Solvency II, messages and findings from QIS 5

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Executive Director
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- Impact of the proposed regime
- Feasibility of Solvency II
- How to get the best regime: next steps

Objectives of QIS5

- Commission’s Call for Advice (July 2010):
  - o Quantitative impact
  - o Check principles and calibration targets
  - o Encourage (re)insurers and supervisors to prepare for the introduction of Solvency II
  - o To provide a starting point for an ongoing dialogue between supervisors and (re)insurers

- Also: EIOPA to test feasibility and assess complexity

Preparedness of insurers and supervisors

Participation solo

- Participation rate

More than doubled solo participation

Solo	Target (set by EC)		Results	
	QIS4	QIS5	*QIS4*	QIS5
	25%	60%	*33%*	**68%**

- 1511 Small
- 791 Medium
- 217 Big

- 610 Life
- 1284 Non-Life
- 111 Reinsurers
- 175 Captives
- 336 Composites

- 382 Health
- 454 Mutual

Participation groups

Groups: QIS4: 106

QIS5: **167**

Increase in number of small and medium groups

	Large	Medium	Small
Number	17	23	127

	EEA groups without non-EEA entities	EEA groups with non- EEA entities	EEA subgroup(s) of non-EEA groups
Number	121	41	5

Challenges to implementation for industry and supervisors

- Complexity of the framework
  - Major overhaul of valuation of balance sheet and calculation of the capital requirements
- Need to improve data quality and management
- IT challenges

Requirements are not final but stabilising !

Current state of preparedness of the industry

- Participation rate shows that Solvency II is a priority to all insurers, regardless of size

- (Re)insurance undertakings and groups are striving to be ready for the implementation date of 1st January, 2013.
  - A majority of undertakings considers they will be ready by end 2012
  - Large undertakings and group members in advance in their preparation (and QIS4 participants)

Keep up the good work !

Gap analysis

- Simplifications
- Spend time to understand the requirements and how they will be implemented operationally
  - Training!
- Quality/quantity of resources (actuarial skills, risk management, ...)
  - Availability of resources
  - Degree of dependence on external resources/consultants (small undertakings)
- Importance of Pillar 2 and 3
  - Strengthening of corporate governance
  - Implementation of ORSA
  - Support the harmonised quantitative reporting

Move from regulation to supervision

- Put proportionality in practice – address the complexity through adapted means

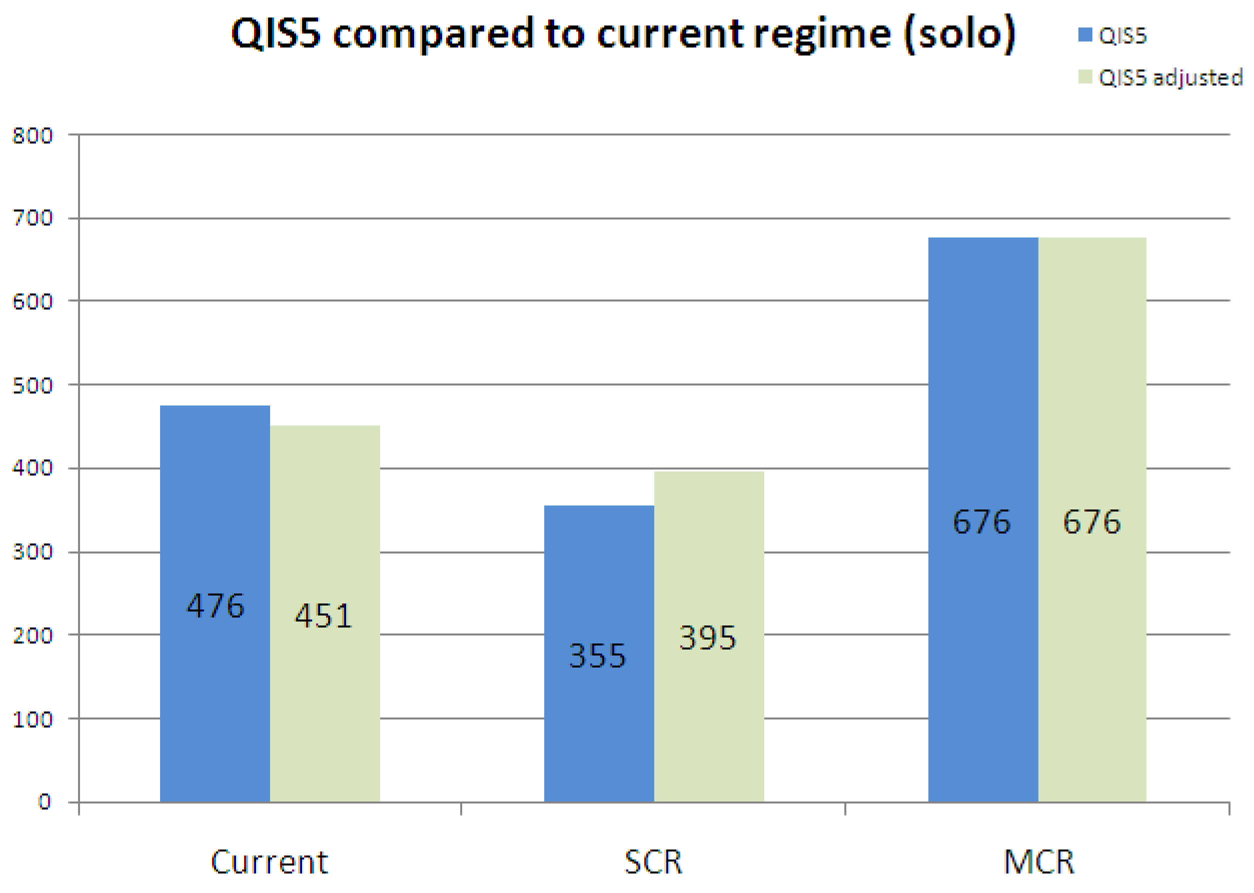
- EIOPA to undertake development of Technical Standards and Guidelines

- Smooth transition to the new system: assess need and appropriateness of transitional measures

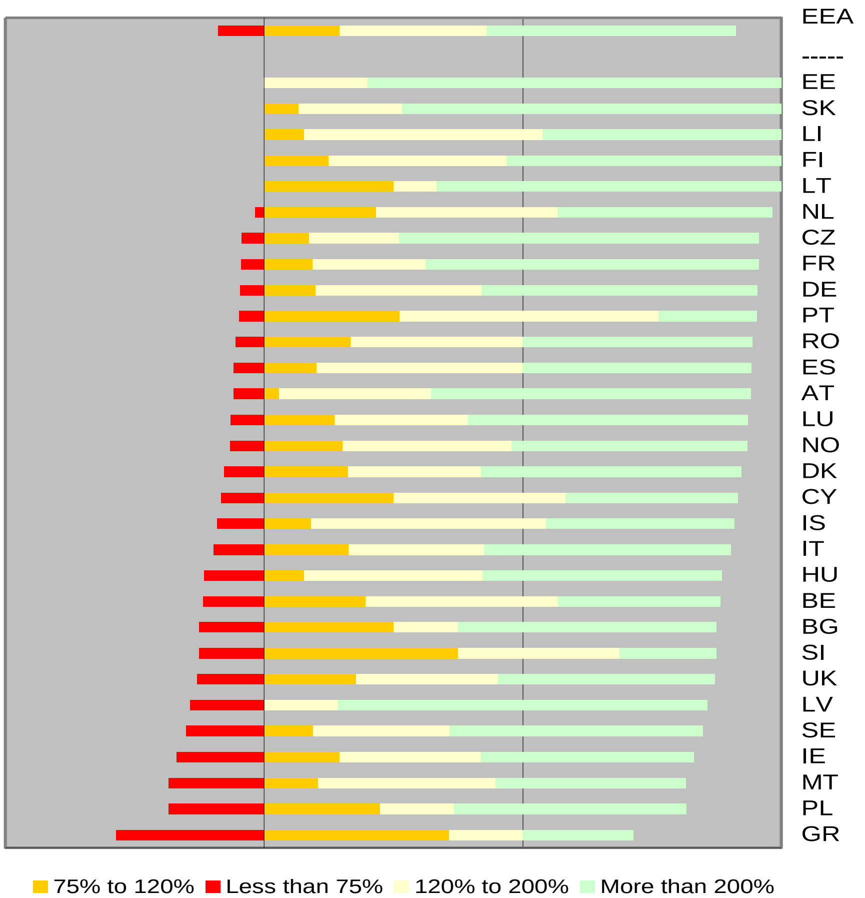
Keep the risk based and principle-based approach inherent to Solvency II

Impact of the proposed regime

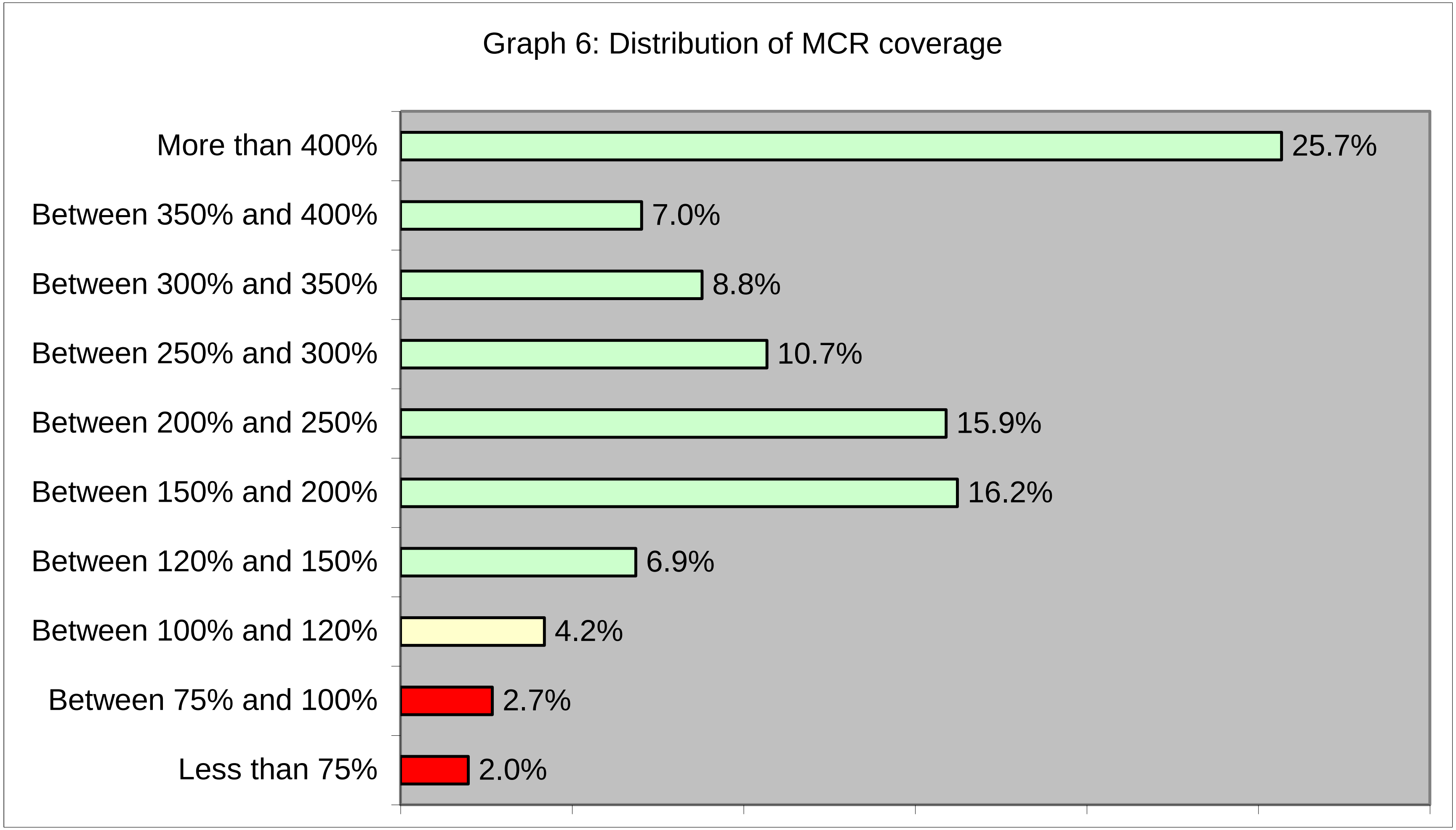
Surplus evolution



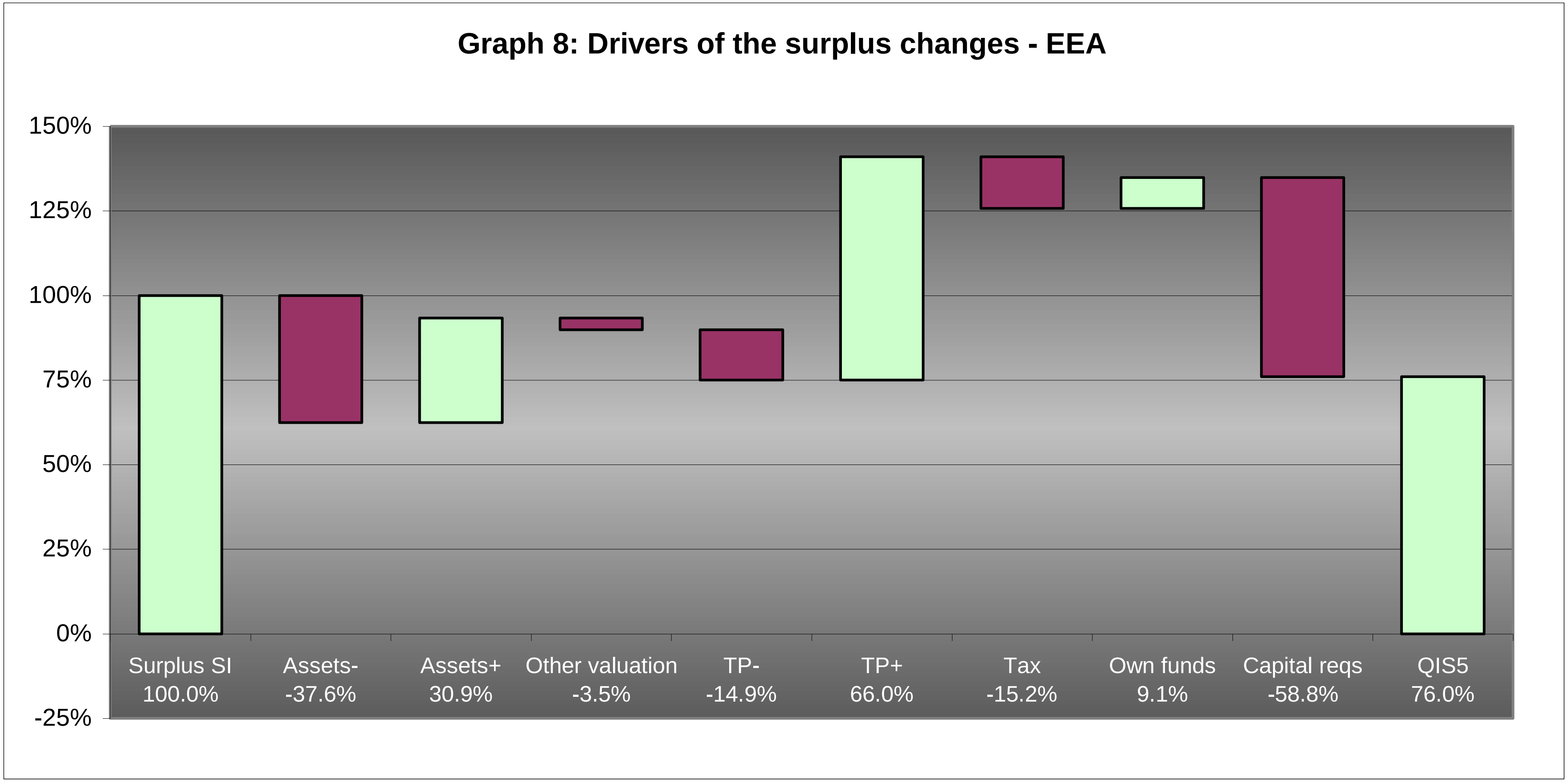
Graph 5: Distribution of SCR coverage by country



Solo MCR coverage



Explanation of solo surplus evolution



Group surplus

(Billions euro)	Surplus Solvency I	Surplus QIS5	Size sample
Results in case internal models were approved and/or local rules under D&A for third countries were used			
Large	**109**	**129**	17
Medium	27	18	21
Small	64	50	109
All	200	197	147
Consolidated method with standard formula			
Large	109	54	17
Medium	27	16	21
Small	64	44	108
All	200	114	146

Technical Provisions

- A general decrease in technical provisions from Solvency 1 to QIS5 due to :
    - Removal of implicit prudence
    - Generally a higher discount rate
    - Different cash-in and –out flows to be assessed
- This statement has however to be nuanced for life business

Risk margin

- Clear support for simplifications
- Unavoidable market risk difficult to assess
- Simplifications to be refined
    - Especially for negative Best Estimates
    - For some lines of products

SCR: Positive outputs

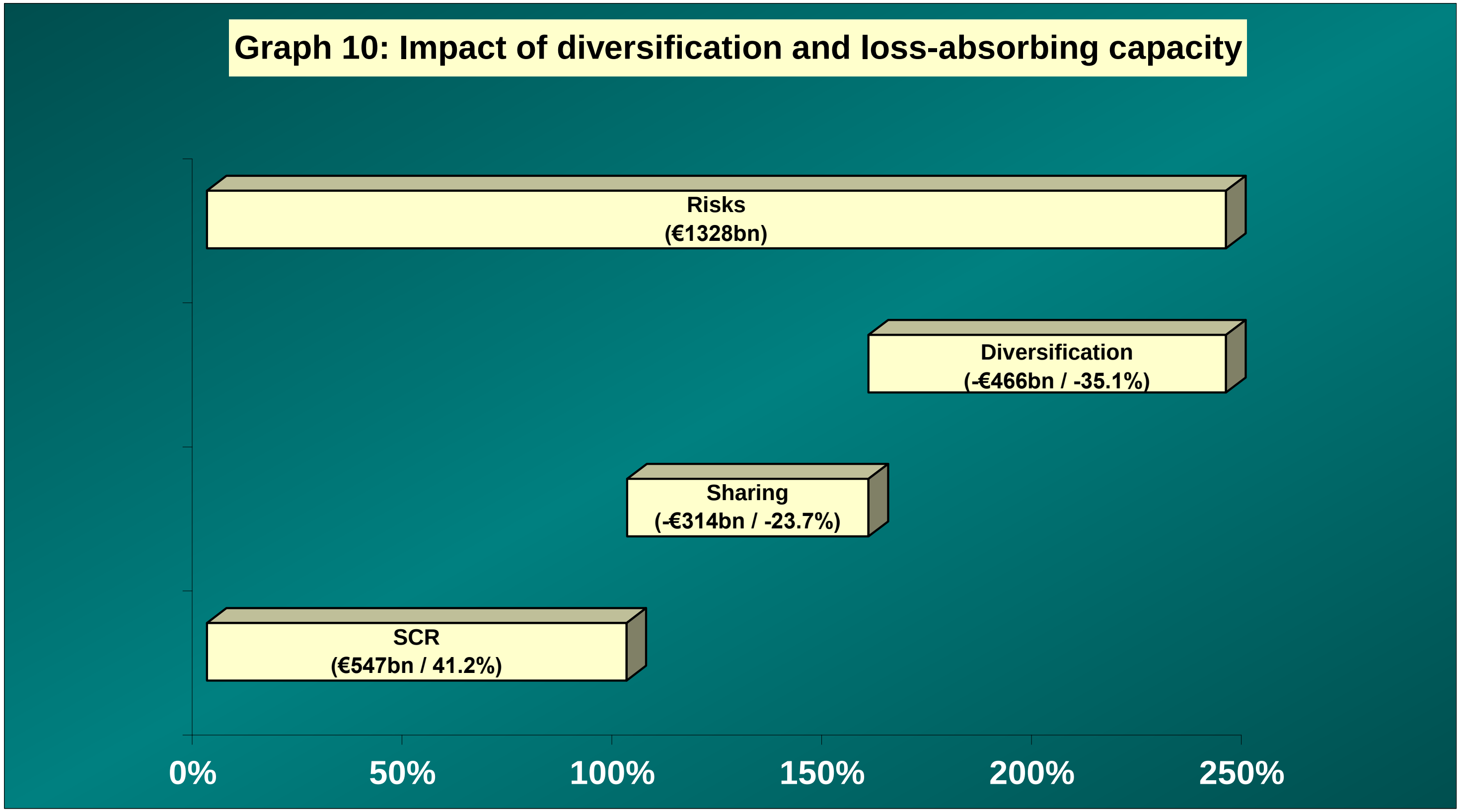
- General design of SCR confirmed
  - Modular approach (modules and sub modules)
  - Diversification through correlation matrices

- Outcome of internal models **on average** similar to the standard formula, and better for well diversified structures

- No major practical difficulties in calculating the MCR

- Interplay between MCR and SCR (MCR / SCR = 33.8%, in the middle of the corridor)

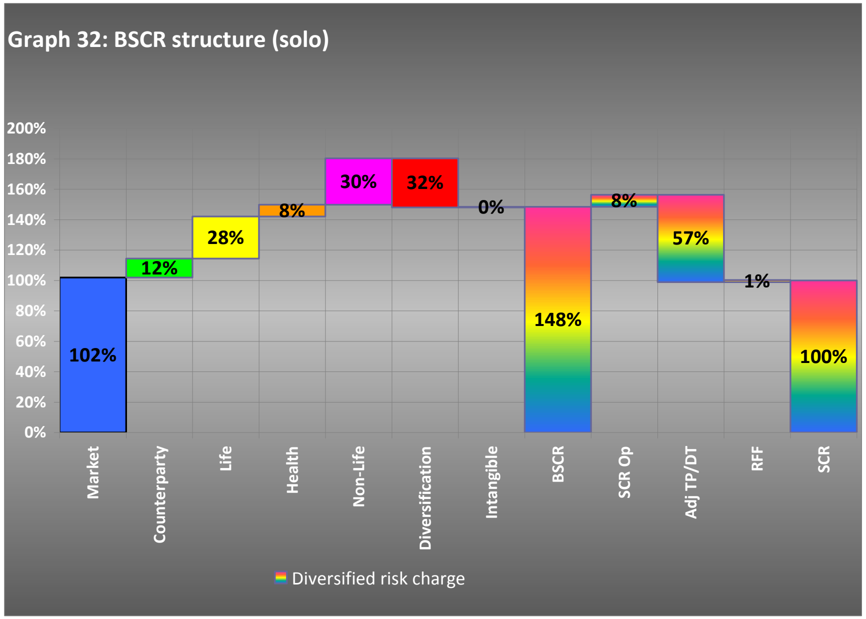
The loss absorbency modelled in the standard formula

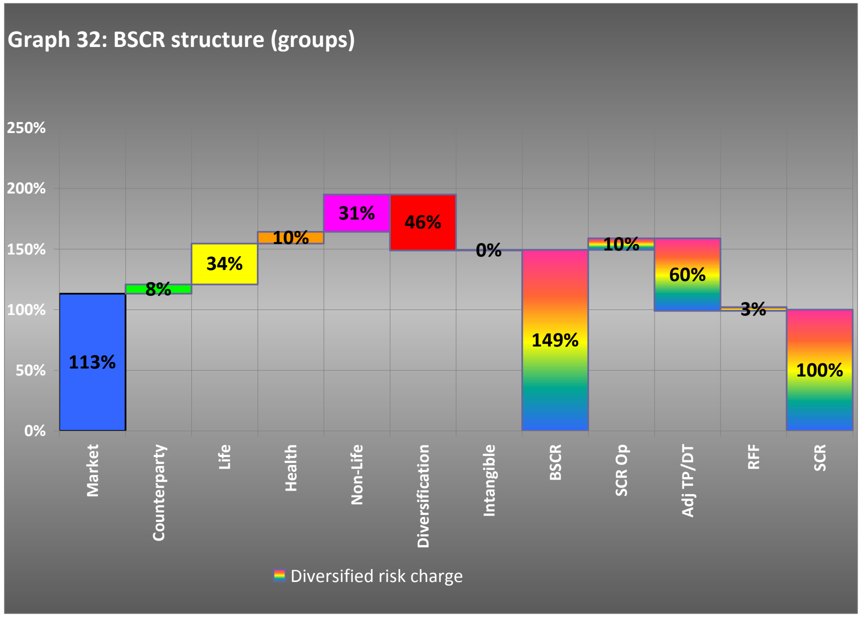


- *Around 40% of the Future Discretionary Benefits were consumed*

SCR Composition

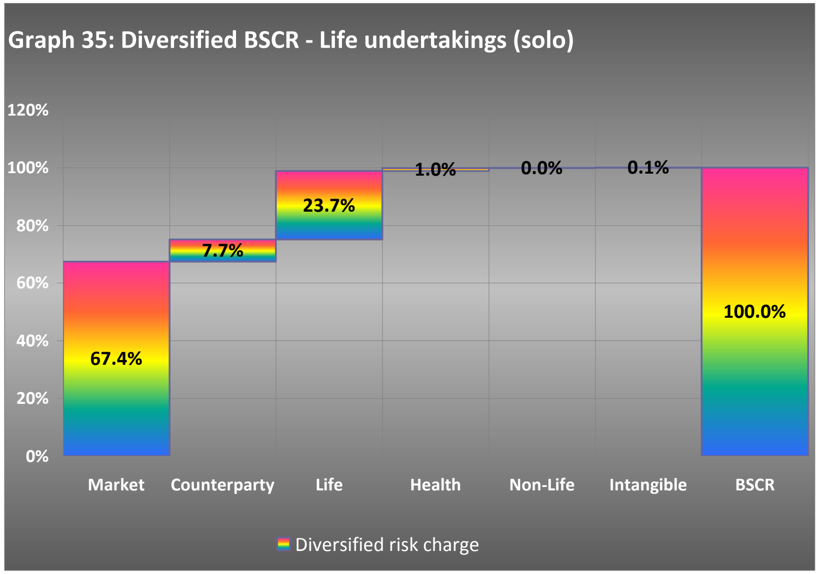
- **Similarities** and differences between solos and groups

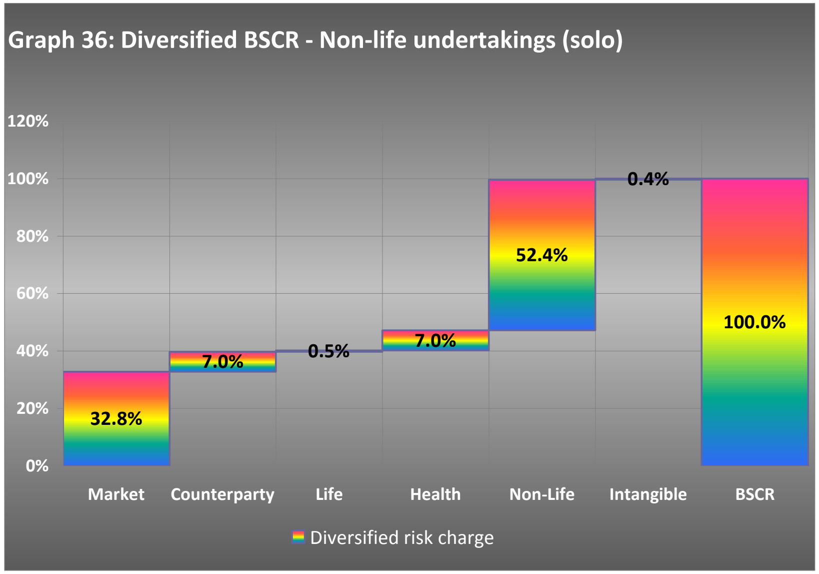




BSCR structure

- Similarities and **differences** for life and non-life





Internal models (1)

- *Caveats: small sample and internal models not finalized*

- Using: 262/309. Working on implementation: 289

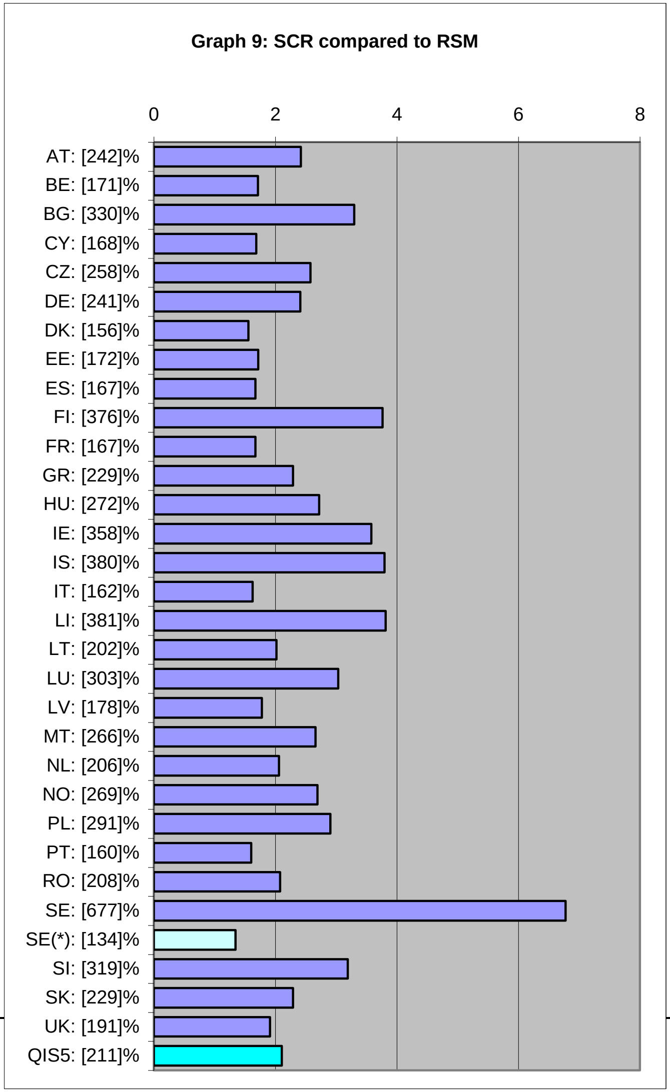
- 96% of group members would use the model developed at group level

- Spike of submissions around the introduction date of Solvency II expected

The standard formula SCR compared to RSM

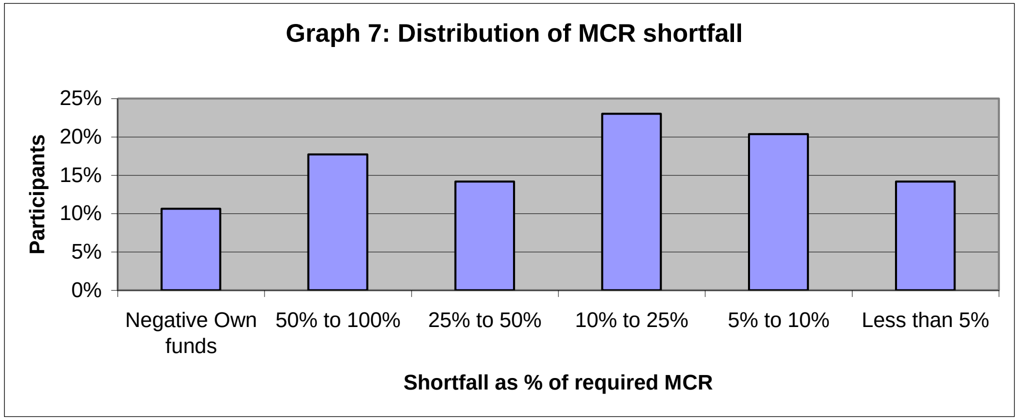
- The removal of implicit prudence in the TP is parallelled by an increase in the explicit, granular, risk based own funds requirements.

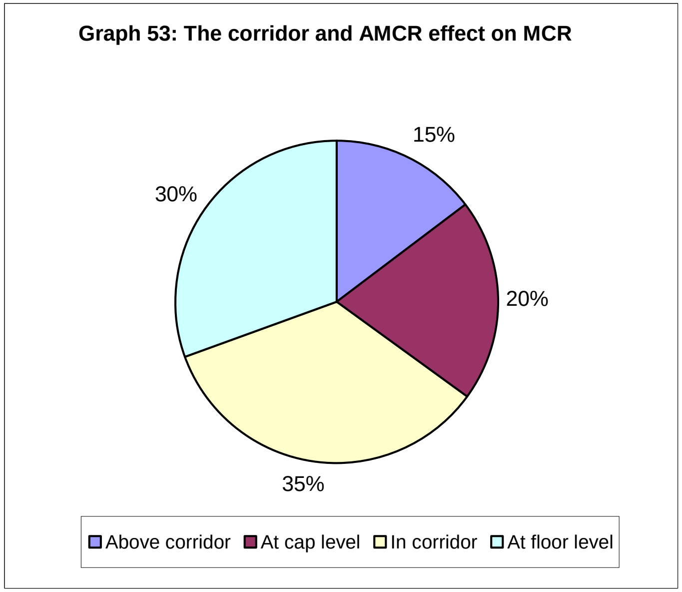
- SCR: Around twice the existing Required Solvency Margin.



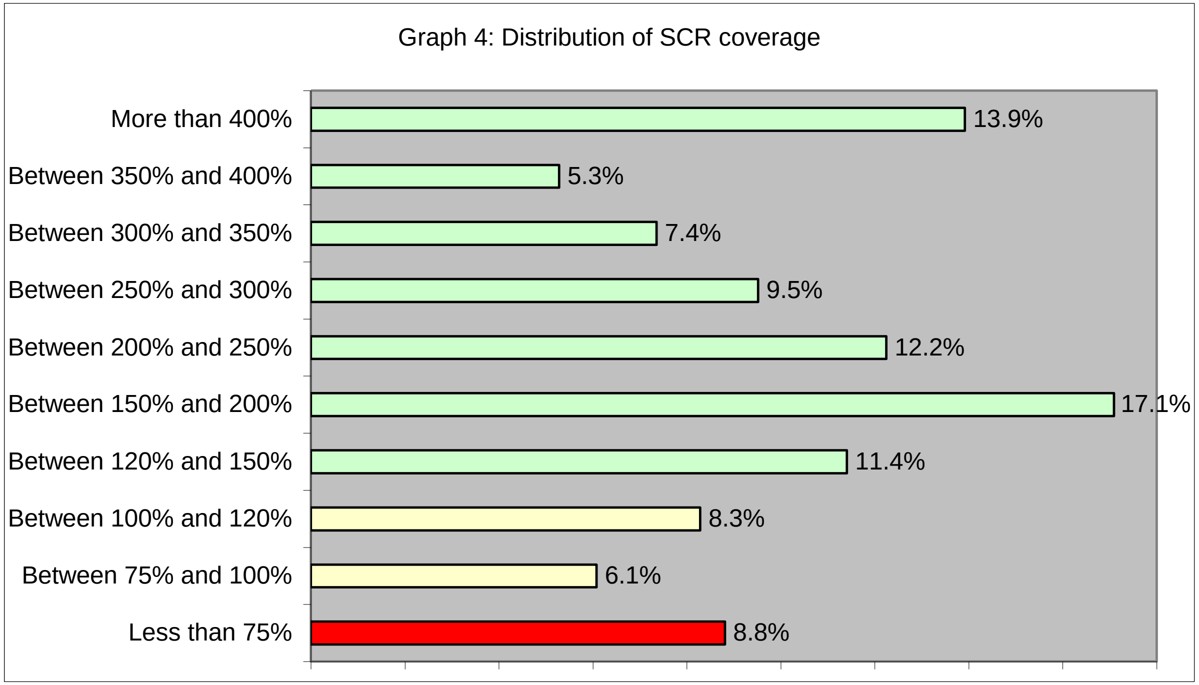
The MCR main essential points

- After the AMCR, 15% of the undertakings are above the corridor
- 1.3% had a shortfall greater than 50%
- 0.6% had negative own funds





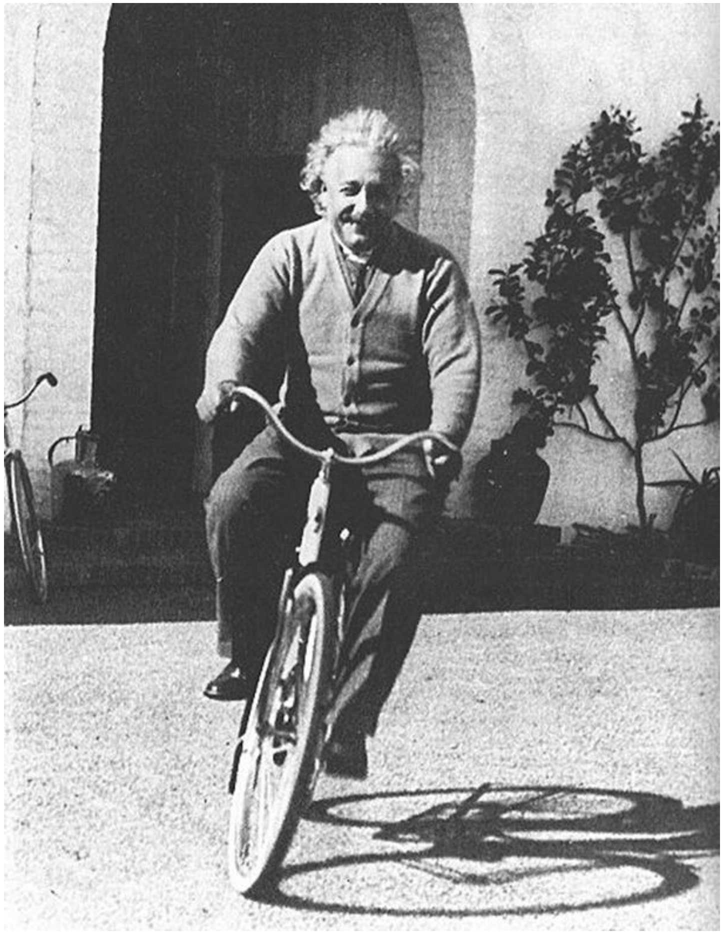
The Standard formula SCR coverage distribution



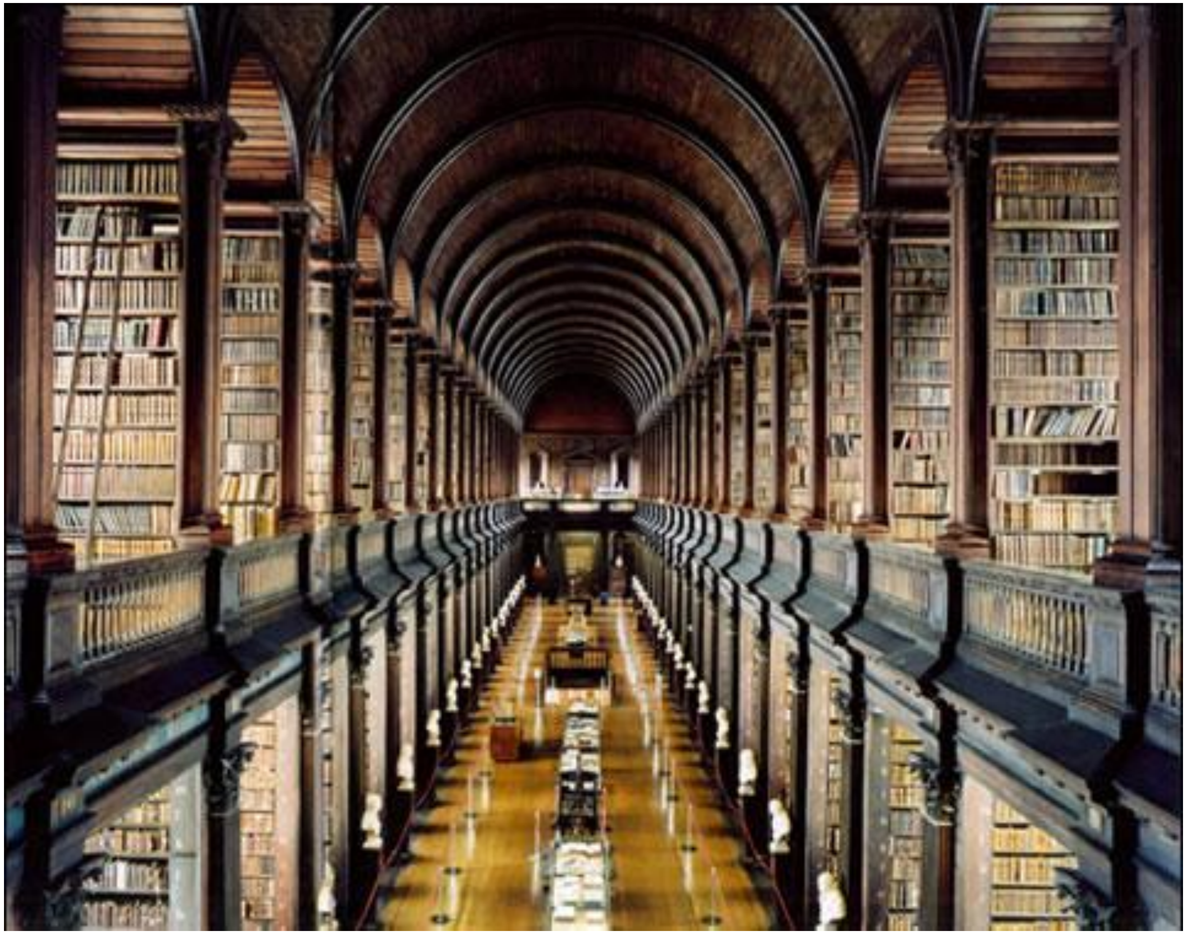
Composition of own funds

- Total available own funds - €921 billion
- €846 billion of Tier 1
- Predominance of ordinary share capital, share premium account and retained earnings
- Reconciliation reserve = 10% approx

Feasibility



How to get the best regime: steps forward



Further work: Valuation

- Consistency with IFRS
- Mark to model
- Deferred taxes

Further work: SCR

- Non-Life catastrophe risk: (calibration, data availability and effort required, risk mitigation)
  - o Further work in progress
- Counterparty default risk
  - o Difficulty applying full calculation
  - o Proportional to (lack) of importance for some ?
- Calculation of loss absorbency of deferred taxes
- Equivalent scenario
- Lapse risk (policy level in life, availability of systems and process in non life)
- Look through approach (e.g. unit-linked)

Further work:
Expected profits in future premiums

- Quantified in QIS5 – amount disclosed as part of Tier 1
- Proxy methodology intended to provide a simple and consistent approach but …
- Poor participation rate – 29%
- Results affected by calculation difficulties, assumptions and undertakings' concerns about the concept
- Care with use of data
- Weighted average – 20% of Tier 1 v 16% for groups

Further work: Groups

- Absorbing effects of deferred taxes and future discretionary benefits at group level
- Treatment of ring fenced funds
- Treatment of intra-group transactions

EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY

Thank you

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