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News Release

In response to today's vote in the European Parliament to adopt the Omnibus II Directive for Solvency II, consultant John Forbes commented,

"Today's vote to adopt the Directive that implements Solvency II was never really in doubt. The EU Parliament had already voted last year in favour of a timetable leading to full implementation by 1st January 2016 and the agreement in November last year after an eight-hour tri-logue negotiation between the European Council, Parliament and Commission had resolved the major points of difference between the various EU bodies.

There remain, however, significant areas of uncertainty for the real estate investment management industry.

Firstly, the Solvency Capital Requirements for investments, including real estate, are dealt with in the level 2 regulations. A draft from October 2011 has been widely leaked but never published. EU officials have confirmed that there is an updated draft, but that this will not be subject to public consultation and will not be published until finalised and translated into the various EU languages. It is being reviewed by an expert group. Although it is suggested that the treatment of real estate remains the same as the October 2011 draft, the real estate industry will not get certainty on this until the regulations are published;

Secondly, the treatment of real estate lending remains confused. The October 2011 draft was generally accepted to be defective, and it had been suggested that this would be subject to a further round of consultation, Disappointingly, this has not occurred. Furthermore, lobbying efforts to remedy the punitive treatment of securitisation has not had the desired effect. The EU regulator's consultation on the treatment of long-term assets, published on 19th December 2013, makes the treatment of Commercial Mortgage Backed Securities worse rather than better;

Thirdly, most large insurers have indicated that they will take up the option to seek approval from their own local regulator to use internally generated models to calculate their Solvency Capital Requirement rather than the Standard Model set out in the regulations. At this stage there is uncertainty as to the extent to which local regulators will allow internally generated models to differ significantly from the calibration under the Standard Model;

Finally, the focus of insurers and regulators is now moving beyond the Solvency Capital Requirements calibration to other aspects of the Directive. In particular, the key focus for 2014 is expected to the the Own Risk Solvency Assessment (ORSA). The requirements for improved governance and risk management will feed through to those real estate investment managers with life insurance companies as clients.

Solvency II represents a major challenge for the real estate investment management industry. With the extraordinarily short timeframe to implementation, most insurers have yet to start looking at what this means for their investment managers. When they do, some fund managers are going to struggle to meet the demands of insurance clients.

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Notes

Solvency II is a fundamental reform of the capital adequacy regime for the European insurance industry. It aims to establish a revised set of EU-wide capital requirements and risk management standards to reduce systemic risk in the insurance industry

For more background regarding Solvency II and real estate:

http://www.johnforbesconsulting.co.uk/solvencyii

For more information on the level 2 timetable:

http://www.johnforbesconsulting.co.uk/solvency-ii-update-feb-2014

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