July 2013

Moving ahead to SAM readiness

SAM Parallel run survey

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Foreword

"The parallel run facilitates the smooth implementation of the new regime, by requiring the various stakeholders to prepare for the changes."

– FSB SAM 2013 Update

Since the end of 2012, when it became apparent that the implementation of Solvency II would be delayed past its originally planned 1 January 2014 implementation date, there have been growing concerns and differing views across the South African insurance industry about how the development of the new Solvency Assessment and Management (SAM) framework would be impacted.

Following consultation with the SAM Steering Committee and key stakeholders, the Financial Services Board (FSB) adjusted the SAM timelines in response to stakeholders' comments. The effective date for SAM implementation will now be 1 January 2016.

The FSB has indicated that the main changes relate to implementation timelines rather than the SAM development timelines.

The FSB's recent SAM 2013 Update provides detail on the SAM parallel run, which is the process which will require insurers to calculate and report information in accordance with the SAM proposals.

The main objective of the parallel run is to aid in the transition and implementation of the new SAM regime. Moving to the SAM regime also has wider implications that extend beyond insurers, as auditors and the FSB also need to prepare for these changes.

The SAM parallel run consists of two phases to enable insurers to meet the SAM requirements. The 'light' phase of the parallel run will be conducted in the second half of 2014. This will mainly be based on the QIS templates, with some simplified specifications. The 'comprehensive' phase will comprise the completion of a full set of quantitative reporting templates (QRTs) and a 'mock-ORSA' exercise, which will need to be conducted during 2015.

Given that SAM will not yet be legislated during the parallel run phases, the current Long- and Short-term Insurance Acts' requirements and regulatory return submissions will also need to be complied with. There will therefore be extensive demands on finance, risk and actuarial teams over this period to perform the compulsory SA QIS 3 exercise from October 2013 to March 2014, the two parallel runs in 2014 and 2015, while at the same time also complying with existing regulatory requirements.

As part of their Solvency II preparations and internal model applications, syndicates at Lloyd's conducted a 'dry run' process between 2009 and 2011. Experience showed that, the right tone at the top and detail upfront planning were key in distinguishing those Lloyd's businesses who struggled from those that have taken the preparations in their stride.

Within this context, we have conducted a high-level survey to obtain initial views from insurers on the practical implications they foresee as a result of the parallel runs.

In this survey, we have identified some of the major challenges foreseen as well as the different opinions expressed. We believe insurers will find these insights useful in benchmarking and evaluating their own readiness for the SAM parallel runs.

We would like to thank all the insurers who participated in this survey and trust that you will find the survey insightful. Should you like to discuss any of the issues addressed in more detail, please speak to your regular PwC contact or those contacts listed at the end of the report.

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Short-term Insurance Leader Africa

Background

The questions

This survey focuses on the practical implications and challenges of the SAM parallel runs in 2014 and 2015.

It sought to provide industry-wide perspectives across large and medium-sized insurers. Where meaningful, it also highlighted some differences between the life and non-life insurers' perspectives.

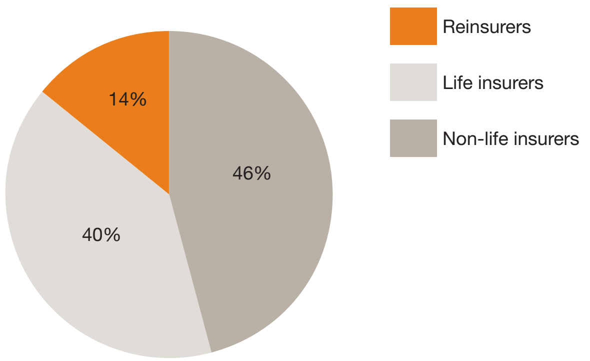
The survey consisted of eight questions and with a focus on requirements to prepare for the SAM parallel runs, managing the business during the parallel run period and insurers' readiness, including reporting challenges. The survey was conducted during April and May 2013.

Participants

The survey was based on a combination of electronic submissions and personal interviews with SAM programme directors, acturial, risk and finance teams of 28 insurance and reinsurance companies.

The responses of the companies remain confidential.

Figure 1. Profile of participating insurers



Source: PwC analysis

Figure 2. Size of life insurers surveyed*

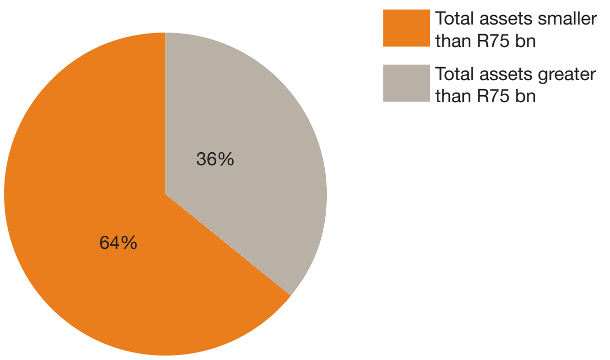
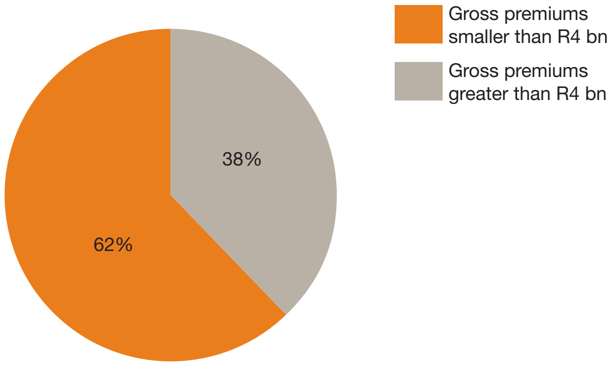


Figure 3. Size of non-life insurers surveyed*



* Source: FSB Fourteenth Annual Report by the Registrar of Long-term and Short-term Insurance 2011

Findings at a glance

Cost and resource implications

Insurers expect substantial cost implications due to duplications in the current and proposed regulatory regimes over the next two years. There are significant implementation costs, which are expected to reduce once SAM is implemented, but savings could be offset by the cost of complying with other emerging regulations such as Treating Customers Fairly (TCF).

Resource capacity and dedicating the right resources to the new regulation, especially during the parallel run phases, given on-going 'business-as-usual' requirements, will be stretched.

Challenging insurance group requirements

Group reporting is of particular importance as it will require solo entities to align certain processes that could have a material impact on their operating models.

Alignment of Pillar 1 and 3

Integrating Pillar 1 and Pillar 3 will be by far the most significant challenge that insurers expect to face.

Pillar 3 uncertainty

Pillar 3 is certainly the biggest unknown at this stage and being more informed about the reporting requirements will be of great help to many insurers. In most cases, new data sourcing, process improvements and system implementations will be required.

An evolving approach

The parallel runs are generally viewed as a step towards phasing in the SAM requirements. Embedding these requirements into day-to-day business will require intense and continuous effort over the next 18 months.

What does a 'mock-ORSA' mean?

There is consensus among insurers that there is not yet clarity on the scope of the 'mock-ORSA' or on the approach the FSB will take with the 'mock-ORSA' exercise.

Time to comply

Insurers will need sufficient time to build system capabilities and to source data. The time to comply will depend on:

- *The level of changes from current reporting to the draft QRTs;*
- *Changes from the 'light' to the 'comprehensive' parallel run; and*
- *The extent of changes to finalise the Pillar 1 technical specifications.*

Survey results

Q: What level of guidance do you require to better prepare yourself for the 'light' parallel run?

Figure 4. Level of guidance to prepare for the 'light' parallel run

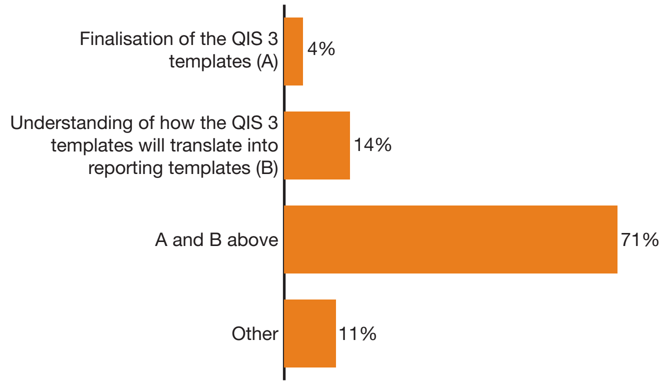


Figure 5. Life insurers

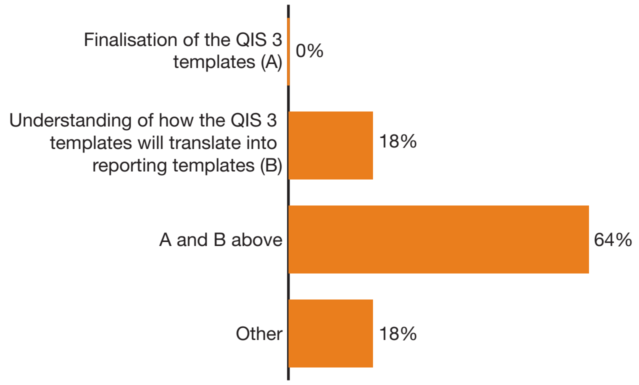
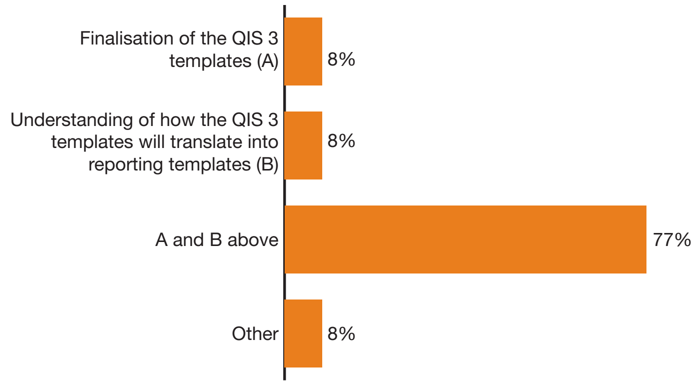


Figure 6. Non-life insurers



The FSB's SAM 2013 Update states that the aim of the 'light' parallel run phase will not be to produce all the information required for annual reporting, but rather to base it on the quarterly reporting requirements. There will therefore be adjustments to the technical specifications and the templates used for QIS 3.

The majority of insurers (71%) highlighted that finalisation of the QIS 3 templates and an understanding of how these templates will translate into the reporting templates are critical requirements needed to support their parallel run preparations. None of the life insurers surveyed indicated that finalisation of the QIS 3 templates on its own would be sufficient.

Generally, insurers believe they are well prepared for QIS 3, following their participation in the previous QIS exercises and for a few, EIOPA's QIS 5 exercise as well.

Changes from QIS 3 templates

Although the QIS 3 templates are not yet finalised, insurers expect that the details of these templates would not materially impact on the outputs or their preparations for the 'light' parallel run.

Some insurers indicated that finalisation of the QIS 3 templates will be useful, but also highlighted that there is substantial other development work that needs to take priority.

The 11% of participants who indicated other considered that the extent of the business processes or change required beyond the current and previous QIS efforts will depend on whether or not the FSB will require reporting in addition to the QIS 3 templates during the 'light' parallel run (for example by incorporating elements of the draft QRTs into the QIS 3 templates).

Clarity for insurance groups

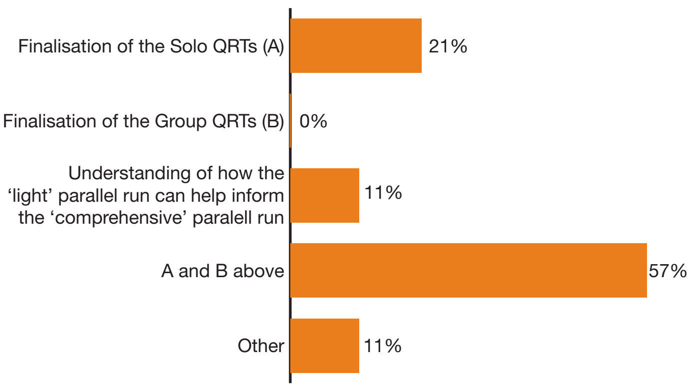
It is apparent that insurance groups need more clarity on the reporting requirements for group supervision in addition to finalising the QIS 3 templates.

This additional clarity should also be aimed at providing a better understanding of how the QIS 3 templates will translate into the reporting templates.

There is an expectation amongst some insurers that the Insurance Laws Amendment Bill (ILAB) will provide clarity on insurance groups and group supervision as well as guidance in respect of group reporting.

Q: What level of guidance do you require to better prepare yourself for the 'comprehensive' parallel run?

Figure 7. Level of guidance to prepare for the 'comprehensive' parallel run



"By the time the 'light' requirements come through, we would not expect any material differences between the 'light' and the 'comprehensive' parallel runs. We would think the differences are only a matter of detail."

"Notable system developments would be required to complete the QRTs. We would want as few changes as possible once the QRTs are released."

It is not surprising that most insurers (57%) consider the finalisation of the solo and group QRTs as important to better prepare them for the 'comprehensive' parallel run. Insurers that form part of a group emphasised the importance of group QRTs in addition to the solo QRTs.

Solo and group QRTs

Guidance with regards to the finalisation of both solo and group QRTs is required. Group reporting requirements are of particular interest since they will in all likelihood require new process and system developments that were not previously required.

Insurers with European parent companies require clarity on the differences between the SAM and Solvency II QRTs. The treatment of groups with non-South African subsidiaries is also an aspect that requires careful consideration.

Results of 'light' parallel run

The 'light' parallel run should reveal a great deal in terms of the impact of new reporting processes, which will provide insight for the 'comprehensive' run. Insurers believe that the SAM requirements should all be stabilised by the time of the 'light' parallel run.

Any differences in technical and reporting requirements between the 'light' and 'comprehensive' parallel runs will, however, be a key determinant (and potentially troublesome) of the level of step up required.

Pillar 3 uncertainty

Pillar 3 is the biggest unknown at this stage and being more informed about the reporting requirements will be of great help to many insurers. In most cases, new data sourcing, process improvements and system implementations will be required.

The lead time from recognising the need for a system change to going live with that system could be 12 months or possibly longer depending on the complexity of the solution and its implementation.

Guidance on qualitative requirements

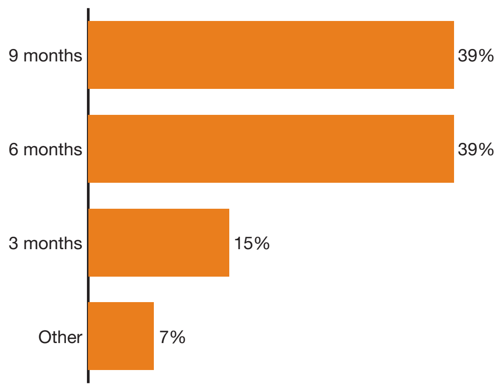
There is uncertainty around the qualitative reporting and guidance is required for both parallel runs.

Further clarity also needs to be provided in terms of whether or not the qualitative reporting will include the ORSA report. If that is the case, guidance on the 'mock-ORSA' report will be useful (for example the scope and extent of the document and the supervisory process around it).

Q: How long before the 'comprehensive' parallel run do you require the QRTs to be finalised, in order to meet the quarterly reporting deadlines?

Responses were mainly driven by the size and complexity of insurers as well as the progress on their current SAM programmes.

Figure 8. Time required to prepare once QRTS are finalised



> *"Nine months is just enough to provide a window for delivering final changes to systems required to populate the QRTs. This is on the assumption that reasonably stable versions of the QRTs are available 18 months before the 'comprehensive' parallel run."*

> *"We need at least nine months to integrate the QRTs into our reporting systems. We would be able to provide the information within a shorter time frame, but considerable manual work would be required."*

Time to comply

Insurers will need sufficient time to build system capabilities and to source data. Large life insurers indicated that the diversity of their investments will have an impact on quality and timely collation of data.

The time to comply will depend on the level of changes required from current reporting to draft QRTs; changes from 'light' to 'comprehensive' parallel run; and taking into account the extent of changes to finalise the Pillar 1 technical specifications.

The stability of the QRTs at an early stage is critical, to allow sufficient time for interpretation by insurers so that they can start data sourcing activities and develop the required processes and calculation capabilities to deliver the input into the reporting systems on time.

In addition to time spent on investigating and assessing the impact, the process of taking the new requirements and changes through governance structures should not be underestimated.

Medium-sized insurers indicated that they could probably achieve preparations within a six-month period. However, it will take several reporting cycles before the process is refined and efficient.

Process and systems

The level of data sourcing required will have an impact on system developments, implementation and testing of systems, which could also mean that manual workarounds may be needed in the transition period. Essentially at least nine months would be required to integrate the QRTs into reporting systems.

Group requirements

Group reporting is of particular importance as it will require solo entities to align certain processes, which could have a material impact on their operating models. The shorter the time frame, the more manual and/or costly the preparation and production will be. Some of the larger insurance groups envisage potential leveraging off group or parent company solutions.

Quarterly reporting

Performing full quarterly calculations will be a challenge requiring a big business change to meet the quarterly reporting requirements for the 'comprehensive' parallel run. This will have an impact on insurers' ability to meet the quarterly reporting deadlines.

Q: Once the required formats are known, what will be the biggest practical challenge in your organisation to produce the QRTs?

Figure 9. Biggest practical challenges

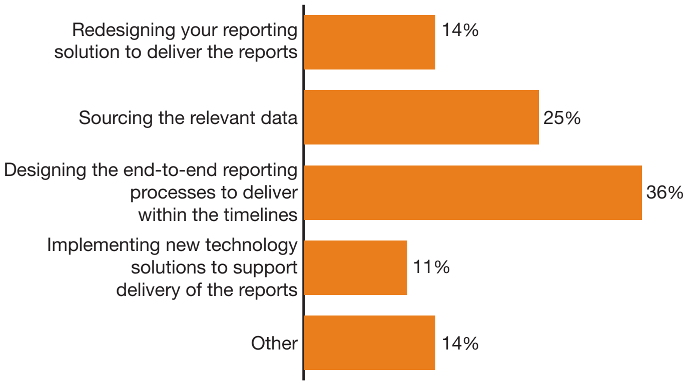


Figure 10. Life insurers

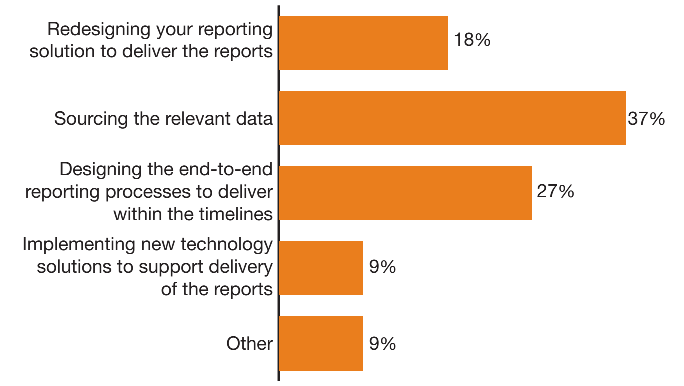
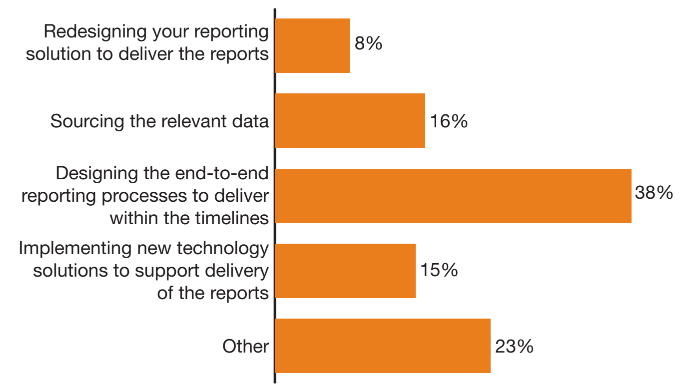


Figure 11. Non-life insurers



"Sourcing the correct data is the biggest challenge - once this is sourced, the rest will follow."

Designing the end-to-end reporting processes to deliver within the timelines is a practical challenge for more than a third (36%) of insurers. Sourcing the relevant data and redesigning their reporting solutions follows closely. Insurers consider that these challenges can be overcome with adequate time and resources. The majority of participants, who indicated other (14%), noted that a combination of all of these factors have to be in place to produce the QRTs. In all instances, it is critical for the reporting requirements to be known as soon as possible.

Sourcing the data

Insurers generally see the phased in approach of the parallel run as beneficial and one insurer indicated that in some aspects (e.g. technical provisions) the current regulatory returns could help. This would, however, depend on the data being of high quality.

More life insurers (37%) than non-life insurers (16%) indicated that sourcing data remains the key challenge. This is mainly driven by the asset data requirements, the different levels of data granularity currently available and the quality of such data.

Nearly two-fifths (38%) of the non-life insurers indicated that designing an end-to-end reporting process will be the biggest practical challenge. However, non-life insurers with an outsourced business model or making use of brokers and underwriting managers (UMAs), view data sourcing as the key challenge.

New technology solutions

Insurers agree that it will be necessary to use additional solutions or tools and implement improved automation to produce the SAM QRTs timely, accurately, and with sufficient granularity.

The timing of implementing new systems varies between insurers, but the majority see no alternative to some form of manual intervention for the initial implementation.

Although some insurers have made progress in the level of automation, others indicated that automating the extraction of data and reporting would only be done in the future as the QRTs stabilise.

Alignment with Solvency II templates

The similarity between the SAM and the Solvency II QRTs will have an impact on the design of certain insurers' reporting solutions. Until recently, the Solvency II QRTs were the only benchmark available for insurers to use in their SAM projects. Should the SAM and Solvency II templates radically diverge, redesigning reporting solutions to deliver the QRTs would then also become one of the major practical challenges for those insurers.

Various stakeholders and responsibilities

Managing the process of producing the QRTs is far reaching and complex for the responsible party (generally the finance function), as there are dependencies on various stakeholders, such as asset managers, brokers, UMAs and business partners.

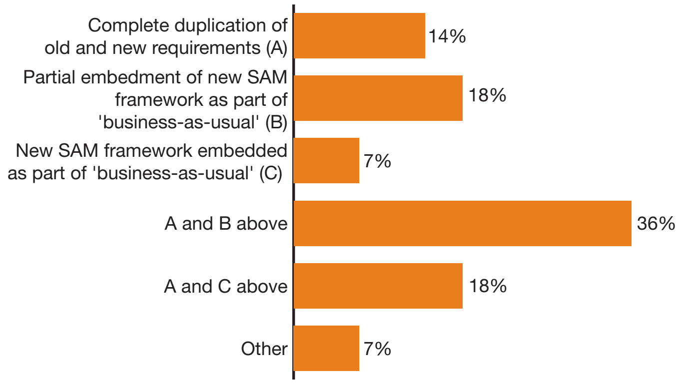
Insurers indicated that interaction is essential with external providers, but also internally with risk and actuarial functions, who are key stakeholders in contributing to a suitable end-to-end process.

For insurance groups this is relevant for each solo entity within the group. In addition, there are further requirements at a group level to collate; consolidate; sign off and report on the group results. This will increase the level of reporting complexity.

Q: How do you plan to embed the new requirements in your 'business-as-usual' during the 'comprehensive' parallel run in 2015 when existing legislation is still effective?

There is uncertainty among insurers especially relating to how they plan to embed the new requirements in their 'businesses-as-usual' during the 'comprehensive' parallel run in 2015, while existing legislation is still effective. This will depend on the FSB's requirements, but all insurers are concerned about the extent of duplication required. This will, however, receive more attention from insurers in 2014 in the hope that more certainty will emerge.

Figure 12. Managing the business during the 'comprehensive' parallel run



An evolving approach

Insurers are in agreement that they will need to comply with the existing regime, but this will require that a number of resources also be focused on the parallel runs and the upcoming implementation of the SAM regime.

Insurers believe it would be ideal to embed the SAM framework in their business by the time the parallel runs commence, but acknowledge that it would probably be unrealistic in practice. It would therefore be better to integrate the old and new reporting requirements as far as possible to avoid unnecessary duplication.

Nearly a fifth of insurers (18%) consider that selective elements of the final SAM solution will be implemented as part of 'business-as-usual', but most of it will comprise partial embedment through manual processes and workarounds (reducing throughout 2015).

The parallel runs are generally viewed as a step towards phasing in the SAM requirements. Embedding these requirements, into the day-to-day business will require intense and continuous effort over the next 18 months.

Insurers indicated that embedding the SAM requirements into 'business-as-usual' will evolve during the parallel run phases.

The insurers that are in their internal model application process (IMAP) see a further complication in that they need to report on their internal model as well as the standard model during the parallel runs.

Product development and design

Current decisions around product development and design are problematic given that certain products may only be launched when SAM is effective or even during the transition stage to the new SAM regime.

In certain cases, reporting solutions can be considered easier to develop than the capital calculation and build up thereto in this transition phase to the new SAM regime.

> *"By definition, insurers will be required to report on the old and new regime metrics so complete duplication of old and new requirements appear to go without saying"*

Q: What area of the 'comprehensive' parallel run in 2015 will be the most challenging to meet?

> *"With the QIS exercises one get to a stage where calculating the numbers is not the biggest challenge."*

Figure 13. Most challenging area during the 'comprehensive' parallel run

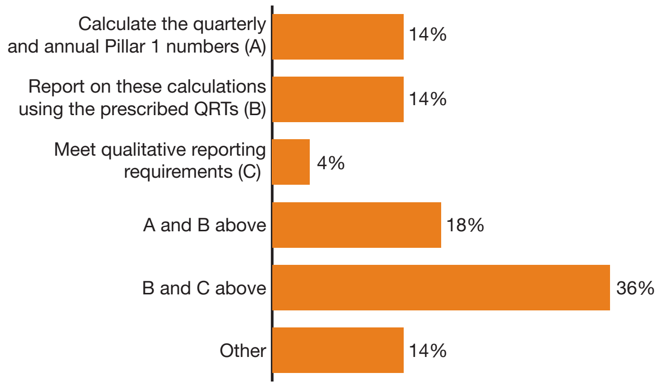


Figure 14. Life insurers

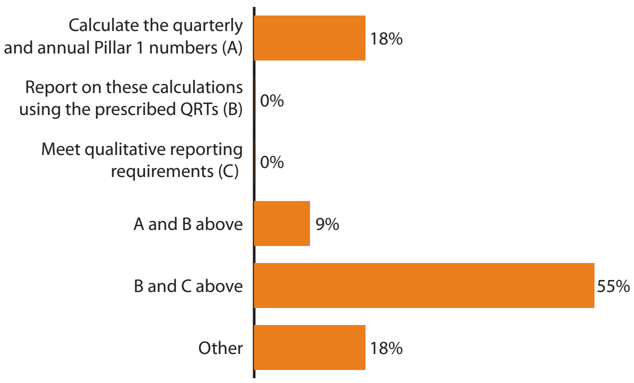
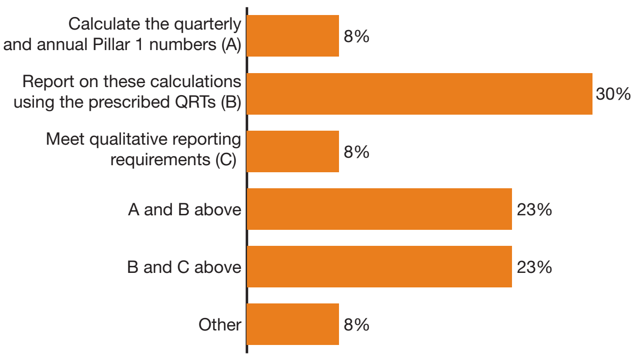


Figure 15. Non-life insurers



> *"Qualitative reporting is seen as the biggest challenge to bring a lot of things together."*

Insurers consider calculating the SAM numbers as a challenge, but believe that the Pillar 1 numbers should to a large extent be embedded as part of 'business-as-usual' given the preceding QIS exercises.

Integrating Pillar 1 and Pillar 3 will by far be the most significant challenge facing insurers. The majority of participants, who indicated other (14%), consider that embedding the ORSA in the business and producing the ORSA report will be the most challenging requirement to meet. Interestingly, more than half (55%) of life insurers would consider populating the QRTs and the qualitative reporting requirements more challenging compared to almost a third (30%) of non-life insurers who consider reporting on these calculations using the QRTs more challenging.

Qualitative requirements

Given that the qualitative requirements are still unknown, there could be a number of other emerging issues.

In addition, qualitative reporting for insurance groups will be new and will create new challenges as this brings a number of additional aspects together.

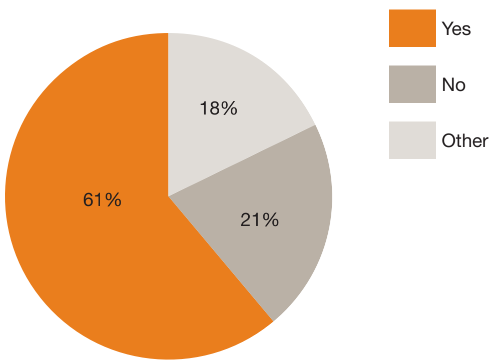
Duplication of reporting

Insurers expressed concern over the potential duplication of reporting. For example, they have questioned the value of duplication in work done for the parallel runs and the current regulatory returns, particularly the qualitative requirements. This would result in a significant level of additional work as well as costs.

One insurer has recommended that the FSB consider less reporting on the current basis and that only key statements of the current regulatory returns be completed. For example, where the same information such as movement data is requested in both the current regulatory returns and the SAM QRTs, it should only be reported once.

Q: Are your ORSA developments on track to submit your ORSA report for the 'mock ORSA'?

Figure 16. ORSA developments



> *"Without a doubt ensuring that all of the processes are in place in order to perform and report on the 'mock-ORSA' in 2015 will remain a key challenge for businesses. This is because many processes and models need to be developed, after which these processes, models and metrics need to be embedded in the business in order to be reported on in the ORSA report."*

The initial results of insurers' self-assessment for the FSB's Pillar 2 Readiness Survey, conducted in July 2012, indicated that approximately 33% of insurers considered their ORSA readiness to be weak. Given that the FSB will conduct a 'mock-ORSA' exercise in 2015, it is concerning that apparently no progress was made over the ensuing nine months, as 39% of insurers indicated their ORSA developments are not on track.

What does a 'mock-ORSA' mean?

The consensus among insurers is that they are not yet clear of the scope of the 'mock-ORSA' or on the approach the FSB will take with the 'mock-ORSA' exercise.

Early stages of development

Most insurers indicated that they are in the early stages of developing their ORSA, which includes:

- Developing an ORSA policy;
- Performing a gap analysis;
- Producing a skeleton ORSA report;
- Working groups analysing the expected requirements;
- Identifying existing ORSA principles already embedded in the business;
- Internal ORSA dry runs prior to the 'mock-ORSA' exercise; and
- Leveraging of group or parent company's ORSA.

Guidance required

More guidance is required for various aspects of the ORSA. This includes:

- Timing of ORSA reporting and whether it has to be aligned with SAM Regulatory Returns;
- The requirements for qualitative reporting versus the requirements for ORSA reporting;
- Whether a group will be allowed to submit a group-wide ORSA report and not solo ORSA reports; and
- The level of governance and review that will be required for the 'mock-ORSA'.

Q: What other important comments or questions do you have that are not covered above?

Given the far-reaching practical implications of the SAM parallel runs, insurers had the following comments:

- **QIS3 changes to the standard model**
  If the QIS 3 specifications are close to what the final position should be, then one could assume that most of the work around Pillar 1 would not be that challenging. The extension of the QIS 3 timelines, however, adds another dynamic to calculating and submission of the QIS 3 results, especially for insurers with December year ends.
- **Valuation date**
  It is clear in the SAM 2013 update when the quarterly calendar reporting timelines are. The valuation date for reporting purposes is, however, not specified for quarterly submissions. For example, for the first 'light' parallel submission on 31 August 2014, would a company with a June year end use a valuation date up to June 2014 (four quarters) or up to March 2014 (three quarters) to do the submissions. It is also noted that for insurers with year ends such as February and August to report their initial quarterly results will not result in a two-month post-quarter timeline unless the FSB's quarterly calendar reporting timelines are changed.
- **Resolution of FSB policy decisions**
  There are still a number of policy decisions, such as segmentation, reinsurance and tax, which could have a significant impact on insurers' readiness for the parallel runs.
- **Keeping to SAM timelines**
  There are questions and concerns whether the SAM timelines can be achieved given the significant development work that still needs to happen. Additional questions were asked about whether any further delays in Solvency II will potentially impact SAM deadlines.
- **FSB's own assessment of supervision during parallel runs**
  There is a concern that the FSB still has to consider its own operating model of supervision during the parallel runs and after January 2016. One insurer noted that until the FSB has considered how they will provide supervision and what they will do with all the data they receive, the requirements and specifications cannot truly be final.
- **Audit scope and requirements**
  Further guidance is sought regarding the level of audit assurance that is required.
- **Guidance on practical problems**
  Some insurers noted that they desire practical guidance in the following areas:
  - The principal of proportionality and its application, especially for medium and small insurers to ensure that an appropriate balance between costs and regulatory requirements is achieved.
  - Clarification of demonstrating use test. For example will the use test include launch of new products and assessment of pricing and capital requirements where the model will be applied in those pricing decisions.
  - Clarifications and the requirements related to the stress tests.

"It is not clear whether firms will be required to report on their financial year on two occasions 'quarterly' within two months of year end plus 'annual' another three months down the line. We note that the five-month year-end reporting deadline also implies reporting on the year end as well as Q1 on the same deadline."

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