The regulatory environment in the European insurance sector

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Agenda

Trends and regulation in Europe

1	Insurance Europe and the European insurance industry
2	Regulatory trends and impact on the industry
3	Stability and supervision
4	Prudential regulation
5	Accounting
6	Gender neutral Pricing
7	Pensions

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Insurance Europe

Who?	▪ European insurance and reinsurance federation, founded in 1953
What?	▪ Represents around 95% of European insurance market by premium income ▪ Covers life, non-Life, (re)insurers, mutuals
Why?	▪ Enhancing the industry's reputation, protecting and optimising insurers' business environment, safeguarding insurability, championing best practice

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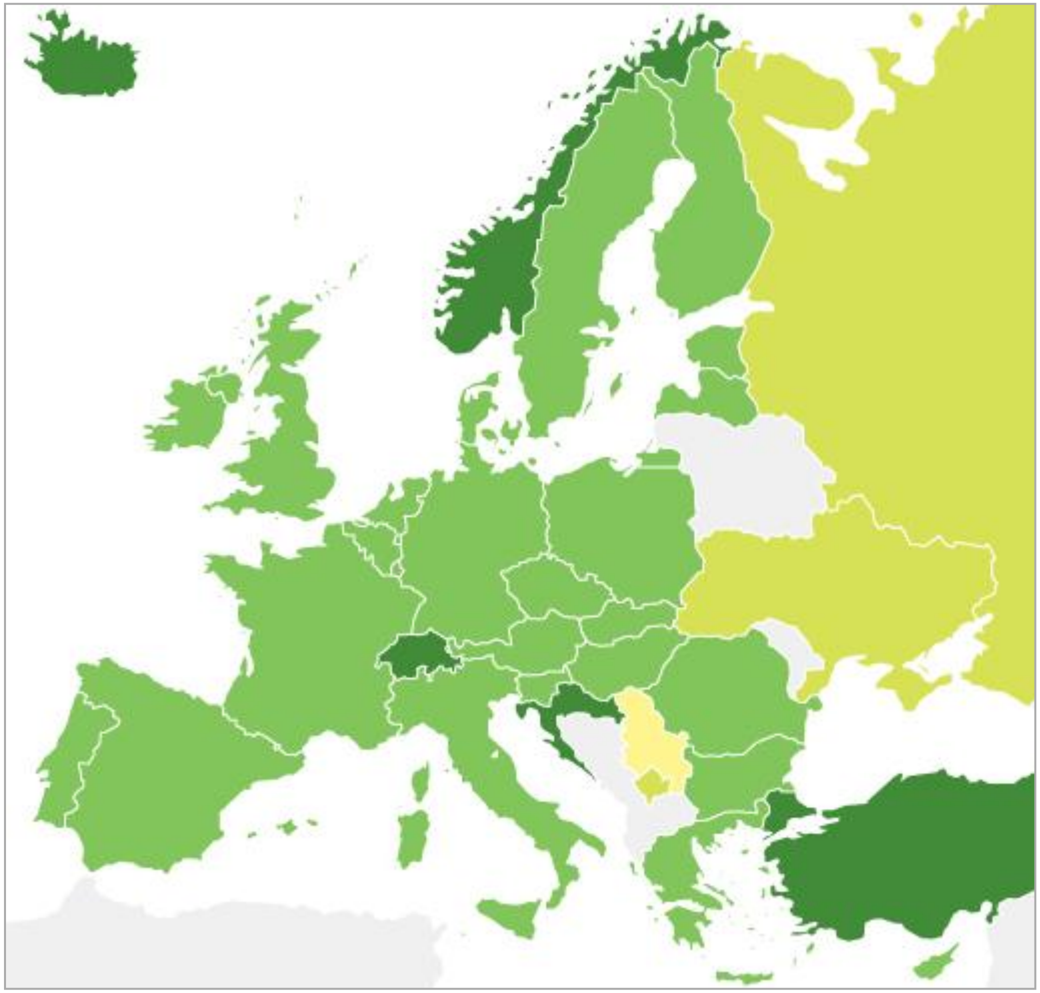
Members



34 national associations

26 EU member states

6 non-EU markets

Croatia, Switzerland, Iceland, Norway, Turkey, Liechtenstein

2 associate members

Serbia, San Marino

3 partners

Russia, Ukraine, Kosovo

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Insurance contribution to the economy

Insurance Europe represents more than 5 000 European (re)insurers, which:

- generate premium income of almost €1 100bn
- employ nearly one million people
- invest around €7 700bn in the economy

Key stakeholders in the EU legislative process

G-20
IAIS
IASB
OECD
FSB
GFIA

Council of the EU
European Parliament
European Commission
ESAs
ESRB

PEIF
RAB
CFO Forum
AMICE
CRO Forum

Business Europe
EBF
EFAMA
BEUC

Ambitious regulatory programme

Omnibus II Solvency II	Pensions IORP review	IAIS ComFrame	Anti-discrimination
Stability issues SIFIs	Data protection	Financial conglomerates	ADR Collective redress
Accounting	EMIR	FTT Savings tax FATCA	Climate change Natural catastrophes
PRIPs IMD MiFID	Anti-money laundering	Credit rating agencies	ELD Offshore oil safety

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Regulatory trends

- Global scope
  - Crisis triggered regulatory activities at global and EU level
  - Political momentum from G20
  - EU/international initiatives develop in parallel, but shared objectives
- Ambitious scope, pace and objectives
  - Broad scope
  - Quick regulatory pace
  - Increasingly complex regulation
- Mostly banks in regulatory/supervisory focus
  - But cross-reading to insurance
- Overly conservative – especially since crisis

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How trends affect insurance

- (Un)level regulatory playing field
- From bank-type regulations to insurance
  - risks of read-across at both EU and international level
  - risks of inappropriate design
- Little knowledge of insurance business model and little consideration of insurance features
- Intensified work on prudential regulation
  - Tendency towards higher level of prudence
  - Failure to properly recognise that nature of insurance business might have unintended consequences

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Stability and macroprudential supervision

What is expected?

- Broad scope – identification of globally systemically important insurers (G-SIIs)
- G-SIIs mostly European?
- Regulatory approach only marginally different from banking
- Large EU insurance companies face a clear risk of being pulled into scope of systemic risk regulation

What are the challenges?

- Risk of additional capital requirements beyond risk profile
- Increased levels of supervision
- Resolution and recovery planning
- Moving beyond the message "insurance differs from banking" towards "the value of insurance for the economy" and unintended consequences

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Prudential regulation

What is expected?

- Supervisory tendencies towards high(er) levels of prudence beyond what is economically justified
- Delays in timing of Solvency II
- Open Solvency II issues:
  - Directive Level Issues:
    - Long-term guarantees package, Equivalence
  - Implementation Level Issues
    - Range of issues on calculation methods and calibrations including CAT risk, Securitisations, Currency

What are the challenges?

- Ensuring regulation correctly recognises the long term nature of insurance and has appropriate calibrations
- Badly designed regulation could have potentially adverse impact for insurers, consumers and the economy
  - Well designed and calibrated regulation provides better protection against future crises
  - If not, risk of higher costs for customers, fewer products and less stability and growth in Europe
- Ensuring regulatory processes are manageable (ie avoid death by documentation)

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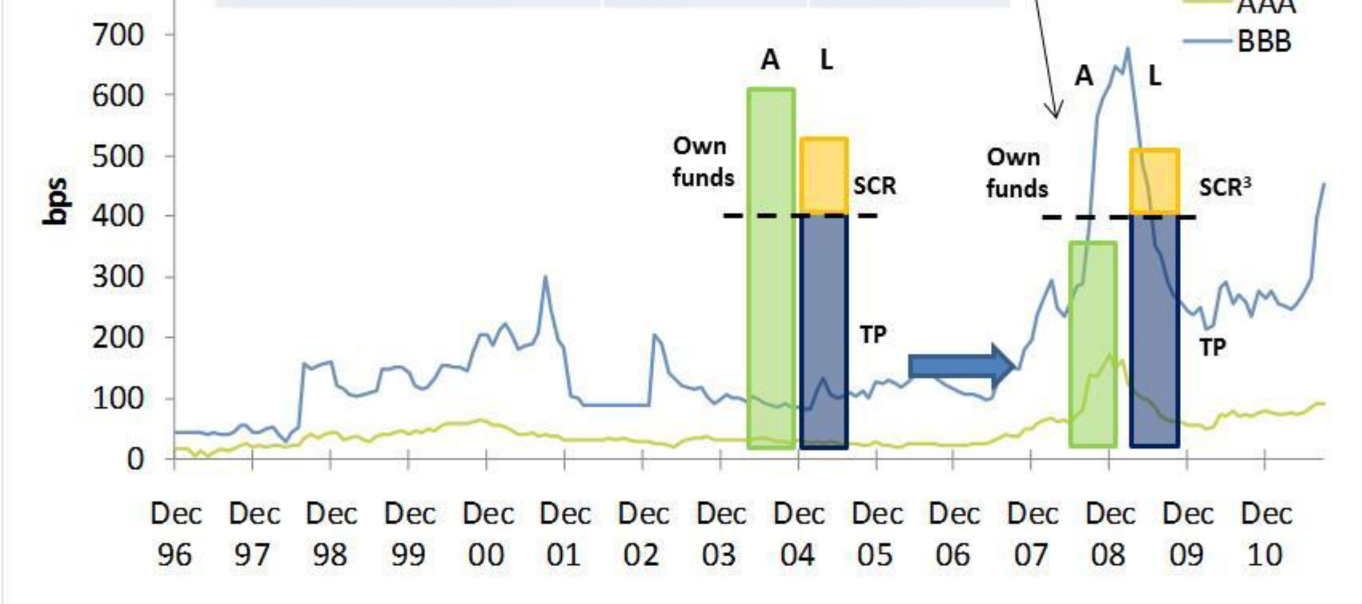
Why the delays with Solvency II?

The crisis showed that SII would overstate credit risk for long-term products, creating artificial and unmanagable volatility

	Dec 04	Dec 08
Typical spread on AAA bonds[1]	19.0	190.0
Impact on solvency ratio[2]	150%	-154%



During times of market distress, when credit spreads jump, asset values and therefore solvency reduce dramatically even where the insurance company cares only about actual defaults.

EUR Credit Spread History
Source: Bank of America Merrill Lynch

[1]Typical spreads are indicative values based on observation of relative movements of EUR AAA credit spreads from the chart.
[2]Solvency ratio estimated assuming all assets are invested in 10 year AAA corporate bonds and using the relative movements in credit spreads– graphics not shown to scale
[3]For the purposes of this illustration, the SCR is assumed to remain constant at 5% of liabilities throughout the periods of spread movement. While, in practice, the level of the SCR would also be expected to fluctuate in response to movements in credit spread, these fluctuations would not be sufficient to offset the decrease in asset values.

Accounting: IFRS 4

What is expected?

- Accounting rules that allow balance sheet and P&L reporting which reflects the real economics and performance of the business
- Timeline
  - ⇒ IFRS available 2014/2015
  - ⇒ Mandatory effective date 2017/2018
  - ⇒ Non-convergence with FASB?
- Limited re-exposure draft H1 2013
- Presentation requirements uncertain
- Interaction with IFRS 9
  - ⇒ Mandatory effective date 2015

What are the challenges?

- Ensure the final standard reflects the nature of insurers' long-term business and avoids confusing volatility
- Avoiding further delay (IFRS 4 Phase I is a half measure)
  - ⇒ Lack of comparability, black box perception, volatility due to rules
  - ⇒ Insurers' cost of capital remains high
- IFRS 4 and 9 mandatory effective dates not aligned: uncertainty of full requirements
- Consistency where appropriate between IFRS and Solvency II

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Differentiation, not discrimination

What is expected?

- 21 Dec 2012: ECJ *Test-Achats* ruling deadline on gender-neutral pricing
- 2014: EC Report on gender
- EU draft Anti-Discrimination Directive (age and disability) stalled in Council

What are the challenges?

- Operators to ensure compliance with ECJ ruling in light of EC guidelines
- Economic impact of the ban on gender (Oxera report, Dec 2011)
- Legal certainty on use of age/disability an absolute priority

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Pensions

What is expected?

- Follow up to White Paper
  - Several initiatives to achieve sustainable pensions:
    - Role of complementary retirement savings
    - Resume work on Portability Directive
    - Develop code of good practice
  - EP report on White Paper: first draft Nov 2012

- Review of IORP Directive
  - QIS exercise: mid-Oct to Dec
  - QIS results: spring 2013
  - Proposal: summer 2013?

What are the challenges?

- Political and highly technical/complex discussions

- Realistic timetable

- Ensure consistent prudential frameworks
  - take account of pension funds' specific features

- Different understanding of "pensions" in different member states can lead to misinterpretations

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For more information:

www.insuranceeurope.eu