred in practice and is not in line with the related going concern assumption.

This issue is of particular relevance for big companies.

6.3. Calibration of the non-life underwriting risk:

Based on the pre-QIS5 survey for the 10 companies, the calibration at solo level for premium& reserve risk have increased by 30% compared to QIS4. The industry is of the view that personalized scenarios (such as under QIS4) should be reintroduced to better factor the variety of classes of business and the geographic concentration specific to each company in particular in catastrophe risk assessment.

The geographical diversification beyond regions was removed (e.g. between France, Belgium, Germany, Switzerland, Netherlands) when geographical diversification is at the heart of the insurance business model. This impact was not been tested in the pre-QIS5 survey though.