

Solvency II regulations

Insurance regulations are currently dominated or influenced by the EU-based regulatory framework, Solvency II. With Solvency II, regulators aim to improve both risk measurement and capital planning in the insurance industry which hasn't undergone regulatory reform since 2006 when Solvency I was implemented. The regulation consists of three pillars: quantitative requirements, supervisory review and market disclosure.



Under Solvency II, Insurance companies will have to comply with minimum capital requirements and be required to calculate two solvency ratios. As well as disclosing capital and risk frameworks, they are also required to demonstrate how the regulations' principles are embedded into their business.

Insurance firms have the choice of two approaches:

- » The Standardised Approach which captures the risk profile of an average insurance company or
- » The Internal Model Approach which is tailored to the specific risk profile of their company. The Internal Model Approach offers incremental benefits in terms of capital allocation savings, competitiveness and robustness of risk management processes.

The objectives of Solvency II capital requirements include:

- » Reducing the risk of an insurer failing to meet claims
- » Reducing the risk of policy holders incurring losses in the event of a firm being unable to meet claims
- » Providing better information and oversight to the regulatory bodies
- » Increasing confidence in the insurance sector

How does Solvency II differ from Basel II regulations?

Whilst the structure of the framework is very similar to that of Basel II regulations, Solvency II requirements are very specific to the Insurance industry.

The regulation covers five risks:

- » Investment Risk which includes **Credit Risk** and **Market Risk**
- » Underwriting Risk which includes **Insurance Risk** (Life, Health, Property & Casualty)
- » Non-financial Risk which includes **Operational Risk** and **Business Risk**

The above-mentioned risks are generally relevant to a given insurance company according to its business model. Insurance firms are usually involved in three types of business: life insurance, non-life insurance, and banks.

Impact for insurance firms

Firstly, due to the scale of the changes, planning and preparation are of paramount importance. Firms need to have the right resources in place to support and deliver the changes.

Secondly, Solvency II places demands on firms to improve their risk management and governance frameworks. This implies needs for enhanced enterprise technology architecture, data management processes, business intelligence and analytics capabilities.

Thirdly, firms will also need to report more information, more frequently.

Finally, according to the industry press, the IT challenge is even greater than it was for banks when implementing Basel II as most insurance companies currently rely on outdated IT infrastructures and systems, including multiple data sources.

Timeline

The European insurance regulator IEOPA requires fully compliance by its members by 2013. Timelines may vary across countries.

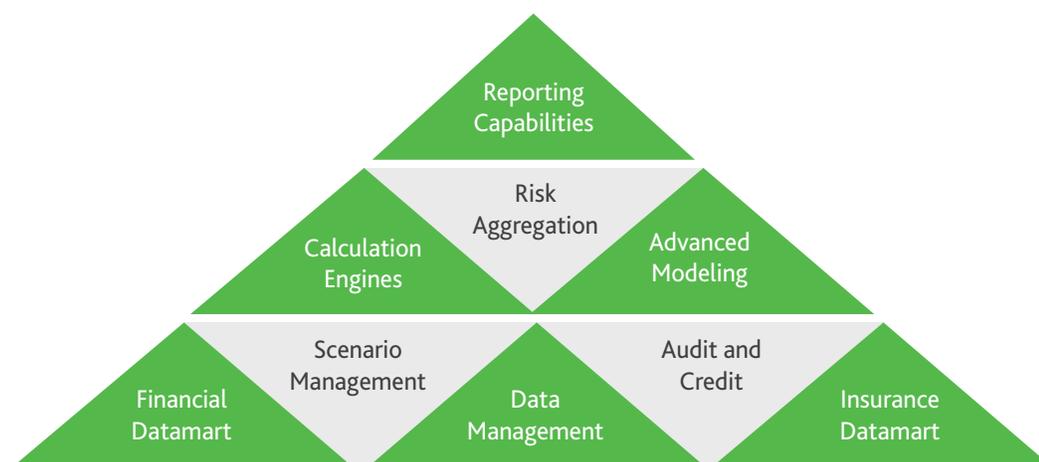
E.U.	Mexico*	Australia*	Israel*	U.S.*	UK	South Africa*	Japan*	China*
2013	2011	2012	2012	2013 (est.)	2013	2014	2015	2015

* Countries implementing a similar regulation to Solvency II according to their own timeline

References you can leverage

BNP Paribas Assurance in France (2010) and AXA MPS in Italy (2010) are customers of Fermat Solvency II.

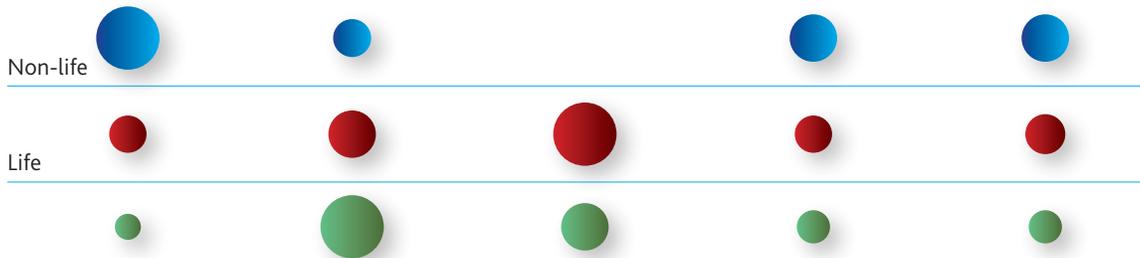
Best-in-class risk management approach



The significance of risks for insurers



Banking



Dodd-Frank Act: regulations overview



The Dodd-Frank Act, passed in July 2010, forms the basis of the U.S. government regulatory response to the financial crisis. Many consider it one of the most sweeping overhaul of financial regulation in the recent U.S. history.

More formally known as the Dodd-Frank Wall Street Reform and Consumer Protection Act, it attempts to fix many of the perceived short-comings of the U.S. financial system and its regulatory regime that came to light during the financial crisis.

The law aims to address the following issues:

- » More stringent capital adequacy requirements for banks and bank holding companies
- » Enhanced prudential supervision regulations, especially for systemically important financial institutions (SIFIs)
- » Reform of the credit rating agencies
- » Reform of the regulatory bodies
- » Regulations on securitization activities
- » Creation of new consumer protection bureau
- » Regulations on OTC derivatives
- » Regulation of municipal advisors
- » Limitations on proprietary trading
- » Corporate governance and executive compensation

How does Dodd Frank differs from Basel regulations?

Dodd-Frank differs from the Basel regulations in both applicability and scope. First, it only applies to U.S. institutions and not to the foreign institutions unless they conduct business in the U.S.

Second, while the Basel regulations are focused on banks, Dodd-Frank covers not only banks but almost all other types of financial institutions such as asset managers, insurance companies (etc...) as well as credit rating agencies.

At the same time, there is overlap between the two regulations that would require the regulators to reconcile them while implementing. For example, since both Dodd-Frank and Basel have regulations regarding bank capital adequacy, the regulators will need to be consistent in their requirements to U.S. banks. One approach might be to require banks to comply with the most stringent of the two rules.