CEA comments on the EP amendments on Omnibus II

1. Discount Rate

It should be ensured that undertakings continue providing products such as pension and savings-type products and continue as long term investors playing their stabilising role for the economy. However, an inappropriately designed and calibrated discount rate could have severe negative consequences on the ability of insurers to continue to carry out these roles.

On the liability side of the balance sheet, the discount rate is an important element to determine the size of technical provisions in normal and stressed situations. On the asset side of the balance sheet, insurers' liabilities are invested in assets accounting for an amount higher than 50% of the GDP of the EU. Therefore, any of the details of the specifications related to the discount rate may have a tremendous impact on the economy overall.

This is, therefore, a technical area but with important political implications.

Undertakings require certainty on the calculation methods or assumptions which should be used for calculating the relevant discount rate, therefore subsequent drafting on the "methodologies, principles and techniques" **should explicitly define in detail the calculation method, assumptions and data basis to be used**.

The decision on whether a **Counter-Cyclical Premium** (CCP) is applied should not be left to the discretion of national supervisors. The trigger for the CCP, based on the declaration of stressed financial markets, should be removed. A declaration by EIOPA of stressed financial markets would be itself have unintended pro-cyclical consequences, including the potential to accelerate and deepen the level of stress in the financial markets and the forced selling of assets.

- ⇨ *Support amendments (strongly support a mixture of the following in order to arrive at the original CEA amendment discussed with MEPs in ECO-11-232): 303, 355, 358, 359, 360, 365, 366, 369, 371, 375, 376*
- ⇨ *Support amendments with changes (amendments are moving in the right direction but do not contain all elements of the CEA proposal): 353, 354, 356, 362, 374.*
- ⇨ *Oppose amendments: 351, 352, 357, 364, 367, 368, 372, 373.*

An appropriate starting point of **extrapolation** is necessary order to reflect the lack of a deep and liquid market for long-term assets. This point should therefore be sufficiently early to avoid excessive and inappropriate volatility in the valuation of long-term guarantees due to the lack of available long-term instruments.

- ⇨ *Support amendments: 304, 349.*

We support the **Matching Premium** concept which could resolve issues with the volatility of the market-consistent balance sheet, if it is applied to the appropriate subset of liabilities and calculated appropriately. The matching premium should be a mechanism which is applicable to suitably designed products across Europe. We see no reason why the matching premium proposals apply only to single premium products or limit the types of risks which the products cover (for example, application should also be possible for contracts with immaterial surrender risk as well as other immaterial underwriting risks (e.g. mortality risk)). The key objective should be that, through the application of the Matching Premium, Solvency II does not charge undertakings for risk they are not exposed to.

With the Matching Premium mechanism, it is necessary to take in account the assets held by the undertaking in valuing the liabilities.

⇨ *Oppose amendments: 344, 346, 348.*

Issues related to the volatility in the market consistent valuation should be resolved in the main by an appropriate calibration of the discount rate. There should be no introduction of "**prudential margins**" which is not in line with the aims of transparency introduced by Solvency II and reverts back to Solvency I-type approaches.

⇨ *Oppose amendments: 343.*

2. Transitional arrangements

2.1 Soft launch

There is support for an approach whereby legal transposition of Solvency II would take place as proposed by the Commission (2001/006/COD), but supervisors and industry would have additional time following transposition before full application of Solvency II requirements.

In order to ensure insurance and reinsurance undertakings and supervisory authorities have sufficient time to make necessary practical adjustments, any requirements introduced by delegated acts, regulatory or implementing technical standards shall, notwithstanding the date of transposition of Solvency II or the date of entry into force referred to in Article 311 of Directive 2009/138/EC, not be binding on insurance or reinsurance undertakings until at least 18 months after their publication.

This is particularly crucial for requirements related to reporting for which undertakings will need at least 18 months upon EC adoption of implementing technical standards to implement and test the necessary systems to support quantitative supervisory reporting.
Furthermore, the provisions necessary to begin, in particular, the supervisory approval process of full and partial internal models (at solo and group level), treatment of SPVs and approval of USPs, should apply from the date of transposition of Solvency II into national law. Many decisions must be taken by supervisors in advance of the application date of Solvency II (determine the scope of group supervision, determine the method of group solvency calculations), however the internal model approval process should remain a high priority for supervisors and colleges in 2012.

If undertakings are ready to comply with new requirements before the full application of Solvency II, there should be an 'opt-in option'.

⇨ *Support amendments: 450, 469, 470*

We have serious concerns with amendments setting out '**opening requirements**', during 2013 undertakings would be required to maintain compliance with Solvency I and in addition implement and obtain supervisory approval for all systems and procedures required to support Solvency II. The industry already has serious concerns that supervisors lack the necessary resources to complete approval processes before entry into force in 2014. This should be taken into consideration when proposing new requirements during a transitional year. Undertakings and supervisory resources should be spent as much as possible on preparing for the entry into force of Solvency II rather than on explaining how undertakings and supervisors are preparing for it in the transitional year.

From a practical perspective, it is not clear what time period would be applied when performing the calculations of 'opening requirements'. Undertakings would need to know on what basis the calculations are to be performed and then would require additional months to collate and present the results. The proposed amendment also requires that a profit and loss account is submitted. A profit and loss account is typically compiled on an annual basis reflecting what has happened over the previous year.

It is not clear what an 'opening' profit and loss account would mean therefore or would add in terms of assessing the solvency situation of an undertaking.

- ⇨ *Support amendments: 454 (solo undertakings) and 457 (groups)*
- ⇨ *Oppose amendments: 276, 451, 452, 453, 455*

2.2 Specific Transitionals

We support the EP's efforts to introduce specific transitional provisions to the Level 1 text so their application is not dependent on the adoption of delegated acts. In particular, we support amendments which clarify the transitional requirements for hybrid debt based on Solvency I:

- ⇨ *Support amendments: 459, 460*

However, we notice that the EP proposes, for certain areas, to delete the legal hook for more specific transitional provisions via delegated acts. The following areas would no longer have the possibility to be subject to transitional provisions via delegated acts: SCR, reporting; capital add-ons; governance; valuation of assets and liabilities, calculation of technical provisions; group solvency and group supervision. A smooth transition to the new Solvency II regime is required, and depending on the finalisation of level 2, **the possibility for transitionals in these areas should be left open**. In particular, we draw your attention to EC's Omnibus II, recital 30 proposal, which clearly states that transitional arrangements should aim at avoiding market disruption and limiting interferences with existing products as well as ensuring the availability of insurance products. We believe that this is key and that the "soft-launch" proposals would not remove the need also for transitionals. Therefore we would not to support those proposed deletions in amendments 274 to 278.

- ⇨ *Support amendments: 459, 460*
- ⇨ *Oppose amendments: 274 - 278, 465*

As a general comment, the decision to apply transitional provisions should not be left to national Member State discretion. To ensure a level playing field, **it is important that a common approach is adopted across the EU**. Therefore, we would not support the proposals for transitionals through use of "may" rather than "shall", which would allow for national discretion.

- ⇨ *Support amendments (subject to changing "may" to "shall"): 454, 457*
- ⇨ *Oppose amendments: 278, 465*

3. Third country issues

The Solvency II equivalence process not only provides useful momentum to achieve greater global convergence but it is also of critical importance to many EU insurance groups. We recognise that not all important third countries will be deemed equivalent before Solvency II comes into force therefore we appreciate the move of the EP towards recognising temporary equivalence of third countries (amendments 185, 208 and 260). However, we believe **the criteria a third country needs to meet, to be granted temporary equivalence as included in a number of proposed amendments are far too strict.**
Over-rigid equivalence requirements could lead to the forced sale of European insurers' third country subsidiaries.

For example, we believe the following requirements for a third country are excessive:
i) to provide the Commission and EIOPA with progress reports every 6 months;
ii) to provide written commitments to the European Union to adopt and apply a solvency regime that is capable of being assessed as equivalent; and
iii) to have a risk based regime based on economic valuation of assets and liabilities.

The success of equivalence is critically dependant on the willingness of third countries to decide to actively participate and therefore it is important that the equivalence process remains flexible and outcomes focused. With respect to the level of prescription of the criteria for transitional equivalence:

- ⇨ *Oppose amendments: 424, 425, 433, 447 (441, 445, 448 (equivalence assessment on group supervision is an important incentive for 3rd country's to engage))*

Although, we believe it is important the Level 1 text is not overly prescriptive, in what is required from a third country, we believe it is important, that enough detail is retained to provide legal certainty and maintain momentum for reform. In particular, it is critically important that the Level 1 text provides, at the very least, a legal hook for 'transitional equivalence'.

- ⇨ *Oppose amendments: 423, 430, 431, 432, 438, 440, 442, 446*

The CEA believes **the transitional period should be extended to at least five years plus a five year review period** given the legal procedures and the regulatory changes required for a regime to move towards equivalence. Such an extension is also important to ensure that at the end of the transitional period there is a high probability the regime will be found equivalent, otherwise concerns about level playing fields and business disruption will only resurface at a later date. On this note, we welcome the reference in Amendment 428, 434 and 449 to a potential five year extension to the original five year transitional period. However, it is important that momentum and timely incentives for reform are not lost; therefore we believe a transitional regime should at the same time include concrete realistic milestones which are agreed to at the initiation of the transitional period. The milestones currently included in Amendment 428, 434 and 449 are too broadly worded. Therefore, we would like to see the reference to the milestones amended to include a requirement for clear concrete milestones to be agreed at the initiation of the transitional period.

- ⇨ *Support amendments: 428, 434, 449 (however **only** if the requirements for granting transitional equivalence are amended to include clear concrete milestones agreed to at the initiation of the transitional period).*

We have concerns with the EP proposal (amendment 262) that following a third country being deemed 'temporarily equivalent' application of Article 261 of the Framework Directive (equivalence of third country parent undertakings outside the Community) is left to **national discretion**. This would have serious consequences for a harmonised approach towards equivalence across the EU. A common approach towards equivalence is required therefore in amendment 262 the wording should be changed from "may" to "shall". In addition, we question the reference to "groups" in amendment 262, an equivalence assessment is focused on a third country supervisory regime not a group therefore we believe the reference to groups in this context is misguided.

- ⇨ *Oppose amendments: 262.*

It is not necessary for third-countries to have implemented group supervision frameworks in order to gain equivalence in all three areas. This should only be the case for the group supervision requirements, and is indeed the purpose of this equivalence assessment! It is not necessary for assessing the equivalence of a third country's reinsurance and group capital requirements. Therefore, this amendment is not necessary and not supported.

- ⇨ *Oppose amendments: 307*

4. The shift from Delegated Acts to Regulatory Technical Standards

The Solvency II Level 2 measures have been under discussion for a long period of time with very significant input from supervisors and industry, and it is not clear how the change from delegated acts to regulatory technical standards, which require EIOPA to do the first draft, would mean for the work undertaken in the last months on the formerly called Level 2 implementing measures. We are very concerned that any shift in drafting initiative from the Commission to EIOPA would involve starting this process again and negatively impact an already tight timeframe.

In many places, the EP amendments on Omnibus II are justified by the reasoning that "delegated acts require supervisory expertise". It is important to recognise that current drafts of the Level 2 implementing measures, to be the future "delegated acts", fully reflect supervisory expertise, provided to the Commission by EIOPA and the former CEIOPS over an extended period.

We agree that many of these areas are detailed and technical, but often due to the considerable importance of the amounts which may be affected, they are also areas with important political implications.
Indeed, many of the issues dealt with under the proposed delegated acts may have a wider macro-economic/social impact which are therefore of a political nature rather than purely technical. It is vital that issues of a political nature remain as delegated acts.

Therefore, we request a revisit of the proposals for areas in which **Delegated Acts (DAs) move to Regulatory Technical Standards (RTSs)**, to ensure that important elements which are not purely technical remain as DAs , as currently there are amendments proposed which move important and non-technical areas to RTSs.

The following issues should remain as Delegated Acts (top priority):

- Technical Provisions *[Oppose amendments 78 to 79; 81 to 90 and 374]* & Valuation of assets and other liabilities *[Oppose amendments 75 to 76]*
  - This is of considerable importance given the size of insurers' liabilities which invested in assets accounting for an amount higher than 50% of the GDP of the EU. Undoubtedly, a small change in the specifications related to the discount rate may have a tremendous impact on the economy overall.
  - There are strong divergences of views amongst regulators and supervisors on this issue and as such we believe that the EC is better placed to provide an approach that is consistent with the level 1.
  - It is key that Solvency II includes counter-cyclical measures that act to stabilise against extreme market movements and to avoid significant increases in the cost of capital that will be detrimental to all stakeholders. In these areas stability and certainty is needed over time.

- Own Funds (including Approval of AOF) *[Oppose amendments 91 to 109]*
  - Classification and eligibility of own funds are areas which can have a significant impact on the insurers' ability to raise capital at a fair cost for their policyholders.
  - There are strong divergences of views amongst regulators and supervisors on the treatment of the excess of assets over liabilities (in particular on the part which has been named by supervisors "Expected Profits in Future Premiums") and as such we believe that the EC is better placed to provide an approach that is consistent with the level 1.
  - The criteria and approval process for ancillary own funds will determine the capitalisation in particular of mutuals and groups - billion of Euros of capital will also depend on these criteria.
  - The treatment of participations is crucial for the level playing field with banks.

- SCR Standard Formula Calibration (including equity dampener) *[Oppose amendments 120 to 134; 170 to 178; 401 to 402; 406]*
  - Capital requirements are at the core of Solvency II. If left to supervisors, we fear that, given EIOPA's advice to the EC at the end of 2009, the calibration of the standard formula may result in a Solvency II regime which includes a level of prudence far beyond that crystallised by the Framework Directive, and which fails to encourage sound risk management and entails a cost of compliance which would be unbearable for policyholders and the industry as whole.

- Groups issues [*Oppose amendment 220 and 436]*
  - If left to the decision of EIOPA, we fear that capital requirements for groups would not recognise the economic reality of groups, and in particular diversification which is at the core of insurance.
  - There are also strong divergences of views amongst regulators and supervisors on the issue of availability/transferability of own funds at group level and as such we believe that the EC is better place to provide an approach that is consistent with the level 1.

- Internal models approval process: *[Oppose amendments 135 to 149]*
  - As for all measures relating to the process to be followed by supervisors, the drafting of these articles should be kept at Commission level. The supervisors shall not define themselves the rules and process they have to comply with. It is the elementary basis for a sound split of powers and responsibilities.

- Reporting *[Oppose amendments 55 to 57 and 329]*
  - Reporting: we should keep in mind that Implementing Measures define all the deadlines and the transitory period for submitting annual and quarterly templates. In this perspective, it is important to keep this decision at Commission Level. Reporting requirements need a lot of investments in the automatisation of processes. These investments require money and time. We cannot on this point accept juridical uncertainty with giving power to EIOPA to shorten the deadlines, now or in the future. Undertakings have already started with implementing their Pillar 3 processes according to current deadlines in Level 2: if EIOPA changes the legal text, a lot of money and time would have been wasted.

- MCR *[Oppose amendments 153 to 155]*
  - The MCR is the level below which ultimate supervisory actions are triggered. It is the level below which undertakings may be required to follow a winding-up procedure. These actions have therefore important political and economical implications with potentially highly pro-cyclical effects.

Additionally, (but medium priority):
- Capital Add-ons *[Oppose amendment 60]*
- Functioning of colleges *[Oppose amendments 242, 245, 246]*
- Governance *[Oppose amendments 157 to 166]*

Although we consider that all of the following also have political dimensions, the potential impact is lower compared to those listed above and therefore the industry could accept that the followings areas would move to RTS:
- Transparency and accountability of supervisors *[amendments 49 and 316]*;
- Public disclosure *[amendments 336 and 337];*
- Assessment period regarding qualifying holdings *[amendment 72];*
- Finite reinsurance *[amendment 190]*;
- SPVs *[amendments 191 to 197]*;
- Decision on ultimate parent undertaking at national level *[amendment 429].*

We would also strongly support a "**sunrise-clause**" which would mean that any shift to RTAs would not impact on the work carried out already and would not delay the entry into force of Solvency II.

⇨ *Support amendments: 317 and 376*

5. Additional issues

5.1 Treatment of participations

There is strong consensus on a treatment of participations, when calculating the SCR, which takes into account the reduction in volatility arising from the strategic nature of the investment and the influence exerted by the participating undertaking. For this reason, we oppose an amendment which deletes the special treatment of participations envisaged by Article 111 (1)(m) of the Framework Directive.

⇨ *Oppose amendment: 404.*

5.2 Application of banking rules to insurers

We strongly oppose amendments which try to force consistency between specific parts of Solvency II and CRDIV. The banking and insurance business models are different and this distinction is reflected in the different regimes in place for banks and insurers. Specific elements of CRDIV should not be blindly read-across to Solvency II.

⇨ *Oppose amendment: 377 [and, as mentioned later in this paper: 310, 378, 381, 382 and 435].*

5.3 Mandatory auditing of Solvency II Information

We support the original Level 1 text on this issue and consequently propose to delete amendments which would introduce mandatory auditing of Solvency II information. Mandatory auditing would have a significant cost impact on the industry.

Under Solvency II, undertakings would implement effective governance and risk management systems which will provide numerous lines of defence when substantiating Solvency II calculations and checking the relevant functions adhere to strict procedures.

Any requirements for mandatory external auditing should be subject to a cost benefit analysis. It is not clear where external auditing would add value or assurance to supervisors or external stakeholders of the undertaking. Auditing is often used as a tool by management on an ad hoc basis, to introduce a blanket requirement would remove the ability of an undertaking's management to do this.

Auditing is also a time consuming process and would require additional time to the already tight reporting and disclosure deadlines, it would essentially delay the delivery of information to supervisors and the market.

External auditing of Solvency II information would require a combination of both actuarial and audit disciplines which at the moment are concentrated only in the larger audit firms. This market concentration may drive up the costs of mandatory auditing even further.

⇨ *Oppose amendments: 335, 339 and 340.*

5.4 Reporting and disclosure

We strongly support the proposed amendments 53, 318, 319, 320 whereby infra-annual reporting would be limited to information that has changed significantly during the course of one year. This is a good application of the principle of proportionality.

We believe that reporting should be harmonised across the EU and as such, Member States should not have discretion over what should and should not be reported under the common EU framework. For this reason, the CEA opposes amendment 322.

The requirements prescribed in amendment 253 are too detailed for the Framework Directive itself. We anticipate this level of disclosure to be required from supplementary texts. However, when included in Level 1, it distorts the overall principles-based approach. Article 256 of the Framework Directive makes no reference to the specific contents of the group SFCR.

- ⇨ *Support amendments: 53, 318, 319, 320.*
- ⇨ *Oppose amendment: 253 (group structure reporting), 322.*

5.5 Counter-cyclical capital buffers

Solvency Capital Requirements under Solvency II should be calculated according to a 1 in 200 year VaR. This has been agreed as one of the key principles behind the regime. A requirement to hold additional counter-cyclical capital buffers over and above this would be inconsistent with the 1 in 200 VaR and we would not support this requirement. We also note that Solvency II has two levels of capital requirements: the MCR is a hard target which is a minimum level of capital, below which ultimate supervisory intervention can take place; whilst the SCR is a soft target. This two-level structure, with a ladder of intervention in between is a vital part of the Solvency II framework because under a market consistent approach there will always be volatility and it is a vital mechanism to allow for that. The SCR will range between 222% and 400% of the MCR and so represents in itself a very significant buffer. Finally it should not be forgotten that companies have sufficient reserves to cover both the best estimate of claims and the risk margin. Therefore, via the best estimate provisions, risk margins and SCR, there are already sufficient reserves and capital buffers held..

Furthermore, it is difficult to see how a counter-cyclical capital buffer could be appropriately calibrated to ensure that it would meet the proposed aims – Solvency II should not set capital requirements which are based on the assumption that markets will always bounce-back, rather Solvency II balance sheets should be based on current expectations of the future asset and liability cash flows and capital requirements.

Any additional capital held over the SCR should be at the discretion of the company y depending on their business model, strategy, dividend policy and target rating.

Insurers are not banks and have not suffered the same impacts of recent market events nor have the same systemic impacts as banks. We also note that CRD4 is not a comparable regime to Solvency II and it is not appropriate to pick and chose parts of one regime to translate across to another.

- ⇨ *Oppose amendments: 310, 311, 381, 382*

5.6 Internal Models vs Standard Formula

We strongly oppose an amendment that places restrictions on the calibration of internal models. Internal models are subject to strict scrutiny by supervisors would be subject to capital add-ons if inappropriately calibrated.

With regards to amendment 378, internal models also need to satisfy the use-test which would not necessarily be possible if their output is restricted to a certain proportion of the standard formula SCR and which by its very nature cannot be expected to appropriately reflect the specific risks of each undertaking precisely.

With regards to amendment 435, undertakings using internal models should not also be required to calculate their SCR using the standard formula, which, due to the strict controls around the use of internal models and better alignment of internal models with undertakings' risks, creates significant and unnecessary burdens.

- ⇨ *Oppose amendments: 378, 435.*

5.7 Proportionality principle

We appreciate the clarification that amendment 48 provides in terms of applying the principle of proportionality to delegated acts, implementing technical standards and regulatory technical standards.

⇨ *Support amendment: 48.*

5.8 Group Issues

We fully support that group solvency calculations should reflect the economic nature of existing legal structures, in particular horizontal groups.

⇨ *Support amendment: 436 (however, not the part of this amendment which moves from DA to RTS)*