UIB NORDIC

THOUGHT LEADERSHIP IMPLICATIONS OF SOLVENCY II

"Quality in Everything We Do"

WHAT IS SOLVENCY II?

The road from Solvency I to Solvency II

The first uniformed regulation framework for insurance companies was introduced in the early 1970´s. This framework focused primary on the paid up capital base of the insurance company. There was no regulation on how an insurance company should control and handle risk or who could sit in the board of directors or any other questions. Solvency I did not comment on how an insurance company should arrange reinsurance and offered no credits for the reinsurance structures arranged.

The introduction of Solvency II is a comprehensive framework for risk management for defining required capital levels and to implement procedures to identify, measure, and manage risk levels.

Solvency II follows the principles used in the Banking industry by the implementation of Basel II and comprises three Pillars which your business should focus on and stand on:

- **Pillar 1** consists of the quantitative requirements (for example, the amount of capital an insurer should hold).
- **Pillar 2** sets out requirements for the governance and risk management of insurers, as well as for the effective supervision of insurers.
- **Pillar 3** focuses on disclosure and transparency requirements.

WHO IS AFFECTED BY SOLVENCY II?

The simple answer is all insurance companies *including captive insurance companies* are subject to Solvency II, but the latest information suggests that insurers with a premium income of less than € 5,000,000 and loss reserves less than € 2,500,000 will be exempt from the general Solvency II regulations and be subject to national control by the respective Financial Supervisor. However, it is assumed that Financial authorities will require that these smaller insurers will live up to similar standard than all other insurers in accordance with Solvency II.

PILLAR 1 OF SOLVENCY II AND THE USE OF REINSURANCE

The pillar 1 framework sets out qualitative and quantitative requirements for calculation of technical provisions and Solvency Capital Requirement (SCR) using either a standard model given by the financial authorities TO BE FINALISED IN April 2011 *or* an internal model created by the insurance company and approved by the Financial Supervisor.

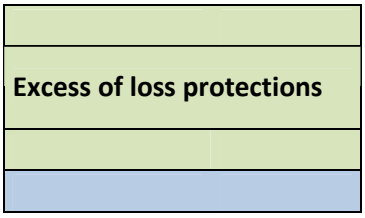
The model includes a phrase called **Technical provisions** which represent the current amount an insurance company would have to pay for an immediate transfer of its obligations to a third party. The solvency is the capital required to ensure that the insurance company will be able to meet its obligations over the next 12 months with a probability of at least 99.5%.

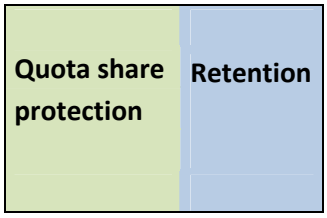
In addition to the Solvency Capital Requirement includes a Minimum Capital Requirement (MCR) which must be calculated and represents the minimum level of capital - the breach of which results in supervisory action.

It is estimated that approximately 60% of all Swedish captives are under-capitalised in accordance with the new Solvency II requirements, which will result in the mother companies owning these captive insurance companies being required to inject new capital into these captive insurance companies. The solvency II models include an element of credit for your reinsurance solutions and depending on your reinsurance structure will depend on the amount of credit that your company can benefit from your reinsurance solutions.

The classic reinsurance structures available are

a) Excess of loss **b) Quota share**





The question is what reinsurance solution serves your company best in light of your:

- ✓ loss history,
- ✓ risk profile and
- ✓ Solvency II requirements.

Your company is a living organisation responding and changing to market circumstances. Your reinsurance solution needs to change to meet these needs and the solution that you have had for many years may not necessarily be the correct solution going forward.

MODELLING YOUR REINSURANCE NEEDS

By modelling your reinsurance programmes, UIB Nordic AB can assist you in developing alternative fact- based analysis to what is the correct road forward for you.

The classic structure of many captive insurers is the Excess of Loss structure. However, if your loss history consists of a frequency of small losses below your retention then what is the benefit of your reinsurance programme and what is your capital relief benefit from your Solvency II requirements?

Alternatively, if you have a proportional solution that is sharing your underwriting profit with reinsurers, then it is time to model your portfolio to get a good understanding of what alternatives are available.

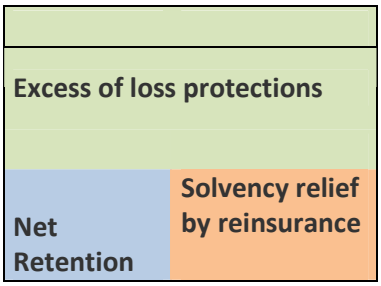
Modelling & analysis can assist with your:

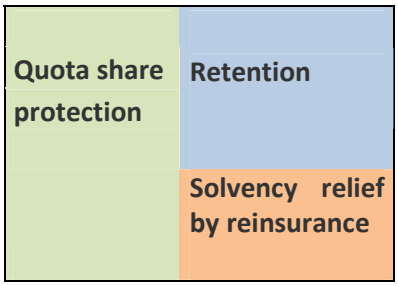
- ✓ Capital relief needs
- ✓ Reinsurance structure
- ✓ Retention levels
- ✓ Probability of loss
- ✓ Limit of protection purchased

FOCUS ON YOUR NET RETENTION

Solvency II, pillar 1 concentrates on the amount of capital an insurer should hold, and your retention has a significant influence on your capital base. In simple terms, a high retention equates to high premium income and high exposure to loss and greater needs for a larger capital base. Lower retention equates to less retained premium income, but also a lower exposure of loss. However Solvency II minimum capital requirements apply, possibly requiring an injection of capital. *Reinsurance focused on your net retention will provide capital relief reducing the need for a capital injection.*

The two below examples illustrate the benefit of solvency relief reducing the retention and consequently the need for increase capital injection:





The capital relief can take the form of:

1. Quota share reinsurance support on your net retention
2. Excess of loss on the net retention
3. Aggregate Excess of loss programme and or stop loss insurance
4. Reinstatement premium insurance

PARTNERS TO THE RESCUE

Solvency II is a complicated issue that requires the support of a number of professionals within your team – insurance specialists, accountants, actuaries, finance.

UIB Nordic AB can be your Partner ensuring a structured systematic approach that will address and resolve all issues. We can act as project leader or support your own project leader and assist the work and reports that are required to be presented to the Steering Group as required:

Steering Group

- CFO
- Chief Legal
- Captive MD / Risk Manager

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Project Leader Group

- Risk Manager
- UIB Project Leader Support

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Project Team

- Finance Staff
- Risk Management staff
- UIB as required

The above is proposed structure to how your team can best assemble around you for the best results.

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ABOUT UIB

UIB Nordic is an international advisor in risk management and insurance. UIB Nordic´s clients are found throughout the Nordic area including Iceland and the Baltic states. UIB Nordic is a wholly owned subsidiary of UIB Group.

Founded in 1987, United Insurance Brokers (UIB) is an independent, international insurance and reinsurance Lloyd's broker with headquarters in London and offices worldwide. Our global reach provides clients with insurance and risk management expertise in more than 110 countries through our network of international offices and membership of UNiBA Partners (www.uniba-partners.com).

In the constantly evolving global insurance marketplace, UIB is renowned for obtaining the most competitive terms and broadest levels of coverage across all major business lines, from markets worldwide.

We maintain the highest standards of innovation, flexibility and professionalism to deliver effective risk solutions backed by the personal service for which UIB has established an unrivalled reputation.

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UIB is accredited by Lloyd's and is authorised and regulated by the Swedish Finansinspektionen and UK Financial Services Authority (FSA).