

European Commission: Solvency II Update

The Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) continues to advise the European Commission on the development of the new insurance solvency system (Solvency II).

Quantitative Impact Studies (QIS)

At this time CEIOPS has completed the first Quantitative Impact Study (QIS 1), with focus on the level of prudence in the current technical provisions. The result was a rough indication of the impact of the proposed rules on the required provisions. Although there was limited time, resources, experience, and lack of sufficient data to perform the calculations, the results showed that liabilities would be lowered based upon the approaches in the QIS (establishing liabilities at the “best estimate” plus a “risk margin”).

Some issues were identified that are similar issues being faced in the U.S. with risk-based capital and principles-based approaches:

- Some participants offered suggested approaches that deviated from the internal company modeling (confidence level) approaches being used. Participants proposed some simplifications to calculations, including the use of deterministic approaches (such as stress and scenario techniques) and the application of risk margins as a percentage of the best estimate. The U.S. faces similar issues when introducing modeling into the Risk-Based Capital calculations. Smaller companies likely need alternative approaches to the calculations.
- Some participants mentioned that the confidence levels being used to determine the liability values seem arbitrary and that such information could likely never be known with confidence. A supervisor also noted that the models and assumptions used by insurance undertakings differed substantially. The U.S. also faces this situation in the determination of whether to offer ranges of values for assumptions and parameters when determining a principles-based valuation approach.

One of the most beneficial results of the QIS1 seems to be that valuable information was gained on the practicability of calculations and what information will be needed in the future for companies to do the calculations in an acceptable manner.

A second QIS (QIS 2) is in progress to study the effect of solvency capital requirements, valuation of assets and liabilities, and the definition of available capital. Both qualitative and quantitative information about the suitability of the possible approaches to the calculation of solvency levels will be studied. Results for QIS 2 are expected by the Commission Services by October 2006.

The quantitative impact studies are intended to be key inputs in the European Commission's required Impact Assessment Report on the Framework Directive.

Consultation Papers

In January 2006, the European Commission asked CEIOPS to provide additional advice related to the valuation of technical provisions, development of the capital levels (the SCR and the MCR formulas), and recognition of reinsurance and other risk mitigation techniques. Consultation papers on those subjects, along with papers on reinsurance, diversification, supervision powers, and other issues, will be worked on this year. Expectations are that some consultation papers will be completed by October 2006.

Implementation

CEIOPS will continue preparatory work related to potential implementation measures for Solvency II, in anticipation of providing advice to the Commission.

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