

Solvency II, and its effect on Asset Managers and Insurance Company

By, Chakradhar Singh, CFA

Solvency II: What is this!!

- Solvency II is the most significant change for the European Insurance and Reinsurance market.
- Based of Risk based capital approach
- Requirement of Capital dependent upon riskiness of assets
- 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.

Enhanced requirements with regard to data
Increased information and reporting
obligation

➔ Higher level of control of the investment activities of asset managers by the insurance companies

} In terms of scope, granularity, aggregation and frequency

Solvency II: Effect on asset managers for insurance companies

- Understanding of risk and transparency and availability of data
 - Understanding various investment risks
 - Understand balance sheet management
 - Effective derivative overlays
- Availability of high quality data
 - Details of the models used to analyze the risk of the investment
 - Ability to provide “look through analysis”

Solvency II: Its potential impact on the insurance sector

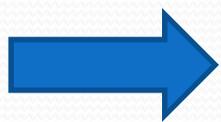
- Positive Expected Outcomes:
 - Improved Efficiency and competitiveness of EU Insurers
 - Recognition of diversification benefits, consolidation and improved efficiency
 - Strengthened EU insurers' balance sheets
 - Optimization of Capital structure, greater transparency and market based discipline
- Potential Negative aspects
 - Some volatility of earnings
 - Some volatility of capital position and EU Insurers' balance sheet
 - Rising vulnerability in the reinsurance sector

Solvency II: Its potential impact on the financial markets

- Positive expected outcomes of potential portfolio allocations in favor of bonds
 - Development of the European Corporate Markets
 - Diversification of investment portfolio
 - Reduction of home bias
- Potential negative outcomes
 - Contained risk of financial market disruption in the short term
 - Potential to aggravate financial stress: a longer term impact

Solvency II: Introduction of new products

- Diversification encourages getting exposure to new products; which are more capital efficient
- Focus on shorter term of the curve
 - As it has lower capital charge
 - Results in steeping of the longer end (supply and demand issues)
 - Would result in duration gap on the balance sheet of life companies



Increased use of Derivatives for bridging the gap of interest rate risk