



Solvabilität  
Solvabilité  
Οικονομική φερεγγυότητα  
Solvibilità  
Vakavaraisuus  
Solvencia  
Fizetőképesség  
Solvabiliteit  
Zdolność płatnicza  
Solvabilidade  
Lahustamisvõime  
Solvens  
Maksätspēja  
Solventnost  
Mokumas

# Solvency II Newsletter

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The European Council and European Parliament are continuing their discussions on the Framework Directive proposal for the future supervisory system. The co-decision procedure means that both sides have to agree for the proposal to be accepted. At the same time, CEIOPS' fourth Quantitative Impact Study QIS4 is due to be completed by the end of July. Parallel to this, CEIOPS is working on the implementing measures, on which several reports and consultation papers have been published since the beginning of the year.

## Current developments

### Council of the European Union

#### Discussions in the European Council

The European Council has discussed the proposed Framework Directive in ten sessions since January of this year. A working group has dealt with some 140 articles in detail concerning the following topics:

- Own funds (eligible capital)
- Solvency and minimum capital requirements (including treatment of the equity risk)
- Group supervision and recognising declarations of capital transfer by other group companies as equity capital (group support)
- Recognising surplus funds as eligible capital

Specifically, questions regarding the definition of eligible capital and its classification were dealt with as well as matters concerning the standard formula and the internal model. Numerous discussions have been held on the subjects of group supervision and declarations of group support.

The Commission's proposal on the supervision of insurance groups is not supported by various member states, which are concerned at the loss of influence over companies for the supervision and safety of which they currently have responsibility. The Commission proposes that certain powers held by local supervisory authorities would be transferred to the group supervisory authority. The greatest doubts concern the legal base of such a transfer, the legal certainty and protection of the insured in the case of financial difficulties.

The discussion on group support is very broad and diverse. By and large, the member states accept that the capital requirement at group level has to be calculated on the basis of a group's solvency balance sheet. This is determined by means of the consolidated financial statement. There are diversification effects resulting from the assumption of risks in different regions or from different insurance products, which lead to a reduction in the solvency capital requirement within the group. Such diversification effects would then be broken



down to individual group companies if declarations of group support are recognised. There are also differences of opinion as to whether the use of such effects should be restricted. The first draft of a compromise proposal on the subject of group support was submitted in early May.<sup>1</sup>

Discussion on most of the articles has now been concluded. However, there remain certain articles where opinions differ very strongly indeed. Agreement on the subject of group supervision remains unclear at this stage and it appears that a compromise solution will have to be found. However, what form such a solution will take is unclear given the different legal and social traditions and the different opinions involved, especially on how to guarantee protection of the policyholder.

## EU Parliament

### Discussions in EU Parliament Committees

The European Parliament's Committee on Economic and Monetary Affairs (ECON<sup>2</sup>) discussed the draft report<sup>3</sup> submitted by parliamentary rapporteur Peter Skinner, for which 821 amendment requests were submitted. These requests were first discussed on 15 July 2008. In this ECON hearing, all parliamentary representatives that contributed to the discussions stressed the importance of Solvency II and there were no fundamental objections to the Directive proposal. Everyone concerned signalled a willingness to compromise so that the Directive can be adopted in this legislative period. However, the uncommonly high number of amendment requests submitted makes this a highly challenging task for ECON. In addition, the parliamentary representatives highlighted the complexity of this Framework Directive, which makes rapporteur Peter Skinner's job of drafting a homogeneous amended proposal all the more challenging. At the same time, the results of the European Council's working group consultations also need to be considered as far as possible.

Skinner submitted some requests of his own on important points. These included a proposal on future recognition of surplus funds as eligible capital. Skinner proposes recognising surplus funds not as tier 1 capital, i.e. highest-quality own funds, but as tier 2 capital. Furthermore, he proposes that surplus funds should no longer be eligible to cover the minimum capital requirement. In a further proposal, he suggests getting rid of the threshold of €5m premium income for application of Solvency II. This would see all insurance companies covered by the future supervisory regulations of Solvency II. Skinner also wants to introduce group supervision and to strengthen cooperation between all supervisory authorities that concern a single group. With the evaluation of the equity risk, he rejects the proposed multi-year view by means of a link to durations on the liabilities side.<sup>4</sup> In this connection, he is also against the proposed increases and reductions in the stress factors related to actual share price development.<sup>5</sup>

Sharon Bowles, co-rapporteur on Solvency II in ECON, made a statement in the European Parliament Committee on Legal Affairs (JURI). The discussions focused particularly on the following areas:

- Group supervision
- Group support
- National supervisory resources and responsibility: The future supervisory regime requires a thorough understanding of the risks of an insurance company. Bowles is demanding that supervisory authorities have the requisite technical knowledge and adequate capacities.

<sup>1</sup> Cf. Council of the European Union: Solvency II - Progress report, available online at: <http://register.consilium.europa.eu/pdf/en/08/st09/st09673.en08.pdf>.

<sup>2</sup> Committee on Economic and Monetary Affairs.

<sup>3</sup> European Parliament: Draft Report, Rapporteur: Peter Skinner, 2007/0143(COD), available online at: [http://www.europarl.europa.eu/meetdocs/2004\\_2009/documents/pr/706/706161/706161en.pdf](http://www.europarl.europa.eu/meetdocs/2004_2009/documents/pr/706/706161/706161en.pdf).

<sup>4</sup> This request is especially supported by France.

<sup>5</sup> This is being tested in QIS4.



- Legal independence for CEIOPS: Bowles is demanding that the legal status and responsibilities of CEIOPS be strengthened. Her argument is based on the idea that this will make it easier for CEIOPS to take decisions on issues that concern various supervisory authorities.
- Minimum capital requirement (MCR): Determining the MCR should be made clear and easy. The capital requirement should be covered by adequate eligible funds.

The Committee for Legal Affairs voted on the amendment requests in late June. JURI has the task of assisting ECON, although JURI's results are not binding for ECON.

The ECON vote on the proposed amendments has been put back to 7 October 2008 – particularly at the request of certain parliamentary representatives who want to analyse the results of the fourth Quantitative Impact Study before making a decision. However, it is still not clear exactly which preliminary QIS4 results will be available by this time. If this date remains in place, a vote could be taken in parliament by November 2008.

### European Commission

#### QIS4

The European Commission launched the fourth Quantitative Impact Study with its publication of the QIS4 test paper on 31 March 2008. The job of actually implementing and evaluating the study has been given to CEIOPS. The European Council and European Parliament hope the results will provide them with support for the decision to adopt the Solvency II Directive.

### CEIOPS<sup>6</sup>

#### Work plan

On 30 June 2008 CEIOPS submitted a work plan for the coming months.<sup>7</sup> CEIOPS' work in 2008 will include both the Quantitative Impact Study QIS4 and different phases of consultation.

In addition, it will be engaged in numerous activities revolving around the implementing measures for the new supervisory regulations (level 2 of the Lamfalussy procedure).

The bulk of these activities should be completed by 2009.



<sup>6</sup> CEIOPS – Committee of European Insurance and Occupational Pensions Supervisors.

<sup>7</sup> Available online at: <http://www.ceiops.eu/media/docman/CEIOPS-AnnualReport2007.pdf>.

These activities will be focusing on:

CEIOPS work plan – Solvency II		
Pillar 1	Pillar 2	Pillar 3
<b>Quantitative requirements</b>	<b>Qualitative requirements</b>	<b>Requirements for transparency, disclosure and reporting</b>
<p>Principle of proportionality: This states that future solvency requirements should be compatible with the nature, scale and complexity of the risks inherent in a company's activity.</p> <p>Internal models: Extensive review, intensive training of supervisors</p> <p>Assets and liabilities: Definition of evaluation criteria (consultation until late 2008)</p>	<p>Preparing implementing measures (publication 2009) and draft details on:</p> <ul style="list-style-type: none"> <li>▪ ORSA</li> <li>▪ Corporate governance</li> <li>▪ Use and level of capital add-ons</li> <li>▪ Special-purpose vehicles (SPVs)</li> <li>▪ Treatment of insurance companies in difficulties or in a situation which contravenes regulations</li> </ul>	<p>Supporting the EU Commission until October 2009 in the area of supervision and public disclosure</p> <p>Drafting a timetable for the introduction of a Europe-wide reporting format</p>

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 covering the following topics:

- The principle of proportionality<sup>8</sup>
- Group supervision<sup>9</sup>
- Internal risk and solvency assessment (ORSA<sup>10</sup>)

### Own Risk and Capital Assessment

Article 44 of the Directive proposal describes internal risk and solvency assessment (ORSA) as part of an insurance company's risk management system. However, interpretation of this article does not appear entirely clear. The uncertainty of many small and medium-sized companies regarding the requirements of ORSA prompted the EU Commission, and thus ultimately CEIOPS as well, to publish an Issues Paper.

In this paper, CEIOPS explains that ORSA does not constitute a requirement to make additional capacity available for SCR, nor should it be interpreted as an obligation for companies to develop their own internal models. CEIOPS also points out that ORSA does not constitute an excessive burden for companies. The principle of proportionality should ensure that all companies can implement ORSA without excessive cost.



<sup>8</sup> Cf. Solvency II Newsletter Issue 11, March 2008, available online at: <http://www.gcactuaries.org/solvency.html>.

<sup>9</sup> A proposal is to be submitted to the European Commission in autumn 2009.

<sup>10</sup> Own Risk and Solvency Assessment.

CEIOPS defines ORSA as an integral component of risk management. Its main objective is the identification, evaluation, assessment, management and disclosure of all risks that insurance companies face in the long term. This includes future financial planning (such as forecasting the income statement) or prognoses for drawing up the economic balance sheet. External factors also need to be considered, such as changes on the capital markets, in jurisdiction or on the insurance market. ORSA is designed to help companies determine the actual value of the eligible capital needed to meet their insurance liabilities on a long-term basis. It also analyses whether the company has enough regulatory capital in the long term.

According to the CEIOPS' Issues Paper, the way ORSA is implemented depends on whether the insurance company calculates its capital requirements for supervisory purposes on the basis of the given standard formula or its own internal model:

In calculating the solvency capital requirement, the standard formula only considers the risks of an average insurance company. In other words, the standard formula will normally fail to properly assess a company's individual risk situation. Insurance companies which calculate their capital requirement on the basis of the standard formula should therefore also examine in ORSA the appropriateness of the supervisory capital requirement in terms of their own individual risk situation. At the same time, this should also increase their understanding (especially on the part of the management) of the future and long-term incurred risks.

If an insurance company uses its own internal model for supervisory purposes,<sup>11</sup> this can also serve as a basis for ORSA assessments. Companies must in addition analyse their medium and long-term risk situation as well as outline the tasks of the internal model in their integrated risk management system.

### **European actuaries – Groupe Consultatif**

The joint CEIOPS / Groupe Consultatif co-ordination group on proxies has published its report, much of which has already been incorporated in the specification for QIS 4.

The Groupe has developed and is discussing with CEIOPS a template for an actuarial report to management on solvency which would facilitate undertakings in meeting ORSA requirements.

The Groupe has discussed with the European Commission certain difficulties in determining provisions and capital requirements in respect of participating business, particularly in the context of mutuals. The Groupe has suggested that a joint co-ordination process with CEIOPS may be required in order to achieve consistency of approach across jurisdictions.

The Groupe has submitted comments to CEIOPS on consultative papers CP24 and CP25 on the principle of proportionality and on the treatment of groups respectively.

The Groupe is expecting to carry out further work with CEIOPS in several areas, including particularly principles and guidance relevant to the calculation of the non-life best estimate.

Following the resignation of Rolf Stölting after four years as reported in our last issue, the Solvency II Project of the Groupe Consultatif is to be headed by Seamus Creedon, an Irish life actuary who works for a London consulting firm. Since the project was launched four years ago he has chaired the project's "Pillar Life 1" working group.



<sup>11</sup> Use of an internal model for supervisory purposes is subject to prior approval by the relevant supervisory authority.

## IAA

### Role of the actuary

Actuarial knowledge is becoming increasingly important in many areas of supervisory systems. In Germany, for example, there has long been the “Responsible Actuary” in life insurance, who, however, does not have to be a member of the German Association of Actuaries. However, in most Anglo-Saxon influenced countries, the “Appointed Actuary” is mandatory and this even in non-life. This task can only be carried out by a member of a national association of actuaries.

There is a working group in the IAA that deals with the “role of the actuary”. Under the Insurance Regulation Committee, headed by Rolf Stölting, this working group incorporates the heads of most IAA committees. It endeavours to develop a uniform definition of the actuary’s profession and presents its view to different international bodies in which actuarial tasks play an important role. In addition to tasks connected with supervisory systems for the insurance industry, this principally covers activities in accounting. Given the increasing importance of risk management, which is becoming ever more complex, the profession of actuary is faced with a very special role encompassing a growing number of tasks and responsibilities. While actuaries were mainly concerned with technical reserves and calculating insurance premiums just a few years ago, the job now also involves an increasing amount of risk management tasks.

### Drafts of new publications

Three IAA publications are due out in the next few months, all of which stem from issues raised by the IAIS<sup>12</sup>. The current status of these publications was discussed at the IAA’s spring conference in June 2008.

The first is a detailed analysis of the subject “Measurement of Liabilities for Insurance Contracts: Current Estimate and Risk Margin”. This is about technical reserves and risk margins, both very important topics for Solvency II.

The second publication deals with “Enterprise Risk Management”. This has been written by the IAA’s Enterprise and Financial Risk Committee and covers the subject of risk management for solvency systems in as much detail as possible.

The third publication looks at the use of internal models.

## IAIS

### Drafts of new publications

The declared objective of the International Association of Insurance Supervisors (IAIS) is to support the current reorganisation of many supervisory systems in different countries by developing and adopting general principles. To achieve this, the IAIS publishes a variety of papers which analyse issues related to supervisory systems. These establish general standards, which IAIS members undertake to adhere to. The publications are generally authorised by the IAIS Technical Committee, in which numerous supervisory bodies are represented. The papers are usually written by subcommittees of the Technical Committee. All publications have to go through a public consultation procedure (sometimes several), each lasting at least two months. All interested organisations or insurance companies can propose modifications to a publication. Final acceptance of a publication is then approved by all member organisations at the IAIS Annual General Meeting.

There are three different types of publication:

- Principles Papers
- Standards Papers
- Guidance Papers

Principles Papers are publications of a more general nature dealing with the principles of insurance supervision. Standards Papers deal with concrete standards and definitions. Guidance Papers provide direct information and ideas



<sup>12</sup> Subcommittee Solvency and Actuarial Issues.

regarding possible implementation in supervisory regulations. The importance of these publications for Europe as a whole and for Solvency II cannot be overstated. The European Commission is a member of the IAIS and a representative of the Commission takes active part in IAIS proceedings, at least in the Solvency Subcommittee.

One of the most active subcommittees of the IAIS is the “Subcommittee Solvency and Actuarial Issues”. It has set itself the task of creating general principles for the regulation of insurance companies, which are then used as a guideline by all supervisory authorities worldwide for their own supervisory systems. Rob Curtis (FSA, UK) has been head of this subcommittee since 2006.

The subcommittee is currently discussing a preliminary draft for a new Standards Paper and Guidance Paper on the subject of “Capital Resources”. This concerns the principles involved in evaluating investments and liabilities within the framework of a supervisory system. An essential and controversial point is the question concerning the extent to which a solvency balance sheet should be drawn up which is in principle independent of an IAS balance sheet but is based on market values and can be largely derived from an IAS balance sheet. This position corresponds to the approach of Solvency II and is strongly supported by European representatives. The USA, by contrast, is trying to establish complete conformity with the still partly undefined drafting of an IAS (IFRS) balance sheet. Europe, however, argues that the objectives of insurance supervision based on a solvency balance sheet are not the same as those for accounting based on a balance sheet in accordance with IAS principles. In the former case, protection of the insured is paramount. IAS is about making as accurate an economic valuation of a company as possible.

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