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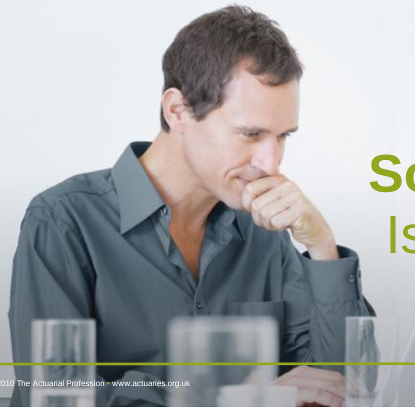
Current Issues in Life Assurance
Mark Chaplin



Solvency II Hot Topics
Is there sufficient time?

CILA 16th May 2012

Content

- Where are we in the process?
- What is being discussed?
- When will the beginning end?

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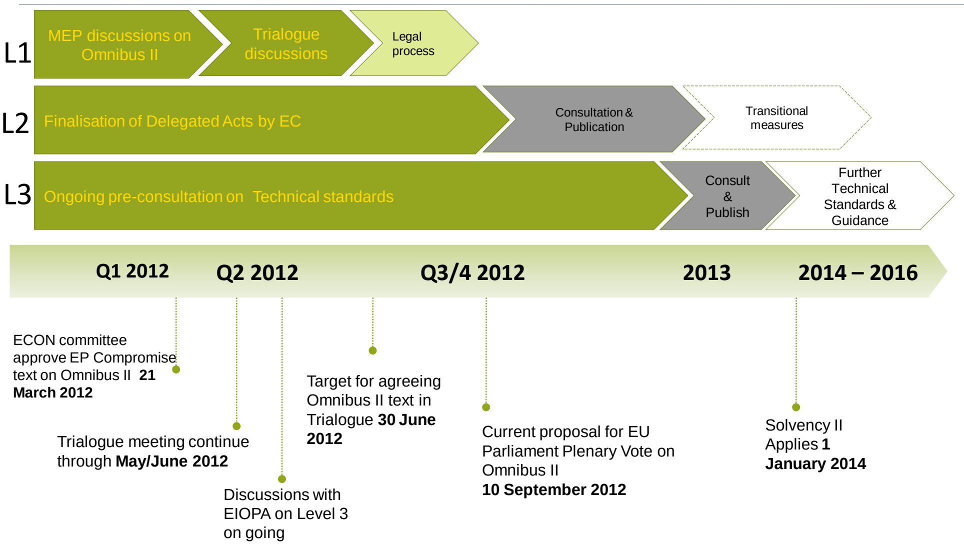
Update on process

Update on progress to date



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What is being discussed?

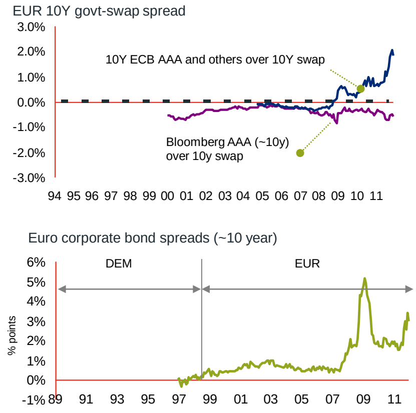
Key issues for trialogue

Four issues dominating the trialogue discussions in Omnibus II:
- Timetable
- Powers of institutions for drafting legislation (L2/L3)
- Long term guarantees
- Equivalence

Long term guarantees and the risk free rate

- **Solvency II requires insurers to use mark-to-market (MtM) valuation of assets.**
- The significant market movements since 2008 have highlighted that proposed Solvency II rules would make insurance balance sheets/own funds appear far more volatile than they are felt to be.
- "A related concern is whether life insurers and pension funds can maintain a long-term investor perspective. … A partial retreat of institutional investors from the long-term and/or illiquid segment of the credit market could reduce the private and social benefits the sector generates through long-term investing, and the extent to which it mitigates the pro-cyclicality of the financial system."[2]

Illustrations: Euro government-swap spreads and Euro corporate bond spreads [1]



A key question is what is really meant by promoting "good risk management"?

1

2 BIS (July 2011) 'Fixed income strategies of insurance companies and pension funds" Report submitted by a working group established by the Committee on Global Financial Stability

ECON proposals

- For the trialogue, the European Parliament ECON committee approved the proposed inclusions of a number of measures to address these challenges in Omnibus II Directive:
- For the relevant risk free rate:
  - Counter cyclical premium
  - Extrapolation
- In the calculation of spread risk sub-module of the standard formula SCR:
  - Symmetric adjustment mechanism
- For certain life insurance obligations:
  - Matching adjustment

Discussions on the risk free rate

"*It is important to prevent risks of heightened pro-cyclicality arising from these planned regulatory changes*"[1]

- **Key considerations**
  - **Matching Adjustment**
    - Permanent solution
    - Scope of application
    - Ability of insurers to substantially eliminate exposures to market movements
    - Detailed calibration
  - **Counter cyclical premium**
    - Objective and predictable triggers for application
    - Objective formula to determine amount of CCP upon application
    - Role of EIOPA
  - **Extrapolation**
    - Starting point for extrapolation
    - Speed to the ultimate forward rate
- **Other options?**
- **How the different concepts interact is important, although there is a question around the level of detail there should be in Omnibus II given the restricted ability to change the legislation once it has been made.**

1 Peter Praet, ECB at European Pension Funds Congress November 2011

Balance of power between institutions - Finalising level 2 and level 3 issues

Depending on the outcome of Omnibus II, there are:

- Further changes likely to the implementing measures (level 2); and
- Refinement of EIOPA views on level 3 guidelines.

Solvency II is a lot more than just Pillar 1, the detail around Pillar 2 and Pillar 3 is crucial implementation

Pillar 1, Pillar 2 and Pillar 3

- Own funds
- Contract boundaries
- Reporting requirements – practicalities, transitional provisions and financial stability
- ORSA requirements
- IMAP guidelines including use test, model change and other elements
- The role of the actuarial function

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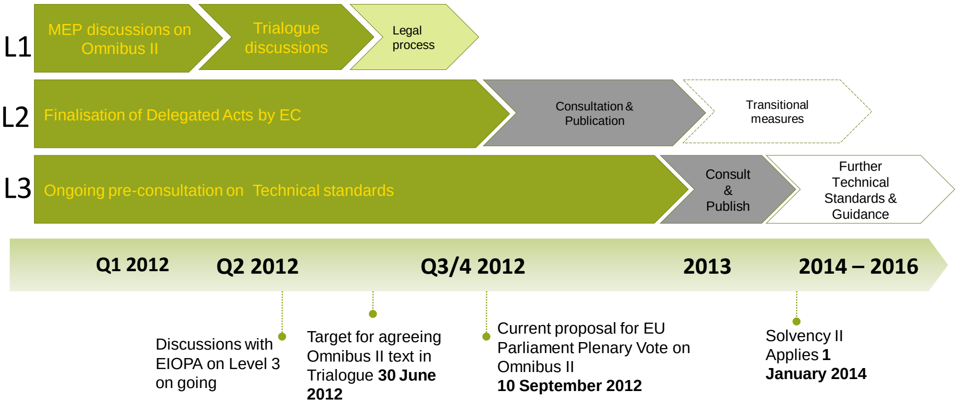
When will the beginning end?

When will it all start?

- The current EIOPA working assumption is for colleges to be able to accept internal model applications from 1 January 2013 with a view to Solvency 2 applying to firms from 1 January 2014
- Recent discussion has focused on whether there should be a delay to the implementation/transposition to 30 June 2013.
- The current assumption is Solvency 2 will continue to apply from 1 January 2014.

When we will know the answers?



Even if the trialogue is completed according to this timetable, the legislative process means that the timetable for 1 January 2014 will be challenging given procedural and consultation requirements.

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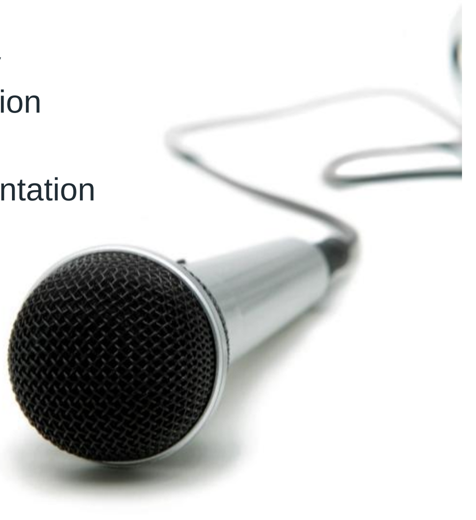
Observations

Observations

- Still considerable uncertainty on key issues and how they will be resolved
- 1 January 2014 is still the date for application of Solvency II
- The on-going discussions are placing increasing pressure on the ability to finish legislation to give firms enough time to prepare.
- Important that the final Solvency II delivers its objectives and the right outcome for all stakeholders.

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.