

Solvency II: QIS4 – what you need to know

The next stage of the development and calibration of Solvency II started this month, with CEIOPS¹ initiation of the fourth Quantitative Impact Study (“QIS4”). This is a chance for all insurance and reinsurance organisations, whether large or small, to have a say in the future of European insurance regulation.

Solvency II offers a choice of calculating statutory solvency using either a standard set of formulae or by the use of an internal model. QIS4 (like its predecessors) focuses on testing the standard formulae. Whilst these are important, we expect the majority of insurers to conclude that an internal model offers a better approach to calculating statutory solvency.

The background: industry reaction to date

The previous impact studies have produced some interesting findings:

- Solvency ratios under QIS3 were generally lower than under current “Solvency I” regulation;
- Niche insurers are generally the most likely to experience a jump in capital requirements;
- Smaller firms are particularly concerned about the cost, time and complexity of the requirements; and
- There is significant potential to reduce capital requirements by using internal models rather than the standard formulae.

QIS4

QIS4 involves you calculating what your solvency position would be under the latest Solvency II proposals, using standard calculation routines provided by CEIOPS. The results will be fed back via national insurance supervisors to CEIOPS and these will be used, on the behalf of the European Commission, to help refine the Solvency II proposals.

Companies wishing to participate in QIS4 must start work soon in order to meet a submission deadline of July 2008.

The benefits of participating in QIS4

Insurance businesses are being hit with an ever increasing stream of regulatory burdens, making it a constant challenge to stay focused on core strategic issues. We empathise with firms who have found it difficult to commit valuable management resources to the previous QIS exercises. However, Solvency II development

¹ The Committee of European Insurance and Occupational Pensions Supervisors

is now moving apace, and the benefits to be gained from beginning to engage actively with the process need to be given serious consideration.

QIS4 feedback is of particular importance for smaller firms or for firms writing specialised business. These firms may find themselves most affected by the “one size fits all” approach that often characterises standard formulae for calculating solvency. Ireland has a large number of small captive insurers and reinsurers, most of which did not contribute directly to the QIS3 exercise. The Financial Regulator in its report on QIS3 has expressed a wish for increases participation in QIS4.

“We are very grateful for the strong participation, which has assisted both the Financial Regulator and CEIOPS in further developing proposals for Solvency II and more immediately for QIS4, due to take place from 1st April 2008. We hope that this participation continues, and indeed increases for QIS4.” (Financial Regulator: Irish Solvency II QIS3 Country Report February 2008)

QIS4 is also an opportunity for you to start your preparations for Solvency II. Doing this now can help avoid any nasty surprises regarding capital requirements in the future. This is especially the case where additional capital needs to be raised, because this process can take time.

The next stage: internal models

Although the Solvency II standard formulae are important, we believe that many insurers will instead opt for an “internal model” approach. Often, internal models are the only way of taking into account the particular characteristics of an insurance business.

Some insurers have already developed internal models in order to comply with the UK’s ICAS regime (although these models will need review in the light of Solvency II). For insurers with internal models, QIS4 includes a questionnaire on your experiences to date.

For those who have not yet fully implemented internal modelling, now is a good time to start considering this. Internal models, if structured and managed correctly, can add significant value to strategic decision making, as well as providing compliance with ICAS and ultimately Solvency II.

Need help?

Participation in QIS4 can bring real benefits if (and it is a big “if”) the process can be carried out quickly and with relatively minimal disruption to your business. Some of the areas where we can assist include:

- helping you plan the QIS4 work to ensure that you get the most benefit out of it
- extracting and interpreting the relevant management information for completion of the QIS4 returns;
- assistance with the derivation of the cost-of-capital risk margin (which can in some cases be complex);
- valuing intangible assets and derivative contracts, and classification of assets between tiers.



Actuaries & Consultants

We can help you kick-start the process of planning for Solvency II in general, including consideration of internal modelling.

This Briefing Note should not be relied upon for detailed advice or taken as an authoritative statement of the law. If you would like any assistance or further information on the contents of this Briefing Note, please contact Declan Lavelle or the partner who normally advises you at LCP on the telephone number +353 (0)1 6144393, or by email enquiries@lcpireland.com. If you need further copies of this or any other Note please contact us.



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