
First tier Solvency II equivalence countries enter the final stretch

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Eiopa's 2014 advice remains the same as in 2011: Bermuda, Japan and Switzerland meet the equivalence criteria but caveats remain

The beginning of 2015 marks the start of the next and final stage of the Solvency II equivalence assessment process for the three “first tier” candidate countries: Switzerland, Bermuda and Japan. On December 19, 2014, European regulator Eiopa launched public consultations on three reports setting out its advice to the European Commission assessing the supervisory systems of these countries for the purposes of equivalence. The reports update the 2011 analysis of the efforts made by the three jurisdictions to align their supervisory systems with Solvency II standards.

Given the EU's ambition to be at the forefront of developing global supervisory standards for the insurance sector, equivalence is an important part of the Solvency II framework since third countries are promised substantial benefits in exchange for aligning their supervisory systems with Solvency II.

Equivalence benefits are available in three areas: reinsurance, group solvency calculation and group supervision. Reinsurance and group supervision are particularly attractive to third countries. Equivalence for reinsurance means contracts concluded with reinsurers from equivalent jurisdictions will be treated in the same way as those concluded with EU reinsurers; the ban on collateral requirements will apply. For group supervision, member states will have to rely on the equivalent third-country group supervision and the burden of dual group supervision will be removed. The third area – group solvency calculation – benefits internationally active EU groups, since these groups will be able to use the local rules on solvency capital requirements and own funds for their third-country subsidiaries when calculating group solvency.

Staggered start

In 2011 the three candidate countries started the process in different positions. In its initial advice Eiopa found, overall, each country met the equivalence criteria but with certain caveats. However, based on the five categories Eiopa uses to assess third-country rules against individual principles, the three candidates differed significantly.

Switzerland and Japan (which is only assessed for reinsurance) were deemed “equivalent” or “largely equivalent” across the board, except each had one “partly equivalent” finding. Bermuda, which has only been assessed in relation to its non-life business, started from a much lower base, with only one “equivalent” finding (professional secrecy). Assessment of other principles ranged from “largely equivalent” to “not equivalent”. Bermuda therefore had to make a significant number of changes to its supervisory system to bring it in line with Solvency II.

The overall conclusion in the December 2014 Eiopa advice remains the same as 2011: all three jurisdictions meet the equivalence criteria but caveats remain. The difference between the initial and the updated reports lies in the details.

Eiopa finds the Swiss system “equivalent” under all principles except one: public disclosure requirements are assessed as “largely equivalent”. This should be addressed through further changes to Swiss legislation in 2015. This positive assessment is no surprise, since Switzerland has been at the forefront of introducing a Solvency II-like regime from the start of the equivalence process.

Eiopa’s advice on Japan is relatively unchanged. The Japanese system is deemed “equivalent” or “largely equivalent” with the exception of the solvency regime, which is deemed “partly equivalent”. Again, Eiopa expects further scheduled changes in Japanese legislation will improve this finding.

Regarding Bermuda, the updated advice reflects the jurisdiction’s significant achievements. Eiopa has extended its assessment to include life business, as well as non-life, but captives remain excluded. Bermuda is found “equivalent” or “largely equivalent” for non-life in all three equivalence areas. Planned legislative changes in 2015 should address a number of Eiopa’s concerns. In relation to life business, Eiopa finds Bermuda “partly equivalent” under some principles and at the same time highlights Bermuda’s ongoing programme to fully align the legal framework for life insurers to Solvency II rules. In sum, Bermuda seems to be in a very good position to obtain a positive equivalence decision at least for large non-life re/insurers (Bermudian classes 3B and 4) and group supervision.

Final decision

The focus now shifts to the European Commission: it takes the final decision on equivalence. It is uncertain how the commission will exercise its discretion in the areas where Eiopa has found the supervisory systems “largely equivalent” or “partly equivalent”. It also remains to be seen whether certain deficiencies Eiopa has identified in its underlying analysis of third-country systems, but which are not included in Eiopa’s advice on individual principles, will affect the commission’s view on whether the equivalence criteria, as set out in the level 2 delegated act (Commission Delegated Regulation), have been fulfilled.

There are no precedents in the insurance sector at present that would assist in predicting the commission’s final equivalence decisions. However, the commission has already exercised similar discretion in equivalence assessments in other financial services sectors, such as credit rating agencies and, more recently, central counterparties. In both cases, the commission adopted positive equivalence decisions on the basis of technical advice

provided by Eiopa's "sister" authority, the European Securities and Markets Authority (Esma). These indicated certain shortcomings in the third-country regime in question and suggest certain deficiencies of third-country regimes do not necessarily preclude a positive equivalence decision by the commission.

Even if the commission were to conclude some of the deficiencies rule out a positive equivalence decision at this stage, any of the "first tier" candidates is likely to be automatically granted a temporary/provisionally equivalent status, thus joining a wider group of candidate countries.

There is yet another "unknown" in this final stage of equivalence process for the three jurisdictions. Equivalence assessment is in the first place a technical, outcome-based exercise – that of verifying whether a given third country meets the equivalence criteria set out in the level 2 delegated act. However, equivalence decisions are a delegated act. Therefore, before the delegated act is legally binding, it must be submitted to the European parliament and the Council of Europe. Both have the right to object. This specific legislative procedure adds an additional (political) component to what is an intensive and technically challenging process for third-country jurisdictions and the cross-border re/insurance business that depends on its successful conclusion.

The commission is expected to take its final decisions on equivalence of the "first tier" candidates as soon as the level 2 delegated measures enter into force (ie, before summer 2015).

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