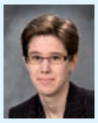
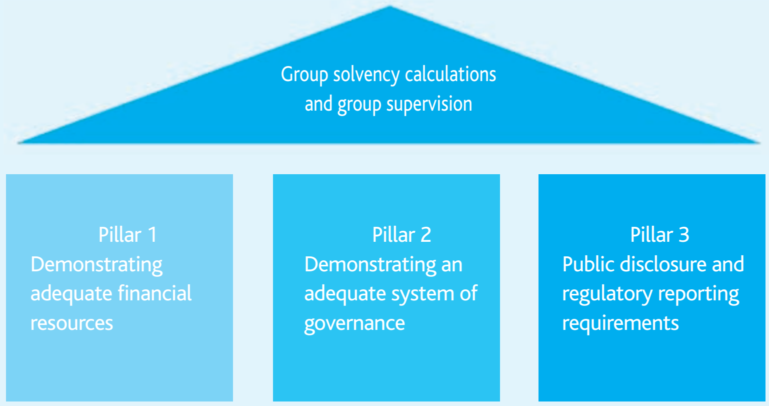
Solvency II and third country equivalence



"A key theme.... is the concept of proportionality"
Clair Le Poidevin

In October 2012 the new Solvency II regime will come in to force. Under this system all insurance companies within the European Union (EU) will be regulated to a common capital requirement and risk management standard. There will be three pillars of assessment, all of which are subject to an overall supervisory review process. Not only do these standards apply at an individual company level, they also have to be met at a group level.

Under the terms of Solvency II, full credit can only be taken for (re)insurance ceded to other EU Member States or to non EU "third countries" that have achieved equivalence. Alternatively, EU insurers dealing with non-equivalent countries (either through (re)insurance or group reporting) may have to hold more capital.



Should non EU teritories seek equivalence under Solvency II ?

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Solvency II will be a benchmark against which capital adequacy and risk management standards are measured. EU insurers may prefer to deal with third countries who they know meet this standard.

Captives and third party insurers are often required to post collateral which may be reduced if minimum EU standards are met.

For group reporting, equivalence would mean that figures could be taken directly from the third country without having to be recomputed.

AGAINST

The capital requirement under Solvency II has to be calculated using a standard formula or an internal model. The standard formula may not be appropriate and internal models can be costly to develop.
For small entities, although the principle of proportionality can be applied, there is a risk of increased regulatory requirements and cost.

A significant review of the existing legislation and governance procedures are likely to be required.

Draft advice on third country equivalence

On 30 November 2009 the Committee of European Insurance and Occupational Pensions Supervisors ("CEIOPS") issued a consultation paper on the technical criteria for assessing third country equivalence. This provides draft advice in three areas:

- reinsurance supervision
- group solvency calculations
- group supervision

Each of these is to be assessed on a stand alone-basis. The structure of the advice is to identify the key supervisory principles and their objectives. Guidance is then provided in terms of "indicators" of equivalence against which equivalence will be assessed.

Equivalence does not mean that the Solvency II regime has to be adhered to word for word, or calculation for calculation, but rather that the general principles are followed. These principles cover areas such as supervisory powers and solvency assessment.

A key theme in the whole Solvency II regime is the concept of proportionality. This means that the level of detail of analysis should reflect the nature, scale and complexity of the risks inherent in the business.

What does this mean for territories such as Guernsey, Isle of Man and Jersey?

These territories are not part of the EU but have a significant number of insurance companies reinsuring business written by EU insurers. Local companies also form part of EU group organisations. Therefore these territories need to consider the implications of Solvency II, both for existing and future business.

The consultation period closes on 5 February. CEIOPS will then review the responses before delivering their final advice to the European Commission (EC) in March.

Once the EC has confirmed the requirements, each territory seeking recognition will need to review and potentially revise their own legislation and systems of governance to meet the equivalence requirements. The final stage is for CEIOPS to carry out an assessment. However, the ultimate decision as to whether equivalence is recognised for a particular territory is made by the European Commission.

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