SUPERVISORY STATEMENT ON SUPERVISION OF REINSURANCE CONCLUDED WITH THIRD COUNTRY INSURANCE AND REINSURANCE UNDERTAKINGS

EIOPA-BoS-24-075
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European Insurance and Occupational Pensions Authority

1. LEGAL BASIS

1.1. The European Insurance and Occupational Pensions Authority (EIOPA) provides this Supervisory Statement on the basis of Article 29(2) of Regulation (EU) No 1094/2010[1]. This Article mandates EIOPA to play an active role in building a common Union supervisory culture and consistent supervisory practices, as well as in ensuring uniform procedures and consistent approaches throughout the Union.

1.2. EIOPA delivers this Supervisory Statement on the basis of Directive 2009/138/EC (Solvency II Directive)[2], in particular Articles 134(1), 172(3) and 173 thereof and Commission Delegated Regulation (EU) 2015/35 (Solvency II Delegated Regulation)[3], in particular Articles 211(2)(b) and (c), 213 and 214 thereof.

1.3. This Supervisory Statement is addressed to the competent authorities, as defined in Article 4(2) of Regulation (EU) No 1094/2010[4], which should apply it considering the principle of proportionality and following a risk based approach.

1.4. The Board of Supervisors has adopted this Supervisory Statement in accordance with Article 2(8) of its Rules of Procedure[5].

2. CONTEXT AND OBJECTIVE

2.1. Reinsurance is an important tool for capital and risk management used also for risks diversification, access to additional underwriting capacity for portfolio expansion, addressing protection gaps and increasing financial stability. It plays a crucial role in the insurance industry's ability to operate and provide coverage to individuals and businesses. As such, cross-border reinsurance could offer numerous advantages to insurance undertakings. The Solvency II Directive recognises the fact that the insurance industry is a global industry. As such, to avoid unnecessary duplication of regulation and promote open international insurance markets, the European Commission may decide

1 Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48).

2 Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (OJ L 335, 17.12.2009, p. 1-155).

3 Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 12, 17.1.2015, p. 1–797).

4 Notwithstanding the fact that specific points of this Supervisory Statement describe supervisory expectations for insurance and reinsurance undertakings, they are required to comply with the regulatory and supervisory framework applied by their competent authority based on Union or national law.

5 Decision adopting the Rules of Procedure of EIOPA’s Board of Supervisors, available at: https://www.eiopa.europa.eu/sites/default/files/publications/administrative/bos-rules_of_procedure.pdf

on the equivalence of a third country's (in this context non-EEA countries) solvency and prudential regime. Particularly for reinsurance, in case of an equivalence decision according to Article 172 of the Solvency II Directive, reinsurance agreements concluded with third-country insurance or reinsurance undertakings (collectively referred to as "third-country reinsurers") from those countries are treated in the same manner as reinsurance agreements concluded with undertakings authorised in the EU. On the other hand, third-country reinsurers based in a non-equivalent third country may be recognized in the Basic Solvency Capital Requirement, for their own merits if their financial strength (ratings) is equal or above CQS 3 under Article 211 of the Solvency II Delegated Regulation.

2.2. Equivalence decisions are taken by the European Commission on the basis of EIOPA's technical assessment. The list of the assessed countries can be found on EIOPA's and European Commission's websites[6] .

2.3. In case of reinsurers from the United States of America (US) the EU-US Agreement on Insurance and Reinsurance[7] (EU-US Agreement) marks an important achievement in the direction of simplifying cross-border market access. The EU-US Agreement sets conditions to simplify EU-US market access in each other's territory and limits group supervision of (re)insurance groups active in both territories to the level of the parent undertaking in its own jurisdiction[8].

2.4. Against this background, national competent authorities (NCAs) should conduct their tasks with due respect to the rights and obligations specific to each equivalence decision granted by the European Commission or any bilateral agreement between the EU and a third country, like the EU-US Agreement[9].

2.5. Although Solvency II includes some provisions that regulate the conditions for recognising reinsurance with third-country reinsurers, Member States may introduce national provisions, such as requiring notification, prior authorisation or the establishment of a local branch office[10].

2.6. The objective of this Supervisory Statement is to raise awareness of the risks stemming from regimes that have not been deemed equivalent by the European Commission and to propose a risk-based approach limiting their effect. This Supervisory Statement is inspired by concrete cases shared by the NCAs. EIOPA intends to ensure that a high-quality and convergent supervision is provided regarding insurance undertakings using

6 https://www.eiopa.europa.eu/browse/regulation-and-policy/international-relations-and-equivalence_en?source=search and List of equivalence Decisions taken by the European Commission - overview-table-equivalence-decisions_en.pdf (europa.eu)

7 EUR-Lex - 4339452 - EN - EUR-Lex (europa.eu) and U.S.-EU Covered Agreement | U.S. Department of the Treasury

8 Other agreements and memorandum of understanding with third countries might exist and might be considered applicable even if not explicitly mentioned.

9 For the areas not explicitly covered by the EU-US Agreement this Supervisory Statement is considered applicable.

10 Some specific market restrictions can exist also based on specific country limitations under any General Agreement on Trade in Services (GATS).

reinsurance arrangements with third-country reinsurers from non-equivalent countries without limiting the use of reinsurance. Where relevant also to reinsurance arrangements with third country reinsurers from equivalent third countries, this is explicitly mentioned in the text.

2.7. Regarding the risk profile of the reinsurance business it should be noted that differences might exist depending on whether the reinsurance arrangements are performed by reinsurance undertakings retroceding their risks (accepted from primary undertakings[11]) or by insurance undertakings mitigating (ceding) their risks. In fact, reinsurance undertakings have in general a business model based on the ability to write a large number of diversified risks in various markets and geographies and as such achieve a wide distribution of risks and diversification of their exposures. Differences might also exist in the strategy, process and procedures in place regarding in particular the choice of the different reinsurance placements and how reinsurance is managed in general. Considering these specificities, this Supervisory Statement refers mainly to insurance undertakings using reinsurance as risk-mitigation techniques; however, it might be also relevant, following a proportionate and risk-based supervision and considering the specific business models, to reinsurance undertakings retroceding their risks[12].

2.8. In line with EIOPA's Annual work plan 2024, EIOPA is working on the use of reinsurance including innovative reinsurance techniques and is expected to provide guidance to the NCAs in the course of 2024.

3. SUPERVISORY EXPECTATIONS

ASSESSMENT OF THE BUSINESS RATIONALE FOR USING THIRD-COUNTRY REINSURANCE AND EARLY SUPERVISORY DIALOGUE

3.1. Reinsurance is an efficient tool for insurance and reinsurance undertakings to manage their risks according to their strategy and capacity. It allows to spread the current risks (regionally or globally) and increase underwriting capacity. It is also an important tool for capital management improving risk diversification and can be used as an instrument to expand the current business. As like all business strategy, it is the responsibility of the undertakings' administrative, management or supervisory body (AMSB) to define, implement and monitor the reinsurance strategy, considering its advantages (e.g. reduction of capital requirements and volatility of Profit & Loss statement) and

11 This can also include insurance undertakings with a significant activity of reinsurance (mixed business model).

12 In the context of reinsurance, please consider as well EIOPA's Opinion on the use of risk mitigation techniques by insurance undertakings (https://www.eiopa.europa.eu/publications/opinion-use-risk-mitigation-techniques-insurance-undertakings_en) including a set of recommendations addressed to supervisory authorities of supervision of risk mitigation techniques including reinsurance.

disadvantages (e.g. cost of reinsurance, creation of additional risks, such as basis risk or counterparty risk). The actuarial function is also responsible for expressing an opinion on the adequacy of reinsurance arrangements[13].

3.2. Undertakings are expected to properly consider and NCAs to assess (considering individual undertaking strategies and specificities) the trade-off between reinsurance premiums, additional risks, etc. and impact on Solvency Capital Requirement (SCR) as well as other regulatory considerations stemming from the use of third-country reinsurance (equivalent and non-equivalent).

3.3. As indicated in the EIOPA Opinion on the use of risk mitigation techniques by insurance and reinsurance undertakings[14], NCAs are encouraged, considering proportionality and materiality, to engage in an on-going supervisory dialogue with the undertaking, as is already common practice in several jurisdictions. In cases where a material level of risk (such as counterparty default risk and life underwriting risk) is transferred through reinsurance (equivalent and non-equivalent), this dialogue may start before the conclusion of the reinsurance agreement to allow NCAs to understand the undertakings' reinsurance strategy and its impact on the solvency position. This dialogue is expected to be maintained over time so NCAs are informed in case of any material changes.

ASSESSMENT OF THE INSURANCE UNDERTAKINGS' RISK MANAGEMENT SYSTEM REGARDING THE USE OF THIRD-COUNTRY REINSURERS

3.4. It is the responsibility of the AMSB of the undertaking to ensure that the risk management and internal control systems are adequate and in line with the reinsurance strategy and policy. Undertakings are expected to demonstrate in the Own Risk and Solvency Assessment (ORSA) that material risks associated with third-country reinsurance arrangements (both equivalent and non-equivalent) are appropriately captured by the risk management framework.[15]

3.5. As part of the on-going supervision of undertakings' system of governance[16], NCAs following a risk-based supervision perform an assessment of the risk management and internal control systems of the insurance undertakings using material reinsurance arrangements with non-equivalent third-country reinsurers taking the following into consideration:

13 Reference to Article 48(1)(h) of the Solvency II Directive.

14 https://www.eiopa.europa.eu/publications/opinion-use-risk-mitigation-techniques-insurance-undertakings_en

15 Regarding EU and U.S. group supervision, the requirements for the risk management and internal control systems/ the Own Risk and Solvency Assessment (ORSA) must conform with the requirements under the Agreement.

16 Reference to Article 36(2)(a) of the Solvency II Directive.

a) Assess if the strategies, processes, and reporting procedures are adequate to continuously identify, measure, monitor, manage and report on the risks to which the undertaking is or could be exposed taken into account the different domiciles of its third country reinsurers[17];

b) Assess if the undertaking's assessment of risks arising from reinsurance agreements include identification of any legal/compliance risk arising from the law of the third countries concerned, including for example counterparty risk[18];

c) Assess if the risk management policies developed by the undertaking cover the principles for the selection of reinsurance counterparties (including the ones from third countries)[19] as well as procedures for assessing and monitoring the creditworthiness and diversification of reinsurance counterparties.

3.6. When performing the assessment under points a) and b) above, NCAs are recommended to evaluate how insurance undertakings assess the qualitative elements of the selected reinsurer, such as: well-established reinsurer, geographical risk diversification, proven willingness to pay, fair behavior, adequate governance, etc. and how they assess the different domicile/country of the non-equivalent third-country reinsurers to be used considering materiality. Undertakings are expected to identify the legal consequences arising in case of insolvency, winding-up procedures or recovery and resolution mechanisms, including the power of disavowal with consequently no enforceability of pledged collateral (in case there is such) and no direct claim on the counterparty in the non-equivalent third country. Undertakings are also expected to identify how risks arising from such regimes may be mitigated.

3.7. In case of a collateral an important part in the assessment of the bankruptcy law includes an assessment of collateral status. In many jurisdictions the collateral is not part of bankruptcy procedures but has a preferential status. In this sense, undertakings should assess whether the non-equivalent third-country law restricts the possibilities to withdraw the collateral and whether it grants the rehabilitator the authority to disavow active reinsurance agreements to which the undertaking is a party.

3.8. The result of this country/domicile assessment should be considered in the undertakings' assessment of compliance with Articles 213 and Article 214 of the Solvency II Delegated Regulation. For non-equivalent third-country regimes where the law on liquidation and bankruptcy raises risks of non-compliance with the reinsurance agreement or the supervisory and resolution procedures include the power of disavowal of the reinsurance agreement that can completely erase all legal rights and obligations

17 Insurance undertakings should note, that the risk carrier of the reinsurance agreement is always the signing entity, and that, in certain cases, this entity, may not be the one who carried the negotiations, but another entity, based in another jurisdiction.

18 In case of concern or material exposure such assessment can be performed also in case of equivalent third countries e.g. to assess whether a similar provision of Article 209(1)(d) of the Solvency II Delegated Regulation is in place.

19 It is worth reminding that using multiple counterparties has the benefit to reduce the SCR for counterparty default risk and potentially the overall SCR as well.

of the parties in relation to pledged collateral, the requirements of Article 214 of Solvency II Delegated Regulation cannot be fulfilled, unless specific measures are available and implemented in that regard.

3.9. One possibility to reduce legal risks from using reinsurance with reinsurers from non-equivalent third-countries is to include in the reinsurance agreement a specific clause or a contractual provision regarding the choice of law considering whether the law system is a large body of relevant reinsurance law and thus provide certainty to the parties. The same applies to a clause or a contractual provision regarding the place of jurisdiction[20] (jurisdiction clause).

3.10. When performing the assessment under point 3.5 c), NCAs are recommended to evaluate how undertakings consider at least the following for the selection of reinsurance counterparties:

- Capital strength, considering the strength/weakness of the capital regime in the country where the counterparty is domiciled;
- Quality of capital of the counterparty (taking into account whatever standards exist in the country);
- Monitoring of the creditworthiness of third-country reinsurers, which for SCR purposes must be at least credit quality step 3 in case of use of non-equivalent reinsurance[21];
- Whether the transaction documentation for the arrangement includes the right for a direct claim in the event of reinsurer's default, insolvency or bankruptcy or other credit event[22];
- Whether any other risk mitigants e.g. collateral, ring fencing etc. are in place.

3.11. One of the expected procedures in the risk management and internal control of undertakings using materially third-country reinsurers from non-equivalent third-country is the assessment of whether they fulfil basic requirements for conducting reinsurance business. This assessment should be performed by the undertakings prior to the reinsurer's selection in a pool of reinsurers acceptable for a ceding insurer and which can be used on a recurrent basis, covering at least the following areas:

- The third-country reinsurer has a license to carry out reinsurance business;
- The third-country reinsurer is allowed to carry out reinsurance business in the Member State where the insurance undertaking is domiciled in case there are rules to access the market;

20 See for reinsurance contracts with US reinsurers Article 3(4)(d) of the Agreement.

21 However, it is worth reminding that, differently from the case of Solvency II equivalent third-country, the compliance with the local solvency requirements applicable in non-equivalent third-country is not requested by Solvency II as a condition to be met to consider the reinsurance cover as risk-mitigation techniques. In such case, Article 211(2)(c) of the Solvency II Delegated Regulation only requires, in addition to other general requirements in Article 209-210, a credit quality step 3 or better.

22 This is already the case for the European reinsurers according to Article 209 (1)(d) of the Solvency II Delegated Regulation

- The experience of the third-country reinsurer with regard to the requested risk transfer solution;
- The third-country reinsurer's rating;
- The existence of any regulatory action taken against the third-country reinsurer.

3.12. A detailed assessment is expected from undertakings when there is a material exposure towards a single or few (equivalent and non-equivalent) third country reinsurer(s) or third country reinsurers belonging to the same group to address concentration and counterparty risk, to the extent this is practically possible (i.e. availability of alternative reinsurers). A detailed assessment is also expected when the type of agreements /risk transfer envisaged is complex[23].

3.13. Undertakings are expected to use different sources of information e.g., financial checks, review of the website of the non-equivalent third-country regulatory authority to confirm whether any regulatory action has been taken against that third country reinsurer, whether the third country is a member of the International Association of Insurance Supervisors (IAIS), assessments done by the International Monetary Fund and other stakeholders, publications of the third country's regulatory authorities, reports of rating agencies.

3.14. Although the requirement for credit quality rating is explicitly relevant for reinsurers from non-equivalent countries[24], in accordance with Article 44(4a) of the Solvency II Directive, undertakings are required to assess the appropriateness of external credit assessments as part of their risk management by using additional assessments wherever practicably possible in order to avoid any automatic dependence on external assessments. In this context, undertakings are expected to consider the followings regarding the rating of third country reinsurers (both equivalent and non-equivalent):

- If a rating exists, who has issued it and assess reports of the rating agencies;
- Any information available from other rating agencies;
- Analysis of the volatility of the rating over the last years;
- Regularly monitor the rating;
- Assess the impact of downgrade risk of third-country reinsurers in the SCR and risk margin.

3.15. NCAs are recommended to assess if/how undertakings monitor the relevant third country reinsurers and have in place procedures on actions to be followed in case:

- The recognition in the SCR of the bespoke risk mitigation contract ceases or is only partial, e.g. as a consequence of a rating downgrade of the third country reinsurer from non-equivalent third country or in case the NCA is of the view that the reinsurance agreement provides none or only partial risk transfer;

23 Please be aware that a similar requirement exists in the Opinion on risk mitigation techniques (paragraph 18 applicable to EU reinsurers).

24 Article 211 of the Solvency II Delegated Regulation.

- In case, the third country reinsurer (in an equivalent solvency regime) breaches its national solvency requirements[25].

ASSESSMENT OF THE REINSURANCE AGREEMENT

3.16. Different elements may be considered as part of a good risk management, depending on the specific case under consideration. An important aspect of the undertakings' reinsurance risk management is to assess if the reinsurance agreement (equivalent and non-equivalent) is in compliance with Articles 209-211 of the Solvency II Delegated Regulation. Such an assessment should take into consideration whether the agreement is an intra-group or non-intra-group reinsurance, short or long-term reinsurance, reinsurance of primary insurance or retrocession.

3.17. In such an assessment undertakings should consider at least:

- Whether the third-country reinsurer can unilaterally terminate the agreement under certain conditions and what are those conditions;
- Whether there are side letter agreements with the third-country reinsurer (which introduce additional conditions and requirements to the existing reinsurance agreement threatening the effectiveness of the arrangement and posing additional risks);
- Whether the reinsurance agreement includes a 'termination clause', providing the insurance undertaking with the right to terminate the agreement in case certain conditions occur, such as the breach of the local solvency requirement or a material deterioration of the financial situation of the third-country reinsurer (including its downgrade for non-equivalent jurisdictions), or if the third-country reinsurer is put on any form of administration by a competent regulatory authority or court;
- Clearly established claims' hierarchy in case of default that does not depend on the third-country accounting principles, or receiver/rehabilitator assessment and mandate;
- Whether there are collateral arrangements and whether they are completely and readily available in the event of third-country reinsurer's bankruptcy, default, rehabilitation or other conditions of financial distress;
- Whether there are further retrocessions, their conditions and agreements as well as soundness and location of the retrocessions where this is relevant given materiality and practically possible (e.g. retrocession by reinsurers).

3.18. If any of the points above are assessed as jeopardising the effective transfer of the risk and/or legality of contractual clauses, the undertaking needs to provide evidence to the NCA considering materiality and proportionality justifying the recognition of the contract as a risk-mitigation techniques in the calculation of the SCR.

25 In case the reinsurance undertaking is from a non-equivalent solvency regime, the assessment should focus on the monitoring of the the creditworthiness of the reinsurance undertaking. See Point 3.11.

3.19. Undertakings should document their assessment of the reinsurance agreement considering proportionally to the country exposure and whether there is an equivalence assessment, including, where applicable, how the above-mentioned aspects were considered, and how it was concluded in compliance with Articles 209-211 of the Solvency II Delegated Regulation. Undertakings should define the selection criteria within their reinsurance policy.

TOOLS TO MITIGATE ANY ADDITIONAL RISKS

3.20. If resulting from the assessments of the country, third-country reinsurer and reinsurance agreement, the undertaking has identified increased material risks, the following tools could be considered (or be recommended by the NCA as part of the supervisory dialogue with the undertaking):

- Pre-emptively limit exposures on certain (equivalent and non-equivalent) third-country reinsurers, through a careful diversification of the reinsurance panels, as far as assigned shares to third-countries reinsurers are concerned, particularly in case of a single or relatively few counterparties, for long tail lines of business and/or types of reinsurance treaties which may generate large recoverable amounts;
- Mitigate counterparty default risk of the third country reinsurer from a non-equivalent jurisdiction with collateral agreements[26]/pledge assets/premium and reserve deposits in cash or securities, with the adequate precautions to prevent situations where the collateral might not be enough or available entirely in case of a bankruptcy, through for example the assessment of the quality of collateral, negotiation of the localisation of the collateralised assets in the jurisdiction where the undertaking is located[27]. The use of collateral should not be considered as a default practice and it should be applied considering the risks posed and the other risk mitigation tools used;
- Make sure that undertakings have in the event of a default, insolvency or bankruptcy of an (equivalent and non-equivalent) reinsurer or other credit event set out in the reinsurance agreement, a direct claim on that reinsurer[28];

26 Examples of type of collateral which may be used include: letter of credit, funds withheld, cash, securities, etc.

27In the case of EU and U.S. reinsurance undertakings, it should be considered that an objective of the Agreement is to eliminate collateral requirements imposed by supervisory authorities under specified conditions (as stated in Art. 1 (b) and also in Art. 3 para. 1 (a), para. 2 (a)). If collateral requirements were to be posted by U.S. or EU reinsurance undertakings, collaterals in terms of Art. 2 (b)) of the Agreement (i.e. assets, such as cash and letters of credit, pledged by the reinsurer for the benefit of the ceding insurer or reinsurer to guarantee or secure the assuming reinsurer's liabilities to the ceding insurer arising from a reinsurance agreement) must conform with the Agreement, in particular with Art. 3 para. 4 (g), (j), which regulates the provision of collaterals.

28 Similarly to the requirement under Article 209(1)(d) of the Solvency II Delegated Regulation.

- Include in the agreements with third-country reinsurers clauses for regular commutations or threshold-initiated execution of a commutation agreement[29].

Done at Frankfurt am Main, [*] .

[signed]

For the Board of Supervisors

Petra Hielkema

Chairperson

29 A commutation agreement is "an agreement between a ceding insurer and the reinsurer that provides for the valuation, payment, and complete discharge of all obligations between the parties under a particular reinsurance contract". It can be used for the final settlement of best estimates for outstanding claims in case the cedent and/or the reinsurer desires to end the contract. A commutation agreement can also be added to long duration reinsurance contracts to avoid the build-up of large best estimate exposures. In such cases the commutation agreement specifies the frequency for best estimate account settlement and reset or defines a specific reinsurance recoverables threshold trigger for the commutation.

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