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from: Working Party on Financial Services  
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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 - Progress report

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Delegations will find attached document 15538/07 submitted by the Working Party on Financial Services on Solvency II.

**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**

Progress report submitted by the Working Party on Solvency II

**I. INTRODUCTION**

1. On 17 July 2007, the Commission submitted its proposal based on Articles 47(2) and 55 of the Treaty (hereinafter referred to as the "Solvency II Directive")<sup>1</sup> to the European Parliament and the Council. The Solvency II project is one of the main outstanding items from the Financial Services Action Plan (1999-2005). Following the Commission's Better Regulation and Simplification agendas, the revision of the present solvency regime has been used as an occasion to recast 13 (re)insurance Directives into one single document in which the new solvency rules have been integrated.
  
2. The general objectives of the Solvency II project are: *(i)* to deepen the integration the European Union (re)insurance market; *(ii)* to enhance protection of policyholders and beneficiaries; *(iii)* to improve the international competitiveness of European Union insurers and reinsurers and; *(iv)* to promote better regulation.

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<sup>1</sup> Ref. COM/2007/361 final - COD 2007/0143.

## II. WORK CONDUCTED WITHIN THE COUNCIL

3. The proposal has been discussed at eleven meetings of the Council Working Party on Financial Services (Solvency II) (6, 7 and 21 September, 3, 15 and 16 October and 5, 15, 16, 23 and 26 November 2007). The proposal was presented by the Commission in a pre-meeting on 16 July 2007. Overall, Member States showed a general support for the Commission's proposal, although there are a number of sensitive issues that need to be addressed. It is relevant to note that this is the first *prudential* Directive in the insurance sector which makes full use of the Lamfalussy approach.
4. The Presidency conducted the above-mentioned meetings with the aim of contributing to a swift adoption of the Directive while preserving the principles-based approach which should allow for adequate distinction between Level 1 and Level 2 legislative measures. Furthermore, the Presidency endeavoured to better reflect the proportionality principle in the Directive, the establishment of the necessary powers of intervention of supervisory authorities in the context of the new risk-based regime and the clarity and consistency of the legal framework.
5. For the purpose of the discussions held in the meetings, the proposal was divided in two distinct parts: Solvency II issues and recast. Regarding recast, as no substantive changes have been made to the existing Directives, except for those changes that are necessary in order to introduce the Solvency II regime, the Presidency decided to treat recast by written procedure, with the exception of a few provisions considered of major relevance that were addressed in a specific meeting. This process is being finalised with only a residual part of the articles still under discussion.

6. Regarding the Solvency II part, taking into account the discussions held, several modifications to the Commission's proposal have been proposed by the Presidency. These proposals have received wide support.

The rationale for the amendments to the Commission's Proposal suggested by the Presidency, following the discussions on the Working Party, is based on one or more of the following principles:

- To keep an adequate balance between a principles-based text and the guarantee of legal certainty;

The Presidency has suggested several amendments in order to improve the understanding of the principles set out in the Directive and to provide further orientation on the scope of the future implementing measures, while maintaining an appropriate distinction between Level 1 and Level 2:

- Clarification of the meaning of the exceptional nature of capital add-ons;
- Inclusion of a reference to the broader concept of business continuity, while retaining the mention to contingency plans;
- Clarification of the interconnections between the different functions included in the system of governance;
- Delimitation of the concept of function and of the scope of key functions.

- To highlight the relevance of the proportionality principle and clarify the scope of its application;

A proper application of the proportionality principle is a key factor in the implementation of the Solvency II regime. The proportionality principle should be applied both to the requirements on the insurance and reinsurance undertakings and on the exercise of supervisory powers, avoiding unnecessary and excessive requirements or demands.

One of the key principles that will determine the success of Solvency II is the way that it will apply to small and medium-sized insurance undertakings. In fact, taking into account that, in the view of the Presidency, a two approach regime is not desirable, the Directive itself and specially Level 2 implementing measures, should allow for an application which is compatible with the nature, scale and complexity of the risks inherent to the business, requiring overall compliance with the principles set out, but assuring that the new solvency regime is not excessively burdensome.

With this aim, some suggestions were made by the Presidency in order to:

- Emphasize the importance of the proportionality principle and clarify that it should be applied both to the requirements on the insurance and reinsurance undertakings and on the exercise of supervisory powers;
- Clarify that the organisation requirements resulting from the system of governance should not lead to unduly burdensome requirements because account should be taken of the nature, scale and complexity of the operations of the undertaking;
- Underline that the “own risk and solvency assessment” does not require the development of an internal model or the calculation of an additional capital requirement;
- Clarify that undertakings may use, for supervisory reporting purposes and where appropriate, elements publicly disclosed under financial reporting, listing and other legal or regulatory requirements;
- Stress that even if all persons that perform key functions should be fit and proper, the notification requirements to the supervisory authority should be restricted to an appropriate level (persons who effectively run the business and persons that are responsible for other key functions).

- To adequately reflect the necessary powers of intervention of supervisory authorities in the context of the new risk-based regime

Amendments have been suggested by the Presidency in order to:

- Better identify the cases and consequences of the exceptional imposition by the supervisory authority of a capital add-on and eliminate the reference to its permanent character;
- Clarify that supervisory authorities shall have the power to require the performance of stress tests by insurance and reinsurance undertakings as part of the supervisory review process;
- Align the deadlines for public disclosure of non-compliance with the Minimum Capital Requirement (MCR) or significant non-compliance with the Solvency Capital Requirement (SCR) with those set to restore the compliance with MCR and SCR;
- Align the supervisory powers regarding outsourcing functions or activities with the ones defined in MiFID and clarify its scope of application

- To further enhance the clarity and readability of the texts according to better regulation principles;

The Presidency has suggested adding or amending recitals in order to help a proper understanding of some concepts in the context of the new legal framework: meaning of the terms *beneficiary, function and key function*; meaning of the reference to *public disclosure*.

Some amendments have been proposed to the wording of some articles with the purpose of clarification or standardisation or in order to assure consistency between articles.

### **III. FURTHER WORK ON CERTAIN ASPECTS OF THE GROUP SUPPORT REGIME**

7. One of the fundamental changes envisaged by the proposal is the innovative regime of group supervision which is characterized essentially by:
  - a) Allowing under certain conditions a parent undertaking to use declarations of group support to meet part of the SCR of any of its subsidiaries, and
  - b) Introducing derogations to some articles on solo supervision, where appropriate.
  
8. This new regime has given rise to many comments by Member States, reflecting different points of view on important issues. The Presidency has promoted an open and transparent discussion on the fundamentals of the proposed regime, focusing on the practical implementation of its main sensitive features.
  
9. As a result of the discussions held in the Working Party, the Presidency has identified, inter alia, some areas where further reflection and work is needed:
  - a) Impact on the integration of the internal market and on competition at national level;
  - b) Impact on the protection of policyholders and beneficiaries in crisis situations;
  - c) Clarification of the legal and practical aspects encompassing the certainty of the cross-border fund transfer between different entities within a group;
  - d) Clarification of the role of “College of Supervisors” and CEIOPS consultation role, within the limits of the Lamfalussy review.

### **IV. ORIENTATION DEBATE**

10. Ministers are invited to take note of the progress achieved.
  
11. Do Ministers agree that further work is needed on the areas identified by the Presidency in point III?