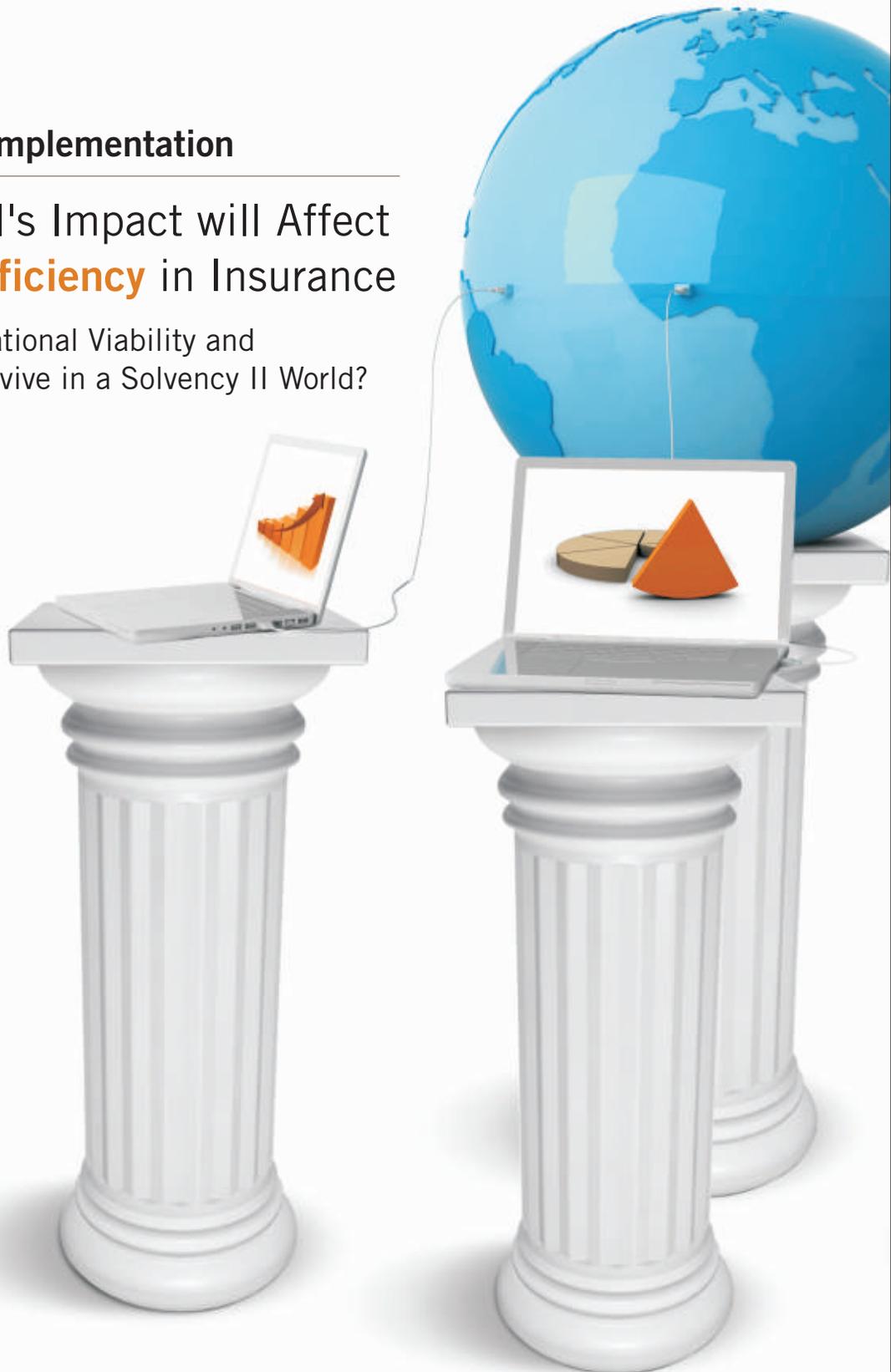


Solvency II Implementation

Solvency II's Impact will Affect **Process Efficiency** in Insurance

Will Your Operational Viability and
Reputation Survive in a Solvency II World?





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The Solvency II framework is based on the three-pillar approach, almost similar to Basel II – the banking regulation.

The three pillars of the Solvency II directive focus on the following areas:

Pillar I – Estimation of the QUANTITATIVE requirements

- Calculation of Solvency Capital Requirements (SCR)
- Minimum Capital Requirements (MCR) using standard or internal controls

Pillar II – Evaluation of QUALITATIVE requirements

- Governance and risk management
- Self-assessment of capital needs and capital
- Risk management processes and procedures

Pillar III – Disclosure of the institution's solvency and financial situation

- Ensure transparency and adherence to the Directive

Solvency II Implementation

A Daunting Task Ahead for Insurers

Implementation of Solvency II is the biggest-ever exercise in establishing a single set of rules governing insurer credit-worthiness and risk management. This European Union Directive, which covers over 30 countries, primarily concerns the amount of capital that EU insurance companies must hold to reduce the risk of insolvency. The appropriate amount of capital is determined according to a set of principles and rules.

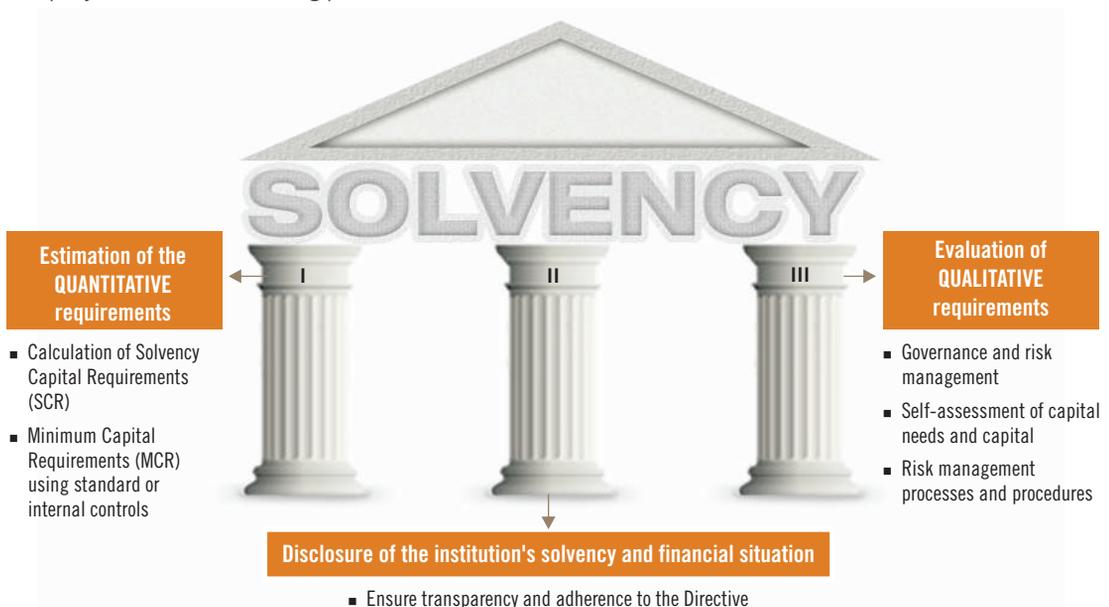
This planned regulatory overhaul for European insurers is well underway and the compliant deadline has been revised to January 1, 2014.

According to a recent Deloitte survey, many insurers are still grappling with the possible implications of Solvency II for their businesses. The survey reveals that for insurers the implications will be at the levels of capital requirements, company structures and revising products.

The new directive introduces a Solvency Capital Requirement (SCR) that is different from the target level that exists in most countries. Given the various levels of maturity and sophistication at which the member countries are operating, implementing the directive will be a daunting task for insurers and a possible operational headache!

The challenge for implementation is both at the qualitative and quantitative levels and insurers will need to attain new capabilities or at least transform existing systems and processes for a successful and meaningful implementation of the directive. Robust systems and procedures must be in place by the revised deadline of January 1, 2014.

The challenges relate to the requirements and approaches of the Solvency II directive are shown in the diagram below:



Solvency II Implementation New Opportunity for Insurers

While Solvency II implementation presents some strategic and tactical challenges, it also opens up new opportunities for insurers to innovate and adopt a well-thought-out approach for a successful implementation. Insurers who are agile enough to respond swiftly to the changing scenario will clearly be at a competitive advantage to outperform.

As a part of an insurer's compliance efforts, an integrated capital performance and risk management framework should be implemented to augment the insurer's capital models to meet regulatory requirements.

To be able to achieve this goal, capabilities will need to be overhauled in the following areas.

1. Internal models
2. Risk management
3. Information technology and data
4. Reporting compliance and disclosures

1. Internal Models

The Draft Directive of Solvency II suggests a two-tier approach for determination of regulatory capital adequacy. The first tier is the Minimum Capital Requirement (MCR), the threshold below which an insurer would not be able to write business. The second tier is Solvency Capital

Requirement (SCR) below which an insurer will likely need to discuss remedies with the regulator.

According to the Solvency II Directive, firms have an option to submit regulatory capital requirements (SCR / MCR) using the standard or an internal model. Although the standard formula is, by definition, more general and straightforward, there is a view that an internal model provides far wider business benefits such as reduced regulatory capital, improved / wider risk management, operational effectiveness, stakeholder assurance and building a more risk-aware business culture.

There is no exact regulatory definition of the 'Internal Model' as such. Broadly speaking, however, the Internal Model is the collection of processes, systems and calculations that together quantify the risks faced by the business. Activities that will need carrying out include:

- Development of actuarial systems (Prophet / Moses / MgAlfa / Igloo) to calculate best estimate liabilities, risk margins and stresses



- Development and testing of various components of the Internal Model running various risk scenarios and calculations, replicating models, providing operational risk reporting and tax and capital rules, economic capital calculation engine / simulation, aggregation and diversification rules
- Testing requirements for supervisory approval:

The Use Test - The insurer will have to show that the model is used as a decision tool in the company's daily risk management work

The Calibration Test - The model must be calibrated using the risk measure and calibration level defined under Solvency II

The Statistical Test - It must be demonstrated that the model is based on relevant and quality-assured data

- Management training and awareness workshops around the internal models

2. Risk Management

According to the Pillar II requirements, organisations need to conduct an Own Risk and Solvency Assessment (ORSA) to consistently assess their overall solvency needs and compliance with capital requirements.

The Solvency II Framework Directive proposal describes ORSA as a tool for risk management systems that require insurance companies to properly assess their own short- and long-term risks and the amount of own funds necessary to cover them.

With Pillar II it is crucial that an insurer demonstrates that it has an effective risk management system embedded in the business. Conforming to this requirement of embedding risk management into the business or implementing the 'use test' requires significant time and resources.



While an approved full internal model measures 'quantifiable' risks, the ORSA should consider all risks. ORSA is part of a wider risk management system requiring all risks to be identified, measured, monitored, managed and reported.

Rating agencies, analysts, shareholders, and regulators are all taking more interest in capital models and risk management. Effective risk management acts as the common link between balance sheet strength, operating performance and business profile.

The key components of effective risk management programme are as follows:

- Align risk appetite and strategy
- Enhance risk response decisions
- Reduce operational surprises and losses
- Identify and manage multiple and cross-enterprise risks
- Improving the deployment of capital

We assist clients in developing ORSA framework, embedding its implementation within a firm's decision-making process at management and operational level and developing effective MI for all the stakeholders.

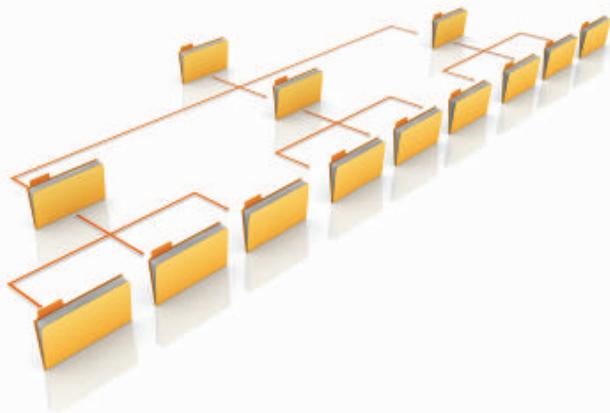
3. Information Technology and Data

Solvency II sets out the requirements for companies to establish systems, processes and controls for effective risk management. It influences many existing IT applications and requires development of additional functionality. It is prudent for insurers to take early action in investigating their company's data availability and quality. In addition to data systems, the insurance industry is expected to make significant investments in actuarial models, IT and risk management systems.

Insurers may need to seek assistance with implementing the information systems and technology requirements across the three pillars of the Solvency II framework.

Effective Data Management

Data is at the very core of meeting Solvency II requirements, and it is clear that any Internal Model Approval Process (IMAP) will focus heavily on the quality of data inputs to the models. It is widely recognised that the increase frequency of Solvency II reporting will require firms to collect and prepare data faster and accurately than they do today. Moreover, they need to aggregate or segment data in new ways and source additional data which they have not done previously.



The European Insurance and Occupational Pensions Authority (EIOPA) has set out a number of requirements for assessing the quality of data.

- Ensure appropriateness, completeness and accuracy of data used in the valuation of technical provisions
- Implement a robust quality management framework, including definition of the data, assessment of the quality of data, resolution of material problems identified and monitoring data quality
- Establish a comprehensive data policy for the collection, storage and processing of data, including the data provided by third parties (intermediaries, for instance) or through electronic sources (Internet for instance)
- Agree with the role of internal and external auditors in validating data quality
- Assess data deficiencies and analyze options to increase the quality and quantity of internal data, including the review of internal processes
- Document the adjustments made to the historical data, in particular the correction of any data errors and omissions, and use of external data / market benchmarks
- External data and market information used to complement internal data needs to be assessed on data quality – appropriateness, completeness and accuracy

An Integrated Approach

For most insurers, a detailed assessment of current systems capability brings forth two important observations:

1. Most insurance companies maintain multiple databases by source and function (risk, finance, actuarial and so on). This makes data integration and getting a single view of customers, a challenging task.

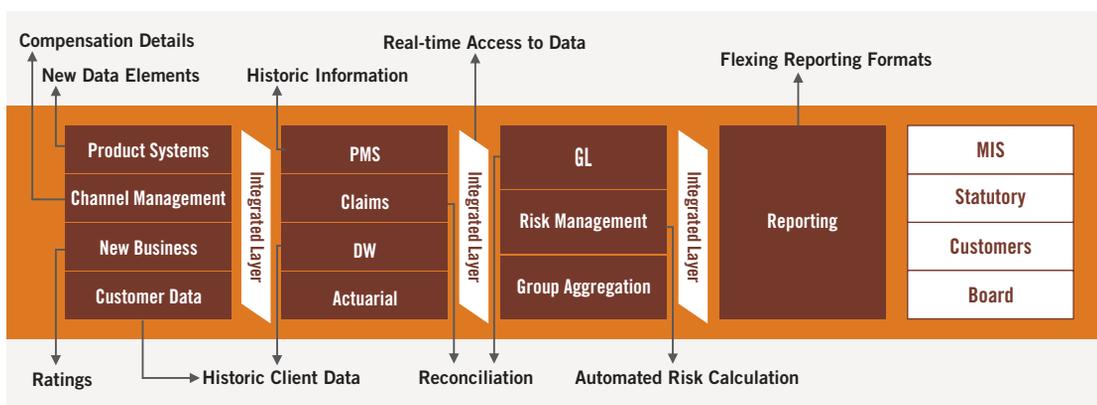
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2. Considering the requirements that the directive spells out, it will be a challenging proposition to have a single end-to-end technology solution to meet all Solvency II requirements. An integrated approach is what will be the most appropriate.

Insurers will need to deploy teams of actuaries, business stakeholders and IT specialists to integrate existing systems that

will now be required to work together, changing the existing systems as necessary and adding new tools where existing technology cannot be used to meet Solvency II requirements.

A schematic view of IT architecture in a post-Solvency II environment can be depicted as follows:



4. Reporting Compliance and Disclosures

Under the Solvency II regime Pillar III deals with the requirements for supervisory reporting and public disclosure. The objectives are to harmonize reporting, promote comparability of valuation and reporting rules with International Accounting Standards and ensure efficient supervision of insurance groups.

The key reporting requirements are as follows:

Solvency and Financial Condition Report (SFCR)

Public disclosure is expected to be made available via electronic publication. The SFCR will be required within three months of an insurer's financial year end. The SFCR must

follow a prescribed structure developed by The Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) covering the following areas: Business and Performance, System of Governance, Risk Management, Regulatory Balance Sheet and Capital Management

Reports to Supervisor (RTS)

The RTS is not public and is communicated only to the firm's supervisor. In broad terms, the private RTS requires information on the following example areas which are not included in the public SFCR such as business strategy, legal and regulatory issues, variance against plan, projections of future solvency needs, and future risk exposure

Insurers must implement a robust Pillar III programme covering the following main themes:

Disclosure Impact Assessment

Identify the impact of the proposed requirements on existing reporting procedures (systems, data, people, processes and controls)

Disclosure Design

Design the structure and principles of the Solvency II reporting regime

Disclosure Reporting Building and Implementation

Implement changes to the reporting framework to deliver the Solvency II requirements

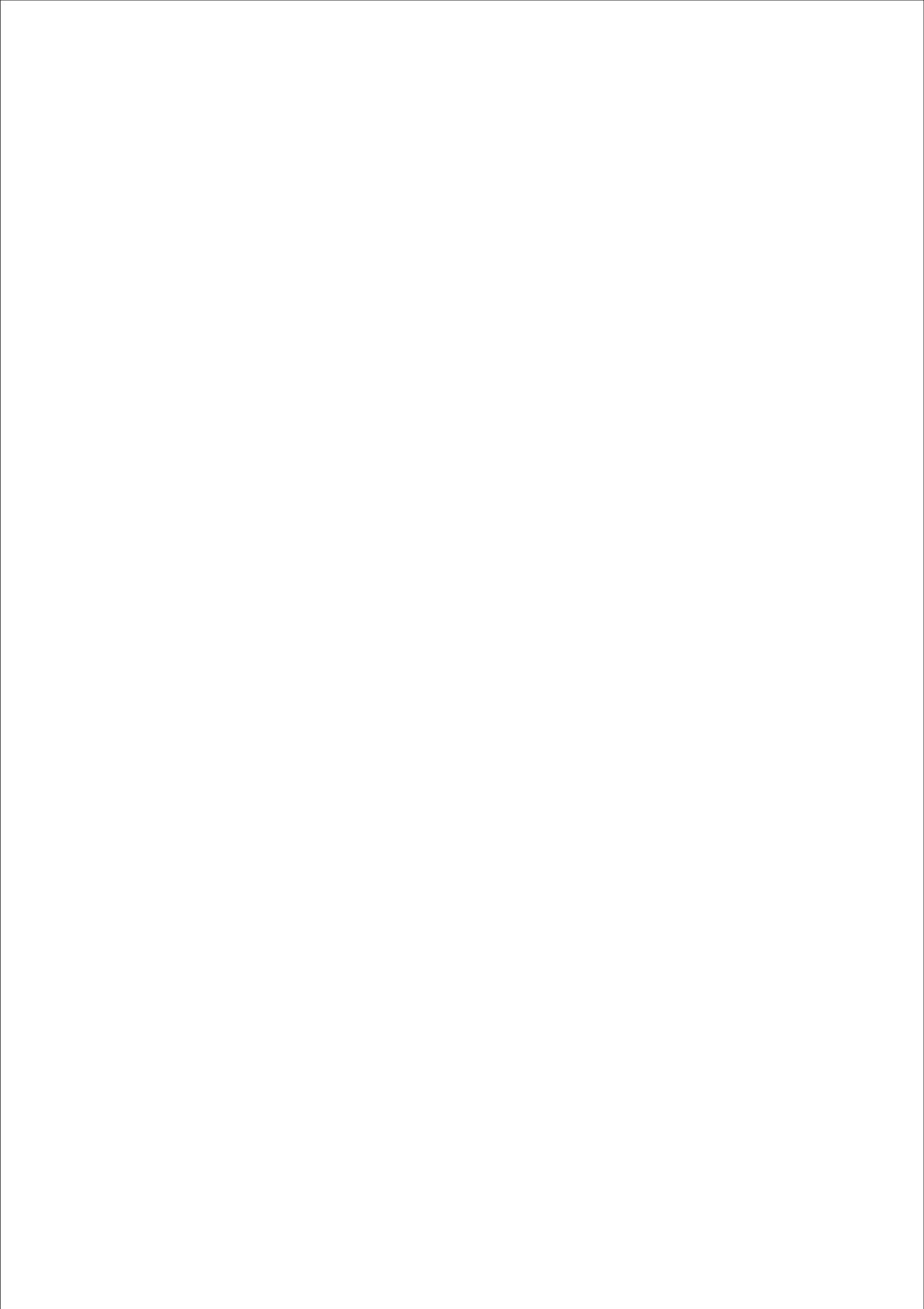
In Conclusion

Insurers are spending millions in order to comply with the impending Solvency II regulatory regime. Solvency II should be seen as opportunity to refine internal processes rather than merely a tick-box exercise, and those who embrace the regime will be able to demonstrate sound operational control and efficiency.

Many European insurers will not only benefit from reduced operational risk and capital adequacy requirements, but also lower operating costs, improved customer service and greater operational insight and to look at outsourcing as a business strategy.

Insurers who are agile enough to respond swiftly to the changing scenario will clearly be at a competitive advantage to outperform.

Insurers able to meet this challenge will find themselves in a position to achieve significant competitive advantage and improved stakeholder confidence. The solution in place to address operational efficiency needs to have the flexibility to take your organization to Solvency II and beyond, providing a platform for continuous process improvement and operational viability.



About WNS

WNS (Holdings) Limited, is a leading global business process solutions company. We offer industry-specific solutions to nine, including Banking and Financial Services; Healthcare; Insurance; Manufacturing; Retail and Consumer Products; Shipping and Logistics; Telecommunications; Travel and Leisure; and Utilities. We also offer horizontal solutions, including Finance and Accounting; Research and Analytics; and Contact Center. We have professionals working across delivery centers in Costa Rica, India, the Philippines, Romania, South Africa, Sri Lanka, UK and USA.

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