Solvency II
Preparatory Guidelines
Omnibus II

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Milliman Breakfast Briefing
20 November 2013

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Lots of activity in recent months

14 June 2013
EIOPA findings on LTGA published

27 Sept 2013
EIOPA final guidelines on preparation for Solvency II

4 Nov 2013
CBI final guidelines on preparation for Solvency II

13 Nov 2013
Trialogue agreement on Omnibus II

We still await publication of the Omnibus II text agreed.

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Busy schedule to implementation

3 Feb 2014	??	??	31 Mar 2015	1 Jan 2016
European Parliament approval	Council Approval	Level 2 and Level 3 measures published and approved	Transposition into national law	Solvency II goes live

Preparatory Guidelines from 1 January 2014

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Structure to Solvency II

Level I	• Directive 2009 (150 pages) • Omnibus II (draft)	Trialogue
Level II	• Delegated Acts (ca. 700 pages) • “Tech Spec” draft Nov 2011	EIOPA
Level III	• ORSA • Reporting • More detail to follow	

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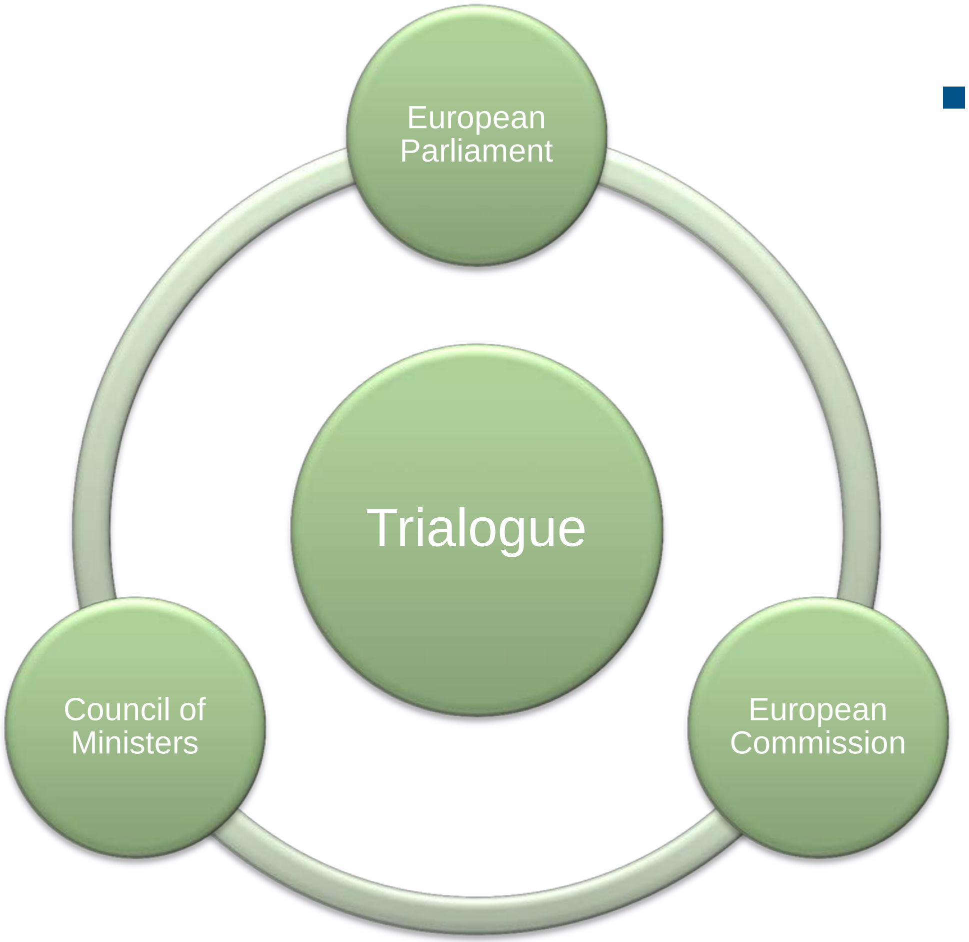
Omnibus II Trialogue Agreement



- Main areas of attention were:
  - Long Term Guarantee package (LTGA)
  - Equivalence
  - Resolution timetable
  - Implementation timetable

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Omnibus II Agreement

- Treatment of Long Term Guarantees was a key issue
- Trialogue concerned that Solvency II could lead to ‘artificial volatility’ & pro-cyclicality without Long Term Guarantee measures
- Could lead to range of unintended adverse social and economic impacts:
  - Shift from longer-term to shorter-term assets
  - Move away from offering long-term guaranteed products
  - Cost of overly-high capital requirements passed on to customers
  - Limit insurers’ traditional role as investors in the European economy
  - Reduce insurers’ traditional role as a stabiliser of systemic risk and market volatility

The long-term guarantees ‘package’

- Extrapolation of risk free yield curve
- Matching adjustment (MA)
- Volatility Balancer
- Transitional provisions

Quite a bit of change from QIS5

30/60 Extrapolation	20/40 Extrapolation
Liquidity Premium	Matching Adjustment
Liquidity Premium	Volatility Balancer
Transition period?	16 year transition period
Credit risk -10bps	Credit Risk -35bps?
Other Calibrations	Some changes - e.g. Mass Lapse

Extrapolation

- Swap curve is starting point, adjustments then made for:
  - Credit (default) risk
  - Market rates used up to Last Liquid Point (‘LLP’)
  - Convergence after LLP to Ultimate Forward Rate (‘UFR’)

- Chosen parameters are:
  - Last Liquid Point 20 years (50 years for Sterling)
  - Ultimate Forward Rate 4.2%
  - Convergence period ‘CP’ 40 years
  - Credit Risk adjustment – would appear to be left to Level 2 (35bps?)

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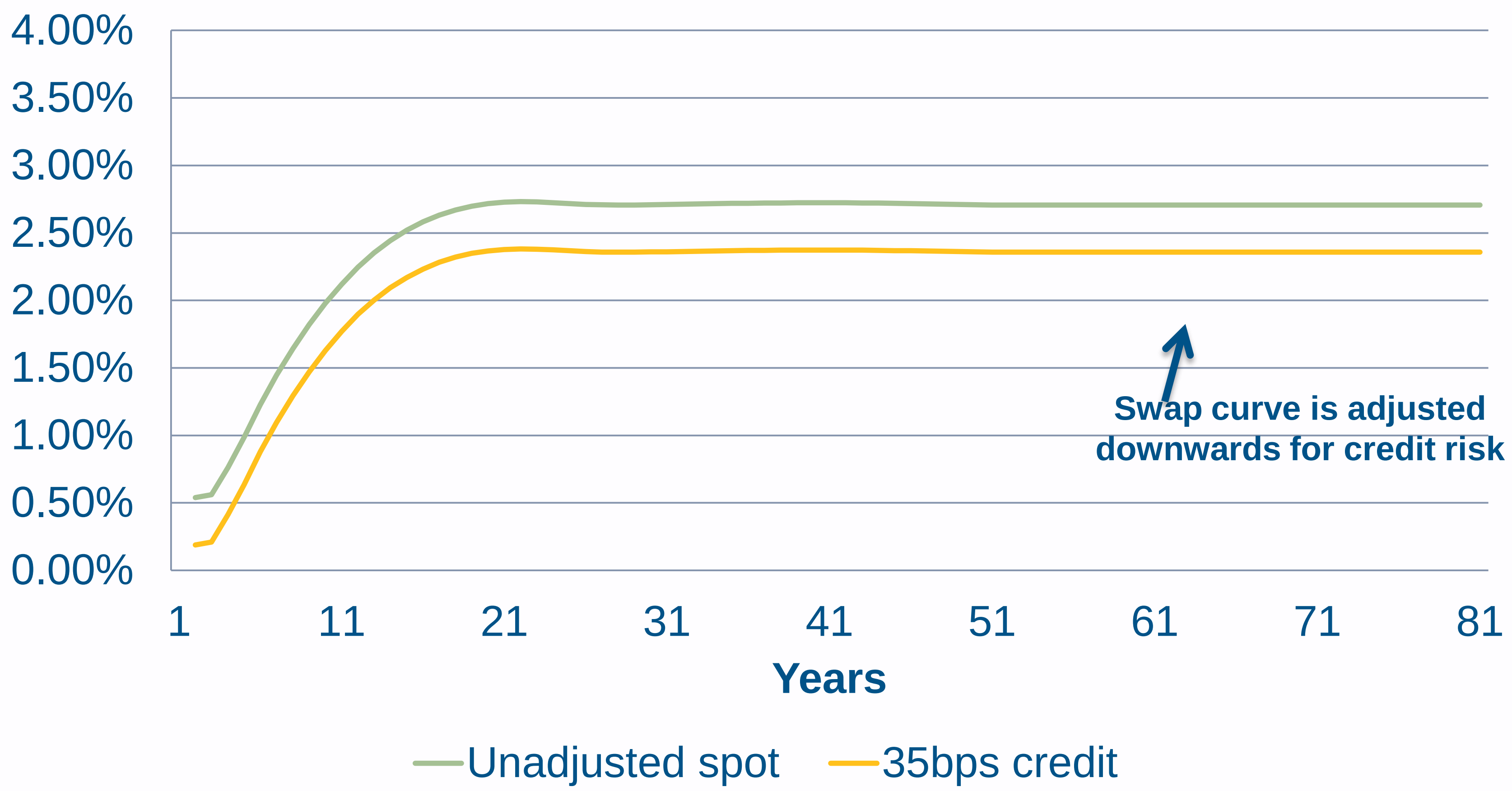
Construction of discount rates



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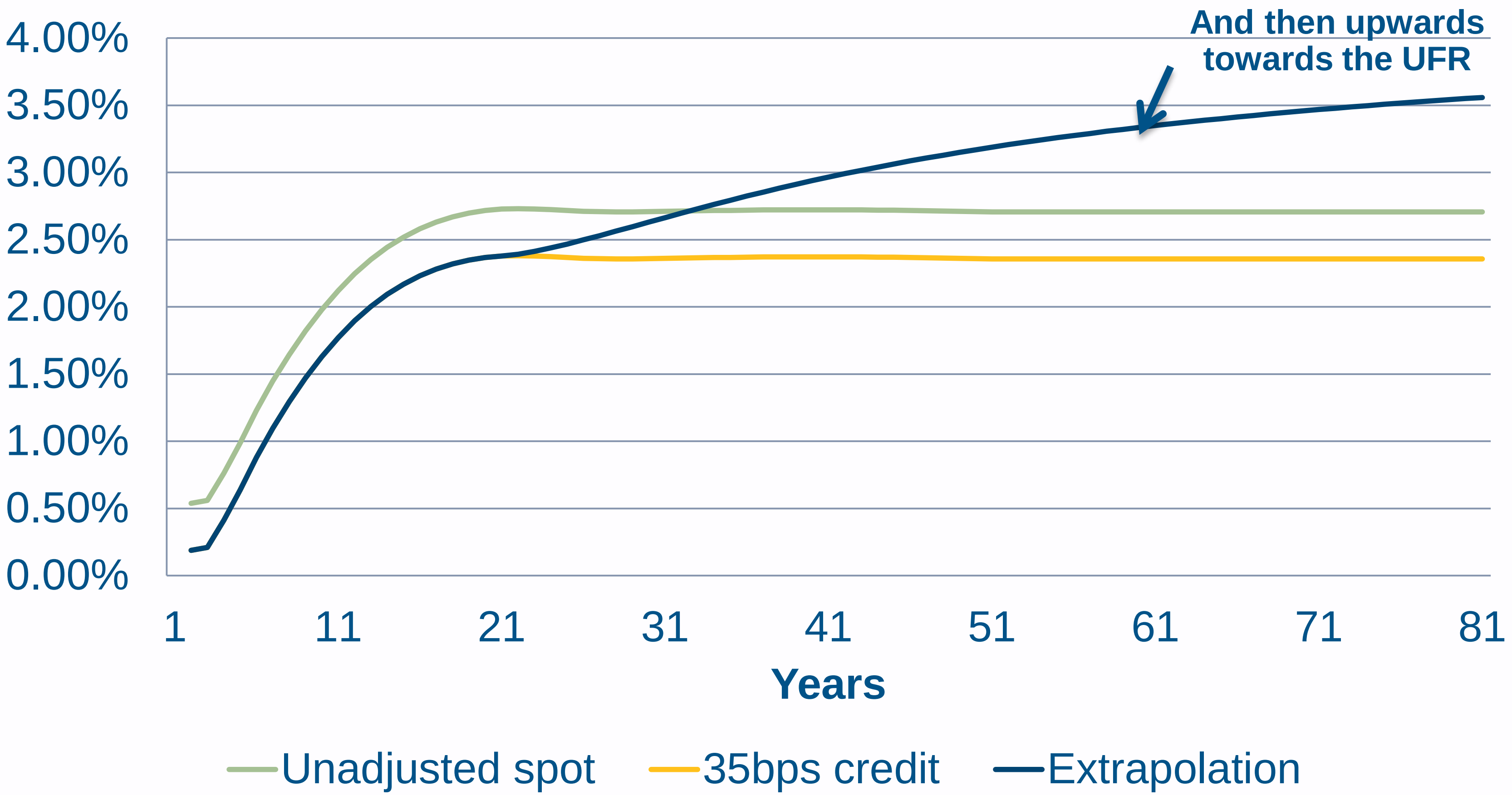
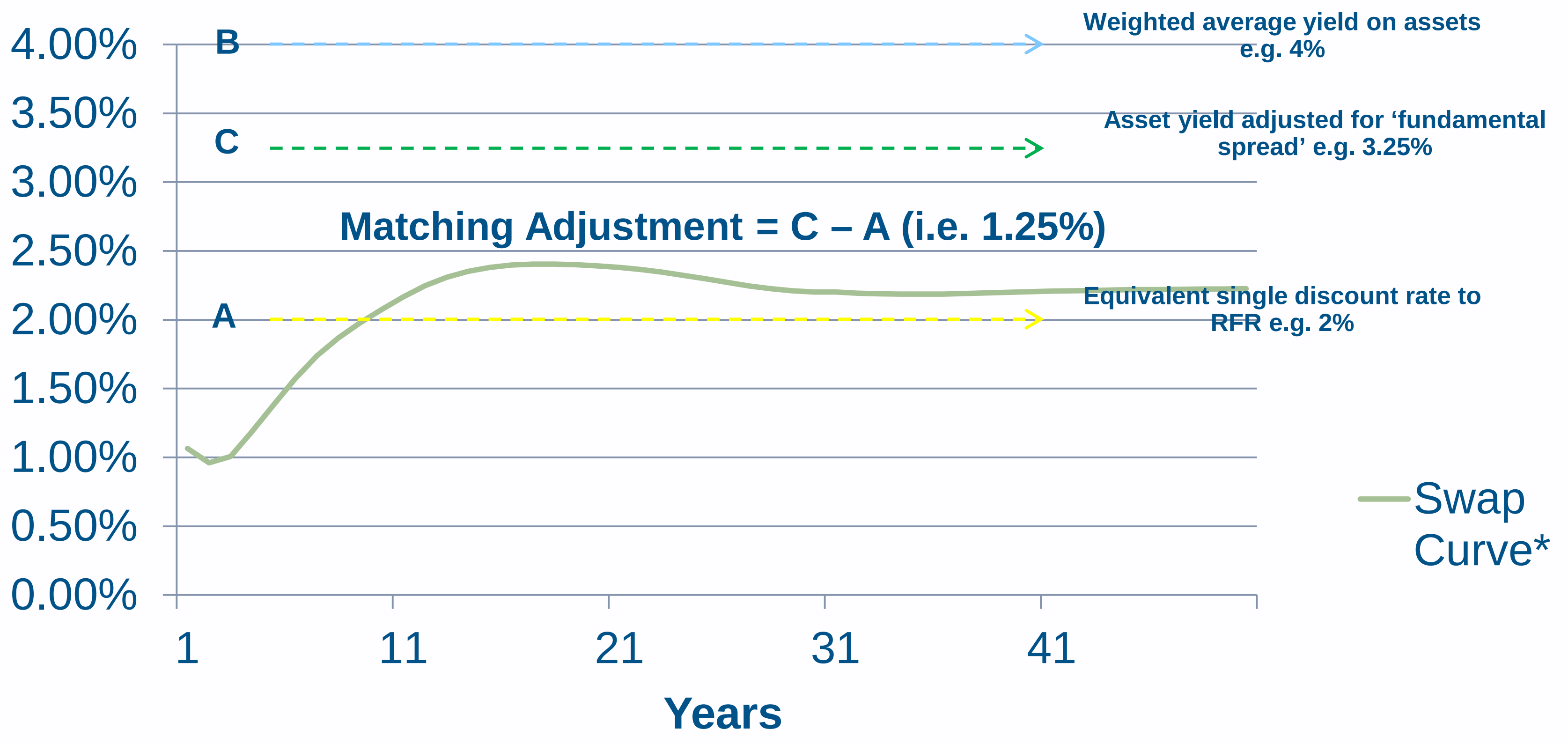


Ignore Volatility Balancer and Matching Adjustment for simplicity at this stage

Matching Adjustment

	Agreed Package
Versions	- Classic Matching Adjustment only
Asset Restrictions	- Must be an identified portfolio of assets - Bonds and similar assets - Materially match the liability cashflow
Product restrictions	- Excludes unit-linked - Limited mortality risk - No future premiums
Asset credit limits	- Credit taken for assets below BBB limited
Sample products	- Immediate annuity

Matching Adjustment – Calculation Step #1



* Swap curve at 31 December 2011 adjusted for credit risk

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Matching Adjustment – Calculation Step #2

	Classic
Fundamental spread - Government	Floor is 30% of long term average spread
Fundamental spread - Corporate	Floor is 35% of long term average spread

Volatility Balancer

- Applies to business not eligible for matching adjustment (unit linked excluded)
- Replaces Countercyclical Premium included in the LTGA test
- Predictable adjustment to the Risk Free Rate at currency level
  – National top-ups in exceptional circumstances
- 65% of the spread to Risk Free Rate on a “reference portfolio” for the currency

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Volatility Balancer – National Adjustment

If:

- Spread on national portfolio > 2 * spread on currency portfolio: and
- Spread on national portfolio > 100bps

Then:

- Adjustment to the spread for that country

- Example:
  - Currency Spread = 50bps
  - National Spread = 150bps
  - Spread used for that Country = 50bps + (150 -2*50bps) = 100bps

Transitional measures

- Proposed blending from Solvency I discount rates over 16 years
  - Weighted average of Solvency I and Solvency II interest rates
  - Weighting for SI rate is 100% reducing to 0% over 16 years
  - Weighting for SII rate is 0% increasing to 100% over 16 years
- Does not apply to assets where Volatility Balancer applies
- Must also report position without transitionals
- If not able to cover SCR without transitionals must outline how this will be achieved

Conclusion on LTGA (Omnibus II)

- Package now clear in most aspects
- Credit adjustment still to be determined
- Must also agree on reference portfolios
- Some open issues on lower rated assets

Other Elements of Omnibus II

- Provisional Equivalence for 10 years
  - Pragmatic solution given international attempts at convergence
  - Some more detail required at Level 2

- Enhanced Public Disclosure

- Enhanced Risk Management

CBI Preparatory Guidelines

System of Governance	FLAOR
Submission of Information	Internal Models

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Preparatory Guidelines – High/Med High

PRISM Rating	High & Medium-High
Submission of Information	**2014**: Prepare reporting systems **2015**: Submit annual (as at YE 2014) & quarterly templates (as at Q3 2015)
Systems of Governance	**2014**: Subject to all Guidelines
Forward Looking Assessment of Own Risks (FLAOR)	**2014**: Perform & report on: ▪ Overall solvency needs **2015**: Perform & report on: ▪ Overall solvency needs ▪ Compliance on a continuous basis ▪ Deviation from SCR assumptions Report using own structured report

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Preparatory Guidelines - Low/Med Low

PRISM Rating	Medium-Low & Low
Submission of Information	**2014**: N/A 2015: Prepare reporting systems
Systems of Governance	**2014**: General requirements apply 2015: Four key functions established & associated guidelines apply
Forward Looking Assessment of Own Risks (FLAOR)	**2014 & 2015**: Perform & report on: ▪ Overall solvency needs Report using CBI ORSA / FLAOR tool

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Conclusion

- Arguing finally over
- **Solvency II will happen in 2016**
- Preparations required in 2014/2015
- Quite a bit of change from Pillar 1

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