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Solvency II: Implementation Challenges & Opportunities

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What is Solvency II about?

The Solvency II Directive is a regulatory framework for the European insurance industry that adopts a more dynamic and integrated risk-based approach

The EU Framework Directive was approved by Commission in May 2009

Rescheduled entry into force of Solvency II from 1 January 2014, pre-applications for internal models from 1 January 2013

Significant change for the European insurance and reinsurance industry, notably:

- Risk-based approach to calculation of capital requirements
- Market consistent approach to calculating insurance technical provisions

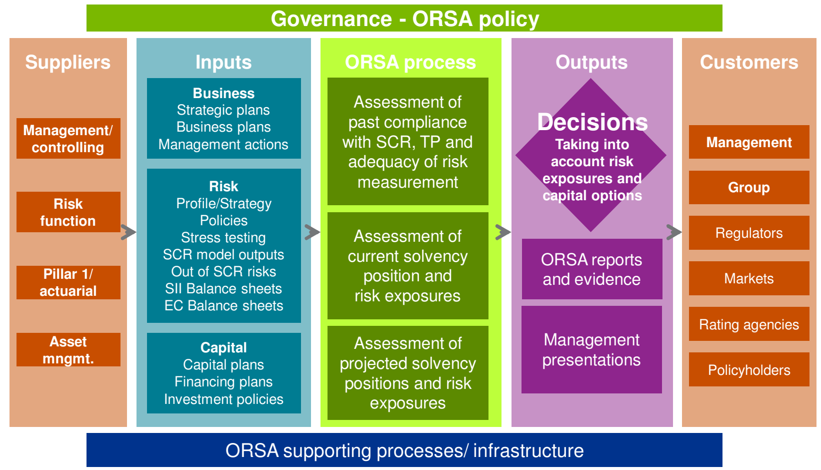
Important aims of the Solvency II are to create a risk based solvency regime which is consistently applied in EU and to encourage a deeper single insurance market within EU

Holistic three pillars approach

Solvency II

Pillar 1: Quantitative requirements	Pillar 2: Qualitative requirements	Pillar 3: Market discipline
Aims to ensure firms are adequately capitalized with risk-based capital	Imposes higher standards of risk management and governance	Aims for greater levels of transparency for supervisors and the public
Standard vs. Internal model	Own Risk and Solvency Assessment – ORSA	Supervisory report
S2 Balance Sheet	Supervisory Review Process - SRP	Public Solvency and Financial Condition Report

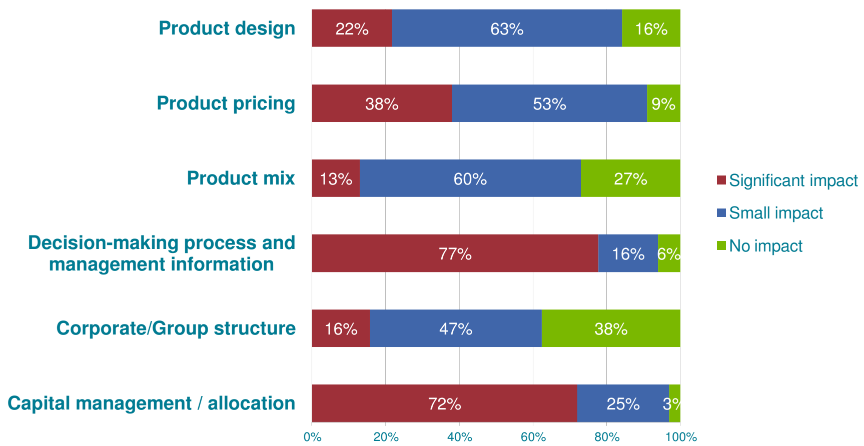
SII (ORSA) framework



Possible business impact

- Product pricing and design, product mix
- Investment strategy
- Risk transfer mechanisms
- Reserving
- Organization
- Decision-making process
- Cost of capital as key decision driver

KPMG's latest research on Solvency II impact



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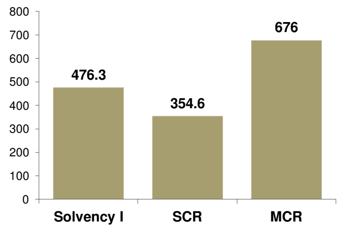
Insurers in CEE do not seem to be undercapitalised

CEE countries seem to be well-placed in terms of capital requirements based on QIS5 results from March 2011.

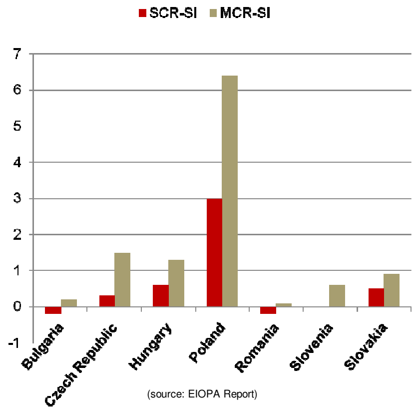
Current regime and QIS5 surpluses (€bn) solo



(source: EIOPA Report)

Based on QIS5 results, the financial position of the insurance sector in most of CEE remains stable.

Surplus of Solvency II capital (SCR and MCR) compared to Solvency I (current rules)



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Gaps in SII preparedness across CEE

P1

- **SCR calculation**
- Valuation methods

P2

- **Board awareness**
- Actuarial Function
- Internal Control System
- **ORSA**
- Outsourcing
- Prudent person principle
- Risk management system
- Remuneration

Solvency II implementation in CEE – KPMG's observations

Insurers across CEE mainly focus on achieving the minimum compliance rather than using the regulation to get competitive advantage and improve internal processes

Pillar1:

- Usually under control – Solvency project driven mainly by actuaries
- Determine the scale, nature and complexity of risks, measure the model error
- No S1 provision does not mean no S2 provision

Pillar 2:

- Areas such as ORSA or risk management framework still in development
- SII consciousness and involvement of board/management
- Embedding of risk management and the model
- Using risk management for decision making
- ORSA
- Validation and documentation

Solvency II implementation in CEE – KPMG's observations

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Pillar 3:

- Insurers currently do not see the importance of disclosing significant amount of commercially sensitive information
- Focus on filling QRTs and are preparing for dry runs towards the end of 2012
- Many insurers have not started yet to actively approach SFCR and RSR
- Majority are implementing new reporting applications (almost half of them are developing applications at the group level)
- EIOPA is developing an XBRL taxonomy for harmonized transmission of reporting which will need to be taken into account

Solvency II implementation in CEE – KPMG's observations

Lack of resources

- Insurers seem to face lack of qualified resources to address the requirements and also to perform activities in business as usual
- Regulators within CEE also seem to face lack of capacity and hold back issuing supporting guidelines (compared to regulators in western Europe)

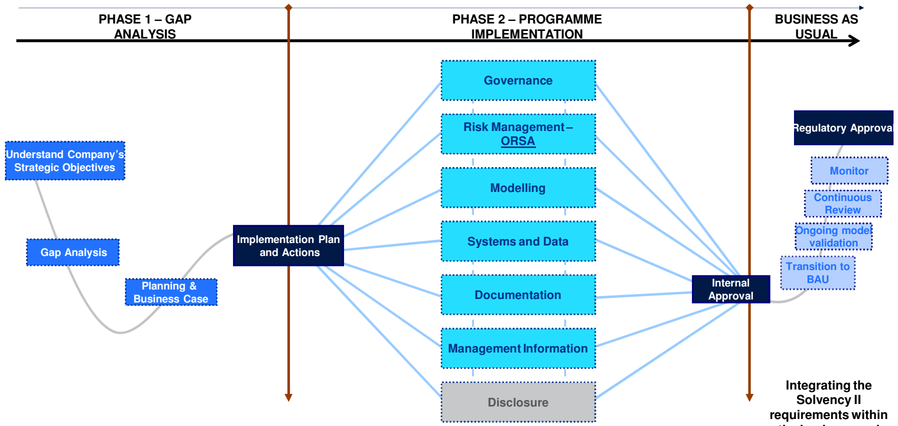
Data and systems

- Most insurers seem to have significant issues ensuring relevant data are available in sufficient granularity and quality to support all three Pillars
- Data governance and especially data quality management are crucial components of Solvency II, many insurers are only starting thinking how to address those

Documentation

- Demanding requirements as regards documentation of models, systems, processes, policies and systems which many insurers are only starting to address now

Identifying critical path for implementation



Identifying gaps and critical path with consideration of Company's Structural, Business and Operational Strategic Plan

Implementing Solvency II Programme, understanding the interdependencies and interlinking each sub-programme to ensure coordination of project

Integrating the Solvency II requirements within the business and identifying improvements before formally seeking regulatory approval

Critical success factors

Management's involvement and ownership – tone at the top

Existence of clear vision or ability to formulate one

Proper assessment of starting position regarding Solvency II implementation

Clear project structure – roles and responsibilities

- Internal resources involvement
- External resources involvement

Strong participation of Company's personnel

- Involvement of future users of the implemented solutions

Adequate resources corresponding to the complexity of vision and envisaged final state

Beyond compliance…

For many insurers, regulatory requirements will present challenges to their existing distribution models and cost structures

Market-leading companies will use the spur of regulation as an enabler to improve internal processes and to gain competitive advantage

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Thank you!