

**CEIOPS' Advice for
Level 2 Implementing Measures on Solvency II:**

**Technical criteria for assessing 3rd country
equivalence in relation to art. 172, 227 and 260**

(Former CP78)

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1. Introduction:

- 1.1. In its letter of 12 June 2009, the European Commission (Commission) requested CEIOPS to provide, by March 2010, fully consulted upon final advice on Level 2 implementing measures in respect of the general criteria to be used to assess third country equivalence under the Solvency II Directive. In a second phase, the Commission will invite CEIOPS to provide advice on individual country assessments.
- 1.2. This submission provides advice for the Level 2 implementing measures referred to in Articles 172 (reinsurance supervision – Chapter I), 227 (group solvency calculations – Chapter II) and 260 (group supervision - Chapter III) of the Solvency II Directive. Where there are common elements between the three articles (e.g. notably in respect of supervisory cooperation, exchange of information and the supervision of undertaking(s) financial condition) a consistent approach has been followed. Each chapter of advice is designed to stand alone, since third countries can be assessed separately in respect of particular articles. For example, the European Commission may decide to assess a third country only for reinsurance equivalence but not for group equivalence.
- 1.3. The Advice identifies the key supervisory principles encapsulated in the Solvency II Directive and the objectives each supervisory principle seeks to achieve. In order to be considered equivalent, a third country regime will have to meet each of the applicable principles and objectives. For each principle and objective the 'indicators' of equivalence are also outlined - namely, those factors which provide guidance in determining whether the relevant principles and objectives are achieved. It should be noted that when assessing a particular principle and objective, every indicator does not necessarily need to be fulfilled in order for principle and objective to be considered observed. This approach is similar to that used by CEIOPS in assessing the equivalence of third country regimes under Directive 2005/68/EC (Reinsurance Directive).
- 1.4. Equivalence assessments will aim to ensure that the third country regulatory and supervisory regimes provide a similar level of policyholder/beneficiary protection as the one provided under the Solvency II Directive¹. This stands as an overarching principle of CEIOPS' advice i.e. it must be met by the third country in relation to each of the above mentioned areas (reinsurance supervision, group solvency calculations and group supervision) for which equivalence is being assessed.
- 1.5. All three equivalence assessments incorporate an indicator relating to internal models. CEIOPS does not consider that the existence of an internal models regime is a prerequisite to a positive equivalence determination under any of the relevant Articles of the Solvency II Directive. However, where an internal models regime exists, and is part of the fabric of supervision within a third country, then the internal models regime needs to be equivalent to that established under the Solvency II Directive.
- 1.6. The Level 1 text sets out a primary objective in requiring an economic approach to valuation of assets and liabilities under Article 75 whilst including in the recitals a secondary objective of ensuring that solvency valuation rules to the ex-

¹ Directive 2009/138/EC - recital 16 (<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:335:0001:0155:EN:PDF>)

tent possible should be compatible with international accounting developments. This will result in similar valuation infrastructure for both accounting and solvency purposes, thereby limiting the administrative burden on (re)insurance undertakings. Nevertheless, depending on the development of international accounting standards, CEIOPS recognises that adjustments to accounting standards may be needed for an “economic approach”.

- 1.7. The current advice takes into account and makes use of all relevant CEIOPS advice for Solvency II Level 2 Implementing Measures, as already delivered to the European Commission². At the same time, this advice also takes into account further guidance received from the European Commission on technical issues in March 2010³. This guidance has not required CEIOPS to change its advice on equivalence.
- 1.8. CEIOPS is aware that the European Commission may also have to take into account the final Level 2 text when finalising the equivalence implementing measures to ensure consistency.

Assessment methodology

- 1.9. The annex to the advice provides a high level outline of the methodology to be used in equivalence assessments. CEIOPS will further develop this methodology in Level 3 guidance which will be subject to consultation. The methodology will allow for available assessments of other parties (e.g. IAIS, IMF, OECD, World Bank) to be taken into account, but such assessments cannot be taken as determinative of equivalence under the relevant articles of Solvency II.

² http://www.ceiops.eu/index.php?option=com_content&task=view&id=706&Itemid=329

³ Please see QIS 5 specifications

2. Chapter I: Equivalence under art. 172

2.1. Background and scope:

2.1.1. Article 172 (1) of the Solvency II Directive requires the Commission to adopt implementing measures specifying the criteria to assess the equivalence of third country solvency regimes with regard to reinsurance activities of undertakings with their head office in the third country.

2.1.2. Based on the criteria and according to Article 172 (2) of the Solvency II Directive, the Commission may decide, in accordance with procedure in Article 301 (2) of the Solvency II Directive, whether a solvency regime of a third-country, applied to reinsurance activities of undertakings with their head office in that third-country, is equivalent to the regime laid down in Title I of the Solvency II Directive.

2.1.3. In case of a positive equivalence determination Member States:

- are required to treat reinsurance contracts concluded with undertakings having their head office in the third country whose regime has been deemed equivalent, in the same manner as reinsurance contracts concluded with an undertaking which is authorised under the Solvency II Directive (Article 172 (3));
- cannot require pledging of assets to cover unearned premiums and outstanding claims provisions (Article 173); and
- shall not require the localisation within the Community of assets held to cover the technical provisions covering risks situated in the Community, nor assets representing reinsurance recoverables (Article 134).

However, this does not constrain the terms of reinsurance contracts as agreed between contracting parties.

2.1.4. The Commission may also submit proposals to the Council for the negotiation of agreements with one or more third countries regarding the means of exercising reinsurance supervision according to Article 175 (1) of the Solvency II Directive. The text is largely consistent with article 50 of the Reinsurance Directive and provides for the Council to enter into agreements with third countries, based on the condition of equivalence of prudential regulation of reinsurance undertakings in the country concerned. Therefore, the criteria developed in respect of Article 172 (1) and the results of any equivalence assessments under Article 172 (3), will also be relevant for a proposal by the Commission under Article 175. Such agreements shall, in particular, seek to ensure:

- market access for reinsurance undertakings headquartered in the territory of each party to the agreement;
- mutual recognition of supervisory rules and practices on reinsurance; and
- that the competent authorities involved are able to obtain information necessary for the supervision of reinsurance undertakings.

The Commission is required to examine the outcome of the negotiations with the assistance of the European Insurance and Occupational Pensions Committee (EIOPC).

- 2.1.5. Subject to article 174 (which prohibits Member States from treating third-country reinsurance undertakings more favourably than reinsurance undertakings which have their head office in a Member State), in the absence of an equivalence decision (art.172) by the Commission, the treatment of reinsurance contracts with insurance companies with their head office in a third country remains a matter for each Member State. The Solvency II Directive does not preclude Member States from undertaking an assessment of third country equivalence, applying the criteria adopted by the Commission under article 174(1), provided there have been no prior equivalence decision by the Commission in respect of the third country in question. However, CEIOPS may consider providing L3 guidance on this matter in order to enhance convergence between Member States equivalence assessment practices.
- 2.1.6. CEIOPS notes that there is a significant difference between the scope of Article 172 of the Solvency II Directive and Article 49 of the Reinsurance Directive. Article 49 refers only to reinsurance undertakings while Article 172 refers to reinsurance activities of undertakings. The interpretation of the wording leads to the conclusion that Article 172 also includes the solvency assessment of insurance undertakings which write reinsurance business (i.e. mixed insurers.).
- 2.1.7. This Chapter provides advice on Level 2 implementing measures as referred to in Article 172 of the Solvency II Directive. Article 172 refers to the solvency regime set out in Title I. This includes Articles 1 to 177 of the Directive. The scope of this advice therefore includes elements related to
- assessment of the Authorisation Process (Articles 14 to 24);
 - expertise and capacity of the Supervisory Authority (Articles 27 to 39);
 - conditions governing business (Articles 40. to 72);
 - requirements of Pursuing Life and Non-Life activities (Articles 73 to 74);
 - valuation of assets and liabilities, technical provisions, own funds, solvency capital requirements, minimum capital requirements and investment rules (Articles 75 to 135);
 - action against (re)insurance undertakings in difficulty or in an irregular situation (Articles 136-144) and
 - reinsurance (Articles 172-177).
- 2.1.8. Special Purpose Vehicles are excluded from the scope of this Chapter, since Article 172 only refers to a solvency regime applicable to insurance and reinsurance undertakings. Furthermore article 211 covering Special Purpose Vehicles is not within Title I.
- 2.1.9. Requirements regarding the right of establishment and freedom to provide services (Articles 145 to 161) are relevant only to EU insurance undertakings.
- 2.1.10. Articles 162 to 171 refer only to direct life and non-life insurance business according to the first subparagraph of Article 2(1) and are therefore not considered.

2.2. Extract from Level 1 text:

2.2.1. Recital 89

(89) In order to take account of the international aspects of reinsurance, provision should be made to enable the conclusion of international agreements with a third country aimed at defining the means of supervision over reinsurance entities which conduct business in the territory of each contracting party. Moreover, a flexible procedure should be provided for to make it possible to assess prudential equivalence with third countries on a Community basis, so as to improve liberalisation of reinsurance services in third countries, be it through establishment or cross-border provision of services.

2.2.2. Article 172

- 1. The Commission shall adopt implementing measures specifying the criteria to assess whether the solvency regime of a third-country applied to re-insurance activities of undertakings with their head office in that third-country is equivalent to that laid down in Title I.*

Those measures, designed to amend non-essential elements of this Directive by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 301(3).

- 2. The Commission may, in accordance with the regulatory procedure referred to in Article 301(2) and taking into account the criteria adopted in accordance with paragraph 1, decide whether the solvency regime of a third country applied to re-insurance activities of undertakings with their head office in that third country is equivalent to that laid down in Title I.*

Those decisions shall be regularly reviewed.

- 3. Where in accordance with paragraph 2 the solvency regime of a third country has been deemed to be equivalent to that laid down in this Directive, reinsurance contracts concluded with undertakings having their head office in that third country shall be treated in the same manner as reinsurance contracts concluded with an undertaking which is undertakings authorised in accordance with this Directive.*

2.2.3. Article 173

Member States shall not retain or introduce for the establishment of technical provisions a system with gross reserving which requires pledging of assets to cover unearned premiums and outstanding claims provisions where the reinsurer is a third-country insurance or reinsurance undertaking, situated in a country whose solvency regime is deemed to be equivalent to that laid down in this Directive in accordance with Article 172.

2.2.4. Article 174

A Member State shall not apply to third-country reinsurance undertakings taking-up or pursuing reinsurance activity in its territory provisions which result in a more favourable treatment than that granted to reinsurance undertakings which have their head office in that Member State.

2.2.5. Article 175

1. *The Commission may submit proposals to the Council for the negotiation of agreements with one or more third countries regarding the means of exercising supervision over the following:*

- (a) third country reinsurance undertakings which conduct reinsurance business in the Community;*
- (b) Community reinsurance undertakings which conduct reinsurance business in the territory of a third country.*

2. *The agreements referred to in paragraph 1 shall in particular seek to ensure, under conditions of equivalence of prudential regulation, effective market access for reinsurance undertakings in the territory of each contracting party and provide for mutual recognition of supervisory rules and practices on reinsurance. They shall also seek to ensure the following:*

- (a) that the supervisory authorities of the Member States are able to obtain the information necessary for the supervision of reinsurance undertakings which have their head offices situated in the Community and conduct business in the territory of third countries concerned;*
- (b) that the supervisory authorities of third countries are able to obtain the information necessary for the supervision of reinsurance undertakings which have their head offices situated within their territories and conduct business in the Community.*

3. *Without prejudice to Article 300(1) and (2) of the Treaty, the Commission shall with the assistance of the European Insurance and Occupational Pensions Committee examine the outcome of the negotiations referred to in paragraph 1 of this Article and the resulting situation.*

2.3 Advice Background

2.3.1. When assessing a third country supervisory system against the criteria mentioned below, the main question shall be whether the supervisory system of the third country provides a level of protection of policyholders and beneficiaries equivalent to that applicable under Title I. Account should also be taken of whether the supervisory system also contributes to financial stability and a fair and stable market.

2.3.2. The recent financial crisis has highlighted the need for co-ordination and proper exchange and use of information between supervisory authorities involved in the supervision of reinsurance undertakings. Reinsurance business is a global business, and in order to be considered equivalent, third country supervisory authorities must be willing and able to exchange confidential information with supervisory authorities within the European Union (EU) / European Economic Area (EEA), under conditions of professional secrecy.

2.3.3. The advice identifies the key supervisory principles encapsulated in the Solvency II Directive and the objectives each supervisory principle seeks to achieve. It is against these principles and objectives that the third country re-

gime shall be assessed. For each principle and objective the 'indicators' of equivalence are also outlined - namely, those factors which provide guidance in determining whether the relevant principles and objectives are achieved.

- 2.3.4. In some third countries, there exist different supervisory regimes applied to reinsurance activities for different classes of undertakings. This could cause a situation where the solvency system for a class of undertakings could be deemed equivalent to that laid down under Title 1, whereas the solvency regime for other classes of undertakings is not equivalent.
- 2.3.5. In the assessment of third country supervisory regimes, consideration should be given to the adequacy of third country practice in applying the proportionality principle. CEIOPS considers that the existence of a proportionality principle in the application of regulatory provisions in third country jurisdictions is contingent upon the nature, scale and complexity of the risks inherent in the business and is, in itself, neither an obstacle nor a prerequisite to the recognition of equivalence.
- 2.3.6. Furthermore CEIOPS also considers that an appropriate System of Governance, in particular an appropriate risk management system, contains policies regarding investments and the investment process, too. Requirements regarding investments are mentioned in Chapter VI, Section 6 of the Solvency II Directive and therefore covered under Principle no. 5 – Solvency Assessment.

CEIOPS' advice

- 2.3.7. In order to be deemed equivalent under the provisions of Article 172, CEIOPS considers that a third country regime will have to meet each of the following principles and objectives. For each principle and objective the 'indicators' of equivalence are also outlined - namely, those factors which provide guidance in determining whether the relevant principles and objectives are achieved. It should be noted that when assessing a particular principle and objective, every indicator does not necessarily need to be fulfilled in order for principle and objective to be considered observed.
- 2.3.8. (Re)insurance undertakings should be subject to a supervisory regime that enables them to absorb significant losses and that gives reasonable assurance to policy holders and beneficiaries that payments will be made as they fall due.
- 2.3.9. In the assessment of third country supervisory regimes, consideration should be given to the adequacy of third country practice in applying the proportionality principle based on the nature, scale and complexity of the risk inherent in the business. However, the proportionality principle does not apply to the professional secrecy provisions in principle 6.

Principle no. 1 – Powers and responsibilities of the supervisory authority

- 2.3.10. **Objective** - Supervisory Authorities must be provided with the necessary means and have the relevant expertise, capacity and mandate to achieve the main objectives of supervision, namely the protection of policyholders and beneficiaries regardless of their nationality or residence. They have to have the resources to fulfil their objectives which include in particular financial and human resources.
- 2.3.11. Furthermore the supervisory authority must be fully empowered to enable the effective carrying out of the supervisory authority's responsibilities. The supervisory authority must have a range of actions available,

based on supervisory law, in order to apply appropriate enforcement or sanctions where problems involving a licensed insurer or reinsurer are identified. Its measures have to be enforced, if needed, through judicial channels.

2.3.12. **Articles – 27, 31, 34 - 36, 51, 62, Recital 17-18,**

2.3.13. **Indicator - The 3rd country supervisory authority should be / have:**

- A legal basis specifying supervisory responsibilities and enforcement powers
- Freedom from undue political, governmental and industry interference in the performance of supervisory responsibilities
- Transparency of supervisory processes / procedures
- Adequate financial and non-financial (e.g. sufficient numbers of appropriately skilled staff) resources
- Appropriate protection from being liable for actions taken in good faith

2.3.14. **Indicator - Appropriate powers to take preventative and corrective measures** to ensure that insurance and reinsurance undertakings comply with the applicable laws, regulations and administrative provisions – as indicated below.

- Ability to ensure compliance on a continuous basis with laws, regulations and administrative provisions (including through onsite inspections) including measures to prevent/penalise further infringements including preventing the conclusion of new contracts
- Communication of concerns , including those relating to the undertaking's financial position
- Obligation on the (re)insurer to respond to concerns raised by the supervisor.
- Ability of supervisory authority to obtain all information necessary to conduct the supervision of the undertaking

2.3.15. **Indicator - Existence/extent of powers in respect of Financial supervision,** verification of:

- System of governance
- state of solvency and financial condition of undertaking
- establishment and increase of technical provisions and covering assets
- administrative/accounting procedures
- internal controls (including those applied to ensure that data received from cedants are reliable and timely)

2.3.16. **Indicator - Existence/extent of provisions in respect of - Information obtainable from undertaking i.e.** Accounting, prudential, statistical information:

- Annual Report on the solvency and financial condition of the undertaking
- annual accounts (covering all operations, financial situation and solvency)

- returns/statistical documents
- information regarding contracts held with intermediaries

2.3.17. Indicator - Qualifying holdings: Existence of powers in respect of:

- Persons (natural/legal) whose actual/proposed qualifying holding may operate against prudent/sound management. Measures may consist of:
 - injunctions
 - penalties against directors/managers
 - suspension of voting rights attaching to shares held by relevant shareholders/members or other instruments
 - nullity of votes cast / possibility of annulment
- Qualifying holding acquired despite opposition of supervisory authority. Measures should consist of:
 - suspension of voting rights
 - nullity of votes cast / possibility of annulment

2.3.18. Indicator - Undertakings in difficulties

- Prohibit disposal of assets
- Recovery plan, finance scheme
- Reestablishment of the level of own funds, reduction of risk profile
- Downward revaluations
- Withdrawal of authorisation
- Measures relating to directors, managers, controllers and other relevant persons

2.3.19. Indicator - Enforcement

- The supervisory authority should have the ability to cooperate with other authorities/bodies in respect of enforcement action

Principle no. 2 - Authorisation Requirements

2.3.20. Objective – To protect policyholders' interest the taking up of reinsurance business shall be subject to prior authorisation to ensure the insurance and reinsurance undertakings satisfy basic standards (which are clear, objective and accessible), prior to becoming authorised to undertake regulated activities and on a continuous basis thereafter.

2.3.21. Articles – 14 – 26, 41-50

2.3.22. Indicator - Existence of standards in respect of - Legal Entity:

- Legal form
- Head office of the undertaking to be situated in the same country as its registered office
- Articles of Association

2.3.23. Indicator - Existence of standards in respect of – Operations:

- Limitation to reinsurance and related operations for pure reinsurance undertakings which may include, for example, a holding company func-

tion

- Limitation to the business of insurance and operations arising directly there from for insurance undertakings.
- Scheme of operations (including, for the first three years, a forecast balance sheet, estimates regarding but not limited to: future Solvency Capital Requirements, Minimum Capital Requirements, the financial resources intended to cover technical provisions and capital requirements.)
- Financial resources to cover set up costs
- Basic own fund items constituting the absolute floor of the minimum capital requirements
- Comply with the system of governance referred to Principle 3

2.3.24. Indicator - Existence of standards in respect of - Provision of information on Shareholders/Members:

- identity of shareholders/members with qualifying holdings; and
- amount of holdings
- assessment of reputation and financial soundness of the owner and acquirer

2.3.25. Indicator - Existence of standards in respect of - Close links:

- Identification of close links. (i.e. a situation in which two or more natural or legal persons are linked by control or participation, or are permanently linked to one and the same person by a control relationship)
- Monitoring of close links to ensure they do not prevent the effective exercise of supervisory powers over the authorised undertaking.

2.3.26. Indicator - Existence of standards in respect of - Refusal/withdrawal of authorisation:

- legally possible
- possible due to qualifications of shareholders/members; and
- where close links prevent effective supervision

Principle no. 3 - System of Governance

2.3.27. **Objective:** The Supervisory Regime shall require an effective system of governance for (re)insurance undertakings which provides for a sound and prudent management of the reinsurance business. In particular, an adequate organisational structure with clear responsibilities, fit and proper management and an effective system of ensuring the transmission of information should be an integral part of the system.

2.3.28. The establishment and maintenance of adequate risk management, compliance, internal audit and actuarial functions is expected. The different tasks of an appropriate risk management and internal control system should be regulated, and subject to regular internal review.

2.3.29. The financial strength of a (re)insurance undertaking is one of the main reasons for policyholders closing a contract with that undertaking. Therefore transparency of this issue is a significant aim and an important part of a prudent supervisory system. (Re)insurance undertakings shall be re-

quired to disclose publicly a report of their financial performance.

2.3.30. Articles: 41-49, 51, 72, 132

2.3.31. Indicator - General Requirements and Risk Management

- Effective system of governance (including but not limited to transparent organisational structure, effective system for transmission of information)
- Requirements relevant to the fitness (for example appropriate professional qualification, knowledge and experience) and propriety (for example good repute and integrity) of management and key function holders
- Effective and well integrated Risk Management System to identify measure, monitor, manage and report (on a continuous basis) the risks to which the undertaking is or could be exposed (on an individual and aggregated level), and the amount of own funds necessary to cover them (comparable to an own risk and solvency assessment)
- sound liquidity management policies which cover short and long term considerations and include stress test and scenario analyses
- Objective and independent Internal Audit function with a direct reporting line to the administrative, management or supervisory body
- Adequate internal control mechanisms
- Sound written administrative/accounting procedures
- Contingency plans

2.3.32. Indicator - Actuarial Function

- Actuarial function with knowledge of actuarial and financial mathematics appropriate to the nature, scale and complexity of the risk inherent in the (re)insurance business. The actuarial function may be fulfilled in any suitable manner, provided that adequate standards are met.

2.3.33. Indicator - Outsourcing

- Continuous supervision of outsourced functions or activities (meeting of obligations shall not be affected)

2.3.34. Indicator - Compliance

- Compliance Function in place which provides the administrative, management or supervisory body advice on compliance with law, regulations and administrative provisions including an assessment of the possible impact of any changes in the legal environment and the identification and assessment of compliance risks

2.3.35. Indicator - Deterioration of financial position

- Identification of deteriorating financial conditions and remediation of deteriorating with appropriate monitoring tools in place

2.3.36. Indicator - Auditors' duty to report:

- breach of laws, regulations, administrative provisions
- issues which may affect the continuous functioning of the undertaking
- refusal (or reservations) in respect of certification of accounts
- non compliance with Solvency and Minimum Capital Requirements

2.3.37. **Indicator: Existence/extent of provisions in respect of** - Public disclosure of report(s) on solvency and financial conditions at least on an annual basis with a description of:

- the business and performance
- system of governance,
- risk exposure, concentration, mitigation and sensitivity,
- assets,
- technical provisions, other liabilities and
- capital management

Principle no. 4 - Business Change Assessment

2.3.38. **Objective** - To ensure the acceptability of proposed changes to the business from an operational, management and supervisory perspective.

2.3.39. **Articles** - 39, 42, 49, 57-63,

2.3.40. **Indicator - Existence/extent of provisions in respect of - Acquisitions:**

- Notification of intention to hold or increase directly or indirectly a qualifying holding
- Right of supervisory authority to oppose proposed acquisition
- Existence of thresholds prompting notification
- Possibility for assessment of acquisition by financial undertakings to be subject to prior consultation

2.3.41. **Indicator - Existence/extent of provisions in respect of - Disposals**

- Notification of intention to dispose directly/indirectly of a qualifying holding
- Thresholds prompting notification

2.3.42. **Indicator - Existence/extent of provisions in respect of - Information obtainable from undertaking**

- Thresholds prompting notification of acquisitions/disposals
- Regular notification (e.g. annual) of qualifying holdings, including size

2.3.43. **Indicator - Existence/extent of provisions in respect of - Outsourcing**

- Notification prior to outsourcing of critical or important functions or activities as well as material subsequent developments

2.3.44. **Indicator - Existence/extent of provisions in respect of - Ongoing disclosure of relevant information** (Disclosure of information, including information in respect of):

- portfolio transfers or transfer of individual contracts (e.g. in the context of reinsurance contracts);
- changes to Board /senior management; and
- scheme of operation

Principle no. 5 –Solvency Assessment:

2.3.45. **Objective:** The supervisory regime shall ensure that reinsurers maintain adequate financial resources in order to prevent disorderly failure, and shall ensure that the assessment of the financial position of the (re)insurance undertaking is based on sound economic principles.

2.3.46. (Re)insurance undertakings shall establish technical provisions (TP) with respect to all (re)insurance obligations that are calculated in a way that enables them to meet their (re)insurance obligations towards the ceding undertaking. Assets covering technical provisions should be invested in the best interest of policyholders and beneficiaries, and undertakings should only be allowed to invest in assets and instruments where the risks can be properly identified, measured, monitored, managed and controlled.

2.3.47. Capital requirements should be based on sound economic principles and reflect a level of eligible own funds of sufficient quality that insurance and reinsurance undertakings are able to absorb significant losses and gives reasonable assurance to policyholders and beneficiaries that payments will be made as they fall due. Capital requirements are covered by own funds of sufficient quality and are based on a prospective calculation to ensure accurate and timely intervention by supervisors.

2.3.48. **Articles – 51, 53-55, 72, 76, 77-135**

2.3.49. **Indicator - Existence/extent of provisions in respect of - Financial supervision**

- Communication of concerns, including those relating to the undertaking's financial position
- Obligation on undertaking to respond to concerns raised

2.3.50. **Indicator - Existence/extent of provisions in respect of - Valuation of assets and liabilities⁴**

- The valuation of assets and liabilities should be based on an economic valuation of the whole balance sheet.
- Assets and liabilities should be valued at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.
- Valuation standards for supervisory purposes should be consistent with international accounting standards, to the extent possible⁵.

2.3.51. **Indicator - Existence/extent of provisions in respect of - Technical Provisions⁶**

- TP should be established in respect of all (re)insurance obligations and aim to capture all expected risks related to (re)insurance obligations of the undertaking.
- TP should be calculated in a prudent, reliable and objective manner.

⁴ Article 75

⁵ IFRS provide principles and guidance for the calculation of fair value for almost all assets and liabilities that are significant to (re)insurance undertakings. As a result, referring to the general IFRS framework for the determination of an 'economic valuation' is a useful starting point for determining the financial position of the undertaking. However, CEIOPS recognises that adjustments may have to be made for local GAAP when the impact on the balance sheet is significant.

⁶ Technical provisions cover all insurance liabilities, including reinsurance recoverable.

- The level of TP should be the amount a third country (re)insurance undertaking would have to pay if it transferred or settled its contractual rights and obligations immediately to another undertaking/knowledgeable willing parties in an arm's length transaction.
- The valuation of TP should be market consistent and make use, to the extent possible, of and be consistent with information provided by financial markets and generally available information on underwriting risks.
- Segmentation of the reinsurance obligation into homogenous risk group, and as a minimum by lines of business should be carried out in order to achieve an accurate valuation of reinsurance obligations.
- Processes and procedures should exist to ensure the appropriateness, completeness and accuracy of the data used in the calculation of TP.
- The supervisor should be able to require the undertaking to raise the amount of technical provisions if they do not comply with the requirements

2.3.52. **Indicator - Own funds⁷**

- Own funds should be classified in accordance with their ability to absorb losses in the case of winding-up and on a going concern basis.
- The highest quality capital should be available to absorb losses in a going concern and in case of a winding up, with additional requirements of sufficient duration of the own fund item, absence of incentives to redeem, absence of mandatory servicing costs and absence of encumbrances.
- A distinction should be made between own funds on the balance sheet and off-balance sheet items⁸ (for example guarantees).
- According to their classification, own funds are eligible to cover partially or fully (for the best quality own funds) of the capital requirements.
- Quantitative limits should apply to the own funds to ensure the quality of own funds covering the capital requirements. In the absence of quantitative limits other supervisory requirements should ensure the high quality of own funds.

2.3.53. **Indicator - Existence/extent of provisions in respect of - Capital Requirements**

- Capital requirements should aim at measuring all quantifiable unexpected risks of the undertaking. Where a significant risk is not captured in the capital requirements, some mechanism should be applied to guarantee that capital requirements adequately reflect such risk.
- There is a capital requirement that reflects a level of own funds that would enable the undertaking to absorb significant losses and that gives reasonable assurance to policyholders and beneficiaries that payments will be made as they fall due. The requirement should enable the undertaking at a minimum to withstand a 1 in 200 ruin scenario over a one year period or ensure that policyholders and beneficiaries receive at least the same level of protection.

⁷ Articles 87-99

⁸ Also referred to as "ancillary funds"

- There should be a minimum level under which capital requirements should not fall or supervisory intervention point which equates to a minimum level of policyholder protection ("supervisory intervention ladder"). The supervisory authority should have powers to take the necessary and appropriate actions against the undertaking to restore compliance with that requirement.
- Capital requirements should be calculated at least annually and monitored on an ongoing basis.
- Appropriate standards should be in place where capital requirements take into account the effect of risk mitigation techniques and diversification effects.

2.3.54. **Indicator – Capital Requirements – Specificities for the assessment of internal models**

- Where the reinsurance undertaking uses a full or a partial internal model to calculate its capital requirements, the resulting capital requirements should provide a level of policyholder protection that is at least comparable to the level that would be required under local rules if no internal model is used (i.e. it adequately models the risks to the undertaking and produces capital requirements with the same confidence level as the standard approach).
- The regime shall have a process for the approval of internal models which includes a requirement for prior approval of the solo internal model before the undertaking is permitted to use the model to determine its regulatory capital requirements
- In order to be equivalent, a regime that includes an internal model element should include the following requirements for an internal model to be used to calculate regulatory capital:
 - A pre-requisite for an adequate risk management system
 - A use test
 - Statistical quality standards
 - Validation standards
 - Documentation standards
 - Calibration standards
 - Profit and loss attribution
- Where the reinsurance undertaking uses a partial internal model to calculate its capital requirements, the scope of the partial internal model should be clearly defined and justified to avoid the "cherry picking" of risks. There should be no ambiguity as to which risks, assets and/or liabilities are included or excluded from the scope of the partial internal model.

2.3.55. **Indicator - Investments**

- Undertakings should only be allowed to invest in assets and instruments where the risks can be properly identified, measured, monitored, managed, controlled and reported and appropriately taken into account in its solvency needs.
- Assets held to cover TP should be invested prudently in the best inter-

est of all policyholders and beneficiaries.

- All assets shall be invested in such a manner to ensure the security, quality, liquidity, availability and profitability of the portfolio as a whole
- prudent levels of investments in assets not admitted to trading
- investment in derivative instruments possible insofar they contribute to reduction of risks or facilitate efficient portfolio management
- avoid excessive reliance on any one particular asset, issuer or accumulations of risk; no excessive risk concentration

Principle no. 6 –Supervisory Cooperation, Exchange of information and Professional Secrecy

2.3.56. **Objective** – To ensure co-ordination and proper exchange and use of information between supervisory authorities involved in the supervision of (re)insurance undertakings and others, where relevant. To ensure that all persons who are working or have worked for a supervisory authority are bound by the obligation of professional secrecy, and that information disclosed to the authority by other supervisory authorities is subject to guarantees of professional secrecy.

2.3.57. **Articles: 64 – 70**

2.3.58. **Indicator - Existence and extent of provisions in respect of - Practical Cooperation**

- Authorisation/ongoing assessment of compliance with operating conditions
 - Preauthorisation consultation in respect of undertakings which form part of a cross-border group
- Supervisory Activity
 - Communication of concerns regarding the reinsurance undertaking, including those relevant to the soundness of the undertaking's financial position, policies and procedures.
- Suitability Assessments
 - Ability and willingness to cooperate in respect of the assessment of:
 - shareholder suitability; and
 - reputation/experience of directors
- Cooperation agreements
 - Ability to enter into cooperation agreements (subject to guarantees of professional secrecy)
- Crisis situations
 - Information sharing

2.3.59. **Indicator - Existence and extent of provisions in respect of - Exchange of Information with:**

- supervisory authorities
- other authorities/bodies/persons/institutions responsible for, or having oversight of:

- supervision of financial organisations /markets
- liquidation/bankruptcy proceedings
- carrying out statutory audits of accounts
- detection/investigation of breaches of company law
- central banks
- government administrations responsible for financial legislation (for reasons of prudential control)

2.3.60. The existence and extent of provisions in respect of - Professional Secrecy - Conditions of obligation:

- Confidential information - identification
- Legal duty to protect confidential information
- Applicable to all relevant individuals (i.e. all those who work, have worked or act(ed) on behalf of the supervisory authority)
- Ongoing obligation (applicable whilst working/acting on behalf of supervisory authority and on continuous basis thereafter)
- Disclosure of confidential information in restricted and clearly defined circumstances as well as subject to conditions of professional secrecy
- Use of confidential information only in the course of supervisory duties:
 - compliance monitoring (including monitoring of technical provisions, solvency margins, administrative/accounting procedures and internal controls)
 - imposition of penalties
 - court proceedings/appeals
- Consent of Competent Authority where the confidential information originates from another competent authority
 - prior agreement to the disclosure
 - disclosure is made in accordance with any specified conditions, including those relating to the purpose of the disclosure and use of the information.

2.3.61. Indicator - Existence and extent of provisions in respect of - Professional Secrecy - Exceptions to obligation:

- Express agreement to disclose/use
- Summary/aggregate disclosure (individual undertaking not identifiable)
- Civil/criminal proceedings (where the undertaking has been declared bankrupt or is being compulsorily wound up - information must not concern third parties involved in rescue attempts)

2.3.62. Indicator – breach of the obligation of professional secrecy

- Provisions in national law in respect of the breach of professional secrecy (offences, penalties, enforcement)

3. Chapter II: Equivalence under art. 227

3.1. Background and Scope

- 3.1.1. Article 227 of the Solvency II Framework Directive refers to the group solvency of an undertaking which is a participating undertaking in a third country (re)insurance undertaking. The equivalence assessment applies solely for the purposes of the deduction & aggregation method under Article 233 (alternative method for the calculation of group solvency). Whereas Article 227 allows a participating undertaking to aggregate the solo requirements of a related third country undertaking using the local third country rules using the deduction & aggregation method, under the default method in Article 230 (accounting consolidation) related third country undertakings are consolidated applying the Solvency II rules. CEIOPS notes that under Article 220(2), the group supervisor must consult the other supervisory authorities concerned and the group itself before deciding to apply the deduction & aggregation method.
- 3.1.2. Under Article 227(1) where the third-country in which that undertaking has its head office makes it subject to authorisation and imposes on it a solvency regime at least equivalent to that laid down in Title I, Chapter VI, Member States may provide that the calculation of the group solvency shall take into account (as regards that undertaking), the Solvency Capital Requirement and the own funds eligible to satisfy that requirement, as laid down by the third-country concerned. Title I, Chapter VI, details the rules on the valuation of assets and liabilities, technical provisions, own funds, solvency capital requirement, minimum capital requirement and investment rules.
- 3.1.3. The reference in Article 227(1) to “*subject to authorisation and imposes on it a solvency regime at least equivalent to that laid down in Title I, Chapter VI*”, gives rise to the question of whether the finding of equivalence must be in respect of both the authorisation standards and solvency regime of the third country. The reference in Article 227(3) to the discretionary obligation on the Commission to adopt implementing measures specifying the criteria to assess the equivalence of the solvency regime of a third country with respect to Title I, Chapter VI, suggests that the equivalence of the third country authorisation regime may be excluded from the scope of the equivalence determination.
- 3.1.4. The Commission, after consultation of EIOPC, may adopt a decision as to the equivalence of a third country solvency regime in respect of Title I, Chapter VI⁹taking into account the adopted criteria. Any such decision, although subject to regular review, are determinative and would supersede any existing determinations by the group supervisor.
- 3.1.5. In circumstances where the Commission has not taken a decision on equivalence, the group supervisor may carry out any verification of the equivalence of the third country regime for the purpose of the group solvency calculation on its own initiative or at the request of the participating undertaking.¹⁰ The group supervisor is required to consult the other supervisory authorities concerned and CEIOPS before taking a decision on equivalence. Where the Commission has adopted criteria for the assessment of equivalence, it is anticipated that

⁹ Article 227(4)

¹⁰ Article 227(2)

these will be utilised by the group supervisor in any equivalence determination (i.e. in the absence of any Commission decision).

3.2. Extract from Level 1 text:

3.2.1. Article 234 - Implementing measures

The Commission shall adopt implementing measures specifying the technical principles and methods set out in Articles 220 to 229 and the application of Articles 230 to 233 to ensure uniform application within the Community.

Those measures designed to amend non-essential elements of this directive by supplementing it shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 301(3).

3.2.2. Article 227 - Related third-country insurance and reinsurance undertakings

1. *When calculating, in accordance with Article 233, the group solvency of an insurance or reinsurance undertaking which is a participating undertaking in a third-country insurance or reinsurance undertaking, the latter shall be treated solely for the purposes of that calculation as a related insurance or reinsurance undertaking.*

However, where the third-country in which that undertaking has its head office makes it subject to authorisation and imposes on it a solvency regime at least equivalent to that laid down in Title I, Chapter VI, Member States may provide that the calculation shall take into account, as regards that undertaking, the Solvency Capital Requirement and the own funds eligible to satisfy that requirement as laid down by the third-country concerned.

2. *The verification of whether the third-country regime is at least equivalent shall be carried out by the group supervisor, at the request of the participating undertaking or on its own initiative.*

In doing so, the group supervisor shall consult the other supervisory authorities concerned, and the Committee of European Insurance and Occupational Pensions Supervisors, before taking a decision on equivalence.

3. *The Commission may adopt implementing measures specifying the criteria to assess whether the solvency regime in a third-country is equivalent to that laid down in Title I, Chapter VI.*

Those measures designed to amend non-essential elements of this directive by supplementing it shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 301(3).

4. ...

5. ...

3.3 Advice Background

- 3.3.1. The equivalence assessment under Article 227 is limited to the Pillar 1 calculations laid out in Title I, Chapter VI. This is because the article is dealing specifically with how the underlying assets and liabilities of the related third country undertaking should contribute to the solvency requirements of a group based in the Community applying the deduction & aggregation method. Therefore, a key issue for the group supervisor and the other supervisory authorities concerned is the comparability and quality of the information on the third country under-

taking. A third country undertaking's contribution to the aggregated group solvency requirement needs to be based on a similar standard to that of an undertaking in the EEA.

- 3.3.2. While not explicitly covered by the implementing measures in Article 227, CEIOPS considers that the equivalence assessment should take into account and be consistent with the advice developed in relation to Article 260 on cooperation and information sharing between supervisory authorities. This is to ensure that the group supervisor is aware of the risks associated with the third country undertaking, their contribution to group solvency and the potential impact on policyholders in the EEA.
- 3.3.3. CEIOPS considers also that the existence of a proportionality principle in the application of regulatory provisions in third country jurisdictions depending on the nature, scale and complexity of the risks inherent in the business of all undertakings that are part of the group and to the cross-border dimension is neither an obstacle nor a prerequisite to the recognition of equivalence.
- 3.3.4. The advice identifies the key supervisory principles encapsulated in the Solvency II Framework Directive and the objectives each supervisory principle seeks to achieve. It is against these principles and objectives that the third country regime shall be assessed. For each principle and objective the 'indicators' of equivalence are also outlined - namely, those factors which provide guidance in determining whether the relevant principles and objectives are achieved.

CEIOPS' advice

- 3.3.5. According to Article 227(1), a related third country (re)insurance undertaking should be authorised pursuant to the authorisation rules of the third country supervisory authority.
- 3.3.6. In order to be deemed equivalent under the provisions of Article 227, CEIOPS considers that a third country regime will have to meet each of the following principles and objectives. For each principle and objective the 'indicators' of equivalence are also outlined - namely, those factors which provide guidance in determining whether the relevant principles and objectives are achieved. It should be noted that when assessing a particular principle and objective, every indicator does not necessarily need to be fulfilled in order for principle and objective to be considered observed.
- 3.3.7. Related third country (re)insurance undertakings should be subject to a Solvency Capital Requirement reflecting a level of eligible own funds that enables them to absorb significant losses and that gives reasonable assurance to policy holders and beneficiaries that payments will be made as they fall due.
- 3.3.8. The aggregation of related third country (re)insurance undertakings must result in a group solvency capital requirement that provides a level of protection at group level ensuring that the undertaking can, at a minimum, withstand a 1 in 200 ruin scenario over a one year period.. The inclusion of related third country (re)insurance undertakings should also reflect the requirement that own funds are appropriately distributed in the group and are available to protect policyholders and beneficiaries where needed.
- 3.3.9. In the assessment of third country supervisory regimes, consideration should be given to the adequacy of third country practice in applying the

proportionality principle based on the nature, scale and complexity of the risk inherent in the business. However, the proportionality principle does not apply to the professional secrecy provisions in principle 2.

Principle no. 1 – Solvency Assessment¹¹

3.3.10. **Objective:** The supervisory regime shall ensure that (re)insurers maintain adequate financial resources in order to prevent disorderly failure, and ensure that the assessment of the financial position of the undertaking is based on sound economic principles.

3.3.11. (Re)insurance undertakings shall establish technical provisions (TP) with respect to all (re)insurance obligations that are calculated in a way that enables them to meet their (re)insurance obligations towards policyholders and beneficiaries. Assets covering technical provisions should be invested in the best interest of policyholders and beneficiaries, and undertakings should only be allowed to invest in assets and instruments where the risks can be properly identified, measured, monitored, managed and controlled.

3.3.12. Capital requirements should be based on sound economic principles and reflect a level of eligible own funds of sufficient quality that insurance and reinsurance undertakings are able to absorb significant losses and gives reasonable assurance to policyholders and beneficiaries that payments will be made as they fall due. Capital requirements are covered by own funds of sufficient quality and are based on a prospective calculation to ensure accurate and timely intervention by supervisors.

3.3.13. There should be sufficient information on the constitution of own funds to ensure that the group supervisor is able to apply the technical principles to the group solvency assessment (e.g. the elimination of double use of eligible own funds).

3.3.14. **Articles – 51, 53-55, 72, 76, 77-135, 222**

3.3.15. **Indicator - Existence/extent of provisions in respect of - Financial supervision**

- Communication of concerns, including those relating to the undertaking's financial position
- Obligation on undertaking to respond to concerns raised

3.3.16. **Indicator - Valuation of assets and liabilities:**

- The valuation of assets and liabilities should be based on an economic valuation of the whole balance sheet.
- Assets and liabilities should be valued at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.
- Valuation standards for supervisory purposes should be consistent with international accounting standards, to the extent possible.¹²

3.3.17. **Indicator - Technical Provisions^{13, 14}**

¹¹ Article 75

¹² IFRS provide principles and guidance for the calculation of fair value for almost all assets and liabilities that are significant to (re)insurance undertakings. As a result, referring to the general IFRS framework for the determination of an 'economic valuation' is a useful starting point for determining the financial position of the undertaking. However, CEIOPS recognises that adjustments may have to be made for local GAAP when the impact on the balance sheet is significant.

¹³ Articles 76-86

- TP should be established in respect of all (re)insurance obligations and aim to capture all expected risks related to (re)insurance obligations of the undertaking.
- TP should be calculated in a prudent, reliable and objective manner.
- The level of TP should be the amount a third country (re)insurance undertaking would have to pay if it transferred or settled its contractual rights and obligations immediately to another undertaking/knowledgeable willing parties in an arm's length transaction.
- The valuation of TP should be market consistent and make use, to the extent possible, of and be consistent with information provided by financial markets and generally available information on underwriting risks.
- Segmentation of the (re)insurance obligation into homogenous risk group, and as a minimum by lines of business should be carried out in order to achieve an accurate valuation of (re)insurance obligations.
- Processes and procedures should exist to ensure the appropriateness, completeness and accuracy of the data used in the calculation of TP.
- The supervisor should be able to require the undertaking to raise the amount of technical provisions if they do not comply with the requirements

3.3.18. **Indicator - Own funds¹⁵**

- Own funds should be classified in accordance with their ability to absorb losses in the case of winding-up and on a going concern basis.
- The highest quality capital should be available to absorb losses in a going concern and in case of a winding up, with additional requirements of sufficient duration of the own fund item, absence of incentives to redeem, absence of mandatory servicing costs and absence of encumbrances.
- A distinction should be made between own funds on the balance sheet and off-balance sheet items¹⁶ (for example guarantees).
- According to their classification, own funds are eligible to cover partially or fully (for the best quality own funds) of the capital requirements.
- Quantitative limits should apply to the own funds to ensure the quality of own funds covering the capital requirements. In the absence of quantitative limits other supervisory requirements should ensure the high quality of own funds.

3.3.19. **Indicator - Capital requirements¹⁷**

- Capital requirements should aim at measuring all quantifiable unexpected risks of the undertaking. Where a significant risk is not captured in the capital requirements, some mechanism should be applied to guarantee that capital requirements adequately reflect such risk.

¹⁴ Technical provisions cover all insurance liabilities, including reinsurance recoverable.

¹⁵ Articles 87-99

¹⁶ Also referred to as "ancillary own funds"

¹⁷ Articles 100-131

¹⁸ Articles 132-135

- There is a capital requirement that reflects a level of own funds that would enable the undertaking to absorb significant losses and that gives reasonable assurance to policyholders and beneficiaries that payments will be made as they fall due. The requirement should enable the undertaking at a minimum to withstand a 1 in 200 ruin scenario over a one year period or ensure that policyholders and beneficiaries receive at least the same level of protection.
- There should be a minimum level under which capital requirements should not fall or supervisory intervention point which equates to a minimum level of policyholder protection ("supervisory intervention ladder"). The supervisory authority should have powers to take the necessary and appropriate actions against the undertaking to restore compliance with that requirement.
- Capital requirements should be calculated at least annually and monitored on an ongoing basis.
- Appropriate standards should be in place where capital requirements take into account the effect of risk mitigation techniques and diversification effects.

3.3.20. Indicator – Capital Requirements – Specificities of assessment of internal models

- Where the (re)insurance undertaking uses a full or a partial internal model to calculate its capital requirements, the resulting capital requirements should provide a level of policyholder protection that is at least comparable to the level that would be required under local rules if no internal model is used (i.e. it adequately models the risks to the undertaking and produces capital requirements with the same confidence level as the standard approach).
- The regime shall have a process for the approval of internal models which includes a requirement for prior approval of the solo internal model before the undertaking is permitted to use the model to determine its regulatory capital requirements
- In order to be equivalent, a regime that includes an internal model element should include the following requirements for an internal model to be used to calculate regulatory capital:
 - A pre-requisite for an adequate risk management system
 - A use test
 - Statistical quality standards
 - Validation standards
 - Documentation standards
 - Calibration standards
 - Profit and loss attribution
- Where the (re)insurance undertaking uses a partial internal model to calculate its capital requirements, the scope of the partial internal model should be clearly defined and justified to avoid the "cherry picking" of risks. There should be no ambiguity as to which risks, assets and/or liabilities are included or excluded from the scope of the partial internal model.

3.3.21. **Indicator - Investments**¹⁸

- Undertakings should only be allowed to invest in assets and instruments where the risks can be properly identified, measured, monitored, managed, controlled, reported and appropriately taken into account in its solvency needs.
- Assets held to cover TP should be invested prudently in the best interest of all policyholders and beneficiaries.
- All assets shall be invested in such a manner to ensure the security, quality, liquidity, availability and profitability of the portfolio as a whole.
- Prudent levels of investments in assets not admitted to trading.
- Investment in derivative instruments possible insofar they contribute to reduction of investment risks or facilitate efficient portfolio management.
- Avoid excessive reliance on any one particular asset, issuer or accumulations of risk; no excessive risk concentration

Principle no. 2 –Supervisory Cooperation, Exchange of information and Professional Secrecy

3.3.22. **Objective** – To ensure co-ordination and proper exchange and use of information between supervisory authorities involved in the supervision of (re)insurance undertakings and others, where relevant. To ensure that all persons who are working or have worked for a supervisory authority are bound by the obligation of professional secrecy and that information disclosed to the authority by other authorities is subject to guarantees of professional secrecy.

3.3.23. In the context of Article 227, supervisory cooperation is important, in particular, to assist the group supervisor to assess the undertaking's contribution to the group capital requirement and the availability (inter alia transferability and fungibility) of own funds for the whole group.

3.3.24. **Articles: 64 – 70**

3.3.25. **Indicator - Existence and extent of provisions in respect of - Practical Cooperation**

- Authorisation/ongoing assessment of compliance with operating conditions
 - Preauthorisation consultation in respect of undertakings which form part of a cross-border group
- Supervisory Activity
 - Communication of concerns regarding the reinsurance undertaking, including those relevant to the soundness of the undertaking's financial position, policies and procedures.
 - Communication of information relevant to the assessment of available group own funds.
- Suitability Assessments
 - Ability and willingness to cooperate in respect of the assessment of:

- shareholder suitability; and
- reputation/experience of directors
- Cooperation agreements
 - Ability to enter into cooperation agreements (subject to guarantees of professional secrecy)
- Crisis situations
 - Information sharing

3.3.26. Indicator - Existence and extent of provisions in respect of - Exchange of Information with:

- supervisory authorities
- other authorities/bodies/persons/institutions responsible for, or having oversight of:
 - supervision of financial organisations /markets
 - liquidation/bankruptcy proceedings
 - carrying out statutory audits of accounts
 - detection/investigation of breaches of company law
- central banks
- government administrations responsible for financial legislation (for reasons of prudential control)

3.3.27. The existence and extent of provisions in respect of - Professional Secrecy - Conditions of obligation:

- Confidential information - identification
- Legal duty to protect confidential information
- Applicable to all relevant individuals (i.e. all those who work, have worked or act(ed) on behalf of the supervisory authority)
- Ongoing obligation (applicable whilst working/acting on behalf of supervisory authority and on continuous basis thereafter)
- Disclosure of confidential information in restricted and clearly defined circumstances as well as subject to conditions of professional secrecy
- Use of confidential information only in the course of supervisory duties:
 - compliance monitoring (including monitoring of technical provisions, solvency margins, administrative/accounting procedures and internal controls)
 - imposition of penalties
 - court proceedings/appeals
- Consent of Competent Authority where the confidential information originates from another competent authority
 - prior agreement to the disclosure
 - disclosure is made in accordance with any specified conditions, including those relating to the purpose of the disclosure and use of the information.

3.3.28. Indicator - Existence and extent of provisions in respect of - Professional Secrecy - Exceptions to obligation:

- Express agreement to disclose/use
- Summary/aggregate disclosure (individual undertaking not identifiable)
- Civil/criminal proceedings (where the undertaking has been declared bankrupt or is being compulsorily wound up - information must not concern third parties involved in rescue attempts)

3.3.29. Indicator – breach of the obligation of professional secrecy

- Provisions in national law in respect of the breach of professional secrecy (offences, penalties, enforcement)

4. Chapter III: Equivalence under art. 260

4.1. Background and scope

- 4.1.1. This Chapter provides advice for the Level 2 implementing measures referred to in Article 260 of the Solvency II Level 1 text¹⁹ (herein "Level 1 text"). Article 260 refers to the assessment of equivalence of third countries' group supervision.
- 4.1.2. Group supervision is a fundamental feature of Solvency II. It is therefore essential to ensure before exempting a group from that supervision at European level that the group supervision regime in the jurisdiction where the head of the group is located is at least equivalent to that under Solvency II.
- 4.1.3. Article 261 states that, in the case of equivalent supervision referred to in Article 260, Member States shall rely on the equivalent group supervision exercised by the third-country supervisory authorities. Articles 247 to 258 on supervisory cooperation apply *mutatis mutandis*, which means that EEA supervisors would expect to play a role in the cooperation arrangements of the third country group supervisor. This highlights the importance of cooperation arrangements with third country supervisors to ensure the appropriate level of supervision of EEA entities.
- 4.1.4. CEIOPS notes that in the absence of a determinative decision on equivalence made by the European Commission, supervisory authorities may come to different equivalence decisions on the same third country regime in respect of different groups. This raises the risk of inconsistency in the treatment of third country regimes and the calculation of group solvency in the EEA.
- 4.1.5. The technical criteria set out in this chapter below aim at ensuring consistency in the way group supervision regime equivalence is assessed, either by the European Commission, or by the group supervisor where the European Commission has taken no decision.
- 4.1.6. The advice adopted identifies the key supervisory principles encapsulated in the Solvency II Framework Directive and the objectives each supervisory principle seeks to achieve. It is against these principles and objectives that the third country regime shall be assessed. The advice also outlines the key 'indicators' of equivalence - namely, those factors which provide guidance in determining whether the relevant principles and objectives are achieved.
- 4.1.7. The Commission may also submit proposals to the Council for the negotiation of agreements with one or more third countries regarding the means of exercising group supervision according to Article 264 of the Solvency II Directive. Such agreements shall, in particular, seek to ensure that the competent authorities involved are able to obtain the information necessary for the supervision at the level of the group of insurance and reinsurance undertakings. Principles 3 and 7 in the advice below will be particularly relevant to any assessment in this respect. The Commission is required to examine the outcome of the negotiations with the assistance of the European Insurance and Occupational Pensions Committee (EIOPC).

¹⁹ <http://eur-lex.europa.eu/JOHtml.do?uri=OJ%3AL%3A2009%3A335%3ASOM%3AEN%3AHTML>

4.2. Extract and brief synopsis from Level 1 text:

4.2.1. Article 260 of the Level 1 text

Parent undertakings outside the Community: verification of equivalence

1. *In the case referred to in point (c) of Article 213(2), the supervisory authorities concerned shall verify whether the insurance and reinsurance undertakings, the parent undertaking of which has its head office outside the Community, are subject to supervision, by a third-country supervisory authority, which is equivalent to that provided for by this Title on the supervision at the level of the group of insurance and reinsurance undertakings referred to in points (a) and (b) of Article 213(2).*

The verification shall be carried out by the supervisory authority which would be the group supervisor if the criteria set out in Article 247(2) were to apply, at the request of the parent undertaking or of any of the insurance and reinsurance undertakings authorised in the Community or on its own initiative, unless the Commission had concluded previously in respect of the equivalence of the third country concerned. In so doing, that supervisory authority shall consult the other supervisory authorities concerned, and CEIOPS, before taking a decision.

- 1a. *The Commission may adopt implementing measures specifying the criteria to assess whether the prudential regime in a third-country for the supervision of groups is equivalent to that laid down in this Title. Those measures designed to amend non-essential elements of this Directive by supplementing it shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 301(3).*
2. *The Commission may adopt, after consultation of the European Insurance and Occupational Pensions Committee and in accordance with the regulatory procedure referred to in Article 301(2), and taking into account the criteria adopted in accordance with paragraph 1a, a decision as to whether the prudential regime for the supervision of groups in a third-country is equivalent to that laid down in this Title.*

Those decisions shall be regularly reviewed to take into account any changes to the prudential regime for the supervision of groups laid down in this Title and to the prudential regime in the third country for the supervision of groups and to any other change in regulation that may affect the decision on equivalence.

When a decision has been adopted by the Commission, in accordance with the first subparagraph, in respect of a third country, that decision shall be recognised as determinative for the purposes of the verification referred to in paragraph 1.

4.2.2. Article 261 of the Level 1 text

Parent undertaking outside the Community: equivalence

1. *In the event of equivalent supervision referred to in Article 260, Member States shall rely on the equivalent group supervision exercised by the third-country supervisory authorities, in accordance with paragraph 2.*

2. *Articles 247 to 258 shall apply mutatis mutandis to the cooperation with third-country supervisory authorities.*

4.2.3. CEIOPS considers that in order to determine the criteria to assess the equivalence of group supervision in third country jurisdictions, it is also necessary to refer the objectives of group supervision under Solvency II stated in the recitals of the level 1 text. The recitals regarding group supervision are the following ones.

4.2.4. Recital 95

Measures concerning the supervision of insurance and reinsurance undertakings in a group should enable the authorities supervising an insurance or reinsurance undertaking to form a more soundly based judgment of its financial situation.

4.2.5. Recital 104

This Directive reflects an innovative supervisory model where a key role is assigned to a group supervisor, whilst recognising and maintaining an important role for the solo supervisor. The powers and responsibilities of supervisors are linked with their accountability.

4.2.6. Recital 105

All policyholders and beneficiaries should receive equal treatment regardless of their nationality or place of residence. [..]

4.2.7. Recital 106

It is necessary to ensure that own funds are appropriately distributed within the group and are available to protect policyholders and beneficiaries where needed. To that end insurance and reinsurance undertakings within a group should have sufficient own funds to cover their solvency capital requirement.

4.2.8. Recital 107

All supervisors involved in group supervision should be able to understand the decisions made, in particular where those decisions are made by the group supervisor. As soon as it becomes available to one of the supervisors, the relevant information should therefore as soon as it becomes available be shared with the other supervisors, in order for all supervisors to be able to establish an opinion based on the same relevant information. In the event that the supervisors concerned cannot reach an agreement, qualified advice from the CEIOPS should be sought to resolve the matter.

4.2.9. Recital 108

The solvency of a subsidiary insurance or reinsurance undertaking of an insurance holding company, third-country insurance or reinsurance undertaking may be affected by the financial resources of the group of which it is part and by the distribution of financial resources within that group. The supervisory authorities should therefore be provided with the means of exercising group supervision

and of taking appropriate measures at the level of the insurance or reinsurance undertaking where its solvency is being or may be jeopardised.

4.2.10. Recital 111

All insurance and reinsurance groups subject to group supervision should have a group supervisor appointed from among the supervisory authorities involved. The rights and duties of the group supervisor should comprise appropriate co-ordination and decision-making powers. The authorities involved in the supervision of insurance and reinsurance undertakings belonging to the same group should establish coordination arrangements.

4.2.11. Recital 116

Insurance and reinsurance undertakings which are part of a group, the head of which is outside the Community should be subject to equivalent and appropriate group supervisory arrangements. It is therefore necessary to provide for transparency of rules and exchange of information with third-country authorities in all relevant circumstances. In order to ensure a harmonised approach to the determination and assessment of equivalence of third country insurance and reinsurance supervision, provision should be made for the Commission to make a binding decision regarding the equivalence of third country solvency regimes. For third countries regarding which no decision has been made by the Commission the assessment of equivalence should be made by the group supervisor after consulting with the other relevant supervisory authorities.

4.2.12. Paragraphs 4.2.13 - 4.2.44 provide a brief synopsis of the main topics and features covered by articles 213 to 260 that are addressed in subsequent advice. The material is intended only as a summary and does not constitute CEIOPS' interpretation of the meaning of the aforementioned articles.

4.2.13. Article 213 ensures that there is supervision at the level of the group of insurance and reinsurance undertakings that are part of a group. It also allows the group supervisor not to carry out the supervision of risk concentration and intra-group transactions if already performed under the provisions of the Financial Conglomerates Directive.

4.2.14. Article 214 determines the scope of group supervision and the relevant powers of the supervisory authority to define that scope.

4.2.15. Article 218 states that at least available eligible own funds shall be sufficient to cover the group Solvency Capital requirement. It also requires a supervisory review by the group supervisor.

4.2.16. Article 219 determines the frequency of group solvency calculation to be carried out and the requirements to monitor the group SCR. The possibility of recalculation in case of alteration and on-going calculation shall be given.

4.2.17. Article 220 details the choice of the calculation method for the group SCR. The Accounting Consolidation-based method is the default method. The group supervisor shall be able to require the use of the deduction-aggregation method or a combination of both methods when the default method is not appropriate.

- 4.2.18. Article 221 deals with the interpretation of the concept of the "proportional share" of related undertakings to be included in the calculation. This includes the recognition of solo solvency deficits at group level and includes an explicit power for the group supervisor to set the proportional share in some cases (dominant or significant influence determined by the supervisory authorities and absence of capital ties). The absence of capital ties often refers to mutual undertakings.
- 4.2.19. Article 222 ensures there are no double use of own funds and addresses the eligibility of own funds at group level taking into account potential availability constraints.
- 4.2.20. Article 223 ensures that the intra-group creation of capital is eliminated when calculating group solvency.
- 4.2.21. Article 224 states that the valuation principles that apply at solo level also apply at group level. It allows Member States to use the solvency figures calculated in other Member States.
- 4.2.22. Article 225 ensures that all related (re)insurance undertakings are included in the group calculations.
- 4.2.23. Article 226 accounts for the inclusion of intermediate insurance holding companies in the group calculations.
- 4.2.24. Article 227 details the equivalence assessment process for third country regimes for the purposes of the deduction and aggregation method.
- 4.2.25. Article 228 accounts for the treatment of related credit institutions, investment firms and financial institutions when calculating group solvency and allows their inclusion (via methods 1 and 2 described in Annex 1 of the financial conglomerates directive 2002/87/EC) unless their deduction is decided by the group supervisor.
- 4.2.26. Article 229 provides for the possibility to deduct the book value of a related undertaking if the information necessary for calculating the group solvency of its participating undertaking is not available.
- 4.2.27. Article 230 describes the default method for the group calculations, the Accounting consolidation-based method, including the minimum consolidated group SCR.
- 4.2.28. Article 231 describes the approval process for a group internal model and the application of a solo capital add-on in the context of a group internal model. The approval process for a group internal model is covered by the advice in the addendum on CEIOPS-DOC-28/09 Level 2 Advice on the approval of an internal model.
- 4.2.29. Article 232 deals with the application, when the consolidation method is used, of capital add-ons at group level. That advice includes the description of issues related to group specific risks. The setting of a capital add-on at group level is covered by the advice in the CEIOPS Advice on capital add-ons (CEIOPS-DOC-49/09).
- 4.2.30. Article 233 describes the deduction and aggregation method for the group calculations, including the imposition of a capital add-on to the aggregated group SCR.
- 4.2.31. Article 235 ensures that a group solvency calculation is carried out at the level of the insurance holding company when relevant.

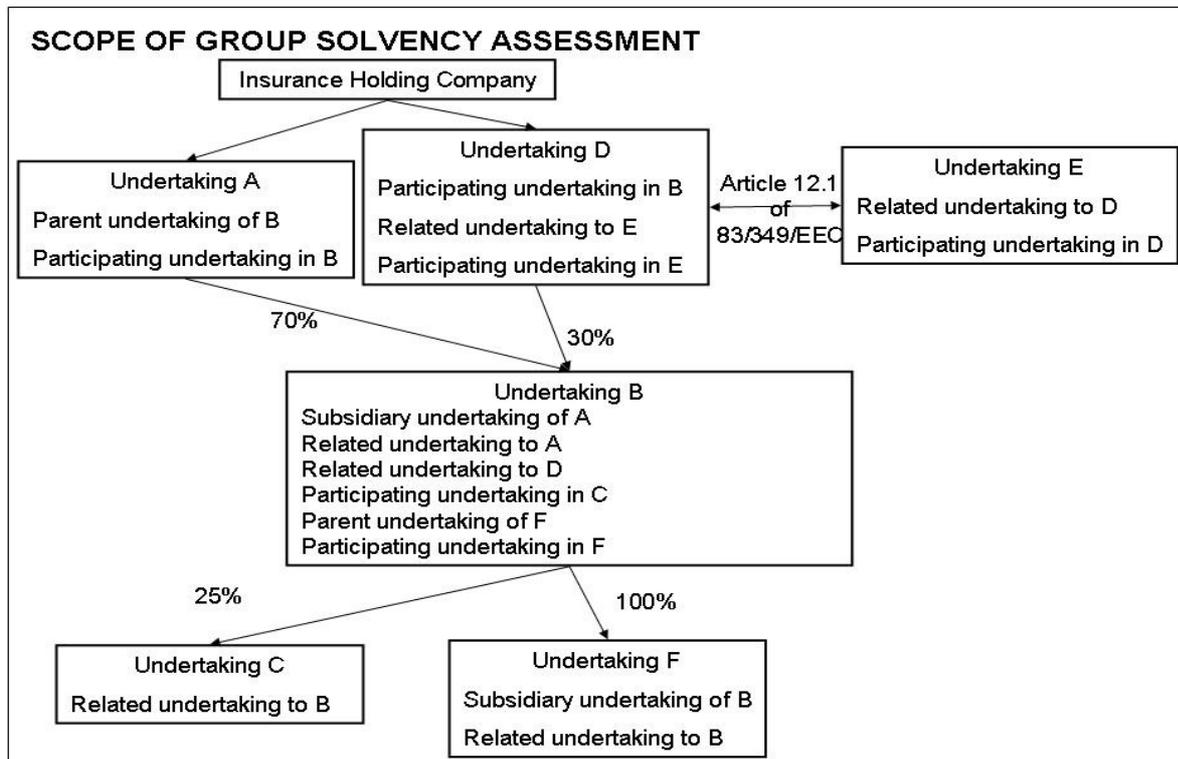
- 4.2.32. Article 244 and 245 gives the responsibility to the group supervisor in cooperation with the others concerned supervisory authorities to supervise risk concentration and intra-group transactions and to review the reporting of those items.
- 4.2.33. Article 246 accounts for the existence at group level of sufficient quality of the governance, including inter alia requirements on internal control and risk management.
- 4.2.34. Article 247 requires the designation of a single authority responsible for exercising group supervision, the group supervisor.
- 4.2.35. Article 248 describes the rights and the duties of the group supervisor. This requirement shall ensure that an efficient supervision of entities included in the scope of supervision is allowed and that the supervision will be made in a fruitful cooperation with other entities concerned.
- 4.2.36. Article 249 deals with the existence of provisions that ensure that the authorities concerned (EEA or third country) by the group supervision will cooperate and exchange information efficiently in going concern and in crisis situation.
- 4.2.37. Article 250 requires that supervisors are able to take appropriate remedial action to address concerns in relation to the functioning of the group.
- 4.2.38. Article 251 describes the coordination mechanisms when the group supervisor makes requests to others supervisory authorities.
- 4.2.39. Article 252 describes the coordination and proper exchange of information between supervisory authorities involved in the supervision of a (re)insurance undertaking and either a credit institution or an investment firm, or both where they are directly related or have a common participating undertaking.
- 4.2.40. Article 253 deals with professional secrecy and confidentiality aspects.
- 4.2.41. Article 254 requires an access to information and their verification by supervisory authorities. The persons included in the group supervision should be free to exchange information that may be relevant for the purpose of group supervision and that the supervisory authority then has access to the necessary information
- 4.2.42. Article 256 deals with the disclosure of insurance group relevant information on their group solvency and financial condition.
- 4.2.43. Article 257 shall ensure that members of the administrative or management body of any insurance holding company have professional qualifications, knowledge and experience (fit) and are of good repute and integrity (proper).
- 4.2.44. Article 258 identifies the supervisory authority responsibility for requiring the necessary measures, to ensure that findings are shared so that necessary measures can be taken and to ensure that supervisory authorities have enforcement powers towards insurance holding companies and undertakings.

4.3 Advice Background

- 4.3.1. In general, the overall objective of solo and group supervision is the adequate protection of policyholders and beneficiaries. When assessing a third country supervisory system against the criteria mentioned below, the main question

shall be if the supervisory regime of the third country ensures the protection of policyholders and beneficiaries in an equivalent manner compared to the solvency regime under Title III. Account should also be taken of whether the supervisory system also contributes to financial stability and a fair and stable market.

- 4.3.2. CEIOPS considers that in order to determine the criteria to assess the equivalence of group supervision in third country jurisdictions, it is necessary to refer to the objectives of group supervision under Solvency II as stated in the recitals of the level 1 text.
- 4.3.3. There should be supervision, at the level of the group, of (re)insurance undertakings which are part of a group, the parent undertaking of which is a (re)insurance undertaking or insurance holding company in the third country.
- 4.3.4. The third country legislation should ensure that the group supervisor has the necessary powers for determining the relevant scope of group supervision. The following example is extracted from CEIOPS' advice to the European Commission on group solvency assessment²⁰.



- 4.3.5. To ensure that coordination is achieved within the authorities responsible for the supervision of the group and that there is a clear responsibility for the exercise of group supervision, only one single authority shall be responsible for exercising group supervision. CEIOPS expects that as an overall principle the legal requirements for group supervision in third countries contain a similar concept of a central contact point as in EEA Member States.

²⁰ <http://www.ceiops.eu/index.php?option=content&task=view&id=611>

- 4.3.6. Third countries supervisory authorities should provide for the supervision at the level of the group of insurance and reinsurance undertakings which are part of a group.
- 4.3.7. Third countries supervisory authorities shall be able to assess relations of control.
- 4.3.8. The third countries supervisory authorities shall indicate in which cases the inclusion of an entity in the scope of group supervision would be inappropriate or misleading (for example in cases where there are legal impediments to transfer the necessary information) or when the entity is of negligible interest for the group supervision.
- 4.3.9. A mutual exchange of information is expected for circumstances where an entity is included or excluded from the scope of supervision.
- 4.3.10. CEIOPS expects that in the third country legislation exists that prevents double counting and the intra-group creation of capital when calculating the capital at the level of the group.
- 4.3.11. The existence of a tier system for own funds shall not be a prerequisite for recognising equivalence.
- 4.3.12. The calculation methods shall lead to a result at least equivalent to one of the two methods of the Level 1 text (accounting consolidation-based method, deduction-aggregation method).
- 4.3.13. Related credit institutions, investment firms, financial institutions as private pension funds shall be included in the group calculation with no allowance for diversification.
- 4.3.14. An adequate system of governance, risk management and internal controls as well as a risk oriented reporting system should be in place within the group and should be assessed on a group wide basis to enhance the assessment of the solo entities. Groups shall be required to disclose publicly a group report on their solvency and financial position with comparable elements to those of the Solvency II framework.
- 4.3.15. Transparency in respect of the financial strength of a group is a significant aim and an important part of a prudent supervisory system. A non-disclosure is only permitted in relation to information which would confer a significant undue advantage on competitors if disclosed, or in relation to which there is a binding obligation of secrecy or confidentiality. The group report on financial performance shall be updated at least in case of major significant developments as for example non-compliance with SCR and lack of realistic recovery plan within a short timeframe.
- 4.3.16. Third country supervisors should focus on the quality of the overall effectiveness of the governance system at group level, in providing for sound and prudent management of the business.
- 4.3.17. Such a system of governance should encompass proportionality aspects, sufficiency of means, methods and powers and a system of assessing risks and capital requirements.

- 4.3.18. In this frame third country supervisor should be able to exercise supervision especially over risk concentration and intra-group transactions, taking into account the nature of the relationships between regulated entities as well as non-regulated entities, including insurance holding companies and mixed-activity holding companies. Appropriate measures shall be taken by the supervisors concerned where the group' solvency is or may be jeopardised.
- 4.3.19. In case of disagreement and to deal with any emerging crisis situations, CEIOPS expects that there should be processes in place for reaching joint agreements with the third countries authorities.
- 4.3.20. Third country supervisory authorities and EEA supervisory authorities should cooperate closely. All relevant information should be made available to any authority concerned, as soon as practicable. In particular information should be given when the solvency requirement of an entity within the group / of the group are not longer complied with.
- 4.3.21. Consultation between third country supervisors and EEA supervisors is necessary in order to be able to take appropriate remedial actions to address concerns in relation to the functioning of the commonly supervised group. Therefore CEIOPS expects that the third country supervisors as well as the EEA supervisors shall
- have general supervisory powers;
 - require insurance and reinsurance undertakings to submit to the supervisory authorities the information which is necessary for the purposes of supervision.
- 4.3.22. This shall at least include an assessment of the system of governance applied by the undertakings, the business they are carrying on, the valuation principles applied for solvency purposes, the risks faced and the risk management systems, their capital structure, needs and management.
- 4.3.23. Furthermore CEIOPS also considers that an appropriate System of Governance, in particular an appropriate risk management system, contains policies regarding investments and the investment process, too. Requirements regarding investments are mentioned in Chapter VI, Section 6 of the Solvency II Framework Directive and therefore covered under Principle no. 6 – Group Solvency Assessment.
- 4.3.24. CEIOPS considers also that the existence of a proportionality principle in the application of regulatory provisions in third country jurisdictions depending on the nature, scale and complexity of the risks inherent in the business of all undertakings that are part of the group and to the cross-border dimension is neither an obstacle nor a prerequisite to the recognition of equivalence.
- 4.3.25. CEIOPS has determined 7 principles to recognise equivalence of third country group supervision regimes.

CEIOPS' advice

4.3.26. In order to be deemed equivalent under the provisions of Article 260, CEIOPS considers that a third country regime will have to meet each of the following principles and objectives. For each principle and objective the 'indicators' of equivalence are also outlined - namely, those factors which

provide guidance in determining whether the relevant principles and objectives are achieved. It should be noted that when assessing a particular principle and objective, every indicator does not necessarily need to be fulfilled in order for principle and objective to be considered observed.

4.3.27. Groups should be subject to a supervisory regime that enables them to absorb significant losses and that gives reasonable assurance to policy holders and beneficiaries of (re)insurance undertakings part of the group that payments will be made as they fall due.

4.3.28. In the assessment of third country supervisory regimes, consideration should be given to the adequacy of third country practice in applying the proportionality principle based on the nature, scale and complexity of the risk inherent in the business. However, the proportionality principle does not apply to the professional secrecy provisions in principle 7.

Principle no. 1 – Powers and responsibilities of a group supervisor

4.3.29. **Objective** - Supervisory Authorities must be provided with the necessary means and have the relevant expertise, capacity and mandate to achieve the main objectives of supervision, namely the protection of policyholders and beneficiaries regardless of their nationality or residence. They have to have the resources to fulfil their objectives which include in particular financial and human resources.

4.3.30. Furthermore the supervisory authority must be fully empowered to enable the effective carrying out of the supervisory authority's responsibilities. The supervisory authority must have a range of actions available, based on supervisory law, in order to apply appropriate enforcement or sanctions where problems in relation with the functioning of the group are identified. Its measures have to be enforced, if needed, through judicial channels.

4.3.31. Supervisors of insurers within a group must be able to form a comprehensive view of the overall group business strategy, financial position, legal and regulatory position and the risk exposure of the group as a whole, which will enable supervisors to assess and react to the prudential situation and solvency of the respective insurers within the group.

4.3.32. **Articles – 213, 214, 247, 248, 258**

4.3.33. **Indicator - The 3rd country supervisory authority should be / have:**

- A legal basis specifying supervisory responsibilities and enforcement powers
- Freedom from undue political, governmental and industry interference in the performance of supervisory responsibilities
- Transparency of supervisory processes / procedures
- Adequate financial and non-financial (e.g. sufficient numbers of appropriately skilled staff) resources
- Appropriate protection from being liable for actions taken in good faith

4.3.34. **Indicator - Appropriate powers to take preventative and corrective measures** to ensure that groups comply with the applicable laws, regulations and administrative provisions – as indicated below.

- Ability to ensure compliance on a continuous basis with laws, regulations and administrative provisions (including through onsite inspections) including measures to prevent/penalise further infringements including preventing the conclusion of new contracts
- Communication of concerns , including those relating to the group’s financial position
- Obligation on the parent undertaking to respond to concerns raised by the supervisor.
- Ability of supervisory authority to obtain all information necessary to conduct the supervision of the group

4.3.35. **Indicator - Existence/extent of powers in respect of Financial supervision,** verification of:

- System of governance
- state of solvency and financial condition of group
- establishment and increase of technical provisions and covering assets
- administrative/accounting procedures
- internal controls (including those applied to ensure that data received from cedents are reliable and timely)

4.3.36. **Indicator - Information obtainable from the parent undertaking:** Ability of supervisory authority to obtain information with regard to the group **i.e.** Accounting, prudential, statistical information:

- Annual Report on the solvency and financial condition of the group
- Group annual accounts (covering all operations, financial situation and solvency)
- Group returns/statistical documents

4.3.37. **Indicator - Qualifying holdings: Existence of powers in respect of:**

- Persons (natural/legal) whose actual/proposed qualifying holding may operate against prudent/sound management. Measures may consist of: :
 - injunctions
 - penalties against directors/managers
 - suspension of voting rights attaching to shares held by relevant shareholders/members or other instruments.
 - nullity of votes cast / possibility of annulment
- Qualifying holding acquired despite opposition of supervisory authority. Measures should consist of:
 - suspension of voting rights
 - nullity of votes cast / possibility of annulment

4.3.38. **Indicator – Ultimate Parent Undertakings in difficulties**

- Prohibit disposal of assets
- Recovery plan, finance scheme
- Reestablishment of the level of own funds, reduction of risk profile
- Downward revaluations
- Withdrawal of authorisation (if applicable)
- Measures relating to directors, managers, controllers and other relevant persons

4.3.39. **Indicator - Enforcement**

- The supervisory authority should have the ability to cooperate with other authorities/bodies in respect of enforcement action

Principle no. 2 - Group supervision

4.3.40. **Objective:** The supervisory regime should have a framework for determining which undertakings fall within the scope of supervision at group level. Nonetheless, undertakings controlled (through significant or dominant influence e.g.) by the group shall be included in the scope of group supervision.

4.3.41. All parts of the group (including holdings, other financial sectors, off-balance sheets items) necessary to ensure a proper understanding of the group and the potential sources of risks within the group have to be included within the scope of group supervision.

4.3.42. **Indicator** - The scope of group supervision shall be at least the same as the one of the level 1 text (Article 213.2). Entities for which there is a dominant or significant influence shall be included in the scope of group supervision.

4.3.43. **Indicator** – There should be a single identified group supervisor responsible for coordination and exercising group supervision.

4.3.44. **Indicator** - The relevant EU supervisory authorities concerned shall be consulted and involved in advance in case the third country group supervisor finally intends to carry out an inspection in an (re)insurance undertaking situated in the EEA.

4.3.45. **Indicator** - The third country group supervisor has to inform the supervisory authority concerned in case the entity has been excluded from the group supervision.

Principle no. 3 – Necessary provisions and arrangements should be in place to allow efficient and effective supervision through corporation and exchange of information among supervisors of the group.²¹

4.3.46. **Objective:** Effective co-ordination and co-operation procedures, going

²¹ Articles: 248, 249, 250, 251, 252, 253, 254, 255, 256, 257

beyond the simple exchange of information, are in place to facilitate group supervision

4.3.47. **Articles – 248-257**

4.3.48. **Indicator - Rights and duties of the third country group supervisor:**

- The group supervisor should be the contact person for key questions at group level and be responsible for:
 - The coordination and dissemination of information;
 - Review of the groups financial position;
 - Planning and coordination;
 - A framework for crisis management;
 - The assessment of the application for a group internal model if relevant and take its decision in consultation with other supervisory authorities concerned.

4.3.49. **Indicator -Establishment and functioning of cooperation mechanisms:**

- Non exhaustive list of criteria for good cooperation to be fulfilled by third country supervisors:
 - Willingness to submit information on intra-group transactions.
 - Exchange of prior information on decisions that could affect the solvency of the entities belong to an EEA MS.
 - Willingness to allow the transfer of cash.
 - Willingness to change the content of written coordination arrangements.
 - Allowance to EEA MS to participate in the validation process of group internal models.
 - Willingness to support restrictions on free assets for supervised entities.

4.3.50. **Indicator -Setting up of cooperation arrangements**

- A college of supervisors or similar cooperation arrangements could be established composing a minima of all relevant authorities for the group supervision under the following circumstances:

²² Articles: - 220-233

²³ IFRS provide principles and guidance for the calculation of fair value for almost all assets and liabilities that are significant to (re)insurance undertakings. As a result, referring to the general IFRS framework for the determination of an 'economic valuation' is a useful starting point for determining the financial position of the undertaking. However, CEIOPS recognises that adjustments may have to be made for local GAAP when the impact on the balance sheet is significant.

²⁴ Articles 76-86

²⁵ Technical provisions cover all insurance liabilities, including reinsurance recoverable.

²⁶ Articles 87-99

²⁷ Also referred to as "ancillary own funds"

²⁸ Articles 100-131

²⁹ Articles 132-135

³⁰ Article 230

- Relevance of the group to overall financial stability;
 - Relevance of the group in specific insurance market;
 - Similarity of supervisory practices;
 - The nature and complexity of the business undertaken by the group.
- In case a College of supervisors or similar cooperation arrangements are established, the functioning and organisation of these mechanisms could be based on written arrangements, including provisions on obligation to cooperate/exchange of information and decision-making processes. The process of the College of Supervisors or similar cooperation arrangements should strive to achieve consensus by supervisory authorities.

4.3.51. Indicator -Decision-making process among supervisory authorities:

- Existence of a mechanism for dispute solving mechanism in case of disagreement with other relevant supervisory authorities.

4.3.52. Indicator -Exchange of information and cooperation between third country supervisors and EEA supervisors:

- The exchange of information and cooperation between third country supervisors and EEA supervisors should be performed closely in a cooperative manner, in going concern circumstances as well as in crisis situations and shall comprise all relevant information, especially when the solvency requirement of an entity within the group / of the group are not longer complied with.

4.3.53. Indicator -Consultation between third country supervisors and EEA supervisors:

- CEIOPS expects that the third country supervisors as well as the EEA supervisors shall have general supervisory powers and require insurance and reinsurance undertakings to submit to the supervisory authorities the information which is necessary for the purposes of supervision.

Principle no. 4 – System of Governance

4.3.54. **Objective** – The Supervisory Regime shall require an effective system of governance across the group which provides for a sound and prudent management of the business. In particular, an adequate organisational structure with clear responsibilities fit and proper management and an effective system of ensuring the transmission of information should be an integral part of the system.

4.3.55. The establishment and maintenance of adequate risk management, compliance, internal audit and actuarial functions is expected. The different tasks of an appropriate risk management and group control systems should be regulated, and subject to regular review.

4.3.56. The financial strength of a group to which a (re)insurance undertaking

belongs to is one of the main reasons for policyholders closing a contract with that undertaking. Therefore transparency of this issue is a significant aim and an important part of a prudent supervisory system. Group shall be required to disclose publicly a report of their financial performance.

4.3.57. **Article – 244, 245, 246, 248, 256, 260**

4.3.58. **Indicator - General Requirements and Risk Management**

- Effective system of governance (including but not limited to transparent organisational structure, effective system for transmission of information)
- Requirements relevant to the fitness (for example appropriate professional qualification, knowledge and experience) and propriety (for example good repute and integrity) of for management and key function holders
- Effective and well integrated Risk Management System to identify measure, monitor, manage and report (on a continuous basis) the risks to which the group is or could be exposed (on an individual and aggregated level), and the amount of own funds necessary to cover them (comparable to an own risk and solvency assessment).
- sound liquidity management policies which cover short and long term considerations and include stress test and scenario analyses. Liquidity management policies should in particular account for situations where liquidity is managed at group level.
- Objective and independent Internal Audit function with a direct reporting line to the administrative, management or supervisory body
- Adequate internal control mechanisms
- Sound written administrative/accounting procedures
- Contingency plans

4.3.59. **Indicator - Actuarial Function**

- Actuarial function with knowledge of actuarial and financial mathematics appropriate to the nature, scale and complexity of the risk inherent in the business of the group. The actuarial function may be fulfilled in any suitable manner, provided that adequate standards are met.

4.3.60. **Indicator - Outsourcing**

- Supervision of outsourced functions or activities (meeting of obligations shall not be affected)

4.3.61. **Indicator - Compliance**

- Compliance Function in place which provides the administrative, management or supervisory body advice on compliance with law, regulations and administrative provisions including an assessment of the possible impact of any changes in the legal environment and the identification and assessment of compliance risks

4.3.62. **Indicator - Deterioration of financial position**

- Identification of deteriorating financial conditions and remediation of

deteriorating with appropriate monitoring tools in place

4.3.63. Indicator - Auditors' duty to report

- Duty to report:
 - breach of laws, regulations, administrative provisions
 - issues which may affect the continuous functioning of the undertaking
 - refusal (or reservations) in respect of certification of accounts
 - non compliance with Solvency and Minimum Capital Requirements

4.3.64. Indicator: Existence/extent of provisions in respect of - Public disclosure of report(s) on solvency and financial conditions at least on an annual basis with a description of:

- the business and performance
- system of governance,
- risk exposure, concentration, mitigation and sensitivity,
- assets,
- technical provisions, other liabilities
- intra-group transactions and risk concentration and
- capital management

Principle no. 5 - Business Change Assessment

4.3.65. **Objective** – To ensure the acceptability of any proposed changes to the business from an operational, management and supervisory perspective.

4.3.66. Articles – 57, 61

4.3.67. Indicator - Existence/extent of provisions in respect of – Acquisitions:

- Notification of intention to hold or increase directly or indirectly a qualifying holding
- Right of supervisory authority to oppose proposed acquisition
- Existence of thresholds prompting notification
- Possibility for assessment of acquisition by financial undertakings to be subject to prior consultation

4.3.68. Indicator - Existence/extent of provisions in respect of - Disposals

- Notification of intention to dispose directly/indirectly of a qualifying holding
- Thresholds prompting notification

4.3.69. Indicator - Existence/extent of provisions in respect of - Information obtainable from undertaking

- Thresholds prompting notification of acquisitions/disposals
- Regular notification (e.g. annual) of qualifying holdings, including size

4.3.70. Indicator - Existence/extent of provisions in respect of - Outsourcing

- Notification prior to outsourcing of critical or important functions or activities as well as material subsequent developments

4.3.71. Indicator - Existence/extent of provisions in respect of - Ongoing disclosure of relevant information (Disclosure of information, including information in respect of):

- portfolio transfers or transfer of individual contracts (e.g. in the context of reinsurance contracts);
- changes to Board /senior management; and
- scheme of operation

Principle no. 6 - Group solvency assessment²²

4.3.72. **Objective:** The supervisory regime shall ensure that groups maintain adequate financial resources in order to prevent disorderly failure, and shall ensure that the assessment of the financial position of the group is based on sound economic principles.

4.3.73. Groups shall establish technical provisions (TP) with respect to all (re)insurance obligations that are calculated in a way that enables them to meet their (re)insurance obligations towards policyholders and beneficiaries of (re)insurance undertakings part of the group. Assets covering technical provisions should be invested in the best interest of policyholders and beneficiaries, and groups should only be allowed to invest in assets and instruments where the risks can be properly identified, measured, monitored, managed and controlled.

4.3.74. Capital requirements should be based on sound economic principles and reflect a level of eligible own funds of sufficient quality that groups are able to absorb significant losses and gives reasonable assurance to policyholders and beneficiaries of (re)insurance undertakings part of the group that payments will be made as they fall due. Capital requirements are covered by own funds of sufficient quality and are based on a prospective calculation to ensure accurate and timely intervention by supervisors.

4.3.75. The calculation methods of the group capital requirement shall lead to a result at least equivalent to one of the two methods of the Level 1 text (consolidation method, aggregation method).

4.3.76. Each undertaking within the group maintains a minimum level of financial resources, below which it should not fall. This assessment should also include how non-insurance undertakings are considered as part of group supervision and how contagion risk is dealt with.

4.3.77. Article – 220-233

4.3.78. Indicator - Existence/extent of provisions in respect of - Financial supervision

- Communication of concerns, including those relating to the group's financial position
- Obligation on parent undertaking to respond to concerns raised

4.3.79. **Indicator - Valuation of assets and liabilities**

- The valuation of assets and liabilities should be based on an economic valuation of the whole balance sheet.
- Assets and liabilities should be valued at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.
- Valuation standards for supervisory purposes should be consistent with international accounting standards, to the extent possible²³.

4.3.80. **Indicator - Technical Provisions**²⁴²⁵

- TP should be established in respect of all (re)insurance obligations and aim to capture all expected risks related to (re)insurance obligations of the undertaking.
- TP should be calculated in a prudent, reliable and objective manner.
- The level of TP should be the amount a third country (re)insurance undertaking would have to pay if it transferred or settled its contractual rights and obligations immediately to another undertaking/knowledgeable willing parties in an arm's length transaction.
- The valuation of TP should be market consistent and make use, to the extent possible, of and be consistent with information provided by financial markets and generally available information on underwriting risks.
- Segmentation of the (re)insurance obligation into homogenous risk group, and as a minimum by lines of business should be carried out in order to achieve an accurate valuation of (re)insurance obligations.
- Processes and procedures should exist to ensure the appropriateness, completeness and accuracy of the data used in the calculation of TP.
- The supervisor should be able to require the undertaking to raise the amount of technical provisions if they do not comply with the requirements

4.3.81. **Indicator - Own funds**²⁶

- Own funds should be classified in accordance with their ability to absorb losses in the case of winding-up and on a going concern basis.
- The highest quality capital should be available to absorb losses in a going concern and in case of a winding up, with additional requirements of sufficient duration of the own fund item, absence of incentives to redeem, absence of mandatory servicing costs and absence of encumbrances.
- A distinction should be made between own funds on the balance sheet, and off balance sheet items (for example guarantees)²⁷. –
- According to their classification, own funds are eligible to cover partially or fully (for the best quality own funds) of the capital requirements.

- Quantitative limits should apply to the own funds to ensure the quality of own funds covering the capital requirements. In the absence of quantitative limits other supervisory requirements should ensure the high quality of own funds.
- Double gearing and the intra-group creation of capital shall be avoided,.
- The result of the assessment of fungibility / transferability issues (e.g. restricted assets) shall be communicated by the group supervisor.
- Solo deficits shall be fully taken into account at group level unless the group can prove that its responsibility is limited to its proportional share of the capital.

4.3.82. **Indicator - Capital requirements²⁸**

- Capital requirements should aim at measuring all quantifiable unexpected risks of the undertaking. Where a significant risk is not captured in the capital requirements, some mechanism should be applied to guarantee that capital requirements adequately reflect such risk.
- There is a capital requirement that reflects a level of own funds that would enable the undertaking to absorb significant losses and that gives reasonable assurance to policyholders and beneficiaries that payments will be made as they fall due. The requirement should require an economic strength from the undertaking comparable to withstanding a 1 in 200 ruin scenario over a one year period or ensure that policyholders and beneficiaries receive at least the same level of protection.
- There should be a minimum level under which capital requirements should not fall or supervisory intervention point which equates to a minimum level of policyholder protection ("supervisory intervention ladder"). The supervisory authority should have powers to take the necessary and appropriate actions against the undertaking to restore compliance with that requirement.
- Group capital requirements should be calculated at least annually and monitored on an ongoing basis.
- Appropriate standards should be in place where capital requirements take into account the effect of risk mitigation techniques and diversification effects at group level.
- In order to reflect the total risks that the group may face, the group SCR shall also reflect the risks that arise at the level of the group and that are specific to the group.
- The calculation methods shall lead to a result at least equivalent to one of the two methods for groups' calculations of the level 1 text.

4.3.83. **Indicator – Capital Requirements – Specificities of assessment of internal models**

- Where the group uses a full or partial internal model to calculate its capital requirements, the requirements should require an economic strength from the undertakings equivalent to withstanding a 1 in 200 ruin scenario over a year period.

- the resulting capital requirements should provide a level of policyholder protection that is at least comparable to the level that would be required under local rules if no internal model is used (i.e. it adequately models the risks to the undertaking and produces capital requirements with the same confidence level as the standard approach)
- The regime shall have a process for the approval of group internal models which includes a requirement for prior approval of the group internal model before the group is permitted to use the model to determine its regulatory capital requirements
- In order to be equivalent, a regime that includes an internal model element should include the following requirements for an internal model to be used to calculate regulatory capital:
 - A pre-requisite for an adequate risk management system
 - A use test
 - Statistical quality standards
 - Validation standards
 - Documentation standards
 - Calibration standards
 - Profit and loss attribution
- Where the reinsurance undertaking uses a partial internal model to calculate its capital requirements, the scope of the partial internal model should be clearly defined and justified to avoid the "cherry picking" of risks. There should be no ambiguity as to which risks, assets and/or liabilities are included or excluded from the scope of the partial internal model.
- Consultation of EEA subsidiaries from which risks are included in the group internal model approved for regulatory purposes; if any.
- Possibility of joint inspection as regards group internal models.

4.3.84. **Indicator - Investments**²⁹

- Undertakings should only be allowed to invest in assets and instruments where the risks can be properly identified, measured, monitored, managed, controlled, reported and appropriately taken into account in its solvency needs.
- Assets held to cover TP should be invested prudently in the best interest of all policyholders and beneficiaries.
- All assets shall be invested in such a manner to ensure the security, quality, liquidity, availability and profitability of the portfolio as a whole.
- Prudent levels of investments in assets not admitted to trading.
- Investment in derivative instruments possible insofar they contribute to reduction of investment risks or facilitate efficient portfolio management.
- Avoid excessive reliance on any one particular asset, issuer or accumulations of risk; no excessive risk concentration.

4.3.85. **Indicator - Floor to the group SCR**³⁰

- Financial regulated entities in the group should be subject to a minimum capital requirement or comparable intervention point which equates to a minimum level of policyholder protection. In the result of ongoing non-compliance the supervisory authority should have powers to take the necessary actions against the undertaking to restore compliance with that requirement. This may include, for example, a withdrawal of the firm's permission to undertake regulated activities.
- The group SCR should therefore not be below the sum of the solo minimum capital requirements of each undertakings of the group.

Principle no. 7 –Supervisory Cooperation, Exchange of information and Professional Secrecy.

4.3.86. **Objective** – To ensure co-ordination and proper exchange and use of information between supervisory authorities involved in the supervision of groups, (re)insurance undertakings and others, where relevant. To ensure that all persons who are working or have worked for a supervisory authority are bound by the obligation of professional secrecy and that information disclosed to the authority by other supervisory authorities is subject to guarantees of professional secrecy.

4.3.87. **Articles: 64 – 70, 248-255**

4.3.88. **Indicator - Existence and extent of provisions in respect of - Practical Cooperation**

- Authorisation/ongoing assessment of compliance with operating conditions
 - Preauthorisation consultation in respect of undertakings which form part of a cross-border group
- Supervisory Activity
 - Communication of concerns regarding the group, including those relevant to the soundness of the group and/or undertaking's within the group's financial position, policies and procedures.
- Ability and willingness to cooperate in respect of the assessment of:
 - shareholder suitability; and
 - reputation/experience of directors
- Cooperation agreements
 - Ability to enter into cooperation agreements (subject to guarantees of professional secrecy)
- Crisis situations
 - Information sharing

4.3.89. **Indicator - Existence and extent of provisions in respect of - Exchange of Information with:**

- supervisory authorities
- other authorities/bodies/persons/institutions responsible for, or having oversight of:

- supervision of financial organisations /markets
- liquidation/bankruptcy proceedings
- carrying out statutory audits of accounts
- detection/investigation of breaches of company law
- central banks
- government administrations responsible for financial legislation (for reasons of prudential control)

4.3.90. The existence and extent of provisions in respect of - Professional Secrecy - Conditions of obligation:

- Confidential information - identification
- Legal duty to protect confidential information
- Applicable to all relevant individuals (i.e. all those who work, have worked or act(ed) on behalf of the supervisory authority)
- Ongoing obligation (applicable whilst working/acting on behalf of supervisory authority and on continuous basis thereafter)
- Disclosure of confidential information in restricted and clearly defined circumstances as well as subject to conditions of professional secrecy
- Use of confidential information only in the course of supervisory duties:
 - compliance monitoring (including monitoring of technical provisions, solvency margins, administrative/accounting procedures and internal controls)
 - imposition of penalties
 - court proceedings/appeals
- Consent of Competent Authority where the confidential information originates from another competent authority
 - prior agreement to the disclosure
 - disclosure is made in accordance with any specified conditions, including those relating to the purpose of the disclosure and use of the information.

4.3.91. Indicator - Existence and extent of provisions in respect of - Professional Secrecy - Exceptions to obligation:

- Express agreement to disclose/use
- Summary/aggregate disclosure (individual undertaking not identifiable)
- Civil/criminal proceedings (where the undertaking has been declared bankrupt or is being compulsorily wound up - information must not concern third parties involved in rescue attempts)

4.3.92. Indicator – breach of the obligation of professional secrecy

- Provisions in national law in respect of the breach of professional secrecy (offences, penalties, enforcement)

Annex 1 - Assessment Methodology

- A.1. **Note: the assessment methodology has not been revised following the consultation period. The text below provides a high level outline of the methodology to be employed in the future by CEIOPS. It constitutes work in progress which once revised will be subject to consultation.**
- A.2. This Annex provides a high level outline of the methodology to be applied when assessing the equivalence of a third country supervisory regime.
- A.3. CEIOPS will perform assessments of the equivalence of a third country supervisory regime upon the request of the European Commission or - in the absence of such a request and where appropriate - on its own initiative.
- A.4. In the performance of an assessment of the equivalence of a third country supervisory regime, any criteria adopted by the European Commission in the form of Level 2 implementing measures, will be applied by CEIOPS. In the absence of any relevant Level 2 implementing measures, CEIOPS will observe the principles, objectives and indicators provided in this advice.
- A.5. Decisions on equivalence can be taken either by the European Commission or by the relevant group supervisor after consulting CEIOPS (see par. 3.1.4 and 3.1.5 as well as Article 227 and 260). In the absence of a decision from European Commission:
- CEIOPS may, on its own initiative, reach a common agreement amongst CEIOPS Members on the equivalence of a third country supervisory regime,; and/or
 - Member States may undertake individual assessments of the equivalence of a third country supervisory regime, within the context of article 172 of the Directive.

Scope

- A.6. The assessment to be performed by CEIOPS will be of the equivalence of the regime in existence and applied by the third country supervisory authority, at the time of the assessment.
- A.7. A third country supervisory authority must demonstrate that the regime applicable in its jurisdiction meets each of the principles and objectives formulated by the European Commission for a positive assessment of equivalence.
- A.8. Assessments will be kept under review and take into account any developments that might lead to relevant changes in the third country supervisory regime.

Conduct of assessments

- A.9. The third country supervisory authority will be invited to complete a questionnaire modeled on criteria formulated by the European Commission.

A.10. The assessment will be based on, but not limited to, the replies provided in the questionnaire. Additional information/explanations will be requested of the third country supervisory authority, where appropriate.

A.11. The process of assessing each principle requires a judgmental weighing of numerous elements. The assessment will be conducted by CEIOPS and the outcome of the assessment communicated to the European Commission. The European Commission makes the final determination of equivalence having received CEIOPS' advice.

Conduct of assessments - access to information

A.12. When conducting the assessment, assessors will require access to a range of information and persons – as such, the cooperation of the third country supervisory authority is essential.

A.13. The information required as part of the assessment may include:

- publically available information (e.g. laws, regulations and administrative policies); and/or
- internal information (e.g. self-assessments and operational guidelines).

The information should be provided by the third country supervisory authority, subject to any professional secrecy requirements.

A.14. The individuals and organisations with which the assessor may need to consult include insurance supervisor(s), other relevant authorities (including supervisory authorities), relevant government ministries, insurance companies, insurance industry associations, actuaries, auditors and other financial sector participants.

Assessment categories - Assessment of principle/objective observance:

A.15. In undertaking the assessment each principle/objective as provided in a Level 2 text or in this advice, will be assessed using five categories: observed, largely observed, partly observed, not observed and not applicable. In assessing each principle and objective, consideration will be given to the relevant indicators of equivalence.

A.16. A1.15. For a principle and objective to be considered **observed**, the third country supervisory authority must provide evidence that the:

- relevant national provisions (e.g. legal, regulatory, administrative provisions) exist; and
- national provisions are applied in practice.

When the national provisions are not in place at the time of the assessment, proposed improvements can, where appropriate, be noted in the assessment report