EUROPEAN
COMMISSION

Brussels, 27.6.2019
COM(2019) 292 final

REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on the application of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking and pursuit of the business of Insurance and Reinsurance (Solvency II) with regard to group supervision and capital management within a group of insurance or reinsurance undertakings

I. Introduction

Since 1 January 2016, when it entered into application, the Solvency II Directive[1] has provided a sound and robust prudential framework for insurance and reinsurance firms in the EU. Based on the risk profile of individual companies, it promotes comparability, transparency and competitiveness.

Title III of the Solvency II Directive concerns the supervision of insurance and reinsurance undertakings in a group (hereafter "group supervision"). The Directive uses an innovative supervisory model, which assigns a key role to a group supervisor, while recognising and maintaining an important role for supervisors of individual insurance entities.

This report assesses the benefit of enhancing group supervision and capital management within a group of insurance or reinsurance undertakings, as required under Article 242(2) of the Solvency II Directive.

On 7 June 2018, the Commission asked the European Insurance and Occupational Pensions Authority (EIOPA) for input to the report[2]. EIOPA's contribution, as provided on 19 December 2018[3], fed into this report.

The report is divided into four parts. Chapter II analyses supervisory practices and challenges related to the determination of the scope and the exercise of supervisory powers over groups. Chapters III and IV assess challenges and legal uncertainties related to group solvency calculation, group governance and group reporting[4]. Finally, Chapter V provides a brief overview of developments in the fields of mediation of supervisory disputes and insurance guarantee schemes (IGS), which are not directly related to group supervision.

Some topics are not addressed in this report. Points (g) and (i) of Article 242(2) of the Solvency II Directive are related to resolution frameworks. While the Commission is monitoring international developments related to resolution and systemic risk[5], there has been no broad EU-wide initiative in this area since the entry into application of Solvency II. Similarly, point (f) of Article 242(2) deals with a harmonised framework on asset transferability, insolvency and winding-up procedures. There is currently no policy development in this area, neither at EU level, nor at international level.

Unless stated otherwise, the report uses data up to the end of 2017, covering the 28 Member States of the European Union.

[1] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), OJ L 335, 17.12.2009, p. 1.
[2] See the letter sent to EIOPA and the detailed annex.
[3] Available at this link.
[4] Commonly referred to as "pillar I", “pillar II", and "pillar III" requirements respectively.
[5] See for instance this link.

II. Scope of group supervision and supervisory powers over insurance and reinsurance groups

Solvency II provides that group supervision must apply in the following cases[6]:

- the group head is an insurance or reinsurance undertaking headquartered in the European Economic Area (EEA), and at least one of its related undertakings is another insurance or reinsurance company headquartered in the EEA or in a third country;
- the group includes an insurance or reinsurance subsidiary undertaking in the EEA, and the parent company of the group is either an insurance or reinsurance undertaking, or an insurance holding company or mixed financial holding company[7] headquartered in the EEA or in a third country;
- the group includes an insurance or reinsurance subsidiary undertaking in the EEA, and the parent company of the group is a mixed-activity insurance holding company[8]; in that specific case, group supervision is limited to the supervision of intra-group transactions involving an insurance or reinsurance undertaking[9].

Based on the supervisory disclosures published by National Supervisory Authorities (hereafter "NSAs"), around 350 groups are supervised by a group supervisor in the EU.

a. Exercise of group supervision where the ultimate parent company has its head office in a third-country

The number of acquisitions of European insurers by non-EEA investors has increased in recent years[10]. Indeed, the introduction of Solvency II has required insurers to re-examine their business in light of new capital requirements. According to some practitioners, this exercise may have facilitated the identification of businesses more suitable for divestments and new acquisitions, although there is no conclusive evidence of this. EIOPA's oversight activities help to monitor this trend.

Currently, approximately 200 insurance groups have their ultimate parent undertaking in a third country. Such groups are subject to group supervision in Solvency II[11]. While NSAs must rely on the group supervision exercised by supervisory authorities of equivalent third countries[12], they are required to directly apply worldwide group supervision where the ultimate parent company has its head office in a non-equivalent third country[13]. Where there is no consolidating holding company in the EEA, the Solvency II Directive provides that the group supervisor should be the supervisory authority, which authorised the insurance or reinsurance undertaking with the largest balance sheet total[14].

[6] See Article 213(2) of the Solvency II Directive.
[7] As defined in points (f) and (h) of Article 212(1) of the Solvency II Directive, respectively.
[8] As defined in point (g) of Article 212(1) of the Solvency II Directive.
[9] See Article 265 of the Solvency II Directive.
[10] For example, since 2017, insurance groups and private equity investors from China, Japan, the United States, Switzerland and Canada acquired (a stake in the capital of) insurance undertakings established in the EU.
[11] See Article 213(2)(c) of the Solvency II Directive.
[12] See Article 261 of the Solvency II Directive.
[13] See Article 262(1) of the Solvency II Directive.
[14] See Article 247(2)(b)(v) of the Solvency II Directive.

Full group supervision at the level of the ultimate parent company can therefore be difficult to exercise, as it implies access to information related to activities outside the Union. This is why in such cases, Article 262(2) of the Solvency II Directive allows supervisory authorities to apply "other methods" which ensure appropriate group supervision. Those methods are not exhaustively described in the Directive, which only explicitly refers to the possibility for the group supervisor to require the establishment of an insurance holding company in the Union to which full group supervision requirements are applied.

However, in practice, there are widely divergent practices regarding the supervision of groups whose parent companies have their head offices in non-equivalent third countries.

On the one hand, in accordance with Article 262(2), by the end of 2018, the Commission has received several notifications of use of "other methods" from two NSAs. In most cases, such notifications included both group supervision at European level, and targeted other reporting requirements to monitor risks stemming from the non-EEA part of the insurance or reinsurance group.

On the other hand, based on supervisory disclosures, other NSAs are supervising groups whose ultimate parent companies have their head offices in third countries. According to EIOPA, one NSA is of the view that it is sufficient to require the establishment of a holding company in the EEA, and that the non-EEA part of third-country groups should not be included in group supervision. Other NSAs that decided not to use "other methods" indicate that the implementation of Article 262(2) may be difficult, and consider that they should be allowed to completely waive worldwide group supervision[15]. However, such approaches are not sufficient to monitor appropriately the risks stemming from the non-EEA parts of third-country groups, and their compatibility with Solvency II would be questionable.

b. Scope of group supervision and supervision at the level of holding companies

Group supervisors may decide on a case-by-case basis, and where certain criteria are met, not to include an undertaking in the scope of group supervision[16] (including the ultimate parent company of the group). This decision may sometimes result in a total absence of group supervision, which can be detrimental to policyholder protection and to the level playing field.

There are risks of having an unlevel playing field even where the exclusion of the ultimate parent company does not lead to the absence of group supervision, but to the exercise of group supervision at the level of an intermediate parent company. Such decisions of exclusion may indeed generate significant capital relief for the group, in cases where the ultimate parent does not hold the whole capital of those subsidiaries.

In addition, where the parent company of a group is a holding company, group supervision may be limited to the reporting of intragroup transactions if the group supervisor considers that the main business of the parent company is not to hold participations in insurance subsidiaries[17]. Therefore, inconsistent approaches to the identification of holding companies

[15] However, group supervision of groups whose parent undertakings are registered in a non-equivalent third country must be exercised in accordance with Article 262 of the Solvency II Directive.
[16] See Article 214(2) of the Solvency II Directive.
[17] In that case, the holding company is a mixed-activity insurance holding company (referred to in Article 212(1)(g) of the Solvency II Directive) and not an insurance holding company (referred to in Article 212(1)(f)).

are likely to lead to an unlevel playing field in the European Union. More generally, EIOPA notes that the powers of intervention by group supervisors at the level of holding companies, which are defined by national laws, are limited in some jurisdictions[18].

c. Early intervention framework at group level[19]

Early intervention is defined by EIOPA as a "*stage where the solvency position of an insurer starts to deteriorate and where it is likely that it will continue to deteriorate and fall below the Solvency Capital Requirement if no remedial action is taken*".

Early intervention at group level necessitates that group supervisors have timely information on deteriorating financial conditions. To this end, the Solvency II Directive[20] requires the participating undertaking of an insurance or reinsurance group to inform the group supervisor as soon as the group Solvency Capital Requirement (hereafter "SCR") is breached or is likely to be breached within the next three months. EIOPA reports four cases of notifications in three different Member States since 1 January 2016 (one of those cases corresponds to an actual breach of SCR). Within two months from the observation of non-compliance with the group SCR, a recovery plan must be submitted to the group supervisor[21]. This was the case for the group, which breached its group SCR.

Although not explicitly covered, early intervention powers are to a certain extent embedded in Solvency II. At solo level, supervisors should have the power to take all measures necessary to safeguard the interests of policyholders where the solvency position of an insurer continues to deteriorate[22]. At group level, Solvency II establishes an obligation for all NSAs as group supervisors to adopt the necessary measures where the group solvency may be jeopardised (even if the group meets all regulatory requirements) or where the intra-group transactions or the risk concentrations are a threat to the financial position of the insurance or reinsurance undertakings within the group[23].

Despite the existence of those provisions, EIOPA reports that only twelve NSAs have explicit powers of early intervention at group level. Further investigations would be needed to understand why a majority of NSAs are reported as having no early intervention power at group level despite the existing provisions in the framework.

Among the national frameworks where NSAs have early intervention powers, the triggers are very different, from purely quantitative (for two NSAs) to purely qualitative criteria (for two other NSAs) – eight NSAs using both quantitative and qualitative triggers. The toolbox of early intervention powers at the disposal of NSAs as group supervisors significantly differs between Member States: while some of them are generally available (for instance to limit

[18] Similar issues were identified in the banking sector. Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU introduces a specific approval procedure and direct supervisory powers over certain holding companies. Further, Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 clarifies the criteria to identify whether the main activity of a financial institution (holding company) is to hold banking subsidiaries.
[19] See Article 242(2)(a) of the Solvency II Directive.
[20] See Article 218(5) of the Solvency II Directive.
[21] See Article 218(4) of the Solvency II Directive.
[22] See Article 141 of the Solvency II Directive. This provision does not apply *mutatis mutandis at group level*.
[23] See Article 258(1) of the Solvency II Directive.

dividend payments), others are only available to a limited number of NSAs (for instance, to require the sale of subsidiaries).

III. Pillar I: group solvency calculation and supervision

Supervision of group solvency implies monitoring that eligible own funds are available in the group, and that their amount is always at least equal to the group SCR[24]. By default, group solvency calculation must be carried out in accordance with method 1 ("accounting consolidation-based method")[25]. In this case, both group own funds and group SCR are calculated on the basis of the consolidated accounts. More than 90 % of European groups apply the default approach.

Where the exclusive application of method 1 would not be appropriate, group supervisors may decide, after consulting the other supervisory authorities concerned and the group itself, to apply to a group either method 2 ("deduction and aggregation method") or a combination of methods 1 and 2[26]. Before making that decision, the group supervisor must consider together a limited number of criteria that are listed in Article 328 of the Commission Delegated Regulation (EU) 2015/35 (hereafter "Solvency II Delegated Regulation")[27]. In that case, the companies that are not in the scope of method 1 contribute to the group own funds and the group SCR through the proportional share of their solo own funds and capital requirements.

In practice, and based on the supervisory disclosures published by NSAs, the "full" deduction and aggregation method is hardly ever applied, and the groups concerned represent less than 0.9 % of the aggregate amount of group own funds at European level.

a. Group own funds

i. Classification of group own funds

In order to be classified at group level, own fund items issued by subsidiary insurance and reinsurance undertakings, insurance holding companies, mixed financial holding companies, and ancillary services undertakings[28], need to meet the requirements set out in Articles 331 to 333 of the Solvency II Delegated Regulation. This implies that for an own fund item to be eligible at group level, it is not sufficient to be classified as an own fund item at solo level.

One explicit additional requirement is for a group own fund item to be free from encumbrances[29]. In practice, this implies that the assessment of encumbrances carried out at solo level may need to be supplemented by an additional analysis at group level.

In particular, recital 127 of the Solvency II Delegated Regulation gives an example of encumbrance in the context of own fund items issued by insurance holding companies or

[24] See Article 218 of the Solvency II Directive.
[25] See Article 220 of the Solvency II Directive.
[26] See Article 220 of the Solvency II Directive.
[27] Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), OJ L 12, 17.1.2015, p. 1.
[28] As defined in points (53) of Article 1 of the Solvency II Delegated Regulation.
[29] See paragraph 1(b) of Articles 331, 332 and 333 of the Solvency II Delegated Regulation.

mixed financial holding companies[30]. EIOPA emphasises that this recital should be followed when assessing whether there is an encumbrance. However, some NSAs would welcome more clarity in a legal provision in order to ensure the enforceability of that requirement. Furthermore, EIOPA underlines that it is not clear whether the principles set out in the recital should also apply to parent insurance or reinsurance undertakings whose own fund items are also required to be free from encumbrances[31]. A few NSAs already follow recital 127 regardless of the nature of the parent company.

An additional requirement for group own-funds[32] is that they should provide for a cancellation or deferral of distributions[33], as well as the suspension of their repayment or redemption[34] where there is a non-compliance (or where the distributions would lead to non-compliance) with the group SCR and/or the group MCR. However, the Regulation is unclear as whether non-compliance with this requirement implies that the instrument cannot in any circumstance be recognised as group own fund, even where it contributes to covering the risks stemming from a related insurance company.

ii. Availability of group own funds

Article 330(1) of the Solvency II Delegated Regulation defines the criteria that NSAs should consider when assessing the availability of own funds at group level. Assessing the availability of group own funds requires an understanding of contract law and corporate law of the different countries where the group is operating. This creates challenges for group supervisors, in particular in cases of large cross-border groups.

Sometimes, the availability assessment is confused with a mere assessment of the liquidity of assets, since availability assessment covers both the capacity of own funds to absorb all types of losses and the ability to transfer assets[35]. It is subject to widely diverging supervisory practices, which can have a significant impact on group solvency calculations. Those uncertainties are related to:

- the methods that may be used to demonstrate the possibility to make own funds available within a maximum of nine months[36],
- the treatment of specific items such as the reconciliation reserve[37] (including expected profits included in future premiums and the benefit of the transitional measures on the risk-free rates or on technical provisions[38]), or minority interests;

[30] "*Own fund items which are issued by insurance holding companies and mixed financial holding companies in the group should not be considered to be free from encumbrances unless the claims relating to those own fund items rank after the claims of all policy holders and beneficiaries of the insurance or reinsurance undertakings belonging to the group*".
[31] In this regard, the title of Article 331 of the Delegated Regulation may not be fully consistent with the content of this article. Indeed, while the title suggests that this article only applies to related insurance or reinsurance undertakings, paragraph 3 of this article provides that it also applies to participating undertakings.
[32] See paragraph (2)(a) of Articles 331, 332 and 333 of the Solvency II Delegated Regulation.
[33] See Articles 71(1)(l), 73(1)(g) and 77(1)(g) of the Solvency II Delegated Regulation. Distributions refer to dividends for equity instruments, and coupon payments for subordinated debts. Cancellation of distributions where the group SCR is breached, is only required for Tier 1 own funds.
[34] See Articles 71(1)(j), 73(1)(f) and 77(1)(f) of the Solvency II Delegated Regulation.
[35] See points (a) and (b) of Article 330(1) of the Solvency II Delegated Regulation.
[36] See Article 330(1)(c) of the Solvency II Delegated Regulation.
[37] As defined in Article 70 of the Solvency II Delegated Regulation.
[38] See Articles 308c and 308d of the Solvency II Directive, respectively.

- the interpretation of the provision allowing certain non-available items to be included in group own funds up to the contribution of each related insurer to the group SCR[39].

b. Group capital requirements

i. Use of method 1 (Accounting consolidation-based approach)

When method 1 is used, Solvency II requires groups to fully consolidate all EEA and non-EEA insurance or reinsurance subsidiary undertakings[40], or where the necessary information is not available, to fully deduct the book value of those companies[41]. However, some NSAs consider those requirements impractical for large international groups, and see room for simplified approaches. More generally, other differences in the consolidation approaches under Solvency II and IFRS may raise significant operational difficulties for groups[42].

The consolidated group SCR should take into account the global diversification of risks that exist across all insurance and reinsurance undertakings in order to reflect properly the risk exposure of that group[43]. Therefore, in almost all cases, where method 1 is used, the group SCR will be lower than the sum of the solo SCRs of all insurance and reinsurance undertakings within that group. However, according to EIOPA, some group supervisors restrict diversification benefits, by considering that the SCR of an insurance or reinsurance undertaking is a barrier to transferability of its own funds. Such an interpretation would have the same effect on group solvency as disallowing diversification benefits between undertakings of a given group.

Furthermore, some stakeholders claim that the approach to calculate the minimum consolidated group SCR (hereafter "group MCR") may lead to unintended consequences. Indeed, while at solo level, the Minimum Capital Requirement (hereafter "MCR") must neither fall below 25 % nor exceed 45 % of an undertaking's SCR[44], there is no such "corridor" at group level. As a result, for some groups, the group MCR is close (or even equal) to the group SCR, and the group MCR ratio can be lower than or very close to the group SCR ratio[45]. Therefore, there may be cases where a group breaches its group MCR before its group SCR. In such situations, the group MCR limits the diversification benefits that groups may recognise in their capital requirements.

Finally, the treatment of third-country insurance or reinsurance undertakings in the group MCR may not be sufficiently clear, despite EIOPA guidelines[46] on this topic.

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[39] Some NSAs are of the view the contribution cannot be covered by non-available items only.
[40] See Article 335(1)(a) and Article 336(a) of the Solvency II Delegated Regulation.
[41] See Article 229 of the Solvency II Directive.
[42] For instance, Article 335 of the Solvency II Delegated Regulation does not make a clear distinction between joint ventures and joint-operations as defined in IFRS 11. This implies that while an insurer must account for its interest in a joint venture using the equity method for accounting purposes, it may have to use proportional consolidation under Solvency II (this requires more granular and possibly non-available information).
[43] See Recital 101 of the Solvency II Directive.
[44] See Article 129(3) of the Solvency II Directive. Note that this "corridor" does not apply in cases where the MCR is equal to the absolute floor as defined in Article 129(1)(d) of the Directive.
[45] This may happen because Solvency II imposes stricter eligibility criteria for own funds to cover the group MCR. Tier 3 own funds and ancillary own funds are not eligible to cover the group MCR, whereas they are eligible to cover the group SCR.
[46] Available at this link.

ii. Use of a combination of methods 1 and 2

Where a combination of methods is used, a few NSAs consider that companies included through method 2 should still contribute to the consolidated part of the group SCR[47]. Others do not agree with this approach, which would lead to a double counting of the same risks, since those companies also contribute to the total group SCR through the proportional share of their solo SCRs[48]. On the other hand, when using method 2 exclusively, the group SCR is based on the solo SCR of each company without eliminating intra-group transactions (therefore, leading to double counting of the same risks).

Another uncertainty is whether method 2 may also be applied to insurance holding companies, and not only to insurers. This would however imply ensuring that a notional capital requirement for such companies is calculated in a consistent manner across the Union.

Finally, it is unclear whether method 2 may apply to a consolidated sub-group[49]. EIOPA is of the view that the deduction and aggregation method may only apply to individual companies.

iii. Group internal models[50]

In line with its risk-oriented approach, Solvency II allows insurance companies and groups to use internal models for the SCR calculation, rather than the standard formula, subject to supervisory approval. Article 231 of the Solvency II Directive defines group internal models and provides rules on how to reach a joint decision on an application to use one.

Based on the supervisory disclosures published by NSAs, there are 45 approved internal models[51] at group level in ten different EU Member States. In general, NSAs consider that Solvency II offers the measures and flexibility required to effectively assess, authorise and monitor the appropriateness of group internal models.

Where the scope of a group internal model does not cover all related insurance and reinsurance undertakings (partial group internal model), groups may decide to apply to companies that are not covered by the internal model:

- one of the integration techniques set out in Annex XVIII of Commission Delegated Regulation (EU) 2015/35 (hereafter "Solvency II Delegated Regulation");
- the deduction and aggregation method (method 2).

However, integration techniques were initially designed to integrate risks, and not companies. Therefore, the use of those techniques at group level may not properly reflect some inter-dependencies between undertakings. There might also be opportunities for regulatory arbitrage between the use of an integration technique (which does not require a dedicated

[47] They may be considered as contributing to the equity, currency and market risk concentration sub-modules.
[48] This argument is disputable regarding currency risk: method 2 may not appropriately capture the currency risk stemming from the use of a different currency at third-country undertaking level and at group level.
[49] This would imply that it is possible to calculate a consolidated capital requirement at the level of the sub-group (i.e. net of intra-group transactions and allowing diversification effects between the companies of that sub-group), and to then aggregate that capital requirement to the rest of the group.
[50] See Article 242(2)(b).
[51] Eleven full internal models or thirty four partial internal models.

approval process) and the use of the deduction and aggregation method (which is subject to prior supervisory approval). Indeed, the inclusion of a company may be more advantageous through an integration technique than through the deduction and aggregation method[52], unless the undertaking concerned has its head office in an equivalent third country, in which case the group may be incentivised to apply for method 2 in order to use local rules[53].

Finally, EIOPA indicates that some groups take certain jurisdictions out of the scope of their internal models due to different supervisory practices. Furthermore, in the context of a joint decision process, the same internal model may be implemented in different ways at group level and at the level of related undertakings on key aspects, such as the implementation of the dynamic volatility adjustment, or the modelling of sovereign risk. Such divergences may affect group risk management.

iv. Treatment of undertakings from other financial sectors

Undertakings from other financial sectors (for instance, credit and financial institutions, or institutions for occupational retirement pensions) should be included in the group solvency calculation through their proportional share of sectorial own funds and capital requirements[54]. Both EIOPA and NSAs are of the view that the legal framework does not clearly specify how such companies should contribute to the group SCR coverage.

In particular, assessing the quality and availability of sectorial own funds in light of Solvency II principles proves to be challenging. Similarly, the legal framework does not specify the treatment of sectorial capital buffers and add-ons.

Finally, Article 228 of the Solvency II Directive provides that when calculating the solvency of a group that includes a related credit or financial institution or an investment firm, that group may apply methods 1 or 2 set out in Annex I to Directive 2002/87/EC[55] *mutatis mutandis.* This article also provides that method 1 may be applied only where the group supervisor is "*satisfied as to the level of integrated management and internal control regarding the entities in the scope of consolidation*". However, in practice, the methods set out in Directive 2002/87/EC are hardly workable, due to the different standards for valuation and consolidation under the two frameworks, and the lack of guidance on how to assess the level of integrated management and internal control.

[52] For instance, minority interests may be part of group own funds when an integration technique is used, whereas it cannot be the case when the deduction and aggregation method is used.

[53] Where a related insurance or reinsurance undertaking included through method 2 has its head office in an equivalent third country as per Article 227 of the Solvency II Directive, that undertaking's own funds and capital requirements may be determined in accordance with local rules for the purposes of group solvency calculation.

[54] See Article 335(1)(e) and Article 336(d) of the Solvency II Delegated Regulation.

[55] Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 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, OJ L 35, 11.02.2003, p. 1.

IV. Pillars 2 and 3: group governance and group reporting[56]

a. Group governance

i. "Mutatis mutandis" application at group level of provisions that are applicable at solo level

Governance requirements at group level are not fully specified in the Solvency II Directive. On the contrary, the Directive simply provides that several provisions that are applicable at solo level also apply *mutatis mutandis* at group level. This makes it more difficult for group supervisors to implement such provisions, according to EIOPA. The main challenges concern:

- the group system of governance[57]. First, non-insurance companies are in the scope of groups and are therefore covered by the group system of governance, which may be challenging. Furthermore, there may be legal uncertainties regarding the identification and responsibility of the "administrative, management and supervisory body" (hereafter "AMSB") at group level[58]. Finally, the AMSB of a solo company may face conflicting objectives, since it has to ensure both the appropriateness of the solo system of governance and its consistency with the group one.
- fit and proper requirements[59], which depend on NSAs' powers of intervention at the level of holding companies. Moreover, the scope of application of those requirements are unclear in EIOPA's view (the AMSB and/or the persons who effectively run the insurance holding company and/or key functions holders)[60].
- group capital add-ons[61], in particular in relation to governance. Since the group system of governance is partly defined via a reference to the *mutatis mutandis* application of solo provisions, which is subject to interpretation, it is more difficult for a group supervisor to ascertain a significant deviation from the Directive.

Those different examples show that the provisions using "*mutatis mutandis*" leave a very wide margin for interpretation, and may raise difficulties for supervisors to enforce their interpretation of the rules. EIOPA has provided guidance on some of the above-mentioned issues. Some NSAs, when transposing the Solvency II Directive into national legislation, have also developed their own national rules or guidance.

ii. Centralised group risk management[62]

Insurance and reinsurance groups are required to establish effective risk management and internal control systems applied consistently in all solo undertakings within the scope of

[56] Although "pillar 3" also covers group public disclosure, this aspect is not in the scope of this chapter.
[57] See Article 246 of the Solvency II Directive.
[58] More precisely, there is no definition of the "group AMSB", and Article 40 of the Solvency II Directive on the responsibility of the AMSB does not apply *mutatis mutandis* at group level.
[59] See Article 257 of the Solvency II Directive.
[60] See Articles 257 (title and text of the article) and 42 of the Solvency II Directive.
[61] See Article 233(6) of the Solvency II Directive.
[62] See Article 242(2)(b); The regime of centralised group risk management replaces the Commission proposal of a "group support regime", which would have allowed groups to meet a part of the SCR of the subsidiaries by a promise that the parent company would provide capital to related insurers when necessary. The group support regime is out of the scope of the Commission's request to EIOPA for technical advice on the review of the Solvency II Directive.

group supervision[63]. However, Solvency II also provides that groups may apply for a regime of group supervision with centralised risk management (CRM) where the risk management processes and internal control mechanisms of the parent undertaking also cover its subsidiaries[64]. The CRM regime therefore implies a transfer of risk management tasks from a related undertaking to the participating undertaking of the same group.

There is currently no case of application of provisions on CRM. In any case, the CRM regime would probably have no significant impact on the capital allocation within a group, since related insurance or reinsurance undertakings would still have to comply with their solo capital requirements. More generally, under the current framework, there is no clear benefit for groups to apply for the CRM regime. Where the CRM regime is applied, the arrangements between the parent company and its subsidiaries related to risk-management processes and internal control mechanisms fall under the scope of outsourcing. Therefore, insurance or reinsurance companies within the group would still have to comply with all Solvency II outsourcing requirements, and more generally remain responsible for the appropriateness of their own system of governance.

b. Reporting of intragroup transactions, risk concentration, and diversification effects at group level

i. Intra-group transactions[65]

An intra-group transaction is a transaction by which an insurance or reinsurance undertaking relies, directly or indirectly, on other undertakings within the same group or on any natural or legal person linked to the undertakings within that group by close links, for the fulfilment of an obligation, whether or not contractual, and whether or not for payment[66].

Insurance or reinsurance groups are required to report to group supervisors significant intra-group transactions at least annually, and very significant intra-group transactions as soon as practicable[67]. Group supervisors must also define the types of intra-group transactions that should be reported by groups in all circumstances[68].

The definition in the Directive of an intra-group transaction may not be sufficiently clear and exhaustive. This leads to different interpretations both among supervisors and among market participants. In particular, the inclusion in the scope of reporting of holding companies, ancillary services undertakings, and companies from other financial sectors is uncertain.

While guidelines from EIOPA could help foster supervisory convergence, there may still a need to ensure legal certainty by amending the definition of intra-group transactions in the Solvency II Directive. A clear delineation of the scope of intra-group transactions may also have an impact on the triggering of enforcement measures, as supervisory authorities have the power to adopt measures where intra-group transactions (or risk concentrations) "*are a threat*

[63] See Article 246(1) of the Solvency II Directive.
[64] See Articles 236 to 239 of the Solvency II Directive.
[65] See Article 242(2)(c) of the Solvency II Directive.
[66] See Article 13(19) of the Solvency II Directive.
[67] See Article 245(2) of the Solvency II Directive.
[68] See Article 245(3) of the Solvency II Directive.

to the financial position of the insurance or reinsurance undertakings"[69]. EIOPA reports one case where such enforcement measures were used at both solo and group level.

Group supervisors follow different procedures and use different criteria and thresholds when requiring the reporting of intra-group transactions. While some supervisors are of the view that a case-by-case approach is justified by the need to take into account the specificities of each group, other NSAs believe that more harmonisation is needed, as inappropriate thresholds (either too low or too high) impair the supervision of intra-group transactions, which is an integral part of the overall risk assessment of groups.

ii. Risk concentration[70]

Participating insurance and reinsurance undertakings, insurance holding companies and mixed financial holding companies are required to report to group supervisors any significant risk concentration at least annually[71]. Group supervisors must also define the type of risks that should be reported in any circumstances by groups[72].

However, there is no clear definition of risk concentrations. Article 376 of the Solvency II Delegated Regulation defines "significant" risk concentration indirectly by its potential impact on the group solvency or liquidity position. That article also provides a non-exhaustive list of direct and indirect exposures that should be considered by groups when reporting significant risk concentrations.

The Solvency II Directive makes a clear distinction between significant risk concentrations, for which quantitative thresholds must be defined from risk concentrations to be reported in any circumstances that should be defined by "type". While some NSAs strictly respect this distinction, others combine quantitative thresholds with qualitative criteria (for instance, different thresholds depending on the rating of the instrument). At this stage, the Commission has no evidence that the variety of supervisory practices in this regard is detrimental to the level-playing field.

More generally, EIOPA identifies similar challenges as for intra-group transactions regarding the determination of thresholds and types of risk concentrations to be reported: while some supervisors favour a case-by-case approach, other NSAs advocate for more harmonisation.

iii. Interactions between Solvency II and FICOD

Where an insurance group is also (or belongs to) a financial conglomerate subject to supplementary supervision in accordance with Article 5(2) of Directive 2002/87/EC (hereafter "FICOD"), the group supervisor under Solvency II may decide, after consulting other supervisory authorities concerned, not to carry out the supervision of risk concentration and/or intra-group transactions[73]. Such possibility is justified by the existence of similar reporting requirements under FICOD[74].

[69] See Article 258(1) of the Solvency II Directive.
[70] See Article 242(2)(c) of the Solvency II Directive.
[71] See Article 244(2) of the Solvency II Directive.
[72] See Article 244(3) of the Solvency II Directive.
[73] See Article 213(3) of the Solvency II Directive.
[74] See Articles 8 and 9 of Directive 2002/87/EC.

EIOPA reports only two cases of use of the waiver[75]. FICOD provides that if there is no agreed threshold, only intra-group transactions exceeding 5 % of the total amount of the conglomerate's capital adequacy requirements should be reported. If the insurance part of the conglomerate is not very big in comparison to the banking part, this threshold is likely to be too high to sufficiently cover insurance-related transactions. Therefore, in the absence of an agreement with the banking supervisor on more granular thresholds, there is no incentive for the insurance group supervisor to grant the waiver.

iv. Diversification effects in a group[76]

Groups must provide to group supervisors a proper explanation of the difference between the sum of the SCRs of all related insurance or reinsurance undertakings of the group and the group consolidated SCR[77]. However, in EIOPA's view, the absence of harmonised reporting templates on diversification benefits leads to widely diverging quality and granularity of information provided to group supervisors.

However, there is no one-size-fits-all approach to the assessment of diversification benefits, which should be tailored to the risk, nature, and complexity of each group. Therefore, some NSAs are of the view that fully standardised reporting and disclosure of diversification benefits do not allow appropriately capturing the specific situation of each group.

V. Other topics listed in article 242(2) of the Solvency II Directive, which are not related to group supervision.

a. Mediation of supervisory disputes by EIOPA[78]

By the end of 2018, there has been no case of request of binding mediation. EIOPA has been approached by some NSAs regarding non-binding mediation related to cross-border issues. EIOPA published its first non-binding mediation opinion in June 2018[79].

b. Insurance guarantee schemes (hereafter "IGS")[80]

The situation in Europe regarding IGSs[81] is fragmented. While some countries have more than one IGS, others have no IGS at all. There are also substantial differences regarding the lines of business covered, the coverage level, the scope of application[82], the sources of funding, the

[75] According to the Joint Committee List of Financial Conglomerates published in 2018, there are 81 financial conglomerates among which 24 are fully or partly waived the application of FICOD.
[76] See Article 242(2)(d) of the Solvency II Directive.
[77] See Article 246(4) of the Solvency II Directive.
[78] See Article 242(2)(e) of the Solvency II Directive.
[79] Available at this link.
[80] See Article 242(2)(h). This section does not cover bodies responsible for compensation of victims referred to in Article 10 Directive 2009/103/EC *("Motor Insurance Directive").*
[81] According to the European Commission's White Paper on Insurance Guarantee Schemes of 2010, "*insurance Guarantee Schemes (IGSs) provide last-resort protection to consumers when insurance undertakings are unable to fulfil their contractual commitments. They thus protect people against the risk that claims will not be met if their insurance company becomes insolvent*".
[82] Protecting policyholders in the home Member State only, or extending to the host Member States where the insurer is operating.

role of the IGS[83], the basis for calculating market participants' contributions, and the capacity for the IGS to raise additional funding in case of shortfalls[84].

VI. Conclusion

Overall, the prudential framework of group supervision is proving to be robust, laying emphasis on capital management and governance, and allowing for a better understanding and monitoring of risks at group level. However, some areas of the framework may not ensure a harmonised implementation of the rules by groups and NSAs, with potential impacts on the level playing field and on capital management strategies.

Chapter II shows that the diverging implementations of Solvency II on group supervision may be detrimental to policyholder protection, depending on how NSAs determine the scope of supervision, and exercise supervision at the level of parent holding companies. It also highlights the importance of ensuring an appropriate supervision of groups whose parent company is headquartered in a third country. In addition, in light of the wide differences between the supervisory powers of the different NSAs, it is necessary to assess the appropriateness of the powers of early intervention embedded in Solvency II.

Chapter III identifies a number of legal uncertainties and diverging supervisory practices that can have a significant impact on group solvency. They concern both group own funds, the group SCR and the group MCR. The use of group internal models may raise additional issues. First, a different implementation of the same internal model at solo level and at group level on key aspects such as the dynamic volatility adjustment can affect group risk management. In addition, the use by a group of a partial internal model could generate regulatory arbitrage regarding the way to integrate in the group solvency the entities out of the scope of the model.

Chapter IV illustrates the wide margin of interpretations regarding the provisions on group governance, which are generally defined in the Solvency II Directive as a *mutatis mutandis* application of solo requirements. This chapter also identifies some reasons why the CRM regime is currently not applied by any group. With regard to pillar III requirements, the definition and scope of intragroup transactions to be reported is considered by EIOPA and NSAs as insufficiently clear and exhaustive. However, there are divergent views among supervisors regarding the appropriate level of harmonisation of the reporting of intra-group transactions and risk concentrations, as well as of the quantification of diversification effects.

Finally, the widely fragmented landscape of IGS in Europe, as shown in Chapter V, can affect policyholder protection, as illustrated by several recent cases of failures of insurers operating cross-border. EIOPA is currently further investigating on the need for potential moves towards harmonisation of IGS, following its Discussion Paper published in 2018[85].

Article 242(2) of the Solvency II Directive provides that the Commission's report may be accompanied with legislative proposals. This report has identified a number of important issues that may need to be addressed, potentially including via legislative changes. However, further analysis is needed on the impact of those potential changes in the rules. Therefore, the Commission deems it appropriate to include group supervision in the scope of the general

[83] Seeking the continuation of insurance policies or policyholders compensation for the loss.
[84] For instance, by issuing debt securities or by increasing the amount of annual contributions.
[85] Available at this link.

review in 2020 of the Solvency II Directive. The Commission has invited EIOPA to provide by 30 June 2020 technical advice on the issues identified in this report, as well as other related issues that may be detrimental to policyholder protection, as part of the 2020 Review of the Solvency II Directive[86].

[86] See the Commission's request to EIOPA for technical advice on the review of the Solvency II Directive.