IAIS

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INSURANCE SUPERVISORS

ISSUES PAPER ON SUPERVISION OF CROSS-BORDER OPERATIONS THROUGH BRANCHES

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Established in 1994, the IAIS is the international standard setting body responsible for developing principles, standards and other supporting material for the supervision of the insurance sector and assisting in their implementation. The IAIS also provides a forum for Members to share their experiences and understanding of insurance supervision and insurance markets. In addition to active participation of its Members, the IAIS benefits from input in select IAIS activities from Observers representing international institutions, professional associations and insurance and reinsurance companies, as well as consultants and other professionals.

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This paper was prepared by the Insurance Groups and Cross-Sectoral Issues Subcommittee in consultation with IAIS Members and Observers.

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1 Introduction

1.1 Background and objectives

1. Insurance cross-border activities are usually carried out through:

   (i) subsidiaries - legal entities which are wholly or majority owned or controlled by another legal entity, such as an insurer or insurance holding company;

   (ii) branches - operating entities which are not legal entities separate from an insurer but part of the insurer in terms of its organisation;

   (iii) joint ventures - legal entities jointly established by two or more parent institutions, at least one of which is incorporated in a different jurisdiction, and not all of which are necessarily insurers; and,

   (iv) cross-border provision of services - in some jurisdictions insurers also provide services on a cross-border basis without establishing a subsidiary, branch, or joint venture.

2. Supervision of foreign branches (those established in a jurisdiction other than that in which the insurer is headquartered) is an essential theme of cross-border supervision. However, there are few academic articles that review how foreign branches are supervised and examine how supervision of foreign branches is different from that of foreign subsidiaries (those established by an insurer or insurance group headquartered in a foreign jurisdiction).

3. This paper has two objectives:

   (i) to identify how foreign branches are supervised, highlighting differences as well as similarities in supervisory practices;

   (ii) to consider (possible) challenges in the supervision of foreign branches.

4. This paper looks at the prudential supervision of foreign branches writing both direct insurance and reinsurance. However its primary focus is on direct insurance. This paper does not deal with the market conduct supervision of foreign branches or the prudential supervision of branches established in a jurisdiction where the insurer is headquartered ("domestic branches"). The supervision of cross-border services as a general rule also falls outside the scope of this paper, however some references are made in order to provide a broader picture of particular issues.

5. In developing this paper the IAIS conducted a survey of its members and undertook a review of academic literature. Members from 35 jurisdictions participated in the survey[1] including ten G20 jurisdictions.

1.2 Literature review

1.2.1 Industry perspective

6. In considering how to supervise foreign branches, it is important to understand why insurers choose to operate as branches or subsidiaries when they operate internationally. As there appear to be few articles that study cross-border operation of insurers through branches, articles dealing with branch operations within banks were reviewed. Since both

[1] Australia, Austria, Belgium, Bermuda, Canada, Chile, Chinese Taipei, Costa Rica, France, Germany, Hungary, Korea, Japan, Jordan, Macau, Morocco, Netherlands, New Zealand, Peru, Poland, Portugal, Russia, Singapore, Slovakia, South Africa, Spain, Sweden, Switzerland, Trinidad and Tobago, Turkey, United Arab Emirates, United Kingdom, and United States (Michigan, Missouri, Washington).

banks and insurers are prudentially regulated and supervised financial institutions this review has provided useful insights for the supervision of insurance.

7. Cerutti et al. (2007)[2] provide observations from two perspectives: exogenous and endogenous. Although the article refers to cross-border operations of banks, these observations are also relevant to this discussion on the cross-border activity of insurance companies. Cerutti at al. identify four exogenous factors – regulations, taxation, degrees of penetration, and economic and political risks in host jurisdictions. Regulations may prohibit the establishment of foreign branches. They observe that branches are favoured in jurisdictions with higher corporate taxes. Branches are also more likely in jurisdictions with smaller scale operations, i.e. in jurisdictions with a lower market penetration. They also find that subsidiaries are more common in jurisdictions where economic risks are high so as to isolate the group from these risks, whereas branches are more likely in jurisdictions with high level of risks stemming from possible government intervention and other major political events. Cerutti also states that banks are actually more exposed when operating as subsidiaries, which typically have higher capital and reserve requirements and larger investments in local fixed assets, relative to branches.

8. Fiechter et al. (2011)[3] also examine endogenous factors and the exogenous factors highlighted above with reference to the banking sector. However their conclusions have also been considered in relation to the insurance sector. With respect to business models and market penetration strategy, they note that banks set up branches in jurisdictions where they target corporate clients, while they prefer subsidiaries when targeting retail customers. They also observe that branches are often associated with the centralised form of organisation where capital flows within a group are managed by the parent, while a group with a decentralised structure tends to set up subsidiaries which are independently managed and financially and operationally self-sufficient.

1.2.2 Supervisory perspectives

9. Fiechter et al. conclude that both branch and subsidiary structures have advantages from a supervisory perspective although the home and the host supervisors may have competing priorities. They find that the host supervisor has greater supervisory control over, and oversight responsibility for, subsidiaries than branches and the opposite is true for the home supervisor. Fiechter et al. observe that host supervisors prefer a subsidiary structure so that they can protect depositors appropriately as there is increased uncertainty over the control of assets and capital in a branch structure.

10. As for the transferability of assets, Fiechter et al. observe that during times of stress, a banking group with a centralised organisation structure that operates through branches outside the home jurisdiction is able to transfer funds from healthy entities to a troubled entity, or draw on the excess capital from the host jurisdiction. They also note that host supervisors prefer the subsidiary structure when facing adverse external shocks but prefer the branch structure when facing domestic shocks, while the opposite is true for the home supervisor. The subsidiary structure may serve to protect the interests of individual subsidiaries, while the branch structure may receive financial support from the parent.

[2] Cerutti, E., Dell'Ariccia, G., Martínez Pería, M., 2007. How banks go abroad: Branches or subsidiaries? Journal of Banking & Finance 31 (2007) 1669-1692.

[3] Fiechter, J., Ötker-Robe, İ., Ilyina, A., Hsu, M., Santos, A., Surti, J., 2011. Subsidiaries or Branches: Does One Size Fit All? International Monetary Fund, SDN/11/04.

1.3 Overview of business practices and supervisory requirements

1.3.1 Business practices

11. The motives identified in Section 1.2 for establishing international bank operations through branches may also apply in the insurance sector. Taxation is also an important factor. Branches may also be a preferred option for initial market penetration as set up costs are often lower than that for subsidiaries and for operations in jurisdictions experiencing a higher political risk profile. The branch structure seems to be more common among insurers conducting wholesale business in other jurisdictions. For example, a number of reinsurers operate cross-border through branches, or through cross-border provision of services. Even though in the majority of jurisdictions foreign insurers are allowed to choose the form of operation, in some jurisdictions, such as Russia and South Africa, it is prohibited to establish branch operations.

12. Insurers (or insurance groups) and insurance industry associations ("the industry") maintain that branches are less costly to operate than subsidiaries. Branches, for example, usually do not require a separate board of directors and in some jurisdictions they are subject to fewer regulatory requirements. The industry argues that, due to the lower operating costs, insurers can supply products at lower prices, thus benefitting policyholders. Additionally, they point out that foreign branches have access to the capital of the parent – this is a benefit that should not be underestimated. It is particularly important for reinsurance business where size is critical.

13. Insurers choose their own business structure, which is supported by the General Agreement on Trade in Services (GATS) [4] and the OECD Code of Liberalisation of Current Invisible Operations. The GATS states that "measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service" are defined as one of the measures "which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its Schedule." At the same time however, the GATS also states that "a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system"[5] to the extent that such measures are not used as a means of avoiding the Member's commitments or obligations under the GATS. Such measures are often referred to as "prudential carve out(s)". The OECD Code of Liberalisation of Current Invisible Operations is a legal instrument under which OECD members have made commitments in respect of the treatment of cross-border provision of financial services and commercial presence. The OECD Code stipulates that "Members may take regulatory measures in the field of insurance and pensions, including the regulation of the promotion, in order to protect the interests of policyholders and beneficiaries, provided those measures do not discriminate against non-resident providers of such services."

1.3.2 Supervisory requirements

14. There are three differences in the supervision of foreign branches: (i) differences among jurisdictions; (ii) differences between foreign branches conducting primary insurance and those conducting reinsurance; and (iii) differences between domestic insurers (including foreign subsidiaries) and foreign branches.

15. The most prominent difference among jurisdictions was observed between the European Economic Area (EEA) and other jurisdictions. The unique supervisory regime adopted in

[4] General Agreement on Trade in Services, Part III, Article XVI, Paragraph 2 (e).

[5] General Agreement on Trade in Services, Annex on Financial Services, Paragraph 2 (a).

the EEA is based upon freedom of establishment and freedom to provide services. Under the regime, once insurers headquartered in a jurisdiction within the EEA are licensed, they are free to operate within the EEA by establishing branches (on the basis of freedom of establishment) or without permanent presence in a host jurisdiction (on the basis of freedom to provide services). In addition, the EEA host supervisor has, in principle, no prudential supervisory authority over the intra-EEA foreign branches in its jurisdiction. (For details about EEA freedom of establishment and freedom to provide service, see Case study 1.)

16. It is worth highlighting the supervisory regime established between the European Economic Community and the Swiss Confederation (L205). An agreement adopted is related to activities of direct insurance (except for life assurance) carried out through a branch established in a different jurisdiction to that of the agreement, with the aim to ensure the freedom of establishment. In particular, in accordance with the scope and terms agreed, the supervisor in the jurisdiction where the insurer is headquartered is in charge of solvency supervision of branches established in other jurisdictions under the regime. In other words, insurers licensed by an EEA jurisdiction may operate in Switzerland through branches for which the supervisor in the home jurisdiction has a responsibility of solvency supervision. Insurers licensed in Switzerland may operate within the EEA through branches for which the supervisor in Switzerland has a responsibility of solvency supervision. The agreement includes specific rules for cooperation between the home and the host supervisors in terms of solvency supervision.

17. For reinsurance branches, it was observed that (i) reinsurers tend to operate through branches rather than subsidiaries and (ii) even within the EEA reinsurers establish branches as well as subsidiaries. According to the limited information collected through the survey however, it appears that foreign reinsurance branches are likely to be subject to similar regulation and supervision as foreign primary insurance branches. Supervisors assess the profitability (performance), asset quality, liquidity, leverage, and overall financial position, etc. of reinsurance branches, but reinsurers appear to have the impression that supervisors are less likely to routinely drill down into these areas for a number of reasons, such as the degree of sophistication of policyholders. Reinsurers also observe that local regulatory approval and requirements would not be likely to differ for traditional insurance branches and reinsurance branches, while the depth and level of on-going monitoring activities are likely to vary based on the inherent differences between traditional and reinsurance branches described above.

18. The survey highlighted three major differences between the supervision of subsidiaries and branches: (i) foreign branches are generally subject to requirements regarding location and control of assets (in many jurisdictions, foreign branches are required to hold assets covering financial commitments and backing their insurance liabilities in host jurisdictions), and in a very few jurisdictions foreign branches are required to obtain approval from the host supervisor prior to accessing the assets backing insurance liabilities; (ii) foreign branches are not required to establish Boards of Directors as branches are not legal entities and in some cases certain control functions of a branch can be performed by the insurer in its home jurisdiction where the company has a Board; and (iii) several jurisdictions do not conduct suitability checks of representatives of a foreign branch.

19. The rest of this paper is structured as follows: Chapter 2 deals with regulation of foreign branches; and Chapter 3 addresses supervisory approaches to foreign branches. Chapter 4 focuses on resolution of foreign branches. Chapters 2 to 4 are developed based on findings from the survey. (Possible) challenges in supervision of foreign branches and possible approaches to meet such challenges are discussed in Chapter 5. In addition, paragraphs in Chapters 2 to 4 refer to regulation, supervision and resolution regimes, respectively, for foreign branches other than those established within the EEA by insurers headquartered in other EEA jurisdiction (hereinafter referred to as “intra-EEA branch” or

"intra-EEA branches"), unless otherwise specified. (When intra-EEA branch specific issues are referred to, such paragraphs say, for example, "in the case of intra-EEA branches" for clarification purposes.)

2 Regulation of foreign branches

20. This Chapter examines the licensing, financial commitment, business, governance, and solvency of foreign branches based on the findings from the survey. Observations with respect to the regulation of intra-EEA branches are made at the end of each subsection. [6]

2.1 Licensing

21. Most jurisdictions require foreign branches, including reinsurance branches, to be licensed. In number of jurisdictions the requirements are the same as those for foreign subsidiaries and domestic insurers. Some jurisdictions have different licensing requirements for foreign branches and may, for example, require less paid-in capital and/or deposits, while other jurisdictions have common licensing requirements for foreign branches.

22. The extent to which cross-border provision of services is permitted varies across jurisdictions. Where cross-border provision of services is permitted, the scope is usually limited.[7]

23. In the EEA jurisdictions, an insurer whose head office is outside the EEA is subject to an official authorisation in the host jurisdiction in accordance with Article 23(1) of the Directive 73/239/EEC concerning non-life and Article 51(1) of the Directive 2002/83/EC concerning life assurance. According to Article 23(2b) of Directive 73/239/EEC and Article 51(2b) of Directive 2002/83/EC, the establishment of an agency or branch in the territory of an EEA Member State is one of the conditions for authorisation of the foreign insurer.

24. In most EEA jurisdictions, it is also possible for a non-EEA reinsurer to set up a branch. Some EEA jurisdictions make the establishment of a branch mandatory for non-EEA reinsurers, and the majority of these jurisdictions require a full authorisation process, which is equivalent to that required of a subsidiary.

25. Provision of services on a branch basis within the EEA is subject to a notification requirement only. Reinsurers from other EEA jurisdictions operating under a freedom to provide services (when a reinsurer has no permanent presence within the jurisdiction) are permitted to do so in the majority of EEA Member States without a formal authorisation requirement although usually under special conditions.[8]

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[6] EEA-related descriptions in the paper reflect those under the current Solvency I Directives. These directives are in the process of being repealed and replaced with a new Directive, Solvency II (Directive 2009/138/EC). The Solvency II Directive would make a number of changes to the rules that apply to foreign branches and the European Commission has specifically asked the European Insurance and Occupational Pensions Authority (EIOPA) to produce guidelines to ensure an appropriate level of harmonisation amongst supervisory authorities in Member States in this area.

[7] Examples include maritime shipping; commercial aviation; goods in transit but also insurance of risk with regard to which an insured person has received a written refusal to conclude an insurance contract from at least three insurance companies authorised in a particular jurisdiction (in Poland); insurance of risk located outside the jurisdiction, if the concluding of insurance contract with the local insurance undertaking is required by law in force in that country; insurance of risk which is required under international agreement to be insured in a particular insurance company.

[8] Please refer to the CEIOPS's Report on the responses to the Questionnaire on the Regulatory Treatment of Third Country Reinsurance Undertakings and on Existing Equivalence Procedures.

https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/CEIOPS-ConCo-05-09-report-questionnaire-treatment-of-3rd-countries-reinsurers.pdf

2.2 Financial commitments

26. In most jurisdictions a foreign branch is required to make financial commitments, i.e. to hold a certain amount of assets when it is set up, as one of the licensing requirements. Such financial commitments are sometimes called "brought-in capital" or "deposits." They are backing (part of) capital (or assets over liabilities) and thus are different from assets backing liabilities. According to the survey, all jurisdictions (except for Bermuda) require foreign branches to hold such assets in the host jurisdiction, but details of the requirements vary jurisdiction by jurisdiction.

27. Some jurisdictions determine the amount required on a risk basis, while others require the same amount of brought-in capital or deposit amount from all foreign branches. (In the latter case, it does not mean that foreign branches are not subject to risk-based solvency requirements.) There are various ways to hold such assets - many jurisdictions require the assets to be deposited in a bank in the host jurisdiction, while others require them to be held in trust with a trustee. It is also worth mentioning that some jurisdictions require foreign branches to obtain approval from the host supervisor before accessing the assets. The following table summarises the survey results regarding financial commitments for foreign branches (excluding intra-EEA branches).

Jurisdiction	Is a foreign branch required to make financial commitments in the host jurisdiction?	Are the commitments deposited in a bank account or held in trust with a trustee in the host jurisdiction?	Is prior approval from the host supervisor required when the branch intends to access the assets?	Do the same requirements apply to domestic insurers/foreign subsidiaries?
Australia	Yes[9]	Other[10]	Yes[11]	Yes
Bermuda	No[12]	NA	NA	Yes
Canada	Yes[13]	Held in Trust	Yes[14]	No
France	Yes[15]	Other[16]	Yes	No
Germany	Yes	Deposited	Yes	No
Italy	Yes	Other[17]	Yes	No
Japan	Yes[18]	Other[19]	No	No
Korea	Yes	Deposited	No	Yes

[9] The amount at least corresponding to PCR needs to be held in the host.

[10] Held by custodians or agents in the case of non-life. In the case of life, a foreign branch is required to hold them in statutory funds (i.e. separate account). A life insurer is required to establish statutory funds that relate solely to the life insurance business of the insurer or a particular part of that business. A statutory fund includes all the assets related to the business of the fund and all liabilities (including policy liabilities) of the insurer arising out of the conduct of the business of the fund. Any other assets and liabilities of the insurer are held in the shareholders' fund.

[11] Prior approval is not required in all circumstances, insurers must seek APRA's consent for certain planned capital reductions and must inform APRA of any significant adverse changes in the capital position.

[12] Branches are required to make financial commitments as one of the licensing requirements, although they are not required to make such commitments in Bermuda. While there is not a requirement, under certain circumstances, the supervisor has power to require assets to be kept in Bermuda. There is a requirement for pre-approval prior to certain planned capital reductions.

[13] Assets covering capital (i.e. assets over liabilities).

[14] Except for limited cases, for example, when the asset withdrawn is replaced, either prior or simultaneously, with a similar asset.

[15] A surplus corresponding to 30% of the increase of the level of technical provisions from one year to another. As of reciprocity, additional financial commitments can be required from foreign branches if the home country requires the same commitments from French branches.

[16] Deposited by the "Caisse des Dépôts et Consignations" or on an account by the "Banque de France."

[17] An amount equal to at least the minimum guarantee fund shall be invested in Italy. An amount in cash or bonds equal to at least one-half of the minimum guarantee fund shall be deposited as security with Cassa depositi e prestiti or with the Bank of Italy. The provision does not apply to Swiss non-life branches.

[18] 200 million JPY.

[19] Deposited with the deposit office.

Jurisdiction	Is a foreign branch required to make financial commitments in the host jurisdiction?	Are the commitments deposited in a bank account or held in trust with a trustee in the host jurisdiction?	Is prior approval from the host supervisor required when the branch intends to access the assets?	Do the same requirements apply to domestic insurers/foreign subsidiaries?
Netherlands	Yes[20]	Deposited	Yes	No
Poland	Yes	Deposited	Yes[21]	No
Singapore	Yes	Other[22]	No	Yes
Spain	Yes[23]	Deposited	Yes[24]	Yes[25]
Switzerland	Yes[26]	Deposited[27]	Yes	Yes
UAE (Dubai)	Yes[28]	No[29]	No	Yes
U.K.	Yes[30]	Deposited	No	No
U.S. (Michigan)	Yes	Deposited	Yes	Yes
U.S. (Missouri)	Yes[31]	Deposited	Yes	Yes
U.S. (Washington)	Yes	Held in Trust	Yes	Yes

28. In the EEA, pursuant to relevant EU directives, foreign branches (excluding intra-EEA branches) are required to possess assets of the value equal to at least one-half of the minimum amount of guarantee funds[32] in the EEA and to deposit one-fourth of the minimum amount as security.[33]

29. Intra-EEA branches are not required to lodge financial commitments in EEA jurisdictions.

2.3 Business

30. Most jurisdictions do not permit an insurer to write both life and non-life business within a single entity. In a few jurisdictions however, a foreign branch may engage in both life and non-life business within a single entity under certain conditions.

[20] An amount equal to at least half of the so-called minimum amount of the guarantee fund needs to be deposited.

[21] Not explicitly expressed in the legislation.

[22] Maintained in separate bank accounts or custodian accounts from those of the Head Office.

[23] Not applicable to Swiss non-life branches. The amount is not smaller than that of capital or mutual funds required for Spanish (re)insurers. The amount is determined depending on class(es) of bussines engaged and receives the denomination of “permanent fund with the head office that needs to be maintained in Spain."

[24] The requirement on the deposit is extended only to the one fourth of the minimum amount of the guarantee fund. If the branch intends to access the mentioned deposit the prior approval of the Spanish Authority should be required.

[25] In terms of the amount.

[26] FINMA determines the required amount of the organisational fund of each foreign branch. The amount ranges from 20% to 50% of the minimum capital requirement. In addition, a security deposit, proportionate to the solvency margin related to the business in Switzerland, is to be established. FINMA determines the amount. In addition, there is a requirement of a minimum amount to be held for restricted assets (ISO, Art. 70). When first established, the required amount of restricted assets is at least: CHF 750’000 for Life insurance business; CHF 100’000 for Non-Life insurance business.

[27] Organisational funds (paid-in capital) are deposited in a bank account in Switzerland. Security deposits (proportionate to solvency margins) are held at the Swiss National Bank.

[28] Assets in excess of their insurance liabilities.

[29] No requirement on how the assets are held.

[30] Except for reinsurers and Swiss non-life insurers.

[31] $600,000 for life companies and $1.2 million for property & casualty companies.

[32] Required capital amounts to the value of solvency margin or guarantee funds. The guarantee fund amounts to one-third of the solvency margin or the minimum amount stipulated in the directives. Apart from these required capital, branches are obliged to maintain technical provisions.

[33] Article 23 (2) (e) of the First Non-Life Directive (73/239/EEC) and Article 51 (2) (e) of Consolidated Life Directive (2002/83/EC).

31. Compared to foreign subsidiaries and domestic insurers foreign branches tend to carry out fewer operations. According to the survey, material operations, such as underwriting, claims management, record keeping, and management of policyholders' information, are mostly performed at the foreign branch level, while few foreign branches engage in intermediation (brokerage). This is because insurance companies do not necessarily sell their products themselves but do so through brokers.

32. For intra-EEA branches, fewer operations are carried out at the branch level compared to those by non-EEA branches. Only a few EEA jurisdictions have the same list of operations to be done at the branch level for both EEA and non-EEA branches.

2.4 Governance

33. While there may be some elements of oversight and governance requirements imposed on a foreign branch in the host jurisdiction, critical governance and oversight functions of the branch are generally located in the head office. This implies, for example, that strategic decision making (including decisions around capital) would not take place in the jurisdiction of the branch.

34. As a general rule, a foreign branch (including an intra-EEA branch) is required to identify a representative in a host jurisdiction. In general the representative performs management functions and/or represents the insurer with regard to the branch's operations. Although there are likely to be responsibilities in accordance with the host jurisdictional regime, generally the representative will not have the same legal obligations as those of board members in terms of governance

35. In most jurisdictions, a foreign branch is required to have in place functions such as compliance, actuarial, risk management, internal and external audit. In some jurisdictions legislation on the mandatory functions provides for exceptions (e.g. control functions can be established at the level of a parent insurer). Most jurisdictions do not require a branch to have its own board of directors because a branch is not a legal entity.

36. In some jurisdictions (e.g. Australia[34], Bermuda, Chile) one person has the general responsibility for the overall operations and functions of a foreign branch performed at the branch level.

37. There is no overall pattern with regards to suitability checks of persons with responsibilities for the operations of a foreign branch. In some cases, the host supervisor alone carries out the suitability checks, while in other cases, both home and host supervisors are responsible for the assessment. In some jurisdictions the activity is conducted by the branch itself.

38. For intra-EEA branches control functions in branches are not obligatory.

2.5 Solvency

39. Solvency requirements for branch operations can be similar to those of foreign subsidiaries.

40. In almost all the jurisdictions, supervisors require branches to calculate a solvency margin and report a branch solvency margin.

41. In some jurisdictions, when the host supervisor recognises the home solvency regulation of the branch as equivalent, a solvency margin can be calculated following the principles of the home jurisdiction.

[34] In the case of a life insurance, the Compliance Committee has general responsibility for the branch.

42. In most of the cases, branches are required to book contracts that they underwrite for residents in the host jurisdiction on the branch balance sheet.

43. In the case of intra-EEA branches, branches are not required to calculate a solvency margin at the branch level, since the solvency margin is calculated for the whole entity and monitored by the home supervisor. As a consequence, branches do not have to provide the host supervisor with solvency reporting at the branch level. Regarding booking requirements, insurance contracts underwritten at the intra-EEA branch level are booked in the balance sheet of the parent insurer in the home jurisdiction.

2.6 Assets backing insurance liabilities

44. In most jurisdictions foreign branches are required to hold assets backing insurance liabilities (in some jurisdictions such assets are called “tied assets”) in the host jurisdiction. According to the survey, Austria, Belgium, Bermuda, Chile, Germany, Jordan, Peru, and Singapore do not have this requirement. Foreign branches in Germany need to hold tied assets within the EEA, and in Bermuda and Singapore the supervisor has power to require foreign branches to hold such assets in their jurisdiction where deemed necessary.

45. Unlike financial commitments in Subsection 2.2, many jurisdictions do not require assets backing insurance liabilities to be deposited in a bank account or held in trust in the host jurisdiction. Exceptions are Canada, Germany in case of life insurance, substitutive health insurance and compulsory long-term care insurance and U.S. states (which require such assets to be held in trust) and Korea (which requires deposits). A small number of jurisdictions require prior approval from the host supervisor when a branch intends to access the assets held in trust (e.g. withdraw or transfer (part of) the assets). An observation is that assets backing insurance liabilities, though they are required to be placed in the host jurisdiction, tend to be easily accessible and transferable, and prior approval from the host supervisor is not required when the branch accesses the assets (though this may be a breach of the law). The following table summarises the survey results regarding assets backing insurance liabilities for foreign branches (excluding intra-EEA branches).

Jurisdictions	Is a foreign branch required to hold assets backing insurance liabilities in the host jurisdiction?	Are the assets deposited in a bank account or held in trust with a trustee in the host jurisdiction?	Is prior approval from the host supervisor required when the branch intends to access the assets?	Do the same requirements apply to domestic insurers/foreign subsidiaries?
Australia	Yes[35]	Other[36]	No[37]	Other[38]
Bermuda	No[39]	NA	NA	Yes
Canada	Yes[40]	Held in trust	Yes[41]	No
France	Yes[42]	Other[43]	Yes	No
Germany	No[44]	Held in trust[45]	No	Yes
Italy	No[46]	No	No	Yes
Japan	Yes[47]	No	No	Yes
Korea	Yes	Deposited	No	No
Netherlands	Yes	No	No	Yes
Poland	No[48]	NA	NA	Yes
Singapore	No[49]	NA	NA	Yes
Spain	Yes	No	No	No[50]

[35] Non-life: assets in Australia must exceed the liabilities in Australia. Life: sufficient assets to meet the liabilities relating to that business.

[36] Non-life: held by a branch's custodians or agents. Life: held in the statutory fund. (In the case of non-life, where assets are held by custodians, they must satisfy the requirements set out in APRA's prudential framework, although some assets are not required to be held by a custodian or the foreign branch's agent in Australia, including real property, premiums receivable (provided that any premiums receivable outstanding for more than six months from the date when the premiums receivable became due and payable are excluded from being an asset in Australia), and, cash held in the foreign branch's bank account in Australia.)

[37] However insurers must seek APRA's consent for certain planned capital reductions and must inform APRA of any significant adverse changes in the capital position.

[38] Non-life: domestic insurers and foreign subsidiaries general insurers are required to hold assets in Australia in excess of their Australian liabilities (i.e. all liabilities in Australia), although there is no requirement that they are held with a custodian or agent in Australia. Life: foreign branches are subject to similar legislative and prudential requirements to Australian-owned and incorporated life companies, for business which is carried out through Australian statutory funds.

[39] Branches are required to demonstrate that they have available adequate capital to support the liabilities of the branch in Bermuda in other jurisdictions. While there is not a requirement, under certain circumstances, the supervisor has power to require assets corresponding to the value of Bermuda insurance liabilities of a branch to be kept in Bermuda under an approved trustee of the Authority and such assets cannot be removed without the Authority's consent in the event it was felt that these measures were necessary. There is a requirement for pre-approval prior to certain planned capital reductions.

[40] Assets covering all liabilities.

[41] See footnote 12.

[42] There is a predefined list of assets that insurance companies can hold to cover insurance liabilities.

[43] Assets covering technical provisions must be deposited by the "Caisse des Dépôts et Consignations" or on an account by the "Banque de France", which are both public institutions (Art. R332-37 and following of the Code des Assurances).

[44] Assets backing insurance liabilities have to be hold within the EEA.

[45] In case of life insurance, substitutive health insurance and compulsory long-term care insurance.

[46] Third country branches may localise assets representing technical provisions in one or more EEA States. At the undertaking's request, ISVAP may authorize the localization of part of the assets in a third State. ISVAP may however require that such assets shall be localized in Italy wherever that is deemed necessary to protect the interests of policyholders and of those entitled to insurance benefits. This provision does not apply to reinsurers.

[47] Assets backing insurance liabilities.

[48] There is no requirement to keep the assets in the territory of Poland. However in a case where the risk is located in the territory of a European Union Member State, the assets may be invested solely in the territory of the European Union Member States.

[49] But, MAS has the power to require any insurer, on a case-by-case basis, to maintain certain assets in Singapore for the purpose of meeting liabilities. In addition, investable assets of the foreign branch in Singapore have to be separately identified in the name of the foreign branch in Singapore, and maintained in separate bank accounts or custodian accounts from those of the Head Office.

[50] The assets in the case of domestic insurers/foreign subsidiaries, with the exception of the credits towards reinsurers, can be situated in any Member State of the EEA. Subject to the appropriate authorisation, the assets covering the tecnhnical provision could be situated outside the EEA.

Jurisdictions	Is a foreign branch required to hold assets backing insurance liabilities in the host jurisdiction?	Are the assets deposited in a bank account or held in trust with a trustee in the host jurisdiction?	Is prior approval from the host supervisor required when the branch intends to access the assets?	Do the same requirements apply to domestic insurers/foreign subsidiaries?
Switzerland	Yes	Other[51]	No	Yes
UAE (Dubai)	Yes/No[52]	No	No	Yes
U.K.	Yes[53]	No	No	Yes
U.S. (Michigan)	Yes[54]	Held in Trust[55]	Yes[56]	No
U.S. (Missouri)	No	NA	NA	Yes
U.S. (Washington)	Yes[57]	Held in Trust[58]	Yes	No

3 Supervision of foreign branches

3.1 On-site inspection

46. In most jurisdictions a host supervisor has an explicitly granted power to conduct an on-site inspection of a foreign branch located in its jurisdiction. Belgium, Costa Rica, New Zealand and Sweden grant such a power to both home and host supervisors. Participation of the home supervisor in on-site inspections of a branch in a host jurisdiction is possible in many jurisdictions on the basis of an agreement, such as a Memorandum of Understanding between the home and the host supervisor, or with prior agreement from the host supervisor.

47. According to EU directives in the case of intra-EEA branches, the home supervisor in a jurisdiction within the EEA may, after having first informed the host supervisor, carry out

[51] The Swiss Insurance Supervisory Ordinance (ISO) regulates the custody of investments as follows (Art. 86): Moveable investments allocated to restricted assets may be held at the headquarters of the insurance business in Switzerland, or at the office for all Swiss business, as applicable, (own custody) or be held by a third-party custodian; investments held in own custody are to be kept segregated from the other assets of the insurance business and are to be marked as such. If stored in a safe, storage in segregated, locked compartments is sufficient; whoever maintains investments with a third-party custodian shall maintain an inventory of the investments and shall mark them as allocated to restricted assets; FINMA may at any time for important reasons order a change of the location of custody.

[52] Assets may be held outside of our jurisdiction due to regulatory obligations elsewhere. This may be recognised on a case by case basis.

[53] Except for reinsurers and Swiss non-life insurers.

[54] In the case of reinsurance, trusteed assets could be reduced assuming the provisions for receiving this credit have been met. Cessions which do not meet the credit for reinsurance requirements must be collateralised by an amount equal to the credit for reinsurance - this collateral does not need to be held exclusively within the Michigan trust.

[55] Under the direction of the Michigan Insurance Commissioner. The trustee must be a Qualified United States Financial Institution, which means any state or nationally chartered bank or trust company, organised under the laws of any state or of the United States that has been granted authority to operate with fiduciary powers.

[56] Trusteed assets are restricted in that they are under the control, ultimately, of the Michigan Insurance Commissioner. The Commissioner is a party to the trust agreement, which is also signed by the trustee and the branch. It should be noted, however that a branch might have assets reported on the regulatory state that are not in trust. These assets (i.e., the non-trusteed assets) may be used to pay valid claims of the branch. In short, while approval from the Commissioner is needed to access the trusteed assets to pay claims, it is also possible that a branch would be paying claims using non-trusteed assets to minimise the need to request approval from the Commissioner for a release of assets, since otherwise they are not allowed. The legislation requires 15 days advance notice to the Commissioner when the Commissioner's prior approval is required. From a supervisory review perspective, the supervisor would perform a review of the request, including the reason for the release, and make a recommendation to the Commissioner for such release (if approval is granted by the Commissioner, a letter would be sent to both the company and the trustee indicating such approval and the amount to be released). The supervisor monitors trust assets quarterly through a review and reconciliation of trust statements (which are filed quarterly by the trustee; the trustee also certifies the assets in trust on the Trusteed Surplus Statement; the Trusteed Surplus Statement is filed quarterly by the branch and comes in with the quarterly or annual statement filing). The supervisor requires that the trust statements be filed with OFIR monthly.

[57] Held in the state of a primary supervisor.

[58] Similar to Michigan.

an on-site inspection of the branch in the host jurisdiction. The host supervisor may participate in the on-site inspection carried out by the home supervisor. This is also addressed by the General Protocol,[59] which provides detailed rules for on-site inspection of branches, including cooperation between home and host supervisors of relevant EEA member states.

3.2 Off-site monitoring

48. In most jurisdictions a host supervisor has the power to carry out off-site monitoring of a foreign branch. In Austria, France, Jordan and Taiwan, both home and host supervisors have this power. In some cases cooperation in this regard is carried out on the basis of a Memorandum of Understanding (MoU).

49. According to EU law, [60] financial supervision of an EEA insurance or reinsurance company, including the business carried out through branches, is the sole responsibility of the home Member State supervisor. If the EEA host supervisor believes the activities of an (re)insurer carried out through a branch may affect its financial soundness it shall inform the home supervisor.

3.3 Supervisory reporting and public disclosure

50. Most host jurisdictions require the submission of audited financial statements on a branch basis, while some, such as Michigan, Missouri, Switzerland, and the UK do not.

51. As a general rule, foreign branches are required to disclose information to the public. Most jurisdictions require audited financial statements to be disclosed, while in some jurisdictions branches are also required to disclose financial statements for solvency purposes, information on risk management systems, on parent company and group structure, or on governance systems. Usually, the disclosures required of branches are the same as those for foreign subsidiaries and domestic insurers.

52. Preparation of financial statements and disclosure of information to the public is not required for intra-EEA branches.

3.4 Supervisory intervention

3.4.1 Intervention power

53. In most jurisdictions a host supervisor has the power to intervene in a foreign branch. In a few jurisdictions, such as Turkey and Dubai, legislation may enable a home supervisor to act in the host jurisdiction with the agreement of the host supervisor as per the legislation in the host jurisdiction.

54. With regard to intra-EEA branches, the primary responsibility for intervention in a branch whose parent is in the EEA rests with the home supervisor as the prudential supervisor. The host supervisor also has such an authority in the case of supervision of conduct of business. Where conduct of business is concerned, the host supervisor can intervene either on the express request of the home supervisor or, under the EU Directives and General Protocol, where prompt action is required.

[59] General Protocol relating to the Collaboration of the Insurance Supervisory Authorities of the Member States of the European Union (Revised Siena Protocol), March 2008

[60] Article 10(1) of Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance, Article 13 of Directive 73/239/EEC as amended by Directive 92/49/EEC, Article 15(1) of Directive 2005/68/EC on reinsurance

55. It was observed by one jurisdiction that the ability to intervene as a host jurisdiction via the home jurisdiction might be achieved by indirect means. Equally, whilst the legal framework may not provide specific conduits for a home supervisor to act in a host jurisdiction, such a matter may be covered by bilateral agreements.

3.4.2 Prohibition of assets transfer

56. In some cases, especially at the time of crisis, assets held by a foreign branch could be transferred to other jurisdictions (sometimes subject to a direction of its parent). Many jurisdictions have the power to prohibit the transfer of assets to other jurisdictions in order to protect policy holders.

57. Intervention powers vary among jurisdictions. While an early intervention framework goes towards ensuring sufficiency of assets, the stage at which authorities intervene and the mechanisms that can be used differ among jurisdictions. Some supervisors[61] have a permanent power to prohibit the transfer of assets to the parent, while others[62] may exercise such power only in distress situations such as the case where an insurance company is put under a special administration regime due to financial difficulties. According to the survey results, several supervisors have successfully used such powers in the past.

3.4.3 Imposition of additional capital or provisions

58. When it is likely that capital or technical provisions of the foreign branch would breach minimum requirements, the host supervisor in many jurisdictions has power to require the foreign branch to hold additional capital or increase technical provisions. Many jurisdictions have predefined triggers for capital increases. One jurisdiction states that capital increases are required where the firm falls below 100% of its risk based capital; other reported thresholds were 150% and 200% of the respective solvency requirement.

59. Host supervisors typically have the power to require increases to both capital and technical provisions. In Switzerland the supervisor does not have power to require increases to solvency capital of foreign branches as the capital is held by the parent company. However it has the power to require an increase to the organisation fund of the foreign branch as well as to technical provisions which subsequently will lead to an increase in tied assets. A few jurisdictions, such as Dubai, Chile, and Sweden do not have such a specific power to require increases to capital or technical provisions of the foreign branch as a host supervisor.

60. In the EEA jurisdictions, host supervisors of intra-EEA branches do not have such power. Their power in relation to branches of insurers headquartered in Switzerland differs: some have power to increase both, whereas others only have power to increase capital.

3.4.4 Conversion to subsidiary

61. According to the survey, most jurisdictions, including EEA jurisdictions, do not have a specific power to require a foreign branch to convert to a subsidiary. Nevertheless, it should be noted that several jurisdictions responded that they may ask the foreign branch to convert to a subsidiary on a voluntary basis in certain circumstances.

62. Several supervisors in the EEA state that they may use persuasion to encourage an applicant firm to establish a subsidiary rather than a branch. One jurisdiction notes that they may request the applicant to form a subsidiary if the risk profile of the firm warrants it. Another jurisdiction states they would ask that a subsidiary be formed if warranted by size,

[61] Please refer to sections 2.2 and 2.6.

[62] For example New Zealand.

market share and policyholder protection issues. The UK's Prudential Regulatory Authority (PRA) has indicated in its planned supervisory approach to insurance supervision for UK branches of non-EEA [63] insurers that in some circumstances "…the PRA will refuse authorisation of the branch. It may instead decide to authorise a stand-alone subsidiary, in which case it may limit the interlinkages with the rest of the group or ring-fence the subsidiary (for example where it considers the home supervisor does not deliver effective consolidated supervision)." The document also states that "…where the PRA has assured itself over the home regulator's supervisory approach, the PRA relies where possible on the home regulator's prudential supervision." Two jurisdictions noted they had encouraged an EEA insurance company to establish a subsidiary instead of a branch. In one case the situation arose in regard to the transfer of business to a new entity. In another case, the supervisor considered it appropriate due to concerns over market share and policyholder arrangements.

3.4.5 Suspension of branch operations

63. Another measure that can be taken is to suspend business operations of the foreign branch. Suspension is typically triggered where the branch fails to meet its regulatory obligations. In most jurisdictions the host supervisor has the power to temporarily suspend the business operations of a foreign branch. In Singapore the home supervisor has the option of instructing the head office to suspend the activities of the foreign branch in a host jurisdiction where it is deemed appropriate to do so.

64. Under the EU directives and the General Protocol the EEA home supervisor has primary responsibility for the suspension of the business operations of intra-EEA branches. However the host supervisor may act using conduct of business regulations where the home supervisor's intervention is not successful or immediate action is required. Most EEA Member States, in respect of branches located within the EEA, jointly require the suspension of branches. Hungary noted that it had power in relation to the branches of Swiss life insurers, whereas Sweden noted that it could not act to suspend the activities of a Swiss branch.

3.4.6 Closure of a branch

65. Non-EEA respondents noted that the host has the power to close a foreign branch. In three jurisdictions, both home and host supervisors have this power. Triggers for closing a branch include the failure to comply with regulatory obligations or having written no business for a specified period of time, for example, six months in Switzerland or twelve months in Dubai.

66. With regard to intra-EEA branches, the home supervisor has the prime responsibility to act in closing a branch. However host supervisors may act to close a branch where there is an immediate need to avert a risk to the interests of policyholders. Three EEA respondents who answered specifically in relation to Swiss branches noted that the host had the power to close a Swiss branch. Sweden responded stating the home supervisor had the power to close a Swiss branch. Germany noted both home and host may close a Swiss branch.

3.5 Cross-border cooperation

67. Supervisors of foreign branches are very often members of colleges. Home supervisors usually encourage host supervisors to participate in colleges when a branch is significant for the insurer.

[63] The Prudential Regulation Authority's approach to insurance supervision (Bank of England Prudential Regulation Aurhotiry, April 2013, page 40): http://www.bankofengland.co.uk/publications/Documents/praapproach/insuranceappr1304.pdf.

68. Some supervisors are not members of a college but are occasionally involved in college activities upon invitation by the home supervisor. In some cases the home supervisor cooperates with the host supervisors bilaterally.

4 Resolution of foreign branches

69. The survey identified that mandates and powers of resolution authorities differ among jurisdictions. There are also differences in jurisdictional resolution frameworks applicable to foreign branches. These frameworks seem to be generally similar to those for subsidiaries. Branch resolution options can be summarised as follows:

- Rehabilitation: management, whether on its own or with assistance from authorities and compensation schemes, works to address identified issues in order to return the institution as a whole to a sound footing. This may involve exiting lines of businesses or activities through run-off, portfolio transfer, or partial sales.
- Run-off: allow the policies in force to run-off. In some jurisdictions there are specialist firms or the branch itself may administer the run-off. This may apply to a book of business, a specific branch or the entity as a whole.
- Restructuring: as a branch cannot be sold as a legal entity, the primary restructuring option available is via a transfer of the insurance business through portfolio transfer/assumption agreements.
- Wind-up: a final solution resulting in the liquidation of the assets of the branch.

4.1 Policyholder protection schemes

70. While the majority of jurisdictions have life and non-life policyholder protection schemes, a number of countries have indicated that such protection schemes have not (yet) been established. The majority of protection schemes do not cover policyholders in other jurisdictions.

4.2 Run-off

71. In most jurisdictions a host supervisor may require insurance contracts of the foreign branch to be placed in run-off. Certain EEA host supervisors of intra-EEA branches may not require insurance contracts of the foreign branch to be placed in run-off.

4.3 Portfolio Transfer

72. In most jurisdictions, the host supervisor may require the foreign branch to transfer the whole portfolio of insurance contracts to third parties. In a few jurisdictions the portfolio transfer is approved by the home supervisor (Costa Rica and Spain, in situations when the foreign branch's direct parent is in the EEA) or by both the home and host supervisors (Trinidad and Tobago and Poland, only in situations when the foreign branch's direct parent is in the EEA).

73. In EEA jurisdictions, this ability primarily depends on whether the parent is within the EEA. In most EEA Member States, when the foreign branch's parent is within the EEA, the host supervisor does not have the ability to require the foreign branch to transfer the whole portfolio of insurance contracts to third parties. However when the EEA Member State does not make a distinction between foreign branches according to where the direct parent is based, the host supervisor (with the exception of Belgium and the UK) has the

ability to require a foreign branch to transfer the whole portfolio of insurance contracts to a third party.

74. In most non-EEA jurisdictions, the host supervisor may require the foreign branch to transfer the whole portfolio of insurance contracts to third parties. However in a few of these jurisdictions this ability does not exist.

4.4 Insolvency proceedings in the home jurisdiction

75. In the majority of the EEA jurisdictions, regardless of whether the foreign branch has been categorised according to where the parent is based, it is not possible for a foreign branch to continue its operations if the parent in its home jurisdiction is subject to insolvency proceedings. The UK, for example, is an exception to this trend.

76. In the non-EEA jurisdictions, about half of the respondents said that it is possible for the foreign branch to continue its business operations even when the parent in its home jurisdiction is subject to insolvency proceedings. Half said that a foreign branch cannot continue its business operation when the parent in its home jurisdiction is subject to insolvency proceedings.

5 Possible challenges and approaches in supervision of foreign branches

5.1 Challenges in supervision of foreign branches

77. This chapter highlights possible challenges[64] in supervising foreign branches, although some of such challenges may also be applicable to foreign subsidiaries.[65]

78. Although home supervisors do not have direct supervisory power over foreign branches in the host jurisdiction[66] they may impose additional requirements on the licensed entity in the home jurisdiction when considering the situation of the foreign branch. It may occur that the home supervisor finds that material gaps exist in regulation and supervision between the two jurisdictions, which means that a certain area of a foreign branch's activity is regulated or supervised neither by the home nor by the host jurisdiction. In such case the home supervisor could consider how to deal with potential risks arising from such gaps. This could affect the parent[67] in the home jurisdiction (Parent) or other entities within the group (Other Group Entities).

79. In general, foreign branches are required to hold assets that correspond to their insurance liabilities and required capital (corresponding assets) in the host jurisdiction. From the home supervisor's point of view, such corresponding assets are not always available to the parent or other group entities.[68]

80. Access to and transferability of corresponding assets are critical to the host supervisor. In some jurisdictions the foreign branch may locate its corresponding assets outside the host jurisdiction. These assets may not necessarily be available for the protection of the

[64] This subsection focuses on describing (possible) challenges and/or difficulties in the supervision of foreign branches. Nevertheless, this subsection does not intend to imply nor should be read to imply that supervision of foreign branches is more difficult than that of domestic insurers and foreign subsidiaries.

[65] Analysing regulation and supervision of subsidiaries and thus analysing applicability of possible challenges in this Subsection as well as possible approaches in Subsection 5.2 to subsidiaries are not an objective of the paper.

[66] It should be noted that sometimes home supervisors do have such power and their supervision of the parent undertaking often includes all the undertaking's activities, wherever they take place, including through branches (as in the EEA for intra-EEA branches).

[67] An insurer in the home jurisdiction is not legally a "parent" of a branch in other jurisdictions. However the term "parent" is used in this Chapter for the purpose of simplification.

[68] In case of subsidiaries assets can be less available to the parent than in case of branches.

branch's policyholders. It must be stressed that location of assets is a critical issue of cross-border operations and not just a consideration for branch operations.

81. Even where the foreign branch is required to hold its assets in the host jurisdiction, the branch may not be required to obtain prior approval from the host supervisor to access the assets. Where prior approval is not required such assets could be transferred from the host jurisdiction to other parts of the group, where they may not be available for the protection of the foreign branch's policyholders. For example, where a foreign branch is financially sound but the parent in the home jurisdiction or the group as a whole is likely to become insolvent, the parent might seek to use the branch assets and put branch policyholders at risk of not having their claims paid in full. The liabilities of the branch are not only backed by assets in the host but also by assets in the home jurisdiction. In difficult times policyholders of the branch may seek support from the home jurisdiction. Nevertheless from the host supervisory point of view, it may be necessary to ensure that an adequate level of assets is maintained in the host jurisdiction for the protection of policyholders of the branch. Host supervisors consider issues related to availability and transferability of assets as one of the most significant challenges in branch supervision.

82. A challenge for the host supervisor may be the legal uncertainty that arises in applying supervisory tools to a branch. Some supervisory tools may have a different effect when applied to a branch rather than a legal entity within the jurisdiction.

83. Although this is not unique to branches, competing interests can sometimes occur between home and host supervisors due to their supervisory perspectives and objectives, and on such occasions the host supervisor may need to take actions to protect policyholders of the foreign branch.

84. Information asymmetry may also be a concern as host supervisors do not always receive information on the parent or the group as a whole in a timely manner. For example, if the host supervisor does not receive timely and accurately information about the condition of the parent in a crisis situation, the host supervisor may not be able to carry out supervisory actions with respect to the foreign branch in a timely and effective manner.[69] This information asymmetry is not just relevant for branches, but also subsidiaries that are part of a group headquartered in other jurisdictions. In the interests of efficiency, supervisors should consider seeking the relevant information about the wider group from the respective supervisors to reduce duplicative reporting requirements.

85. Governance should be considered. A branch is not a legal entity and thus in most jurisdictions a branch does not have its own board of directors. Most jurisdictions have established suitability requirements for a representative of the foreign branch, but the representative does not have the same legal responsibility as that of a board of directors.

5.2 Possible approaches for supervising foreign branches

86. Several approaches[70] have been used to supervise foreign branches. A specific approach that applies in a particular situation may not be an appropriate measure in all circumstances. This section attempts to analyse possible approaches that could be taken without recommending any particular approaches. Such approaches include, but are not limited to, the following[71]: (i) strengthening communication and cooperation between the home and the host supervisors; (ii) enhancing regulation and supervision of foreign

[69] This is why some jurisdictions require basic financial reporting of the entire group so that this risk can be mitigated.

[70] This subsection focuses on possible approaches to meet (possible) challenges/difficulties in the Subsection 5.1. Nevertheless, this subsection does not intend to recommend any specific approaches nor should it be read to imply that all jurisdictions need to take these approaches.

[71] In some jurisdictions where a supervisory regime for the supervision of foreign branches is already established and there is no material weakness or challenges in the supervision of the branches, the approaches discussed in this subsection need not to be implemented.

branches; and (iii) where legally permissible, setting requirements about the legal form an entity may take based upon a risk assessment.

87. In some cases, communication and cooperation has been strengthened between the home and the host supervisors. This is essential for detecting any possible signs of an adverse impact on the soundness of the foreign branch and its policyholders and taking necessary actions in a timely manner. Communication and cooperation can be strengthened by, for example, entering into an agreement for the information exchange and supervisory cooperation, such as a MoU, and/or establishing a supervisory college in which host supervisors of foreign branches are members or at least are involved in college activities on a permanent basis.

88. Host supervisors may strengthen regulatory requirements applied to foreign branches. For example, to mitigate concerns about the outflow of corresponding assets of the foreign branch, the host supervisor may consider requiring (part of) such assets to be held in trust or deposited to a bank located in the host jurisdiction and requiring the branch to obtain prior approval from the host supervisor before accessing those assets. The host supervisor may consider conducting more frequent on-site inspections of foreign branches. This is not possible in case of intra-EEA branches on the basis of freedom of establishment.

89. Where legally permissible under applicable laws in their jurisdiction, host supervisors may set requirements and/or guidelines regarding the legal form an entity may take and also may ask foreign insurers, under certain circumstances, to operate in a specific form (for instance, a subsidiary or a branch) in the host jurisdiction. Based on the survey results, this approach is taken on a case-by-case basis in some jurisdictions. Due consideration would be needed before such an approach is taken.[72] This possible option may need to be considered from the following viewpoints: (i) accessibility to diverse insurance covers, (ii) legislation or agreement, (iii) nature of business and business strategy, and (iv) possible impact on financial stability and policyholder protection. It should be stressed that in certain cases such action could require novation or renegotiation of contracts written by the branch or that these contracts could be put into run-off, depending on the legal system of a host jurisdiction.

90. Entry into a jurisdiction could be facilitated by allowing insurers to set up branches. This provides potential policyholders with greater access to insurance and could contribute to the further development of an insurance market. Being required to set up subsidiaries when entering a new market (especially emerging markets) may discourage insurers from operating in such a market and accessibility to insurance could be impeded. Thus, a jurisdiction may benefit from allowing insurers to enter a jurisdiction by setting up branches especially in jurisdictions where the insurance market is still developing.

91. The nature of business as well as insurers' business strategy also needs to be taken into account. Reinsurance, for example, is a global business conducted between insurance entities. In most jurisdictions, reinsurers may enter into markets on a cross-border basis without having physical offices in host jurisdictions, although some reinsurers may choose, for commercial reasons, to maintain a physical presence in the form of a branch or a subsidiary if there is no specific regulatory requirement regarding a legal form in those jurisdictions where they operate. In such a case, a branch tends to be favoured over a subsidiary as it leverages the benefits of the global reinsurance market. As to business strategy, some insurers intend to do business with, for example, only some types of corporations or a limited number of individuals in foreign jurisdictions as is often seen in the non-life sector. In these cases, the host supervisor may not see the necessity of localising such a business operation in the host jurisdiction.

[72] The paper does not intend to portray that this approach is routinely used as this could be a distortion to free market choices and could also be to the detriment of policyholders if the approach were to be taken without due consideration of possible implications of the approach such as those mentioned in Chapter 5.2.

6 Conclusion

92. Operations through both subsidiaries and branches have advantages and disadvantages. Supervisors currently use a range of supervisory tools and requirements in order to apply prudential supervision to branches in a way that could achieve similar outcomes with respect to policyholder protection and financial stability as supervision of foreign subsidiaries. Such tools and requirements are very similar to those used for foreign subsidiaries however the different legal structures could mean these tools may not have same effect.

93. In the future the IAIS may consider undertaking further work to explore particular aspects of cross-border operations.

94. A conclusion of this paper is that the supervision of the operations of an insurer or group by the host or home supervisor (perhaps in coordination and cooperation with involved supervisors) is based on similar principles whether the operations are structured as a branch or a subsidiary. However, the Issues Paper serves to highlight and contrast the unique features of branches and their possible supervisory implications.

Annexes - Case studies

I. Freedom of establishment and freedom to provide services in the EU

As of 1990 for non-life [73] and from November 1992 for life insurers, [74] insurers with an establishment [75] in a Member State of the European Union (EU)/European Economic Area (EEA) have the right to provide services to another Member State of the EU/EEA (i.e. to cover a commitment in another Member State of the EU/EEA). In order to do so the insurer first has to notify the competent authority of the Member State of the head-office, or of the branch-office, of its intention to provide services to another Member State and of the nature of the commitments to be covered. Details regarding the intention to provide services to another Member State have to be sent to the competent authorities of the Member State of provision of services. From the moment that the competent authorities of the Member State of provision have received all the required information the insurer in the Member State of establishment is allowed to cover commitments in that other Member State through provision of services.

For a comprehensive overview of the relevant provision, please refer to 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), Title I, Chapter VIII, sections 2-4.

Following the implementation and application of these provisions – and also relating to the provisions on the freedom of establishment as regulated to the so-called third generation directives [76] - uncertainties did arise on the interpretation of these provisions and the distinction between the rights of provision of services (without permanent presence in a host jurisdiction) and the rights of establishment (in form of a branch or an agency). In order to address these uncertainties the European Commission used its powers to issue a so-called Commission Interpretative Communication through the Communication on Freedom to provide services for the general good in the insurance sector. [77]

In this Interpretative Communication the Commission considered that it is not always easy to draw the line between the two concepts of provision of services and establishment. Some situations are difficult to classify, in particular where the insurer, in order to carry on its insurance business, uses a permanent infrastructure in the Member State of provision. This arises in particular in the case of recourse to independent persons established in the host Member State.

On the basis of the outcome of relevant Court decisions, the Commission considered that, for the links between an independent person such as, for example, an independent intermediary and an insurance company to be regarded as meaning that the insurance company falls within the scope of the rules governing the right of establishment rather than those applicable to the

[73] Second Council Directive 88/357/EEC of 22 June 1988 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 73/239/EEC

[74] Council Directive 90/619/EEC of 8 November 1990 on the coordination of laws, regulations and administrative provisions relating to direct life assurance, laying down provisions to facilitate the effective exercise of freedom to provide services and amending Directive 79/267/EEC

[75] Establishment means head-office, branch-office or agent.

[76] Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and amending Directives 73/239/EEC and 88/357/EEC (third non-life insurance Directive) and Council Directive 92/96/EEC of 10 November 1992 on the coordination of laws, regulations and administrative provisions relating to direct life assurance and amending Directives 79/267/EEC and 90/619/EEC (third life assurance Directive) (the latter replaced by Directive 2002/83/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 5 November 2002 concerning life assurance).

[77] Official Journal of the European Communities,16.2.2000, C 43/03).

freedom to provide services, independent persons must meet the following three cumulative conditions:

- they must be subject to the direction and control of the insurance company they represent;
- they must be able to commit to the insurance company; and,
- they must have received a permanent brief.

It is, therefore, only where the independent person acts as a genuine extension of the insurance company that the insurance company falls within the scope of the rules applicable to the establishment of a branch.

The Commission takes the view that it is only where the above three conditions are met (i.e. where the independent person to the direction and control of the insurance company is able to commit to the insurance company and has received a permanent brief) that an insurance company, using independent persons, for example, intermediaries permanently established in the host Member State, must be treated as if it had a branch in the host Member State. In all other cases where an insurer operates in another Member State using some form of permanent infrastructure in the other Member State, such an activity should be considered as performing the provision of services and should be treated likewise.

Cooperation within the EU

From the very beginning of the coming into force of the first generation of European Insurance Directives the relevant supervisory authorities of Member States of the EEC (now EU) started developing *a Protocol relating to the collaboration of insurance supervisory authorities*, under the aegis of *Conference of Insurance Supervisory Authorities of European Union Member States* (Conference). In 2003 all rights and duties of the *Conference* were passed onto the *Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)*, and then passed onto the European Insurance and Occupational Pensions Authority (EIOPA) by 2011.

The latest version of the protocol referred to above is the *General Protocol relating to the collaboration of the insurance supervisory authorities of the Member States of the European Union.* [78]

Part I of the General Protocol deals with general principles of cooperation and information exchange and of professional secrecy. The second part covers the authorisation of domestic insurers. Part III deals with cross-border activities, in this part focussing on the starting-up or closing of activities through an establishment (branch) or provision of services.

The cooperation and information exchange during the on-going supervision of an insurance company is dealt with in part IV. This deals with, among others, all kinds of enforcement actions, transfer of insurance portfolios, treatment of insurers in distress, and withdrawal of licenses. Part V addresses the treatment of branches of insurers of third countries (non EU/EEA countries). The European Insurance Directives include a specific requirement on collecting and exchanging statistical information on the activities of insurance companies in host Member States by authorities of the home Member States. Part VI deals with these information exchanges. Cooperation and information exchange in the case of handling of complaints of policy holders is dealt with in Part VII. Specific issues concerning assistance, data on health insurance, and maximum interest rates are addressed in Part VIII.

[78] https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/protocols/RevisedSienaProtocol.pdf.

II. Branch operation within U.S. States

In the U.S., non U.S. insurers, i.e. those headquartered outside the U.S., who wish to sell insurance policies, are required to establish either a licensed insurance legal entity (subsidiary) or branch office. Such licensed insurance legal entity or branch may sell products in multiple states, but must obtain licenses from each state in order to do so. The licensed insurance legal entity may establish insurance subsidiaries or branches in other states, but it is not required to do so. Rather, a more common practice is that the licensed insurance legal entity or branch establishes offices (neither an insurance subsidiary nor an insurance branch) as bases for their sales activities in other states, and then sells products. Such offices may be established only in some (key) states and the licensed insurance legal entity or branch may operate not only in states where it has such offices in place but also in neighbouring states. (For example, Insurer X established by a non-U.S. insurer in State Y as a branch or subsidiary may sell products in 49 other states once Insurer X is granted a license in each state. Insurer X is required to set up neither an insurance legal entity (subsidiary) nor a branch in the 49 other states. Insurer X may have offices in some of the 49 other states, but it may sell products in states where it does not have such offices.)

Branches of insurers and reinsurers established (domiciled) in states (hereinafter referred to as "U.S. branch" or "U.S. branches") are subject to the same regulation as that applied to insurance/reinsurance legal entities (i.e. (re)insurers). More precisely, U.S. branches are required to comply with qualitative and quantitative regulatory requirements which are applied to insurers under the NAIC Financial Regulation Standards and Accreditation Program ("Accreditation Program"), although each state may impose additional requirements. For example, U.S. branches are required to calculate their solvency margins and prepare audited financial statements in accordance with the same principles/rules required of insurers and must maintain prescribed assets in trust to offset liabilities. They are also subject to ladders of intervention and examinations (on-site and off-site) and holding company filing requirements as well as requirement to produce additional information on the group when requested.

With respect to supervision, the Accreditation Program does not address supervision of branches explicitly, but U.S. branches are supervised under the Program. As was mentioned earlier, a U.S. branch in one state (e.g. U.S. Branch X established in State Y) may conduct business in other states (e.g. State Z) if it is granted a license in the states. In such a case, the supervisor of the state where the insurer has established a branch, i.e. State Y, is responsible for the supervision of the U.S. branch. Examination (both on-site and off-site) of the U.S. branch is performed by State Y. However State Z also has the power to perform such duties, but under the U.S. state-based system, it would generally defer its authority to State Y. Any reporting, including filing of financial statements, is made by U.S. branch X to both States Y and Z. In addition, U.S. branch X may set up a sales office in State Z. In this a case, the sales office is subject to supervision by the supervisor in State Z.

If the non-U.S. insurer establishes branches in multiple U.S. states, then each state where a branch is established is required to follow the requirements of the Accreditation Program. In this case (no current example) one single state (the lead) would be responsible for analysis of the financial condition of the group and/or working with the non-U.S. group-wide supervisor to obtain and document such an analysis. However if the non-lead supervisor in the U.S. had information that they believed the lead needed, they would communicate that to the lead. Even in such a case, each state where the branch has obtained a license may conduct on-site and off-site examination and impose additional requirements on the branch. However in a case where the state is accredited, supervisors in other states, in general, would rely on the supervision by the state where the branch is established and the lead supervisor in regard to the supervision of multiple U.S. branches that have been established.

In the case of U.S.-based insurers, like U.S. branches, they may sell products not only in a state where it is incorporated but also in other states once it is licensed in those other states. They are required to set up neither an insurance legal entity (subsidiary) nor a branch in other states,

although they may do so. In practice, they generally have offices in place in other states, rather than establish branches in multiple states.

III. Resolution of branches: Confederation Life Insurance Company, Canada

Overview

The liquidation of the Canadian domiciled Confederation Life Insurance Company (Confed) was the largest and most complex liquidation involving life branches in North America. Confed operated in the US and the UK through both a branch and subsidiaries, and in Bermuda and Cuba through branches. In August 1994, Confed's policyholder liabilities were approximately $12.4 billion worldwide and it had in excess of $10 billion of assets under administration in various funds. Over a million people depended on Confed for income support of all kinds, including life insurance, health and disability benefits, and pensions. After the failure of concerted efforts to rescue Confed and avoid a liquidation, winding-up orders were made in August 1994.

Branch Specific Results:[79]

All branch and subsidiary policyholders in all jurisdictions received their full policy benefits and all ordinary creditors were paid in full, together with interest. In total, payments of $900 million were made to various claimants.

Factors Contributing to the Success for Branch Resolution included:

a) *The building of a co-operative relationship between the Canadian liquidator, the Rehabilitator of the US State Branch and their regulatory and credit constituencies from the outset that allowed both estates to make progress before they reached a settlement, and then to reach a settlement, avoiding litigation that could have seriously delayed the liquidation and prejudiced the results; and,*

b) *Immediate action at the beginning of the resolution (intervention) process preserved goodwill in the individual life and group life and health block, leading to substantial benefits to the branch and subsidiary policyholders and the estate.*

Overview of Approach to the Major Jurisdictions with Branch Operations

United States

As noted, Confed did business in the U.S. as a branch and through a subsidiary Confederation Life Insurance and Annuity Company ("CLIAC"). Confed's U.S. branch wrote approximately US$ 6.173 billion of life insurance, including policies sensitive to competition from other carriers and annuities that funded pensions. For example, Michigan's civil service retirement programs had acquired a US$ 100 million annuity contract from the U.S. branch. The U.S. branch was in total about twice the size of the estate in Canada.

For a branch to operate in certain U.S. states, it must be licensed as an insurer, so Confed had to deposit assets in trust in Michigan, its U.S. port of entry, to support its insurance liabilities. Prior to its liquidation, CTSL had removed cash from the Michigan trust account, replacing it with CTSL promissory notes. In August 1994, when the liquidation orders were made, about US$ 640 million of notes were in the trust, which CTSL could not repay, and about CAN$ 350 million of mortgages and private placements located in Canada were pledged to the trust, but were effectively under the control of the Liquidator because of the winding-up. Although the Canadian estate faced an apparent shortfall to policyholders, it was clear from the outset that the shortfall to U.S. policyholders would be significantly greater. There was a

[79] A comprehensive case study and related results is available in the IAIS Issues paper on resolution of cross-border insurance legal entities and groups.

high risk of extremely complex and costly litigation, with ensuing uncertainty and delay to the administration of both estates that would seriously prejudice an orderly wind-up in both jurisdictions.

In order to assess the best interests of the estate, efforts were made to determine the likely range of results under various scenarios involving unitary proceedings or separate proceedings. Estimating the ultimate realisation from Confed's assets required the exercise of judgment in quantifying the expected results of future events. These estimates were, by necessity, influenced by many factors that made precision virtually impossible.

The Canadian Liquidator and U.S. State Rehabilitator negotiated an interim arrangement while different avenues for dealing with the two estates were being explored, pursuant to which they would consult on all material transactions, given the possibility of combining the U.S. and Canadian proceedings, and given that as a result each was the major stakeholder in the other's estate. Further, at the request of the U.S. State Rehabilitator, the Canadian Liquidator spoke at many U.S. stakeholder meetings, acknowledging the Liquidator's obligation to all policyholders of Confed wherever situated, thus providing the same level of disclosure as to Canadian stakeholders, and thereby building credibility for a negotiated solution.

In June 1996, a settlement was reached that was approved by both supervising courts without opposition. The Canadian Liquidator initially paid US$225 million to the U.S. State Rehabilitator, and $US309.2 million was returned to the Canadian Liquidator, under the true-up mechanism.

Bermuda

Confed was licensed under Bermuda law to conduct most types of life insurance and annuity business in non–Bermuda currency and with non-Bermuda entities, on both a direct and reinsurance basis. Confed's Bermuda branch targeted an international market of high net worth individuals. The Bermuda branch business had approximately 170 outstanding policies with a face amount of approximately US$ 170 million (plus various term certain annuities), policyholder liabilities of approximately US$ 7 million, and annual premium income of approximately US$ 3.1 million.

By order of the Supreme Court of Bermuda in August 1994, a Bermudian liquidator was appointed for the Bermuda branch. In March 1995, responsibility for administration of the Bermuda branch was transferred, by that Court's further order, to the Liquidator.

Following this, the Liquidator set up an escrow arrangement whereby premiums for the Bermuda branch policies would continue to be received and held, pending completion of an assumption reinsurance transaction which was completed in July, 1995, with the approval of the Bermuda and Ontario courts.

Cuba

Confed operated a branch in Cuba. The Cuban government had prevented the assets of the Cuban branch from being removed from Cuba and had passed a decree ordering insurance companies not to pay any policyholder who left Cuba permanently in the 1950s. The liabilities of the Cuban branch were primarily payable in Cuban pesos, which were not readily negotiable outside of Cuba. The books and records remained at the Cuban branch, access to which required a visa, and remained in the control of the Cuban government. The Liquidator's best estimate of the liability in respect of policies issued through the Cuban branch to policyholders who had left Cuba permanently was in the range of US$ 2 million to US$ 4 million. The Liquidator, with the assistance of the Canadian government, negotiated an agreement with the Cuban government that ensured all policyholders of the Cuban branch, whether resident in Cuba or not, would be paid. In addition, the Cuban government caused periodic payments totalling US$ 9 million to be paid to the Liquidator.

The effect of the agreement was to ensure that all policyholders of the Cuban branch were covered, to allow the Liquidator to realise a recovery in respect of the Cuban branch assets in a liquid form, notwithstanding that they were denominated in Cuban pesos and had been seized

by the Cuban government, as well as ensuring that the Liquidator had access to the books and records of the Cuban branch to allow it to deal with policyholders resident outside of Cuba.

Some lessons learned related to branch considerations:

a) *US Rehabilitator had authority to restructure policies, which gave it far greater flexibility in selling blocks of business. Canada also has adopted similar powers in its winding–up legislation. Take away – authority to restructure policies can create value.*

b) *CTSL, the treasury subsidiary, managed Confed's derivative book and also acted as a market maker in its own right maintaining what was supposed to be a matched book of business and transferring funds among entities that required liquidity. Take away –you cannot consider the consolidated assets and liabilities in resolving a multi-national financial institution insolvency. Each branch or subsidiary and jurisdiction will need to be considered on its own, even if there is the potential for some of the jurisdictions to accept a universalist approach. Participants in a winding-up have a tendency to go into a shell to protect themselves and their position (i.e., ring-fencing), which can be counterproductive to achieving an overall resolution.*