Transferability restrictions limit the available own funds at the Group

- Transferability is the ability to make available the own funds of an insurance undertaking to cover the solvency margin requirement of another participating insurance undertaking.
- While own funds appear to be available, there are a number of transferability restrictions that means that this may not be the case

Regulatory Requirements on Transferability

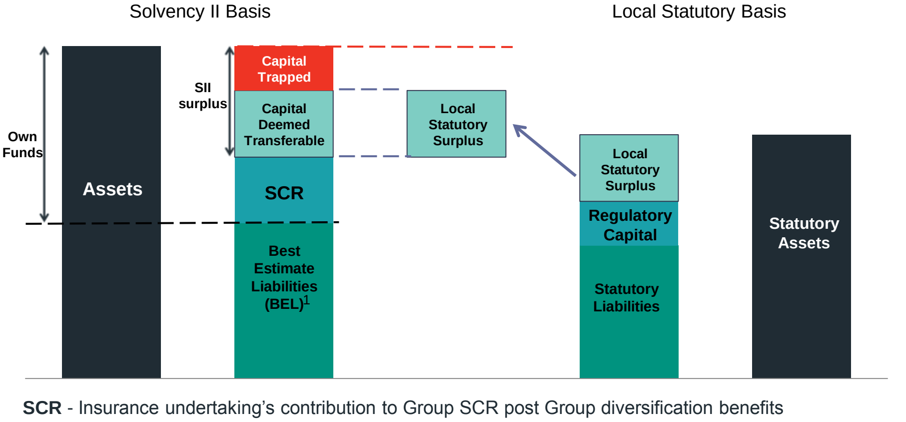
- Proposed Solvency II transferability rules more restrictive.

Current Pillar 1 (IGD)[1]	Proposed Solvency II (Draft)[2]
Differentiate between restricted and unrestricted assets	Demonstrate that certain entity own funds are not dedicated to absorb only losses in that entity
Assets legally restricted from being transferred must be excluded from Group Capital Resources (GCR), e.g. surplus on long-term ring fenced fund	Demonstrate that there are no significant obstacles to moving own fund items from one entity to another
Credit can be taken of restricted assets to the extent that it backs the capital resource requirement of the fund.	Demonstrate that own funds used to cover the Group SCR can be made available within 9 months
There is no limit on the credit that can be taken for unrestricted assets	May also be required to justify fungibility and transferability of own funds from its non-EEA entities to its SII College of Supervisors, which could include the regulators of those non-EEA entities

1 Source: INSPRU 6.1.41 R, INSPRU 6.1.42 G and DIRECTIVE 98/78/EC

2 Source: Article 323 SCG3(1), L2 Implementing Measures, Oct 11 and Guideline 16, L3 Guidelines, Jan 12

Case study 1
Asian Entity: Trapped Capital?

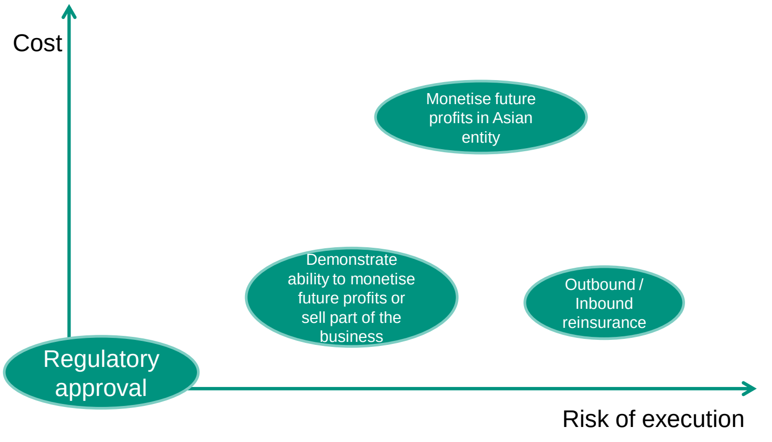


SCR - Insurance undertaking's contribution to Group SCR post Group diversification benefits

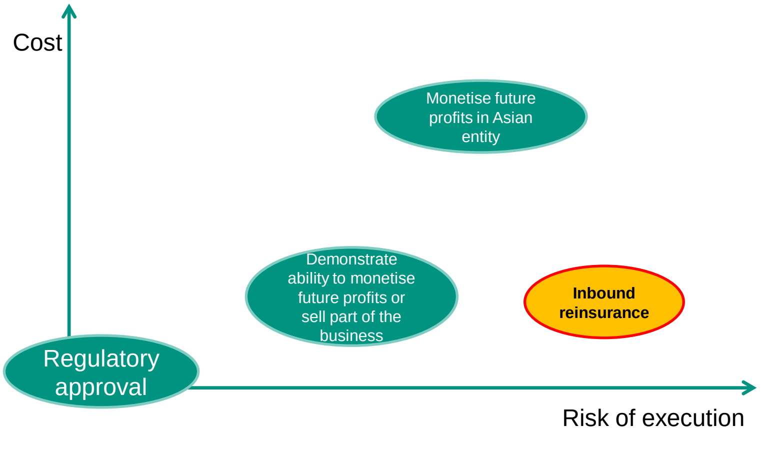
Regulatory capital based on the higher of the legal and regulatory minimum requirements. Internal capital requirement may also have an impact.

1 Risk margin shown as part of BEL

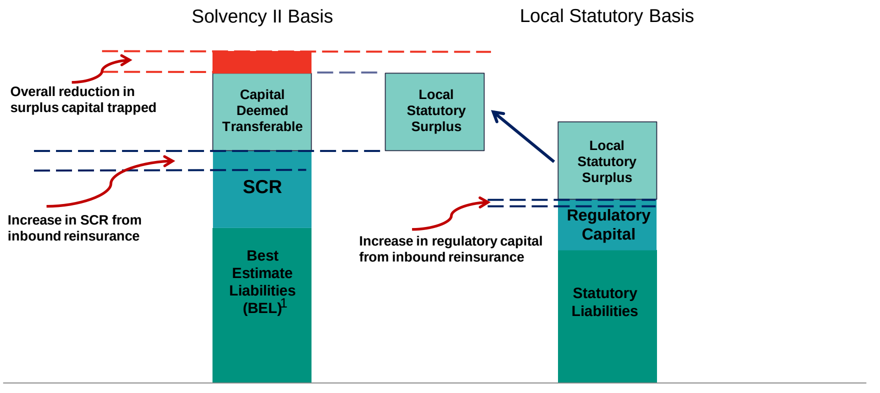
Asian entity: Cost-Benefit Analysis of potential solutions



Asian entity: Cost-Benefit Analysis of potential solutions



Asian Entity: Impact of inbound reinsurance



- Inbound reinsurance has a bigger impact on SII surplus than the local surplus basis, closing the gap between the two and reducing the amount of trapped capital
- Group capital resources increase by the reduction in SCR of the other entity

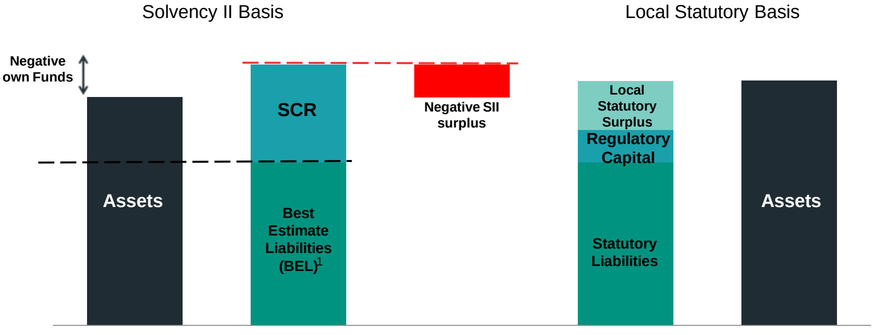
1 Risk margin shown as part of BEL

Inbound reinsurance

- Use of reinsurance to transfer risk across the group in order to close the gap between local statutory surplus and Solvency II

Pros	Cons
Internal transaction	Would need to deal with multiple regulators
Low costs	Additional admin/legal/accounting/tax burden and the receiving entity requires authority to write reinsurance
Could create a hub in one territory to co-ordinate reinsurance with all Asian entities	Might create SCR for counterparty default risk - However, a highly-rated external reinsurer could be used to reduce any counterparty SCR
A benefit could also be achieved through a lower risk margin - e.g. having longevity and mortality business together in one entity could result in lower risk margin due to diversification	Reputational risk

Case study 2
US Entity: Local solvency basis weaker than SII



SCR - Insurance undertaking's contribution to Group SCR post Group diversification benefits

Regulatory capital based on the higher of the legal and regulatory minimum requirements

1 Risk Margin shown as part of BEL

Note: Illustration above assumes no equivalence

US equivalence – what is the likely outcome?

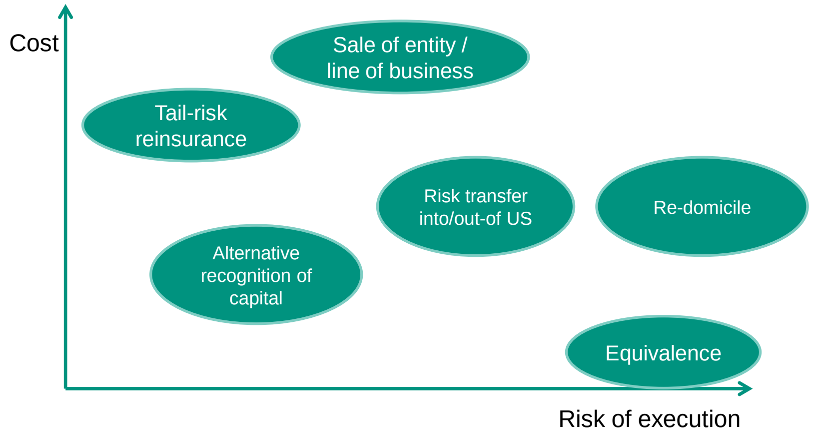
Kevin McCarty, President of the National Association of Insurance Commissioners (NAIC) has said:

- the US has "no intention" of going through a checklist of proposed Solvency II directives
- "No disrespect to the EU but I think it's kind of interesting, at best, they would want to make a comparison to a system [Solvency II] that isn't in place yet. It's a theoretical system ... measured up against a system that's been tried and tested for decades."
- "It's kind of silly to even consider that an equivalence process."
- "when they started saying 'under Solvency II your system would ...', I just said: 'I'd like to remind my esteemed colleagues from Europe that we have no intention of going through a checklist of what you want to do'."

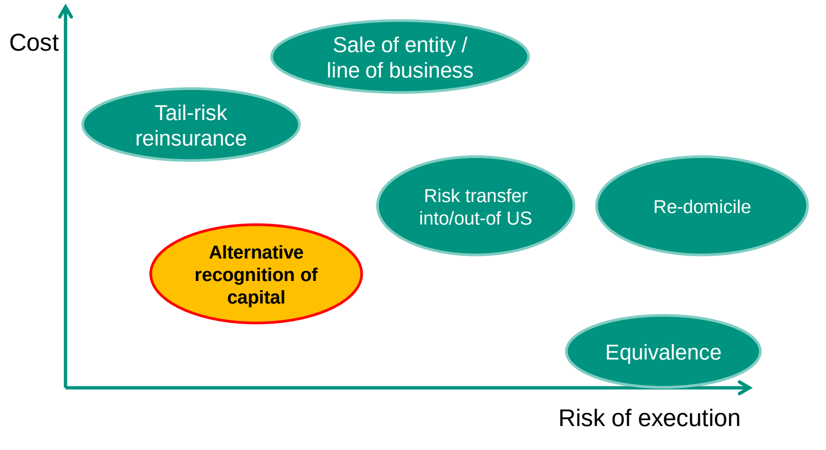
Sharon Bowles, Chair of the EU's Economic and Monetary Affairs Committee, has said:

- "if they [EU Commission] don't get this right then they leave the European industry to be picked off [in the US]. Therefore, some kind of recognition of equivalence [of the US regulatory system] will need to be done in order to prevent that."

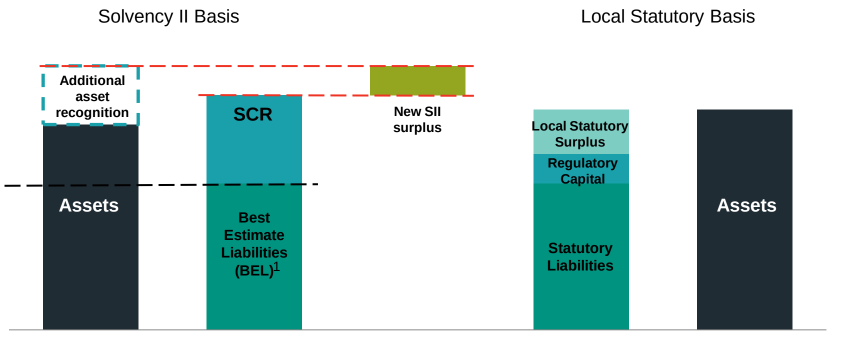
US entity: Cost-Benefit Analysis of potential solutions



US entity: Cost-Benefit Analysis of potential solutions



US Entity: Potential recognition of goodwill



SCR - Insurance undertaking's contribution to Group SCR post Group diversification benefits

Required capital based on the higher of the legal and regulatory minimum requirements

1 Risk margin shown as part of BEL

Conclusion

- Hopefully sense will prevail from regulators;
- Otherwise, opportunity for reinsurers/banks/global insurers and Actuaries to facilitate solutions for surplus transferability

Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenter.