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Deloitte Insurance
Breakfast Briefing
Solvency II

15 September 2009



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Agenda

Introduction

Solvency II - The Whole Picture

Level 2 CEIOPS Consultation Papers

UK Survey & Gap Analysis

Survey - Your Opinion

Public Disclosure & Reporting (Pillar 3)

Website Launch

Summary & Things to do

Questions & Answers

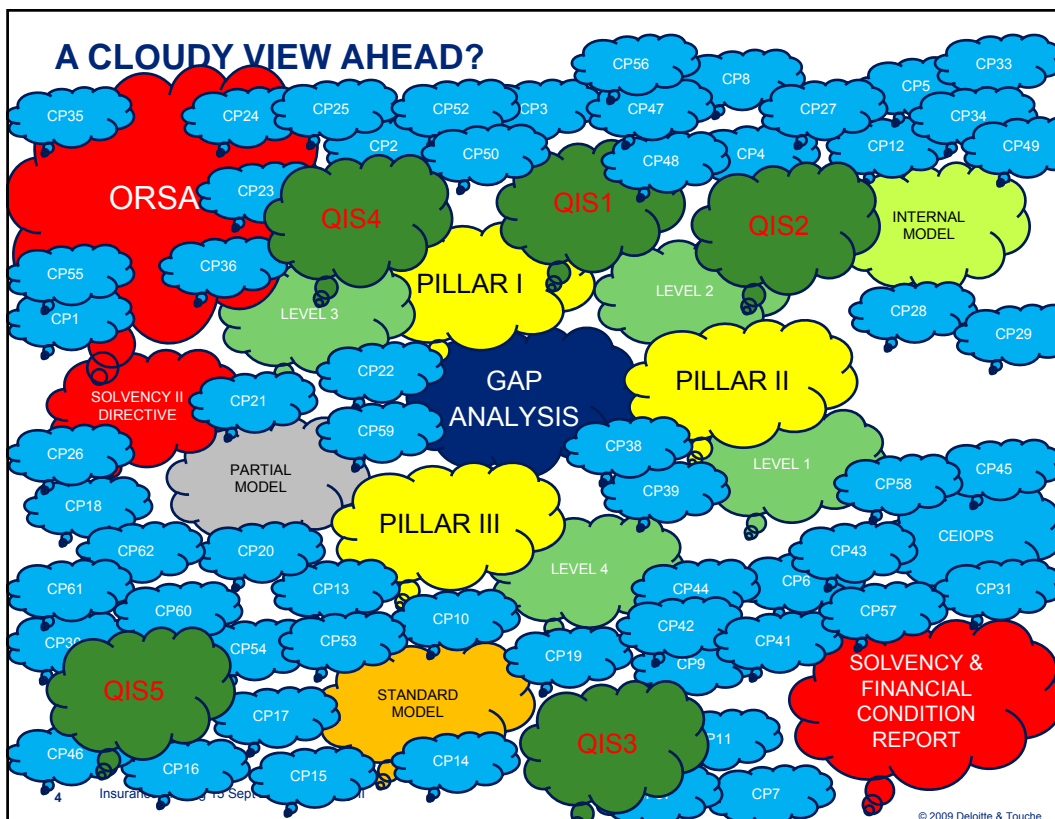
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Solvency II The Whole Picture

Dick Tulloch



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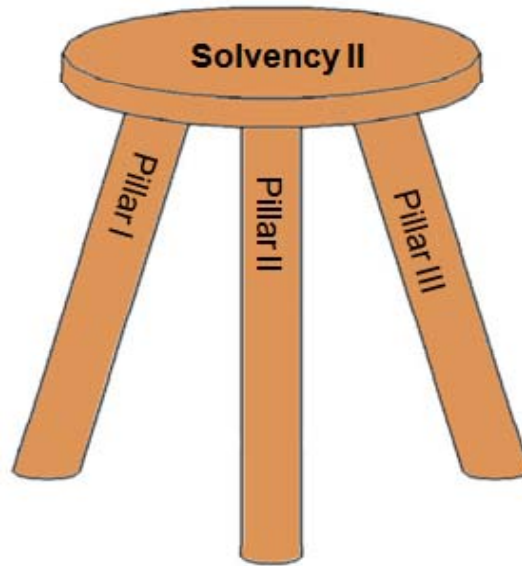
Solvency II

Structure:

Pillar 1 – Quantitative

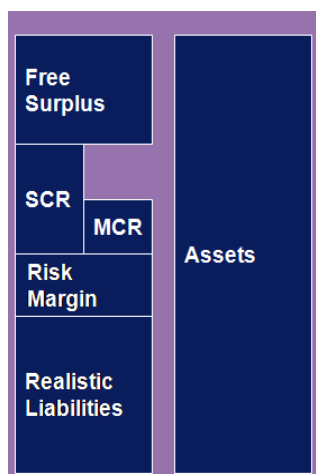
Pillar 2 – Qualitative

Pillar 3 – Market discipline

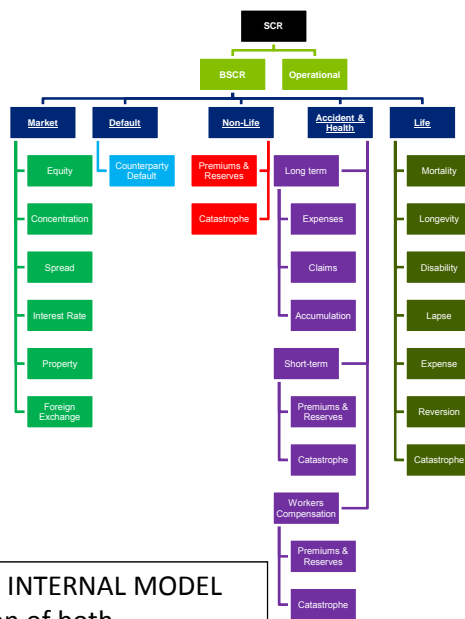


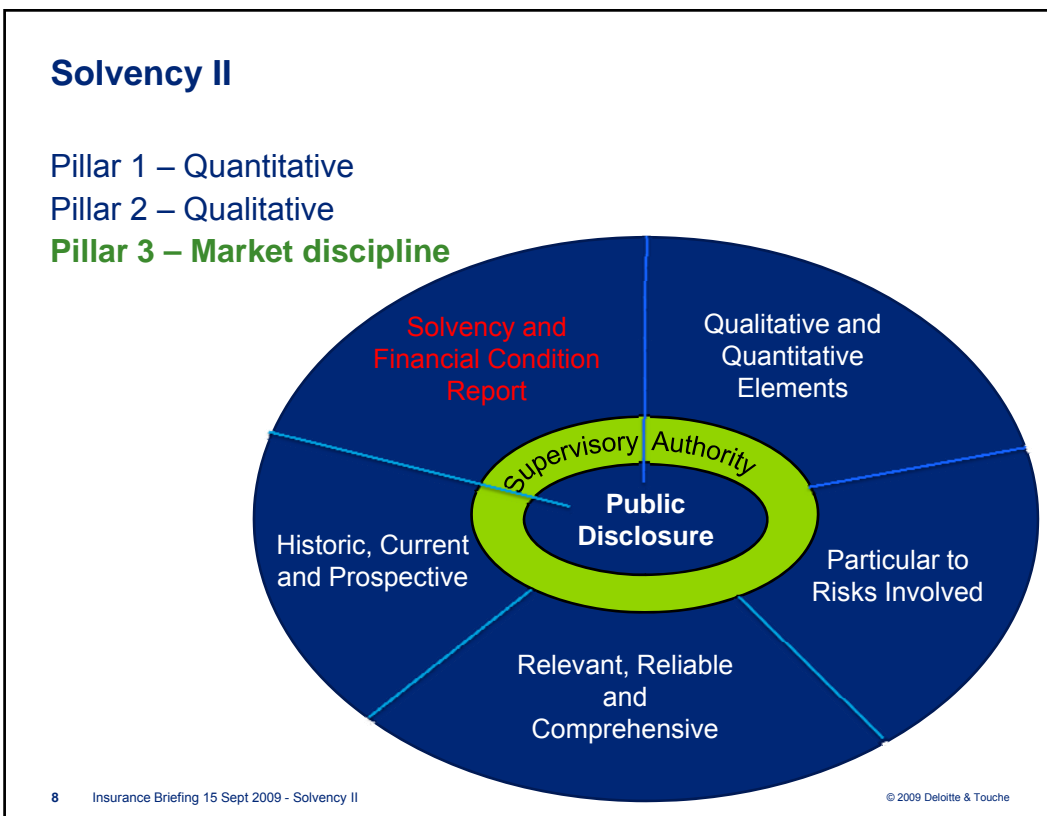
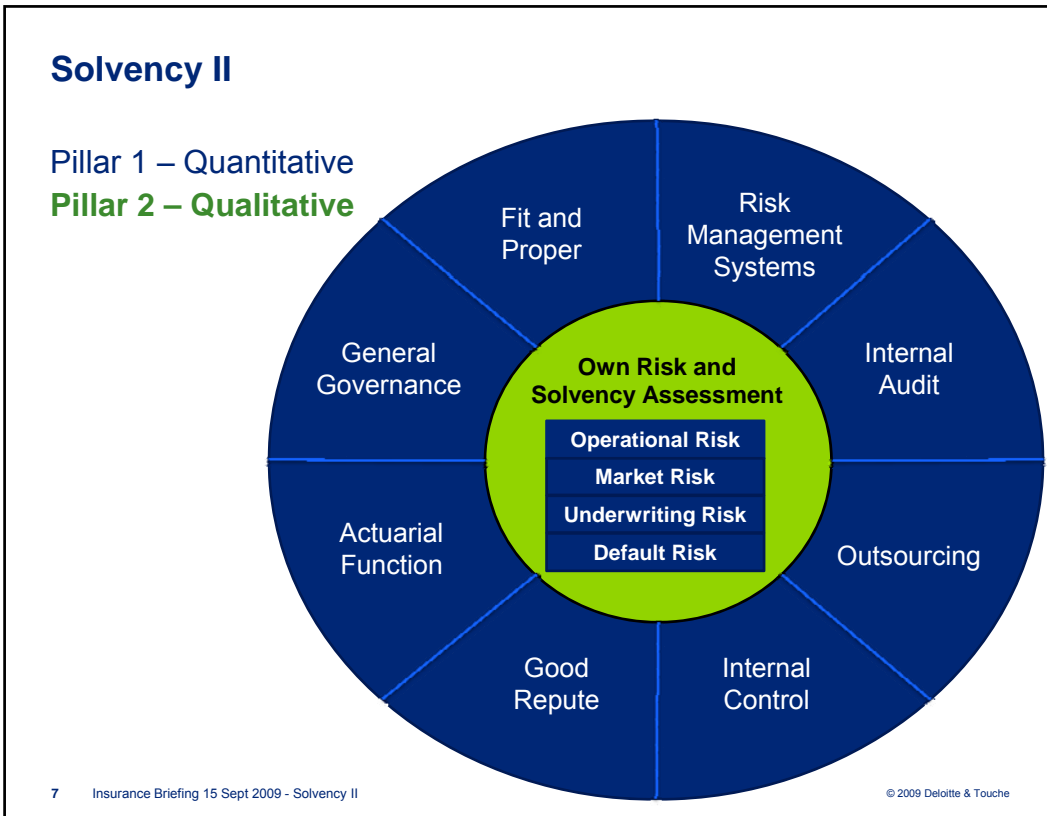
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Pillar 1 – Quantitative



STANDARD MODEL v INTERNAL MODEL
or combination of both





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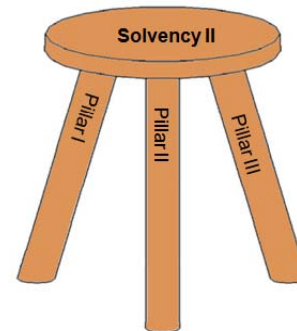
Process:

Level 1 – Framework Principles (Completed 5th May 2009)

Level 2 – Implementing Measures (In process – Consultation Papers)

Level 3 – Setting of Supervisory Standards (In process – Issues Papers)

Level 4 – Monitoring of Compliance and Enforcement



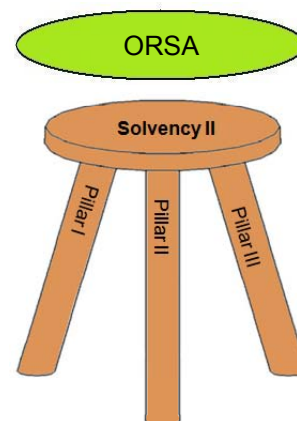
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ORSA - Article 44 - Own Risk and Solvency Assessment

Level 3 not level 2, but brought forward to assist in issues paper in May 2008

EC has stated that the ORSA

- Does not stipulate a requirement for an internal model
- Is not a capital requirement separate from SCR & MCR
- Should not be too burdensome

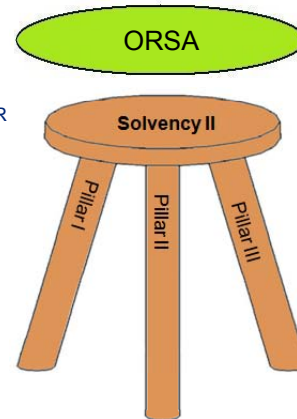


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ORSA - Article 44 - Own Risk and Solvency Assessment

Should highlight

- Specific risk profile, approved risk tolerance limits and business strategy
- Compliance with the capital requirements (Articles 101 to 129) covering SCR and MCR
- Significance of difference between risk profile of company and that of the SCR model
- Proportionate approach based on nature, scale and complexity
- processes to assess short and long term risks
- If internal model then ORSA considers the recalibration necessary to transform internal risk into SCR
- Integral part of business strategy and used in strategic decision process
- Regularly and without delay following significant risk profile changes
- Inform supervisory authorities
- Covers wider risks than just SCR risks including liquidity, reputational and strategic
- Contents: areas covered, process, responsibilities, stress tests and results, overall solvency needs, financial condition, strategies for raising funds, internal assessment and results, frequency and content of internal reports



Solvency II

Public Disclosure - Solvency & Financial Condition Report – Article 50

Should contain Description of

- Business and performance
- System of governance and assessment of adequacy to meet risk profile
- Each risk category, exposure, concentration, mitigation and sensitivity
- Assets, technical provisions and other liabilities including bases and methods of valuation
- Structure of own funds
- SCR & MCR
- Main differences between standard and internal model if applied
- Any non compliance with MCR or SCR
- Analysis of changes and movements
- Any capital add-ons etc (this may be deferred until 5 yrs after implementation of SII)

Note: based on Article 52

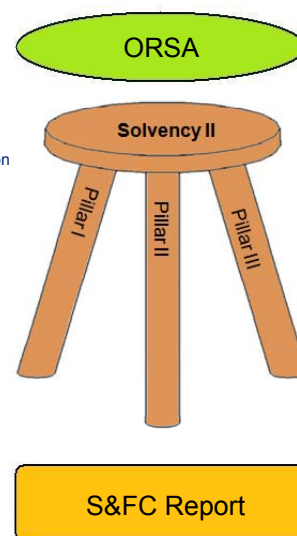
Permitted not to disclose if

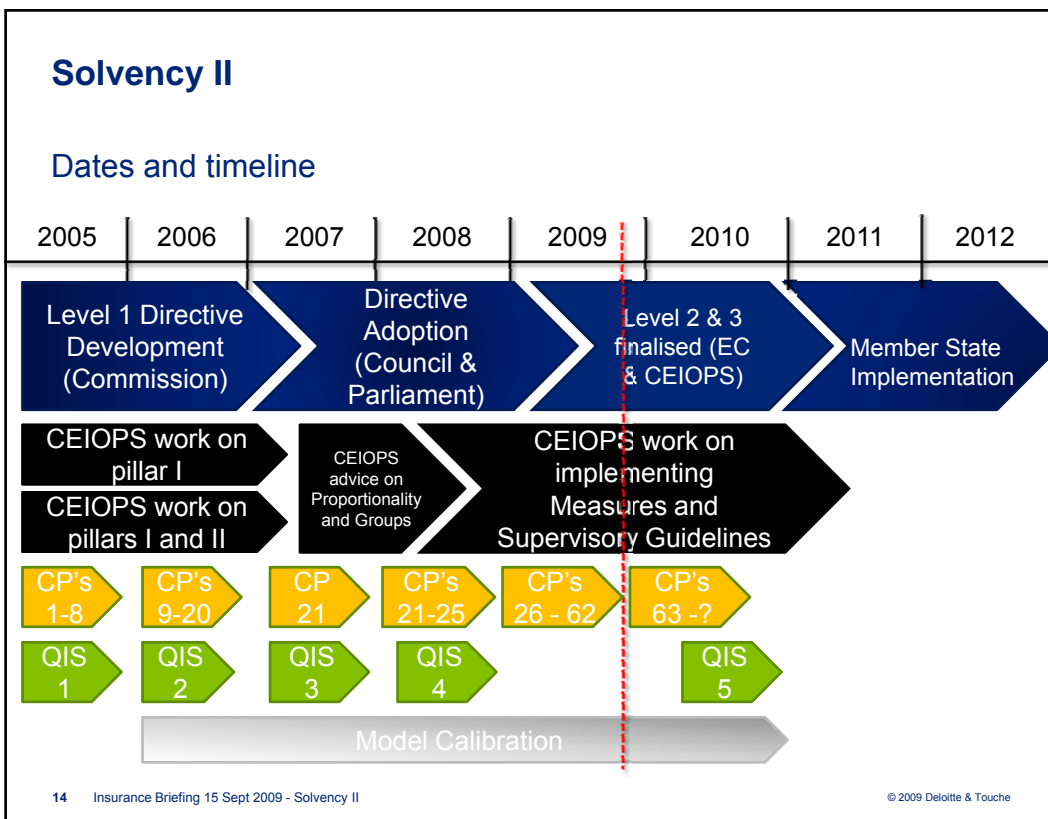
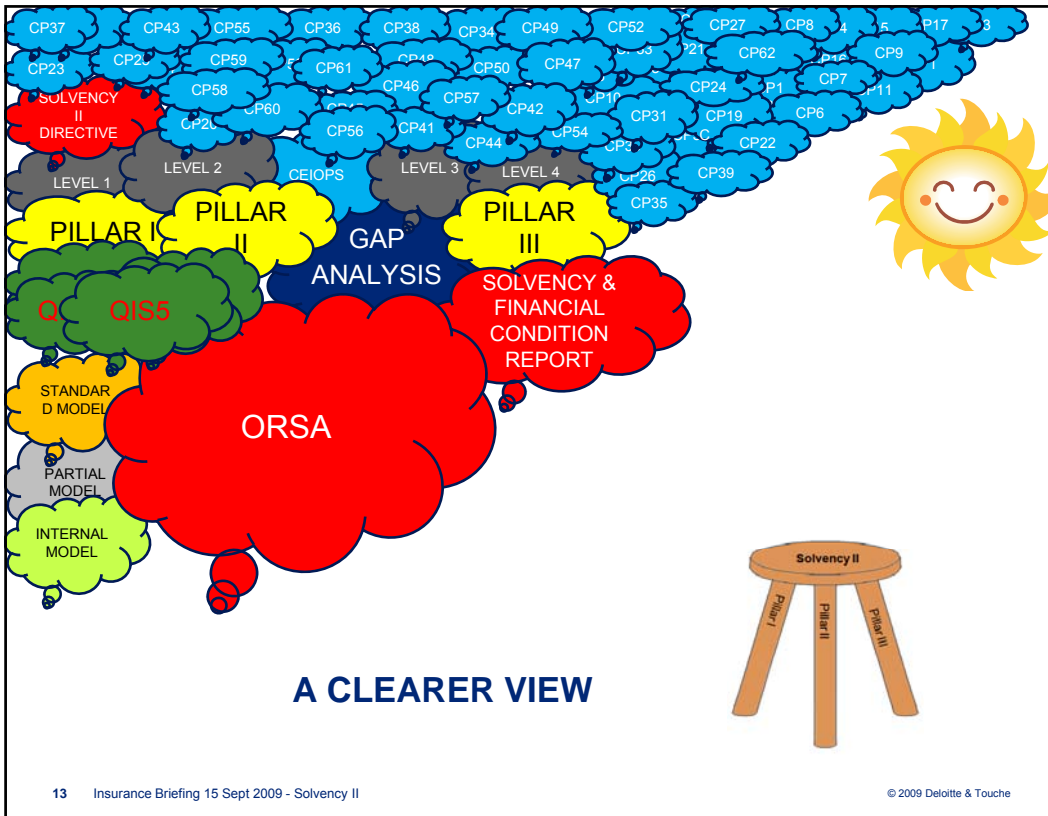
- Competitors may gain significant undue advantage
- Obligations of secrecy or confidentiality to policyholders or counterparties

But, if permitted by supervisor then it should be stated in the Solvency & Financial Condition Report

This exemption will not apply to

- Structure of own funds
- SCR & MCR
- Main differences between standard and internal model if applied





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CEIOPS Level II Implementing Measures Consultation Papers

Zora Law



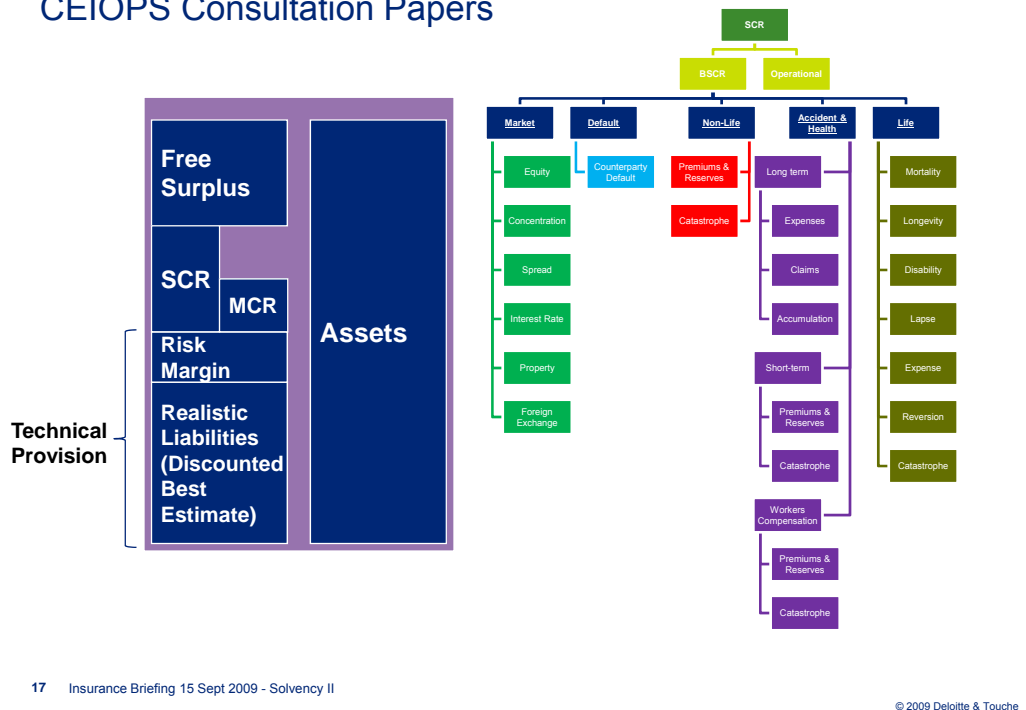
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Level 2 Implementing Measures

CEIOPS Consultation Papers #26-37, 39-62

Technical Provision	CPs 26, 27, 30, 32, 39-41, 43-45
SCR	CPs 28, 31, 47-54
MCR	CP 55
Risk Margin	CP 42
Other Liabilities	CP 35
Own Funds	CPs 29, 46
SPV	CP 36
Internal Model	CPs 37, 56
Group Assessment	CPs 60-61
Pillar 2	CP 33 (System of Governance), CP 57 (Capital Add-on) CP 62 (Supervisors)
Pillar 3	CP 34 (Transparency & Accountability) CP 58 (Reporting & Disclosure)
Remuneration	CP 59

Level 2 Implementing Measures CEIOPS Consultation Papers



Level 2 Implementing Measures Technical Provision

Best Estimate (CPs26,39)

- Methods and statistical techniques - stochastic, deterministic and analytical
- Valuation - modelling, expert judgement and business knowledge
- Process - qualitative and quantitative data collection, setting of assumptions, qualifications of estimates, documentation and control
- Overseen by an individual with adequate mathematical and actuarial expertise and experience
- Allow for all expenses including overheads and future expenses
- Non-life: allocated between premium and claim provisions
- Life: surplus funds to be excluded
- Consider: options and guarantees, policyholder's behaviour, management actions and the distribution of extra benefits
- Principle of substance over form
- Recoverables from reinsurance, SPV and finite reinsurance separately
- Validation and back-testing techniques

Risk-free Interest Rate (CP40)

- Euro-zone: AAA government yield curve by ECB

Level 2 Implementing Measures

Technical Provision

Standards for Data Quality (CP43)

1. Appropriateness
 2. Completeness
 3. Accuracy
- Definition of data, assessment of quality of data, resolution of problems identified, monitoring data quality
 - Audit specific sets of data by auditors
 - Review quality of data for reasonableness and consistency by actuaries

Counterparty Default Adjustment (CP44)

- Recoverables from reinsurance contracts and SPV
- Expected present value of the loss-given default of the counterparty, weighted by the probability of default of the counterparty
- Calculated separately for each lob and counterparty
- Recovery rate for each counterparty, (max 40% if n/a)
- Risk-mitigating instruments - consider the associated credit risk

Level 2 Implementing Measures

Technical Provision

Simplifications (CP45)

- Assess the nature, scale and complexity of underlying risk
- Quantitative assessment of the model error
- Back testing and validation

Calculation as a whole (CP41)

1. The future cashflows can be replicated reliably
2. provided by financial instruments
3. which have reliable and observable market values.

Future Management Actions (CP32)

- Objective, Realistic, Verifiable

Future Premiums (CP30)

Segmentation (CP27)

Level 2 Implementing Measures

SCR Standard Formula

Counterparty Default Risk (CPs28,51)

- Using Exposure, Probability of default and Loss given default
- Type 1 exposures:
 - reinsurance arrangements, derivatives, securitisations, deposits with ceding institutions, letters of credit and cash at bank.
 - > 99.5th percentile of the variance of the combined exposure
- Type 2 exposures (more diversified but unrated):
 - receivables from intermediaries, policyholder debtors and deposits with ceding institutions (if numbers of counterparties are below a certain threshold)
 - > sum of the [Exposure multiplied by a (generic) Risk Factor]
- Credit derivatives: credit risk transferred goes to (market) credit spread risk

Level 2 Implementing Measures

SCR Standard Formula

Market Risk (CP47)

- Interest rate risk:
 - + Increase in the volatility of interest rates
- Currency risk:
 - Most onerous result for each individual foreign currency and then aggregate
- Spread risk:
 - Credit stresses vary by duration
- Property risk:
 - Consider different shocks to commercial, retail and other types of property
- Concentration risk:
 - Thresholds 1-2% (from 3-5%)

Level 2 Implementing Measures

SCR Standard Formula

Non-life Underwriting Risk (CP48)

- Geographical diversification removed
- Premium risk:
 - Multi-year products: risk of change in premium provisions
 - Credibility-weighted standard deviations removed but can use own estimates of standard deviation within standard formula
 - Further allowance for risk-mitigation measures (e.g. non-prop r/i) excluded
- CAT risk:
 1. Standardized scenarios (QIS5)
 2. Alternative factor-based method
 3. Higher of the scenario/alternative factor-based method for the following:
 - Exposure outside the EU
 - Non-proportional reinsurance or
 - Where the scenario is not applicable (e.g. where the contract excludes such scenarios) or
 - Where the footprint is not applicable.

Level 2 Implementing Measures

SCR Standard Formula

Life & Health Underwriting Risk (CPs49,50)

- Mortality stress: 15% permanent increase in rates (from 10%)
- Morbidity/disability stress:
 - 20% permanent decrease in recovery rates
 - Inception rates 50% increase (from 35%) in inception rates in year one followed by a 25% increase for all subsequent years
- Lapse stress: the greater of
 - 50% increase in lapses
 - 50% decrease in lapses
 - Sum of 30% of surrender strains of policies where the surrender strain is positive
- CAT risk:
 - A 2.5 per mille mortality catastrophe test (from 1.5 per mille in QIS4)
 - Morbidity CAT stress moved to health risk - a number of pan-European catastrophe scenarios will be developed

Level 2 Implementing Measures SCR Standard Formula

Operational Risk (CP53)

- Additional elements:
 - Risks arising from any external management of investments:
0.5% of the highest amount held with a single 3rd-party management company
 - Risks associated with increased business activity:
Additional capital if the technical provisions/earned premium are expected to increase by more than 10% over the year
 - Risk associated with the use of management actions in calculating life provisions:
An increase in the loading applied to life technical provisions
- Substantial increases in the capital factors:

	New Factors	QIS4 Factors
TP – life	0.9%/1.0%	0.3%
TP - non-life	4.4%	2.0%
Prem - life	7.6%	3.0%
Prem - non-life	4.1%	2.0%
UL factor	50%	25%
BSCR cap	60%	30%

- Still no credit for diversification between operational and other risks

Level 2 Implementing Measures SCR Standard Formula

Reinsurance Mitigation (CP52)

- Reinsurance could have significantly less effect in reducing MCR/SCR than under Solvency I
 - Credit for R/I in stressed scenario analysis is significantly less than those in determination of best estimate provisions -> partial model
1. Effective risk transfer
 2. Economic effect over legal form
 3. Legal certainty, effectiveness and enforceability
 4. Liquidity and valuation
 5. Credit quality of the provider of the risk mitigation

Allowance of financial mitigation techniques (CP31)

Loss Absorbing Capacity of Technical Provisions and Deferred Taxes (CP54)

- Loss absorbing – conditional and pure discretionary benefits (discretionary participating features in IFRS)

Level 2 Implementing Measures

MCR & Risk Margin

MCR Calculation (CP55)

- Linear formula based on basic volume measures
- SCR Corridor 25%-45%(from 20%-50%)
- Expected to be calculated quarterly.

Risk Margin (CP42)

- the cost of providing funds equal to SCR by a reference undertaking
- net of reinsurance at lob level and include allowance for unavoidable market risks
- no allowance for diversification between lob
- cost of capital rate indep of solvency position; must be at least 6%
- Sum of PV of SCR multiplied by CoC rate, discounted by risk-free interest rate, for each year until expiry of business

Level 2 Implementing Measures

Internal Model

The Procedure for the approval of an Internal Model (CP37)

1. Pre-application
2. Application
3. Policy for changing the full or partial internal model
4. Assessment
5. Decision-making process

Tests and Standards for Internal Model Approval (CP56)

- Internal model governance:
 - Administrative/management body (the board)
 - Risk management system
- Use test - Foundation + 9 Principles
- Statistical Quality Standards
- Calibration Standards
- Profit & Loss Attribution
- Validation
- Documentation Standards
- External Models and Data

Level 2 Implementing Measures Pillar II elements

System of governance (CP33)

1. General governance requirements
2. Fit and proper person requirements
3. The risk management system (including risk management function)
4. The internal control system (including compliance function)
5. The internal audit function
6. The actuarial function
7. Outsourcing

Capital Add-On (CP57)

1. Risk profile capital add-on
 - Underestimation of particular risks included in the SCR
 - Quantifiable risks not covered in the SCR
 - Aggregation mechanism
2. Governance capital add-on
 - 3 stages: identification, assessment and calculation

Level 2 Implementing Measures CEIOPS Consultation Papers

**Please pick up a copy of
Deloitte's summary on
second set of CPs
at the stand**

**Please find a soft
copy of this document at
the link below:**

http://www.deloitte.com/view/en_GB/uk/industries/financial-services/issues-trends/solvencyii/article/13e2f08829483210VgnVCM200000bb42f00aRCRD.htm

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Solvency II – Implementing Measures Shedding light on the future requirements

Introduction

On 2 July 2009, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) issued its second set of draft technical advice on level 2 implementing measures for consultation.

Following on from the first set of consultation papers (CP33) released earlier in March this year, this draft advice covers a range of topics across the areas of Solvency II technical implementing measures of the Minimum Capital Requirement (MCR), the Solvency Capital Requirement (SCR) Standard Formula, Internal Model Own Funds, Reporting and the Supervisory Review Process.

This draft advice will influence the final stages of insurance regulation across European Union member states, with final advice on these implementing measures due to be submitted to the European Commission in January 2010. The second set of papers is subject to a six week consultation period ending at April 07: on 11 September 2009, we welcome the opportunity that this consultation process provides for the industry to engage in the development of the detailed implementing measures, and for emerging, innovative, firm and other stakeholders to provide consultation, and practical feedback.

We have presented here a summary of each of the second wave of consultation papers, listing out the main elements of the advice, along with our view of the key messages and impacts for the UK insurance industry. We hope that you will find it useful. Deloitte has committed our professionals to this consultation process and we will continue to express our views to assist CEIOPS in its crucial rule-making activities.



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Solvency II Survey 2009 & Gap Analysis

Lenka Marsikova



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Solvency II Survey 2009

Solvency II Survey 2009

The survey is based upon a questionnaire completed by executives of UK insurance companies during Q1 2009.

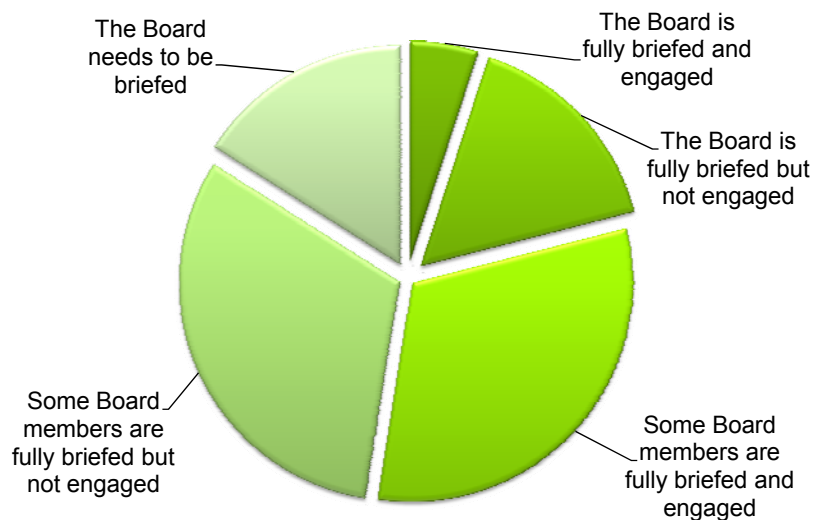
Thirty-nine companies took part, representing life, non-life and composite insurance companies.

Topics covered include:

- Stakeholder engagement
- Strategic intent
- Embedding Solvency II within the business
- Implementation priorities

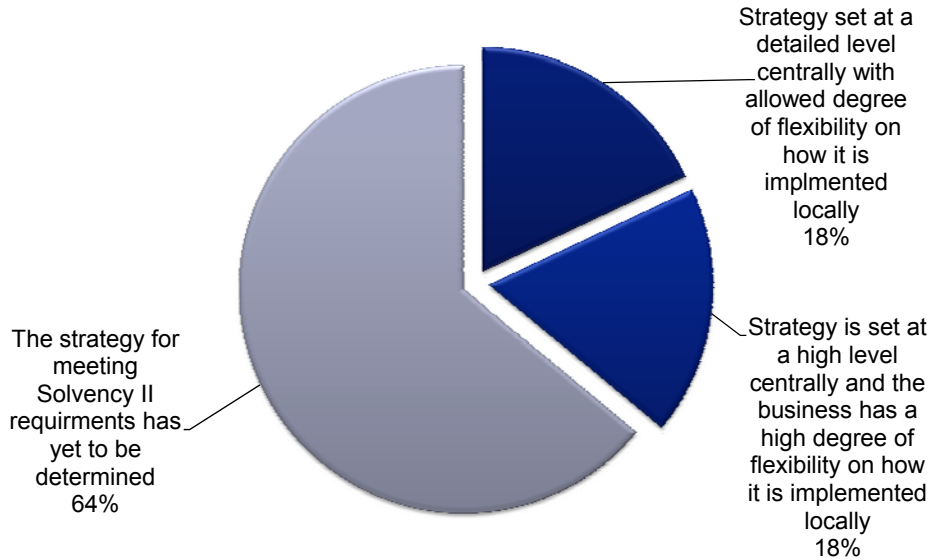
Solvency II Survey 2009 – Stakeholder Engagement

How would you categorise the level of awareness of Solvency II amongst your Board?



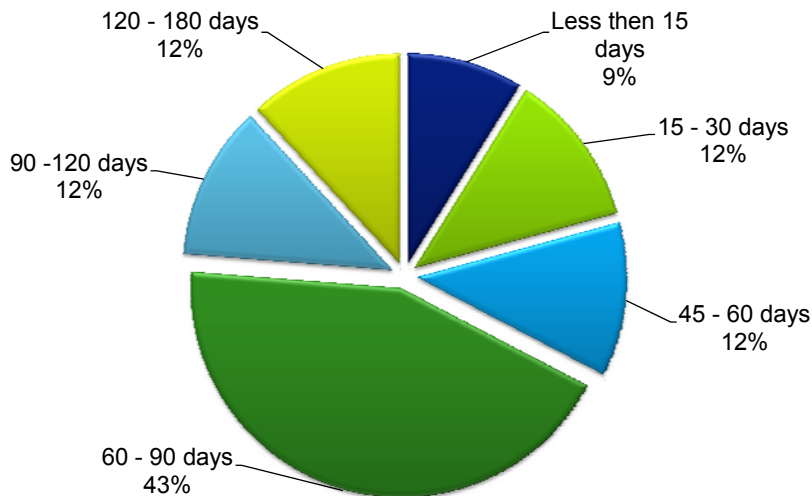
Solvency II Survey 2009 – Strategic Intent

Which of the following best describes your approach to Solvency II?



Solvency II Survey 2009 – Models

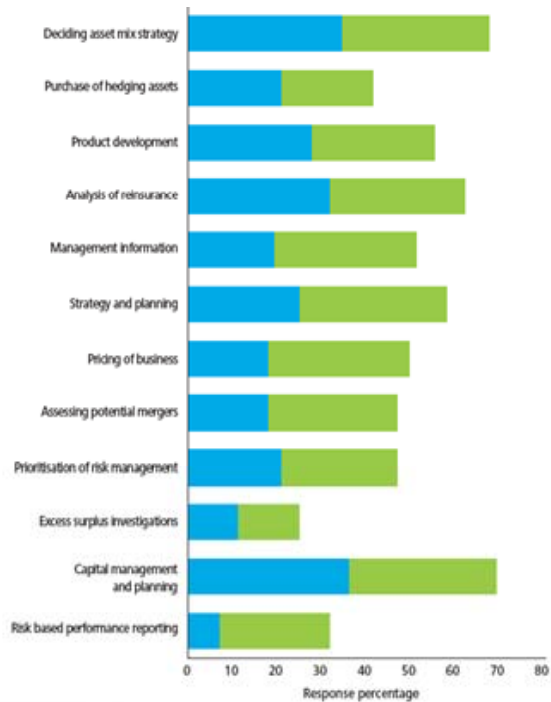
How many days does it take you to carry out a full, accurate economic capital calculation?



Solvency II Survey 2009 – Stakeholder Engagement

What are the potential areas of use for the economic capital model?

1. Capital management & pricing
2. Deciding asset mix strategy
3. Analysis of reinsurance
4. Strategy and planning
5. Product development



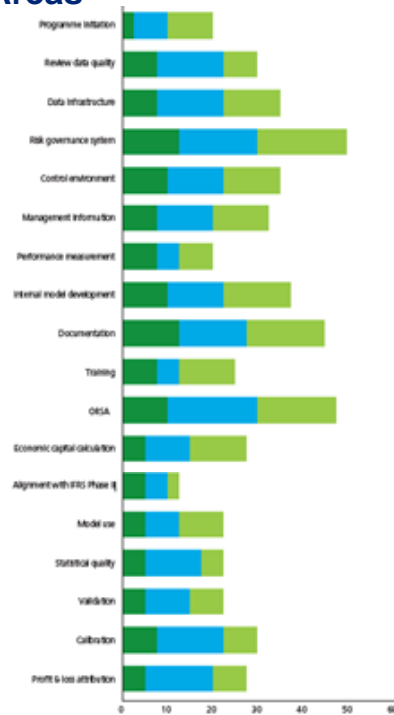
Solvency II Survey 2009 – Focus Areas

Priorities over next six months:

For 90% companies, the priorities are **programme initiation, gap analysis and implementation planning**. Followed by documentation, internal model development and risk governance systems.

Priorities over next six to 12 months:

In longer term, priorities include **risk governance systems, documentation** and developing approach to Own Risk and Solvency Assessment (**ORSA**).



Conclusion on the Survey

- There is now more awareness about Solvency II
- It is necessary to obtain board and senior management buy-in
- Consider interactions between Solvency II and IFRS Phase II
- At this point, organisations should conduct a gap analysis to identify what needs to be done

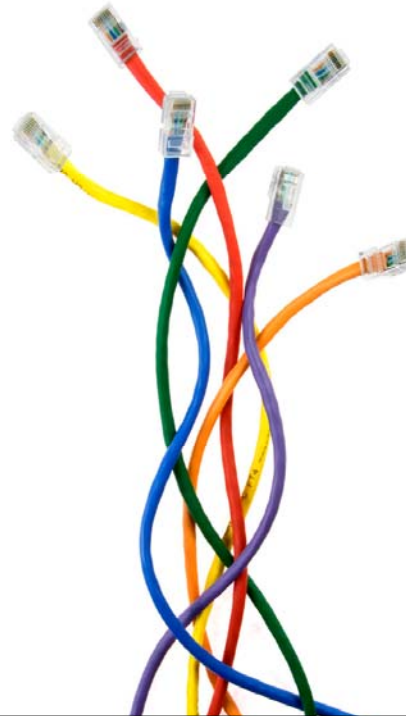
Solvency II – Pillar II

It deals with qualitative aspects of a company's **internal controls**, **risk management** process and the approach to supervisory review. It stresses the importance of **corporate governance**.

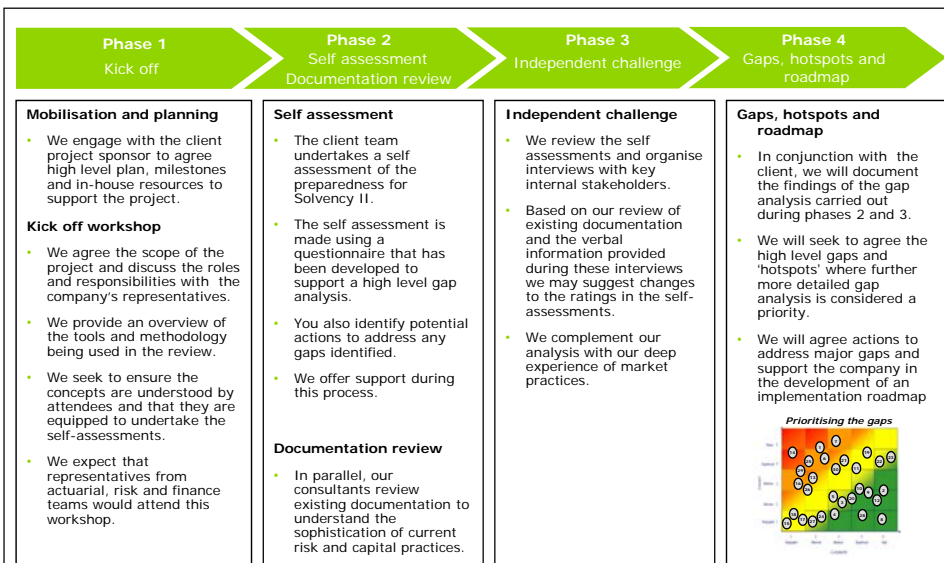


GAP Analysis

A multi-dimensional analysis across the three pillars of the Solvency II Directive and all classes of risks.



Solvency II Gap Analysis – An outline of our approach



GAP Analysis Tool

Deloitte. SII Gap Analysis Toolkit

* BIS
CEIOPS
ED7

Source: CP4 Article Number: 39 Article Title:

ERM Category: Risk governance & organisations

Content:

CEIOPS advises the Commission Services to reflect high level principles on governance in the future Framework Directive. This is consistent with the CRD. The system of governance of an insurance undertaking must provide for a sound and prudent management of the business. This implies an appropriate organisational structure, set of responsibilities and 'fit and proper' requirements, effective processes to identify, assess, manage, monitor and report the risks it is or might be exposed to, as well as an appropriate and understood system of internal control suitable reporting arrangements, and an audit framework. Ultimate responsibility for ensuring that an undertaking is well run and adequately manages its risks rests with its Board of Directors. Insurance undertakings are required to disclose information about the structure of their system of governance.

Questions:

Does the system of governance of the insurance company provide for a sound and prudent management of the business? Does the ultimate responsibility for ensuring that it is well run and adequately managing its risks rest with the Board of Directors?

Key Words:

Systems and Controls; Senior Management Responsibility

Links to other papers

CEIOPS:

S and P:

FSA: 1.4.11*

Swiss Solvency:

Risk Class covered

- Credit Risk
- Market Risk
- Liquidity Risk
- Operational Risk
- Insurance Risk
- Group Risk

SII Pillar

- Pillar I
- Pillar II
- Pillar III

Rating:

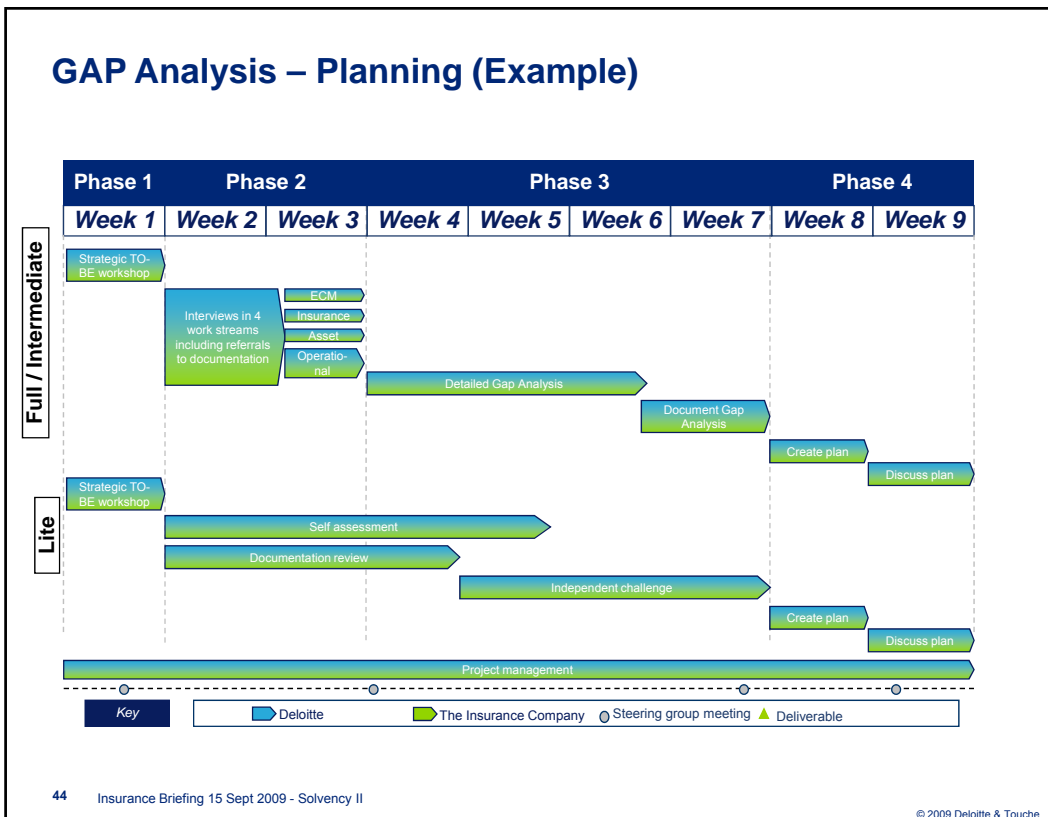
Rating: Some related activities in place.

Impact: High

Complexity: Medium

Record: 1 of 34 (Filtered)

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GAP Analysis – Implementation Plan and Deliverables (Example)

ID	ERM capability	Question	Solvency II article reference	Phase 2		Phase 3	Gap	Phase 4			
				RAG	Management self assessment Comments	Deloitte Observation		ID	Description	Priority	
										Impact	Complexity
1	Risk Appetite & Tolerance	Have you developed a risk appetite and limit setting framework incorporating an integrated capital modelling process and output?	Section 2 Article 43	Yellow	Risk appetite has been discussed at Board with broad consensus on a 'top level' CaR measure reached. This is not however cascaded into a more granular limit framework enabling day to day measurement of risk exposure against appetite.	In addition to management observations, policy documentation does not articulate risk appetite approach or threshold. However Board minutes provided indicate discussion on appetite took place and was agreed.	Risk appetite framework to be deepened and aligned with more granular limit framework. Policy documentation to be updated with approach for risk appetite	1	Develop risk appetite framework enabling top level CaR measure to be cascaded across risk types and business units. Deepen risk appetite framework to align with more granular risk limits.	M	H
								2	Update risk policy documentation with risk appetite approach	L	L
2	Process and methodologies – quantitative	What process and methodology do you have to understand the drivers of your capital requirement? How readily and timely are you able to calculate your capital requirements in support of decision making?	Section 4 Article 101, 104, 108, 117 and 118-122	Red	Regulator gave an ICG of 120% of the submitted ICA in March 2008. Some understanding of the drivers of capital through the ICA process, but lacks clear articulation and tolerance from group. ICA calculated half yearly. Insurance risk can be calculated for most lines relatively quickly, but there have been problems with asset risk data for outs. inv. management firm	Management are currently enhancing their risk framework and re-calculating the asset risk from investment funds which have some exposure to US mortgage debts and these issues were cited as source of additional risk by the Regulator.	Significant gaps exist in complying with SCR calculations as per section 4 of directive. Specifically do not comply with article 104 (calculation of BSCR requirement) Do not have robust risk framework for demonstrating the 6 tests for int. model approval (articles 118-122)	3	Carry out analysis of capital using QIS4 model relative to current ICA to understand potential solvency constraint	H	M
								4	Develop internal process for calculating technical provisions on a best estimate basis	M	H
								5	Review data capture methodology and design and specify data requirements for SCR calculations	H	M

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GAP Analysis – Summary

- Points out what needs to be done
- Helps in the construction and preparation of ORSA
- Recommended by the Regulator
- Should be completed as soon as possible to make sure that there is enough time to meet the Solvency II implementation deadline

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Survey - Your Opinion

Aim is to get an indicator of the state of the Market's SII development and worries

We will provide results to all attendees so please verify that we have your email

Deloitte Solvency II Briefing - Survey Questionnaire

Name _____ (Optional)
 Company Name _____ (Optional)

Q. 1 What is the type of your company?

Direct	Life
Reinsurance	Non-life
Capital	Health
	Composite

Q. 2 How is your QIS involvement so far?

	QIS3	QIS4	QIS5
Did nothing			
Did an internal exercise			
Submitted a return			
Will do an internal exercise			
Will do and submit			

Q. 3 What is the state of your own internal planning on Solvency II?

Developed and implemented a detailed strategy	
Established an internal team to consider implications	
Waiting for Financial Regulator advice before acting	
Done little to date	
Quite lost as to what to do next	
Responded to Financial Regulator's Letter of 5 Aug 2009	

Q. 4 Which SII model do you think you will be using?

Standard	
Full Internal	
Partial Internal	
Not decided	

Q. 5 What are you main focus priorities for Solvency II?

(Numerical Order 1 to 8)

Risk Governance System and ORSA	
Documentation	
Data & Reporting Issues	
SII/IFRS alignment	
Standard Model	
Internal/Partial Model	
Training	
Business Planning Model	



Solvency II Reporting Insurance Breakfast Briefing 15 September 2009



Carol Lynch

Background

- CEIOPS Consultation Paper no 58
- Implementing measures of Pillar 3 of Solvency II regime
- Requirements for supervisory reporting and public disclosure
- As requested in Article 35, Article 55 and Article 260 of the general approach on the Solvency II Directive
- Objectives
 - Harmonise reporting
 - Promote comparability of valuation and reporting rules with IFRS
 - Introduce proportionate requirements for small undertakings
 - Ensure sufficient supervision of insurance groups and financial conglomerates
 - Improve market transparency
- Reporting requirement applies to stand alone regulated entity and group level

Key Reporting Requirements

The key reporting requirements are;

- At predefined periods
 - Solvency and Financial Condition Report (SFCR)
 - Report to Supervisor (RTS)
- Information to be received by the supervision authority
 - On occurrence of pre-defined business events
 - Those that can lead to material changes in an undertaking's solvency position or risk profile
 - During enquiries regarding the situation of an undertaking
 - To further understand if an undertaking is complying with relevant laws and regulations
 - Obtain information on any contracts entered into by the undertaking
 - Request information from external experts who work for or with an undertaking

Solvency and Financial Condition Report

- Annual report to be required within 3-4 months of undertaking's year end
- Target audience to include other insurance/reinsurance undertakings, financial analysts, rating agencies, shareholders, policyholders and investors.
- To follow a prescribed structure to include
 - Executive Summary
 - Business and Performance
 - System of Governance
 - Risk Management
 - Regulatory Balance Sheet
 - Capital Management

Report to Supervisor (RTS)

- Is a private document communicated only to the undertakings supervisor.
- Consistent with the structure of the SFCR - also a standardised structure.
- Information may need to be presented differently to the supervisor as RTS is part of ongoing supervisory between undertaking and supervisor.
- Indication that RTS will be required every 5 yrs at a minimum – frequency could be increased.
- RTS information not required by the SFCR
 - Business plan and risk strategies, including business continuity plan
 - Legal and regulatory issues affecting the business
 - Variance against plan rather than prior period
 - Future anticipated solvency needs, U/W performance projections, changes in risk exposure, and;
 - Significant additional disclosure explaining results of the internal model

Common Requirements

- Insurance/Reinsurance holding company allowed provide a single group wide SFCR subject to agreement with the group supervisor .
- Undertakings are required to develop a written policy to ensure the on-going appropriateness of the information to be disclosed to be approved by management and to include;
 - The governance procedures
 - Responsibilities of individuals/functions re drafting and reviewing the information
 - Timeframes
 - Materiality principles
- Requirement for external audit
 - Quantitative and qualitative aspects to be included in this scope to be finalised
- Specifies the structure and minimum content to allow supervisors and users of public disclosures to compare one undertaking to another.

Conclusion

- Content of the reports builds on existing IFRS disclosure as the reference framework for the regime.
 - Both frameworks recognise risks and their management as key disclosure requirements
 - Finalisation of IFRS 4 Phase II will provide further alignment between Solvency II and IFRS.
- Need for senior management engagement
 - Ensure reporting process works effectively and collaboratively as different departments responsible for various technical input
 - Enhance the relationship between undertaking and customer
- Analyse potential disclosure requirements now and assess changes required if proposals were finalised as drafted.
- Undertakings will need to ensure they meet minimum level of regulatory compliance when Solvency II is operational 31 October 2012.

Solvency II

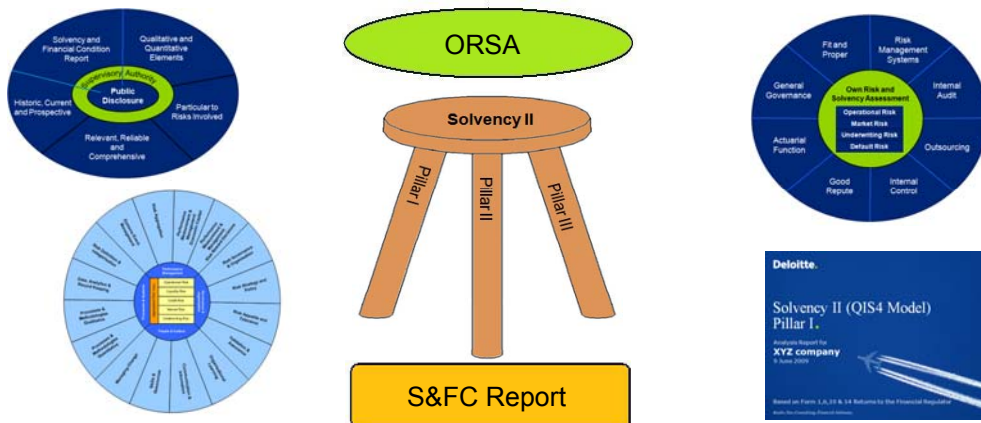
Deloitte's website on Solvency II

<http://www.deloitte.com/ie/solvency2>

Solvency II

Solvency II is a reality - implementation date: 31Oct 2012

- S** Solvency & Financial Condition Report
- T** Three Pillars all of equal importance
- O** Own Risk and Solvency Assessment
- O** Option to use own model or part - but need to be planning now
- L** Last minute actions are not an option – will likely incur penalties



Solvency II

Ten Action Points

1. Respond to Financial Regulator
2. Get Board/Director involvement in Solvency II
3. Establish cross-department SII Team
4. Conduct a GAP analysis/Risk audit
5. Get Help and instigate Training to enable catch up
6. Establish business planning model to integrate decision making and assist with ORSA
7. Plan to take part in QIS5
8. Decide on Standard/ Internal/Partial Model
9. Review and audit data collection and recording requirements
10. Monitor and Keep up to date with Developments

Solvency II

Questions & Answers



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