

# European Solvency II Survey 2014



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# Contents

<b>01</b>	Key findings
<b>02</b>	Background
<b>04</b>	General implementation readiness
<b>06</b>	Implementation readiness - Pillar 1
<b>07</b>	Implementation readiness - Pillar 2
<b>12</b>	Implementation readiness - Pillar 3
<b>14</b>	Data and IT readiness
<b>18</b>	Application of internal models
<b>22</b>	Regulatory interaction
<b>24</b>	Organizational transformation of risk management
<b>26</b>	Recovery and resolution planning (RRP)
<b>30</b>	Managing capital under Solvency II

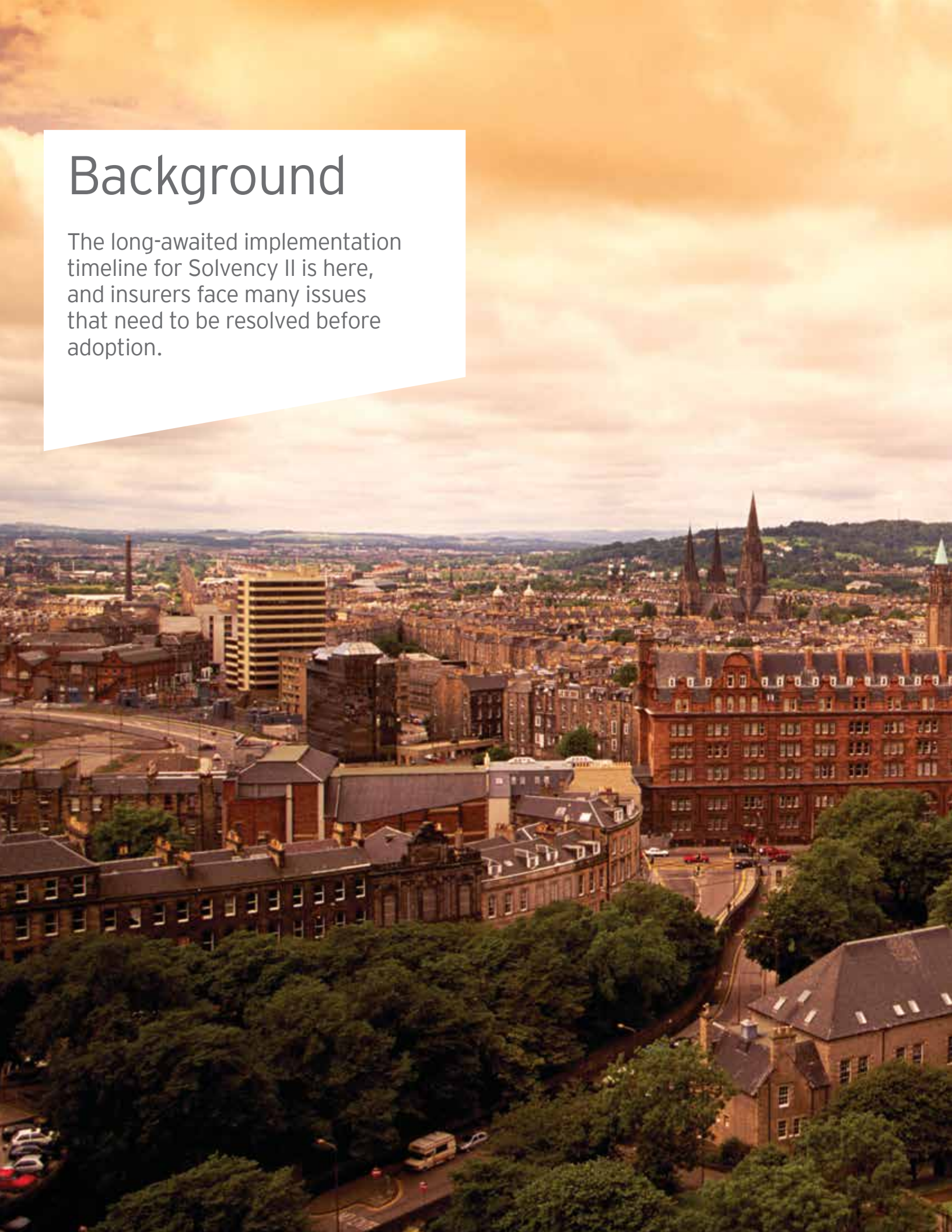
# Key findings

Overall, the insurance industry is on track to implement Solvency II by 1 January 2016; however, a significant amount of work is needed between now and then to address preparedness across all three pillars.

- ▶ Considerable variability in the level of preparedness exists by country, with Dutch, UK and Nordic insurers most confident of meeting the requirements, while French, German, Greek and Eastern European insurers are less confident.
- ▶ There is a strong, consistent message that insurers are seeking to improve the effectiveness of their risk management, including many dimensions in culture, appetite, controls, people and systems.
- ▶ Challenges of reporting and ensuring robust data and information technology (IT) remain very significant, and many companies have yet to sufficiently energize this part of their plans.
- ▶ Preparedness for Pillar 3 remains relatively low and action is needed by companies in 2014 to meet the requirements on time.
- ▶ Achieving internal model approval remains a major challenge; there is only a slight reduction in the number of companies planning to take this route. However, leading insurers remain strongly committed to obtaining internal model approval from inception of the new Solvency II regime and have aligned their work plans to reach this goal.
- ▶ Many insurers are not satisfied with the level of support from their regulators in providing timely feedback on plans and interpretation of new requirements; this is due, in part, to the significant resourcing challenges regulators face.
- ▶ Automation of many risk management activities, particularly reporting, remains relatively low and, as companies develop their plans, we expect this will be an area of increasing focus.
- ▶ Insurers are increasingly receiving requests for recovery and resolution planning.
- ▶ Companies are beginning to invest significant effort in understanding how to manage their capital under Solvency II so that they are properly prepared for the new regime.

# Background

The long-awaited implementation timeline for Solvency II is here, and insurers face many issues that need to be resolved before adoption.

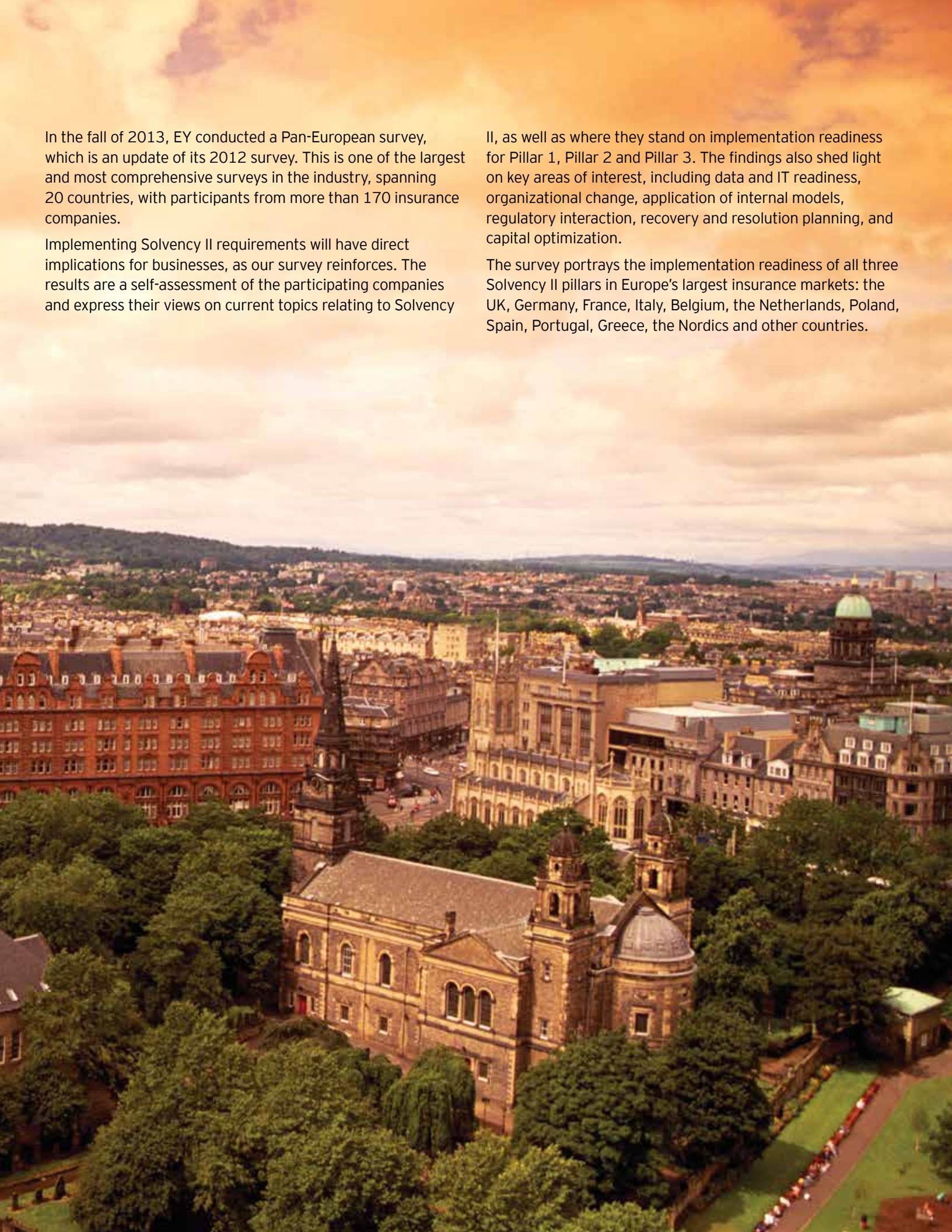


In the fall of 2013, EY conducted a Pan-European survey, which is an update of its 2012 survey. This is one of the largest and most comprehensive surveys in the industry, spanning 20 countries, with participants from more than 170 insurance companies.

Implementing Solvency II requirements will have direct implications for businesses, as our survey reinforces. The results are a self-assessment of the participating companies and express their views on current topics relating to Solvency

II, as well as where they stand on implementation readiness for Pillar 1, Pillar 2 and Pillar 3. The findings also shed light on key areas of interest, including data and IT readiness, organizational change, application of internal models, regulatory interaction, recovery and resolution planning, and capital optimization.

The survey portrays the implementation readiness of all three Solvency II pillars in Europe's largest insurance markets: the UK, Germany, France, Italy, Belgium, the Netherlands, Poland, Spain, Portugal, Greece, the Nordics and other countries.





# General implementation readiness

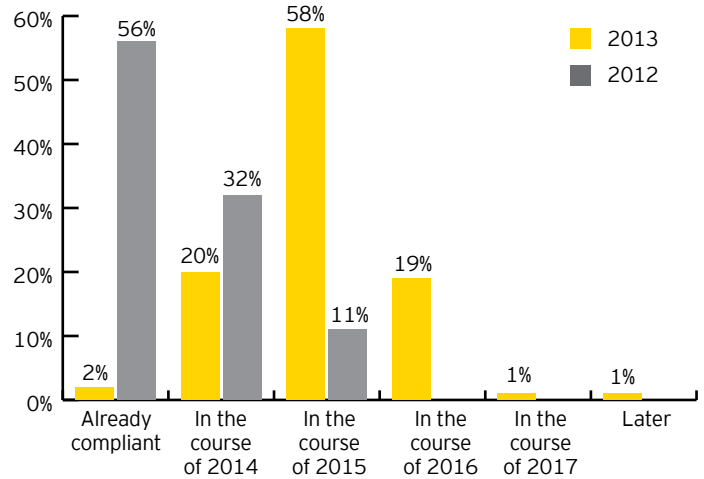
Nearly 80% of European insurance organizations expect to fully meet the significant Solvency II requirements before the new January 2016 deadline.

Postponing the regulatory deadline has strongly bolstered the confidence of insurance companies to meet the requirements in the time frame. A significant number of organizations (79%) do not expect to be compliant until 2015 or later. Many countries, particularly France, Greece and the UK, have become more pessimistic or perhaps realistic about their implementation readiness. Compared to our last survey, many insurance companies in these countries have delayed the due date of their implementation plans by at least one year.

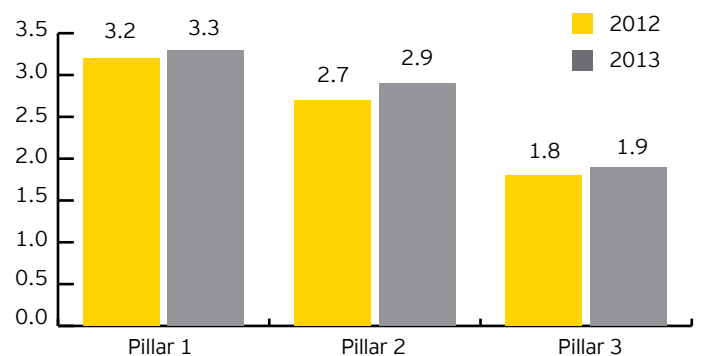
Only Dutch insurers consider themselves to be well prepared and expect an implementation readiness date of 2015, with none stretching into 2016. In contrast, a number of French, Greek and German insurers are noting an expected compliance date later than 1 January 2016 (Figure 3).

The majority of European insurance companies reveal that they have made limited progress or recognized more demanding requirements across all three pillars, compared to the earlier survey (Figure 2). They indicate a consistently high state of readiness to implement all components of a Pillar 1 balance sheet and fulfill most Pillar 2 requirements. Pillar 3 still presents a major challenge.

**Figure 1: European Solvency II readiness**

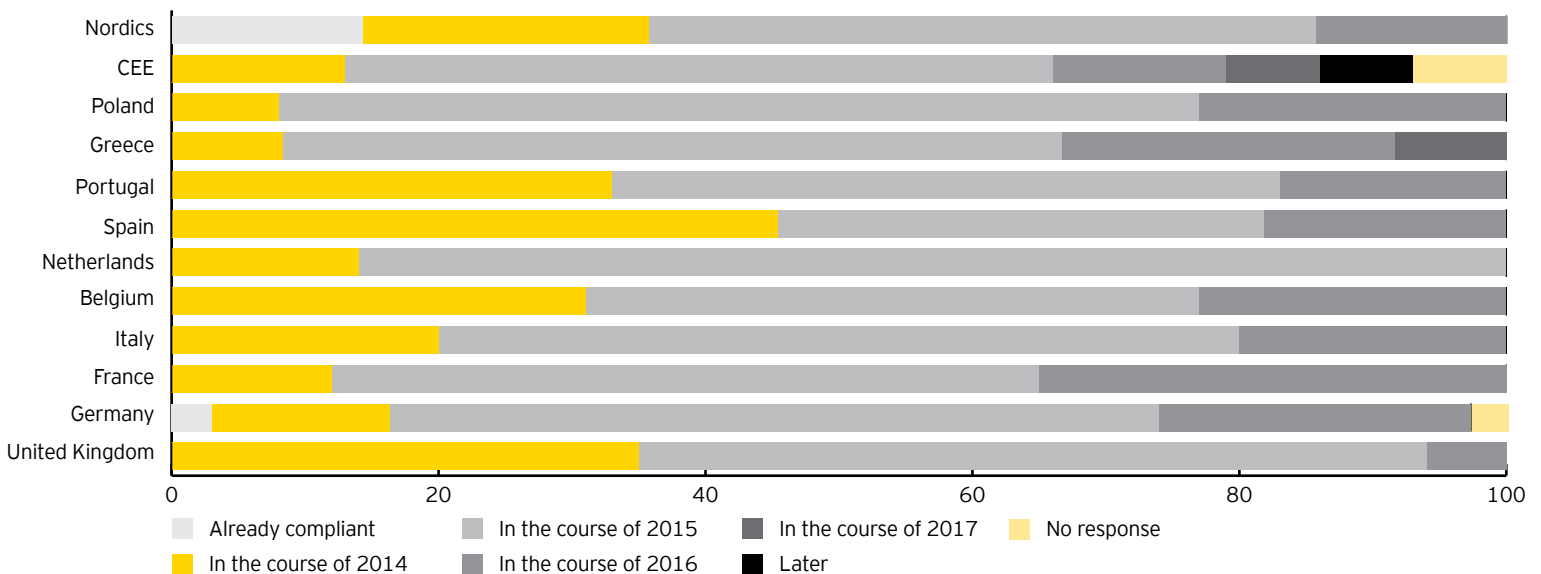


**Figure 2: Overall implementation status by pillar**



1: The requirements are not met  
 2: Some of the requirements are met  
 3: Most of the requirements are met  
 4: All of the requirements are met  
 5: The company already goes beyond the Solvency II requirements

**Figure 3: Implementation of Solvency II requirements – country comparison 2013**



# Implementation readiness – Pillar 1

Insurance companies appear generally well prepared on all aspects of Pillar 1 and continue to make steady progress.

Readiness has improved in all areas, building on the response to our previous survey, which on average indicated a status of at least meeting “most” Solvency II requirements in each of the areas considered.

Since the last survey, the most progress has been made in own funds calculations, which are now the most advanced area within Pillar 1. However, uncertainty remains in some important areas, such as equivalence.

Best estimate liabilities, risk margin and standard formula (SCR) calculations have made less progress, which may reflect the lack of clarity over the past year regarding the final Solvency II basis. This has now been resolved through the Omnibus II agreement, particularly with respect to long-term guarantees.

Readiness responses in each Pillar 1 category were slightly higher for insurers implementing (partial) internal models than for those using the standard formula. Overall, there is only a marginal difference in readiness between internal model and standard formula users for the core Pillar 1 calculations.

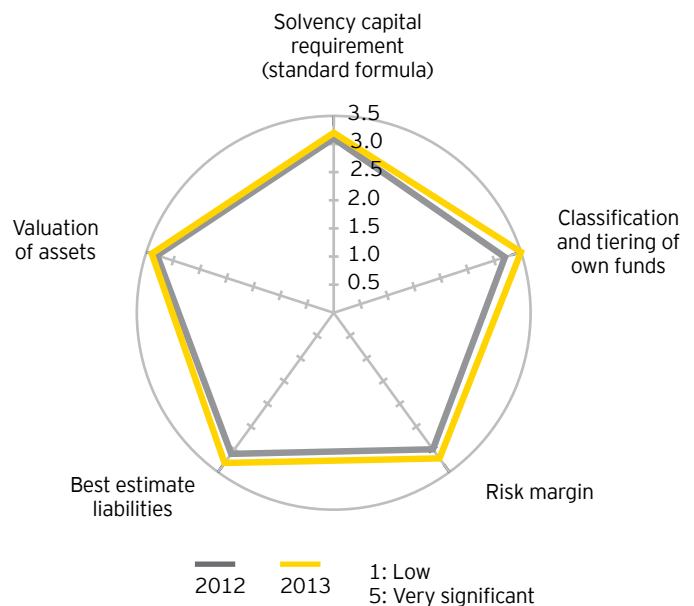
Strong overall progress on Pillar 1 readiness masks significant variations between country responses.

As shown in Figure 5, French, Dutch and Italian companies appear to be particularly well prepared, with readiness approaching full compliance with Solvency II requirements.

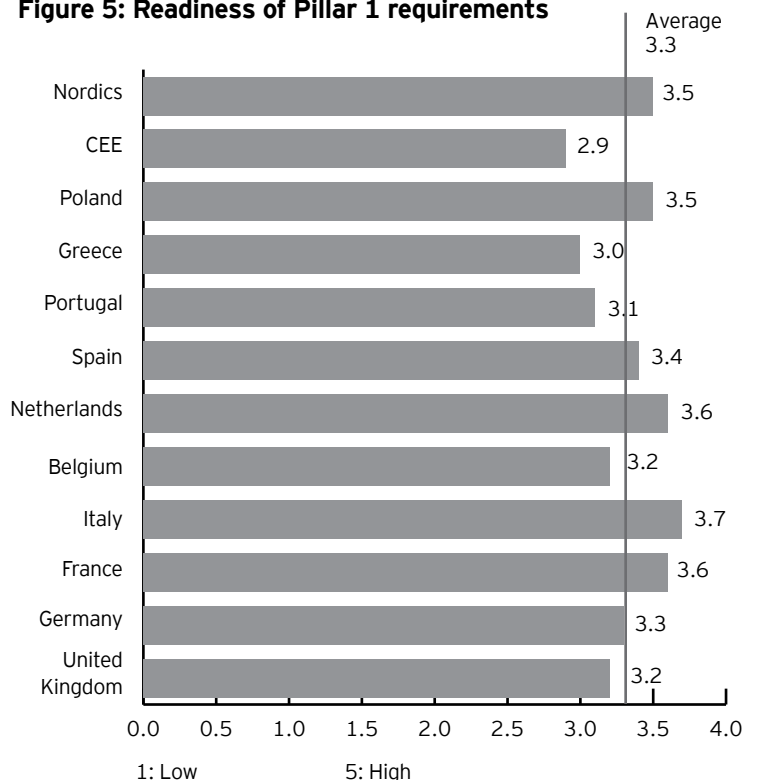
French readiness responses may have benefitted from work performed to provide core Solvency II results to the regulator in September 2013. This was completed on a voluntary basis, but participation was encouraged by the regulator. The exercise was designed to help the regulator assess the French market’s degree of preparation for Solvency II valuation principles and reporting, as well as to inform discussion between regulators and companies on key topics.

A lower level of readiness was assessed by Greek, Portuguese, and Central and Eastern European (CEE) companies, where the risk margin calculations were the weakest area within Pillar 1. Insurers in these countries do not yet consider that they are meeting “most” Solvency II requirements for this balance sheet component.

**Figure 4: Pillar 1 implementation status**



**Figure 5: Readiness of Pillar 1 requirements**







# Implementation readiness – Pillar 2

Overall, survey results show that insurance companies need to do a lot more to become Solvency II compliant and to demonstrate sufficient progress on risk management effectiveness to supervisors.

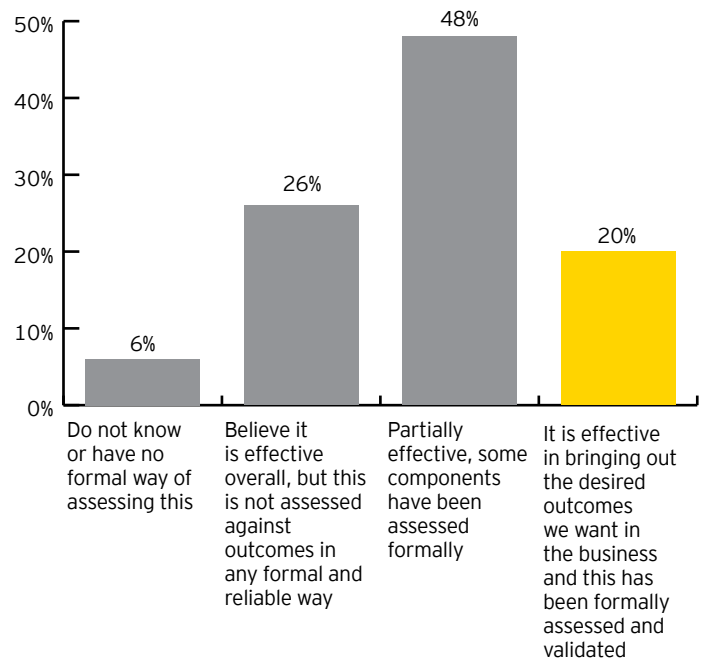
Although progress has been made in most areas since the last survey, the results suggest that respondents are anticipating increased risk management activity in several areas.

The results also suggest an increase in the percentage of companies that have some formal mechanism to assess risk management system effectiveness. However, EY considers statement 4 in Figure 6 as being compliant with Solvency II and, in that context, only 20% of respondents fall within that category (a slight increase from the last survey).

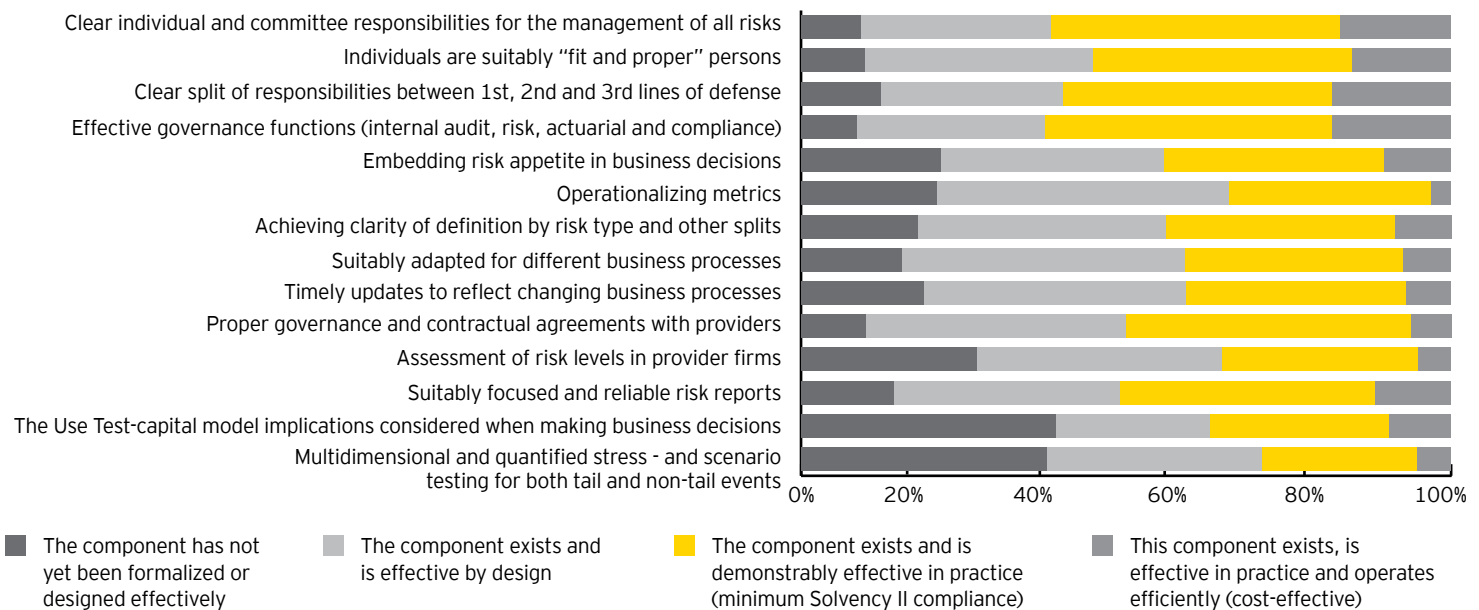
It is interesting that 32% of respondents have no formalized way of assessing effectiveness against outcomes. Even if there was no regulatory requirement to have effective risk management, it is difficult to understand why companies would not seek to understand this element of business management so that they could improve it.

Given the increased availability of effectiveness assessment methodology and the requirement for National Competent Authorities to demonstrate progress to the European Insurance and Occupational Pensions Authority (EIOPA) on risk management effectiveness, we anticipate that insurance companies will be undertaking more formal assessments.

**Figure 6: Effectiveness of risk management system**



**Figure 7: Fulfilment of selected requirements for Pillar 2**



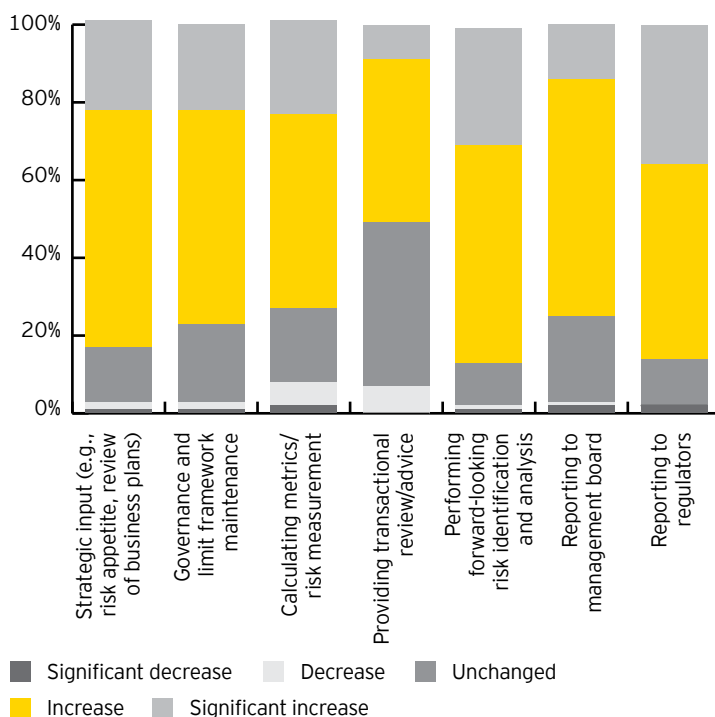
In most areas, organizations have not yet reached the minimum level of Solvency II compliance. For each component, about half believe that the component is not effective in practice.

Only 15% of respondents feel their components are effective and efficient, suggesting that 85% of respondents see opportunity for effectiveness and/or efficiency improvements in many of these areas (Figure 7).

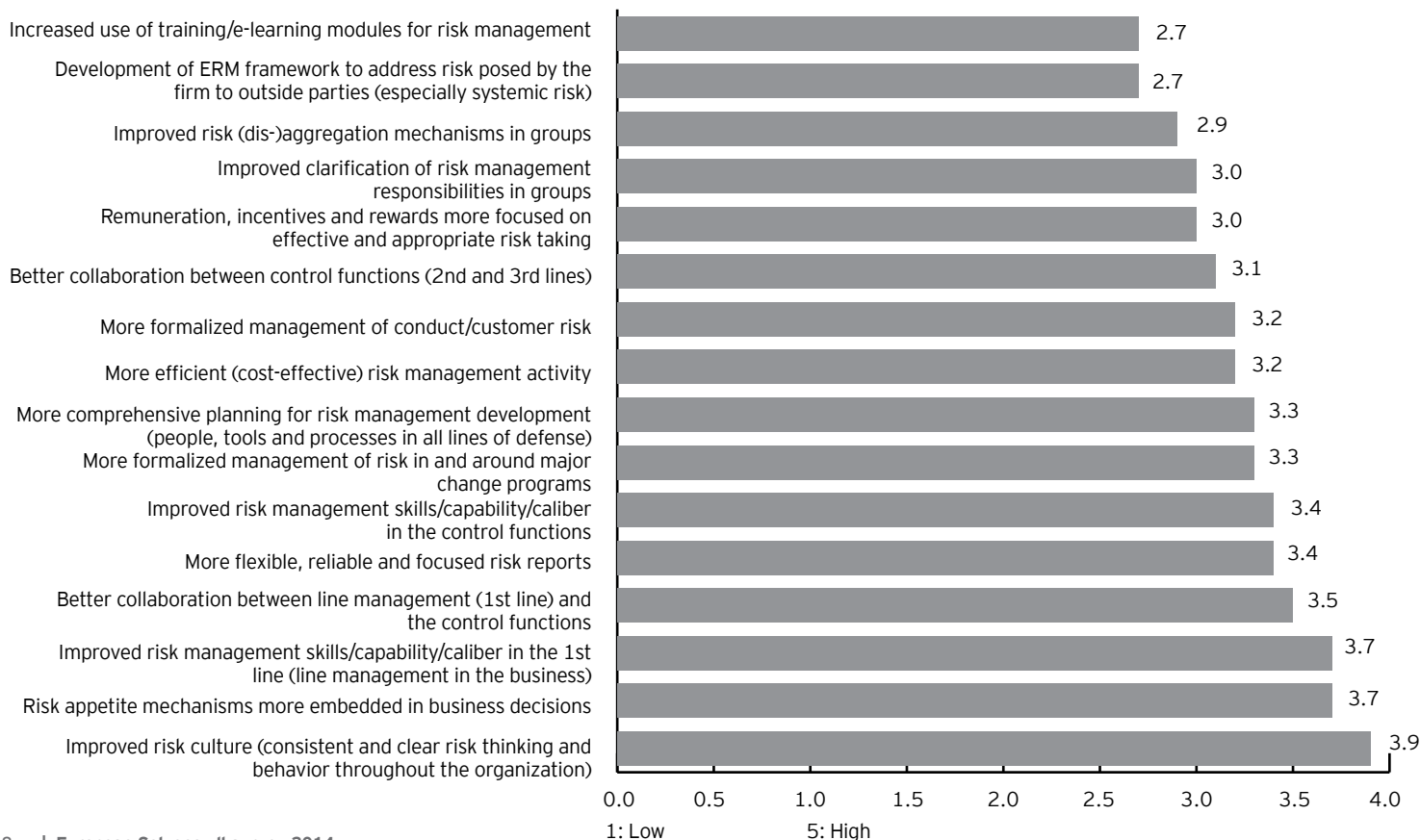
The percentage of companies anticipating a heavier workload is dramatic. Half to three-quarters of respondents expect the amount of work undertaken in every one of these areas to escalate (Figure 8).

Approximately one in every four respondents contemplate a significant increase in the time spent on measuring risk, strategic input, governance and limit framework maintenance. Approximately one-third of all respondents anticipate appreciably more effort on forward-looking risk assessment and reporting to regulators.

**Figure 8: Future focus areas of risk managers**



**Figure 9: Future benefit of measures increasing risk management effectiveness**



It is encouraging to see that 84% (Figure 8) of respondents expect to spend more time on strategic input, as that is a key part of ensuring that the risk management system is properly aligned with the business strategy. More explicit linkage of risk management priorities to business strategy should follow.

Three-quarters of all respondents anticipate spending more time on reporting to management boards. This reflects increasing demand from management teams for risk-related information. It also poses an interesting question: should 2nd line resources be spent on increased reporting to management boards or should that be the responsibility of the 1st line individuals who manage risk? Only 3% of respondents anticipate a decline in this area, so improved risk reporting can be expected.

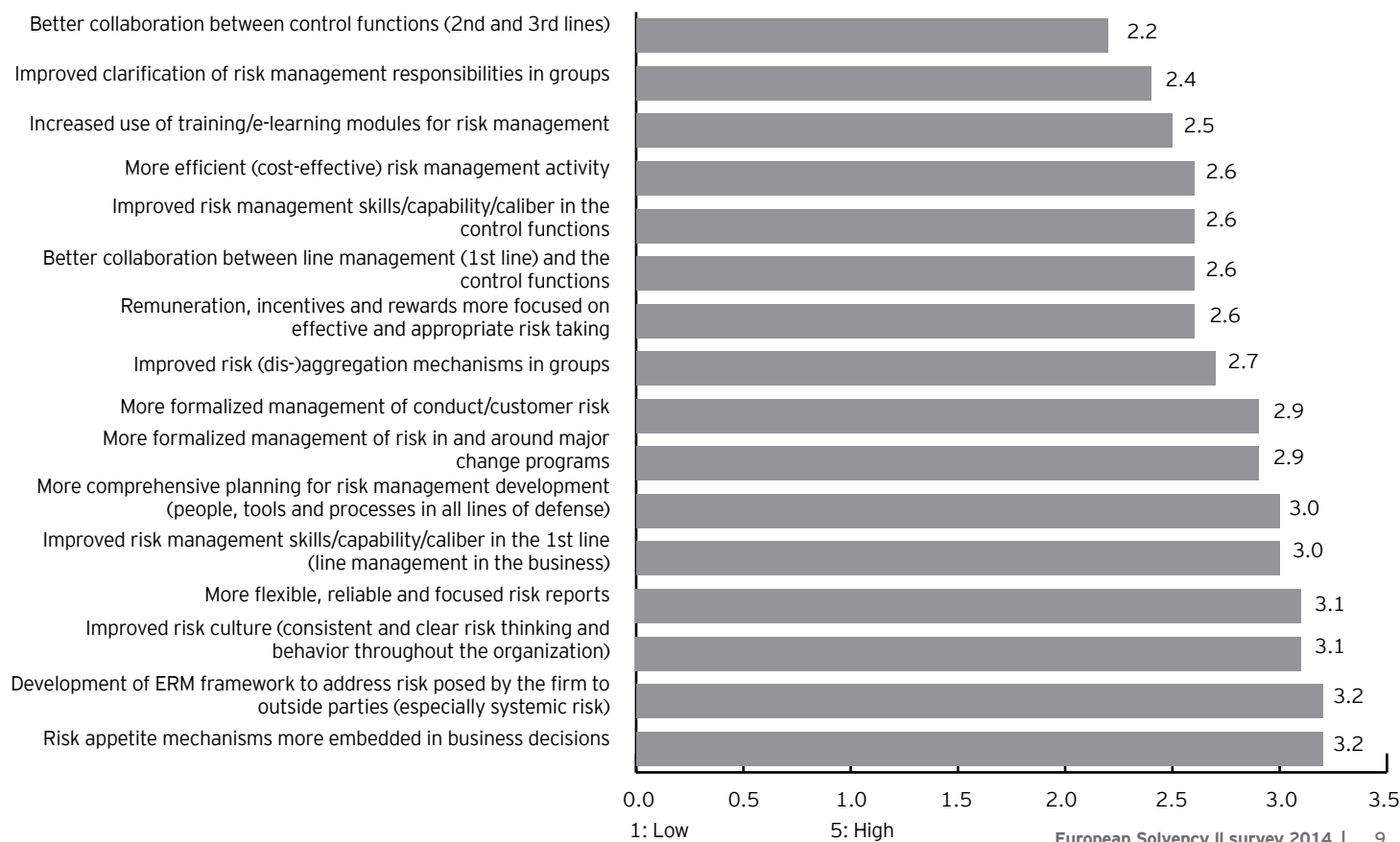
Of the items listed in Figure 9, improved risk culture scored the highest average mark in terms of potential benefits. Improving risk culture is receiving significant attention in banks and increasingly in insurance companies because it underpins decisions made on the management of risk.

However, it is also interesting to note that the four highest scoring items all relate to interface with the 1st line. Improved 1st line risk management capability and greater embedding of risk appetite both ranked number two, followed by better collaboration between the 1st line and control functions. In other words, improvements in the 1st line would seem to bring most benefit to insurers' overall risk management activity.

When respondents were asked to score the same items in relation to the effort required (Figure 10), risk appetite, risk culture and improved capability in the 1st line were again highly ranked. This suggests that the highest benefit areas may also be the most difficult to achieve.

However, there were some exceptions. Better collaboration between the 1st line and control functions (a higher benefit item) was much lower on the scale in terms of the effort needed.

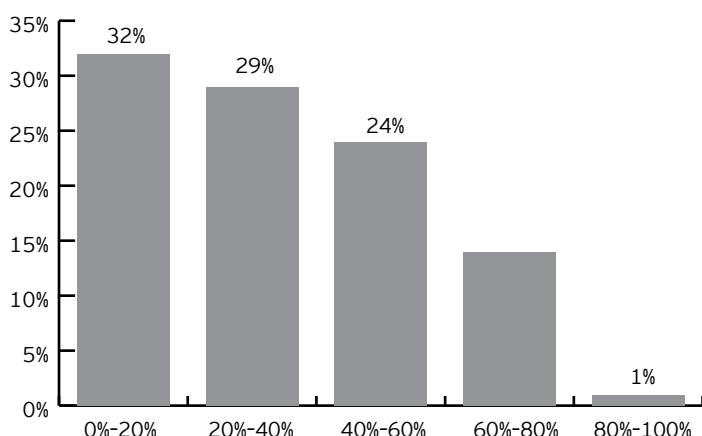
**Figure 10: Effort of measures increasing risk management effectiveness**



The development of an ERM framework to address an organization's risk to others (activity from regulatory initiatives to address systemic risk) received high ratings in terms of the effort required, but came in second to last in terms of the benefits of taking action (Figure 10).

As an example, improved risk management skills, capability and caliber of control functions were rated high in potential benefits, but relatively lower in terms of the effort needed for implementation.

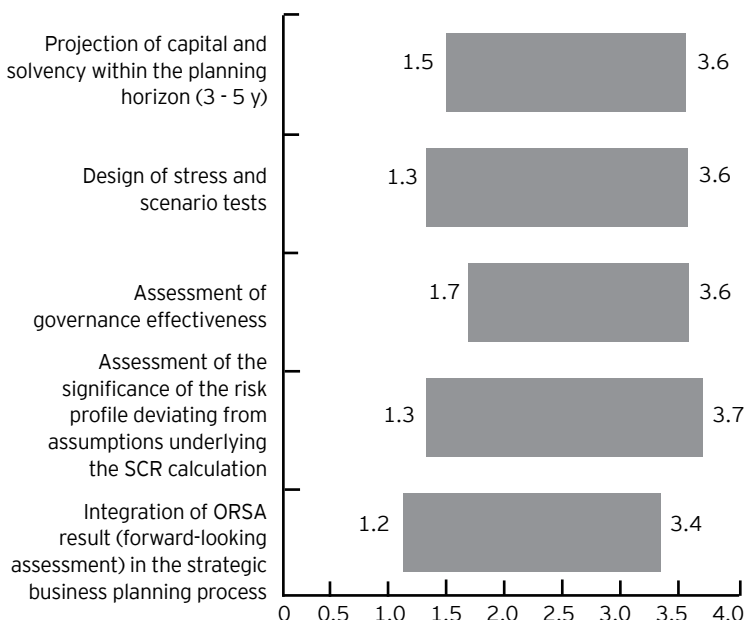
**Figure 11: Level of automation for risk reporting and calculation of key risk management metrics**



The vast majority (83%) of companies are manually reporting and calculating key risk management metrics. There is considerable opportunity for increased automation.

Almost one in six companies have 60% of these processes automated (Figure 11). This demonstrates that although some progress has been made, there is substantially more potential –perhaps in alignment with other activities–to improve the information flows throughout the organization. Leveraging technology and data progress to improve risk management cost effectiveness is an area of opportunity for many insurance companies.

**Figure 12: Own Risk and Solvency Assessment (ORSA) implementation readiness—spread from lowest to highest country**



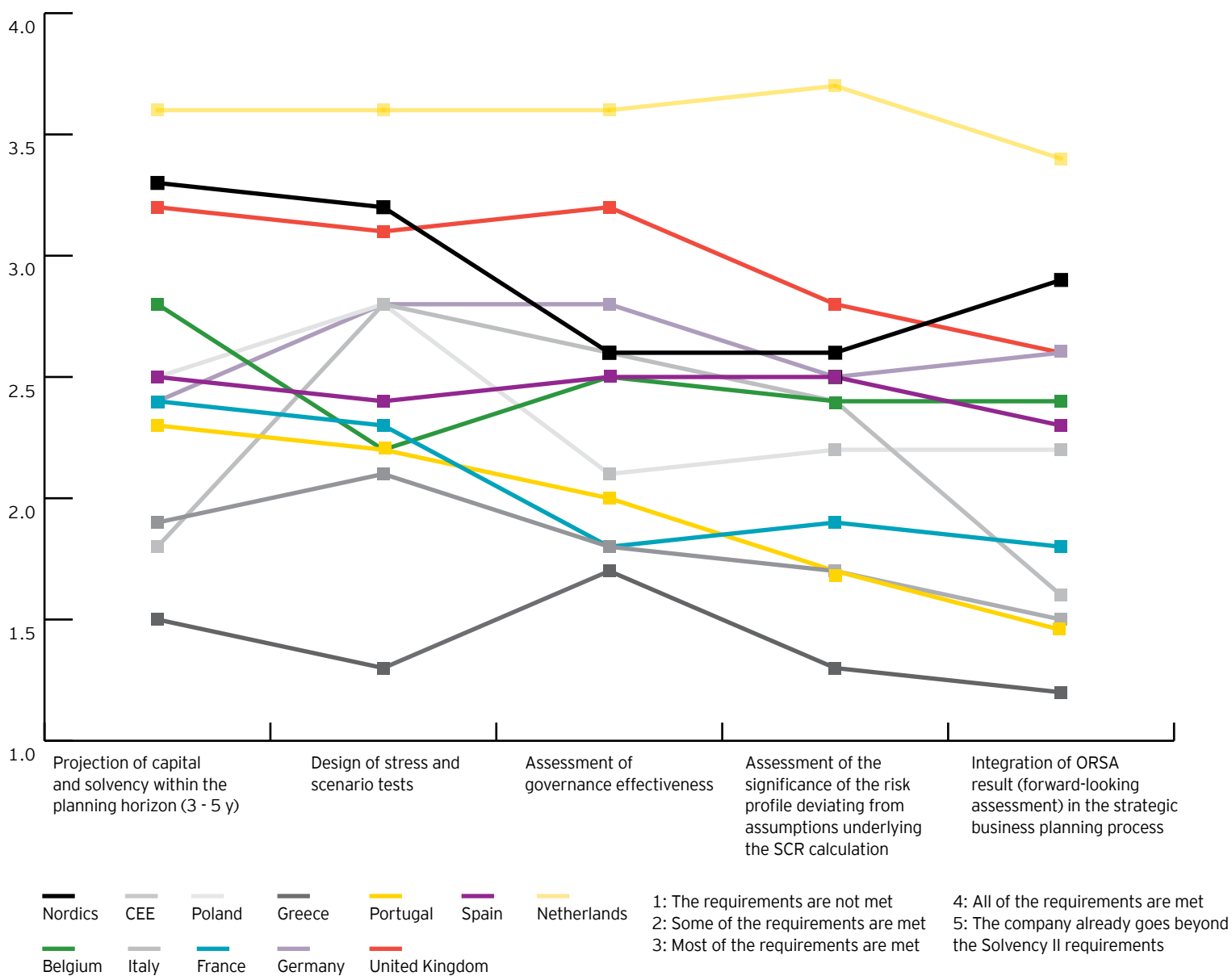
- 1: The requirements are not met
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One of the most striking things about these results is the spread of response between countries with the lowest average scores and those with the highest (Figure 12). Although no country responses average at “all of the requirements are met” (and therefore, progress is required in all countries on all items), some scores average as high as 3.7. In contrast, in other countries, the average scores were very low—just over 1—and therefore, closer to “the requirements are not met” than to “some of the requirements are met.” This self-assessment suggests a very low level of readiness in some countries in relation to ORSA.

One of the interesting features in this analysis of average scores by country is the mix. Some countries are relatively more advanced for some aspects than for others. The pattern is reversed for other countries. Although there is some downward trend from left to right in the chart (Figure 13), overall, there is very little commonality in average scoring per component.

Generally speaking, the Netherlands, the Nordics and the UK view themselves as relatively more prepared, while Greece, Portugal and CEE consider themselves the least well developed.

**Figure 13: ORSA implementation readiness**





# Implementation readiness – Pillar 3

Most organizations have registered little progress since 2012. Almost 76% of respondents say that they have yet to meet most or all Solvency II reporting requirements (a marginal improvement compared to 80% in 2012).

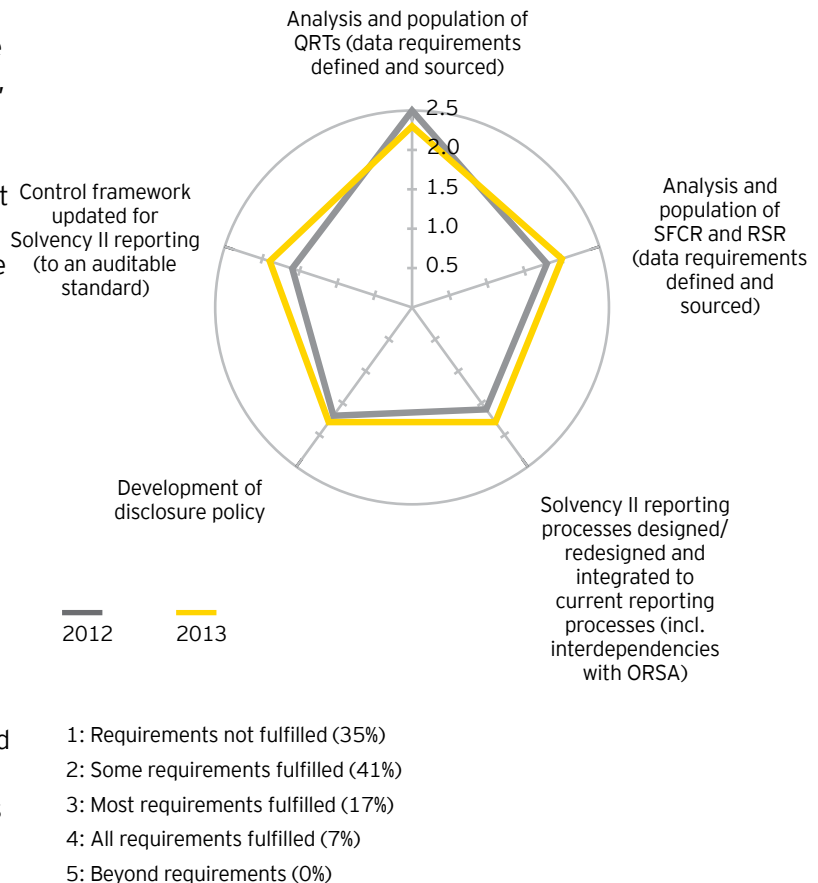
In our current survey, 99% of respondents have yet to meet all Solvency II reporting requirements, and 76% say they have only partially met or have yet to meet any requirements thus far. In terms of implementation readiness, Pillar 3 remains the least developed area compared to Pillar 1 and Pillar 2. Clearly, there is significant work ahead for most organizations.

When comparing across geographies, some markets, such as Germany, the Netherlands, Italy and CEE, have made the most progress since 2012. However, for Germany and Italy, the progress could be viewed as simply catching up, as these were previously two of the markets where the most effort was needed.

The Netherlands remains relatively the most advanced, with 43% of respondents saying that they already meet most of or all of the requirements.

In comparison, the UK and France may have previously underestimated the requirements, as their level of preparedness and implementation readiness appears to have regressed. In 2012, both the UK and France appeared to be relatively more advanced in their preparation compared to the rest of Europe, with 30% to 40% of respondents in these markets saying that they met most, if not all, of the requirements. In our latest survey, the percentage has reduced significantly, with only 19% to 22% of respondents in these markets saying that they meet most or all of the requirements (Figure 15).

**Figure 14: Pillar 3 implementation status**

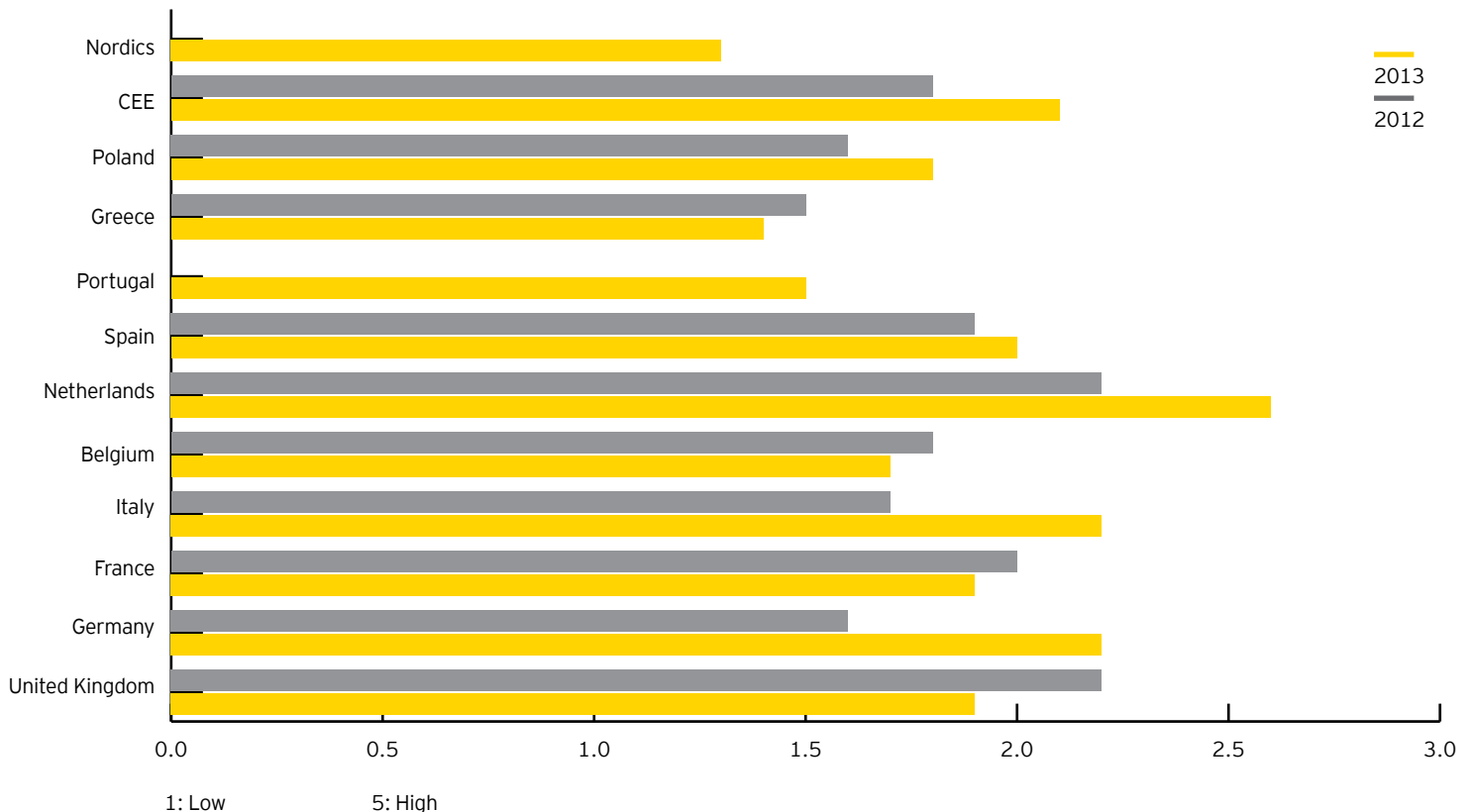


In 2012, the relative lack of progress in Pillar 3 compared to Pillar 1 and Pillar 2 could be explained. Most organizations were awaiting more certainty in the Solvency II Pillar 3 requirements before committing serious effort and work to defining and implementing reporting solutions. The subsequent delays and deferral to the Solvency II implementation date may explain why little progress has been made since then.

However, the timeline has changed with the release of Omnibus II at the end of 2013, the transitional reporting requirements for 2015 and the full implementation and reporting required in 2016. The remainder of 2014 will be a critical period for organizations to now restart and, in many cases, accelerate their Pillar 3 projects.

Given the current status and level of preparedness, the reality for many is that the 2015 transitional reporting will need to be done largely on a manual basis. In 2016, the focus will be on more automated, robust and embedded solutions. But given the data, process, control and IT challenges that many organizations still face, achieving and embedding the reporting requirements within these time frames is likely to prove to be a demanding task.

**Figure 15: Implementation of Pillar 3 requirements**





# Data and IT readiness

Nearly 79% of European insurance companies say they have met none or are only meeting some of the requirements to document and control end-user computing tools. This is a clear sign that there is a long way to go in terms of Solvency II data and IT readiness.



Making a data landscape work across multiple and complex IT systems, multiple reporting bases and potentially across both group and solo entities remains a significant challenge. Our survey suggests that achieving adequate data integration, quality and control remains an important priority for all companies.

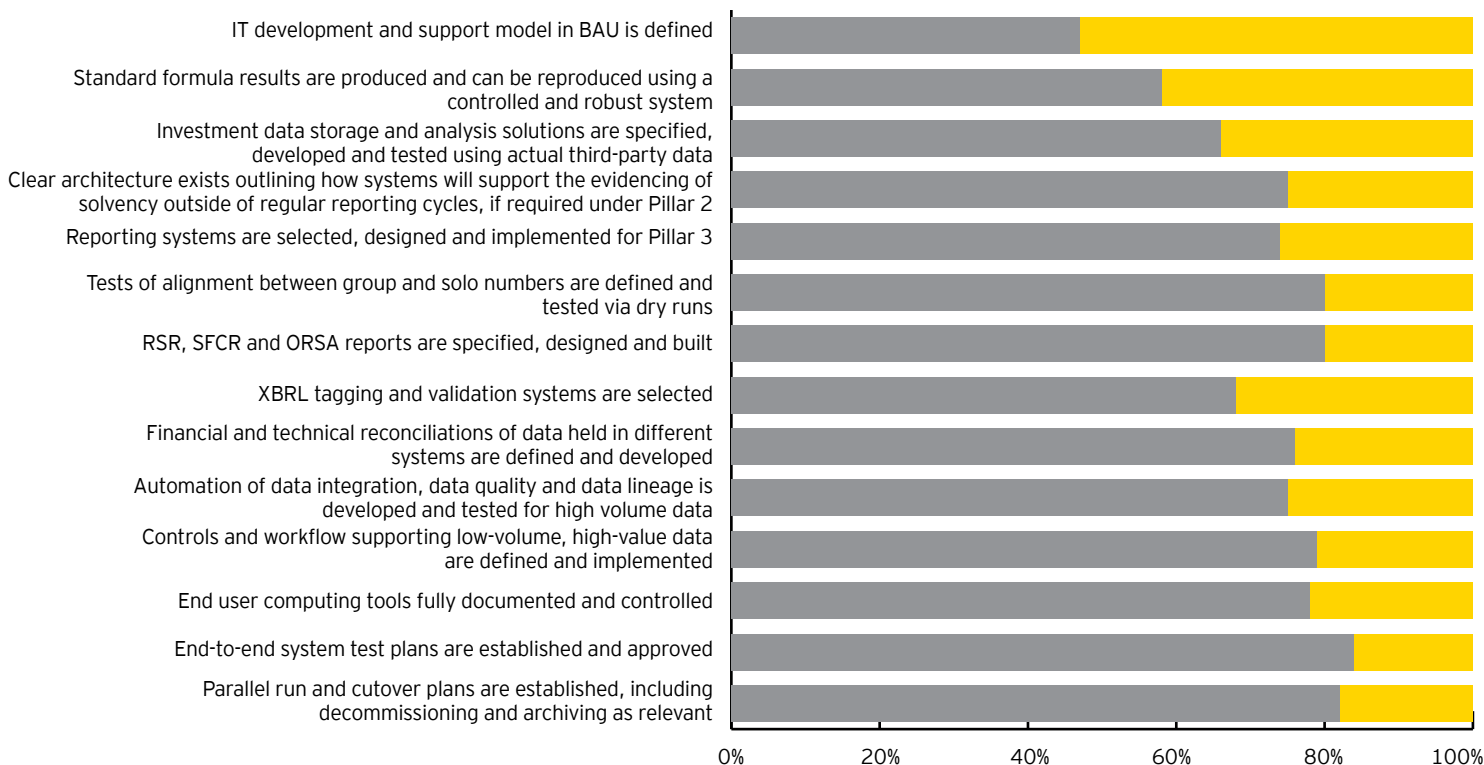
Designing a system and infrastructure architecture that meets Solvency II requirements across all pillars is equally challenging. The biggest issues involve:

- ▶ Designing systems that reuse business rules and share common data across pillars
- ▶ Deploying infrastructure that is sufficiently flexible and scalable to handle ad hoc requests from management and regulators
- ▶ Providing a robust data integration, quality and control framework

These elements must be addressed to underpin reporting in the public domain and to allow insights into financial performance and risk exposures on a dynamic basis.

As our survey shows, limited progress has been made on some of the fundamental decisions that will allow data, systems and infrastructure to work together effectively. Surprisingly, there is very slow progress on specification and design of Regular Supervisory Reporting (RSR), the Solvency and Financial Condition Report (SFCR) and the ORSA report, with nearly 80% of respondents not meeting most requirements. Definition of the Solvency II reports, in combination with the Quantitative Reporting Templates (QRTs), helps identify where data needs to be brought together across pillars, ideally in an automated and orchestrated sequence to drive efficiencies. The progress made on the Solvency II report definition extends into the weak description of financial and technical reconciliations required, as well as to other reporting bases where only 32% of respondents meet most or all of the requirements.

**Figure 16: IT system readiness**



Stage 1-2: Requirements not met/some requirements met

Stage 3-5: Most requirements met/all requirements met/beyond requirements

In 2012, the survey identified that 37% of respondents had implemented most of the requirements related to system readiness. The most significant progress was made in assessing the systems required to deliver Solvency II capabilities and the simultaneous identification of system capability gaps. In this year's survey, more specific questions were asked to better identify the progress and pinpoint the gaps.

- ▶ Companies have made good progress in meeting most of the standard formula requirements, with 53% now indicating that they can produce standard formula results in a repeatable, controlled and robust manner. Of the remainder, only 9% have not met any of the requirements.
- ▶ Compared with the previous survey, it appears that more companies are electing to use manual alternatives to data integration, quality and control, with just 24% having most or all of the Solvency II data requirements met through automation. The results are consistent across high-volume (transactional data) and low-volume and high-value data. This indicates that while large system investments have been made, notably on Pillar 1, the data integration investment is lagging.
- ▶ Respondents indicated that Pillar 2 was well advanced; however, almost 66% of respondents noted that data and systems are not designed or ready to support ORSA assessments beyond the normal reporting cycle. This seems to be an oversight, as this is where management and the regulator will pressure companies to work dynamically and provide reliable information.

- ▶ Almost 42% have met most or all of the requirements for investment data. This is consistent with market feedback, indicating that many insurers recognize the value of investment information beyond the regulatory requirement. They are using this information to better manage concentration risk, collateral and credit risk and to make decisions on a group rather than simply a solo basis.
- ▶ Data and systems readiness for Pillar 3 continues to lag behind Pillars 1 and 2, with only 25% of respondents indicating that they have selected and designed a system to meet most or all of the Pillar 3 requirements. Furthermore, in terms of readiness to meet XBRL tagging and validation, a staggering 52% have not selected a system to meet this mandatory requirement.

Not surprisingly, the decision to freeze or place programs into "business as usual" has meant that only limited progress has been made across all pillars in the past 12 months.

Our survey indicates that there is a significant amount of near-term activity required. At the same time, there is a lack of forward thinking around end-to-end test plans (41% do not have these ready) and parallel run and cutover plans (44% do not have these ready). These two factors give rise to real concerns about the readiness of many respondents to meet the Solvency II requirements. For many respondents, our survey implies the need for rapid gap assessments, prioritization and strong project leadership to meet the confirmed deadlines.



# Application of internal models

The proportion of insurers planning to use a (partial) internal model has dropped since our previous survey. However, partial internal models have shown the most noticeable reduction, and companies adopting full internal models are more likely to be continuing with their plans.



There is a marked reduction in the proportion of companies adopting a (partial) internal model: from 49% to 40% of respondents (Figure 17). As in our previous survey, the profile of participants is weighted toward larger organizations that are more likely to apply to use a (partial) internal model given the expense and resources that an application requires.

Companies are becoming more concerned about the costs associated with the extended pre-application process for model approval. Many have been engaging with their regulator since 2010 in pre-application processes. Formal applications are only expected to be possible from April 2015, reflecting the deferred implementation date for Solvency II. There also appears to be greater awareness of the ongoing costs of operating the internal model processes as part of “business as usual.” Setting the total cost burden against the potential capital benefit has led some companies to reconsider the attractiveness of the internal model approach compared to the standard formula.

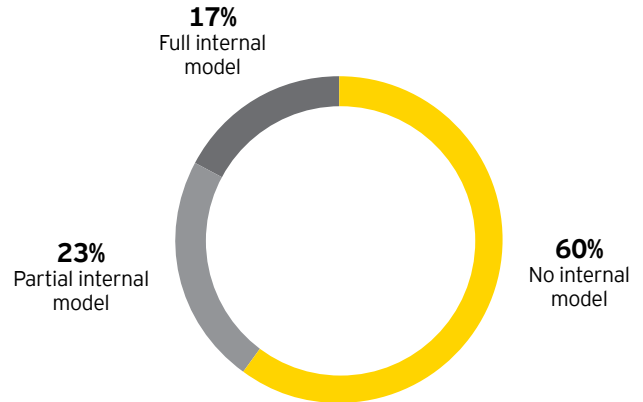
The lack of acceptance of internal models appears to come from companies considering partial internal models. The proportion of organizations continuing with full internal models has been more resilient, falling only slightly from 19% to 17%. This is perhaps to be expected. Companies adopting a partial internal model are more likely to consider that their risk profile is sufficiently close to that underlying the calibration of the standard formula to make adoption of the SCR viable.

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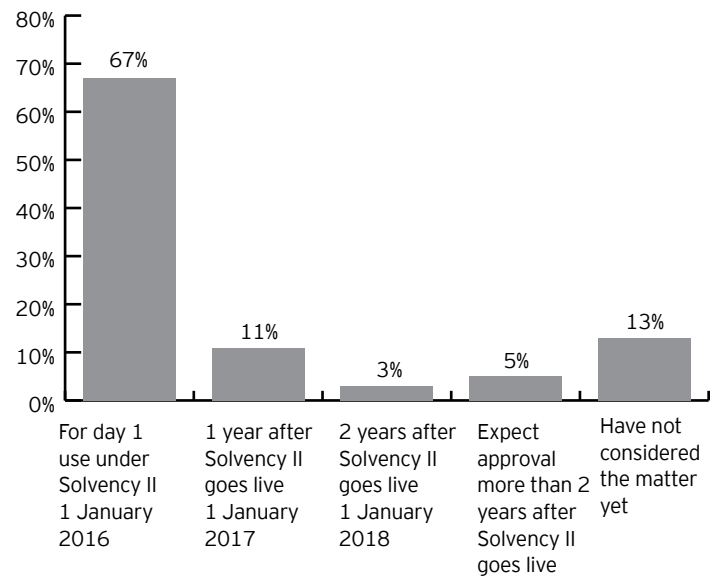
Given the two-year delay of the Solvency II implementation date, insurers appear to be more confident in the approval of their models for day 1 use. This reflects the extra time they have had to finalize their programs. Two-thirds of internal model users expect to have received model approval in time to use their models at the start of Solvency II.

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**Figure 17: Internal model development 2013**



**Figure 18: Internal model approval 2013**



At the time of our previous survey, over half of internal model users anticipated receiving approval by 1 January 2014; this was expected to increase to 65% by 1 January 2016. This is in line with the responses in the latest survey, with 67% of companies now expecting to receive approval by 1 January 2016 (day 1 use per the expected implementation timetable - Figure 18).

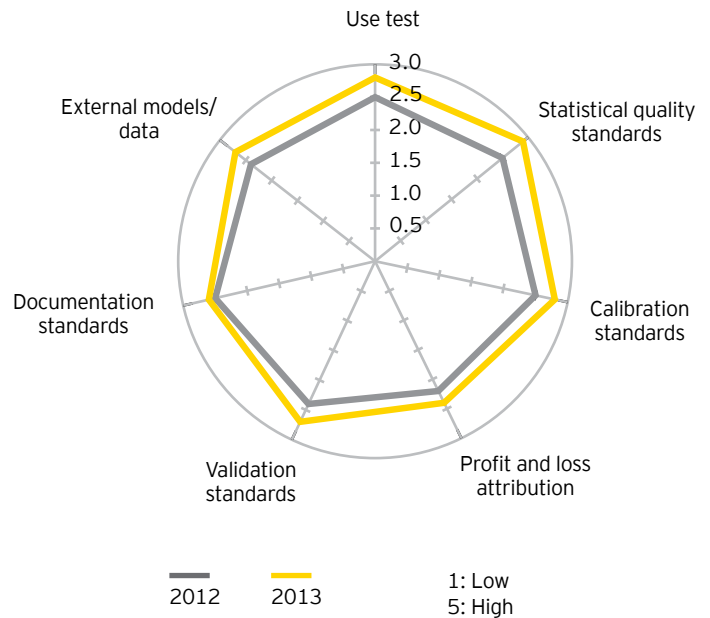
In general, internal model requirements have been stable, reflecting limited regulatory changes since our earlier survey. As a result, companies have been able to progress with some certainty regarding Solvency II requirements.

Internal model users' readiness assessments have advanced across each of the internal model tests and standards. However, there is still much to do relative to Pillar 1, particularly in meeting the requirements of profit and loss attribution and documentation standards, which remain a significant challenge.

In spite of the progress made in complying with internal model tests and standards, this has not, so far, supported an assessment where the average company meets most of the requirements in any of the internal model tests and standards (Figure 19).

This is in contrast to the progress made on the Pillar 1 calculations where the average readiness rating is significantly higher for all aspects and organizations are moving toward full compliance with Solvency II. The lowest internal model ratings are in respect to the standards for documentation and profit and loss attribution.

**Figure 19: Solvency II requirements for internal models**



## In our experience, the current challenges that companies now need to address include:

### **Profit and loss attribution**

- ▶ There are often issues relating to the alignment of the profit definition(s) so they are not only relevant to the business but also Solvency II compliant (i.e., on an “economic basis”).
- ▶ A common problem, relating especially to those companies with partial internal models, has been the difficulty in eliminating items from the actual result that are not covered by the scope of the model.
- ▶ The level of granularity used in the risk modeling may exceed that of the readily available experience data, requiring a sufficiently detailed analysis.

### **Documentation**

- ▶ Poor articulation of why a particular approach or risk calibration has been chosen (i.e., preferred to other possible choices). Emerging practice is to identify, early in the process, why choices were made and why others were not.
- ▶ Documentation often does not explain the rationale for the data selection, the filtering applied to data or why outliers have been removed. Frequently, there is no information on the significance of the choices that have been made.
- ▶ Many implicit assumptions and judgments exist in the calibration documents without adequate explanation or justification.
- ▶ Recognition of weaknesses and limitations in the model, and how this aligns to the model development plan, is often immature. It may not provide clarity to the trigger points for additional validation or calibration and the escalation procedures to be followed.

The image shows a highly detailed stone doorway. The central feature is a large, arched wooden door with intricate ironwork. Above the door is a stone niche containing a carved female face. The entire doorway is framed by elaborate floral and scrollwork carvings. To the left, a window with pink flowers is visible. The ground in front is paved with cobblestones.

# Regulatory interaction

Most insurance organizations are not completely satisfied with the support they currently receive from their regulators, and they expect an increase in supervisory intervention once Solvency II comes into effect.



The overall frequency of interaction with the regulatory bodies seems to be considered adequate by most companies (48% of respondents are completely satisfied); however, insurers expect more from this cooperation (Figure 20). Insurance organizations are calling for much better support in the interpretation of regulatory requirements, with only 21% being satisfied with the current assistance they receive by the regulatory authorities. Insurers expect more of their regulators in terms of the amount and quality of feedback provided on company-specific implementation progress. Only 25% of companies deemed this as at least satisfactory.

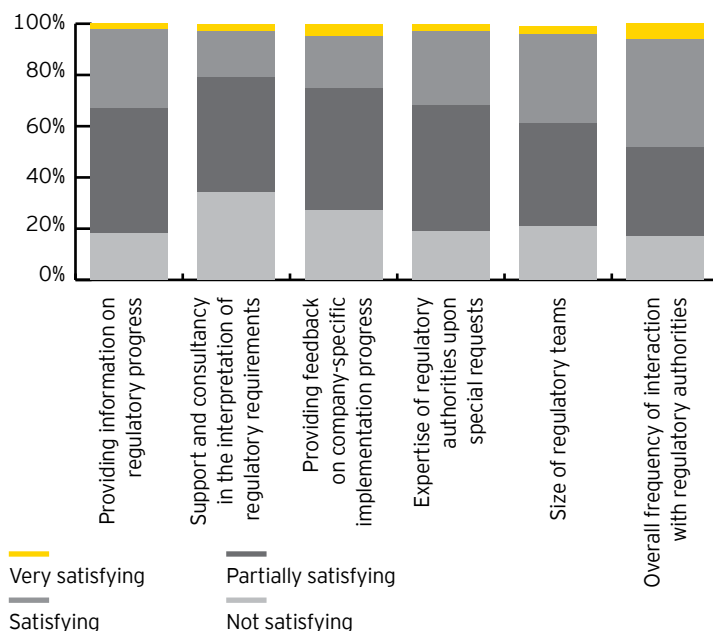
Providing information on regulatory progress and responsiveness upon special request is another key area where regulatory authorities should improve, with 67% and 68% of surveyed insurance companies, respectively, not being fully satisfied.

This might reflect the fact that supervisors are understaffed as they cope with the new regulation. Nearly 61% of the surveyed insurance organizations are not completely satisfied with the size of their supervisory teams.

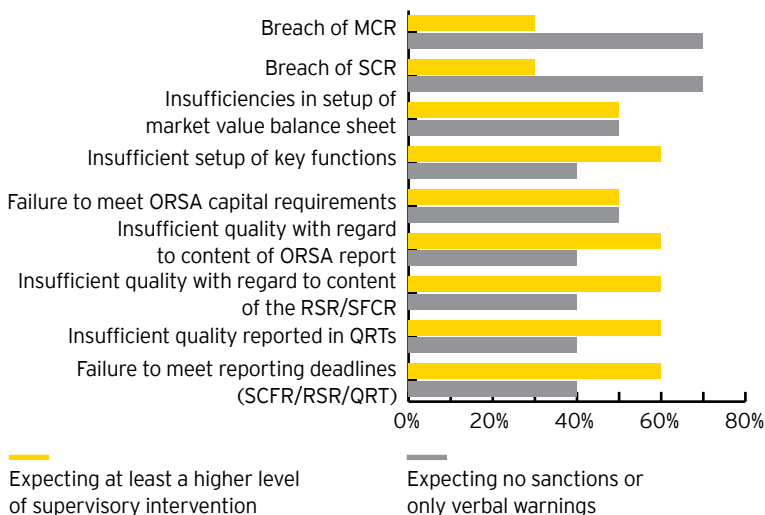
Insurers also were asked about their expectations regarding supervisory intervention once Solvency II comes into effect. Many believe that an increase in regulatory intervention is most likely when there is a breach in either the company's SCR or MCR. Insufficient setup of the market value balance sheet and the failure to meet ORSA capital requirements are additional areas where regulatory authorities are expected to be rigorous and more likely to impose sanctions.

Less than a quarter (22%) of surveyed insurers expect their regulator to require them to hold additional capital (beyond the requirements of the Solvency II directive) through capital add-ons, "early warning indicators" for internal models or other means once this regulation comes into effect. Companies will need to be vigilant to ensure that "gold-plating" of a prudent capital standard does not occur.

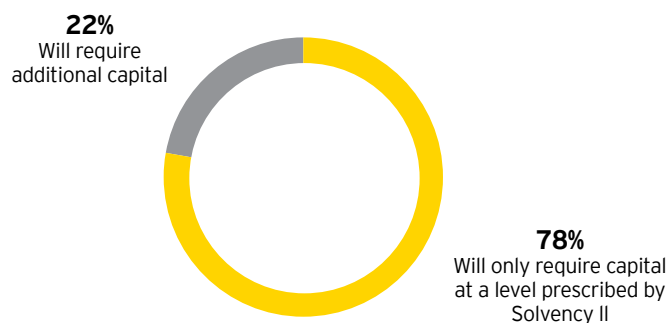
**Figure 20: Evaluation of regulatory authorities**



**Figure 21: Evaluation of potential sanctions**



**Figure 22: Additional capital requirements**





# Organizational transformation of risk management

The level of automation of risk reporting is still poor; however, insurers recognize the need for changes required in the IT and risk information landscape.

In the future, the risk management function is expected to be evenly involved in many important activities, with greater focus on:

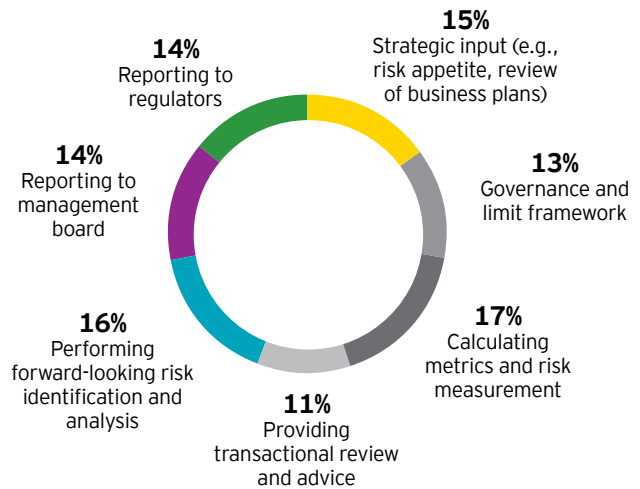
- ▶ Calculating risk metrics
- ▶ Performing a forward-looking assessment of risk
- ▶ Providing business with strategic inputs, such as risk appetite, review of business plans, etc.

Solvency II will lead to an increased focus of risk managers on all the main areas.

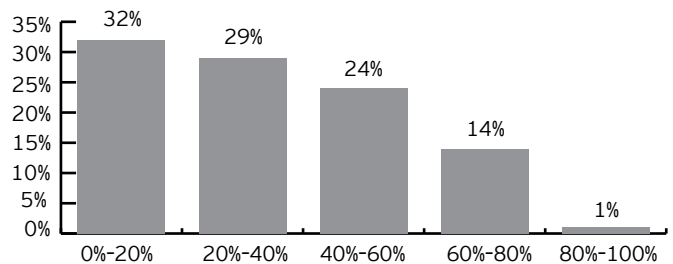
As illustrated in Figure 24, the level of automation of risk reporting and calculation of key risk management metrics leaves much to be desired. More than 60% of the respondents estimate that their level of industrialization is less than or equal to 40%.

Most insurance companies expect moderate to significant change in their IT landscape due to Solvency II implementation. Additional areas with a high potential for change and restructuring are risk information flow, risk culture and top management focus on risk management.

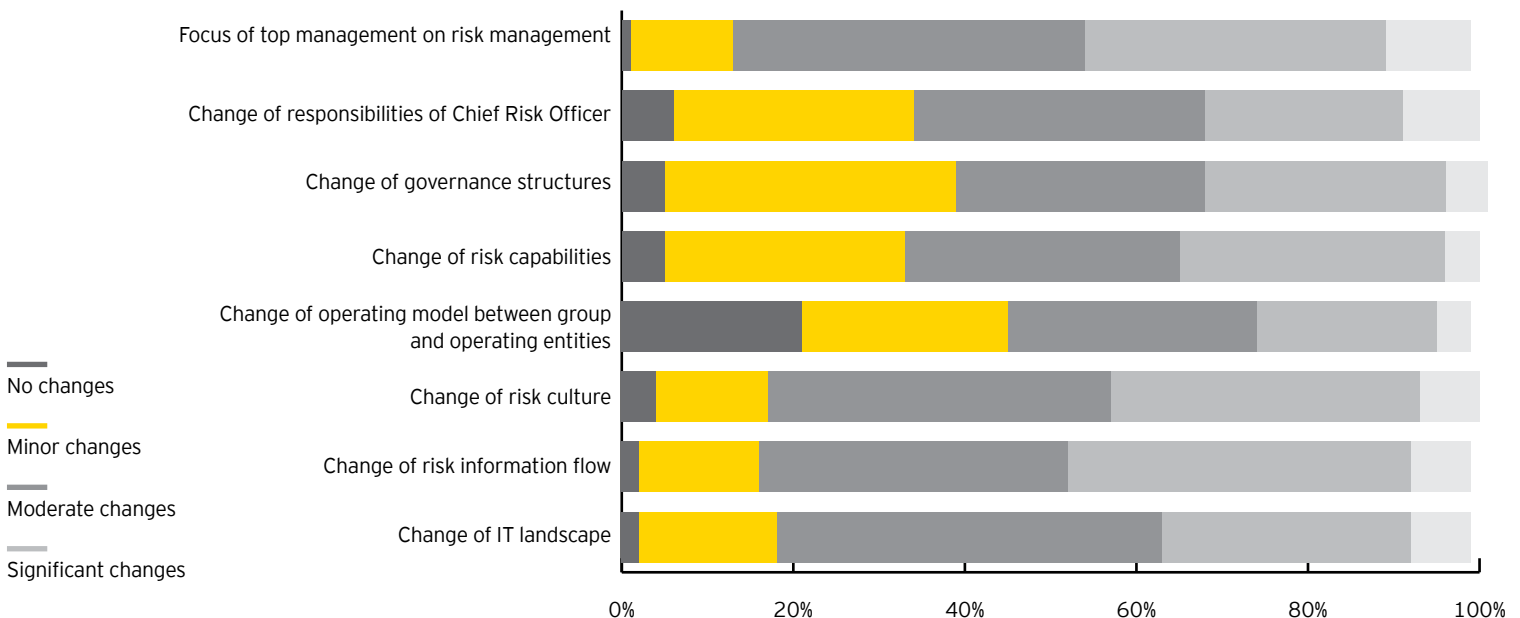
**Figure 23: Future focus areas of risk managers**



**Figure 24: Level of automation for risk reporting and calculation of key risk management metrics**

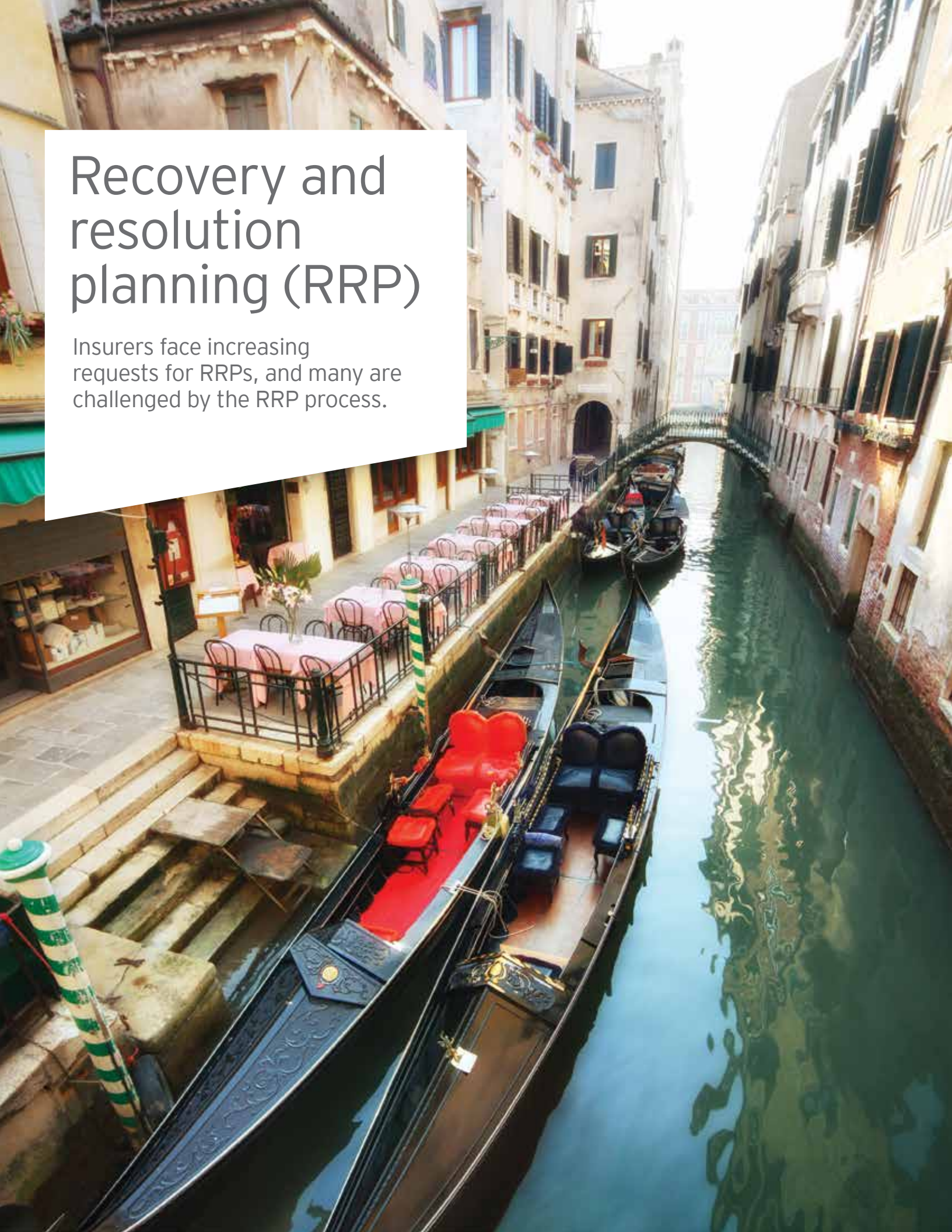


**Figure 25: Change and restructuring due to Solvency II is expected in the following areas**



# Recovery and resolution planning (RRP)

Insurers face increasing requests for RRP, and many are challenged by the RRP process.



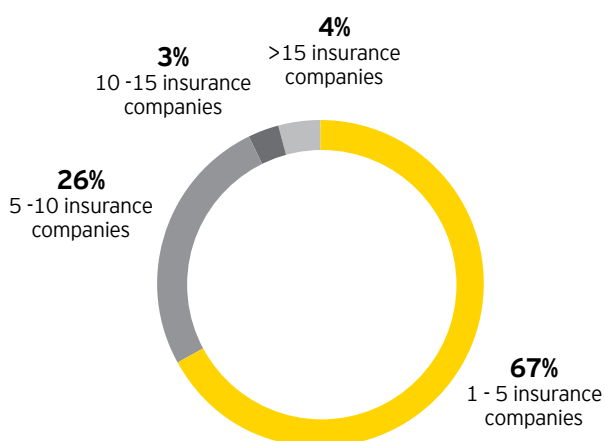
As insurance RRP is mobilized by many of the global systemically important insurers (G-SIIs) that were designated in July 2013 and by multiple, large, domestic insurers, both regulators and insurers alike recognize the challenges of developing plans with international dimensions.

### Different approaches and stages of implementation

Home and host regulators are at different stages of implementation and are demonstrating marginally different approaches to RRP for insurers. Because protocols are not yet settled, insurers are finding it difficult to interpret regulators' expectations for information requirements and depth of analysis. Even fundamental substantive questions, such as clarity around when the authorities in each jurisdiction will in practice trigger resolution, remain open for many insurers.

In light of different regulatory requirements around the world, the International Association of Insurance Supervisors (IAIS) and the Financial Stability Board (FSB) have asked home and host regulators to work more closely together. Therefore, in 2014, the first set of crisis management groups, comprised of home and host regulators, will be established for the G-SIIs. This cross-border approach seems, in part, also to be driving the pace of domestic requests for RRPs and systemic risk management plans (SRMPs), as regulators see how others are approaching this topic and consider potential systemic risks posed by insurers in their own markets.

**Figure 26: Expectation of additionally identified, systemically relevant insurance companies**



If the banking regulatory trend is an example, it is possible that the focus for domestic requests will be in the G20 countries, where regulators have required the G-SIIs to submit plans by the end of 2014. There are some notable exceptions in countries where the regulators do not currently have a designated G-SII but have previously required their global systemically important banks (G-SIBs) to submit plans. As such, they are requesting their largest domestic insurers to initially complete recovery plans, with requests for resolution plans to follow.

Many insurers are aware of this emerging development in RRP requests. Nearly 26% of respondents expect at least another five to ten insurance companies (in addition to designated G-SIIs) in their own country to be considered as domestic systemically important insurers and likely to receive requests for plans from the home regulator.

Proposed developments in regulatory guidance would tend to support this; for example, a recent consultation paper (CP2/14) issued by the Prudential Regulatory Authority (PRA) in the UK includes a proposed requirement (Fundamental Rule 8) that "a firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with minimum disruption to critical services." This means that the regulator expects insurers in the UK to provide all information needed for the PRA to perform an assessment of their resolvability. Expectations are that most regulators will follow this direction, at least within the G20 countries and potentially wider audience.

## Progress with recovery plans

Recovery plans, which establish how an insurer will use a series of predefined recovery options to avoid failure, are further along in development than resolution plans.

Encouragingly, most insurers and reinsurers have previously undertaken a degree of analysis around stress testing, development of triggers and management actions that can be leveraged to build a recovery plan. Indeed, no insurer should have to start from scratch.

The survey explored the level of familiarity with the recovery tools available to insurers and the importance that the respondents placed on specific recovery options. The range of responses was broad, with most recognizing the value of capital-raising options when under severe financial pressure. Unsurprisingly, in case of a crisis, putting selected subsidiaries into run-off and disposing of entities were cited as useful recovery options.

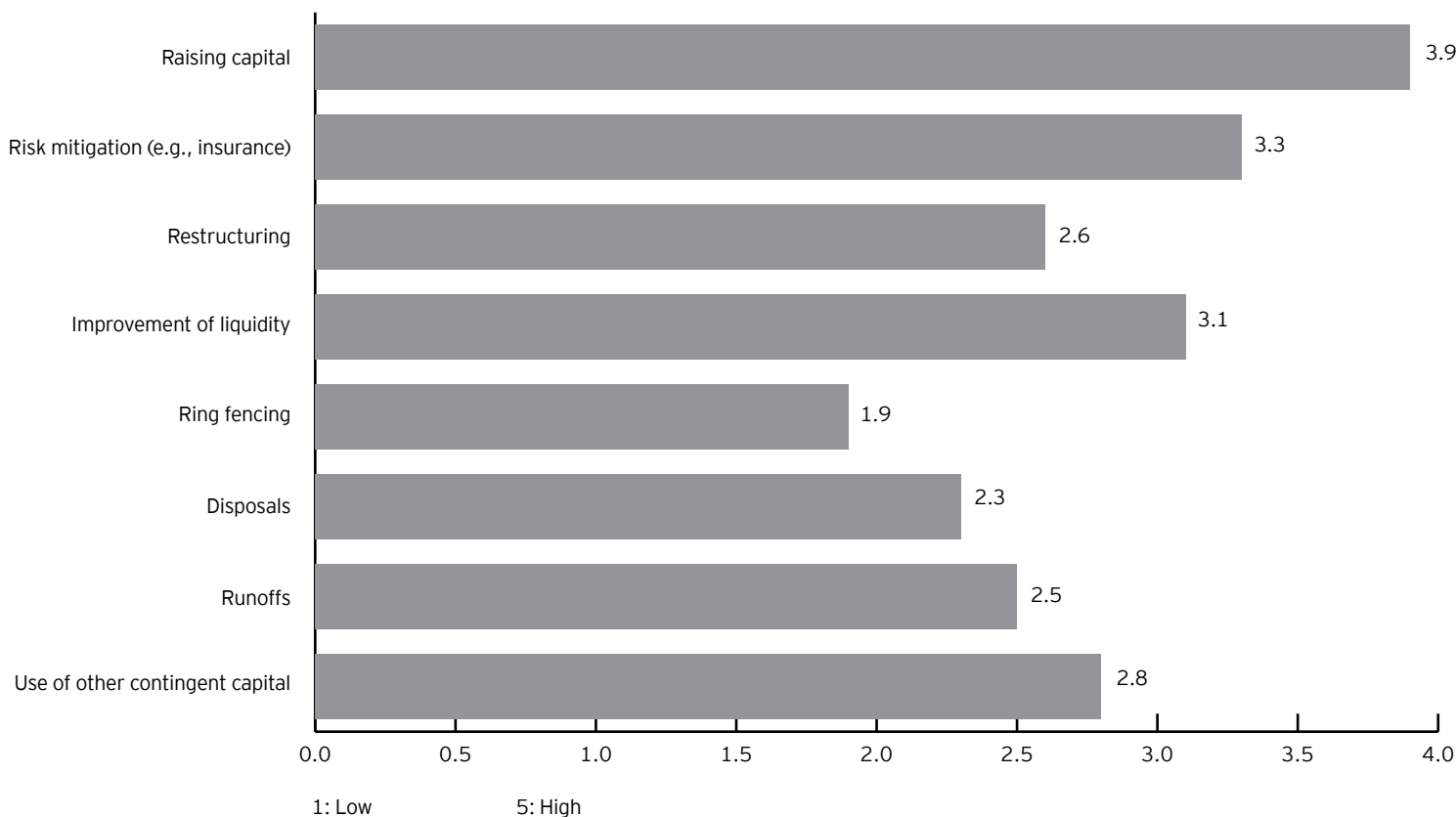
What is clear, as the plans develop, is that each insurer will create a portfolio of recovery options (Figure 27). The range will depend on the current group structure and what is considered to be core and non-core business. Our experience

shows that most insurers have completed a significant amount of groundwork in relation to management actions in order to qualify as recovery options and meet the regulatory requirements. However, further work is required to ensure that the recovery options are sufficiently material and capable of being executed in a timely manner in a crisis. As development of the recovery options tends to represent 50% to 70% of the effort required to develop a recovery plan, the time and resources required to build out existing management actions should not be underestimated.

Views on the pros and cons of completing RRP vary, but most senior executives view recovery planning, in particular, as beneficial to the group and a worthwhile management exercise.

In summary, many insurers are challenged by aspects of the RRP process. There is some confusion around expectations, and many are concerned about regulators moving at different speeds with differing priorities. The requirements that national insurance regulators will impose on domestic insurers are emerging. The plans that have most commonality across jurisdictions are the recovery plans, while regulatory requirements for resolution plans and SRMPs continue to evolve.

**Figure 27: Average importance of recovery options—G-SII only**







# Managing capital under Solvency II

After years of waiting, Solvency II is again a prominent consideration when looking at the optimization of the balance sheet.



As shown in Figure 28, many companies anticipate an increase in capital requirements and a reduction in the reported group capital ratio.

Current or planned activity is being driven both by a desire to improve and optimize the reported capital ratio and to combine this with the in-force backroom management initiatives that focus on improving other metrics. This is especially apparent in life insurance.

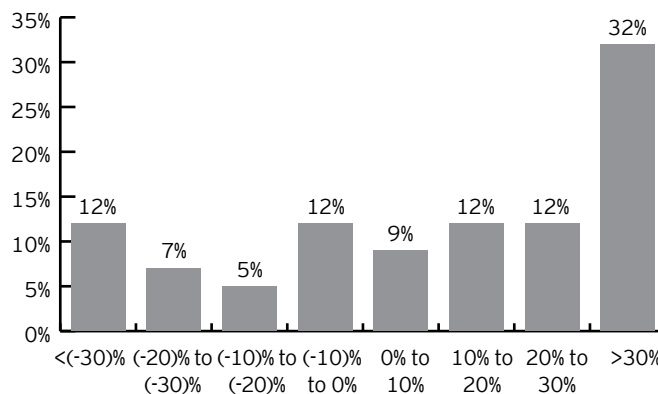
Figure 29 shows the range of options being considered to improve the position, and some of these are being implemented. This includes a combination of internal and external options, covering new and existing business in liability management and restructuring, as well as optimizing the asset side of the balance sheet. In particular, as the details of the various discount rates and acceptable stresses in the internal model become clear, there will be a large amount of additional asset-focused activity. Current hedging and reinsurance arrangements are already under review and will shortly receive greater attention. At the same time, product design and pricing for new business will be reviewed.

As clarity emerges, companies will be more inclined to implement strategic options, such as legal entity restructuring.

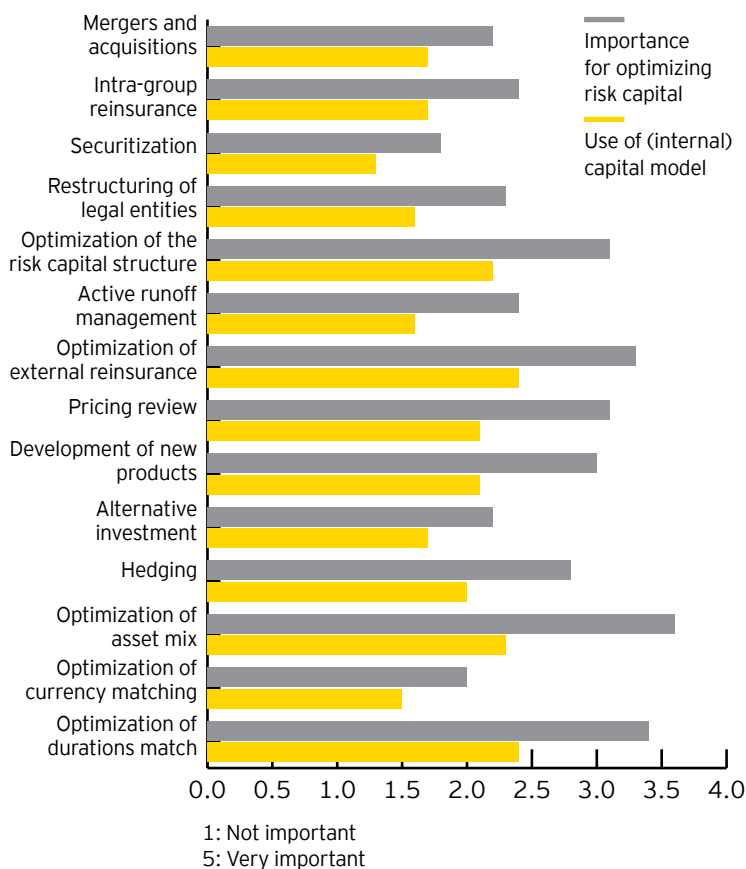
Irrespective of the exact figures that are finally achieved, it is clear that companies intend to spend significant management time and effort in this area and to realize significant benefits. Challenges remain due to the continuing uncertainty of the details of the proposed regulation and the interpretation of specific items by the regulator. In addition, it is not known how much these initiatives need to be fully implemented to illustrate the benefit or whether a less material implementation can be used to claim fuller credit.

In addition, much of these initiatives are focused on fungibility of capital and, in many cases, moving or proving the ability to move capital around the group. This poses challenges for local boards and regulators and begins to interact with the need to demonstrate RRP. All of these issues can be and are being dealt with already, but each add to the need to consider all stakeholders when looking at options to improve the balance sheet.

**Figure 28: Expected total capital requirements**



**Figure 29: Average importance of specific management instruments and strategies for optimizing risk capital**







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