

Swiss Re



The Swiss Solvency Test

Mexico-CNSF's International Seminar

Mexico City, November 27-28, 2008

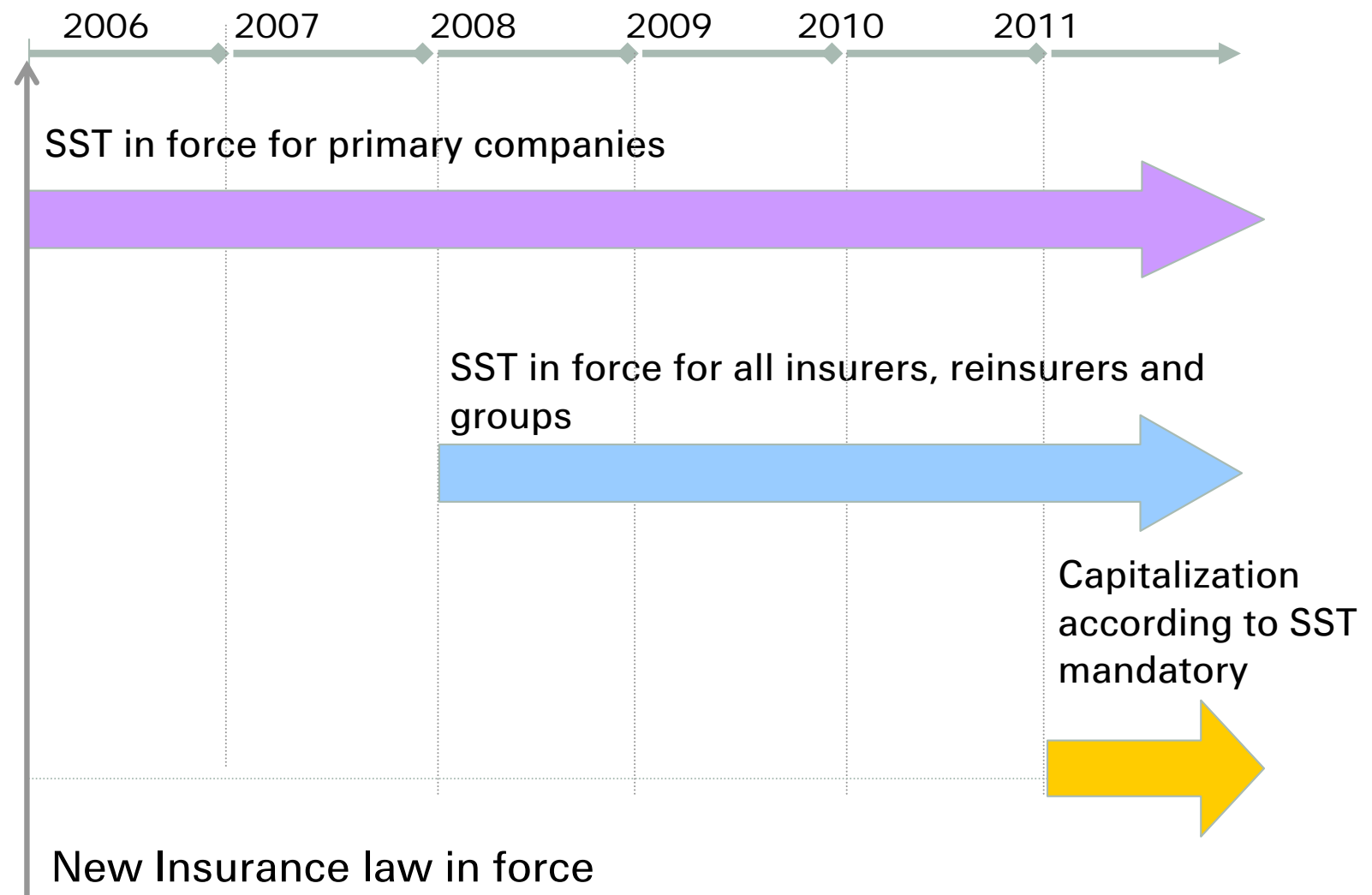
Giovanni Gentile

Head Group Capital Management

Swiss Reinsurance Company



Legal Introduction of the Swiss Solvency Test - SST






Supervision in the Past: Statutory Valuation



"The actuarial convention according to which the composition of the assets determines the size of the liabilities is one of the weirdest emanations of the human mind. It's a metaphor - like saying that the advent of jet planes made the Atlantic narrower - and metaphor has a limited place in finance"

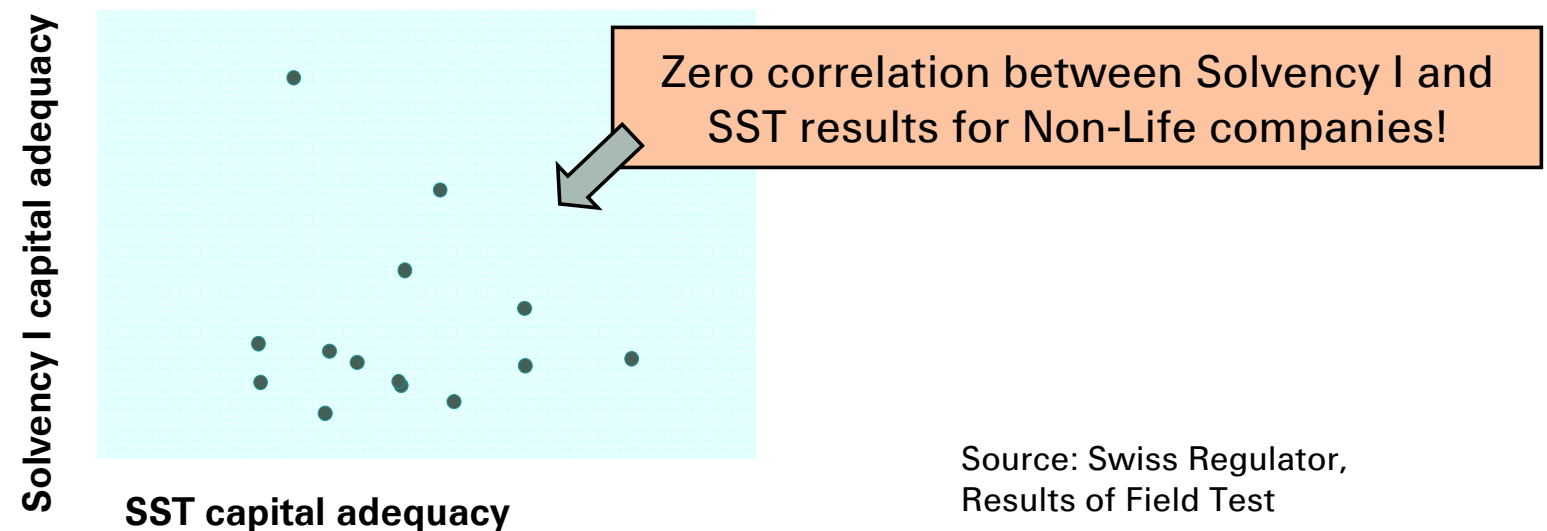
Martin Taylor, chairman of WHSmith's pension fund

- Discount rates for liabilities were set with reference to an expected asset profit based on past experience
 - Implicit - often unknown - prudence in liabilities
 - No explicit valuation of embedded options and guarantees
 - **Solvency 1: No capital requirement for market and credit risk**
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- High risk assets resulted in reduction of liabilities
 - Sales-forces pushed for adding high guarantees to life policies
 - Cash flow underwriting
 - Downward spiral when business contracts
 - Underwriting cycles are exacerbated



Solvency I poorly measures risk

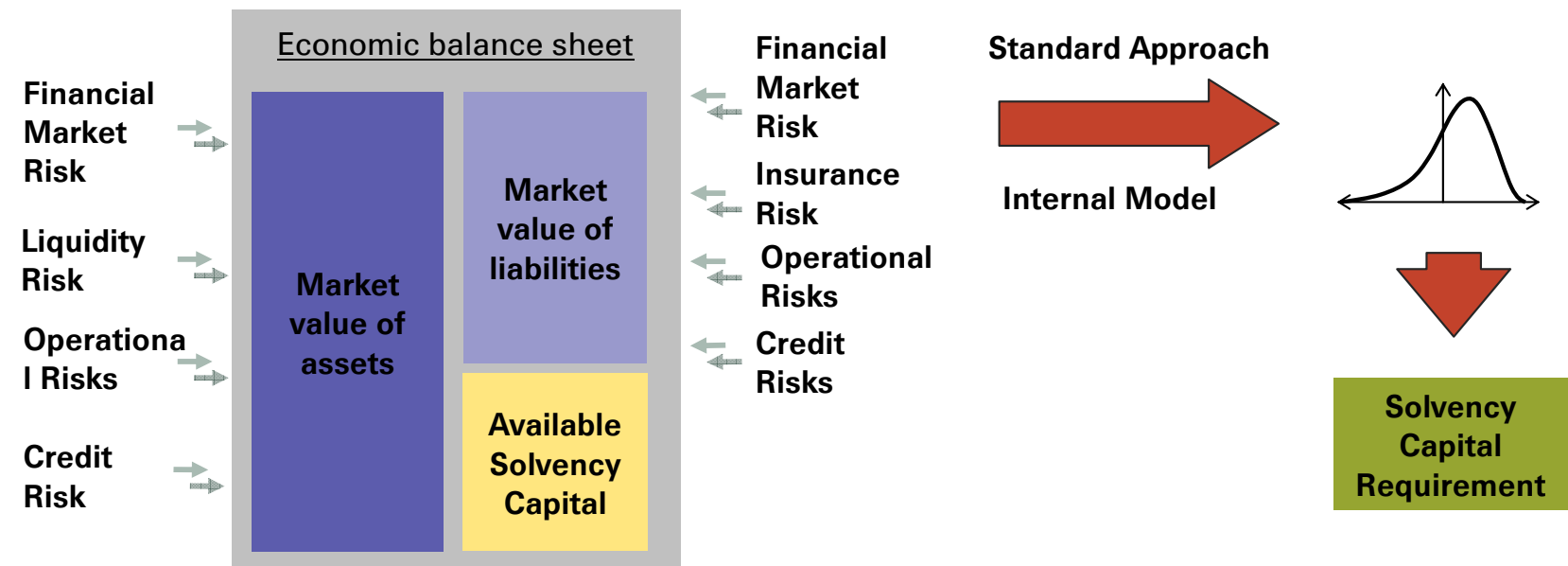
- Solvency I reflects risks extremely poorly and is the reason for some company failures and near-failures in the past
 - in particular inexistent measure of asset-liability management
 - financial market options embedded in many Life products not recognized
- SST shows that Solvency I is a useless measure for the true risk:





SST: Total balance sheet approach

- All assets and liabilities need to be valued on a market consistent basis
- All risks (and their interactions) that assets and liabilities are exposed to need to be considered

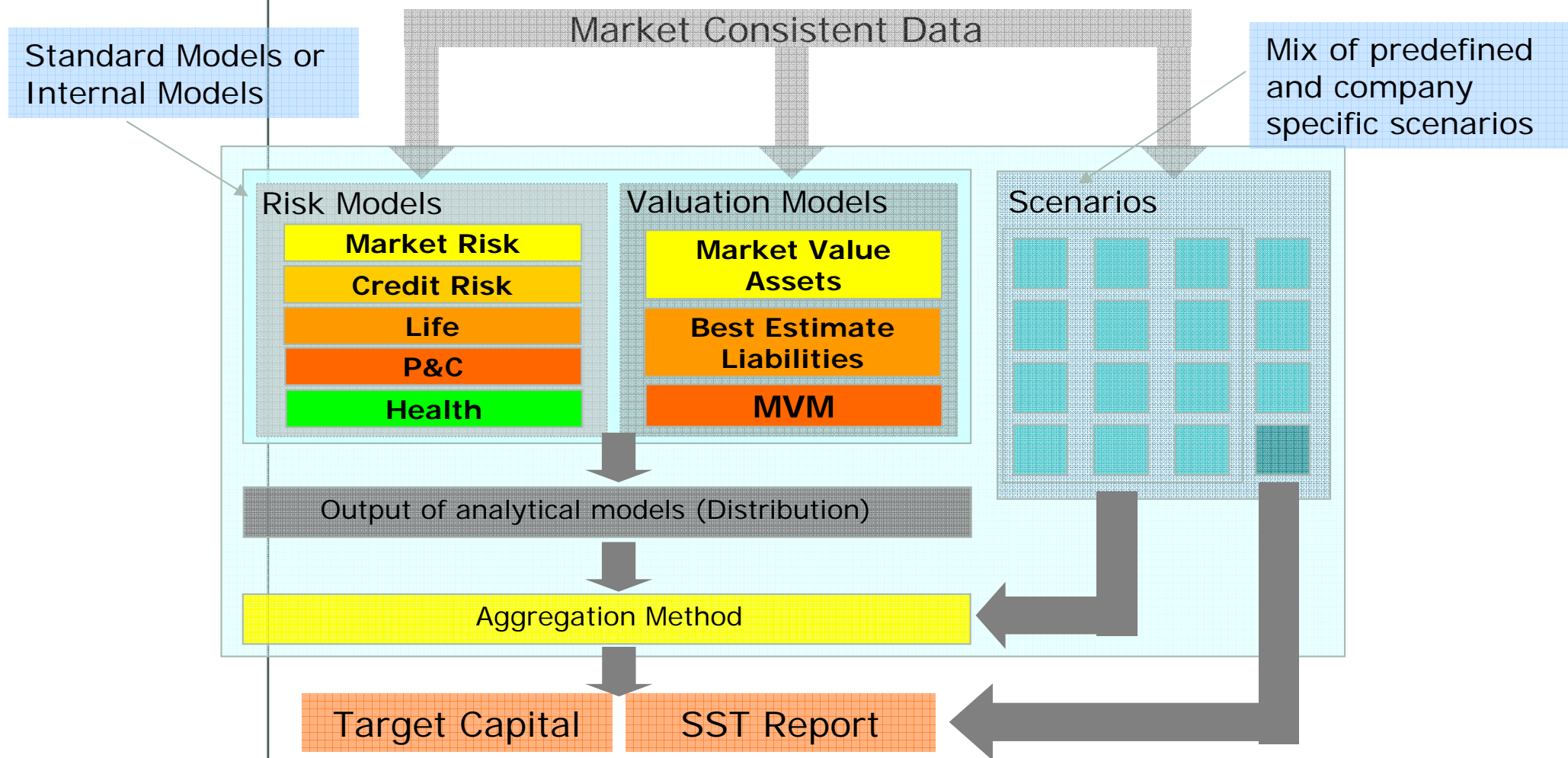


实事求是, We must seek truth from facts

邓小平, Deng Xiaoping



The Swiss Solvency Test: Standard Models



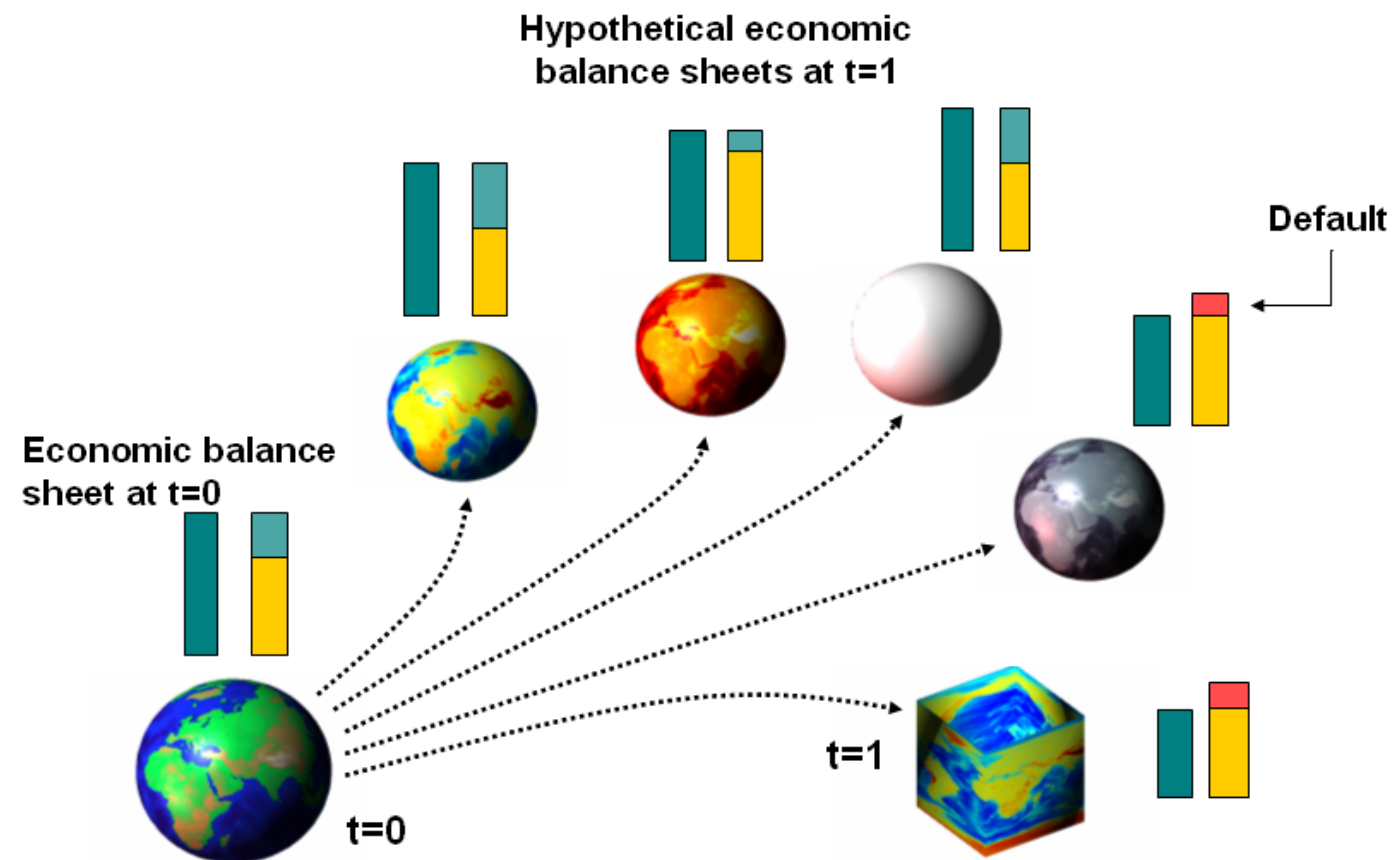


The Swiss Solvency Test : Scenarios

Prediction is very difficult, especially about the future

Niels Bohr

Under the SST each company has to evaluate the impact under a set of given scenarios



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Change in SST Ratio due to Impact of Historical Scenarios (Intervention Levels)

Intervention Levels:

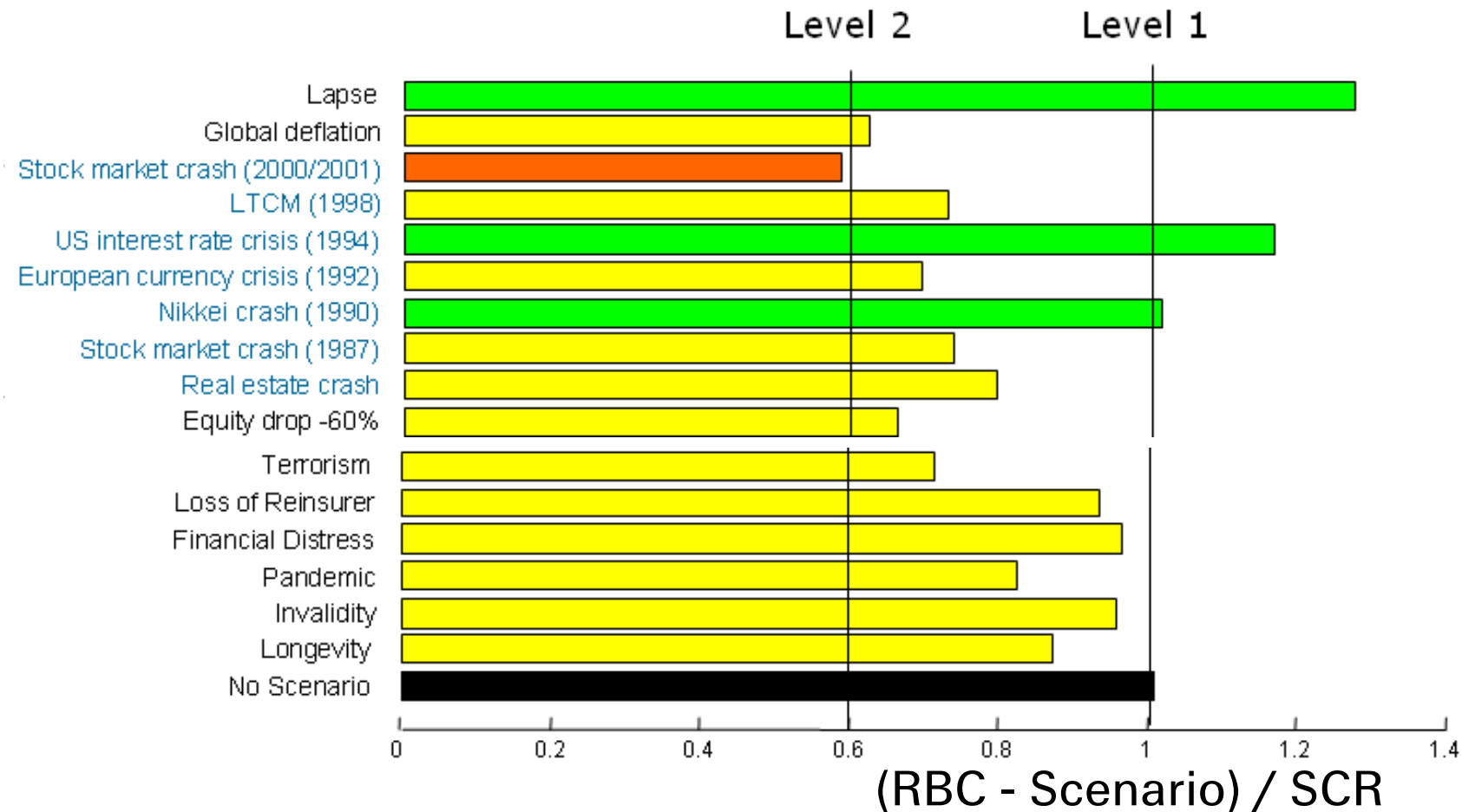
1. **Green Level** – SST ratio remains over 100 %

2. **Yellow Level** – SST ratio falls below 100 %, but remains over 60 %

3. **Orange Level** – SST ratio is reduced to less than 60 %

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Total Impact of Scenarios on the Swiss Life Market



Source: Swiss Federal Department of Finance (FDF) and Federal Office of Private Insurance (FOPI)

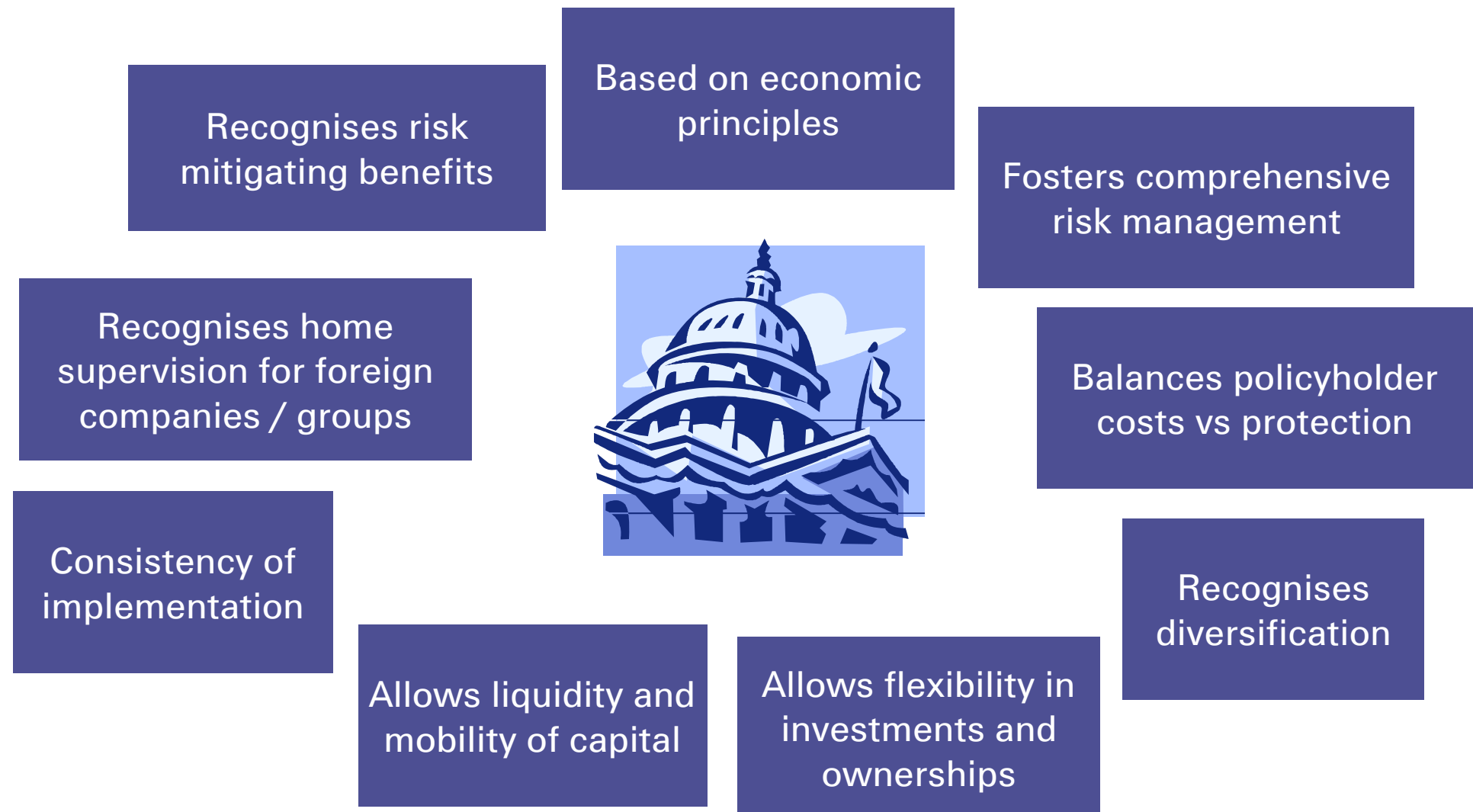


Implementation of new Regulation: Key Success Factors

- Risk culture: Willingness to know about risks and acceptance that strategy has to be aligned with the company's risk bearing capacity, engaged board of directors
- Open dialogue within the company (e.g. departments communicate well, in particular CRO, CFO, Actuary and CIO)
- Direct reporting line of the CRO to the CEO
- Integrity of responsible persons
- Risk management and capital management aligned
- Deep know-how of model experts, know-how and support of senior management and the board



Swiss Re's view of an Efficient Regulatory System





Questions ?

For further information
Giovanni_Gentile@swissre.com

www.swissre.com

