



The European Federation of Insurance Intermediaries

La Fédération européenne des intermédiaires d'assurances

BIPAR RESPONSE

European Commission's Consultation document on the Level 2 implementing measures for Directive 2009/138/EC on the taking up and pursuit of the business of Insurance and Reinsurance (Solvency II)

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BIPAR, the European Federation of Insurance Intermediaries, is a non-profit European organisation grouping professional associations of insurance intermediaries in Europe. It presently has a membership of 50 national associations, established in 32 countries, and represents some 80,000 insurance agents and brokers, employing in all about 250,000 people. Founded in Paris in 1937, BIPAR headquarters were moved to Brussels in 1989. It is today the official and recognised voice of insurance intermediaries with the European Institutions.

INTRODUCTION

1. **BIPAR, the European Federation of Insurance Intermediaries**, is a non-profit European organization grouping professional associations of insurance and financial intermediaries in Europe. It presently has a membership of 46 national associations, established in 31 countries, and represents some 80,000 insurance agents (self-employed), brokers and financial intermediaries, employing in all about 250,000 people in the EU. BIPAR acts today as the recognized single voice of insurance and financial intermediaries with the European Institutions.

According to BIPAR, it is of vital importance to customers that insurers are financially secure and able to meet all valid claims. In this respect, according to BIPAR, it is the insurers' responsibility to ensure that they are, at any time, able to honour their commitments to policyholders. The role of supervision by or on behalf of the state is to ensure that insurance companies are able at any moment to fulfil their obligations and that the interests of the policyholders are sufficiently safeguarded. At any time priority should be given to measures, which anticipate an insurer's insolvency, based on the effectiveness of prudential standards and supervisory requirements and supervisors should take quick action when necessary to minimise the harm to the public.

Intermediaries play an important role in the insurance process

For clients, intermediaries :

- ✓ identify the risks clients face,
- ✓ ensure that clients take informed decisions about the risks they wish to insure,
- ✓ design new and innovative solutions,
- ✓ reduce the clients' search costs,
- ✓ put their knowledge at the service of the clients,
- ✓ assist their clients with claims related services and policy administration services.

For insurers, intermediaries:

- ✓ facilitate entry into the market by new insurance companies, as the latter can reach a wide client base without having to incur the costs of building a distribution network. This is important in terms of European Single Market development.
- ✓ assist insurers with claims-related services and policy administration services.
- ✓ are key providers of risk data and advice to underwriters

Insurance intermediaries are mostly SME-size companies employing altogether many hundreds of thousands of employees

Broadly speaking, in the EU, the insurance intermediation sector is divided into three major sub-sectors:

- ✓ A few global and multinational business insurance intermediaries, which serve major multinational and domestic firms, and which provide a wide range of services to these clients in addition to the traditional brokerage services. They also serve a large part of the SME client market.
- ✓ Some domestic intermediaries that provide services to (national) larger and medium-sized companies. They also serve some of the national branches or subsidiaries of multinationals and small companies. Such intermediaries are likely to be present throughout the country.
- ✓ Many small private intermediaries which focus mainly on serving the “small” end of the business spectrum and the personal lines market, occasionally serving larger companies on a relationship basis.

Most intermediaries are micro or SME-size operations. Our contribution to the Level 2 measures of the Commission have to be understood essentially within the above context.

2. BIPAR notes and welcomes the Commission’s consultation on the Solvency II implementing measures. BIPAR appreciates that the Commission with its Solvency II project aims to bring risk management at the center of insurance enterprise management while increasing customer protection to a probability of 99,5 VaR in one year thus increasing market stability. BIPAR appreciates also the supervisory convergence this exercise will entail. The Solvency II project is a further stone in the building of the EU single insurance market.
3. The consultation paper has 57 questions. Questions 1 to 36 relate to policy issues of which only questions 1 to 15 relate to high level issues (see annex 1). Therefore BIPAR although indirectly concerned replies to most of these questions. Questions 37 to 45 relate to the impact on products and markets and question 45 to 57 to the social and economic impact. We will also reply to those.
4. In general BIPAR stands ready to work together with the Commission and EIOPA on implementing measures on issues such as methods, procedures, templates and structures of disclosures which may also impact intermediaries while urging the Commission at the same time to be realistic about what can be achieved within a reasonable time horizon. In that context, BIPAR welcomes the transition periods proposed in the recently published Omnibus II directive (max. 3 years for supervisory reporting).

CONTEXT

5. The Commission seeks in this consultation more views on the potential impact the implementation measures could have *on pricing, design and availability of insurance products, the corresponding effects for consumers and the wider social or economic impacts*. We particularly welcome the relentless effort of the Commission to keep stakeholders involved and informed in this very important European project. In general BIPAR welcomes the Commission's commitment to only pursue activities where there is clear evidence of concrete benefits for citizens and companies and a strong economic rationale¹. We therefore welcome the Level 2 impact assessment exercise especially the summary of Deloitte's analysis and conclusions² with respect to each policy issue so as to allow us to consider whether we can subscribe these estimated impacts, while taking into account the changed economic conditions since its writing. We however reserve the right to adjust our position, should the final impact assessment report deviate from the current view/summary. We have also taken note of the fact that the Commission would like qualitative views to be supported with empirical evidence.
6. Whatever the option retained, BIPAR stresses that such option should not lead to unjustifiable costs on insurers, intermediaries and ultimately consumers. The solution retained should assure to introduce proportionate requirements both for small and specialized insurers so as to continue to guarantee diversity and a wide choice of carriers. Increased costs for carriers risk reducing choice through consolidation. Choice allows intermediaries to fulfill their role of customer guide and adviser, and without such choice also the role of the intermediary will decline and ultimately the number of insurance intermediaries. Also, intermediaries stimulate competition. Less intermediaries would make products more expensive, and result in less cross-border business. Any choice which limits market offer should be avoided also for sound competition reasons.

¹ See BIPAR's reply 2007 to RFS GP

² as the Impact Assessment report of Deloitte on the Level 2 Impact assessment is not a public document, BIPAR has based its observations on the Commission's summary of this draft Impact Assessment report as summarized in the current consultation.

POLICY ISSUES

7. Q1 – Q8 – Questions relating to Technical provisions – best estimate – risk-free interest rate, risk margin – cost-of-capital rate, diversification, quantitative limits SCR and MCR, procyclicality - pillar II dampener

Although BIPAR is not directly concerned by these questions, any solution(s) retained should assure

- ✓ to introduce proportionate and adequate requirements for small and also for specialized insurers and small and specialized reinsurers so as to continue to guarantee a wide choice in carriers: :
 - Smaller regional companies focussing on a limited numbers of types of business are likely to suffer more heavily under the SCR as they do not benefit so much from diversification benefit, either across class or by region. They also may be disadvantaged as they will not have the resources to build and run an internal model and so lose the opportunity to demonstrate that they need less capital than the standard formula, an opportunity open to larger groups. Specifically the scenarios for the catastrophe element of non-life business are predicated on a primarily residential book of business.
 - Companies specialising in specialist classes may find themselves penalised by the standard formula and again, lose the benefits of cross country diversification if regionally based.
 - These factors may mean that smaller, regional and/or specialist insurers are forced to consider merger or sale, to the detriment of consumer choice
- ✓ to properly reflect the cost to support the insurance obligations over the life time. Any choice which limits market offer should be avoided, especially if the financial trade-off is minimal. BIPAR welcomes a stable but diversified industry: insurance and reinsurance intermediaries are in favor of stable carriers and a competitive market. .

More precisely,

- ✓ As to the Pillar II dampener, an appropriate Pillar II dampener according to Deloitte's report promotes competitiveness. If that is the case, BIPAR can only be in favour of a lenient adjustment period in case of an exceptional fall in financial markets so as not to jeopardize recovery. However, there should be absolute clarity as to when such an exceptional fall in financial markets occurs and who makes that decision. The list of factors to be taken into account by the supervisory authorities when deciding to grant such a period should be left open especially in the transition period, thereafter EIOPA may issue such a list.

8. 5. Supervisory reporting – content, form and modalities

Overall BIPAR notes that the new requirements for supervisory reporting (including public disclosure) will require an investment in e.g. time and resources, not only for carriers and their intermediaries, but also for supervisors. A transitional period as currently proposed in the Omnibus II directive is therefore appropriate so as to allow all concerned parties including the supervisors to prepare the necessary systems, procedures and methods, templates and structures for meaningful and efficient reporting and disclosure.

Q9: Deloitte's report found that implementing costs would be a significant cost driver especially because of its administrative burden, which are not business-as-usual costs. The Commission favours together with CEIOPS and Deloitte scenario 3 on the reporting.

BIPAR sees two possible issues:

1. Demand for increased and new reporting will also impact intermediaries as they will be requested to provide for increased and new data, both directly and indirectly.
2. Increased demands on the carriers will increase costs hence push carriers to consolidate to reap benefits from economies of scale.

On 1: The issue of supervisory reporting is also relevant to BIPAR's members as new supervisory reporting formats will also impact the intermediaries' sector directly and indirectly.

- ✓ Directly, through art 35,2,b as supervisory authorities will be given the power "to obtain any information regarding contracts which are held by intermediaries or regarding contracts which are entered into with third parties". Art 35,6 refers to the need for implementing measures on this point.

We note what CEIOPS wrote in this respect³:

"3.598. Article 35(2)(b) states that supervisors can obtain any information regarding contracts which are held by intermediaries or regarding contracts which are entered into with third parties CEIOPS expects to obtain this information where it considers necessary and important for the purposes of supervision. Supervisors could request such information, as deemed necessary during the course of the SRP, as material insurance or reinsurance contracts (both written or accepted), details of financial arrangements such as committed borrowing facilities or debt raising, contracts relating to the outsourcing of critical or important functions etc.

3.599. If contracts are held by third parties, for example, if a broker is writing business on behalf of the insurer, CEIOPS expects that the insurer either has, keep copies of or has immediate access to, these contracts as part of its records management procedures.

3.602. The information to be obtained from undertakings on contracts which are held by intermediaries or regarding contracts which are entered into with third parties shall be requested where it is considered necessary and important for the purposes of supervision.

3.603. The undertaking shall have, keep copies of or have immediate access to, contracts held by third parties."

- ✓ Indirectly, as insurers will need much more exact standards of risk and capital evaluation under Solvency II.
 - This implies collecting as much detailed information as possible about underlying risks. As a result, insurers will therefore demand more refined and disaggregated information about the risks that certain type of intermediaries are accepting. This may be an important logistical challenge. It is therefore to be expected that Solvency II will require tougher standards in terms of completeness, accuracy and appropriateness of data. The Solvency II requirements will ask the same quality standards from external parties as to internal data. These external parties are also insurance intermediaries, be they brokers or agents. This will be a significant effort for many intermediaries⁴.

³ See CEIOPS – Level 2 final advice on Supervisory reporting and disclosure, October 2009

⁴ See PWC, Increasing speed, September 2010, which details further "Although some brokers have already been raising the bar by providing more effective risk information to their insurer partners, the data others deliver is often quite sparse. This means that many brokers will have to improve their own data capture and analysis systems to meet the needs of insurers. They must also ensure that the analytical techniques they use as underwriting agents stand up to rigorous scrutiny. As agents provide outsourced underwriting services, they may also need to bring in or develop better risk management capabilities."

- Additionally, if insurers are likely to want an increased amount of data from intermediaries, there should be an attempt somehow to standardise the data required. The consequences of no standardisation is that each insurer will have separate requirements, which inevitably will lead to an even greater administrative nightmare for intermediaries.

More, both these requirements may not necessarily run parallel, which entails the risk of additional cost and management complexity.

BIPAR is of the opinion that European-wide supervisory reporting data standards (which includes requirements relative to article 35,2 (b)) should thus be developed before harmonized data reporting begins. EIOPA may have a better chance of obtaining the quality data it seeks in collaboration with the private sector which should help in defining the business process, the data elements and their context.

On 2: BIPAR favours a solution which introduces proportionate and adequate requirements for small and also for specialized insurers so as to continue to guarantee a wide choice in carriers. BIPAR believes that decisions about frequency of disclosure and level of disclosure should be subject to a cost/benefit analysis. The cost related to this should not be underestimated.

BIPAR does favour quantitative data reporting in a standardized reporting format, but it does not see the need for ALL quantitative data to be provided quarterly. All data should be provided annually unless the directive requests otherwise.

Q10: We agree that in line with the proportionality principle only material and/or relevant information should be provided in the RTS (Report to Supervisor). What is material and relevant should be determined by the insurer based on guidelines from and framework provided by the supervisory authorities. As mentioned sub Q9, the consequences of no standardisation is that each insurer will have separate requirements, which inevitably will lead to an administrative nightmare for intermediaries.

Q11: Which specific quantitative data should be subject to external audit: BIPAR does favour quantitative data reporting in a standardized reporting format, but it does not see the need for ALL quantitative data to be audited externally annually. It suggests the following principles:

- ✓ All data relative to contracts held by intermediaries should NOT be subject to external audit if already audited at the intermediary.
- ✓ Also in this respect the proportionality principle should be applicable.
- ✓ Other data should be subject to external audit (annually) when they are subject to annual reporting.

BOX 1: Solvency II and intermediaries – direct reference

The SII directive refers to intermediaries directly in a number of instances:

Article 35 (Information to be provided for supervisory purposes):

1. Member States shall require insurance and reinsurance undertakings to submit to the supervisory authorities the information which is necessary for the purposes of supervision. That information shall include at least the information necessary for the following when performing the process referred to in Article 36 (=supervisory review process):

2. Member States ensure that the supervisory authorities have the following powers:

(...)

- to obtain any information regarding contracts which are held by intermediaries or regarding contracts which are entered into with third parties;

Article 105 (Calculation of Basic SCR)

(...)

6. The counterparty default risk module shall reflect possible losses due to unexpected default, or deterioration in the credit standing, of the counterparties and debtors of insurance and reinsurance undertakings over the following 12 months. The counterparty default risk module shall cover risk-mitigating contracts, such as reinsurance arrangements, securitisations and derivatives, and receivables from intermediaries, as well as any other credit exposures which are not covered in the spread risk sub-module. It shall take appropriate account of collateral or other security held by or for the account of the insurance or reinsurance undertaking and the risks associated therewith.

Q12: The Commission asks for evidence that groups are considering the reporting requirements from a centralized top down perspective. BIPAR has no information on this question.

9. Public disclosure – content, form and modalities

Q13: This question relates to the Report on Solvency and Financial Condition report (also called SFCR) which needs annually to be publicly disclosed.

As stated in our reply to Q9 above, BIPAR favours a solution which assures proportionate and adequate requirements for small and specialized insurers so as to continue to guarantee a wide choice of carriers. The Commission suggests disclosure either on the undertaking's website, on a trade association's website or if not, upon first demand. BIPAR favours disclosure on the supervisor's website.

Q14: The SFCR should be a reflection of the RTS (without details on sensitive information in relation to competition). An important group of stakeholders which should be considered are the policyholders and their intermediaries. (Throughout the industry) a standardised simple disclosure on the financial health of the insurer will serve the purpose (e.g. a 'rating'). Superfluous detail should be avoided.

We note also here CEIOPS' reply to the Commission to which we agree:

“Given the SFCR is a public document, it could be read by a wide variety of stakeholders external to the undertaking. Undertakings should consider the potential audience of the SFCR and their information needs when compiling this document. Potential readers could include other insurance and reinsurance undertakings, intermediaries, trade associations, financial analysts, professional advisors, rating agencies, investors, shareholders, and policyholders, alongside of course supervisory authorities.”⁵

Q 15: Solvency II will be based on an economic valuation of all assets and liabilities. The Commission suggests to disclose a number of aggregated key figures arising from solvency valuation, and their material differences with accounting valuation. BIPAR would support this approach. The precise content of these aggregated key figures should then be defined.

IMPACT ON INSURANCE MARKETS AND PRODUCTS

IMPACT ON PRODUCTS

10. According to our members, Solvency II will impact all those involved in the insurance industry, so there will certainly be an impact on products.

“In a Fair Value world, both available and required capital will become more volatile. History proves that this has always been the case. The only difference that Solvency II will bring is that the figures will need to be calculated and disclosed. How investors will look at insurance companies in a Solvency II era is still unclear and will depend on whether the volatility disclosed is higher or lower than what is currently assumed by the markets. Solvency II will certainly bring capital – and all the elements that can create or destroy it – to the people in a much more harmonised way than in the past. For sure, this will have an impact on management, the product department, the reinsurance department, the actuaries, and – due to its one-year risk approach – also to accountants who will favour the balance sheet to balance sheet approach. In fact, Solvency II will touch all those involved in the insurance business.”⁶

More precisely, the following effects may be expected in terms of products and services related to Solvency II:

- ✓ Primary carriers will expect from their reinsurance brokers that they adapt their services to the new Solvency II environment. Reinsurance brokers will have and are adapting their services to carriers regarding reinsurance to the Solvency II environment, such as to help to optimise the use of reinsurance in the area of capital management, and to assist the carrier in the risk evaluation. We have observed that some brokers have already started to act in view of these new developments in areas of actuarial services, corporate finance teams or catastrophe modelling and also in-house software. In that context we repeat that it is important as stated above to retain a competitive and diversified reinsurance market which choice of carriers⁷.

⁵ See note 3

⁶ See AON Benfield, Solvency II for reinsurance managers, key discussion points for non-life insurers, July 2010.

⁷ See PWS, Increasing speed, September 2010

- ✓ Regarding (direct) insurance intermediation, Solvency II will require more transparency and focus on risk, so insurers (and reinsurers) will reflect these requirements on intermediaries. We expect that insurers in general may have less appetite for specialized risks if the final Solvency II framework is not proportional or adapted while taking specialized markets into account.
- ✓ In the framework of delegated authorities, procedures will need to be compliant with Solvency II, both on the side of the intermediaries as on the side of the insurer who delegated the authority.

11. Q37: Will the Commission's current approach result in increasing/decreasing insurance prices?

A recent survey of Towers Watson's indicated that *"the main concern of insurance organisations centred on the need for capital raising, with 60% of respondents citing this as a potential concern. A similar proportion of companies expressed concerns about changes in the relative attractiveness of existing products and probable higher prices to consumers"⁸.*

Why are higher prices probably expected?

- ✓ Solvency II will help in identifying those risks, including those products, that attach a high capital requirement to them.
 - Some lines of business, e.g. trade credit will indeed be hit by a high capital charge.
 - The disproportionate impact on smaller, regional and/or specialised companies who may need to raise capital and or merge, causing likely reduction in competition and price increases
- ✓ Also, Solvency II takes the investment risk of the insurer into consideration. Main issue re investment is that with lower investment returns in the current market insurers will need to look more at underwriting profitability to deliver returns with upwards pricing pressure. Differential risk loads on different investment types will reduce the insurers ability to make higher investment returns in a recovering market, although it is appreciated that the equity dampener will help.

We expect that capacity will decline and also shift throughout the industry, impacting pricing as well as (widespread) insurance availability. Solvency II might urge insurers to focus even more on RORAC (Return on Risk Adjusted Capital), which may lead to less capacity for high end risk categories and higher prices for those risks. Such impact will also jeopardize innovative approaches to insurance for new types of risk. Diversity and so customer choice will reduce and this may lead to less competitive price pressure.

Impact on pricing is only expected when solvency requirements impact results significantly, for which the results of QIS 5 will be a good indication.

12. Q38: Will Solvency II Level 2 suggested approach have an impact on cross-subsidization between different business lines or policyholders' groups? As BIPAR does not have detailed view about the current situation in individual companies, we cannot answer this question.

13. Q39: Whether it will only be the Level 2 implementing measures which will stimulate product innovation is difficult to separate from the Level 1 impact for the time being. BIPAR observes that e.g. on the life side members expect the arrival of new investment products with lower capital requirements, introduction of pension products related to

⁸ See Towers Watson's sixth biennial Insurance Industry ERM survey, 23 November 2010

market value⁹, etc. On the reinsurance side, reinsurance brokers will use the Solvency II project to develop new businesses especially on the risk transfer side. They will help in analyzing the potential impact of Solvency II on the insurer's businesses and offering advice on the most appropriate risk transfer initiatives.

14. Q40: Will the Commission's suggested approach for Level 2 measures result in the withdrawal of certain products from the markets? See above
15. Given all the above, BIPAR is concerned that such an impacting new legislative framework will be accorded the necessary transition time to be phased in, avoiding market disruptions both for retail as well as corporate buyers.

IMPACTS ON MARKETS

16. Q41: Whether the Commission's approach promotes particular types of insurance business models is unclear to us. But we note from market experience that also small and/or specialised insurers serve in many cases a niche market, often in new and/or innovative and/or highly technical risk areas. These carriers should be able to continue to have their place in the market, also under the Solvency II framework, as they are providing much needed capacity in these specific areas. The Commission should therefore make sure that its approach promotes the required diversity of offer as it suggests.
17. Q42: The Commission's current approach to Level 2 will affect competition across undertakings in the EU. Whereas Q41 wondered about favouring a particular type of insurance business, this question is more general.

A possible consequence of Solvency II might be that again a wave of consolidation will take place, but it is unclear to what extent this wave will be Solvency II related or related to other circumstances. It is our opinion that Solvency II may accelerate the consolidation process.

⁹ AON, Pensioenbulletin, Mei 2010, Invloed van Solvency II op pensioenregelingen in Nederland: "Markt-waardering maakt risico's inzichtelijk voor de verzekeraars. Dit gaat waarschijnlijk de gehele bedrijfsvoering raken. Elementen die werkgevers en herverzekerde pensioenfondsen rechtstreeks raken zijn de pricing van pensioenproducten en de verzekeringsvoorwaarden. In de praktijk zien wij nu al effecten, zoals bijvoorbeeld:

- ✓ wijziging kostenstructuur voor uitkeringsgaranties;
- ✓ restricties aan het beleggingsbeleid (kredietrisico apart prijzen);
- ✓ invoering van nieuwe beleggingsproducten;
- ✓ introductie van marktwaarde-gerelateerde pensioenproducten;
- ✓ discussie over de vraag of vaste rekenrentes voor pensioenpremies en winstdeling nog gehandhaafd kunnen worden.

De kosten en voorwaarden van (rechtstreeks) verzekerde regelingen zullen steeds meer gaan lijken op die van pensioenfondsen. Uiteindelijk wordt de invloed van Solvency II groter dan wij nu denken. In de huidige marktomstandigheden zal pensioen niet goedkoper worden en is herbezinning over de inrichting van het pensioenproduct belangrijk"

- 18.** Q43: The impact of the Commission's approach to Level 2 measures on small and medium sized insurers risks being very serious. Financial flexibility, operational efficiencies will become more important with a subsequent tendency in concentration. AM Best was recently quoted as follows:
*"Given the diversification credits and the costs involved in adopting internal capital models, A M Best said the new Solvency II regime will benefit the larger players in particular. Scale is expected to become more important, in terms of financial flexibility and operational efficiencies. Developing any high margin line of business that requires increasing levels of capital (e.g. bulk purchase annuities) is likely to be restricted to the largest players only. The rating agency also foresaw the market tending toward higher concentration, with fewer companies remaining in the market and a reduced and simplified range of product lines."*¹⁰
- 19.** Q46-52 on social impact: Stricter regulation might force parties to retreat from (parts of) the insurance market, thus making insurance capacity less available for companies as well as the public, which might also have an impact on pricing. Impact could be greater in regions with higher insurance needs.
- 20.** Q54-57 on economic impact: Solvency II seems to encourage a shift towards obtaining less risky assets. This could impact (financial) markets considerably, since the investments of the insurers active in the EU are vast. The current asset mix and the needed shift, however, should be considered and will become clearer when the QIS 5 results are available.

¹⁰ Source: www.insuranceERM.com, 12 October 2010