Introduction

Solvency II has already been dominating the agendas of non-life insurers for a number of years. And, with the recent delays to implementation, it looks certain to continue to demand their attention for several more.

The preparations for the new regime have required substantial investment of time, resources and money and there is no end in sight. But what do insurers really think of Solvency II? Will all the effort, the frustrations and the headaches be worth it once the regime is in place? Will the benefits ultimately outweigh the costs and will the end justify the means?

In order to discover the answers to these questions, we undertook a survey of senior executives in the non-life insurance sector during September and October 2012. We asked them how prepared they are for the brave new world of Solvency II, what areas they still need to focus on, and how they view the new regime after so many years of effort. Their answers make for fascinating reading.

It is more than three years since our last Solvency II survey. At that time, preparations for the regime were in their infancy and little guidance had been issued. The contrast between the responses we received then and now is extremely interesting.

We received responses to our latest survey from the UK, Ireland, Continental Europe and Bermuda and from a range of different insurance entities. We are enormously grateful to everyone who took the time to complete the survey – it is self-evident, but nonetheless true, that without you, this report would not exist.

Regardless of whether or not you responded to the survey, we hope that you will find the results as interesting and informative as we do.

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Headline findings

- Only one in four participants believes that Solvency II is the most appropriate way to run their business.

- There is a feeling that the Directive’s good principles have been ruined by the proportion of complexity of its implementation.

- Since our 2009 survey, there have been increases of 425% in the proportion of respondents who believe that Solvency II is a box ticking exercise and 300% in the proportion of respondents who believe that Solvency II is more red tape from Brussels.

- As expected, insurance companies are further behind in their preparations than their peers in the Lloyd’s market.

- Almost one in ten Lloyd’s managing agents believes that the calculation of the standard formula is not relevant for them.

- There is a small minority of insurance companies who believe that transferring Solvency II from project basis to business as usual is not relevant for them.

- The most significant constraints for the insurance market in implementing Solvency II are the lack of clarification of the regime’s requirements and the lack of resources.

- Even at this relatively late stage, more than half of respondents reported that they were constrained by a lack of understanding and more than a third were constrained by a lack of board engagement.

- The vast majority of participants believe that they will be ready (if necessary) by 1 January 2014. However, only 37% believe that 70% or more of the insurance market will also be ready by this date.

- One third of insurance companies and Lloyd’s managing agents have not yet considered IFRS4 at all.
Our goal was to gather a representative sample of non-life insurers in order to be able to extrapolate the survey’s results to the whole insurance industry. The analysis of the responses revealed some interesting facts about the industry’s perceptions regarding Solvency II.

The insurance industry does not seem to accept the necessity for Solvency II as currently formulated, since only one in four participants believes that it is the most appropriate way to run their business. What is clear is that the industry appears to have become more doubtful about Solvency II over the last few years since, in our 2009 survey, over half of all respondents believed that Solvency II was the most appropriate way to run their business. The reasons for this scepticism are reflected in the survey. Whilst Solvency II has the potential to add value to the business, as its principles are perceived positively by the market, this potential is ruined by the complexity of its implementation. It is safe to say that the insurance market believes that the European Insurance and Occupational Pensions Authority’s (EIOPA) approach has been too complicated and this has had a negative impact on the market’s perceptions about Solvency II. Furthermore, the implementation date of Solvency II has been postponed several times, creating uncertainty around the actual implementation date and reluctance in some parts of the insurance market to commit time, money and resources.

The negativity of the market is also supported by the fact that in the last three years there has been an increase of more than 400% in the proportion of respondents who believe that Solvency II is a box ticking exercise and an increase of 300% in the proportion of respondents who believe that Solvency II is more red tape from Brussels. This overall view is reinforced when we take into account the responses of people more closely involved in implementing Solvency II; actuaries and risk professionals. Almost half of actuaries and risk professionals consider Solvency II to be a box ticking exercise, while 60% of actuaries and 20% of risk professionals consider Solvency II as more red tape from Brussels. These percentages
clearly demonstrate a shift in the market’s perception since, in 2009, the corresponding percentages were all zero. The implementation process, the constant delays, the complexity of the regime and the quantity of man hours that have been expended preparing for Solvency II, have all resulted in a loss of the market’s hearts and minds. This should be of concern to regulators and supporters of Solvency II who will need to promote the benefits of the new regime effectively and persuade the market of its usefulness in order to ensure buy-in from senior management.

Based on the responses that we received, it is evident that insurance companies are further behind in the preparations than their peers in the Lloyd’s market. This is not a surprise in the light of the Corporation of Lloyd’s efforts to drive the syndicates through the process, which included the imposition of strict deadlines, accompanied by significant guidance and support. However, although the level of preparedness is different, it is evident from the responses that both insurance companies and Lloyd’s managing agents have exactly the same priorities on their agendas for the coming months and this is in line with our experience of talking to people in the market.

An interesting observation is that one in ten Lloyd’s managing agents believes that the calculation of the standard formula is not relevant for them, despite the fact that regulators have the right to require an insurer to calculate its Solvency Capital Requirement (SCR) on the basis of the standard formula even if it is using an internal model, and therefore they should be prepared for that eventuality. Another noteworthy observation is that although transferring Solvency II from project basis to business as usual is very high in the agendas of both Lloyd’s managing agents and insurance companies, 3% of the latter believe that this is not relevant for them. This may be explained by the fact that some insurance companies are not yet fully aware of Solvency II requirements, since they still need to make progress in various Solvency II elements, as illustrated in detail in the main body of the survey. This could be a signal to regulators to devote more attention to small and medium insurers by providing further assistance and support to ensure these companies will keep up with the pace and will be fully Solvency II compliant on time.

In terms of the calculation of the regulatory capital requirements, Lloyd’s managing agents are obliged by the Corporation of Lloyd’s to use an internal model. However, the same is not true for insurance companies and when we asked them how they proposed to calculate their requirements, the results were enlightening and demonstrated a shift in the market position. At the time of our 2009 survey, 34% of the
insurance company participants had chosen to use an internal model for the calculation of their SCR, 8% a partial internal model, and none had chosen the standard formula, while 58% were undecided. These percentages have changed in 2012 with 39% of the insurance company participants choosing to use an internal model, 14% a partial internal model and 47% choosing either the standard formula or the standard formula with Undertaking Specific Parameters (USPs). This may suggest that the vast majority of the companies that were undecided in 2009 ended up selecting the standard formula. An analysis of the responses indicates that many small to medium insurance companies have been put off the development of an internal model by the complicated and time consuming internal model approval process, the onerous documentation and validation requirements and the shortage of experienced resources. This finding accords with our experience of the market.

Interestingly, the most significant constraint identified by participants in implementing Solvency II is the lack of certainty around the requirements. This implies that, despite the voluminous information produced by EIOPA and the regulators, Solvency II requirements are still not clear. As a result, companies are concerned about investing too much time before the final details have been clarified in case some of that time turns out to have been wasted in the light of information that subsequently emerges. This is perhaps understandable given the recent delays and the potential that they could lead to previously resolved
issues being reopened. Nevertheless, we would caution firms against delaying for too long while awaiting further clarification. There is still a significant amount of work to do and it is imperative that firms begin to tackle it as soon as possible. Although some minor details of the new regime are expected to change between now and the final implementation date, the structure as currently envisaged will not change substantially.

Of some concern is that, even at this stage, 55% of respondents cited a lack of understanding as a constraint and 35% were constrained by a lack of board engagement.

A further finding is that, although the participants are confident in their own ability to be fully Solvency II compliant by 1 January 2014, with 81% of insurance companies and 94% of Lloyd’s managing agents saying that they would be, they are less confident of their peers’ progress with only 37% believing that 70% or more of the insurance market will be ready by 1 January 2014, and 25% thinking that less than 50% of the market will be ready. This divergence of opinion could indicate either overconfidence in respondents’ own readiness or an unjustified pessimism about that of their competitors.

A final interesting insight that the responses revealed is the market’s limited awareness about IFRS 4 Phase 2. Since IFRS 4 Phase 2 is going to change the way insurers are accounting for their insurance contracts, it will have a material impact on insurers’ reporting structure. Despite this, more than a third of the market has not considered it at all. Although it is understandable that participants are currently focusing on Solvency II, it is important that insurers do not underestimate the challenges and the complexity IFRS 4 will bring and ensure they leave sufficient time and resources for them to be addressed. This issue is exacerbated by the fact that IFRS 4 will, like Solvency II, require substantial changes to IT systems. In our view it will be significantly more efficient to build the requirements of both regimes into a single project rather than running separate sequential projects.
Detailed findings

Composition of respondents

**Type of companies**
Our survey was focused on the non-life insurance sector. Of those who completed the survey, 50% were from insurance companies (including composites and reinsurers) whilst 45% were Lloyd’s managing agents (Fig. 1).

**Role within organisation**
The survey was sent to a wide selection of senior executives in the insurance sector. Responses were received from individuals in a variety of roles. More than a third of the returned surveys (39%) were completed by executives in risk management departments, while 23% were returned by actuaries (Fig. 2). 11% of the responses came from finance directors and 7% came from personnel who were dedicated to implementing and complying with the Solvency II directive (ie Solvency II project teams). 2% of the responses came from CEOs, while the remaining 18% were returned by executives in a variety of different functions including compliance, claims and internal audit.
**Annual premium income**

Annual premium income of the companies that participated in the survey ranged from less than £20m to more than £1bn. We have split the participants into three groups; small firms (less than £100m), medium firms (between £100m and £500m) and large firms (more than £500m). On this basis 11% of the participants came from small firms, 43% medium firms and 46% large firms (Fig. 3).

A closer look at the responses reveals that 67% of the small firms are insurance companies and 33% are Lloyd’s managing agents (Fig. 3). The composition of the medium firms is different, with 42% being insurance companies and 58% being Lloyd’s managing agents. As for the large firms, 53% of them are insurance companies and 47% Lloyd’s managing agents.

**Gross technical provisions**

The gross technical provisions of the companies that participated in the survey ranged from less than £50m to more than £3bn. We have split the participants into three groups; small firms (less than £250m), medium firms (between £250m and £1bn) and large firms (more than £1bn). On this basis, 33% of the participants came from small firms, 28% medium firms and 39% large firms (Fig. 4).

56% of the small firms are insurance companies and 44% are Lloyd’s managing agents (Fig. 4). The composition of the medium firms is different, with 29% being insurance companies and 71% Lloyd’s managing agents. As for the large firms, 67% are insurance companies and 33% Lloyd’s managing agents.
Preparing for Solvency II

**Impressions of Solvency II**

Generally speaking, the insurance industry does not appear to accept the need for Solvency II, with only 24% agreeing that the Solvency II regime is ‘clearly the most appropriate way to run our business going forward’ (Fig. 5a). Interestingly, the insurance industry appears to have become more doubtful about Solvency II over the past three years. This can be demonstrated by the fact that in 2009, over half of all respondents agreed that Solvency II regime was ‘clearly the most appropriate way to run our business going forward’.

27% of the respondents believed that ‘Solvency II is a necessary evil’; a similar percentage (30%) expressed this opinion in our 2009 survey. An interesting observation is that the percentage of respondents that chose the remaining options has increased significantly. 21% believe that Solvency II is ‘a box ticking exercise’ (the corresponding percentage in 2009 was only 4%) and 28% believe that it is ‘more red tape from Brussels’ (in 2009 only 7% believed this was the case).

All in all, the industry appears to have become more cynical about Solvency II over the last three years.
There does seem to be some suggestion that the attitude towards Solvency II varies according to role. It is interesting to note that 60% of actuarial professionals, but only 20% of risk executives, believe that Solvency II is ‘more red tape from Brussels’, while the corresponding percentages that believe that Solvency II is ‘a box ticking exercise’ are both 47% (Fig. 5b and Fig. 5c). In 2009, all of these percentages were zero. Consequently, it is safe to conclude that actuaries and risk professionals have become more sceptical about the usefulness of Solvency II over the past three years.

This increasing scepticism is supported by the fact that only 21% of CEOs and finance directors believe that ‘the Solvency II regime is clearly the most appropriate way to run their business going forward’ (in 2009 the percentage was almost double, standing at 40%) (Fig. 5d). Risk executives also demonstrated a sharp fall in their support, since the percentage who believe that ‘the Solvency II regime is clearly the most appropriate way to run our business going forward’ has reduced by nearly a third within three years, from 75% in 2009 to 53% in 2012. This accords with our experience of talking to people in the market. We have encountered a number of companies where the implementers and the Board are convinced that they will not run the business based on Solvency II, but based on internally developed metrics that will be more appropriate for them.
The majority of the participants (74%) believe that ‘Solvency II is using up resources that would be better deployed in other areas’ and a not much lower percentage (65%) believe that ‘Solvency II preparations are distracting senior management from running the business’ (Fig. 6a). These answers imply that Solvency II is viewed more as a burden and, as such, it is not currently adding value to the business. This conclusion confirms the negative impression that the insurance market currently has of Solvency II, as reflected earlier. However, the market has a positive attitude towards the potential benefits that Solvency II could have on the business, since its principles are sound, they take the view that this potential has been ruined by the complexity of the implementation. Based on the corresponding percentage in 2009 was only 30%. In addition, 82% believe that ‘the principles of Solvency II have been ruined by the implementation’. This indicates that although the majority believe that Solvency II has the potential to add value to the business, since its principles are sound, they take the view that this potential has been ruined by the complexity of the implementation. Based on the survey results, it is safe to say that the insurance market believes that EIOPA’s approach to Solvency II has been too complicated and this has had a negative impact on the market’s perception about Solvency II and its merits.

Although almost the whole market (99%) believes that ‘Solvency II principles are good’, 89% believe that ‘as currently envisaged, Solvency II is too complicated’ (Fig. 6b). The
Implementation progress
As expected, Lloyd’s managing agents are generally better prepared for Solvency II than insurance companies. The vast majority of Lloyd’s managing agents and insurance companies (87% and 84% respectively) have completed (or are ahead of plan/on track with) the calculation of the standard formula (Fig. 7a and Fig. 7b). However, it is interesting that 9% of Lloyd’s managing agents (almost one in ten) believe that the calculation of the standard formula is not relevant for them, despite the fact that the regulator has the right to request an insurer to calculate its Solvency Capital Requirement (SCR) on the basis of the standard formula, even if it is using an internal model [Solvency II Directive, Article 112 (7) and Article 129(3)].

The vast majority of Lloyd’s managing agents (more than 80%) have completed (or are ahead of plan/on track with) a significant number of Solvency II requirements. However, almost one in four (23%) of the Lloyd’s respondents are slightly behind plan on developing stress tests and transferring Solvency II from a project basis to business as usual (Fig. 7a).

Perhaps unsurprisingly, insurance companies are even further behind in these two areas, with 30% of the respondents significantly behind/slightly behind on developing stress and scenario tests and 39% significantly behind/slightly behind on transferring to business as usual. It is interesting and a little worrying that 3% of insurers believe that transferring Solvency II from a project basis to business as usual is not relevant for them.

Based on the responses that we received, it is evident that the preparations of insurance companies lag behind their peers in the Lloyd’s market. Apart from developing stress and scenario tests and transferring to business as usual, which were described earlier, insurance companies have further to go in various Solvency II elements such as demonstrating the use and embedding of internal model (40% behind plan), reporting and disclosure (35%) and risk appetite (32%). This is not unexpected in the light of the Corporation of Lloyd’s effort to drive the syndicates through the process, which included the imposition of strict deadlines, accompanied by significant guidance and support. However, it does demonstrate the success of those efforts.
Standard formula v internal model

In order to calculate their SCR, Solvency II gives firms a choice between using the standard formula and using an approved internal model. The standard formula will be simpler to use. However, the internal model is likely to be better tailored to an individual company’s risk profile. Developing an internal model has far reaching benefits in terms of quantifying the risks underlying the business and using this information to make better decisions.

The survey asked companies whether they intended to use an internal model or the standard formula for calculating their SCR. Amongst Lloyd’s entities, 100% of the respondents will use a full internal model. This is unsurprising as Lloyd’s requires managing agents to do so.

What has proven more interesting is the analysis of the insurance companies’ responses, where the picture was rather different. 39% of respondents have chosen to use a full internal model, 33% to use the unadjusted standard formula, with the remaining 28% equally divided between developing a partial internal model and using the standard formula with Undertaking Specific Parameters (USPs) (Fig. 8a). It is interesting to compare these results with those of the 2009 survey. In 2009, 42% of insurance companies responding had chosen to use an internal model (either a full or a partial one), with the remaining 58% being undecided (Fig. 8a). At this stage, no respondents had decided to use the standard formula. This comparison suggests that the majority of those who were undecided in 2009 may have now chosen to use the standard formula (either with or without USPs) for calculating their regulatory capital requirements under Solvency II.

A closer look at the results demonstrates a correlation between the size of the insurance company and the method selected for calculating the SCR (Fig. 8b). Two thirds of the small insurance companies, and almost half of the medium companies, have chosen to use the standard formula for calculating their SCR. On the other hand, only 17% of the large insurance companies will calculate their SCR using the standard formula, while a substantial 39% will use a full internal model. It is clear from our discussions with the market that many small to medium insurance companies have been put off the development of an internal model by the complicated and time consuming internal model approval process, the onerous documentation and validation requirements and the shortage of experienced resources.
Future focus

Next, the survey asked firms where they will be focusing their efforts over the next six to twelve months. The responses that we received revealed that insurance companies and Lloyd’s managing agents have exactly the same priorities on their agendas. The most popular answer for both groups was ‘Reporting and disclosure requirements (Pillar III)’, with 81% and 93% respectively putting either significant or moderate effort into this aspect of Solvency II (Fig. 9a and Fig. 9b). The next most popular answer was ‘Demonstrating use/embedding’ (81% and 90%), followed by ‘Transferring Solvency II from project basis to business as usual’ (69% and 86%). Well over half of the market is also planning to allocate time to the ‘ORSA’ and ‘Stress and scenario testing’ in the next twelve months.

The replies to this question are consistent with the responses to the question about the market’s preparedness regarding various Solvency II elements (as discussed earlier) and they are in line with our experience of talking to people in the market. We have encountered a number of companies who are stressing the fact that there is still a substantial amount of work to be done in many areas before they fully operate on a Solvency II basis.
**Constraints**

We asked respondents about their main constraints in preparing for the new regime. The most significant ones identified in our survey are that firms are awaiting further clarification as to what Solvency II will require (given as a constraint by 91% of respondents), that they lack the necessary resources (85%) and that they have data issues (78%) (Fig. 10a). A relatively high percentage of the respondents (75%) also considers the uncertainty around the actual Solvency II implementation date to be a constraint. Of some concern is that, even at this stage, 55% of respondents cited a lack of understanding, and 35% were constrained by the lack of engagement at boardroom level.

A closer look at the responses that we received reveals that although Lloyd’s managing agents are, as expected, generally more prepared for Solvency II than insurance companies, they still have many constraints. 91% need further clarification regarding Solvency II requirement, 84% do not have adequate resources, while 75% have data issues and 65% consider the uncertainty over implementation date to be a constraint (Fig. 10b).

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**Fig 10a: What are the main constraints in your Solvency II preparations?**

**Fig 10b: What are the main constraints in your Solvency II preparations? (Lloyd’s)**
Similar trends are observed amongst insurance companies where 94% need further clarification regarding Solvency II requirements, 89% do not have adequate resources, 84% consider the uncertainty over implementation date to be a constraint and 78% have data issues (Fig. 10c).

Based on the responses that we received, it is evident that both Lloyd’s managing agents and insurance companies have the same constraints in their preparations.

This suggests that many companies are engaged with the Solvency II process and are aware of what needs doing. However, they fear that they may have insufficient resources to action their plans and it appears that they still want further clarification as to what Solvency II will require, despite the vast quantities of information issued by EIOPA and national supervisors. As a result, they are concerned about investing too much time before the final details have been clarified, in case some of that time turns out to have been wasted in the light of information that subsequently emerges. This is perhaps understandable given the recent delays and the potential that they will result in previously settled issues being reopened. Nevertheless, we would caution firms against delaying for too long while they await further clarification. There is still a significant amount of work to do and it is imperative that firms begin to tackle it as soon as possible. Although some minor details of the new regime are expected to change between now and the final implementation date, the structure as currently envisaged will not change substantially.

IFRS 4 Phase 2

IFRS 4 Phase 2 is going to change the way insurance companies account for their insurance contracts and is likely to be introduced a few years after Solvency II. Since it will have a material impact on insurers’ reporting requirements, we asked firms if they have considered it. The responses that we received are worrying, since 34% of both insurance companies and Lloyd’s managing agents have not considered it at all (Fig. 11). Like Solvency II, IFRS 4 Phase 2 will require substantial changes in IT systems. In our view, it will be far more efficient to build the requirements of both systems into one project rather than running two sequential projects that will result in significant duplication of effort.
Going live

Implementation date
With impeccable timing, the survey was launched just before the failure of the Omnibus II talks, but by the time most respondents completed the survey, it was clear that the talks had failed to reach a consensus and that the implementation date of the new regime would have to be deferred. Consequently it was not surprising that 97% of respondents believed that Solvency II will be delayed (Fig. 12). Following the failure of the Omnibus II talks it quickly became apparent that the delay to implementation was going to be at least a year and, while 42% of the participants believed that the delay would only be a single year, 51% believed that ‘it will be delayed by more than one year’ and an especially pessimistic 3% believed that ‘it will never happen’.

Will you be ready?
There are encouraging signs that companies are proceeding with their preparations for Solvency II. Even now that the implementation date has been postponed, only 3% of the insurance companies and none of the Lloyd’s managing agents felt that, if required, they would definitely not be ready to comply with the new regime by 1 January 2014. Despite the ambiguity around the implementation date, 94% of the Lloyd’s participants and 81% of insurance companies believe that, if required, they will be fully Solvency II compliant by 1 January 2014. Only 6% of Lloyd’s participants and 16% of insurance companies were not sure (Fig. 13).
Will the market be ready?

However, there is less confidence about competitors’ preparations. The final question of the survey was about the perception that the participants had with regards to the preparedness of the insurance market as a whole. Based on the responses that we received, it is clear that although the participants are confident in their own readiness, they do not share the same confidence for their peers, since only 37% believe that 70% or more of the insurance market will be ready by 1 January 2014 if so required (Fig. 14). Exactly the same percentage believe that between 50% and 70% of the market will be ready by then, and a substantial 25% of the participants believe that 50% or less will be ready by 1 January 2014.

This divergence of opinion between respondents’ views of their own preparations and those of their peers could indicate either overconfidence in their own readiness or an unjustified pessimism about that of their competitors.

Fig 14: If companies are required to comply with Solvency II by 1 January 2014, what percentage of the insurance market do you think will be ready?
Our survey has identified several interesting points relating to the preparedness of the non-life insurance sector for the Solvency II regime. In particular, it is clear that the negativity towards the new regime has increased markedly over the last few years. Although some negativity was evident in our 2009 survey, the level of scepticism appears to have grown substantially. This has in part been caused by the constant delays, the increasing complexity of the regime, the quantity of man hours that have been expended in preparations and the shortage of experienced resources. It is interesting but regretful that the vast majority of the market believes that sound principles in the Solvency II Directive have been undermined by the complexity of the implementation.

With this level of negativity and the latest significant delay to implementation, it would be all too easy for insurers to take the opportunity to halt their preparations. However, we would caution against this. There is still a significant amount of work to do and it is best that firms begin to tackle it as soon as possible. Although some minor details of the new regime are expected to change between now and the final implementation date (whenever that may be!), the structure as currently envisaged will not change substantially. And if insurers lose momentum at this stage, it is going to be far more difficult and far more costly for them to pick up the pace later.
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