

Insurance Industry Group: Global Corporate Insurance & Regulatory Bulletin

US – Solvency II – Bermuda, Switzerland and US recommended by CEIOPS for First Wave Assessment for Equivalence

The implementation of Solvency II will have a significant impact on capital requirements for the insurance and reinsurance business in the European Union. The impact of Solvency II on cross-border reinsurance transactions and multinational groups with operations both within and outside of the European Union will depend, in part, upon the equivalence determinations that will be made with respect to non-European Union jurisdictions. Bermuda, Switzerland and the U.S. are likely to be the subjects of the first wave of equivalence determinations, based upon recent recommendations by the Committee of European Insurance and Occupational Pensions Supervisors (“CEIOPS”) to the European Commission.

There are three equivalence assessments to be made under the Solvency II Directive. The relevant articles within the Solvency II Directive under which equivalence assessments will be made are Article 172, Article 227 and Article 260. Article 172 addresses the equivalence of reinsurance supervision; Article 227 addresses the group solvency calculation; and Article 260 addresses the equivalence of third country group supervision.

In June 2010, the European Commission requested that CEIOPS provide recommendations as to which countries should be included in the first wave of third country equivalence assessments. In July 2010, CEIOPS issued its Consultation Paper 81 “Draft CEIOPS Advice to the European Commission – Equivalence assessments to be undertaken in relation to Articles 172, 227 and 260 of the Solvency II Directive”. Bermuda, Switzerland and Japan (in relation to Article 172 only) were included as likely first wave jurisdictions in that draft. Comments to that paper from interested parties were to be provided by 13 August 2010.

CEIOPS issued its final advice to the European Commission on 31 August 2010. When considering the countries to be included in the first wave, CEIOPS focused primarily on the risk-based nature of the third country regulatory regime and the materiality of an equivalence finding to European Union insurance and reinsurance undertakings and their policyholders. CEIOPS recommended that Bermuda and Switzerland be included in the first wave of equivalence assessments in respect of all three articles. Somewhat surprisingly, CEIOPS also recommended that the United States be included in the first wave of assessments in respect of Article 172 (reinsurance supervision) and Article 227 (group solvency calculation). Japan interestingly was not included, reportedly due to reservations expressed by the Japan regulators about being part of the first wave assessments.

The European Commission is expected to decide whether to act on the recommendations of CEIOPS in October 2010. CEIOPS is then expected to start individual assessments of the first wave countries and will consult on its draft advice to the European Commission in March 2011. CEIOPS is scheduled to give its final advice on the individual assessments in July 2011. The European Commission is then expected to make its decision in June 2012. Solvency II is scheduled to become effective on 1 January 2013.

David Alberts and John Drnek

UK – Speech by Ken Hogg of the FSA on the future of the life insurance industry

On 1 September 2010, Ken Hogg, the director for the insurance sector at the FSA, delivered a speech at the CILA II Seminar regarding the future of the life insurance industry.

The speech explored how the recent economic crisis has affected the life insurance sector and provided a reminder that firms need to (i) increase their attention to capital management and planning, with a particular focus on the risk of a further downturn in the economy and (ii) review their strategies and plans.

Ken Hogg then discussed the new regulatory framework for financial services which will be introduced from 2012 and, importantly, how the FSA will act in the period prior to these changes. Ken Hogg highlighted that the FSA “*will continue to focus on delivering the policies and reforms required to ensure stronger, more proactive regulation, creating a more stable economy and better outcomes for consumers. We will continue to progress our core reforms, such as the RDR, the Mortgage Market Review, the implementation of Solvency II and our work to progress the regulatory philosophy of intensive supervision. We will continue to be at the forefront of the debate on, and reform of, financial regulation, both domestically and internationally*”.

The speech then reviewed in detail :

1. the FSA's with-profits review and the publication of the FSA's findings;
2. the FSA's retail distribution review, one of the FSA's core reforms which will remain on the regulatory agenda;
3. Solvency II, which Ken Hogg classed as another core reform which will continue at pace; and
4. Government reforms, specifically those beyond the changes to the regulatory framework which will also affect the insurance sector.

Lastly, Ken Hogg discussed the impact of all the above factors on life insurance companies. Specifically, Ken Hogg raised the following questions which life insurers will need to answer:

1. *“How will you access customers in a post retail distribution review environment? Without the influence of commission, you will need to find ways of making products visible and attractive to consumers in Independent Financial Advisers’ shop windows;*
2. *If you are a Group Personal Pension provider, how will the introduction of NEST and auto-enrollment affect your firm’s retention planning and profitability?; and*
3. *How will Solvency II affect your ability to provide products that meet demand?”*

To view a summary of Ken Hogg’s full speech, please click [here](#).

Ian Slingsby

CHINA/HONG KONG - CIRC Permits Insurance Companies to Diversify Their Investments into Private Equity and Real Estate Sectors

The China Insurance Regulatory Commission (“**CIRC**”) now permits those insurance companies which are subject to its regulation to diversify their investments into the private equity and real estate sectors pursuant to the “Interim Measures for the Administration of Utilisation of Insurance Funds”, effective 31 August 2010.

The CIRC has also issued the “Interim Measures on Investment of Insurance Funds in Equity” (“**PE Regulations**”) and “Interim Measures on Investment of Insurance Funds in Real Estate” (“**RE Regulations**”), effective 5 September 2010, which provide more detailed guidelines.

PE REGULATIONS

The PE Regulations permit an insurance company, subject to meeting certain qualification requirements, to invest in limited industry sectors:

- up to 5% of total assets in direct equity investments in unlisted companies; and
- up to 4% of total assets in private equity funds,

but the aggregate of all such investments cannot exceed 5% of total assets.

An insurance company cannot utilise leverage in making such investments.

The PE Regulations prescribe restrictions on the type (and growth stage) of companies or private funds in which an insurance company can invest. Direct equity investments by an insurance company are limited to investments in other insurance companies, finance companies, facilities for the elderly, or hospitals that are related to the insurance industry. For investments in private equity funds, an insurance company is prohibited from investing in venture capital funds. An insurance company is not permitted to set up a private fund or fund management company itself.

The PE Regulations also require an insurance company to analyse and monitor the investment activities of private equity funds in which it invests and to ensure appropriate corporate governance mechanisms are in place.

RE REGULATIONS

The RE Regulations provide that an insurance company, subject to meeting certain qualification requirements, can invest:

- up to 10% of total assets in real estate; and
- up to 3% of total assets in real estate related financial products e.g. a real estate fund,

but the aggregate of all such investments cannot exceed 10% of total assets.

An insurance company cannot utilise leverage in making such investments.

An insurance company may invest in commercial real estate (the term is not clearly defined), office buildings, housing for the elderly and hospitals, but it cannot invest in residential property, develop real estate, or set up, invest in or own real estate development companies. The RE Regulations also contain a set of certification requirements for the real estate projects that an insurance company may invest in. The RE Regulations permit an insurance company to invest in real estate related financial products, but the procedures for such investments will be subject to separate guidelines to be promulgated by the CIRC.

Both regulations permit investment management companies to manage, or offer investment products for, insurance companies' private equity or real estate investments. The regulations contain slightly different qualification requirements for such management companies, which include, among others, registration under PRC law, registered capital requirements, asset under management requirements and investment personnel and qualification requirements.

CONCLUSION

The growth and development of RMB funds (investment funds whose capital commitments and contributions are denominated in China's domestic currency) in China has been significantly hampered by the scarcity of sophisticated PRC institutional investors. PRC insurance companies have long been considered to fill such a role. The regulations represent an important first step in opening the door for insurance companies to participate in investments in private equity and real estate funds in China. They are also expected to, over time, further stimulate the growth of RMB funds.

Phill Smith and Yong Ren

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