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Solvency II - Experience from introduction and transitional measures

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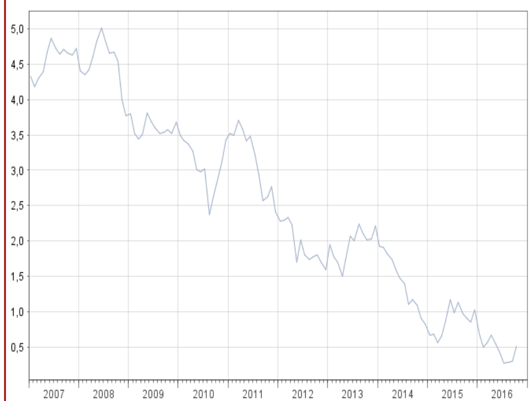
Agenda

1. *State of the insurance markets in Europe*
2. *Current challenges of Solvency II*
3. *Adjustments to the risk-free interest rate term structure*
4. *Transitional measures*
5. *Summary*

1. State of the insurance markets in Europe

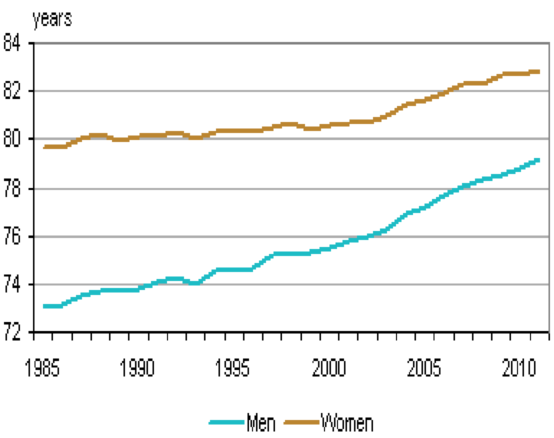
State of the insurance markets in Europe (1/2)

Low interest rate environment, especially Germany…



Source: German National Bank, EUR 10 year swap rates and 10 year German bonds

…people live longer than expected

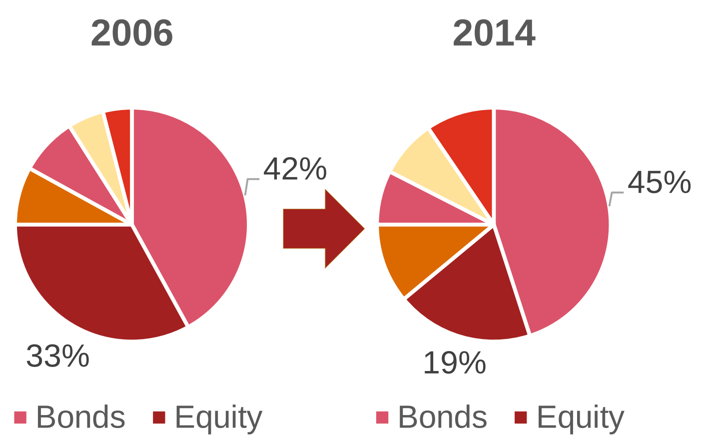


Source: CBS

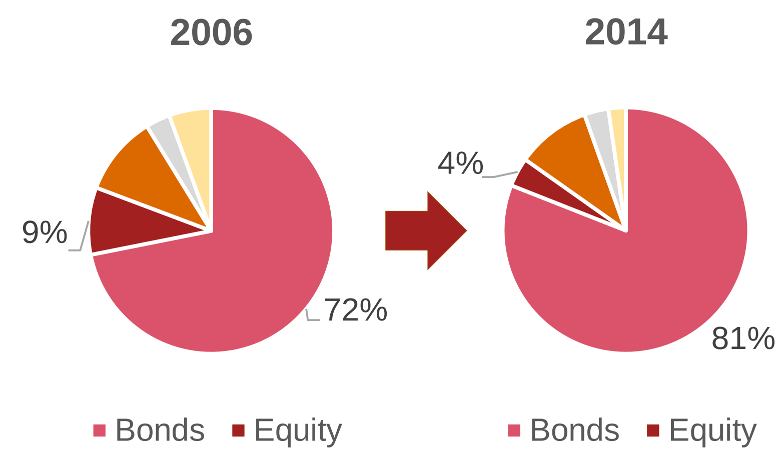
- *Increasing reserves / decreasing solvability*
- *Increasing costs for options & guarantees*
- *Decreasing new business*
- *Need for innovative products with less to no guarantees*

State of the insurance markets in Europe (2/2)

Asset mix global insurance market



Asset mix German insurance market



Sources: Dutch Central Bank and GDV

De-risking of asset portfolio since financial market crisis 2008/2009:

- *Less equity*
- *More high-rated bonds*

2. Current challenges of Solvency II

Current challenges of Solvency II (1/2)

Actuarial models for TP and SCR

- *Choice of an actuarial model (Standard/Internal model)*
  - *Possible adjustment of already existing models (e.g. MCEV, ALM etc.)*
- *Standardized tools from German insurance associations for life and health insurers (BSM/INBV)*

The figures should be auditable

Processes and internal control framework

Art. 46 S II Directive

- *Fit Solvency II process into existing actuarial process environment*
- *Implement Solvency II control framework*
- *Documentation requirements*

Actuarial modernization

Current challenges of Solvency II (2/2)

Validation of Technical Provisions

Art. 264 Delegated Acts (EU) 2015/35

- Data (data quality standards, external data etc.)
- Assumptions and parametrization (adequacy, traceability etc.)
- Model, methodology and process (documentation, limitations etc.)

Current Discussions

- Possible adjustment of UFR in discussion (no change until 2018 expected)
- Interferences with IAIS regarding insurance capital standards (ICS)
- Regulation of digitalization (Big Data, Blockchain etc.)

Documentation and Validation Report

Further Challenges

Facilitation for the transition to SII: Transitional Measures

3. Adjustments to the risk-free interest rate term structure

Adjustments to the risk-free interest rate

Matching adjustment (MA)

Art. 77b and 77c S II Directive

- *Approval by the supervisor for the adjustment*
- *Application on specific portfolio with no future premiums, that is organized and managed separately (entity-specific adjustment)*
- *Similar cash-flow characteristics of the assigned asset portfolio and defined insurance obligations over the lifetime of the obligations*
- *No reversion to an approach that does not include a MA*
- *Requirement to set up a liquidity plan (Art. 44 S II Directive)*
- *Application in UK: average MA 140 bps as of Q1 2016*
- ***No use** of MA in Germany, Netherlands, France, Austria, Belgium, Italy, Greece or Luxembourg (PwC Survey)*

High requirements for MA application

Adjustments to the risk-free interest rate

Volatility adjustment (VA)

Art. 77d S II Directive

- *Approval by the supervisor for the adjustment*
- *VA is not an entity-specific adjustment*
- *The VA is provided by EIOPA at least on quarterly basis*
- *Calculation for each relevant currency with potential country-related adjustment*
- *Requirement to set up a liquidity plan (Art. 44 S II Directive)*
- *VA is 33 bps for EUR and 59 bps for GBP as of Q3 2016*

Wide VA application in addition to transitional measures

4. Transitional measures

Transitional measures

Goal of transitional measure (TM): Phase in the effect of the standard stress factor in the equity risk sub-module (SCR impact)

Equity transitional measure *(Art. 304 S II Directive)*

- *No approval by the supervisor required*
- *Only for equities purchased before January 1st, 2016*
- *Calculation of the equity adjustment in line with Art. 304 and comparison with the full stress factor prescribed for the risk sub-module*
- *The transitional period is 7 years; linear or quicker movement to 100 %*
- *Due to the high effort required for the calculations, the equity TM is reasonable primarily for entities with high equity exposure*

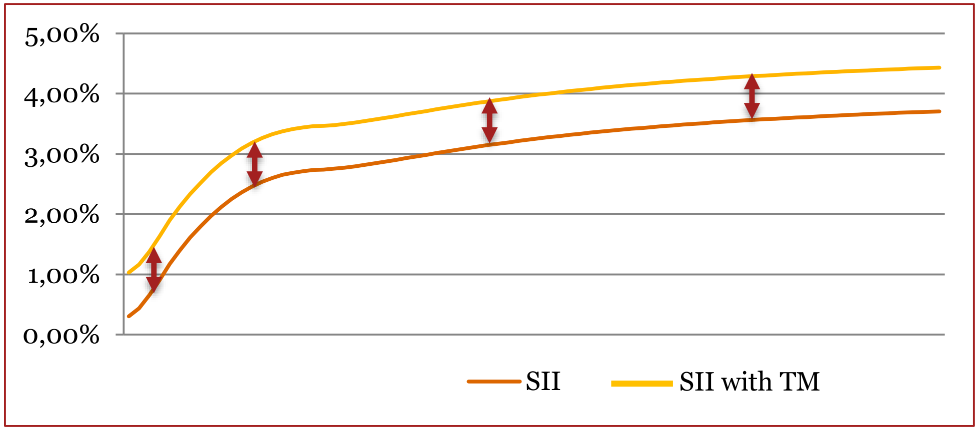
Wide application of equity TM

Transitional measures

Goal of transitional measures (TM): Smooth transition from SI to SII valuation in the next 16 years

TM on the risk free interest rates *(Art. 308c S II Directive, §351 VAG)*

- *Approval by the supervisor for the temporary adjustment*
- *Application on complete portfolio*
- *For ORSA purposes also calculations without TM*
- *Solvency ratio calculation and reporting also without TM*

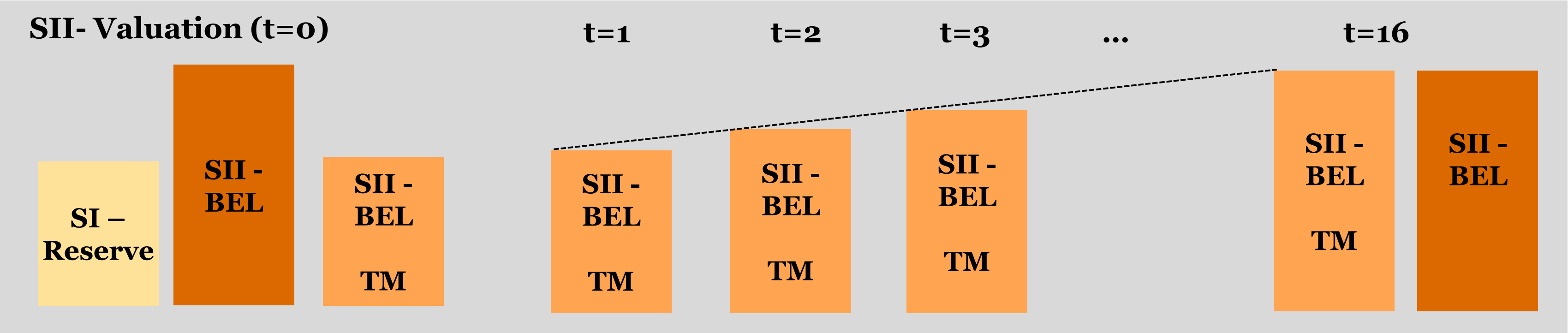


Transitional measures

Goal of transitional measures (TM): Smooth transition from SI to SII valuation in the next 16 years

TM on technical provisions *(Art. 308d S II Directive, §352 VAG)*

- *Approval by the supervisor for the temporary adjustment*
- *Application only on parts of insurance portfolio possible*
- *Recalculation of TM as result of a material change in risk profile or on request of the supervisor*



Transitional measures

Application of transitional measures in Germany

- *German supervisor (BaFin) approved over 60 TMs*
- *53 of 84 German life insurers apply TM*
- *Many insurers apply TM in addition to volatility adjustment*
- *Only 1 life insurer in Germany applies TM on the risk free interest rates*
- *Intense ongoing monitoring of application by BaFin*
- *BaFin vs. EIOPA on UFR adjustment*

TMs are huge facilitation for life insurers

5. Summary

Summary

Changing insurance market environment

- *Change of new business strategy in Germany*
- *Development of new insurance products*
- *Increasing number run-off solutions*
- *Adjustment of asset strategy for Solvency ratio purposes*
- *Solvency II figures will be hardly comparable between companies*
- *Parallel preparation for IFRS 17*

Transitional measures required to enable implementation of Solvency II in challenging market conditions

Your contacts

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Thank you.