Beata Mrozowska-Bartkiewicz

Implementation of Solvency II to Polish Insurance Law – Ancillary Transposition

In this article, the author has discussed the recent revision of the Act of 11 September 2015 on Insurance and Reinsurance Activity and of other acts. Its purpose was to completely harmonise Polish law with the EU regulations applicable to the insurance and reinsurance activity. The amendment was necessary because of insufficient transposition of the provisions of the Solvency II and Omnibus II Directives which had been implemented into the Polish legal system on the basis of the above-mentioned act.

Keywords: co-insurance, large risks, freedom of services, equity instruments, transitional measures, captive insurance undertakings, Solvency II, Omnibus II.

1. Introduction

Directives Solvency II and Omnibus II that have key meaning to insurance system in the European Union, were implemented to Polish legal system mainly by the Act on insurance and reinsurance activity, passed on 11 September 2015.

The problem of incomplete implementation of insurance directives by the Member States was the topic of European Commission analysis. As a result, on 17 May 2017 the European Commission, following Poland's lack of notification of the means of transposition of certain provisions of Solvency II[1] and Omnibus II[2] Directives to the national legal system, issued an opinion toward Poland on the basis of the Article 258 of the Treaty on the Functioning of the European Union.

In its opinion the European Commission, specified that the following Directives' provisions were not implemented to the Polish legal system regarding insurance and reinsurance activity, namely:

1) provisions on internal insurance and reinsurance undertakings, including definitions of these undertakings, information requirements for the supervisory body and the amount of the minimum capital requirement threshold for these undertakings (Article 13 point 2 and 5, Article 35,

[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 (Solvency II).

[2] Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014 amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) No 1060/2009, (EU) No 1094/2010 and (EU) No 1095/2010 in respect of the powers of the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority) (Omnibus II).

paragraph 8 letter j and Article 129 paragraph 1 letter d subparagraph (iii) of the Solvency Directive and Article 2 point 7 letter b and Article 2 point 32 letter a of the Omnibus II Directive);

2) a provision that gives the supervisory body the possibility of prohibiting the freedisposal of assets located on the territory of Poland, at the request of a supervisory body from another EU Member State that supervises an insurance or reinsurance undertaking performing activities in the territory of the Poland through a branch or on the principle of freedom to provide services (Article 140 of the Solvency II Directive);
3) provisions defining the co-insurance rules in the European Union (Article 190 of Solvency II);
4) transitional measures regarding:
   a) transferable securities or other financial instruments based on transformed loans that were issued before 1 January 2011 (Article 308 paragraph 11 of the Solvency II and Article 2 paragraph 80 of the Omnibus II Directive),
   b) equity instruments acquired before 1 January 2016 (Article 308b paragraph 13 and Article 2 paragraph 80 of the Omnibus II Directive).

Consequently, as a reply to the opinion, Poland introduced the relevant legal changes into the Polish legal order under the Act of 14 December 2017, amending the Act on insurance and reinsurance activity and some other acts, coming into force within 7 days from the day of announcement[3], which will be presented below.

2. New legal provisions concerning captive insurance and reinsurance undertakings

Pursuant to the Act of 14 December 2017, amending the Act on insurance and reinsurance activity and some other acts ("**The Amendment**"), new provisions were adopted to create the opportunity of establishing the captive insurance and reinsurance undertakings. The provisions of Article 13 points 2 and 5 of the Solvency II Directive[4] that constitute the glossary, in which the internal insurance and internal reinsurance undertakings were defined, were supplemented by provisions of Article 3 paragraph 1 points 53 a and 53 b.

[3] The act was announced on 3 January 2018 in the Journal of Laws of 2018 item 8.

[4] "**Internal insurance undertaking**" means an insurance undertaking whose owner is a financial entity other than the insurance or reinsurance undertaking or a group of insurance or reinsurance undertakings within the meaning of Article 212 par. 1 lit. (c), or a non-financial entity whose purpose is to cover only the risks of the establishment or establishments to which it belongs, or the risk of the establishment or establishments being part of the group of which it is a member.

"**Internal reinsurance undertaking**" means a reinsurance undertaking whose owner is a financial entity other than an insurance or reinsurance undertaking or a group of insurance or reinsurance undertakings within the meaning of Article 212 par. 1 lit. (c) or a non-financial entity whose purpose is to reassure only the risks of the establishment or establishments to which it belongs, or the risk of the establishment or establishments of the group of which it is a member.

According to the definition included in the referred provisions, a **captive insurance company** is an insurance company whose shareholder is:

a) a financial entity that is not an insurance undertaking or a reinsurance undertaking or does not belong to a group made up of insurance or reinsurance undertakings, or
b) an entity that is not a financial entity.

– the purpose of which is to insure only the risks of the entity or entities that are its shareholders or the same group entities.

The adoption of the above definition was justified by the analysis of the laws implementing the Solvency II Directive in other EU Member States, e.g. in Spain[5] and Ireland, where a large number of internal insurance companies perform their activities[6].

The Amendment has set out the information on basic requirements of these facilities for the supervisory authority, the level of the minimum capital requirement for captive insurance and reinsurance undertakings and the principle that captive insurance and reinsurance undertakings **have the option of using the simplified calculations of the risk subcategories for:**

a) premiums and technical reserves in non-life insurance (Article 91),
b) interest rate (Article 103),
c) risk of credit spread associated with bonds and loans (Article 105),
d) concentration of assets risk (Article 106).

According to Article 129 paragraph 1 letter d of the Solvency II Directive, **the lower threshold of the minimum capital requirement** for captive reinsurance undertakings is lower than for mutual reinsurance companies. This provision has been implemented in the Act on insurance and reinsurance activity as Article 272 paragraph 1. However, this regulation does not set the level of the absolute floor of the minimum capital requirement for captive insurance and captive reinsurance undertakings. Therefore, there is a provision added in Article 272 paragraph 1 point 5, according to which the lower threshold of the minimum capital requirement for captive reinsurance undertakings is set as the **equivalent of 1.2 million euro in PLN**, which is three times lower than for other than captive reinsurance undertakings.

To avoid interpretation difficulties, Article 3 paragraph 1 point 29a, in the glossary of the Act, introduces the **definition of "financial entity"** in accordance with Article 13 point 25 of the Solvency II Directive. According to the new provision, the financial entity shall be:

a) a credit institution,
b) a financial institution in the meaning of Article 4 paragraph 1 point 7 of the Act of August 29, 1997 – Banking Law (Journal of Laws of 2017, item 1876),
c) an ancillary banking services company as defined in Article 4 paragraph 1 point 12 of the Act of August 29, 1997 – Banking Law,

[5] https://www.boe.es/buscar/act.php?id=BOE-A-2015-7897
[6] http://www.irishstatutebook.ie/eli/2015/si/485/made/en/print

d) an insurance undertaking,
e) a reinsurance undertaking,
f) the dominant insurance entity,
g) an investment company,
h) the dominant unregulated entity.

The new provisions introduced the principle according to which the Polish Financial Supervision Authority will be able, by decision, to recognize an insurance or reinsurance undertaking as a captive one at the request of the founder or at a request of an insurance or reinsurance undertaking, if the statutory requirements are met.

On the other hand, if an insurance or reinsurance undertaking ceases to meet the requirements set for a captive insurance or reinsurance undertaking, the insurance or reinsurance undertaking will be required to inform the Polish Financial Supervision Authority and adapt its activity to the requirements set out in the law for insurance undertakings that are not captive insurers (or reinsurers).

3. Prohibition or restriction on the disposal of assets

The provisions of Chapter 13 of the Act of 11 September 2015 on insurance and reinsurance activity relating to the resolution and liquidation of insurance and reinsurance undertakings provide the supervisory body with the possibility of issuing a **prohibition or restriction on the disposal of assets** of a domestic insurance company or a domestic reinsurance undertaking if the undertaking does not comply with the Solvency Capital Requirement, or with the Minimum Capital Requirement or with the regulations regarding the creation and setting of the value of technical provisions for solvency purposes.

The Amendment also introduced an extension of issuing a prohibition or restriction on the free disposal of assets located on the territory of the Republic of Poland by the Polish Financial Supervision Authority. At the request of a supervisory body from another Member State of the European Union, which supervises a foreign insurance or reinsurance undertaking performing activities in the territory of the Poland by a branch or in a way other than the branch, under the freedom to provide services, and in the event where the foreign insurance company or a foreign reinsurance undertaking does not meet the Solvency Capital Requirement, does not comply with the Minimum Capital Requirement or with the legislation of the home Member State regarding the creation and determination of technical and insurance provisions for solvency purposes and the supervisor may take measures to limit or prohibit the free disposal of assets.

Moreover, the Amendment provides the authorization for the Polish Financial Supervision Authority to issue decisions regarding the restriction or prohibition of free disposal of assets located on the territory of the Poland at the request of a supervisory body from another EU Member State that supervises a foreign insurance or reinsurance undertaking pursuing its activity in the territory of the Poland through a branch or in a way other than the branch, under the freedom to provide services.

The supervisory authority of the registered office at the territory of the Member State of that insurance or reinsurance undertaking may submit such an application in the event where the undertaking's authorization to pursue its insurance or reinsurance activity has been withdrawn.

4. Changes regarding co-insurance

The glossary has been supplemented with the **definition of a leading co-insurer**. According to the new definition, the leading co-insurance provider should be understood as an "*insurance company selected from among participants in the co-insurance agreement to carry out activities specified in this contract on behalf of itself and other insurance companies co-insurance*".

The amendment to the Act provides for the use of leading co-insurance institutions in the case of co-insurance contracts for large risks, as well as for co-insurance agreements of risks other than large risks. The new regulations provide for the conclusion by domestic insurance companies of large-risk co-insurance agreements located in the territories of other European Union countries and the conclusion of foreign-type co-insurance contracts by foreign insurance companies located on the territory of Poland if the co-insurance agreements meet the following conditions:

1) only the leading co-insurance holder is responsible to the policyholder for all risks;
2) at least one co-insurance company is an insurance company based in another EU Member State than a leading co-insurance or participates in a co-insurance agreement by a branch established in another EU Member State than the one in which the co-insurer is established;
3) the leading co-insurance holder determines the amount of insurance premiums and terms of the insurance contract.

Regulations specifying the rights and information obligations for these supervisory bodies shall be applied only to the foreign insurance company being the leading co-insurer. The Amendment also stipulates that domestic insurance companies which are leading co-insurers are obliged to the creation of technical and insurance reserves for the purpose of solvency under co-insurance agreements in accordance with the provisions defining the principles of creating and determining the value of these reserves taking into account the conditions of co-insurance agreements.

5. Transitional measures

The amendment introduced provisions on transitional measures regarding:

1) transferable securities or other financial instruments based on transformed loans that were issued before 1 January 2011,
2) capital instruments acquired until 1 January 2016.

A transitional measure, concerning transferable securities or other financial instruments based on transformed loans, which were issued before 1 January 2011, results from Article 308b paragraph 11 of Solvency II Directive, according to which the requirements are set out in Article 135 para-

graph 2 of the Directive. These provisions authorize the European Commission to issue implementing acts specifying the **quality requirements** that must be met by originators or sponsor entities and insurance companies investing in securities or other financial instruments based on transformed loans that were issued after 1 January 2011. In addition, the circumstances have been specified in which the supervisory body will be able to set a capital add-on in the event that these requirements are violated. They will apply to insurance and reinsurance undertakings investing in securities or other financial instruments, based on converted loans, which were issued after 1 January 2011, only if new base exposures were added after 31 December 2014 or when the exposures have been replaced.

It is worth noting that Article 135 paragraph 2 of this Directive is not subject to implementation, because it concerns the activities of the European Commission.

They implement certain requirements imposed by the Solvency II Directive in the Polish legislation. The Amendment introduced the following provision: "*The provisions of Commission Delegated Regulation (EU) 2015/35 based on the authorization contained in Article 135 (2) of Directive 2009/138/EC apply to insurance and reinsurance undertakings investing in transferable securities and other financial instruments based on converted loans issued before January 1, 2011, when new base exposures or exposures were replaced after December 2014*".

On the other hand, as regards the transitional measure concerning capital instruments acquired before 1 January 2016, it results from Article 308b paragraph 13 in conjunction with Article 304 of the Solvency II Directive, then Article 490 section 3a of the Act on insurance and reinsurance activity, which defines the principles for insurance and reinsurance undertakings to calculate the standard parameters of the share price risk sub-module applied to assets (shares) acquired before 1 January 2016. The added article reads as follows:

"*Until 31 December 2023, the insurance and reinsurance undertakings calculating the capital adequacy requirement according to the standard formula will calculate the standard parameters of the share price risk sub-module for the type 1 shares referred to in art. 168 of Commission Delegated Regulation (EU) 2015/35 acquired until January 1, 2016, and risk-free stock prices based on the duration referred to in Art. 304 Solvency II Directive in accordance with the following rules:*

1) *the standard parameter used to calculate the share price risk sub-module is the Weighted Average:*
   a) *the parameter used to calculate the equity risk sub-module in accordance with Art. 170 section 1 of Commission delegated regulation (EU) 2015/35,*
   b) *the parameter used to calculate the equity risk sub-module in accordance with Art. 169 sec. 1 Commission Delegated Regulation (EU) 2015/35;*

2) *the weight of the parameter referred to in point 1 letter b is increased at least linearly at the end of each calendar year from 0% in 2016 to 100% on January 1, 2023.*

The transitional provision will apply only to type 1 shares, which results from art. 173 of Commission delegated regulation (EU) 2015/35. On the other hand, the proposed references to the relevant provisions of Commission Delegated Regulation (EU) 2015/35, i.e. 170 section 1 and art. 169 section 1 are intended to ensure greater clarity of the provision".

6. Summary

Polish implementation of missing Solvency II Directive provisions at the moment closes the topic of introducing the new system into the insurance industry.

New provisions are crucial for practical aspects of conducting the insurance and reinsurance activity in Poland and should be welcomed by Polish insurance industry. They solve problems that many insurance companies have been facing in their everyday activity. That is especially applicable to co-insurance, where the lack of regulations raised questions how the responsibilities and obligations should be shared by cooperating insurers.

The absence of legal framework for captive insurance undertaking was also visible, as the form of mutual company has been replacing this activity. Hopefully, we shall observe the growth of this activity on the Polish market.

Furthermore, the recent amendment of the Insurance and Reinsurance Act has been a good example of the important role of the European Commission acting as a guardian of the proper implementation of European Law into the Member countries' legal systems.

Beata Mrozowska-Bartkiewicz
Legal counsel

Wprowadzenie dyrektywy Wypłacalność II do polskiego prawa ubezpieczeniowego – transpozycja uzupełniająca

W artykule autorka omówiła problematykę niedawnej nowelizacji ustawy z dnia 11 września 2015 r. o działalności ubezpieczeniowej i reasekuracyjnej i innych ustaw. Przedmiotem noweli było pełne dostosowanie polskiego prawa do przepisów Unii Europejskiej odnoszących się do działalności ubezpieczeniowej i reasekuracyjnej. Przeprowadzenie zmian było spowodowane niedostateczną transpozycją do polskiego porządku prawnego przepisów dyrektyw Wypłacalność II i Omnibus II, które zostały implementowane na podstawie ustawy z dnia 11 września 2015 r. o działalności ubezpieczeniowej i reasekuracyjnej.

Słowa kluczowe: koasekuracja, swoboda świadczenia usług, instrumenty pochodne, środki przejściowe, wewnętrzne zakłady ubezpieczeń, Wypłacalność II, Omnibus II.