

Solvency II: An overview

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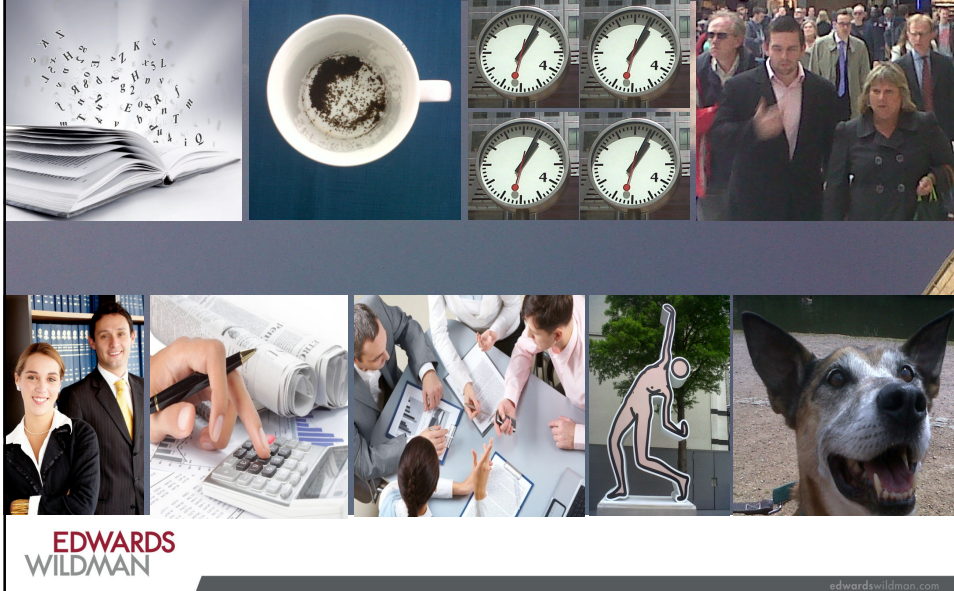
Introductory comments

- ◆ About me
- ◆ About Solvency II (why, when, who & where)
 - ◆ Costs (2009):
 - ◆ Commission: reduce surplus assets by 14.5% or €56bn
 - ◆ FSA: spend £2bn preparing for & £200m pa complying with
 - ◆ Benefits?
 - ◆ Business benefits?
 - ◆ Commission: 15% won't meet SCR & 5% won't meet MCR
 - ◆ FSA: 20% of UK won't meet SCR

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Solvency II – what you'll need to prepare:



Here comes the science Solvency II's capital requirements

The Basic Proposition

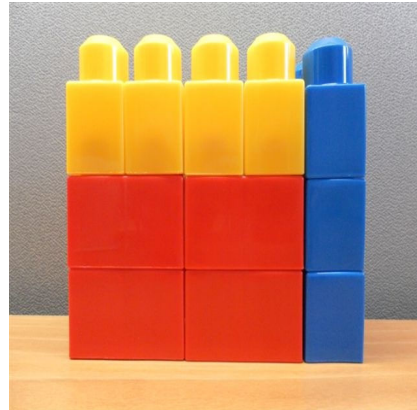
- ◆ (Re)insurers will have to
 - ◆ Calculate their:
 - ◆ technical provisions (reserves);
 - ◆ minimum capital requirement; and
 - ◆ solvency capital requirement; and
 - ◆ Hold appropriate assets against each of these things.

Here comes the science Solvency II's capital requirements

- ◆ Calculating the technical provisions
 - ◆ Prudent, reliable, objective
 - ◆ All cash in- & out-flows

Best estimate + Risk margin

Financial instrument

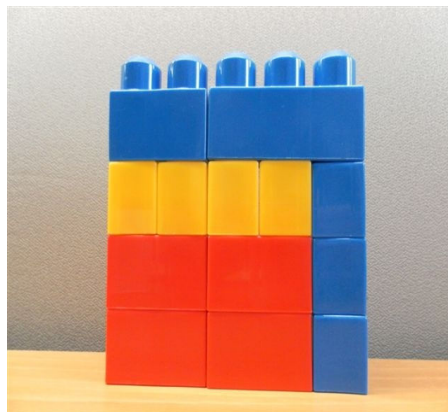


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Solvency II's capital requirements

- ◆ Calculating the minimum capital requirement (MCR)
 - ◆ Formula
 - ◆ Quarterly & 85%
 - ◆ 85% confidence
 - ◆ Floor €2.3m - €5.4m
 - ◆ Corridor 25% - 45% SCR



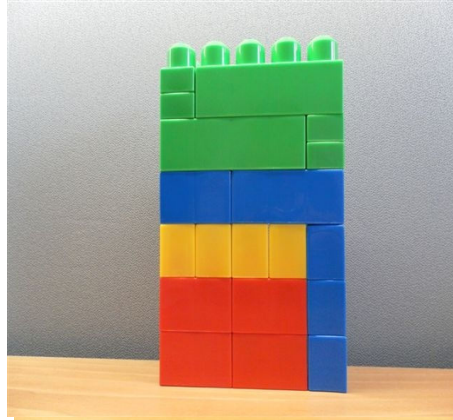
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Solvency II's capital requirements

- ◆ Calculating the SCR – annual & 99.5%

- ◆ Standard formula
 - ◆ Basic SCR +
 - ◆ Op Risk +
 - ◆ adjustment for loss absorb of TPs & tax
 - ◆ Simplification
 - ◆ USPs
- ◆ Internal model



Holding appropriate capital Categorisation

Stage 1:

- ◆ Basic own funds
 - ◆ Excess of assets over liabilities, less own shares; and
 - ◆ Subordinated debt
- ◆ Ancillary own funds
 - ◆ Not basic own funds but can still be called upon to absorb losses
 - ◆ Supervisory approval required before you can count them

Holding appropriate capital Categorisation

Stage 2:

- ◆ Deeming provisions (Directive & L2)
 - ◆ Tier 1 – Fully paid up ordinary shares & audited retained profits
 - ◆ Tier 2 – LoC, LoG, perpetual sub-debt & long dated sub-debt
 - ◆ Tier 3 – Short dated sub-debt

- ◆ No deeming provisions?
 - ◆ Characteristics – permanent availability & subordination
 - ◆ Features – perpetual or dated? requirements or incentives to redeem? mandatory fixed charges? and unencumbered?

Holding appropriate capital The reasonably prudent person principle

- * Only invest if you can identify, measure, monitor, manage, control and report the risks

- * Invest to ensure the security, quality, liquidity and profitability of the portfolio as a whole

- * Localise (α)

- * Diversify



Holding appropriate assets Technical Provisions

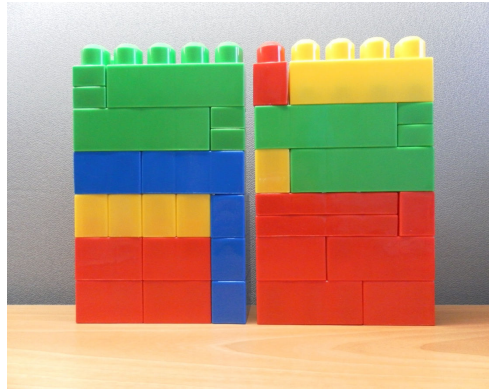
**Best interests
of all
policyholders**

Well matched
< 20% Tier 2

≥ 80% Tier 1

≥ 50% Tier 1

≤ 15% Tier 3



Pillar 2

- ◆ The key function holders – fitness and propriety
- ◆ The **risk management** function
- ◆ The **internal control** function
- ◆ The **internal audit** function
- ◆ The **actuarial** function
- ◆ All those who **effectively run the business**

Pillar 3

- ◆ Reporting to the regulator
- ◆ The Supervisory Review Process and the risk of a capital add-on
- ◆ The Solvency and Financial Condition Report
- ◆ The risks in pillar V

Impact on insurers

- ◆ Group reorganisation
- ◆ Changing investment strategy (*cf* banking)
- ◆ Shifting risk to policyholders (if and when possible)
- ◆ Review reserves
- ◆ Change premiums
- ◆ Closure, run off or sale

Who'd like to ask...

the first question?

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