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The SME view of QIS5:

After the fifth quantitative impact study (QIS5), what are the issues facing small and medium-sized insurers? A survey by Barnett Waddingham, in which most respondents were from this sector, gave a glimpse of how these firms are facing up to the challenges of Solvency II.

The survey showed considerable variations in capital requirements under QIS5 compared with Solvency I. Nearly one in five respondents to the survey said their capital requirements under QIS5 were more than double those under Solvency I.

Despite this, 78% of the firms surveyed did have sufficient funds to cover the capital requirements, which is relatively consistent with the EU-wide results.

Of those that did not have sufficient assets, only one was expecting to raise the capital externally, while the others were equally split between raising capital within the group and hoping that the calibrations will change.

The majority of undertakings did not use an internal model to assess capital requirements for QIS5. The survey showed that a number of firms are intending to implement an internal model but were not in a position to produce results mainly because the calculation kernel was not ready. This is a key next step for these firms. There is a question over the capital benefits of using an internal model, particularly for life firms, and this may put off other firms from seeking approval.

Data quality

The FSA's report on QIS5 stated that, on average, firms' assessment of data quality was good for small-to-medium sized firms, except for life and health underwriting risk and to a lesser extent non-life underwriting risk. These results are in part inconsistent with the survey where the key data issues were health underwriting risk and counterparty default risk.

Although overall the data was largely suitable for QIS5, interestingly the survey showed that 91% of respondents are now going to be reviewing their data collection processes following QIS5.

The issue of data quality is very important, as results are only as good as the inputs. We hear varying opinions in the market on the quality of the data. It may be that data was good enough for QIS5; however, whether this is the case for the "real" thing is a different matter.

More pragmatic guidance is required on when it is not appropriate to use an approach because of the complexity. We hope this will be provided in the level 3 text. Many firms are spending time, effort and money on this but firms are working in the dark without the final level 2 and level 3 texts.

QIS5 spreadsheets

The spreadsheets provided by the European Insurance and Occupational Pensions Authority (EIOPA) for QIS5 were not mentioned in the report on that exercise but were highlighted in our survey, with half of respondents finding completing the spreadsheet problematic. Numerous versions of the spreadsheet were released before the final one and many firms did not allocate enough time to complete this as they were thought it would be straightforward to do so.

EIOPA has indicated that it will not be providing similar spreadsheets in the future. This emphasises the importance of streamlining the processes from calculation to reporting, and, while there may be changes in some of the modules, the overall structure is not expected to change significantly.

Calculating the SCR

It is now time for EU firms to consider how they will perform the calculation of the solvency capital requirement (SCR) using the standard formula. There are off-the-shelf packages available that automate this, linking up to existing reserving and asset packages and then directly feeding into reporting templates and management reports. Reviewing the reporting requirements was listed by over half of the respondents as a key next step in their project plan.

While QIS5 posed many problems, this exercise has raised some specific issues that respondents will now be addressing, for example reviewing their investment and reinsurance strategies. Investing in another asset class or changing reinsurers may have an instant impact on the company's SCR. QIS5 results have now been passed to FSA supervisors and firms will be asked about their QIS5 position.

Stress tests

The recently announced EU-wide stress tests for 2011 are on the QIS5 basis as at 31 December 2010. So firms not only have to update QIS5 for 2010 data but also perform the stress tests by the end of May 2011. This is a big job and will distract resources from other aspects of their Solvency II implementation plan.

For firms that are not requested to participate it may be a good idea to update QIS5 results in any event, both for management information and engagement with the FSA. This will not only help to understand better the impact of Solvency II but assist in embedding it in the business and improving the process.

Most firms are confident they will meet the Solvency II requirements by 2013, according to our survey. EIOPA is working on level 2 and level 3 texts but it is dependent on the implementation of Omnibus II and this is not expected until the end of the year. Firms may lose momentum and direct resources elsewhere in the belief that transitional arrangements may be put in place. This is obviously not what regulators will want but it may be difficult to enforce.

ORSA top of the agenda

Also to be considered is the own risk and solvency assessment (ORSA) -- which tops the agenda of 75% of respondents to the survey -- as well as the implementation of an ERM framework.

None of the respondents to our survey are intending to pull out of certain markets or geographic locations. Only one firm was considering relocating to a non-EEA country. This is quite a drastic response to QIS5 and, while it may be a tempting option, there is significant risk that these territories could eventually adopt a regime similar to Solvency II.

From the companies' point of view, there are still a lot of uncertainties. None of these is likely to be addressed until the end of the year. Many insurers are facing programme fatigue and severe strain on resources but it is important to keep up the momentum.

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http://www.insuranceerm.com/opinion/the-sme-view-of-qis5.html?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+InsuranceERMRssFeed+%28InsuranceERM+RSS+feed%29

Data quality is integral to Solvency II:

The insurance industry must revise its ad hoc attitude to data management, says Colin Rickard.

Many insurers are seeking to gain approval for their own internal model to calculate their Solvency II capital requirements on their own terms. According to the Solvency II Directive, firms are required to demonstrate a commitment to data management, including governance procedures to assure the regulator that data will accurate, complete and appropriate.

Following the FSA's review of the first batch of internal model applications, it is apparent that the requirements to manage data are being taken seriously. But there is work to be done, as according to the FSA, most firms had "overstated their current level of (data management) preparedness".

The regulator added: "It is important that firms ensure they have the resources to meet the challenges of documentation for data management purposes and the ensuing data governance requirements under Solvency II".

So why is the insurance industry in this situation? And why is there such a fuss over data quality?

Anyone who's been working in data management or business intelligence is likely to understand the fundamental issue: if risk models are based on inaccurate or incomplete data then the decisions an insurer makes are likely to be inaccurate and without a clear view of solvency, i.e. how liabilities relate to assets.

Achieving a single view of solvency requires data to be brought together from across the entire company, often from a wide range of source systems and a plethora of proprietary systems such as spreadsheets or Microsoft Access databases. The industry has long suffered from fragmented silos that result in duplicate and redundant data. For example, a recent survey by the Actuarial Profession estimated that general insurance actuaries spend an average of more than 25% of their time fixing data quality issues within spreadsheets.

Achieving a single view of data also requires that data is validated for accuracy by removing duplicate records relating to claims or asset data for example. And herein begins the challenge: a single repository of data, more often than not a data warehouse, which is populated by accurate information calls for data migrations and requires data quality business rules to be constructed, which are then enforced across various systems. This is actually relatively straightforward, as mature technology exists to enable business users to define and build that business logic. However, the associated change in culture is far from straightforward.

Recently, 30 senior risk, data and compliance professionals from the insurance industry attended an event hosted by DataFlux to debate these issues. Throughout the discussion there were three key challenges that surfaced time and again. The first related to ownership of the issue, in that a large number of firms data quality is still seen as an IT problem. Many in the room made the point that IT staff do not have the business context to build appropriate data improvement business rules; additionally, in some cases, there was a lack of board-level engagement which meant resources were scarce.

The second challenge is the provision of evidence to the regulator: How can it be effectively demonstrated that a firm is taking steps to improve data quality? Some firms that are further on in their data management journey have created and documented a ‘data dictionary', defining terms and polices by which data is governed and subsequently measured against over time. One attendee from a commercial property insurer said that documenting and demonstrating clear data lineage - the flow that moves through within the organisation - was an approach his team are focused on.

Finally, some contributors felt the regulator needed to go further in its definition of quality standards, questioning whether a 70% data quality level is enough and asking whether a 90% target level should be aimed for. This is a difficult question to answer, although some data management analysts make the point that over time firms are likely to aim for ever higher levels of quality as they use models to achieve competitive advantage.

What is becoming increasingly clear is that the FSA isn't going to settle for a piecemeal approach to governing the accuracy of data. It is seeking a complete, integrated data store which is populated with accurate data and it is looking for evidence of the lifecycle that data has taken.

I have been working in the insurance sector for longer than I care to mention and it seems to me that Solvency II will be the driver to finally tackle the industry's ad hoc approach to its most important asset: data.

Colin Rickard is managing director, EMEA at DataFlux
Article obtained from the Insurance ERM website

Solvency II Snippets:

- The FSA is currently estimating its implementation costs for Solvency II at around £100m, according to chief executive Hector Sants.

- At the recent FSA Conference held in London a quick survey was conducted among the 500 plus delegates in attendance:

    - The majority of insurers in the UK are planning to use some form of internal model for Solvency II. Of those polled, 38% were developing a full internal model, while 19% were seeking to use a partial model. The remaining 43% said they would use the standard formula

    - Delegates were also asked how significant a change Solvency II would be for their organisation? Nearly two-thirds (64%) said it was a very significant change, while just under a third (29%) said the new regime represented some change. Of the remainder, 5% said it was a completely new start and 2% said Solvency II would make little or no change

    - The conference was asked what the greatest challenge is for the firms in terms of programme management. The results held near equal weight, with 35% saying the own risk and solvency assessment (ORSA) posed the greatest challenge, 33% governance and 32% reporting.

- Omnibus II will now be considered by the European Parliament in January 2012, after a revised timetable for the directive was issued. An indicative date of 17 January 2012 has been set for the European Parliament to review the Omnibus II directive. The European Commission had wanted Omnibus II to be finalised by June 2011, although this was seen as a tight timeframe. ***(Omnibus II will amend the Solvency II framework directive, to bring it in line with the EU's Lisbon Treaty and to take account of the EU's new supervisory structure)***

- According to a report Released by auditors Deloitte it was found that only 46 per cent of insurers are confident that the industry will meet the 1 January 2013 deadline, down from 63 per cent according to a similar survey conducted in 2010.

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