

QIS5 SURVEY

# BARNETT WADDINGHAM – QIS5 SURVEY

## INTRODUCTION

QIS5 is expected to be the final of the Quantitative Impact Studies conducted by the European Commission in the run up to the implementation of Solvency 2, which is due to go live on 1 January 2013. There is the possibility of a QIS6 as there are still a large number of outstanding issues, but taking into account the lack of time available it seems unlikely that a further study across the whole industry will be required.

The target participation for QIS5 was 60% for “solos” and 75% for “groups” and the European Commission was keen for medium and small sized entities to take part. The supervisors are currently putting together country reports and the results of QIS5 are expected in March 2011.

The European Commission and supervisors wanted results to be of a good quality and act as a dry run for the real thing, rather than a best effort as previous studies have been, so that key stakeholders can understand the likely quantitative impact of Solvency 2. Due to late changes to the specification, models not being completed and additional requirements such as the detailed qualitative questionnaire and equivalence scenario, QIS5 has been a challenge for most participants.

As the country reports and overall report will not be available until later this year, we thought the market would like to have a ‘preview’ of the results. Barnett Waddingham conducted a survey in late 2010 to find out what the potential impact of Solvency 2 will be on businesses both now and in the future.

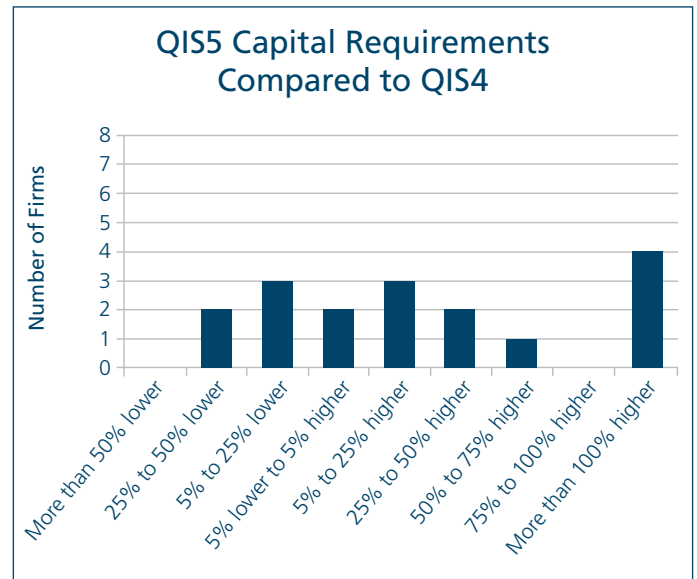
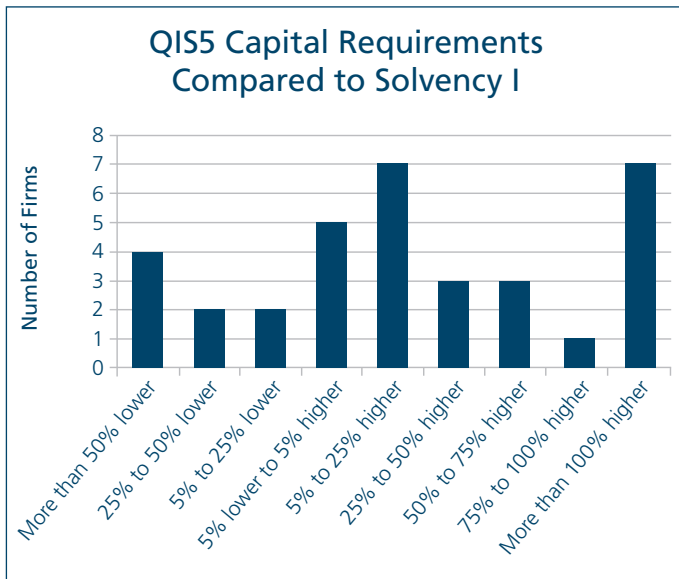
Our survey was sent to a wide range of undertakings. We received 37 completed responses, comprising 22 life, 11 non-life and 4 composite undertakings, of which:

- 8 are listed companies, 7 are Lloyd’s syndicates / London market firms and 12 are from the Mutual sector
- 10 write reinsurance business
- 95% classify themselves as small or medium
- 19 are part of a group of which 10 did a whole group submission
- Only one of the respondents did not complete the QIS5 exercise
- 22 respondents took part in QIS4.

The questions covered a range of topics including processes, results of the QIS5 exercise and the impact Solvency 2 is expected to have on their businesses.

- There was considerable variation in capital requirements under QIS5 compared with Solvency I, usually being higher under QIS5. Nearly 1 in 5 identified capital requirements under QIS5 more than 100% higher than under Solvency I.
- Despite this, 78% of undertakings surveyed have sufficient funds to cover the capital requirements.
- 64% of non-life undertakings responded that the Standard Formula provided a poor representation of their risk profiles.
- 83% of undertakings did not use an internal model to assess capital requirements under QIS5; only 27% of these are now in the process of having one approved.
- 48% of respondents found completing the spreadsheet problematic and 32% found completing the questionnaire problematic. These were the main problems with meeting the requirements of the technical specifications, rather than the calculations themselves.
- 56% of undertakings required external resources to complete the study.

## QIS5 RESULTS



### Capital Requirements

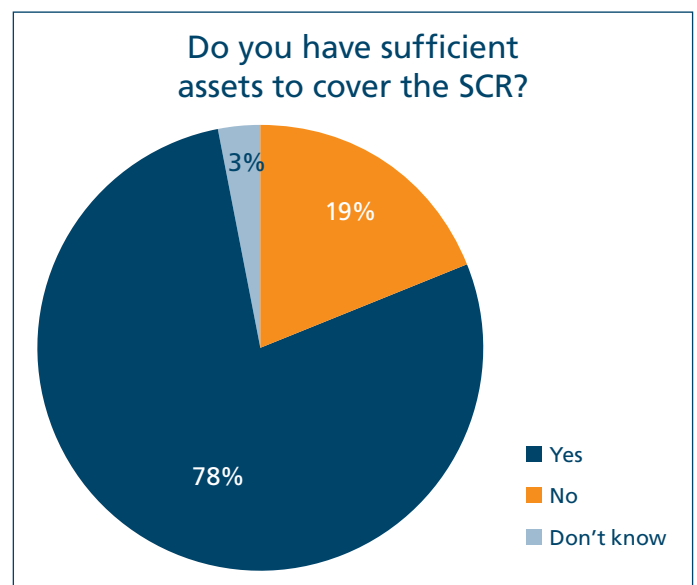
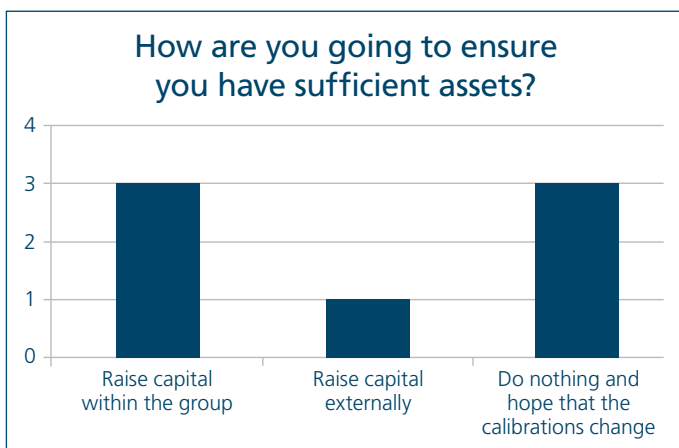
Overall, capital requirements under QIS5 are higher than those under Solvency I and QIS4. 19% of respondents identified capital requirements under QIS5 more than 100% higher compared to Solvency I.

From our survey, 60% of non-life undertakings now have capital requirements more than 50% higher than under Solvency I, compared with only 25% of life undertakings.

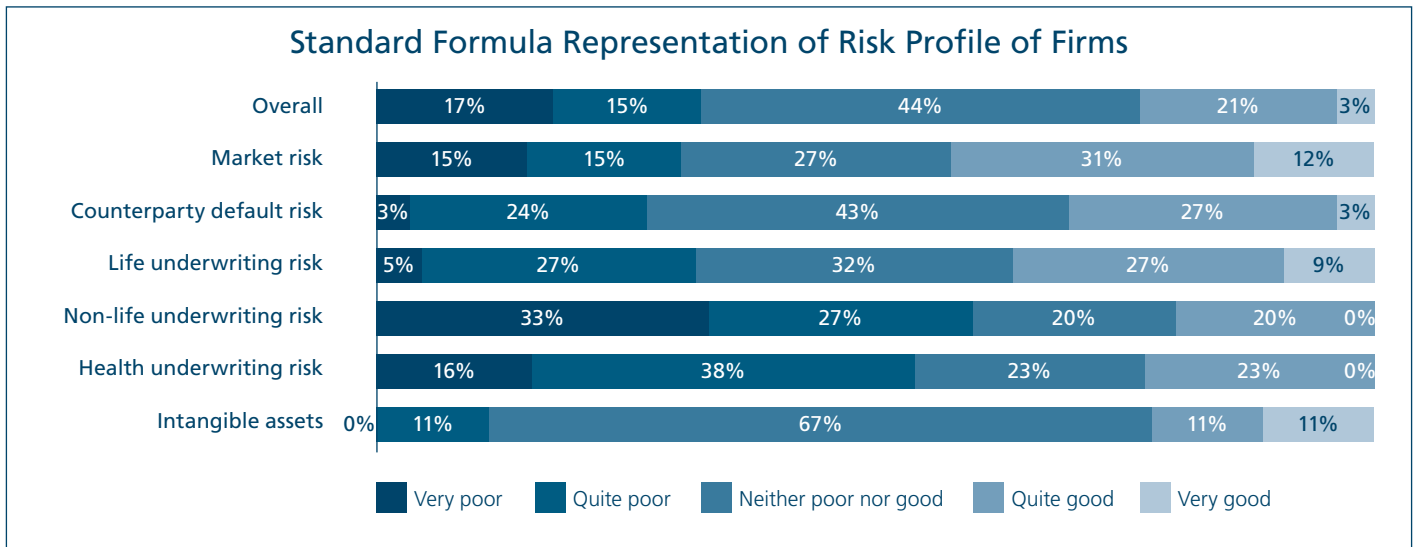
The difference between the capital requirements of QIS4 and QIS5 is less dramatic, with only 5 of those surveyed reporting that the QIS5 requirements were more than 50% higher than QIS4.

### Sufficient assets

78% of those questioned have sufficient funds to cover the Solvency Capital Requirements (SCR) under QIS5. Only one of the remaining 22% is planning to raise capital externally.



## QIS5 RESULTS *continued*



### Standard Formula

Overall, 32% of respondents think the Standard Formula is a poor representation of their risk profile, with 24% finding it a quite good or very good representation.

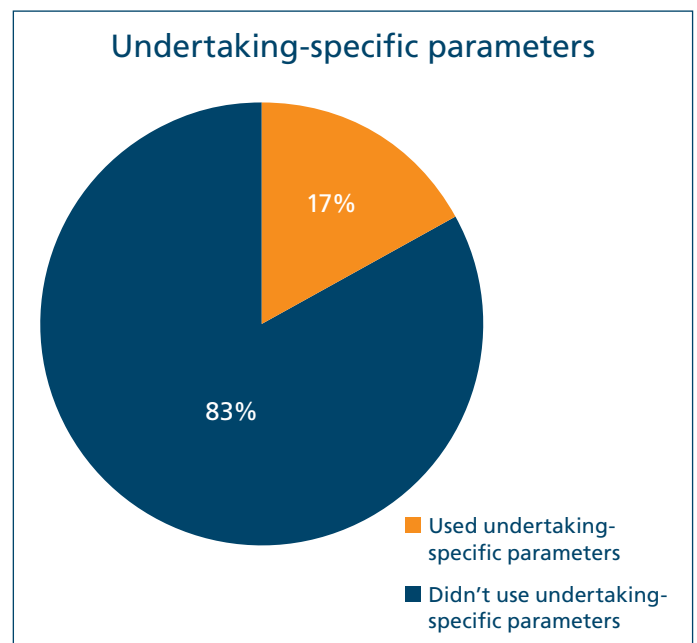
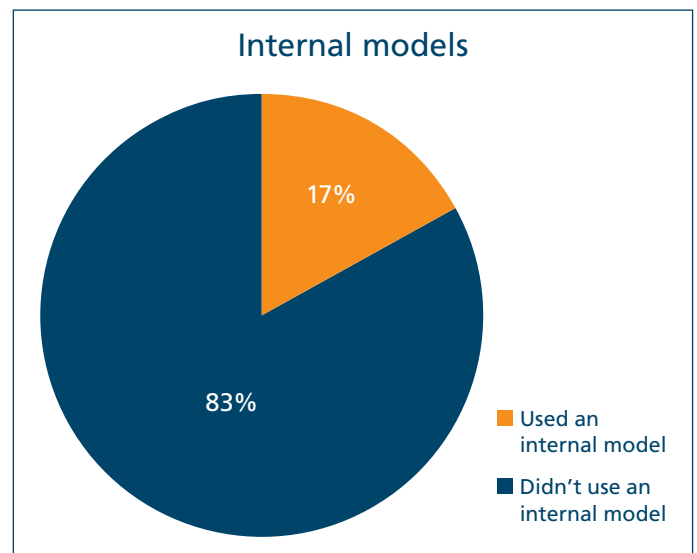
An interesting comparison is how the Standard Formula for the life and non-life underwriting risk modules reflect the risk profile of the insurers. The life underwriting risk module received very mixed reviews, whereas the non-life underwriting risk module results were skewed towards it being a poor representation; this reflects the general feeling of the industry that the capital requirements for non-life undertakings still need significant adjustments. The Standard Formula was devised to represent the 'standard' firm in the EEA. It will be interesting to see how the results compare with other country reports.

### Internal Models

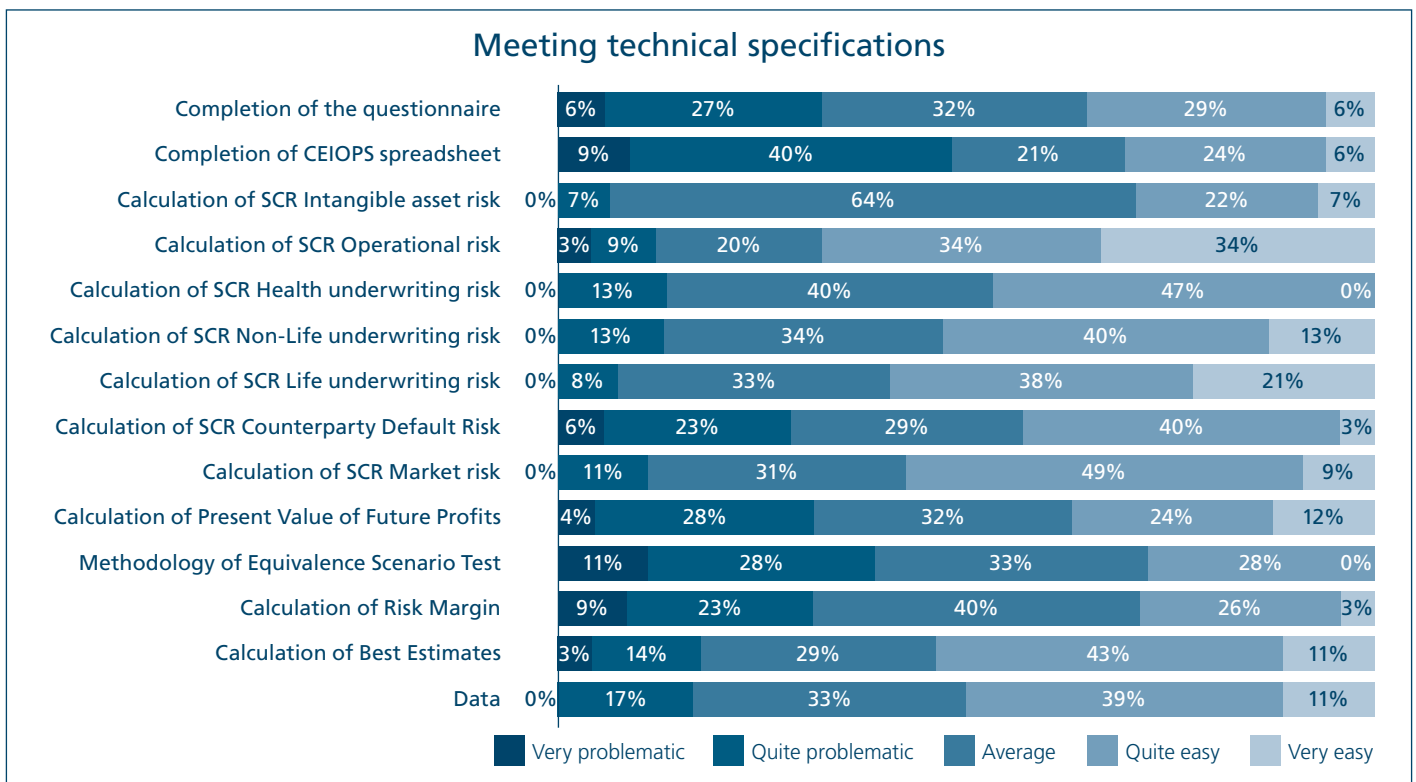
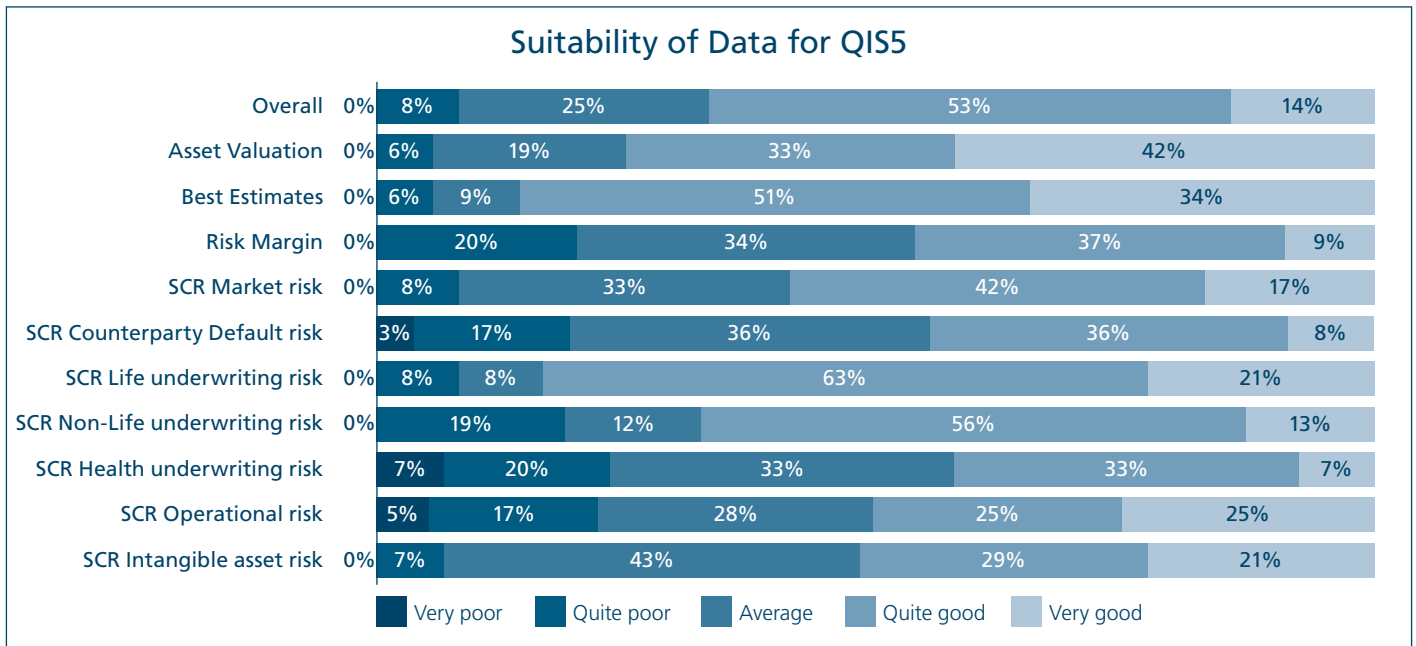
17% of respondents used an internal model for the QIS5 exercise. 27% of those who used the standard model are in the process of having an internal model approved.

Co-incidentally 17% of respondents used undertaking-specific parameters (USPs) in conjunction with the standard model for the QIS5 exercise. 20% of those who did not use USPs are in the process of having them approved or are now considering using them.

56% of non-life undertakings that participated are in the process of having an internal model approved, compared with 12% of life undertakings.



## QIS5 PROCESSES



### Suitability of Data

Most respondents think that overall the data they currently have is suitable for QIS5, with 92% giving a response of at least average suitability.

The responses on the suitability of data for various aspects of QIS5 varied slightly. 85% of respondents think that data for the best estimate is quite good to very good. This compares with responses on the quality of data for the counterparty default risk where only 44% responded that data was either good or very good.

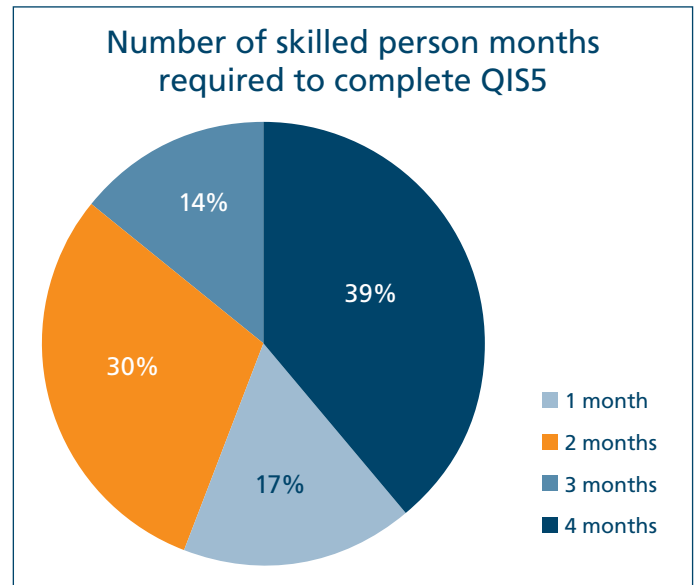
### Meeting specifications

There is one aspect that both life and non-life respondents found particularly difficult to complete - the CEIOPS (now EIOPA) spreadsheet and questionnaire. Possible reasons for this are that numerous versions of the spreadsheet that were released before the final one, or perhaps firms not allocating enough time to complete these tasks as they were thought to be straightforward. The calculation of the risk margin, which now takes into account diversification between different lines of business, also caused problems. However the availability of a number of simplifications will have made this an easier requirement to meet than in previous studies.

## QIS5 RESOURCES

56% of respondents said they did not have sufficient resources to complete QIS5 and had to recruit or use external resources. Out of the 20 undertakings that hired external resources only 40% replied that they worked well with the internal team; 30% replied that there was transfer of knowledge by using external resources and 35% responded they will use this approach in future Solvency 2 projects.

There were differences in the man-hours needed to complete QIS5, with 17% of undertakings completing the exercise within one month of a skilled person's time and 39% requiring 4 months.



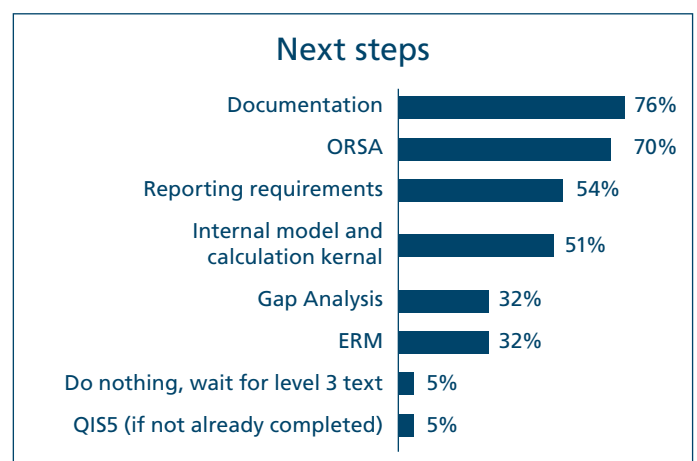
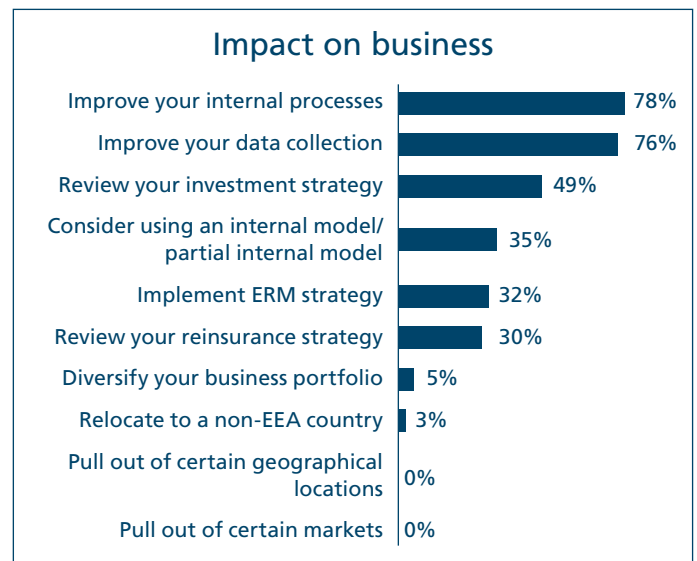
## LOOKING FORWARD

Whilst Solvency 2 poses many problems, this exercise has raised some issues that respondents will now be addressing. Over 75% of undertakings will be improving their process and data collection. What is reassuring is the low expectation of undertakings pulling out of certain markets and geographical areas.

An interesting observation is that our survey shows that 91% of non-life undertakings are now going to be reviewing their data collection processes following QIS5, despite the results that the data was largely suitable.

The focus for undertakings will now be other aspects of the Solvency 2 regime. 70% are focusing on the ORSA, including 88% of listed companies, 67% of the Mutual sector and 43% of Lloyd's syndicates and London market firms. Only 32% are giving attention to ERM, which is surprising given the current emphasis in the industry about the importance of good ERM.

76% of respondents stated that they were either 'quite confident' or 'very confident' that they would meet the Solvency 2 requirements by 2013.



## BARNETT WADDINGHAM COMMENTS

Participation in QIS5 was expected to be much higher than any previous QIS exercise raising concerns that those who had not submitted previous exercises would not be as well equipped to complete QIS5 and would be behind in the process of implementing Solvency 2. There does not appear to be much difference in any of the results from our survey between those that completed QIS4 and those that did not.

It is not uncommon for the QIS5 requirements to be more than double the current capital requirements but as our survey shows this is not consistent over all sectors of the industry with some faring better than others. It will be interesting to see from EIOPA's reports in due course whether this impact is consistent with the rest of Europe.

2013 is not too far away and some companies are better prepared than others. From our survey it is reassuring that insurers have ORSA in Pillar 2 and Reporting Requirement in Pillar 3 high on their agendas.

Needless to say more guidance and further clarifications from EIOPA are needed. Learning from the QIS5 exercise, binary events, risk margins in the technical provisions, CAT risks, revision risk are just some of the issues that need resolving in Pillar 1. Some issues pose slightly different levels of difficulty for life and non-life undertakings. These issues are not impossible to resolve but they may require some thought and extra resources.

## COMMENTS FROM PARTICIPANTS

"The S2 concept is dangerous and will result in a riskier industry"

S2 and the results of QIS5 will lead to an "Increase in the amount of pointless work"

"Proportionality is unclear for medium/small insurers"

"CEIOPS spreadsheet was not particularly user-friendly"

## HOW BARNETT WADDINGHAM CAN HELP

Barnett Waddingham's Insurance Consulting Practice can assist on all aspects of your Solvency 2 implementation project. We have worked with a number of firms on QIS5 and GAP analysis.

Our consultants attend all FSA Solvency 2 meetings and are up to date on the current issues and status of Solvency 2 implementation.

*We would like to thank the participants for taking the time to complete our survey.*

## FOR FURTHER INFORMATION

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