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SOLVENCY II AND THE CONVERGENCE OF STANDARDS FOR INSURANCE, BANKING AND PENSIONS

A Panel Discussion

[Held by the Faculty of Actuaries, 17 November 2008]

It was agreed that this meeting would be partially held under Chatham House rules in order that there could be open discussion. Accordingly this is a summary of the meeting and, any speaker who did not wish his or her name to appear, has had those wishes respected.

The panel consisted of four speakers each with a particular point of view. The session was opened with comments about the use of models, regulation and what we might learn from the current crisis. In particular the comments highlighted the gap that appears to have existed and may still exist between those doing the modelling and those overseeing the various financial institutions. The question was posed as to whether diversification really is available in certain circumstances, a case in point being the illiquidity that featured during the recent crisis. The Sharma Report was mentioned with reference to the causes of insurance insolvencies. Although these result from running out of money, the cause is a strategy or risk portfolio decision made by senior management or a board of directors, not the models that are used to monitor it. There has been a feeling in certain quarters that the "old boys" network of the City has historically made it difficult to enforce rigorous regulation.

Mr M. C. Saker, F.I.A., introduced the audience to the current state of play in accounting, talking about IFRS 4 and the IASB's Phase 2 plans. The objective is to have a universal accounting system that gives the same insight, transparency and understanding whatever the company being reported on. A major stumbling block is how to value liabilities and when profit should be recognised. The comparison of a mobile phone company's in force contracts and an insurance company's premium income illustrated the difference in accounting treatments. Even within the insurance world there is disagreement as to whether to use exit value or entry value, what expense allowances are reasonable and what discount rate is appropriate, including whether the credit rating of the company should have a bearing on this. Agreement is possible but actual implementation is some years off.

Mr C. A. Hancorn, F.F.A., commented on lessons that might be learned from implementing Basel II for Solvency II which could help keep cost down and deliver value. He noted the different starting points for the two with Basel looking at risk weighted capital whilst Solvency looked at the probability of insolvency. Solvency II was expressed as an extension of Basel II in so far as it covers the same risks but has the additional risks of

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insurance and liquidity. A feature of Solvency II is that diversification is a big issue and needs to be allowed for whereas in Basel II risk capital is added together with minor adjustments.

It was highlighted how important starting to do the work – collecting data, analysing it, modelling it, getting the right teams together, getting the language right and getting senior management and board sign-in – would be and the earlier this happened the better.

Mr C. Taylor, F.I.A., discussed the position of pensions in the context of the Solvency II capital requirements, regulation and disclosure. He emphasised how different the capital requirements of pension funds were, how important the employer covenant is and the horrendous impact that the Solvency II approach might have on company accounts. He also commented on how this might affect PPF levies.

The President (Mr R. S. Bowie, F.F.A.) opened the discussion to the floor and there were contributions from Mr S. J. Richards, Mr T. M. Ross, Mr C. W. F. Low, Professor R. S. Clarkson and Dr D. J. P. Hare. Topics covered included whether pension funds should be regulated in a similar manner to insurance companies, the pension promises and the need for real returns, and that implementing Solvency II in its current form would likely force a number of companies into very weak financial positions (undesirable from all stakeholders perspectives). Model soundness, explaining what use they should be put to and the need to ensure that all parties understood what their output meant were also commented on. There was also some discussion as to whether non-zero risk of failure was acceptable in light of the different stances taken by different European regulators.

The meeting concluded that as this was still the early stages of implementation there would be many more discussions on outstanding issues but that it would be important to learn from Basel II implementation and put in place appropriate systems as early as possible.

References

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