Media information

Swiss Re

New Swiss Re report shows how (re)insurers can increase capital efficiency under Solvency II

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Zurich, 19 May 2009 – Swiss Re today published a series of recommendations to improve the recognition of risk mitigation techniques in the EU Solvency II framework, as a means to better managing capital efficiency. For non-life insurance companies, ensuring that non-proportional reinsurance is properly recognised should be a key priority under the incoming risk and capital regime. Swiss Re's new Focus report, "Solvency II Standard Formula: Consideration of Non-Life Reinsurance", provides a leading contribution to help reinsurers and their clients adapt to the new regulatory environment.

The conclusions of Solvency II were adopted by the EU Council at the beginning of May. Due for implementation in 2012, the new regulatory approach will strengthen the position of the European insurance industry by introducing an economic and risk-based view of the (re)insurance business.

Raj Singh, Swiss Re's Chief Risk Officer, said: "Solvency II provides incentives for sound risk and capital management and offers better protection for policyholders. It creates a prudent framework that more accurately reflects the risks borne by insurers."

Assessing the required solvency capital

Under Solvency II, insurers will need to apply "economic principles" in order to calculate how much capital they need to support the business they write. This means that assets as well as liabilities have to be valued using a market consistent view. Based on its own circumstances, each (re)insurance company must decide which approach to use for this calculation: the Solvency II Standard Formula, a partial internal model, or a full internal model.

The Standard Formula is currently being calibrated through a series of Quantitative Impact Studies (QIS) in order to assess the financial impact of the Solvency II regime on (re)insurers. The results show that proportional

reinsurance contracts are fully reflected in the Standard Formula, leading to an appropriate capital relief of firms' solvency capital requirements.

Room for improvement for non-proportional reinsurance
However, for non-proportional non-life reinsurance, in the case of excess of loss and stop loss treaties for example, the Standard Formula typically fails to recognise the economic benefits of these structures. As a result, non-proportional non-life reinsurance is not afforded the appropriate capital benefit under Solvency II. A better alternative for insurers could be to use partial or full internal models to produce a more accurate estimate of the required capital.

Martin Albers, Member of Swiss Re's Executive Board, urges insurers to make themselves aware of the shortcomings of the Standard Formula: "We want to help our clients benefit from an appropriate calculation of capital requirements. The larger the company and the more complex its business, the more appropriate a partial or full internal model will be. We have assessed the complete range of products offered by Swiss Re against the requirements of Solvency II. Based on this thorough research, we have the expertise to help our clients make their capital management under Solvency II highly efficient."

Notes to editors

The Focus report "Solvency II Standard Formula: Consideration of Non-Life Reinsurance" is available electronically on Swiss Re's website: www.swissre.com.

Quantitative Impact Studies
Four Quantitative Impact Studies (QIS 1-4) have so far been conducted by CEIOPS, the Committee of European Insurance and Occupational Pensions Supervisors. The QIS5 exercise – taking into account the proposed implementation measures and lessons learned from QIS4 – is expected to be carried out between April and end of July 2010.

Standard Formula vs. Internal Model
Under the Solvency II Directive, insurers have a choice of which method they use to assess capital requirements. They can use the **Standard Formula**, an internal model or a partial internal model. Under the Standard Formula, companies' risks are assessed based on pre-determined market parameters. Entity-specific parameters are only partially taken into account. The market parameters are provided by CEIOPS (Committee of European Insurance and Occupational Pensions Supervisors). The advantage of the Standard Formula is that capital requirements are relatively easy to calculate. The drawback is that a quantification of the capital relying primarily on market parameters may result in an over- or underestimation when compared to the economic capital that the company actually needs to hold. An **internal model** based on the company's own risk landscape would assess that risk landscape in a more accurate manner. However, development of an internal model requires major effort. As a pragmatic alternative, a **partial internal model** combining

aspects of both the Standard Formula and the internal model may improve the assessment based on the Standard Formula in a cost-efficient manner.

Swiss Reinsurance Company Ltd
Swiss Re is a leading and highly diversified global reinsurer. The company operates through offices in more than 20 countries. Founded in Zurich, Switzerland, in 1863, Swiss Re offers financial services products that enable risk-taking essential to enterprise and progress. The company's traditional reinsurance products and related services for property and casualty, as well as the life and health business are complemented by insurance-based corporate finance solutions and supplementary services for comprehensive risk management. Swiss Re is rated "A+" by Standard & Poor's, "A1" by Moody's and "A" by A.M. Best.