

Solvency II Update - European Parliament Approves Omnibus II Directive

1. Introduction and Summary

On 11 March 2014, by 560 votes to 113, the European Parliament approved the Omnibus II Directive. This is an important milestone on the path to Solvency II implementation and provides (after the agreement at the Trialogue meetings in November 2013) some further certainty around the timing and shape of the Solvency II regime.

This briefing provides an update on where we are now in the Solvency II implementation process and the anticipated next steps.

2. Where are we now?

Key Implementation Dates

31 March 2015	<ul style="list-style-type: none"> Solvency II rules will need to be implemented into national law in all EU Member States although not yet in force for insurers. National regulators will be given relevant powers relating to implementation (e.g. to approve internal models) – see the new "Phasing-in" Article 308a which Omnibus II adds to the Solvency II Directive.
1 January 2016	<ul style="list-style-type: none"> Solvency II requirements are expected to come into force for insurers. In our view it is unlikely that this date will be deferred again, given the political effort which has already been expended to get to this point and the EU Parliament elections later in 2014.

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Implementation Measures – Status and Anticipated Next Steps

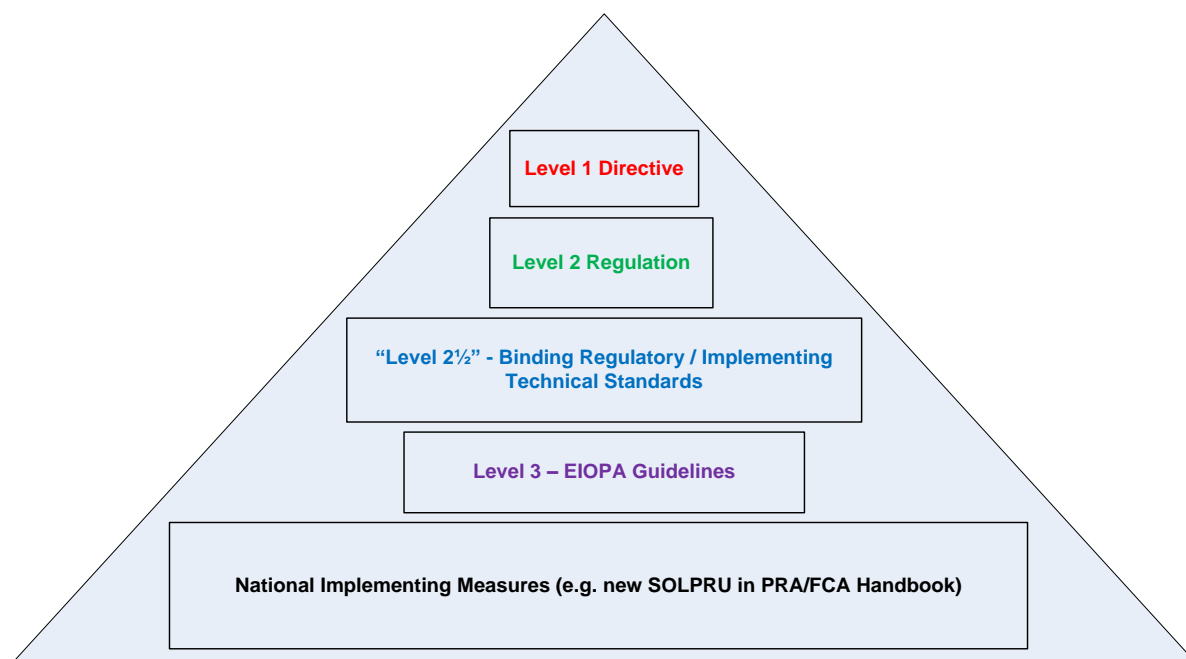
Category	Where are we now?	Anticipated next steps
<p>Level 1 – the Framework Directive.</p> <p>Sets out the overarching principles and includes implementing powers for detailed rules at Level 2.</p>	<ul style="list-style-type: none"> Adopted April 2009 and published December 2009. Original implementation date was 31 October 2012, but amended by "Quick Fix" Directive and "Quick Fix 2 Directive" – now 1 January 2016. 11 March 2014: approval of Omnibus II Directive, which amends Solvency II Directive, by European Parliament. 	<ul style="list-style-type: none"> Approval of Omnibus II by the European Council. Entry of Omnibus II into the Official Journal.
<p>Level 2 – Regulation or implementing act</p> <p>More detailed technical rules set by the Commission following advice from EIOPA.</p>	<ul style="list-style-type: none"> Non-public draft dated 10 January 2014 circulated to certain industry participants for consultation. Will be in the form of a Regulation which will have direct effect in EU Member States. 	<ul style="list-style-type: none"> <u>March / April 2014</u>: Release of the next, near final, draft Level 2 Regulation for consultation. Not clear if this will be publicly available or only provided to selected industry participants. <u>August 2014</u>: Level 2 Regulation expected to be formally proposed by European Commission to European Council and European Parliament. <u>February 2015</u>: Final agreement on Level 2 Regulation expected by this date.
<p>"Level 2.5": Implementing / Regulatory Technical Standards (ITS)</p> <p>Legally binding, prepared by EIOPA and adopted by Commission.</p>	<ul style="list-style-type: none"> None published by EIOPA yet, but we understand that a large amount of work has been done by EIOPA already on preparing these documents. 	<ul style="list-style-type: none"> EIOPA is expecting to carry out a public consultation on Set 1 of ITS between <u>April – June 2014</u> and on Set 2 of ITS between <u>December 2014 - March 2015</u>. Final sets of ITS expected to be provided by EIOPA to the Commission in: <ul style="list-style-type: none"> a) <u>31 October 2014</u> (Set 1) b) <u>30 June 2015</u> (Set 2)
<p>Level 3 Guidelines: guidance produced by EIOPA for national supervisors to ensure that rules are consistently implemented across Member States.</p> <p>Non-binding but "comply or explain".</p>	<ul style="list-style-type: none"> CEIOPS published draft Level 3 guidance in some areas (e.g. pre-application process for internal models) in 2010. In October 2013, EIOPA published Preparatory Guidelines for the preparation 	<ul style="list-style-type: none"> EIOPA is expecting to carry out a public consultation on Set 1 of Level 3 guidelines between <u>June-September 2014</u> and on Set 2 of Level 3 guidelines between <u>December 2014-March 2015</u>. EIOPA is then expected to publish the final Level 3 guidelines in all EU

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Category	Where are we now?	Anticipated next steps
	<p>of Solvency II on:</p> <ul style="list-style-type: none"> a. system of governance b. forward looking assessment of own risks c. submission of information to national competent authorities (NCAs) d. pre-application for Internal Models 	<p>languages in:</p> <ul style="list-style-type: none"> a) <u>February 2015</u> (Set 1) b) <u>July 2015</u> (Set 2)
<p>UK National implementing measures</p>	<p>Within the UK:</p> <ul style="list-style-type: none"> • HM Treasury consultation regarding amendments to legislation (FSMA) to implement Solvency II (November 2011). • FSA CP 11/22 – “Transposition of Solvency II – Part 1” (November 2011). • FSA CP 11/23 – “Solvency II and linked long-term insurance business” (November 2011). • FSA CP 12/13 – “Transposition of Solvency II – Part 2” (July 2012). • PRA CP on draft supervisory statement regarding PRA’s expectations of firms in relation to EIOPA Preparatory Guidelines (October 2013). • PRA CP 3/14 – “Solvency II – Recognition of Deferred Tax” (February 2014). 	<ul style="list-style-type: none"> • <u>Mid-March 2014 (expected)</u>: PRA CP on “Solvency II: the calculation of technical provisions and the use of internal models” for general insurance firms. • PRA Policy Statement expected following the Consultation Papers from 2011-2012. • Solvency II expected to be implemented in new SOLPRU in PRA / FCA Handbook.

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The Solvency II Legislative Architecture



3. Outstanding Issues and the Path to Implementation

As is clear from the table above, there remain a large number of implementing documents still to come. These implementing measures should provide further detail on the various issues which were for many months holding up the finalisation of the Omnibus II Directive. For example:

- **Long Term Guarantees:** following proposals made by EIOPA in 2013, a compromise position was reached on long term guarantees during the Trialogue negotiations in November 2013 and provisions on the matching adjustment were included in the Directive. More detail on long term guarantees, including on the matching adjustment, is expected in the next draft Level 2 Regulation.
- **Equivalence:** the European Commission will need to confirm which countries will be considered to have equivalence, "temporary equivalence" and "provisional equivalence" for the purposes of Solvency II. EIOPA has advised the Commission that the regimes of Bermuda and Switzerland can be considered equivalent for each of the relevant provisions in the Solvency II Directive (Articles 227, 260 and 172) and that the regime in Japan can be considered equivalent for reinsurance only (Article 172). The concept of "provisional equivalence" was introduced under Omnibus II and is expected to be applied to the US in particular.
- **Transitional Measures:** Omnibus II has added various transitional provisions to the Solvency II Directive, including grandfathering for certain existing capital instruments (although in practice the PRA are not allowing insurers to issue new capital instruments now without complying with Solvency II requirements). It also includes a transitional adjustment to the relevant risk-free interest rate and a transitional deduction to technical provisions, in each case for 16 years. More transitional measures may be introduced as we get closer to the implementation date in order to ensure implementation is not delayed again.

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4. Conclusion

The finalisation and approval of Omnibus II has for a long time been the bottleneck for Solvency II implementation. Now that it has been approved by the EU Parliament, we expect Solvency II momentum to increase. Certainly, significant progress towards implementation needs to be made in the next twelve months in order to meet the implementation date of 1 January 2016.

On a purely practical level, the sheer volume of Solvency II-related EIOPA/Commission-generated paper which insurers will be expected to review and absorb during 2014 and 2015 is likely to be significant. Despite the added burden this will bring, we are optimistic that the draft regulations and guidelines will begin to bring much-needed clarity and, perhaps, a wave of pent-up transactional activity within the industry in Europe.

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