II

(Preparatory Acts)

EUROPEAN ECONOMIC AND SOCIAL COMMITTEE

412th PLENARY SESSION OF 27/28 OCTOBER 2004

Opinion of the European Economic and Social Committee on the 'Proposal for a Directive of the European Parliament and of the Council on reinsurance and amending Council Directives 73/239/EEC, 92/49/EEC and Directives 98/78/EC and 2002/83/EC'

(COM(2004) 273 final – 2004/0097 (COD))

(2005/C 120/01)

On 10 June 2004 the Council decided to consult the European Economic and Social Committee, under Article 95 of the Treaty establishing the European Community, on the abovementioned proposal.

The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 6 October 2004. The rapporteur was Mr von Fürstenwerth.

At its 412th plenary session of 27/28 October 2004 (meeting of 27 October) the European Economic and Social Committee adopted the following opinion 158 votes to four with three abstentions:

1. Introduction

1.1 There is currently no harmonised framework for the supervision of reinsurance undertakings in the EU. As a result, reinsurance supervision regimes vary widely from one Member State to another.

1.2 On 21 April 2004, therefore, the Commission submitted a proposal for a Directive on reinsurance and amending Council Directives 73/239/EEC, 92/49/EEC and Directives 98/78/EC and 2002/83/EC. Its key features are as follows:

— a supervisory approach based on harmonisation and mutual recognition and underpinned by current direct supervision rules;

— a fast-track approach by a directive based on current direct supervision rules;

— a mandatory licensing system;

— solvency margin requirements in line with those for direct insurance, with, however, the possibility of increasing this margin through comitology.

2. The Commission proposals

2.1 The purpose of the directive is to establish a harmonised supervisory framework for reinsurance undertakings and captives [1] in the European Union.

2.2 The proposal lays down the minimum conditions necessary to obtain official authorisation. Among other things, these conditions stipulate that the undertaking in question must have a specific legal form. It must submit a scheme of operations and must also hold a minimum guarantee fund. Business is limited to reinsurance and related operations and the qualifying shareholders and management of the undertaking are also subject to checks. An authorisation, once granted, is valid for the entire Community.

2.3 The directive seeks to prohibit reinsurers from depositing security with primary insurers, where this is required under Member States' national law. Contractual deposits remain

(1) A reinsurance captive is a reinsurer belonging to a company or a group of companies where that company or group of companies is not engaged in primary insurance or reinsurance. A captive operates only to offer reinsurance protection to the company or group of companies in question.

unaffected. In addition to establishing a functioning single market, the Commission is also seeking to lay down an international benchmark to alleviate worldwide the constraints placed on European reinsurers as a result of the deposit of security.

2.4 Under the solvency provisions for undertakings, the solvency requirements that apply to primary non-life insurance companies are also to apply to the non-life reinsurance business. These requirements may be increased by up to 50 % through the comitology procedure. The solvency provisions for life reinsurance undertakings are to be based on those that apply to primary life insurance undertakings. Where an undertaking conducts life and non-life reinsurance business simultaneously, the total sum must be covered by its own funds. Like primary insurance undertakings, reinsurance undertakings will also be required to maintain a minimum guarantee fund of not less than EUR 3 million. For captive reinsurance undertakings, that figure may be reduced to EUR 1 million.

2.5 The proposed directive lays down specific supervisory powers in cases where a company's financial situation deteriorates, where no adequate technical provisions are in place or where there is insufficient solvency. These powers match those in the primary insurance sector and provide scope to require the submission of a plan for the restoration of a sound financial situation, a finance scheme and a financial recovery plan, and to withdraw authorisation.

2.6 Reinsurance undertakings which were entitled or authorised to conduct reinsurance business before the date of implementation of the directive may continue to do so without requesting authorisation. They are subject to the substantive provisions of the directive, although the Member States may grant an additional transitional period of two years.

2.7 The proposal gives the Commission implementing powers to make technical adjustments to the directive ('comitology').

2.8 The life, non-life and insurance groups directives are also to be adapted in line with the supervision rules for reinsurance undertakings. Thus,

— the supervisory authority may not refuse a reinsurance contract on the grounds directly related to the financial soundness of an EU insurance or reinsurance undertaking;

— there must be no provision for a system of gross reserving which requires the pledging of assets to cover unearned premiums and outstanding claims provisions (prohibition of deposit of security);

— primary insurance undertakings that also offer reinsurance are subject to the same solvency requirements as reinsurance undertakings;

— the insurance groups directive is being amended to place reinsurance undertakings on the same footing as primary insurance undertakings.

3. General comments

3.1 The Committee welcomes the Commission's proposal which will help consolidate Europe's position as a financial centre by ensuring that reinsurance undertakings and captives have adequate capital at their disposal to meet their obligations. This will give a lasting boost to the position of European reinsurance undertakings on the international insurance markets.

3.2 The Committee would expressly point out the importance of the reinsurance industry for Europe's position as a financial centre. In 2002, the total reinsurance premium of the 40 largest reinsurers amounted to USD 138 601 200 000, of which USD 58 544 000 000 stemmed from EU reinsurers.

3.3 The reinsurance business is concerned mainly with the relationship between primary insurers and reinsurers. However, the loss of one or more reinsurers may have an impact on consumers if, as a result, a primary insurer is no longer able to meet its obligations. The Committee therefore recognises that the proposed directive also indirectly boosts EU consumer protection. The Committee also draws attention to the benefit to consumers of adequate reinsurance cover. That in turn requires the availability on the European market of sufficient reinsurance capacity at reasonable premiums.

3.4 The Committee welcomes the Commission's fast-track approach, i.e. that the reinsurance supervision rules are be adopted on the basis of the current primary insurance supervision rules. This is the right approach, not least in the light of the ongoing Solvency II project.

3.5 A key fact about reinsurance is that it is a global market. In the ongoing consultations on the directive, therefore, the Committee would ask the European Parliament, the Council and the Commission to pay particular attention to the international competitiveness of the European reinsurance industry.

3.6 The Committee recognises that the European reinsurance industry in particular proved its financial soundness in the wake of the 11 September 2001 attacks. Thus, any new burden placed on the European reinsurance industry should be subject to a rigorous cost-benefit analysis.

3.7 The Committee acknowledges that, up to now, different supervision regimes have been in operation in the EU, involving a mix of solvency, capital investment and deposit-related rules. Under the Commission proposal, the current rules for deposits in particular are set to disappear. It is vital to ensure that the supervisory authorities concerned develop sufficient trust in the future supervisory mechanisms and their uniform application across the EU.

4. Solvency requirements for life reassurance activities (Article 38)

4.1 Under the proposed directive, the provisions for calculating the solvency margin of primary life insurance undertakings are also to apply to life reinsurance undertakings. For life reinsurance, the Commission proposes the adoption – unchanged – of the solvency rules of the primary insurance sector. The solvency calculation comprises two elements: 3‰ of the sum at risk and 4 % of the mathematical provisions. The Committee feels that this places a disproportionate burden on European life reassurance undertakings. The Commission's proposal:

— fails to reflect the business and risk profile of life reinsurance activities and results in a disproportionate overcapitalisation of life reinsurers;

— puts European life reinsurers at a substantial disadvantage compared with their international competitors (cf. appendix) and raises fears of a further depletion of reinsurance capacity;

— makes reinsurance cover considerably more expensive;

— may contribute to the destabilisation of the financial markets if increased costs mean that primary insurance undertakings do not buy the requisite reinsurance cover;

— places a considerable additional cost burden on private funded pension schemes.

4.2 In Europe, the risk structure of primary life insurance undertakings and life reinsurers differs considerably. In the life reinsurance business, the capital investment risk generally remains with the primary insurer. That difference alone shows that the solvency formula for primary life insurance cannot adequately reflect the risk structure in the life reinsurance business.

4.3 It is clear from a comparison with the calculation methods used by rating agencies that the proposed EU requirements would seem excessive. US solvency requirements for instance, while based on the amount at risk, also include a variable factor contingent on the size of the relevant portfolio (0.8‰ on holdings over EUR 25 billion – see appendix). The Canadian supervisory authorities and rating agencies take a similar approach.

4.4 While the primary insurance business between insurer and client still bears national hallmarks, reinsurance has always been an international operation, not least because of the need for international risk diversification. It is therefore necessary to establish a level playing field between providers within the Union and international competitors in the USA, Bermuda and Switzerland.

4.5 The fear for European reinsurers competing globally is that they would be placed at a serious disadvantage compared with their rivals outside Europe, where capital requirements are lower. Much of the reinsurance business could well shift to non-European reinsurance centres such as Bermuda or the USA. Any shift in reinsurance capacity would considerably weaken Europe's position as a financial centre. The excessive requirements would inevitably deplete reinsurance capacity and/or make reinsurance more expensive. Such price hikes for reinsurance will inevitably be reflected in the cost of primary insurers' products and thus filter down to consumers too. In turn higher prices will inevitably also have an adverse impact on the establishment of private funded pension schemes that is so urgently needed.

4.6 The Committee feels that none of these developments are conducive to promoting the European single market. The new EU Member States in particular are keen to have a properly working single European market in reinsurance and would be particularly affected by any adverse changes in the structure of reinsurance provision.

4.7 The Committee therefore concludes that the method for calculating the solvency margin for life reinsurance activities proposed in the draft directive could damage European reinsurers' competitiveness. It thus feels that significant changes are needed to the Commission's proposed solvency provisions of life reinsurance undertakings.

4.8 Building on that, the Committee proposes that the solvency calculation for non-life reinsurers should also be taken as a guide for the life reinsurance sector.

4.8.1 In terms of risk and competition, the solvency calculation method for non-life insurers is more than adequate. The non-life solvency formula is broadly consistent with comparable international solvency requirements so that there is little chance of European reinsurers being placed at a competitive disadvantage.

4.8.2 The non-life formula adequately meets the needs of the life reinsurance sector. Because of its overwhelming reliance on existing calculations of mortality risk, the life reinsurance business has more in common with the primary non-life insurance and the non-life reinsurance sectors than with the primary life insurance business.

4.8.3 Individual risks not reflected in the non-life formula can easily be incorporated under the Solvency II project.

4.8.4 From a legislative standpoint, the non-life formula is easy to implement as the Commission has already submitted a finished text in its draft proposal for a directive (revision 3).

4.8.5 By using the non-life formula, life reinsurance undertakings are able to determine their solvency requirements quickly since companies already have the requisite data which does not therefore need to be collected. The non-life formula is especially useful given the lack of information in international business.

4.8.6 The non-life solvency formula is particularly well suited to a fast-track approach. It is easy to apply as it needs no further adjustment in cases where, for instance, contractual deposits are placed.

5. **Solvency provisions for non-life reinsurance activities (Articles 37 and 55)**

5.1 The proposed directive applies the provisions for calculating the solvency margin of primary non-life insurance activities to the non-life reinsurance business as well. The proposal also allows for the possibility of increasing the solvency requirements for non-life reinsurance by up to 50 % under the Lamfalussy procedure.

5.2 The Committee feels that, under the fast-track procedure, it is appropriate to transfer, unchanged, the solvency rules for primary non-life insurers to non-life reinsurers. However, the Committee has considerable misgivings about extending the Lamfalussy procedure in the area of solvency requirements.

5.3 The proposed directive was conceived as a fast-track project, not as a framework directive within the Lamfalussy procedure. The solvency requirements should only be amended as part of the more far-reaching Solvency II project.

5.4 Nor is there any material case for applying the Lamfalussy procedure. Capital requirements for reinsurance undertakings are not in any sense implementing measures under the terms of the Lamfalussy procedure. As is readily clear from the protracted Basle II negotiations in the banking sector, capital requirements are the very core of the future supervisory system and not some downstream detail.

5.5 The Committee feels that the specific capital requirements should be made clear in the directive itself and not in downstream Community legislation. This distinction is also backed up by the current Convention draft, which requires that substantive provisions be incorporated into the directive itself. The Commission's reference to extensive consultation of the relevant stakeholders does not therefore go far enough.

6. **Reinsurance and retrocession factors (Articles 37 and 38)**

6.1 Under the proposed directive, retrocession to other reinsurers may be taken into account in solvency calculations only up to a ceiling of 50 % of the gross amount of claims. This is in line with the current rules for primary insurers in the life and non-life sectors. The draft directive on the supervision of reinsurance undertakings is designed to make a substantial contribution to boosting the financial soundness of the reinsurance sector within the European Union. The Committee therefore feels that full recognition of cessions of primary insurers and retrocessions of reinsurers is warranted, provided the ceding or retroceding undertaking concerned is subject to supervision within the EU.

6.2 The Committee would recommend increasing the reinsurance and retrocession factors, not least given the increased demands made on the insurance industry to resolve issues facing society as a whole. Because of the low reinsurance and retrocession factor, it has not always been possible to offer economical solutions, e.g. in response to the calls made in the wake of the 11 September 2001 attacks to cover industry and the aviation sector against terrorist risks. In some Member States, the low retrocession factor has so far prevented the development of insurance cover for terrorist risks.

7. **Investment rules (Article 34)**

7.1 The Committee accepts the qualitative prudential rules provided for in Article 34 (the 'prudent person principle'). Given the special features and, in particular, the international nature of the reinsurance business, such an approach is more appropriate than a rigid quantitative one. The EU is thus pursuing a modern approach that is also recommended by the International Association of Insurance Supervisors (IAIS). At the same time, however, the Committee recognises that a qualitative approach is not a blank cheque, but requires undertakings to continuously monitor and improve the capital investment process.

7.2 As the directive restricts or repeals existing prudential rules (as regards depositing security for instance), the Committee recommends that the directive should give Member States the option of requiring the application of additional quantitative investment rules for reinsurers established in their territory. Any such rules must, however, be justified under the 'prudent person principle' and the obligations entered into.

8. **Transitional periods (Article 51)**

As things stand, reinsurance undertakings are not subject to any uniform EU legal framework. The Committee would therefore recommend that the Commission examine closely whether additional transitional arrangements are required. Such arrangements could, for example, affect capital instruments currently used by reinsurers, which are not recognised under the capital requirements for primary insurers.

9. **Conclusions**

9.1 The Committee backs the Commission's Proposal for a Directive of the European Parliament and of the Council on reinsurance and amending Council Directives 73/239/EEC, 92/49/EEC and Directives 98/78/EC and 2002/83/EC subject to the reservations set out above. It considers that the proposal covers almost all areas relating to the supervision of reinsurance undertakings. The full implementation of the directive will go a considerable way to meeting the Commission's objective of strengthening and stabilising the reinsurance markets in the European Union.

9.2 Having examined the Commission document, the Committee has addressed selected aspects of the proposal for a directive in order, among other things, to give the Commission practical pointers and suggestions for further deliberations and analysis. The Committee proposes that the solvency calculation for non-life reinsurers should be taken as a basis for the life reinsurance sector as well. The solvency requirements should remain outside the scope of Lamfalussy procedure. The Committee considers this to be a key directive and therefore calls for a rapid legislative process.

Brussels, 27 October 2004.

The President

of the European Economic and Social Committee

Anne-Marie SIGMUND