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**Draft Minutes of the 7th meeting of the
European Insurance and Occupational Pensions Committee**

Brussels, 4 July 2007

Opening and welcome

The meeting was opened and chaired by Mr Elemér Terták, Director for Financial Institutions in the Internal Market and Services Directorate-General. Mr Terták welcomed in advance the various guests and visitors who were to contribute to this meeting of the EIOPC devoted largely to the Solvency II impact assessment work.

1. Agenda

The Chairman proposed the draft agenda for adoption. He noted that one delegation had asked for a brief discussion of the Commission's work on critical infrastructure protection and had distributed that delegation's letter on this subject. Two other delegations asked for a discussion of the Commission's draft letter to CEIOPS on that Committee's further work on Solvency II. Another delegation asked for the inclusion under other business of the new comitology legislation with respect to insurance. With the adoption of these various points the agenda as amended was adopted.

2. Minutes of the 5th meeting of the EIOPC

No requests for changes to, or comments on, the draft minutes were raised and the minutes of the 5th meeting of the EIOPC as tabled by the Commission were adopted.

3. Impact assessment for Solvency II

The Chairman introduced this, the major item of the Committee's agenda for the current meeting. The impact assessment (IA) report, which was to be published alongside the proposal for a directive, was a major piece of work. It had been submitted on 18 April to the new Commission Impact Assessment Board made up of senior officials.

The Chairman announced the various presentations of the contributors to the IA report. The Commission would make the first general presentation, to be followed by the contributions from the Industry (CEA, AISAM and ACME), the supervisors (CEIOPS), the consumers (FIN-USE), the European Central Bank (on financial stability) and lastly the Commission's DG ECFIN, covering the macro-economic aspects.

The Commission Representative gave a general introduction to the IA work. IA was an integral part of the better regulation approach. It had involved a large volume of work and the Commission's Solvency II team had produced a professional and impressive report, the quality of which had been recognised by the IA Board. He paid tribute to the work of his team.

The first element was to define the problem and set the objectives and possible options. A qualitative and quantitative analysis then had to be made to assess the different options. This was difficult given that much of the quantitative data would only be available at a later stage. It was clear that the current regime was not risk-sensitive and the different systems applied in the Member States posed problems for the functioning of the Single Market. In addition there was a lack of international and cross-sectoral consistency, the banks being ahead of the insurance industry. The present situation concerning groups was far from ideal.

The objectives were to deepen integration, to enhance policyholder protection, to improve international competitiveness and achieve better regulation.

The Commission had carried out a detailed analysis (both qualitative and quantitative) of the policy options, taking account of the various inputs from the various sources that would be presenting their contributions at this meeting. The Commission Representative thanked all concerned for their valuable help.

The clear conclusion from the IA work was that the introduction of a new risk-based solvency regime was desirable. It should make full use of the Lamfalussy framework and proceed in stages with full transparency.

One delegation took the floor to congratulate the Commission team for their excellent work, given the constraints of timing and staffing. One regret related to the partial leaking of the proposal, even though most of it had remained confidential. It was essential to maintain a level playing field for all the stakeholders.

The Commission replied on the question of confidentiality. Although this project had been conducted in a spirit of great transparency, the Insurance Unit had kept the actual proposal confidential and had not released it to anyone. However, confidentiality was much harder to maintain when the proposal entered Inter-Service Consultation and then was submitted to the Chefs de Cabinet.

The powerpoint slides used by the Commission Representative are available on the Insurance and Pensions Unit website under the heading of the EIOPC Committee at:
http://ec.europa.eu/internal_market/insurance/committee_en.htm

The full Impact Assessment Report is available on the same website under the Solvency II heading.

The CEA spoke on behalf of the industry, representing its own members as well as the members of AISAM and ACME.

The industry had carried out four analyses. The first consisted in a topographical exercise, namely a description of the market based on statistical data. The second analysis was the IA survey. The third was an administrative cost analysis and the fourth analysis looked at the impact on bigger groups of the lack of harmonisation under Solvency I.

Virtually the whole of the industry had been involved via the CEA members, the mutual and co-operative members of AISAM and ACME, together with the CEO forum and the credit insurers. The industry shared the objectives of promoting deeper integration and enhanced international competitiveness at the same time as improving policyholder protection.

The industry believed these objectives could be attained by a real risk-based economic approach. This would create incentives for greater efficiency and would increase policyholder protection. The current regime could not take account of the way the market was evolving. The industry favoured transparency. It wished to distinguish between capital requirements and prudence and the economic approach meant no allowance for prudence in the liabilities. Capital requirements should be risk sensitive and diversification effects should be recognised. For groups, supervisors should work together with a lead supervisor.

The industry's main conclusions were that the insurance industry played an important role in the economy and for consumers. The current system was not optimal and provided no incentive for good risk management. Many Member States had their own additional requirements and the degree of harmonisation was low. A true risk-based approach should therefore be followed and would benefit both the industry and consumers. This could be done at a relatively low cost.

One delegation asked about anticipated changes in investment strategy in Eastern Europe.

The CEA Representative replied that these changes should not be dramatic but there was a need for a better alignment between risk and capital.

Another delegation found the CEA cost estimates on the low side, especially in comparison with the Basel 2 costs in the banking sector, and asked how confident the CEA was in its estimated figures.

In reply the CEA Representative said that there could be no certainty about any of the figures advanced, but he wondered whether Basel 2 was a good point of comparison. Basel 2 was less risk based and less holistic. The insurance industry was assuming some of the costs already as many companies were already aiming at a more risk sensitive approach.

One delegation asked the CEA Representative what the industry expected as regards the lead supervisor concept.

The reply was that the industry was in favour and saw this as a key element in the debate. The larger groups already accounted for more than 50% of the market by premium. The diversification effects across borders involving risk spreading and mitigation should be recognised at group level. If the industry were to manage its capital on a risk-based basis this called for a supervisory response at the group level. One supervisor having all the necessary information would help to reveal any problems at an earlier stage. The lead supervisor would have to work closely with the local supervisors. This would be to the benefit of all, including the local supervisors.

The powerpoint slides used by the CEA are available on the Insurance and Pensions Unit website under the heading of the EIOPC Committee at:

http://ec.europa.eu/internal_market/insurance/committee_en.htm

The CEA-AISAM-ACME report on insurance products and markets, the CEA topography of EU 25 insurance market, the CEA-AISAM-ACME report on administrative costs and the CEA report on the impact of lack of harmonisation are available on the same website under the Solvency II heading.

The **CEIOPS** presentation covered two pieces of work, namely the assessment of the impact on the supervisory authorities and the CEIOPS work on the quantitative analyses.

CEIOPS had set up its Compass task force to devise tools to promote convergence and training initiatives and to deliver the requested input into the IA report.

CEIOPS had sent out a questionnaire to its 30 members and observers and had received 26 replies. This impact should be seen in the context of market developments, with industry moving towards a risk-based approach. Accordingly, not all changes were directly Solvency II related. CEIOPS had asked for a broad idea of the state of readiness, looking at available tools, human resources, foreseeable organisational changes. Regarding costs and benefits, the analysis was mainly qualitative since a quantitative estimate was too difficult at this stage.

With regard to readiness, a majority of supervisors anticipated an impact but were awaiting more details. Others said they were already planning changes, while others would await the implementation stage. The CEIOPS conclusion was that only a minority of supervisors were currently ready to supervise according to the Solvency II framework. There was no obvious link between readiness and size.

A large majority expected that they would have to change their supervisory tools, but few had started to prepare for this. Relevant aspects included reporting systems and IT, better and deeper information exchanges with other Member State colleagues, human resources, both in number and profile. Regarding costs, few quantitative estimates were possible at this early stage. The main cost factor would be the increasing sophistication of necessary tools and skills. The necessary increase in the budget would have to come from an increased levy on industry or from government. The main benefits would take the form of more efficient supervision and more timely intervention. There would be increased co-operation between the industry and the supervisors and between the supervisors in CEIOPS, leading to greater convergence and a common supervisory culture. CEIOPS would have a major role via training and exchanges of staff.

One delegation commented on the state of preparedness and noted with concern that many supervisors took a wait-and-see approach, when in fact they "should have started yesterday".

The CEIOPS Representative noted that all were aware of the need to adapt but it was true that supervisory tools could still change, for example as regards groups.

The powerpoint slides used by CEIOPS are available on the Insurance and Pensions Unit website under the heading of the EIOPC Committee at:
http://ec.europa.eu/internal_market/insurance/committee_en.htm

The CIOPS report is available on the same website under the Solvency II heading.

The FIN-USE Representative, representing the consumers' viewpoint, welcomed the Solvency II project improving risk management and responding to financial innovation. This should improve the level of consumer confidence and consistent implementation should serve consumers' interests. Insurance users were generally not aware that their insurer could fail (reference was made to the Equitable Life affair). This meant that there was a need for European rules on insurance guarantee schemes and Solvency II should include this aspect.

The FIN-USE report, which had been published in January 2007, pointed to a possible diverse impact on large and small insurers. The impact on and costs for smaller insurers could be greater, possibly leading to market consolidation and a possible reduction in choice and diversity. There was a parallel concern regarding internal models, leading to reduced capital requirements for larger companies. A level playing field had to be ensured.

The Commission had asked some specific questions which were dealt with in the FIN-USE report. A number of points emerged which merited attention. These included lower requirements than for banks (hence the need for guarantee funds), the need for enhanced cooperation between supervisors regarding cross-border business, the position of mutuals which could less easily raise capital, the role of intermediaries where commission payments (front-end loading) were a problem. On customer information, the current requirements were insufficient and the complex legal documents provided were intended to protect insurers' interests rather than inform the consumers. A complete revolution in this area was needed with plain and concise language on the risk, the cover and exclusions.

One delegation noted that while larger firms should not receive an unfair advantage, neither should smaller firms be given privileged treatment.

Another delegation took up the question of the lower capital levels for banks and wondered whether the Commission should not favour comparable treatment.

On this complex issue the Commission representative recalled that on the banking side there was no explicit overall calibration target but rather different targets for different aspects including a tougher target of 99.9% for the financial stability aspect and a lower target for the trading book.

Lastly one delegation asked for the Commission's reaction to the consumers' call for supervisors to control the drafting of insurance policies when the 3rd generation directives had prohibited this.

The Commission replied that it had no intention to revise the directives on this point.

The representatives of DG ECFIN reported on the study they had carried out into the possible macro-economic and financial sector effects of Solvency II.

Their presentation covered the scope of their analysis and its possible limitations, the framework of the analysis, the core of their report, namely the macro-economic and financial sector impact, and lastly their conclusions.

They had tried to review the various channels through which the implementation of a new solvency regulation in the insurance sector could affect the economy. However, it had been very difficult to draw conclusion at this stage, while the details of the implementing legislation and the QIS results were not yet available.

Accordingly, the analysis had focused on qualitative macro-economic impacts.

The conclusions were as follows. The main impact of Solvency II on insurance sector should be an improvement of risk management and therefore a more adequate risk pricing. The sector should become healthier, as a result of the better alignment of risks and capital requirements. Eventually, a more efficient allocation of capital in the economy and a greater stability in financial performance of insurance companies should be achieved. The improved resilience of the sector should contribute to policyholder protection and enhance competition in the market.

Based on a preliminary review of the various transmission channels, it appeared that the direct macroeconomic effect of Solvency II would be rather marginal. It was likely that policyholders would be offered a wider range of products, possibly at a better price and the products could be more flexible. Nevertheless, the relatively low share of insurance expenses relative to budget constraints both for households and the corporate sector could indicate a

rather marginal potential effect. Moreover, the impact of a change in insurance availability on the performance of the economy was not clear-cut.

As far as financial markets were concerned, two main positive effects were identified: a possible reduction in the price of risk leading to a lower cost of capital and an increased access to external financing due to changes in the financial sector (additional demand for long-term fixed income assets). However, other implications of Solvency II could be less favourable, such as reallocation of investment risk among economic agents, possibly leading to macro-economic effects.

On balance, the ECFIN conclusion was that the net macroeconomic impact would seem to be neutral or possibly slightly positive.

Several delegations stressed the importance of maintaining appropriate investment choices, noting the risk of a shift away from equities.

Another delegation asked whether the IA report was a live document that would continue to be worked on and updated.

In response, the Commission stated that the IA report would be published with the directive proposal and would not be updated. On the other hand, the Commission had committed itself to providing a full impact assessment at Level 2. The Commission would liaise with DG ECFIN and the Joint Research Centre to help build up a macro-economic quantitative model.

In response to a question relating to the impact on the cost of insurance, the Commission stated that it envisaged a possible increase in the cost of cover for low frequency/high impact events and a possible decrease in the cost of high frequency/low severity risk cover.

The powerpoint slides used by the ECFIN representatives are available on the Insurance and Pensions Unit website under the heading of the EIOPC Committee at:
http://ec.europa.eu/internal_market/insurance/committee_en.htm

The ECFIN report is available on the same website under the Solvency II heading.

The ECB Representative reported on the difficult task of assessing financial stability effects. Taking the practical definition of the ability to withstand shocks, the ECB saw a positive effect on the insurance industry through greater resilience. This would be the result of improved risk management, the recognition of diversification and mitigation effects and enhanced market discipline via greater transparency under Pillar 3. These effects were in line with the banking effects under Basel 2, though one aspect peculiar to insurance was a transfer of market risk to policyholders via an increase in unit-linked business.

Possible negative effects might lie in transition costs for smaller and medium sized insurers which might cause some to exit the market. There might also be some volatility of stock prices and of earnings as a result of greater risk sensitivity in the new regime.

Risk transfer to the reinsurance sector might lead to a concentration of risk in that sector which might however be offset by greater securitisation.

Overall the balance was seen as favourable.

Regarding financial markets, the impact of Solvency II was expected to be fairly limited. The effect on the corporate bond sector was seen as positive. The ECB also took up the point of the pro-cyclicality risk in the new risk-based system in the event of financial disturbances.

Lastly the impact of Solvency II on the banking sector was also viewed as positive overall via the creation of a more level playing field and increased competition though there was an interdependency risk through cross-holdings of securities.

The powerpoint slides used by the ECB representatives are available on the Insurance and Pensions Unit website under the heading of the EIOPC Committee at:
http://ec.europa.eu/internal_market/insurance/committee_en.htm

The ECB report is available on the same website under the Solvency II heading.

4. Motor insurance

The Chairman welcomed the visitors from the Council of Bureaux (CoB) who would address the question of combating uninsured driving (UD). He stressed the importance of this matter for the Commission, given that the obligation to enforce the insurance requirement was the foundation of the first motor directive and the cost of UD fell on the law-abiding motorist.

The Commission also reminded the Member States to provide their figures on UD as agreed at the EIOPC meeting on 6 July 2006. Only a few had yet done so.

The CoB representative was seeking Member States' views on best practice to combat UD. The CoB was not at this stage in a position to make formal recommendations as it was still discussing this matter and would hold a Management Committee meeting on this in August.

Based on 2003 figures, it was estimated that some 3% of EEA motorists were uninsured and that the cost of UD meant an average premium surcharge of €1. This surcharge was not spread evenly but would range from less than €1 in some countries to up to €50 in others. The impact of major claims could be very serious and was often met by the Guarantee Funds.

The CoB had identified six good practices among the best performing countries in this field. These consisted of awareness and education campaigns; the requirement to have a valid insurance in order to obtain a registration plate; the automatic renewal of third party cover whereby the insurer remained on risk until the police could remove the plate; the use of a windscreen sticker to show insurance; the establishment of a premium fixing office for drivers with a bad record who found it difficult to obtain cover; and lastly a range of possible punitive measures.

The CoB was happy to provide further information and answer questions for any Member State interested in the good practices followed in other States.

The Chairman thanked the CoB for its presentation and proposed taking the Any Other Business motor insurance points straight away.

Under the first of these points the Commission proposed the creation of an EIOPC working party on motor insurance to continue the work on the fight against UD and to deal with implementation issues under the 5th motor directive (e.g. the use of various options, levels of cover, transitional periods). The Commission proposal was approved.

The Commission also reminded Member States of the now expired 11 June deadline for the implementation of the 5th directive. Only a few had so far made the necessary notification.

Next the Commission informed Member States of the adoption and publication on 25 June of the motor insurance report covering the effectiveness of the claims representative and legal expenses cover.

The Commission also referred to the forthcoming adoption on 9 July of the Commission Decision on the extension of the Multilateral Agreement to Bulgaria and Romania. Insurance checks should accordingly be suspended as from 1 August.

Lastly, the Commission reported on the outcome of the Rome II negotiations under the conciliation procedure agreement of 15 May. The European Parliament had been very keen to address the question of the law applicable to the victims of cross-border traffic accidents. The final compromise involved a recital inviting national judges to take account of all factors affecting such victims, while the Commission had undertaken to provide a study on the treatment of cross-border victims by the end of 2008.

5. The retail insurance market and the Commission's Green Paper on retail financial services

The Commission Representative introduced this point. He reported that on 2 May 2007, the European Commission had published its Green Paper on Retail Financial Services in the Single Market. The publication of the Green Paper had launched a public consultation which would be open until 16 July 2007. Members of the Committee were urged to participate and ensure that their stakeholders contributed as well. The Commission would then organise a hearing on 19 September to draw the conclusions of the consultation launched by the Green Paper and discuss with all stakeholders which initiatives were needed to bring about a more efficient internal market for retail financial services. The results of the consultative process would be incorporated into the Single Market Review, to be published in the autumn, the aim of which was a better functioning Single Market.

The view was often expressed that the level of integration in the European retail insurance market was insufficient. With the exception of certain niche markets, the level of cross frontier business was very limited. Motor insurance was cited by some as an example of a branch where there was insufficient cross-border business and competition.

The Commission Representative noted that the CEA had looked at the working of the retail market in 2004 and considered it to be a competitive market which should not be judged solely on the level of freedom of services business.

The purpose of the Green Paper was above all to get more information from all the stakeholders. Was there a large untapped demand from consumers for more cross-border business? Were insurers interested in this business but were deterred by a series of obstacles? If there were obstacles, what were they how important?

Or was it true, as others maintained, that most insurance business was destined to remain local with consumers preferring to have a local contact to deal with and insurers preferring to operate through fixed establishments with local expertise in the country of the risk? Would the role of intermediaries play an enhanced role under the Mediation Directive? In short, was there a real problem with the European retail insurance market?

Regarding the possible obstacles to cross-border business, the Commission's working document listed several that had been brought to its attention, including general good requirements, the administration of premium taxes and supervisory fees. The Commission would welcome a preliminary discussion with members of the Committee on these obstacles and on how they might be addressed in the future work of this Committee.

One delegation believed that the limited use of branching merited further attention. Another referred to the possible development of 28th regime products. Others broadly agreed with the

Commission's suggested areas of examination but referred to the problems posed by any discussion of tax questions (Member State competence) or the lack of harmonisation of contract law.

The Commission replied that it was for the industry to propose 28th regime products. It did not challenge Member States' right to levy premium taxes but would like to examine the administrative arrangements for their collection and the need for fiscal representatives. A questionnaire on supervisory fees would be appropriate.

6. Any other business

Draft letter to CEIOPS

The Commission introduced the draft letter to the CEIOPS' Chair concerning CEIOPS' future work. The letter had been circulated to Member States on 18 June and had been distributed again at the beginning of the meeting together with a template visualising the timetable.

The Commission explained that the aim of the letter was to steer CEIOPS' future work on the Solvency II project with regard to both future implementing measures and Level 3 guidance. The letter included the steps to develop the European Standard Formula and CEIOPS' role in the impact assessments for future level 2 implementing measures.

Concerning the implementing measures, the Commission explained that the proposal contained implementing measures which were introduced with "The Commission may adopt..." and those introduced with "The Commission shall adopt...". Some were thus optional while others were obligatory. The letter divided the implementing measures which were introduced by a "shall" into 2 sets according to their urgency. The first set of implementing measures would be directly relevant for the successful conclusion of the negotiations. Final CEIOPS advice should therefore be submitted to the Commission by May 2008. The second set of CEIOPS advice on implementing measures had to be finalised by autumn 2009. All obligatory implementing measures had to be adopted 18 months before the Directive needed to be implemented. Level 3 guidance connected to issues outlined in this letter should be finalised by the second half of 2010. It was foreseen that the Directive would be implemented by October 2012.

One Member State asked what the role of the EIOPC would be during the negotiations of the Directive.

Another asked for clarification whether the implementing measures would be Directives or Regulations. Moreover, the letter would be open as to who decided the split between Levels 1, 2 and 3. It should be made clear that this was not for CEIOPS to decide. Moreover, CEIOPS should first concentrate on work on future implementing measures, rather than level 3. Furthermore CEIOPS final advice on the simplification of the SCR standard formula should already be available by May 2008. QIS 4 should not be delayed until the end of 2008, but should be conducted already from April 2008, so that the results could be included in the negotiations on the Directive. Concerning the Commission's review of the IORP Directive in 2008 the same MS asked whether CEIOPS should be mandated in this letter to analyse the impact of Solvency II on pension funds already this year as well so that this analysis could be included in the review in 2008.

Two Member States pointed out that the timetable should be more ambitious with regard to the implementation deadline for the Directive. Two Member States were hesitant to include the impact of Solvency II on pension funds in the letter.

The Commission clarified that any parallel work between this Committee and the Financial Services Working Party of the Council had to be avoided. Whether the implementing measures would be Directives or Regulations would be part of the Commission's right of initiative. As regards QIS4 the Commission and CEIOPS delegates had discussed the following time-plan for QIS 4: Following a public consultation of the QIS 4 specifications, QIS 4 should start in April 2008 so that the results would be available in autumn 2008. This would also enable CEIOPS to work on advice on simplifications for the SCR standard formula already by May 2008.

With regard to the impact of Solvency II on pension funds, the Commission agreed that CEIOPS should analyse the impact of Solvency II on pension funds; it would however prefer to issue a mandate to CEIOPS in a separate document.

Concerning the implementation deadline the Commission explained that the transposition deadline of three years had been chosen deliberately in order to have enough time to have all the implementing measures adopted 18 months before the Directive had to be transposed into national law.

UK letter on critical infrastructure protection

The delegation that had raised this issue referred to its letter to the Commission that had been distributed to Committee members. It noted that this issue was a substantive item on the EBC agenda on 5 July. There were concerns regarding the impact of the proposed critical infrastructure protection directive on the financial services sector. The risks were of duplication of effort and extra administrative burden, a reduction in clarity regarding cross-border systems and a danger of undermining current and effective co-operative arrangements that worked well without statutory backing. Member States should ensure proper co-ordination between their Justice and Finance Ministries on this matter.

New comitology arrangements for insurance

One delegation sought an update from the Commission on ongoing discussions and asked whether only the new regulatory procedure with scrutiny was to apply in the insurance sector.

The Commission referred back to its report to the November 2006 meeting of the EIOPC (see the Item 10 minutes). Four insurance directives were on the priority list for adaptation to the new with-scrutiny procedure giving greater powers to the European Parliament (the Life, Non-Life, Reinsurance and EIOPC Directives). The last of these had given rise to the most discussion since the Commission and the Member States insisted on retaining the possibility of using the old regulatory committee procedure in addition to the new scrutiny procedure. The Commission had stressed to the Parliament that it had no immediate plans to use the old procedure. The Solvency II proposal would only make use of the new with-scrutiny regulatory procedure. Discussions with Parliament were ongoing and the Commission was optimistic that a satisfactory solution would be found.

Newsletter

The Chairman drew the attention of delegates to the traditional Insurance Committee newsletter which had been circulated.