

Client Update

Solvency II Equivalence Decisions and U.S.-EU Covered Agreement

NEW YORK

Alexander R. Cochran
arcochran@debevoise.com

Eric R. Dinallo
edinallo@debevoise.com

Ethan T. James
etjames@debevoise.com

Thomas M. Kelly
tmkelly@debevoise.com

Gregory J. Lyons
gjlyons@debevoise.com

Nicholas F. Potter
nfpotter@debevoise.com

John M. Vasily
jmvasily@debevoise.com

Samuel E. Proctor
seprocto@debevoise.com

LONDON

James C. Scoville
jcscoville@debevoise.com

Edite Ligere
eligere@debevoise.com

Benjamin J. Lyon
blyon@debevoise.com

FRANKFURT

Dr. Peter Wand
pwand@debevoise.com

HONG KONG

E. Drew Dutton
eddutton@debevoise.com

Stuart J. Valentine
sjvalentine@debevoise.com

INTRODUCTION

On 26 November 2015, the European Commission adopted third-country equivalence decisions in respect of Bermuda and Japan under the European Solvency II regime (which comes into force on 1 January 2016).¹ The equivalence determinations represent a significant step forward for Bermudian and Japanese insurers and reinsurers writing business in Europe.

Bermuda follows Switzerland as the second country to be granted full equivalence by the Commission, with the result that Bermudian insurers and reinsurers will be able to operate in Europe without any additional regulatory burden once Solvency II comes into force. The equivalence decision essentially places Bermudian firms on a level playing field with European firms when acquiring European companies and insurance portfolios, while still allowing them to benefit from favourable domestic tax and regulatory treatment.

Previously, Bermuda had been granted (together with Australia, Brazil, Canada, Mexico and the United States) provisional equivalence with regard to group solvency calculations for 10 years.

Industry stakeholders have encouraged the European Parliament and Council to approve these decisions promptly ahead of the implementation of Solvency II in January, and leading figures at the European Commission have urged national supervisors not to treat these third countries as nonequivalent while the Commission equivalence decisions are pending in the European Parliament and Council.

¹ http://ec.europa.eu/finance/insurance/docs/solvency/international/151126-bermuda_en.pdf and http://ec.europa.eu/finance/insurance/docs/solvency/international/151126-japan_en.pdf

In a separate development, on 20 November 2015, the U.S. Federal Insurance Office (“FIO”) and Trade Representative announced plans to commence negotiations on a “covered agreement” between the United States and the EU on insurance. FIO Director Michael McRaith stated that “Negotiating a covered agreement with the European Union is a critical step toward levelling the playing field for American insurers and reinsurers.”² The covered agreement will be negotiated to address reinsurance collateral, confidentiality issues and group supervision issues between the EU and the United States and reduce uncertainty around regulatory treatment.

BERMUDA

Bermuda, having been granted provisional equivalence in June 2015 and following the adoption of new insurance legislation by Bermuda in July 2015, has been granted full equivalence for an indefinite period in all three areas of Solvency II: (i) reinsurance (relevant to Bermudian reinsurers), (ii) group solvency (relevant to EU insurers operating in Bermuda), and (iii) group supervision (relevant to Bermuda-domiciled insurance groups with EU activities).

Solvency

- For group solvency purposes, this means that an EU insurer with a subsidiary in Bermuda that calculates group solvency on the basis of the “deduction and aggregation” method can calculate the subsidiary’s solvency capital and own funds on the basis of Bermudian solvency rules, rather than having to use Solvency II.

Supervision

- For group supervision purposes, this means that if an insurance group is headquartered in Bermuda, EU member states must rely on the group supervision exercised by the Bermuda Monetary Authority (“BMA”), rather than applying Solvency II group supervision to the group themselves.

Reinsurance

- Reinsurance contracts entered into by an EU insurer with a reinsurer in Bermuda are treated in the same way as reinsurance contracts entered into with EU reinsurers. In particular, a reinsurer does not need to have been assigned a specific minimum credit rating (although having a credit rating may be advantageous), nor are collateral arrangements required.

² <http://www.insurancejournal.com/news/national/2015/11/22/389715.htm>

Reporting

- The changes made by the BMA in order to gain equivalence mean that Bermudian insurers will be required to provide the BMA with any information necessary for supervision concerning transparency, insurance or reinsurance undertakings and groups, and must publish a solvency report at least annually. The BMA has the power to impose sanctions or enforcement action where necessary.

JAPAN

Japan has been granted (i) temporary equivalence for reinsurance purposes, and (ii) provisional equivalence for group solvency purposes, following advice from the European Insurance and Occupational Pensions Authority (“[EIOPA](#)”).

Temporary

- Under Solvency II, temporary equivalence can be granted for five years (ending on 31 December 2020), with a possible extension for a further year. In order to be granted temporary equivalence, a third country must give a commitment to adopt and apply a prudential regime that is capable of being assessed as equivalent, and to engage in a future equivalence assessment process. The third country must also demonstrate that it has established a work programme and allocated sufficient resources to fulfil its commitments within the transitional period.

Provisional

- Provisional equivalence can be granted for a period of 10 years and may be renewed for successive additional periods of 10 years. In order to be granted provisional equivalence, it is sufficient to demonstrate that the current third country regime would be able to meet the full equivalence requirements, or that the regime is likely to be adopted and applied in the future.

WHAT NEXT FOR BERMUDA AND JAPAN?

The European Commission’s decisions will now be scrutinised by the European Parliament and Council in a 90-day consultation period. Once the decisions have been approved, they will be published in the Official Journal of the European Union and come into force 20 days later.

The equivalence decisions should provide legal certainty for both EU insurers operating in these third countries, and insurers in these third countries operating in EU states. The European Commission will continue to monitor, with the

technical assistance of EIOPA, the evolution of the regulatory regimes for insurance and reinsurance in force in Bermuda and Japan and the fulfilment of the conditions on the basis of which the equivalence decisions have been adopted. In Japan, the Commission, with the technical assistance of EIOPA, will carry out an assessment of the evolution of the regulatory regime for reinsurance in force and the fulfilment of the conditions for full equivalence before the expiry of the temporary equivalence decision.

COVERED AGREEMENT

Currently, EU (re)insurers must comply with both Solvency II and U.S. reinsurance collateral requirements. If adopted, the covered agreement could make it easier for EU (re)insurers to operate in the U.S. The agreement is also being viewed as a stepping stone towards Solvency II equivalence which will make it easier for U.S. (re)insurers to operate in the European market. As the U.S. currently has only been granted provisional equivalence with regard to group solvency calculations, U.S. groups with EU subsidiaries or branches will potentially be subject to group supervision in the EU unless EU member state regulators permit alternative measures (which may including potentially establishing a European intermediate holding company) that allow the U.S. group to demonstrate that worldwide supervision is not needed.

* * *

Please do not hesitate to contact us with any questions.