

Solvency II Newsletter

January 2011

- **EIOPA replaced CEIOPS and the Commission proposed amendments to Solvency II**

EIOPA (European Insurance and Occupational Pensions Authority) was created as a result of the reform of the structure of supervision of the financial sector in the European Union. In the area of insurance and pensions, the EIOPA replaced the CEIOPS. Items on its work plan for 2011 include assisting the Commission in the development of the level 2 implementing measures and the drafting of binding technical standards, and the preparation of the level 3 guidelines.

As from January 2011 the EU established three new European supervisory authorities (ESAs) and a European Systemic Risk Board (ESRB) to replace the former supervisory committees.

March 2011

- **EIOPA published results of Fifth Quantitative Impact Study (QIS 5)**

EIOPA published the QIS5 report on 14 March 2011. QIS 5 is the fifth and last full quantitative impact study before the Solvency II regime is implemented and the publication of the QIS 5 report represents a key milestone in the finalisation of the Solvency II project.

Almost 70% of all insurance and reinsurance companies under the scope of the Solvency II directive participated in QIS 5, up from 33%, who participated in QIS 4 (which was conducted in 2008).

- **CEA sent Solvency II cat risk proposals to European Commission**

Following publication of the results of QIS 5, the CEA has called for essential corrections to the implementing measures that will provide the technical detail of the new regime. In this context, the CEA sent the Commission on 28 March possible solutions to problems with the design of the catastrophe risk sub-module.

Focus on:

Budgets of European insurers for the Solvency II project

Implementation of the new Solvency II regime in European insurance companies is running at full speed. Both supporters and opponents of the regime generally agree that the introduction of Solvency II will result in insignificant costs for European insurance companies. According to a survey conducted by Deloitte in selected European markets, insurance companies usually approach the introduction of Solvency II as a project (or program) lasting several years. They employ tens or even hundreds of their own employees and also other external sources in it.

According to Deloitte's estimates, European insurance companies will spend a total of about 4 billion euros on the introduction of Solvency II (previous estimate made by the European Commission was about 3 billion euros). Total budget for the Solvency II project in an insurance company depends on many factors, but it can be estimated from the size of the company. The budget of a larger European insurer is between 0.2% and 0.5% of annual gross written premium. Smaller insurance companies have to count with a higher percentage (up to about 1% of annual premium). Up to half of the costs for Solvency II is to be attributed to IT costs, on average one fifth to development of actuarial models. Costs are spread on average over 3 years.

An interesting question is whether the Central European markets like the Czech and Slovak Republic will incur higher or lower costs for the introduction of Solvency II. As many Western European markets (e.g. Great Britain) have a persistently higher rate of insurance regulation, the transition to Solvency II is not such a leap for them. Therefore, we would expect higher costs for Central European markets. On the other hand, insurance companies from Central Europe may paradoxically benefit from shorter history of the portfolio and IT systems. If we applied the above estimates from Western European countries on the Czech market (with annual GWP of 150 billion CZK) without any adjustments, we would get an estimate of the Solvency II's costs of about 300 to 750 million CZK for the whole market. For each of the two largest insurance companies, the costs would be about 70 to 180 million CZK. For the third to seventh largest insurance companies (according to market share) we would expect approximately 20 to 50 million CZK.

These estimates may not reflect the real situation of a given insurer. They cannot reflect the quality of internal processes and different composition of premium. However, they can serve as a benchmark for the actual budget and future budget consideration for the period 2012-2014.

April 2011

- EIOPA published Report on Variable Annuities in order to establish common EU guidelines for supervisors that would foster convergence and spread best practices for the supervision on insurers selling variable annuities
- EIOPA published Report on reporting requirements to supervisory authorities – an analysis on differences in reporting requirements between Member States. The aim was to examine the potential factors that could explain these differences.
- **Insurers urged EU Commissioner to correct Solvency II implementing measures**

On 29 March 2011 the CEA and three other pan-European insurance associations (the CFO Forum, the CRO Forum and the Pan European Insurance Forum) sent the European Commissioner for the Internal Market and Services, Michel Barnier, a joint letter to ensure that the excessively conservative and prescriptive elements that remain in the draft implementing measures are urgently addressed.

- **On 29 April 2011 CEA commented on the adoption of Omnibus II**

The CEA published its position paper on the EU's Omnibus II Directive, which amends several pieces of financial services legislation to reflect the powers given to the new EU financial services supervisory authorities.

The position paper outlined key concerns of the CEA in relation to the following points:

- Proposed timing for adoption of Omnibus II;
- Transitional provisions;
- Amendments to Solvency II Levels 1 and 2.

May 2011

- On 2 May CEA published a proposal for Health Insurance Catastrophe Risk under Solvency II standard formula.

June 2011

- The Groupe Consultatif carried out a survey under the auspices of its Insurance Committee to assess the readiness of the actuarial profession in Europe to meet the demands of the new system. The results of the survey show a profession ready and able to play its full part in the implementation of the new solvency system. The Groupe has established a project team to consider the development of professional and technical standards to assist actuaries working in the Actuarial Function. The Groupe is also working on a framework for reporting from the Actuarial Function and on professional standards of practice for actuaries

in the different roles that they will fulfil under Solvency II.

- There was an increase in sales of business units due to the optimization of capital in relation to Solvency II. Aviva confirmed the £1bn sale of its RAC roadside rescue business to private equity firm Carlyle Group, while Zurich Financial Services said it would be transferring a portfolio of run-off business to Swiss Re.
- **Proposals to move the start of Solvency II**

The Council of the European Union proposed under the Hungarian presidency to delay the implementation of Solvency II by one year. The proposal to move the date of implementation of Solvency II from 1 January 2013 to the same date in 2014 was revealed by the fourth version of the proposed presidency compromise text for the Omnibus II directive, issued on 21 June.

Under the Council's proposal, Solvency II's legal requirements would need to be transposed into national law by 31 March 2013. The elements of the directive regarding supervisory approvals (for example, the use of internal models, ancillary own funds, use of undertaking specific parameters in the standard formula SCR) would apply from 1 July 2013, but any approvals that were granted could not take effect before 1 January 2014.

On 1 July 2013 insurance and reinsurance companies should submit their implementation plan to the supervisory authority. The plan should demonstrate their progress made in adapting to the new regime. Level 2 measures should be adopted at the end of 2012, but cannot be presented and discussed in the formal legislative process before the publication of Omnibus II. Adoption of Omnibus II is expected in early 2012 and adoption of the Level 2 implementing measures at the end of 2012.

EIOPA also presented a plan to delay Solvency II. The implementation date of 1 January 2013 would remain, but a comprehensive package of transitional measures would in effect delay the start of the regime for a year.

During this interim year, under EIOPA's proposal, the national insurance regulatory bodies would collect appropriate Solvency II data but would not automatically intervene if companies did not fulfil Solvency II criteria, unless an insurer's capital level fell below the minimum capital requirement (MCR).

July 2011

- **On 4 July 2011 EIOPA announced the aggregated results of its second European insurance stress test**

The second Europe-wide stress test was launched on 23 March and was conducted in cooperation with

the respective national supervisory authorities. It was carried out based on 2010 financial results.

The stress test is one of a range of supervisory tools for assessing the strength of individual institutions and evaluating the stability of the insurance sector. Furthermore, it helps supervisors to understand the capital positions of insurers and insurance groups in adverse situations. The stress test covered more than 50% of each country in EU/EEA member states and Switzerland, based on statutory gross premium written, for both life and non-life business. As a result, the exercise included more than 200 insurers, including the large and important European insurance groups.

This stress test intended to replicate macroeconomic scenarios and aimed to identify and quantify the impact of three different stress scenarios: baseline, adverse and inflation scenario, especially in terms of insurers' ability to meet the future Solvency II Minimum Capital Requirements (MCR). The stress scenarios comprised market, credit and insurance-related risks. Simultaneously, EIOPA performed a supplementary test to evaluate sovereign bond exposures.

The results of this stress test indicate that overall the European insurance market is well prepared for potential future shocks. However, data showed that approximately 10% (13) of the participating groups and companies do not meet the MCR under the adverse scenario. 8% (10) fail to meet the MCR in the inflation scenario.

- **CEA responded to EC corporate governance consultation**

On 20 July the CEA responded to the European Commission's consultation on its Green Paper on corporate governance, which is looking at ways to improve existing corporate governance mechanisms.

In its response, the CEA pointed out that the new Solvency II regulatory regime will already introduce new requirements for corporate governance in the insurance sector. These requirements will be a key part of the new risk-based system to ensure that capital adequacy and control systems are sufficiently robust.

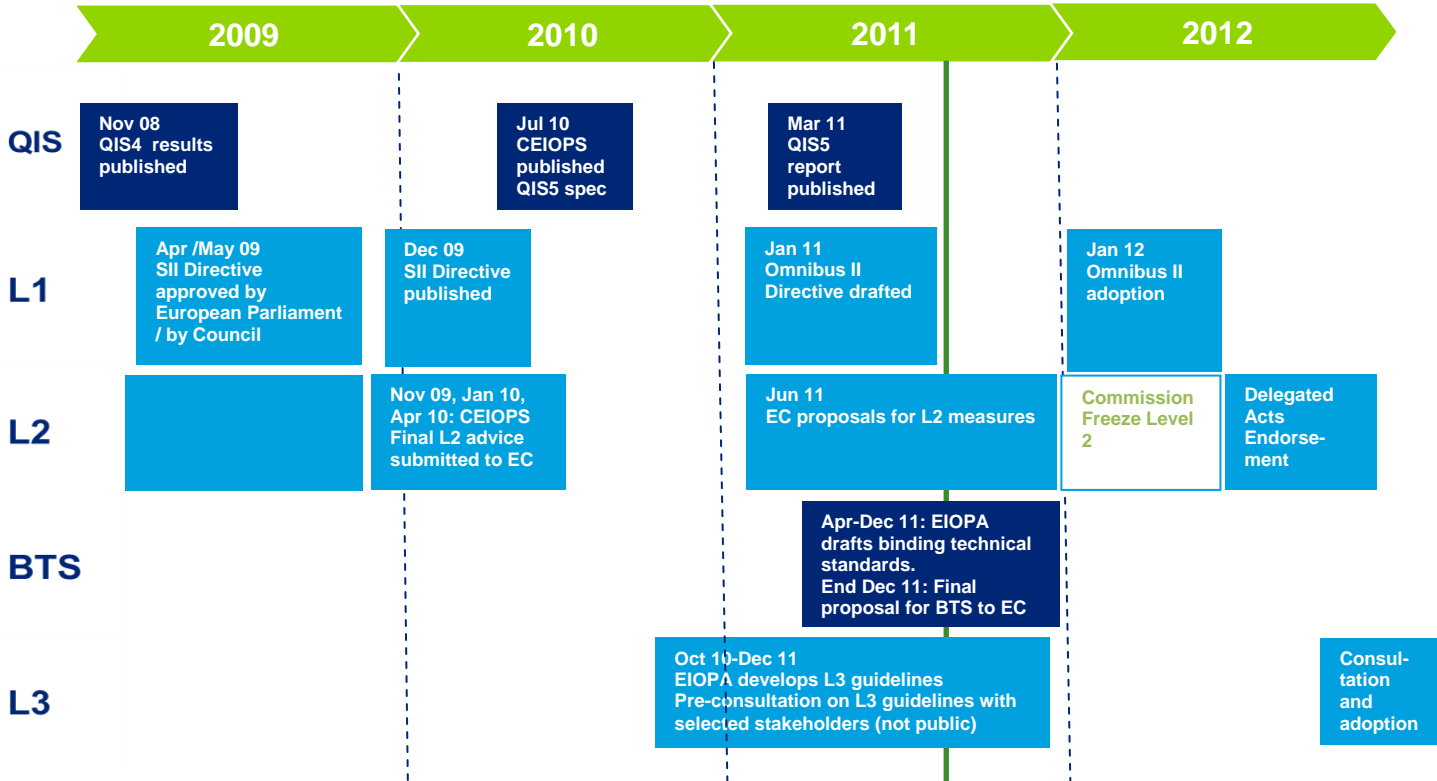
- **European Parliament proposes extensive changes to Omnibus II and Solvency II**

On 27 July the European Parliament's Committee on Economic and Monetary Affairs published the draft report on the proposed Omnibus II directive.

The report proposes changes to the wording of the draft Omnibus II directive to align it to the Omnibus I directive, adopted by both the banking sector and the securities and markets sector in October 2009. In addition, amendments to the Solvency II requirements are proposed in a number of areas (the timing and duration of transitional measures, the illiquidity premium, third-country equivalence, reporting requirements and the minimum capital requirements).

The draft report includes a proposed deferral of the full implementation date for Solvency II to 1 January 2014, while introducing a phasing-in of the requirements throughout 2013.

Solvency II development



Note: The timetable reflects the course of actions expected prior to publication of the shift of Solvency II implementation. The European Commission has not yet published the final proposal for Level 2 measures and further changes in the timetable can be expected.