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TECH FOCUS

Co-operating with standards

Organisations are close to agreement on regulatory change, GREG MACIAG says

SOLVENCY II will soon be a reality in Europe.

Insurers will report unprecedented levels of detail on their activities to their domestic regulator.

European regulators will, in turn, submit data to Eiopa to analyse trends and results.

Eiopa will also organise supervisory colleges where insurance regulators can share plans and organise cross-border discussions based on the new data.

Legions of consultants from information technology, accounting and actuarial companies now offer fully developed products and practices to support compliance.

There are multiple discussion groups on the subject and some recruiting companies are totally focused on placing Solvency II professionals.

The influence of Solvency II as a sea-change in the international insurance regulatory environment is occurring both within the EU and beyond.

Bermuda, Japan, South Africa, Australia and other countries have set in motion or have instituted principles-based solvency oversight regimes.

The National Association of Insurance Commissioners in the US is presently undertaking a project to re-examine its state-based solvency regime and has travelled to Frankfurt to offer assistance in data gathering and design.

The International Association of Insurance Supervisors is moving rapidly to evolve its insurance core principles to include more sophisticated compliance elements.

In 2005, Eiopa (and its predecessor, Ceiops) invited insurers to participate in a series of five "practice runs" : the Quantitative Impact Studies (QIS).

The QISs gave regulators data to fine-tune calibration, asset valuation and other issues.

Most interesting for IT insurance experts were comments about the quality of the data itself – regulators could not be sure they were comparing "apples to apples" and worried year-to-year data might vary.

It sounds like a case for data standards to me.

Eiopa recently announced it will build its data repository in a

uniform format on XBRL standards. Like ACORD, XBRL is an XML-based system of data definitions for banking, tax and financial reporting. Our goal is for ACORD global insurance standards, as well as existing domestic insurance standards, to be mapped along with the XBRL financial standards.

This ready made set of industry accepted formats would satisfy both sides of the balance sheet.

For years, ACORD has met industry association stakeholders to advocate for the inclusion of insurance data standards in technical planning.

The organisation has submitted comments calling for standards to the consultation papers released by Ceiops and recently began discussions with XBRL leadership and Eiopa experts.

I am extremely pleased with the level of co-operation among all the industry organisations.

We all need to ease the impact of the added friction that often results from such regulatory change.

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Take advantage of proposal to extend deadline for Solvency II compliance

Insurers should make sure their IT department is fully compliant before the EU directive comes into effect, JUERGEN WEISS says

THE UPCOMING regulatory framework addressing European insurers' capital requirements and risk-management practices, Solvency II, continues to fire debate between supporters and opponents of the regulation.

When there was a proposal to extend the deadline for Solvency II implementation to January 1, 2014, rather than January 1, 2013, one could hear both sides of the industry debate.

On the one hand, 60% of European insurer delegates attending Aon Benfield's international analytics conference were in favour of the one-year delay, while on the other, 90% of Lloyd's managing agents backed maintaining the existing Solvency II timetable for implementation.

Tactical versus strategic

These conflicting messages are no surprise and are actually the result of two different perspectives and attitudes towards Solvency II.

As with every other regulatory framework, insurers can either treat Solvency II as a box-ticking exercise or analyse seriously how the new framework will eventually transform the way they do business today.

In our conversations with clients, we have learned many European insurers are making the same mistakes the banks did when Basel II was introduced: they often focus purely on the compliance aspects of Solvency II.

This is a shortsighted and very tactical approach and will hardly justify the IT costs of becoming compliant with Solvency II.

A more reasonable approach would be to centre compliance activities on a strategic, value-based management strategy, ensuring all business processes and the entire organisation are targeted at maximising the enterprise value.

Information about risks can be helpful to improve business processes and business performance reporting. European insurers should take Solvency II as a rationale to improve their international competitive positions for the future.

Information technology

In our opinion, the new regulatory framework will have one of the most transformational effect on the European (and potentially global insurance industry) in the past 20 years.

We anticipate Solvency II will affect most core insurance processes and IT systems including product development, marketing and sales, quotations, underwriting and risk management and policy administration, as well as asset and investment management.

In other words: Solvency II will separate the wheat from the chaff.

Large, multinational insurers could be the ones to benefit most from the new regulation because they are in a much better position to better use their solvency capital, thereby improving their competitive position.

This can be also seen in the Fifth Quantitative Impact Study survey from Eiopa, Europe's insurance regulatory body, which demonstrated the financial advantage of an internal solvency model over the standard formula.

Unfortunately, the reality does not really match the expected high impact of Solvency II on the insurance industry.

In 2010, technology researchers Gartner predicted close to 25% of European insurers will not have concluded their IT investment for Solvency II by 2013. Many insurance companies have simply underestimated the huge effect Solvency II will have on their IT landscape.

They have spent too much time on the quantitative aspects of Solvency II (Pillar 1) and not enough time to prepare their IT infrastructure for a qualitative risk-management framework (Pillar 2).

This tendency has already been criticised by several insurance chief executives, who raised concern about the effect of too much actuarial influence on the regulatory framework.

Closing the gaps

Another issue is IT organisations usually lack the business knowledge to properly identify the functional gaps of their IT architecture. Collaboration with business – namely, the risk-management department – and other units within the organisation is generally poor.

And finally, there continues to be a considerable amount of uncertainty among European insurance chief information officers (CIOs) about the IT investments required to meet the expectations from local regulators because of an absence of best practices and lack of detailed guidance. This present delay, actually the second in a row, essentially constitutes a confession by both Eiopa and the Council of the EU the initial roadmap for Solvency II does not reflect the state of preparations within the 27 member states and in most insurance organisations.

There has been strong pressure from European insurers to change the newly established capital rules for the industry.

In March 2011, four leading industry bodies sent a letter of protest to the European commissioner for markets, demanding changes to the "overly conservative" Solvency II capital rules (for example, the method of calculating liabilities for long-term savings or guaranteed products), which the letter writers claim would damage the viability of the European insurance industry.

Regulator workload

We also believe local regulators are concerned they will not be capable of handling the volume of approval requests necessary for internal and partial-internal models. In particular, local regulators say they would struggle to handle the workload created by larger European insurers' use of internal models to calculate solvency capital ratios.

A skills shortage in the market has already left regulators such as the Financial Services Authority in the UK competing for talent against insurers, software vendors and consulting companies.

Use time wisely

European insurers should, on the other hand, be realistic about the

consequences of the latest twist in the Solvency II story.

The council's proposal calls on the EU member states to transpose the Solvency II Directive into national law by March 31, 2013.

The new proposed Directive would give supervisors the right to require insurers to submit an implementation plan regarding their progress in complying with the new regulatory framework by July 1, 2013.

And certain elements of the Solvency II Directive will also be applied as soon as July 1, 2013 – including the use of internal models and the use of specific parameters in the standard formula. As a consequence, the delay in implementing the Solvency II deadline will only slightly alleviate the deadline pressure on European insurers.

Organisations should therefore use the additional time wisely to review the scope of their implementation programmes, to implement and test the sophisticated integration scenarios and to validate IT and process changes.

Data quality

CIOs and IT managers in European insurers should by no means reduce their Solvency II compliance activities.

One of the most common issues identified in on-going Solvency II implementation projects is data quality. CIOs should therefore review the timeline of their implementation programmes to add more time for testing more sophisticated integration scenarios and addressing data-quality issues.

They should also continue the dialogue with the business and local regulators to clarify open questions about IT implementation plans before the formal approval in 2013.

The Solvency II train has already left the station. It may arrive a bit later but it surely will not be derailed.

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