

## CEA response to the EC Consultation on the future of financial services supervision in the EU

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Pages:	4		

### 1. Introduction

This note outlines the views of the CEA, the European insurance and reinsurance federation, on the de Larosière report and some of the issues addressed by the European Commission's communication of 4 March 2009 (COM 2009 (114)) *Driving European Recovery*. We will mainly focus our response on the recommendations and actions concerning prudential supervision and the insurance industry, as these are the priority issues for us.

The CEA welcomes the report by the de Larosiere group as this review of financial services supervision makes an appreciated contribution to the efforts to restore confidence in the financial markets. There is a clear need for a more harmonised and consistent set of supervisory powers to be developed at European level, and with an approach suitable in a global context. Cooperation between regulators in order to avoid regulatory fragmentation is in our opinion of utmost importance for achieving the desired results.

The insurance model is fundamentally different from that of banking. While not immune to a crisis that has affected the entire financial system, the insurance industry has not been the source of the crisis and is also less affected than the banking industry. Many European (re) insurance firms have already implemented appropriate risk management strategies and controls over the last few years. These strategies have stood up well in the current turmoil, and with few exceptions insurers have not needed the state assistance provided to the banking industry despite being hit by general falls in equity values and investment returns.

For this reasons, we recommend that any regulatory initiative following the current crisis takes the insurance model's specificities into account and is based on market evidence, in order to avoid over-regulation.

However, the current financial crisis has underlined the importance of reforming the prudential regulation of the financial services industry and of strengthening supervisory architecture. The CEA is keen to contribute to the dialogue on the future of financial services supervision in the EU.

## 2. Solvency II (recommendation 5)

The CEA welcomes the de Larosière report's support to Solvency II and its endorsement of a group support regime. In our view, Solvency II addresses many of the shortcomings of the current EU regulatory framework for insurance. Solvency II will give us a harmonised risk-based and economic prudential regulatory regime. Importantly, it will also improve the way groups are supervised. We welcome in particular the overall harmonisation of regulatory standards and approaches and the introduction of colleges of supervisors. In our view the group support regime remains a key part of Solvency II and we therefore underline our support for re-considering it after the Directive has been in place for three years.

In this context we would also like to make a specific comment on recommendation 10 and on recommendation 20. We fully agree with the need to have harmonisation and consistent implementation of legislation. Derogations, exceptions, and other differences made at national level should be minimized. It is important, however, to take account of the existing work that is being undertaken to address these problems. In the insurance sector Solvency II is designed to deliver high-level harmonisation. Based on Solvency II, supervisors will have the same tools at their disposal and this will facilitate the convergence of day to day supervisory practices. It is therefore not necessary to harmonise pre-Solvency II prudential rules as these will be harmonised by Solvency II.

## 3. A European System of Financial Supervision (recommendations 18-23)

### First phase

We welcome the de Larosière Group's recommendations on the two stages for the European System of Financial Supervision. In our view, the role and powers of the three Level 3 committees need to be reinforced immediately as set out in the recommendation 21. On the condition that a suitable legal framework can be provided for, we support the idea of giving wider powers and responsibility as well as better funding to 3L3 in order to ensure financial stability in Europe and improved and convergent supervision of financial institutions. In particular, the setting up and strengthening of colleges of supervisors for all major cross-border institutions is important. The colleges, chaired by the group supervisor, must work on a clear allocation of responsibilities and using the common convergent toolkit. Colleges of supervisors alone are not sufficient but they must be based on an appropriate prudential framework, which reflects the economic reality of groups while balancing the role of the host and home supervisors.

### Second phase

With regards to the second phase of the ESFS, we support the transformation of 3L3 into European authorities with the competences set out in recommendation 22. These new powers will aid supervisory convergence and make supervision more effective. In particular, the legally binding mediation role and legally binding decisions and supervisory standard will be important. The experiences drawn from the existing coordination committees have shown that voluntary cooperation and coordination need to be supported by a legal cooperation framework. It is also clear that supervisors need to have concrete tasks or mandate to cooperate on (like the approval of a group-wide internal model). We would also like to stress the fact that the group supervisor shall be responsible for coordinating with macro-prudential supervision so that no further reporting burden will be put on the industry.

The accountability and transparency of the new authorities is also an issue that we would like to highlight. In view of the new role of the 3L3, they should have an appropriate governance to reflect their new responsibilities. We agree with maintaining the authorities independent of the European Commission but reporting to the three European institutions.

We also fully support increased coordination and cooperation between the different Level 3 committees, or at a later stage, authorities. The Joint Committee on Financial Conglomerates (JCFC), already set up by CEIOPS and CEBS, is a good example of such a form of liaison.

## 4. Review of the European System of Financial Supervision (recommendation 24)

As stated in the de Larosière report, it is necessary to review the functioning of the new system in a few years' time. In our view, however, it is not advisable to merge banking and insurance authorities. Improved coordination and cooperation arrangements should be sufficient for the time being.

Different financial services sectors have different sectoral requirements, which reflect the specificities of the sectors. Cross-sectoral integration can therefore only proceed up to a point. There is a great deal of work to be undertaken on improving cross-border cooperation of supervisors and the supervision of cross-border financial institutions. Focus should therefore be on these issues at the moment. Improved cross-sectoral cooperation, on the other hand, can be achieved by other means than merging CEIOPS and CEBS, i.e. by fostering the 3L3 cooperation. In our view, the problems in each individual financial sector should be addressed first before considering a merger.

The European insurance industry remains reluctant to the idea of merging the existing 3L3 in their operating structures. The great differences in business models and risk-taking means that insurance and banking issues need specific expertise and this has to be properly reflected by supervisory authorities. At the moment there is no significant trend towards an increase in the number of financial conglomerates and hence no need for full cross-sectoral integration.

With regards to the idea of having an EU-wide conduct of business authority (in addition to the merged banking/insurance authority), we are not convinced that this is feasible in practice. Harmonisation of conduct of business rules across the EU would be difficult due to the significant national regulatory differences and practices. The conduct of business regulation should address the retail market and be tailored to the needs of consumers. In this context, there are a number of national specificities that should be taken into account.

## 5. Other recommendations

We would also like to briefly comment on some of the other recommendations.

- Recommendations 3, 7, 8 and 9: These recommendations increase the scope of regulation to credit rating agencies, hedge funds, securitised products, derivatives and investment funds. We support considering the extension of regulation to these key sectors. This extension should proceed carefully and take into account the specificities of different sectors. In the area of securitisation, for example, we would like to emphasise that insurance-linked securitisation differs significantly from those issued by other financial services providers due to the type of risk transferred and to the well defined and transparent environment in which insurance-linked securitisation takes place. The current market turmoil should therefore not lead to undue constraints on insurance-linked securitisation. In our view it is very important that new regulation is limited to measures genuinely targeted at the causes of the financial crisis and that situations where the pressure to reform financial regulation leads to inefficient or overregulation is avoided.

- Recommendation 4: We believe market-consistent valuation promotes transparency and market discipline and ensures the appropriate pricing of risks embedded in assets and liabilities. However, efforts should be made to improve the methodology for achieving market-consistent valuation, in particular in illiquid markets. We also see the need for prudential rules that address the effects of pro-cyclicality. It has become clear that pro-cyclical effects have contributed to aggravating the financial crisis. It is therefore fundamental to avoid pro-cyclicality and we believe further work needs to be done in order to determine how prudential rules could be adapted to tackle this issue.
  
- Recommendations 10: We are very much in favour of equipping Europe with a harmonised set of rules.  
One of the main issues for the insurance sector is the rules governing European pensions. In line with what was explained during the European Consultation on Institutions for Occupational Retirement Provision (IORP) at the end of 2008, the CEA would like to emphasise that European citizens' pensions deserve sound and secure protection irrespective of the pension provider. If IORPs manage the same risks as other pension providers, a level-playing field for the application of prudential principles has to be achieved. This is especially true against the background of the current financial crisis where the need to secure consumers' pensions has become even more evident. The principles should refer to a modern, economic and risk-based approach following the Solvency II principle-based rules for insurers. Where economically significant differences between pension providers might prevail, these will be recognised and taken into account by the Solvency II principles.
  
- Recommendations 11: As institutional investors we support principles on remuneration in all financial services as they enhance stability. However, any initiatives on remuneration should take into account the differences between the different financial services sectors. Insurance companies function in a very different way to banks and this also include their remuneration policies. The insurance industry will be covered by the Solvency II process where remuneration issues will at least implicitly be addressed in the implementing measures. Therefore, the insurance industry would welcome having the detail of the issues dealt with in this context.
  
- Recommendations 13, 14, and 15: We also support proposals to improve crisis management arrangements. The present crisis has clearly shown the need to address this area. At the same time we should be mindful of the potential implications for level playing fields and competition. Any crisis management tools and initiatives should be designed in a way that ensures that competition is not being distorted. The reaction to the economic crisis should not lead to protectionism. This covers both competition between different sectors of financial services and within the same sector. State aid must be limited to avoid insolvencies and significant disturbance of financial markets. The protection of consumers should set the overall objective.
  
- Recommendation 16: In principle we welcome the creation of the European Systemic Risk Council, but the lack of information about such a council and its exact tasks makes it difficult to provide any precise comments at this stage. However, since the ESRC would be formed by the ECB and composed largely by central bankers, we would like to stress that it is important to ensure that insurance is sufficiently represented and that the ESRC receives appropriate amounts of insurance information. It should also be ensured that the additional reporting will not be burdensome and will not replicate existing regulatory reporting.

*The CEA is the European insurance and reinsurance federation. Through its 33 member bodies, the national insurance associations, the CEA represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. The CEA, which is based in Brussels, represents undertakings that account for approximately 94% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of €1 122bn, employ one million people and invest more than €7 200bn in the economy.*