Solvency II, Gap Analysis

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The Solvency II regime is a major evolution for all life, non-life, and reinsurance companies in the EU. The move to Solvency II will mean significant changes for companies in most areas of their businesses from strategic to operational levels.

Considering the European Commission's demanding timetable from now until the end of 2012, setting up a Solvency II road map is a priority for companies. An important initial step is preparing a gap analysis that compares the current position of the organisation to the future regulatory requirements. That gap analysis is then used to plan Solvency II implementation from now until 1 January 2013 when Solvency II will come into effect.

In this briefing note we discuss some of the main issues for companies to consider when conducting a gap analysis. (See Figure 1)

FIGURE 1: SOLVENCY II REQUIREMENTS

GAP ANALYSIS

As the name implies, a gap analysis is an exercise that compares a company's current position to the Solvency II requirements and the company's vision/target for where it wishes to be following the implementation project. The analysis covers all areas of the business from the quantitative requirements (Pillar 1), to systems of governance and risk management (Pillar 2), to the new regulatory reporting requirements (Pillar 3).

MAIN ISSUES

From our experience, the main issues for companies in addressing Solvency II requirements fall into three main areas: technical, organisational, and strategic, as illustrated in Figure 2 on the following page.

The gap analysis will need to consider each of these areas.

Approach

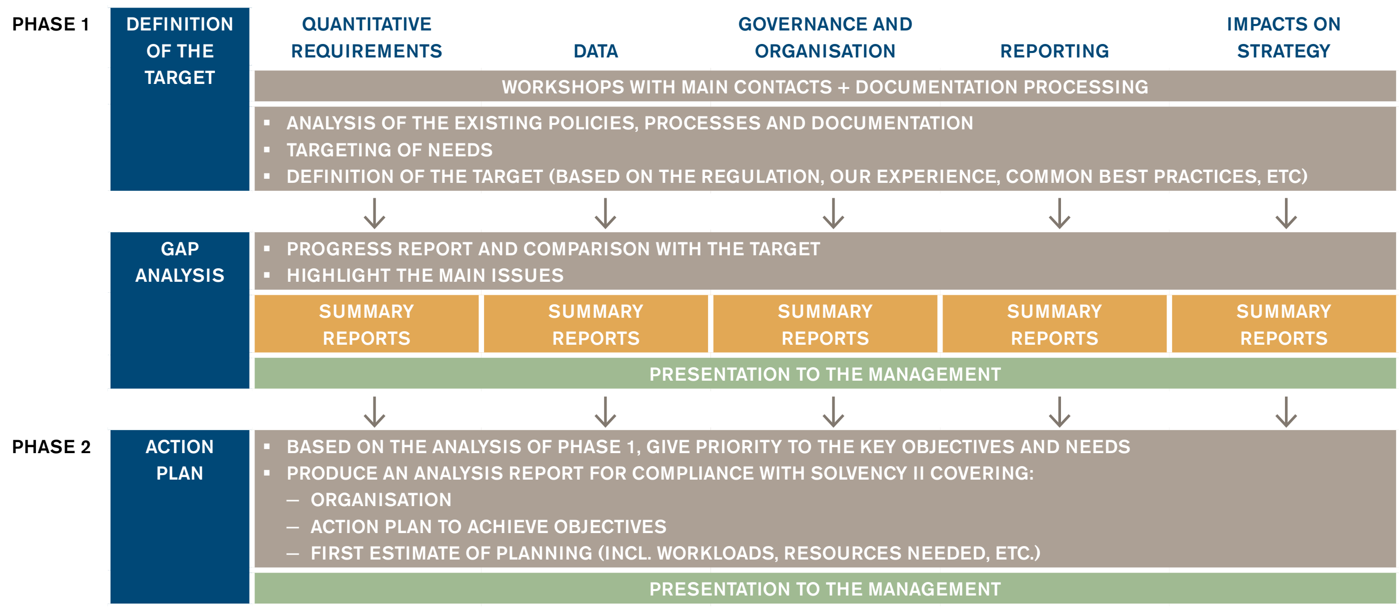
Our approach to undertaking a Solvency II gap analysis is a phased one:

- **Phase 1**
  - Initial introductory session with senior management responsible for Solvency II implementation to outline high-level Solvency II requirements and approach.
  - Define the company's target for the Solvency II project such as compliance with Directive, improved understanding and modeling of risks, improved data quality, meeting group requirements, etc.
  - Conduct workshops with key business areas to ensure clear understanding of requirements and to identify needs and objectives.
  - Review existing processes and documentation, capabilities, and governance, and compare to the Solvency II requirements, including the Directive, consultation papers, and Advice on Level 2 Implementing Measures.
  - Prepare gap analysis report that compares the current position with the target and identifies areas to be addressed. This analysis includes a comparison to market best practice and identifying possible alternative approaches for addressing gaps.

FIGURE 2: SOLVENCY II CHALLENGES

TECHNICAL	▪ Need to complete the **quantitative framework** in order to estimate the economic capital that is consistent with: — the principles defined to date by the Directive and the Level 2 advice published by CEIOPS — individual companies' business models (products, governance, risk management) ▪ Need to build a model that complies with all the identified requirements ▪ Need to take into account the particular issues linked to a consolidated vision of risks at a group level
ORGANISATIONAL	▪ The **Solvency II project** aims to deal simultaneously with the following areas: — quantitative requirements — data — governance framework — reporting and financial communication — impacts on strategy This requires an approach that is structured to take into account **possible synergies** between these areas in order to guarantee a consistent treatment of issues, for example the Own Risk and Solvency Assessment (ORSA). ▪ Need to put in place a structure that is able to deal with the evolution of the regulatory framework ▪ Control over the timetable of the project
STRATEGIC	▪ Successfully complete the transition to new prudential reporting (Solvency and Financial Condition Report (SFCR) and Report to Supervisor (RTS)) ▪ Integrate the prudential reporting into the reporting and strategic decisions system within the group ▪ Define the group Own Solvency and Capital Assessment (group ORSA)

FIGURE 3: SOLVENCY II GAP ANALYSIS APPROACH



- **Phase 2**
  - Based on the analysis from Phase 1, an implementation plan can then be developed that identifies key issues and priorities based on:
    - market best practices
    - the company's exposure to risk
    - management outlook
  - The implementation plan will identify:
    - action plan by topic
    - first estimate of timetable and resource requirements.
  - This document will also highlight the key priorities, main milestones, and possible synergies at group level.

This approach is illustrated graphically in Figure 3.

SOLVENCY II TIMETABLE

The timetable for Solvency II from now until 1 January 2013 will place pressure on company resources to meet this demanding schedule. It is important for companies to start planning now to ensure a sound implementation of the Solvency II requirements. (See Figure 4)

WHY MILLIMAN?

Our consultants have a wide range of experience derived from deep industry background in providing actuarial consulting advice to insurers and reinsurers including guidance on market entry, license applications and extensions, product development, financial reporting (under various GAAPs), risk management and mitigation, and strategic advice on portfolio transfers, new distribution models, and mergers and acquisitions.

We have been involved in advising our clients on Solvency II issues since its conception. As a result, our consultants have been actively involved in industry, professional, and other bodies that have been analysing Solvency II and commenting on the various consultation papers that have been developed.

We have also undertaken a range of work for clients on Solvency II including:

- Gap analysis covering Pillars 1, 2, and 3.
- Assessing the implications of Solvency II for client businesses, particularly through participation in the QIS3 and QIS4 initiatives.
- Providing wider advice to clients on the implications of the Pillar 2 and Pillar 3 elements of Solvency II.
- Making board presentations on the new governance requirements.
- Advising on risk management and on work that will be required under all Pillars.
- Specific training to client companies on the implications of the recently issued consultation papers.

Also, as part or our commitment to assisting the industry in coming to grips with Solvency II, we have hosted a series of breakfast briefings on Solvency II covering the various consultation papers from CEIOPS. We have prepared summaries of each of the recently issued consultation papers that are available on our website (milliman.ie).

Above all, we remain focussed on efficiency and practical delivery.

FIGURE 4: SOLVENCY II TIMETABLE

JANUARY: CEIOPS PROVIDES REMAINING TECHNICAL ADVICE TO COMMISSION, INCLUDING IMPACT ASSESSMENT.
Q1: COMMISSION HOSTS PUBLIC HEARING ON SOLVENCY II.
MARCH: CEIOPS PROVIDES COMMISSION WITH DRAFT QIS5 TECHNICAL SPECIFICATION.
INTERNAL MODEL PRE-APPLICATION PROCESS.
JUNE 2010 - QIS5 TECHNICAL SPECIFICATION PUBLISHED
AUGUST-NOVEMBER: QIS5.
OCTOBER/NOVEMBER: COMMISSION ADOPTS PROPOSAL FOR IMPLEMENTING MEASURES
Q1/2: CEIOPS PUBLISHES DRAFT LEVEL 3 SUPERVISORY GUIDELINES.
APRIL: CEIOPS PUBLISHES QIS5 REPORT.
Q3/Q4: INTERNAL MODEL REVIEW/APPROVAL PROCESS.
OCTOBER: LEVEL 2 IMPLEMENTING MEASURES IN PLACE.
DECEMBER: CEIOPS PUBLISHES FINAL LEVEL 3 SUPERVISORY GUIDELINES, INCLUDING IMPACT ANALYSIS.
MEMBER STATES TRANSPOSE SOLVENCY II INTO NATIONAL LAWS.
JANUARY 2013: GO-LIVE

2010 2011 2012 2013

MILLIMAN IN EUROPE

In December 2009, Life Strategies became Milliman Limited following its acquisition by Milliman Inc., one of the premier worldwide consulting and actuarial firms.

Milliman has offices throughout Europe covering life, non-life, and health practices in:

- Amsterdam
- Bucharest
- Dublin
- London
- Paris
- Madrid
- Milan
- Munich
- Warsaw
- Zurich

FIGURE 5: MILLIMAN OFFICES IN EUROPE

CONTACT

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