SST versus Solvency II - Comparison analysis

Transcript of investor and analyst video presentation

Patrick Raaflaub, Group CRO

Zurich, 29 April 2016

The following transcript must be read in conjunction with (i) the presentation slides and related materials made available by Swiss Re Ltd ("Swiss Re") on its website under http://www.swissre.com/investors/financial_information/ solely for your information in connection with the presentation on SST versus Solvency II – Comparison analysis and (ii) with all other publicly available information published by Swiss Re.

Cautionary note on forward-looking statements

Certain statements and illustrations contained herein are forward-looking. These statements (including as to plans, objectives, targets, and trends) and illustrations provide current expectations of future events based on certain assumptions and include any statement that does not directly relate to a historical fact or current fact.
Forward-looking statements typically are identified by words or phrases such as "anticipate", "assume", "believe", "continue", "estimate", "expect", "foresee", "intend", "may increase", "may fluctuate" and similar expressions, or by future or conditional verbs such as "will", "should", "would" and "could". These forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause Swiss Re's actual results of operations, financial condition, solvency ratios, capital or liquidity positions, or prospects to be materially different from any future results of operations, financial condition, solvency ratios, capital or liquidity positions, or prospects expressed or implied by such statements or cause Swiss Re to not achieve its published targets. Such factors include, among others:

- instability affecting the global financial system and developments related thereto;
- deterioration in global economic conditions;
- Swiss Re's ability to maintain sufficient liquidity and access to capital markets, including sufficient liquidity to cover potential recapture of reinsurance agreements, early calls of debt or debt-like arrangements and collateral calls due to actual or perceived deterioration of Swiss Re's financial strength or otherwise;
- the effect of market conditions, including the global equity and credit markets, and the level and volatility of equity prices, interest rates, credit spreads, currency values and other market indices, on Swiss Re's investment assets;
- changes in Swiss Re's investment result as a result of changes in its investment policy or the changed composition of its investment assets, and the impact of the timing of any such changes relative to changes in market conditions;
- uncertainties in valuing credit default swaps and other credit-related instruments;
- possible inability to realise amounts on sales of securities on Swiss Re's balance sheet equivalent to their mark-to-market values recorded for accounting purposes;
- the outcome of tax audits, the ability to realise tax loss carryforwards and the ability to realise deferred tax assets (including by reason of the mix of earnings in a jurisdiction or deemed change of control), which could negatively impact future earnings;
- the possibility that Swiss Re's hedging arrangements may not be effective;
- the lowering or loss of one of the financial strength or other ratings of one or more Swiss Re companies, and developments adversely affecting Swiss Re's ability to achieve improved ratings;
- the cyclicality of the reinsurance industry;

- uncertainties in estimating reserves;
- uncertainties in estimating future claims for purposes of financial reporting, particularly with respect to large natural catastrophes, as significant uncertainties may be involved in estimating losses from such events and preliminary estimates may be subject to change as new information becomes available;
- the frequency, severity and development of insured claim events;
- acts of terrorism and acts of war;
- mortality, morbidity and longevity experience;
- policy renewal and lapse rates;
- extraordinary events affecting Swiss Re's clients and other counterparties, such as bankruptcies, liquidations and other credit-related events;
- current, pending and future legislation and regulation affecting Swiss Re or its ceding companies and the interpretation of legislation or regulations;
- legal actions or regulatory investigations or actions, including those in respect of industry requirements or business conduct rules of general applicability;
- changes in accounting standards;
- significant investments, acquisitions or dispositions, and any delays, unexpected costs or other issues experienced in connection with any such transactions;
- changing levels of competition; and
- operational factors, including the efficacy of risk management and other internal procedures in managing the foregoing risks.

[Patrick Raaflaub]

Good day everyone! Thank you for watching this presentation on Swiss Re's Group solvency under the Swiss Solvency Test and Solvency II. My name is Patrick Raaflaub, I am Swiss Re's Group CRO.

Slide 2: SST and Solvency II are equivalent but not equal

As a Swiss insurance group, Swiss Re has been reporting its solvency under the SST since 2008. The SST became legally binding for all Swiss insurance companies in 2011. It was also the first regime to gain full equivalence to Solvency II in 2015.

It is important to stress that equivalent does not mean equal. SST and Solvency II are conceptually very similar. However, there are important differences between the two methods. As a consequence, an SST ratio cannot be directly compared with a Solvency II ratio.

In this presentation, I will show you how Swiss Re's Group SST ratio translates into a comparable Solvency II ratio. Currently, the difference is about 90 percentage points. This comparison is based on our interpretation of the EU Solvency II requirements as we implemented it for our legal entities in Luxembourg. It was not externally reviewed and was produced on a best effort basis using Swiss Re's SST calculation for 2016.

Slide 3: SST and Solvency II have many similarities but also important differences

SST and Solvency II share many similarities. For example, both frameworks are risk-based and apply an economic balance sheet approach.

Under an "economic balance sheet approach", assets and liabilities are valued on a market consistent basis in order to derive the available capital.

The approach is "risk-based" as we use our internal risk model to measure the required capital.

If the available capital is greater than the required capital, the company holds regulatory excess capital and has a solvency ratio above 100%.

Despite these similarities, SST and Solvency II differ in key aspects. These differences can lead to a significant divergence of the solvency ratios. I would like to focus on the six differences shown on this slide as they explain the main difference between our Group SST ratio and the comparable Solvency II ratio.

There are also other differences, such as the deduction and aggregation method or long-term guarantee measures to address cyclical volatility under the Solvency II framework. As Swiss Re follows a strict economic view, we do not apply these adjustments in our Solvency II assessment.

Slide 4: Swiss Re's Group Solvency II ratio is significantly higher than our SST 2016 ratio

On this slide you can see the walk between our Group SST ratio and the comparable Group Solvency II ratio.

When applying the six main differences, our Group SST ratio currently translates into a Solvency II ratio of 312%. This is about 90 percentage points higher than the SST ratio. Let me provide you with more details on each of these differences and how they impact our Group Solvency II ratio.

Slide 5: Impact of capital cost recognition

The first difference between SST and Solvency II is the way run-off capital costs are recognised.

Run-off capital costs compensate for the required capital during the run-off of the liabilities. On the economic balance sheet, they form part of the liabilities. However, SST requires run-off capital costs to be added to both available and required capital.

Not adding these costs increases the solvency ratio by about 38 percentage points.

Slide 6: Impact of risk measure

The second difference is well known.

Solvency II uses the 99.5% Value at Risk measure, also called VaR, which represents the loss that will likely be exceeded only once in 200 years.

SST applies the 99% shortfall measure, also called tail VaR, which represents the average of all annual losses that occur less than once in 100 years. This is represented by the blue area below the curve in the graph.

For insurers, 99% tail VaR typically represents a higher loss than 99.5% VaR, as their portfolios include significant exposure to rare but severe events like pandemics. For Swiss Re's risk profile, the difference between the two measures is currently estimated to be USD 2.4 billion.

Using VaR instead of tail VaR decreases the required capital. This leads to an increase in our solvency ratio of about 42 percentage points.

Slide 7: Impact of modelling differences

The next difference relates to the fact that some risks are modelled differently under SST and Solvency II.

An important aspect is the way we model run-off capital costs: under SST, they are based on 99% tail VaR, while under Solvency II they are based on 99.5% VaR. In addition, SST acknowledges diversification at group level, while Solvency II does not. As a result, SST run-off capital costs are lower than under Solvency II. This impacts both available as well as required capital.

Required capital is further impacted by operational risk, which is not explicitly modelled under SST but is quantified under Solvency II.

With regard to credit risk, Swiss Re reflects sovereign risk in its internal model and is therefore compliant with the latest EIOPA opinion.

Under Solvency II, credit spread risk can be significantly dampened where the regulator allows application of the deduction and aggregation method or long-term guarantee measures. However, we do not use these measures in our Group Solvency II assessment.

Currently, the modelling differences shown here decrease our solvency ratio by 10 percentage points.

Slide 8: Impact of valuation difference due to discounting

There are also a number of valuation differences. The largest impact results from the usage of different yield curves.

Under SST, discounting can be based on own risk-free interest rates approved by FINMA.

Solvency II requires discounting to be based on credit adjusted LIBOR swap curves and applies ultimate forward rates.

The main impact of this difference is on available capital, but it also affects required capital. The direction and magnitude of the impact depends heavily on the shape of the yield curves.

Swiss Re applies its own set of risk-free interest rates, which are approved by FINMA. They are based on government bonds. We do not use ultimate forward rates and do not apply any long-term guarantee measures.

Currently the Solvency II curves are lower. This results in less available and slightly higher required capital.

It decreases the solvency ratio by 18 percentage points.

Slide 9: Impact of deferred taxes

Finally, SST and Solvency II differ in their treatment of taxes: SST is pre-tax, while Solvency II is post-tax.

On the economic balance sheet, future profits are recognised as unrealised gains. The tax debt that corresponds to such an unrealised gain is recognised as a deferred tax liability.

While not relevant for SST, deferred taxes form part of the liabilities on the Solvency II balance sheet. This decreases available capital. At the same time, the loss absorbing capacity of deferred taxes reduces the Solvency II required capital.

In most cases the solvency ratio increases from this change, even though the impact on required capital is usually smaller than the impact on available capital.

Based on our calculations, the post-tax view increases our solvency ratio by about 37 percentage points.

Slide 10: Conclusion

I hope this presentation provided you with some clarity on the important differences between the Swiss Solvency Test and Solvency II. Even though both frameworks apply economic and risk-based solvency principles, the resulting ratios are not directly comparable.

Swiss Re is very strongly capitalised under both SST and Solvency II.

When comparing public disclosures, it is important to bear in mind that an SST ratio typically translates into a significantly higher Solvency II ratio.

Swiss Re has been actively engaged in SST and Solvency II discussions for many years.

We work closely with regulators and clients around the world to support the development – and more importantly the convergence – of economic solvency regimes.

Thank you very much for watching this video!

Corporate calendar & contacts

Corporate calendar

29 July 2016	Second Quarter 2016 Results
3 November 2016	Third Quarter 2016 Results
2 December 2016	Investors' Day
23 February 2017	Annual results 2016
16 March 2017	Publication of Annual Report 2016 and EVM Report 2016
21 April 2017	153rd Annual General Meeting
4 May 2017	First Quarter 2017 Results

Investor Relations contacts

E-Mail	Investor_Relations@swissre.com
Hotline	+41 43 285 4444
Philippe Brahin	+41 43 285 7212
Jutta Bopp	+41 43 285 5877
Manfred Gasser	+41 43 285 5516
Chris Menth	+41 43 285 3878
Iunia Rauch-Chisacof	+41 43 285 7844