Risk of delay: Getting Pillar 3 on track

Preparing for Solvency II disclosure (Pillar 3) has tended to take the back seat to capital evaluation (Pillar 1) and risk management (Pillar 2) within many insurers. With Solvency II implementation likely to be delayed by a year, Pillar 3 could slip further down the list of priorities. Yet, with supervisors likely to require extensive transitional disclosure in 2013 and getting ready for full reporting in 2014 likely to require a huge step up in data, systems and governance, Pillar 3 preparations cannot be put off any longer. How can you get Pillar 3 on track, who should be involved and what are the potential bottlenecks to be overcome?

While it would be natural to presume that any delay in the launch of Solvency II would ease the pressure on your implementation programme, it may actually make it harder in some areas. Pillar 3 is a clear case in point.

Even though the Solvency I capital requirements would continue to apply in the interim period, many national supervisors are already indicating that they will expect preliminary Solvency II reports in 2013. This means that your evaluation, validation and governance procedures will need to be in place by then. There is every possibility that the transitional period will result in the additional burden of preparing both Solvency I and Solvency II returns.
Further pressure on timings is going to come from the need to reconcile your Solvency II disclosure with financial reporting. There are a number of key differences between IFRS/local GAAP and Solvency II, in areas ranging from contract boundaries to the basis for discounting. It will therefore be important to prepare the Solvency II disclosure, based on 2012 results, to allow you sufficient time to start identifying any divergence and be able to explain the reasons to internal management and analysts. If you don’t come to grips with these, early enough in the implementation process, you could find yourself sending out mixed messages and incompatible numbers when Solvency II goes live, which can only undermine your market credibility.

Ultimately, it is important to decide what information and analysis your company needs in today’s changing business and regulatory landscape, which covers both internal management information boards and external disclosure. Pillar 3 should ideally be developed in parallel with other systems and information upgrades to make sure it is aligned with, and makes the most of, improvements in risk analysis and insight.

**Scale of the task**

So how difficult will it be to meet the demands of Solvency II disclosure? Pillar 3 encompasses quarterly and annual quantitative reporting templates, the Regular Supervisory Report (RSR) and the publicly available Solvency and Financial Condition Report (SFCR). Figure 1 outlines the key elements of the quantitative reporting templates, which are likely to place the greatest demands on systems and organisational resources. Figure 2 outlines the key elements of the RSR and the SFCR, which include detailed explanations of the strategy and rationale for risk and capital management.

You might assume that much of the necessary data can be derived from Pillar 1 and Pillar 2 analysis. However, Pillar 3 requires a considerable amount of further information, including details of each of the assets held and breakdowns of reinsurance by risk type and reinsurer. Moreover, while some firms have established Pillar 3 workstreams, these are rarely integrated with those for Pillar 1 and Pillar 2. Therefore, there has been little assessment of what data is in place for inclusion in the Pillar 3 reports and what further information might need to be sourced.

If you’re operating in a market where regulatory reporting requirements are already quite extensive, you might expect that Pillar 3 will require little more than straightforward adaption. Nonetheless, it will be important to check whether your existing reporting capabilities are equipped for Solvency II and what further work is required. The most significant departure is the speed with which you will have to produce the numbers. Under current proposals, you will have a matter of weeks after each quarter-end to prepare, check and submit analysis of the balance sheet, capital requirements, technical provisions, investment data, own funds, premiums, claims, reinsurance and expenses.

Another possible reason for delay is uncertainty over what will be expected. In fact, the bulk of the requirements are known and only the details remain to be finalised. The data, systems, governance and organisational demands of Pillar 3, the areas that are likely to require the most work, are also very unlikely to change.

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**Figure 1: Content of quantitative reporting templates (solo entity)**

<table>
<thead>
<tr>
<th>Balance Sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets – Investments</td>
</tr>
<tr>
<td>Solvency capital requirement (SCR), minimum capital requirement (MCR) and own funds</td>
</tr>
<tr>
<td>Technical provisions – Life</td>
</tr>
<tr>
<td>Technical provisions – Non Life</td>
</tr>
<tr>
<td>Variation analysis, country and cover</td>
</tr>
<tr>
<td>Reinsurance</td>
</tr>
</tbody>
</table>

In addition to the above, group templates would include consolidated solo information, risk concentrations and intra-group transactions

**Figure 2: Content of RSR and SFCR**

The publicly available SFCR is designed to open up risk and capital management to the discipline of market scrutiny. It has close parallels with the RSR presented to supervisors. The RSR and SFCR combine quantitative and qualitative information about the risk position and related capital adequacy with a description of critical risk management processes. Key elements include:

- Nature of the business and external environment, objectives, strategies and performance
- Governance structures, responsibilities of the board, senior management and key committees
- Risk profile and risk management approach for each category of risk
- Valuation bases for assets and liabilities including technical provisions, with explanation of any major differences to the bases used in the financial statements
- Capital management including SCR, MCR and quality/structure of solvency reserves
- Detailed information on the internal model if used (RSR only)

It will be important to prepare the Solvency II disclosure, based on 2012 results, to allow you sufficient time to start identifying any divergence and be able to explain the reasons to internal management and analysts.
Allowing sufficient time

Even if your risk and capital analysis is relatively advanced, there may still be a lot to do. You will have to source a huge amount of data from around the organisation and make sure it meets exacting standards of quality, consistency and reliability. This is one of the areas that has been proving most difficult and time-consuming in the Pillar 1 preparations, and the extra demands of Pillar 3 can only add to the challenge. Common bottlenecks include the fragmentation of data across the organisation and the multiple dependencies that can slow down supply. Different subsidiaries may also be using different risk assumptions and monitoring procedures, all of which may need to be aligned centrally.

Organisationally, Pillar 3 reporting requires engagement and collaboration between multiple functions and stakeholders. Typically, finance teams will need to engage with risk teams and consider how to meet the reporting challenges, importantly working through what all this means for business as usual.

Groups with operations or headquarters outside the European Economic Area (EEA) face the additional challenge of sourcing key information from entities that are not subject to Solvency II. It will be important to liaise with non-EEA subsidiaries and parents as early as possible to explain what is required and its potential implications for investor relations.

Further demands include liaising with third parties such as asset managers. Significant amounts of detailed information will need to be reported at asset level, rather than at just fund level. You will also need to make sure that the standard of the risk information they supply and the governance and control procedures that underpin this are up to scratch.

Reporting also needs to be built into governance procedures. It will take time for boards to become comfortable with what may be complex and unfamiliar analysis. They will also need time to assess how the business will come across under this new window of disclosure and make any adjustments to strategy, risk and capital management that may be necessary. It is important to engage with investor relations as early as possible and integrate risk and capital reporting into the overall communications strategy.

Given the amount of moving parts, dependencies and oversight involved in Pillar 3 reporting, allowing time for a dry run and any subsequent fixing is essential. If you add all these data, systems, governance and dry-run demands together, now is the time to get moving if you haven’t already. Ideally, you should be ready to have a dry run in mid-2012 and have reporting up and running by the end of that year.

Getting over the line

Some insurers are considering systems investment and process re-engineering to help them meet the demands of data quality and reporting frequency. Given the considerable amount of data that will need to be processed through these systems, it is important to have a robust and flexible platform. This will take time to build, test and fully integrate into the business. Therefore, while these developments will be beneficial in the long-term, it may be necessary to have an interim option.

Building on your existing capabilities, there are less costly and easier to implement short-term alternatives that would allow you to get over the line in time. Figure 3 sets out a possible roadmap for implementation. The key is being able to identify and then focus resources on the principal priorities (internal and external). It is then possible to streamline reporting processes along the critical path, and identify and eliminate sources of delay. This includes determining effective division of responsibilities between finance, risk and actuarial teams. Within the organisation as a whole, each link in the data supply chain should be clear about what needs to be delivered by when, including the required standards of consistency and quality.

To make sure these demands are met, it can be useful to assign data owners or service level agreements as appropriate. The practical aims are fewer needless hold-ups and less call for data cleaning and manual workarounds.

Coordination and collaboration are going to be crucial in meeting this tight timeline. This includes close cooperation between the workstreams for Pillar 1 (e.g. technical provisions), Pillar 2 (e.g. ORSA) and Pillar 3 to make the most of what is already available, avoid duplication and identify any gaps. It is also important to make sure that the Pillar 3 workstream is integrated with, and reflects the wider demands on, management information and financial reporting.

Boards should be involved from the outset, getting used to the disclosure, aligning it with their own management information and using it to help run the business. Solvency II reporting is a matter for the CFO, CRO, CEO and audit committee, and all should be actively engaged.

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Figure 3: Roadmap for implementation

![Figure 3: Roadmap for implementation](source: PwC)
Even if your firm has well-developed reporting capabilities, the timings and detail of Pillar 3 are still likely to stretch systems and resources. Boards also need time to build the new disclosure and its implications into the strategy and presentation of the enterprise.

When you come to the dry run, it will be important to make sure the conditions are as real as possible. That means conducting it alongside annual or period-end reporting, so the demands on key personnel and systems can be properly evaluated.

Looking ahead, it will be important to make the reporting a sustainable element of business as usual and build it into the target operating model. For some insurers, this has included or will include investment in data warehouses, which can provide a common source of information for multiple reporting and reconciliation. A number of vendors including SAS, SAP, Moody’s and Oracle are, or are considering, developing specific systems to support Pillar 3 reporting, some of which build on developments for Pillar 1 and Pillar 2. If looking at such an option, it will be important to assess how effectively it can integrate with your existing risk engine and data warehouse. It is also important to check the scope of the solutions as some may focus on the quantitative reporting templates, rather than encompassing the broader requirements of the RSR and the SFCR. The underlying consideration is how these solutions fit into your overall target operating model.

Are you on-track?

While Pillar 1 has been the main focus of attention, Pillar 3 may in fact come on-stream, ahead of the new capital requirements. Even if your firm has well-developed reporting capabilities, the timings and detail of Pillar 3 are still likely to stretch systems and resources. Boards also need time to build the new disclosure and its implications into the strategy and presentation of the enterprise. Meeting these demands will require organisational involvement and understanding, far beyond Solvency II project teams. It is also important to build Pillar 3 into any decisions over process re-engineering and operational design, so it becomes sustainable and enhances value.

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