EUROPEAN COMMISSION
Internal Market and Services DG

FINANCIAL INSTITUTIONS
Insurance and pensions

'SOLVENCY II': Frequently Asked Questions (FAQs)

1. Why does the EU need harmonised solvency rules?

The aim of a solvency regime is to ensure the financial soundness of insurance undertakings, and in particular to ensure that they can survive difficult periods. This is to protect policyholders (consumers, businesses) and the stability of the financial system as a whole.

Solvency rules stipulate the minimum amounts of financial resources that insurers and reinsurers must have in order to cover the risks to which they are exposed. Equally importantly, the rules also lay down the principles that should guide insurers' overall risk management so that they can better anticipate any adverse events and better handle such situations.

The rationale for EU insurance legislation is to facilitate the development of a Single Market in insurance services, whilst at the same time securing an adequate level of consumer protection. The third-generation Insurance Directives established an "**EU passport**" (single licence) for insurers based on the concept of minimum harmonisation and mutual recognition. Many Member States have concluded that the current EU minimum requirements are not sufficient and have implemented their own reforms, thus leading to a situation where there is a patchwork of regulatory requirements across the EU. This hampers the functioning of the Single Market.

The new 'Solvency II' rules will replace these old requirements and establish more harmonised requirements across the EU, thus promoting competitive equality as well as high and more uniform levels of consumer protection.

2. What is new about Solvency II (as compared with existing legislation)?

'Solvency II' will introduce **economic risk-based solvency requirements** across all EU Member States for the first time. These new solvency requirements will be more risk-sensitive and more sophisticated than in the past, thus enabling a better coverage of the real risks run by any particular insurer. The new requirements move away from a crude "one-model-fits-all" way of estimating capital requirements to more entity-specific requirements.

Solvency requirements will also be more comprehensive than in the past. Whereas at the moment the EU solvency requirements concentrate mainly on the liabilities side (i.e. insurance risks), Solvency II takes account of the asset-side risks. The new regime will be a **'total balance sheet'** type regime where all the risks and their interactions are considered.

In particular, insurers will now be required to hold capital against market risk (i.e. fall in the value of insurers' investments), credit risk (e.g. when third parties cannot repay their debts) and operational risk (e.g. risk of systems breaking down or malpractice). These are all risks which are currently not covered by the EU regime. However, experience has shown that all these risk types can pose a material threat to insurers' solvency.

Although one of the big steps forward under the new regime will be the introduction of more risk-sensitive solvency requirements and adopting the 'total balance sheet' approach to measuring solvency, the new regime also emphasises that capital is not the only (or the best) way to mitigate against failures. Under 'Solvency II', new rules will for the first time compel insurers specifically to focus on and devote significant resources to the identification, measurement and proactive management of risks.

Together with a greater focus on risks and their management, the new solvency system will also adopt a more prospective focus. Whereas at the moment solvency requirements are based on largely historical data, the new rules will require insurers also to think about any future developments, such as new business plans or the possibility of catastrophic events which might affect their financial standing. A new development in this area will be the introduction of the "**Own Risk and Solvency Assessment" (ORSA)"** (see also question 27).

Another new requirement is the "**Supervisory Review Process**" (**SRP**). The purpose of the SRP is to enable supervisors to better and earlier identify insurers which might be heading for difficulties. Under the SRP, supervisors evaluate insurers' compliance with the laws, regulations and administrative provisions adopted pursuant to this Directive and its implementing measures.
The new rules require insurers to **disclose** certain **information publicly** to a far greater extent than currently is the case. This will bring in **'market discipline'**, which will help to ensure the soundness and stability of insurers, as market players will be able to exercise greater supervision over and offer greater competition to other insurers. Insurers applying 'best practice' are more likely to be rewarded by lower financing costs, for example.

Finally, the new framework will **strengthen the role of the group supervisor** who will have specific responsibilities to be exercised in close cooperation with the solo supervisors. This will mean that the same economic risk-based approach will be applied to insurance groups which can now be better managed as a single economic entity. Furthermore, the new solvency provisions will foster and force greater cooperation between insurance supervisors and will further supervisory convergence.

3. What does Solvency II mean for consumers?

The new rules will ensure a uniform and enhanced level of policyholder protection across the EU, reducing the likelihood that policyholders lose out if insurers get into difficulties. A more robust system will give policyholders greater confidence in the products of insurers. 'Solvency II' will increase competition, especially for mass retail lines of business, such as motor and household insurance, putting downward pressure on prices. Product innovation will give consumers more choice.

4. Who will be covered by the new rules?

The new framework – like the current rules – applies to almost all EU insurers and reinsurers. Only the smallest ones (which fulfil a number of conditions, including having gross written premium income of less than €5 Mio. annually) will not be subject to these new rules, although they can choose to 'opt in' if they so wish.

5. Will the new regime cover also pension funds?

Solvency II does not apply to pension funds covered by Directive 2003/41/EEC (the "occupational pension funds" Directive, or IORPs). The Commission is currently examining how suitable solvency requirements can or should be developed for pension funds.

6. Will Solvency II affect the supervision of credit institutions or financial conglomerates?

Solvency II does not cover credit institutions or financial conglomerates. The Financial Conglomerates Directive is currently under review and this includes an analysis of the impact and lessons to be learnt from Solvency II. New solvency requirements for credit institutions have been agreed in 2006 in the form of the Capital Requirements Directive which implemented the Basel II agreement in Europe.

7. Does Solvency II cover insurance guarantee schemes?

No. Solvency II covers issues related to ensuring the continued financial soundness and the prudential supervision of insurers in Europe. Insurance guarantee schemes provide last resort protection in case an insurer fails.

The Commission in its Communication of 4 March 2009 "Driving European recovery" underlines the need to reinforce the protection of consumers, investors and small companies. Additional measures are needed to reinforce depositor, investor and policyholder protection. An effective and comprehensive legal framework for retail financial services needs to be put in place. The Commission will therefore review, by the end of 2009, the adequacy of existing guarantee schemes in insurance and make appropriate legislative proposals. To this end the Commission intends to adopt a White Paper on Insurance Guarantee Schemes by the end of this year.

8. When will the new framework be in place?

The new system will apply to insurers from the end of October 2012.

9. Are the EU solvency rules compliant with international solvency standards?

Yes, the new rules are compliant. Great care has been taken to ensure that the new EU regime will be in line with the existing international guidelines in this area as agreed by the International Association of Insurance Supervisors (IAIS), as well as with the ongoing work of IAIS on a new international agreement for a solvency regime for insurers and reinsurers.

10. What does Solvency II say about mutual and co-operative insurers?

Solvency II is neutral when it comes to the legal form of the insurer; what matters is the nature, scale and complexity of the insurance business that it is running. However, Solvency II allows "supplementary members' calls" to be recognised as Tier 2 capital under certain conditions, thereby recognising the particular nature of the mutual sector.

11. How is the Commission assessing the impact of these new rules?

In line with the Better Regulation approach the Commission's Proposal of 2007 was supported by a full impact assessment. This provides background to the various policy options that have been considered and analysis of the expected impact of the new rules. (For further information, see Impact Assessment)

The Commission's future proposal for implementing measures will also be accompanied by an impact assessment.

12. What quantitative requirements will insurers have to meet under the new solvency framework?

As is the case with the current solvency regime, insurers under the new solvency framework will have to establish **technical provisions** to cover expected future claims from policyholders. The technical provisions under the new framework should be equivalent to the amount another insurer would be expected to pay in order to take over and meet the insurer's obligations to policyholders. In addition, insurers must have available resources sufficient to cover both a **Minimum Capital Requirement (MCR)** and a **Solvency Capital Requirement (SCR)**.

The SCR is based on a Value-at-Risk measure calibrated to a **99.5% confidence** level over a 1-year time horizon. The SCR covers all risks that an insurer faces (e.g. insurance, market, credit and operational risk) and will take full account of any risk mitigation techniques applied by the insurer (e.g. reinsurance and securitisation). The SCR may be calculated using either a new European Standard Formula or an internal model validated by the supervisory authorities.

13. What is Value-at-Risk (VaR)?

Value-at-Risk (VaR) is a commonly used measure in financial services to assess the risk associated with a portfolio of assets and liabilities. VaR answers the question how much money would be lost, if events develop in an adverse and unexpected way. More precisely, Value-at-Risk (VaR) measures the worst expected loss under normal conditions over a specific time interval at a given confidence level. For example, if VaR is measured over a one-year period at a confidence level of 99.5% then this corresponds to the worst loss one would expect to occur in a single year over the next two hundred years.

14. What happens if an insurer breaches the solvency control levels?

One reason for the introduction of two capital requirements is to establish a better early warning mechanism and thus allow more time for supervisory intervention.

If an insurer's available resources fall below the SCR, then supervisors are required to take action with the aim of restoring the insurer’s finances back into the level of the SCR as soon as possible. If, however, the financial situation of the insurer continues to deteriorate, then the level of supervisory intervention will be progressively intensified. The aim of this 'supervisory ladder' of intervention is to capture any ailing insurers before a serious threat to policyholders' interests.

If, despite supervisory intervention, the available resources of the insurer fall below the MCR, then 'ultimate supervisory action' will be triggered. In other words, the insurer's liabilities will be transferred to another insurer and the license of the insurer will be withdrawn or the insurer will be closed to new business and its in-force business will be liquidated.

15. What level of protection will policyholders get in practice under the new solvency framework?

The level of the SCR under the new framework ensures that the likelihood of an insurer being ruined during the year is no more than 1 in 200. However, in practice the likelihood of ruin occurring is actually much lower than this, because as soon as the SCR is breached supervisors will be required to intervene and take action to restore the financial position of the insurer.

In addition, studies of insurance failures and 'near misses' by CEIOPS (see also question 42) have shown that the primary causes of failures were poor management and inappropriate risk decisions rather than inadequate capitalisation per se. The introduction of new qualitative requirements, in particular with respect to governance including risk management, should reduce the likelihood of insurance failures under the new solvency framework.

Furthermore, even in the rare event that an insurer gets into financial difficulties, the requirement for supervisors to take ultimate supervisory action once the MCR has been breached should ensure that in most of these cases an insurer's business can either be liquidated or that its insurance obligations can be transferred to another insurer, thus minimising any disruption or loss to its policyholders.

16. Is this a 'zero-failure' regime?

Despite the many safeguards in the new solvency framework which are designed to minimise the likelihood of insurance failure and the costs to policyholders in the event of failure, 'Solvency II' is not a 'zero-failure' regime. It is not possible to build a viable system that provides a cast iron guarantee that no insurer will ever fail.

For example, it would not make sense to require insurers to hold sufficient capital to cover an extremely unlikely, yet devastating event such as a large meteor hitting a major city in Europe. When designing a regulatory system, it must be kept in mind that protection comes at a cost – that is to say – the higher the level of the guarantee, the higher the cost to policyholders and the economy as a whole. A balance has to be struck in order that insurers can offer affordable, yet sufficiently safe insurance products.

17. What are the three "pillars"?

The new solvency framework will consist of three main thematic areas, or 'pillars', of regulation which are designed to be mutually reinforcing. Pillar 1 consists of the quantitative requirements (i.e. how much capital an insurer should hold). Pillar 2 sets out requirements for the governance and risk management of insurers, as well as for the effective supervision of insurers. The focus of Pillar 3 is on supervisory reporting and transparency requirements.

18. What is the European Standard Formula?

The European Standard Formula is the new basic calculation method that insurers can use to determine their solvency capital requirement (SCR).

19. When will the final calibration of the European Standard Formula be decided?

The final calibration will be included in an implementing measure that will contain the technical detail needed for insurers to run the formula in practice. The Commission is committed to having the implementing measures in place at least 12 months before insurers will need to start applying the new rules, meaning that they would need to be agreed before October 2011.

20. Will the new framework allow for securitisation?

The new solvency framework will recognise the economic substance of insurance activity and will focus on risk and the management of risk. Securitisations, as well as other risk mitigation techniques such as reinsurance and derivatives, can be a very useful tool for insurers in managing their risk exposures. The new solvency regime allows insurers to use such techniques and to get commensurate solvency capital relief arising from such a use, provided that insurers can demonstrate that they understand the nature and limitations of such techniques, and provided that there is a real transfer of risk.

21. Can insurers now invest in any asset they wish?

Yes, provided that they can demonstrate that they understand the risks involved in such investments and that they have adequate systems and controls in place to manage these risks.

22. Will the new rules deter insurers from investing in equity?

Under Solvency I, there is no explicit capital requirement related to market risk. This means that insurers do not have to hold capital against the risk of holding equity investments, or any other volatile or risky financial asset. The management of investment risk is dealt with in a more simplistic and non-risk sensitive way by splitting investments into two categories: a) 'assets covering technical provisions', which back obligations relating to policyholders and are subject to a number of quantitative restrictions (e.g. asset eligibility criteria and quantitative limits); and b) 'free assets', i.e. any other assets which are not subject to quantitative restrictions.

Under the new regime, this distinction will cease to exist. Instead, equity investment along with all other assets will be subject to a capital requirement commensurate with the level of risk of the asset. This means that the more volatile a particular asset category tends to be over the one-year regulatory time horizon, the higher the capital charge. That said, Solvency II also includes 'dampener' mechanisms to ensure that it does not amplify cycles in equity markets (see question 22b).

One of the reasons why it is necessary to also consider market risk, or risk associated with investments, is that experience has shown that inappropriate investment strategies or adverse movements in the value of the investments can threaten the financial soundness of an insurer and its ability to meet its commitments. Requiring insurers to hold capital against such adverse scenarios arising out of their investments not only mitigates against insurance failures, but also incentivises insurers to consider the appropriateness of their investment portfolio and the risk associated with it. Solvency II also sets out some new strengthened governance requirements concerning the management of assets that should further improve practice in this area.

The extent to which insurers might change their investment behaviour as a result of the new rules will depend on a number of factors, including their existing investment strategy or their particular business model and strategy. It will be up to insurers to decide whether their expectations regarding investment returns on more volatile assets are sufficient to compensate them for the additional costs arising from the need to hold more capital to cover the investment risk arising from such investments. Others might choose to minimise their asset-liability mismatch risk or might not be willing to pay the associated costs involved in running a complex and riskier investment portfolio.

It is also worth noting that the new rules might spur insurers to increase their share in higher risk investments, such as start-ups, SMEs and venture capital. Under the new rules insurers will be able to invest in any asset they wish, whereas under the existing rules investment e.g. in non-listed entities is limited to 1% of assets covering technical provisions.

22a. What is the duration approach?

The duration-based approach is an alternative method for calculating the risk arising from movements in equity prices, which Member States may allow to be used instead of the standard approach. This approach is limited to ring-fenced retirement provision business of life assurance undertakings that satisfy a number of explicit requirements. The use of the duration-based approach is subject to prior supervisory approval.

22b. Will Solvency II amplify equity market fluctuations?

Rules can be described as procyclical when they unnecessarily amplify swings in underlying economic cycles or contribute to excessive market movements. Solvency II is carefully designed to limit procyclical effects, particularly in respect of equity risk. Firstly, the Pillar 1 equity risk sub-module includes a symmetric adjustment mechanism to the standard equity capital charge to cover the risk arising from changes in the level of equity prices. Secondly, under Pillar 2, supervisory authorities may extend the recovery period for breaches of the Solvency Capital Requirement in the event of an exceptional fall in financial markets, taking into account all relevant factors.

23. How will the new rules impact on the organisation of insurers?

The governance requirements for insurers mean that they will have to establish 'functions', or specific areas of responsibility and expertise, to deal with risk management, risk modelling (for internal model users), compliance, internal audit and actuarial issues.

These 'functions' have been specifically identified in order to help insurers in their practical implementation of the new rules. That said, Solvency II does not prevent an insurer from deciding how best to organise itself. For example, some insurers might conclude that combining their risk modelling and actuarial functions makes sense for them. Others might decide to keep them separate. It is also possible to fully or partially outsource the exercise of these functions and more than one function can be carried out by one person or organisational unit simultaneously.

24. Solvency 2 says that all insurers must have an actuarial function and a risk management function. Does this mean that all insurers now need to employ a full-time actuary or a Chief Risk Officer?

The number and type of staff that an insurer employs is not prescribed in Solvency II. Instead, insurers need to demonstrate that they have sufficient in-house expertise or access to such expertise. So, although Solvency II sets out that insurers are required to have an actuarial function, this does not mean that they have to actually employ an actuary, as long as they have access to the necessary (actuarial or mathematical) expertise. The same applies for risk management.

25. What does Solvency II mean for the management of insurers?

Insurers must have an adequate and transparent governance system with a clear allocation of responsibilities and effective reporting lines. Solvency II identifies several ‘functions’, such as the risk management function and the actuarial function, which insurers must have. Other requirements relate to internal control and internal audit, the need to carry out a self assessment of the company's risk and solvency position and the need for board members and senior management to be ‘fit and proper’.

The requirements concerning governance and risk management must be proportionate to the nature, scale and complexity of the insurer. The review of the governance arrangements and risk management capabilities will form a central part of the supervisory review process.

It should be noted that in general in the 'Solvency II' context 'governance' is used in a broad sense, encompassing aspects of corporate governance as well as the concept of risk management.

26. What do the new 'fit-and-proper' requirements mean in practice?

In order to safeguard the interests of policyholders and beneficiaries, insurance companies must be managed soundly and prudently. In this respect it is essential that individuals in key positions do not pose a risk to the interests of the insurance company or its shareholders, e.g. through conflict of interests, inadequate knowledge of the business of insurance or through criminal activity. Minimum standards are therefore set concerning the fitness and propriety of board members and people who occupy key management positions.

Insurers will need to continue to demonstrate that these persons are adequately qualified and proper to do their jobs, and that collectively e.g. the board of an insurer has sufficient knowledge and expertise to exercise effective supervision over and offer a healthy challenge to senior management.

27. What is the 'Own Risk and Solvency Assessment'?

As part of their risk management system, all (re)insurance undertakings must have a regular practice of assessing their overall solvency needs with a view to their specific risk profile, known as 'Own Risk and Solvency Assessment' (ORSA). The main aim of the ORSA is to identify whether the particular risk profile of an undertaking deviates from the assumptions underlying the regulatory capital calculation (e.g. European Standard Formula).

The ORSA has a twofold nature. It is an internal assessment process within the undertaking and is as such embedded in the strategic decisions of the undertaking. It is also a supervisory tool for the supervisory authorities, which must be informed about the results of the undertaking's ORSA.

The ORSA does not require an undertaking to develop or apply a full or partial internal model. However, if the undertaking already uses an approved full or partial internal model for the calculation of the SCR, the results of the model should be used for the ORSA.

The ORSA does not create a third solvency capital requirement. A deviation between the ORSA and the SCR calculation does not lead to an automatic increase of capital. The supervisory authorities have a range of supervisory tools if they deem it necessary to react. A capital increase is just one possibility (see question 28).

The ORSA is very specific to the undertaking's risk profile. It should therefore not be too burdensome for small or less complex undertakings.

28. Can supervisory authorities apply so-called 'capital add-ons'?

The starting point for the adequacy of the quantitative requirements in the (re)insurance sector is the SCR (see also question 12). Supervisory authorities may therefore require insurance undertakings only under exceptional circumstances, strictly defined in the Directive, to hold more capital.

Even though the standard formula aims at capturing the risk profile of most insurance undertakings in the EU, there may be some cases where the standard formula might not entirely reflect the very specific risk profile of an undertaking. The supervisory authority has a range of possibilities for dealing with this situation. Where the deviation is material and the development of a full or partial internal model is inefficient, one possibility is to ask for an increase in capital. This increase serves to bring the undertaking concerned back in line with the target of 99.5% VaR.

29. How does the new EU framework deal with small and medium-sized insurers?

Solvency II is designed for insurers and reinsurers of all sizes and complexities. Although the same general principles will apply to large and small insurers alike, this will not mean that the new regime will be too burdensome for small and medium-sized insurers. The new regime takes account of the specificities of this sector and will allow for a range of methods to be used in order to meet those principles, tailored to the nature, size and complexity of the insurer. Solvency II fully respects the **proportionality principle**.

The application of the rules in a proportionate manner relates to all areas, i.e. both quantitative and qualitative requirements, as well as to the rules on supervision.

For example, **simplifications** will be provided for the calculation of technical provisions and the future European Standard Formula, to be applied where an insurer's operations are relatively straight-forward. With respect to the qualitative requirements, in accordance with the proportionality principle, a smaller insurer conducting simple business will not have to have the same kind of systems and controls as a larger insurer with multiple business lines in multiple countries.

30. Would it not be more appropriate to apply the new rules only to large insurers?

To make the new rules only available to large insurers would put all other insurers at a potential competitive disadvantage. These insurers would not benefit from the possibility of using full or partial internal models and from potentially lower capital requirements and they would be seen by the market as 'second tier insurers' operating under outdated and less sound rules, with matching higher funding costs. This might further advance consolidation of small insurers in the EU rather than protect their present position.

31. Do the new insurance solvency rules take account of the ongoing discussion and development of the new international accounting standard for insurance contracts (IFRS Phase 2 project)?

The new solvency framework only covers prudential valuation rules and not accounting. That said, the Commission's aim is to reduce as far as possible initial implementation and ongoing administration costs for insurers resulting from the introduction of the new solvency framework. This is why care has been taken to ensure that the valuation rules set out in Solvency II are compatible with international accounting developments. In particular, the valuation rules are based on the concept of market consistency.

32. What will Solvency II mean for insurers that are headquartered outside the EU ('third-country insurers')?

Solvency II includes specific rules for branches of direct insurers headquartered outside the EU which are similar to those applied to branches of insurers headquartered within the EU. Conversely, the treatment of cross-border provision of insurance services and reinsurance activities conducted by third-country insurers and reinsurers essentially remains a matter for Member States as long as they respect their EU and international obligations.

However, in order to promote greater harmonisation with respect to the treatment of third-country insurers and reinsurers and to take account of the international nature of insurance markets today, Solvency II includes a number of provisions that enable the equivalence of a third-country solvency regime to be assessed.

Solvency II also allows for the conclusion of mutual recognition agreements with third countries concerning the supervision of reinsurance entities that conduct business in the territory of each contracting party.

33. How will Solvency II improve the supervision of insurance and reinsurance groups?

Solvency II will substantially modernise and simplify group supervision and includes a number of improvements to the existing system, which are inspired by the more recent Financial Conglomerates Directive (2002) and Capital Requirements Directive (2006). These improvements will be of benefit to all insurance and reinsurance groups.

34. How will groups now be supervised?

Groups will have a dedicated 'group supervisor' with real powers and responsibilities to organise the supervision of that group. This 'group supervisor', in close co-operation with the other supervisors, will set the SCR for the group; it will validate any group internal model; and it will act as the central point for the effective supervision of the group.

35. Why is it necessary to improve the current system for group supervision?

It is widely recognised that the current system for insurance groups supervision, as regulated by the Insurance Groups Directive adopted in 1998, needs to be significantly improved.

The current Insurance Groups Directive does not provide for a 'group or lead supervisor'; it does not define clearly enough the rights and duties of the different supervisory authorities involved in the supervision of a group; it is not clear how cooperation between supervisors (e.g. exchange of information, consultations, verification of information etc.) should be organised; and it is based on the premise that supplementary supervision should be carried out at each subgroup level.

This has resulted in group supervision being carried out by too many supervisory authorities at too many levels, with inefficiencies in terms of costs and time for both groups and supervisory authorities themselves.

36. Is it true that Solvency II will result in local supervisors having no role to play in the supervision of subsidiaries?

No. Solvency II will ensure that group supervision is carried out at the right level(s) and more efficiently. The respective rights and duties for the group supervisor and the local supervisors will be defined in a clearer fashion, thus facilitating better cooperation and improved supervisory assessments of the group's overall financial situation. This will mean the supervision of groups will become more robust. As a consequence, the protection of policyholders of insurers belonging to groups will be enhanced.

37. Will Solvency II mean that insurance from an insurer that is part of a group will be less safe?

No. Policyholders should, and can expect the same level of confidence whether they buy their insurance products from big or small insurers, or from a stand-alone insurer or from an insurer which is part of a group.

37a. What happened to the 'Group Support' regime as initially proposed by the Commission?

The text approved by the European Parliament does not go as far as introducing the group support regime as initially proposed by the Commission. The introduction of a review clause specifically mentioning this regime will however enable the Commission to come back to this issue when progress in a number of other areas, connected to the recommendations of the de Larosière report, will have been made and will have brought about a more favourable environment for further reforms on cross-border co-operation between group and local supervisors.

38. How will coherent implementation of the new framework be ensured?

The new framework sets out the principles for the first truly harmonised state-of-the-art solvency rules in the EU. Solvency II also provides for all supervisors to have a similar set of powers to implement the new regime. This will have significant beneficial effects in enhancing the level playing field within the Single Market.

The rules incorporate important requirements for supervisory authorities to work together so as to ensure an efficient and proportionate regulatory environment for cross-border groups. Solvency II also requires supervisors to publicly disclose how they implement and apply the rules in practice.

The Committee of European Insurance and Occupational Pensions Supervisors will play an essential role in ensuring consistency and convergence in the application of the new framework.

The Commission will work closely with Member States and stakeholders to assist in achieving convergent implementation and will rigorously examine whether the national implementations and practice are in line with the form and the spirit of the new requirements.

39. Is Solvency II a 'Lamfalussy'-style Directive? What are implementing measures?

Yes, Solvency II is a 'Lamfalussy'-style Framework Directive. This means that the Framework Directive ('Level 1') focuses mainly on elaborating the basic enduring principles, or political choices, underpinning the solvency system. The more detailed, technical rules will then be put in place by the Commission in the form of implementing measures ('Level 2'), which will be subject to scrutiny by the European Parliament and the Council of Ministers. (See Annex A.3 of the Impact Assessment on the 2007 Proposal for an explanation of the Lamfalussy Process).

40. Why didn't the Commission include all the technical detail in the Solvency II Framework Directive?

Insurance solvency is a very complex and technical issue, where there are continuously new developments and improvements in market theory, risk management techniques and industry best practice. This makes insurance solvency very well suited to a principles-based Directive. It would be a mistake to try to include current practices in Level 1 legislation (i.e. a Framework Directive), because it is more difficult to make even small adjustments responding to such changes. Such rigidity hampers innovation, reduces the competitiveness of the sector and can have adverse effects on policyholder protection.

If the technical detail is contained in the implementing measures, it will be easier for regulation to keep up with the changes in the real world of fast-changing financial markets, as the Commission can decide to update some or all of the implementing measures as times move on. The implementing measures can also facilitate the fostering of convergence of implementation across the EU as they have the force of law, as opposed to 'Level 3' guidance.

Supervisory authorities are indeed encouraged to implement the new system as consistently as possible and to seek supervisory convergence. CEIOPS, the Committee of European Insurance and Occupational Pensions Supervisors, will have a key role to play in this respect. Where the principles, supported by guidance from supervisors, are working, there will be no need to impose additional rules on the industry.

41. When will these implementing measures be developed and enacted? Can the stakeholders have a say in these measures? Will the European Parliament be involved?

The Commission has now turned its attention to implementing measures, and will approach this drafting in an open and transparent manner, involving and listening to stakeholders throughout the process. Where useful, public consultations will be held. The Commission is committed to having the new requirements in place at least 12 months before insurers will need to start applying the new rules. This would mean that the implementing measures would need to be agreed some time before October 2011.

CEIOPS, the Committee of European Insurance and Occupational Pension Supervisors, will be requested to provide the Commission with technical advice concerning aspects of the possible implementing measures. The Commission will announce publicly what topics CEIOPS is expected to work on, and when. CEIOPS will then follow its own guidelines for stakeholder consultation and engagement when developing its advice.

The implementing measures will be subject to the 'scrutiny' comitology procedure, which means that both the European Parliament and the Council of Ministers will have a say over the implementing measures before they become law.

42. What is CEIOPS? What is the role of CEIOPS in the Solvency II project?

CEIOPS is the Committee of European Insurance and Occupational Pensions Supervisors. It was established under the terms of the European Commission Decision 2004/6/EC of 5 November 2003 (replaced by Decision 2009/79/EC of 23 January 2009) and is composed of high-level representatives from the insurance and occupational pensions supervisory authorities of EU Member States. The authorities of the Member States of the European Economic Area also participate in CEIOPS. CEIOPS' secretariat is located in Frankfurt am Main.

CEIOPS is the **Level 3 Committee** for the insurance and occupational pensions sectors. It provides technical advice to the European Commission on legislative matters and works towards agreeing joint supervisory standards and guidelines to enhance convergent and effective application of EU legislation and to facilitate cooperation between national supervisors.

The Commission requested CEIOPS' advice in the run-up to the adoption of the Solvency II proposal and CEIOPS has been asked to provide further advice concerning the technical detail of the possible implementing measures.

43. What is QIS? What is its role in the process?

QIS stands for 'quantitative impact study'. These are simulations, performed by insurers on a voluntary basis, of the impact of proposed new requirements on their financial resources. These have been run by CEIOPS, on the request of the Commission. The results of QIS 4 were made public in

November 2008. A further QIS 5 will be conducted in 2010. The QIS are the primary means for testing the design of the future European Standard Formula, as well as the main route for finding the correct calibration. The QIS are also instrumental in collecting data on the potential impact of the new Formula.

44. Is it likely that problems such as those relating to Equitable Life will reoccur under Solvency II?

The new solvency regime addresses in particular a number of problems which have appeared in the Equitable Life situation. An early-warning mechanism will be established enabling supervisors to intervene at an earlier stage if and when things start to go wrong. The new regime requires insurers to take account of all relevant risks and this will be reflected in their capital requirements and therefore also in the design of their products and the level of their premiums. The new framework provides supervisors with a range of possibilities to help an insurance company experiencing difficulties to redress the situation before it is too late.

It is therefore less likely that situations such as that experienced in the case of Equitable Life will reoccur in the future.