

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Insurance Groups under Solvency II

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1. Introduction

The Solvency II Directive¹ requires groups to be supervised on a holistic basis to gain a coherent understanding of the risks that exist at group level. The Directive sets out measures applicable specifically to insurance groups and to solo undertakings which form part of the group.

This guidance paper provides a **high-level overview** of the key aspects of Solvency II related to insurance groups and aims to assist these groups to prepare for the implementation of Solvency II.

As the drafting of the Level 2 and Level 3 texts are still being finalised at the time of publication of this guidance paper, changes may be effected.

2. Defining an insurance group

For the purposes of understanding the meaning of an insurance group, the following definitions apply:

- (a) ‘participating undertaking’ means an undertaking which is either a parent undertaking, or other undertaking which holds a participation, or an undertaking linked with another undertaking by a relationship as set out in Article 12(1) of Directive 83/349/EEC².
- (b) ‘parent undertaking’ means a parent undertaking within the meaning of Article 1 of Directive 83/349/EEC.
- (c) ‘related undertaking’ means either a subsidiary undertaking, or other undertaking in which a participation is held, or an undertaking linked with another undertaking by a relationship as set out in Article 12(1) of Directive 83/349/EEC.
- (d) ‘participation’ means the ownership, direct or by way of control, of 20% or more of the voting rights or capital of an undertaking.

In the context of this guidance paper for the purposes of the group solvency calculation only, the participating undertaking is the parent undertaking.

- (e) ‘group’ means a group of undertakings that:
 - (i) consists of a participating undertaking, its subsidiaries and the undertakings in which the participating undertaking or its subsidiaries hold a participation, as well as undertakings linked to each other by a relationship as set out in Article 12(1) of Directive 83/349/EEC; or
 - (ii) is based on the establishment, contractually or otherwise, of strong and sustainable financial relationships among those undertakings, and that may include mutual or mutual-type associations, provided that:
 - one of those undertakings effectively exercises, through centralised coordination, a dominant influence over the decisions, including financial decisions, of the other undertakings that are part of the group; and,
 - the establishment and dissolution of such relationships are subject to prior approval by the group supervisor,

¹ 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. The link to the Solvency II Directive is available on the MFSA website www.mfsa.com.mt under Insurance - Solvency II - Solvency II Directive

² Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts

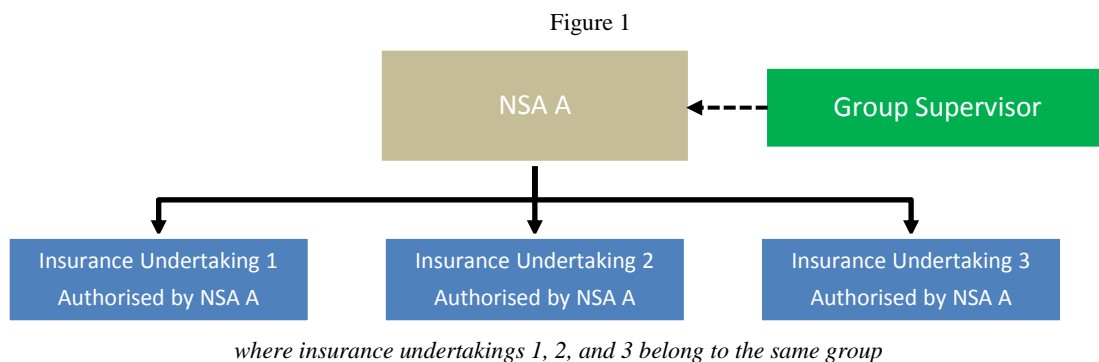
where the undertaking exercising the centralised coordination shall be considered as the parent undertaking, and the other undertakings shall be considered as subsidiaries.

- (f) ‘insurance holding company’ means a parent undertaking which is not a mixed financial holding company within the meaning of Directive 2002/87/EC³ and its main business of which is to acquire and hold participations in subsidiary undertakings, where those subsidiary undertakings are exclusively or mainly insurance undertakings, or third country insurance undertakings, at least one of such subsidiary undertakings being an insurance or reinsurance undertaking.
- (g) ‘mixed-activity insurance holding company’ means a parent undertaking, other than an insurance undertaking, a third country insurance undertaking, an insurance holding company or a mixed financial holding company within the meaning of Directive 2002/87/EC, which includes at least one insurance or reinsurance undertaking among its subsidiary undertakings.

Please note that for the remaining sections of this document, an insurance undertaking refers to both insurance and reinsurance undertakings.

- (h) ‘group supervisor’ means the supervisory authority responsible for the coordination and exercise of group supervision which can be illustrated in Figures 1 to 6 below.

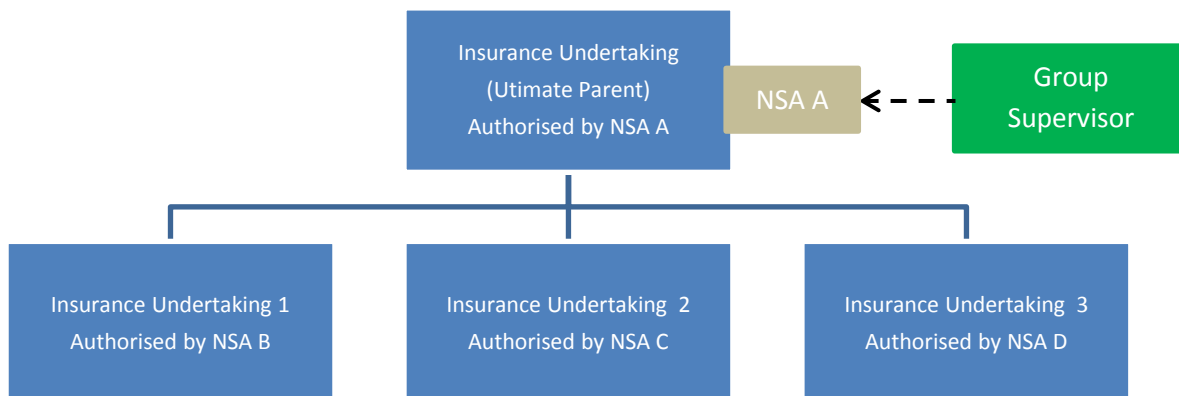
Where the same supervisory authority is the national supervisory authority for all insurance undertakings in a group, the task of the group supervisor is exercised by that national supervisory authority. The insurance undertakings of the group and the supervisory authority are in the same national market; (Figure 1)



³ Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council

Where the group is *headed* by an insurance undertaking, the task of group supervisor is exercised by the supervisory authority which has authorised that undertaking; (Figure 2)

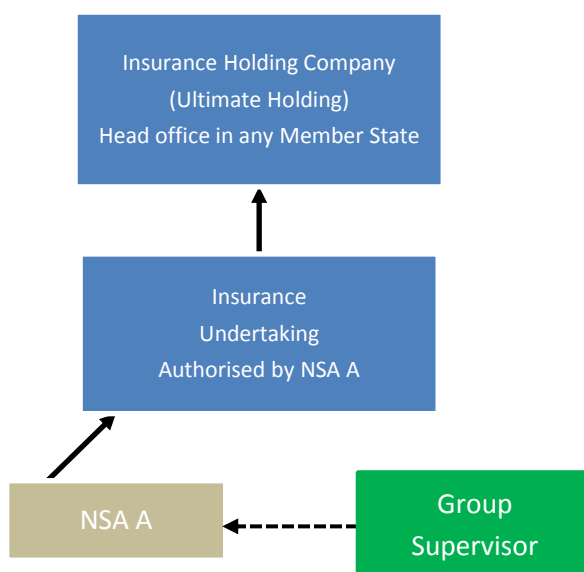
Figure 2



Where the group is *not headed* by an insurance undertaking, the task of group supervisor is exercised as follows:

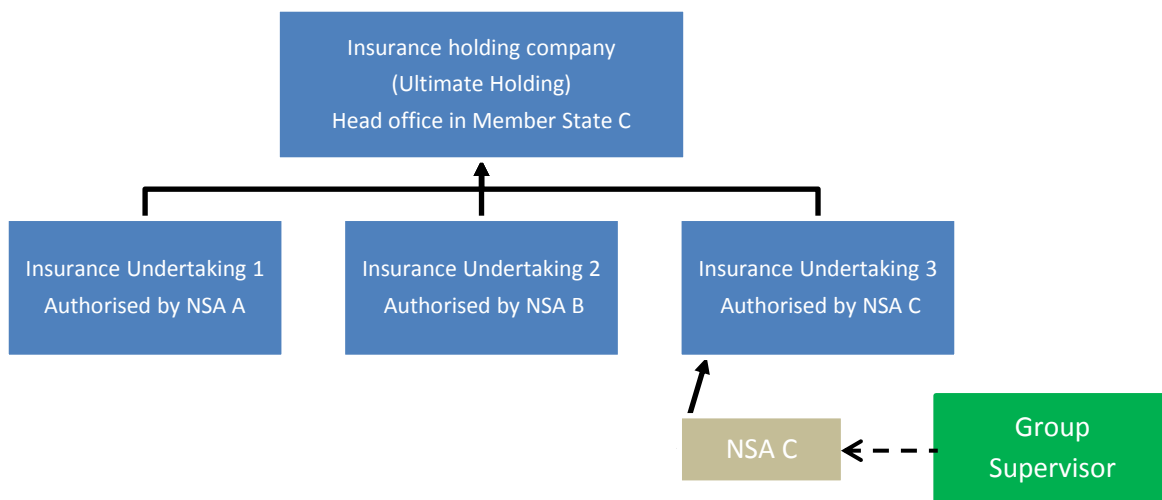
- where the parent of an insurance undertaking is an insurance holding company, by the supervisory authority which has authorised that insurance undertaking; (Figure 3)

Figure 3



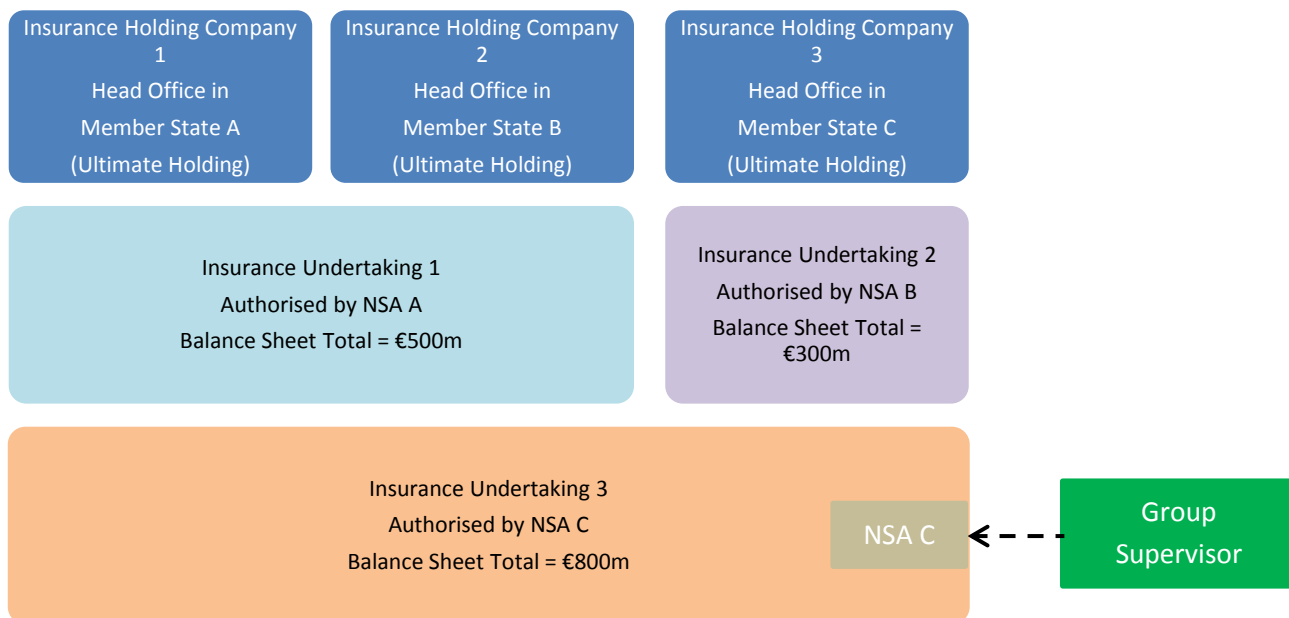
- where more than one insurance undertaking in the Union⁴ have as their parent the same insurance holding company, and one of those undertakings has been authorised in the Member State in which the insurance holding company has its head office, by the supervisory authority of the insurance undertaking authorised in that Member State; (Figure 4)

Figure 4



- where the group is *headed* by more than one insurance holding company with a head office in different Member States and there is an insurance undertaking in each of those Member States, by the supervisory authority of the insurance undertaking with the largest balance sheet total; (Figure 5)

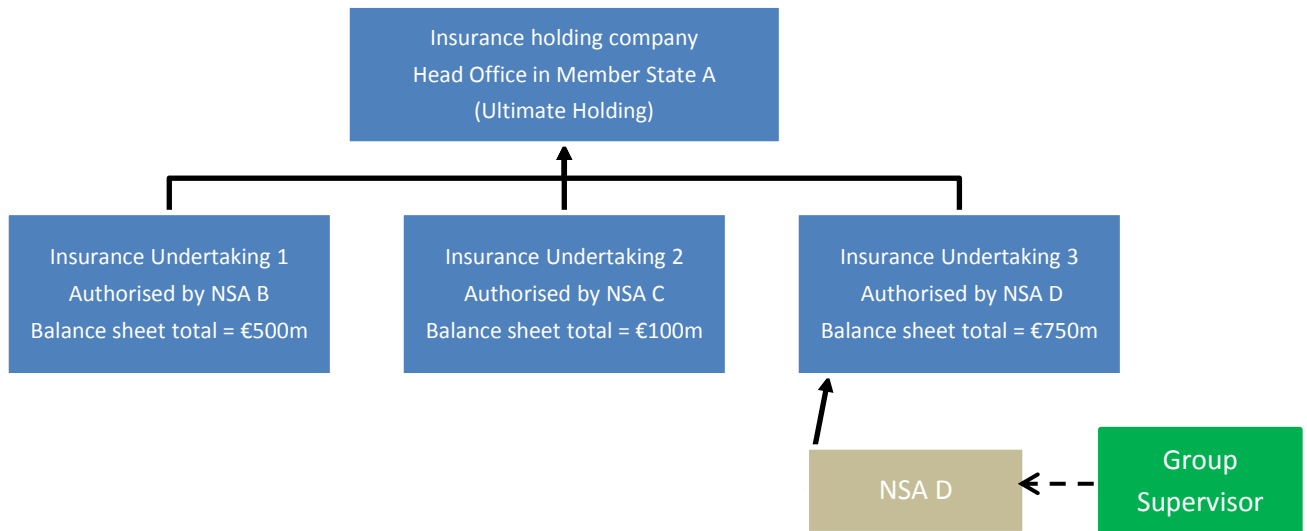
Figure 5



⁴ The Union means a Member State of the European Communities and/or EEA State

- where more than one insurance undertaking in the Union have as their parent the same insurance holding company and none of those undertakings has been authorised in the Member State in which the insurance holding company has its head office, by the supervisory authority which authorised the insurance undertaking with the largest balance sheet total; (Figure 6)

Figure 6



- where the group is a group without a parent undertaking, or in any circumstances not referred to above by the supervisory authority which authorised the insurance undertaking with the largest balance sheet total.

3. Cases of application of group supervision

Supervision at the level of the group applies as follows:

- to insurance undertakings in the Union, which are participating undertakings in at least one insurance undertaking in the Union, or third country insurance undertaking; (Figure 7)
- to insurance undertakings in the Union where the parent undertaking is an insurance holding company in the Union; (Figure 7)
- to insurance undertakings in the Union where the parent undertaking is an insurance holding company in a third country or an insurance undertaking in a third country; (Figure 7)
- to insurance undertakings in the Union where the parent undertaking is a mixed-activity insurance holding company in the Union or third country. (Figure 8)

Where the participating insurance undertaking or the insurance holding company referred to in (a), (b) and (c) above is itself a subsidiary undertaking of another insurance undertaking or of another insurance holding company in another member state in the Union, group supervision shall apply at the level of the ultimate parent insurance undertaking or insurance holding company. However, where sub-groups exist at a national level, supervisory authorities may decide, after consulting the group supervisor and the ultimate parent insurance undertaking or insurance holding company at Union level to subject group supervision on the ultimate parent insurance undertaking or insurance holding company at national level.

The following are graphical illustrations of the application of group supervision:

- (i) Full group supervision is applied to groups defined under (a) and (b) above, as explained in the sections that follow.
- (ii) For groups defined under (c) above, the application of full group supervision depends on supervisory equivalence, as set out in Section 10 below.
- (iii) Group supervision is limited to intra-group transactions for groups defined under (d) above, as explained in Section 6.3 below.

Figure 7

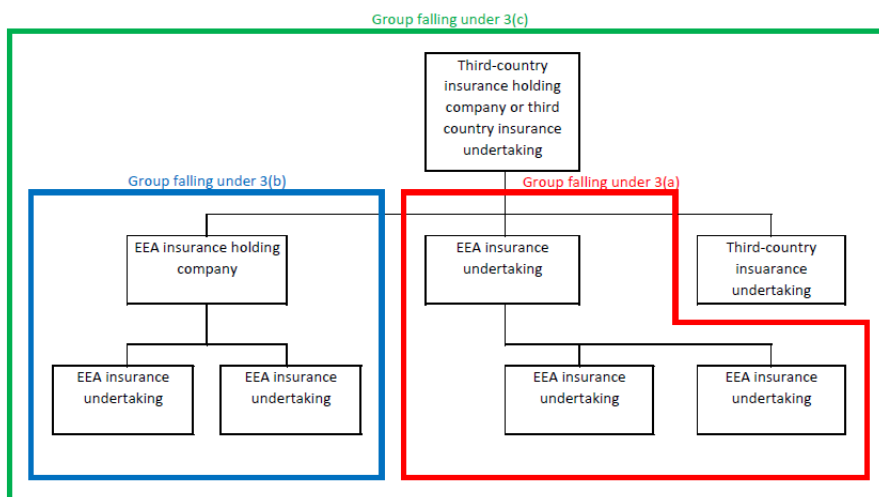
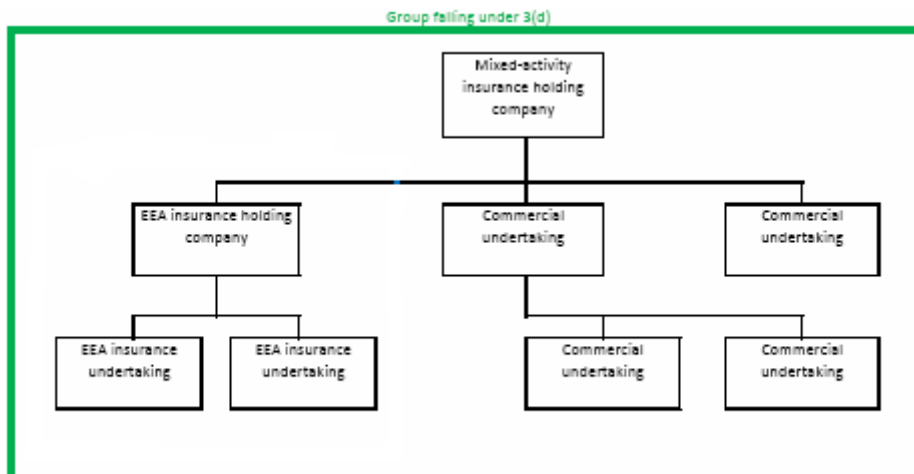


Figure 8



4. The scope of group supervision

The cases of application of group supervision highlighted in Section 3 above does not imply that supervisory authorities are required to play a supervisory role in relation to the third country insurance undertaking, the insurance holding company or the mixed-activity insurance holding company individually. With regards to insurance holding companies, supervisory authorities shall require that all persons who effectively run the insurance holding company are fit and proper to perform their duties.

The group supervisor may decide on a case-by-case basis to exclude a related undertaking in the group supervision referred to in Section 3 above, when the undertaking is situated in a third country where there are legal impediments for the transfer of information or the undertaking is either of negligible interest or its inclusion would be inappropriate or misleading, with respect to the objectives of the group supervision. If the necessary information is not available subject to the condition above for any undertaking within the group, the undertaking is excluded from group supervision. Regardless of the above, participating insurance undertakings and insurance holding companies should always be included in the scope of group supervision.

5. Group Solvency Capital Requirement (Group SCR)

5.1. General principles

Participating insurance undertakings or insurance holding companies are required to calculate a group SCR at least annually. They should ensure that all related undertakings and all risks within the group necessary for forming a proper understanding of the group solvency are included in the group solvency calculation in line with the cases of the application of group supervision as explained in Section 3 above.

The group solvency calculation should be applied to:

- (a) insurance undertakings in the Union, which are participating undertakings in at least one insurance undertaking in the Union, or insurance undertaking in a third country;
- (b) insurance undertakings in the Union where the parent undertaking is an insurance holding company in the Union;
- (c) insurance undertakings in the Union where the parent undertaking is an insurance holding company in a third country or a third country insurance undertaking;

For groups falling under (c) above, the application of group solvency depends on finding positive equivalence⁵.

The group solvency calculation **does not apply** to insurance undertakings where the parent undertaking is a mixed-activity insurance holding company.

5.2. Calculation methods

The calculation of the group solvency calculation should be carried out in accordance with technical principles by using either the accounting consolidation-based method, the deduction and aggregation method or a combination of both methods. Participating insurance undertakings or insurance holding companies shall apply the accounting consolidation-based method **by default** unless otherwise advised by the group supervisor or upon request by the participating insurance undertaking or insurance holding company within the group.

All group solvency calculations shall be carried out at the level of the ultimate parent insurance undertaking or insurance holding company. However, where sub-groups exist at a national level, supervisory authorities may decide, after consulting the group supervisor and the ultimate parent insurance undertaking or insurance holding company at Union level, to apply the calculations on the ultimate parent insurance undertaking or insurance holding company at national level.

⁵ Refer to Section 10 below

The group supervisor may allow participating undertakings or insurance holding companies to apply the deduction and aggregation method or a combination of both methods:

- (a) when the amount and quality of information available in relation to a related undertaking are not sufficient for it to be able to apply the default method;
- (b) where a group internal model is used for the group SCR and a related undertaking is not covered by that group internal model; and
- (c) when the use of the default method in relation to a related undertaking would be overly burdensome.

5.3. Method 1 (Default method): Accounting consolidation-based method

The accounting consolidation-based method implies that the calculation of the group solvency of the participating insurance undertaking or the insurance holding company shall be carried out on the consolidated accounts. The group solvency of the participating insurance undertaking or the insurance holding company amounts to the difference between the eligible own funds and the SCR. The SCR at group level shall be calculated using either the standard formula or an approved internal model.

5.3.1. Determination of consolidated data for the calculation of group solvency

The consolidated data for the purposes of the group solvency calculation should be calculated as follows:

- (a) full consolidation of data of all the insurance undertakings, third country insurance undertakings, insurance holding companies and ancillary services undertakings which are subsidiaries of the parent undertaking;
- (b) full consolidation of data of special purpose vehicles, other than special purpose vehicles that are existing insurance undertakings which assume risks from insurance undertakings and which fully fund their exposure to such risks through the proceeds of debt issuance or any other financing mechanism where the repayment rights of the proceeds of such debt or financing mechanisms are subordinated to the reinsurance obligation of the special purpose vehicle towards the ceding insurance undertaking and which either comply with the requirements as set out in Article 211 of the Solvency II Directive or are regulated by third country supervisory authority;
- (c) proportional consolidation of data of the insurance undertakings, third country insurance undertakings, insurance holding companies and ancillary services undertakings managed by an undertaking included in (i) above together with one or more undertakings not included in the above points and where those undertakings' responsibility is limited to the share capital they hold;
- (d) on the basis of the adjusted equity method, data of all holdings in related insurance undertakings, third country insurance undertakings and insurance holding companies which are not subsidiaries of the parent and which are not considered in any of the points above;
- (e) the proportional share of the undertakings' own funds calculated according to the relevant sectoral rules as set out in Annex I to Directive 2002/87/EC in relation to holdings in related undertakings which are credit institutions, investment firms and financial institutions, institutions for occupational retirement provision within the meaning of Directive 2003/41/EC⁶ and non-regulated undertakings carrying out financial activities.

5.3.2. Consolidated Group Solvency Capital Requirement

The consolidated group SCR is the summation of the capital requirement of all the different undertakings that form part of the group and is based on consolidated data as described in Section 5.3.1 above. Related undertakings of the group are included in the consolidated data using either full or proportional consolidation. This implies that the respective assets and liabilities of each related undertaking are included line by line in the consolidation.

⁶ 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

The related insurance undertakings in the Union that are subsidiaries of the group, contribute fully to the diversification effects recognised at the group level when calculating the consolidated group SCR, resulting in the diversified SCR ($SCR^{diversified}$) at the group level. (Figure 9)

However, this does not apply to related insurance undertakings that are not subsidiary undertakings of the group, related undertakings that belong to other non-insurance financial sectors, and non-regulated undertakings carrying out financial activities, as explained later in this section.

The notional SCR for insurance holding companies shall be calculated in accordance with Articles 100 to 127 of the Solvency II Directive, which is the same methodology used to calculate the SCR for insurance undertakings in the Union based on Solvency II valuation principles. This applies to parent and intermediate insurance holding companies in the Union and in third countries.

For related insurance undertakings and insurance holding companies which are not subsidiary undertakings of the group, the *proportional* share of the notional SCR is included in the consolidated group SCR. These are referred to as the SCR for non-controlled participations (SCR^{NCP}). The resulting SCR shall be included in the consolidated group SCR as a simple sum, as no diversification effect can be recognised at group level.

Related insurance undertakings situated in third countries are also included in the consolidated group SCR. The notional SCR to be used for the purpose of the group solvency calculation should be calculated as if they were insurance undertakings in the Union based on Solvency II valuation principles. Where the related insurance undertakings situated in third countries are subsidiary undertakings, the resulting notional SCR is fully consolidated into the group SCR ($SCR^{diversified}$), as diversification effects can be recognised at group level. Where the related insurance undertakings situated in third countries are not subsidiary undertakings, the *proportional* share of the resulting notional SCR is then included in the consolidated group SCR (SCR^{NCP}) as a simple sum, as diversification effects cannot be recognised at group level.

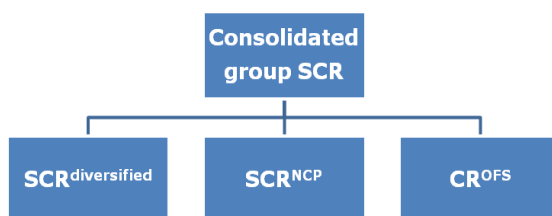
For related undertakings which are credit institutions, investment firms, financial institutions, and Institutions for Occupational Retirement Provision (IORPs), the *proportional* share calculated according to the relevant sectorial rules is then included in the consolidated group SCR as a simple sum as no diversification can be recognised at group level.

For non-regulated undertakings carrying out financial activities, the *proportional* share of the notional capital requirement for each non-regulated undertaking is also added to the consolidated group SCR as a simple sum as no diversification effects can be recognised at group level.

The calculation of a notional SCR is not required for ancillary services undertakings and special purpose vehicles as these would be included implicitly in the data used to calculate the $SCR^{diversified}$.

The diagram below shows all the components that should be included in the consolidated group SCR:

Figure 9



Where:

- (a) $SCR^{diversified}$ = SCR for the fully consolidated undertakings
- (b) SCR^{NCP} = SCR for non-controlled participations
- (c) CR^{OFS} = Capital requirements for other financial sectors

The calculation for the proportional share of the SCR of the related undertaking is:

- (a) 100% when including the subsidiary undertaking in the consolidated data (fully consolidated);
- (b) The percentage used to include the non-controlling participations for the purposes of the consolidated accounts (partial consolidation);
- (c) The proportion of the subscribed capital that is held, directly or indirectly, by the participating insurance undertaking or insurance holding company when including related undertakings in the consolidated data (partial consolidation).

5.3.3. Minimum consolidated group solvency capital requirement

When adopting the accounting consolidation-based method or a combination of both methods (the accounting consolidation-based method and the deduction and aggregation method⁷), for the calculation of the group solvency, a minimum consolidated group SCR applies. This is equal to the sum of the following:

- (a) the minimum capital requirement (MCR) of the participating insurance undertaking or notional MCR of the insurance holding company; and
- (b) the proportional share of the MCR of the related insurance undertakings and intermediate insurance holding company.

The calculation of the proportional share of the MCR of the related undertakings should be based on the proportional share that is included in the consolidated data. For example, a fully consolidated subsidiary is included 100% in the consolidated data.

The notional MCR for the *insurance holding companies* should be 35% of the notional SCR. It is assumed to amount to 35% since it is the percentage in the middle of the 25%-45% corridor for insurance undertakings' MCR as prescribed in Article 129(3) of the Solvency II Directive.

Regardless of any equivalence decision, the solo MCR with respect to third country insurance undertakings should be the local capital requirement below which authorisation would be withdrawn by the third country local supervisor.

Ancillary services undertakings and special purpose vehicles are not included in the sum of the minimum capital requirement since no notional SCR is required for them.

5.3.4. Consolidated group own funds

The consolidated group own funds are calculated using consolidated data including the proportional share of own funds in related undertakings in other financial sectors. Consolidated group own funds should be calculated net of any intra group transactions and are subject to the same tiering limits that apply at solo level, to determine the amount of group own funds eligible to cover the group SCR.

5.3.5. Eligible own funds to cover the Group SCR

The double use of own funds eligible for the SCR amongst the different undertakings in the group is not allowed.

In order to calculate the amount of eligible group own funds, as a first step, the group needs to assess the amount of eligible own funds from each solo related undertaking that is also available at the group level i.e. the group needs to determine if there are restrictions on the transferability or fungibility of each solo related undertaking's eligible own funds to the group. Where there are restrictions on the transferability or fungibility of own fund items, these items are regarded as non-available eligible own fund items. Where there are no restrictions on transferability or fungibility of own funds to the group, the own funds are considered as available and eligible at group level.

To determine the amount of each solo related undertaking's eligible own funds that is available at the group level, the amount of eligible own funds for each solo related undertaking that is not transferable or fungible to the group

⁷ See Section 5.4 below

is deducted, for the purposes of the calculation, from the solo related undertaking's eligible own funds. This deduction is made from the relevant own funds item of the consolidated group own funds and also from the relevant tiers. These reflect the non-available eligible own fund items.

Non-available eligible own funds items are assumed to be but are not limited to the following:

- (a) the value of any asset of the participating undertaking or related undertaking representing the financing of own funds eligible for the SCR of any of its related undertakings;
- (b) any subscribed but not paid up capital which represents a potential obligation on the part of the participating undertaking, or on the part of any one of the related undertakings;
- (c) ancillary own funds;
- (d) preference shares;
- (e) subordinated liabilities;
- (f) net deferred tax assets; and
- (g) minority interests.

The non-available eligible own fund items of the related undertaking which are subsidiary undertakings can be used to cover the group SCR but only up to the contribution of that related undertaking's SCR to the group SCR. If the amount of non-available eligible own fund items exceeds the contribution of the solo undertaking to the group SCR, the excess is not available to the group and has to be deducted from the group eligible own funds. (Table 1 & Figure 10)

Where the non-available eligible own fund items of the related undertaking is lower than the contribution of the related undertaking's SCR to the group SCR, then the above limitation does not apply.

When using the accounting consolidation-based method and the standard formula, the contribution of the related insurance undertaking 'j' which is a subsidiary undertaking is calculated by using the following formula:

$$\text{Contr}^j = \text{SCR}^j \times \text{SCR}^{\text{diversified}} / \sum_i \text{SCR}^{\text{isolo}}$$

Where:

- (a) SCR^j = the solo SCR of the undertaking j
- (b) $\text{SCR}^{\text{diversified}}$ = consolidated group SCR
- (c) $\text{SCR}^{\text{isolo}}$ = the sum of the solo SCR of the parent undertaking, each insurance undertaking and the intermediate insurance holding company (undiversified) that has been included in the calculation of the consolidated group SCR ($\text{SCR}^{\text{diversified}}$)

Where the group SCR is calculated using an internal model, the contribution of undertaking j is calculated as the product of the SCR of the undertaking j and the percentage corresponding to the diversification effects attributed to undertaking j as calculated by the internal model.

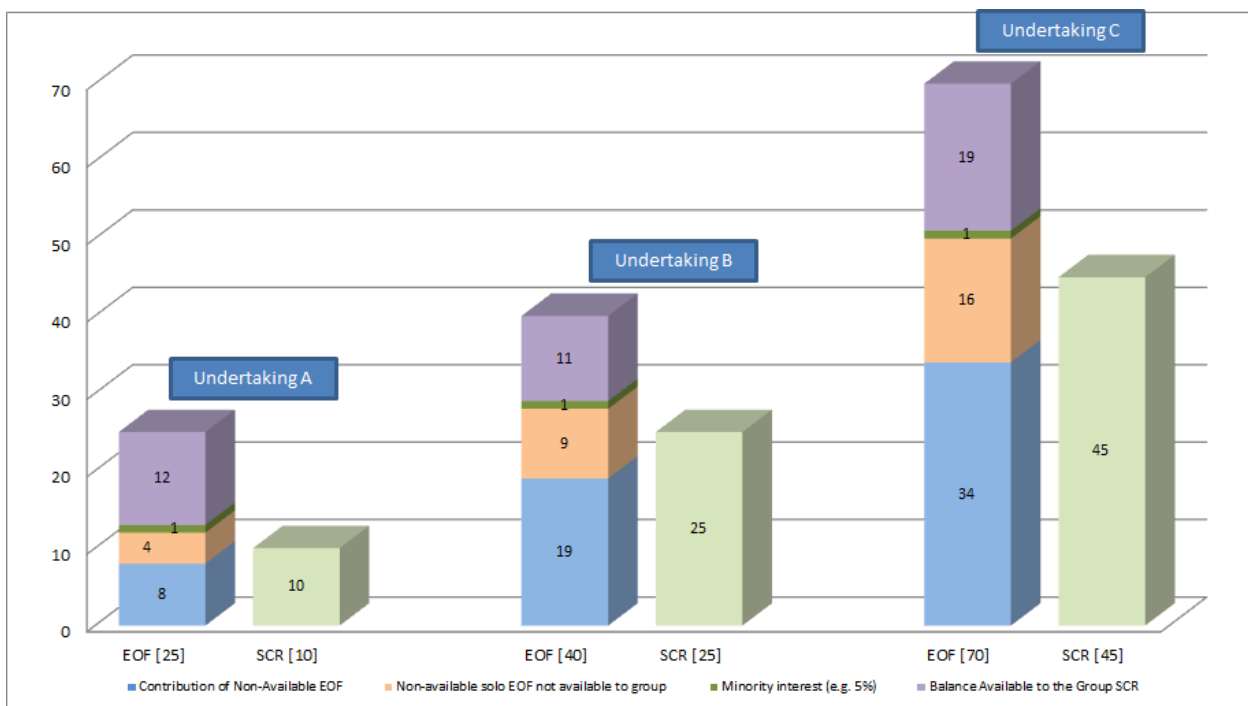
The assessment of the availability of own funds in respect of ancillary services undertakings, special purpose vehicles, and related undertakings that are not subsidiaries to the group, has to be explained to the group national supervisory authority and the solo national supervisory authority by the participating insurance undertaking or the insurance holding company.

Table 1 and Figure 10 below provide an *illustration* of the contribution calculation of the related insurance undertakings to the group SCR:

Table 1

Undertaking		A	B	C
Solvency Capital Requirement (SCR)	a	10	25	45
Eligible Own Fund (EOF)	b	25	40	70
<i>Of which Non-available EOF</i>	c	12	28	50
Contribution of Solo Non-Available EOF available to the Group SCR	$f = (a / e) * d$	$= (10/80) * 60$ = 8	$= (25/80) * 60$ = 19	$= (45/80) * 60$ = 34
Solo Non-Available EOF that is not available to the Group	$g = c - f$	4	9	16
Minority interest (e.g. 5%) <i>(Section 5.3.6 below)</i>	h	1	1	1
Balance Available to the Group	$i = b - c - h$	12	11	19
Total EOF	b	25	40	70
Group SCR	d	60		
Sum of the solo SCRs	e	80		

Figure10



5.3.6. Treatment of minority interests for covering the group solvency capital requirement

When applying the accounting consolidation-based method or when using a combination of the two methods, the parent undertaking or insurance holding company should consider the amount of minority interest in the eligible own funds as non-available eligible own funds for covering the group SCR.

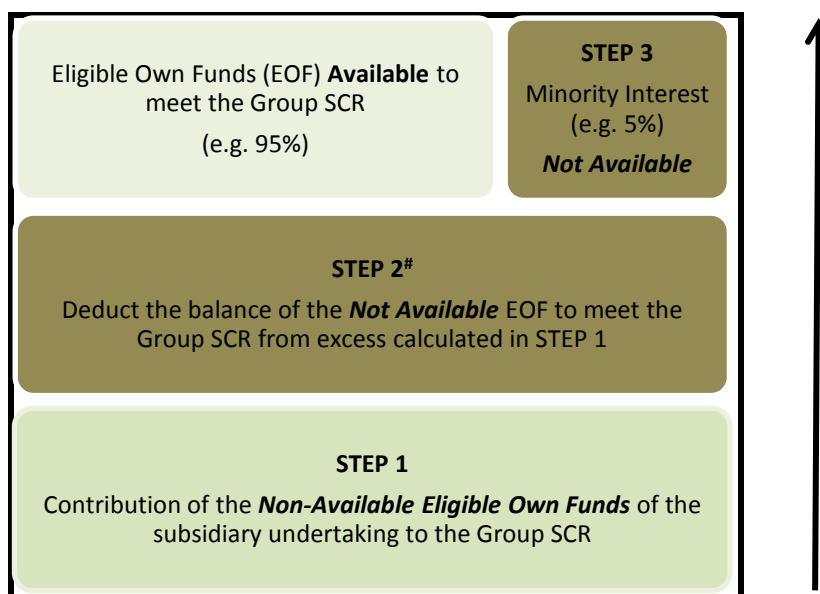
The calculation of the amount to be excluded, as minority interest shall be calculated for each insurance undertaking or insurance holding company included in the group SCR calculation as follows:

- (a) Calculate the eligible own funds exceeding contribution of the subsidiary undertaking to the group SCR
- (b) Deduct non-available eligible own funds from the result in (i)
- (c) Deduct the minority interest share from the result in (ii).

The illustration below shows the order of the calculation in respect of section 5.3.5 and 5.3.6 (below):

Figure 11

Breakdown of Eligible Own Funds of the Subsidiary Undertaking available to cover the Group SCR



#In the event that the non-available eligible own fund items of the related undertaking is lower than the contribution of the related undertaking's SCR to the group SCR, step 2 will not apply.

5.3.7. Group technical provisions

The group best estimate of technical provisions should be equal to the sum of best estimates of technical provisions calculated at the solo level and deducting only the part of the best estimate of technical provisions resulting from internally reinsured activities to avoid double counting of commitments as in the consolidated accounts.

The risk margin of technical provisions for a group should be equal to the sum of the following:

- (a) the risk margin of the participating *insurance* undertaking; and
- (b) the proportional share of the participating undertaking in the risk margin of the related *insurance* undertakings.

5.4. Method 2 (Alternative method): Deduction and aggregation method

Under this method, rather than applying the standard formula to the consolidated accounts, group solvency is assessed through the sum of the solo SCR and own funds of the participating undertaking and of the proportional share of its related undertakings.

5.4.1. Aggregated group own funds

Aggregated group eligible own funds consist of the sum of the own funds eligible for the SCR of the participating insurance undertaking or notional own funds of the insurance holding company, the proportional share of own funds of the related undertakings, the proportional share of own funds of related third country undertakings and the proportional share of own funds of credit institutions, investment firms, financial institutions and institutions for occupational retirement provisions calculated according to the relevant sectorial rules. Own funds should also be calculated net of intra group transactions and net of adjustments related to non-available own funds.

The contribution of a subsidiary undertaking to the group SCR when using the deduction and aggregation method is the solo SCR since diversification effects at group level cannot be recognised.

5.4.2. Group solvency capital requirement

The group SCR based on the deduction and aggregation method is calculated as the sum of the solo SCR of participating insurance undertakings or notional SCR of insurance holding company, the proportional share of the SCR of each related undertakings and proportional share of notional SCR of intermediate insurance holding companies, the proportional share of SCR of related third country undertakings and intermediate insurance holding companies, and the proportional share of the capital requirements for credit institutions, investment firms, financial institutions and institutions for occupational retirement provisions calculated according to the relevant sectorial rules.

5.4.3. Minimum group solvency capital requirement

There is no MCR calculation required under the deduction and aggregation method.

5.5. Group internal model

In the case of an application for permission to calculate the group SCR, or SCR of insurance undertakings within the group, using an internal model, supervisory authorities concerned shall cooperate to decide whether or not to grant that permission and to determine the terms and conditions to which that permission is subject. The application needs to be submitted to the group supervisor who is required to inform the other supervisory authorities concerned.

The supervisory authorities concerned shall as far as possible reach a joint decision on the application within 6 months from the date of the application. This period may be extended by a further 2 months if the group supervisor or any of the other supervisory authorities concerned decide to consult EIOPA.

The group supervisor and the other supervisory authorities involved will assess the appropriateness of the scope of the internal model upon receiving the relevant application from the group. This assessment involves considering the significance of related undertakings with respect to the risk profile of the group and compare this risk to the overall group risk profile. The group supervisor and the other supervisory authorities concerned will also consider the appropriateness of the use of the standard formula or another internal model for the calculation of the solvency capital requirement of related undertakings included in the scope of the group internal model.

If any of the supervisory authorities concerned consider that the risk profile of an insurance undertaking under its supervision deviates significantly from the assumptions underlying the internal model approved at group level and where the undertaking has not properly addressed the concerns of the supervisory authority, that authority may set a capital add-on to the solvency capital requirement of that insurance undertaking resulting from the application of such internal model. In exceptional cases where the capital add-on would not be appropriate, the supervisory authority may require the undertaking concerned to calculate its solvency capital requirement using the standard formula. These decisions need to be explained to the insurance undertaking and the group supervisor.

5.6. Group Capital add-on

The process for setting a capital add-on for solo undertakings and for insurance groups is identical. Following the supervisory review process, supervisory authorities may in exceptional circumstances decide to set a capital add-on stating the reasons.

This may only arise when the risk profile of the solo undertaking or insurance group deviates significantly from the assumptions underlying the SCR as calculated using the standard formula or using an internal model or when the system of governance deviates significantly from the standards set out in the Solvency II Directive.

5.6.1. Risk Profile Capital add-on

A risk profile deviation is considered to be significant if the revised SCR calculated using the standard formula, or an approved internal model modified to reflect the actual risk profile of the solo undertaking or group, exceeds the SCR by 10%. Supervisory authorities can exercise discretion over this threshold.

When the supervisory authority concludes that a significant risk profile deviation occurs, it first identifies the assumptions that are being challenged and identifies the sources of the deviations. Deviations may include an underestimation of the particular risk modules or sub-modules, quantifiable risks which are not covered by the standard formula or the aggregation mechanism such as the correlation parameters or assumptions. In this respect, the supervisory authority may require the undertaking or group concerned to replace a subset of the parameters used in the standard formula calculation by parameters specific to that undertaking when calculating the life, non-life, and health underwriting risks modules. If this solves the significant deviation noted, a capital add-on will not be imposed.

If the above approach is not feasible, adequate, or not approved, the supervisory authority will then consider if the group shall be required to develop an internal model prior to imposing the capital add-on. The internal model needs to be developed and approved by the supervisory authority concerned within an appropriate period of time which must not exceed six months from the formal application date. If the internal model approach does not provide the desired result, or was not developed in the appropriate period of time, the supervisory authority shall finally set a capital add-on.

5.6.2. Governance Capital add-on

A governance deviation is considered to be significant if it prevents the undertaking or group from identifying, measuring, monitoring, managing, and reporting the risks that it is or could be exposed to. Governance deficiencies drawing the supervisory authority's attention could include the background, history and external environment of the group, regulatory changes that result into implications on the system of governance of the group, non-compliance with regulatory requirements indicating potential problems in internal control mechanisms or in general compliance, complaints from policyholders, high turnover of key personnel, lacking quality noted in the Solvency and Financial Condition Reports or in the Regular Supervisory Reports and also material changes observed on a frequent basis in the groups system of governance structure.

The materiality of a deviation in governance can be measured both quantitatively and qualitatively. Quantitative materiality takes into account the financial loss that the undertaking or group could incur on account of the deviations. Qualitative materiality considers the quality of the system of governance as seriously impaired giving rise to material risks.

The supervisory authority will establish the appropriate timeframe of a maximum limit of six months for the undertaking or the group to resolve the governance deviation prior to imposing a capital add on.

5.6.3. Communication with the undertaking or group

Once the supervisory authority decides to set a capital add-on, this decision should be communicated to the solo undertaking or group in written form. This should include a rationale for the decision to set the capital add-on, the amount of the capital add-on, a description of the assumptions used and methodology applied, the timeframe in which the undertaking or group should implement the measures and actions to amend the circumstances leading to

the decision to set the capital add-on and the content and frequency of the required progress reports regarding measures and action to be taken by the undertaking or group to appropriately amend the circumstances leading to the decision of imposing a capital add-on.

5.6.4. Reviewing of conditions which lead to a capital add-on

When the circumstances which led to the decision to set the capital add-on have changed, the supervisory authority will conduct a review on those conditions.

The risk capital add-on should be reviewed at least annually and whenever the SCR is re-calculated. Based on the outcome of this review the capital add-on may be removed, reduced, increased or remain unchanged.

6. Risk concentration and Intra-group transactions

6.1. Group risk concentration

Group risk concentrations are subject to supervisory review by the group supervisor.

The ultimate parent insurance undertaking is required to report on a regular basis and at least annually to the group supervisor any significant risk concentrations at the level of the group. Where the ultimate parent undertaking is not an insurance undertaking, information on significant risk concentrations of the group should be submitted by the ultimate insurance holding company or by a related undertaking in the group identified by the group supervisor after consulting both the other supervisory authorities concerned and the group.

The types of risk that need to be reported are determined by the group supervisor after considering the specific group and risk management structures of the group. The thresholds used by the group supervisor to identify the significant risk concentrations to be reported, are based on the SCR, technical provisions or both. The group supervisor is required to also review and monitor the possible risk of contagion in the group, conflicts of interest and the volume and level of risks.

6.2. Intra-group transactions

Intra-group transactions are subject to supervisory review by the group supervisor.

The ultimate parent insurance undertaking is required to report on a regular basis and at least annually to the group supervisor any significant intra-group transactions within the group including those performed with a natural person with close links⁸ to an undertaking in the group. Where the ultimate parent undertaking is not an insurance undertaking, information on significant intra-group transactions within the group should be submitted by the ultimate insurance holding company or by a related undertaking in the group identified by the group supervisor after consulting both the other supervisory authorities concerned and the group.

The types of intra-group transactions that need to be reported are determined by the group supervisor.

6.3. Mixed-activity insurance holding companies and intra-group transactions

Where the parent undertaking of one or more insurance undertakings is a mixed-activity insurance holding company, the supervisory authorities responsible for the supervision of those insurance undertakings will exercise general supervision over transactions between those insurance undertakings, the mixed-activity insurance holding company, and its related undertakings.

⁸Article 13(17) of the Solvency II Directive

7. Group System of Governance

The governance requirements in Section 2, Chapter IV, Title 1 of the Solvency II Directive, which apply to solo undertakings, apply mutatis mutandis at the level of the group. This is established by Article 246 (1) of the Solvency II Directive. The preparatory guidelines on the System of Governance which will be applicable from January 2014 should be considered when implementing the System of Governance at group level.

The guidance papers⁹ issued in 2010 and 2012 by the MFSA in relation to the system of governance requirements for solo undertakings are therefore also relevant to group structures. This paper does not repeat the detail that was explained in those guidance papers and it is therefore recommended that this paper be read in conjunction with those earlier papers.

The ultimate parent insurance undertaking or insurance holding company must identify the undertaking within the group which is defined by the guidelines as the ‘entity responsible for fulfilling the governance requirements at group level’. This will be referred to as the **‘responsible undertaking’** in this paper. The identity of the responsible undertaking is to be notified to the group supervisor. The responsible undertaking is usually the parent undertaking, but depending on the structure and organization of the group this entity may be other than the parent undertaking.

The Solvency II Directive requires all solo insurance undertakings and groups to have in place an effective system of governance which provides for sound and prudent management of the business. The implementation of governance requirements at group level should be understood as a group having in place a robust governance system applied to one coherent economic entity (holistic view) comprising all undertakings in the group.

The responsible undertaking should assess the appropriateness of the organisational and operational structure of the group and should be able to demonstrate a good understanding of the interactions and risks arising from the structure. Any changes to the group structure should not diminish the sound and prudent management of all the undertakings within the group.

The responsible undertaking should set adequate internal governance requirements across the group appropriate to the structure, business and risks of the group and of its related undertakings, and consider the appropriate structure and organization for risk management at group level, setting a clear allocation of responsibilities between all undertakings within the group. The system of governance at group level should take into account the interests of all the undertakings belonging to the group and how these interests contribute to the common purpose of the group as a whole over the long term.

When a solo undertaking outsources a key function within the group, the responsible undertaking must document which functions relate to which legal entity within the group. The responsible undertaking should ensure that the performance of the key functions at the level of the solo undertaking is not impaired by such intra group arrangements. The solo undertaking remains responsible for the outsourced function and has to manage the outsourcing arrangement effectively and also have in place suitable business contingency plans.

7.1. The Board of Directors (“Board”)

The governance requirements at the level of the group consider the corporate governance responsibilities of both the Board of the responsible undertaking and the Boards of legal entities that belong to the group. The responsible undertaking should ensure that the responsibilities of the Board of each undertaking in the group are not impaired. Even if some or all of the governance requirements do not apply at the individual level for some entities belonging to an insurance group, namely holdings and other non-regulated entities, all governance requirements are applied to the coherent economic entity which in a holistic way aggregates all the entities in the group.

⁹ Three Guidance Papers were issued. The first paper was issued on 22 April 2010 and was titled “The System of Governance under Solvency II”. The second paper was issued on 18 January 2012 and was titled “The System of Governance”. The third paper was issued on 6 August 2012 and was titled “Risk Management – Guidance Paper”.

The Board of the responsible undertaking should have an appropriate interaction with the Boards of all undertakings within the group by requesting information proactively in the matters that may affect the group and challenging the decision making both at group and undertaking level.

The group's policies should clearly define the role and responsibilities of each undertaking in the group in relation to the group's overall strategic objectives. The governance responsibilities, strategies and policies established at each regulated solo undertaking in a group structure should be consistent with group strategies and policies. Any group-level decisions or procedures have to be evaluated to ensure that they do not put the solo undertaking in breach of applicable legal or regulatory provisions or prudential rules at national level.

7.2. Group risk management

The Board of the responsible undertaking should establish an effective risk management system for the whole group and ensure it is consistently implemented across the group. The group should ensure that its risk management strategy is supported by an integrated framework of responsibilities and functions driven from group level down to individual undertaking levels. The board of each undertaking within the group is, in turn, responsible to implement the risk management strategies and policies established by the board of the responsible undertaking.

Although each individual undertaking within a group is responsible for its risk management policy, the responsible undertaking must provide a general steer. In providing its steering, the responsible undertaking is expected to take into consideration possible discrepancies between the group perspective and local market specificities.

The responsible undertaking should consider the risks both at individual undertaking and at group level and their interdependencies and in particular any risks that may have an impact which is significantly different at group level than at solo undertaking level. These may be concentration risks that do not represent a threat at solo undertaking level but are a threat at group level. Similarly the management of liquidity risk should be supported by clear agreements that govern the use of excess funds, supervision of each entity's financial position and regular stress and transferability testing. Monitoring procedures should also be in place to ensure that the group structure and any existing agreements or connected transactions do not undermine the efficacy of own funds items. The availability of assets in third countries also needs to be assessed.

8. Group Own Risk and Solvency Assessment (ORSA)

The ultimate parent insurance undertaking or insurance holding companies are required to undertake an ORSA at the level of the group and this shall be subject to review by the group supervisor. The group ORSA should be designed by the responsible undertaking for fulfilling governance requirements at group level.

The group ORSA should be designed to reflect the nature of the group structure and its respective risk profile. All the undertakings that fall within the scope of group supervision are included in the group ORSA. The responsible undertaking for fulfilling governance requirements at group level should adequately identify, measure, monitor, manage and report all group specific risks, the interdependencies within the group, the impact of these risks and their respective interdependencies on the group risk profile. The key drivers of the overall solvency needs of the group including any diversification effects assumed need to be explained.

When using internal models for calculating the group solvency, the group should indicate the related undertakings included in the scope of group supervision which do not use the internal model for the calculation of their solvency capital requirement and the underlying reasons for that in the group ORSA report.

The group ORSA should capture all specificities of the group and should at least include a description of:

- (a) All risks specific to the group;
- (b) Risks that might not be taken into account at individual level;
- (c) National specificities; their likely effects and how they are reflected at group level;
- (d) Key sources of own funds within the group in the advent of a requirement for additional new own funds;

- (e) Assessment of availability, transferability or fungibility of own funds;
- (f) Reference to any planned transfer of own funds within the group;
- (g) Alignment of key individual strategies with the ones established at group level
- (h) The impact of the different stress tests and scenario analysis carried out at group level.

The group ORSA should highlight the impact on the group solvency and on related undertakings of all material risks that the group is facing which cannot be identified at individual level. Group specific risks include at least contagion risk, risks arising from intra group transactions, risk concentrations, interdependencies within the group and their impact on the risk profile, currency risk and risks arising from the complexity of the group structure.

The group ORSA should include the overall solvency needs of the group in quantitative terms including also a qualitative description of the major risks surrounding the group. A description of the materiality and contribution of each related undertaking at the group level needs to be included together with a comparison of the group overall solvency needs and the sum of the solo overall solvency needs. An assessment of any diversification effects assumed at group level needs also to be undertaken and included in the group ORSA document.

8.1. Specific requirements for a single ORSA document

The ultimate parent insurance undertakings or insurance holding companies may decide, subject to prior approval from the group supervisor, to undertake an ORSA at the level of the group and at the level of any subsidiary in the group at the same time and produce a single document covering all the assessments. The group should provide an explanation on how the subsidiaries are covered within the group ORSA and how the subsidiaries administrative management or supervisory body is involved in the assessment process and approval of the outcome.

9. Disclosure and reporting requirements at group level

The public disclosure and supervisory reporting requirements at the group level are the same as the requirements at the level of the solo undertaking. In this respect, please refer to the guidance paper¹⁰ relating to Supervisory Reporting and Public Disclosure Requirements that was issued by the MFSA in 2011 and the EIOPA report¹¹ on reporting and disclosure requirements published on 9th July 2012.

With respect to the solvency and financial condition report, groups can obtain approval from the group supervisor to submit a single report which includes the information at the level of the group and the information for all of the subsidiaries within the group which must be individually identifiable.

10. Third countries

10.1. Verification of equivalence

In the event that the ultimate parent undertaking is an insurance holding company in a third country or a third country insurance undertaking, the supervisory authorities concerned need to verify whether the insurance undertaking is subject to supervision by a third country supervisory authority and determine whether the supervision carried out is equivalent to the supervision carried out at the level of the group in the Union.

When a decision has been made by the Commission on the equivalence of supervision of a third country, that decision shall be recognised as determinative for the purposes of the verification.

¹⁰ This Guidance Paper was issued on 22 June 2011 and was titled “Supervisory Reporting and Public Disclosure Requirements”

¹¹ EIOPA Final Report on Public Consultations No. 11/009 and 11/011 on the Proposal for the Reporting and Disclosure Requirements (link: <https://eiopa.europa.eu/en/fixed-width/consultations/consultation-papers/2011-closed-consultations/november-2011/draft-proposal-on-quantitative-reporting-templates-and-draft-proposal-for-guidelines-on-narrative-public-disclosure-supervisory-reporting-predefined-events-and-processes-for-reporting-disclosure/index.html>)

10.2. Positive equivalence

In the event of equivalent supervision, reliance should be made on the equivalent group supervision exercised by the third country supervisory authorities.

When the ultimate parent insurance undertaking or the insurance holding company has its head office in a third country which has positive equivalence, or temporary or transitional equivalence, the group solvency calculation should be applied at the level of the ultimate parent insurance undertaking or insurance holding company where a group as defined in Section 3(a) and (b) above exists.

Where there is not a group in the Union, the national supervisory authorities of the insurance undertakings in the group cannot require the establishment of a group at Union level for the purpose of applying group supervision.

10.3. Absence of equivalence

Where the ultimate parent insurance undertaking or the insurance holding company has its head office in a third country and there is no positive equivalence, or temporary or transitional equivalence, the group solvency calculation should be applied at the level of the ultimate parent insurance undertaking or insurance holding company where a group as defined in Section 3(a) and (b) above exists.

Where there is not a group in the Union, the national supervisory authorities of the insurance undertakings in the group may require that an insurance holding company in the Union be set up and apply group supervision to the insurance undertakings in the group headed by that insurance holding company.

10.4. Application of equivalence in the group solvency calculation

For the purposes of the group solvency calculation, the application of equivalence is only considered when the group solvency calculation is performed using the deduction and aggregation method.

When performing the group solvency calculation in accordance with the deduction and aggregation method, the third country undertaking is, solely for the purposes of that calculation, treated as a related undertaking. Where there is positive equivalence, the local solvency requirements for the related undertaking are used to calculate the solvency capital requirement. In the absence of equivalence, the related undertaking calculates the solvency capital requirement as per the requirements set out in the Solvency II Directive for undertakings in the Union.

Group solvency is assessed through the sum of the solo SCR and own funds of the participating undertaking and of the proportional share of its related undertakings in the Union and in third countries.

11. Summary application of group supervision and group solvency requirements

	Type of group supervision	Group SCR applicable
Groups falling under section 3(a) and (b)	Full	Yes
Groups falling under Section 3(c)	Depends on regulatory equivalence	Depends on regulatory equivalence
Groups falling under Section 3(d)	Limited to intra-group transactions	No