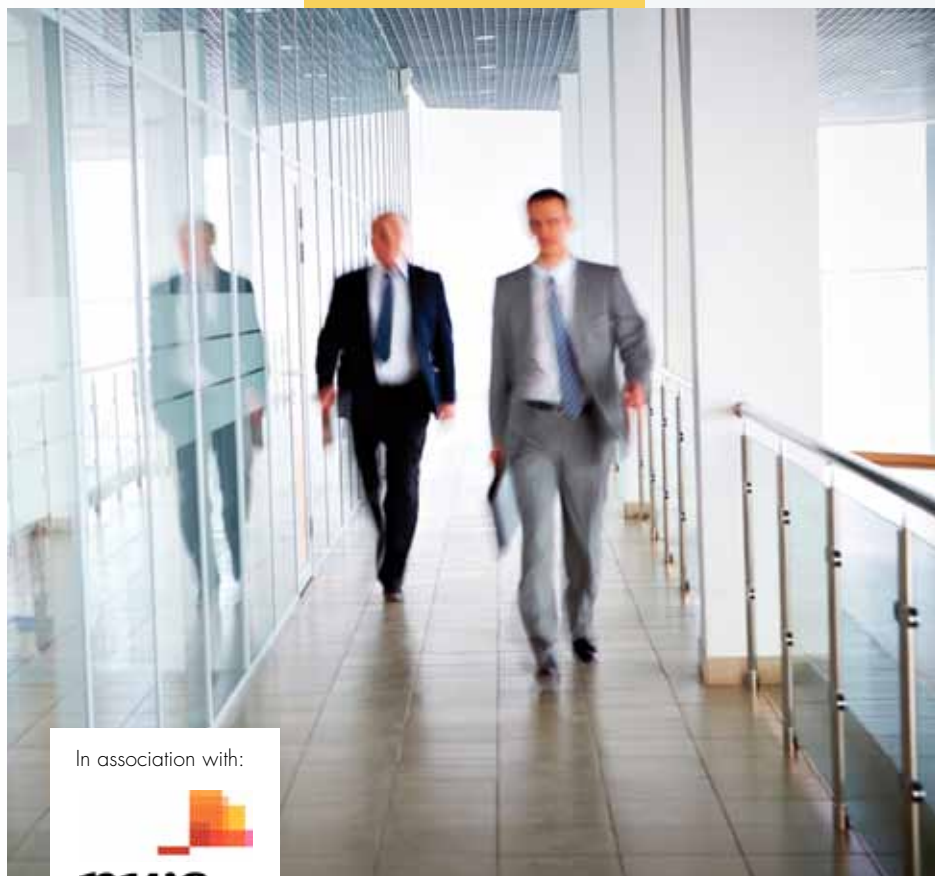


THE Review

WORLDWIDE REINSURANCE

The survivors' guide to **SOLVENCY II**

2011



In association with:



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Solvency II presents potentially daunting project management challenges. Yet with a clear description of the expected business benefits, how you're going to operate and what each person has to do to make this work, you can cut out unnecessary distractions and get to where you want to be a lot quicker. More effective allocation of responsibilities and co-ordination of deliverables will also make it easier to build Solvency II into business as usual.



PAGE 22 – THE CHANGING FACE OF INSURANCE WORLDWIDE

Solvency II is affecting different countries in very different ways. We asked PwC Solvency II subject matter experts in France, Norway, Bermuda, the US, Central and Eastern Europe to describe the particular challenges facing local insurers and regulators, their state of readiness and what the industry hopes to gain from the shake-up ahead.

The FOREWORD

Looking back over the last 12 months, we've seen high impact communications from those central to the implementation of Solvency II. First came the transitional measures in January from the European Commission and then, in the summer, the proposal to delay the implementation date from the European Council and the ECON Committee of the European Parliament. Each highlights the magnitude and complexity of the task in hand, both for insurers to implement and regulators to approve.

Now, we expect the full requirements of Solvency II to be implemented on 1 January 2014. It's welcome news as there is still a lot of technical detail to be finalised, which may become clearer if a 'frozen' draft of the Level 2 measures is released in the Autumn this year. However, insurers cannot afford to be complacent with their plans as it is likely that they will still be required to file Solvency II information over the course of 2013 to prove their readiness. To do this, they'll need to have the appropriate systems and processes in place by the end of 2012.

The more crucial piece for the industry now is how the areas of disagreement on some of the Level 2 implementing measures are resolved, such as contract boundaries, long term guarantees and Cat Risk calibration (to name just a few). We are unlikely to get any clarity on this until the Autumn and the rules won't be finalised until well into 2012.

The Survivors' Guide to Solvency II has been prepared by subject matter experts from PwC¹. Drawing on our work with clients and regulators, the focus is on the practicalities rather than the technicalities, along with the implications for the management of the business. We explore the implications of Solvency II without borders, adapting to group supervision, progress on agreeing equivalent status and with feedback from our European and US Solvency II subject matter experts.

If you would like to discuss the subjects covered in this guide in more detail or any other aspect of Solvency II, please speak to your usual PwC representative or one of the authors listed on page 27.

Paul Clarke, PwC Global Solvency II leader

¹PwC¹ refers to the network of member firms of PricewaterhouseCoopers International Limited (PwCIL)

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ALTHOUGH THERE IS STILL ROOM FOR A CERTAIN AMOUNT OF POLITICAL
MANOEUVRING AND CHANGE, WE ALREADY KNOW ENOUGH ABOUT
WHAT'S COMING AND IT'S IMPLICATIONS TO PUSH AHEAD

Pressing ahead with SOLVENCY II

Gareth Arnold talks to Paul Clarke from PwC about the implementation timings, the industry and supervisors' state of readiness and the key challenges ahead as legislators and regulators begin to put the final pieces in place.



Paul leads PwC's global Solvency II team. His wide-ranging work with both insurance clients and supervisors means he is well placed to judge the progress, direction and potential pitfalls ahead.

Gareth Arnold: When is Solvency II likely to go live?

Paul Clarke: There is a strong possibility that the new capital requirements won't come into force until the beginning of 2014. However, while firms will continue to be bound by the existing Solvency I capital demands until then, it's very possible that they will need to provide their supervisors with confirmed Solvency II numbers in 2013 as originally planned. This means that their evaluation, validation and governance procedures will need to be in place before the formal implementation date. Even if coming up with the numbers in 2013 is not a formal regulatory requirement, companies will still need to go through the process to be ready for a 1 January 2014 launch date.

Gareth Arnold: How much are the rules likely to change?

Paul Clarke: The proposed deferral is designed to give insurers and their supervisors more time to prepare, rather than providing another year to debate the rules. The revised Level One legal framework is due to be agreed early next year when Omnibus II goes for its final vote in the European Parliament. The Level Two implementation measures will then be published in the middle of the year, though formal approval may take a little longer. This will then be followed by the initial Level Three guidelines on supervisory enforcement and harmonisation at the end of 2012 or beginning of 2013, though further details are likely to be announced over the course of 2013.

Gareth Arnold: **How does the European Commission view the deferral?**

Paul Clarke: The Commission is quite happy to allow more time to reach suitable compromise solutions. It sees Solvency II as a journey, in which the destination is more important than how and how quickly insurers and supervisors get there. The Commission realises that it's dealing with a diverse range of companies and regulators, which are coming from very different starting points. The main priority for the Commission is coaxing them in the same direction.

Gareth Arnold: **Should insurers hold back or push ahead?**

Paul Clarke: Although there is still room for a certain amount of political manoeuvring and change, we already know enough about what's coming and its implications to push ahead. If insurers delay implementation, the costs and disruption are going to escalate. In contrast, getting the transition over with as quickly as possible offers reputational advantages and will allow firms to concentrate on realising the competitive benefits of their investment.

Gareth Arnold: **What should insurers be doing to make sure they're on track?**

Paul Clarke: Firms should really have completed the design and build phase and be well into implementation and integration. The implementation phase requires a different approach to design. The key to making it work is moving out of project mode and getting the business fully involved. Boards should be setting out a clear vision about where the business is heading and how it's going to get there. This will help to make Solvency II real to the business and help build up momentum for implementation.

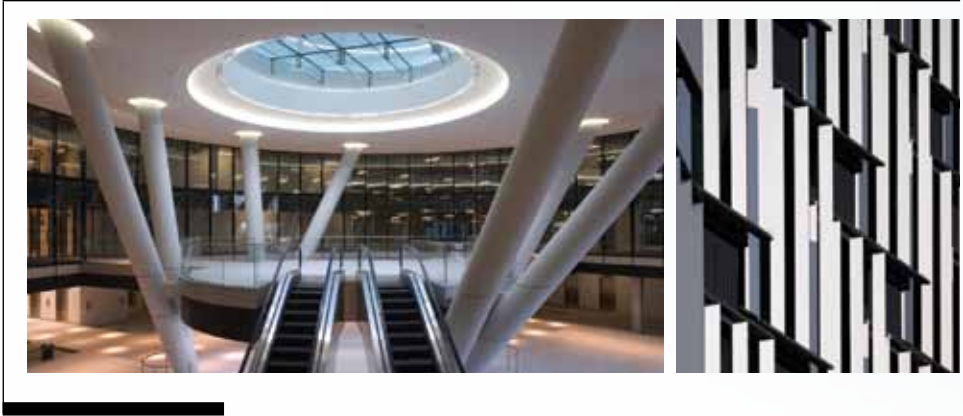
Gareth Arnold: **What are the key challenges for companies seeking internal model approval?**

Paul Clarke: The UK FSA has deferred internal model applications until the spring of next year. This does give companies in the first wave a little more time to prepare. They should be using the extra time before submission to strengthen confidence in their model and how well it's integrated and governed within the business.

Gareth Arnold: **What are the key challenges for companies opting for the standard formula?**

Paul Clarke: This is also a crucial time for companies opting for the standard formula. The lobbying on areas that have caused concern continues. This includes the calibrations for catastrophe risk and guaranteed products. It also includes the level of complexity in the rules. However, firms cannot assume that the rules are going to be changed in their favour. Even if there are modifications, there is unlikely to be a fresh quantitative impact study to evaluate the ramifications. So among the key priorities over the next few months will be carrying out capital and competitor analyses to help prepare for different scenarios, including the possibility of little or no change in the proposed rules.

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Gareth Arnold: **How is group supervision coming together?**

Paul Clarke: The colleges of supervisors are beginning to come together, but this is still a very new process for those involved. It's going to take them some time to work out who does what in areas such as risk evaluation. While one supervisor will take the lead, usually the national regulator in the company's headquarters country, local supervisors are going to play a much more active role than some groups might have anticipated. Groups with operations outside the EEA or equivalent countries will have to apply Solvency II to these subsidiaries, which could have competitive implications.

Gareth Arnold: **What are the prospects for equivalence?**

Paul Clarke: Bermuda, Japan and Switzerland look like they're on track to achieve equivalence. The US will probably be subject to a five year transitional period in which there will in effect be equivalence while the US moves towards greater convergence with Solvency II. EU groups won't have to apply Solvency II capital rules to their US operations during this transitional period, which will help to avoid any potential competitive disadvantages. The situation could become delicate if the US hasn't made much progress towards convergence when these arrangements are reviewed.

Gareth Arnold: **How much restructuring is there going to be ahead of the launch date?**

Paul Clarke: Tax, capital and operating structures that are designed around current regulations are unlikely to be as effective under the new regime. A number of groups have or are planning to restructure their operations. Groups that are looking to follow suit may not have time to adjust their structures before the directive comes into force. But analysts will expect companies to have assessed the impact of the new rules and have developed plans to move to their preferred structure.

IT LOOKS LIKE THE WRANGLING OVER THE SOLVENCY II WILL GO UP TO THE WIRE AND PERHAPS EVEN BEYOND AND DELAYS WILL HAVE A KNOCK-ON EFFECT FURTHER DOWN THE LINE

Dealing with UNCERTAINTY

The launch date and some of the technical specifications for Solvency II are still subject to debate. Yet, this shouldn't affect progress on implementation as more than 80% of what needs to be done is already clear.

It looks like the wrangling over Solvency II will go up to the wire and perhaps even beyond. Even though the legal framework (Level One), implementing measures (Level Two) and the technical guidance (Level Three) are being developed in parallel, they have to be formally agreed and ratified in sequence. This means that any delays will have a knock-on effect further down the line.

As things stand, the revised framework and the duration of the various transitional measures will be enacted as part of next year's Omnibus II legislation. The European Commission will then publish the implementing measures, though they might have to be 'frozen' (i.e. fixed but not ratified) to provide insurers with a stable platform until the measures are formally approved by the European Parliament and Council of Ministers. By the time the initial technical guidance is ready to be announced, Solvency II may be about to go live or even be up and running. This means that the detail in Solvency II is likely to be fleshed out over time.

Solvency II was originally due to go fully live in January 2013. However, we understand that the Commission may be considering a so-called 'soft' launch for Solvency II in January 2013, in which Solvency I calculations and other interim arrangements would continue until the directive takes full effect in January 2014. How these arrangements would work is unclear at this stage. While the Solvency II capital requirements may not come into force until 2014, you may still need to provide your supervisor with confirmed Solvency II numbers in 2013.



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PRESSING ON

Clearly this uncertainty isn't ideal, though the main planks of the directive and their implications are well established and very unlikely to change. There is therefore no reason why your company shouldn't press on with implementation while the timings and technical details are being finalised.

The quicker you get compliance out of the way, the sooner you can begin to focus on realising the business benefits from your investment. If you hold back until everything is agreed, you're going to leave yourself with too little time to carry out all the heavy lifting that will be required.

So what can you do now, how do you prepare for possible changes and how might the phased approach to rolling out the new regime affect the way you apply the rules and run your business?

PILLAR 1: SOLVENCY BALANCE SHEET AND CAPITAL REQUIREMENTS

What is going to take the most time from an operational perspective is building and validating the data gathering, modelling/analysis and the reporting capabilities needed to come up with the new risk and capital numbers. Once the technical standards are fixed, it will then be just a matter of plugging them in to make the necessary calculations.

From a business perspective, the final decisions on many of the technical standards could have a crucial impact on the strength of the solvency balance sheet. Key areas that are still subject to debate include the discount rate, contract boundaries and capital calibrations for market risk and catastrophe risk. It will be important to assess the impact of different outcomes and prepare any necessary contingency plans. Further areas that will require scenario and contingency planning include possible delays in internal model approval and the decisions on equivalence (see 'making the most of equivalence' on page 14).

While the draft Omnibus II allowed for up ten years breathing space, many of the provisions are likely to be phased in over 18-24 months. One or two areas are likely to require a longer lead time including the classification of hybrid capital. There may also be some form of temporary approval for internal models if the timetable or supervisory workload doesn't allow for proper accreditation before Solvency II goes live.

PILLAR 2: SUPERVISORY REVIEW

Risk frameworks and other key aspects of Pillar 2 will need to be developed and in place from the outset (in Germany, these provisions have already been built into local regulation). It will be important to allow enough time to make sure that risk considerations are demonstrably embedded in decision making. Other pressing challenges include preparing for the own risk and solvency assessment (ORSA) process.



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CLEARLY THIS UNCERTAINTY ISN'T IDEAL, THOUGH THE MAIN PLANKS OF THE DIRECTIVE AND THEIR IMPLICATIONS ARE WELL ESTABLISHED AND VERY UNLIKELY TO CHANGE

PILLAR 3: DISCLOSURE

The transitional arrangements will determine the scope and timelines of the public and supervisory disclosures. From the outset, reports to supervisors are going to be much more onerous than current disclosures (quantitatively and qualitatively), more frequent and with less time to produce them. If Solvency I requirements do run alongside Solvency II, you will have the additional burden of preparing two sets of numbers.

IFRS CROSS-OVER

In addition, there is the prospect of an IFRS insurance contract standard in the coming years. It will be important to consider the implications of the planned new contract standard in both technical and disclosure developments for Solvency II to avoid the need to re-engineer systems and processes shortly after implementing the directive.

KEEPING ON TRACK

Some of the timings and technical details of Solvency II are still up in the air, but the main foundations are clear. This includes the risk and capital evaluation systems and their integration into business management, areas that are likely to take the most time to bed down.

Although there is no need to hold up implementation while the continuing areas of uncertainty are resolved, it will be important to carry out scenario evaluations to gauge the impact of different eventualities on your business and have contingency plans in place to address them. Key areas to focus on include the risk calibrations, decisions on equivalence and impact of any delays in internal model approval.



Getting to grips with group SUPERVISION

Under Solvency II, group supervision will be led by a single supervisor. Yet in practice, compliance is likely to be more complex, especially for groups with multiple entities or headquarters outside the European Economic Area (EEA). This underlines the importance of effective group-wide governance and a clear understanding of what both lead and local supervisors expect. For some groups, Solvency II may also act as a catalyst for rationalisation and restructuring.

One of the key aims of Solvency II is to strengthen the single market within the EEA through a harmonised prudential framework. A single supervisor will set the strategy for regulation of a group, working with a college of regulators covering the different local entities. EIOPA, based in Frankfurt and replacing CEIOPS, is going to develop its role as the regulatory body with key responsibility for regulatory consistency across groups and will have a role to play in supervisory colleges.



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Yet, how the colleges will operate in practice has yet to be ironed out and won't be finalised until the guidelines for supervisory enforcement (Level Three) are announced. We're also awaiting confirmation of how own risk and solvency assessments (ORSAs) will be implemented at group and solo entity levels. Continued lobbying will be important in helping to make sure that the system of group supervision promotes harmonisation and simplifies compliance.

Even when these requirements are finalised, there will continue to be some uncertainty over application. This is a very new model for the regulatory community to get used to and it will inevitably take time to bed down. Key challenges include creating a co-ordinated plan for overseeing risk.

What is certain is that local supervisors are going to continue to play an influential role, both at entity level and within the college. This is understandable as subsidiaries which may have only a marginal impact on the overall capital requirements of a group could be extremely important in a particular local market.

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WHAT IS CERTAIN IS THAT LOCAL SUPERVISORS
ARE GOING TO CONTINUE TO PLAY AN
INFLUENTIAL ROLE, BOTH AT ENTITY LEVEL
AND WITHIN THE COLLEGE





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Although Solvency II aims to level the playing field, your group will still have to deal with a number of 'referees', who may have different priorities and interpret the rules in particular ways. It will therefore be important to engage with each of your local regulators and work with them to understand what they expect and how this can best be applied.

STRUCTURING GOVERNANCE AND RISK MANAGEMENT

With groups facing more complex demands on how they manage risk and build this into decision making, effective governance is going to be even more important.

We know from the draft technical standards that there will need to be close interaction between risk management at entity and group level, with clear organisational structures and accountabilities and a consistent view of risk management and its objectives across the group.

In practice, this will require a combination of centralisation and de-centralisation. Centralisation will help to promote group-wide consistency, lower the costs of developing best practice and demonstrate good governance to supervisors and other key stakeholders. An element of decentralisation will be required to make sure local entities take ownership of their risks and that application has buy-in on the ground.

At the summit of this escalating structure is the group CRO. Some decisions on how risk is managed will be taken locally, though capital allocation will need to be authorised at group level. This underlines the importance of effective communication and a clear line of sight between group and entity operations.

RATIONALISING COMPLIANCE

The more entities you have, the greater the cumulative capital requirements and cost of compliance. Multiple entities can also increase the amount of trapped capital as it can be difficult to convince local regulators to allow you to move funds to where they can be more efficiently deployed. As we examine in 'Sharpening capital efficiency' on page 16, this is encouraging some groups to look at ways to rationalise their entity structures.

Solvency II presents particular challenges for groups with headquarters outside the EEA. The directive is primarily focused on Europe and European groups and is arguably less well-suited to the operations of groups based outside. Solvency II may apply to the entire group worldwide. As a result, you may be required to hold funds at least equivalent to the group solvency capital requirement even if your headquarters is outside the EEA. Intra-group transactions including reinsurance to non-EEA or non-equivalent jurisdictions may also attract higher capital charges. There is a risk that you might therefore face higher compliance costs and capital charges than local peers with no EEA operations in the event the 3rd country is not equivalent, or part of any ongoing equivalent assessment.

THE MORE ENTITIES YOU HAVE, THE GREATER THE CUMULATIVE CAPITAL REQUIREMENTS AND COST OF COMPLIANCE

If this is the case, it will be important to assess the significance of your non EEA operations and whether they would have a disproportionate impact on your overall capital requirements. If so, one possible option would be setting up an EEA-based holding company (some groups may be required to do this by their supervisor). The structure in Figure 1 might segregate EEA operations from those in the rest of the world and therefore ring-fence the rest of the group from the Solvency II capital requirements (subject to supervisory approval). It may be possible to further enhance the position by reinsuring EU liabilities into a rated reinsurance company domiciled in an equivalent jurisdiction, such as Bermuda if it secures approval.

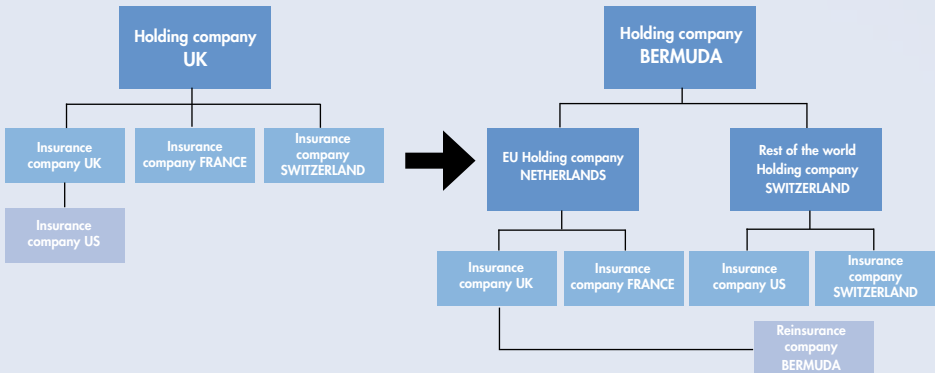
COMPETITIVE DIFFERENTIATOR

The way your group gears up for supervision under Solvency II is not only a key compliance issue, but also a potential competitive differentiator. Key priorities include engaging early with regulators, developing a robust system of group-wide governance and considering how the group could be most effectively structured. If you get this right, you will be able to reduce the cost of compliance and free up capital. You will also be able to improve your operational flexibility and ability to capitalise on opportunities.



Figure 1

HOLDING COMPANY OPTIONS



Source: PwC



Making the most of EQUIVALENCE

'Equivalent' status under Solvency II should provide important benefits for policyholders and insurers, both within the EEA and the potentially equivalent jurisdictions, though the full extent and impact of equivalence remains uncertain. Lobbying will be crucial in making the most of equivalence.

Equivalence is an important consideration for global groups who wish to write business in the European Economic Area (EEA) or provide reinsurance to EEA-based insurers.

The outcome is especially important for reinsurers from Switzerland, Bermuda and Japan, the countries that hope to be the first to gain equivalent status. Without it, the reinsurance they provide may be less attractive to EEA insurers.

Reinsurance

Equivalence would provide effective access to EEA markets for reinsurers based outside the EEA.

Group supervision

If implemented well, group supervision provides an opportunity to reduce duplicative regulation and bring supervision closer into line with the way groups are governed (see 'Getting to grips with group supervision' on page 10). For a company based in an equivalent jurisdiction, equivalence will limit the scope of Solvency II compliance to its EEA operations rather than the group as a whole.

Group solvency

Review and approval of internal models for insurers based within the EEA is subject to possible delays. Groups based in equivalent jurisdictions have an opportunity to push ahead and demonstrate a centralised and cohesive approach to the management of risk. This approach will help to maximise the benefits of Solvency II compliance.

SOME NON-EEA GROUPS HAVE ASSUMED THAT EQUIVALENCE WILL PROVIDE A LICENCE TO DO BUSINESS ACROSS EUROPE AKIN TO THE EU PASSPORTING ARRANGEMENTS. YET IT IS UNLIKELY TO BE THAT STRAIGHTFORWARD

CONTINGENCY PLANS

Bermuda, Switzerland and Japan are included in the 'first wave' of applications and the draft inspection reports suggest that Switzerland is equivalent and Bermuda is equivalent with some caveats. However, the process of confirming equivalence is not yet complete and therefore it is important that companies have contingency plans in case approval is either not confirmed, or is confirmed with limitations.

LIMITS OF EQUIVALENCE

Some non-EEA groups have assumed that equivalence will provide a licence to do business across Europe akin to the EU passporting arrangements. Yet it's unlikely to be that straightforward. Supervision will be applied at both group and local entity level, with Solvency II applying to entities in the EEA. With the practical implementation of the rules on group supervision still under debate, it's also unclear what part equivalent supervisors would play in the colleges of supervisors. It's therefore important that groups based in equivalent states continue to lobby for a clear and straightforward approach to group supervision that provides genuinely equivalent status.

FIVE YEARS GRACE FOR THE US

Although the US is not included in the first wave of countries being assessed for equivalence, it's likely to be classed as a 'transitional' regime. This would provide the benefits of full equivalence, albeit on a temporary basis, whilst being assessed. The transitional period is likely to run for five years, from the date Solvency II is implemented. If the US is deemed to have made sufficient progress towards convergence at the end of this period, equivalence would become permanent.

US regulators are looking closely at the Insurance Core Principles (ICPs) being developed by the International Association of Insurance Supervisors, a number of which are strongly influenced by Solvency II. Resulting developments in the US include proposals for a local version of the own risk and solvency assessment (ORSA). However, whether the US will have made sufficient progress towards convergence and what criteria will be applied to evaluate this are far from clear.

OPEN-ENDED QUESTIONS

Whether Bermuda and Switzerland will achieve equivalence won't be confirmed for some time and is not yet guaranteed. With so much hinging on the outcomes, assessing the impact of and planning for all eventualities are vital. Even if equivalence is approved, it's uncertain how much of a level playing field it will actually provide. It's therefore vital that groups continue to press for a group supervision regime that is true to the principles of international cooperation and an open market.



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Sharpening capital EFFICIENCY

Capital management structures that are tailored to existing regulation are likely to be less efficient under Solvency II. What levers can you pull to improve your capital position?

Preparing for compliance with Solvency II is clearly challenging. Yet the markets won't judge your firm on its implementation alone, but how you optimise your capital and the returns you deliver.

As last year's quantitative impact study (QIS 5) highlighted, structures created for the current solvency regulations may no longer be fit for purpose under the new regime. One of the clearest instances is the penal capital loading for ceding risk to an unrated reinsurer. In many cases, the unrated reinsurers are internal captives that have been set up to enhance capital under the current arrangements, but will have the opposite effect once the new solvency rules come into effect.

Using the QIS 5 results as a starting point, it's possible to analyse the factors driving your capital requirements, determine whether your current arrangements are still appropriate and assess what levers are available to improve capital efficiency.

In our view, there are five main areas of opportunity, with the transitional arrangements potentially giving you more time to put these strategies in place:

1 LIABILITY MANAGEMENT

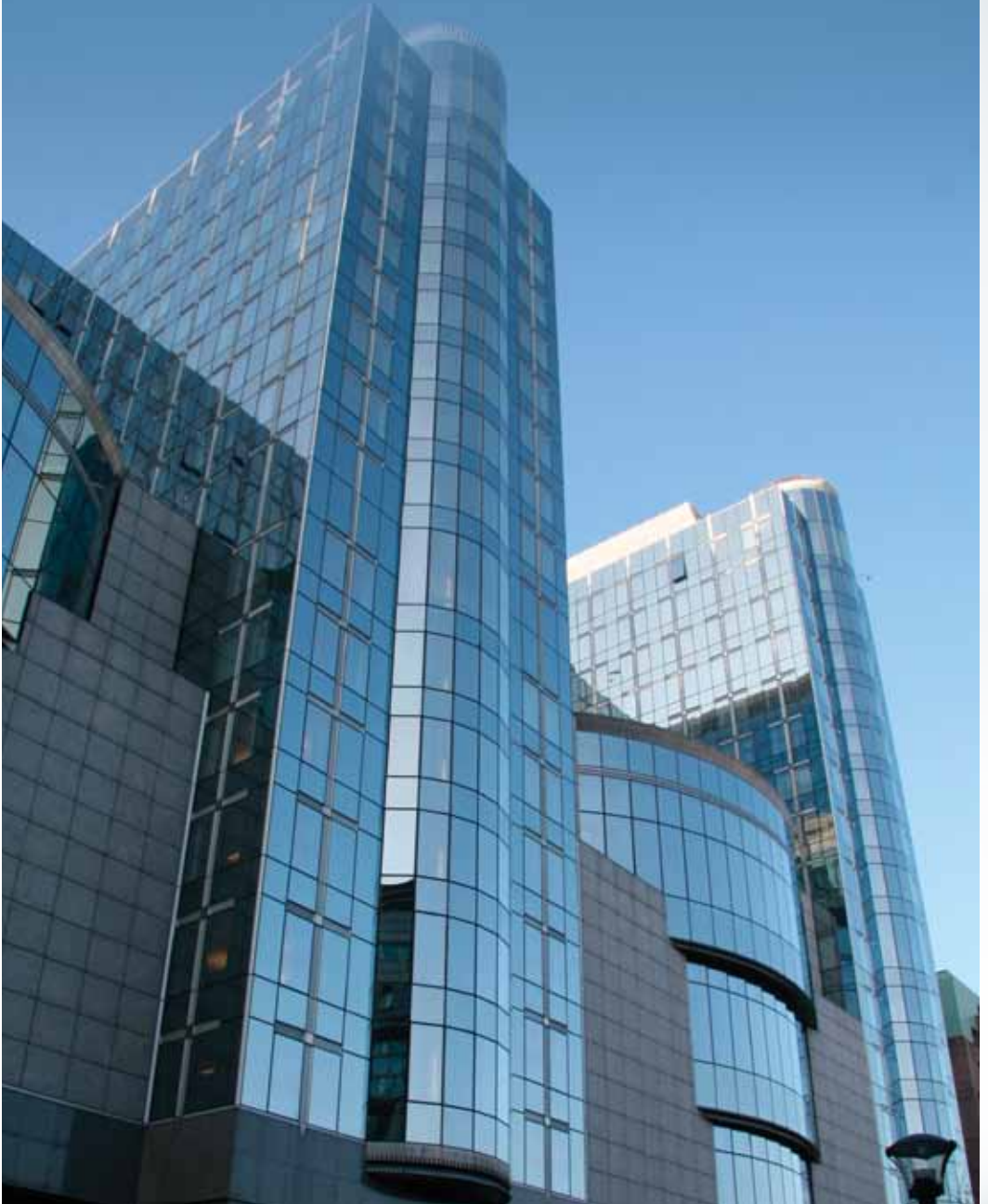
Additional diversification could offset some of your more capital intensive exposures. Another option is to collapse multi-entity structures to consolidate a variety of risks in a single entity.

It will be important to review reinsurance programmes to make sure they're still suitable under Solvency II (see Figure 1). In addition to unrated reinsurers, other areas that may attract high loadings include large exposures to single counterparties.



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USING THE QIS5 RESULTS AS A STARTING POINT, IT'S POSSIBLE TO ANALYSE THE FACTORS DRIVING YOUR CAPITAL REQUIREMENTS, DETERMINE WHETHER YOUR CURRENT ARRANGEMENTS ARE STILL APPROPRIATE AND ASSESS WHAT LEVERS ARE AVAILABLE TO IMPROVE CAPITAL EFFICIENCY



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Figure 1
REVIEW OF REINSURANCE

IS THE REINSURANCE STILL PROVIDING ADEQUATE BENEFIT?

- DOES THE REINSURANCE COVER YOU IN EXTREME SCENARIOS? IS THERE FULL CREDIT IN THE SCR?
- IS IT TAX EFFICIENT?
- DO YOU STILL GET REGULATORY ARBITRAGE?
- LARGE EXPOSURE TO SINGLE COUNTERPARTY
- INTERNAL REINSURANCE TO UNRATED ENTITIES

Source: PwC

2 ASSET VALUATION

Solvency II introduces a more demanding approach to the assets used to back different classes of liabilities, with different capital requirements to those under the current solvency rules. This is spurring a re-think of asset liability matching strategies to optimise capital requirements. Non-life companies are starting to take more notice of this hitherto largely life focused area, especially in terms of duration and currency matching. Areas for consideration include new hedging strategies or replacing certain assets within the investment portfolio. Investment banks are also likely to develop new synthetic products to fit in with Solvency II.

3 LEGAL STRUCTURES

Rationalising complex group structures can help to reduce capital and compliance costs and make it easier to move funds around the group. It may also help to reduce your tax burden.

The structure in Figure 2 seeks to minimise the costs of maintaining a large number of what may be superfluous entities under Solvency II. The structure may also be more efficient from a capital and operational perspective due to diversification benefits, along with cost savings from reduced governance and reporting demands.

Collapsing subsidiaries into the branch structure seen in Figure 3 would enable you to market your products locally, while concentrating capital in a single tax-efficient location. In the Type 1 European branch structure, the capital requirements are centred in a single European insurance company, but the separate branches are currently taxed under their local tax regimes. By moving to a Type 2 structure in which the services are passported into the various countries, the taxable presence is concentrated in the underwriting vehicle.

4 PRODUCT OFFERINGS

Higher capital charges will reduce the profitability of certain products. You may be able to offset some of the charges through diversification. Some products could also be re-designed in a way that reduces capital requirements or even takes them beyond an insurance designation. This may give rise to a competitive advantage, though this will take time to impact on capital requirements. It's important to bear in mind the time needed to secure regulatory and policyholder approval for changes to existing products and re-design and launch new policies.

5 FUNDING

Solvency II values various forms of capital in particular ways and the optimum amounts and types of capital will differ from the current arrangements. In addition, new forms of capital ('ancillary own funds'), such as guarantees and letters of credit can count towards the capital requirements. Although to date letters of credit have not been widely used outside the Lloyd's market, the latest guidance implies that in future a significant proportion of the capital requirements could be met by such instruments. Existing types of capital,

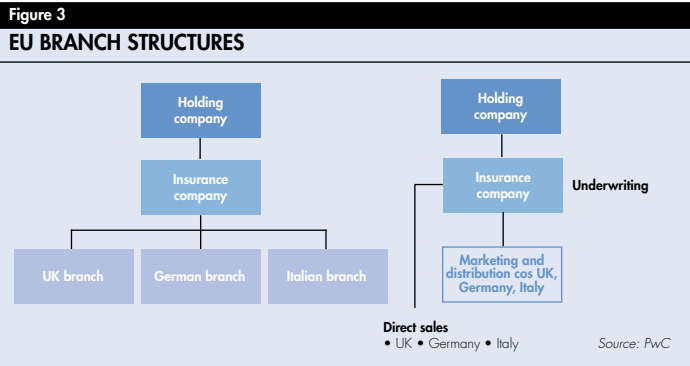
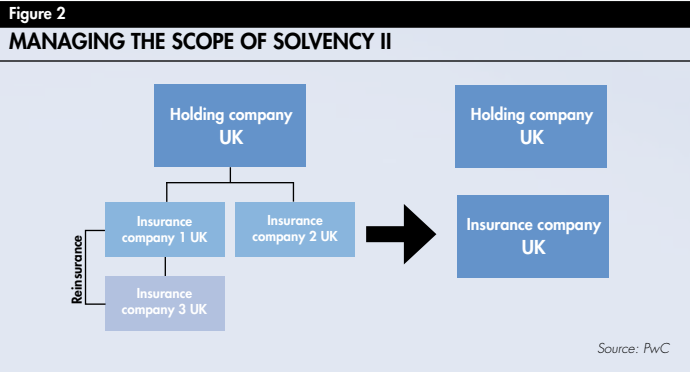
such as contingent loans and financial reinsurance, may not be as efficient under the new regime. If your results suggest that you need to raise additional capital, it will be important to get moving as quickly as possible to avoid being caught up in a pre-deadline rush.

PRIMED FOR THE NEW REGIME

Some groups have already begun to restructure their businesses to optimise capital and reduce compliance costs under the incoming regime. Early movers will reap the dividends. If you're considering following suit, it will be important to bear in mind that many of the restructuring strategies will take time to implement, so even with the extra breathing space of the transitional measures it would be good to get moving in 2011. At the very least, the markets will expect you to have evaluated how your present structures are likely to be affected by Solvency II and have clear plans in place on how to adapt them. If you don't, you could soon face questions from analysts about the relative capital efficiency of your business or find yourself losing business to lower cost competitors operating with more optimal structures.



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RATHER THAN MAKING AD HOC DECISIONS, IT'S IMPORTANT TO CONSIDER HOW ANY MODIFICATIONS WILL AFFECT OVERALL DELIVERY AND THE INTERDEPENDENCIES WITH INITIATIVES THAT HAVE ALREADY BEEN IDENTIFIED

ON TRACK to deliver

Solvency II presents potentially daunting project management challenges. Yet with a clear description of the expected business benefits, how you're going to operate and what each person has to do to make this work, you can cut out unnecessary distractions and get to where you want to be a lot quicker. More effective allocation of responsibilities and co-ordination of deliverables will also make it easier to build Solvency II into business as usual.

For many organisations, Solvency II is going to lead to fundamental changes in how decisions are made, how capital is used and how performance is managed and judged. Even if some of the required systems and approaches are in place, they're going to have to be much more systematically structured, controlled and documented than before.

Yet many firms still find themselves bogged down in technical minutiae or struggling to make sense of how the business will actually change and work in the new world. Many are also finding it difficult to secure the organisational buy-in, understanding and co-ordination needed to make all the many different moving parts click together. As a result, people are confused about what they should be doing. It's difficult to get a clear idea of the costs and how each process inputs into another. There are also widespread inconsistencies in how projects are being implemented and the rate of progress within different parts of the organisation.



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WHAT NEEDS TO CHANGE?

So how do you bring all the pieces together and realise your core objectives while limiting the cost and disruption to the business? The starting point is a clear definition of exactly what you want to get out of Solvency II. It's then possible to map out who needs to do what, how expectations and ways of working for different teams and individuals are going to change and what they need to deliver by when to make sure the next link in the chain can carry out their particular responsibilities. This detailed plan will make it much easier to co-ordinate and communicate the required roles, responsibilities and interdependencies among work streams, while cutting down on needless duplication and activities that are likely to provide limited returns.

A photograph of a person in a blue suit and striped tie, carrying a black briefcase. The person is walking, and the background is blurred. The image is positioned on the right side of the page, partially overlapping the text area.

Data inputs and outputs provide a good example of how this more clearly defined approach would help to sharpen the project focus and cut down on delays. There is no way you can set up procedures to check the quality of all the data being used within your business. That would take years. But you can pinpoint the data needed to run your model, and then map how this is going to be sourced, from whom, at what frequency and in what format, ready for use. You can also work out who needs the outputs and how they're going to be used, bearing in mind that a lot of the analysis that now takes several months may need to be delivered in a matter of days. What information and insights would make a difference to business planning or M&A decisions, for example? How can it be refined and presented in the most accessible way?

SUSTAINING MOMENTUM

Keeping progress on track will require clear accountabilities and reporting lines. Inevitably, there will be road blocks. Project leadership should have the authority to challenge work streams about their priorities and progress, and get them to speed up or change tack if necessary. Flexibility is also crucial. Some tactical compromises will inevitably be needed as the deadline moves closer. Rather than making ad hoc decisions, it's important to consider how any modifications will affect overall delivery and the independencies with initiatives that have already been identified.

Although the first priority will be getting over the line, defining expectations, dependencies and responsibilities will provide the foundations for embedding the directive into the running of the business. This isn't just a matter of compliance, but also making sure that the fruits of your investment in Solvency II are an integral part of decision making and value generation. You will know when you're there when frontline teams recognise that risk drives their performance rating and when they see tangible bottom line benefits.

STRAIGHT TO THE POINT

While implementing Solvency II is going to be hard, there is no need to make it any harder. A clearer definition of what you need and expect to achieve can help to cut through all the technical complexity and organisational rigmarole to communicate what exactly is going to change, each person's part in making this happen and how they're likely to benefit. This will help to make Solvency II real to people within the business and help build up momentum for implementation. It will also help to make sure that resources are targeted where they can make the most difference, both to the effectiveness of implementation and the competitive edge of your business.

The CHANGING face of insurance worldwide

Solvency II is affecting different countries in very different ways. We asked PwC Solvency II subject matter experts in France, Norway, Bermuda, the US, Central and Eastern Europe to describe the particular challenges facing local insurers and regulators, their state of readiness and what the industry hopes to gain from the shake-up ahead.



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NORWAY

The Norwegian insurance market is dominated by a small number of large players, most of which are among the seven companies seeking internal model approval in the first wave.

This concentration at the top of the market has put quite a lot of reputational and competitive pressure on the way the big players approach implementation. Each is looking to use Solvency II to gain an edge on its rivals. While there is a certain amount of industry collaboration in specific areas, most are privately developing their own solutions. This in turn means that there is no overall industry-wide consensus on how to approach implementation or benchmark against which to measure progress, as there would be in most other markets.

While the larger players are moving ahead quickly, the smaller firms are finding it more difficult to make progress in the face of the risk, compliance and documentation demands. The challenge is made more difficult by the lack of industry-wide consensus and benchmarks for them to follow.

A particular challenge in the Norwegian market is the inclusion of many pension schemes within Solvency II on account of the compulsory life insurance coverage attached to them. While recognising the challenges, some funds see this as an opportunity to benefit from more effective risk management and broaden investment portfolios. However, legislative issues between Solvency II and national laws still need to be resolved, and there is pressure on the Ministry of Finance and Financial Supervisory Authority to come up with solutions. A public hearing on national legislation aimed at transposing Solvency II into law is already under way.

THIS CONCENTRATION AT THE TOP OF THE MARKET HAS PUT QUITE A LOT OF REPUTATIONAL AND COMPETITIVE PRESSURE ON THE WAY THE BIG PLAYERS APPROACH IMPLEMENTATION



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JIMMY ZOU leads PwC's Solvency II team in France

Norwegian companies are reviewing their reinsurance placement and many are likely to increase their use of reinsurance as a result of Solvency II.

FRANCE

France has a few giant players. There is then a significant drop down in size to the middle rank and after that a large number of quite small, mainly mutual insurers. Implementation within the larger groups is well advanced and they make up most of the first two waves of internal model applications. Some of the middle rank are likely to follow in a further wave (with a transition period under the standard formula), with the closing date for entering the pre-application questionnaires now imminent.

After a relatively slow start, the smaller players are now under pressure from the regulator to step up the pace of implementation. The catalyst for action has been a recent questionnaire assessing their state of readiness (the deadline to submit responses is coming up in September). The results are due in October.

Solvency II is a new departure for most of the smaller mutuals as they will have to develop formal risk frameworks and have a CRO in place for the first time. The challenge is how to make the new risk function a valuable strategic partner, which is able to deliver competitive benefits in areas such as sharper risk insight and improved asset liability management (ALM).

The other main challenge for the mutuals is size. While relatively well-capitalised, many mutuals are concerned that they won't have the scale to compete on price with larger and more capital-efficient rivals under the new regime. This is leading to an acceleration in consolidation and 'demutualisation'. The number of mutuals is falling rapidly as a result. In 2006, there were 1300. By the end of 2010, the number had dropped to just over 700, with much of the reduction having taken place over the past two years¹.

Asset managers and service providers such as fund administration businesses are also facing considerable challenges as their insurance clients demand faster data, more transparent products and a secure internal control environment (as asset management and sometimes also ALM are outsourced 'critical' functions for many insurance clients). Some asset management businesses also see Solvency II as an opportunity to provide profitable services for less well-resourced clients, such as helping them to calculate their market risks.

Some of the larger insurers may look to review, diversify and possibly increase their use of reinsurance and structured products. However, many of the smaller players (generally very well capitalised under Solvency I) will still prefer to absorb any losses rather than taking out reinsurance, especially as their cost base is set to increase as a result of the demands of Solvency II.

RUSSIA AND EASTERN EUROPE

The insurance markets in most CEE EU member states are dominated by the subsidiaries of international groups. Although most local firms have a lot to do in developing a more systematic approach to risk management and the people needed to run it, Solvency II is not yet on the radar of most local boards. The impetus for progress on implementation and whether internal models are being developed at entity level are heavily dependent on the amount of input and resources local subsidiaries are receiving from their parent group. While some local firms are quite advanced, others have yet to carry out gap analysis or prepare implementation plans. The Polish and Slovenian markets are the exceptions in being dominated by locally-based insurers. Poland is also the only CEE state to be running a model approval process, with 16 firms registering for the initial pre-application programme.

QIS 5 indicated that the insurers in most states are sufficiently capitalised, though the reliability of the results is tempered by the relatively basic risk information capabilities within many firms. Bringing the infrastructure of analysis and reporting up to speed in time to produce quarterly supervisory returns is set to be a significant challenge.

Although some local regulators have been slow to get moving on Solvency II, the Czech, Polish and Romanian supervisors are pushing ahead and already playing a very active role within the supervisory colleges. Subsidiaries that may have a marginal impact on group capital requirements could be extremely significant within a local CEE market. Supervisors are therefore going to be fighting their corner within the colleges.

Outside the EU, a number of countries including the Ukraine are taking a close interest in Solvency II. Russia has issued a draft regulation for insurers which will require insurers to enhance their risk and capital management processes and improve their system of governance. However, this take time to approve, implement and bed down.

BERMUDA

Bermuda sees equivalence as a key priority, enhancing its status as a leading global financial centre and reflecting the strong presence of many of its companies in Lloyd's and other European markets. The Bermuda Monetary Authority's (BMA) willingness to actively contribute to the application of Solvency II can be seen in its development of the XBRL taxonomy for Pillar 3 reporting, something that is being adopted by the European Insurance and Occupational Pensions Authority (EIOPA).

The output from the recent equivalence inspection by EIOPA officials was an important milestone that has validated the significant effort the BMA and companies have made, with a few areas where work remains in progress. Preparing for equivalence hasn't required a fundamental change in regulation as Bermuda already had a risk-based approach. Steps to bring BMA regulation closer into line with Solvency II include the development of the insurance Code of Conduct, Bermuda Solvency Capital Requirement (BSCR) and Commercial Insurers Solvency Self-Assessment (CISSA), which is akin to the European own risk and solvency assessment (ORSA).

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In July, the Code of Conduct came on stream and the first CISSAs were filed. From those that we have seen, the response is encouraging.

The challenge for Bermuda is making sure that other regulators will view the anticipated 'equivalence' status as meaningful and react accordingly. Bermuda's position as group supervisor for many insurers will only be effective for companies if other regulators appreciate the sophistication and strength of the Bermuda regulatory environment and adjust their approach to local entities accordingly. Bermuda is well positioned to be a meaningful group supervisor in a Solvency II environment and market stakeholders should encourage the international regulatory community to embrace the concept of equivalence.



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UNITED STATES

US supervisors recognise the importance of equivalence with Solvency II and are working closely with regulators in Europe. However, while US supervisors are seeking to enhance international supervisory co-operation and develop mechanisms for information sharing, they aren't looking to bring US regulation completely into line with Solvency II.

Although US and European regulation is moving closer in some important areas, this is a result of the continued focus on enterprise risk management (ERM) by the US National Association of Insurance Commissioners (NAIC) and international developments in regulatory practice being promoted by the International Association of Insurance Supervisors' (IAIS), rather than a policy of convergence with Solvency II.

Many US groups conduct business in Europe, so equivalence with Solvency II is a significant consideration for insurers here. Groups will be watching the NAIC's discussions with Europe closely over the next year or so. However, insurers will need to be convinced that any changes will work in the US regulatory environment before they are accepted.

In 2008, the NAIC launched the Solvency Modernization Initiative (SMI), an on-going assessment of the US regulatory framework. As part of the SMI, the NAIC is reviewing international developments including the IAIS' revised Insurance Core Principles (ICPs). The ICPs relating to enterprise risk management (ICP 16), capital adequacy (ICP 17) and group supervision (ICP 23) have strong parallels with Solvency II.

Recent developments include a proposed new US own risk and solvency assessment (ORSA). Although this is due to come into force in 2012, a number of issues have yet to be resolved including confidentiality and whether subsidiaries would be required to prepare an ORSA. A recent PwC survey of readiness for the ORSA found that only around 15% of companies are currently prepared to meet the requirement, with 70% in the process of preparation. The remainder have considerable work to do.²

REFERENCES: ¹Autorité de Contrôle Prudentiel Annual Report 2010
²Live poll of 169 insurance companies carried out during PwC insurance solvency webcast on 06.04.11

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The survivors' guide to
SOLVENCY II