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'INSURANCE CURRENT AFFAIRS' ROUND TABLE IN COLLABORATION WITH MAIDEN

Reinsurance or subordinated debt? Both

SO FAR, THE ISSUANCE OF SUBORDINATED DEBT IS AN INSTRUMENT RARELY USED IN OUR COUNTRY TO IMPROVE CAPITAL. UNDER SOLVENCY II THE LANDSCAPE CHANGES DRAMATICALLY, GIVEN THAT IT CAN BE A GREAT HELP FOR INSURANCE COMPANIES, PARTICULARLY FOR SMALL COMPANIES AND MUTUAL INSURANCE COMPANIES, IN THEIR NECESSARY COMMITMENT TO INCREASING COMPETITIVENESS AND TO REINFORCE AND/OR PROTECT THEIR SOLVENCY CAPITAL. IN ADDITION, IT IS A PERFECTLY COMPLEMENTARY TOOL, NOT INTERCHANGEABLE WITH REINSURANCE. THIS ALL ADDS UP TO THE CONSIDERABLE INCREASE THAT HAS OCCURRED IN RECENT YEARS BOTH IN THE NUMBER OF ISSUERS OF SUBORDINATED DEBT (TODAY THERE ARE ALREADY THIRTY AT THE EUROPEAN LEVEL) AS WELL AS THE NUMBER OF INVESTORS INTERESTED IN ACQUIRING THE SUBORDINATED DEBT. THIS INSTRUMENT WHICH IS AVAILABLE TO THE COMPANIES ALSO HAS —AS IT WAS CONCLUDED IN A RECENT ROUND TABLE ORGANIZED BY THIS MAGAZINE IN COLLABORATION WITH MAIDEN, WHICH WE SUMMARIZE— THE EXPLICIT SUPPORT OF EIOPA AND THE EUROPEAN REGULATORS, CONSTITUTING A FORM OF “PREAUTHORIZED” SOLVENCY CAPITAL.

THE ROUND TABLE WAS MODERATED by Juan Manuel Blanco, editorial director of INESE, and had the participation of: Guido Romani, Business Development Adviser of MAIDEN GLOBAL HOLDINGS; Patrick Haveron, chairman of MAIDEN GLOBAL HOLDINGS; Francisco Carrasco, head of International Relations of the General Directorate of Insurance and Pensions (DGSFP, Dirección General de Seguros y Fondos de Pensiones); Fe Fernández, director of Internal Auditing of PELAYO; Jesús María Rioja, chief financial officer of PREVISIÓN SANITARIA NACIONAL; Miriam Blázquez, Chief Risk Officer de SANITAS; Arturo Lozano, managing director of GUY CARPENTER; Patrick Kone, director of AON BENFIELD ANALYTICS; Enrique Sánchez and Isabel Velázquez, partners of Mazars; José Luis Maestro, partner of Ideas; and Oliver Tattan, CEO of Insurance Regulatory Capital.

Guido Romani made the introduction. In it he stated that it was high time we stopped thinking about what Solvency II is and what to do to adapt to it and we started to look beyond it, thinking of when the legislation is already fully implemented. "We have to see what the new tools are, the options and possibilities that Solvency II offers to the companies to enhance their capital and solvency, and consider them to find an ideal balance. We offer reinsurance solutions, but there are solutions beyond that," he said.

After this reflection, we began to talk about the specifics of instruments such as reinsurance and subordinated debt under Solvency II.

FRANCISCO CARRASCO: The instruments counted as own funds such as subordinated debt, have not presented an important development under Solvency I in the Spanish market. There is the possibility that certain capital instruments, which were valid to count as own funds within the scope of Solvency, are still alive in Solvency II, through transitional measures.

With regard to the new capital instruments, we have the delegated acts that establish a list of requirements mainly in Articles 71, 73 and 77 that are many and quite detailed. And the delegated acts are directly applicable. In addition, EIOPA has published a series of guidelines that deal with the own funds, about the classification, treatment of stakes, etc., guidelines that Spain has already said it intends to apply. The outline of the landscape is quite clear and it is up to the companies to decide whether to use these instruments. Solvency II gives them wide latitude to handle themselves as they wish. Moreover, these instruments do not even require an authorization from the DGSFP, as they are not complementary own funds. Some institutions come to us to see if a particular instrument would be valid as Tier 1, Tier 2 or Tier 3, but the truth is that the regulation is quite detailed. In addition, this area enjoys a very high degree of harmonization. If the DGSFP believes that an own funds instrument is valid as Tier 2, for example, our European supervisor colleagues will have the same impression. When any doubt, interpretation or discussion comes up, it is essential to get in touch with our colleagues and, together, come up with a solution that enables the market participants to have sufficient legal certainty.

MIRIAM BLÁZQUEZ: The regulator and the regulations give absolute freedom for everyone to invest wherever they want. We do not have a closed list of assets and each company can organize themselves as they like, provided that they comply with the minimum SCR and other requirements. But when we take decisions, we must consider what will be the capital charge of those actions. In terms of profitability, nothing is free. If I invest in something, I have to think about profitability. And if I get into debt, I have to think about the interest I pay. Also, you need to think in tax terms. We must also consider that, as we are going to have a SCR level, we must have an adequate level of own funds. And it is no longer a still-photograph, as in old photo, but it is a very volatile picture, because both the SCR and the level of the own funds or their rating can move. There is no single answer.

FRANCISCO CARRASCO (DGSFP): "CAPITAL AND REINSURANCE ARE COMPLEMENTARY INSTRUMENTS BUT VERY DIFFERENT. SUBORDINATED DEBT FORMS PART OF THE CAPITAL MANAGEMENT POLICY AND THE REINSURANCE INTO THE RISK MANAGEMENT. SOMETIMES IT SEEMS THAT THEY ARE COMPLETELY INTERCHANGEABLE INSTRUMENTS. FROM MY PERSPECTIVE, THEY ARE NOT AT ALL"

It will depend on the risk appetite and how far you want to push it, in addition to what is allowed by the regulator. Moreover, no company will start from scratch on January 1, they will have an initial situation, with a level of own funds and some exposures that cannot be easily undone. All management decisions will depend on the initial position. With respect to reinsurance and subordinated debt, in Spain that starting point is clearly in favor of reinsurance. It is a well-known product, all companies have resorted to at some point and that gives them confidence. It is also a mechanism that the supervisor knows perfectly well and completely transparent in terms of risk, so it is easier to implement than subordinated debt. In addition, the level of solvency of insurance companies has always been very high in Spain, with own funds constituted by share capital and reserves. There has been very little leveraging. Companies have been very cautious and have not had the need or interest of going to the markets to borrow. It is a door that it is now open to companies and we will have to see how it evolves, but I think it will not be a radical change. We are not going to change our philosophy. It will depend on how 'the shoe pinches.' A company will go to the debt market if they need to. If they meet with their own funds the SCR levels, they will not need to.

ARTURO LOZANO: The formulas of hybrid capital such as subordinated debt, have not been common in Spain. There has been only 2 or 3 operations in the last 20 years. Solvency I lacked something that is highly developed in Solvency II: the philosophy of risk management. In Spain natural disasters are virtually covered by the CCS (Consorcio de Compensacion de Seguros [Insurance Compensation Consortium]), leaving very little of the catastrophic risk in the private insurance, so reinsurance is a provider of risk capital almost exclusively. For reinsurance decisions, it is increasingly common to confront the gross risk capital to net reinsurance and compare the cost of the capital saved with the cost to the reinsurance (implicit average profit of the reinsurer).

ARTURO LOZANO (GUY CARPENTER): “THE FORMULAS OF HYBRID CAPITAL SUCH AS SUBORDINATED DEBT, HAVE NOT BEEN COMMON IN SPAIN. THERE HAS BEEN ONLY 2 OR 3 OPERATIONS IN THE LAST 20 YEARS”

MIRIAM BLÁZQUEZ (SANITAS): “THE REGULATOR AND THE REGULATIONS GIVE ABSOLUTE FREEDOM FOR EVERYONE TO INVEST WHEREVER THEY WANT. BUT WHEN WE TAKE DECISIONS, WE MUST CONSIDER WHAT WILL BE THE CAPITAL CHARGE OF THOSE ACTIONS”

That cost is usually much lower than the subordinated debt and even less than the remuneration required by the shareholders. Usually, reinsurance provides added value, among others, in terms of risk capital. But sometimes, the reinsurance market does not offer the capacity demand[ed] at a reasonable cost. For example, not long ago, in Japan there was a crisis in which this situation occurred and they had to resort to alternative solutions and markets. Other times, when the cost of reinsurance does not seem right because either it exceeds the cost of capital, or because it reduces by a little the capital (financial reinsurance) or because the traditional capacity is very expensive, buying hybrid capital (subordinated debt) emerges as a natural option. In a long-term strategy, subordinated debt can be an efficient way of financing the risk capital and the traditional capital. The question is: at what price.

INITIAL SITUATION

ENRIQUE SÁNCHEZ: It is true that subordinated debt is used in Spain residually or internally in large groups. Until now, under Solvency I, the solvency of the companies has been quite good. With the new regulation and the low-rate environment we have, many organizations are finding that the situation is eating into their own funds, particularly so in the case of small and medium-sized companies, which also have long-term commitments. In certain circumstances the possibility of using subordinated debt might come up. Reinsurance is acting on the needs of capital. Instead, subordinated debt backs the capital. They are complementary things. Companies rely on reinsurance to influence one of the risks, the underwriting risk. But you can also find the situation of many companies that do not know how to meet their capital needs, with some very high “Best Estimates.” Then, a window of opportunity can open to the complementarity of the subordinated debt.

FE FERNÁNDEZ: The initial situation is what it is, it cannot be changed. On the date of entry into force of the legislation insurance companies will have the assets and liabilities on the balance sheet with the corresponding risks associated with them and a certain level of own funds to cover them. This initial situation is the one that will have to be managed. There will be companies with difficulties that will have to explore different options. Reinsurance is one of them, it is going to mitigate the technical risk but also, in turn, adds up capital consumption that generates a counterparty risk, and this should be considered. The question is whether to improve the solvency position through reinsurance or through issuing subordinated debt or considering both. Medium and small companies have serious problems to place the subordinated debt, especially when it is issued because they are in a position of compromised solvency. What cost will that debt have to be compensated at? And, how are they going to access the capital markets? During the financial crisis, the savings banks (cajas) issued preference shares in order to increase their own funds, but their marketability was not the same that, for example, mutual insurance companies have. Said savings banks placed the debt among their clients, but the small and medium-sized insurance companies, specifically the mutual insurance companies, are not going to sell debt to their members or customers. The option of improving the solvency position through reinsurance seems more accessible. Solvency II, and more specifically the analysis of the capital charge for catastrophic risk, has meant that, in our case, we improve our protection in relation to the clusters, thus reducing the capital charge for the technical or underwriting risk.

PATRICK HAVERON: In the Spanish market, companies have had a good solvency position, with a very strong capital and little of resorting to subordinated debt. An interesting thing of Solvency II is that it opens the door to the mutual insurance companies and other companies to resort to all types of capital and risk management instruments, from reinsurance to subordinated debt, as the large multinational companies have been doing. It is true that Spanish insurance companies have not had much need to resort to subordinated debt because under Solvency I they feel comfortable, but this is certainly likely to change when a risk adjusted model, like the Solvency II one, is implemented.

ENRIQUE SÁNCHEZ (MAZARS):
"REINSURANCE IS ACTING ON THE NEEDS OF CAPITAL. INSTEAD, SUBORDINATED DEBT BACKS THE CAPITAL. THEY ARE TWO COMPLEMENTARY THINGS"

Surely it is important to measure the cost of the various instruments available, but it is not a one-to-one comparison at face value. Another nice thing is that Solvency II brings transparency to the market. The SCR of the companies comes to the surface and it is known better. Over time, as the markets change, this subordinated debt may be an opportunity for companies of any size to be able to use all the capital instruments available to become more competitive. The companies that resort today to subordinated debt may be the ones that need to solve a problem of solvency, but it is not just for that, but also to compete better and have more options.

JESÚS RIOJA: We are a life mutual insurance company. In this field, being a mutual insurance company of professionals, that is, without a huge size, the solution of the issuance of debt seems almost the only way to find own funds at this moment. We consider that a sensitivity somewhat similar to that of other European countries is lacking in the regulation of some collaborative schemes between mutual insurance companies and benefit societies. In France there is the possibility of mutual insurance companies and benefit societies collaborating, allowing the use of own funds and having some synergies. When we have needed financing to address a project, we have not found the capacity to do so through the issuance of debt, but we have found that reinsurance was a way of obtaining such help. The difficulty of placing the debt is evident. Could reinsurance help small mutual insurance companies place debt in the market? Life reinsurance helps us in the mortality risks, but not in the longevity risk, because it is not clear that there are reinsurance solutions for this type of risks.

FE FERNÁNDEZ (PELAYO): "MEDIUM AND SMALL COMPANIES HAVE SERIOUS PROBLEMS TO PLACE THE SUBORDINATED DEBT, ESPECIALLY WHEN IT IS ISSUED BECAUSE THEY ARE IN A POSITION OF COMPROMISED SOLVENCY"

We also have reinsurance for interest rate risks. This interest rate risk, although it can be covered to some extent with the 'matching adjustment,' is a complication. If we apply the 'volatility adjustment', we employ a mechanism that is counterproductive with respect to that for which it was intended. This mechanism does not improve the problem, rather it complicates it, to the point that if we improve the SCR and own funds, but the 'volatility' drops, we need more millions than in the previous year, despite having carried out a better management. And what about the reinsurance of special purpose companies that allow us to securitize certain areas? There are many unknowns to clear and the role of reinsurance is very important, even in the issuance of private debt.

JOSÉ LUIS MAESTRO: We are focusing on the role of subordinated debt and reinsurance, but I want to go a little further. Too much emphasis is placed on doing things that consume little capital. Theoretically, it makes sense, but in practice that is not going to be the case. Firstly, because although little capital is consumed in certain modules, everything is correlated and what matters is the final SCR. Although we do something because it consumes less equity risk capital or interest rate risk, what ultimately matters is what happens on top, in the overall SCR, not in each module. Secondly, it makes no sense to think that companies will do what consumes less capital and that they opt for a specific investment or operate in certain areas due to the capital consumption. The companies will do what they can, as it has always happened. They are going to sell what they can; and if they consume more capital, they consume more capital. And if there is a capital surplus so much the better. In Spain we have a very good solvency situation and the new SCR requirements of Solvency II will not be a big problem, but there will be less of a surplus than there is now. However, there are issues that are up in the air. We are talking about SCR, but if we go to the standard formula, we are not very sure that it is the final solution. In principle, the SCR comes from the standard formula, but if the risk profile does not conform to the underlying assumptions, they will ask for more.

JESÚS RIOJA (PREVISIÓN SANITARIA NACIONAL):
"WHEN WE HAVE NEEDED FINANCING TO ADDRESS A PROJECT, WE HAVE NOT FOUND THE CAPACITY TO DO SO THROUGH THE ISSUANCE OF DEBT, BUT WE HAVE FOUND THAT REINSURANCE WAS A WAY IN OF OBTAINING SUCH HELP"

PATRICK KONE (AON): "REINSURANCE CAN BE USED TO ADJUST THE CAPITAL REQUIREMENTS AT A LEVEL WHERE YOU ARE COMFORTABLE AND CONTRACT COVERAGE FOR SITUATIONS THAT CONSUME A LOT OF CAPITAL"

Though we do not know how, or when, or how much. Moreover, nobody knows clearly how the risk profile is defined, and how the assumptions of the standard formula are compared to the risk profile. Moreover, another concept appears, which are the overall solvency needs that are not defined. Everyone gets their impression of the local situation and, if it is reasonable, it is assumed that the regulator will say that it is fine, but it is not certain.

COMPLEMENTARY INSTRUMENTS

FRANCISCO CARRASCO: Capital and reinsurance are complementary instruments but very different. Subordinated debt forms part of the capital management policy, of the optimal allocation of resources; and reinsurance forms part of risk management. Sometimes it seems that they are completely interchangeable instruments. From my perspective, they are not at all. Reinsurance directly influences the risk profile, readapting it and reducing the SCR, but taking into account that it can incorporate other risks, such as counterparty risks, currency risks, etc. And capital does not influence the SCR that you have to cover, rather it enables it to have more funds to cover the SCR. The price of these two products is also important. Surely it is possible to detect some kind of correlation between liquidity stress situations in the capital markets and a lower capacity in the reinsurance market. They are different markets, but the prices and the exposures of the funds worldwide can move with some correlation. When we decide to resort to the capital markets with a low interest rate, there is probably a lot of liquidity; and perhaps in the reinsurance market there is also high capacity and low prices. As for the mutual insurance companies Solvency II is a system that is harmonized throughout the European Union, but the regulation of mutual insurance companies is not harmonized. The French case has been mentioned here, where there is a very varied typology of mutual insurance companies and differences between them for different reasons. I daresay that it is an extreme case in the EU.

With regard to the 'volatility adjustment,' it is true that it contributes these problems to the balance sheets, but it is a numerical adjustment that is made on the risk curve when certain circumstances occur, regardless of the management of the insurance company. Therefore, the application of the 'volatility' can have a biased effect because it is completely insensitive to the management of the company. An instrument that does recognize the management is the 'matching adjustment,' which can be used when certain requirements are met with the mandatory authorization of the DGSFP.

PATRICK KONE: Reinsurance and subordinated debt are two instruments of capital financing. A major change with Solvency II is that no capital is required for the risks we assume, including those that up to now under Solvency I we did not consider. Reinsurance has an impact both in the risk management and in the claim rate and it also has the advantage of being very dynamic, finding solutions for needs that did not used to exist, such as the capital consumption due to the life risk market, for example. Reinsurance is very efficient because it has a positive impact on both the risk and the capital. It can therefore be used to adjust capital requirements to a level where it is comfortable, by taking out specific coverage for risks that consume a lot of capital. However now, under Solvency II, the impact of reinsurance on capital is more volatile because the impact on the underlying risk is also very volatile. Subordinated debt can be used in a complementary manner to establish a cushion to help maintain the objective solvency situation in case of deviations in the required capital that we might have if we have underwritten a risk that has an 'x' impact on the capital, if the interest rates have moved in a direction we did not expect or if the claim rate has been very different from the one expected. If this is the reason why we issue debt, it is likely that we will also find a better price than we would if we did it because we are in a difficult financial situation.

ISABEL VELÁZQUEZ: Both reinsurance and subordinated debt are complementary instruments and their use will depend on the situation in which the company is. Besides the benefits that financing in one way or another brings, we must take into account the duration of the commitments.

PATRICK HAVERON (MAIDEN): "AN INTERESTING ASPECT OF SOLVENCY II IS THAT IT OPENS THE DOOR TO THE MUTUAL INSURANCE COMPANIES AND OTHER COMPANIES TO RESORT TO ALL TYPES OF CAPITAL AND RISK MANAGEMENT INSTRUMENTS, FROM REINSURANCE TO SUBORDINATED DEBT, AS THE LARGE MULTINATIONAL COMPANIES HAVE BEEN DOING"

Reinsurance contracts have a duration of approximately one year and can be changed and adapted depending on the results obtained, it is more flexible, while subordinated debt is a longer-term commitment. Another important aspect to consider is related to the Pillar III and the transparency and information to the market. For example, we can show to the market that we have a coverage ratio of 150%, but the most important thing is how it is being balanced, that is, its composition. Therefore, we must adequately reflect how risk is managed, what is in the best interest of the company and what image you want to give to the market.

OLIVER TATTAN: It is increasingly important for all types of companies to have a target SRC. Across Europe we are asked what should be the target for the SCR and how to reach it. Reinsurance and subordinated debt are complementary instruments, but not interchangeable. In the past, the CEO of the company resorted to the subordinated debt and the Chief Risk Officer resorted to the reinsurance. Not anymore. We get requests for an instrument, whichever, but we do not get one or another depending on the managerial position. Previously, the subordinated debt market was in the hands of a few who had access to large financial markets operations with public underwriting operations, as there were only 18 issuers in Europe, while there were around 5,000 insurance companies. All of them are now able to access this form of capital, not only with public operations, but more suitably with private ones for limited amounts.

JOSÉ LUIS MAESTRO (IDEAS): "IN SPAIN WE HAVE A VERY GOOD SOLVENCY SITUATION AND THE NEW SCR REQUIREMENTS OF SOLVENCY II WILL NOT BE A BIG PROBLEM, BUT THERE WILL BE LESS OF A SURPLUS THAN THERE IS NOW"

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And there were also differences between some jurisdictions and others. However, this year between 10 and 15 new 'Mid-Tier' issuers of subordinated debt have emerged. As a result the issuance of subordinated debt is reaching companies like ours. And because of the harmonization that Solvency II provides, there is an implicit support to the issuance of subordinated debt by the EIOPA and other EU regulators. As for the operational difficulties in small and medium-sized companies issuing debt, that it is not really the case. In fact, the issuance of subordinated debt is very simple. In the past, there were no investors who bought paper. But in the future there will be more players on the market and more access. The private debt placement market is developing very quickly and mutual insurance companies, which previously did not have the possibility of resorting to own funds, now have an instrument such as the subordinated debt. They now have three instruments, as they can use their own funds, reinsurance and subordinated debt.

MIRIAM BLÁZQUEZ: It is true that business decisions are not always defined by the SCR level. Firstly because the market is what it is. You may want to insure artworks but not everyone has a 'Picasso' at home, but they do have a car or need home insurance. Moreover, the SCR is not straightforward. It is not like a simple arithmetic operation such as 2+2. It depends on the interpretation of the supervisors, the evolution of the risks, etc. All European institutions are determining the extent of the ideal SCR or the target risk they want to reach. I would like to know if these levels are different by country, also depending on the requirements of the local supervisors, the size of the company, the rating, etc.

COMPARABILITY AMONG COMPANIES

OLIVER TATTAN: There have been many differences by jurisdiction.

OLIVER TATTAN (INSURANCE REGULATORY CAPITAL): "THE SCR WILL PROVIDE COMPARABILITY AMONG DIFFERENT COMPANIES. THIS WILL AFFECT THE PERCEPTION OF THE COMPANIES BY THE DIFFERENT MARKET PLAYERS, SUCH AS INVESTORS, CORPORATE CLIENTS AND SHAREHOLDERS"

ISABEL VELÁZQUEZ (MAZARS): "BESIDES THE BENEFITS THAT FINANCING IN ONE WAY OR ANOTHER BRINGS, WE MUST TAKE INTO ACCOUNT THE DURATION OF THE COMMITMENTS. A REINSURANCE CONTRACT HAS A DURATION OF APPROXIMATELY ONE YEAR, IT IS MORE FLEXIBLE. SUBORDINATED DEBT IS A LONGER-TERM COMMITMENT."

Under Solvency I, there were many different interpretations by the regulators, while under Solvency II a greater harmonization has been achieved. The SCR will provide comparability among different companies. This will affect the perception of the companies by the different market players, such as investors, corporate clients and shareholders. For example, overcapitalization can cause problems with shareholders. Tables will be published comparing the various companies. For example, in the Netherlands it has already been done and we have seen how it has influenced the stock price, which has gone up or down depending on how they performed on these tables.

GUIDO ROMANI: This comparability will also generate competitiveness, comparing the SCR. Operating in a single market, this competitiveness may be marginal, but globally, is much more important. It is there that the harmonization between markets will accelerate, while now it is only because of the implementation of the regulations.

PATRICK HAVERON: There is quite a bit of comparability on the European market and companies are beginning to recognize that it is important. Not only is the Spanish market in a strong or healthy situation, but there are other markets in Europe that are also very healthy. What happens is that the conversation has changed. Six months or a year ago, the health of the own funds of European insurance companies was being discussed. Now it is no longer such a hot topic because the date on which the Pillar III tables will be published is fast approaching. The dialogue that is taking place is not about protecting the SCR, which is already very healthy and strong, but about competitiveness, to demonstrate that the companies not only have a very solid SCR, but are also competitive in the light of the publication of the tables.

JOSÉ LUIS MAESTRO: We are talking about big companies and thinking more than anything in groups with an international presence, but there are also Spanish companies here very strong at the national level.

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I am convinced that most will do what they have done so far. They will boast that they have a good solvency situation, because they compare SCR and own funds. But nobody, in general, will distribute the solvency surplus to the shareholders. That has been done in Spain by some multinationals based here. They have just covered the bare minimum, the solvency margin and little else. And they take it all to their country of origin. But the Spanish ones, even the strongest, usually do not distribute the surplus to their shareholders. I am sure that the companies will have in Spain a comfortable position and will boast of the solvency surplus compared to the SCR, but none will leave the minimum SCR to do with it something else.

FRANCISCO CARRASCO: I have referred earlier to issues concerning Pillars I and II. Comparability leads us to Pillar III. It is no coincidence that some ratings are published and the markets react. That is what is sought after under Solvency II. Pillar III, which is often cited as the pillar of reporting or information to the supervisor, is really the mainstay of the market discipline. The intention is that markets have sufficient information to "reward" those who are doing a good job, accepting less interest for their subordinated debt, raising the price of shares, requiring a lower capital cost, lower cost of reinsurance, etc.

FE FERNÁNDEZ: For subordinated debt to be assigned to Tier 1 it has to be almost perpetual, 30-year debt. Furthermore, the first repayment period should be at least 10 years. It is difficult that someone buys 30-year debt from a small business under these conditions. At present, as discussed above, it seems difficult to think that small and medium-sized insurance companies can easily place subordinated debt and especially quality subordinated debt, so that it can be assigned to Tier 1.

OLIVER TATTAN: Tier 1 is 30-year debt or perpetual debt, but no one is offering on the market Tier 1 debt, everything is being issued in Tier 2. We are talking about a 10-year repayment, with the possibility of reimbursement after 5 years if the issuer wants. The big companies are already at 20%-30% of regulatory capital on Tier 2 debt, given that the period and the conditions imposed by EIOPA have an undeniable strategic value. In the long run, smaller companies will surely also resort to this form of capital, to approach a percentage very close to the one of large companies.

GUIDO ROMANI (MAIDEN): "SOLVENCY II POSES A NEW CHALLENGE: A LONG-TERM RELATIONSHIP OF THE COMPANIES WITH THE CUSTOMERS, THAT GOES BEYOND THE SIMPLE PROFITABILITY THAT CAN BE OFFERED THROUGH REINSURANCE"

As for the potential impact on shareholders of the capital surplus being distributed, they must be the ones who decide whether they want more risk in exchange for a higher interest.

PATRICK HAVERON: Sometimes we speak of comparability between reinsurance and subordinated debt and this is how our group has considered it from an intellectual and commercial point of view. We see ourselves as a provider of capital, whether reinsurance or other type of product. With the introduction of Solvency II, it is essential that we continue to be able to offer the market the range of products we have available. The evaluation process of candidates for reinsurance and subordinated debt is 80% or 90% identical. That makes the interaction between the insurance company and the provider of capital very similar and there is much comparability between both products. Regarding the duration, we must deliver products that offer a greater or lesser term and that respond to different needs. The reaction that insurance companies are having to a product that has not been used so far is normal, when reinsurance is better known. But eventually it will be accepted. It is a long-term process but raises many opportunities and it is going to introduce a lot of dynamism on the market.

GUIDO ROMANI: Solvency II is creating new challenges to the reinsurance world, including the challenge of changing the approach of the Tier. A reinsurer offers capital solutions, including what they have always been doing, reinsurance. But it is a contribution of a form of capital, down the liabilities route. Capital management is also added to the risk management, so the reinsurer is forced to also understand said requirements. They have to be able to combine both services. Moreover, markets today are characterized as being very volatile, with excess capacity. It is a commodity market and therefore opportunistic. But there are demands for growth. Solvency II poses a new challenge: a long-term relationship of the companies with the customers that goes beyond the simple profitability that can be offered through reinsurance.