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**Reforming insurers' solvency and risk management: a necessary reform
in an increasingly complex and uncertain world**

"New" risks that have to be recognised and specifically evaluated

This globalised world in which we now live is generating "new" risks that we need to be able to recognise, assess and manage, and this is not possible under the present flat-rate¹ Solvency I system. The approach that underlies the new system of prudential regulation will instead be based on an economic assessment of risks:

- A "zero" risk level is no longer sought, but rather an "acceptable" risk level,
- The risk level against which companies will attempt to cover themselves would be set at a likelihood of loss over a one-year period for any insurance provider below 0.5%. This level is equivalent to the likelihood of any one company failing once in 200 years.
- The estimated prudential equity capital necessary to ensure this level of solvency² requires the application of statistical modelling tools. Providers will be able to choose either to use a common tool that is currently being developed by CEIOPS³—the standard model—or to develop their own internal model.

This change in the regulatory system is expected to generate many benefits for both customers and the industry:

- To free up the surplus capital and thus enhance the development of insurance companies both at the European and at the global level.
- Price reductions whenever prudential own funds are reduced
- Adequate pricing based on a fair risk assessment and therefore
- "Insurability" for an increased number of risks (health, retirement, natural disasters, etc.),
- Increased confidence in the solvency of each provider individually and of the profession as a whole,

A reform that raises some concerns

However, the radical technical change that this new approach involves is such that a highly significant impact on the profession's total prudential capital is to be expected and the effects have not yet been analysed with any precision.

In addition, the reforms envisaged have to guarantee that the standard model for risk assessment is sufficiently flexible to provide appropriately for the specific needs of all the diverse insurance activities and insurers under conditions of fair competition

Moreover the insurance sector should continue to play the same key role by investing in the European economy through the various types of investment (bonds, stocks, structured products, etc.) offered today.

Finally, the reform will have to ensure that the supervision mechanism make it possible to obtain simultaneously the benefits of geographical diversification of risks for cross-border groups under conditions of fair competition and to guarantee for each EU member state the solvency of the companies operating on its territory.

¹ Prudential own funds are scaled on a 16% flat rate for non-life premiums and 4% for life technical provisions... This prudential capital is intended to enable companies to cope with contingencies of all kinds, even if in reality neither the probability of their occurring nor their possible extent is known.

² Known as SCR or Solvency Capital Requirements.

³ CEIOPS: Committee of European Insurance and Occupational Pensions Supervisors.

Possible suggestions

In order to facilitate the process that will be following the issuing of the important project of directive the European Commission has elaborated, it seems useful to suggest to:

- ensure that the level of surplus European capital in the profession, which allows it to finance its growth, to create new products, etc., is improved on this occasion, at the same time as the solvency of the sector
- supplement technical modelling provisions wherever the present approach appears to show deficiencies
- implement an integrated European system of supervision at the level of each cross-border group. Eurofy proposes 7 principles as a basis for such supervision

When the moment had come the ECOFIN tackles those subjects it would be necessary to have gathered those clarifications; this should make it possible to build political consensus needed for a coherent and timely implementation of the Solvency II measures as requested by the industry on the basis of a clear agenda

7 principles for an effective integrated cross border group supervision

Various propositions have already been made upon this Integrated EU supervision (EFR, FAS). The out come of the work Eurofi has undertaken which implicated some supervisors as well as some insurers can be summarized by seven principles which seem the relevant basis for an effective integrated groups wide supervision:

1. The home supervisor accepts responsibility towards each of the national authorities. This responsibility applies to:
 - the appropriateness of the assessment of the group's solvency,
 - the quality of the provisions for guarantee within the group,
 - the provision of group-level solvency information,
 - the provision of information such as would demonstrate the appropriateness of the internal models.
2. The supervisors of the countries where subsidiaries or significant branches are established likewise accept their responsibility towards all the countries in which the group is set up, in particular as regards the applicability of the internal models in relation to local specific features, and through their participation in a specific, integrated, control mechanism.

On those bases, in the event of any divergence of views between supervisors, the home supervisor would have the last word, as provided by the Capital Requirements Directive for banks in the area of validation of internal models.

3. These organisational principles apply in countries where there is company activity that can be regarded as significant in the context of the totality of risk portfolios of the group being supervised. Nevertheless, in order to ensure that they had appropriate information at their disposal, it is indispensable that, at least once a year and as required, all the supervisors of the cross-boarder group should be brought together, no matter what scale of activity they represent. It will be the responsibility of the parent company's supervisor to organise this cooperation.

4. The three principles listed above require that national supervisors should all have explicit European-focused mission statements. In particular, their mission must be explicitly focused on optimisation of the group's solvency and not on that of its local establishments. In addition, it appears that the effectiveness of the provision would be greatly facilitated if the supervisors as a whole had analogous status and powers.

A board of supervisors is therefore set up for each cross border Group going beyond current cooperation arrangement.

5. The surplus own funds arising from the diversification of the groups must be able to circulate freely within the group so as to ensure that it can effectively support any local difficulties.
6. More over, the legal reality, at least at European level, of the financial liabilities between parent company and subsidiaries (intragroup guarantees) must be made secure at legislative level; this probably requires specific legislation for the management of bankruptcies of cross-boarder insurance groups similar to that which is already in force for credit establishments, but equally impacting subsidiaries and branches.
7. A European authority gathering EU supervisors for an effective harmonisation of the assessment of the diverse internal models as well as the actual day to day supervisory practices in order to achieve an effective EU level playing field; this authority also arbitrates on major differences of view between supervisors of a group, it also represents an emergency recourse in the case of an important concern would not be finding appropriate answers within the board of supervisors of the Group.

The application of these principles must be spelt out in legislative provisions.

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