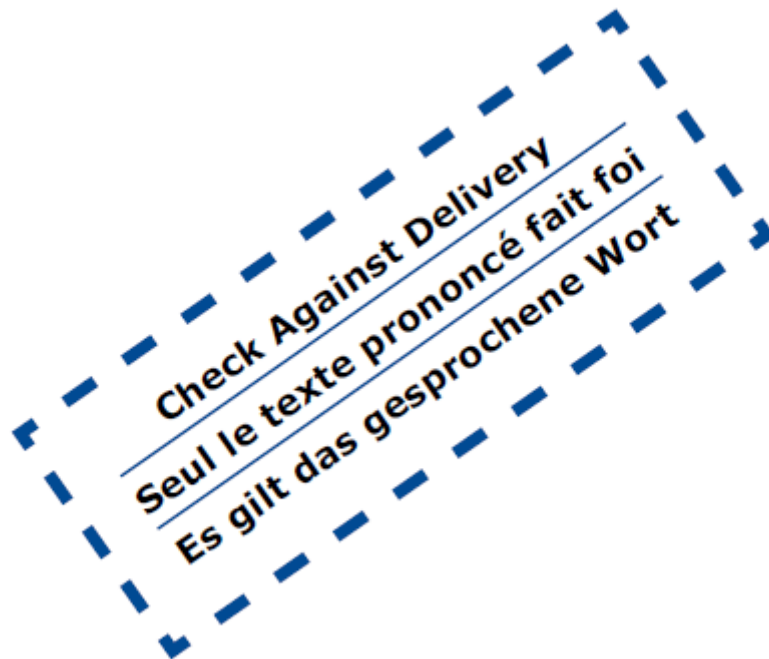




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Challenges for effective and efficient group supervision



**8th Annual International Insurance Regulatory Issues Dialogue
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Ladies and Gentlemen,

It is a pleasure to address you today within the framework of the 8th Annual International Insurance Regulatory Issues Dialogue organised by the Association of Bermuda Insurers and Reinsurers (ABIR).

I want to thank the organisers of this annual event for giving us the opportunity for an exchange of views.

Today I would like to share with you my vision on the main challenges for effective and efficient group supervision, in particular in the context of Internationally Active Insurance Groups (IAIGs). I will focus on the Solvency II approach and touch upon the role of Equivalence. Also, I will highlight the importance of Global Insurance Capital Standards in the current economic context as well as their contribution to an efficient and effective group supervision of IAIGs.

Solvency II - From Regulation to Supervision

In the European Union (EU), following more than 15 years of development and 10 years of intense negotiations, we are rapidly approaching the date of implementation of Solvency II. For EIOPA, this will bring the next challenge, which is to ensure that Solvency II is applied in a consistent way throughout the EU, including for group supervision.

We will use all the tools at our disposal to deliver on this objective. EIOPA will put a strong emphasis on the promotion of supervisory convergence by contributing to improving the quality and consistency of national supervision and strengthening oversight of cross-border groups.

Group supervision has become an important aspect of the overall supervisory process, to which Solvency II assigns great importance. The assessment of risks at group level is an important complement to solo supervision in ensuring policyholder protection, by providing an integrated overview of the risks at the level of the group, together with the identification of the unique risks and benefits generated by the group which affect its individual members.

More than an additional number to consider (the group Solvency Capital Requirement), group supervision is about increased trust, cooperation and mutual understanding among relevant supervisors. Colleges of supervisors play a vital role, in this regard.

The implementation of Solvency II brings significant changes for colleges of supervisors. EIOPA has prioritised the consistent and coherent functioning of colleges and, for a number of years, has been reinforcing its participation in them. Working together with EU Members and also with third countries, we are building a common supervisory culture and enabling supervisors from different countries to feel comfortable when working together.

In my view colleges of supervisors have made good progress in the last few years and have been fundamental to improving the exchange of information between supervisors worldwide, moving towards greater consistency in the analysis and measurement of risks.

Another breakthrough introduced by Solvency II is the concept of Equivalence. The Solvency II Directive recognises the fact that the insurance industry is a global industry. To avoid unnecessary duplication of regulation, the European Commission can make a decision on the Equivalence of a third country's solvency and prudential regime. Positive equivalence findings are mutually beneficial to European Economic Area (EEA) (re)insurers and third country (re)insurers. Moreover, Equivalence findings promote open international insurance markets, whilst simultaneously ensuring that policyholders are adequately protected globally.

Non-EU countries can be granted the status of Equivalence under the provisions of the Solvency II Directive. This status means that EU insurers can use local rules to report on their operations in third countries, while third country insurers can operate in the EU without complying with all EU rules.

The concept of Equivalence does not mean that third country jurisdictions must copy the European standards, as some improperly seem to interpret it. Instead, it is about setting a path for convergence of practices and increased cooperation. This is reflected well in the different possible outcomes of Equivalence assessments: full, temporary or

provisional. However, from a practical point of view the benefits for market participants are the same, once a positive Equivalence decision has been made.

EIOPA is heavily engaged in the Equivalence process:

Already in 2011 EIOPA delivered Solvency II Equivalence assessments of the Swiss, Bermudan and Japanese supervisory systems and in 2015, the final advice on these three countries was submitted to the EC.

In the course of the last few years, EIOPA has also analysed a number of other supervisory regimes and assessed professional secrecy requirements across many others.

Only recently (on 5 June) the Commission adopted a first package of third country Equivalence decisions under Solvency II. The Equivalence decisions take the form of delegated acts. Switzerland is granted full Equivalence in all three areas of Solvency II: solvency calculation, group supervision and reinsurance. The provisional Equivalence decision adopted concerns six third countries: Australia, Bermuda, Brazil, Canada, Mexico and the USA. It covers the solvency calculation and is granted for a period of 10 years. Such provisional Equivalence is granted for third countries which may not meet all the criteria for full Equivalence but where an Equivalent solvency regime is expected to be adopted and applied by the third country within the foreseeable future. The decisions now need to pass to the European Parliament and the Council for scrutiny, for which the time limit is three months, with possible extension by a further three months. Publication in the EU Official Journal and entry into force will only take place following this scrutiny period for the Parliament and Council.

Recently EIOPA issued an Opinion on internal models, where we recommend that EU supervisors accept internal model applications that take into account the EU Commission Equivalence decisions. But Equivalence will also be key in avoiding duplicate layers of supervision, for instance in the context of sub-group supervision.

In the recent EIOPA's Guideline on Group Solvency we set supervisor's expectations and criteria for applying the Solvency II requirements regarding sub-group supervision.

According to Article 215 of the Solvency II Directive, where a sub-group exists, the group supervisor, after consulting with other supervisory authorities concerned, should ensure that group supervision applies by default at the level of the ultimate parent undertaking in the European Union.

However, where the parent company is headquartered outside the EEA and is subject to Equivalent third country group supervision, the group supervisor should rely on the group supervision exercised by the third-country supervisory authorities and exempt the third-country group from group supervision at the ultimate level of the European Union on a case-by-case basis, where this would result in a more efficient supervision of the group and would not impair the supervisory activities of the supervisory authorities concerned in respect of their individual responsibilities.

After consulting with other supervisory authorities concerned, the group supervisor should consider more efficient group supervision as achieved when the following criteria are met:

- (a) the worldwide group supervision allows for a robust assessment of the risks to which the EEA subgroup and its entities are exposed, considering the structure of the group, the nature, scale and complexity of the risks and the capital allocation within the group;
- (b) the cooperation currently in place between the third-country group supervisor and EEA supervisory authorities for the group concerned is structured and well-managed through regular meetings and an appropriate exchange of information within a college of supervisors to which the EEA supervisory authorities and EIOPA are invited;
- (c) an annual work plan, including joint on-site examinations, is agreed upon in these regular meetings by the supervisory authorities involved in the supervision of the group.

Where the parent company is headquartered outside the EEA and is not subject to Equivalent third country supervision, group solvency supervision should be applied at the level of the ultimate parent undertaking in the European Union where a group exists. Where such group does not exist, the supervisory authorities should decide

whether to require the establishment of an insurance holding company or a mixed financial holding company which has its head office in the European Union and subject this EEA group to group supervision and a group solvency calculation.

These criteria show that Equivalence decisions bring further efficiency to the supervisory process.

International Regulatory cooperation

The financial turmoil of recent years demonstrated the urgent need for the development of robust international standards, for close cooperation and information exchange between supervisors as well as consistent supervisory practices.

In the recent decades insurance business has become more globalized and more interlinked. For example, many European insurance groups have developed a significant presence worldwide, with growing businesses in a number of emerging markets.

At the same time, risks arising from this global exposure are also increasing and in order to identify and mitigate those risks in a timely manner, there is a growing need for risk-based supervision.

It is fundamental to achieve more comparability and a truly level playing field between the main competitors in the world insurance market.

This can only be done if we work on the worldwide level in developing more convergent global regulation and supervision.

I believe that the development of Solvency II has already been a catalyst for an international movement towards risk-based regulation and supervision, and that the Solvency II Equivalence process has been instrumental in this regard.

The evolution in regulatory standards in insurance has been remarkable. In many countries all over the world, risk-based regulation and supervision is already being enacted, with different nuances, but with lots of commonalities. In each continent, there are countries where good practices are being implemented, including risk-based capital requirements, and a stronger emphasis on good governance and risk

management as well as improvements in public disclosure. In the US, through the solvency modernization initiative, in Japan, China, Brazil, Bermuda, Mexico, etc...

But there has been also a great deal of progress in the work done by the IAIS.

We have in place a methodology allowing assessment of, and ultimately identification of, global systemically important insurers (G-SIIs). The first nine G-SIIs have already been announced in July 2013. The methodology is under review by the IAIS.

The development of the Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame), which includes criteria for the identification of Internationally Active Insurance Groups (IAIGs), is also well underway.

Under a very challenging timeline the IAIS has begun to develop International Capital Standards, which include a Basic Capital Requirement (BCR), Higher Loss Absorbency (HLA) and an Insurance Capital Standard (ICS).

In the history of Insurance supervision we can call this work unprecedented, because it is the first time that insurance supervisors are working together to develop more concrete global supervisory standards, including capital requirements. Discussions on this issue are progressing at an increasingly fast pace. EIOPA is very supportive of these developments and sees its role in coordinating the voice of European supervisors at the level of the IAIS. I am glad that we have achieved good progress so far.

The Basic Capital Requirements approach is based on the principles of simplicity, straightforwardness in its presentation and, therefore, reliance on a factor-based approach. The BCR ensures a first level of comparability but it is not a minimum capital requirement.

With regard to Higher Loss Absorbency (HLA), our view is that it should be mainly targeted at the sources of "SIFIness" that lead to the designation of insurance groups as G-SII, introducing incentives for a reduction of systemic risks. Considering that the HLA addresses risks which are usually not captured in micro prudential regimes around the World, it is natural to expect that it will ultimately indicate the need for G-SIIs to hold more regulatory capital than they would be required to hold in the case they were not so designated.

Higher Loss Absorbency will build on the Basic Capital Requirements finalized in 2014 and should be completed by the IAIS by the end of this year. Technical work is progressing at a good pace and Field Testing exercises will allow for the collection of necessary information for the completion of the design and calibration work.

The Insurance Capital Standard (ICS) should provide the basis for the comparability of capital needs at group level for the international Active Insurance Groups. The ICS will create a common language of risks, capital requirements and capital resources. Although this project is still at an earlier stage of development, much work has already been done and EIOPA is happy to see supervisors from across the entire world working together towards a common ultimate goal of enhanced convergence and comparability.

I believe that the development of an ICS in the insurance sector is necessary and achievable. All jurisdictions around the globe, coming from more mature markets like the EU and the US, but also from emerging markets in Asia, Latin America and Africa, need to work together to ensure improved convergence over time. The setting up of an ICS is a fundamental objective for financial stability, as stated by the Financial Stability Board.

A true global standard must be developed in an inclusive manner, as success will be measured by its subsequent adoption and implementation by the majority of jurisdictions, with a special focus on the largest markets. I am confident that during this journey the current differences will be minimized and more commonality will emerge.

In my view the ultimate goal should be that Comframe, including the International Capital Standard (ICS), becomes an international minimum standard that national or regional standards should comply with.

The ultimate goal should be to develop a single ICS based on a common methodology by which we can achieve substantially the same capital requirements across jurisdictions, avoiding regulatory and capital arbitrage and improving the effectiveness of the supervision of internationally active insurance groups.

This will take some time. A step by step approach should be set with clear intermediate milestones in order to ensure improved convergence over time on the key elements of the ICS towards the ultimate goal.

Going forward, all jurisdictions should be open to make adjustments to their systems in order to ensure convergence with the ICS. It is clear that convergence means a move from the status quo. At the end insurance groups should be subject to only one group capital regime.

EIOPA believes that ICS should contain fundamental principles such as a:

- Risk-sensitive valuation;
- total balance sheet approach;
- clear and transparent target calibration criteria for capital requirements;
- explicit recognition of risk diversification; and
- consideration in the capital requirements of all the material risks to which the insurance group is exposed.

A risk-based prudential standard needs to have clear and transparent target calibration criteria for capital requirements. In order to inform the discussions, it is fundamental to collect sufficiently granular information during the Field Test Exercises. It is premature at this stage of the development of the ICS to try to anticipate what the finally agreed level of calibration will be.

The introduction of global capital standards should help prevent regulatory arbitrage, increase financial stability, guarantee a level playing field and strengthen international supervisory coordination, for the benefit of the economy at large, consumers and the insurance industry.

Global capital standards will reinforce the supervisory network by providing competent authorities with a common system, facilitating the work of the colleges of supervisors that play such an important role in an increasingly globalized market. With global capital standards, supervisory authorities participating in colleges will obtain a common understanding of qualitative and quantitative requirements for insurance groups, fundamental for the efficient, effective and consistent functioning of colleges.

Over time, the ICS should incorporate some level of flexibility to allow different jurisdictions with different market realities to evolve from their current differentiated regimes to a more comparable, and potentially more sophisticated, global standard.

Ladies and gentleman,

There are many challenges for effective and efficient group supervision at an international scale. Progress is being made at a regional and an international level but more needs to be done.

The Solvency II group supervision framework and the concept of equivalence are a huge step in the direction of more efficient supervision. The development of international standards has the potential to bring that efficiency to a global scale. More efficient group supervision will benefit financial stability, safeguard consumer protection and ensure that global insurance players will face a level playing field.