

Solvency II update

22 September 2011

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Agenda

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

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LEGISLATION UPDATE

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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)	Enforcement	<i>Ensure full and correct implementation by Member States</i>	<i>Commission)</i>

* Formerly known as "Implementing Measures"

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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)

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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

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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)

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OMNIBUS II – THE STORY SO FAR

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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



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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.

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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”

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History of Presidency Compromises

19 January 2011

- Draft Omnibus II directive
- Transition arrangements

28 March 2011

- Presidency Compromise 1 (“new technical standards deadline”)

14 April 2011

- Presidency Compromise 2

7 June 2011

- Presidency Compromise 3 (“counter-cyclical premium”)

21 June 2011

- Presidency Compromise 4 (“1 Jan 2014”)

4 July 2011

- Presidency Compromise 5 (“still 1 Jan 2014”)

15 July 2011

- Presidency Compromise 6 (formula for counter-cyclical premium to be published)

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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



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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

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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

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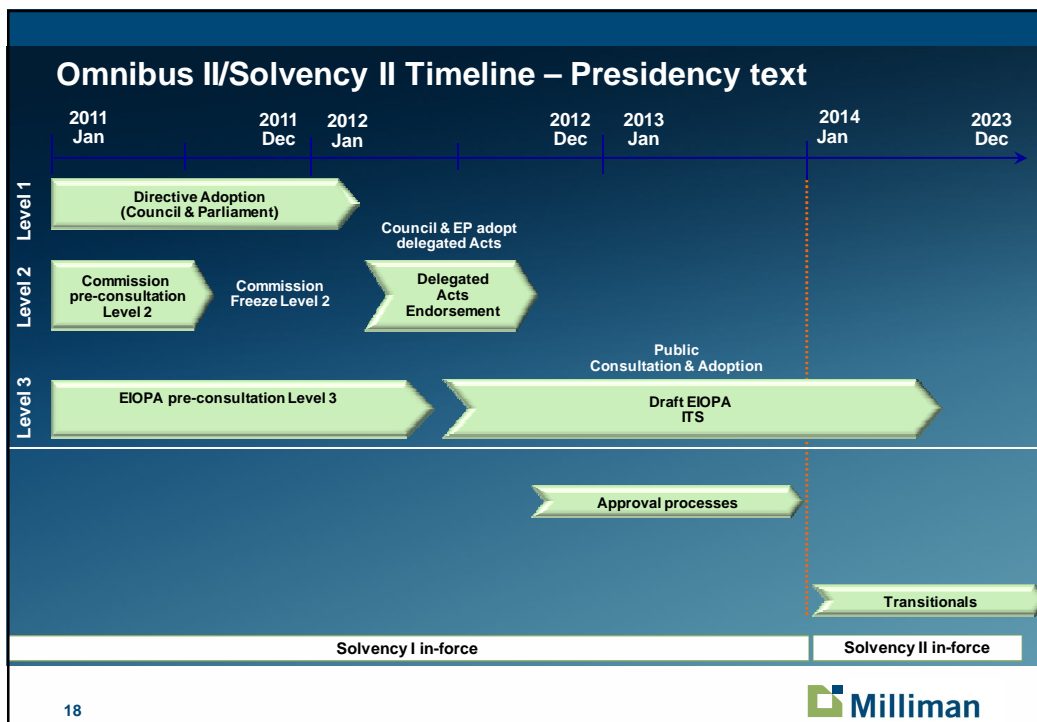
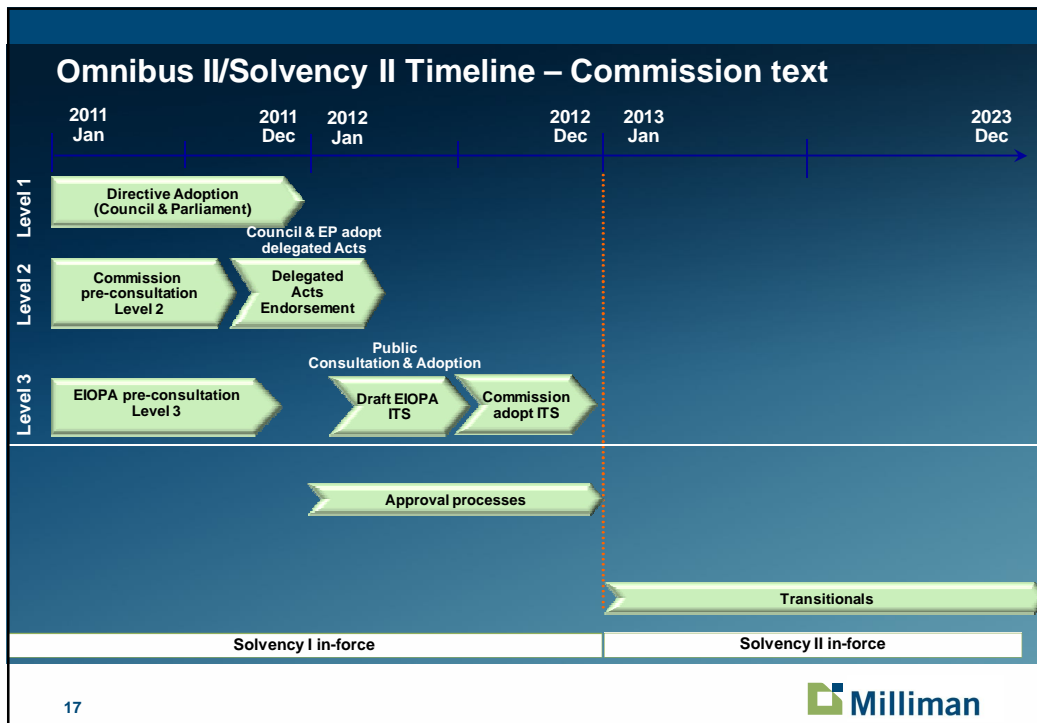


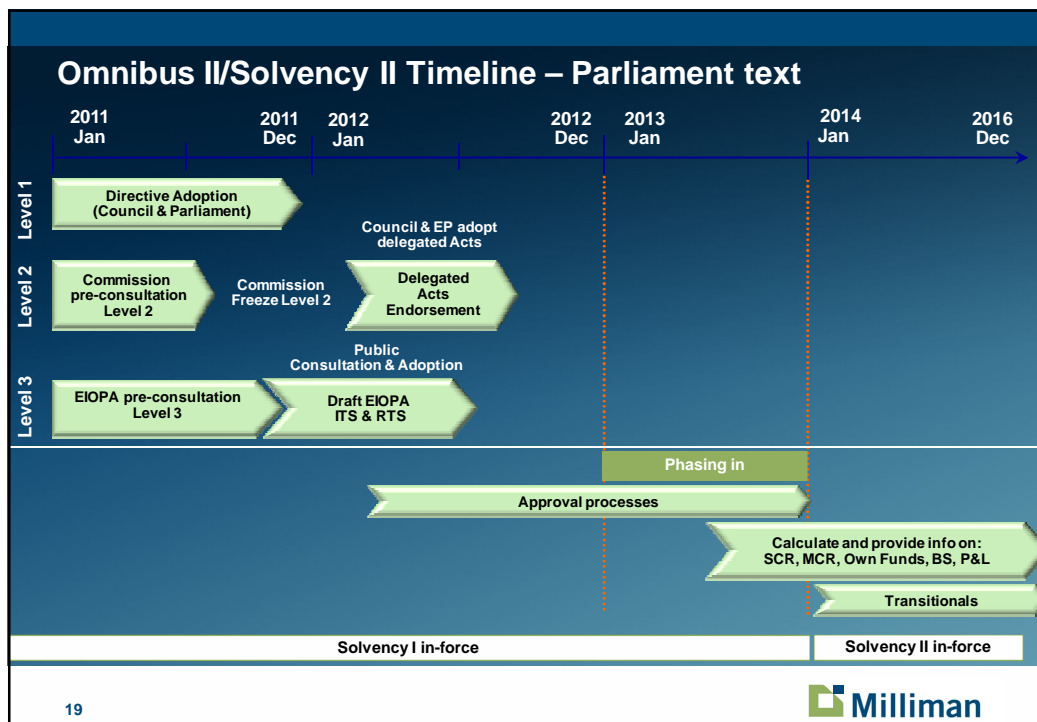
Going forward

- 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

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LEVEL 2 – HOT TOPICS

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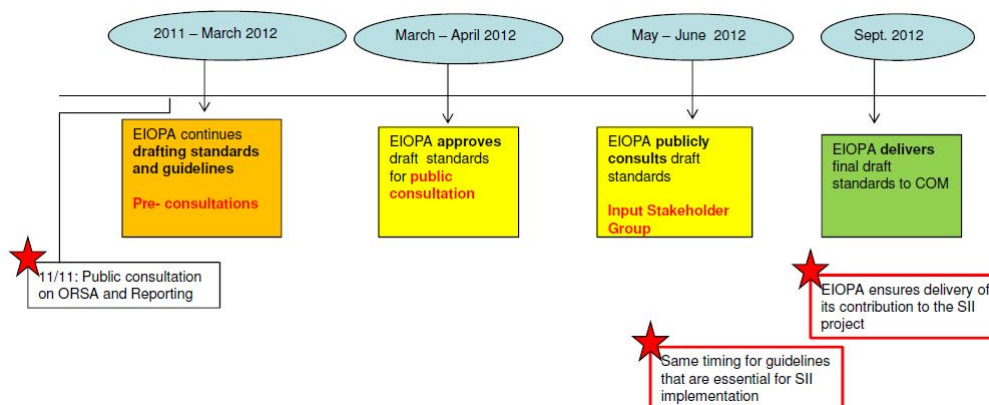
Process

- 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

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EIOPA work plan for ‘standards’



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

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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

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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)

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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

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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

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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

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THIRD COUNTRY EQUIVALENCE

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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)

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EIOPA reports on Bermudan, Swiss and Japanese supervisory systems:

eioipa

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)

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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

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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

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