SAIA
Publication of the South African Insurance Association

SAM NEWS

SAIA – (011) 726 5381 *Issue 1 / 2012*

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2012 – The beginning of the end

The first tangible sign of change in respect of the solvency capital requirements for South African Insurers and Reinsurers is upon us, with the effective implementation of ***Board Notice 169 of 2011***, pertaining to the ***prescribed requirements for the calculation of the value of the assets, liabilities and capital adequacy requirement of short term insurers***.

This Board Notice forms part of the Interim Measures leading up to the SAM implementation date currently set as 1 January 2014 and effectively signals the beginning of the end of the current solvency regime applicable to South African Insurers and Reinsurers.

A number of SAM milestones have been set for the year ahead and insurers and reinsurers alike have their work cut out for them in contributing towards the design of the new proposed SAM regime.

Some of the important milestones that insurers and reinsurers can expect in 2012

1. *Primary Legislation*

Towards the close of 2011 the Financial Services Board ***(FSB)*** has been finalising draft two of the Primary Legislation. It is expected that numerous drafts and versions of this particular legislation will be circulated for industry comment during 2012.

2. *Secondary Legislation*

The first draft of the much anticipated Secondary Legislation should be finalised and available to the insurance industry for consideration mid to late 2012.

The main input in constructing the secondary legislation stems from the work done by the various SAM Task Groups in the form of Discussion Documents and Position Papers. Hence it is critical that insurers and reinsurers participate in the development of these particular documents, to ensure that the FSB is made aware of the concerns and opinions of the short-term insurance industry pertaining to SAM.

3. *The South African Quantitative Impact Study Two (SA QIS2)*

The first South African Quantitative Impact Study (SA QIS1) was a resounding success and has provided the FSB with crucial insight as to the impact that SAM will have on insurers and reinsurers. In order to ensure that the Standard Formula is refined and properly calibrated another quantitative impact study, SA QIS2, is proposed to take place in 2012.

It has been suggested that the SA QIS2 will follow similar timelines and deadlines as those that were applicable to the SA QIS1 in 2011. It is expected that the technical specifications applicable to the SA QIS2 will be available in May 2012 and insurers and reinsurers will have until the end of September 2012 to complete the SA QIS2. If all goes according to schedule the results of the SA QIS2 should be available towards the end of 2012.

We would like to thank our SAIA members for the tremendous participation in the SA QIS1. In like manner we encourage our members to continue to build upon the excellent work done thus far by taking part in the SA QIS2.

4. *The Economic Impact Study*

The Economic Impact Study Task Group is being finalised and the group is expected to begin their work on the impact that SAM will have on insurers and reinsurers and the South African macro - economic environment.

The SA QIS2 is likely to provide important input for National Treasury's Economic Impact Study. Your participation in the SA QIS2 will go a long way in assisting with the Economic Impact Study expected to be conducted in 2012.

5. *Internal Model Approval Process (IMAP) – Window Two*

According to the FSB's SAM Roadmap, the second pre-application window period, as part of the Internal Model Approval Process (IMAP), is scheduled to begin on 2 April 2012. This window will be open for three months until 30 June 2012. The window will not extend beyond this date, as the FSB needs to allow sufficient time for insurers and reinsurers to complete both the pre-application process and the formal application phase, by the SAM implementation date of 1 January 2014.

6. *Interim Measures*

The Insurance Laws Amendment Bill is currently scheduled for presentation at Parliament in the second quarter of 2012. The Bill is expected to be enforced by the beginning of 2013. This Bill addresses the interim measures specific to **Governance**, **Internal Controls**, **Risk Management** and **Insurance Groups**.

The SAM project has evolved reaching a new plateau where technical skill and expertise are urgently required from the insurance industry to ensure that the drafting of Primary and Secondary Legislation is comprehensive, fair and adequately suitable to insurers and reinsurers.

We look forward to your continuous contribution to the design of the new proposed SAM regime throughout the course of 2012.

For further information regarding this article please contact Gareth van Deventer at gareth@saia.co.za

Are your systems ready for Governance?

The Corporate Governance Task Group has compiled a massive 123 page Discussion Document to assist the Financial Services Board (FSB) in its development of the subordinate legislation regarding Governance. The document, Discussion Document 71 "System of Governance", seeks to provide an understanding of the governance, risk management and internal control requirements emanating from the Solvency II Directive, as well as addressing components and sub-components of the governance, risk management and internal controls requirement from the Solvency II Directive.

The current document only addresses governance for solo insurers. A separate document will be compiled by the Insurance Task Group on Group Governance with similar requirements including integrated risk and capital management, specifics for group-wide and centralised functions.

Within governance the key sub-components addressed include general governance, including the Board of Directors, Board designated committees (e.g. Audit Committee), Senior Management, business rescue and IT governance. Within the component of the risk management system the Task Group have sought to address remuneration and the risk management framework, while the section on system of internal control focus on a controls framework.

It also discusses outsourcing with particular reference to the governance, risk management and internal controls implications pertaining to outsourcing arrangements. This section has however not been scrutinised by the Task Group for consistency with the proposed interim measures and Directive 159.A.i

The document used the Controls Functions as defined in the Solvency II Directive which are: the risk management function, actuarial control function, compliance and the internal audit functions; all collectively referred to as the “system of governance”. This document still has to consider the findings of a Discussion Document entitled “the role of the Statutory Actuary”, as to how and where this particular role belongs within the system of governance.

The final section of the documents addresses the governance, risk management and internal control requirements that should be considered by insurers and reinsurers that seek to use an internal model/partial internal model for regulatory reporting purposes.

The document is comprehensive and makes reference to a number of other relevant sources such as the King Code on Corporate Governance, the Companies Act, and the International Association of Insurance Supervisors’ Insurance Core Principles.

Good corporate governance is an essential component of any sustainable business. The challenge however is to ensure that a balance is maintained between the cost, value and performance. This is particularly true and challenging for smaller insurers, where although the principle of proportionality theoretical applies, in practice it would be difficult to achieve.

There is a strong possibility that we will see the FSB performing a “governance assessment” later in 2012 to evaluate insurers and reinsurers preparedness of these final measures.

For further information regarding this article please contact Nico Esterhuizen at nico@saia.co.za

SAIA SAM Workshop - Discussion Document 71 (v2): System of Governance

The SAIA SAM Project Support Office is hosting a Workshop on the **13th, 14th & 16th February 2012** to scrutinise and provide comments to the FSB on **Discussion Document 71** entitled the **System of Governance**.

We consider Discussion Document 71 a significant Discussion Document as it covers essential aspects pertaining to governance under the new proposed SAM regime. It is therefore imperative that this document is scrutinised and commented upon by all key stakeholders, especially the insurance industry.

The workshop will consist of five individual sessions, four of which will be held at the Country Club Johannesburg ***Woodmead*** and one session which will take place at the SAIA offices in Milpark, as per the *Workshop Schedule* below.

Workshop Schedule

Session Number	Session Title	Individuals required	Venue	Date	Time
1	System of Governance	• Senior Executives with relevant experience • Company Secretaries • Governance experts	Country Club Johannesburg Woodmead	13th February 2012	09h30 *to* 12h30
2	Risk Management System	• Risk Managers • Remuneration experts • Individuals familiar with remuneration processes	Country Club Johannesburg Woodmead	13th February 2012	13h00 *to* 15h00
3	System of Internal Control & Outsourcing	• Internal Auditors • Executives with the relevant experience	Country Club Johannesburg Woodmead	14th February 2012	09h30 *to* 11h30
4	Control Functions	• Risk Managers • Internal Auditors • Compliance Officers • Actuaries	Country Club Johannesburg Woodmead	14th February 2012	12h00 *to* 15h00
5	Governance, risk management and internal controls – *Internal/partial internal model*	• Risk Managers • Actuaries • Internal Auditors • Governance experts	SAIA Offices Milpark	16th February 2012	10h00 *to* 12h00

Delegates attending each session will be required to adequately prepare for the particular session in order to facilitate a focussed session/discussion.

We kindly request all persons with the necessary expertise, knowledge and skill to join us at the relevant sessions to scrutinise this document.

Should you or your nominated colleagues be interested in attending this Workshop please confirm attendance by sending an e-mailing to seema@saia.co.za with an ***indication of the session or sessions*** in which you would like to participate.

SAM Snippets

- SA QIS 1

In December 2011 the FSB released its report on the results of SA QIS1. The aggregated capital impact of SA QIS 1 on the short-term industry is summarised below:

Capital	Short term Insurers and Reinsurers	
	Current position (R'bn)	SA QIS 1(R'bn)
Available Capital	33.7	39.1
Capital Requirement	13.6	25.9
Free Surplus	20.0	13.2
Capital Coverage Ratio	2.5	1.5

The capital impact of SA QIS1 relative to current requirements (Number of participants) is:

Capital	Short term Insurers and Reinsurers	
	Higher under SA QIS1	Lower under SA QIS1
Available Capital	37	18
Capital Requirement	53	2
Free Surplus	16	39
Capital Coverage Ratio	7	48

In terms of meeting the prescribed capital requirements 81.8% of all the short-term insurers and reinsurers that participated met the solvency capital requirements (SCR). A total of 8 insurers/reinsurers did not meet the SCR and 2 insurers/reinsurers did not meet the minimum capital requirements.

The report further highlights a number of issues that are of concern to the FSB which will be reviewed in the SA QIS 2.

- At the FSB's SAM Steering Committee meetings held on 05 December 2011 the following Discussion Documents and Position Papers were approved for industry comment:

Discussion Document Number	Title	Task Group
32 (v3)	Methods and approaches to best estimate liabilities	Technical Provisions
37 (v2)	Risk Margin	Technical Provisions
39 (v3)	Assets and liabilities other than technical provisions	Assets
41 (v5)	Contract boundaries	Technical Provisions
42 (v2)	Calculation of technical provisions as a whole	Technical Provisions
47 (v2)	Equity Risk	Capital Requirements
71 (v2)	System of Governance	Governance
73 (v2)	Treatment of new business in SCR	Capital Requirements

New Position Paper	Title	Task Group
34 (v5)	Own Risk Solvency Assessment	ORSA and Use Test
35 (v4)	Use Test	ORSA and Use Test
43 (v2)	Internal Models: Validation	Internal Models
54 (v3)	Internal Models: Model Governance Models	Internal Models
55 (v2)	Internal Models: Statistical Quality and Calibration	Internal Models
56 (v2)	Internal Models: Documentation and Data Requirements	Internal Models
57 (v2)	Partial Internal Models	Internal Models

- Primary and Secondary Legislation Proposed FSB Timelines:

Primary Legislation	Deadline	Comment Period
2nd Draft circulated to the SAM task groups for comment	28 January 2012	28 January 2012 - 30 March 2012
3rd Draft to be tabled by FSB Drafter	29 June 2012	29 June 2012 - 28 September 2012
4th Draft to be tabled by FSB Drafter	05 December 2012	-

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Secondary Legislation	Deadline	Comment Period
1st Draft tabled by FSB Drafter to SAM Task Groups for comment	30 April 2012	30 April 2012 - 29 June 2012
2nd Draft to be finalised by FSB Drafter	31 August 2012	31 August 2012 - 31 October 2012
3rd Draft to be tabled by FSB Drafter	31 December 2012	-

- The number of Discussion Documents being generated by the SAM Governance Structure continues to climb and now stands at 91.

For further information regarding these SAM Snippets please contact Gareth van Deventer at gareth@saia.co.za

The Six Key Challenges of Solvency II

Many firms believe they're already close to compliance with Solvency II, when it's clear that quite a few are not. The problem is: the more progress insurers make, the more they realise they have to do - *Simon Kirby spells out the six areas that most need attention*.

There are many changes required to meet the Solvency II standards but clarity and guidance from the EU and the European Insurance and Occupational Pensions Authority (Eiopa) will not be with us for some time yet.

The EU's level 2 implementing measures and binding technical standards are not due for publication until summer 2012 and Eiopa's level 3 guidance documents cannot be published until after the level 2 is published.

Insurers may also need to incorporate changes imposed by the revised International Financial Reporting Standards (IFRS). This means that platforms, systems and processes built now must be flexible enough to absorb changes to the requirements in the future.

In the short-term, this transformation has become a necessary compliance exercise. But, by building a platform that can be quickly and cost-effectively adapted later, insurers can still invest in their long-term competitive advantage.

Insurers are therefore seeking to build flexible IT platforms and data management frameworks that both enable them to be compliant now and provide a solid foundation for future innovation and development.

What is increasingly clear is that the more progress insurers make, the more they realise they have to do.

This anecdotal evidence is supported by the findings of the FSA's Solvency II: internal model approval process thematic review which found that some firms "judged themselves to be already close to Solvency II standards but, on closer questioning, were not able to provide evidence to justify this".

We have identified six key challenges that insurers must address immediately to meet Solvency II standards in time.

Challenge one: data management

Data management - or more precisely, managing the quality and consistency of data is fundamental to Solvency II compliance. The directive requires data to be accurate, timely and appropriate for all stakeholders, across actuarial, risk and financial functions. But, in many firms, “siloed” use has led to disjointed data; an issue that must be addressed for firms to be Solvency II compliant.

Many insurers have made plans for improved data management, but have stumbled at the implementation phase. The FSA commented that most firms "have overstated their current level of preparedness against Solvency II criteria."

The regulator noted that insurers had started to create data dictionaries, to help with company-wide classification of understanding of data. These data dictionaries will help to convert data into the information each stakeholder needs - whether that be risk profiling or reporting information - and ensure everyone is compliant.

However, the FSA also commented that there is little evidence of "timely maintenance and consistent use" of the data dictionaries across the business. It therefore recommends that one or more "data experts" should be the custodians of data quality and management for the entire firm.

In addition, the regulator views multiple spread sheets as an area of risk, leading to an uncoordinated approach and a lack of cross-functional alignment, and not the best route to compliance.

A centralised software solution is therefore essential to ensure consistent use and easy maintenance of data, as well as reliable monitoring and reporting. But with multiple stakeholders, and limited resources, how can companies ensure policy-wide compliance, in the remaining time?

Solvency II compliance is a massive and multifaceted exercise, but does not require firms to tackle data management at a policy-by policy level. Insurers using the regulator's standard formula will find that homogenous risk groups are acceptable. Others should prioritise the data that has a material impact on their compliance issues, and ensure these are clearly defined in the data dictionary.

Challenge two: capital requirements

In the past, insurers have used numerous, separate actuarial models to calculate capital requirements and project cash flow for individual products or subsidiaries. This siloed approach has meant that balance sheets -- and therefore regulatory capital -- have not always truly reflected all of the risk undertaken by the business, e.g. market, credit, underwriting, liquidity and operational risk.

Solvency II requires all insurers to integrate the models used to calculate their Solvency Capital Requirement (SCR) and to produce an accurate balance sheet that is reflective of all risk taken at product, subsidiary and corporate level. This applies to all firms, regardless of which approach insurers base their capital requirement calculations on: internal model, standard formula or a combination of the two.

However, there are very few software solutions on the market that can apply these complex calculations in a compliant and harmonised way. And, with the proposed delays to the implementation of the directive, there is still uncertainty as to the exact calculation standards.

Insurers must develop a central risk calculation engine that will analyse risk and calculate capital requirements in line with both Solvency II and company strategy.

This engine should be quick and easy to use whenever firms need to measure risks, at a subsidiary or corporate level. Furthermore, it should not only be used for capital and risk calculations, but also for aggregation, stress testing, and for validation and reporting purposes as well.

Challenge three: risk management

Measuring and managing all types of material risk is not just about regulatory Compliance; it also informs business strategy, planning and operational decision- making. Insurers will therefore continue to assess all types of risk, especially those specific to their own business, using an own risk and solvency assessment (ORSA).

To produce a complete risk profile that is both compliant and strategically valuable, the Solvency II standards and ORSA must be calculated and managed in a consistent way. Risks identified by an ORSA should be included in or reconciled with a firm's Solvency II model, and resultant capital requirements will directly impact financial planning.

In addition, progressive insurers will want to improve their risk management systems continuously over time, as they turn this compliance exercise into an opportunity to create competitive advantage.

Insurers should therefore take this opportunity to develop a unified risk management system and calculation engine to help produce both the SCR and the economic capital requirements under the ORSA.

Challenge four: compliance reassurance

Solvency II compliance is not just about establishing compliant policies and business processes and implementing them. Insurers are required to demonstrate how they arrived at these policies and processes and that their implementation is valid and consistent. They also have to prove that they have been fully embedded into the firm's working practices.

The FSA will conduct frequent assessments of an insurer's compliance with the Solvency II rules through the supervisory review process (currently known as ARROW in the UK). It will be vital that insurers can explain how and why they comply with the rules, justify their internal models and detail the processes in place to meet the standards. In addition, insurers will need to be able to quickly and easily provide the FSA with regular implementation updates as the go-live deadline approaches.

Experience has shown that companies that conduct self-assessments of their own compliance with the rules have better relationships with the FSA, are less at risk of fines or censure and ultimately have a lower overall cost of compliance.

Beyond regulatory scrutiny, these self-assessments form the foundation of a strong internal control framework to help ensure continued long-term compliance.

Challenge five: reporting

Greater transparency -- through public disclosure and reporting requirements -- is one of the central foundations of Solvency II. Insurers will be expected to produce more reports than ever before -- such as capital calculation and risk management results -- on a monthly, quarterly and annual basis - both for internal, regulatory and market scrutiny.

Not only will firms need to produce more reports, the frequency of reporting has been increased with both quarterly and annual reports proposed. Also, final reporting requirements will not be fully defined until the level 2 standards are finalised.

Meeting the new reporting standards will need an unprecedented amount of work, in a time of immense pressure and limited resources.

For many insurers, reporting is the final hurdle to compliance - and they stand to fail if they do not put sufficient reporting tools in place now.

Managing separate reporting systems for regulatory, market and management reporting will not be practical or cost-efficient once Solvency II legislation comes into effect. Insurers must therefore save time and money by integrating their reporting system to produce consistent, timely and relevant information for all stakeholders.

Challenge six: IFRS reconciliation

The move to Solvency II and the forthcoming IFRS accounting changes will both have huge implications for how insurers measure their performance and are viewed by the financial markets and regulators. Failure to communicate capital management and value creation effectively will lead to greater market scrutiny and an increased cost of capital.

Firms must be able to report both standards clearly, and help the market and regulators understand any discrepancies the two methodologies create.

The cross-over of the implementation of Solvency II with the IFRS changes presents an opportunity to integrate the two reporting frameworks. The logistics of this will present huge challenges. However, expense and risk associated with managing them separately make reconciliation the most prudent long-term strategy.

Insurers should therefore consider IFRS evolution and Solvency II compliance as part of the same process.

Article by: Simon Kirby who is the Solvency II Consultant at SAS in the UK, taken from the InsuranceERM website. Article dated: 27 October 2011

It is envisaged that SAM will experience similar challenges to that of Solvency II. As such the above article by Simon Kirby provides some useful insight for insurers and reinsurers to consider when implementing their SAM plans and strategies.