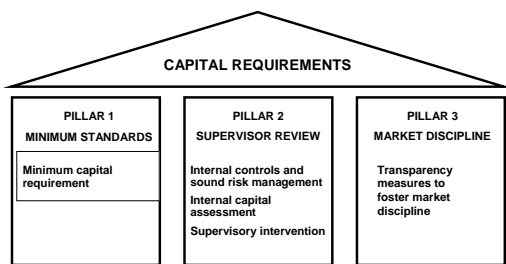


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The business implications of Solvency 2


John Cummings

Solvency II - borrowing from Basel . . .



The diagram shows a house-like structure with a triangular roof labeled 'CAPITAL REQUIREMENTS'. Below the roof are three pillars:


- PILLAR 1
MINIMUM STANDARDS**
Minimum capital requirement
- PILLAR 2
SUPERVISOR REVIEW**
Internal controls and sound risk management
Internal capital assessment
Supervisory intervention
- PILLAR 3
MARKET DISCIPLINE**
Transparency measures to foster market discipline



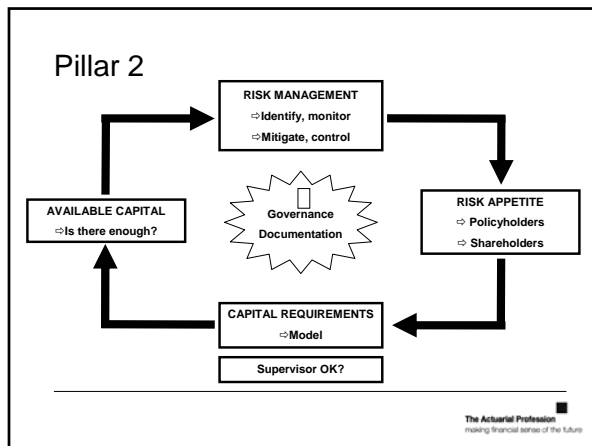
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Pillar 1

- Like CP190/195?
 - But same across Europe?
- Calibration
 - Too much capital?
 - Or too little?



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Pillar 3

- Any more than IFRS4?
- Will it be effective?
 - Too little transparency?
 - Or too much?

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Pillar 4?

- Increasing independent scrutiny
- UK
 - Audit of liabilities
 - Peer review of actuaries
- US - s404
 - Material weakness – “An internal control deficiency . . . more than a remote likelihood that a material misstatement . . . will not be prevented or detected.”
- What for Europe?

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Why focus in risk management?

Issues

- Equitable, Independent
 - Treating customers fairly
 - Market risk
 - HIH
 - Not just insurance - Enron, Worldcom, Parmalat
-
- Bad luck . . . or bad management?

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"The insurance business is completely screwy now. You know they've introduced the death penalty for insurance company directors?"

"Really?" said Arthur. "No, I didn't. For what offence?"

She frowned.

"What do you mean, offence?"

- MOSTLY HARMLESS, BY DOUGLAS ADAMS

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Causes of failures

- Insurance company failures are not mono-causal
- Management is the root cause
 - Incompetence or operating outside of competence
 - Imprudence and attitude
 - Weak, bow to external pressures
 - Or, perhaps, insufficient imagination?
- Management is a major operational risk

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Where now?

- Senior management
 - Will have to engage in actuarial and risk management matters
 - Will have to know a lot more
- Will behaviours change?
 - Enough sticks and carrots to make it worthwhile?
 - Or is it worthwhile anyway - competitive advantage?

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FSA's view

- "We want to underline the responsibilities senior management have for making the key decisions . . . Our perception is that, in the past, too many Boards have, in effect, contracted these responsibilities out to the appointed actuary, giving his or her recommendations too little critical review."

JOHN TINER

- Was / is he right?

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Implications for actuaries

The Actuary



The Thrill of Victory



The Agony of Defeat

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Implications for actuaries

- Actuaries will have to live with much closer scrutiny
- Threat?
 - To the independence of the profession
 - To our self-esteem
- Opportunity?
 - Outside challenge is good
 - Opportunities in risk management

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Winners?

- Risk management competence
 - Developing technology
 - New risks to worry about – op risk, group risk
 - Requires lots of skill and resource
 - ⇒ Competence – and size – matter
- Diversity
 - ⇒ Spread – and size – matter
- Handle the volatility
 - Legacy problems

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Winners?

- Match risk appetite to risk management to capital
 - Change credit rating
 - Change risk profile
 - Guarantees are off – or are they?
 - Reinsurance

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Issues for regulators

- There's a long way to go, even for FSA, e.g.
 - Market risk
 - Operational risk
 - Group risk
- Must allow evolution
 - As techniques develop
 - As issues develop
- Effectiveness of Pillar 2!

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Transition

- EC probably move towards UK – but all the way?
 - Even if it is
 - Will it be the same across Europe?
 - Years of super-equivalence
- ☹ Will firms vote with their capital?
- ☺ Or will UK get competitive advantage from risk management?

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