

**Fifth Progress Report
to the European Commission
on
CEIOPS' work in the field of the Solvency II project
(March 2006)**

The European Commission has requested CEIOPS to advise on the development of a new solvency system to be applied to life, non-life and reinsurance undertakings in the European Union.

As a part of this, CEIOPS is requested to give regular Progress Reports to the Commission at e.g. four-monthly intervals, informing of the steps taken to advance technical work and respond to the specific Calls for Advice, as well as draw attention to any further issues identified by CEIOPS' Working Groups. This is the Fifth Progress Report.

Calls for Advice

In July 2004 CEIOPS received the first wave of Calls for Advice covering Internal Control (CfA 1), Supervisory Review Process (General and Quantitative tools/CfAs 2&3), Transparency of Supervisory Action (CfA 4), Investment Management Rules (CfA 5) and Asset-Liability Management (CfA 6).

In December 2004 CEIOPS received the second wave of Calls for Advice covering Technical Provisions in Life and Non-Life Insurance (CfAs 7&8), Safety Measures (CfA 9), Solvency Capital Requirement: Standard Formula and Internal Models, Life and Non-Life (CfAs 10&11), Reinsurance (and other risk mitigation techniques/CfA 12), Quantitative Impact Study and Data Related Issues (CfA 13), Powers of Supervisory Authorities (CfA 14), Solvency Control Levels (CfA 15), Fit and Proper Criteria (CfA 16), Peer Reviews (CfA 17), and Group and Cross-Sectoral Issues (CfA 18).

The Answers to the European Commission's first and second wave of Calls for Advice, were approved at the CEIOPS Members' Meetings 28 June 2005 and 27 October 2005 respectively. The Answers (CEIOPS-DOC-03/05 – first wave) and (CEIOPS-DOC-07/05 – second wave) were subsequently sent to the European Commission, as well as published at CEIOPS' website (www.ceiops.org) together with the comments received from public consultation and the resolution on the comments (CEIOPS-SEC-43/05 - first wave, CEIOPS-SEC-86/05 – second wave).

The draft answers to the third wave of Calls for Advice were approved for public consultation at the extraordinary CEIOPS' Members Meeting 6 December 2005 in Copenhagen and subsequently published (CEIOPS-CP-06/05) on CEIOPS' website (www.ceiops.org). These cover:

- Eligible Elements to Cover the Capital Requirements (No. 19);
- Cooperation between Supervisory Authorities (No. 20);
- Supervisory Reporting and Public Disclosure (No. 21);
- Procyclicality (No. 22); and
- Small Undertakings (No. 23).

Due to the increase in consultation papers expected in 2006 because of the need to give further detailed advice to the European Commission, in relation to this consultation paper CEIOPS considered it necessary to shorten the consultation period under its consultation policy to two months. The consultation period ended accordingly 09 February 2006. The comments are currently being processed.

On 7 September 2005 CEIOPS held a public hearing on its draft answers to the third wave of Calls for Advice and other outstanding issues on the Solvency II project in Frankfurt.

Next steps

Besides finalizing the answers to the third wave of Calls for Advice, CEIOPS will continue to work on the overall Solvency II project through assisting the European Commission in dealing with all its different phases. Given the complexity and duration of the Solvency II project, CEIOPS intends to cover the entire development of the new prudential framework, not only by contributing to the preparation of the Framework Directive (Level 1 measures), but also by continuing to assist the European Commission in the preparation of potential implementing measures (Level 2 measures) and by issuing any consequent supervisory measures (Level 3 measures).

2006 should see the developing definition of the Framework Directive. According to the revised Road Map of the European Commission¹, the proposal for such a Directive is planned for mid-2007. In particular, it is envisaged that CEIOPS will publish further consultation papers focussing on those parts of its advice to the Commission which were not fully elaborated and/or defined and thus require additional inputs from interested parties.

In line with the request of the European Commission for additional advice in its letter of 24 January 2006² the consultation papers will cover key Pillar I issues such as the valuation of technical provisions, development of the SCR and the MCR formula and the recognition of reinsurance and other risk mitigation techniques. Other consultation papers will cover the functioning of Pillar II issues (Pillar II add-on and the treatment of reinsurance within the Solvency II framework) and group issues (e.g. admission of diversification effects, sub-group supervision and cooperation with third countries). In addition to the issues

¹ REVISED ANNEX TO MARKT/2502/05-rev 2.

² Available on CEIOPS' website: www.ceiops.org.

outlined in the European Commission's letter CEIOPS envisages further consultation papers covering Pillar II issues, i.e. issues safety measures (limits on concentration in covering assets and diversification requirements, fit and proper requirements and supervisory powers as well as Pillar I issues covering recognition of SCR internal models, and eligible elements). This further advice is aimed at giving the European Commission more detailed information for the development of the Framework Directive and will also take into account the results of QIS1 and 2 (see below).

The consultation papers on group aspects as well as Pillar II aspects on the treatment of reinsurance within the Solvency II framework, fit and proper requirements and supervisory powers are envisaged to be approved for public consultation in June 2006. The final advice is expected in October 2006. An additional consultation paper on Pillar II add-on and safety measures (limits) is planned to be approved for public consultation in October 2006. The consultation paper on Pillar I issues is also scheduled for October 2006 because it mainly depends on the results of QIS2 (see below).

In the context of this activity, CEIOPS will also progress the preparatory work for delivering answers to expected requests for advice on potential implementation measures. Indeed, the European Commission is planning the preparation of implementation measures in parallel to that of the Framework Directive. This activity, of course, will be also aimed at paving the way for future Level 3 measures.

CEIOPS is making good progress in developing its further advice to the European Commission. There are however some high level political issues, such as the prudential margin to be included in the valuation of technical provisions, where CEIOPS' members have divergent views due to long lasting divergent traditions and practices in European Member States. Given the tight timeframe outlined in the above mentioned letter of 24 January 2006 some political guidance would be useful to accelerate the progress in developing advice and stick to the given time frame. CEIOPS understands that the European Commission has already scheduled a meeting of the EIOPC Expert's Group Insurance Solvency on 20 March 2006 to discuss technical provisions.

In developing its advice CEIOPS analyzed and discussed Basel II/CRD approaches, where an important point of reference. In this context it has realized that Basel II/CRD solutions are not always optimal for the insurance sector. However, any diverging solutions are supported by significant reasons.

In the frame of the Solvency II project several rounds of Quantitative Impact Studies (QIS) are foreseen. They will provide a key input for the Impact Assessment report of the European Commission on the Solvency II Framework Directive.

From the middle of October to the end of December 2005, CEIOPS conducted a first round of QIS (QIS1), restricted on technical provisions in life and non-life, with particular regard to the level of prudence to be embedded in the measurement. According to the note of the European Commission on *The Impact Assessment of the Solvency II Level 1 Directive* (MARKT/2519/05) the European Commission expects the results of QIS1 in February 2006. The QIS1 summary report was approved by CEIOPS' members at the Members' Meeting 22 February 2006.

CEIOPS is currently preparing a more comprehensive, second round of QIS (QIS2), including solvency requirements in close cooperation with European stakeholders. QIS2 is expected to start in May 2006. The draft QIS2 specifications were discussed for finalization at the Members' Meeting 22 February 2006. The pre-test phase of this QIS, with a small sub-sample of insurers in each Member State, is scheduled for end of March/beginning of April 2006. The results of QIS2 are planned to be sent to the European Commission in October 2006.