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Green Paper for Capital Markets Union: a mixed bag for insurers

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European Commission consultation on CMU set to close on May 13

In February the European Commission published its Green Paper on Building a Capital Markets Union (CMU). In the consultations on three parallel documents, the commission is seeking stakeholders' input on various possible initiatives under its flagship project to build "an integrated, well-regulated, transparent and liquid" CMU.

It is now time to examine in more detail the content of the document that Insurance Europe, the European re/insurance federation, welcomed as covering "several key areas of importance for insurers, a primary example being the prudential treatment of long-term investments".

Before looking at aspects of the Green Paper that may be of particular interest to the re/insurance industry, an important caveat: to date, CMU is an objective that is yet to be defined in detail. Except for certain short-term priorities, the Green Paper should be seen as a mapping exercise the commission has undertaken in order to facilitate defining the content of CMU and deciding on priorities. The deadline of 2019 for putting the essential building blocks for the CMU in place further highlights that the CMU is an action plan for this commission's whole term of office. It is likely to be the initiative that will determine the success – or otherwise – of Lord Hill as the new commissioner for Financial Services and Markets.

The Green Paper focuses on short-, medium- and longer-term initiatives the EU could take to create a single market for capital so that EU companies may more easily access non-bank sources of financing. Each of these categories includes possible measures that will affect the EU re/insurance industry.

High-quality securitisation

One of the short-term priorities is developing an EU framework for "high-quality" securitisation. The commission has dedicated a separate consultation document to this initiative and has committed to deliver a proposal on this subject in 2015. The consultation gives the re/insurance industry an opportunity to comment on points, such as the regulatory treatment of short-term securitisation instruments, which were not covered by the Solvency II delegated acts published last January. Re/insurers can also revisit the shortcomings in the Solvency II standard formula calibrations set out in the delegated acts, such as the classification of investments in non-senior tranches of qualifying securitisations.

The consultation document also asks stakeholders to give feedback on whether a new, single piece of EU legislation establishing requirements for high-quality securitisation instruments and applicable to all financial sectors would be a preferred option. While the commission acknowledges itself that EU legislation would not be able to harmonise all aspects of securitisation, the prevailing view in Brussels seems to be that an overarching legal text would be the simplest way of achieving the objectives set out in the consultation paper.

Medium- and long-term initiatives

Certain medium- to long-term measures the commission has identified as building blocks of CMU also deserve re/insurers' attention since they will (indirectly) affect the way re/insurance business is carried out in the EU. They range from sector-specific initiatives, such as the calibration of the Solvency II capital requirement for infrastructure investments and EU action on personal pensions, to cross-sectoral questions, for example harmonising insolvency law and national tax regimes.

Infrastructure investments

The commission is considering amendment of insurance prudential standards by further calibrating the Solvency II capital charge for infrastructure investments. This option is seen as an addition to the "long-term guarantee" (LTG) package introduced in the Omnibus II Directive – which itself was an initial amendment of the 2009 Solvency II Directive. Stakeholders are requested to comment on whether future reviews of Solvency II should target specific sub-classes of assets as part of the work on a tailored treatment of infrastructure investments. However, the re/insurance industry should note this idea does have a source: in its advice on the scope of the LTG package, the EU insurance supervisory authority, Eiopa, has already explored in some detail how infrastructure investments could be treated more favourably, though without recommending any actual calibrations of prudential standards.

Personal pensions

Insurers will also be quite familiar with another sector-specific building block, the creation of a single market for personal pensions through the introduction of a "29th" regime governing standardised personal pension products, ie, a separate EU regime additional to the pension frameworks in place for the 28 EU member states. The commission and Eiopa have been working on a possible EU initiative in this area since mid-2012. Including this topic on the CMU agenda seems to be a rather unfortunate duplication of effort since, as recently as July 2014, the commission requested Eiopa to deliver comprehensive advice on the development of an EU single market for personal pension products. Eiopa is expected to report to the commission by February 1, 2016.

Insolvency law

Turning to cross-sectoral initiatives, re/insurers, as any other institutional investor, would undoubtedly benefit from harmonisation at the EU level of substantive insolvency legislation since, from time to time, they end up holding assets of issuers which have gone into liquidation. EU stakeholders have been discussing the need to harmonise national insolvency frameworks for more than a decade and numerous studies have highlighted that these frameworks differ considerably from one EU Member State to another, tend to work too slowly and often do not protect private creditor rights effectively.

Together with possible harmonisation of national tax regimes described below, harmonisation of insolvency law is one of the most ambitious proposals of the entire Green Paper. Insolvency legislation is often closely linked to national constitutional arrangements; these arrangements make implementation of this initiative a technically and politically difficult task. Given the slow pace of discussions to date, full harmonisation does not seem to be a realistic objective. The commission may be happy simply to achieve minimum harmonisation or a narrower scope.

Taxation

Finally, the most challenging item on the commission’s “shopping list” for CMU is taxation. The Green Paper refers to differences between national tax regimes which constitute significant obstacles for creating a single market for capital. The commission has identified discriminatory taxation of pension and life insurance capital, contributions and payouts; withholding tax relief procedures relating to post-trading; and differences in tax treatment of equity and debt as well as their definition for tax purposes. Stakeholders are invited to comment on any other tax barriers the commission should address as a priority when implementing the CMU agenda. The absence of harmonisation of national insurance premium tax rules might well be one such barrier.

At the EU level, unanimity among the 28 EU governments is still required for adoption of EU tax rules – a herculean task. Although a reduced number of governments can decide to forge ahead if unanimity is impossible – a process known as “enhanced co-operation” – the failure to date of this process in relation to the proposal for a Financial Transactions Tax is a salutary warning.

The commission’s consultation on CMU closes on 13 May. Lord Hill will then deliver a comprehensive action plan in the summer.

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