Regulations in General Insurance

Solvency II

Solvency II – What is it?

- Solvency II is a new risk-based regulatory requirement for insurance, reinsurance and bancassurance (insurance) organisations that operate in the European Union
- It deals with the adequacy of capital allocation and risk management to protect policyholders

Current

Solvency I

- Uneven playing field across Europe
- 'One size fits all' rather than a risk based approach to solvency capital requirements
- Simplistic premium and claim volume driven model

Future

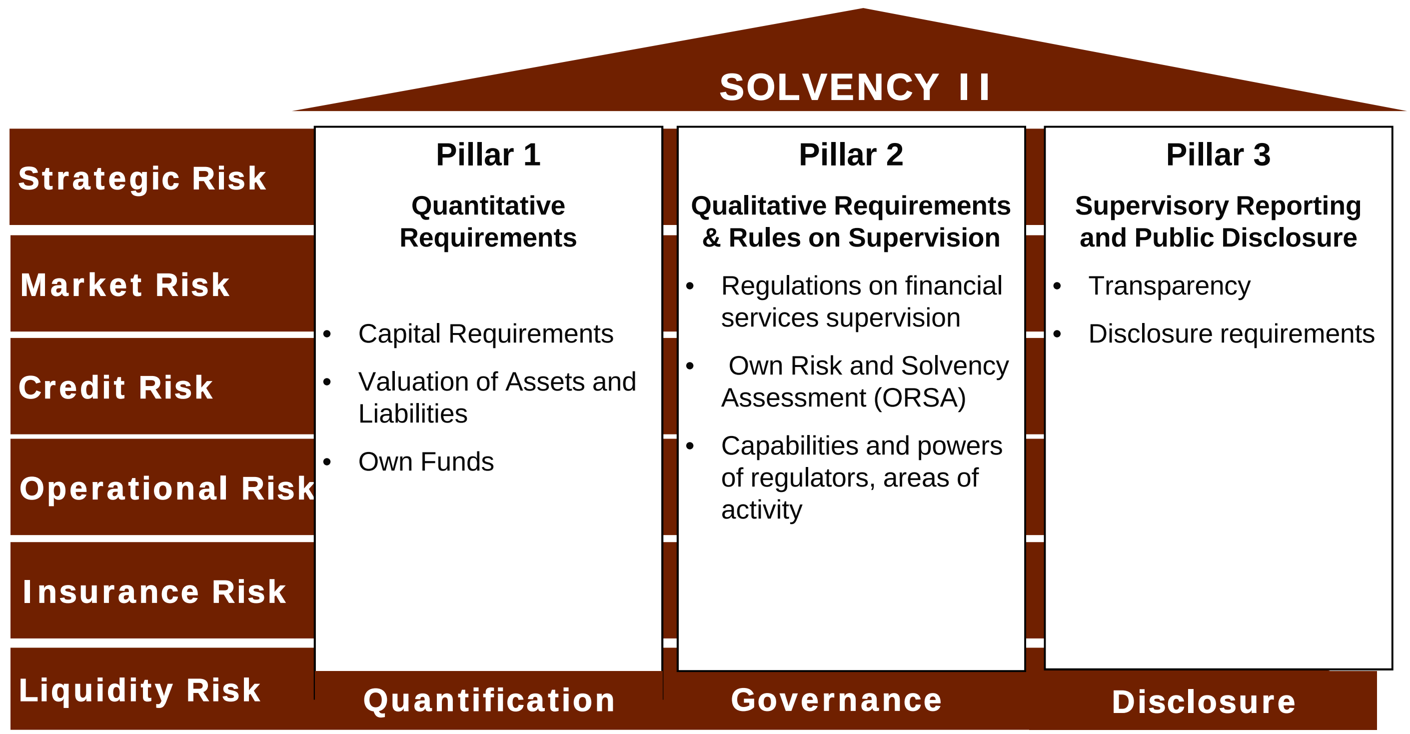
Solvency II

- Replaces Solvency I across Europe and ICA in the UK, promising a (more) level playing field
- Is risk based, encouraging and rewarding demonstrated (i.e. evidenced) good integrated risk management
- Uses market consistent valuation methods for all insurers, with set risk parameters calibrated with industry experience
- Organisations 'invited' to choose to use standard formula, internal model or both (subject to approval from regulators)
- Greater emphasis on self assessment (ORSA)
- Explicit requirement to have an actuarial, risk management compliance and internal audit function
- Requires an annual report on solvency and financial conditions with predefined content through identifying specific risks
- Approach extended to both asset and liabilities, defining quality and market benchmarks required as part of capital

Solvency II – The Structure

Solvency II is based on three guiding principles (pillars) which cut across market, credit, operational, insurance and liquidity risk

– The new system is intended to offer insurance organisations **incentives** to better measure and manage their risk situation – i.e. lower capital requirements, lower pricing etc.



Solvency II – Process

- Level 1 – Framework Principles (Completed 5th May 2009 -The Directive)
- Level 2 – Implementing Measures (In process – Consultation Papers, Advice to EC)
- Level 3 – Setting of Supervisory Standards EIOPA (In process – Issues Papers, Regulatory working groups)
- Level 4 – Monitoring of Compliance and Enforcement

Solvency II – It's a big deal!

Consumer Impact	Insurer Impact	Social & Economic Impact
• Better protection • Less cross-subsidisation • Transparency	• Raising & releasing capital • Composition of business portfolio • Company structure • Core processes • Risk culture & mindset • Administrative burden	• Coverage exclusion • Net capital flows into EU • Corporate bond market • Capital raising in smaller countries

Solvency II – The Impact

Expected impact of Solvency II

Strategic

- Capital optimisation could lead to companies acquiring or disposing portfolios.
- Re-pricing of products could lead to significant changes in product mix and risk exposure.
- Opportunity to decrease cost of capital by enhancing risk management framework and disclosures to markets

Financial

- Solvency capital requirements to increase (but regulatory capital is not necessarily the only capital consideration for insurers)
- Overall impact on capital requirements will depend on product mix and the level of current capital
- Technical provisions are discounted and include expected future premiums on in-force business but risk margin represents an addition to liabilities

Operational

- Opportunity to minimise costs by considering potential synergies with other on-going projects such as IFRS2.
- Data quality and data management processes to be enhanced to meet new requirements.
- More frequent and more detailed internal and external reporting will be required. This will result in more streamlined / automated processes and an enhancement of the control environment.
- Significant effort/investment will be required to meet six tests for internal model approval.
- Capital models to be enhanced to reflect new requirements.
- Potential changes in organisational charts and reporting lines to reflect S II required functions.
- Training required for staff with operational roles and for senior management / board members who have new / extended responsibilities under S II
- Implementation work could lead to significant pressure on existing resources.

Solvency II – Core Functions

- The Solvency II Directive indicates four required core functions:
  - Risk Management
  - Internal Control
  - Internal Audit
  - Actuarial

Solvency II – Actuary's Role

- The Actuarial Function is one of the four core functions mentioned in the Solvency II Directive.
- Article 47 of the Solvency II directive sets out the requirement for the Actuarial Function.
- The risk based nature of Solvency II is a great opportunity for actuaries and they have a key part to play in successful implementation of Solvency II.
- Actuaries need to drive the development of methodologies, deal with complex technical challenges and be able to clearly communicate complex issues and results to colleagues and senior management.
- Pillar I largely falls within the actuary's remit and actuaries are also expected to assist and play a key role with the implementation of ORSA actuaries. S II also offers actuaries the opportunity to get involved more widely in the risk management of the organisation.

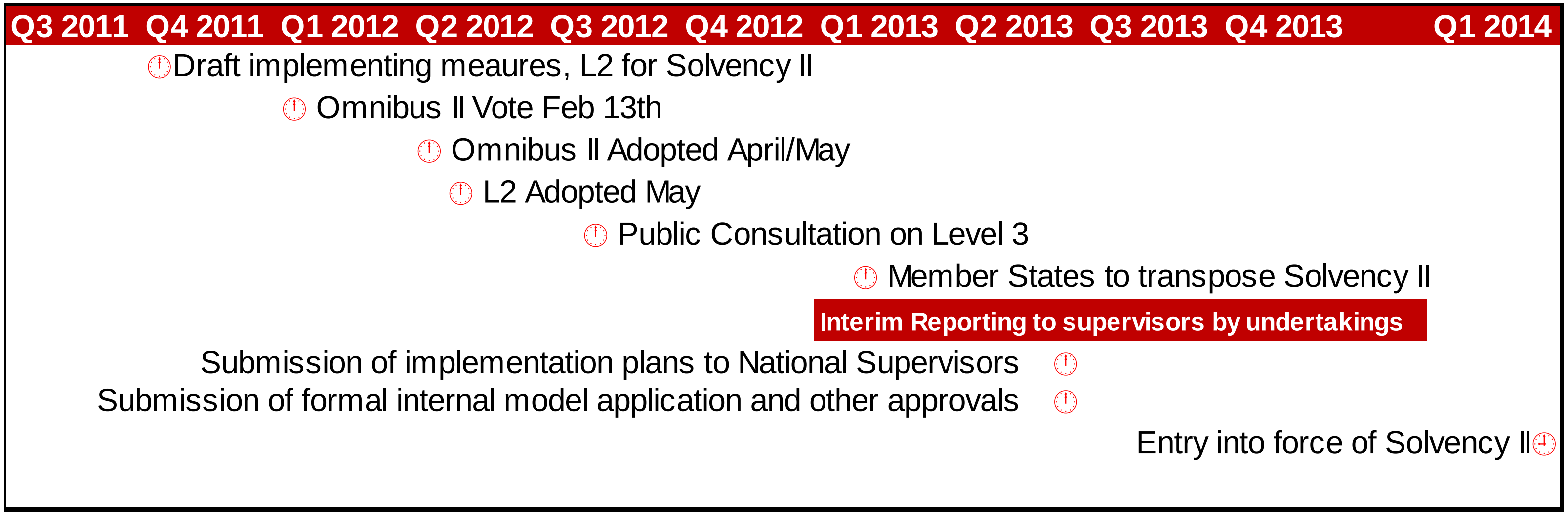
Solvency II – Actuary's Role

The main points of Article 47, Actuarial Function, requires the following:

- *Coordinate the calculation of technical provisions and ensure the appropriateness of the methodologies, assumptions and underlying models used.*
- *Assess the sufficiency and quality of the data used in the calculation of technical provisions.*
- *Compare best estimates against experience*
- *To express an opinion on the overall underwriting policy*
- *To express an opinion on the adequacy of reinsurance arrangements*
- *To contribute to the effective implementation of the risk management system in particular with respect to the risk modelling underlying the calculation of the capital requirements.*

Solvency II – Current issues

Latest European Timetable (from CBI)



- So the SII date of full implementation is now January 2014 instead of 2013

However the CBI emphasises:

- It doesn’t mean that Industry has an extra year to prepare for SII
- 2013 is a transition year between SI and SII; the details of the “transition year” are yet to be finalised
- Companies should work towards undertaking reporting under Solvency II during 2013

Solvency II – Current Issues

Equivalence

- The E.U. is currently examining the regulatory structures of the insurance industries in Bermuda, Switzerland and Japan as the first round of countries that could gain equivalence.
- The European Insurance and Occupations Pensions Authority issued a report suggesting that each of the countries could largely be seen as equivalent with a few important caveats, *but the ultimate decision has yet to be made*.

Consultation Papers

- There are currently two open public consultations. Comments are invited from interested parties by January 2012:
    - ORSA
    - Reporting

Solvency II