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**Summary of a survey
on equalisation provisions**

Introduction

1. In May 2008, CEIOPS' Financial Requirements Expert Group conducted a survey on equalisation provisions among its members. A questionnaire was drafted which concentrated on non-life insurance and it mapped the use of equalisation provisions in the European Economic Area (EEA). 23 CEIOPS Members and Observers have responded to the questionnaire¹ (hereafter referred to as "countries").
2. The purpose of the survey was to study how equalisation provisions have been used, what the characteristics of these provisions are and how big their impact is. On the latter point, data has been collected on the amounts of equalisation provisions as well as on premiums and technical provisions. Furthermore, countries were asked to explain how equalisation provisions are treated in QIS4 and to make a prediction of their role in the future Solvency II framework.
3. According to the Insurance Directives² (hereafter "Directives") the purpose of the equalisation provisions is to equalise fluctuations in loss ratios in future years or to provide for special risks. Equalisation provisions are part of the technical provisions on the balance sheet and the change in equalisation provisions is included in the technical account of the profit and loss account.
4. The Directives stipulate the establishment of equalisation provisions in credit insurance. Member States can, however, require or allow the constitution of equalisation provisions in any line of business. Those Member States which require the constitution of equalisation provisions shall prescribe the valuation rules to be applied. In addition, it is possible to have reserves that are constituted for the same purpose as equalisation provisions. The questionnaire tried to investigate the use of all these three categories of equalising systems.
5. The survey shows that equalisation provisions are widely used among countries and they reach substantial amounts. However, the application of the different equalising systems and consequently their valuation rules and sizes vary considerably from one country to another. QIS4 showed that different views exist on the future classification of equalisation provisions in own funds following their exclusion from the technical provisions. The role of the

¹Austria, Belgium, Bulgaria, Czech Republic, Germany, Denmark, Estonia, Spain, Finland, France, Hungary, Ireland, Italy, Lithuania, Luxembourg, Netherlands, Norway, Poland, Portugal, Sweden, Slovenia, Slovak Republic and United Kingdom.

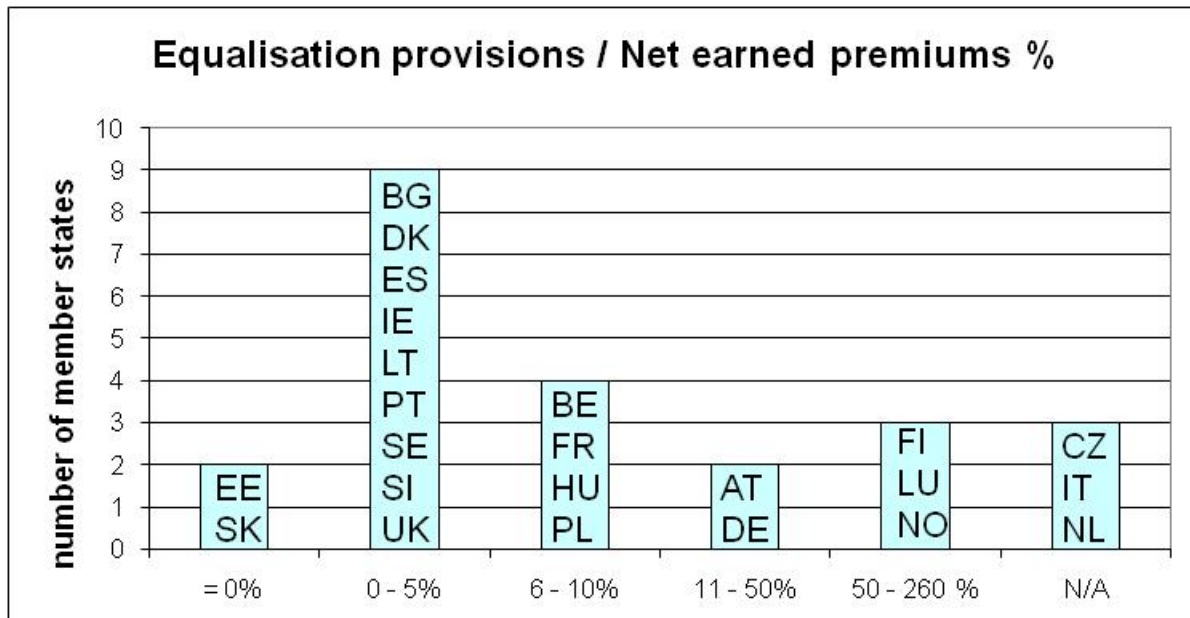
² Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and amending Directives 73/239/EEC and 88/357/EEC (third non-life insurance Directive); Directive 2005/68/EC of the European Parliament and of the Council on reinsurance and amending Council Directives 73/239/EEC, 92/49/EEC as well as Directives 98/78/EC and 2002/83/EC; Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings; Council Directive 87/343/EEC of 22 June 1987 amending, as regards credit insurance and surety ship insurance, First Directive 73/239/EEC on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance.

equalisation provisions in the future is still an open question in most countries.

Equalisation provisions in the EEA

6. According to the Non-Life Directives, Member States shall require an insurance undertaking which underwrites credit insurance to set up an equalisation provision. A Member State may, however, exempt insurance undertakings from this obligation where the premium does not exceed a given threshold. 14 countries have implemented this exemption in their legislation. In the remaining 9 countries equalisation provisions are obligatory for all undertakings that underwrite credit insurance.
7. Countries were asked to give the number of credit insurers with a non-negative equalisation provision. 141 undertakings were identified, 115 of which were direct insurers and 26 pure reinsurers. The true numbers are somewhat higher as some of the countries were unable to provide this information. There were only 3 countries where no credit insurer had an equalisation provision on its balance sheet.
8. The data was gathered on net (of reinsurance) earned premiums, net technical provisions and equalisation provisions, separately for direct insurers and pure reinsurers. Some inconsistencies could be noted in the figures: figures were given either for accounting year 2006 or 2007, which makes their summation arbitrary. In some countries only part of the data was available. Some countries could not make the division into direct insurers and reinsurers or separate credit insurance from credit and suretyship. In certain cases, gross figures were reported instead of net figures.
9. Despite these drawbacks, the data collected gives a clear picture of the role of equalisation provisions in credit insurance. The total amount of the equalisation provisions that has been reported, amounted to 2,5 billion euro. This is a substantial amount since, for example for direct insurers equalisation provisions corresponded to approximately 56 percent of the net earned premiums and 39 percent of the net technical provisions (excluding equalisation provisions). Equalisation provisions have thus a fundamental role in credit insurance.
10. In other lines of business equalisation provisions are allowed or required in 15 countries. Equalisation provisions have been used in many different ways. Some countries require every undertaking to have equalisation provisions in every line of business. Others require them only for certain risks, e.g. nuclear risks or terrorism. Some countries require equalisation provisions for certain risks and allow them for some other risks.
11. The total number of undertakings which have equalisation provisions was reported to be 738, of which 469 were direct insurers. The true numbers are likely to be much higher because some large countries were not able to deliver this information.
12. The total amount of equalisation provisions reported for all lines of business (both credit and other lines) is 53 billion Euros. This is approximately

19 percent in proportion to the net earned premiums and 9 percent in proportion to the net technical provisions (without equalisation provisions). The proportions vary from one countries to another (see figure below). But on the whole, equalisation provisions are of considerable size. As a comparison, the order of magnitude of the capital requirement under Solvency I is “only” 16 – 18 % of the net premiums.



N/A: information not available

13. Countries were also asked about the tax treatment of the equalisation provisions. In most countries (18) the equalisation provision is exempt from taxation (in the sense that the transfer to the equalisation provision is made out of untaxed profits/loss and vice versa), although there may be some conditions, restrictions or limits to the favourable tax treatment. 4 countries reported that there is no tax benefit for equalisation provisions.
14. In portfolio transfers equalisation provisions can be treated differently in different countries. If the credit insurance portfolio is transferred to another undertaking, this will result in a transfer of the equalisation provision or part of it in 10 countries. If the transfer is being made across the border to another Member State then the treatment may be different depending on whether the accepting undertaking is required to hold an equalisation provision or not. Several countries did not, however, have regulation or experience on this issue.
15. In general, equalisation provisions cannot be used for any other purpose than what they have been set up for. Only a few exceptions to this were reported. In case of winding-up the provisions will eventually be able to absorb any losses.

Reserves similar to equalisation provisions

16. A country may also constitute reserves that are meant for the same purpose as equalisation provisions. 7 countries reported the existence of such reserves, although in two countries their value was zero. The use of such

reserves varied greatly but most often they were linked to catastrophic events. The total amount reported in these reserves was 12 billion euros.

Equalisation provisions in QIS4

17. The survey has been conducted before the final results of the QIS4 exercise were available. For further, more up to date details on the treatment of equalisation provisions in QIS4, we refer to the QIS4 report which will be published on 19 November 2008.
18. Whereas a large majority of countries (20) considers equalisation provisions or corresponding reserves to be own funds items, only 12 of them would opt for a classification under tier 1. Restricted loss absorption is indicated by 6 countries as a possible obstacle to such a classification and more guidance is deemed necessary concerning the loss absorbing capacities of tier 1 elements in order to give a final answer.
19. Divergent opinions are equally expressed concerning the amount to be considered as own funds, 10 countries opting for the full amount, other countries considering that deferred taxes or the variation of other technical provisions have to be taken into account.
20. When asked as to whether they would provide national guidance in QIS4 as to the treatment of equalisation provisions, 12 countries have not given national guidance for the QIS 4 exercise; among the other countries some (4) of them consider a classification of equalisation provisions under tier 1 to be appropriate, eventually (for one of them) under the item of "other reserves with restricted loss absorbency"; 2 countries gave the same guidance as to the item without expressing any opinion about the tier. Only two countries required a classification under tier 2 for all or at least part of the equalisation provisions.

Equalisation provisions under Solvency II

21. Within the Solvency II regime no requirement exists to set up equalisation provisions. However, according to Directive 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings, a Member State may still require the constitution of equalisation provisions for statutory accounting purposes. The question remains whether these requirements will be maintained and, if yes, how to treat these provisions when establishing the Solvency II balance sheet.
22. When asked about their future plans, 3 countries indicated that they will not allow setting up equalisation provisions. Two countries explicitly mentioned they will maintain the requirement.
23. A majority of 13 countries has no final plans on how to treat equalisation provisions in the future, but 6 countries foresee that equalisation provisions are likely to disappear.