Slaughter and May Podcast
Solvency II – Supervision

Robert Chaplin	Hello and welcome. I'm Robert Chaplin, one of Slaughter and May's corporate insurance partners. With me is Beth Dobson, our insurance practice support lawyer. This is our overview of the rules on supervision under Solvency II. For more information please see chapter 1 of our Solvency II App. If you don't already have the App please email solvency.two@slaughterandmay.com to request access. As stated in Article 27 of the Solvency II directive, the main objective of supervision is the protection of policyholders and beneficiaries. The directive requires member states to ensure that supervisory authorities have the relevant expertise, capacity and mandate to achieve this main objective. Supervisory authorities in EU member states are required to consider the potential impact of their decisions on the stability of EU financial systems. In the UK, the PRA's objectives in its supervision of financial firms are set out in sections 2B and 2C of the Financial Services and Markets Act. The PRA has a general objective of promoting the safety and soundness of firms it regulates and, in respect of insurers, the insurance objective of contributing to the securing of an appropriate degree of protection for those who are or may become policyholders. This is broadly equivalent to the main objective of supervision under Solvency II. For UK firms, the rules on supervision are set out in the PRA Rulebook and the onshored Level 2 delegated regulation. Firms should also have regard to PRA guidance, including the PRA's "approach to insurance supervision" document.
Beth Dobson	The Solvency II regime expects a supervisory authority to have sufficient powers to ensure that insurance undertakings comply with all applicable laws and regulations. This includes having the necessary quantitative tools to assess the economic position of firms it regulates as part of the supervisory review process. To ensure that supervisory authorities have the information necessary for the purposes of supervision, the directive requires firms to submit qualitative and quantitative reports on a regular basis. This takes the form of, firstly, a Regular Supervisory Report and, secondly, separate quantitative reporting templates The Regular Supervisory Report contains both qualitative and quantitative information on the firm's solvency and financial condition.

	The detailed content requirements of the RSR are set out in the delegated regulation. This includes information on: • the business and performance of the firm • the firm's system of governance • the risk profile of the firm • assets, technical provisions and other liabilities; and • capital management, including own funds and capital requirements. The RSR must be submitted in full at least every three years and can be requested by the supervisory authority at the end of any financial year. For any year where the full RSR is not prepared, firms must submit a summary report detailing any material changes from the previous year.
Robert Chaplin	In addition to the RSR, firms must submit annual and quarterly templates in a form prescribed by implementing regulations. Supervisory authorities can limit quarterly supervisory reporting where it would be overly burdensome. In the UK, the PRA has issued guidance that all category 4 and 5 firms are eligible for a waiver of the quarterly reporting requirements and that it will consider waivers for category 3 firms on a case-by-case basis. In addition to the harmonised EU-wide templates, the PRA has developed a number of national specific templates to address areas which are not covered by the harmonised templates, such as with-profits bonuses, financial guarantee insurers and Lloyd's requirements. Supervision of insurance firms extends to an element of direct supervision of outsourced activities. Where an insurer outsources a function to a service provider, the supervisory authority must have access to relevant data of the service provider and the right to carry out on-site inspection of premises. Responsibility for the outsourced activity, of course, remains with the insurer. It is also the insurer's responsibility to ensure that access to data and premises is provided by the service provider to the supervisory authority. The sheer quantity of reporting requirements under Solvency II has been criticised by many across the European insurance sector. As part of the 2020 review of Solvency II, EIOPA has proposed amending the quantitative reporting requirements to divide it into a set of core templates applying to all firms and a set of additional templates only

	applying to firms with business above pre-defined risk based thresholds. The results of the review have not yet been published. In the UK, reduction in the reporting burden is a key topic being looked at as part of the Government's current review of Solvency II. A full consultation on changes emerging out of that review is not expected until early 2022. In the mean-time, however, the PRA published a consultation in July on proposals to reduce the volume of financial information reported to the PRA. This is the first phase of proposed changes to reporting and disclosure requirements and is intended to focus on changes which could be implemented relatively quickly and with low operational impact. The second phase will be a more in-depth review of all the components that make up the UK reporting and disclosure framework, taking into account reform proposals in other areas of the Solvency II review.
Beth Dobson	In exceptional circumstances, following the supervisory review process a supervisory authority may decide it is appropriate to set a "capital add-on" for an insurance undertaking. This would require the undertaking to hold more capital than their calculated SCR would otherwise determine. Capital add-ons are intended to be used rarely and can only be applied where specific circumstances apply. These are: • where the insurer uses the standard formula to calculate its SCR and the risk profile of the insurer deviates significantly from the assumptions underlying the SCR, as calculated using the standard formula; • where the insurer uses a full or partial internal model to calculate its SCR and the risk profile of the insurer deviates significantly from the assumptions underlying the SCR, as calculated; • where the insurer's system of governance deviates significantly from the standards required by the regime and those deviations mean the insurer cannot properly identify and manage its risks; and • where the insurer applies the matching adjustment, volatility adjustment or transitional measures and its risk profile deviates significantly from the assumptions underlying those adjustments or measures. Even in these circumstances, a capital add-on should only be used if the insurer has not been able to remedy the position, for example by developing a full or partial internal model to address issues with the standard formula, adapting an internal model, or remedying deficiencies

	in the system of governance. Detailed methodologies for the calculation of capital add-ons are set out in the Level 2 delegated regulation. In practice capital add-ons have not been used extensively. EIOPA's latest report on the use of capital add-ons, covering 2019, showed that nine supervisory authorities had set capital add-ons in respect of 19 undertakings, out of 2816 total Solvency II undertakings across the EEA and UK. Some responses to the UK government's call for evidence on its review of Solvency II suggested that capital add-ons should be used more flexibly, for example in the context of internal model approval, where the PRA might approve an internal model with a capital add-on rather than rejecting it, or as an alternative to requiring a standard formula firm to develop a partial internal model.
Robert Chaplin	A final area covered by the supervision requirements under Solvency II is the prudential assessment of the acquisition of qualifying holdings in insurance undertakings. These rules were originally set out in the Acquisitions Directive. The rules have been transposed in the UK into Part 12 of FSMA. Where a proposed acquirer plans to acquire a direct or indirect holding representing 10% or more of the capital or voting rights in an insurance undertaking, or which would make it possible to exercise a significant influence over the management of the undertaking, the supervisory authority of the undertaking must be notified in advance. The supervisory authority will then assess the suitability of the proposed acquirer, taking into account factors such as the reputation of the proposed acquirer, the reputation and experience of any person who will direct the business of the insurer post-acquisition, the financial soundness of the proposed acquirer, whether the new group will have a structure that enables the supervisory authority to exercise effective supervision, and whether there are reasonable grounds to suspect that any money laundering or terrorist financing is involved. Disposals of holdings in an insurance undertaking also require notification to the supervisory authority, if the disposing person or entity has a qualifying holding and the disposal would reduce the qualifying holding to below 20%, 30% or 50%, or so that the undertaking would no longer be its subsidiary. This brings us to the end of this podcast. If you have any questions about supervision rules please get in touch with either of us or your usual contact at Slaughter and May.