

**Sharon Bowles (MEP)**

**Speech**

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**I am very pleased to be here, though maybe we are not quite in the situation that we expected in terms of Solvency 2 or the general financial situation when I was invited to speak.**

**During Parliament's work on Solvency 2, which started well over a year ago, I recall not always making myself flavour of the month by expressing concern - over correlations, supervisory capacity and dealing with catastrophic group failure or winding up. I did not have a crystal ball and of course the current crisis has not been centred on the insurance sector, but I think that the work we did on that and other parts of Solvency 2 stands up well.**

**So where are we?**

**On 7th October, while the Parliament voted in the ECON committee the financial markets were crashing around us and we felt, perhaps, that we were a small beacon for reasoned, collective thought amidst the crisis. Of course many MEPs had flavours of their national positions within their preferences, but both individually and collectively many of us were always being more ambitious than our respective governments back home. That is often the way with the Parliament.**

**Unfortunately, and on the same day, the Council was unable to make similar progress and - as I am sure many of you know - it has not improved since.**

**So what did the ECON committee agree?**

**I can not possibly cover it all, so I will stick to the topical and controversial.**

**Group Supervision. We modified the Commission proposal to give local supervisors equal access to information and more influence in both the group supervision and group support procedures. Our view is that this is very much an inclusive, dynamic dialogue.**

**We enhanced the role of CEIOPS, including proposing a legal status commensurate with its tasks, and emphasised CEIOPS' role in mediation and issuing a 'comply or explain' recommendation in the event of disagreement between supervisors. Those of you familiar with other reports in the Parliament will know we developed further our vision for the role of CEIOPS and the other level three committees in our report on the Lamfalussy review.**

**I have noticed that the kind of balance we struck in Solvency II was more or less replicated in parts of the recent proposals for amending the banking Capital Requirements Directive.**

**The hot spot in group supervision was that after all the mediation and explanation, we left the last word on capital add on with the group supervisor and a significant number of Member States are not happy with that. A similar issue arises in the CRD, but on that the Council looks set to reverse the Commission's position so that in banking the 'last say' will reside with the local supervisor. One of the reasons for treating banking and insurance differently was that a much closer arrangement is envisaged in insurance with the group support regime.**

**So that brings us to the second hot spot of group support. Put bluntly, there is mistrust by some states and supervisors of the ability or willingness of groups to transfer the needed funds rapidly, and especially the fear that if things got bad at group level the support might never be forthcoming.**

**But the ECON position also dealt with such a group level problem, for example by amending article 244 which directs the process for any winding up during group support and detailing the need for implementing regulations as to how this should be achieved equitably, over time.**

**It is clear that in a group level crisis, by which I mean where most of, or the entire, group is affected, it may take a long time for claims or policies to mature and for the settlement by liquidators to take place.**

**During that time some subsidiaries may fair better than an initial snapshot indicated, and others may not do so well. Therefore settlement on a 'snapshot' may be very inequitable for policyholders or for guarantee schemes. So more detail is required and that is where I say over to you CEIOPS, and I know that you have also been looking at it.**

**This is a feature of the committee position that could be built upon.**

**Facing up to the difficulties of failure and cross border winding up is something that clearly has to be grasped not run away from. In the current climate I think that would be a much more reassuring message for the public and policyholders. In effect what we have said is that group support is contingent on the outcome of the implementing measures relating to failure and winding up. That is surely a better way forward than abandoning group support as in the Presidency proposal of last Friday.**

**Group support is a concept worth fighting for - we must not forget that a key part of Solvency 2 is delivering safe, affordable insurance and group support is part of that. If times are getting harder we need it all the more.**

**What else did Parliament do?**

**We agreed that the role of supervisors both in colleges and in CEIOPS had to be recognised in national mandates so as to avoid conflicts, and stated that supervisory authorities must have relevant expertise and capacity - especially because dealing with qualitative as well as quantitative criteria is more demanding. Promotion of supervisory convergence was also specifically included.**

**We came to a compromise on the calculation of the MCR, wishing to see a link to the SCR with it lying in a corridor of 25% to 45% and we agreed on surplus funds with definition of how its use was limited in group support.**

**For the consumer we urged that work be brought forward to establish comprehensive and equivalent guarantee schemes. This is entirely consistent with the expectations of the Parliament contained in the report into the demise of Equitable Life. The Commission has of course recently held a consultation on the subject.**

**I believe our work is all the more valid because the majority of it was done not in heat and haste as a response to the crisis. Also, as I said, a lot of what is in there bears more than a passing resemblance to what is being suggested in banking as a response to the crisis. That is certainly no reason to throw it away or wait for it to be reinvented, then modify it for insurance and find ourselves back where we started.**

**But we did also have opportunity to pay heed to the effects of the turmoil and developing crisis, for example writing in that supervisors could take account of actions that might be pro-cyclical in times of market stress – at all times taking account of the interests of policyholders. This would take account of some equities volatility, but that was as far as we wanted to go on the equity smoothing front. One might argue this could extend to some kind of special case for current circumstances that phases out over a longer time, but as a long term proposition, no.**

**My understanding is that the equity smoothing is unacceptable to most Member State supervisors. For me it seems not only incompatible with Group Support but also with the whole concept of Group Supervision.**

**Certainly do not be seduced by any whispers that it is OK to agree to the Presidency position because Group Support will sneak back in before too long. It introduces every reason to ring fence to the Member State. Frankly it is goodbye Solvency 2 because it would corrupt an overall consist approach to groups.**

**What next?**

**Well, if we are to try and get a first reading agreement the Parliament and Council will have to find an agreed text to vote on. I have just outlined the Parliament's position and that is the basis for our negotiations and all three rapporteurs have made that clear in a letter last week to the French Presidency.**

**Now I touched on implementing regulations in the context of winding up.**

**Another implementing regulation that might well be coming is a write across of the retention and due diligence requirements from the CRD. It is considered that this should not just apply to banking and credit institutions but that it should be copied across to Solvency 2. UCITS is in line to get it as well, or maybe a general horizontal proposal.**

**For any of you not familiar with the proposal it has two parts. First it requires originators to keep 5% of the securitisations that they issue. This retention issue has been very controversial and well discussed in principle. Nevertheless we do not really know its effect because there has not been an impact assessment. Two possible consequences are that there will be a cost increase to consumers and companies, and the resulting incremental expansion in banks' books will both absorb some of the precious**

**recapitalisation that governments have just invested and put a limit put on the number of securitisations that can be done.**

**Possibly these things can be lived with if one is of the opinion that securitisation went too far and volume restriction is good, but the vast majority of European securitisation is still performing to expectations.**

**The second part is that the investors – which if it comes into solvency 2 means insurance companies – will have to conduct extensive independent due diligence, both before purchase and on an ongoing basis. This seems reasonable, indeed well meaning in its intention and something the Parliament has also called for, but the detail is draconian to the extent of unworkable.**

**You would be required, if it is copied across to Solvency 2, to analyse :-**

**risk characteristics of both the individual securitisation positions and underlying exposures;**

**the collateral quality,**

**and methodologies and concepts for valuation.**

**It will also be necessary for investors to apply stress tests independently of rating agencies, indeed if the Council has its way different from those of the rating agencies in general.**

**In case you are still in doubt about the extent and detail of the due diligence required, the Commission proposal covered monitoring, among other things, default rates and dates past due for 30, 60 and 90 days, prepayment rates, loans in foreclosure, collateral types, occupancy, credit scores across the underlying exposures, industry and geographical diversification and frequency distribution of loan to value ratios with band widths.**

**And by the way, as well as having to bear the cost for this, under the new credit rating agency proposals the idea is to shift the cost of rating on to investors. So you will be paying twice.**

**If supervisors consider the due diligence is not done adequately, then a one on one capital charge applies. Pretty much a death penalty: in fact one so effective that instead of urging due diligence it urges total avoidance of taking the risk of purchasing the product at all.**

**There are no provisions in the text that is near agreement in Council for moderating this approach if there is a good reason for non compliance, such as a bankruptcy and unavailable information earlier in the chain. In essence the asset would become unsellable.**

**If the risk of buying is too great, securitisations will no longer have a market, and it will remain closed as it is now. This would suggest a long continuation in unavailability of credit for the consumer and business, despite the urgings of the central banks to make credit available.**

**So you may think that is it. You will not be interested, nobody will be doing securitisation or if they are you will keep well away. Bad news maybe for the economy, but you will not have to put insurance companies at risk of the death penalty.**

**However the proposal is more like a crocodile than a shark – even if you keep out of the water it can still come out and get you. If you have any existing securitisations it may apply to them if any new underlying exposures are added or substituted.**

**But as I said, there has not been an impact assessment. Unfortunately politicians are anxious to go before the public and say they have done something quickly.**

**As I said earlier, Council negotiations indicate acceptance of the proposal without substantial change, possibly because more attention has been paid to home host arguments.**

**I have some ideas that would make it workable.**

**First, it is my view that any implementation of these measures, within the CRD or extended into Solvency 2 or anything else, should be made conditional upon the Commission completing the impact assessment. After all it is part of the inter-institutional agreement that impact assessments be performed.**

**In the event that the impact assessment shows there is or would risk being a block to the securitisation markets, most of which were beneficial but are now shut, then the Commission would be required to modify its proposals. I also think that reports from the level 3 committees on more certain and appropriate application of criteria for investors are needed and I would be interested in the view of the ECB and other central banks.**

**This would still not be an ideal state of affairs because of a dangling uncertainty in fragile times, but there is time to do it before the suggested implementation date and there would be no delay in implementation if all is fine after all.**

**To avoid the dangling uncertainty, and make the proposal workable, among other things, most importantly I would narrow the scope, exclude traders from being caught in the investor definition and replace the death penalty with a lighter sentence, both for investors and in the back on your books clause. I also suggest more proportionality and certainty over compliance and flexibility for the supervisors not to apply penalties when the fault is not that of the investor or there are other substantial social or systemic risks.**

**It would be wrong to finish on notes of gloom.**

**So finally, looking at the banking failures that we have had what does it say about EU cross border behaviour as a generality?**

**Although there are some rather nationally-minded incidents that we should be less than proud about, on the whole the response has been good. Subsidiaries have not been cast adrift. If this is contrasted with what has happened with third countries it is a whole lot better. It shows we have a lot to build upon and we have every reason in Solvency 2 to be pressing forward, not moving back.**

**Thank you.**