EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY

Solvency II
Towards a risk based system

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P/C Risk-Based Capital: State and International Solvency Regulation
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Towards a single rulebook
Crucial step to achieve a single market

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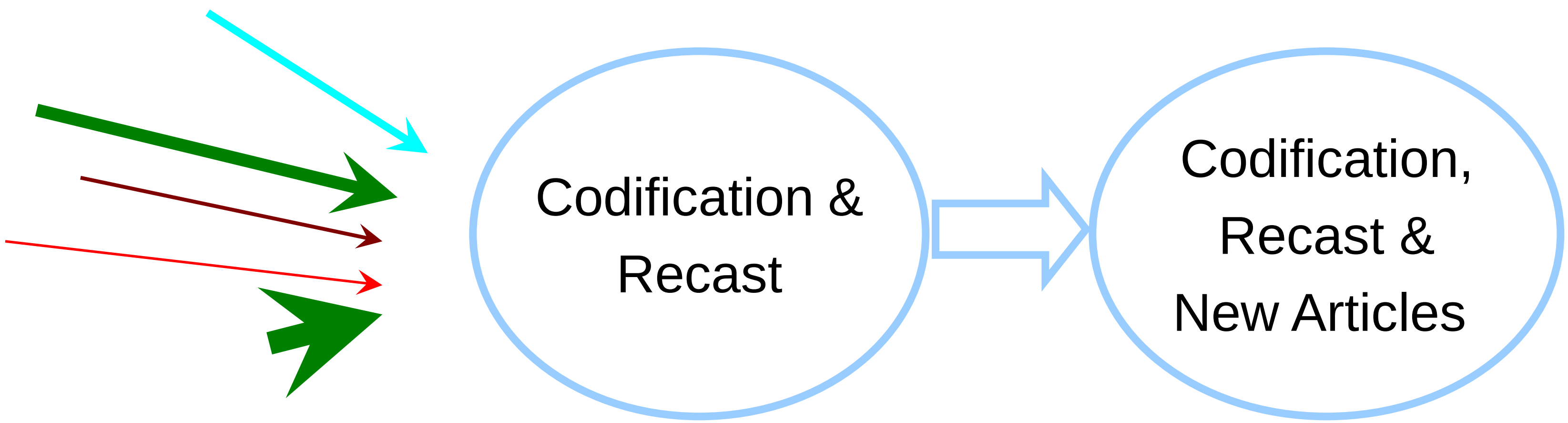
Fourteen existing Directives on insurance and reinsurance supervision, insurance groups and winding-up

+ Solvency II



= 1 Directive on insurance and reinsurance supervision

Reminding ourselves of the objectives and opportunities of Solvency II

- **Objectives**:
  - Deepen the integration of the internal market (Single Market)
  - Enhance protection of policyholders
  - Improve international competitiveness of EU insurers
  - Achieve “better regulation”

- **Opportunities**:
  - Better match between supervisory framework and internal risk management
  - Harmonised supervision and reporting requirements within the EEA
  - Improved group supervision
  - Convergence of supervision in the EEA

The foundation of Solvency II

Supervision of solo undertakings and groups

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Pillar 1

Quantitative Requirements

- Technical provisions
- MCR and SCR – SF/IM
- Prudent person investment rule
- Own funds

Total balance sheet approach
Market-consistent valuation
Approval of internal models

Harmonized Valuation standards

Pillar 2

Qualitative requirements

- Internal control and risk management (incl. **ORSA**)
- Supervisory review process (qualit. & quant - Add-ons)

Focus on firm's responsibility
Convergence of supervisory practices

Convergence of supervisory practices

Pillar 3

Reporting and disclosure

- Supervisory reporting
- Public disclosure
- Market discipline

Better risk-based information
Increased transparency

Harmonized supervisory reporting

Valuation of assets and liabilities for solvency purposes

- Defines basis of solvency assessment

- Solvency II follows an economic approach:
  - ✓ Economic market-consistent valuation of all assets and liabilities
  - ✓ Consistent across assets and liabilities

- Shall support economic assessment and consistent measurement of risks

Own funds

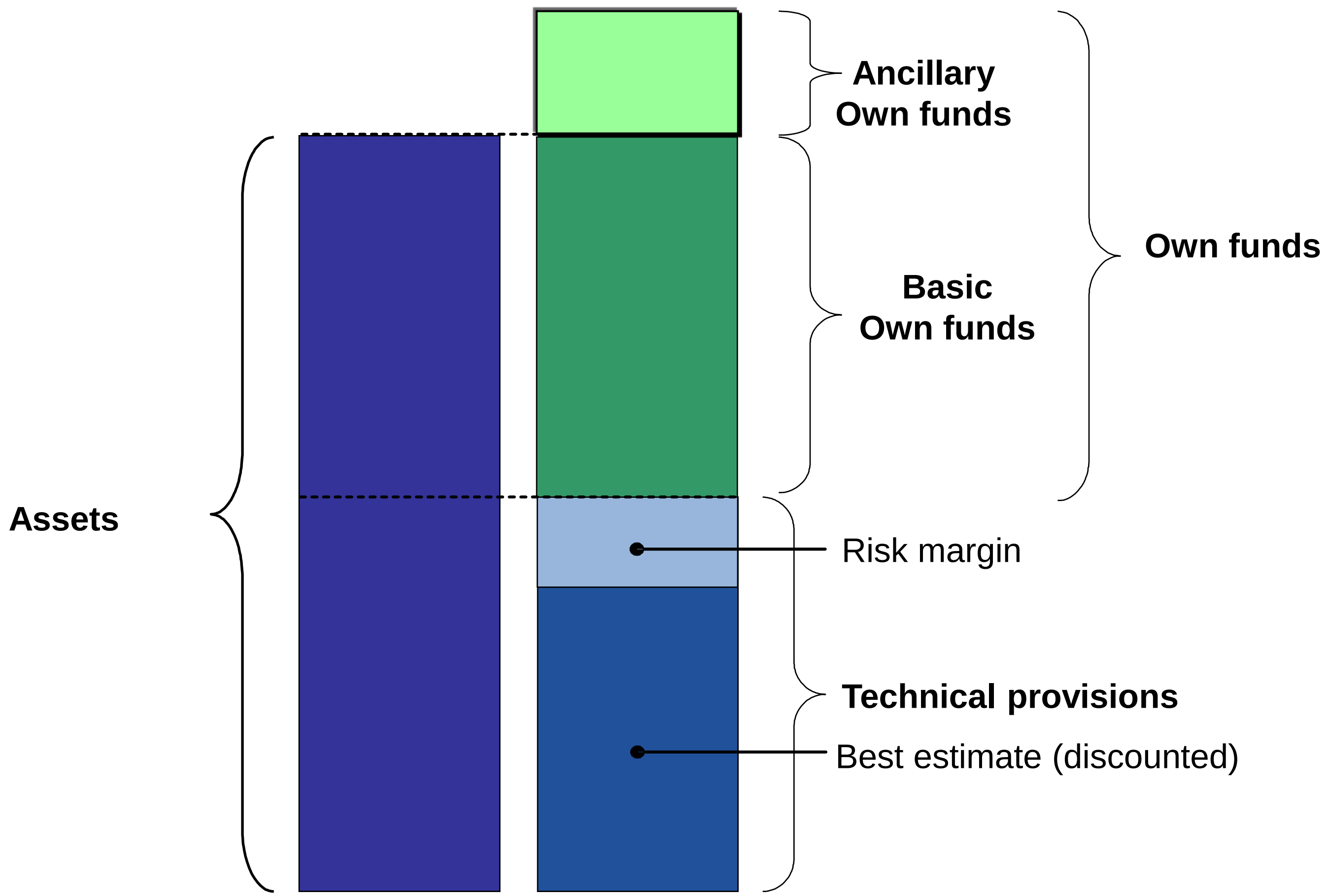
- Own funds = excess of assets over liabilities, aka “net asset value” or available capital resources
- Shock absorber against adverse losses
- Shall ensure that the insurer is able to meet its obligations to policyholders when they are due
- Distinguish the quantity and the quality (loss absorbing capacity) of the own funds

Required regulatory capital

- Capital which insurer is required to hold should be sufficient to ensure that, in adversity, an insurer's obligations to policyholders will continue to be met
- Applies at solo and group level
- Calculated via standard formula or (full or partial) internal model
- Solvency II aims for risk-based and economic determination of required capital
  - ✓ **SCR** - Solvency Capital Requirement: defined such that assets exceed technical provisions and other liabilities with a specified level of safety over a defined time horizon
  - ✓ **MCR** – Minimum Capital Requirement: lowest level, triggers strongest supervisory actions

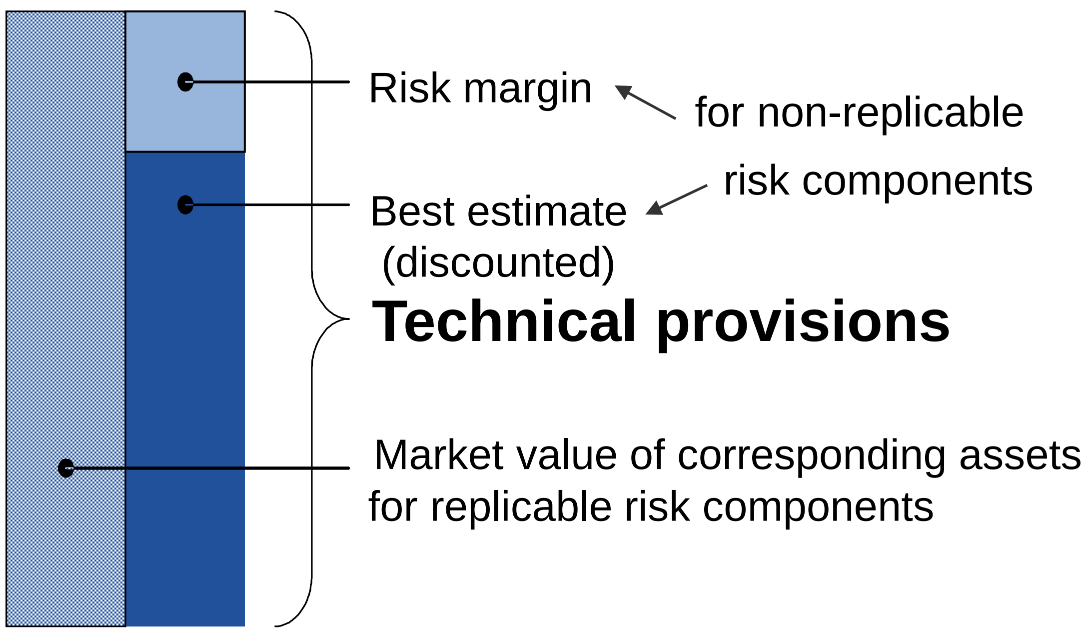
Overall approach to solvency assessment

The Solvency II balance sheet

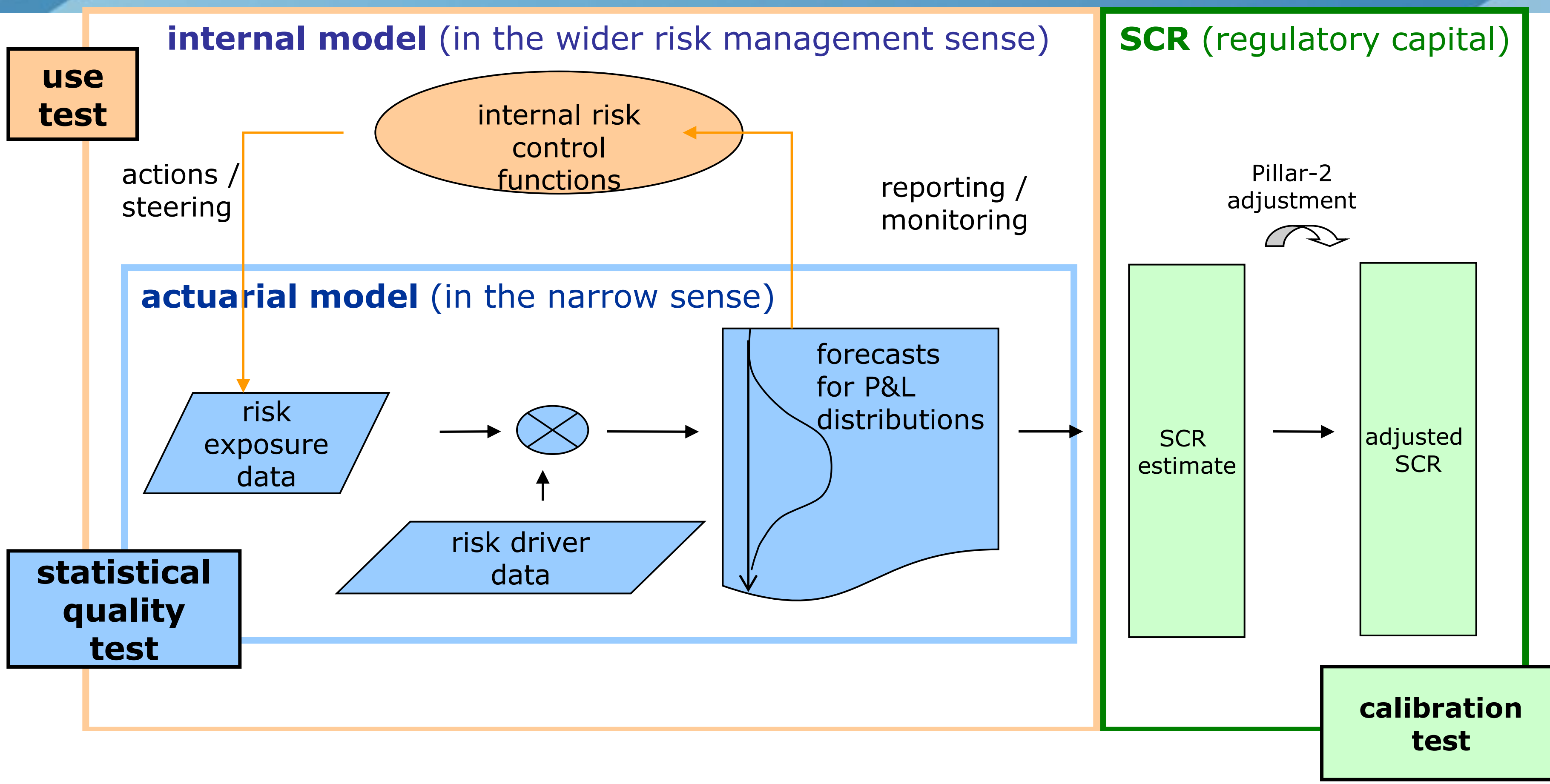


Technical Provisions

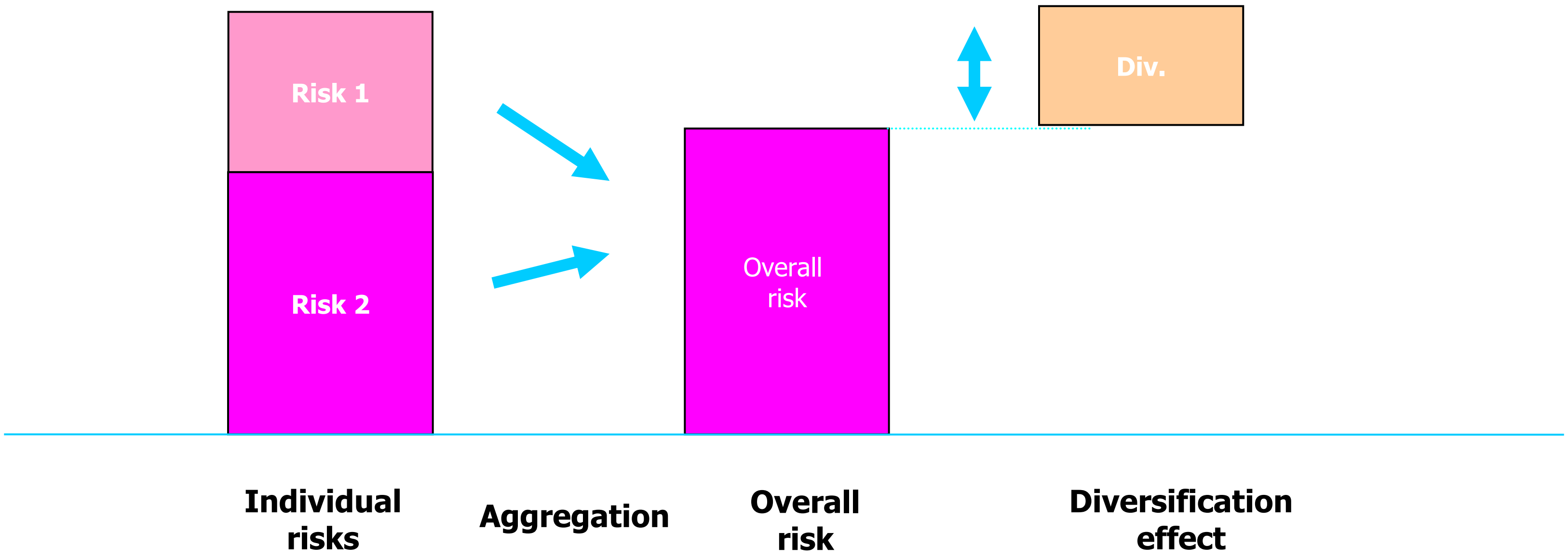
Components of technical provisons



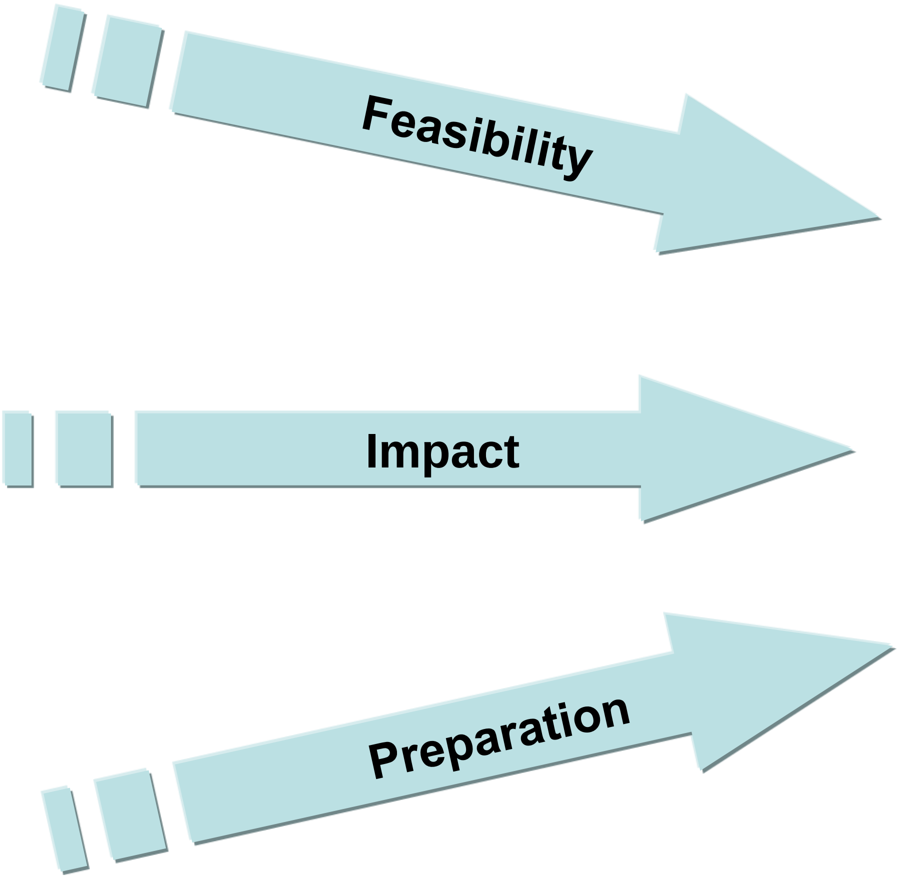
Internal Models Framework



Recognition of diversification effects



What did we learn from QIS5?



Lessons from QIS5

- **Complexity**
  - Solvency II is a major overhaul of valuation of balance sheet and calculation of the capital requirements
  - Simplify where impact is not material (**proportionality**)
- Need to spend time to understand the requirements and how they will be implemented operationally
  - Pillar II and Pillar III (ORSA, Governance, disclosure)
  - Training, Human resources
  - IT, Data collection
- **Impact**
  - Overall financial position remains comfortable
  - But need for smooth transition – transitional measures
    - Hybrids, Third country equivalence, discount rate

What is EIOPA doing?

❶ Working groups with the industry and the EC

- Calibration of the non-life and health risks
- Calibration of the Catastrophe risk
- Expected profits in future premiums and contract boundaries

❷ Technical standards

- Reporting to supervisors
- USP approval process
- Discount rate
- Contract boundaries
- Integration techniques on partial internal models
- …

❸ Guidelines

- ORSA
- Actuarial guidelines
- Intra-group transactions and risk concentrations
- Functioning of the supervisory colleges
- …