

Solvency II: Make time for Solvency, too

At least by the astronomical calendar, the decade of Solvency II has arrived. The insurance industry faces many challenges. Make sure that complying with Solvency II does not become an additional challenge for your business.

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As 2010 moves from the holiday season into commercial activity, many of us spend a little time debating intellectual and esoteric facts with our friends. Is Jan 1, 2010 the start of the new decade or is it Jan 1, 2011? If the last ten years were the Noughties, what should the next ten be called? If the next ten years are called the Teenies, where does that leave 2010 to 2012?

All amusing for a conversation in a bar catching up with old friends, but commercially useless. The next few years bring many challenges for the insurance industry. BRAVE Partners implores that firms make time for Solvency II, too; or to make a catch phrase – make time for Solvency, too.

“Whilst facing all of the industry challenges of 2010, insurance executives must ensure that they make time for Solvency, too.”

Christopher Cloke-Browne
Managing Partner
BRAVE Partners LLP

Challenging times

The insurance industry weathered the financial storm well. Lloyds is not just alive, but is in rude health. The capacity at Lloyds for 2010 is the highest ever. However the financial crisis is now bringing its own issues to the insurance sector.

Softening rates

Increased supply in the face of falling demand is bad for prices. BRAVE Partners is pleased to see the Lloyds market doing so well, but the increase in capacity is not good news for profits. Insurance Insider recently ran two telling articles:

1. Reinsurance brokers see disciplined softening at 1/1.
2. Embattled insurers fighting to maintain market share, says rating agency.

Don't under-estimate an embattled insurer

Part of the increase in capacity stems from the fact that insurers, in general, have fared the credit storm better than anticipated. A little under a year ago AIG was about to report the largest quarterly corporate loss in history at a little over \$60bn. XL Capital looked to be on its way out and The Hartford was teetering on the brink. Losing just one of those companies would have squeezed capacity in many lines.

Losing all three would have created a capacity crunch that would have given available capital a licence to print money.

Lag time

Bringing capacity into the insurance markets takes some time. So, the capacity geared up on the perception of an opportunity. In reality the capacity has arrived and there is no opportunity. In reality there are only rumours that AIG is cutting rates to maintain market share, putting further downward pressure on rates.

Soft market challenges

So insurers face the challenges of a soft market – such as maintaining profitability and market share. The soft market and gradual reopening of financial markets will also bring a flurry of M&A. Managements will need to be wary of opportunistic, predatory buyers who will wish to capitalise on any perceived weakness in a competitor.

Solvency II

With a 2012 start date, Solvency II might still seem far off and unimportant to many managements. However, there is a lot to do for Solvency II and, critically, it involves management. A key requirement in the Solvency II regulations is that the firm's risk model must be embedded in the management and governance processes of the firm. This means that the management, even the board, must understand the risk model, its inputs and its outputs.

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Night classes

BRAVE Partners has heard murmurings that at least one of the major consultancy firms is establishing a huge team to provide senior managers in the insurance industry with training on risk models and modeling. So, one solution to the Solvency II requirements is for senior management to attend night classes on complex mathematics.

There is another way

At BRAVE Partners we promote a different method for ensuring that the management understand the modeling. BRAVE Partners believes that models should be constructed where the input and the outputs are created directly from the risk items on the management's agenda. The model should fit the business. The management should not have to attend night classes to make the business to fit a model.

Proof is in the pudding

Americans say “The proof is in the pudding” which always seems like a fairly bizarre statement. Somewhere in the mid-Atlantic the end of the saying got lost. In the UK the saying is “The proof of the pudding is in the eating.” Tell that to an American and they will thank you for making their life a lot less confusing!

BRAVE Partners has a proof in the pudding. Or, to be less confusing the firm has posted some examples of its modeling approach on the BRAVE Partners website.

Description	Weblink
Modeling framework	http://www.bravepartners.com/BRAVE%20RiskAnalytics.php
Simple bond default risk model	http://www.bravepartners.com/BRAVE%20ModelDemo.php
Homeowners insurance demo model	http://www.bravepartners.com/BRAVE%20HomeOwnersExample.php
Solvency II framework demo model	http://www.bravepartners.com/BRAVE%20S2ModelDemo.php

BRAVE Partners services

BRAVE Partners can assist clients to develop a Solvency II framework as an asset of the business that can place a firm among the leaders in the business.

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BRAVE Partners can assist insurance firms in achieving this goal.

Seminars

BRAVE Partners is giving a number of seminars on embedding models for Solvency II organized by a number of trade bodies. If you would like BRAVE Partners to organize or speak at your seminar, then please contact enquiries@bravepartners.com

For seminar details watch the SEMINARS page on www.bravepartners.com

Interaction

If you enjoyed this commentary and would like to receive a weekly update by E-Mail, then please contact BRAVE Partners on commentary@bravepartners.com

If you would like to comment on the content of this piece, then please send an E-Mail to discussions@bravepartners.com

- Solvency II has become a top agenda item for insurers in 2010.
- Whilst regulations due in 2012 might seem unimportant in a challenging environment of 2010 – a robust Solvency II plan will separate the strong from the weak.
- In a lively M&A environment, management need to position their firm among the strong.
- BRAVE Partners can assist insurers to build a Solvency II framework and a detailed capital plan as an asset for the business.
- A robust capital plan will place a firm among the strong as M&A picks up during 2010.