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# Solvency II

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European Union – Solvency II Updates

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CEA and the European industry's input to Solvency II

Key Aspects of the Solvency II Directive

QIS4

Legislative process

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# CEA's Member Associations

**33 national member associations:**

**27 EU Member States**

**+ 6 Non-EU Markets**

Switzerland, Iceland, Norway, Turkey, Liechtenstein, Croatia

**2 Observers**

Russia Ukraine

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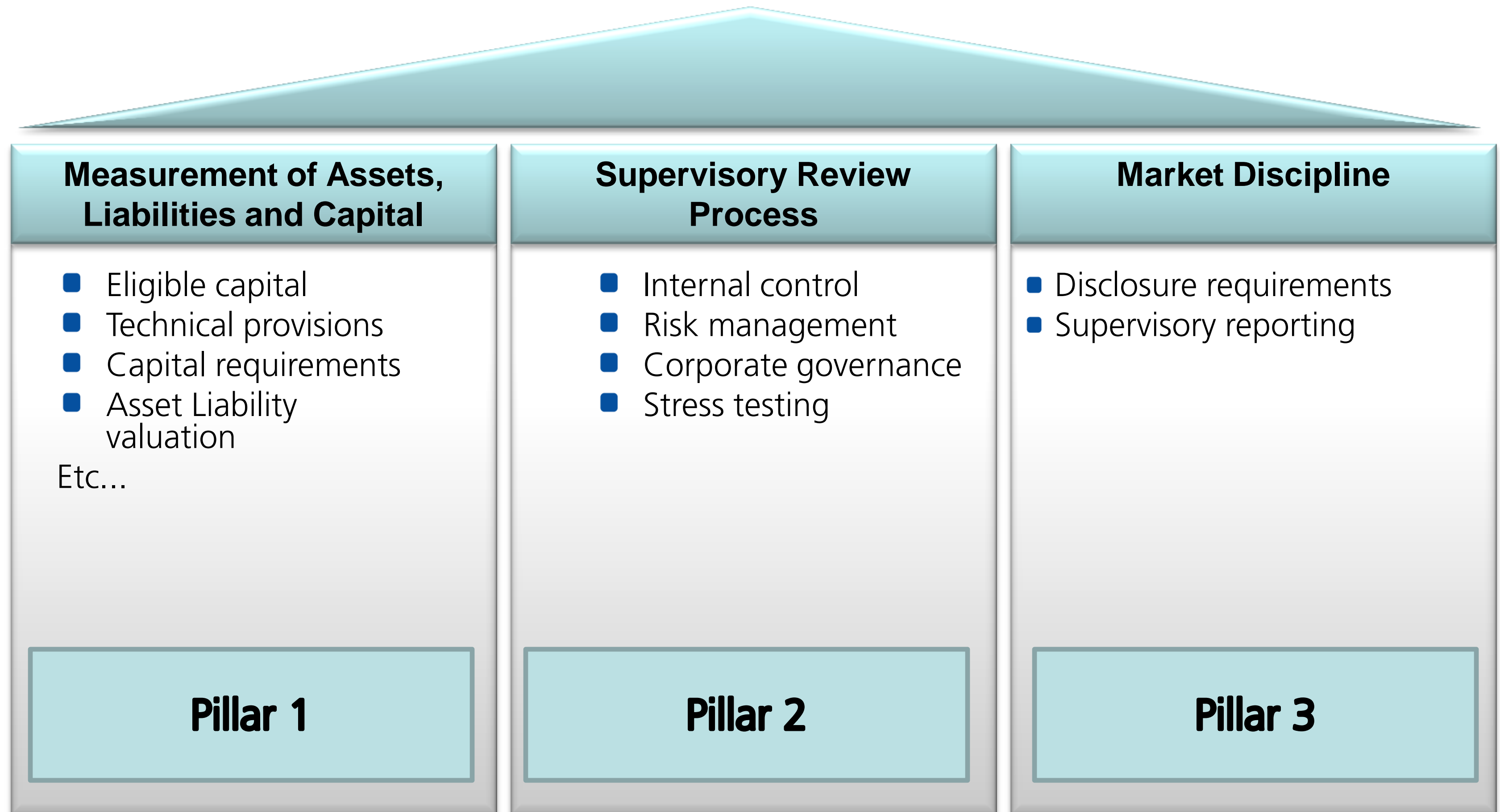
# Why a new Solvency framework ?

- Solvency I is out-of-date and not able to achieve EU objectives of consumer protection, deepening EU single market and competitive industry.

- Solvency I disadvantages:
  - Rules can conflict with good risk management: focus on back-looking financial aspects rather than governance
  - Capital requirement is not adequately directed to risks
  - A lack of harmonisation across the EU
  - Inconsistency with IFRS
  - No recognition of economic reality of groups

# Solvency II Framework – 3 Pillars Approach




Solvency II covers not just capital requirements, also internal management and disclosure requirements.

➢ Makes managers aware of the risks they run

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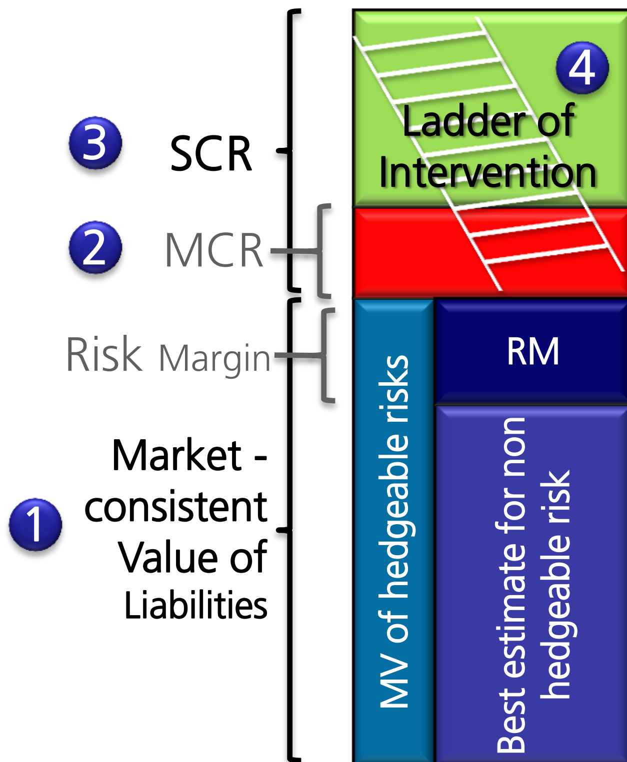
# An economic approach for Solvency II

- "Overall" solvency approach (3 Pillars)
- Economic, risk-based calibration of financial requirements (P1)
  - Market consistent value of assets and liabilities
  - Capital charge to reflect all quantifiable risks associated to them, under a pre-defined risk measurement
  - Recognition of diversification and risk mitigating mechanisms
  - Possible use of internal models for regulatory purposes
- New supervisory relationship (P2)
  - Ladder of intervention
  - Incentive to enhanced ERM
- Opening up to discipline of market scrutiny (P3)
- Enhanced group supervision
- Risk-proportional application

# Pillar I - Key Components




## 1 Market Consistent Value of technical provisions

- Calculated to cover policyholder obligations

## 2 Minimum Capital Requirement (MCR)

- Reflects a level of capital below which ultimate supervisory action should be triggered

## 3 Solvency Capital Requirement (SCR)

- Target Capital that an entity should meet under normal operating conditions
- It enables to absorb significant unforeseen losses over a specified time horizon
- The standard calculation can be replaced by the use of internal model under supervisory validation

## 4 Ladder of Intervention

- Solvency II should be designed to guarantee an appropriate ladder of intervention if the available capital falls below SCR

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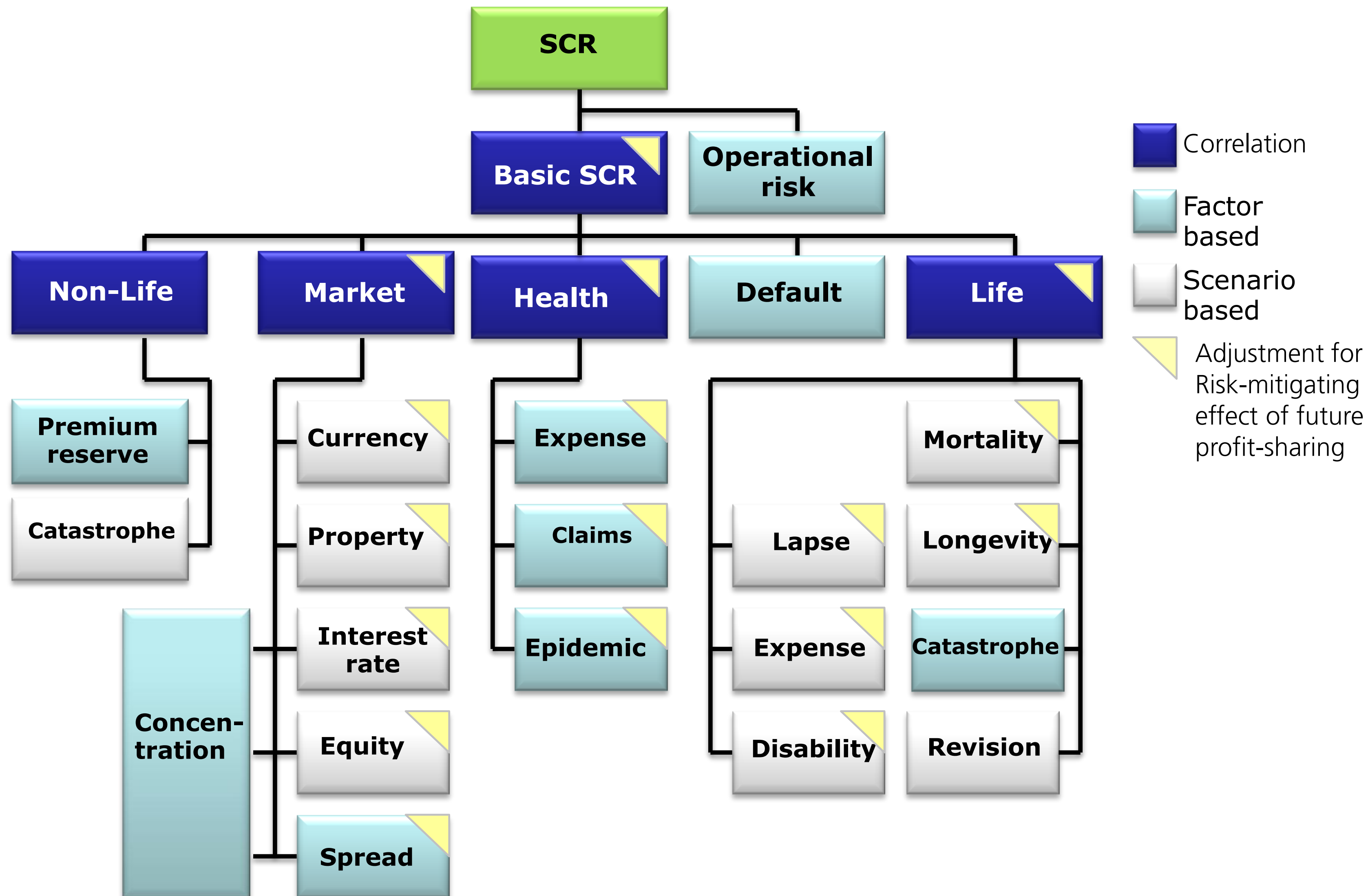
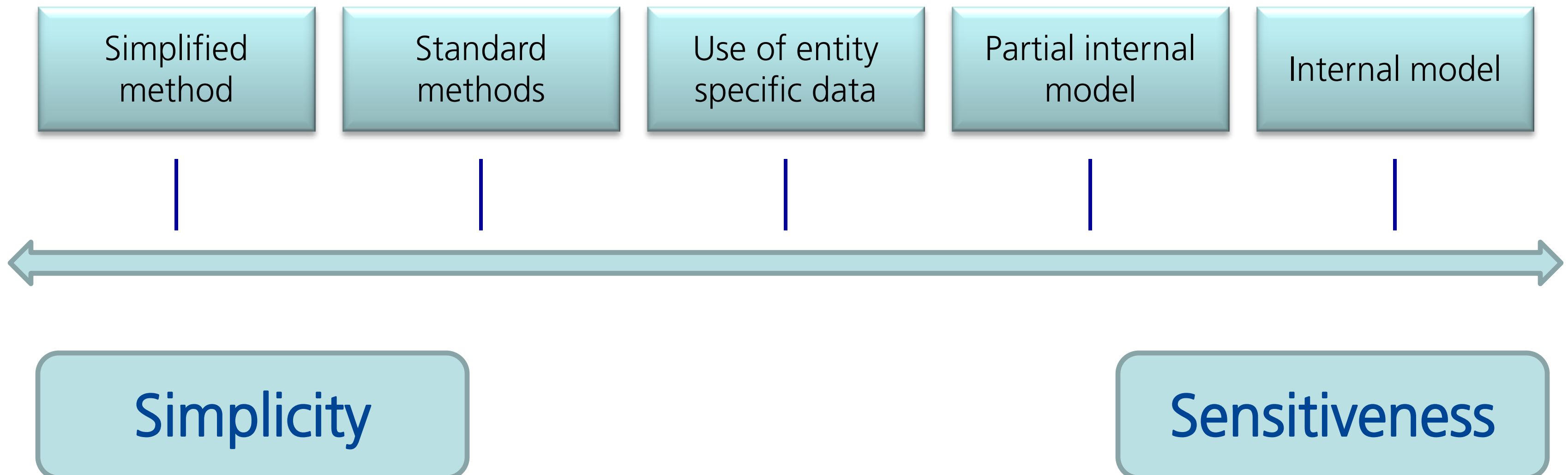
# Pillar I - The SCR Standard Approach




Source: CEIOPS

# Pillar I – Balancing feasibility and sensitivity in SCR



# Pillar II

- The introduction of qualitative risk management standards covering all risks, not just those captured by the Pillar 1 requirements aims at:
  - ensure that risk assessment and risk management play a central role in the system of governance
  - explain to supervisors how insurers manage and control the risks they run and how they assess their own capital needs (ORSA)

# Pillar III

- The introduction of new disclosure requirements bringing market discipline to bear on insurers will require:
  - to explain to shareholders, rating agencies and analysts clearly and accurately how insurers risk profile and risk appetite fits in with their overall business strategy
  - to explain to external stakeholders how insurers assess and manage risk, particularly those insurers using an internal model to calculate capital requirements

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# Group Supervision

- Identification and appointment of a group supervisor
- Group supervisor has primary responsibility for all key aspects of group supervision and must act in close cooperation and consultation with local supervisors
- Groups may apply for the introduction of a group internal model
- Group support regime will come back after some time (review clause) and taking account of the progress received on the reform of the supervisory architecture in the EU (de Larosière Report)

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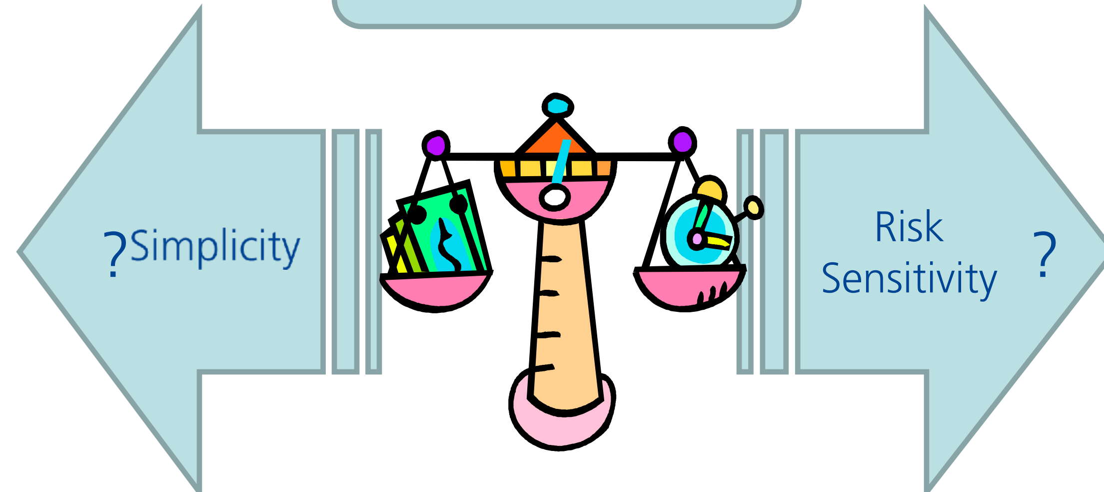
# Areas for future work as a result of QIS4 - General areas

Calibration

Methodology

Proportionality



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# Lamfalussy process of decision making

**Level 1: Framework Directive**
European Commission, European Parliament, European Council

**Level 2: Implementing measures**
EIOPC

**Level 3: Convergent implementation**
CEIOPS

**Level 4: Enforcement of legislation**
European Commission

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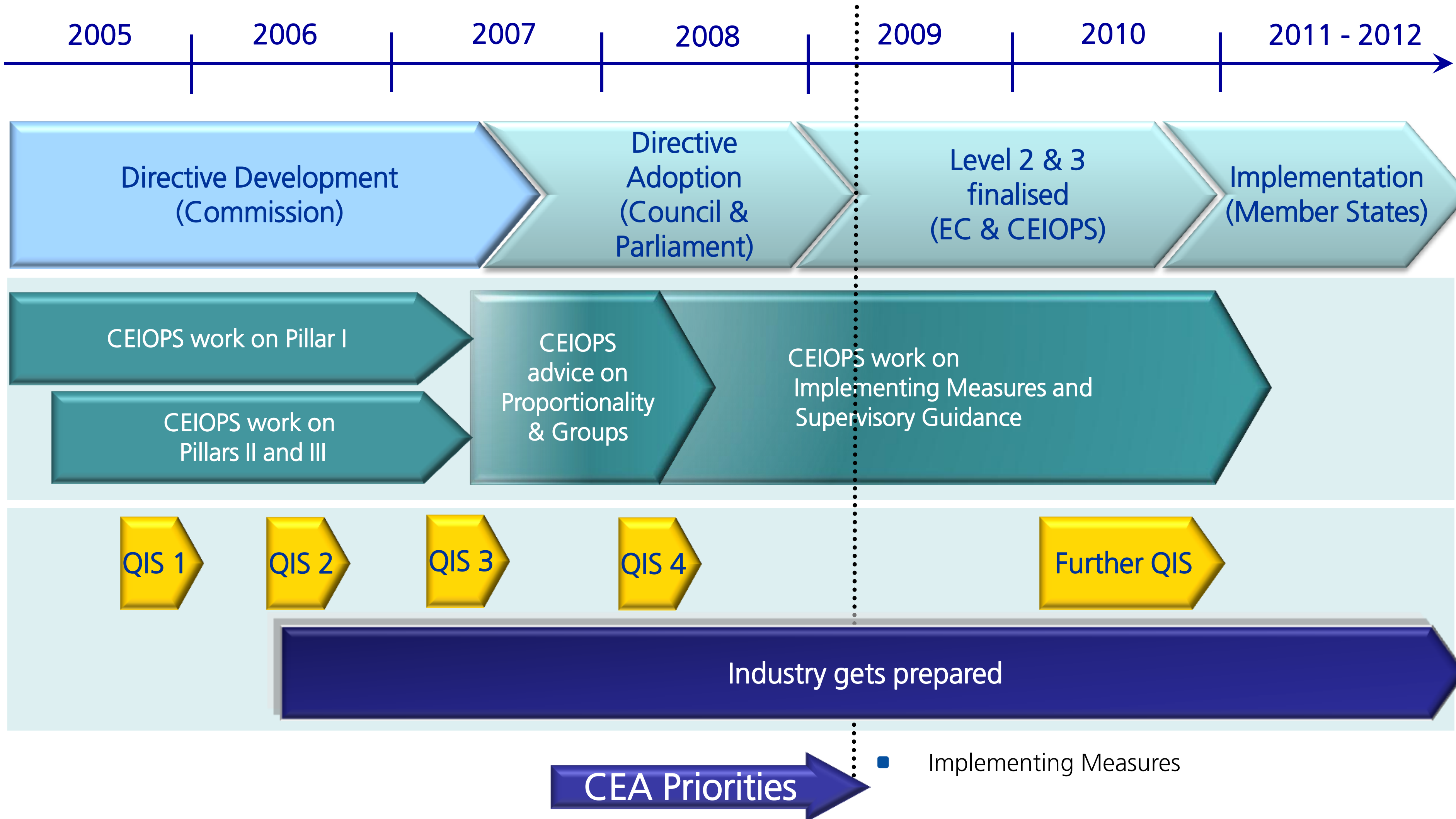
# Solvency II Timeline



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# Messages from QIS4 and the current financial crisis

- A risk based prudential framework is necessary
- Solvency II architecture, as designed in the draft framework directive, is solid and workable
- Consideration of lessons learned from crisis in levels 2 and 3
- In developing “implementing measures”, economic foundations of SII should be retained
    - Fostering Enterprise Risk Management
    - Transparency – Market consistent valuation is the way forward
    - Group supervision in line with groups’ economic reality and based on enhanced supervisory coordination

European Insurers highlight the ever increased need for Solvency II

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