

Consultation Paper No. 14

**Draft Advice to the European Commission in
the framework of the Solvency II project
on
sub-group supervision, diversification effects,
cooperation with third countries and issues
related to the MCR and SCR in a group context**

CEIOPS welcomes comments from interested parties on "Draft Advice to the European Commission in the framework of the Solvency II project on sub-group supervision, diversification effects, cooperation with third countries and issues related to the MCR and the SCR".

Due to the increase in Consultation Papers in 2006 because of the need to give further detailed advice to the European Commission in addition to the answers to the three waves of Calls for Advice CEIOPS considers it necessary to shorten the consultation period under its consultation policy to two and a half months.

Please send your comments to CEIOPS by email (Secretariat@ceiops.org) by 12 September 2006, indicating the reference "CEIOPS-CP-03/06".

CEIOPS will make all comments available on its website, except where respondents specifically request that their comments remain confidential.

Style convention

The following has been adopted for this document:

Advice appears in shaded (blue) boxes, headed **CEIOPS' Advice**

Extracts from the Calls for Advice appear in unshaded (white) boxes, with text in italics

Descriptive headings are used (such as 'Background', 'Explanatory text' etc.) in an attempt to improve the navigability of the answers.

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Introduction

1. The European Commission has requested CEIOPS to advise on the development of a new solvency regime for insurance and reinsurance undertakings in the EU.
2. CEIOPS has submitted its Advice in the form of answers to three waves of Calls for Advice from the European Commission and following public consultation¹.
3. Certain areas relevant to CEIOPS previous Advice on group issues are under development by CEIOPS. As part of that process CEIOPS has formulated principles which it considers material to the proposed Level 1 Directive.
4. These principles cover:
 - sub-group supervision;
 - diversification effects;
 - cooperation with third countries; and
 - issues related to the MCR and the SCR in group context.
5. CEIOPS has set out its explanations and Advice according to those headings. The draft Advice is to be taken together with CEIOPS' answers to the first, second and third waves of Calls for Advice.

¹ Answers to the European Commission on the first wave of Calls for Advice (CEIOPS-DOC-03/05), Answers to the European Commission on the second wave of Calls for Advice (CEIOPS-DOC-07/05) and Answers to the European Commission on the third wave of Calls for Advice (CEIOPS-DOC-03/06), available at www.ceiops.org.

Subgroup supervision within the Solvency II framework

Explanatory Text

Background

- 1.1. In its letter of 24 January 2006² the European Commission asked CEIOPS for further advice on the level at which sub-groups' solvency should be supervised in the Solvency II framework.
- 1.2. CEIOPS therefore considered the current EU legislation, namely the Insurance Groups Directive³ (IGD) and the Financial Conglomerates Directive⁴ (FCD), the Capital Requirements Directive (CRD), the accounting regulation (the Accounting Directive⁵) as well as IAS, namely and its *Recommendation on possible need for the amendment of the Insurance Groups Directive*⁶.
- 1.3. Insurers are increasingly operating on a group basis, either insurance groups or financial conglomerates, and CEIOPS is aware of the impact it has in terms of, e.g. management and risks. Indeed, this document and its contents reflect such concern by CEIOPS. A clearer focus on consolidated supervision will help, in the longer term and together with solo supervision, to ensure that supervision is carried out at the appropriate level. Solo supervision remains today and should remain in the future, especially in a risk based system, the cornerstone of insurance supervision⁷. CEIOPS is also sensitive to the negative impact of double or multiple reporting, and is working to minimize the supervisory burden on undertakings, finding a leverage between supervisory needs and requests in terms of information on the one hand, and undertakings reporting as well as disclosure to the stakeholders on the other. The industry considers that such burdens have increased as a result of consolidation calculations required under the IGD at the different levels, especially where such calculations have to be carried out under different assumptions or requirements. Therefore, in addition to the concrete issue of

² Available at: <http://www.ceiops.org/content/view/5/5/>.

³ Directive 98/78/EC of the European Parliament and of the Council of 27 October 1998 on the supplementary supervision of insurance undertakings in an insurance group.

⁴ The Directive 2002/87 EC, on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council.

⁵ Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54 (3) of the Treaty of consolidated accounts.

⁶ Available at CEIOPS' website: www.ceiops.org.

⁷ See Amended Framework for Consultation (MARKT/2515/06), April 2006, Para. 6, available at www.ceiops.org.

subgroup supervision, CEIOPS should try to find ways to reduce such burden, by means of increasing supervisory convergence and analyzing the convenience of harmonization of formats for information required in the different Member States.

Current regulation at EU level

Current insurance regulation at EU Level

- 1.4. The IGD deals with the application and scope of supplementary supervision in Articles 2 as well as Annex I section 2.1 (which allows adjusted solvency to be waived at lower level if there is adequate distribution of capital) and Annex II section 2 (for the PUSC). It sets a regime in which "...Member States shall provide supervision of any insurance undertaking which is a participating undertaking in at least one insurance undertaking, reinsurance undertaking, or non-member-country insurance undertaking shall be supplemented in the manner prescribed in Articles 5, 6, 8 and 9", whilst it also allows and provides for the possibility of granting waivers on a case-by-case basis⁸.

⁸ IGD, Article 2

Cases of application of supplementary supervision of insurance undertakings

1. In addition to the provisions of Directives 73/239/EEC and 79/267/EEC which lay down the rules for the supervision of insurance undertakings, Member States shall provide supervision of any insurance undertaking which is a participating undertaking in at least one insurance undertaking, reinsurance undertaking, or non-member-country insurance undertaking shall be supplemented in the manner prescribed in Articles 5, 6, 8 and 9.

2. Every insurance undertaking the parent undertaking of which is an insurance holding company, a reinsurance undertaking or a non-member-country insurance undertaking shall be subject to supplementary supervision in the manner prescribed in Articles 5(2), 6, 8 and 10.

3. Every insurance undertaking the parent undertaking of which is a mixed-activity insurance holding company shall be subject to supplementary supervision in the manner prescribed in Articles 5(2), 6 and 8.

IGD, Annex I, 2.1.

Related insurance undertakings:

The adjusted solvency calculation shall be carried out in accordance with the general principles and methods set out in this Annex.

In the case of all methods, where the insurance undertaking has more than one related insurance undertaking, the adjusted solvency calculation shall be carried out by integrating each of these related insurance undertakings.

In cases of successive participations (for example, where an insurance undertaking is a participating undertaking in another insurance undertaking which is also a participating undertaking in an insurance undertaking), the adjusted solvency calculation shall be carried out at the level of each participating insurance undertaking which has at least one related insurance undertaking.

Member States may waive calculation of the adjusted solvency of an insurance undertaking:

1.5. According to CEIOPS' *Recommendation on possible need for the amendment of the Insurance Groups Directive* insurance groups may consist of one or more subgroups. CEIOPS generally acknowledges that supplementary supervision of subgroups may not be needed, when there is satisfactory supplementary supervision carried out at a group level. However, it is still within the powers of the affected supervisory authorities to carry out supplementary supervision at any significant subgroup level. A supervisory authority may deem such subgroup supervision necessary for example if the subgroup is in a stressed financial

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- if the undertaking is a related undertaking of another insurance undertaking authorised in the same Member State, and that related undertaking is taken into account in the calculation of the adjusted solvency of the participating insurance undertaking, or
 - if the insurance undertaking is a related undertaking either of an insurance holding company or of a reinsurance undertaking which has its registered office in the same Member State as the insurance undertaking, and both the holding insurance company or the reinsurance undertaking and the related insurance undertaking are taken into account in the calculation carried out.

Member States may also waive calculation of the adjusted solvency of an insurance undertaking if it is a related insurance undertaking of another insurance undertaking, a reinsurance undertaking or an insurance holding company which has its registered office in another Member State, and if the competent authorities of the Member States concerned have agreed to grant exercise of the supplementary supervision to the competent authority of the latter Member State.

In each case, the waiver may be granted only if the competent authorities are satisfied that the elements eligible for the solvency margins of the insurance undertakings included in the calculation are adequately distributed between those undertakings.

Member States may provide that where the related insurance undertaking has its registered office in a Member State other than that of the insurance undertaking for which the adjusted solvency calculation is carried out, the calculation shall take account, in respect of the related undertaking, of the solvency situation as assessed by the competent authorities of that other Member State.

IGD, Annex II, 2:

2. Member States may waive the calculation provided for in this Annex with regard to an insurance undertaking:

- if that insurance undertaking is a related undertaking of another insurance undertaking and if it is taken into account in the calculation provided for in this Annex carried out for that other undertaking,
- if that insurance undertaking and one or more other insurance undertakings authorised in the same Member State have as their parent undertaking the same insurance holding company, reinsurance undertaking or non-member-country insurance undertaking, and the insurance undertaking is taken into account in the calculation provided for in this Annex carried out for one of these other undertakings,
- if that insurance undertaking and one or more other insurance undertakings authorised in other Member States have as their parent undertaking the same insurance holding company, reinsurance undertaking or non-member-country insurance undertaking, and an agreement granting exercise of the supplementary supervision covered by this Annex to the supervisory authority of another Member State has been concluded in accordance with Article 4(2).

In the case of successive participations (for example: an insurance holding company or a reinsurance undertaking which is itself owned by another insurance holding company, a reinsurance undertaking or a non-member-country insurance undertaking), Member States may apply the calculations provided for in this Annex only at the level of the ultimate parent undertaking of the insurance undertaking which is an insurance holding company, a reinsurance undertaking or a non-member-country insurance undertaking.

situation, or if the subgroup has a large market share in one country or region (affecting orderly financial markets). Therefore, in the present regime and situation⁹, the option is left to the local involved supervisor on a flexible case-by-case basis, although exercise of the option should be sensitive to avoiding unnecessary burden to the groups, as CEIOPS clearly recommends.

Current regulation for financial conglomerates

- 1.6. The FCD sets a regime for the prudential supervision of financial conglomerates, intended to deal with the solvency position and risk concentration at the level of the conglomerate, the intra-group transactions, the internal risk management processes at conglomerate level, and the fit and proper character of the management. It is settled as a supplementary supervision, meaning that it will be fully compatible with supervision, both at solo level and (for insurance) insurance groups level. It explicitly recognizes the existence of sub-groups in Article 2 FCD (Definitions)¹⁰, and includes the possibility of waiving such level of supervision in Article 5¹¹.

⁹ The supervision of national sub-groups has already be discussed during the so-called phase I of the Solvency II project. More precisely in early 2002, the Group Consultatif carried out a research across EU-members to assess if technical provisions presented a common pattern across countries. The results conveyed that there was a wide range of differences, and that a huge effort of harmonization was necessary for the sake of comparability and homogeneity.

This exercise has been repeated in 2005 with the same results, in such a way that insurers belonging to the same insurance group may account very different technical provisions (up to almost a 50 per cent of difference), depending on the country of the subsidiary.

An additional confirmation of the quite heterogeneous systems of technical provisions has been demonstrated along the development of IFRS4 for consolidated accounting purposes. The range of different practices is so huge at present, that IFRS4-phase I at preset in force, had to allow the continuation of existing practices up to a more complete analysis has been done.

Having in mind the situation at present, it seems too premature to remove the supervision of national sub-groups, as it would impact directly in the level playing field at national level. One should have in mind that under current solvency regulations the level of technical provisions has a direct impact on solvency requirements, and therefore the great heterogeneity currently existing impedes clearly the replacement of the supervision of national sub-groups within a multinational insurance group, as their solvency requirements will not be equivalent in anyway.

¹⁰ FCD, Article 2.14

Definitions

"financial conglomerate" shall mean a group which meets, subject to Article 3, the following conditions:

- (a) a regulated entity within the meaning of Article 1 is at the head of the group or at least one of the subsidiaries in the group is a regulated entity within the meaning of Article 1;
- (b) where there is a regulated entity within the meaning of Article 1 at the head of the group, it is either a parent undertaking of an entity in the financial sector, an entity which holds a participation in an entity in the financial sector, or an entity linked with an entity in the financial sector by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC;
- (c) where there is no regulated entity within the meaning of Article 1 at the head of the group, the group's activities mainly occur in the financial sector within the meaning of Article 3(1);

The current banking regulation

- 1.7. The CRD consolidation requirements (pillar 1 and 2 only - pillar 3 applies essentially at ultimate EU parent level) apply to EU credit institutions which are members of a banking group on the basis of the consolidated financial situation of:
- the top parent credit institution or the financial holding company in any Member State (Article 71);
 - the EU parent credit institution or EU financial holding company (provided there is an EU credit institution in the group to trigger the requirement) of any credit institution, financial institution or asset management subsidiary located in a third country (Article 73.2);
 - the top non-EU parent credit institution or financial holding company of a banking group which contains an EU credit

(d) at least one of the entities in the group is within the insurance sector and at least one is within the banking or investment services sector;

(e) the consolidated and/or aggregated activities of the entities in the group within the insurance sector and the consolidated and/or aggregated activities of the entities within the banking and investment services sector are both significant within the meaning of Article 3(2) or (3).

Any subgroup of a group within the meaning of point 12 which meets the criteria in this point shall be considered as a financial conglomerate;

¹¹ FCD, Article 5

Scope of supplementary supervision of regulated entities referred to in Article 1

1. Without prejudice to the provisions on supervision contained in the sectoral rules, Member States shall provide for the supplementary supervision of the regulated entities referred to in Article 1, to the extent and in the manner prescribed in this Directive.

2. The following regulated entities shall be subject to supplementary supervision at the level of the financial conglomerate in accordance with Articles 6 to 17:

- (a) every regulated entity which is at the head of a financial conglomerate;
- (b) every regulated entity, the parent undertaking of which is a mixed financial holding company which has its head office in the Community;
- (c) every regulated entity linked with another financial sector entity by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC.

Where a financial conglomerate is a subgroup of another financial conglomerate which meets the requirements of the first subparagraph, Member States may apply Articles 6 to 17 to the regulated entities within the latter group only and any reference in the Directive to the terms group and financial conglomerate will then be understood as referring to that latter group.

institution (Article 143). If the authorities in that non-EU country do not apply consolidated supervision governed by equivalent principles to the CRD, the EU competent authorities shall either apply the consolidated supervision requirements of the CRD by analogy or apply other appropriate techniques (e.g. require the establishment of an EU financial holding company and apply the provisions of the CRD at that level, possibly with ring-fencing).

- 1.8. Thus, the CRD potentially applies consolidated supervision at three levels – the ultimate parent (worldwide or EU), the top parent within an individual Member State and the EU parent of a third country subsidiary.
- 1.9. The CRD also applies solvency and certain other requirements on an individual entity basis (Article 68). This however may be waived under strict conditions (essentially for subsidiary or parent undertakings subject to the same consolidated supervision with common risk management and cross-guarantees, Article 69).

Possible options in the Solvency II framework

- 1.10. If CEIOPS takes as a starting point the current situation, i.e., in principle all sub-levels should be considered subgroups, unless a waiver was granted by the national competent authorities¹², the following different approaches are possible:
 - a. keep the present regime with no changes;
 - b. keep the present regime, but setting some limitations, namely requiring that competent authorities would only ask for adjusted solvency and/or parent undertaking solvency calculation (PUSC) at subgroups considered as significant in their markets, applying waivers in all other situations;
 - c. apply sub-group supervisions where it is necessary. The concept of “unity of decision” as applied in the accounting regulation (Accounting Directive) is a sensible concept;
 - d. amend the current regime, by setting as a general rule the lack of calculations at subgroup level, but allowing on a case-by-case basis to the competent authority (or the national supervisor) to decide if supervision at subgroup level is deemed necessary because of its significance;

¹² Please note that CEIOPS, in its *Recommendation on possible need for amendments to the Insurance Groups Directive* suggests that the reference would be made to the supervisory authorities, instead of to the competent authorities.

- e. eliminate any kind of subgroup levels, and have the group supervisor carrying out the supervision of the whole group according to the different national legislations (or transposition of rules); or
 - f. eliminate any kind of subgroup levels, and have the group supervisor carrying out the supervision of the whole group according to its own supervisory standards.
- 1.11. In order to provide the most appropriate advice, CEIOPS considered the existing and the upcoming regulation, including the fact that today undertakings are free to choose operating under a subsidiary or branch structure, the supervisory practices and needs, the industry's views, and the demand of convergence within the financial sector, namely with the banking sector/the CRD.
- 1.12. According to the existing situation, CEIOPS considered that, in terms of subgroup supervision, no legal change should be made¹³, although supervisors should act in a transparent and flexible way, applying waivers whenever possible, trying by all existing means to avoid unnecessary burden to the entities.
- 1.13. However, with Solvency II the insurance sector will move towards a risk oriented system in which new factors have to be taken into consideration, including the following: harmonization amongst insurance supervisors will be fostered and improved (e.g. via level 3 guidelines and cooperation processes), convergence of supervisory practices and rules within the financial sector (the 3L3 cooperative framework is working on it, and it's also a demand from all stakeholders) is an aim, the fact that groups shall be using internal models for capital purposes and the evidence that strategies will be determined in many cases at group level, the need for more transparency and disclosure, both, for undertakings and supervisors. All these elements need to be taken into consideration in order to provide a satisfactory answer to the issue of subgroup supervision, as all of them will have an impact in terms of choosing one solution or another.
- 1.14. The move towards a risk oriented system means that additional importance shall be given to the management and control function at group level, but also that special attention shall have to be paid at solo level, as different risks and impact will need to be analysed and supervised at solo level. A risk oriented system also means that internal models will be used at group level¹⁴, but the formula provided by CEIOPS will help reduce some of the concerns of the industry in terms of calculation of the PUSC according to different

¹³ See CEIOPS' *Recommendation on possible need for amendments to the Insurance Groups Directive*.

¹⁴ See CEIOPS' answer to Call for Advice 20, paras. 20.114 and 20.115 on the validation of internal models at group level, available at www.ceiops.org.

rules, as the normal situation will imply agreement among supervisors, therefore no different calculations at the different levels.

- 1.15. A risk oriented system also affects the solvency assessment of the entities that are part of a group, namely due to both diversification and contagion effects¹⁵.
- 1.16. Improved supervisory harmonization will have a positive impact in terms of level playing field, as well as the reduction of burden to the industry. It will also help to give a Group supervisor additional competences (CEIOPS considers aligning with the FCD as a good solution).
- 1.17. Financial convergence is an important objective, as stated by the ECOFIN¹⁶ or the FSC¹⁷. Therefore, it's of core importance to take a look at the solution of the same issue in the banking sector and see if a similar approach is convenient or not, and, in case CEIOPS decides advising a different approach, justifying it appropriately. Furthermore, the existence of the FCD makes it even more necessary to take into consideration financial convergence and to avoid arbitrage both at sectoral and at financial conglomerates' level.
- 1.18. As outlined above the CRD (Articles 68-73) settles a regime where calculations shall be compulsory at top of the group level both at consolidated level and on an individual basis. Subconsolidation will be required at national level for parent insurance undertakings or parent holding companies in a Member State.
- 1.19. Increased transparency and disclosure both by the supervisory authorities and the undertakings mean a positive impact when it comes to demonstrate that a supervisory decision on whether to proceed on supervision of a concrete subgroup is needed, e.g. due to the significance and importance of the subgroup and the existence of a financial situation that demands such supervision and not an arbitrary one.
- 1.20. CEIOPS also considered the IAS standards, and namely IAS 27¹⁸.

¹⁵ Please see below, chapter on diversification effects.

¹⁶ See press release of ECOFIN of 05 May 2006 available at http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/89449.pdf.

¹⁷ FSC 4159/06, FSC report on Financial Supervision.

¹⁸ IAS 27

Definitions:

Consolidated financial statements are the financial statements of a group presented as those of a single economic entity.

Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities

- 1.21. CEIOPS is sensitive to the reality of certain groups' structures and the need to allow for setting the level in which sub-consolidation should be applied at regional level (including more than one country, e.g. Scandinavian countries) in certain circumstances (e.g. where "unity of purpose" applies). In cases where there are at the same time national sub-levels the national level of subconsolidation may be waived to avoid unnecessary burden to the entities.
- 1.22. CEIOPS considers that it is compatible with the aforementioned principles to allow the supervision of those sub-groups where there is a unity of decision, in principle at national level¹⁹. Additionally to that, and to be in line with the current existing situation of certain entities operating on a supranational level, it would include the possibility for involved supervisors to agree on a different level of supervision, e.g. at a certain level, such as Scandinavia. Finally, solo supervision should not be waived under any circumstances, as it has a core role to play in the upcoming Solvency II system.
- 1.23. Such a regime would reduce unnecessary supervisory burden, as the existing general rule of subconsolidation at all levels unless a waiver was granted would be changed by a more sensitive one that only requires subconsolidation where the supervisors involved consider it necessary. These could include a stressed financial situation of a subgroup or if the subgroup is an important actor on the involved local market. It would make compatible the needed flexibility of supervisory action with adequate supervision of risks, and protection of policyholders.

The cost method is a method of accounting for an investment whereby the investment is recognised at cost. The investor recognises income from the investment only to the extent that the investor receives distributions from accumulated profits of the investee arising after the date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognised as a reduction of the cost of the investment.

A group is a parent and all its subsidiaries.

Minority interest is that portion of the profit or loss and net assets of a subsidiary attributable to equity interests that are not owned, directly or indirectly through subsidiaries, by the parent.

A parent is an entity that has one or more subsidiaries.

Separate financial statements are those presented by a parent, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees.

A subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).

¹⁹ In principle, it will be necessary that a parent company is present in the involved country. However, it will also be necessary to address the issue of groups whose structure is not based on participation in capital (e.g. Mutuals).

- 1.24. It would profit from increased disclosure, transparency and supervisory convergence. It would be, at the end, fully compatible with the Solvency II framework.

CEIOPS' Advice

- 1.25. CEIOPS considers that, in a series of situations, subgroup supervision has an important role to play in order to carry out the appropriate supplementary supervision to solo level, complementing top-level group supervision in order to better protect policyholders. CEIOPS also considers that avoiding unnecessary burden is a vital goal to be achieved in the supervisory framework. Therefore, CEIOPS recommends to apply sub-group supervision where the supervisor involved considers that it is necessary (such cases could include a stressed financial situation of a subgroup or if the subgroup is an important actor on the involved local market), instead of applying it at all sublevels. The concept of "unity of decision" as applied in the accounting regulation (Accounting Directive) is a sensible concept as it allows to capture the reality of certain groups' structures in a flexible way, such as sub-consolidation on a regional level or on a very concrete line of business. CEIOPS strives to avoid a multiplication of supervised sub-levels. In principle, except in the case of very special structures of groups, no more than 2 levels of group supervision should be required.
- 1.26. CEIOPS will consider objective criteria, namely those set by the accounting rules²⁰, for determining the circumstances under which there is a unity of decision.

²⁰ FCD, Articles 2.12 and 2.13 on definition of "group":

"Group" shall mean a group of undertakings, which consists of a parent undertaking, its subsidiaries and the entities in which the parent undertaking or its subsidiaries hold a participation, as well as undertakings linked to each other by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC

"Close links" shall mean a situation in which two or more natural or legal persons are linked by

- (a) "participation", which shall mean the ownership, direct or by way of control, of 20% or more of the voting rights or capital of an undertaking, or
- (b) "control", which shall mean the relationship between a parent undertaking and a subsidiary, in all cases referred to in Article (1) and (2) of Directive 83/349/EEC, or a similar relationship between any natural or legal person and an undertaking. This relationship is characterized by the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Group Diversification Benefits and their incorporation in the solvency framework

Explanatory Text

Introduction

- 2.1 In its letter of 24 January 2006 the European Commission asked CEIOPS to advise on "Distribution of capital within a group and [the] extent to which diversification benefits/costs should be taken into account and transfers of capital [.....] admitted".
- 2.2 There may be both positive and negative effects arising from membership of a group. In this advice the term "diversification benefit" is used to refer to the positive effect of diversification of risk and "diversification effect" is used to refer to the net effect of "diversification benefit" and "group risk", that is to say, events or factors relating to being part of a group may have an adverse financial, legal or reputational effect on individual entities of the group.
- 2.3 Diversification effects may arise within and between various risk factors. The calculation of diversification effects can be conducted at the level of individual company and/or at the group level.
- 2.4 This advice addresses diversification between entities within a group and uses the term "group diversification benefit/effect" unless the reference is specifically to diversification benefits/effects arising within a single entity. The advice focuses on two main issues, first the measurement of diversification effects at group level, and secondly allocation of those effects to individual insurance undertakings within a group.

Measurement of group diversification effects

- 2.5 Diversification is fundamental to risk management in the insurance industry. CEIOPS agrees that group diversification effects should be embedded in the solvency framework for insurance groups to the extent that they can be satisfactorily and objectively identified, measured and supervised. However, CEIOPS has a number of serious concerns about how possible it is to satisfactorily and objectively measure diversification effects, in particular regarding statistical approach and coverage of tail events.
- 2.6 So, although CEIOPS in principle can agree that at least on a conceptual level positive group diversification effects may exist, CEIOPS also notes that at least at the moment in reality it has proven rather difficult to demonstrate that these exist in practice. It further notes that the scientific literature on the subject is less

than conclusive. The onus is thus very much on the industry to provide evidence on their existence and magnitude.

- 2.7 CEIOPS also observes that possible positive group diversification effects are, at least at the moment, hard to estimate; their value may vary considerably over time; and there is not enough experience on how diversification effects may be affected, e.g. during times of stress (e.g. by how much and how rapidly they might change). The supervision of diversification effects is particularly challenging.
- 2.8 It is also important to keep in mind that diversification across entities introduces additional factors including separate legal incorporation, fungibility of capital, cost of transfer, and group risks. It is essential that these factors are taken into account in the overall measurement of diversification effects. The potential problems arising from these kinds of issues are particularly amplified in a group context where the entities of the group are located in different jurisdictions.
- 2.9 So, although CEIOPS in principle agrees that group level diversification effects should be reflected in the future solvency regime, it also highlights the need for further investigation on the possible risks and uncertainties involved.
- 2.10 Subject to concerns about the measurement and objective evidencing of diversification effects being satisfactorily addressed, CEIOPS notes the following:
- Group diversification benefits should be defined as the difference between the sum of the solo SCRs of each regulated entity²¹ in the group and the group SCR, as calculated by a standard formula used on consolidated data or by an internal group model²² before group-specific risks have been taken into account.
 - The overall group diversification effect should take into account group contagion risks, issues around the fungibility of capital and any potential weaknesses in the correlation data, particularly under stress conditions. These may either be factored directly into the group model or reflected in a subsequent adjustment to its result.

²¹ That is insurance and reinsurance undertakings. Where an insurance group has cross-sector holdings capital requirement for these should also be taken into account (relevant capital requirements for credit institutions and investment firms and notional requirements for unregulated financial institutions are set out in the CRD).

²² In principle it may be possible to include cross-sector diversification effects in the model. In practice, however, this may be too complicated. In this case solo cross-sector capital requirements would simply be added to the modelled group SCR so that no cross-sector diversification benefit would accrue.

- Group diversification effects should be recognised in the group SCR where an approved internal group model is used (approval for these purposes would require the group supervisor to be satisfied that group diversification benefits have been appropriately identified and measured and that group contagion risks and fungibility of capital have been properly taken into account).

Use of a standard formula

- 2.11 Where a standard formula is used, the group SCR should be calculated according to consolidated data so that diversification benefits resulting from intra-group offsets on consolidation and the fact that the different insurance portfolios in the group are treated as one get recognised²³. In this case a risk factor would need to be applied to take account of group risks. It is worth pointing out here that the extent that diversification benefits get recognised may depend on the form of standard formula adopted at EU level.
- 2.12 It could *inter alia*, potentially be particularly punishing on smaller groups if they were not allowed to benefit from at least some diversification effects even though they might not immediately have the resources to build an internal model. In this respect, it might be helpful to observe that, subject to final decisions on the form and calibration of the standard formula/s, it should be the case that internal models allow for more accurate measurement of risks and possible positive diversification effects, so in comparison to the relatively 'crude' standard formula situation, there should be an incentive for groups to move to using internal models.
- 2.13 In this context it has also been suggested that it might be necessary for the group supervisor to have the power to request the group to start using an internal model. But, as it might take some time before an approved model is in place, being able to utilise the consolidated data and standard formula method would be useful for the transitional period.

Conditions under which group diversification effects could be taken into account at solo level

- 2.14 Recognition of group diversification effects in the solvency framework (to the extent that they are positive²⁴) will result in a group SCR being less than the sum of the solo SCRs of its component entities. After the recognition of group level

²³ The extent of diversification benefits recognised automatically in the consolidated account approach may depend on the type of standard formula adopted.

²⁴ Negative effects (i.e. where group contagion risk outweighs group diversification benefits) should be taken into account in the group SCR. This may not necessarily need to be allocated to solo SCRs.

diversification benefits, the next key question to address is how to allow for the distribution of positive diversification effects to solo entities in the group. It is noted that this could be achieved either by reducing solo capital requirements or by increasing available solo capital. The former would result in a different capital requirement for the same risk profile in an entity which is part of a group compared to one which is not part of a group. Although this approach might make it less likely that groups would need to resort to potentially complex intra-group transactions that might make the supervision of groups more challenging, CEIOPS nevertheless considers that lowering the solo capital requirement this way would give the wrong information to stakeholders and therefore recommends allocation of positive group diversification effects via available solo capital as a more transparent approach.

2.15 It is also important to consider that allowing the “down-streaming” of the group level positive diversification effects to the solo level may open a potential contagion channel within a group. If the positive effects were, for example under stressed conditions, to disappear, this would then influence all the entities in a group.

2.16 Positive diversification effects, which are available and potentially distributable from the group level, can be divided into two parts:

- any part of the surplus which is actually covered by eligible elements of capital already held centrally; and
- the remaining part of diversification effect which is not covered by existing capital held by the group.

2.17 On this issue, it is noted that there are different views within CEIOPS:

- firstly, it is argued that it is prudent to only allow a part (following adjustments) of the positive diversification effect that is covered by eligible elements of capital held centrally to be down-streamed to the solo entities;
- second, it is argued that the entirety of the actual capital surpluses should be allowed to be allocated to solo entities;
- third, it is argued that only a part of the diversification effects not actually covered by eligible capital elements should be downstreamed to the solo entities, provided that there is a surplus of eligible capital held by the group above the group SCR. The fraction would be based on the capital surplus above the group SCR (it would in essence limit the leverage effect).
- fourth, all of the accepted positive diversification effect should be allowed to be down-streamed whether covered by eligible capital or not.

- 2.18 It is noted that further consideration is needed on the question of allocation of surpluses, which are not backed by existing capital. On the one hand there are concerns if the diversification effects are not covered by eligible capital elements, and if there is a breach of the group SCR. In this case, the group would have to raise extra funds in the market which would have various implications including cost, timing and potential pressure on solo entities to provide a return on the group's investment. On the other hand, it is a consideration that as long as the diversified group SCR continues to be met and appropriate adjustments are made to avoid double counting of elements covering the group SCR, it should not be necessary to restrict a parent holding company's ability to provide support to group entities. It should indeed be possible for the parent to raise capital from the capital markets if this is needed to support a subsidiary, although in this respect it has also been noted that this ability might be somewhat curtailed during times of stress. Mutuals and small groups might find it particularly challenging to raise funds.
- 2.19 Furthermore it is worth noting at this stage that if the diversification effects admitted at group level are not entirely down-streamed to solo entities, incentives are given to groups to create group capital in order to cover the solo SCRs (double gearing and/or debt issued by holding companies in order to cover solo capital requirements).

Ways in which diversification effects could be allowed to be down-streamed

- 2.20 Regulatory capital headroom resulting from group diversification effects could be allocated in a variety of ways. Some of these are already possible under existing rules including for example risk transfer via internal reinsurance²⁵ or subscription to eligible elements of capital in solo group entities. CEIOPS recommends that methods already recognised under existing rules should be allowed as a means to distribute positive diversification effects to solo entities.
- 2.21 But there may be downsides to these methods. They involve intra-group risk transfer and intra-group capital creation which can cause complex intra-group relationships. This may reduce transparency and add to costs and reduce flexibility when compared to allocation techniques which would allow group diversification surpluses to continue to be held at group level and allocated to solo entities in the form of contingent capital support. In these conditions, it could be envisaged that surpluses arising from group diversification effects should be allocated in the form

²⁵ In fact, internal reinsurance reduces solo capital requirements.

of a commitment by a parent company to support individual group entities in the form of contingent capital.

- 2.22 CEIOPS has considered the use of contingent capital commitments for the allocation of group diversification effects. On the one hand contingent capital is not normally considered suitable for covering regulatory capital requirements although the current insurance Directives do allow it to be recognised in limited circumstances (for example unpaid share capital or, in the case of mutuals, initial funds and supplementary calls). On the other hand there is little economic difference between legally-binding risk transfer instruments which are already accepted as risk mitigants in the current regulatory regime (e.g. re-insurance) and a legally-binding contingent commitment to provide capital support as proposed by the industry. This suggests that contingent capital support could be acceptable subject to legal certainty that commitments would be met promptly in the form of eligible capital when required. That said, it is also noted that there are some serious doubts currently on the likelihood of successful and timely enforcement of contingent capital support if used to down-stream group level diversification effects. These doubts are even greater in the case of contingent capital support crossing jurisdictions and legal systems.
- 2.23 To facilitate further discussion, CEIOPS has drawn up a list of suggested possible minimum conditions, or principles, under which allocation in the form of contingent capital support may be allowed. It is noted that this is not necessarily an exhaustive list and it is recalled that some CEIOPS members consider that these conditions should relate only to either a proportion of, or the entirety of group diversification effects actually covered by capital held centrally. Others consider they should relate to a greater amount of positive diversification effects, not necessarily covered by capital held by the group.

Conditions under which positive group diversification effects might be allowed to be allocated to solo entities in the form of contingent capital support

- 2.24 Conditions under which positive group diversification effects might be allowed to be allocated to solo entities in the form of contingent capital support are:
- a. In the case that a group internal model is being used, as part of the model validation process the group supervisor, together with involved solo supervisors, must approve the methodology and correlation inputs used for calculating diversification effects within an internal group model (in particular group risks, fungibility and any potential

- weaknesses in correlation data should be taken into account in the model).
- b. In the case that a standard formula is used on consolidated data, it will need to be checked that all the risks, particularly the group risks, the fungibility of capital and other potential weaknesses are identified and taken into account when considering the group diversification effect.
 - c. Contingent capital support must constitute a commitment to provide support in the form of eligible capital (a promise of support in the form of a loan will not qualify as capital support).
 - d. In addition to the powers that the supervisors of solo entities will have to ensure that solvency requirements are met, additionally, also the group supervisor should be enabled to require a parent undertaking to deliver "capital support" in cash and in a timely manner when needed at solo level. Appropriate powers and responsibilities of the group and solo supervisors should be clearly set out in the level 2 implementation of the Solvency II Directive.
 - e. "Capital Support" must be in the form of a legally water-tight commitment which ensures there are no barriers to the prompt delivery of capital support if and when needed. The treatment of capital support in the case of a winding-up must be clarified.
 - f. Capital support should only be recognised for the purpose of covering a part of the solo SCRs. This will be limited to a proportion (which will need to be determined at a later stage) of the difference between the solo MCR and solo SCR of the receiving entity. CEIOPS will need to consider the classification of this form of capital. The treatment of contingent capital has already been discussed in the answer to Call for Advice 19, para. 19.57²⁶.
 - g. The provider of capital support must be financially sound.
 - h. Whenever "capital support" is used by an individual group entity the parent must replace it with eligible capital.
 - i. The group must be subject to centralised risk management (see conditions in the CRD, Articles 69 and 70).
 - j. Capital support must be transparent and fully disclosed.

²⁶ Available at www.ceiops.org.

CEIOPS' Advice

Recognition of group diversification effects

- 2.25 CEIOPS recommends that group diversification benefits should be defined as the difference between the sum of the solo SCRs of each regulated entity in the group and the group SCR as calculated by an internal group model or by the standard formula based on consolidated data.
- 2.26 Group specific risks and fungibility of capital should be taken into account when calculating the overall group diversification effects.
- 2.27 Group diversification effects (either positive or negative) should be recognised in the group SCR where an approved internal group model is used. Approval for these purposes would require the group supervisor to be satisfied that group diversification benefits have been appropriately identified and measured and that group specific risks and fungibility of capital have been properly taken into account.
- 2.28 Where a standard formula is used, CEIOPS recommends that the group SCR is calculated according to the consolidated accounts method so that diversification benefits resulting from intra-group offsets on consolidation is automatically recognised. In this case an additional risk factor would need to be applied to take account of group risks and fungibility of capital
- 2.29 Consideration will have to be made on the form and the calibration of the standard formula.

Allocation of group diversification effects to solo entities in a group

- 2.30 In order to take advantage of positive group diversification effects, CEIOPS recognises that groups should in principle be allowed to allocate the regulatory capital headroom created to the component entities of the group. This should be done by increasing the available solo capital of the group's entities rather than reducing their capital requirement.
- 2.31 CEIOPS notes that regulatory capital headroom resulting from group diversification effects could be allocated in a variety of ways. Some of these are already possible under existing rules including for example risk transfer via internal reinsurance or subscription to eligible elements of capital in solo group entities. Allocation of positive group diversification effects by these methods should be allowed.
- 2.32 CEIOPS recognises, however, that there may be economic advantages to groups if they are allowed to continue to keep the

capital headroom at group level and allocate it to solo entities by means of contingent capital commitments. CEIOPS recommends that this could be allowed under certain strict conditions. Further consideration is however needed on whether these conditions should relate to the whole positive diversification effect or only to a part and under which conditions.

2.33 Further consideration should be given to those minimum conditions, or principles, under which allocation in the form of contingent capital support may be allowed.

Groups with third country connections

Explanatory text

Introduction

- 3.1 In its letter of 24 January 2006²⁷ the European Commission asked CEIOPS for further advice on cooperation with third countries (parent companies and subsidiaries) in the Solvency II framework.
- 3.2 The experience CEIOPS has gathered over the years since the IGD came into force shows that supervision of insurance groups with third countries' relations represents particular challenges. Establishing adequate infrastructure for exchange of information and supervisory cooperation has in several cases been a particular problem. When introducing a model-based regime for supervision and solvency calculation some of the problems of the current regime will be further exacerbated and need to be addressed in the future Level 1 Directive.
- 3.3 These problems concern cases where:
- a group is headed by a company located within the EEA and has subsidiaries in third countries; and
 - a group is headed by a company located in a third country and has subsidiaries within the EEA.

A group is headed by a company located within the EEA and has subsidiaries in third countries

- 3.4 For all third country subsidiaries representing significance to the risk profile of the group the Group supervisor should initiate an equivalence assessment of the involved supervisory regimes in accordance with the guidance issued by CEIOPS unless a recommendation from CEIOPS on the equivalence of that particular third country's regime already exists.
- 3.5 The assessment must cover:
- the ability and willingness of the third country supervisor to exchange relevant information (both qualitative and quantitative) of equivalent Solvency II standard and to cooperate fully with the Group supervisor.
 - where an internal group model is used, local risks are properly reflected in the inputs from the third country entity to the group model.

²⁷ Available at: <http://www.ceiops.org/content/view/5/5/>.

- 3.6 CEIOPS should, preferably in cooperation with CEBS, develop guidance for assessing equivalence of the different aspects of supervisory regimes in third countries.
- 3.7 CEIOPS recommends following the principles laid down i.a. in the FCD, Articles 18 and 19, for the purpose of establishing whether the supervisory regime of a particular third country can be regarded as equivalent for supervising those parts of a group with its head office within the EEA that are located in a third country. This includes that the Group supervisor should decide on the equivalence of supervisory regime in a particular third country after consulting the other relevant competent authorities. To avoid an unnecessary burden both for EEA supervisor and supervisors in a third country (as well as the group concerned) of conducting multiple equivalence testing, as well as to avoid different EEA supervisors reaching different results, CEIOPS should issue guidance to its members on which countries can be seen as having equivalent supervisory regimes for the purpose of meeting EU group supervision responsibilities for EU groups with third country subsidiaries. Further details on how such a process of issuing guidance on equivalence could be included as level 2 implementing measures or as level 3 supervisory guidance.
- 3.8 CEIOPS recommends introducing the possibility of avoiding a burdensome procedure of testing the equivalence of a particular third country if in the opinion of the Group supervisor after consulting the relevant competent authorities it is seen to represent an insignificant risk to the overall situation of the group.
- 3.9 If the outcome of the assessment is that the regime in the particular third country is of equivalent standard to what is described in the future Level 1 Directive, and thus cooperation and exchange of information with the supervisory authority in the third country can be trusted, the Group supervisor may, after consulting relevant competent authorities, rely on that third country's supervisory input for the purpose of meeting its group supervision responsibilities (both qualitative and quantitative) including inputs for internal models at group level.
- 3.10 If, on the basis of an assessment of the supervisory regime of the third country equivalent standards do not apply and the competent authorities in the EEA can't be guaranteed full access to relevant information from the company and the authority, the Group supervisor must take appropriate action to ensure that risks from group entities located in that third country are properly addressed. This may include applying a proxy capital charge for the third country entity based on Solvency II requirements or deduction of the group's investment in that entity. Where a group model is used it may include applying a standard formula to those entities or a capital add-on .

A group is headed by a company located in a third country and has subsidiaries within the EEA

- 3.11 For all groups headed by a company in a third country the Group supervisor should initiate an equivalence assessment of the involved supervisory regime in accordance with the guidance issued by CEIOPS unless a recommendation from CEIOPS on the equivalence of that particular third country's regime already exists.
- 3.12 The assessment must cover:
- the third country supervisory authority's approach to group supervision as a whole (both qualitative and quantitative);
 - where an internal group model is used, the rules and principles for validating internal models in the particular third country; and
 - the ability and willingness of the third country supervisor to exchange information and cooperate fully with the Group supervisor.
- 3.13 CEIOPS should, preferably in cooperation with CEBS, develop guidance for assessing equivalence of the different aspects of supervisory regimes in third countries. Particular work should be done in developing the conditions under which a third country supervisory authority could act as a Group supervisor, either on a stand-alone basis or in cooperation with an EEA authority.
- 3.14 CEIOPS recommends following the principles laid down i.a. in the FCD, Articles 18 and 19, for the purpose of establishing whether the supervisory regime of a particular third country can be regarded as equivalent for supervising groups with their head office outside of the EEA. This includes that the group supervisor should decide on the equivalence of supervisory regime in a particular third country after consulting the other relevant competent authorities. To avoid an unnecessary burden both for EEA supervisor and supervisors in a third country by conducting multiple equivalence testing, as well as to avoid different EEA supervisors reaching different results, CEIOPS should issue guidance to its members on which countries that can be seen as having equivalent supervisory regimes for the purpose of meeting EU group supervision responsibilities for groups owned by third country parents. Further details on how such a process of issuing guidance on equivalence could be included as level 2 implementing measures or as level 3 supervisory guidance. Nevertheless the relevant EEA Group supervisor should remain the ultimate responsible of equivalence testing for a specific group
- 3.15 Particular work should be done in developing the conditions under which a third country supervisory authority could act as a Group

supervisor, either on a stand-alone basis or in cooperation with an EEA authority.

- 3.16 If the group equivalence is established, the Group supervisor may, after consulting relevant competent authorities, rely on group supervision undertaken by the third country authority for the purpose of fulfilling its group supervision responsibilities towards EU entities vis a vis a third country parent, including the use of an internal group model developed in and validated by the supervisory authority in the third country being the home supervisor of the group.
- 3.17 If the outcome of the assessment is that the supervisory regime of the particular third country is not equivalent to the requirements laid down in the future Level 1 Directive, the Group supervisor should apply other methods for meeting its group supervision responsibilities which may include requiring the establishment of an EU holding company and application of Solvency II requirements to the EEA sub-group, if necessary together with ring fencing measures with respect to the non-EEA parts of the group. In particular the Group supervisor should not allow for the use of an internal model covering any part of the group situated in the third country. For such cases the Group supervisor may allow for the use of an internal model covering those parts of the group that are within the EEA and that a standard model is applied for those parts of the group that are situated outside of the EEA. As an alternative, the Group supervisor may allow for the use of internal models for the whole group, but should require that additional capital is held to cover the uncertainties stemming from the parts of the group situated outside the EEA.

CEIOPS' Advice

- 3.18 CEIOPS recommends following the principles laid down i.a. in the FCD, Articles 18 and 19, for the purpose of establishing whether the supervisory regime of a particular third country can be regarded as equivalent for supervising groups with their head office outside of the EEA as well as for supervising those parts of a group with its head office within the EEA that is located in a third country. This includes that the Group supervisor should decide on the equivalence of supervisory regime in a particular third country after consulting the other relevant competent authorities. To avoid an unnecessary burden both for EEA supervisor and supervisors in a third country by conducting multiple equivalence testing, as well as to avoid different EEA supervisors reaching different results, CEIOPS should issue guidance to its members on which countries that can be seen as having equivalent supervisory regimes. The assessment of equivalence of a third country may differ depending on whether it is made in the context of an EEA group with regulated entities in a third country or a third country group with regulated entities in

the EEA and depending on whether the assessment relates to overall group supervision or specifically to the use of internal group models.

Groups having their head office within the EEA

3.19 For groups having their head office within the EEA, CEIOPS recommends the following:

3.20 If the outcome of the assessment of the supervisory regime of a particular third country is that the regime is of equivalent standard to what is described in the future Level 1 Directive, and thus cooperation and exchange of information with the supervisory authority in the third country can be trusted, the Group supervisor may, after consulting relevant competent authorities, rely on that third country's supervisory input for the purpose of meeting its group supervision responsibilities (both qualitative and quantitative) vis a vis parts of an EEA-headed group located in this third country, including inputs for internal models at group level

3.21 If, on the basis of an assessment of the supervisory regime of the third country equivalent standards do not apply and the competent authorities in the EEA can't be guaranteed full access to relevant information from the company and the authority, the Group supervisor must take appropriate action to ensure that risks from group entities located in that third country are properly addressed. This may include applying a proxy capital charge for the third country entity based on Solvency II requirements or deduction of the group's investment in that entity (c.f. CEIOPS' answer to Call for Advice 19.106). Where a group model is used it may include applying a standard formula to those entities or a capital add-on.

3.22 If the Group supervisor, after consulting the relevant competent authorities is of the opinion that the activities in a certain third country are insignificant to the overall risk of the group, it can decide to omit testing the equivalence of the supervisory regime.

Groups having their head office outside of the EEA

3.23 For groups having their head office outside of the EEA, CEIOPS recommends the following:

3.24 If the outcome of the assessment of the supervisory regime of a particular third country is that the regime is of equivalent standard to what is described in the future Level 1 Directive, and thus cooperation and exchange of information with the supervisory authority in the third country can be trusted, the Group supervisor may, after consulting relevant competent

authorities, rely on that third country's supervisory input for the purpose of meeting its group supervision responsibilities (both qualitative and quantitative) vis a vis parts of an EEA-headed group located in a third country including inputs for internal models at group level.

- 3.25 If the outcome of the assessment is that the supervisory regime of the particular third country is not equivalent to the requirements laid down in the future Level 1 Directive, the Group supervisor should apply other methods for meeting its group supervision responsibilities which may include requiring the establishment of an EU holding company and application of Solvency II requirements to the EEA sub-group, if necessary together with ring fencing measures with respect to the non-EEA parts of the group. In particular the Group supervisor should not allow for the use of an internal model covering any part of the group situated in the third country. For such cases the Group supervisor may allow for the use of an internal model covering those parts of the group that are within the EEA and that a standard model is applied for those parts of the group that are situated outside of the EEA. As an alternative, the Group supervisor may allow for the use of internal models for the whole group, but should require that additional capital is held to cover the uncertainties stemming from the parts of the group situated outside the EEA.
- 3.26 CEIOPS' recommendations are in line with what already exist in the FCD and the CRD as far as assessment of equivalence of supervisory regime in general is concerned. CEBS and CEIOPS should consider to develop common guidance with regards to allowing models for groups origin outside of EEA.

Issues related to the MCR and SCR in a group context

Explanatory Text

- 4.1 In its letter of 24 January 2006²⁸ the European Commission asked CEIOPS for further advice on the development of the MCR and SCR formulas for insurance and reinsurance undertakings in light of the approach outlined in the answer to Call for Advice 18.

Minimum Capital Requirement (MCR) and Solvency Capital Requirement (SCR)

MCR

- 4.2 In the answer to Call for Advice 18²⁹ CEIOPS clearly concluded "There is no general need to define a group MCR as a separate trigger for supervisory intervention" (paras. 18.18-18.39). It was only recommended that a proxy MCR should be calculated to determine a floor to the SCR. This proxy MCR should roughly be the sum of solo MCRs.

SCR

- 4.3 Considering this requirement may be regarded as a kind of "economic capital", it is natural that it will be the cornerstone of the financial requirements at group level. So is the use of an internal model for the calculation of this capital requirement.
- 4.4 In accordance with the respective calibration of MCR and SCR at solo level it should be necessary to define the floor of SCR.

Next Steps

- 4.5 CEIOPS notes that the design of the proxy MCR and SCR at group level is highly dependent on the design of the capital requirements at solo level. CEIOPS is currently testing the SCR, standard formula and internal model, and the MCR at solo level in its second Quantitative Impact Study (QIS). A post-QIS 2 consultation paper is intended in late October 2006. Further QIS exercises including capital requirements at group level will be necessary to ensure that the approaches under consideration meet the prudential objectives of the Solvency II framework.

²⁸ Available at: <http://www.ceiops.org/content/view/5/5/>.

²⁹ Available at www.ceiops.org.

CEIOPS' Advice

- 4.6 In line with its previous advice, CEIOPS recommends that the requirement of a MCR at group level is not necessary.
- 4.7 A proxy MCR should be calculated for the purpose of the group's solvency calculation (which will be the sum of the solo MCRs) in order to define a floor to the group SCR.
- 4.8 In essence, the floor for the group SCR would be based on the proxy MCR multiplied by a factor equal to one or more. The determination of this factor will mainly depend on the outcomes of the calibration of the solo MCR.
- 4.9 Further work on this issue will be necessary when the work on the MCR and the SCR on solo level progresses, including QIS.