

To: Thomas Steffen  
Chairman  
CEIOPS e.V.  
Westhafenplatz, 1  
DE - 60327 Frankfurt am Main

CC: /

Reference: ECO-09-158

Subject: **CEIOPS First and Second set of CPs on Solvency II Implementing measures**

Brussels, 2 September 2009

Dear Thomas, *dear Thomas,*

We are writing to express the major concerns of the European insurance industry with regards to CEIOPS' draft advice on the Solvency II Implementing Measures.

As you know, the CEA is strongly supporting the Solvency II project and has always appreciated CEIOPS' contribution to its development. However, after analysing the first and second sets of draft advice, we have realised that CEIOPS appears to have abandoned the principle-based and economic approach it had adopted in favour of crude ratcheting up of financial requirements. Overall, the draft advice is characterised by a systematic injection of quantitative and qualitative elements of conservatism that lead to a number of proposed measures which, in our opinion, are not only inconsistent with the principles crystallised in the Framework Directive, but also not in line with the agreed fundamentals of the new regime. The cumulative effects of the proposed solutions would result in a regime which includes a level of prudence that goes far beyond the level which has been politically agreed, fails to encourage sound internal risk management and entails a cost of compliance that would be unreasonable for the whole European industry.

We are convinced that, if the levels of capital implicit in the draft advice are maintained, then the real losers will be Europe's citizens. They will pay much more than they need to for all classes of insurance, and the market for insurance products - both in the general and life side of the market - will be smaller than it should be. Similarly, Europe's businesses and public organisations will face unnecessarily heightened costs, and the lack of a competitive market from which to buy insurance and savings products.

The costs would be further increased by the level of complexity and administrative requirements which are the result of many of CEIOPS' proposals. These run counter to the objective of a smooth and timely application of Solvency II.

The content of many parts of the advice are also in direct contradiction with the objectives underpinning the new regime as they would prevent companies from using Solvency II tools not only as a means of calculating capital requirements, but also as a means of running the business and expanding the importance of monitoring and managing risks.

Let us stress that it is in the interest of the whole European (re)insurance industry to build a robust and sound prudential regime, which enhances policyholder protection while improving the competitiveness of the European industry and deepening the European single market. We believe that, if the proposed solutions are put in place, the regime would fail to achieve these objectives. The excessive prudence in the regime could create serious obstacles to the sound functioning of insurance business and, as a result, become counterproductive to the interests of European policyholders.

We agree with CEIOPS that the experience of the current crisis should be taken into due consideration when designing and calibrating the new regime. However, as repeatedly stated, the crisis did not originate from negligence in market practices or shortcomings of insurance regulation and any regulatory initiative should be justified on the grounds of insurance specificities and objective regulatory needs.

The CEA is firmly convinced that, in the field of insurance prudential regulation, the best response to the recent turmoil is to complete and put in place the Solvency II regime in line with its agreed basic principles. In the light of the assessment of the crisis, as stated also by CEIOPS, the regime as designed in the Framework Directive is sound and does not need significant adjustments. On the contrary, we believe that, in developing the L2 implementing measures, which will provide the detailed content of the regime, it will be of the utmost importance not to depart from the principle-based, economic approach of the Framework Directive and to maintain the consistency of the whole regulatory package.

The CEA is commenting on the draft CEIOPS advice and is keen to provide detailed evidence of our concerns, which refer to a number of aspects of the proposals, in relation to the first and second set of draft advice. In the attached annex we have summarised the areas of major concern.

The concerns of the European industry are amplified by the impossibility of using the solutions proposed by CEIOPS, which are radically different from the tentative solutions tested in the past four rounds of QIS, as a basis for the specifications of QIS5. If this were the case, in fact, we strongly believe that QIS5 would not allow an appropriate assessment of the quantitative impact of the new regime and, as a consequence, a proper cost/benefit analysis of the new legislation, in line with the better regulation policy, would be seriously undermined.

We would like to stress that the CEA appreciates the extremely demanding timeframe within which CEIOPS has been asked to prepare its advice. We understand that some of the problems in the CEIOPS advice could have resulted from a lack of the necessary time to assess the overall results of the tentative technical solutions.

At the same time, we see the preparation of implementing measures as a crucial stage in the project, as they determine the practical impact of the new regime and could undermine its soundness.

We stand ready to discuss with you our specific concerns in the framework of the effective cooperation already in place between our organisations.

Yours sincerely,



Michaela Koller  
Director General



Alberto Corinti  
Deputy Director General / Director Economics & Finance

Encl.: Annex: Key Industry Concerns

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**Market consistent valuation of assets and liabilities, based on a going concern assumption, should remain the principle that underpins prudential oversight, without implicit additional prudential margins.**

This principle is crucial to ensure risk sensitiveness and transparency of capital requirements as well as to foster internal risk management. We have noted, instead, that the proposed measurement approach tends to embed additional prudential margins which unduly limit the available capital. In addition, in several places, the advice discusses the measurement of assets and liabilities from the perspective of run-off assumptions, which appear to be in breach of the “going concern” valuation approach stated in the Directive.

The proposed calculation of technical provisions, in particular, presents a number of solutions, such as the asymmetric approach adopted in the recognition of future premiums, the choice of the discount interest rate, the limitation to the recognition of diversification effects between lines of business in the risk margin and the related level of cost of capital, which inflate undue prudence in the technical provisions.

**The calculation of the SCR should be economically justified; recognising diversification between risks and giving appropriate credit to risk mitigation techniques.**

Some solutions proposed in the draft advice limit the recognition of risk diversification when calculating the solvency capital requirement. In this regard, we are aware that the crisis has shown that the correlation between risks tends to increase in times of crisis, but at the same time we have to remember and stress that diversification of risks is at the core of insurance business and at the basis of sound risk management and that consequently the future prudential regime should recognise and reward risk management practices based on genuine diversification, both at solo and group level. A diversified entity will better protect its policyholders than a non-diversified entity and this should be reflected in the solvency requirements.

Also, we have noted that the proposed approach to the recognition of risk mitigation techniques is excessively severe. Reinsurance and other risk transfer mechanisms are essential instruments in the insurance business model, which are particularly important for SMEs. Their application should not be penalised by criteria for supervisory review which are excessively prescriptive and unduly burdensome. Any limitation of these techniques should be taken into account in the calculation of the SCR to the extent of their genuine transfer of risks, rather than leading to their complete exclusion.

**Based on market consistent valuation of assets and liability, the calibration of the SCR should respect the 99.5% over 1 year risk measurement, as stated in the Directive.**

The calibration of some parameters has been significantly increased compared to the last tentative solutions (in some cases parameters have been doubled). Even though most of the calibrations have still to be proposed, in a number of cases we believe that these factors are not supported by appropriate evidence and that they lead to an overestimation of the capital charge, as in the case of the operational risk module as well as of the recoverability rate in the counterparty risk module.

**The prudential treatment of own funds should ensure an appropriate quality of capital in terms of loss absorbency and permanency, without hampering the capability of undertakings to raise capital at a reasonable cost.**

We strongly believe that, taken cumulatively, the proposed requirements for the eligibility of both basic and ancillary own funds, including the proposed tiers limitation, are not only much more restrictive than specified in the Framework Directive, but, in practical terms, could seriously damage the capability of insurance companies to attract any eligible element of capital other than ordinary equity. This would put European insurance companies at an unacceptable competitive disadvantage, vis-a-vis both non-European insurance companies and other financial services providers, and could also make the increased capital requirement due to Solvency II hard to sustain, especially for small companies.

**Group supervision should complement solo supervision by applying prudential oversight to the group as a whole, in line with its economic reality.**

Based on the draft advice, it appears that regulatory attention is mainly on the potential additional risks for an individual undertaking derived from being part of a group, rather than on the need to set up a consolidated assessment of the risk situation of the group as a whole. Also, the draft advice focuses mainly on limiting the recognition of group diversification effects in calculating the group SCR, on the basis of the potential lack of transferability of capital. In our opinion, the calculation of capital requirements should fully take into account genuine diversification between risks located in different legal entities, including third country entities; any lack of transferability of capital should only affect the determination of group own funds.

In general, the draft advice poses very restrictive limits on the recognition of the economic reality of groups. Depending on its concrete application, this approach could undermine the very nature of group supervision as introduced by the Framework Directive and could end up compelling European insurance groups to reconsider their business structure.

**Supervisory reporting and public disclosure have the objective respectively of giving the necessary information for the supervisory review process and adequately informing all stakeholders in order to trigger market discipline. However, they should not oblige undertakings to bear unreasonable costs to provide excessive information, both in terms of quantity and frequency, which would be ineffective in achieving the above purposes.**

The European industry is seriously concerned about the overall volume of the proposed requirements, in terms of scope, granularity and reporting frequency. We think that more rigorous cost-benefit analysis should be carried out in defining the required public and private regular reporting. Also, more attention should be given to the quality of the information rather than its quantity, avoiding duplication with information already provided under the accounting regime. The principles of materiality and proportionality have to be applied.

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