

**FINANCIAL SERVICES ACTION PLAN:  
PROGRESS AND PROSPECTS**

**EXPERT GROUP ON  
INSURANCE AND PENSIONS**

**FINAL REPORT**

**MAY 2004**

## EXECUTIVE SUMMARY

The Insurance and Pensions Expert Group is committed to a vision of a European single market for insurance and pensions services that is diverse, open, efficient and competitive; where customers benefit from a wide choice of innovative products at competitive prices; provided by an EU insurance and pensions industry regulated in an effective and cost-efficient environment that does not undermine domestic operation and allows business the opportunity to achieve European scale and scope economies to reinforce its global competitiveness.

Insurance and pensions are major economic activities. Insurance premium represents almost 9% of EU GDP and assets managed by insurers and occupational pension funds are equivalent to over 75 % of EU GDP. The imminent Accession of 10 new Member States and the demographic challenge of an ageing population will lead to further growth. The EU market is slowly consolidating. 'Pan-European' groups, operating in two or more Member States, now have sizeable EU market share.

Further integration should provide significant benefits for customers, the industry and the wider EU economy. Notwithstanding the existing single passport system and the FSAP measures adopted, the business reality is that national markets remain fragmented. Cross-border competition is limited by a variety of market entry barriers, reducing consumer choice and hindering efficient business operation.

Limited market integration has taken place primarily through cross-border freedom of establishment (FOE) via acquisitions and holdings. Branching activity is relatively unimportant except for reinsurance. While beneficial, establishment based trade does not produce the full benefits of an integrated market. Furthermore, emerging pan-European groups cannot harness operating efficiencies because of the current legal and prudential framework. In particular, group supervision and supervisory reporting requirements under the Insurance Groups and Financial Conglomerates Directive need urgent remedy. Macro-crisis management at EU level and increasing overlaps of regulatory supervision at the global level need addressing.

The volume of cross-border retail business under freedom of services (FOS) is negligible. While the situation is more satisfactory for large (i.e. industrial) risks, efforts to promote the cross-border selling of mass (i.e. retail) risks have created disproportionate costs for domestic markets without achieving significant FOS sales. The nature of retail business is such that, for many lines of business, FOS sales will always remain relatively limited. At the customer level, language and culture differences, customer preferences and consumer protection rules act as entry barriers. At the supplier level, the need for local risk knowledge and a local claims service, business and distribution characteristics as well as abusive use of 'general good' rules, make cross-border selling difficult. Taxation presents a gamut of challenges. There is no unique legislative panacea that will create a genuine single market. While some barriers should be tackled by business-led initiatives and not by legislation, a variety of measures could help FOS sales emerge where there is a real market potential.

The Group has also examined issues for specific market participants. Industry customers experience problems caused by the growing number of compulsory national pools and the

taxation of multi-national policies. Intermediaries could play an important role in promoting FOS sales but rules in the Insurance Mediation Directive and the proposed Investment Services Directive need both some rationalisation and time to bed down. Mutuals, niche operators and their members could benefit from increased cross-border co-operation with a tailored legal framework. Pensions providers welcome the new 'Pensions' Directive. Local tax, labour and social security laws require local product delivery but integration benefits could be realised in the upstream value chain, e.g. asset and risk management. A 2-way 'knowledge gap' between EU pension professionals and the wider market needs to be narrowed. The position for reinsurance branches would be eased by the proposed reinsurance directive, but reinsurers suffer from the same group supervision problems as primary insurers.

The Group identified a series of horizontal principles that should be respected in the preparation and review of all EU legislation. The EU legislative framework should be the minimum necessary for all market operators to enjoy the freedoms of a single market. It should focus on efficiency and convergence to ensure business competitiveness for the benefit of customers and the wider economy.

The Group recommends that the following actions be taken to improve the functioning of the single market in insurance and pensions :

- Complete the FSAP including Solvency II, reinsurance and satisfactory international accounting standards- but in Solvency II a balance needs to be maintained between the absolute level of capital required, the cost implications for insurance customers and the competitive impact on the European insurance sector;
- Hold a regulatory pause to consolidate legislation. This would also be beneficial in the context of enlargement;
- Focus on the convergent implementation and effective enforcement of EU legislation. This goal will be facilitated by the correct application of the 'Lamfalussy' process, enhanced by due industry consultation and a new mechanism to speed up the resolution of disputes;
- Streamline current supervision, especially for groups ,conglomerates and pan-European players and remove barriers (such as VAT on inter group services) that hamper companies developing a genuine European 'shared services' model ;
- Make existing FSAP and other EU-insurance, related legislation more coherent, and simple where possible;
- Simplify and clarify identified tax issues;
- Foster the organic development of a single market by:
  - studying the development of a 26<sup>th</sup> regime;
  - encouraging business to develop pan-European products;
  - adopting the statutes for a European mutual society;

- addressing those product/customer segments where the cross border business model is most likely to succeed in the short term (e.g. SME sector, expatriates, consumers with properties in more than one Member State, simple life products)

In relation to the adoption of new, as well as the review of existing, EU legislation, the Group stresses that the following principles be rigorously respected:

- Consult widely and in a timely fashion with industry and other stakeholders;
- Adopt a flexible and targeted approach to EU initiatives and legislation:
  - Use non-legislative measures where possible (e.g. self-regulation, codes of conduct, ombudsman, etc. );
  - Resort to legislation only where necessary;
  - Develop a variable legislative approach, e.g. mutual recognition, where possible and harmonisation, only if essential;
- Prioritise any EU policy initiative by rigorous evidence-based justification and quantitative cost-benefit analysis, where feasible ;
- Test the impact of any proposed measure on wider business competitiveness for both proprietary companies and mutuals;
- Seek to create a real single market by reducing or eliminating unnecessary host country rules and options that act as barriers to cross-border business.

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## 1. INTRODUCTION

1. As the five-year operational phase of the FSAP draws to a close, the Commission has embarked on a wide-ranging and transparent assessment of the results of the FSAP. In the autumn of 2003 the Commission services took a first step by establishing four expert groups (banking, insurance and pensions, securities and asset management) to assist it in producing an in-depth review of the state of integration of European financial markets and to draw up a series of recommendations for further action. This report presents the views of the expert group on insurance and pensions.

*The Expert Group was asked to assess the degree of integration and make recommendations for future.*

2. This report is divided into eight chapters as follows:

*The report is divided into 8 chapters.*

1. Introduction
2. EU Market Vision and Overview
3. Financial Services Action Plan and Market Integration
4. Analysis of Issues relating to Freedom of Establishment and the operation of pan-European groups.
5. Analysis of Issues relating to Freedom of Services
6. Analysis of Issues for specific market participants
7. Principles for the preparation and application of EU Legislation
8. Recommendations.

## 2. SINGLE MARKET VISION AND OVERVIEW

### 2.1. THE EUROPEAN INSURANCE AND PENSIONS MARKET – A VISION

3. The European Single Market in insurance and pensions services should be diverse, open, efficient and competitive – both for service providers and their customers. All methods of transacting business (including branches, subsidiaries and Freedom of Services) should be given equal weight in the measurement of the openness and competitiveness of the Single Market.

*The EU Single Market should be diverse, open, efficient and competitive....*

4. *Single* should not mean *uniform*: objective local geographical, social and cultural factors which differentiate the retail markets should be accepted. At the same time, local and national markets should be open and readily contestable, with no entry barriers caused by legislation, so that consumers reap the direct and indirect benefits of market pressures on companies. Once open to new entrants, local markets should be allowed to converge – or not – at their own pace and according to natural business dynamics. The Single Market must be formed by businesses and consumers, not only by regulation.

*...allowing consumers to reap the full benefits and...*

5. Consumer benefits will be maximised when such a market supports a wide diversity of business models and a wide choice of products where business can operate in a legislative and regulatory environment that enhances its competitiveness, both in a European and global context.

*...business to remain competitive....*

6. Market operators (undertakings and intermediaries) should be subject to the lightest-touch and least expensive regulatory, fiscal and reporting environment compatible with sensible levels of consumer protection and adequate prudential requirements. Poorly-targeted and costly regulation, with little real benefit for companies or consumers, should be avoided. The EU should become a stable and cost-effective regulatory jurisdiction. This will require both a rapid reduction in the rate of, and a more considered approach to, new legislation. The EU will then improve its attractiveness for internationally-mobile capital.

*...through a light touch and efficient regulatory regime.*

7. Any action by governments, or the EU institutions, should be concentrated on the elimination of local market protection and the reduction of unnecessary regulatory (and hence consumer) costs. Market-based solutions should be found for clearly identified problems. Non-legislative means should be preferred, wherever possible. And the principle of subsidiarity should be strictly applied, so that even where legislative solutions appear justified, these are enacted on an EU-wide basis only if local measures have clearly been demonstrated to have failed or to be impracticable.

*EU action should eliminate local market protection but avoid legislation where possible and....*

8. Within such an approach, means should be found to reduce the costs of the provision of insurance and pensions services by eliminating unnecessary differences between national markets in the implementation of the existing body of EU law and regulation. At the same time, opportunities to simplify and rationalise the regulatory environment, including tax structures, capital adequacy rules and accounting standards, should be studied. The EU should establish a target to reduce overall regulatory and supervisory costs by say, 30%, over the duration of the next 'action plan'. Simplification of the existing framework will be an important contributor to positioning the EU as an attractive location for mobile capital and should assist European companies to operate effectively in an increasingly competitive global marketplace.

*...harmonise national rules only where necessary, while simplifying and rationalising existing EU rules to maintain Europe's business competitiveness ...*

9. A similar approach should be taken to consumer protection, so that it is easier for consumers to purchase insurance, with confidence, regardless of the

*... and provide EU consumers with the right*

origin of the company concerned. With the right regulatory regime, opportunities for direct cross-border trade will be exploited naturally, where and when this makes sense for companies and consumers.

*protection.*

## 2.2. MARKET OVERVIEW

10. Insurance and pensions<sup>1</sup> are major economic activities. In 2001 EU insurance premium<sup>2</sup> income amounted to 822 billion euro, representing 30% of worldwide premium and 8.6% of EU GDP. Over the period 1991-2001, life business has grown strongly, rising from 3.0% to 5.4% of GDP. Non-life business has remained stable at around 3.2% of GDP. Given the challenges faced by social security systems and increasing longevity, life and health business can be expected to show further growth. Insurance is an important employer with approximately 900 000 direct jobs and an additional 460 000<sup>3</sup> in distribution. The assets of EU pension funds represent 26% of EU GDP. Assets managed by insurers amount to approximately 50% of EU GDP.

*Insurance and pensions are major economic activities. EU insurance premium represents almost 9% of EU GDP; insurance and pension fund assets total over 75% of EU GDP.*

11. Although there are still a large number of insurance companies operating in the EU, consolidation is taking place. The number of companies (i.e. legal entities) has fallen from 4974 to 4608 in the period<sup>4</sup> 1991-2001. Further consolidation can be expected as a result of industry pressures and in the wake of the events of recent years. This has led companies to re-focus and concentrate their business strategies, by rationalising operations, tightening-up underwriting, monitoring asset risk, increasing solvency capital, and generally allocating capital much more efficiently in relation to the expected risk/reward contribution.

*The EU market is slowly consolidating, but this will accelerate due to industry pressures and recent events.*

12. After Enlargement on 1<sup>st</sup> May 2004, the EU will grow from 15 to 25 countries. While the increase in insurance premium terms is small - approximately 1.9 %, economic convergence by the 10 new EU countries with the existing EU-15 affords the potential for considerable future premium growth.

*Catch-up should see premium growth in the new EU countries.*

13. Through the single passport system, an insurer authorised in any one Member State can legally trade throughout the whole EU and in EEA countries as well. While the single passport system has facilitated the exercise of the

*Despite single passport, the market remains*

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<sup>1</sup> Unless otherwise indicated, "Pensions" in this report refers to both occupational (2<sup>nd</sup> pillar) and individual (3<sup>rd</sup> pillar) pensions.

<sup>2</sup> Includes insurance premiums for second pillar occupational pensions and third pillar individual pensions. Data source: CEA. Preliminary 2002 data gives a similar picture.

<sup>3</sup> Approximately 400 000 tied intermediaries and 60 000 brokers. Source: BIPAR.

<sup>4</sup> These numbers are likely to overstate the position since some companies may not be active in the market or may be part of a larger group.

freedoms of establishment (FOE) and provision of services (FOS), the business reality is that the European insurance market remains fragmented. With the exception of reinsurance where branching remains important, such EU market integration as has taken place, has primarily occurred through cross-border acquisition<sup>5</sup> and the creation of pan-European<sup>6</sup> groups. Enduring product, distribution and other differences at the national level has meant that these emerging pan-European groups are seeking to achieve economies of scale and scope in upstream activities in the management of the value chain. But this remains difficult. The current degree of fragmentation is not satisfactory. It remains the main issue to tackle after completion of the (enlarged) FSAP. This will promote the development of strong European insurance companies, which can compete effectively in an increasingly global insurance market place.

*fragmented for many reasons.*

*Pan-European groups are slowly emerging but they cannot operate efficiently. This needs to be tackled.*

### 3. FSAP AND MARKET INTEGRATION

14. All insurance and pensions measures in the original FSAP endorsed by the European Council at Cologne in 1999 have now been adopted. Full implementation of these measures will spur further financial services integration. With the exceptions of the Solvency II project, the proposal for a directive on reinsurance (both recently added to the original FSAP) and the adoption of satisfactory international accounting standards, a regulatory pause is now essential. This will ensure the proper consolidation of existing legislation. However, this should not block efforts to improve the current regulatory and supervisory basis, e.g. by simplifying or removing unnecessary rules, as identified below. Furthermore, European legislation should be substitutive for, not additive to, national legislation. A plethora of Member State options fragments markets.

*With the exception of Solvency II, reinsurance and accounting, a legislative pause is desirable to consolidate and improve existing EU legislation.*

15. An integrated market for financial services should provide significant economic benefits by promoting investment, growth and employment, in accordance with the goals agreed by EU Heads of Government in Lisbon in March 2000. While the emphasis has been on the benefits arising from capital market integration, the benefits flowing from insurance and pensions integration are potentially substantial, both on the demand and the supply side.

*Further financial integration should provide significant benefits.*

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<sup>5</sup> i.e. the acquisition of an existing insurer active in one Member State by another insurer active in another (or more) Member State(s)

<sup>6</sup> For the purposes of this report, a pan-european group means a business group that has commercial activities carried out by separate legal entities in two or more different Member States, i.e.it does not include branch sales or FOS sales.

16. On the demand side, customers<sup>7</sup> will gain from lower prices, increased choice and accelerated product innovation. On the supply side, a competitive and integrated EU market will lead to better risk diversification and lower risk capital requirements, than would otherwise be the case. It will improve financial stability as well as buttress the EU industry's position in global markets. It will also provide wider, knock-on benefits. An efficient and strong insurance and pension funds industry will support and facilitate the risk-taking that is essential to the success of the wider economy. Life insurers and pension funds can help meet the future demographic challenges of an aging population.

*Customers gain from lower prices, increased choice and accelerated product innovation.*

17. While integration will provide a variety of significant benefits, the primary objective should be improving business competitiveness. The aim should be a cost-efficient and effective regulatory environment allowing insurers to develop their own business model throughout Europe with maximum efficiency.

*... but the regulatory environment must sustain competitiveness.*

### **3.1. ASSESSMENT OF CURRENT INTEGRATION**

18. The group assessed the current degree of market integration in relation to a number of criteria: competition, entry barriers, business operation, product choice and price. The small sample size did not permit rigorous quantitative assessment, but revealed a generally consistent qualitative picture.

*Assessment of market integration shows that ....*

19. Competition from outside a member state remains relatively limited because of a variety of implicit market-entry barriers, both regulatory and non-regulatory, particularly for retail products. Consequently effective access by retail customers to insurance products outside their home Member State is curtailed. The position for industrial customers is better. Market integration has occurred primarily through acquisition of local providers, but with some notable exceptions (asset management, large risks and reinsurance), the realisation of operating economies of scale or scope by business integration on an EU-wide scale remains difficult. This is a priority issue for improving business competitiveness. Finally, the complicated nature of many insurance products, in part reflecting differences in local/national risk conditions, means that simple price comparison is generally not meaningful, and not a useful guide to the degree of market integration.

*...cross-border competition is limited due to market entry barriers, which reduce consumer choice and hinder efficient business operation.*

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<sup>7</sup> See also study on the benefits of retail market integration by ERT "The Benefits of a Working European Retail Market for Financial Services" and it has been prepared by Friedrich Heinemann and Mathias Jopp. The study can be downloaded at the EFR web page ([www.efr.be](http://www.efr.be))

### Results of questionnaire on market integration

These conclusions were supported by the results<sup>8</sup> of a questionnaire completed by group members<sup>9</sup>. The questionnaire examined integration with respect to three categories: business functions, products and channels of market entry.

With regard to business functions, members considered that strategic development, issuance, investment management and information technology exhibited the greatest degree of integration. On the other hand there was little or no cross-border integration for risk underwriting<sup>10</sup>, claims settlement and dispute handling. In general life business showed lower levels of integration than non-life.

With respect to products, reinsurance and assistance guarantee, closely followed by large risks, showed the greatest degree of integration. Mass risks<sup>11</sup>, motor and occupational pensions showed almost no integration. Notwithstanding a few exceptions, which varied by country, overall markets for key insurance products and services in life as in non-life were not integrated.

The questionnaire results for ease of market entry accorded with intuitive expectations. Establishment by acquisition or subsidiary generally reflected low or surmountable entry barriers. Branch establishment was feasible for reinsurers and certain niche operators. In contrast, market entry by direct cross-border B2C (business to consumer) sales or in response to active consumer interest was very limited and largely an uneconomic strategy. Between these two extremes lay B2B (business to business) sales for large risks. The pension funds of employers were considered as an example of B2B sales. The implementation of the Pension Funds Directive is expected to act as a catalyst for increased cross-border activity by decreasing entry barriers. A large number of participants highlighted the importance of acquiring local distribution capacity for market entry.

*These conclusions were supported by the results of a detailed opinion survey within the group*

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<sup>8</sup>While members recognised that the aggregate analysis employed can and does mask important details, the results were nevertheless considered instructive from a qualitative perspective, albeit limited from a quantitative angle.

<sup>9</sup> 16 of the 23 group members participated in this survey

<sup>10</sup> Excluding MAT (*i.e. marine, aviation and transport*) risks

<sup>11</sup>Mass risks correspond to retail policies such as motor (third party and comprehensive), household policies for natural perils and theft, individual life, savings and pension policies etc.

## 4. FREEDOM OF ESTABLISHMENT AND THE OPERATION OF PAN-EUROPEAN GROUPS

20. The analysis in the preceding chapter shows that establishment through cross-border acquisition is considered the principal means of 'market integration' although branching<sup>12</sup> remains important in some cases. It should be noted that while a pan-European group operating in two Member States does allow some of the benefits of market integration (e.g. through product or technology transfer-and, better risk diversification), it does not create a fully integrated market in the two Member States concerned.

*The analysis shows that cross-border acquisition is the principal means of limited market integration.*

21. At least fourteen<sup>13</sup> major groups were identified as having significant sales in two or more Member States. Although representing only a relatively small number of companies, the identified undertakings hold a combined EU market share<sup>14</sup> of about 37%.

*But emerging 'pan-European' groups....*

22. In a purely national context, an acquisition strategy could be expected to produce operating efficiencies<sup>15</sup>. Through effective competition this would benefit policyholders. However, pan-European groups are unable to organize most business functions at European level because of the current legal and prudential framework. Major impediments to genuinely pan-European supervisory standards need to be urgently addressed.

*.... cannot harness operating efficiencies unless....*

### 4.1. ALLEVIATING REGULATORY BURDENS FOR PAN-EUROPEAN GROUPS

23. Since the primary motor for harnessing "integration benefits" is cross-border acquisition of existing local establishments, there is a prima facie case for alleviating the regulatory burdens for groups active or wishing to become active cross-border in this sense. In particular this calls for a simplification of group supervision, individual supervision and reporting requirements for pan-European groups. Other legislative and administrative hurdles also need examination and in particular the use of 'options' in EU legislation which fosters

*....group supervision and reporting requirements are alleviated.*

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<sup>12</sup> Branching is important for reinsurance.

<sup>13</sup> AEGON, Allianz, Aviva, AXA, Fortis, Generali, Groupama, ING, Legal & General, Prudential, Royal Sun Alliance, Skandia, Winterthur, Zurich. Although some groups have a relatively low level of sales outside their home Member State, it should be noted that the above list is not complete. For example Ergo, Swiss Life, Storebrand, Sampo, KBC, etc are also believed to have significant sales in two or more Member States.

<sup>14</sup> This market share has been calculated on the basis of life and non-life premiums for 2000.

<sup>15</sup> In principle, similar gains might also be obtained via a more uniform cross-border market in retail products, but most members felt that in practice, this was likely to be a limited prospect for the foreseeable future, in part because of the inherently local nature of many of the markets concerned

differing local rules thus hindering integration.

24. A simpler, more effective, efficient and coherent framework for group supervision is essential. This would not only reduce company costs but would also promote supervisory convergence and mitigate regulatory arbitrage as well as strengthen financial stability. The IGD (Insurance Groups Directive) poses several problems and is in need of a major overhaul. While the FCD (Financial Conglomerates Directive) represents a first step forward in the right direction, both Directives require improvement across several fronts. Supervision relating to individual companies needs to evolve to capture established best practices, and thus aid group supervision. In particular, the following weaknesses should be tackled (see box below):

- The role for a lead supervisor needs extending (IGD) and strengthening (IGD and FCD);
- Efforts should be made to improve supervisory convergence. Better coordination between supervisors is a prerequisite to better individual, group and financial conglomerate supervision. Solvency II must deliver a more harmonised model capturing established best practices for both capital requirements (Pillar I) and supervisory action (Pillar II). However, Pillar I capital requirements under Solvency II must not impose additional financial burdens on insurance companies which would impact negatively- both on costs for customers and on the broader competitive position of European insurers. The European insurance sector has coped well with the recent crisis in financial markets post “September 11” and showed that the overall level of capital was adequate to cope with these exceptional events
- In addition to improved guidance at supervisory level (i.e. level III) under the ‘Lamfalussy’ model), one approach to achieve similar supervisory standards for pan-European groups would be the establishment of teams composed of differing national supervisors.
- If this type of evolutionary approach - in accord with the ‘Lamfalussy’ model - fails, a more radical approach might need to be considered. In particular, some Members of the Group consider that the establishment of an EU-wide supervisory authority is already desirable. They feel that such an authority would have many benefits: it could make rapid judgements in infringement cases or where Member State implementation differed; it could supervise conglomerates at holding level on a consolidated basis; and it could set rules to ensure a level-playing field between purely regional and multinational providers.
- Parallel efforts should be made to simplify and standardise supervisory reporting. While the situation would be partly alleviated by the introduction

*The Insurance Groups and Financial Conglomerate directives must be improved by...*

*.... a greater role for lead supervisors ...*

*....improved supervisory convergence, through the ‘Lamfalussy’ extension and....*

*.... similar supervisory standardsenforced by multi-national supervisory teams.*

*If unsuccessful, we may need to consider establishing an EU-wide supervisory authority.*

*There is also a need to improve and standardise*

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<sup>16</sup> E.g. risk exposures relating to flood claims in a territory outside their jurisdiction.

of satisfactory, international accounting standards, supervisory requirements involve much broader reporting requirements. Greater uniformity here – in format, content and frequency- would facilitate the broader objective of supervisory convergence, promote financial stability and produce substantial cost savings for groups.

*supervisory reporting;....*

- Obstacles to staff mobility within pan-European groups constitute a huge practical impediment to greater European financial integration. Article 3 of Directive 95/26/EC means that Member State authorities are obliged to require the head offices of insurance undertakings to be located in the same Member State as their registered offices. The application of this requirement is an obstacle to more efficient staff allocation in a pan-European group. This should be reviewed. Unless exceptional circumstances arise, supervisors should not be authorised to oppose such staff mergers.

*..... to facilitate staff mobility; ....*

- Other routine administrative burdens should be reduced and preferably eliminated, especially in the context of the approval of the acquisition of “qualifying holdings”. A cascade holding structure could produce situations where a party is subject to extensive reporting obligations, but has no material influence over the entity reported. Similar burdens arise in relation to “fit and proper requirements”. One of the largest, recent, cross-sectoral acquisitions almost had to be abandoned because of the length of time required to obtain the necessary approvals for individuals who already satisfied EU “fit and proper” requirements, albeit under differing national supervisors. A sole approval by the lead supervisor should suffice. Situations where several supervisory authorities, exercising supervision over different local subsidiaries which are all part of the same insurance group, each require reporting of common risk exposures<sup>16</sup> outside their home jurisdiction should be avoided. A single report to the Lead Supervisor should again suffice. In the context of a single market, there should be no need for separate supervisory rules for branches and subsidiaries. Another example is the application of the data protection rules which block different subsidiaries in the same financial services group using each others’ client data. A further example is the taxation of inter-group services. These all impede more efficient group operation.

*....to simplify the reporting of qualifying holdings; ....*

*....and the obtaining of ‘fit and proper’ approvals; ....*

*.... to avoid multi-reporting of group exposures; ....*

*....provide relief from data protection rules; ....*

- While group operation has been facilitated in an EU cross-border context by the adoption of a European Statute for companies and cooperative societies, scope for improvement still remains in relation to some specific areas (including tax, accounting, and social issues)

*....and to develop an European Statute for mutuals .*

## **The Insurance Groups and Financial Conglomerates Directives**

### *Insurance Groups Directive (IGD):*

- The current obligation under the IGD for each national supervisor to apply a Supplementary Capital Test (SCT) poses particular problems.
- Different supervisors define different groups or sub-groups and apply the test on different bases, resulting in different interpretations. This leads to multiplication of effort and confusion.
- Greater reliance should be placed on a lead supervisor who alone would carry out the SCT. In particular, paralleling the approach of the FCD, the SCT should only be applied at the main group level and not at a variety of sub-group levels.
- Further harmonisation of both capital and supervisory rules are required to ensure that implementation is consistent, thus facilitating greater mutual recognition in a group supervision context.
- In essence, the IGD should be streamlined towards the philosophy of the FCD (i.e. a single coordinator, top down supervision, no duplication of tests and reporting) by January 2006 at the latest.

### *Financial Conglomerates Directive (FCD):*

- While the FCD is yet to be implemented, the Directive has the merit of specifically establishing a coordinator role. However, Group Members feel it is likely to suffer from inconsistent interpretation and implementation.
- The European Commission should thus closely monitor the current implementation process of the FCD to ensure that such helpful features are not watered down or jeopardised through ineffective transposition.
- Furthermore, the following points need addressing: guidance should be provided on the meaning of significant risk concentrations, intra-group transactions, reporting frequency, the interaction of differing sectoral capital rules, and the claimed equivalence of the different methods for calculating solvency.

25. In the context of emerging pan-european groups, expert members identified two further issues for attention: first, macro-crisis management at the European level and secondly, in a global context, the overlap with regulatory and supervisory action by other major jurisdictions.

## 4.2. MACRO-CRISIS MANAGEMENT

26. The institutional arrangements for macro-crisis management in the EU insurance and pensions industry need urgent action. EU harmonization of insurance supervision addresses micro-crisis management, i.e. the position of an individual undertaking or an individual group of undertakings . But it does not address the broader picture of macro-crisis management, where some shock could affect the industry or the financial sector as a whole and even spill over to other sectors.

*Macro-crisis management at EU level needs urgent attention  
.....*

27. Improved co-ordination of the European governance system is necessary. The impact of macro-economic policy errors for insurance companies should be given attention. In particular, the current EU and national prudential rules should be screened to identify those representing potential sources of macro-prudential and systemic risk for the European economy as a whole. An EU governance system based on reinforced coordination arrangements between supervisors would assist in providing a stronger and more consistent response, should the need arise.

*.....to avoid creating systemic risks.*

## 4.3. THE GLOBAL DIMENSION

28. The European financial services market, while still relatively independent remains strongly linked with the world, and particularly the US, economy. Due to regulatory proliferation, there are increasing supervisory overlaps with direct impact on EU companies. More effort has to be made to co-ordinate legislative initiatives with the US regulators on a proactive basis. Where international differences of opinion arise, an over-arching supra-national body may be needed.

*EU regulation also needs better coordination with other jurisdictions, especially the US.*

## 5. FREEDOM OF SERVICES

29. Despite EU legislation and a variety of Commission communications and initiatives, experts acknowledge the volume of cross-border retail business sold on a freedom of services basis remains very low. With a couple of notable exceptions<sup>17</sup>, the volume of FOS retail business can often be calculated in fractions of a percent. This reflects the nature of retail markets, which remain local for a variety of reasons. However, a distinction needs to be drawn between large risks<sup>18</sup> and mass risks.

*The volume of cross-border retail business under freedom of services is minimal.*

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<sup>17</sup> Although accurate statistics are difficult to obtain, Luxembourg and Ireland have significant (ie 10-15% for non-life) FOS sales, but this appears to be largely explained by branch or subsidiary selling to customers in the parent's home country. Luxembourg appears also to have very significant FOS life sales for the same reason.

<sup>18</sup> Large risks are defined at Article 5 of Directive 88/357/EEC. In layman's language they basically correspond to non-life risks where the customer is not a private individual.

## 5.1. LARGE OR INDUSTRY RISKS

30. Although no statistics are available and most large risks are not placed on a FOS basis, the situation is generally considered satisfactory<sup>19</sup>. This is explained by a number of reasons. Such policies benefit from greater contractual and jurisdictional freedom. The policyholder is a sophisticated buyer and the selling process is not complicated by consumer protection laws. As a result, the scope for invoking 'general good' requirements is substantially diminished. From a business perspective, "large risk" contracts also involve significant premiums. They are therefore better able to support the higher unit selling costs inevitably involved in FOS sales. However, there are some specific and emerging problems, as identified in the section of this report dealing with industry customers.

*For large (i.e. industry) risks the situation is more satisfactory.*

## 5.2. MASS OR RETAIL RISKS

31. Given the inroads made by distance selling in some national markets for certain mass risks (e.g. for compulsory third-party motor), it should at first sight be possible to penetrate other markets via FOS selling. However, it is important to remember that an insurance policy is not a simple good but a service whose performance and delivery depends vitally on local/national characteristics. These aspects make it difficult, if often not impossible, to design products for universal EU sale. Cumulatively they produce significant, natural entry-barriers to FOS selling. While some could be addressed by regulatory action, this is certainly not the case for all.

*For mass (i.e. retail) risks efforts to promote cross-border selling....*

32. In fact many participants feel strongly that the nature of retail business is such that, for many lines of retail business, demand for cross-border supply will always constitute only a small percentage of overall sales. In the light of past experience with the FSAP, concern was expressed in discussion that further legislation to facilitate an EU-wide mass retail market would produce disproportionate costs relative to the expected benefits for a marginal group of policyholders. In consequence, new (and indeed existing) legislation should always be subject to a strict cost-benefit analysis.

*.... has created disproportionate costs without achieving significant FOS sales.*

33. The group identified a series of entry barriers at customer and supplier level:

- *At customer level:* An insurance policy must provide security. This means there is consumer resistance to buying from unknown, foreign based insurers (for expatriates the requirement for brand familiarity can operate in the opposite sense and favour suppliers from the expatriate's home country). For life and savings policies, where the policyholder entrusts substantial monies to the insurer for many years, the need for the customer to feel comfortable with the product supplier is considered particularly strong. Non-life policies frequently require after sales service, particularly in the event of a claim. Thus

*Language and culture, contractual and consumer protection rules at the customer level ...*

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<sup>19</sup> Subject to a number of reservations as identified later in the text (eg tax).

customer expectations of future service and satisfaction will be important considerations at the time of purchase. For life policies, tax relief on a policy with a non-domestic insurer is often difficult to secure, if at all.

- *At supplier level*: The scope for contractual and jurisdictional freedom is restricted. Generally host country law and jurisdiction have to be followed. Complicated consumer protection and conduct of business rules (e.g. relating to pre-contractual information) need to be observed. Business can be subject to excessive general good requirements. Companies often need to appoint separate claims and tax representatives. Language and culture varies between markets. As for pricing, often there are fundamental differences in expected claims costs. Thus the different national markets require detailed local market knowledge and produce different premium levels. Compulsory products also have to respect host country rules. For third party motor liability which represents the largest non-life category at about 40-50% of premium, vehicle registration and other requirements make it impossible or non-viable to insure on a FOS basis. Companies need to provide local service for claims management and claims policing. The latter is important given the growing incidence of fraudulent claims. These features mean that FOS policies are often commercially unattractive, with low premium relative to high risks, particularly for some non-life business, subject to high unit costs and the additional complexity inherent in cross-border business.

*... local risk, business and distribution characteristics at the supplier level, create significant natural entry barriers.*

### **5.2.1. Demand for FOS retail sales**

34. Despite the above litany of implicit and explicit entry-barriers, group members see a continued role, but potentially growing - albeit limited-, for FOS sales for specific customers and products. Customers who live in border areas, have high-net-worth, are expatriates or regular purchasers on the internet are expected to demonstrate a greater propensity towards cross-border purchasing. Products less impacted by the local risk and regulatory environment ought to be easier to sell on a FOS basis. Examples may include term life, repatriation insurance, medical assistance and householder's all risks. Certain life products such as unit linked, some pension business or simple savings products may find a cross-border market, provided potential barriers created by tax relief and consumer protection rules are surmountable.

*There may be a FOS retail market for specific customer niches.*

### **5.2.2. Measures to support FOS sales**

35. Given the disparate nature of the barriers, no unique solution can address all the issues. Furthermore, some barriers should be tackled direct by business (e.g. customer preferences) rather than through legislation. The Group identified a series of proposed measures, whose cumulative effect could increase the scope for FOS retail sales where there is a real market potential.

*There is no unique remedy. The following measures could help:*

- *-Study a "26<sup>th</sup> Regime"*: To combat contractual and jurisdictional issues, an alternative, optional EU regime governing essential parameters could be developed (the so-called 26<sup>th</sup> regime). This would facilitate the marketing of

*Study a '26<sup>th</sup> ' regime;*

pan-European products on an EU-wide scale. However, this calls for careful study before implementation, since the nature of such a regime would vary considerably from product to product. The danger of introducing additional costs for minimal benefits needs to be avoided, but in principle, a 26<sup>th</sup> regime-approach need not result in a new, additional regulatory framework with new administrative burdens. Such an approach must be “channel neutral” and not privilege certain distribution channels as compared with others.

- -Develop Pan-European Products: In addition to efforts to facilitate the sale of “national products” on a cross-border basis, consideration should also be given to the development of new, specific “pan-European products”. These products could be sold throughout the EU on a universal basis and would allow providers to benefit from economies of scale. Even if pan-European products only satisfy the demands of a nominal part of the 450 million EU citizens, the potential sales volume would be significant. For example, although views differ, some think a European annuity-type product in conjunction with a suitable “26<sup>th</sup> regime” could play a role in third pillar individual pension products. Indeed, given the wide diversity of new national rules in the pensions area, some feel that the evolution of a pan-European pension product based on a 26<sup>th</sup> regime was the only viable way forward in the short term. However, after-sales service (claims handling, complaints) would call for special organisation e.g. by brokers or by the companies’ own networks. The design of such products should not be imposed by EU legislation. The important thing is that industry should be encouraged to develop such products organically, and an open debate among the currently divergent opinions should be fostered.

*Encourage companies to develop pan-European products;*
- -Tackle general good abuse. Abusive use of general good requirements should be vigorously tackled by the Commission. An extensive list for consideration has been identified.

*Tackle abusive general good rules;*
- -Improve the existing legal and administrative framework. Time delays for notification requirements by home to host country authorities could be reduced/eliminated. The status and obligations of claims and fiscal representatives could be clarified and stream-lined. The current legal interpretation<sup>20</sup> for FOS sales could be illuminated and simplified.

*Streamline the legal and administrative framework;*
- -Give consumers confidence. Consumers should have better information and benefit from rapid and effective redress systems (eg FIN-NET, SOLVIT or their successors). The convergence<sup>21</sup> of consumer protection rules should be fostered.

*Give consumers the confidence to buy cross-border;*

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<sup>20</sup> Under current jurisprudence, FOS sales are arguably temporary in nature, as compared to establishment. In a true single market FOS sales – at whatever level - should be considered as a permanent feature.

<sup>21</sup> See propositions of the European Financial Services Round Table published on 1 March 2004.

- Address differences in tax regimes (see box below)
- Expand definition of large risks. Since “large risks” are generally easier to sell on a cross-border basis, one simple, but potentially significant, approach to facilitating more cross-border business could be to expand the definition of large risks. This could be achieved relatively easily by lowering the current policyholder thresholds<sup>22</sup> for turnover, balance sheet and, especially, number of employees. This would give SMEs greater freedom to purchase insurance cover outside their home Member State.

*Help SMEs to purchase insurance cross-border.*

**Box: Tax Difficulties**

Members identified a series of tax difficulties.

- At customer level, the paramount concern was to secure tax relief on life business and to avoid being subject to double taxation on non-life premia.
- For the suppliers, difficulties arose at a variety of levels. More generally, the appointment of a local tax representative could be simplified. Ideally, a person in the registered office (i.e. in the home country) could be appointed and non-essential “supplementary duties” for tax representatives waived.
- Some harmonisation of tax collection, payment and reporting would be very welcome.
- The operation of VAT presented particular difficulties for cross-border groups. Frequently VAT was levied on the provision of intra-group services, but any VAT paid could not be re-claimed. This created a barrier to a more efficient organisation of back-office services.
- There should be greater uniformity in the tax (and legal) treatment of branches and subsidiaries.
- In particular, the negative tax effects induced when moving from a subsidiary to a branch structure needed to be addressed.
- An extensive analysis was made of tax barriers arising in the context of occupational pensions. Difficulties arose in three areas:
  - i.* first, with the double taxation of benefits,
  - ii.* secondly, with the failure to obtain tax relief on contributions and fund investment income (e.g. non-discriminatory treatment of cross-border investments);

<sup>22</sup> Current thresholds are 6.2 million euro (balance sheet total), 12.8 million euro (net annual turnover) and 250 employees.

*iii.* and thirdly, as regards capital transfers before normal benefit payment where a worker took up employment in a different member state and wished to transfer accrued pension rights to the new employer's fund.

## 6. ANALYSIS OF ISSUES FOR SPECIFIC MARKET PARTICIPANTS

36. The group analysed a number of issues for specific market participants.

### 6.1. INDUSTRY CUSTOMERS

37. Given that the cross-border insurance of large risks is generally considered satisfactory, industry customers report no major problems. However, there are two emerging issues that require attention.

*No major barriers to serving industry customers...*

38. A first challenge arises with the emergence of compulsory national pools. The growing incidence of such pools, e.g. for certain terrorist, natural catastrophe or liability risks, renders the management and integration of required insurance coverage for international groups both difficult and expensive (through duplicate covers). While some industry customers favour the establishment of an EU-wide pool, the EU insurance industry has serious reservations. Technical problems make the calculation of the covers requested by large customers difficult and major risks vary by territory, e.g. flooding. National pools should be open and non-exclusive and participation on a FOS basis be facilitated.

*... but problems created by compulsory national pools need to be tackled and ....*

39. The second major concern of industry customers is tax collection and tax allocation on multi-national policies. Under the recent ruling<sup>23</sup> by the ECJ in the 'Kvaerner' case, tax was calculated by reference to location<sup>24</sup> of risk. This was based on the provisions of Directive 88/357. While the ruling was clear, its implementation is not economic in a cross-border group context. In many cases, the mere cost of tax collection for all the individual slices of premium relating to the different Member States could exceed the amount of the premium! A three-pronged solution is proposed: a revision of the relevant provisions of Directive 88/357, greater harmonisation of insurance taxes, and the introduction of a minimum threshold for the transfer of taxes to other MS (as for tangible goods).

*...taxation of multinational policies needs to be rationalised.*

### 6.2. INTERMEDIARIES

40. Insurance intermediaries are a vital link in the process of selling insurance

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<sup>23</sup> Case C-191/99, *Kvaerner plc v Staatssecretaris van Financiën*, 14.6.2001

<sup>24</sup> A particular problem for large risks lies in the fact that general covers for a whole group (e.g. excess liability limits, additional covers under an Multinational Programme) have to be split artificially by MS in order to secure each country's insurance tax.

products in the European Union. They also play a pivotal role in protecting the interests of insurance customers, primarily by offering advice and assistance to insurance customers and by analysing their specific needs.

41. Untied intermediaries could play a major role in promoting the sale of insurance cross-border. A survey has demonstrated that customers exhibit much greater propensity<sup>25</sup> to purchase insurance cross-border if a local intermediary recommends the product. Cross-border selling by intermediaries would be facilitated by the recently adopted Insurance Mediation Directive (IMD) but time is needed for the new legislation to bed down and no new EU legislation should be introduced in the short run.

*Intermediaries have an important role to play in promoting FOS sales..*

42. However, considerable scope to improve the current situation remains. Where possible, inconsistencies in EU legislation should be removed. In particular the differing requirements on customer information and professional qualifications in different Directives<sup>26</sup> create considerable administrative burdens for intermediaries. The cumulative effect of these directives is that an intermediary is obliged to provide over 50 different items of pre-contractual information. The differences between rules for professional requirements, depending on whether the intermediary distributes insurance or other financial products, are inefficient and disrupt market practices. The situation for intermediaries needs to be rationalised, but rationalisation should not lead to an accumulation of all existing requirements.

*...but the Insurance Mediation and other Directives need to be rationalised and ....*

43. From an intermediary perspective, cross-border selling could also be facilitated by: simplifying insurance tax payment and avoiding double taxation, considering the development of an EU-mandated insurance guarantee scheme and generally improving consumer redress mechanisms.

*...other measures would also help.*

### 6.3 MUTUALS AND NICHE OPERATORS

44. In general terms, mutuals and niche operators encounter the same difficulties as proprietary companies when selling cross-border. As most enjoy a national or regional vocation, in practice they possess limited cross-border experience. Group members from mutual undertakings singled out two specific areas where mutuality called for a more tailored approach.

*Mutual and niche operators need a tailored approach.*

45. First, the statutes for a European mutual society should be finally adopted and a new, specific legal instrument, similar to the “*Société de groupe d’assurance mutualiste*”, as adopted in France in 2001, should be developed at EU level to facilitate cross-border co-operation by mutuals. Such cross-border co-operation

*A legal instrument permitting cross-border mutual*

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<sup>25</sup> The survey showed that when an intermediary was involved (HK) 37% of consumers were willing to buy cross-border as compared to only 9% when there was no intermediary.

<sup>26</sup> E-commerce Directive 2000/31/EC, OJ L 178 , 17/07/2000; Insurance Mediation Directive 2002/92/EC OJ L9, 15/01/2003; and Distance marketing Directive 2002/65/EC OJ L 271, 09/10/2002 as well as the proposed Investment Services Directive.

was vital for mutuals and niche operators. In this way they could significantly improve their risk diversification and risk management as well as share and develop common services on a cost-efficient basis. Customers would benefit from broader and higher risk covers at the lowest possible cost. *cooperation is essential and....*

46. Second, group members from mutuals suggested that solvency capital rules need to be reviewed. By their very nature mutuals are handicapped in raising capital in financial markets. They argued therefore that greater flexibility in the eligibility requirements for solvency capital should be allowed by raising the current 50% ceiling on subordinated debt. *....existing solvency rules need more flexibility.*

#### 6.4. PENSIONS PROVIDERS

47. Occupational and individual pensions are strongly growing sectors of the market. Given the demographic reality, they will become even more important in the future. Participants highlighted the fact that pensions providers, whether corporate pensions funds or insurance companies, are substantial investors and major facilitators of EU capital and labour market integration. *Occupational, group and individual pension contracts will grow in importance.*

48. However, there is widespread agreement that the supply of pension and related products requires local delivery - even more so than other insurance products, as pension benefits are impacted by specific national tax rules, social and labour law requirements, as well as by national pensions and social security systems. *Local delivery required because of local tax, labour and social security laws*

49. A regulatory pause is also recommended to enable industry "to digest" the FSAP and other EU legislation. It will also provide a breathing space for industry dynamics to reshape the market and leverage the opportunities currently opening up in the new EU-wide and international markets. *A pause is now needed to digest FSAP legislation.*

50. A distinction is drawn between wholesale and retail markets: the former are more integrated and enjoy rising cross-border sales; the latter are less integrated and had less need of cross-border sales. Therefore, future EU initiatives are more likely to have a greater impact if targeted at facilitating pension provision by pan-European companies operating across the EU. Such action would benefit the numerous, local and internationally mobile, individuals employed by these companies, instead of broadly targeting the whole retail segment of the pensions market with a scattergun approach. *Pensions integration should focus on the wholesale level, not on the retail level....*

51. In this context, participants welcome the new pensions directive<sup>27</sup>. This should facilitate integration at the upstream end of the value chain, e.g. asset and risk management, even if numerous legal, social and tax hurdles remain. The Commission should seek consistent Member State implementation of the cross- *...e.g. asset and risk management could benefit from integration*

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<sup>27</sup> Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement pensions, OJ L234/10, 23.9.2003

border elements of the Directive. The Commission should provide succour to pensions providers and companies developing international pension plans which seek to overcome the remaining hurdles, including tax. This is particularly necessary where parties encounter difficulties availing themselves of the freedoms afforded by the new directive.

*in the upstream value chain.*

52. Group members stressed the size of the two-way knowledge gap between wider market participants and those professionals directly concerned with EU legislation affecting the pensions industry. Progress towards an integrated EU pensions market can be advanced by: more formal, structured and closer industry consultation, not just as part of the new 'Lamfalussy' approach; greater national dissemination of information on the new international market openings; easier access to information sources for market practitioners; and thorough research into the real needs of savers. The last should be encouraged, particularly given the demographic realities.

*A two-way knowledge gap between EU pensions professionals and wider market participants needs to be narrowed.*

53. The group recognises the over-riding political goal of encouraging adequate provision of retirement income. It is important that measures taken at EU level do not undermine national efforts to achieve that goal. A sensible first step may be an in-depth study, based on consultation with all stakeholders, of tax barriers, with a view to identifying those which had a genuine impact on consumers' purchasing decisions

*Advocate a study on the promotion of retirement saving and identification of tax-barriers to saving.*

## **6.5. REINSURANCE**

54. Not surprisingly, reinsurers reported supervisory problems largely analogous to direct insurers (but without the problems of consumer protection issues etc). For branches, particular problems were identified when preparing supervisory/accounting reports etc. for host country supervisors. This situation is expected to improve considerably when the proposed draft directive on reinsurance is implemented. For pan-European reinsurance groups, the same group supervision issues arise: e.g. the need to develop a lead supervisor role, to standardise financial & supervisory reporting, and to simplify the notification of qualifying holdings and the obtaining of 'fit and proper' approvals.

*New reinsurance directive will reduce problems with host country supervision of branches, but reinsurers still have the same 'group issues' as primary insurers.*

## 7. PRINCIPLES FOR THE PREPARATION AND APPLICATION OF EU LAW

55. The Group identified a number of principles which must be respected if the preparation and application of EU legislation is to be efficient, effective and convergent. These themes run across different product and market sectors.

*Principles for efficient, effective and convergent EU legislation.*

### 7.1. CONVERGENCE (CONSISTENT IMPLEMENTATION AND VIGOROUS ENFORCEMENT OF EU LAW)

56. To achieve convergence, great emphasis should be placed on the consistent application and vigorous enforcement of EU law, including within the framework of the 'Lamfalussy' extension to insurance and pensions. At the supervisory level, consistent implementation should be strengthened by promoting supervisory convergence. This could include the issue of guidance notes and interpretative statements in some areas. The establishment of a peer review process for supervisors could spread best practice across supervisory authorities. There should be wide consultation with market participants, consumers and end-users. Supervisory measures should be flanked by vigorous enforcement action by the Commission and Member States. In particular, the Commission should draw up an action plan to tackle infringements as well as 'abusive' use of general good requirements. Greater public dissemination of information on EU and national legislation through the internet would facilitate more effective and convergent implementation

*Convergent supervision is essential. Exploit the potential of the Lamfalussy approach for consistent application and vigorous enforcement of EU law.*

57. A primary concern for Accession countries is the practical introduction of the "acquis communautaire". EU legislation that was consolidated<sup>28</sup> in text, clear in purpose and coherent in nature would greatly simplify practical transposition in accession countries. The Commission and national authorities in existing Member States should continue to provide educational support to assist supervisory authorities in the new EU countries.

*Commission and existing Member States should help the new Member States to apply EU legislation.*

### 7.2. POLICY PRIORITISATION

58. Given resource constraints it is sensible to prioritise action. Efforts should focus on measures with the greatest net benefit, ease of implementation and lowest cost.

*EU Policy needs prioritisation.*

### 7.3. EVIDENCE BASED JUSTIFICATION FOR LEGISLATIVE ACTION

59. CBA (Cost Benefit Analysis) must play a much greater role. This is an imperative – not just for new legislation, but also for existing legislation. Concern was expressed by members lest burdensome legislation be produced for the many,

*EU legislation – both new and old- must be*

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<sup>28</sup> Although a consolidated life text has recently been adopted, no consolidated non-life text exists.

relative to limited potential benefits for the few. There should therefore be systematic and permanent evaluation of legislation through cost-benefit analysis. Its application could and should lead to the relaxation of some regulation already adopted. Furthermore, European legislation should be substitutive for, not additive to, national legislation. Unfortunately all too often the latter is the case.

*justified by cost-benefit or equivalent analysis....*

60. Three examples were identified where proper CBA could have produced higher quality EU legislation: first, the inconsistencies in the treatment of groups under the IGD and FCD; second, the cumulative effects of various directives with equity capital requirements; and third, the contradictory rules for insurance contract closure as between the 3<sup>rd</sup> Life/Non-life Directives, the Distant Selling Directive and the Insurance Mediation Directive.

61. Participants expressed a clear preference for quantitative analysis, but recognise that precise benefit calculation is often difficult, if not impossible. In these cases, efforts should be made using cost-effectiveness analysis or other evidence-based justification for legislative proposals. The analysis should retain a strong business focus, respecting the need for maintaining competitiveness and channel-neutral legislation.

*...recognising that precise quantitative analysis is often difficult.*

#### **7.4. INDUSTRY AND USER CONSULTATION**

62. Extensive industry and user consultation is a “sine qua non”. This applies not just to the Internal Market Directorate General but across all Commission departments. In particular, participants high-lighted concerns with the current Commission proposals for a directive on gender equality: consultation had been inadequate and the impact assessment of the proposal had neglected the likely adverse effects on customers, as well as on industry efficiency. Moreover, the consultation process should grant industry and user organisations sufficient time to conduct in-depth analysis and engage in further membership consultation.

*In particular, full and timely industry and user analysis is a ‘sine qua non’.*

63. Greater use should be made of surveys or polls. These could inter alia identify niche customers (such as mobile staff, expatriates or clients resident in border areas) who could be expected to benefit from more cross-border retail trade. One strategic issue requiring study is the long term impact of internet use.

*More market research is necessary.*

#### **7.5. SELF-REGULATION**

64. Where possible, legislation should be avoided. Greater reliance should be placed on industry codes of practice and self-regulation. These are rapid, flexible and can more easily target specific situations. Problems have been identified with the provision of pre-contractual and technical information. One member suggested that the insurance industry develop a kind of ‘harmonised European information prospectus’ paralleling that introduced for mortgages and other banking products.

*Legislation should be avoided where possible, e.g. using industry self-regulation.*

## 8. RECOMMENDATIONS

65. The Group is committed to its vision of a European single market for insurance and pensions services that is diverse, open, efficient and competitive; where customers benefit from a wide choice of innovative products at competitive prices, provided by an EU insurance and pensions industry regulated in an effective and non-burdensome environment that does not undermine domestic operations and allows European scale and scope economies to reinforce its global competitiveness.

66. The EU legislative framework should be the minimum necessary for operators to enjoy the freedoms of a single market; it should focus on convergence and efficiency, thus strengthening business competitiveness.

67. The Group recommends that the following actions be taken to improve the functioning of the single market in insurance and pensions:

- 1) Complete the FSAP including Solvency II, reinsurance and satisfactory international accounting standards- in the case of Solvency II a balance needs to be maintained between the absolute level of capital required, the cost implications for insurance customers and the competitive impact on the European insurance sector (AC) ;
- 2) Hold a regulatory pause to consolidate legislation, which would also be beneficial in the context of Enlargement;
- 3) Focus on the convergent implementation and effective enforcement of EU legislation, strengthened by the correct application of the 'Lamfalussy' process with due industry consultation and a new mechanism to speed up the resolution of disputes;
- 4) Streamline current supervision, especially for groups ,conglomerates and pan-European players combined with the removal of barriers (such as VAT on inter group services) that hamper companies developing a genuine European 'shared services' model ;
- 5) Make existing FSAP and other EU-insurance, related legislation more coherent, and simple where possible;
- 6) Establish an overall EU target (e.g. 30%) to reduce regulatory/supervisory costs;
- 7) Simplify and clarify identified tax issues;
- 8) Foster the organic development of a single market by:
  - a. studying the development of a 26<sup>th</sup> regime;
  - b. encouraging business to develop pan-European products;
  - c. adopting the statutes for a European mutual society
  - d. addressing those products/customer segments where the cross border business model is most likely to succeed in the short term (e.g. SME sector, expatriates,

consumers with properties in more than one Member State, simple life products).

68. In relation to the adoption of new, and the review of existing, EU legislation, the Group stresses that the following principles be rigorously respected:

- 1) Consult widely and in a timely fashion with industry and other stakeholders;
- 2) Adopt a flexible and targeted approach to EU initiatives and legislation:
  - a. Use non-legislative measures where possible (e.g. self-regulation, codes of conduct, ombudsman, etc. );
  - b. Resort to legislation only where necessary;
  - c. Develop a variable legislative approach, e.g. mutual recognition, where possible and harmonisation, only if essential;
- 3) Prioritise any EU policy initiative by rigorous evidence-based justification and quantitative cost-benefit analysis, where feasible ;
- 4) Test the impact of any proposed measure on wider business competitiveness for both proprietary companies and mutuals;
- 5) Seek to create a real single market by reducing or eliminating unnecessary host country rules and options that act as barriers to cross-border business.

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