

# Regulatory change will dominate 2011

Accounting overhaul and continuing preparations for Solvency II's introduction likely to shape this year, **SCOTT VINCENT** says

2011 is expected to be a defining year in two areas of international insurance regulation, with the introduction of a revised industry accounting standard expected in July and progress towards the implementation of Solvency II at the end of 2012 continuing.

Regarding the latter, the results of the Fifth Quantitative Impact Study (QIS5) are due in April and the publication of the next phase of disclosure requirements in the summer months is expected to bring much more certainty for insurers' planning.

Meeting the challenges posed by these regulatory reforms is perhaps the most significant item on the industry-wide agenda for 2011. As has often been stated, the industry has tended to lack a strong, coherent voice in regulatory debates. With reform taking place across many regimes, the need for the industry to state its position has long been called for. The extent to which the industry has been successful in doing this, though, is subject to some debate.

Julian James, former director of worldwide markets at Lloyd's, who joined broker Lockton in 2007, sums it up by saying: "For an industry that is not short of executives with opinions and whose job is to take a view on risk, insurance collectively is a 'shrinking violet' – with no body or mechanism whose job it is to speak out on behalf of the industry."

If the credit crunch has taught us anything, James argues, it is the reputation of a whole industry can be destroyed in a frighteningly short period of time.

"Insurance has very little goodwill to fall back on – everybody buys it, but no-one understands it. We have a recent coalition government in the UK, regulatory uncertainty as the Financial Services Authority is broken up and ongoing investigations and actions from the European Commission. We need someone who can join the dots and be an advocate for the industry," he says.

From a UK perspective, some argue the industry is now doing a better job of making its voice heard. Adrian Brown, UK chief executive of insurer RSA, is one of them; he says the industry is engaging with a range of stakeholders on regulatory reform.

"Some of our arguments appear to be being heard. At RSA, we're working closely with the Association of British Insurers on this issue and have fed into its consultation responses and select committee submissions. Last year, we hosted a series of roundtable events at the three party conferences. The event was attended by key MPs and decision-makers, such as Mark Hoban [who serves as financial secretary to the Treasury]. We promoted the benefits of insurance in financial recovery and the fact insurance needs to be treated differently from banking.

"This engagement needs to continue into 2011; the industry faces a number of challenges with the ongoing regulatory reform and we need to ensure the key decision-makers understand our perspective on the issue," he says.

Dave Matcham, chief execu-

tive of the International Underwriting Association, also believes the industry is working hard to ensure its views are considered by government and regulators.

"This is a continual battle that requires a considerable effort. In recent years, it has been a real challenge to ensure responses to the financial crisis are appropriate to the insurance industry and not unduly influenced by problems in the banking sector," he says. "However, this message is now getting through and in the UK the industry is keen to work with the government to ensure its proposed new regulatory system works well. A key challenge will be to ensure any new supervisory bodies are adequately resourced with well-qualified staff."

Matcham believes work towards the creation of a Prudential Regulatory Authority, a Consumer Protection and Markets Authority and the introduction of Solvency II will transform the supervisory landscape in the UK during the coming year.

"Companies will need to make sure they are prepared for these changes while dealing with tough ongoing investment conditions and a competitive underwriting market," he says.

From an international perspective, the Geneva Association has in recent years increasingly attempted to fulfil the role of transmitting information on collective industry issues to the outside world.

Patrick Liedtke, the association's secretary-general and managing director, says the body

## 'We have vital role in climate and demographic challenges'

INSURANCE can make important contributions to demanding questions about demographics and climate change in 2011, Patrick Liedtke (pictured), secretary-general and managing director of the Geneva Association, believes.

"The challenges related to climate change are long and far-reaching but there are also opportunities for insurance," he says.

"Insurers have deeper and more detailed knowledge about extreme weather events and the possible consequences of shifts in climate risks than any other industry. While government-level talks have stalled and produced disappointing outcomes in Copenhagen and more recently Cancún, the challenge of how to deal with threatening scenarios linked to climate risks remains. Few risks transcend borders as readily, put as many lives, livelihoods and values at risk and require as close a co-operation between public and private partners."

Liedtke also believes a serious demographic challenge lies ahead for most societies. "The shift towards longer life expectancy has not only a massive and direct impact on the organisation of old-age security and health provision, but it will also change the way in which societies look at risks, organise their infrastructures and generally deal with economic and other challenges."

With existing solutions for old-age security in many cases unsustainable, Liedtke believes insurance can make important contributions to tackle these longer-term issues.



will remain directly involved in discussions about the regulation of insurers in 2011.

He believes the direction of international insurance regulation is going to be critical for the industry this year, with important decisions due on advancing Solvency II and accounting reforms.

"We are working with international regulators and standard setters such as the International Association of Insurance Supervisors, the International Accounting Standards Board and others to help them tackle the complex questions on how to best regulate and supervise the insurance industry, projecting additional knowledge into the discussions and hoping to ensure the future regulatory framework allows for efficient insurance solutions in the interest of economic growth and development," he says.

The G20 has handed the

Financial Standards Board (FSB) the task of addressing and solving the problems surrounding the resilience of the global financial system and Liedtke said there still remain issues to be addressed for large insurers in this area.

"While systemic threats do not emanate from insurance activities, there are a number of issues that need to be discussed in 2011, when important decisions will have to be taken by governments. The role of insurance companies that operate as financial conglomerates carrying out potentially systemically risky activities has to be properly addressed," he says.

On this issue, Liedtke believes the confusion surrounding the FSB's identification of "systematically important financial institutions" – and whether major international insurers fit into this description and are sub-

ject to regulations accordingly – needs to be overcome.

Another area likely to arise again in discussions about financial stability in 2011 is the difference between insurance and banking when regulations are established – an issue that frustrated insurers in both the UK and internationally during 2010.

"The differences between insurance and banking have to be taken appropriately into account and any solutions need to be compatible with the distinct roles that insurers and banks play for a modern economic system, avoiding situations where societal interests suffer because of regulatory imprecision or over-stretch," Liedtke argues.

The fear of regulatory over-stretch was a dominant industry theme of 2010. This looks likely to continue in 2011 as regulatory reform gathers pace.



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IUA

## QIS5 results mark first date of important year for Solvency II

THE RESULTS of the Fifth Quantitative Impact Study are expected to be announced in March – the first important date of 2011's Solvency II calendar.

For the UK insurance sector, where most large insurers are producing their own models, one of the next steps is to start producing results from these models and

testing the value of the outputs.

"These models will then need to start being linked to pricing, risk management and operations from board down," Neil Coulson, partner at consultancy Littlejohn, said. "It will be the rolling out of all this background theory, models and documentation into new practices that will be the

next big step. Even for those not developing new models, new documentation, governance and procedures focusing on risk management will need to be developed and implemented."

Coulson said testing the effectiveness of the processes being developed by people independent from implementing the new

requirements will be an important part of progress during 2011.

Simon Gallagher, partner at Moore Stephens, said for those entering the internal model pre-application and approval process, there is much work to do in terms of refining model governance procedures, documenting model processes, defining model data

quality standards and identifying and planning for system changes.

"In our experience, the data issues related to the model and other reporting processes will be the key area for many over the coming year and getting to grips with data issues early will allow insurers to plan for any required system changes, business process changes

or new control environment implementations, such as spreadsheet management procedures and/or systems, to ensure data quality standards are met," Gallagher said. "Early implementation of new systems or procedures will allow them to be introduced in a timely and controlled manner and allow bedding down and refinement."