

# **Solvency II Requirements and Implications for Takaful / Re-Takaful**

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# What is Solvency II ?

- **Fundamental review of the solvency and risk management standards for the insurance industry with the aim to strengthen the prudential regulation of the insurance sector**
- **Replace regulatory capital requirements for all EU (re)insurers with Gross Written Premium (GWP) > € 5m or Reserves > € 25m.**
- **Risk based capital regime**
- **Enterprise Risk Management (ERM)**
- **Regulations will take effect from October 2012**

# What are the aims / impacts ?

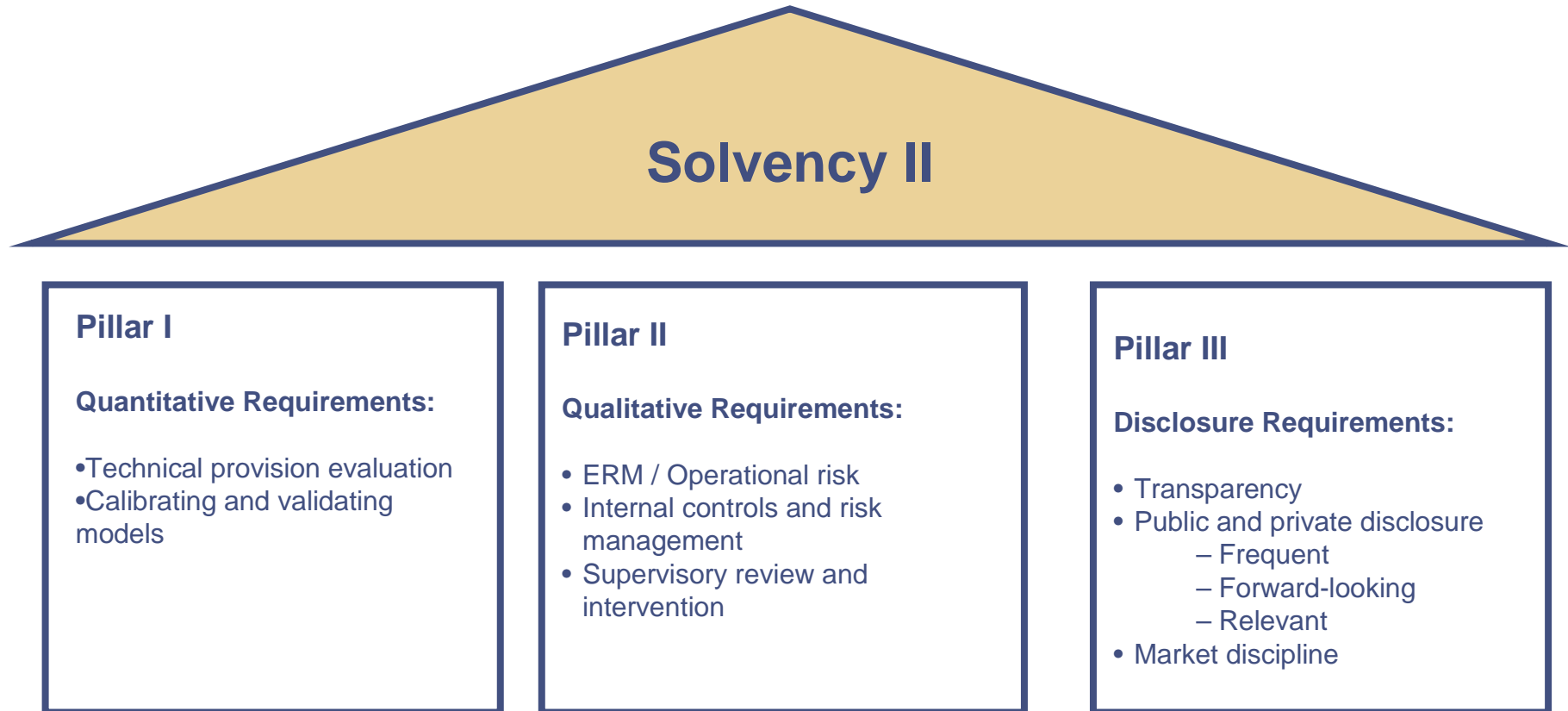
## ➤ Aims

- Create a system of risk based regulation
- Protect policyholders
- Deepen the market in insurance services
- Enhance transparency
- Strengthen competition within the insurance sector

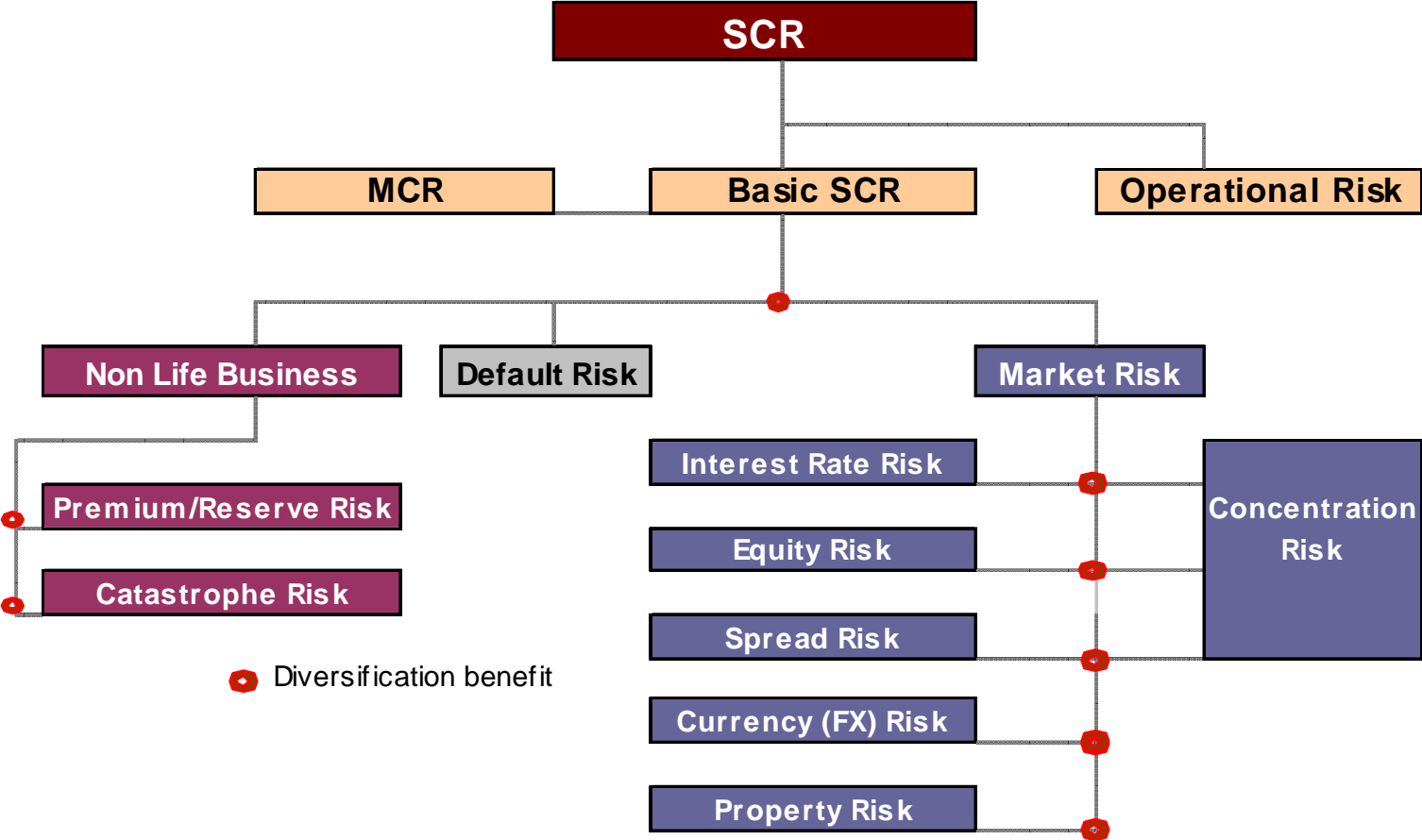
## ➤ Impacts

- Insurance co. management better understand overall dynamics of business
- Risk of business better understood
- Alignment of strategy to risk
- Alignment with Rating agency's view on Enterprise Risk Management
- Convergence with rating agency's approach

# Three Pillars of Solvency II



# Pillar I – Quantitative Analysis



## Pillar II – Qualitative Requirements

➤ Pillar II focuses on enterprise wide view of risk management ( ERM)

➤ Pillar II requires that companies have developed robust and strongly functioning:

- Systems of governance and risk management
- Internal controls and procedures
- Management structures
- Integrated Risk Based Capital modelling procedures

➤ Increased scope of regulatory focus and influence

➤ Poor Risk Management will lead to capital loading

➤ Challenging to assess Pillar II structures and procedures

# Global developments

➤ International Association of Insurance Supervisors (IAIS) meet last week in Taipei

➤ 190 members

- Estimate covers 97% of GWP worldwide

➤ Aim to improve Insurance Supervision

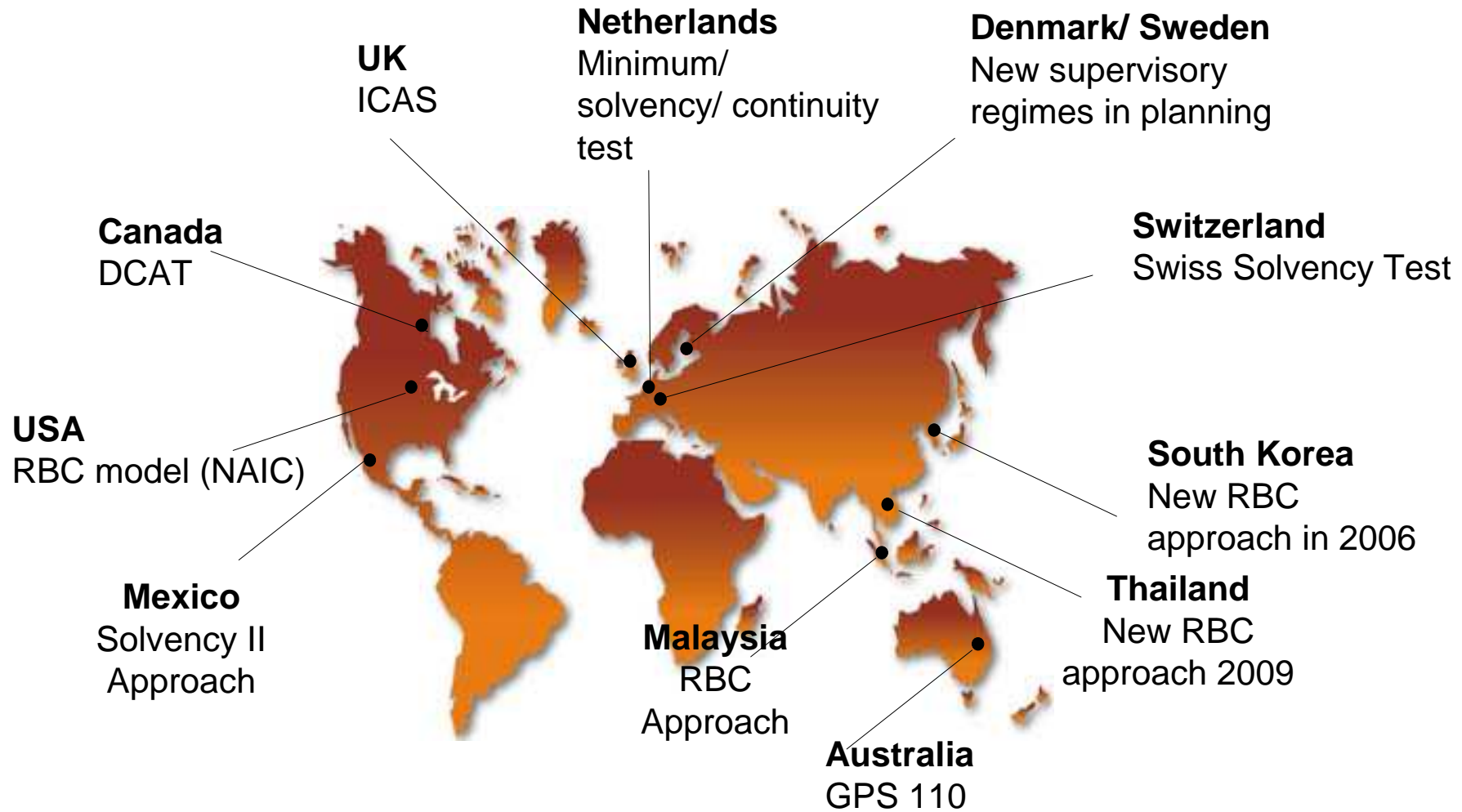
➤ IAIS task force reviewing a Common Assessment Framework

- Basis of this is Solvency II

➤ Objective to get consistency of standards of regulation

**➤ Takaful and Re-Takaful markets likely to be regulated under regime similar to Solvency II in future**

# The EU-Solvency II Initiative is Not Alone



# Implications for Takaful market

- Global spread of Risk Based Capital (RBC) methods to more regulatory regimes
- Takaful and Re-Takaful markets likely in future to fall under RBC regulatory framework
  - E.G. Malaysia, Thailand
- Best practice would be to adopt principles of Solvency II / ERM
- In this way apply risk management in comprehensive manner
  - Across all major risks of the entity
  - Consistently across risks
  - Consistently in line with the fundamental objectives / strategy of the entity

# Benefits

- Clearly defined corporate risk appetite signals a well-run company
  - Strong risk management and brand are rewarded by investors
  - Better informed management decisions considering all key risks adds transparency to decision making process
- Promotion of risk awareness across the entire organisation
- Framework for dealing with regulators
  - Solvency II and Basel II, FSA in UK
- Rating agency expectations and capital requirements
  - Poor ERM capabilities result in downwards rating pressure
- Aligns stakeholder interests – investors / regulator / rating agency

# Importance for (Re)Takaful Industry

- Solvency II approach will help with the strategic and operational challenges faced by (Re)Takaful operators
  - Solvency II approach will become a permanent fixture due to the changing risk landscape
    - event driven risks and correlation of risk
    - stakeholder needs
    - accounting, regulatory, legislative, corporate governance initiatives
  - Solvency II approach can leverage the significant investment required to compete with conventional insurance
  - Solvency II approach important for growing companies as it minimises the need to incur massive overheads associated with more manual methods of risk containment
  
- Approach protects policy holder interests and is consistent with sharia'h compliance e.g. reputational risks

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