

# SOLVENCY II: AN OVERVIEW

LLOYD'S  
JULY 2010

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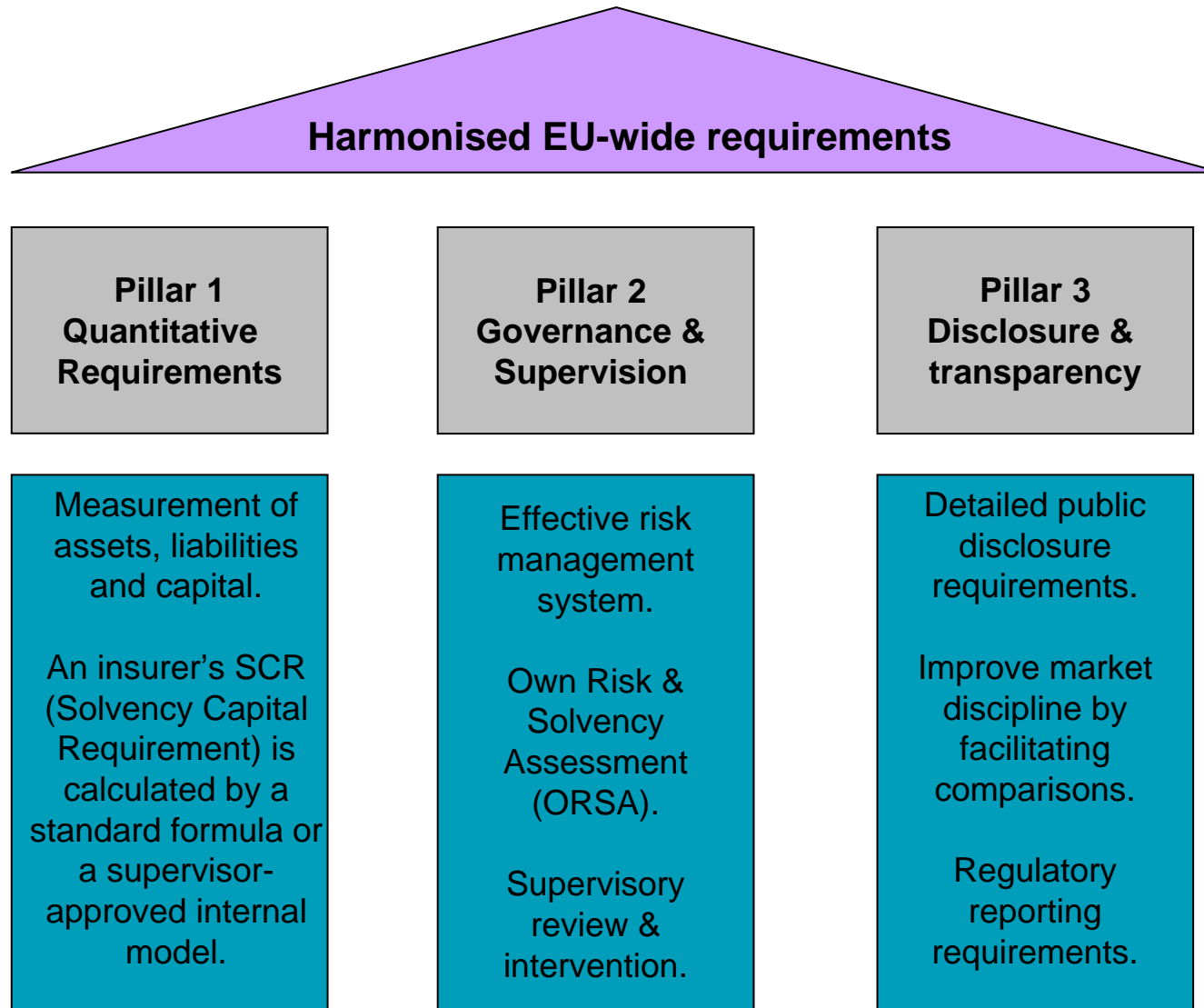
- **Solvency II: key features**
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# **SOLVENCY II: KEY FEATURES**

# Solvency II – the basics...

- Introduces a **new, harmonised EU-wide regulatory regime**.
- **Replaces 14** existing insurance directives.
- **No substantive changes** to existing provisions apart from those “**necessary** in order to introduce the **new solvency regime**”.
- Objectives:
  - **Greater risk awareness** in governance and operations.
  - **Deeper** integration of EU insurance market.
  - **Enhanced** policyholder protection.
  - **Improved** competitiveness of EU insurers.

# Solvency II is based on a three-pillar approach



# Key features of Solvency II

- **Economic risk-based solvency requirements...**
  - ...insurers required to hold capital against a range of risks, not just insurance risks.
- **Total balance sheet type regime...**
  - ..all the risks and their interactions considered.
- Insurers required to **identify, measure and proactively manage risks...**
- ...introduction of Own Risk and Solvency Assessment (**ORSA**).
- **Supervisory Review Process.**
- **Greater public disclosure.**
- Strengthened role for **group supervisor.**

**“SOLVENCY II IS NOT JUST ABOUT CAPITAL. IT IS A CHANGE OF BEHAVIOUR”.**

**THOMAS STEFFEN, FORMER CHAIRMAN OF CEIOPS**

# LEGISLATIVE PROCESS



# Legislative structure

- Developed in accordance with the EU's "**Lamfalussy process**":
  - **Level 1 – Framework Directive**
    - Sets out key principles.
    - Adopted via co-decision: by European Parliament and Council.
  - **Level 2 – Implementing Measures**
    - Detailed requirements.
    - Tested through QISs (Quantitative Impact Studies).
  - **Level 3 – Supervisory co-operation** to ensure harmonised outcome
  - **Level 4 – Post-implementation enforcement**

# Countdown to Solvency II

- November 2009 – **Framework Directive** adopted.
- December 2011 – Adoption of **Implementing Measures**.
- December 2011 – Delivery of **Level 3 Guidelines**.
- By January 2013 – Transposition of the Directive into **national laws**.



# **SOLVENCY II IMPLEMENTATION**

# Pillar 1 requires demonstration of adequate financial resources

- **Minimum Capital Requirement (MCR)**
  - Below the MCR, **policyholders** are exposed to **unacceptable risk**.
  - **Breaching the MCR** leads to serious supervisory action.
  - Calculation method yet to be finalised.
- **Solvency Capital Requirement (SCR)**
  - At a **confidence level** of **99.5%** over one year.
  - May be calculated using **standard formula...**
  - ...or an **internal model**, with supervisory approval.
  - Both calculation methods take at least **six specified risk modules** into account.

# The SCR can be calculated in 2 ways ...

## **The standard formula**

- Detailed in Solvency II rules
- The default option
- Formulaic factor based calculation
- Not “firm” specific
- A means of calculating SCR only – no wider significance

vs

## **The internal model**

- Standards set out in Solvency II rules
- Regulator pre-approval required
- Specific to individual firm and risk profile
- Can be partial or full
- Must be widely used and play an important part in firm’s system of governance

# Pillar 2 includes developing and embedding governance requirements

- An insurer must have an **effective risk management system...**
  - ...owned and implemented by **senior management**.
  - Must consider **all risks** to which insurer is exposed.
  - **Risk** and **capital** management must be **integrated**.
- An insurer must undertake an **Own Risk and Solvency Assessment (ORSA)**.
  - **Internal risk assessment process**.
  - Aims to ensure senior management have conducted a review of risks...
  - ...and that the insurer holds **sufficient capital** against those risks.

## Pillar 3: harnessing market discipline to support regulatory objectives

- Aims to ensure **consistent supervisory reporting and disclosure** across the EU.
- Detailed harmonised reporting requirements still to be finalised.
- Insurers should be prepared to **disclose more information publicly** than at present.
- The requirement will include producing:
  - Public, annual **Solvency and Financial Condition Report (SFCR)**;
  - **Report to Supervisors (RTS)** on a quarterly/annual basis.

# FSA: Solvency II preparation requires input from across a business

|                       | Key Messages | Governance & Reporting | Financial resources | Internal models | Implications for supervision |
|-----------------------|--------------|------------------------|---------------------|-----------------|------------------------------|
| Board and senior mgmt | XXXXXX       | XXXXXX                 | X                   | X               | X                            |
| Risk Management       | XXXXXX       | XXXXXX                 | XX                  | XXXX            | XXX                          |
| Finances              | XXXXXX       | XXXX                   | XXXXXX              | XXX             | XX                           |
| Actuarial             | XXXXXX       | XXXX                   | XXXXXX              | XXXXXX          | XXX                          |
| Internal Audit        | XX           | XX                     | X                   | X               | X                            |

**XXXXXX** Action  
**XXXX** Key Responsibility  
**XXX** Active Involvement

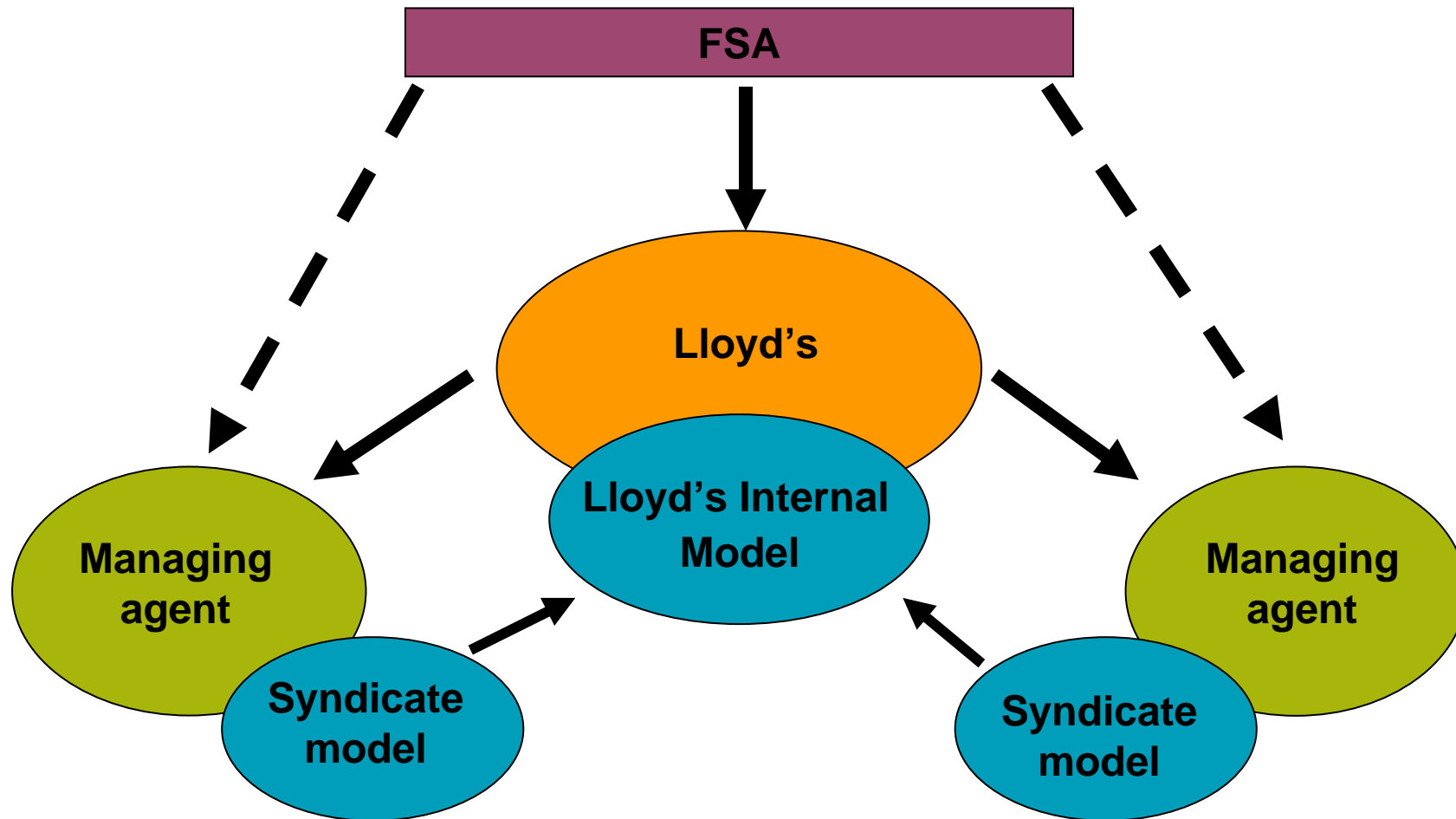
**XX** Contribute  
**X** Be aware



# Solvency II and Lloyd's

- Framework Directive continues to treat Lloyd's as a single entity - the “**Association of underwriters known as Lloyd's**”...
- ...So Solvency II capital requirements **apply to Lloyd's as a whole**.
- Lloyd's will seek FSA **approval** for an **internal model**...
  - ...And **syndicate internal models** will be key components of Lloyd's internal model.
- Current capital regime - UK **ICAS**.
  - Lloyd's experience of ICAS will help it to meet Solvency II.
- Importance of **Letters of Credit** recognised.
- Ongoing discussions with the FSA about the implementation of Solvency II at Lloyd's.

# Solvency II and Lloyd's: internal model



# Solvency II - Conclusions

- *“We are setting a world-leading standard that requires insurers to focus on managing all the risks they face and enables them to operate much more efficiently. It’s good news for consumers, for the insurance industry and for the EU economy as a whole.”*

*Charlie McCreevy, Former EU Internal Market and Services Commissioner*

- Solvency II is a major programme of regulatory change for the EU insurance industry.
- But it will also have an impact on insurers worldwide.
- Qualitative aspects are as important as the numbers.
- Many important details remain to be finalised...
- ... but the industry is already engaged to ensure compliance by 2013.

