



Solvency II

- a temperature check -





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Executive summary

The ‘Solvency II – a temperature check’ survey examined how far insurance companies had come in the process of bringing their operations into line with *Solvency II* by May - August 2009, when the survey was conducted.

All of the large companies surveyed were found to be conducting ongoing work within the *Solvency II* framework. In contrast, the majority of companies yet to begin *Solvency II* adaptations were small companies.

The survey revealed that responsibility for adaptation projects was most likely to fall to the financial, actuary, risk and/or compliance departments. Estimations as to when *Solvency II* projects would be finalised varied from the end of 2009 until the 2012 deadline. In comparison, developing internal models, banks took three to five years to become compliant with *Basel II*.

Systems and/or processes were identified as those areas most affected by *Solvency II* and thus, as those areas where adaptation is most needed. Process changes and calculation of the capital requirement were identified as being the main challenges. It is noteworthy that a lack of commitment on the part of management was also identified as a challenge.

The majority of companies surveyed said they intended to use the standard model for calculating the capital requirement. Approximately 25 per cent of respondents said

they intend to use some sort of internal model. This is a very high percentage as compared with figures for *Basel II* (a similar framework for credit institutions), where only eight institutions (or 5%) initially used an internal model for calculating credit risk. One disadvantage of choosing an internal model is that it is more time-consuming, as the model must be evaluated by the Swedish FSA prior to approval. This requires more resources to be expended and as such, an internal model is a more expensive option.

Respondents were evenly divided as to whether or not the capital requirement would increase with the change to the calculation model: half of those who answered believed it would, while the other half believed it would stay the same. A minority of respondents were unable to answer the question at the time of the survey.

A large majority of respondents foresaw no need to take on extra staff in order to become compliant with *Solvency II*. A minority anticipated a need for additional staff, either internal or external. This is interesting in light of the fact that about half of all respondents answered that they ‘[did] not know’ what amount of staff would be needed to implement framework adaptations.

Most respondents believed they would be able to use their existing system solution if it was somewhat adapted. The remainder were unsure as to whether they would need to purchase a new system or not.



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Preface

In recent years, the introduction of an increasing number of regulatory frameworks has forced the financial sector to adapt to new market conditions.

Solvency II, which affects the insurance industry, is a new regulatory framework currently due for implementation. The deadline for compliance with *Solvency II* is set at year-end 2012. The main tenets of the framework are: recalculation of the capital requirement; preparing for potential changes in processes; organisational and systems adaption and; establishing new routines for public disclosure.

Often referred to as 'Basel for insurers', *Solvency II* is somewhat similar to the *Basel II* banking regulations. For example, the proposed *Solvency II* framework also comprises three main areas (pillars):

- **Pillar 1** consists of the quantitative requirements (e.g. the amount of capital an insurer must hold).
- **Pillar 2** sets out requirements for the governance and risk management of insurers, as well as for the effective supervision of insurers.
- **Pillar 3** focuses on disclosure and transparency requirements.

Given that the changes imposed by *Solvency II* are of a similar nature to those of *Basel II*, it is helpful to apply the lessons learned from *Basel II* in the current projects.

Crescore is a consulting company specialising in assisting organisations within the financial services industry to implement solutions to operational problems. Over the years, we have worked with most of the major organisations in the Nordic region.

Crescore would like to thank all those who have participated in this survey for taking the time and effort to share their views and the status of their *Solvency II*-adaptation work. We hope that these results will assist you as you work to achieve compliance with *Solvency II* before it takes full effect in 2012.

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About the survey

In light of the upcoming implementation of the *Solvency II* regulations, Crescore decided to conduct a survey in order to evaluate to what extent the insurance industry has prepared itself for the new regulations at this point in time. This was done by means of the survey 'Solvency II – a temperature check'.

What was the objective of the survey?

The objective of the survey was to identify the current status of framework adaptations within insurance companies. A second objective was to identify their biggest challenges and how and by what means they intend to solve any future issues. Furthermore, an additional point of interest was finding out what different companies have identified as possible challenges in the adaptation work and which of these challenges they have in common. The collated answers to these questions are intended to give the reader a sense of where insurance companies are in the overall adaptation process at present and also to indicate what needs to be done in the near future.

What areas were covered by the survey?

The survey was divided into four main areas:

- Current status
- Challenging areas
- Calculation of the capital requirement
- Resource planning

The survey included insurance companies of all sizes and offering all product lines, resident in Sweden and falling under the jurisdiction of the Swedish FSA.

How was the survey designed, implemented and evaluated?

The 2009 'Solvency II – a temperature check' survey was conducted by means of an interview questionnaire addressed to persons responsible for *Solvency II* adaptations within insurance companies. The responding companies were divided into small, medium and large based on the number of employees and the companies' premium income.

The questionnaires were completed via interviews held over the phone in May – August 2009 and were conducted by Crescore consultants with previous experience in the financial regulatory framework area.



Observations

Generally speaking, most respondents have begun *Solvency II* adaptations in some form. The larger companies are well ahead in the process of initiating projects, while small companies are yet to begin. Some respondents have not yet initiated an adaptation process nor participated in any Solvency II studies, which makes anticipating their future needs more difficult. Underestimating time and cost factors was the most obvious negative lesson learned from the *Basel II* projects. It took three to six years to become fully compliant with *Basel II* (if internal models were being used), which is a much longer period than many companies questioned in this survey have estimated for achieving compliance with *Solvency II*. The total cost of *Basel II* adaptation projects ranged from MSEK 30-500 for Swedish institutes developing internal models, depending on the organisation's size and complexity.

Respondents were evenly divided as to whether or not the capital requirement would increase with the change to the calculation model: half of those who answered believed it would, while the other half believed it would stay roughly the same.

Most respondents anticipated no need for taking on additional internal or external staff

in order to implement the adaptations. 32 per cent of respondents anticipated the workload associated with becoming *Solvency II*-compliant to require just a few resources. 20 per cent anticipated the workload to be even larger, involving several resources. Approximately 48 per cent of respondents were unable to provide an estimate at the time of the interview. In the case of *Basel II* adaptation (for which an extensive number of staff was required), relevant expertise was in short supply. As such, a success factor in achieving compliance was a bank's ability to secure staff with cutting-edge expertise. These were often found externally.

The majority of respondents identified systems and processes as the areas most affected by *Solvency II* and hence, as those areas representing the biggest challenges to achieving compliance. They also responded that necessary changes would be accommodated by developing their current system solution. This was also the most common approach used during the *Basel II* adaptations. Changes to systems and processes during *Basel II* adaptations required external help and securing this help was responsible for a large portion of the total cost of achieving *Basel II* compliance.



Survey results

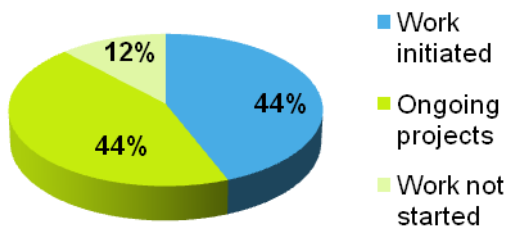
The survey resulted in a number of interesting points as described below.

Current status

Those surveyed were asked whether they had begun *Solvency II* adaptations as yet. Eighty-eight per cent of respondents answered that they had begun work to different degrees.

Of those close to ninety per cent, approximately half had formalised their projects. The majority of those companies that had not yet started their *Solvency II* adaptations were small companies. All large companies surveyed were conducting some kind of ongoing work within the *Solvency II* framework.

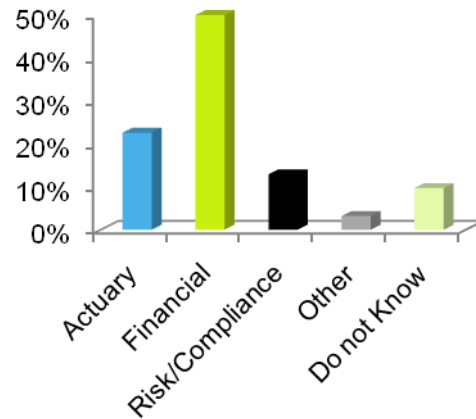
Work progress



The survey revealed that the internal department responsible for implementing the framework differed from company to company (as below, in descending order):

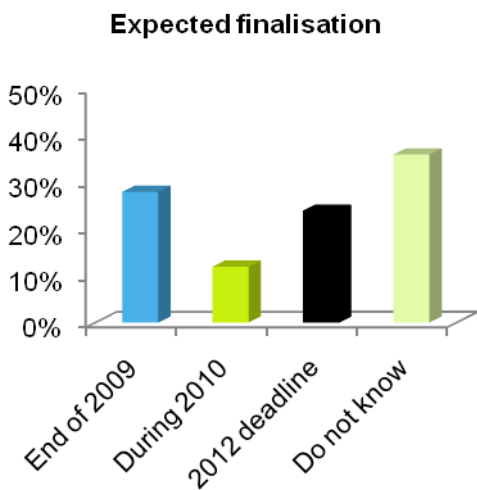
1. Financial
2. Actuary
3. Risk/Compliance
4. Other

Project Responsibility



In general, large companies responded that at the time of the survey, they did not yet know what part of the organisation would be assigned responsibility for the implementation. Conversely, medium-sized and small companies had a somewhat clearer picture of where in the organisation the responsibility would lie.

Respondents' estimations as to when adaptations will be finalised varied from the end of 2009 until the 2012 deadline. One interesting aspect of the responses received is that most of the smaller companies believe they will complete adaptation before year-end 2009, in spite of the fact that few of them had adaptation projects in place at the time of the survey.

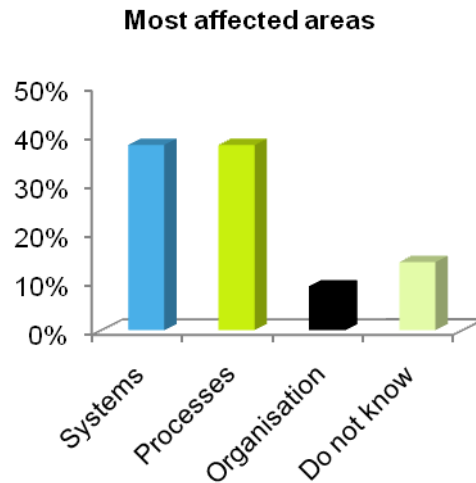


All of the companies with projects already in place were large companies. These companies estimated that work would continue all the way

up to the deadline in 2012. As seen in the *Expected finalisation* graph, a large number of respondents do not know when their adaptation work will be complete. This uncertainty of expected finalisation corresponds to the fact that several companies don't have established ongoing projects.

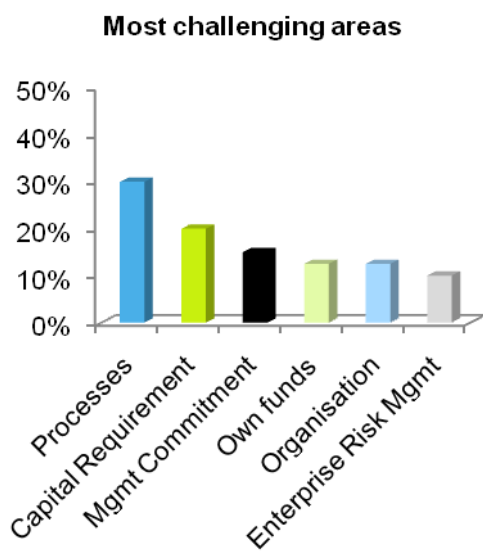
Challenging areas

The survey revealed that 77 per cent of the companies interviewed have identified systems and/or processes as the areas most likely to be affected by *Solvency II* and thus, as those areas where most adaptation-work needs to be done. This is shown in the *Most affected areas* graph below.



As seen in the *Most challenging areas* graph below, adaptation within systems and processes

was identified as the area where respondents anticipate facing their biggest challenges. These challenges are identified as capital requirement and processes.

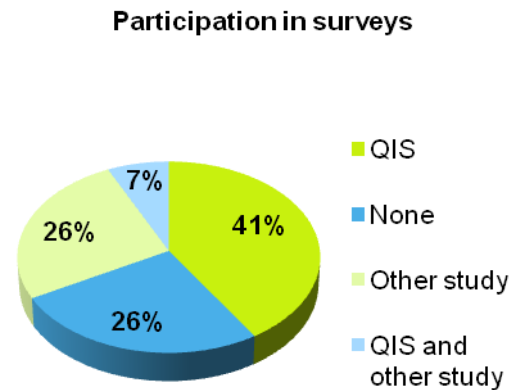


Somewhat surprisingly (and worryingly) is the fact that commitment, or rather, a lack of commitment on the part of management, was identified as a challenge.

A lack of commitment on the part of management may cause difficulties for some companies, particularly for the group of companies that has not yet initiated projects or started their *Solvency II* work at all. These companies were mostly identified as belonging to the group of medium-sized companies.

Calculation of the capital requirement

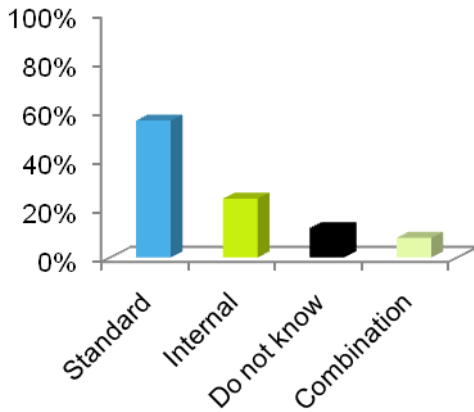
All large companies within the insurance industry have taken part in the *European Quantitative Impact Studies* (QIS). Medium-sized and small companies have tended to be less involved in *Solvency II* studies.



Approximately 75 per cent of this survey's respondents had taken part in some sort of study (internal or external) within the area. All those companies that had not previously participated in a QIS study were small companies.

More than half of all respondents revealed they intend to use the standard model for their capital requirement calculation, while approximately one quarter will use some sort of internal model.

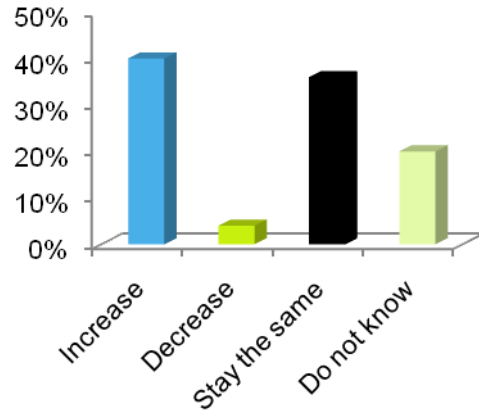
Selection of model



The model a company chooses to use to calculate its capital requirement may depend on its line of business and on its product portfolio. A combination of the standard model and an internal model has been considered by some respondents.

About 20 per cent of those surveyed were not yet able to answer the question about change of capital requirement. With the exception of one company, all respondents who were able to answer predicted that the capital requirement would either stay the same or increase as a result of the change of calculation model. One respondent expected a decrease in the required capital.

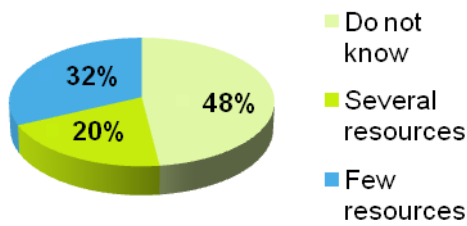
Change of capital requirement



Resource Planning

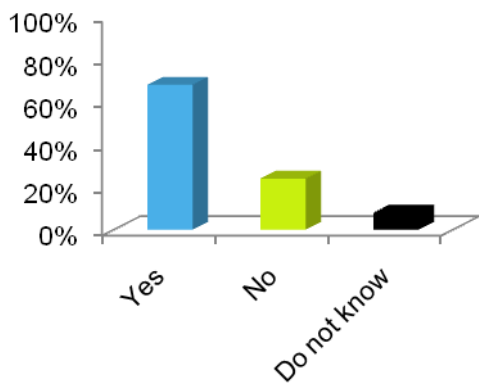
Approximately 50 per cent of respondents stated that they '[did] not know' what amount of staff would be needed to implement framework adaptations. 30 per cent estimated that they would require just a few resources, while the remainder believed it would require several resources.

Resource Planning



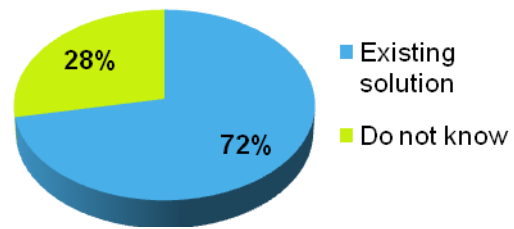
Only 20 per cent of respondents anticipated they would need to recruit or use external help to carry out *Solvency II* adaptations. The remaining respondents anticipated no need for extra internal or external staff.

Ability to manage adaptations within existing organization



The *System solution* graph below shows that a majority of those surveyed anticipated needing to develop their existing system solution to accommodate *Solvency II*. As such, additional external systems would not be required.

System solution



Irrespective of their size, the remaining respondents did not know whether they would need to purchase a new system solution or not.

ABOUT CRESCORE

Crescore is a financial services consulting company that works primarily with leading financial institutions and insurance companies in northern Europe. Through our offices in Copenhagen, Oslo and Stockholm, we assist the most demanding and challenging clients in the financial industry.

With Crescore's unique competence in the financial markets and extensive expertise in financial processes, regulations and systems, we provide our clients with solutions and assist them to both reach their goals and master their challenges.

Recent surveys from Crescore:

- Solvency II – a temperature check
- It's all about data – a survey on Strategic Data Management
- 2008 Nordic Front Office Survey

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