

As EC officials and MEPs prepare themselves for the summer break, they leave behind a number of items of unfinished business for completion by the end of the year. The list includes both relatively long-standing issues such as the new financial supervisory framework, Solvency II and the alternative investment funds directive as well as newer but no less contentious issues such as the future of EU occupational pensions and more extensive state insurance compensation schemes. Add to this list, the respective reviews of MiFID and IMD being undertaken by the Lamfalussy Committees, plus related customer disclosure projects within PRIPS and UCITS, and it becomes very clear that European institutions have a lot on their plates to resolve before the end of 2010.

A further unknown element is how the beleaguered interim Belgian Government will perform now that, in addition to trying to sort out their own internal problems, it has assumed the EU Presidency for the second half of the year.

This edition brings readers up-to-date with the latest developments.

New financial regulation

The new EU financial regulatory architecture, designed last year in the joint form of the European Systemic Risk Board and European System of Financial Supervisors, still awaits final transfer from the drawing board to the statute book. Work has continued within the EU on the new financial supervision legislation right up to the last few days, in a continuing effort to try and reach agreement between the European Council of Finance Ministers (ECOFIN) and the European Parliament on a draft compromise text.

At the heart is an on-going tussle over the powers of the new European Supervisory Authorities (ESAs) to be able act, if necessary, over the heads of national regulators. Until such time as agreement is reached, the ESAs, which are due to start work in early 2011, will remain still-born with the existing Lamfalussy Committees (CEBS, CESR and CEIOPS) remaining in-situ. MEPs have in particular pressed for the new European Banking Authority to have greater emergency powers to apply decisions direct to firms if the local supervisor is hesitant or unwilling and latest indications appear to point to the Council conceding this position.

Discussions are scheduled to continue into early autumn with September being targeted for final agreement. A similar time-frame is being adopted to reach final agreement on the Alternative Investment Funds Directive (or 'hedge fund' directive) the draft text of which has caused a split along similar lines between the two institutions as to the degree to which such activities should be controlled by

regulation. Commission officials will actually be working on a further set of issue papers in August to try and achieve final settlement in the following month - so much for the traditional summer break!

With the Belgian EU Presidency starting this month, it is understood that, despite the interim domestic status of their government, they are keen to press ahead with EU measures to beef up financial regulation and economic governance as well as revitalise talks on tax harmonisation.

Solvency II

EU Commissioner for Internal Markets and Services, Michel Barnier, officially announced at a Solvency II conference in May that the timetable for the implementation would be pushed back three months to Jan 2013 to enable the measures to take initial effect over a full calendar/accounting year.

This slight deferment has allowed for more considered debate with much of the past few months spent in EC working group deliberations on the content and fine detail of the Solvency II Implementing directive (level II). Concern continues to be expressed over the differing approaches between the UK and other member states making for a potentially long and complicated piece of legislation unless agreement can be reached on the key issues. In particular, a hiatus continues over the treatment of long-term annuity business so vital to UK insurers interests but seemingly of little consequence elsewhere in Europe. The new coalition government has already made clear in the corridors of Brussels that this remains one of the critical UK issues without which it would be forced to withhold support for the level II directive.

Elsewhere, it has been acknowledged that the exact arithmetic formulae and calibrations to be used in determining levels of capital solvency must await the QIS5 test that runs from August-November but with the results not being known until April 2011. In a letter to CEIOPS this month, the Commission points out that in several areas it has not been possible to prescribe one approach or method of testing and that double or, in some cases, multiple calculations should be tested to allow for results comparison. Double calculations bear most heavily on:-

- transitional provisions for the discount rate including an illiquidity premium
- SCR within both the internal model (where adopted) and standard formula
- loss absorbing capacity of technical provisions and deferred taxes within standard formula

Data will also be collected to assess alternative approaches affecting the illiquidity premium, risk margin (for groups), equity shock (participations), own funds (transitional provisions) and expected profits in future premiums.

The EC letter re-affirms the intention that QIS5 should cover as wide a spectrum of insurers/re-insurers as possible with the aim of achieving at least 60% participation amongst individual firms and 75% of groups. In particular, smaller and specialist insurers are being encouraged to take part as the outcome will have a direct bearing on the level II directive which will be published in final draft form afterwards. In this context, the relevant spreadsheets are being made as user-friendly as possible.

The full text of this Commission letter setting the parameters of QIS5 can be viewed on <http://www.ceiops.eu/media/files/consultations/QIS/QIS5/EC-letter-to-CEIOPS-QIS5-CfA-20100706.pdf>

EU Pensions review

The EC has started a major debate on the future of EU pensions by launching a Green Paper against a background of the number of working people supporting the retired population dropping from 4:1 today to 2:1 by the year 2060. Recent European research reveals that 73% of EU citizens either explicitly anticipate lower pension benefits or think they will have to postpone their retirement or save more money for old age. Meanwhile, 54% are worried that their income in old age would be insufficient for them to live a decent life, including a majority in 17 of the EU 27 member states.

The Green Paper acknowledges that much of the pension provision is and will remain in the hands of individual member states but, through the previous IORP Directive in 2003 covering occupational pension schemes, the EC does have a role to play in:-

- cross border coordination of social security pensions to facilitate the free movement of workers and equal treatment for workers who change country
- establishing an internal market for funded occupational schemes and the necessary minimum standards on prudential rules to protect scheme members and beneficiaries
- minimum guarantees concerning occupational pensions and accrued rights in case of the insolvency of enterprises as sponsors
- anti-discrimination rules that apply, although with some differentiation, to both statutory and private pension schemes.

The future objectives set out in the GP are therefore to assess how:-

1. EU can best support member states, taking account of structural changes in society and labour markets and of rising life expectancy.
2. Obstacles to mobility of workers as well as capital, resulting from pension arrangements, including supplementary pension schemes, can be removed.
3. To ensure the safety of pensions now and in the future by mitigating risk and volatility for workers and pensioners and that funded pension systems are secure.

In the document, reference is made to the discriminatory aspect of domestic tax rules hampering cross-border transfers and mobility, on-going trends in the migration from DB to DC schemes and whether Solvency II rules will be adequate for ensuring asset levels of pension fund schemes or is a separate set of solvency rules required. In all there are 14 questions to address and the text is supported by background statistical data and analysis.

Once the feedback to the GP is received and considered, with a closing date of *15 November*, the EC will consider the next stage in the debate either in the form of a White Paper or specific targeted measures. However, at this stage, the EC is not recommending any increase in the pensionable age nor forcing people to take out private pensions, both of which are matters for member states.

The EC Green Paper can be accessed via
<http://ec.europa.eu/social/BlobServlet?docId=5551&langId=en>

Insurance Guarantee Schemes

In a recent package of measures designed to bolster consumer protection in financial services, the EC has issued a White Paper recommending the establishment of

insurance guarantee (or compensation) schemes in all member states. Similar measures are to be introduced to improve protection in respect of deposit savers and holders of other types of investment.

At present, only 12 countries operate one or more IGS which cover life and/or non-life insurance policies varying in levels of protection and eligibility and methods of funding. Put another way, in terms of gross written premiums, one third of the entire EU-EEA insurance market is not covered by any IGS in the event of an insurance company going bankrupt, with the collapse of a Greek insurance group in 2009 alone affecting 800,000 policyholders.

Whilst the White Paper does not intend to harmonise insurance products, it advocates a coherent approach to protection by means of a minimum set of design requirements. Insurance default cases will be dealt with on the basis of 'home country' principle covering domestic insurers and domestic branches of other member state firms and funded by means of *ante*-contributions by insurers possibly complemented by *post*-contributions in case of lack of funds.

Although of minimal relevance to the UK, which already satisfies EU requirements through the Financial Services Compensation Scheme (FSCS), the White Paper is still worthy of perusal. Deadline for feedback on the White Paper is *30 November* and can be viewed via

http://ec.europa.eu/internal_market/consultations/docs/2010/whitepaper-on-igs/whitepaper_en.pdf

Customer disclosure

As the industry awaits further developments on the MiFID and IMD reviews (MiFID 2, IMD 2) respectively, the EC has signalled its intention to return to the subject of PRIIPS (packaged retail investment products) in October when it launches a consultation paper. It is likely to suggest a common disclosure and selling regime for diverse products ranging potentially from standard savings plans to pension annuities following lengthy Commission academic study and market research. The measures may be stand-alone or partially incorporated in IMD2.

In the meantime, CESR has issued a further MiFID 2 consultation paper on client categorisation which amongst other things, asks whether tests of knowledge and experience should be used more widely in respect of assessing 'professional' clients in their use of complex products. On the strength of a number of highly-profiled cases involving investor complaints, CESR questions whether so-called sophisticated clients really do have a sufficient understanding of complex instruments such as over-the-counter (OTC) derivatives. The deadline for response is *9 August*.

Finally, CESR has also issued further CPs containing guidelines relating to the use of Key Investor Information (KII), to replace the Simplified Prospectus, in respect of UCITS products. Amongst other things, they seek to lay down the style and format of the KII, using simple terms and language (and avoiding industry jargon), culminating in a model template with specific sections dedicated to objectives and investment policy, risk and reward profile, fund charges and past performance. One innovation involves the use of a synthetic graphic risk-reward indicator on a scale of 1-7. Deadline for responses is *10 September* with the KII due to take effect on 1 July 2011 upon the implementation of UCITS IV directive.

CESR papers can be accessed on <http://www.cesr-eu.org/index.php?page=consultation&mac=0&id=>

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