

## Update

# Solvency II Implementation – Hurry up and wait

### Known unknowns

A sense of frustration over the anticipated implementation of Solvency II has been growing within the UK insurance market. Having spent considerable amounts of time and money preparing for the new regime, the insurance industry can easily be forgiven for this, not least due to the uncertainty regarding the key questions around exactly when and how the implementation will happen.

Some of the uncertainty was removed following the adoption by the European Parliament on 3 July of the Commission's proposal for a short directive, which gives effect to the anticipated delay in the implementation of the Solvency II regime to 1 January 2014. The Solvency II directive must now be transposed into national law by 30 June 2013, rather than 31 October this year, as had been required under the original Solvency II directive. It is also confirmed that companies must fully comply with Solvency II from 1 January 2014 and the current Solvency I regime will be extended until that date. This does not answer all the questions on timetable, however, as uncertainty remains as to when the Omnibus II directive and 'Level 2' rules will be finalised. If there is any significant slippage in this process, it is likely to have further implications for the overall timetable for the implementation of Solvency II.

Insurers across all sectors – and particularly in the UK – are still investing really significant amounts of time and money in preparing for implementation and, in particular,

in building internal models or in preparing for the adoption of the standard formula. They are having to do this in an environment where there is an ongoing lack of clarity about the final shape of the legislation – particularly the more detailed rules and guidance – but at the same time the work required to get Solvency II-compliant models approved and adopted is becoming increasingly constrained. In addition, despite the uncertainty, pressure is continuing to mount from the FSA, which believes that the direction of travel for the new regime is sufficiently clear to enable firms to execute their planning and preparations for implementation – and that there is no need to wait for all the final details. Yet firms are also being reminded to allow for flexibility in their plans to accommodate further changes.

### Soaring costs amidst resourcing constraints

And none of this is cheap. The FSA estimated the industry's one-off cost for implementing Solvency II at £1.9bn and has budgeted £110m for its own implementation programme between 2008 and 2013. The Lloyd's market is expecting to spend around £300 million on its preparation for the new rules. With the actuarial resources required likely only to be found at a premium, and further delays and changes needing to be responded to, it is very likely that there will be an impact both on a firm's final model, organisational design and integration of the new regime within its business – delivering further cost surprises.

Resource problems have already begun to bite the industry and as insurers gear up for the implementation resourcing issues are likely to worsen further still. Assessing the performance of Solvency II models in readiness for implementation and beyond, under a variety of different circumstances, is highly specialised – it needs a range of actuarial skills; technical, commercial and operational. The actuaries involved need to be able to understand the technicalities but also to describe the business impact to the senior management and board of the insurer. One of the key challenges is that there are simply not enough actuaries in the market who fully understand how these models will and should operate within firms. And if that is a problem in the UK market, it will be an even more serious issue in other parts of the EU.

The key concern for the regulators is what they refer to as ‘solvency deterioration’. While they recognise that significant effort is put into the approval process, they are concerned that inadequate attention is given to ongoing appropriateness.

The FSA is now developing a number of early warning indicators to ensure that models continue to deliver outputs that are consistent with the requirements of Solvency II. The good news is that the indicators will be tailored to specific sectors of the market, although as always, the devil will be in the detail and the FSA has indicated that in the event that an early warning indicator is triggered, firms will be required to notify the regulator immediately and in all but exceptional cases, the regulator will take immediate supervisory action.

So to paraphrase the old military idiom, the next 18 months are likely to be typified by a “hurry up and wait” mentality as insurers try to contain their frustration – and costs – while dealing with a set of rules and regulations that are likely to continue to move.

**Written by Andy Tromans and Heidi Durnford for Insurance Day - reproduced with the kind permission of Informa**

### Further information

If you would like further information on any issue raised in this update please contact:

#### **Andy Tromans**

Partner

E: andy.tromans@clydeco.com

#### **Heidi Durnford**

Senior Associate

E: heidi.durnford@clydeco.com

Clyde & Co LLP  
The St Botolph Building  
138 Houndsditch  
London EC3A 7AR

T: +44 (0)20 7876 5000

F: +44 (0)20 7876 5111

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### Keeping your foot on the gas

However, this is not simply a case of heaving the legislation over the line and breathing a deep sigh of relief. In their letter to firms dated 13 June 2012, the FSA made it clear that – while their current focus is on being able to give firms a decision on their internal model application for the first day of the regime – they are already looking beyond that date. They are looking for clear assurances that firms have put in place systems which ensure that the internal model operates properly and on a continuous basis.