



Society of Actuaries in Ireland

---

# **Solvency II – three lines of defence**

Esko Kivisaari

---

25.09.2013

---

# Europe in the world

---

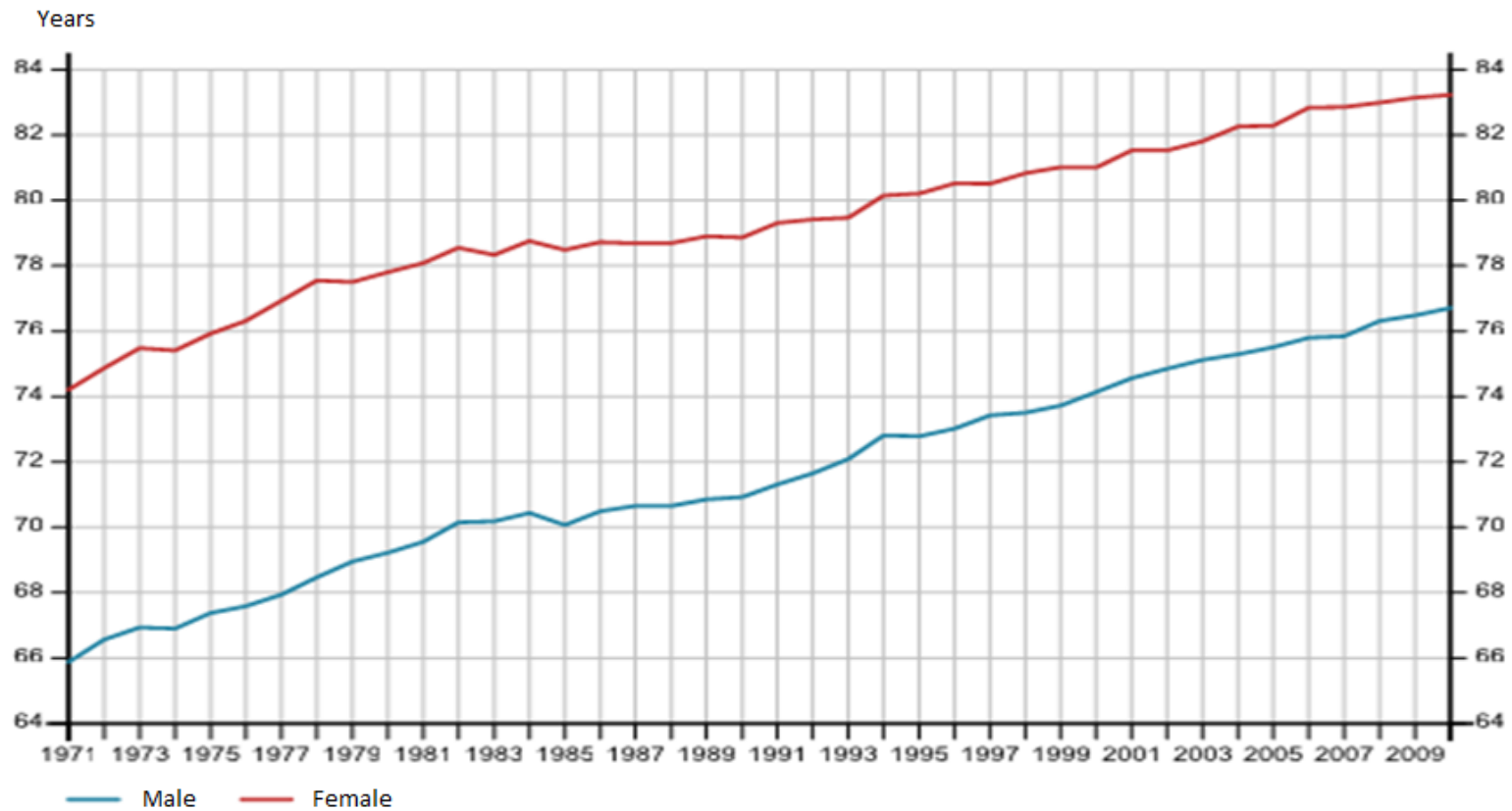
- *Ageing is accelerating: our working age population will be reduced by about 2 million by 2020, and the number of 60+ is increasing twice as fast as before 2007*
- *Productivity levels are lagging behind: two-thirds of our income gap with the US is due to lower productivity*
- *Our public finances are very severely affected: deficits at 7% GDP on average and debt levels at over 80%; 2 years wiped out 20 years of consolidation*
- *Global competition is fierce: EU share of global exports is declining relative to China and India*
- *We must face up long-term realities – globalisation, pressure on resources, ageing, technological trends – and tap our full potential*

## Stresses to traditional insurance:

---

- Increasing longevity,
- Declining interest rates, and...
- Solvency II and emerging risk management

# Longevity in Finland since 1971



Source: Finnish Center of Statistics

# Low interest rates – volatile markets?

---

- In Fennougric languages you were not allowed to say the word karhu (bear) in order to avoid inviting him to attack you - you had a number of other words to use instead – oksi, ohto, otso, otsonen, mesikämmen, kouki, kouko, kouvo, kontio, metsän kuningas, metsän omena, nalle etc
- Maybe no coincidence that especially during Soviet times we used the term "karhu" for our Eastern neighbour...
- Do we have the same phenomenon now with "volatility" – the need to pretend it does not exist? "Artificial volatility"?



EIOPA's chair Gabriel Bernardino, [interview](#) 3.4.2013

---

“One misunderstanding that needs clearly to be spelled out is that it’s not Solvency II that provokes challenges to business. It’s the economic environment. Solvency II makes one difference: You need to recognize it earlier. If you have a market consistent valuation of assets and liabilities it will be much more clear that you have a challenge in your portfolio. If you continue to have a valuation that does not reflect the market, then you can pretend that there is no problem. But the problem exists. Solvency II makes this transparent and that is good for consumers, for companies and also for supervisors. We need to have a preventive supervision. Supervision should not be there to act when the fire is already in your home. Supervision should be there to prevent that the fire occurs.”

## Three lines of defence - IAIS in ICP 8 (Insurance Core Principles on Risk management and internal controls, 8.1.16)

---

- first line of defence = management and its actions
- second line of defence = control functions (other than internal audit) like risk management function or actuarial function
- third line of defence = internal audit
- The “line of defence” thinking continues in ICP 17 (Capital Adequacy) where in 17.11.5 the IAIS talks of capital requirements. Especially the assets covering the minimum capital requirement are thought to be the last line of defence





## IAA: A Global Framework for Insurer Solvency Assessment

---

- Three pillar approach:
  - minimum financial requirements
  - supervisory review process
  - measures to foster market discipline
- support to principles based approach
- total balance sheet approach
- degree of protection should be transparent
- appropriate choice of time horizon
- definition of what risks are included
- definition of appropriate risk measures
- recognition of risk dependencies
- role of risk management
- possibility for standardized approaches but support for advanced company-specific approaches
- market efficient capital requirements.

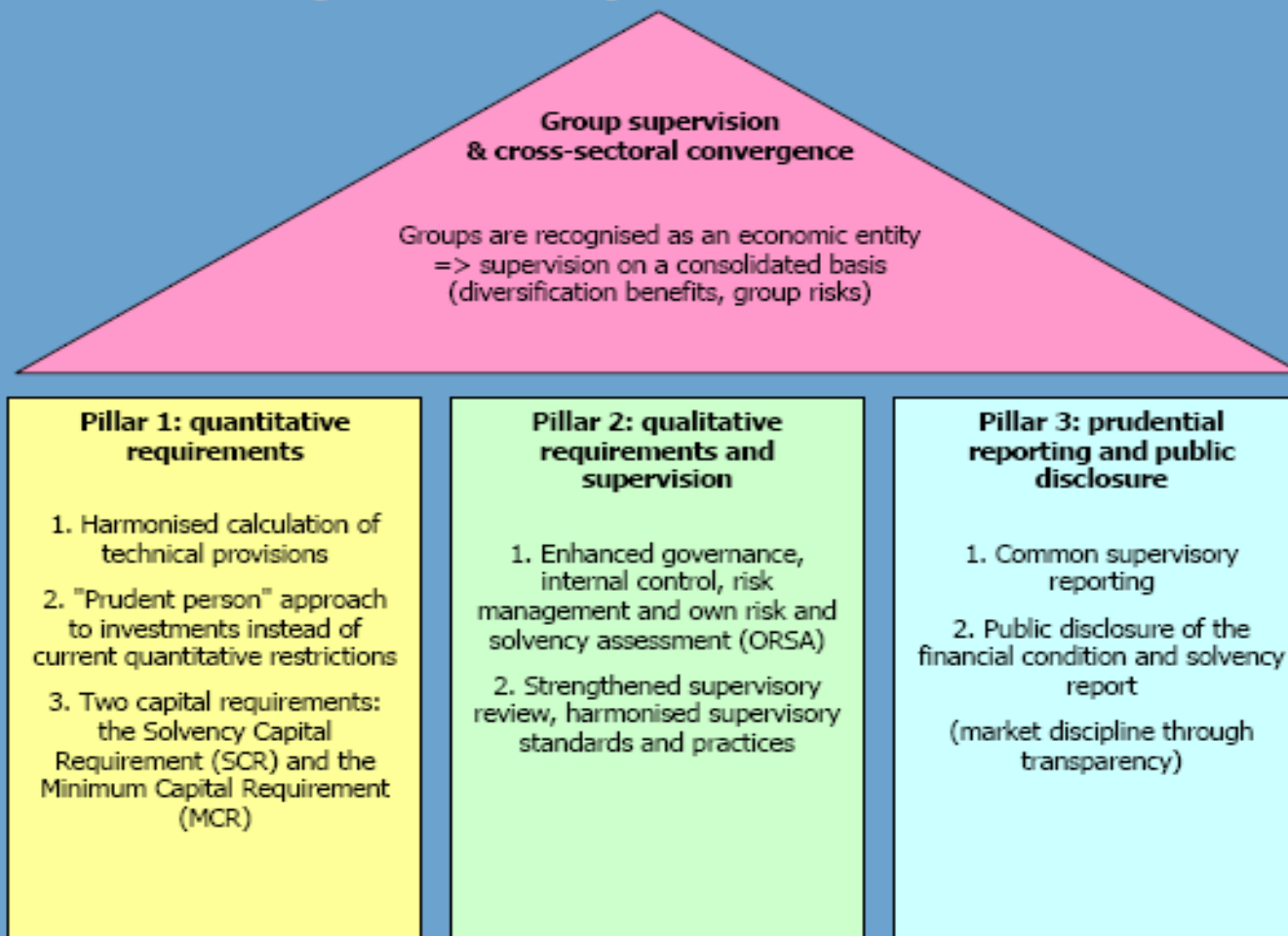


Principles or rules based?

---



# Solvency II: 3 pillars and a roof





## Second line of defence in Solvency II

---

- Elements of the system of governance
  - General governance requirements
  - Principle of proportionality
  - Risk management system
  - Areas covered by the risk management system
  - Internal control system
- Functions
  - Risk management function
  - Compliance function
  - Internal audit function
  - Actuarial function
- Fit and proper requirements
- Outsourcing
- Remuneration issues



## EIOPA guidance - ORSA principles

---

Principle  
A

The ORSA is the responsibility of the undertaking and should be regularly reviewed and approved by the undertaking's administrative or management body.

Principle  
B

The ORSA should encompass all material risks that may have an impact on the undertaking's ability to meet its obligations under insurance contracts

Principle  
C

The ORSA should be based on adequate measurement and assessment processes and form an integral part of the management process and decision making framework of the undertaking

Principle  
D

The ORSA should be forward-looking, taking into account the undertaking's business plans and projections

Principle  
E

The ORSA process and outcome should be appropriately evidenced and internally documented as well as independently assessed



## Solvency II timeline

---

- All depends on the trilogies of this Autumn, September - October
- If (!) there is a deal on Omnibus II then:
  - Final O II Directive published in the Official Journal in March-April 2014 (EP plenary scheduled to March, maybe already 1 February)
  - Commission will give its proposal on Level 2 Regulation immediately after the publication of the directive (unofficial consultations on level 2 just after the trilogies)
  - EIOPA will start its official consultation on level 3 after the Commission proposal
- All could still be ready for the start at the beginning of 2016 (maybe Quick Fix 2 to make this solid)
- And – if no deal – EIOPA will go on with its powers...



## Groupe Consultatif activity

---

- Through its Core Syllabus for actuarial education, Mutual Recognition Agreement, and code of professional conduct, the Groupe has in place a robust governance framework which ensures the objectivity, integrity and independence of actuaries.
- Advice and comments provided by the Groupe on behalf of the European actuarial profession are totally independent of industry interests.
- The Groupe regularly publishes, via its web site (<http://www.gcactuaries.org>), surveys amongst its member associations on issues of topical relevance in pensions, insurance and investment and financial risk.
- The Groupe is in links with the EU institutions, the CEIOPS / EIOPA, the Industry associations (Insurance Europe, CRO Forum, CFO Forum, Amice).
- The Solvency 2 project team is divided into 5 teams with approximately 50 actuaries in all : Pillar 1 (life), Pillar 1 (non life), Pillar 5 (Pillar 2 + Pillar 3!), Groups, Internal models. It responds to most consultations on behalf of its members.



Thank you for your attention!

---

- Esko Kivisaari
  - Chair of the Groupe Consultatif Insurance Committee
  - Deputy Managing Director, Federation of Finnish Financial Services
  - [Esko.kivisaari@fkl.fi](mailto:Esko.kivisaari@fkl.fi), +358 500 447776