



The Actuarial Profession

making financial sense of the future

Life Conference and Exhibition 2011

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Solvency II switchover

The challenges with transition

22nd November 2011

Introduction

- Background
 - We are the Profession's Solvency & Capital Management Research Group
 - Our focus today is the transition to Solvency II (SII), in particular the key challenges from a practical perspective
 - In September we carried out a survey of UK Life insurers
 - The results of which have been used to inform this talk

The agenda for today

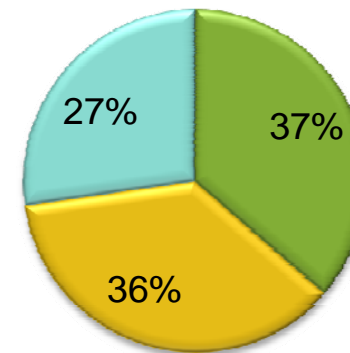
	Speaker
Overview of Practical Challenges	Carole
Reporting Metrics and Use Test	Carole
Pillar 3 Disclosures	Roger
Resourcing and Infrastructure	Roger
Asset Strategy	Richard
With Profit Management	Richard
Transitional Arrangements	Mike
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Overview of Practical Challenges

Uncertainty

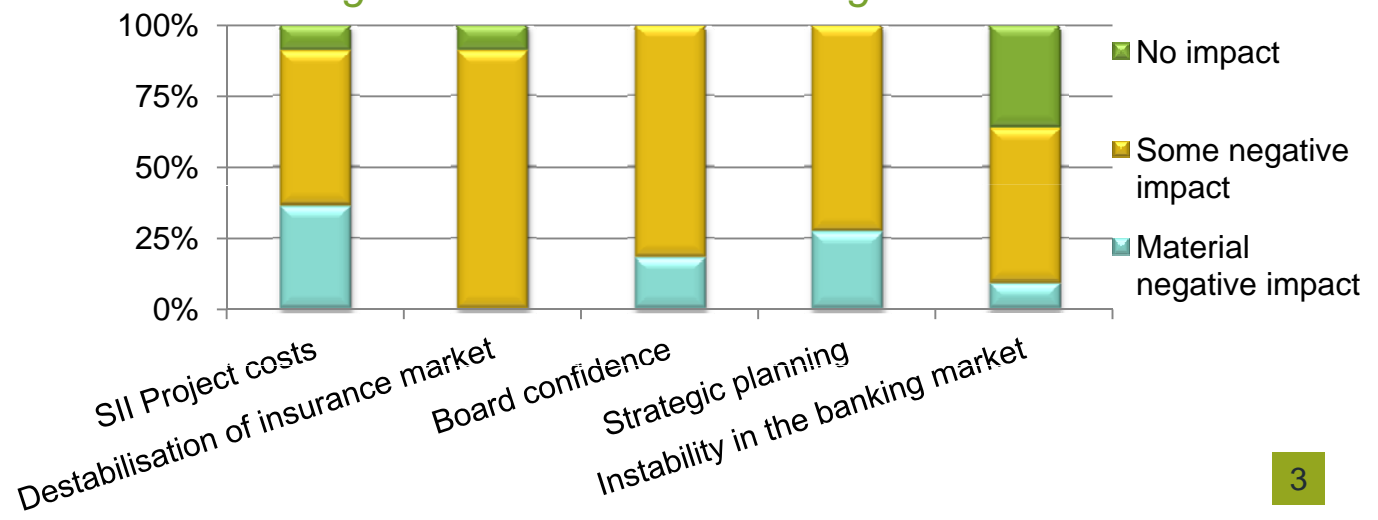
- Uncertainty
 - Implementation date changed recently
 - Binding Technical Standards (BTS) are not yet finalised
 - This uncertainty is a big issue for various aspects of company management.

When do you expect BTS to be finalised?



- 1 April 2012 - 1 January 2013
- 1 January 2013 - 1 January 2014
- After 1 January 2014

How big an issue is rules not being finalised ?

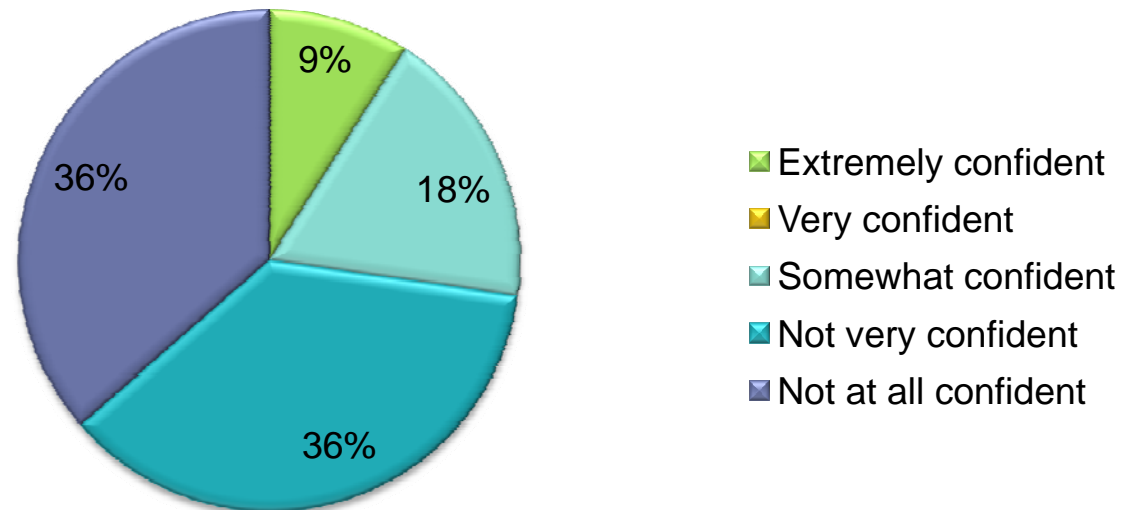


Overview of Practical Challenges

Confidence

- Confidence issues
 - Lack of confidence around level playing field

How confident are you that the final SII rules will provide a "fair playing field" across Europe to allow insurance companies to compete on a consistent capital basis?

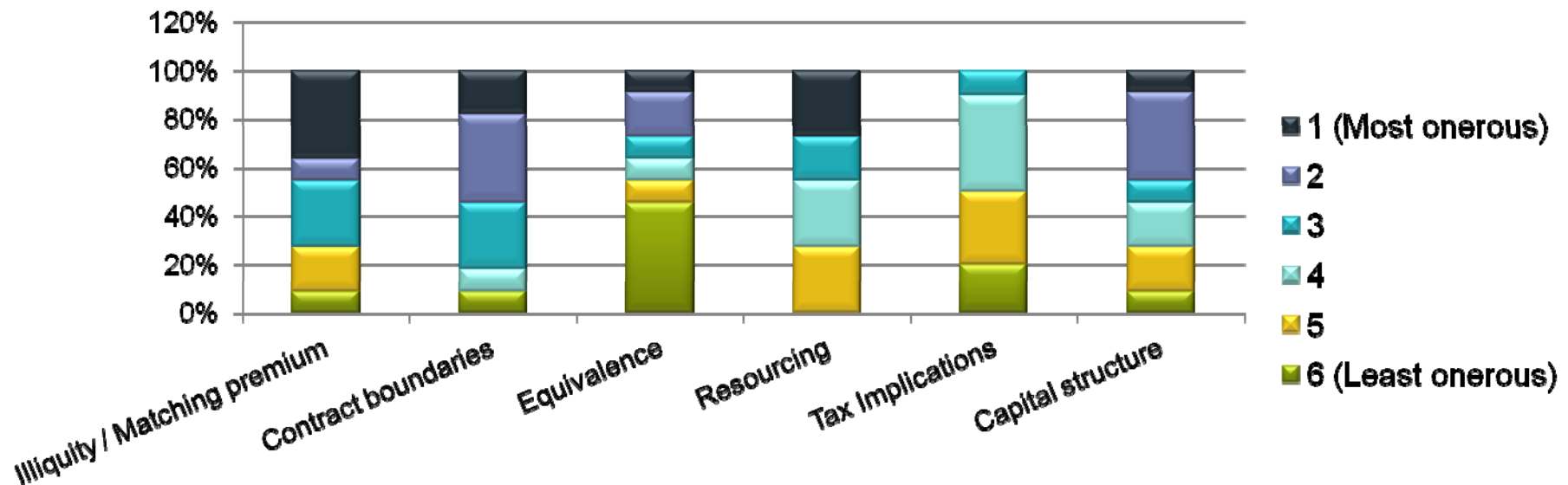


Overview of Practical Challenges

SII Issues

- Ask respondents to rank the following set of SII issues in terms of the challenge it represented for their company:
 - Illiquidity premium / Matching premium
 - Contract boundaries
 - Equivalence
 - Resourcing
 - Tax implications
 - Capital structure

Overall Onerousness of SII Issues



Reporting metrics and Use Test

- The challenges of moving from current MI to Solvency II MI
- When will Solvency I be switched off?
- Which measure will be used for IFRS reporting until phase II is implemented?
- Which reporting measure will management use when Solvency II goes live?

Pillar 3 Disclosures

- SFCR is public; RSR is private; QRT is partially public
- Still significant uncertainty about eventual shape, and this is the key challenge!
Others include:
 - Amount and granularity of information required
 - Interpreting the requirements and lack of guidance
 - Timescales
 - The flow of contents within each section of SFCR and RSR
 - Risk profile section of SFCR
 - Quarterly reporting requirements of QRT
- Current progress

Resourcing and Infrastructure

Resourcing Challenges

- Gaining sufficient actuarial resources has been a key challenge on Solvency II programmes to date
- Companies have used consultants and contractors, as well as increasing their permanent headcount
- A significant number of respondents to our survey have listed it as one of their current most onerous challenges
- Many firms expect the level of demand to remain unchanged for 2012 (at a level of around 25% above pre-Solvency II)
- ...but for it to reduce in 2013 to perhaps 10% above pre-Solvency II levels

Resourcing and Infrastructure

Infrastructure Challenges

- Getting appropriate infrastructure in place has been challenging
- Some of the key challenges at the moment include:
 - Model efficiency and improving run-times to meet regulatory and management needs
 - Dealing with legacy systems
 - Building P&L attribution tool
 - Building ORSA framework
 - Aggregation (including results from non-UK entities)
 - Capital projections to meet managers' expectations
 - Data quality assessment and documentation
 - Results storage

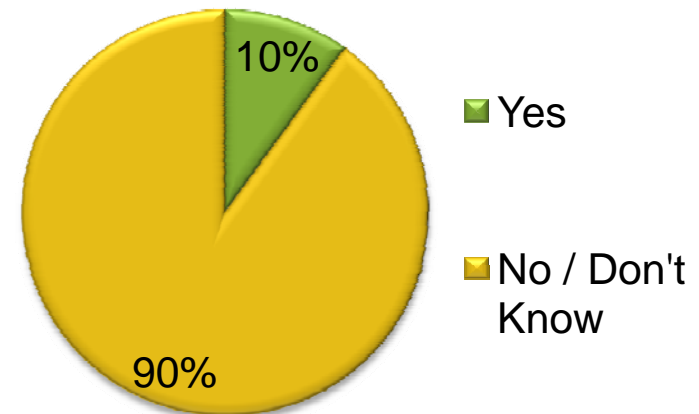
Asset Strategy

SII strategy impact

- Several areas of Asset Strategy potentially impacted by Solvency II Regulations

- Risk-free mismatch

*If risk-free rate in SII is swaps based
do you anticipate making increased
use of swaps ?*



- Investment strategy for With Profits
- Future profits/VIF hedging
- Risk/reward implications for certain asset classes

Asset Strategy

SII uncertainty impact

- Impact of Counter Cyclical Premium and Matching Premium

If the final SII regulations specify use of an illiquidity/ matching premium do you anticipate changing your asset strategy?

	Yes	No / Don't Know
Annuities	79%	21%
With-Profits	40%	60%
Other NP	38%	62%

- Uncertainty continues to be the the main challenge
 - Calculation method
 - EIOPA discretion
 - Transitional arrangements

With Profits Management

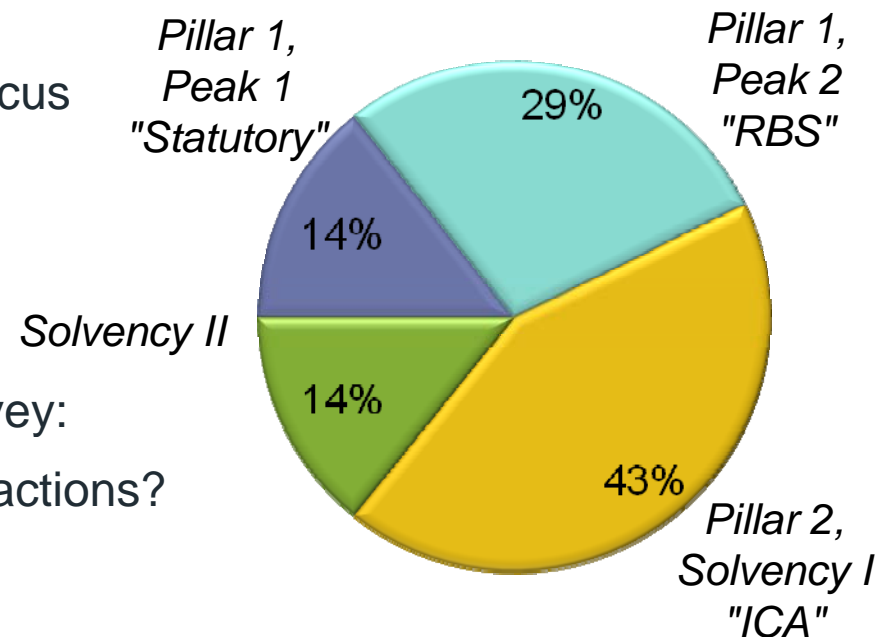
- Current balance sheet management focus
 - No significant change?

General trends from responses to the survey:

- Any Intention to change management actions?
- Any Intention to change WP strategy?
- Will it change WP perception?

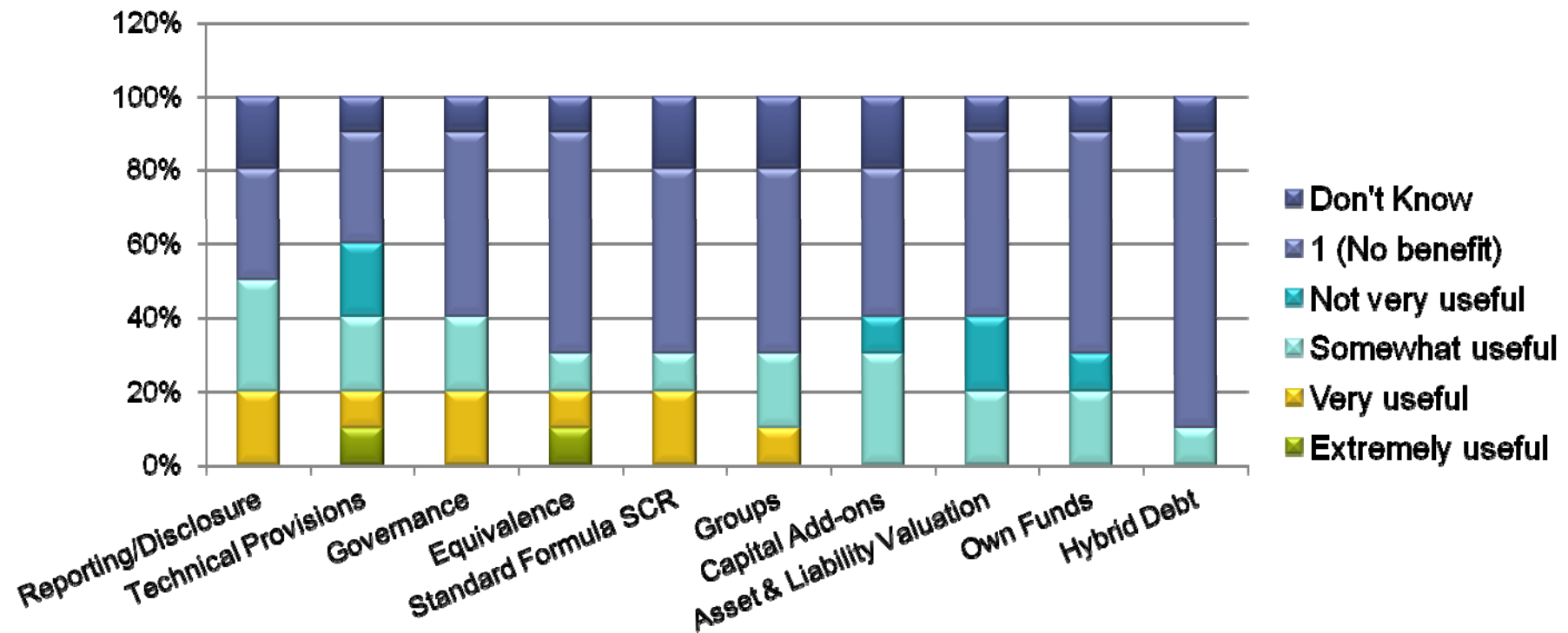
Other comments:

- CP11/05 ... bigger impact



Transitional Arrangements

- Respondents were asked to rate the usefulness of transitional arrangements



Capital and Solvency Considerations

Capital Transitional change

- Need to ensure that capital instruments are appropriate for Solvency II
 - Value of existing instruments may decrease under Solvency II
 - New forms of capital may become available
 - May need to raise additional capital
- Transitional period up to 1st January 2014
 - Demand to increase / changing asset portfolio during transition
- Funding
 - Majority (60%) of firms surveyed did not consider need for alternative funding to be an issue
- Reinsurance:
 - Of firms who use reinsurance as a tool to manage their liabilities over half were planning to / are re-assessing their current arrangements prior to SII implementation

Capital and Solvency Considerations

Mergers and “SII Capital Arbitrage”

- Recent merger and acquisition activity in the life sector has been somewhat muted due to market conditions and regulatory uncertainty.
- Expectation is that once there is more clarity on SII M&A activity will increase
 - 64% of survey respondents expected there to be an increase in M&A.
 - 60% of respondents stated that acquiring/selling elements of business was either a part of the overall SII review or had specific resource allocated to investigate opportunities.
- Consider small monoline insurance company (e.g. specialist annuity provider).
 - Likely to have high capital requirements
 - Limited options - best option for shareholders likely to be merger
 - Large company with different/diversified portfolio can incorporate at significantly lower capital cost due to diversification.

Capital and Solvency Considerations

Solvency positions

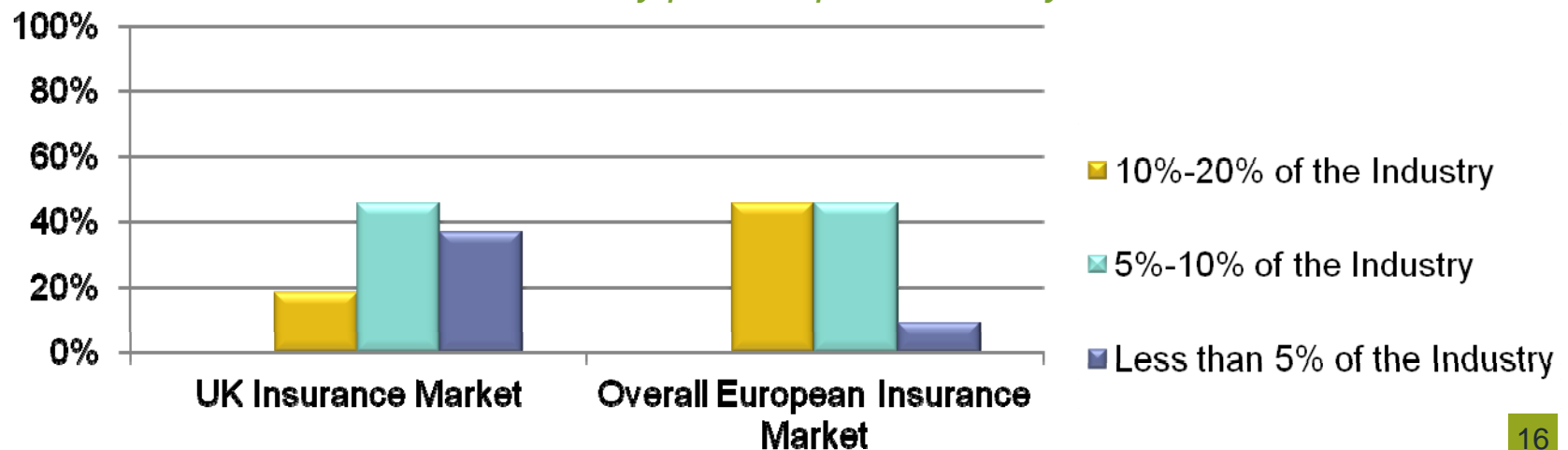
- Being solvent under a new solvency regime is not certain

*“London Scottish
Bank shares dive on
lack of capital”
Guardian 01Jan2008*

*“London Scottish
Bank put into
administration”
Independent 01Dec 2008*

- Survey reinforces these concerns with the expectation that solvency failure will be more acute for certain European sectors

What proportion of the market will struggle to have a supportable solvency position post Solvency II?



Capital and Solvency Considerations

Areas of concern

- Concerns that Ratings Agencies and Market Analysts may not understand the capital implications of Solvency II

*55% stated they were “**Not Very Confident**” that ratings agencies and market analysts understand the impact that Solvency II will have on the capital positions the UK insurance industry*

- Potential risk that Ratings Agencies will push for Standard Formula information for all firms
- Specific Solvency concerns highlighted in the Survey were
 - *If companies cannot get their internal models approved and they have to use the Standard Formula (SF is not well calibrated for some risk modules)*
 - *Volatility of the financial statements caused by market movements*
 - *Development and understanding of the ORSA position*

Summary

- Obvious key point remains the significant uncertainty around the rules
- Concerns around final state of matching premium and counter-cyclical premium means balance sheet capital planning / management is difficult
- Solvency II not only issue for WP but other WP challenges exist (CP11/05)
- Concerns around rating agency and market expectations
- Potential significant restructuring / M&A
- Even with date change still expect significant resourcing requirements
- Development of ORSA framework a big challenge for some



Significant practical challenges in running a life company during transition

Summary

SII transition is challenging
PRACTICALLY
as well as
TECHNICALLY

Questions

