Solvency II

New EU requirements for insurance companies

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Solvency II basics

Solvency II refers to the statutory *own funds* required to always be able to fulfill obligations to insurance policy holders.

3-pillar model of Solvency II

Solvency II

1	2	3
Capital requirements	Risk management	Disclosure
SCR/MCR Calculation models	Governance ORSA ALM	SFCR RSR QRT

Data storage, data quality and calculation engine

Solvency margin covered by own funds

To ensure that their liabilities under the insurance contracts may be fulfilled at all times, the insurance undertakings are obliged to maintain own funds free of all foreseeable liabilities in an amount not less than the required solvency margin, which is determined in relation to the total volume of business. One-third of the required solvency margin is deemed to be the guarantee fund.

General information

Objectives of Solvency II

/ Risk-adjusted capital reserves
/ Introduction of an "early warning system" (for SCR shortfall)
/ EU-wide protection of insurance policy holders
/ Integration of European insurance market
/ Improvement of internal risk management approach (ORSA)

Initial situation

EU-wide solvency requirements have been in place since the 1970s. Their verification and harmonization led to the introduction of Solvency I in 2002. The demand for a second more comprehensive reform process already evolved during the introduction process of Solvency I. This reform should specifically focus on all relevant risks for insurers.

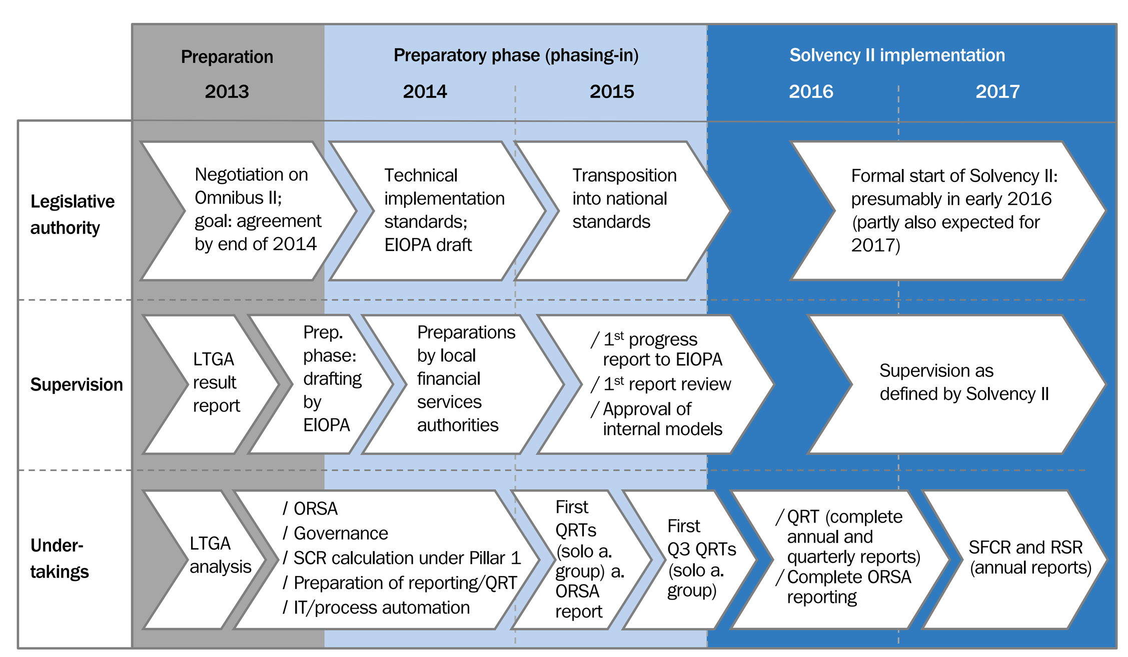
Motivation

Due to developments of the past years, the Solvency I calculation basis for reserving own funds has become obsolete, which also applies for risk management rules. In addition, rules for a continuous exchange with all stakeholders are missing. Supervisory authorities have hardly any possibilities to take precautions in order to prevent a company from threatening the entire market. Solvency II offers solutions for these drawbacks.

Legal framework

Solvency II is a reform process initiated by the EU in 2002 and introduces new provisions that specify the future mandatory amount and method for reserving capital (Pillar 1). It also defines new risk management requirements (Pillar 2) which, in part, have already been transposed into national standards. Furthermore, Solvency II specifies the disclosure of information to supervisory authorities and the public (Pillar 3). It also specifies various expansions of authority by supervisory authorities and transitional provisions (for example in the Omnibus II directive). Supervisory responsibility is assumed by local financial services authorities and EIOPA as a group supervisor in the EU. The implementation of the entire set of regulations as of 2016 or 2017 is currently under discussion—the formal decision of the European legislative authority is still due. As part of a preparatory phase ("Solvency 1.5"), selected elements of the regulation may be subject to an early implementation in 2014 and 2015.

Schedule



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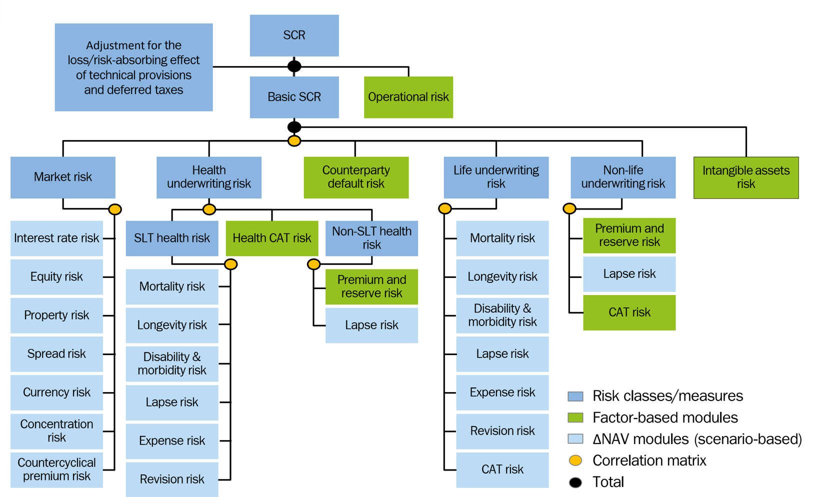
Requirements of the three Pillars

1 Capital requirements

Goal Comparison of solvency capital requirement (SCR) and minimum capital requirement (MCR) with available own funds

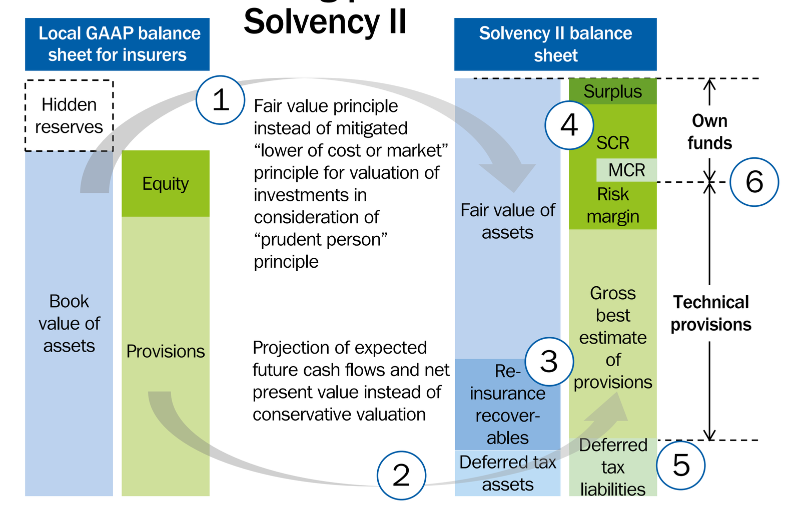
/ Preparation of solvency balance sheet to determine own funds
/ Interventions by supervisory authority upon SCR or MCR shortfall

Solvency capital requirements by risk modules



/ Risk quantification of individual risks through statutory standard model or (partially) internal model
/ Adequate consideration of expected/unexpected losses upon quantification of risks

Solvency balance sheet (fair value B/S) as core element and starting point for all calculations in Solvency II



Regulatory consequences of SCR and MCR shortfall

OF < MCR	Creation of short-term funding plan for, at least, MCR compliance and prohibition of free disposal of assets or withdrawal of approval
SCR > OF > MCR	Creation of restructuring plan, reduction of risk profile and restriction of free disposal of assets and decision on return to standard formula
SCR < OF	Pillar 1 requirements are met

/ **SCR** = value at risk of loss distribution with 99.5% confidence level and 12-month time frame
/ **MCR** = linear function of net provisions and premiums of the last year or capital at risk
/ **Risk margin** = amount that another insurance company would claim on top of the best estimate of insurance-related provisions to assume insurance obligations
/ **Best estimate** = present value of the expected future gross cash flows discounted with the current risk-free yield curve
/ **OF** = own funds of the insurance company

1 **Market valuation of investments**
/ Look-through approach for funds

2 **Determination of gross best estimates vs. provisions**
/ Segmentation of insurance contracts (unbundling in regulatory defined segments)
/ Delineation of insurance contracts according to economic contract limits
/ Application of actuarial statistical procedures
/ Consideration of future developments, implicit and explicit insecurities and insurance policy holder behavior

3 **Determination of reinsurance recoverables**
/ Limited availability of historical reinsurance contract data in database format
/ Adequate selection of a procedure for deduction of risk mitigation through reinsurance

4 **Risk calculation (SCR) and projection (risk margin)**
/ Iterative procedure for determining the risk-mitigating effect for counterparty default risks
/ Adequate selection of a procedure for determining the risk margin

5 **Determination of deferred taxes**
/ Obligation to disclose fair value of deferred tax assets

6 **Determination of own funds**
/ Evaluation of the quality of capital components

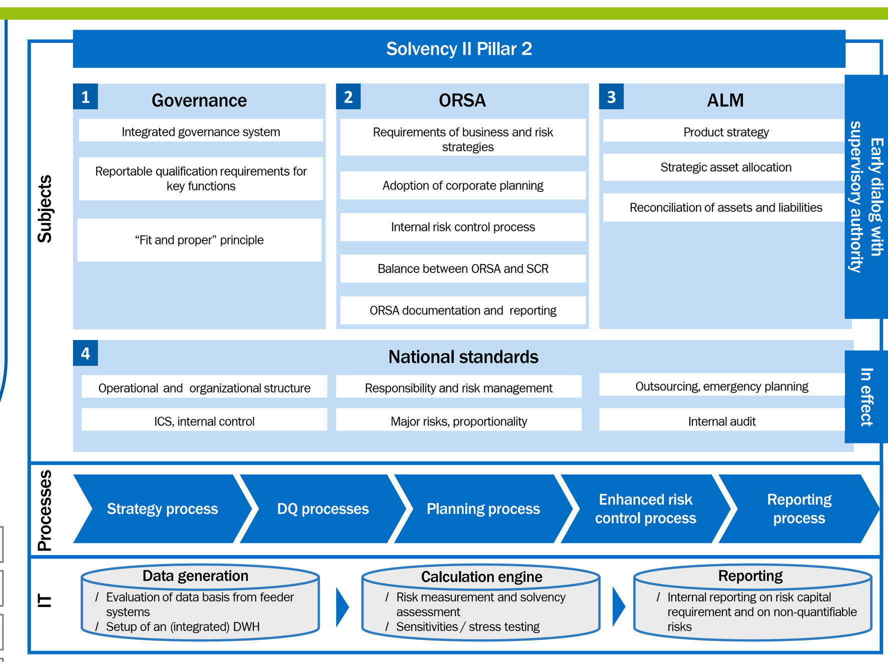
2 Risk management

Goal Increased risk awareness through minimum requirements for risk management

/ Qualitative requirements for a company's operational and organizational structure
/ Integration of business and risk strategy
/ Regular assessment of risk-bearing capacity (ORSA)

Governance system

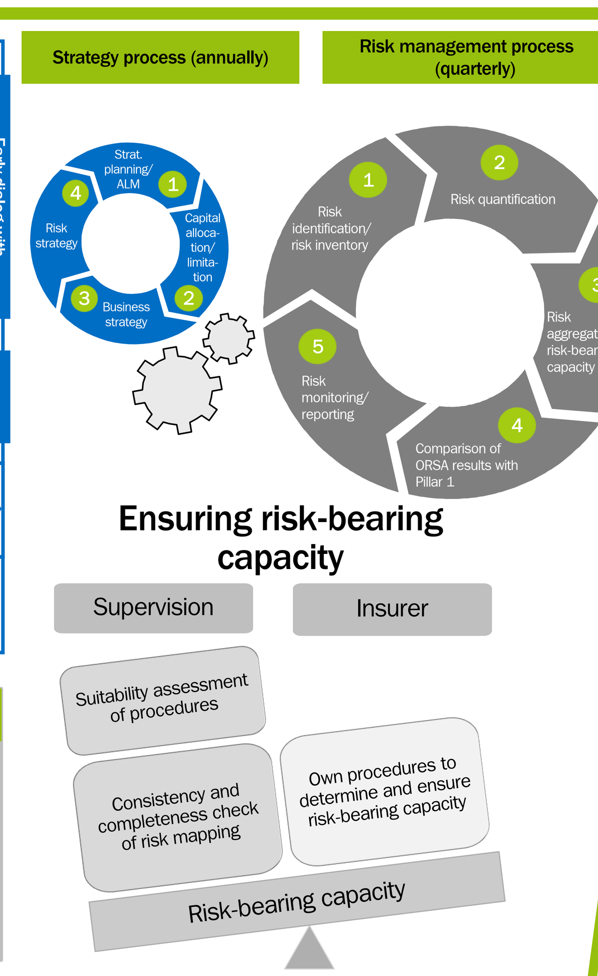
1 Governance system (comprehensive)
2 "Fit and proper" principle
3 Risk management
4 "Prudent person" principle
5 Governance of own funds
6 Internal control system
7 Internal audit function
8 Actuarial function
9 Outsourcing
10 Group-specific governance requirements



Regulatory power

Say and decision-making power for the following topics:

✓ Provision of all information necessary for supervision
✓ Staffing of positions with executive or key functions
✓ Possible actions to reduce identified risks

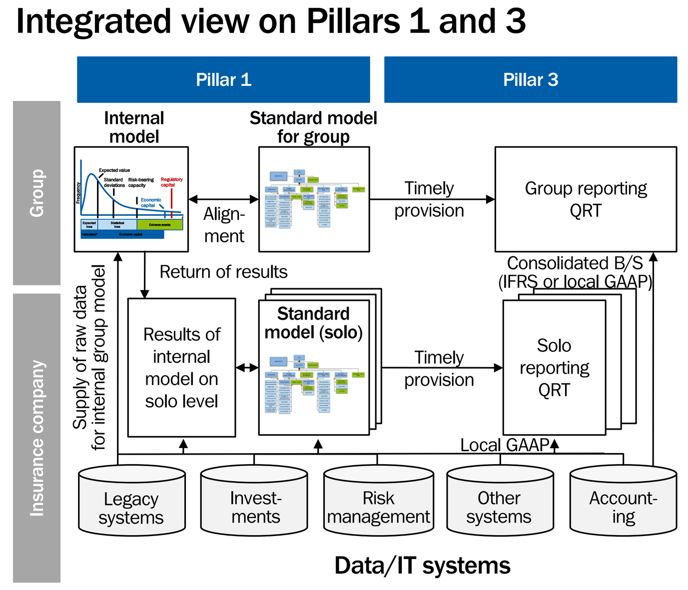


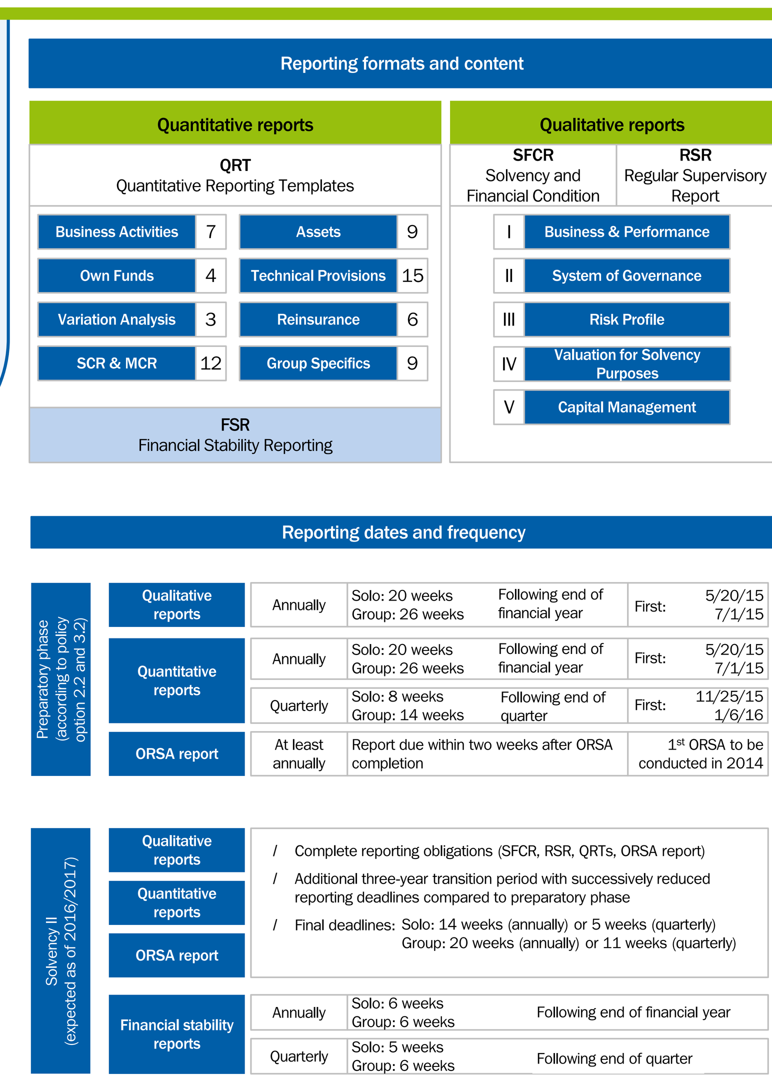
3 Disclosure

Goal Increased transparency on European insurance market

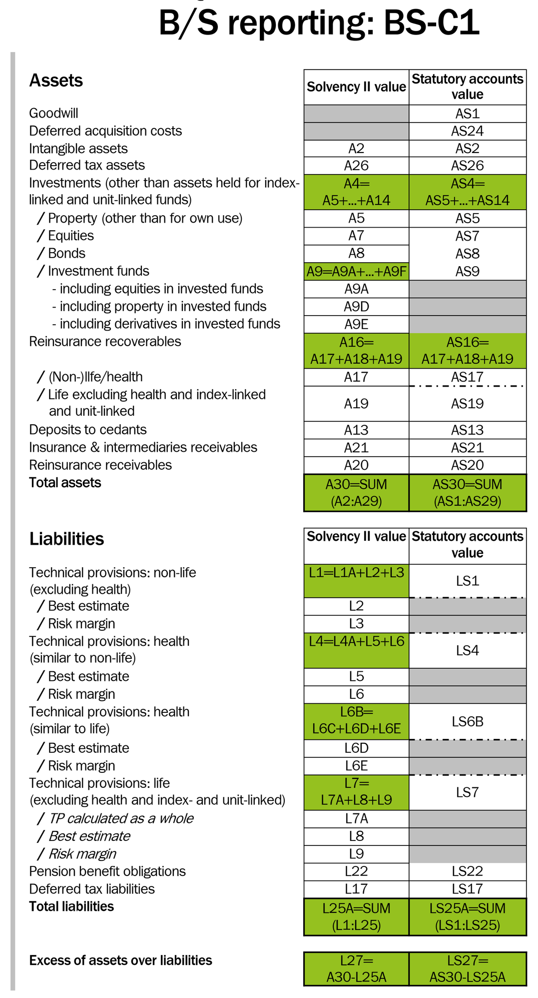
/ Regular solvency reporting (QRT) to supervisory authority
/ Report on current solvency situation (RSR) for supervisory authority
/ Report on solvency and financial situation (SFCR) for the public

Integrated view on Pillars 1 and 3





Extract of QRT Excel form for solvency B/S reporting: BS-C1

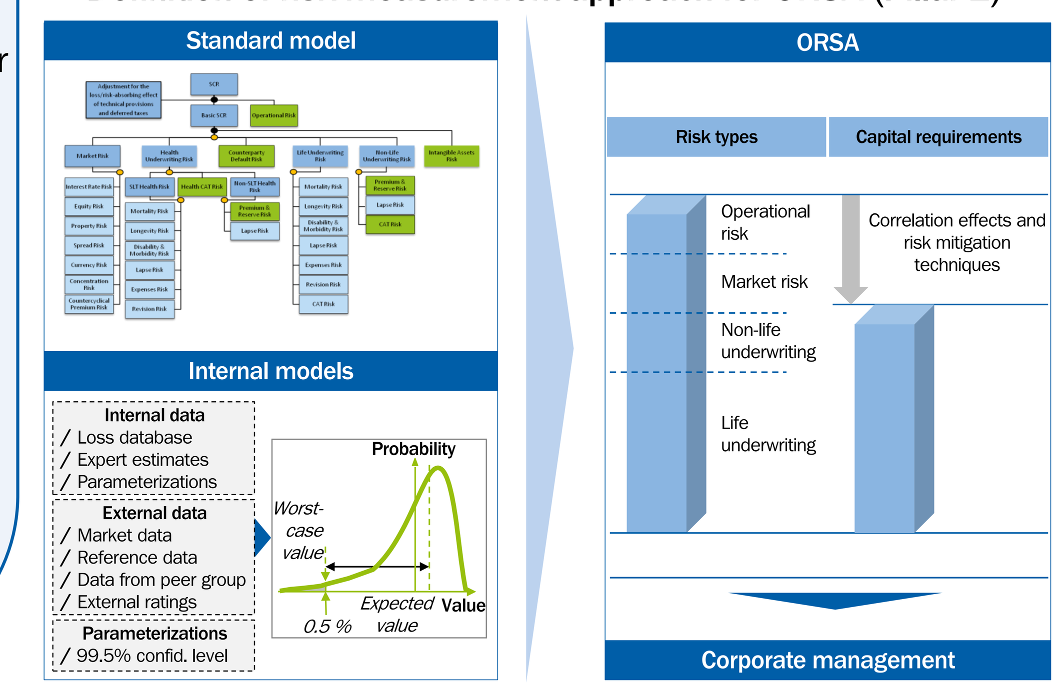


Our solution portfolio

Business consulting

/ zeb/ has detailed knowledge of the legal and regulatory requirements for Solvency II implementation (assistance for QIS studies, implementation support)
/ Support of numerous Solvency II implementation projects (e.g. regulatory reporting)
/ IT implementation expertise from large international projects with various IT infrastructures
/ Regular exchange of information with EIOPA and local financial services authorities

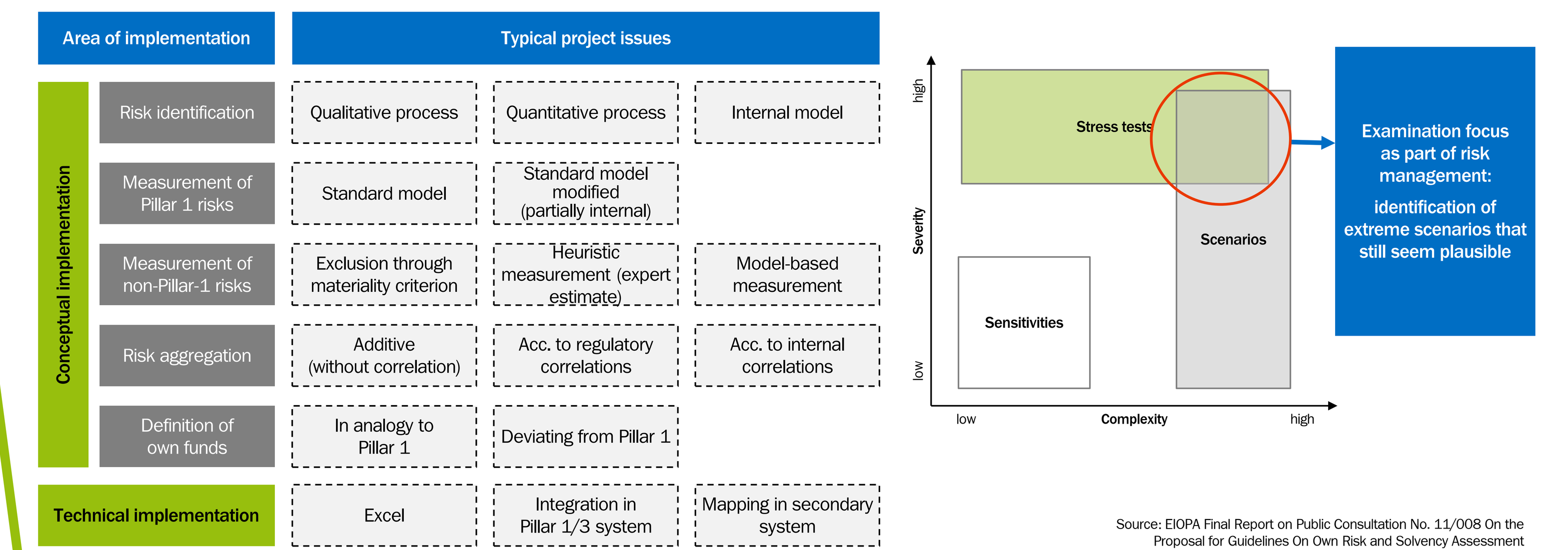
Definition of risk measurement approach for ORSA (Pillar 2)



Guideline 8: / "For this, and where appropriate, the undertaking should subject the identified risks to a sufficiently wide range of stress test/scenario analyses to provide an adequate basis for the assessment of the overall solvency needs."

Guideline 9: / "The undertaking's assessment of the overall solvency needs should be forward-looking."

/ Insurance companies need to develop appropriate methods to be able to project regulatory and economic **capital requirements using various multi-year scenarios.**



Source: EIOPA Final Report on Public Consultation No. 11/008 On the Proposal for Guidelines On Own Risk and Solvency Assessment

Software

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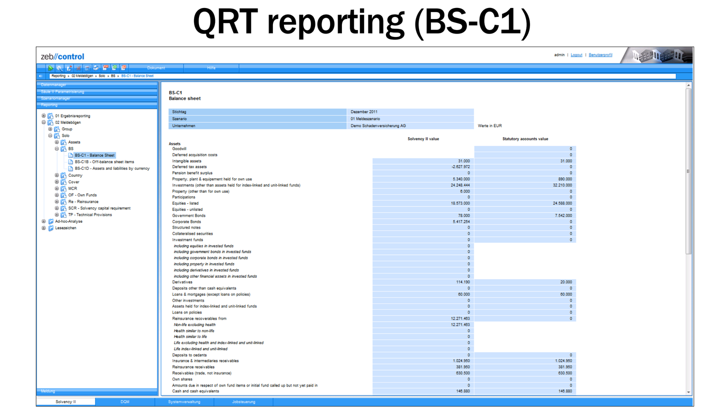
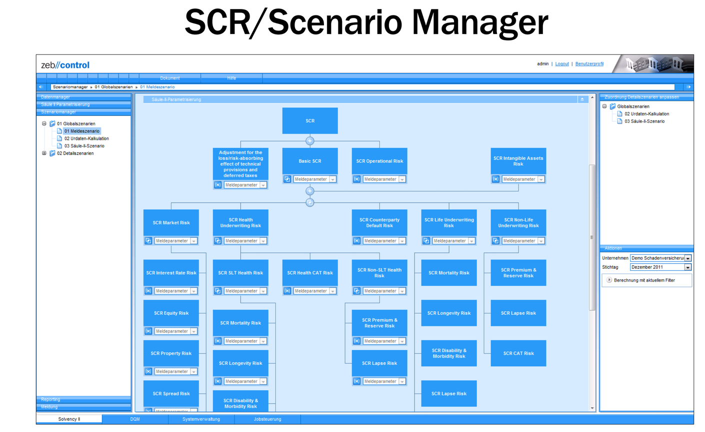
Integrated solution covering all three Pillars:

/ Use of Solvency II standard model to calculate SCR requirements for solo and group (Pillar 1)
/ Preconfigured and audit-proof reporting process including comprehensive assessment and correction options for the QRTs (Pillar 3)
/ Flexible Scenario Manager to simulate risk parameter shifts for all risk types (Pillar 2)
/ Automated reporting by means of XBRL format
/ Integration of partial internal models
/ Modular setup and open architecture, system can be gradually expanded
/ Open and standardized input and output interfaces
/ Reuse of results

QRT reporting (BS-C1)



SCR/Scenario Manager



Standardized reporting process with comprehensive assessment and correction options