



MARKT/2506/04-EN Orig.

Solvency II:
Road Map for the Development of Future Work-
Proposed Framework for Consultation and
Proposed first wave of Specific calls for advice from CEIOPS

Important note: At the Insurance Committee on 30th June 2004, it was decided that occupational pensions was an important and separate subject that should be addressed at a later date, but not now.

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Executive Summary

At the 32nd Insurance Committee meeting in April last year, Members endorsed the fundamental principles for the design of a future prudential system for the supervision of insurance undertakings in the EU, i.e. the Solvency II project.

Since then the Commission services have continued to carry forward the development work for the project in close cooperation with national regulators and supervisors as well as through extensive and transparent consultation with stakeholders.

While these discussions have advanced the project and demonstrated that widespread consensus exists on many issues, they have nevertheless highlighted three major challenges covering substantive, procedural, and legislative issues.

These issues are addressed in the following Road Map proposed by the Commission Services. The Insurance Committee is requested to provide guidance on the proposed Road Map.

Essentially, the Road Map proposes that:

- The Commission prepare before the end of 2005 a draft proposal for a Framework Directive;
- The detailed Solvency II legislation be subsequently adopted through implementing measures under a comitology procedure with a target completion date of 2008; and
- To facilitate the preparation of these measures and later preparation of formal mandates, a Framework for the Consultation of CEIOPS and other stakeholders be drawn up. Furthermore, CEIOPS should be consulted by means of three waves of specific calls for advice in accordance with the attached timetable (Schedule 1).

The Insurance Committee is also requested to provide guidance on the Framework for Consultation (Annex 1 to the Road Map) and the first wave of specific calls for advice (Annex 2 to the Road Map).

Questions to the Members of the Insurance Committee

- 1. Do you have any comments on the proposed Road Map for Solvency II?***
- 2. Do Members have any comments on the proposed Framework for Consultation of CEIOPS and other stakeholders?***
- 3. Do Members have any comments on the first wave of Specific Calls for advice from CEIOPS?***
- 4. Do Members agree that institutions for occupational retirement pensions¹ be already included in the Framework for Consultation, but that a specific call for advice be prepared at a later date, after the first three waves of specific calls for advice?***

¹ Important Note: At the IC Meeting on 30 June 2004, it was agreed that solvency capital requirements for institutions for occupational retirement provision was a separate and important topic that should be considered at a later date.

I. INTRODUCTION

Background

At the 32nd Insurance Committee meeting in April last year, Members endorsed the fundamental principles, proposed by the Commission services, for the design of a future prudential system for the supervision of insurance undertakings in the EU, i.e. the Solvency II project.

The detailed principles are set out in the paper MARKT 2509/03. The main features are briefly summarised below. The new solvency system should:

- assess “overall solvency”;
- be based on a Basle 2 -type three-pillar structure, adapted to insurance;
- build on a more risk-oriented approach, with incentives for proper risk management;
- increase harmonisation of quantitative and qualitative supervisory methods;
- seek more efficient supervision of insurance groups and financial conglomerates;
- employ “Lamfalussy” or comitology techniques to adopt/adapt legislation efficiently;
- ensure consistency between financial sectors;
- be developed in parallel with international developments², and in particular be compatible with the estimated outcome of the international accounting (IASB) work.

Since then the Commission services have continued to carry forward the development work for the project in close cooperation with national regulators and supervisors as well as through extensive and transparent consultation with stakeholders. Three major papers³ have been discussed at length by the Insurance Committee Solvency sub-committee. In the interests of transparency and mindful of the importance attached to this by the European Parliament, all papers as well as comments received have been placed on the Commission web-site⁴ for public access.

² E.g. organisations like the International Association of Insurance Supervisors (IAIS), the International Actuarial Association (IAA) and the International Accounting Standards Board (IASB)

³ MARKT 2539/03 which considered issues relating to various new Articles for the Framework Directive as well as more detailed aspects of the Pillar I, II and III arrangements. MARKT 2543/03 which reviewed procedural developments of the new Committee Architecture, considered some over-arching issues, and entered into a preliminary examination of difficult technical issues on technical provisions and target capital, and also reviewed some practical supervisory issues. MARKT 2502/04 which examined asset management, ALM, minimum solvency margin, solvency control levels and supervisory powers issues.

⁴ http://europa.eu.int/comm/internal_market/insurance/solvency/solvency2-workpapers_en.htm

Need for IC Guidance

While these discussions have advanced the project and demonstrated that widespread consensus exists on many issues, they have nevertheless highlighted three major challenges on which it is necessary to receive guidance from the Insurance Committee. The first is substantive, the second is procedural, the third is legislative.

At the substantive or technical level, it is clear that many of the issues will require extensive analysis before definitive proposals can be formulated. Furthermore, paralleling the Basle II process, comprehensive field testing and simulation exercises will be required. This work can best be undertaken by CEIOPS when greater clarity exists with regard to the proposed methodology for solvency capital determination.

At the procedural level, there is a need to organise and structure the work, as well as to efficiently deploy the available resources to bring the project to fruition. In terms of resources, it is perhaps useful to remember that: on the one hand, the development of a satisfactory model to determine solvency margin requirements based on an economic capital approach for target capital will probably be as challenging for an insurance undertaking as for a banking institution; and on the other hand, for insurance there is no analogous body with the resources of the Basle Committee to pioneer the project's development. Consequently, the Solvency II project will call for sustained support and commitment by Members States, stakeholders and the Commission.

Fortunately, CEIOPS has already dedicated substantial resources to progress Solvency II work. CEIOPS has constituted five specific working groups⁵ (Pillar I- Life; Pillar I- Non-Life; Pillar II; Pillar III (accounting and disclosure) and Cross-sectoral & group issues). While these working groups are to be congratulated in that they have already started their deliberations, their activity nevertheless merits policy guidance in a more formal way. Furthermore, CEIOPS has already indicated the desirability of receiving such guidance.

It should also be noted that major stakeholders such as the CEA and the Groupe Consultatif of European Actuaries⁶ have committed significant resources to the project, and other stakeholders have also responded actively to the above Commission papers.

The longer-term intention is to make use of a 'Lamfalussy' approach whereby detailed legislation is adopted through implementing measures under a comitology procedure. These measures would be drawn up by the Commission in the light of the advice received from CEIOPS, provided in response to a formal mandate on which the Insurance Committee would be first consulted.

The procedural difficulty at the current time is that, while the Council and the Parliament have agreed in principle to the Lamfalussy extension⁷ to insurance and occupational pensions, the definitive texts have still to be published. Furthermore, the Commission still has to adopt a

⁵ There are two further working groups: financial stability and occupational pensions.

⁶ In fact the Groupe Consultatif of European Actuaries have established a parallel structure to the CEIOPS working groups.

⁷ The Insurance Committee has already examined the establishment of the New Committee Structure in MARKT/2533/03 and details of the Commission proposals can be found in press release IP/03/1507.

proposal for a Framework Directive and consequently no mandates can be given to CEIOPS. In fact, the Commission is only at a preliminary stage in the preparation of the proposed draft Framework Directive.

At the legislative level, the Commission still has to determine⁸ definitively and exhaustively what topics/ level of detail should be treated by primary legislation (i.e. through a Framework Directive) and what by secondary legislation (i.e. through a comitology procedure).

Given the complexity of the project and the importance of the results of the future field-testing, it is not obvious that all desirable information will be available when the draft Framework Directive is discussed at the end of next year. A good example in this context, and of particular importance to Finance Ministries and industry, are the definitive capital requirements for the insurance sector as a whole. These requirements are likely to be influenced by subsequent implementing measures.

Nevertheless, it is vital to maintain project momentum. The Insurance Committee is therefore requested to give guidance with regard to the following Road Map proposed by the Commission Services to address these issues.

II. PROPOSED ROAD MAP

The proposed Road Map for the completion of the Solvency II project should be determined by the following principles:

1. Framework Directive

The Commission should prepare a proposal for a Framework Directive setting out the key principles governing the new Solvency II system before the end of 2005.

Ideally, all elements would have been analysed and field-tested before the proposal for a Framework Directive is adopted⁹. However, given the complexity of the project, if this approach were followed, it would result in the Framework Directive being delayed well beyond 2005. Furthermore, much progress has already been achieved at the Solvency sub-committee level on the structure and content of the Framework Directive. Pressing ahead will help to clarify issues and crystallise out problems. If, in the light of the available information and advice received from CEIOPS, adoption of the Framework Directive proves infeasible or undesirable, the situation can always be reviewed. In the meantime, a target deadline will help maintain project momentum.

⁸ In the above papers the Commission has in fact considered some draft Articles, typically relating to Pillar II, for inclusion in a possible Framework Directive for Solvency II.

⁹ See the series of QIS (Quantitative Impact Studies) for Basle II.

2. Implementing Measures

The detailed requirements of the Solvency II system should be adopted by implementing measures prepared in accordance with the ‘Lamfalussy’ extension to insurance before the end of 2008.

The target deadline of end 2008 may appear generous, but it is fact likely to prove very tight having regard to the large number of issues to be examined and their linkage and dependence on international developments, e.g. the completion of Phase 2 of the IASB insurance project. Furthermore, the date of 2008 is also predicated on rapid adoption by the Community co-legislators of the Framework Directive.

Implementing measures would of course be prepared in accordance with the specific institutional arrangements agreed as part of the Lamfalussy extension to insurance and with full respect to the principles of wide consultation.

3. CEIOPS will be the primary advisor of the Commission

In accordance with the future Lamfalussy approach, CEIOPS will be the primary advisor of the Commission. Although the Commission retains the right to consult other stakeholders, the advice of CEIOPS is of particular importance since CEIOPS will have a major role to play in helping develop the new system as well as, after Member State implementation, holding responsibility for the practical application of the new system.. The Commission stresses that institutional responsibility for the formal drafting of proposed legislative texts clearly rests with the Commission in accordance with the above policy orientations.

4. Before formal adoption of the Framework Directive, CEIOPS will advise the Commission and the Insurance Committee through specific “calls for advice”.

For the reasons described above, no formal mandates in the sense of the Lamfalussy approach can currently be given to CEIOPS. It is therefore recommended that advice be sought from CEIOPS through “calls for advice”.

These calls for advice will be prepared by the Commission and be first submitted to the Insurance Committee for consultation, before being transmitted to CEIOPS. In the interests of transparency, “calls for advice” will be published on the Commission Solvency II web-site. The calls for advice will clearly describe the nature and type of advice sought, as well as indicate a target deadline for the provision of that advice. Given that some calls for advice will be complex and necessarily require time for completion, the Commission may request CEIOPS to provide regular interim reporting on progress.

Where execution of the call for advice requires guidance of a policy nature, the Commission may provide such guidance, in accordance with principles for the Solvency II project already endorsed by the Insurance Committee. Where major policy issues are identified, the Commission may first consult with the Insurance Committee before giving such guidance.

In accordance with the spirit of Article 5 of the Commission Decision¹⁰ establishing CEIOPS, CEIOPS shall, at an early stage, consult extensively and in an open and wide manner with market participants, consumers and end-users.

5. The Commission will prepare a general Framework for Consultation for all stakeholders in Solvency II as well as a series of specific calls for advice from CEIOPS. The Framework for Consultation will set out the general policy principles and guidelines for the development of Solvency II. The specific calls for advice will address individual areas of work important for Solvency II.

Calls for advice will be prepared in accordance with the attached timetable (Schedule 1).

The Commission services have identified more than 25 specific areas¹¹ of work where advice will be needed from CEIOPS. A list is attached in **Schedule 1**. Some of these work areas may be grouped together in the specific calls for advice. In order to prepare the best possible calls for advice, as well as to provide initial guidance to CEIOPS, the Commission services have already discussed many of these topics in the forum of the Solvency Sub-Committee. Further discussions will be necessary to prepare the calls for advice for the outstanding work areas. Consequently, it is not possible today to prepare all calls for advice.

The Commission services propose to prepare a general Framework for Consultation whose scope generally covers the totality of the Solvency II project and all stakeholders. The general Framework for Consultation will also facilitate early commencement of work by CEIOPS. In addition the Commission intends to prepare specific calls for advice from CEIOPS, as rapidly as possible, in three waves:

- The first wave, which is attached to the present document, focuses mainly on Pillar II
- The second wave, which will be considered by the next IC, addresses Pillar I,
- The third wave, which will be considered by the following IC, will examine Pillar III and remaining issues.

Where possible to accelerate work, the Commission will consider whether IC consultation on some calls for advice could be completed through a written procedure. Although the first wave focuses on Pillar II, the Commission services recognise the desirability of immediately engaging all CEIOPS Solvency II working groups. For this reason, all CEIOPS working groups should be invited to develop work on Solvency II topics, under their own initiative, in accordance with the policy principles and guidelines set out in the Framework for Consultation and seeking inspiration from prior Commission services papers (and in particular from papers MARKT : 2539/03, 2543/03 and 2502/04).

¹⁰ Commission Decision 2004/6/EC, OJ L3/30, 7.1.2004

¹¹ Other areas may become apparent as work develops.

This ‘own initiative’ activity by CEIOPS will of course be superseded by more developed guidance, provided in the relevant specific call for advice. Scheduling details for all specific calls for advice are indicated in Schedule 1.

The likely need for policy guidance to CEIOPS during the execution of specific calls for advice has already been identified. The Framework for Consultation should therefore be updated to reflect the policy guidance given by the Commission. As such the Framework for Consultation will be dynamic in nature.

6. Having regard to the complexity, as well as the scale of the project, it may be necessary to refine or re-schedule the above road map in the light of developments.

Although every effort will be expended to fully respect the proposed schedule in the attached Road Map, given the issues involved, it seems sensible to recognise the need for some potential flexibility. However, this will be made in a transparent and consultative manner.

7. Framework for Consultation

The Framework for Consultation is attached in Annex 1. IC Members comment and guidance is requested.

8. First Wave of Specific Calls for Advice

The first wave of specific calls for advice from CEIOPS is attached in Annex 2. IC Members comment and guidance is requested. The first wave focuses on Pillar II issues and covers the following Solvency II topics:

<u>Request No.</u>	<u>Topic</u>
1	Internal control and risk management
2	Supervisory Review Process (general)
3	Supervisory Review Process (quantitative tools)
4	Transparency of Supervisory Action
5	Investment Management Rules
6	Asset-liability management