Quantitative impact of Solvency II

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Solvency II

Why a change was needed

- Current regime (Solvency I) 30 years old
- Lack of risk sensitivity and proportionality
- Lack of convergence of supervisory practice across EU

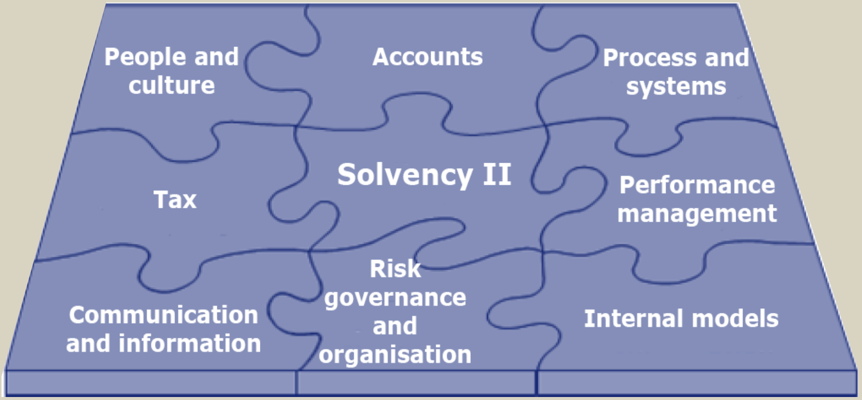
Solvency II structured in 3 pillars

Quantitative requirements
- SCR, MCR, own funds…

Governance
- Risk management, ORSA…

Reporting
- FSA, public disclosure

The Solvency II puzzle



Source: Deloitte

Quantitative impact of Solvency II

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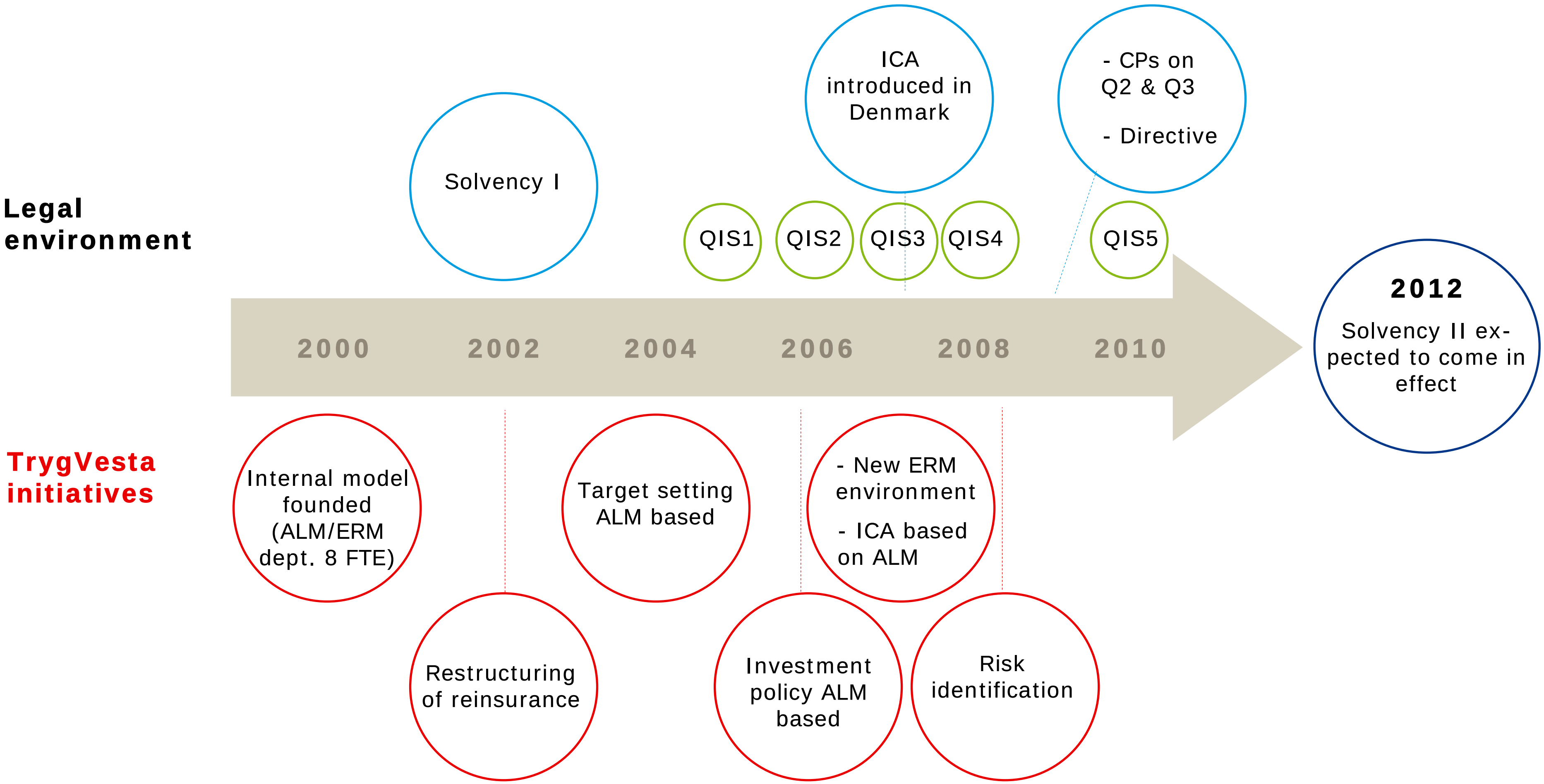
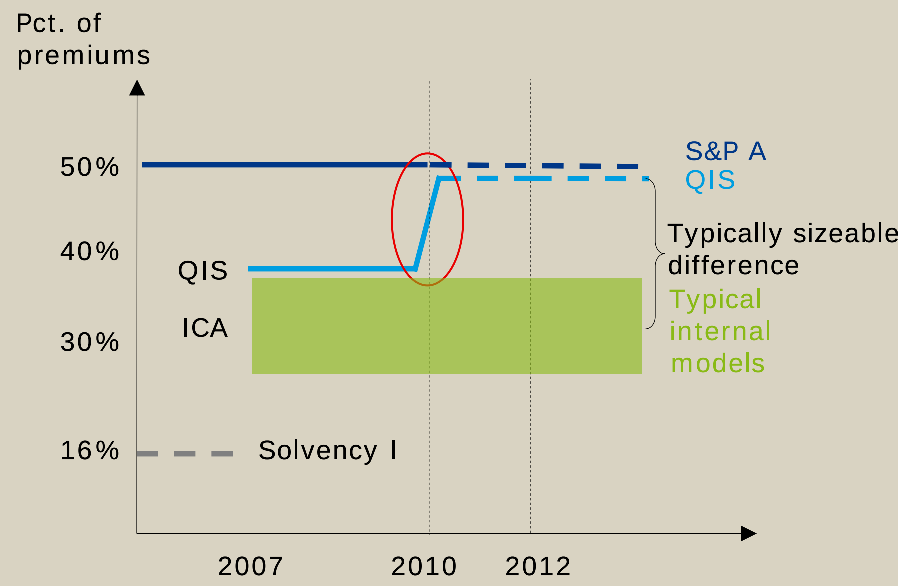


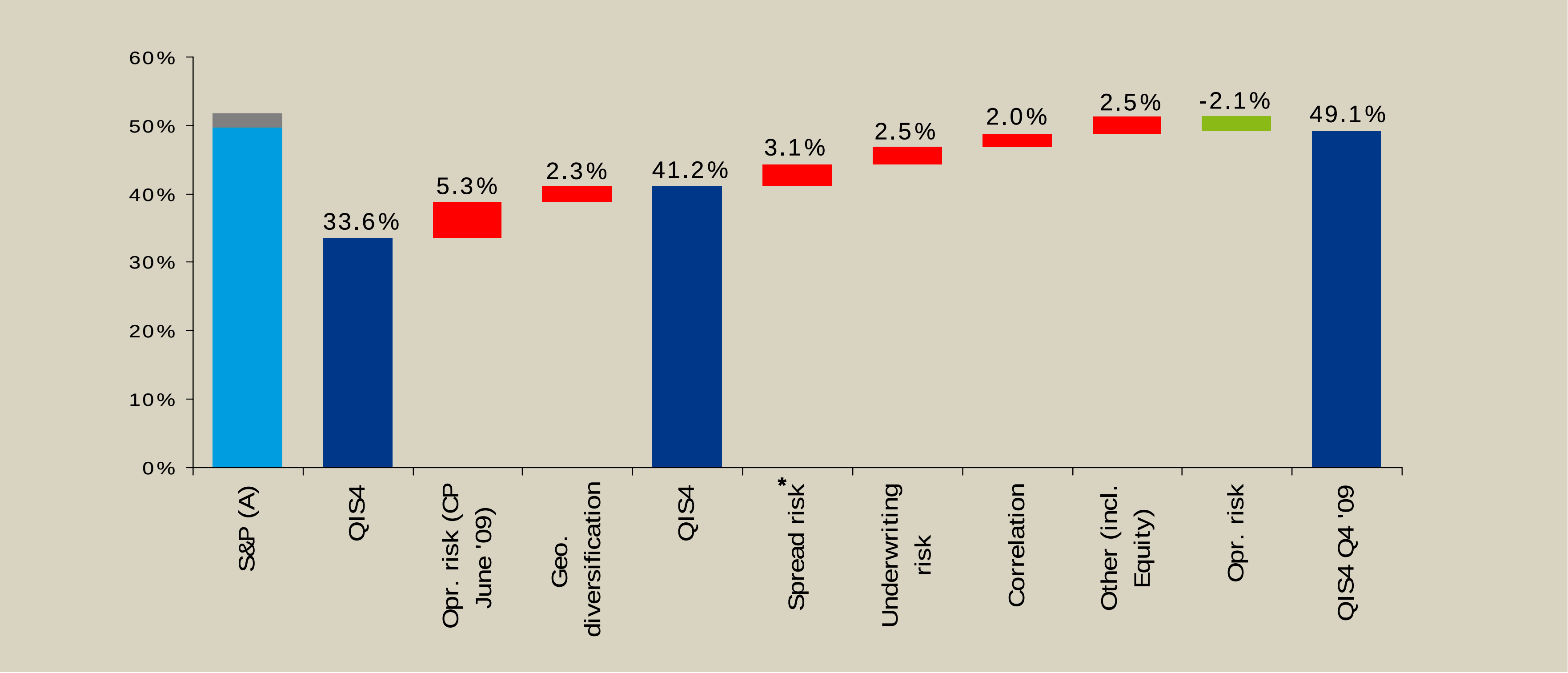
Development of regulatory capital requirement

- 4 out of 5 QIS-rounds have been completed
- SCR standard model requirements changes with new Consultation Papers (CP)
- Recent CP's from Nov. 2009 increased SCR requirements substantially.
- For TrygVesta the increase was from 39% to 49% of premiums
- Now approaching S&P A requirements



Increase in capital requirements – New CP's

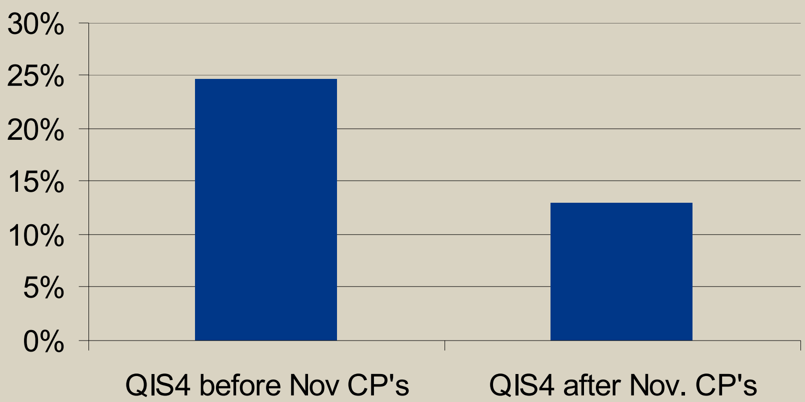
Capital requirement as percentage of premiums



* Does not include the effect of Danish mortgage backed bonds being treated different with respect to duration/maturity

Increase in capital requirements – Correlations

Diversification benefit as percentage of capital requirement for market risk



Change in the correlation for market risk

New market correlation matrix

CorrMkt	Int. rate	Equity	Prop.	Spread	Conc.	Fx
Int. rate	100%					
Equity	50%	100%				
Prop.	50%	75%	100%			
Spread	50%	75%	75%	100%		
Conc.	75%	75%	75%	75%	100%	
Fx	50%	50%	50%	50%	50%	100%

Old market correlation matrix

CorrMkt	Int. rate	Equity	Prop.	Spread	Conc.	Fx
Int. rate	100%					
Equity	0%	100%				
Prop.	50%	75%	100%			
Spread	25%	25%	25%	100%		
Conc.	0%	0%	0%	0%	100%	
Fx	25%	25%	25%	25%	0%	100%

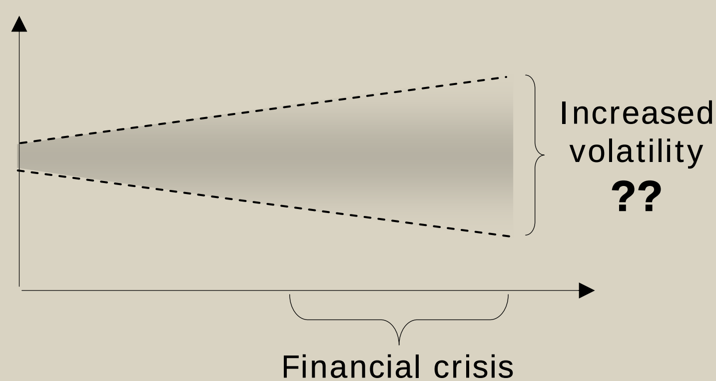
Increase in capital requirements

- Geographical diversification can no longer be applied for non-life companies
- In practice risks are correlated within the Nordic countries, but not perfectly correlated
- Can be recognized in an internal model

Geographical diversification

- Increase in risk charges for premiums and reserves. Significant increase on
  - Marine, aviation and transport
    Premium risk: 12.5% ↗ **20%**
    Reserve risk: 10% ↗ **17.5%**
  - Third party liability
    Premium risk: 12,5% ↗ **17.5%**
    Reserve risk: 15% ↗ **20%**

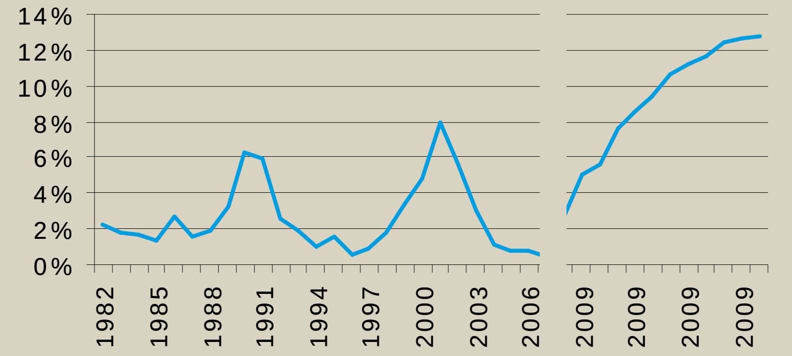
Underwriting risk



Increase in capital requirements – Spread and equity risk

- Marked increase in spread risk under financial crisis
- Significantly higher charges e.g.:
  - AAA rating, 5 year maturity:
    1.1% ➚ **5.5%**

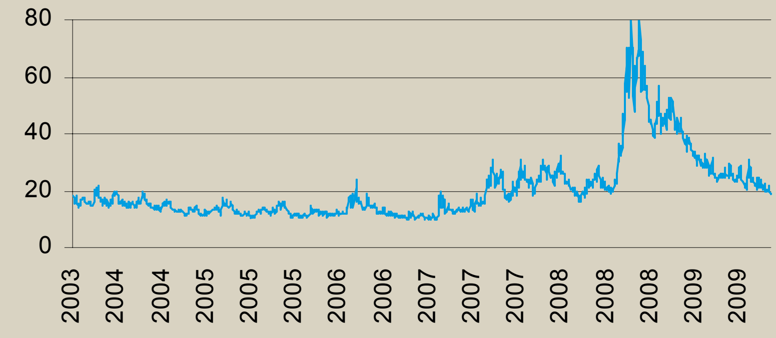
Spread risk: Default rates – spec grade



Source: S&P and Moody's

- Equity volatility peaked during the crisis
- Equity risk charge:
  32% ➚ **45%**
- Property risk charge:
  20% ➚ **25%**

Equity volatility



Source: S&P

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Status on implementation

UK and DK insurers have pre-implemented parts via ICA

Solvency II related issue	DK (mainly risk based supervision)	UK (risk based supervision)	Other Europe (rule based or risk based supervision)
Individual capital assessment (ICA)	(√)	(√)	%
Internal modeling	(√)	√	%
ORSA	%	%	%
Reserves – market value	√	(√)	(√)
Reserves best estimate	√	√	(√)
Discounting of reserves	√	%	%
Risk Margin/CoC	(?)	(%)	%
Risk Management	(√)	√	(√)
Functions and Procedures	(√)	√	(√)
Rules regarding Investments	√	√	(√)
Documentation of RM policies	√	√	(√)

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Summary

Solid capital position and well on the way for Solvency II

Solvency and rating requirements are converging

Increased requirement in standard model will represent a challenge to large parts of the industry – increased focus on earnings

Increased potential for use of internal model