Solvency II – Quo Vadis?

Carlos Montalvo Rebuelta
Executive Director
Handelsblatt Jahrestagung, Cologne, 13 April 2011
The “single” rule book

- Directive: Entry into force 1 January 2013

- Implementing measures
  - Delegated acts (known as “Level 2 measures”):
  - Implementing acts: development of implementing technical standards by EIOPA, endorsement by Commission

- EIOPA Guidelines and Recommendations
  - EIOPA to ensure convergent practices of industry and supervisors

- EIOPA tasks under Solvency II
  - QIS5 tested the feasibility of the proposed measures
  - Ongoing discussion in Commission Solvency Expert Group, to be followed by approval in Council and Parliament
  - Omnibus II Directive to define scope and timing
  - For example: derive and publish risk free rate, eligibility of ECAIs, be consulted and settle disagreements on group internal models, appointment of group supervisor, determine exception fall in financial markets (PII dampener)…
  - EIOPA to ensure convergent practices of industry and supervisors
What was the aim of QIS5?

- Objectives
  - Assess the **quantitative impact**
  - Check principles and **calibration** targets
  - Encourage (re)insurers and supervisors to **prepare** for the introduction of Solvency II
  - To provide a starting point for an **ongoing dialogue** between supervisors and (re)insurers

- Also: EIOPA to test **feasibility** and assess complexity
What did we learn from QIS5?

Feasibility of Solvency II ?!

Sustainable impact for all insurers ?!

Are industry and supervisors prepared ?!
Feasibility of Solvency II

• Complexity
  o Solvency II is a major overhaul of valuation of balance sheet and calculation of the capital requirements
  o Simplify where impact is not material

• Need to spend time to understand the requirements and how they will be implemented operationally
  o Pillar II and Pillar II (ORSA, Governance
  o Training, Human resources
  o IT, Data collection

• Impact
  o Smooth transition – transitional measures
Impact of the proposed regime
A sustainable impact on the surplus

QIS5 compared to current regime (solo)

- Current: QIS5 - 476, QIS5 adjusted - 451
- SCR: QIS5 - 355, QIS5 adjusted - 395
- MCR: QIS5 - 676, QIS5 adjusted - 676
Explanation of solo surplus evolution

Graph 8: Drivers of the surplus changes - EEA

- Surplus SI: 100.0%
- Assets: -37.6%
- Assets+: 30.9%
- Other valuation: -3.5%
- TP-: -14.9%
- TP+: 66.0%
- Tax: -15.2%
- Own funds: 9.1%
- Capital reqs: -58.8%
- QIS5: 76.0%
### Group surplus

(Billions euro)

<table>
<thead>
<tr>
<th></th>
<th>Surplus Solvency I</th>
<th>Surplus QIS5</th>
<th>Size sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large</td>
<td>109</td>
<td>129</td>
<td>17</td>
</tr>
<tr>
<td>Medium</td>
<td>27</td>
<td>18</td>
<td>21</td>
</tr>
<tr>
<td>Small</td>
<td>64</td>
<td>50</td>
<td>109</td>
</tr>
<tr>
<td><strong>All</strong></td>
<td><strong>200</strong></td>
<td><strong>197</strong></td>
<td><strong>147</strong></td>
</tr>
</tbody>
</table>

Results in case internal models were approved and/or local rules under D&A for third countries were used

<table>
<thead>
<tr>
<th></th>
<th>Surplus Solvency I</th>
<th>Surplus QIS5</th>
<th>Size sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large</td>
<td>109</td>
<td>54</td>
<td>17</td>
</tr>
<tr>
<td>Medium</td>
<td>27</td>
<td>16</td>
<td>21</td>
</tr>
<tr>
<td>Small</td>
<td>64</td>
<td>44</td>
<td>108</td>
</tr>
<tr>
<td><strong>All</strong></td>
<td><strong>200</strong></td>
<td><strong>114</strong></td>
<td><strong>146</strong></td>
</tr>
</tbody>
</table>

Consolidated method with standard formula
SCR coverage across the EEA

Graph 5: Distribution of SCR coverage by country

- **75% to 120%**
- **Less than 75%**
- **120% to 200%**
- **More than 200%**
Graph 6: Distribution of MCR coverage

- More than 400%: 25.7%
- Between 350% and 400%: 7.0%
- Between 300% and 350%: 8.8%
- Between 250% and 300%: 10.7%
- Between 200% and 250%: 16.2%
- Between 150% and 200%: 15.9%
- Between 120% and 150%: 6.9%
- Between 100% and 120%: 4.2%
- Between 75% and 100%: 2.7%
- Less than 75%: 2.0%
Technical Provisions

- A general decrease in technical provisions from Solvency 1 to QIS5 due to:
  - Removal of implicit prudence
  - Generally a higher discount rate
  - Different cash-in and -out flows to be assessed

- This statement has however to be nuanced for life business
## Preparedness – solo participation rate

- Participation rate

<table>
<thead>
<tr>
<th>Solo</th>
<th>Target (set by EC)</th>
<th>Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>QIS4</td>
<td>25%</td>
<td>QIS4</td>
</tr>
<tr>
<td></td>
<td>QIS5</td>
<td>60%</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>33%</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>QIS5</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>68%</strong></td>
</tr>
</tbody>
</table>

- More than doubled solo participation

- **1511 Small**
- **791 Medium**
- **217 Big**

- **610 Life**
- **1284 Non-Life**
- **111 Reinsurers**
- **175 Captives**
- **336 Composites**

- **382 Health**
- **454 Mutual**
### Preparedness – Groups participation rate

**Groups:** QIS4: 106  
**QIS5:** 167

**Increase in number of small and medium groups**

<table>
<thead>
<tr>
<th></th>
<th>Large</th>
<th>Medium</th>
<th>Small</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number</td>
<td>17</td>
<td>23</td>
<td>127</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>EEA groups without non-EEA entities</th>
<th>EEA groups with non-EEA entities</th>
<th>EEA subgroup(s) of non-EEA groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number</td>
<td>121</td>
<td>41</td>
</tr>
</tbody>
</table>
<pre><code>                                   |                                  | 5                               |
</code></pre>

14 April 2011
Current state of preparedness of the industry

• Participation rate shows that Solvency II is a priority to all insurers, regardless of size

• (Re)insurance undertakings and groups are striving to be ready for the implementation date of 1st January 2013.
  o A majority of undertakings considers they will be ready by end 2012
  o Large undertakings and group members in advance in their preparation (and QIS4 participants)
Caveat: small sample and internal models not finalized/approved

- Using: 262/309. Working on implementation: 289
- 96% of group members would use the model developed at group level
- Spike of submissions around the introduction date of Solvency II expected
Further work: SCR

- Non-Life catastrophe risk: (calibration, data availability and effort required, risk mitigation)
  - Further work in progress

- Counterparty default risk
  - Difficulty applying full calculation
  - Proportional to (lack) of importance for some?

- Calculation of loss absorbency of deferred taxes

- Equivalent scenario

- Lapse risk (policy level in life, availability of systems and process in non life)

- Look through approach (e.g. unit-linked)
Further work: Expected profits in future premiums

- Quantified in QIS5 – amount disclosed as part of Tier 1
- Proxy methodology intended to provide a simple and consistent approach but ...
- Poor participation rate – 29%
- Results affected by calculation difficulties, assumptions and undertakings’ concerns about the concept
- Care with use of data
- Weighted average – 20% of Tier 1 v 16% for groups
Further work: Groups

- Absorbing effects of deferred taxes and future discretionary benefits at group level
- Treatment of ring fenced funds
- Treatment of intra-group transactions
Thank you