

Regulatory reform - Solvency II and The end of Group Support April 2009

Solvency II- Agreeing the Level One Directive

April 2009

- After several months of intensive negotiations between the Parliament, the Council and the Commission, the European Parliament adopted the text of the Solvency II Framework Directive in a plenary vote on Wednesday, 22 April 2009. The draft text of the Directive, as approved by the Parliament, will now return to the Council and is likely to be formally adopted during the Economic and Financial Affairs Council on 5 May 2009.
- The draft text abandons the concept of “group support” which was included in earlier drafts and provided that part of the capital requirement for a subsidiary could be met by a guarantee that funds would be transferred from the group if needed.

Other Solvency II- Levels Two and Three

FSA and HMT- April 2008

- HMT and FSA publish a joint discussion paper entitled *Enhancing Group Supervision under Solvency II*.

FSA- September 2008

- FSA publishes *Insurance Risk Management: The Path to Solvency II*. The feedback period for this discussion paper ran until 31 December 2008. FSA has stated that it will publish a feedback statement on the responses it received in early May.

CEIOPS- 28 October 2008

- CEIOPS issues a press release on the current financial crisis in the context of Solvency II indicating that it was reflecting on the “lessons to be learnt” for the proposed regime.

CEIOPS- 8 January 2009

- CEIOPS publishes a 2009 work programme for its Insurance Groups Supervision Committee (“IGSG”) covering 19 different workstreams for Solvency II.

CEIOPS- January 2009

- IntMod published a “stock taking report” on the use of internal models which helps explain the differences between the UK’s ICAS regime and the Solvency II rules on internal models.

De Larosière - February 2009

- Publication of the De Larosière Report on “High Level Group on Financial Supervision in EU”. This provides that, under the new European System of Financial Supervision (ESFS), CEIOPS will be replaced by an enhanced European standard-setting

body with a wider remit including as a rule-making body.

CEIOPS – 26 March 2009

- CEIOPS published for consultation its first set of advice on Solvency II Level Two Implementing Measures covering: methods and statistical techniques for calculating the best estimate, segmentation, counterparty default risk, own funds, treatment of future premiums, allowance of financial mitigation techniques, assumptions about future management actions, System of Governance, Transparency and Accountability, Valuation of Assets and “Other Liabilities”, SPVs and the procedure to be followed for the approval of an internal model.

Key Terms Explained

Market risk and the equity dampener- a mechanism included in the amended text of Solvency II draft Directive 16237/08 which was proposed during the recent French presidency of the Council. The adjustment mechanism seeks to address the problem of procyclicality described below.

Group support- regime set out in Articles 234-247 of Commission proposal 6996/08 for Solvency II whereby the required solvency (the solvency capital requirement or “SCR”) for an individual insurer would be met in part by guarantee style commitments from the parent. A group of 12 smaller member states are opposed to the regime on the grounds that it may make them reliant on regulators in larger nations and that capital may not be transferred to subsidiaries when needed. The concept of group support is strongly advocated by UK government, FSA, and ABI and was also adopted and proposed by the European Commission.

Internal model- an individual firm’s own model/formula for calculating its regulatory capital and public disclosure requirements. This internal model must be approved by the relevant regulator. Firms not using an internal model must calculate SCR using the standard formula as set out in Solvency II legislation.

Procyclicality- the tendency for insurers’ regulatory capital requirements to rise with downswings in the economy and to fall with upswings. The question is whether Solvency II legislation should include counter-cyclical measures to enable insurers to keep assets they are holding to meet their long term liabilities even through a period of market crisis.

QIS- Quantative Impact Studies which are essentially large scale field testing exercises to calibrate the requirements of Solvency II. Four such studies have been undertaken so far and a fifth may be scheduled in 2009/10.

<u>Solvency II- Scheduled Timeline</u>	
22 April 2009- 5 May 2009	Adoption of the Framework Directive by the European Parliament and Council
End April 2009	FSA's first communications exercise will be sent to firms shortly after the European Parliament vote on 22 April 2009. FSA plans to give firms until late June 2009 to respond.
Summer 2009	Publication of Level One Directive in the Official Journal
July 2009	A further set of consultation draft advice on Level Two Implementing Levels
October 2009	CEIOPS approves for consultation draft advice on: - valuation of assets - approach to own funds - detailed design of the SCR and MCR - full and partial internal models - governance requirement - supervisory reporting and public disclosure - use of capital add-ons
Autumn 2009	A further set of consultation draft advice on Level Two Implementing Levels
September 2009	FSA Stage 1 Thematic Review will be published
Autumn 2009- Spring 2010	QIS5 - Possible Testing of Implementing Measures
Q1 or Q2 2010	European Commission issues its proposal for Solvency II implementing measures
Q3 2010	FSA Stage 2 Thematic Review will be published
2010	Adoption of the Level 2 Implementing Measures
2011	Member States and Industry prepare for implementation
31 October 2012	Solvency II comes into force

Internal Model Approval Provisional FSA Deadlines

June 2009 - Deadline for indication of intent to apply for internal model approval

April to June 2010 - QIS-5 exercise expected to form part of the qualifying criteria to enter the first dry run

July to September 2010 - Commencement of first model dry-run period

October 2011 - Receipt by FSA of first batch of dry-run submissions

April 2012 - Informal feedback on first batch dry-run submissions

FSA has stated that it cannot guarantee to reach a view in time for 31 October 2012 (planned Solvency II implementation date) on any submissions received after April 2012 (i.e. firms dry-running from November 2011)

[Click for FSA Update on Solvency II Planned FSA Communications](#)

Key Stakeholders

ABI- Association of British Insurers. The ABI has published two papers – Regulation and Markets for the 21st Century and The Insurance Industry: Rebuilding Confidence in Europe.

CEA- European Insurance and Reinsurance Federation (EU equivalent of the ABI)

CEIOPS- Committee of European Insurance and Occupational Pensions Supervisors which has 19 separate working parties focussing on different aspects of the Solvency II regime

FSA- Financial Services Authority

HMT- HM Treasury

INTMOD- The Internal Models Expert Group, the CEIOPS working party responsible for the development of an effective framework for the review and approval of internal models

Lamfalussy Process

Solvency II will be adopted using the four stage Lamfalussy Process:

- **Level 1 Directive**- contains the broad framework and core political principles as decided by the Parliament and the Council on the basis of a proposal from the European Commission.
- **Level 2 Implementing Measures** - Technical measures are adopted by the Commission with the assistance of a regulatory committee and an advisory committee. These committees help to ensure the provisions are up to date with market developments.
- **Level 3** - Implementation of Level 1 & 2 in the Member States. National regulators work on coordinating new regulations with other states and the "level 3 committees" such as CEIOPS.
- **Level 4** - Enforcement of the Solvency II regime.