Milliman Solvency II Pillar 3 Survey

INTRODUCTION

Following the full implementation of Solvency II on 1st January 2016, insurers were required to submit Pillar 3 quantitative reporting templates ('QRT's) to the Central Bank of Ireland ('CBI') in May 2016. These included both the Day 1 Reporting templates (based on the opening Solvency II balance sheet as at 1 January 2016) and the Q1 2016 templates.

Milliman undertook a survey of Irish (re)insurance companies to understand their experience to date with the Pillar 3 requirements, to identify the key challenges faced by (re)insurers, and to gauge the level of work required to meet the first annual reporting requirements in May 2017[1].

In total, 37 companies took part with participants representing a broad cross-section of insurers, in both the domestic and cross-border markets.

Figure 1. Breakdown of survey participants

Sector	Participants
Life	24
Non-Life	7
Reinsurer	6
Total	37

EXPERIENCE TO DATE

70% of respondents stated that they did not encounter difficulties meeting the Day 1 Reporting or Q1 2016 deadlines. The CBI has provided feedback to companies on these submissions and this is discussed in the CBI feedback section below.

Where difficulties did arise, they often related to the following:

- the level of detail required in the asset reporting templates
- interpretation of National Specific Templates ('NST's)
- validation errors on the online reporting system

Asset Reporting Templates

The two assets templates that caused the most difficulty were S.06.02 (detailed list of assets) and S.06.03 (look through of Collective Investment Undertakings).

All companies were required to complete template S.06.02 based on their asset holdings at end Q1 2016. This template requires detailed information on each asset held and proved to be one of the most challenging and time consuming aspects of the quarterly templates.

Issues generally arose where companies could source some, but not all, of the required information for a small proportion of assets. In some cases this was due to difficulties in identifying the exact issuer of debt issued by large corporations, which in turn resulted in problems sourcing the Legal Entity Identifier (LEI) code, issue code and external credit rating.

While the workload required to complete S.06.02 was significant for Q1 2016, we expect this will reduce once processes and procedures have been bedded down.

The asset look-through template for Collective Investment Undertakings (S.06.03) is one of the more contentious and challenging aspects of the Solvency II reporting requirements, particularly for unit-linked companies where a look-through of investment funds held in policyholder funds is required. S.06.03 requires each investment fund to be deconstructed into underlying components including the nature of the underlying assets (equity, bonds, etc.), currency, and the country of issue.

Only companies with a high or medium-high rating under the CBI's PRISM impact rating system are required to prepare the look-through template for quarterly reporting during 2016. Companies with a

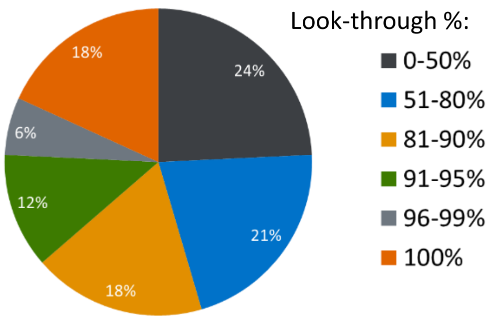
[1] This briefing note assumes a year-end of 31st December. For companies with a financial year-end at an alternative date, the reporting deadlines will differ.

low or medium-low PRISM rating will have to prepare the look-through template for the first time in respect of 31 December 2016. The effort involved should not be underestimated.

Looking ahead, 46% of survey respondents stated that they do not expect to fully meet the look-through requirements at year end 2016 (56% among unit-linked companies). That is, companies do not expect to be in a position to provide a 100% look through of all collective investment funds.

The survey results showed that levels of compliance varied widely amongst the survey respondents. Currently, 24% of respondents can provide a look-through of 96% of investment funds or higher. At the other end of the scale, the same proportion of respondents (24%) can only provide a look-through on collective investment funds of 0 - 50%. Typically, respondents with coverage of 96% or higher were not unit-linked providers, but rather companies with a small portfolio of collective investment funds.

Figure 2. Proportion of companies achieving different % of look-though



In terms of difficulties in meeting the look-through requirements, survey respondents cited a wide range of issues. However, difficulties arising from the sourcing of data from external asset managers were a common theme throughout. Some of the issues associated with this included:

- Out of date information
- Difficulty looking through multiple levels in the case of funds
- Lack of an explicit materiality threshold beyond which look-through is not required
- Lack of uniformity in look-through data provided by data sources
- Level of detail required for portfolio bond providers

It is worth noting that in July 2016 the European Commission requested technical advice from EIOPA on the review of specific items in the Solvency II Delegated Regulation including proportionality and simplifications in relation to the look-through approach (among other things). The Commission has requested EIOPA to provide its advice by 31 October 2017. This indicates that there may be the possibility of changes to the look-through requirements in the coming years.

National Specific Templates

The National Specific Templates are templates required by local regulators only. There are 13 NSTs in total required by the CBI. Most of the survey respondents (80%) only had to complete two of these - NST.12 (Quarterly Aggregate Balance Sheet) and NST.13 (Quarterly Aggregate Reporting of Security Holdings).

Despite the fact that only two templates applied to most companies, many respondents encountered difficulties in preparing the NSTs. Common issues included difficulties aligning the asset classifications in NST.13 with S.06.02 (List of Assets) and the lack of a facility to download the NSTs in Excel format for validation. A download facility has since been introduced.

Validation issues

Some survey respondents noted issues with the validation checks carried out when uploading the QRTs. The main difficulty was interpreting the error messages presented on the online reporting system.

We believe that the CBI turned off a number of validation checks for the Q1 2016 to help companies for the first submission. However, we understand these have been turned on for future submissions. Companies should ensure that their QRTs contain accurate and consistent data to avoid validation errors.

CBI Feedback

The CBI wrote to companies in July 2016 with some initial feedback on the Day 1 and Q1 2016 submissions. The responses were broadly positive, with a relatively short list of minor issues highlighted for most companies.

Common issues raised included the lack of consistency between asset categories on S.06.02 (List of Assets) and S.02.01 (Balance Sheet). While this did not create validation errors on upload at Q1

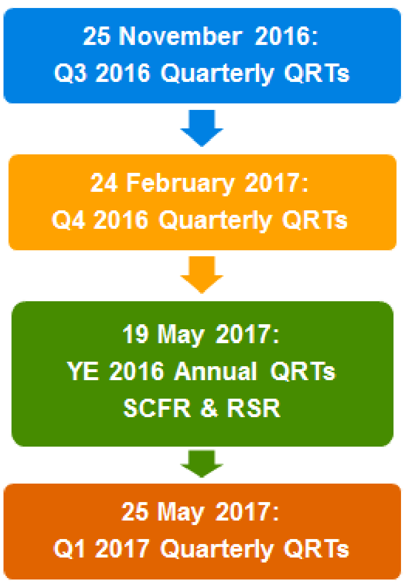
2016, it is expected that these validations will apply in future. Negative values were also queried and in most cases could be supported with a reasonable explanation.

In relation to asset look-through, the CBI has engaged directly with high and medium-high PRISM rated companies and has set out their expectations with regard to future reporting periods. Insurance Ireland, in conjunction with Financial Services Ireland, is currently engaging with the CBI on behalf of these companies to work towards a practical and achievable approach in respect of asset look-though.

LOOKING AHEAD - ANNUAL REPORTING

Meeting the first quantitative reporting deadlines in respect of the Day 1 and Q1 2016 QRTs in May 2016 represented a significant milestone on the road to implementing the Solvency II reporting requirements. However, annual reporting in respect of year-end 2016 will be a bigger hurdle for many companies. By 19th May 2017[1] at the latest, companies will be required to submit the first set of annual QRTs, in addition to the first set of narrative reports – the public Solvency and Financial Condition Report ('SFCR') and the Regulatory Supervisory Report ('RSR').

Figure 3. Upcoming Reporting Timelines



Annual QRTs

The number of templates required as part of the annual reporting process is a significant step up from quarterly reporting - there are 13 quarterly QRTs in total, but there are 70 annual QRTs. However not all templates will be applicable for all companies.

As part of the survey, participants were asked to rank their level of preparedness for the annual templates by area. The majority of participants consider themselves to be almost fully prepared for the annual technical provisions and SCR templates. However, for the asset and reinsurance templates, the level of readiness was significantly lower. This reflects the challenges involved in sourcing information for the asset look-through template and the level of detail required in reinsurance QRTs.

Narrative Reporting – SFCR & RSR

Narrative reporting consists of both a public report (SFCR) and a private report to the supervisor (RSR). Both are due for the first time by 19th May 2017.

The workload involved in preparing these reports for the first time should not be under-estimated. Approximately 50% of respondents have not yet started drafting the SFCR and RSR.

We received a wide range of estimates in terms of the expected length of these reports. On average, respondents expect the SFCR to be between 50 and 100 pages in length and to require between 11 and 50 person days to prepare. The estimated length and person days involved in producing the RSR is expected to be similar.

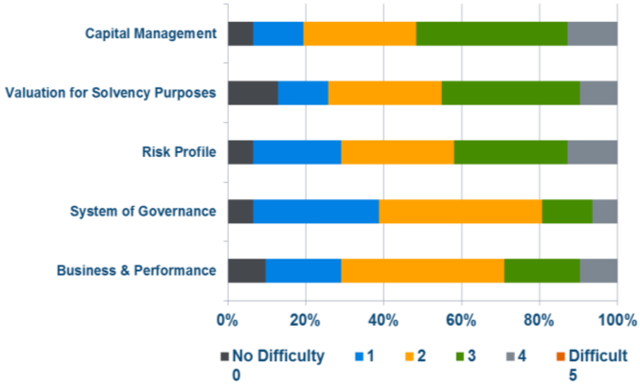
Both reports follow the same structure and cover the following five headings:

- Business and Performance
- System of Governance
- Risk Profile
- Valuation for Solvency Purposes
- Capital Management

However, there is significantly more detail required in the regulatory report e.g. on underwriting and investment performance.

Participants were asked to rank these 5 areas in terms of difficulty. While none of the sections were ranked as very difficult, "risk profile", "valuation for solvency purposes", and "capital management" survey respondents ranked as the most challenging to draft.

Figure 4. Areas of difficulty in SFCR/RSR



Much of the required content will already be available in other documents required under Solvency II such as the ORSA, QRTs, Actuarial Function Report, and risk management policies, in addition to the company's financial statements. However, the challenge for companies is to collate all the required information and manage the drafting process to ensure consistency throughout the various reports.

In addition, the SFCR will be a publicly available document and is likely to be used by stakeholders to analyse the financial strength of the company. Therefore, care needs to be taken with regard to what is disclosed in this document, while also ensuring that all of the Solvency II requirements are met.

Figure 5. Information sources for narrative reports

We asked participants which departments they expect to prepare the SFCR and RSR. As expected, we received a wide range of responses. Almost all companies expect to involve the actuarial function, risk management function, and finance department. Other departments mentioned included underwriting and compliance.

A good starting point in preparing the SFCR and RSR would be to map out the various section headings and identify the sources of information and the department responsible for completing each section. Companies don't need to wait until next year to begin this work - there are a number of areas where the information required is not specific to year-end data. For instance, there are significant portions of the System of Governance and Risk Profile chapters that could be substantially completed in advance of year-end.

THE REPORTING PROCESS

The CBI recently published guidelines for the Directors compliance certificate, including the certificate on the accuracy of the annual QRTs and each RSR. While the annual QRTs require board approval, the Solvency II requirements do not specifically require the quarterly templates to be approved by the Board. These templates may instead be approved by persons (or an executive committee) who effectively run the undertaking.

With this in mind, we asked participants what level of approval they require for the quarterly templates. 96% of respondents intend for senior management (e.g. CEO, CFO, and Head of Actuarial Function) to approve the quarterly templates, with the remainder requiring board sub-committee approval.

The Level 3 Guidelines on Reporting and Public Disclosure require companies to have a supervisory reporting policy. However 51% of participants did not currently have a supervisory reporting policy in place.

External Audit

The Central Bank recently consulted on the proposed external audit of the SFCR and associated annual QRTs, with the aim of determining its final policy position by end September 2016. Under the proposal, the scope of external audit would include elements of the SFCR relating to:

- Balance sheet
- Own Funds
- Capital Requirements

The scope also includes the public templates (QRTs) relating to each of these areas. Under the proposal, the audit would be conducted annually and should be completed by the reporting deadline for the SFCR i.e. 19th May in 2017.

With external audit in mind, we asked participants if they intended to seek external review of quarterly or annual templates. 70% of respondents intend to get some form of external review of annual templates. Of these, approximately 45% intend to seek a formal review. Group or actuarial consultants were mentioned as the most common providers of external review.

CONCLUSION

The submission of Day 1 and Q1 2016 templates was generally successful across the industry. Nonetheless there is further work required in the area of asset look-through in order to meet the Solvency II requirements in full, and the CBI's expectations.

Looking ahead to the first annual reporting process, there is significant work required to prepare the annual QRTs and the SFCR and RSR reports. We would encourage companies to start as soon as possible in order to frontload the work in advance of year-end.

HOW MILLIMAN CAN HELP

Our consultants have been involved in advising our clients on Solvency II issues since its conception. We have undertaken a range of work for clients across all three Pillars of Solvency II.

In relation to Pillar 3 reporting our services include:

- Interpretation and planning of reporting requirements;
- Assistance in preparing the narrative reports (SFCR and RSR);
- External review of Pillar 3 templates.
- Pillar 3 training courses – full day or tailored to your needs (link).

Milliman also has a range of software available to support companies in relation to the ongoing Solvency II requirements including:

- Vega®: An automated Pillar 3 reporting and standard formula aggregation system (link)
- Solvency II Compliance Assessment Tool (link)

As a result, we have a wide range of experience that can be brought to bear to benefit your business.

ABOUT MILLIMAN

Milliman is among the world's largest providers of actuarial and related products and services. The firm has consulting practices in healthcare, property & casualty insurance, life insurance and financial services, and employee benefits. Founded in 1947, Milliman is an independent firm with offices in major cities around the globe. For further information, visit milliman.com.

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Milliman maintains a strong and growing presence in Europe with 250 professional consultants serving clients from offices in Amsterdam, Brussels, Bucharest, Dublin, Dusseldorf, London, Madrid, Milan, Paris, Stockholm, Warsaw, and Zurich.

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