Brussels, 10-07-2007

The European mutual insurance sector and Solvency II: an overview

The European mutual insurance sector

A major value added player

More than two thirds of all insurers in Europe belong to the mutual and cooperative insurance sector which accounts for close to 30% of all insurance premiums paid by European policyholders. Mutual insurers add to the diversity and competitiveness of the European insurance market, and provide a wider choice for consumers. In addition, many of them were and still are created to remedy market imperfections by offering insurance cover in difficult, very small or specific sectors.

AISAM and ACME

The Association Internationale des Sociétés d'Assurance Mutuelle/International Association of Mutual Insurers (AISAM) and the Association of European Cooperative and Mutual Insurers (ACME) represent about 80% of the mutual insurance market in Europe and over 6% of the worldwide insurance premiums. Their members are present in at least 16 European countries and employ over 300,000 people either directly or through their subsidiary companies.

Two major challenges in the Solvency II project

The European mutual and cooperative insurance sector welcomes the Solvency II reform as a real opportunity to align capital requirements with underlying risks thus ensuring adequate consumer protection and efficient use of capital.

Mutual insurers however face two particular challenges in the context of the Solvency II project:

- Challenge one: The new regime has to strike the right balance between the risk-based approach and the proportionality principle, and between diversification and specialisation without which mutual insurers will find it extremely difficult to implement the new rules while continuing to serve their member-customers in the most efficient way.
- Challenge two: A state of the art Solvency II regime will not be sufficient to establish a level-playing field within the European insurance sector. In a consolidating market, the continued absence of a European Mutual Society statute will significantly limit the contribution of mutual insurers compared to their joint-stock and cooperative competitors.

General support for the Solvency II reform

AISAM and ACME work closely with the European Insurance and Reinsurance Federation (CEA) and broadly share the same views. This includes among others:

- Approving the use of a total balance sheet approach (without any arbitrary limits), the cost-of-capital approach, and the removal of the size factor;
- Requesting a lead supervision principle;
- Concerns about the potential impossibility of using entity specific data in the reserve risk.

In addition, AISAM and ACME strongly support adequacy and proportionality as key principles of Solvency II.

We wish however to underline a number of concerns that particularly relate to the corporate and capital structure of mutual insurers.

What is important to the mutual insurance sector?

Because we are the only ones concerned…

Mutual specific capital elements

Mutual insurers are jointly and indivisibly owned by their member-policyholders. Capital items such as members' accounts should therefore continue to be treated as equity equivalent.

Amongst the different options available for accessing additional capital, a special mention should be made of supplementary calls. When specified in their bylaws that mutuals can return to their members for a supplementary contribution, this stipulation allows them to call on their members when additional capital input is needed. These 'drawing rights' on members are permanently available, without costs, have a loss-absorbing potential essentially in an ongoing concern and therefore merit appropriate treatment as eligible capital.

Exemption regime for very small mutuals

Very small mutual insurance societies, active only nationally and in particular lines of business, which function with a loss controlling mechanism or which can request additional capital from their members when need be, should be excluded from the scope of Solvency II.

Today very few mutual insurance societies benefit from the current exemption regime. According to our calculations, adjusting the current exemption threshold for inflation, and even beyond, would have a minimal impact on the European insurance market, as it would only exempt a maximum 0.2% of the EU life insurance market and 0.4% of the EU non-life insurance market.

Because we are particularly concerned…

Deeply subordinated debt and hybrid capital

As mutual insurers cannot raise share capital on financial markets, it is of the utmost importance to ensure that the Solvency II regime caters adequately for deeply subordinated debt. Together with the rest of the industry, AISAM and ACME request that any deeply subordinated debt and equivalent instruments meeting clearly established criteria should be accepted automatically and entirely as part of the core available solvency margin.

Tax application

ACME and AISAM are concerned that taxation applicable to eligible elements might miss the point that eligible elements[1] are only meant to cover the financial consequences of an adverse event.

Clarification of such taxation aspects would assist in minimising diverse interpretations by market participants and national authorities, and therefore help to better assess the final capital available for solvency purposes.

Simplified regime for small and medium sized entities

The new Solvency II regime should strike a balance between the risk based approach and proportionality. Many but not all mutual insurers are small and medium sized entities. That's why AISAM and ACME, together with the rest of the industry, insist on the fact that Solvency II must provide a proportionate framework for supervising insurers, while still being risk based. The question of the implementation of this principle throughout the three Solvency II Pillars is still pending. In Pillar I, the standard formula should therefore clearly be designed in such a way as to be able to apply to all companies.

Specialised and long tail players

Many specialized players are mutual insurers. Whereas diversification can be used to decrease volatility within an insurance portfolio, specialization in a product or customer segment is also a valuable instrument in managing risks efficiently. This point is recognized by CEA and by AISAM and ACME.

In addition, long tail risks, such as workers' compensation, medical malpractice liabilities, decennial liabilities in construction, and equivalent must be managed with a long-term perspective. Thanks to their particular expertise, mutual insurers have traditionally been leaders in such risk sectors and have demonstrated their efficiency in managing long tail risks. This ability to manage long tail and specific risks properly should be acknowledged in the underwriting risk section of the standard formula.

ACME and AISAM will continue to work on these issues, with a view to:

- Refining the calibration of the underwriting risk (reserve and premium risk) within the standard formula;
- Refining the cost of capital calculation for long tail risks;
- Introducing the use of entity specific data within the reserve risk.

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[1] i.e. the difference between the book value of the technical provisions on the one hand and the BEL plus the MVM on the other hand, and unrealized gains on assets

Diversification

AISAM and ACME recognise that diversification, in general, is an efficient tool for decreasing the risk within an insurance portfolio. Consequently, diversification must be properly taken into account within a solvency regime. As regards geographical diversification (including diversification between entities and/or between countries), AISAM and ACME consider that geographical diversification should satisfy two conditions:

- It must remain consistent with a risk based approach;
- It must preserve a level playing field between mutual insurers which can not develop international business while keeping a mutual structure (see paragraph “Items related to Solvency II” below) and other players.

Equity treatment

Solvency II should strike a balance between the risk-based approach and an optimal investment strategy. Such a strategy entails aligning investments with liabilities, and corresponds to state of the art asset-liability management. In particular, any new solvency system should therefore take due account of the time horizon of liabilities. Indeed, equity and property investments, which may put insurers at risk if they cover short term contracts, are fully justified for longer term policies.

AISAM and ACME fully support the alternative approach of a decreasing capital requirement according to the duration of liabilities, and hope this alternative approach will be endorsed in the final standard formula.

Analysis of QIS3 results

QIS3 aims at testing the calibration of the standard formula. Public disclosure of the results from QIS3 overall, and more specifically for mutual insurers, small players, mono-liners and long-tail insurers would help to better identify its true impact on each type of player.

Items related to Solvency II

European Mutual Society

Solvency II will be a demanding project. Pressure on smaller insurance undertakings is expected to increase given the significant costs involved in developing and maintaining advanced ‘Pillar 2’ internal measurement models. Larger undertakings benefit from a virtuous circle of more resources with better access to capital - and at better rates - than their smaller counterparts. Solvency II may push this competitive advantage to new levels. To some extent, therefore, this may catalyze pressure for consolidation.

Consolidation is also expected to increase as insurers endeavor to fully benefit from the mitigation effects of group diversification embedded in Solvency II.

However, while there is no European statute for mutual societies, as there is for all other insurers, it is impossible for the mutual insurance sector to consolidate cross-border and grow stronger in a way which is coherent with mutual values. The adoption of a European Mutual Society statute is indispensable for mutual insurers to be able to compete on a level-playing field in the new Solvency II regime.

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