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Solvency II Reform in the Users' Eyes - Costs and Benefits

Bruno Porro

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Solvency II - Supervision

Draft Directive issued July 10, 2007

- Is still a draft and will be under high scrutiny by the Commission and the EU parliament. Modifications still possible and likely.
- Follows Lamfalussy approach, which means that only principles are stated, implementing measures will follow on different lower levels.
- QIS (quantitative impact studies) are performed to clarify the effects on required capital that proposed directive will have.
QIS4 to start now, April 2008



Goals and Limitations of Solvency II

Article 27

- The main objective of (re)insurance regulation and supervision is adequate policyholder protection
- Financial stability and fair and stable markets should also be taken into account but should not undermine that main objective
- Does not apply to mutual undertakings and small insurance undertakings, pension funds.
- Does not change actual regime applicable to Financial Conglomerates



Solvency II Principles

- Supervision shall be based on prospective and risk-oriented approach.
- Makes optimal use of financial market information wherever available (marked consistent valuation).
- Not too burdensome for small and medium-sized undertakings (proportionality principle)
- Supervisors shall conduct their tasks in a transparent and accountable manner (Art30)



Solvency II Principles (2)

- Supervisors review and evaluate strategies, processes and reporting procedures (supervisory review process SRP).
- Can under strictly defined exceptional circumstances ask for capital add-ons following the SRP, which may have permanent character.
- Undertakings required to meet principles rather than rules (Art. 40)
- Companies should have an Own Risk and Solvency Assessment in place (Art 44)

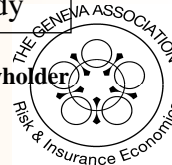
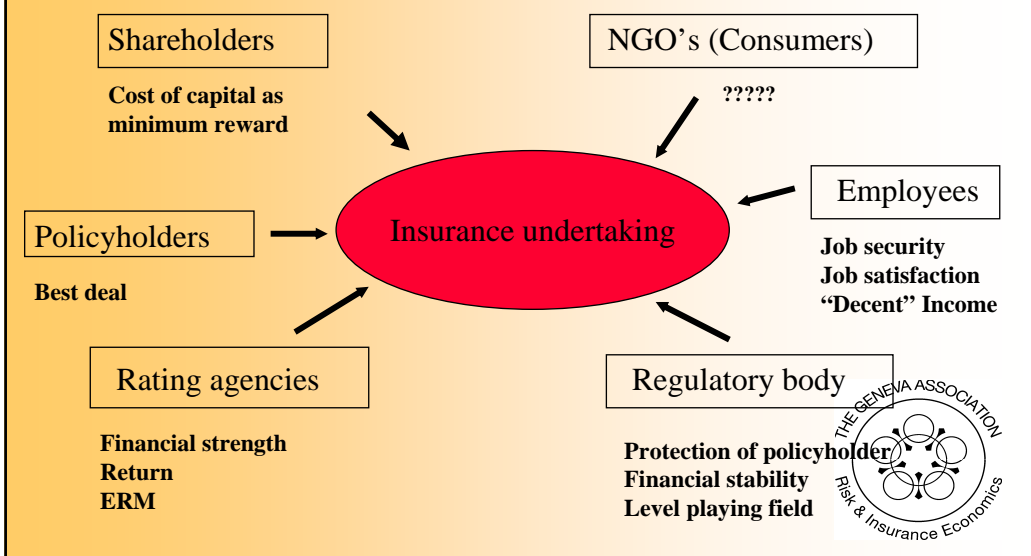


Self Regulation and Supervision

- Governmental supervision is a second line of defense that follows internal governance and risk management of the undertaking. It is by nature slower in assessing and controlling critical risk situations
- There is widespread concern – which I share based on personal experience - that additional protection results for the policyholders from stronger supervisory requirements. At least for companies that follow „best practice“ and constantly evolve their risk management culture.
- I am not against supervision, but I question the false sense of security that it creates in the perception of policyholders and politicians.



Stakeholders have different objectives



Users' Wish List (..the ideal world)

- The same economic capital management principles to be applied in regulatory, statutory and rating agency reporting.
- One accounting regime????? (IFRS?)
- One single definition of own funds and its translation into available capital.
- Full consideration of risk mitigation (reinsurance, hedging) and diversification benefits.
- One single regulator (lead) per group, independent of location of headquarters (Principle of equivalence).
- Definition of Minimum Capital Requirements (MRC) should be consistent with economic principles applied in the calculation of the Solvency Capital Requirements (SRC).
- Continuous Cost/benefit evaluation of regulatory burden

