

SOLVENCY II: WHERE DO YOU STAND?

Willis

WILLIS ALERT

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ARE YOU UP-TO-DATE WITH SOLVENCY II PREPARATION? WILLIS EXPLAINS WHAT STEPS COMPANIES SHOULD BE TAKING TO ENSURE THEY ARE ON TRACK.

THE SOLVENCY II PROJECT

Solvency II (SII) is the new capital adequacy regime for EU insurers and reinsurers that will take effect from 2013. It aims to improve capital adequacy and risk-management practices of the insurance industry and will replace the current Solvency I (SI) regime under which EU domiciled insurers and reinsurers now operate.

WHO IS AFFECTED?

Although predominantly intended for the commercial insurance and reinsurance market, SII will apply to Captives with premiums of more than €5 million and those operating across national borders within the EU.

THE QIS5 SURVEY

The Fifth Quantitative Study (QIS5) was conducted in late 2010 to assess the capital requirements of European insurers under SII. The results compiled from our clients domiciled in three major European onshore locations show a representative cross-section of EU Captive outcomes.

WILLIS QIS5 RESULTS

The results of the QIS5 Survey reaffirm broad Captive industry findings, but arrive at slightly different conclusions in certain areas. Our key findings are:

- In our experience, if a company had good reasons to be onshore then QIS5 is not changing this
- The average QIS5 capital required is almost five times the SI requirement.
- Over 50% of Captives have sufficient capital to meet the anticipated increase (this shows that the reported undercapitalisation is not true).
- Of those remaining Captives, the average capital shortfall is 80% (this is reflective of the fact that the one size fits all approach of QIS5 is very penal for Captives).

FURTHER FINDINGS

Our research also clearly demonstrates that:

- Increases in solvency requirements are a function of the unique business plans and strategies pursued by captives and can be substantially mitigated by relatively straight forward changes to them.
- Market impact is as yet uncertain but there is no evidence of captive migration activity being triggered by SII
- Captive set-up activity in domiciles within and outside Europe has not been materially affected by the anticipation of SII albeit companies are increasingly interested in utilising cells technology.
- To date, there is no evidence of any immediate or future impact on commercial market pricing or any expectation of changes to fronting costs/ security requirements for fronting EU risks to non-EU captives.

WHAT WILLIS IS DOING

- As part of its SII Navigator service, Willis has developed a number of general mitigation strategies to minimise the impact of changes in solvency requirements
- This also delivers highly efficient implementation strategies in relation to Pillar II and III compliance challenges.
- Learning from our own experience and benchmarking. Following Pillar II requirements and preparing for Pillar III
- Conducting a gap analysis to identify where you are now in relation to where you need to be to satisfy the requirements of SII.

WHAT SHOULD YOU BE DOING THROUGH THE PILLAR II PHASE?

With responses to solvency changes increasingly settled, captive owners should already be responding to the Pillar II challenge. The basic requirements in accordance to the SII Directive, Pillar II preparation process are:

1. Define and measure risk strategy and appetite
2. Define risk management information required, and develop systems and procedures to collate, analyse and deliver it.
3. Enhance key functions and governance arrangements
The proportionate outcome expected is:
 - Key functional roles can be demonstrated to be clearly defined and allocated.
 - Clear Terms of Reference are in place for the Board of Directors and key management Committees (where required).
 - There is a suitable process for regular review of governance arrangements.
 - There is the capacity to demonstrate that operational risk has been considered and allowed for.
 - Training programmes are used where appropriate to support and embed.
4. Enhance and develop the systems and controls framework
This should include;
 - A corporate governance framework
 - A risk management system
 - An internal control system
 - An outsourcing policy
 - Internal Audit and actuarial functions are required, but these can be outsourced
5. Develop forward-looking risk management activity and contingency planning. Link business planning and risk management and requirement for capital.

Willis is assisting clients in their preparation for SII Pillar II, tailoring the solution to meet their individual needs and taking into account the appropriate application of the proportionality principle. We are working with clients to identify the key stages within the implementation process based on the results of our GAP analyses which identifies work that needs to be undertaken to become 'SII ready'.

NEXT STEPS

Willis is implementing Solvency mitigation and Pillar II compliance plans. We will be responding to Pillar III consultation as regulators' plans are published. Finally, Willis is monitoring the development of the European Insurance and Occupational Pensions Authority (EIOPA) legislation and advising clients throughout the process. We will update clients on developments as and when consultation documents are available on the [EIOPA website](#).

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