Suitability assessment procedures in Solvency II

Outlining suitable processes for own assessment of article 42’s fit and proper requirements

Isak Bondesson
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**Abbreviations**

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<th>Abbreviation</th>
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<tr>
<td>CEIOPS</td>
<td>Committee of European Insurance and Occupational Pensions Supervisors</td>
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<td>ECOFIN</td>
<td>The Council in its economic and financial affairs configuration</td>
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<td>EIOPA</td>
<td>European Insurance and Occupational Pensions Authority</td>
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<td>EU</td>
<td>European Union</td>
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<td>FI</td>
<td>Finansinspektionen, Swedish Financial Supervisory Authority</td>
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<tr>
<td>FRL</td>
<td>Försäkringsrörelselag (2010:2043)</td>
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<td>FSA</td>
<td>UK Financial Services Authority</td>
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<td>IAA</td>
<td>International Association of Actuaries</td>
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<td>IAIS</td>
<td>International Association of Insurance Supervisors</td>
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<tr>
<td>ICP</td>
<td>IAIS’s Insurance Core Principles</td>
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<td>IESBA code</td>
<td>International Ethics Standards Board for Accountants’ Code of Ethics for Professional Accountants</td>
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<td>ISA</td>
<td>International Standard on Auditing</td>
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<td>MCR</td>
<td>Minimum Capital Requirement</td>
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<tr>
<td>ORSA</td>
<td>Own Risk and Solvency Assessment</td>
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<tr>
<td>Prop.</td>
<td>Proposition</td>
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<td>RB</td>
<td>Rättegångsbalk (1942:740)</td>
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<tr>
<td>RN</td>
<td>Revisorsnämnden, Supervisory Board of Public Accountants</td>
</tr>
<tr>
<td>SAf</td>
<td>Svenska Aktuarieföreningen, Swedish Actuary Association</td>
</tr>
<tr>
<td>SCR</td>
<td>Solvency Capital Requirement</td>
</tr>
<tr>
<td>SOU</td>
<td>Statens offentliga utredningar, Swedish Government Official Reports</td>
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<tr>
<td>SRP</td>
<td>Supervisory Review Process</td>
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<td>TFEU</td>
<td>Treaty of the Functioning of the European Union</td>
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1 Introduction

In November 2009 the European Parliament and the Council issued Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (hereby referred to as ‘the directive’). The directive sets out a framework for the conducting of business in insurance undertakings. Though mainly a consolidation of earlier directives in the field of insurance, Solvency II does bring about some new regimes. The most notable changes lie within the solvency models. Instead of the former, strictly capital based, solvency requirements the directive instates new, risk based, models for the calculation of solvency. There are also amendments concerning governance in insurance undertakings, with requirements on persons who manage undertakings or work in key positions within such undertakings or, in the case of outsourcing, persons fulfilling similar tasks on an independent basis. This essay will explore the ‘fit’ and ‘proper’ requirements stated in article 42 of the directive and their scope, but foremost the processes demanded of the insurance undertakings to ensure compliance with the directive.

1.1 Purpose and scope

The purpose of this essay is to present the Solvency II regime and explore the processes with which an insurance undertaking can ensure and demonstrate their compliance with the suitability requirements of the Solvency II directive’s article 42.

The content of the essay will be limited to the limited liability company variant of insurance undertakings, and thus excluding mutual insurance companies and insurance associations. The essay will solely concern single companies and will not address the special regulations surrounding insurance undertaking groups.

1.2Disposition

The essay will first outline the ideas and history behind the Solvency II regime. After this, in section 3, the general content of the Solvency II directive will be presented, with more weight put on the elements of direct interest to the essay’s purpose. Section 4 contains the

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2 Ibid, paragraph 15. See also ‘Solvency II: Frequently Asked Questions (FAQs)’ p. 1, q. 2.
3 Articles 41-50, in particular article 42 (Fit and proper requirements for persons who effectively run the undertaking or have other key functions) and article 49 (outsourcing).
presentation of comparable suitability assessment processes in different legislation, which will be part of the ground for the analysis in section 5.

1.3 Method and materials

Since this essay spans over different legal questions from different jurisdictions, which have reached different stages of maturity, its composition has utilised a number of methods. With different stages of maturity is simply meant that when discerning and exploring legal questions related to the Solvency II directive one is not served well by only using one fixed method due to the legal aspect’s different stages between issuing and implementation. On the whole three different methods have been used.

A comparative method has been used in reaching conclusions throughout the analysis, where different solutions to the processes surrounding the assessment of persons against reigning suitability requirements, in their respective field, have been compared, or rather used to inspire solutions. This has been the main operative method used during the composing of this essay. The comparison has not taken place between certain legal rules, or in fact between any legal situations or effects at all. Instead the comparative method has been used to compare different ways of reaching different goals in different legislative areas where the common denominator is the procedures of assessing suitability. The goal has been to find suitable processes for ensuring compliance with the suitability requirements of the Solvency II directive’s article 42 and the requirements surrounding documentation and own-supervision.

To be able to use this comparative method, the ground material has first to be gathered. For the material connected to Swedish law, a traditional Swedish legal research method has been used, i.e. the law has been analysed through a consultation of further regulation in the same area, preparatory work and case law. This method is used to ascertain what the practical meaning and application of the legal texts are, a method necessary to enable the comparative method. With the Solvency II directive, since it has not yet come to effect, any information regarding its practical application is, of course, nonexistent. The same goes for Swedish documentation on its implementation, apart from the Swedish Ministry of Finance’s report on the matter, which has been used continually throughout this essay to give a Swedish interpretation on the contents of the directive. In interpreting the Solvency II directive, the travaux préparatoires, mainly the commission’s ‘COM’, documents have been used. Since the objective of the essay, to some part, is to precede The European Insurance and Occupational Pensions Authority (EIOPA) in their guidance on assessment procedures, their
recommendations so far have been used to outline their general mindset towards the assessment procedures. The core of this method has thus been to analyse sources who offer a, somewhat, utopian view. Utopian, not in the way that they give light to impossible ideas or that they are overreaching in their recommendations, but rather in the way that the legislation itself has no practical track record and the guidance and recommendations so far only provide one side of the story, the side of how it all is supposed to work. How the legislation will be implemented in the member states, and how the corresponding supervisory authorities will conduct their obligations is, however, still unknown.

To eliminate some of the naïveté this ineluctably brings, the statements made in the travaux préparatoires and the EIOPA guidance have been complemented and compared to the standards and principles of the International Association of Insurance Supervisors (IAIS). These sources are undoubtedly noteworthy, even though they must be referred to as soft law sources, as almost every EU member state also is a member of IAIS. The IAIS’s standards, in many respects, look very much alike the Solvency II regulation and, as will be discussed later, Solvency II seems to have adopted structural thinking stemming from the IAIS. Seeing to these facts, the correlation and interaction between the both, one could easily put faith in IAIS standards when trying to assess the future actions of the EU and EIOPA.

2 Background

2.1 Purpose of Solvency II

A part of the Financial Action Plan of 1999, an underlying purpose of the directive is, of course, to bring about a harmonisation of the financial markets within the European Union, thus creating an internal market for financial services. This would also increase the competitiveness of European Union insurance providers and re-insurers, rendering them in play on a level, and vastly larger, playing-field. Though the implementation of a common regulatory framework would guarantee the aforementioned goals, the content of the regulations themselves is meant to bring an increase in consumer protection for insurance takers. This is done through preventing insurance undertakings from losing too much capital, which could ultimately result in them going belly up. The same mechanism is going to fulfil the purpose that was introduced into the directive after the 2007-2009 financial market crashes, namely the objective of bringing stability to the financial markets, which had recently

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5 Ibid, p. 12 et alia.
been hurt by failing insurance companies. Finally, the decision to consolidate the multitude of earlier directives in the insurance field instead of issuing additional amendments was taken as a part of the European Unions ‘better regulation’ scheme, aimed at simplifying regulation for users, fulfilling the fifth general objective of the directive. Making the regulation in the insurance field more penetrable for the users will also vouch for a fairer market for the small and medium-sized enterprises, thus further increasing the effectiveness of the market.

2.2 The history of Solvency II

The history of the new solvency regime starts, of course, in the old regulations on the insurance market. The regulation regarding the insurance market is divided in the European Union legislation. There has been and, even after the Solvency II regime, will be separate legislation for life insurance, non-life insurance and motor vehicle insurance. The first directive on the non-life insurance sector was issued in 1976 and was followed by a second and a third generation in 1990 and 1994. The main aim of the first non-life insurance directive was to ensure minimum harmonisation of the legislation in the member states, as well as setting up standards for consumer protection. Among these standards were the first EU solvency requirements on insurance undertakings. For the second non-life insurance directive the objective was to facilitate cross border services, whilst the third directive focused on realising the principles of right of establishment for the insurance business. It was only with the third directive minimum harmonisation was reached, enacting a standard of an ‘EU passport’ for insurance companies. The first life insurance directive was issued in 1979 and was followed by two additional directives in the same manner, and with roughly the same interval, as the non-life sector. Those three directives were in 2004 replaced by Directive 2002/83/EC, a consolidation of the three life insurance directives, which now, in part, is being replaced by Solvency II.

The field of motor insurance has been harmonised separately from the rest of the insurance sector, due to the awesome impact this type of insurance has on the free movement of people, services and goods within the union. At present, the substantive rules are found in directive

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9 Seyad p. 42 in fine.
11 Seyad p. 44.
2009/103/EC, which engulfs the regulation previously found in the first through fifth motor insurance directives.\(^{14}\) The provisions of the Solvency II directive are applicable on the insurance companies providing motor insurance, even though motor insurance historically has been regulated separately.

By the time the third generation of insurance directives was being written, in the early 90s, it had become apparent that the insurance market had outgrown the regulation, and that the solvency rules stemming from the 70s had been outdated. The financial markets had undergone significant changes, making a huge impact in the way the insurance companies handled, or wanted to handle, their capital.\(^{15}\) The rules had in fact, in light of market developments, adverse effect on the insurance companies from what was the objective of the earlier solvency regime, with undertakings gaining from taking too high risks.\(^{16}\) Both of the third generation directives, in non-life and life insurance, included provisions demanding the commission to further investigate and report on the need for a new solvency regime.\(^{17}\) The commission commissioned a report which was presented in 1997, the Müller report.\(^{18}\) The suggestions of this report was to raise one of the instruments of the former solvency regime, the minimum guarantee fund, to a more appropriate level, this to assure solvency in case of negative market developments. Another recommendation was to instate an early warning measure with the supervising authorities, making it possible for action against an insurance undertaking on the grounds of negative development, even if the solvency margins still were kept.\(^{19}\) These recommendations were part of the 1999 Financial Action Plan and underwent an expedited implementation procedure, resulting in what came to be known as ‘Solvency I’.\(^{20}\) From the process behind Solvency I the need for further alterations of the solvency regulation became apparent.\(^{21}\)

\(^{14}\) See the European Commission homepage under Insurance – Motor insurance. The five directives are 72/166/EEC, 84/5/EEC, 90/232/EEC, 2000/26/EC and 2005/14/EC.


\(^{16}\) Study into the methodologies to assess the overall financial position of an insurance undertaking from the perspective of prudential supervision. ‘The KPMG report’. European Commission, 2002.


\(^{18}\) Müller, Helmut (chairman) et alia, 1997.

\(^{19}\) Ibid, p. 42.


To assess the market need pertaining to a new solvency regime the commission ordered two
reports, the KPMG report\textsuperscript{22} and the Sharma report\textsuperscript{23}. The KPMG report focused on the risks
associated with insurance and how insurers managed these risks. It then analysed how well
the current solvency regime took account of the risk measuring and mitigation techniques,
reaching the conclusion that a new risk-based set of rules was necessary to gain consistency in
solvency measurement. Furthermore, the report reached the conclusion that the three-pillar
architecture used in the Basel II\textsuperscript{24} regulations should also be used for Solvency II.\textsuperscript{25} The
Sharma report, on the other hand, looked at historical factors. It measured the success of the
earlier regulations by studying cases where insurance undertakings had gone into winding-up
or where they had come close to doing so. In short, the study was one into the reasons of
regulatory failure. The result of the Sharma study showed that it was, in fact, improper
management decisions and imprudent risk taking that had led to most of the failures and 'near-
misses' over the studied time period, and not a lack of capital.\textsuperscript{26} These two reports,
accompanied by a plethora of commission working papers, constituted the main part of the
first preparatory phase of Solvency II.

With the groundwork laid down in phase 1, phase 2 handled the work of turning the visions
agreed upon into reality.\textsuperscript{27} In line with the better regulation ideals, this process was carried out
with a great deal of stakeholderism.\textsuperscript{28} Although an institution with no formal powers, a lot of
the workload stemming from phase 2 was laid on the Committee of European Insurance and
Occupational Pensions Supervisors, CEIOPS.\textsuperscript{29} The bulk of this advice was requested from
the Committee in a series of ‘calls for advice’, where CEIOPS consulted stakeholders to set
out the technical provisions of Solvency II. CEIOPS has now been replaced with the
European Insurance and Occupational Pensions Authority, EIOPA.\textsuperscript{30} (more about EIOPA

\begin{flushleft}
\textsuperscript{22} Study into the methodologies to assess the overall financial position of an insurance undertaking from the
\textsuperscript{23} Sharma, Paul (chairman) et alia, 2002.
\textsuperscript{24} International Convergence of Capital Measurement and Capital Standards, A Revised Framework,
Comprehensive Version, Bank for international settlements, 2006. Basel II is an international agreement on
capital standards for banks, i.e. solvency regulation.
\textsuperscript{26} SEC(2007)871, Solvency II - Impact Assessment Report, p. 10 and 54, Sharma, Paul (chairman) et alia, 2002,
p. 9.
\textsuperscript{27} Design of a future prudential supervisory system in the EU – Recommendations by the Commission Services,
MARKT/2509/03.
\textsuperscript{28} Solvency II: Road map for the Development of Future Work – Proposed Framework for Consultation and
Proposed first wave of Specific calls for advice from CEIOPS, MARKT/2506/04, p. 6 ff.
\textsuperscript{29} Ibid. p. 4.
\textsuperscript{30} Regulation 1094/2010, Article 1 and 80.
\end{flushleft}
under section 3.3.2.4) This approach to designing legislation is a big part of the Lamfalussy architecture, which will be discussed in greater detail in section 3.2.2.

The directive, when issued in 2009, was meant to be implemented into the member state's legislation before 31 October 2012. However, in January 2011, in light of the instating of new European supervisory authorities in the financial sector, the Commission put forward a proposal amending Solvency II in different respects. This proposal, named the Omnibus II-directive, suggests changes due to the accession to the Lisbon treaty and updates to the language concerning the supervisory authorities. It also recommends changes pertaining to the time frame of Solvency II's implementation. The change in the time frame put forward in Omnibus II is really an empowerment entrusted to the Commission, which would allow them to enact transitional regulations spanning as far as ten years after the actual time limit of the implementation, which in Omnibus II is moved to 31 December 2012. Though omnibus II is still a proposal the Swedish Ministry of Finance have, nonetheless, stated that an implementation by 1 January 2014 for the majority of the legislative alterations should be acceptable. The UK Financial Services Authority, FSA, in a statement also revised their views on the time frame, concurrent with the Swedish authorities. Nevertheless, one should take notice of the FSA's use of words when they point out that it is, at this point, only assumptions as to when Solvency II is meant to be implemented.

3 The Solvency II directive

This section of the essay will in greater detail explore the material issues of Solvency II. Section 3.1 will cover the legal basis of the directive, as stated in the directive itself and the acts leading up to it. The following section, 3.2, will discuss the structure of the Solvency II regime, focusing on the one hand on the three-pillar system inspired by Basel II, and on the other hand the Lamfalussy architecture and what its impacts have been on the regulatory design.

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31 Directive 2009/138/EC, article 309. However, some articles ‘shall apply’ from 1 November 2012 (Article 311).
33 Ibid, p. 5.
34 Ibid, p. 45 f. (article 308a).
The general content of Solvency II will be addressed under section 3.3, where quantitative as well as qualitative regulation will be covered. Among the quantitative regulations one finds the main subject of this essay, the fit and proper requirements of article 42. The last part of this section will go into the new supervision regime, looking at the regulation as regard to the national level as well as the European Union level.

Finally, the implementation of Solvency II, already briefly covered under section 2.2, will be discussed. The main part of this section will explore the Omnibus II directive, and the transitional powers granted to the Commission therein.

3.1 The legal basis of the Solvency II directive

The legal basis of the directive can be found in the second reason of the preamble, where it is stated that the directive builds on articles 47 (2) and 55 of the Treaty establishing the European Community. As the Omnibus II directive affirms, these articles now, after the Lisbon Treaty, correspond to article 53 TFEU and article 62 TFEU, respectively. These articles constitute the basis for European Union legislation when it comes to creating an internal market in financial services. Article 53 TFEU is part of the chapter on the freedom of establishment, prompting the European Parliament and the Council to issue directives coordinating the Member states legislation when it comes to establishing and running businesses. The other provision, article 62 TFEU, is in the chapter concerning the providing of services and simply states that the provisions of articles 51-53 TFEU shall apply to the services chapter as well.

Though not addressed at any length in this essay, it should be mentioned that the involved institutions naturally have to keep within their competence when issuing legislation, and with that within the limits of the principles of proportionality and subsidiarity. In the preparatory works for Solvency II it casually mentioned that this legislation is not in breach of the aforementioned principles.

3.2 Structure

As was briefly covered under section 2.2. the matter of the structure of the Solvency II regime has been a matter of some discussion. At this point one should make the important distinction between the structure of the Solvency II regime and the structure of the Solvency II directive.

39 Ibid.
The structure of the directive is inspired by the Basel II three-pillar structure, which will be addressed under section 3.2.1. The whole of the Solvency II regime, on the other hand, is based on the Lamfalussy architecture. As explained under section 3.2.2 this is where the distinction between the directive and the regime comes in.

### 3.2.1 Designing the directive in three pillars

The three-pillar design of the directive is inspired by the Basel II accords. This design divides the directive into sections under the general headings ‘financial resources’, ‘supervisory review’ and ‘market discipline’. The first pillar, ‘financial resources’ includes the quantitative regulations concerning capital requirements, how to calculate the value of assets and debts and how to make prudent calculations of risks. This pillar is largely a consolidation of the old solvency rules, updated with the new models for solvency calculations. The second pillar, ‘supervisory review’ is the one containing the qualitative regulations. Here you find the requirements concerning governance, including the requirement on persons running the undertaking or working in key positions. On the whole, the second pillar is divided down one line, with the regulation regarding the internal control on one side and the rules pertaining to supervision on the other. One part of the second pillar deserving of extra attention is the fact that the undertakings themselves have to make an assessment of their own risks and solvency margins. The Swedish Ministry of Finance points out in their report that this is where the supervisory ‘chain’ begins, and that the supervision, effectively, works as the authorities supervising the undertakings abilities to supervise themselves. The third pillar directs focus to transparency. The lion’s share of these regulations is found in the directive articles 51-56 under the heading ‘Public disclosure’. The content of these articles will be discussed further in section 3.3.4.

Recognising this structure in the directive is not at all obvious. In fact, it seems that it serves more as a general notion on how to categorise different articles than it does actually structuring the directive. One could easily come to the conclusion that the decision to build the directive in this manner coincides with the fact that many insurance undertakings are active in cross market business, where they offer banking services as well as insurance

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43 SOU 2011:68 p. 45.
services to their clients. In making sure that areas and tasks are separated from each other in a coherent way spanning banking and insurance, implementation cost for many businesses could, of course, be kept to a minimum. Having to come to your own conclusion at all in this matter stems from the explanations surrounding the three-pillar system being scarce at best. It is mentioned briefly in the KPMG report that building on the same structure as Basel II would be preferable, a statement that, in the preparatory work has been left uncritised.

The likely explanation to the apparent understanding that the three-pillar structure was the way to go comes from the non-governmental institution International Association of Insurance Supervisors, IAIS. IAIS had earlier tried to implement a standard similar to the one of the Basel II which, allegedly, should be compatible to that standard. Almost all of the EU member states are also members of IAIS, and so is the Commission as well as EIOPA. The lack of discussion surrounding the coherence of banking laws and insurance laws in the preparatory works might very well be because it had already been addressed in this forum.

3.2.2 Enacting the Solvency II regime through the Lamfalussy process

After the 1999 Financial Services Action Plan was announced ECOFIN called for a report on how to speed up the implementation and development of new legislation. To this end ECOFIN created the Committee of Wise Men on the Regulation of European Securities Markets, a committee that came to be led by one Alexandre Lamfalussy. The findings of the committee were issued in the ‘Lamfalussy report’, which brought suggestions on how a new legislative regime on financial regulations could look.

The report recommended a four-level approach to legislation, which since then has been accepted and brought to force for the whole financial regulations sector. The first level in the Lamfalussy approach is a framework legislative act from the Council and/or the Parliament which sets out all the political goals of the legislation. Level 2 consist of the commission adopting technical implementation measures, with full insight of the European Parliament. After the Lisbon treaty this is of course closely linked to the implementing and delegated acts being under the commission’s purview, and when the Omnibus II directive comes into force,

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47 See www.iaisweb.org.
48 ECOFIN 213, 10491/00, 17 July 2000.
49 Lamfalussy (chairman) et alia, Final Report of The Committee of Wise Men on the Regulation of European Securities Markets.
the references to the commissions implementing measures will use the new language of implementing and delegated acts. As an effect of level 3 there are now institutions within the EU referred to as being level 3-institutions or authorities. When the Lamfalussy reform was initiated these were known as level 3 committees, with CEIOPS being the committee in charge in the insurance sector. As stated earlier CEIOPS have now been replaced by EIOPA, which is a level 3 authority. The part these authorities play in the Lamfalussy process is to issue interpretation recommendations, guidelines and standards as well as conducting peer review and ensuring consistent implementation of the level 1 and level 2 legislation. Finally, level 4 consist of the supervisory powers of the commission, with them controlling that the member states have fulfilled their obligations as to implementing the EU legislation correctly.

As earlier explained, the Lamfalussy report was prompted by the need for speedy reformation of the financial services regulation. The report reaches the conclusion that the regulatory system in force at the time was too slow, not precise enough and much too rigid for an ever changing market place. Too much time, says the report, is spend on ironing out every last detail while in many cases reaching a result which can be ambiguous, resulting in ambiguous implementation. Furthermore, where there is an ambiguous implementation, there is no overarching (effective) European coordination of regulators. With leaving the political decisions to the politicians and the technical decisions to technicians the legislative process could be faster while simultaneously resulting in higher quality legislation.

With the Solvency II regime being enacted through the Lamfalussy process, the directive, of course, constitutes level 1. Level 2 is under the purview of the commission, which should adopt technical implementing measures. However, with Solvency II implementation in general running behind schedule, level 2 implementing measures are not expected until the summer of 2012. In their pursuit of sound technical implementing measures the Commission has taken help from EIOPA. (for the remainder of this essay, instead of referring to both EIOPA and CEIOPS, only EIOPA will be referred to if not materially inappropriate)

What EIOPA has done is to conduct a series of exercises, quantitative impact studies, with participation of insurance, and reinsurance, undertakings. Through these exercises the technical provisions have been tested in real life situations, giving indication as to their clarity.

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50 COM(2011)8, p. 4.
53 This, at the moment, if of course only an educated guess. See Lloyds timeline for Solvency II implementation at http://www.lloyds.com/The-Market/Operating-at-Lloyds/Solvency-II/Information-for-managing-agents/Solvency-II-Timeline
54 These studies can be found at https://eiopa.europa.eu/consultations/qis/.
and usefulness.\textsuperscript{55} This has been a way to make sure that the upcoming implementing measures are effective and calibrated.\textsuperscript{56}

EIOPA is, as earlier stated, the authority ‘in charge’ at level 3. As their recommendations are based on the implementing measures of Level 2, there are almost no level 3 materials yet. However, since EIOPA is the main consulting authority for the Commission, they are in a good position to leave preliminary advice.\textsuperscript{57} To date, however, there is only one such publication, issuing guidance on a proposed pre-application process for the use of internal models in solvency and capital calculations.\textsuperscript{58}

In drawing up the distinctions between the different levels of the Lamfalussy process, one can easily make the distinction between the Solvency II directive and the Solvency II regime. Even though the major political decisions are taken, the technical details of the Solvency II regime are still to be announced. Furthermore, the coordination of national supervisory agencies, which is a crucial step in guaranteeing coherent implementation throughout the union, will not be engaged until level 3. So, while the directive is already here, the Solvency II regime is still a work in progress.

3.3 Content

The main focus of this essay is to study the ‘fit’ and ‘proper’ requirements in the Solvency II regime, which stems from article 42 of the directive. This, also the main focus of this chapter, will be explored under section 3.3.2., together with the other issues of the second pillar, i.e. governance and supervision. Firstly shall, nonetheless, the quantitative regulations relating to the first pillar be explored. Ultimately, the rules regarding market discipline; transparency and public disclosure will be addressed. In this sense the content will largely follow the pillar structure of the directive.

3.3.1 First pillar, quantitative regulation

As focus will be on the second pillar, this section will serve as a brief run through of the regulation pertaining to financial resources, i.e. the first pillar. The rules of the first pillar can be divided into six sections; valuation of assets and liabilities, technical provisions, own funds, Solvency Capital Requirement (SCR), Minimum Capital Requirement (MCR), and investments. Where the directive outlines the different conditions that have to be met for

\textsuperscript{55} EIOPA Report on the fifth Quantitative Impact Study (QIS5) for Solvency II, p. 4 ff, but in particular p. 17 f.
\textsuperscript{56} Ibid, p. 17 f.
\textsuperscript{58} CEIOPS-DOC-76/10, CEIOPS Level 3 Guidance on Solvency II: Pre-application process for Internal Models.
insurance undertakings to be authorised, however, the SCR and the MCR are the deciding factors, with the other sections serving as background elements. 59

To be able to conduct any calculation of capital requirements, one must first be able to value the assets and liabilities. The chapter on valuation sets out rules for how an insurance undertaking shall value their assets and liabilities, using a ‘fair value’ principle. This means that the valuation should be conducted as it would be between ‘knowledgeable willing parties in an arm’s length transaction’. 60 Part of the chapter on valuation of assets and liabilities are the technical provisions. Technical provisions are the values or liabilities connected to any insurance obligation, e.g. how much a certain contract is worth to the insurance undertaking. Simplified, calculating technical provisions is done through adding a best estimate and a risk margin with the result being equal to what the insurance undertaking would have to pay another undertaking to take over the contractual rights and obligations. 61

The next part of the valuation chapter is own funds, were rules pertaining to the determination, classification and eligibility of funds are found. 62 Own funds are divided into basic own funds and ancillary own funds, where the ancillary funds cover a broader spectrum of assets, such as commitments from other entities. 63 The funds are also classified into three tiers, depending on their availability to the undertaking in need of absorption of losses. 64

Finally, which funds are eligible to cover the SCR is decided through a proportionality clause in article 98. Of the own funds that can be used to answer for the SCR, more than a third has to be of tier one and no more than one third can be own funds out of tier three.

The Solvency Capital Requirement is designed to ensure that insurance undertakings hold enough capital to only go into bankruptcy or fail once every 200 years, or in a more relevant time frame; a 0.5 percent risk over one year. 65 This is done through what is called a Value-at-Risk (VaR) scheme. When calculating the SCR the insurance undertakings has two options, either to use the standard formula accounted for in the directive, or to construct an own, internal, formula. 66 The standard formula consists of three parts, the Basic SCR, the capital requirement for operational risk and an adjustment for the loss-absorbing capacity of technical

59 Directive 2009/138/EC, article 18.1 d-f, 18.2 paragraph 2, 18.3 (a), 18.4 (a).
60 Ibid, article 75.
61 Ibid, article 76-77.
63 Ibid, articles 88-89.
provisions and deferred taxes. Each, including sub-parts of, or all of these three parts are interchangeable with internal models. However, if the undertaking wishes to use an internal model, fully or partially, the will have to undergo an application where they produce extensive materials guaranteeing the soundness of the model.

As the ultimate stress test, the Minimum Capital Requirement sets a level of own funds an insurance undertaking can not fall below. The MCR shall correspond to a confidence level of 85 percent over a one year period, compared to 99.5 percent for the SCR. There are also fixed bottom limits, stated in Euros, for the MCR depending on which kind of insurance the undertaking provides, ranging from € 1 000 000 for certain types of reinsurance businesses, to € 3 200 000 for life insurance undertakings. An additional requirement of the MCR is that it has to be in a span between 25 and 45 percent of the SCR.

The SCR and the MCR can be clarified with an example from the Swedish Ministry of Finance’s report on Solvency II. For every risk that an insurance company takes it has to simulate a scenario with the likelihood of 0.5 percent, for example that the value of their investments in stocks will fall by 39 percent. Then they have to analyse how that fall would affect the capital of the company, and that ‘cost’ would then correspond to the capital requirement for that risk. As the undertaking sums up these requirements they are allowed to deduct amounts for those cases where risks count-act each other or were the undertaking has used a risk mitigation technique, such as reinsurance.

The reason for there being two levels of requirements is connected to the sanctions the supervisory authorities can impose on insurance undertakings, in case of their non-compliance. When an insurance undertaking finds it has slid below the SCR or the MCR, or is faced with the risk of going below either the SCR or the MCR within three months, they shall immediately inform the supervisory authority. In the case of the SCR they then have two months to produce a realistic recovery plan and submit it to the supervisory authority. This plan should restore the SCR within six months, or if the supervisory authority decides to

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67 Ibid, article 103.
68 Ibid, article 112.2.
69 Ibid, article 112-125.
70 Ibid, article 129.1 (c).
71 Ibid, article 129.1 (d).
72 Ibid, article 129.3.
73 SOU 2011:68.
74 For the SCR, 15 percent for the MCR.
76 Directive 2009/138/EC, article 138-139.
77 Ibid, article 138.2.
prolong the respite, within nine months. On the other hand, when it comes to the MCR the undertaking only has one month to submit a financial scheme capable of restoring the company to the MCR within three months. In all cases, any recovery plan or financial scheme must be approved by the supervisory authority.

Article 144 of the directive states the cases where the supervisory authority can withdraw the insurance undertaking’s authorisation to carry out their business. The first category of reasons connects to inactivity of the undertaking. In cases as such, the authorisation may be withdrawn when; the authorisation has not been put to use within 12 month of its issuing, the undertaking ceases their business for a period exceeding six months or if the undertaking renounces the authorisation on its own behalf. The other reasons for withdrawing an authorisation are either if the undertaking no longer fulfils the conditions for authorisation, or if it fails seriously in its other legal obligations. This division points out that any other breach of the directive, besides not fulfilling the conditions for authorisation, has to be serious for the supervisory authorities to intervene.

Besides revoking the authorisation, a sanction available to the supervision authority is to restrict or prohibit the undertakings disposal of its assets. This option is possible in any case where the undertaking has failed its MCR, but only in exceptional cases regarding an undertaking’s failure to meet the SCR. The option of restricting or prohibiting the disposal of an undertakings assets is also available, as an only sanction, where an undertaking fails to fulfil their obligations stated in the technical provisions chapter.

The sixth part of the first pillar concerns investments. Mainly, this section lays out a ‘prudent person principle’ for how an undertaking should conduct their investments. This principle spans not only with what risk a company can place its capital, but also with which availability to the company. Although the connection to the own funds and the SCR and MCR is obvious, it is expressly addressed that the funds covering the capital requirements has to be invested in such a manner as to ensure ‘security, quality, liquidity and profitability’.

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78 Ibid, article 138.3.  
79 Ibid, article 139.2.  
80 See note 76 and 78.  
81 Ibid, article 144.1 (a).  
82 Ibid, article 144.1 (b-c).  
83 Ibid, articles 138.5 and 139.3.  
84 Ibid, article 137.  
85 Ibid, article 132.2-4.  
86 Ibid, article 132.2 paragraph 2.
3.3.2 Second pillar, qualitative regulation

The qualitative spectrum of rules is divided into two sections, with ‘Supervisory authorities and general rules’ stated first in the directive, followed by ‘System of governance’. However, in this presentation of the subjects the order will be reversed, with the material rules being introduced before the supervisory measures that are designed to uphold them. This will more clearly depict the impact of the second pillar regulation. As earlier mentioned the focus will lie on the fit and proper requirements of article 42 with the surrounding regulation merely introduced.

As mentioned in, among others, the Sharma report the greatest threat to insurance undertakings, and in turn their customers, under the former regulatory regime was not undercapitalisation per se, but rather a lack of proper risk management. To remedy this lack of dimension to the EU insurance regulation Solvency II introduces a number of rules dictating how an undertaking must organise itself, control itself and also who can be included in such decision-making processes.

3.3.2.1 Organisational structure

The chapter on governance starts of with demanding from the undertakings that there be an effective system of governance which provides for sound and prudential management. Simply put the bodies, or persons, held responsible for a company’s action must also be in control. The rules regarding governance is not clearly separable like the rules in the first pillar are, however, dividing the rules into the following categories might illuminate some of the issues, as regards the purely organisational part of the directive. On the whole, one finds the directive states that there are different functions, that there shall be clear divisions when it comes to company organisation - ‘who does what’, and that there are rules pertaining to which functions are to be separated more vigorously from the others.

When discussing the functions of the insurance undertaking one first has to turn to the directive’s definition of a function. A function, according to the directive, relates to an ‘internal capacity to undertake practical tasks’, continuing; ‘a system of governance includes the risk-management function, the compliance function, the internal audit function and the actuarial function’. A similar definition is found in the preamble, however, with some important alterations. Instead of ‘internal capacity to undertake practical tasks’, the preamble

89 Ibid, article 13 (29).
defines a function as ‘an administrative capacity to undertake particular governance tasks’.

The reason also states that ‘the identification of a particular function does not prevent the undertaking from freely deciding how to organise that function in practice, save where otherwise specified in this Directive’. The preamble goes on to say that there should be a sense of proportionality in this definition and that the same unit or person should be able to work with more than one function, at least in smaller entities. This view is shared by EIOPA in their level 2 advice, although expressed as it is the larger companies that need to separate their key functions. In conclusion a function is a unit administratively assigned to a certain practical task.

The defining of what a function is is naturally linked to the question of organisational structure. The directive’s article 41.1 gives, in its second paragraph, that the system of governance shall be transparent with clearly assigned and separated tasks. However, this structure has only to be “at least adequate”. What is deemed adequate is, of course, dependent on the size and the complexity of the undertaking, and to this end there is included a proportionality clause, covering the entire system of governance. However large or small, complex or simple, the organisational structure might be, there is still a demand for effective communications.

So far, theoretically, the smallest, least complex, insurance undertaking only has to have an organisational structure consisting of the key functions; risk-management, compliance, internal audit and actuarial functions. Quite obviously, however, the internal audit function has to be separated from the other functions. As it also has to be objective this separation is not only an administrative one, but the personnel of the internal audit function has to be unique to that function.

The Swedish Ministry of Finance’s report clarifies their standpoint in the matter by saying that seeing how Solvency II is a principle-based directive the important factor in implementing the legislation into Swedish law is not to do so verbatim, but rather in a way that meets the goals of the directive. This, in their view, means that the division of tasks

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90 Ibid, preamble, reason 31.
91 Ibid.
92 Ibid, preamble, reasons 31-32. See also Directive 2009/138/EC, article 41.2.
93 CEIOPS Advice for Level 2 Implementing Measures on Solvency II: System of Governance, CEIOPS-DOC-29/09, p. 12.
95 Ibid, article 41.1.
96 Ibid, article 47.2.
97 Ibid. See also SOU 2011:68 p. 318.
between the key functions and the naming of such functions is moot as long as an undertaking can show that the governance requirements are met.\textsuperscript{98} In line with this argument they, however, point out the fact that the same reasoning is not to be applied to the internal audit function.\textsuperscript{99}

3.3.2.2 Responsibilities of the management

Apart from the organisational regulations, the chapter on governance lays out material rules and procedures for the managing body of an undertaking to answer for. Named amongst the general governance requirements is the demand put on undertakings to issue internal written policies, at least in relation to the key functions.\textsuperscript{100} In light of article 40 and 41.1, and with the Swedish Ministry of Finance’s reasoning in mind, these policies should likely be produced in relation to any larger function the undertaking has. All such policies should be reviewed annually and be approved by the board, or by the body to which the board has delegated the relevant power.\textsuperscript{101} The policies should outline the responsibilities, goals, processes and reporting procedures to be used by the relevant function.\textsuperscript{102} However, for the purpose of risk-management, the directive expressly states what must be included in the policies, i.e. what risks must be considered.\textsuperscript{103} Besides the demand for certain policies, the article on risk-management states that an insurance undertaking must have in place an effective system of risk-management capable of continuous measuring and managing of risks.\textsuperscript{104} As risk-management is key to the governance requirements of Solvency II, the system for risk-management shall be weaved together with the system of governance.\textsuperscript{105}

The cornerstone of the risk-management function is the own risk and solvency assessment, ORSA. The ORSA requires the undertaking to make an assessment of its overall solvency need with respects to risk profile and business strategy.\textsuperscript{106} The overall solvency need encompasses a greater deal of the general business strategy and risks compared to the SCR, and should be made with a lengthier perspective then the same, covering any existing

\textsuperscript{98} SOU 2011:68 p. 280.
\textsuperscript{99} Ibid.
\textsuperscript{100} Directive 2009/138/EC, article 41.3.
\textsuperscript{101} Ibid, paragraph 2. Mind that this is dependant on the national legislation on the possibility for the board to delegate certain powers.
\textsuperscript{102} CEIOPS Advice for Level 2 Implementing Measures on Solvency II: System of Governance, CEIOPS-DOC-29/09, p. 14.
\textsuperscript{103} Directive 2009/138/EC, article 44.2.
\textsuperscript{104} Ibid, article 44.1.
\textsuperscript{105} Ibid.
\textsuperscript{106} Ibid, article 45.1 (a).
business plan. This broader assessment shall be used when making strategic business decisions, and as such be kept updated by the undertaking. Even though the overall solvency requirement of the ORSA and the SCR are two different constructions, they are not entirely separated as part of the ORSA is to assess the compliance with the SCR and MCR, as well as compliance with the regulations on technical provisions. Furthermore, once the compliance with the capital provisions is assessed, the undertakings risk profile is to be compared with the risk assumptions underlying the SCR. In comparing the ORSA with the SCR one should keep in mind that the ORSA does not set up any parameters for what level of solvency need is acceptable, only that the ORSA continually shall serve as an indicator of the way the undertaking balances risk and revenue. Moreover, the ORSA is done in a forward looking manner, stretching farther than the one year perspective of the SCR. Because of this, the ORSA shall include an assessment of the significance of the difference between the overall solvency need and the SCR, as regards the underlying risks. Note here that it is the significance that shall be assessed, not the difference in risk handling itself.

Besides the risk-management system, and also a part of the system of governance, insurance undertakings shall have an effective internal control system. The internal control system should be a ‘coherent, comprehensive and continuous set of mechanisms’ put in place to ensure certain goals. According to EIOPA’s explanatory text on the directive’s article 46 these goals are: effectiveness and efficiency of operations in view of its risks and objectives; availability and reliability of financial and non-financial information; and compliance with laws, regulations and administrative provisions. For instance, it should be in the purview of the compliance function to gain access to any records it would need to complete its tasks from any employee, at its own accord. The same text also recommends that any major compliance problems should be reported to the board of directors.

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108 Ibid, article 45.4-5.
109 Ibid, article 45.1 (b).
110 Ibid, article 45.1 (c).
111 SOU 2011:68 p. 278.
112 See note 109.
114 CEIOPS Advice for Level 2 Implementing Measures on Solvency II: System of Governance, CEIOPS-DOC-29/09, p. 46.
115 Ibid.
116 Ibid, p. 50.
117 Ibid.
A function with a nexus to the internal control system is, of course, the internal audit function. It is the task of the internal audit function to assess the internal control system, as well as the rest of the system of governance.\(^{118}\) It thus is within the responsibility of the internal audit function to ensure that the abovementioned written policies are adhered to, as well as any processes and reporting procedures mentioned in them or elsewhere.\(^{119}\) In order to ensure that the internal audit function is effective the undertaking is required to supply them with sufficient resources. Additionally, an effect of the internal audit function’s need to be objective is that they can not be given any instructions by the board when it comes to performing and evaluating audits. The board is, in this respect, only allowed to change or approve audit plans.\(^{120}\)

The two last issues regulated in the governance chapter are the actuarial function and outsourcing. Article 48.1 on the actuarial function lays out requirements on the effectiveness and quality of the work carried out within that function. The article itself is not one of a technical nature; however, it sets out the technical responsibilities of the actuarial function, such as coordination of the calculation of technical provisions, the carrying out of tests on the quality of statistical data and the comparing of best estimates against experience. The directive also puts demands on the persons working within the actuarial function as regards their technical knowledge and experience.\(^{121}\) These demands should not be interpreted as if though a certain degree is needed, neither is any certification granting the professional title ‘actuary’.\(^{122}\) However, EIOPA also states that the national and international associations setting standards for actuaries can be used to ensure compliance with the actuarial requirements until a European standard is enacted.\(^{123}\) Last in the chapter on governance is the article on outsourcing. Without going in to greater detail, this article simply states that an insurance undertaking should not allow any loss of quality or any unduly increase in risk and that an undertaking always should report to the supervisory authority before outsourcing important functions.\(^{124}\)

\(^{118}\) Directive 2009/138/EC, article 47.1.
\(^{119}\) CEIOPS Advice for Level 2 Implementing Measures on Solvency II: System of Governance, CEIOPS-DOC-29/09, p. 50.
\(^{120}\) Ibid, p. 51.
\(^{121}\) Directive 2009/138/EC, article 48.2.
\(^{122}\) CEIOPS Advice for Level 2 Implementing Measures on Solvency II: System of Governance, CEIOPS-DOC-29/09, p. 53.
\(^{123}\) Ibid, p. 54.
\(^{124}\) Directive 2009/138/EC, article 49.
3.3.2.3 The fit and proper requirements

The main focus of this essay is the fit and proper requirements of the directive’s article 42, therefore, this section has been lifted out from the general governance run-through to be separately addressed here. The title of article 42 is ‘Fit and proper requirement for persons who effectively run the undertaking or have other key functions’, and to make the presentation of this article as lucid as possible the first part of this presentation will be divided into three main parts following the phrasing of the article. Thus, the three parts are; the fit requirement, the proper requirement and the question of who falls within the scope of the article. Subsequently, the processes and policies an insurance undertaking must carry out to ensure compliance will be discussed.

First, some general remarks on materials. The directive and surrounding explanatory texts, such as EIOPA’s final advice on the Level 2 implementing measures, does not supply adequate guidance as to what the processes and policies needed for compliance with article 42 should be. To this end, texts stemming from the abovementioned IAIS will be consulted. Nearly all the EU member states are members of IAIS and seeing to both the fact that they have already agreed on materially the same regulation in another forum earlier, and the fact that ideas stemming from IAIS have been used readily in constructing the Solvency II directive, one might bestow upon their practices and guidelines some measure of importance. IAIS enacted their first set of insurance core principles (ICP) in 2003, where suitability of persons constituted one of the principles. Two years later the IAIS issued standards for the supervision of this principle. This document will supply some guidance together with the newly adopted Insurance Core Principles, Standards, Guidance and Assessment Methodology issued in October 2011.

To what extent a person is deemed fit depends on that person’s professional qualifications, knowledge and experience. In short, fitness relates to professional competence. The directive and the surrounding documents are all silent on the matter if fitness necessitates any certain education. The reasoning in the actuarial case would imply that no such education is

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125 See section 2.2.1.
126 Insurance Core Principles and Methodology, International Association of Insurance Supervisors, October 2003, p. 16.
127 Supervisory Standard on Fit and Proper Requirements and Assessment for Insurers, International Association of Insurance Supervisors, October 2005.
130 CEIOPS Advice for Level 2 Implementing Measures on Solvency II: System of Governance, CEIOPS-DOC-29/09, p. 17.
necessary.\textsuperscript{131} This seems only logical as the opposite interpretation would impair the possibility of in-office ascension. The phrasing does however raise the question if it is all of the categories, professional qualifications, knowledge and experience that have to be fulfilled or if they are interchangeable. This is hardly a question when it comes to the actual qualification, where one might apply the assumption that the relevant experience also carries the relevant knowledge, however, it might be an issue when it comes to what information the insurance undertaking has to provide the supervisory authority with. That is, would it be enough to show the supervisory authority that the person in question had the sought after experience? The newest IAIS standards seemingly leave this issue unanswered. In regards to their suitability standards, the text reads ‘competence can generally be judged from the level of an individual’s professional or formal qualifications and knowledge and/or pertinent experience…’ \textsuperscript{132} There are two possible ways of reading this locution, one that demands some qualification together with at least one out of knowledge or experience, and a second one that makes the first two categories surmountable by experience. Reading the older IAIS supervisory standards, one finds that the knowledge and experience of the individual in question at least has to be at an adequate minimum level, when put against the possibility of taking the collective competence into consideration.\textsuperscript{133} The final element of IAIS viewpoint in the matter follows under the section describing what materials a key person must supply the supervisory authority with. An individual in a key position should submit a ‘résumé indicating the professional qualifications as well as previous and current positions of the individual’.\textsuperscript{134} This can be understood as if one has to bear a professional qualification, but it can also be interpreted as if one has a professional qualification it shall be accounted for. As earlier discussed, the lack of a demand of a professional qualification in the actuarial case, however uncertain any logical spill-over onto other key position would be, might speak for the view that no professional qualification can be demanded and thus, the categories knowledge and experience, in this question, prevails.

To what extent the requirements of article 42 are individual or collective is another important issue. The advice from EIOPA makes a distinction at this point, between ‘technical

\textsuperscript{131} See last section.
\textsuperscript{132} Insurance Core Principles, Standards, Guidance and Assessment Methodology, International Association of Insurance Supervisors, October 2011, article 5.2.2.
\textsuperscript{133} Supervisory Standard on Fit and Proper Requirements and Assessment for Insurers, International Association of Insurance Supervisors, October 2005, p. 4, paragraph 28.
\textsuperscript{134} Ibid, p. 5, paragraph 33.
competence’ and ‘management competence’.\textsuperscript{135} The members of the board must collectively be able to manage the undertaking in a way that adheres to the principles of Solvency II, while retaining their separate fields of technical expertise.\textsuperscript{136} The width and depth of both these types of competence is subject to the general principle of proportionality, and varies accordingly depending on what task a person is responsible for as well as with the size and complexity of the undertaking.\textsuperscript{137} All persons on the board will not, for example, know the intricate details of the SCR, or the designs of the undertaking’s internal model for its calculation. Needless to say, a person in a key position which is not on the managing board does not have to have the same managing competence as a member of the board. The principle of proportionality also results in the fact that a holder of a key function of a larger undertaking may have technical knowledge surpassing the board member responsible for the same area of expertise in a smaller undertaking. On the issue of collective versus individual requirements, IAIS supervisory standards allows for the knowledge and expertise of other employees of an undertaking to complement the knowledge of a key functionary.\textsuperscript{138} This would hardly be appropriate relating to the management competence of a board member, but could with a certain degree of proportionality be used on a holder of another key function. In conclusion relating to the manner of collective versus individual requirements, as regards the board, the technical competence can be viewed as collective in that sense that each board member answers for a certain expertise, where collectively the whole spectrum of details pertaining to the managing of the undertaking is accounted for.\textsuperscript{139} That is, a collection of competences answering a multitude of governance demands. For the management competence the requirement is collective in the sense that each board member brings a certain degree, a part, of managerial competence resulting in one whole capacity to manage the undertaking. Assessment of the technical competence can therefore be individual to a greater extent, compared to the managerial competence which must be assessed collectively. On the subject of the suitability of the board EIOPA also states that the overall group dynamics of the board may be important for the sound and prudent managing of an insurance undertaking.\textsuperscript{140}

\textsuperscript{135} CEIOPS Advice for Level 2 Implementing Measures on Solvency II: System of Governance, CEIOPS-DOC-29/09, p. 17.
\textsuperscript{136} Ibid.
\textsuperscript{137} Directive 2009/138/EC, article 41.2.
\textsuperscript{138} Supervisory Standard on Fit and Proper Requirements and Assessment for Insurers, International Association of Insurance Supervisors, October 2005, p. 4, paragraph 28.
\textsuperscript{139} CEIOPS Advice for Level 2 Implementing Measures on Solvency II: System of Governance, CEIOPS-DOC-29/09, p. 17, 3.42.
\textsuperscript{140} CEIOPS-DOC-76/10, CIEOPS Level 3 Guidance on Solvency II: Pre-application process for Internal Models, p. 44.
Naturally, one must give the thought, that a board full of risk taking personalities would ensue a higher risk, its due merit. Nonetheless, how an assessment of the board’s group dynamics would be conducted is hard to imagine, and as it seemingly falls outside the scope of article 42 it will not be addressed further here.

Thus far, the ability to carry out one’s responsibilities, within the scope of the fit requirement, has only been discussed in terms expressly stated in article 42.1 (a). Another variable affecting the suitability for a board membership or the holding of a key function is the level of commitment the position requires, at least in the eyes of the IAIS.\textsuperscript{141} This factor is named under the section covering governance, where it should likely fit into the Solvency II regime as well.\textsuperscript{142} However, since it concerns the personal suitability and competence of the prospective board member it is a factor that should be assessed in appraising the suitability of board members. The IAIS standards demand of a board member that he or she possess the appropriate commitment, a property shown, e.g., through the pertinent allocation of time to the tasks at hand, or by limiting the number of external board commitments a board member can hold.\textsuperscript{143} It should be stressed that this, as abovementioned, shall be measured against the general governance requirements of article 41, but kept in mind towards the end of this chapter.

Onwards to the next requirement of article 42, namely the proper requirement. Before discussing what factors might influence one’s propriety, a few issues raised above shall be addressed in regards to the proper requirement. The proper requirement is an individual one, and all key functionaries shall be proper.\textsuperscript{144} Consequently, one ‘very’ proper board member and an ‘almost’ proper board member do not make for two adequately proper board members. Contrary to the proportionality clause’s applicability on the fit requirement, the size or complexity of an undertaking, or any other factor for that part, does not affect the proper requirement.\textsuperscript{145} Hence, all persons running an undertaking or holding a key function has to meet the same requirement.

The proper requirement is phrased as a person being ‘of good repute and integrity’.\textsuperscript{146} One can easily see how integrity is a most important quality of anyone who governs an insurance

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\textsuperscript{141} Insurance Core Principles, Standards, Guidance and Assessment Methodology, International Association of Insurance Supervisors, October 2011, article 5.2.2.
\textsuperscript{142} Ibid, article 7.3.2.
\textsuperscript{143} Ibid.
\textsuperscript{144} CEIOPS Advice for Level 2 Implementing Measures on Solvency II: System of Governance, CEIOPS-DOC-29/09, p. 17, 3.43.
\textsuperscript{145} Ibid.
\textsuperscript{146} Directive 2009/138/EC, article 42.1 (b).
undertaking, especially when it comes to making appropriate risk related decisions. That a key functionary’s reputation might affect the external view of an undertaking is of course true, a fact that could bring adverse effects to its reputation as a whole and thus affect the business of the undertaking. How that fact would get legal importance is, however, unclear. Such an interpretation of the word repute would bring certain injustices with it. The term should rather be interpreted in a more formal manner, and be treated as indicative as to the integrity of the person. EIOPA’s level two advice expresses their thoughts in a manner that sheds some light what is meant by reputation. It states that a supervisory authority, at least, should assess the person’s reputation when assessing the propriety, and goes on to give examples of what areas the supervisory authority might look in to. Continuing on the same subject, it says ‘[t]his approach does not imply that all previous infringements will automatically result in a declined application…’, a locution that on the surface presupposes transgressions where there is a reputation, but rather should be interpreted as that ‘reputation’ in fact means ‘track record’. In this respect IAIS talk about ‘integrity demonstrated in personal behaviour and business conduct’, which coincides with the latter interpretation of EIOPA’s text. In short, the supervisory authority should assess the key functionary’s integrity through studying that person’s conduct historically.

On the factors that could influence the assessment of propriety, the EIOPA level 2 advice and the IAIS standards generally corresponds to each other. That is to say, both texts supply similar examples of what could be indicators, without ruling out other factors.

Most apparent, and first mentioned in all text, are criminal antecedents. The basic principle in this respect is that a person should not have a criminal record showing a conviction for a crime under a law designed to protect the public against financial loss. Examples of this could be embezzlement and fraud. The same goes for similar crimes, not directly aimed at the public, such as money-laundering and the financing of terrorism. Even though the principle, understandably, is one of a zero tolerance, the supervisory authority should take into account into their assessment the severity of the crime, the time elapsed since the transgression and

147 CEIOPS Advice for Level 2 Implementing Measures on Solvency II: System of Governance, CEIOPS-DOC-29/09, p. 18, 3.50.
how the person’s behaviour has changed since the incident.\textsuperscript{150} One should also keep in mind that other criminal activity could, of course, be indicative of a person’s character and integrity, however, for an assessment to be fair, only abovementioned criminal conduct of an economic or financial nature should be directly disqualifying. That is to say, the fact that the propriety requirement does not fall under the proportionality clause does not mean that facts not pertinent to the governing of an undertaking should become a factor in the propriety assessment.\textsuperscript{151}

A second example of factors deteriorating one’s reputation is financial indicators of misconduct. Among these factors can be found personal factors, such as personal bankruptcy, financial difficulties leading to civil proceedings, or otherwise. This category also encompasses negligence in decision making with former employees. On that same note, the fact that one has been a board member or has held a key position in a company that has undergone bankruptcy or insolvency procedures, can also reflect negatively on the assessed.\textsuperscript{152}

Information collected by the supervisory authority at hand, or another supervisory authority, could of course become a factor if the person who is being assessed has shown misconduct in earlier dealings with the authorities. Examples of this could be instances of submission of wrongful information to the supervisory authority by the functionary, or instances were the supervisory authority has taken corrective action against the assessed.\textsuperscript{153} In excess to this, IAIS also introduces a category named ‘other indicators’ where they list such things as disciplinary actions from professional organisations, e.g. a bar association, or where a former employer has had reasons for lawful dismissal of the person because of his or her improper or unprofessional behaviour.\textsuperscript{154}

In conclusion, the assessment of the proper requirement can include any factor which relates to the professional conduct of the assessed person. However, as the purpose of the regulation is to ensure sound and prudent management of insurance undertakings, taking facts into

\textsuperscript{150} Ibid.
\textsuperscript{151} Ibid.
\textsuperscript{152} Ibid.
\textsuperscript{153} Ibid.
\textsuperscript{154} Supervisory Standard on Fit and Proper Requirements and Assessment for Insurers, International Association of Insurance Supervisors, October 2005, p. 3, paragraph 24, Insurance Core Principles, Standards, Guidance and Assessment Methodology, International Association of Insurance Supervisors, October 2011, article 5.2.4.
account that do not relate to the person’s business conduct or management should not be possible, an example of this is the abovementioned non-financial criminality.

With the fit and proper requirements outlined the next step is to identify who is subject to the suitability regulation, and in what sense. Article 42’s heading states that it is the persons who effectively run the undertaking or have other key functions that should be covered by the suitability requirements. The first group covered by the rule is ‘persons who effectively run the undertaking’. This category includes, but is not necessarily exclusive to, members of the undertaking’s managing board. Additionally, senior managers, holding position where they take part in high level decision making or are responsible for the carrying out of internal strategies and policies, can be part of this category. Significant owners could, of course, exercise great influence over an undertakings management. However, the suitability of the significant owners is regulated elsewhere in the Solvency II directive, and as such it is not covered by the fit and proper requirements of article 42. In the Swedish corporate system, where the managing director is not a part of the board, that person would be covered by this, the first part of the locution, which is also expressly stated in the Swedish Ministry of Finance’s report. The seemingly irrelevant distinction between who is a person who effectively runs the undertaking and who is a person who has a key function is in fact relevant, and why so will be discussed below.

Also covered by the requirements of the directive’s article 42 are persons who have a key function. Which functions an undertaking has is, as earlier stated, up to its own accord, however, there are some mandatory functions. These mandatory functions also constitute key functions. However, in smaller undertakings some of these functions may be merged, with the same persons working within different functions, and in larger undertakings there may be additional functions classified as key due to their importance or size. The question then becomes if ‘persons who… have other key functions’ relates to anyone working within a key function, or if it someway is limited. The first factor in determining the scope of the

156 Ibid, article 42.
157 CEIOPS Advice for Level 2 Implementing Measures on Solvency II: System of Governance, CEIOPS-DOC-29/09, p. 16, 3.38.
158 Ibid.
161 Ibid.
163 CEIOPS Advice for Level 2 Implementing Measures on Solvency II: System of Governance, CEIOPS-DOC-29/09, p. 16, 3.39., also see note 92.
article is found in the context. The article is placed in the governance chapter, and as such pertains to governing, or at least some measure of decision making. The phrasing ‘persons who effectively run the undertaking or have other key functions’ also illuminates the fact that the requirements cover persons that have influence over the undertaking. Simply put, if everyone working within a function was to be covered by the fit and proper requirements, this would have been stated clearly. This view is fortified by the fact that the qualifications of anyone working within the actuarial function is regulated separately.\textsuperscript{164} Article 48.2, on the actuarial function, specifically points out personnel in that function and sets out different requirements for them, from what is stated in article 42. As the actuarial function is a key function, the personnel in this function would have been covered by the fit requirement in article 42, if its scope was ‘universal’.\textsuperscript{165}

So if anyone included in a key function does not constitute a person who has a key function, the question then becomes; who does? At this point the notification requirements put on the insurance undertaking becomes crucial. Article 42.2-3 outlines the undertaking’s responsibility as regards to changes to the roster of persons running the undertaking, or who are responsible for key functions. Of course, when starting up an insurance undertaking, an assessment of the system of governance will be included in the process, however, in this case EIOPA states that the insurance undertakings shall notify the supervisory authority who the persons covered by article 42 in their undertaking are. This is also the case when the legislation is coming into force, the point at which all existing insurance undertakings are now.\textsuperscript{166} Noteworthy of this statement, which is also reiterated in the preamble, albeit in regards to the notification requirements, is that the text speaks of key function holders.\textsuperscript{167} The preamble even goes as far as distinguishing between performers of key functions and key function holders. All of the above have to be fit and proper, but only the key function holders are subject to the notification requirements. With that said it becomes clear that it is not only function seniors, or chiefs, that are covered by article 42, but also more junior employees.

As now apparent, which parameters article 42 ranges within, is fairly unclear. As the reading as well as the context leaves it unclear one might acquire some guidance from the reasons behind the regulation. Among the first indicators that spurred this regulation was the

\begin{itemize}
\item \textsuperscript{164} Directive 2009/138/EC, article 48.
\item \textsuperscript{165} Directive 2009/138/EC, preamble, reasons 30 and 33.
\item \textsuperscript{166} CEIOPS Advice for Level 2 Implementing Measures on Solvency II: System of Governance, CEIOPS-DOC-29/09, p. 17, 3.41.
\item \textsuperscript{167} Ibid, Directive 2009/138/EC, preamble, reason 34.
\end{itemize}
The abovementioned Sharma report. The report showed that most of the undertaking failures were due to incompetence of the management and improper risk managing decisions. As a result the governance regulation was introduced to prevent insurance undertakings from going belly-up due to bad management. Seeing to the fact that the regulation was enacted to prevent such mishaps by way of restricting the access to power for unsuitable persons, article 42 could be seen as being applicable on the appointment of all positions which gives the holder power within the undertaking. As the regulation is meant to restrict the damage done to the company, or its holdings, which would put the insurance taker in a less favourable position, one might also come to the conclusion that a certain degree of independence in the decision making would indicate a position covered by the suitability requirements.

In conclusion, as regards the scope of article 42, the following seems to be the situation. The managing board plus senior officials taking part in high level decision making, such as the managing director, constitutes the persons who effectively run the undertaking. Persons who have key functions are not everyone working within such a function, but it is on the other hand not limited to the heads of such functions either. Junior officers can be included in the scope, if they have the power and independence in their decision making to adversely influence the company in such a way as would endanger the position of the insurance takers.

With the new solvency regime comes a change in the supervisory procedures, at least compared with earlier Swedish legislation, since the suitability assessment is not done beforehand by the supervisory authority but is instead conducted by the insurance undertaking itself. In the same manner as Solvency II, the IAIS now demands of the insurance undertaking to demonstrate the suitability of the persons in key positions. To ensure this is done properly by the undertaking it has to instate policies laying down procedures for this assessment. It is then these processes and procedures which are going to be assessed by the supervisory authority, creating a model where the supervisory authority assesses the undertaking’s ability to supervise itself. This process is called the Supervisory Review Process, SRP. Eiopa have already stated that guidance on these procedures will be offered

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168 Sharma, Paul (chairman) et alia, 2002.
170 See section 2.2..
172 Insurance Core Principles, Standards, Guidance and Assessment Methodology, International Association of Insurance Supervisors, October 2011, article 5.3.
173 CEIOPS Advice for Level 2 Implementing Measures on Solvency II: System of Governance, CEIOPS-DOC-29/09, p. 17, 3.44.
under level 3 and have not left much to go on so far. The processes and procedures that might come to include will be discussed further under section 5.

3.3.2.4 Supervision

This section will briefly outline the rules regarding supervision in the Solvency II directive. In doing so, it will also present the different authorities involved in the supervision. As this essay takes a Swedish viewpoint, the national supervisory authority presented will be the Swedish Financial Supervisory Authority (Finansinspektionen, hereinafter FI).

The main objective of the supervisory measures given to the supervisors is the protection of policy holders and beneficiaries, just like the main objective of the directive as a whole. A secondary objective for the supervisory authorities is to guard the financial stability, and to do this in a manner preventing pro-cyclical effects, i.e., effects that enhance the economic fluctuation’s extremes. In the same manner as the general insurance regulation has moved towards a more risk-based approach with Solvency II, so has the idea of how the supervision should be carried out. The result of this thinking is the abovementioned SRP. As the supervision goes from examining quantitative factors towards examining qualitative factors, such as governance structures and reporting procedures, the supervision is covered by a general proportionality clause, stating that all supervision shall be proportionate to the nature, scale and complexity of the supervised entity. This does not mean that the aforementioned propriety requirement is covered by a proportionality clause, contrary to what has been stated above, but rather that the supervision regarding the procedures for ensuring this propriety might be more strenuous towards more complex undertakings.

According to Article 30.1 of the Directive, the supervision of an insurance undertaking, including its branches and foreign business operations, is the sole responsibility of the home Member State. For insurance undertakings who have Sweden as their home Member State, the supervisory authority is FI. Their responsibilities range from assessing internal models for the calculation of the SCR to stress testing the SRP thus assessing the internal processes.
regarding an undertaking’s fitness assessments.\textsuperscript{181} With a large number of tasks, spanning from routine controls to thorough examinations, a great deal of flexibility is demanded of FI.\textsuperscript{182} With this flexibility might come a need for greater resources, a fact that has been addressed in the Directive’s article 27. The article demands that Member states ensure that the supervisory authorities have all the required resources to carry out supervision in accordance with the directive, a statement so self-evident in the eyes of the Swedish Finance Ministry’s rapporteurs that they conclude that this does not have to be implemented into Swedish law.\textsuperscript{183}

The general supervisory powers are presented in article 34 of the Directive. The general idea of the directive as regards supervision is that the supervisory authorities should have all necessary powers, and be able to take any necessary measures, to ensure the compliance by the undertakings under its supervision.\textsuperscript{184} Certain elements of these powers and measures are elaborated on in article 34. As will be discussed under section 3.3.3. the third pillar of the directive, regarding transparency, requires the insurance undertakings to provide the supervisory authorities with certain information. Under the supervisory powers heading, the member states are demanded to ensure that the supervisory authorities possess the power to demand of insurance undertakings to produce such information.\textsuperscript{185} Furthermore, the supervisory authorities should be able to devise models for testing undertaking’s readiness towards possible changes in the financial climate or certain events. The supervisory authorities should also be able to make the undertakings undergo these tests.\textsuperscript{186} To highlight the fact that both off and on-site supervision is necessary to uphold the standards of the directive, the article specifically states that supervisory authorities must be able to conduct on-site investigations into the undertakings’ operations.\textsuperscript{187} Perhaps the provision most to point, however, is the demand that supervisory authorities should be able to force insurance undertakings to remedy weaknesses or deficiencies that are found through the SRP.\textsuperscript{188}

The keystone to the new supervisory regime is, of course, the SRP. The article on the SRP lays out general provisions which are then complemented by a list of issues the supervisory authorities should give extra attention.\textsuperscript{189} The shift in focus towards own supervision shines

\textsuperscript{181} Ibid, article 34.4, 36.4, 112.3-7.
\textsuperscript{182} SOU 2011:68, p. 336.
\textsuperscript{183} Ibid, p. 338.
\textsuperscript{184} Directive 2009/138/EC, article 34.1-2.
\textsuperscript{185} Ibid, articles 34.3 and 35.
\textsuperscript{186} Ibid, article 34.4.
\textsuperscript{188} Directive 2009/138/EC, article 36.5.
\textsuperscript{189} Ibid, article 36.
through in the first paragraph, stating that the supervisory authorities shall ‘review and evaluate the strategies, processes and reporting procedures […]’ that the undertakings have designed. It goes on to say that this evaluation should include the system of governance, the risks pertinent to the undertaking at present and going forward as well as the undertaking’s ability to assess and handle these risks themselves.\(^{190}\)

To accomplish this, the supervisory authorities should have monitoring tools in place, both to identify how the undertaking in fairing financially, and when meeting adverse financial conditions in the undertaking, how such adversities are coped with.\(^{191}\) For the supervisory authorities to keep their insight into the undertakings, the evaluations and reviews shall be carried out regularly.\(^{192}\) However, as discussed above, the whole chapter on supervision lives under a veil of proportionality. Not only is this mentioned generally in the beginning of the chapter, but again under the supervisory powers, and under the SRP.\(^{193}\) This means that the supervisory authorities’ evaluations and reviews under the SRP should be adjusted, not only in scope, but also in frequency.

Though stated earlier in the chapter on supervision that the supervisory authorities shall be able to take all measures necessary to insure compliance to laws and regulations by the undertakings, one measure has been separately addressed, the capital add-on.\(^{194}\) This measure is only to be inflicted on the undertakings in exceptional situations, following three specific occurrences. The first of these occurs when the insurance undertaking’s risk profile differs significantly from what the assumptions underlying the SCR standard formula are, and no alternative internal model is in place or if the internal model is not working accordingly.\(^{195}\) Simply put, if the SCR is not enough to keep a responsible capital buffer due to the undertaking having a risk profile not anticipated by the directive, a capital add-on can be added to make up for the difference.\(^{196}\) The second situation is similar to the first, with the difference that it occurs when an undertaking is using an internal model that has been deemed insufficient, and where measures to correct this insufficiency has not been taken quickly enough.\(^{197}\) The third and last situation where a capital add-on can be inflicted on the undertaking is where there are substantial shortcomings in the system of governance, resulting

\(^{190}\) Ibid, article 36.1 paragraph 2, article 36.4.
\(^{191}\) Ibid, article 36.3.
\(^{192}\) Ibid, article 36.6.
\(^{193}\) Ibid, articles 29.3, 34.6 and 36.6 paragraph 2.
\(^{194}\) Ibid, article 37.
\(^{195}\) Ibid, article 37.1 (a).
\(^{196}\) Ibid, articles 37.2 and 101.3.
\(^{197}\) Ibid, article 37.1 (b).
in a poor ability to assess and handle risks. The option of a capital add-on in this third situation is however limited to situations where no other measure available to the supervisory authority could be effective quickly enough.\textsuperscript{198} In the third case, the add-on is not calculated as a difference between the undertakings SCR and the correct capital buffer, but is instead proportionate to the shortcomings of the undertaking.\textsuperscript{199}

EIOPA is the supervisory authority on the EU-level. Their main objective and task is to coordinate supervision throughout the EU to ensure that supervision in different member states is consistent and effective.\textsuperscript{200} This is done through collecting data from the member state’s supervisory authorities and enacting technical standards, guidelines and recommendations.\textsuperscript{201} This is, as mentioned earlier, EIOPA’s role as the Level 3 authority.\textsuperscript{202} This is done mainly to improve consumer protection, but also as a measure to level the playing field.\textsuperscript{203}

Enacting Level-3 legislation can be thought of as an ‘indirect’ power, however, EIOPA has also been granted some ‘direct’ powers. The least dramatic of these is EIOPA’s role as a mediator, should disagreements arise between supervisory authorities in cross-border situations, or in cross-section situations.\textsuperscript{204} More substantial are the powers granted EIOPA in the case of the Council declaring an emergency situation. Such an emergency can be declared if developments threaten the orderly function or integrity of the financial markets or the stability of the EU’s financial system.\textsuperscript{205} In those cases, EIOPA can be put in charge of coordinating the actions of the national supervisory authorities, with express powers to dictate their actions if needed.\textsuperscript{206} Should this not be effective, EIOPA can even take supervisory decisions aimed at the supervised entities themselves, decision holding superior legal standing to the ones issued by the national supervisory authority.\textsuperscript{207}

In conclusion, the supervisory regime in Solvency II is based on own supervision, where undertakings and supervisory authorities interacts through the SRP. This is done under the supervision of EIOPA, whose task it is to ensure that supervision throughout the EU is conducted in the same, effective and efficient, manner.

\textsuperscript{198} Ibid, article 37.1 (c).
\textsuperscript{199} Ibid, article 37.1 paragraph 2.
\textsuperscript{200} Regulation 1094/2010/EU, article 8, 21, 29 and 31.
\textsuperscript{201} Ibid, articles 10-16, 30 and 35, and Directive 2009/138/EC, articles 52 and 71.
\textsuperscript{202} See section 3.2.2..
\textsuperscript{203} Regulation 1094/2010/EU, article 9.
\textsuperscript{204} Ibid, articles 19-20.
\textsuperscript{205} Ibid, article 18.
\textsuperscript{206} Ibid, article 18.3.
\textsuperscript{207} Ibid, article 18.4-5.
3.3.3 Third pillar, transparency

The third pillar consists of rules aimed at what information an insurance undertaking has to share, and to whom. The regulation in this respect can be divided into two main parts, information the undertaking has to provide to the supervisory authority, and information the undertaking has to provide to the public.\textsuperscript{208} The third pillar also contains regulations on what circumstances might excuse an undertaking from sharing or publishing certain information.\textsuperscript{208}

As discussed earlier, the management of the undertaking holds a number of responsibilities as to issuing written policies and procedures with regards to the different operational aspects of the undertaking.\textsuperscript{209} In the last section, the manner in which this will be supervised was mentioned, as well as the power that lies with the supervisory authority to force the undertaking’s to produce information enabling supervision. Looking at the same policies and procedures from a third perspective is article 35, which regulates what information the undertakings need to supply the supervisory authorities with. Most of this regulation was already included in the earlier directives on the insurance market, and as such, the lions share has already been implemented into Swedish law.\textsuperscript{210} The following will only provide a short run-through of the content of article 35.

Logically, the provision starts of by stating that the undertakings should provide the supervisory authorities with information enough to conduct the SRP in an appropriate manner.\textsuperscript{211} Which information this is, and how detailed the information has to be is left up to the supervisory authority.\textsuperscript{212} This may include information on contracts held by insurance intermediaries or contracts entered with third parties as well as information from external experts, such as auditors and actuaries.\textsuperscript{213} The article also describes the nature of the information, such as it having to reflect the nature and complexity of the undertaking as well as it has to be relevant, reliable and comprehensive.\textsuperscript{214}

Other than article 35, there are rules in the directive pertaining to certain situations where an undertaking has to supply the supervisory authority with information. An example of this is

\begin{itemize}
\item [\textsuperscript{208}] This is the same division of the regulation as is used in SOU 2011:68, chapter 14.
\item [\textsuperscript{209}] See section 3.3.2.2..\textsuperscript{209}
\item [\textsuperscript{210}] SOU 2011:68, p. 378.
\item [\textsuperscript{211}] Directive 2009/138/EC, article 35.1.
\item [\textsuperscript{212}] Ibid, article 35.2 (a).
\item [\textsuperscript{213}] Ibid, article 35.2 (b-c).
\item [\textsuperscript{214}] Ibid, article 35.3.
\end{itemize}
when an insurance undertaking faces the risk of dropping below the SCR or the MCR in the near future. \footnote{Ibid, articles 138-139.}

The other side of the third pillar is the regulation regarding public disclosure. With the purpose of enabling and simplifying the comparison of different undertakings, the undertakings are required to issue a report on their solvency and financial condition at least annually. \footnote{Ibid, article 51, preamble, reason 38. See also SOU 2011:68 p. 384.} The required contents of this report are listed in article 51 of the directive. The report must, for instance, include a description of the system of governance including an assessment of how well the system of governance coincides with the risk profile of the undertaking. \footnote{Ibid, article 51.1 (b).} The report must also include information regarding the assets, liabilities and technical provisions as well as what risks the undertaking is operating with and how these risks are being handled. \footnote{Ibid, article 51.1 (c-d).} Furthermore, capital management has to be addressed at length, with descriptions of own funds, amounts of the SCR and MCR and, when an internal model is being used, how this model differs from the standard formula in its risk assumptions. \footnote{Ibid, article 51.1 (e).} In excess to the information the undertaking is required to disclose annually, the undertaking must also issue a public report if it undergoes any major development, such as non-compliance with the capital requirements. \footnote{Ibid, article 54.}

To the rules on public disclosure there are, of course, exceptions. The supervisory authorities may grant an insurance undertaking the option not to disclose certain information if doing so would unjustly give the undertakings competitors an advantage, or if disclosing information would be in breach of secrecy or confidentiality between the undertaking and policy holders or third party. \footnote{Ibid, article 53.1.}

\section*{3.4 Implementation and the Omnibus II directive}

As mentioned in section 2.2., the implementation date of Solvency II is in all likelihood being moved to a later date with the enacting of the Omnibus II directive. Originally, the Solvency II directive was to be transposed into national legislation by the end of October 2012. \footnote{Ibid, article 309.} In the Omnibus directive, this date is pushed back to 1 January 2013. \footnote{COM(2011)8, p. 49, (72).} Furthermore, a plethora of
instances where the commission may grant transitional provisions has been added.224 With regards to the requirements of article 42, there is no option to prolong the transitional period or push back the time of implementation, however, there are other changes which effects the assessment processes connected with article 42. For instance, the application of the requirements of articles 41.1 and 41.3 may be moved three years, meaning that the written policies on assessment process do not have to be in place, although the requirements of article 42 are.225 In the same manner, processes and procedures for sharing information with the supervisory authorities under the SRP may also be postponed up to five years.226

In conclusion, though probably coming to effect in 2014, the abovementioned parts of the Solvency II directive might not be ‘active’ in national legislation until as late as 2019.

4 Comparing the fit and proper requirements

To be able to better determine what factors might influence the fit and proper assessment as well as determining what processes and procedures could be used for a suitability assessment, this part of the essay will explore comparable issues in current legislation surrounding insurance undertakings, as well as comparable issues in other legislation. In exploring suitability requirements in other legislation, and the processes and procedures connected with their assessment one might find useful methods for insurance undertakings to apply in their assessments.

This section will first look at the current regulation on the Swedish insurance market. As the Swedish legislator is in the midst of implementing Solvency II, this has shown in some of the regulation, however, on the areas pertaining to suitability of key personnel, the Directive is not implemented. After this, other areas where there are suitability requirements will be explored. First the regulation and standards for the Swedish bar association, and secondly the standards for real estate agents. Although the actual suitability requirements might differ from the ones introduced with Solvency II, the procedures pertaining to proving one’s suitability might serve as a yard stick on what is deemed acceptable when it comes to such procedures.

4.1 Current legislation on the Swedish insurance market

The main bulk of the legislation regarding the operation of the insurance undertakings, in Swedish legislation, can be found in the Försäkringsrörelselag (2010:2043) (hereinafter FRL).

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224 Ibid, p. 46.
225 Ibid, point 3.
226 Ibid, point 1.
The legislation contains suitability requirements for a number of categories of professionals. Of these professions three categories; actuaries; accountants; and board members and managing director will be addressed. Of course, it is only the third category, board members and managing director, that is covered by the suitability requirements of article 42.

4.1.1 Actuaries

FRL demands that the undertaking’s technical provisions be made under the supervision of one or more actuaries who possess the required insight and experience, in relation to the undertaking’s size and complexity.\(^{227}\) Now, the requirement of that article might seem like it is only proportionate to the size and complexity of the undertaking, however, there are professional standards to be fulfilled by anyone who wants the bear the title actuary.\(^{228}\) To work as an actuary for a Swedish insurance undertaking one has to fulfil the requirements of either Svenska Aktuarieföreningen (the Swedish Actuary Association, hereinafter SAf) or the International Association of Actuaries (IAA), who both have standards for receiving an actuarial diploma.\(^{229}\) To be able to work at a Swedish insurance company an actuary also needs to have sufficient knowledge of the Swedish language to understand the legislation in the insurance field, as well as a minimum of three years experience.\(^{230}\)

To become a full member of the SAf, and thus receiving the actuary diploma, the SAf requires, first and foremost, a university degree of at least 180 ECTS credits, i.e. at least a bachelor’s degree.\(^{231}\) These credits have to be taken within certain fields, with a basis in maths and statistics with the addition of insurance related courses such as insurance law, and insurance economics.\(^{232}\) SAf, just as the Swedish legislator, puts demands on language proficiency, in both Swedish and English, with the applicant being able to understand actuarial literature in both languages as well as compose actuarial reports in both languages.\(^{233}\) To receive a diploma one also has to attend one activity arranged by the SAf on the topic of the actuary’s role, write a diploma essay corresponding to at least 100 work hours as well as having a minimum of three year’s experience.\(^{234}\)

The IAA’s system for qualification is in reality aimed at their members, that is, other actuarial

\(^{228}\) Kompetenskrav för olika medlemskap inom Svenska Aktuarieföreningen, revised 4 June, 2008, p. 2.
\(^{229}\) FFFS 2011:19, § 2.
\(^{230}\) Ibid, § 3
\(^{231}\) Ibid.
\(^{232}\) Ibid.
\(^{233}\) Ibid.
\(^{234}\) Ibid.
associations and not the prospective actuaries per se. Their system consists of two documents, the educational guidelines and the educational syllabus. The guidelines state that to become a full member of the IAA, an actuarial association must instate education requirements at least as demanding as the ones put up in the educational syllabus. The syllabus itself contains a list of subjects to be studied, as well as topics to be included within these subjects. The subjects are divided into ten categories, e.g. financial mathematics, economics, statistical methods and actuarial risk management. The IAA leaves it to the member associations to decide what educations should be recognised as fulfilling the requirements of the educational syllabus. The IAA is, in this matter, not biased towards any specific kind of institution for education, and names professional qualifications as well as university education as possible ways of attaining the appropriate education.

Neither the SAf nor the IAA has any propriety demand for becoming an actuary; they do however both include some kind of ‘role’ or professionalism training in their ‘syllabuses’. The SAf requires the prospective actuary to participate in an activity which should discuss the legal role of the actuary, the actuarial association’s internal rules as well as the ethics surrounding the profession. The IAA has included professionalism as the tenth subject in their educational syllabus. Topics to be addressed under that subject are, among others, code of conduct; analysis and resolution of ethical issues and the public interest. As the SAf is a member of the IAA, the topics listed under the subject professionalism should all be covered by the SAf’s educational syllabus as well, and as such must be included in either the educational demands put by the SAf or be a part of their own activities.

With the use of the vocabulary in the Solvency II directive, the requirements for the fitness of an actuary are elaborate and tangible, with demands for education in the appropriate combination of subjects and to the appropriate degree. There are concrete guidelines for assessing the fitness of an actuary, but since it only applies to one profession, the level of complexity is not directly comparable with the fitness assessment demanded by Solvency II.

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236 Ibid.
238 Ibid.
239 Ibid, p.1 f.
240 Kompetenskrav för olika medlemskap inom Svenska Aktuarieföreningen, revised 4 June, 2008, p. 3.
4.1.2 Accountants

The discussion of the accounting profession might be oddly placed together with the other professions in the Swedish insurance legislation, and could have been placed in together with the professions outside the Swedish insurance legislation. However, with its mentioning in the FRL and with the fact in mind, that the demands on the accountant serves many of the same protectional purposes as the other suitability demands in this legislation, namely that they in the end promotes customer protection, the discussion will be held here.

The regulation regarding accountants in insurance companies is found in the Aktiebolagslag (2005:551), approximately ‘limited liability company law’. The regulation stipulates for an accountant to be either approved or authorised to be qualified for the position as company accountant. The mandate to approve and authorize accountants in Sweden lies with the Supervisory Board of Public Accountants (Revisorsnämnden, hereinafter RN). They are also responsible for issuing regulations on the more intricate details of the legal requirements surrounding the approval demands and procedures of accountants.

An accountant has to pass either the standard qualification test to become an approved accountant, or the higher level qualification to be an authorised accountant. To be eligible to take the approved accountant exam one has to have at least a bachelor degree with a major in corporate economics and three year’s practical training within accounting focused on auditing annual closings. For the higher level, authorised accountant’s, exam the applicant has to have a bachelor degree plus 60 ECTS credits, or a master’s degree in economics, and at least five year’s practical training, including experience of auditing companies that are large or otherwise difficult to audit.

In the same manner as the IAA has done in the field of actuarial science, the RN have adopted regulations depicting what the structure of an applicant’s theoretical education has to look like. The regulation points out what subjects has to be studied and in many cases to what extent, i.e. how many ECTS credits that have to be attained in each subject. For example, the

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243 This precludes other types of entities, such as mutual insurance associations.
244 Aktiebolagslag (2005:551), chapter 9 § 12.
245 Revisorslag (2001:883), § 3.
249 Ibid, § 5.
regulation states that an applicant has to have attained 15 ECTS credits in tax law.\textsuperscript{251}
Likewise, the document includes guidelines for the practical education of the applicant.\textsuperscript{252} As is the case with the actuarial profession’s fitness requirements, the fitness of an accountant is fairly easily assessed.

The law regulating the accounting profession in Sweden, Revisorslag (2001:883), puts propriety demands on the accountants. An accountant has to be ‘proper and in all other senses suitably for practicing accounting’.\textsuperscript{253} As the accreditation of accountants is done for a five year period at a time, this standard is being upheld regularly.\textsuperscript{254} However, when assessing the propriety, not only the current situation of the accountant is weighed in, but also previous conduct. In a case from the early last decade the Swedish Supreme Administrative Court upheld a RN decision not to prolong authorisation for an accountant who had earlier suffered from bad business revenue and consequently lagged behind with his taxes and fees.\textsuperscript{255} Since he had had a long career with a good track record, and because of the fact that he had worked his way out of the financial difficulties, the court declared his impropriety a temporary lapse, partly due to reasons out of the accountants control and thus chose to authorise him.\textsuperscript{256}

The legislation also holds the possibility of revoking the approval or authorisation if an accountant was to act intentionally against the regulation surrounding the accounting procedures the accountant was occupied with.\textsuperscript{257} Also, unbecoming behaviour can result in revoking of approval or authorisation.\textsuperscript{258} This behaviour could, for example, consist of criminal acts whose natures are of the kind to normally disturb the general public’s trust in the person’s profession as an accountant.\textsuperscript{259} The Revisorslag also demands of accountants to act in accordance with ‘good audit custom’ and ‘good accountant’s custom’, that is, one standard applicable on the work conducted by an accountant and one standard applicable on the accountant as a professional.\textsuperscript{260} The upholding of these standards is ultimately the responsibility of the courts; however, the responsibility to see to that the standards are

\textsuperscript{251} Ibid, § 3.
\textsuperscript{252} Ibid, §§ 6-9, §§ 12-13.
\textsuperscript{253} Revisorslag (2001:883), § 4 point 6, author’s translation. ‘Proper’ in this case is the translation of the Swedish ‘redbar’ meaning honest, thorough and conscientious.
\textsuperscript{254} Ibid, § 18.
\textsuperscript{255} RÅ 2001 ref 13.
\textsuperscript{256} Ibid.
\textsuperscript{257} Revisorslag (2001:883), § 32.
\textsuperscript{258} Ibid.
\textsuperscript{259} Prop. 2000/01:146, p. 48.
\textsuperscript{260} Revisorslag (2001:883), § 19.
evolving in an appropriate direction lies with the RN. FAR, the main interest organisation for Swedish accountants, have since 1 January 2011 adopted the International Standard on Auditing (ISA) as what constitutes good audit custom. The ISA, in turn, refers to the International Ethics Standards Board for Accountants’ Code of Ethics for Professional Accountants (IESBA code). The IESBA code is divided into two parts, one conceptual framework consisting of general principles, part A, and part B illustrating the application of part A through practical examples. The code discusses, inter alia, objectivity, integrity and personal behaviour. On the note of personal behaviour the IESBA code states that ‘actions that a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at that time, would be likely to conclude adversely affects the good reputation of the profession’ should be avoided. However, these standards are in Sweden only adopted on the area of good audit custom, and should not be applied on the accountant outside of his professional practices. On the subject of good accountant’s custom FAR have a number of recommendations on the ethics of the accountant.

On the whole one find that rules and recommendations on what is good accounting and what is a good accountant are abundant and readily available. This in itself is, of course, not connected to the assessment of ones propriety ‘beforehand’, however, as the approval and authorisation for accountants are reassessed every five years, these factors will influence propriety assessments at some point. As such they make for a good comparison for possible suitability assessment procedures.

4.1.3 Board members and managing director

In the current Swedish legislation the scope of the suitability requirements, i.e. those suitability requirements reminiscent to the ones of article 42, are confined to members of the board and the managing director. The provision is included in the demands put on an insurance undertaking to receive their permit for conducting business in the insurance field. The requirement reads ‘... those intended to be included in the board of the company and being managing director of the same, or their replacements, have to possess the insight and the experience that has to be demanded of someone who is effectively running an insurance...

262 Andersson, S, Commentary on Revisorslag (2001:883) § 3 paragraph 1 point 4, Karnov online, page last visited 20 January 2012.
263 International Standard on Auditing 200, Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing, paragraph A14.
264 Andersson, S, Commentary on Revisorslag (2001:883) § 3 paragraph 1 point 4, Karnov online.
265 EtikR and EtikU, see ‘God revisorssed’ on www.far.se, last viewed 20 January 2012.
266 Försäkringsrörelselag (2010:2043), chapter 2 § 4 paragraph 1 point 4.
undertaking and in every other respect be suitable for such assignment. Just as the requirements of article 42, this statement is rather obscure. Through Försäkringsrörelseförordning (2011:257) FI are empowered to issue guidance on these demands to possibly clarify them, something which has not been done. So far, the only document pertaining to the assessment of suitability for the requirements of FRL is no more than a guide on what materials that has to be submitted for the FI to make their assessment, including a questionnaire aimed at the different subjects of the assessment of the candidate. Initially, the candidate has to submit a résumé displaying relevant education and experience. The next part of the questionnaire contains questions regarding other occupations, ownership in the company at hand, next of kin’s ownership of the same company or other conflicts of interest that may be at hand or arise. Finally, before signing the questionnaire, and thus guaranteeing its truthfulness, there are a number of question regarding ones propriety. For example, there are questions on past criminal activity, and questions regarding problems at earlier employments.

The questionnaire sheds some light on what the factors can be that influences the assessment, however, the lion’s share of the criteria for the assessment are still murky at best. This fact was also illuminated by the Swedish Bar Association in their comment on the proposed legislation, before the current FRL was enacted. Their opinion was that the new text should include more tangible criteria for the assessment, leaving less room for arbitrage, as arbitrage is unwanted from a legal security viewpoint. However, as is clear from the current legislation, their wishes went unanswered.

4.2 The standards of the Swedish Bar Association

Another profession surrounded by formal demands, outside the insurance business and outside the insurance regulations, is the Swedish advokat profession. As the title advokat has many English translations, with different meaning in different legal fields and jurisdictions, I will use the Swedish term advokat throughout this section. An advokat is a member of the Swedish Bar Association (hereinafter SBA). The requirements for becoming a member of the bar are stated in the eighth chapter of the Rättegångsbalk (the Process/Trial Code,
hereinafter RB). The first requirement, not of interest to this essay, is the domicile requirement where a person has to live in the EU, EEA or Switzerland to be eligible.\textsuperscript{275} Apart from this there are four requirements one has to fulfil to become a member of the bar. First, the person must have passed all knowledge tests required to be qualified to become a judge, i.e. one must hold a law degree from a Swedish university.\textsuperscript{276} Secondly, the person has to have undergone practical and theoretical education pertinent to the advokat profession.\textsuperscript{277} This means that the person, after gaining his or her law degree, has to have at least three years practise at a law firm or from independent practice in the field of providing legal services to the public.\textsuperscript{278} The theoretical education refers to the course the SBA organises.\textsuperscript{279} This education consists of three two-and-a-half day boarding school format occasions where ethics, constitutional law and practical matters relating to the advokat profession are discussed and where the participants go through oral examination in those subjects.\textsuperscript{280} The third requirement is that the candidate has to have made him or herself known for probity, which is connected to the fourth requirement stating that the person has to be in all other senses suitable for the advokat profession.\textsuperscript{281} It is up to the candidate to establish his or her own reputation through references. As the requirement on probity is very high, candidates have been refused membership on the grounds of them not being able to produce the sufficient number of references for all doubts to be put to rest. The fact that the required length of practical experience recently has been cut from five to three years might as such make less difference than it would seem, as the three years might not allow for the number of references needed.\textsuperscript{282} As a candidate also has to be independent, candidates have been rejected on grounds of having to large debts.\textsuperscript{283}

Acting as an advokat one has to follow god advokatsed, approx. good legal custom.\textsuperscript{284} The complexities and intricacies of the good legal custom is too large a subject to discuss in any meaningful length here, hence the following short rundown. A large part of the good legal custom is displayed in the relationship between the advokat and his or her client. This entails

\begin{itemize}
\item \textsuperscript{275} Ibid, chapter 8 § 2 paragraph 1 point 1.
\item \textsuperscript{276} Rättegångsbalk (1942:740) chapter 8 § 2 paragraph 1 point 2.
\item \textsuperscript{277} Ibid, point 3.
\item \textsuperscript{278} The Swedish Bar Association’s by-laws, § 3 paragraph 1 point 3. See also NJA 1996 s. 221 on the fact that The Swedish bar Association’s by-laws should be indicative of the meanin of Rättegångsbalk (1942:740) chapter 8 § 2 paragraph 1 point 3.
\item \textsuperscript{279} The Swedish Bar Association’s by-laws, § 3 paragraph 1 point 5.
\item \textsuperscript{280} The Swedish Bar Association homepage, \texttt{http://www.advokatsamfundet.se/Att-bli-advokat/Advokatexamen/}.
\item \textsuperscript{281} Rättegångsbalk (1942:740) chapter 8 § 2 paragraph 1 point 4-5.
\item \textsuperscript{282} Sangborn, J, commentary on Rättegångsbalk (1942:740) chapter 8 § 2 paragraph 1 point 5, Karnov online.
\item \textsuperscript{283} Ibid.
\item \textsuperscript{284} Rättegångsbalk (1942:740) chapter 8 § 4 paragraph 1.
\end{itemize}
acting with loyalty towards the client and secrecy towards others. There are also rules on how to act towards the public, opposite parties and courts. The same law passage that contains the demand to follow good legal custom also demands of the advokat to take on all tasks with zealousness and probity. Questions of breach of the good legal custom are handled by the SBA’s disciplinary board as well as the board of the SBA itself. In case of a breach, the SBA board or disciplinary board can issue an admonition, issue a warning, which can be complemented with a fine, or as a last resort disbar the person.

The regulation surrounding good legal custom is complex and, in terms of the disciplinary boards actions, not always predictable in detail. On the other hand, the requirements for becoming an advokat are far more tangible, with clear education requirements and solid procedures for assessing propriety.

4.3 The standards for realtors

Buying a house is for many people the largest investment of their lives, and as well as having that sort of impact on peoples life, the general state and order of the real estate market tends to influence the markets at large. To ensure that the business on the real estate market is conducted in a fair and reliable way for all parties, real estate agents, or realtors, need to fulfil certain requirements to be licensed/registered.

There are a number of requirements for an aspiring realtor to fulfill. First one must not be disqualified due to lack of legal competence, i.e. one must: be of age; not be bankrupt; not be banned from business operation and not be put under guardianship. The applicant also needs to hold a liability insurance, to be able to answer to any claims due to negligent or intentional damage caused by the realtor. Additionally, the applicant has to have sufficient education, possess the intent to work as a realtor and to be proper and in all other senses suitable for the profession.

The educational demands are specified in a regulation as well as by the Fastighetsmäklarnämnden, the Swedish Board of Supervision of Estate Agents (hereinafter FMN). To become a realtor one has to study real estate brokering; real estate law as well as general civil

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285 Vägledande regler om god advokatsed, The Swedish Bar Association, article 1 paragraph 2 and article 2.2.1.
286 Rättegångsbalk (1942:740) chapter 8 § 4 paragraph 1.
287 Rättegångsbalk (1942:740) chapter 8 § 6-7.
288 Fastighetsmäklarlag (2011:666), § 6 paragraph 1 point 1.
289 Ibid, § 6 paragraph 1 point 2, and § 25 paragraph 1.
290 Ibid, § 6 paragraph 1 point 3-5. Author’s translation: ‘Proper’ in this case is the translation of the Swedish ‘redbar’ meaning honest, thorough and conscientious.
law; tax law; economics; construction engineering and real estate appraising to a total of at least 120 ECTS credits.\textsuperscript{292} The distribution of credits within, and specific content of each, subject has been outlined by the FMN serving as a guide for the educational institutions offering realtor ‘degrees’\textsuperscript{293}. In excess of this theoretical education, the candidate also has to have undergone a ten week practical education with a licensed realtor.\textsuperscript{294}

As to the demand lain upon the applicant to possess the intent of going into business as a realtor, one realises the difficulties that arise from proving this. This demand has in practicality been limited to the applicant stating his or her intent in the application for registration as a realtor.\textsuperscript{295} The last of the demands, concerning the propriety and suitability of the applicant has similarly no practical usage in the application procedure, and is not assessed beforehand unless circumstances calls upon this to be done.\textsuperscript{296} The purpose of the regulation is instead to be able to withdraw the realtor’s license, should a realtor display improper behaviour, or otherwise show his or her unsuitability for the profession.\textsuperscript{297}

As with abovementioned professions the realtors work under god fastighetsmäklarsed, approx. good realtor’s custom. This custom distinguishes itself in the way that it is described in the law at rather great detail.\textsuperscript{298} The supervisory authority responsible for enforcing these customs is the FMN, who also bears the responsibility for the evolution of the good realtor’s custom. This is done through the FMN disciplinary board who decides in cases of realtor misconduct, with the empowerment to admonish, warn or revoke a realtor’s registration.\textsuperscript{299}

In line with many of the abovementioned professions, the realtor profession has clear and unambiguous educational demands for the applicants to fulfil. The propriety demands, however, are not only unclear, but rather non-applicable on the registration of realtors as it serves as a possibility to revoke the registration should improper behaviour ensue. It is, in this context, fair to say that there is no propriety assessment made beforehand and thus no assessment procedure for later comparison.

\textsuperscript{292} Ibid, § 15, FMN 2011:1 § 7.
\textsuperscript{293} FMN 2011:1, appendix 1.
\textsuperscript{294} Ibid, § 8.
\textsuperscript{295} Prop. 1994/95:14 p. 65 f.
\textsuperscript{296} Ibid, p. 34.
\textsuperscript{297} Ibid.
\textsuperscript{298} Fastighetsmäklarlag (2011:666) §§ 8-22.
\textsuperscript{299} Ibid, §§ 28-29.
5 Analysis

The aim of this analysis is to portray some processes with which an insurance undertaking can ensure and display their compliance with Solvency II. In doing so, the other professions and suitability standards depicted in section 4 will serve as a comparison and an inspiration. Like the presentation has done earlier, and as my belief is that the presentation gains from it, the following analysis will be divided with regards to the presentation of the processes surrounding the fit requirement, and those surrounding the proper requirement. This has its basis in the thought that the processes surrounding the fitness assessment are ones of a positive nature, i.e. they need to be in place to show the presence of a quality. The processes surrounding the propriety requirement may be of the opposite nature, in that that they in some cases search for the absence of negative antecedents.

First however, a very short summary of the essay so far; the purpose of the directive and the Solvency II regime is to protect customers and the financial stability of the Union. This shall be attained by making sure that insurance undertakings are capitalised enough to answer to their obligations and to not go belly up. Since earlier failures by insurance companies have been shown to be connected to poor management decisions and imprudent business behaviour, the new regime also sets out demands for persons with a large impact on their undertakings to be suitable for their assignments. This suitability is divided into fitness, which brakes down to knowledge and experience, and propriety which more or less corresponds to responsible behaviour. The suitability assessment is done by the insurance undertaking itself, after laying down processes and procedures in written documents. This information is then shared with the supervisory authority who evaluates the policies, processes and procedures. The assessment procedures themselves, the way they are documented and the way that these documents are shared all need to fulfil relevant standards in the directive.

5.1 Setting out fitness requirements

To ensure that the suitability assessments are done in a satisfactory manner, not only has the suitability of the candidate to be assessed, but it must also be compared to a set of requirements. This is a result of the suitability requirements being expanded from only including the managing board and the managing director to now, as explained earlier, include persons in key positions. In this sense, it is only natural that the assessment now has been left to the undertakings. Undertakings might employ different internal structures resulting in different positions being target for article 42’s requirements. It would therefore be too large a
burden for FI to handle. Essential in this process is that the undertaking sets out clear and
detailed specifications for the different positions falling within the scope of article 42.
Compared to the other professions discussed under section 4, the suitability assessment
regarding article 42 spans over many professions. These professions might not be as clear cut
or contained as the ones under section 4, and thus the undertaking becomes responsible for
demonstrating ‘both sides of the coin’. The responsibility of composing written policies with
regards to the job specifications is laid on the undertaking through article 41. The other side
of this coin is, of course, the suitability requirements of article 42.

Regarding specifications, my view is that they do not have to be individual to be detailed.
Instead, it ought to be sufficient to outline specifications for a number of ‘levels’ within the
organisational structure. Many companies already employ such system of levels for their
employees, based on knowledge and experience. In an insurance undertaking an example of
this can be a system that controls how large amounts of insurance compensation a claims
adjuster can pay out without being reviewed by a superior. An internal career system of that
manner could advantageously be integrated with the documentation process surrounding the
suitability assessments. For instance, if the undertaking is providing internal education or
keeping steady performance reviews these should be kept well documented. Should a person
in the future be the subject of a suitability assessment, this could be done more readily while
at the same time providing written information needed for supervisory purposes.
The abovementioned idea, using different ‘levels’ within an undertaking’s organisational
structure should not be used when assessing the fitness of a person ‘effectively running the
undertaking’, or at least not exclusively. To establish a minimum of adequate technical
knowledge, this system could be used. However, the assessment of this category of persons
includes more factors. To begin with, the requirements for the management of the undertaking
are collective. Not everyone has to have knowledge or experience of everything, as long as
they together possess enough knowledge and experience to constitute a fit unit. This
inevitably results in the specifications written for the management being collective, set out for
the management as a group. In setting up processes for the assessment of the management’s
technical competence the undertaking could use a set of competence areas and through the
assessment making sure that ‘every box is ticked’. Comparing the specifications and the
assessment of the technical competence could be facilitated by such an approach. However,
when ensuring the technical competence of the management the undertaking can also take
expert knowledge among other key functionaries into account. The specification of the
technical competence for the management should nonetheless look the same, the ‘boxes’ however, can in this metaphor be ‘ticked’ through the competence of other key functionaries. More, if not most, difficult to assess is the management competence. Specifying the requirements of the management in this aspect surely has a lot to do with knowledge, but maybe even more with experience. In the same manner as experience in a technical capacity will increase the technical knowledge experience in a leading capacity will improve the leadership skills. Thus, the requirement on the management competence should in large be one of management experience. As the requirement is collective, not everyone in the management needs to have the sought-after experience. No demand of an adequate minimum is set in this respect either, but one must assume that a total lack of management experience should constitute an exception amongst the persons in the management. The assessment procedure is furthermore impeded by the nature of experience. What I mean by this, is to say that three people with three years’ experience, bar the fact that the might complement each other, combined still only have three years experience. As such, there is no point in specifying a management that, collectively, should have five or ten years’ experience in management positions. A suitable requirement, however, could be that at least some of the persons in the management have prior experience of being, e.g. a board member. The other persons should have management experience of a reasonable high standing. As abovementioned, persons without management experience could theoretically be part of the management.

5.2 Measuring knowledge

The professions discussed under section 4 all have in common a demand for certain knowledge. As earlier stated, the difference from the requirements of article 42 is that those assessments are made against defined areas of knowledge. For the undertakings to be able to assess the knowledge there might thus be a need to compartmentalise the assessed personnel according to the knowledge needed for their function. To one person the intricacies of the SCR might be key to be able to execute his or her tasks, while another person needs no knowledge of the capital requirements at all. Such a system could be combined with the earlier mentioned idea of a system of levels. The knowledge requirements of the professions in section 4 all, except the management requirements in the current insurance legislation (which throughout this analysis will be left as the exception in almost every case), have fixed demands on education. Actuaries have to study a certain amount of mathematics, accountants have to study tax law and realtors have to
study property law, to name a few examples. In applicable cases, this is a model that can be adapted to ensure the compliance with article 42. Through collecting copies of transcripts, or similar documentation, the undertaking can with reasonable assurance assess a person’s knowledge within a certain field. To allow for a past education to fulfill a knowledge requirement the education should not be too far back in time. If the final stages of the education were not finished recently, the experience of the candidate should in applicable cases be allowed to constitute a deciding factor. The following example can illustrate this train of thought. The specification for a certain role states that the applicant should have education within subject A to the extent of X credits and should have done so no more than three years ago, due to the changeful nature of subject A. If the person in question since the graduation in subject A has been working with questions pertaining to that subject, the experience within the field should excuse the time elapsed since graduating. The knowledge requirement itself can then be fulfilled due to the experience. This idea should be separated from the idea of having certain experience requirements connected to a specification, as will be addressed in the next section.

There might however be areas too sector- or undertaking-specific to be sufficiently depicted by an education requirement. The assessment procedure for the accountant may in this situation provide inspiration for a solution. Not only does an aspiring accountant have to have the suitable education, they must also pass a test showing that their education together with their three or five years’ experience has rendered a sufficient level of understanding. In the same manner, an undertaking could design tests to assess the knowledge of individuals covered by the requirements of article 42. Doing so nonetheless results in an additional number of issues that must be resolved. First and foremost, the tests must serve as an accurate measurement of the knowledge that is being required. The easiest way of ensuring this would be in connection with an education effort from the undertaking. Showing that the education is relevant to the issue, and that the assignments or questions of the test reflects the education is probably just as easy to demonstrate as demonstrating the appropriateness of questions on their own. Seeing to the fact that issuing such tests most likely will ensue from a situation where there is no appropriate external education, this solution will probably be the most natural anyway. Secondly, any assessment procedure including the arranging of tests brings with it a need to establish procedures and policies to prevent cheating or foul play. This includes that the questions for the tests must be updated with certain intervals to ensure that they appropriately reflects the sought after knowledge, and to prevent candidates from
predicting the content of the questions. The undertaking must also ensure that only a limited group of people can access the tests, through computer systems or otherwise, as well as it has to ensure the independence of the personnel responsible for the grading of such tests.

In the same way that certain knowledge should be able to be demonstrated through educational transcripts, or similar documentation, the possession of a professional qualification should do the same. Should, for example, an organisation that offers certification within the area of SCR internal model calibration be deemed as professional by the supervisory authority, the undertaking should be able to rely on such qualifications and thus being able to omit their own knowledge, possibly also experience, assessment. One can also think of a solution where an external educational regime is thoroughly examined by the undertaking itself, thus resulting in documentation demonstrating reason to omit further scrutiny of the individuals that have undergone such qualification. Seeing to the fact that the requirements of article 42 covers a plethora of different thinkable occupations and expertises, the possibility of there being one institution, similar to the SAf or the RN for the certifying of insurance workers, is non-existent.

5.3 Experience

As mentioned under section 3.3.2.3. experience is a main factor constituting fitness. Through section 4 it has been shown that experience in many cases serves as an important piece in reaching a demanded level of fitness for a profession. Just as in the case of the advokat, the actuary and the accountant, specificity of the experience is needed to ensure fitness. In the same manner that a requirement for an aspiring advokat is that he or she has to have experience either of working with a law firm or working independently in a similar capacity, the specifications within an undertaking should not only state the amount of experience needed for a position, but rather be as specific as possible as to the nature of the experience when setting the experience requirement. In the case of an internal promotion, the documentation regarding experience within the field at hand should be readily available. Seeing that different undertakings, as well as other employers, are organised in different ways, demonstrating the appropriate experience in case of an external recruitment might pose a greater challenge. In those cases, detailed accounts of earlier task and work experience can serve as documentation demonstrating the compliance with the set requirement. Measuring experience in itself might be more pliable as a concept then the measuring of appropriate knowledge. Thus, the fulfilment of an experience requirement might to a larger extent be up
to persuasive reasoning from the undertaking’s perspective, for example in cases where a person has significant experience in two fields neighbouring a third, sought-after, field.

As stated earlier, experience should also, to some extent, possibly be interchangeable to a knowledge requirement, or rather ‘fill out the gaps’ when assessing the knowledge through education demands.

5.4 Propriety

In comparing the propriety requirements one must first establish what interests they are meant to protect. For instance, the propriety requirements surrounding the advokat profession are necessary due to the crucial part the profession plays in society. As an advokat in many cases acts in the paramountly important role as the defense against the state, there can be no doubts as to the integrity of that person. Similarly a society dependant on tax revenue, as well as it is dependant on the secure investments in businesses, needs accountants to ensure that companies run their operations in a correct manner. The interests protected through Solvency II might not be as crucial to the functioning of society, although the development throughout the union markets in recent years and recent months calls attention to the financial stability aspect of those interest. I am in no way suggesting that the consumer protection interest is unimportant, and should thus result in a forgiving propriety assessment; the protected interest does however dictate the method of assessment.

There are, in my view, two different main assessment procedures that can be employed when assessing a person’s propriety. The first one is the negative one, i.e. a method where one tries to establish the absence of encumbering antecedents. The second method is positive, where the idea is to demonstrate propriety through positive statements. In my view, a positive method is needed where the most important interests are at risk. The only true example of this in the professions discussed in this essay is the advokat profession, where one positively has to show one’s propriety to get accepted to the bar. The other professional standards all rely on a negative propriety assessment, even though this is carried out in a variety of manners ranging from active, or preemptive, to passive measures. For an example, an accountant has to show his or her propriety every five years. This is however done through examining the lack of encumbering incidents, resulting in an active negative method. On the passive side one finds the propriety regulation surrounding realtors, where no assessment is made until a breach of law or standards have occurred. This would constitute the quintessential passive negative assessment.
Though the propriety assessment procedure currently used by the FI is obscure to the outside spectator, its basis is the questionnaire mentioned in section 4.1.3. The fact that they are basing the assessment on the mentioned questionnaire means that they employ a negative method of assessment. In this method, the outset is that the person being assessed is proper if no aggravating circumstances are brought forward. As the responsibility of the assessment is now bestowed upon the undertakings themselves, I find that a similar procedure should be adequately effective if employed by an undertaking. The easiest way of doing this would seemingly be to produce a questionnaire similar to the one the FI uses, containing the different categories of factors discussed in 3.3.2.3., for example occurrences of financial criminal activity or past experience with bankruptcy in the companies where the assessed was a part of the management. Relying on the truthfulness of the answers given in the questionnaire the undertaking should be able to easily assess the person’s propriety, as most of the questions in such a questionnaire are of an, more or less, eliminating nature. Should the undertaking find the person to be proper even though there are transgressions in the person’s past, this should have to be thoroughly documented, to allow for supervision. As stated earlier in this essay, a transgression should not automatically result in a failure to meet the propriety requirement, for example should the time elapsed since the occurrence and the change in the persons behaviour since then be allowed to influence the assessment. A possible way of handling the situation where an encumbering antecedent has been revealed could be to employ a positive assessment method, and thus weigh out, or compensate, for this with references regarding the candidate’s propriety.

To ensure compliance with the propriety requirement in regards to persons with a larger influence in the undertaking, such as board members or managing director, an undertaking may want to employ a positive propriety assessment. In my view, this would be ‘playing it safe’, as such an assessment is more demanding. Even though this kind of assessment might be more demanding and as such leave stronger assurances, it is also in a larger extend open to arbitrage, since the references have to be given a value as proof of the propriety of the candidate. Should an undertaking chose to use a positive assessment procedure, they should any how demand a signed questionnaire from the candidate to complement the assessment.

Since the propriety requirement is not affected by the proportionality clause of the governance chapter, the propriety of all persons should be held to the same standard. Deploying special assessment procedures for persons with a greater influence, as suggested in the last paragraph, should thus not be needed.
5.5 Conclusions

The fit and proper requirements of Solvency II may be located in article 42, but the regulation regarding the procedures and policies surrounding their assessment are equally dependent on the governance requirements set out in article 41 and the transfer of information regulation of article 35.

For the assessment procedures to comply with the requirements of article 41, clear specifications regarding fitness, depicted as knowledge and experience, must be written. The assessment procedure for propriety should be easier to give an account of since it is rather one-dimensional. However, if an undertaking chooses to employ a certain contingency plan for situations where a simple questionnaire is not sufficient, such a procedure should be documented in detail.

Since all of the abovementioned demands are connected, the most streamlined way to ensure compliance with them all, at least in my view, would be to integrate the systems to the farthest extent possible. In this context that means that an undertaking should systemise their organisational structure after two factors. The first of these is the compartmentalisation of positions according to the type of knowledge needed to fulfil the tasks connected to that position. The other factor has to do with level of competence, where knowledge and experience combined should correspond to a certain level.

Fulfilling the demands of article 35, thus enabling the SRP under article 36, would be simplified if educational measures, either internal or external, corresponded to the same system of levels and type, and remained well documented. The following example might clarify my view. A person is hired in a position covered by the notification requirements of article 42.2. Having a fully integrated system in the organisation structure could then simplify the process of reporting the assessment procedure to a mere statement of; ‘position ‘A’ with a specified requirement of knowledge in subject ‘X’ corresponding to level ‘3’ and with at least 5 years’ experience of working with subject ‘X’, has been filled by person ‘Y’ who has undergone and passed internal and/or external education in said subject corresponding to said level, having worked with said subject for seven years. Person Y has signed a propriety assessment questionnaire stating no encumbering antecedents.’

In conclusion, the suitability assessments pertaining to article 42 of the Solvency II directive could be carried out effortlessly, if the proper groundwork is put in place.
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