



Solvabilität
Solvabilité
Οικονομική φερεγγυότητα
Solvibilità
Vakavaraisuus
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Solvency II Newsletter

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A proposal for a Framework Directive for the future new supervisory system is currently being debated in the European Parliament and the Council of the European Union. For the first time, the Lamfalussy procedure is being applied in full to proposed legislation for the insurance sector. The European Commission has requested CEIOPS to prepare implementing measures.

Current developments

Council of the European Union

Progress report from the Council of the European Union

The proposal for a Directive is currently being debated in the Council. The current status of the discussions has been published in the latest progress report.¹

One of the fundamental changes introduced in the Directive proposal concerns the supervision of insurance groups. The proposal that groups should in future be supervised by a group supervisor does not have the support of all EU member states and is therefore at the centre of discussions in the Council. A number of member states are concerned at the loss of influence over companies for the supervision and safety of which they currently have responsibility.

The principle of “capital add-ons” has also been addressed in the discussions. The proposal for a Directive includes the requirement that supervisory authorities should “only impose a capital add-on to the Solvency Capital Requirement under strictly defined exceptional circumstances following the supervisory review process”.² The Council requires the exceptional nature of such action to be emphasised more clearly.

The issue of the governance system from Section 2 of the Directive proposal was also taken up. The requests to emphasise more clearly the relationship between the various functions³ and to limit the key functions mentioned in Article 42 were duly recorded.

The Council requires that the proportionality principle be more strongly emphasised⁴ and that its scope of application⁵ be made absolutely clear.

¹ Cf. Progress report of the Council of the European Union, document 15538/07, page 4, online at <http://register.consilium.europa.eu/>.

² Cf. Proposal for a directive, COM (2007) 361 final, page 20, point 17, online at http://ec.europa.eu/internal_market/insurance/solvency/index_en.htm#proposal.

³ The risk management, internal control and compliance, internal audit and actuarial functions described in Articles 43, 45, 46 and 47 of the directive proposal.

⁴ The application of the Directive should be compatible with the nature, scale and complexity of the risks inherent to the business, so as not to jeopardise compliance with the regulations.

⁵ The proportionality principle should apply not only to insurance companies, but also to the exercise of supervisory powers by supervisory authorities.



QIS4

European Commission

To support preparation of implementing measures,⁶ CEIOPS was asked by the Commission to carry out the fourth quantitative impact study, QIS4, from April to July 2008.⁷ The study will have a considerable effect on many areas of the future Solvency II supervisory regime.

QIS4 again has the objective of familiarising stakeholders in advance with the likely requirements and impact of the new solvency rules as compared to the existing Solvency I rules. The study is also expected to verify whether the implementing measures comply with the principles and approaches to calibration in the Directive proposal.

The valuation methods, formulae and parameters to be used in the calculation of capital requirements have again been adjusted following QIS3. The European Commission requires the study to focus on:

- the practicability of the QIS4 specifications, particularly regarding the proposals both for simplified methods and proxy solutions⁸ for the calculation of capital requirements, and for approximation solutions⁹ for the determination of technical provisions under Solvency II;
- the practicability of the QIS4 specifications relating to the use of parameters specific to companies;
- the comparability of results derived from standard formulae and (partial) internal models;
- methods of calculating the minimum capital requirement (MCR);
- the calculation of capital requirements at insurance-group level and its effects.

Changes from the last impact study are expected in the following areas:

- Own funds: amended criteria for the three categories of capital (“tiers”) used in the calculation of own funds, for example for hybrid capital
- Capital requirements:
 - In accordance with the principle of proportionality, simplified methods and proxy procedures should be allowed, for example, for calculating both technical provisions and capital requirements
 - Introduction of geographical diversification for non-life (as was already the case for the varying origins of natural catastrophes)
 - Company-specific parameters may be used for the calculation of the reserve risk within the solvency capital requirement¹⁰
 - A linear approach to the calculation of the MCR is to be tested for the first time¹¹

Several changes to the method of determining the capital requirement for health insurance will be expected. The methods of calculating capital requirements in respect of market risk and operational risk remain essentially unchanged.

QIS4 provides both insurers and supervisory authorities with the opportunity to analyse internal processes and hence to start preparations now in order to be equipped to cope with the new legislation, currently scheduled for introduction in 2012.



⁶ See the “CEIOPS – Implementing measures” section.

⁷ Cf. Draft Call for Advice MARKT/2520-07, online at http://ec.europa.eu/internal_market/insurance/solvency/index_en.htm.

⁸ With the proviso that they should only be permitted for companies meeting certain criteria.

⁹ Cf. “European actuaries – Groupe Consultatif – Coordination Group on Proxies” section.

¹⁰ As is the case for the premium risk.

¹¹ Refer to the “Pros and cons of different approaches to the calculation of the minimum capital requirement” section.

The European Commission anticipates that the participation rate in the insurance sector in Europe will continue to rise and expects at least 25% of European insurance companies and 60% of European insurance groups to take part in the study.

It launched the public consultation process on the technical specifications for the fourth quantitative impact study in December 2007. Stakeholders had until 15 February 2008 to submit their comments.

The study itself will be performed by CEIOPS from April to July 2008.

At the end of January 2008, the Commission held a public hearing to give interested parties the opportunity to discuss the draft of the QIS4 specifications. At the centre of the discussions were the application of the principle of proportionality, rules for the supervision of insurance groups and internal models.

On 11 February, it also invited stakeholders, notably representatives of AMICE, CEA, CEIOPS, CRO Forum and Groupe Consultatif, to Brussels to discuss important issues relating to the organisation of QIS4. Topics in the forefront of the discussions included group issues, the valuation of future premium income under existing contracts and the determination of interest rates to be used for calculating the current value of future premium income.

CEIOPS¹²

Implementing measures

Apart from QIS4, CEIOPS is also focusing on preparing other implementing measures and has published a number of papers on them in the last few months. CEIOPS has been requested, for example, to prepare implementing measures relating to

- the principle of proportionality,¹³
- the harmonisation of the content and format of information produced for public disclosure or for the purpose of supervision of insurance companies.¹⁴

Proportionality principle

The new supervisory rules should not constitute an excessive burden for companies. Future quantitative and qualitative solvency requirements should be compatible with the nature, scale and complexity of the risks inherent in a company's activity. However, policyholder protection should not suffer as a result.

The proportionality principle thus embraces all three pillars:

The first pillar concerns the development of simplified methods for determining technical provisions and calculating capital requirements. In future, some companies will be permitted to use simplified approaches provided they fulfil certain criteria. They will be able to test simplified methods for the first time in the course of QIS4.

The second pillar relates primarily to reduced requirements for the governance system and the scope of the supervisory review process. For example, companies will in future have to inform supervisory authorities of the results of internal analyses of their risks and solvency (ORSA¹⁵). The methodology for recording and assessing risks incurred, which should also take into account future changes in the economic situation, should be compatible with a company's activity. This should also apply to reports submitted to the regulator for supervisory purposes. Companies with complex risk structures will be required to submit more detailed reports at more frequent intervals.

The third pillar mainly covers reporting. Indeed, one of Solvency II's key aims is to harmonise reporting and disclosure requirements to facilitate supervision within EU member states.



¹² Committee of European Insurance and Occupational Pensions Supervisors

¹³ A proposal is to be submitted to the European Commission in May 2008.

¹⁴ A proposal is to be submitted to the European Commission in autumn 2009.

¹⁵ Own Risk and Solvency Assessment.

Consultation paper: Information for supervisory reporting and public disclosure

In any event, even if a company's size is not to be a criterion for the application of the proportionality principle, small and medium-sized companies will benefit most from this rule, notably through their ability to use simplified approaches to the calculation of capital requirements.

Both the need for a level playing field and the desire for convergence make harmonised reporting and disclosure requirements across Europe a necessity. In the context of its work on preparing implementing measures, CEIOPS published a paper on 1 November 2007 on the harmonisation of the content and format of information for supervisory reporting and public disclosure purposes.¹⁶ It was a first attempt to specify with greater precision what information will be required by regulators.

The core objectives identified were:

- enhanced quality of reporting,
- avoidance of regulatory arbitrage and unequal treatment within Europe,
- rapid and high-quality collection of information for statistical purposes across Europe,
- reduction of the reporting burden for groups of companies,
- facilitation of the supervisory process.

The harmonisation of reporting throughout Europe lies at the crux of these objectives. In practice, special local requirements can stand in the way of total harmonisation, for instance additional information under local accounting regulations that will still be required at national level.

The paper again makes reference to the principle of proportionality, stating that reporting should be compatible with the nature, scale and complexity of a company's activity.

The Solvency II reporting system should be designed in such a way that a company's own risk management information can be used as a basis for information submitted for supervisory purposes to avoid duplication of work at the company. At the same time, it will provide an opportunity to establish a common supervision culture throughout Europe. Moreover, with harmonised rules, exchange of information and cooperation between supervisory authorities will be easier.

However, discussions are still at an early stage, though CEIOPS has announced that it wishes to progress the matter quickly.

Pros and cons of different approaches to the calculation of the minimum capital requirement

There are currently a number of proposals for the calculation of the minimum capital requirement (MCR). In principle, the intention is that the calculation of the MCR should be clear and straight-forward. CEIOPS' paper *Architecture of the MCR. Pros and cons of different approaches*¹⁷ published in December 2007 lists the advantages and drawbacks of the various methods. Whilst the paper focused on the modular¹⁸ and the compact¹⁹ approaches, two alternatives, the combined approach²⁰ and the linear approach, were also discussed. With the latter approach, the MCR is calculated separately for life, non-life and health. For example, the MCR for non-life is equal to the sum of a fixed percentage of premium income or of the technical provisions, whichever is the higher figure, and a fixed percentage of investments.

Even though the linear approach involves a simple calculation, it is not supported by the majority of the stakeholders because of its similarity to Solvency I. Nevertheless, it is to be tested by companies in QIS4. It cannot as



¹⁶ Cf. CEIOPS Issues Paper, online at <http://www.ceiops.eu/content/view/236/154/>.

¹⁷ Online at <http://www.ceiops.eu/content/view/345/1/>.

¹⁸ MCR calculation similar to SCR, though simplified, with risk categories limited to underwriting and market risk.

¹⁹ MCR calculated as a fixed percentage of the SCR – cf. CEIOPS DOC-22/07, page 8.

²⁰ MCR equal to the higher of a fixed percentage either of the SCR or the technical provisions – cf. CEIOPS DOC-22/07, page 14.

yet be forecast with any certainty which calculation method will be used for the MCR.

European actuaries – Groupe Consultatif

Coordination Group on Proxies

As a matter of principle, actuarial methodology for determining the best estimate²¹ is to be used in the calculation of the technical provisions. The risk margin²² should then be added. Actuarial methods cannot always be used due to inadequate statistical data or – for the time being at least – a shortage of actuarial expertise at some companies. In such cases, proxy methods may be used. In order to produce a description of such methods as applicable to non-life business, CEIOPS founded the Coordination Group on Proxies working group, which is jointly led by CEIOPS and the Groupe Consultatif.²³

The group published its *Interim Report including testing proposals for proxies under QIS4* at the end of 2007, available both as an appendix to the QIS4 technical specifications and as a CEIOPS consultation paper.

The interim report addresses the issue of defining the area of application of proxy methods. It must be made clear that these methods may not be used as a general substitute for actuarial methods. The Framework Directive does in fact impose restrictions on their use, stipulating that the proxy methods are only admissible as “simplifications” in the context of the proportionality principle.

The area of application of these methods has actually increased for QIS4 because some insurance companies have only recently begun to accumulate the statistics needed for long-tail business.

Proxy methods will only be permissible for insurance companies that

- do not yet have sufficient actuarial expertise,
- are as yet unable to compile an adequate statistical database, because, for example, loss statistics are for various reasons only available as from now,
- are operating in new fields of business or have portfolios that are too small for them to build up an adequate database.

In the short term, the Coordination Group will be concentrating on supporting companies through the next impact study, QIS4, collecting information on various approximation techniques. However, completion of QIS4 will not mark the end of the Group’s work. In the medium term, it will support CEIOPS in the development of implementing measures for the European Commission. Apart from that, it will be involved in developing supervisory standards, preparing recommendations and guidelines for the creation of technical provisions for Solvency II purposes, and assisting with the training of supervisors.

Expectations of this working group are high. According to the European Commission, the need for consistency and comparability throughout the EU in the Solvency II valuation principles for the determination of technical provisions is one of the major challenges that lie ahead. Uniform valuation principles are essential for the creation of a level playing field.

Project Manager

Rolf Stölting is relinquishing his role as the Groupe Consultatif’s Solvency II project manager in mid-April, and steps are being taken to identify a successor as soon as possible. The Groupe would like to express its profound respect and gratitude to Rolf for his contribution to the project over the past 4 years.



²¹ Current value of future payments.

²² Using the cost-of-capital method.

²³ See Solvency Newsletter No. 10.

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