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**Relationships between**  
**Solvency II and the Insurance Accounts Directive**

## 1. INTRODUCTION

The existing prudential Directives contain a few articles referring to the Insurance Accounts Directive (91/674/EEC), in relation essentially to the calculation of technical provisions and/or the valuation of admissible assets. These relationships raise the question whether the introduction of Solvency II requires amendments to the Insurance Accounts Directive (IAD).

This question is not new and has been raised by Member States at earlier meetings, but it had been left aside in recent years because it was felt that it could be better addressed, for reasons of consistency, once the IASB would have delivered its revised Insurance Contracts standard (IFRS 4 – Phase II). Now that it clearly appears that the Solvency II proposal will be presented in advance of the adoption of the revised IFRS 4, the time has come to revisit this question again.

## 2. REFERENCES TO THE IAD IN THE EXISTING PRUDENTIAL DIRECTIVES

### 2.1. Non-life

The 1st NL Directive of 1973, as amended, contains two explicit references to the IAD:

- Article 15 : *"1. The home Member State shall require every insurance undertaking to establish adequate technical provisions in respect of its entire business. The amount of such technical provisions shall be determined in accordance with the rules laid down in Directive 91/674/EEC."*
- Article 16 : *"For those insurance undertakings which discount or reduce their technical provisions for claims outstanding to take account of investment income as permitted by Article 60(1)(g) of Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings (1), the available solvency margin shall be reduced by the difference between the undiscounted technical provisions or technical provisions before deductions as disclosed in the notes on the accounts, and the discounted or technical provisions after deductions. This adjustment shall be made for all risks listed in point A of the Annex, except for risks listed under classes 1 and 2. For classes other than 1 and 2, no adjustment need be made in respect of the discounting of annuities included in technical provisions."*

### 2.2. Life

Recital 6 of the Recast Life Directive of 2002: *"This Directive forms part of the body of Community legislation in the field of life assurance which also includes Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings (1)."*

The Recast Life Directive contains a series of provisions on the calculation of technical provisions, valuation of admissible assets and identification of eligible items, but none of them refers explicitly to the IAD.

### 2.3. Reinsurance

The Reinsurance Directive of 2005 contains the following references to the IAD:

- Article 32 (in line with Recital 21) : "*1. The home Member State shall require every reinsurance undertaking to establish adequate technical provisions in respect of its entire business. The amount of such technical provisions shall be determined in accordance with the rules laid down in Directive 91/674/EEC. Where applicable, the home Member State may lay down more specific rules in accordance with Article 20 of Directive 2002/83/EC.*"
- Article 36 : "*For those reinsurance undertakings which discount or reduce their non-life technical provisions for claims outstanding to take account of investment income as permitted by Article 60(1)(g) of Directive 91/674/EEC, the available solvency margin shall be reduced by the difference between the undiscounted technical provisions or technical provisions before deductions as disclosed in the notes on the accounts, and the discounted or technical provisions after deductions. This adjustment shall be made for all risks listed in point A of the Annex to Directive 73/239/EEC, except for risks listed under classes 1 and 2 of point A of that Annex. For classes other than 1 and 2 listed in point A of that Annex, no adjustment need be made in respect of the discounting of annuities included in technical provisions.*"

### 2.4. Insurance Groups

The Insurance Groups Directive of 1998, as amended, contains two references to the IAD, in its Annex I :

- Annex I.1.E : "*The value of the assets and liabilities shall be assessed in accordance with the relevant provisions of Directives 73/239/EEC, 91/674/EEC, 2002/83/EC and 2005/68/EC.*"
- Annex I.3 (consolidated method) : "*The provisions of Directives 73/239/EEC, 91/674/EEC, 2002/83/EC and 2005/68/EC shall apply for the calculation of the elements eligible for the solvency margin and of the solvency requirement based on consolidated data.*"

## 3. STATUS OF THE IAD IN THE CONTEXT OF SOLVENCY II : EXISTING OPTIONS AND THEIR MERITS

The Commission Services are of the view that at least the following two fundamental options can be envisaged : A) in depth revision of the IAD, i.e. significant modernisation of the important provisions on at least calculation of technical provisions and valuation of admissible assets with a view to bringing them in line with the current thinking developed in the Solvency II project, or B) introduction in the future Solvency II Directive of the prudential rules (essentially on the calculation of technical provisions and valuation of admissible assets) required in the context of Solvency II, leaving the IAD untouched (at least until the adoption of a new insurance standard by the IASB).

At first sight, Option A seems attractive, since the IAD would be significantly modernised in the short term and it could be enough for the prudential Directives to

simply refer to the modernised rules of the IAD, achieving perfect consistency between financial reporting and supervisory reporting since a single set of rules would apply to both statements.

However, Option A seems to present a series of disadvantages:

- The Commission services have repeatedly expressed the opinion that it would be preferable to wait until the IASB releases its final insurance standard (currently expected in 2009) before the IAD is amended. A decision to amend the IAD now in the context of Solvency II would indeed mean that the IAD would most likely have to be amended a second time in a few years.
- It is not clear that the accounting rules should be significantly modified with a view to aligning them on the current thinking developed in Solvency II. Financial reporting and supervisory reporting do not necessarily have the same objectives and users, so that it can legitimately be considered that accounting rules do not necessarily have to be fully aligned on prudential needs.
- Even if the idea was accepted that the IAD would contain a set of modern rules closely reflecting prudential needs, so that the prudential directive could simply refer to those rules, such a system does not seem to be appropriate in a context where the IAD is not the only accounting framework applicable to insurance undertakings anymore. Indeed, a number of undertakings will be required or permitted by Member States to use the IAS/IFRS framework and will therefore largely escape the provisions (whether modernised or not) contained in the IAD.

For the reasons stated above, the Commission services consider that Option B is the only one that seems likely to meet the objectives of the Solvency II project.

It should be observed that Option B has the following additional merits :

- It is in line with the logic of the current prudential directives, which refer to the IAD to the extent possible but already contain a series of specific provisions aiming at reflecting the prudential concerns (on technical provisions, admissible assets, and eligible items).
- It is consistent with the thinking developed by CEIOPS in its answer to Call for Advice 19 on eligible elements of capital, where it is stated that a) both the IAS/IFRS and the national accounting rules will be used by different undertakings, b) the application of the particular accounting regime should be neutral, c) a common reference standard should be determined and prudential filters should be established to achieve it, d) calculation of technical provisions and valuation of admissible assets should be carried out in line with the market consistent principles underlying the SCR calculations. (CEIOPS 19.17 – 19.27)
- It is not different from the approach adopted in banking, where prudential filters have been introduced in the CRD. (CEIOPS 19.20)

#### 4. CONCLUSION

Based on the preliminary analysis outlined above, the Commission services are inclined to think that the IAD should not be amended in the short term as part of the Solvency II project.

Prudential rules relating to the calculation of technical provisions and the valuation of admissible assets should be included in the prudential directive, which would not refer anymore to the existing accounting rules on such topics contained in the IAD. However, the assessment of the solvency of undertakings, as organised in the prudential directive, would continue to make use of some key figures presented in the financial statements (whether established in accordance with IAS/IFRS or the IAD), since the prudential directive should continue to contain provisions on the eligible elements of capital (subject to the necessary prudential filters).

The Commission services would highly appreciate Member States comments on the following questions:

- (1) Do Member States agree that all undertakings subject to Solvency II should apply in their supervisory reporting a set of modern rules (on the calculation of technical provisions and the valuation of admissible assets) to be inserted in the prudential directive, regardless of the regime applied in their financial reporting (whether established in accordance with IAS/IFRS or the IAD) ?
- (2) The consequences of such an approach would be that undertakings subject to Solvency II might have to carry out (for technical provisions and/or admissible assets) two sets of calculations, generating different figures for solvency and for accounting purposes. Do Member States agree that such a situation, which is not substantially different from the current one, is justified by the different objectives assigned to supervisory reporting and financial reporting ?
- (3) If the answer to question (2) is negative, what solutions would Member States support to ensure perfect consistency between solvency and accounting rules, allowing undertakings to carry out only one set of calculations ? For example, would it be appropriate to introduce in the IAD an option for undertakings subject to Solvency II to make use in the preparation of their financial statements of the rules on calculation of technical provisions and valuation of admissible assets contained in the prudential directive (by derogation to the IAD rules on such topics) ? Would any other solution appear to be appropriate ? .

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