



Managing the Practical and Operational Challenges of Implementing
Solvency II in the Lloyd's and London Market

Iain Wright

1 July 2010

Contact:

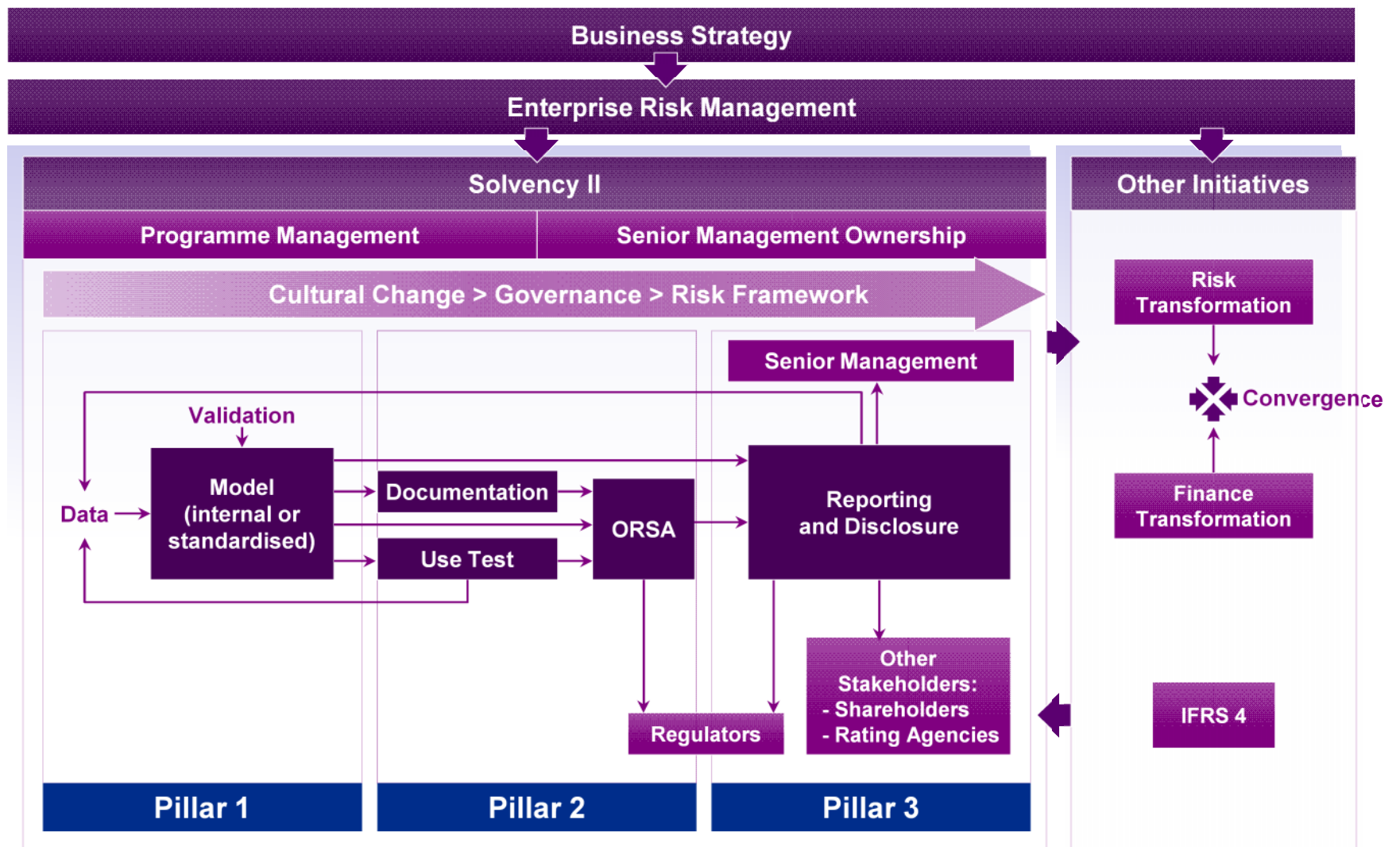
Iain Wright, Partner

iain.wright@avantage.eu.com

Tel: +44 20 77 09 40 04

avantage

SOLVENCY II | Organisational Context



SOLVENCY II | Programme checklist

- Programme Management:
 - Set goal
 - Ownership
 - Authority
 - Senior management engagement
 - Phasing
 - Establish PMO
 - Establish workstreams
 - Links to other projects
 - Reporting
- Resource:
 - Business case
 - Budget
 - Resources
 - Buffer
- Contingency planning
- Plan for change
- Stakeholder communications

PROGRAMME CHECKLIST | Prioritise & Align Solvency II Initiatives

Identify Portfolio	<ul style="list-style-type: none">• Baseline requirements established<ul style="list-style-type: none">• Data requirements, KPIs, Performance Measures• Contingency Management Strategy
Develop Prioritisation Model	<ul style="list-style-type: none">• Thresholds and constraints established<ul style="list-style-type: none">• Prioritisation processes defined• Develop and weight value and risk criteria
Collect Project Information	<ul style="list-style-type: none">• Key information about projects gathered<ul style="list-style-type: none">• Consolidate data• Categorise benefits to Solvency II value drivers
Analyse Portfolio	<ul style="list-style-type: none">• Projects and programmes impacting Solvency II identified<ul style="list-style-type: none">• Assess value and risk of each project• Deadlines and cut-offs set
Prioritise Projects & Programmes	<ul style="list-style-type: none">• Prioritised list of projects established<ul style="list-style-type: none">• Constraints• Thresholds
Communication & Report	<ul style="list-style-type: none">• Portfolio progress reporting established<ul style="list-style-type: none">• Steering Committee reporting• Risk Committee / Executive Committee Reporting
Monitor Programmes & Projects / Changes	<ul style="list-style-type: none">• Projects and Programme tracking in place<ul style="list-style-type: none">• Benefits, costs, resources, Solvency II alignment• Portfolio health indicators
Deploy & Run Portfolio	<ul style="list-style-type: none">• Execution against prioritised plan

PILLAR 1 | Practical issues

- Model development
 - Trade off between sophistication and usability
 - Management understanding of the model
 - Integrating with risk management processes
 - Operational risk
 - Risk MI
- Validation
 - Of mechanics
 - Of assumptions
 - Does output look sensible?
 - What are the parameters within which the model can be relied on?
- Model approval
- Documentation
 - Documentation in sufficient detail to allow a reasonably competent third party to pick it up and allow it to operate the model
 - Documentation should be prepared reasonably contemporaneously with the model
- Data
 - Quality of available data (legacy v new syndicates)
 - Appetite for change (minimum compliance using what you have v highly effective data management)

PILLAR 1 | Data Requirements

- Solvency II stipulates disciplines and methodologies to calculate capital requirements within a risk framework.
- Data management is important for Solvency II as:
 - It requires that large volumes of policy and financial data at a granular level can be consolidated across the insurer's product portfolio and brought together into calculation, modelling and reporting tools
 - The firm must satisfy themselves and the regulator that there are policies, practices and procedures in place to assure the quality of the data which must be:
 - **Appropriate**
 - **Complete**
 - **Accurate**
- **Data Directory** to document and publish business definitions of data, quality standards, ownerships, policies and lineage back to sources
- **Data governance practices**, policies, roles and responsibilities and a practical method of establishing and embedding this into the firms
- **Data models**, architectures and data warehouse solutions and structures designed to meet the requirements of solvency II
- **Data quality assessments**, benchmarking and rules libraries within a methodology for calculating materiality and managing data quality issues.

USE TEST

- Insurance and reinsurance undertakings shall demonstrate that the internal model is **widely used and plays an important role** in their system of governance, referred to in Articles 41 to 50, in particular:
 - (a) their **risk-management system** as laid down in Article 44 and their **decision-making processes**;
 - (b) their **economic and solvency capital assessment and allocation processes**, including the assessment referred to in Article 45.
- In addition, insurance and reinsurance undertakings shall demonstrate that the **frequency** of calculation of the Solvency Capital Requirement using the internal model is consistent with the frequency with which they use their internal model for the other purposes covered by the first paragraph.
- The administrative, management or supervisory body shall be responsible for ensuring the **ongoing appropriateness** of the design and operations of the internal model, and that the internal model **continues to appropriately reflect the risk profile** of the insurance and reinsurance undertakings concerned.

Uncertainty as to:

- Scope
- Use:
 - The ORSA is a company's understanding of its risks, solvency needs and capital position. (**O**wn Risk and Solvency Assessment)
 - "The ORSA is ... a source of information in the decision-making process undertaken through the Supervisory Review Process."* (CEIOPS)
- Structure
- Content
- Level of independent review
- Lloyd's and regulators' needs and wants

Content	
Governance	Capital position
Strategy	• Required capital
Risk profile	• Available capital
Future projections	Future projections (beyond one year)
Documentation	Stress testing
• Internal model	Use test
• Systems and controls	External reporting

PILLAR 2 | ORSA and regulatory interaction

- Complicating factors:
 - Cuts across the whole organisation
 - May require change to the way in which you look at your company and your processes and controls; ORSA should be integral to your management and division-making processes
 - Ensure it is aligned with use test
 - Build in stress testing
- Other practical challenges
 - Need to assess all material risks (even the difficult ones)
 - Risks must be true **risks**, not a restatement of backward-looking **issues**
 - How do you make this something useful and not a box-ticking process?
- But you have things in place already:
 - Financial Condition Report?
 - ICAS
 - Budgeting and strategic planning processes
 - Model documentation
 - etc

PILLAR 3 | Reporting and disclosure

- Currently a low priority for many agents
- Know your stakeholders:
 - Management
 - Lloyd's
 - Supervisors
 - Other?
- Aim for consistency of approach with other reports

CONTACT DETAILS

London

avantage (UK) Limited

5th Floor, Dukes House
32 – 38 Dukes Place
London, EC7A 3LP
England

Telephone: +44 20 7709 4000

Facsimile: +44 20 7283 2402

www.avantage.eu.com

Partner

Iain Wright

Mobile: +44 7776 468 420 (Mobile)

E-mail: iain.wright@avantage.eu.com

Luxembourg

avantage (Luxembourg) SàRL

11 Place Saints Pierre et Paul
L-2334-Luxembourg
Luxembourg

Amsterdam

avantage (Netherlands) BV

The Atrium
Strawinskylaan 3051
1077 ZX Amsterdam
The Netherlands

Edinburgh

avantage (UK) Limited

Ground Floor
4 Randolph Place
Edinburgh, EH3 7TQ
Scotland

All information contained in this document is proprietary and confidential to avantage (UK) Limited. No part of it may be published, communicated, disseminated, adapted or reproduced by any group, entity or other entity, agents or contractors without the prior consent of avantage.