

# Bridges to Solvency II

Colin Murray outlines the capital-friendly nature of the Irish reinsurance regime.



**The current credit crunch has left many life insurers seeking ways to release capital. At the same time, QIS4 has shown that when Solvency II is implemented, capital is likely to be released for certain lines of business. If only that capital were available today.**

There are several options available to the life insurer to release capital:

- securitisation
- financing reinsurance
- traditional reinsurance to a third party.

Securitisation can be expensive and the current market conditions are unlikely to be receptive to bond issuance. Financing reinsurance (with cash) is also expensive due to the credit crunch. Traditional reinsurance to a third party (as part of a cashless financing) may not be sufficiently bespoke for the needs of the life insurer.

There is a further option which potentially satisfies the bespoke needs of the reinsurer and is providing capital releases for some companies. This is to set up a dedicated life reinsurer, reinsure the current capital-hungry business into this vehicle and gain a release of capital until Solvency II arrives. Many companies are considering Ireland as a base for such reinsurers. It is worth noting that Solvency II will apply to reinsurance vehicles and therefore there will be convergence of capital requirements between direct writers

and reinsurers when Solvency II is introduced (scheduled for 2012).

### Background

The EU Reinsurance Directive 2005 (Directive 2005/68/EC) was implemented in Ireland in 2006 by statutory instrument SI380/2006. Watson Wyatt assisted The Financial Regulator in implementing the Directive into law. The statutory instrument broadly transposed the basic requirements of Reinsurance Directive, that is no further detail or requirements were added. The Financial Regulator also issued guidelines (available on their website [www.financialregulator.ie](http://www.financialregulator.ie)) and the Society of Actuaries in Ireland issued professional guidance to actuaries under ASP-LA-11.

### Key benefits

The key benefits of the Irish reinsurance regime are:

- The Financial Regulator delegates the certification of the adequacy of reserves to a Signing Actuary
- the reserves for liabilities have to be simply more prudent than the best estimate of the liability
- policy-by-policy reserving is not required
- asset admissibility is based on a 'prudent person' regime (with some additional requirements for collateralisation)
- negative reserves are allowable (as DAC is an admissible asset)
- an allowance for lapses can be made
- account can be taken of a proportion of credit spreads for liquidity
- allowance can be made for dynamic hedging
- collateral is admissible (if structured appropriately)
- solvency margin for protection business is based on non-life rules
- the reinsurer is a regulated entity within the EU and can passport into EU territories.



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Therefore, in overall terms the life reinsurer can hold a liability close to the economic value of the risk with little restriction on the assets (with the appropriate collateralisation).

Ireland is a well-known financial hub for reinsurance. In the past, many of the life reinsurers who gained authorisation were subsidiaries of major US multinationals and that flow has continued. However, more recently we have seen more interest from European life insurers and multinationals (particularly from the UK, Italy, Germany and the Netherlands) as well as from domestic Irish companies. These companies are seeking to release capital in advance of Solvency II, and some are already using Ireland as a centre of excellence for managing their worldwide risks. Watson Wyatt has been assisting these clients in reviewing the capital benefits of differing lines of business and in gaining authorisation for new reinsurers in Ireland.

For European insurers the overall process has been:

- to review the QIS4 output to determine whether there are any large differences between Solvency I requirements and Solvency II requirements for any particular product line
- local experts in the relevant country assist in determining whether capital savings are available through other, simpler, alternatives and structures
- if these alternatives are ruled out, we then need to establish the life insurer's economic capital for that business line (if not already available) and any interactions with other lines of business (for example, diversification benefits, natural hedges and so on)
- determine precisely what the Irish reinsurance requirements would be, and thereby estimate the capital savings

- throughout this process we recommend that appropriate tax, legal and accounting advice be taken.

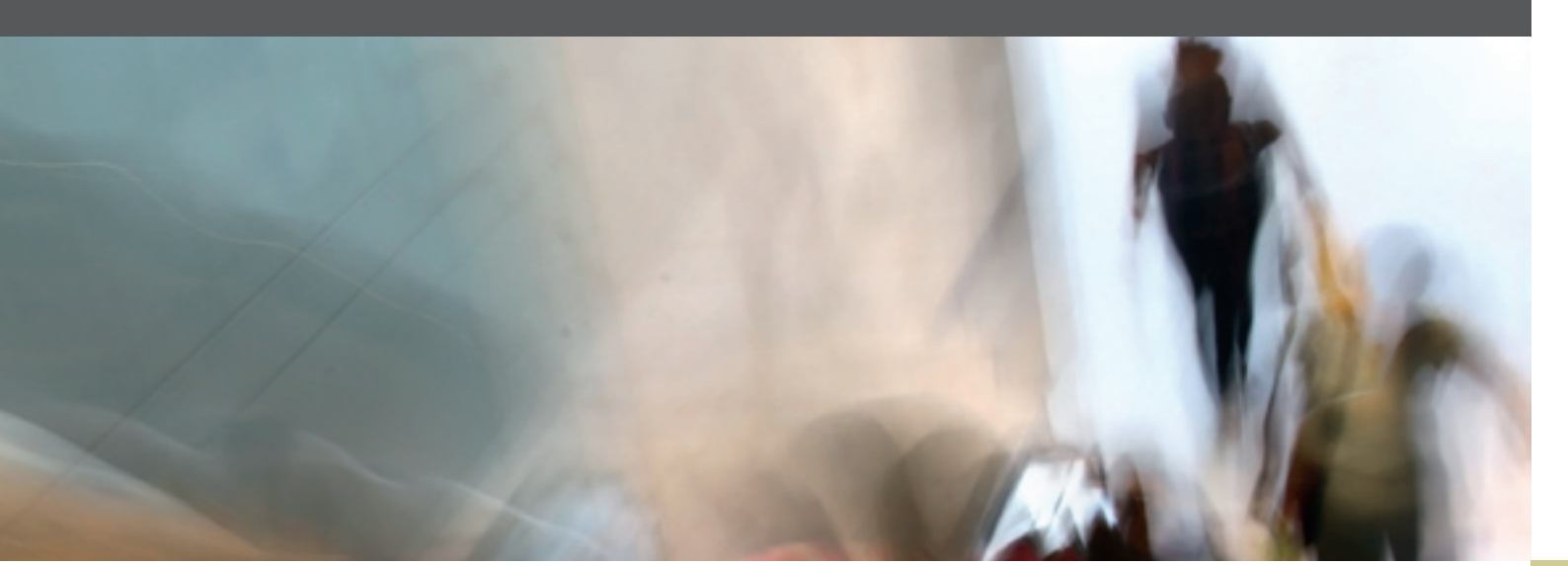
### Authorisation

Should the life insurer wish to proceed to the next step of establishing a reinsurer, this is a relatively well-trodden path which generally takes six months. The minimum capital requirements are typically a multiple of the relevant solvency margin (150 per cent) plus funding for three years of business (if funding is required).

### Types of business reinsured

The type of business we have seen reinsured into Ireland from Europe are shown in [Figure 1](#) opposite.





**Figure 1** | Reinsurance by business type

Type of business	Benefit
Variable annuities	Liability closer to economic capital.
Unit-linked business	Grouping of contracts. Unlikely to need additional reserves over unit-linked liabilities (unless there are guarantees).
Term assurance/PHI business	Allowance for lapses. Mortality provisions may be closer to best estimate than other jurisdictions.
Annuities	Liquidity premium on underlying corporate bonds. Mortality provisions may be closer to best estimate than other jurisdictions.

### Conclusion

With capital particularly scarce and the options for raising capital limited, setting up a reinsurance company offers a potentially low-cost and quick way of releasing 'uneconomic' capital that is tied up. It offers a bridge over the current troubled waters, anticipating the effects of Solvency II.

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