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Solvency II – Some legal issues

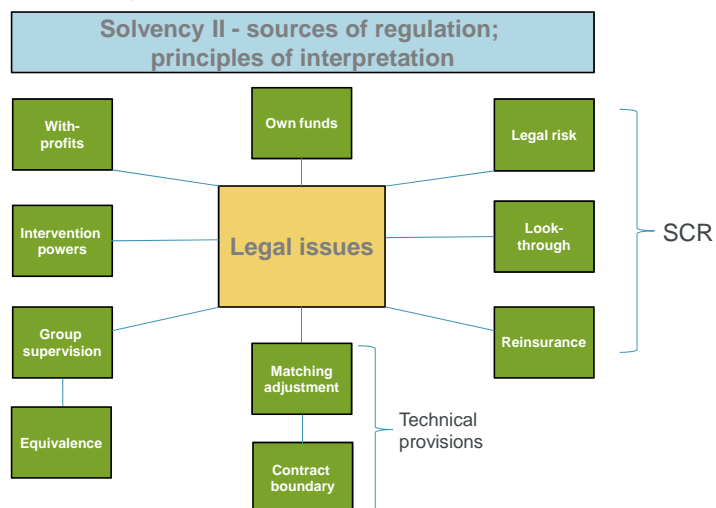
Geoffrey Maddock
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Herbert Smith Freehills LLP

06 November 2014



Session Objectives



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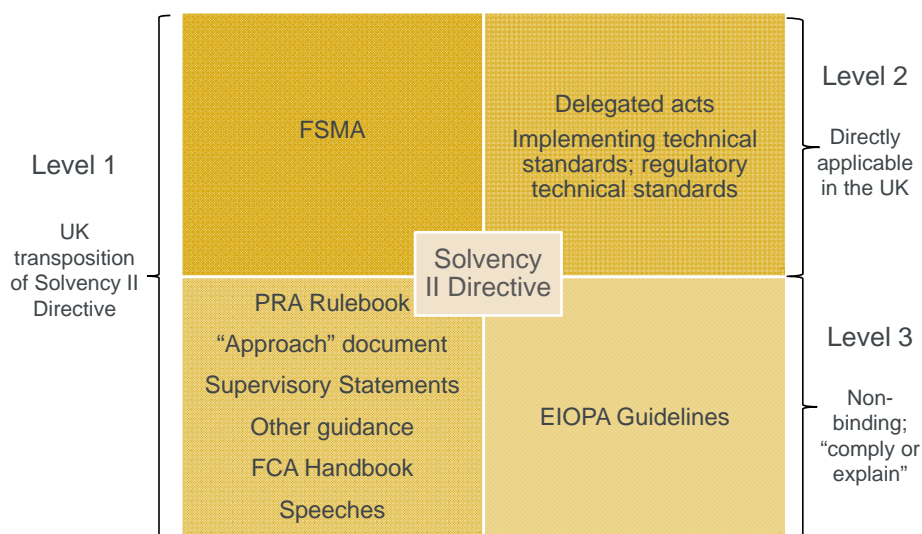


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Sources of regulation and principles of interpretation



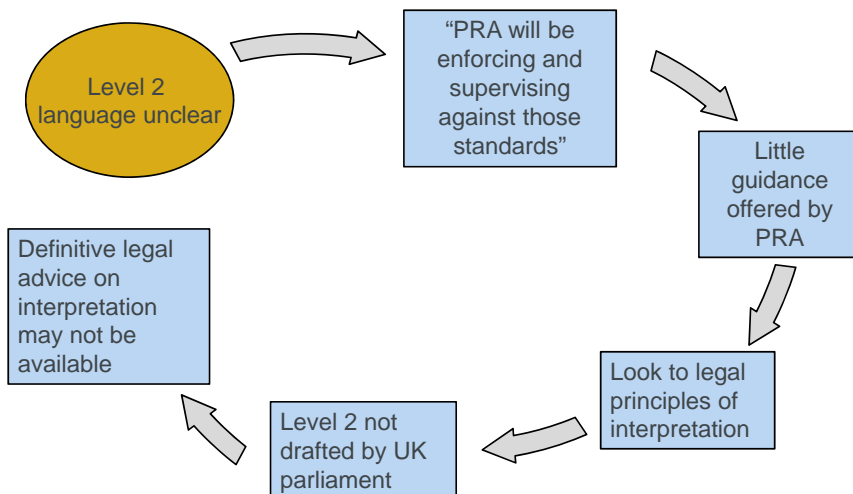
Sources of regulation – Solvency II



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Principles of interpretation



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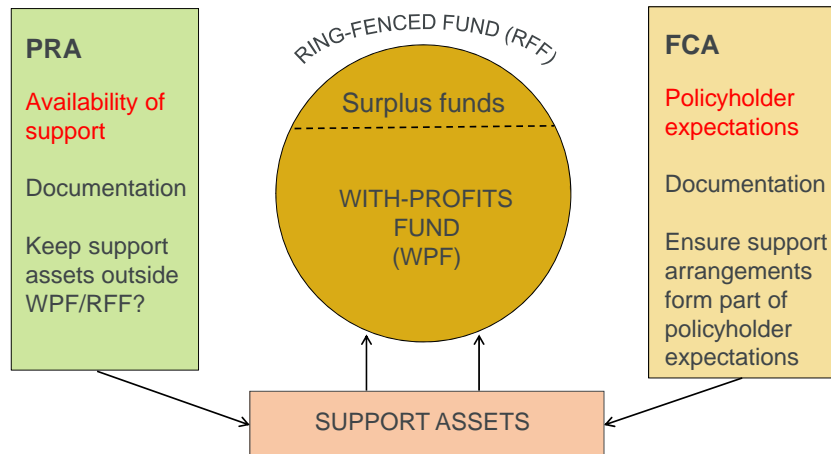


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With-profits



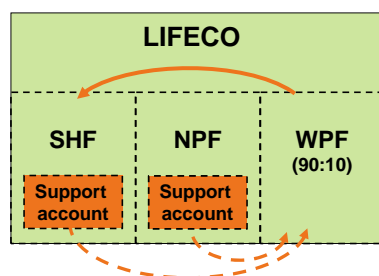
With-profits



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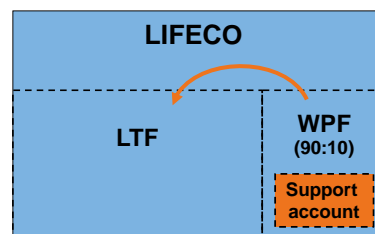
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Part VII Schemes



- Do changes need to be made to Schemes before 1/1/2016?
- Process?
- Regulatory approach to Scheme changes

- Any Scheme benefits which might be lost (e.g. impact of no SHF/NPF split)?
- Does the Scheme still work?
 - Support accounts "dragged" into the WPF?
 - 90:10 calculation?



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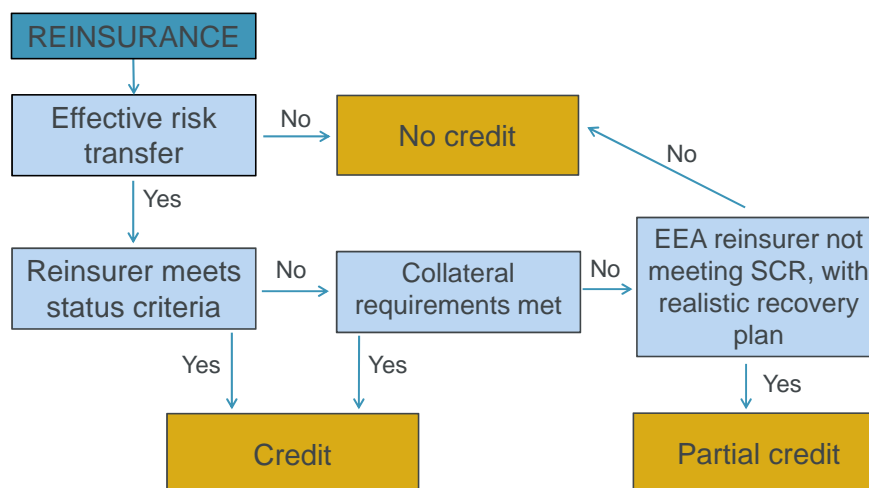


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Reinsurance



Reinsurance as a mitigant of risk



Effective risk transfer

SOLVENCY II QUALITATIVE CRITERIA	EXISTING INSPRU REQUIREMENT?
Legally effective and enforceable in all relevant jurisdictions	Yes
Clearly defined and incontrovertible	Yes
All appropriate steps to ensure effectiveness of arrangement and address risks	Yes
Cedant is able to monitor effectiveness of the arrangement and address related risks on an ongoing basis	No*
Cedant has a direct claim on its counterparty, in the event of a default, insolvency etc	Yes
No double counting of risk-mitigation effects	Yes

* May lead to more onerous audit provisions

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Reinsurer status

TYPE OF REINSURER	CONDITION
EEA reinsurer	Meets SCR (or with realistic recovery plan*)
Non-EEA reinsurer in equivalent jurisdiction	Meets relevant solvency requirements
Other non-EEA reinsurer	Assigned to credit quality step 3 or better
EEA SPV	Meets SII approval requirements
Non-EEA SPV	Meets requirements equivalent to SII

* Partial recognition only

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Collateral

Why?

As an alternative to having a suitable risk mitigation counterparty
To improve counterparty credit risk generally

How should collateral be assessed?

Article 214, L2 – Collateral arrangements

Article 197, L2 – Risk adjusted value of collateral (Article 214 relevant again)

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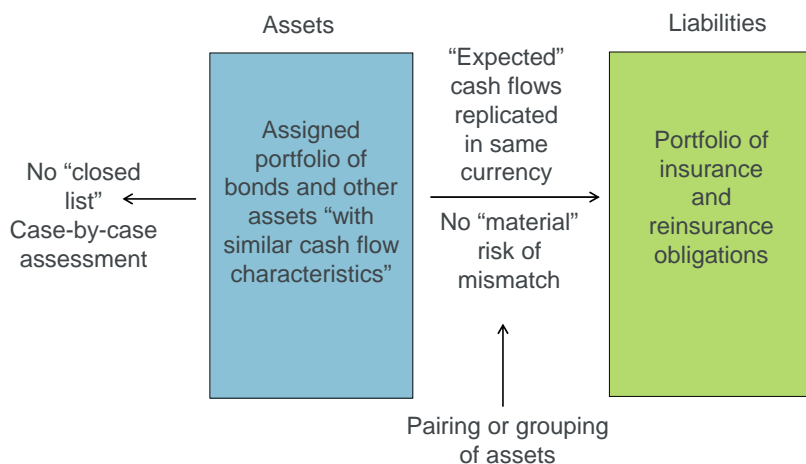


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Matching adjustment



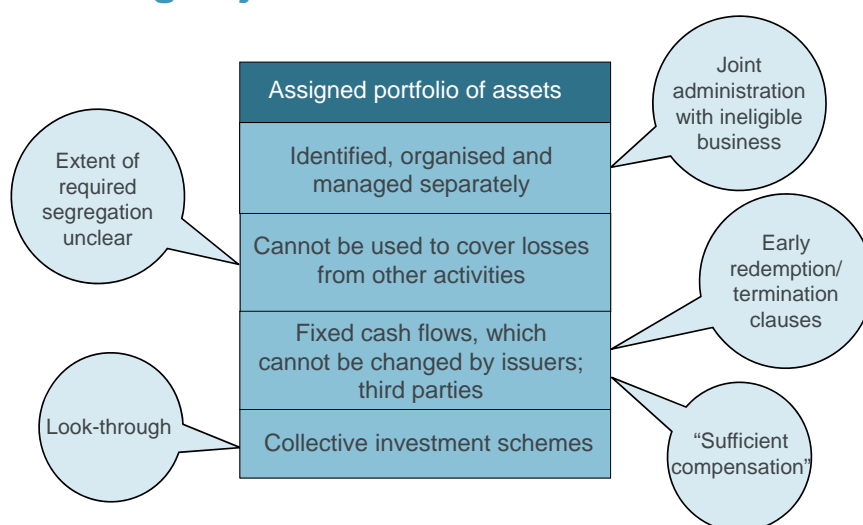
Matching adjustment – approval criteria



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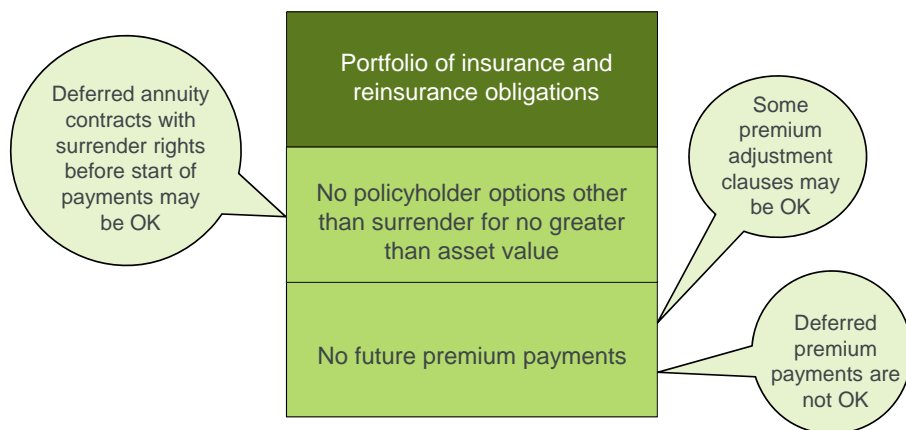
Matching adjustment – assets



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Matching Adjustment – liabilities



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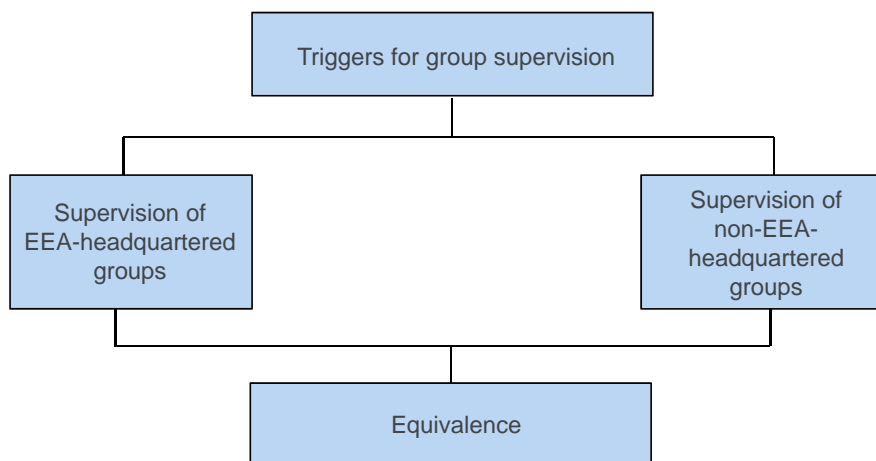


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Group supervision



Group supervision

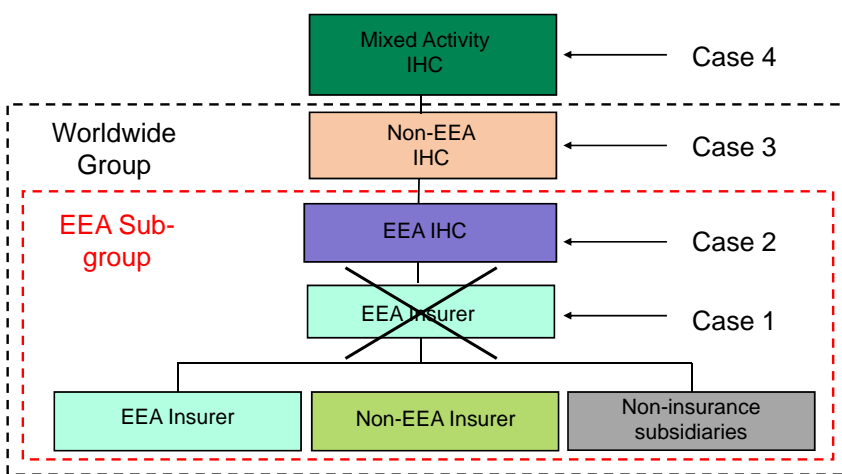


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Group supervision - triggers

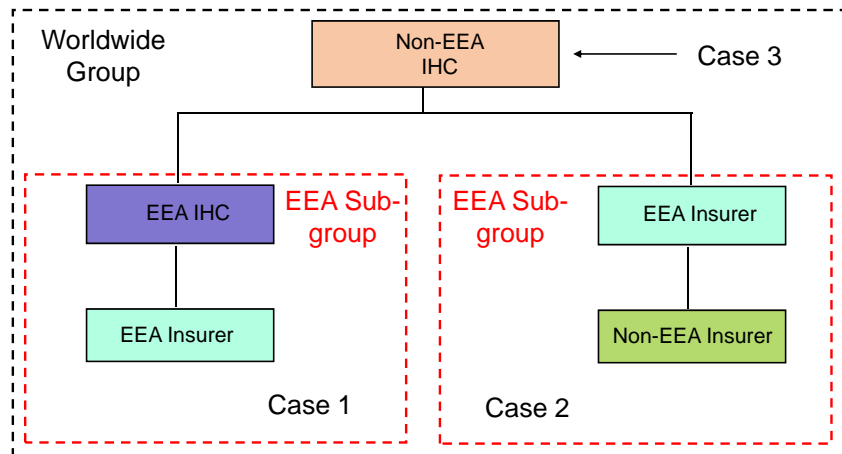
"IHC" = Insurance Holding Company



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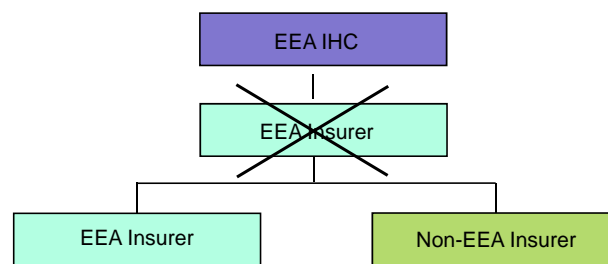
Group supervision - triggers



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EEA groups



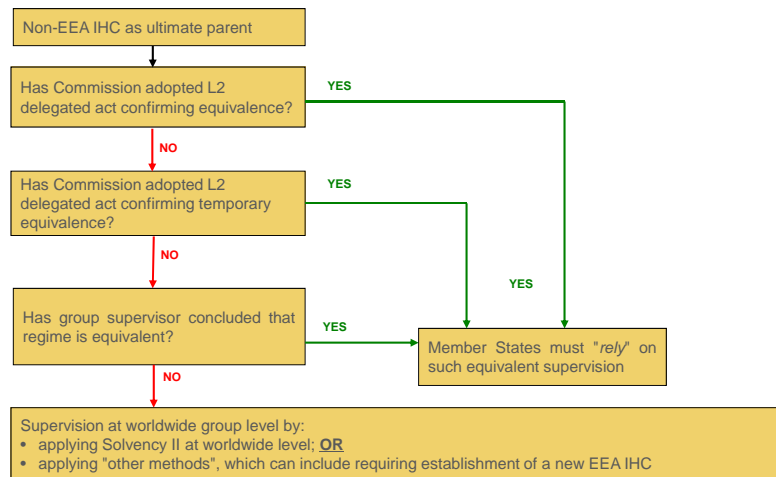
Non-EEA insurer brought in on Solvency II basis UNLESS:

- Group supervisor decides accounting consolidation-based approach to group solvency calculation is not "appropriate"
- Non-EEA insurer is located in an "equivalent" jurisdiction
- MS option to apply local rules has been exercised

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Non-EEA groups – equivalence



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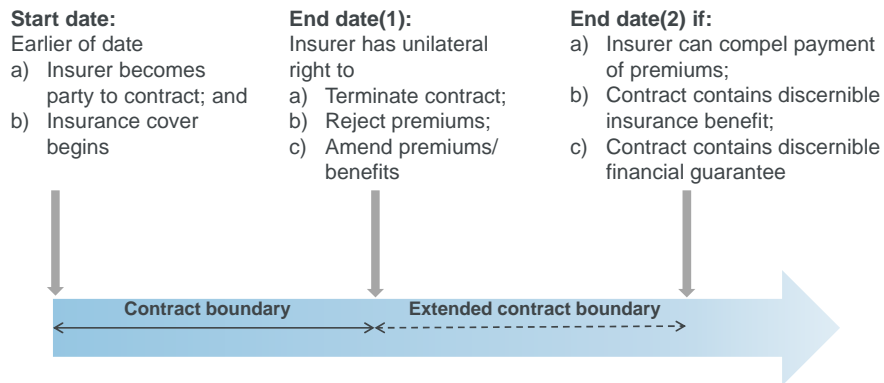
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Some other legal issues

Contract boundary
Own funds
Legal risk
"Look-through"
Intervention points



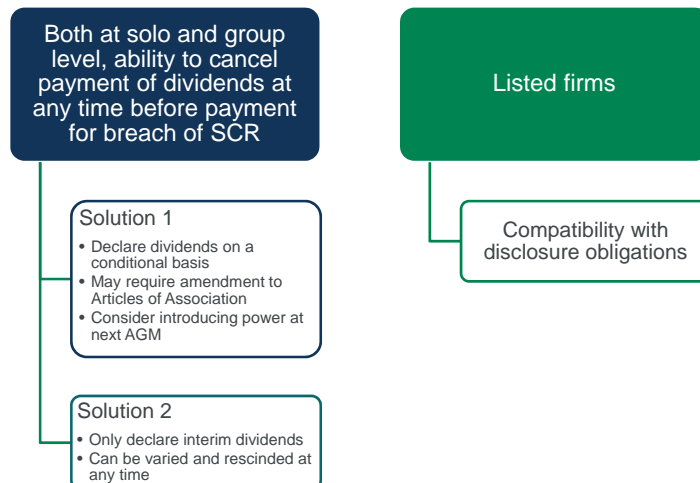
Contract boundary



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Own funds – tier 1



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Own funds - subordination to policyholders

Classification of own funds, L2

- Tiers 1, 2 and 3
- "Free from encumbrances"

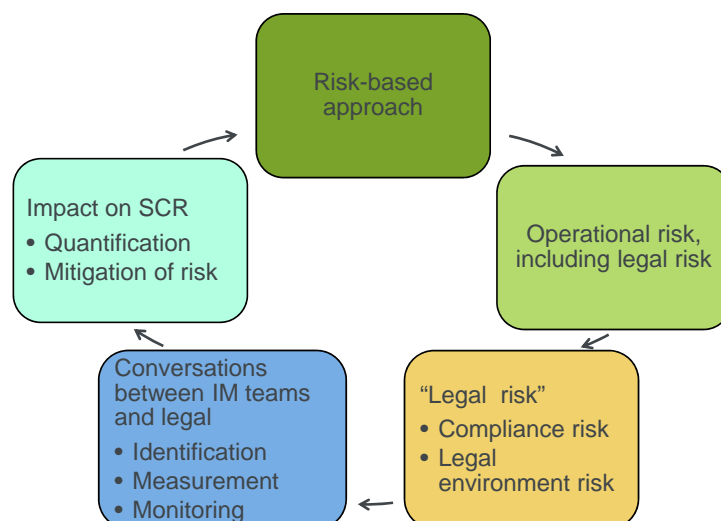
Recital 127, L2

- OF items issued by insurance holding companies and mixed financial holding companies
- Must rank after all policyholders/beneficiaries of group (re)insurance companies

Draft L3 guidance

- OF items issued by a "finance subsidiary"

Solvency II and legal risk



Market risk - look-through

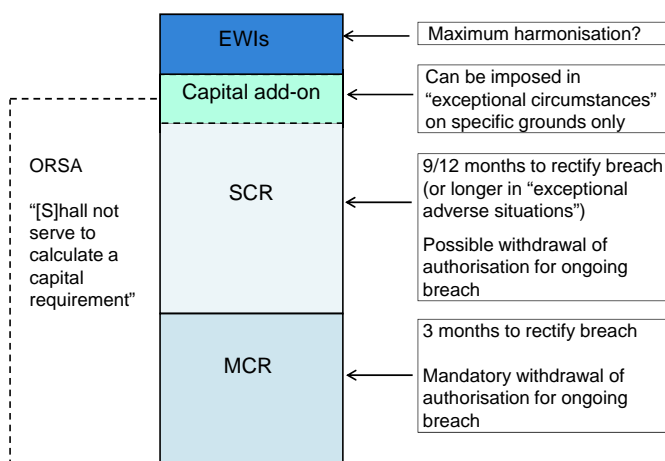
UCITs; AIFs*	✓	Where look-through cannot be applied, use target underlying asset allocation subject to certain conditions. Use of data groupings subject to 20% limit of value of insurer's assets
Other investments packaged as funds	✓	Where look-through cannot be applied, use target underlying asset allocation subject to certain conditions. Use of data groupings subject to 20% limit of value of insurer's assets
Other indirect exposures to market risk	✓	No guidance as to meaning
Investments in related undertakings	X	
Social entrepreneurship funds; venture capital funds; closed-ended and unleveraged alternative investment funds	X	Capital charge as for EEA/OECD listed equities

"Undertakings should perform a sufficient number of iterations of the look-through approach ... to capture all material risk." (Draft L3 guidance)

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Solvency II – intervention points



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