# Solvency II Conference

Two years on and two reviews

# Presentation

**Olav Jones**

Deputy director general

Insurance Europe

# Agenda

| | |
|---|---|
| 1 | **Successful launch** |
| 2 | Impact survey |
| 3 | Concerns about excessive capital |
| 4 | Case studies |
| 5 | Solvency II reviews |

# A long journey …

**2000**
Solvency II project

**2007**
Proposal by Commission

**2009**
After extensive negotiations, agreed by EC, EP, Council to be applied October 2012

**2010**
QIS 5 revealed need for essential corrections

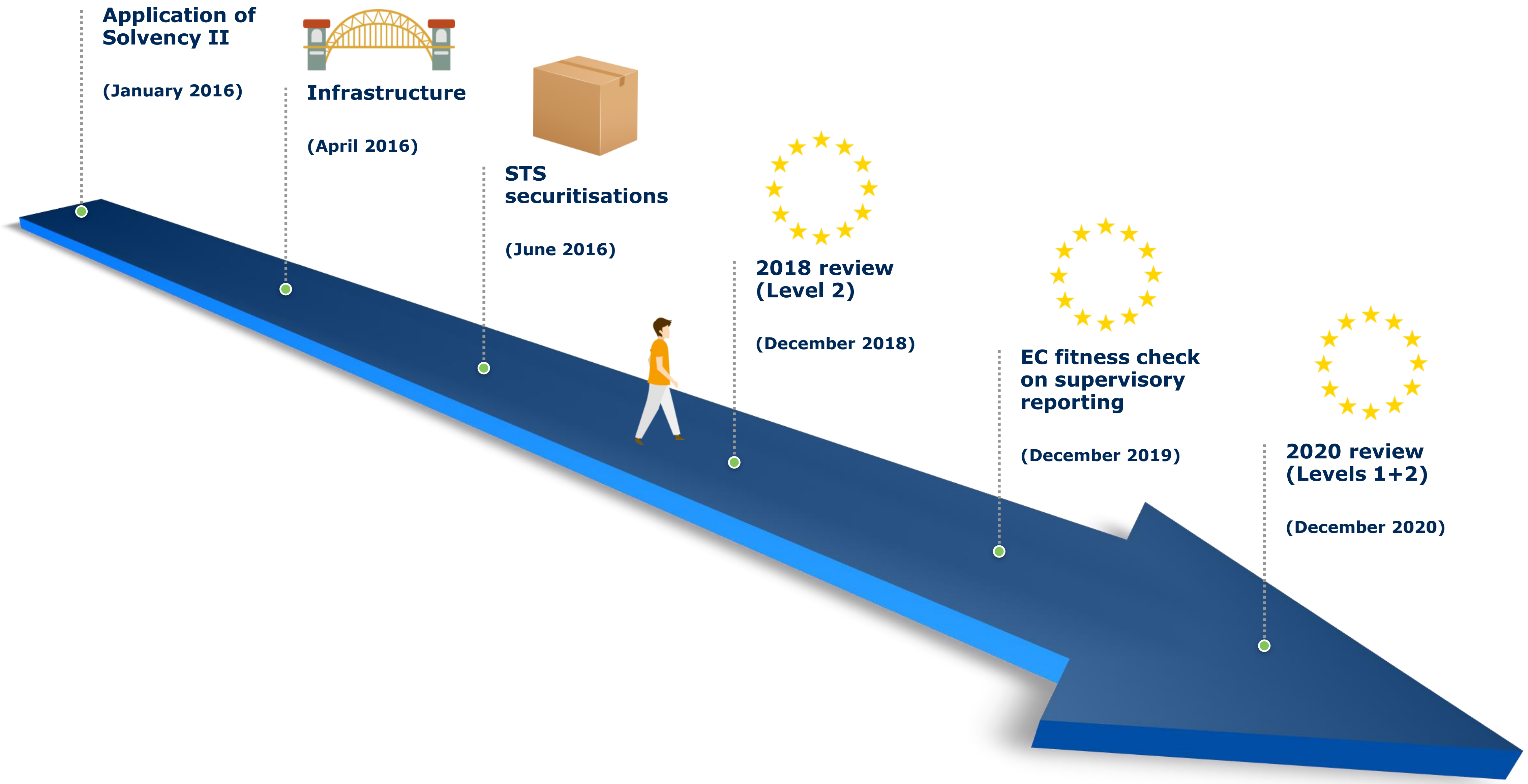
**2011**
EC taskforce with EIOPA & industry to work on solutions

**2013**
LTGA to fix treatment of long-term business & liabilities valuation
(Omnibus II)

**2013–2014**
Final political agreement in November 2013
Finalisation of implementation rules

**January 2016**
Application

# A long journey … and it is not over yet



# Huge implementation challenge

Revolution not evolution

3000 companies with €10trn of assets

Sophisticated modelling required even for standard formula users

184 reporting templates

3500+ pages of requirements

# Successful implementation was not by chance

Industry already:

- very strongly capitalised
- with risk management as core focus
- with widespread development of ERM & economic capital concepts

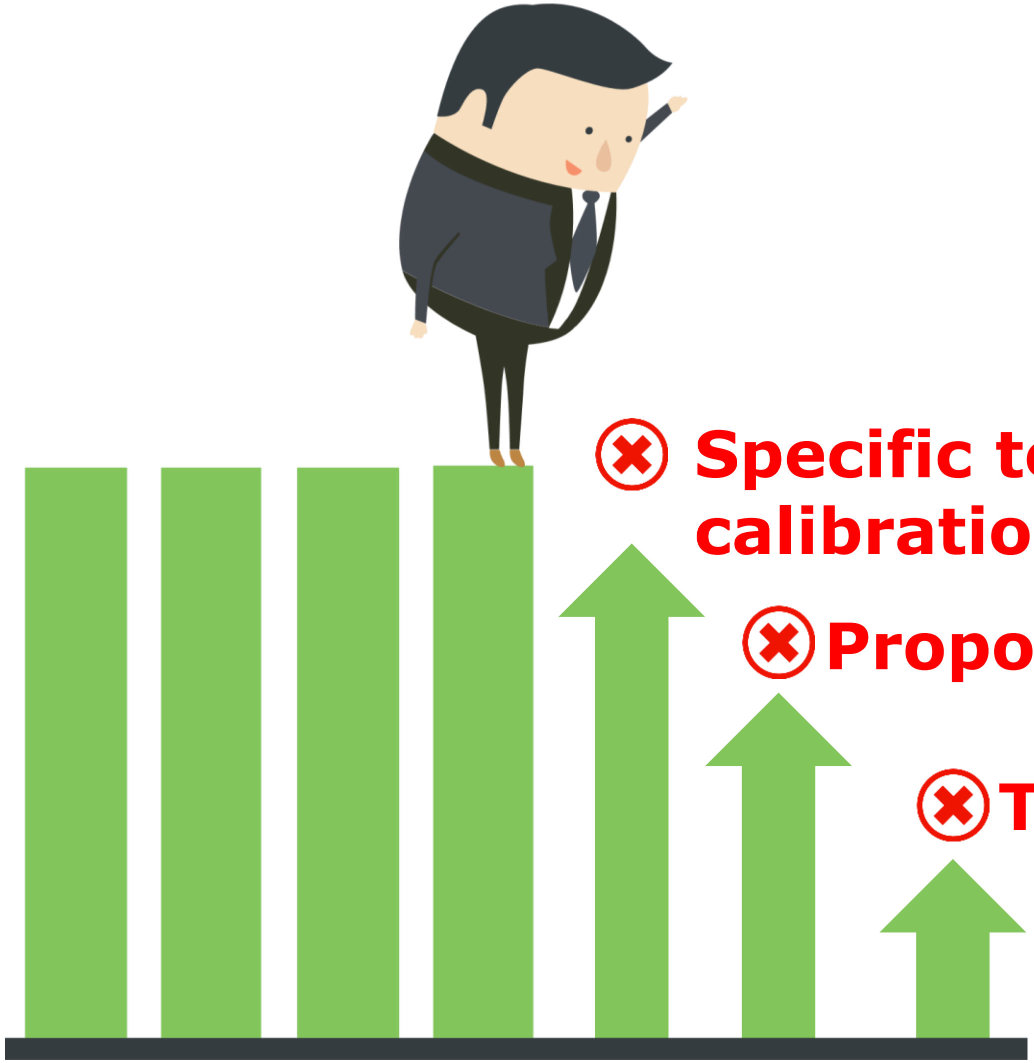
Significant preparation over many years:

- helped by many QISs
- very significant efforts by industry, national supervisors & EIOPA
- huge investment

# World-class framework

- Three pillars
- Group & solo measures
- Economic valuation of assets & liabilities
- Best estimates of liabilities
- All risks (28 in standard formula)
- Most risks use scenario (stress test) approach
- Internal models allowed
- Two levels of capital (SCR & MCR) allowing early supervisory intervention
- Strong & clear target level of protection: 99.5%
- Significant testing & transitional measures

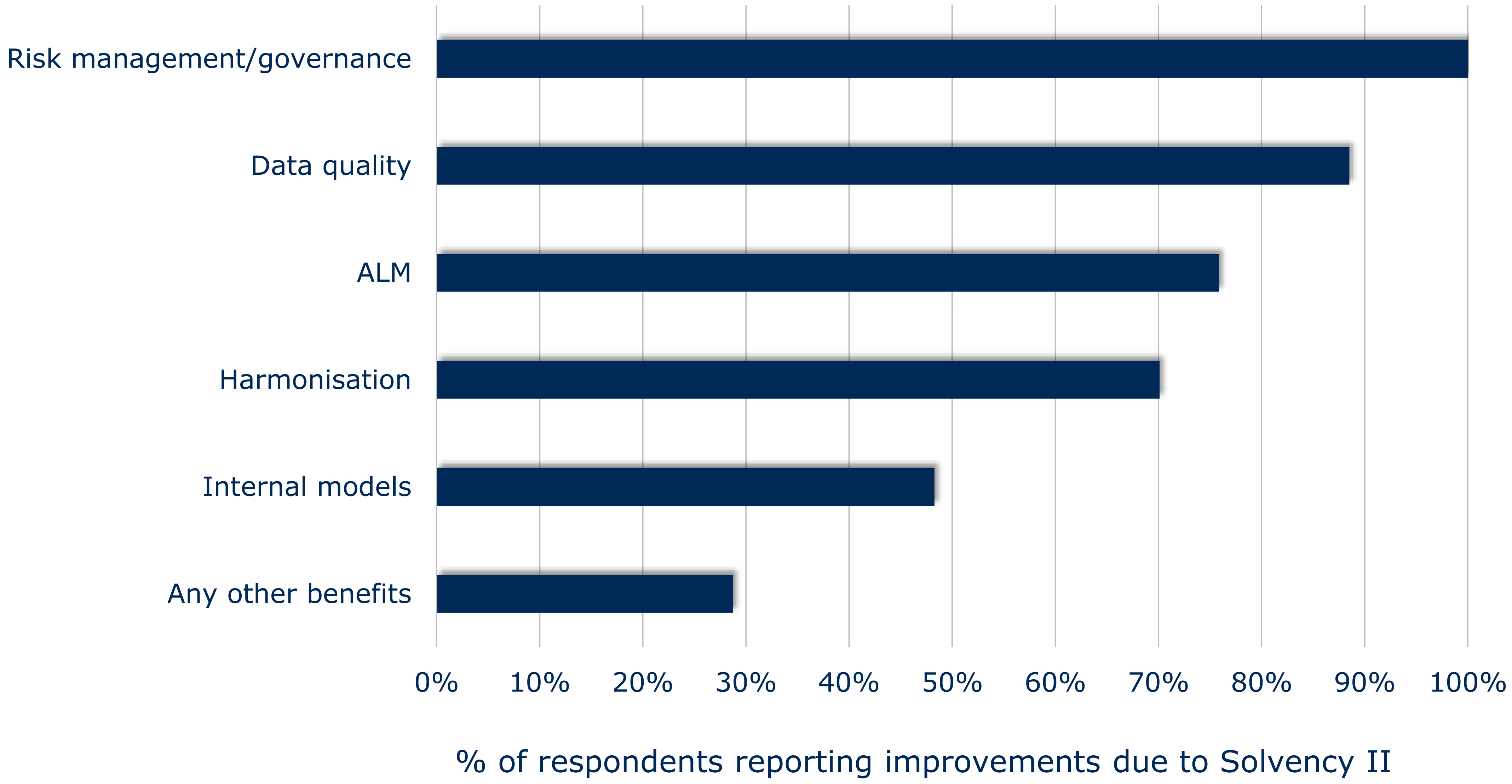
# Some improvements still needed



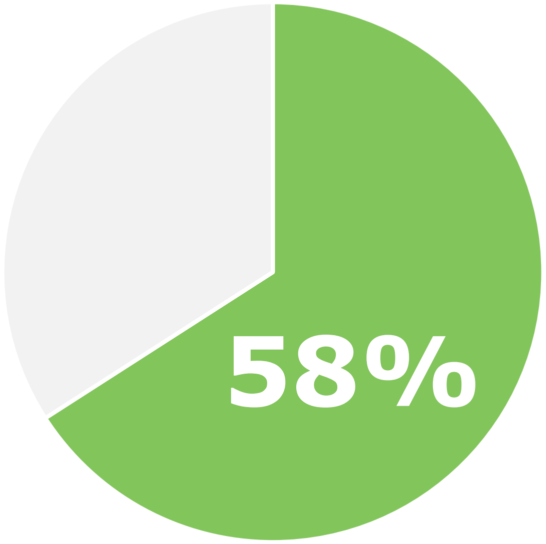
- Specific technical issues/ calibrations
- Proportionality
- Treatment of long-term business

# Agenda

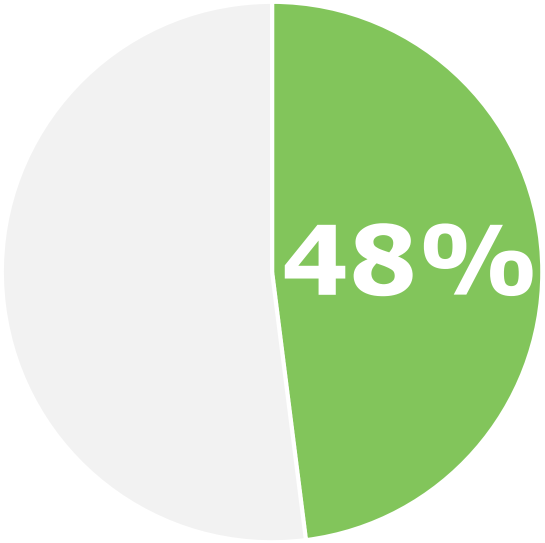
# Positive impacts



# Unintended consequences




"SII contributed to negative impact on guarantee business"




"We invested less than optimally in real economy due to SII capital requirements"

# Unintended consequences

*"Increased SII requirements would make investment strategies for clients too conservative if they have guarantees"*

*"SII has led to a stronger focus on capital light products"*

*"We have prioritised the sales of unit-linked business with low capital requirements compared to other guaranteed products"*

*"The current offer of guaranteed capital products will not be sustainable … strategic plan envisages the gradual decline in the supply of guaranteed products with the growth of unit-linked products"*

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# Unnecessarily high capital = unnecessary impact

**Too high solvency capital** ⇒ **Higher premiums or charges** and/or **Less optimal long-term investment e.g. equities** and/or **Lower benefits paid**

**Procyclical behaviour**

**Fewer products available**

# Three causes

Regulatory Technical provisions

(Amount needed to cover payment of claims and other liabilities)

**1. Liabilities exaggerated**

*Illustrative not to scale*

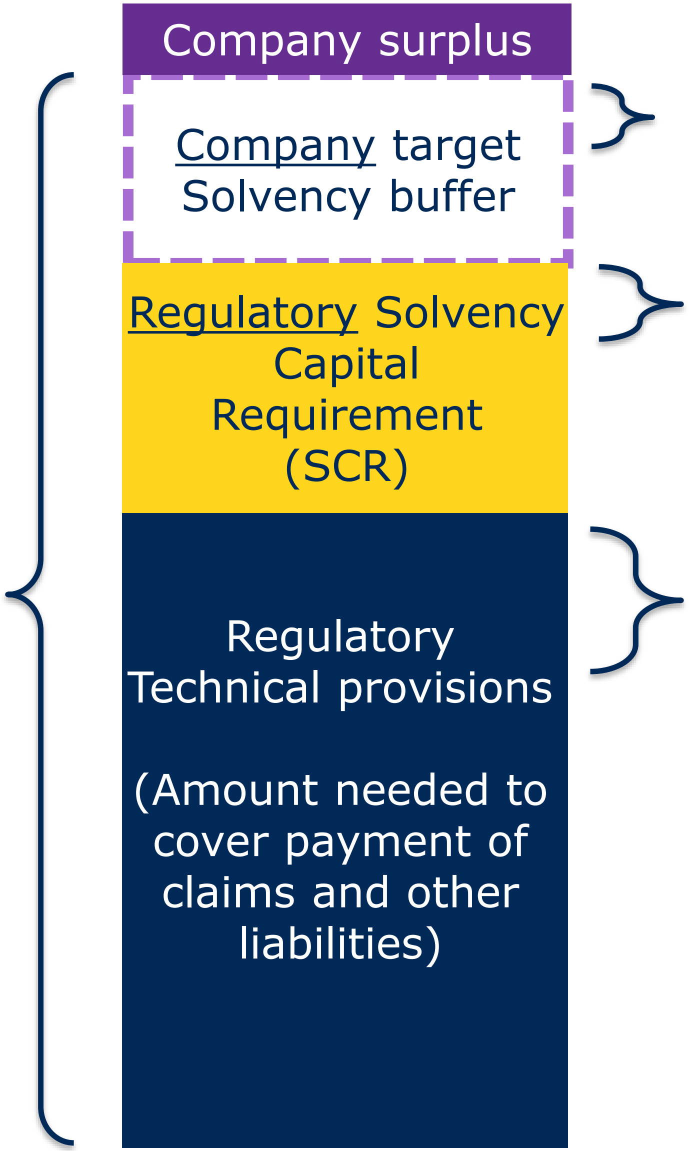
# Three causes


1. **Liabilities exaggerated**
    - Discounting close to risk free
    - Risk Margin

*Illustrative not to scale*

# Three causes

**Total amount needed by SII can be excessive**




**3. Artificial volatility**
- Larger buffers than necessary

**2. Excessive SCR requirements**
- Wrongly based on “trading risk” instead of “long-term investment risk”

**1. Liabilities exaggerated**
- Risk Margin
- Discounting close to risk free

*Illustrative not to scale*

# Agenda

1. Successful launch
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4. **Case studies**
5. Solvency II reviews

# Long-term investment ≠ trading

# Importance of measuring risk correctly

## Equity example

| | | *1-in-200 outcome* |
|---|---|---|
| 1 | **Trader** can be forced to sell entire portfolio after worst-case, 1-year price fall | -43% |
| 2 | **Insurer** can invest for 10 years and get dividends | -26% |
| 3 | **Insurer** can invest for 10 years, get dividends and use pooling/smoothing, diversifying across customers/time | +9% |

*Analysis based on 100 years of US stock market data*

# Excessive capital requirements

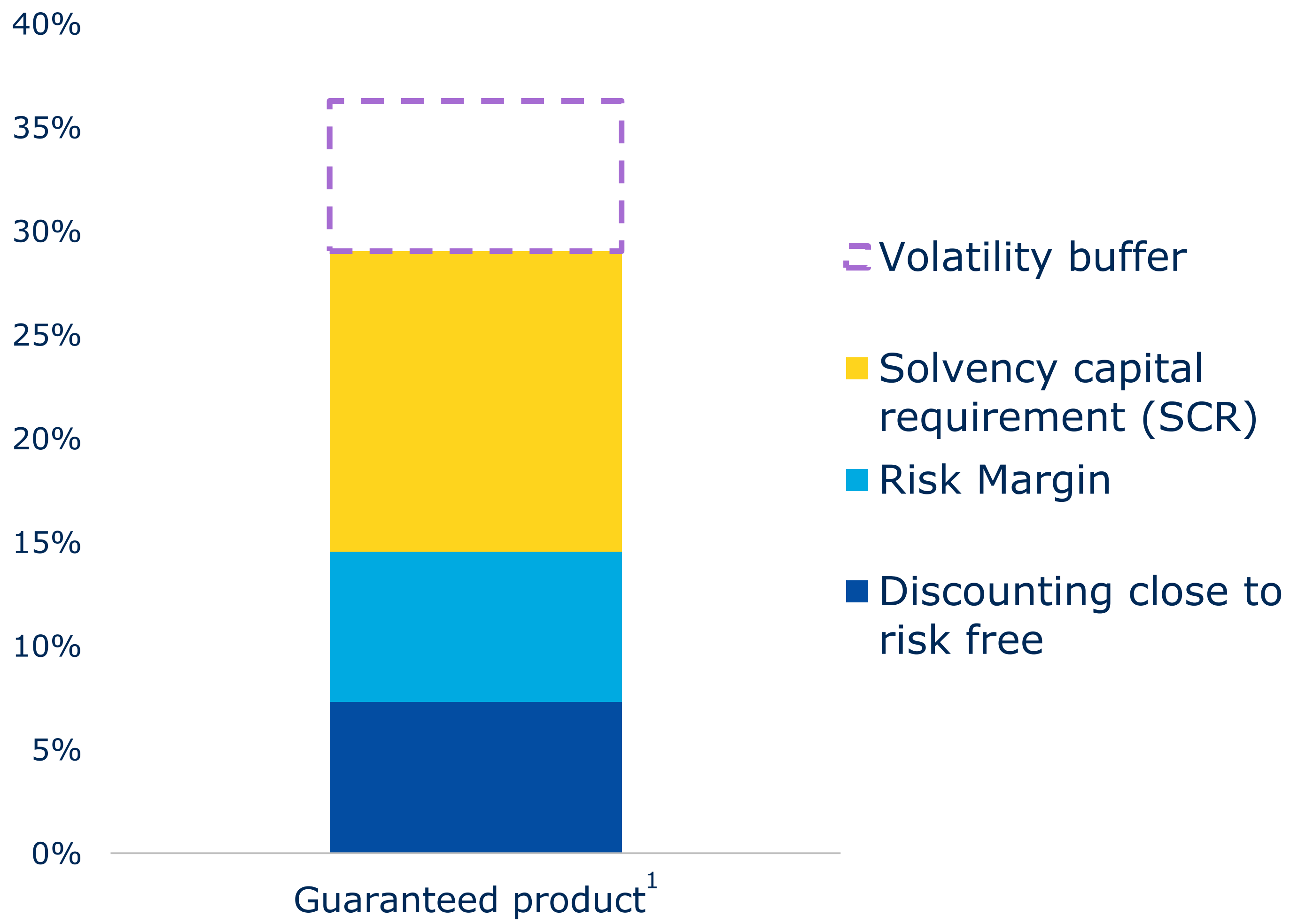
CASE STUDY

**Simple, long-term product with guarantee**

- €10,000 single premium
- Fully matched (no interest rate risk)
- Standard Formula and Volatility Adjustment
- Only invested in A-rated corporate bonds
- Risk Margin = 40% of SCR in line with EU average for life companies

# Preliminary analysis

## Total additional amount shareholders need to inject




[1] Risk-free rate is 0.50%
Credit spread is 1.25%
Volatility adjustment is 0.04% (Dec. 2017)
Charges are 0.50%

# Preliminary analysis

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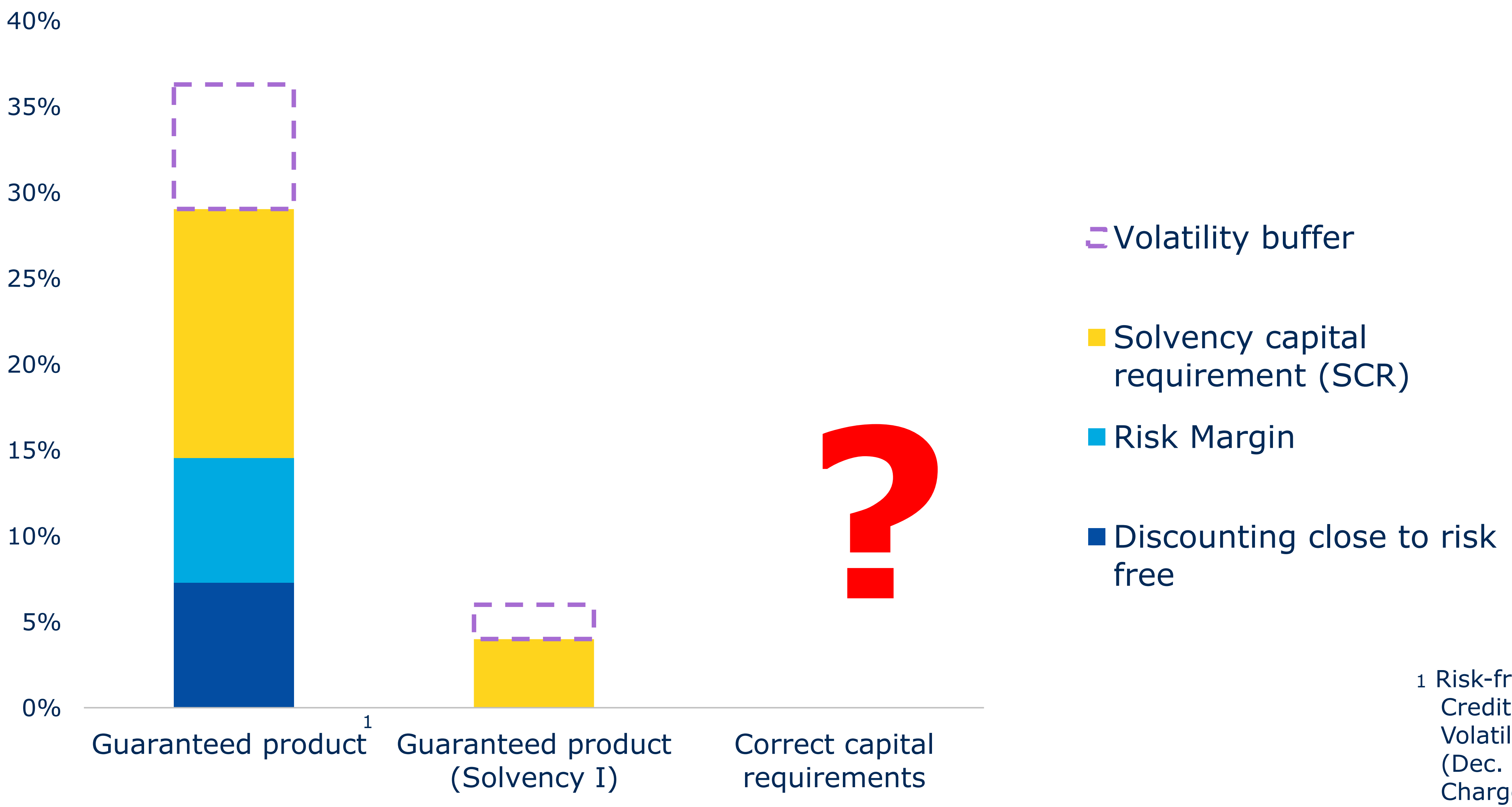


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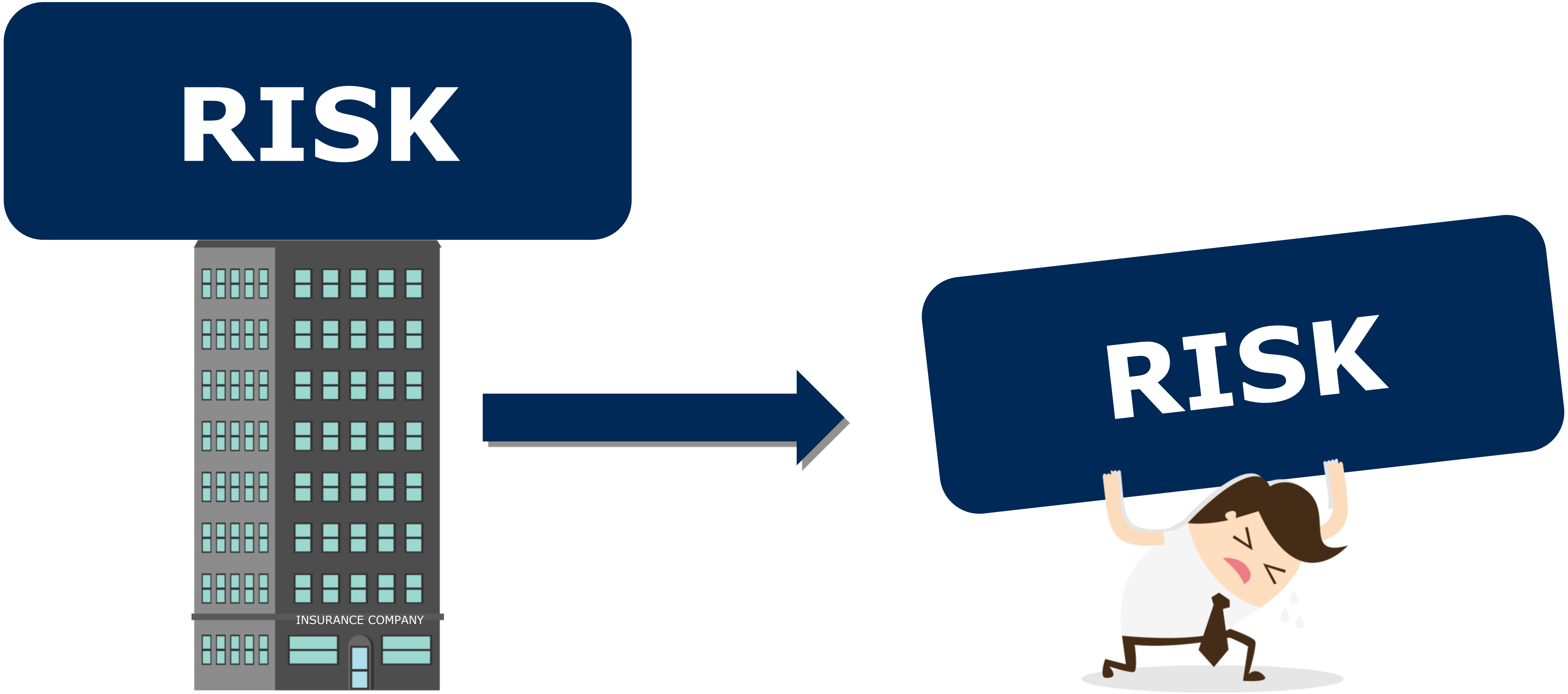
# Solvency II = shifting the risks on to individuals



# Further work needed

- Industry, academics, supervisors and regulators need to work together to fully understand different measures & their impact

- Examine improvements:
  - VA/MA/dynamic VA/Country adjustments
  - Risk Margin
  - SCR for investments
  - Test against different products & market conditions

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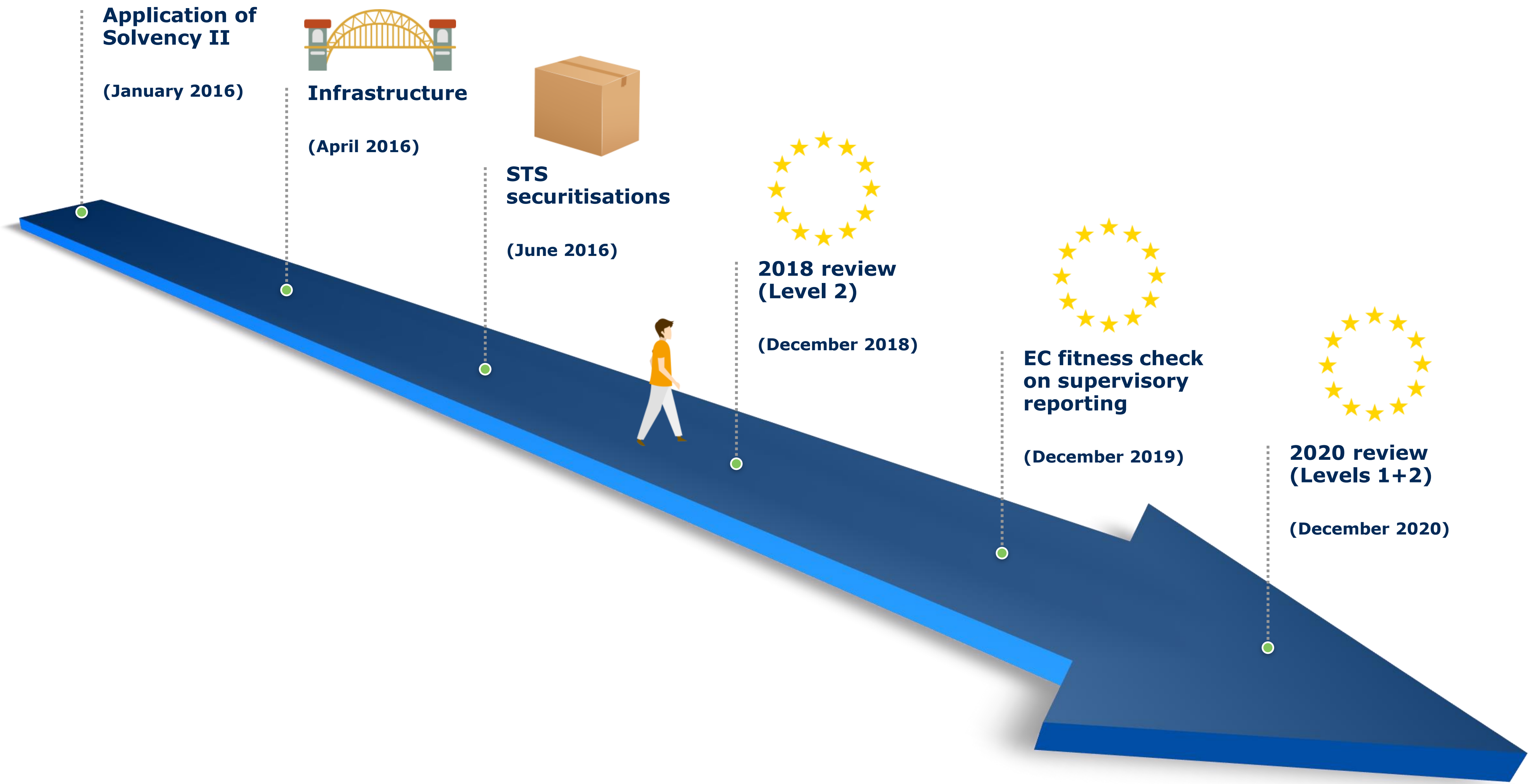
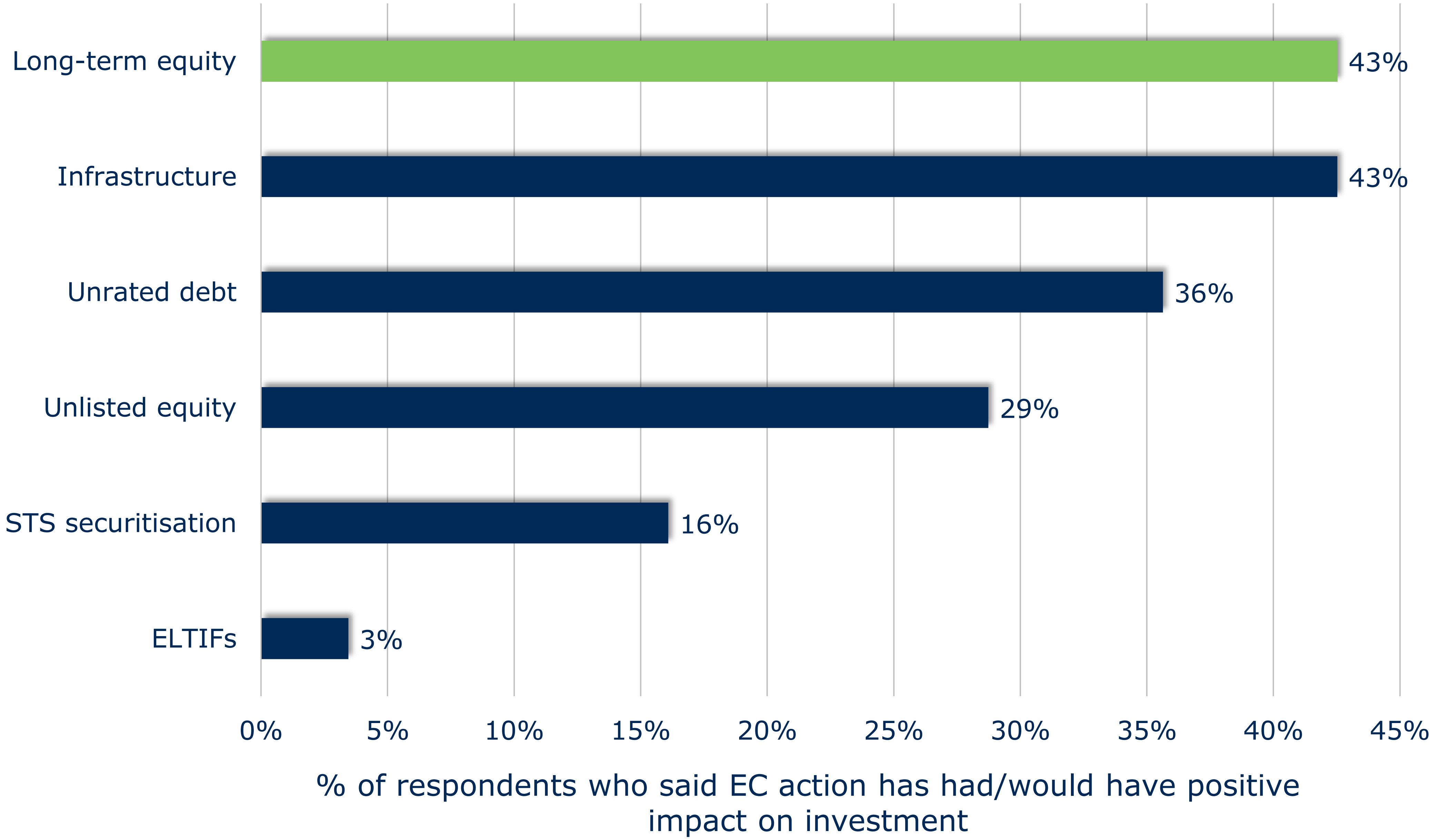


# EC action can make a difference



# On the path to improvement

| PROBLEMS | SOLUTIONS: Capital Markets Union | SOLUTIONS: 2018 review | SOLUTIONS: 2020 review |
|---|---|---|---|
| **Solvency II doesn't reflect long-term business** | ▪ Infrastructure<br>▪ STS securitisations | ▪ Equity (unlisted and **listed**)<br>▪ Unrated debt | ▪ Other long-term investments |
| | | ▪ Risk Margin — cost of capital | ▪ Risk Margin<br>▪ Discount rates (MA, VA, etc.) |
| **Proportionality/ reporting** | | ▪ Simplifications | ▪ Streamlining |
| **Other technical issues** | | ▪ Address flaws/ inconsistencies | ▪ Address flaws/ inconsistencies |