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**The Insurance Industry and Enterprise
Risk Management: From Compliance to
Value Creation**

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&

Uninsured Industrial Risks

Ongoing Research Project
by Tileman Fischer

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Layout & Distribution: Valéria Kozakova

The Relationship between Insurance Industry and Stakeholders – Future Challenges for the European Insurance Industry

Alberto Corinti




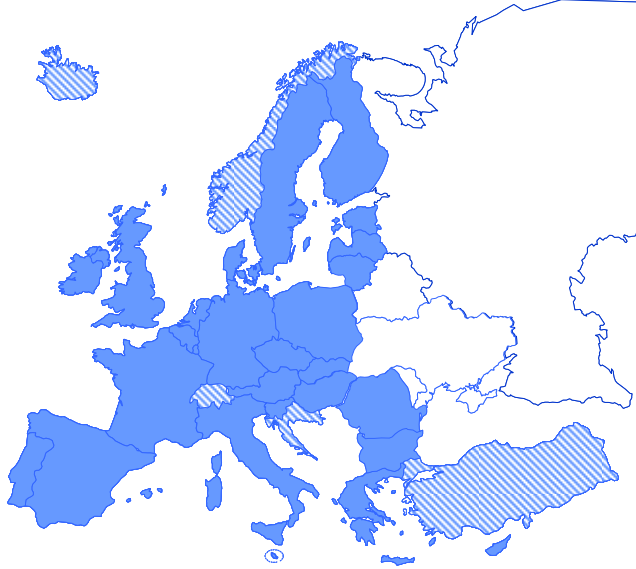
Agenda

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| 2. Why a new Solvency II Framework |
| 3. The EC proposal for a Solvency II Framework Directive |
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About CEA

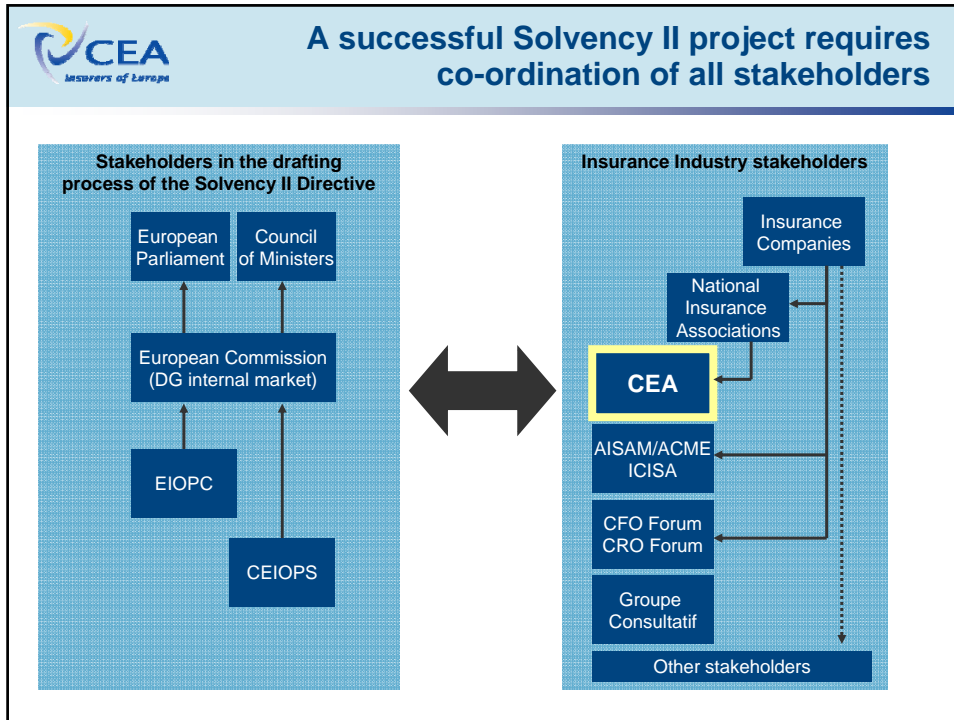
- 33 member bodies - national insurance associations
- CEA represents all types of insurance and reinsurance undertakings
 - pan-European companies, monoliners, mutuals & SMEs
- CEA represents 94% of total European insurance premiums


CEA's Member Associations



33 national member associations:


- 27 EU Member States
- + 6 Non-EU Markets
Switzerland, Iceland, Norway, Turkey, Liechtenstein, Croatia
- 3 Observers
Russia Ukraine
AISAM



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Why a new Solvency framework ?

- Solvency regimes need to evolve to ensure appropriate consumer protection and efficient capital allocation
- Solvency I disadvantages:
 - Rules can conflict with good risk management
 - Capital is not adequately directed to risks
 - A lack of harmonisation across the EU
 - Lack of recognition of groups' economic reality
- Europe is ready for a better and more appropriate risk based solvency regime which can transform compliance in value creation



Objectives of Solvency II

- Strong, effective policyholder protection with optimal capital allocation
- To achieve a harmonised approach to supervision across all EU markets
- To increase competition within EU insurance markets and the global competitiveness of EU insurers

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What is an economic risk based approach?

The industry believes that the objectives of Solvency II can only be achieved through a risk based economic approach

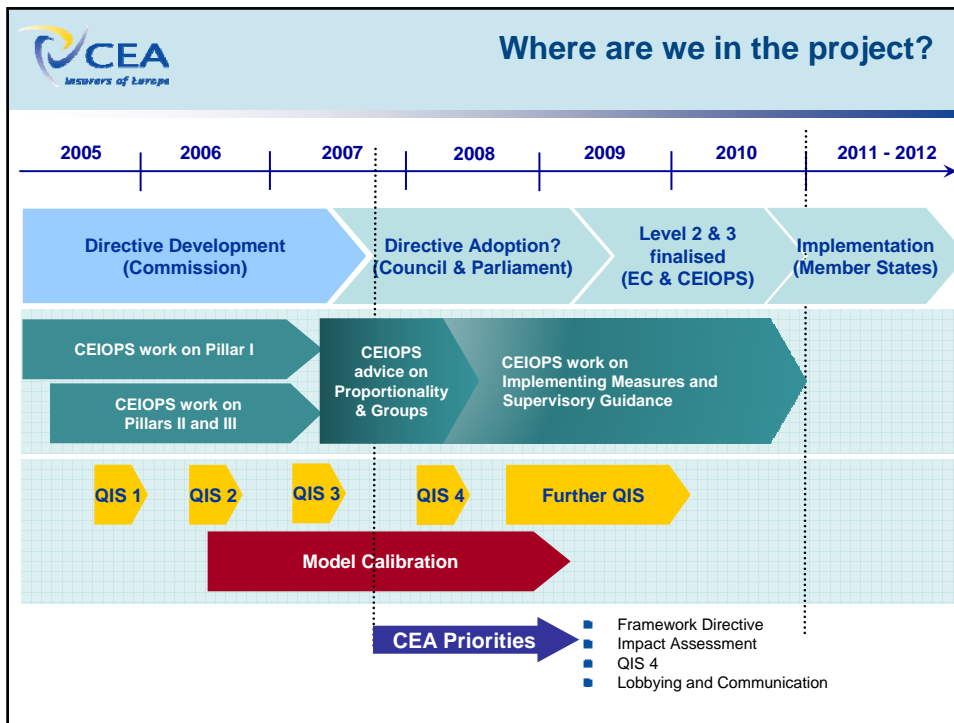
- assets and liabilities at market-consistent values
- full recognition of diversification and risk mitigation of all forms (reinsurance, securitization etc.)
- aligning capital requirements with the underlying risks of an insurance company
- developing a proportionate, risk-based approach to supervision with appropriate treatment both for small companies and large, cross border groups

This will allow alignment of compliance with creation of value.

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Solvency II Framework Key Components

- **Market Consistent Value of Liabilities**
 - Is sufficient to cover policyholder obligations
- **Solvency Capital Requirement (SCR)**
 - Target Capital that an entity should aim to meet under normal operating conditions
- **Minimum Capital Requirement (MCR)**
 - Reflects a level of capital below which ultimate supervisory action could be triggered
- **Ladder of Intervention**
 - Solvency II should be designed to guarantee an appropriate ladder of intervention if the available capital falls below SCR




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CEA welcomes the Solvency II Directive Proposal

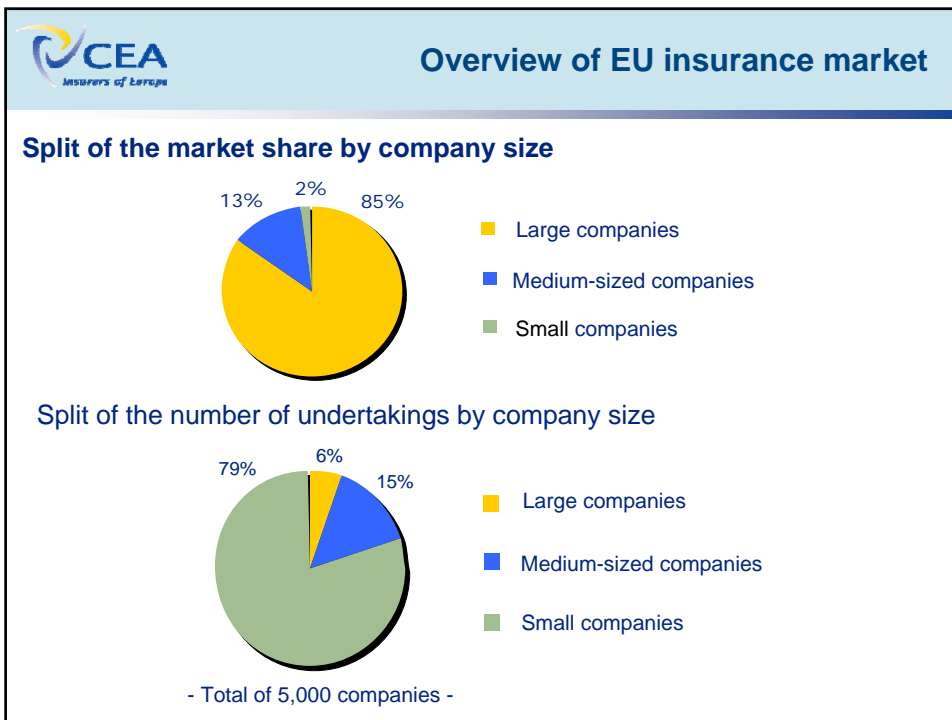
- The underlying economic approach is strongly supported
- Strong support for the use of internal models
 - The Framework Directive will allow companies to develop bespoke and more sophisticated models to determine their capital requirements (so called internal and partial models) subject to these models being approved by supervisors. The CEA strongly supports this.
- A solvency system that will evolve and continue to be appropriate in the future
 - The principles based approach adopted in the Framework Directive, together with the underlying risk based economic methodology, means that the Solvency II regime will be able to adapt and evolve in the future as economic conditions change and new risks and products emerge. The CEA strongly supports the flexibility and adaptability inherent in the Framework Directive.
- Much increased harmonisation across the EU
- Principle of Proportionality
- A major step forward in the supervision of groups




Framework Directive - Areas requiring further improvement

- MCR and SCR calculation methods need to be aligned
- The treatment of own funds should be consistent with a policyholder view
- Detailed calculation specifications should not be in the Directive
- It is essential that supervisory powers are proportionate and harmonised
- Disclosure requirements must remain proportionate
- The SCR should not be a hard target


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SME role in the EU insurance market

- Small and Medium-sized Entities (SMEs) represent around 95% of the number of European insurance companies
- SMEs play a very important role:
 - Increasing specialised product availability
 - Increasing competition and contributing to better prices for consumers
- SMEs generally operate through:
 - Specialised product offerings / niche markets
 - Historic links with certain customer segments




Support for a risk-based economic approach

- SMEs support the risk-based economic approach
- The solvency regime requirements for SMEs and groups are very similar:
 - e.g. alignment of capital requirements with underlying risks; recognition of risk mitigation schemes; allowance for diversification effects, etc
- Same risk, same requirement
- However, SMEs have some specific needs ...




The standard approach

- CEA's Impact Assessment indicates that the Standard Approach will be of particular relevance for SMEs
- Risk mitigation such as reinsurance is particularly important to SMEs
 - It allows companies to spread their risks
 - It needs to be fully recognised under the future standard approach
- Certain SMEs operate in niche markets
 - Specialisation is a key part of their business rationale
 - The standard approach must allow some flexibility to recognise this expertise when determining their capital requirements




The principle of proportionality

- One-size-fits all approach not possible
 - Flexibility based on the different nature, scale and complexity of the undertakings is required
 - The standard approach must allow simplified calculations provided certain criteria are met
 - Standard approach needs to retain its risk sensitivity without becoming an unnecessary administrative burden, in particular for smaller companies



Exemptions from Solvency II

- Solvency II aims to provide equal protection for policyholders
- Capital requirements should be risk based and not unduly influenced by the size or legal form of the company
- Solvency II represent a challenge in particular for SMEs. However, smaller undertakings have expressed their concerns that exclusion from Solvency II would:
 - Lead them to being seen as second class companies
 - Lead them open to local regulation without the guarantee of harmonisation and a level playing field
 - Require them to opt-in to Solvency II to satisfy policyholders looking for Solvency II security when purchasing their contracts



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- ### Solvency II and Groups
- Insurance groups are increasingly managed at the group level
 - Allows better assessment of risks
 - Policyholder protection should also be considered at the group level
 - Issues to be considered
 - Group supervisor
 - Fungibility of capital
 - Under Solvency I, supervision primarily takes place at the solo level
 - Supervisory requirements vary greatly between countries
- Also for groups, supervision should reflect their economic reality**

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Group Supervisor

- A Group supervisor with appropriate cooperation with other involved supervisors would benefit:
 - Policyholder protection
 - more effective assessment of risks - implies earlier detection of possible issues
 - Supervisory best practice
 - Enhance dialogue amongst group and solo supervisors


- Group supervisor would reduce cost of supervision
 - supporting more efficient and competitive internal market for insurance services (political objective)

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Diversification is key for Insurers


■ Diversification benefits are at the heart of the concept of insurance

Effects particularly relevant for groups



Full recognition of diversification effects


- Diversification types vary
- Diversification exists at group level:
 - Across companies within a single jurisdiction
 - Across regulatory jurisdictions
- A more stable development of claims leading to lower capital requirements
- Solvency II should fully recognise all diversification effects and reflect this in the capital requirements at both solo and group levels





Supervisory Harmonisation


- The significant differences in supervisory practice inhibit the development of the insurance market
 - Groups operating in EU face patchwork of requirements
- Solvency II is an opportunity to address some of these supervisory issues
 - e.g. making reporting requirements more consistent
- Adopting a Group supervisor approach in an harmonized regulatory and supervisory framework is an important part of achieving a single market

It is essential that there is supervisory harmonisation under Solvency II with a supervisory system that is adapted to how groups are managed today and tomorrow

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 Conclusions – Challenges for the industry	
■ The Industry strongly supports Solvency II objectives	<ul style="list-style-type: none">■ Current rules are not aligned with economics & risks of the business■ Objectives can only be reached through a risk based economic approach
■ Let's keep the positive momentum we observe today, even if hard work is required from all parties	
■ Much has been achieved thus far but the pace is increasing with challenges for all stakeholders.	<ul style="list-style-type: none">■ Areas where further work is required including calibration, group issues, eligible elements of capital, small companies and the articulation/ functioning of Pillar 2 and Pillar 3
■ The Industry will continue to actively and constructively contribute to the debate	
■ QISs are an opportunity for the industry and supervisors	
■ Provided that current objectives of Solvency II project will be transformed into reality, European industry is committed to get ready for the implementation of the new regime and exploit its features to the benefit of all stakeholders	

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	Further reading...
Key strategic publications available on the CEA website (www.cea.assur.org) include:	
☞ Introductory Guide to Solvency II	A 10-pages brochure (including synthetic executive summary) introducing the main concepts of Solvency II
☞ Proposals for a European Standard Approach – ESA for SCR	The ESA aims at capturing the requirements of a consistent economic risk-based approach within a workable solution
☞ CEA's view on the Impact of Solvency II on the Average Level of Capital	A guide on the comparison of the current Solvency I and future Solvency II frameworks
☞ CEA Working Document on MCR and a Proposed Ladder of Intervention	CEA aims to contribute to the ongoing development of critical issues such as the Minimum Capital Requirement (MCR) and proposes a methodology to calculate MCR as well as an approach to a ladder of intervention
☞ CEA Working Paper on the risk measures VaR and TailVaR	This paper discusses the issues related to using VaR and TailVaR as risk measures within the solvency assessment of insurance companies
☞ CEA 10 Key messages on Solvency II	
☞ Solvency II Impact Assessment	
☞ Solvency II Glossary	
☞ CEA information paper on Groups and Solvency II	
☞ CEA information paper on Diversification and Specialisation benefits	
☞ CEA information paper on Small and Medium-sized Undertakings (SME)s and Solvency II	