

IAA Fund Seminar in Chinese Taipei

Solvency II

12 October 2014



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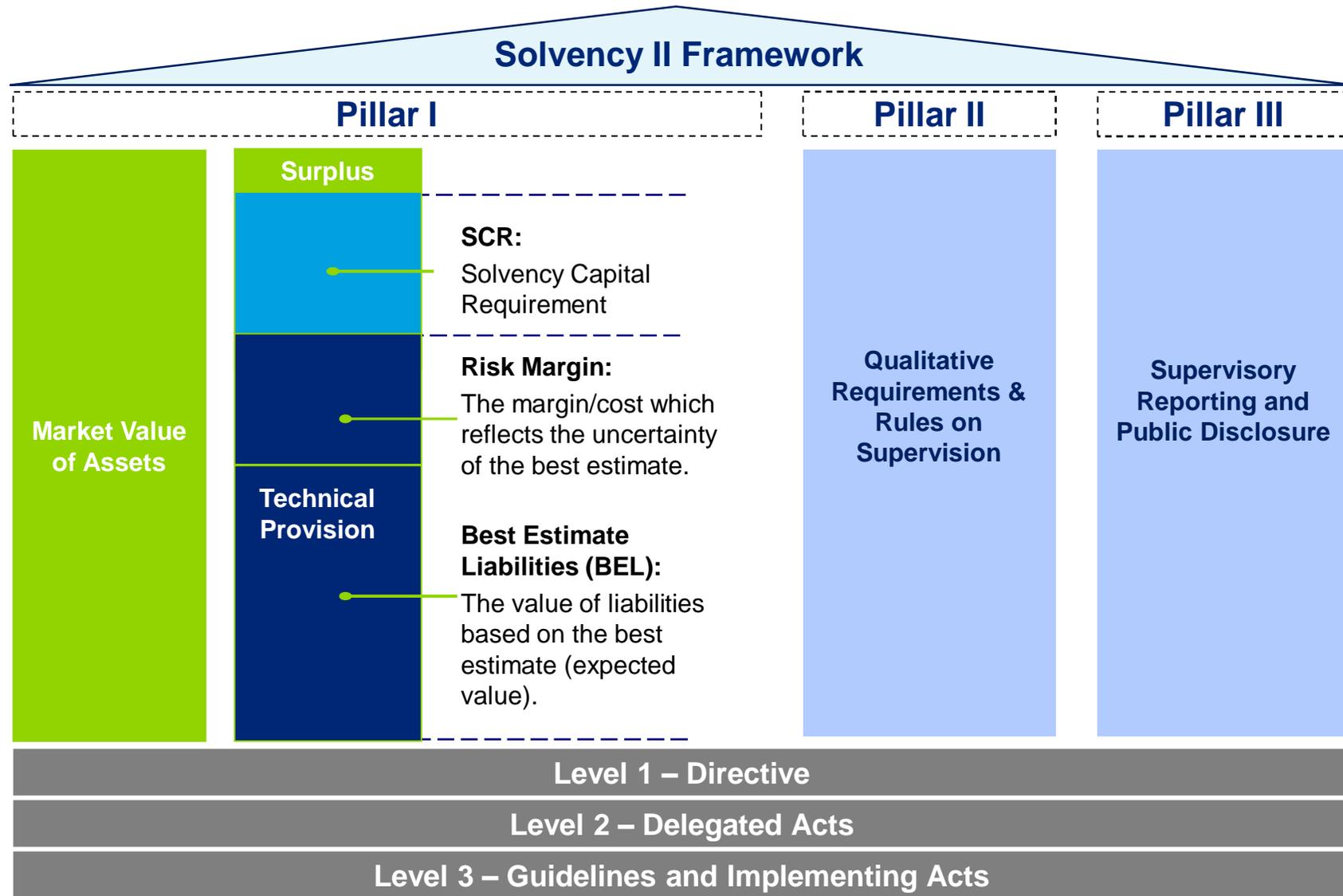


What is Solvency II

- Solvency II at a glance

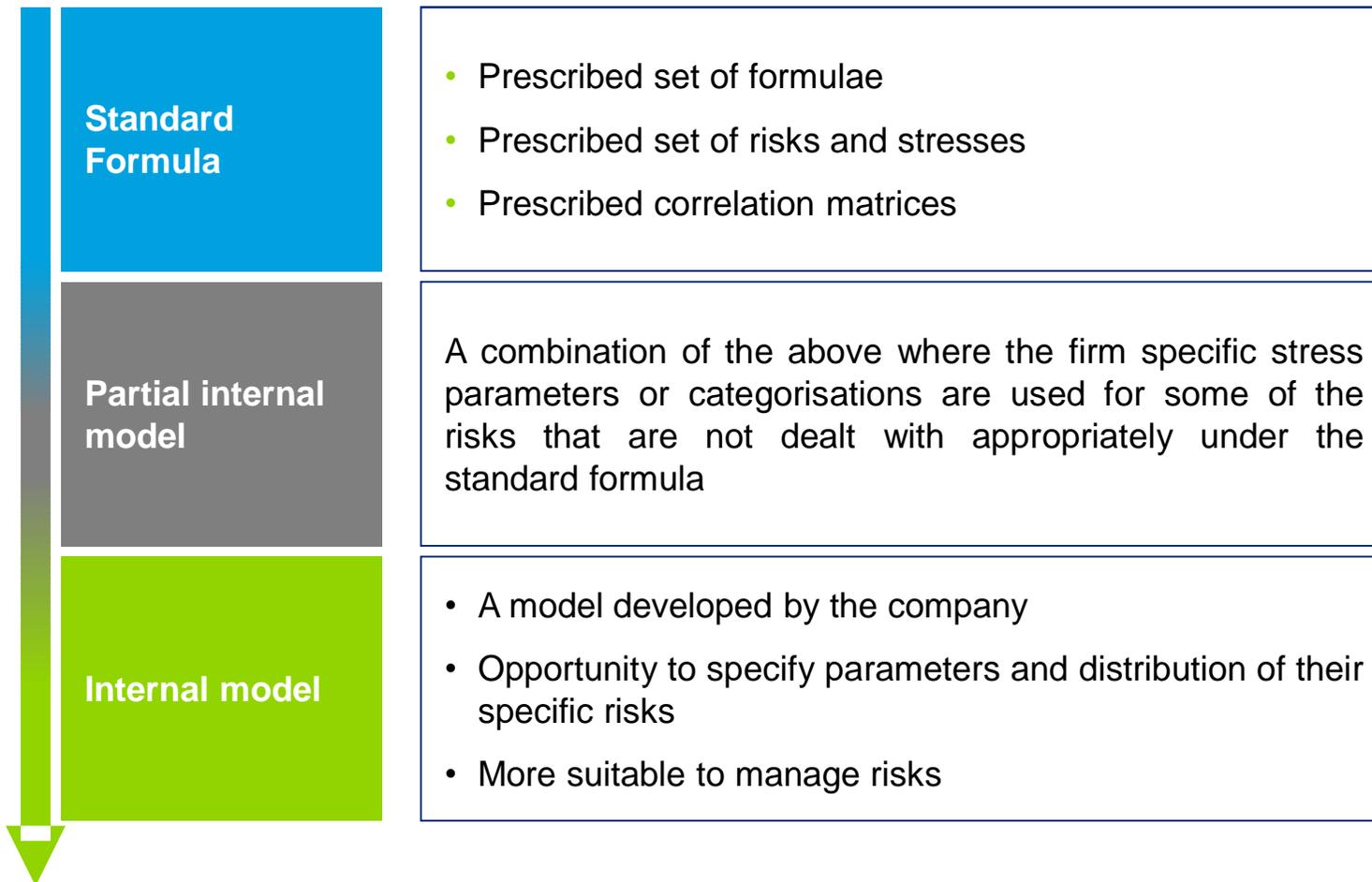


Solvency II - Structure at a glance



Solvency II Model Choices – Model Choices

Companies can apply either the standard formula, internal model or a combination of the two to calculate their solvency capital requirements.



Solvency II in the News – Timeline of European Adoption



November 2013

- EIOPA issued final Guidelines for the preparation of SII
- European Parliament voted in favour of the proposal to set the application date of SII to be 1st Jan 2016

2014 to 2015

- National Competent Authority (NCA) to send progress report to EIOPA, on the application of these Guidelines, the first one is due Feb 2015
- Covering the 4 areas:
 - ✓ System of Governance
 - ✓ Forward-Looking Assessment of Own Risks
 - ✓ Submission of information to NCAs
 - ✓ Pre-application for Internal Models

Q1 2014

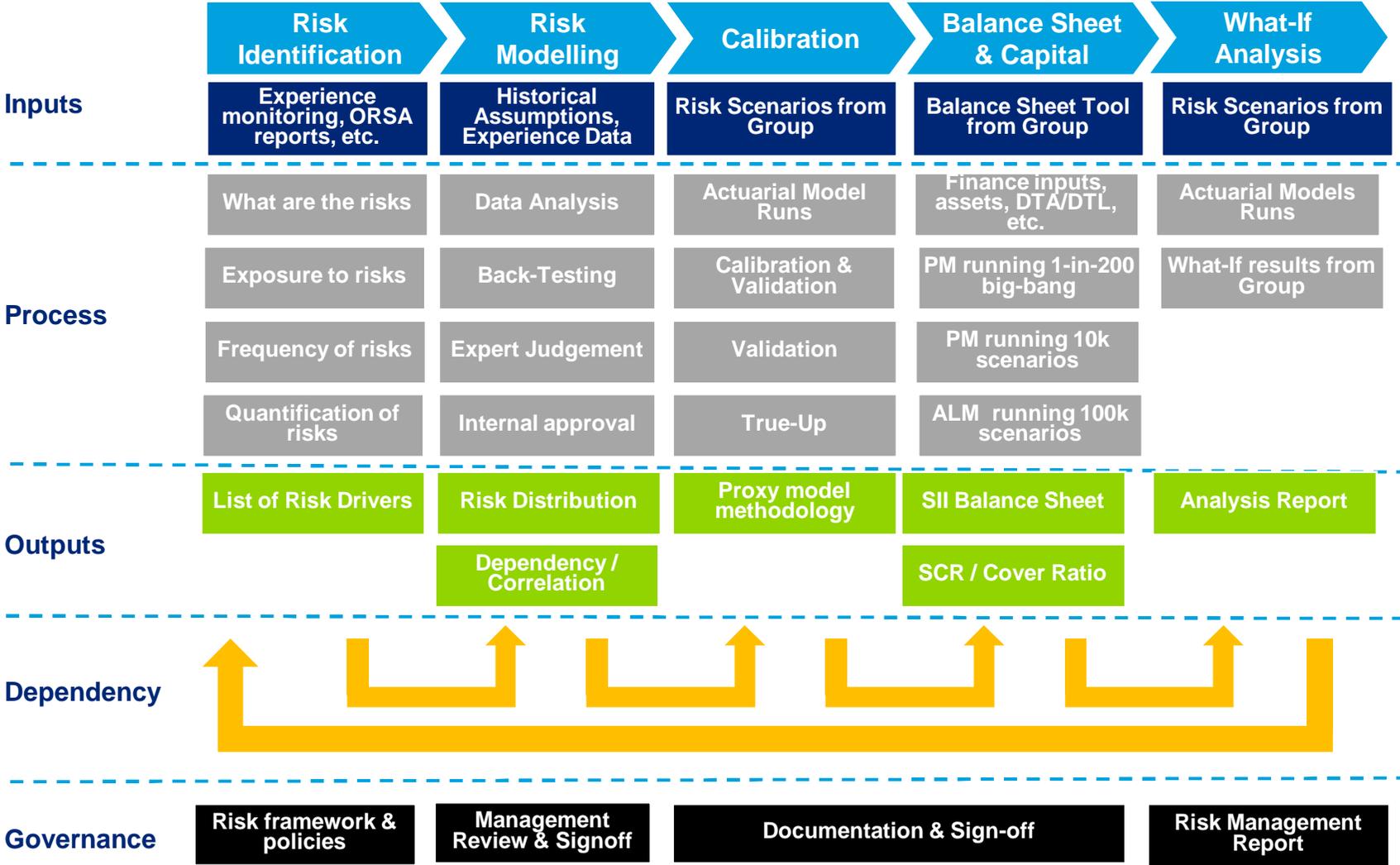
- European Parliament to vote on Omnibus II final text in Feb, followed by publication

**SII go live on
1st Jan 2016**

What are the Loose Ends?



EC Operations of Insurers – Annual Reporting of SII results



Loose Ends – European Regulators Updates on Treatments

Some of the insurance regulators in Europe engage in continuous discussion with the industry to resolve loose ends of implementation of a effective economic capital management framework

Matching Adjustment

- Similar in purpose to existing “liquidity premium”
- The PRA will review asset portfolios on a case-by-case basis as part of the approval process, taking into account all of the evidence provided by the firm within its application
- Fixed cash flows in terms of timing and amount, except: a) index-linked assets to matching index-linked liabilities, or b) varying cash flows, but there is such an event that the firm receives sufficient compensation to allow it to obtain the same cash flows, where “sufficient compensation” must be adequately demonstrated;
- Trial submission in July 2014 to PRA on a best-effort basis, but PRA will not make any decision based on trial submission.

Contract Boundary

- Determines the split between existing and future new business, implication for Asia business with a lot of renewal premium products;
- EIOPA guidance issued in June 2014, more detailed instructions and clarifications mean another round of work with legal team, claims, risk team, and possibly business distribution to come up with an appropriate interpretation of contract boundary for the firm;
- The June 2014 guideline has especially mentioned that supervisory authorities are not among third parties.

Proxy Modelling

- Most firms have developed some form of proxy model to produce a probability forecast of changes in Own Funds and to calculate capital requirements;
- To assess whether the proxy model is fit for purpose, acceptance criteria needs to be considered carefully:
 - By type of business;
 - With reference to assets or liabilities alone or Own Funds;
 - Individual business level or Group level;
- Limitations of the proxy model should be communicated to users of the model and results.

Loose Ends – Some Practical Challenges

Data Quality

Data into Internal Model - Accuracy, Completeness, Appropriateness and Timeliness

- Data Directories – regional data, local data, how they flow into Internal Model must be documented and validated

Quarterly & Other Reporting Bases

S II usually is produced only annually

- How do we align with other reporting bases, e.g. ICA, or EEV?
- Pilot test runs, all other reporting bases report more frequently than annual, can we use proxy-models to do half-year or quarterly reporting?

Management Action

Management actions being allowed for in Technical Provision and Capital

- Examples include bonus declaration, medical inflation re-pricing, reviewable expense charges re-pricing, etc.
- The difficulty is to provide justification based on actual experience

Internal Model Change

Proper approval and documentation of changes made to the Internal Model

- Requirement to quantify “Major” and “Minor” model change;
- IM changes cover changes in risk modelling, changes in proxy-model methodologies, changes in IM, but NOT changes in actuarial models

Documentation

Basically documentation of everything!

- Need to sign-post to requirements of the SII Directive and avoid unnecessary difficult terms;
- Also need to go through appropriate level of challenge and governance

On The Way to IMAP
(Internal Model Application Process)



On the Way to IMAP – Requirements for approval



On the Way to IMAP – Issues Facing Insurers in IMAP

Issues Facing Insurers in IMAP

Pre-application of Internal Model

- In November 2013, EIOPA issued guidelines on pre-application of Internal Models, for National Competent Authorities (NCA) to form a view on how prepared the (re)insurance company is to submit a proper application
- Applicable from 1 January 2014

Submission of Standard Formula SCR Results

- When (re)insurance companies are pre-applying or applying for approval of their Internal Models, they need to prepare for the eventuality that their IM may not be approved, and set up processes to calculate SF solvency capital requirement

Submission of information

- In November 2013, EIOPA issued guidelines on submission of both quantitative and qualitative information to NCA, to ensure they have appropriate systems and structures in place that would allow an adequate exchange of information with the NCA

Model Change and Model Validation

- During the pre-application process, one of the basic requirements is to have an Internal Model Change Policy in place:
 - Major and minor change
 - Quantitative and qualitative assessments
 - Validation of Internal Models

On the Way to IMAP – Issues Facing Insurers in IMAP

Issues Facing Insurers in IMAP

Use Test

- Insurance and reinsurance undertakings shall demonstrate that the internal model is widely used in and plays an important role in their system of governance, in particular the risk management system, decision-making processes, economic and solvency capital assessment and allocation processes
- The Internal Model...
 - ... is well understood by senior management
 - ... produces information at the required frequency for different uses
 - ... is integrated into the risk management system on a consistent basis for all uses
 - ... is used to support and verify decision making
 - ... reflects the nature, scope and complexity of the risks inherent in the business

Expert Judgement

- During the pre-application process, (re)insurance companies need to ensure:
 - the use of expert judgement are documented in a manner that the process is transparent, and can be **validated**
 - the resulting data/assumptions/models and their materiality, the experts involved, the intended use and period of validity

Solvency Regime in Asia Pacific



Trends in Asia Pacific

There is a obvious trend that **economic capital** is emerging as the preferred risk management tool

Recent Changes of Regulatory Regimes in Asia Pacific		
	Solvency Requirement	Economic Capital
	<ul style="list-style-type: none"> LAGIC 	<ul style="list-style-type: none"> As part of ICAAP, voluntary from 2013
	<ul style="list-style-type: none"> Solvency margin C-ROSS expected in 2015 	<ul style="list-style-type: none"> Mandatory from 2015
	<ul style="list-style-type: none"> Solvency margin Study for an risk-based regime underway 	<ul style="list-style-type: none"> Consultation paper just issued
	<ul style="list-style-type: none"> Risk-based capital 	<ul style="list-style-type: none"> Economic value-based regime being considered by FSA
	<ul style="list-style-type: none"> Risk-based capital “RBC2” review underway 	<ul style="list-style-type: none"> As part of ORSA, mandatory from 2014

In particular, components in the Solvency II Directive are often referenced by local regulators in the Asia-Pacific region when establishing ERM framework and measures.

While regulators in the more developed countries in the region are generally in line with their western counterparts in putting economic measures in place, regulators of less developed economics have demonstrated commitment and progress to move towards regimes consistent with SII

Common Challenges in Asia Pacific

