A challenging year

The year ahead holds many challenges for the insurance sector and financial services in general, not the least of which is mere survival, but more long-standing challenges can't be ignored either. **Paul Barrett**, assistant director of financial regulation and taxation, at the Association of British Insurers (ABI) urges companies to get up to speed with the Solvency II capital adequacy regulations, which will transform the sector

Solvency II is a proposed European Directive to draw together and substantially modernise the regulatory regime and the capital requirements for insurers, on a consistent basis across the EU. Current plans are for implementation from 31 October 2012, although a huge amount of preparation will be needed both by insurers and by supervisors. For those planning to use internal models, the Financial Services Authority has already set target dates in the first half of 2009 for those wishing to be in the first wave of model approval. But at present, it is hard to be certain as we have not yet reached final agreement on the Directive text itself, although there is a good chance that this may happen in the next couple of months. Once the Directive is agreed (this is 'Level 1') the implementing measures (also known as 'Level 2') can be developed.

The Directive has been in development for several years and indeed some have called it 'Basel for Insurers' as its capital adequacy rules and risk calculations may well ape the banking stipulations somewhat. The European Commission published its first text in July 2007. By October 2008 the European Parliament had voted in its Committee on Economic and Monetary Affairs (ECON) to approve a text which largely kept in tact the Commission's original proposals. This is a text which the ABI and the European insurance industry (including its representative body the CEA) strongly support. The discussions in the European Council, which represents the governments of each of the 27 member states who must also approve the Directive, have been more difficult. A minority led by Spain and Poland – sometimes referred to as the 'group of 12' (though their number and degree of support varies) have opposed proposals for a radical overhaul of group supervision which would allow group capital structures and diversification effects to be properly recognised using 'group support' as a capital instrument. Instead, Spain and Poland prefer to look back toward solo supervision and solo capital requirements in the hope that they can maintain walls at their national boundary restricting capital flows. I believe this is contrary to the intention of the single market and undermines one of the key proposals for Solvency II. However, this 'group of 12' have been very effective in standing firm and marking out their position as a blocking minority under EU rules.

From the outset the French authorities have been pressing for a very liberal approach to equity risk based upon the duration of liabilities and assumptions regarding lapses. The French have pursued this objective relentlessly, but they have failed to produce any detailed proposals, nor have they been able to satisfactorily answer the genuine concerns raised by many parties including most supervisors across Europe. This intransigence had the most serious consequences for the negotiations on Solvency II in the second half of last year, since France held the Presidency and hence was able to control the drafting and amendment process for the Council's version of the Directive text.

This meant little progress was made for most of the period of the French Presidency and in the closing stages desperate steps were taken to try and cut a deal with the Spanish and Polish to drop group supervision provided that they would support the French approach on equity risk. However, from 1 January, the Czechs have assumed the Presidency and I am hopeful that they will adopt a more conventional negotiating style which will enable a sensible compromise text to be reached. If Solvency II is to remain on track, a deal must be reached that both the Council and the European Parliament can accept before May, when the European Parliament is dissolved for elections. If a deal is not reached by then it is likely that Solvency II will be delayed by at least a year, with the risk of even more delay.

However, there are good reasons to believe that a deal will be reached before the May deadline, with strong incentives for many involved to move forward with Solvency II. Assuming that this does happen, consultation on the detailed implementing measures is expected to follow almost immediately upon approval of the Directive, from as early as March this year. This will comprise a large number of consultation papers from the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), the college of European insurance supervisors, who will be asked to prepare 'advice' on the technical standards and methodologies required under the Directive. We can expect around 26 different workstreams covering the topics mentioned in the opening paragraph of this article and many more issues.

• If you would like to learn more about Solvency II, please take a look at our website at www.abi.org.uk/solvency2 and prepare yourself for this important change in the industry. Also, see *FST's* feature on page 38 for more details.