

Selected Key Elements of the EU Group Supervision under Solvency II

Lutz Oehlenberg

Director

Federal Financial Supervisory Authority – BaFin

Agenda

1. Introductory General Remarks

2. Intra-Group Transactions (IGT)

3. Risk Concentration (RC)

4. College of Supervisors

5. Equivalence Determinations

6. End

Agenda

1. Introductory General Remarks
- 2. Intra-Group Transactions (IGT)**
3. Risk Concentration (RC)
4. College of Supervisors
5. Equivalence Determinations
6. End

2. Intra-Group Transactions (IGT)

Intra-Group Transactions

1. Why are intra-group transactions important for group supervision?
2. Level 1 - Directive 2009/138/EC
3. Level 2 - Draft proposal – no specific provision
4. Level 3 - EIOPA pre-consultation paper on supervision of **IGT** and Risk Concentration (RC) (work in progress)

2. Intra-Group Transactions (IGT)

Level 1 - Directive 2009/138/EC

Recital (109)

Risk concentrations and **intra-group transactions could affect the financial position of insurance or reinsurance undertakings**. The supervisory authorities should therefore be able to exercise **supervision over** such risk concentrations and **intra-group transactions, taking into account the nature of relationships** between regulated entities as well as non-regulated entities, including insurance holding companies and mixed activity insurance holding companies, and **take appropriate measures at the level of the insurance or reinsurance undertaking where its solvency is being or may be jeopardised**.

2. Intra-Group Transactions (IGT)

Why are intra-group relationships important for group supervision?

Intra-group relationships provide a range of economic benefits for entities, including:

- Diversification of risk;
- Efficient use of capital and liquidity;
- Integrated risk management.

But also present a number of risks:

- Exposures to problems in other group entities;
- Risk of a conflict of interest;
- Governance system;
- Contagion risk.

2. Intra-Group Transactions (IGT)

Level 3 - Supervision of IGT (work in progress)

Scope of IGT:

The scope of IGT shall include **all transactions between entities within a group** as well as between these undertakings and a **natural person** who controls or holds a participation in an entity in the group.

Supervised IGT shall include all IGT where **a (re)insurance undertaking is involved directly or indirectly as one of the parties in the transaction** and those **IGT that can affect the solvency position of a (re)insurance undertaking**.

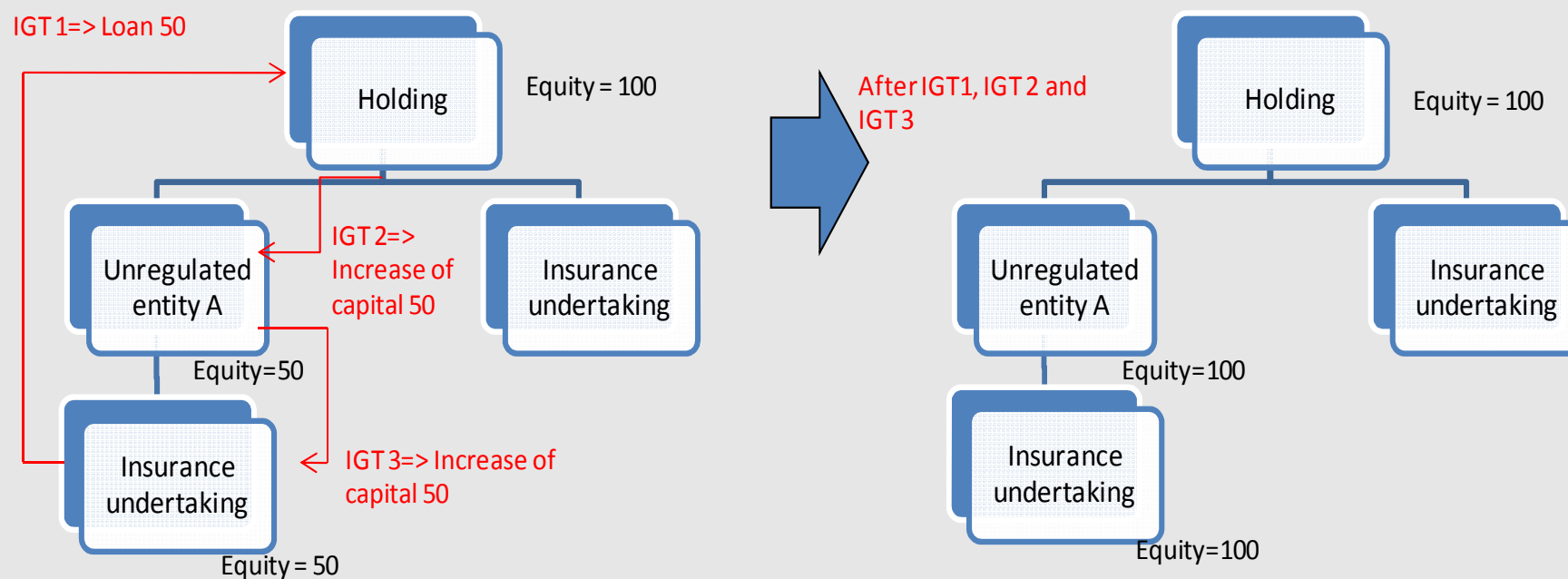
The type of entities that may fall within the scope of a related undertaking shall include, in particular:

- Third country (re)insurance undertakings;
- Other regulated entities (e.g. credit institutions);
- Unregulated entities (e.g. ancillary entities, SPVs).

2. Intra-Group Transactions (IGT)

Level 3 - Supervision of IGT (work in progress)

Scope of IGT:



Source: Presentation of Teresa Casado, Portuguese Insurance and Pensions Funds Supervisory Authority, Seminar on Group-Wide Supervision, Frankfurt, 11 July 2011

2. Intra-Group Transactions (IGT)

Level 3 - Supervision of IGT (work in progress)

Significant IGT (1/2):

Types of significant IGT to be reported shall include (non exhaustive list):

- Elements eligible for the solvency margin;
- Cross shareholdings;
- Participations, investments, including CDS, hedges and instruments involving the conversion or return of capital;
- Intercompany accounts including loans;
- Guarantees and commitments provided to, or received from, other entities in the group including shareholders and off-balance sheet transactions;
- Dividends (including extraordinary dividends), coupons, interest payments and other transfers of own funds to or from entities within the group;

2. Intra-Group Transactions (IGT)

Level 3 - Supervision of IGT (work in progress) **Significant IGT (2/2):**

Types of significant IGT to be reported shall include (non exhaustive list):

- Reinsurance and retrocession operations;
- Other transactions that shift risk exposures between entities in the group;
- Provision of management or other service arrangements, including agreements for the centralized management of assets or liquidity in the group, or to share costs;
- Purchase or sale of assets and liabilities with other entities within the group;
- Transactions involving intra-group special purpose vehicles.

2. Intra-Group Transactions (IGT)

Level 3 - Supervision of IGT (work in progress)

Very significant IGT (1/2):

IGT shall be considered **very significant** for the **purposes of reporting if they may weaken the financial condition of the group or any solo undertakings within the group.**

Types of very significant IGT to be reported include (non exhaustive list):

- Movements of capital or income outright without proper collateralization;
- Unusual or large amounts of capital or income being transferred from an undertaking;

2. Intra-Group Transactions (IGT)

Level 3 - Supervision of IGT (work in progress)

Very significant IGT (2/2):

- IGT not conducted at arm's length and which may be disadvantageous to an undertaking – i.e. transactions on terms or under circumstances which parties operating at arm's length would not approve or participate;
- IGT that can adversely affect the solvency, liquidity or profitability of an undertaking, or are used as a mean of supervisory arbitrage to evade capital or other regulatory requirements;
- Significant cases of breach on governing rules around those transactions.

2. Intra-Group Transactions (IGT)

Level 3 - Supervision of IGT (work in progress)

Thresholds for reporting significant IGT:

Supervisors shall use discretion to set **different quantitative thresholds for different groups and different categories of transactions** (e.g. equity type IGT, internal cost sharing IGT, etc) in order **to take into account the unique features of each group and types of transactions.**

The appropriate thresholds result from the **supervisory coordination** between the group supervisor and the other supervisory authorities of the **college** as well as **with the group.**

Agenda

1. Introductory General Remarks
2. Intra-Group Transactions (IGT)
- 3. Risk Concentration (RC)**
4. College of Supervisors
5. Equivalence Determinations
6. End

3. Risk Concentration (RC)

Risk Concentration (RC)

1. Level 1 - Directive 2009/138/EC
2. Level 2 - Draft proposal – no specific provision
3. Level 3 - EIOPA pre-consultation paper on supervision of IGT and **RC** (work in progress)

3. Risk Concentration (RC)

Level 1 - Directive 2009/138/EC

Recital (109)

Risk concentrations and intra-group transactions **could affect the financial position of insurance or reinsurance undertakings**. The supervisory authorities should therefore be able to exercise **supervision over** such **risk concentrations** and intra-group transactions, **taking into account the nature of relationships** between regulated entities as well as non-regulated entities, including insurance holding companies and mixed activity insurance holding companies, and **take appropriate measures at the level of the insurance or reinsurance undertaking where its solvency is being or may be jeopardised**.

3. Risk Concentration (RC)

Level 1 - Directive 2009/138/EC

Article 244 Supervision of risk concentration:

The Member States shall require insurance and reinsurance undertakings or insurance holding companies to **report on a regular basis and at least annually** to the group supervisor **any significant risk concentration** at the level of the group.

3. Risk Concentration (RC)

Level 3 - Supervision of RC (work in progress)

RC should be assessed as part of the **overall risk assessment** and should be appropriately reflected in the capital requirements.

For groups the effect of risk concentration should be part of the determination of the diversification benefit.

3. Risk Concentration (RC)

Level 3 - Supervision of RC (work in progress)

RC-Scope:

- Risk concentrations can take many forms, including exposures to (this enumeration is not exhaustive):
 - Individual counterparties;
 - Groups of individual but interconnected counterparties or related entities;
 - Counterparties in specific geographical locations;
 - Industry sectors;
 - Specific products;
 - Service providers;
 - Natural disasters or catastrophes.

3. Risk Concentration (RC)

Level 3 - Supervision of RC (work in progress) **Thresholds for reporting significant RC:**

Supervisors shall use discretion to set **different quantitative thresholds for different groups in order to take into account the unique features of each group.**

The appropriate thresholds result from the **supervisory coordination** between the group supervisor and the other supervisory authorities of the **college** as well as **with the group.**

Agenda

1. Introductory General Remarks
2. Intra-Group Transactions (IGT)
3. Risk Concentration (RC)
- 4. College of Supervisors**
5. Equivalence Determinations
6. End

4. College of Supervisors

Level 1: College of Supervisors – Overview

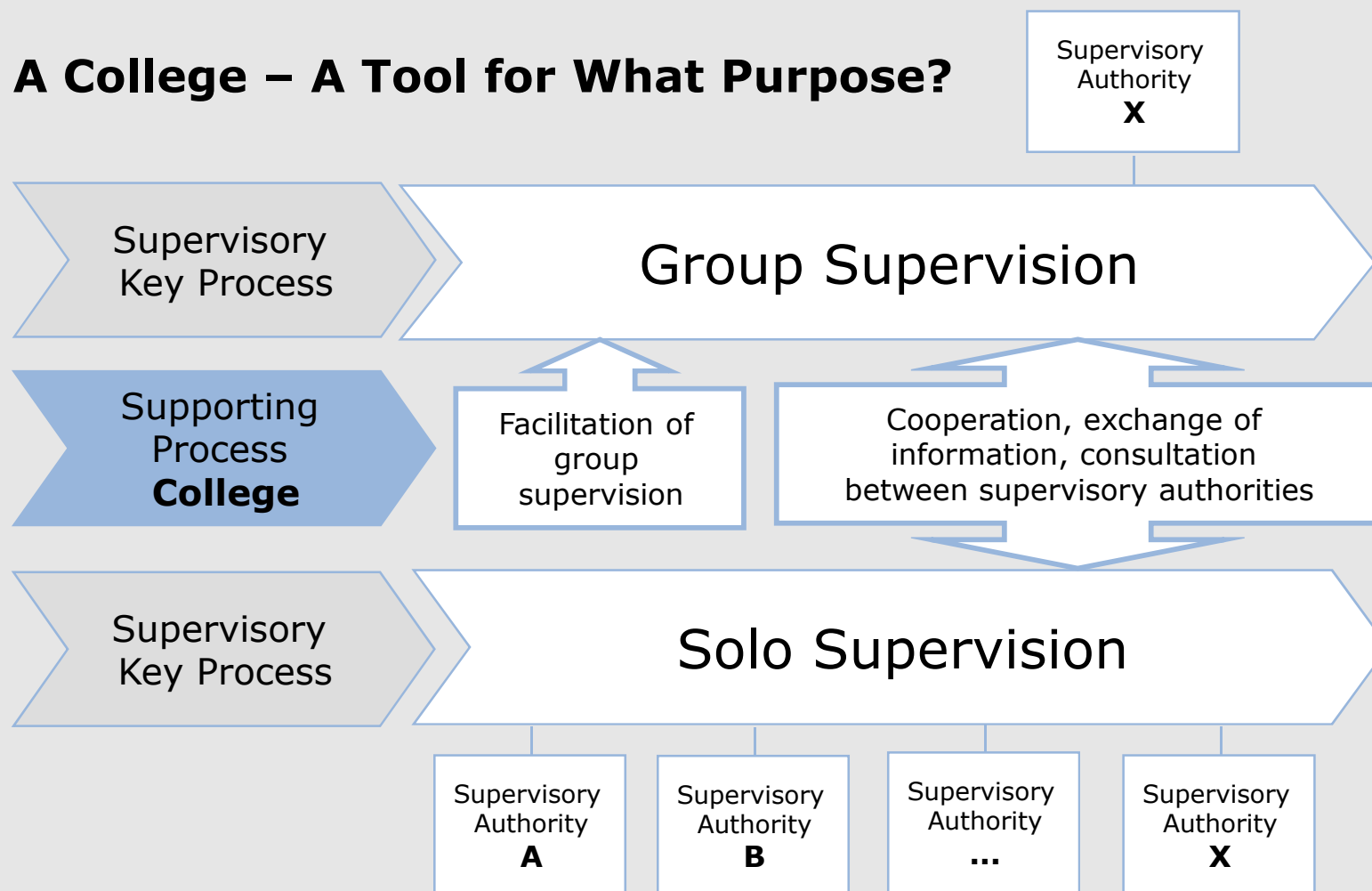
Recital (114) (DIRECTIVE 2009/138/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)):

The **activities** of the College should be characterised by:

- Proportionality
- Transparency
- Convergence

4. College of Supervisors

A College – A Tool for What Purpose?



Source: Presentation of Petra Faber-Graw and Florian Stelter, BaFin, Cross-sector seminar on Supervisory Colleges, Berlin, 9 December 2010

4. College of Supervisors

Level 1: What are the rights and duties of the Group Supervisor?

(Article 248 DIRECTIVE 2009/138/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)):

<p>(a) coordination of the gathering and dissemination of [...] information for going concern and emergency situations, including the dissemination of information which is of importance for the supervisory task of a supervisory authority;</p>	<p style="writing-mode: vertical-rl; transform: rotate(180deg);">Facilitation of group supervision tasks through establishment of a college, chaired by the group supervisor.</p>
<p>(b) supervisory review and assessment of the financial situation of the group;</p>	
<p>(c) assessment of compliance of the group with the rules on solvency and of risk concentration and intra-group transactions [...];</p>	
<p>(d) assessment of the system of governance of the group, [...] and of whether the members of the administrative, management or supervisory body of the participating undertaking [...] (are fit and proper);</p>	
<p>(e) planning and coordination, [...] of supervisory activities in going-concern as well as in emergency situations, in cooperation with the supervisory authorities concerned [...];</p>	
<p>(f) other tasks, measures and decisions assigned to the group supervisor by this Directive or deriving from the application of this Directive, in particular leading the process for validation of any internal model at group level [...] and leading the process for permitting the application of the regime established in Articles 237 to 240 (groups with centralised risk management).</p>	

4. College of Supervisors

Level 1: Membership and Participation:

Aim?	Who?	Status?
Facilitate the exercise of the group supervision	Group supervisor and supervisory authorities of all the Member States in which the head office of all subsidiary undertakings is situated	Member-ship
Efficient exchange of information	The supervisory authorities of significant branches shall also be allowed to participate in the college of supervisors.	Partici-pation
Defined by group supervisor	Supervisory authorities of non-EEA entities (subsidiary, insignificant branch, related undertakings) and related regulated undertakings.	Possible involvement by group supervisor

Source: Presentation of Petra Faber-Graw and Florian Stelter, BaFin, Cross-sector seminar on Supervisory Colleges, Berlin, 9 December 2010

4. College of Supervisors

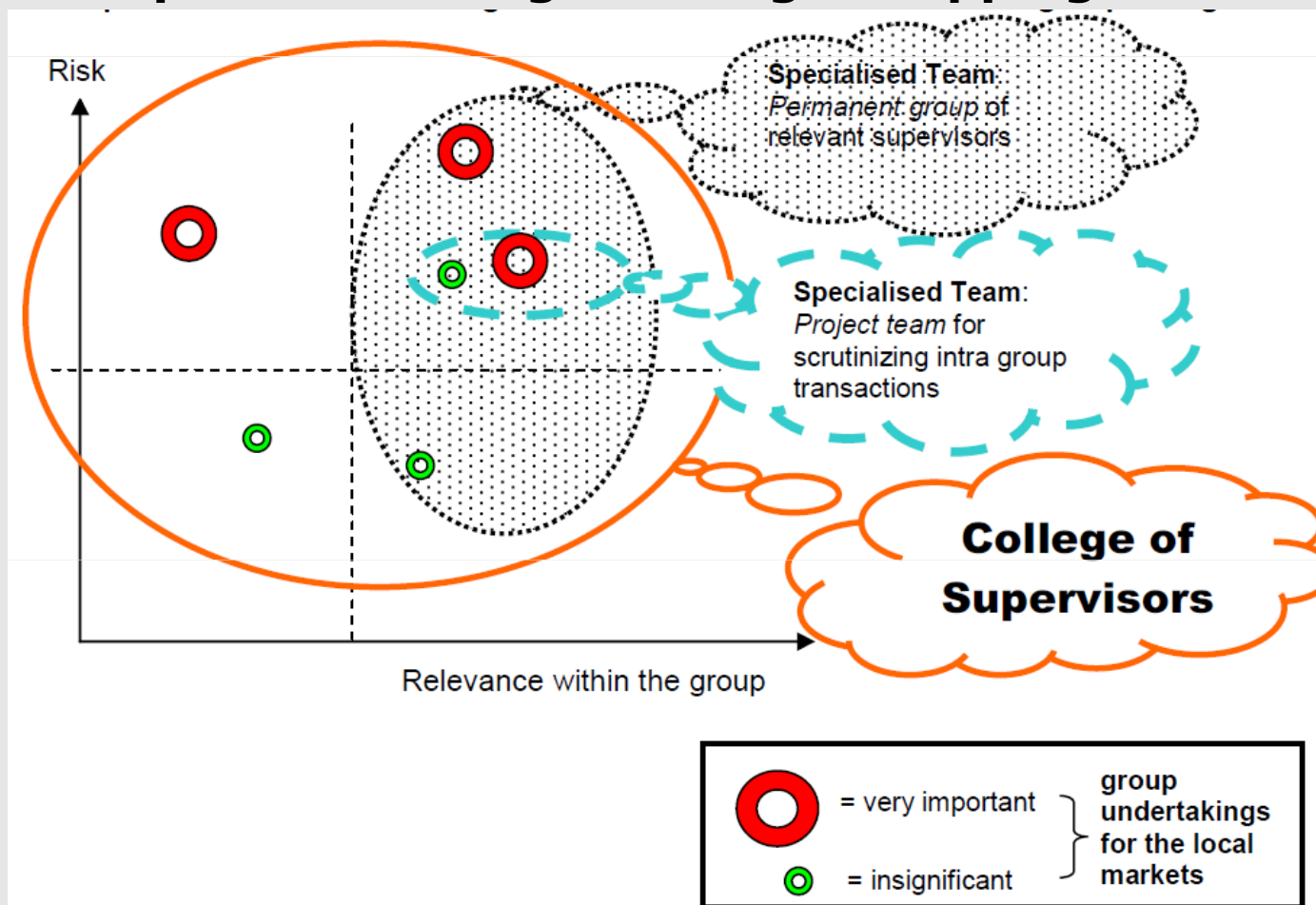
Preconditions for Successful Colleges:

- „The supervisory authorities agree on the **need and importance of co-operation** in order to carry out their responsibilities in an optimal manner.“
- „They will carry out the co-operation and co-ordination [...] in a **spirit of mutual trust**, aiming for an optimal rather than minimalist implementation of the Directive.“
- „ [...] the supervisors of the Member States concerned should strive for forms of co-operation [...] which are **based on a genuine wish to work together**.

Source: PROTOCOL RELATING TO THE COLLABORATION OF THE SUPERVISORY AUTHORITIES OF THE MEMBER STATES OF THE EUROPEAN UNION WITH REGARD TO THE APPLICATION OF DIRECTIVE 98/78/EC ON THE SUPPLEMENTARY SUPERVISION OF INSURANCE UNDERTAKINGS IN AN INSURANCE GROUP ("Helsinki Protocoll"), 11 May 2000

4. College of Supervisors

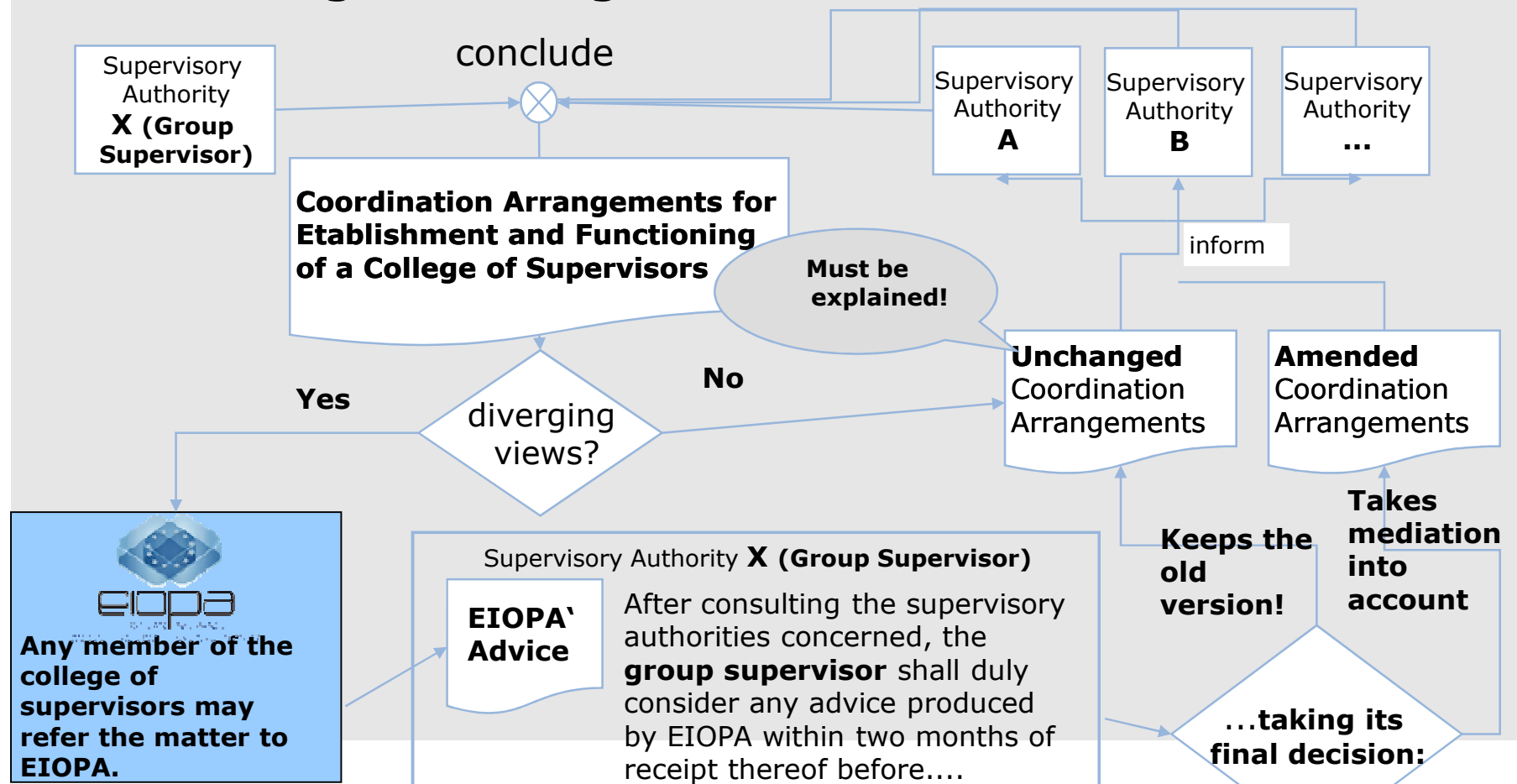
Example for a College Setting – Mapping of Foreign Entities:



Source: Presentation of Petra Faber-Graw and Florian Stelter, BaFin, Cross-sector seminar on Supervisory Colleges, Berlin, 9 December 2010

4. College of Supervisors

Coordination Arrangements for Establishment and Functioning of a College:



Agenda

1. Introductory General Remarks
2. Intra-Group Transactions (IGT)
3. Risk Concentration (RC)
4. College of Supervisors
- 5. Equivalence Determinations**
6. End

5. Equivalence Determinations

Equivalence Provisions:

Ref. DIRECTIVE 2009/138/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II):

- Article 66 – Professional secrecy;
- Article 227 – Group solvency calculations;
- Article 260 – Group supervision.

5. Equivalence Determinations

Group solvency calculation:

- The Commission may, after consultation with EIOPC, adopt a decision as to the equivalence of a third country regime;
- Any decision is determinative, and would supersede any existing assessments/determinations of the Group Supervisor.

5. Equivalence Determinations

Positive Equivalence Determination (1/2):

- Head of the group in EEA and third country (TC) regime is EQUIVALENT.
- Group solvency calculation:
 - Default method:
 - Group calculation done by the parent undertaking in EU on consolidated accounts;
 - Diversification is recognized (under constraint of availability of own funds).

5. Equivalence Determinations

Positive Equivalence Determination (2/2):

- Alternative method:
 - Group calculation done by the parent undertaking in EU;
 - Solo capital requirement calculated under LOCAL rules;
 - No recognition of group diversification.
- Need to demonstrate the availability and quality of required data.

Note that the undertaking has to be subject to authorisation in the TC.

5. Equivalence Determinations

Solvency assessment with TC entities (1/2):

- Treatment for TC entities = treatment for EEA entities.
- If a dominant influence is exercised (insurance subsidiaries):
 - Default method:
 - ⇒ Full/partial integration => **Diversification recognized.**
 - Alternative method:
 - ⇒ Deduction/aggregation => **No diversification recognized:**
 - ⇒ if the country is equivalent => local capital requirement is used;
 - ⇒ elsewhere => Solvency II capital requirement is used.

5. Equivalence Determinations

Solvency assessment with third-country entities (2/2):

- If a significant influence is exercised:
 - Default method:
 - ⇒ Equity value => **No diversification recognized:**
 - ⇒ Solvency II capital requirement is used as capital charge.
 - Alternative method:
 - ⇒ Deduction/aggregation => **No diversification recognized:**
 - ⇒ if the country is equivalent => local capital requirement is used;
 - ⇒ elsewhere => Solvency II capital requirement is used.

5. Equivalence Determinations

Consequences of Equivalence:

The following table outlines a series of options depending on whether an equivalence decision has been made by the group supervisor or the European Commission. *Table: The head office of the group is within EEA*

Decision adopted by the Commission (Art.227.4)	Decision taken by Group Supervisor (Art.227.2)	Option (2 nd paragraph Art. 227.1) implemented by MS	Capital requirement and eligible own fund of a participating undertaking in a third-country (only for deduction aggregation)
Equivalence	No decision to take	YES	Local requirements
		NO	Solvency II requirements
Non-equivalence	No decision to take	Only NO	Solvency II requirements
No-decision adopted	Equivalence	YES	Local requirements
		NO	Solvency II requirements
	Non-equivalence	Only NO	Solvency II requirements

5. Equivalence Determinations

Group supervision:

- The Commission may, after consultation with EIOPC, adopt a decision as to the equivalence of a TC regime.
- Any decision is determinative, and would supersede any existing assessments/determinations by the Group Supervisor.

5. Equivalence Determinations

Positive Equivalence Determination:

- Head of the group is outside the EEA and the TC regime is EQUIVALENT.
- Group solvency calculation:
 - Equivalent group supervision exercised by the TC supervisory authority;
 - EEA supervisors expect to play a role in the cooperation arrangement.
- Also note Article 264, which permits the Commission to submit proposals to the Council for the negotiation of an agreement with a TC regarding the means of exercising group supervision.
- Importance of the EC on equivalence:
 - Decisions on equivalence will promote consistency and harmonization of Solvency II.

5. Equivalence Determinations

Negative Equivalence Determination:

- Head of the group is outside the EEA and the TC regime is NOT EQUIVALENT.
- Group solvency calculation:
 - Solvency II rules on group supervision apply by analogy;
 - Group calculation done at the level of;
 - insurance holding company
 - TC (re)insurance undertaking
 - Accounting consolidation or alternative method;
 - Verification carried out by the relevant supervisory authority (Art. 248(2)).
- Establishment of a new consolidated point in EEA:
 - Level text (Art. 260(2)) provides the option to require the establishment of an insurance holding company which has its head office in the EEA;
 - Group supervision is applied at this level.

5. Equivalence Determinations

Consequences of Equivalence:

Table: The head office of the group is outside the EEA

Decision adopted by the Commission (art.260.2)	Decision taken by Group Supervisor on equivalence (art.260.1)	Sub group calculations required at EEA level
Equivalence	No decision to take	No
Non-equivalence	No decision to take	Yes, if needed
No-decision adopted	Equivalence	No
	Non-equivalence	Yes, if needed

Agenda

1. Introductory General Remarks
2. Intra-Group Transactions (IGT)
3. Risk Concentration (RC)
4. College of Supervisors
5. Equivalence Determinations
- 6. End**

6. End: Thank you for your attention!

Contact:

Lutz Oehlenberg Actuary DAV
Director (Head of Section)

Federal Financial Supervisory Authority
Insurance and Pension Funds Supervision
Graurheindorfer Straße 108
53117 Bonn
Germany

Fon: +49[0]228 4108-7338
Fax: +49[0]228 4108-1550
E-mail: lutz.oehlenberg@bafin.de