



Insurers Shift Focus to Solvency II Compliance: From Model Development, to Transformed Processes

Executive Summary

The Solvency II Directive is a fundamental review of the capital adequacy regime for the European insurance industry. It provides a revised set of European Union (EU)-wide capital requirements and risk management standards that must be met by 2012. The directive replaces current solvency requirements by establishing stronger EU-wide requirements on capital adequacy and risk management for insurers, with the following goals:

- Increasing policyholder protection.
- Reducing the possibility of consumer loss or market disruption in insurance.

Solvency II will apply to all insurance and reinsurance firms with gross premium income exceeding €5 million or gross technical provisions in excess of €25 million. The requirements apply to North American insurers chartered to provide services in Europe, as well.

This white paper lays out a framework for creating, deploying and implementing systems and process changes that enable faster and more effective compliance with Solvency II.

What is Solvency II?

There are three main pillars to the proposed Solvency II framework (see Figure 1, next page):

- **Pillar 1:** Consists of the quantitative requirements (i.e., how much capital an insurer should hold).
 - Minimum Capital Requirement (MCR)
 - Solvency Capital Requirement (SCR)
- **Pillar 2:** Establishes requirements for the governance and risk management of insurers, as well as for the effective supervision of insurers.
 - Own Risk and Solvency Assessment (ORSA)
- **Pillar 3:** Focuses on supervisory reporting and transparency requirements.
 - Public disclosure
 - Supervisory reporting

Insurers have two choices for Solvency II implementation: using an internally developed model or one of the models prescribed by the supervisor.

Three Pillars of Solvency II

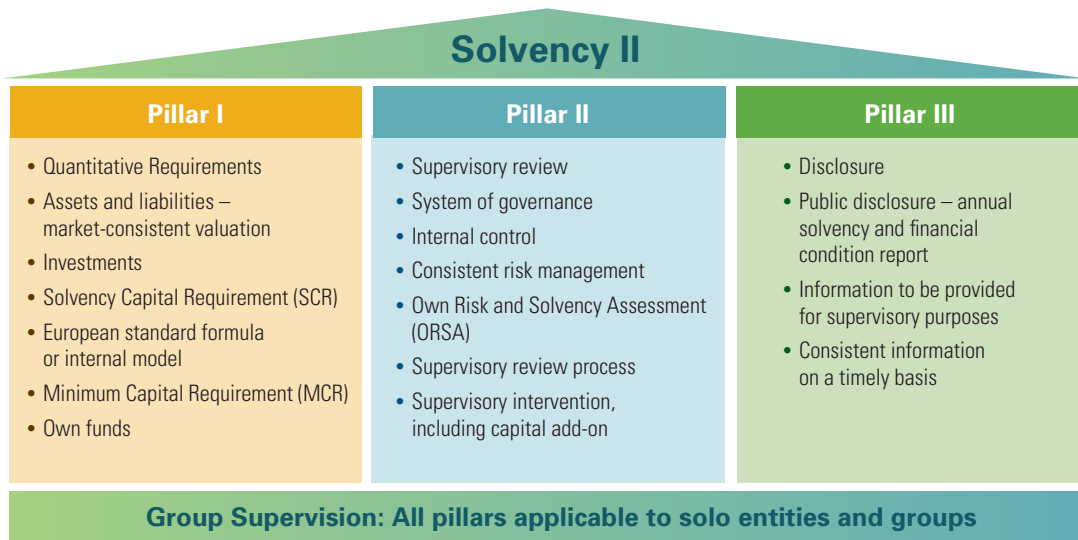


Figure 1

This year, insurance firms are expected to step up their efforts and resources to achieve Solvency II compliance, focusing primarily on data and systems, reporting and ORSA (see Figure 2).

Although risk management is an intrinsic characteristic of the insurance business, the new elements introduced by Solvency II and the two possible choices for its implementation will

generate a high level of transformation in the organization and tools of insurance companies.

According to initial estimates by the Committee of European Insurance (CEA), the total costs for complying with Solvency II will exceed €4.5 billion for the five leading geographies that account for nearly 80% of the European market, alone.

Solvency II Timeline and Effort

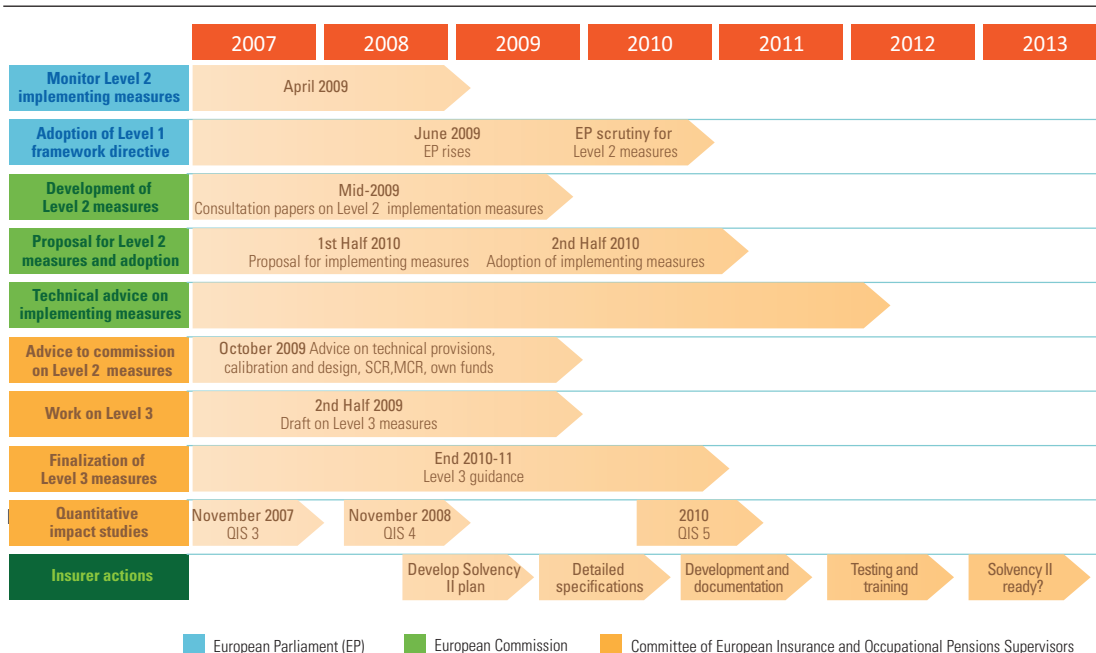


Figure 2

Solvency II Costs in Key Geographies

Geography	No. of Players	Gross Written Premium*	Solvency II Cost*
UK	1,050	249	1325
France	1,077	204	1154
Germany	607	165	859
Benelux	511	120	641
Italy	246	92	561

*in millions of Euros

Source: Committee of European Insurance

Figure 3

Pillar I costs include the efforts for quantitative analysis and transformation of IT systems, which are typically resource-consuming activities. Because Pillar II includes more qualitative and process-related projects, the costs here are much lower than in Pillar I. Pillar II projects also reuse work completed within Pillar I for the collection of data with a sufficient level of quality.

Navigating the Solvency II Compliance Journey

To be Solvency II compliant, companies need to emphasize key focus areas spanning each of the three pillars. To address enhanced quantitative requirements under Pillar I, the organization's Internal Solvency Model development process must come under review, especially solvency capital risk model requirements, definition, modeling solution development, regulatory

filings and model refinement requirements. A supervisory review and governance requirements will require greater attention, particularly around data and documentation work streams.

Under the data work stream, the focus must revolve around effective management with respect to data directory, data model, ensuring data quality, as well as integration and governance with a comprehensive data warehouse and architecture. The documentation work stream will involve creation of policies and systems of governance to validate the internal model functioning, along with maintenance of a central documentation register. Another key aspect under the new Solvency II regime will be enhanced reporting requirements, both to the supervisor and the public.

Although insurers are quite experienced at Internal Solvency Model development, they need to address possible contingencies arising from other key focus areas related to data, documentation and reporting. Figure 4 highlights the focus areas from an insurer's perspective.

Most insurers say they will meet the 2012 deadline to implement Solvency II, according to research by PricewaterhouseCoopers LLP. A survey of 115 companies in 22 countries in the fall of 2010 found that 74% of insurers were confident of meeting the deadline, although 40% were still only in the preparatory stages or had yet to launch their implementation projects.

From Pillar to Post: Key Focus Areas

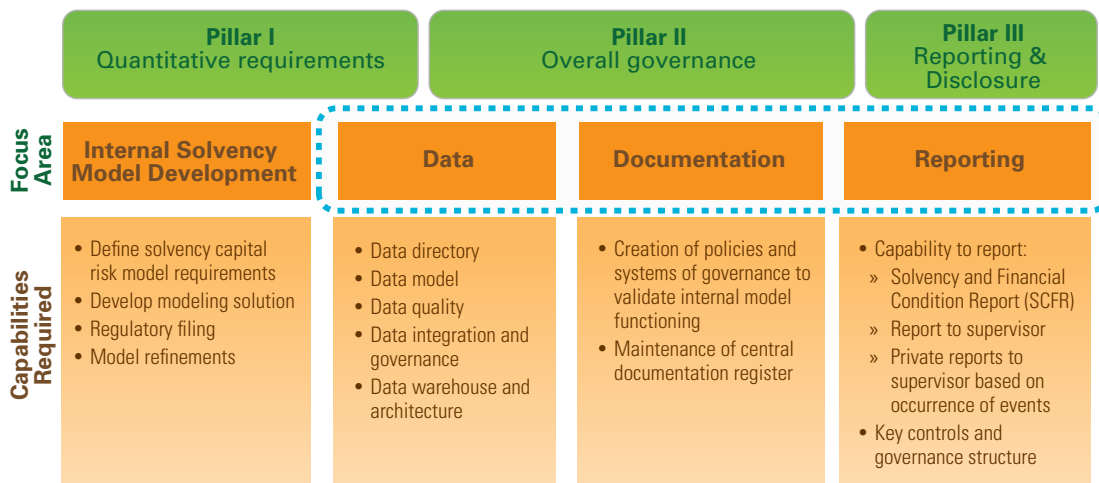
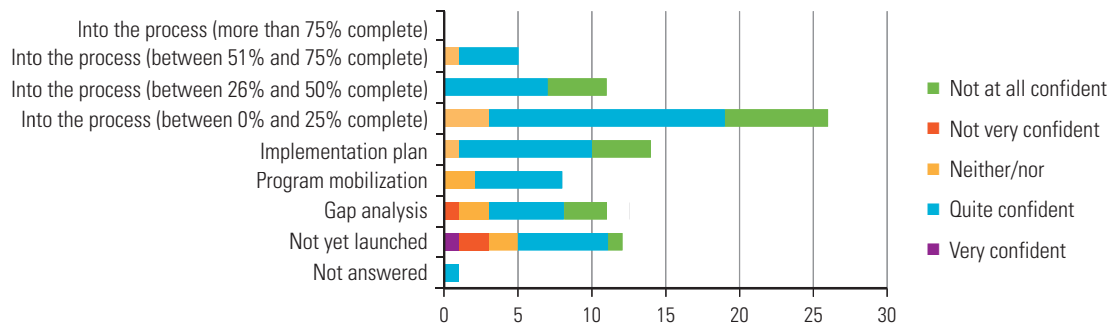


Figure 4

Solvency II Program Status



Source: PwC

Figure 5

However, none of the more advanced participants report being “very confident” of finishing on time (see Figure 5). In fact, the level of confidence decreases as insurers further analyze the impact of Solvency II, indicating the need for a more rigorous approach to dealing with the possible contingencies.

Conclusion

To become compliant with Solvency II within the required timeframe, insurers need to focus on areas revolving around data, documentation and reporting, especially since there has so far been a lack of focus on these work streams. Even though the final reporting guidelines are awaiting

Level 3 advice from the European Insurance and Occupational Pensions Authority (EIOPA), formerly the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), insurers should be using the existing guidelines and connecting the dots now between the data and the reporting requirements as currently specified.

Insurers need to ensure completion of their internal models and move toward implementation by combining data and reporting requirements, as well as technology planning and preparations, to provide a complete business and technology solution for Solvency II compliance.

References

“Getting Set for Solvency II,” PricewaterhouseCoopers, November 2010, <http://www.pwc.com/gx/en/insurance/solvency-ii/countdown/ifrs-solvency-ii-implementation-europe.jhtml>

“Consequences of Solvency II for Insurers’ Administrative Costs,” Committee of European Insurance, March 2007, http://ec.europa.eu/internal_market/insurance/docs/solvency/impactassess/annex-c08b_en.pdf

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