



CEIOPS-SEC-70/05

September 2005

**First Progress Report on Supervisory Convergence
in the Field of Insurance and Occupational Pensions for the
Financial Services Committee (FSC)**

Executive Summary

Following the invitation of the EU Financial Services Committee (FSC), this paper reports on the activities currently under way within CEIOPS for enhancing convergence of supervisory practices in the field of insurance and occupational pensions. CEIOPS welcomes the opportunity to regularly report on this issue in order to further enhance its transparency and accountability.

Although the development of a new prudential, more risk-orientated and robust insurance regulatory framework (Solvency II) is a current high priority of CEIOPS and the new regime is not expected to be operational for several years, the Committee is also determined to further convergence in current supervisory practices. However, it is important to note that the current work undertaken by the Committee in assisting the European Commission in preparing the future Solvency II Directive, is in fact laying down the foundations for a substantial body of supervisory convergence work that will follow the adoption of the Solvency II Directive, and any subsequent implementing measures. For this reason an explanation of CEIOPS activities in this area has been included.

Besides the work on the Solvency II project, the report describes the areas on which CEIOPS has undertaken concrete action to enhance convergence of supervisory practices and highlights further opportunities for greater convergence. The main areas of convergence relate to:

- Supervision of insurance groups
- Supervision of occupational pension funds
- Supervision of insurance mediators
- Implication of accounting on supervision and supervisory reporting

This report emphasises that, although CEIOPS has already taken some substantive steps, there is much that still can be done. Supervisory convergence is one of the major objectives of the Committee and CEIOPS will continue to pursue opportunities to develop and adopt best practice across jurisdictions, especially in the context of Solvency II.

Convergence of supervisory practices across national borders should to the extent possible and necessary be consistent with converging practices in other financial sectors. Hence CEIOPS – along with CEBS and CESR – will be working together to organise an appropriate cross-committee approach to financial conglomerates. This is an urgent issue at this stage where CRD is in the process of being enacted and Solvency II being designed.

The Committee welcomes the encouragement and suggestions of the FSC and draws attention to the necessity of high-level of political support.

Introduction

At its meeting of 9 July 2004 the FSC invited the three Level 3 Committees (CESR, CEBS and CEIOPS) to report regularly on the concrete results achieved in the performance of the tasks concerning supervisory convergence, i.e.

- (i) contributing to common and uniform *day to day* application of Community legislation; issuing guidelines, recommendations and standards that the Members will introduce in their regulatory practices on a voluntary basis; undertaking reviews of regulatory and supervisory practices within the Single Market; and
- (ii) enhancing day to day consistent supervision and enforcement of the Single Market for financial services.

More specifically, the FSC expressed its interest in knowing which arrangements have been made in various areas, also elaborating on areas where supervisory convergence could not be achieved or on difficulties met in the process. This should enable the Council, through the FSC, to get a clear picture of the possible obstacles to further convergence that the Committees have identified in their work and of the nature of such obstacles. In this way, the regular reporting may indeed help identify potential areas for improvement.

CEIOPS welcomes the opportunity to regularly inform the FSC of the Committee's activities in this context as an effective means of further enhancing the Committee's transparency and accountability.

The aim of this paper is to set out the various tasks and initiatives that CEIOPS has undertaken in the framework of its present work programme which are relevant for improving consistency in supervisory practices. This paper provides a snap-shot of its main activities but it is worth noting that there are other work areas, although not specifically explored in this paper, that are nevertheless contributing towards the objective of supervisory convergence (e.g. seeking greater alignment in the supervisory approaches across sectors, co-operation with authorities from third countries, positions with regard to proposals and developments in other fields, etc).

This report does not elaborate on CEIOPS' interpretation of its role and tasks in a forward-looking perspective. A more comprehensive view, encompassing all aspects of CEIOPS' activity, could be gathered by complementing this paper with the Annual Report and the paper on the development of CEIOPS' Medium Term Work Programme (CEIOPS-SEC-57/05), which have also been distributed to the FSC in occasion of its informal meeting in July 2005.

Concrete results on supervisory convergence

To fulfil its tasks, CEIOPS has established a) Permanent Committees working on areas identified by their particular terms of reference, and b) Expert Groups carrying out tasks under a specific mandate and are intended to be disbanded once the specific tasks are accomplished.

The Solvency II project

Solvency II: organisation of work

The single biggest workstream that CEIOPS is presently undertaking focuses on providing technical advice to, and assisting the European Commission in its efforts to develop a future high-level, principles-based Framework Directive for Solvency II. The Solvency II project is aimed at putting in place an EU-wide state-of-the-art prudential supervision framework for insurance undertakings. CEIOPS has been requested to provide the European Commission with a series of advice covering all aspects of prudential supervision:

- Financial requirements (Pillar I);
- Aspects pertaining to undertakings' management and to the supervisory review process (Pillar II) and
- Supervisory reporting and disclosure requirements for enhancing market discipline (Pillar III).¹

CEIOPS' advice is to pay due attention to cross-sectoral implications and group issues.

At this stage, CEIOPS' advice is asked mainly in view of the preparation of the EU Commission's proposal for a Framework Directive. Subsequently, CEIOPS is expected to be asked to provide additional technical advice underpinning any future implementing measures. Following the agreement on the legislative framework, the Committee is expecting to undertake a substantial amount of work to ensure the consistent implementation across Member States through e.g. guidance, protocols and peer reviews.

CEIOPS has created **four Expert Groups**² with a specific focus on Solvency II. One has the task of conducting preparatory work on Pillar I issues for "life" and "non life" insurance business, in particular providing analysis on capital requirements and technical provisions. Two further groups have been formed to carry out preparatory work on Pillar II and Pillar III issues respectively. Considering the close relation between financial disclosure and the accounting framework, the Expert Group on Pillar III also deals with accounting developments which are relevant for insurance. Further group has been tasked with analysing the implications for the supervision of groups and cross-sector activities, as well as to take into account aspects related to the integration

1 These three pillars are usually referred to for describing the overall prudential model which has been designed for insurance companies. Indeed, the general lines of the new model have already been defined. The current work is aimed at producing the detailed rules for giving content to these general lines.

2 Actually, at the beginning of the work five Expert Groups were established. The Pillar I – Non-Life and Pillar I – Life Expert Group were merged after the accomplishment of the preparatory work, forming a common Pillar I Expert Group.

between financial sectors. CEIOPS Financial Stability Committee is leading the work on Quantitative Impact Studies. Each group is working under heavy time pressure in order to keep to the overall challenging timetable of the Solvency II project.

CEIOPS' answer to the "First Wave of specific Calls for Advice" was submitted to the European Commission on 30 June 2005. CEIOPS' answer on the "Second Wave of specific Calls for Advice" is expected to be sent to the European Commission by 31 October 2005. CEIOPS' answer to the third wave of Calls for Advice is expected by the end of February 2006. A public consultation process is undertaken in advance for each answer, in accordance with CEIOPS' consultation policy.

Solvency II: contribution towards furthering supervisory convergence

In its advice to the European Commission, CEIOPS is paying particular attention to the objectives of consistent implementation of the future regime and furthering convergence in supervisory practices. On a very practical level, it is already evident that the very intense and close working between supervisory authorities in the context of preparing CEIOPS' advice has in itself started to facilitate unprecedented levels of exchange of ideas between members, as well as increasing levels of understanding of each other's regulatory approaches, frameworks and concerns. Trust and common purpose is being fostered.

The issues that CEIOPS is advising on as a part of the Solvency II project will form the basis for convergence in the prudential supervision of insurance undertakings. For example, in addition to helping to put together an appropriately harmonised capital requirements regime, CEIOPS is also working to establish common approaches in the requirements and assessment of internal control and risk management; to create an appropriately harmonised framework for the supervisory review process, both in terms of fundamental principles and tools; to harmonise the measurement of technical provisions – and in particular their margin of prudence - and, as a consequence, the approach in their supervisory assessment. CEIOPS is also aiming to introduce qualitative and quantitative rules on investments at EU level which avoid the use of unjustified differences in the supervisory treatment of similar operation; to create a level playing field across Europe with regard to the use and the validation of internal models; and to introduce a harmonised framework for solvency control levels and consequent scales of supervisory interventions.

It will in due course be necessary to address other issues, such as the role and organisation of peer reviews or transparency of supervisory actions. Although it is fair to say that this particular area has not been the main focus of development work so far as there is a more pressing need to focus on the core technical aspects of the future regime, CEIOPS envisages that this work-stream will become more central as the Solvency II project moves closer to actual implementation.

To summarise, the work leading to the adoption of the new prudential regime is itself already fostering a joint understanding of the objectives, concepts and tools that will form the bedrock of supervision under the new regime, thus paving the way for the successful deployment of eventual Level 3 measures. It

should be underlined that even though the Solvency II Calls for Advice issued by the European Commission are mainly aimed at preparing the Framework Directive, CEIOPS is already discussing the scope and purpose that should be given to supervisory measures. Much work still needs to be done in order to find the right balance between Levels 2 and 3. The preparation of CEIOPS' advice is preceded by a healthy discussion on this particular topic.

In this respect, the Committee would like to emphasise the importance of leaving sufficient room for Level 3 measures when Levels 1 and 2 are being decided. A robust and appropriately harmonised regulatory framework will profit from a substantial Level 3. Standards, guidelines and recommendations, as tools for enacting Level 3 measures will enable the system to respond to relevant changes quickly and flexibly, as well as cover aspects that so far have not been dealt with in the EU prudential framework. The Committee welcomes the FSC's political support in achieving the objectives of the Lamfalussy process.

Other activities to further supervisory convergence

Despite the tight timetables and resource requirements of the priority Solvency II project, CEIOPS has a number of other substantial work-streams aimed at facilitating a more consistent implementation of current EU legislation and encouraging more convergence in supervisory practices.

Supervision of insurance groups

Continuing the work initiated under the auspices of the former *Conference of the European Insurance Supervisory Authorities*, another Permanent Committee, the Insurance Groups Supervision Committee, is looking at the issues raised by the implementation of the Directive on the supplementary supervision of insurance groups ('Insurance Groups Directive – IGD'). In particular, the Committee works on applying the coordination arrangements defined by the Protocol concluded for the supervision of cross-border groups³.

In this respect, this Committee facilitates discussion amongst supervisors and comparison of national implementation of the IGD and, where possible, work at defining a common approach for implementing and interpreting it (e.g. ensuring actual equivalence in the calculation of the adjusted solvency margin). Based on the experiences of actual national implementation, CEIOPS has prepared a recommendation to the European Commission on the possible amendments to the Directive⁴. After the usual consultation period, the recommendation is expected to be released this autumn.

The Committee has also worked at establishing and coordinating the supervisory committees (Coordination Committees) which have been established in relation

³ Protocol relating to the Collaboration of the Supervisory Authorities of the Member States of the European Union with regard to the Application of the Directive 98/78/EC on the Supplementary Supervision of Insurance Undertakings in an Insurance Group (11 May 2000), so called "Helsinki Protocol".

⁴ CEIOPS-CP-03/05 Consultation Paper No. 3: Report on Possible Need for Amendments to the Insurance Groups Directive

to each multinational insurance group pursuing the provisions of the CEIOPS "Helsinki Protocol", a protocol concluded by EU insurance supervisors regulating their collaboration and co-ordination in the actual supervision of multinational insurance groups under the requirements of the IGD. The main goal of Coordination Committees (Co-Cos) is to facilitate a common and global assessment of the financial position and management of each individual group, striving to combine the need to consider the economic reality of the group with the legal framework of each group's undertaking.

Each Co-Co is composed of the national supervisors involved in the day-to-day supervision of the group's entities. Specific contact lists, including identification of national supervisors involved and a key supervisor with coordinating tasks, have been established for each insurance group involving more than one European supervisor. By means of this arrangement EU supervisors exchange relevant information for the application of the IGD, co-operate on common supervisory issues and, when appropriate, take co-ordinated supervisory actions concerning the respective groups.

In this context, CEIOPS issued in June 2005 "Guidelines" on the functioning of the Coordination Committee⁵.

In the framework of the Insurance Groups Supervision Committee, CEIOPS is also engaged in negotiating with relevant third countries' supervisors co-ordination agreements dealing with the supervision of groups including non-EU entities. Two model MoUs are presently under preparation with the US and Swiss authorities.

Despite the progress already made, CEIOPS is aware that significant room for further convergence in facilitating a common approach to supervising multinational groups and in finding more streamlined coordination arrangements. It is envisaged that some additional progress in with regards the legal framework can be made through the Solvency II project. More generally, CEIOPS is convinced that this area could benefit from a greater legal clarity with regards the tasks and responsibilities among supervisors involved in the supervision of multinational groups.

This strand of work could be further developed through seeking alignment across sectors and the need to apply similar supervisory arrangements where relevant, especially in the field of financial conglomerates. CEIOPS is committed to working together with CEBS and CESR in seeking joint approaches to supervisory issues where they appear desirable. In particular, CEIOPS will rely on the close connections established through the regular meetings of the Chairs and Secretary Generals of the three "Level 3" Committees.

Supervision of insurance intermediaries

The Insurance Mediation Directive is a first step in trying to facilitate the emergence of a Single Market in this particular sector.

⁵ CEIOPS-DOC-02/05 Guidelines for Coordination Committees in the Context of Supplementary Supervision as Defined by the Insurance Groups Directive (98/78/EC)

For its part, CEIOPS has been preparing a Protocol to be concluded between authorities competent for applying the recent Insurance Mediation Directive (IMD). The Protocol aims at regulating reciprocal duties and procedures for cooperation and exchange of information in case of cross-border mediation activity. A draft has been issued for public consultation in June 2005.⁶ In addition to providing a framework for co-operation in this area, this work-stream is also intended as a significant tool for creating a common approach to supervision.

Differences in the powers of competent authorities, as well as still significantly divergent national markets (number of market operators, legal characteristics and ways of operation) present particular challenges, and a clearer view of the scope for CEIOPS activity in converging supervisory practices will only be possible after all Member States have actually transposed the Directive. Close co-operation with this industry sector and the competent authorities will be essential.

Supervision of occupational pension funds

The CEIOPS Occupational Pensions Committee has been working since February 2004 to enhance convergence between Member States in supervising occupational pension funds, pursuant to the provisions of the Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (IORP-Directive). This Directive represents the first step on the way to an internal market for occupational retirement provision organised on a European scale.

CEIOPS has worked mainly in two areas. The first relates to enhancing a common understanding of the Directive and thus facilitating its consistent transposition as well as a convergent application of its provisions. Furthermore, CEIOPS has worked out questionnaires on the application of certain provisions in the Directive, thus facilitating comparison between jurisdictions and creating a forum for discussion.

The second main work stream is aimed at facilitating the supervisory co-operation, co-ordination and exchange of information between occupational pensions supervisors on the cross-border membership in an IORP. A Protocol is in the process of being agreed and is planned to be finally adopted by the end of this year.⁷

The deadline for the transposition of the Directive is in September 2005, and, again, a clearer view on the scope for more CEIOPS work will be possible after this date. Significant differences between jurisdictions in the legal status and management of the institutions concerned present particular challenges in this area. CEIOPS is planning to monitor and compare relevant aspects of national transpositions. The results of this work could lead to further work. In this

6 CEIOPS-CP-05/05 Consultation Paper No. 8: Protocol Relating to the Cooperation of the Competent Authorities of the Member States of the European Union in Particular Concerning the Application of Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on Insurance Mediation

7 CEIOPS-CP-02/05 Consultation Paper No. 5: Protocol Relating to the Collaboration of the Relevant Supervisory Authorities of the Member States of the European Community in Particular in the Application of the Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the Activities and Supervision of Institutions for Occupational Retirement Provision (IORPs) Operating Cross-Border

context, any need for consistency with the regime applicable to life insurance will be considered.

Implications of accounting on supervision and supervisory reporting

The insurance accounting practices in the EU are broadly based on the Fourth, the Seventh and the Insurance Accounts Directives. These Directives contain a significant number of options that have been exercised differently in Member States. However, the introduction and continued development of international financial reporting standards, 'IFRS', should result in greater convergence of accounting practices in the future. Although the current IFRS standard on insurance contracts largely allows the continued existence of diverse practices for the accounting of insurance contracts, the rest of the IFRS standards applicable to insurers will result in significant changes to the way insurers measure and recognise other parts of their balance sheets.

CEIOPS has been working on issues around the introduction of IFRS, with two main objectives. First, to identify and analyse the key effects of the introduction of IFRS on the existing supervisory regimes across the EU; and second, to make proposals for potential prudential treatments ("supervisory filters") to address the effect of the new accounting rules on supervisory reporting. CEIOPS recognises that, in the absence of changes to the supervisory rules and calculations, accounting developments may affect the magnitude, quality and volatility of supervisory measures.

A paper is expected to be finalised this autumn.⁸ This paper, in light of the ongoing work on Solvency II, is aimed at limiting suggested amendments to the current regime to a minimum and recommending supervisory reaction which largely depends on the actual regulatory framework in force within each jurisdiction, both in the accounting and in the prudential field.

CEIOPS is aware that this is particular area which requires particular work towards an appropriate harmonisation in order to facilitate a consistent approach in the assessment of supervisory issues by EU supervisors as well as to improve cost-efficiency of the supervisory regime, in particular with regard to reporting requirements addressed to multinational groups.

Macroeconomic surveillance and analysis

CEIOPS has also put in place common structures to review the sector-wide conditions of the insurance and occupational pensions markets. A Permanent Committee has been charged with establishing a **macro-prudential surveillance programme** for analysing the interplay between the insurance and occupational pension markets and financial stability. The Committee also regularly reports on the vulnerabilities and challenges the insurance and occupational pension sectors and carries out analysis on particular market developments, keeping close contact with the working groups of the other financial sectors dealing with financial stability review.

⁸ CEIOPS-CP-03/04 Consultation Paper No. 3: Implications of IAS/IFRS Introduction for the Prudential Supervision of Insurance Undertakings

Challenges to greater convergence

Besides the specific issues mentioned above, CEIOPS thinks it is worthwhile to underline some general issues that are relevant in facilitating the achievement of its objectives.

Enhancing convergence requires that the supervisors develop their supervisory practices in line with the European standards and practices developed within CEIOPS. This requires that competent authorities are sufficiently resourced to allow for active engagement in the work of CEIOPS and to develop their own practices.

In some areas, such as the already identified Solvency II project, it might be necessary to take legislative steps at the European level in order to facilitate more consistent implementation. However, any new legislation should only be initiated if it can be justified following rigorous *ex-ante* market failure and cost-benefit analyses.

Experience to date would suggest that it would be beneficial if there would be more commonality in the powers of competent authorities and that the competent authorities must be adequately resourced. But, the Committee is also aware that the above is not necessarily enough to achieve convergence of practices. Convergence of objectives - and hence independence of supervisors in line with the IAIS-standards - is also an important precondition. For this reason CEIOPS is working on giving recommendations on its own initiative to the EU Commission on this issue in the framework of its work on Solvency II.