

SOLVENCY II AND THE ACTUARIAL FUNCTION

Philip Shier, Chairperson AAE

Bologna, 15 June 2016

Agenda

1. Brief Introduction to the AAE
2. Solvency II
 - a) New Requirements
 - b) Roles for actuaries
 - c) Position of the AAE
3. Current issues

Actuarial Association of Europe

The Actuarial Association of Europe (AAE) was established in 1978, originally as the Groupe Consultatif Actuariel Européen, to represent actuarial associations in Europe.

Its purpose is to provide advice and opinions to the various organisations of the European Union – the Commission, the Council of Ministers, the European Parliament, EIOPA and their various committees – on actuarial issues in European legislation.

The AAE currently has 36 member associations in 35 European countries, representing over 21,500 actuaries.

Advice and comments provided by the AAE on behalf of the European actuarial profession are totally independent of industry interests.



Philip Shier

AAE Strategic Objectives

1. Establish/maintain/strengthen relationships with key European institutions
2. External communication - raise the profile and reputation of actuaries
3. Support and add value to member associations
4. Education and research
5. Promote development and recognition of actuarial profession

Strategic Review

- Review the strategic objectives and the business plan, in all their aspects, as decided in the meetings of the General Assembly in 2010 in Brussels and in 2013 in Dublin
- Review existing links with external stakeholders such as European institutions, professional organisations and industry bodies, and consider how to develop these further
- Consider whether there are any useful precedents to be taken from the recent IAA review of its strategy and organisational structure
- Assess the impact of different strategies on the AAE and make corresponding recommendations to the General Assembly [Barcelona, 26 September 2016]
- Ensure sufficient opportunity for contributions to this review from all member associations

AAE : current Officers

Kristoffer Bork (DK)
vice Chair

Philip Shier (IE)
Chair

Michael Renz (DE)
past Chair

Standards, Freedoms and Professionalism Committee

David Martin (UK)

Insurance Committee

Esko Kivisaari (FI)

Pensions Committee

Falco Valkenburg (NL)

Investment and Financial Risk Committee

**Christoph Krischanitz
(AU)**

Education Committee

Mark Stocker (UK)

Karel Goossens (BE)
Honorary Treasurer

www.actuary.eu

Ad Kok
Chief Executive

AAE activity in relation to Solvency II

- Responsibility of Insurance Committee
- Established Solvency II project team and working parties to mirror EIOPA structure during development phase
- AAE has decided to continue the Solvency II Project Team approach based on revised terms of reference.
 - Project Manager Siegbert Baldauf (DE)
- Instead of five working groups there will be three, led by
 - Life Dylan Brooks (UK), Colin Murray(IE)
 - Non-Life Dr. Clemens Frey (DE), Declan Lavelle (IE)
 - Cross sectoral Lauri Saraste (FI)
- Twice yearly meetings between Officers and EIOPA Senior Management in Frankfurt (covering whole range of EIOPA/AAE areas of mutual interest)
- Two AAE “representatives“ on EIOPA Insurance and Reinsurance Stakeholder Group – Annette Olesen (DK) and Tony O’Riordan (IE)

Solvency II

- New Requirements in the context of Solvency II
- Roles of actuaries
- Position of the AAE

Solvency II

- **New Requirements in the context of Solvency II**
- Roles of actuaries
- Position of the Actuarial Profession

New requirements

- Modelling requirements
 - Market Consistent Valuation of Assets and of Liabilities
 - Loss Function Modelling
- Risk Management Requirements
 - Risk Management System
 - Own Risk and Solvency Assessment

Professional Requirements

- System of governance
 - Risk Management Function
 - Actuarial Function
- Fit and proper criteria
 - Professionalism
 - Judgement

Reporting Requirements

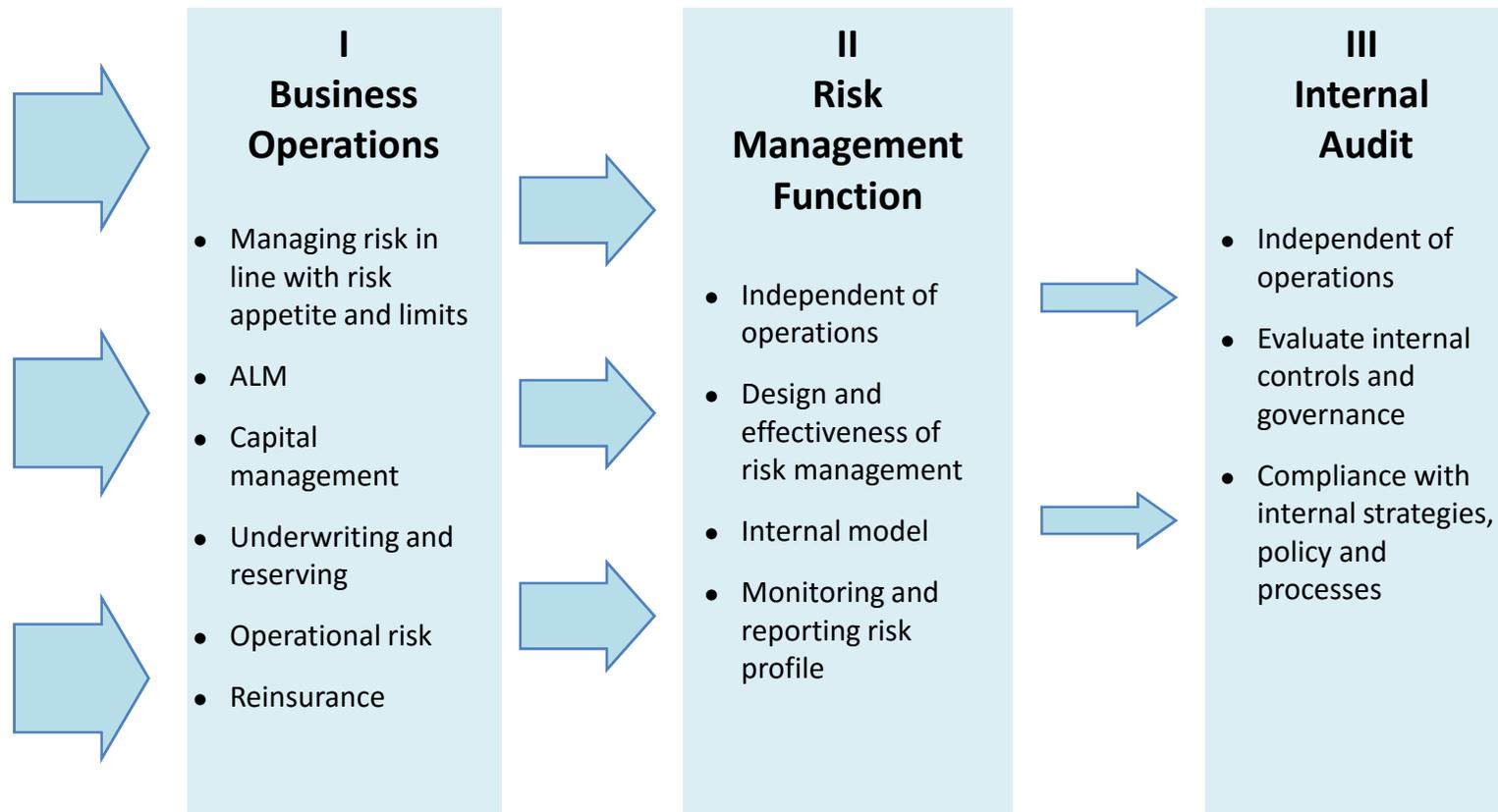
- Actuarial Function Report
 - Administrative Management and Supervisory Board (AMSB)
 - Data quality, methods and assumptions, back testing, underwriting, reinsurance
- Report to the Supervisor ('RTS'): not public
- Solvency and Financial Condition Report ('SFCR'): annual public report

Risk Management Framework



Clear separation of responsibilities

The “Three Lines of Defence”



Solvency II

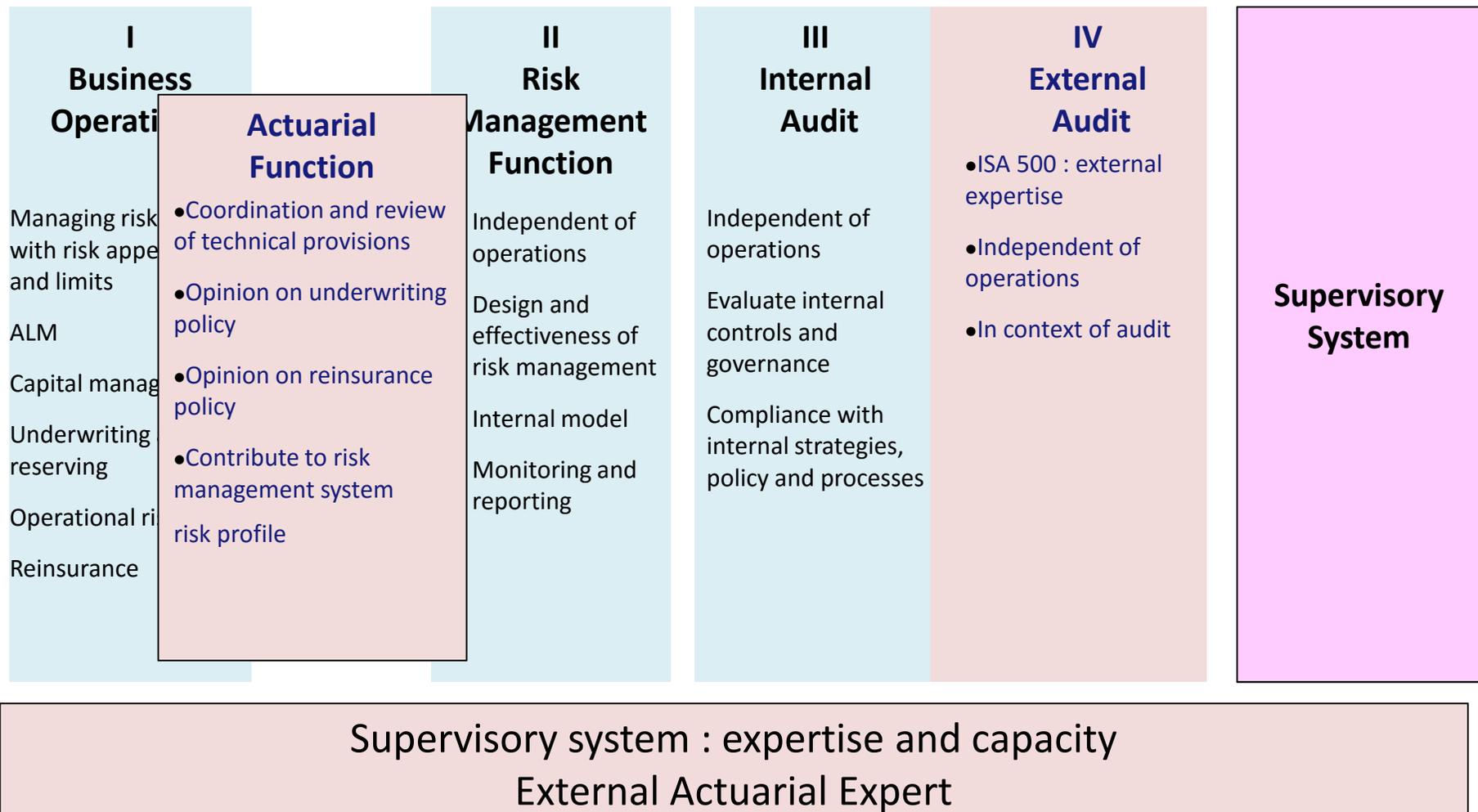
- New Requirements in the context of Solvency II
- **Roles of actuaries**
- Position of the AAE

The 4 Key Functions in the Solvency II System of Governance



Positioning of Actuarial Function

The “Three Lines of Defence” becomes 5 lines of defence



Actuarial Function : article 48

- Technical provisions
 - Coordinate the calculation of technical provisions

- Methods, assumptions and data
 - Appropriateness of the methodologies, assumptions and models
 - Sufficiency and quality of the data used in the calculation of technical provisions
 - Compare best estimates against experience

- Reporting requirements
 - Inform on the reliability and adequacy of the technical provisions
 - Express an opinion on the underwriting and reinsurance policies

- Risk Management
 - Contribute to the risk management system, with respect to the risk modelling and to the ORSA

The Actuarial Function's playing field

The technical standards are defining the actuarial function's playing field

These are being developed by EIOPA and cover:

- Review and validation of data
- Segmentation and unbundling
- Assumptions
- Methodologies

The Fit & Proper standards

- Technical standards are developed by EIOPA
- The actuarial profession has a code of conduct

EIOPA makes reference to the standards of the actuarial profession as an “additional benchmark”

The Report of the Actuarial Function

The primary audience is the management body

The supervisor may also request the actuarial report

Descriptions	Justifications	Opinions / Conclusions
<ul style="list-style-type: none"> methodologies for assessing sufficiency of technical provisions assumptions the review of data the contribution to the risk modelling 	<ul style="list-style-type: none"> differences between technical provisions in different years 	<ul style="list-style-type: none"> conclusions from comparing actual versus expected an opinion on the overall underwriting policy an opinion on the overall reinsurance policy recommendations how shortcomings could be remedied

EIOPA does not intend to define the structure and content of the Actuarial Function's report

European Standard of Actuarial Practice ESAP2 "ACTUARIAL FUNCTION REPORT UNDER DIRECTIVE 2009/138/EC" approved by AAE General Assembly on 31 January 2016

Comparing the Actuarial and Risk Management Functions

	Technical Provisions	Internal Model	Risk Policies	ORSA
Actuarial Function	Design Implement? Validate Co-ordinate	Contribute to risk modelling Provide assistance	Express opinions <ul style="list-style-type: none"> • Underwriting • Reinsurance 	Contribute
Risk Management Function		Design Implement Validate Document Inform	Written policies <ul style="list-style-type: none"> • Underwriting • Reserving • Investment • Liquidity & concentration • Operational • Reinsurance 	Determine solvency needs Assess compliance Reconcile ORSA & SCR

Risk Management

- 66% of CRO's are actuaries (weighted average)
- Others have expertise in economics, finance, law, business, bank CRO
- A rough estimate shows that about 25% of insurance actuaries are involved in risk management mainly in underwriting and financial RM
- Based on proportionality, it is allowed to combine the AF and RM in most countries
- A qualified actuary complies with the RM requirements in 90% of cases
- There is a local RM association in 40% of cases

External Audit

- External auditors work with actuarial experts in 77% of the markets
- In such cases, audit firms employ actuaries and in about 50% of these markets, external audit firms will also refer to independent actuarial firms.
- There is generally little interaction between the actuarial and the audit profession

Solvency II

- New Requirements in the context of Solvency II
- Roles of actuaries
- **Position of the AAE**

Positioning of the Role of the Actuary

- 1. The fully qualified actuaries of the actuarial associations are best fit for the Actuarial Function*
- 2. The actuary is actively involved in the risk management system*
- 3. The actuary is available for an independent review of the Solvency II Financial Condition Report*
- 4. The actuary can act in an external and internal role*
- 5. The actuary works together with other experts*
- 6. The interaction with the external auditor has to be organised*

AAE discussion paper on the Independent Review of Solvency II Reports (Nov 2014)

- Independent review of Solvency and Financial Condition Report (SFCR) is important part of the overall governance framework for Solvency II.
- Solvency reporting gives to a larger extent forward looking or prospective information. As a result Solvency reporting will serve a different and additional purpose than regular financial reporting. **As a consequence, there will be an enhanced role of professional judgment by experts such as qualified actuaries.**
- The Solvency II reports supplement existing mandatory financial reporting and supplement the embedded value (EEV or MCEV) reports which are currently drawn up by many life insurers on a voluntary basis. The importance of external reviews of such additional reports has already been acknowledged by the industry.

AAE discussion paper on the Independent Review of Solvency II Reports (Nov 2014)

- The AAE is concerned about the potential lack of convergence between the national practices related to external scrutiny and review process for the purposes of the Solvency II
- The AAE believes that all quantitative information, including underlying methodologies, assumptions and in any case the implications of this quantitative information for the potential future development of the solvency and capital position of the undertaking under review should be assessed and attested. This review will be specific to each undertaking and will rely on a combination of analysis of past experience and judgment of future trends, including various potential economic and entity specific scenarios that could influence the solvency and capital position of the undertaking.

AAE discussion paper on the Independent Review of Solvency II Reports (Nov 2014)

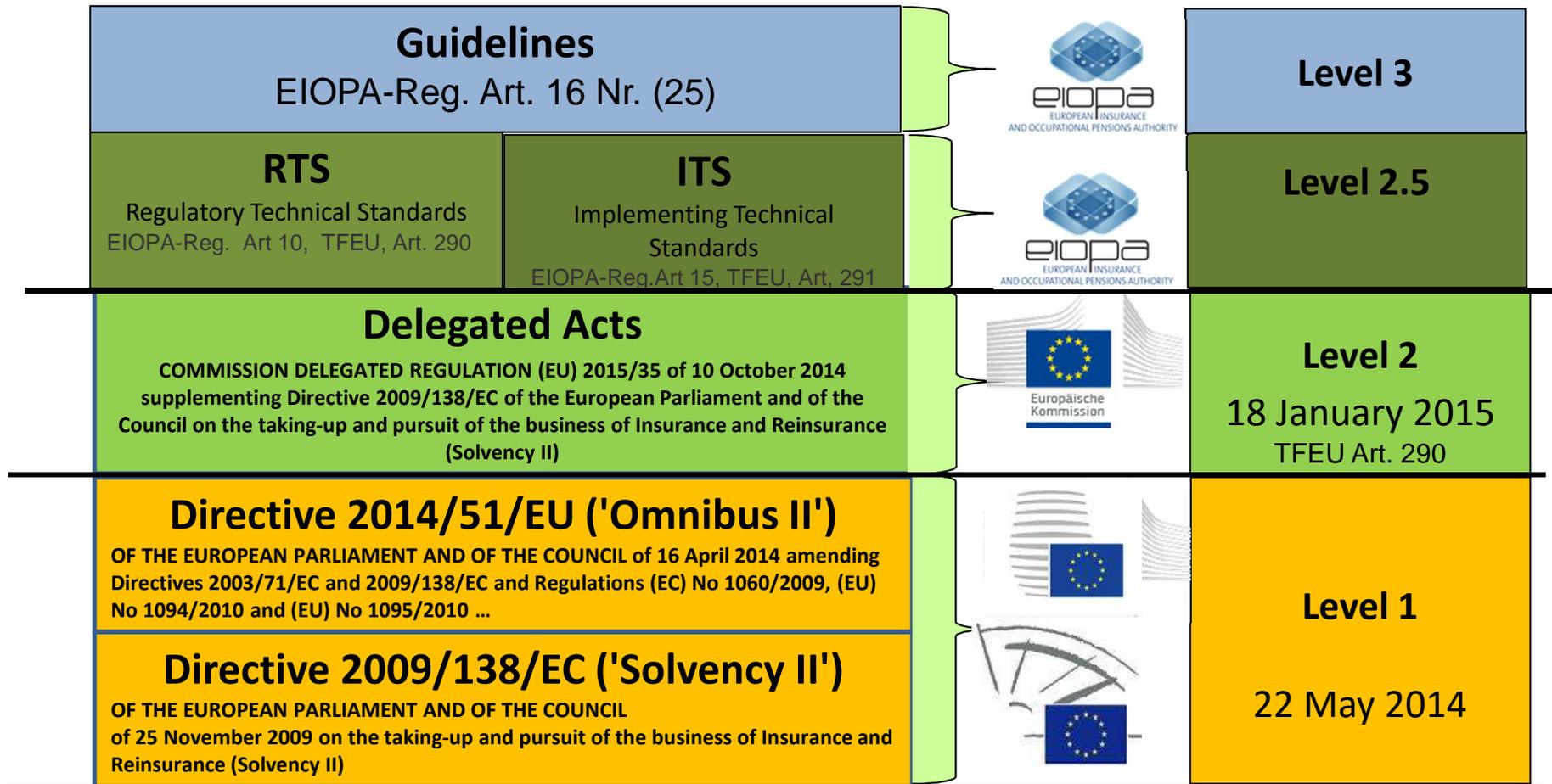
- As a consequence the review should “*be carried out by persons who have knowledge of actuarial and financial mathematics, commensurate with the nature, scale and complexity of the risks inherent in the business of the insurance or reinsurance undertaking, and who are able to demonstrate their relevant experience with applicable professional and other standards.*” (SII directive, Art 48 (2))
- Since the professional judgments provided by the Actuarial Function need actuarial expertise, an independent actuary’s opinion should be required to perform any independent review in order to assure the public and the supervisor that the professional judgments applied in the process are appropriate.
- As a means of giving independent confidence to the public, the opinion of the independent actuary should be disclosed. This disclosure should include the basis of the independent actuarial review, by which actuary it was performed and the opinion of that actuary.

Solvency II

- **Current status**

Legal Framework is completed

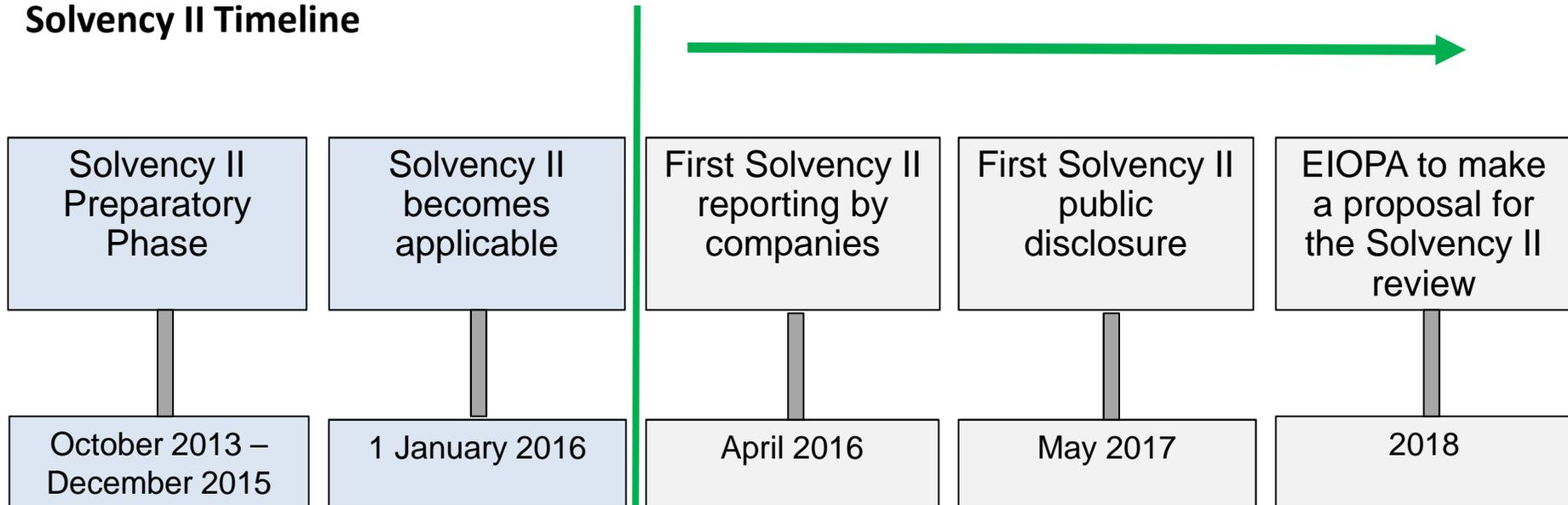
TFEU (Treaty on the functioning of the EU) and EIOPA Regulation (EU) 1094/2010 define proceeding



EIOPA: “Solvency II Going Live”

On 1 January 2016, the new supervisory framework for insurance and reinsurance companies – Solvency II - has become applicable.

Solvency II Timeline



<https://eiopa.europa.eu/Pages/Supervision/Insurance/Solvency-I-Going-Live.aspx>

Solvency II is effective. What's next?

Gabriel Bernardino, Chairman of EIOPA :

“As of 1 January 2016, the new European Union supervisory framework for insurance – Solvency II – is going to be implemented.

The regulatory phase of Solvency II has been completed.

Thus one journey comes to an end, but a new journey just starts. It is a journey towards consistent and convergent application of the new risk-based regulatory framework.

It will be challenging not only for industry and supervisors.”

- Source : 10. December 2015, EIOPA Press event “Implementation of Solvency II”

Agenda for review process (Article 77f)

- On an annual basis, EIOPA shall until 1 January 2021 report to the EP, the Council and the Commission about the impact of the application of LTG – measures
- Supervisory authorities shall provide EIOPA with the following information:
 - (a) the availability of long-term guarantees in insurance products in their national markets and the behaviour of undertakings as long-term investors;
 - (b) the number of undertakings applying LTG - measures
 - (c) the impact on the undertakings' financial position of the measures listed in (b) , at national level and in anonymised way for each undertaking;
 -

Further reviews required by the Delegated Regulation (Citation 150)

- The Commission will review the methods, assumptions and standard parameters used when calculating the SCR with the standard formula:
 - in particular the **methods, assumptions and standard parameters used in the market risk module**, including a review of the standard parameters for fixed-income securities and long-term infrastructure,
 - the standard parameters for **premium and reserve risk**,
 - the standard parameters for **mortality risk**, as well as
 - the subset of **standard parameters that may be replaced by undertaking-specific parameters** and
 - the standardised methods to calculate these parameters.
- Review should make use of the experience gained by undertakings during the transitional period and the first years of application of these delegated acts, and be performed before December 2018

Current issues

- Stress test
- Consultation on UFR

EIOPA Stress Test 2016

Stress tests are one of EIOPA's supervisory tools that help them to assess the resilience of the insurance sector to potential adverse market developments and to extract valid conclusions to support the stability of the financial system.

The Stress Test 2016 aims to assess insurers' vulnerabilities and should not be interpreted as a pass-or-fail test. It is designed to assess the resilience of the European insurance sector to severe adverse market developments based on a common analytical framework. Furthermore, this stress test will examine the potential increase of systemic risks in situations of stress.

It focuses on two major market risks:

- The prolonged low yield environment
- The so-called "double-hit", i.e. a negative market shock to asset prices combined with a low risk free rate

The exercise focuses on long-term business performed by solo undertakings (no insurance groups). In order to include a higher number of small and medium size insurers, the participation target was increased from a 50% in 2014 to a 75% share of each national market in terms of gross life technical provisions.

<https://eiopa.europa.eu/Pages/Financial-stability-and-crisis-prevention/Stress-test-2016.aspx>



EIOPA Stress test 2016: Timeline

Date	Activity
April 2016 (1st half)	Workshop with industry participants
May 2016 (2nd half)	Launch of a Europe-wide stress test specifications and templates for the insurance sector
July 2016 (1st half)	Submission deadline for industry participants to the national supervisory authorities (NSAs)
August 2016	Collection and validation of undertakings' data by the national supervisory authorities (NSAs)
September 2016	Centralised validation by EIOPA of all the submitted results
December 2016	Disclosure of the results of the stress test analysis

<https://eiopa.europa.eu/Pages/Financial-stability-and-crisis-prevention/Stress-test-2016.aspx>

Consultation on Ultimate Forward Rate

- Issued by EIOPA on 20 April 2016, with deadline for submissions of 18 July 2016
- Outcomes decided in September but no change to UFR until after end 2016
- The proposal of EIOPA made in their consultation paper consultation paper would lead to significant changes.
- This would lead to a yearly change of the UFR.
- The methodology proposed still has weaknesses and AAE are trying to address these in our response.