



EIOPA-BoS-17/141  
11.07.2017

## **Opinion on supervisory convergence in light of the United Kingdom withdrawing from the European Union**

### **1. Legal basis**

1. The European Insurance and Occupational Pensions Authority (EIOPA) issues this opinion on the basis of Article 29(1) (a) of Regulation (EU) No 1094/2010<sup>1</sup> (EIOPA Regulation). According to this article EIOPA shall play an active role in building a common Union supervisory culture and consistent supervisory practices and approaches throughout the Union.
2. This opinion is based on Directive 2009/138/EC<sup>2</sup> (Solvency II Directive), Commission Delegated Regulation (EU) 2015/35<sup>3</sup> (Delegated Regulation) and EIOPA's guidelines and other relevant instruments.

### **2. Context, objective and scope**

3. The United Kingdom (UK) on 29 March 2017 notified the European Council of its intention to withdraw from the European Union. The withdrawal will take place on the date of entry into force of a withdrawal agreement or, failing that, two years after the notification on 30 March 2019.
4. The UK's decision to withdraw from the European Union includes the UK leaving the European single market.<sup>4</sup> The opinion assumes that the UK will become a third country (non-EU) for the purposes of applying the Solvency II framework after its withdrawal from the EU. Until then the EU legislative framework applicable will remain in force in the UK. This opinion is notwithstanding any specific arrangements that may be reached between the UK and the EU or where applicable, existing national rules relating to market access or the effect of any equivalence decision.

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<sup>1</sup> Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48)

<sup>2</sup> Directive 2009/138/EC of 25 November 2009 of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 335, 17.12.2009, p. 1–155)

<sup>3</sup> Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 12, 17.01.2015, p. 1)

<sup>4</sup> See: HM Government, The United Kingdom's exit from and new partnership with the European Union, February 2017

5. Solvency II allows (re)insurance undertakings to pursue business in the EU, only if the undertaking is authorised in the EU.<sup>5</sup> Based on this authorisation undertakings may do business on a freedom of establishment and freedom to provide services basis in other Member States.
6. Upon withdrawal from the single market, UK (re)insurance undertakings lose their right to conduct business across the EU Member States by way of freedom of establishment and freedom to provide services.
7. This will have as a consequence that in light of UK's decision to withdraw from the European Union UK-based undertakings may seek to relocate to or set up a new business in the EU27 in order to maintain access to the EU single market. Relocations can take place at different stages of the negotiations, in light of the extent of the cross-border activity, the business requirements or the extent of clarity on the future treatment. It is important however, that undertakings engage as early as possible in order to properly plan for the continuity of their business.
8. Considering the importance of the UK as the most important financial centre in the EU contributing by 24% of EU28 to the total financial and insurance activities in 2015, this unique situation requires a common effort at EU level to ensure a consistent supervisory approach to the relocation of undertakings. Communication between the UK and EU supervisors is encouraged in this context.
9. EIOPA has carried out on-site visits to certain supervisory authorities and discussed the processes and resources in place to deal with potential relocations.
10. The general objective of the opinion is to foster convergence and consistency of authorisation processes across Member States by setting out guidance on the application of the existing legal framework considering arrangements between EU and non-EU entities. While proportionality in the application of the prudential requirements under Solvency II allows supervisory authorities a certain judgmental evaluation, it is important to emphasise that proportionality is not a mean for lowering standards or for disregarding prudential requirements.
11. This opinion is addressed to the national competent authorities of the EU Member States<sup>6</sup> and applies to authorisation processes and on-going supervision of undertakings falling under the Solvency II framework.

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<sup>5</sup> Similarly, branches from undertakings with head offices situated outside the European Union need authorisation according to Article 162 of the Solvency II Directive. The authorisation of a branch however does not grant the right to conduct business across the EU Member States by ways of freedom of establishment and freedom to provide services. The opinion covers the authorisation of such branches to the extent this is proportionate.

<sup>6</sup> Including the EEA-EFTA members

### 3. Principles

#### I. Authorisations and approvals

12. An increased amount of requests for authorisation or approvals for relocating undertakings to be handled in a short timeframe would put pressure on authorisation processes in Member States and require resources for supervising new entrants. Member States should ensure that they have a sound authorisation process in place and have adequate resources to appropriately deal with the complexity of any new authorisation and the on-going supervision of the new undertakings. Interaction between authorisation teams and supervisory teams should exist in order to ensure effective on-going supervision after the initial authorisation.
13. Supervisory authorities are responsible for granting authorisations to undertakings seeking to provide (re)insurance services in the EU. When assessing an application for authorisation, supervisors should satisfy themselves that the undertaking has provided sufficiently detailed information to allow them to assess that it complies with the requirements under the relevant legislation. Supervisory authorities should apply a prospective and risk-based assessment of the authorisation. This involves supervisors having regard to the business model of the undertaking, assessing uncertainties associated with the strategy and how these will be managed.
14. No recognition of authorisations granted by other authorities is foreseen in Union law nor would the conditions of authorisation be identical to those which the initial authorising authority had to examine before granting an authorisation. Hence there cannot be any automatic recognition of an authorisation granted by another supervisory authority. An application is reviewed on its own merits and the required review process should be completed.
15. Supervisory authorities should ensure that conditions set by the relevant legislation are met from day one of the authorisation. The supervisor should, where appropriate, inform its assessment based on a previous authorisation by taking some aspects of the assessment of other regulators into consideration. This would be the case, for example for fit and proper requirements.
16. At the same time, supervisory authorities should apply strong scrutiny to the undertakings' governance structure, human and technical resources, geographical distribution of activities, as well as outsourcing arrangements. The supervisor should ask the applicant about any previous formal or informal requests to establish the undertaking in other Member States and, where applicable, the reasons why such applications were rejected or withdrawn.<sup>7</sup>
17. Similarly, any previous approval, for example for the recognition of own funds or the use of an internal model, should be subject to a new approval by the relevant supervisory authority (or authorities) before use. In assessing the internal model application, the supervisor can take the previous approval into

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<sup>7</sup> See: Section 5.2 of the Decision of the Board of Supervisors on the collaboration of the insurance supervisory authorities of the Member States of the European Economic Area (EIOPA-BoS-17/013)

account where relevant. Any changes in the risk profile, the risk management system or use of an internal model should be assessed.

18. In the case of an existing approval to use an internal model, a range of scenarios is possible. If a EU27-based subsidiary of a UK group is currently using the group internal model to calculate the subsidiary's solo capital requirement, a new application to use a solo model might be required by the subsidiary. In this case, the relevant supervisory authority will have been part of the joint decision to approve the group model and so will be well positioned to review a new application. Where a new EU27 subsidiary is being created, the relevant supervisory authority might have no familiarity with any existing internal model. Even for EU27-based groups with a UK subsidiary that becomes a third country subsidiary there are scenarios where a new group model application would be required.
19. Authorisation and approval processes take time. Undertakings seeking to relocate in the EU27 should approach the relevant supervisory authorities well in advance of seeking authorisations and where relevant enter into pre-application processes (for internal models). Where applicable, supervisory authorities should ensure that undertakings understand which approvals need to be obtained and are aware of the timescales involved.
20. Supervisory authorities should exchange information on approvals or authorisations where previous approvals or authorisations exist.

## **II. Governance and risk management**

21. The supervisor should scrutinise whether governance arrangements in the undertaking seeking authorisation ensure effective decision-taking and risk management in the Member State of authorisation and allow for proper supervision. Undertakings should not display the characteristics of an empty shell.
22. EIOPA expects that the EU undertaking demonstrates an appropriate level of corporate substance, proportionate to the nature, scale and complexity of the planned business. This includes appropriate presence of the administrative, management or supervisory board (AMSB) members and key function holders in the Member State who dedicate sufficient time to fulfil their duties, as well as a level of local staff commensurate to the nature and amount of business being run from the entity.
23. The supervisor should require evidence on expected activity via freedom to provide services or freedom of establishment in other Member State(s)<sup>8</sup> and on the senior management's proper knowledge of local market specificities, products and risks.
24. Any transfer of risk to participating undertakings or other entities should be carefully scrutinised by the supervisor in light of the business model and risk management capacity of the undertaking, the effectiveness of the risk transfer and related risks.<sup>9</sup> The extent of reinsurance carried out by an undertaking

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<sup>8</sup> See: Section 2.6 of the Decision of the Board of Supervisors on the collaboration of the insurance supervisory authorities of the Member States of the European Economic Area (EIOPA-BoS-17/013)

<sup>9</sup> Article 209 of the Delegated Regulation

should not undermine the responsibility or capacity of the entity to manage its risks and should be part of a coherent, well considered strategy which is aligned with the undertaking's risk appetite. Supervisors should be aware of extensive reinsurance arrangements (either intra-group or to third parties). A minimum retention of risks by the authorised undertaking should be required by the supervisor. As an indication, a minimum retention of 10% of the business written could be envisaged. The ratio of gross technical provisions in relation to the reinsurance recoverables provides an indication of the amount of business retained within the authorised undertaking.

25. The supervisor should challenge the risk transfer by requiring an assessment of the following parameters: impact of the risk transfer on the undertaking's counterparty risk and currency risk, the impact on asset composition (as it can be expected that the reinsurance recoverable would be a very significant asset), as well as the extent to which the reinsurance recoverable will be collateralised and the strength of the (re)insurer and the capital proposed to be held by the undertaking in the Member State of authorisation. Scenario analysis may be required from the undertaking to assess the effectiveness of the risk transfer in scenarios of adverse circumstances (such as default) at group level or with the third party.

### **III. Outsourcing of critical and important activities**

26. The use of outsourcing may be an efficient way to perform some functions or activities, in particular within a group. However, outsourcing can also pose a number of challenges both for undertakings and for the supervisory authorities, especially when the outsourcing is critical to the functioning of the undertaking. Such concerns are heightened where the service provider is located outside the EU, as the ability of undertakings and supervisors to, respectively, control and supervise can be significantly impacted.
27. Relocating and new entities may seek to limit the impact of relocation through an extensive use of outsourcing of functions or activities. Such an approach cannot be allowed to deplete the corporate substance of the EU entities with repercussions on the adequacy of their management and on the effectiveness of supervision by the EU27 supervisors.
28. As a general principle, outsourcing of critical or important functions (or key functions) or activities is permitted for EU undertakings or branches provided that the AMSB remains fully responsible for the outsourced activity, and the outsourcing does not
  - materially impair the quality of the system of governance,
  - unduly increase operational risk,
  - impair the ability of supervisors to monitor compliance or
  - undermine continuous and satisfactory service to policyholders.<sup>10</sup>
29. There should be a person within the undertaking responsible for outsourced key functions on an ongoing basis.<sup>11</sup> Conflicts of interest should be prevented

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<sup>10</sup> See Article 49 of the Solvency II Directive

<sup>11</sup> See Guideline 14 of the EIOPA Guidelines on system of governance

between the undertaking and the service provider. In particular where the service provider is part of the same group, supervisors should carefully assess the undertaking's ability to control and influence the actions of a service provider to which critical or important functions or activities are outsourced.<sup>12</sup> This should involve assessing the undertaking's access to data, premises and involvement in decision-making in relation to its business. In particular where the service provider is located in a third country, access to information and to the service provider's premises, by the undertaking and supervisor should be guaranteed. The cooperation between relevant supervisory authorities to guarantee, where relevant, on-site inspections to service providers, should be ensured.

30. The part of key activities or functions that should be retained in the undertaking compared with tasks outsourced should be assessed having regard to the nature, scale and complexity of the business. The undertaking should retain sufficient expertise and resources to monitor and manage its risks. The undertaking should be in a position to resume direct control over an outsourced activity either by insourcing or through an alternative outsourcing arrangement.
31. The outsourcing of activities which are critical or important in an insurance undertaking, such as the design and pricing of insurance products, investment of assets or portfolio management, claims handling, compliance function, internal audit, accounting, risk management or actuarial support, provision of data storage or the provision of on-going systems maintenance or support should require particular attention by the supervisor when being notified of the intended outsourcing.
32. While it may be acceptable that undertakings with simple risk-profiles or a small scale of business outsource a significant part of their key functions, it would not be acceptable that undertakings with complex risk-profiles or a large scale of business do so. Considerations on proportionality on the outsourcing of critical or important functions should at a minimum consider the complexity of the business model, average number of employees, the total amount of the balance sheet and net annual turnover (earned premiums net of reinsurance).

#### **IV. On-going supervision**

33. Supervisors should be able to review and evaluate undertakings' strategies and processes and have the necessary powers to require undertakings to remedy weaknesses or deficiencies. The supervisor should have in place the appropriate monitoring tools to assess existing and arising risks and have access to the relevant information, also in the case of activities outsourced by the undertaking.<sup>13</sup>
34. In particular, supervisory authorities should ensure that initial conditions set (at the moment of authorisation) are met on a continuous basis, including those relating to outsourcing. Furthermore, it should be ensured that any outsourcing does not impact their ability to enforce the relevant legislation. The supervisor should have full access to outsourced providers of critical or important functions, whether external entities or within the same group as the authorised

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<sup>12</sup> Article 274 of the Delegated Regulation

<sup>13</sup> Articles 34 and 36 of the Solvency II Directive

undertaking. Legal or practical impediments to carrying out on-site inspections or to access information, regardless of location, should lead to the conclusion that the function or activity cannot be outsourced.

35. Proportionate to the risks of the business model, the supervisor should exercise specific supervisory review in the first years following authorisation to review the consistency with the initial business model, its underlying assumptions and financial projections in order to assess whether the conditions of authorisation are being continuously met.
36. When dealing with authorised undertakings that have cross-border operations, effective and efficient cooperation and exchange of information among supervisory authorities is of utmost importance, including with authorities in third countries.<sup>14</sup> Cooperation should be initiated in the early phase of authorisation, in order to set up the necessary platforms in view of planned or actual cross-border activity of the authorised undertaking.<sup>15</sup>
37. Where needed to ensure proper on-going supervision, supervisors may consider whether the establishment of an EU holding company would promote and facilitate the coordination of group supervision at European level.<sup>16</sup>

## **V. Monitoring by EIOPA**

38. Authorisation and supervision of, and potential enforcement against, supervised undertakings are a competence of the national supervisory authorities.
39. EIOPA will monitor the developments applying a risk-based approach and using information collected from Members. It will conduct its analysis and make use of its powers and oversight tools to support supervisory convergence through bilateral engagements with the supervisory authorities, providing opinions and initiating investigations as the need arises.

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<sup>14</sup> See Section 2.2 of the Decision of the Board of Supervisors on the collaboration of the insurance supervisory authorities of the Member States of the European Economic Area (EIOPA-BoS-17/013)

<sup>15</sup> See Section 4.1 of the Decision of the Board of Supervisors on the collaboration of the insurance supervisory authorities of the Member States of the European Economic Area (EIOPA-BoS-17/013)

<sup>16</sup> Article 262(2) of the Solvency II Directive