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The Same Hymn Sheet
Harmonising Solvency II Reporting Requirements

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Consultation Paper 58/09 (CP58) sets out the Committee of European Insurance and Occupational Pensions Supervisors' (CEIOPS') draft technical advice to the European Commission for the development of the Level 2 implementing measures of Pillar 3 of the Solvency II regime.

Pillar 3 deals with the requirements for supervisory reporting and public disclosure under Solvency II. The objectives are to harmonise reporting, promote comparability of valuation and reporting rules with International Accounting Standards, introduce proportionate requirements for small undertakings and ensure efficient supervision of insurance groups and financial conglomerates.

CEIOPS has considered a number of options in its impact assessment on the most appropriate content, frequency, level of assurance and format of the reporting. The reporting requirements apply at both a stand-alone regulated entity ("solo" reporting) and group level.

The key reporting requirements are:

1) Solvency and Financial Condition Report (SFCR)
This report is public and will be required either 3 or 4 months (to be determined by CEIOPS before Level 2 advice to the Commission) after an insurer's financial year-end. The SFCR must follow a prescribed structure that CEIOPS developed based on the Framework Directive in CP58 covering: Business and Performance, System of Governance, Risk Management, Regulatory Balance Sheet and Capital Management.

2) Report to Supervisor (RTS)
The RTS is not public and is communicated only to the firm's supervisor. The RTS expands on the SFCR's disclosures using a similar, prescribed structure but this time presenting the information differently as part of the ongoing supervisory dialogue with the firm. The frequency for providing full information through the RTS will be linked to the intensity of the Supervisor Review Process (SRP). CP58 indicates that each regulator can require the RTS as a minimum every five years. However, the frequency could be increased up to an annual basis.

3) Private reports to the regulator on occurrence of pre-defined business events

The content required builds on existing IFRS disclosure, as the reference framework for the regime, incorporating Solvency II specific outputs such as the internal model and details of the Own Risk and Solvency Assessment (ORSA) and defines materiality in the context of the IAS definition.

Both the SFCR and RTS contain qualitative and quantitative information including prescribed Quantitative Reporting Templates (QRTs). CP58 sets out several provisional QRTs of which a subset will be reported to the supervisor on a quarterly basis, 3 or 4 weeks after the quarter end (to be determined by CEIOPS before Level 2 advice to the Commission).

Key themes
There are a number of key themes in common with the rest of the Solvency II regime which are of particular importance for Pillar 3:

- Alignment with IFRS;
- Need for senior management engagement;
- Control, documentation and assurance.

Alignment with IFRS
To minimise the administrative burden of Pillar 3 the Solvency II reporting extensively refers to IFRS disclosures. This approach is consistent with the reference to IFRS as endorsed in the EU as the basis for valuation of assets and non-insurance liabilities in the solvency balance sheet as proposed in CEIOPS CP 35 published last March.

CEIOPS seems to have contemplated market-wide synergies that would arise from using IFRS as the single statutory reporting basis across the EU however the draft regulations do not go as far as making IFRS the required financial reporting framework, leaving it to member state governments to voluntarily extend the use of IFRS beyond listed companies.

Although IFRS and regulatory reporting serve different purposes, both frameworks are being developed to recognise risks and their management as key disclosure requirements. The ability to see how risk and capital are managed by senior executives will provide valuable insights into the quality of risk management and decision making of European insurers.

There are considerable overlaps between the disclosure requirements of Pillar 3 and current financial reporting requirements, including IFRS, Companies Act 2006 and the UK Listing Rules. For insurers already on IFRS the key issue is to establish how good the IFRS disclosures are compared with the requirements of the SFCR. The use of existing public disclosures is subject to a qualitative test of equivalence in terms of their nature and scope.

The finalisation of the IFRS 4 Phase II project will provide further alignment between Solvency II and IFRS. Both use best estimate valuation techniques as the starting point for the measurement of the insurance liabilities. However, Solvency II will not follow the IFRS product classification, instead it will define its scope based on the legal entity regulatory status as an authorised insurer selling regulated products which could include both insurance contracts

accounted for under IFRS 4 and investment contracts accounted for under IAS 39. For jurisdictions such as the UK where tax for life insurers is based on regulatory returns this difference in scope could also have tax implications.

The alignment of Solvency II to IFRS offers an opportunity for insurance companies to adopt an integrated approach that, with the implementation of IFRS at legal entity level, will facilitate the compliance with the Solvency II requirements and simplify processes and systems of the organisation.

For UK GAAP reporters, the latest developments in financial and regulatory reporting provide a dilemma. It would be sensible to perform a cost-benefit assessment of the impact of moving to IFRS as there will be clearer synergies between IFRS and Solvency II reporting bases.

Senior management engagement

The type of information which needs to be disclosed will mean senior management have to engage in the preparation as well as review of the SFCR and RTS. Some of the disclosures will not be easily delegated to the financial reporting function, for example around business strategy, ORSA and system of governance. The relative ease with which users will be able to interrogate the disclosure given its comparability will further increase pressure on Boards to “get it right”.

Since the main stakeholders addressed in the SFCR are the policyholders, disclosure could prove particularly beneficial for relationships between insurers and their customers. It is possible that customer relationship directors would be directly involved in the shaping of the messages in the SFCR. This combined with the sheer range of information required, will have a profound impact on the internal organisation of insurers.

This is not simply a Pillar 3 observation but one that applies throughout Solvency II. For example, the requirement for the ORSA to embed solvency calculations in day-to-day decision making will require internal management information to describe clearly the risk and capital impacts of different courses of actions and business decisions. Those responsible for preparing the new reports must be encouraged and empowered to challenge the technical input from other departments. Senior management must take the lead to make this new reporting process work effectively and collaboratively.

Control, documentation and assurance

Disclosure policy

Insurers need to set out in a disclosure policy, approved by management, appropriate governance procedures over reporting. Whilst insurers may already have timetables with the key milestones and deliverables for regulatory reporting, they are less likely to have a documented policy. In developing this written policy and the related infrastructure, the insurer should consider how to have its departments interacting with each other to avoid inefficiencies and duplication of effort and at the same time ensure consistent, accurate and complete compliance with the policy and the regulations.

Asset management certification
One further aspect which senior management needs to consider is the requirement to certify that assets have been invested in accordance with the "prudent person" principle, namely that the complexity of the assets underlying the insurer's portfolio is commensurate with the ability of the appropriate personnel and systems to understand, monitor and manage those instruments. The introduction of this certification process is not unique to Solvency II. For example, the UK government has recently introduced a requirement of "certification" for the accurateness of tax returns.

External audit
CP58 confirms there will be some form of external audit requirement and sets out tentative conclusions on which aspects this will include.

The scope proposed for external audit is not unduly onerous and there will be synergies with the existing statutory audits of financial statements. However, this form of audit would be an additional compliance cost that the regime could introduce.

CEIOPS recognises the difficulties for requiring an external audit of an approved internal model and has not included this in the proposed scope. Requiring the audit of internal models that do not generate audited financial information would call for an extensive audit effort with significant cost implications for sign off to be achieved within the timelines envisaged. On the other hand the internal model is the cornerstone of the new regime and regulators need to be satisfied there are alternative forms of external oversight giving assurance that the internal model is used as approved.

Another fundamental dimension surrounding the decision on audit requirements is the legacy of each member states. The UK market is used to regulatory returns being subject to audit, unlike other countries. For example, in France, Germany and Italy, the is no requirement for an external audit, while in Spain a limited audit is required on selected regulatory forms.

Pillar 3 implementation programme
The timing of a Pillar 3 programme will be significantly influenced by the finalisation of the proposals of the Level 2 implementing measures that the European Commission expects to adopt formally by November 2010 and the outcome of other Solvency II legislative projects, for example the development of Level 2 implementing measures for the ORSA and the SCR, as well as by the size, nature and complexity of the insurer.

CP58 encourages insurers to start analysing the potential disclosure requirements and assessing changes that could be required to the IT systems now if these proposals were finalised as drafted. CP58 obviously discourages any full system implementation activity at this stage. Significant CEIOPS work has already been input to develop the QRTs and, as it points out, much of the information will be information which management itself needs to monitor the business compliance with Solvency II.

The Pillar 3 programme could include three main components:

1. Disclosure impact assessment – identifying the impact of the proposed requirements on existing reporting procedures (systems, data, people, processes and controls);

2. Disclosure design - designing the structure and principles of the Solvency II reporting regime; and

3. Disclosure report building and implementation – implementing changes to the reporting framework to deliver to Solvency II requirements.

Insurers need to ensure they meet the minimum level of regulatory compliance in their Pillar 3 reporting when Solvency II is operational on 31 October 2012. However, by investing in a reporting programme insurers can optimise the use of their Solvency II resources and turn the compliance burden in a number of strategic opportunities:

- Building relationships with customers, shareholders, rating agencies and other stakeholders;

- Aligning Solvency II with IFRS information could help investor relations: delivering both quantitative and qualitative risk information to demonstrate how risk appetite is linked to strategic objectives and decisions and to IFRS profit.

- Building a brand recognised for strength of capital position, transparency in its operations and sound risk management practices to maintain customer confidence and market share.

- Demonstrating the effectiveness of control functions such as risk, compliance and internal audit giving greater assurance over the reporting, particularly if the ultimate choice on the external audit is for a limited degree of independent assurance.

Conclusion

IFRS as endorsed in the EU has emerged as the reference framework for the Solvency II balance sheet and disclosure. There is an opportunity here for insurers to adopt an integrated approach to move beyond short-term IFRS conversion measures by implementing IFRS and Solvency II systems and processes concurrently particularly following the plans of the International Accounting Standards Board to accelerate the completion of its projects on insurance liabilities and investment accounting in the next 24 months.

A Pillar 3 programme starting with an assessment against the proposals of CP58 should help insurers prepare for the production of useful, transparent and tailored information, consistent with other disclosure that can help to capture these advantages.