News release

Swiss Re

Swiss Re *sigma* study on Solvency II: an integrated risk approach for European insurers

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Zurich, 20 June 2006 – The Solvency II Directive will strengthen European insurers' focus on risk/return. According to Swiss Re's latest *sigma* study, Solvency II will reinforce risk-adequate pricing. An improved supervision framework will benefit both policyholders and insurers.

The existing solvency regulation for insurers in the EU, Solvency I, is out of date: it is based on rules that do not properly reflect the economic value of insurers' assets and liabilities. It does not take sufficient account of underwriting and investment risks, and it fails to give adequate credit for risk mitigation instruments.

An integrated risk approach

The Solvency II project, launched by the EU Commission, aims to enhance the supervisory framework of insurance companies. The draft Directive is likely to be adopted in mid-2007, and implementation should be completed by 2010. Solvency II will be based on the Basel-type three-pillar approach used in banking: Pillar 1 sets out rules for financial resources, Pillar 2 defines the principles of the supervisory review process and risk management, and Pillar 3 is designed to increase disclosure and transparency to reinforce market mechanisms.

Assets and liabilities will most probably be valued on a market-consistent basis for solvency calculation purposes. Insurers may calculate their solvency requirements either by using the standard model provided by the supervisory authorities or by applying their internal models, which reflect the company's specific risk profile.

Solvency and capital charges

Solvency II will lead to a more complete picture of an insurer's solvency situation and create greater transparency. One of the main changes will be the introduction of risk-related capital charges for both underwriting and investment risks, which should result in more stringent capital requirements for products with a high claims volatility (eg certain property covers), long-term products and products with guarantee and option features. Capital charges for investment risks will reflect the relative riskiness of different investment strategies.

Risk-adequate pricing and diversification
Solvency II will reinforce risk-adequate pricing. Furthermore, insurers should be more adequately rewarded for diversification and for using risk mitigation tools which are key ingredients of risk management.

No major undercapitalisation of the industry
One of the greatest concerns voiced about Solvency II is that it could reveal major undercapitalisation in the insurance industry. But empirical evidence has shown that this should not be the case. Only insurers that have not taken adequate account of the risks in their portfolio could be challenged. This may be the case in life insurance, where traditional actuarial practice has often resulted in insuffіcent pricing of product guarantee and option features. However, insurers with advanced risk management should welcome the improved supervision framework.

Notes to editors

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How to obtain a copy of this *sigma* study:
The English, German, French, Italian and Spanish versions of the *sigma* study "Solvency II: an integrated risk approach for European insurers" are available electronically on Swiss Re's website: www.swissre.com/sigma

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