



Solvency II

Presented by Neil Clutterbuck

Origins of Solvency II



- Solvency II is an incremental development from Solvency I
- Continued movement towards a single common market
- Solvency II proposed to solve inconsistent regulatory standards in the EU:
 - Move towards a single regulatory market
 - Promote business activity across the EU
 - Competitiveness of insurers
- Reaction to the Global Financial Crisis



Objectives of Solvency II

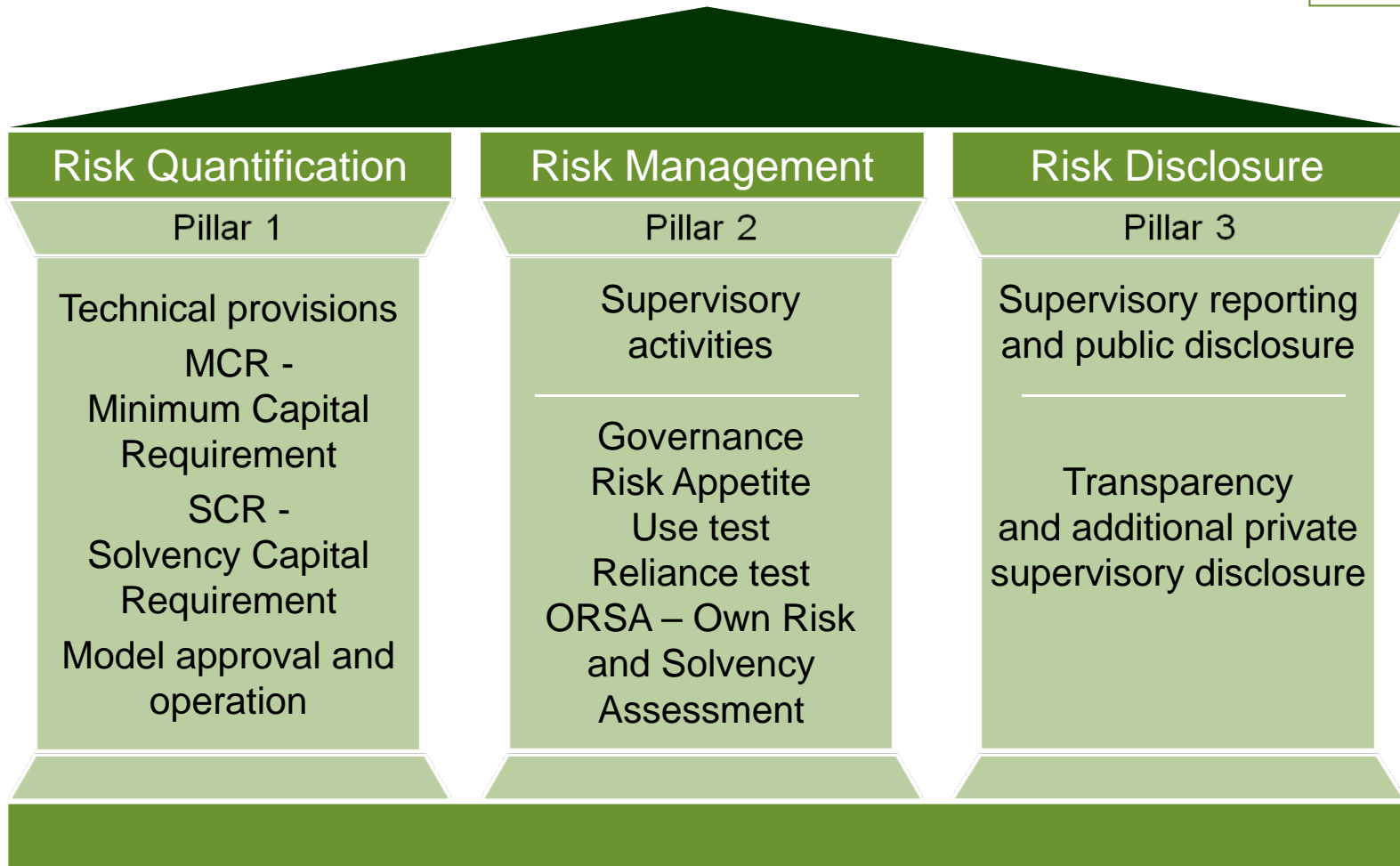


Solvency II will set out new, stronger EU-wide requirements on capital adequacy and risk management for insurers with the aim of increasing protection for policyholders.

Objectives:

- Strengthen solidarity of insurers and security of those insured
- Establish more consistent and comprehensive standards across the European framework
- Contribute to the modernisation of European insurance sector and its competitiveness

Solvency II – Three Pillars



Interplay between EU and Non-EU based Companies



Though Solvency II is a European Union initiative, it will have very significant effects far outside the EU:

- EU based companies are required to calculate consolidated Solvency II results covering their global insurance business
- EU operations of non-EU groups
- Many countries outside of the EU are talking about adopting their own versions of Solvency II



Importance and Benefits of Solvency II



Companies will **have** to get the balance right in understanding the risks they face and their implications, to make better decisions around effective use of capital...



Better and more informed risk taking



Better pricing and reserving practices



Possible improved financial results with reduced capital, higher ROCE



Sets out the framework by which EU regulators expect insurance companies to run and manage their business

- Stronger linking of risk, business decisions and capital leading to industry stability and policyholder protection
- Recognition of the economic realities of the risks that firms face
- Streamlining of the way that insurance groups are supervised across Europe
- Group Companies are using Solvency II as an opportunity to implement an improved capital models.



Greater Flexibility

- In asset structures
- In capital structures
- May lead to changes in Group structures

Greater Transparency

- Better linkage between products and the risks they embody
- More consistent and realistic reserving
- It will be more difficult to hide true profitability

Policyholder benefits

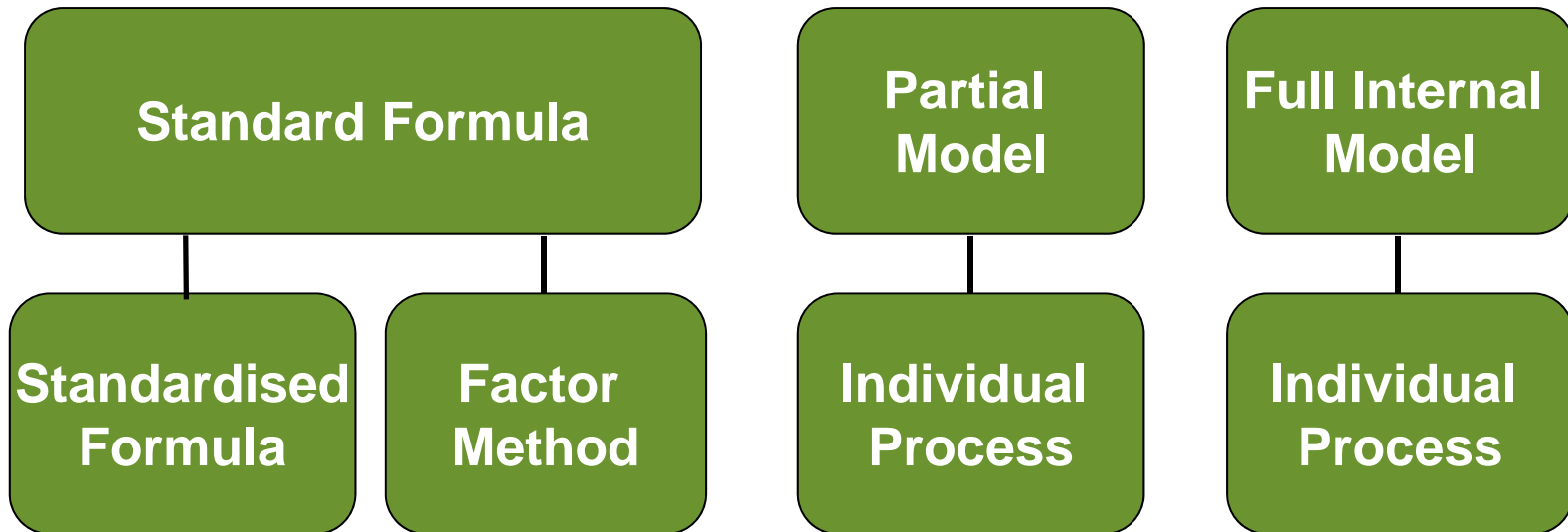
- More level playing field → greater competition
- Policyholder protection more consistent across EU

= (Even) more stable insurance industry

Own Model Vs Regulators Model



- Decision Time – Standard Formula vs Internal Model
- Internal Models
- Helping to make a decision



Solvency II – Possible Risks



- Excessive bureaucracy may be imposed by Regulators (although a barrier to new entrants)
- Capital levels may be constrained by regulatory “non-risk” adjustments
- Inconsistent regulation by company and country
- Goalposts moving

Effects on Engineering Businesses



- Potential changes to capital requirements for engineering lines
- Increased transparency
- Increased administration burden on companies
- Data consistency and integrity
 - Supervisory reporting & public disclosure
 - Continued trend towards a model of corporate governance
 - Consistency in European reporting standards



Engineering business is not explicitly mentioned in the “standard formula” and is treated like “Fire”



Does Solvency II make certain classes of business less economical?

In the **Solvency II standard formula** the capital requirement for the underwriting risk of specific lines of business (LoB) is made up of a premium and a reserve risk component. There is provision for twelve lines of business and primary insurance and proportional reinsurance are treated in the same way. For each individual LoB, the standard deviations and volume measures for both premium risk and reserve risk are determined. As a general principle, the higher the volume and the underlying risk, the higher the capital requirement will be.

Engineering business is not explicitly mentioned in the QIS5 technical specifications and is treated under “Fire”. Fire again has comparatively **low** risk capital requirements (See below)

Engineering business is not explicitly mentioned in the “standard formula” and is treated like “Fire”



SCR.9.25. The market-wide estimates of the net standard deviation for premium risk for each line of business are:

<i>LoB</i>	<i>standard deviation for premium risk (net of reinsurance)</i>
<i>Motor vehicle liability</i>	10% NP_{lob}
<i>Other motor</i>	7% NP_{lob}
<i>MAT</i>	17% NP_{lob}
<i>Fire</i>	10% NP_{lob}
<i>3rd-party liability</i>	15% NP_{lob}
<i>Credit</i>	21.5% NP_{lob}
<i>Legal expenses</i>	6.5% NP_{lob}
<i>Assistance</i>	5% NP_{lob}
<i>Miscellaneous</i>	13% NP_{lob}
<i>Np reins (prop)</i>	17.5%
<i>Np reins (cas)</i>	17%
<i>Np reins (MAT)</i>	16%

Solvency II tends to favor large insurers over smaller insurers



Do small insurers have to worry more due to Solvency II?

Large insurers are expected to benefit under Solvency II relative to smaller insurers, as larger carriers usually are better diversified and have economies of scale when the SII implementation costs are considered

What are the general effects on engineering insurance business?

It can be expected that Solvency II's final introduction and the process of adapting to it will force EEA-based engineering insurers to act even more rationally and economically efficiently. However it can not be expected that the "rules of the game" will be changed completely.

The most advanced engineering/construction companies in the EEA might see Solvency II as an opportunity rather than a threat. They are expected to transform their captives from "transactional vehicles" into strategic risk management assets, which help them to build an effective risk data base, increase the understanding of the mechanics of risk financing and therefore lower their total cost of risk

Solvency II will clearly increase the challenge for captives to generate economic value



Captives will likely face significantly higher risk capital requirements

Significant investments in infrastructure, especially in respect of Pillar II and Pillar III requirements

Lack of own modeling capacities will lead to application of more capital intensive standard approach

Major enhancement of processes, modeling capabilities and information gathering required in order to comply with the 'fit and proper' regime

Chief Financial Officers and analysts will potentially question the necessity to run a captive, given assumed deteriorated profitability



Council of the European Union

Proposed compromise to the Omnibus II Directive - 1 yr delay

Recommends supervisory power to demand implementation plan requirements

U.S. insurers begin work on Solvency II

U.S. insurers "are viewing this as something that will come in the marketplace no matter what,"

Any delay may have potential benefits

Additional time to implement Solvency II, allowing more time for key issues to be finalised and addressed

Concerns over European sovereign debt

Solvency II was written at a time when sovereign debt was considered as safe

Summary



- Overcome inadequacies of Solvency 1
- Movement towards a single regulatory market
- Modernisation of European insurance sector and its competitiveness
- Worldwide review of Solvency
- Industry stability and policyholder protection
- Greater transparency

