COUNCIL OF
THE EUROPEAN UNION

Brussels, 25 September 2008

Interinstitutional File:
2007/0143 (COD)

13369/08
ADD 1

LIMITE

SURE 24
ECOFIN 355
CODEC 1182

NOTE

from :	General Secretariat of the Council
to :	Working Party
Subject :	Proposal for a Directive of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance, SOLVENCY II - Presidency compromise

Delegations will find below an updated version of document 12870/1/08 REV 1.

Changes and additions with respect to the Commission proposal (doc. 6996/08 + REV 1 (de, en, fr)) are underlined; deletions are denoted by (…) and changes with respect to doc. 10862/08 appear in bold (while deletions appear in strikethrough text).

Article 4

Exclusion from scope due to size

1. Without prejudice to Articles 3 and 5 to 10, this Directive shall not apply to ~~insurance~~ undertakings carrying on insurance activities which fulfil all of the following conditions:

(a) the annual gross written premium income does not exceed EUR 5 million;

(b) the total of technical provisions gross of the amounts recoverable from reinsurance contracts and Special Purpose Vehicles, as referred to in Article 75, does not exceed EUR 25 million;

(c) where they belong to a group, the total of the technical provisions of the group (gross of the amounts recoverable from reinsurance contracts and Special Purpose Vehicles) does not exceed EUR 25 million; and

(d) the business of those undertakings does not ~~cover~~ include :

- ~~through~~ insurance or reinsurance activities covering liability, credit and suretyship insurance risks, unless they constitute ancillary risks within the meaning of Article 16(1), nor;

- reinsurance ~~obligations~~ operations exceeding EUR 0.5 million of their gross written premium income **or EUR 2.5 million technical provisions gross of the amounts recoverable from reinsurance contracts and Special Purpose Vehicles or more** than 10% of their gross written premium income or technical provisions **gross of the amounts recoverable from reinsurance contracts and Special Purpose Vehicles**.

2. Notwithstanding paragraph 1, any undertaking that wishes to carry on insurance or reinsurance activities shall be subject to prior authorisation.

3. If any of the amounts set out in paragraph 1 is exceeded for three consecutive years this Directive shall apply from the fourth year.

4. By way of derogation from paragraph 1, this Directive shall apply to all undertakings seeking authorisation to carry on insurance and reinsurance activities whose annual gross written premium income or ~~gross~~ technical provisions **gross of the amounts recoverable from reinsurance contracts and Special Purpose Vehicles** (…) are expected to exceed the amounts set out in paragraph 1 within the following 5 years.

5. This Directive shall cease to apply ~~from the fourth year~~ to those insurance undertakings ~~which fulfil~~ for which the supervisory authority has verified that all of the following conditions are met:

(a) the amounts set out in paragraph 1 have not been exceeded for the three last consecutive years; and

(b) the amounts set out in paragraph 1 are not expected to be exceeded within the following 5 years.

As long as the insurance undertaking concerned carries on activities in accordance with of Articles 143 to 147, the first subparagraph shall not apply.

6. Paragraphs 1 and 5 shall not prevent any undertaking from applying, or continuing to be authorised under this Directive. [Delete Article 14(3)].

Article 13

Definitions

For the purposes of this Directive, the following definitions shall apply:

(1) *insurance undertaking* means a direct life or non-life insurance undertaking which has received authorisation in accordance with Article 14;

(1bis) c*aptive insurance undertaking* means an insurance undertaking owned either by a financial undertaking other than an insurance or a reinsurance undertaking or a group of insurance or reinsurance undertakings **(…)**, or by a non-financial undertaking, the purpose of which is to provide insurance cover exclusively for the risks of the undertaking or undertakings to which it belongs or of an undertaking or undertakings of the group of which the captive insurance undertaking is a member;

(2) *third country insurance undertaking* means an insurance undertaking which would require authorisation in accordance with Article 14, if it had its head office in the Community;

(3) *reinsurance undertaking* means an undertaking, which has received authorisation in accordance with Article 14 to carry on reinsurance activities;

(3bis) c*aptive reinsurance undertaking* means a reinsurance undertaking owned either by a financial undertaking other than an insurance or a reinsurance undertaking or a group of insurance or reinsurance undertakings **(…)** or by a non-financial undertaking, the purpose of which is to provide reinsurance cover exclusively for the risks of the undertaking or undertakings to which it belongs or of an undertaking or undertakings of the group of which the captive reinsurance undertaking is a member

(4) *third country reinsurance undertaking* means a reinsurance undertaking which would require authorisation in accordance with Article 14 if it had its head office in the Community;

(5) *reinsurance* means either of the following:

(a) the activity consisting in accepting risks ceded by an insurance undertaking, a third country insurance undertaking or by another reinsurance undertaking or third country reinsurance undertaking;

(b) in the case of the association of underwriters known as Lloyd's, the activity consisting in accepting risks, ceded by any member of Lloyd's, by an insurance or reinsurance undertaking other than the association of underwriters known as Lloyd's;

(6) *home Member State* means any of the following:

(a) for non-life insurance, the Member State in which the head office of the insurance undertaking covering the risk is situated;

(b) for life insurance, the Member State in which the head office of the insurance undertaking covering the commitment is situated;

(c) for reinsurance, the Member State in which the head office of the reinsurance undertaking is situated;

(7) *host Member State* means the Member State other than the home Member State in which an insurance or a reinsurance undertaking has a branch or provides services; **for life and non-life insurance the Member State of the provision of services means respectively the Member State of the commitment and the Member State in which the risk is situated, if the commitment or risk is covered by an insurance undertaking or a branch situated in another Member State;**

(8) *supervisory authorities* means the national authorities which are empowered by law or regulation to supervise insurance or reinsurance undertakings;

(9) *branch* means an agency or a branch of an insurance or reinsurance undertaking which is located in the territory of a Member State other than the home Member State;

(9a) *establishment* means the head office or branch of an undertaking.

(10) *Member State where the risk is situated* means any of the following: (…)

(a) the Member State in which the property is situated, where the insurance relates either to buildings or to buildings and their contents, in so far as the contents are covered by the same insurance policy;

(b) the Member State of registration, where the insurance relates to vehicles **of any type**;

Article 50

Report on solvency and financial condition: contents

1. Member States shall, taking into account the principles set out in paragraphs 3 and 4 of Article 35, require insurance and reinsurance undertakings to publicly disclose, on an annual basis, a report on their solvency and financial condition.

That report shall contain the following information, either in full or by way of references to equivalent information, both in nature and scope, disclosed publicly under other legal or regulatory requirements:

(a) a description of the business and the performance of the undertaking;

(b) a description of the system of governance and an assessment of its adequacy for the risk profile of the undertaking;

(c) a description, separately for each category of risk, of the risk exposure, concentration, mitigation and sensitivity;

(d) a description, separately for assets, technical provisions, and other liabilities, of the bases and methods used for their valuation, together with an explanation of any major differences in the bases and methods used for their valuation in financial statements;

(e) a description of the capital management, including at least the following:

(i) the structure and amount of own funds, and their quality;

(ii) the amounts of the Minimum Capital Requirement and of the Solvency Capital Requirement;

(iibis) the option set out in Article 105bis used for the calculation of its Solvency Capital Requirement;

(iii) information allowing a proper understanding of the main differences between the underlying assumptions of the standard formula and those of any internal model used by the undertaking for the calculation of its Solvency Capital Requirement;

(iv) the amount of any non-compliance with the Minimum Capital Requirement or any significant non-compliance with the Solvency Capital Requirement during the reporting period, even if subsequently resolved, with an explanation of its origin and consequences as well as any remedial measures taken.

2. The description referred to in point (e)(i) of paragraph 1 shall include an analysis of any significant changes as compared to the previous reporting period and an explanation of any major differences in relation to the value of such elements in financial statements, and a brief description of the capital transferability.

The disclosure of the Solvency Capital Requirement referred to in point (e)(ii) of paragraph 1 shall show separately the amount calculated in accordance with Chapter VI, Section 4, Subsections 2 and 3 and any capital add-on imposed in accordance with Article 37, together with concise information on its justification by the supervisory authority concerned.

However, and without prejudice to any disclosure mandatory under any other legal or regulatory requirements, Member States may provide that, although the total Solvency Capital Requirement referred to in point (e)(ii) of paragraph 1 is disclosed, the capital add-on need not be separately disclosed during a transitional period not exceeding five years after the date referred to in Article 310.

The disclosure of the Solvency Capital Requirement shall be accompanied, where applicable, by an indication that its final amount is still subject to supervisory assessment.

Article 74

Valuation of assets and liabilities

1. Member States shall ensure that, unless otherwise stated, insurance and reinsurance undertakings value assets and liabilities as follows:

   (a) assets shall be valued at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction;

   (b) liabilities shall be valued at the amount for which they could be transferred, or settled, between knowledgeable willing parties in an arm's length transaction.

   When valuing liabilities, no adjustment to take account of the own credit standing of the insurance or reinsurance undertaking shall be made.

2. The Commission shall adopt, implementing measures to set out the methods and assumptions to be used in the valuation of assets and liabilities as laid down in paragraph 1.

Those measures designed to amend non-essential elements of this Directive, by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 304(3).

Article 75

General provisions

1. Member States shall ensure that insurance and reinsurance undertakings establish technical provisions with respect to all of their insurance and reinsurance obligations towards policyholders and beneficiaries of insurance or reinsurance contracts.

2. The <u>(...) value</u> of technical provisions shall <u>(...)</u> <u>correspond to the current amount insurance and reinsurance undertakings would have to pay if they were to transfer their insurance and reinsurance obligations immediately to another insurance or reinsurance undertaking</u>.

3. The calculation of technical provisions shall make use of and be consistent with information provided by the financial markets and generally available data on insurance and reinsurance technical risks (market consistency).

4. Technical provisions shall be calculated in a prudent, reliable and objective manner.

5. Following the principles set out in paragraphs 2, 3 and 4 and taking into account the principles set out in paragraph 1 of Article 74, the calculation of technical provisions shall be carried out in accordance with Articles 76 to 81.

Article 76

Calculation of technical provisions

1. The value of technical provisions shall be equal to the sum of a best estimate and a risk margin as set out in paragraphs 2 and 3.

2. The best estimate shall be equal to the probability-weighted average of future cash-flows, taking account of the time value of money (expected present value of future cash-flows), using the relevant risk-free interest rate term structure.

The calculation of the best estimate shall be based upon (…) up-to-date and credible information and realistic assumptions and be performed using adequate actuarial and statistical methods (…).

The cash-flow projection used in the calculation of the best estimate shall take account of all the cash in- and out-flows required to settle the insurance and reinsurance obligations over the lifetime thereof.

The best estimate shall be calculated gross, without deduction of the amounts recoverable from reinsurance contracts and special purpose vehicles. Those amounts shall be calculated separately, in accordance with Article 80.

3. The risk margin shall be such as to ensure that the value of the technical provisions is equivalent to the amount insurance and reinsurance undertakings would be expected to require in order to take over and meet the insurance and reinsurance obligations.

4. Insurance and reinsurance undertakings shall value the best estimate and the risk margin separately

However, where (…) future cash flows associated with insurance or reinsurance obligations can be replicated using financial instruments for which a reliable market value is (…) observable, the value of technical provisions associated with those future cash flows shall be determined on the basis of the market value of those financial instruments. In this case, separate calculations of the best estimate and the risk margin shall not be required.

5. Where insurance and reinsurance undertakings value the best estimate and the risk margin separately, the risk margin shall be calculated by determining the cost of providing an amount of eligible own funds equal to the Solvency Capital Requirement necessary to support the insurance and reinsurance obligations over the lifetime thereof.
The rate used in the determination of the cost of providing that amount of eligible own funds (Cost-of-Capital rate) shall be the same for all insurance and reinsurance undertakings.
The Cost-of-Capital rate used shall be equal to the additional rate, above the relevant risk-free interest rate, that an insurance or reinsurance undertaking holding an amount of eligible own funds, as set out in Section 3, equal to the Solvency Capital Requirement would incur to hold those funds.

Article 77

Other elements to be taken into account in the calculation of technical provisions

In addition to Article 76, when calculating technical provisions, insurance and reinsurance undertakings shall take account of the following:

(1) all expenses that will be incurred in servicing insurance and reinsurance obligations;

(2) inflation, including expenses and claims inflation;

(3) all payments to policyholders and beneficiaries, including future discretionary bonuses, which insurance and reinsurance undertakings expect to make, whether or not these payments are contractually guaranteed, unless those payments fall under Article 90.

Article 78

Valuation of financial guarantees and contractual options included in insurance and reinsurance contracts

When calculating technical provisions, insurance and reinsurance undertakings shall take account of the value of financial guarantees and any contractual options included in insurance and reinsurance policies.

Any assumptions made by insurance and reinsurance undertakings with respect to the likelihood that policyholders will exercise contractual options, including lapses and surrenders, shall be realistic and based on current and credible information. The assumptions shall take account, either explicitly or implicitly, of the impact that future changes in financial and non-financial conditions may have on the exercise of those options.

Article 79

Segmentation

Insurance and reinsurance undertakings shall segment their insurance and reinsurance obligations into homogeneous risk groups, and as a minimum by lines of business, when calculating their technical provisions.

Article 80

Recoverables from reinsurance contracts and special purpose vehicles

The calculation by insurance and reinsurance undertakings of amounts recoverable from reinsurance contracts and special purpose vehicles shall comply with Articles 75 to 79.

When calculating amounts recoverable from reinsurance contracts and special purpose vehicles, insurance and reinsurance undertakings shall take account of the time difference between recoveries and direct payments.

The result from that calculation shall be adjusted to take account of expected losses due to default of the counterparty. That adjustment shall be based on an assessment of the probability of default of the counterparty and the average loss resulting therefrom (loss-given-default).

Article 81

Data quality and application of approximations, including case-by-case approaches, for technical provisions

Member States shall ensure that insurance and reinsurance undertakings have internal processes and procedures in place to ensure the appropriateness, completeness and accuracy of the data used in the calculation of their technical provisions.

(…)Where, in specific circumstances, insurance and reinsurance undertakings have insufficient data of appropriate quality to apply a reliable actuarial method to a set or subset of their insurance and reinsurance obligations, or amounts recoverable from reinsurance contracts and special purpose vehicles, appropriate approximations, including (…) case-by-case approaches, may be (…) used in the calculation of the best estimate.

Article 82

Comparison against experience

Insurance and reinsurance undertakings shall have processes and procedures in place to ensure that best estimates, and the assumptions underlying the calculation of best estimates, are regularly compared against experience.

Where the comparison identifies systematic deviation between experience and the best estimate calculations of insurance or reinsurance undertakings, the undertaking concerned shall make appropriate adjustments to the actuarial methods being used or the assumptions being made.

Article 83

Appropriateness of the level of technical provisions

Upon request from the supervisory authorities, insurance and reinsurance undertakings shall demonstrate the appropriateness of the level of their technical provisions, as well as the applicability and relevance of the methods applied, and the adequacy of the underlying statistical data used.

Article 84

Increase of technical provisions

To the extent that the calculation of technical provisions of insurance and reinsurance undertakings does not comply with Articles 75 to 82, the supervisory authorities may require insurance and reinsurance undertakings to increase the amount of technical provisions so that they correspond to the level determined pursuant to those Articles.

Article 85

Implementing measures

The Commission shall adopt implementing measures laying down the following:

(a) actuarial <u>and statistical</u> method<u>ologies</u> (<u>…</u>) to calculate the best estimate referred to in Article 76(2);

(b) the relevant risk-free interest rate term structure to be used to calculate the best estimate referred to in Article 76(2);

(c) the circumstances in which technical provisions shall be calculated as a whole, or as a sum of a best estimate and a risk margin, and the methods to be used in the case where technical provisions are calculated as a whole;

(d) the methods and assumptions to be used in the calculation of the risk margin including the determination of the amount of eligible own funds necessary to support the insurance and reinsurance obligations and the calibration of the Cost-of-Capital rate;

(e) the lines of business on the basis of which insurance and reinsurance obligations are to be segmented in order to calculate technical provisions;

(f) the standards to be met with respect to ensuring the appropriateness, completeness and accuracy of the data used in the calculation of technical provisions, and the (<u>…</u>) <u>specific circumstances</u> in which it would be appropriate to use <u>approximations, including</u> (<u>…</u>) case-by-case approach<u>es</u>, to calculate (<u>…</u>) <u>the best estimate</u>;

(g) the methodologies to be used when calculating the counterparty default adjustment referred to in Article 80 designed to capture expected losses due to default of the counterparty;

(h) where necessary, simplified methods and techniques to calculate technical provisions, in order to ensure the actuarial and statistical methodologies referred to in point (a) and (d) are proportionate to the nature, scale and complexity of the risks supported by insurance and reinsurance undertakings.

Those measures designed to amend non-essential elements of this Directive, by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in of Article 304(3).

Article 86

Own funds

Own funds shall comprise the sum of basic own funds, referred to in Article 87 and ancillary own funds referred to in Article 88.

Article 87

Basic own funds

Basic own funds shall consist of the following items:

(1) the excess of assets over liabilities, valued in accordance with Article 74 and Section 2;

(2) subordinated liabilities.

The excess amount referred to in point (1) shall be reduced by the amount of own shares (…) held by the insurance or reinsurance undertaking.

Article 88

Ancillary own funds

1. Ancillary own funds shall consist of items other than basic own funds which can be called up to absorb losses.

Ancillary own funds may comprise the following items to the extent that they are not basic own fund items:

(a) unpaid share capital or initial fund that has not been called up (…)

(b) letters of credit and guarantees;

(c) any other legally binding commitments received by insurance and reinsurance undertakings.

In the case of a mutual or mutual-type association with variable contributions, ancillary own funds may also comprise any future claims which that association may have against its members by way of a call for supplementary contribution, within the (…) forthcoming twelve months.

2. Where an ancillary own fund item has been paid in or called up, it shall be treated as an asset and cease to form part of ancillary own fund items.

Article 89

Supervisory approval of ancillary own funds

1. The amounts of ancillary own fund items to be taken into account when determining own funds shall be subject to prior supervisory approval.

2. The amount ascribed to each ancillary own fund item shall reflect the loss-absorbency of the item and shall be based upon prudent and realistic assumptions. Where an ancillary own fund item has a fixed nominal value, the amount of that item shall be equal to its nominal value, where it appropriately reflects its loss-absorbency.

3. Supervisory authorities shall approve either of the following:

(a) a monetary amount for each ancillary own fund item;

(b) a method to determine the amount of each ancillary own fund item, in which case supervisory approval of the amount determined in accordance with that method shall be granted for a specified period of time.

4. For each ancillary own fund item, supervisory authorities shall base their approval on an assessment of the following:

(a) the status of the counterparties concerned, in relation to their ability and willingness to pay;

(b) the recoverability of the funds, taking account of the legal form of the item, as well as any conditions which would prevent the item from being successfully paid in or called up;

(c) any information on the outcome of past calls which insurance and reinsurance undertakings have made for such ancillary own funds, to the extent that information can be reliably used to assess the expected outcome of future calls.

Article 90

Surplus funds

In so far as authorised under national law, (…) accumulated profits (…) that have not been made available for distribution to policyholders and beneficiaries (surplus funds) shall not be considered as insurance and reinsurance liabilities, to the extent that they fulfil the criteria as set out in Article 94(1) (…)

Recital

Surplus funds should be valued in line with the economic approach laid down in the Directive. In this respect, a mere reference to the evaluation of surplus funds in the statutory annual accounts should not be sufficient. In line with the requirements on own funds, surplus funds should be subject to the criteria laid down in the Directive on the classification into tiers. This means, inter alia, that only surplus funds which fulfil the requirements for classification into tier 1 should be considered as tier 1 capital.

(27) The assessment of the financial position of insurance and reinsurance undertakings should rely on sound economic principles and make optimal use of the information provided by financial markets, as well as generally available data on insurance technical risks. In particular, solvency requirements should be based on an economic valuation of the whole balance-sheet.

Article 91

DELETED

Article 92

Implementing measures

1. The Commission shall adopt implementing measures specifying the following:
   (a) the criteria for granting supervisory approval in accordance with Article 89;
   (b) the treatment of participations, within the meaning of the third subparagraph of Article 210(2), in financial and credit institutions with respect to the determination of own funds.
   (c) the treatment of related insurance and reinsurance undertakings within the meaning of paragraphs 1 and 2 of Article 210.

   Those measures designed to amend non-essential elements of this Directive, by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article.

2. Participations in financial and credit institutions as referred to in point (b) of paragraph 1 shall comprise the following:
   (a) participations which insurance and reinsurance undertakings hold in:
      (i) credit institutions and financial institutions within the meaning of Article 4(1) and (5) of Directive 2006/48/EC,
      (ii) investment firms within the meaning of point 1 of Article 4(1) of Directive 2004/39/EC;

(b) subordinated claims and instruments referred to in Article 63 and Article 64(3) of Directive 2006/48/EC which insurance and reinsurance undertakings hold in respect of the entities defined in point (a) of this paragraph in which they hold a participation.

3. Where necessary, the Commission may adopt implementing measures specifying the treatment of own fund items which can only be used to cover losses arising from specific insurance or reinsurance liabilities or particular risks.

Recital

In order to address material concerns regarding the fungibility of certain own fund items, provision should be made to allow, where necessary, the Commission to adopt implementing measures specifying the treatment of those own fund items.

Article 93

Characteristics and features used to classify own funds into tiers

1. Own fund items shall be classified into three tiers. The classification of those items shall depend upon whether they are basic own fund or ancillary own fund items and the extent to which they possess the following characteristics:

(a) the item is available, or can be called up on demand, to fully absorb losses on a going-concern basis, as well as in the case of winding-up (permanent availability);

(b) in the case of winding-up, the total amount of the item is available to absorb losses and the repayment of the item is refused to its holder until all other obligations, including insurance and reinsurance obligations towards policyholders and beneficiaries of insurance and reinsurance contracts, have been met (subordination);

2. When assessing the extent to which own fund items possess the characteristics set out in points (a) and (b) in paragraph 1, currently and in the future, due consideration shall be given to the duration of the item, in particular whether the item is dated or not. Where an own fund item is dated, the relative duration of the item as compared to the duration of the insurance and reinsurance obligations of the undertaking shall be considered (sufficient duration).

In addition, the following features shall be considered:

(a) whether the item is free from requirements or incentives to redeem the nominal sum (absence of incentives to redeem);

(b) whether the item is free from mandatory fixed charges (absence of mandatory servicing costs);

(c) whether the item is clear of (…) encumbrances (absence of encumbrances).

Article 94

Main criteria for the classification into tiers

1. Basic own fund items shall be classified in Tier 1 where they substantially possess the characteristics set out in points (a) and (b) of Article 93(1), taking into consideration the features set out in Article 93(2).

2. Basic own fund items shall be classified in Tier 2 where they substantially possess the characteristic set out in point (b) of Article 93(1), taking into consideration the features set out in Article 93(2).

Ancillary own fund items shall be classified in Tier 2 where they substantially possess the characteristics set out in points (a) and (b) of Article 93(1), taking into consideration the features set out in Article 93(2).

3. Any basic and ancillary own fund items which do not fall under paragraphs 1 and 2 shall be classified in Tier 3.

Article 95

Classification of own funds into tiers

Member States shall ensure that insurance and reinsurance undertakings classify their own fund items on the basis of the criteria laid down in Article 94.

For that purpose, insurance and reinsurance undertakings shall refer to the list of own funds referred to in point (a) of Article 97(2), where applicable.

Where an own fund item is not covered by that list, it shall be assessed and classified by insurance and reinsurance undertakings, in accordance with the first paragraph. This classification shall be subject to approval by the supervisory authority.

Article 96

Classification of specific insurance own fund items

Without prejudice to Article 95*)* and point (c) of Article 97(1) for the purposes of this Directive the following classifications shall be applied:

(1) surplus funds falling under Article 90 shall be classified in Tier 1;

(2) letters of credit and guarantees which are held in trust for the benefit of insurance creditors by an independent trustee and provided by credit institutions authorised in accordance with Directive 2006/48/EC, (…) shall be classified in Tier 2;

(3) any future claims which mutual or mutual-type associations of shipowners with variable contributions solely insuring risks listed in classes 6, 12 and 17 in point A of Annex I (…) may have against their members by way of a call for supplementary contributions, within the (…) forthcoming twelve months, shall be classified in Tier 2.

Article 97

Implementing measures

1. Where it is necessary to ensure the overall quality of own funds and cross-sectoral consistency, the Commission (…) may adopt implementing measures laying down the following:

   (a) (...) the division of tiers into sub-tiers;

   (b) the criteria used to classify own fund items into the sub-tiers referred to in point (a) based on the characteristics set out in Article 93.

2. The Commission shall adopt implementing measures laying down the following:

(a) a list of own fund items deemed to meet the criteria, set out in Article 94 and in point (b) of paragraph 1, which contains for each own fund item a precise description of the features which determined its classification;

(b) the methods to be used by supervisory authorities, when approving the (…) classification of own fund items which are not covered by the list referred to in point (a).

3. Those measures designed to amend non-essential elements of this Directive, by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 304*(3)*.

4. The Commission shall regularly review and, where appropriate, update the list referred to in point (a) of paragraph 2 in the light of market developments.

Article 98

Eligibility and limits applicable to Tier 1, Tier 2 and Tier 3

1. As far as the compliance with the Solvency Capital Requirement is concerned, the amounts of Tier 2 and Tier 3 items shall be subject to the following limits:

(a) (...) the eligible amount of Tier 2 together with the eligible amount of Tier 3 shall be limited to twice the total amount of Tier 1 items;

(b) (...) the eligible amount of Tier 3 shall be limited to half the sum of the amount of Tier 1 and the amount of eligible Tier 2.

2. As far as the compliance with the Minimum Capital Requirement is concerned, the amount of basic own fund items eligible to cover the Minimum Capital Requirement which are classified in Tier 2 shall be limited to the total amount of Tier 1 items.

3. Where sub-tiers have been introduced, in accordance with point (a) of Article 97 (1), specific limits shall apply to the amount of own fund items classified in those sub-tiers.

4. The eligible amount of own funds to cover the Solvency Capital Requirement set out in Article 100 shall be equal to the sum of the amount of Tier 1, the eligible amount of Tier 2 and the eligible amount of Tier 3.

5. The eligible amount of basic own funds to cover the Minimum Capital Requirement set out in Article 126 shall be equal to sum of the amount of Tier 1 and the eligible amount of basic own fund items classified in Tier 2.

Article 99

Implementing measures

The Commission shall adopt implementing measures laying down the specific limits applicable to sub-tiers, where sub-tiers have been introduced,.

Those measures designed to amend non-essential elements of this Directive, by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 304(3).

Article 100

General provisions

Member States shall <u>require</u> that insurance and reinsurance undertakings hold eligible own funds covering the Solvency Capital Requirement.

The Solvency Capital Requirement shall be calculated, either in accordance with the standard formula in Subsection 2 or using an internal model, as set out in Subsection 3.

Article 101

Calculation of the Solvency Capital Requirement

1. The Solvency Capital Requirement shall be calculated in accordance with paragraphs 2 to 5:

2 The Solvency Capital Requirement shall be calculated on the presumption that the undertaking will carry on its business as a going concern.

3. The Solvency Capital Requirement shall be calibrated so as to ensure that all quantifiable risks to which an insurance or reinsurance undertaking is exposed are taken into account<u>. It shall cover existing business, as well as the new business expected to be written over the next twelve </u>months. With respect to existing business, it shall cover unexpected losses <u>only.</u>

It shall correspond to the Value-at-Risk of the basic own funds of an insurance or reinsurance undertaking subject to a confidence level of 99.5% over a one-year period.

4. The Solvency Capital Requirement shall cover at least the following risks:

(a) non-life underwriting risk;

(b) life underwriting risk;

(c) health underwriting risk;

(d) market risk;

(e) credit risk;

(f) operational risk.

Operational risk as referred to in point (f) of the first subparagraph shall include legal risks, and exclude risks arising from strategic decisions, as well as reputation risks.

5 When calculating the Solvency Capital Requirement, insurance and reinsurance undertakings shall take account of the effect of risk mitigation techniques, provided that credit risk and other risks arising from the use of such techniques are properly reflected in the Solvency Capital Requirement.

Article 102

Frequency of calculation

1. Insurance and reinsurance undertakings shall calculate the Solvency Capital Requirement at least once a year and report the result of that calculation to the supervisory authorities.
Insurance and reinsurance undertakings shall ensure that they hold eligible own funds which cover the last reported Solvency Capital Requirement.
Insurance and reinsurance undertakings shall monitor the amount of eligible own funds and the Solvency Capital Requirement on an on-going basis.
If the risk profile of an insurance or reinsurance undertaking deviates significantly from the assumptions underlying the last reported Solvency Capital Requirement, the undertaking concerned shall recalculate the Solvency Capital Requirement without delay and report it to the supervisory authorities.
2. Where there is evidence to suggest that the risk profile of the insurance or reinsurance undertaking has altered significantly since the date on which the Solvency Capital Requirement was last reported, the supervisory authorities may require the undertaking concerned to recalculate the Solvency Capital Requirement.

~~*Article 102(bis)*~~

~~*Implementing measures*~~

~~In order to ensure an appropriate treatment of related undertakings within the meaning of (…) Article 210 in the calculation of the Solvency Capital Requirement, the Commission shall adopt implementing measures laying down the approach to be taken with respect to those related undertakings in the calculation of the Solvency Capital Requirement.~~

Article 103

Structure of the standard formula

The Solvency Capital Requirement <u>calculated in accordance with the standard formula referred to in paragraph 1 of Article 109</u> shall be the sum of the following items:

(a) the Basic Solvency Capital Requirement, as laid down in Article 104;

(b) the capital requirement for operational risk, as laid down in Article 106;

(c) the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes, as laid down in Article 107.

(…)

Article 104

Design of the Basic Solvency Capital Requirement

1. The Basic Solvency Capital Requirement shall comprise individual risk modules, which are aggregated in accordance with point 1 of Annex IV.

   It shall consist of at least the following risk modules:

   (a) non-life underwriting risk;

   (b) life underwriting risk;

   (c) (...) health underwriting risk;

   (d) market risk,

   (e) counterparty default risk.

2. For the purposes of points (a), (b) and (c) of paragraph 1, insurance or reinsurance operations shall be allocated to the underwriting risk module that best reflects the technical nature of the underlying risks.

3. The correlation coefficients for the aggregation of the risk modules referred to in paragraph 1, as well as the calibration of the capital requirements for each risk module, shall result in an overall Solvency Capital Requirement which complies with the principles set out in Article 101.

4. Each of the risk modules referred to in paragraph 1 shall be calibrated using a Value-at-Risk measure, with a 99.5% confidence level, over a one year period.

   Where appropriate, diversification effects shall be taken into account in the design of each risk module.

5. The same design and specifications for the risk modules shall be used for all insurance and reinsurance undertakings, both with respect to the Basic Solvency Capital Requirement and to any simplified calculations as laid down in Article 108.

6. With regard to risks arising from catastrophes, geographical specifications may, where appropriate, be used for the calculation of the life, non-life and special health underwriting risk modules.

7. Subject to approval by the supervisory authorities, insurance and reinsurance undertakings may, within the design of the standard formula, replace a subset of its parameters by parameters specific to the undertaking concerned when calculating the life, non-life and (...) health underwriting risk modules.

Such parameters shall be calibrated on the basis of the internal data of the undertaking concerned, or of data which is directly relevant for the operations of that undertaking using standardised methods.

When granting supervisory approval, supervisory authorities shall verify the completeness, accuracy and appropriateness of the data used.

Article 105

Calculation of the Basic Solvency Capital Requirement

1. The Basic Solvency Capital Requirement shall be calculated in accordance with paragraphs 2 to 6.

2. The non-life underwriting risk module shall reflect the risk arising from (…) non-life insurance obligations, in relation to the perils covered and the processes used in the conduct of business.

It shall take account of the uncertainty in the results of insurance and reinsurance undertakings related to the existing insurance and reinsurance obligations as well as to the new business expected to be written over the next twelve months.

It shall be calculated, in accordance with point 2 of Annex IV, as a combination of the capital requirements for at least the following sub-modules:

(a) the risk of loss, or of adverse change in the value of insurance liabilities, resulting from fluctuations in the timing, frequency and severity of insured events, and in the timing and amount of claim settlements (non-life premium and reserve risk);

(b) the risk of loss, or of adverse change in the value of insurance liabilities, resulting from significant uncertainty of pricing and provisioning assumptions related to extreme or exceptional events (non-life catastrophe risk).

3 The life underwriting risk module shall reflect the risk arising from the (…) life insurance obligations, in relation to the perils covered and the processes used in the conduct of business.

It shall be calculated, in accordance with point 3 of Annex IV, as a combination of the capital requirements for at least the following sub-modules:

(a) the risk of loss, or of adverse change in the value of insurance liabilities, resulting from changes in the level, trend, or volatility of mortality rates, where an increase in the mortality rate leads to an increase in the value of insurance liabilities (mortality risk);

(b) the risk of loss, or of adverse change in the value of insurance liabilities, resulting from changes in the level, trend, or volatility of mortality rates, where a decrease in the mortality rate leads to an increase in the value of insurance liabilities (longevity risk);

(c) the risk of loss, or of adverse change in the value of insurance liabilities, resulting from changes in the level, trend or volatility of disability, sickness and morbidity rates (disability – morbidity risk);

(d) the risk of loss, or of adverse change in the value of insurance liabilities, resulting from changes in the level, trend, or volatility of the expenses incurred in servicing insurance or reinsurance contracts (life expense risk);

(e) the risk of loss, or of adverse change in the value of insurance liabilities resulting from fluctuations in the level, trend, or volatility of the revision rates applied to annuities, due to changes in the legal environment or in the state of health of the person insured (revision risk);

(f) the risk of loss, or of adverse change in the value of insurance liabilities, resulting from changes in the level or volatility of the rates of policy lapses, terminations, <u>renewals</u> and surrenders (lapse risk);

(g) the risk of loss, or of adverse change in the value of insurance liabilities, resulting from the significant uncertainty of pricing and provisioning assumptions related to extreme or irregular events (life catastrophe risk).

4. <u>(...)</u> The health underwriting risk module shall reflect the risk arising from the underwriting of health insurance <u>(...)</u> <u>obligations, whether it is pursued on a similar technical basis to that of life insurance or not</u>, following from both the perils covered and the processes used in the conduct of business.

It shall (...) cover at least the following risks:

(a) the risk of loss, or of adverse change in the value of insurance liabilities, resulting from changes in the level, trend, or volatility of the expenses incurred in servicing insurance or reinsurance contracts;

(b) the risk of loss, or of adverse change in the value of insurance liabilities, resulting from fluctuations in the timing, frequency and severity of insured events, and in the timing and amount of claim settlements at the time of provisioning;

(c) the risk of loss, or of adverse change in the value of insurance liabilities, resulting from the significant uncertainty of pricing and provisioning assumptions related to outbreaks of major epidemics, as well as the unusual accumulation of risks under such extreme circumstances.

5. The market risk module shall reflect the risk arising from the level or volatility of market prices of financial instruments which have an impact upon the value of the assets and liabilities of the undertaking. It shall properly reflect the structural mismatch between assets and liabilities, in particular with respect to the duration thereof.

It shall be calculated, in accordance with point 5 of Annex IV, as a combination of the capital requirements for at least the following sub-modules:

(a) the sensitivity of the values of assets, liabilities and financial instruments to changes in the term structure of interest rates, or in the volatility of interest rates (interest rate risk);

(b) the sensitivity of the values of assets, liabilities and financial instruments to changes in the level or in the volatility of market prices of equities (equity risk);

(c) the sensitivity of the values of assets, liabilities and financial instruments to changes in the level or in the volatility of market prices of real estate (property risk);

(d) the sensitivity of the values of assets, liabilities and financial instruments to changes in the level or in the volatility of credit spreads over the risk-free interest rate term structure (spread risk);

(e) the sensitivity of the values of assets, liabilities and financial instruments to changes in the level or in the volatility of currency exchange rates (currency risk).

(f) additional risks to an insurance or reinsurance undertaking stemming, either from lack of diversification in the asset portfolio, or from large exposure to default risk by a single issuer of securities or a group of related issuers (market risk concentrations).

6. The counterparty default risk module shall reflect possible losses due to unexpected default, or deterioration in the credit standing, of the counterparties and debtors of insurance and reinsurance undertakings over the forthcoming twelve months. The counterparty default risk module shall cover risk-mitigating contracts, such as reinsurance arrangements, securitisations and derivatives, and receivables from intermediaries, as well as any other credit exposures which are not covered in the spread risk sub-module.

For each counterparty, the counterparty default risk module shall take account of the overall counterparty risk exposure of the insurance or reinsurance undertaking concerned to that counterparty, irrespective of the legal form of its contractual obligations to that undertaking.

Article 105 bis

Calculation of the equity risk sub-module

1. With respect to equity risk as referred to in point (b) of Article 105(5), insurance and reinsurance undertakings shall apply one of the following calculation approaches:

a) an equity risk sub-module which is calibrated using Value-at-Risk measure, with a 99.5% confidence level, over a one-year period; or

b) notwithstanding Article 104(4)**,** ~~and~~ if it is authorised under national law **and subject to prior approval of the supervisory authority**, an equity risk sub-module which is calibrated using a Value-at-Risk measure, over a time period which is consistent with the typical holding period of equity investments for the undertaking concerned, with a confidence level which provides policyholders and beneficiaries with a level of protection equivalent to that set out in Article 101.

The approach set out in point b) of paragraph 1 shall only used if the solvency and liquidity position as well as the strategies, processes and reporting procedures of the undertaking concerned with respect to asset – liability management are such as to ensure, on an on-going basis, that it is able to hold equity investments for a period which is consistent with the typical holding period of equity investments for that undertaking. The undertaking shall be able to demonstrate to the supervisory authority, that this condition is verified with the level of confidence necessary to provide policyholders and beneficiaries with a level of protection equivalent to that set out in Article 101.

For the purpose of point b) of paragraph 1, the equity risk sub-module shall be based on equity returns over the typical holding period of equity investments. The typical holding period of equity investments of an insurance or reinsurance undertaking shall be determined taking into account the asset – liability structure, strategy and management of the undertaking concerned. In particular, it shall take into account the duration of the technical provisions of that undertaking, as well as the long-term nature of the investments in the case of holdings in related undertakings within the meaning of Article 210.

2. Insurance and reinsurance undertakings shall not revert to applying the approach set out in point a) of paragraph 1, except in duly justified circumstances and subject to the approval of the supervisory authorities.

If insurance and reinsurance undertakings using the approach set out in point b) of paragraph 1 does not comply with the condition set out in the second subparagraph of paragraph 1, the supervisory authorities may require the undertaking concerned to apply the approach set out in point a) of paragraph 1.

3. The assumptions used by insurance and reinsurance undertakings in the calculation of this adjustment for the loss-absorbing capacity of technical provisions and deferred taxes, as referred to in Article 107, shall be consistent with the assumptions underpinning the equity risk calculation approach which those undertakings apply.

4. The Commission shall submit to the European Insurance and Occupational Pensions Committee, at the latest five years after the date referred to in Article 310(1), a report on the scope of the use of the approach set out in point b) of paragraph 1 and the supervisory authorities' practices adopted pursuant to paragraph 1.

This report shall address in particular cross-border effects of the use of this approach in a view to preventing regulatory arbitrage from insurance and reinsurance undertakings.

Recital

The Solvency Capital Requirement should reflect a level of eligible own funds that enables insurance and reinsurance undertakings to absorb significant losses and that gives reasonable assurance to policyholders and beneficiaries that payments will be made as they fall due. Provision should also be made that Member States may allow an approach to equity risk whereby the calibration of the capital requirement should properly take into account the long holding period of assets that is typical in insurance business (where liabilities could be of a long duration), in particular for certain types of assets, such as equity, and shall not discourage undertakings from holding participations in financial and non-financial firms. The typical holding period is calculated taking into account the investment strategy of the undertaking, its asset-liability management, and the duration of liabilities. The assessment of the investment strategy should reflect in particular the long-term nature of strategic participations. The duration of liabilities used in the calculation of the typical holding period should not be longer than the average run-off period of the insurance or reinsurance contracts of the undertaking.

Article 105 ter

Calculation of the equity risk sub-module : adjustment mechanism

The equity risk sub-module referred to in Article 105(5), whether calculated using the approach set out in point a) or the approach set out in point b) of Article 105bis(1), shall include a symmetric adjustment mechanism.

That adjustment mechanism shall be calculated as a function of the current level of equity prices and a weighted average level of those prices over an appropriate period of time.

Recital (new)

To avoid the exacerbation of procyclical effects, a macro-economic dimension should be introduced in the supervisory rules and practices.

First, the equity risk sub-module should include a symmetric adjustment mechanism (equity dampener) to avoid that insurance and reinsurance undertakings would be unduly forced to raise additional capital or sell equities as a result of an adverse movement in equity markets and that they unduly buy equities as a result of a favourable movement in equity markets.

Second, in the event of exceptional falls in financial markets and where this adjustment mechanism is not sufficient to enable insurance and reinsurance undertakings to comply with their Solvency Capital Requirement, provision also be made to allow supervisory authorities to extend the time period which undertakings have to re-establish the level of eligible own funds covering the Solvency Capital Requirement.

Article 106

Capital requirement for operational risk

1. The capital requirement for operational risk shall reflect operational risks to the extent they are not already reflected in the risk modules referred to in Article 104. That requirement shall be calibrated in accordance with Article 101(3).
2. With respect to life insurance contracts where the investment risk is borne by the policyholders, the calculation of the capital requirement for operational risk shall take account of the amount of annual expenses incurred in respect of those insurance obligations.
3. With respect to insurance and reinsurance operations other than those referred to in paragraph 2, the calculation of the capital requirement for operational risk shall take account of the volume of those operations, in terms of earned premiums and technical provisions which are held in respect of those insurance and reinsurance obligations. In this case, the capital requirement for operational risks shall not exceed (…) a fixed percentage of the Basic Solvency Capital Requirement relating to those insurance and reinsurance operations.

Article 107

Adjustment for the loss-absorbing capacity of technical provisions and deferred taxes

The adjustment referred to in point (c) paragraph 1 of Article 103 for the loss-absorbing capacity of technical provisions and deferred taxes shall reflect potential compensation of unexpected losses through a simultaneous decrease in technical provisions <u>or</u> deferred taxes <u>or a combination of both</u>.

That adjustment shall take account of the risk mitigating effect provided by future discretionary benefits of <u>(…)</u> insurance contracts, to the extent insurance and reinsurance undertakings can establish that a reduction in such benefits may be used to cover <u>(...)</u> unexpected losses when they arise. The risk mitigating effect provided by future discretionary benefits shall be no higher than the sum of technical provisions and deferred taxes relating to these future discretionary benefits.
For the purpose of the second paragraph, the value of future discretionary benefits under adverse circumstances shall be compared to the value of such benefits under the underlying assumptions of the best-estimate calculation.

Article 108

Simplifications in the standard formula

Insurance and reinsurance undertakings may use a simplified calculation for a specific sub-module or risk module where the nature, scale and complexity of the risks they face justifies it and where it would be disproportionate to require all insurance and reinsurance undertakings to apply the standardised calculation.

Simplified calculations shall be calibrated in accordance with Article 101(3).

[Article 108(bis)

To be discussed together with Article 236]

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Article 109

Implementing measures

1. In order to ensure that the same treatment is applied to all insurance and reinsurance undertakings calculating the Solvency Capital Requirement on the basis of the standard formula, or to take account of market developments, the Commission shall adopt implementing measures laying down the following:

   (a) a standard formula in accordance with the provisions of Articles 101 and 103 to 108;

   (b) any sub-modules necessary or covering more precisely the risks which fall under the respective risk modules referred to in Article 104 as well as any subsequent updates;

   (c) the methods, assumptions and standard parameters to be used, when calculating each of the risk modules or sub-modules of the Basic Solvency Capital Requirement laid down in Articles 104 and 105, **~~including, if necessary, those set out in Annex IV Article 105bis(4)~~** **as well as the adjustment mechanism referred to in Article 105ter;**

   (d) the correlation parameters, including, if necessary, those set out in Annex IV;

   (e) where insurance and reinsurance undertakings use risk mitigation techniques, the methods and assumptions to be used to assess the changes in the risk profile of the undertaking concerned and adjust the calculation of the Solvency Capital Requirement;

   (f) the qualitative criteria that the risk mitigation techniques referred to in point (e) must meet in order to ensure that the risk has been effectively transferred to a third party;

   (g) the methods and parameters to be used when assessing the capital requirement for operational risk set out in Article 106, as well as the fixed percentage referred to in paragraph 3 of Article 106;

   (h) the method to be used when calculating the adjustment for the loss-absorbing capacity of technical provisions, as laid down in Article 107;

   (i) the subset of standard parameters in the life, non-life and (...) health underwriting risk modules that may be replaced by undertaking-specific parameters as set out in Article 104(7);

(j) the standardised methods to be used by the insurance or reinsurance undertaking to calculate the undertaking-specific parameters referred to in point (i), and any criteria with respect to the completeness, accuracy, and appropriateness of the data used that must be met before supervisory approval is given;

(k) the simplified calculations provided for specific sub-modules and risk modules, as well as the criteria that insurance and reinsurance undertakings shall be required to meet in order to be entitled to use each of these simplifications, as set out in Article 108.

Those measures designed to amend non-essential elements of this Directive, by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 304(3).

2. The Commission may adopt implementing measures laying down quantitative limits and asset eligibility criteria in order to address risks which are not adequately covered by a sub-module. Such implementing measures shall apply to assets covering technical provisions, excluding assets held in respect of life insurance contracts where the investment risk is borne by the policyholders. Those measures shall be reviewed by the Commission in the light of developments in the standard formula and financial markets.

Those measures designed to amend non-essential elements of this Directive, by supplementing it shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 304(3).

Article 110

General provisions for the approval of full and partial internal models

1. Member States shall ensure that insurance or reinsurance undertakings may calculate the Solvency Capital Requirement using a full or partial internal model as approved by the supervisory authorities.

2. Insurance and reinsurance undertakings may use partial internal models for the calculation of one or more of the following:

(a) one or more risk modules, or sub-modules, of the Basic Solvency Capital Requirement, as set out in Articles 104 and 105;

(b) the capital requirement for operational risk as laid down in Article 106;

(c) the adjustment referred to in Article 107.

In addition, partial modelling may be applied to the whole business of insurance and reinsurance undertakings, or only to one or more major business units.

3. In any application for approval, insurance and reinsurance undertakings shall submit, aFs a minimum, documentary evidence that the internal model meets the requirements set out in Articles 118 to 123.

Where the application for that approval relates to a partial internal model, the requirements set out in Articles 118 to 123 shall be adapted to take account of the limited scope of the application of the model.

4. The supervisory authorities shall decide on the application within six months from the receipt of the complete application.

5. Supervisory authorities shall give approval to the application only if they are satisfied that the systems of the insurance or reinsurance undertaking for <u>identifying, measuring,</u> monitoring<u>, (…)</u> managing <u>and reporting</u> risk are adequate and in particular, that the internal model complies with the requirements referred to in paragraph 3.

6. Any decision by the supervisory authorities to reject the application for the use of an internal model shall be accompanied by the reasons therefore.

7. For a period of two years after having received approval from supervisory authorities to use an internal model, insurance and reinsurance undertakings shall provide supervisory authorities with an estimate of the Solvency Capital Requirement determined in accordance with the standard formula, as set out in Subsection 2.

Article 111

Specific provisions for the approval of partial internal models

1. In the case of a partial internal model, supervisory approval shall only be given if that model complies with the requirements set out in Article 110 and the following additional conditions:
   (a) the reason for the limited scope of application of the model is properly justified by the undertaking;
   (b) the resulting Solvency Capital Requirement reflects more appropriately the risk profile of the undertaking and in particular meets the principles set out in Subsection 1;
   (c) its design is consistent with the principles set out in Subsection 1 so as to allow the partial internal model to be fully integrated into the Solvency Capital Requirement Standard Formula.
2. When assessing an application for the use of a partial internal model which only covers certain sub-modules of a specific risk module, or some of the business units of an insurance or reinsurance undertaking with respect to a specific risk module, or parts of both, supervisory authorities may require the insurance and reinsurance undertakings concerned to submit a realistic transitional plan to extend the scope of the model.
   The transitional plan shall set out the manner in which insurance and reinsurance undertakings plan to extend the scope of the model to other sub-modules or business units, in order to ensure that the model covers a predominant part of their insurance operations with respect to that specific risk module.

Article 112

Implementing measures

The Commission shall adopt implementing measures setting out following:

(1) the procedure to be followed for the approval of an internal model;

(2) the adaptations to be made to the standards set out in Articles 118 to 123 in order to take account of the limited scope of the application of the partial internal model.

Those measures designed to amend non-essential elements of this Directive, by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 304(3).

Article 113

Policy for changing the full and partial internal models

As part of the initial approval process of (...) an internal model, (...) the supervisory authorities shall approve the policy for changing the model of the insurance or reinsurance undertaking (...). Insurance and reinsurance undertakings may change their internal model in accordance with that policy

The policy shall include a specification of minor and major changes to the internal model.

Major changes to the internal model, as well as changes to the policy, shall always be subject to prior supervisory approval, as laid down in Article 110.

Minor changes to the internal model shall not be subject to prior supervisory approval, insofar as they are developed in accordance with the policy.

Article 114

Responsibilities of the administrative and management bodies

The administrative or management bodies of the insurance and reinsurance undertakings shall approve the application to the supervisory authorities for approval of the internal model referred to in Article 110, as well as the application for approval of any subsequent major changes made to that model.

The administrative or management body shall have responsibility for putting in place systems which ensure that the internal model operates properly on a continuous basis.

Article 115

Reversion to the standard formula

After having received approval in accordance with Article 110, insurance and reinsurance undertakings shall not revert to calculating the whole or any part of the Solvency Capital Requirement in accordance with the standard formula, as set out in Subsection 2, except in duly justified circumstances and subject to the approval of the supervisory authorities.

Article 116

Non-compliance of the internal model

1. If, after having received approval from the supervisory authorities to use an internal model, insurance and reinsurance undertakings cease to comply with the requirements set out in Articles 118 to 123, they shall, without delay, either present to the supervisory authorities a plan to restore compliance within a reasonable period of time, or demonstrate that the effect of non-compliance is immaterial.
2. In the event that insurance and reinsurance undertakings fail to implement the plan referred to in paragraph 1, the supervisory authorities may require insurance and reinsurance undertakings to revert to calculating the Solvency Capital Requirement in accordance with the standard formula, as set out in Subsection 2.

Article 117

Significant deviations from the assumptions underlying the (...) standard formula calculation

Where it is inappropriate to calculate the Solvency Capital Requirement in accordance with the standard formula, as set out in Subsection 2, because the risk profile of the insurance and reinsurance undertakings concerned deviates significantly from the assumptions underlying the (…) standard formula calculation, the supervisory authorities may, by a decision stating the reasons, require the undertakings concerned to use an internal model to calculate the Solvency Capital Requirement, or the relevant risk modules thereof.

Article 118

Use test

Insurance and reinsurance undertakings shall demonstrate that the internal model is widely used in and plays an important role in the following:

(1) their system of governance, referred to in Articles 41 – 49, in particular

   (a) their risk-management system as laid down in Article 43 and their decision-making processes;

(b) their economic and solvency capital assessment and allocation processes, including the assessment referred to in Article 44.

In addition, insurance and reinsurance undertakings shall demonstrate that the frequency of calculation of the Solvency Capital Requirement using the internal model is consistent with the frequency with which they use their internal model for the other purposes covered by the first paragraph.

The administrative or management body shall be responsible for ensuring the on-going appropriateness of the design and operations of the internal model, and that the internal model continues to appropriately reflect the risk profile of the insurance and reinsurance undertakings concerned.

Article 119

Statistical quality standards

1. The internal model, and in particular the calculation of the probability distribution forecast underlying it, shall comply with the criteria set out in paragraphs 2 to 9.

2. The methods used to calculate the probability distribution forecast shall be based on adequate actuarial and statistical techniques and shall be consistent with the methods used to calculate technical provisions.

The methods used to calculate the probability distribution forecast shall be based upon current and credible information and realistic assumptions.

Insurance and reinsurance undertakings shall be able to justify the assumptions underlying their internal model to the supervisory authorities.

3. Data used for the internal model shall be accurate, complete and appropriate.

Insurance and reinsurance undertakings shall update the data sets used in the calculation of the probability distribution forecast at least once a year.

4. No particular method for the calculation of the probability distribution forecast shall be prescribed.

Regardless of the method of calculation chosen, the ability of the internal model to rank risk shall be sufficient to ensure that it is widely used in and plays an important role in the system of governance of insurance and reinsurance undertakings, in particular their risk-management system and decision-making processes, and capital allocation in accordance with Article 118.

The internal model shall cover all of the material risks to which insurance and reinsurance undertakings are exposed. As a minimum, (...) internal models shall cover the risks set out in Article 101(4).

5. As regards diversification effects, insurance and reinsurance undertakings may take account in their internal model of dependencies within risk categories, as well as across risk categories, provided that supervisory authorities are satisfied that the system used for measuring those diversification effects is adequate.

6. Insurance and reinsurance undertakings may take full account of the effect of risk mitigation techniques in their internal model, as long as credit risk and other risks arising from the use of risk mitigation techniques are properly reflected in the internal model.

7. Insurance and reinsurance undertakings shall accurately assess the particular risks associated with financial guarantees and any contractual options in their internal model, where material. They shall also assess the risks associated with both policyholder options and contractual options for insurance and reinsurance undertakings. For this purpose, they shall take account of the impact that future changes in financial and non-financial conditions may have on the exercise of those options.

8. In their internal model, insurance and reinsurance undertakings may take account of future management actions that they would reasonably expect to carry out in specific circumstances.

In the case set out in the first subparagraph, the undertaking concerned shall make allowance for the time necessary to implement such actions.

9. In their internal model, insurance and reinsurance undertakings shall take account of all payments to policy holders and beneficiaries which they expect to make, whether or not these payments are contractually guaranteed.

Article 120

Calibration standards

1. Insurance and reinsurance undertakings may use a different time period or risk measure than that set out in Article 101(3) for internal modelling purposes as long as the outputs of the internal model can be used by those undertakings to calculate the Solvency Capital Requirement in a manner that provides policyholders and beneficiaries with a level of protection equivalent to that set out in Article 101.
2. Where practicable, insurance and reinsurance undertakings shall derive the Solvency Capital Requirement directly from the probability distribution forecast generated by the internal model of those undertakings, using the Value-at-Risk measure set out in Article 101(3).
3. Where insurance and reinsurance undertakings cannot derive the Solvency Capital Requirement directly from the probability distribution forecast generated by the internal model, the supervisory authorities may allow approximations to be used in the process to calculate the Solvency Capital Requirement, as long as those undertakings can demonstrate to the supervisory authorities that policyholders are provided with a level of protection equivalent to that set out in Article 101.
4. Supervisory authorities may require insurance and reinsurance undertakings to run their internal model on relevant benchmark portfolios and using assumptions based on external rather than internal data in order to verify the calibration of the internal model and to check that its specification is in line with generally accepted market practice.

Article 121

Profit and loss attribution

Insurance and reinsurance undertakings shall review, at least annually, the causes and sources of profits and losses for each major business unit.

They shall demonstrate how the categorisation of risk chosen in the internal model explains the causes and sources of profits and losses. The categorisation of risk and attribution of profits and losses shall reflect the risk profile of the insurance and reinsurance undertakings.

Article 122

Validation standards

Insurance and reinsurance undertakings shall have a regular cycle of model validation which includes monitoring the performance of the internal model, reviewing the on-going appropriateness of its specification, and testing its results against experience.

The model validation process shall include an effective statistical process for validating the internal model which enables the insurance and reinsurance undertakings to demonstrate to their supervisory authorities that the resulting capital requirements are appropriate.

The statistical methods applied shall not only test the appropriateness of the probability distribution forecast compared to loss experience, but also to all material new data and information relating thereto.

The model validation process shall include an analysis of the stability of the internal model and in particular the testing of the sensitivity of the results of the internal model to changes in key underlying assumptions. It shall also include an assessment of the accuracy, completeness and appropriateness of the data used by the internal model.

Article 123

Documentation standards

Insurance and reinsurance undertakings shall document the design and operational details of their internal model.

The documentation shall demonstrate compliance with Articles 118 to 122.

The documentation shall provide a detailed outline of the theory, assumptions, and mathematical and empirical basis underlying the internal model.

The documentation shall indicate any circumstances under which the internal model does not work effectively.

Insurance and reinsurance undertakings shall document all major changes to their internal model, as set out in Article 113.

Article 124

External models and data

The use of a model or data obtained from a third-party shall not be considered to be a justification for exemption from any of the requirements for the internal model set out in Articles 118 to 123.

Article 125

Implementing measures

The Commission shall, in order to ensure a harmonised approach to the use of internal models throughout the Community and to enhance the better assessment of the risk profile and management of the business of insurance and reinsurance undertakings, adopt implementing measures with respect to Articles 118 to 124.

Those measures designed to amend non-essential elements of this Directive, by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 304 (3).

Article 126

General provisions

Member States shall (…) require that insurance and reinsurance undertakings hold eligible basic own funds, to cover the Minimum Capital Requirement.

Article 127

Calculation of the Minimum Capital Requirement

1. The Minimum Capital Requirement shall be calculated in accordance with the following principles:

   (a) it shall be calculated in a clear and simple manner, and in such a way as to ensure that the calculation can be audited;

   (b) the Minimum Capital Requirement shall correspond to an amount of eligible basic own funds below which policyholders and beneficiaries are exposed to an unacceptable level of risk if insurance and reinsurance undertakings were allowed to continue their operations;

   (c) the linear function referred to in paragraph 2 used to calculate the Minimum Capital Requirement shall be calibrated to the Value-at-Risk of the basic own funds of an insurance or reinsurance undertaking subject to a confidence level of [8**2]** ~~0 to 90~~% over a one-year period;

   (d) it shall have an absolute floor of (...):

   (i) 2.200.000 EUR for non-life insurance undertakings, including captive insurance undertakings, except in the case where all or some of the risks included in one of the classes 10 to 15 listed in point A of Annexe 1 are covered, in which case it shall not be less than 3.200.000 EUR,

   (ii) 3.200.000 EUR for life insurance undertakings, including captive insurance undertakings,

   (iii) 3.200.000 EUR for reinsurance undertakings, except in the case of captive reinsurance undertakings, in which case the Minimum Capital Requirement shall not be less than a minimum of 1.000.000 EUR,

   (iv) the sum of the amounts set out in points (i) and (ii) for insurance undertakings as referred to in Article **72~~(2) and~~ (5).**

2. Subject to paragraph 3 the Minimum Capital Requirement shall be calculated as a linear function of a set or sub-set of the following variables: the undertaking's technical provisions, written premiums, capital-at-risk, deferred tax and administrative expenses. The variables used shall be measured net of reinsurance. ~~liabilities for non-life business, and as a linear function of the undertaking's technical provisions, capital-at-risk and deferred tax liabilities for life business.~~

3. Without prejudice to point (d) of paragraph 1, the Minimum Capital Requirement shall not fall below 20%, nor exceed 50%, of the undertaking's Solvency Capital Requirement, calculated in accordance with Chapter VI, Section 4, Sub-sections 2 or 3, and including any capital add-on imposed in accordance with Article 37.

Member States shall allow their supervisory authorities, for a period not exceeding two years after the date referred to in Article 310(1), to require an insurance or reinsurance undertaking to apply the percentages referred to in the previous subparagraph exclusively to the undertaking's Solvency Capital Requirement calculated in accordance with Chapter VI, Section 4, Sub-section 2.

4. Insurance and reinsurance undertakings shall calculate the Minimum Capital Requirement at least quarterly and report the results of that calculation to supervisory authorities.

If either of the limits referred to in paragraph 3 determine an undertaking's Minimum Capital Requirement, the undertaking shall provide to the supervisory authority information allowing a proper understanding of the reasons for this.

5. The Commission shall submit to the European Insurance and Occupational Pensions Committee, at the latest five years after the date referred to in Article 310(1), a report on Member States' rules and supervisory authorities' practices adopted pursuant to paragraphs 1 to 4.

This report shall address in particular any problems faced by supervisory authorities in the application of the first subparagraph of paragraph 3, and the frequency at which the percentages set out in that subparagraph determine an undertaking's Minimum Capital Requirement.

Article 128

Implementing measures

The Commission shall adopt implementing measures specifying the calculation of the Minimum Capital Requirement, referred to in Articles 126 and 127.

Those measures designed to amend non-essential elements of this Directive, by supplementing it shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 304 (3).

Article 129

Transitional arrangements regarding compliance with the Minimum Capital Requirement

By way of derogation from Articles 137 and 142, where insurance and reinsurance undertakings comply with the Required Solvency Margin referred to in Article 28 of Directive 2002/83/EC, Article 16 a of Directive 73/239/EC or Articles 37, 38 or 39 of Directive 2005/68/EC respectively on the date set out in Article 310(1) but do not hold sufficient eligible basic own funds to cover the Minimum Capital Requirement, the undertakings concerned shall comply with Article 126 within one year from the date as set out in Article 310(1).

If the undertaking concerned fails to comply with Article 126 within the period set out in the first paragraph, the authorisation of the undertaking shall be withdrawn, subject to the applicable processes provided for in the national legislation.

Article 130

"Prudent person" principle

1. Member States shall that insurance and reinsurance undertakings invest all their assets in accordance with the "prudent person" principle, as specified in paragraphs 2,3 and 4.

2. With respect to the whole portfolio of assets, insurance and reinsurance undertakings shall only invest in assets and instruments whose risks the undertaking concerned can properly monitor, manage and control, <u>and appropriately take into account in the assessment of its overall solvency needs in accordance with Article 44(1)(a).</u>

   All assets, in particular those covering the Minimum Capital Requirement and the Solvency Capital Requirement, shall be invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole. <u>In addition the localisation of those assets shall be such as to ensure their availability.</u>

   Assets held to cover the technical provisions shall also be invested in a manner appropriate to the nature and duration of the insurance and reinsurance liabilities. Those assets shall be invested in the best interest of policyholders and beneficiaries;

   In the case of a conflict of interest, insurance undertakings, or the entity which manages their asset portfolio, shall ensure that the investment is made in the best interest of policyholders and beneficiaries.

3. Without prejudice to paragraph 2, with respect to assets held in respect of life insurance contracts where the investment risk is borne by the policyholders, the second, third and fourth subparagraphs of this paragraph shall apply.

Where the benefits provided by a contract are directly linked to the value of units in an UCITS as defined in Directive 85/611/EEC, or to the value of assets contained in an internal fund held by the insurance undertakings, usually divided into units, the technical provisions in respect of those benefits must be represented as closely as possible by those units or, in the case where units are not established, by those assets.

Where the benefits provided by a contract are directly linked to a share index or some other reference value other than those referred to in second subparagraph, the technical provisions in respect of those benefits must be represented as closely as possible either by the units deemed to represent the reference value or, in the case where units are not established, by assets of appropriate security and marketability which correspond as closely as possible with those on which the particular reference value is based.

Where the benefits referred to in second and third subparagraphs include a guarantee of investment performance or some other guaranteed benefit, the assets held to cover the corresponding additional technical provisions shall be subject to paragraph 4.

4. Without prejudice to paragraph 2, with respect to other assets than those covered by paragraph 3, the second to fifth subparagraphs of this paragraph shall apply.

The use of derivative instruments shall be possible insofar as they contribute to a reduction of risks or facilitate efficient portfolio management.

Investment and assets which are not admitted to trading on a regulated financial market shall be kept to prudent levels.

Assets shall be properly diversified in such a way as to avoid excessive reliance on any particular asset, issuer or group of undertakings, or geographical area and excessive accumulation of risk in the portfolio as a whole.

Investments in assets issued by the same issuer, or by issuers belonging to the same group, shall not expose the insurance undertakings to excessive risk concentration.

Article 131

Freedom of investment

1. Member States shall not require insurance and reinsurance undertakings to invest in particular categories of assets.
2. Member States shall not subject the investment decisions of an insurance or reinsurance undertaking or its investment manager to any kind or prior approval or systemic notification requirements.
3. ~~Paragraph 1 shall not apply to assets held in respect of life insurance contracts where the investment risk is borne by the policyholders, as referred to in Article 130(3).~~ **This Article is without prejudice to Member State requirements restricting the types of assets or reference values to which policy benefits may be linked. Any such rules shall only be applied in the case where the investment risk is borne by a policyholder who is a natural person and shall not be more restrictive than those set out in the Directive 85/611/EEC (UCITS).**

Article 132

Localisation of assets and prohibition of pledging of assets

1. (…)

(…) With respect to recoverables from reinsurance contracts against undertakings authorised in accordance with this Directive or having their head office in a third country whose solvency regime is deemed to be equivalent in accordance with Article 170, Member States shall not require the localisation within the Community of the assets representing those recoverables.

(…)

2. Member States shall not retain or introduce for the establishment of technical provisions a system with gross reserving which requires pledging of assets to cover unearned premiums and outstanding claims provisions if the reinsurer (…) is an insurance or reinsurance undertaking authorised in accordance with this Directive.

Article 133

Implementing measures

In order to ensure the uniform application of this Directive, the Commission may adopt implementing measures specifying qualitative requirements in the following areas: (…):

(a) the identification, measurement, monitoring, managing and reporting (…) of risks arising from investments in relation to the first subparagraph of Article 130(2);

(b) the identification, measurement monitoring, managing and reporting (…)of specific risks arising from investment in derivative instruments and assets referred to in the second subparagraph of Article 130(4);

Those measures designed to amend non-essential elements of this Directive by supplementing it shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 304(3).

Article 136

Non-Compliance with the Solvency Capital Requirement

1. Insurance and reinsurance undertakings shall immediately inform the supervisory authority as soon as they observe that the Solvency Capital Requirement is no longer complied with, or where there is a risk of non-compliance in the following three months.

2. Within two months from the observation of the non-compliance with the Solvency Capital Requirement the insurance or reinsurance undertaking concerned shall submit a realistic recovery plan for approval by the supervisory authority.

3. The supervisory authority shall require the insurance or reinsurance undertaking concerned to take the necessary measures to achieve, within six months from the observation of the non-compliance with the Solvency Capital Requirement, the re-establishment of the level of eligible own funds covering the Solvency Capital Requirement or the reduction of its risk profile to ensure compliance with the Solvency Capital Requirement .

   The supervisory authority may, if appropriate, extend that period by three months.

In the event of an exceptional fall in financial markets, and where the adjustment mechanism referred to in article 105ter is insufficient to enable insurance and reinsurance undertakings to comply with the Solvency Capital Requirement within the periods set out in the first and second sub-paragraphs, the supervisory authorities, may extend the period set out in the second sub-paragraph by another six months.

4. In exceptional circumstances, if the supervisory authority is of the opinion that the financial situation of the undertaking concerned will deteriorate further, it may also restrict or prohibit the free disposal of the assets of that undertaking. That supervisory authority shall inform the supervisory authorities of the host Member States of any measures it has taken. Those authorities shall, at the request of the supervisory authority of the home Member State, take the same measures. The supervisory authority of the home Member State shall designate the assets to be covered by such measures.

Article 183

Information for policyholders

1. Before the life insurance contract is concluded, at least the information set out in paragraphs 2 to 3a shall be communicated to the policyholder.
2. The following information about the life insurance undertaking shall be communicated:
   (a) the name of the undertaking and its legal form;
   (b) the name of the Member State in which the head office and, where appropriate, the branch concluding the contract is situated;
   (c) the address of the head office and, where appropriate, of the branch concluding the contract;
   (d) a concrete reference to the report on the Solvency and financial condition as laid down in Article 50, allowing the policyholder easy access to this information.

3. The following information about the commitment shall be communicated:

(a) Definition of each benefit and each option;

(b) Term of the contract;

(c) Means of terminating the contract;

(d) Means of payment of premiums and duration of payments;

(e) Means of calculation and distribution of bonuses;

(f) Indication of surrender and paid-up values and the extent to which they are guaranteed;

(g) Information on the premiums for each benefit, both main benefits and supplementary benefits, where appropriate;

(h) For unit-linked policies, definition of the units to which the benefits are linked;

(i) Indication of the nature of the underlying assets for unit-linked policies;

(j) Arrangements for application of the cooling-off period;

(k) General information on the tax arrangements applicable to the type of policy;

(l) The arrangements for handling complaints concerning contracts by policyholders, lives assured or beneficiaries under contracts including, where appropriate, the existence of a complaints body, without prejudice to the right to take legal proceedings;

(m) Law applicable to the contract where the parties do not have a free choice or, where the parties are free to choose the law applicable, the law the assurer proposes to choose.

<u>3a. In addition, specific information shall be supplied in order to provide a proper understanding of the risks underlying the contract which are assumed by policyholders.</u>

4. The policyholder shall be kept informed throughout the term of the contract of any change concerning the following information:

(a) the policy conditions, both general and special;

(b) the name of the life insurance undertaking, its legal form or the address of its head office and, where appropriate, of the <u>(…)</u> branch which concluded the contract;

(c) all the information listed in points (d) to (j) of paragraph 3 in the event of a change in the policy conditions or amendment of the law applicable to the contract;

(d) every year, information on the state of bonuses ;

<u>(e) Where, in connection with an offer for or conclusion of a life assurance, the insurer provides figures relating to the amount of potential payments above and beyond the contractually agreed payments, he must provide the policyholder with a specimen calculation whereby the potential maturity payment is set out applying the basis for the premium calculation using three different rates of interest. This shall not apply to term insurances and contracts. The insurer must inform the policyholder in a clear and comprehensible manner that the specimen calculation is only a model of computation based on notional assumptions, and that the policyholder may not derive any contractual claims from the specimen calculation.</u>

<u>(f) In the case of insurances with profit participation, the insurer must inform the policyholder annually in writing of the status of his claims, incorporating the profit participation. Furthermore, where the insurer has provided figures about the potential future development of the profit participation, he must inform the policyholder of differences between the actual development and the initial data.</u>

5. The information referred to in paragraphs 2, 3, [3a] and 4 shall be provided in a clear and accurate manner, in writing, in an official language of the Member State of the commitment.
   However, such information may be in another language if the policyholder so requests and the law of the Member State so permits or the policyholder is free to choose the law applicable.
6. The Member State of the commitment may require life insurance undertakings to furnish information in addition to that listed in paragraphs 2, 3, <u>3a</u> and 4 only if it is necessary for a proper understanding by the policyholder of the essential elements of the commitment.
7. The detailed rules for implementing paragraphs 1 to 6 shall be laid down by the Member State of the commitment.

Article 220

Elimination of double use of eligible own funds

1. The double use of own funds eligible for the Solvency Capital Requirement among the different insurance or reinsurance undertakings taken into account in that calculation shall not be allowed.

   For that purpose, when calculating the group solvency and where the methods described in Subsection 4 do not provide for it, the following amounts shall be excluded:

   (a) the value of any asset of the participating insurance or reinsurance undertaking which represents the financing of own funds eligible for the Solvency Capital Requirement of one of its related insurance or reinsurance undertakings;

   (b) the value of any asset of a related insurance or reinsurance undertaking of the participating insurance or reinsurance undertaking which represents the financing of own funds eligible for the Solvency Capital Requirement of that participating insurance or reinsurance undertaking;

   (c) the value of any asset of a related insurance or reinsurance undertaking of the participating insurance or reinsurance undertaking which represents the financing of own funds eligible for the Solvency Capital Requirements of any other related insurance or reinsurance undertaking of that participating insurance or reinsurance undertaking.

2. Without prejudice to paragraph 1, the following may only be included in the calculation in so far as they are eligible for covering the Solvency Capital Requirement of the related undertaking concerned:

   (a) <u>surplus funds falling under Article 90</u> ~~profit reserves and future profits~~ arising in a related life insurance or reinsurance undertaking of the participating insurance or reinsurance undertaking for which the group solvency is calculated;

(b) any subscribed but not paid-up capital of a related insurance or reinsurance undertaking of the participating insurance or reinsurance undertaking for which the group solvency is calculated.

However, the following shall in any case be excluded from the calculation:

(a) any subscribed but not paid-up capital which represents a potential obligation on the part of the participating undertaking;

(b) any subscribed but not paid-up capital of the participating insurance or reinsurance undertaking which represents a potential obligation on the part of a related insurance or reinsurance undertaking;

(c) any subscribed but not paid-up capital of a related insurance or reinsurance undertaking which represents a potential obligation on the part of another related insurance or reinsurance undertaking of the same participating insurance or reinsurance undertaking.

3. If the supervisory authorities consider that certain own funds eligible for the Solvency Capital Requirement of a related insurance or reinsurance undertaking other than those referred to in paragraph 2 cannot effectively be made available to cover the Solvency Capital Requirement of the participating insurance or reinsurance undertaking for which the group solvency is calculated, those own funds may be included in the calculation only in so far as they are eligible for covering the Solvency Capital Requirement of the related undertaking.

4. The sum of the own funds referred to in paragraphs 2 and 3 may not exceed the Solvency Capital Requirement of the related insurance or reinsurance undertaking.

5. Any eligible own funds of a related insurance or reinsurance undertaking of the participating insurance or reinsurance undertaking for which the group solvency is calculated that are subject to prior authorisation from the supervisory authority in accordance with Article 89 may only be included in the calculation in so far as they have been duly authorised by the supervisory authority responsible for the supervision of that related undertaking.

Art 235

Subsidiaries of an insurance or reinsurance undertaking: decision on the application

1. In the case of applications for permission to be subject to the rules laid down in Articles 236 to 241, the supervisory authorities concerned shall work together, in full consultation, to decide whether or not to grant the permission sought and to determine the other terms and conditions, if any, to which such permission should be subject.

An application as referred to in the first subparagraph shall be submitted only to the group supervisor. The group supervisor shall inform and forward the complete application to the other supervisory authorities within the college without delay.

1bis. **Notwithstanding Article 105bis, where the parent undertaking has submitted an application for the permission to be subject to Articles 236 to 241 regarding any subsidiary undertaking situated in a Member State that has not allowed the use of the approach set out in paragraph 1b of Article 105bis, the application shall only be accepted if the parent undertaking does not apply the approach set out in point b) of paragraph 1 of Article 105bis to calculate the group Solvency Capital Requirement.**

2. The supervisory authorities concerned shall do everything within their power to reach a joint decision on the application within six months from the date of receipt of the complete application by all supervisory authorities within the college.
[…].

3. During the period referred to in paragraph 2, in the case of a dispute concerning the approval of the application referred to in paragraph 1, the group supervisor ~~shall, at the request of~~ or any of the other supervisory authorities concerned may consult the Committee of European Insurance and Occupational Pensions Supervisors. ~~The group supervisor may consult the Committee on its own initiative.~~ Where the Committee is consulted, all supervisory authorities concerned should be informed and the period referred to in paragraph 2 shall be extended by two months.

Where the Committee of European Insurance and Occupational Pensions Supervisors has been consulted, the supervisory authorities concerned shall duly consider such advice before taking their joint decision.

4. The group supervisor shall provide to the applicant the joint decision referred to in paragraphs 2 and 3 in a document containing the fully reasoned decision and an explanation of any significant deviation from the positions adopted by the Committee of European Insurance and Occupational Pensions Supervisors, where it has been consulted. The joint decision shall be recognized as determinative and applied by the supervisory authorities in the Member States concerned.

5. In the absence of a joint decision between the supervisory authorities concerned within the periods set out in paragraphs 2 and 3, the group supervisor shall make its own decision on the application.

In making its decision, the group supervisor shall duly consider the following:

(a) any views and reservations of the supervisory authorities concerned expressed during the applicable period;

(b) any reservations of the other supervisory authorities within the college expressed during the applicable period;

(c) where the Committee of European Insurance and Occupational Pensions Supervisors has been consulted, the advice of that Committee.

The decision shall be set out in a document containing the fully reasoned decision and an explanation of any significant deviation from the reservations of the other supervisory authorities concerned and the advice of the Committee of European Insurance and Occupational Pensions Supervisors. The decision shall be provided to the applicant and the other supervisory authorities concerned by the group supervisor. That decision shall be recognised as determinative and applied by the supervisory authorities in the Member States concerned.

Article 237

Subsidiaries of an insurance or reinsurance undertaking: coverage of the Solvency Capital Requirement

[…]

2. The group support shall take the form of a declaration to the group supervisor, expressed in a legally binding document and containing a commitment of the parent undertaking to transfer own funds eligible under Article 98(5) and Article 98(4), in the cases mentioned respectively in Article 238(3) and (4). The commitment shall be expressed in a legally binding document and meet all requirements existing under the law of the parent undertaking to be recognised as a legal commitment. No recourse before a legal or administrative body shall have a suspensive effect that would delay the transfer of funds.

3. Before accepting the declaration referred to in paragraph 2, the group supervisor shall verify the following:

(a) that the group has sufficient eligible own funds, to cover its consolidated group Solvency Capital Requirement.

(b) that there is no current or foreseeable material practical or legal impediment to the prompt transfer of the eligible own funds referred to in paragraph 2. In particular, where the parent undertaking foresees that the funds transferred in accordance with Article 238 may be provided by other subsidiaries, the administrative or management bodies of those subsidiaries will not oppose such transfers;

(c) that the document containing the declaration of group support meets all requirements existing under the law of the parent undertaking to be recognised as a legal commitment, and that any recourse before a legal or administrative body shall not have suspensive effect.

Article 305a

Amendments to Directive 2003/41/EC

1. Article 17(2) is replaced by the following:

"For the purposes of calculating the minimum amount of additional assets, the rules laid down in Articles 17a to 17d shall apply."

2. The following Articles 17a to 17d are inserted:

"Article 17a (ex-Article 27 of Directive 2002/83/EC)

Available solvency margin

1. Each Member State shall require of every institution referred to in Article 17 (1)which is located in its territory an adequate available solvency margin in respect of its entire business at all times which is at least equal to the requirements in this Directive.

2. The available solvency margin shall consist of the assets of the institution free of any foreseeable liabilities, less any intangible items, including:

(a) the paid-up share capital or, in the case of an institution taking the form of a mutual undertaking, the effective initial fund plus any accounts of the members of the mutual undertaking which meet all the following criteria:

(i) the memorandum and articles of association must stipulate that payments may be made from these accounts to members of the mutual undertaking only in so far as this does not cause the available solvency margin to fall below the required level, or, after the dissolution of the undertaking, if all the undertaking's other debts have been settled;

(ii) the memorandum and articles of association must stipulate, with respect to any payments referred to in point (i) for reasons other than the individual termination of membership in the mutual undertaking, that the competent authorities must be notified at least one month in advance and can prohibit the payment within that period;

(iii) the relevant provisions of the memorandum and articles of association may be amended only after the competent authorities have declared that they have no objection to the amendment, without prejudice to the criteria stated in points (i) and (ii);

(b) reserves (statutory and free) not corresponding to underwriting liabilities;

(c) the profit or loss brought forward after deduction of dividends to be paid;

(d) in so far as authorised under national law, profit reserves appearing in the balance sheet where they may be used to cover any losses which may arise and where they have not been made available for distribution to members and beneficiaries. The available solvency margin shall be reduced by the amount of own shares directly held by the institution.

3. Member States may provide that the available solvency margin may also consist of:

(a) cumulative preferential share capital and subordinated loan capital up to 50 % of the lesser of the available solvency margin and the required solvency margin, no more than 25 % of which shall consist of subordinated loans with a fixed maturity, or fixed-term cumulative preferential share capital, provided that binding agreements exist under which, in the event of the bankruptcy or liquidation of the institution, the subordinated loan capital or preferential share capital ranks after the claims of all other creditors and is not to be repaid until all other debts outstanding at the time have been settled.

Subordinated loan capital shall also fulfil the following conditions:

(i) only fully paid-up funds shall be taken into account;

(ii) for loans with a fixed maturity, the original maturity shall be at least five years. No later than one year before the repayment date, the institution shall submit to the competent authorities for their approval a plan showing how the available solvency margin will be kept at or brought to the required level at maturity, unless the extent to which the loan may rank as a component of the available solvency margin is gradually reduced during at least the last five years before the repayment date. The competent authorities may authorise the early repayment of such loans provided application is made by the issuing institution and its available solvency margin will not fall below the required level;

(iii) loans the maturity of which is not fixed shall be repayable only subject to five years' notice unless the loans are no longer considered as a component of the available solvency margin or unless the prior consent of the competent authorities is specifically required for early repayment. In the latter event the institution shall notify the competent authorities at least six months before the date of the proposed repayment, specifying the available solvency margin and the required solvency margin both before and after that repayment. The competent authorities shall authorise repayment only if the institution's available solvency margin will not fall below the required level;

(iv) the loan agreement shall not include any clause providing that in specified circumstances, other than the winding-up of the institution, the debt will become repayable before the agreed repayment dates;

(v) the loan agreement may be amended only after the competent authorities have declared that they have no objection to the amendment;

(b) securities with no specified maturity date and other instruments, including cumulative preferential shares other than those mentioned in point (a), up to 50 % of the lesser of the available solvency margin and the required solvency margin for the total of such securities and the subordinated loan capital referred to in point (a) provided they fulfil the following:

(i) they may not be repaid on the initiative of the bearer or without the prior consent of the competent authority;

(ii) the contract of issue shall enable the institution to defer the payment of interest on the loan;

(iii) the lender's claims on the institution shall rank entirely after those of all non-subordinated creditors;

(iv) the documents governing the issue of the securities shall provide for the loss-absorption capacity of the debt and unpaid interest, while enabling the institution to continue its business;

(v) only fully paid-up amounts shall be taken into account.

4. Upon application, with supporting evidence, by the institution to the competent authority of the home Member State and with the agreement of that competent authority, the available solvency margin may also consist of:

(a) where Zillmerising is not practised or where, if practised, it is less than the loading for acquisition costs included in the premium, the difference between a non-Zillmerised or partially Zillmerised mathematical provision and a mathematical provision Zillmerised at a rate equal to the loading for acquisition costs included in the premium. This figure may not, however, exceed 3,5 % of the sum of the differences between the relevant capital sums of life assurance and occupational retirement provision activities and the mathematical provisions for all policies for which Zillmerising is possible. The difference shall be reduced by the amount of any undepreciated acquisition costs entered as an asset;

(b) any hidden net reserves arising out of the valuation of assets, in so far as such hidden net reserves are not of an exceptional nature;

(c) one half of the unpaid share capital or initial fund, once the paid-up part amounts to 25 % of that share capital or fund, up to 50 % of the lesser of the available and required solvency margin.

5. The Commission may adopt implementing measures relating to paragraphs 2, 3 and 4 to take into account developments that justify a technical adjustment of the elements eligible for the available solvency margin.

Those measures designed to amend non-essential elements of this Directive shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 21b.

Article 17b (ex-Article 28 of Directive 2002/83/EC)

Required solvency margin

1. Subject to Article 17c, the required solvency margin shall be determined as laid down in paragraphs 2 to 6 according to the liabilities underwritten.

2. The required solvency margin shall be equal to the sum of the following two results:

(a) first result:

a 4 % fraction of the mathematical provisions relating to direct business and reinsurance acceptances gross of reinsurance cessions shall be multiplied by the ratio, for the last financial year, of the mathematical provisions net of reinsurance cessions to the gross total mathematical provisions. That ratio may in no case be less than 85 %.;

(b) second result:

for policies on which the capital at risk is not a negative figure, a 0,3 % fraction of such capital underwritten by the institution shall be multiplied by the ratio, for the last financial year, of the total capital at risk retained as the institution's liability after reinsurance cessions and retrocessions to the total capital at risk gross of reinsurance; that ratio may in no case be less than 50 %.

For temporary assurance on death of a maximum term of three years the fraction shall be 0,1 %. For such assurance of a term of more than three years but not more than five years the above fraction shall be 0,15 %.

3. For the supplementary insurance referred to in Article 2(3)(a)(iii) of Directive [COM(2008)119] the required solvency margin shall be equal to the required solvency margin for institutions as laid down in Article 17d.

4. For capital redemption operations referred to in Article 2(3)(b)(ii) of Directive [COM(2008)119], the required solvency margin shall be equal to a 4 % fraction of the mathematical provisions calculated in compliance with paragraph 2(a).

5. For operations referred to in Article 2(3)(b)(i) of Directive [COM(2008)119], the required solvency margin shall be equal to 1 % of their assets.

6. For assurances covered by Article 2(3)(a)(i) and (ii) of Directive [COM(2008)119] linked to investment funds and for the operations referred to in Article 2(3)(b)(iii), (iv) and (v) of Directive [COM(2008)119], the required solvency margin shall be equal to the sum of the following:

(a) in so far as the institution bears an investment risk, a 4 % fraction of the technical provisions, calculated in compliance with paragraph 2(a);

(b) in so far as the institution bears no investment risk but the allocation to cover management expenses is fixed for a period exceeding five years, a 1 % fraction of the technical provisions, calculated in compliance with paragraph 2(a);

(c) in so far as the institution bears no investment risk and the allocation to cover management expenses is not fixed for a period exceeding five years, an amount equivalent to 25 % of the last financial year's net administrative expenses pertaining to such business;

(d) in so far as the institution covers a death risk, a 0,3 % fraction of the capital at risk calculated in compliance with paragraph 2(b).

Article 17c (ex-Article 29 of Directive 2002/83/EC)

Guarantee fund

1. One third of the required solvency margin as specified in Article 17b shall constitute the guarantee fund. This fund shall consist of the items listed in Article 17a(2), (3) and, with the agreement of the competent authority of the home Member State, (4)(b).

2. The guarantee fund may not be less than a minimum of EUR 3 million. Any Member State may provide for a one-fourth reduction of the minimum guarantee fund in the case of mutual undertakings and mutual-type undertakings.

Article 17d (ex-Article of 16a of Directive 1973/239/EEC)

Required solvency margin for the purpose of Article 17b(3)

1. The required solvency margin shall be determined on the basis either of the annual amount of premiums or contributions, or of the average burden of claims for the past three financial years.

2. The amount of the required solvency margin shall be equal to the higher of the two results as set out in paragraphs 3 and 4.

3. The premium basis shall be calculated using the higher of gross written premiums or contributions as calculated below, and gross earned premiums or contributions.

The premiums or contributions (inclusive of charges ancillary to premiums or contributions) due in respect of direct business in the last financial year shall be aggregated.

To this sum there shall be added the amount of premiums accepted for all reinsurance in the last financial year.

From this sum there shall then be deducted the total amount of premiums or contributions cancelled in the last financial year, as well as the total amount of taxes and levies pertaining to the premiums or contributions entering into the aggregate.

The amount so obtained shall be divided into two portions, the first portion extending up to EUR 50 million, the second comprising the excess; 18 % and 16 % of these portions respectively shall be calculated and added together.

The sum so obtained shall be multiplied by the ratio existing in respect of the sum of the last three financial years between the amount of claims remaining to be borne by the institution after deduction of amounts recoverable under reinsurance and the gross amount of claims; that ratio may in no case be less than 50 %.

4. The claims basis shall be calculated, as follows:

The amounts of claims paid in respect of direct business (without any deduction of claims borne by reinsurers and retrocessionaires) in the periods specified in paragraph 1 shall be aggregated.

To this sum there shall be added the amount of claims paid in respect of reinsurances or retrocessions accepted during the same periods and the amount of provisions for claims outstanding established at the end of the last financial year both for direct business and for reinsurance acceptances.

From this sum there shall be deducted the amount of recoveries effected during the periods specified in paragraph 1.

From the sum then remaining, there shall be deducted the amount of provisions for claims outstanding established at the commencement of the second financial year preceding the last financial year for which there are accounts, both for direct business and for reinsurance acceptances.

One-third of the amount so obtained shall be divided into two portions, the first extending up to EUR 35 million and the second comprising the excess; 26 % and 23 % of these portions respectively shall be calculated and added together.

The sum so obtained shall be multiplied by the ratio existing in respect of the sum of the last three financial years between the amount of claims remaining to be borne by the institution after deduction of amounts recoverable under reinsurance and the gross amount of claims; that ratio may in no case be less than 50 %.

5. If the required solvency margin as calculated in paragraphs 2, 3 and 4 is lower than the required solvency margin of the year before, the required solvency margin shall be at least equal to the required solvency margin of the year before multiplied by the ratio of the amount of the technical provisions for claims outstanding at the end of the last financial year and the amount of the technical provisions for claims outstanding at the beginning of the last financial year. In these calculations technical provisions shall be calculated net of reinsurance but the ratio may in no case be higher than 1."

3. The following Articles 21a and 21b are inserted:

"Article 21a (ex-Article 30 of Directive 2002/83/EC)

Review of the amount of the guarantee fund

1. The amount in euro as laid down in Article 17c(2) shall be reviewed annually starting on [31 October 2012], in order to take account of changes in the European index of consumer prices comprising all Member States as published by Eurostat.

The amount shall be adapted automatically, by increasing the base amount in euro by the percentage change in that index over the period between [XX 2009] and the review date and rounded up to a multiple of EUR 100 000.

If the percentage change since the last adaptation is less than 5 %, no adaptation shall take place.

2. The Commission shall inform annually the European Parliament and the Council of the review and the adapted amount referred to in paragraph 1.

Article 21b (ex-Article 65 of Directive 2002/83/EC)

Committee procedure

1. The Commission shall be assisted by the European Insurance and Occupational Pensions Committee established by Commission Decision 2004/9/EC[1].

2. Where reference is made to this paragraph, Articles 5a(1) to (4) of Decision 1999/468/EC shall apply, having regard to the provisions of Article 8 thereof."

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Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision contains references in its Article 17(2) to the existing legislative provisions on solvency margins. In order to maintain the current situation, it is necessary to adapt and complete these references accordingly. However, the solvency rules provided for pension funds should be reviewed with a view to enhancing convergence of supervisory practices and the level playing field for providers of similar products, resulting in similar risks.

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1 OJ L 3, 7.1.2004, p. 34.

ANNEX IV

SOLVENCY CAPITAL REQUIREMENT (SCR) STANDARD FORMULA

1. Calculation of the Basic Solvency Capital Requirement

The Basic Solvency Capital Requirement set out in Article 104(1) shall be equal to the following:

$$Basic\ SCR = \sqrt{\sum_{i,j} Corr_{i,j} \times SCR_i \times SCR_j}$$

where SCR_i denotes the risk module i and SCR_j denotes the risk module j, and where "i,j" means that the sum of the different terms should cover all possible combinations of i and j. In the calculation, SCR_i and SCR_j are replaced by the following:

– $SCR_{non\text{-}life}$ denotes the non-life underwriting risk module;
– SCR_{life} denotes the life underwriting risk module;
– $SCR_{special\ health}$ denotes the special health underwriting risk module;
– SCR_{market} denotes the market risk module;
– $SCR_{default}$ denotes the counterparty default risk module.

The factor $Corr_{i,j}$ denotes the item set out in row i and in column j of the following correlation matrix:

j / *i*	*Market*	*Default*	*Life*	*Special health*	*Non-life*
Market	1	0.25	0.25	0.25	0.25
Default	0.25	1	0.25	0.25	0.5
Life	0.25	0.25	1	0.25	0
Special health	0.25	0.25	0.25	1	0
Non-life	0.25	0.5	0	0	1

2. Calculation of the non-life underwriting risk module

The non-life underwriting risk module set out in Article 105(2) shall be equal to the following:

$$SCR_{non-life} = \sqrt{\sum_{i,j} Corr_{i,j} \times SCR_i \times SCR_j}$$

where SCR_i denotes the sub-module i and SCR_j denotes the sub-module j, and where "i,j" means that the sum of the different terms should cover all possible combinations of i and j. In the calculation, SCR_i and SCR_j are replaced by the following:

– $SCR_{\text{nl premium and reserve}}$ denotes the non-life premium and reserve risk sub-module;

– $SCR_{\text{nl catastrophe}}$ denotes the non-life catastrophe risk sub-module.

3. Calculation of the life underwriting risk module

The life underwriting risk module set out in Article 105(3) shall be equal to the following:

$$SCR_{life} = \sqrt{\sum_{i,j} Corr_{i,j} \times SCR_i \times SCR_j}$$

where SCR_i denotes the sub-module i and SCR_j denotes the sub-module j, and where "i,j" means that the sum of the different terms should cover all possible combinations of i and j. In the calculation, SCR_i and SCR_j are replaced by the following:

– $SCR_{\text{mortality}}$ denotes the mortality risk sub-module;

– $SCR_{\text{longevity}}$ denotes the longevity risk sub-module;

– $SCR_{\text{disability}}$ denotes the disability - morbidity risk sub-module;

– $SCR_{\text{life expense}}$ denotes the life expense risk sub-module;

– SCR_{revision} denotes the revision risk sub-module;

– SCR_{lapse} denotes the lapse risk sub-module;

– $SCR_{\text{life catastrophe}}$ denotes the life catastrophe risk sub-module.

4. Calculation of the special health underwriting risk module

The special health underwriting risk module set out in Article 105(4) shall be equal to the following:

$$SCR_{special\ health} = \sqrt{\sum_{i,j} Corr_{i,j} \times SCR_i \times SCR_j}$$

where SCR_i denotes the sub-module i and SCR_j denotes the sub-module j, and where "i,j" means that the sum of the different terms should cover all possible combinations of i and j. In the calculation, SCR_i and SCR_j are replaced by the following:

– $SCR_{health\ premium\ and\ reserve}$ denotes the health premium and reserve risk sub-module;

– $SCR_{health\ expense}$ denotes the health expense risk sub-module;

– $SCR_{health\ epidemic}$ denotes the health epidemic risk sub-module.

5. Calculation of the market risk module

a) Structure of the market risk module

The market risk module, set out in Article 105(5) shall be equal to the following:

$$SCR_{market} = \sqrt{\sum_{i,j} Corr_{i,j} \times SCR_i \times SCR_j}$$

where SCR_i denotes the sub-module i and SCR_j denotes the sub-module j, and where "i,j" means that the sum of the different terms should cover all possible combinations of i and j. In the calculation, SCR_i and SCR_j are replaced by the following:

– $SCR_{interest\ rate}$ denotes the interest rate risk sub-module;

– SCR_{equity} denotes the equity risk sub-module;

– $SCR_{property}$ denotes the property risk sub-module;

– SCR_{spread} denotes the spread risk sub-module;

– $SCR_{concentration}$ denotes the market risk concentrations sub-module;

– $SCR_{currency}$ denotes the currency risk sub-module.

~~**b) Calculation of the equity risk sub-module**~~

~~**i) In order to calculate the equity risk sub-module, as referred to in paragraph 1 of Article 105bis, insurance and reinsurance undertakings shall assess the combined quantitative impact on their basic own funds of:**~~

- ~~**an instantaneous decrease of *x*% in prices for equity investments which are traded on a regulated market and listed in a State belonging to zone A as defined in Directive 2000/12/EC [an EEA or OECD country], and**~~

- ~~**an instantaneous decrease of *y*% in prices for other equity investments.**~~

~~**ii) With respect to equity investments which are traded on a regulated market and listed in an EEA or OECD country:**~~

~~**- Where insurance or reinsurance undertakings apply the calculation approach for equity risk, as set out in point a) of paragraph 1 of Article 105 bis, the percentage *x*% shall be equal to the 32% percentage plus a "dampener correction" in accordance with the following formula:**~~

$$\cancel{x\% = 32\% + \alpha \times P(Index_t)}$$

~~**where:**~~

~~**- P(Index$_t$) denotes the position in the financial cycle for the reference index for equity investments which are traded on a regulated market and listed in an EEA or OECD country. This position index shall be positive where the equity price index is higher than its trend calculated over the last 36 months and negative where the equity price index is smaller than its trend;**~~

~~**– α denotes a fixed dampener factor;**~~

~~**- the 32% percentage does not take into account the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes, as referred to in Article 107.**~~

~~- Where insurance or reinsurance undertakings apply the calculation approach for equity risk, as set out in point b) of paragraph 1 of Article 105bis, the percentage *x*% shall be equal to the sum of:~~

- ~~a percentage calibrated as a function of the typical holding period of equity investments of the insurance or reinsurance undertaking, in accordance with paragraph 1 b) of Article 105bis;~~
- ~~a dampener correction that may depend on the typical holding period of equity investments of the insurance or reinsurance undertaking.~~

~~iii) With respect to other equity investments, the percentage *y*% shall be equal either to a fixed percentage in accordance with the approach set out in point a) of paragraph 1 of Article 105bis, or to a set of fixed percentages in order to take account of the various natures of other equity investments considered in accordance with the approach set out in point b) of paragraph 1 of Article 105bis.~~