

Solvency II: A challenge also for actuaries

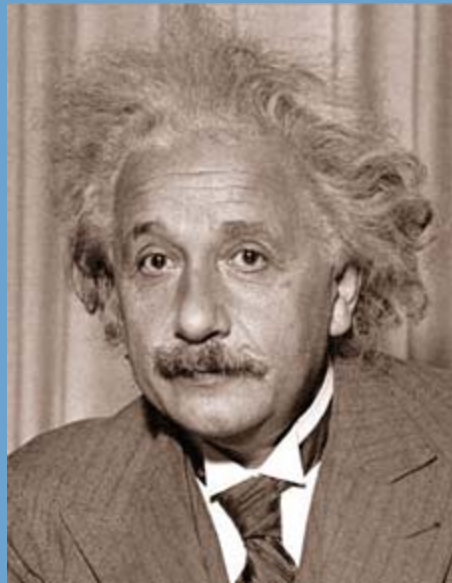
**IAA AFIR Colloquium
Munich, 10 September 2009**

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European Commission

- « Not everything what can be counted counts – and not everything what counts can be counted »

Albert Einstein



Why Solvency II?

Why the approach chosen?

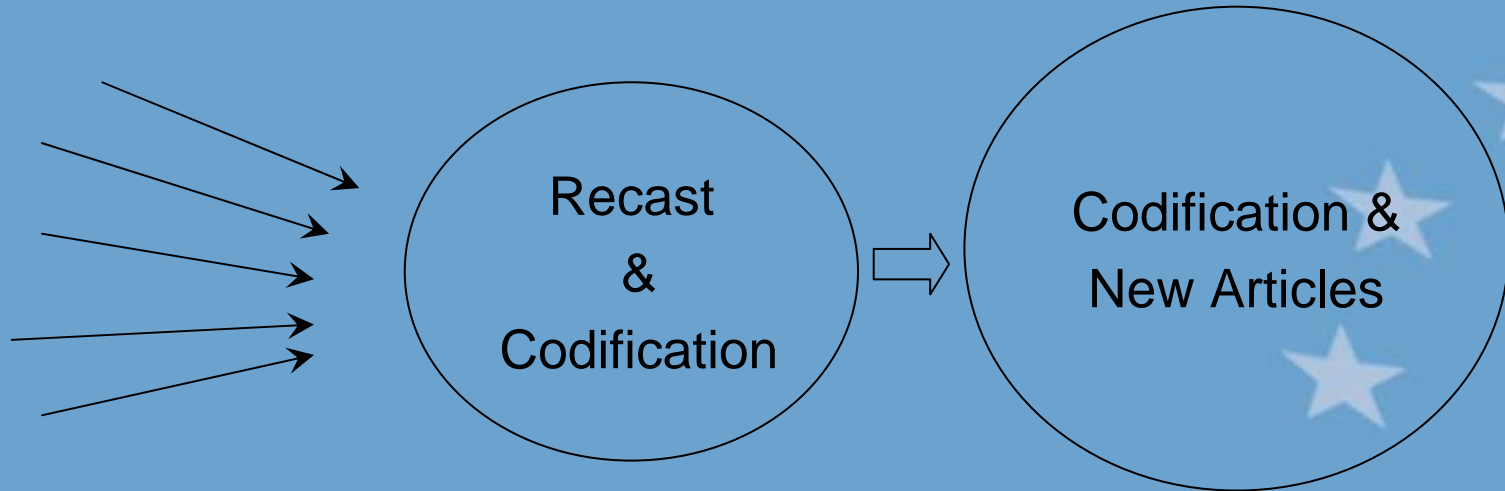
Why Solvency II?

- Modernise regulatory framework
- Need to act now before the present Solvency I regime breaks down
- Provide the insurance industry with more capacity to take on new risks
- Improve supervisory convergence
- Reduce regulatory arbitrage between banking and insurance

Framework Directive

14 existing Insurance Directives (direct insurance, reinsurance, groups etc.)

+ Solvency II



= 1 Directive 'EU Insurance sourcebook'



Solvency II – 4 Principal Objectives

- Deepen the Single Market
- Enhance policyholder protection
- Improve (international) competitiveness of EU insurers
- Further Better Regulation

The new regime...

- Establishes risk-sensitive capital requirements to encourage and reward good risk management
- Places emphasis on the responsibility of the senior management to manage their business responsibly
- Fosters and demands greater supervisory convergence → Single Market



Intensive consultation process

- Framework for Consultation
- Three waves of calls for advice to CEIOPS
- Interviews with selected number of SMEs by Commission staff
- QIS 1 and QIS 2
- Impact Assessment with 45 options

Consultation continued

- Commission proposal prepared following consultation and dialogue with CEA, AMICE, CRO Forum, CFO Forum, Groupe Consultatif, CEIOPS, EIOPC
- Close contact with ECON members
- QIS 3 and QIS 4
- Several public hearings and public meetings with stakeholders

Legislative Process - Lamfalussy

Level 1: Framework Directive

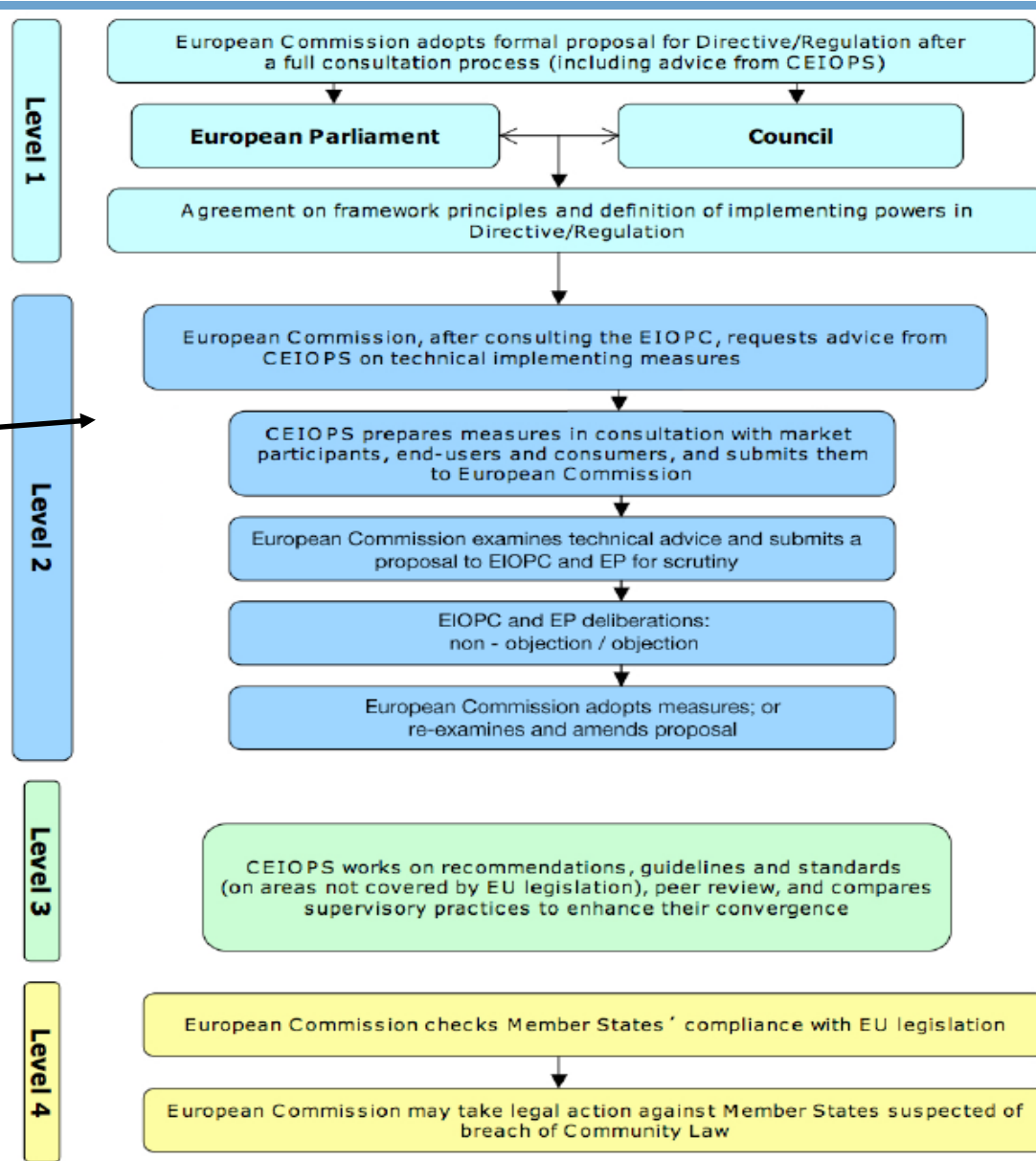
Level 2: Implementing Measures (Commission)

Level 3: Convergent implementation assisted by close co-operation between national authorities

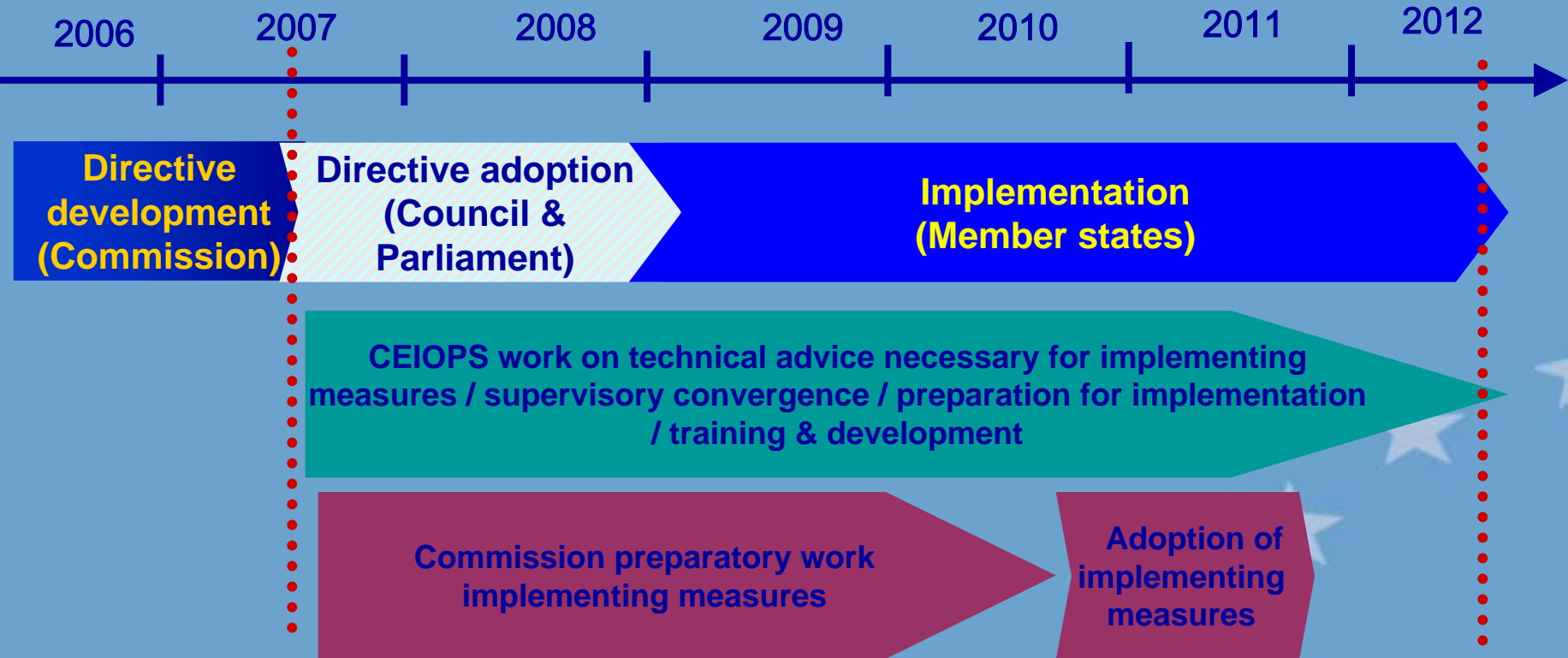
Level 4: Rigorous enforcement of Community legislation by the Commission



We are here!



Solvency II Timetable for 2007-2012



July 2007

Solvency II Directive published

October 2012

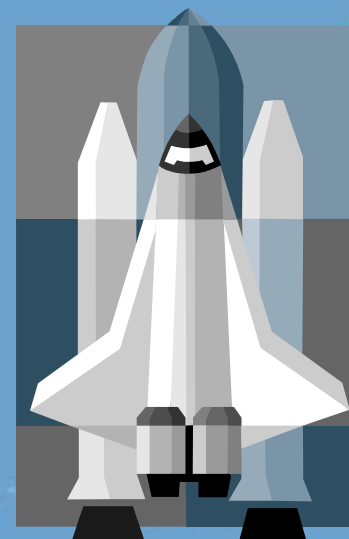
Solvency II enters into force



European Commission
Internal Market & Services DG



*New European solvency
regime in place and
operational in all Member
States by October 2012!!*



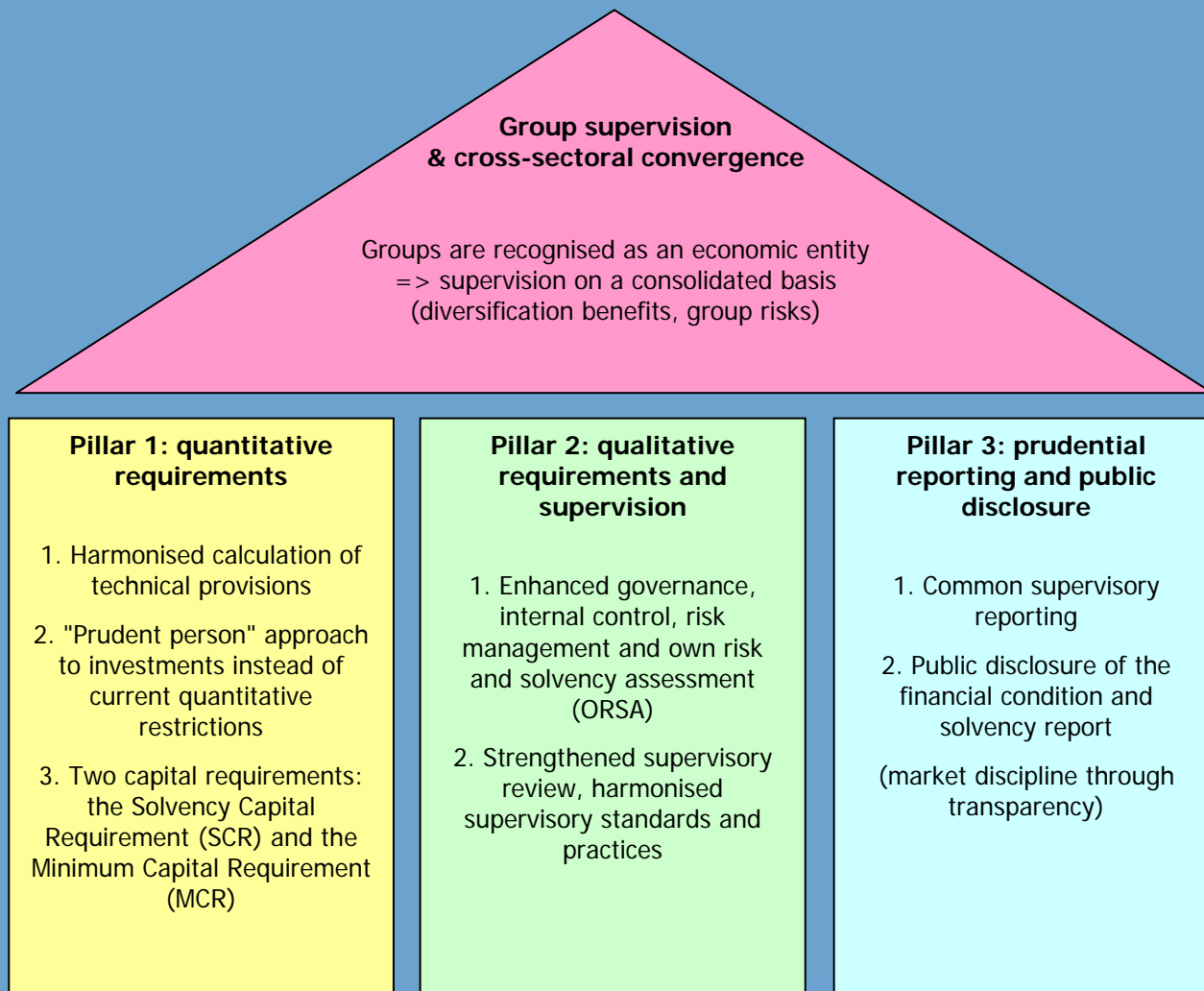
Solvency II

Key aspects

Solvency II...

- 3 'Pillars' of equal importance:
 - Quantitative requirements
 - Qualitative requirements
 - Disclosure and reporting
- Economic, risk based approach
- Proportionality principle
- Group supervision

Solvency II: 3 pillars and a roof



Pillar 1

Quantitative requirements

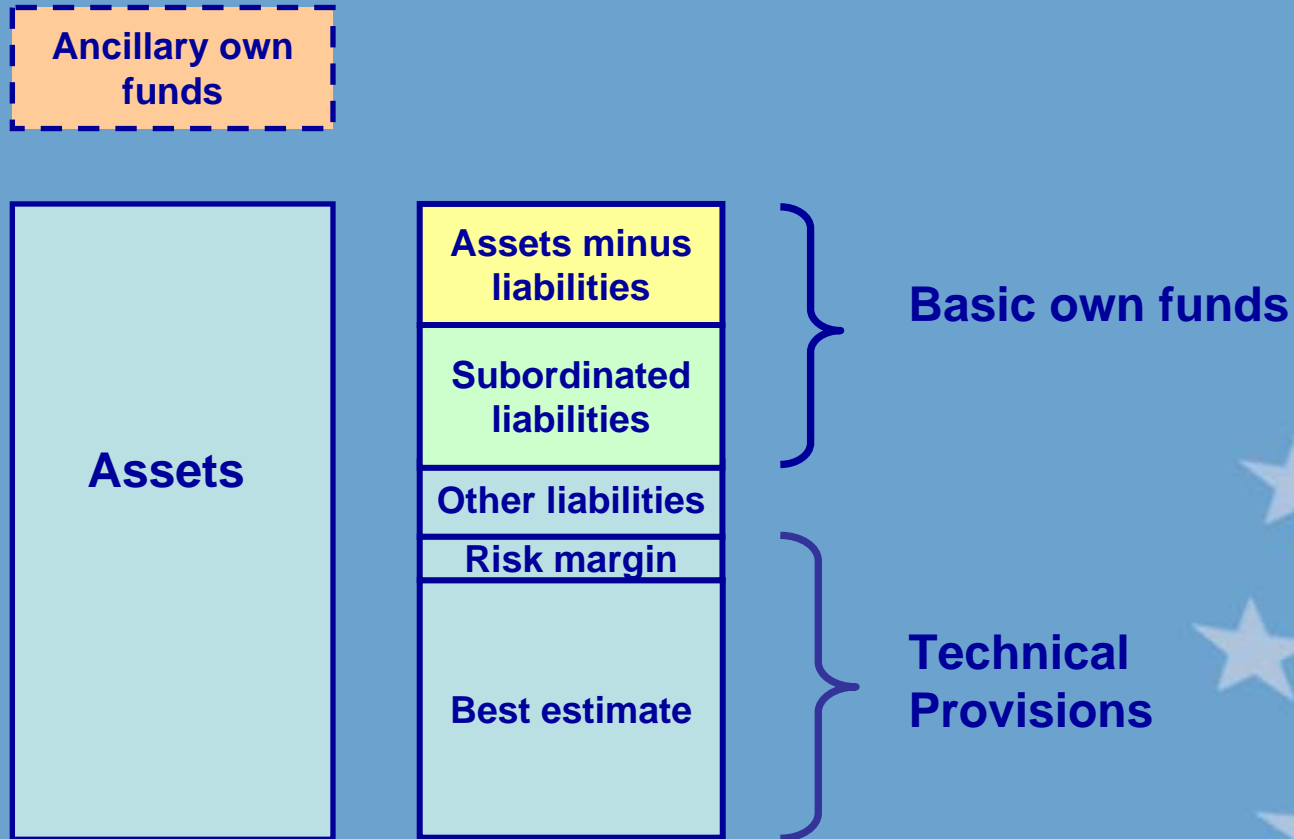
Valuation of Assets and Liabilities

- Assets shall be valued at the amount for which they could be exchanged, and liabilities at the amount for which they could be transferred, or settled, between knowledgeable willing parties in an arm's length transaction
- When valuing liabilities, no adjustment to take account of own credit standing shall be made
- The Commission shall adopt implementing measures to set out the methods, assumptions to be used

Valuation of Technical Provisions

- The value of technical provisions shall be set equal to the sum of a best estimate and a risk margin
- The best estimate is the expected present value of future cash flows, using the relevant risk-free interest rate term structure based upon up-to-date and credible information and applicable and relevant methods
- The risk margin shall ensure that the value of the technical provisions is equivalent to the amount insurance and reinsurance undertakings would be expected to require in order to take over and meet the obligations

Visualising Own funds



Capital Requirements

- Two capital requirements: the Solvency Capital Requirement (SCR) and the Minimum Capital Requirement (MCR)
- Provides for a ladder of intervention
- Breach of MCR triggers ultimate supervisory action

SCR General principles

- Designed to ensure all quantifiable risks are taken into account
- SCR can be calculated using either a standard formula or an internal model
- SCR calibrated to the Value-at-Risk of basic own funds subject to a confidence level of 99.5% over a 1 year time horizon
- Covers at least underwriting risk, market risk, credit risk and operational risk
- SCR shall take account of the effect of the use of risk mitigation techniques

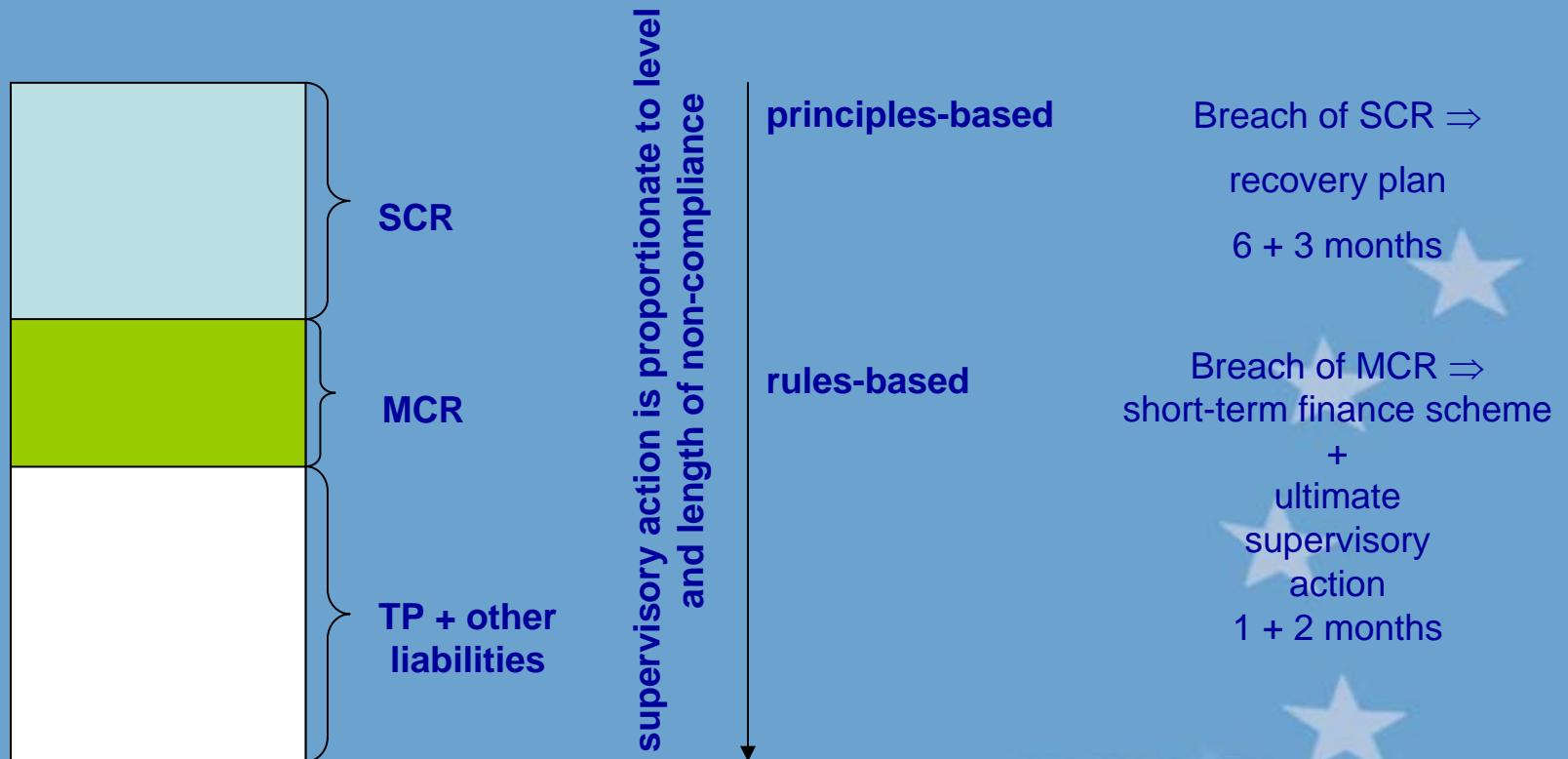
MCR

- MCR shall satisfy the following principles
 - MCR shall be calculated in an auditable, robust and simple manner
 - MCR shall be calibrated to a Value-at-Risk (VaR) subject to a confidence level of 85% over a one-year time horizon
- MCR shall be subject to an absolute floor
- MCR shall not fall below 25% nor exceed 45% of the undertaking's SCR
- MCR shall be calculated quarterly
- Breach of MCR triggers ultimate supervisory action

Investments

- “Prudent person” approach:
 - Insurer is able to invest in assets whose risks it can identify, measure, monitor, manage, control and report
 - Insurer invests in the best interest of policyholders
 - Insurer pays due attention to ALM
 - Insurer pays due attention to concentration and liquidity issues
- Freedom to invest: no asset categories prescribed, no prior supervisory approval

Supervisory ladder of intervention



Pillar 2

Governance and Risk Management

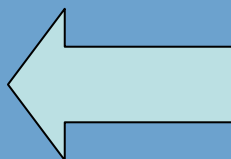
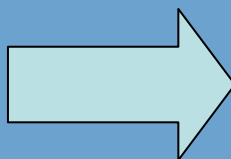
Pillar 2

- Qualitative requirements to cover risks which are not captured in the SCR
- Enhanced internal control, governance, and risk management, as well as self-assessment of capital needs
- Strengthened supervisory review, harmonised supervisory standards and practices

Pillar 2: Supervisory Activities

Supervisory activities

- general rules on supervision
- supervisory powers
- supervisory review process
- principle of proportionality

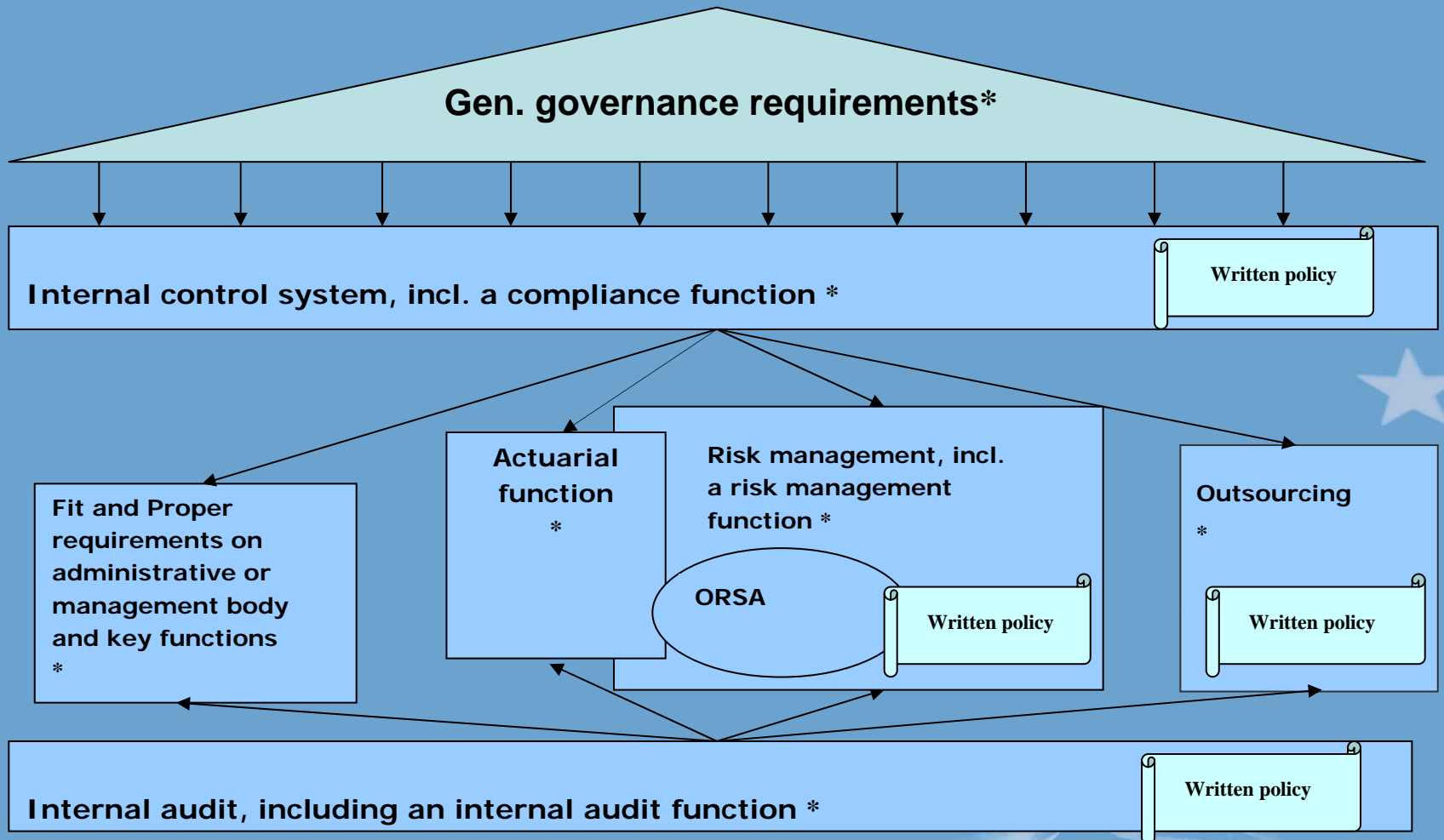


Qualitative requirements on undertakings

- system of governance
- principle of proportionality



Pillar 2: Governance System – Structure



Actuarial Function

- Specifically recognised and important
- **Technical provisions:**
 - Coordinates the calculation of technical provisions
 - Ensures appropriateness of methodologies
 - Assesses data quality...
- **Risk management system**
 - Contributes to the effective implementation of the risk management function
- No actuarial qualification as such required

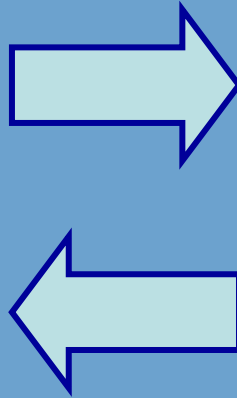
Pillar 3

Supervisory reporting and public disclosure

Pillar 3

Supervisory Reporting

- General principles for the submission of information to supervisors
- Implementing measures



Public Disclosure

- Disciplinary effects
- Solvency and financial condition report
- Implementing measures



Report on solvency and financial condition

- Annual report on solvency and financial condition
- Must be kept up-to-date
- Undertakings can disclose additional information on voluntary basis
- Undertakings must have policy on public disclosure
- Report must be approved by undertaking's management before publication

Group Supervision

A new approach

Reinforcement of group supervision

- Identification and nomination of a group supervisor
- Rights and duties of the group supervisor for all key elements of group supervision
- Enhancement of the duty to exchange information
- Full recognition of diversification effects
- Internal model to calculate the group SCR
- Group ORSA and Group Solvency and Financial Condition Report
- Subgroups: max. three levels of supervision
- Implementing measures to further specify principles at level 2

Supervision of Group Solvency

- Supervision of Group Solvency for Groups with Centralised Risk Management
- Review clause on supervisory cooperation (two years after entry into force of the directive) and group supervision (three years after entry into force of the directive)

Next steps

- EP adopted agreed text on 22 April 2009 (593 votes in favour against 80 opposed)
- Final adoption by Council in Autumn 2009
- 3 consultation rounds by CEIOPS during the course of 2009 for level 2 measures
- QIS 5 to be launched in August 2010
- Final advice from CEIOPS end January 2010

Solvency II and international developments

IAIS and Solvency II

- Solvency II is well aligned with the new solvency standards being developed by the IAIS
- One of the specific objectives we set ourselves at the beginning of the project is to help promote international convergence
- The development of international standards is the best way to promote the creation of open international insurance markets, whilst at the same time ensuring that policyholders are adequately protected

Solvency II and equivalence

- Under Solvency II, the Commission will be able to make binding decisions regarding the equivalence of third countries' group and reinsurance supervision
- Where a third country is deemed to have equivalent standards, EU supervisors will rely on the supervision applied in that country and (re)insurers from that third country will be treated in the same manner as EU (re)insurers
- Ultimately the equivalence assessments refer back to the Directive. However, if the work on Solvency II and the work of the IAIS remain well aligned, then it could enable us to rely to a large extent on the IAIS standards and guidance when making equivalence determinations

Questions?

Unit H2

“Insurance and Pensions”

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