The Actuarial Profession
making financial sense of the future

Life Convention 2011
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G8: Groups issues and structures in an SII context

Detail and Design

22 November 2011

Introduction
Groups and Solvency II

- Currently, the solvency calculation for insurance groups with at least one subsidiary in the EEA is reported and supervised under the Insurance Groups Directive.
- Solvency II will replace the Insurance Groups Directive with its Title III; which includes group solvency and group supervision requirements.
- Insurance groups come in a wide variety of structures and sizes, and although there are common themes, each insurer needs to examine its group structure carefully in order to decide if changes are required, and if so what the most appropriate changes would be.
- There are a number of areas of areas to consideration for groups under Solvency II. Groups, especially complex groups, should consider at least:
  - Scope of their Solvency II group and location of group entities;
  - Equivalence;
  - Accounting methodology; and
  - Business model.
- A key task under Solvency II is determining and agreeing the scope of the group solvency calculation and the operating model for group supervision. All insurers should have done this by now and shared this information with the FSA.

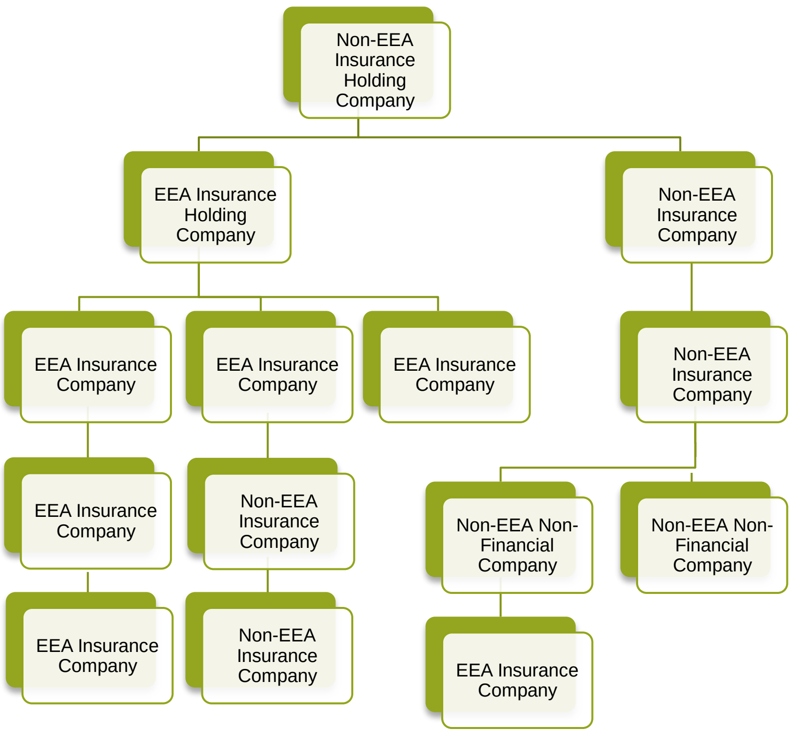
Solvency II Title III Supervision of Groups

Shifting focus from solo entities toward groups

Group Solvency

- Group Solvency Capital Requirement compared to Group Own Funds
- Can be calculated using the standard formula and/or internal modelling (including Undertaking Specific Parameters)

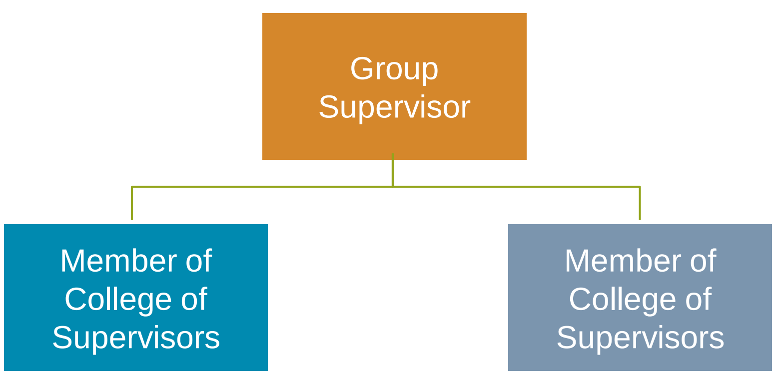
Example



Group Supervision includes (but is not limited to):

- Supervision of group solvency and the group system of governance, including group risk management and internal control
- Solo requirements plus requirements for management of risk concentration and intra-group transactions

College of Supervisors



Solvency II Title III Supervision of Groups

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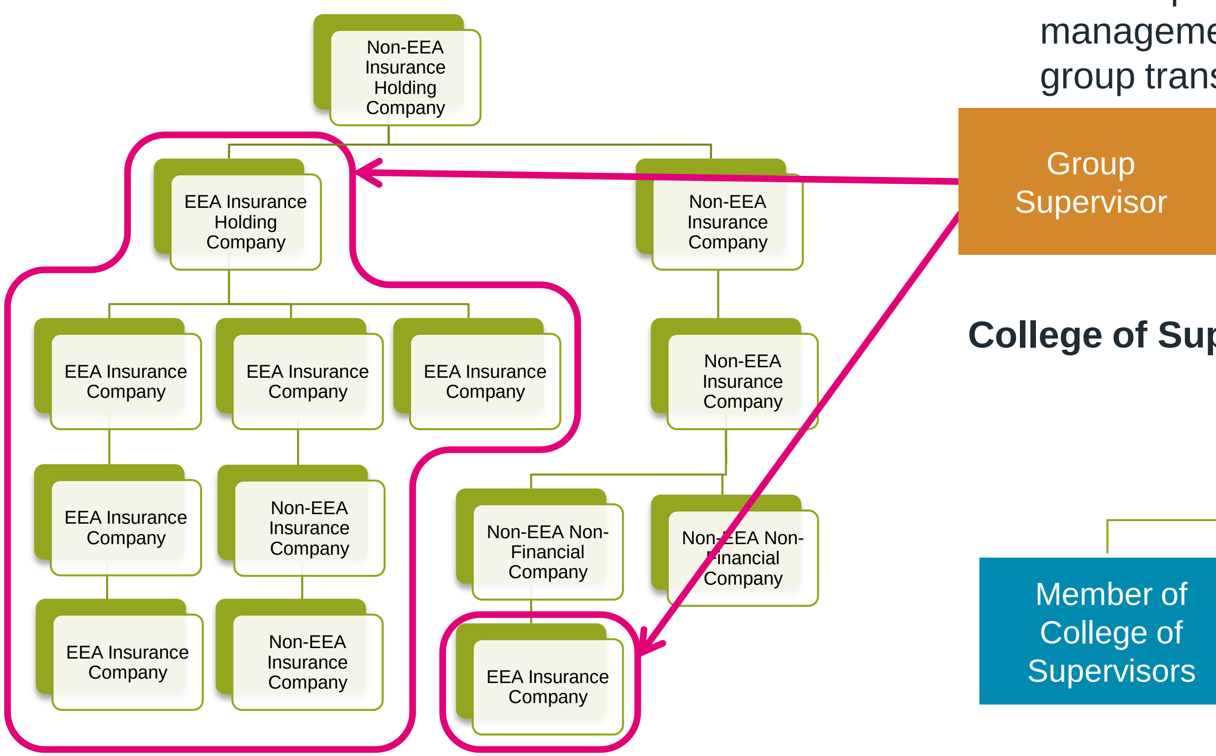
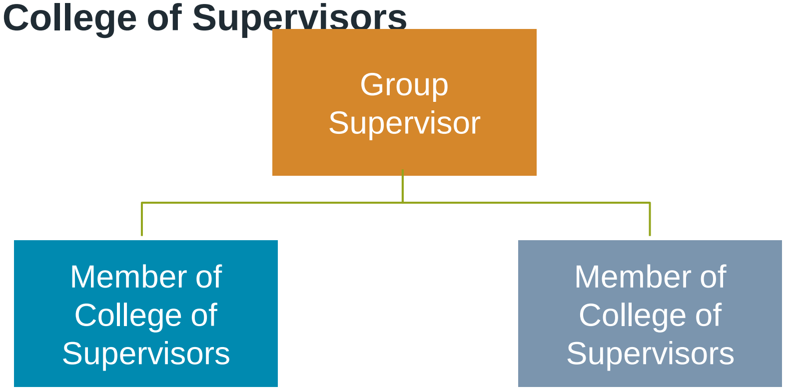


Theoretical example under article 262[2].

College of Supervisors



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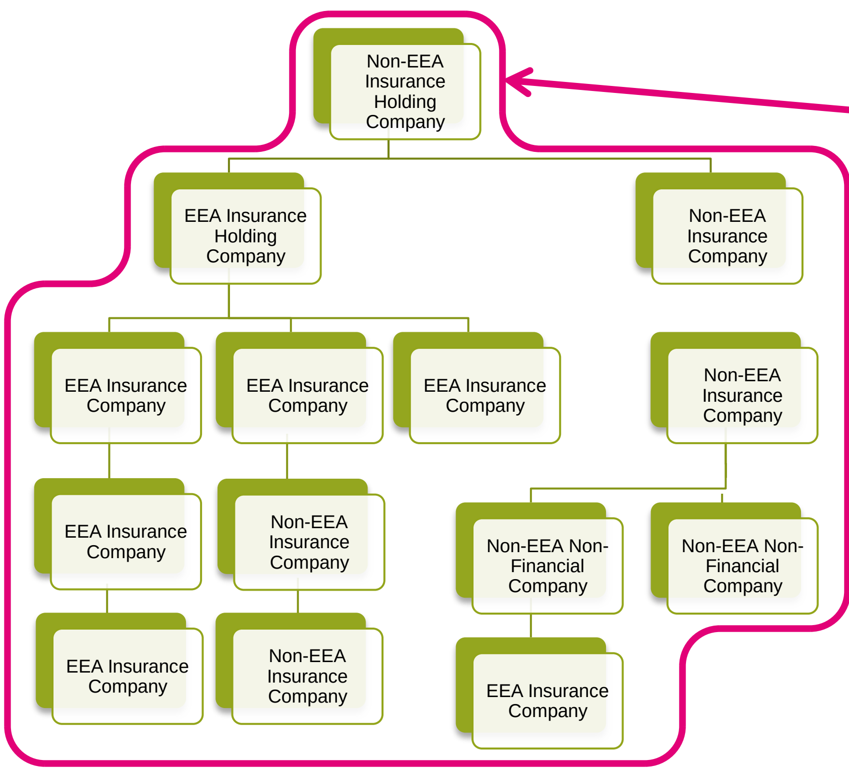
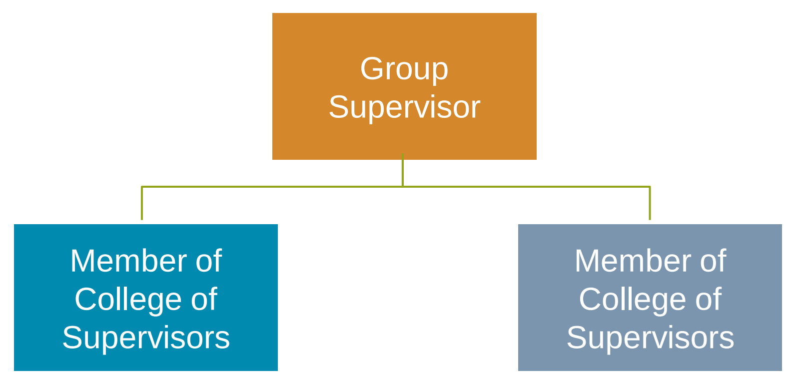


Theoretical example under article 262[1].

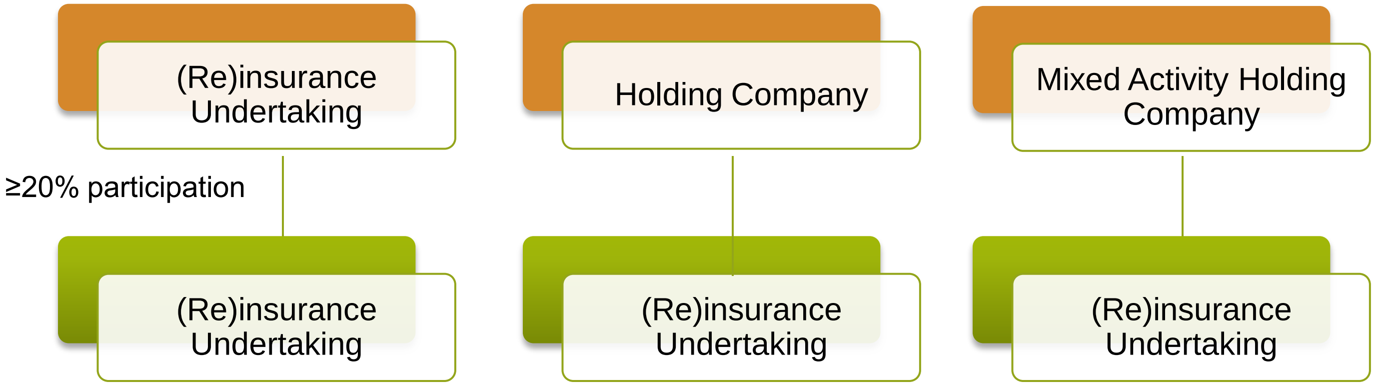
College of Supervisors



Consideration: Scope and Location of Group

Triggering the groups requirements under Solvency II.

- Identification of a group



Identification of a group takes into account EEA and non-EEA entities.

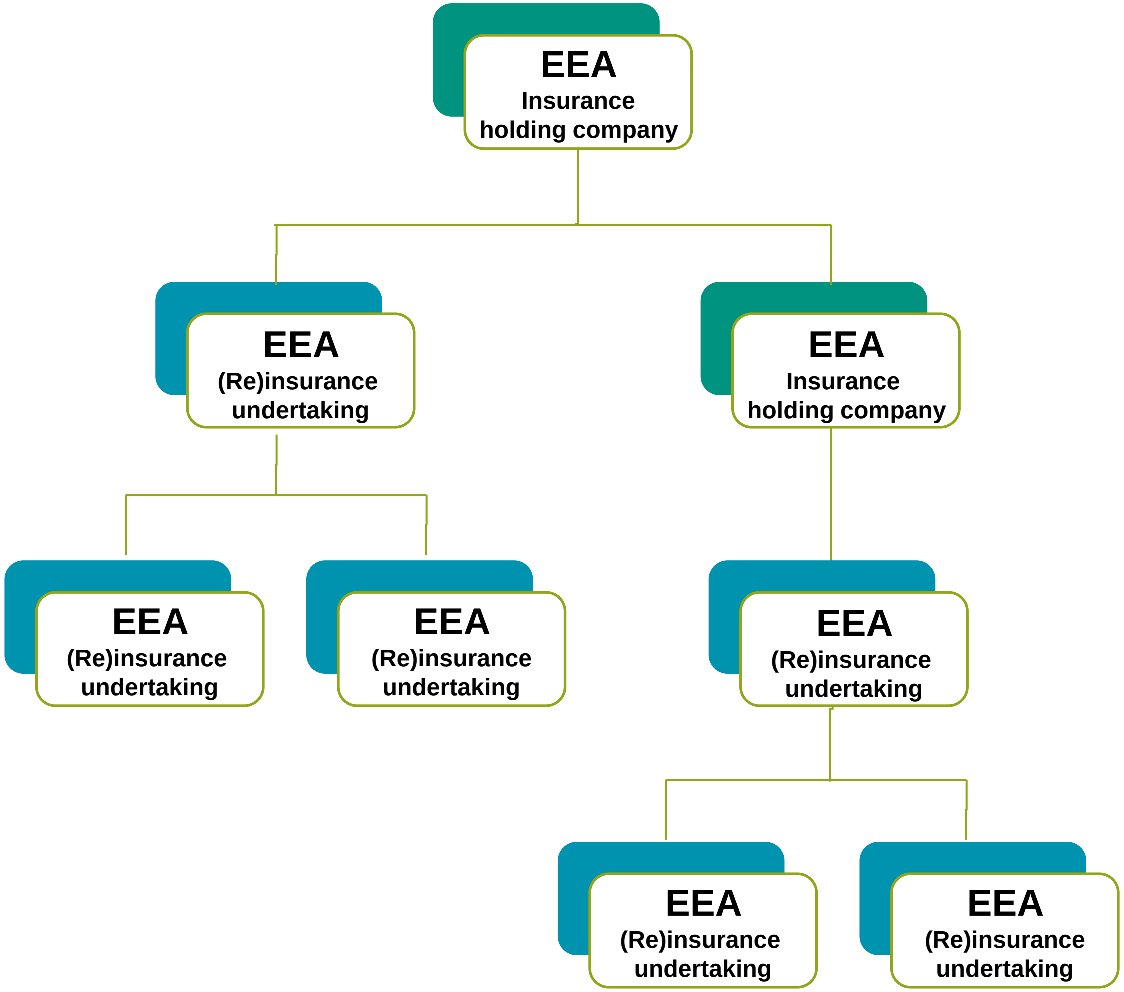
The solo requirements apply irrespective of whether the solo entities form a group.

- Considerations when looking at group structure:
  - Location of ultimate parent and sub-group parent(s)
  - Location of subsidiaries
  - Location of branches
  - Location of participations
  - Location of qualifying holdings
  - Type of entity (insurance company, insurance holding company, mixed activity holding company, financial or credit institution, non-insurance companies, strategic participations, etc)

Consideration: Scope and Location of Group

European lower complexity groups

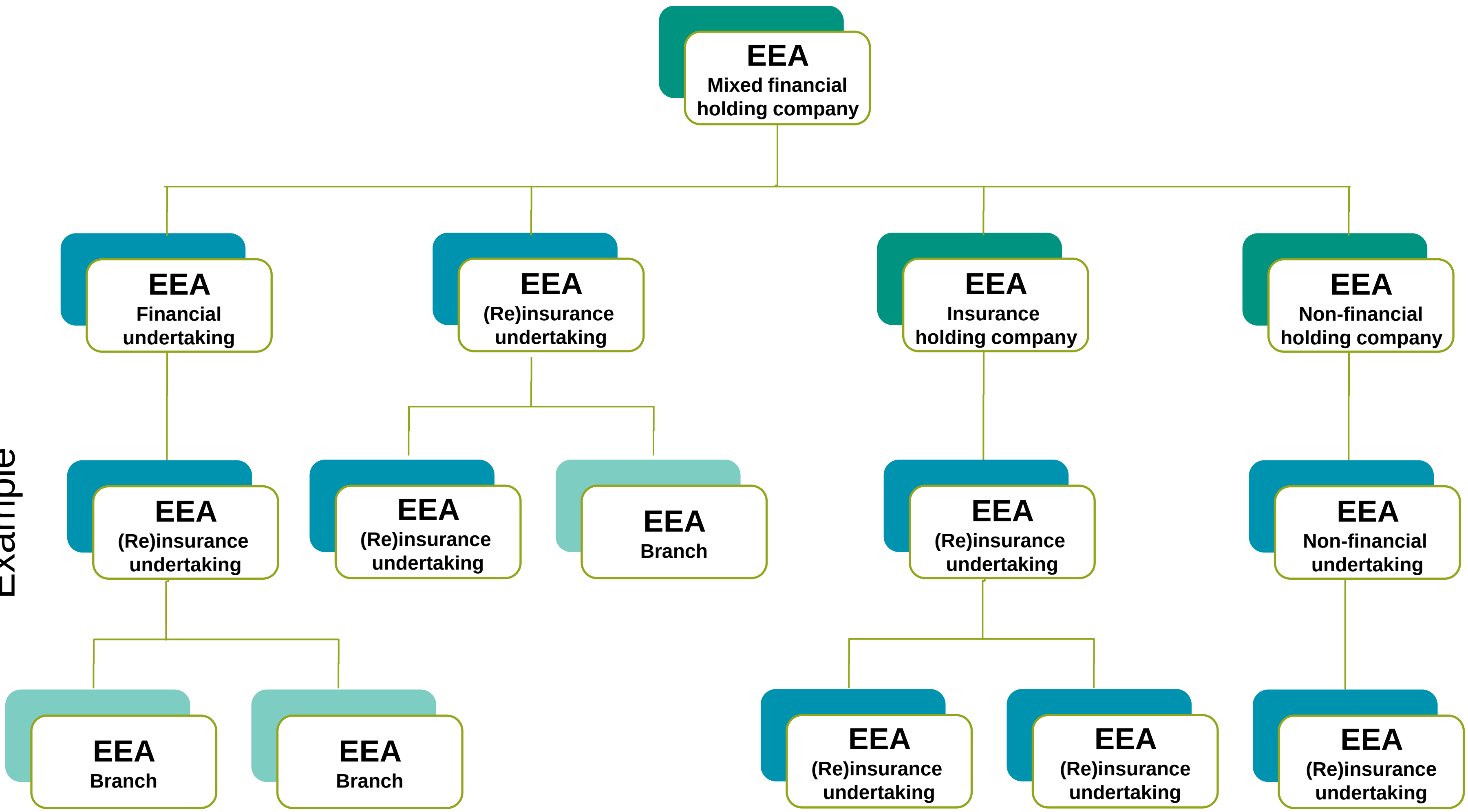
Example



Consideration: Scope and Location of Group

European higher complexity groups

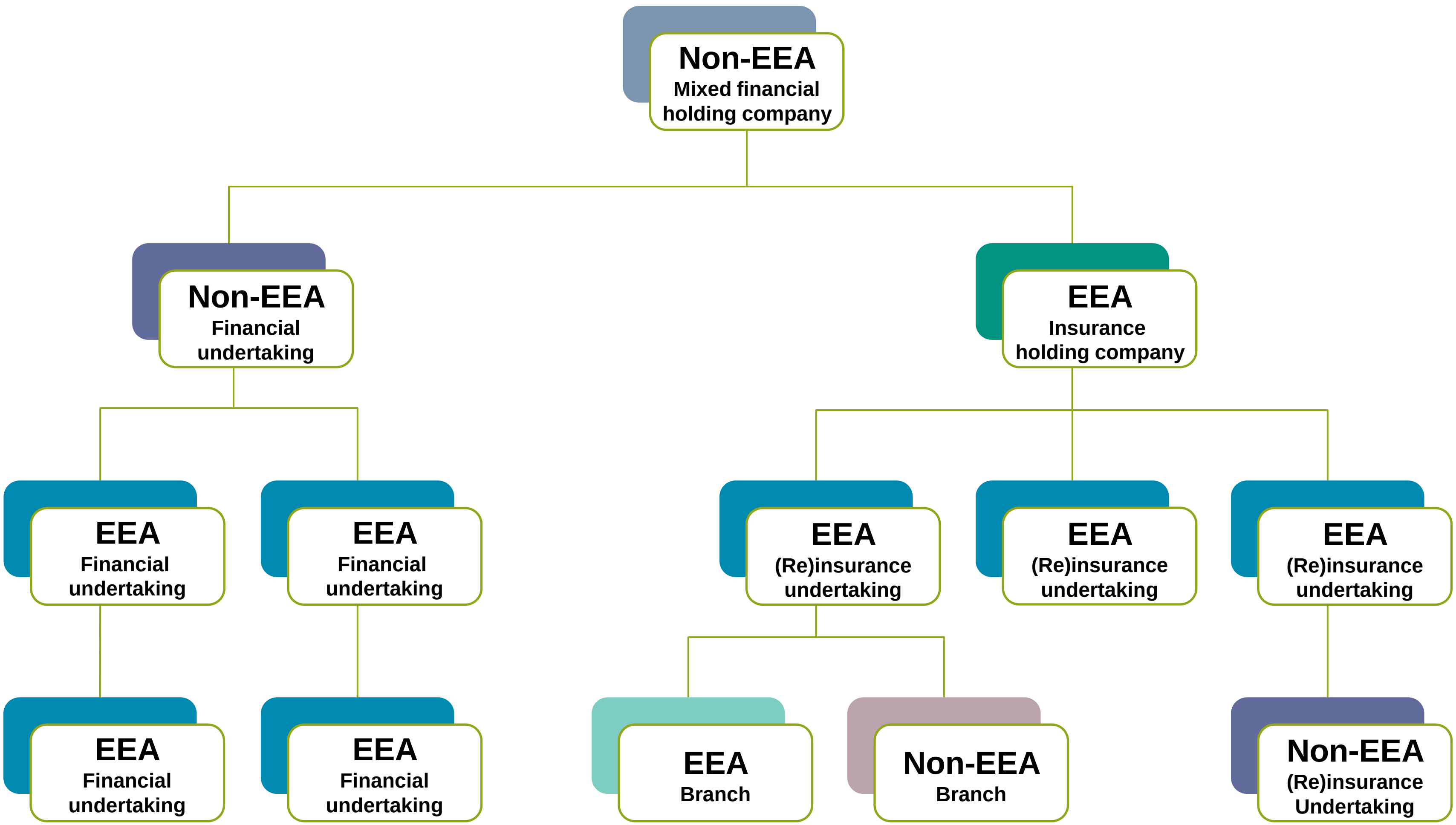
Example



Consideration: Scope and Location of Group

Global lower complexity groups

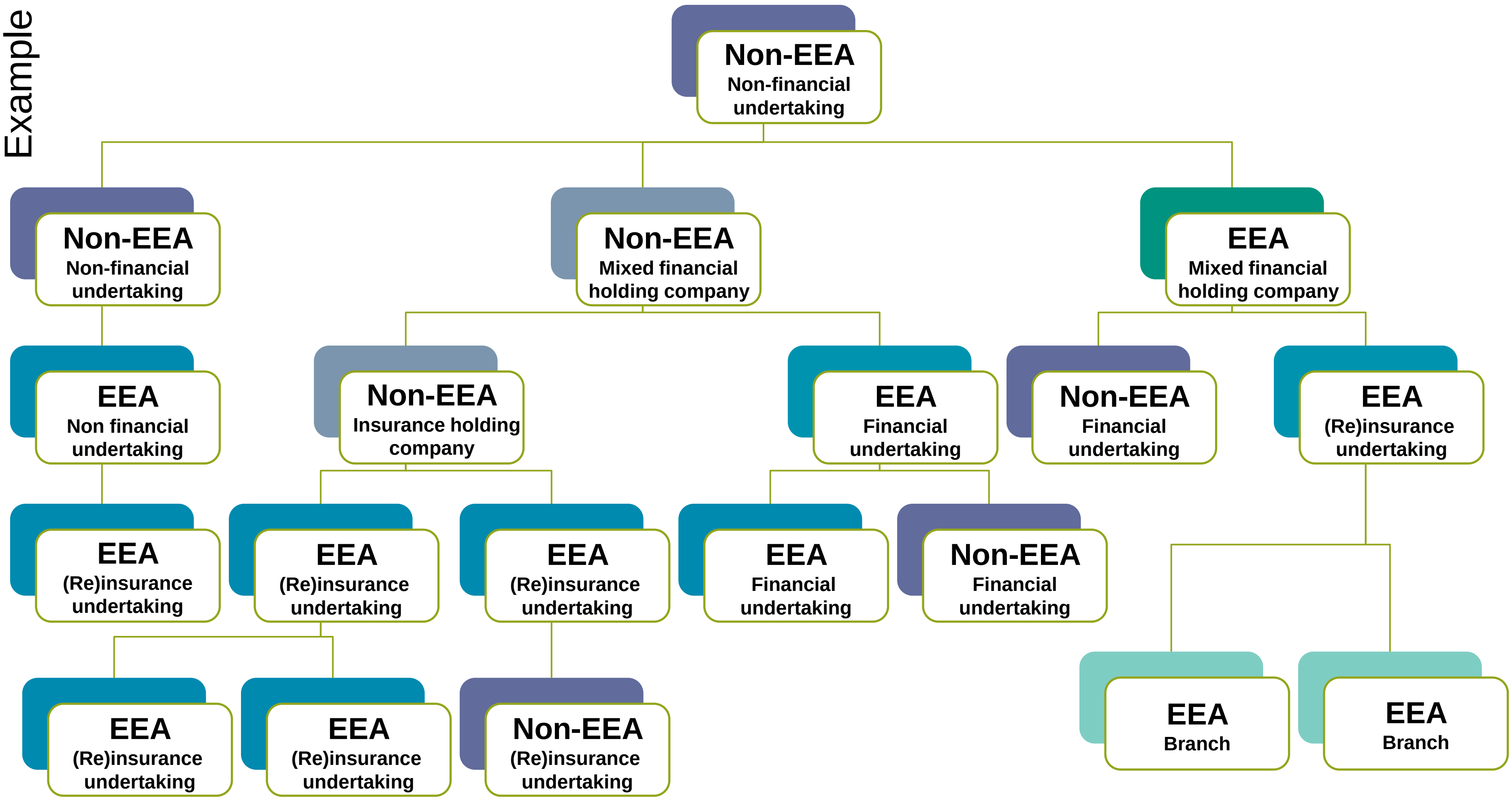
Example



Consideration: Scope and Location of Group

Global higher complexity groups

Example



Consideration: Equivalence

Group Solvency and Group Supervision

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Group Solvency

- **Insurance or reinsurance**
- **Related entity (subsidiary or participation) in a third country**
- **Aggregation and deduction only**
- **Solely for the purpose of the group solvency calculation (includes the valuation of assets and liabilities (including technical provisions), own funds, capital requirements, investment management)**

NOTE: This does not replace the requirements for the group to implement the system of governance across all of the related entities as set out in Article 246.

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Group Supervision

- **Insurance or reinsurance**
- **Head office in a third country**
- **Group supervision regime equivalent to Title III (includes all group requirements across all three pillars)**
- **Group supervision is carried out by the third country supervisor**

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Reinsurance

- **Reinsurance**
- **Head office in a third country**
- **Solvency regime equivalent to Title I (includes all solo requirements across all three pillars)**
- **Reinsurance contracts shall be treated in the same manner as if the contract had been issued by an SII regulated firm**

An excerpt of the Level 1 Solvency II Directive text relating to equivalence is included in the Appendix.

Transitional Arrangements

Transitioning into the Solvency II regime and its group impacts

Solvency II

- At present, Solvency II is silent on transitional arrangements, as these were not envisaged when the Directive was passed.

A. European Commission Omnibus II

Implementation date of 1 January 2013

- Automatic equivalence subject to L2 conditions covering:
  - commitments given by the supervisory authorities,
  - convergence to an equivalent regime over a set period of time,
  - the existing or intended content of the regime, and
  - matters of cooperation, exchange of information and professional secrecy obligations.
- Maximum 5 year transitional period for reinsurance contracts from a reinsurer with a head office in a third country.
- Maximum 5 year transitional period for group solvency to use the SCR and own funds as laid down in the third country concerned.
- Maximum 5 year transitional period for relying on group supervision exercised by third country supervisory authorities.

Bifurcation

- Solvency II transposed into national laws by 1 January 2013 with activation of supervision commencing 1 January 2014

B. European Parliament Omnibus II

Implementation date of 1 January 2014

- Temporary equivalence based on:
  - third country providing a written commitment to the EU of their intention to adopt and apply a solvency regime that is capable of being assessed as equivalent before the end of the transitional period,
  - third country must have established a convergence programme,
  - sufficient resources have been allocated,
  - the present third country's solvency regime is risk-based and based on market valuation of assets and liabilities,
  - agreements must be in place for exchange of confidential supervisory information, and
  - third country is assessed to comply with the core principles and standards adopted by the International Association of Insurance Supervisors (IAIS).
- Maximum 5 years temporary equivalence for reinsurance, group solvency and group supervision.
- Shift from group solvency (Article 227) toward group supervision for related entities situated within third countries.

Consideration: Accounting Methodology

Consolidation, Deduction and Aggregation, or Mixed

	Consolidation	Deduction and Aggregation	Mixed
Article	230	233	220
Default method	Yes	No, requires regulatory approval.	No, requires regulatory approval.
Diversification benefit between solo entities.	Yes, except for credit and finance institutions, and other special cases.	No, Solo own funds and solo SCR's are added together to give Group Own Funds and Group SCR respectively.	Yes - within consolidation part of the calculation only.
Third country considerations	•Third country consideration: EEA supervisor access to asset and liability data. •Solo local capital calculations for equivalent third country regimes may not be included using the consolidation method.	If Equivalence is granted the capital calculated under a third country regime may be added to other solo SCR's to calculate the group SCR.	If Equivalence is granted the capital calculated under a third country regime may be added to other solo SCR's to calculate the group SCR.
Other		Care needs to be taken not to double count the capital charge on intra-group transactions.	Combination of the other two methods.

Consideration: Business Model

Impacts of business model on group structure decisions

The business model of a group can have significant impacts on the group structure. The requirements and incentives of Solvency II must be weighed against the business benefits of pursuing alternative group structures that produce other business benefits.

Tax

Tax treatments vary by jurisdiction and tax benefits can have significant balance sheet impacts.

Competitive landscape

Gaining market share in existing markets, accessing new markets and increasing profitability can drive group structure decisions.

Strategy

Strategy drives products, markets, capital allocation, investment and group structure decisions.

Regulation & capital requirements

Regulation can impact on group structures. Firms should consider the Capital Requirements Directive and Financial Conglomerates Directive in conjunction with Solvency II (if applicable).

Profitability

Profitability experience and goals can drive group structure charges as shifting business development focus between jurisdictions.

Macro-economy

Wider economic factors can drive charges in focus of business between jurisdictions.

Reinsurance

The reinsurance recoverables treatment under Solvency II can drive decisions such as level of coverage and suppliers.

Geographic diversification

Diversification strategies can impact the group structure and markets in which groups operate.

Supervisory relationship

Relationship with the supervisor can drive the location of the ultimate parent undertaking, location of branches versus subsidiaries, etc.

Option: Part VII Transfers

Increased diversification benefit

- Each legal entity under SII is required to hold capital to cover its own SCR.
- Therefore the sum of each solo SCR must be held.

Unless....

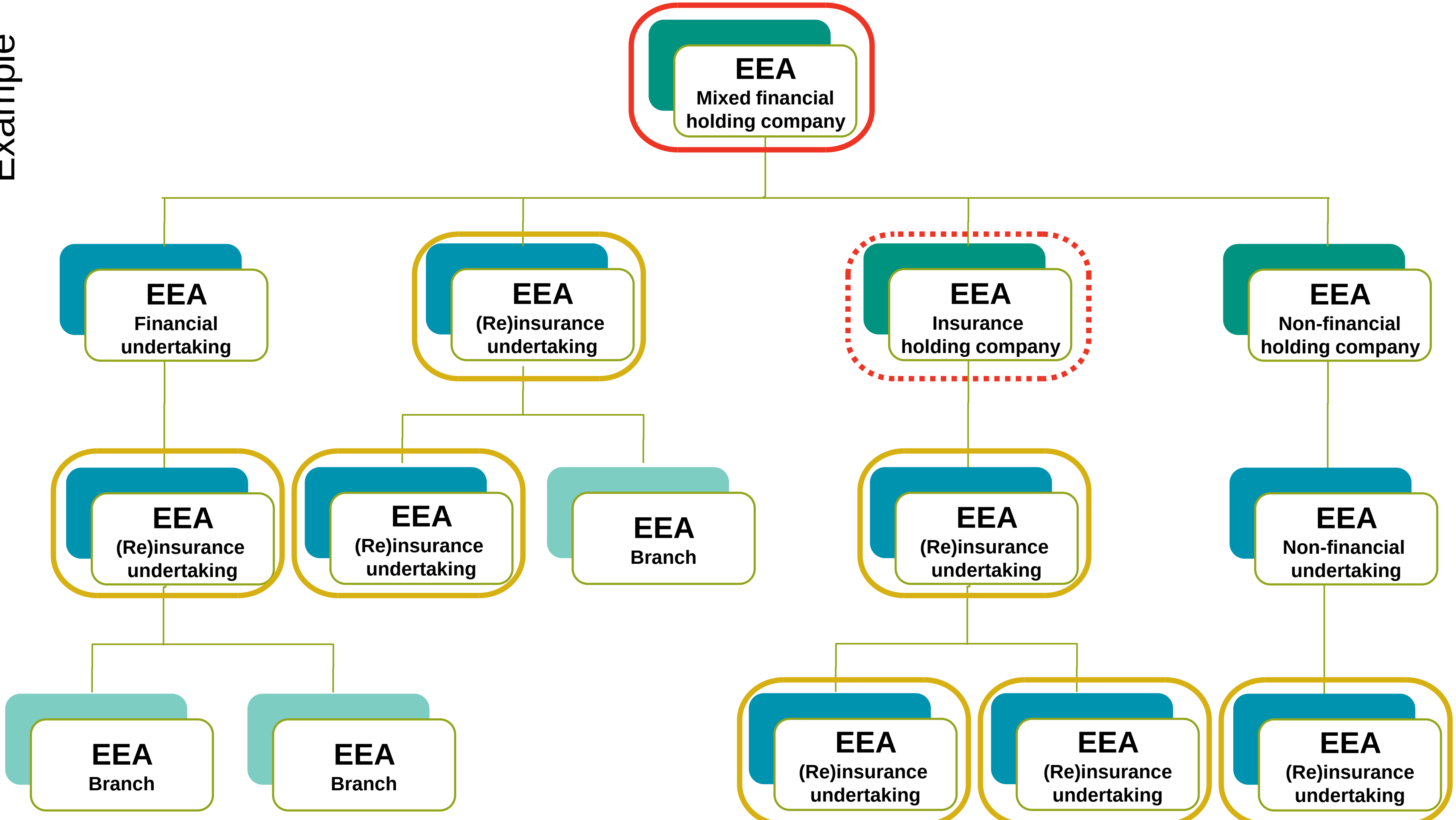
- The funds are combined into one legal entity and diversification benefit between the different types of business can be taken.
- Therefore the SCR as a combined entity is lower than the SCR of the separate entities.

> - A Part VII transfer takes 6 – 12 months from start to finish or longer.
> - The timetable needs to be discussed and agreed with the regulator in advance.
> - Unexpected delays can occur
> - Don’t leave it to the last day (!)

Example: Part VII Transfers

7 solo SCRs, 1 group SCR and 1 possible sub-group

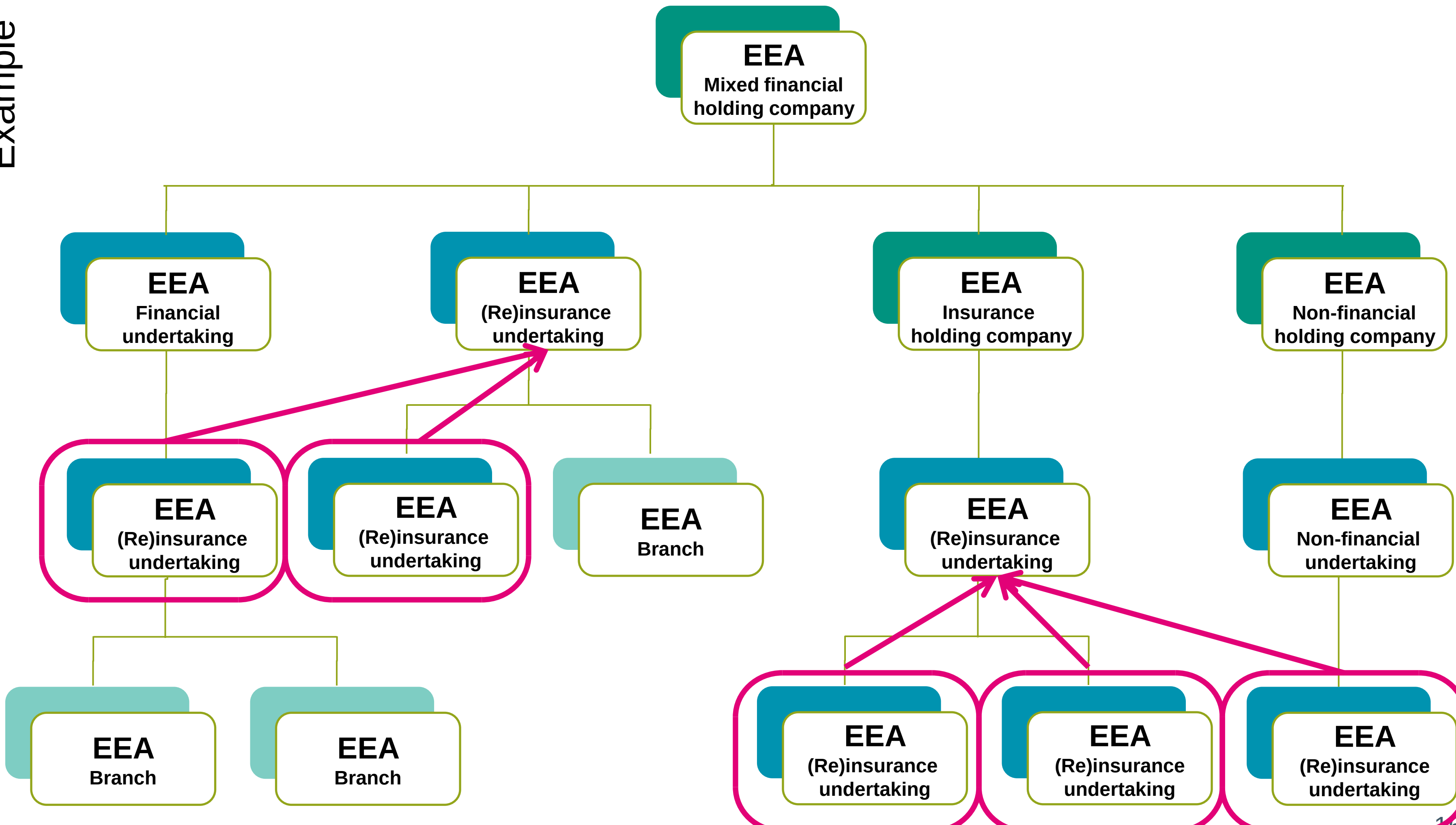
Example



Example: Part VII Transfers

Move to new group structure by merging funds

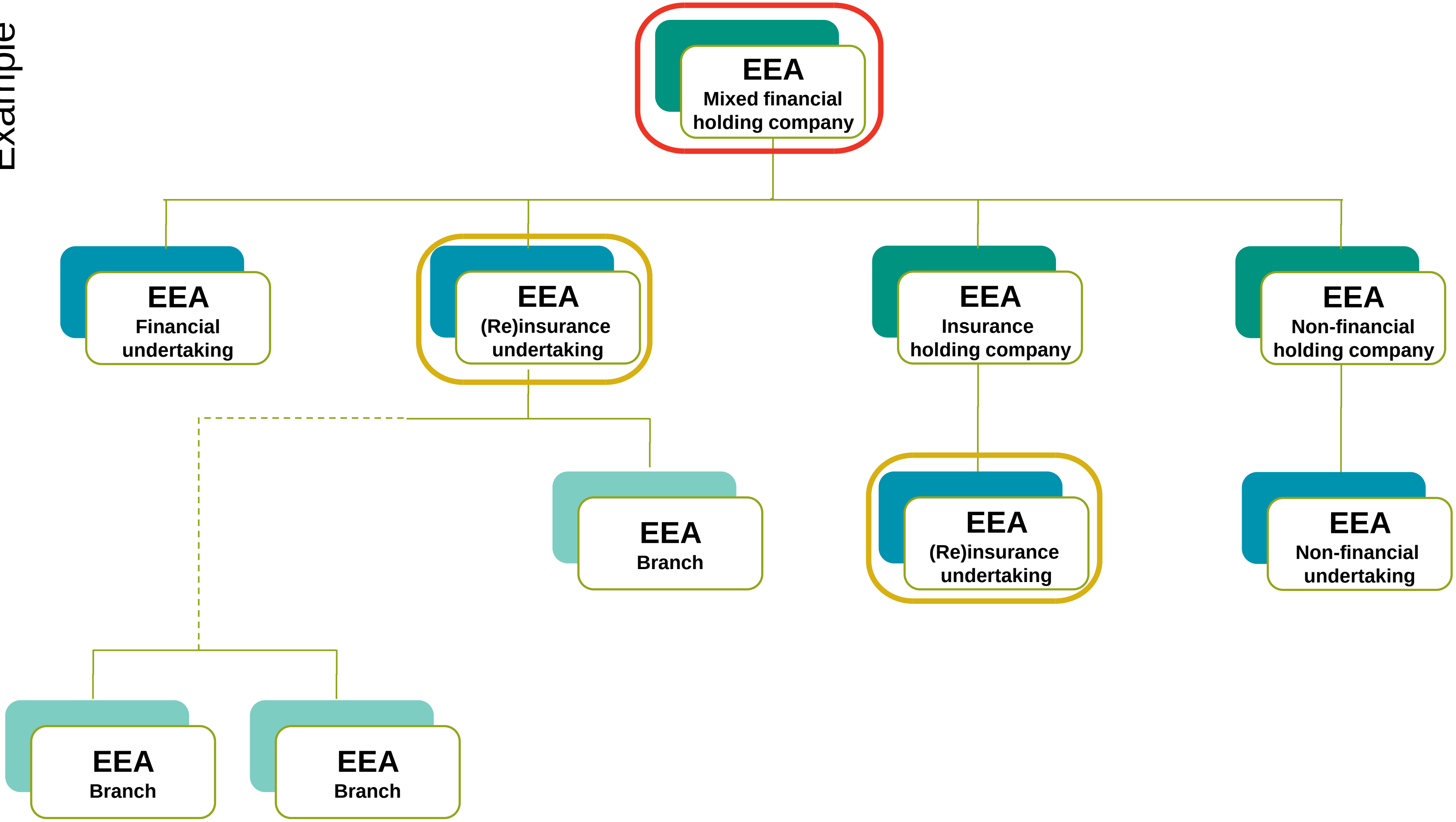
Example



Example: Part VII Transfers

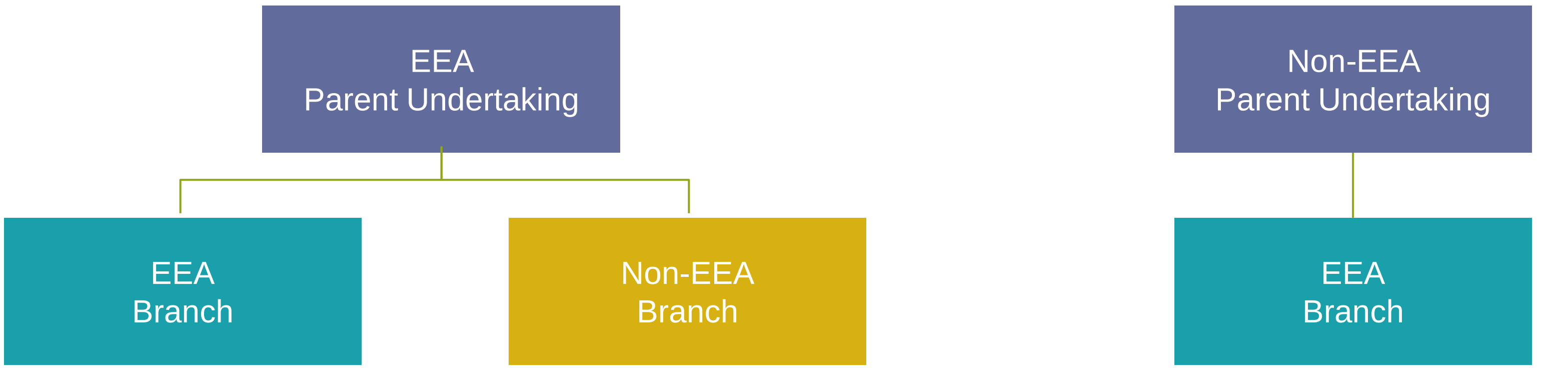
2 solo SCRs and 1 group SCR

Example



Options: Branches

Treatment of branches (Title 1, Chapters III and IX)



Branches with EEA Parent

- Consolidated into the EEA undertaking of which it is a branch (30, 33)
- Subject to the same governance requirements as the undertaking of which it is a branch (33)
- Major EEA branch supervisors involved in college.

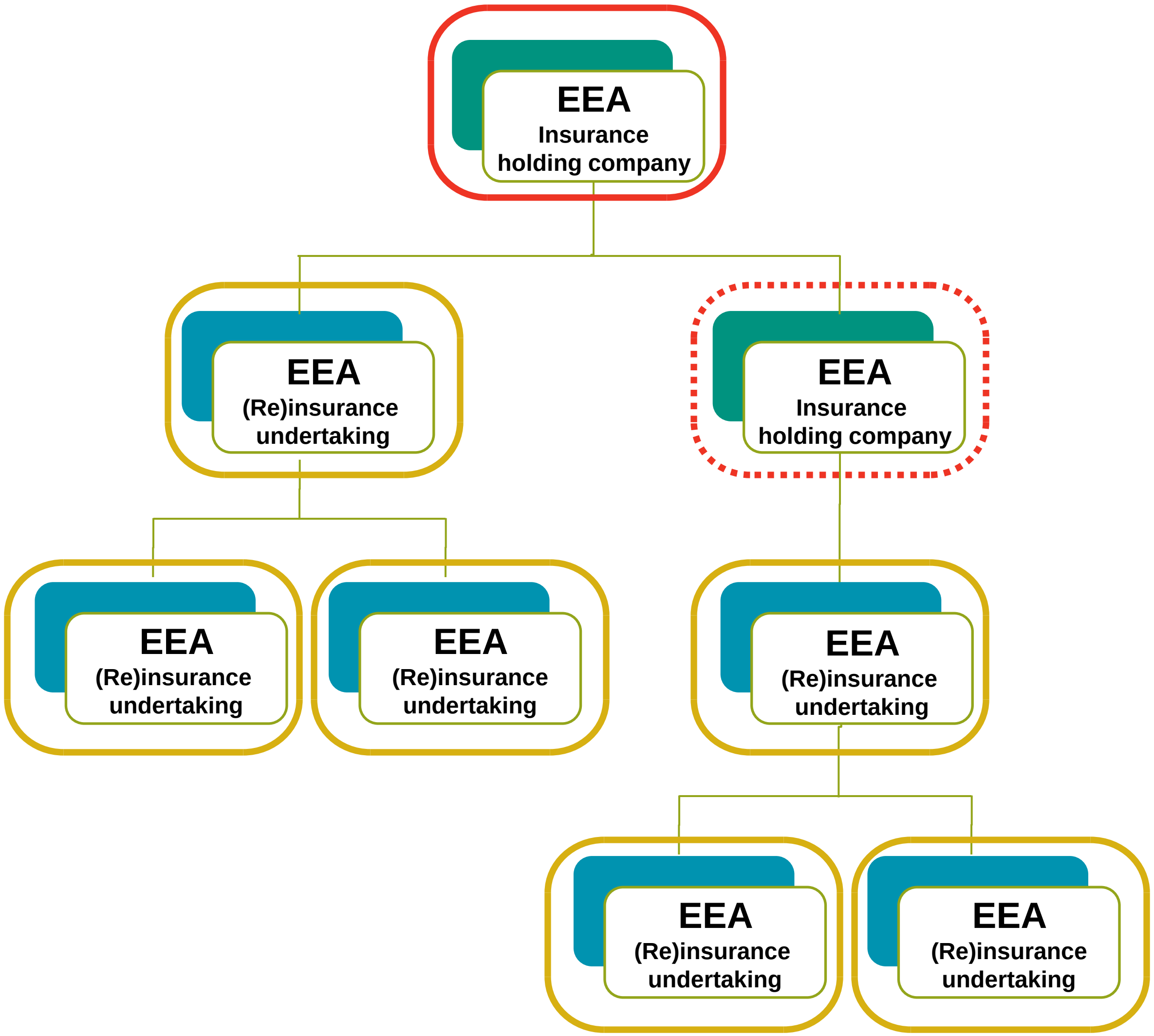
Branches with Non-EEA Parent

- Calculate an MCR and SCR (162[2]f) and hold eligible own funds either:
  - MCR in local jurisdiction and difference to SCR within Community (166[4])
  - With approval: calculate one SCR for all branches in the Community and hold eligible own funds in one Member State (167[1])
- Assets equal to at least half of the absolute floor* and deposits equal to at least a quarter of the absolute floor* must be held (162[2]e)

* (i) EUR 2 200 000 for non-life insurance undertakings, including captive insurance undertakings, save in the case where all or some of the risks included in one of the classes 10 to 15 listed in Part A of Annex 1 are covered, in which case it shall be no less than EUR 3 200 000,
(ii) EUR 3 200 000 for life insurance undertakings, including captive insurance undertakings,
(iii) EUR 3 200 000 for reinsurance undertakings, except in the case of captive reinsurance undertakings, in which case the Minimum Capital Requirement shall be no less than EUR 1 000 000.

Example: Branches

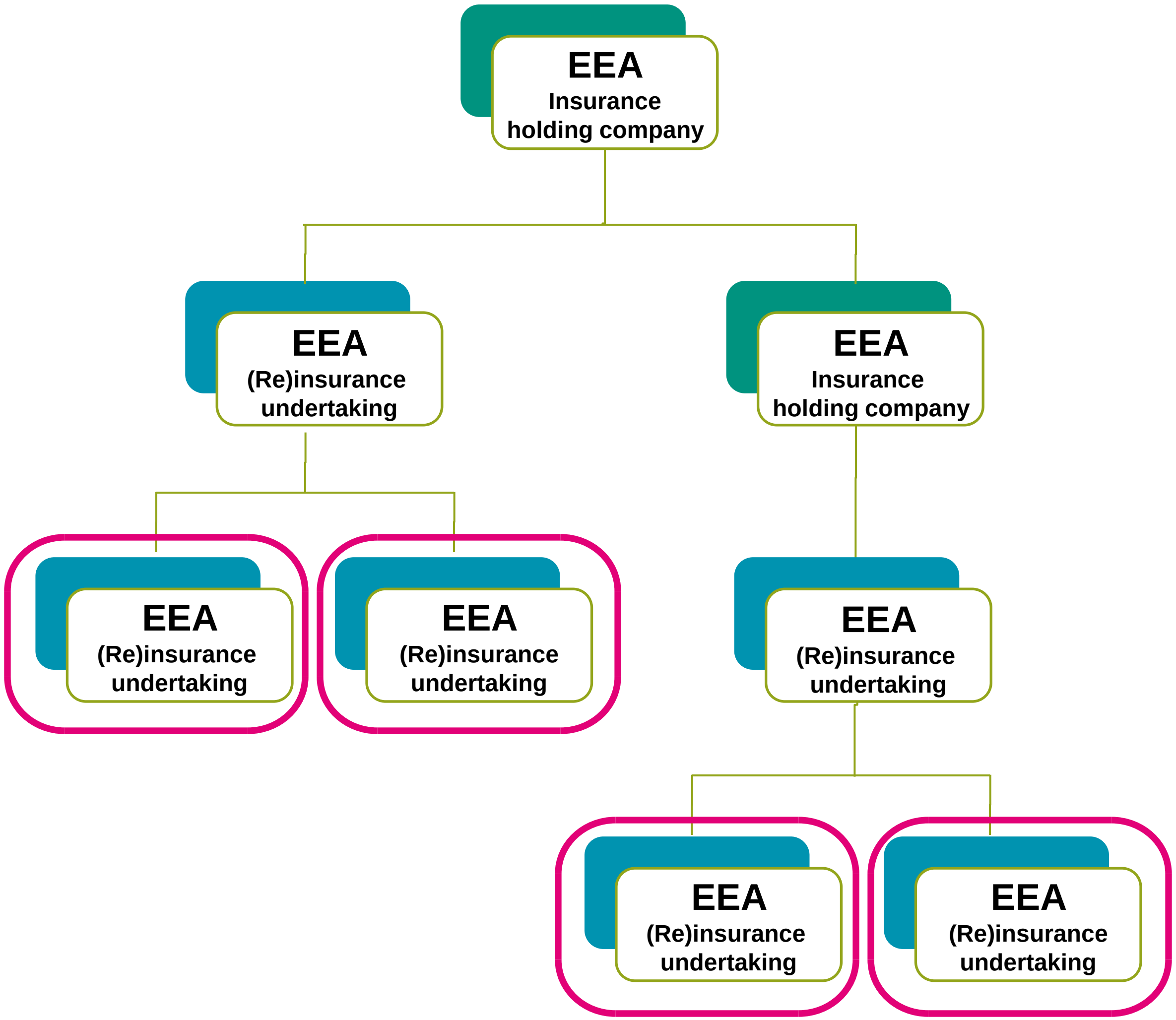
6 solo SCRs, 1 group SCR and 1 possible sub-group



Example

Example: Branches

Move to a branch structure

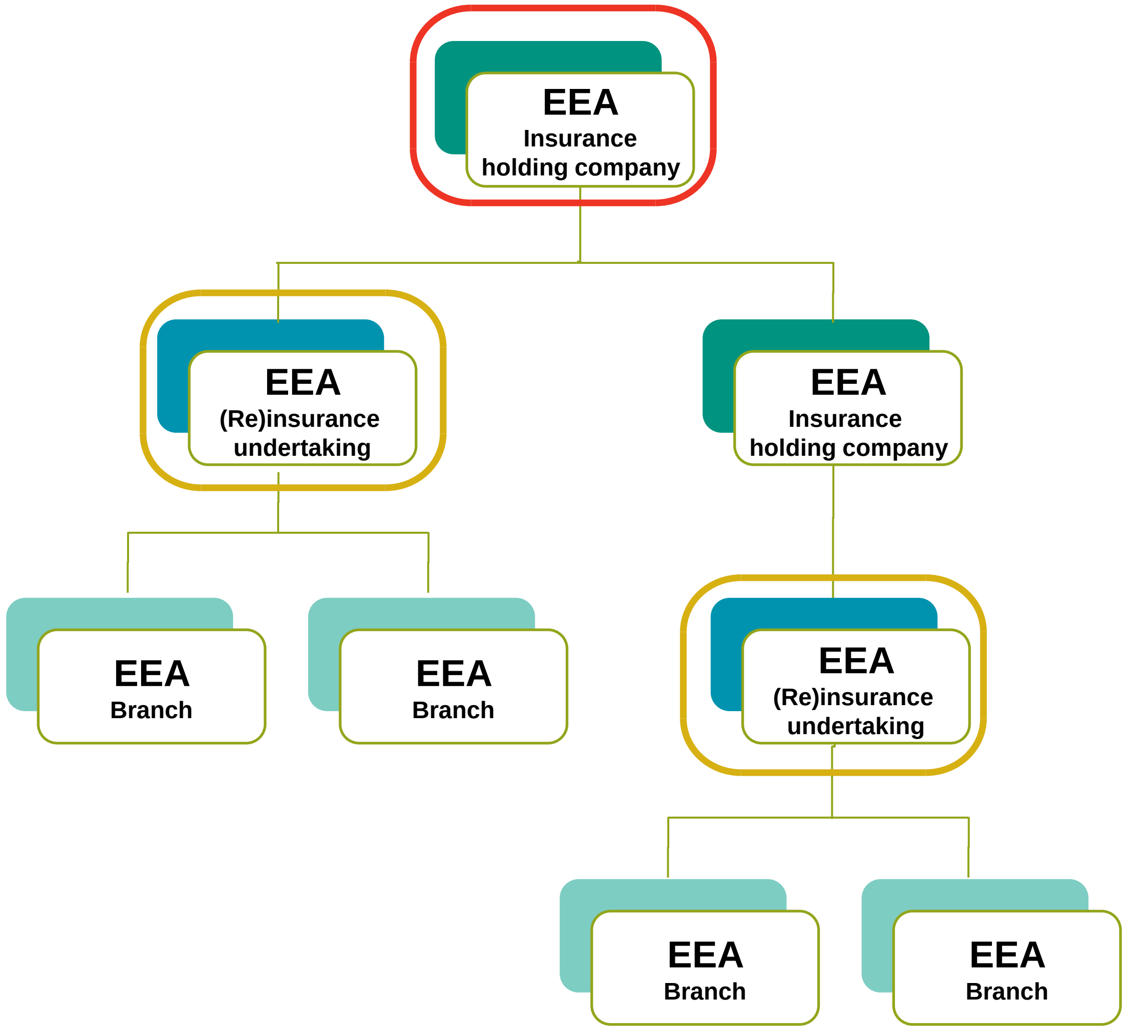


Example

Example: Branches

2 solo SCRs, 1 group SCR and flexibility in location of capital

Example



Option: European Holding Company

Other Methods under Article 262(2) of the Level I Directive

• In the case where there is not a European Holding Company and the group has more than one solo insurance entity within the EEA, the group is exposed to the supervisory college's interpretation of Article 262. This Level 1 Directive Article gives various supervisory options to the college, including:

- requiring the group to establish a European holding company;
- applying Solvency II to a parent company outside the EEA;
- or no further action.

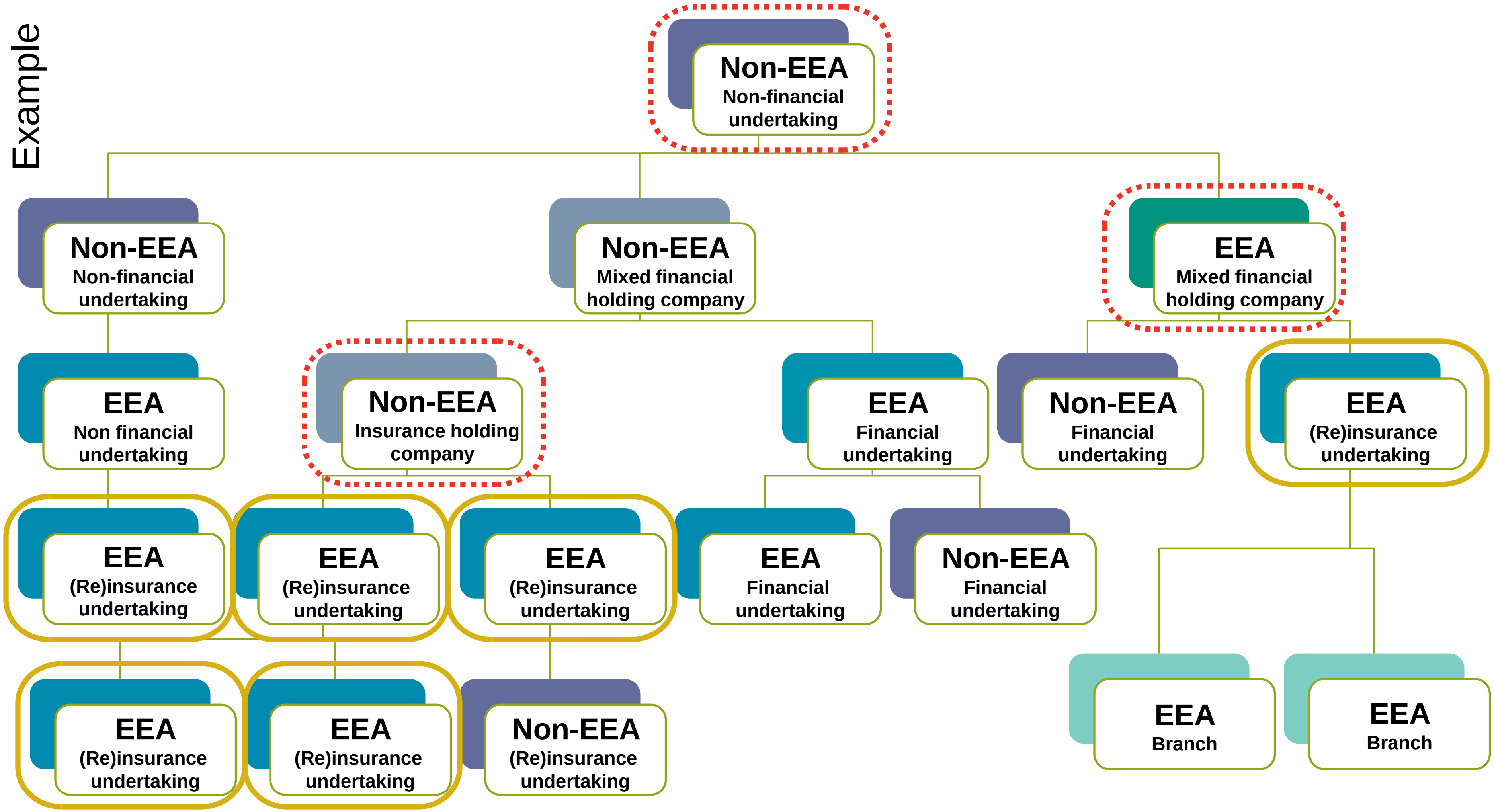
➢ Where a European Holding Company exists and the topmost insurance holding company is in a third country, Article 262[2] allows the EEA college of supervisors to limit the application of Solvency II to the European sub-group.

➢ In order for this to be approved the group needs to demonstrate effective risk management within the European community.

Example: European Holding Company

6 solo SCRs and 3 possible group/sub-groups.

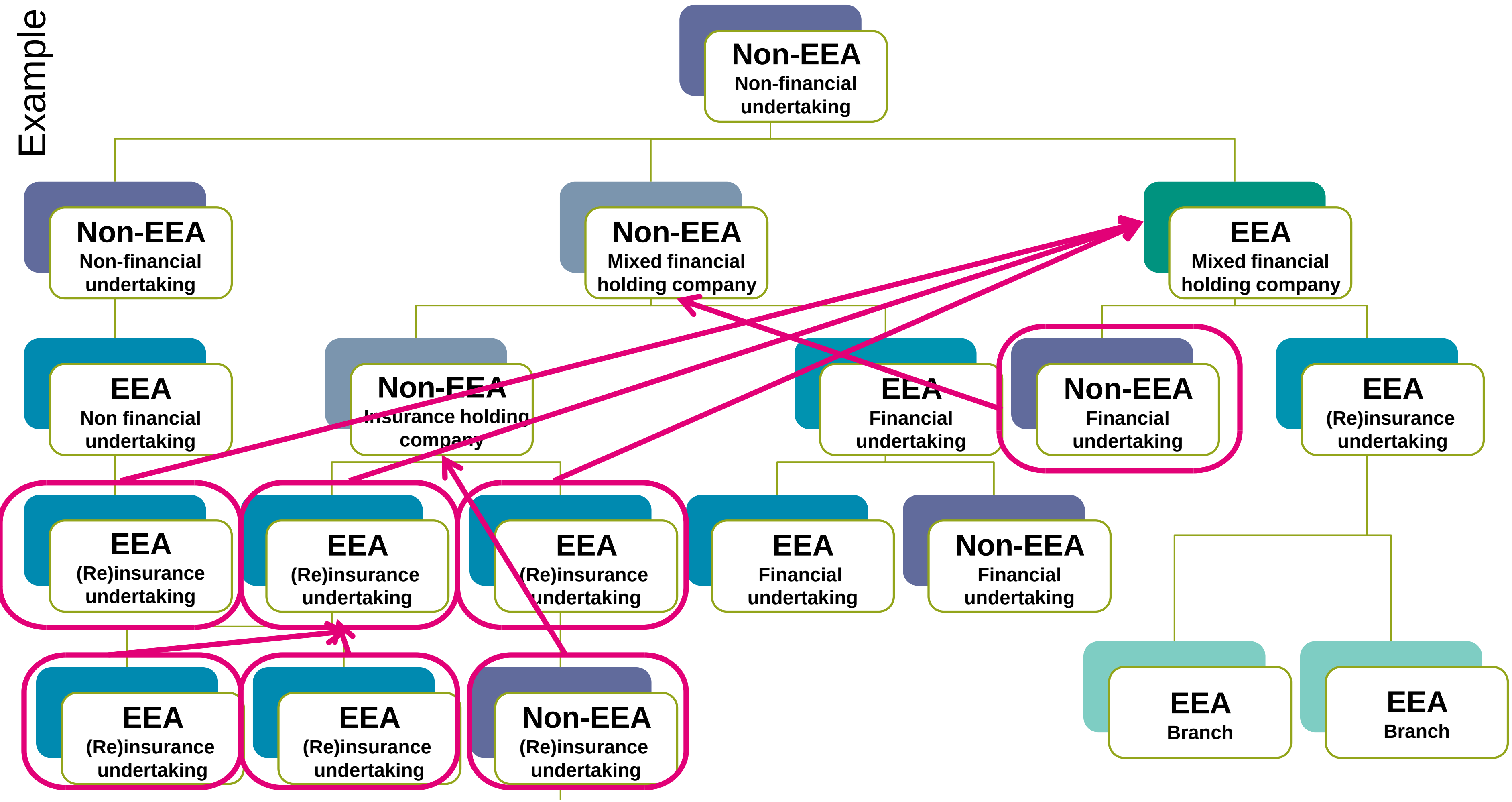
Example



Example: European Holding Company

Move to use of a European holding company for EEA insurance business

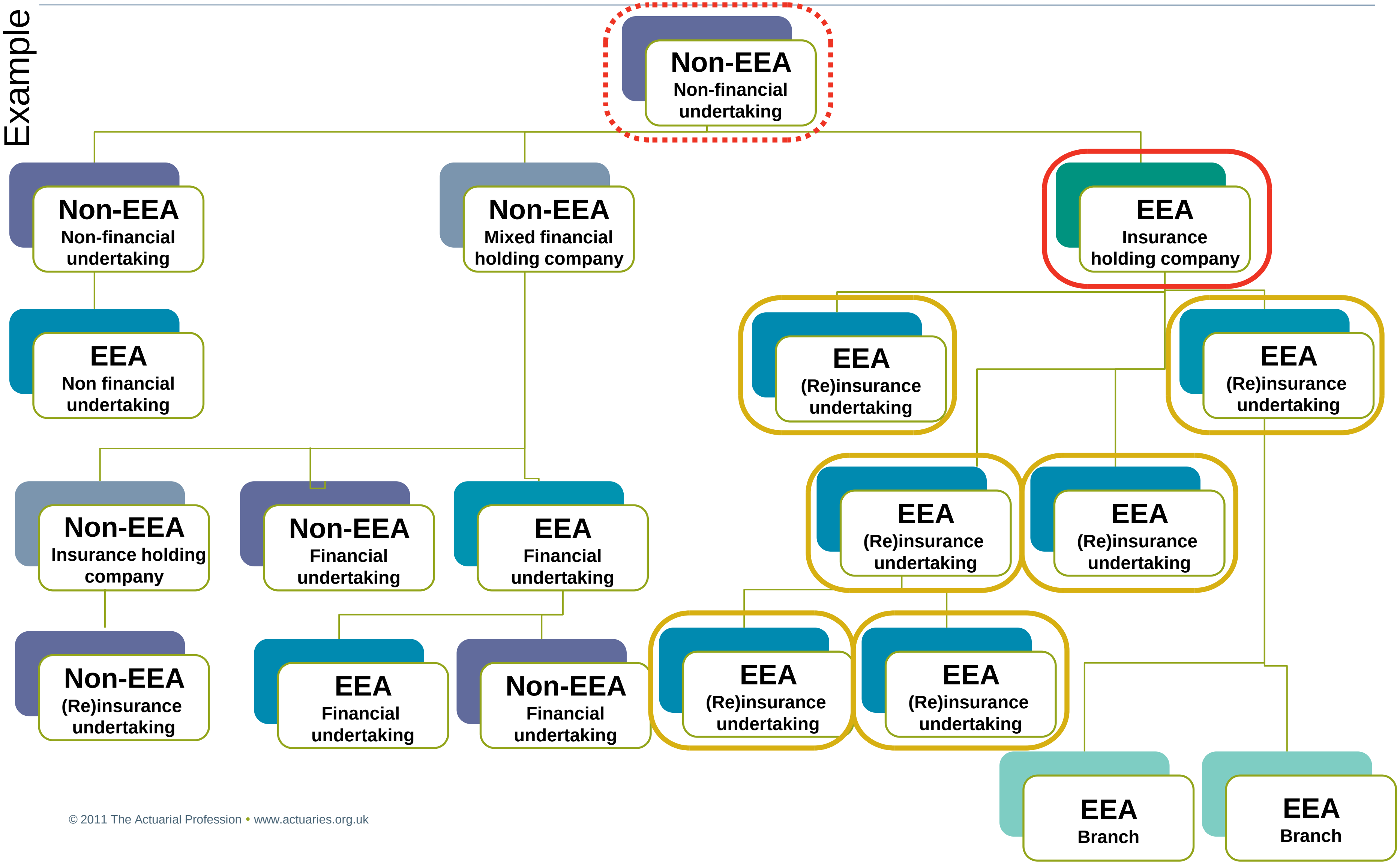
Example



Example: European Holding Company

6 solo SCRs and 1 likely EEA group SCR

Example



Option: Corporate Simplification

Removal of dormant companies

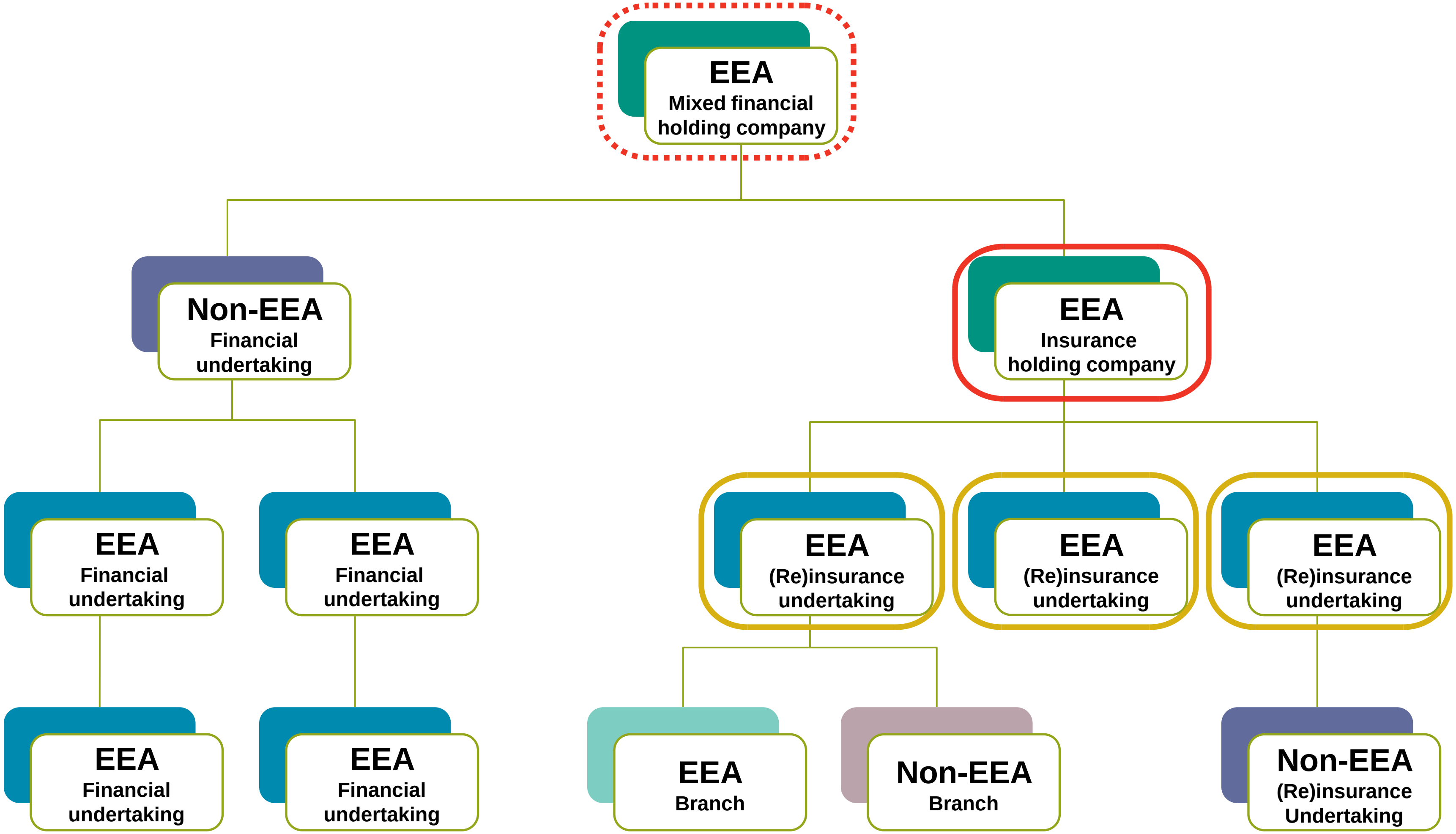
The Solvency II Directive will require insurance companies to calculate a Group SCR from the date of implementation. One issue for insurers in calculating this group SCR is that they need to be sure that they have included a capital charge for all the relevant companies to which Solvency II applies. The more simplified the company structure can be, the more certainty and clarity there is in determining the Group SCR result. Corporate Simplification removes dormant companies. Further benefits include:

- ✓ Ease of demonstrating to the local regulator that all relevant companies have been included in the Group SCR.
- ✓ Ease of conversation with College of regulators.
- ✓ Ease of communication to board and other internal governance committees.

Example: Corporate Simplification

3 solo SCR and 1 likely EEA group SCR

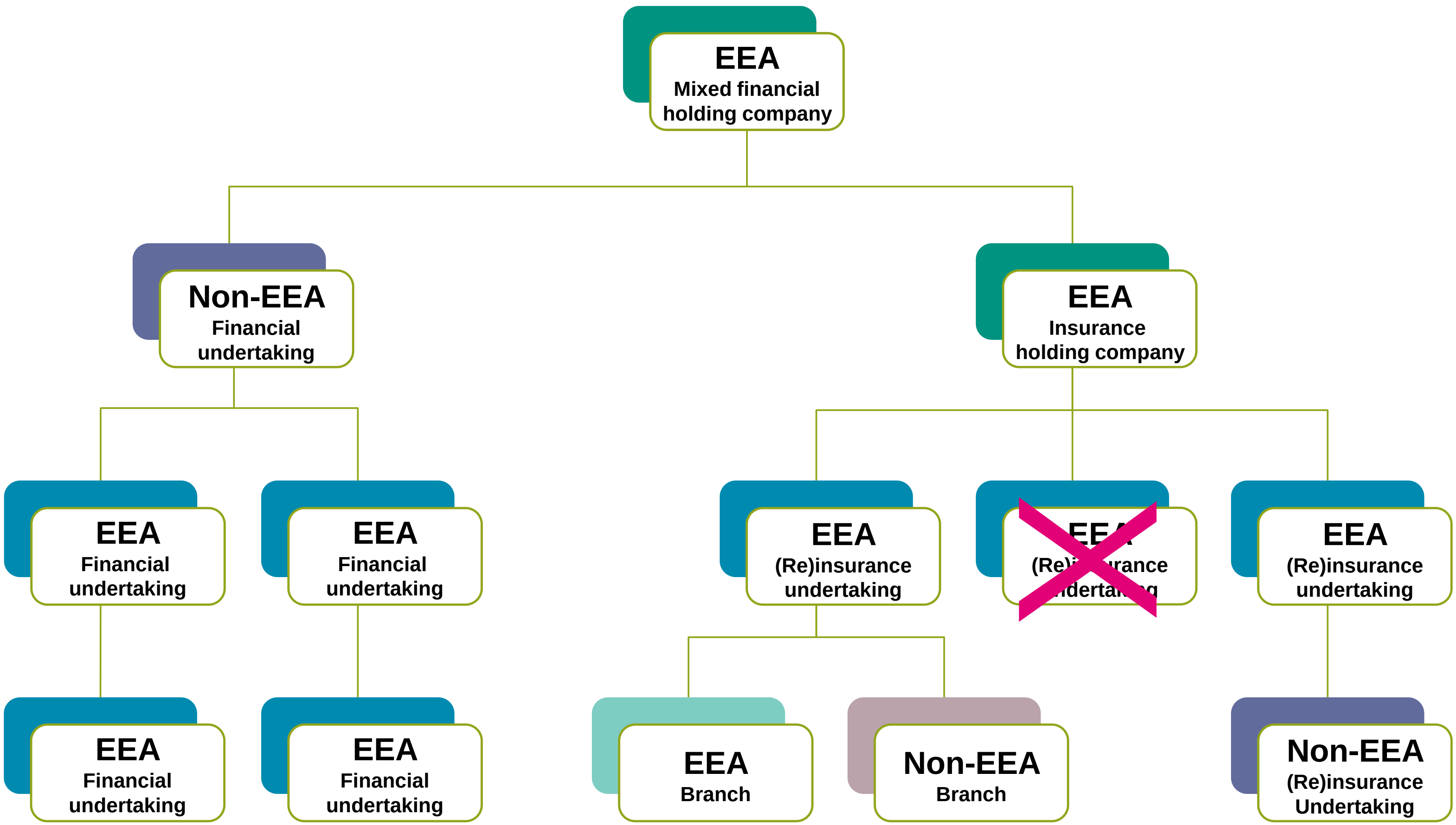
Example



Example: Corporate Simplification

Removal of dormant entities

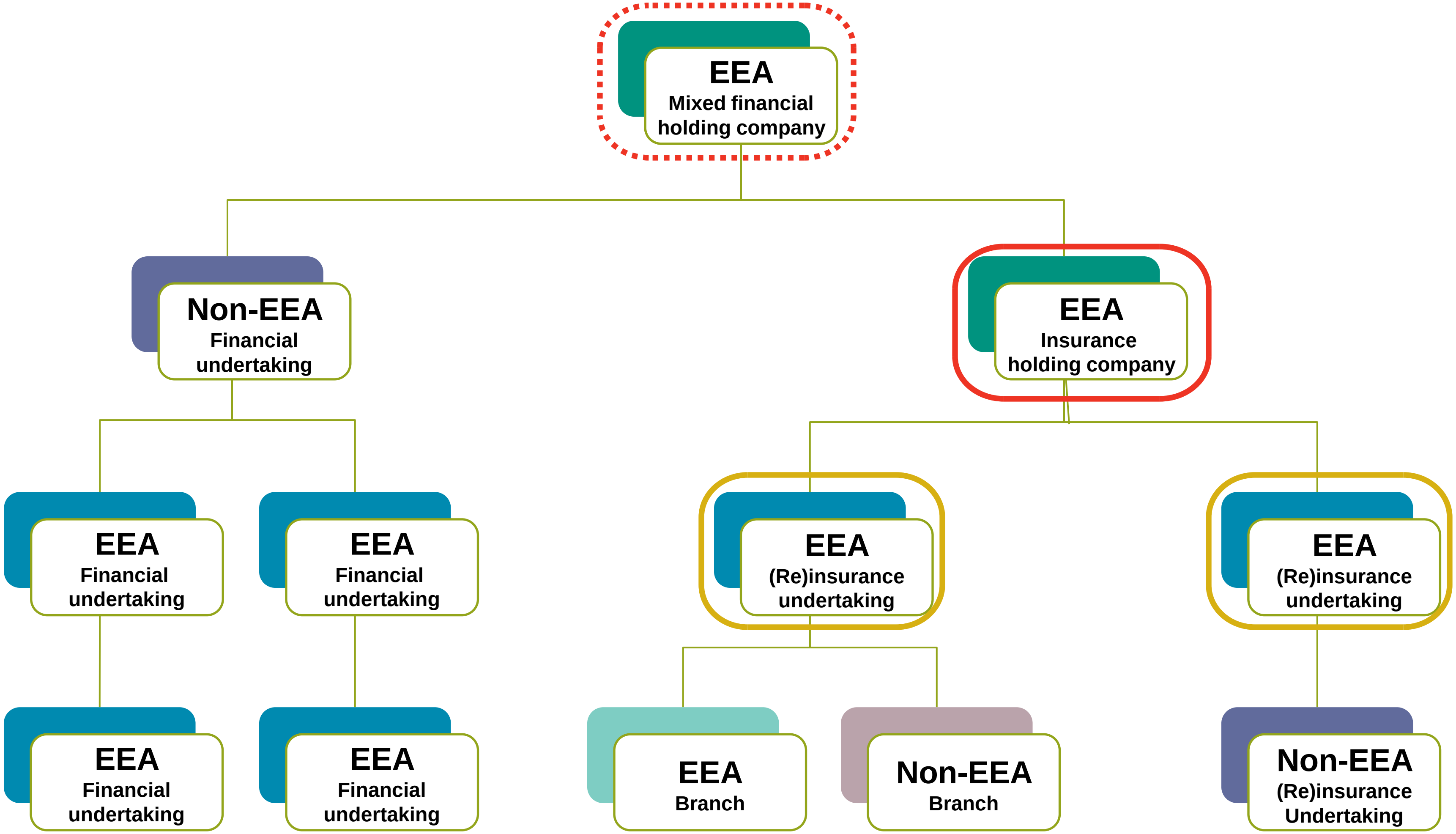
Example



Example: Corporate Simplification

2 solo SCRs and 1 likely EEA group SCR

Example



Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenters.

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Appendix I: Equivalence Excerpts from Solvency II

Group Solvency, Group Supervision and Reinsurance

Reinsurance
Article 172
Equivalence

1. The Commission shall adopt implementing measures specifying the criteria to assess whether the solvency regime of a third country applied to reinsurance 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 reinsurance 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 undertakings authorised in accordance with this Directive.

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, solely for the purposes of that calculation, be treated 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 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 so doing, the group supervisor shall consult the other supervisory authorities concerned and CEIOPS 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. 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 3 of this Article, a decision as to whether the solvency regime in a third country is equivalent to that laid down in Title I, Chapter VI. Those decisions shall be regularly reviewed to take into account any changes to the solvency regime laid down in Title I, Chapter VI, and to the solvency regime in the third country.
5. Wherein accordance with paragraph 4 the Commission adopts a decision on equivalence of the solvency regime in a third country, paragraph 2 shall not apply. Where a decision adopted by the Commission in accordance with paragraph 4 concludes that the solvency regime in a third country is not equivalent, the option referred to in the second subparagraph of paragraph 1 to take into account the Solvency Capital Requirement and eligible own funds as laid down by the third country concerned shall not be applicable and the third-country insurance or reinsurance undertaking shall be treated exclusively in accordance with the first subparagraph of paragraph 1.

Risk management and internal control
Article 246
Supervision of the system of governance

1. The requirements set out in Title I, Chapter IV, Section 2 shall apply *mutatis mutandis* at the level of the group. Without prejudice to the first subparagraph, the risk management and internal control systems and reporting procedures shall be implemented consistently in all the undertakings included in the scope of group supervision pursuant to Article 213(2)(a) and (b) so that those systems and reporting procedures can be controlled at the level of the group.
2. Without prejudice to paragraph 1, the group internal control mechanisms shall include at least the following:
    a. adequate mechanisms as regards group solvency to identify and measure all material risks incurred and to appropriately relate eligible own funds to risks;
    b. sound reporting and accounting procedures to monitor and manage the intra-group transactions and the risk concentration.
3. The systems and reporting procedures referred to in paragraphs 1 and 2 shall be subject to supervisory review by the group supervisor, in accordance with the rules laid down in Chapter III.
4. Member States shall require the participating insurance or reinsurance undertaking or the insurance holding company to undertake at the level of the group the assessment required by Article 45. The own-risk and solvency assessment conducted at group level shall be subject to supervisory review by the group supervisor in accordance with Chapter III. Where the calculation of the solvency at the level of the group is carried out in accordance with method 1, as referred to in Article 230, the participating insurance or reinsurance undertaking or the insurance holding company shall provide to the group supervisor a proper understanding of the difference between the sum of the Solvency Capital Requirements of all the related insurance or reinsurance undertakings of the group and the group consolidated Solvency Capital Requirement. Where the participating insurance or reinsurance undertaking or the insurance holding company so decides, and subject to the agreement of the group supervisor, it may undertake any assessments required by Article 45 at the level of the group and at the level of any subsidiary in the group at the same time, and may produce a single document covering all the assessments. Before granting an agreement in accordance with the third subparagraph, the group supervisor shall consult the members of the college of supervisors and duly take into account their views or reservations. Where the group exercises the option provided in the third subparagraph, it shall submit the document to all supervisory authorities concerned at the same time. The exercise of that option shall not exempt the subsidiaries concerned from the obligation to ensure that the requirements of Article 45 are met.

Article 260
Parent undertakings outside the Community: verification of equivalence

1. In the case referred to in Article 213(2)(c), 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 Article 213(2)(a) and (b). 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. NE0 01/533LOfficial Journal of the European Union L 335/101
2. 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).
3. 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 2, 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.

Article 261
Parent undertakings 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.