

Solvency II The Global Insurance Financial Trojan Horse

Les Boughner

EVP & Managing Director

Willis Captive & Consulting Practice

Solvency II

- What is it
- Why is it important to you
- What is the US Impact
- Impact on Self Insurance
 - Captives

What is it

A new regulatory regime that shall apply from January 1, 2013 onwards. It is a risk based system introducing a comprehensive risk management framework to establish required capital levels and to implement procedures to identify, measure and manage risk levels.

Solvency II aims to strengthen regulatory requirements for insurance companies' capital and risk management by aligning capital requirements with risk profile. The regime also seeks to improve risk awareness and quantification; and the integration of this information into business decision-making, governance and operation. Through a combination of these the regulation aims to reduce the likelihood of an insurer failing or disruption to the marketplace.

European Union 2011

- 27 member states and 24 languages.
- >500 million inhabitants in 2005.
- 11 different currencies.
- One supranational governing authority composed of the Council of the European Union, the European Parliament and the European Commission.
- A President of the Council which rotates between all member states every six months.
- A legislation system based on directives.

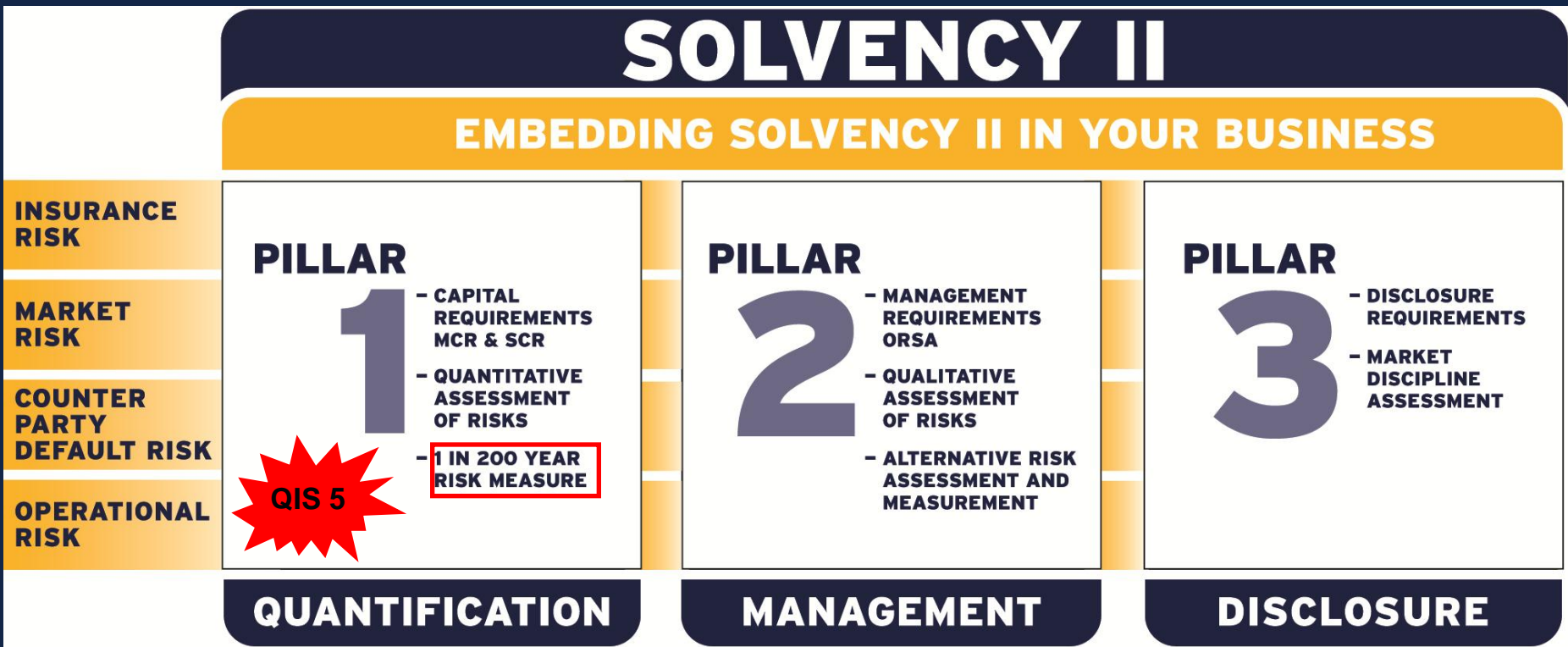
Jargon Buster

- **CEIOPS – Committee of European Insurance and Occupational Pensions Supervisors (The European Commission’s Insurance Advisors)**
- **EIOPA – European Insurance and Occupational Pensions Authority (Replaced CEIOPS January 1, 2011)**
- **MCR –The absolute minimum capital requirement to operate as a going concern.**
- **ORSA – Own Risk and Solvency Assessment.**
- **SCR – Solvency Capital Requirement reflects the level of capital enables an insurer to absorb significant unforeseen losses**
- **QIS – Quantitative Impact Study**
- **Proportionality – A principle for taking into account the relative size of Insurance Companies.**
- **Equivalence – Non EU jurisdictions can seek to receive credit for their regulatory systems.**

Important to US ?

- US Subsidiary of a European Insurer could be at a competitive disadvantage in North America.
- North American Insurer will have to comply in Europe.
- Fronting?

Solvency II in 1 slide



US Impact ?....SMI

NAIC is not seeking “Equivalence” under Solvency II

HOWEVER

- Solvency Modernization Initiative (SMI)
- Solvency II = IAIS = SMI
- ORSA (Solvency II) = ORSA (SMI)

Captives

Are defined in Framework Directive

Proportionality principle apply

Simplified method for calculation of SCR proposed (Value at risk concept)

Lessons from QIS4:

- Cat risk is main driver
- Premium & reserves risks is second
- Concentration risk is third

Captive concerns on Pillar 1

Concentration risk: need a better calibration

Captive simplifications: factors need to be included for practical use

Specific monitoring and information regarding the Cat Risk exposures and liability durations

Pure fronting captives will experience much higher level of SCR (Counterparty Risk effect)

Captive concerns on Pillar 2

Proportionality – not fully understood and therefore not possible to fully reflect position for captives and as a result viewed as too onerous for captives

Increased cost – given the uncertainty over proportionality there is concern that the cost profile of a captive will become prohibitive

The ORSA as a system of governance – concern that for a captive the ORSA may not be a useful document but will be shelved once completed

Erosion of the captive model value proposition – that an unproportional Pillar 2 regime may create a barrier to entry for new captives and may cause others to reevaluate and close down

Documentation – there is concern that the level of documentation required will take over and will have a negative impact on the Board's effective decision making

Clearly lobbying on proportionality remains key

QIS 5

- **70% Participation**
- **\$550 Billion > Required SCR**
- **\$940 Billion > Required MCR**
- **15% had insufficient capital**
- **5% are in danger of insolvency**
- **A.M. Best 5/16/2011**
 - “a significant number of captives may have to increase their capital up to fourfold due to Solvency II”

Captive Update

Omnibus II

Watch Bermuda