Solvency II
Towards a risk based system

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Towards a single rulebook
Crucial step to achieve a single market

Fourteen existing Directives on insurance and reinsurance supervision, insurance groups and winding-up

+ Solvency II

Codification & Recast

Codification, Recast & New Articles

= 1 Directive on insurance and reinsurance supervision
Reminding ourselves of the objectives and opportunities of Solvency II

• **Objectives:**
  - Deepen the integration of the internal market (Single Market)
  - Enhance protection of policyholders
  - Improve international competitiveness of EU insurers
  - Achieve “better regulation”

• **Opportunities:**
  - Better match between supervisory framework and internal risk management
  - Harmonised supervision and reporting requirements within the EEA
  - Improved group supervision
  - Convergence of supervision in the EEA
The foundation of Solvency II

Supervision of solo undertakings and groups

Pillar 1
Quantitative Requirements
- Technical provisions
- MCR and SCR – SF/IM
- Prudent person investment rule
- Own funds

Pillar 2
Qualitative requirements
- Internal control and risk management (incl. ORSA)
- Supervisory review process (qualit. & quant - Add-ons)

Pillar 3
Reporting and disclosure
- Supervisory reporting
- Public disclosure
- Market discipline

Total balance sheet approach
Market-consistent valuation
Approval of internal models

Harmonized Valuation standards

Focus on firm’s responsibility
Convergence of supervisory practices

Convergence of supervisory practices

Better risk-based information
Increased transparency

Harmonized supervisory reporting
Valuation of assets and liabilities for solvency purposes

• Defines basis of solvency assessment

• Solvency II follows an economic approach:
  ✓ Economic market-consistent valuation of all assets and liabilities
  ✓ Consistent across assets and liabilities

• Shall support economic assessment and consistent measurement of risks
Own funds

- Own funds = excess of assets over liabilities, aka “net asset value” or available capital resources
- Shock absorber against adverse losses
- Shall ensure that the insurer is able to meet its obligations to policyholders when they are due
- Distinguish the quantity and the quality (loss absorbing capacity) of the own funds
Required regulatory capital

- Capital which insurer is required to hold should be sufficient to ensure that, in adversity, an insurer’s obligations to policyholders will continue to be met.
- Applies at solo and group level.
- Calculated via standard formula or (full or partial) internal model.
- Solvency II aims for risk-based and economic determination of required capital.
  - **SCR** - Solvency Capital Requirement: defined such that assets exceed technical provisions and other liabilities with a specified level of safety over a defined time horizon.
  - **MCR** – Minimum Capital Requirement: lowest level, triggers strongest supervisory actions.
Overall approach to solvency assessment

The Solvency II balance sheet

- Technical provisions
- Best estimate (discounted)
- Risk margin
- Ancillary Own funds
- Basic Own funds
- Own funds

Assets
Components of technical provisions

- Risk margin for non-replicable risk components
- Best estimate (discounted)
- Market value of corresponding assets for replicable risk components
Internal Models Framework

**internal model** (in the wider risk management sense)

- use test
- actions / steering
- internal risk control functions
- reporting / monitoring

**actuarial model** (in the narrow sense)

- risk exposure data
- risk driver data
- forecasts for P&L distributions

**SCR** (regulatory capital)

- Pillar-2 adjustment
- SCR estimate
- adjusted SCR
- calibration test

**statistical quality test**
Recognition of diversification effects

- Risk 1
- Risk 2
- Overall risk
- Diversification effect

- Individual risks
- Aggregation
- Overall risk

Recognition of diversification effects
What did we learn from QIS5?

Feasibility

Impact

Preparation
Lessons from QIS5

- **Complexity**
  - Solvency II is a major overhaul of valuation of balance sheet and calculation of the capital requirements
  - Simplify where impact is not material (**proportionality**)

- **Need to spend time to understand the requirements and how they will be implemented operationally**
  - Pillar II and Pillar III (ORSA, Governance, disclosure)
  - Training, Human resources
  - IT, Data collection

- **Impact**
  - Overall financial position remains comfortable
  - But need for smooth transition – transitional measures
    - Hybrids, Third country equivalence, discount rate
What is EIOPA doing?

1 Working groups with the industry and the EC
   - Calibration of the non-life and health risks
   - Calibration of the Catastrophe risk
   - Expected profits in future premiums and contract boundaries

2 Technical standards
   - Reporting to supervisors
   - USP approval process
   - Discount rate
   - Contract boundaries
   - Integration techniques on partial internal models
   - ...

3 Guidelines
   - ORSA
   - Actuarial guidelines
   - Intra-group transactions and risk concentrations
   - Functioning of the supervisory colleges
   - ...

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