



The Financial
Services Club

Capital Markets Chamber



Reinventing the wheel?

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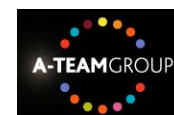
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This house believes that Solvency II
and liquidity risk have reinvented
the wheel.

*A debate on the similarity of new risk
management standards*



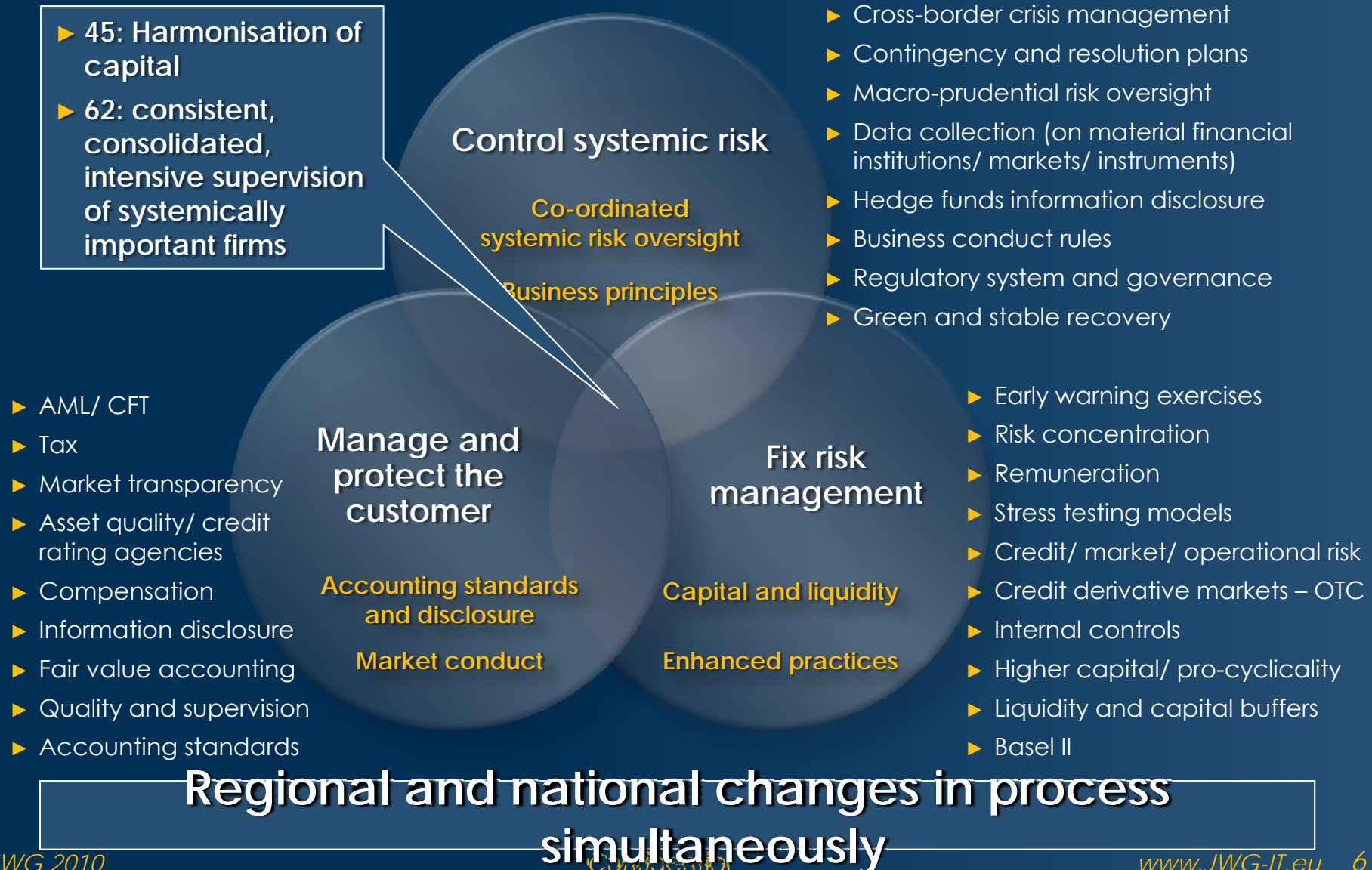
Executive summary

- ▶ The FS crisis has triggered a call for convergence in banking and insurance business model oversight
- ▶ Many common problems have been identified and new regimes put in place to address them
- ▶ However, the insurance and banking wheels have been spun from different lathes with different standards
- ▶ Integrated financial institutions and their regulators must develop the capabilities to turn both wheels well
- ▶ Defining what 'good compliance' for both these regimes looks like will require a new level of industry standards

Many worlds need to collide to make this happen

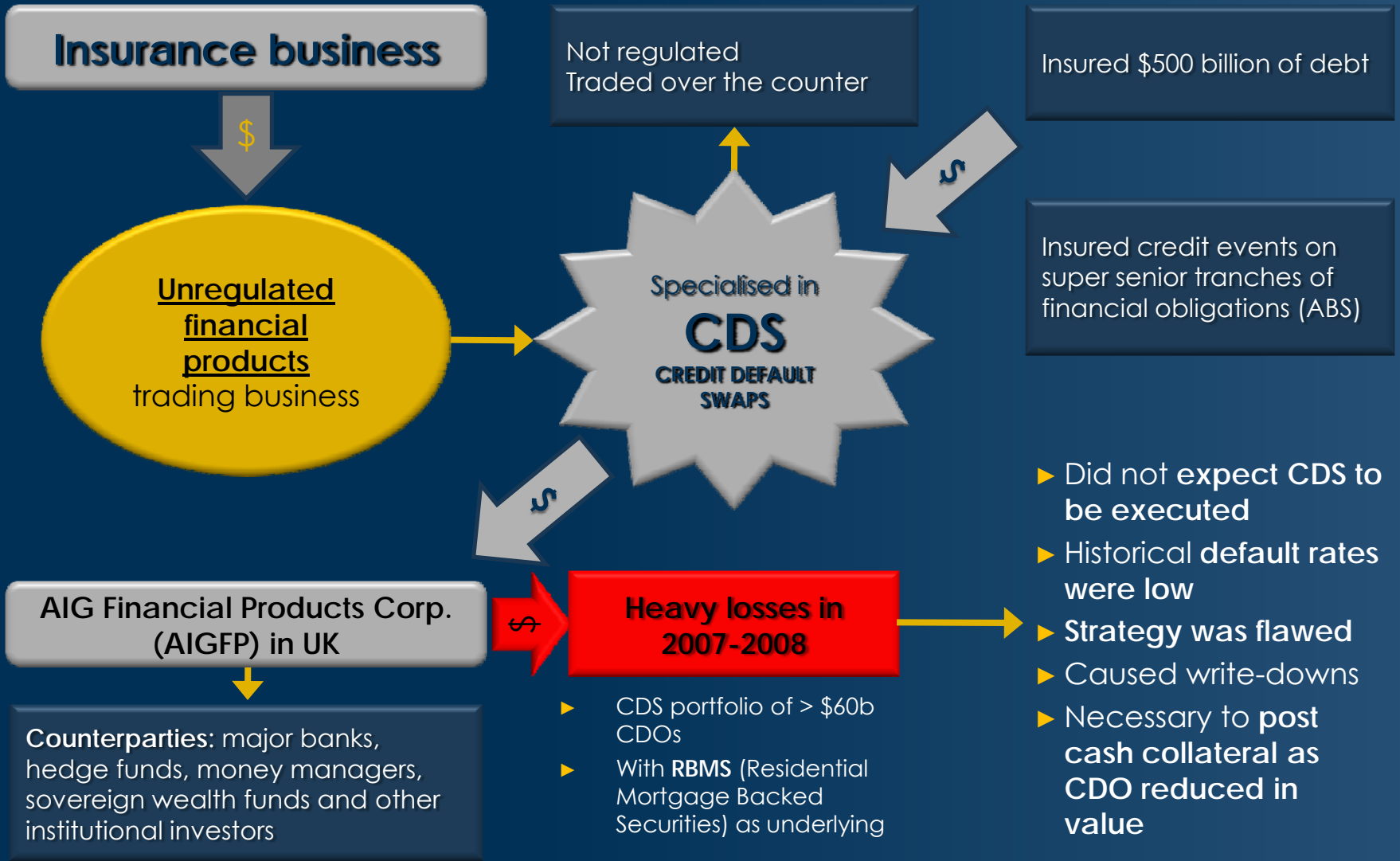


A helicopter view of the G20's political storm





The \$170 billion AIG problem



Source: Joint Forum report January 2010, New York Times



The convergence agenda:

Area	Commonality between insurance and banks
Preconditions	Both sectors see sound and sustainable macroeconomic policies and well-developed public infrastructure as preconditions to effective supervision.
The supervisory system	Both sectors consider customer protection and systemic stability as objectives of the supervisory system. All sectors also recognise the need for operational independence and adequate resources for supervisors, and have the ability to apply supervisory sanctions.
The supervised entity	Both sectors require supervisors to have a regime for licensing entities and vetting of key individuals and encourage sound corporate governance within licensed entities.
Ongoing supervision	Both sectors require an effective system for monitoring , onsite inspection , and cooperation with other supervisors.
Prudential standards	All core principles describe criteria for capital adequacy , internal controls , large exposure limits , accounting policies and procedures , and risk management processes .
Markets and customers	All core principles take some supervisory responsibility for the prevention of financial crime .

Source: JWG analysis of *The Joint Forum Review of the Differentiated Nature and Scope of Financial Regulations* January 2010



What are the issues?

Banks	Insurers
<ul style="list-style-type: none">▶ Inadequate liquidity risk tolerance▶ In sufficient liquid asset buffer▶ Inappropriate allocation of liquidity costs, benefits and risks to all significant business activities▶ Failure to identify and measure full range of liquidity risks, including contingent liquidity risks▶ Inadequate management of intraday liquidity risk and collateral▶ Poor quality and robustness of firms' liquidity stress testing▶ Ineffectiveness of contingency plans put in place to deal with stressed circumstances▶ Inadequate nature and frequency of supervisory reporting on bank liquidity position	<ul style="list-style-type: none">▶ Inadequate provisions to fund obligations▶ Relying on inter-company debts to demonstrate compliance▶ Insufficient analysis of firms' cash generation capabilities▶ Inadequate changes to funding to manage liquidity▶ Weaknesses in risk assessments▶ Poor quality of systems and controls▶ Poor quality of firms' professional indemnity insurance in relation to exposures▶ Inadequate analysis of business model and operational structure▶ Various aspects of firms financial statements are poor▶ Insufficient attention to types of liabilities exposure▶ For groups; inadequate recoverability of intercompany balances, amounts due from connected person

Source: JWG analysis of FSA Dear CEO letter: "Adequate financial resources for insurance intermediaries", February 2010; FSA CP08/22; FSA Dear CEO letter: "FSA requirements on your firms liquidity risk management," January 2010

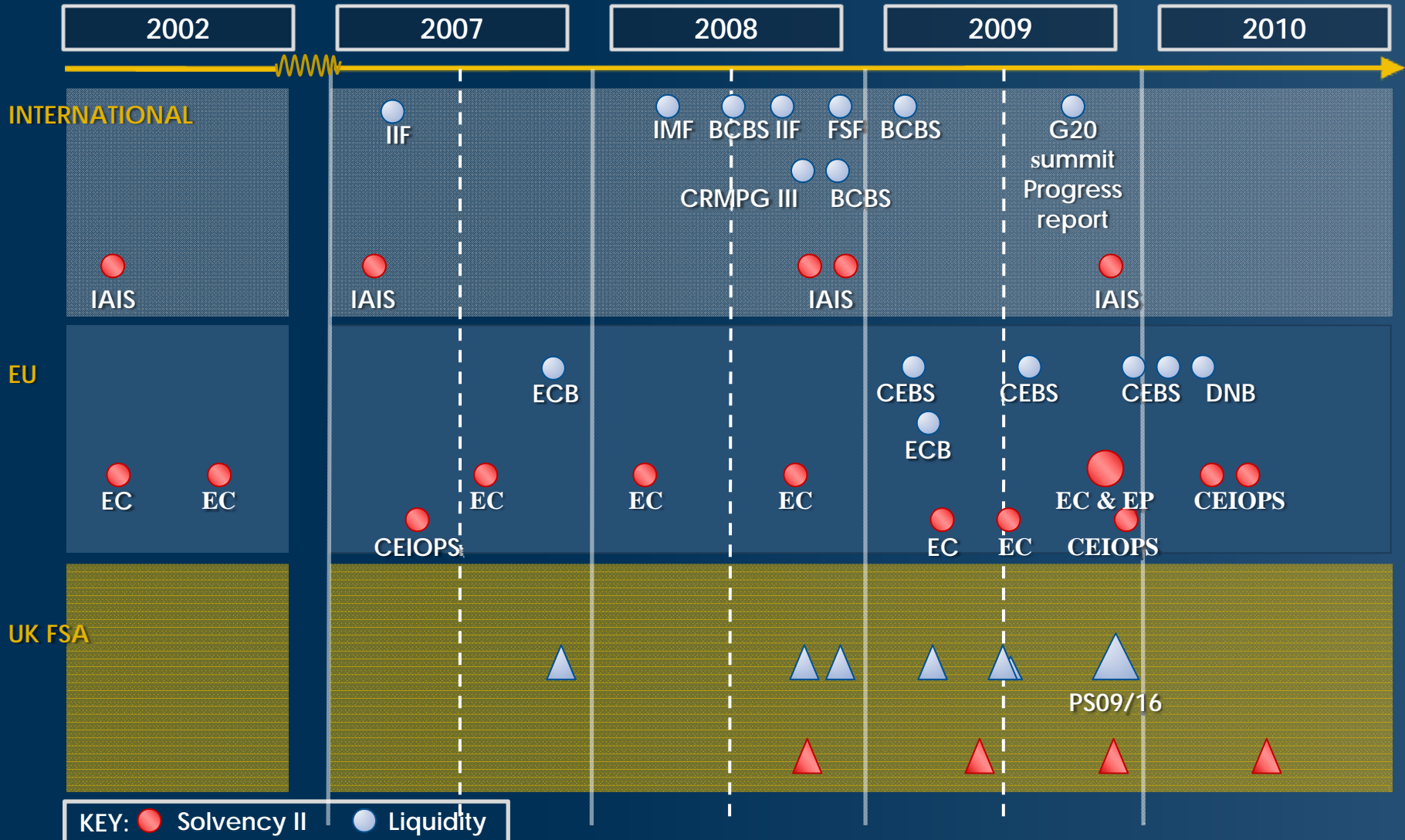


Who is doing what?

Region	Banks	Insurers
GLOBAL	<ul style="list-style-type: none"> ▶ BCBS: International framework for liquidity risk measurement, standards and monitoring (Dec 09) ▶ BCBS: Principles for Sound Liquidity Risk Management and Supervision (Sept 08) 	<ul style="list-style-type: none"> ▶ IAIS: Std No. 2.2.6 on ERM for capital adequacy and solvency purposes (Oct 2008) ▶ IAIS: Standard No. 2.2.7 on the use of Internal Models for regulatory capital purposes
EU	<ul style="list-style-type: none"> ▶ CEBS CP28: Guidelines on liquidity buffers (Jul 09) ▶ CEBS CP19: technical advice on liquidity risk management (Jun 08) 	<ul style="list-style-type: none"> ▶ EP&EC 2009/138/EC Directive taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (Nov 2009) ▶ CEIOPS 73/10 Advice for L2 Implementing Measures on Solvency II (Jan 2010) + 100s more
UK	<ul style="list-style-type: none"> ▶ FSA PS09/16 Strengthening liquidity standards (Oct 09) ▶ FSA CP09/14 Transitional measures (Jun 09) ▶ FSA CP09/13 Liquidity reporting (Apr 09) ▶ FSA CP08/22 strengthening liquidity standards (Dec 08) 	<ul style="list-style-type: none"> ▶ FSA FS09/1 The Path to Solvency II (May 09) ▶ FSA DP08/4 Insurance risk management: the path to solvency II (Sept 08)
US	<ul style="list-style-type: none"> ▶ Federal Banking Agencies Interagency policy on funding and liquidity risk management (Mar 2010) 	<ul style="list-style-type: none"> ▶ NAIC- Solvency Modernisation Initiative Issues for consideration (Jun 2009)
AU	<ul style="list-style-type: none"> ▶ APRA proposes enhanced liquidity requirements for ADI (Sept 09) 	<ul style="list-style-type: none"> ▶ APRA GPS 113 Capital adequacy: internal model based method (Jun 2008)
CN	<ul style="list-style-type: none"> ▶ CBRC Guideline on liquidity risk management of commercial banks (Oct 2010) 	<ul style="list-style-type: none"> ▶ FSC Regulation governing the capital adequacy of insurance companies (Dec 2007)



When?





How - solvency II consultation

CEIOPS			
Date	Code	Title	Public response date
Jan-10	CP80	Draft CEIOPS Level 3 Guidance on Solvency II, Pre-application process for Internal Models	08-Mar-10
Nov-09	CP73	Draft Level 2 Advice on Simplifications for Captives	11-Dec-09
Nov-09	CP78	Draft Level 2 Implementing Measures on Technical criteria for assessing 3rd country equivalence	05-Feb-10
Nov-09	CP77	Draft Level 2 Advice on Simplification for SCR	11-Dec-09
Nov-09	CP76	Draft Level 2 Advice on Simplifications for Technical Provisions	11-Dec-09
Nov-09	CP75	Draft Level 2 Advice on Undertaking Specific Parameters for SCR	11-Dec-09
Nov-09	CP74	Draft Level 2 Advice on Correlation parameters	11-Dec-09
Nov-09	CP73	Draft Level 2 Advice on Calibration of the MCR	11-Dec-09
Nov-09	CP72	Draft Level 2 Advice on Calibration of the health- underwriting risk	11-Dec-09
Nov-09	CP71	Draft Level 2 Advice on Calibration of the non-life underwriting risk	11-Dec-09
Nov-09	CP70	Draft Level 2 Advice on Calibration of the market risk sub-module	11-Dec-09
Nov-09	CP69	Draft Level 2 Advice on Design of the Equity risk sub-module	11-Dec-09
Nov-09	CP68	Draft Level 2 Advice on Treatment of ring fenced Funds	11-Dec-09
Nov-09	CP67	Draft Level 2 Advice on Treatment of Participations	11-Dec-09
Nov-09	CP66	Draft Level 2 Advice on Group Solvency for Groups with centralised risk - management	11-Dec-09
Nov-09	CP65	Draft Level 2 Advice on Partial Internal Models	11-Dec-09
Nov-09	CP64	Draft Level 2 Advice on Extension of Recovery Period	11-Dec-09
Nov-09	CP63	Draft Level 2 Advice on Repackaged loans investments	11-Dec-09
Jul-09	CP62	Draft Level 2 Advice on Group Solvency Assessment	11-Sep-09
Jul-09	CP61	Draft Level 2 Advice on Intra-group Transactions and Risk Concentration	11-Sep-09
Jul-09	CP60	Draft Level 2 Advice on Group Solvency Assessment	11-Sep-09
Jul-09	CP59	Draft Level 2 Advice on Remuneration Issues	11-Sep-09
Jul-09	CP58	Draft Level 2 Advice on Supervisory Reporting and Disclosure	11-Sep-09
Jul-09	CP57	Draft Level 2 Advice on Capital add-on	11-Sep-09
Jul-09	CP56	Draft Level 2 Advice on Tests and Standards for Internal Model Approval	11-Sep-09
Jul-09	CP55	Draft Level 2 Advice on MCR calculation	11-Sep-09
Jul-09	CP54	Draft Level 2 Advice on SCR Standard Formula - Loss Absorbing Capacity of Technical Provisions	11-Sep-09
Jul-09	CP53	Draft Level 2 Advice on SCR Standard Formula - Operational Risk	11-Sep-09
Jul-09	CP52	Draft Level 2 Advice on SCR Standard Formula - Reinsurance Mitigation	11-Sep-09
Jul-09	CP51	Draft Level 2 Advice on SCR Standard Formula - Counterparty Default Risk	11-Sep-09
Jul-09	CP50	Draft Level 2 Advice on SCR Standard Formula - Health Underwriting Risk	11-Sep-09
Jul-09	CP49	Draft Level 2 Advice on SCR Standard Formula - Life Underwriting Risk	11-Sep-09
Jul-09	CP48	Draft Level 2 Advice on SCR Standard Formula - Non-life Underwriting Risk	11-Sep-09
Jul-09	CP47	Draft Level 2 Advice on SCR Standard Formula - Market Risk	11-Sep-09
Jul-09	CP46	Draft Level 2 Advice on Own Funds - Classification and Eligibility	11-Sep-09
Jul-09	CP45	Draft Level 2 Advice on Technical Provisions - Simplifications	11-Sep-09
Jul-09	CP44	Draft Level 2 Advice on Technical Provisions - Counterparty Default Adjustment	11-Sep-09
Jul-09	CP43	Draft Level 2 Advice on Technical Provisions - Standards for Data Quality	11-Sep-09
Jul-09	CP42	Draft Level 2 Advice on Risk Margin	11-Sep-09
Jul-09	CP41	Draft Level 2 Advice on Technical Provisions - Calculation as a whole	11-Sep-09
Jul-09	CP40	Draft Level 2 Advice on Technical Provisions - Risk Free Interest Rate	11-Sep-09
Jul-09	CP39	Draft Level 2 Advice on Technical Provisions - Best Estimate	11-Sep-09
Mar-09	CP37	Draft Level 2 Advice on the Procedure to be followed for the approval of an Internal Model /	01-Jun-09
Mar-09	CP36	Draft Level 2 Advice on Special Purpose Vehicles	08-Jun-09
Mar-09	CP35	Draft Level 2 Advice on Valuation of Assets and "other Liabilities"	08-Jun-09
Mar-09	CP34	Draft Level 2 Advice on Transparency and Accountability	08-Jun-09
Mar-09	CP33	Draft Level 2 Advice on System of Governance	08-Jun-09
Mar-09	CP32	Draft Level 2 Advice on Technical Provisions - Assumptions about future management actions	01-Jun-09
Mar-09	CP31	Draft Level 2 Advice on SCR Standard Formula - Allowance of financial mitigation techniques	01-Jun-09
Mar-09	CP30	Draft Level 2 Advice on Technical Provisions - Treatment of Future Premiums	01-Jun-09
Mar-09	CP29	Draft Level 2 Advice on Own Funds - Criteria for supervisory approval of ancillary own funds	01-Jun-09
Mar-09	CP28	Draft Level 2 Advice on SCR Standard Formula - Counterparty default risk	01-Jun-09
Mar-09	CP27	Draft Level 2 Advice on Technical Provisions - Segmentation	03-May-09
Mar-09	CP26	Draft Level 2 Advice on Technical Provisions - Methods and statistical techniques for calculating the best estimate	01-Jun-09

Level 3 guidance:

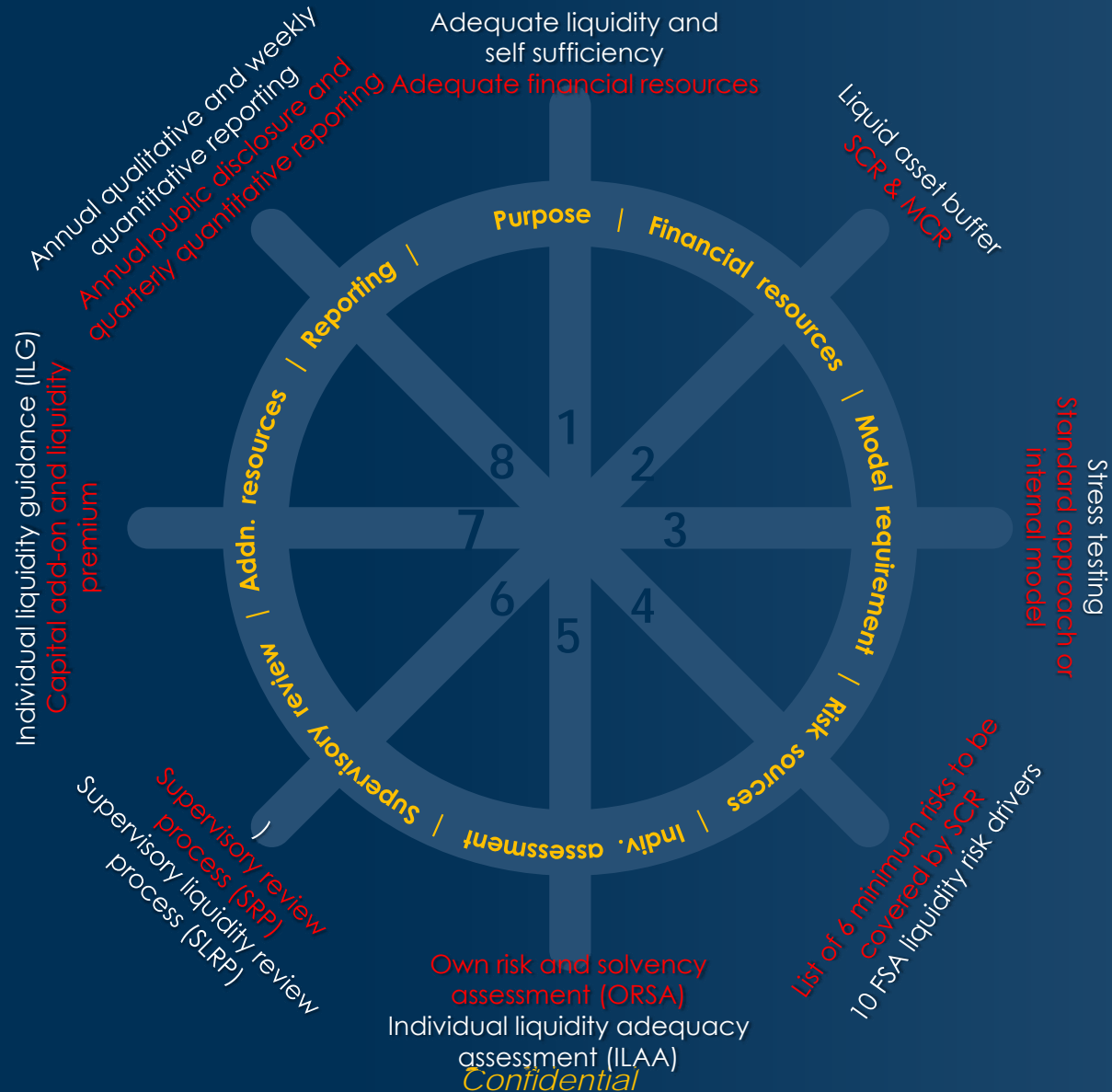
Covering pre-application process for firms planning to apply for an internal model approval to calculate the SCR

Level 2 advice: 53

consultation papers covering implementing measures for key elements of the Solvency II directive



What does the wheel look like?



Solvency II
Liquidity



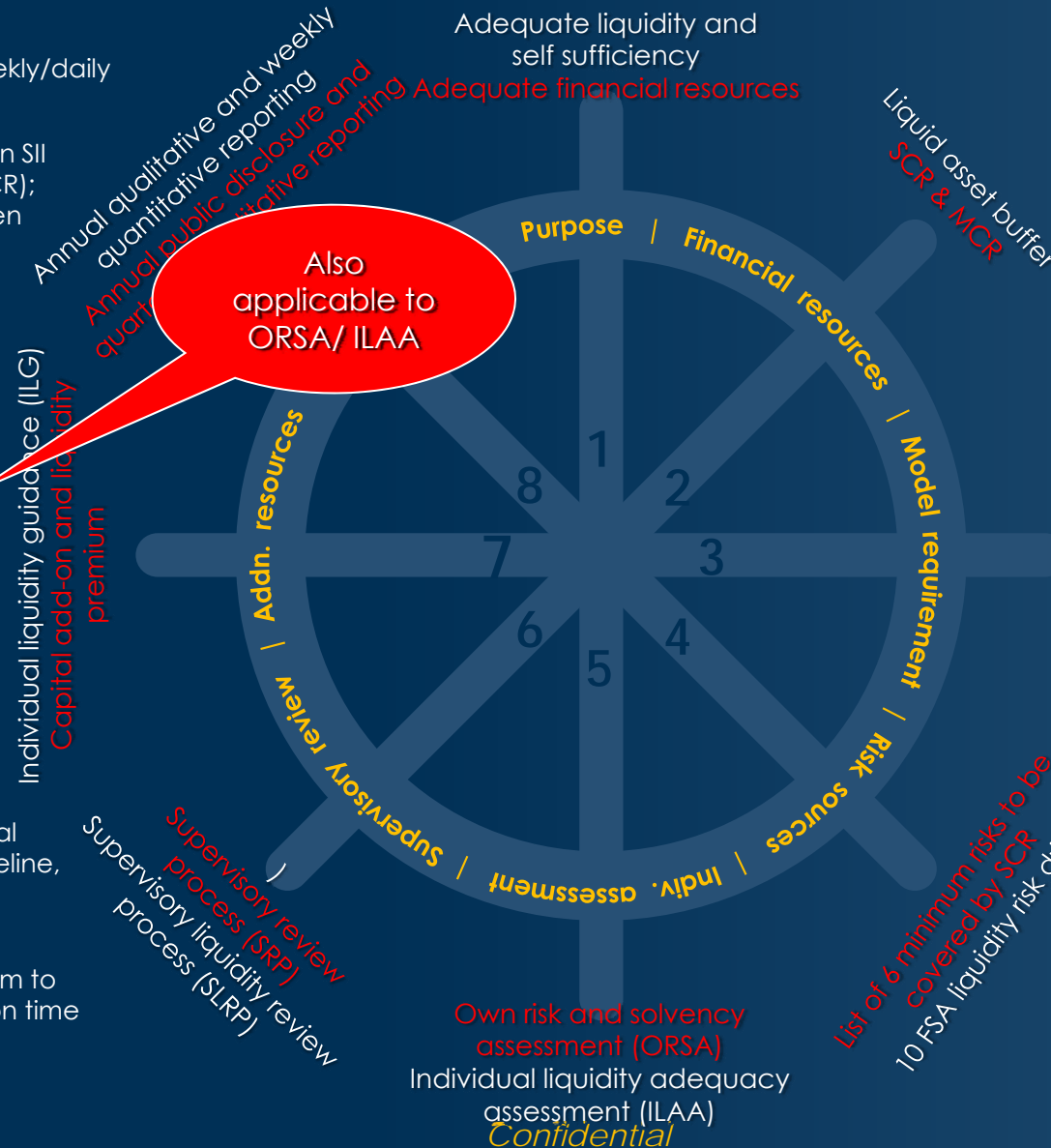
What does the wheel look like?

- ▶ Unable to meet weekly/daily reporting deadlines
- ▶ Duplication between SII reports (RTS and SFCR); unreasonable burden

- ▶ Poor data quality means firms unable to adequately price liquidity risks
- ▶ Firms will not have sufficient data to comply when SII comes in force

- ▶ Unrealistic transitional implementation timeline, 50% firms not ready
- ▶ Propose a 'sliding transition' mechanism to meet SII standards on time

Solvency II Liquidity



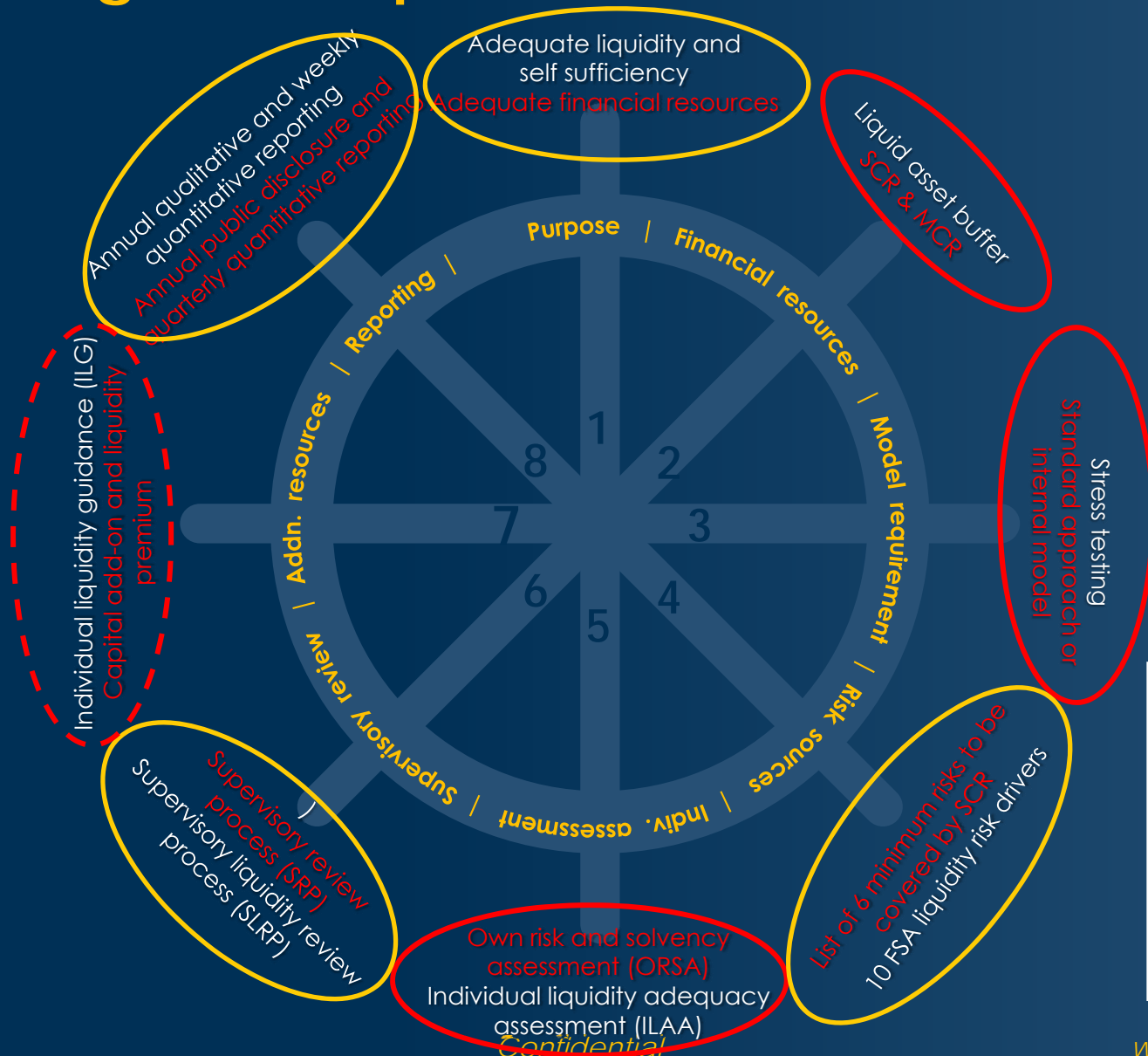
- ▶ Liquid asset buffer definition too narrow
- ▶ The 'prudent person' approach should prevail at all times, without exclusions

- ▶ Lack of IT infrastructure for stress test model
 - ▶ The Standard Formula has certain weaknesses, e.g., exclusion of geographic diversification
- Stress testing
Standard approach or internal model*

- ▶ Need to ensure assumptions meet business and FSA requirements
 - ▶ Design of certain SII scenarios are pro-cyclical, e.g., for equity volatility stress
- List of 6 minimum risks to be covered by SCR
10 FSA liquidity risk drivers*



How will Liquidity PS09/16 and Solvency II work together in practice?



Solvency II
Liquidity

KEY

- Feed the liquidity into SII requirement
- Integrate approaches
- Implement separately

- **What happens when it all goes wrong? Have we learnt the lessons of 2008?**
- **Do the new approach to liquidity and solvency management make sense both individually and together?**
- **What do ‘good systems and controls’ for these regimes look like? How will they work together in practice?**
- **What are the implications on the internal models, stress testing and reporting to management and regulators? Are the infrastructures there? What is it that usually goes wrong?**
- **To what extent does the industry believes that there is a need for common standards, codes of practice, training, etc.**

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and liquidity risk have reinvented the
wheel

What do YOU think?

Date	Debate
19 January	This house believes that stress is a killer for banks operating in the UK. A debate on what it takes to do stress testing right in the capital markets in 2010
11 February	This house believes that a single customer view will always be fuzzy. A debate on the achievability of FS compensation scheme aims in 2010
16 March	This house believes that banks' infrastructures are not up for the BIS' new risk controls. A debate on strengthening the resilience of banking
20 April	This house believes that Solvency II and liquidity risk have reinvented the wheel. A debate on the similarity of new risk management standards
11 May	This house believes that payments infrastructure risk has been largely forgotten. A debate about whether the payments infrastructure is up to the new risk management standards
8 June	This house believes that global capital and liquidity buffers standards will never exist. A debate about the achievability of global consistency in risk management approaches



Next up

UK FSCS SCV implementation challenges go global?

An anonymous survey on the implementation challenges that 'single customer view' regulation brings <http://www.jwg-it.eu/survey.php?typeID=1>

SWIFT'S liquidity risk management survey

Confidential survey on the challenges brought by new regulatory demands of yet more granularity and still greater frequency of reports.

<http://survey.swift.com/sw/surveys/part.asp?S=7047&P=2143525&R=1&H=3D489A69A92FC6690F2B71A341BB775F62DBC0F8>

Check the website for LiRAN and MiFID meetings due to be scheduled soon

<http://jwg-it.eu/events.php>



For more info: email: admin@jwg-it.eu or call PJ +44 (0) 7811 430 503



Thank you

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