

Comments on CP 25

General Comments

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As we stated in our presentation at the CEIOPS hearing on April 2, the Group of North American Insurance Enterprises (GNAIE) supports initiatives to better coordinate and streamline supervision of insurance groups and therefore welcomes the opportunity to comment on CEIOPS' draft advice on group supervision (CP 25). We recognize the importance of the issues addressed in the paper and agree with the theoretical premise that underpins the development of the Group Support Regime (GSR).

- 1) Given the North American based-membership of GNAIE, our comments focus primarily on the treatment of non-EEA entities. We also express concerns about the implementation of a GSR within the EEA and globally given the lack of harmonization of legal and regulatory powers in different jurisdictions. We believe these practical issues need to be addressed more completely.
- 2) It is not clear how insurance groups headquartered in jurisdictions outside Europe will be treated if there is equivalence. The Framework Directive is silent on the treatment. We believe that equivalence should provide the full benefits of Solvency II.
- 3) It is also not clear how equivalence of regulatory regimes will be determined. These will probably be determined by Level II implementing measures, but MEP Peter Skinner has proposed several amendments which could make it much harder to obtain equivalence, including a requirement for reciprocal equivalence.
- 4) Further, it is not clear what the criteria will be for determining the country of the lead supervisor for third countries for purposes of determining equivalence or mutual recognition. Will this be the home of the parent insurance group or the corporate parent? These issues need to be addressed.
- 5) GNAIE remains concerned that there may be no options for equivalence or mutual recognition which could be applied to the United States because of the system of state-based regulation. We believe that if there is no option for the US under the current system, not only will US companies be disadvantaged competitively in the US and in Europe, but that European consumers (individuals and business) will also be harmed.
- 6) We are disappointed that CP25 does not address how the group supervision regime could effectively apply to non-EEA groups with subsidiaries in Europe. Paragraph 11 of the report suggests that "further safety guards" may be needed in order to fully recognize group support as it relates to the subsidiaries of non-EEA groups. This would be contrary to the goals of mutual recognition. The principles of effective supervision should be spelled out and made applicable to groups in Europe and outside of Europe.
- 7) GNAIE would like to see developed a mutual recognition framework which allows non-EEA groups to be treated equitably using the same Group Support Regime requirements as for EEA groups. If regulatory equivalency is accepted, it should be possible to afford effective, coordinated group supervision through mutual recognition agreements, wherever a qualifying jurisdiction exists. The elements necessary to obtain confidence in a group support regime

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should be made clear in mutual recognition agreements on which the EEA and the IAIS are working. GNAIE suggests CEIOPS add commentary regarding how to address group supervision in eligible jurisdictions including a Group Support Regime.

- 8) Since the Framework Directive for Solvency II is unclear as to how third country operations will be dealt with, and CP25 does little to resolve the issues around fungibility of capital from third countries. We believe it is critical that group supervision operates effectively for supervisors of subsidiaries whose parent company is in another Member State **or in a third country**, and that these issues need to be addressed as a matter of priority. There are many European insurance companies with global operations (located outside the EU) as well as numerous subsidiaries of North American insurance companies operating within the EU, writing a large volume of business. It is vitally important for all policyholders that the group support regime delivers a regulatory framework which is robust and effective, and does not create an un-level playing field.
- 9) The question of where capital should be held is not resolved. For example, it is not clear whether capital held in the US to meet RBC can be counted as own funds, allowing credit to be taken for this in the EU. We believe that, to the extent that funds have to be retained in a third country to meet (higher) solvency capital requirements imposed by the local regulators, they should not be eligible for credit in the EU.

Other challenges to the feasibility of a GSR that complies with prudential standards of supervision, which CP 25 does not resolve, include (1) compatibility of declarations of group support with national company law, insolvency law and policyholder compensation schemes to demonstrate the transferability of capital across borders; (2) ensuring that regulators will enforce capital transfers from one group company to another both in normal conditions and in times of stress; (3) coordination between group and home supervisors that will promote fair and equal treatment of policyholders in different counties in the event of the group facing financial difficulties (crisis management); (4) harmonization of supervisory practices between jurisdictions to ensure a level playing field and so avoid a “race to the bottom” in the supervision of insurance groups; (5) alignment of a group supervisory model with policies and procedures for cross-group financing and efficient management of group-wide capital resources that can be demonstrated work in practice and are approved by the parent and subsidiary Boards; (6) practical differences between branches and subsidiaries of an insurance group headquartered in the EU or in a third country; what about joint venture partners with potentially different interests; and (7) how the benefits of diversification of risk are to identified and measured in a prudent and realistic manner; also the recognition of risk concentrations across the group companies.

- 10) Finally, CEIOPS appears to view the solo entity MCR as the primary driver for supervision and capital assessment, while viewing the Group Support Regime as incidental. This leads to a suggestion that groups should hold capital in excess of the group SCR up to the amount of group support declared. This would (per paragraph 67) result in groups being required to hold capital equal to the sum of the solo SCRs of the undertakings in the group which is in contradiction to the Framework Directive. The group SCR, calculated on consolidated data, is the appropriate capital requirement for the group as a whole taking into consideration group-wide diversification effects. (i.e. the group SCR, calculated on consolidated data, is less than the sum of the solo SCRs of the undertakings within the group). For the group to mitigate any unexpected loss in any of its subsidiaries up to at least the level of the subsidiary's SCR. So a key question is whether eligible own funds equal to the group SCR is a sufficient requirement to ensure that the probability that the commitment to policyholders in each of the subsidiaries will be met is equivalent to the level of protection afforded to policyholders in a solo undertaking.

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Paragraph		
3	<p>Solvency II is based on a prospective and risk-orientated approach to insurance supervision and is not a zero-failure regime. In this respect understanding the relationship between the MCR and the application of the Group Support Regime is of the utmost importance in understanding the overall Solvency II concept. Group support is not of theoretical nature. With a calibration of the MCR at 80% to 90% confidence level, the group support gains practical relevance. The lower the MCR is calibrated, the higher is the average statistical probability that the undertakings will become insolvent or will need to trigger group support for the transfer of additional own funds. Therefore, establishing robust criteria for the transfer of own funds pursuant to a group support commitment is essential.</p>	<p>CEIOPS appears to view the solo entity MCR as the primary driver for supervision and capital assessment, while viewing the Group Support Regime as incidental. This assumption, inherent in CP25, that each solo entity within a group shall continue to be supervised on an individual basis is inconsistent with the draft Framework Directive for Solvency II (which views an insurance group as a coherent economic entity), and is likely to result in more stringent supervisory requirements for groups that use the Group Support Regime than those who chose not to.</p> <p>The focus should not be for solo supervisors to look at the individual entity in isolation considering only the capital held locally. Instead they should consider (in dialogue with the other supervisors in the group) the overall financial strength of the group. If the group is strong and can meet its group SCR, then the Group Support Regime set out in the Framework Directive should ensure that each solo entity can also operate at its SCR.</p>
9	<p>The Framework Directive Proposal could be interpreted differently with regard to the treatment of non-EEA subsidiaries of European groups regarding the recognition of diversification effects with third countries.</p> <ul style="list-style-type: none"> - Article 234(1) first paragraph of the Directive Framework Proposal implies that by default there is recognition of diversification benefits with non-EEA entities (because third countries related entities are treated as if they were EEA entities); - However, Article 234(1) second paragraph states that where the third country in question has a system of supervision deemed equivalent, local requirements may be taken into account, which could imply that no diversification is recognised. 	<p>Paragraphs 9-13 discuss non-EEA subsidiaries of an EEA parent, but CP25 does not consider the diversification benefits of a non-EEA parent with EEA subsidiaries. Further clarification and guidance is required. Including how equivalence of regulatory regimes will be determined.</p> <p>GNAIE believes that advice related to the directive should apply to entities of a non-EEA parent, which operate within the EU, as well as those of an EEA parent.</p> <p>GNAIE also believes that in today's global environment, the group SCR must reflect group-wide diversification benefits under the consolidated approach, including diversification arising from non-EEA operations. The global insurance marketplace is enhanced by healthy competition and so insurers should be treated the same</p>

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		whether they are based in the EU or elsewhere. [
10	So, Article 234(1) first paragraph of the Framework Directive Proposal implies that diversification benefits with non-EEA entities could be recognized , provided that these non-EEA entities are part of the group's consolidation.	GNAIE believes third country insurers and reinsurers subject to a solvency regime equivalent to the one applied within the EU should be treated in the same manner as EU insurers and reinsurers. Further clarification and guidance is required to clarify the position: - How will operations outside Europe will be treated with regard to group diversification credits? - How will the proposals relate to groups headquartered outside of Europe? - The obligations of both the local and the group supervisor to the policyholders of a local subsidiary, which is part of a group whose head office is outside that Member State and operating under the group support regime, should be clearly articulated.
11	The possible legal difficulties in transferring assets from third countries, especially under stressed circumstances (including regulatory restrictions on the payment of dividends) could result in EU policyholders being less protected than third country policyholders, if no further safety guards are to be put into the system.	All policyholders should be equally well protected, irrespective of their location.
12	Therefore it is important to consider the treatment of third countries activities in all circumstances to ensure that the recognition of diversification effects could not, in any way, undermine the level of protection of EU policyholders with respect to a situation in which no diversification effects would be recognised . The treatment of diversification between EEA entities and non-EEA entities in the solvency assessment is of most importance in cases where groups build part of their strategy on geographical diversification and different business-mix on a worldwide basis.	To achieve this, further consideration and additional guidance is required on the treatment of third countries activities.
13	Therefore it seems important to CEIOPS, in order to ensure an adequate distribution of capital within the group under the Group Support Regime, to consider the impact that the diversification effects of non-EEA subsidiaries have on the available own funds being used by the Group to cover group support commitments given to EEA subsidiaries (in order to ensure appropriate down streaming of	Equally, GNAIE believes that it is important, in order to ensure an adequate distribution of capital within the group under the Group Support Regime, to consider the impact that the diversification effects of non-EEA subsidiaries have on the available own funds being used by the Group to cover group support commitments given to EEA subsidiaries.

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	diversification effects).	
14	CEIOPS considers it important that the treatment of third country diversification effects be conditional on the protection of EU policyholders in all circumstances. Recognition of the group support regime by third countries could be a way of downstreaming diversification benefits coming from third countries activities.	<p>The treatment of diversification should equally protect all policyholders, not only EU policyholders; otherwise it would go against the pillar II risk management process and integrating that of the parent and that of the subsidiary.</p> <p>Requiring an “all circumstances” test for third country insurers sets a higher standard than that for European companies of 1 in 200 years.</p>
15	<p>The Framework Directive Proposal provides detailed obligations that apply under the Group Support Regime:</p> <ul style="list-style-type: none"> - an obligation to have eligible own funds to cover the group SCR; - an obligation that there are sufficient transferable eligible own funds available to meet commitments by the parent undertaking, including that there is "no current or foreseeable material practical or legal impediment to the prompt transfer." of these eligible funds; - an obligation to ensure that the commitment covers the difference between the MCR and the SCR of a subsidiary in the Group Support Regime; - an obligation to ensure that the MCR of a subsidiary in the Group Support Regime is covered with eligible own funds at all times; and - an obligation on the group to transfer own funds pursuant to a commitment in specific circumstances. 	<p>There should be no legal requirement to hold own funds in excess of the group SCR as a pre-condition for group support.</p> <p>If locally held own funds are in excess of the MCR then there would be no obligation to ensure that the commitment covers the difference between the MCR and the SCR of a subsidiary in the Group Support Regime. The commitment should only need to cover the difference between the eligible own funds held locally and the SCR.</p>
16	Before authorising the application of the Group Support Regime to a subsidiary, CEIOPS expects that the group must be able to demonstrate the sound financial position of the group as a whole and its ability to meet the group support commitment on a going concern basis also both at the time of authorisation and beyond, including the requirement to have sufficient eligible own funds to cover the consolidated group SCR. ¹ Thus, in line with recitals 35 and 67, and Article 28 of the Framework Directive Proposal, the Group Supervisor assisted by the College of Supervisors should conduct a prospective assessment of the group's capacity to meet the SCR in the future and check the adequate distribution of own funds within the group before authorising the application of the Group Support Regime.	It appears that supervisory requirements for groups which operate within the group support regime are more rigorous than for those outside it, such as the requirement for the group to have the ability to meet its SCR in the future.
23	For solvency purposes, a minority of CEIOPS' Members are analyzing	GNAIE is not sure the 'credit method' approach (paragraph 23) for

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	<p>the possibility that the commitment could be regarded as a credit from the supporting to the supported undertaking, when group support is triggered by a subsidiary (see Annex 1 under C for a further explanation and Annex 2 for an example). Hence, in that case the commitment shall yield interest to the creditor, in order to avoid any kind of conflict (i.e. with supported undertaking minority shareholders or with-profits policyholders). The yield would then be predefined on the declaration of group support, and must be paid in cash to the creditor. The yield would be competitive under market conditions to ensure that no subsidiaries under group support benefit from an artificially low cost of capital.</p>	<p>structuring an instrument of group support is reasonable. It appears to depart from market consistency and might be a means of protecting small regional insurers' interests. Is the intent that these would be off balance sheet until such time as the instrument is triggered, clearly depending on the form that is put in place. How does one create additional support under the credit method?</p>
29	<p>29. For the purpose of transparency and for the clear allocation of responsibilities, individual declarations of group support (bilateral between undertakings) shall contain, at least, the following:</p> <ul style="list-style-type: none"> - an unconditional and irrevocable guarantee from the parent to the subsidiary (a parental guarantee) on first demand; - a guarantee given by the parent undertaking with an immediate implementation of group support ("first pay, then raise objections if deemed necessary"); - Parties involved: supporting and supported undertaking. Unspecified support (generally or vaguely specified) should not be allowed; - Explicit declaration that no time limits or exclusions for the commitment exist (no side letters); - Explicit declaration of responsibility for updating the content of the declaration to adapt to future circumstances; and - Explicit declaration of responsibility for guaranteeing policyholders' rights. <p>The following criteria relate only to the possibility where the commitment would be recognised as a credit (see para. 23):</p> <ul style="list-style-type: none"> - Capital committed: supporting undertaking's credit risk should be considered when calculating the amount of support provided – depends on the outcome; - Compensation for the transfer of assets: yield, frequency and dates of payment; and - Assets backing group support. 	<p>The advice should clarify that any guarantee, if it is the legal form used to provide group support, can only be triggered when the MCR is in excess of the own funds in the subsidiary. It would also be important to note in the advice that this is one possibility and there may be others.</p> <p>The last bullet on guaranteeing policyholder rights seems to suggest an open ended guarantee and certainly one that is in excess of the amount of the group support provided (up to the full difference between the SCR and the MCR).</p>

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51	While in principle, intra-group participations may be eligible capital instruments for the purposes of the solo calculations, at group level, this may affect the ability to identify where eligible own funds reside within the group.	GNEAI believes that participations in another insurer provide value that can be used to meet the commitments arising from group support.
67	In order to avoid such a material practical impediment, Article 246(3)(b) of the Framework Directive Proposal will be interpreted by CEIOPS in such a manner, that a group actually needs capital in excess of the SCR to the extent that the group support is declared. If a group only holds enough capital to cover the group SCR, it is conceivable that it has no actual immediately available capital to supply as group support.	<p>This interpretation is not consistent with our understanding of the Framework Directive.</p> <p>It appears that CEIOPS would force groups to hold more capital than the SCR standard of 99.5% 1 year VaR.</p> <p>The Directive states that: <i>“The Solvency Capital Requirement at group level based on consolidated data shall be calculated on the basis of either the standard formula or an approved internal model, in a manner consistent with the general principles contained in [Articles 100 – 125: Solvency Capital Requirement] [Article 228]</i></p> <p><i>“By way of derogation from Article 98(4), any difference between the Solvency Capital Requirement and the minimum capital requirement of the subsidiary shall be covered either by own funds eligible under Article 98(4) or group support, or any combination thereof.” [Article 237]</i></p> <p>In our view, this allows group support to be provided from within the assets backing the group’s total, consolidated SCR which is based on an assessment of all risks and assets on a consolidated basis.</p>
72	This has especially to be ensured in the case of a holding company. The Framework Directive Proposal is more specific on the scope of enforcement powers and sanctions that supervisors must be able to exercise over holding companies in comparison to the FCD (Article 271). However, European supervisors are not required to play a supervisory role in relation to a holding company taken individually except for the fit and proper management of the holding company. As	Clearly the holding company should be integrated into the group SCR as they are the entity pledging support, but they should be considered as part of the group, not as a separate entity. An individual SCR would make no sense for such an entity.

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	<p>a result, the powers of supervisors over holding companies may differ for each Member State. If the parent undertaking in the Group Support Regime is a holding company, most of the European supervisors may not have sufficient power or authority to play a proactive role in supervising the holding company in the same way as they would a direct insurance undertaking operating as parent in the Group Support Regime. This may restrict the effective functioning of the Group Support Regime where a holding company seeks to apply under Article 256. CEIOPS therefore recommends that future implementing measures on enforcement and the application of the supervisory Pillar II toolkit for solo undertakings shall be considered, especially the right to require any risk-based information that is necessary to assess as supervisor the actual risk profile of the holding company and its eligible own funds within the group. Alternatively CEIOPS considers that a further clarification could be provided at Level 1.</p>	
101	<p>Therefore, CEIOPS considers that the degree to which risk management processes and internal control mechanisms are integrated in a group is an important component of the assessment of Article 243(b) and that the development of further criteria is necessary. The risk of not tailoring the generic group requirements on systems of governance to the assessment of Article 243(b) is that supervisors may apply a range of criteria. This could lead to divergence in supervisory practices and raise the potential for regulatory arbitrage. Therefore, Article 259 should be customised to account for the differences between the Group Support Regime and solo/supplementary supervision.</p>	<p>GNAIE agrees that the benefits of GSR should be granted only to groups that can demonstrate how they manage risk and capital in an integrated, holistic manner across the organization and that criteria for that assessment need to be developed.</p> <p>This section seems to suggest that solo supervisors might apply different criteria to risk management and governance. This difference would pose a challenge of integrating these divergent processes within the group. This difficulty can be avoided by clarifying that there should not be different criteria to assess risk management and governance across a group.</p> <p>Further, the integration of risk management in the parent and subsidiary should recognise that the parent's senior management should not be running the subsidiary (paragraph 101).</p>
117	<p>Considering the specificity of the Group Support Regime as well as the objective of assuring an appropriate market transparency and discipline, immediate disclosures are deemed necessary, in the</p>	<p>This section seems to propose some uneven treatments between those who apply for group support and those that don't. For example, why would all disclosures associated with group support need to be</p>

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<p>form of an update of the section on capital management entitled “group support regime” on the Solvency and Financial Condition Report, in predefined events as described below.</p> <ul style="list-style-type: none">i) The decision to allow group support pursuant to Article 244 to any subsidiary in the group;ii) New declarations as foreseen in Article 247(2);<ul style="list-style-type: none">o A new declaration can be provided when the SCR is no longer fully covered by the eligible own funds and the amount of group support declared, nevertheless sufficient to cover the MCR.o Simultaneously, at subsidiary level, in accordance with Article 53 of the Framework Directive Proposal, insurance undertakings shall disclose immediately the amount of the non-compliance, together with an explanation of its origin and consequences, including any remedial measure taken, unless a recovery plan considered viable is delivered to the supervisory authorities within 2 months. Where, in spite of the recovery plan initially considered to be viable, a significant non compliance with the SCR has not been resolved 4 months after its observation, it shall be disclosed at the end of that period, together with an explanation of its origin and consequences, including any remedial measure taken. It should be noted that if a viable recovery plan is delivered and the breach has been resolved within the referred period, no disclosure is required.o In cases of insurance undertakings subject to group support, the recovery plan could refer to the provision of a new declaration. As a result, if the new declaration is delivered within the predefined timeframe, the amount of the non-compliance is not subject to immediate disclosure. Nevertheless this still should be disclosed at yearend within the Solvency and Financial Condition Report.o However, since the increase of the group support is considered to be an event affecting significantly the relevance of the information disclosed, insurance undertakings shall disclose, immediately after the delivery of the new declaration, appropriate information on its delivery, nature and effects.	<p>immediate when those not associated with group support don't need to be? Also some of the wording implies that groups have to correct issues faster than those entities that haven't applied for group support. GNAIE believes the standards should be the same.</p>
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