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Legal Update
September 2015

Solvency II: Equivalence Decisions

Introduction

1. On 5 June 2015 the European Commission published its first set of third country equivalence decisions made under Directive 2009/138/EU[1] (**"Solvency II"**). These decisions relate to Switzerland, Australia, Bermuda, Brazil, Canada, Mexico and the United States of America (**"US"**). This legal update considers what the decisions mean and their potential effect on insurers and reinsurers in these third country jurisdictions. The update first outlines the scope of Solvency II generally and then focuses on its extraterritorial impact, particularly the meaning of third country 'equivalence' under the Solvency II regime and the effect of an 'equivalence decision'. Finally, the update looks at the decisions made thus far by the Commission and the practical effect these decisions will have on the business of (re)insurers both within and outside the European Economic Area ("EEA").[2]

The scope of Solvency II

2. Solvency II establishes a new solvency and supervisory regime for the EEA insurance market. It will enter into force on 1 January 2016 and will replace 14 insurance and reinsurance directives (previously known collectively as **"Solvency I"**). This new prudential regulatory regime is aimed at developing a single market for the EEA insurance sector, which is one of the largest sectors in the EEA accounting for around a third of worldwide insurance business.[3]

3. Solvency II primarily applies to direct life and non-life insurance and reinsurance undertakings which are established in, or which wish to become established in, the EEA[4] and which are not small (re)insurance undertakings.[5] The nature of some of its provisions and requirements, however, means that it will also have an impact on non-EEA (re)insurers in certain situations.

The extraterritorial effect of Solvency II

4. The extraterritorial effect of Solvency II is significant. In addition to its application within the EEA, there are three areas in which Solvency II has extraterritorial effect. Solvency II may affect:

   (a) non-EEA reinsurers when involved in EEA reinsurance contracts;

   (b) non-EEA subsidiaries of EEA (re)insurers; and

   (c) non-EEA (re)insurers with EEA subsidiaries but which do not have an EEA sub-group with an EEA parent.

   The aim of these extraterritorial provisions is to prevent distortions of competition and regulatory arbitrage by creating a level playing field amongst all (re)insurers active in the EEA, regardless of whether the (re) insurance group is based inside or outside the EEA.

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1 As amended by Directive 2014/51/EU (**"Omnibus II"**).
2 At the time of writing , the EEA consists of the 28 Member States of the European Union plus Iceland, Lichtenstein and Norway.
3 Insurance Europe Key Facts report, found at: http:// www.insuranceeurope.eu/uploads /Modules / Publications /european -insurance - - - key-facts-2014. pdf. Accessed 1/7/2015.
4 See Article 2(1) Solvency II.
5 See Article 4 Solvency II.

5. In respect of category (a) in the above paragraph, non-EEA reinsurers writing reinsurance contracts with EEA entities may be affected because Solvency II does not prevent EEA regulators imposing additional regulatory requirements on contracts of reinsurance written by reinsurers from a country outside the EEA which has not been deemed to have a solvency regime equivalent to Solvency II. Articles 172(3) and 173 of Solvency II prevent Member States from treating reinsurance contracts written by reinsurers from outside the EEA less favourably than those written by EEA insurers but only where an equivalence decision has been adopted for the third country in which the non-EEA reinsurer is based. So in the absence of an equivalence decision, Member States may impose additional requirements on non-EEA reinsurers. The most commonly imposed additional requirements relate to collateral: a non-EEA reinsurer can be subject to increased collateral requirements within the EEA, thus placing the non-EEA reinsurer at a competitive disadvantage to EEA reinsurers (and those non-EEA reinsurers whose home jurisdiction has been deemed equivalent) who are protected from such extra requirements by Solvency II.

6. In relation to category (b) above, Article 227 of Solvency II prima facie requires EEA (re)insurers to calculate consolidated group solvency across their global insurance business. Where the EEA (re)insurer has a subsidiary (or subsidiaries) based in a non-EEA jurisdiction, there is likely to be a discrepancy between the methods of calculation of solvency used by that subsidiary and those used by the EEA parts of the business: the subsidiary will typically use the locally accepted method of its home jurisdiction and the EEA-based entities will use the methods of Solvency II. To avoid this discrepancy, Solvency II requires the subsidiary to use Solvency II formulae for European reporting purposes. This creates consistency across the group but is likely to create an additional and duplicative burden as the subsidiary may be required to calculate and report solvency data on two bases.

7. If the subsidiary is required to use two different methods for calculation of solvency, it is possible that the results of the calculations will differ between the local regime and the Solvency II regime. For example, a subsidiary might be given credit under its local system for anticipated income or credit but Solvency II is based on market-consistent principles and so its formulae do not give credit for anything based on future performance. The liability and asset requirements for the subsidiary could be, therefore, higher under Solvency II than they have been while the subsidiary was solely subject to the local system, suddenly requiring the subsidiary to find or maintain more assets and fewer liabilities.

8. If the home jurisdiction of the non-EEA subsidiary has been deemed equivalent, the group may take account of that jurisdiction's solvency capital requirement and the capital eligible to meet that requirement in the calculation of group solvency. If an equivalence decision has not been taken by the Commission, the EEA group supervisor, in collaboration with the European Insurance and Occupational Pensions Authority (**"EIOPA"**) and college members, may undertake an equivalence assessment[6] on its own initiative or at the request of the (re)insurer concerned.

9. A non-EEA (re)insurance group with an EEA subsidiary but not an EEA sub-group (as mentioned in paragraph 4(c) above) could encounter different problems under Solvency II. Solvency II contains provisions regarding the supervision of (re)insurers that are part of a group. These provisions potentially apply to non-EEA groups with a subsidiary in the EEA whose parent undertaking is headquartered outside the EEA. In the absence of an equivalence determination in respect of the non-EEA jurisdiction in which the group is headquartered, an EEA supervisor may decide to apply the group provisions set out in Articles 218 to 235 and Articles 244 to 258 to the worldwide group as if it were based in the EEA. Alternatively, EEA Member States have a discretion to permit their supervisors to use "other methods" which ensure appropriate supervision

6 See Article 227(2) Solvency II.

of the non-EEA group. Solvency II and EIOPA envisages an "other method" of supervision to be the requirement to establish an EEA holding company[7] so that supervision can be exercised at that level. This is because there is specific provision in Solvency II for non-EEA groups that have an EEA sub-group with an EEA parent undertaking that is itself a (re)insurer or insurance holding company. When there is such a group structure, Article 215 provides that Solvency II group supervision should only be applied at the level of the ultimate EEA parent.

10. Where a non-EEA group does not have an EEA sub-group, then it is possible that Solvency II group supervision will be applied to the worldwide group. This is not the default position as there are three other options:

    (a) A Commission decision that the non-EEA group is subject to equivalent group supervision enables reliance to be placed on that supervision as opposed to the imposition of Solvency II requirements.

    (b) As with the solvency assessment, if an equivalence decision has not been taken by the Commission, the acting EEA group supervisor,[8] in collaboration with EIOPA and college members, may undertake an equivalence assessment at the request of the non-EEA parent undertaking, the EEA subsidiaries or on its own initiative.[9] A determination by the EEA supervisor that the non-EEA group is subject to equivalent group supervision enables reliance to be placed on that supervision in the same way as a Commission equivalence decision.

    (c) Member States have a discretion to permit their national supervisors to apply other methods to ensure appropriate supervision. Those methods must be agreed by the group supervisor, after consulting the other relevant supervisors.

    In the absence of both an equivalence determination and a decision to apply "other methods" to the non-EEA group, that group is required to apply the relevant Solvency II requirements to the worldwide group as if it were based in the EEA.

11. The group provisions referred to above include the group solvency assessment summarised at paragraphs 6 – 8 of this update, the possible imposition of a group capital add-on, supervision of risk concentration and intra-group transactions, supervision of the system of governance, a requirement for a group solvency and financial condition report and a requirement that the persons running the insurance holding company are fit and proper. These requirements, if imposed, could be onerous. An EEA subsidiary of a non-EEA (re) insurance group, for example, is required to report on its individual financial condition as part of a report on the financial condition of its group.[10] This could require third country groups of insurers with an EEA element to produce full Solvency II financial condition reports, simply by virtue of one (potentially quite small) part of the group's business being caught by the group supervision regime.

12. The UK regulator, the Prudential Regulation Authority (**"PRA"**), has explained that an application may be made to the PRA for a waiver from the requirement to apply the relevant Solvency II requirements to a non-EEA worldwide group as if it were a group based in the EEA. The application should state other methods of supervision for the PRA to consider. The PRA will assess such applications on a case-by-case basis, taking into account the objectives of group supervision as specified by Solvency II. An application may be submitted before a relevant equivalence decision is made but the PRA may refrain from making a decision until an equivalence decision has been finalised.[11]

7 Article 262(2) Solvency II and Guideline 5 of *Guidelines on group solvency* EIOPA-BoS-14/181.
8 The EEA supervisor who would be the group supervisor if the Solvency II criteria (set out in Article 272(2)) were applied.
9 See Article 260(1) Solvency II.
10 It is a group supervision requirement under Article 256 that the solvency of individual subsidiaries is included in a group financial condition report.
11 See Supervisory Statement | SS9/15 *Solvency II: group supervision* March 2015, Section 9.

What is equivalence?

13. To temper its extraterritorial effect and as indicated above, certain provisions[12] of Solvency II allow the determination of whether particular elements of the prudential regimes of non-EEA countries are equivalent to the prudential regime laid down in Solvency II. Where one of these particular elements meets relevant criteria, the Commission will adopt an equivalence decision in respect of that element. Where the Commission does not adopt an equivalence decision, a national supervisor may, in respect of certain elements only, undertake an equivalence assessment based upon the same criteria.

14. There are three elements of a non-EEA prudential regime which may be deemed equivalent by the Commission. They are:

    (a) reinsurance supervision under Article 172 (see paragraph 5 above);

    (b) solvency assessment under Article 227 (see paragraphs 6 to 8 above); and

    (c) group supervision under Article 260 (see paragraphs 9 to 12 above).

    National supervisors may undertake an equivalence assessment in respect of solvency assessment and group supervision only.

15. A full equivalence decision in respect of one of these elements lasts for an unlimited period, subject to regular review. The Commission also has the power to make a decision of provisional equivalence in respect of solvency assessment (under Article 227(5)) and temporary equivalence in respect of reinsurance and group supervision (under Articles 172(4) and 260(5)) where a third country is working towards equivalence and it is an ongoing process. A temporary equivalence decision lasts up until 31 December 2020 under Articles 172(5) and 260(6). Decisions of provisional equivalence last for a ten-year period renewable for further ten-year periods under Article 227(6). In addition and as noted above, in the absence of an equivalence decision adopted by the Commission and in relation to categories (b) and (c) of paragraph 14, EEA group supervisors, in collaboration with EIOPA and college members, may undertake an equivalence assessment.

16. The effect of an equivalence decision or a positive equivalence assessment differs between the three potentially equivalent elements:

Potentially equivalent element	Effect of equivalence decision
Reinsurance supervision (Article 172)	Reinsurance contracts concluded with the equivalent non-EEA country's reinsurers shall be treated in the same manner as contracts concluded with reinsurers governed by Solvency II (i.e. EEA reinsurers) (Article 172)(3)). No possibility of equivalence assessment.
Solvency assessment (Article 227)	Member States may provide that the calculation of solvency for a non-EEA subsidiary of an EEA group can be done using the calculation methods laid down by the equivalent third country where the subsidiary is established (if the EEA group uses the deduction and aggregation method from Article 233) (Article 227)(1)). Equivalence assessment has same effect.
Group supervision (Article 260)	(Re)insurance groups that are subject to supervision by a non-EEA supervisory authority which is equivalent to the supervision provided for by Solvency II are exempt from certain Solvency II group supervision requirements (Articles 260(1) and 261). Equivalence assessment has same effect.

12 See Articles 172(2), 227(4), and 260(3) Solvency II.

The equivalence decision process

17. There are several steps to making an equivalence decision. First, a technical assessment of the third country's prudential regime is undertaken by EIOPA. Then EIOPA delivers its findings to the Commission. EIOPA may publish a report on its findings, and occasionally undertakes public consultation.[13] The Commission is required to consult with EIOPA about its technical assessment, but it is the Commission's decision whether to adopt an equivalence decision in relation to any of the three elements of the third country regime which have been assessed by EIOPA. The Commission decision can be vetoed by the European Parliament or Council.

18. The criteria to be met for a full equivalence decision can be found in Articles 378, 379 and 380 respectively of Commission Delegated Regulation 2015/35.[14] They are also laid out in Annex 1 of this update. Some examples of the criteria which are applied to non-EEA regimes include that the supervisory authorities in the country are sufficiently resourced to protect policyholders and beneficiaries; that the non-EEA country imposes adequate capital requirements on (re)insurers; and that the non-EEA country requires (re)insurers to have effective systems of governance in place.

19. For a temporary or provisional decision the criteria are less onerous. They are summarised in Annex 2 and can be found in full at Articles 172(4), 227(5) and 260(5). They include requirements for the non-EEA country to have agreed to set up a regime which will eventually be found equivalent under Solvency II and for it to have set aside resources for this purpose. There is also a requirement for the existing regime to be risk-based and for the non-EEA country to have an independent supervision system already in place. These conditions ensure that provisional equivalence is only given to countries which are already on their way to being fully equivalent.

20. An equivalence decision takes the form of a Commission Delegated Decision. A Decision is made through the procedure laid down in Article 301(2) Solvency II. This procedure allows the Commission to adopt the Decision unless the European Parliament or Council express an objection within three months or, if the three-month period is extended, six months. The final text of the Decision is then published in the Official Journal of the EU and comes into effect within 20 days of publication.

21. The first set of Decisions (alluded to above and detailed below) is currently under scrutiny from the European Parliament and Council,[15] having been proposed by the Commission. Accordingly, these Decisions are not yet final.

What has the Commission done thus far?

22. As mentioned above, the Commission released its first set of Solvency II equivalence decisions on 5 June 2015. The two decisions relate to Switzerland[16] and Australia, Bermuda, Brazil, Canada, Mexico and the US.[17]

23. Switzerland has been granted full equivalence in all three areas, meaning that its local prudential regime can be substituted for Solvency II in respect of reinsurance supervision, solvency assessment and group supervision. Australia, Bermuda, Brazil, Canada, Mexico and the US, however, have only been granted provisional equivalence in the area of solvency assessment. For these six countries, this means first, that their equivalence is not indefinite: it will expire after ten years (on 1 January 2026) subject to renewal or any further equivalence decisions being taken. Second, that there is no finding of equivalence in the areas of reinsurance supervision and group supervision: only equivalence in respect of reinsurance supervision is the object of the present Decision on the six countries other than Switzerland. Further detail on the process and results of the two Decisions can be found below.

13 As in the case of the 19 December 2014 consultation on the approach to Switzerland, Bermuda, and Japan.

14 This supplemented the original Solvency II Directive and is now par t of the Solvency II package

15 On 14 July 2015 the Council indicated that it will not object to the adoption of the two equivalence decisions but the European Parliament has extended the period for consideration of the second equivalence decision (on Australia, Bermuda, Brazil, Canada, Mexico and the US) to six months. The period for objection to the second equivalence decision will thus expire on 7 December 2015.

16 Commission Delegated Decision C(2015) 3754 final.

17 Commission Delegated Decision C(2015) 3740 final.

SWITZERLAND

24. The Commission draft Decision on Switzerland is a full equivalence decision, meaning that Switzerland has been deemed equivalent for the three purposes of Solvency II described above for an indefinite period. This means that the Commission considers the Swiss regime to provide a level of policyholder and beneficiary protection[18] comparable to that provided by Solvency II. The advice given by EIOPA to the Commission on Swiss equivalence can be found on EIOPA's website and helps explain the basis of the Commission Decision. The legislation which EIOPA considered in Switzerland and which the Commission views as equivalent includes the Swiss Financial Markets Supervisory Act 2007 (**"FINASMA"**), the Insurance Supervision Act (**"ISA"**) and the Insurance Supervision Ordinance (**"ISO"**) which entered into force on 1 July 2015.

25. The Decision explains the application of the equivalence criteria to the Swiss regime. For example, recital 10 states that the Swiss financial market supervisor has the power effectively to supervise (re)insurance activities and impose sanctions or take enforcement action where necessary; recital 11 explains that the Swiss Solvency Test is based on sound economic principles; and recital 12 states that the Swiss regime requires (re)insurers to have an effective system of governance in place.[19] The equivalence criteria is set out at Annex 1 to this update.

26. The Decision is perhaps unsurprising given that Switzerland and the EU have entered into a number of bilateral treaties and that the EU has "closer ties with Switzerland than any other non-EEA country".[20] The Decision puts particular weight on Memoranda of Understanding (**"MoUs"**) signed between Switzerland and the Member States of the EU to facilitate international co-operation.[21]

27. Practically, this full equivalence decision means that:

    (a) A Swiss reinsurer doing business in the EEA cannot be subjected to collateral requirements or any other additional requirements on top of those to which EEA reinsurers are subject under Solvency II. Reinsurance with a Swiss reinsurer is to be treated in the same way as reinsurance with EEA counterparties.

    (b) A EEA (re)insurer can complete all of the required prudential reporting for its Swiss subsidiary in Switzerland under Swiss capital requirement rules and still comply with Solvency II.

    (c) A Swiss (re)insurance group with EEA subsidiaries is exempt from the otherwise extraterritorial aspects of Solvency II group supervision. The EEA supervisor must rely on the group supervision of the Swiss regulator (FINMA) rather than conduct group supervision itself under Solvency II.

AUSTRALIA, BERMUDA, BRAZIL, CANADA, MEXICO AND THE US

28. In the Explanatory Memorandum to the Commission's draft Decision on Australia, Bermuda, Brazil, Canada, Mexico and the US, it is made clear that Article 227 equivalence is the only type of equivalence which is the subject of the Decision. As mentioned above, the Decision is also only of provisional equivalence which means it lasts for ten years[22] as opposed to a full equivalence decision which is unlimited in duration. The provisional nature of the equivalence decision, however, is not commercially as limiting as the lack of an equivalence decision under Articles 172 and 260.

18 See recital 6 Commission Delegated Decision (EU) C(2015) 375 4 (final).
19 The final report on this advice can be found at: https://eiopa.europa.eu/Pages/Consultations/CP-14041.aspx
20 European Union External Action Service webpage: EU relations with Switzerland http: //eeas .europa .eu/switzerland/ index _ en.htm.
21 See recital 16 Commission Delegated Decision (EU) C(2015) 375 4 (final).
22 See Article 227(6) Solvency II.

29. EIOPA assessed and analysed the regimes of all six of these jurisdictions but has not made all of its findings publicly available.[23] The Commission decided that all of the jurisdictions met the criteria under Article 227(5) for provisional equivalence in respect of solvency assessment but it did not consider that any of the jurisdictions met the full equivalence criteria under Article 379 of Regulation 2015/35. Further, the Commission did not consider whether any of the jurisdictions met the criteria for equivalence under Articles 172(4) and 260(5) in respect of reinsurance and group supervision.[24]

30. It is notable that the only area in which these six jurisdictions have been found equivalent is the area in which equivalence is most beneficial to EEA (re)insurers. Equivalence in respect of solvency assessment (under Article 227) means that EEA (re)insurers can allow their subsidiaries in Australia, Bermuda,[25] Brazil, Canada, Mexico and the US to continue to calculate their standalone solvency based on locally accepted methods rather than having to convert to the methods prescribed by Solvency II (for at least the next ten years) provided that they use the deduction and aggregation method[26] (see paragraphs 6 to 8 and 17 for more detail).

31. Lack of equivalence in respect of reinsurance (under Article 172) adversely affects mainly non-EEA reinsurers making the EEA market less accessible for them (see paragraphs 5 and 16 above), although it may also have consequences for EEA insurers who want to have the option of reinsuring risk with insurers outside the EEA. Lack of equivalence in respect of group supervision (under Article 260) predominantly impacts non-EEA groups of (re)insurers with EEA-based activity (see paragraphs 9 to 12 and 16 for more detail).

32. The effect of the Decision, if adopted, is significant for non-EEA (re)insurers. An EEA regulator can (continue to) impose additional requirements, such as the imposition of collateral requirements, on contracts of reinsurance which originate in any country outside the EEA save for Switzerland. Further, all non-EEA (re)insurance groups, apart from Swiss (re)insurance groups, which have EEA subsidiaries but not EEA sub-groups could be subject to Solvency II group supervision requirements as well as the group supervision exercised by its home jurisdiction. The fact that an equivalence decision has not been made in respect of group supervision, however, enables national supervisors to carry out an equivalence assessment. In the absence of both an equivalence decision and an equivalence assessment, EEA supervisors may apply "other methods" to group supervision instead of supervising the non-EEA group under Solvency II.[27] As explained at paragraph 12 above, the PRA will take a case-by-case approach and requires a non-EEA (re)insurance group to submit a waiver application requesting the use of "other methods". There are no such options in relation to reinsurance supervision.

33. Some may consider it surprising that the Commission found the US insurance regime (the largest insurance market in the world) wanting in the areas of reinsurance and group supervision but this result was certainly foreseeable when consideration is given to the fact that the EU – US insurance dialogue project, which aims to achieve improved mutual understanding of the respective insurance regulatory and supervisory regimes, started in 2012 but has still to reach an agreed conclusion about mutual recognition. For example, negotiations over reduction of collateral requirements in the US for EEA reinsurers have been ongoing for years but progress has been slow: instead Solvency II does not prevent the EEA imposing collateral requirements on US reinsurers.

23 The full text of the report on Bermuda is available online here: ht tps: //eiopa .europa .eu/ Pages / News / EIOPA- publishes-the- Final- Reports-on-full- equivalence -assessments-of- Bermuda -Japan -and-Switzerland. a spx . The full text reports on the other five jurisdictions which are the subject of this decision are not publicly available.

24 See Annexes 1 and 2.

25 Captive insurers regulated in Bermuda are excluded from the equivalency decision.

26 See Article 233 Solvency II.

27 See paragraphs 9 to 12 above.

34. The US insurance industry, through the ACLI,[28] RAA[29] and other trade associations, has been pushing the federal government to negotiate a covered agreement with the EU to prevent the above referenced potentially adverse, competitively disadvantageous outcomes from a lack of equivalence decisions by the EU. Those negotiations continue to be mired in political positioning within the federal government (at Treasury and the US Trade Representative), with the US state regulators and with the EU regulators, and time is running short. Solvency II is scheduled to take effect on 1 January 2016 and at present it appears unlikely that the US will be granted equivalence by the Commission in respect of reinsurance and group supervision. In respect of group supervision much is, therefore, in the hands of the EEA supervisors.

The equivalence assessment process

35. As Solvency II has not come into force, it is not yet possible for an equivalence assessment to be carried out. It will, as described above, be possible for EEA supervisors to make an equivalence assessment of the group supervisory regime of Australia, Bermuda, Brazil, Canada, Mexico and the US after 1 January 2016 but EIOPA guidelines[30] make clear that a later equivalence decision by the Commission would supersede any equivalence assessment. The EEA supervisors can also make equivalence assessments (in respect of both solvency assessment and group supervision) of the many non-EEA countries which are unlikely to ever be the subject of a Commission equivalence decision.

36. The EIOPA guidelines set out the methodology for equivalence assessments by national supervisors. They stress the importance of the active cooperation of the third country in the equivalence assessment process: it is determinative in the case of group supervision and lack of cooperation would lead to a non-equivalent outcome. An equivalence assessment is based on the same criteria as an equivalence decision, which are set out in Annex 1 to this update. National supervisors can conduct the assessment themselves, with assistance from EIOPA and in consultation with other EEA supervisors, or request EIOPA to carry out the assessment. Unlike an equivalence decision, there is no possibility of a temporary or provisional equivalence assessment.

37. Positive equivalence assessments require regular review: they must be reviewed at least every three years or following significant developments in the jurisdiction assessed. Negative equivalence assessments may be revisited at the request of the relevant (re)insurer or at the national supervisor's own initiative where there have been significant changes to the supervisory regime laid down Solvency II or to the supervisory regime of the non-EEA country concerned. Unless there have been such changes, it is not possible for national supervisors to take divergent equivalence decisions regarding the same non-EEA country. Equivalence assessments will have effect more broadly than just for the requesting (re)insurer or group. Accordingly, when carrying out an equivalence assessment, national supervisors must assess the entire non-EEA regime not just the regime as it applies to the (re) insurer or group concerned. For example, even if a group conducts only life insurance business, it would still be necessary for the national supervisor to assess the third country regime for non-life business.

EEA sub-groups

38. As noted at paragraph 9 above, where a non-EEA group does not have an EEA parent undertaking and is not subject to an equivalence determination by either the Commission or a national supervisor, EIOPA has suggested that national supervisors should consider requiring such a non-EEA group to establish an EEA sub-group. Such a requirement will understandably be regarded as onerous but doing so would mean that only the EEA sub-group would be subjected to Solvency II group supervision and the group solvency calculation.

28 The American Council of Life Insurers.

29 The Reinsurance Association of America.

30 See *Final Report on Public Consultation No.14/015 on Guidelines on the methodology for equivalence assessments by national supervisory authorities under Solvency II EIOPA-BoS-14/182 27 November 2014.*

39. Where an equivalence determination has been made, there is no need to create an EEA sub-group but non-EEA groups with such a structure will find themselves subject to dual regulation whilst their competitors without an EEA parent undertaking will be able to rely solely on the group supervision exercised by their home supervisor. EIOPA, if not Solvency II, has considered this dichotomy.

40. In its guidance EIOPA suggests that where the wider non-EEA group is subject to equivalent third country group supervision, the acting EEA group supervisor should rely on the group supervision exercised by the third-country supervisory authorities, and exempt the EEA sub-group from Solvency II group supervisions on a case-by-case basis but only where this would result in a more efficient supervision of the group and would not impair its supervision. EIOPA sets out criteria that the acting group supervisor should consider when deciding whether such an exemption should be granted. They are:

    (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 non-EEA group supervisor and the EEA supervisors for the group concerned is structured and well-managed through regular meetings and appropriate exchange of information within a college of supervisors to which the EEA supervisors and EIOPA are invited; and

    (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.[31]

41. EIOPA guidance is not binding on the national supervisors but the supervisors have informed EIOPA whether or not they intend to comply with it. Only Germany has stated that it will not comply with the relevant guidance because, it explains, German law does not permit a case-by-case approach. It appears, therefore, that the effect of an equivalence determination by either the Commission or a national supervisor could be to exempt an EEA sub-group from Solvency II group supervision and solvency calculation. This possibility already exists for Swiss (re)insurance groups.

What happens next?

42. The Commission has indicated[32] that there are assessments of other third country jurisdictions currently in progress and that some jurisdictions are modifying their insurance frameworks in order to facilitate equivalence decisions. In the light of this, a second package of decisions is expected in the autumn of 2015. A positive decision on reinsurance equivalence for Japan, already the subject of an EIOPA report,[33] is expected to be included in the next package. Further, given EIOPA's findings, it would not be surprising if the Commission makes a positive decision regarding group supervisory and reinsurance equivalence for Bermuda but the future is less clear for the US, Australia, Brazil, Canada and Mexico. In the meantime, non-EEA (re) insurance groups will want to consider their group structure in order to ascertain how the extraterritorial provisions of Solvency II may affect them.

31 Guideline 5 of *Guidelines on group solvency* EIOPA-BoS-14/181

32 Draft minutes of a meeting of the Commission's expert group on banking , payments, and insurance (in its insurance formation), 5 March 2015.

33 See fn. 23.

If you have any questions about any of the issues raised in this alert, please contact your usual contact or one of the lawyers listed below:

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Annex 1

Potentially-equivalent element (Directive 2009/138/EU)	**Criteria to determine equivalence** (Commission Delegated Regulation 2015/35)
Reinsurance supervision (**Article 172**)	• The supervisory authorities of the third country must have the power (by law or regulation) to effectively supervise domestic reinsurance undertakings and to impose sanctions or take enforcement action where necessary. (**Article 378(a)**) • The supervisory authorities of the third country must have the necessary means and resources, relevant expertise, and the mandate to effectively protect policyholders and beneficiaries wherever located. (**Article 378(b)**) • The supervisory authorities of the third country should always duly consider the potential impact of their decisions on the global stability of financial systems, particularly during an emergency. (**Article 378(c)**) • The supervisory authorities of the third country must take into account the potential pro-cyclical effects of their actions where exceptional movements in the financial markets occur. (**Article 378(d)**) • There must be a requirement for reinsurers to be authorised to provide business in the third country, and there must be a clear, objective, and publicly available set of written authorisation standards. (**Article 378(e)**) • The solvency regime of the third country must require domestic reinsurance undertakings to have an effective system of governance which provides sound and prudent business management including: – an adequate, transparent organisational structure with clear allocation and appropriate segregation of responsibilities; – requirements for ensuring that persons who effectively run the undertaking are 'fit and proper'; – effective processes to ensure the timely transmission of information both internally and to the relevant supervisory authorities; and – requirements for ensuring that outsourced functions/activities are effectively supervised. (**Article 378(f)**) • The solvency regime of the third country must require domestic reinsurance undertakings to have an effective risk management system comprising: – strategies, processes, and internal reporting procedures to identify, measure, monitor, manage, and report risks to which the undertaking is/could be exposed at an individual and an aggregated level and on a continuous basis; and – effective internal controls (**Article 378(g)**) • The solvency regime of the third country must require domestic reinsurance to establish and maintain effective risk-management, compliance, internal audit, and actuarial functions. (**Article 378(h)**)

- The solvency regime of the third country must require domestic reinsurance undertakings to:
  - provide third country authorities with any information necessary for supervision; and
  - disclose publicly, at least annually, a report on their solvency and financial condition. (**Article 378(i)**)
- The solvency regime of the third country requires that proposed changes to the business policy or management of domestic reinsurance undertakings, or to qualifying holdings in such undertakings, be consistent with maintaining sound and prudent management. (**Article 378(j)**)
- Assessment of the financial position of domestic reinsurance undertakings should rely on sound economic principles and solvency requirements should be based on an economic valuation of assets or liabilities. (**Article 378(k)**)
- The solvency regime of the third country must require domestic reinsurance undertakings to hold adequate financial resources, including requirements to:
  - establish technical provisions with respect to all reinsurance obligations towards policyholders and beneficiaries of reinsurance contracts;
  - invest assets held to cover technical provisions in the best interests of all policyholders and beneficiaries (taking into account any disclosed policy objective);
  - invest only in assets and instruments whose risks the undertaking can properly identify, measure, monitor, manage, control, and report;
  - meet capital requirements set at a level equivalent to that under Solvency II which ensures that beneficiaries and policyholders are adequately protected and continue to receive payments in the event of significant losses;
  - maintain a minimum level of capital (or suffer immediate supervisory intervention); and
  - meet capital requirements referred to above with own funds of sufficient quality to be able to absorb significant losses both in a going concern and in a case of winding up. (**Article 378(l)**)
- The capital requirements of the solvency regime in the third country should be risk-based to capture quantifiable risk, and any significant non-quantifiable risk should be addressed through another supervisory mechanism. (**Article 378(m)**)

	• The solvency regime of the third country must ensure timely intervention by local supervisory authorities in the event that capital requirements are not complied with. (**Article 378(n)**) • The solvency regime of the third country must provide that all persons working or who have worked for local supervisory authorities and auditors or experts acting on behalf of those authorities are bound by obligations of professional secrecy which extend to information received from all supervisory authorities. (**Article 378(o)**) • Without prejudice to cases covered by criminal law, confidential information received by all persons who work or have worked for the supervisory authorities in the third country must be kept confidential from all other persons and authorities, except in a summary or aggregate form which does not allow identification of individual undertakings. (**Article 378(p)**) • Where a reinsurance undertaking has been declared bankrupt or is being compulsorily wound up, confidential information which does not concern third parties involved in attempts to rescue the undertakings should be able to be divulged in civil or commercial proceedings. (**Article 378(q**) • The supervisory authorities of the third country which receive confidential information from other authorities must only use that information in the course of their duties or: – to check conditions attached to the business of reinsurance, systems of governance, and public disclosure and solvency assessments; – to impose sanctions; – in administrative appeals against supervisory authority decisions; or – in court proceedings relating to the solvency regime in the third country. (**Article 378(r)**) • The supervisory authorities of the third country must be permitted to exchange information received from supervisory authorities, in the discharge of their functions or detection and investigation of breaches of company law, with other authorities, bodies, or persons where that authority, body, or person is subject to an obligation of professional secrecy in the third country, and such information should only be disclosed once the express agreement of the originator has been obtained, and solely for the purposes for which the originator gave its permission. (**Article 378(s)**)

<table>
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<td>Solvency assessment
(Article 227)</td>
<td>• Assessment of the financial position of domestic (re)insurance undertakings should rely on sound economic principles and solvency requirements should be based on an economic valuation of assets or liabilities. (Article 379(a))
• The solvency regime of the third country must require domestic (re)insurance undertakings to hold adequate financial resources, including requirements to:
– establish technical provisions with respect to all (re)insurance obligations towards policyholders and beneficiaries of (re)insurance contracts;
– invest assets held to cover technical provisions in the best interests of all policyholders and beneficiaries (taking into account any disclosed policy objective);
– invest only in assets and instruments whose risks the undertaking can properly identify, measure, monitor, manage, control, and report;
– meet capital requirements set at a level equivalent to that under Solvency II which ensures that beneficiaries and policyholders are adequately protected and continue to receive payments in the event of significant losses;
– maintain a minimum level of capital (or suffer immediate supervisory intervention); and
– meet capital requirements referred to above with own funds of sufficient quality which are able to absorb significant losses both in a going concern and in a case of winding up. (Article 379(b))
• The capital requirements of the solvency regime in the third country must be risk-based to capture quantifiable risk, and any significant non-quantifiable risk must be addressed through another supervisory mechanism. (Article 379(c))
• The solvency regime of the third country should ensure timely intervention by local supervisory authorities in the event that capital requirements are not complied with. (Article 379(d))
• The solvency regime of the third country must provide that all persons working or who have worked for local supervisory authorities and auditors or experts acting on behalf of those authorities are bound by obligations of professional secrecy which extend to information received from all supervisory authorities. (Article 379(e))
• Without prejudice to cases covered by criminal law, confidential information received by all person who work or have worked for the supervisory authorities in the third country must be kept confidential from all persons and authorities, except in a summary or aggregate form which does not allow identification of individual undertakings. (Article 379(f))</td>
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	• Where a (re)insurance undertaking has been declared bankrupt or is being compulsorily wound up, confidential information which does not concern third parties involved in attempts to rescue the undertakings should be able to be divulged in civil or commercial proceedings. (Article 379(g)) • The supervisory authorities of the third country which receive confidential information from other authorities should only use that information in the course of their duties or: – to check conditions attached to the business of reinsurance, systems of governance, and public disclosure and solvency assessments; – to impose sanctions; – in administrative appeals against supervisory authority decisions; or – in court proceedings relating to the solvency regime in the third country. (Article 379(h)) • Are the supervisory authorities of the third country permitted to exchange information received from supervisory authorities, in the discharge of their functions or detection and investigation of breaches of company law, with other authorities, bodies, or persons where that authority, body, or person is subject to an obligation of professional secrecy in the third country, and is such information only disclosed once the express agreement of the originator(s) has been obtained, and, where appropriate, solely for the purposes for which the originator gave its permission? (Article 379(i))
Group supervision (**Article 260**)	• The supervisory authorities of the third country have the necessary means and resources, relevant expertise, and the mandate to effectively protect policyholders and beneficiaries wherever located. (**Article 380(a)**) • The supervisory authorities of the third country are empowered by law or regulation to: – determine which undertakings fall under the scope of supervision at group level; – supervise (re)insurers which are part of a group; and – impose sanctions or take enforcement action where necessary. (**Article 380(b)**) • The supervisory authorities of the third country are able to effectively assess the risk profile and solvency/financial position of (re)insurers which are part of a group, and the group's business strategy. (**Article 380(c)**) • Supervision at group level includes all undertakings over which a participating undertaking exercises dominant or significant influence (unless not appropriate for group supervision objectives). (**Article 380(d)**) • The supervisory authorities of the third country must duly consider the potential impact of their decisions on the stability of financial systems globally, particularly during emergency situations. (**Article 380(e)**)

	• The supervisory authorities of the third country must take into account the pro-cyclical effects of their actions where exceptional movements in financial markets occur. (**Article 380(f)**) • The prudential regime of the third country requires an effective system of governance at group level, which provides for sound and prudent business management and prescribes: – that there must be an adequate transparent organisational structure with clear allocation and appropriate segregation of responsibilities; – requirements to ensure that persons who effectively run the undertaking are fit and proper; – effective processes to ensure the timely transmission of information both within the group and to the relevant supervisory authorities; and – requirements for ensuring that the outsourced functions or activities are effectively supervised. (**Article 380(g)**) • The prudential regime of the third country requires an effective risk management system at group level comprising at least: – the strategies, processes, and internal reporting procedures necessary to identify, measure, monitor, manage, and report risks on a continuous basis to which the group is/could be exposed; and – an effective internal control system (**Article 380(h)**) • The prudential regime of the third country should require the group to have sound reporting and accounting procedures to monitor and manage intra-group transactions and risk concentrations. (**Article 380(i)**) • The prudential regime of the third country should require the group to establish and maintain effective risk-management, compliance, internal audit and actuarial functions. (**Article 380(j)**) • The prudential regime of the third country requires the group to: – provide third country supervisory authorities with any information that they need; – report significant risk concentration at the level of the group and significant intra-group transactions, on at least an annual basis; and – disclose publicly, at least annually, a report on the solvency and financial condition of the group. (**Article 380(k)**) • The prudential regime of the third country must require that proposed changes to the business policy or management of the group (or qualifying holdings in the group) are consistent with the sound and prudent management of the group. (**Article 380(l)**)

	• Assessment of the financial position of the group should rely on sound economic principles and assessment of solvency should be based on an economic valuation of all assets and liabilities. (**Article 380(m)**) • The prudential regime of the third country should require the group to hold adequate financial resources, including a requirement for: – technical provisions with respect to all obligations towards policyholders and beneficiaries of (re)insurance undertakings in the group; – assets held to cover technical provisions to be invested in the best interests of all policyholders and beneficiaries (taking into account any disclosed policy objective); – the group to invest only in assets and instruments whose risks it can properly identify, measure, monitor, manage, control, and report; – the group to meet capital requirements at a level which ensures that in the event of significant losses policyholders and beneficiaries are adequately protected and continue to receive payments as they become due; – (re)insurance undertakings which are part of the group to maintain a minimum level of capital, non-compliance with which triggers immediate supervisory intervention; and – group capital requirements to be met with own funds that are of a sufficient quality to be able to absorb significant losses in both a going concern and a case of winding up. (**Article 380(n)**) • The capital requirements of the prudential regime of the third country should be risk-based to capture quantifiable risks, and where a significant risk is not quantifiable that risk should be addressed through another supervisory mechanism. (**Article 380(o)**) • The prudential regime of the third country should ensure timely intervention by the supervisory authorities of the third country in the event that capital requirements are not complied with. (**Article 380(p)**) • The supervisory authorities of the third country restrict the use of own-fund items of a related (re)insurance undertaking where the items cannot effectively be made available to cover the capital requirement of the participating undertaking for which group solvency is calculated. (**Article 380(q)**) • The calculation of group solvency in the third country's prudential regime should produce a result that is at least equivalent to the result produced by either one of or a combination of the calculation methods in Solvency II, and the calculation method used should ensure that there is no double use of own funds to meet the group capital requirement and that the intra-group creation of capital through reciprocal financing is eliminated. (**Article 380(r)**)

	• The prudential regime of the third country should provide that all persons who work or have worked for the supervisory authorities of the third country, as well as auditors and experts acting on behalf of the authorities, are bound by obligations of professional secrecy which extend to information received from all supervisory authorities. (**Article 380(s)**) • Without prejudice to cases covered by criminal law, confidential information received by all person who work or have worked for the supervisory authorities in the third country must be kept confidential from all persons and authorities, except in a summary or aggregate form which does not allow identification of individual undertakings. (**Article 380(t)**) • The prudential regime of the third country should provide that, where a (re)insurance undertaking has been declared bankrupt or is being compulsorily wound up, confidential information which does not concern third parties involved in attempts to rescue the undertaking may be divulged in civil or commercial proceedings. (**Article 380(u)**) • The third country supervisory authorities which receive confidential information from other supervisory authorities must only use that information in the course of their duties or: – to check conditions attached to the business of reinsurance, systems of governance, and public disclosure and solvency assessments; – to impose sanctions; – in administrative appeals against supervisory authority decisions; or – in court proceedings relating to the solvency regime in the third country. (**Article 380(v)**) • The third country supervisory authorities should be permitted to exchange information received from supervisory authorities, in the discharge of their supervisory functions or the detection or investigation of breaches of company law, with other authorities, bodies, or persons where that authority, body, or person is subject to an obligation of professional secrecy in the relevant third country provided that the information is only disclosed with the express agreement of the originator, and only for the purposes for which such authority was given. (**Article 380(w)**)

Annex 2

Potentially temporarily/ provisionally equivalent area	Criteria to determine temporary/provisional equivalence
Reinsurance supervision (**Article 172(4)**)	(a) The third country has committed to adopt and apply a solvency regime that is capable of being assessed as fully equivalent before the end of the temporary period of equivalence ends. (b) The third country has established a work programme to fulfil (a). (c) The third country has allocated sufficient resources to fulfil (a). (d) The third country has a solvency regime that is risk based and establishes quantitative and qualitative solvency requirements and requirements relating to supervisory reporting and transparency. (e) The third country has entered into written arrangements to cooperate and exchange confidential supervisory information with EIOPA and supervisory authorities. (f) The third country has an independent system of supervision. (g) The third country has established obligations of professional secrecy for all persons acting on behalf of its supervisory authorities (particularly on the exchange of information with EIOPA and supervisory authorities).
Solvency assessment (**Article 227(5)**)	(a) The third country either already has an equivalent solvency regime in place or one may be adopted or applied. (b) The third country has a solvency regime that is risk based and establishes quantitative and qualitative solvency requirements and requirements relating to supervisory reporting and transparency. (c) The third country's law, in principle, allows cooperation, and exchange of confidential supervisory information, with EIOPA and supervisory authorities. (d) The third country has an independent system of supervision. (e) The third country has established obligations of professional secrecy for all persons acting on behalf of its supervisory authorities.

Group supervision (**Article 260(5)**)	(a) The third country has committed to adopt and apply a solvency regime that is capable of being assessed as fully equivalent before the end of the temporary period of equivalence ends. (b) The third country has established a work programme to fulfil (a). (c) The third country has allocated sufficient resources to fulfil (a).
	(d) The third country has a prudential regime that is risk based and establishes quantitative and qualitative solvency requirements and requirements relating to supervisory reporting, transparency, and group solvency. (e) The third country has entered into written arrangements to cooperate and exchange confidential supervisory information with EIOPA and other supervisory authorities. (f) The third country has an independent system of supervision. (g) The third country has established obligations of professional secrecy for all persons acting on behalf of its supervisory authorities, in particular on the exchange of information with EIOPA and other supervisory authorities.

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