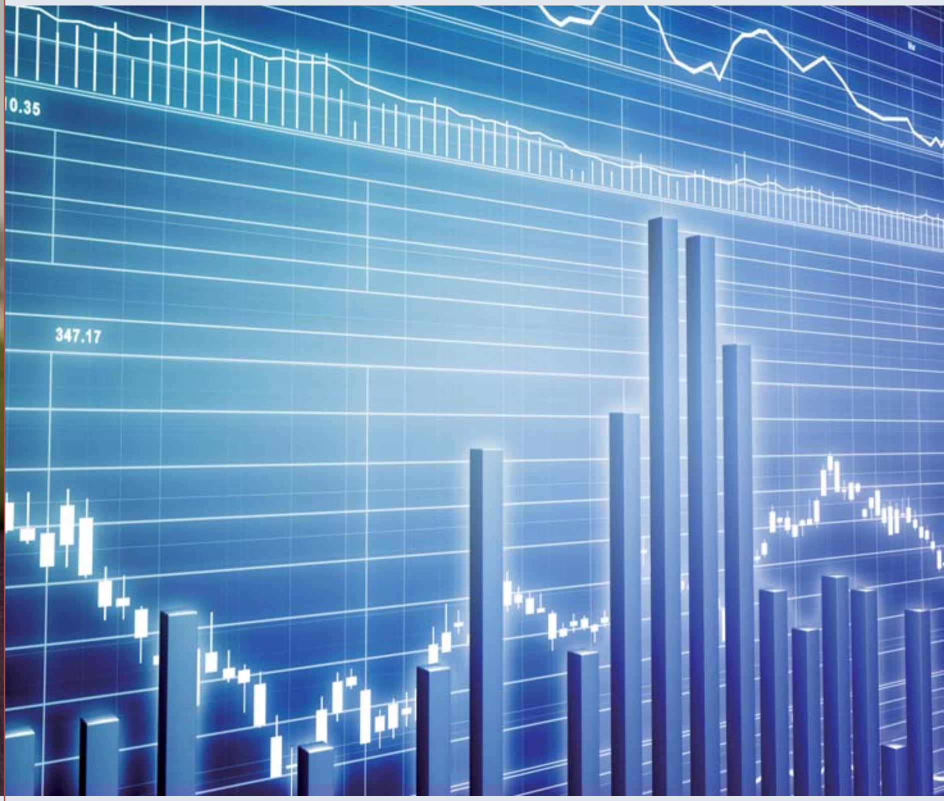
interview to **Ricardo Lozano**

Director-General of Insurance
and Pension Funds in Spain



Ricardo Lozano was born in December, 1962. He graduated in law from the University of Alcalá de Henares in 1986 and went on to obtain his doctorate of law from the Complutense University of Madrid in 1996. He also obtained a degree in actuarial and financial studies from the University of Alcalá de Henares in 1998. In 1991, he passed the public examination to become a State Inspector of Insurance, and has been a State Inspector of Finance since 2000.

Between 2002 and May, 2004, he held the post of Manager of Financial Advisory Services for Insurance Companies with KPMG, the auditing and consultancy company.

At the proposal of the Minister of Economy and Finance and on the basis of Royal Decree 1279/2004 dated 21 May, he was appointed as Director-General of Insurance and Pension Funds; by virtue of this appointment, he also became chairman of the Insurance Compensation Consortium, a corporation established under public law which operates privately.

"It is important to highlight the strength shown by the insurance sector during the recent crisis"

The Spanish insurance sector is passing through an exceptional period. On the one hand, it is weathering the impact of the global financial and economic crisis with equanimity, despite the marked slowdown in growth; and on the other, as in the rest of Europe, it is fully occupied with the task of adapting to the new financial methodology imposed by Solvency II, which must be in place by January 2013. Spain held the Presidency of the European Union for the first six months of 2010. Now that this term of office has been completed, we asked Ricardo Lozano, Director-General of Insurance and Pension Funds, about the progress that has been made, his vision for the Spanish insurance industry and the roadmap for dealing with some of the key pending issues.

Spain held the Presidency of the European Union for the first six months of 2010. Which aspects stand out in terms of the work accomplished in the insurance sector?
The Spanish Presidency's role focused mainly on continuing the discussion of the draft for Solvency II and the Level 2 measures, following the approval of the Solvency II Directive.

What is Solvency II?
It is a new system of requirements for capital adequacy, and a code of conduct for the insurance companies as they carry out their activities. It is being set up for the entire European insurance sector. Solvency II is similar to the framework that was adopted for the banking industry some years ago -the Basel Accords, which are being updated at the moment. Having had several regulatory frameworks to standardize solvency requirements over the last 30 years, the insurance sector has now tackled the job that was necessary: an update of the entire methodology for approving these new solvency requirements. But Solvency II also incorporates some other important ideas such as market transparency that is to say, more information from the supervisory authorities as well as the companies, for the insured parties as well as the general public. Ultimately, Solvency II entails the development of a methodology that is more appropriate to the risk profile of each individual company. More

efficient insurers will need less capital and will be subject to fewer requirements. On the other hand, a less efficient company, or one that takes on more risks, is likely to encounter greater difficulties with its commitments and will require more capital. At the same time, a series of rules is being brought in to improve all aspects of corporate governance, transparency and information.

How will these changes affect supervision?
There are two aspects on which Solvency II does not focus: one of them is the financial architecture of supervision. The Spanish Presidency played a clear part in pressing ahead with the establishment of the new supervisory bodies that will operate at financial level in the future. There are also some aspects of work that relate to Level II. There are precedents in the Framework Directive regarding supervisory bodies or systems for multinationals and financial conglomerates. As regards these two issues, some aspects fall more within the scope of Solvency II and the Level II measures, whereas others are of a more generic nature.

Was there a specific Spanish initiative in connection with the new Directives?
No initiative was launched during the six months of the Spanish Presidency, because the objective was to ensure the continuity of the work in progress. At present, the Commission has a fixed timeline in place for the pending issues such as insurance mediation; a new Directive on this aspect is planned for the start of 2011. The main effort is focused on the work related to Solvency II.

And what about the issue of a new financial supervisory model for Europe?
Last summer saw the approval of a European supervisory model based on three specialized authorities: for banking, insurance and markets. Given that the scope comprises the 27 member countries of the European Union (EU), different supervisory models are emerging; there will certainly be some new features, and the frameworks that are currently in place will be modified and restructured. Ultimately, this is a problem of design and assignment of authorities. The existence of three Community supervisory agencies is perfectly compatible with differences among the supervisory models at the level of each individual country.

As far as Spain is concerned, is the government still thinking of changing the current system and reducing the three supervisory agencies back to only two?
There is no proposal on the table at present. And also, the point that keeps coming up is that the overall situation of the financial system calls first and foremost for solutions to the most urgent issues. For example, a start has been made on reorganizing the savings banks. Once this process has been completed, the discussion will again turn to new supervisory scenarios.

Do you think that Spanish insurers will run into major problems as they adapt to Solvency II? Are there differences in the ways that large, midsize and small firms will have to adapt?
There are challenges, rather than problems. After all, this involves a spectacular leap in terms of quality. We are trying to involve as many companies as possible in the impact studies, so that managers can precisely identify the requirements that Solvency II will impose on them, allowing them to work on the planning. UNESPA (*Unión Española de Entidades Aseguradoras y Reaseguradoras*, Spanish Union of Insurance and Reinsurance Companies) is cooperating to the maximum extent in this area, as is my organization and also the *Confederación Española de Mutualidades de Previsión Social* (Spanish Confederation of Mutual Provident Societies).

In your view, will this prompt a new wave of consolidation or concentration in the sector?
Not necessarily. That will depend on many decisions, and on the managers that is to say, on whether they will be able to cope with the challenges of Solvency II. There will be a threshold level for smaller-sized companies without a "European passport" they will not have to comply with sophisticated regulations such as those which Solvency II may impose, so this will not necessarily lead to concentration.

As regards the implementation of Solvency II, for which impact tests are being conducted at regular intervals, there is a timeline that assumes everything will be ready by the end of 2012. Are Spanish insurers going to meet the deadline?
We shall try to but obviously, issues may arise as the project progresses and we shall have to take them as they come. The cooperation

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Insurance in the Spanish market volume of gross accrued premiums
(Figures in EUR million)

	2005	2006	2007	2008	2009*	Variation 09/08 (%)
Total for Sector	48,950	53,255	55,078	59,447	60,374	1.56
Life insurance	20,617	22,950	23,246	26,850	28,538	6.29
Non-Life insurance	28,333	30,306	31,832	32,597	31,836	-2.33
Total insurance companies	312	298	297	296	294	

* Provisional data
Not including Mutual Provident Societies
Source: Directorate-General of Insurance and Pension Funds (D.G.S.F.P.)

Solvency II aims to bring the management models closer and those who do a better job of managing risk require less capital

shown by UNESPA, the sector association, is exceptionally good. It is sending out a very clear message, and the work is excellently planned. It is making a great effort to convince the entire sector and to ensure that everyone participates. It has a roadmap, and it has identified in detail the requirements that Solvency II will entail for the companies. We are holding regular meetings with the sector to offer suggestions, clarify issues and clear up any doubts. We are also making major efforts in our own organization. The Supervisory Law is being drafted in stages; at the recent consultative meeting of last 20th July, we saw a new section of the draft. Everything is being done in order to achieve the objective. Once it has become a draft law, it must be adopted by the Congress of Deputies (Spanish Lower House) but in any case, the aim is to push ahead with it as far as possible.

The International Insurance Society (IIS) held its 46th annual seminar in Madrid. What were the outstanding subjects discussed at this event?
There was much talk about Solvency II, solvency models and capital adequacy calculations

for the various insurance lines. There was also quite an interesting discussion about the two zones of influence, the American and the European. Solvency II aims to bring the management models for both zones closer together. Its philosophy and methodology are based on risk. Accordingly, those who do a better job of managing risk require less capital. But the European methodology has been preferred because its antecedents are taken from other models such as those of Canada, the USA or Switzerland. Also, the methodological options are more finely differentiated, as are the various impact tests that are being conducted.

Another important issue for Spain is the current situation regarding the future Law on Insurance Contracts.

A process is in place to make headway with this legislation, but it will retain a structure that has been in operation for many years, since the existing Law on Insurance Contracts dates from 1980. Generally speaking, what is under way is an updating process, given that this is a commercial contract with general terms and clauses. There are numerous aspects related to case law, and controversial points that come up time after time the wording and the language that are used, to take one example. The technical wording is inseparable from the society in which we live, but we have to provide explanations so that balanced interpretations will be possible later on. And the linguistic aspects are determined by the scope of the official languages that are in force.

Is there anything outstanding as regards the future Law on Insurance Contracts?

No, I think that in overall terms, it has covered (or has attempted to cover) every aspect. Some points were missing, such as death and dependents' insurance. Certain improvements will be introduced in the area of consumer protection; for example, refusal of extension will not be permitted.

And what about insurance on the internet?

This is more a matter of distribution and channels, but all aspects of information prior to entering into a contract will be covered in an Annex to the Law on Insurance Contracts. The process involves updating all the relevant standardization. Now we would like to discuss and debate this with the sector, and this is a process that moves slowly.

The crisis that we are passing through, which is to some extent structural in nature, has triggered a reduction in state revenues and cutbacks in social benefits. Will this situation offer an opportunity for private insurance, for example if private saving increases in an attempt to complement public-sector pensions?

We always try to take the view that the capacity of the private sector must be increased to respond to society's requirements. I am convinced that there is a need for balance, and

	Non-Life insurance	
	2009	**2008**
Status of Non-Life solvency margin (Figures in EUR million)		
Own assets	17,150	16,181
Minimum amount Solvency Margin	5,047	5,051
Difference (surplus)	12,103	11,130
Technical reserve cover (Non-Life) (Figures in EUR million)		
Technical reserves to be covered	32,268	33,100
Assets allocated	44,396	43,675
Difference (surplus)	12,128	10,575

Source: Directorate-General of Insurance and Pension Funds (D.G.S.F.P.)

	Life insurance	
	2009	**2008**
Status of Life solvency margin (Figures in EUR million)		
Own assets	13,311	11,817
Minimum amount Solvency Margin	6,333	5,715
Difference (surplus)	6,978	6,102
Technical reserve cover (Life) (Figures in EUR million)		
Reserves to be covered	136,873	129,251
Assets allocated	159,025	149,644
Difference (surplus)	22,152	20,663

Source: Directorate-General of Insurance and Pension Funds (D.G.S.F.P.)

The insurance sector is bearing up to the crisis well

hence for active participation, between the public and private sectors. This is one of the most important achievements of European society. Logically, complex situations may arise for each party, but overcoming these problems calls for a global effort by society as a whole, while respecting the various interests that are always involved.
We take the view that the public/private dichotomy has so far made it possible to develop a welfare "formula" of a reasonably high standard, enabling people to aim for increasingly satisfactory standards of living; but clearly, we shall have to see whether all the aspects are sustainable.

As an EU member, Spain has a regulatory framework for insurance that is based on European standards. What are the repercussions of this for the Latin American markets? How do they view us?

I think that they have a very special and very fond view of us. For instance, we take the time to work with those who request our help and we have frequent contacts and exchanges of information with them. Obviously, our relations within Europe are easier and more regular, because we participate in ongoing work with the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the European Commission. As regards Latin America, the relationship is definitely very fluid. Suffice it to say that Mexico has been expressing interest in implementing Solvency II in its market for some time now. And generally speaking, the other Latin American countries are backing a line that will bring them close to us. We are their point of contact with Europe.

Why do we not have more Spanish insurance multinationals?

There are many reasons for this, starting with the fact that the size of the Spanish insurance industry has always been relatively small except in the last ten years, when it accomplished a major leap forwards. The history of the insurance industry has generally been very complex, and it has rarely been possible to count on companies having sufficient capacity to embark on international ventures. Nor has there been much support from the administrative side. Of course, recent years have seen some relevant changes. There have been some

significant changes to the law. There has also been an increase in the number of strong companies and operators, which would imply a trend towards seeking business abroad. However, it is important to highlight the strength shown by the insurance sector in the recent crisis, and its capacity to respond to the situation especially on the part of the credit companies, which were faced with enormous difficulties that proceeded to grow worse every day. We are good listeners, we are receptive towards all innovative projects, and I think that there are very few cases where a procedure for authorizing a new line of business has not come to fruition.

Is the 'per capita' premium ratio in Spain going to register a continuous increase?
Yes; the point here is that there will be no enormous leaps. Many factors have a bearing on this: culture, education, necessities and savings capacity, for example. Development will be based on day-to-day work and gradual progress. It will be a matter of motivating companies to continue to grow, while encouraging the general public to put their trust in insurance as part of the solution to their problems.

The impact of the crisis

How is the insurance sector bearing up to the crisis?
Generally speaking, it is bearing up well. As logically, all the European supervisory authorities have been following the situation closely. We were repeatedly asked for information; solvency tests were carried out in various Spanish groups, and the results are available. In some cases, the data for 2009 were actually better than those for 2008. It was possible to confirm that the sector has the right capacity to react to the difficulties that confronted it. There were merely some isolated problems in connection with credit insurance, which is obviously cyclical in nature; the ratio of claims to premiums took a nose-dive here. This led to a plan for some measure of public support from the Insurance Compensation Consortium *(Consorcio de Compensación de Seguros)*.

Is credit insurance from public companies such as CESCE (*Compañía Española de Seguros de Crédito a la Exportación*, Spanish Export Credit Insurance Company) supporting the ICO (*Instituto de Crédito Oficial*, Official Credit Institute) in any way?
No, that is still an open question. What we have seen is the possibility of making it easier for credit providers and clients wanting credit insurance to move closer together. The ICO is a facilitator of credit, not of credit insurance, but a rapprochement could stimulate business in such a way as to resolve doubts on the demand side as well as the supply side. In this respect, it is true that various initiatives have been tabled which could be channeled through the ICO.

The cooperation shown by UNESPA, the sector association, is exceptionally good in Solvency II implementation

Standard scale for physical injuries

The standard scale for personal injuries used by the Spanish insurance sector is the only one in the European Union which is stipulated at legislative level. What progress is being made with updating it?
This has been a very positive factor for the sector in Spain. There are various elements involved in updating the scale: the quantitative aspects, the development of medical aspects that enable recovery and reduce the after-effects, and also legal questions such as: who are the beneficiaries, how can they get the compensation payments, and to whom is the compensation due? Questions of this sort are more legal in nature.

Compensation payments to victims of serious injuries are not very generous. There are major differences between payments made in Spain and in other European countries.
This may be one of the questions that needs to be resolved. The members of the working group will be sensitive to this issue, and proposals will be made that take account of the efforts to raise the Spanish public's awareness of all aspects of road safety.

Is the updating of the compensation limits for mandatory motor vehicle liability insurance not going to trigger the cancellation of many voluntary liability covers?
There is no need for these covers to disappear. To be sure, the new limits are very high, but we should also remember that the objective here is to provide insurance that really does cover the consequences of a driver's actions in traffic. This is the aim that is being pursued in Europe, and it is also being incorporated into Spanish law: it is an attempt to ensure that anyone who

Insurance mediation

What stage have we reached with the new Mediation Directive that will be implemented in the future?
The European Commission has forwarded an ambitious draft to us. The work will focus on issues of remuneration, which are the bone of contention in every country.

Will commission be the basis?
There are many different formulas. We are proposing some approaches involving thresholds based on the premium, or at the request of the insured.

Will discounts be banned?
Yes. In fact, they are already banned in many countries, including Spain. On this matter, we shall have to arrive at a relatively balanced solution. Afterwards, it may also be necessary to arrive at a more accurate estimate of the figures that could work on the market. These are the most important issues. In any case, we are talking about a Mediation Directive for which the proposal will be submitted in the first half of next year. Discussion of it may take some time, and that will be followed by the start of a transitional period.

Is there any work in progress aimed at differentiating or completely separating banking and insurance activities? After some difficult experiences, Canada decided to prohibit the distribution of insurance by the banks.
We are aware that there is concern on the part of the intermediaries, and even a confrontational situation to some extent. As we have said on many occasions, the point is that we already have a regulatory framework. Obviously, we oppose anything that resembles the imposition of an insurance contract, no matter by whom. We have heard evidence from various mediation associations and we have noted that they make generalized complaints, but they have never submitted any specific cases of persons on whom an insurance contract has been forced. We should aim to find reasonable solutions and conditions, and to establish a balanced situation between the parties. But what we usually point out to them is that the solution clearly goes beyond the bounds of the insurance sector. If we

has insurance will be covered by it for the consequences.

But is it normal for there to be a European Directive that sets maximum death or accident limits for motor insurance, and then for the Spanish Standard Scale for Physical Injuries to make substantial reductions to the figures stated in the Directive?

We are aware that the reform involves two stages, and we are quite insistent about the need to update the Standard Scale. We have two options: to increase the limits per victim, with the system that we used to have a few years back, or to change over to majority European usage, i.e. to set specific limits per claim. Basically, we are opting to adapt to the European system, so an update of the scale is needed in order to do this.

want to ban a bank from selling insurance in its branches, we have to take on the banking sector and obtain a ruling at legislative level. I do not know whether the Canadian model would be a solution, or whether it would make the problems even worse. Here in our banking industry, we have some excellent insurance professionals. Many of them used to work in the insurance world and they have joined the banking sector to do the same work. I think that generalizations are sometimes unjustified; however, the matter is open for discussion.

When it comes to the distribution of insurance, some systems will prevail over others. Do you think that bancassurance has an advantage because of the potential resources available to it?

Our view is that it is a good thing for the Spanish public to have different channels, and for those channels to become stronger. We cannot see that it would be better to have one single channel, because more distribution channels mean more expertise, so more information will flow onto the market. There will be greater scope for choice.