



International Association for the
Study of Insurance Economics

Études et Dossiers

Extract from

Études et Dossiers No. 340

**4th International Insurance and Finance
Seminar of The Geneva Association**

6-7 December 2007
London

February 2008

**Working Paper Series of
The Geneva Association**

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Solvency II and the Work of CEIOPS

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Pensions Supervisors



TIMES THEY ARE A-CHANGIN' (B. DYLAN)

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CEIOPS

Index

- Progress made under Solvency II and outstanding issues.
- Lessons learned from Internal Models under CRD, priorities in the CEIOPS Internal Models Group.
- Possible Impact of Solvency II on the European and global competition.

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CEIOPS

Progress made under Solvency II and outstanding issues

1. Framework Directive Proposal
 - The first*
 - Lamfalussy Process Directive
 - Risk-oriented regime for insurance
 - Maximum harmonisation with less national options
 - Consensus on difficult areas e.g. SCR (MCR), technical provisions, qualitative requirements, disclosure, reporting


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Progress made under Solvency II and outstanding issues

2. Quantitative Impact Studies

- QIS 1, learning curve for CEIOPS and industry
- QIS 2, built on lessons learned
- QIS 3, first calibration exercise, high industry participation, results recently published
- QIS 4, to be launched in Spring 2008 under Commission's guidance



LEARNING PROCESS: IMPORTANT LESSONS TAKEN


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Progress made under Solvency II and outstanding issues

Open issues on level 1

- Smaller companies' position – proportionality, with exemptions / simplifications
- Insurance groups supervision – some controversial negotiations on political level
- Occupational Pensions – part of CEIOPS' and Commission's IORP review 2008



POLITICAL vs. TECHNICAL ISSUES

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CEIOPS

Internal Models: principles, lessons learned & priorities


- **PRIORITIES FOR CEIOPS WORK ON INTERNAL MODELS:**
 - Development of QIS4 Technical Specification
 - Stock-taking exercise on internal model best practice
 - Development of implementing measures
 - Raise awareness on the need for firms to start collecting data
 - Exchange information with banking supervisors

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Future Internal Models: principles, lessons learned & priorities

- **The CRD/Basel II experience has shown that to develop and maintain an internal model four main conditions need to be satisfied:**
 - Good understanding of the business
 - Commitment of senior management
 - Knowledge, expertise to create and maintain model
 - Good, deep and rich data sets



LEARNING PROCESS... AND LESSONS TAKEN

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Internal Models: principles, lessons learned & priorities

- **The Framework directive proposal allows for two types of models:**
 - Full internal models (FIM)
 - Partial internal models (PIM)
- **Insurance and reinsurance undertakings may use partial internal models for the calculation of one or more:**
 - risk modules or sub-modules of the SCR
 - operational risk
 - adj. for the loss-absorbing capacity of TPs and deferred taxes
- **In addition to:**
 - the whole business of insurance and reinsurance undertakings, or
 - only one or major business unites

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Internal Models: principles, lessons learned & priorities

- **The SCR calculated by an internal model should:**
 - be calibrated using a VaR measure, with a 99.5% confidence level, over a one year period
 - As a minimum, cover insurance, market, credit and operational risk
 - be part of the supervisory review process (SRP)
- **Insurers must satisfy:**
 - Use test
 - Statistical quality standards
 - Calibration standards
 - Validation standards
 - Documentation standards
- **Use of external vendor models does not exempt insurers from any of the standards**

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Solvency II: Second generation of risk based solvency system?

- Experience of existing risk based solvency systems
 - Eg. EU Basel II
 - Eg. US Risk based capital (RBC)
- Second generation?
 - Economic approach: total balance sheet approach
 - Market consistent valuation; Impact of IFRS
 - Internal modelling freedom
- Interest of third countries in the impact of Solvency II
 - EU single market approach: single license, freedom of establishment
 - Move towards mutual understanding and recognition, based on principles of equivalence

Possible Impact of Solvency II on the European and global competition.

- Is Solvency II likely to change the competitive landscape in Europe and more globally?
 - Geographic levels: National, European, Global.
 - Cross-sectoral level: Banking... and others (Pensions)
 - Structure of undertakings: large groups vs. SMEs, local vs. pan-European, monoliners ...

**COMPETITION IS BASIC, AND WILL GENERATE POSITIVE EFFECTS...
ALTHOUGH SOME RISKS WILL HAVE TO BE LOOKED AFTER.**

Possible Impact of Solvency II on the European and global competition.

- Will Solvency II be beneficial to the Economy and Consumers?
 - Move towards a risk oriented system.
 - Alignment of the design of the system with the economic reality underlying.
 - Focus on Governance (including explicit responsibilities).
 - Need to enhance risk management and controls.
 - Increase of transparency and disclosure.
 - Objectives of supervision (protection of policyholders, but also financial stability and fair & stable markets).



WE ARE CHANGING, AND CHANGING FOR GOOD