Solvency II

Why Solvency II?

Solvency II replaces Solvency I, a collection of 14 EU Directives first developed over 40 years ago. By creating one clear Directive, Solvency II aims to offer a harmonized framework for insurance companies in the EU that will strengthen financial soundness in the industry and ensure businesses can survive even in difficult periods. It seeks to improve policyholder protection, increase competition and increase transparency.

Solvency II is a new EU Directive that will affect everyone in Aegon, irrespective of region

What are Directives?

Directives are legal acts that require EU Member States to achieve particular results without dictating exactly how they must be achieved. Directives are prepared by the European Commission and approved by the European Parliament and Council.

Who? Where?

Solvency II is a Directive of the European Union. It will be implemented in all 28 EU Member States. Its provisions apply to most insurance and re-insurance companies established, or wishing to be established, in EU countries.

Pillar 1: Capital Requirements

This pillar covers insurance balance sheets, which are based on liabilities, assets and an amount of capital needed to ensure that claims can be paid with a high likelihood. Pillar 1 of Solvency II requires businesses to calculate their Solvency Capital Requirement (SCR), using either the Standard Formula (determined by the regulator) or a (Partial) Internal Model (calibrated by the insurance company). The Minimum Capital Requirement (MCR) must also be calculated. This is the figure below which the regulator would intervene to protect policyholders.

I

What is 'The Standard Formula'?
It is a more simplistic calculation with more prescribed (rather than company developed) parameters. Each company is given the factors and formulas they have to use without flexibility. A company needs to demonstrate that the Standard Formula is relevant and appropriate before it can be used.

What is 'The Internal Model'?
It's a risk management system developed by an individual insurer. Since this deviates from the Standard Formula, it needs to be approved by the regulator before it can be used. By using an Internal Model, insurers may be able to better describe their own risks and thus treat them more appropriately than under the Standard Formula.

***What is the 'Partial Internal Model'?**
This combines the Standard Formula and an Internal Model. It is used where it is appropriate for a company to develop a more sophisticated model for certain risks only. Aegon, like most of the major insurance players in Europe, has opted to use this approach.

> *"The high level of scrutiny that we are exposed to means that approval for our Internal Model is a great achievement."*
>
> John McCrossan
> Head of Financial Risk Management, Aegon Group

THE THREE PILLARS OF SOLVENCY II

When?

Solvency II became effective on January 1, 2016.

Pillar 2: Governance & Supervision

This pillar covers the structure and management of insurance businesses and how they are governed. It requires insurers to identify, measure, monitor, manage and report risks they're exposed to. Insurers must put risk management at the heart of decision-making, and are required to conduct an Own Risk and Solvency Assessment (ORSA).

How does it affect Aegon?

Aegon must base its capital requirements on the new Solvency II framework and in particular our own internally developed model. But Solvency II is not just about the numbers, it's about how we make decisions, how the company is structured and governed. To put it simply, it is about how the company is run.

Pillar 3: Reporting & Disclosure

This pillar covers the supervisory reporting and public disclosure of financial and other information by insurance companies.

II

III

What about non-European country units?

The US regulatory system is accepted under the EU system, so the US continues to do its capital calculations as it always has done – adding its own capital on to the European numbers. Beyond Europe, regardless of the numbers, Solvency II has direct influence on how the group as a whole and therefore the businesses individually make decisions; the governance, even the structures and three lines of defense (risk taking; risk oversight; Independent assurance).

Are we prepared?

The statutory supervisory standard under Solvency II is 100%, which means that an insurer's capital is such that it will still be able to meet its obligations in the event of a severe shock that is expected to occur once in every 200 years. At year-end 2016 Aegon's estimated Solvency II ratio stood at approximately 157%, well within our target range of 150% to 200%. This means that we are strongly capitalized.

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