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# FRANCE

## FINANCIAL SECTOR ASSESSMENT PROGRAM

October 2019

## TECHNICAL NOTE—ISSUES IN INSURANCE SUPERVISION AND REGULATION

This Technical Note on Issues in Insurance Supervision and Regulation on France was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on October 1, 2019.

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October 1, 2019

# TECHNICAL NOTE

## ISSUES IN INSURANCE SUPERVISION AND REGULATION

Prepared By
**Monetary and Capital Markets Department**

This Technical Note was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) in France in December 2018 and March 2019 led by Udaibir Das. Further information on the FSAP program can be found at http://www.imf.org/external/np/fsap/fssa.aspx

# CONTENTS

# Glossary

| | |
|---|---|
| ACPR | Autorité de Contrôle Prudentiel et de Résolution |
| CdA | Code des Assurances |
| EIOPA | European Insurance and Occupational Pensions Authority |
| EU | European Union |
| EU27 | Countries of the European Union excluding the United Kingdom which after Brexit occurs will simply be the countries of the EU |
| EUR | Euros |
| FSAP | Financial Sector Assessment Program |
| GAAP | Generally-Accepted Accounting Principles |
| LTG | Long-term Guarantee |
| MA | Matching Adjustment |
| ORSA | Own Risk and Solvency Assessment |
| QIS | Quantitative Impact Study |
| QRT | Quantitative Reporting Template |
| Sapin II Law | Law No. 2016-1691 |
| SCR | Solvency Capital Requirement |
| SCR Coverage Ratio | Own Funds/SCR |
| SFCR | Solvency and Financial Condition Report |
| Solvency II | Directive 2009/138/EC of the European Parliament and of the Council of November 25, 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance |
| SRP | Supervisory Review Process |
| TRFR | Transitional on Risk Free Rate |
| TTP | Transitional Deduction on Technical Provisions |
| VA | Volatility Adjustment |

# EXECUTIVE SUMMARY[1]

**The French insurance industry is the largest in the EU27 and therefore the largest in the European Union after Brexit.** The French insurance market is large both because the French economy is the second largest in the EU27 and because insurance is a significant part of the French economy. France has a very high level of insurance penetration, particularly for life insurance.

**There are 742 insurers in the insurance industry.** This large number of insurers creates a diverse and competitive market. There are 339 insurers subject to Solvency II with less than EUR 1 billion in assets. It appears these small insurers are well capitalized with all exceeding a 100 percent SCR even if the transitional measures in Solvency II and the long-term guarantee package are not taken into account. Given the diversification benefits embedded in Solvency II capital requirements and the challenging environment of prolonged low interest rates, the presence of many independent small entities will have an impact on the overall efficiency and cost of delivering products to policyholders in the market.

**Implementation of Solvency II in France occurred on January 1, 2016 as in other EU jurisdictions**. Solvency II is a high-quality regulatory framework. Solvency I continues to apply to a very small part of the French insurance market. Solvency II transitional measures are used by a small number of French insurers as at year end 2018. French insurance companies are significant users of the Volatility Adjustment (VA), with companies representing more than 90 percent of the technical provisions in the French insurance industry using the VA. The French insurance market largely relies on the standard model to calculate the SCR with only two major (re)insurance groups using full internal models.

**A highly relevant development for the French insurance market is the release of a discussion paper by European Insurance and Occupational Pensions Authority (EIOPA) in March 2019,[2] that indicates additional reporting on liquidity risk and improved monitoring of liquidity risk are under consideration at a European level for macroprudential purposes.** Autorité de Contrôle Prudentiel et de Résolution (ACPR) and EIOPA should move toward putting these proposals in place with ACPR encouraged to begin field testing such requirements at the earliest opportunity on a voluntary basis. While the EIOPA discussion paper stops short of recommending liquidity requirements for insurers, given the prevalence of bancassurance models France should consider the development of a liquidity requirement for financial conglomerates.

**There should be a minimum number of independent members of the Board.** Currently, Solvency II does not mandate that there be any independent Administrative Management or Supervisory Boards (AMSB) members. While this is not required in the ICPs either, international best practice is to require a minimum number of independent board members. French authorities should advocate to the relevant EU authorities to introduce a minimum number of independent members of the AMSB, at least one-third. Before such a change is implemented, ACPR could work with the insurance industry to promote the role of independent Board members and increase their presence

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[1]This note has been authored by Peter Windsor.

[2]Other potential macroprudential tools and measures to enhance the current framework, July 31, 2018, EIOPA.

on Boards in France with a target of achieving independent members becoming at least one-third of Board membership.

**Quantitative Reporting Templates (QRTs) submitted to ACPR are not required to be audited and there is no audit requirement for Solvency and Financial Condition Reports (SFCRs) disclosed to the public.** With respect to reporting to ACPR, at least the annual QRTs (or a core subset) should be subject to audit requirements. In addition, audit assurance processes are recommended to be required for the systems and procedures used to complete QRTs and SFCRs.

**ACPR should review the intensity and frequency of on-site supervision and its relationship to off-site supervision.** With a number of other meetings with insurance companies possible, some of these meetings may be close to what other supervisors would call focused on-site inspections. More focused and regular on-site inspections could be envisaged, which would provide more flexibility in terms of the rules around frequency of on-site inspections.

**Table 1. France: Recommendations for Insurance Supervision and Regulation**

| Recommendations | Time[1] |
|---|---|
| In line with EIOPA's discussion paper, Systemic Risk and Macroprudential Policy in Insurance,[2] additional reporting on liquidity risk and improved monitoring of liquidity risk should be developed and ACPR is encouraged to begin field testing such proposals at the earliest opportunity on a voluntary basis (see paragraph 26). | NT |
| Introduce liquidity management requirements and liquidity stress tests at the conglomerate level carried out by the supervised entities, including insurance companies within financial conglomerates (see paragraph 26). | MT |
| To implement good practice with respect to governance, there should be a minimum number of independent directors of the Board of French insurers, at least one-third of the Board should be independent members where legally possible (see paragraph 28). | NT |
| ACPR should review the intensity and frequency of on-site supervision and its relationship to off-site supervision (see paragraph 37). | NT |
| With respect to reporting to ACPR, at least the annual QRTs (or a core subset) should be subject to audit requirements. In addition, audit assurance processes are recommended to be required for the systems and procedures used to complete QRTs and SFCRs (see paragraph 23). | NT |
| ACPR should continue its supervision processes aimed at improving the implementation of Own Risk and Solvency Assessment (ORSA) and embedding the ORSA process in insurance company risk culture (see paragraph 28). | MT |
| The propriety of non-executive board members should receive increased supervisory attention. and ACPR's proposed new procedures are encouraged to be implemented (see paragraph 30). | MT |
| [1]I=Immediate (within 1 year); NT=Near term (within 1–2 years); MT = Medium Term (within 3–5 years).<br>[2]Other potential macroprudential tools and measures to enhance the current framework, July 31, 2018, EIOPA. | |

# BACKGROUND

## A. Scope

1. **This Technical Note covers insurance supervision and regulation in France.** This Technical Note does not attempt to assess Solvency II as a regulatory framework, as that work has been done in the Euro Area FSAP.[3] Instead the focus of the work in the France FSAP is to assess the implementation of Solvency II in France.

2. **An Insurance Core Principles (ICP) Detailed Assessment Report was published in June 2013 in the context of the previous FSAP for France.** The assessment was carried out prior to the implementation of Solvency II. That assessment found that of the 26 ICPs, 4 were partially observed, 9 were largely observed and 13 were observed. It was noted, at the time, that a number of the issues resulting in partially observed or largely observed grades would be addressed by the implementation of Solvency II, (the partially observed ICPs were: ICP 5 Suitability of Persons, ICP 7 Corporate Governance, ICP 16 Enterprise Risk Management for Solvency Purposes and ICP 20 Public Disclosure). These issues were therefore included in the scope of this focused review but were not subject to a formal assessment of observance. Implementation of Solvency II has indeed led to expected improvements in these subjects. This Technical Note has recommendations related to suitability of persons, corporate governance (in the context of best practice rather than ICP observance) and enterprise risk management for solvency purposes (with respect to fully embedding ORSA requirements).

## B. Market Overview

3. **The French insurance industry is the largest in the EU27 and therefore the largest in the European Union after Brexit.** The French insurance market is large both because the French economy is the second largest in the EU27 and because insurance is a significant part of the French economy. France has a very high level of insurance penetration, particularly for life insurance as life insurance is used as a savings vehicle for retirement and estate planning purposes. See Figure 1 for comparison of the French industry to selected other European countries.

4. **There are 742 insurers in the insurance industry.** There are 250 life and composite companies, 381 non-life insurers and 111 substituted mutual insurers.[4] Of these, 285 were insurance companies subject to regulation under the *Code des Assurances* (French Insurance Code), 421 were mutual insurers subject to regulation under Book II of the *Code de la Mutualité* (French Mutual Insurance Code) and 36 were provident institutions governed by the *Code de la Sécurité Sociale*

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[3]Euro Area Policies: Financial Sector Assessment Program, Technical Note—Insurance, Investment Firm, and Macroprudential Oversight, IMF Country Report No 18/230.

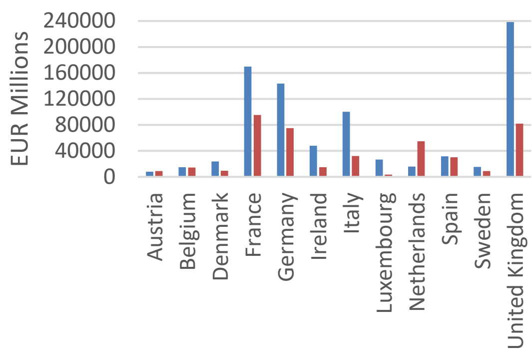
[4]Substituted mutual insurers are mutual insurers whose written risk is borne by another mutual insurer.

(French Social Security Code). There has been a gradual reduction in the number of insurers as set out in Table 2 below.

**Figure 1. France: Size of the Insurance Sector**

*France has the largest insurance sector in the EU except for the UK which is leaving the EU…*

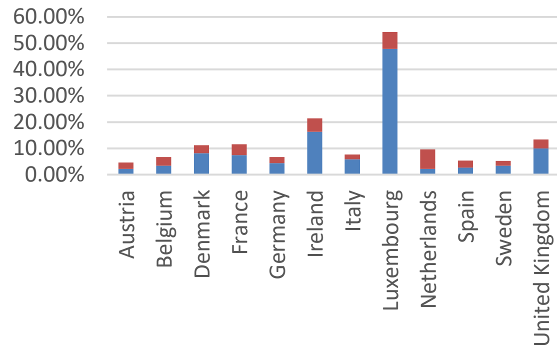
**Gross Written Premium 2017**




Source: European Insurance and Occupational Pensions Authority (EIOPA).

*…one of the reasons for this is high insurance penetration (GWP/GDP)*

**Gross Written Premium/GDP**




Source: European Insurance and Occupational Pensions Authority (EIOPA), Eurostat and IMF staff calculations.

**Table 2. France: Number of Insurers**

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Entries | 7 | 2 | 2 | 3 | 5 |
| Exits–mergers and takeovers | -35 | -46 | -66 | -36 | -24 |
| Exits–suspensions of business | -12 | -19 | -18 | -15 | -10 |
| Bankruptcy, closure by supervisory authority | -3 | -2 | | -1 | |
| Exits–others | -1 | | -1 | -3 | -3 |
| Total insurers at end of year | 974 | 909 | 826 | 774 | 742 |

Source: Autorité de Contrôle Prudentiel et de Résolution (ACPR).

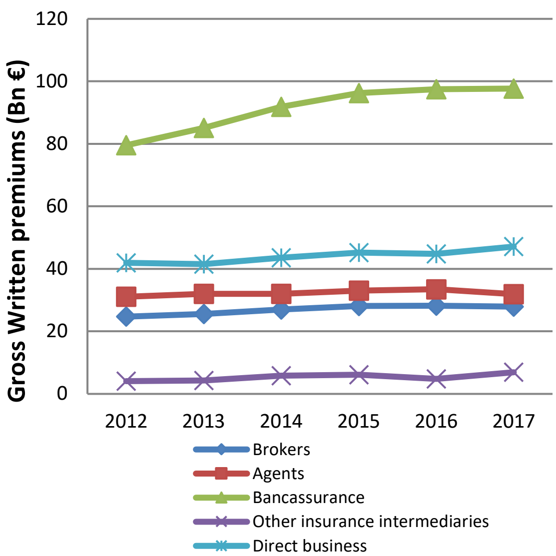
5. **This large number of insurers creates a diverse and competitive market.** The top 10 life and composite companies represent 67 percent of the share of total assets. Bank-owned life insurers in the top 10 companies control 33 percent of the life insurance assets. This is set to increase to 49 percent if the proposed takeover of CNP Assurances by La Banque Postale occurs. In the non-life sector, the top 10 non-life companies represent 49 percent of the total assets, however there are only 6 corporate groups represented among these top 10 entities. The reinsurance sector is highly concentrated with 99.8 percent of the reinsurance market's assets concentrated in the top 10 entities with one group representing 49 percent of the reinsurance market's assets.

**6. The bancassurance channel is even more important in life insurance than the ownership of life insurance companies would suggest with approximately 60 percent of life insurance premiums distributed via the bancassurance channel (see Figure 2).** Life insurance companies that are not controlled by banking groups also use the bancassurance channel for distribution of products through distribution agreements.

**Figure 2. France: Distribution Channels**

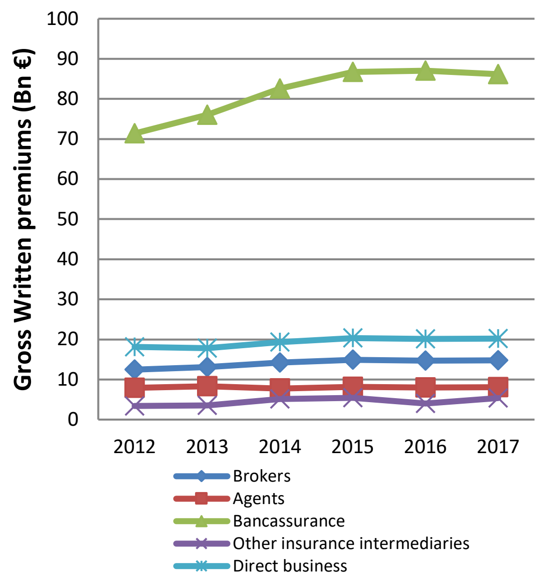
*Bancassurance is the dominant channel for distribution of insurance products…*

**Total Insurance Market**




*…mainly due to the dominant and strengthening position of the bancassurance channel in life insurance with 64% of the market in 2017.*

**Life Insurance Market**




Source: Autorité de Contrôle Prudentiel et de Résolution (ACPR).

**7. There are 339 insurers subject to Solvency II with less than EUR 1 billion in assets.** A concern when there are so many small insurers is their ongoing viability. However, it appears these small insurers are well capitalized with all exceeding a 100 percent SCR even if the transitional measures in Solvency II and the long-term guarantee package are not taken into account. ACPR should closely monitor the viability of small insurers and encourage strategic mergers where necessary in the interests of policyholders. ACPR's view is that the role of a supervisor is to be neutral regarding market structure and the IMF does not disagree with that view. However, ACPR does also acknowledge that intensified competition and Solvency II requirements regarding governance and complexity of solvency calculations is putting pressure on small insurers to merge operations or seek a group affiliation. Such mutualization of resources so that economies of scale can be achieved while maintaining small institutions is another way of dealing with the need for efficiency and effectiveness in small institutions. The point being made here is that having many independent small entities will have an impact on the overall efficiency and cost of delivering products to policyholders in the market.

**8. Life insurance premiums have been relatively stable over 2015 to 2017 after experiencing growth from 2013.** The share of unit-linked business is increasing but participating business still dominates (see Figure 3).

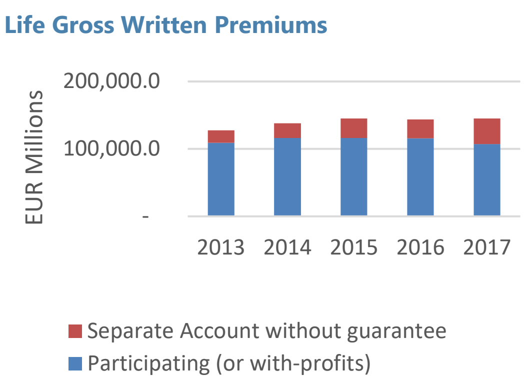
**9. Overall SCR coverage levels appear strong in the life insurance industry (see Figure 4) with an average SCR coverage ratio of 217 percent.** This apparent strength is mitigated somewhat when taking into account transitional measures for Solvency II and the impact of the long-term guarantee package, but the industry still appears on average to easily meet the SCR, in current circumstances, if these are not taken into account. See 'Implementation of Solvency II' for further analysis. Based on the data provided, it is known that only one life insurance company with assets between EUR 5 billion and EUR 10 billion would have an SCR coverage ratio below 100 without transitional measures.

**10. Life insurance general account asset allocations are heavily weighted towards bonds with 31.5 percent in government bonds and 31.2 percent in other bonds as at the end of 2017.** Geographically, investments are heavily weighted towards France with 60.2 percent of investments. Other investments are with other European countries with only one non-European country standing out as material, the United States with approximately 4 percent of the general account investments of life insurers.

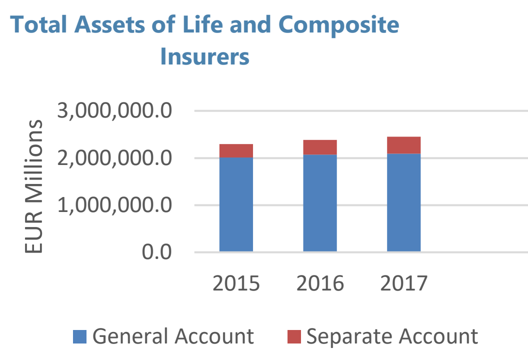
**11. Life insurers have been able to make returns on assets that exceed guaranteed returns to policyholders on the general account.** Some small to medium non-life mutual insurance companies have not been able to make a positive return on equity. Medium-size life and composite non-mutual insurance company (5 billion to 10 billion euros of assets) are showing a negative return on equity (see Figure 5), but this result is driven by two companies and is not a wider trend.

**Figure 3. France: Premium Flows for Life Insurance Companies**

*Premium flows for life companies have been relatively stable for 2015 to 2017 however there is an increasing share of unit-linked business…*



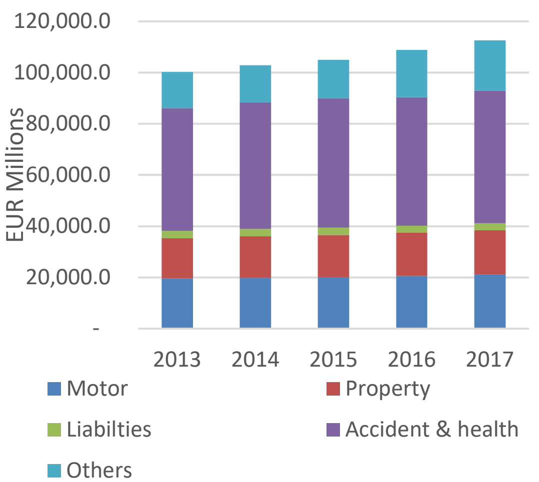

*…but that is only slowly translating to a higher share of assets for unit-linked business.*




Source: Autorité de Contrôle Prudentiel et de Résolution (ACPR).

## Figure 4. France: Key Non-life Metrics and Insurance Company SCR Ratios

*There has been steady growth in non-life premiums led by increases in premiums for accident & health…*

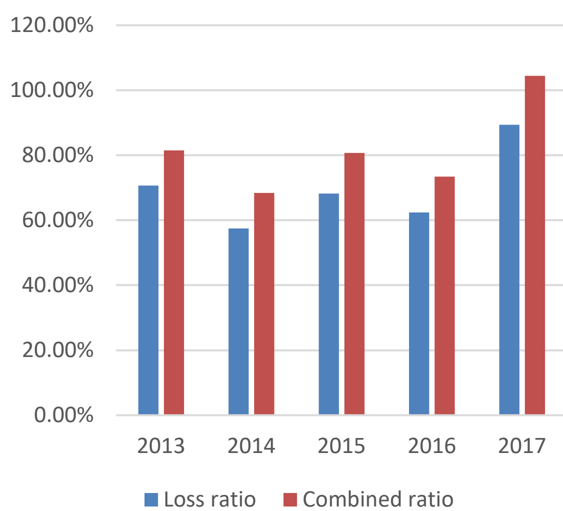



Source: Autorité de Contrôle Prudentiel et de Résolution (ACPR).

*…and combined ratios and loss ratios mean the industry is making an underwriting profit consistently.*

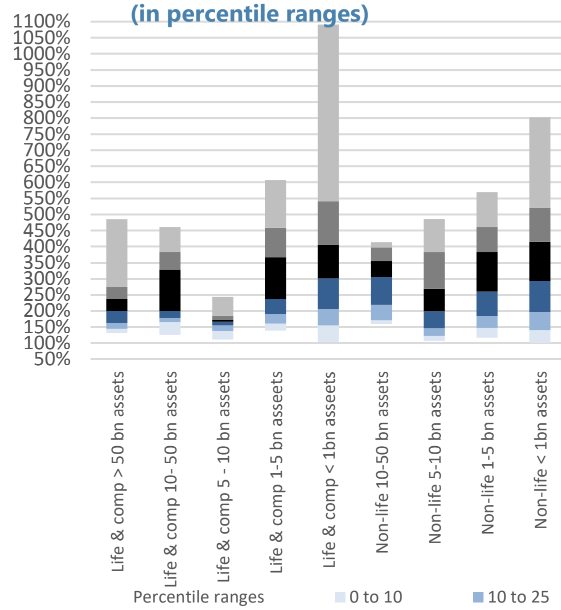

Source: Autorité de Contrôle Prudentiel et de Résolution (ACPR) and IMF staff calculations.

*Loss ratios and combined ratios are more volatile for reinsurers with the combined ratio going above 100% in 2017 but well under that benchmark in previous years*




Source: Autorité de Contrôle Prudentiel et de Résolution (ACPR) and IMF staff calculations.

*Including transitional and LTG measures, all insurance companies meet the 100% SCR coverage ratio with the widest distribution of SCR coverage ratios for seen for small insurance companies*

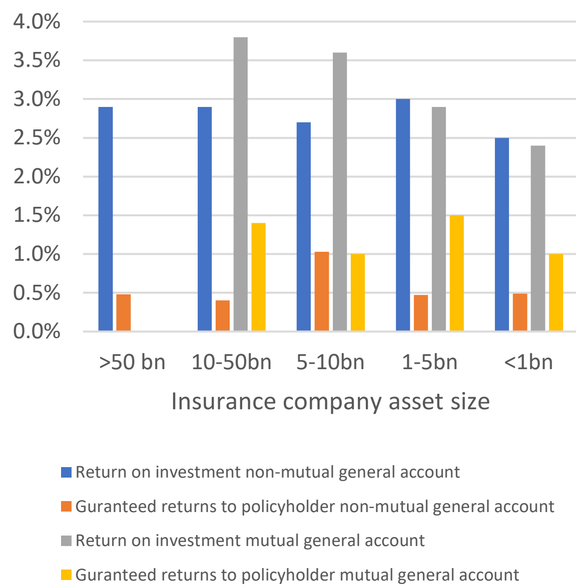



Source: Autorité de Contrôle Prudentiel et de Résolution (ACPR).

**Figure 5. France: Profitability of Life Insurers**

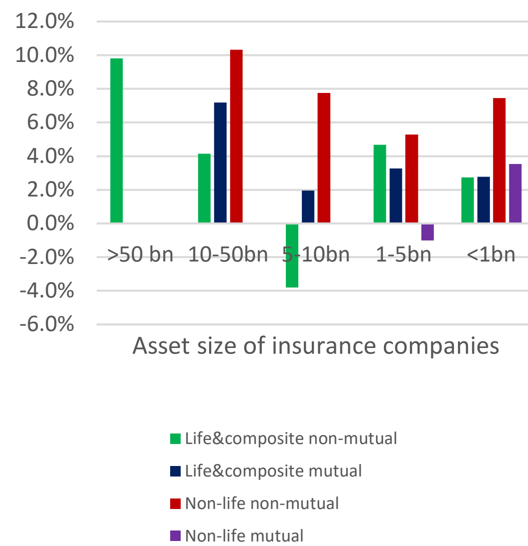
*Returns on assets of life insurance general accounts exceeds the guaranteed returns to policyholders on average across a range of life insurance company size in 2017…*

**Comparison of Return on Investment and Guaranteed Returns to Policyholders**




*…however not all types and sizes of insurance companies are able to make, on average, a positive return on equity in 2017.*

**Return on Equity of Insurance Companies**




Source: Autorité de Contrôle Prudentiel et de Résolution (ACPR).

# IMPLEMENTATION OF SOLVENCY II

## A. General

**12. Implementation of Solvency II in France occurred on January 1, 2016 as in other EU jurisdictions.** Solvency II establishes a risk-based solvency framework. Pillar I of the framework is a risk-based solvency capital requirement calculated using a balance sheet with a market-consistent valuation of assets and a modified market-consistent valuation of liabilities. This Pillar I quantitative requirement is complemented by qualitative requirements and a supervisory review process (Pillar II) and rules for supervisory reporting and public disclosure (Pillar III).

**13. Solvency II is a high-quality regulatory framework.** The Euro Area FSAP found that: "The adoption of the Solvency II Directive has contributed to improved risk management practices and governance in the insurance sector but differences in national accounting rules, taxation and social security laws contribute to a continued fragmentation."[5]

[5]Euro Area Policies: Financial Sector Assessment Program, Technical Note—Insurance, Investment Firm, and Macroprudential Oversight, IMF Country Report No 18/230.

**14. Solvency I continues to apply to a very small part of the French insurance market.** As at the end of 2017, 142 insurers out of 742 continue to be supervised according to Solvency I. These insurers are all very small representing 0.03 percent of the assets of the insurance market and 0.17 percent of the premiums of the insurance market.

**15. The implementation of Solvency II in France was aided by the ACPR's approach to requiring participation of all French insurers in EIOPA QIS exercises and conducting its own implementation exercises.** Insurance industry representatives cited this as one of the reasons for a smooth implementation of Solvency II in France.

## B. Transitional Measures and Long-Term Guarantee Package[6]

**16. Solvency II transitional measures are used by a small number of French insurers as at year end 2018.** These transitional measures applicable to technical provisions are applied for 16 years after the introduction of Solvency II at the beginning of 2016 and enable insurance companies to spread the impact of the change from the calculation of technical provisions based on Solvency I standards to a calculation based on Solvency II standards. Transitional measures are subject to approval by ACPR.

**17. Seventeen solo insurance companies were using the transitional deduction on technical provisions (TTP) representing less than 10 percent of technical provisions in the French market.** The TTP is based on the difference between Solvency II technical provisions and Solvency I technical provisions and other provisions and reserves required under Solvency I in France. The difference is deducted from technical provisions after applying a coefficient that decreases in a straight line over time. Removing the TTP decreases the average SCR ratio for the French market as a whole by 10 percentage points and it decreases the SCR coverage ratio of insurance companies using the measure to 188 percent on average, a reduction of 31 percentage points. One solo insurance company with a negligible market share was using the transitional on risk free rate (TRFR). This measure is based on the difference between discount rates currently used to calculate Solvency I technical provisions, and discount rates used to calculate Solvency II technical provisions. It is added to the discount rate used to calculate Solvency II technical provisions and will decrease over the transitional period. The transitional measure may only be applied to contracts that give rise to an insurance liability before December 31, 2015. Removing the TRFR would reduce the SCR coverage ratio by 36 percentage points to 168 percent for the particular insurer.

**18. Fifty-two solo insurance companies and eight groups were using the transitional measure on equity risk.** This transitional measure consists of calculating the capital requirement for this risk based on a shock of 22 percent in the first year, increasing in a linear manner to correspond to the standard shock of 39 percent plus the symmetric adjustment (type 1 equities) or 49 percent

[6]Note impacts of transitional measures and the long-term guarantee package are derived from *Report on long-term guarantees measures and measures on equity risk* 2018, EIOPA, December 18, 2018.

plus the symmetric adjustment (type 2 equities) by January 2023 at the latest. This transitional measure only applies to equities acquired no later than January 1, 2016.

**19. Twenty-five solo insurance companies and eleven groups were using the transitional measure on own funds.** This measure is essentially grandfathering treatment of certain capital instruments issued before Solvency II became effective. Overall, the French insurance industry is not significantly reliant on transitional measures in order to meet Solvency II requirements on an ongoing basis.

**20. French insurance companies are significant users of the Volatility Adjustment (VA), with 175 French insurance companies out of 696 insurance companies in Europe using the VA.** These 175 insurance companies represent more than 90 percent of the technical provisions in the French insurance industry. Sixteen insurance companies apply both the VA and the TTP representing 9 percent of technical provisions. ACPR does not require prior approval for use of the volatility adjustment, although under Solvency II it may choose to require prior approval. The VA involves insurance companies adjusting the relevant risk-free interest rates to mitigate the effect of increases of bond spreads. The VA is calculated as 65 percent of the spread between the interest rate that could be earned from a reference portfolio of assets (after risk correction) and the risk-free interest rates. The reference portfolio is representative for the assets in which insurance companies have invested in the relevant currency. Removing the VA would reduce the average SCR coverage ratio of the French insurance market from 238 percent to 228 percent. Focusing on just insurance companies using the measure, their average SCR coverage ratios would decline from 216 percent to 202 percent. No French insurer applies the Matching Adjustment (MA). Overall, the French insurance industry is not significantly reliant on the VA in normal times to meet the SCR coverage ratio of 100 percent, however it is a measure that aims to address balance sheet fluctuations in stressed market conditions.

**21. The French insurance market largely relies on the standard model to calculate the SCR with only two major (re)insurance groups using full internal models representing 17 percent of total French technical provisions, with insurers representing a further 5 percent of total French technical provisions using partial models**. In the EEA, there are 2912 (re)insurance companies applying Solvency II, only 81 use full internal models and 105 use partial internal models with the remaining 2726 using the standard formula. At the Group level, there are 363 (re)insurance groups supervised under Solvency II and 8 of those use full internal models, 33 use partial internal models and the remaining 322 use the standard formula. The users of internal models tend to be those insurers that are large and complex and for which the standard formula is less suited.

## C. Selected Issues in the French Implementation of Solvency II

**22. QRTs submitted to ACPR are not required to be audited and there is no audit requirement for Solvency and Financial Condition Reports (SFCRs) disclosed to the public.** Other European countries have imposed various audit requirements. Accountancy Europe conducted a survey in 2016 and found that 12 out of 13 countries surveyed have some audit requirements with respect to Solvency II reporting, with France being the exception.[7] During the mission, it was found that the quality of data provided to ACPR under Solvency II could be improved. Audit requirements for QRTs and SFCRs are strongly recommended to improve the quality of reported data both to ACPR and the public. With respect to reporting to ACPR, at least the annual QRTs should be subject to audit requirements. If the audit of the entire suite of QRTs is seen as too costly, then at least core QRTs that are core to supervision and macroprudential surveillance should be subject to audit. In addition, audit assurance processes are recommended to be required for the systems and procedures used to complete QRTs and SFCRs.

**23. The 'Euro Funds' life insurance product is theoretically highly liquid but subject to tax incentives that undermine the liquid nature of the product.** This is because the government provides tax incentives which require the funds to remain with the life insurer for at least eight years to access those tax benefits. In normal times, this provides a strong incentive for French policyholders to maintain their funds in this product. Policyholders are able to demand withdrawal of their 'Euro funds' product immediately or at most with a one- to two-day delay with the only possible consequence being loss of tax incentives. There are no surrender fees and therefore little disincentive to a withdrawal. The bancassurance model may exacerbate this liquidity risk where insurance companies are tied by name and reputation to banking groups. The branch model also provides the means for easy withdrawal.

**24. ACPR requires weekly reporting of inflows and outflows from life and mixed insurance companies, accounting for 80 percent of the life insurance market.** This enables ACPR to monitor trends in inflows and outflows. ACPR has the power to order the cessation of benefit payments from a particular life insurance company, if necessary. In addition, the Haut Conseil de Stabilité Financière has been given the power, under the Sapin II law, to limit life insurance withdrawals in the event of a crisis for a maximum of six months. The power to limit withdrawals can apply to the whole market or part of it and can be made only in very exceptional conditions. This power is only to be used to prevent strong threats to the financial health of the whole insurance market or financial system. This requires a balancing of financial stability and the interests of the policyholders. So, there are crisis measures in place to address a sharp increase in liquidity risk and there is regular monitoring of net flows to or from life insurance companies. However, liquidity risk issues do not appear to be sufficiently embedded in the regulatory framework.

**25. Under Solvency II, liquidity risk is expected to be addressed in Pillar 2, but the requirement could be more explicit.** In the list of risks that ORSA must address, liquidity risk is not mentioned by name.[8] Liquidity risk is a risk required to be addressed in the SFCR. In a sample of four SFCRs reviewed, liquidity risk was only addressed in a qualitative way with no quantitative measures of liquidity risk. Within the Pillar 1 SCR calculation, the lapse risk module of the Solvency II standard formula addresses this risk but in the way it affects the balance sheet values of assets and liabilities

[7]Scope of audit of Solvency II reporting by insurance undertakings, Accountancy Europe, December 2016.

[8]According to Article 45 of the Solvency II Directive, transposed in article L 354-2 and R 354-2 of the Code des Assurances (CdA) (French Insurance Code) does not include liquidity risk explicitly as an element to consider in ORSA.

and therefore the net assets of the insurance company; in other words, it addresses the capital implications of surrender behavior. It does not address whether the assets are sufficiently liquid to meet demands for surrenders of life policies. In the French context, the heightened liquidity risk of life insurance products means that liquidity needs to be addressed explicitly, in both a qualitative and quantitative way. This could be addressed through additional requirements at the European level or additional requirements applied in France in addition and outside of the Solvency II framework.

**26. EIOPA has released a discussion paper in March 2019, Systemic Risk and Macroprudential Policy in Insurance,[9] that indicates additional reporting on liquidity risk and improved monitoring of liquidity risk are under consideration at a European level for macroprudential purposes.** The French insurance market has distinct liquidity characteristics which make these proposals highly relevant for France. ACPR and EIOPA should move toward putting these proposals in place with ACPR encouraged to begin field testing such requirements at the earliest opportunity on a voluntary basis. While the EIOPA discussion paper stops short of recommending liquidity requirements for insurers, the prevalence of the bancassurance model in France may make such requirements for those insurers within financial conglomerates more relevant than is generally the case in the European market. The highly liquid nature of insurance liabilities and the connection of some liquid assets with insurance company parent banks creates this greater concern for the liquidity of certain major insurance companies in France. French and European authorities should introduce liquidity management requirements and liquidity stress tests at the conglomerate level to be carried out by the supervised entities, including insurance companies within financial conglomerates. In addition, the ORSA and the Solvency and Financial Condition Report (SFCR) should be required to explicitly address liquidity risk in both a quantitative and qualitative way.

## D. Own Risk and Solvency Assessment (ORSA)

**27. The French insurance industry is on a journey of fully implementing ORSA with different insurance companies at different stages of integrating ORSA into their company risk culture.** According to findings from ACPR, some companies still need to internalize the ORSA process as they are still seeing it as a compliance burden rather than their own process to improve risk management. A number of the large insurance companies interviewed noted the usefulness of ORSA and that it has been internalized as their own process and it is seen as a positive by these industry representatives. ACPR should continue its supervision processes aimed at improving the implementation of ORSA and embedding the ORSA process in insurance company risk culture.

## E. Governance

**28. There should be a minimum number of independent members of the Board.** There are a range of practices within the insurance industry with regard to voluntarily appointing independent

[9]Other potential macroprudential tools and measures to enhance the current framework, July 31, 2018, EIOPA.

members of the Board. It is particularly notable that some insurers within Financial Conglomerates do not have independent board members. The use of the term 'independent' Board members here rather than non-executive members is deliberate to emphasize that the Board members should be independent of both executive management and controlling shareholders. Currently, Solvency II does not mandate that there be any independent Administrative Management or Supervisory Boards (AMSB) members. While this is not required in the ICPs either, international best practice is to require a minimum number of independent board members.[10] Ideally, Solvency II would be amended to require a minimum number of independent members of the AMSB, at least one-third. Before such a change is implemented, ACPR could work with the insurance industry to promote the role of independent Board members and increase their presence on Boards in France with a target of achieving independent members becoming at least one-third of Board membership where legally possible.

**29. There is a greater focus on assessing the propriety of executive board members and senior management than non-executive Board members.** It is recommended that the propriety of non-executive board members receive increased supervisory attention. The IMF is aware that ACPR is making progress towards increasing that attention as it began instituting changes to its requirements, moving towards an annual self-assessment of the propriety of non-executive AMSB members which could be made available to the ACPR on request. In terms of the fitness of non-executive board members, it is appropriate that ACPR continue to focus on collective competence of the Board.

## F. Supervision Processes and Resources

**30. ACPR requires reporting in line with Solvency II requirements (the QRTs) and additional data particularly in relation to French GAAP.** In addition, it requires weekly reporting of inflows and outflows for some certain life insurance companies as mentioned above. This provides ACPR with a comprehensive set of data to perform off-site analysis.

**31. For each insurance company, a risk assessment is undertaken on at least an annual basis and is recorded in a supervisory review process (SRP) tool.** The risk assessment is based both on automated quantitative assessment that is derived from QRTs and other reporting as well as expert judgement. Other inputs are also taken into account notably the results of EIOPA stress tests. There is an assessment of both impact of failure and risk of failure and the scores for each are combined into an overall risk score. As well as this at least annual process, key risk indicators are assessed using an IT tool that automatically calculates a number of KRIs each quarter based on quarterly reporting and graphically presents them to supervisors. The consequence is that the intensity of supervision is determined according to the risk assessment. While there are some

[10]Examples: The Australian Prudential Regulation Authority requires a majority of independent directors except where the regulated entity is owned by another regulated entity or foreign equivalent and then the minimum is two independent directors where there are up to seven directors and three independent directors where there are more than seven directors. The Monetary Authority of Singapore requires regulated entities to have a board with one-third independent directors.

defined rules regarding supervisory intensity related to the risk assessment there is room for judgement.

**32. There are general rules for the frequency of on-site inspections.** These are set out in Table 3 below. There is no difference in substance between the frequency of on-site inspections for risk ratings 1 and 2, as once every 50 years is essentially the same as no minimum frequency. It is recommended that ACPR review the minimum frequency of on-site inspections for risk ratings 1 and 2 to create a definable difference in frequency between the two risk ratings. While these are general rules, ACPR will take into account specific risks, the economic environment and the authorization requests (for internal models in particular) in determining the allocation of on-site inspection resources.

**Table 3. France: Risk Ratings and On-site Inspections**

| Risk Rating | Minimum Frequency of On-site Inspections |
|---|---|
| 4 (highest) | Every year |
| 3 | Every 5 years |
| 2 | Every 50 years |
| 1 | No minimum frequency |

Source: Autorité de Contrôle Prudentiel et de Résolution (ACPR).

**33. On an annual basis an overall supervisory plan is determined across all entities and approved by the General Secretary of ACPR within an overall framework determined by the College of ACPR.** This plan takes into account individual supervisory plans and risk ratings as well as the availability of supervisory resources. The plan is determined in February each year. It can be subject to change if the operating environment for insurers changes or specific risks emerge for specific insurers**.**

**34. On-site inspections are intense and can last months but with team members not necessarily on-site for all that time.** Insurance companies are required to provide dedicated space for on-site inspection teams for the period of the on-site inspection.

**35. Off-site analysis can also result in meetings with management of insurance companies and there are required meetings with some insurance companies.** Examples are:

- If one of the seven subjects of the qualitative risk analysis is scored 4 then there is a requirement for a dive-down meeting on that subject with management;

- If the impact score of 2 or above is determined, then an annual meeting on the insurance company's prudential situation is undertaken at year-end;

- If an impact score of 4 is determined, then there is a meeting between ACPR's management and insurer's senior management in order to review all supervisory subjects and there is a meeting with the insurance company's auditor; and

- If the overall score is 3 or 4 then there are dedicated exchanges with the insurance company on its Solvency II reporting as well as a meeting with the senior management.

**36. ACPR should review the intensity and frequency of on-site supervision and its relationship to off-site supervision.** With a number of other meetings with insurance companies possible, some of these meetings may be close to what other supervisors would call focused on-site inspections. There is a possibility that more focused and regular on-site inspections could be envisaged and then that would provide more flexibility in terms of the rules around frequency of on-site inspections mentioned above. ACPR contends that the spectrum of supervision formats is deliberately broad based to adapt to different situations and the frequency of on-site inspections is adapted to risks. However, the point about reconsidering the intensity and frequency of on-site visits remains valid as the resource requirement for the very intense on-site inspections appears to be greater than observed in other countries. It appears that the number of insurers receiving on-site inspections annually is reduced due to this intensity of on-site inspection leading to those insurers that are smaller and of lower perceived risk receiving less or no on-site supervisory attention. The use of the word 'perceived' here is intentional in that risk assessments of these entities are focused on off-site analysis and risks may not be identified due to reliance on off-site analysis. International benchmarking of supervisory intensity particularly with insurance supervisors outside the EU may be helpful.

## G. Issues with Insurance Companies Passporting into the French Market

**37. Under EU law, an insurance company licensed in an EEA Member State may provide its insurance services on the territory of another EEA Member State without permanent establishment.** This is known as the freedom to provide services or "passporting".

**38. France has experienced difficulties with obtaining claims payments from a number of insurers licensed outside of France offering long-term non-life insurance contracts, particularly construction defects insurance.** This issue was addressed in EIOPA's *Opinion on non-life cross border insurance business of a long-term nature and its supervision* issued on December 21, 2018. This Opinion sets out obligations for home NCAs (National Competent Authorities) in terms of supervisory assessment, communication with host NCAs and actions home NCAs should take in the event of identified prudential issues. EIOPA will follow up with relevant NCAs six months after the publication of the Opinion (so in June 2019). EIOPA will investigate the supervisory actions taken by the NCAs. This may result in further guidance. ACPR and EIOPA should continue to work together to ensure that home NCAs are informed of the risks of the long-term non-life contracts in the French insurance market and work cooperatively with those NCAs to enhance the supervision of relevant insurers. French authorities should coordinate with home NCAs of relevant insurers, particularly in Gibraltar, Denmark and Ireland to ensure that insurance companies established in their jurisdictions and conducting business in France are adequately provisioning for this business and have sufficient capital to support such long-term business.