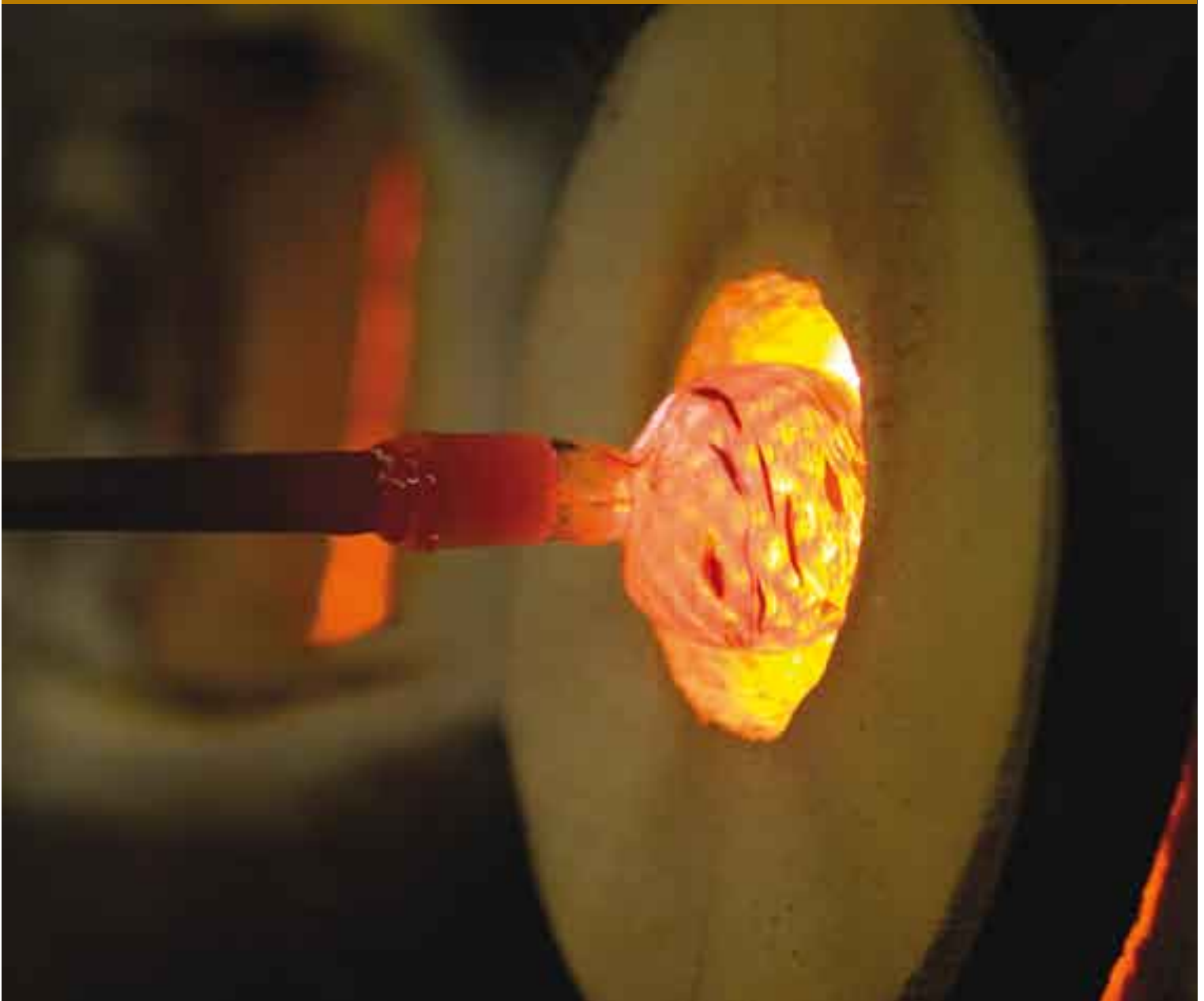


# 04

## Making it happen: The political process

ANNETTE OLESEN AND WENDY REED

July's publication of the draft Solvency II framework marks the first stage of what could be a demanding process of EU legislative enactment, technical formulation and eventual application. Annette Olesen and Wendy Reed examine the political hurdles ahead and how insurers can influence the process.



Politics is the art of the possible. However, seeking to reach EU-wide agreement on a complex solvency directive among 27 member states with very different regulatory structures could stretch the realms of possibility to their limits. In an interview with the UK's Life & Pensions magazine earlier in the year, Peter Skinner MEP, Chairman of the European Parliamentary Insurance Caucus and the 'rapporteur' responsible for corraling Parliament's views on Solvency II, accepted that this 'is an incredibly difficult beast to grapple with'.<sup>1</sup> The challenges ahead are reflected in July's announcement of the postponement of planned implementation from 2010 to 2012.

Solvency II forms an important extension to the European Commission's (EC) Financial Services Action Plan. The preparation, consultation and enactment of the directive are being speeded up through the Lamfalussy Process, a four-stage framework designed to break down national and bureaucratic barriers to integration (see Figure 1).

It is a testament to the urgency and importance attached to Solvency II that the Council has scheduled two two-day meetings per month up until December to help move the process forward.

The main time-saving feature of the Lamfalussy Process is that much of the detailed technical design draws on the expert advice of committees of supervisors working in consultation with businesses, consumers and other stakeholders (in the case of Solvency II this is the Committee of European Insurance and Occupational Pensions Supervisors – CEIOPS). This should ideally leave the politicians to

concentrate on the higher level principles and their implications, rather than expending valuable time hammering out the small print.

### Legislation

Drafting directives or other legislation is the responsibility of the EC. The European Parliament's (EP) job is to provide democratic scrutiny, amendment and assent in parallel with a Council of Ministers drawn directly from national governments. This process of mutual deliberation, modification and ratification is known as 'co-decision-making'.

The draft Solvency II framework Directive was presented to the EP for its first reading in July. To move forward, Peter Skinner MEP and his team will need to balance a multitude of different local perspectives and rationalise what could be dozens or even hundreds of proposed amendments emanating from lobbying of MEPs across Europe.

Following debate and amendment, the revised draft will be passed to the Council of Ministers. In practice, there tends to be considerable behind-the-scenes negotiation prior to this point to help forge a consensus among the different member states and between the Council and the EP.

It is a testament to the urgency and importance attached to Solvency II that the Council has scheduled two two-day meetings per month up until December to help move the process forward. The Council had also requested that all countries submit issues and suggested amendments by the beginning of September. If countries have not raised their concerns already, it may now prove difficult to have them added to the agenda.

If the Council is unhappy with any element of the revised draft it will send it back to the EP with its comments for a second reading

**Figure 1** The Lamfalussy Process

#### Level 1:

'**Framework Directive**' setting out basic enduring principles, or political choices, underpinning the solvency system.

#### Level 2:

'**Implementing Measures**' formulating more detailed, technical rules.

#### Level 3:

'**Supervisory Standards**' setting out guidelines for national supervisors to ensure a consistent interpretation and application.

#### Level 4:

'**Evaluation**' enabling the European Commission to monitor compliance and enforcement.

Source: PricewaterhouseCoopers

<sup>1</sup> Life & Pensions, 01.04.07.

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and further amendment. If the Council is still not satisfied after the second reading, the last resort is conciliation. If that fails, it is back to the drawing board.

Even with the aid of the Lamfalussy provisions, legislative enactment can be a long and arduous process. Although significantly faster than in the past, it still took 17 months of intensive debate to pass the primary legislation for the Markets in Financial Instruments Directive (MiFID). Admittedly, MiFID is the most complex and extensive Lamfalussy directive to date, though Solvency II promises to be even more so.

Technical preparatory work on Solvency II will be well underway by the time the Level 1 directive is passed, though nothing will be set in stone until the primary legislation is on the statute books. An understanding of the detail is proving essential in the design of such a complex framework, though this shows that Lamfalussy is itself an evolving political process.

## Potential tensions

Prior to the introduction of the Lamfalussy process, a draft directive would be out of the hands of MEPs once the primary legislation was passed, leaving them with little influence over the subsequent technical formulation. Therefore, the EP often pushed for more technical details in the primary legislation.

Although Lamfalussy sought to address this potential difficulty, the Council retained the right of 'call-back' on all

Level 2 measures. As a result, the EP has been fighting a determined rearguard action against this continuing institutional imbalance through such mechanisms as 'sunset clauses' designed to ensure that delegation of its powers is only temporary. This has led to tension between the EC, the Council and a Parliament that is keen to put itself on an equal footing with its co-decision-making counterpart.

Enactment of Solvency II would ideally be achieved ahead of the campaigning for the European Parliamentary elections in June 2009. If the process of finalisation slips into the campaign season and subsequent vote then the local political pressures on MEPs will inevitably be heightened. The particular EU presidency in place at the time could also be an important factor, as the views and priority given to this legislation may differ from country to country (see Figure 2).

Figure 2 EU Presidencies

July – December 2007	Portugal
January – June 2008	Slovenia
July – December 2008	France
January – June 2009	Czech Republic
July – December 2009	Sweden

Source: European Commission

## Preparing for implementation

The experience of MiFID also highlights the potential challenges facing Solvency II once it moves into its interpretation, implementation and enforcement phases. Once again, this is an evolving process.

MiFID embodies the concept of 'maximum harmonisation', which aims to impose a level playing field by setting a relatively high regulatory bar and expecting member states to adhere to it closely. This is a radical move away from the 'minimum harmonisation/mutual recognition' approach, which left the door open to a range of protectionist measures.

To reinforce maximum harmonisation, MiFID's requirements relating to record-keeping and interaction with financial markets, where a common approach at the outset is feasible, were enacted as a regulation that is automatically binding on member states. While other provisions still require implementation at the national level, both the EC and the Committee of European Securities Regulators (the relevant Level 3 committee) have worked hard to ensure consistent interpretation. Moreover, any additional requirements in relation to key organisational and conduct of business issues are prohibited unless they can be fully justified.

How far Solvency II goes down the road of maximum harmonisation is difficult to say at this stage. Smaller firms may find themselves at odds with their larger counterparts, who naturally seek economies of scale. Yet the interests of smaller insurers and retail policyholders are certain to top the EP's agenda.

The balance of home and host supervision could prove another source of contention. The draft Directive sets out proposals for the streamlining of group oversight that would allow a single authority to take the

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lead in the supervision of European groups. This could potentially reduce compliance costs and lower capital charges by enabling companies to take account of group-wide risk diversification. This position has been championed by supervisors and industry groups from a number of large and well-developed markets, such as the UK. However, some other countries contend that local operations which may be relatively insignificant to a large international group could be critical to the financial health of their particular market. Allowing national supervisors to impose additional capital requirements may assuage some of the concerns, though further debate is likely.

A briefing published by the European Parliamentary Financial Services Forum in July 2006 concluded that 'tough problems may be ahead, as some European insurance supervisors have fundamentally different approaches to the supervision of insurance companies that may be difficult to resolve without political guidance'.<sup>2</sup>

### Targeted lobbying

There is no doubting the importance and urgency attached to Solvency II by both the EC and its political masters in the EP and Council of Ministers. However, progress and development will inevitably

be subject to political manoeuvring, delay and difficulty within what is in itself an evolving political process.

As the publication of the draft Directive extends opportunities for comment and influence beyond the CEIOPS consultation papers and quantitative impact studies, insurers need to understand how this complex political process works. They need to monitor developments to ensure that they make their voices heard by the right people at the right time. ■



<sup>2</sup> European Parliamentary Financial Services Forum Solvency II Briefing, 12 July 2006.