The Actuarial Profession
making financial sense of the future

Solvency II – The Potential Impact

… and how actuaries can contribute to the new European regulation

Annette Olesen

14 October 2004

Content of this presentation

- Solvency II overview
- Solvency II development and consultation
- CEIOPS request
- How actuaries can contribute

Solvency II – Timetable

Commission publish Framework Directive (end of 2005)

Implementation (acc. to Lamfalussy) (end of 2008)

Solvency II – Three pillars as per Basel II

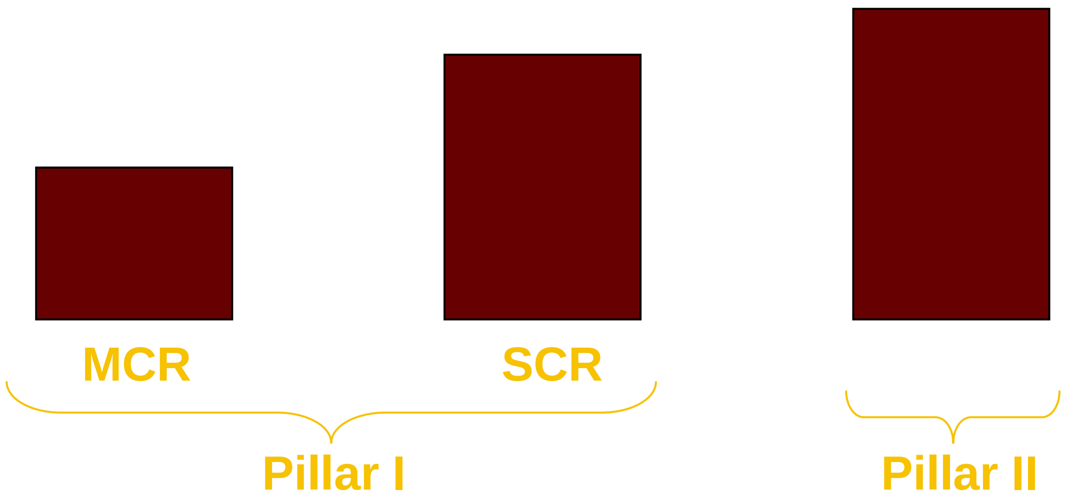
CAPITAL REQUIREMENTS

PILLAR 1	PILLAR 2	PILLAR 3
MINIMUM STANDARDS	SUPERVISOR REVIEW	MARKET DISCIPLINE
Asset valuation rules Liability valuation rules	Internal controls and sound risk management Supervisory intervention	Disclosure • Frequent • Forward-looking • Relevant

Solvency II – Key message

- Three-pillar structure
- Assess “overall solvency”
- Build on a more risk-orientated approach
- Increase harmonisation of quantitative/ qualitative supervisory methods
- Ensure consistency between financial sectors
- Be developed in a parallel with international developments, and in particular IASB’s work

Pillar I/ Pillar II capital structure



Risk Categories:

- Underwriting Risk
- Market Risk
- Credit Risk
- Operational Risk

Risk Categories:

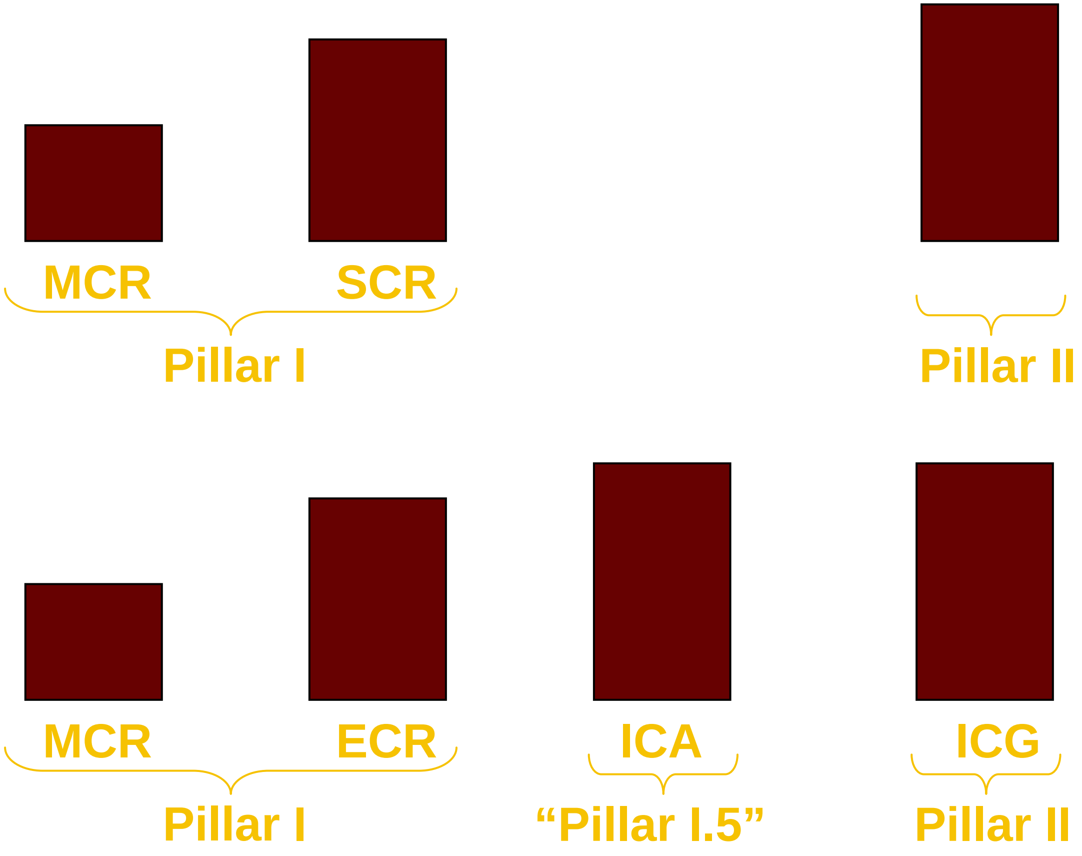
- Operational Risk?
- Wider Risk including: system & controls, Strategic Risk, Group Risk, Liquidity Risk

Solvency Capital Requirement (“SCR”) approach

CEIOPS suggested options:

- Factor based model
- Use of Stress and Scenario testing
- Use of internal model
- Or combination of the above

Solvency II compared to the ICAS framework



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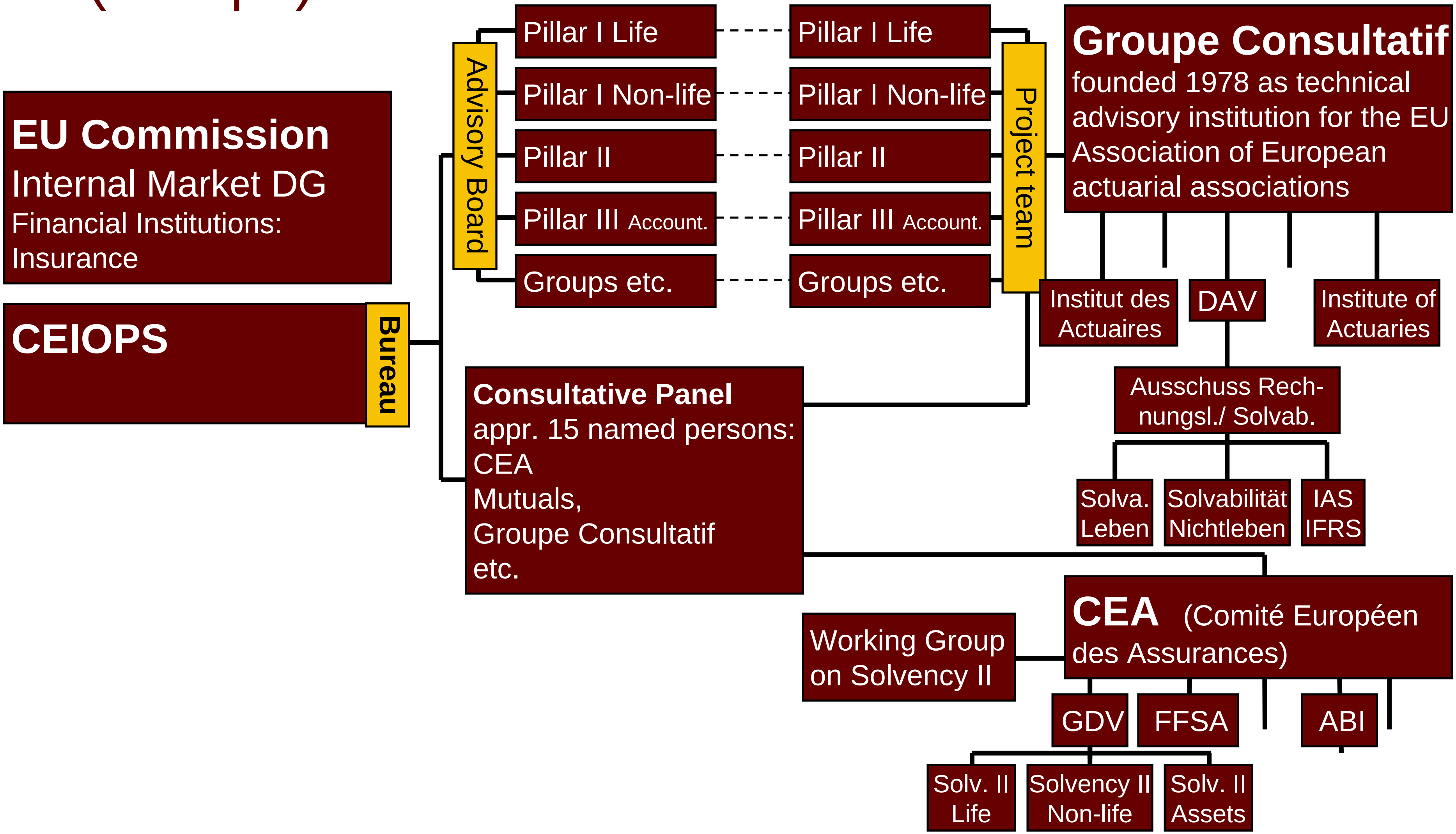
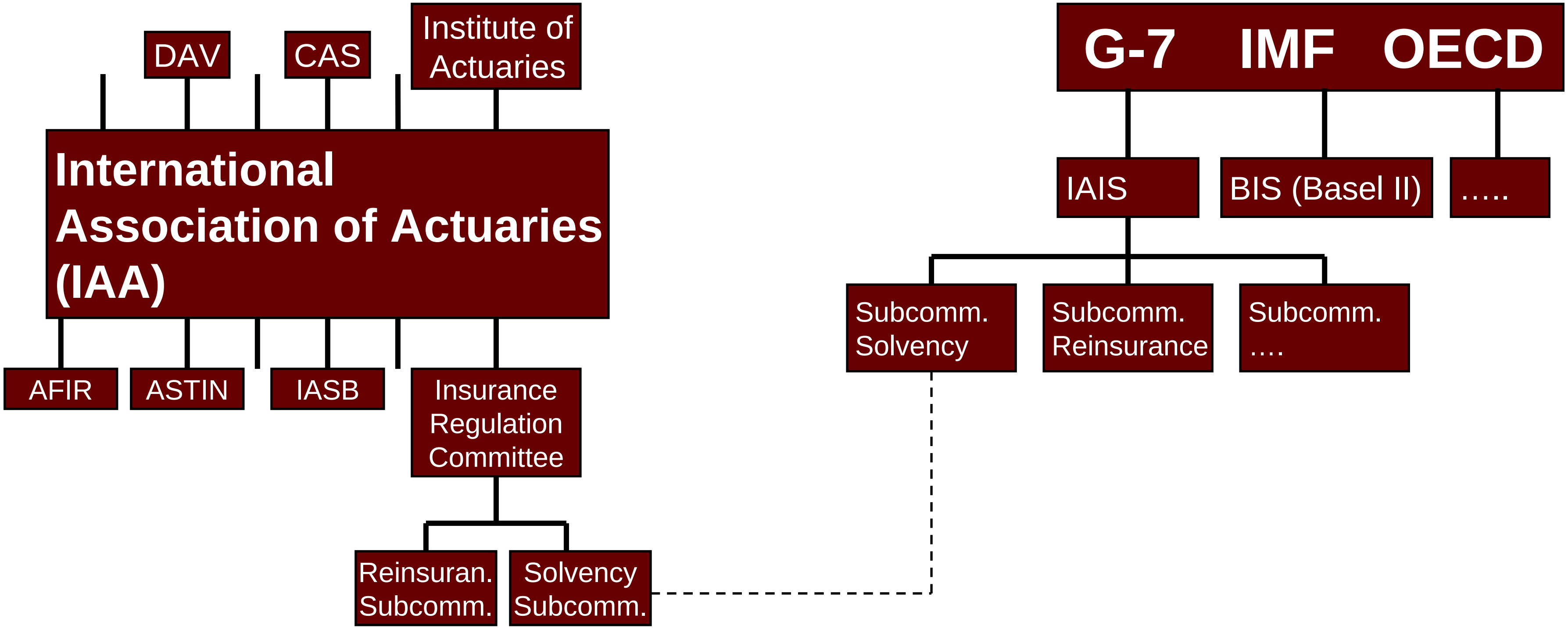
Overview of initiatives / working groups (Europe)



Overview of initiatives / working groups (Internationally)



GC Solvency II Project Structure

Insurance committee
Groupe consultatif
Bart De Smet (chairman)
Manuel Peraita (sponsor)

Project team
Rolf Stölting (project manager)
Chairmen of working groups (5)
Petra Wildemann (team member)

IAA/IRC
Solvency
Sub Committee

Pillar I Life
Seamus Creedon
Felix Arias

Pillar I Non Life
Annette Olesen
David Paul

Pillar II
Jean-Paul Bouquin

Accounting & Pillar III
Esko Kivisaari
G.Vandenbosch

Groups & conglomerates
H.v.Broekhoven
Alan Joynes

Groupe Consultatif's Initial reaction to MARKT papers

- Support the move to a risk based solvency regime
- Support maximum harmonisation
- Dependency on development in accounting environment
- Complex nature
  - Definition of different capital measures required
- Agree with the suggested use of both standardised approach and internal models
- GC source of technical help to CEIOPS and Commission

Three waves of "specific calls for advice" to CEIOPS

Framework for consultation:

Dynamic reference document for development criteria of Solvency II

Wave 1: Pillar II (started July 2004)

Wave 2: Pillar I (starting Dec. 2004)

Wave 3: Pillar III (starting March 2005)

- General & Pillar I-III issues
- Reference papers: 2539/03, 2543/03, 2502/04
- CEIOPS reporting: four-monthly intervals (starting Oct. 2004)
- Third parties invited to comment (*to*: CEIOPS, *cc*: EC Services)

Source: MARKT/2506/04

General features set within the Solvency II framework

Framework for consultation:

Dynamic reference document for development criteria of Solvency II

- New naming convention:
  Solvency Capital Requirement (SCR) and
  Minimum Capital Requirement (MCR)
- Recognition of (partial or full) internal models (supposed that they are appropriately validated)
- Compatibility with work of IAIS and GC/IAA
- Necessity of quantitative impact studies

Source: MARKT/2506/04

General features within Solvency II for Pillar I

Framework for consultation:

Dynamic reference document for development criteria of Solvency II

- Quantitative benchmark for prudence level in technical provisions
- SCR to be based on going-concern basis
- Standard approach for SCR not yet settled (factor-based, probabilities, scenarios etc.)
- MCR close to Solvency I
- Risks addressed: underwriting, credit, market, operational, liquidity (if not quantifiable then in Pillar II)
- A rather general statement each for Pillar II and Pillar III.

Source: MARKT/2506/04

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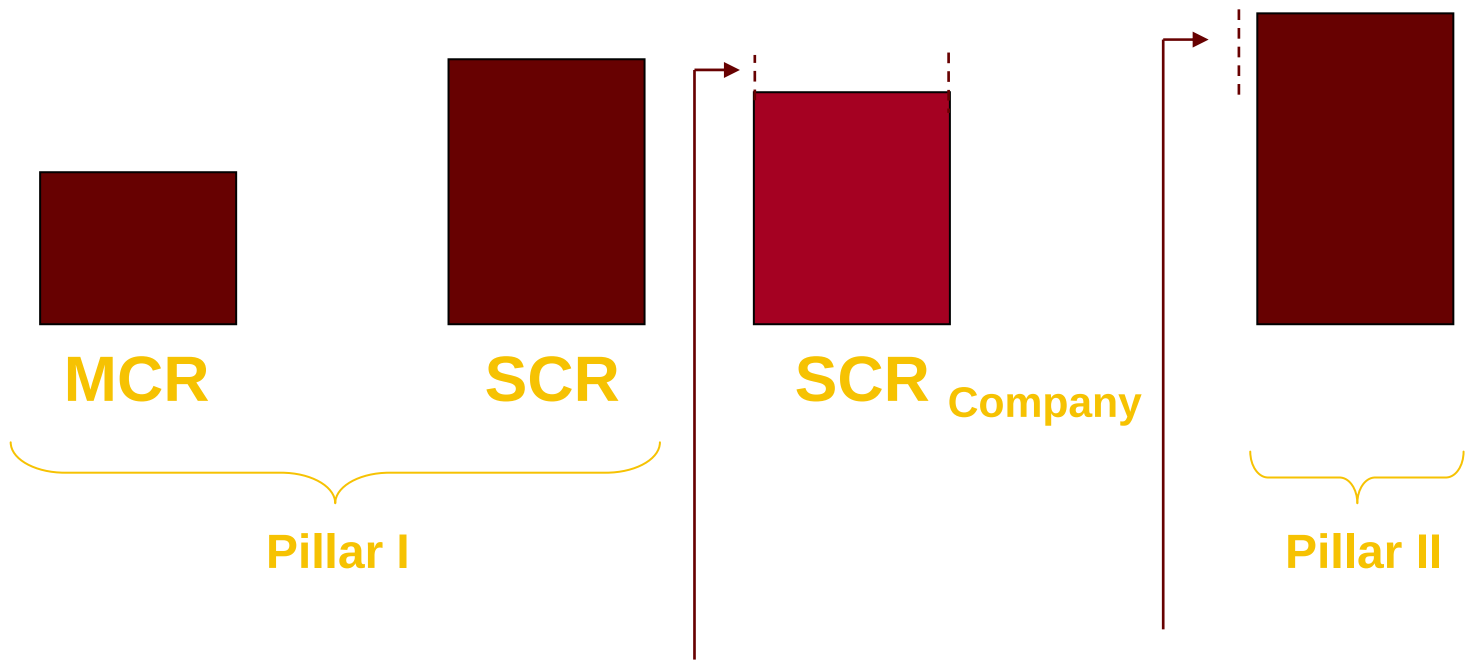
Question raised by CEIOPS

How can we calibrate a **factor-based model** using linear correlations so as *not to overstate the diversification effects* applying to risks that are not normally distributed?

Source: Letter of P. Sharma to A.Olesen (26 July 2004)

GC's understanding – Pillar I/ Pillar II structure



- Reduction due to diversification benefit/ good risk management/ …
- Use of internal model/ Stress testing may form the backing..

- Allowance wider risks
- Supervisors view

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Key Questions:

1. Should the MCR formula be simple? Or based on SCR?
2. Should the model be parameterised by member state?
3. Features for a SCR formula?
4. Allowance for correlation formula vs internal model?
5. Total balance sheet approach vs provision plus margin?

Comments to

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