NEWS ANALYSIS

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Brazil and the EU work together on Solvency II

On 11 March 2014, the European Parliament voted to adopt a directive which completes the long-awaited Solvency II Directive, thus finalising the new framework for insurance regulation and supervision in the EU. The Solvency II project is now scheduled for implementation on 1 January 2016 and is primarily targeted at insurance and reinsurance firms and groups based in the European Economic Area (EEA).

The proposed Solvency II rules are based on three main pillars: minimum capital requirements; corporate governance and risk management requirements and disclosure and transparency requirements. It represents a significant development for the prudential regulation and supervision of (re)insurance companies in Europe.

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Solvency II will apply to Brazilian firms that have establishments in the EEA and accordingly, Brazil's insurance watchdog, Susep has applied to the European Insurance and Occupational Pensions Authority (EIOPA) for Solvency II equivalence.

EIOPA also intends to conduct equivalence studies with regulators of other countries in Latin America, including Chile and Mexico, with the aim of achieving equivalence in terms of local solvency regulations. The studies in relation to Brazil have already started. Once these are done, the regulators should negotiate an agreement recognising equivalence in terms of solvency rules.

There are three equivalence tests under Solvency II, which will impact Brazilian (re)insurers in the following manner:

• Equivalence under article 172 relates to reinsurance placed with reinsurers in Brazil. A finding of equivalence will mean that reinsurance ceded by an EEA firm to a (re)insurer in Brazil is treated for regulatory purposes as if it were ceded to a European firm. This will allow an EEA firm to claim credit for this reinsurance in calculating their regulatory capital and will encourage EEA firms to continue to seek reinsurance in the Brazilian market.

• Equivalence under article 227 relates to Brazilian insurers that are part of EEA groups. There is a risk that if Solvency II applies to the Brazilian subsidiary, instead of Brazilian rules, higher levels of capital may be required, resulting in a corresponding rise in the capital required to be maintained by the EEA group. Even if this is not the case, there would be the burden of complying with two sets of potentially conflicting rules. A finding of equivalence will reduce the likelihood of operations in Brazil requiring extra regulatory capital.

• Equivalence under article 260 relates to the group supervision of EEA insurers with a parent company in Brazil. A finding of equivalence means that European supervisors are required to rely on group supervision by SUSEP without duplication by a group supervisor in Europe. However, it remains possible for European supervisors to seek to supervise any EEA subgroups within the Brazil group.

The recognition of equivalence would clearly be beneficial to both Brazil and the EU to the extent that it facilitates cross-border regulation and market access. The intention is to foster investments by insurance companies operating in the EU to Brazil and insurance companies operating in Brazil to the EU.

The Brazilian rules on solvency have changed significantly recently. According to Susep, the Brazilian regulatory framework has advanced in the subject of Solvency II pillar 1, minimum capital requirements and pillar 3, disclosure and transparency requirements. Susep is also working on improving pillar 2 regulation on corporate governance and risk management.

There is no indication as to the timeframe in which the analysis by EIOPA will be conducted and equivalence between the solvency regulations of the EU and Brazil will be achieved. Nevertheless, this is an important step towards implementing a globalised regulatory framework, allowing for more cooperation and investment between the two regions. ■

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