

**Comments**  
**of the**  
**German Insurance Association**  
**(Gesamtverband der**  
**Deutschen Versicherungswirtschaft e.V., GDV)**  
**on the**  
**3L3 MEDIUM TERM WORK PROGRAMME**

**Gesamtverband der Deutschen  
Versicherungswirtschaft e.V.**

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## Summary

The German insurance industry welcomes the publication of the Lamfalussy Level 3 Committee's (3L3) list of cross-sector areas for enhanced cooperation and consistency and the opportunity to comment on it. The 3L3-work on common long-term objectives has, in our view, to cope with two major challenges: on the one hand, the specifics of each sector have to be taken into account (e.g. with regard to the definition of own funds). On the other hand, where competition between the sectors exists, a level playing field has to be maintained or established (e.g. with regard to "guarantee funds"). Finally, the work being undertaken by the 3L3 with regard to the activities of third parties affecting all the three sectors is indispensable to achieve supervisory convergence and is thus very much appreciated.

The comments of the German Insurance Association (Gesamtverband der Deutschen Versicherungswirtschaft e.V., GDV)<sup>1</sup> follow the prioritisation made by the 3L3:

- home-host/delegation of tasks
- competing products
- credit rating agencies
- internal governance
- conglomerates (Interim Working Committee on Financial Conglomerates)
- valuation of financial instruments

Comments on other topics mentioned in the consultation paper and some complementary aspects will complete the contribution.

## 1. Home/host-delegation of tasks (n.18-19)

The GDV does not want to repeat its general position on group supervision which is regularly put forward in the Solvency II debate. In the present context we would only like to highlight the following aspects:

The German insurance industry strongly supports cooperation between national authorities. Home/host-delegation of tasks and the cooperation between supervisors are crucial issues to ensure an efficient and effective

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<sup>1</sup> GDV is the umbrella organization of private insurers in Germany. Its 452 member companies with 226.000 employees and trainees offer comprehensive risk protection and provision for both private households as well as for trade, industry and public institutions by means of 431 million insurance contracts. GDV pleads for a regulatory framework which allows insurers to fulfil their tasks in the best possible way.

supervision of solo-undertakings and groups. However we think before special recommendations for the possible transfer of tasks and responsibilities are discussed, a clear definition of supervisory powers of the host supervisor and the home supervisors is needed. Double supervision (as is the case e.g. in subgroup supervision) has to be avoided. Moreover, although consultation of the home supervisors by the host supervisor is vital in a concept of cooperative group supervision<sup>2</sup>, final supervisory decisions should be reserved to the host supervisor (i. e. a single group supervisor), for instance the approval of a group internal model.

Furthermore, the discussion about cross-sectoral delegation should carefully take into account sector specifics and recognise that due to different business models in the banking and insurance sector there are natural limits to the combination of supervisory tasks.

## **2. Competing products (n. 33-34)**

GDV welcomes that the 3L3 address regulatory arbitrage in the field of financial products containing the same or similar risk features for the service provider. The German insurance industry sees indeed a need for action with regard to the rules governing the supply of capital guarantees:<sup>3</sup> In some EU Member States investment fund companies issue so called “guarantee funds” and distribute them across national boundaries. Naturally, the consumers trust in the inherent value of these guarantees.

At present, however, guarantee funds are not subject to any or only to insufficient requirements regarding underlying own funds. The EU legal framework for investment funds (UCITS Directive) provides only low own funds requirements for investment fund companies<sup>4</sup>, which do not take into account at all that providing guarantees is an own financial service separate from collective investment management and gives rise to a specific risk profile. Given a volume of administered fund assets of several billion EURO it is obvious that this amount of own funds is by no means sufficient. Asset management companies are usually not obliged to

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<sup>2</sup> For more details on this issue see GDV’s “Concept for cooperative group supervision”:

[http://www.gdv.de/Downloads/Themen/SII\\_Gruppenbeaufsichtigung\\_GDV\\_en.pdf](http://www.gdv.de/Downloads/Themen/SII_Gruppenbeaufsichtigung_GDV_en.pdf)

<sup>3</sup> This is also recognized by the European Commission in the Green Paper on the enhancement of the EU framework for investment funds.

<sup>4</sup> In Germany, e.g., the maximum requirement amounts to only 10 million EURO.

provide additional cover. Their unit-holders will be willing to provide additional cover of their own accord only if they can expect risk-adequate yields. Even if, exceptionally, additional own funds should have to be provided by the investment fund companies, the question arises as to where ex post these own funds are to come from and whether a parent company is really prepared to make supplementary payments of own funds, if necessary. Presumably, the average client will not be capable of correctly evaluating these risks, even if he or she should in principle be aware of them.

Unlike guarantee funds, under the EU life insurance directive, life insurers have to meet high requirements both regarding own funds and the establishment of prudent mathematical provisions. The safety level of life insurances is, as a consequence, considerably higher than that of guarantee funds. Therefore, in the interest of consumer protection, it is necessary to lay down adequate own funds requirements for guarantee funds, so that the slogan becomes true: "Where guarantee is on the label, guarantee must be inside." It must be ensured that same guarantees require same underlying assets and provisions.

Appropriate rules must be adopted at European level, because otherwise there will be the risk of Member States competing in terms of the most lenient prudential or safety standards. Against this background, the European Parliament has recently called on the European Commission to propose how the appropriate provisions, e.g. capital requirements, for guarantee funds can be achieved at the EU level in order to ensure effective consumer protection<sup>5</sup>. Given the importance of the topic, such a proposal should be included in the ongoing amendment process of the UCITS directive.

The issue "competition between unit-linked life insurance and investment funds" is dealt with intensively in the frame of the ongoing Call for evidence of the European Commission suggesting a horizontal approach to product transparency and distribution requirements for substitute retail investment product. In its response to the Call for Evidence which will be published at European Commission's website GDV has outlined in detail why unit linked life products and investment funds are complements rather than substitutes.

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<sup>5</sup> Report „Asset Management II“ (13 December 2007), para 19.

### **3. Credit rating agencies (CRA; n. 35)**

The German Insurance Association strongly welcomes that the 3L3 have identified credit rating agencies as one of their key issues. The insurance industry depends crucially on high standards in the rating process and on the reliability and quality of the ratings issued by CRAs. Insurers use external credit ratings extensively, both in their role as institutional investors and as issuers in the financial markets. In addition, CRAs' ratings are an increasingly important part of insurance supervision. In order to maintain both the quality of credit ratings and the efficiency of the rating process, the implementation of binding minimum standards for the business of CRAs is essential. Therefore, we fully support the regulatory framework created with the publication of the IOSCO Code of Conduct Fundamentals for CRAs in 2004 and CESR's monitoring of CRAs' compliance with the IOSCO Code in the EU. We appreciate the valuable work already undertaken by the Committees in this area which has contributed to a significant improvement in CRAs' business conduct over the last years. However, further progress remains necessary. For example, disclosure of the type of rating by CRAs so far cannot be regarded as sufficient. In our view, with respect to all regulatory activities concerning CRAs it is essential that there is a close co-operation between CESR, CEBS and CEIOPS in order to achieve consistency across all fields of European legislation and supervisory practice (e.g. regarding definitions and requirements for ratings used in prudential regulation). In addition, to ensure the efficient functioning of global financial markets there should be close co-ordination with the SEC and full consistency with the IOSCO Code of Conduct in European policy.

### **4. Internal governance (n. 41-42)**

We support supervisory shift from capital monitoring to evaluating institution's governance system and the quality of risk management. The suggestions in the proposal for a Solvency II Framework Directive can be a starting point for harmonisation of internal governance. The increased importance of internal governance should not result in increased regulatory requirements. There is an overall necessity for all financial institutions that the internal system of governance should be proportionate. Principles are needed rather than detailed guidelines as each company's circumstances will differ. Supervisors should review adequacy of risk governance and management, but should not in general

interfere in the strategic decision making and running of the company<sup>6</sup>. On the other hand guidelines have to be such that an insurance company can use them to do their day to day business in the best way.

## **5. Conglomerates (Interim Working Committee on Financial Conglomerates; n. 44-45)**

From GDVs perspective, the review of the Financial Conglomerates Directive (FCD) and the European Commission's Call for Technical Advice on this subject should initiate a more advanced approach to the supervision of financial conglomerates. The German insurance industry absolutely agrees that all barriers being currently in place and preventing conglomerates from managing their business in a risk-adequate way should be removed. Solvency II's aim is to introduce an integrated risk-oriented supervisory approach and will therefore be the more advanced regime. It should thus be the starting point for the review. The work programme should consider that the review should head for a full economic view (applicable on capital requirements as well as on eligible elements).

## **6. Valuation of financial instruments**

In the field of valuation of financial instruments the need for coherence and consistency between the activities of the 3L3 and the activities of all the other involved bodies (EU institutions, EFRAG, IASB....) is of utmost importance. Therefore the German insurance industry suggests highlighting this aspect in the description of this key issue in the medium term work programme.

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<sup>6</sup> See for details in the Solvency II context page 12ff in [http://www.gdv.de/Downloads/Themen/Stellungnahme\\_RL\\_070924\\_en.pdf](http://www.gdv.de/Downloads/Themen/Stellungnahme_RL_070924_en.pdf)

## 7. Other topics mentioned in the paper

- **Professional secrecy and limits to exchange of information (n.22-24)**

Privacy and data protection issues are not concerned in case of exchange of pure professional information (e.g. under pillar 1 of Solvency II). However, if the 3L3 transmit information, e.g. on the occasion of a cross-border-consultation concerning the fulfilment of fit and proper requirements (Art. 42, 260 ff., 308 of the Solvency II - proposal), personal data of persons who effectively run the undertaking or have other key functions is concerned. In this regard it is absolutely necessary to comply with the requirements of the European Data Protection Directive and further provisions in national legislation implementations to ensure the data protection rights of these persons.

- **Cross border consolidation (n. 40)**

GDV welcomes the intention to publish guidelines assisting in the implementation of the directive on cross border consolidation. It is immensely useful that according to the directive in a case of acquisitions and the increase of shareholdings in the insurance sector the assessment of whether the management of a participating company fulfils the fit and proper -criteria has not to be undergone twice. Another very important point about that directive is to speed up acquisitions and mergers and GDV feels that CEIOPS could help in reaching these goals by publishing appropriate guidelines, keeping in mind to make things uncomplicated, simple and quick.

- **Capital modelling CRD (Basel II) and Solvency II (n. 46 – 47)**

In line with the principle of „same risk – same capital“ both regimes should treat capital requirements resulting from the same risks in the same way. However the underlying business models differ greatly and the application of similar requirements does not have the same impact on insurers and banks. From our point of view, it is important to ensure that the new regulation adequately reflects insurance sector specifics. When divergent requirements are economically justified (e.g. modelling of credit or operational risk) they should remain.

- **Own funds definition - Definition of eligible capital elements (n. 50)**

The German insurance industry recognises that own funds are also a cross-sectoral issue and supports the aim of harmonisation of banking and insurance provisions to ensure a level playing field and foster a single market for financial services (especially financial conglomerates). Convergence is supported, but not at the cost of inappropriate solvency rules.

Where the principles are economically justified and adequate for insurance, an alignment of banking and insurance principles might start with the new Solvency II -regime and reviewing sectoral rules on eligible capital in the banking/securities sector (see also page 6 point 5).

If capital instruments are eligible for banks they should also be eligible for insurance companies to ensure a level playing field (equal treatment of equal capital instruments). The recognition and the classification of own funds items and a tier and limit system - if any - have to take into account the marketability of (hybrid) capital instruments (the draft QIS4-specifications fail to do so).

However, the banking rules should not just be copied. For instance certain prudential filters currently applied in the banking regulations on unrealised gain/loss would not be appropriate under Solvency II. While all risks of insurance companies will be captured in a holistic way under Solvency II in capital requirements, this is not the case for risks of credit institutions under the Capital Requirements Directive (CRD, 2006/48/EC). A common working definition of own funds - as mentioned in n. 44 - has to be linked to an economic measurement of risks if required and available capital should be determined consistently.

## **8. Additional issues**

- **Treatment of life insurance under the CRD**

The current CRD-rules on accepting life insurances as collateral security stipulate that life insurance policies are accepted as a hedging instrument reducing equity capital only if the life insurer concerned has at least one good long-term rating by an approved

rating agency (e.g. Standard & Poor's: A-). This additional condition does in no way justice to the primary security of the product of life insurance. To reach an appropriate solution for European life insurers GDV proposes that for the insurance policy of an EU life insurer a minimum credit quality step 2 (S&P: A-) should basically be assumed, making it possible to use a risk weight of 50 %. In cases where the life insurer has an external long-term rating by a rating agency approved by the supervisory authority which is even better in qualitative terms (credit quality step 1), this may be used as well, corresponding to a risk weight of 20 %. This rule should be applied by analogy to all model approaches available within the Directive.

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