

Solvency II update

22 September 2011

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Agenda

- Quick legislation update Mike
- Omnibus II William
- Hot topics in Level 2 Mike
- Solvency II equivalence Mike

2



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LEGISLATION UPDATE

3



Reminder of building blocks & hierarchy

Level	Description	Purpose	Responsibility of
1	Directive	Sets out overall framework	Council and Parliament
2	Delegated Acts*	Provides greater level of detail on specifics	Commission with advice from EIOPA
3	Guidelines & Implementing Acts	EU-wide technical standards and regulatory guidelines to ensure consistency	EIOPA
(4	<i>Enforcement</i>	<i>Ensure full and correct implementation by Member States</i>	<i>Commission)</i>

* Formerly known as "Implementing Measures"

4



Level 1 and impact on Levels 2 and 3

- Text of Solvency II Framework Directive adopted in April 2009
- A draft “Omnibus II” appeared in January 2011 that proposes to amend some sections of the 2009 Directive
- New buzzword - “Trilogue” process for Omnibus II

Omnibus II (by end 2011 or very early 2012)

- Certain ‘standards’ may move to Level 1, e.g. Illiquidity Premium
- ‘Trilogue’ development and somehow converge at the end

Level 2 Delegated Acts follows with any gaps (public March/April 2012)

- Own Funds
- Expected Profits in Future Premiums (“EPIFP”)
- Contract Boundaries

Level 3 as final catch-all (date unknown)

5



Level 2

- The Level 2 text is intended to expand on and provide greater detail on the Level 1 principles as set out in the Directive
- The Commission has drafted a consolidated Level 2 text
 - Under discussion by Solvency II Experts Group (chiefly representatives of national Finance Ministries)
 - Not yet in public domain but circulated to certain key stakeholders (including “IRSG” of EIOPA)
- Final agreed text will be published in due course (guess March/April 2012)
 - For public consultation and for approval by Council and Parliament

6



Level 3

- EU-wide technical standards and regulatory guidelines
 - Intended to ensure consistency in application across all Member States
- Two 'flavours'
 - Implementing Acts (binding technical standards)
 - Technical Guidelines (guidance)
- Being developed by various working groups within EIOPA
- 'Pre-consultation' protocol put in place
 - Limited release to 'key stakeholders' in advance of full public release
 - Public release can only take place once Level 2 has been published
- But seems likely that ORSA and Reporting Level 3 can commence earlier (EIOPA proposes November 2011)

7



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OMNIBUS II – THE STORY SO FAR

8



Omnibus II

- Draft published by European Commission in Jan 2011
- Proposes adjustments to Level 1 Directive
- EIOPA replaces CEIOPS
- Implementation date 1 January 2013
- Introduces delegated acts for Level 2 details
- Proposes transitional arrangements



9

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Omnibus II – EIOPA (1)

- Omnibus I introduces EIOPA
- Omnibus II aligns Solvency II to EIOPA regulation, replacing CEIOPS



- Omnibus II proposes a number of new articles to L1 setting out further powers and responsibilities for EIOPA
- Increased powers of intervention and mediation:
 - Previously legally non-binding CEIOPS advice could be requested by national supervisors where no joint agreement could be reached within a college of supervisors.
 - Omnibus II introduces a binding mediation power by EIOPA.

10

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Omnibus II – EIOPA (2)

- EIOPA responsibilities:
 - Valuation of assets and liabilities where no reference market
 - Harmonising inputs to the Standard formula:
 - Assessing the eligibility of external credit assessment institutions
 - Specifying equity index to be used for the calibration of the equity risk sub-module and providing information on the symmetric adjustment
 - Defining when a “market event” has occurred and may do so in relation to an individual market
 - Publishing information on the relevant risk-free interest rate term structure and information on the illiquidity premium “in periods of stressed liquidity”

11



History of Presidency Compromises

19 January 2011	<ul style="list-style-type: none">• Draft Omnibus II directive• Transition arrangements
28 March 2011	<ul style="list-style-type: none">• Presidency Compromise 1 (“new technical standards deadline”)
14 April 2011	<ul style="list-style-type: none">• Presidency Compromise 2
7 June 2011	<ul style="list-style-type: none">• Presidency Compromise 3 (“counter-cyclical premium”)
21 June 2011	<ul style="list-style-type: none">• Presidency Compromise 4 (“1 Jan 2014”)
4 July 2011	<ul style="list-style-type: none">• Presidency Compromise 5 (“still 1 Jan 2014”)
15 July 2011	<ul style="list-style-type: none">• Presidency Compromise 6 (formula for counter-cyclical premium to be published)

12



European Parliament's draft report

- Published 27 July 2011 by the European Parliament's Committee on Economic and Monetary Affairs (Rapporteur: Burkhard Balz)
- Based on the second Presidency Compromise text for Omnibus II (as at 14 April 2011)
- Proposed deferral of the full implementation date for Solvency II to 1 January 2014, while introducing a phasing-in of the requirements throughout 2013
- Proposes that the illiquidity premium should be derived from a formula specified in Article 86 of the Level 1 Directive



13

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Where are we now?

- There are now three proposals for Omnibus II:



The original Commission text



The Council/Presidency compromise text



The European Parliament draft text

- Final versions of each scheduled for the end of 2011, followed by consideration of a single proposal to be agreed on
- Final approval scheduled for Plenary session of European Parliament on 14 December 2011

14

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Comparison of texts

			
Published	19 January 2011	28 March 2011 – 15 July 2011	27 July 2011
Implementation date	1 January 2013	1 January 2014	1 January 2013 (soft) 1 January 2014 (hard)
Transitional periods	Max. 5 or 10 years	2, 5, 7 and 10 years (some specified)	Soft implementation, 2 and 10 year transitionals
Illiquidity premium/CCP	Prescribed IP	Formula-based CCP	Formula-based IP
Technical standards (TS)	Implementing	Implementing	Regulatory and implementing
Draft TS timeline	31 December 2011	31 December 2012, 2014, 2015 and 2017	RTS: 1 March 2012 ITS: 1 June 2012 and 1 July 2012

15

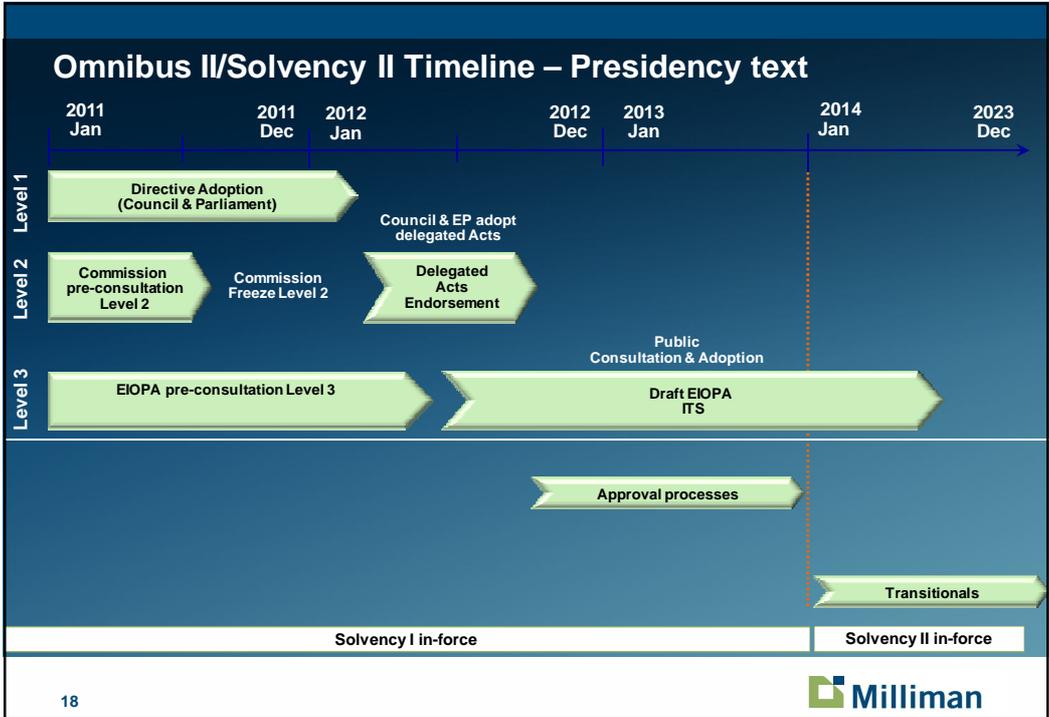
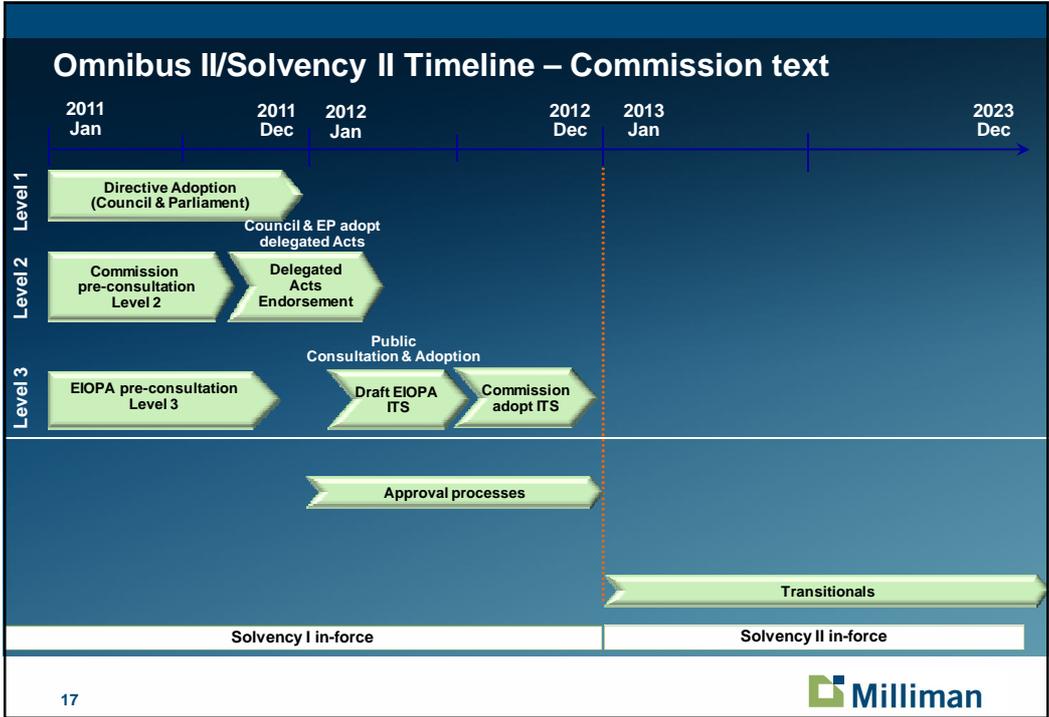
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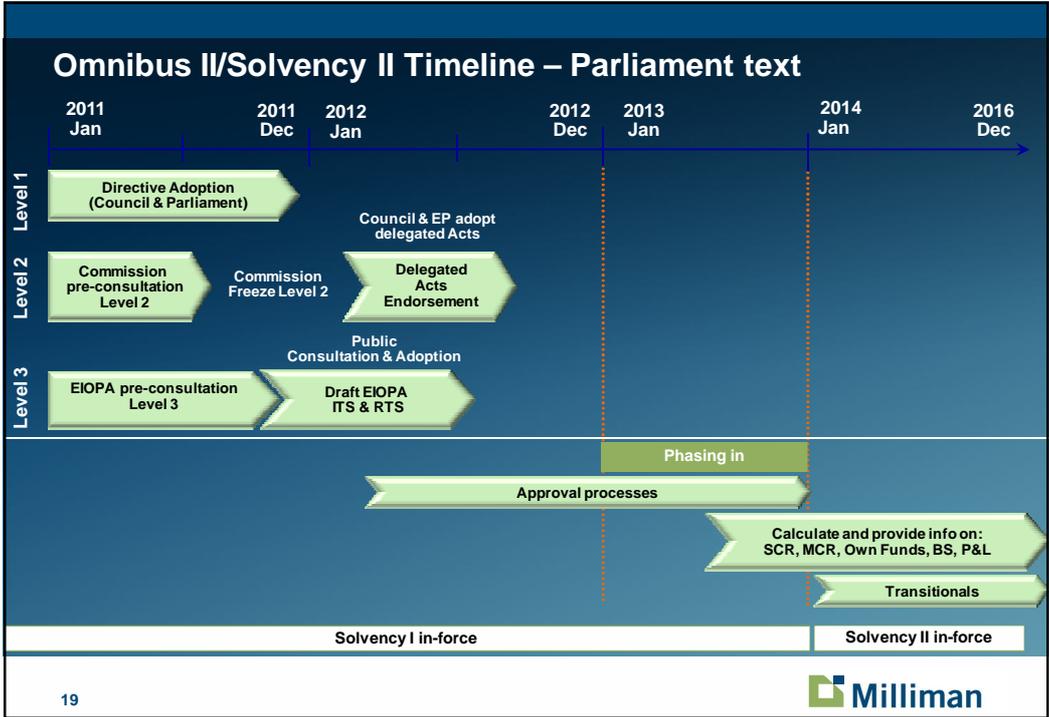
Going forward

- Next Presidency Compromise text due in September 2011
- Texts due to be finalised and consolidated in November 2011
- Final version scheduled for first reading at European Parliament on 22 November 2011
- Debated and adopted at Plenary sitting of European Parliament 14 December 2011
- Then the finalisation of Level 2 and formal Level 3 consultation

16

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LEVEL 2 – HOT TOPICS

20

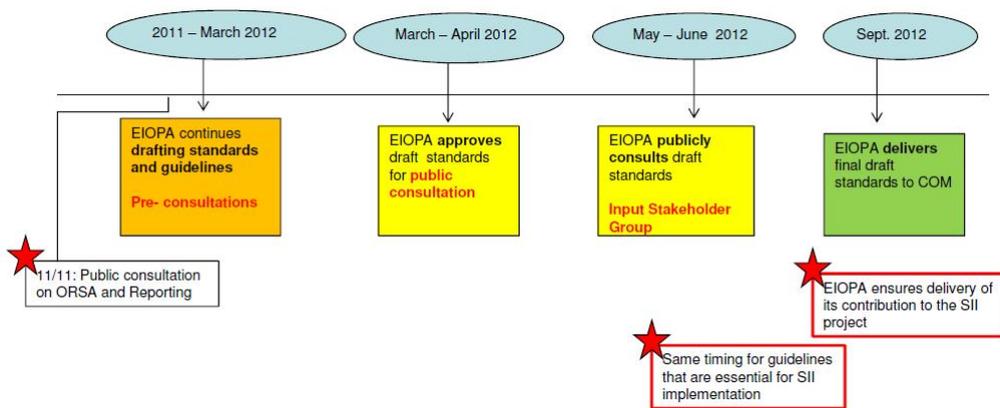
Process

- Solvency Expert Group (“SEG”) working to resolve a short list of key issues
 - Own Funds
 - Contract Boundaries
 - Expected Profits in Future Premiums
 - Special Purpose Vehicles (mainly non-life)
 - Calibration of non-life SCR
- This is not a public process
- Output will feed into Commission drafting of Delegated Acts (Level 2)
- Target public consultation in March/April 2012

21



EIOPA work plan for ‘standards’



Source – EIOPA Insurance and Reinsurance Stakeholder Group (“IRSG”) meeting papers 13 Sept 2011

22



Own Funds current thinking (1)

- Key issue – proposal to grandfather existing structures, but will need to apply limits as for Solvency II
- We expect to see text on transitional measures in Omnibus II
- Level 2 might progress as follows
 - Classification of the share premium account to follow the classification of the instrument that it relates to
 - No dividends if SCR or MCR breached – governance issue
 - Ordinary shares are the most deeply subordinated own fund items
 - Tier 1 hybrid capital instruments required to have an original maturity of 30 years, but may have an issuer call option 5 years after the date of issuance provided that this is not coupled with an incentive to redeem

23



Own Funds current thinking (2)

- Own-fund items included in Tier 1 by virtue of the transitional measures are limited to 20% of total Tier 1
- Own-fund items included in Tier 2 by virtue of the transitional measure are limited to 20% / 50% of the own-funds eligible to meet the MCR / SCR
- Transition up to 10 years (watch out for Omnibus II)

24



Contract Boundaries

- Refers to Regular Premium business, proposal to 'descope' future premiums under certain conditions
- QIS 5 approach "unlimited ability to amend premiums or benefits"
- Our understanding of current thinking is based on "fully reflect the risks":
 - Non-linked (e.g. term assurance) – all future premiums included
 - Unit linked savings & pensions – PUP'd immediately
 - Unit linked protection – to next premium review (maybe?)
- Debate on why MCEV principles not followed (especially on RP savings and pensions where $MCEV > VIF$ component of BEL)
- Consultation completed – feedback on economic substance may not have influenced change

25



Expected Profits in Future Premiums

- Also a Regular Premium issue, contradiction remains that all 'future profits' for SP business is Tier 1
- Current proposal – yes to Tier 1, but disclose this fact and manage it
 - EPIFP included in Tier 1 as part of the reconciliation reserve
 - Risks associated with EPIFP are explicitly considered as part of liquidity risk management (under systems of governance)
 - EPIFP is publicly disclosed (Solvency and Financial Condition Report)
- This gives some calculation consequences
 - EXTEND mass lapse risk to capture all situations of premium discontinuance

26



Our view on next steps

Publication	Our guess
Omnibus II – “Trilogue”	Target approval by European Parliament on 14 Dec 2011
Level 2 Delegated Acts (“written procedures”)	Further selected stakeholder consultation maybe in October 2011? March 2012 – public consultation
Level 3	November 2011 – ORSA and Reporting public consultation The rest only after Level 2

27



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THIRD COUNTRY EQUIVALENCE

28



Three dimensions to “equivalence”

1. Article 172 – EEA direct writers using reinsurance outside EEA
 2. Article 227 - Group Solvency Calculation for an EEA parent company with a subsidiary in a third country
 3. Article 260 - Group Supervision for a parent company in a third country with a subsidiary in the EEA
- EIOPA issued public consultation on 17 August 2011 for Bermuda, Switzerland, Japan (reinsurance only)

29



EIOPA reports on Bermudan, Swiss and Japanese supervisory systems:

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December 2010: Call for evidence & Questionnaires sent to BMA, FINMA and JFSA



End January 2011: BMA, FINMA and JFSA provided their replies.



February - March 2011: EIOPA Desk-based assessment



April 2011: Additional rounds of written clarifications



May - June 2011: On-site visits to BMA, FINMA and JFSA



August 2011: Public consultation procedure (ends 23.09.2011)



October 2011 (Final Advice delivered to EC)

30



EIOPA view on equivalence (1)

	Bermuda (OK for certain classes only)	Switzerland	Japan
Article 172 (reinsurance)	Partly equivalent: <ul style="list-style-type: none"> • authorisations • head office location • governance • public disclosure Not equivalent: <ul style="list-style-type: none"> • shareholders • reserving? 	Partly equivalent: <ul style="list-style-type: none"> • governance • public disclosure • reserving (for captives exempt from the SST) 	Largely equivalent: <ul style="list-style-type: none"> • authorisations • governance • public disclosure • shareholders Partly equivalent: <ul style="list-style-type: none"> • reserving
Article 227 (Third country subsidiary)	No conclusion on reserving (plus new regime only started in 2011)	OK	N/A

31



EIOPA view on equivalence (2)

	Bermuda (OK for certain classes only)	Switzerland	Japan
Article 260 (Third Country parent)	Partly equivalent: <ul style="list-style-type: none"> • exchange of info • governance • public disclosure • shareholders 	Partly equivalent: <ul style="list-style-type: none"> • governance • public disclosure 	N/A

32



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