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Dear Thomas,

I was very pleased to meet with you and your colleagues from the Managing Board and the Secretariat on 17 April and subsequently with you and the General Secretary of CEIOPS on the 11th July.

As you are aware the Framework Directive Proposal was adopted by the Commission on 10 July 2007 as planned. I would like to take this opportunity to thank you for the enormous efforts CEIOPS have made over the last few years, in order to enable us to publish the proposal on schedule. The timetable was ambitious and has only been met because CEIOPS has consistently delivered high quality timely advice to the Commission.

Further work on Solvency II

As a result of your efforts, we are now ready to move on to the next stage (Phase 3) of the Solvency II project. Before doing so though, I thought it would be helpful for everyone if we were to outline how we see the rest of the project panning out. In this respect, I also promised to send you a letter indicating how we see CEIOPS' follow-up work on potential future implementing measures and supervisory guidance, including the development of the European Standard Formula.

The Proposal sets out the necessary principles to underpin the future regime. These principles will be supplemented by more detailed rules at Level 2 and guidance at Level 3. Before putting forward any implementing measures the Commission is committed to consulting all stakeholders, and, where necessary, request CEIOPS to provide further technical advice. This is in line with our commitments to the Lamfalussy-approach and Better Regulation.

CEIOPS, and other stakeholders, have produced a wealth of material thus far on Solvency II. This material has been extremely valuable for the Commission Services in assessing the various options for the design of the overall framework and subsequently in drafting the Framework Directive Proposal.

Although a lot of preparatory work has already been done and consideration given to the future regime, it will still be necessary to do some more analysis and development work so that the new regime can be put into operation. After having analysed the existing advice provided by CEIOPS carefully, we have identified a number of areas where further work is needed. In order to avoid delaying the entry into force of Solvency II, it would be beneficial if CEIOPS could start preparing this work already now.

The Commission is committed to transparency and dialogue with the legislative partners and all the stakeholders, fully in the spirit of the Lamfalussy process. We must keep the European Parliament, the Council of Ministers and stakeholders fully informed of further development work to be done. We will copy this letter to the Presidency and the *Rapporteur* in the European Parliament and we intend to publish this letter on our website.

Framework Directive Proposal

All CEIOPS advice and recommendations should take as their starting point the Commission's Proposal for a Framework Directive. The Commission Services will keep CEIOPS updated on the progress of the negotiations. The Commission will not issue any formal mandates with respect to advice regarding implementing measures, nor draft any implementing measures before the conclusion of the negotiations on the Framework Directive. The subsequent formal mandates will of course be based on the adopted Framework Directive. However, this should not prevent CEIOPS from working on the topics set out in this letter in the meantime.

In some areas, it is already clear that an implementing measure will be needed before the new regime enters into force. In other areas, where an implementing measure is foreseen, it may be possible to proceed, at least initially, with level 3 action fostering supervisory convergence (e.g. through the development of common practice and supervisory guidance) without introducing implementing measures.

In the Framework Directive Proposal, the Commission has identified these two separate cases via the use of the word "shall" and "may" in the various Articles that provide the Commission with Comitology powers to adopt implementing measures (See Annex 1 – Implementing measures in the Framework Directive Proposal). The issues covered in this letter relate to those areas where the Commission believes implementing measures will need to be in place before the new regime enters into force and becomes operational.

When preparing advice in these areas, CEIOPS should not restrict itself simply to the preparation of level 2 measures, but should also consider what level 3 guidance should be developed in order to ensure strong supervisory convergence, knowing that the ultimate split between level 2 and level 3 will be decided by the Commission in close consultation with the Council and the European Parliament.

Tentative road-map for the Solvency II project

Although it is difficult at this stage to outline with certainty a timetable for the remainder of the project, we think it would nevertheless be helpful for all the stakeholders if we outlined what we think the timing might be.

The Commission hopes that the negotiations on the Framework Directive will be concluded during the course of 2008, so as to allow the EU to benefit from this new regime as soon as possible.

It is the Commission's intention to have any necessary implementing measures and supervisory guidance in place at least 18 months before the new regime becomes operational, in order to give the industry enough time to prepare for the new solvency regime.

We therefore expect that we will need final, fully consulted advice from CEIOPS on all the issues outlined in this letter by October 2009. This should enable, following consultation with stakeholders and following the scrutiny-procedure, implementing measures to be adopted during the second half of 2010 and Level 3 supervisory guidance connected to the issues outlined in this letter to be finalised during the second half of 2010.

This timetable should enable the EU to move to the new regime during 2012 (See Annex 2 – Solvency II Roadmap).

CEIOPS Deliverables and timings

In order to meet this timetable we have identified the following concrete deliverables that we will need from CEIOPS, along with a suggested timing. In addition, to providing final advice in October 2009 on all those issues where more detail is needed to put the regime into operation, these deliverables relate to the third and fourth quantitative impact studies and to two specific issues, relevant for negotiation of the Directive.

- *Factual report on the results of QIS3 – November 2007*

We would like CEIOPS to produce a factual report on the results of QIS 3, to be presented to the co-legislators by mid-November. This report should provide an overview of the quantitative and qualitative results of QIS3 and the impact on the industry as a whole as well as on specific segments of the market (e.g. life and non-life, SMEs and groups, mutuals, composites, and national markets). The report should take into account the views of stakeholders although we understand that the usual consultation period of two months is impossible given the tight time schedule. It should in particular focus on the architecture and high level design of the European Standard Formula for the calculation of the SCR, the approach to own funds and the design of the MCR. With respect to the MCR, the report should include an analysis of the pros and cons of different approaches that could be used for its calculation using the data collected for QIS3 (including the CEIOPS modular approach, the CEA compact approach, the compact approach based solely on the SCR standard formula as well as an approach based on a margin over liabilities).

- *Complete Draft QIS4 Specification – December 2007*

The development and testing of the European Standard Formula (including the detailed valuation standards, calibration parameters and own funds regime) is of central importance to the success of the project. Much progress has already been made and QIS 3 will be a timely and useful check of where we have got to thus far. However, it is already clear to us at this stage that further thought and testing is needed in order to get the Formula right. Further work will also be needed to come up with suitable simplifications for small and medium-sized insurers.

We would therefore like CEIOPS to deliver a complete draft QIS4 specification developed in close co-operation with the industry and other stakeholders by 20 December 2007. The new QIS 4 specification should be in line with the Commission's Proposal for a Framework Directive and should incorporate any lessons learnt from QIS 3. In particular, QIS 4 should test simplifications for technical provisions, as well as simplified approaches to the calculation of specific risk modules and sub-modules for the SCR standard formula and the use of entity specific parameters in the underwriting risk modules. The complete draft QIS4 specification should include explanation and justification for the approaches adopted as well as analysis supporting the chosen calibration.

The Commission Services will launch a public consultation in collaboration with CEIOPS on the complete draft QIS4 specification, in order to allow for wide consultation before the QIS4 exercise is launched. During the consultation period the Commission Services will organise a public hearing and a meeting with Member States as well technical meetings with stakeholders in collaboration with CEIOPS to discuss the specification. Following the consultation process, the Commission Services will issue a call for advice to CEIOPS setting out the final QIS4 specification and asking CEIOPS to launch and run QIS4 based on this specification between April and July 2008. The call for advice will include a request for CEIOPS to produce a factual public report on the results of QIS4 by November 2008.

- *Advice on two specific issues relevant for the negotiation of the Directive – May 2008*

We would like CEIOPS to provide the Commission with advice on the application of the **proportionality** principle (covering all three Pillars), as well as with advice on practical measures to facilitate the effective supervision of **groups** and in particular the supervision of the 'group support' regime, as it is likely that parties involved in the negotiation will want to have more details about how these topics will be dealt with in practice, even if much of the detail will be left to level 2.

It is worth emphasising that with respect to the advice provided on the practical measures to facilitate the effective supervision of groups and in particular the supervision of the 'group support' regime, the advice should not put the Commission Framework Directive

Proposal into question, but rather provide technical answers to issues such as group support, cooperation between supervisors and diversification.

Work on these issues is urgent as it will be directly relevant for the successful conclusion of the negotiations. I would therefore like to suggest that you provide fully consulted upon advice on these issues by May 2008.

- *Final advice on "priority issues" - October 2009*

In addition to the two issues highlighted above relating to the Proposed Framework Directive itself, there are a number of other areas where final advice from CEIOPS on the future regime requires further elaboration in preparation for potential future level 2 and level 3 measures.

A first group of issues relate to quantitative requirements, namely the **valuation of assets and liabilities, including technical provisions, the approach to own funds, the detailed technical design and calibration of the SCR and the design of the MCR.** This work should include detailed consideration of the simplifications to be applied both with respect to the valuation of assets and liabilities, including technical provisions, and the Solvency Capital Requirement as well as the use of entity specific parameters in the underwriting risk modules.

A second group of issues relates to **full and partial internal models, including the application and approval processes; governance requirements, regular supervisory reporting and public disclosure requirements, and the use of capital add-ons.**

Final advice from CEIOPS on the above topics should be in line with the adopted Framework Directive and should take into account the results of QIS3 and QIS4 as well as international supervisory and accounting developments (i.e. IAIS work on solvency and IASB work on insurance contracts).

Impact assessment

We plan to subject the level 2 implementing measures on the above topics to a full impact assessment, similar to the exercise performed for the level 1 Framework Directive, and produce an impact assessment report that will accompany the Commission proposal.

In connection with this, we will in due course, provide CEIOPS with further guidance on the information that we need with respect to the preparation of the impact assessment on the above topics in order to ensure that sufficient quantitative and qualitative evidence is collected to support the final policy options chosen.

In particular, where key issues remain outstanding, the impact of a number of different options will need to be analysed and compared and we will give you detailed guidance on the information we will require from you in this regard. Clearly, the results of QIS3 and QIS4 will be invaluable in this respect, as QIS exercises offer an excellent opportunity to collect both qualitative and quantitative information on the potential impact of the introduction of the new regime.

In addition, detailed information will have to be collected to determine the net administrative cost of supervisory reporting and public disclosure requirements under the new system. The net administrative cost will need to be calculated in accordance with the European Commission Standard Cost Model. Again, we will provide you with detailed guidance on the information we require from you on this topic.

Further advice

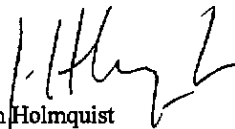
It may well be that during the negotiations in Council and Parliament, further clarifications will be needed. In this case, I intend to inform you as soon as possible about any new requests for further assistance.

In addition to the issues listed in this letter, CEIOPS is of course free to start work on other areas where it believes further guidance would help to foster supervisory convergence and facilitate harmonised implementation of the new regime.

We would also encourage CEIOPS to continue with the work it has already started, considering ways, other than through the development of level 3 guidance, in which it can help to ensure the preparedness of supervisory authorities for the introduction of the new regime (e.g. by providing training and organising secondments).

I thank you and your colleagues once again for all your good work on this important project and I would appreciate if you could confirm your agreement with the suggested deliverables and timing set out in this letter by the end of July 2007.

Yours sincerely


Jörgen Holmquist

ANNEX I - LIST OF IMPLEMENTING MEASURES IN THE PROPOSAL FOR A DIRECTIVE

The choice of "may" or "shall" in the Comitology Articles of the Proposal reflects whether the Commission retains some discretion with respect to adopting such measures, or actually undertakes to do so.

"Shall" is used where it is intended to adopt the implementing measure before the new regime enters into force. "May" is used where it is not intended to necessarily adopt an implementing measure before the new regime enters into force, but the Commission wishes to retain the option to do so in the light of developments and/or practical implementation experience.

The table below provides an overview of the Implementing Measures Articles included in the Proposal, identifying for each of them whether it is a "may" or a "shall" implementing measure and what deliverables would be expected from CEIOPS over the coming years with respect to that implementing measure - i.e. specific input into the report on the results of QIS3, input for the complete draft QIS4 specification as well as the due date for any advice.

In addition, for "shall" implementing measures, the table identifies a number of areas where the Commission Services believe it would be strongly recommended for level 3 supervisory guidance to be developed in order to ensure supervisory convergence, as the regime is likely to allow for some flexibility. This should not be read however to infer that the Commission Services believe it would not be beneficial for level 3 supervisory guidance to be developed for other areas as well. Indeed, CEIOPS is encouraged to develop level 3 supervisory guidance, particularly on any topic that furthers convergence.

Area	Article reference	Description of issues	May or Shall	Specific input into the report on the results of QIS3 (Nov 2008)	Input for complete draft QIS4 specification (Dec 2008)	Final advice due from CEIOPS by:	Level 3 guidance strongly recommended in order to ensure supervisory convergence, as the regime is likely to allow for some flexibility
Transparency and accountability of supervisory authorities	Article 30	Aggregate statistical data on key aspects of prudential framework applied in Member States and the format, structure, contents list and publication date of the disclosures	Shall	No	No	October 2009	-
Supervisory reporting	Article 35 (See also Proportionality principle below)	Information to be provided by insurance and reinsurance undertakings to supervisory authorities	Shall	No	No	October 2009	Yes
Capital add-ons	Article 37	Circumstances under which a capital add-on may be imposed as well as calculation methods for capital add-ons	Shall	No	No	October 2009	Yes
System of governance	Article 49 with references to Articles 41, 42, 43, 45, 46, 47 (See also Proportionality principle below)	1) system of governance, risk management, internal control and internal audit, in particular ALM and investment policy 2) functions 3) fit and proper requirements 4) conditions for outsourcing	Shall	No	No	October 2009	Yes
Public disclosure	Article 55	Information to be disclosed in the Solvency and Financial Condition report	Shall	No	No	October 2009	-
Valuation of assets and liabilities	Article 73	Methods and assumptions for the valuation of assets and liabilities following a fair value approach	Shall	No	Yes	October 2009	-
Valuation of Technical Provisions	Article 84 with references to Articles 75, 76, 79 and 80 (See also Proportionality principle below)	a) methods for best estimate b) risk-free interest rate term structure c) hedgeable versus non-hedgeable risks d) risk margin e) segmentation f) data standards and case by case approach g) counterparty default	Shall	No	Yes	October 2009	Yes

Area	Article reference	Description of issues	May or Shall	Specific input into the report on the results of QIS3 (Nov 2008)	Input for complete draft QIS4 specification (Dec 2006)	Final advice due from CEIOPS by:	Level 3 guidance strongly recommended in order to ensure supervisory convergence, as the regime likely to allow for some flexibility
Own funds	Article 91 with reference to Article 88	a) supervisory approval of ancillary own funds b) treatment of participations in financial and credit institutions	Shall	Yes	Yes	October 2009	-
	Article 96 with reference to Articles 92 and 93	a) division into sub-tiers, if necessary b) criteria to classify own funds into sub-tiers c) list of own funds d) supervisory approval, assessment and classification of own fund items	Shall	Yes	Yes	October 2009	-
SCR standard formula	Article 98	limits for sub-tiers, if necessary	Shall	Yes	Yes	October 2009	-
	Article 102	overall structure of the standard formula	Shall	Yes	Yes	October 2009	-
SCR internal models	Article 108 Paragraph 1 with reference to Articles 103, 105 and 106 (See also Proportionality principle below)	a) sub-modules b) design and parameters of risk modules and sub-modules of BSCR c) correlations d) risk mitigation techniques e) qualitative assessment of risk transfer f) operational risk g) loss-absorbing capacity of technical provisions h) the standard parameters that can be replaced with entity specific parameters i) methods for calculation of the entity specific parameters j) simplifications	Shall	No	Yes	October 2009	-
	Article 108 Paragraph 2	quantitative limits 1) approval of internal models 2) adaptations of standards for partial internal models	May	No	No	-	-
MCR	Article 111	use test, statistical quality standards, calibration standards, profit and loss attribution, validation standards, documentation standards and external models	Shall	No	No	October 2009	Yes
	Article 124 with reference to Articles 117-123	Design of MCR	Shall	Yes	Yes	October 2009	-
Investments	Article 125	control of risks of investments and derivatives	May	No	No	-	-
	Article 132	specifications with respect to recovery plan and finance scheme	May	No	No	-	-
Undertakings in difficulty or in an irregular situation	Articles 135 and 136	qualitative control of risks arising from finite reinsurance activities	May	No	No	-	-
Finite reinsurance	Article 217	scope of authorisation, mandatory conditions to be included in contracts, fit and proper requirements, accounting and prudential requirements	May	No	No	-	-
SPV authorisation	Article 218		May	No	No	-	-

Area	Article reference	Description of issues	May or Shall	Specific input into the report on the results of QIS3 (Nov 2008)	Input for complete draft QIS4 specification (Dec 2008)	Final advice due from CEIOPS by:	Level 3 guidance strongly recommended in order to ensure supervisory convergence, as the regime likely to allow for some flexibility	
Groups	Article 223	national sub-group supervision	May	No	No	-	-	
	Article 224	regional sub-group supervision	Shall	No	No	October 2009	Yes	
	Articles 241 with reference to Articles 227-236 and 237-240	group solvency calculation	May	No	No	-	-	
	Article 254 with reference to Articles 243-253	a) criteria to be used when assessing compliance with conditions that need to be met in order to apply the group support regime b) criteria to be used when assessing whether a declaration of group support is legally binding c) public disclosure of declarations of group support d) exchange of information between supervisors with respect to the group support regime	Shall	No	No	May 2008	Yes	
	Article 257	definition, identification and reporting of a significant risk concentration	May	No	No	-	-	
	Article 258	definition, identification and reporting of a significant intra-group transaction	May	No	No	-	-	
	Article 261	coordination arrangements for group supervision	Shall	No	No	May 2008	Yes	
	Article 262	- information to be gathered and disseminated systematically by the group supervisor to other supervisory authorities or to be transmitted to the group supervisor by other supervisory authorities; - specification of items essential or relevant for supervision at group level with a view to enhancing convergence of supervisory reporting	Shall	No	No	May 2008	Yes	
	Article 271	coordination of enforcement measures	May	No	No	-	-	
	Proportionality principle	Article 28 Paragraph 3;	(i) application of the proportionality principle with respect to system of governance;					
		Article 41, paragraph 2; Article 84 Paragraph h); Article 108 Paragraph J); Article 35 Paragraph 4 point (a)	(ii) general approach to be taken in the development of simplified methods and techniques to ensure calculation of technical provisions is proportionate to the nature, scale and complexity of an insurance undertaking; (iii) the general approach to be taken to the development of simplified calculations for specific sub-modules and risk modules of the SCR standard formula as well as the criteria that need to be met in order to be able to use the simplified calculation (iv) general approach to be adopted towards supervisory reporting in order to ensure that requirements are proportionate to the nature, scale and complexity of an insurance undertaking	Shall	No	Yes	May 2008	Yes

