



The Actuarial Profession

making financial sense of the future

Solvency II – update on timelines and recent developments
Michael van Vuuren



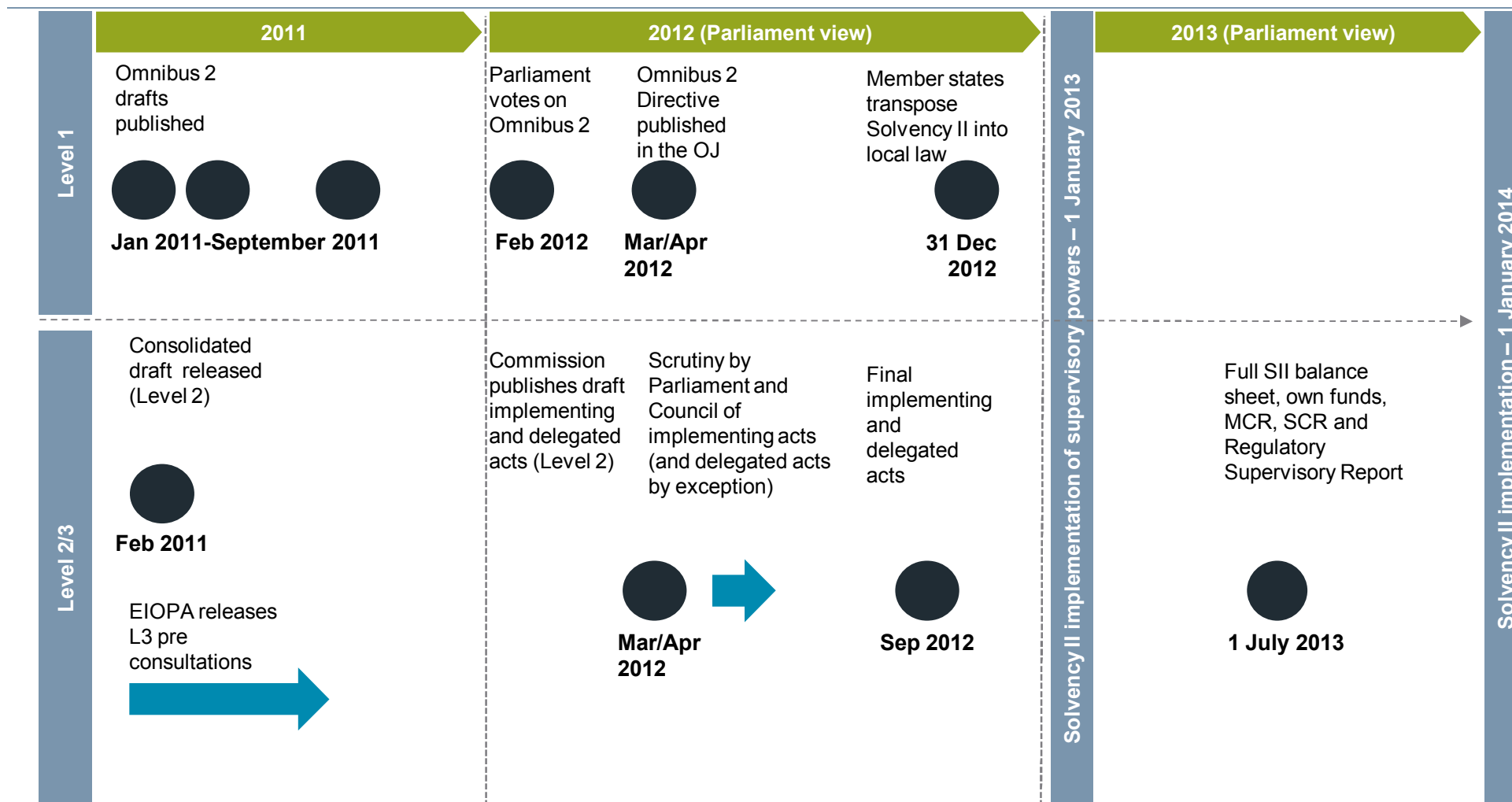
CILA II – Royal College of Physicians

6 October 2011

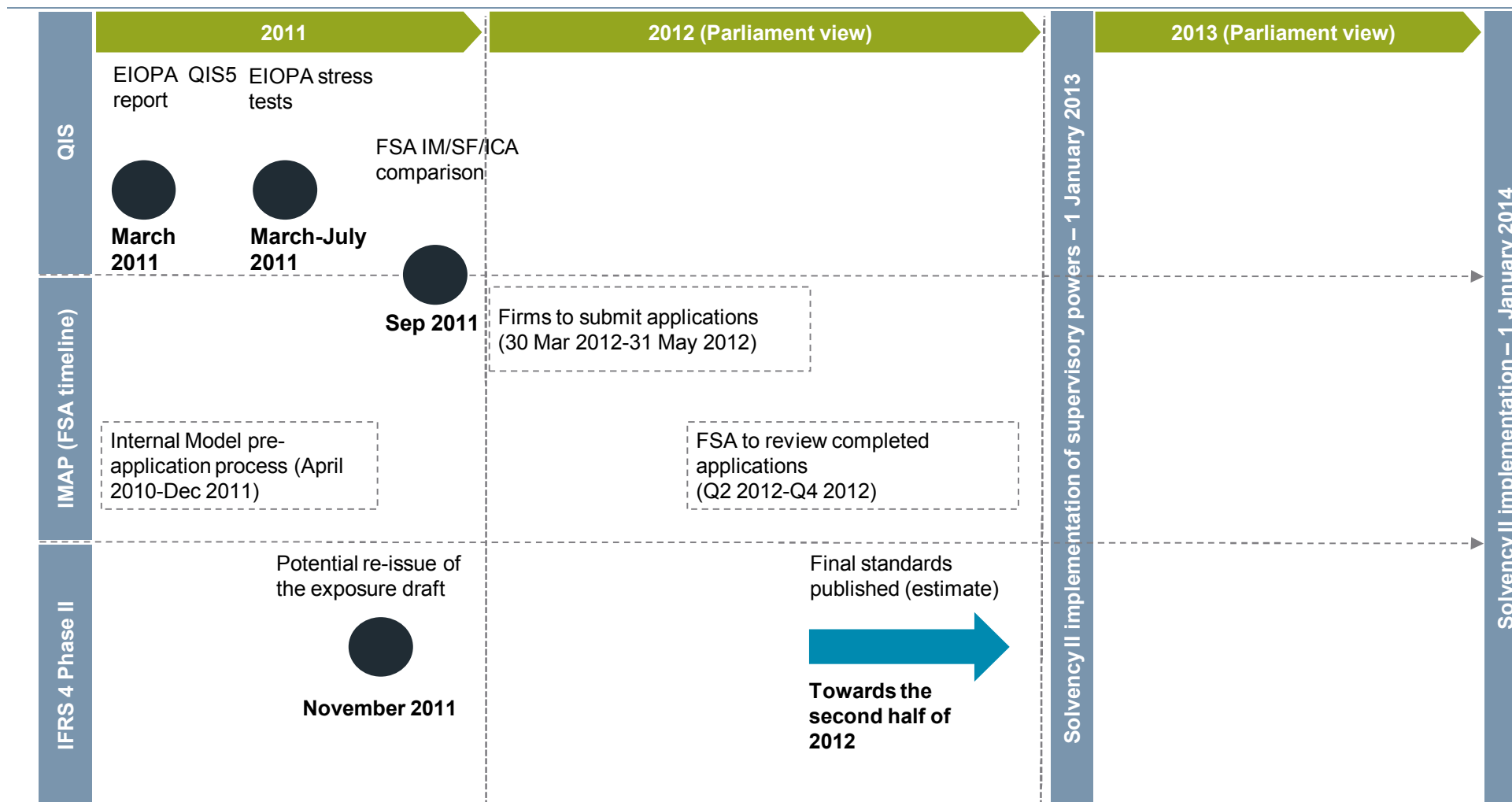


Update on timelines

Regulatory timelines (1)



Regulatory timelines (2)



Timeline implications

- Solvency II project end date?
- Transition to business as usual
- Programme resourcing and cost implications
 - Firms
 - FSA
- Internal model application window dates (currently Q2 2012)

Timeline implications

- Regulatory powers and expectations in 2013
- Multiple concurrent bases
- Incorporating tax changes
- IFRS 4 Phase II alignment
- When to execute 'strategic solutions'
- ...



Recent developments

Omnibus II proposals and Level 2

Omnibus II - Recap

- The original Solvency II directive required implementation of Solvency II from 31 October 2012
- This directive required amendment for the new European system of financial regulation
- These amendments are brought together in the “**Omnibus II**” directive proposed by the European Commission
- Concerns over the preparations of some Member States and the insurance industry are leading to proposals to delay the implementation of Solvency II
- Other amendments, in addition to the implementation date, were also included and have evolved during the negotiations on the Omnibus II proposal
 - defining the transitional measures and their maximum duration, and
 - vesting significant powers in EIOPA

Omnibus II - Approval process

- Omnibus II requires approval from both the European Parliament and the Council of the EU
- It is expected to be voted on by the European Parliament in February 2012 and will be published in the Official Journal of the European Union in March/April 2012
- Both Parliament and Council are proposing an **implementation date of 1 January 2014 for firms**. (For supervisory powers, the implementation date is 1 January 2013.)
- There are many differences in the proposals between parliament and council

Any draft Directive or proposal amending Directive, such as Omnibus II, **requires approval** from the European Parliament and the Council of the European Union and **will be subject to intense political debate** and compromises



Much of this debate on Omnibus II has taken place to date in the European Council under the Hungarian and now Polish Presidencies of the Council



To conclude on the amendments of Omnibus II there will be a **trialogue exercise** comprised of the Commission, Polish EU Presidency and rapporteurs from the European Parliament

Parliament vs. Council – Pre 1 January 2014

Item proposed	Parliament (draft ECON report 27/7/11)	Council (Presidency compromise 15/7/11)
Transposition of Directive into national law	31 December 2012	31 March 2013
Power for granting of supervisory approvals (e.g. Use of internal models, ancillary own funds, use of undertaking specific parameters in the standard formula SCR)	1 January 2013	1 June 2013
Pre implementation reporting	As of 1 July 2013 Full SII balance sheet, own funds, MCR, SCR and Regulatory Supervisory Report	By 1 June 2013 An implementation plan providing evidence of the progress made
Implementation of Directive's full requirement	1 January 2014	1 January 2014
Transposition of Directive into national law	31 December 2012	31 March 2013

- Consensus to **delay Solvency II implementation until 1 January 2014** with **2013 being seen as a year of transition**
 - Generally both Parliament and Council are **introducing more detail** into Omnibus II than the original Commission proposal
 - **Parliament has helpfully proposed a short timeline for further technical detail to emerge** - with all draft implementing and regulatory technical standards required by July 2012
 - All parties appear prepared to **smooth the transition** and have made proposals in similar transition areas

Parliament vs. Council – Transitional measures (1)

Item proposed	Parliament	Council
Insurers in run-off	N/A	<p>Insurers in run-off will not be subject to SII requirements provided activities will be terminated within 3 years of SII's implementation</p> <p>Insurers in run-off that are subject to reorganisation and where an administrator has been appointed are not subject to SII's requirement for 5 years</p>
Equivalence of third parties	<p>Duration: 5 years</p> <p>A set of minimum requirements must be met for deemed equivalence to be granted</p>	<p>Duration: 5 years</p> <p>Delegated acts may be adopted setting out the specified conditions</p>
Non-compliance with SCR	Member States may allow insurers with balance sheet totals of <€500bn* a period of 2 years to comply with SCR	Where insurers fail to comply with SCR during the first year of application of SII, they will have 12 months to achieve compliance
Regulatory and public reporting	Member States may allow insurers a period of up to 2 years to develop the system and structures necessary to produce the Regular Supervisory Report and the Solvency and Financial Condition Report.	N/A

- Both Parliament and Council are proposing that Omnibus II should **set out in more detail the actual transitional measures** that should apply rather than leaving this to Level 2 legislation.

*[sic]. EY believes this was intended to be <€500m

Parliament vs. Council – Transitional measures (2)

Item proposed	Parliament	Council
Eligibility of existing own funds items	<p>Duration: 10 years</p> <p>Basic own fund items in issuance at 31 Dec 2012 that meet specified criteria shall be included in Tier 1 or Tier 2 basic own funds</p> <p>Conditions for inclusion of Tier 1 and Tier 2 are specified</p>	<p>Duration: 10 years</p> <p>Basic own funds items that meet criteria shall be included in Tier 1 or Tier 2 basic own funds</p> <p>The criteria that must be met have not yet been specified but, as a minimum, insurers will need to meet the requirements of the SI Directives</p>
Risk free interest rate	N/A	<p>Liabilities which were valued using a discount rate based on asset yields can be discounted using a weighted average of that asset backed discount rate and the risk free rate that is required under SII. The rate used will move from the asset backed discount rate to SII rate on a straight line basis over 7 years</p>
Equity risk capital charges	N/A	<p>The capital charge that applies to equities not subject to the duration based approach shall move on a straight line basis (from 22% to either 39% or 49% ± up to 10% dampener effect) over 5 years</p>
Concentration and spread risk charges for own government debt	N/A	<p>Duration: 2 years</p> <p>Exposures to own government debt denominated in third country currencies should be treated in the same way as exposures in the domestic currency</p>

Level 2 – Definitions and update*

- Various definitions are used by the level 2 legislations including implementing technical standard, implementing act, regulatory technical standard and delegated act
- A list of different areas are considered by the implementing and regulatory technical standards
- There are differences between the Parliament's proposal and the Council's proposal
 - For example, the Parliament has proposed more details on the calculation of SCR by standard formula, qualitative requirements for investments, internal model approval and exceptional falls in financial markets
 - The Council has introduced the counter-cyclical premium to replace the illiquidity premium
- Parliament has proposed a more accelerated timeline compare to the Council
 - Under the Parliament draft report, all regulatory technical standards would be need to submitted by EIOPA by 1 March 2012, with implementing technical standards to follow by 1 June 2012 and 1 July 2012, depending on the topic

*For further details, please see appendix A.

Current Level 2 ‘hot topics’

- Contract boundaries
 - Definition (‘unlimited extent’, ‘fully reflects risk’)
 - Portfolio vs Contract
 - Alignment to IFRS
- Discount rates
 - Matching premium
 - Countercyclical premium
- EPIFP (Expected profit in future premiums)
 - Definition
 - Disclosure
 - Tiering

* Please note this is not a complete list and ignores non life specifics



Recent developments

Equivalence

EIOPA's findings – Third country equivalence (1)

- EIOPA's conclusions in respect of each of the country regimes against a set of principles are described below:

Country (Regulatory body)	Japan (JFSA)			Bermuda (BMA)			Switzerland (FINMA)
Principle	All	Small captives	Large Captives	Small insurer s	Medium sized insurer s	Large Insurers	All
Powers and responsibilities of third country supervisory Authorities	Equivalent	Partly equivalent	Equivalent	Largely equivalent	Largely equivalent	Largely equivalent	Equivalent
Professional secrecy, exchange of information and promotion of supervisory convergence	Equivalent	Equivalent	Equivalent	Equivalent	Equivalent	Equivalent	Equivalent
Taking up of business	Largely equivalent	Partly equivalent	Partly equivalent	Partly equivalent	Partly equivalent	Partly equivalent	Equivalent
System of Governance and Public Disclosure	Largely equivalent	Not equivalent	Not equivalent	Not equivalent	Partly equivalent	Partly equivalent	Partly equivalent
Changes in business, management or qualifying holdings	Largely equivalent	Not equivalent	Not equivalent	Not equivalent	Not equivalent	Not equivalent	Equivalent
Solvency Assessment (Reinsurance)	Partly equivalent	Not equivalent	Not equivalent	Largely equivalent	Largely equivalent	Largely equivalent	Equivalent
Solvency Assessment (all insurers)	Not applicable	Not equivalent	Not equivalent	Not applicable	Largely equivalent	Largely equivalent	Equivalent
Parent undertakings outside the Community: scope of group supervision	Not applicable	Equivalent	Equivalent	Equivalent	Equivalent	Equivalent	Equivalent
Parent undertakings outside the Community: cooperation and exchange of information between supervisory authorities	Not applicable	Partly equivalent	Partly equivalent	Partly equivalent	Partly equivalent	Partly equivalent	Equivalent
Group System of Governance and Public Disclosure	Not applicable	Partly equivalent	Partly equivalent	Partly equivalent	Partly equivalent	Partly equivalent	Partly equivalent
Group Changes in business, management or qualifying holdings	Not applicable	Not equivalent	Not equivalent	Not equivalent	Not equivalent	Not equivalent	Equivalent
Group Solvency assessment	Not applicable	Largely equivalent	Largely equivalent	Largely equivalent	Largely equivalent	Largely equivalent	Equivalent

Table key: ■ Not equivalent ■ Partly equivalent ■ Largely equivalent ■ Equivalent ■ Not applicable

EIOPA's findings – Third country equivalence (2)

Equivalence under the following three articles are considered:

- Article 172 – treatment of reinsurance
- Article 227 – group solvency calculations
- Article 260 – group supervision

The overall conclusions from the assessments against the above articles appear to be **generally positive with 'Equivalence, subject to Caveats'**.

An exception is the conclusion in respect of Article 227 in Switzerland, where the **Swiss Solvency Test is already judged fully equivalent for group solvency purposes**.

- Conclusions appear to be consistent with the ongoing development of the prudential regimes in each of Japan, Switzerland and Bermuda.
- Swiss regime has been in place for some time and has continued to develop with respect to Pillars 2 and 3; it now appears to be very close to achieving equivalence on Articles 172 and 260 as well as Article 227.
- In respect of Japan, although there will be some refinements to the solvency regime in March 2012 we expect that the introduction of the new solvency regime in the medium term should address the most significant point raised in the draft assessment of equivalence with Article 172.
- Long term business is excluded (as rules are too new) but Bermuda appears to have made significant progress in developing its regulatory regime in respect of insurers and this is recognised by EIOPA in its overall conclusion. However aspects of EIOPA's assessment appear to require that in order to be judged as equivalent, a significant degree of prescription of how the regulator will behave in a wide variety of circumstances is required. This may lead to a reduction in judgement available to supervisors.



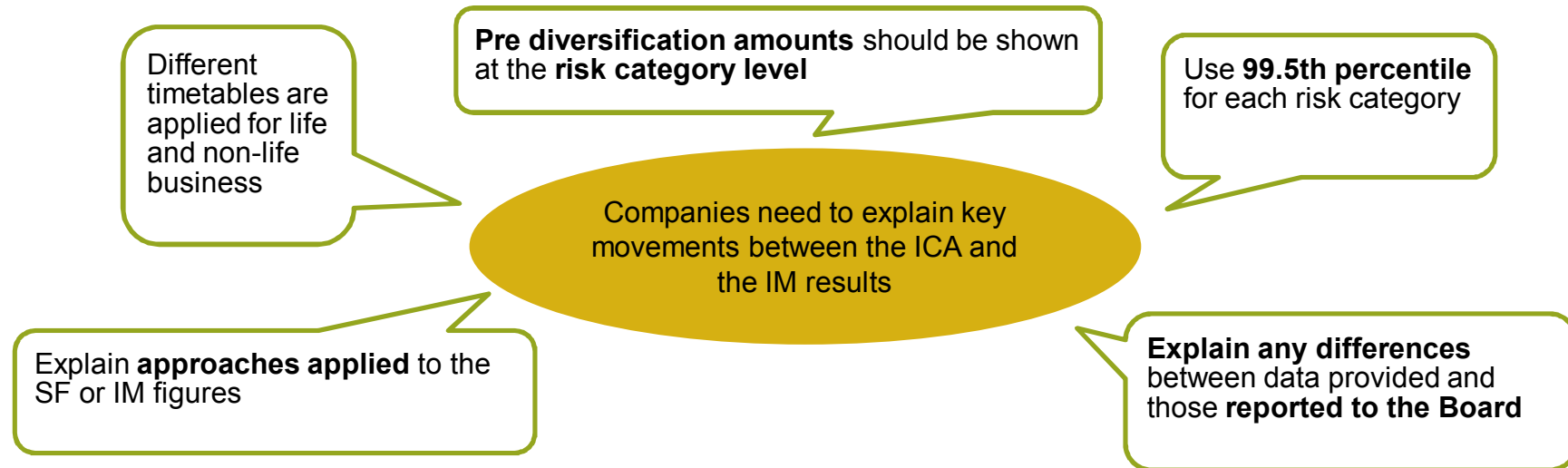
Recent developments

FSA developments

FSA quantitative tools

Comparison between ICA, SF and IM results

The purpose of this process is to **show and explain the differences in capital requirements** between the current ICA and the future IM calculation

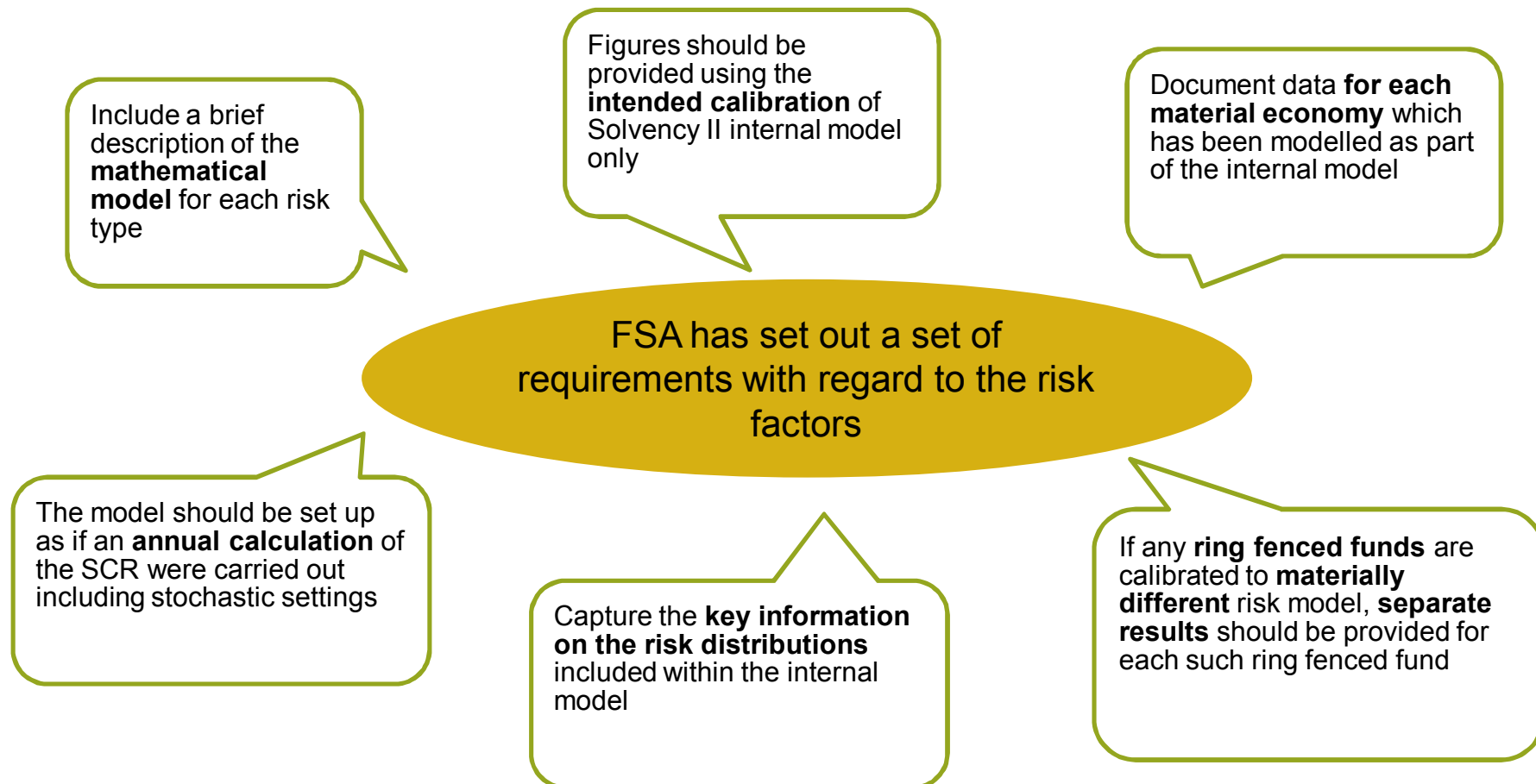


Commentary to cover:

- Main reasons why IM more appropriate than SF
- Rational for any approximated calculation and the method used
- Categories included in the "other" risk categories
- Material changes to the underlying risks in the risk categories
- Level of stress applied for each risk category under both ICA to IM calibration
- Changes in methodology from ICA to IM calculation

FSA quantitative tools

Standardised risk and aggregation information – risk factor



FSA quantitative tools

Standardised risk and aggregation information – aggregation

- The requirements with regard to the aggregation calculation cover:
 - Results should be provided using the **intended calibration for IM only**
 - **Explain any approximation** used in capturing dependency information
 - Provide a **separate result for ring fenced funds** which use a materially different dependency structure
 - Total capital requirement should **reflect all adjustments**
 - Allow **no diversification benefit between consolidate risk types** but allowing **the firm's own diversification benefit within each risk type**

The information required include:

- Input correlation assumptions
- Dependency information and dependency structure
- 99.5th percentile capital requirement and the allocation of the diversified capital
- For each risk factor, a brief description of the risk measure and an indication to which consolidated risk type the risk factor relates
- How firms will present and communicate their dependency structures and diversification benefits

- The emphasis is placed on the understanding and communication of three areas:
 - Correlation assumptions
 - Dependency structures, and
 - Diversification benefit allocation

FSA quantitative tools

Data “external review scoping tool”

- FSA has prepared an “external review scoping tool” to provide a structure for an external review of data (developed through a pilot with several firms in May and June 2011)
- This is to be performed by someone who is independent of model design, build and operation
- The scope is relatively high level and covers five key risks areas:
 - Data policy, standards and procedures
 - Data governance, ownership, reporting and monitoring
 - Data directory and data lineage, and associated risk and control assessments
 - Data quality controls and periodic data quality assessments
 - IT general controls

FSA quantitative tools

Data “external review scoping tool” (cont’d)

- The structure is broadly aligned, but no explicit mapping to former CPs 43 and 56
- Timing not made explicit
- A formal report will be submitted to FSA, including "Yes" or "No" conclusions for each control area defined in the scope document.
 - "Yes" conclusions require evidence of both design and operating effectiveness of processes and controls.
 - Action plans and deadlines to resolve any "No" conclusions will be required. (Categorised as either "in plan" or "remedial")



Recent developments

Model approval

The FSA approval process

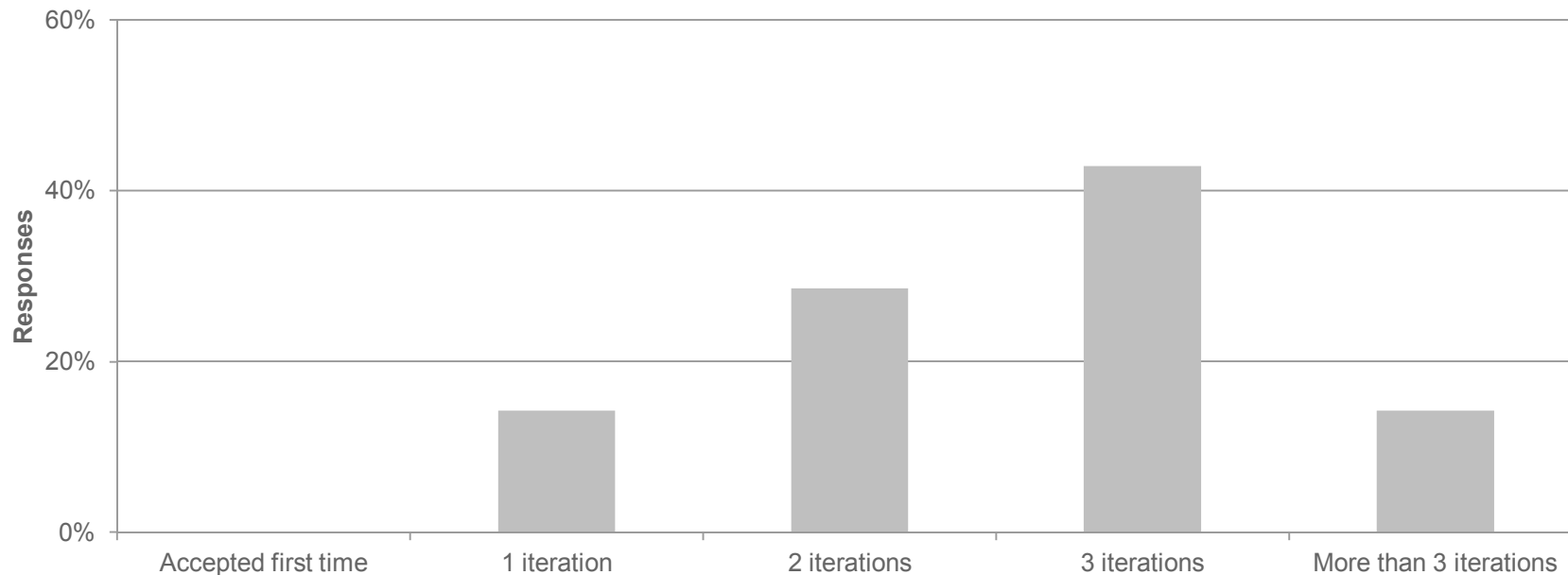
Stage	FSA Panel required	
Review of PAQC and decision to allow firm to enter pre-application	No	<ul style="list-style-type: none"> All IMAP firms should have moved beyond this step and submitted their self assessment template (SAT)
Review of self-assessment and agreement of work plan	Yes	<ul style="list-style-type: none"> Most firms are currently at this stage When the FSA is satisfied with the SAT, a work plan will be discussed and agreed. Not all companies have yet been given work plans. FSA sets out risk priorities which need to be addressed by firm and will want to see evidence that the level of specialist resource commitment is appropriate for the firm's risk profile
Quarterly updates of SAT	No	<ul style="list-style-type: none"> Monitoring stage – firms submit quarterly updates on their SATs The FSA will consider if a firm is making sufficient progress in terms of improvements to its policies / production of documentation
Pre-app decision	Yes	<ul style="list-style-type: none"> FSA decides if a firm can submit a formal application
Application decision	Yes	<ul style="list-style-type: none"> FSA decides if a firm can report on its solvency using an Internal Model

- We understand that the panel make up and decisions process are reliant on FSA's overall view of firm rather the tier allocated
- A firm's tier only drives the level of FSA resources reviewing the templates during the process
- If a firm is ejected from IMAP process, the decision is final for most firms - there is a lack of clarity on any escalation or appeal process

FSA self assessment template submissions

EY survey results (September 2011)

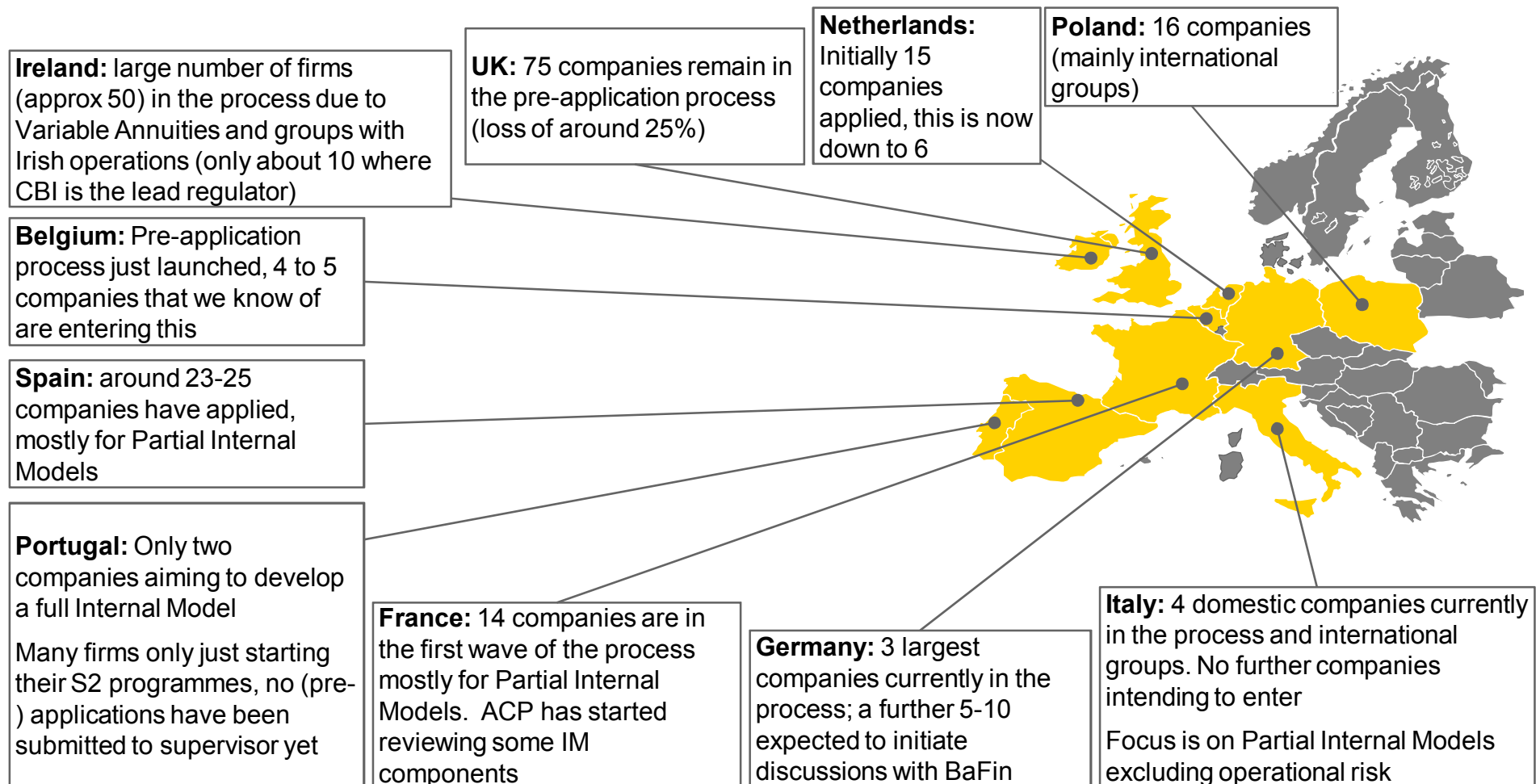
Number of initial SAT iterations



Reasons:

- ▶ Requirement for enhanced detail of evidence
- ▶ Further proof of compliance with implementation of policies
- ▶ Timing of provision of evidence
- ▶ Unable to understand how disclosures fitted together, when looked at in isolation
- ▶ Too detailed!

IMAP European perspective





Questions?

Presenter contact details:

Michael van Vuuren | Director | European Actuarial Services
Ernst & Young LLP
1 More London Place, London, SE1 2AF, United Kingdom
Direct: +44 20 7951 4734 | Mobile: +44 77 4747 6386 |
mvanvuuren@uk.ey.com



Appendix A

Level 2 – Definitions and update

- Implementing technical standard (ITS)
 - an implementing act, technical, prepared by the EIOPA, provides for the uniform application of certain provisions in the basic legislative act, and should not involve strategic decisions or policy choices
 - Implementing act
 - prepared by the Commission and used where uniform conditions for the implementation are necessary; these are likely to be used to “adopt” the ITSs and subject to Parliament/Council scrutiny
- Parliament has proposed a much more accelerated timeline compare to the Council.
 - Under the Parliament draft report, all regulatory technical standards would be need to submitted by EIOPA by 1 March 2012, with implementing technical standards to follow by 1 June 2012 and 1 July 2012, depending on the topic.

Level 2– Definitions and update (cont'd)

- Regulatory technical standard (RTS)
 - a delegated act, technical, prepared by the EIOPA, and should further develop, specify and determine the conditions for consistent harmonization of the rules included in the basic legislative act, and should not involve strategic decisions or policy choices
 - Delegated act
 - non-legislative act of general application, prepared by the European Commission, and supplements or amends certain non-essential elements of the legislative act; these are likely to be used to “adopt” the RTSs and give Parliament/Council the right to object
- Parliament has proposed a much more accelerated timeline compare to the Council.
 - Under the Parliament draft report, all regulatory technical standards would be need to submitted by EIOPA by 1 March 2012, with implementing technical standards to follow by 1 June 2012 and 1 July 2012, depending on the topic.

Level 2

Areas considered by regulatory & implementing technical standards by Parliament

Areas considered by RTS (submitted by 1 March 2012)

- Information to be provided to supervisors
- Valuations of assets and liabilities
- Calculation of BEL and RM
- Calculation of the illiquidity premium
- Assessment of eligibility of own funds
- Calculation of SCR by standard formula
- Internal models
- Calculation of MCR
- Qualitative requirements for investments
- Exceptional falls in financial markets
- Non-compliance with the SCR
- Finite reinsurance and special purpose vehicles (SPVs)
- Group SCR and internal model

Areas considered by ITS (submitted by 1 June 2012)

- Supervisory approval of own funds
- Supervisory approval process for undertaking-specific parameters (USPs)
- Internal model approval
- Approval of major changes to internal models
- Capital add-ons
- Solvency and financial condition report (SFCR), solo and group
- Procedures for updating correlation parameters
- SPVs
- Determination of the existence of an exceptional fall in financial markets
- Information to be provided to supervisors*
- Information to be disclosed by member states*
- *submitted by 1 July 2012

Parliament's proposal for additional areas covered by Level 2

Item proposed	Parliament's proposal
Calculation of SCR by standard formula (RTS)	Emphasis is placed on the consistent recognition and use of the rating agencies. EIOPA should make optimal use of ESMA's (European Security and Market Authority) competences and experience
Qualitative requirements for investments (RTS)	The requirement of "reporting of risks arising from investments" is removed
Internal model approval (ITS)	EIOPA shall develop draft implementing technical standards with regard to: (a) the approval of an internal model; and (b) the approval of major changes to an internal model. EIOPA shall submit these by 1 June 2012
Exceptional falls in financial markets (ITS)	<p>The determination of the exceptional fall needs not depend on the condition of insurance undertakings being seriously and adversely affected</p> <p>In the event of an exceptional fall of financial markets the recovery period for insurance and reinsurance undertakings not complying with the SCR may be prolonged</p>

With regard to the calculation of the illiquidity premium, the Council has introduced the counter-cyclical premium

- Comparing to the Council, the Parliament has proposed more amendments referring to further details using RTSs and ITSs.*