

# Solvency II Governance & Group Supervision

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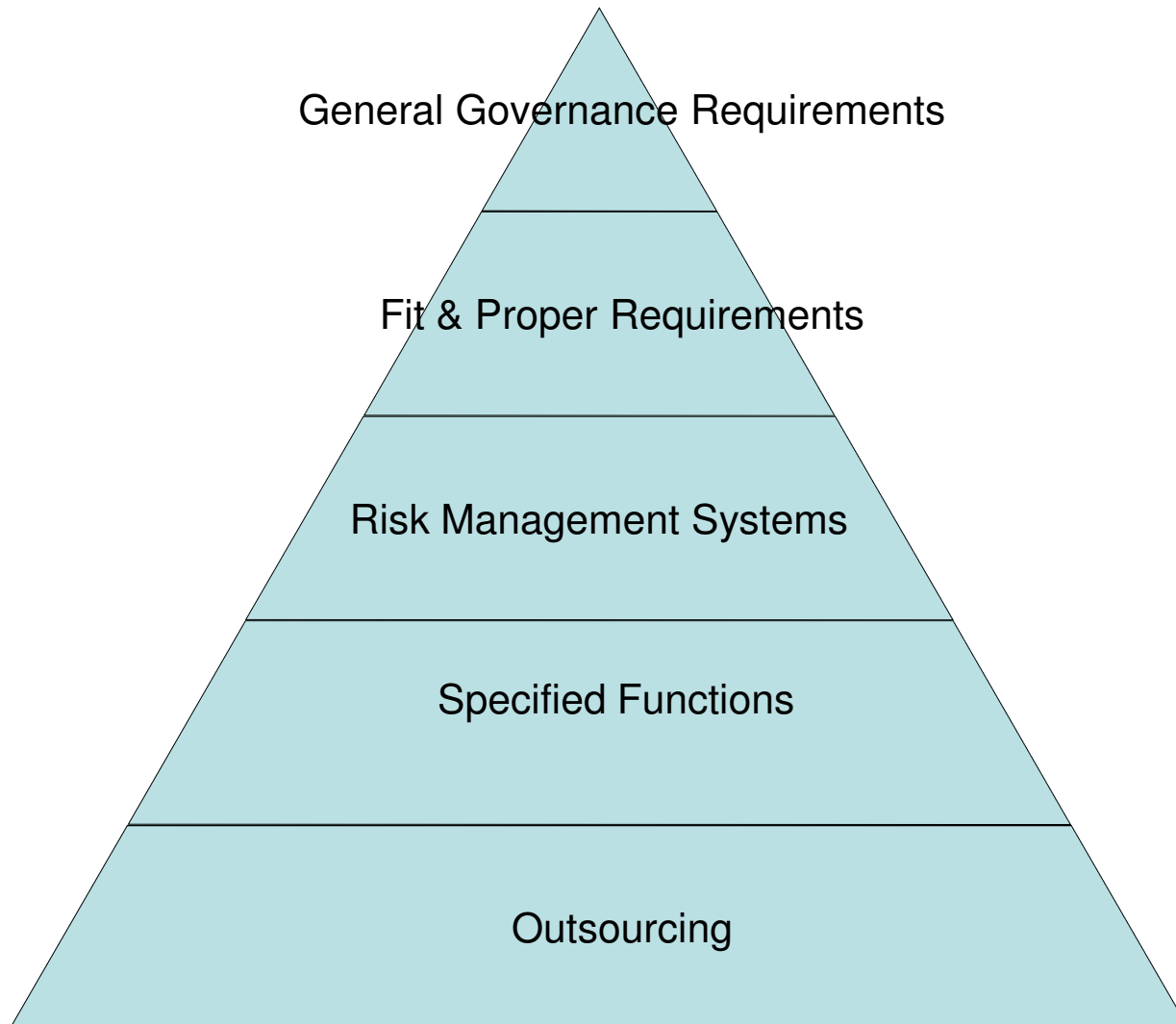
Breakfast Briefing  
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# Governance Framework



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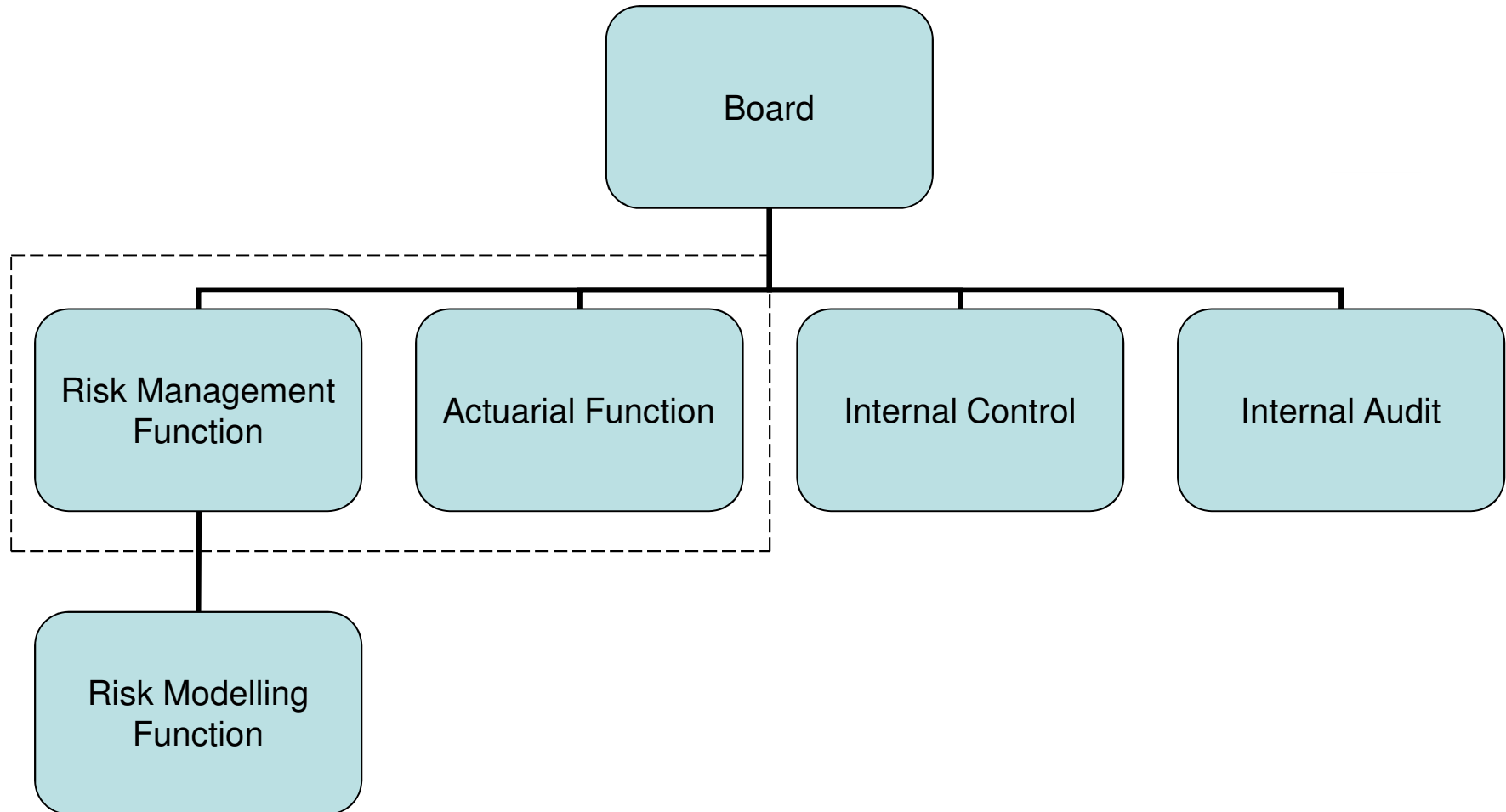


# Specified Functions



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- Level 1 Text
  - “administrative or management body” (the Board) is ultimately responsible
  - Written policies will be required “in relation to, at least, risk management, internal control, internal audit and, where relevant, outsourcing”.
- CP33 CEIOPS Advice
  - The organisational structure, reporting lines, skills, decision making process and record keeping should be appropriate.
  - Potential conflicts of interest should be identified and managed.
  - The required written policies should clearly set out relevant responsibilities, goals, processes and reporting procedures.
  - Contingency and business continuity plans should be in place.

- CP33 explanatory text comments of interest
  - Remuneration policies should be in line with business strategy, risk profile and objectives and should avoid potential incentives for unauthorised or unwanted risk taking.
  - There should be an assessment of the effectiveness of the system of governance and reports drawn up at least annually, consistent with the principle of proportionality, to the Board. This report should include conclusions drawn from the ORSA process.
  - Subject to national laws, companies should consider whether there should be sub-committees of the Board including audit, risk, investment or remuneration committees.
  - Internal audit can't be combined with other functions and must be objective and independent from other functions

# Fit & Proper Requirements



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- These apply to all persons who effectively run the company including senior management and Board members.
- Requirements are similar to the existing requirements in Ireland.
  - But companies will need to have documented policies and procedures in place to ensure that all key persons are fit and proper.

# Risk Management System



- Risk Management System, as distinct from Risk Management Function.
- Board is responsible for ensuring that the implemented risk management system is **suitable**, **effective** and **proportionate** to the nature, scale and complexity of the risks inherent in the business.
- CP33 specifies minimum requirements for an effective risk management system including:
  - a clearly defined risk management strategy (which should be approved by the Board) and
  - adequate written policies (by senior management) to support the implementation of the risk management strategy

# Risk Management System



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- Written policies are required in respect of at least
  - underwriting and reserving;
  - asset – liability management;
  - investment, in particular derivatives and similar commitments;
  - liquidity and concentration risk management;
  - operational risk management;
  - reinsurance and other risk mitigation techniques.
- CP33 sets out CEIOPS views on what should be covered in the written policies for the asset liability management and investment policies.
- CEIOPS plans to expand on written policies for the other risks through level 3 guidance.



# Risk Management System



- CP33 explanatory text
  - Board member should be designated to oversee the risk management function.
  - Larger companies and companies with more complex risk profiles should appoint a Chief Risk Officer.
  - Companies expected to set internal quantitative limits on investment policies even though “prudent person” principle will apply.
    - quantitative limits and asset eligibility criteria may be developed under level 2 in the future by the Commission.
  - Companies should understand and be able to value their own investments according to Solvency 2 valuation principles.
    - e.g. will be necessary to independently verify tracker bond prices supplied by the asset issuer.

# Risk Management Function



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- Should be organised so that it can be objective and not be responsible for the results of the operational business.
- Should assist the Board and management in the effective operation of the risk management system.
- Responsible for integration of the internal model with the risk management system and the day to day functions of the company.

# Internal Control Function



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- Effectively a control and compliance function.
- Will be necessary to document a compliance plan setting out all the intended compliance activities.
- The function will have to report any major compliance issues promptly to the Board.

# Internal Audit Function



- Should have an appropriate standing in the company to ensure its independence
  - be free to audit any area of the company, with unrestricted access to information and people, and be free to express its opinions.
- An audit plan should be documented taking a risk based approach to deciding priorities.
- A written report should be presented to the Board at least annually.

- Level 1 Text – Article 47(1)

- (a) to coordinate the calculation of technical provisions;*
- (b) to ensure the appropriateness of the methodologies and underlying models used as well as the assumptions made in the calculation of technical provisions;*
- (c) to assess the sufficiency and quality of the data used in the calculation of technical provisions;*
- (d) to compare best estimates against experience;*
- (e) to inform the administrative or management body of the reliability and adequacy of the calculation of technical provisions;*
- (f) to oversee the calculation of technical provisions in the cases set out in Article 81;*
- (g) to express an opinion on the overall underwriting policy;*
- (h) to express an opinion on the adequacy of reinsurance arrangements;*
- (i) to contribute to the effective implementation of the risk management system...*

- CP33 expands on what would be expected in each of these areas.

# Actuarial Function

- Level 1 Text – Article 47(2)

*The actuarial function shall be carried out by persons who have knowledge of actuarial and financial mathematics, commensurate with the nature, scale and complexity of the risks inherent in the business of the insurance or reinsurance undertaking, and who are able to demonstrate their relevant experience with applicable **professional** and **other standards**.*

- CP33 sets out different options on technical standard setting, favouring the establishment of a new European body.
  - The Groupe Consultatif Actuariel Europeen has developed a proposal for discussion with CEIOPS and the Commission.

# Outsourcing – CP33



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- Written policy should consider impact on the business and the reporting and monitoring arrangements that should be put in place.
- For outsourcing within a group, reasonable to take into account extent to which company controls or can influence service provider.
- CEIOPS specifies minimum criteria
  - For choosing a service provider for any critical or important functions.
  - For inclusion in written agreement with the service provider.
- Outsourcing of any critical or important functions or activities should not lead to a material impairment of the quality of the company's governance system .

# Outsourcing – CP33

- CP33 explanatory text
  - Possible to outsource to non-EU service providers
    - different supervisory notification arrangements are not necessary.
  - In principle all functions and activities can be outsourced with the exception of core management functions.
  - CEIOPS will expand further on what might or might not constitute outsourcing in level 3 guidance.
  - Companies required to notify the supervisor prior to outsourcing of critical or important functions or activities



# Group Supervision - Agenda



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- Scope of Group Supervision
- Group Supervision Measures
- Other

# Scope (1)

- A Group encompasses
  - A group of undertakings, that consists of a participating undertaking, its subsidiaries and the entities in which the participating undertaking or its subsidiaries hold a participation (>20% voting rights or capital).
  - Undertakings linked to each other by a relationship as set out in Article 12(1) of the Directive 83/349/EEC.
  - Where there are strong and sustainable financial relationships, whether or not established on a contractual basis.
  - Undertakings where there is dominant (>50% voting rights) or significant influence (>20%).

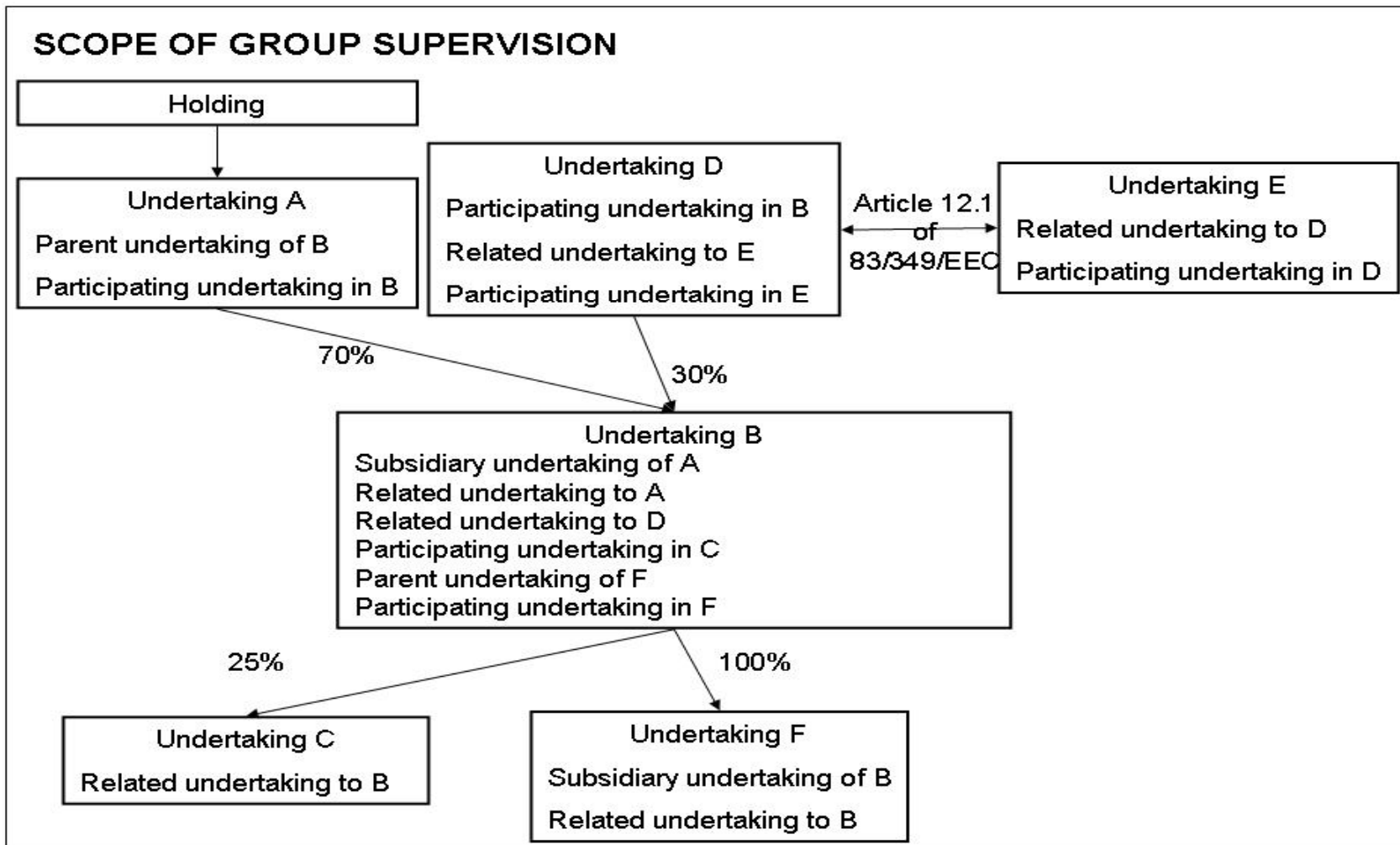
CP 60 3.18. CEIOPS considers that all parts of the group necessary to ensure a proper understanding of the group and the potential sources of risks within the group have to be included within the scope of group supervision.

# Scope (2)



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## Scope (3)

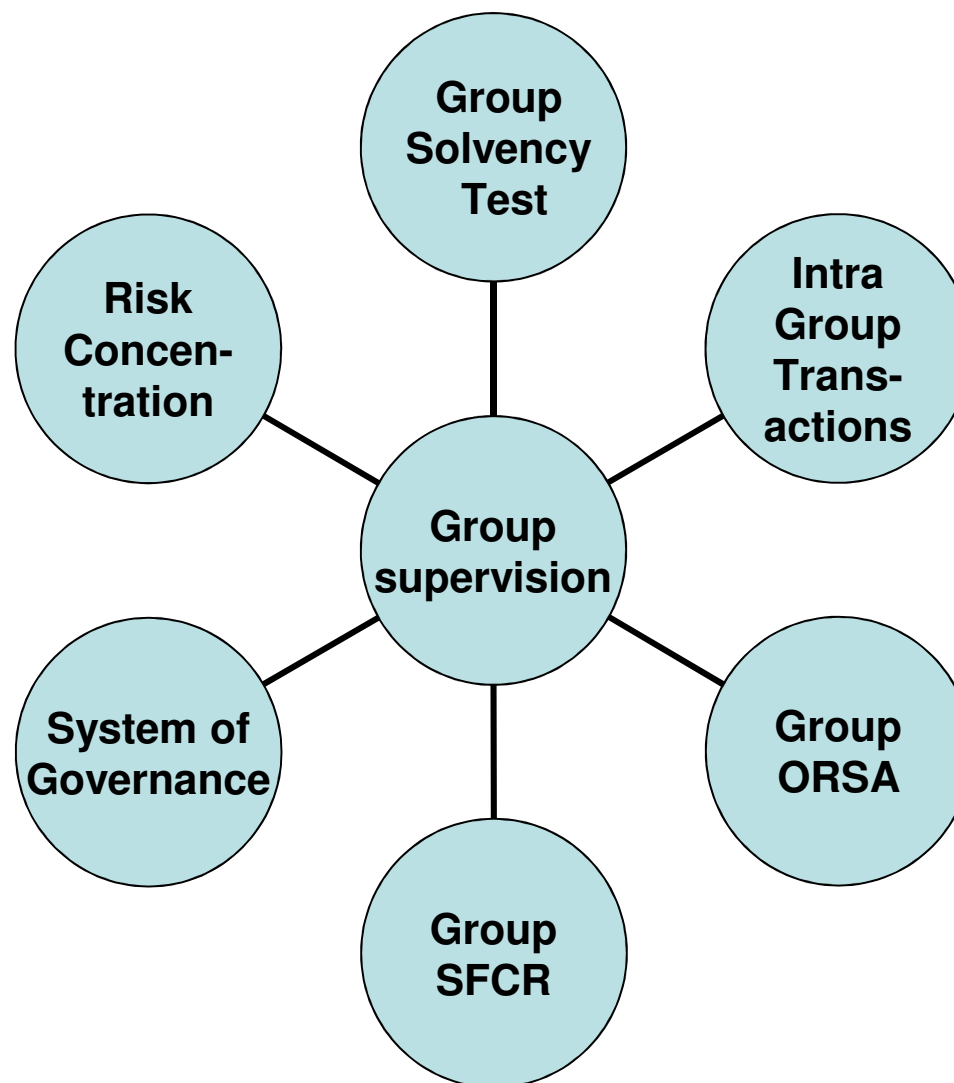
- Extends to include
  - Insurance holding companies
  - Third country undertakings on insurance holding company
  - Mixed activity insurance holding company
- Individual undertakings can be excluded in certain circumstances, subject to supervisory approval.
- In principle, Group supervision applies at the “top of the tree”.

# Group Supervision Measures



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# Group Solvency Test (1)

- Eligible own funds at Group level must exceed Group SCR.
- Must be calculated at least once a year.

## **Method 1: Accounting consolidation method**

- Default method
- Calculation of own funds and SCR at consolidated level
- Group diversification benefits
- Reduced by amounts that can't be used for solvency purposes in other parts of the Group

## **Method 2: Deduction & Aggregation method**

- No Group diversification benefits
- Addition of solo entity own funds and SCR

- Elimination of double counting of own funds and intra-group creation of capital.

# Group Solvency Test (2)

- Group internal model
  - Group supervisor takes the lead in approval process.
- Group capital add-ons
  - If risk profile of the Group is not adequately reflected.
  - If specific risks exist at Group level that are not covered because they are difficult to quantify!
  - If Group internal model is not appropriate for an individual undertaking within the Group.

# Group Solvency Test (3)



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- Third country undertakings
  - Applies where either the head office is outside EEA or head office is within EEA but subsidiaries/participations are outside the EEA.
  - If equivalent supervisory regime to Solvency 2, can use third country undertakings solvency calculations.
  - If no equivalence, need to calculate on Solvency 2 basis.
  - If head office outside EEA and no equivalence, supervisors can require establishment of an insurance holding company within EEA.
- Supervisors may allow use of equivalent figures where participations in credit institution, investment firm or financial institutions.



# Other Measures

- Risk concentration (RC) & Intra group transactions (IGT)
  - Report regularly, at least annually.
  - Scope should include third country undertakings, branches, other regulated entities and unregulated entities.
  - IGT includes loans, guarantees, dividends, fees, commissions etc.
  - Derogation possible where there is a related regulated entity or mixed financial holding company subject to supplementary supervision under the Financial Conglomerates Directive.
- System of Governance should apply consistently across the Group.
- ORSA and SFCR requirements apply at Group level.

- Group supervisor
  - Where Group headed by (re)insurance undertaking, its supervisor is the Group supervisor.
  - Directive sets out decision tree for other cases.
- Group supervision will be supported by colleges of supervisors
  - CP62 provides CEIOPS advice on role and operation.
- Review clauses
  - Commission to review co-operation between supervisors, legal status of CEIOPS and practice re capital add-ons after 2 years.
  - Commission to assess benefit of enhancing group supervision and capital management (group support regime) after 3 years.