

Solvency II

Solvency II is the common name used to refer to the project directive under development by the European Commission which will provide a comprehensive new framework for insurance supervision and regulation. It is intended to introduce across the European Union a more sophisticated, economic risk-based approach to supervision and capital assessment, using modern techniques for market-based valuation of assets and liabilities.

Aims

Its objectives are to:

- ensure adequate policyholder protection in all EU Member States;
- review the overall financial position of insurance companies;
- better reflect the true risks of insurance companies;
- achieve convergence in supervisory requirements and review processes; and
- provide a regulatory framework that can accommodate and take advantage of developments in risk management, capital markets and international financial reporting.

Structure and Content

Solvency II is based on a three-pillar structure -

Pillar 1

How insurers should value their assets and liabilities and calculate their reserves and capital requirements. The approach has been broadly welcomed by the industry.

Pillar 2

A new EU wide supervisory review process. This will include requirements applying to the insurer's internal systems and controls, a risk and capital assessment to be produced by the insurer, and a supervisory review of the pillar 1 capital requirement and the insurers' risk management processes.

Pillar 3

Public reporting requirements, including quantitative information on capital, qualitative information on business performance and strategy and an overall statement on the insurer's solvency and financial condition.

By promoting more sophisticated approaches, including firms' internal capital models, Solvency II will ensure a more accurate allocation of capital to risk. This should reduce the probability of firm failure, increase efficiency in the use of capital, thereby improving returns and achieve a more efficiently priced market for insurance products.