



Solvency regulation in EU and US

A comparison of impacts to ERM

A presentation to Casualty Loss Reserving Seminar

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September 17, 2013

TOWERS WATSON 

As companies invest considerable resources in Solvency II, how can the US benefit from the EU experience and vice versa?

- Using the results of our ERM Survey we will be trying to understand the main differences in ERM approaches between US and EU
- We will present a comparison between US and EU of the current perception in terms of impact on:
 - Level of capital
 - Areas of investments and priorities
 - Business
- We will also present some of the challenges that companies in EU experienced in embedding internal models in business decisions

Towers Watson has conducted its seventh biennial survey on Enterprise Risk Management in the insurance sector

- During the third quarter of 2012, we surveyed insurance executives around the world
- This is the largest insurance industry ERM survey; roughly 70% of the total 539 respondents were C-suite
- Respondents include a wide range of insurance organizations from North America (37%), Europe (25%), Asia-Pacific (31%), Latin America (5%) and Middle East and Africa (2%)
- Respondents come from many lines of business, including life insurance (41%), property & casualty (P&C) insurance (25%), multiline insurers (18%) and reinsurance (11%)
- We present here the results limited to P&C companies and the differences between the EU and US

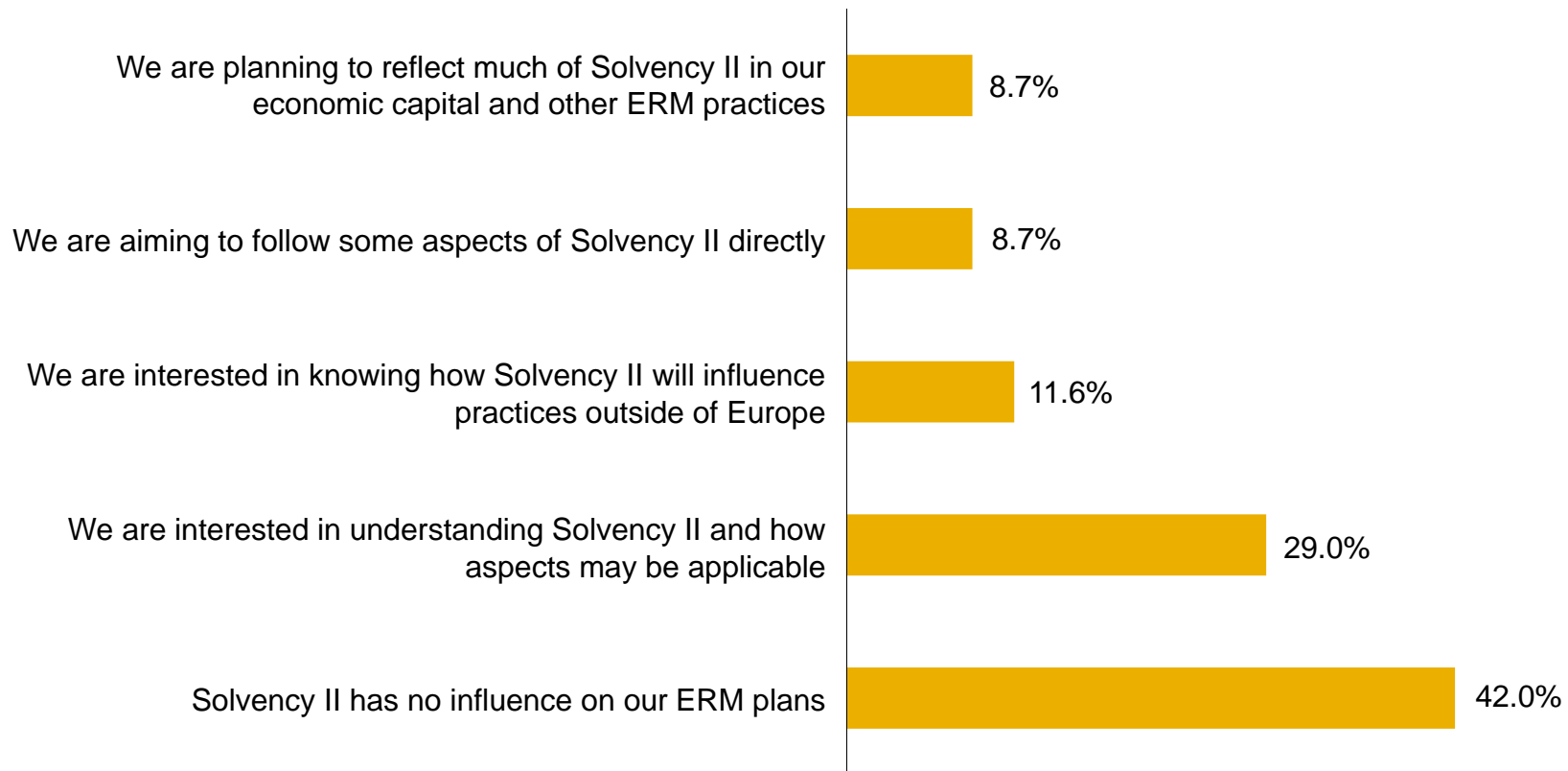
Geographical Terms

- North America: U.S., Canada and Bermuda
- Europe: U.K. and continental Europe
- Asia/Pacific: Asia and Australia
- Latin America: Mexico and South America
- Middle East/Africa: Middle East and Africa

Annual Revenue Size Terms

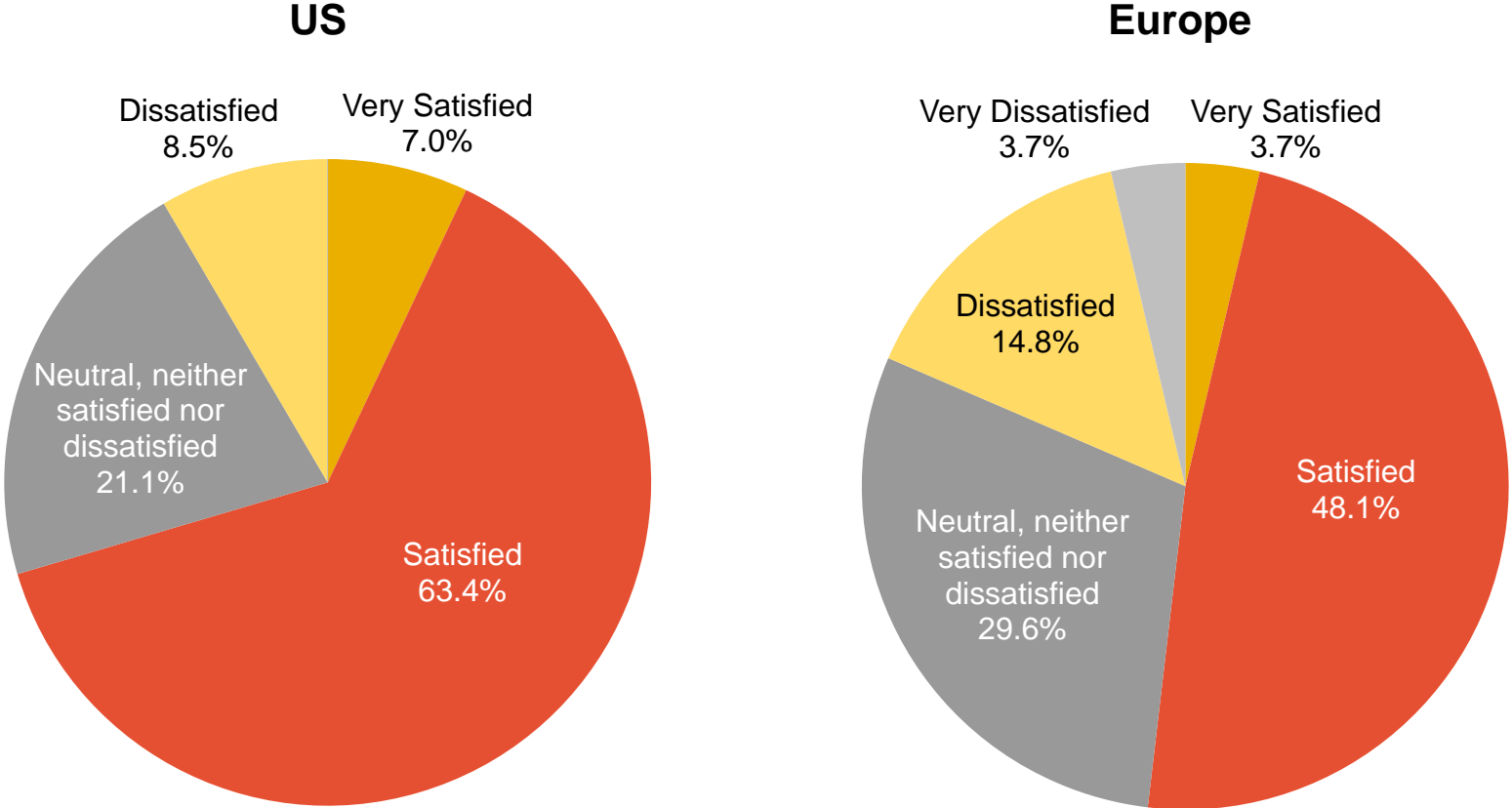
- Large: > \$10 billion
- Medium: \$1 billion to \$10 billion
- Small: < \$1 billion

The US is looking with interest at SII; however, influence on US ERM practices remains relatively low



Base: United States insurers for **US.3. To what extent are you recognizing Solvency II in developing your ERM practices?**

US companies are more satisfied with ERM compared to the EU, but on both sides of the pond few companies are very satisfied

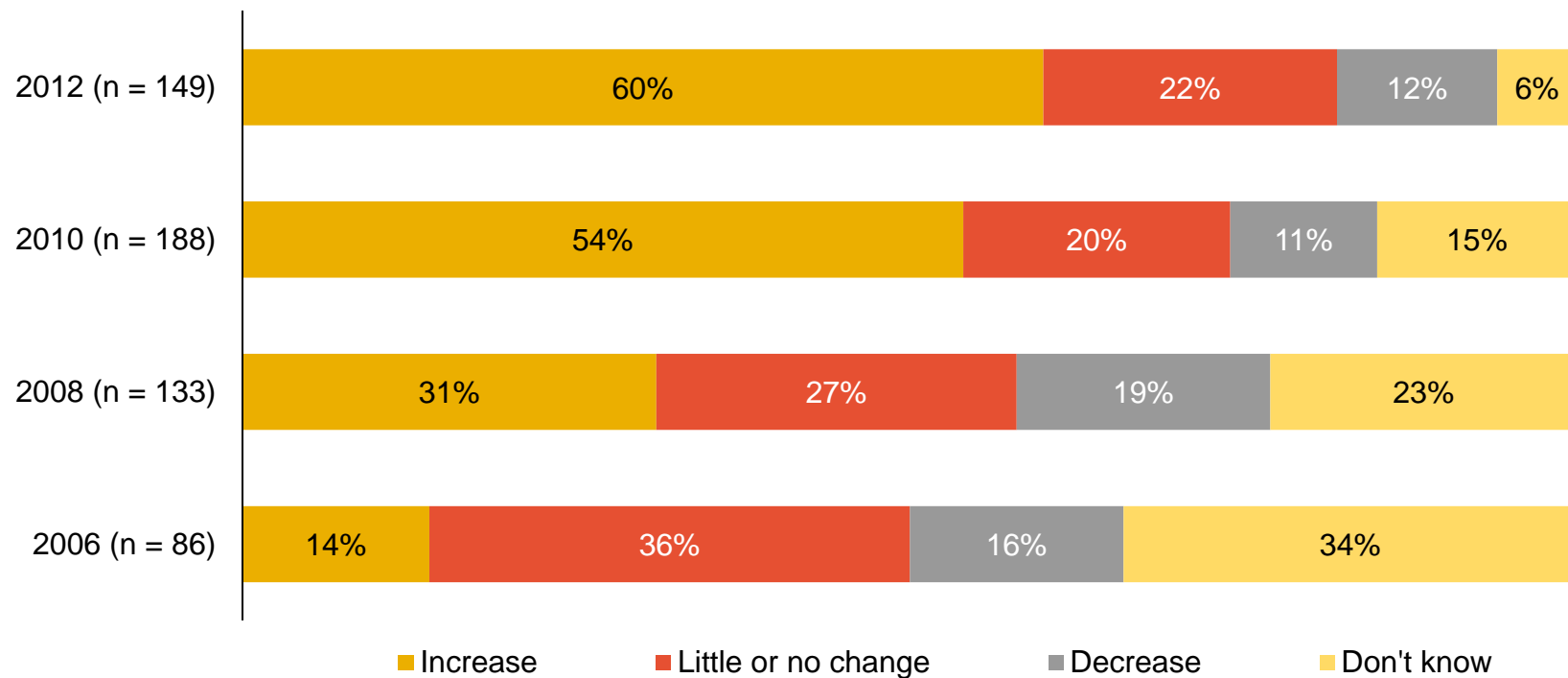


Overall satisfaction is defined as either “satisfied” or “very satisfied.”

Base: Q.1. How satisfied have you been with the performance of your ERM capabilities over the last 24 months?

Most EU participants expect increasing capital requirements from Solvency II — this picture changed dramatically over the years

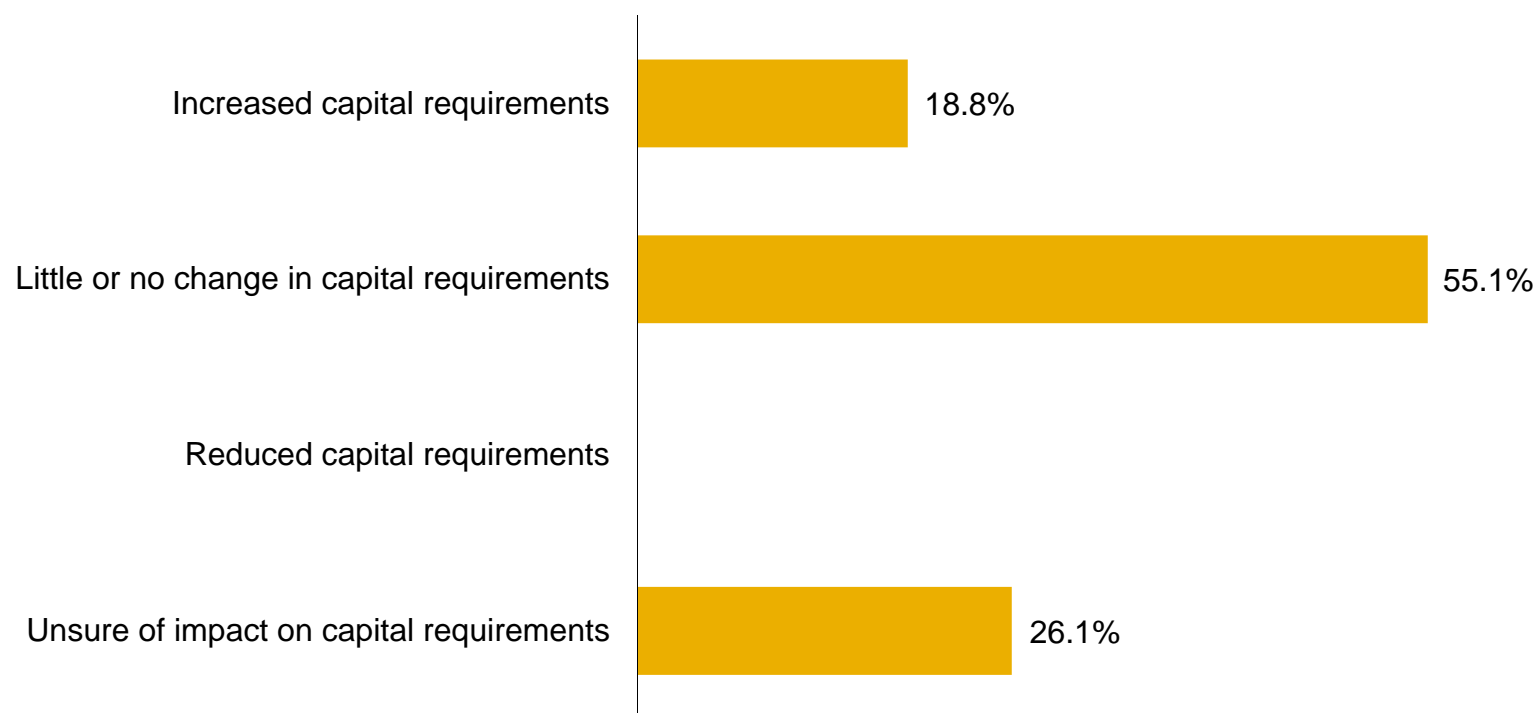
- Within **large** organizations, relatively fewer participants expect an increase in capital requirements (50%), with relatively more expecting little or no change (39%)



Base: European Economic Area insurers for **S.1. What effect do you expect Solvency II to have on the level of capital your business is required to hold?**

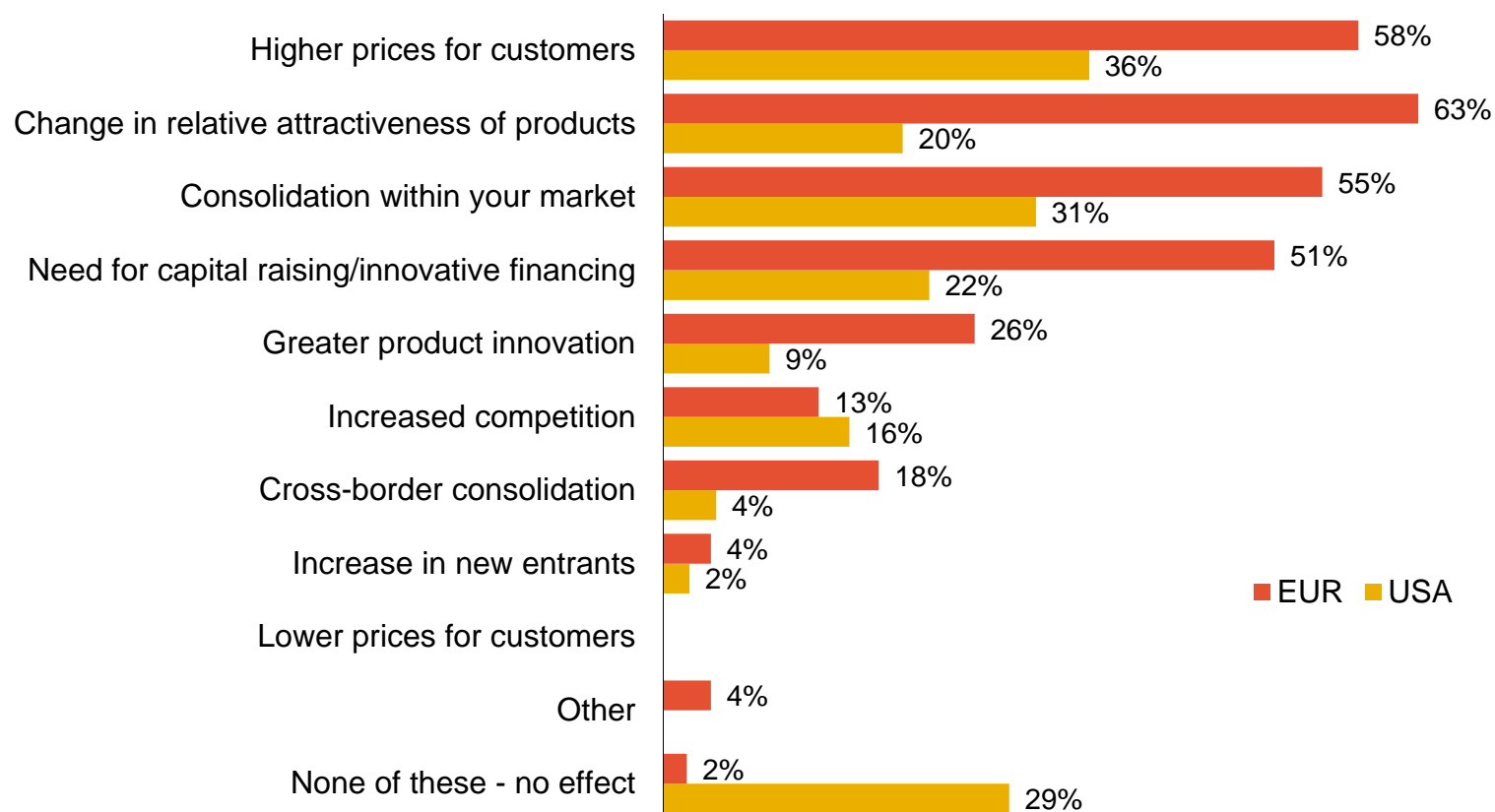
In the US there is a completely different picture, with companies expecting little change or being still undecided

- This can be due to a number of reasons, including timing of calculations? Different roles of rating agencies? Others?



Base: United States insurers for **US.1. What effect do you expect the current change in the regulatory system in the United States (e.g., US NAIC SMI) to have on the level of capital your business is required to hold?**

However, regulatory changes are expected to impact various aspects of the business

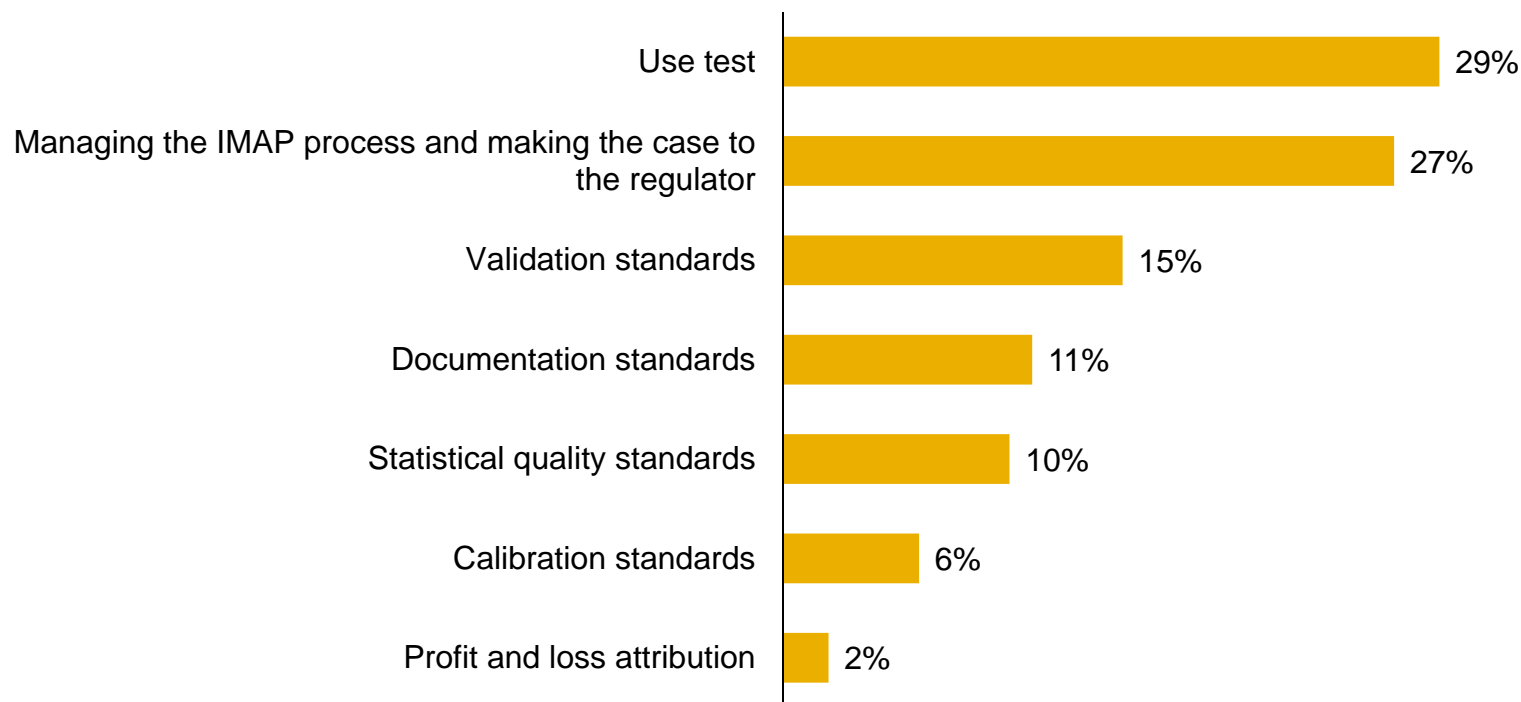


Base: European Economic Area insurers giving a valid answer (percentages exclude “don’t know”) for **S.2. What do you believe will be the main effects of Solvency II on your market? Please select all that apply.**

Base: United States insurers giving a valid answer (percentages exclude “don’t know”) for **US.2. What do you believe will be the main effects of these current regulatory changes on your market? Please select all that apply.**

The “use test” is still seen as the most challenging requirement for EU internal model approval

- Many companies recognize that managing the process and successfully making the case to the regulator are also very challenging
- The less prescriptive US approach will make embedding models in business decisions easier



Base: European Economic Area insurers using or planning to use internal models for S.5. Which of the following requirements do you see as the most challenging area for achieving internal model approval? *Please select only one.*

What we are seeing in the market

Main challenges in embedding the internal model

Limited involvement of senior management on how the model is used

No common understanding of the expected risk attitudes and behaviors

Model uses defined on paper but not fully operationalized

Excessive focus on technical areas of model, e.g., calibration, parameterization, validation

Board/Senior management questioning business benefit of SII

What needs to change to generate value?

Business Processes

- Adapt/align current business processes to consider model output
- Robust governance of data inputs, processes and outputs
- Adapt/align current governance structures to support use of model
- Set up clear roles and responsibilities

People and Behaviors

- Risk culture that promotes effective risk identification and management
- Positive behaviors toward risk are encouraged by senior management
- Understanding of model operation, limitations and outputs
- Communication flow between the actuarial team and the rest of the business

Systems and IT

- Systems capable of producing information at the right level of detail
- Flexible systems capable of producing timely information
- Models can be run and output generated and reviewed in time to meet business expectations

What are the value outcomes?

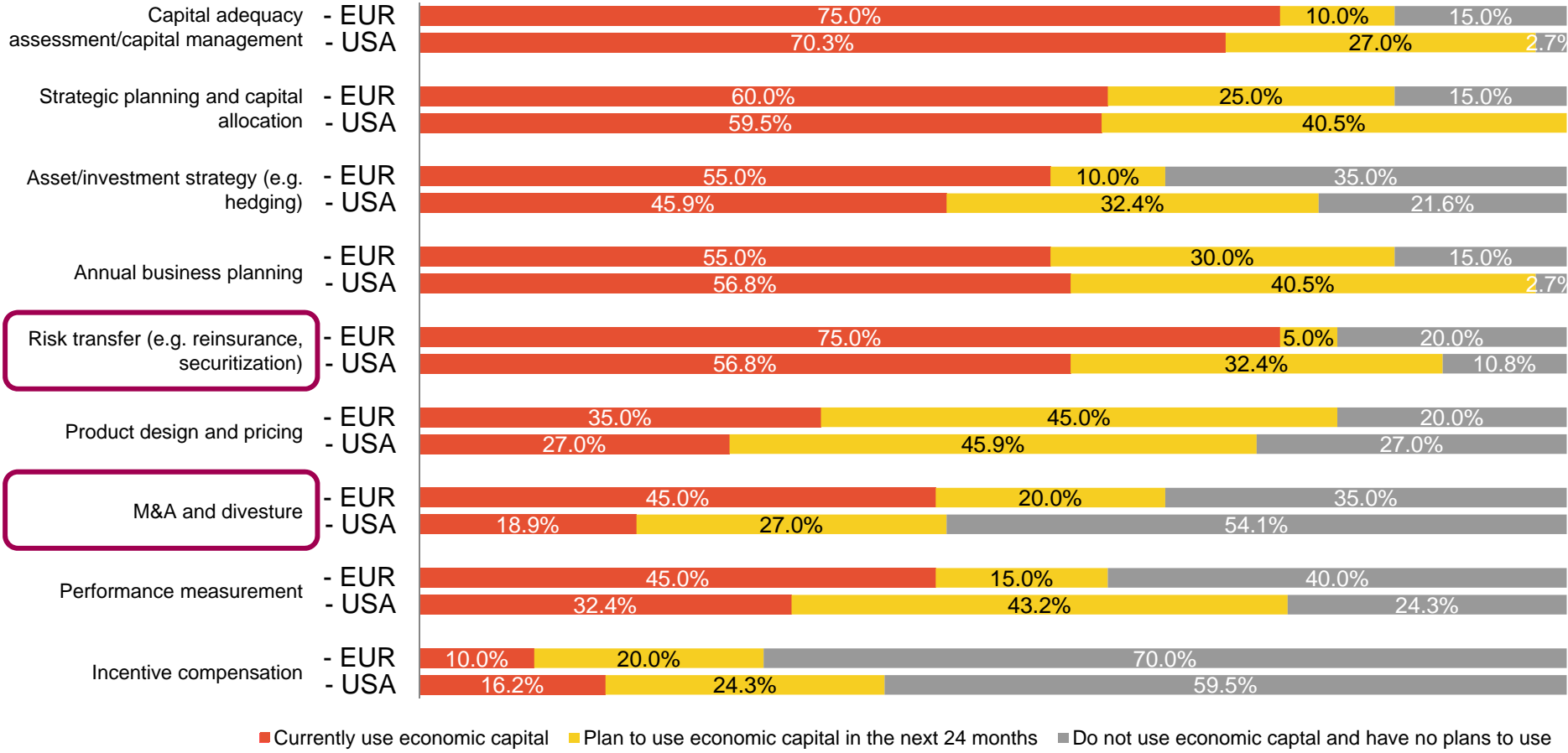
“Better business”

- Risk appetite is clearly **defined, communicated and linked** to business strategy
- Better **understanding** of the key risk drivers
- **More informed** basis for key business decisions
- The right **attitudes and behaviors** are promoted and encouraged
- **Governance framework** that promotes the use of the risk model
- **Timely and flexible** management information in a “user friendly” format

“Bottom Line” wins

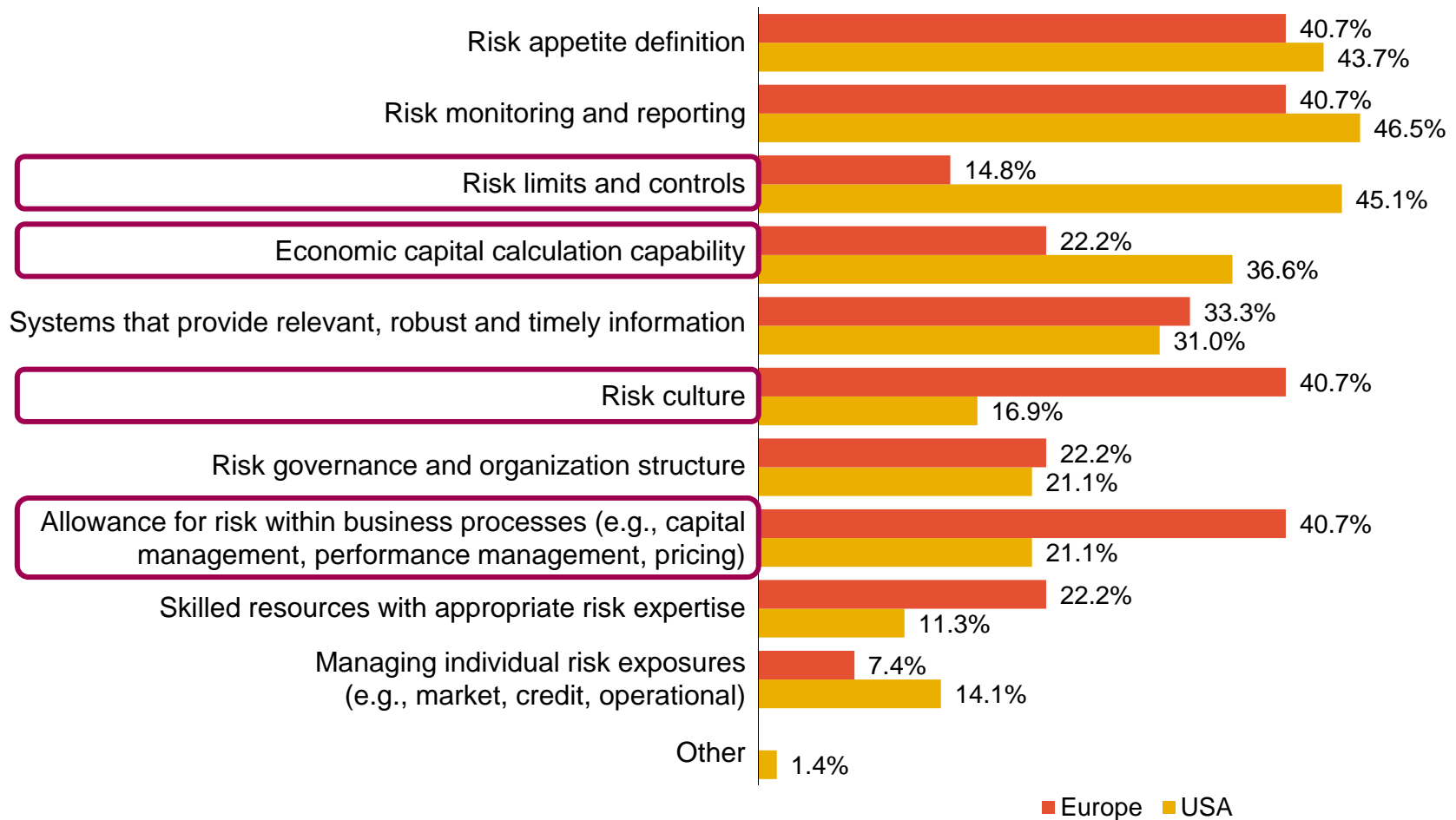
- **Cost-effective** reinsurance program
- **Optimized** asset portfolio
- **Improved** business strategy setting
- **More robust business plans** (e.g., capital implication of alternate plans)
- **Capital efficiency** (e.g., diversification benefits)

Economic capital is currently used in a broad range of business decisions, with some notable differences in EU and US



Base: Those calculating economic capital for Q.33. Do you currently use economic capital in decision making for the following areas, or plan to use it in the next 24 months? Please select one in each row.

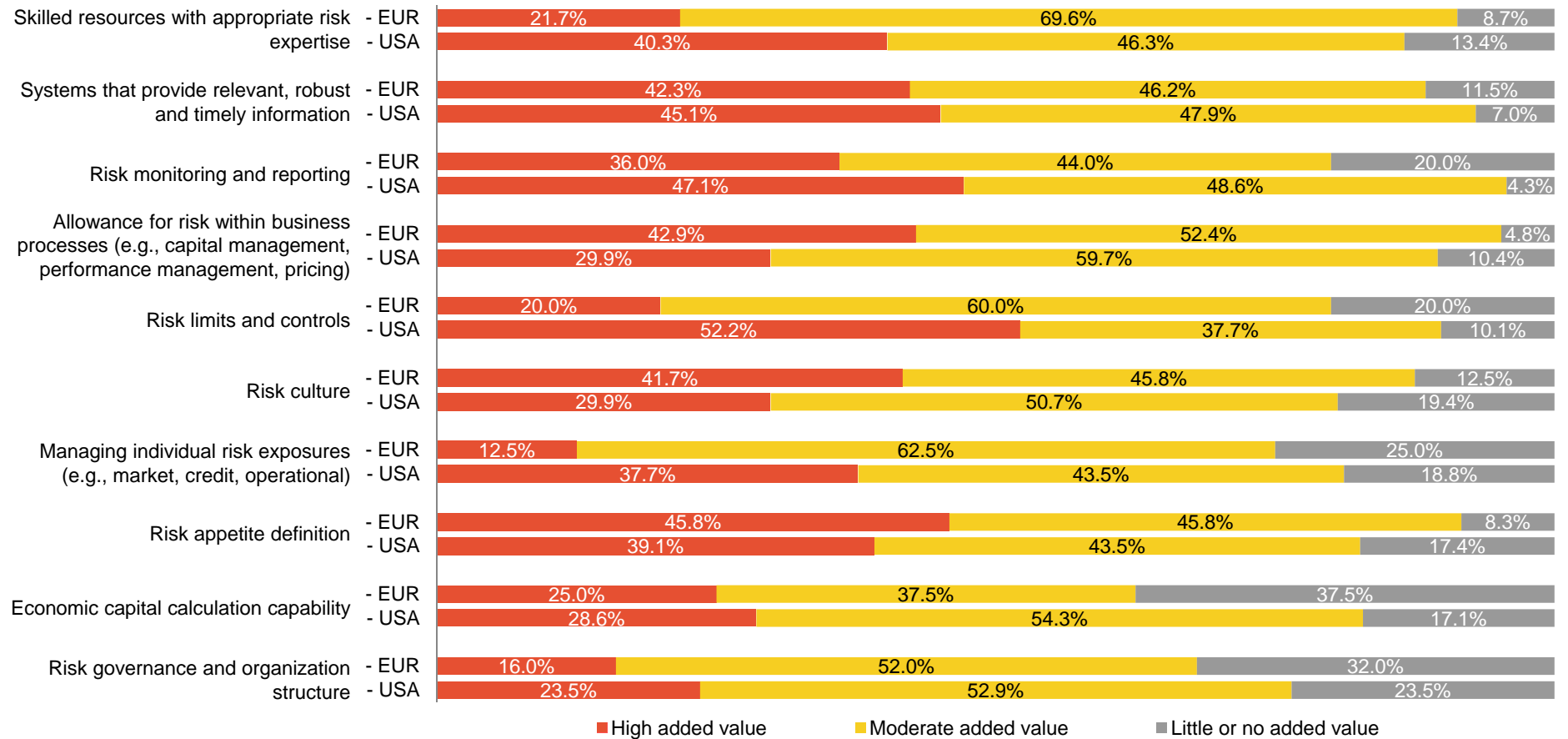
Many of the ERM priorities differ between US and Europe...



Base: Q.6. What are your top ERM development or improvement priorities for 2012–2013? Please select up to three.

...and this is reflected in planned investments

- Skilled resources and robust risk information systems rank highest in terms of potential added value



Base: Q.7. Given your organization's current state, how would you characterize the potential added value to the business from additional investment in the following ERM areas? Please select one in each row.

Conclusions

- Different timing in the EU and the US has an impact on priorities of investments for EU and the US
- The US is interested in what has been done with EU regulation and vice versa. US companies with a presence in Europe may have an easier path to implementing NAIC ORSA
- Perceptions of the capital requirement are currently different on the two sides of the pond. Will this change in the future?
- Embedding capital models into an effective business decision process will be the most challenging task. The less prescriptive approach taken by NAIC ORSA might favor this process in the US