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

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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**

In terms of scope, granularity, aggregation and frequency

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

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