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CEA Executive Update

THE NEWSLETTER FOR INSURANCE EXECUTIVES

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Summary

EU Signals New Focus on Healthcare

Insurers launch dialogue in Strasbourg

The CEA publication on 'Improving the Health of the EU Working Population' received a positive political reaction at its launch in Strasbourg on 4 April. The well attended MEP Insurance Luncheon, part of a series of events organised by CEA and which was hosted by Member of European Parliament (MEP) **Avril Doyle**, considered the implications for Europe of the increasing strain being put on healthcare budgets.

Health spending rising faster than GDP

The debate focused on occupational health issues and the implications of demographic changes. Health spending levels are currently rising faster than GDP. In Europe, an aging population means that a diminishing working population will have to support the increased healthcare spending required to cope with the health needs of an ageing population. Clearly, initiatives to keeping the working population healthy will become increasingly valuable for Europe.

Pekka Shemeikka, Finnish Permanent Representation in Brussels, noted that health will be a top priority for the Finnish Presidency of the EU, which starts in July. There will be a particular focus on health at work, combining the approaches of health protection, health promotion and occupational health. A series of meeting will be organised which will ensure that, at the highest political level, health is recognised a one of the major contributors to economic growth.

Private medical insurance can make significant contribution

Julian Ruiz Ferran, Chair of the CEA Health Committee welcomed the emphasis the Finnish Presdency will place on health. Whilst the economic and social challenges of the financing and management of healthcare of all EU citizens are substantial, he underlined that private medical insurance is in a position to make a real and significant contribution.

Padraic Ryan, Director, GlaxoSmithKline, made a presentation on employee health management. He emphasised that healthy people make healthy companies and outlined the strategies his organisation put in place which resulted in improved performance.

Daniel Schanté, CEA Director General, noted that in 1999 the EU lost 500 million working days as a result of

accidents, disability or health problems. Good occupational health schemes can keep more people at work, reduce benefits bills for governments and make business more productive and competitive. He emphasised that insurers are the key partners of employers looking to set up occupational health policies.

MEPs welcomed the launch of the debate on healthcare. They were especially interested in funding aspects of healthcare structures in the member states. **Avril Doyle**, MEP, made a specific reference to the upcoming initiative of the European Commission on healthcare, pointing out that issues such as patient mobility will need careful consideration. ■

The CEA Publication 'Improving the Health of the EU Working Population' is available to download free-of-charge from:
www.cea.assur.org

Europe's Life Insurers Break Records

Exclusive preview of latest analysis of Europe's € 551 billion life insurance market (data from 2004)

The latest comprehensive statistical analysis of CEA's European life insurance market will be published shortly. The latest figures reveal that 2004 was a memorable year for the sector: there was growth in all markets surveyed bar one; turnover grew to a record figure of € 551 billion and benefits paid out for direct life insurance business rose to € 409 billion.

CEA's yearly overview of the European life insurance market provides a snapshot of a market which is key driver of the European economy. Total investments by insurance companies related to life activity were € 4625 billion at the end of 2004. This amount, which is invested in order to cover all sums due to the insured, has increased by 5.6%.

Europe Leads World Life Industry

The European life insurance market has consolidated its position as the world leader in the life industry. The European share of world life premiums is now 37.6%. Clearly, insurance products have become an essential part of household savings management in many European countries.

Within Europe, the life insurance share of total insurance premiums also increased and now accounts for 60.2% of the market. The share of life premium is above 50% in half of all European countries surveyed, with Finland and Sweden having the highest share.

Turnover Reaches € 551 billion

The European life insurance market experienced growth of 3.7% in 2004 to achieve a record turnover of € 551 billion. Premium levels are for the first time higher than those recorded at the end of 2000. This increase ends a three year cycle which was characterised by relative stability of premium income. Benefits paid out for direct life insurance business in Europe rose to € 409 billion in 2004. For the first time in several years, premium growth is superior to the growth of benefits paid.

The growth in the life market has been accompanied by an increased interest in unit-linked products, whose share in total life premium income rose to 37.3%. The positive evolution of these products is directly related to low interest rates and to the restoration of confidence after the financial crisis of 2001-2002.

The European life insurance market is dominated by four countries (United Kingdom, France, Germany and Italy) which together represent 70.9% of the European market. The United Kingdom remains the biggest European market. Turnover in France, the second biggest market, grew by 12%. With its high level of growth, France was the primary contributor to European growth in 2004. Several Central and Eastern European countries showed a double-digit growth rate on their life market. This sustained high growth reflects the healthy economic environment of these countries coupled with the potential for development of the life insurance market.

Market Players

About 1302 companies were active on the life insurance market in 2004. Almost 70% of these companies are specialized in life products whilst the others sell life and non-life products. Distribution channels for life insurance products show very different patterns across European countries. In several countries in western continental Europe, the bank-insurance network is an important distribution channel for life products. In the United Kingdom, Ireland and Slovakia, brokers are the most important selling channels of life products.

Pension Pressure Drives Change

The growth observed in most western countries over the last few years is, among other things, related to the change in European demography, characterized by a decline in the active population (due to lower birth rates), an increase in the number of pensioners and longer life expectancy. This evolution will put the current pension system under pressure within the next 30 years and imposes an immediate and profound need for reform to achieve a sustainable pension system. The new pension systems under development emphasize the role of private insurance in the provision of pension revenue. This change is reflected by tax advantages for several life products in many countries. ■

Jérôme Cornu
Chairman CEA Life Statistics Working Group

The CEA publication: 'European Life Insurance Market in 2004' is available free-of-charge from the CEA website: www.cea.assur.org

Solvency II Latest

Achieving Market-Consistent Liability Valuation
CEA launches proposal utilising a Cost of Capital approach

A new CEA working document tackles an important issue for the Solvency II project. This latest document presents a solution to assess the market-consistent valuation of the liabilities based on the Cost of Capital approach. This document was broadly distributed to CEA's stakeholders, including CEIOPS and the European Commission, to promote the discussion with the industry on this very important topic.

The main objectives of the document are to highlight certain issues and to promote understanding of the concept of the economic approach and to describe a workable solution for the implementation of the Cost of Capital under a standard approach like the European Standard Approach. CEA believes that this is a key input in the current discussions on the specifications for the second Quantitative Impact Study that are expected to be finalized by the end of April.

Cost of Capital as One of the Important Components of the Overall Solvency Framework

Industry believes that the implementation of a sound economic Framework would fulfil the objectives set at the outset of the Solvency II project (*see accompanying box*). It would provide enhanced transparency for supervision and foster best practice risk management (e.g. rewarding risk mitigation strategies). Cost of Capital is a small but important piece of puzzle for this new framework.

Developing a solvency framework on sound economics implies the consideration of a total balance sheet with market-consistent valuation of both assets and liabilities. These valuations form the basis for the calculation of the available capital on the one hand and of the Solvency Capital Requirement (SCR) on the other hand. The SCR will allow a company to withstand adverse circumstances, even severe ones (1 in 200 events or 99.5 % confidence level).

The SCR captures all unexpected risks that might negatively impact the available capital. This also includes the potential impact on the run-off of the liabilities (e.g. negative mortality trend impacting the future payments of the insurers to their policyholders). Therefore, no additional prudence is required in the market-consistent valuation of the liabilities.

The Challenge of Assessing Liabilities on a Market-Consistent Basis

When either liquid markets or generally accepted valuation techniques exist, the assessment of market-consistent values is straightforward. Risks are priced by the markets and readily available from observed market prices. This is mostly the case on the asset side of the balance sheet and for financial risks.

For certain liabilities, things can be more complicated, in particular where liquid markets do not yet exist to provide reliable pricing information. In these cases, companies often build valuation models based on best estimates. It is recognized that these do not necessarily reflect a market consistent value (i.e. that allows for the transfer of the liability to a third-party). An amount in addition to the best estimate liability, a so-called, *Market Value Margin*, will be required as a proxy.

Solvency II Project Objectives

From the start of the Solvency II project, industry has strongly supported a new Framework which combines the interests of the policyholders with incentives for the companies to properly manage their risks. The main objectives of Solvency II are expressed in the 4 following points:

1. "Enabling an institution to absorb significant unforeseen losses and gives reasonable assurance to policyholders" (Framework for Consultation on Solvency II)
2. "Giving to the supervised institutions incentives to measure and properly manage their risks" (Framework for Consultation on Solvency II)
3. Contributing to a "better managed and more competitive insurance industry that can better perform its key function of accepting and spreading risk" (Commissioner McCreevy)
4. "Encouraging a single European market for financial services" (European Union Lisbon Strategy 2000)

Cost of Capital as a Coherent Proxy for Market Value Margin

To estimate the market value margin, discussions currently focus on a Cost of Capital approach. Its theoretical basis is that investors would require compensation for the capital that they have put forward to run an insurance company. In other words, when a company acquires a new portfolio of risks, its capital requirements will increase. Theoretically, the company will have to support these additional requirements by getting fresh capital. Capital providers who will inject this capital will demand compensation for the capital supply. The Cost of Capital approach reflects the cost of this compensation.

A Simple and Coherent Solution for All Market Participants

The clear separation of market consistent liabilities and capital requirements ensure the fundamental advantages of this framework. It provides con-

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sistency and transparency in a system that can both be used to manage a company and supervise the insurance market.
Other approaches (in particular based on a percentile approach) have the disadvantage of including arbitrary amounts of prudence in the value of liabilities and not encouraging the assessment of a company's true economic situation. This lack of transparency is inadequate for supervisory purposes and in the long run it will also be detrimental for both policyholders and shareholders.

Outlook

As with any new system, concerns were raised on the workability of the cost of capital approach, both for the regulatory authorities as well as for the supervised institutions. CEA has worked on a solution integrating the Cost of Capital approach in the European Standard Approach for determining the SCR. Based on this proposal, market value margins based on Cost of Capital can be calculated in 5 steps which can be applied to all companies including small and medium-sized enterprises.
CEA is aware that there is still debate around the concept. However, CEA also believes that this paper paves the way for a field study on the true economic approach in the context of the Quantitative Impact Study to be launched in May 2006. ■

The CEA Working Document on Cost of Capital is available to download from:
www.cea.assur.org

New Appointments at CEA Secretariat

Derek McGlynn has been appointed Communications and PR Manager for the CEA. He looks forward to leading CEA's communications and public relations activities, which in the short term will include contributing to the organisation of the General Assembly and Conference, preparing the Annual Report and developing press contacts. For the past five years he has been Communications Manager at the FEE, which represents the European accountancy profession. ■

Benoit Malpas joined the Economics and Finance Department of CEA in March 2006 as Technical Manager. He is responsible for accounting matters. Before joining CEA, Benoit has worked for 7 years with PricewaterhouseCoopers in Luxembourg, including a two-year secondment in London. During those years he has developed his knowledge of the insurance industry as well as investment fund management. ■

Insurance Schedule Update

Insurance Contracts	19-21 April	IAIS Insurance Contracts Subcommittee
Road Safety	19April 27 April	**European Parliament** - Deadline for amendments on the Report on Road safety: bringing eCall to citizens - Discussion in plenary
Natural Catastrophes	20 April	**European Parliament** Vote in REGI Committee on: - Adoption of a draft report on Natural disasters (fires, droughts and floods) - Adoption of a draft opinion on the Commission proposal for a Directive on Flood assesment and management
Services Directive	21 April	**Informal Competitiveness Council** Commission officially submits its position to the Council
Asset Management	26 April	**European Parliament** Vote in plenary
Solvency II	2 May	**CEIOPS** Launch of Quantitative Impact Studies 2 (deadline 31 July 2006)
Solvency	3-5 May	IAIS Solvency Subcommittee

Director of Publication:
Daniel G. SCHANTÉ
(schante@cea.assur.org)