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**Foreword**

**Solvency II** is fast-approaching and the insurance industry is gearing itself up in preparation for the introduction of a regime that will mean a step change in how risk and capital is managed. It is against this backdrop that KPMG has benchmarked the Solvency II readiness of Maltese insurance firms.

It is a reality that firms are still grasping the full scale and complexity of what is required to achieve compliance under Solvency II. Firms’ thinking on what it will take to move them closer towards the new system is in evolution. We know there is currently a considerable number of different Solvency II strategies and approaches and the extent to which firms have embraced, or are willing to embrace, the required changes varies. Nevertheless, we also know that this divergence in the market exists concurrently with an understanding by all insurers that they need to adapt, in some way or other, to meet the new requirements.

There is learning to be had from what others in the industry are doing, and understanding (and some comfort) to be gained from shared challenges. The current state of flux of the Solvency II regime and firms’ state of preparedness, coupled with the length of the journey ahead, means that firms are undoubtedly keen to understand whether they are in the pack, or lagging. Firms are interested in obtaining benchmarking information that provides them with insights on industry readiness and challenges.

In the light of this, KPMG’s Risk and Compliance Advisory Services practice has released this report outlining the results of its Solvency II Readiness Survey in Malta. This report is not intended to be conclusive. A company’s business model is a tailor-made blueprint for that organisation and its operations. There is no single formula for success in Solvency II implementation. What this report does try to achieve is to summarise information about insurance firms’ current state of Solvency II implementation, and for some of them this status report could be a starting point for further debate and discussion on some of the issues that they need to be aware of and which could affect boardroom decisions.

This document was made possible through the participation of a significant number of company representatives. Our foremost thanks go to these people, who despite their busy schedules gave so freely of their time to provide us with their responses to the survey questions. We also thank them for their willingness to share their views and discuss the issues with us. We hope that in reading the results you will find the report a useful barometer to the current state of play in Malta and an insight into how the Solvency II Directive is being applied.

With this in mind, it should come as no surprise that KPMG in Malta has a team of professionals dedicated to helping organisations from the financial sector in implementing Solvency II. The team also has access to dedicated KPMG resources across the extensive KPMG global network, thus bringing to their clients cutting edge expertise. If you would like to know more about how our firm can assist your business, please contact us, or inquire through our website.
This report is part of KPMG Malta’s Cutting Through Complexity Thought Leadership Programme.

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About this survey

KPMG in Malta launched this Solvency II survey during the second KPMG Insurance Breakfast Seminar, which was held on August 27, 2010. The survey was carried out during the months of October and November 2010 and in all thirty-four insurance companies were surveyed. The replies to the questions posed by KPMG were supplemented by short interview sessions with company representatives in order to gain a better understanding of the reasons behind their replies and to be in a position to provide more meaningful aggregate information.

The survey was designed to provide insights into the Maltese insurance industry’s initial response to the Solvency II Directive and the proposed governance arrangements. Respondents were asked to share their views on resourcing issues, about those functions within their structures that were driving the project forward, and to describe the progress they have made in implementing Solvency II. They were also asked to consider where they believe the regime adds value, where it presents challenges and concerns and where they expect it will bring about changes within their organisations.

The survey was initiated when the Solvency II Directive and the CEIOPS1 final advice on Level 2 Implementing Measures had already been published. These publications generated lively discussions in the market particularly about the prudent capital requirements contained in these proposals. By the time you read this report, the industry will be anticipating the results of the fifth quantitative impact study (QIS5) and the issues would already have started to be discussed.

We would like to thank all those who participated in this survey.

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1 As of 1 January 2011, the European Insurance and Occupational Pensions Authority (EIOPA) replaces the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).
Executive Summary

- All respondents indicated that they had actively started working on a Solvency II project. 38% indicated that their Solvency II projects are focused on one particular area, predominantly quantitative Pillar 1 issues. 85% of respondents decided to start a Solvency II project on their own initiative, without pressure from the authorities or their parent/group.

- 94% of respondents nominated an accountable individual to manage their Solvency II project, in most cases this being the Chief Finance Officer. 74% of respondents claimed that the finance department is driving the Solvency II project and 71% added that the Board is also a driver. In fact it emerged that the Board is always involved, even when it is not considered to be the driver. Over 80% indicated they have external resources involved in their Solvency II project.

- 97% of respondents do not see the need to have dedicated resource working solely on Solvency II. Insurers are utilising business-as-usual resource to undertake their Solvency II project work. Actuarial expertise is felt to be the primary missing resource.

- Only 26% of respondent firms have approved business cases and only 9% have budgets approved for their Solvency II projects. Respondents also highlighted that they are progressing with carrying out gap analysis exercises.

- 44% of companies plan to adopt the Standard Formula approach to calculate their capital requirements. An aggregate of 29% of respondents plan to adopt a partial or full internal model to calculate capital requirements. The majority of the remaining respondents claimed they are still uncertain as to the approach they will adopt, with the results of QIS5 most likely to impinge on their decision.

- Meeting compliance costs is perceived as the major challenge which firms are facing. Just over 70% of respondents stated that Board engagement is a challenge. Respondents also believe that the ORSA and the valuation of liabilities are major causes for concern with 50% of respondents specifically expressing their concern on the ORSA. Most respondents claimed that Solvency II is expected to bring about changes to management information and capital planning and some changes are also expected to existing committee structures.

- 59% of respondents do not expect a reduction in capital requirements as a result of their Solvency II project. Respondents, however, do see the Solvency II project as a strong contributor to improved data availability (68%), improved capital management (79%), enhanced risk management techniques (88%) and improved management of risks (88%).
Solvency II project: initiation, reasons and approach

Solvency II project initiation

It is encouraging that by the time we carried out our survey all our respondents indicated that they had actively started working on a Solvency II project. Specifically, 27% of respondents have initiated projects that cover all three pillars of the regime, albeit to different degrees.

38% of respondents indicated that their Solvency II projects are focused on one particular area. When questioned further, respondents indicated that the focus lies predominantly on quantitative Pillar 1 issues. Pillar 2 issues are also being dealt with by some, but were mentioned to a lesser extent, whilst Pillar 3 issues are still lying on the backburner, with respondents highlighting that it may be premature to tackle Pillar 3 matters when the requirements of Pillar 1 and Pillar 2 are more pressing and urgent.

35% of respondents said that they are assessing the Directive’s strategic impacts on their business.

KPMG COMMENT

The finding that all insurers have initiated Solvency II projects is encouraging and is a reflection of the sector’s commitment to address Solvency II in a timely manner. It is also commendable that some insurers have progressed beyond a mere assessment of Pillar 1 and Pillar 2 to assessing the broader strategic impacts of the new regime on their business. A focus on strategic impacts enables insurers to better understand the scale of requirements of Solvency II and the consequent impact on their business. This will impinge on the success or otherwise of their Solvency II implementation efforts. By looking at strategic impacts, insurers can engage in useful internal debates which will ultimately carve out the benefits of Solvency II for their business.
Pillar 1 and the associated calculation aspects are clearly the predominant focus of insurers. The debate that is currently taking place between regulators and insurers about the prudent capital requirements being proposed, is testimony to the concern that insurers have on Pillar 1 issues - hence the focus is understandable. However it is important for insurers not to overlook Pillar 2 and Pillar 3 of the regime and it is strongly advisable that Solvency II project initiatives should progress across each of the three pillars.

An understanding of Pillar 2 is even more imperative. The lessons learnt from recent market events in the banking sector should act as a trigger for insurers not to underestimate Pillar 2 requirements. Regulators have become more focused on the soundness of firms’ governance arrangements, and the embedding of risk management frameworks and controls in regulated business. In our experience, truly embedding risk and capital management change can be difficult and can take considerable time especially when this necessitates a change in mind set.

Pillar 3 requirements will bring about an increase in the level of information that insurers disclose publicly, compared to what is currently the case. Insurers should be prepared for this change as it will raise significant challenges surrounding the collation of the relevant risk management and other information required, and ensuring that there is appropriate rigour around data and reporting processes. We have found in discussions with clients that focusing on disclosure information makes Solvency II become more tangible for the finance function in an insurance company.
Reasons for starting a Solvency II project

The vast majority of respondents, 85%, decided to start a Solvency II project on their own initiative. They decided to take an early stand because they were uncertain of the impact the Directive would have on their business. However, 18% of respondent companies, especially those lacking group support, attributed the reason for starting the project to pressures from the regulator. We have noticed that some respondents, including those that started the project on their own initiative, also stated that, given the impending requirements, they had no choice other than to initiate a Solvency II project.
Approach to the Solvency II project

What is your approach to an existing/future Solvency II project?

- We will use/utilize the Solvency II project support provided by our parent company/group
- Being a solo entity or an ultimate owner, it will be worked out by us

53% of respondents have approached and will continue to approach the Solvency II project entirely on their own or by utilising the resources and support being put at their disposal by insurance management companies. On the other hand, 47% of respondents have approached and will continue to approach the project with group support.

KPMG COMMENT

The insurance market in Malta is very diverse, featuring companies which are stand-alone entities, others forming part of international financial services groups and others forming part of international non-financial services groups. Despite this diversity, it is very encouraging to note that most entities have started their Solvency II preparations regardless of any parent/group or regulatory pressure. We note that there is also considerable reliance being placed on insurance management companies. This reflects the prevalent model in Malta which is that of the managed insurance company. It is also interesting to note that many respondents which form part of financial services groups are clearly not waiting for group-wide approaches to be forthcoming but want to play an active role in charting their own Solvency II course. This is a sound approach that indicates that these companies consider Solvency II as a tool for increasing risk awareness in their companies and it also bears witness to the level of autonomy that these companies enjoy.
Management of the Solvency II project and the main drivers

Accountable individuals

The vast majority of companies, 94%, have nominated an accountable individual to manage their Solvency II project. In cases where there is high involvement from the group in the Solvency II initiative, some respondents claimed that the appointment of project managers was determined by their group or by their parent.

Different companies have charged different individuals with responsibility for their Solvency II project. The various responsible individuals include Board members, risk officers and actuaries. However, in most cases, the Solvency II project is managed by the finance department through the Chief Finance Officer (CFO) or equivalent.

Respondents, including some of those who have nominated an accountable individual, also stated that the project should not be a one-man effort, but should reflect the joint effort of all the functions within the organisation.
74% of respondents claimed that the finance department is driving the Solvency II project. Most accountable individuals have indeed been appointed from the finance department. 71% of respondents noted that the Board is also a driving force behind the project.

The Board is always involved in Solvency II projects, even when it is not considered to be a driver. Respondents highlighted that the Solvency II project mandate is always given by the Board. This high level of commitment by the ultimate decision-making body in the organisation is certainly a positive aspect.

Responses also show that a number of functions are involved in Solvency II projects even where these are not the drivers per se. Of particular relevance is the involvement of the actuarial, internal audit and risk functions.

Interestingly, over 80% of respondents indicated that they have external resources which are involved in the Solvency II project but in the majority of cases external resources are not the drivers of the project. This response can be seen in the light of the particular business model in Malta whereby certain companies are effectively wholly managed by insurance managers, with some respondents clearly indicating that insurance managers are heavily involved in the Solvency II projects of the companies they manage with some even being responsible to drive the projects forward.
KPMG COMMENT

From our experience the Chief Finance Officer (CFO) is most often the nominated accountable executive and this has been supported by the survey findings. Even where a firm has a Chief Risk Officer (CRO), more often than not, it is still the CFO who is the nominated accountable executive. The reasons for this may be that the finance function is normally responsible for capital calculations and possibly because historically the CFO has tended to be more senior than the CRO. Either way, it is encouraging to see that Solvency II is debated at Board level at most of the surveyed firms. Without top-down buy-in and commitment, Solvency II programmes will never gain the traction needed to support large scale regulatory change.

The Risk and Actuarial functions do not dominate as the drivers of Solvency II projects but this may be expected to change in the future. It is also positive that some respondents highlighted the specific involvement of these functions and this shows a growing maturity in the sector and the opening up to these new roles and responsibilities.

Our view is that we should expect more functions to become involved in driving implementation, as projects progress towards integration and embedding phases. In these later stages we expect to start seeing business areas such as Operations, Underwriting etc. becoming more active in driving the projects forward. The confirmation by respondents that other functions e.g. Internal Audit are also involved in their Solvency II projects shows that firms are appreciative of the wide-ranging implications of Solvency II and the need for firm-wide understanding and embedding of the requirements of the regime and have adopted the good practice of a multidisciplinary approach.

Cross-functional involvement is to be encouraged because it enhances communication between functions. In our experience there is much need for this increase in communication, particularly between the Risk and Finance functions. Traditionally we have witnessed little communication between these functions, and part of the issue may, perhaps, have been territorial, with professionals from each discipline worried about losing responsibility for certain activities. There is still some way to go before these lines of communication are optimised but Solvency II may be bringing about the desired change.
Resourcing issues under Solvency II

Allocation of resources

The overwhelming majority of respondents (97%) do not see the need to have a dedicated team working solely on Solvency II, and have assumed the responsibilities for Solvency II as part of their normal business operations. A very minor few indicated that whilst they do not have a dedicated team working on Solvency II nevertheless, individuals within the organisation have been selected to focus on driving forward the Solvency II initiatives, in addition to their existing roles.

"Responsibility for Solvency II is spread amongst different departments and no team is dedicated fully to the project”

- Survey Respondent
The survey findings highlight a low level of dedicated resource. This situation may be primarily driven by the fact that most insurance companies in Malta believe they are not large enough to merit such dedicated resource. Whilst this may hold for the majority of companies, yet some of the more important players would, in our opinion, be expected both by the market and the regulator to have a dedicated resource.

It is advisable that insurers adopt measures to start becoming more aware of the demands on staff which Solvency II will generate and the scale of change expected in this area. Staff having Solvency II competencies will be in increasing demand as companies will look to recruit in support of their evolving Solvency II projects. Those insurers who recognise early on the need for such focused resources will beat the competition in accessing this potentially limited resource pool.

The findings clearly underline a tendency by insurers to utilise business-as-usual resource to undertake Solvency II project work. Understandably such an approach has its merits because solutions developed by staff sitting within the business are likely to be more aligned with the business’ needs, and will have a greater chance of becoming embedded later in the process. There is however, a potential drawback because when the same individuals are expected to juggle between Solvency II work and their existing responsibilities, inevitably Solvency II initiatives will tend to be placed on the backburner. In this manner it will be less easy to achieve early traction for the project and as a result there is a risk of delay in implementing the programme fully.

The right team structure will however depend on the structure of the organisation. How easily can staff keep time ring-fenced for Solvency II whilst continuing with their business-as-usual role in current market conditions? Does the culture support business ownership of centrally developed solutions? In our experience often the ideal solution takes elements from both arrangements – comprising a small dedicated programme team driving the project forward, with most project deliverables coming from, and owned by, the business.
Resources required for the Solvency II project

76% of respondent companies expect to be able to tap into their own resources when preparing their Own Risk and Solvency Assessment (ORSA) while 65% are confident they can utilise their own resources for the implementation of a Solvency II-compliant system of governance. Interestingly 74% of respondents claimed that their own resources are sufficient to address insurance risk under Solvency II, both its quantification and its overall management.

External resources will predominantly be required for actuarially driven areas and processes, including internal modelling, use of simplifications and market valuation of liabilities. With respect to internal models, only 26 out of the 34 companies surveyed provided their views. The rest were unwilling to consider the scenario, possibly because they have definitely ruled out developing an internal model under Solvency II. Some companies also stated they have acquired resources in the form of data modelling applications for the purposes of developing internal models. The actuarial function is seen as an external resource needed by virtually all companies, including those companies expecting actuarial support from their group.

KPMG COMMENT

There is a general feeling across the market players that the resource which is primarily missing is that of actuarial expertise. Most respondents noted that whilst in most areas of Solvency II they expect to be able to utilise own resources together with external assistance and expertise, the actuarial aspects of the regime, which they quote as being substantial, are beyond their current resource capabilities.

Therefore they must necessarily pitch for external resource. It is encouraging to note that many respondents are willing, and feel it is beneficial in the long term, to look into enhancing their resource pool with this specific expertise, particularly in view that the actuarial function will become mandatory under Solvency II.

We also note that companies are fully aware of, and are also considering, the possibility to outsource certain functions under Solvency II. It is likely that we will witness a move towards this solution within the local market as Solvency II draws closer.
26% of firms have approved business cases and only 9% have budgets approved for their Solvency II projects, although a significant number of respondents claimed that these are in progress. Interestingly 21% said they are not considering going through a business case approval process while 26% stated that they will not engage in a formal budgeting process which would be subject to Board approval.

While most firms have kicked off their Solvency II projects, 50% of respondents claimed that implementation plans are in progress and 71% of respondents noted that an analysis of the implications of Solvency II on their risk management framework is in progress. The majority of respondents also highlighted that they are progressing with carrying out gap analysis exercises and calculating capital requirements under the regime, with 15% also remarking that their gap analysis exercise is complete.
KPMG COMMENT

Generally we observe a lack of ‘business case’ and ‘budget’ culture within the local market. Clearly little time is being allocated to evaluating the costs associated with implementing the requirements of Solvency II and presenting formal business cases for approval by the Board. It is worth noting that a budget and a business case tend to ‘focus the mind’ and with them comes, perforce, a better understanding of the Solvency II requirements. Without a budget, a Solvency II project would appear bottomless, something which it should not be and which really does not make business sense.

We observe that there are some firms which have moved into the implementation phases of their Solvency II projects without apparently having initiated or completed a gap analysis. Where gap analysis exercises have been undertaken, we observe a variety in the quality and depth. This raises concerns around potential gaps which may not be identified by insurers in a timely manner and a project scope which is not properly co-ordinated and aligned.

Best practice advocates that, in light of the magnitude of this new regime, insurers should look to complete a comprehensive gap analysis against the principles of the Directive, covering all three pillars of the Solvency II requirements. This call for comprehensive gap analyses by insurers is also being heard in some EU jurisdictions, coming from the industry regulators.

By carrying out a meaningful gap analysis firms will obtain an early independent assessment of their status of compliance against the current Solvency II Directive. This, supported by a comprehensive implementation plan with clear milestones, will help ensure that management is fully aware, and can act on, resource needs as well as the process and solution issues. Large scale regulatory projects will always include an element of re-scoping as requirements become clearer and the translation of requirements becomes better defined. Knowing the gaps and acting on them will go a long way towards a smoother journey to achieving compliance with fewer last minute surprises and the associated cost of addressing unforeseen issues.
56% of respondents claimed that they have participated in QIS4, with 84% of these (47% of the total sample) stating that they have participated through a full submission. All participants have claimed that they are participating in QIS5.  

KPMG COMMENT  

It is encouraging to note that the vast majority of firms are looking at QIS5 as an opportunity to assess closely the implications of Solvency II on their capital requirements. The general attitude is that the exercise is being viewed as fundamental to insurers' preparations for Solvency II. There is widespread commitment amongst the players in the market to address QIS5 by applying the necessary amount of resources in terms of expertise and timing, to ensure that the exercise is beneficial to the entity and produces meaningful results which can be used as a basis for decisions going forward.

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1 CEIOPS ran QIS5 between August and November 2010. All insurers and reinsurers should have sent their submissions to the national regulator by October 31, 2010. Insurance and reinsurance groups should have sent their submissions to the national regulator by November 15, 2010.
Calculation of capital requirements under Solvency II

Calculation approach

Which calculation approach will be adopted?

44% of companies plan to adopt the Standard Formula approach to calculate their capital requirements. Some respondents expect to utilise Undertaking Specific Parameters. A number of respondents claimed they will start off with the Standard Formula but expect to have to evolve into using other approaches in the future. It is worth noting that an aggregate of 29% of respondents plan to adopt a partial or full internal model to calculate capital requirements. However, the general feeling is that the decision on the calculation approach is very much dependent on the results of QIS5.
KPMG COMMENT

We view the response by 29% of the respondents, indicating that they will calculate capital requirements through the use of a full or partial internal model, as positive and as a clear sign that the initial scepticism towards the regime is being replaced by a desire to identify the opportunities which Solvency II could offer.

The main reason why firms intend to use full/partial internal models is to achieve an enhanced understanding of the risks to which the business is exposed and the capital required to support those risks. Full/partial internal models are also increasingly being seen as a tool to enable firms to optimise their capital allocation thereby resulting in improved capital efficiency and potentially improved risk-based product pricing.

The indication of companies’ willingness to utilise full/partial models to calculate capital requirements is a reflection of the very niche insurance business offerings in Malta. Some insurers are finding that the Standard Formula under Solvency II does not capture their specific realities and therefore is penalising in terms of capital requirements. Hence they are looking to develop their own models to parcel out certain risks which they feel are resulting in unreasonable capital requirements, in terms of the Standard Formula parameters as they stand to date.

Those insurers who intend to go down the path of full/partial models may have a difficult task ahead of them due to the significant challenges associated with developing an internal model. Firms choosing this option will have to contend with significant business change necessary to achieve internal model approval. In reality these firms will have to deal with issues surrounding availability of data, they will need to implement robust modelling which is documented at a detailed level, and importantly they will need to demonstrate the use of models, and robust risk management and governance across the organisation, to the regulator.

In view of the degree of complexity surrounding the implementation of an internal model it is possible that some firms may change their view on the matter as they come face-to-face with the reality of implementation. Some firms may find they can develop a full internal model only in the long term. Many may see model development as an iterative process and develop the model, to supervisory standards, in stages using partial modelling approaches for the key risks they are exposed to.

From our interaction with the market, we have seen the QIS5 results play a determining role in firms’ decisions on whether to go for the Standard Formula option or advance to more complex and tailored modelling solutions. Indeed, following completion of QIS5, we have seen firms fast-tracking propositions to their Board for approval to pursue a full/partial internal model route. Other firms are still assessing the implications of QIS5 parameters on their capital requirements and are currently in the process of determining the manner in which they will calculate capital requirements under the new regime going forward.
Implementation challenges, concerns and expected changes

Implementation challenges

Respondents identified almost all the areas considered in the survey question as presenting implementation challenges under Solvency II. However, meeting compliance costs remains the major challenge which firms are facing in advance of the regime. Indeed, some respondents clearly claimed that the requirements are burdensome and will cost both time and money.

Integrating and embedding risk management in the business is also being viewed as a significant challenge under Solvency II. The same can be said for actuarial resources with 85% of respondents claiming this is an implementation challenge of significance.

Interestingly just over 70% of respondents stated that Board engagement is a challenge. Some respondents maintain that the Board lacks the technical knowledge required by Solvency II.

50% of the respondent companies do not deem the clarity of Solvency II to be a major challenge as they reaffirmed they can tap into external assistance in cases where they feel they need more understanding of the requirements and their implications.

“The Board is a challenge because most of the members are new to Solvency II”

- Survey Respondent
KPMG COMMENT

It comes as no surprise that a real challenge for local insurers under Solvency II will be that of meeting implementation costs. Admittedly Solvency II is a large and relatively complex regime which is difficult to interpret, particularly the inter-relationships between its different elements. The concerns around implementation costs may also potentially signal the lack of clarity around the requirements, which may be causing concerns for firms. Firms that misinterpret the requirements and underestimate the efforts required to implement the changes run the risk of significant additional implementation costs and of being placed under the spotlight by the regulator.

We cannot stress enough the importance of ensuring Board commitment to Solvency II. It is worrying that some are still viewing Board engagement as a big challenge but this is also not surprising in view of the radical outlook on insurance activities which the regime is proposing and which therefore calls for a fresh approach even at Board level. We sense a real problem locally with Board expertise. Gone are the days when a director appointment means just attending a Board meeting once every quarter. It is to be expected that individuals with a risk background or understanding will be in great demand, going forward. We also believe that there is a need for the introduction of a culture of Board training within local entities. We are aware this is not widespread practice at the moment but we feel it is going to become crucial going forward especially in the wake of regulatory regimes such as Solvency II.
Implementation concerns

Similarly to implementation challenges, respondents are concerned on almost all areas considered in the survey question, albeit to varying degrees. 50% of respondents highlighted the ORSA as being their most significant cause for concern under Solvency II. 56% noted that the market consistent valuation of (insurance) liabilities is also a highly significant concern while 65% claimed that the use of simplifications is an area of significant concern. With respect to internal models only 26 out of the 34 companies surveyed provided their views and the majority of these consider it to be an area of significant concern. The rest were unwilling to consider the scenario possibly because they have ruled out any eventuality of developing an internal model under Solvency II or because they are not yet cognisant of the benefits, if any, that a model would have on their capital requirements. Individual risks under Solvency II (operational, credit, market and insurance) were also indicated as being areas of certain concern.

“ORSA is a cause for concern because it is still a grey area, notwithstanding our group support”

- Survey Respondent

KPMG COMMENT

Much concern surrounding the ORSA is understandable in view that to date there has been little definition of the expectations of firms in this respect. Firms are therefore aware of the importance of the ORSA, wish to do a good job of it, but do not have in hand clear guidelines on what is expected of them. On the other hand, we sense there is a tendency for technical issues to be a cause of worry to insurers as they imply the need for technical expert resource. These concerns should be seen in the light of the fact that insurers are viewing expert resources as a challenge under Solvency II.
Changes required to the business

The majority of respondents claimed that most changes will be required in respect of management information and capital planning, 68% and 71% respectively. 82% of respondents noted that they do not expect that Solvency II will bring about changes to the structure of their capital. This is reflective of the current capital structure of most insurers in Malta which mainly comprises equity capital and very little subordinated debt and lower tier capital.

Interestingly only 21% of respondents noted that Solvency II is expected to bring about possible changes at Board level. 32% of respondents expect some changes to be made to the structure of their existing committees while 65% of respondents noted that Solvency II is going to result in the setting up of new committees.
KPMG COMMENT

The expectation by firms that Solvency II will bring about changes to management information is reasonable. This is to be expected particularly with the hindsight of the experience of the banks following the implementation of Basel II. Many banks had commented that the large volumes of robust and consistent data which sharpened strategic decision-making were the most immediate and strongest benefit of Basel II. The same can be expected of Solvency II.

The expectation by companies that Solvency II will bring about changes to their committee structures, primarily by resulting in the creation of new committees, reflects an understanding by companies that the regime will require of them a more formalised governance system than that which is practised currently. It could potentially also imply that insurers feel the need to have committees which to date have not featured in their governance structures, such as the Risk Committee, which would align with the focused requirements of Solvency II.

Whilst many insurers view Board engagement as a challenge under Solvency II, they nevertheless do not expect to see major changes to their existing Boards. This resistance to change may be expected, particularly in a small and relatively tight-knit finance community such as the one in Malta. In light of this observation one would urge insurers not to be afraid to take the necessary actions even though these may cause discomfort initially. It is expected that proactive Board members will identify their limitations and should welcome changes to their Boards, including the introduction of new faces on the Board, that bring a fresh and perhaps more technical approach to Board discussions.
The value add from Solvency II

Expectations of value-added

59% of respondents do not expect a reduction in capital requirements as a result of their Solvency II project. On the other hand most respondents see the Solvency II project as contributing high/significant value to improved data availability (68%), improved capital management (79%) and enhanced risk management techniques (88%). 88% also envisage that it will bring about high/significant value-add to the way that they currently manage their risks.

KPMG COMMENT

Many firms expect Solvency II to bring business benefits to a number of areas of their operations. It is worth noting however that these expectations will only materialise if firms can make the required regulatory-driven changes work for the business – projects seen purely as compliance initiatives are unlikely to bring real value.

It is evident that firms are more convinced of the impact that Solvency II will have on risk management than they are of the capital reductions that may be realised under the regime. This is a consequence of the fact that medium sized and smaller firms are less likely than the larger firms to see capital incentives or diversification benefits. The local market is principally constituted of such firms.
Conclusion

The findings of the survey clearly show a warming up to the Solvency II regime by the local insurance sector. There is an evident change in sentiment now, than what could be observed until perhaps some time ago. The triggers are various but notably the regulator’s active involvement in the sector’s preparedness, the reality of QIS5 and the proposals in the CEIOPS final advice on Level 2 Implementing Measures acted as stark awakening calls.

Many firms are now fully in preparation mode however there is still some way to go. To meet the current January 2013 target date, firms have to step up the pace of implementation considerably and obtain Board approval on a process to be followed and an associated budget. The key enablers to a successful Solvency II project lie in having a clearly defined strategy which brings to life a vision of the end state and extending the focus from one which is compliance-driven to one which embraces the business holistically.
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