



Association of British Insurers

## Solvency II – Much achieved, but lots more to do

**Steven Wells**

Association of British Insurers

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### Background: Solvency II – *cui bono?*

“The solvency system aims at the **protection of policyholders and beneficiaries.**”

“It should also improve the **competitiveness of EU insurers** and provide for **better allocation of capital** resources, without causing significant market disruptions and impeding innovation in the insurance industry.”

Source: “Amended framework for consultation on Solvency II”, European Commission (April 2006)

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### Background: Solvency II – key aims

Two-fold: Better risk management  
Adequate (risk-sensitive) capital

**Incentivise and reward** insurance firms to use **modern risk measurement and management techniques** that are appropriate to the size and nature of their business.

Protecting consumers and maintaining market confidence also requires **adequate levels of capital**. This means a more risk-sensitive and risk-responsive capital requirement that takes account of risks on liability side and asset side, and gives appropriate credit to the use of risk mitigation.

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## Background: Solvency II – ambitions

“(A) contribution to the **emergence of a world-wide standard**. (...) And our work is very much in line with the solvency standards being developed by the IAIS. (...) (T)he gradual convergence of insurance regulations at international level will bring tremendous benefits to insurers, policyholders around the world and the economy at large.”

“Within this new system, **supervisors will have to co-operate** more closely and independently. The possibilities for further integration of the insurance industry largely depend on this **supervisory convergence**.”

Source: Speech by Commissioner McCreevy, LIMRA conference, Warsaw, 15 September

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## How does the 10 July text measure up?

### A great deal has been achieved

- ✓ Market-based methods for valuation of assets and liabilities (including cost of capital for non-hedgeable risks)
- ✓ (✗) Appropriate capital requirements (solvency capital requirement (SCR) and minimum capital requirement (MCR))
- ✓ (✗) An economic and streamlined approach to group supervision
- ✓ (✗) A principles-based regime

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## Content of the Directive

- Massive instrument  
367 Pages, 321 Articles, 93 recitals, 7 Annexes  
Re-cast of 13 directives
- Attempts to apply provisions to direct insurers and re-insurers
- A huge/highly political process

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## Key outstanding challenges – for Level 1

Much more work to do on the standard formula – QIS4

QIS 3 issues: motor underwriting risk  
niche player diversification/granularity of business

Defending the groups proposal

Establishing the right calibration for the MCR – industry still regards the "compact approach" as the best methodology

Ensuring the proportionality principle is respected

Getting public disclosure and supervisory reporting right

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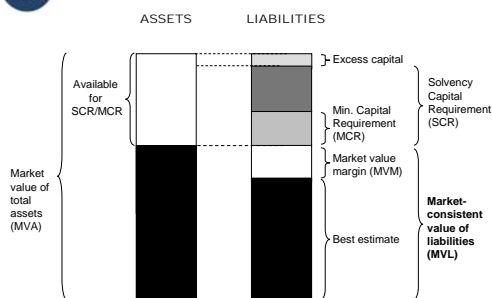
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## Overview of the Economic Balance Sheet



Adapted from the joint CEA/CRO Forum Paper "Solutions to major issues for Solvency II" January 2006

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## Solvency II : (MCR/SCR)

- Articles 126 to 128 set out the MCR requirements – MCR triggers 'the most severe regulatory action'. So it is vital that MCR is calibrated appropriately and does not interfere with the use of management actions and good risk mitigation.
- There are competing views of how to calculate the MCR (Modular vs. Compact Approach) and whether it can be aligned to an SCR calculated using an internal model
- Articles 99 to 124 set out the SCR requirements - the amount of capital needed to ensure that liabilities to policyholders can be met to a 99.5% confidence level over one-year.
- SCR may be derived from a 'standard approach' defined under the Directive, or by the use of a firm's own internal model, subject to approval by the firm's supervisor

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## Implementation

Getting the transition right from ICAS to Solvency II:  
Industry will need **early clarity on model requirements** to ensure model development can proceed effectively and in time for 2012

Will others be "in time for 2012" or will we be gold-plated for a few years?

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## Pillar 3

### Supervisory reporting

- ☐ Information necessary to enable the effective supervision of (re)insurance firms

### Public disclosure

- ☐ Qualitative and quantitative information disclosed to the market to provide a summary of a firm's solvency and financial condition

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## Supervisory Reporting – A highly principles based approach

- ☐ The Directive requirements outline the characteristics that reported information should have, but not the format or structure of reporting
- ☐ Implementing measures will add detail to ensure supervisory convergence
- ☐ Hence much left to debate at Level 2

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## Public Disclosure - Directive objectives

- ❑ **Commitment to transparency** - the European Commission is strongly committed to a high level of public disclosure – “what is relevant to the regulator is relevant to the market”
- ❑ **Deepening of single market** – consistent EU wide disclosure will create a level playing field across the EU and increase cross-border opportunities for firms that follow good practice
- ❑ **International competitiveness** - transparency should increase the efficiency of EU (re)insurers and increase the attractiveness of EU (re)insurers to international investors thus enhancing the international competitiveness of the EU insurance market

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