



AUTHOR
Blanche Neal,
*Chief Risk Officer
Europe,
Assurant Solutions*

This article was
published by
Lending Zone,
28 March 2011

Embracing Solvency II standards

Solvency II legislation is due to come into force across Europe in 2013 and will have an immediate and significant impact on the insurance market.

2011 has been highlighted as a key year as insurers accelerate their preparations. It is forecast that these preparations may cost billions, requiring insurers to make significant investments in modelling tools to meet the latest financial reporting requirements. Those adopting internal models will face the additional challenge of testing and proving to supervisors that their model is robust enough to meet the approved criteria. And the preparations won't just impact insurers - the regulator must also gather resources to cope with the supervisory responsibilities resting on its shoulders.

The move towards this new system of regulation clearly poses a significant challenge for insurers as they prepare for its impact, not only on their capital and solvency amounts, but also on their underlying systems of governance, risk management, control and disclosure, and reporting. However, the nature of that challenge and the budget and effort required varies enormously depending on the nature of the business itself. It also will vary according to the nature of the risk framework, systems and controls that individual organisations currently have in place.

Adequate resource is clearly critical to achieving a successful outcome. As each business works its way through the three pillars, ensuring placement of the appropriate level of resource represents a challenge in itself. This is a highly competitive environment and the talent pool is starting to look quite limited as both insurers and the regulator vie to secure the necessary resources each need to manage the process.

And it's not just a question of having the appropriate resource on board to manage the process of building a Solvency II model. There is the additional question of how a business can demonstrate that it has embedded the principles of Solvency II throughout its organisation. Whilst the regulator has not provided specific detail as to what it will be looking for, in my opinion,

this will need to be driven from the very top of the business so that individual employees will understand the relevance of Solvency II to their own role and embrace its principles.

However, I don't think that specialist insurers can put forward the argument that the workload for niche and smaller insurers is disproportionate to the larger players. Our business, for example, has three core personal product lines to analyse in detail - creditor, extended service contracts and mobile handset protection. A larger company that underwrites a huge range of products across the general insurance, life and pension markets faces an even bigger challenge.

Solvency II is designed to place risk at the heart of the way an insurance company is run. I would argue that only by achieving this will we truly understand and manage the risks we face and make effective risk-based decisions. Good risk management should result in more stable returns or a level of volatility that is in line with the amount of risk that the company chooses to take and so, broadly speaking, I would expect there to be a more conscious link between risk and company performance.

Will Solvency II achieve this? Well, there is no such thing as a perfect system. In some ways, it is going to be up to insurers themselves to deliver this objective. It will depend, in my view, on whether insurers embrace the principles of the regulation and don't over-engineer solutions. Overly complex solutions could have the unintended result of encouraging management to bypass the models to make quicker decisions. Neither the market nor organisations will wait for days, weeks or months for complex analysis to be completed in advance of a decision. The model that companies develop must reflect the speed and complexity of a decision, and flex appropriately.

I believe that companies have to develop a model that is fit for purpose for their own business. Think about it in these terms. You only need to build a Formula 1 car if you're planning to race in a grand prix. If you're just doing the school run every day, then build a Ford Focus. Placing the appropriate amount of resource in terms of manpower and budget will achieve the outcome the business is looking for, and ultimately deliver a far better return on the investment required.

This is where companies going down the bespoke route will, I believe, have a distinct competitive advantage. Whilst it could be a more complicated and time-consuming path, it will result in companies achieving a bespoke capital risk system. If they don't know it already, companies will know in detail which of their activities make money and which do not, enabling them to

make informed decisions regarding their lines of business. The information they gather from this modelling will guide their everyday decision-making process and promote more accurate product pricing. The sensitivity analyses on each product line will better equip them to respond swiftly and correct any imbalance, delivering a far more robust approach to each product line.

All of this will result in a far more resilient and sustainable business model - one that is better placed to flex according to market conditions and more adaptive to the appetite for risk. I believe this will certainly present a more attractive insurance proposition to any prospective business partner.

Solvency II should make companies comparable, transparent and safer for investors and customers alike. We just need to be sensible in our approach and build the right structure for our own individual businesses. In the end, the benefits should outweigh the costs, not just for the individual business but for the industry as a whole.