

EIOPA advice to the European Commission on equivalence



October 2011

Three reports from EIOPA end a 10-month assessment and consultation in relation to the supervisory regimes of Japan, Switzerland and Bermuda and their equivalence with Solvency II requirements

INTRODUCTION

On 26 October 2011, EIOPA published its final reports providing its advice regarding the equivalence assessment on the Bermudan, Japanese and Swiss supervisory systems. These follow three public consultation papers on the respective supervisory systems published by EIOPA in August 2011.

Under Solvency II, equivalence for third country solvency regimes is assessed under three articles of the Solvency II Directive:

- Article 172 – EEA direct writers using reinsurance outside EEA
- Article 227 – Group Solvency Calculation for an EEA parent company with a subsidiary in a third country
- Article 260 – Group Supervision for a parent company in a third country with a subsidiary in the EEA

While the detailed methodology of the assessment has been presented separately in EIOPA's consultation paper 82, six overarching principles underpinning the equivalence assessment have been highlighted in the reports. These specify that the third-country supervisory system should:

- provide a similar level of policyholder and beneficiary protection
- maintain supervisory cooperation under conditions of professional secrecy
- be a flexible process based upon principles and objectives
- apply the proportionality principle
- be applied by the third country at the time of assessment
- be kept under review, with equivalence advice updated at least every three years

EIOPA has commented that the findings for each assessment criteria will be reported under one of five categories: "equivalent", "largely equivalent", "partly equivalent", "not equivalent" and "not applicable".

To assist you in digesting these reports, Milliman has prepared this short summary of the content of the documents, setting out the implication of EIOPA's advice for equivalence of the supervisory regimes in the three territories.

JAPANESE SUPERVISORY SYSTEM

The Japanese supervisory system was assessed for reinsurance under Article 172 only. EIOPA found that, overall, the Japanese system met the criteria for equivalence under Article 172 but with a number of caveats. Specifically, the Japanese solvency regime was found to be only "partly equivalent" for reinsurers in the level of policyholder protection it provides (although EIOPA comments that it expects this to become "largely equivalent" once the anticipated move to market consistent valuations of liabilities is finalised).

SWISS SUPERVISORY SYSTEM

The Swiss supervisory system was found to fully meet the criteria for equivalence under Article 227 for the calculation of Group Solvency where an EEA parent company has a subsidiary in Switzerland. Equivalence was also advised under Articles 172 and 260, albeit with certain caveats.

A specific caveat in relation to the Swiss solvency regime was included under Article 172 in relation to reinsurance captives which are exempt from the Swiss Solvency Test ("SST"). These were found to be only "partly equivalent" due to the lower confidence levels applied to their solvency calculations. Shortcomings were also noted in relation to governance and public disclosure

requirements, particularly around the reduced level of public disclosure required and the lack of equivalent compliance and internal audit functions. EIOPA has noted that the Swiss Financial Market Supervisory Authority ("FINMA") is currently performing a review of the governance and public disclosure requirements and it proposes to reassess the equivalence of these areas once this has been concluded.

BERMUDAN SUPERVISORY SYSTEM

The Bermudan supervisory system categorises non-life insurers into four main classes (with a further sub-division of Class 3 into three sub-categories). As the Bermudan Monetary Authority ("BMA") applies different requirements to each class, the equivalence assessment has been sub-divided in a consistent way. Further details of these classes are set out at the end of this summary paper.

EIOPA has advised that the Bermudan supervisory system meets the criteria for equivalence under Article 260 (Group Supervision for a parent company in a third country with a subsidiary in the EEA) for all classes. However, under Articles 172 and 227, only the supervisory system applicable for insurers of Classes 3A, 3B and 4 was found to be equivalent. In all cases, a number of caveats are applied to the advice. Specifically EIOPA has noted that in a number of cases, the provisions are still under development and, as such, the conclusions drawn will only be fully applicable once these are fully implemented.

A number of significant weaknesses have been identified in relation to the governance and disclosure requirements and around the valuation framework, which is currently not risk-based for a number of classes. Furthermore, the possibility of writing both insurance and non-insurance business in a single company represents a significant difference to the provisions under Solvency II.

EIOPA further notes that the Bermudan regime for long-term insurers has not yet been assessed, as this has only been in force since the beginning of 2011 (and the reclassification of the relevant insurers into classes has not yet been completed).

SUMMARY

The publication by EIOPA of three reports into third country equivalence ends a 10-month assessment and consultation in relation to the supervisory regimes of Japan, Switzerland and Bermuda and their equivalence with Solvency II requirements.

EIOPA has advised that the Japanese supervisory regime should be considered equivalent for reinsurance (under Article 172). The report caveats this advice, noting that while the Japanese solvency regime for reinsurers is currently only partly equivalent to Solvency II, this should be improved when the expected move to market consistent valuations of liabilities is finalised.

The Swiss supervisory regime was also found to be equivalent to Solvency II, although several caveats were noted in relation to the regime surrounding reinsurance and for group supervision where the parent company is based in Switzerland with a subsidiary in the EEA. EIOPA has noted that FINMA is currently conducting a review in a number of these areas and equivalence will be reassessed once this has been concluded.

For Bermuda, EIOPA notes significant deviations between the Bermudan supervisory system and Solvency II, specifically surrounding governance, disclosure and the valuation framework. As a result, equivalence was only advised for certain classes of non-life insurers, and with the additional caveat that a number of developments required for this assessment are still not fully implemented.

EIOPA has stated that the advice on equivalence should be regularly assessed and updated at least every three years, although it appears a more regular assessment may prove necessary for territories such as Bermuda where revised supervisory regimes are currently under development.

BERMUDA'S INSURANCE CLASS SYSTEM

Non-life insurers:

- Class 1: single owner captive insurers insuring only the risks of their owners or of affiliates of the owners. Third party liability risk of the owner can be insured.
- Class 2: single or multi-owner captive insurers deriving up to 20% of their net premiums from unrelated parties.
- Class 3: captive insurers deriving up to 50% of their net premiums from unrelated parties.
- Class 3A: commercial insurers deriving 50% or more of their net premiums (and/or net loss and loss expense provisions) from unrelated parties, where total net premiums from unrelated business are less than \$50 million.
- Class 3B: commercial insurers deriving 50% or more of their net premiums (and/or net loss and loss expense provisions) from unrelated parties, where total net premiums from unrelated business are \$50 million or more.
- Class 4: commercial insurers with capital and surplus of \$100 million or more, or writing catastrophe business.
- Special Purpose Insurer ("SPI") class: insurers that conduct special purpose business.

Long-Term Insurers:

- Class A: single-owner captive insurers insuring only the risks of their owners or of affiliates of the owners. Beneficiaries for related business may nevertheless be unrelated parties.
- Class B: single or multi-owner captive insurers deriving up to 20% of their net premiums from unrelated parties.
- Class C: commercial insurers with total assets less than \$250 million.
- Class D: commercial insurers with total assets equal to or greater than \$250 million, but less than \$500 million.
- Class E: commercial insurers with total assets equal to or greater than \$500 million.
- Dual Licence: insurers writing a combination of long-term (or life) business and non-life business.

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