

Solvency II

The Political Process

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Abstract

This thesis analyses the political process of the EU-directive Solvency II, as well as the amending directive of Omnibus II. Solvency II is the new regulatory regime of the European insurance industry which is to take effect on the 1st of January 2016. The result of this implementation is that life and non-life insurers across the EU will be sharing a common regulatory framework for the first time in history.

Since 2001, EU regulation in the realm of financial services has been conducted under the legislative ‘Lamfalussy process’ which consists of a four level structure. The first step in the process tracing study is to give a theoretical account of this system including the ways in which it was changed following the Lisbon Treaty of 2009. The description of this process also necessitates a presentation of the relevant institutions at the EU level of which CEIOPS and EIOPA are of particular importance.

Furthermore, the involvement and interests of other involved actors are presented. The interests of the Member States have varied significantly as a consequence of differences in domestic insurance markets. The non-governmental stakeholders which were involved in the process – represented by the insurance industry - are identified and accounted for as well.

The Solvency II process is traced through the following six distinct phases:

- 1999-2004 Solvency II – Learning phase: Preparations for the process*
- 2004-2008 Solvency II – Development phase: Consultations and expert advice*
- 2008-2009 Solvency II – The political phase: Co-decision procedure and trialogue*
- 2009-2011 The Financial crisis and the Lisbon Treaty: Significant external “shocks”*
- 2011-2012 Omnibus II – Pre-trialogue process: Adaptation to the Lisbon Treaty*
- 2012-2016 Omnibus II – Trialogue process: Long-term guarantee issues and trialogue*

The analysis of these stages is conducted from three separate perspectives, namely i) the knowledge-based perspective of epistemic communities; ii) the state-centric framework of liberal intergovernmentalism; and iii) the theory of multilevel governance. None of the frameworks applied provide a reasonable explanation for every part of the directive during all six phases. Yet, each has explanatory power for some part of the legislation during some

periods of the process. As might be expected, the development phase is best explained by the knowledge based approach whereas the dialogues resemble the bargaining between nation states predicted by liberal intergovernmentalism. Furthermore, evidence to support the MLG theory is to some extent identified throughout the process, particularly due to the heavy involvement of private insurance companies as providers of expert advice and as lobbyists.

The period of *the Financial crisis and the Lisbon Treaty* appears as a breaking point in the process after which the explanatory power of all three theories changed as follows:

- Epistemic communities: EIOPA which (it is argued) resembles an epistemic community, was set up as a powerful and (semi-)independent EU agency.
- Liberal intergovernmentalism: For many European Member States the financial crisis implied more pressing, and diverging, national interests which raised the stakes of the political process. Hence, the relevance of this perspective was increased.
- Multilevel-Governance: following the Lisbon treaty, the European Parliament gained increased powers and EIOPA was created. Hence, the independent influence of sovereign EU actors was enhanced.

Preface

The project of writing this Master's Thesis was conducted between January and December 2014 while being a full-time employee at DNB Skadeforsikring (Property & Casualty insurance). The chosen topic was motivated by my task and experience of working with Solvency II implementation in this organization. However, the project has been private and the opinions and conclusions of this paper are those of the author, and do not necessarily in any way reflect positions held by DNB.

I would like to thank the people who have had a direct impact on the result of this project. My supervisor Åse Gornitzka, Professor at the *University of Oslo*, and my co-supervisor Chris Lord, Professor at ARENA Centre for European Studies, have both been greatly helpful in provided me useful suggestions and constructive feedback. Furthermore, I want to thank the four anonymous interviewees who willingly participated in this study. They represent *Finanstilsynet (the Norwegian Financial Supervisory Authority)*, *Finansdepartementet (the Norwegian Ministry of Finance)* and the insurance company *Gjensidige*. I would also like to thank Sophia Javaid for having proofread the text and even more so for all her support throughout this project.

In a comprehensive study such as this, conducted with limited resources, some errors are unavoidable. Any such mistakes are the responsibility of the author alone.

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Tord Kopland Eid, Oslo, 18th of December 2014

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Contents

1	Introduction.....	1
2	The Field of Insurance	6
2.1	The Insurance Business Model	6
2.2	Insurance Regulation: The Aim of Solvency II	10
2.3	European Insurance Regulation	12
2.3.1	Rationale for European Wide Regulations	12
2.3.2	Solvency I	14
3	Introducing Solvency II	17
3.1	Towards a New European Regime.....	17
3.2	The Three Pillars	19
3.2.1	Pillar I – Capital requirements	19
3.2.2	Pillar II – Risk management and System of governance	22
3.2.3	Pillar III – External reporting.....	23
4	Three Theories for Three Hypotheses.....	25
4.1	Epistemic communities	26
4.2	Liberal Intergovernmentalism	29
4.3	Multilevel Governance.....	32
5	Methodology.....	36
5.1	Process Tracing Case Study	36
5.2	Data Sources.....	39
6	Solvency II: Process, Participants and Interests	42
6.1	Solvency II in the European Union	42
6.1.1	The European Union	42
6.1.2	EU Insurance Agencies.....	44
6.1.3	The Lamfalussy Process of Solvency II.....	47
6.1.4	The ‘Lamfalussy Process’ of Omnibus II	51
6.2	Varieties of the European Insurance Industry	53
6.3	Stakeholder Interests: Participation and Representation.....	57
7	Tracing the Solvency II Process	61
7.1	Solvency II – The Learning Phase: 1999-2004	62

7.2	Solvency II – The Development Phase: 2004-2007	62
7.3	Solvency II – The Political Phase: 2007-2009	65
7.3.1	Work Streams of the EP and the Council	65
7.3.2	Solvency II trialogue.....	68
7.4	The Financial Crisis and Solvency II	70
7.4.1	The European Wedge.....	71
7.4.2	The Insurance Industry: Low Return, Low Discount	74
7.5	Omnibus II: Pre-Trialogue Process 2011-2012.....	78
7.6	Omnibus II: trialogue Process: 2012-2014.....	79
8	Interpreting Solvency II	83
8.1	The Knowledge-Based Directive	83
8.2	The Bargained Directive	91
8.3	The Plural Directive	95
8.4	Summing up: A Comparative Analysis.....	102
8.5	Generalizations.....	106
9	Conclusion	108
	Bibliography	110
	Appendix: Interview guide	120

1 Introduction

Risk and uncertainty are inherent parts of all human activity. From the dawn of time, people have spent a great deal of effort attempting to limit the likelihood and consequences of external factors that may aggravate, or end, the lives of themselves or their loved ones. The various measures taken span through all kinds of inventions and precautions: From the construction of city walls and the development of stable sources of food supply in ancient times, to the medical vaccinations and financial derivatives of the present day. In other words, as expressed by Peter Bernstein (1998, p. ix), “the subject matter [of risk] is daunting. Risk touches on the most profound aspects of psychology, mathematics, statistics and history”. Risk, and attempts to reduce it, is everywhere around us.

All risk-mitigating initiatives mentioned above have the common motivation of making life and property less vulnerable. However, the most significant type of insurance applied by human beings is probably not any material artifact as much as it is other humans. Having children – or more broadly, making friends and allies - has probably been the most common strategy to ensure a safe and comfortable livelihood during the human lifespan. In the 20th century, this form of inter-human insurance was, in part, replaced by complex institutions. One example is the democratic welfare state system that has been a particular characteristic of many European societies following World War II. Another example, and the topic of this study, is the private insurance industry.

The historical roots of insurance activities are often traced to Chinese merchants who diversified by splitting their cargo between several ships around 3000 BC; or to guaranteed shipping loans in the Babylonian empire around 1800 BC. Most likely, there are many such historic examples from around the world, but the formalized operations of the business originated with the signing of the first insurance contract in Genoa, Italy, in 1347. The modern industry then really began developing in London, following the great city fire in 1666, and with the establishment of the first insurance company – Lloyd’s – in 1688. Since then, insurance has grown into one of the major businesses of the modern world. In 2012, the

European insurance industry employed about one million people and the written premium¹ was close to €1.1tr (Insurance Europe, 2014b).

For most customers, the services of the insurer are usually called upon as a consequence of an unfortunate incident affecting the life of the policy holder. Thus, for many clients, the relationship with their insurance company is characterized by low activity, if any. Yet, in developed societies, almost all inhabitants are customers of the industry, relying on the insurer to provide safety against economic loss or ruin. People are beneficiaries of the stability and safety which the industry brings about; enabling them to relax and/or take on more risks than they otherwise would, knowing that financial losses will be covered in the event of property or bodily damage. Furthermore, the insurance industry also affects society in another subtle, yet equally important way: (life) insurance companies are generally among the institutions in the world with most investments in financial assets. In 2011, European insurers had investment portfolios which amount to about €7.5tr (Insurance Europe, 2013b, p. 34). Hence, insurers are important investors and lenders for firms and governments in need of funding.

Thus, the importance of the insurance industry for the general development and stability of society can hardly be exaggerated. It should come as no surprise then, and we shall return to the reasons why in chapter 2, that the insurance companies of the developed world are also highly regulated. In Europe, the industry has been regulated through minimum prudential standards known as Solvency I, since the 1970s (van der Ende, Ayadi, & O'Brien, 2006, p. 61). However, as will be argued in the subsequent chapter, this framework was long ago deemed unfit for regulation of such an important industry in the 21st century and it is finally about to be replaced by a new, extensive and controversial regulatory regime: the EU directive of Solvency II. The development of this new directive – as well as amendments to it in the subsequent directive Omnibus II – has been an ongoing EU legislation process for over a decade that is finally set to take effect from the 1st of January 2016.

Solvency II will have, and has already had, a significant impact on European insurance and capital markets, and thus implicitly for the lives of hundreds of millions of people. Hence,

¹ Written premiums are the amount of money charged by the insurance company for a policy that has already become effective.

there are important empirical reasons why studying Solvency II is necessary. New phenomena carrying such far reaching implications are almost by definition interesting topics of study. Furthermore, the Solvency II case is also useful for testing the merit of theoretical frameworks of policy processes and in order to make contingent generalizations on European legislation and integration. In sum, studying this case is both interesting for its own sake and as a means of providing empirical feedback to theories.

In order to do so, however, the topic and the research design first needs further specification. The implications of Solvency II could easily be the topic of study in a variety of subjects, such as economics or finance. However, as Bjerke (2007, p. 3) wrote in his Master's thesis on the Basel II Accord, "as a student of politics, I am [...] more interested in how an economic policy is made, than its consequences". This is also the spirit of this thesis. Methodologically and in terms of theories applied, I will pursue a path similar to that of Bjerke. The subject of investigation, however, is moved from banking to insurance with the purpose of investigating the following:

Is the political process of the Solvency II directive best explained by expert knowledge; Member State interests; or by sectoral interests?

The question above is operationalized in terms of three hypotheses that can be interpreted in light of more or less compatible theoretical frameworks all of which relate to how EU legislation is conducted. In particular, these hypotheses are as follows:

The process and outcome of the Solvency II/Omnibus II legislation has been dominated by:

- H1.** *epistemic communities seeking to achieve an optimal regulatory regime from a knowledge-based perspective.* This hypothesis is related to the theoretical framework of epistemic communities, associated with Haas (1992) and Davis Cross (2013). If this hypothesis holds merit, it will imply that the Solvency II process has been developed according to the knowledge perspective. That is, it has mainly been produced by experts who are seeking to create an optimal regulatory regime which is devoid of special interests.

H2. *the interests, power and bargaining of the nation states.*

This hypothesis is related to the theoretical framework of Liberal Intergovernmentalism, associated with Moravcsik & Schimmelfennig (2009). If this hypothesis holds merit, it will imply that the Solvency II process has been developed according to the traditional state-centric interest perspective, that is by Member State executives seeking to influence the regulatory regime in accordance with the interests of their country.

H3. *a multitude of institutions and stakeholders with different interests.*

This hypothesis is related to the theoretical framework of Multilevel Governance, associated with (Trnski, 2005) and (Peters & Pierre, 2009). If this hypothesis holds merit, it will imply that the Solvency II process has been influenced directly either by non-state actors or by supranational institutions (at the EU level) operating independently of the Member States.

Most likely, reality is found to resemble some combination of these hypothetical explanations, but in order to examine the extent to which they hold explanatory power it is necessary to conduct a process tracing exercise. Through the process tracing, more concrete questions are to be explored such as:

- Who have been the crucial participants and stakeholders?
- What interests were these actors pursuing?
- Which forums were most important for decision making?
- Which topics were the most critical during the political process?
- What was the outcome of the discussions on the most controversial topics?

The aim of this paper is to answer these questions, and thereby shed light on the hypotheses outlined above. Ultimately, this will lead to some conclusions and generalizations on the paramount question.

This paper is organized in the following manner: In chapter 2, the insurance industry and regulation of this business is outlined in general whereas chapter 3 gives an introduction to the Solency II regulations and its consequences. This sets the background stage for the case that is under investigation. In chapter 4, the theoretical frameworks that were referred to above are outlined in detail. In chapter 5, the methodology of the study is presented. The analysis is conducted as a case study, applying the process tracing method and the data is acquired through semi-structured elite-interviews. The reasons for, and implications of, these choices are further elaborated in this chapter. The process tracing investigation starts in chapter 6 which contains a presentation of the theoretical political process, as well as the participants and stakeholders involved. In chapter 7, the empirical political process – in particular the key conjunctures - are examined. Chapter 8 brings the pieces together by discussing the process in terms of the theoretical frameworks: is Solvency II a *knowledge-based* directive (epistemic community); a *bargained directive* (Liberal intergovernmentalism); or a *plural directive* (Multilevel Governance)?

2 The Field of Insurance

Although the insurance industry is well known to the average citizen of most developed countries, the complexities and variations of the insurance business model – let alone the motivations for regulating the industry - are not straightforward. The aim of this paper is not to give a textbook account of insurance theory. However, the directive, and the political process, of Solvency II can hardly be understood without some familiarity with the industry that is to be regulated. Therefore, this chapter is dedicated to providing such fundamental knowledge through a discussion of the insurance business model. Next, we turn to why the insurance industry needs to be regulated in the first place and thus also define the aims of the Solvency II directive. The final section gives an outline of the reasons why pan-European regulation is beneficial in this case.

2.1 The Insurance Business Model

For companies in most industries, the operational risks of their daily production activities are usually regarded as unfortunate side effects of the activities required to provide their customers with goods and services. For the financial sector, in particular banks and insurance companies, risk is more than just a negative side effect. In these industries, the business model *is* risk (de Weert, 2011). The general idea is to charge the customer a fixed or floating – controllable – fee, and in return to take over a particular risk to which the customer is exposed. For insurers, the payment is usually obtained from the customer in advance, and repaid only if the life- or property-insurance risk were to materialize. That is, the risk that the customer will put forth valid claims due to damage on life or property, or, in the case of pension products, that the customers live in retirement (i.e. entitled to pension benefits) for several decades.

The insurance industry is divided in two parts by legal requirement: The life insurance industry and the non-life² industry. In general, the former offers insurance that will prevent the customer from living without income for significant parts of their lives (due to bad health

² Also known as Property & Casualty or general insurance.

or during retirement). The latter offers compensation for damage to (or caused by) cars, property, home content etc³.

One distinction between the industries is that non-life generally pays compensation as a lump sum. Life insurers, on the other hand, more commonly offer products through which the customer may receive installments for extensive periods of time. However, what is perhaps the most important difference between the two types of insurance business is the average length of risks. In the non-life industry claims are usually settled within a few years. The life insurance business, by contrast, is characterized by products with long lasting risk exposures. This means that it may take several decades before the complete claim of a policy – and thus the profitability of a particular customer – is known. For example, a life-insurance transaction for a pension product may last from the first premium payment of the customer during his first working year until the customer dies and stops receiving retirement compensation at an old age. As an illustration, note a typical cash flow profile (i.e. the expected future liabilities) of a typical life insurance undertaking:

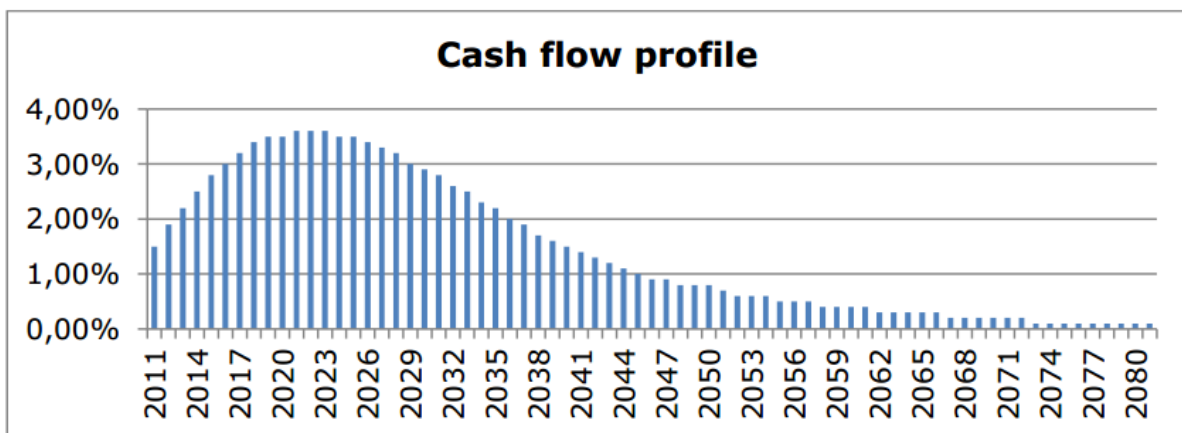


Figure 1: Cash flow profile of a typical (German) life insurer: Expected share of payments to current customers in future years. BaFin (2013, pp. 43-44).

The significant time span between the present day premium payment from the customer and the future disbursement of funds from the insurer to the customer has some very important implications. In particular, it holds clues as to why regulation of the insurance industry is necessary. To understand this, consider the following question: with expected claims still in

³ See (CEIOPS, 2009b, pp. 6-8) for an overview of all lines of business (LoB) in Solvency II.

the future, how should the insurer treat the income gained from premium payments already obtained? Aside from covering operational costs, there are essentially two options. One option is to regard the income as financial surplus and thus pay the obtained premium, less operational costs, to the shareholders (owners) as dividend. Clearly, regarding all paid premium as income is in essence equivalent to an assumption that there will be no future claims (e.g. that none of those saving for retirement will live past the retirement day to receive pensions). Surely, no rational customer would want to purchase insurance from a company that was making such assumptions. In fact, this is no more than a theoretical possibility resembling fraud rather than insurance. It is clear then that for an insurer to be able to cover future expected claims, only a limited share of the aggregate premium income received from the customers, in any given year, may be regarded as profit. Thus, the second option, which is to set aside a significant share of (or all) the paid premium as *reserves*⁴, is the choice made by all serious insurance companies. Reserving is a fundamental activity in insurance and it is the key competence area of the mandatory actuarial function.

Hence, for an insurer to underestimate the frequency and size of future claims would be reckless, and sooner or later lead to bankruptcy and inability to honor the commitments which the customers have already paid for. However, the risk that the claims will surpass the premium paid by the customer, not only depends on whether the insurer sets aside *sufficient* reserves. It also depends on how those reserves are *handled* by the insurer in the years and decades that may pass by prior to the payment of compensation to the customer. Indeed, the importance of the latter matter – market risk - increases with the time span of the insurance contract, so that for life insurers in particular this is a crucial question. Several options are open to the insurer as to how the premium funds – the assets under management – are to be invested. The options are usually between different classes of financial assets, each of which is associated with a unique trade-off between risk and return.

⁴ Also called *Provisions*

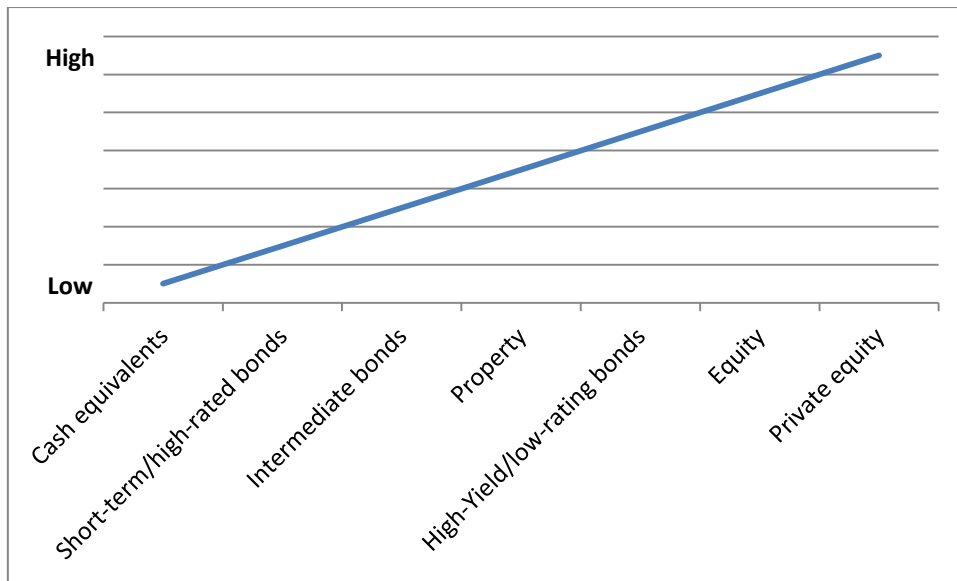


Figure 2: Simplified illustration of risk & return expectations for selected asset classes

As the table above demonstrates, equities (shares) are generally regarded as risky in the sense that the value of any given asset may decline a lot over a short period of time. However, the flip side of the coin is that this asset class is also associated with a high expected return over the long run. Investment-grade bonds⁵ and interest rate assets, on the other hand, are generally regarded as safe and stable, but the corresponding expected return is low. Hence, to clarify with an example, an insurer could set aside a sufficient amount of reserves to cover the future claims, but in turn invest the funds in equities and risk losing a significant share of the provisions in the event of a stock market crash.

Clearly, for the customer, there is not necessarily any guarantee that he will receive the compensation he is entitled to after having paid the insurance premium in the past. Why then is insurance purchased voluntarily, in large amounts, by people all over the world? It appears safe to infer from this that insurance companies are not regarded by the general public as reckless risk takers. People expect that they will receive a pension from their employer's life insurance vendor. They expect to receive compensation if their house burns to the ground. Part of the answer, in the terminology of game theory, is that the insurance business is a dynamic game. Any insurer selecting to regard all premiums as income would soon obtain a very sketchy reputation. Hence, any strategy by a company to ignore the future claims in exchange for profit would surely be a very short-sighted one. Through competition, the

⁵ Rating no lower than BBB from any of the three rating agencies; Moody's, S&P and Fitch

players of the insurance markets are competing to offer the lowest price, relative to quality. For insurance customers, quality consists to a great extent of the trust that can be placed in the insurance provider when it comes to the latter being able to cover its liabilities.

Given that the incentives of insurers to honor their commitments to their customers are generally amplified by the dynamic and competitive forces of the market place, one might ask why regulation of the insurance industry is necessary. After all, it is the individual insurance company that holds the expertise and, presumably, knows the portfolio and company risks better than any outsider. However, as will be argued in the next section, the nature of the unregulated insurance market is such that the reasons for government intervention in this industry are persuasive.

2.2 Insurance Regulation: The Aim of Solvency II

According to the de Larosi re report on financial regulation in the EU (2009, p. 13), regulation is “the set of rules and standards that govern financial institutions”. Any kind of such regulation undeniably implies costs: The regulatory rules have to be constructed and decided. Time and money - that otherwise could have been applied to profit generating activities - must be spent by the insurer in order to understand and implement the regulatory regime. The latter may well force the company to make sub-optimal or irrelevant decisions from a business perspective, as industry regulations to some extent will be general and, almost by definition, not tailor-made for any particular company. Last but not least, the regulation must be monitored and any potential implementation failures by the companies need to be associated with some sort of costly sanctions. Given these costs that are associated with regulation of the insurance industry, a strong rationale for doing so in the first place is required. In other words, it is necessary to establish what the aim of Solvency II is and why the unregulated insurance market (without either Solvency I or II) is not desirable. This section thus provides an essential basis for the analysis that will lead to an answer to the overarching question.

Traditionally, the case for regulation of an economic industry is based on market failure, which means that the unregulated market leads to an outcome that is not Pareto-optimal. A

Pareto-optimal state, namely a situation in which no one can be better off without at least one other market participant being worse off, is a desirable situation which is reached in the theoretical, unregulated market. Making such an outcome come about is often the purpose of government regulation of firms and industries.

In contrast with the traditional textbook example of market regulation, the Solvency II regime is not so much about making the insurance market function optimally, as it is about other objectives. One such objective is the harmonization of legislation in order to avoid regulatory arbitrage. For example, since the insurance industry is closely linked with the banking sector⁶, it is important that legislation is consistent between these industries (Norwegian Ministry of Finance, 2014 [Interview]). Second, a core regulatory aim in insurance is to avoid the costly knock-on effects of insurers going bankrupt.

Bankruptcy is a necessary and crucial part of the capitalist economic system. However, in the case of the unregulated insurance industry, such incidents may often affect the lives of the unprofessional creditors – namely the customers – to such an extent that they experience great financial difficulty and even poverty. With some contracts lasting for several decades (as discussed above), the market mechanism works too slowly to apply the necessary constraints on the (life) insurance industry.

It can be assumed that most people would consider it unacceptable that sick or elderly citizens, who were unfit for work, were forced to live in poverty because their insurer had failed to set aside sufficient reserves. Most likely, the political pressure for social benefits would increase. In particular, for a society with a significant welfare state, the burden induced by a failing group of insurance companies would soon appear as an externality⁷ as it was shifted to the innocent tax payer. For this reason in particular, it should come as no surprise that governments want to control the insurance industry and avoid insufficiencies in pricing, reserving and general risk management.

In sum, it is clear that the main regulatory aim of Solvency II is to avoid bankruptcies by enforcing risk management and capital requirements on the insurance companies. This is to

⁶ Often banks offer insurance products and vice versa

⁷ Costs or benefits that affects a third-party that did not choose to incur that cost or benefit

be achieved by ensuring that every insurer maintains a level of capital which corresponds to the risk exposure of the company. In insurance, as in banking and related financial sectors, the regulatory aim is focused on anti-bankruptcy as a result of the potentially vast economic and political consequences that follow when large financial institutions break down.

2.3 European Insurance Regulation

Although the case for regulation of insurance markets in general is a strong one, this does not necessarily explain why the regulation should be pan-European. Thus, the reasons why this is desirable are examined in the first subsection. Next, the current, non-harmonized, regulatory regime of the European insurance industry (Solvency I) is outlined, elaborating the most commonly identified flaws of this set of regulations. Lastly, we investigate how the new regime (Solvency II) is designed with the purpose of resolving these ‘flaws’.

2.3.1 Rationale for European Wide Regulations

The European Union and the European Economic Area (EEA) currently consists of 31 independent states, each of which is characterized by a unique national economy, social security system and insurance market. In order to supervise and regulate these markets, in every country there is also an independent and sovereign national insurance regulator. The implication is that the insurance markets in the EEA are regulated in 31 different ways. There may well be advantages to such a system in which decentralized regulators, aware of the culture and local characteristics of their domain, define the rules of the game in their homeland. However, as in any process of European integration, whatever these advantages of national regulation may be, they are supposedly matched by those of the pan-European regulatory regime.

In a paper on European securities regulation, Yannis Averinos (2003) discusses several rationales for a single European regulator that applies to the insurance market as well. Firstly, there are arguments relating to the efficiency and the quality of the regulator. Regulation is a service which implies significant fixed costs. The initial costs of setting it up is high, but once

a law or a regulatory framework has been created, it may be repeatedly used by an unlimited number of users. Thus, as the market grows in size, the expenditures of regulation and supervision do not increase proportionally. This implies that a single and centralized regulator may perform its role much more efficiently than what may be expected from 31 regulators each supervising a specific share of the total market. Furthermore, according to Averinos (2003, pp. 28-29), “Any existence of multiple supervisory agencies and different regulatory regimes entails the possibility that powerful interest groups may impede any national or cooperative supranational developments”. In other words, it is reasonable to assume that a larger supervisor, relative to the companies, is more likely to be able to resist *regulatory capture*⁸. Particularly, this may be an issue in countries that are hosts to large insurance groups, especially if the national economy as a whole is dependent on the decisions made and the general performance of this insurance company. Another example could be domestic companies that are favored in competition with branches of foreign companies operating in the same country. In order to avoid such unfortunate biases, a centralized European regulator – disengaged from any single national economic interest – may certainly be beneficial.

Secondly, a single European regulator is a necessity in order to maintain the same regulatory framework, i.e. a *level playing field*. Identical rules across Europe are highly beneficial for insurers operating in multiple countries. For example, costs required to understand and implement the rules of every national regulator are avoided, thus providing incentives to enter new national markets. In turn, these benefits affect the insurers as well, as more markets entrants imply – *ceteris paribus* - increased competition and reduced prices. Furthermore, insurance customers moving from one European country to another can feel confident that the regulatory regime maintains the same standard in both nations.

Thirdly, the lack of cross-border financial supervision was identified as a key flaw in the financial system which made the European regulatory regime unable to respond efficiently to the financial crisis in 2008-9 (de Larosi re, 2009, pp. 10-11). As the global economy, including the European market, becomes increasingly defined by globalization and

⁸ Regulatory capture happens when a regulatory agency, formed to act in the public's interest, eventually acts in ways that benefit the industry it is supposed to be regulating, rather than the public (Investopedia, Investopedia, 2014).

commercial intercourse, it is evident that economic crises are rarely confined to a specific country. Rather, the causes and consequences are bound to be international, thus highlighting the need for cross-border cooperation in regulation and supervision. In particular, there is a great need for regulation of groups operating in different countries; with the purpose of ensuring that group-wide risks are not overlooked as such large multinational groups make up a significant share of the European insurance market. In addition, a pan-European regulator should be able to acquire information, and develop skills, that surpass that of any smaller and less informed national supervisor (Everson, 2012, p. 9).

Lastly, a common regulatory framework will most likely induce economic interdependence as the complexities that come with cross-border operations are reduced. Hence, the development of a European regulatory regime is also a movement towards further European integration and the common market. Hence, it can be argued that pan-European insurance regulation is also an indirect contribution to the declared aims of the European Union which includes peace, security and free and fair trade (European Union, 2014). In other words, Solvency II is a project much in the tradition of creating a unified Europe by abandoning the many national variations that exist under the current regulatory regime.

2.3.2 Solvency I

Solvency I is the regulatory regime of the European insurance industry currently in operation. However, this framework was neither consistently planned nor developed in the manner of the current Solvency II process. In fact, even though Solvency I consists of 14 directives from the 1970s, it was only in 2002 that it was adapted into a uniform directive (Wood, 2004). The opinion that Solvency I is inadequate as a regulatory regime is widely shared among the top-level stakeholders of the European insurance industry, such as the interest organization *Insurance Europe* (2007) and by the European Commission (Barnier, 2011). According to *Insurance Europe*, in some cases, the current rules of Solvency I can even conflict with good risk management (*Insurance Europe*, 2007, p. 3).

This consensus exists in spite of the fact that there have been relatively few cases of insolvencies and bailouts in the European insurance industry over the past decades, for example relative to banks. Part of the explanation for this is that there are no close business

links between insurers. Thus, unlike the banking sector, the risk that other insurers were to follow if one was in trouble is low. In other words, one can hardly speak of the existence of an “insurance system” through which financial stress can spread (Insurance Europe, 2014d, p. 31). Nonetheless, insurers are certainly at risk of failure as well. For example, in the Sharma report, 21 cases of insurance failures, or near failures, between 1997 and 2002 were analyzed as a preparation for the Solvency II process (Sharma et.al, 2002, p. 23). Furthermore, there were indeed some cases of insolvency during the financial crisis of 2008-09⁹.

Although Solvency I has done a fairly good job of protecting consumers, it does so through exorbitant prudence and an “inefficient allocation of capital which prevents insurers from taking on more risks” (van Hulle, 2011, p. 179). Hence, even though the current regulatory regime has been able to fulfill its main purpose to a large extent, it has achieved this through means that are inefficient and crude as the capital buffer insurers have been required to maintain have not corresponded well to the actual risk exposure of the company. In this regard, the flaws of the old regime are numerous: First, only insurance risk is taken into account when the capital which is the insurer is required to hold is determined. Furthermore, even though the question of whether there are sufficient reserves to cover future claims is taken into consideration, this is done only in a very simplistic manner and there is no distinction between different insurance products. Second, and very important for our purpose, the insurance liability exposure is calculated based on book value (historic value) so that changes in the market values and the interest rate are not taken into account in the valuation process. Third, the question of how these funds are allocated (market risk) is not taken into account at all. Thus,

Under existing European rules, volatility and uncertainty in the estimated value of liabilities is addressed in a way that often does not reflect the underlying risk. Insurers are obliged to include additional, undefined prudence in their valuation of liabilities, coupled with simplistic capital requirements (Braun, 2007).

Fourth, Solvency I is meager when it comes to requirements for reporting, risk management and forward looking assessments. Finally, the current regime is not harmonized across the

⁹ In particular, five Greek insurers were shut down in September 2009 (Tsentas, 2010), and several insurers in the Netherlands, Belgium and Luxembourg – such as AEGON, ING and Fortis were in need of government support during the economic downturn (Woolner A. , 2010)

EU. Thus, for example, the method for valuation of insurance liabilities or the risks entailed with the allocation of capital is treated differently by the individual national regulatory authorities, implying that there is not a single European market for insurance (van der Ende, Ayadi, & O'Brien, 2006, p. 60).

The implication of these issues is that European consumers and insurance companies miss out on the benefits of pan-European regulation listed earlier. Furthermore, although the insurance industry has not been blamed for causing the crisis (Barnier, 2011), general financial uncertainty has nonetheless increased the pressure on financial institutions in general to prepare for future crises. In sum, both for theoretical and empirical reasons, Solvency I – with its flaws and inadequacies – is unfit as a regulatory regime of the 21st century. The case for developing Solvency II is therefore a strong one.

3 Introducing Solvency II

This chapter is organized as follows. First, the development from Solvency I to Solvency II is outlined. Second, the content of Solvency II is presented through the simplified, yet pragmatic, three pillar system. Third, the consequences of the regime for the insurance industry are discussed.

3.1 Towards a New European Regime

In a historical perspective the harmonization initiative of the European insurance markets stems from June 1988, when the industry was liberalized and cross-border competition allowed for (Meek, 2013). During the 1990s, the existing regulatory regime was evaluated and deemed unfit for its purpose. Preparations for the new regime were launched by the European Commission around year 2000 with the aim to “establish a solvency system that is better matched to the true risks of an insurance company” (KPMG, 2002). However, it was not until 2004 that the Solvency II process really began, with an “overhaul process for insurance regulation; aiming for completion by end-2008” (Meek, 2013).

After five years of development, extensive consultations and delays, the Solvency II directive text was finalized and adopted by the European Parliament and the European Council on the 25th of November 2009 (van Hulle, 2011, p. 177). The adoption implied the most significant regulatory initiative ever directed towards the insurance industry, although it was clear that many challenges remained when the legislation was to be specified further in the implementing measures. At the time, the directive was scheduled to come into force in November 2012, but this would turn out to be only one of several exceeded deadlines.

Early on it was clear that alterations would need to be made in the directive text. The implementation date was first moved back to January 2014 in the “Short Directive” in July 2012, but the really significant changes were to be advanced through the Omnibus II (OII) directive which was proposed by the Commission in 2011. The OII directive’s aim was to “adapt the Solvency II Directive implementing measures to the new architecture introduced in the Lisbon Treaty (2009) and the new financial supervision” which included the establishment of the European Insurance and Occupational Pensions Authority (EIOPA)

(Chairman of EIOPA, 2013). On a more technical level, the OII directive implied some significant changes to the Solvency II directive text, and this need was significantly increased by the consequences of the financial crisis which changed the conditions for insurers across Europe. OII also implied a delay of Solvency II when it was first published.

When Solvency II replaces Solvency I in 2016 it is not entirely accurate to refer to the former as “the new regime”. In fact about 35 per cent of the articles are continuances of the past regulations that are also part of Solvency I (Kristiansen, 2014, p. 4). Nonetheless, the differences that are brought about by Solvency II are vast, as the aim has been to deal with all the weaknesses of Solvency I mentioned above. The implication is that the future insurance regulations to a greater extent will seek to align capital requirements with the underlying risks to which the individual insurer is exposed, so that if risks are to materialize and lead to financial losses, the insurer should not so easily go bankrupt. Furthermore, the directive demands that insurers have appropriate risk management and reporting systems in place. The ultimate aim then, is protection of the insurance customers through better risk, reserving and pricing capabilities and hence fewer bankruptcies. This is all in addition to a harmonized supervisory approach across the EU, entailing the theoretical benefits of the single regulator identified above (Insurance Europe, 2007, p. 11).

The key differences between the current Solvency I regime, and the planned Solvency II regulations, can be summarized as follows:

Topic	Solvency I	Solvency II
Valuation of assets and liabilities	▪ Valued at (historic) book value	▪ Valued at (current) discounted market value
Capital requirements	▪ Calculated as a percentage of the insurance liabilities	▪ Statistical calculation taking more risks into account ▪ Standard model or Internal model
Market risk	▪ No impact on capital requirements	▪ Capital requirements depending on risk of asset portfolio
Operational-, counterparty- and disaster risk	▪ No impact on capital requirements	▪ Included in capital requirements calculation
Risk management and regulatory reporting	▪ Limited	▪ Extensive
Life and non-life insurance regulation	▪ Separate regulation	▪ Joint regulation
Insurance liabilities – Level of detail	▪ Homogeneous: Limited variation between lines of business	▪ Heterogeneous: Risk exposure varies with the line of business

Table 1: Overview of differences between Solvency I and Solvency II

3.2 The Three Pillars

The Solvency II level 1 text consists of 312 articles and seven annexes (Council, 2009).

However, like Basel II, the directive is usually presented in the more pedagogic form of three interconnected pillars that are outlined in this section.

3.2.1 Pillar I – Capital requirements

Solvency II is a regulatory system that has the company balance sheet as basis for the risk and capital evaluation. Simply put, a balance sheet is a snapshot of the financial status of a specific company, identifying what the entity owns (assets) as well as what it owes (liabilities). The latter is split between debt (held by creditors) and equity (held by the owners of the company). A regular insurance balance sheet may be depicted as follows:

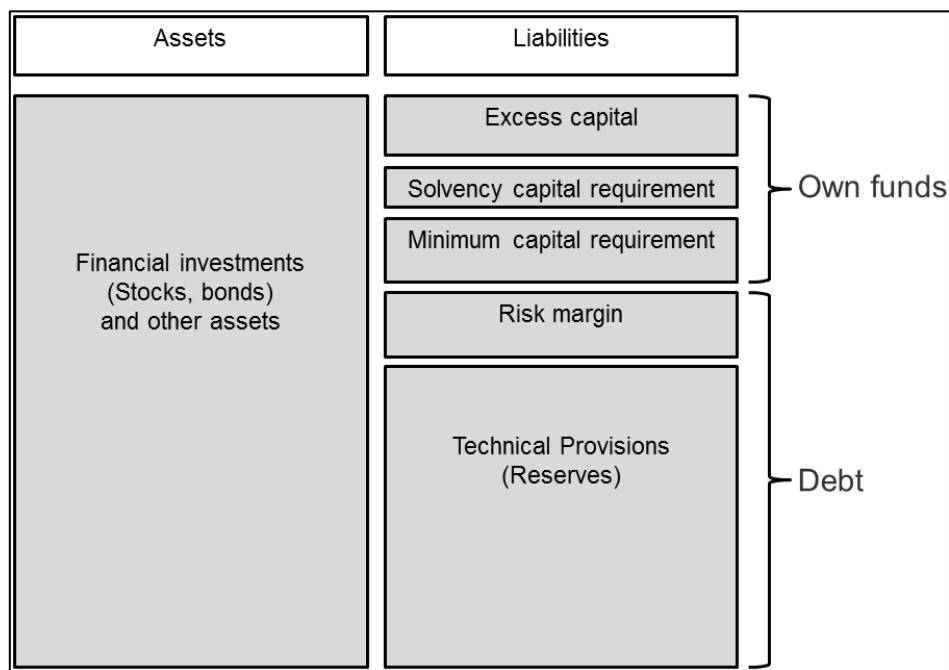


Figure 3: Solvency II – typical insurance balance sheet

A basic understanding of the balance sheet is crucial if one is to grasp the political discussions of the Solvency II process. First, note that the balance sheet is an equation that must always hold:

$$(1) \quad \text{Assets} = \text{Debt} + \text{Own Funds}$$

This may be rewritten as:

$$(2) \quad \textit{Net assets} = \textit{Own Funds} = \textit{Assets} - \textit{Debt}$$

Insurers are required to be financially solid and to maintain an own funds¹⁰ base which is proportionate to the risk exposure of the company so that the company does not face bankruptcy. This is the result when (2) is negative and may happen for various reasons: Either the value of the assets may drop (e.g. if the stock market declines), or the debt may increase (e.g. if more houses burn down or if people live for longer than expected). Whether an insurer in fact does go bankrupt in such events depends to a great extent on the amount of own funds held in the company. The higher the share of own funds, the less liabilities are owed relative to the amount of assets. Hence, the capital of a company works like a buffer which reduces the likelihood of bankruptcy.

The flip side of the coin, however, is that capital is costly. The owners of the firm prefer to hold as little of it as necessary in the company, in order to get the highest return possible. However, the levels of capital that the owner regards as acceptable, may well differ from what the government regulator (or the enlightened consumer) is comfortable with. As discussed above, the failure of an insurer may imply significant externalities in terms of poverty. The regulator's solution is simple: a 'floor' above which the insurer needs to maintain its level of capital is established. Under Solvency II, there are two such floors known as the Solvency Capital Requirement (SCR) and the Minimum Capital Requirement (MCR). Essentially, quantifying these figures is the main purpose of Pillar I. This task raises several important questions:

- i) How are the individual elements in the balance sheet to be valued?
- ii) How risky/volatile are the elements that are valued in i)?
- iii) How is the Solvency Capital Requirement to be calibrated in order to reflect this?

Giving complete answers to these questions goes beyond the scope of this essay. However, due to its importance for our purpose¹¹, the logic of valuing the provisions should be noted. According to the methodology of Solvency II, future insurance liabilities are discounted. This

¹⁰ Also called capital

¹¹ it was a major part of the political debates.

Each module in this image represents a mathematical model based on pre-set assumptions and parameters aiming to calculate the amount of capital that the insurer should expect to lose once in 200 years¹³. This model applies to all insurers across the EU, and the standard model is thus a one-size-fits-all approach which is generally thought to be conservatively calibrated. However, one may still opt for the lengthy and complex optional process of building a tailor-made internal model for a particular company. In essence, this allows the insurer to determine its own capital requirement, as long as the process through which this is calculated is approved by the regulator (Gjensidige, 2014 [Interview]). However, this approach is in reality reserved for larger insurers, more well-endowed with the analytical resources that are required to build such a model.

3.2.2 Pillar II – Risk management and System of governance

This part of the directive contains new requirements regarding the internal control systems of the companies. Every insurance company should have a formalized system of governance, meaning that the policies and guidelines of important operational areas are documented, approved by the board and utilized in the organization. Furthermore, the insurance companies are required to “appropriately implement the following key functions: risk management function, compliance function, internal audit function and actuarial function” (EIOPA, 2013). These functions ensure that important tasks and activities in the remainder of the organization are performed according to the formalized procedures and that the risk exposure is within acceptable levels.

In addition, Pillar II also contains requirements for the Own Risk and Solvency Assessment (ORSA) process. Under this part of Solvency II, insurers are required to perform a self-assessment analysis of its risk exposures, risk management system and capital requirement. The process is to be performed at least annually, and shall include an evaluation of all the risks that the insurer is exposed to, whether or not they are included in the Pillar 1 model. The optimal ORSA process is a continuous process through which the insurance company

¹³ Level of significance equal to 99.5 %

identifies its risk profile and the capital situation of the company, both at present and for the next three to five years. Typically, such a process is depicted as follows:



Figure 5: Example of a general ORSA-process

At the end of the ORSA process, an extensive ORSA-report is to be produced and disclosed to the regulatory authorities.

3.2.3 Pillar III – External reporting

The requirements for submission of information to the national authorities are significantly increased compared with Solvency I. Under Solvency II, insurers are required to submit three types of reports:

- **Quantitative Reporting Templates (QRT):** For most companies 30-60 (in some cases extensive) QRT's shall be submitted to the authorities on a quarterly basis to give detailed information on the balance sheet, capital requirements, assets, provisions and so on.
- **Solvency and Financial Condition Report (SFCR):** This report shall contain essential information on the solvency and financial condition of the undertaking and is to be disclosed in public for anyone to access (CEIOPS, 2009a). This report most likely is to be produced annually.

- Report to Supervisor (RTS): This report will contain all the regularly reported information necessary for the purposes of supervision, within a private document sent to the supervisory authority (CEIOPS, 2009a). The frequency is likely to be less than annually.

The amount of data that are to be reported to the regulator in the QRTs on a quarterly and annual basis is a concern, particularly for smaller companies. The scale of the reporting is, however, only part of the challenge. Perhaps more demanding is the consistency requirements: the data that shall be reported is usually stored in different sources and based on complex calculations. However, a successful completion of the QRTs implies that all figures are consistent and add up in the final report. In order to handle such requirements, expensive and complex IT systems and external assistance is necessary for most insurance companies. Thus, achieving compliance with the regulatory framework in this regard implicitly puts strict requirements of professionalism and formalization on the insurers.

4 Three Theories for Three Hypotheses

In the previous chapters, the fundamentals of the case in question have been accounted for. It is thus time to proceed with the “tools” that are to be utilized in the analysis. In this chapter the theoretical basis is constructed. In the next, methods and sources of the study are presented and discussed.

The social sciences, as opposed to the natural ones, are characterized by the fact that they deal with human action. The implication is that the complex reality which is to be understood and explained is unfit for the “perfect” experiments of natural science in which the hypothesized causal relationship may be isolated from other potential factors. Hence, progress in social science rather needs to come about through the continuous, imperfect interaction between theory and empiricism.

A theory in political science is an abstraction of a defined, isolated phenomenon or causal relationship. The theories are rarely, if ever, completely true or false. Rather, they usually reflect on some part of reality and are useful in order to conduct empirical studies which, in turn, give feedback on the validity of the theoretical framework. Thus, caution must be applied when interpreting theories and their purpose has to be taken into consideration. In short, the potential purposes of applying theories in a case study like this may stem either from realism or analyticism (Hvidsten, 2014, p. 201). Based on this understanding, the following applications of theories are all relevant to some extent for this case study:

1. **Stability:** theoretical frameworks ensure a stable context against which the ever changing reality may be interpreted (analyticism).
2. **Structure:** theoretical frameworks provide the empirical researcher with guidance for specific and selected aspects on which to focus attention (analyticism).
3. **Evaluation:** theoretical frameworks support the assessment of the consistency between assumptions and reality (realism).
4. **Testability:** given that the theories are testable, they allow the researcher to assess the theoretical validity based on empirical investigations (realism).

Thus, a theoretical basis is crucial for any empirical investigation. In this paper, three theoretical frameworks – each related to a hypothesis outlined in chapter 1 - are applied and will provide the basis for the analysis of the empirical material. Several theoretical frameworks may potentially shed light on the question of what drives policy processes and outcomes. However, the three frameworks in this case are selected in order to capture the most important actors involved, as well as to highlight the distinction between knowledge and interests as the driving forces of the political process. The role of the expert is concretized by the theory of Epistemic Communities, whereas the approach of Intergovernmentalism represents the more traditional interests of the nation state. Lastly, the Multilevel Governance perspective focuses on the complexity of various stakeholders that are involved in the EU legislative process and evaluates the extent to which they influenced the process, if at all.

In sum, these three theoretical explanations of policy change and their associated hypotheses are outlined in the subsequent sections. The aim is to provide a general understanding of each perspective, as well as to indicate their relevance in the Solvency II process. This is achieved by the operationalization of each of the three hypotheses into six – more easily ‘testable’ - sub-hypotheses. Furthermore, it is indicated how these hypotheses are to be assessed in chapter 8.

4.1 Epistemic communities

In a theoretical, optimal situation, omnipotent and benign experts would create the regulatory regime and implement this in all member countries without adverse influence from Member States or stakeholders with special interests. This would lead to a framework which induced insurance companies to organize themselves in such a way as to maximize the value created by the industry as a whole. Obviously, such circumstances are not going to come about in the complex reality. Experts are never omnipotent or (completely) without interests or prejudice, and proving that this was so would in any case not be possible. In a political process such as Solvency II, most of the actors attempting to influence the process will represent special interests, whether these origin nationally, in the insurance industry or elsewhere. However, this does not mean that certain actors or institutions involved cannot aim to be such

knowledgeable and neutral experts. To the extent that such participants exist in a political process, they can be of key importance for the development of a successful regime.

The perspective of epistemic communities is based on the view that experts with common goals and knowledge impact policy processes. Davis Cross interprets epistemic communities as “networks of experts who persuade others of their shared causal beliefs and policy goals by virtue of their professional knowledge” (2013, p. 142). By influencing states and other relevant stakeholders, the hypothesis of this theory is that the policy outcomes are shaped by information and expert opinions of causal relations, rather than by power struggles and interests. This approach is usually traced to Haas (1992) who defines the epistemic community as “a network of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue-area” (Haas, 1992, p. 3). The epistemic community approach is – in contrast with the interest based theory - associated with strive for Pareto-improvement and plays a role of policy coordination. According to Adler & Haas (1992, p. 371), epistemic communities influence policymaking by creating expectations in an evolutionary process consisting of policy innovation, diffusion, selection and persistence.

In order to investigate whether H1, stated in chapter 1, has merit, we first need to examine the following sub-hypothesis:

H1.1 Epistemic communities – aiming to create an optimal knowledge-based directive - have existed, and are possible to identify, in the Solvency II process

If we are to identify such epistemic communities, these communities must be distinguishable from other actors. In essence, the task is to identify non-political communities that participated in the development process and were uncoupled from special interests.

Hence, it is necessary to define the characteristics of what is to be regarded as an epistemic community. Fortunately, criteria that enable us to do exactly that are already developed by Haas (1992, p. 18). In particular, Epistemic Communities vs. other types of groups and political actors may be distinguished along four separate dimensions maintaining that epistemic communities have:

1. *Principled beliefs*: Share normative beliefs within the relevant issue area. This entails a high degree of internal consensus within the group, on which outcomes are desirable, and which are not.
2. *Causal beliefs*: Share a set of causal beliefs, which define how the members perceive links between possible policy alternatives and desired outcomes.
3. *Knowledge base*: Professes a shared notion of validity, having internally defined criteria for weighing and validating knowledge.
4. *Interests*: Share a common policy program. A shared set of practical responses to a particular problem. It is around this policy program all activity of the epistemic community centers. Members are motivated by the desire to see the policy program realized, not by the prospect of private material gains.

Thus, these are the four criteria against which any potential candidate of an epistemic community should be evaluated. Once it is established whether or not epistemic communities did in fact take part in the Solvency II process, this is clearly not sufficient either to support or to falsify H1. Thus, in order to do so, it also needs to be established that:

H1.2 The opinions and recommendations of the identified epistemic communities prevailed at important conjunctures of the Solvency II process

It is through the investigation of this hypothesis that the methodology of process tracing (elaborated in the subsequent chapter) really comes to the aid of the current study. By analyzing the normative and causal policy process and thereby understanding how the end result came about we may comment on the influence of epistemic communities.

As a next step, it will then be helpful to evaluate whether the conditions of this case are such that epistemic communities are likely to be persuasive in general. Davis Cross (2013, p. 144) has assembled a set of criteria that may be applied in order to determine whether or not this is the case. These conditions, further specified in chapter 8, states that the influence of epistemic communities varies depend on:

- i. Scope conditions: Complexity and controversy of the issue at stake

- ii. Political opportunity structure: Ability to access top decision makers
- iii. Phase in the policy process: The stage which it attempts to influence
- iv. Coalition building: The level of internal coordination and the level of coordination in competing groups
- v. Policy field coherence: The extent to which the issues at stake is technical and scientific in nature

Once it is established whether it is likely that the epistemic communities defined above have had influence, it is time to consider whether they actually influenced the process. First, the different stages of the process in which epistemic communities could have an impact, and in what way, must be identified. Second, the opinions and recommendations of the epistemic community are to be outlined. Third, the activities of the Community is traced, especially at important junctures of the process. Forth, it is examined whether any epistemic community identified under H1.1 did in fact have an impact on the policy outcome, or whether there are alternative explanations or solutions. If the latter is in fact the case, then there should also be some causal links between the outcomes and the objectives of the epistemic community.

4.2 Liberal Intergovernmentalism

In the traditional Realist theory of International Relations, the state is interpreted as the central actor of international politics. States act in line with their national interests and non-governmental actors and institutions have a secondary role, if any. What matters is the power play between the official representatives of the nation states. Along the same lines, the state centric approach of *Intergovernmentalism* sees the European Council as the core of the EU, whereas the other institutions – such as the Commission and the European Parliament – are little but coordinators and facilitators for the states, with insignificant ability to influence EU policy processes independently (Moravcsik & Schimmelfennig, 2009, p. 68). Thus, in this sense, the EU is first and foremost an organizer of negotiations between states that use European institutions to achieve their national interests. States are seen as hierarchical organizations of which only the top level matters in the EU processes.

Originally, the state-centric perspective was mainly developed for the study of international security policy, an area in which the aims of survival and enhanced power are common interests to all states. However, it is clear that in order to define a state's interests – particularly in cases where the domestic circumstances and aims vary significantly between countries – it is necessary also to look at the internal conditions of the countries involved. A challenge for the classic realist approach is that although states surely will have opposing interests, it largely ignores how these interests are rooted in domestic preferences or the processes that equate them with the national interest.

The framework of *Liberal Intergovernmentalism* (LI) resolves this concern as it takes into consideration that “The fundamental goals of states [...] are neither fixed nor uniform: they vary among states and within the same state across time and issues according to issue-specific societal interdependence and domestic institutions”. Hence, state decision-makers do in fact respond to the nested political pressures from stakeholders at the lower domestic levels, but these actors at the lower level have neither any direct nor independent influence on European Integration (Trnski, 2005, p. 25). Furthermore, this approach is resting on the assumption that states are actors and that they are rational in defining preferences, bargaining for agreements and shaping institutions (Moravcsik & Schimmelfennig, 2009, p. 68).

If the empirical evidence is to support the Liberal Intergovernmentalist approach – hypothesized by H2, the following hypothesis first needs to be assessed:

H2.1 The EU member states have had significantly different interests during the Solvency II process

For our purpose, the relevant differences between state preferences should be expected to be the areas that Solvency II impact the most, namely the insurance (and pension) industries. The interests of any Member State will be dependent on several factors in this regard, such as the size, the type and the relative importance of its insurance market to the national economy and the population as a whole. Thus, these are the indicators that need to be examined in order to evaluate H2.1. The implication is that there is, potentially, a significant overlap between industry and national interests in each Member State.

Yet, the overlap should not be expected to be complete. Although insurers should benefit from having a formalized and prudent regulatory framework, it should also be expected that the preference of the customers – and hence the national interests – is on average for insurers to be more conservative than the companies would prefer. Furthermore, the national interest in relation to Solvency II also goes beyond that of insurance profitability and solidity. For example, as noted above, the new regulatory regime will impact capital markets and may have significant consequences for the financing of long-term infrastructure projects or for the direct borrowing costs of governments.

However, identifying a variation in national interests – whether associated with the national insurance industry, the customers (often equivalent to most of the general population) or the national capital markets - does not necessarily mean that these were decisive in shaping the Solvency II process. Hence, in order to examine H2, the following sub-hypothesis is required as well:

H2.2 These diverging interests have been decisive in shaping the policy process of Solvency II

According to the theory of Liberal Intergovernmentalism, domestic governments will accept European integration only to the extent that it is in its national interest to do so. Thus, the political bargains rest on the lowest common denominator of the participating Member States (Trnski, 2005, p. 25). Furthermore, Moravcsik argues that:

EU integration can best be understood as a series of rational choices made by national leaders. These choices responded to constraints and opportunities stemming from the economic interests of powerful domestic constituents, the *relative power* of states stemming from asymmetrical interdependence (Moravcsik, 1998, p. 18).

Since the political process of Solvency II may be interpreted as a special case of EU integration, this must also be true here if the LI perspective is to have explanatory power. Hence, if the evidence is to support H2.2, it is necessary to identify the cases in which Member States – based on national interests – arguably opposed and prevented the

harmonized and knowledge-based regulatory framework from being realized. To the extent that such examples are not found, it will weaken the LI argument.

In order to assess the process accordingly, it is necessary to build on the findings in the examination of H2.1, before analyzing the process in the following step-by-step manner:

1. Identify the different ways in which the Member States could impact the process
2. Identify the concrete conjunctures and issues that were influenced by the Member States
3. Assess the link between the objectives of the Member State and the outcome. Consider the extent to which equifinality is present¹⁴.

This is the underlying approach applied in the analysis of chapter 8.

4.3 Multilevel Governance

Whereas the traditional study of international relations has focused on the national interests of the states, the third theory identifies multiple actors and arenas of influence in the EU (Peters & Pierre, 2009, p. 95). Thus, the processes of EU politics are seen as equivalent to that of a nation state with a complex interplay of actors involved, rather than as an international organization without independent influence.

A key point of multilevel governance (MLG), relative to the intergovernmental perspective, is that it disputes the assumption of the nation state as the sole type of institution that matter at the EU level. According to MLG, states “no longer monopolizes European level policy making or the aggregation of domestic interests” (Trnski, 2005, p. 26). The national interests and powers of the Member States still matter, but these interests are no longer treated as a “black box”. Instead this approach emphasis the direct influence of non-governmental stakeholders such as corporations and lobbyists as well. These actors are brought into play in the EU process either through formal participation or informal lobbying. In addition, such actors may well be transnational entities that break the barriers of the national interests. The theory is concretized in the following hypothesis:

¹⁴ The alternative paths through which the outcome of interest might have occurred (Checkel, 2008, s. 185).

H3.1 Non-governmental stakeholders – other than epistemic communities – have participated in, and influenced, the Solvency II process

The obvious starting point is to identify the actors involved and it is clear that the focus in this regard will be on the stakeholders which were formally involved in the process. Many stakeholders and interest organizations have participated through informal channels, but it goes beyond the present study to identify, let alone analyze, all such groups that may have had some involvement or influence during the Solvency II process. Thus, the focus will be on fewer, but more prominent stakeholders.

Once these actors and interests are identified, it must be determined whether they influenced the process. In order to do so, they most likely held some kind of “important resources, such as information, political power or expertise” (Trnski, 2005, p. 24) which enabled them to have a direct impact on the EU process. According to Bjerke (2007, p. 81), There are essentially two ways through which independent stakeholders may impact the legislative process: Information and capture. The former implies that the stakeholders are involved solely to provide the regulators with information on the industry that is to be regulated. The latter rather refers to the case in which the regulated industry is able to impact the regulator such that the latter starts to identify the interest of society with whatever are the interests of the industry.

Hence, both of these channels are to be examined in order to determine whether the stakeholders involved actually had an impact on the process. In the event that they did, it should be expected that the role as suppliers of information will make the actor in question resemble (or at least replace the need for) an epistemic community. If the impact instead was of the nature of regulatory capture, it would imply that the directive has been influenced by special interests of non-state actors.

The challenge is that there is no easy way to distinguish between the two. Bjerke (2007, p. 82) suggests – as a proxy – to investigate whether involvement of interest groups was strongest in issues with high uncertainty (which indicates that the involvement of the stakeholder is to provide information), or by contrast, in issue areas with high distributional

consequences (indicates that the involvement is motivated by capture ambitions).

Furthermore, Bjerke notes that

The best indication of capture in the policy process is if we could identify a part of the final accord which benefits a transnational interest group involved in the policy process, which is inconsistent with the policy program of the epistemic community, and which could not be explained as a concession to national preferences as those identified under the [Liberal Intergovernmentalist] perspective (Bjerke, 2007, p. 83).

Thus, although admittedly an imperfect measure, this is the approach that is to be applied in the current study as well.

The MLG perspective does, however, add another feature to the analysis. The top-level government is still seen as the main protagonist of national interests, but so does the supranational institutions of the EU. Naturally, the EU institutions are vital to any legislative and political process in the European Union. However, if the EU institutions are to be something more than mere facilitators of Member State bargaining, and independently impact the process, there must be some factors that induce them to do so. Of course the Member States will have some rational interest in paying the price of some lost sovereignty and national competence, in order to gain in other areas (Trnski, 2005, p. 25). In particular, those gains may for example be the ones identified in 2.1.3, and this would still be in line with the LI perspective. However, according to the MLG view, sovereignty is transferred from the Member States to the EU institutions beyond what could be explained by rational and self-interested state executives. To explore whether evidence for this perspective is found in the case in question, we need to investigate the following hypothesis.

H3.2 The supranational EU institutions were independent actors in the Solvency II process, and affected the outcome

Trnski (2005, p. 27) lists several reasons why Member State power could be transferred to the EU institutions. First, the fact that the EU presently consists of so many countries makes it harder for any single (or group of) Member State(s) to control the process and the EU institutions. This is especially important as the ability by the Member States to use veto power is low and in decline. Second, the EU bodies have developed significant information advantages and networks that go beyond most, if not all, of the Member States. Third, it is

not possible for the state representatives to forecast precisely the effects of their collective actions. To this latter point, it should be added that these interests may certainly change, or short-sighted politicians may discount the long-term future interests of the nation.

These factors may all potentially shed light on the extent to which the EU institutions that have been involved in the Solvency II process have been able to act independently and affect the outcome in spite of the interests of some Member States. In order to assess hypothesis H3.2, we are thus to evaluate, for all relevant EU institutions, whether the end result differs from what would have been the case if EU institutions were mere facilitators of Member State bargaining.

5 Methodology

In this chapter, the choice of method and the way it has been conducted is presented and analyzed. The data sources applied are presented and discussed as well.

5.1 Process Tracing Case Study

A study of Solvency II could have been conducted from many different points of view and by applying a range of different methods, but the need for a detailed examination of the topic at hand makes the case study a natural choice. The case study is able to accommodate complex causal relations such as equifinality, complex interactions effects, and path dependency (George & Bennett, 2005, p. 22). All issues are highly relevant in the context of a case of EU legislative development which essentially is an attempt to make actors with different agendas contribute to merging a significant number of different systems – each with its own history – into one.

This case study may be categorized as *theory guided* within Levy's typology (2008, p. 4), implying that the purpose first and foremost is to explain the Solvency II process. However, although answering this question is the main purpose, the ambition of this study is also to make some generalizations beyond this particular case. That is, a study of Solvency II is also a study of European integration and the institutions, processes and power relations between the most important state and non-state actors. According to Lund's account of the validity system of Cook & Campbell; "strong external validity (generalizations) is achieved if the causal relationship may be generalized with certainty to, or over, relevant individuals, situations or time periods" (Lund, 2002, p. 107). Although case studies are rarely associated with high external validity, George & Bennett (2005, p. 110) point out that such studies may instead be limited its ambition to contingent generalizations. This is certainly valid for the present study.

Although the Solvency II-process deals with a concrete and (in some ways) rather narrow field, there are still several related areas to which contingent generalizations may be drawn. Firstly, the Solvency II process is an example of how legislative and political processes in the EU works and how decisions are made. Thus, this case can potentially provide generalizable

knowledge on the power structures in the EU, and also when it comes to the cooperation both between the EU institutions internally, as well as between the EU institutions and external actors.

At the same time, the threats to external validity that are usually identified in case studies are also present in this project. Firstly, it must be taken into account that the process has lasted for many years during which it has been shaped and affected by unique historical incidents such as the financial crisis. Most likely, as we shall see, the progress and direction of the process would have been substantially different if the economic crisis in Europe had not taken place. In some ways, this kind of a “shock” to the process is advantageous as it may serve as a quasi-experiment, but it also creates mess as it becomes less clear whether the events prior to the crisis are still valid for future generalization. Secondly, the number of comparable cases may be limited if this is to extend only to directives of related industries with similarly vast implications as that of Solvency II. Hence, although the Solvency II process may be interpreted as a special case of European integration, it should be stressed that the generalizations drawn are contingent and thus must be interpreted and applied to other cases with care.

Within the genre of case study research, there are various ways in which such a project may be conducted. When investigating causal chains and conducting analyses of complex decision-making processes, George and Bennett (2005, p. 173) argue that the method of process tracing is advantageous because “multiple types of evidence are employed for the verification of a single inference”. According to these authors, process tracing is defined as a method in which the researcher

Examines histories, archival documents, interview transcripts, and other sources to see whether the causal process a theory hypothesizes or implies in a case is in fact evident in the sequences and values of the intervening variables in that case. The process tracing method attempts to identify the intervening causal process – the causal chain and causal mechanism – between an independent variable and the outcome of the dependent variable (George & Bennett, 2005, p. 766).

The goal of process tracing is “to obtain information about well-defined and specific events and processes” (Tansey, 2007, p. 765). At face value, this method is indeed very suitable for

a case study of Solvency II, but this is not to say that applying such a method is without challenges. As Tansey (2007) points out, process tracing requires a significant amount of data, a necessity which is unrealistic to fulfill adequately in a project with limited resources. Second, it is questionable whether the relevant information is even made public, especially given the fact that Solvency II is yet to be implemented. Finally, a key challenge pointed out by Bjerke (2007, p. 35) is that alternative explanations to the causal chain of events identified will have to be eliminated (equifinality). In a complex and prolonged case such a Solvency II, in which thousands of people have been involved, this is certainly a valid criticism of the process tracing method.

In spite of these challenges, the process tracing method still stands out as the appropriate one in this case. This is also the conclusion reached by Bjerke (2007, p. 79) who explains that “process tracing implies that the relevant actors and stakeholders are identified, and that their preferences as well as their influence on the process are mapped and identified at the critical phases”. Hence, the same approach is selected for this paper as well.

In the following chapters, the key actors and stakeholders of the Solvency II process are identified and their interests and activities outlined. In chapter 6, the actors and their roles in the model of legislative development are outlined. Furthermore, the country variations of the national insurance markets in Europe are analyzed in order to understand the interests of these and other actors. In chapter 7 the process of development and bargaining in the Solvency II and Omnibus II processes are traced from one phase to the next. Key issues, disagreements and outcomes are identified. In chapter 8, this material is discussed in order to assess each hypothesis specified in chapter 4. Once this is achieved, the overarching question specified in chapter 1 is answered through an assessment – inspired by quasi-experimental design - of the explanatory power for each of the three theoretical perspectives. In the end some contingent generalizations are provided.

The choice of process-tracing case study methodology implies that the Solvency II process is to be examined in detail as a single event, rather than being compared with some, or many, other cases in an empirical or statistical study. Yet, this decision does not necessarily dictate the method for data acquisition. Thus, this question is to be dealt with next.

5.2 Data Sources

What is the most appropriate method of data generation in a process tracing study? According to Tansey, “interviewing, and especially elite interviewing, is highly relevant” (2007, p. 766). In the case of Solvency II, there are several reasons to follow this advice. First, the amount of available information is massive, and the content is often complex. Finding the critical facts under such circumstances is challenging and increases the value of advice and opinions from experts who are able to identify what matters. This is especially important to the extent that useful information may not be public. Second, interviews enable the researcher to access informal affiliations or decision making arenas. During the Solvency II process, important decisions have perhaps also been made in unofficial forums that are not known to the public. In general, interviews also allow the interviewees to communicate considerations and nuances that are not necessarily possible to grasp by studying documents. For these reasons, it was decided to perform the present study partly by conducting semi-structured elite interviews.

A key challenge, given this choice, is of course to locate and obtain interviews with the most appropriate experts. Tansey argues that “random sampling runs against the logic of the process tracing method, as it risks excluding important respondents from the sample purely by chance” (2007, p. 765). Thus, scholars seeking to conduct interviews for such studies should rather attempt to find experts with the appropriate knowledge, rather than aiming to draw a random sample of potential interviewees. Various sampling strategies may be applied in order to select such experts and, in this case, a combination of purposive and snowball sampling has been selected. Whereas the former strategy implies that the researcher selects interviewees based on his own knowledge of potential experts, the latter utilized the expert knowledge in the sampling as they are asked to suggest other respondents. Although there is a risk that interviewees will suggest people who share their opinions to a great extent, this has been a necessary sampling strategy for this case.

Elite interviews imply that the data collection has been carried out as “conversations regarding a limited number of open questions” (Berry, 2002). Clearly, this style of interviewing is not without flaws. In particular, it relies heavily upon the subjective knowledge and interpretations of the source, which may be highly dependent on the parts of

the process in which the interviewee has been involved, as well as on the interests the person concerned has represented. Furthermore, there may be significant time lags between the participation and the date of the interview. Thus, these disadvantages must be kept in mind when interpreting reasoning that is based on such interviews.

During this project, three interviews – with a total of four interviewees – have been conducted representing *The Financial Supervisory Authority of Norway (Finanstilsynet)*, *the Ministry of Finance (Finansdepartementet)* as well as *Gjensidige*, the largest non-life insurer in Norway - representing the industry. The respondents of Finanstilsynet and Finansdepartementet have all been directly involved in some part of the SII or OII process, whereas the representative of Gjensidige has extensive experience from implementation of the regulatory requirements in the insurance company. Ideally, more interviews should have been conducted and a clear limitation to this study is that no first-hand interview has been conducted with EU employees or representatives of the life insurance industry.

In addition to these interviews that have been conducted in person, a great variety of sources have been utilized. However, to the knowledge of this author, the past research on the political process of Solvency II is limited in the field of political science. There are numerous sources discussing the technical content of the directive, but the process through which this regulation was developed does only appear to be documented and analyzed to some extent in outdated papers such as van der Ende et.al. (2006) and Eling et.al. (2007). Notable exceptions are indeed represented by Sandström (2011, pp. 575-666), which provides a comprehensive overview of the Solvency II process up until 2010, and by van Hulle (2011) who explains the consequences of the financial crisis and Lisbon Treaty to Solvency II. However, no source appears to present a comprehensive political analysis of the complete Solvency II process including the consequences of Omnibus II. Admittedly, this is not puzzling as the latter process is still ongoing at the time of writing.

Because of the novelty of the topic under investigation, many of the sources utilized in this study – particularly for the Omnibus II process – consists of news articles and second hand interviews with high-level politicians, bureaucrats and industry representatives with significant involvement in the Solvency II and Omnibus II processes. The main provider of

these have been the websites www.risk.net¹⁵ and www.solvencyiiwire.com which are both among the most professional and persistent providers of news on Solvency II. However, in spite of this fact, the use of such sources should come with a caveat as they cannot be expected to be of the same quality as, for example, articles in scientific journals. This is not ideal for the validity of any study. However, in order to alleviate this concern a significant number of sources have been utilized so that the main facts presented in this paper are - to the extent possible and unless otherwise is stated - cross checked with different sources. Other noteworthy sources have included letters from industry representatives and politicians, meeting minutes from discussions in specific EU institutions, as well as impact studies conducted during the process.

¹⁵ Registration is required to access articles

6 Solvency II: Process, Participants and Interests

The first step in a process tracing analysis is to identify the key participants and stakeholders involved. The political process of Solvency II (and Omnibus II) have been initiated, driven and is going to be finalized by the institutions of the European Union. Hence, it is difficult to understand the political process of Solvency II without first grasping the roles of the EU institutions involved and how they have interacted. Next, it is also necessary to investigate the interests of the EU Member States and the insurance industry.

6.1 Solvency II in the European Union

For our purpose, examining the political process of Solvency II, it suffices to confine focus to the European Parliament (EP), the Council of Ministers (the Council) and the European Commission (the Commission)¹⁶. Thus, an account of how these institutions have been involved in Solvency II is given in the first section. Furthermore, several committees and other specialized EU organizations – such as EIOPA - have had a critical role in the Solvency II process. The most important ones are presented in the second subsection. In the final two subsections, the legislative Lamfalussy process, as well as how this process was altered as a consequence of the Lisbon Treaty, is explained.

6.1.1 The European Union

The Commission is organized in 28 departments known as Directorates-General (DG) that are each dedicated to a specified policy area. In the case of Solvency II, the relevant DG has been *the Internal Market and Services* (DG MARKT), headed by the Commissioner Michel Barnier. The DG MARKT is further divided in separate Directorates, such as Directorate H – Financial Institutions. The Commission's work on Solvency II and Omnibus II has mainly been conducted in unit H5 (Insurance and Pensions) of this Directorate. During most of the Solvency II process, the unit was led by Karel van Hulle (who also led the Solvency II trialogue), until he was replaced in January 2013 by Klaus Wiedner. Thus, it is the latter that has been in charge during the final stages of the Omnibus II process. The DG MARKT has arguably been the key engine in the legislative development of Solvency II.

¹⁶ The reader is assumed to be familiar with the general role, purpose and organization of these institutions. For a comprehensive presentation see e.g. (Bomberg, Corbett, & Peterson, 2012, pp. 47-73).

The Council is made up by ten configurations. For the purpose of Solvency II, the relevant one has been the configuration *Economic and Financial Affairs* (ECOFIN) that is composed of national ministers on economics and finance. It is the ECOFIN which ultimately adopts the Council's version of a legislative act, but it does so only after discussing it with the Committee of Permanent Representatives (COREPER). The COREPER is split between COREPER I and II. The former is made up of permanent representatives dealing with technical matters, whereas the COREPER II consists of the Member States' ambassadors to the EU and is chaired by the Member State which currently holds the presidency of the Council. The COREPER is both a forum for dialogue and discussion between the Member States, as well as a source of political control and guidance for the expert groups that are working on draft legislation (European Union, COREPER).

The Council also exercise executive powers by controlling the Commission through the 'comitology'¹⁷ system (Hix, 1999). According to Hix (p. 21), the Council and the Commission's division of labor as executives of the EU government may sometimes lead to deadlocks, but the comitology system is one of the mechanisms which are in place in order to avoid such deadlocks. The comitology system is a set of committees, designed by the Council, through which national experts issue opinions on the implementing measures proposed by the Commission. Thus, the comitology system enables the governments to scrutinize the Commission. The system consists of five different procedures, and there is a negative relationship between the autonomy of the Commission and number of the procedures since the Commission has to consult the relevant committee of national experts that is related to the specific procedures. In the case of Solvency II, the *Regulatory committee* was the relevant procedure, which implied that the Commission could "enact the measures *only if the [comitology] committee supports* the measures by Qualified Majority Voting (QMV), otherwise the matter is referred to the Council (Hix, 1999, pp. 41-43).

In general, there are several reasons for the delegation of governing responsibilities from the Council to the Commission. The Commission is independent in the sense that the positions of

¹⁷ As shall be demonstrated, the Lisbon Treaty has (at least to some extent) disrupted the comitology system. Yet, accounting for this system is still relevant for our purpose as Solvency II was mainly developed prior to the Lisbon Treaty.

its members are not affected by the uncertainty and time-constraints associated with political elections. This allows the Commission to be (more) neutral regarding national or sectorial interests, and it enables the institution to deal with legislation of complex, technical matters (Hix, 1999, pp. 50-52). In addition, the exercise of executive powers by the Commission and the Council is scrutinized by the European Parliament.

In the European Parliament, the legislative work to draw up, amend or adopt proposals is conducted by the 20 standing committees. In general, the committee members have an important agenda-setting role in preparing legislation for debate in the Parliament (Pollack, 2009, p. 130). As described above, the EP receives legislative proposals from the Commission, and these are assigned – by the EP president – to the *committee responsible* in the relevant policy area to present a report on the proposal to the plenary. The committee responsible appoints a rapporteur who is to write the report on its behalf (Sandström, 2011, p. 627). For the Solvency II process, the committee of Economic and Monetary Affairs (ECON) appointed Peter Skinner as its first rapporteur, whereas the committee of legal affairs (JURI) also appointed a rapporteur, namely Sharon Bowles, both of whom published their draft amendments to the Final directive of Solvency II in 2008.

6.1.2 EU Insurance Agencies

In 2003, the Commission established two insurance committees that were to be engaged in matters of insurance regulation. The newcomers were the *European Insurance and Occupational Pensions Committee* (EIOPC) and *The Committee of European Insurance and Occupational Pensions Supervisor* (CEIOPS) (MARKT, 2003). Whereas EIOPC was to be a regulatory committee, replacing the former *Insurance Committee*, CEIOPS replaced the former *Insurance Conference* as a supervisory committee (Sandström, 2011, pp. 575, 576, 590). Both committees were established following the European Parliament's endorsement of the four-level Lamfalussy process for development of EU banking and insurance regulation (examined in the subsequent section).

From the beginning of the Solvency II process, EIOPC was set to have a key role in the legislative development. EIOPC was set up as a Comitology committee in order to assist the

Commission in adopting implementing measures (essentially operationalizations of the directive) (COD 2003/0263). This is the forum in which Commission aimed to keep the technical discussions, such as provisions and the target capital level, in the development process of Solvency II, (Sandström, 2011, p. 609). It was set up as a committee of regulators consisting of national ministers of finance, or regulatory authorities from the Member States, which were to meet at regular intervals as well as “whenever the situation demands” (European Commission, 2014b).

CEIOPS was established by the Commission and consisted (at the end of the SII process) of 15 high-level representatives from insurance and pensions supervisory authorities of EU states. The purpose of this establishment was to remove the most technical negotiations of the legislative development away from the discussions in the Commission during the development process of the legislation. In fact, the Commission was *required* to consult CEIOPS before adopting new measures (Weber-Rey, 2011a, p. 4). In addition, the committee worked to define supervisory policies, as well as to converge supervisory rules and practices through the college of supervisors¹⁸ (de Larosière, 2009, p. 52).

Throughout the development of the Solvency II directive, the involvement of CEIOPS was significant. In particular, the Committee prepared its advice for the Commission by first consulting the market participants through working groups and transparent public consultations (Sandström, 2011, p. 578). Furthermore, CEIOPS was responsible for the dialogue and relations with insurance undertakings as well as the supervisory authorities (Sandström, 2011, p. 609), however in cases, on which agreement in CEIOPS was not possible, the matter would be handled by EIOPC (Sandström, 2011, p. 611).

The importance of EIOPC and CEIOPS in the Solvency II process was crucial, but the financial crisis provided considerable drive to reform the financial regulatory architecture of Europe. This also included a review of the role of these insurance committees. The process of reform was formally initiated by Mr. José Manuel Barroso, President of the European Commission. In November 2008, he established an expert committee, tasked with formulating a proposal for a new supervisory architecture for European financial markets and institutions. The committee, chaired by Mr. Jacques de Larosière, published its final report in

¹⁸ Multilateral supervisory groups that are responsible for the supervision of multinational financial institutions (EIOPA, 2014b).

February 2009 (the ‘de Larosière Report’). It recommended the establishment of an EU-level body, mandated to oversee risk in the financial system as a whole, as well as the replacement of the Commission advisory bodies (including CEIOPS) with EU agencies (de Larosière, 2009, p. 47).

The result – materializing from the beginning of 2011 - was the creation of the European System of Financial Supervision (ESFS), which included Micro- and Macro-prudential supervision and consisted of three European Supervisory Authorities (ESAs) representing banking, securities and insurance. The ESA for insurance, which replaced CEIOPS (as well as equivalent banking and securities committees) was a new supervisor of insurance regulation in the European Union: The European Insurance and Occupational Pensions Authority (EIOPA) (Regulation 1094/2010). The establishment of EIOPA was clearly in line with de Larosière report and it symbolized a new era in European insurance supervision. Whereas CEIOPS had been a small committee offering non-binding advice for the Commission, EIOPA was to be an independent and institutionalized advisor to the Council and the Parliament, as well as the Commission. Furthermore, EIOPA was created in order to further cross border insurance regulation and supervision in the European Union, protect and rebuild trust in the financial system, as well as to ensure consistency in the regulation of the insurance industry.

EIOPA is composed of various committees in which representatives of the national supervisory authorities participate, whereas political representative ministers are not involved. The committees are responsible for writing draft legislations that are presented to the Board of Supervisors, which is the main decision-making body of EIOPA, consisting of leaders and representatives from the national supervisory authorities (EIOPA, 2014a).

The creation of EIOPA (and the other ESAs) is an important event in the process of European integration. Indeed, the introduction of agencies with such significant rule-making and supervisory capabilities “mark them out as some of the most powerful institutions ever established at the EU level” (Everson, 2012, p. 17). The fact that this “technocratization” takes place in the financial industries should not come as a surprise given the intuitive argument that complex technical areas should be governed by experts rather than politicians that are more likely to conflate “market regulation with redistributive macro-economic

policies” (Everson, 2012, p. 11). The problem with this move towards independent technocratization is clearly that it implies a move away from democratic legitimacy.

Yet, this depends on how independent of the other EU institutions EIOPA actually is. On the one hand, EIOPA could of course only be created with the permission of the Council and the Parliament. It operates under the Commission which retains “final decision making power” and the Meroni doctrine – which prohibits the delegation of discretionary power to agencies – “continues to preclude the full independence of agencies at EU level. Accordingly, EU agencies are only ever ‘semi-autonomous’” (Everson, 2012, p. 13). On the other hand, several arguments support the claim that EIOPA is in fact an independent actor. First, this is supported by the fact that the members of its scientific committees are appointed in open competitions based on expertise. Second, it is ensured by the fact that Member State agencies, operating within the EU national network are ‘autonomous’ of their own government. Finally, the fact that the Council and the Parliament in most cases are not bound to follow the decisions made by EIOPA, the need for the Member States to introduce politics at the agency level is limited (Everson, 2012, pp. 15,26). In sum then, the balanced judgment on the autonomy of EIOPA is perhaps that no one controls EIOPA, yet EIOPA is under control (Everson, 2012, p. 24).

6.1.3 The Lamfalussy Process of Solvency II

The process of legislative development for financial regulation in the European Union was significantly altered following the Lamfalussy report and the resulting implementation of the formalized Lamfalussy Process in 2001. The stated aim of the new process was that “in the future Europeans will be able to rely on a more accountable and efficient regulatory structure” (Lamfalussy, 2001, p. 8). This brought the EU regulation of the banking, securities and insurance industries “from the national to the supranational level and put in place much of the institutional and political foundations necessary for integrated financial markets” (Posner, 2007, p. 3). Several directives have been produced according to the rules of this process, of which Solvency II is one of the most important examples. According to a review of the process by the Commission, the Lamfalussy system has been “a pioneer in introducing and strictly applying sound regulatory principles: a bottom-up approach, open consultation, impact analysis, early and thorough participation of market professionals and consumer bodies plus national regulators” (European Commission, 2007a).

However, as part of the Lisbon treaty, the Lamfalussy process was altered so that there are – for our purpose - in effect two different frameworks: The pre-Lisbon Lamfalussy process (under which the Solvency II directive was partly developed) and the post-Lisbon process in effect from the 1st of December 2009 (under which the Omnibus II directive was developed). The original, four-level, framework of the Lamfalussy process thus applies to the pre-Lisbon process. This is described and illustrated as it was below, whereas the important alterations made to this framework - particularly as a result of the establishment of EIOPA - are subsequently explained.

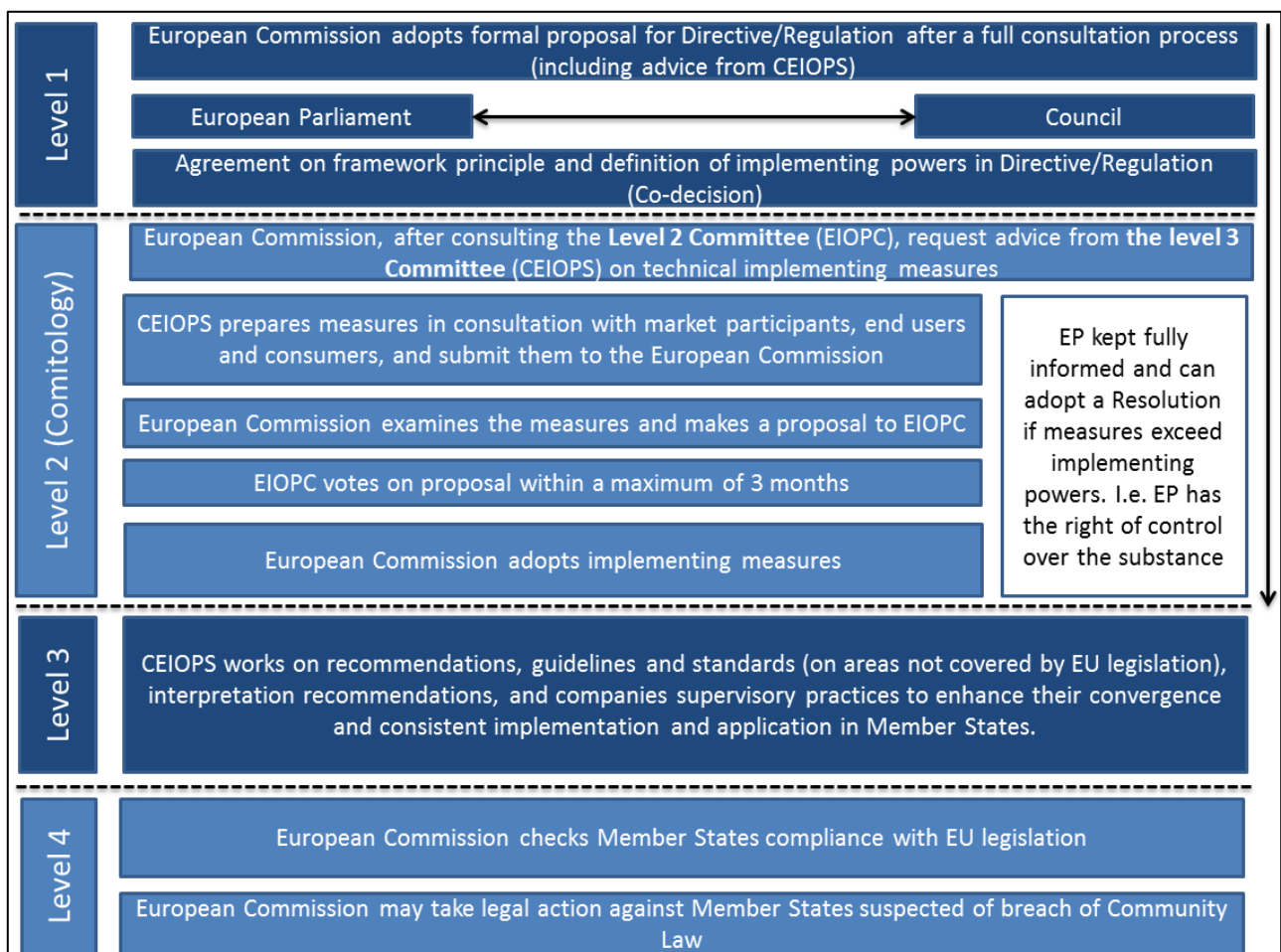


Figure 6: Pre-Lisbon Lamfalussy Process (European Commission, 2007a, p. 14)

The Level 1 – **Framework legislation** - of the process is the Legislative Act which states the enduring principles (and political outcomes) underpinning the solvency system; hence it is a “skeleton” text which states the overall direction of the regulatory regime. The level 1 text in

the Lamfalussy process is developed according to the following co-decision¹⁹ procedure in the EU.

The Commission develops the first legislative proposal through a comprehensive consultation process with stakeholders that are formally or informally included in the process. In the early phases of the (Solvency II) process, experts from all Member States – often representing the national FSAs and MoFs participated in drafting groups, as well as in the EIOPC, together with Commission experts. In the EIOPC, draft legislation and other matters were discussed, and delegations provided advice to the Commission prior to finalization of various drafts and proposals.

The proposal is then passed on for the *first reading* of the European Parliament which may either adopt or amend the text. The text then continues to the Council which may approve or amend the proposal from the EP. In the latter case, the Council adopts a *Common position* which is returned to the Parliament for its *second reading* (the Council may also reach a principal agreement – a *General approach* - before the EP's first reading). In turn, the EP may accept or amend the Common position, and in the latter case it is returned back to the Council. If the Council does not approve the suggested amendments to the Common position, the *Conciliation committee* is convened, the aim of which is to attain agreement on a final joint text (Codecision “Step by step”).

As the deadlines are tight, both to set up the Conciliation Committee following the Council's second reading and for reaching agreement in the Committee, negotiators usually meet in advance of the formal initiation of the process. These informal, ad-hoc discussions are usually joined by all three institutional bodies, and are thus known as the “*Triologue*” (Codecision “Step by step”). During the trialogue negotiations, the national interests are pursued much a lot more bluntly relative to the development phase, but the process is much less transparent to the general public. According to Sandström (2011, pp. 629-630), this is where the real negotiations are taking place and, as we shall see, this has been the case both for the Solvency II and the Omnibus II processes.

Thus, for an EU directive to pass and become part of the national law of all member states, the Conciliation Committee process must ensure that the Parliament and the Council reach a

¹⁹ The name of the procedure has later been changed to the ‘ordinary legislative procedure’.

final compromise on the Commission proposal. The Commission, being the originator of the legislation, has a mediating role and aims to reconcile the positions of the Parliament and the Council, as well as to defend the original content and purpose of the draft legislation.

The level 2 texts are **implementing measures** specifying the level 1-directive in further detail. However, this is an area in which the Lisbon Treaty brought about significant changes. Under the original process the Commission was to develop the level 2 text in accordance with the *Comitology* procedure introduced earlier. The aim of this procedure was to improve the efficiency of the legislative process. As the Council would find it difficult to reach agreement on all aspects of the (non-essential) elements of the legislation, these were delegated to the Commission which was given the task of preparing and adopting texts. The responsibility of the Commission was to perform this task within the framework that was given by the level 1 text and, hence, the implication was that the level 2 documents was not required to go through the co-decision process described above.

The Commission would develop these measures by first requesting technical advice from CEIOPS. Working groups in CEIOPS would draft these texts following frequent consultation with the insurance industry as well as public hearings, before returning with recommendations to the Commission which finalized the texts (Insurance Europe, 2007, p. 7).

However, in order to supervise and control the Commission's exercise of these powers, EIOPC – which comprised of Member State representatives – would vote on the measures and was thus able to block the Commission and refer the matter in question to the Council (Financial Services Authority, 2011). Hence, prior to the Lisbon Treaty, the Commission was able to adopt implementing measures only after consulting EIOPC. However, this procedure was subject to a great deal of controversy due to worries in the European Parliament who saw EIOPC as a “mini-council” and feared that “the Commission together with the Council might unduly interfere with its co-decision powers” (van Hulle, 2011, p. 187). This was the background for the important modifications introduced by the Lisbon Treaty to this part of the process.

The level 3 of the Lamfalussy process is the **supervisory standards** that were developed by CEIOPS under the original SII process. These texts are guidelines for the implementation of the level 1 and 2 texts, which shall enable the national insurance supervisors to apply the directive and the implementing measures to the insurance industries in the Member States (Insurance Europe, 2007, p. 5).

The fourth level is **Enforcement**, namely the act of monitoring and ensuring compliance with the directive in the member states. This task is performed by the Commission (European Commission, p. 12).

For our purpose, it is the level 1, and to a lesser extent level 2, texts that are in scope, as this is where the political process has really taken place.

6.1.4 The ‘Lamfalussy Process’ of Omnibus II

As noted above, the Lamfalussy process described applies to pre-Lisbon directives only, such as Solvency II, as the Lisbon Treaty and the financial crisis brought about significant changes to financial legislation in the European Union. One of the main intentions with the Omnibus II directive was indeed to adapt the Solvency II directive to these changes.

Under the new Lisbon procedure of legislative development, the Parliament and the Council obtained the right to prescribe which of two procedures were to be used by the Commission for adoption of the level 2 acts: delegated acts and implementing acts.

The delegated acts, following Article 290 of the Lisbon Treaty, apply to non-legislative acts that amend or supplement the level 1 directive. The Commission develops these acts through consultations with expert committees, namely the new Expert Group on Banking, Payments and Insurance (EGBPI) which is composed of experts appointed by the Member States and has replaced EIOPC in this regard (European Commission, 2014a). According to a respondent from the Norwegian Ministry of Finance – with some experience from EIOPC/EGBPI meetings, the work conducted in these forums could be characterized primarily as experts seeking to agree on sound legislation based on objective criteria, even though there is some bargaining between delegations based on national circumstances and

interests as well (Norwegian Ministry of Finance, 2014 [Interview]). Following the finalization of the draft text by the Commission, the delegated act is sent to the Parliament and the Council which may oppose the act, in which case it is to be amended by the Commission. If the act is not opposed, it is adopted as drafted by the Commission (Weber-Rey, 2011a).

As for the implementing acts, following Article 291 of the Lisbon Treaty, the Commission seeks advice from EIOPA and then develops the Level 2 text in accordance with the level 1 directive. Yet, the Commission no longer has to obtain the acceptance of EIOPC, and there is no specific role for the Council or the EP to control the Commission's exercise of implementing powers. This control is instead exercised by the Member States who are responsible for the implementation of legally binding acts (van Hulle, 2011, pp. 188-189). The Parliament and the Council shall be informed, but have no right to prevent the implementing acts from entering into force unless they deviate from the level 1 text.

In addition to the amendment of the level 2 legislative development process, the Lisbon Treaty also brought about enhanced powers for EIOPA. Of particular importance was the fact that EIOPA – unlike its predecessor CEIOPS – was given the right to create *legally binding* technical standards. This new level '2.5' in the Lamfalussy process requires EIOPA to draft Regulatory technical standards (RTS) for the delegated acts, and implementing technical standards (ITS) for the implementing acts. Whereas the Parliament and the Council may revoke the former, this is not the case for ITS (Weber-Rey, 2011a). However, both of these technical standards developed by EIOPA are to specify technical (not politically controversial) areas of the regime only. Although this description is confirmed by the representative of the Norwegian FSA, this interviewee also adds that it has also been the case – particularly during the Omnibus II process – that working groups hosted by EIOPA to some extent has been affected by political signals and guidance (FNAN, 2014 [Interview]). The scrutiny of the RTS and the ITS has been delegated to the Commission, implying that if it opposes the technical standards, the Commission has the “power only to delay its full adoption as a regulation or decision, subject to parliamentary and Council scrutiny” (Everson, 2012, pp. 17-18).

The legal standards at level '2.5' will co-exist with the level 2 legislation of the Commission. In addition, the powers of EIOPA were strengthened further as the national supervisory

authorities from this point were bound to the level 3 legislation on a ‘comply or explain basis’. Hence, national regulators are required to follow the level 3 legislation unless they have a clear explanation for why it should not apply to their domestic market (Freshfields Bruckhaus Deringer, 2012, p. 3). Hence, in essence the establishment of EIOPA implies that the national supervisory authorities, according to the former head of the British FSA, became arms of an EU policy-setting body (Freshfields Bruckhaus Deringer, 2012, p. 3).

Thus, amendments of the Lisbon Treaty as well as the establishment of EIOPA, has altered the Lamfalussy process in significant ways. First, since level 2 acts are no longer necessarily developed under the Comitology procedure (under which the level 2 committee may refer the text to the Council), the European Parliament has gained control over level 2 texts through its right to reject delegated acts. Second, the establishment of EIOPA with enhanced rights and resources implies that the power and influence of the experts in the supervisory authority is increased. Third, since the Parliament and the Council are unable to reject implementing acts, and the technical standards developed by EIOPA are supposed to be non-political, the delegated acts at level 2 are really the last strictly political stage in the rule-making process. Thus, politically controversial legislation may be found, not only in the level 1 text, but in the delegated acts as well (Coelho, 2014).

6.2 Varieties of the European Insurance Industry

A key aim of the Solvency II project is to harmonize the rules of the European insurance industry which varies greatly between countries. However, it is not only the laws that vary between the European nations, so does the subject matter that is to be regulated: The difference in size, composition and complexity of the national industries in the EU Member states are highly significant. It goes beyond the scope of this paper to deal with these national variations in much detail, but a fundamental understanding is vital for the analysis of the political negotiations.

By intuition, it appears that the biggest insurance markets are to be found in the largest and wealthiest nations, that is, the countries in which the Gross Domestic Product is greatest. However, it is not possible to predict - based only on the size of a nation’s economy – what size its insurance market will be. Several factors, such as culture, risk environment and national regulations also impact the market. In sum, there is a significant variation in the

share of EU nations' GDP that is spent on insurance products. As the graph below illustrates, the Eastern European nations – in addition to generally being the poorest nations of the EU – also spend a lower share of their national income on such products, relative to the wealthier western neighbors. Whereas the insurance market in the United Kingdom amounts to about 12.9 % of its GDP, the comparable figure for Romania is only 1.2 %.

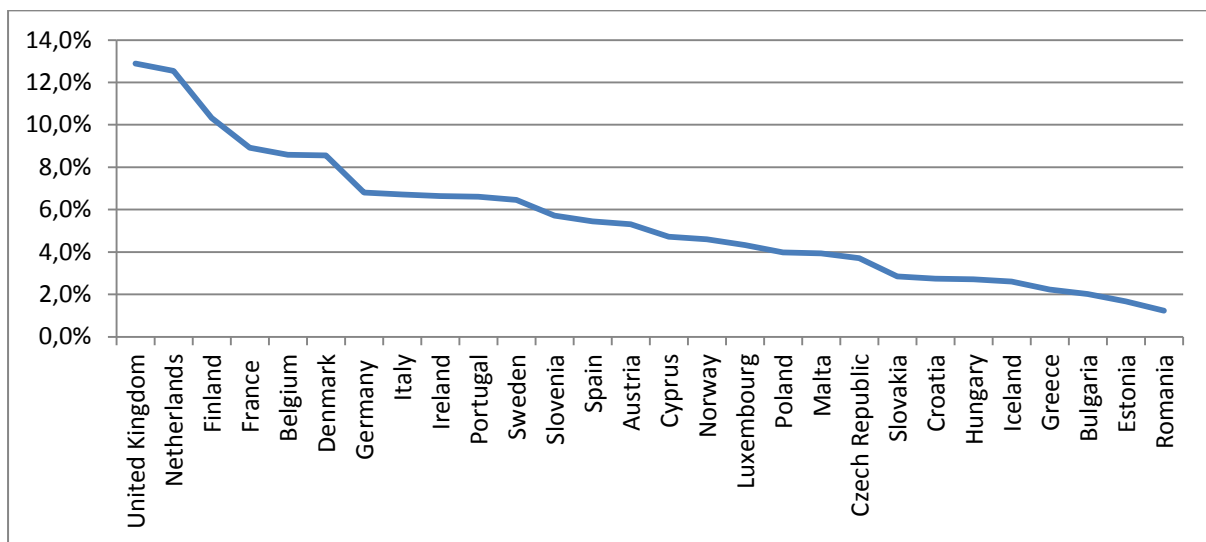


Figure 7: Selected EU Member States: Insurance premium as share of GDP in 2012 (Gross Domestic Product). Source: (Insurance Europe, 2014c).

Hence, the European insurance market is in essence determined by the size of the national economies, modified by the proportion of the national income that is spent on insurance. In total then, the size of the most significant EU insurance states/regions are depicted as follows, split between the life and non-life industry

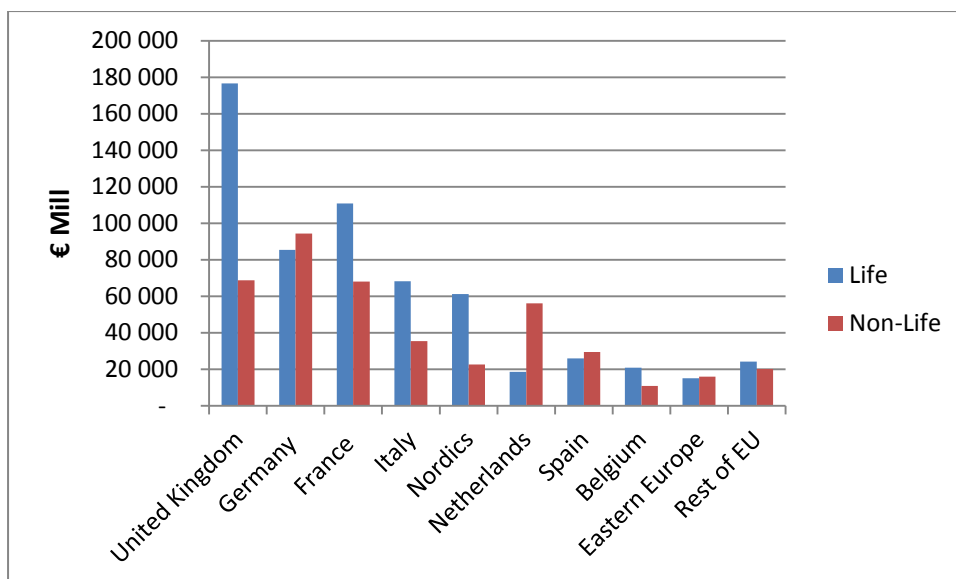


Figure 8: Gross Written Premium: Life and non-life insurance in selected European countries and regions 2012²⁰ (Insurance Europe, 2014c).

There are several notable facts in these figures. Firstly, it is clear that the life insurance industry is of relatively greater importance compared with the non-life industry. Second, in the less economically advanced countries of Eastern Europe, the importance of non-life insurance is relatively speaking greater compared with most of the western European nations. Finally, the data shows that about 80 % of the European life insurance business is written either in the United Kingdom, Germany, France or Italy. Since it was established above that the greatest challenges of Solvency II have been related to this industry, it should come as no surprise that these countries and their biggest companies are key actors in the Solvency II process.

However, size is not the only factor distinguishing European insurance markets. The variations that are significant between some European countries – also reflect the fact that there are differences in the structure of life insurance pension schemes and are not be counted for in the data pictured above. For example, in some countries pension funds (not life insurance) are important alternatives to the life insurance business (Davis, 2011). These differences are often related to the more general welfare state systems and public benefit

²⁰ Nordics = Norway, Sweden, Denmark, Finland, Iceland.

Eastern Europe = Poland, Czech Republic, Hungary, Slovenia, Slovakia, Romania, Croatia, Bulgaria, Estonia.
Rest of EU (on which there is data) = Austria, Portugal, Ireland, Greece, Luxembourg, Cyprus, Malta.

schemes that are specific to each Member State (Gjensidige, 2014 [Interview]). One distinction between type of welfare/insurance model which stands out for our purpose is the one often found in the mature welfare states of North-Western Europe. The extensive life insurance markets of these areas generally have a relatively high share of insurance products with guaranteed-benefits through which the insurer has obliged itself to pay the customer a fixed annual payment²¹ following illness or retirement (whether for a specified number of years or until the death of the customer). Many other parts of Europe have instead welfare systems that are more savings-based, implying that the risk resides with the customer, not with the insurer (Norwegian Ministry of Finance, 2014 [Interview]).

Furthermore, the variations of the European insurance industry are not confined to the industry itself. It is also reflected in the traditions and capabilities of the national supervisors. The European insurance industry is far from homogeneous when it comes to national regulation and supervision. As one might expect, the largest companies in the biggest insurance markets also in general appear to be better prepared for the Solvency II regulations than their peers in smaller and/or less developed markets. According to EIOPA,

there are ‘huge differences in the preparedness’ for Solvency II among European national supervisors and certain authorities will have to undertake a ‘fast journey’ to be ready for the implementation of the directive in 2016 (Kristiansen, 2014, p. 17).

In sum, the variation of the European insurance industry is a consequence of many different factors such as general historical and cultural specifications, welfare state traditions, general macroeconomic development, industry traditions and capitalization, as well as the supervisory traditions. Surely, the road to harmonization is far from straightforward, and potential country, industry and company interests abound. However, in order for such interest to be taken into account in the new legislation, representation and participation in the development process is necessary. This is the topic to be explored next.

²¹ A serious issues for insurers is that such historic contracts often assume an annual return significantly above current interest rates.

6.3 Stakeholder Interests: Participation and Representation

So far in this chapter, an account has been given of how European financial legislation is created through interactions between EU institutions that are directly, or indirectly, influenced by the interests of the member states. However, as described above, the Solvency II process has also seen significant participation from non-government organizations and it was from the start characterized by extensive consultation with stakeholders. In essence, these stakeholders may be separated in two, non-exclusive, groups: First, organizations that have had a formal role in the Solvency II process. Second, entities that have attempted to impact the legislative development through informal lobbying.

Due to the duration and complexity of the Solvency II process, identifying the key actors is a task which is not possible to fully cover in a study of this magnitude. Hence, in the following, only the actors and stakeholders of the insurance industry, which is arguably have been of most significance during the process, are included.

Although the entities most heavily involved in the formal legislative development represented the insurance industry itself, single European insurers were usually not directly involved in the formal process. As illustrated in the figure below they were instead represented by several interest organizations:

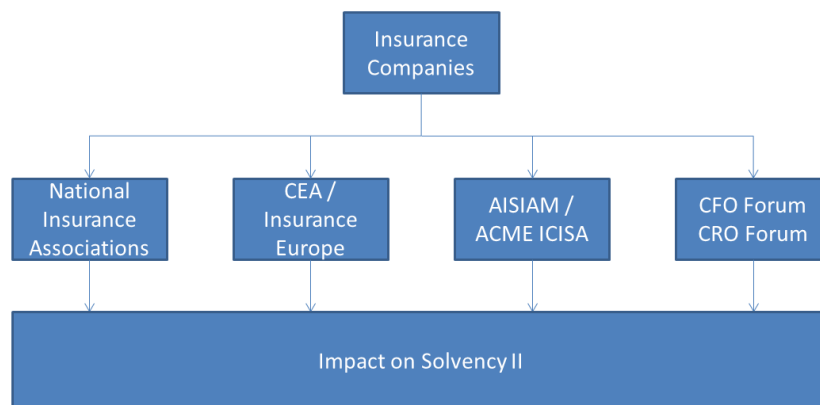


Figure 9: Formalized role of insurance company interests in the Solvency II drafting process (Insurance Europe, 2007, p. 7)

CEA (*Comité Européen des Assurances*), which was renamed Insurance Europe in March 2012, has perhaps been the key non-governmental stakeholder throughout the Solvency II

development phase and was arguably the most important representative of the insurance industry. Insurance Europe is the interest organization for European insurance companies, and has 34 European national insurance associations as members. In turn, these national associations represent about 95 % of the total written premium in the European insurance industry (Insurance Europe, About us, 2014a). Thus, both large and small companies from all parts of the industry were relying on CEA to represent their interests in the development of the new framework (Insurance Europe, 2014a). In its own words, the organization works to build industry consensus, a task that may certainly be a challenge given the variation which exists between European insurance markets.

Across the EU insurance market, there are over 5,100 companies in operation. Yet, the market share is split very unevenly between these companies. In fact, according to a report by the interest organization of European insurers, the largest insurers have a combined market share close to 85 % even though only about 6 % of the companies are classified as large (defined as Gross Written Premium > €1,500m) (CEA [Insurance Europe], 2007). Furthermore, the same report states that the 20 largest groups alone account for approximately 55 % of the total volume of the industry. These insurance giants are mostly based in the largest countries of Western Europe, but they operate abroad - in other EU countries or other continents – as well. Furthermore, they usually have interests or ownership stakes in other insurance firms, thus resulting in complex group structures with entities operating across many different national jurisdiction and regulatory regimes. In addition, these large companies also have their own channels of direct participation, namely the CRO Forum and the CFO forum, the latter of which represents 20 large European insurers. Both groups have been active and formally included in the Solvency II process.

The challenges of representing a heterogeneous European industry may also manifest itself in other ways. One example of this, pointed out by a representative of the Norwegian FSA, refers to an incident following a publication in the early phases of the Solvency II process: The CEA announced its official opinion on the publication, only to be followed by significantly different opinions published by some of the largest national insurance organizations (FNAN, 2014 [Interview]). Nevertheless, there is little doubt that the CEA has provided the industry with a platform and, as we shall see, has provided advice and support during important phases of the project. Furthermore, the CEA has also cooperated with other,

more specialized insurance organizations, such as AISAM/ACME which represent mutual insurers and ICISA, whose members are credit insurers.

The Groupe Consultatif (GC), which changed its name to the Actuarial Association of Europe (AAE) in 2014, represents the actuarial profession in Europe. Actuaries are traditionally the employees who are in charge of calculating the premiums and reserves of the insurance company. Although the GC/AAE is based on voluntary contributions from its members, its involvement in the Solvency II process, as we shall see, has been significant and it has been one of the main stakeholders in the drafting group of the directive. Although most actuaries are employed in the insurance industry, the self-proclaimed aim of the group is “to provide an impartial academic viewpoint that is less influenced by political and commercial considerations than other individual stakeholders (such as corporates or member states)” (Brooks & Murray, 2013, p. 4). Obviously, one should not conclude from this that the actuarial interest organization is without interests (making the role of the actuary more comprehensive would be an obvious one), but it is still the case that the main role and objective of actuaries should be to estimate the provisions for future claims correctly from a technical perspective. Hence, relative to profit seeking insurance companies and politicians of the Member States, a certain higher degree of neutrality and adherence to the overarching principles should be expected from the actuarial organization.

When it comes to the informal contributors and lobbyists in the Solvency II process, it goes beyond the scope of this study to give a comprehensive overview of the entities that have taken part in the process. In any case, this is certainly a very demanding task given the number and variety of more or less formal lobbyists that have attempted to impact the process. According to a representative of the Norwegian FSA, Karel van Hulle - who was in charge of Solvency II at the Commission between 2004 and 2013 – lobbyists appeared from all thinkable interest positions during the process (FNAN, 2014 [Interview]). Such interests may of course not be limited to insurance companies. Furthermore, examples of non-insurance industries that have clear business interests in Solvency II – and have been mentioned during the interviews for this study – are investment banks, accounting firms, management consultants, as well as IT-software providers. However, the most prominent lobbyist – as we shall see - has still been the insurance industry which has made a significant

effort to impact the process both by utilizing its formal involvement, as well as through more informal channels.

7 Tracing the Solvency II Process

In the previous chapter, the theoretical Lamfalussy Process was described and the main institutions, states and stakeholders identified as the first step in the process tracing exercise. Thus, we now move on to the actual legislative development of Solvency II and Omnibus II, and to discuss how the identified actors were involved and influenced the process.

For pedagogic purposes, the processes of SII and OII can be separated into the following six distinct, simplified and chronological phases that shall constitute the steps of the process tracing exercise. It must be stressed however, that a different classification of phases could have been equally reasonable.

Years	Phase/Process	Main topics & activities	Notable actors involved (non-exhaustive list)
1999-2004	Solvency II – Learning phase	<ul style="list-style-type: none"> Analyses and case studies conducted – reports produced Focus on provisions 	European Commission, Insurance Committee (predecessor of EIOPC) Insurance Conference (predecessor of CEIOPS), CEA, Groupe Consultatif, National insurance supervisors, KPMG
2004-2008	Solvency II – Development Phase	<ul style="list-style-type: none"> Calls for advice (1-3) Quantitative Impact Studies (1-3) Development of the level 1 text 	European Commission, CEIOPS, EIOPC, CEA, Groupe Consultatif, Member State experts, The Insurance industry
2008-2009	Solvency II – The Political Phase	<ul style="list-style-type: none"> Quantitative Impact Study (QIS4) Legislative process in the Council and the EP Implementing measures Triologue debate: <ul style="list-style-type: none"> Group support regime Equity issues 	Triologue: EP, Council, Commission. Lobbyists. Insurance companies (in the QIS)
2009-2011	Financial crisis and legislative change	<ul style="list-style-type: none"> Financial Crisis Lisbon Treaty: Altered Lamfalussy process The de Larosi�re report Establishment of EIOPA 	EIOPA, Triologue
2011-2012	Omnibus II – Pre-Triologue process	<ul style="list-style-type: none"> Quantitative Impact Study (QIS5) Development of the OII Directive Legislative process of the EP and Council 	EIOPA, Commission, EP, Council, Insurance companies (in the QIS)
2012-2016	Omnibus II – triologue process and implementation	<ul style="list-style-type: none"> LTGA report: Triologue debate; <ul style="list-style-type: none"> LTGA Issues Adjustments to the Lamfalussy process Third Country Equivalence Delegated acts & Implementing acts 	EIOPA, triologue: EP, EC, Commission. Insurance companies (In the LTGA study)

Table 2: Overview of phases in the Solvency II process

7.1 Solvency II – The Learning Phase: 1999-2004

When the Solvency II directive finally comes into force in 2016, seventeen years will have passed since the Commission agreed to conduct “a more fundamental and wider-ranging review of the overall financial position of an insurance undertaking, including investment risk” (MARKT, 1999). In the following four years, several reports were produced in what Sandström (2011) describes as “the learning phase” of Solvency II. This was the phase in which many studies were carried out, and reports were produced, leading eventually to the overall design of the Solvency II system (van der Ende, Ayadi, & O'Brien, 2006, p. 66).

Early on the *Insurance Committee* (the predecessor of EIOPC) initiated four different projects aiming to prepare the ground for the future Solvency system. The four studies resulted in four individual reports, each of which were distributed to the Member States as well as to core stakeholders such as CEA and Groupe Consultatif. (Sandström, 2011, p. 579). Two studies focused on provisions in life- (MARKT, 2002a) and non-life insurance (MARKT, 2002b), whereas the recent historical causes of insolvency in the insurance industry were analyzed in the Sharma report (2002). In addition, the KPMG report summarized background knowledge on the current regulatory regime. It also suggested the application of the three pillar approach (already used for banking regulation in the Basel framework) to the regulatory regime for insurance (KPMG, 2002, p. 16). Already during this “learning phase” of the process it was evident which of these pillars that was to raise most controversy in the years to come:

On most issues, particularly those relating to pillars II and III, there was significant agreement between Member States. On quantitative methods, there seems to be support for the general approach from most Member States, but different views exist on certain detailed technical matters. These will be subject of further analysis and discussion before the draft CEIOPS mandates are finalized (MARKT/2530/03, 2003).

7.2 Solvency II – The Development Phase: 2004-2007

The development of the Solvency II framework began early in 2004, as the Commission started to prepare the main draft framework directive, draft mandates for working areas of significant agreement (Pillar II) as well as documents to follow up issues on which there was less agreement (Pillar I).

The Commission also published a first proposed framework for the solvency system, thereby introducing the architecture of Solvency II. The legislative development work reflected the Lamfalussy model as the work was divided into separate legislative levels and streams (Sandström, 2011, pp. 590-591). Hence, in accordance with the procedures for level 1-3 documents presented above, both EIOPC and CEIOPS were given important tasks. Whereas the former would be make important decisions on the principles of the legislation at level 2, the latter were to give technical advice, communicate with stakeholders and develop guidelines for supervisors. In order to fulfill its tasks, CEIOPS set up a number of technical subgroups, to perform the work related to the SII project. These groups were operational from the summer of 2004, and both the CEA and the Groupe Consultatif organized shadow working groups in order to be able to cooperate with the groups set up by CEIOPS (Sandström, 2011, p. 590).

At the Insurance Committee's (EIOPC) meeting in June 2004, the Commission presented its road map for the development of Solvency II (Sandström, 2011, p. 592). The road map aimed at completion of the level 1 text by July 2007, whereas the implementing measures were to follow in 2008 or 2009 (Sandström, 2011, p. 592). The road map also included extensive consultation from the insurance industry and the actuarial profession. A key recommendation of the Lamfalussy report was that, during the legislative process, the Commission should "put in place a more rigorous consultation and transparency mechanism" (Lamfalussy, 2001, p. 25). Indeed, hearings are mandatory for legislative development in the EU, and the Solvency II process was certainly conducted in line with this requirement. The legislative process has thus been public and involved a very significant number of stakeholders that have participated in the debate (Insurance Europe, 2007, p. 5). According to one interviewee there has been an enormous amount of comments and input from stakeholders throughout the process. The main organizations, such as CEA/Insurance Europe, Groupe Consultatif/AAE and AMICE have been particularly active in this regard. At times, these organizations have also obtained draft documents for consultations that have not been available to other stakeholders (FNAN, 2014 [Interview]).

The participation of stakeholders was ensured by CEIOPS, which was "committed to consult, both before and after the drafting of each Consultative paper, stakeholders such as market participants, consumers, and end users, in different ways" (Sandström, 2011, p. 639). One of the main ways through which CEIOPS brought stakeholders into the process was through

“calls for advice” on important legislation and technical matters. These were requests from the Commission to CEIOPS, developed based on advice from EIOPC. In the early phases of the legislative process, the Commission issued three such waves of calls for advice for CEIOPS that dealt with Pillar II (July 2004), Pillar I (December 2004) and Pillar III (February 2005). Before the calls for advice were issued to CEIOPS stakeholders such as Group Consultatif and CEA, were asked to give their comments on the text (Sandström, 2011, p. 592).

Another way through which the legislative authorities obtained input from the industry was by conducting Quantitative Impact Studies (QIS) that were to help assess the valuation and capital requirement issues in Pillar 1. From the early stages of the process, it was clear that such studies, with the purpose of providing “basic reasoning for the major policy decisions taken during the Solvency II project as well as to gauge their impact”, was necessary (MARKT/2502/05, 2005, p. 5). Since the impact assessments were to contain aspects relevant for negotiations in the Council and the Parliament, the focus of the study was to concentrate on the major issues, specifically the overall quantitative impact of the new regime (Ibid:2005). In total five QIS studies were conducted between 2005 and 2010 (Sandström, 2011, pp. 640-641, 648). As the graph below illustrates a large portion of European companies, from all parts of the industry, took part as the number of participants increased significantly in each impact study.

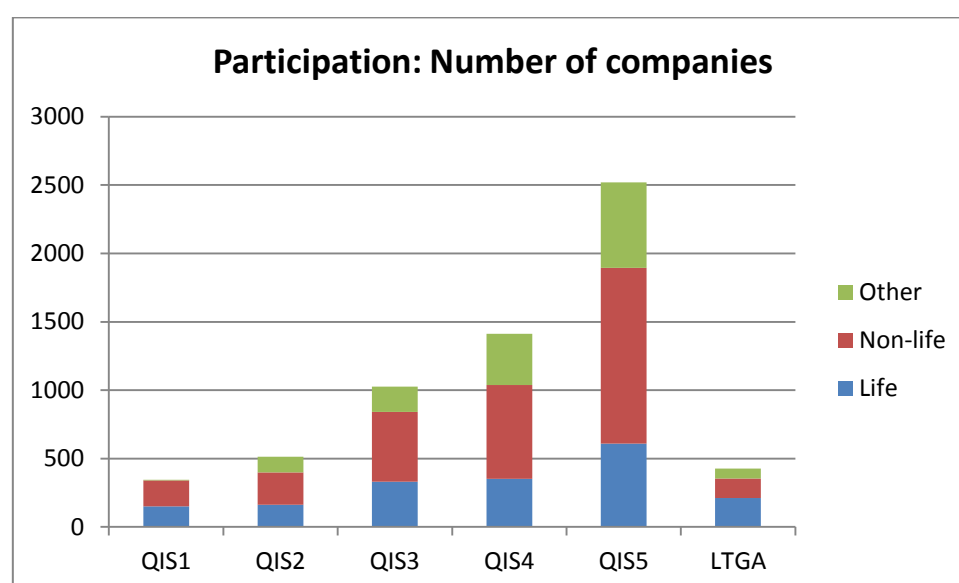


Figure 10: Number of Participants in Solvency II/Omnibus II quantitative impact studies (QIS-reports 1-5 and LTGA report).

Based on the work performed by the sub-groups, responses to consultations such as the “calls for advice” as well as the Quantitative Impact Studies, the Commission developed draft proposals of the Final Directive (i.e. the level 1 text of the directive). After postponements, the first was produced in July 2007 (Sandström, 2011, pp. 592; 603-608). In line with the co-decision procedure, the next step was to get approval from the Parliament and the Council as the real political negotiations of Solvency II began.

7.3 Solvency II – The Political Phase: 2007-2009

The ‘political phase’ was initiated with the proposal delivery from the Commission as described in the previous chapter. This meant that the EP and the Council were to produce their own versions of the level 1 text, before the three parties were to come to agreement in the final trialogue.

7.3.1 Work Streams of the EP and the Council

The individual work streams of the EP and the Council were both set up after the release of the proposed directive text by the Commission. Now both organizations were to assess and amend the draft in separate working groups within each institution.

In the EP, the Commission draft was discussed in the ECON and JURI committees, and also with stakeholders such as CEA, AMICE, national insurance associations and lobbyists who directed their efforts directly towards the rapporteurs and the MEPs (Sandström, 2011, p. 627). Eventually, there were over 800 proposed amendments to the Commission text, and the final report was adopted by the ECON Committee on the 7th of October 2008.

The working group of the Council consisted of many of the same participants that took part in the EIOPC during the development phase. According to Sandström (2011, pp. 627-628), some of these meetings were for national experts, some for the attachés, whereas some meetings included both of these. During the Slovenian presidency in the spring of 2008, compromises were reached on most issues, yet two stood out: the group support regime and the treatment of equity risk.

The Group support regime

The *group support regime* (articles 234-247 in the draft directive) had been suggested by the UK at an early stage of the Solvency II process and was directed at the large, multinational insurance groups of Europe. The idea was that such corporations were to be regarded as one company, so that they no longer would need to fulfill the capital requirement (SCR) in each local jurisdiction in which they were operating (van Hulle, 2011, p. 181). Thus, multinational groups would be allowed to fulfill only the minimum capital requirement (MCR) (not the higher requirement of the SCR) in associated subsidiaries in other EU countries, as long as a guarantee to transfer capital under stressed conditions was issued by the parent company. The group support system would therefore allow large insurance groups to operate with less capital in other EU countries relative to local companies. This approach was based on the thought that the risk profile of a group should be assessed taking into account that risks might be mitigated across companies in different jurisdictions. In other words, the risk that a group is exposed to is not equal to the sum of the risk of each solo entity belonging to the group (CEA (Insurance Europe), 2008). In addition, the legislative measure also included better supervision of such groups as a cross-border authority would be dedicated to the specific group.

However, in the heterogeneous European insurance industry which is dominated by rather few large insurance groups that are present with branches in many countries, the group support suggestion turned out to be controversial. On the one hand, the large insurance groups (particularly the UK) would be able to lower their capital requirements and thus increase the return on capital from subsidiaries in other jurisdictions. On the other hand, for those countries whose national markets have a strong presence of foreign companies, the group support regime caused a worry that they would be reliant on supervisors in larger nations, and that capital might not be transferred to subsidiaries (and thus their domestic customers) when needed (Clark, 2009).

Equity Risk: The Dampener and the Duration Approach

The *equity dampener*, which was proposed by the French presidency during the work stream of the Council in September 2008, is an adjustment to the equity risk module of the standard model. It is a stabilizing mechanism of the capital requirement, which works by taking stock

market movements over the past three years into account when calculating the equity risk. The purpose of this mechanism is lowered during recessions, so that insurers are not induced to sell equities, thus reinforcing economic downturns. According to a representative of the Norwegian FSA, this was one of the first really political elements of the Solvency II process (FNAN, 2014 [Interview]).

Another such measure related to equity risk is known as the *equity duration approach*. This reduces the capital requirement of equities by taking into account that the volatility of equities is important in the short term, but not expected to be significant in the long run. Hence, this measure was introduced by the French presidency in order for the capital charge to be reduced by taking into account the long holding period of such assets (Sandström, 2011, pp. 628, 813).

Outcome

Van Hulle explains that all of these issues had been controversial prior to the Council process. However, it was the initiation of the financial crisis that made them unacceptable. Regarding the Group support regime,

it became impossible to convince particular Member States (those Member States in which the subsidiaries are located) that a parent undertaking would be prepared to provide group support to a subsidiary when either the parent or the group as a whole would face serious financial difficulties (van Hulle, 2011, p. 178).

On the equity duration approach as well “most Member States were opposed to a reduction of the capital charge for equity investment as the financial crisis had shown once more how quickly equity investments suffer from a fall in financial markets” (van Hulle, 2011, p. 179).

Given the disagreements on these two particular issues, the COREPER II meeting in the beginning of October was unable to reach a final agreement. When the ECOFIN met on October 7th, it was thus decided to return the draft to the COREPER in order to find a solution on both issues (Sandström, 2011, p. 628).

During the French Presidency, which lasted from July to December 2008, a compromise was reached in which the equity dampener and the duration approach were added to the directive.

The group support regime, which was opposed by 12 Member States, was removed from the legislation proposal of the Council (Sandström, 2011, p. 629). The compromise was sufficient to complete the work stream of the Council. Hence, its version of the final directive was adopted as a “general approach” by the COREPER II on the 19th of November and finally by the ECOFIN on the 2nd of December 2008 (Sandström, 2011, p. 629).

The Commission was strongly opposed to the text adopted by the Council, and stated that it would “not be able to support the presidency compromise” (Bateson, 2009). Furthermore, according to one news article on the process, Sharon Bowles, the EP JURI rapporteur, tagged the Council-compromise a “dirty deal” in which the presidency exchanged the removal of the group support regime (which several of the Eastern European Members did not want) in order to include the equity dampener (Woolner A. , 2010). The outcome was also opposed by the UK Council representative, who warned that the legislation would set capital requirements below the current levels for British insurers (Bateson, 2009).

7.3.2 Solvency II trialogue

A year and a half after the finalization of the draft proposal by the Commission, the work streams of both the Parliament and the Council were completed at the end of 2008. This marked the beginning of the Conciliation procedure: namely the trialogue in which the Council, the Parliament and the Commission meet to reach a final compromise for the legislation (Sandström, 2011, pp. 626-627).

In total, eight trialogue meetings – the first on the 22nd of January 2009, the last on the 18th of March - were conducted. In addition, it was agreed to set up a technical committee for nonpolitical issues, which met and agreed on 96 articles in the directive (Sandström, 2011, pp. 629-630). Thus, it is worth noting that a significant number of issues were regarded as “non-political” even in the trialogue.

In the political meetings, on the other hand, several controversial topics were defined, and the five that were to be discussed further were agreed at the second meeting. These were (Sandström, 2011, p. 630):

1. The Group support regime
2. Anticyclical mechanisms (including the equity issues)
3. Cooperation among supervisors

4. Third-country issues
5. Quality of Own Funds

At the beginning of the trialogue, in December 2008, it was the directive version of the Council that stood out from the other two, both regarding the group support regime and the equity issues. As described above, this was caused by the fact that the Council wanted to alter the draft proposal of the Commission by removing the group support regime and including the equity proposal. The Commission and the Parliament, on the other hand, wanted the Group support regime, whereas neither had the equity measures included in their versions of the directive (Sandström, 2011, p. 629).

Early on in the trialogue process, the Parliament presented a united front on its version of the text and made clear that there would be no discussion on the equity issues unless a compromise was first put forth on the group support regime. (Sandström, 2011, p. 630). Initially, the Czech Presidency of the Council did not have much of a mandate to compromise with the Parliament, but in order to make progress the former produced a draft compromise and obtained such a mandate from the Council Working Group on the 18th of February. According to Sandström (2011, p. 630), “This was seen as a major step forward and was a thaw in the negotiations”.

However, the EP’s answer to this compromise was rejected by the Council Working Group with opposition coming in particular from Poland, Spain and Portugal, along with several smaller Member States (Sandström, 2011, p. 616). According to Sandström, these countries were very successful in standing firm as a blocking minority in the political process. Given the opposition the suggested text the “Presidency decided to come up with a new compromise proposal in order to break the deadlock” (2011, p. 631).

The new proposal was to remove the group support regime from the final directive, but to include a ‘review clause’ which 1) calls on the Commission to present, two years after the transposition date, a report on the application of the provisions regarding group supervision; 2) three years after the transposition the Commission shall make an assessment of the benefit of enhancing group supervision (Sandström, 2011, p. 633).

At the trialogue meeting the 11th of March, the Presidency informed the Parliament and the Commission about this solution, which most Member States were willing to accept. As the representatives of the Parliament also concurred with the suggested review clause, the group support regime was removed from the directive, and in reality postponed. In the next meeting, on the 17th-18th of March, a compromise was reached that also led to the inclusion of the equity dampener. As for the equity duration approach, the compromises introduced this measure for some pension products, and, as a notable exception to the general rule of the directive, it was made optional for the Member States (van Hulle, 2011, pp. 179, 184 (footnote)). A final informal agreement was reached on the 26th of March 2009.

In its statement on the completion of the trialogue the Czech Presidency listed as the most sensitive issues both the group support regime and the treatment of equity risk (Sandström, 2011, p. 632). The industry – represented by the CEA – expressed satisfaction with the compromise, but noted that the removal of group support from the directive was unfortunate. In particular, reference was made to the de Larosiére report which, one month earlier, had recommended that “the Solvency 2 directive must be adopted and include a balanced group support regime, coupled with sufficient safeguards for host Member States [...]” (de Larosiére, 2009, p. 23).

The directive was adopted by the EP on the 22nd of April and by the European Finance Ministers at the Council on the 5th of May, shortly before CEIOPS was asked to begin work on the implementing measures. The Solvency II act was formally adopted on the 25th of November 2009.

7.4 The Financial Crisis and Solvency II

The Solvency II process just described took place in a period during which most European economies, relatively speaking, were characterized by moderate interest rate levels along with stable and high economic growth. Furthermore, prior to the financial crisis, the European economies were relatively similar in these regards. In other words, conditions were beneficial for (life) insurers, as well as for the development of a harmonized European

regime. However, as the financial crisis and the related sovereign debt crisis unraveled, this situation was about to be significantly altered.

7.4.1 The European Wedge

When the de Larosière report was published in February 2009, it described the present state of the economy as “the most serious and disruptive financial crisis since 1929” and went on to claim that to “prevent the recurrence of this type of crisis, a number of critical policy changes are called for”. The report saw Solvency II as an important part of the effort to bring about such policy changes (de Larosière, 2009, pp. 6,22).

Hence, the financial crisis created a sense of urgency in establishing the new insurance regulations. However, in another way, it changed the landscape of the European economy and insurance markets so that the necessary political compromises became harder to achieve. Initially, in 2009, the financial crisis affected most of the EU Member States in a similar way: All the main national economies slumped. However, as illustrated below, this situation was not to prevail as the financial crisis was transformed into a Eurozone government debt- and currency crisis. For reasons that go beyond the scope of this paper, a significant gap ensued in the EU (and the Eurozone), between, on the one hand, fast growing, competitive and modestly leveraged (mostly) Northern European economies and, on the other hand, recession-prone, uncompetitive (mostly) Southern European countries with debt levels out of control.

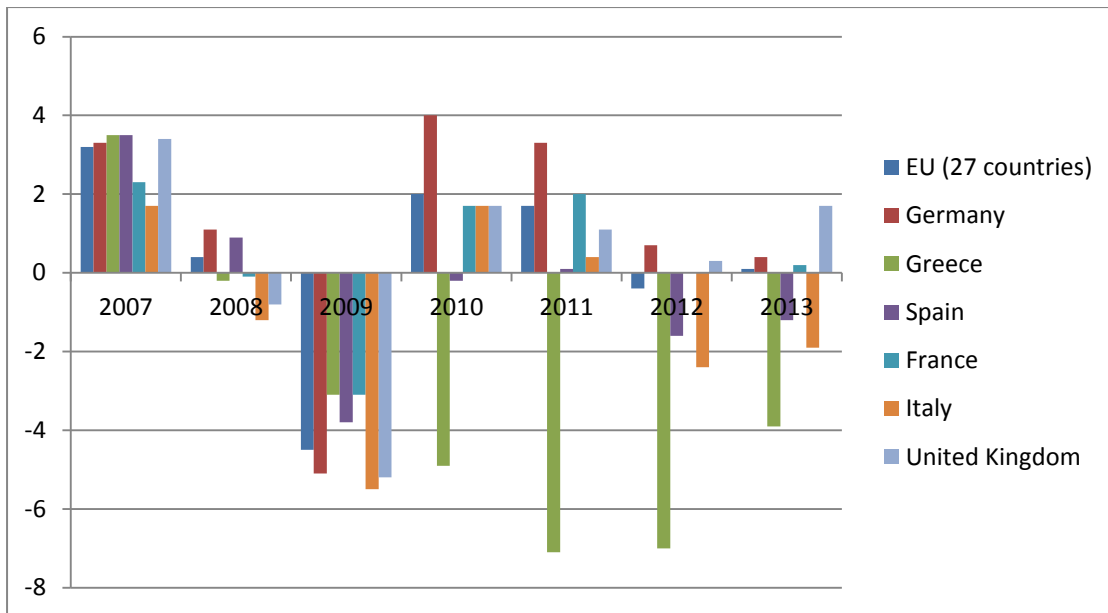


Figure 11: Real GDP growth rate – volume. Percentage change on previous year (Eurostat, 2014).

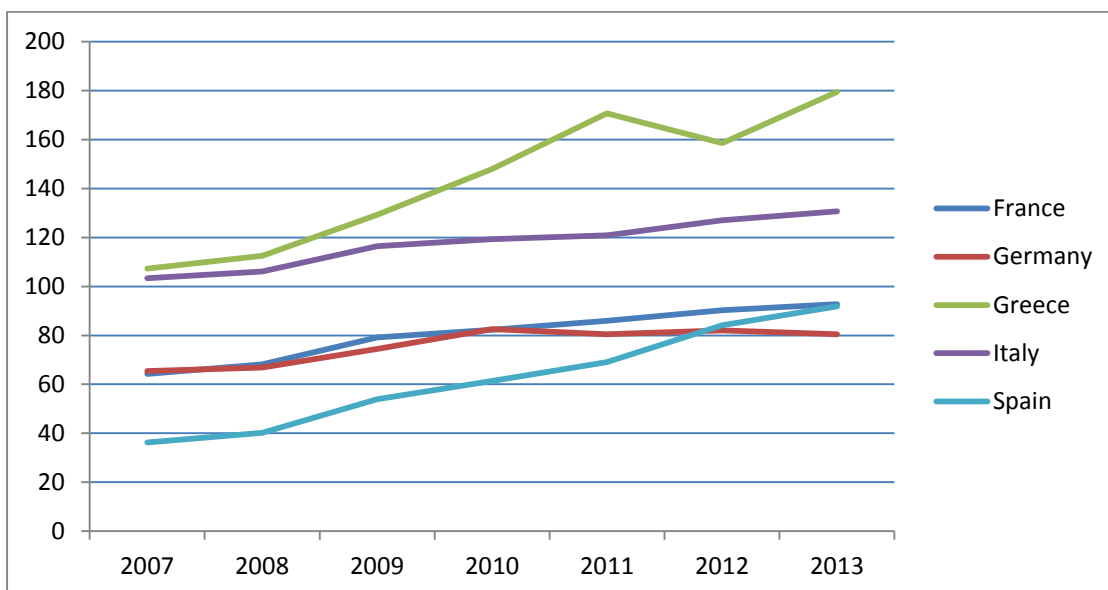


Figure 12: General government gross debt, percentage of GDP (International Monetary Fund, 2013).

The combination of high levels of debt and negative growth manifested itself in the borrowing costs of the national economies involved. The interest rates on the debts of Italy, Spain, and in particular Greece, all surged as investors feared what had previously been the unthinkable case of sovereign default. On the other hand, the governments of the sound European economies, particularly Germany and the Nordics, experienced all-time low

borrowing costs as investors were eager to find more solid investment assets. The Eurozone project which was supposed to bring the continent closer together had instead created a financial wedge between the north and the south.

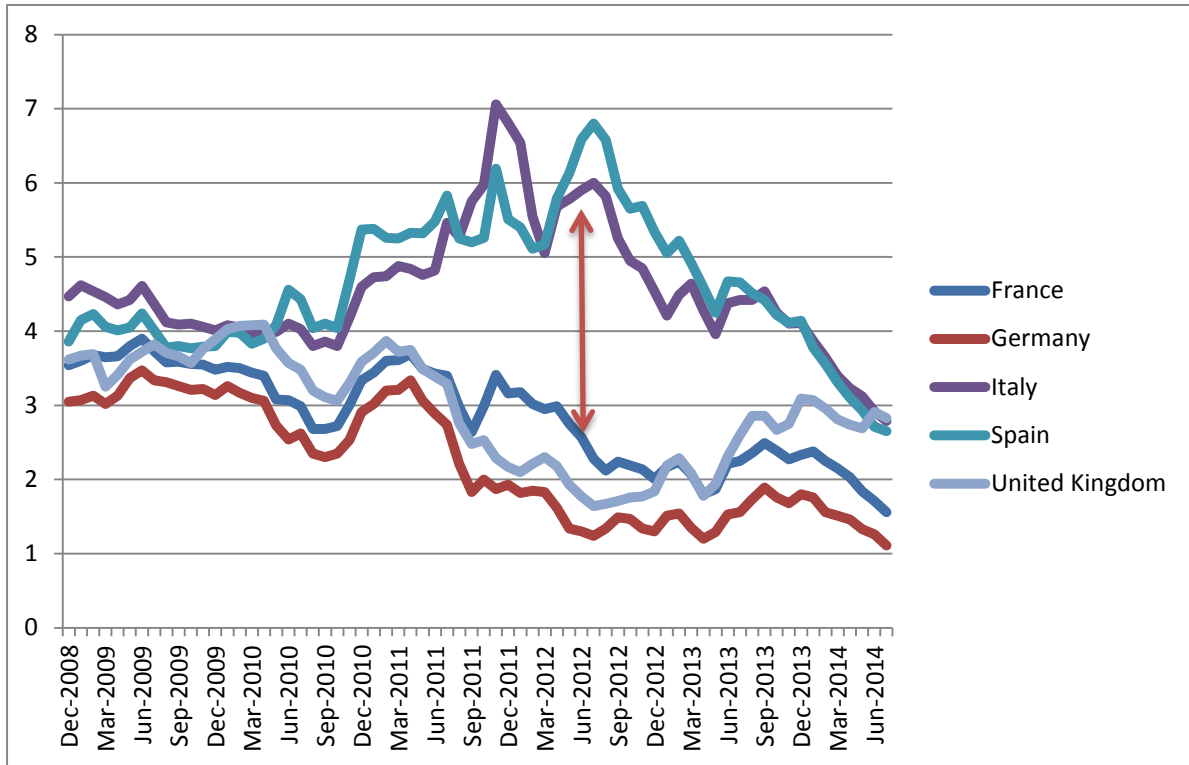


Figure 13: Sovereign debt interest rates of selected European countries (OECD, 2014).

Low, often negative, macroeconomic growth was, however, not the only concern for national governments. Declining stock markets, failing banks and soaring unemployment added to the pressure for governments to take action. In a response to these developments, Central Banks all over the world, including the European Central Bank and other non-Eurozone Central Banks in the EU, lowered interest rates in an unprecedented monetary expansion which is reflected in the following graph:

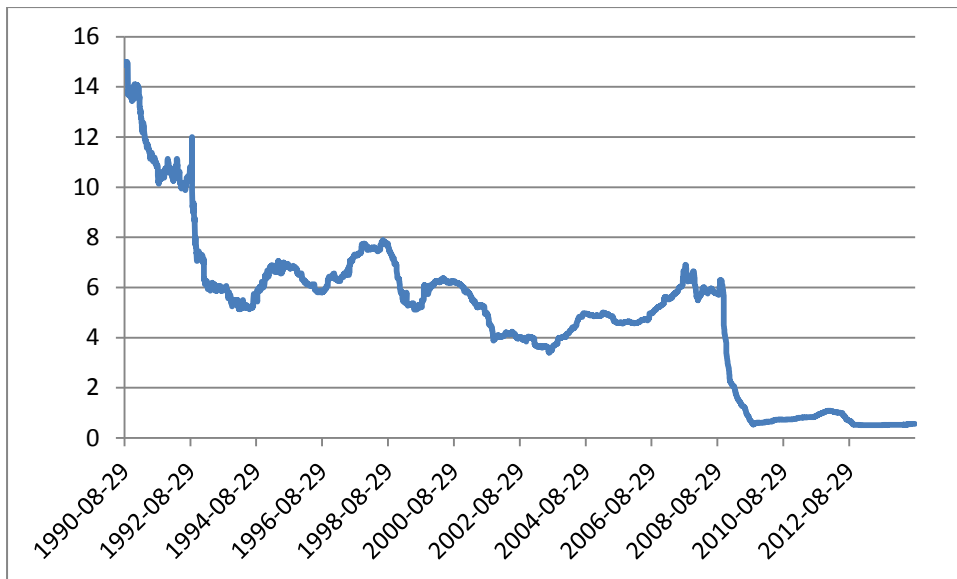


Figure 14: 3-Month London Interbank Offered Rate (LIBOR), based on British Pound (Federal reserve bank St.Louis, 2014)

Within just a year – from 2008 to 2009 - the 3-month LIBOR²² interest rate dropped from about 6 % to less than 1 %. Furthermore, the striking thing is not simply that interest rates have been at record low levels for a long time; there are not really any signs that this situation is about to change in the future as long-term interest rates are low as well. Naturally, for an industry that is highly dependent on the interest rate level – such as insurance – this implies a very significant change of circumstances which, as it turned out, happened to coincide with the finalization of the new regulatory regime.

7.4.2 The Insurance Industry: Low Return, Low Discount

It is the long durations of insurance liabilities, explored earlier in this essay, which makes the financial state of an insurer highly sensitive to changes in interest rate levels. On the one hand, low interest rates increase the value of insurance liabilities due to reduced discounting effects. On the other hand, poor financial conditions and increased risk in government bonds reduced the return of assets and thus the ability to pay for these liabilities in the future.

²² The London Interbank Offered Rate is a benchmark rate that some of the world's leading banks charge each other for short-term loans (Investopedia).

The controversies surrounding the capital requirements of Solvency II (already reflected in the Group support regime and equity issues discussed above) was further increased as CEIOPS, in 2009 and 2010, proposed conservative implementing measures. The measures, which in part were a response to the financial crisis, were controversial and not welcomed by the industry (van Hulle, 2011, p. 184). Indeed, the industry was able to persuade the Commission that the advice from CEIOPS was excessively prudent, thereby altering the models for the fifth quantitative impact study (Freshfields Bruckhaus Deringer, 2012, p. 3).

Nonetheless, the consequences of the financial crisis were highlighted in the QIS5 study which was conducted in 2010 based on year-end data from 2009. In its summary report, EIOPA noted that

Since the previous QIS, which was run on end 2007 accounts, the insurance sector financial surplus under the current solvency regime has seen a marked decrease in 2008 (of the order of €200bn) - followed by a partial recovery in 2009. This evolution is largely explained by the impact the financial crisis had on the value of assets owned by the sector, and on interest rates used to discount liabilities in some countries. At the end of 2009 the surplus was approximately €500bn (EIOPA, 2011, p. 23).

Hence, the financial crisis had led to a significant increase in reserve and capital requirements as a consequence of the drastic reduction in the general interest rate level. Yet, it must be noted that once again the divisions across Europe were rather significant. As can be seen from the table and graph below, France and Germany had a relatively high share of solid companies, whereas a large proportion of British companies were close to the SCR requirement, which would trigger supervisory sanctions under Solvency II.

High proportion of solid companies	High proportion of companies that are below, or just above, the SCR requirement	High proportion of companies that are below the SCR requirement
France, Germany, Slovakia, Estonia, Finland, Austria	Lithuania, Portugal, Cyprus, Belgium, Bulgaria	Greece, United Kingdom, Poland, Malta, Sweden, Latvia

Table 3: Selected countries classified according to capitalization of companies (EIOPA, 2011, p. 26).

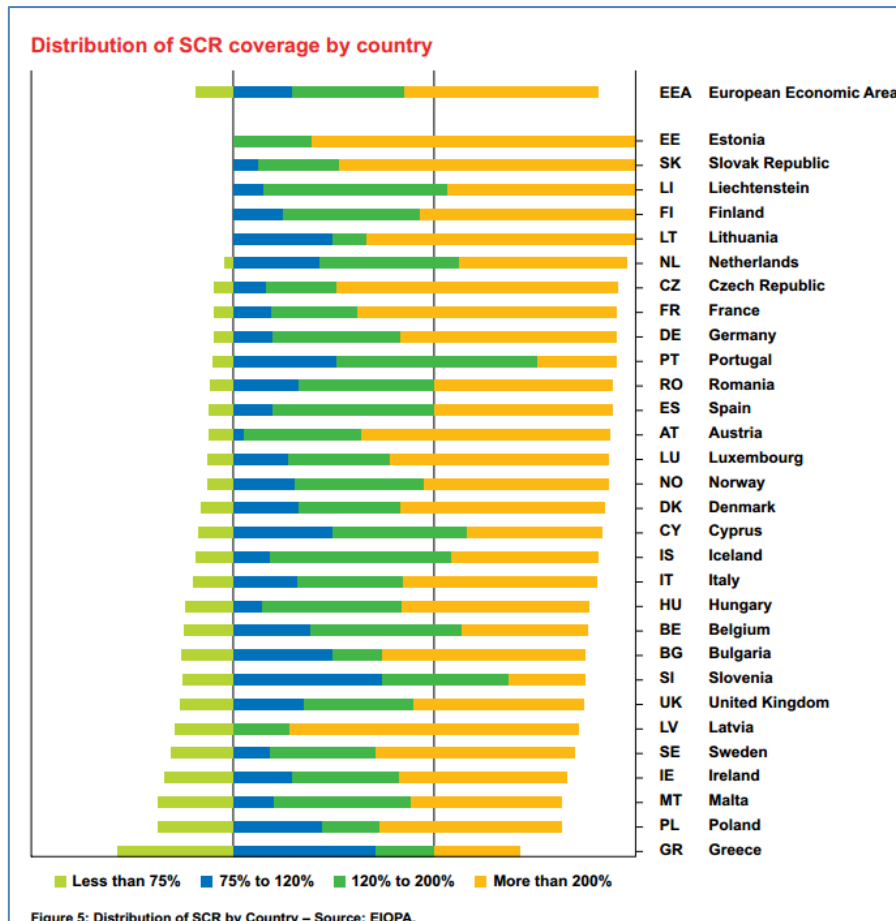


Figure 15: Percentage of participants with different SCR solvency ratio (EIOPA, 2011, p. 26).

These differences are partly explained by trivialities, such as the fact that the participation ratio varied significantly from one country to the next. However, there is no doubt that it is also a reflection of the characteristics of markets and products referred to in the previous section. For instance, the relatively weak capitalization of many British insurers was a consequence of the fact that this is the market in which products sensitive to low interest rates are most developed (Dunbar, 2006).

More generally, this situation stemmed from the fact the insurers most severely affected by the macro-economic development – which was mirrored in the capital requirements through the Solvency II QIS5 calibration – were providers of long-term guarantee products. In several European countries such insurers were already dealing with the (for the companies) problem of increased longevity, and the drop in interest rates thus worked to aggravated the already strained conditions.

The reactions, warnings and debates over the consequences for the long-term guarantee business have been significant. In 2009, the Association of British Insurers (ABI) sent a letter to the then UK Chancellor of the Exchequer, Alistair Darling, arguing that insurers in Britain alone would need to raise capital of £50bn – close to the total value of the UK industry - in order to meet the capital requirements (Insurance Times, 2009). In other words, the Solvency II principle of valuing assets and liabilities according to market value was making insurers with long term liabilities dependent on short-term volatility in interest rates and the general macro economy. As the financial crisis brought attention to this issue, the options were clear: Either many companies offering traditional life insurance and long-term guarantees (LTG) would cease to exist, or the rules of the Solvency II capital requirements from the development phase would need to be altered. Based on the QIS5 study, the German Insurance Association (GDV) reached a similar conclusion in 2011, arguing that it “has shown that the regulations are not ready for implementation. The study has made it clear that there is substantial room for improvement in SII. We are not talking about cosmetic changes” (von Furstenwerth, 2011).

Hence, the problems faced by life insurers were not confined to Britain alone, but were an issue for several European nations with a tradition for guaranteed benefit schemes. For example, despite its relatively solid performance in the QIS5 study, it became increasingly clear that German life insurers in the past had provided such guarantees that were above the interest rates which they could presently get (Wiedner, 2013). In addition, as illustrated above, the Greek industry was characterized by the fact that the nation’s insurers were barely able to satisfy the Solvency I capital requirements let alone the normally higher requirements under Solvency II (Tsentas, 2010). As the Eurozone crisis unraveled, more Southern European Member States shifted its priorities towards economic growth which (at least in the short run) is not necessarily compatible with a priority of prudent insurance regulation.

Hence, in general, the Financial- and Eurozone crises changed the interests and divisions of European nations and insurance companies having in turn, as will be explored next, a significant effect on the Omnibus II process.

7.5 Omnibus II: Pre-Trialogue Process 2011-2012

When the Omnibus II directive was proposed by the Commission in January 2011, it was supposed to be a rather straightforward directive with the purpose of amending Solvency II that had become part of European law two years earlier. The initial purposes of Omnibus II were, first, to adapt the level 1-text of Solvency II so it was up to date with the Lisbon Treaty, including the new supervisory structure characterized by the establishment of EIOPA (Freshfields Bruckhaus Deringer, 2012, p. 3). Second, Omnibus II was to specify delays to several elements of Solvency II, such as transitional measures for capital requirements and provisions and reporting requirements (Carver, 2011). However, as a consequence of the Eurozone crisis in 2010, as well as the QIS5 report which was published in March 2011, “a range of industry associations and lobby groups lined up to present alternative solutions to the problem – the merits of which varied from pragmatism to almost opportunism, and Member States often backed their respective insurance industry’s position” (Solvency II Wire, Two lessons from Solvency II, 2014b). As it turned out, Omnibus became an arena for discussions of a number of issues that surpassed what EIOPA originally intended or expected (FNAN, 2014 [Interview]).

The issue of LTG products really turned into a political debate when the European Parliament – in its version of the Omnibus II directive - moved the set of implementing measures that were to deal with LTG issues from level 2 to the Level 1 text in March 2012 (Solvency II Wire, 2012b). The decision by the EP to do so was indeed inconsistent with past procedures. During the pre-Lisbon process, the level 1 text was supposed to be principles-based only, but during Solvency II the Parliament held the opinion that it should contain policy choices and decisions as well whereas the Level 2 were to contain technical requirements only.

According to Solvency II Wire (2014b), the decision to move the LTG measures into the level 1 text was a consequence of intensive lobbying, and effectively turned the technical matters of these measures into political bargaining chips. Furthermore, the move ensured that EIOPA was sidelined as it was left only with providing non-binding advice on the LTG issues (Ibid: 2014). This fact is important given that the Parliament upon the creation of EIOPA “enthusiastically welcomed the three EASs”, thereby dropping “its long standing opposition to the further consolidation of EU governance by means of supranational ‘agentification’” (Everson, 2012, p. 9). Hence, even though the Parliament accepted the

creation of EIOPA in the first place, evidence indicates that this acceptance may be reduced in turn by an unwillingness to allow important decisions to be decided by the technocratic agency.

Regarding the functionality of the LTG measures which was the root of the controversy the aim was to limit the excessive volatility in the Solvency II balance sheet as a consequence of changes in long-term interest rates. Several specific measures were suggested and calibrated during the process, namely: The Matching Adjustment (MA), the Countercyclical Premium (CCP) and the Yield Curve Extrapolation (YCE)²³.

Although most MEP's supported the LTG measures as a set of adjustments to imperfect market prices that were necessary to keep the long-term guarantee industry profitable, the Green party was a particularly articulate opponent. Upon the finalization of the EP's position in March 2012, the party's representative Sven Giegold wrote that "the legislative process was a case study in the dominance of vested interests of financial lobbies over general interests of consumer protection, financial stability and tax payers" (Giegold, 2012). In particular, he identified the insurance lobbies of Spain, Italy and the UK – along with their respective governments - as highly active, while consumer organizations were "totally absent" (Giegold, 2012). The EP was not, however, the only arena of lobbying. According to the minutes of an EIOPA stakeholder meeting, van Hulle pointed out that "Ministers [in the Council] get heavily lobbied" (EIOPA, 2012, p. 2). Against this background of high stakes and opposing interests, the stage was set for the trialogue discussions.

7.6 Omnibus II: trialogue Process: 2012-2014

According to the minutes of the 22nd EIOPC meeting, there were significant differences between the legislative texts approved by the European Parliament's ECON Committee in March 2012, and the Council's general approach of September 2011. The Chair referred to both questions discussed in the previous sections as particularly difficult areas of the trialogue (MARKT.ddg2.h.2, 2012, p. 2).

²³ The LTGA measures are highly technical and beyond the scope of this paper. For a thorough assessment of the individual measures see (EIOPA, 2013c).

The first controversial area was the package deal of the long-term guarantees. In the trialogue, there was significant disagreement as for which of the LTG measures that were to be included and also how they were to be calibrated. In fact, these questions turned out to be the main topics of the Omnibus II process. Since this was a direct consequence of the low interest levels, the scope of Omnibus II was indeed significantly expanded because of the financial crisis.

The second issue was the alteration of the Lamfalussy process following the Lisbon Treaty. Thus, an important issue in the OII negotiations was “whether an implementing measure in SII should take the form for a Commission delegated act or an EIOPA regulatory technical standard” (MARKT.ddg2.h.2, 2012, p. 2). But this was also directly related to the LTG measures as there were disagreements over whether the new measures were to be included at level 1 or level 2. Whereas the Council suggested placing one such measure (the counter-cyclical premium) at Level 1, and two others (extrapolation and the matching premium) at level 2, the Parliament wanted all these measures as part of Level 1 (Towers Watson, 2013).

During the first months of the trialogue in 2012, it was clear that the gap between the three parties was so great that the progress of the process as a whole was held up over these issues. In a press release issued on the 12th of July 2012 it was announced that all parties in the trialogue had agreed “to commission an impact study of the various schemes on long-term guarantee measures” (Solvency II Wire, 2012c).

The decision to launch the LTGA study led to a slowdown in the Omnibus II process and subsequent delays to implementation of the regulatory framework. The impact study was in essence a request from the trialogue parties to EIOPA, “to review the design and the calibration of the standard formula to encourage certain long-term investments” (Wiedner, 2013). In the report which was published on the 14th of June 2013, EIOPA gave its advice for each of the LTG measures.

In essence, the underlying question for each measure is how insurance liabilities are to be discounted and thus valued, questions which have a significant impact on the amount of capital that insurers are to set aside for reserves and capital requirements. Although the LTG measures are technical and complex, the principles that they represent may be of crucial

political importance. In practice, this implies that a slight adjustment in a decimal number of a mathematical model today may in fact be the difference between a profitable business and insolvency in the future. In turn, this may be of crucial importance for insurance and pension customers. One news site pointed this out, stating that

The contrast between the minutiae of the technical details under discussion and the potential huge adverse effects on the retirement prospects of so many policyholders can hardly be grasped. In fact it is not grasped: that is why this debate is receiving so little attention outside of the SII community (Solvency II Wire, 2012a).

In the LTGA study, EIOPA tested, and gave its opinion, on the measures that were discussed during the dialogue. According to the report, out of the 213 life insurers participating in the study, 56 would fall short of reaching the SCR requirement at year-end 2011 without the measures, as the result of a total shortage of €90bn by the companies participating in the study (EIOPA, 2013, pp. 32, 158). The fact that such a significant portion of participating insurance companies proved to be undercapitalized, could essentially stem from at least one of two causes: Either the model calibration was too conservative and prudent; or the model gave a realistic solidity requirement for an industry that was actually undercapitalized. The latter explanation would have serious implications for the long-term guarantees market in several Member States. A reasonable point of view is that both explanations hold some merit. Even though important real drivers of the life insurance business have turned against the companies in recent years, demanding that long-run market values are influenced by short term interest volatility (i.e. according to the Solvency II standard) may still not be reasonable. This was also observed by van Hulle who noted that: “We have to take artificial volatility out of the system; otherwise these products will not be offered” (Davis, 2011).

Although the LTG measures suggested by EIOPA reduced the SCR-requirements for European insurers with more than €220bn²⁴ (EIOPA, 2013, p. 2; EIOPA, 2013, p. 32), the response from the stakeholders in the insurance industry was generally negative. For example, Insurance Europe wrote that its preliminary review “raises significant concerns that the measures proposed would not work as intended” (Insurance Europe, 2013a). AMICE also expressed concerns about some the EIOPA recommendations in a different letter (AMICE, 2013). Furthermore, it was indeed clear that the advice of EIOPA automatically were to be

²⁴ These figures are of course subject to substantial uncertainty. However, if the reserve requirements – and not only the SCR requirements – are taken into account they are most likely substantially higher.

adhered to. In response to a question on whether EIOPAs recommendations were weakened in order to make possible a political compromise, Wiedner (of the Commission) replied that

No one should have expected that we would take EIOPA's technical report and say 'well done, we will adopt it'. There is a political process. The commission said it wanted the negotiations to be made on the basis of the report and the other parties accepted the 'menu' under pressure. But it was clear that the calibrations would move. There are some red lines, obviously, but in our view these have not been crossed (Wiedner, 2013).

Nonetheless, the advice from the EIOPA study had enabled the triologue to pick up the pace and to finally reach this compromise on the LGT-package was finally reached in on November 13th.

In the end the insurance industry avoided this outcome as many of EIOPA's suggestions in the LTGA report were diluted and hence made more liberal in terms of reserve and capital requirements. In total, the Council compromise reduced the capital requirements with an additional €47bn relative to EIOPA's suggestion in the LTGA report (EIOPA, 2013b). The Green party of the EP was once again highly critical of the compromise, commenting that "years of intensive lobbying have paid off for the insurance companies of the largest Member States. The industry achieved to lower prudential capital requirements and hence increase profits for long term insurance products" (Giegold, 2013). The outcome of the LTG-process does indeed appear to provide some evidence in this direction as the various measures appear to have been almost tailor-made for specific countries: the UK and Spain benefitted from the Matching Adjustment, Italy and France "got" the Volatility Balancer whereas both the Yield Curve Extrapolation and the Transitional measures improved the solidity of insurers in a host of countries, yet most clearly in Germany.

Once this issue was resolved however, the triologue was able to find a compromise on Omnibus II. The formal vote which adopted the level 1 text of the directive with 560 to 130 votes (with four abstentions) took place the 11th of March (Solvency II Wire, 2014a).

8 Interpreting Solvency II

In this chapter we return to the initial question stated in the first chapter:

Is the political process of the Solvency II directive best explained by expert knowledge; Member State interests; or by the influence of sectoral interests?

In order to answer this, we investigate each of the sub-hypotheses from chapter 4 individually in the following three sections. Next, the perspectives are brought together in the final section of the chapter where the relevance of each of the three main hypotheses are discussed.

8.1 The Knowledge-Based Directive

Throughout this paper, the complexities of the insurance industry and the heterogeneity of the European market have been emphasized. Hence, it is clear that the contribution of technical experts has been required in the Solvency II process. In this section we investigate the following hypothesis based on the empirical evidence.

H1.1 Epistemic communities have existed, and are possible to identify, in the Solvency II process

According to Davis Cross (2013, p. 138), the literature is unclear about the type of groups that constitute epistemic communities, and she suggests that the concept has been interpreted too narrowly in the past. To some extent, the author points out certain ways in which this interpretation can be broadened. For one thing, she argues that epistemic communities may be located *within* government structures, and furthermore goes on to claim that “it does not matter whether members of an epistemic community come together organically, are spurred to action by an NGO, or are *brought together by governments to form an advisory committee*²⁵” (Davis Cross, 2013, pp. 153-154). These suggestions are also in line with Haas’ original article in which he maintained that the extent to which an epistemic community consolidates bureaucratic power within national administrations and international secretariats, it stands to institutionalize its influence and insinuate its views into broader international politics” (Haas, 1992, p. 4). With this in mind it does not appear that characterizing

²⁵ Italics added.

institutionalized entities as epistemic communities break with past use of the concept. Hence, such actors may be identified even as formal participants in the process.

A clear candidate of an epistemic community within the framework of development of financial regulation in the European Union, then, is CEIOPS and even more so its more powerful successor, EIOPA.

EIOPA

Although EIOPA is rather distant from the typical image of the voluntary, unorganized and arbitrary epistemic community, the causes that led to the establishment of EIOPA – namely the financial crisis – is in line with the “central avenue for epistemic community influence [which] is generally understood to be post-crisis conditions of uncertainty for decision-makers” (Davis Cross, 2013, p. 151). Thus, based on the fact that EIOPA (and its predecessor) to a large extent can be characterized as an “advisory committee”, it can be argued that EIOPA is – or at least shares some of the important characteristics of – an epistemic community.

Prior to its establishment, the de Larosiére report argued that the new European institutions of financial supervision should be

independent from possible political and industry influences, at both EU and national level. This means that supervisors should have clear mandates and tasks as well as sufficient resources and powers. In order to strengthen legitimacy and as a counterpart for independence, proper accountability to the political authorities at the EU and national levels should be ensured. In short, supervisory work must be independent from the political authorities, but fully accountable to them (de Larosiére, 2009, p. 47).

Indeed, as we have seen, EIOPA was to a large extent established in accordance with this report; the aim for the organization was from the beginning that it should be devoid of political and national interests. However, there may of course be a significant gap between the intentions and the formal set up of an organization compared with how it is actually operating. Thus, before we can assume that EIOPA has functioned as an epistemic community, this needs to be investigated further. One way of doing so, is to consider how the working groups set up by EIOPA – in which national supervisors participate – function. For this purpose, the interview with the Norwegian FSA is a useful source given that the interviewees have first-hand experience. Regarding their role in EIOPA working groups, the

interviewees expressed clearly that they take part in these discussions as neutral experts. Thus, their aim is to contribute to the best possible regulatory framework, rather than to defend national policies and interests. This is in line with the findings of Isaksen (2012, pp. 48-50). However, one interviewee also expressed that they do not necessarily always experience that this is the case for the supervisors of every other states (FNAN, 2014 [Interview]). For obvious reasons, this is difficult to verify especially as the interests of the participating countries, as well as their supervisory traditions, differ significantly.

However, even if the national experts involved appear not mainly to be pursuing their national interests, it still appears that the discussions between national supervisors in the EIOPA working groups are not free from politics. The explanation is that the Commission is often involved relatively early on in the process, and may well provide the working groups with guidance based on political discussions that have already taken place. If EIOPA truly was an epistemic community, it should not really be expected that such information would alter the recommendations of EIOPA, unless complemented by persuasive arguments. However, according to the interviewee, the result may often be that “attempts are made to follow these political signals before it is really required” (FNAN, 2014 [Interview]). On the one hand, this may weaken the case for EIOPA as an epistemic community, but on the other hand it may be argued that it is a rational strategy not to produce draft legislation or recommendations that are unrealistic from a political perspective.

Another respondent also noted that there has been a certain development when it comes to the presence of politics in EIOPA meetings: “In the beginning [of the Omnibus II process], the discussions in EIOPA were completely dominated by technical issues. However, once the political signals became clearer it has been easier to note a consistency between the various nations’ interests and their positions during EIOPA meetings” (FNAN, 2014 [Interview]).

Hence, we cannot conclude that all arenas hosted by EIOPA are purely neutral ones in which no political activity is ongoing. However, it would also be wrong to induce from the activities of national supervisors in such forums that EIOPA itself does not resemble an epistemic community. For one thing, Haas points out the broad range of roles played, and tasks performed, by epistemic communities. In particular, they articulate

the cause-and-effect relationships of complex problems, *helping states identify their interests, framing the issues for collective debate, proposing specific policies, and identifying salient points for negotiation*²⁶ (Haas, 1992, p. 2).

Thus, based on this perspective, an epistemic community may have a more broadly defined role. For example, it might not only be the case that national supervisors articulate already defined national interests in the EIOPA working groups. It could also be the case that these national interests are shaped and defined as the national representatives' increase their understanding during EIOPA meetings.

In order to undergo a more clear-cut examination of whether EIOPA may indeed be equated with an epistemic community, one may employ the criteria identified by Haas (1992) which were listed in chapter 4.1, and assess EIOPA against these as follows:

Criteria	Evaluation of suitability for EIOPA	Conclusion
<i>Principled / Normative beliefs</i>	On a high level, it is clear that if EIOPA is to function according to its purpose, the normative beliefs must largely be shared across the organization. This strategic goals are related the quality of the EU insurance market and European insurance supervision(EIOPA, 2014c).	<i>EIOPA – unlike the traditional epistemic community – is institutionalized with a clear aim and strategic purpose.</i> <i>From its actions and deliverables, we can infer that EIOPA employees in general share the strategic goals of EIOPA, hence this criteria is fulfilled</i>
<i>Causal beliefs</i>	The main causal beliefs of EIOPA – related to the aims referred to above - demand prudent insurers with sufficient reserves and capital buffers. This can and should be achieved by government regulation and supervision.	<i>It seems unlikely that anyone associated with EIOPA would argue against this. Hence, this criteria is fulfilled.</i>
<i>Knowledge: Shared notion of validity</i>	EIOPA appears to believe in the use of consultations and impacts studies. However, the extent which EIOPA weighs evidence based on these findings against other sources of knowledge is unclear.	<i>Fulfilled to some extent, but inconclusive.</i>
<i>Shared Interests</i>	Ideally, this would be the case for EIOPA. However, EIOPA involves representatives of various highly different national FSAs. Furthermore, it is a professional work place	<i>Criteria not fulfilled, although it is most likely true for many of its employees.</i>

²⁶ Italics added.

	<p>with paid employees, rather than a composition of voluntary idealists.</p> <p>Thus, although the employees of EIOPA certainly should be expected to desire the realization of the organization’s aims, this can most likely not be said to be the main motivation – like one would expect from a voluntary organization - for why they contribute to the cause of EIOPA.</p>	
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In conclusion, it is clear that EIOPA is not an epistemic community in the traditional sense. However, given that it does score rather well on the criteria outlined above, a qualified assumption – rather than a conclusion – is that EIOPA does in fact resemble an epistemic community. At the very least, it has replaced the need for one.

The Insurance Industry

Earlier in this paper we have seen how the insurance industry, most prominently represented by Insurance Europe, has by far been the most active stakeholder. From the very beginning of the Solvency II process, insurers were brought in to contribute to the extensive consultative process which defined the development phase and included calls for advice as well as quantitative impact studies on Pillar 1. Given that five (six if the LTGA is included) such studies have been conducted, with a high participation rate from European insurers; this is where the industry has spent the most time in Solvency II participation. Due to the technical nature of insurance this has been a necessity, not only for the legislators to get the legitimacy from the industry it is to regulate, but also in order to get the information which has been required in order to do so properly. Without the contribution of the insurance industry, it would not have been possible - even in theory – to construct an optimal directive.

With a possible exception of Groupe Consultatif (AAE), the industry is too heterogeneous and prone to sectoral interests for such a conclusion to be reached. However, there is no doubt that the insurance industry in many cases has contributed greatly with neutral information, data and (technical) advice, thereby replacing the need for more traditional

epistemic communities. In other words, the chief interest of the industry has, during most of the process, been to contribute to a best possible, knowledge-based regulatory regime.

H1.2 The opinions and recommendations of the identified epistemic communities prevailed at important conjunctures of the Solvency II process

In order to assess this hypothesis, it is first helpful to evaluate the criteria assembled by Davis Cross (2013, p. 144), which provide guidance as for when Epistemic communities are more likely to be persuasive:

Epistemic communities are more likely to be persuasive when:		Suitable description of CEIOPS/EIO PA during SII/OII
Scope conditions	<ul style="list-style-type: none"> • There is uncertainty surrounding the issue because it is complex or new (uncertainty from perceived crisis) • The issue is surrounded by uncertainty and it is politically salient (continuous uncertainty) • The decision-makers they are trying to persuade are unhappy with past policies and present problems (uncertainty from perceived crisis) 	Yes (OII)
		Yes
		Yes, to some extent
Political opportunity structure	<ul style="list-style-type: none"> • they have access to all necessary top decision-makers • they anticipate other actors' preferences and actions despite fluidity in the system (as in the EU) 	Yes, to some extent
		Questionable
Phase in the policy process	<ul style="list-style-type: none"> • they seek to influence the terms of the initial debate, instead of the decision itself • they deal with subsystem, technocratic phase of decision-making, rather than shaping broader political beliefs 	Yes
		Yes(?)
Coalition building	<ul style="list-style-type: none"> • The networks they are competing against are not as cohesive or certain of their aims • They share a high level of professional norms and status 	Varies
		Yes
Policy field coherence	<ul style="list-style-type: none"> • There is respected quantitative data, instead of very subjective qualitative data • The issue involves natural systems (that is, the environment), instead of social systems • Their norms and policy goals are compatible with existing institutional norms 	Yes
		No
		Questionable

Although the evaluation of CEIOPS/EIOPA in the table above is admittedly simplistic, it does – for what it is worth – lead us to expect that there were good conditions for their persuasiveness during the process.

One of the key points in this exposition has been the fact that when it comes to the level 1-text of the legislation, the politicians in the trialogue will always have the final say on the outcome. On this level, both CEIOPS and EIOPA have had advisory roles only. Hence, the only formal way through which the epistemic community (for the SII and OII processes assumed to be equivalent with EIOPA, and to a lesser extent CEIOPS) could have a direct impact on the directive text is when their opinion is requested, and adhered to, by the trialogue parties.

However, this does not necessarily imply that they had no impact whatsoever. Although EIOPA was deprived of control over the concrete specifications of the LTG measures, it was still given a prominent advisory role in the trialogue on Omnibus II after the three parties agreed to request the LTGA study.

Furthermore, the epistemic community may potentially have a significant impact in the development phase which also affects the agenda of the trialogue discussions. For example, CEIOPS/EIOPA might have been achieved by affecting the agenda of the trialogue. Either this could be done through actions that made otherwise critical topics uncontroversial, or it would happen if CEIOPS or EIOPA managed to bring legislation they were unhappy with to the debating table of the trialogue.

It is difficult to assess the importance of these potential channels of influence in the current case. Nonetheless, the parts of the level 1 directive that were agreed to by the politicians, without ever being a controversial part of the trialogue, make up a very large share of the legislation and are designed in the expert-led process in which CEIOPS played a crucial role. In particular, this has been the case in relation to pillar 2 and 3, on which there has been a relatively high degree of consensus from the beginning.

Furthermore, at the level 2, and particular 3, of the Lamfalussy process, the power of the epistemic community is significant. This was the case in the Solvency II process, but even more so in the Omnibus II process following the establishment of EIOPA. The fact that EIOPA were given enhanced powers also demonstrates that the role of the experts in the

epistemic community gained prominence following the crisis. Hence, even though EIOPA's recommendations in the LTGA report were not fully adhered to by the politicians, the Lisbon-treaty has ensured that EIOPA in the future will be making final legislation, enhancing the independence of this epistemic community.

In sum, there can be little doubt that the epistemic communities of CEIOPS and EIOPA have had a significant impact on the Solvency II and Omnibus II process. However, it must be admitted that the influence has been greatest in the least controversial areas of the directive. That is, in the development phase; in pillar 2 and 3; and in the less-controversial areas of pillar 1. When it comes to the most disputed parts of the directive – most prominently the LTGA debate – EIOPA was left without formal powers whereas its advice was heavily criticized and, in several cases, disregarded.

Insurance Industry

As underlined above, insurance companies most certainly participated and impacted the process by providing information and knowledge. Particularly, this was the case during the development phase prior to the financial crisis, which is when a significant portion of the directive was created. From this perspective, it can thus credibly be argued that the insurance industry has been involved in the Solvency II process first and foremost as providers of information, and only secondary in the pursuit of sectoral interests. There is no doubt that involvement of the companies as contributors of information – both in terms of time spent, number of companies involved and in terms of the portion of the directive that was affected – many times surpass the efforts spent on lobby activities.

Furthermore, it could in fact also be argued that the involvement of the industry in the discussions on the LTG measures during the Omnibus II process was motivated by the pursuit for a knowledge-based directive rather than by sectoral interests. This argument is valid if one accepts that the industry's so called lobbying – rather than having avoided a too restrictive and prudent regulatory regime – was motivated by efforts to ensure a more realistic and evidence-based regulatory outcome, evidence which happened to imply less capital requirements.

8.2 The Bargained Directive

Given the importance of the insurance sector in many Member States, it should be expected that there is a certain degree of correlation between the interests of a nation and the interests of its insurance industry. Throughout this paper it has been stressed that significant differences exist between the insurance markets of the Member States, each of which has a distinct set of interests. This essentially gives away this study's conclusion on the next hypothesis:

H2.1 The EU member states have had significantly different interests during the Solvency II process

Clearly, there is evidence to support this, and even more so as the interests diverged further as a result of the financial crisis. In sum, we have seen above how the Member State's national insurance markets differ on several accounts:

- **Size:** About 80 % of the European life insurance market premiums, and more than 60 % of the non-life premiums, are written either in the United Kingdom, France, Germany or Italy. The combined volume for Eastern Europe make up only about 3-4 %. As illustrated in figure 8, there are also significant national differences even when adjusted for gaps in population and income levels.
- **Composition:** Life insurance is of greater relative importance in the wealthier countries with traditional welfare states. Especially this is the case for Member States in North- and Western Europe and less so for the, traditionally, more family-based systems of some Southern European countries or the former communist states of Eastern Europe.
- **Capitalization:** The capitalization of life insurers in general, and those with guaranteed benefits schemes in particular, was severely aggravated by the financial crisis and the new normality of low interest rates.
- **Domestic Market structure:** Some national markets consist of large, complex insurance groups that are based in the country. Other national markets are dominated by branches of foreign insurance companies whose headquarters are located abroad.
- **Regulation and supervision:** The experience, culture and resources of national regulators across Europe vary significantly.

Early on in the Solvency II process, at the beginning of the century, the financial conditions of European states and insurance companies were relatively solid. National economic growth, as well as interest rate levels, were high compared with the current situation. Thus, even though insurers and authorities across Europe had different concerns, these were less articulate and not as pressing as were to be the case after the financial crisis. A respondent from the Norwegian FSA commented that

in such a situation it is easy to be somewhat bold and agree to conservative capital requirements. However, the issue arises once the financial conditions deteriorate, and the pressure increases. Then, attempts are made to adjust the capital or the capital requirement so that the effect of the fluctuations and the financial stress is reduced. One may ask what sort of risk-based system is really in place if the actual economic cycles are not reflected (FNAN, 2014 [Interview]).

When the crisis ensued, with low growth, low discount rates and low return on assets, it made the Solvency II directive significantly more costly for many insurers and member states. Thus, the national interests diverged – and the pressure to pursue these interests increased - during the process.

A possible objection to this chain of logic which assumes altered interests for insurers and nation states may, however, be put forth as follows. The economy is dynamic and unlikely to stay the same for many years and decades. Thus, although the current conditions are challenging under the Solvency II standard model it could be argued that what is required is a long term perspective, not alteration of the rules. In other words, one would expect the national interest to change if the current situation of low interest rates were (expected) to last indefinitely, but it is far from certain that this will be the case. Hence, the national interests should be affected only to a limited extent if the long-term view is kept in mind. However, valid as this point may be in theory, it is a somewhat naïve perspective given that – as a fact of human nature - insurers, politicians and lobbyists have a bias towards the short-term and tend to discount the consequences in a future that they might not even themselves be part of. Thus, it should come as no surprise that the national interests did in fact change as a consequence of the crisis. This was indeed confirmed by one interviewee:

it is clear that many member states have altered their point of view as a consequence of the financial crisis and the problems they are facing. If one had traced the statements made by the

various national representatives throughout the process it would surely make up an interesting set of data which most likely would have reflected this (FNAN, 2014 [Interview]).

Clearly, the fact that the capital requirement may be reduced in the long run is of limited comfort to insurers if they expect that they have to close down business due to high capital requirements next year. This becomes a national political concern as well if it is happening to a significant share of a domestic industry.

Furthermore, it could be argued that it is the Solvency II regulations – without the LTGA measures – that were too simplistic given that short term volatility was allowed to have an excessive effect on the capital requirements of long term business. As pointed out by the representative of Gjensidige: “the new information one acquires in any given quarter, on developments that are several decades away, is very limited. This implies that the capital requirement should not change so much either, but the challenge is to find good mechanisms that can ensure this in a suitable way” (Gjensidige, 2014 [Interview]). Hence, based on this reasoning the altered national interests may in fact be reasonable. Based on this view, it was the theoretical Solvency II model that was too simplistic and sensitive to short term changes, and it needed to be changed regardless of national or sectoral interests.

Whether this reasoning is justified or not from a neutral and theoretical point of view, the Omnibus II process illustrated that the national interests pursued did in fact change and diverge, as the LTGA process led to new debates on parts of the directive that had previously been agreed to.

H2.2 These diverging interests have been decisive in shaping the policy process of Solvency II

The national interests of the Member States may certainly have been incorporated into the Solvency II process in different ways. One possible channel is through participation in the development phase. Another possibility is through direct or indirect lobbyism, for example of the European Parliament. It is, however, through the Council and during the trialogue meetings that the national interests are most clearly shaping the process as the real

negotiations are taking place. Hence, this is what the scope of this analysis will be constrained to.

In general, the gaps between different Member States have made the regulations - which originally were supposed to be principles based – more detailed in order to include the many compromises that have been reached throughout the process (Gjensidige, 2014 [Interview]). Furthermore, as discussed above, there are several specific examples (from the trialogue) of how national interests influenced the Solvency II directive. Among the most controversial (at least prior to Omnibus II) took place in the Council Working Group where the Group support regime was removed from the draft directive, in exchange for measures on equity risk. The removal of the Group support regime, which was especially unwanted in parts of central- and Eastern Europe, happened in spite of the recommendations from CEIOPS and experts who had been involved in the development of the directive, including the de Larosi re report. Furthermore, it was removed against the will of Insurance Europe.

This is particularly interesting as it may be inferred from this that national interests may go against both the prudent European regulator (whose main concern is for the consumers) and the insurance organizations (whose main concern is for the profit-seeking insurance companies) at the same time. This is puzzling as one might expect every nation to have in its national interest at least one of these perspectives at any time. Yet, although the Group support regime perhaps was sufficiently prudent for the citizens of the EU as a whole, several Member States felt that it was not sufficiently prudent for the consumers in their respective home countries. This concern increased further as a consequence of the financial crisis. Certainly, this question must have been challenging for Insurance Europe as well, as its decision to support the Group support regime was mainly in line with the interests of the biggest insurance companies operating in the largest markets. Furthermore, it is a very clear example of how (in line with the MLG approach discussed below) the private insurance association – although unsuccessful – was an advocate of the part of the Solvency II directive which perhaps most clearly is linked with European integration.

The Group Support issue is not only an example of how diverging interests had an important impact on the outcome of Solvency II, but also demonstrates how a group consisting mainly of smaller EU nations (especially in terms of insurance volume) may make this happen

against the will of the most powerful nations. Although these nations were able to alter the directive in accordance with their interests in this case, there is still little doubt that it is the most populous nations, with the largest insurance markets and the most developed regulatory traditions that have had the most impact and success in getting their views across in the Solvency II process.

What the examples of the Group support regime and the LTG measures have in common is that there were significant costs and risks at stake. The LTG measures have reduced the required level of capital by €260bn which, as we have seen, was more than the effect of the financial crisis identified in the QIS5²⁷. The Group support regime would have allowed multinational insurance groups to move large amounts of capital out of states in which their subsidiaries operate. Yet, this became unacceptable as the political discussion coincided with the crisis, and the financial distress experienced by many European countries increased the importance of solid financial institutions as part of the national interest. Hence, even though the influence of the epistemic communities – as discussed above – and of the Commission have had significant influence in many areas of the legislation, it is the national interests which prevail when it comes down to clear economic interests.

8.3 The Plural Directive

In this section we examined the extent to which non-state actors – unless identified as experts in 8.1 - have independently impacted the process. We then move on to discuss whether the EU institutions have been able to influence the process beyond what the LI perspective would suggest.

H3.1 Non-Governmental stakeholders – other than epistemic communities – have participated in, and influenced, the Solvency II process

Previously, it has been noted how the political process of Solvency II was influenced by a significant number of non-governmental actors, but for the sake of brevity, our focus has

²⁷ Although these figures are subject to significant uncertainty and also not necessarily divided equally between firms.

been on the insurance industry which anyway has made up the most active and successful stakeholders. In chapter 4, two separate ways in which such stakeholders may impact the process were identified: Information and capture. The former was already discussed above in the section on epistemic communities where it was made clear that insurance companies have served a critical role as providers of information and knowledge. The MLG perspective predicts that stakeholder contributions are of greater significance in technical and complex industries, and this is certainly the situation in the case of insurance (Trnski, 2005, p. 24). Hence, the direct influence of insurers – through its role as provider of technical advice and data – supports both of these perspectives.

Yet, there is little doubt that the participation of insurers in the Solvency II process also has been motivated by the fact that they have significant economic interests in the outcome of the process, and that the industry exercised its right to pursue these interests. This was for example expressed by the Green Party MEP, Sven Giegold, who wrote that the day in which the EP approved the Omnibus II directive was “A truly black day for everyone who hopes that the EP could overcome national interest driven regulatory capture in the financial industry” (Giegold, 2012).

To some extent, the interests of the insurance companies have coincided with that of the Member States. Given that insurance companies are among the most important institutions of modern societies; what is good for the insurer is often also good for society as a whole. However, this logic only goes so far. As was discussed in chapter 2; unregulated insurance companies cannot be expected to organize themselves in such a way as to first and foremost aim to benefit society as a whole, especially not in the long run. Like other corporate companies, insurers are required to produce profitable results for their owners in the short run. Unlike most other companies, however, there is no way of knowing for the insurer what this result will be until the last of its current customers die several decades from today. All serious companies want to set aside sufficient reserves, but when it is unknown what “sufficient” amounts to, it should be expected that many insurance companies would prefer having better financial results today instead of having excessive reserves some decades into the future.

There can in fact be little doubt that the legislators to some extent were influenced by regulatory capture during the Omnibus II process. On the one hand, the industry may credibly argue that the measures were necessary to deal with the imperfections of the standard model as it was near consensus that something needed to be done about the impact of the short-term volatility on discount rates. But on the other hand, the calibrations which were in the end agreed to imply that the markets cannot really be trusted. Since market values are what Solvency II is based on, this is arguably a problem. Furthermore, it is nonetheless true that “corporations can now distribute profits even if market values suggest that they might not be able to meet claims of policy holders” (Giegold, 2013). The LTGA measures do provide many European life insurers with significant short term relief, even though it is questionable whether it is justified. Given the numerous adjustments that have been made to the discount rate curve, it is certainly reasonable to ask what this implies for the overarching, theoretical principles of prudence that were originally agreed to.

Yet, it is not necessarily possible to conclude from this that insurance companies were *independently* able to significantly influence the process. The causality is disturbed by the noise of the nation states, whose interests largely coincided with those of their domestic insurers. Hence, even though the insurance companies most likely were able to “capture” the process to some extent, it is difficult to know whether this was possible only because the (largest) Member State considered this behavior to be in the best national interest. On the other hand, this argument is less persuasive given the presence of large multinational insurance corporations at the core of the debate. It is not unlikely that these have been able to influence the process beyond what the national interests of the country in which it resides would suggest. However, drawing such conclusions are not justified based on the present study.

On a more technical note, the interests of the insurance industry are in essence linked to the calculation of the capital requirements. The high capital requirements that were suggested by CEIOPS following the financial crisis and by EIOPA as the outcome of the LTGA calculations, the reactions to which from the industry were generally negative, can essentially be interpreted in three separate ways.

1. It can be argued that the model was indeed “correct” and that insurers in general were undercapitalized. The consequences would be a need for these European insurers to increase their SCR coverage ratios and for politicians and insurers to accept this fact.

This would then have been consistent with the knowledge based approach, devoid of special interests. Clearly, this is not what happened.

2. Second, if the model was regarded as “incorrectly” calibrated for its purpose, the implication – also in accordance with the knowledge based approach – would be to adjust it e.g. by introducing the LTGA measures.
3. The third and final option is that the model was in fact “correctly” calibrated, and hence increased capitalization. However, as the consequences of this would have been losses and closure of business for many insurers, this outcome would be against the short-term interests of many shareholders as well as politicians who would reject the first option of increased capitalization and instead demand alleviating measures. Hence, based on this reasoning, the LTGA measures were introduced – and indulgently calibrated – not mainly on the basis of expert judgement. Rather the LTGA package was a set of redistributive measures in which the short-term interests of politicians, shareholders (and some customers of today) were up against the interests of the insurance customers of the future. Hence, according to this interest based approach, the LTGA measures were introduced and calibrated beyond what was rational from a technical and evidence-based perspective.

The problem is that there is really no possible way to determine whether the LTG measures are best explained by the second or the third option. Most likely, the truth is somewhere in between, and this appears also to be the conclusion of EIOPA which wrote that

the crisis has highlighted an important element that needs to be addressed: volatility and its consequences. It is EIOPA’s view that volatility is a fact, which is shown by market consistent valuation, and should be an integral part of the risk management of companies, both as a risk and a potential business opportunity [i.e. the LTGA measures should be limited]. At the same time, if not appropriately understood, it may lead to “artificial” – in the sense of unnecessary – consequences or actions, including supervisory action, which should be avoided, in particular regarding short-term volatility [i.e. the LTGA measures are required] (EIOPA, 2013, p. 21).

On the one hand, the interest rate curve appears to put excessive weight on short term fluctuations in interest rates when valuing long term liabilities. Thus, the model was to some extent “incorrect” in relying on market valuations to such an extent. On the other hand, it does not appear to be the case that the interest curve extrapolations during the OII process have been replaced with a more scientifically valid alternative. According to one interviewee

in the Norwegian FSA, the convergence debate has been a case in point where the technical criteria for the chosen interest rate curve appears to have been replaced by short-term national and industry interests, aiming to reduce the capital requirements of life insurance companies (FNAN, 2014 [Interview]). This opinion is shared by other experts as well, one of whom noted that “the 20 year LLP that emerged from the ECON Committee in March 2012 was a pure compromise with no technical justification and, I suspect, simply an average of the competing 10 and 30 year proposals” (Fulcher, 2013). A different study writes that “Our assessment of the new calibration of bond risk as defined by the LTGA impact study does not conclusively confirm it as an improvement on the calibration under QIS5” (EDHEC, 2013). In sum, it appears to be beyond reasonable doubt that the calibrations of the LTGA measures, at least to some extent, have been motivated by short-term economic and political gains.

H3.2 The supranational EU institutions were independent actors in the Solvency II process, and affected the outcome

Although several EU institutions and agencies have been involved in the Solvency II process, it is not assumed necessary to include in the assessment of H3.2 institutions that are obviously not independent of the Member State interests, such as the Council. Hence, the focus here is directed towards the EU institutions that are (predominantly) guided by other aims.

European parliament

From the exposition and analysis of this paper, it should be clear that the EP has not been a mere facilitator or bystander to the process of Solvency II. In the Co-decision procedure, that is the level 1 procedure in the Lamfalussy process, the EP was highly involved and appears to have been much like an equal to the Council. This was particularly evident during the SII trialogue, in which the representatives of the Parliament refused to accept the removal of the Group support regime or the inclusion of the equity measures. Hence, the Council was able to get its views across only by reaching a compromise. However, when it came to the implementing measures of Solvency II the EP were clearly at risk of being sidelined by the Council (through EIOPC) and the Commission. Although the EP held some rights in relation

to these level 2 documents, it was still not able to control – to the same extent as the Council – that the level 1 legislation was implemented as planned.

However, following the Lisbon Treaty in 2009, this lack of control was removed as the legislative procedure and the Lamfalussy process was altered accordingly. The change significantly enhanced the powers of the EP over the level 2 documents and what should be delegated to the Commission and EIOPA. The result, as expressed by Wiedner was that “part of the discussion [in Omnibus II] is about what should go into the level 1 text, what should be fixed in the delegated acts and what should be left for EIOPA” (Wiedner, 2013).

In turn, the Parliament was responsible for the inclusion of LTGA measures in the level 1 text during the Omnibus II process, thus essentially ensuring that these became part of the trialogue. According to Giegold, this happened only after heavy lobbying, implying from the industry and Member States also identify the EP as a crucial actor in the process. The fact that the LTGA measures were made part of the level 1 discussion was perhaps the most important event of the Omnibus II process, as it led to prolonged political debates on alternatives worth billions of Euros.

It is clear enough that the EP affected the outcome of the SII+OII process and that its influence increased following the Lisbon Treaty. However, the extent to which it did so independently, and not only to the extent that it was within Member State interests, is not possible to answer based on this study. Arguably, the Member States have given up some level of sovereignty to the EP, but as this study indicates, when it comes down to the questions that are really of crucial national interest, the most powerful nation states are still in command.

The Commission and EIOPA

The Commission has been at the core of the Solvency II process essentially leading it from the very beginning, and it is the only institution that has been highly involved throughout the preparatory and development phases of Solvency II and in both the dialogues (SII and OII). It also has a key role in the implementation of the directive. Furthermore, Karel van Hulle, who ran the project between 2004 and 2013, is the single person who has generally been regarded

as the most important for the Solvency II legislation. In other words, there can be no doubt that the Commission has influenced the outcome of the directive.

The extent to which the Commission has acted independently of the Member States during the Solvency II process is, however, not possible to conclude based on this study. However, the fact that the Commission so strongly expressed discontent with the Council's version of the SII directive does at the very least demonstrate that the former is not simply executing the will of the latter.

Furthermore, as was already discussed in section 8.1, EIOPA, the supervisory agency formally organized in the Commission, appears to be an institution which increasingly operates as a European supervisor independently of the political interests of the Member States. Indeed, it appears that the establishment of EIOPA has created a new agency which private stakeholders (that is, insurance companies) relate to and are governed by, as much as with the national supervisors.

The legitimacy and independence that EIOPA is gaining is based on the fact that complex areas of legislation and supervision are best dominated by experts. There is thus reason to expect that the powers of independence of EIOPA and the other two ESAs will increase as their competencies are enhanced. The fact that EIOPA will have access to an amount of insurance data which surpass any insurer, national supervisor or other government institution should add to this fact. Indeed, the establishment of EIOPA should support the MLG hypothesis in the case of insurance regulation. Its role also points to further questions raised by (Everson, 2012, pp. 1-2) regarding the input legitimacy of EIOPA and the consequences of the technocratisation of the EU for democratic legitimacy. However, this is beyond the scope of this study.

H3.2: General Assessment

The one and a half decade of the Solvency II process appears to point towards a trend of an increasingly complex political system of the EU, in which the Member State executives are far from the only actors with influence.

European institutions are more important when the national interests are less critical. This appears to make timing highly important in the European negotiation process. The Member States are more willing to make decisions that are at odds with their national interests if these

interests are uncertain and represent only future potentials. For example, prior to the financial crisis the Member States were (more) willing to accept the Group support regime and also to apply the market valued interest rate as discount factor. However, once their interests changed with the crisis, so did their willingness to agree to a pan-European compromise. If Solvency II had been in place, say, in 2004 it is not clear that it would have been as easy for the insurers and the Member States to get acceptance for the LTGA measures. Thus, for the sake of the MLG argument, the crisis work in both ways: on the one hand, the national interests related to financial activities rose in prominence, thus preventing European integration. However, on the other hand, the transnational character of the crisis was unmistakable, and led among other things to the establishment of powerful and (relatively) independent agencies which has brought financial and insurance supervision from the national, to the European, level.

8.4 Summing up: A Comparative Analysis

Underneath this analysis of Solvency II has been a distinction between knowledge-based principles and national or sectorial interests. The distinction between principles and interests is certainly not an easy one to make. In fact, it belongs to the sometimes frustrating, yet fascinating, realm of human action of which conclusions never can be drawn with certainty. Indeed, it is not possible to verify whether any particular participant argues based on principles or based on special interests. Anyone who has taken part in the Solvency II process has inevitably been affected by their background, education and knowledge gained prior to their involvement. This is true, even though we have identified some institutions – in particular CEIOPS and EIOPA – as neutral and expert-driven, seeking to create an optimal regulatory framework unaffected by special interests. On the other hand, states and insurance companies are actors whose interests may well happen to coincide with what is optimal from a theoretical knowledge-perspective. In such cases, it is particularly difficult to assess whether the legislative outcome on a certain issue is achieved because it is preferred by the neutral epistemic community, or if it is the special interests that have achieved the desired outcome through bargaining.

In chapter 1, we set out to answer the following question:

Is the political process of the Solvency II directive best explained by expert knowledge; Member State interests; or by sectoral interests?

Which was further specified in the following three hypotheses:

The process and outcome of the Solvency II/Omnibus II legislation has been dominated by:

- H1.** *epistemic communities seeking to achieve an optimal regulatory regime from a knowledge-based perspective.*
- H2.** *the interests, power and bargaining of the nation states.*
- H3.** *a multitude of institutions and stakeholders with different interests.*

In order to determine the extent to which these hypotheses can shed light on the Solvency II process, it is useful to draw inspiration from quasi-experiments. In particular, it appears fruitful to make comparisons on *different parts* of the process, and then attempt to explain these differences from the perspective of each theoretical framework. Such comparisons have been made along several axes throughout the paper:

- Before and after the financial crisis (essentially Solvency II vs Omnibus II)
- Different phases in the processes (development vs trialogue)
- Between the three pillars
- Between the life and the non-life industry

This section thus aims to evaluate the three main hypotheses above by assessing these comparisons.

In total, based on the findings of this study, a rather clear image of the Solvency II/Omnibus II process of the past decade emerges. From the initiation of the Solvency II directive, the Commission had a clear ambition to construct a theoretically and empirically based directive through public consultation with the industry and other stakeholder. The subsequent development phase ensured that – in most areas – the legislation obtained a solid and well-tested basis which was set to provide the European insurance industry with significant improvements in risk management, capital requirements and public disclosure of information.

However, as the process advanced, it became more detailed and an increasing number of political compromises were required. The political footprint is mainly present from about 2009 when the financial- and Eurozone crises raised the stakes for many actors involved. Although the crisis led to the creation of what resembles a strong, institutionalized epistemic community – namely EIOPA – the interests of insurers and Member States rose also significantly in this same period as low interest rates and increased longevity, brought about a crisis for parts of the life insurance industry. The group support regime, as well as the equity issues, was controversial during the original Solvency II trialogue.

In turn, the process of Omnibus II became heavily influenced by the consequences of the substantial external changes, as the national interests arguably to some extent were pursued at the expense of the foundational principles of the directive. Although EIOPA was able to leave a strong mark on the Omnibus II process with the publication of the LTGA-report, the trialogue parties were certainly not alien to ignore the recommendations they were given.

Furthermore, the non-life industry, which relatively speaking has been almost absent from the Omnibus II process, has been affected by the financial crisis to a much lesser extent than the life industry. Hence, the stakes have been lower and neither Member States nor the industry has had much reason to “temper” with the calibrations of the pre-crisis decisions. Two separate sources of this study – the Norwegian FSA and Gjensidige – did in fact concur that if the Solvency II directive had been separate for the non-life and the life industry, the former would most likely have been finalized and implemented long ago (Gjensidige, 2014 [Interview]; FNAN, 2014 [Interview]).

In sum, the key issues under Solvency II and Omnibus II are rather clear: The vast majority of these are related to pillar 1 issues, whether related to the low interest rate curve and the high reserve- and capital requirements of the life insurance industry (FNAN, 2014 [Interview]) or the group support regime. On pillar 3, and even more so pillar 2, the process has to a much greater extent been characterized by consensus. Hence, in total, the Solvency II legislation has really been halted by a small part of just one of the three pillars. Furthermore, it has almost exclusively affected only one of the industries regulated under the directive as the state of the financial markets have had a serious impact on the life insurance industry. Hence, it is a very small subset of issues that have been of significant importance to the most

influential nations in the EU and thus introduced Member State interests to the very core of the process.

Based on this discussion and the wider evidence of this study, the explanatory power of the three perspectives can be assessed as follows:

H1. Epistemic communities and the knowledge perspective)

- *The explanatory power of H1 is particularly significant prior to 2009, that is, during the preparatory phase and the development phase of the Solvency II directive.*
- *H1 explains the development of pillar 2 (and 3) better than pillar 1.*
- *EIOPA and CEIOPS resemble epistemic communities to some extent and both have had an important influence on the SII and OII directives respectively thereby strengthening the explanatory power of H1.*

H2. Member State Interests

- *H2 is mainly supported in the Council Working Group and during the trialogues.*
- *The Member State interests were expressed only to a limited extent during the development phase.*
- *The explanatory power of H2 increases from 2009 and is very present in the Omnibus II process when were particularly high.*
- *H2 is most relevant in explaining the development of pillar 1, particularly for the life insurance industry.*

H3. A multitude of institutions and stakeholders with different interests.

- *The evidence supports H3 throughout the process, however the basis changes around 2009-10.*
- *Prior to 2009 the non-governmental actors with the most influence appears to have been the insurance industry which contributed with data and knowledge in the development phase, particularly for pillar 1.*
- *Following the financial crisis and the Lisbon treaty, the European Parliament gained increased powers and EIOPA was created. Hence, the independent influence of sovereign EU actors was enhanced.*

- *The insurance industry, supported by Member States, most likely affected the outcome of the LTGA process through lobbying.*

8.5 Generalizations

European Integration is a process through which the differences and barriers between the states of Europe are gradually reduced. Since Solvency II is really a case study of a specific part of this integration, it is natural that generalizations from the case of Solvency II are based on this perspective and on the theories utilized in this study to explain it. It must be pointed out, however, that the list below are far from exhaustive, and that the explanatory power most likely increases when they apply at the same time.

1. Based on the case of Solvency II, the theory of *epistemic communities* is more likely to have explanatory power when the following factors apply:
 - The complexity of the field or industry to be regulated is high.
 - The regulation in question is based on general and qualified statements.
 - The regulation in question affects Pareto-efficiency rather than redistribution. (Also noted by Everson (2012, p. 12)).
 - The matter in question is subject to significant uncertainty.
2. Based on the case of Solvency II, the theory of *liberal intergovernmentalism* is more likely to have explanatory power when the following factors apply:
 - The starting points of the Member State differ in important ways. Decisions have been made in the past that are difficult and costly to revert from (Path dependency).
 - The regulation impacts significant economic interests and matters of implication for (short term) profits.
 - The regulation in question affects redistribution rather than Pareto-efficiency.
 - The regulation in question is based on specific and quantified rules.
3. Based on the case of Solvency II, the theory of *multilevel governance* is more likely to have explanatory power under the following circumstances:

- The long term national interests are hidden, or at least not pressing. In such cases current state executives are more willing to transfer sovereignty to supranational institutions.
- The regulations in question affect entities that operate across (European) borders.
- The interests related to, and consequences of, the regulation in question is evenly distributed between Member States.
- The successful regulation of a specific field or industry requires significant information and/or expertise which is kept only by non-governmental actors.

In chapter 5 of this paper, it was noted that absolute generalizations are not to be expected from intricate studies such as this one. Rather, as is common for case studies, the aim is to make contingent or typological generalizations which mean that the scope, or domain, of the generalization must be clearly specified. To what range of institutional settings, cultural contexts, time periods, geographic settings and situational contexts do the findings apply? (George & Bennett, 2005, pp. 119-120). Although such considerations go beyond the scope of this study, this is left as a warning and reminder that the inferences made about will not necessarily be true for the given theories if applied to case studies significantly different from the topic of Solvency II.

9 Conclusion

The Solvency II project has been in the making for 15 years, spanning through a period of significant financial turmoil and the political reform of the Lisbon Treaty. It is clear that the legislative and political process that has led to a pan-European regulatory regime for the European insurance industry has not been left unaffected by these changes.

Even without such shocks to the political process no single theoretical perspective could have explained the entire legislative process of a directive with the scope of Solvency II. The Lamfalussy process under which it was produced implies that the knowledge-based theory of epistemic communities have explanatory power for the development phase whereas the theory of liberal intergovernmentalism is a more suitable approach for the Council working group and the trialogue. In addition, given the complexity of the insurance industry, and the countless number of actors affected, the multilevel governance approach is relevant, particularly for explaining the involvement of the stakeholders representing the industry. This is indeed supported by the evidence in this study.

However, the shocks mentioned above caused other breaking points and distinctions that were less predictable. The Lisbon treaty made the EU look more like a distinct political system than an international organization, especially through the enhanced powers obtained by the EP. Furthermore, the financial crisis created a sense of urgency in establishing the new insurance regulations, leading to the establishment of EIOPA. However, it also changed the solidity of European economies and brought to life the differences and path dependencies of the European life insurance industries. As a consequence, the necessary political compromises were made harder to achieve. Indeed, at the end of the process, the great power interests were brought to the top of the agenda, demonstrating that EU integration is still subject to the self-interests of state executives.

In sum, as a consequence of the impact of these national interests, even if Solvency II functions according to the intentions, it will most likely take decades until European insurance regulation can be said to be fully harmonized. One reason is the traditional measures which are planned to last at least until 2032. Another is the significant variations that exist across Europe: Both in the nature of the national insurance markets and in terms of

supervisory traditions. New legislation can of course not change this overnight. However, it has induced the beginning of a process towards a united and equal European insurance market in which customers and companies face the same requirements and expectations regardless of nation state.

It is yet to be seen how prudent the regulatory regime will turn out in the end. The LTGA measures essentially assume that the current markets are wrong and that the current long-term interest level is too low. The measures will most likely reduce the probability of companies leaving the market in the short run. However, it also allows many European companies, particularly in the large Western European countries, to reduce the level of reserves otherwise required. If interest rates do in fact stay low for years and decades to come this might become a problem as the Solvency II regime may, in some important areas, turn out to be insufficiently prudent. Nonetheless, analyzing and monitoring the risk that such an outcome might arise is just what Solvency II – unlike Solvency I - has been designed to do. Hence, there is little reason to doubt that Solvency II in the end is a significant and necessary improvement of the regulatory regime for the European insurance companies.

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Appendix: Interview guide

The questions in the following interview guide were the basis for interviews conducted in this study. However, as is common practice in semi-structured interviews, it is not necessarily the case that (all) the questions were asked (in the order stated). Rather, adaptations were made depending on the position, nationality, role, experience of the interviewee, as well as on the answers given to preceding questions. All questions were not necessarily relevant for every interviewee. The questions were split into five groups as follows.

Group 1: Introduction and identification of the role and experience of the interviewee

1. What is the basis of your personal participation and activities in relation to the Solvency II process?
 - During which periods have you been involved?
 - What is the scope of your involvement?
 - What has been the most relevant questions and issues in relation to your participation?
 - Given that you have participated in committees/expert groups etc. Has your mandate been to participate freely based on your own expert judgment; or have you had (political) instructions from your authorities.
 - What was your impression of the previous point when it came to participants from other nations?
2. Who were the most influential actors in the process based on your personal involvement and participation in the process?

Group 2: The Solvency II process in general

1. Describe your general impression of the Solvency II process (not necessarily solely based on your personal participation in the process)?
2. Which arenas (formal or informal) have been most important for progress and delays during the Solvency II process?
3. Which time periods have been most important/intense?
4. What actors have been most important in shaping and developing the process? Has there been specific participants of particular importance?

Group 3: Core debates and issues in the Solvency II-process

1. Which actors (countries, interest organizations etc.) have most strongly attempted to, or succeeded in, affecting the process? Have these actors operated domestically or directly in the EU process?
2. What are the main reasons for the delays of Solvency II? Has there been many smaller issues or rather some few main problems?
3. Between which actors has there mainly been disagreements? National interests (whether FSA's or on the political level); Internally in the EU; Interest organizations; Individuals).
4. What has been the main reasons for disagreements between these parties? Has it been related to technical issues or something else?
5. Two important issues have been the issue of Long Term Guarantees for Life insurers, and the question of equivalence for the regulatory regimes of non-EU states. Between who, and in relation to what specific issues, has there been disagreements in relation to these questions?

Group 4: Theory

Different theories may give different answers to what drives and affects the process and the outcome of specific political processes. A potential distinction can be made between the following explanatory models:

- i. The political process has been driven by idealistic experts that are seeking to achieve a (Pareto)-optimal aim.
 - ii. The political process has been driven by the participating actors seeking to attain their aims based on special interests..
1. Do you have an opinion – preferably based on examples – on the extent to which these perspectives were present during important phases of the Solvency II process?
 2. Are there, in your opinion, other theoretical perspectives that could explain the process?

Group 5: Ending

1. Is there anything you would like to add?
2. Can you recommend other interviewees?