Introduction

This presentation provides an update on progress towards Solvency II:
- Timeline
- Results of the QIS4 exercise
- Publication of a Discussion Paper, “Insurance Risk Management: The Path to Solvency II”

We signal recommendations for action by firms in preparation for Solvency II implementation

Solvency II – political process

- Political agreement on the Level 1 text (Directive) is expected late 2008 / early 2009
- CEIOPS has begun preparing advice to the Commission on Level 2 (implementing measures), to detail Solvency II requirements
  - CEIOPS advice will be published mid-2009, with the Commission seeking to confirm implementing measures by mid-2010
- Firms now need to take action to ensure their plans for Solvency II implementation are robust
- Implementation is targeted for October 2012
QIS4 Participation

- Total of 146 spreadsheets received
  - 66 from life firms
  - 63 from non-life firms
  - 17 from groups
- Plus 74 completed questionnaires, and many useful supplementary notes
- Size of participating firms
  - 54 large
  - 50 medium
  - 25 small
- Market coverage by provisions (Life firms) and annual premium (Non-Life)
  - 75% for life
  - 85% for non-life

Overall impact on solo firms

- Calibration for QIS4 still fairly provisional! Overall, any changes may have minor effect on the capital amounts but more justification of the standard formula is required.
- Under QIS4, most firms would see a reduction in their solvency ratios, but most would still be well above 100%
- 89% of non-life firms and 73% of life firms could cover their SCR and 95% of firms could cover their MCR
- Internal model SCR was higher than the standard approach for life and lower for non-life
- Some categories of firm observed a poor fit between the QIS4 standard and Solvency I or ICAS – mainly:
  - Annuity providers
  - Motor insurers

Summary of perceived Key Issues for UK firms from QIS4

- Equity risk methodology and calibration
- Design and calibration of counterparty risk module
- Use of Internal models / Comparison of SCR
- Segmentation and calibration of SCR for non-life u/w risk
- MCR design and calibration
- Application of Solvency II to Groups
MCR – non-life

1. Companies where the SCR is high relative to peers mainly due to particular risks.

Equity risk - comparison of approaches

- Compared with 39% equity stress:
  - 32% equity stress results in reduction in required capital
  - "dampener" approach leads to further reduction of around 20% in required capital for life firms based on undiversified requirements
- Average equity stress for internal models was 41%
  - leads to questions about incentives to adopt internal models

Other issues noted from QIS4

- Many other useful issues raised about suitability, practicability and calibration, including
  - Risk margin calculation
  - Operational risk
  - Non-life Cat risk
  - Calibration of parameters for SCR
  - Classification of own funds
Non-Life cat risk – occurrence v annual basis

• Presentation of key results by CEIOPS to EP on 22nd September
• CEIOPS will discuss QIS4 results with representatives of the European industry in October
• CEIOPS will send completed QIS4 report to European Commission in late October
• The report and ensuing discussions will then lead to the production of advice by CEIOPS on the draft implementing measures for Solvency II

Next steps


• Insurance Risk Management: The Path to Solvency II
  – This is the first public presentation of the FSA’s Discussion Paper on Solvency II
  – It is relevant to all non-life actuaries, particularly if you are involved or interested in capital management
Insurance Risk Management: The Path to Solvency II – key messages

- Solvency II will bring changes in UK regulatory requirements
- Firms should be making effective plans now for the implementation of Solvency II
- These key messages are aimed at insurance company boards and senior management:
  - “To ensure firms successfully implement this new regime, it is essential that senior management consider now the implications for their business and start planning immediately”
  - The DP indicates how these activities might be managed / delegated

Suggested actions

- Draw up an implementation plan for Solvency II
  - key responsibility, risk management framework, resourcing and timelines – a form of gap analysis
- Make sure you have completed the QIS4 spreadsheets
  - firms who have done this have confirmed that they have a better understanding of Solvency II
- Think about “internal model v standard formula”
  - UK firms will be invited to indicate to the FSA, by June 2009, whether they intend to follow a (full or partial) internal model route for SCR calculation

Caveat

- The detail of Solvency II standards and their implementation is subject to the uncertainty that accompanies all international negotiations and policymaking.
- However, although the detail of the European requirements is not finalised, the aim is now clear
- The risks of waiting before starting to plan for implementation are considerable in terms of non-compliance in 2012 and/or being forced into costly high-risk programmes of work at short notice.
Systems of governance (Pillar 2) and reporting requirements (Pillar 3) under Solvency II

Governance:

- an effective risk management system
  - owned and implemented by senior management
- a risk-based evaluation of the whole firm
  - based on the chosen risk appetite and level of capital required to run the business
- Own Risk and Solvency Assessment (ORSA)
  - Report to supervisors (private), annual Solvency and Financial Condition (SFC) report (public) and standardised reporting forms.
- Under Pillar 3, disclosure requirements, both public and supervisory, will be different from current UK requirements.

Extract from the Directive – actuarial function

- Are you ready to meet these responsibilities?

Pillar 1

- Technical provisions
  - Art 76 - definition of “best estimate”, application of risk margin, discounting (on the basis of what?).
- Own funds
  - Classification into three tiers, principles-based
- Standard formula
  - Relevant to all firms, tested in QIS, standards will be subject to further refinement
Extract from the Directive – technical provisions

You need to consider the implications of this Article

Internal models

Seven tests / requirements:
- Data
- Statistical quality
- Calibration
- Validation
- Profit & Loss attribution
- Documentation
- Use

Internal models

Approval is not based on your chosen software platform
- Nor is it based on the number generated by your model

Approval is required at the level of the model itself – i.e. its scope, design, build, integrity and application
- To embed the model into the business, you first have to embed the business into the model
UK Firms – preparation for Internal Models:
Indicative progress as at September 2008 (size of balloon indicates relative importance)

Implications for supervision

• FSA has started our own preparation for Solvency II implementation
  - For each action required of firms, there is a matching supervisory implication, e.g.
    • Mapping existing ICAS / ARROW activity to Solvency II, incl public and private reporting
    • Regulatory intervention
    • Regulatory reporting forms
    • Internal model approval process
  - Work practices, resources, systems issues and training requirements are being evaluated with structured gap analyses and workplans

Internal Model Approvals Process
Internal model approvals process – key dates

- March 2009 – firms to advise:
  - intent to apply for model approval, and
  - intent to enter the “dry run” process of preparing their application

- June – Nov 2010:
  - firms to demonstrate compliance with dry run entry criteria
    - High-level implementation plan
    - Internal model development plan
    - QIS exercise completed
    - Model documentation essentially complete, incl indication of how Directive requirements / tests will be met
  - start of “dry run” process
    - Working towards preparation of the application

Summary of Solvency II Preparation Responsibilities - 2008/09

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* Important: Key to understanding and sounding organisational activity
  ** Key responsibility: Responsible for the design / delivery of the organisational objective
  *** Key involvement: Day-to-day involvement as part of senior responsibilities
  **** Contribute to the process of preparing for Solvency II
  ***** Action now: Responsible for initiating and directing organisational activity

Contacts

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