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SOLVENCY II

Industry must act on Solvency II now

Tomorrow will see the publication of the draft framework for Europe's Solvency II proposal. LIZ BOOTH reports from Brussels on Karel Van Hulle's thoughts ahead of tomorrow's publication and MEP Peter Skinner's opinion on the influence the directive may have on the rest of the insurance world

Solvency II: the new European directive could well provide a template for a move towards a global framework, according to MEP Skinner

The insurance industry must act now ahead of the implementation of Solvency II across Europe, despite it not coming into effect until 2012, according to Karel Van Hulle, the architect of the plan.

Speaking at a seminar held by Steptoe & Johnson last Thursday, Van Hulle, head of unit insurance and pensions for the European Commission, stresses that the programme, which sees the launch of the draft framework tomorrow, should be treated as urgent by the industry.

Group supervision and diversification have emerged among the key changes in the plan, which runs to 1,000 pages.

Van Hulle says this will be the first major project under the Lamfalussey process and will be principle- rather than rule-based regulation.

Van Hulle says: "The new regime introduces an economic risk-based approach that will reward good risk management and enhance policyholders' protection.

"Risk is the business of insurance so it is rather odd that Solvency I is not risk-based. The framework will place emphasis on the responsibility of senior management to manage their business.

"[Solvency II will] foster greater supervisory convergence across the community. We have a natural tendency not to talk to each other. There is a lot of work to be done but CEIOPS [the Committee of European Insurance and Occupational Pensions Supervisor] has been involved in the design of the regime and so the supervisors have been getting together and talking.

"Solvency II has been designed bottom-up and not top-down, following intensive consultation and dialogue with the industry and all other interested parties."

Van Hulle stresses that tomorrow is just the next stage in a long process. The latest quantitative impact study (QIS) still has to be assessed and published, while a fourth QIS will be carried out next year.

Not behind schedule

He denies that the directive is another year behind schedule, saying that there is a lot of work to be done between now and 2010, which then gives member states and the industry two years to bring the directive into being.

"We are not postponing, as has been suggested in the past week, but giving a realistic dateline. The objective is to produce a modern, innovative and liberal directive with prudential supervision based on sound economic principles."

He says the directive will bring together a total of 13 existing directives – a change from the original 14 proposed. One industry practitioner has been asking which directives will be incorporated. Van Hulle has made it clear that pensions will not be included but did not list the 13. He says pensions will be reviewed separately next year.

The directive will be overseen through the parliamentary side of the process by member of the European parliament Peter Skinner – the man who brought the reinsurance directive through the same process.

Heated debate

Although supporting the proposals in broad terms, he is sure that certain sections will produce heated debate.

"At the same time as we try to harmonise there is a call for subsidiarity and for control to remain in member states," he warns.

"This proposal needs to be something that delivers for the market and for policyholders. From what I have seen so far I am quite convinced we are going in the right direction."

He stresses that it needs to be harmonised across 27 states and while he admits parliament can be a "black hole" in the process, he believes it adds a vital part to the law-making system.

Skinner believes that Solvency II could well provide a template for a move towards a global framework. In recent visits to the US "we have seen a note of change", he says, adding that Solvency II could become a template to bring harmonisation across the 50 states of the US.

"As to whether there is something out there for the rest of world – I hope so. I think if you are looking at other markets – China and India – then we really have to have global rules. Australia and Japan are talking about working alongside Europe."

He hopes that the parliamentary process will be a "series of scuffles rather than out and out war", but he believes there will be challenges to some elements of the proposals.

Some flexibility

One piece of good news for industry is that it appears there will be some flexibility in approach. For example, insurers had feared that proposals for partial internal models would be temporary, but Van Hulle says firms will have choices about whether or not they go down the route of preparing internal models.

He says the rewards for those that do will be reduced capital requirements and he will be encouraging industry to consider developing full internal models. But as one observer says: "It is unlikely to appeal if the cost of producing the internal model is £4m [($8.04m)] and the saving on capital requirement is £500,000, so we welcome the news that partial models are here to stay."

Both Van Hulle and Skinner are concerned that in creating rules for groups, the smaller firms are not disadvantaged. As Skinner says, there are a small number of major groups, but around 5,000 smaller operators.

Proportionality will be a key aspect of the directive with Van Hulle stressing that while the principles would be the same across the industry, there is still room for proportionality so that small firms do not suffer from undue costs relative to the size of their business.

"A one-size-fits-all approach may not be the best solution," he says.

"It might appear that internal models are the playground for the big firms and small companies will go for standard forms but I don't think it is black and white. I think it will be quite a mix."

Asked about the standard of regulators, Van Hulle says: "As supervisors were closely involved in the design of this, they have learned to talk to each other. All 27 have been involved in decisions at the design stage."

Guidance on specifics

He adds that there will be guidance on how to carry out the specifics of the regulation. The recent report on Equitable Life highlighted the importance of supervisors taking responsibility and not "bandying the blame around".

Van Hulle explains, however: "Clearly in establishing a system whereby a group supervisor will take on more responsibility we must be careful not to upset the balance in a way which will leave a sole supervisor disadvantaged."

He believes the proposals "are the answer to business reality because anything else would create costs".

He explains: "I keep hearing rumours that we are creating Fortress Europe but it is not true.

"We have to deal with places outside Europe and we have to address third-country players."

Without giving away what is in the framework, he stresses that it will not create a Fortress Europe. "It is not our intention to do that and it will not be a consequence of this proposal," he says.

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