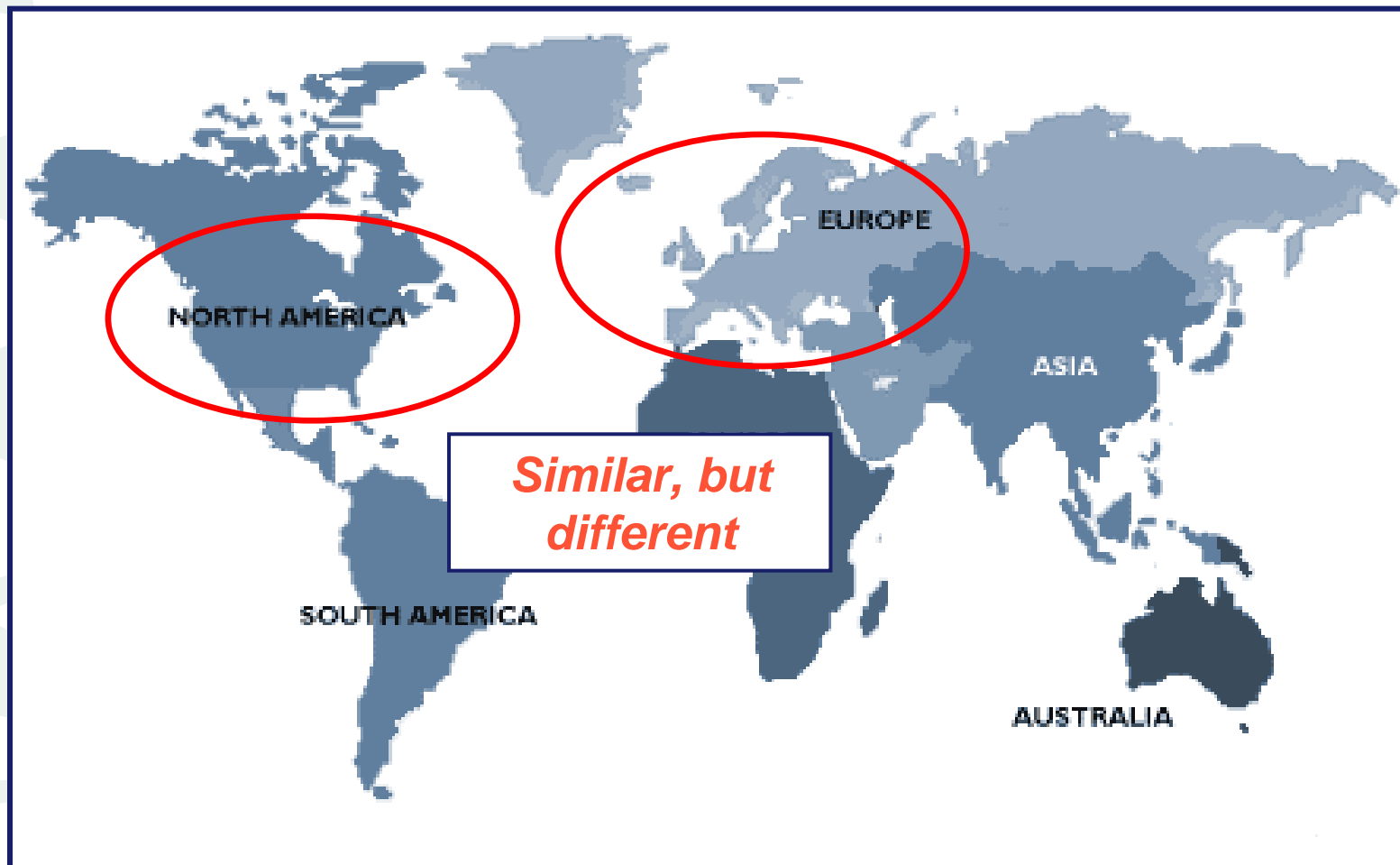


Solvency 2 - the new prudential regime in Europe

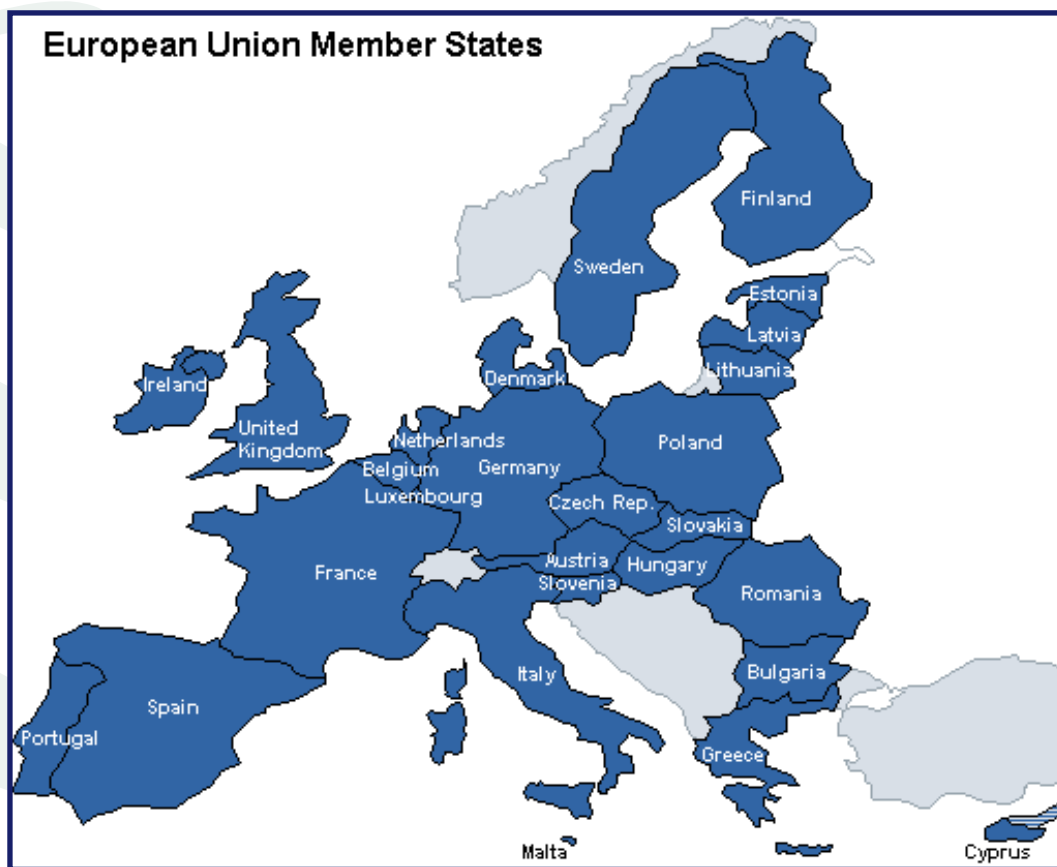
18 November 2009

**Kathryn Morgan
Financial Services Authority, United Kingdom**

Europe.....



European Union....



- 27 countries
- 23 languages
- Economic union
- Social union
- 30 countries in the European Economic Area
- Different legal systems

European Union statistics



- **> 500m people**
- **20% of GWP**
- **\$19,000bn GDP – services 70% of this**
- **Largest exporter in the world**

- **5,200 insurance companies**
- **41% of world insurance premium**
- **> €1,000 bn of premiums**

- **Key decision makers:**
 - European parliament
 - Council / Council of Ministers / Council of the European Union / Consilium
- **Strategy setters:**
 - European Commission
 - European Council (council of all the heads of state)

European Union in practice



- **EU Commission proposes and drafts**
- **Parliament and Council amend and agree**
 - Rules on who has to agree what and when
 - Voting rules based on population size
 - Voting depends on the issue
- **Lots of consultation of stakeholders**
- **Cost benefit analyses**
- **EU laws adopted into local laws – deadline for this**
- **Fines paid if not done, or not followed locally**

- **Financial services action plan**
 - A single wholesale market
 - An open and secure retail market
 - State of the art prudential rules and supervision (Solvency II is in here)
- **Committees of wise men**

Lamfalussy process



- Process for producing EU financial services legislation that can cope with rapidly changing technical standards



- Four-level approach:

- **Level 1: framework principles** – instrument that sets out essential framework principles, including implementing powers for detailed measures at Level 2
- **Level 2: implementing measures** – this involves making more detailed implementing measures (prepared by the Commission)
- **Level 3: cooperation** – Committees work on joint interpretation recommendations, consistent guidelines and common standards (incl. peer reviews and comparisons of regulatory practices)
- **Level 4: enforcement** – ensuring consistent application of the regime across the community

Solvency II



- **Solvency I tidied up the current rules**
- **BUT:**
 - Formula approach to minimum capital
 - Not risk-based
 - Many countries had higher individual capital requirements
 - No group supervision

Why do we need Solvency II?



“Solvency 2 is a fundamental review of the solvency and risk management standards for the European insurance industry aiming to strengthen the prudential regulation of the insurance sector.”

- **Desire to harmonise consumer protection across the EU**

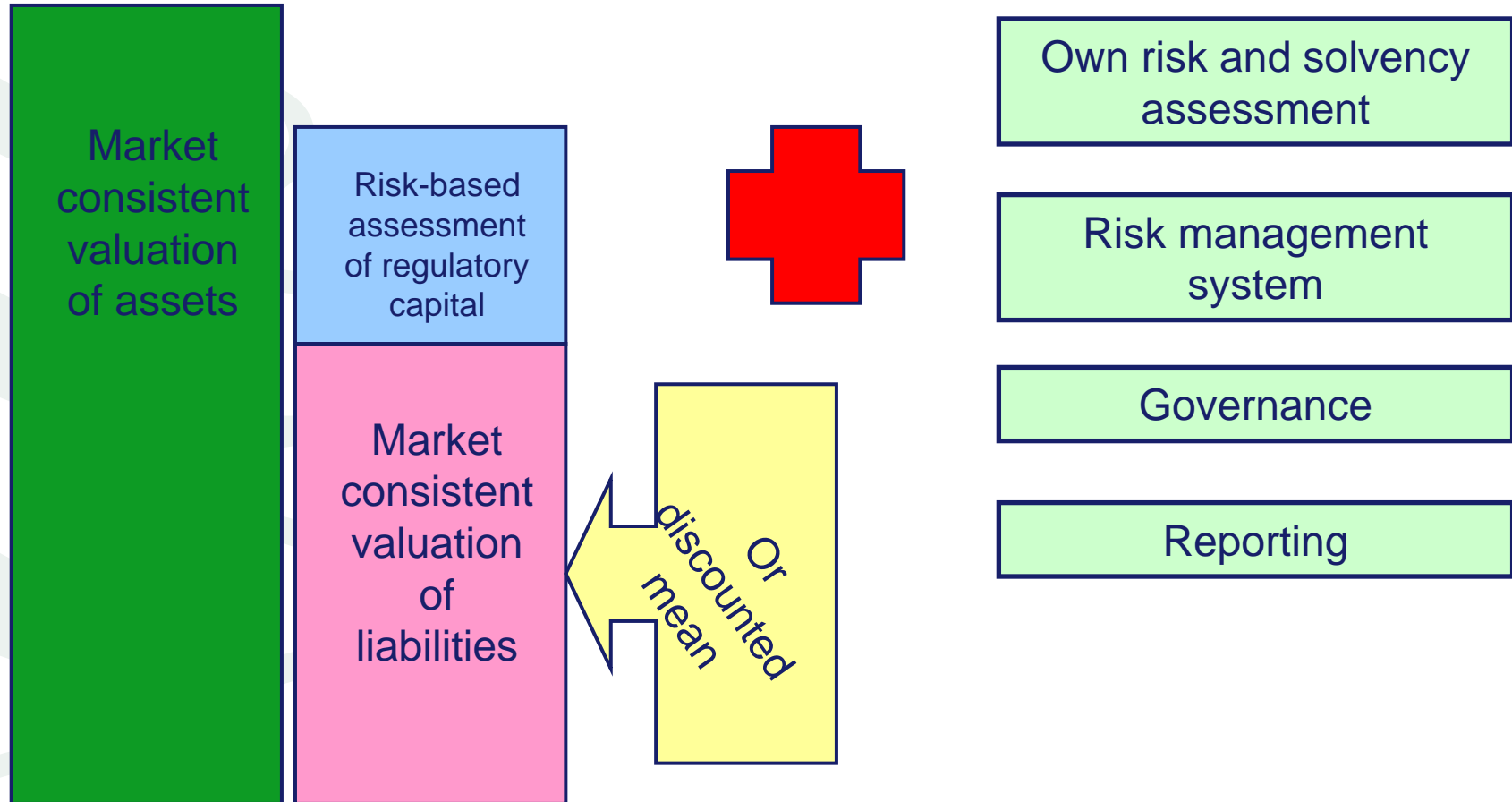
- The strengthened regime should reduce the possibility of consumer loss or market disruption in insurance

- **With harmonised regulation, well-run insurers enjoy a competitive advantage**

- **Solvency II is principles-based and risk-based (calculated at the 1/200 one-year VaR level)**

- Solvency 2 will set out new, strengthened EU-wide requirements on capital adequacy and risk management for insurers with a view to reducing the likelihood of an insurer failing

Solvency II



Interesting bits



- **Technical provisions have to be the mean**
- **The law requires 99.5% one-year VaR capital**
 - Calculate using a pan-EU standard formula
 - Risk-based, complex, allows for diversification effects
 - OR use the standard formula with firm specific parameters
 - OR use an internal model
 - OR a combination
- **Regulatory capital should reflect the risk profile**
- **AND be consistent**

- **Actuarial function (Article 48)**
 - Technical provisions
 - Co-ordinate
 - Appropriate methods and models
 - Data
 - Communicate
 - Opinion on underwriting policy
 - Effective risk management system
 - Professional standards

Implications for European actuaries



- **Actuarial function does not have to be done by actuaries**
- **Consistent standards across the European Union**
- **Groupe Consultatif working on this with industry and regulators**

- **More research needed on technical provisions**
- **Building internal models is hard:**
 - Use test
 - Governance
 - Statistical quality
 - Calibration
 - Validation
 - Documentation

Implications for non-European actuaries



- **Working in groups with EU business / subsidiaries**
- **Reinsurance of EU companies**
- **Solvency II is “state of the art” - it will spread**

Where are we now in the great adventure?



- **It starts on 1 November 2012**
- **The legislation is agreed and final**
- **The European Commission is being advised on the detail underlying the legislation – 4,000 pages of advice**
- **The “level 3 committee” – CEIOPS – is planning the details of guidance for supervisors**
- **Firms are spending heavily**

Useful links



Legal text:

<http://register.consilium.europa.eu/pdf/en/09/st03/st03643-re01.en09.pdf>

FSA pages:

<http://www.fsa.gov.uk/pages/About/What/International/solvency/index.shtml>

CEIOPS pages:

<http://www.ceiops.eu/>

Groupe Consultatif pages:

<http://www.gcactuaries.org/solvency.html>

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