Dr Hans PEER, PhD
Vice-President of the Supervisory Board
Generali Austria, Wien

PARADIGMS SUBSTITUTION IN THE TURBULENT TIMES (EU SOLVENCY II PROJECT)

SUMMARY

The recent crisis sent shockwaves through world economies and has had a disturbing effect on the lives of many. It is important to examine the crisis with a view to learning the right lessons. To the ultimate benefit of its policyholders, but also to the benefit of the economy at large, the European insurance sector’s positive role as a risk-taker and risk-absorber, and as a long-term investor, needs to be ensured by putting it in the best position possible to withstand any future severe disruptions to the global economy. One of the key lessons learnt from the 2001/2002 crisis was that reliance on capital requirements alone is insufficient. Analysis of the history of insurance company insolvencies has shown that the vast majority of insolvencies were preceded by either internal management or governance shortcomings or some external trigger events. In both instances, however — unlike in banking — in insurance there was a period of incubation between the cause and the final insolvency. During this incubation period, the management of the company and/or a properly informed supervisor (with the relevant tools), could have prevented the insolvency. Key in the Solvency II regulatory reform, therefore, is the high level of importance that is placed on the qualitative supervisory review process.

Solvency II offers several fundamental improvements: Market-consistent valuation of assets and liabilities and explicit measurement of risk capital, holistic, cross-balance sheet approach covering all quantifiable risk types and their interdependencies, higher risk transparency that requires a greater risk awareness among managers to be embedded in key decision-making processes, risk management focus - tackling the source of problems, not symptoms (regulation as reinforcement of risk management best practices), ladder of interventions - starting at an upper threshold (Solvency capital requirement) requiring companies to submit a plan for prompt corrective actions and ending at a lower threshold at which the regulator takes over (minimum capital requirement), Group supervision — considering the real aggregated economic profile of groups, yet in conjunction with supervision at legal entity level and market discipline driven by full disclosure of the risk profile.

However, overly prudent or excessive capital requirements — as suggested by the advice papers issued by CEIOPS during 2009 — might not only mismatch regulatory expectations of higher policyholder protection but also bring a quite worrying downside for policyholders, the overall economy and insurers.

Industry practitioners believe that current CEIOPS advice papers may lead to a quite heavy toll for the insurance sector. According to some recent estimates, the required Solvency capital under Solvency II could be as much as 65–75% higher than the standard model calibration under the fourth industry-wide quantitative impact study (QIS 4), while available sources of capital may suffer a reduction of up to 20-50%. According to other, more conservative, estimates, the new Solvency II requirements would represent an additional capital burden of 30–50% on the sector, or even more than 70% in some parts.