



The Actuarial Profession

making financial sense of the future

consultation response

CEIOPS –

(Committee of European Insurance and Occupational Pensions Supervisors)

Quantitative Impact Study 2

(QIS 2)

<http://www.ceiops.org/content/view/118/124/>

July 2006

Introduction

This submission from the UK Actuarial Profession is in response to the request from the European Commission (EC) to CEIOPS to prepare advice in order to introduce a new solvency and supervisory standard (Solvency II) for European insurance undertakings. QIS2 (Quantitative Impact Study 2) studies the effect on insurance undertakings of the possible restatement of the value of both assets and liabilities under the Solvency II framework, as well as some possible options for setting capital requirement (MCR and SCR).

Full details of QIS2 may be found at the CEIOPS website at:

<http://www.ceiops.org/content/view/118/124/>

UK Actuarial Profession Response To QIS2

The UK Actuarial Profession has reviewed the shape of the SCR and MCR formulae from the QIS2 specification from a general insurance perspective. We generally are happy with the proposed formula for the SCR, and consider that most aspects of a general insurer will be covered by the elements proposed. Obviously, the parameterisation of the formula will be key, and until this happens, we are unable to comment further on this.

We do have some specific observations:

- For the reserving capital (NL_{res1}), we have some doubts about the suitability of the market factors in 5.174. We do recognise that these are placeholders for the purpose of QIS2, but we do not consider that they reflect the volatility of the lines of business.
- The CAT risk capital (NL_{CAT}), we consider that the concept of the regulators setting scenarios is a good one. However, we would warn that it is difficult to set meaningful scenarios – when trying to make them applicable to many companies there is a danger of making them too vague; when making them more specific the applicability will be limited.
- Another comment on NL_{CAT} is that there are non-natural catastrophe events, such as terrorism or credit related events that will apply to some insurers.
- Most general insurers will allow for an average level of catastrophe in business plans – the capital formula for NL_{CAT} should cover the excess over that in the plans. This is potentially complicated to cover in a standard formula and may be regarded as a Pillar 2 issue.
- In terms of premium capital (NL_{PREM}), we consider that not allowing for the underwriting cycle will overstate the capital requirement. One approach would be to develop an index of pricing strength by line of business and use this to calibrate the SCR. However, the lines of business being used do not lend themselves to this type of analysis.
- We are reasonably comfortable with using combined ratio in the formula for NL_{PREM} , as this removes the need for a separate expense element.
- For the reinsurance element of NL_{PREM} we would prefer to see the different classes of reinsurance split out for direct writing companies who also write reinsurance. Otherwise there is a danger of mis-estimating the capital requirement by making the formula too

broad.

- In our opinion, NLPREM, will overstate the capital requirement and inspire companies to move to an internal model, which we consider to be a good thing.
 - One consequence of the formula as stated is that the more money an insurer has, the more capital is required! This could be fixed by restricting the analysis to non-free assets.
 - The formula for credit risk capital, SCR_{CRED} , is reasonable, although we consider the increase in “g”, the risk weight, to be steep. We assume this will be calibrated when QIS2 results are analysed.
 - In terms of NL_PL , the expected profit or loss from the following year’s business, we believe the proposal to allow for this in the SCR is reasonable, and would fit with current UK practice. However, a more realistic measure would be the profit from the company’s business plan. This may be covered in Pillar 2.
 - For the MCR, we believe there is an issue about what is disclosed. Although this is covered by Pillar 3, it is important when determining the formula as the SCR may be effectively disclosed by disclosing the MCR.
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