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Solvency II
Past, Present and Future

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Agenda

1. The past
2. The present
3. Experience with Solvency II
4. Changes in the air
5. Are we on the right track?
6. The truth about Solvency II

1. The past

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Insurance regulation under Solvency I

- Was boring: very difficult to explain to an outsider how to calculate the solvency margin under Solvency I
- Insurance regulation was highly prescriptive and paternalistic
- Insurance regulation was very legalistic and did not reflect the economics of the insurance business model
- Insurance regulation was more concerned with policyholder protection than with insurance
- Insurance supervisors were considered less important or qualified than their banking colleagues

Insurance supervision under Solvency I

- Insurance supervision was often limited to a detailed scrutiny of a number of forms
- Form over substance – tick-the-box exercise
- Insurance supervisors rarely engaged directly with supervised entities
- Insurance supervisors rarely had direct market experience: employment moves between supervision and industry or vice versa were often seen as suspect
- Insurance supervisors preferred detailed rules rather than a principles based approach, requiring judgment

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The birth of Solvency II

- Planned at the end of last century (FSAP 1999)
- Slow start because not considered a first priority
- Conceived in 2004 (Framework for consultation)
- Healthy pregnancy between 2004 and 2007
- Delivery in 2009, not without complications
- Affected by postnatal depression (financial crisis)
- Severely ill between 2011 and 2013 (LTG-measures)
- In intensive care with EIOPA in 2013/2014
- Injection of extra dose of vitamins in 2014 (Omnibus II)
- Alive and kicking since 1 January 2016

2. The present

Impact of SII on the insurance sector

- The introduction of SII went very smoothly, notwithstanding pressure from the low interest rate environment
- No (re)insurance undertaking failed as a result of the introduction of Solvency II, although some (life) insurance undertakings went into run-off
- Virtually all (re)insurance undertakings have an SCR ratio which is well above the required 100%
- (Re)insurance groups showed in the last (2018) stress test that they can manage even a very severe nat cat scenario
- Many insurers have changed their business model and are moving away from offering long term guarantees

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Why has the impact been so positive?

- Solvency II was overdue and (re)insurers and supervisory authorities embraced the reform with enthusiasm
- The introduction of Solvency II was thoroughly prepared (QIS exercises and long gestation period)
- Risk management has considerably improved within the insurance sector since the Solvency II discussions started
- Transitional measures were introduced to facilitate the transition from Solvency I to Solvency II
- Solvency I was overly prudent and the excessive prudence in technical provisions could be transferred to own funds

Has Solvency II delivered?

- Economic theory has advanced a number of criteria for evaluating the adequacy of a risk-based solvency regime:
  - Capital requirements must be risk-sensitive
  - Risks must be appropriately calibrated
  - Economic balance sheet
  - Focus on those insurers that are likely to impose the highest cost on the economy
  - Discourage misreporting
  - Adequacy in economic crisis/anticipation of systemic risk
  - Flexibility over time
  - Strengthening of governance and risk management
  - Proportionality (I would add this)

Role of prudential supervision

- In order to deliver the desired outcome, the qualitative criteria relating to the solvency regime must be enhanced with criteria relating to prudential supervision:
    - The supervisory regime must be proportionate, risk-based and forward looking
    - Supervisors must have the necessary information
    - Supervisors must have sufficient powers, skills and resources to carry out their supervisory tasks, to intervene effectively and in time and to take enforcement actions when necessary

Assessment

- Overall, it can be argued that Solvency II satisfies these conditions and that Solvency II has therefore delivered
- However, some critical comments can be made:
  - Insufficient recognition of long-term business model
  - The system has become too complex and too detailed
  - Insufficient application in practice of proportionality
  - Too burdensome framework for governance
  - Still too much focus on capital (SCR seen as MCR)
  - Insurers and supervisors have a tendency to apply a Solvency I attitude to the Solvency II framework

3. Experience with Solvency II

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3.1. Capital requirements

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Pillar I

- Most people are satisfied with the standard formula but nobody is really excited about it
- Market consistent valuation of insurance liabilities remains a challenge: there is no satisfactory theoretical solution yet for measuring long term liabilities
- Capital charges for equity investment remain controversial
- Too much actuarial involvement in the development of the standard formula? Limits to quantification?
- Supervisors look at the SCR as the MCR!
- Too frequent changes in the calibration

Only 737 undertakings used LTG in 2017

Type	Total	VA	TTP	MA	TRFR	DBER	None
Life	596	273	110	20	4	0	293
Non-life	1620	220	11	0	0	1	1398
Life & non-life	402	179	40	13	2	0	213
Reinsurance	294	24	1	1	1	0	271
Total	**2912**	696	162	34	7	1	**2175**

Breach of SCR on 31 December 2017

Country	Undertakings	Country	Undertakings
Bulgaria	1	Portugal	2
Cyprus	1	UK	10
Czech Republic	1		
Greece	1		
Ireland	1		
Luxembourg	6		
Netherlands	1		
Norway	1	**EEA Total**	**25**

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Weighted average SCR Ratio (Q3 2018)

- Total EEA: 243%
- Lowest: Latvia: 124%
- Highest: Germany: 343%
- Ireland: 184%

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Weighted average MCR Ratio (Q3 2018)

- Total EEA: 650%
- Lowest: Latvia: 265%
- Highest: Germany: 937%
- Ireland: 506%

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Use standard and internal model 2017

	Standard	Partial	Full	Total
Life	546	29	21	596
Non-life	1541	42	37	1620
Life and non-life	365	29	8	402
Reinsurance	274	5	15	294
Total	**2726**	**105**	**81**	**2912**

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3.2. Governance

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Pillar II: Governance

- Regulators and supervisors rightly attach a great deal of importance to this area
  - Risk management (linkage between risk and capital)
  - Risk culture with tone from the top
  - Proportionality
  - ORSA
- Regulatory overshooting : too many requirements and too little proportionality
- Lack of clarity concerning the role of the 4 key governance function holders and other key function holders

Own Risk and Solvency Assessment

- Analysis and recommendations by EIOPA (19 June 2017):
  - Majority of undertakings have made good progress in implementing the ORSA process
  - Need for greater involvement of the AMSB
  - Scope of risk assessment must be further expanded
  - Overreliance by undertakings on the standard formula
  - Quality of stress testing including reverse stress tests and scenarios used in the ORSA can be further improved

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3.3. Public disclosure and supervisory reporting

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Pillar III

- Extensive supervisory reporting is needed in a principles based regime
- Change in culture: insurance sector has no transparency tradition. Is it too much, at once?
- Problem of data quality: comparability not evident. Can all insurers and supervisors deliver the same quality?
- Supervisory reporting should further a real dialogue. Is that the case?
- Public disclosure (SFCR) should help all stakeholders to better understand the complexity of the insurance business model. Should it apply to all (re)insurers?

Solvency and Financial Condition Report

- Analysis and recommendations from EIOPA (18/12/2017):
  - Mostly timely and compliant
  - Different language styles and formats: comparability
  - Need for better “summary”
  - QRT’s alone do not convey the message
  - ORSA information needs to be more specific
  - Information on risk sensitivity can be improved
  - Information on valuation not sufficiently clear
  - Information on eligible own funds must be more detailed
  - Comparative information needed

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3.4. Group supervision

Group supervision

- Difficult to implement because of legal, cultural, psychological, language, etc. reasons
- Group supervision was one of the most difficult issues in the development of Solvency II
  - The texts are often unreadable: what is a group?
  - Group support was (unfortunately) deleted
  - All supervisors are equal, but some are….
  - Some supervisors still fail to see the relevance of group supervision
  - Need for common supervision of large insurance groups

First assessment of group supervision

- EIOPA assessment (22 December 2017)
  - Group definition
  - Removal of sub-group supervision
  - Cooperation within colleges of supervisors
  - Need for greater consistency for approval of group internal models

- EC assessment (5 April 2018)
  - Reforms will be dealt with as part of the 2020 review
  - Greater role for EIOPA in ensuring supervisory convergence in the area of internal model applications as part of the ESA review

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Second assessment of group supervision

- EIOPA Report on Group Supervision, Capital Management within Groups and FoS and FoE (14 December 2018)
  - Group solvency calculation remains a challenge
  - Problems of policyholder protection in the case of groups operating in different MS
  - Need to improve supervision of cross-border business and to enhance cooperation between home and host
- EC assessment ???
  - EC specifically asked to report by end 2018 on group support and…..

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4. Changes in the air

Review of the Delegated Regulation

- Review to take place before December 2018
- Call for advice from EC to EIOPA: proportionality, simplifications, calibration changes and technical improvements and removal of undue restrictions to corporate finance
- EIOPA advice delivered on 30 October 2017 (137 p.) and on 28 February 2018 (610 p.)
- EC has published amendment on its website in Nov. 2018
- EP is asking for further changes: risk margin, design of new equity class for LT investments and improvement of national component of volatility adjustment

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Review of the Framework Directive

- Review of LTG package and other issues to take place before 1 January 2021
- Likely topics on the agenda:
  - Long-term insurance (illiquid liabilities)
  - Calculation of technical provisions (risk margin)
  - Proportionality
  - Changes to the standard formula (market risk)
  - Changes to the calibration (e.g. following from Brexit)
  - Group supervision
  - Recovery and resolution

Solvency II and sustainable finance

- How can Solvency II be adapted to facilitate LT investment and to contribute to a more sustainable environment, while maintaining its risk based nature?
  - Because of the visible evidence of climate change, the pressure for rapid change in this area will not go away
  - Insurance by its very nature has an important role to play but it is not just a question of insurance
  - Much can already be done within the existing framework
  - S II should not be “strangled” and remain risk based
  - We need more than just to add the word “sustainability” everywhere

5. Are we on the right track?

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Solvency II: a dynamic process

- No need for Solvency III
- Solvency II is not perfect and was never meant to be
- Solvency II has been designed as a flexible regime that can and should be regularly amended in order to take account of practical experience
- Many reviews are specifically foreseen in the Framework Directive, in the Delegated Regulation and in the EIOPA Regulation
- Difficult to marry sometimes conflicting objectives: level playing field with banking, capital markets union, long term investments, sustainable finance

Early lessons from Solvency II

- Insurers and insurance supervisors have difficulties to work with a principle based approach
- Insurers are developing strategies to optimize capital
- EIOPA stress tests show that most insurers are well capitalised
- Risk management of most insurers has improved
- Insurance and insurance regulation/supervision is taken more seriously (also by banking supervisors)
- Supervisory colleges are playing an important role in furthering a single European rulebook

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Important aspects of Solvency II

- Solvency II puts more emphasis on the responsibility of each individual undertaking
- Internal models are an inherent part of Solvency II
- Solvency II recognises the strength and the weakness of human nature: more focus on risk management and governance
- Solvency II cannot work without a change in management culture and supervisory culture
- Insurers and reinsurers should use the SFCR to demystify their activities to external stakeholders

5. The truth about Solvency II

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Where to find the truth about SII?

- **“Solvency Requirements for EU Insurers: Solvency II is good for you”**
- Author: Karel Van Hulle
- Foreword: Gabriel Bernardino
- Publisher: Intersentia (Mortsel - Cambridge)
- ISBN 978-1-78068-177-1
- Number of pages: 600 pp.
- When? May 2019
- Is it worth reading? YES

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