

## ERM trends and Solvency II requirements

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# Agenda

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- **Overview of recent trends in ERM frameworks noticed by S&P**
- **Discuss S&P's view of the impact of Solvency II on insurer's ERM frameworks**

# Recent trends in ERM frameworks noticed by S&P

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- **Increased allowance of risk in strategic decision making – especially in the reinsurance sector**
- **Significant developments in risk appetite frameworks and linking these to risk limits**
- **Development of reporting and MI**
- **Improvements in risk models**

# Standard & Poor's ERM assessment

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**Standard & Poor's ERM assessment includes an analysis of:**

- **Risk management culture;**
- **Risk controls;**
- **Risk models;**
- **Emerging risk management;**
- **Strategic risk management.**

# Solvency II Risk Management Requirements

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- **The Solvency II includes requirements on risk management, internal models, and their use**
- **Requirements may be demanding for some**
- **There may be a risk that different supervisors could interpret these requirements differently**
- **EIOPA role design to ensure consistency of approach to the requirements**

# **Risk Management Culture: Impact of Solvency II**

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- **We view the Solvency II governance requirements as positive for the development of risk culture within the insurance industry**
- **We view favourably the Solvency II requirements for having:**
  - robust governance structure;
  - a well-integrated risk management system;
  - robust risk appetite frameworks consistent with their overall strategies
  - well-documented risk processes and policies;
  - extensive reporting procedures.
- **We expect that insurers that have implemented an ERM framework that fully complies with the Solvency II requirements would have a "strong" risk management culture.**

# Risk Controls: Impact of Solvency II

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- **CEIOPS' latest advice on specific risk controls includes requirements that we consider to be the basis for a "strong":**
  - underwriting data requirements
  - investment policies should take into account their overall risk tolerance levels, liquidity position, and capital adequacy;
  - extensive investment and concentration limits;
  - robust asset-liability management policies
- **However, Solvency II requirements are not yet sufficiently specific, may lead to inconsistencies in the application by different regulators**
- **Weaker standards, even if accepted by a supervisor, could be scored as "adequate" under our criteria**

# Risk Models: Impact of Solvency II

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- **Solvency II's requirements for approving internal models are demanding and will encourage insurers to improve their models**
- **Meeting Solvency II's requirements may result in us assessing the quality of an insurer's internal model as "strong"**
- **Again, there is a risk that without more detailed guidance Solvency II requirements will be applied differently by different supervisors, so an internal model approved by supervisors:**
  - may not necessarily receive a "strong" assessment from S&P;
  - its results will not be automatically incorporated in our capital adequacy assessment.

# Strategic Risk Management: Impact of Solvency II

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- **We expect Solvency II to be positive for insurers strategic risk management capabilities.**
- **Solvency II is likely to lead to development of internal capital models that more consistently capture an insurer's material risks.**
- **Model quality and model governance should improve.**
- **Models are likely to become more reliable and management more likely to trust their results.**
- **To satisfy the Solvency II “use test”, an insurer should be able to demonstrate that the model underpins key business and strategic decisions such as pricing, reinsurance protection, asset-liability management, and capital management.**

# **S&P ERM Criteria vs Solvency II Risk Management Requirements**

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- **In our view, Insurers that fully implement the Solvency II principles are likely to get a "strong" ERM assessment under our criteria**
- **However, where supervisors allow insurers more latitude in the implementation, ERM may be assessed as "adequate"**
- **We do not expect insurers that we assess as having "weak" ERM capabilities under our criteria to be able to meet the Solvency II requirements**

# Industry Preparedness For Solvency II Requirements

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- **In our opinion, insurers with "strong" ERM assessments under our criteria should be in a good position to meet the Solvency II requirements on risk management, internal models, and the use test.**
- **18% of all rated European insurers currently have "strong" ERM assessments. We believe a further 14% may achieve a "strong" ERM assessment over the next two years.**
- **We believe that the remaining rated insurers will likely have to make improvements to their risk management capabilities to comply with Solvency II's requirements.**



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