Comment

of the German Insurance Association (GDV)

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on the European Commission's proposal for a review of the European system of financial supervision (ESFS)

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General comments

The German Insurance Association (GDV) welcomes the Commission's decision to maintain the well-established and balanced system of European financial supervision, in particular the **sector-specific responsibilities of EIOPA, EBA and ESMA**. It is vital that the responsible European authority has specific expertise in the field of insurance. We also appreciate the **continuing competence** of the ESAs for both **prudential and market conduct** oversight. The introduction of the so- called twin peaks-approach would be hardly feasible in the insurance sector as solvency and consumer protection requirements are integrated in Solvency II. A separation would result in unnecessary double supervision and increased bureaucratic burdens due to the constant need for coordination.

The GDV strongly believes that EIOPA's prime responsibility is to ensure a **convergent application of EU regulatory requirements**. We support any measure to provide EIOPA with the necessary means to fulfil this important mandate. However, we are convinced that existing Regulation (EU) No 1094/2010 does not suffer from a lack of regulation**,** but from **deficits in enforcement**.

In terms of setting guidelines and drafting opinions, reports etc. we have noticed that EIOPA's activities –though probably unintended–in some cases had the impact of **challenging or adding complexity to the rules** which are based on a due political and legal process. This has created a great deal of **legal uncertainty** and virtually resulted in an **additional layer of regulation**. We also **acknowledge** that EIOPA's solicited **involvement as a mediator** in matters of ongoing supervision with cross border implications has proven to be helpful. However, it is **paramount** that the national supervisory authorities (NCAs) remain **responsible for the direct supervision** of insurance undertakings. Bearing this in mind, the GDV believes that the Commission's proposal should be reconsidered taking into account the following aspects:

- **Proportionality**

The proposal adds a considerable **number of new powers for EIOPA**, in particular:

- Issuing Supervisory Handbooks (Articles 8, 29-new);
- Issuing Strategic Supervisory Plans (Article 29a-new);
- Drafting Opinions on Internal Model-applications (Art. 112, 231, 231a-new of Directive 2009/138/EG);
- Direct information requests and enforcement (Articles 35a – 35h-new);

We fail to see how these amendments should improve EIOPA's ability to ensure uniform and consistent application of Union law.

Instead, they will likely end up in **more bureaucracy** and **undermine the competence of NCAs**. Furthermore, we question whether they would still be covered by EIOPA's mandate derived from Art. 114 TFEU. The principle of proportionality also applies to the exercise of supervisory powers. That is why we would recommend realizing **the full potential of EIOPA's existing tools** and envisage **adjusting the power of setting guidelines** to the extent what is inevitably needed first before additional powers are considered. Moreover, the acceptance and credibility of EIOPA would benefit from **extending the legal remedies** for the industry.

- **Effective control mechanisms**

The potentially detrimental ramifications of extending EIOPA's powers and jurisdictions are amplified by the revisions of the **governance structure**. The proposed **strengthening of the newly established Executive Board**, including its Chairperson, and the consequential **weakening of the Board of Supervisors** creates an **imbalance in terms of required checks and balances**. While we acknowledge that the direct allocation of powers to the Executive or Management Board may make sense where breaches of Union law or settlement of disputes between NCAs are affected (e.g. Articles 17 and 19 of Regulation (EU) No 1094/2010), **proper influence of Member States** needs to be ensured with regard to any other action of EIOPA. The empowerment of the **Stakeholder Group** to challenge guidelines and recommendations is welcomed, but **does not effectively compensate** the imbalance since the required 2/3 majority will constitute a major obstacle to effectively exercise control. Apart from that, the **European institutions** –in particular the European Parliament– should have a **broader und constant mandate** to improve accountability and transparency of EIOPA's actions which goes beyond the power to appoint and remove the Chairperson as well as the full time members of the Executive Board. This involvement is welcomed, but does not ensure effective control of the ongoing business of EIOPA.

- **Transparent funding scheme**

The proposed settlement on a maximum EU annual contribution up to 40% of EIOPA's budget and the shift to annual contributions from the industry of at least 60% creates **significant uncertainty** to assess the **financial burden for the insurance undertakings** concerned. This uncertainty goes along with a **lack of effective control** regarding the establishment of the budget which will very likely account for significant increases. The Board of Supervisors **won't have viable interests** to challenge the estimates of the Executive Board as the NCAs do not contribute payments to the budget any longer. The Budgetary Authority responsible for the adoption of the future budget will only scrutinize the **balancing amount** to be charged to the EU. Therefore, **effective control for the amount payable by the industry** needs to be ensured.

I. Introduction

On 20 September 2017, the European Commission submitted its proposal for a regulation to reform the European System of Financial Supervision. Key part of the reform package is a **revised legal framework** concerning the European Supervisory Authorities **EIOPA, EBA and ESMA** with extensive revisions in terms of **powers**, **governance** and **financial provisions**. The detailed comments set out below follow this hierarchy and solely refer to revised Articles of of Regulation (EU) No 1094/2010), unless stated otherwise.

II. Detailed comments

1. Powers

As set out in the general comments, any proposal should be challenged against the **necessity, suitability and proportionality** for EIOPA's ability to ensure uniform and consistent application of Union law. Overall, we have doubts that the revisions to the powers and responsibilities of EIOPA serve this goal, but rather contribute to **unnecessary regulation and complexity** instead of addressing the **enforcement deficit** of the current framework:

a. Guidelines and recommendations (Article 16)

Key to ensure **proportionality** is that the existing powers of EIOPA are focused on what is **inevitably needed** to ensure convergence. Furthermore, the amount of guidelines has to be viewed critically with respect to safeguarding a principles based regulation.

Hence, we **welcome** that carrying out **cost-benefit-analyses** must be considered as a rule by EIOPA prior of issuing guidelines and recommendations. Granting the Stakeholder Group the **right to object respectively file an opinion** to the Commission if EIOPA has exceeded its mandate is also a **step into the right direction**, although the required 2/3-majority to effectively exercise this right may prove to be an almost impassable obstacle.

However, these measures are **not sufficient**. While we acknowledge that guidelines and recommendations have proven to be an important and successful tool of supervisory convergence in certain cases, EIOPA has also occasionally **stretched the constraints of its competences** to a questionable extent. As the most prominent example of the recent past,

EIOPA's pressing efforts to advocate a reduction of the Ultimate Forward Rate (UFR) clearly show the need to implement **more effective safeguards and restrictions**.

We believe it is in the interest of both EIOPA and the insurance undertakings if the competence on setting guidelines or recommendations under Article 16 is **legally clarified**. It is important to ensure that EIOPA-guidelines **comply with the applicable supervisory legislation** and do not go beyond the Solvency II Directive (Level 1) and the other provisions by way of Delegated Acts (Level 2). Furthermore, EIOPA's competence to issue guidelines or recommendations should be narrowed and require a **specific authorization** in a legislative act. This would ensure political control over the amount and subject of the guidelines issued. If a Guideline-setting activity of EIOPA is not based on a specific authorization in a legislative act it should at least rely on a **concrete mandate** issued by the EU-Commission.

Also, a clarification whether Article 9 paragraph 2 contains a **distinct authorization** to issue guidelines and recommendations is needed. In our view, guidelines and recommendations issued pursuant to Article 9 paragraph 2 aiming to promote the safety and soundness of markets and convergence of regulatory practice with respect to new and existing financial activities should be **subject to the same restrictions** laid out above with respect to Article 16.

Furthermore, **effective legal protection** against EIOPA **guidelines** and **different formats** of communications which create de facto binding effects is necessary. Insurance undertakings indirectly affected must be granted **a formal appeal against** such measures. Article 60 only refers to decisions, indicating an immediate legal effect on undertakings which is admittedly not imposed by Guidelines. Therefore, the scope of Article 60 should be extended to Guidelines and different formats of communication aiming at the assessment by the Board of Appeal whether the measure in question is equivalent to a decision in terms of its effect on undertakings and should be treated accordingly.

b. Breach of Union law (Article 17)

Article 17 is the most **important enforcement tool** for EIOPA to meet its primary task, which is to ensure consistent and uniform application of insurance supervision regulations in Europe. The GDV continues to believe that Article 17 in its **current drafting provides all necessary means**. However, the envisaged procedure to request information from other competent authorities or relevant insurers in order to investigate possible violations of EU law may constitute a **reasonable refinement** of EIOPA's

toolkit if handled **properly** and applied strictly **consistent** with the purpose of Article 17, i.e. it must be clear that the investigated breach is committed by an NCA, and that EIOPA cannot investigate under Article 17 whether insurance undertakings comply with Union law (as the proposed drafting could suggest).

Relevant information on potential breaches of Union law may also be proactively brought to the attention of EIOPA by NCAs and insurers. Article 17 should provide for this scenario as well and require EIOPA to **ensure transparency** about how this information is processed.

c. Settlement of disagreements (Article 19)

The amendments of Article 19 ensure that EIOPA can **act and intervene decisively** in relation to the settlement of disagreements between competent authorities. In particular, we **support** the possibility to enter into a settlement procedure upon EIOPA's **own initiative**. The introduction of an obligation for competent authorities to notify the ESAs when an agreement has not been reached within the time limit prescribed in the relevant legislation is also **welcomed**.

d. Information requests and enforcement (Articles 35-35h)

Due to the envisaged adoption of direct requests to NCAs and insurance undertakings in the context of breach of Union law-investigations (see above, Article 17), we **question the need and purpose** to maintain indefinite information requests.

In addition and in contrast to Article 17, there is a considerable **lack of safeguards** since Article 35 simply refers to information necessary to carry out the tasks allocated to EIOPA. Accordingly, Article 35b does not require EIOPA to provide any explanation for its request to undertakings. Furthermore, undertakings cannot challenge nor legally appeal the request, provided it is issued as a simple request as opposed to a request by decision. We understand that the inclusion of Article 35 in the scope of Article 60 paragraph 1 only grants protection against requests by decision. Given these shortcomings, we consider EIOPA's authority to impose fines or periodic penalty payments **excessive and disproportionate**. Therefore, Articles 35a-35h should be abandoned.

In this context, it should be emphasized that EIOPA's competence to request information from and take enforcement action against individual companies needs **to respect the limits set by the European Court of Justice (ECJ)** in its judgment C-270/12 where it ruled on the ESMA's ability to prohibit short sales pursuant to Article 28 of Regulation 236/2012 on

short sales and credit default swaps. In this judgment, the ECJ emphasized that ESMAs competence to prohibit the entry by legal persons into short sale transactions was only permissible to the extent that such action was necessary to defend financial stability and preserve the financial system, i.e. under extraordinary circumstances. It is also worth mentioning that the Advocate General had concluded that Article 28 of Regulation 236/2012 was not covered by Art. 114 TFEU. The Advocate General viewed ESMA's competence pursuant to Article 28 not as a measure to harmonize the internal market –which would have been necessary to be based on Art. 114 TFEU– but as a transfer of competence from national competent authorities to ESMA, which should have been based on Article 352 TFEU. Given that the competences in favour of EIOPA provided for in Articles 35-35h would include any information that enables EIOPA to carry out its duties, it appears that this would **not meet the standard established by the ECJ**; further, it would also amount to a transfer of competences from the national competent authorities to EIOPA in a form that the Advocate General **considered excessive**.

e. Strategic Supervisory Plan (Article 29a)

EIOPA should be empowered to set EU-wide priorities for supervision in the form of a Strategic Supervisory Plan against which all competent authorities will be assessed. As a result, NCAs will be required to draw up annual work programs in line with the plan. We do **not believe** that EIOPA should be allowed to **act as a superior supervisor**. The responsibility of the NCAs for direct supervision inevitably **includes the decision about setting priorities**, as they are defined by market specifics which should **not be second-guessed** by EIOPA.

Apart from that, we fail to recognize how the Strategic Supervisory Plan is supposed to contribute to more supervisory convergence as envisaged. Drafting **the supervisory agenda of** NCAs does not ensure that regulations are consistently applied.

f. Outsourcing of activities and risk transfer (Article 31a)

We **oppose** giving EIOPA the opportunity to **intervene in the decision making process** of NCAs with regard to outsourcing transactions by drafting factually binding opinions and **imposing undue pressure** by publicly exposing non-compliant NCAs.

From a legal perspective, the proposal **undermines Article 50 of Directive 2009/138/EG**. Section 2 requires EIOPA to develop draft regulatory technical standards to be adopted by the Commission to further specify

the conditions for outsourcing, in particular to service providers located in third countries. No such regulatory technical standards have been adopted to date. Article 31a clearly **circumvents this procedure,** which would ensure transparency and proper stakeholder participation, to define criteria for convergence.

In addition, the interference of EIOPA would –equivalent to the situation with Internal Models (see below, 2.)– **compromise the separation** between indirect and direct supervision. EIOPA's role in respect of outsourcing activities should thus be that of a standard-setter by way of proposing regulatory technical standards and, if required, to enforce the compliance with such standards by the NCA. However, it should not be involved in the supervision of outsourcing activities by individual insurance undertakings.

In terms of wording, it needs be clarified that **cross-border reinsurance** to third countries would **not qualify** as a "risk transfer" in the sense of Article 31a. Otherwise, it would collide with Article 172 et seq. of Directive 2009/138 as well as separate general guidelines on cross-border reinsurance, in consideration of existing international standards and EU commitments.

From a practical perspective, the involvement of EIOPA would lead to **inefficiencies and delays** in the authorisation/registration processes. Next to adding complexity to the process, the collaboration between EIOPA and the NCAs **neglects basic principles of transparency** as the insurers concerned are neither informed nor consulted.

g. Union-wide stress tests (Article 32)

The proposed annual consideration of Union-wide assessments without safeguards such as cost-benefit analyses is very likely to **inappropriately increase the interval** of stress test exercises. We consider **EIOPA's existing powers** and responsibilities with respect to Union-wide stress tests **sufficient**.

In addition, the proposal does no take account of the fact that insurers already **disclose a comprehensive view** of their ability to resist in adverse situations via the Solvency and Financial Condition Report (SFCR). According to Article 295 Section 6 of the Delegated Acts undertakings have to disclose specific methods, assumption and outcome of stress testing and sensitivity analysis for material risks and events matching the individual risk profile. Adding an increasing number of stress tests with uniform requirements and assumptions would create inappropriate and disproportionate efforts. .

The proposed emphasis on **publication** of stress-test results on **entity level** is an area of particular **concern**. Fundamental standards on professional secrecy must **not** be **impaired** as the test data reveals very sensitive company-related information. **There is a danger of confusion** and of sending **conflicting messages** to the public as the results give **leeway for speculation** if test results are not properly communicated and explained to the public.

h. Environmental, social and governance factors (Article 8)

EIOPA should take account of risks related to environmental, social and governance factors when carrying out their tasks. Sustainable finance of the European economy including the possible impact on the regulation of financial institutions are currently **under discussion**. The German insurance industry **supports** the goal of aligning financial market activities with sustainability objectives and is willing to work together with European regulators on this initiative. Therefore, we consider it **premature and less helpful** to task EIOPA with defining standards in this context in **absence of** binding legal **rules**. These rules need to be developed and politically agreed upon by the competent legislative bodies.

i. Supervisory Handbook (Articles 8, 29)

We are concerned that the development of a Supervisory Handbook would enable EIOPA to establish a set of separate supervisory rules rather than contributing to a convergent application of existing EU-regulation. It should not be in EIOPA's remit to –as stated in Article 29– take account of changing business models and practices. It is the task of the European legislator to assess and determine a regulatory response to such developments.

Moreover, Article 8 provides an **ex-post legal basis** for an EIOPA-initiative that was well underway prior to the Commission's proposal. Irrespective of this unusual approach the GDV **questions the benefit** of such a book. The explanatory remarks of the proposal only refer to an alignment with EBA-rules, without justifying the necessity to adopt this regulation for the EIOPA-framework. Adding the Supervisory Handbook to the already **exhaustive regulation** of European insurance supervision on various levels (including a considerable number of EIOPA guidelines, opinions etc) would increase the risk of establishing **another supervisory level** rather than defining supervisory best practises, as envisaged. The legal nature of the Supervisory Handbook remains unclear, but should be properly reflected, also with regard to the general mandate of EIOPA and applicable control mechanisms. In terms of a due process, there is a considerable **lack of transparency** since the development and update of the

Supervisory Handbook are not subject to public consultation with NCAs and other stakeholders. It is paramount to keep supervisory actions **publicly accountable**. Therefore, if any, the process surrounding the Supervisory Handbook needs to be transparent.

2. Internal Models (Article 21a)

We **welcome** that –under the circumstances set out under Article 231 (6a)-new of Directive 2009/138/EC– **undertakings may request EIOPA's assistance** to forge an agreement between the supervisory authorities involved. This is an important measure to prevent a stalemate in the authorization process due to the reluctance of NCAs to accept Internal Models. Furthermore, the annual review procedure for the supervisory practice as foreseen in Article 231b-new of Directive 2009/138/EC is a useful measure to foster best practices in this regard.

In contrast, we do **not support** an active involvement of EIOPA on its **own initiative** by issuing opinions on the application to use or change an Internal Model. **Regulation (EU) 2015/460** of 19 March 2015 laying down implementing technical standards with regard to the procedure concerning the approval of an internal model in accordance with Directive 2009/138/EC **already ensures convergence** in this regard. Moreover, EIOPA itself provided **Guidelines** on the use of Internal Models which should **enable supervisory authorities to approve** and continue to allow the use of an Internal Model. Further involvement of EIOPA is **neither necessary nor helpful** as it would only slow down and add inefficiencies to the whole process

Apart from that, the proposal **blurs the line** between indirect monitoring through EIOPA and exercising direct supervision of insurers through national supervisors. The separation of powers constitutes a **fundamental principle of European insurance supervision**.

As a result EIOPA should continue to **focus on arbitration** whereas the application process should remain in the remit of the national supervisory authorities.

3. Governance

a. Executive Board (Article 45)

The main element of EIOPA's revised governance structure is the replacement of the Management Board by an Executive Board, which is supposed to consist of three full time members and the chairperson. This

is **not only a formal change**, but constitutes a **paradigm shift** in the allocation powers and the decision making-process of EIOPA which puts the **effective control** of the authority **into question**:

- The influence of the **chairperson** will be considerably **strengthened**. Since his or her vote has a casting effect, all members of the Executive Board would have to **unanimously collaborate** in order to **overrule** the Chairperson, which is very unlikely to happen in practice to maintain unity in external communications.

- The elevated position of the Chairperson particularly **materializes in relation to the Board of Supervisors**. He or she will be solely responsible to prepare the work of the Board of Supervisors (Article 48 Section 1), amplified by the provision that the Board of Supervisors won't be in full charge of taking the decisions referred to in Chapter II any longer (Article 43 Section 1).

b. Board of Supervisors

The increased standing of the Executive Board inadequately corresponds to a **significant weakening** of the Board of Supervisors, most prominently embodied by a **shift of direct powers and responsibilities to the Executive Board** in a number of important areas (Article 47 Section 3):

- Strategic Supervisory Plan (Article 29a);
- Outsourcing and risk transfer to third-countries (Art 31a);
- Direct information request and enforcement thereof (Art 35b to 35h);
- Withdrawal of competence to appoint/repeal the members of the Executive Board, including the Chairperson (Articles 45 paragraph 2, 48 paragraph 2).

In addition, the proposal missed the opportunity to adjust the decision making-process of the Board of Supervisors by introducing a **qualified majority** as a general rule of decision-making**.** It is still difficult to understand why decisions are generally met by a simple majority, while exceptions apply when the Board of Supervisors deals with draft Regulatory Technical Standards and Guidelines.

c. Stakeholder Groups

Unfortunately, the **imbalance** between the Executive Board and the Board of Supervisors in terms of checks and balances will **not be equalized** by the influence of the Stakeholder Groups on EIOPA's decisions. Although we generally welcome the newly attributed power to challenge guidelines or recommendations by sending a reasoned opinion to the Commission,

the required 2/3-majority creates an **unnecessary obstacle** to effectively use this tool (Article 16 Section 5). Moreover, the maintained authority of the Board of Supervisors to select the members of the Stakeholder Groups –which will be even fostered by the extension of their regular tenure to four years (Article 37 Section 5) – **raises questions in terms of objectivity**.

d. Conclusion

Although we understand the motive to make EIOPA's decisions quicker and more streamlined, the changes in the governance structure go **way too far**. They will probably create an environment where EIOPA can act **even more as a supervisor** and undermine requirements and restrictions which are based on political agreements. Therefore, the proposal must be weighed against EIOPA's ability to **ensure uniform and consistent application of Union law**. Accordingly, the refinements of Articles 17 and 19 and the elevated role of the Executive Board in this context make sense. Beyond that, the resulting **impairment of effective control mechanisms**, in particular with regard to the Board of Supervisors, is not acceptable. After all, EIOPA must continue to be a **member's driven organization**.

4. Funding

Considering the envisaged extension of EIOPA's powers, the EIOPA **budget** is likely to **grow considerably** over the coming years. The financial burden will be **borne by the insurance industry** to a large extent, as funding will be provided by the private sector at a **minimum rate of 60%** in the future.

Hence, the insurers' legitimate interests in controlling EIOPA's budget need to be based on a **new foundation**, as the NCA's will be relieved of their funding requirements and have no viable incentives anymore to exercise strict surveillance via the Board of Supervisors. Moreover, the EU-authorities concerned (particularly the Budget Authority) only take account of the balancing amount of 40% at a maximum of the established EIOPA-budget.

Effective control might be achieved, for instance, by creating a **new committee on Budgetary Control**, equally representing EU Parliament and ministries as well as supervisory authorities and the industry. In addition to that, appropriate measures must be taken to **protect the companies from double financial burdens** arising from their continuing contributions to the funding of national supervisors.

Berlin, 5 December 2017