

Gearing up for Solvency II

Making Solvency II work for the business*

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Introduction

Solvency II is reaching a decisive point in its development as the framework legislation is adopted and the focus moves to how the directive will be implemented in practice and how it will shape the competitive landscape of the insurance industry.

Solvency II has often been seen as primarily a technical actuarial exercise. However, many insurers are now coming to recognise its far-reaching business implications, with a number also beginning to appreciate its competitive potential. This includes more efficient use of capital, a more informed basis for decision-making and an improved ability to convey the strength and potential of the enterprise to analysts, investors, counterparties and rating agencies.

Although the directive is not due to go live until 2012, forward-looking insurers are already seeking to realise these opportunities and secure early mover advantages. As the experience of Basel II underlines, companies that allow themselves to slip behind may not only find that implementation becomes more costly and disruptive, but also leave themselves on the back foot competitively.

In our 2007 paper, 'Gearing up for Solvency II: The new business environment'¹, we looked at the requirements in the proposed framework directive. We encouraged insurers to define their ambition for Solvency II, considering how to make compliance work for the business. This paper looks further at how this ambition can be realised in practice to enhance competitive advantage.

'Making Solvency II work for the business' draws on analysis carried out by PricewaterhouseCoopers² industry experts from around Europe about how leading insurers are putting themselves on a firm competitive footing for Solvency II. It includes a checklist of key considerations for executives and a series of milestones that will need to be addressed over the coming year.

¹ Free copies are available for download from www.pwc.com/solvencyII.

² PricewaterhouseCoopers refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

Executive summary

How can insurers deliver the competitive payback from the changes and investment required to comply with Solvency II?

Solvency II should prove as much a strategic opportunity, even competitive imperative, as a compliance requirement.

Solvency II will require European insurers to consider their balance sheet on an 'economic' basis and assess their regulatory capital requirements within a forward-looking risk-sensitive framework. Companies will also need to present their own risk and solvency assessment (ORSA) and prepare for probing public disclosure about their risk and capital position.

More informed basis for decision-making

This offers a number of valuable opportunities, with the development of a **more informed basis for decision-making** at the forefront. As such, Solvency II could improve companies' ability to strike a more sustainable balance between risk and reward and provide comfort for the board and external stakeholders that risks are being actively controlled. Lessons from the credit crunch provide a clear indication of the value of such a process. Boards that could draw on timely, reliable and forward-looking analysis of their firm-wide exposures were generally able to anticipate the looming crisis and withdraw before they suffered major losses.³ To realise these benefits, many insurers will need to develop a more systematic approach to governance and risk management.

Better use of capital

One of the key benefits of a more informed basis for decision-making will be the ability to make **better use of capital** at a time of mounting funding constraints and competition for investment. The directive should provide the regulatory impetus to instil economic capital evaluation and related enterprise-wide risk management (ERM) into the strategy, operations and communications of the business. The challenges include bringing boards, management and business teams to understand what for many may be complex and unfamiliar risk and capital analysis.

Digging up the road twice

The key foundations of improved decision-making and more efficient use of capital are reliable valuation systems, clear processes and sound controls. With Solvency II's valuation

bases moving in the same direction as the latest developments in IFRS Phase II for insurance contracts, companies are facing a potentially costly overhaul of their reporting systems, which will inevitably compete for resources with other equally pressing demands. If approached holistically, however, the parallels between Solvency II and IFRS Phase II should enable companies to realise valuable synergies in data, modelling and information systems. This would improve the consistency of both internal and external reporting, while avoiding the needless cost and disruption of 'digging up the road twice'. While synergies exist, companies need to anticipate and explain the new numbers, along with any differences between the IFRS and Solvency II assumptions and results, to possibly unfamiliar or even sceptical analysts and investors.

Enhanced product profitability

Solvency II will cast the spotlight on riskier and capital-intensive products. This may require significant modifications in prices and the make-up of the product portfolio. However, it may also provide opportunities for portfolio optimisation, keener pricing and **enhanced product profitability** among companies with superior information systems and well-embedded ERM capabilities.

How much and how little

The principle of 'proportionality' will require companies to match the sophistication of their governance structures with the individual scale, nature and complexity of the business – **how much and how little?** Insurers need to judge where their current business is likely to fit in the three-dimensional 'grid' of scale, nature and complexity under Solvency II, both now and in the future, and assess the resulting compliance implications. They will also need to produce documentary evidence to justify that their planned approach is 'proportionate' and engage with their supervisor to ensure their response will meet with regulatory approval. Examining the possible implications and engaging in the consultation process now could improve a company's ability to influence a still far from finalised implementation plan. Leaving this to the last minute could prove highly costly and have the potential to impede future business development and growth.

³ 'Observations on risk management practices during the recent market turbulence', a study published in March 2008 by the Senior Supervisors Group, a body that brings together financial services regulators from the US, UK, France, Germany and Switzerland, concluded that 'firms that avoided such problems demonstrated a comprehensive approach to viewing firm-wide exposures...and engaging in more effective dialogue across the management team'.

Addressing this lengthy list of competitive issues will require a shift in the culture and mindset of the business with important implications for strategic planning, management skills, incentives and organisational behaviour. Running what could be a much more elaborate infrastructure of risk, governance and capital management will lead to heightened competition for qualified personnel, leading to further pressure on the availability of already scarce talent as the deadline for implementation draws closer.

The proposed streamlining of group supervision under Solvency II could have an important impact on the way companies operate and structure their businesses. Although the details of

how this is likely to work in practice are still subject to debate, a number of significant proposals have emerged in recent months. These developments and their potential implications are outlined in Appendix 1 on page 13.

The Executive checklist below sets out some of the pressing considerations in ensuring effective Solvency II implementation and realising the competitive potential of the directive.

Executive checklist

1. What is your ambition for Solvency II? How does this align itself to your risk profile and the current scale, nature and complexity of the business?
2. Have you appointed an executive sponsor for Solvency II?
3. Are your plans underpinned by clear and realisable timetables and appropriate allocation of responsibilities and resources for delivery?
4. How could you streamline implementation of Solvency II and IFRS Phase II to ease the cost and potential disruption?
5. Will your valuation standards and risk and capital management procedures stand up to heightened market scrutiny?
6. How will Solvency II affect your organisational and operational structures?
7. Do you have a plan for identifying, retaining and developing talent?
8. How will Solvency II affect the capital position of subsidiaries and the group as a whole?
9. How capital efficient are your products?
10. How could the required risk and capital analysis sharpen decision-making within the business?
11. Are technical teams working with business units to ensure that the Solvency II project delivers benefits for frontline personnel?
12. Are you engaging with external stakeholders to manage expectations?



More informed decision-making

Solvency II will have crucial implications for the way insurers set strategy, measure performance and are judged by analysts, investors, counterparties and rating agencies.

Opportunities

Under the Pillar 2 governance articles of Solvency II, insurers need to demonstrate that risk management considerations are a fully integral element of their strategic decision-making and capital management processes.

This is a demanding requirement. However, the development of an integrated risk and capital management framework should help to strengthen decision-making and deliver more favourable and sustainable returns by enabling insurers to assess the full trade-off between risk and reward. Particular benefits include greater transparency around the basis for evaluating business options and the approach used to determine and manage all potential exposures. This transparency should provide greater comfort for the board and stakeholders ('no surprises'). It will also improve companies' ability to evaluate past decisions and hone their strategy accordingly. Developments such as the Own Risk and Solvency Assessment (ORSA) and disclosure of information on each risk category will support this.

An integrated risk and capital management framework will enable companies to convey a consistent view of the risks they run to all interested parties. It will also help them to support stakeholders in gaining a clearer understanding of the organisational mechanics and rationale for key decisions within the business. The potential benefits include enhanced investor confidence, stronger ratings and reduced regulatory capital over the medium term.

Challenges

To realise these opportunities in an orderly and cost-effective way, boards need to determine a Solvency II implementation strategy that is 'fit for purpose' – balancing development costs against potential benefits. The governance and risk management infrastructure needs to be flexible enough to adapt to market changes and strategic developments (the section on 'proportionality' on page 12 examines this in more detail). To be effective, the risk and capital management framework needs to be underpinned by reliable and consistent data, with cohesive IT systems supporting the flow of information throughout the organisation.

Creating a common firm-wide understanding of risk and its implications will be a challenge for many organisations. Securing buy-in from the board to the back office and delivering a consistent approach to risk management that permeates throughout the organisation will require considerable resources

and change management skills. In particular, boards and management need to become familiar with new types of information and ensure that the risk management and operational behaviour are being applied consistently within the business. To do this, they need to understand and, where necessary, be able to challenge the assumptions and drivers underlying the risk and operational assessments to a greater extent than today. This analysis and its ramifications also need to be trusted, intelligible and usable by commercial teams on the ground. Failure to do so could not only make it harder to meet the Solvency II 'use test', but also limit the commercial value of investment in enhanced information systems.

Experience of Basel II indicates that an industry-wide overhaul on this scale can place severe strains on available talent and other resources. It is therefore essential that companies assess the implications and set realisable objectives, while looking at how to ensure controlled change with minimal disruption.

Delivering the additional public disclosures of the risk exposures, concentrations, sensitivities and mitigations will place further demands on systems development. Increased disclosure will also open insurers up to more probing enquiry from interested stakeholders. Addressing this will require timely education and explanation for those analysts and investors that may be unfamiliar with Solvency II valuation bases/assumptions and how they differ from other reported numbers such as those on an IFRS basis.

Although transitional measures may postpone disclosure requirements for some years, they will come in the end. Companies need to factor the implications of this scrutiny into their strategic thinking for Solvency II. Moving early to provide more effective risk disclosure could provide significant competitive advantages.

Making it happen

A common theme throughout all elements of Solvency II implementation is the need for senior management to take the lead in defining the company's ambition and strategy and providing the necessary resources and direction to make it happen.

Management need to develop a realisable strategy. Ideally, this should include a clear outline of the company's risk appetite, objectives for risk management and how these are being met, along with year-on-year changes in risk sensitivities and the forward-looking management assumptions that underpin risk evaluation and management. Companies need to decide how to

provide a clear explanation of their approach and convincing evidence that they are in control. This includes judging what to disclose, what not to disclose and how to present the information in the most intelligible way.

To ensure consistency of approach and understanding it is important to develop common systems and comparable metrics (a common 'risk language') that applies to all risks. This will require education and explanation within the organisation, along with a shift towards risk-based performance objectives and incentives. Risk teams also need to be able to challenge key business decisions and be supported by a culture that encourages such dialogue, even if it goes against the strategic grain.

Determining the company's risk appetite, developing the associated risk tolerances and embedding these into the business could prove needlessly cumbersome and stifling if

approached from a purely compliance perspective. A flexible approach that balances compliance with the needs of the business is therefore essential.

As outlined earlier, firms need reliable and consistent data and a cohesive IT infrastructure (encompassing internal models, where appropriate) to ensure that the process does not fall into the trap of churning 'garbage-in and garbage-out'. Companies should assess the adequacy of their data and IT systems now.

Key personnel could prove scarcer and more expensive to hire, the closer companies come to the implementation deadline. Insurers therefore need to develop a clear strategy for identifying, retaining and developing talent. This includes judging whether to recruit or develop from within.

Milestones

- Appoint an executive sponsor for your business
- Articulate your Solvency II ambition and incorporate it within your overall business strategy
- Bring together a team to lead the project, and identify whether people with the appropriate skills/talent are in place to drive the Solvency II process
- Assess the impact of Solvency II on your organisational and operational business structures
- Assess your current business processes against the new requirements in key areas including data, IT systems, risk management, governance structures, models
- Develop a communication strategy for external stakeholders (regulators, investors and rating agencies) capable of clearly conveying risk and capital evaluation and management
- Develop a strategy for talent acquisition and retention



Better use of capital

Solvency II should increase transparency for insurers (shareholder-owned, mutual, listed or not), enabling them to better understand the capital usage of various aspects of their business and hence enhance their ability to target investment effectively.

Opportunities

Risk-based economic capital evaluation is now a key driver for decision-making within a number of insurers in areas such as new business initiatives and capacity planning. In addition, rating agencies are using this approach in their evaluations of insurance companies. Solvency II will bring regulatory capital within this risk-based capital management framework by requiring the Solvency Capital Requirement (SCR) to be determined by applying risk measures set by the regulator.⁴

These requirements provide an incentive for organisations to upgrade their systems and an opportunity to bring risk-based capital evaluation out of its 'black box'. Furthermore, the Solvency II use test reinforces the need to integrate risk-based capital evaluation and related ERM more closely into the day-to-day decision-making and the longer term strategy of the business.

A key building block of economic capital evaluation is the clear articulation of the company's risk appetite. If used as part of Solvency II implementation, such articulation will encourage a more consistent enterprise-wide view of how risks are accepted, accumulated and diversified through effective portfolio management.

The spotlight on capital efficiency will inevitably focus greater attention on qualifying capital, corporate and operational structures. Solvency II introduces new forms of qualifying solvency capital, such as preference shares and hybrid capital (e.g. letters of credit), which may be less costly than existing capital. From a structural perspective, groups may consider relocating their headquarters and/or moving to a branch structure to realise capital, operational and tax efficiencies. Solvency II has already accelerated consideration of such changes within many organisations and others are likely to follow suit as the deadline for implementation moves closer.

Challenges

Realising these opportunities will require the development of strong modelling capabilities, underpinned by consistent data and a clear understanding of the key drivers of risk and reward.

Even within organisations that do not use their own model for SCR and strategic purposes, management will need to be able to assess the capital impact of their strategic decisions. This should ensure that capital evaluation and allocation are seen to be relevant to the business, rather than being a remote and arbitrary process that bears little relation to the day-to-day priorities of the business.

The underlying challenge is to determine how effectively risk awareness is embedded into the culture and operations of business and how well risk tolerances are articulated and understood within the organisation. Clearly, there can be no reward without risk, and therefore management needs to have the confidence and demonstrable understanding to convince all stakeholders, both internal and external, that they can balance risk-taking and control.

While it is accepted that economic capital criteria are now applied by many rating agencies, another challenge for senior management is to understand and reconcile the methodologies used, and if necessary educate, to ensure consistency. As capital requirements are opened up to public scrutiny, management need to be able to explain and justify why their business has a different risk/reward balance and/or a lower or higher SCR than a competitor.

⁴ Value-at-Risk of 99.5% over one year.

Making it happen

The implementation of risk-based economic capital systems is already well under way within a number of organisations. This has required significant senior management sponsorship, a comprehensive project plan and highly skilled resources. Use of a dominant capital metric to drive decisions and judge performance against objectives will help to embed risk awareness within the organisation and ensure that risks are determined on a consistent basis. Companies will also need to develop and introduce a capital policy to determine the right mix of qualified capital.

Companies that are able to reconcile any disparities between their financial reporting, own internal models, regulatory requirements and rating agency assessments will be able to present a more coherent picture to their stakeholders, making external communication more straightforward.

The first steps in the implementation of an integrated risk-based economic capital system are a thorough assessment of the company's risk profile and, building on this analysis, a clear articulation by the board of the risk appetite of the organisation. Evaluating risk awareness and tolerance throughout the company will enable management to determine how aligned organisational behaviour is with the defined risk appetite.

Internal models not only need to be advanced enough to deal with complex evaluations, but also be appropriately controlled and documented. Training will be required to ensure management and business personnel understand the capital analysis produced by the models and how it should be used. Given that management will need to promote and manage the necessary developments under Solvency II, this training will need to commence within the short term.

Milestones

- Assess the capital impact of Solvency II on your operational business structures
- Decide on your dominant capital metric
- Analyse how Solvency II will affect the capital position of subsidiaries and the company as a whole



Valuation – don't dig up the road twice!

To realise the benefits of more effective capital management and a more incisive basis for decision-making demands reliable valuation systems.

Opportunities

Solvency II will use a market-consistent economic approach to the valuation of liabilities. This is in keeping with developments in the evaluation of technical provisions under the proposed IFRS Phase II. Dovetailing Solvency II implementation with IFRS would therefore avoid digging up the same road twice. This includes realising the potential synergies in data, modelling and reporting systems, which could save considerable time and money, while enhancing long-term operational efficiency.

Insurers can use the necessary investment in Solvency II/IFRS as an opportunity to rationalise disparate models and valuation systems onto one platform. They might also consider consolidating back-office valuation and reporting processes into centralised hubs. A harmonised IT platform and valuation approach could facilitate a faster close for both accounting and capital results, which should in turn enhance credibility with key external stakeholders.

Challenges

Realising these benefits is likely to require further development of internal models and IT structures, valuation processes and controls, and reporting systems. Specific Solvency II requirements, such as the need to split insurance liabilities between homogeneous risk classes and the attribution of profit and loss by risk category, could increase complexity and expense if not useable for IFRS purposes. The new valuation systems could also require significant maintenance, including more active monitoring and the use of experience assumptions.

The eventual IFRS regime may still require different processes – in particular, IFRS deals with the contract and Solvency II with the entity, so policies that may not be designated as insurance under IFRS, such as investment plans, would still fall under Solvency II. There could also be differences in the calibration of assumptions and the treatment of certain liabilities. Any differences in the numbers need to be disclosed in the financial and solvency condition report (public disclosure will be mandatory although perhaps not until 2017).

Companies need to anticipate and, where possible, reconcile any changes. They also need to keep up to date with the evolving IFRS debate, as their Solvency II implementation programmes progress.

Making it happen

Prioritisation is critical. The first step is to assess the implications of reporting under the new Solvency II and IFRS valuation bases and the extent to which re-engineering of the valuation systems might be required. As part of this assessment, it is worth considering the opportunities to also enhance management information, streamline model platforms and use modelling staff more efficiently and effectively.

The next step is for management to build up a clear understanding of the valuation methods, their underlying assumptions and the potential implications for the volatility of assets and liabilities, earnings and market judgement. This would enable them to anticipate and explain the likely impact on the numbers to stakeholders.

Early development of a well-planned implementation programme, which allows sufficient time to understand the numbers under the new Solvency II valuation basis, should realise these opportunities, while balancing competing demands on scarce resources.

Milestones

- Assess the impact of Solvency II on your valuation basis and operational structure
- Decide on the scale of re-engineering of finance and risk functions that will be required and how this can be realised
- Regularly communicate benefits to senior management and external stakeholders

Enhanced product profitability

Solvency II should provide an opportunity to develop a clearer understanding of product margins and movements in the underwriting cycle.

Opportunities

Solvency II should help insurers to strengthen their economic capital evaluation, which could in turn provide a more risk-sensitive approach to portfolio management and product development.

As a result, some companies may increase the price of riskier products, exit certain capital-intensive lines or modify their portfolios, for example switching from guaranteed to unit-linked savings instruments. More effective risk analysis could alternatively help firms to offer keener prices on particular products, thereby carving out a valuable market niche or encouraging competitors that are less able to adapt to withdraw.

Choosing to exit from certain business lines would release resources for more profitable or strategically consistent products. However, it is important to note that insurers with more diversified product portfolios or distribution channels should benefit from lower regulatory capital charges under Solvency II.

Solvency II provides an opportunity to develop more risk-sensitive incentives for business units. Through closer alignment between the overall risk appetite and limits on the ground, the directive could also strengthen the enforcement of underwriting and pricing controls and hence manage the risks more effectively through the business cycle.

Challenges

Once again, realising the full benefits may require a cultural shift. In particular, effective product design and development is likely to require the combined expertise and close cooperation of marketing, underwriting, risk management, compliance and actuarial teams. These various functions may have different approaches and in some cases have worked largely in isolation before.

Companies may also need to reassess the IT systems supporting their product development and sales process. Moreover, insurers need to consider the impact on the sales and distribution channels supporting the various products. For example, how might a broker or independent financial advisor respond to the withdrawal of a product?

Making it happen

Developing a better understanding of risk-adjusted product returns and fostering closer partnership between marketing, underwriting, risk management, compliance and actuarial teams will require common metrics and approval processes that can be applied across the organisation. Insurers also need to ensure the principles and priorities of this risk-conscious approach are understood and applied throughout the company.

By way of example, marketing and risk teams may have had limited experience of working together in the past and may have had very different performance objectives and measures. A common 'language' of risk and reward should help to underpin closer cooperation and mutual understanding. The development of risk-based incentives could in turn help ensure that risk considerations become more integral to the day-to-day priorities of frontline teams.

Many leading insurers are developing predictive analytics/pricing controls to help them manage the cycle in a more proactive way. Examples include lead indicators to track premium rating adequacy at the point of sale. This could provide significant competitive advantages over traditional approaches, under which the first indication that business has been written at a loss may only come when claims are submitted. Even then, it can take many months before this reactive analysis is translated into prices on the ground. When aligned to risk-adjusted technical pricing approaches, companies can not only price more keenly, but also assure analysts that the business being written is genuinely profitable and in keeping with the overall risk appetite.

Milestones

- Develop a common understanding of risk-adjusted product returns across the organisation
- Ensure common language of risk and reward is used across marketing, underwriting, risk management, compliance and actuarial teams

How much and how little (proportionality)?

Insurers need to move early to influence and understand the potential implications of 'proportionality' under Solvency II.

Opportunities

By getting to grips with Solvency II's 'proportionality' principle now, early movers can evaluate how it will affect each element of their strategy. This will help them to judge whether their business may need to be modified or remodelled to ensure that their governance and functional requirements under Solvency II are cost-effective. For example, it may be necessary to withdraw certain products or adjust operating structures to avoid excessive demands on what might in most other respects be a relatively simple business.

Early assessment of the potential implications will also put companies in a better position to influence supervisors to ensure that the eventual implementation measures are workable and proportionate.

Proportionality will not be determined exclusively by size. It should result in less stringent requirements for companies that can prove they underwrite less risky and complex business and have relatively simple organisational and operational structures. Conversely, tougher measures are likely to apply to firms operating with greater complexity and risk. For individual firms, the principle could apply both ways. For example, certain mono-line companies may face severe Pillar 1 demands as a result of risk concentrations, but find some relief in less rigid governance requirements under Pillar 2, as a result of their relative simplicity.

'Proportionality works two ways: it justifies simpler and less burdensome ways of meeting requirements for low risk-profile portfolios, but also increases the likelihood that undertakings in fulfilling requirements will need to apply more sophisticated methods and techniques for more complex risk portfolios.'

From CEIOPS Advice to the European Commission on the Principle of Proportionality in the Solvency II framework Directive Proposal, May 2008

Challenges

The proportionality principle applies to all elements of Solvency II and its (yet to be defined) implementing measures.

A working group from the Committee of European Insurance and Occupational Pension Supervisors (CEIOPS)⁵ is looking at both the 'Level 2' implementation measures and 'Level 3' standards for consistent EU-wide application. Given the current timetable, however, it may be late in 2009 before clearer guidelines for implementation of the principle emerge.

Nonetheless, insurers need to assess the nature, scale and complexity of their business and how this might translate into governance, disclosure and other key requirements under

Solvency II. This appraisal needs to take account off both current circumstances and future business objectives. For example, expanding across borders may increase the perceived complexity of a company and therefore affect its proportionality status. Although supervisory expectations need not discourage firms from operating in other EU states, companies may need to adjust their governance and other structures accordingly.

It may take some time for supervisors to become comfortable with the implications of proportionality. In this initial period, it will be important to ensure that an overly cautious approach does not prompt them to impose needless operational costs and inappropriately complex structures on regulated firms. Ensuring consistency of approach to smaller, less sophisticated players will require significant cooperation, dialogue and convergence of supervisory practices from one country to another.

Making it happen

Companies should not wait for further clarification over the Level 2 or 3 measures before they begin to map the nature, scale and complexity of their current and future operations and hence determine a proportionate governance structure. This assessment should ideally run in parallel with other initiatives outlined in this paper.

It would be helpful to open a dialogue with national supervisors and rating agencies to promote consistency of approach and avoid unexpected demands. Given the shortages of qualified personnel that are likely to occur in the run-up to implementation, it is better to know now what is likely to be required and plan accordingly. Companies also need to ensure that their views and concerns inform the Level 2 process by communicating them to CEIOPS or the European Commission.

The governance system needs to be flexible enough to respond to any changes in the risk profile of the organisation. When devising their plans, insurers should consider the potential impact of strategic or tactical choices on governance structures, as well as capital requirements.

Milestones

- Assess the nature, scale and complexity of your business and how the Solvency II requirements might apply to you
- Incorporate these views into the corporate strategic plan
- Help to influence the definition and application of proportionality (through, for example, industry bodies)

⁵ CEIOPS is a key advisor to the European Commission.

Appendix 1

Group supervision under Solvency II

The greatest departure, and perhaps advantage, of the Solvency II regime is the approach to group supervision. Solvency II constitutes a natural extension of the concept of group supervision which has been developed over the past decade through EU directives on banking and insurance group supervision and the Financial Conglomerates Directive. Even with the powers of the 'group supervisor', as proposed by the European Commission, diluted through negotiations in the European Council and Parliament, Solvency II still takes a significant step forward.

The benefits of the new approach are essentially twofold – simplification of the cross-border supervisory framework and a system that encourages more effective cross-border use of capital and regulatory recognition of diversification effects. The challenges of establishing a legally watertight approach to group support may negate some of these benefits, particularly in respect of operations outside the EU. Local supervisors will also continue to hold considerable sway over subsidiaries within their national jurisdiction.

The concept of the college of supervisors in Solvency II will move well beyond the Co-ordination Committees (Co-Cos) of the CEIOPS 2000 Helsinki Protocol and the associated 'supplementary supervision' concept.⁶ The establishment of more than a 100 Co-Cos has seen certain tasks delegated to the lead supervisor. However, Solvency II could bring much broader delegation of tasks and, importantly, related responsibilities.

How the colleges will operate in practice still needs to be further developed under Solvency II. Insurers would be well advised to contribute to the Level 2 and 3 consultation processes. This applies to internationally active groups as well as national insurers. In future, attention should be paid to supervisory consistency and convergence, not just across borders, but also between groups and non-groups.

Solvency II may not only set the framework for how insurers are supervised going forward in Europe. In light of the Financial Stability Forum's April 2008 paper, which advocated the use of a similar concept internationally, this could be an indication of how insurers will be supervised globally in the future.

⁶ CEIOPS Protocol relating to the collaboration of the supervisory authorities of the Member States of the European Union with regard to the application of Directive 98/78/EC on the supplementary supervision of insurance undertakings in an insurance group, 11 May 2000.

Appendix 2

Where to look

Want to know more about...

See draft framework
Directive – Article⁷

See Solvency II FAQs⁸

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⁷ See http://ec.europa.eu/internal_market/insurance/solvency_en.htm ('Proposal COM (2007) 361').

⁸ See http://ec.europa.eu/internal_market/insurance/solvency_en.htm ('Frequently Asked Questions').

Want to know more about...

See article

See FAQs

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