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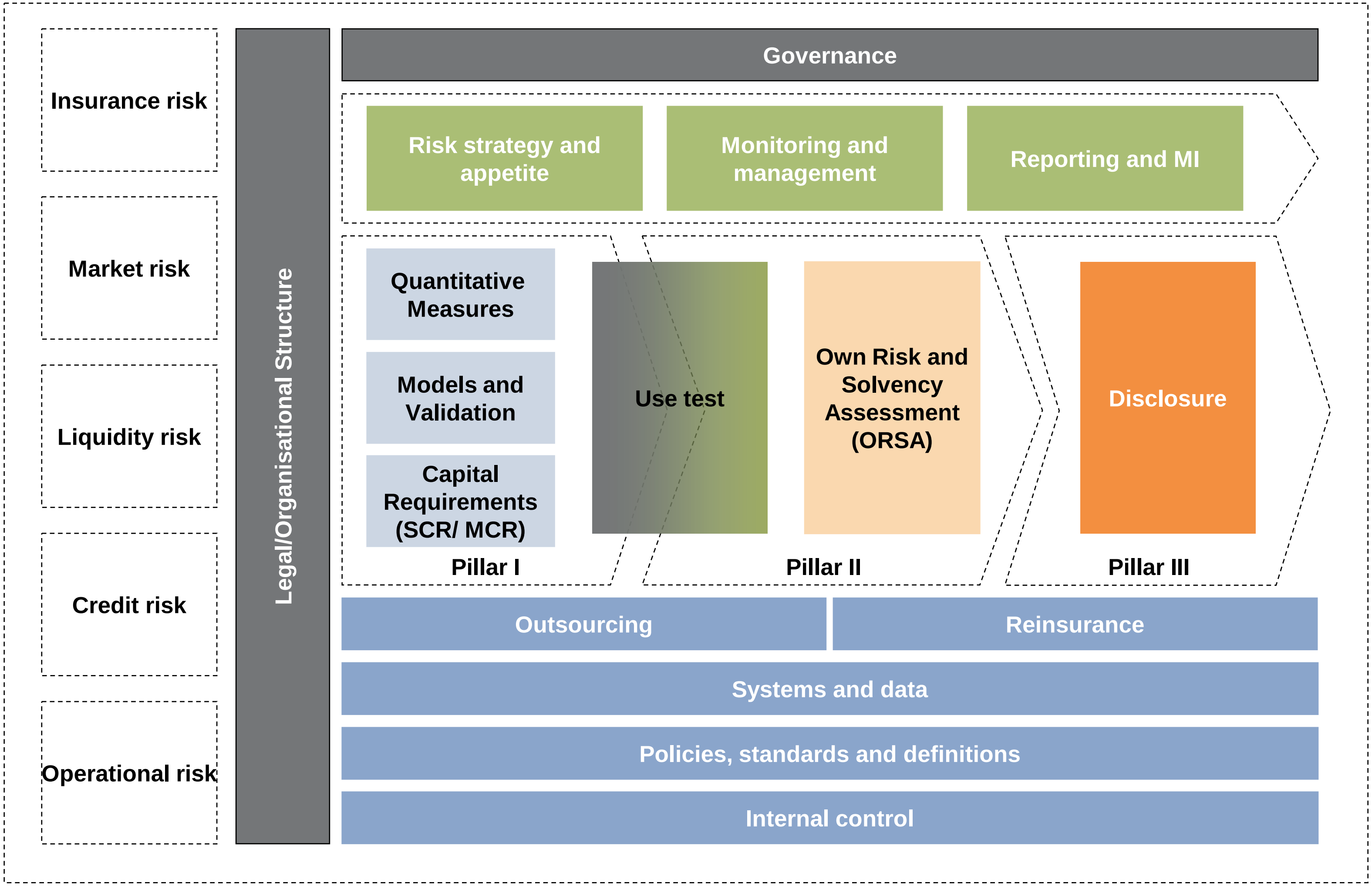
FALL 2011 CASE MEETING:

Solvency II for US Insurers

Overview

1. Solvency II – The Directive
2. Exploring the three pillars
3. Pillar 1: Demonstrating Adequate Financial Resources
4. Pillar 2: Demonstrating an Adequate System of Governance
5. Pillar 3: Public Disclosure and Regulatory Reporting Requirements
6. Group Supervision
7. Why should US Insurance Industry care about Solvency II?
8. Conclusion

Solvency II – The Directive



Solvency II: Three Pillar Approach

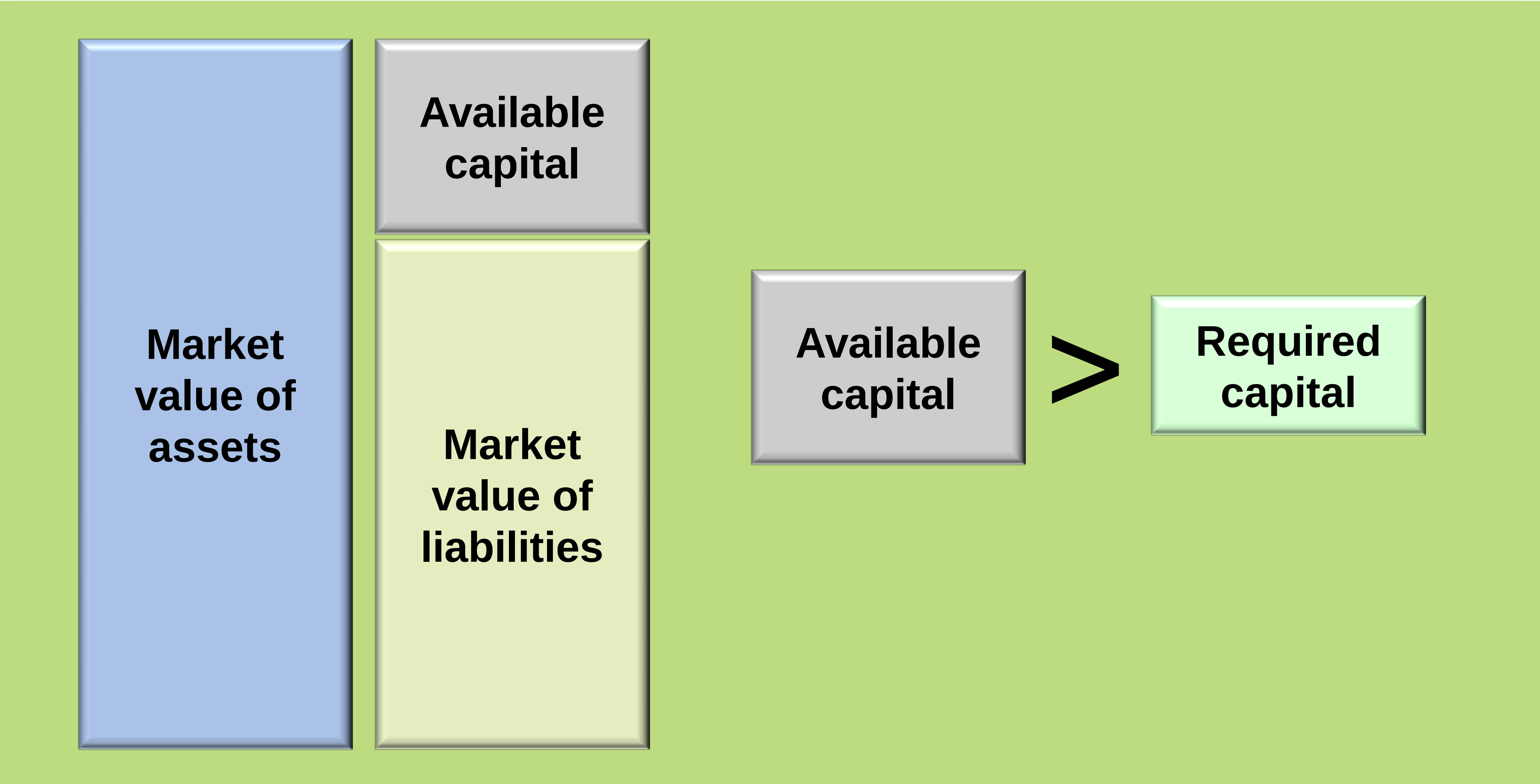
Governance

Pillar 1: Quantitative capital requirements	Pillar 2: Qualitative supervisory review	Pillar 3: Market discipline

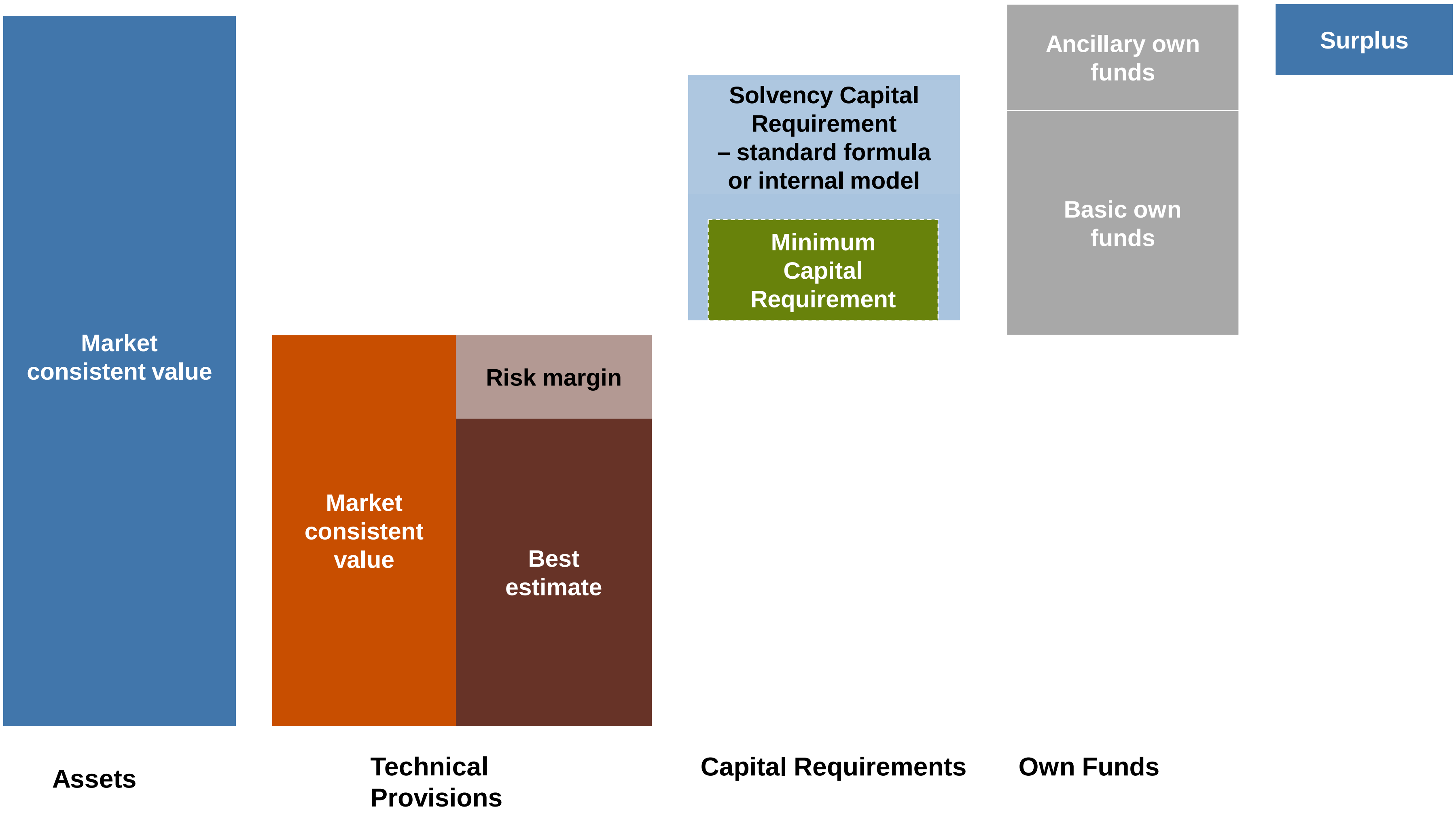
• Market-consistent valuation
• Own funds
• Economic risk based capital requirements
  – Minimum Capital Requirements (MCR)
  – Solvency Capital Requirements (SCR)
• Investment rules
• Groups
	• Internal controls and risk management
	• Required functions
	• Own Risk and Solvency Assessment (ORSA)
	• Supervisory review
	• Capital add-ons
		• Transparency
		• Disclosure
		• Solvency and Financial Condition Report (SFCR)
		  – Solo
		  – Group

Compliance and Audit

Pillar I: The Economic Balance Sheet



Pillar I: Quantitative Capital Requirements



Pillar I – SCR: Standardized Approach

Calculation of SCR

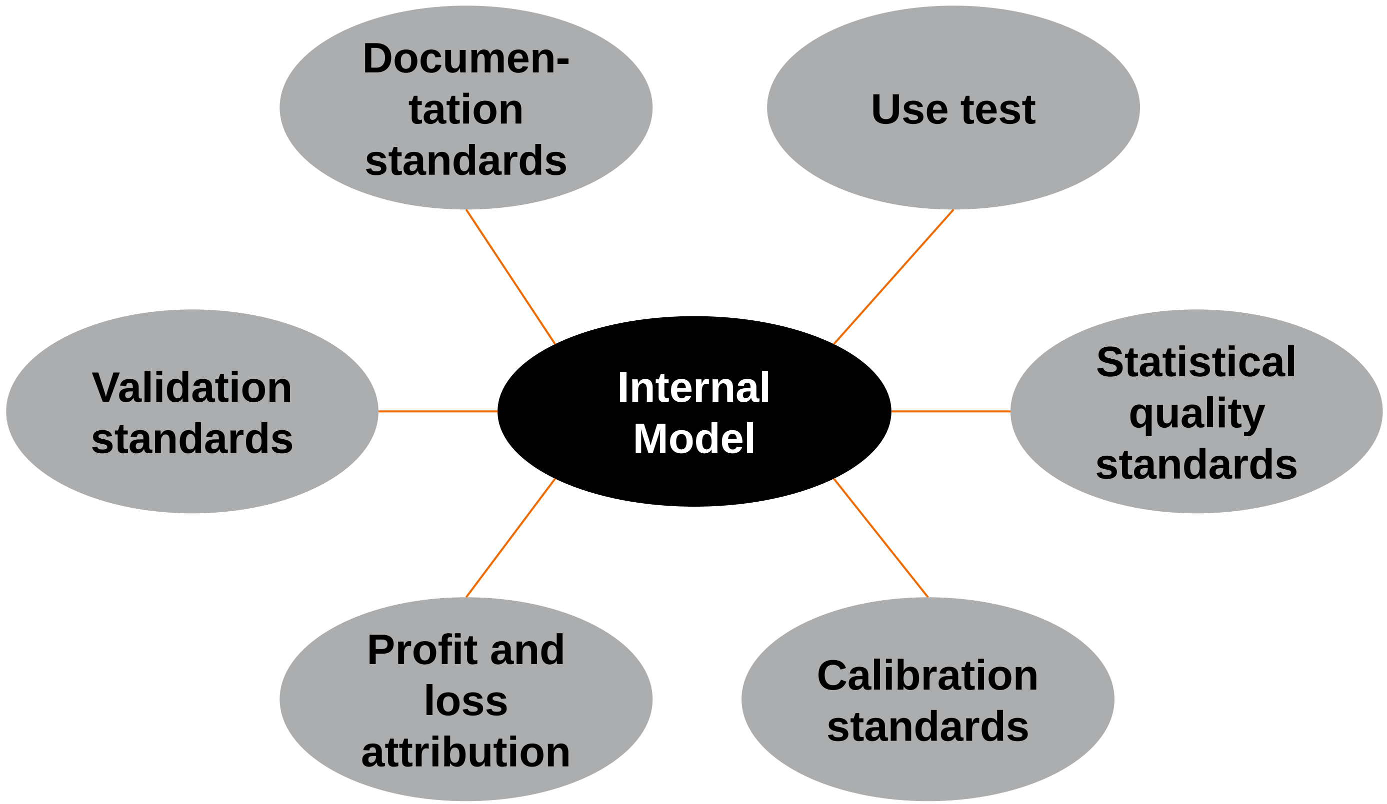
BASIC SCR + Op Risk = SCR

BASIC SCR:

- Non-life Underwriting (UW) Risk
- Life UW Risk
- Health UW Risk
- Market risk
- Counterparty Default risk

Internal Model – 'Six Tests'

"To embed the model in the business you have to embed the business in the model first"



Use of external vendor models does not exempt insurers from any of the standards

Internal Model – Use Test

Use test

Article 120 Foundation Principle: *"Insurance and reinsurance undertakings shall demonstrate that the internal model is widely used in and plays an important role in their system of governance"*

CP 56 provides further detail on CEIOPS view of how the Use test could be proven.

"the undertaking's use of the internal model shall be sufficiently material to result in pressure to improve the quality of the internal model."

To support this 9 other principles are proposed.

The CEIOPS has interpreted that the framework establishes 2 levels of responsibility for implementation of the internal model:

Board and senior management

Responsible for the governance of the internal model:

- Approval of the internal model application
- Delegating roles and responsibilities, including risk expert in senior management
- Alignment with risk profile and company strategy
- Allocation of resources

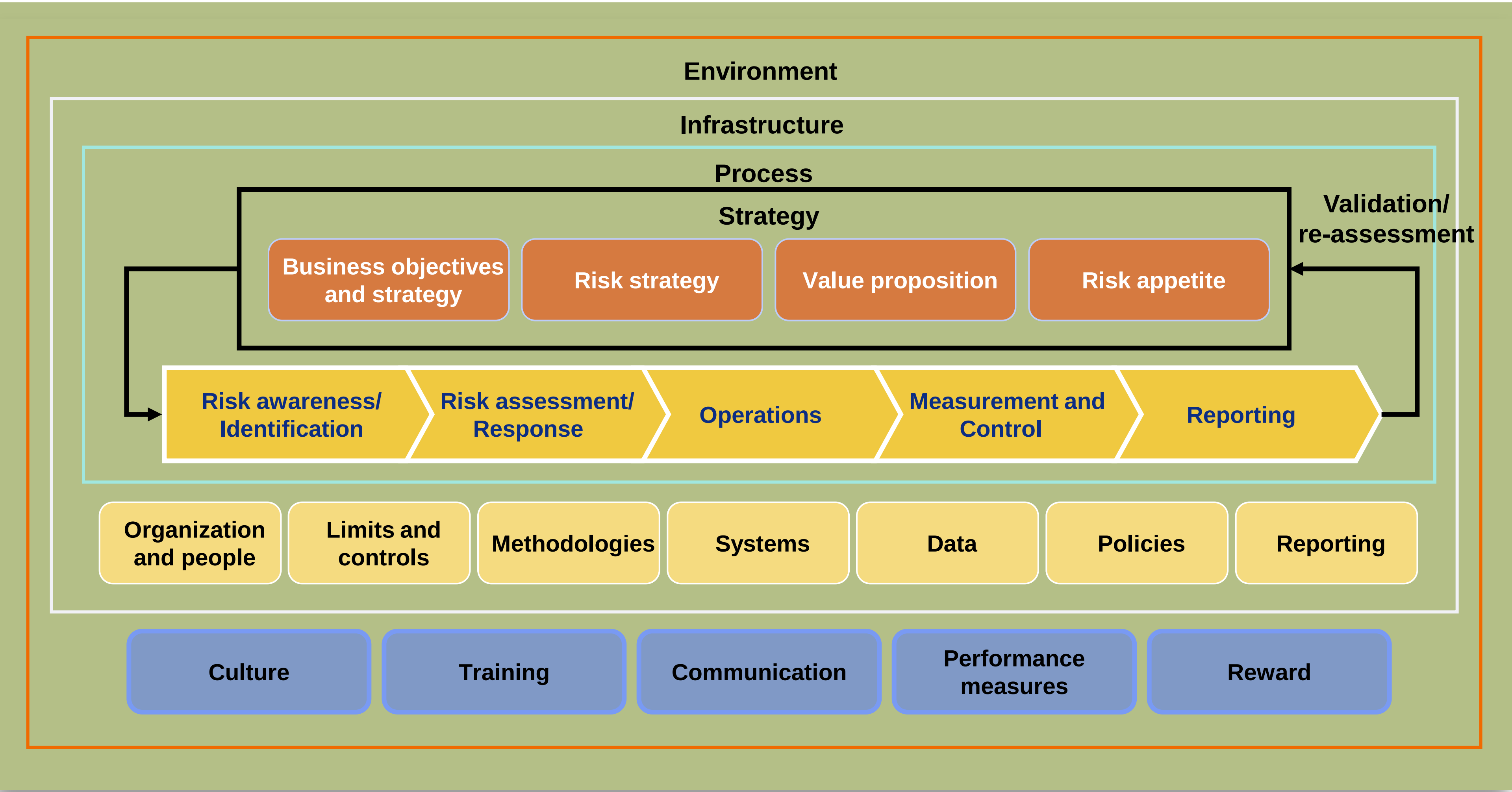
Risk management function

Responsible for detailed implementation, defined in Article 43 of directive as:

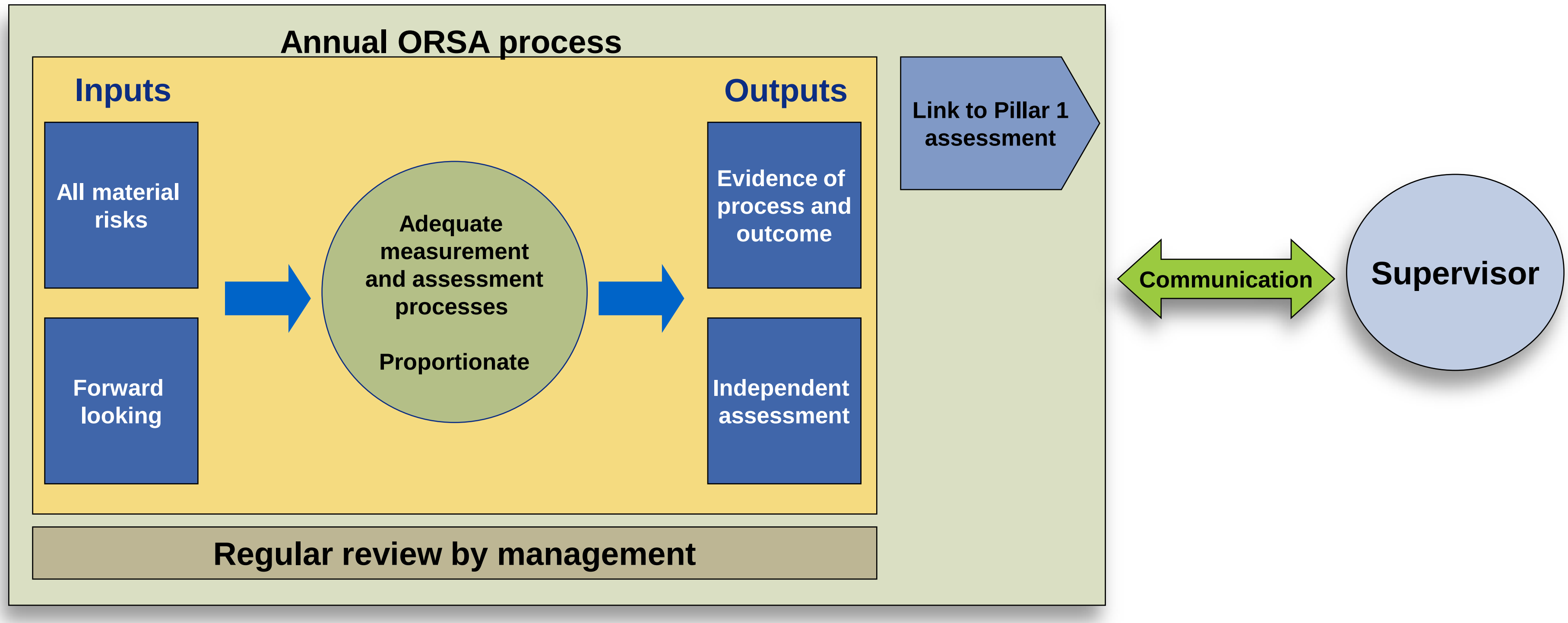
- Design and implementation
- Testing and validation
- Documentation
- Analysing and reporting on the performance
- Liaise closely with users and suggest improvements

Many of these responsibilities currently sit within actuarial function

Pillar II: Demonstrating an Adequate System of Governance



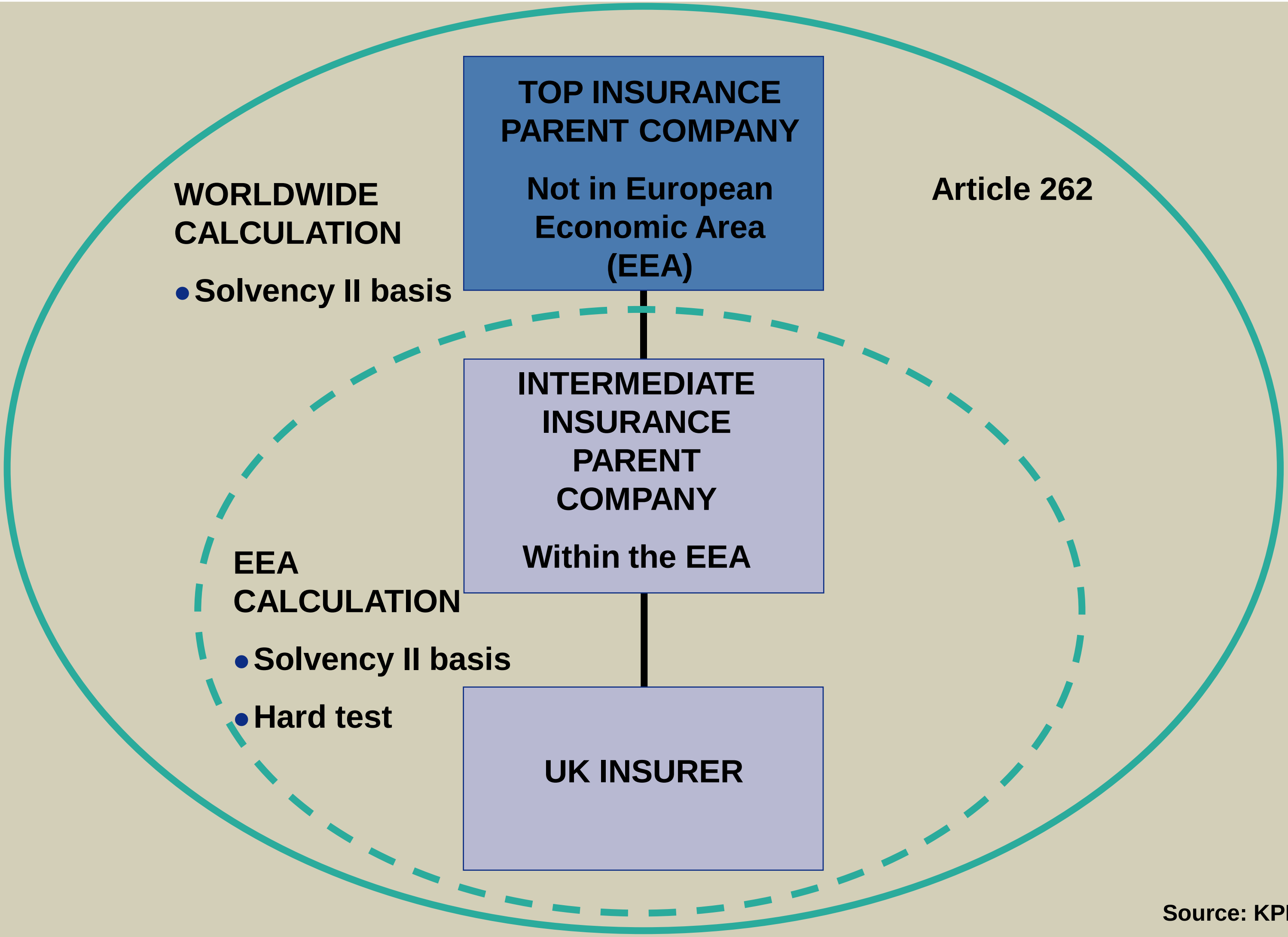
Pillar II: ORSA Overview



Pillar III: Public Disclosure and Regulatory Requirements

Private Reporting to Supervisors	Public Disclosure
Return to Supervisors (RTS) ■ Full RTS or material change RTS ■ Full at least every 5 years **Quantitative reporting forms (QRT)** ■ Annual ■ Quarterly to support MCR calculation	**Solvency and Financial Condition Report (SFCR)** **Extracts from Quantitative reporting forms (QRT)** ***(Note: must have a policy on public disclosure)***

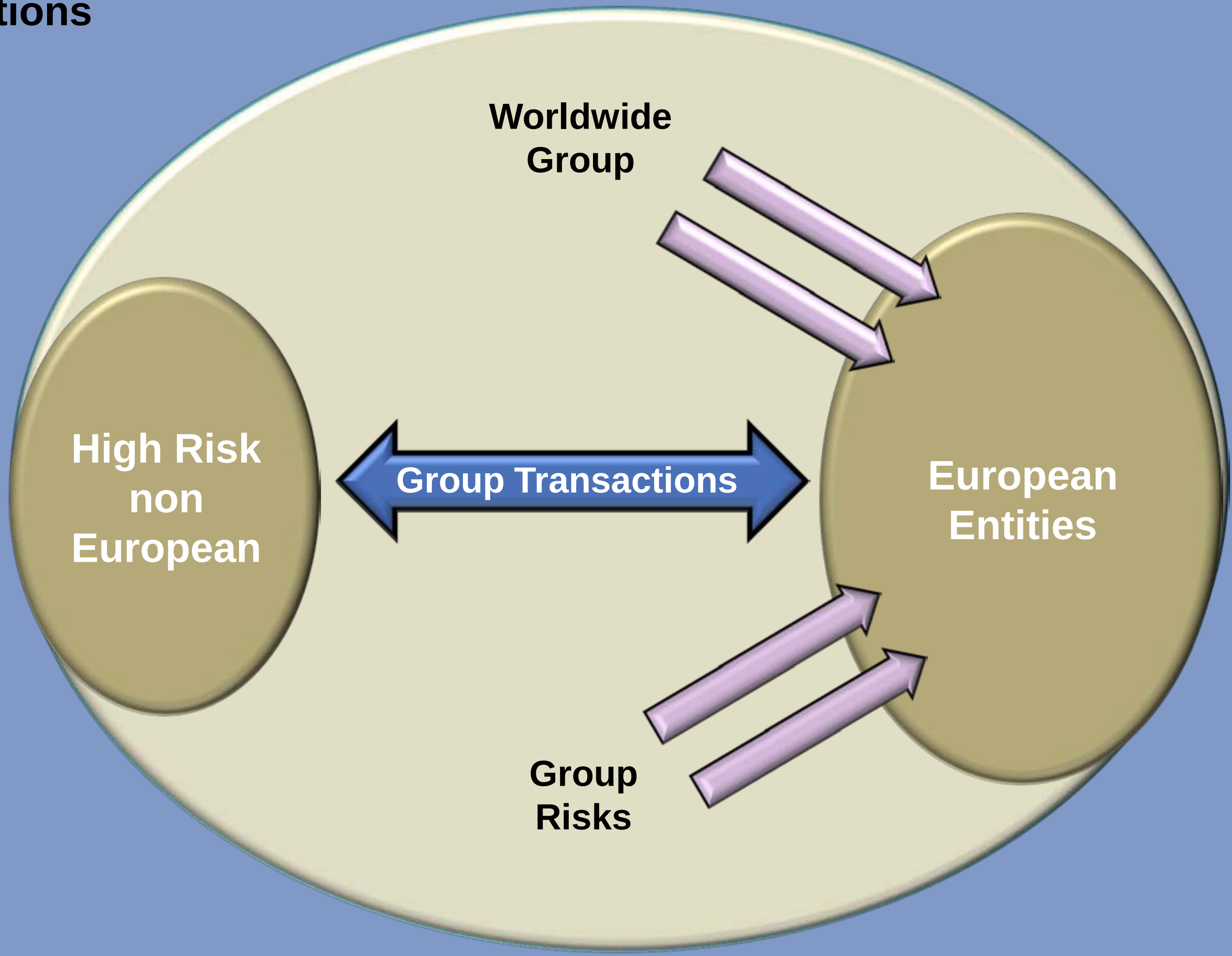
Group Supervision - Non European Economic Area Parent (Non EEA), Not Equivalent



Source: KPMG LLP (UK)

Group Supervision: Aims of the Regime under Solvency II

Key Considerations



Why should US Insurance Industry Care about Solvency II?

- US Subsidiaries of an EU Parent
- EU Subsidiaries of a US Parent
- Competitive Environment
- Rating Agencies
- Regulatory Change

Solvency II: How Does it Affect US Insurers?

Pillar 1:
Quantitative capital requirements

- Market-consistent valuation
- Own funds
- Economic risk based capital requirements
  - Minimum (MCR)
  - Solvency (SCR)
- Groups

Pillar 2:
Qualitative supervisory review

- Internal controls and risk management
- Required functions
- Own risk and solvency assessment (ORSA)
- Supervisory review
- Capital add-ons

Pillar 3:
Market discipline

- Transparency
- Disclosure
- Solvency and financial condition report

- Use of economic capital models becomes standard outside U.S. – could apply pressure for global companies
- Cost of capital: IFRS

- Sophisticated ERM will be widely implemented
- Competitive advantage of SII compliant insurers
- Rating agency pressure

- Some pressure from analyst to provide similar information
- Regulators may require

Rating agencies are streamlining their approach for Solvency II

"More significantly, the enterprise risk management criteria we launched in 2005 will be aligned with the risk management reviews under Solvency II's supervisory review requirements under Pillar 2.

Furthermore, we are now introducing economic capital analysis, which will overlap with supervisors'"

Standard & Poor's. February 2009

- **Solvency II raises the bar for risk and return management**
- **Competitors with European links will invest in modern ERM**
- **Indirect influence on the US market due to rating companies**

Concluding Remarks: The Road Ahead

- Implementation of Economic Risk Based Capital will be a significant step forward in delivering more risk based capital management and will help to meet the challenges of Solvency II.

- A considerable amount of resource and expense is still required to have a fully integrated approved model. The capital benefits are significant.

- A strong risk management culture will ensure risks are understood, controlled and effectively communicated. Effective ERM will be a key driver in achieving Solvency II.

- It is crucial that capital and risk management is embedded into the business. It is the DNA of an insurance Company.

- Return on risk adjusted capital should be a key driver in the remuneration of underwriters and management.

- While Solvency II is an EU regulatory initiative, will have both direct and indirect implications to the U.S. insurance industry.

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Questions or Comments?

Thank You

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