Malta Country Report
on the fifth Quantitative Impact Study (QIS5) for Solvency II

Malta Financial Services Authority
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Contents

1. Introduction

Solvency II, the new regulatory regime that shall apply from 2013 onwards, is a risk-based system, introducing a comprehensive risk management framework to establish required capital levels and to implement procedures to identify, measure, and manage risk levels. Under Solvency II, two levels of capital requirements are defined: the Minimum Capital Requirement (MCR) and the Solvency Capital Requirement (SCR). The SCR is the capital required to ensure that the (re)insurance undertaking will be able to meet its obligations over the next 12 months at the 99.5% VaR confidence level, while the MCR represents the minimum level of required capital, the breach of which, triggers supervisory action.

Apart from the possibility of calculating the SCR using the standard formula, Solvency II explicitly allows for the use of internal modelling (full or partial) for the calculation of capital requirements.

As part of the Solvency II project, the European Commission has requested that CEIOPS[1] run a number of large scale field-testing exercises, called Quantitative Impact Studies (QIS), to assess the practicability, implications and possible impact of the various approaches considered. Following months of discussions with Member States and stakeholders, the Commission issued a Call for Advice on 5 July 2010, asking CEIOPS to launch the fifth Quantitative Impact Study (QIS5) on Solvency II.

This study was conducted between August and November 2010 and was largely based on 2009 year end data[2]. It was mainly intended to test the calibration and potential quantitative impact of the proposals (including a number of alternative approaches), as well as the preparedness of the insurance market for Solvency II.

As reported by CEIOPS, QIS5 was probably the last fully comprehensive test to take place before the implementation of Solvency II. Additional testing to further improve the framework may take place through ad hoc work dealing with specific areas.

Operational arrangements to conduct QIS5 and gather results from insurance undertakings were made by national insurance supervisors separately in each Member State, supplemented by a centrally-coordinated collation of groups' results. Results collated at national level were then shared within CEIOPS (EIOPA), which published the QIS5 results on a European level on 14 March 2011. This report is available on EIOPA's website:

https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/QIS5_Report_Final.pdf

EEA undertakings were asked to provide results on a 'best efforts' basis within a relatively short timeframe, which may have resulted in the quality of data being at a level which did not always permit detailed analysis. This limitation should be kept in consideration when reviewing the conclusions drawn from this report.

[1] As of 1 January 2011, the European Insurance and Occupational Pensions Authority (EIOPA) replaces the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).

[2] Undertakings whose financial year end did not coincide with the calendar year end could report as per own financial year end.

This report sets out the results for the participating Maltese (MT) insurance undertakings, and aims to be objective. These results are therefore reflective of the participating undertakings and the quality of their submissions. Data at the aggregated EEA level, used for reference or comparison throughout this report, has been quoted from the European report published by EIOPA.

2. Participation, data collection and preparedness for Solvency II

2.1. Participation and Data Collection

The MFSA received 38 completed QIS5 submissions out of the 44 authorised insurance undertakings as at end of the year 2009, a participation rate of 86.4%.

All participants were classified as small insurance undertakings, with the exception of two undertakings that were classified as being medium. The criteria for classifying an undertaking as small were that gross written premiums do not exceed €100m in the case of non-life business and the gross technical provisions do not exceed €1,000m in the case of life business.

	Number SII affected	QIS5 participants	Of which		
			small	medium	large
Life	7	5	5	0	0
Non-life	22	19	18	1	0
Reinsurers	3	3	2	1	0
Captive	8	7	7	0	0
Composite	4	4	4	0	0
All	**44**	**38**	**36**	**2**	**0**
of which Health	*0*	*0*	*0*	*0*	*0*
of which Mutuals	*0*	*0*	*0*	*0*	*0*

The Maltese market participation in the QIS5 exercise was considerably higher than that for the previous QIS4 exercise, conducted in 2008. The market coverage in terms of gross premiums written was 99.1% for life business and 99.2% for non-life business (compared with 95% for life business and 53% for non-life business market coverages under the QIS4 exercise).

	QIS4	QIS5
Life	2	5
Non-life	9	19
Reinsurers	2	3
Captives	3	7
Composites[3]	-	4
All undertakings	**16**	**38**

[3] In the QIS4 Malta Country Report, this category was not used.

2.2. The appropriateness, completeness and accuracy of the QIS5 input data and results

In general, MT undertakings completed the entire QIS5 spreadsheet, with the CAT risk sub-module being the most notable risk sub-module that was either not completed or partially completed by a number of undertakings.

Overall, MT undertakings gave a good rating to the input data required in respect of the calculation of technical provisions, the valuation of assets and liabilities other than technical provisions, the calculation of the SCR standard formula Life underwriting risk and the calculation of own funds.

MT undertakings gave a marginally lower rating (though still close to a good rating) for the appropriateness, completeness and accuracy of the input data required for the calculation of the risk margin and in the calculation of the SCR standard formula.

In general, the quality of the input data (in terms of appropriateness, completeness and accuracy) for the respective calculations was perceived the highest by life undertakings, whereas captives gave the lowest rating to the quality of the input data.

An overall good rating was also given to the reliability of the results. In particular the higher ratings resulted for the valuation of assets and liabilities other than technical provisions, for SCR standard formula life underwriting risk and for own funds. The results relating to the risk margin were given the poorest rating.

Again, life MT undertakings rated the overall reliability of the results the highest, whilst captives rated the reliability of the results as the lowest.

2.3. Practical difficulties encountered when completing QIS5

The most important practical difficulties encountered by a number of MT undertakings related to the following:

- Generally and in particular for start-up companies, there was insufficient historical data available to calculate the technical provisions as per technical specifications for certain LoBs.

- The lack of in-house actuarial resources, which constrained the MT participants to make use of external resources for the determination of best estimate technical provisions and for assistance with the completion of the spreadsheet overall. This led to significant extra costs for such undertakings. This lack of actuarial expertise was most commonly reported by non-life undertakings.

- The QIS5 reporting template itself was considered to be too complex and not user-friendly. Certain undertakings, especially those participating in a QIS for the first time, were of the view that the reporting template was targeted at large and complex insurance undertakings rather than at relatively small and non-complex insurance undertakings.

- Other undertakings familiar with a QIS5 questionnaire encountered difficulties in understanding and interpreting the data input requirements within the SCR calculation tab, and in interpreting the results generated by the spreadsheet and the helper tabs, to ascertain whether they are sensible and proportionate.

- Difficulty in understanding contract boundary rules, especially for the life business.

- Calculation of the CAT risk capital requirements.

- Aligning the LoBs to those provided by CEIOPS.

2.4. Preparedness for Solvency II

As is also the case on an EEA level, nearly all MT undertakings specified that they do not currently have all the resources available and a specific implementation plan in place. However, most of these undertakings reported to have sufficient plans to be ready for Solvency II by the end of 2012.

A wide range of levels of overall preparedness in the Maltese industry for the upcoming Solvency II regime was observed, ranging from the well-prepared in terms of technical, organisational and other resources to the relatively unprepared, especially in terms of technical resources. Despite this fact, a noticeable step-up in the preparation pace was observed in the MT market when compared to the previous QIS4 exercise. It is expected that the less prepared undertakings, most of which did not take part in previous QIS exercises, will gear-up in their level of overall preparedness for the upcoming Solvency II regime. In doing so, the following measures were reported as the most fundamental measures that need to be taken:

- Producing and implementing detailed project/action plans based on the findings of QIS5 and the longer term strategy of the company.

- Aligning the undertaking's strategies and policies to meet the Solvency II requirements.

- Optimising usage of existing resources or, if insufficient, improving resources, to satisfy the requirements of the Solvency II implementation. Undertakings also consider engaging specialised external assistance.

- Conducting a gap analysis, especially with regards to Pillars 2 and 3.

- Understanding the Pillar 2 requirements taking into consideration the undertaking's nature, scale and complexity for proper implementation of the proportionality concept. Some MT undertakings commented that they are waiting for further guidance as how to implement the ORSA.

- Developing the risk identification process further for the implementation of an adequate risk management function under Pillar 2.

- Carrying out organisational and strategic changes to the company structure.

- Upgrading of IT systems to ensure data is captured in the required format and level of detail and appropriately categorised in the Solvency II LoBs.

- Ensuring appropriateness of data used for the calculation of best estimates.

- Further improving data collation methods and databases for further accuracy of results.

- Searching for alternative solutions/proxies where there is lack of historical data.

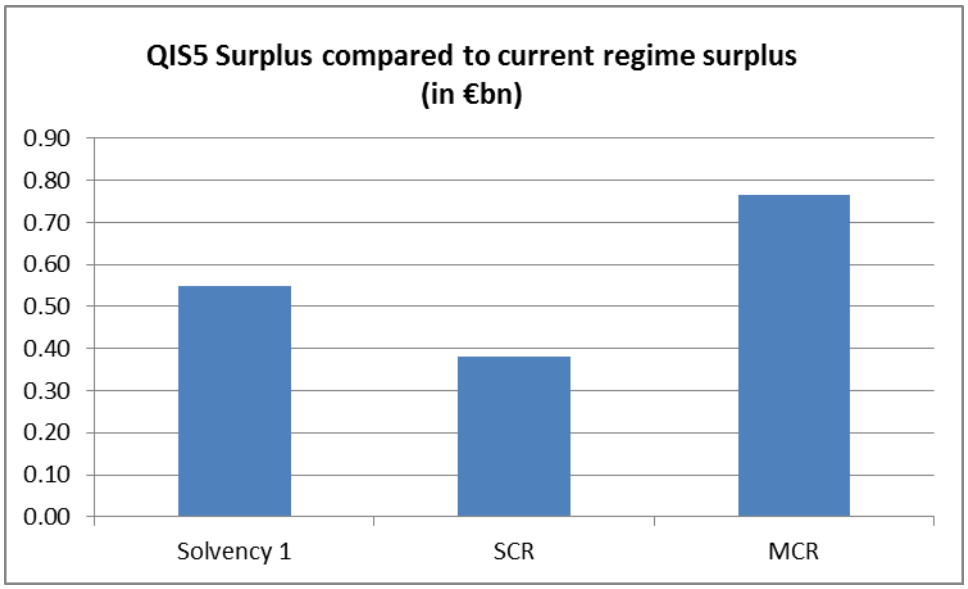
- Aligning own segmentation of LoBs with those prescribed by CEIOPS.

- Developing undertaking-specific models which will allow projection of future SCRs, and the development of stochastic modelling capabilities for specific LoBs.

3. Overall Financial Impact

3.1. Overall Surplus

The following graph illustrates the overall quantitative effect on the financial surplus for the MT insurance industry from the current Solvency I principles to the two Solvency II capital thresholds as specified under QIS5 valuation principles, namely the SCR and the MCR.



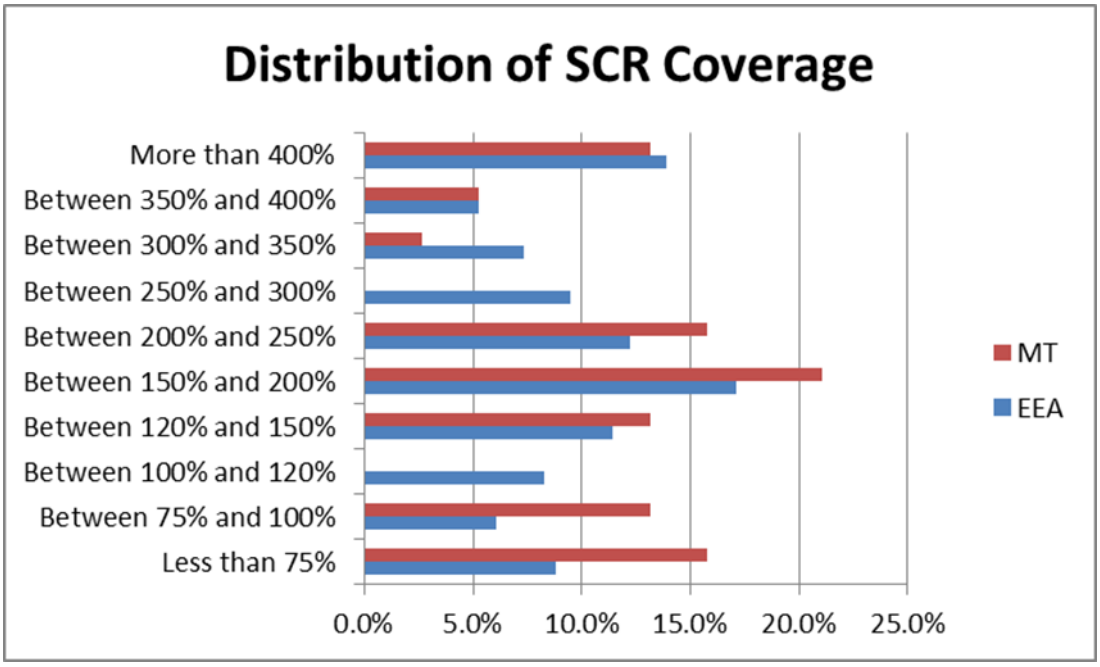
The financial surplus for the MT insurance industry under the current Solvency I valuation principles stood at €0.55bn. The surplus over the SCR under the QIS5 valuation basis amounted to €0.38bn, a drop of 31% from the Solvency I valuation principles. The surplus over the MCR stood at €0.77bn and therefore, at MT market level, the MCR margin may be seen to be almost twice as wide as the SCR margin. This is in line with the surplus distribution on an EEA level, whereby the SCR surplus dropped by more than 25% from the current Solvency I to QIS5 valuation principles and the MCR margin also resulted to be twice as wide as that in relation to the SCR.

The following table displays the solvency ratios, the solvency surplus, the capital requirements and the eligible capital for the overall MT industry under both regimes.

	MT			EEA		
	Current Regime	Solvency II		Current Regime	Solvency II	
		SCR	MCR		SCR	MCR
Solvency ratio	308%	158%	420%	310%	165%	466%
Surplus	0.55	0.38	0.77	476	355	676
Capital Requirements	0.26	0.66	0.24	227	547	185
Eligible own funds	0.81	1.04	1.00	703	902	861

3.2. SCR Coverage

The distribution of the undertakings by SCR solvency ratio coverage based on QIS5 valuation principles is illustrated in the following graph:

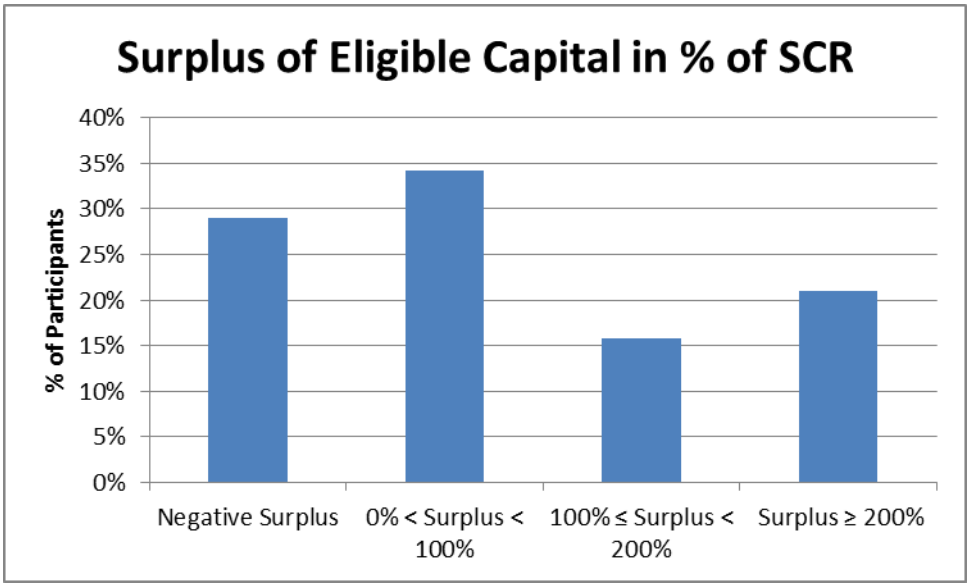


At MT level, around 21% of the participating undertakings had an SCR coverage within the interval 150%-200%, which is the interval that includes the MT overall market average of 158%. Around 37% of the MT market held more than twice their capital requirements, whilst this percentage was slightly less than 50% on an EEA basis.

Eleven of the MT undertakings obtained a solvency ratio of less than 100%, with two of these just under the threshold, with a cover of 0.90 and 0.97. Six undertakings had a solvency ratio that was under 0.75.

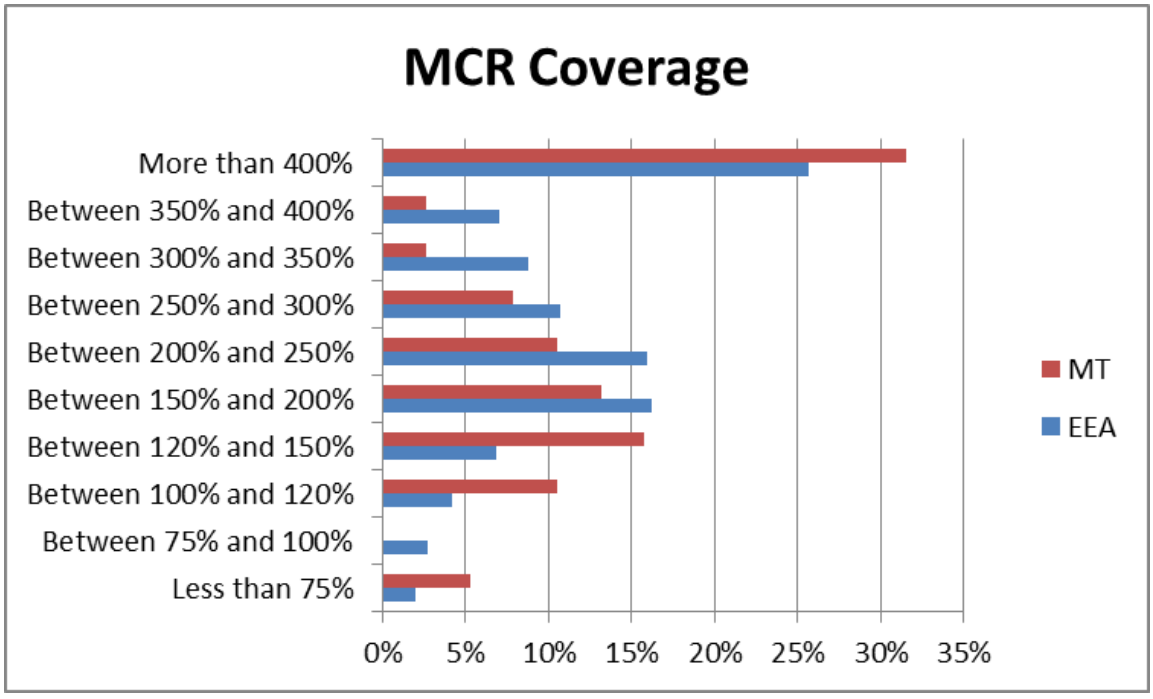
The relative size of the SCR compared to the current Solvency I capital requirement for MT undertaking amounted to 266% against an EEA average level of 211%.

The graph overleaf considers the surplus of eligible own funds over the SCR for all MT undertakings. Whilst approximately 85% of the EEA undertakings meet their SCR, this percentage stands at 71% on an MT level. Around 21% of the MT undertakings have sufficient eligible own funds to cover their SCR at least twice over.



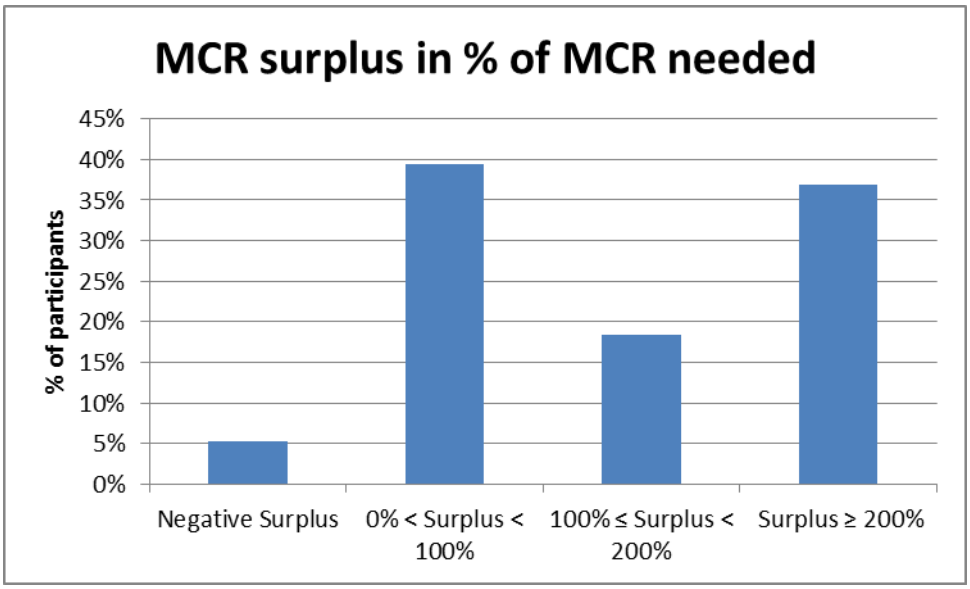
3.3. MCR Coverage

Two MT undertakings were unable to meet the MCR requirement, and this compares well with the 5% that did not meet the MCR on an EEA level. The distribution of the undertakings by MCR coverage based on QIS5 valuation principles is illustrated in the following graph:



While on an EEA level, 68% of undertakings can cover more than twice their MCR, this percentage stands at 55% for MT. Also, whilst 9% of all EEA QIS5 participants display an MCR coverage ratio under 120%, this percentage stands at 16% on an MT level.

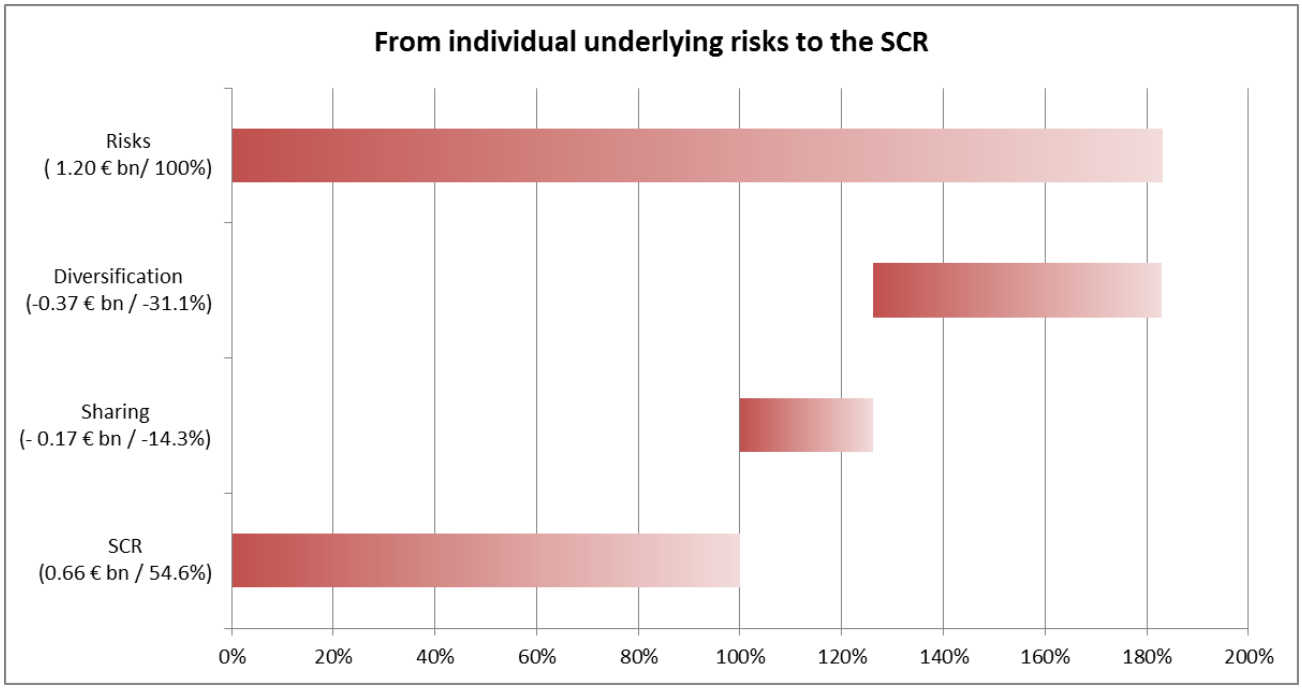
The distribution of the MT undertakings by the MCR surplus in proportion to the final MCR taken was as follows:



Around 37% of the MT undertakings have enough eligible own funds to cover their MCR at least twice over.

3.4. Impact of Diversification

In order to deduce the final SCR, the Solvency II standard formula adopts the so-called modular bottom-up approach, whereby the Solvency II SCR is calculated by deducting the diversification effects corresponding to each underlying risk, which takes into account the fact that not all risks are expected to crystallise at the same time, and also the adjustment for the loss absorbency of technical provisions and for the effect of deferred taxes, from the sum of each individual risk. Based on QIS5 valuation principles, the MT aggregate risk charge incurred amounted to over €1bn. Since the MT undertakings benefitted from around €0.4bn in respect of diversification effects, the sum of the individual risks was reduced by this amount. Furthermore, the overall MT risk charge was reduced by another €0.17bn, given the fact that if the risks were to materialise, part of the cost would be shared with the policyholders and tax authorities.



3.5. The quantitative impact on the overall financial position

The table below summarizes the total eligible capital, total required capital, total solvency surplus and the respective solvency ratios by type of undertaking.

Type of Business	Solvency I Basis				QIS 5 Valuation Basis			
	Eligible Capital	Required Capital	Solvency Surplus	Solvency Ratio	Eligible Capital	Required Capital	Solvency Surplus	Solvency Ratio
Overall	**974,975**	**246,933**	**728,041**	**3.95**	**1,037,648**	**657,507**	**380,142**	**1.58**
Non-Life	287,810	86,797	201,013	3.32	293,759	169,129	124,630	1.74
Life	134,807	61,170	73,637	2.20	167,053	52,322	114,731	3.19
Reinsurers	290,333	37,973	252,360	7.65	318,545	229,446	89,099	1.39
Composites	50,154	29,096	21,057	1.72	77,549	37,513	40,037	2.07
Captives	211,871	31,897	179,974	6.64	180,742	169,097	11,645	1.07

3.5.1. Overall Impact

The overall solvency surplus on a QIS5 valuation basis has decreased from the current basis by more than 47%, the reason being that the required capital increased by 166% from the current basis whilst the eligible capital increased by only 6% from the current basis. As a result, the solvency ratio was more than halved from the current basis (decreased by 60%). The biggest drop was experienced by captives and reinsurers (decrease of 84% and 82% respectively).

3.5.2. Impact on Life MT undertakings

In the case of Life undertakings, the solvency surplus increased by 56%, and is attributed to the fact that while the required capital decreased, the eligible capital increased. The main reason for the increase in the eligible capital was due to lower technical provisions. Consequently, the solvency cover increased from 220% in the current basis to a ratio of 319% under the QIS5 valuation basis.

3.5.3. Impact on Non-life MT undertakings

The solvency surplus was seen to decrease by 38% for the non-life industry, which is due to the required capital almost doubling (increase of 95%) from the current basis to QIS5 solvency basis and the available capital slightly increased by around 2% from the current basis. Therefore the solvency ratio was almost halved (the cover decreased by 48%), from a cover of 332% on the current basis to 174% on a QIS5 valuation basis.

3.5.4. Impact on composite MT undertakings

In the case of composite undertakings, the required capital increased by only 29% whilst the eligible capital increased by 55%. This led to an increase in the solvency surplus (increased by 90%) and to a 20% increase in the solvency cover, from current basis to QIS5 valuation basis.

3.5.5. Impact on MT reinsurance undertakings and captives

Reinsurance undertakings experienced a considerable reduction (65%) in their solvency surplus, whilst for captives the solvency surplus decreased by 94% from the current basis to QIS5 valuation basis. This drop in the solvency surplus is a result of a marked increase in the required capital for both reinsurers and captives (with an increase of 504% and 430% respectively, from the current basis), whilst the available capital was seen to vary only minimally between the current and QIS5 valuation bases (reinsurers experienced a slight increase of 10% from current basis, whilst for captives this decreased by almost 15%). Consequently, the solvency ratio decreased for both reinsurers and captives, by 82% and 84% respectively.

4. Valuation of assets and liabilities other than technical provisions

With regards to the QIS5 valuation of assets and liabilities other than technical provisions, undertakings gave a good rating to the appropriateness, completeness and accuracy of the input data as well as to the reliability of the valuation results. This was particularly due to the similarity of the valuation requirements with the EU-endorsed international accounting standards (IFRS), which the local insurance industry is familiar with.

Overall, the change in the valuation principles did not have any major impacts on the composition of the aggregated MT balance sheet. The liabilities of MT undertakings were more impacted, as was the case on an EEA level.

4.1. Impact of valuation change on assets

The following table shows the structure of the balance sheet assets under the two valuation principles.

	Current MT Asset Structure	QIS5 MT Asset Structure
	% of Total Assets	% of Total Assets
Total Assets	**€3.8bn**	**€3.6bn**
Unit linked	5.4%	5.7%
Corporate bonds	4.9%	8.5%
Sovereign	23.2%	20.9%
Equity	4.9%	4.5%
Mortgage	1.5%	1.6%
Property	2.8%	3.0%
Cash	19.1%	20.1%
Reinsurance	9.3%	8.2%
Investment funds	6.1%	6.5%
Deferred tax assets	0.2%	0.2%
Goodwill	0.0%	-
Other	22.6%	20.8%

As is also the case on an EEA level, investment assets, which make up more than 43% of the total QIS5 MT assets, form the largest component on the asset side of the balance sheet.

The structure of the total assets for MT was not significantly affected by the change in the valuation principles. In fact, sovereign bonds, cash deposits to cedants, cash and cash equivalents, short-term bank deposits and 'other assets' make up more than 61% of the MT asset structure under both valuation bases. The 'other assets' component include 'other intangibles', derivatives, long-term deposits, 'other investments', insurance and intermediaries' recoverables, deferred acquisition costs, trade receivables, amounts due to called but unpaid capital, and 'other assets' not elsewhere shown on the balance sheet.

Whilst on an aggregated EEA level, the total assets dropped by a marginal percentage of 0.33% (from €7,457bn under the current basis to €7,432bn under QIS5 valuation principles), the MT total assets dropped by 5% (from €3.8bn under Solvency I basis to €3.6bn under QIS5 valuation principles).

The most significant changes in the MT asset structure between the two valuation principles, may be observed for corporate bonds and cash-related assets (including cash deposits to cedants, cash and cash equivalents and short-term bank deposits), both of which make an increased proportion of the total assets under QIS5 valuation basis. Sovereign bonds, 'other assets' and reinsurance recoverables make up a smaller portion of the QIS5 balance sheet as compared to that under the current basis.

On an EEA level, the most significant changes in the asset structure between the two regimes were reported for unit-linked assets and sovereign bonds under QIS5 valuation, whereby their share in proportion to the total QIS5 assets has increased from that under the current balance sheet. For investment funds, reinsurance recoverables and 'other assets', the share in proportion to the total QIS5 assets has decreased from that under the current balance sheet.

4.2. Impact of valuation change on Liabilities

The following table shows the distribution of the balance sheet liabilities under both valuation principles.

	Current MT Liability Structure	QIS5 MT Liability Structure
	% of Total Liabilities	% of Total Liabilities
Total Liabilities	**€2.7bn**	**€2.5bn**
Non-Life TP	29.2%	28.1%
Health TP	1.6%	1.4%
Life TP	49.1%	41.4%
Unit-linked TP	7.7%	7.7%
Risk margin	-	8.3%
Short term liabilities	4.5%	4.3%
Deferred tax liabilities	1.1%	1.5%
Others	6.9%	7.4%

Liabilities under the QIS5 valuation basis decreased by 7%, from €2.7bn under the current Solvency I basis to €2.5bn under the QIS5 valuation basis. As is also the case on an EEA level, this drop is mainly attributed to a decrease in technical provisions, where technical provisions make up more than 87% of the MT current balance sheet and more than 78% of the MT QIS5 balance sheet.

The most notable changes in the liabilities structure of the QIS5 balance sheet include an increase in the proportion of 'other liabilities' and deferred tax liabilities under QIS5 balance sheet and a decrease in the share of technical provisions, especially within the life business.

'Other liabilities' as defined in the above table include derivatives, provisions other than technical provisions, amounts owed to credit institutions, financial liabilities other than amounts owed to credit institutions, pension benefit obligations, contingent liabilities, and 'any other liabilities excluding subordinated liabilities' not shown elsewhere in the balance sheet.

4.3. Impact of valuation change on Basic Own Funds (BOFs)

As is also the case on an EEA level, the BOFs for the MT industry increased marginally by less than 1% from the current valuation basis to the QIS5 valuation principles. The total BOF items for MT totalled to just over €1bn under both regimes. As is evident from the table below, more than 70% of the BOF items relate to ordinary share capital (net of own shares).

The most significant changes in the QIS5 basic own fund structure may be observed for 'other reserves' which decreased significantly from the current balance sheet. The proportion of ordinary share capital make a larger share of the QIS5 balance sheet than the current Solvency I balance sheet.

The following table shows the distribution of the BOFs under both valuation principles.

	Current MT BOF Structure	QIS5 MT BOF Structure
	% of Total BOF	% of Total BOF
Total BOF	**€1.08bn**	**€1.09bn**
Shares and equivalent	74.6%	79.3%
Share premium account	8.5%	8.5%
Retained earnings	9.6%	9.5%
Asset adjustments	-	-19.7%
Liabilities adjustment	-	-1.2%
EPIFP	-	21.6%
Other reserves	6.8%	3.5%
Subordinated liabilities	0.4%	0.4%
Others	0.1%	-1.8%

The component 'others' in the above table includes adjustments to other liabilities, other adjustments and other items not specified elsewhere in the balance sheet.

5. Technical Provisions

Twelve out of 38 MT undertakings reported that they are fully prepared with respect to the calculation of technical provisions (TP), having all data available and no problems with methodologies. The remaining undertakings (70%) all claimed that they either have problems with data or with methodologies.

With regards to the undertakings' own assessment of the QIS5 methodology, undertakings ranked as good the QIS5 implementation of the calculation of technical provisions to be a market-consistent assessment of the value of liabilities of the undertaking.

The most important difficulties reported by the industry in applying the QIS5 valuation principles regarding TP were:

- Lack of in-house actuarial knowledge
- Risk margin calculation
- Separation over LoBs.

The most important points of discrepancy related to the use of the illiquidity premium and the concept of contract boundaries.

The Chain Ladder Method and the Bornhuetter-Ferguson Methods were the most commonly used methods in the calculation of the non-life best estimates, while Life TP were generally calculated using the probability-weighted discounted cash flow approach.

The main material problems encountered in segmenting LoBs were related to (1) disability and morbidity business split into Life and Health NSLT, (2) personal accident LoB, which had to be classified under health category and (3) historical motor data split between Motor Liability and Motor Other. Difficulties were also reported in respect of the risk margin, where the related segmentation over the different LoBs also proved to be difficult. Also for reinsurers, business assumed on a non-proportional basis that could be ceded as proportional business, created a mismatch between gross and net TP.

Only a small number of undertakings reported problems in the consideration of taxes in calculating TP.

Undertakings believe that the Solvency II rules for calculating TP will require changes to their current reserving process, data gathering, reinsurance arrangements and level of prudency applied. These, in turn, will have an impact on the possible release of reserves, on how reinsurance purchase is structured and its payment patterns.

As expected, the most significant impact of the allowance of future premiums in TP was experienced in the calculation of life TP, particularly in the "other life insurance and other disability/morbidity" LoB. In the non-life TP, the LoB most significantly impacted was "legal expense" insurance, with the least impacted LoB being "fire and other damage to property" insurance.

Seventy five percent of the respondents agree with the current definition of a boundary of an existing (re)insurance contract while the rest commented that a revised definition could be more appropriate.

The main methods used to calculate the best estimate of non-life premium provisions were related to actuarial techniques that take into account historic data consisting of premiums and claims payment/outstanding patterns both on a gross and net basis, claims handling expenses, administrative expenses and numbers of policies/claims per line of business. Such data was used to compute the best estimate liability and risk margins. Other undertakings with very small portfolios within a particular LoB, calculated their provisions on a policy-by-policy basis while those engaged in very short-tail business assumed their current level of provisions to reflect best estimates. A number of undertakings plan to enhance the methods used to calculate the best estimate of non-life premium provision.

Overall MT undertakings believe that the assumptions/methods used for the calculation of non-life TP are reliable, not complex and provide satisfactory outputs. Also, undertakings made average usage of expert judgment for almost all assumptions/methods.

With regards to the calculation of life TP, overall, undertakings believe that the assumptions/methods used are of limited reliability but provide satisfactory outputs. Also, in relation to the significance of the use of expert judgement, most of the undertakings reported this as immaterial. The complexity required for biometric assumptions, expense assumptions and inflation or revision rates of benefits is perceived to be low, while assumptions on CAT claims, assumptions on the exercise rate of policyholder options, and assumptions on future discretionary benefits and management actions require a significant level of complexity to compute. Equal use of internal and external data was made for different assumptions and methods.

With regards to reinsurance recoverables in the calculation of TP, most of the undertakings believe that the methodology used provides satisfactory outputs for cash outflows projections, cash inflows projections due to claims recovered, other cash inflows and allowance for CAT claims. In contrast, the methodology used to determine the values for probability of default of reinsurer, loss given default of reinsurer and the adjustment due to expected default, is equally divided between satisfactory outputs and open to challenge.

Calculations of cash outflow projections, other cash inflows, and probability of default of reinsurer were reported to be of low complexity by most undertakings, while adjustment due to expected default and allowance for CAT claims was considered to be of medium complexity.

Complexity of cash inflows projections due to claims recovered and loss given default of reinsurer was equally distributed between low and medium.

Most of the MT undertakings believe that all assumptions used to calculate the TP with respect to reinsurance recoverables are of normal reliability.

The use of expert judgement in the valuation of reinsurance recoverables was not material. In this respect, most of undertakings made use of internal data. Most of the undertakings have records of data ranging between 3 to 10 years for non-life, life TP and TP with respect to reinsurance recoverables.

Two undertakings reported negative best estimates. With respect to the valuation of the risk margin, the most commonly used method was the fixed percentage of the best estimate. Most of the undertakings that applied this method did so due to lack of time and expertise resources rather than due to the appropriate application of the proportionality principle.

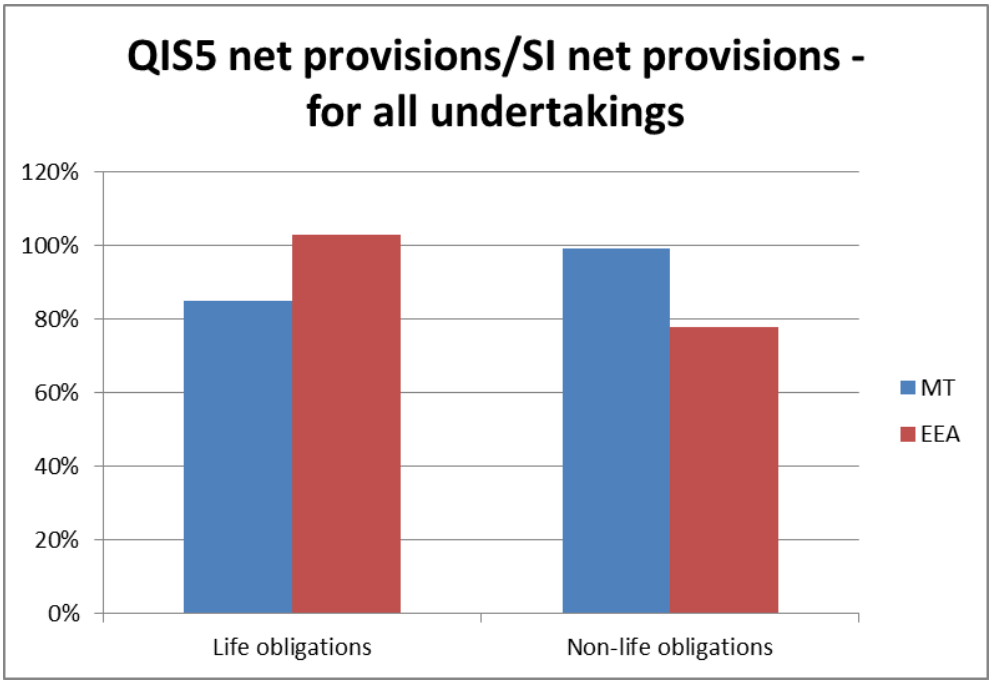
Out of 29 replies, 15 MT undertakings did not feel that the QIS5 specifications on the application of 'proportionality principle' with respect to the calculation of the technical provisions were sufficiently clear; 9 undertakings believed that the 'principle of proportionality' definition was generally quite clear. Certain undertakings were of the opinion that this principle should be further simplified in the technical specifications so that the proportionality was further widened.

The simplification which was most commonly used by MT undertakings was the method based on pro-rata of premiums in the calculation of the non-life premium provision. The two simplifications that were not used were 'Life insurance - Biometric risk factors' and 'Life insurance - Future discretionary benefits'.

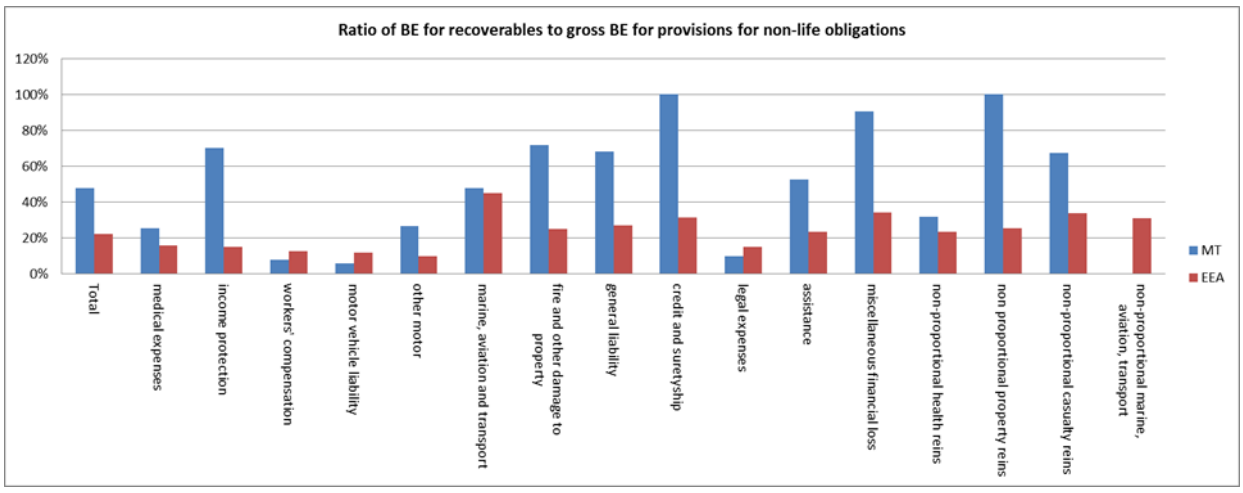
5.1. Comparison with the current regime

For life insurance business carried out by MT undertakings, net technical provisions in QIS5 decreased in comparison with Solvency I; the ratio of QIS5 net provisions to Solvency I net provisions stood at 85%. The difference is mainly explained by: (1) the use of a new discounting model including the use of an illiquidity premium, (2) the use of realistic assumptions in the best estimate calculation, and (3) the recognition of future premiums and charges. The EEA average for this ratio is 103%, the slight increase in net technical provisions being the result of an observed decrease in reinsurance recoverable.

For a considerable number of MT undertakings writing non-life business, net technical provisions decreased between Solvency I and QIS5. However the overall non-life insurance net technical provisions for all participating MT undertakings resulted in the same levels for Solvency I and QIS5, due to some undertakings reporting significant increases in provisions under the QIS5 valuation which offset the decreases reported by most of the other undertakings. The reasons for a resulting decrease in provisions were the effects of discounting future cashflows and more relaxed assumptions in the valuation basis (best estimate instead of prudent); undertakings reporting increases were those that did not take into account discounting or calculated the risk margin over the current prudently-valued provisions. Some undertakings also reported the decrease in reinsurance recoverables as being more than the decrease in gross TPs.



The proportion of the gross best estimate for non-life provisions that is recovered is markedly higher for MT undertakings than the EEA average. 48% of the total gross best estimate for non-life provisions is represented by the best estimate for recoverables against the EEA average of 22%. However, in the case of life business, only 7% of the total gross best estimate for provisions is represented by the best estimate for recoverables against the EEA average of 12%.

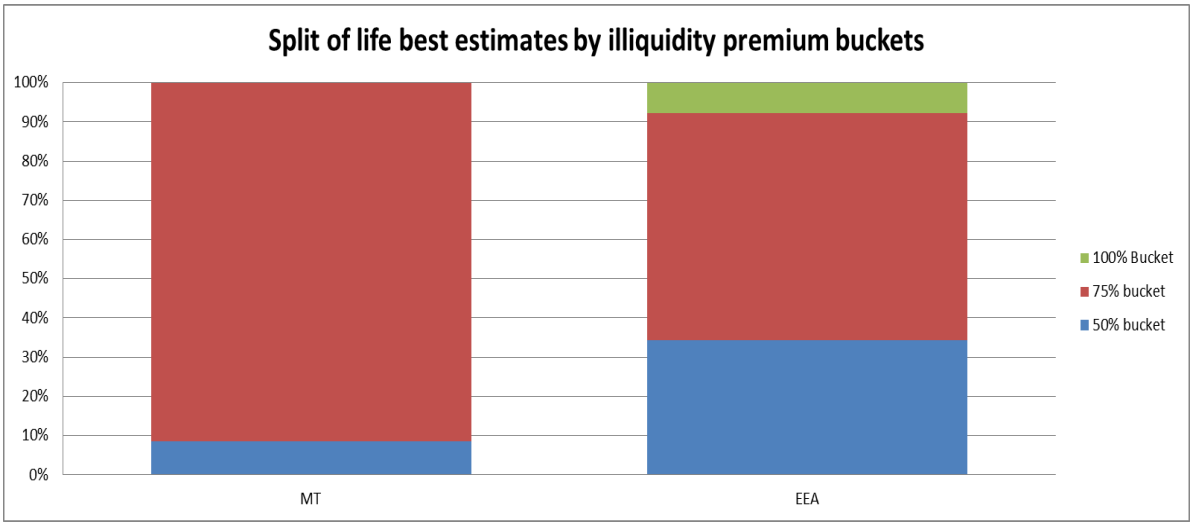


5.2. Discount rate and illiquidity premium

There were no life undertakings that reported applying the 100% illiquidity premium bucket to discount its future cashflows. 91% of the life liabilities were discounted with the risk-free interest

rate term structures that included the 75% illiquidity premium, while the 50% illiquidity premium bucket was applied to the remaining 9%.

The most common life products to which the 75% illiquidity premium bucket was applied were with profit participation in general and pure savings products. The 50% illiquidity premium bucket was applied to unit and index-linked business, without profit participation and SLT health. Non-life business in general, non-SLT health and reinsurance all applied the 50% illiquidity premium bucket.



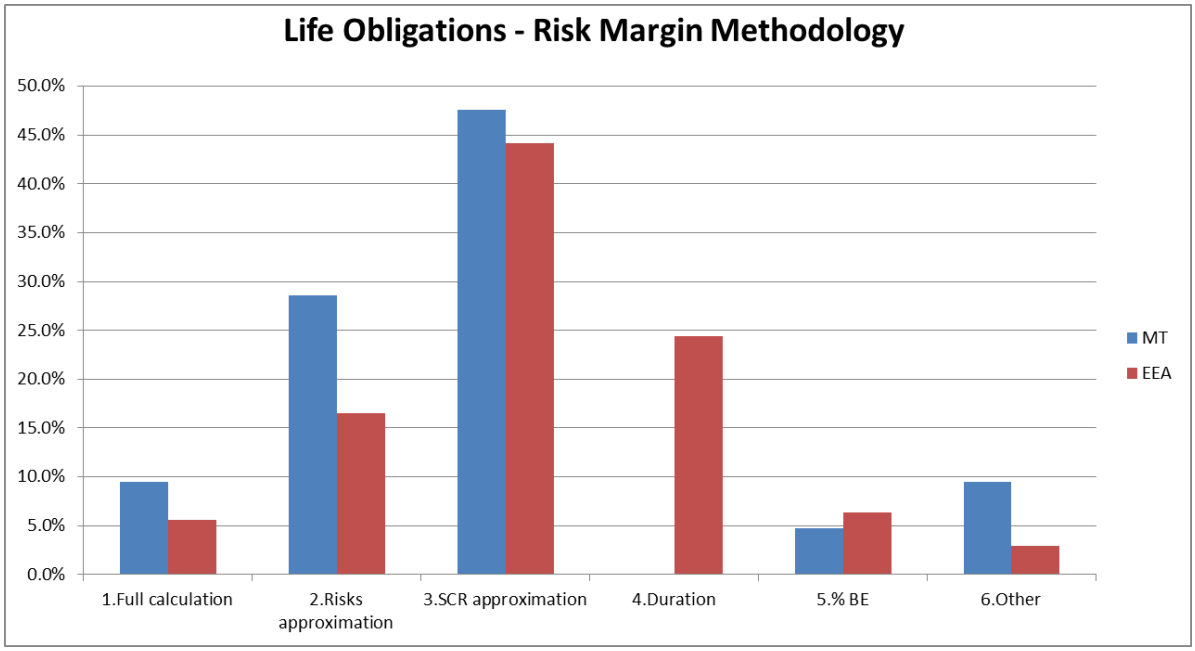
5.3. Risk margin

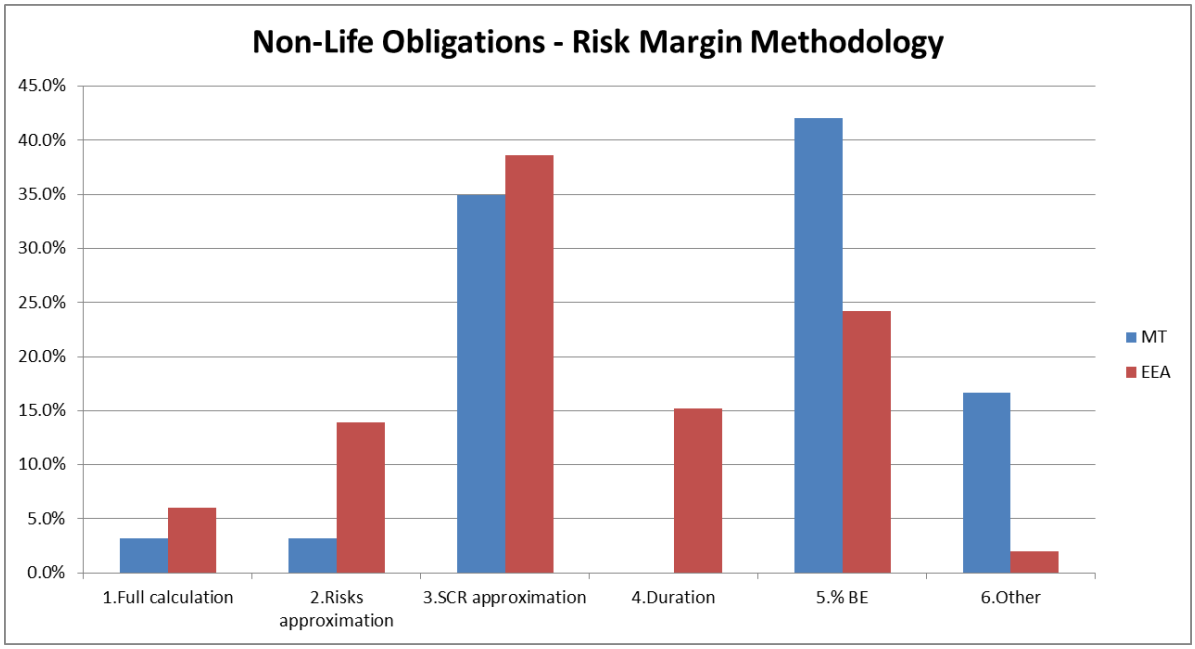
The QIS5 technical specifications provided a choice of methods (hierarchy of simplifications) for the calculation of the risk margin for non-hedgeable insurance obligations. The most commonly used technique for the valuation of the risk margin in life obligations was the SCR approximation (48% of cases), with the full calculation of all future SCRs without using simplifications only being applied in 9% of the times.

In the case of non-life obligations, undertakings largely used the simplest methodology for the calculation of the risk margin, with 42% of the cases using the percentage of the best estimate approximation. The full calculation was only used in 3% of the cases.

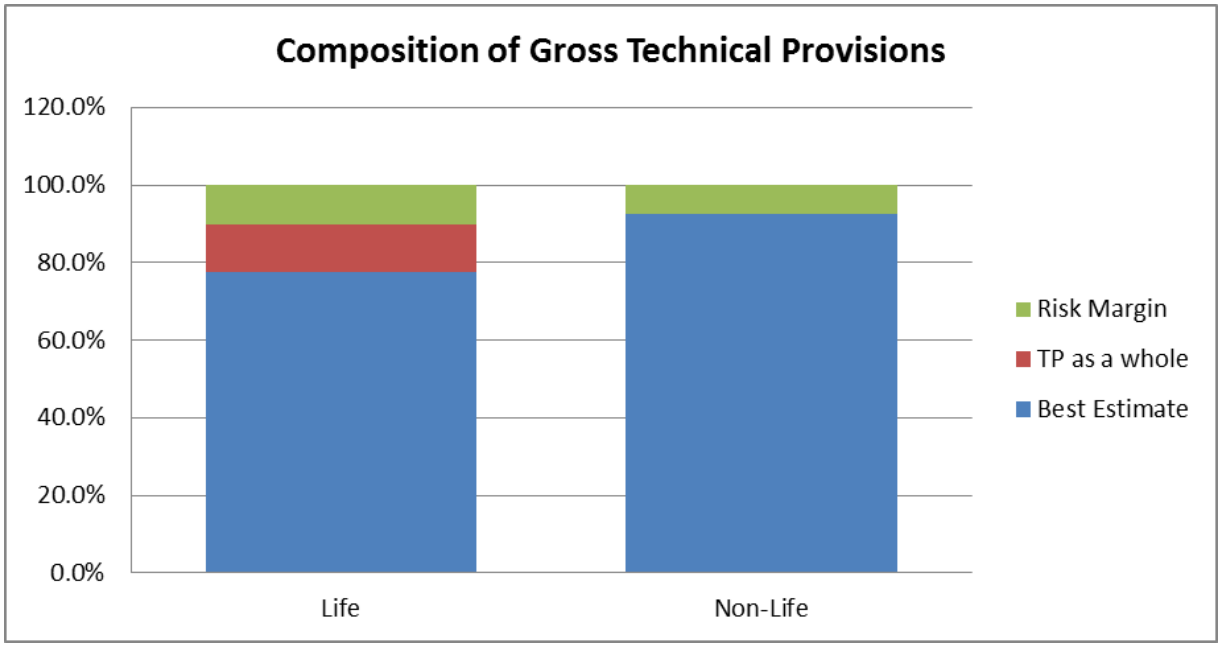
No undertaking used the duration approach to calculate the risk margin in either life or non-life obligations as opposed to 24% and 15% EEA averages in life and non-life respectively.

The results outlined above are illustrated in the following graphs, shown overleaf.

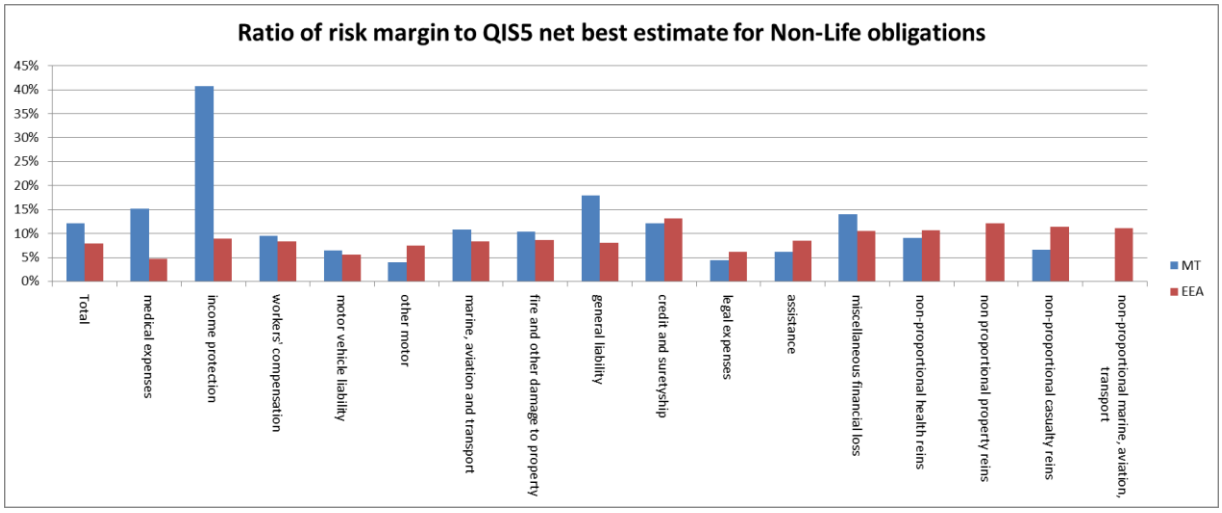




As can be seen from the following graph, the proportion of hedgeable technical provisions, and hence calculated as a whole, of the total QIS5 gross provisions is nil in non-life, whereas the proportion amounts to 12% of the total life gross insurance obligations. The best estimate provisions make up 78% and 93% of the gross life and non-life technical provisions respectively.



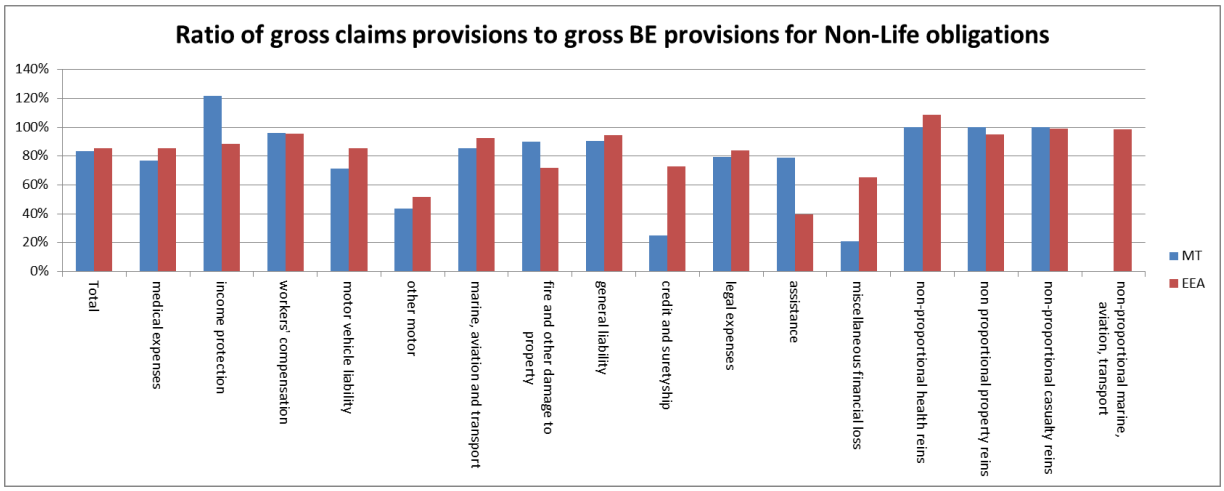
In the above graph, the non-life risk margin amounts to 7.3% of the gross technical provisions. Taken as a ratio of the QIS5 net best estimate provisions, the non-life risk margin amounts to 12.1% of the net best estimate. The equivalent average EEA percentage of net best estimate is equal to 7.8%. The graph below provides a comparison between MT and EEA in respect of the ratio of risk margin to the QIS5 net best estimate for the non-life obligations, split by LoBs.

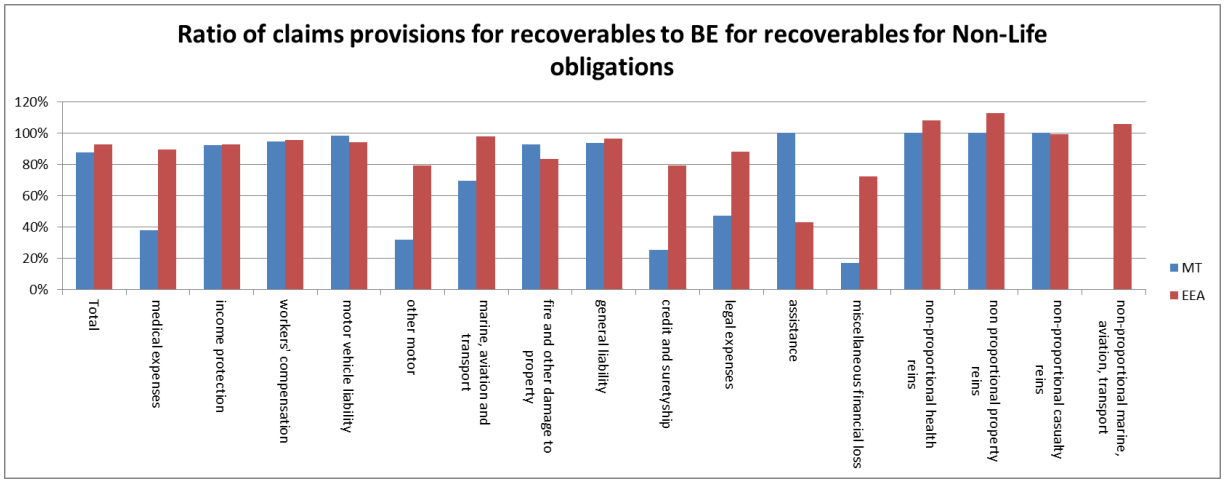


5.4. Claims provisions

Undertakings generally used the chain-ladder or the Bornhuetter-Ferguson methodologies to determine the best estimate of claims provisions.

The ratio of gross claims provision to the gross best estimate provision stood at 84% (average EEA ratio was 85%). 88% of the total best estimate recoverables are made up of claims recoverables, against the EEA average ratio of 93%. The graphs below illustrate the ratios of: (1) gross claims provisions to BE provisions and (2) claims provisions for recoverables to BE for recoverables for non-life obligations, split by LoBs.





6. SCR – Standard formula

6.1. The Overall SCR

The Solvency Capital Requirement (SCR) is the risk-based capital requirement for undertakings under Solvency II. It is calibrated to the 99.5% VaR confidence level over one year. The SCR is composed of a number of modules which, in turn, are composed of sub-modules. The capital requirements arising from these sub-modules and modules are aggregated through correlation matrices.

In the calculation of the SCR, 75% of the undertakings either had problems with data or problems with methodologies, with the remainder stating that they are fully prepared.

With regards to the undertakings' own assessment of the QIS5 methodology, the implementation of the standard formula was reported to be only a fair reflection of their own solvency and risk position. Similarly, the standard formula's correlation matrices, segmentation, design and calibration were ranked as fairly appropriate for the measurement of their own solvency and risk position.

Also, some undertakings believe that, in general, the methodology appears to address all their risk exposures, but commented that the broad risk factors contained in the spreadsheet may lead to significant overstatement of risk/lack of proportionality, leading to an overstatement of the SCR, especially for simple undertakings that have a number of risk mitigation factors in place.

The complexity of the spreadsheet could give rise to significant error and overstatement of the capital requirement. For example, some MT undertakings believe that they are being penalized for property investments, as there is a capital allocation under both property and concentration within the market risk module.

Certain undertakings encountered several problems in segmenting data into the required levels and classes of business since data was in some cases not maintained internally in line with QIS5 LoBs. Thus certain data was not readily available and was collated for the first time for QIS5. For example, splitting motor data between 'Motor Vehicle Liability' and 'Motor, Other Classes' and the classification of disability/morbidity business into SCR-Life and SCR-Health proved to be ambiguous for a few undertakings, and commented that they require further clarification on the split between LoBs. Other undertakings had problems to collate data for the counterparty risk module.

In general, certain undertakings felt that allowing for new business was difficult in all modules whilst others felt that the equivalent scenario and the modular approach methods require further explanations.

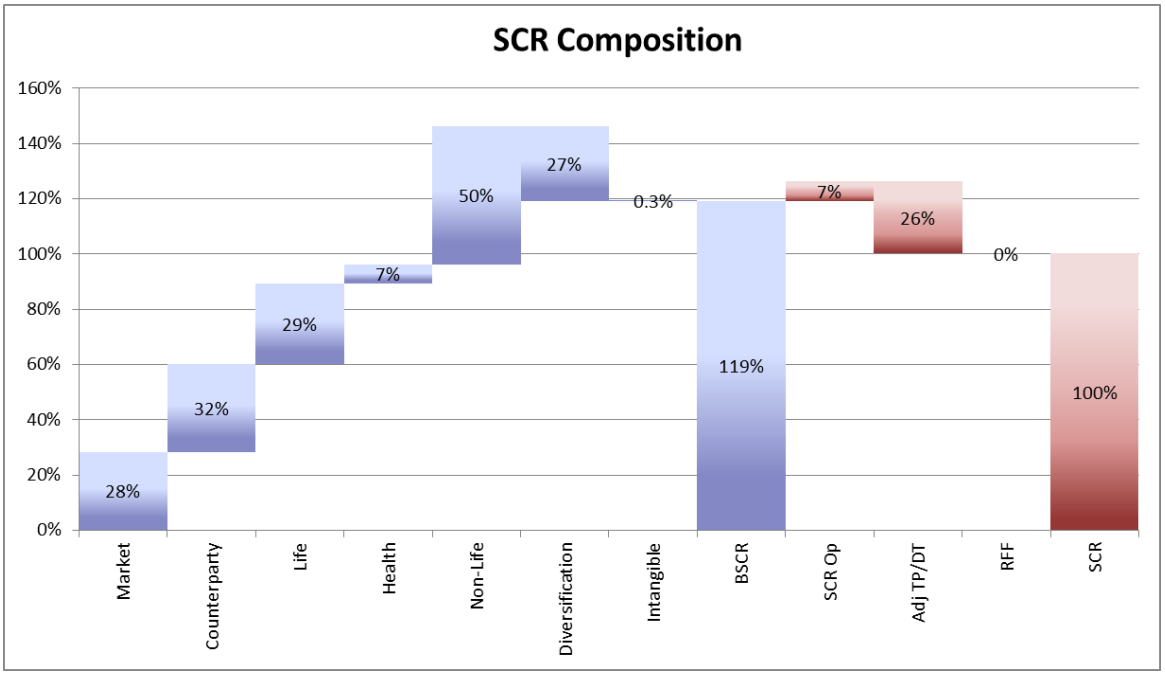
In the calculation of the various different man-made catastrophe scenarios, undertakings encountered difficulties relating to the lack of information/data availability and in modelling these scenarios accurately.

In the counterparty default risk module, the most common Type I exposures were reinsurance recoverables, cash at bank and deposits with banks and credit institutions, whilst the most common

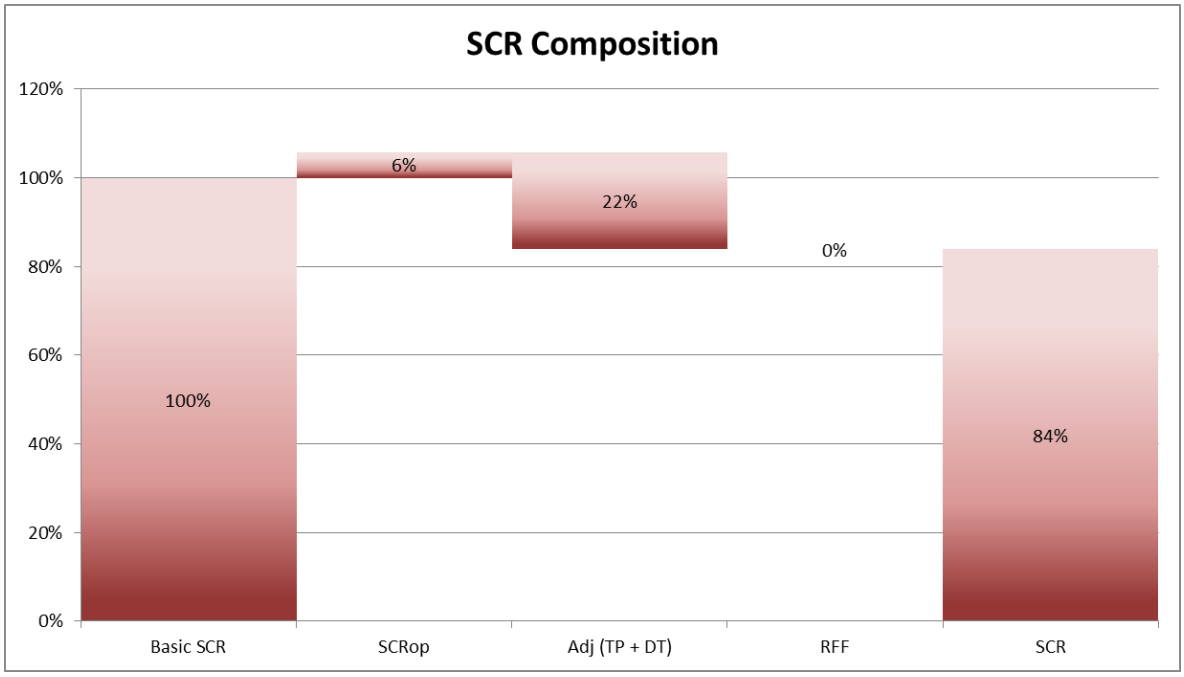
Type II exposures were insurance receivables/recoverables which were due for less than 3 months, and premium receivable from intermediaries and policyholders.

6.2. Composition of the SCR

The composition of the SCR for MT undertakings is shown in the following chart:



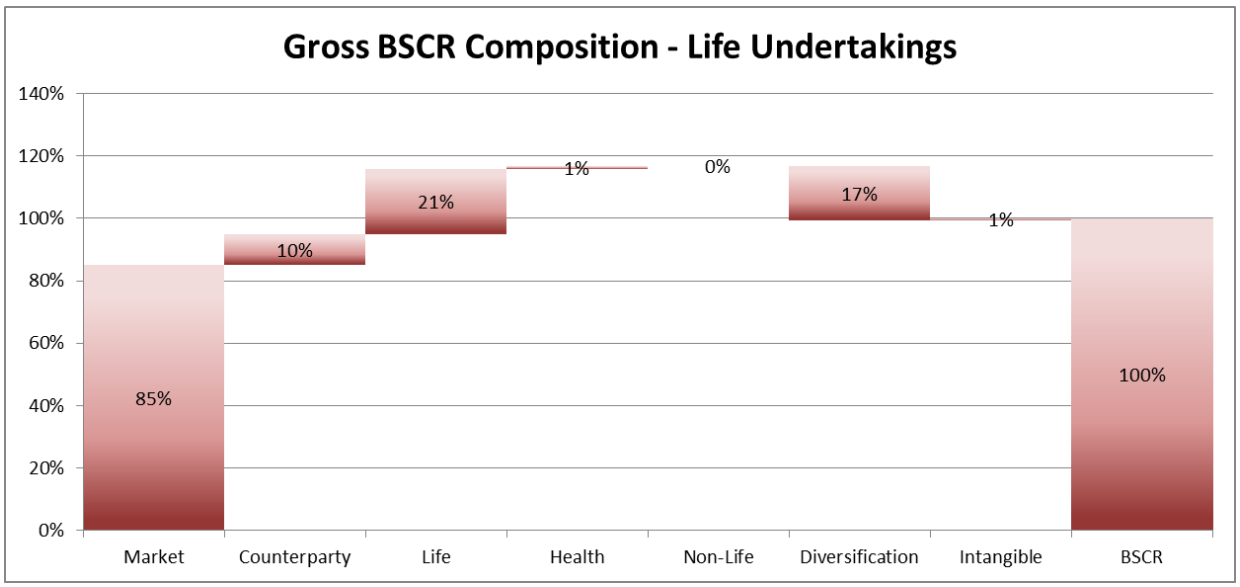
Before allowing for diversification, the non-life underwriting risk amounted to 50% of the SCR, followed by counterparty default risk which constitutes 32% of the SCR. Health underwriting risk and intangible asset risk are the smallest risks, comprising only 7% and 0.3% of the SCR respectively. The distribution of the risks for Malta differs from the average distribution of EEA, for which market risk makes up the largest component of the SCR while counterparty default risk is one of the smallest. Diversification amongst the BSCR components amounted to 27% for MT undertakings, and the BSCR resulted in being 1.2 times greater than the SCR. As shown in the graph below, following a downward adjustment of 22% and an additional charge for operational risk, the SCR attained was 84% of the BSCR.



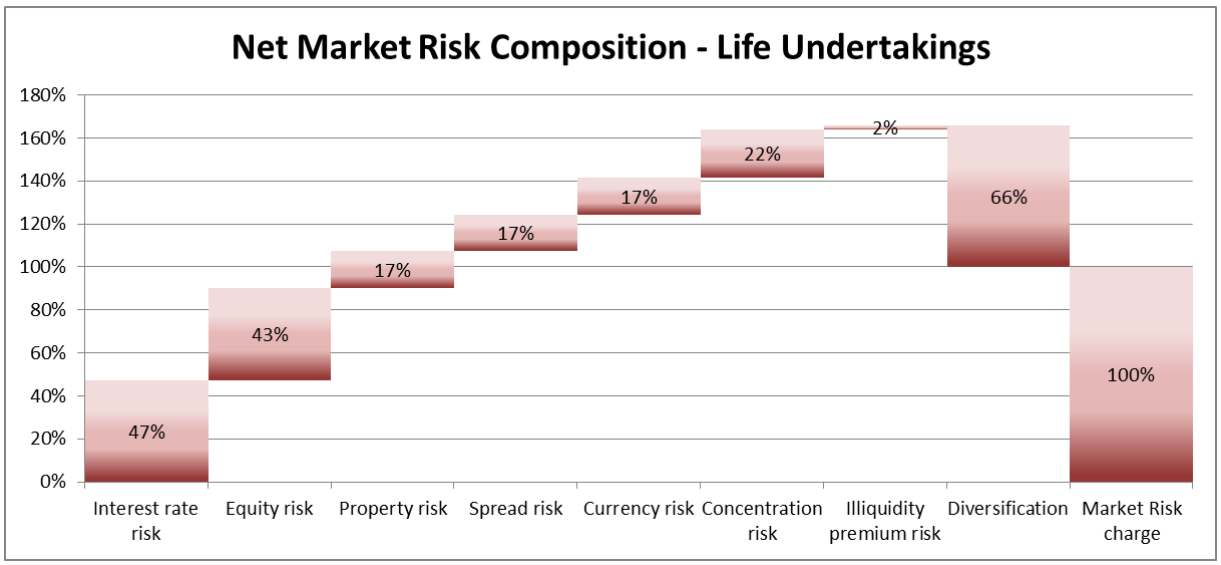
Non-Life underwriting risk is the most significant element within the BSCR, while health underwriting risk and intangible asset risk are the least significant. However, the relative importance of the sub-modules within the BSCR varies widely by type of MT undertakings, as shown in the following sections.

6.2.1. Life undertakings

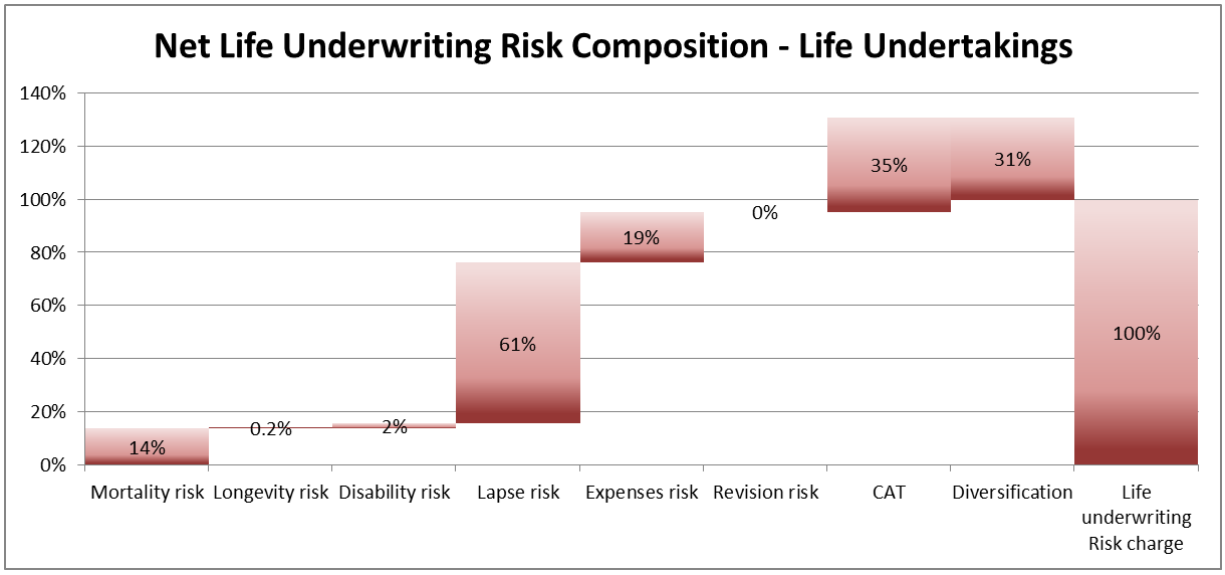
The most significant risk within the BSCR composition for MT undertakings writing life business only is the market risk, constituting 85% of the BSCR. This is then followed by life underwriting risk (21%), counterparty default risk (10%) and health (1%). The distribution of risks within the BSCR structure of life undertakings is in line with the average EEA distribution for life undertakings.



Within the market risk module, interest rate risk and equity risk are the most dominant components for life MT undertakings, constituting 47% and 43% of the market risk charge respectively. Illiquidity premium risk is the least significant, being only 2% of the market risk charge.



The next most significant risk within the BSCR for life undertakings is the life underwriting risk.



Lapse risk is the largest risk within the life underwriting risk module, comprising 61% of the life underwriting risk charge, followed by CAT risk (35.3%). Lapse risk is also the largest risk in respect of the average EEA life underwriting risk structure, followed by longevity risk (respectively 46% and 44%). Longevity risk is, however, relatively insignificant for MT undertakings, being only 0.2% of the final charge.

MT life undertakings reported that the definition of 'mortality risk' in the life mortality risk sub-module requires that a policy is either classified as a mortality risk or longevity risk based on the relationship between the amount payable on death and the technical provisions held for the policy

in the best estimate liability calculation. As a result, a policy is either classified as a mortality risk or a longevity risk based on the risk it presents in the base scenario, which can be different to the risk it presents in a stress scenario. As the SCR represents the capital required in a stress scenario, undertakings stated that it would be more appropriate to make this classification in the stress scenario (i.e. by performing both the mortality and longevity stress and taking the most onerous). Moreover, the definition of 'mortality risk' for the purposes of the life mortality risk sub-module and the life catastrophe risk sub-module should be aligned from a consistency perspective.

For the lapse SCR calculation, a policy-by-policy comparison of the surrender value to the best estimate liability was required. Undertakings considered this to be a time-consuming exercise, requiring significant manual manipulation of valuation model output.

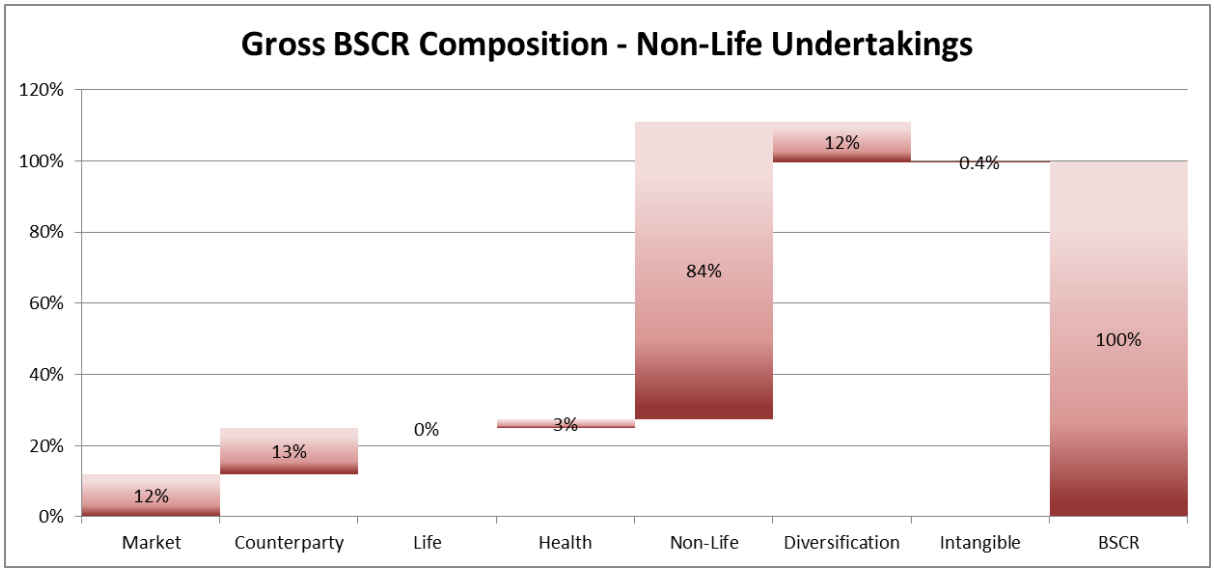
Life undertakings considered the counterparty default risk module to be disproportionately onerous to apply relative to the resulting SCR. The practical difficulty was in respect of the granularity of data required for the calculation, the methodology to calculate the SCR and the additional model runs required.

The calculation of the capital requirement for life catastrophe risk was quite difficult particularly insofar as concentration is concerned (assessment of the number of people situated within a small area).

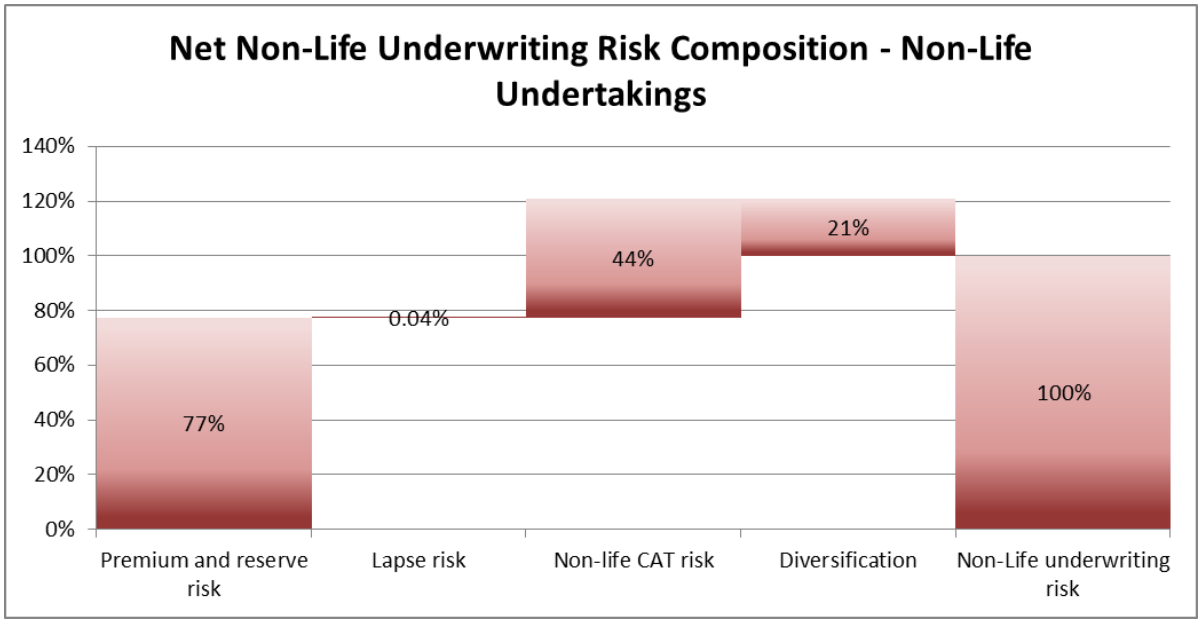
Undertakings had some difficulties in sourcing the asset data at the required level of granularity to apply the look-through calculations on unit-linked holdings. They believe that the principle is sound but that the difficulty in applying it accurately will not be outweighed by the benefit and impact on the SCR.

6.2.2. Non-Life undertakings

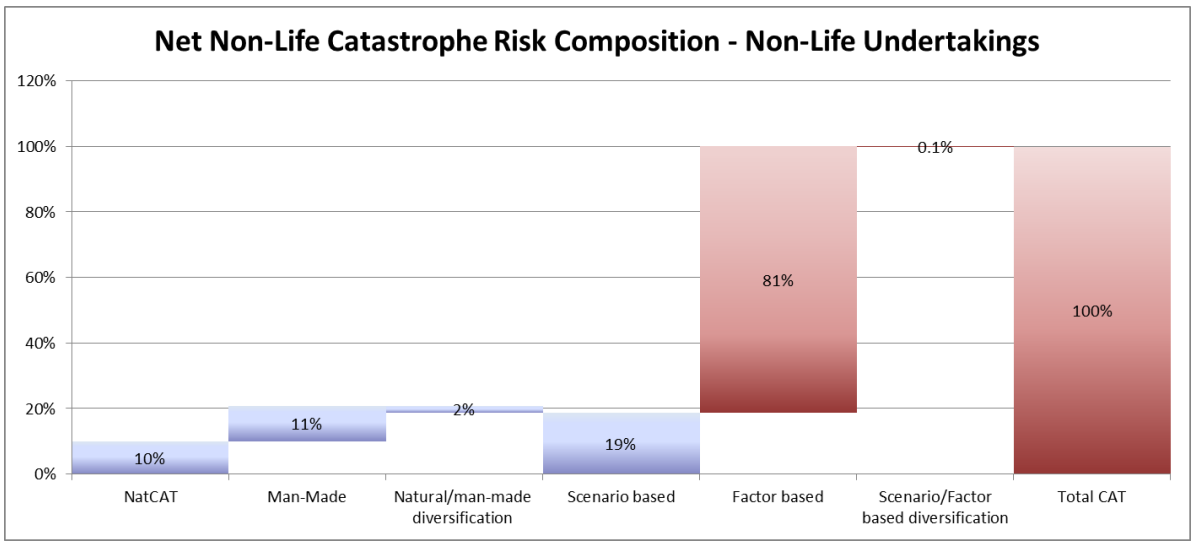
The largest component of the BSCR for MT undertakings, writing only general business, is comprised of non-life underwriting risk, as is also the case with average EEA BSCR structure.



Premium and reserve risk is the largest component of the non-life underwriting risk for MT undertakings writing general business only while lapse risk is almost negligible being only 0.04% of the non-life underwriting risk. The distribution of the sub-modules within the non-life underwriting risk is very similar to that of average EEA.



From the chart below, it is evident that most of the MT undertakings writing only general business used the factor-based method for the calculation of the non-life catastrophe risk. The scenario-based method was equally utilised for natural and man-made catastrophe risks.



Undertakings writing risks in Malta were not able to use the helper tab to calculate the natural catastrophe risk since there were no gross loss damage ratios (specifically in respect of earthquake) provided for Malta. For such undertakings estimating the total sums insured by zone is not an issue given that all exposures are located within a single zone.

For risks situated outside Malta, where undertakings were not able to split by CRESTA zones, undertakings faced difficulty due to lack of available data. In this case undertakings approximated

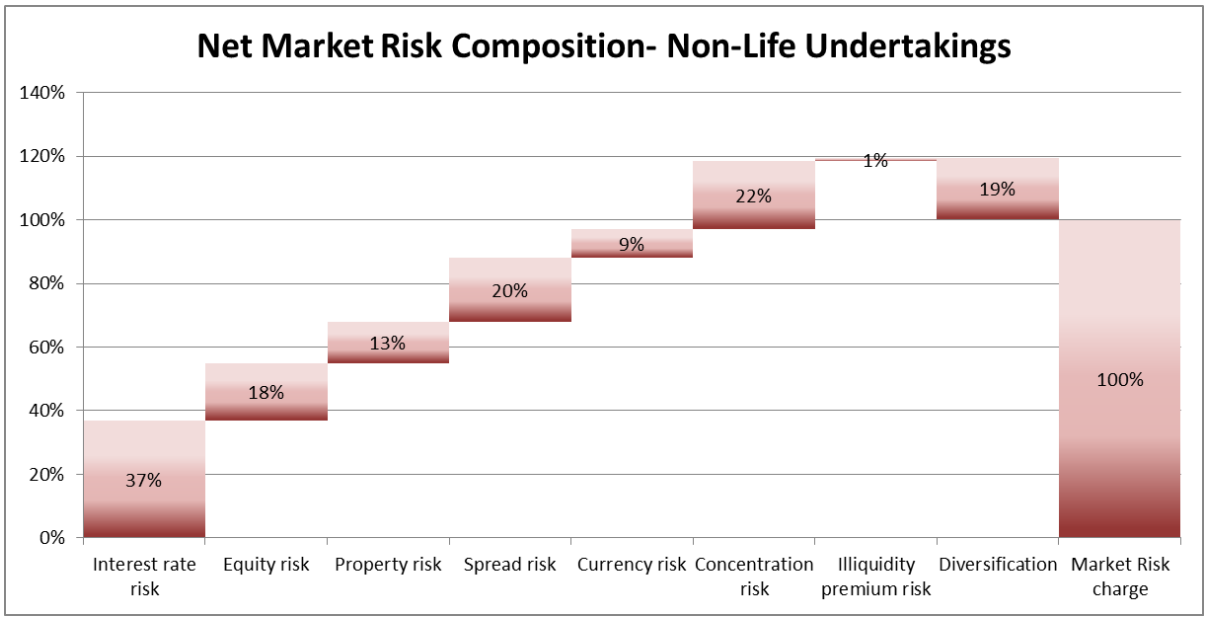
the total insured values by carrying out all calculations in aggregate at country level. This was seen to be too prudent given the geographical spread of risk within the country. Some undertakings also raised the issue of obtaining different results depending on the method used for the calculation of catastrophe risk.

The following is a list of difficulties reported by different undertakings when calculating the various different man-made catastrophe scenarios:

- The result derived from the helper tab on the Motor LoB was not reasonable as it gave a negligible figure.
- Data availability.
- Approximation used was to total exposure but this was seen to be too prudent given the level of reserves already in place and the geographical spread of risk within the country.
- Best estimate assumptions had to be carried out however certain scenarios were too far-fetched to adopt accurately.

The next most significant risk within the BSCR composition for non-life MT undertakings is counterparty default risk, comprising 13% of the BSCR. 66% of this risk is attributed to Type I exposures, with the remaining 24% being attributed to Type II exposures. Some MT non-life undertakings raised the issue that not all counterparties are rated and thus these had to be classified as unrated incurring a high charge.

Market risk is mainly composed of interest rate risk, constituting 37% of the final market risk charge, while illiquidity premium risk is the least significant, being only 1% of the final risk charge. One undertaking commented on the consideration of term deposits under the spread risk sub-module; it was reported that if the term deposits are breakable with a small immaterial fee, these would become payable immediately and therefore are not dissimilar to cash. These incurred a larger charge under the spread risk sub-module relative to that under SCR-Counterparty, where cash is treated.

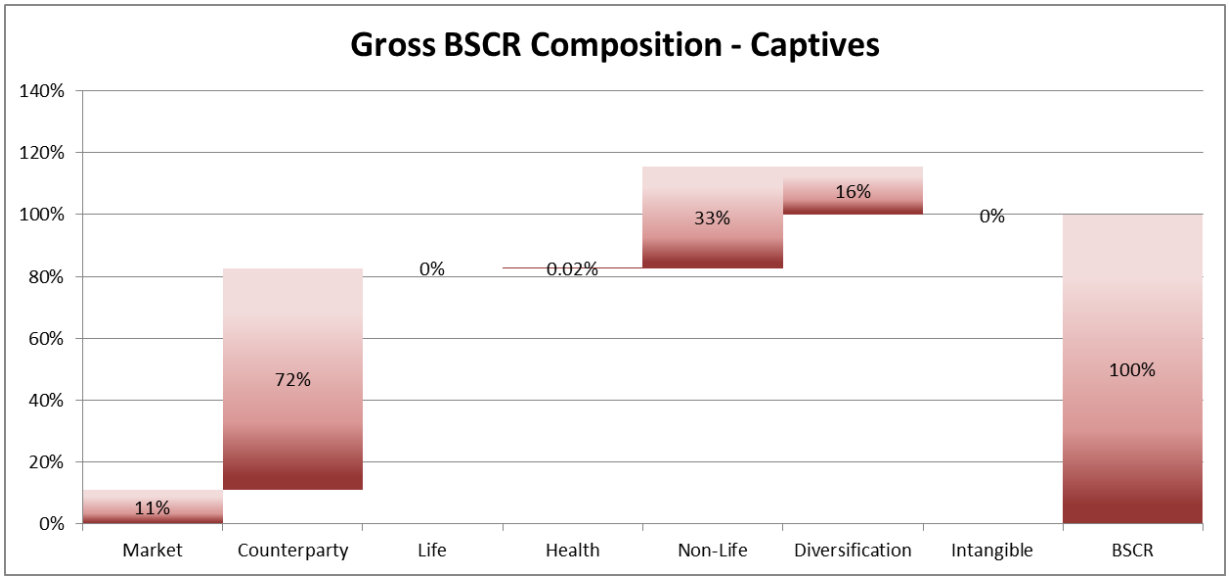


3% of the BSCR for non-life MT undertakings is attributed to health underwriting risk, which in turn is mainly attributed to Non-SLT health (non-similar to life techniques). Only 4 non-life MT undertakings reported to have intangible assets risks, an amount which totalled to less than 1% of the BSCR.

In addition to the above, some non-life MT undertakings also reported that the stress scenarios were considered as too onerous and others were of the opinion that standard deviations are hardly measurable for smaller undertakings, to be statistically credible. Therefore, sometimes the proposed standard values had to be chosen but these were still seen as likely to be inappropriate for the smaller undertakings. Also, a major factor in determining the underwriting risk is the premium volume declared in the premium tab, which is based on the reporting year and subsequent year. When substantial growth was expected in the following year, the SCR geared up substantially to cover that growth. While this can be considered as acceptable, what is not considered adequate is the fact that no recognition was given to profit reserves that would have accrued from that substantial growth and when claims loss ratios were expected to be low.

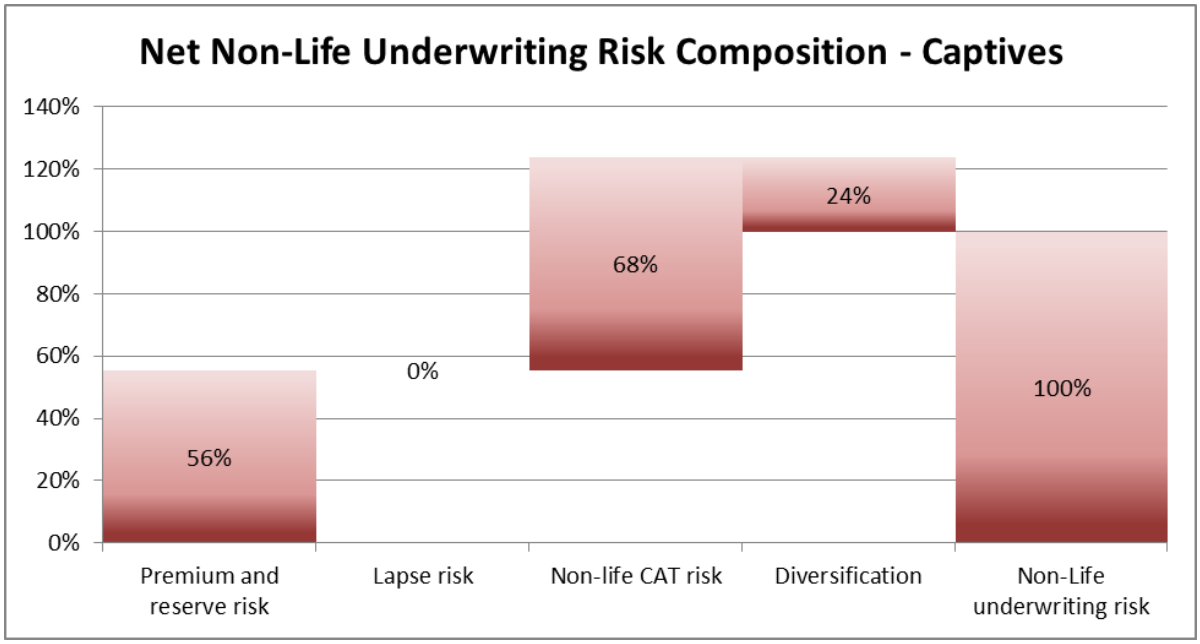
6.2.3. Captives

Counterparty default risk is the most dominant within the BSCR composition of MT captive undertakings, constituting 72% of the final BSCR. The counterparty risk charge is made up almost entirely of Type I exposures (92%). Health underwriting risk is the least significant being only 0.02% of the BSCR.



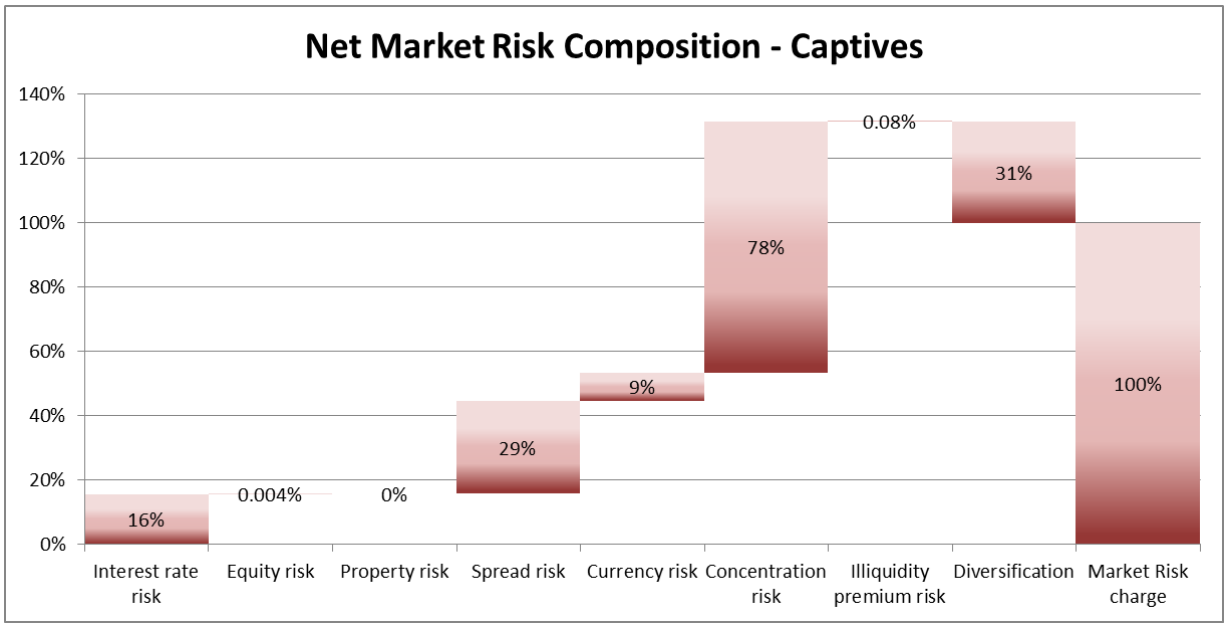
Non-life underwriting risk for captives is composed mainly of non-life CAT risk, comprising 68% of the final underwriting risk charge. Captives report that the treatment of the parent as a counterparty should take into account the lower possibility of a parent defaulting on the group.

There were no captive undertakings which assumed lapse risk.



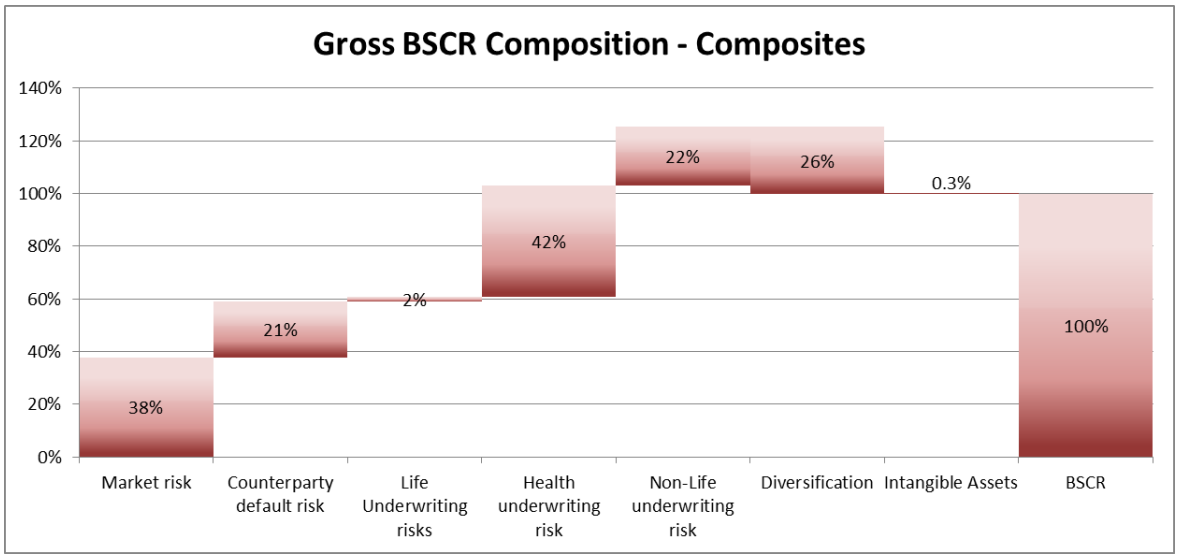
93% of the non-life catastrophe risk for captive undertakings was calculated using the scenario-based method, with the remaining 7% using the factor-based method. There was no captive undertaking which used both methods in its calculation of the non-life catastrophe risk. Most of the captives, using the scenario-based method, assumed man-made scenarios with only 1% being attributed to natural scenarios. Similar to what has been reported by non-life undertakings, captive undertakings reported about the different results obtained depending on the method used for the calculation of catastrophe risk, as well as about the lack of data and the use of the helper tab being limited to European exposures only.

Market risk, which makes up 11% of the BSCR for captive undertakings, is mainly composed of concentration risk, being 78% of the final market risk charge, while equity risk and illiquidity premium risk are barely significant comprising 0.004% and 0.08% of the market charge respectively.



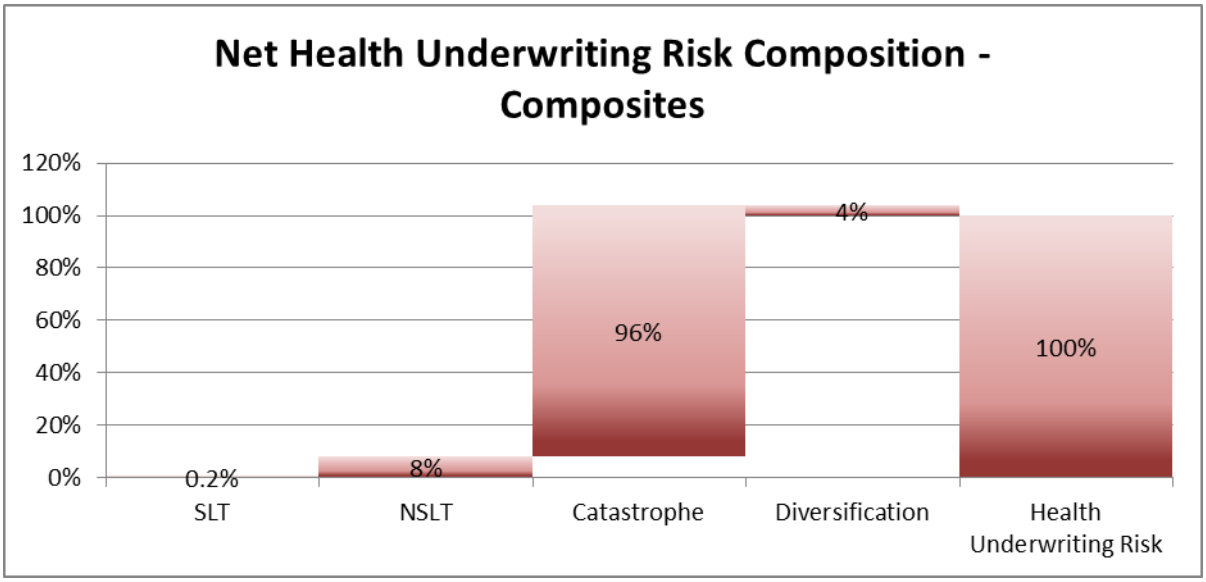
6.2.4. Composites

The BSCR of MT undertakings, writing both life and general business, is mostly composed of health underwriting risk, making up 42% of the BSCR while intangible asset risk is the least significant comprising 0.3% of the BSCR.

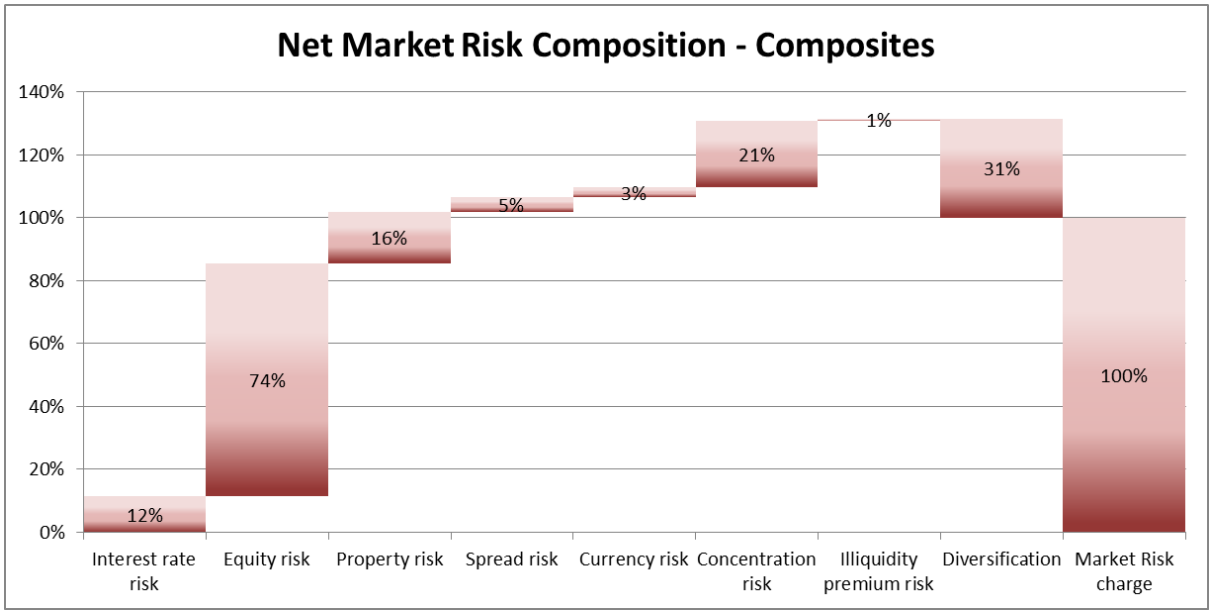


The largest component within the health underwriting risk is catastrophe risk (96%), 99% of which is related to concentration, 3% pandemic and 3% arena disaster with a diversification of 5%. The NSLT is mainly composed of premium and reserve risk, with only one composite undertaking having lapse risk.

Some undertakings believe that the health CAT event provided by CEIOPS was not considered adequate for Malta, while others reported that the capital charges applicable for a catastrophe scenario were seen to be excessive, particularly in the light of the fact that the whole sum-at-risk is considered more than once in calculating the capital charge thereon. For instance, the whole sum-at-risk is considered for accidental death, medical, short-term disability and so on. Another difficulty related to whether the entity's health portfolio should be classified as Health (Similar To Life) Techniques or Health (non-Similar To Life) Techniques.



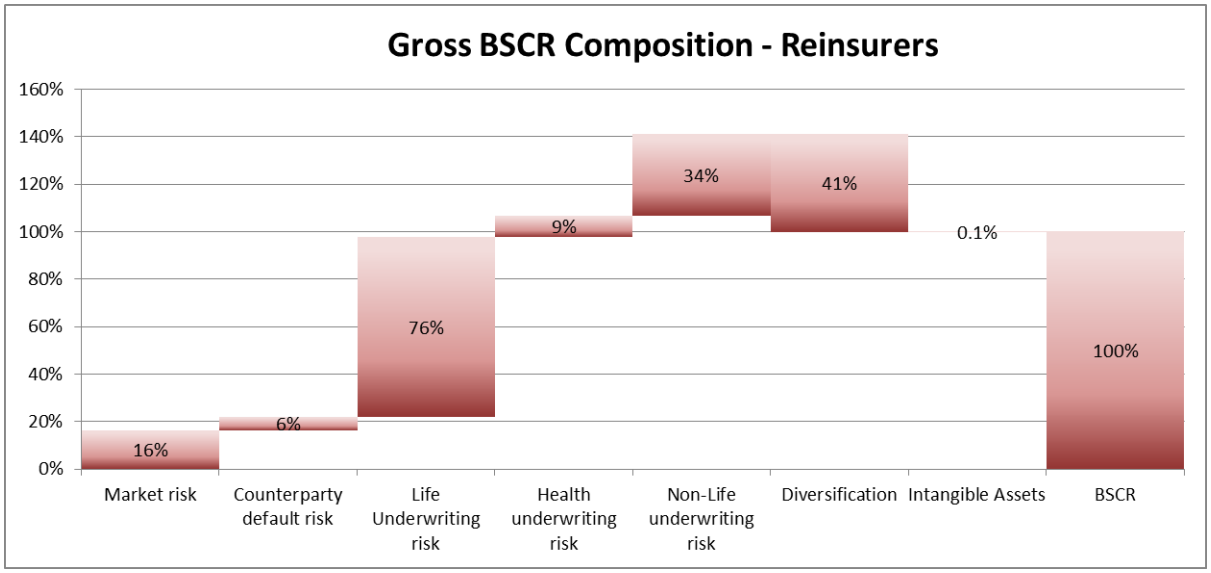
The next largest component of the BSCR structure for MT composite undertakings is the market risk, which is mainly attributed to equity risk (74%) followed by concentration risk (21%). Illiquidity premium risk is the least significant, comprising 1% of the market risk charge as shown in the graph hereunder.

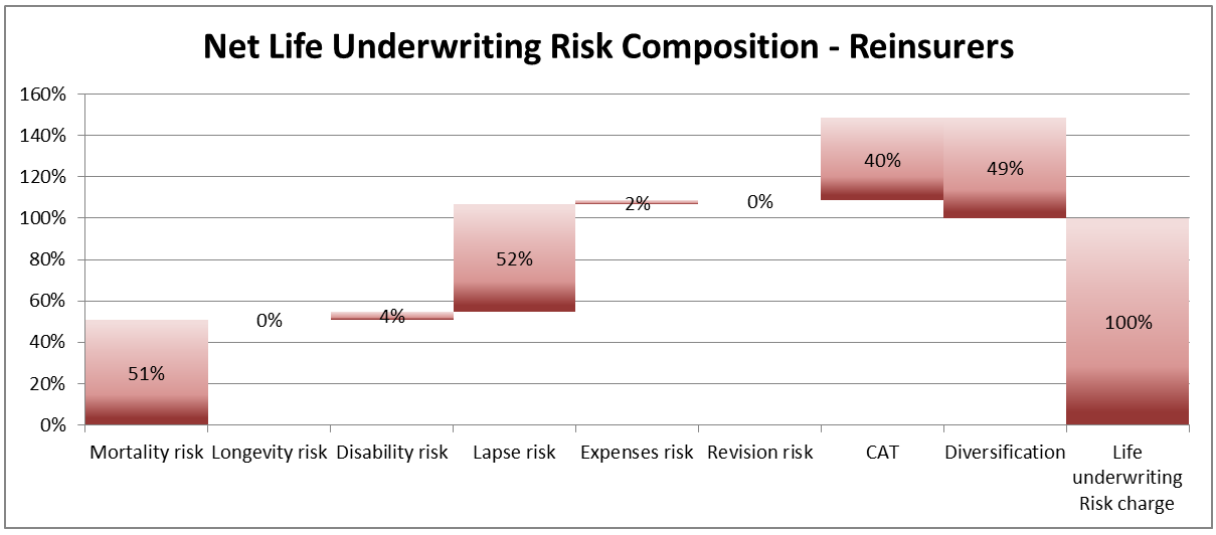


Non-life underwriting risk, which is the third largest component within the BSCR structure, is composed of 91% premium & reserve risk, 23% CAT risk and 1% lapse risk, with a diversification of 15%.

6.2.5. Reinsurers

Life underwriting risk is the most dominant component within the BSCR structure for reinsurance MT undertakings, comprising 76% of the BSCR, followed by non-life underwriting risk which constitutes 34% of the BSCR. Intangible asset risk is the least significant making up 0.1% of the BSCR.





The largest three components within the life underwriting risk are lapse, mortality and CAT risk. There were no reinsurers which had a capital charge for longevity and revision risk.

86% of the non-life underwriting risk is attributed to premium and reserve risk and 22% is attributed to catastrophe risk, with a diversification of 8% within the non – life underwriting risk module.

Market risk, which comprises 16% of the BSCR, is mainly attributed to interest rate risk (62%) and spread risk (49%). It has been reported that the stressed scenario to calculate the interest rate risk

capital requirement is not capturing the interest rate volatility. This was also pointed out by other jurisdictions within the EEA.

Other difficulties reported by reinsurers include the fact that the capital charge for life mortality and particularly for life catastrophe risk appears to be excessively high. Also a positive correlation between lapse and longevity does not seem reasonable for annuities business.

Another reinsurer also reported that life business should also benefit from geographical diversification, whilst another reported that for reinsurance it is not clear whether the assumptions for calculating the capital charge for lapse risk relate to the lapse rates of the underlying primary insurance policies or the termination probabilities of the reinsurance treaties.

The difficulty in segmenting properly the health business into SLT (Similar to Life Techniques) and non-SLT (Not Similar to Life Technique) lines was also encountered by reinsurers.

6.3. Loss absorbing capacity of technical provisions and deferred taxes

Around 70% of the undertakings taking part in QIS5 calculated a loss absorbency adjustment for deferred taxes, which may mean that the SCR is overstated for undertakings which did not perform the calculation. This signals a strong need for additional technical guidance.

Several undertakings reported experiencing difficulties with the methodology for calculating the adjustment for the loss absorbency of deferred taxes, calling for additional guidance in this area.

6.4. Operational Risk

Operational risk accounted for 6% of the SCR. It was reported that the operational risk formula will not appropriately reflect the operational risk profile for any undertaking, let alone a “standard” undertaking. There is no incentive to reward undertakings with well-developed internal control systems to minimise these risks and exposures. Moreover, undertakings reported that the operational risk capital charge gives out an over-prudent and unrealistic result.

It has been suggested that this could be calculated as a percentage of operating expenses incurred.

6.5. Use of SCR simplifications

The Maltese industry reported to have used simplifications in the calculation of credit spread, mortality, health, and counterparty default risk. Most of the undertakings are of the opinion that the simplifications provided by CEIOPS are generally appropriate for the measurement of their risk

position. No undertaking claimed that the simplifications are perfectly appropriate for the measurement of their risk position.

It is probable that the choice of simplifications was due to time and expertise constraints rather than as a result of the application of the proportionality principle. Lack of data was also a reason for opting to use simplifications rather than full calculations. Particularly in the case of small and non-complex undertakings, consideration should be given to the application of the proportionality principle in terms of the use of the simplifications whereby the result that is obtained from such simplifications may be greater than that resulting from the use of more complex methodologies for which the undertaking lacks the necessary technical and financial resources.

7. Minimum Capital Requirement (MCR)

More than half (55%) of the MT undertakings reported that they are fully prepared in respect of the MCR calculation, having all data available and with no problems with methodologies. The rest either encountered problems with the available data or else encountered problems in the methodologies for the calculation of the MCR.

The few MT undertakings which reported to have encountered difficulties or reported discrepancies in respect of the MCR calculation raised the following issues:

- The MCR is perceived to be unnecessarily complex. It was suggested that the MCR should instead be calculated by simply using a single percentage of the SCR.

- To the extent that the MCR depends on output from the SCR and technical provisions, both the data and systems of the undertakings require development.

- There may be the need to re-design the way undertakings are currently inputting premiums in the life and disability schemes.

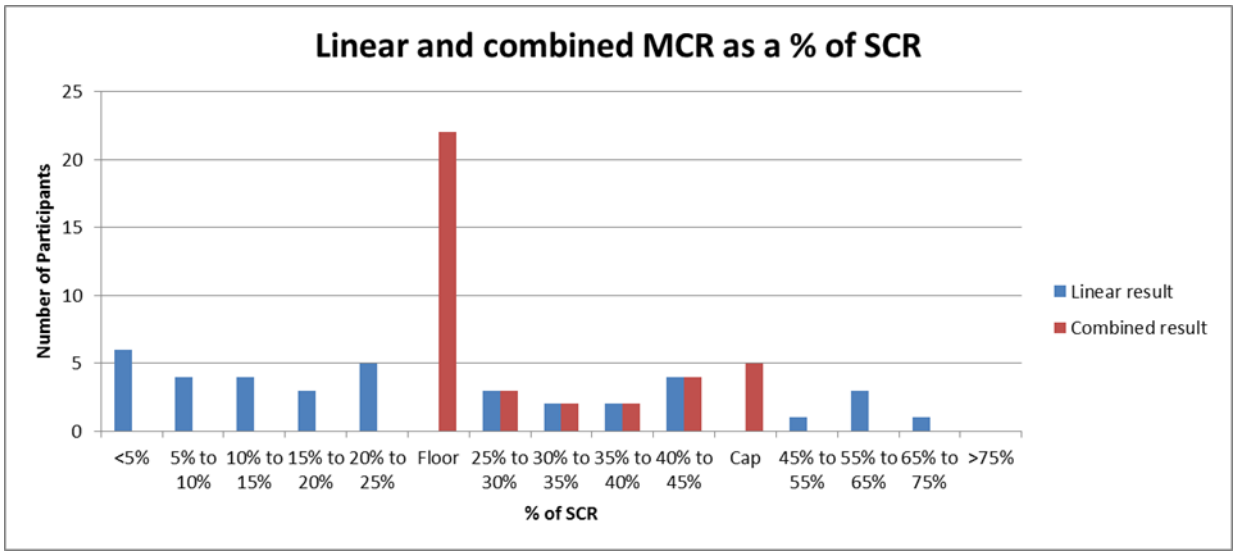
The distribution of the MCR, as calculated by the linear formula result, in proportion to the SCR for the MT insurance sector was as follows:

Linear result as a % of SCR	Participants
< 5%	6
5% to 10%	4
10% to 15%	4
15% to 20%	3
20% to 25%	5
Floor	-
25% to 30%	3
30% to 35%	2
35% to 40%	2
40% to 45%	4
Cap	-
45% to 55%	1
55% to 65%	3
65% to 75%	1
> 75%	-

The linear MCR for 11 MT undertakings (29%), lay within the MCR corridor (25%-45% of the SCR). For these 11 undertakings, their MCR as per linear formula result was then also taken as their final combined MCR. The EEA average proportion of undertakings whose linear MCR was equal to the final combined MCR stood at 35%.

For 22 undertakings (58%) the calculated linear MCR was observed to lie below the floor parameter (25% of the SCR). The EEA average stood at 41%. In such cases, the respective undertakings' floor parameters were then taken as the combined MCR.

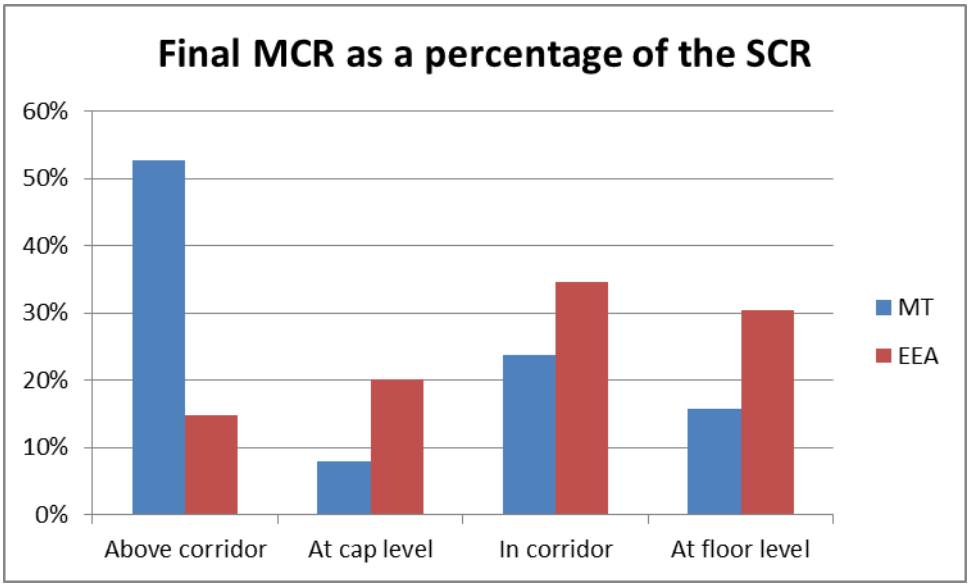
The remaining 5 undertakings (13% of MT undertakings) resulted in having an MCR linear formula result above the cap (45% of the SCR). The respective EEA average of undertakings was 23%. In such cases, the amount in relation to the cap parameter was then taken as the combined MCR of the undertaking.



The final MCR taken, was the maximum of the combined MCR and the Absolute Minimum Capital Requirement (AMCR). For 23 MT undertakings, which make almost 61% of the MT participants, the AMCR exceeded the combined MCR and therefore the former amount was taken as the final MCR. For more than 34% of the MT participants (13 MT undertakings), the combined MCR resulted to be larger than the amount in relation to their AMCR and thus the combined MCR was then taken as their final MCR.

Whilst the final MCR resulted to be above the 45% cap of the SCR for only 15% of the EEA undertakings, more than half (specifically, 20 MT undertakings) of the MT participants resulted in having their final MCR above the cap parameter.

Eight undertakings (21%) resulted to have their final MCR exceeding their SCR. This percentage on an EEA level resulted to be less than 7%.



The only discrepancy reported by the MT industry in respect of the MCR methodology, was, in fact, related to this scenario: where the MCR exceeds the SCR. One undertaking is of the opinion that this should be fairly resolved without asking for additional capital over and above the existing requirements. Consideration needs to be taken of the fact that the undertaking would already be adequately solvent in light of the risks to which it is exposed and so it is recommended that in this scenario the SCR is considered to be equal to the absolute minimum MCR and vice-versa. Other EEA countries also expressed concerned in respect of this scenario, and questioned how the ladder of supervisory intervention would apply in these cases.

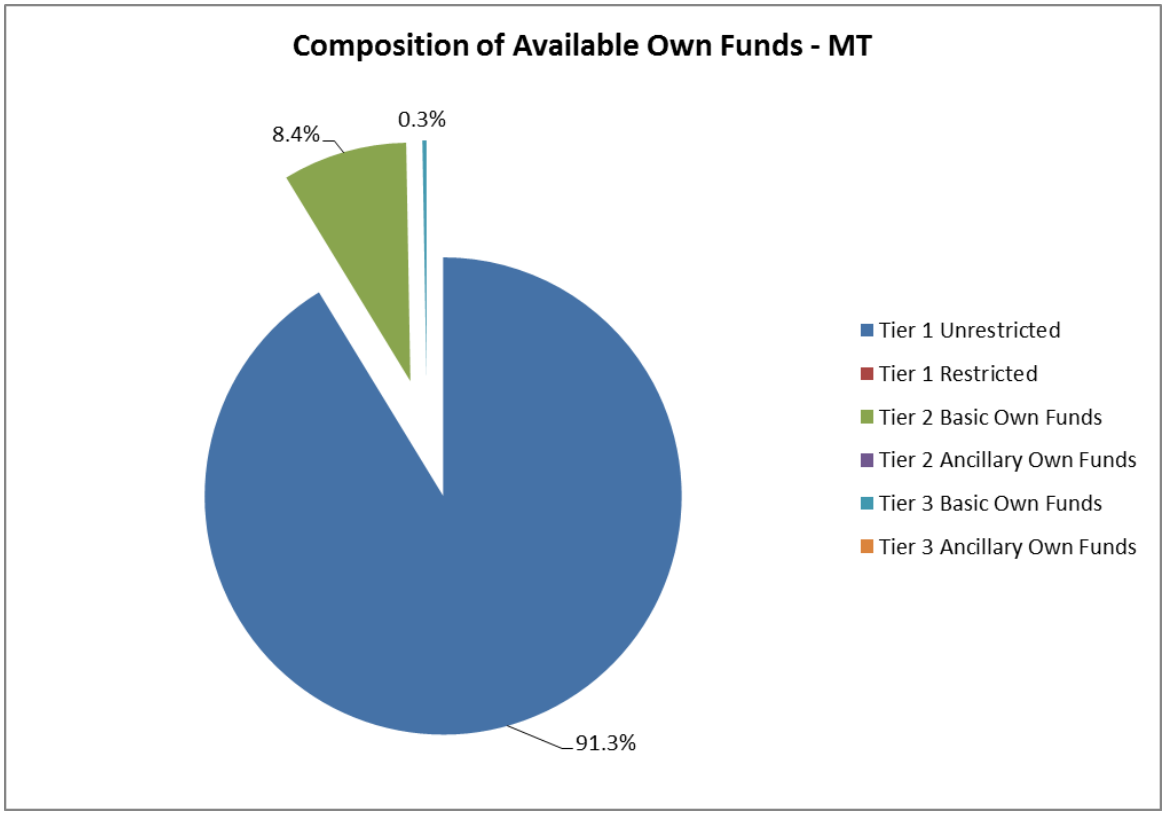
8. Own Funds

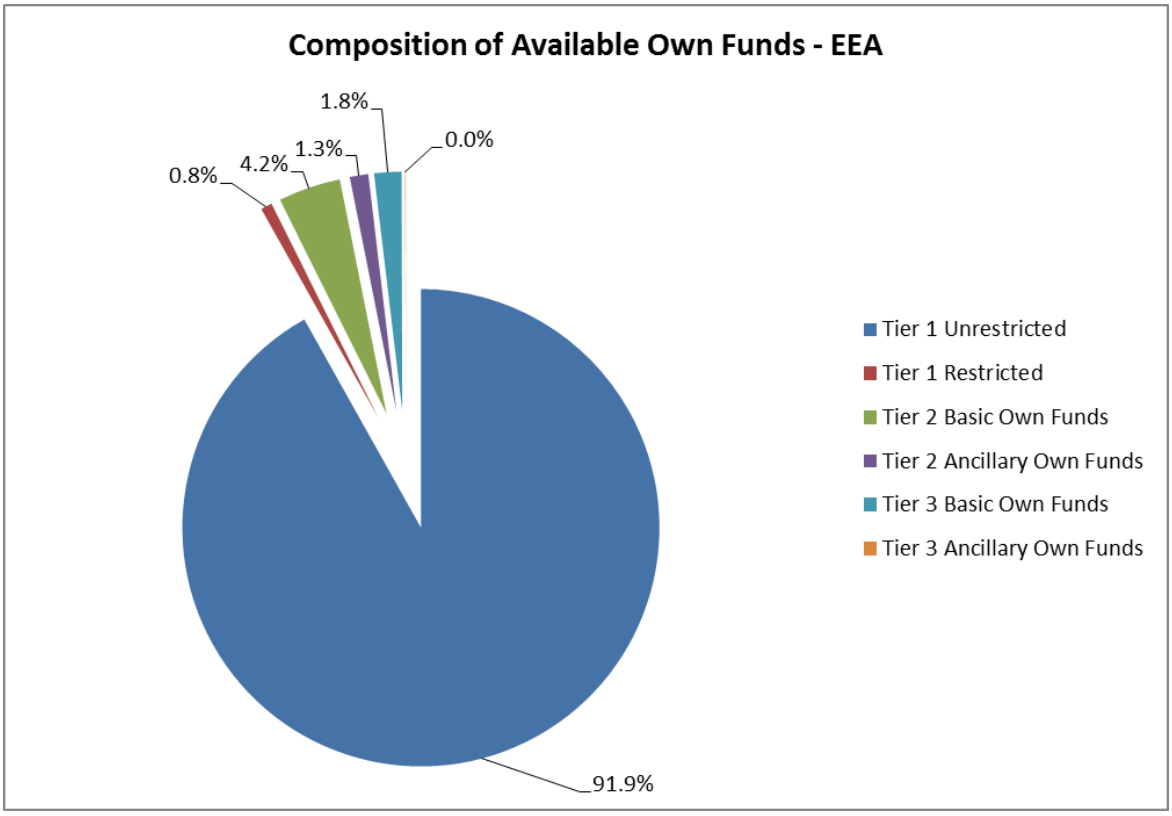
In general, 82% of the participating undertakings reported that they are fully prepared with respect to data availability or methodologies regarding the determination of own funds, with all data available and no problems with methodologies. Only 5 out of the 38 QIS5 participants reported to have encountered problems when applying the QIS5 own funds methodology.

Most of the undertakings consider as good quality the QIS5 categorization of own funds and own funds tiering.

8.1. Composition of Own Funds

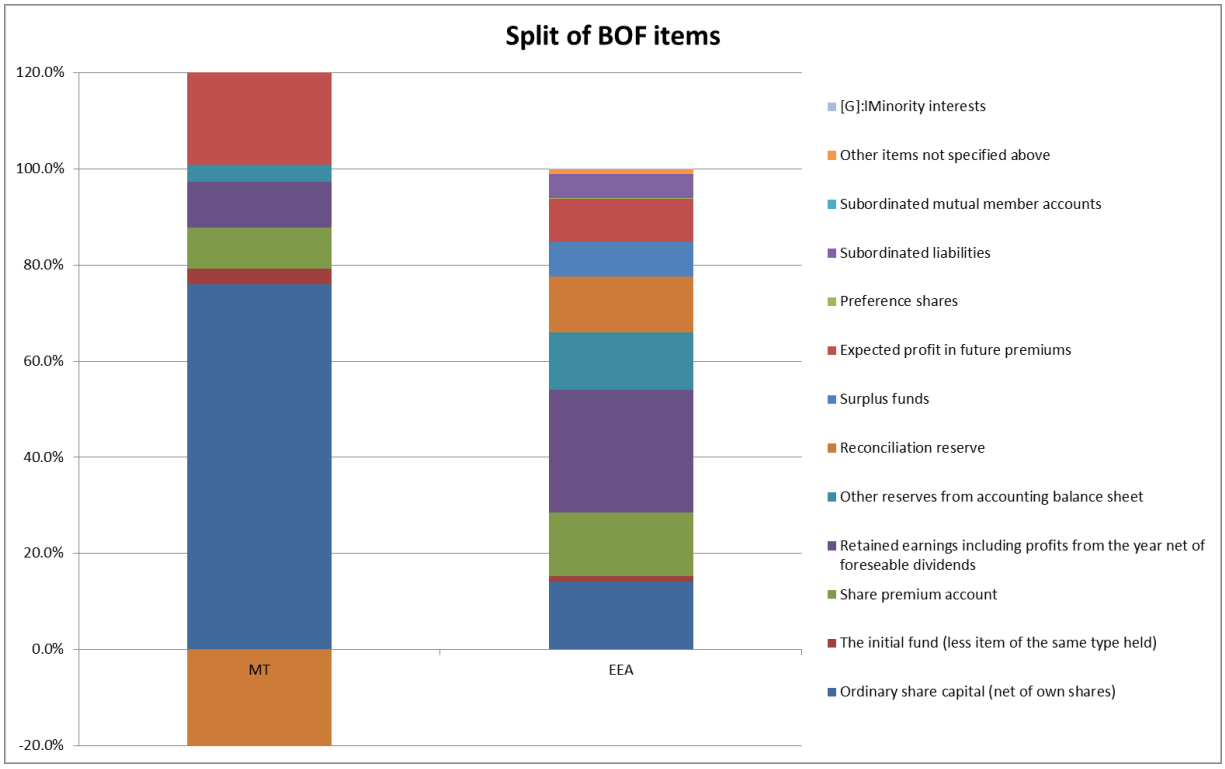
Under the Solvency II regime, there are two sorts of own funds: basic own funds and ancillary own funds. A breakdown of the available own funds for both MT and EEA is given in the charts below. It is evident that opposed to EEA, MT undertakings do not have any ancillary own funds and neither restricted Tier 1 capital. Total available own funds for MT undertakings amount to €1.1bn. Of this, 91% represents unrestricted Tier 1.





8.2. Basic Own Funds (BOF)

Ordinary share capital makes up the largest share of basic own funds for MT undertakings, making up 76% of total BOF as opposed to EEA (14%), the latter having retained earnings including profits from the year net of foreseeable dividends as the largest component, with a share of 25%. The graph below shows a negative reconciliation reserve for Malta, whereas the average reconciliation reserve for EEA undertakings is positive. The main reason for this was that for the average EEA undertakings, the positive adjustment to technical provisions was greater than the negative adjustment to assets, expected profits in future premiums and other liabilities, while for MT undertakings the positive adjustment to technical provisions did not offset the negative adjustments to the other components.



8.3. Comparison with Solvency I

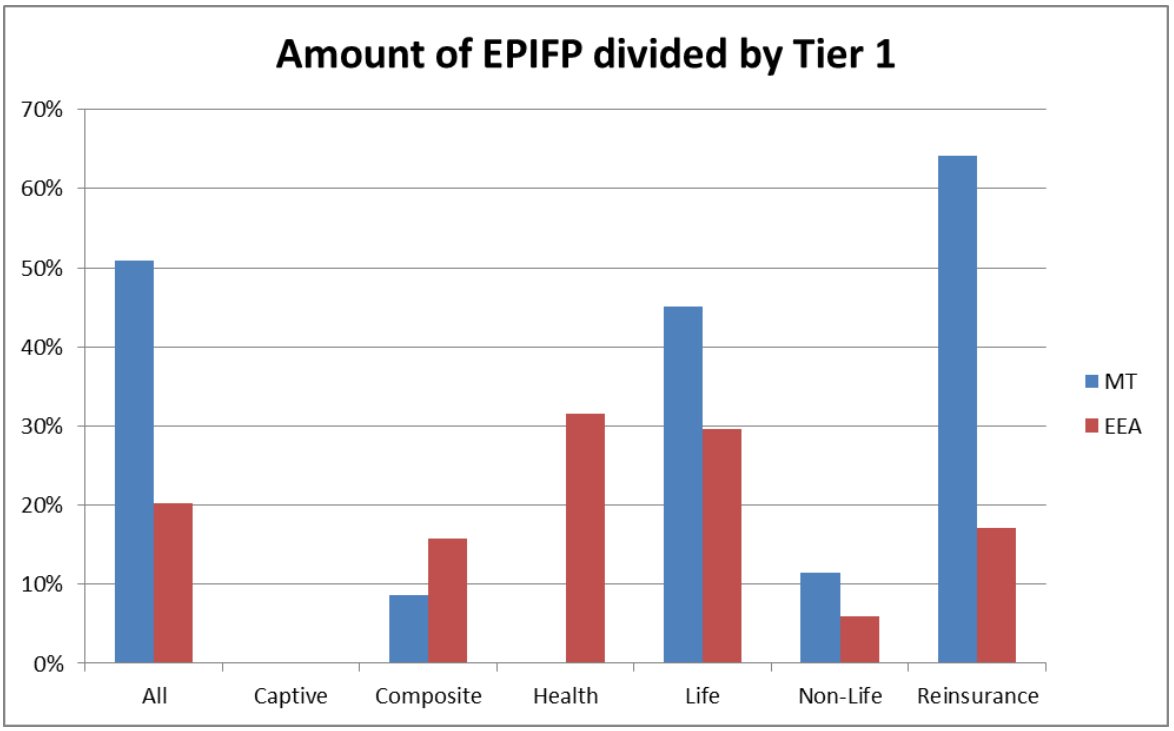
Total basic own funds of MT undertakings before adjustment under QIS5 were 12% higher than under Solvency I, which is below the average 27% increase in respect of EEA undertakings. This increase has been mainly due to an increase in ordinary share capital, retained earnings including profits from the year net of foreseeable dividends and expected profits in future premiums. From the Solvency I basis to the QIS5 valuation basis, there has also been a decrease in other reserves together with the inclusion of negative reconciliation reserves.

8.4. Expected Profits in Future Premiums (EPIFP)

Out of the 38 participating undertakings, only 8 undertakings reported data relating to EPIFP. The total amount reported was €235m representing an average of 51% of the Tier 1 capital of these 8 undertakings. As seen from the chart below, the average amount of EPIFP as a percentage of Tier 1 is higher than that of EEA. In fact, Malta has the fourth largest share of Tier 1 as EPIFP within EEA. As opposed to the EEA average, the largest share of EPIFP for MT undertakings is shown within the reinsurance undertakings, followed by life undertakings.

Undertakings that have not allowed for EPIFP have reported that they do not exclude examining this in the future. However, some undertakings commented that the approach set out in the technical specifications does not provide sufficient clarity as to the nature and scope of the EPIFP calculation

and hence lacked understanding of the concept of EPIFP. Specifically, the treatment of policies with no surrender value was very unclear for certain undertakings. It was also unclear how the calculation is used in the overall solvency assessment and this is the reason why most of the undertakings have not performed such calculation.



Annex

List of Abbreviations

AMCR – Absolute Minimum Capital Requirement
BOF – Basic Own Funds
BSCR – Basic Solvency Capital Requirement
CAT – Catastrophe
CEIOPS – Committee of European Insurance and Occupational Pensions Supervisors
CRESTA – Catastrophe Risk Evaluation and Standardising Target Accumulations
DT – Deferred Taxes
EEA – European Economic Area
EIOPA – European Insurance and Occupational Pensions Authority
EPIFP – Expected Profits in Future Premiums
IFRS – International Financial Reporting Standard
LoB – Line of Business
MCR – Minimum Capital Requirement
MFSA – Malta Financial Services Authority
MT – Malta
NSLT – Not Similar to Life Technique
ORSA – Own Risk and Solvency Assessment
QIS – Quantitative Impact Study
RFF – Ring Fenced Fund
SCR – Solvency Capital Requirement
SLT – Similar to Life Technique
TP – Technical Provisions
VaR – Value at Risk