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Solvency II : the new regulation of insurance industry: What are the main expectations of the European insurance industry?

by Gérard de la Martinière, President, CEA

+ Strong support and active contribution provided (namely under the umbrella of CEA, the European Trade Association), reflecting a high level of expectation of the whole insurance and reinsurance industry.

Why ?

1. The environment of the European insurance industry has changed dramatically since the completion of the previous regulatory rules :
Just to mention some of the changes:

- * increasing demands for diversified range of products, services, coverage, guarantees from the customers and sometimes from public authorities
- * growing uncertainties of assumptions (nat.cat., terrorism, market volatility ...)
- * more resources to be drawn from sophisticated financial markets
- * strong progress achieved in IT capabilities, risk analysis and modelisation
- * progressive building of a true European coverage by some insurance groups within a strong trend towards globalisation
- * fierce competition between market players
- * struggle for capital raising and shareholders activism

→ clearly, the old system is out of date

2. With the full agreement of the industry the EU Commission decided by the turn of the nineties to address these challenges by designing a brand new scheme of prudential regulations :

- o Taking benefit of the experience of the banking sector (Basel II architecture Pillar 1.2.3)
- * but more ambitious by aiming to encompass the whole balance sheet of the insurance companies
- * choosing to base the new scheme on a comprehensive risk-based approach

Main consequences from our point of view:

- o To keep the consistency of this approach throughout all the steps of the process. It must be ensured that in shaping Solvency II, an overall and consistent vision of the system be maintained at any given time: coherence has to remain an ongoing concern which should underpin any reflection on specific elements of the project. Indeed, there is otherwise a real risk to create a “patchwork” and therefore sub-optimal regime. This would be the case if the outcome was to be a mixed model, i.e. old style arbitrary prudence rules & floors in addition to risk based requirements.

- To admit clearly that pure risk-based analysis has to work both sides, i.e. risks measurement and risk mitigation. In other words, the aim should be to “Give an incentive to the supervised institutions to measure and properly manage their risks”, as stated by the Commission in their *Framework for Consultation on Solvency II*.
 - To understand that supervision will have to change. As a consequence, supervision will have to adapt to a system promoting the development of efficient internal controls: supervisors will need to move from the current practice of “external supervision” to one of controlling the adequacy of companies’ internal controls to the risks entailed by their operations. As expressed by Commissioner McCreevy, the system should thus promote a “better managed and more competitive insurance industry that can better perform its key function of accepting and spreading risk”.
 - To forget about any reference to the figures provided by the old system.
3. European Financial Services far from being integrated according to the conclusions provided by the assessment of FSAP last year. In line with this statement we expect Solvency II to be a key component of the new FSP to be designed very soon by the White Paper of the commission in order to strongly promote market integration in the area of insurance.
- This means from our point of view:
- * True standardisation of solvency requirements:
 - no options
 - no adjustment by local authorities
 - no gold plating in transposition
 - * Favouring rather than preventing multi country coverage by market players (FOS- FOE don’t work market integration resulting from M/A operations)

Therefore group approach required from the outset, taking account of group benefits (diversification) as well as of group risks.

- * Lead supervisor – cooperation → coordination → collective take over (CEIOPS)
 - * Every category of players concerned – not only large groups but also niche players (mutuals)
4. European key strategic priority as stated by the Lisbon Agenda is to “make the EU the most competitive and dynamic knowledge driven economy by 2010” End of 2005 we are still lagging dramatically behind this target.

Developing insurance inside Europe should be considered as a key driver of the completion of the Lisbon Agenda.

- Indeed, insurance - allows entrepreneurial initiatives and investment
- provides long term funds to finance the corporations

- contributes more and more to welfare and therefore maintains consumption
- and is clearly a dynamic sector of the economy. (look at life and pension growth and knowledge-driven business (internal models, risk-modelisation) depends on capital availability.

With that contribution of insurance to economic growth, Solvency II should not be considered only as a toll designed in order to improve PH protection, but as well (as stated in the Commission's orientations) to allow better capital allocation.

- * among market players (without national or category bias)
- * at sector level

The target is to set not a maximal but an optimal capital requirement

- * which will provide enough PH protection at reasonable cost (total protection would mean unaffordable cost to citizens)
- * which will in the same time allow best use of limited capital to provide the more diversified and complete range of products and services.
PH expectations as far as we know and we know a lot through daily relationship of our networks and many commercial polls, are primarily to get the maximum coverage at the lowest cost.

Just to mention that adequate capital allocation will result not only from well designed Solvency II but also from IFRS phase II and from the proper contribution of the new approach.

Conclusion:

Finally perhaps the highest expectation of the industry is to get the new scheme delivered as soon as possible.

Having been personally involved at the starting point of the discussion related to the revision of solvency rules around 1995, I can testify that our greatest fear would be to see endless delays.

Obviously time is required to provide good regulation (QIS and preparation). Why not considering gradual implementation in an experimental way with the well prepared market. players?