Position Paper

Insurance Europe response to Joint Forum on Principles for Supervision of Financial Conglomerates

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Summary

The European (re)insurance industry recognises the need to revisit the 1999 principles on supervision of Financial Conglomerates in the current regulatory and supervisory environment.

Generally speaking, financial services legislation all over the world has undergone an intensive overhaul in recent years, notably in light of the 2007/2008 banking crisis. In particular, the Basel Committee has adopted in 2010 the Basel III Framework, which significantly amends the 2004 Basel II Framework. In insurance, where there is no similar framework at international level, many countries are in the process of modernising the legislation currently in place. In Europe, the (re)insurance industry is preparing to implement Solvency II (2009/138/EC) and already we are seeing proposals being introduced to this package which will address additional concerns arising from financial stability discussions.

We believe that financial conglomerate supervision should be limited to the interconnectedness between sectoral activities. Sectoral legislation is designed to look at the operational activities of groups and financial conglomerates, compliance is assessed by the supervisor who is responsible for granting authorisation. It is important therefore that international principles do not seek to overwrite sectoral legislation upon which individual (re)insurance and banking authorisations are based.

In the case that sectoral legislation is deemed equivalent for financial conglomerate supervisory purposes, it should be possible for supervisors and undertakings to perform these functions once, it would be inefficient for the same task to be performed multiple times. Under a system of enhanced cooperation and information sharing, supervisors will be able to maintain a sufficient level of oversight.

Insurance Europe would like to thank the Joint Forum for the opportunity to comment on their draft principles and in response, we have provided comments on each of the respective sections of the Joint Forum report.

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Scope and Supervision

Under point 3 of the opening section, Insurance Europe has concerns with the order of wording used when identifying the scope of application. The Financial Conglomerates Directive (FCD) (2002/87/EC) recognises a financial conglomerate at European level when at least one of the entities in the group is within "the insurance sector and banking sector or investment services sector". The FCD continues to say that investment services are then added to the largest financial sector.

It is unclear how "securities", as a financial sector activity, would be interpreted at international level. If it is likely to be interpreted as investment services/asset management, then we find it even more important to reflect the ancillary nature of that activity. For this reason, we would propose to reorder the wording to align with the FCD.

This is an important point for European (re)insurers which may perform their investment services functions in-house. Misinterpretation of the Joint Forum wording could result in these groups being identified as a financial conglomerate, despite that their core business is carried out in only one financial sector. In general, it will be difficult for groups to manage their obligations if their status is recognised differently at international and regional level.

In response to principle 9, consideration should also be given to procedures which would allow that corrective measures are removed or discontinued upon compliance of the financial conglomerate.

Corporate Governance

Corporate governance frameworks are dependent on the company law framework of the jurisdiction in which the undertaking is established. Corporate governance terminology can vary per jurisdiction depending on the legal structure of that country.

For this reason, we propose that international principles be sufficiently high level so as not to contradict the legal framework of the jurisdiction in which undertakings and groups are established. For example, terminology such as "Board" and "Senior Management" used in principles 11 to 13 may give rise to ambiguity.

In Europe there is a distinction between the management board and supervisory board. As such, the roles and responsibilities of boards will differ depending on whether a one or two tier structure is applied in that jurisdiction i.e. whether the management and supervisory board are combined or separated. The exact structure is dependent on national company law and cannot be altered via sectoral legislation. Under Solvency II, legislators have used the term "Administrative, Management or Supervisory Body"; this accommodates both one and two tier board structures.

Capital Adequacy and Liquidity

We do not agree with the Joint Forum's proposed text in implementation criteria (16d), referring to the need for group-wide capital to exceed regulatory minimums and targets. Firstly, we believe that sectoral legislation in Europe is sufficiently risk based. Secondly, for the (re)insurance groups under scope of Solvency II, there will be two capital requirements (SCR and group SCR floor) allowing for a supervisory ladder of intervention in the case of a breach. Thirdly, Pillar 2 mechanisms such as ORSA will consider non-quantifiable risks and longer term capital planning to ensure that capital planning considers more than just regulatory capital requirements. In this context, we believe that sectoral regulatory requirements are sufficiently robust and we would therefore ask the Joint Forum to remove reference to additional "targets".

Insurance Europe wishes to stress that regulatory capital requirements for groups are well-advanced in certain parts of the world and we would invite the Joint Forum to give due consideration to these discussions before moving forward with additional principles which may contradict existing frameworks.

We also have concerns with the wording of principle 19. Supervisors should not introduce obstacles limiting the performance of intra-group transactions (IGTs) within financial conglomerates. IGTs are legitimate business transactions and do not infer a greater amount of risk in comparison to those transacted outside of a financial conglomerate or group. Adequate reporting of IGTs should allow for sufficient supervisory oversight. Any restrictions should be thoroughly considered on a case by case basis in cooperation with the financial conglomerate.

Risk Management

The structure and integration of a financial conglomerate's risk management system into the rest of its business operation will be specific to their business model and legislative framework under which they operate. For these reasons, international principles should be sufficiently high level and focus on the outcomes of the system of governance as opposed to how it should exactly be performed. We find the Joint Forum's principles overly detailed in this respect.

Principles 22 to 24 aim to predetermine a financial conglomerate's approach towards their risk management culture, risk tolerance and assessment of new business. We find that these principles are linked more to the operational activities of each sector of a financial conglomerate and as such, should be considered in that context. As previously mentioned, we do not believe that international principles should overwrite sectoral legislation.

We also foresee problems with the proposal in implementation criteria (21b) which would require independence of the risk management function. Risk management is intrinsic to other operational and oversight functions within financial conglomerates and groups. In Europe, it is foreseen that the risk management function be incorporated in such a way that it is free from influences that may compromise the function's ability to undertake it's duties in an objective and fair manner. We believe that this approach is preferable to full operational independence. Under Solvency II, operational independence is only required of the internal audit function.

Finally, in response to implementation criteria (28d), we do not agree that quantitative limits should be set on IGTs. It would be difficult to establish a common set of thresholds that would apply consistently to all financial conglomerates.

Insurance Europe again would like to thank the Joint Forum for holding a public consultation on these draft principles.

Insurance Europe

as at 1 March 2012

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