White Paper

Will your process efficiency impact your operational viability in a Solvency II world?

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Are you tackling the right issue?

With the Solvency II deadline potentially delayed until January 2014, and continued uncertainty surrounding the final shape of the legislation, the insurance market is tasked with a significant challenge. Most of the time and effort expended on Solvency II thus far has been spent on implementing systems and procedures for measuring and calculating levels of capital and prime risk. However, without adequate processes and controls in place in business operations, the capital adequacy levels required could be adversely impacted by operational risk weightings with consequent impact on the competitiveness of the organisation in question. In order to maintain operational viability post-Solvency II, insurers will need to devote a comparable amount of resources towards ensuring they have best practice processes that are controlled, auditable, and able to adapt to future strategic and legislative change.

Solvency II rationale

Consisting of three pillars, the Solvency II framework covers different aspects of the economic risks facing insurers. The first pillar concerns the requirement for insurers to measure their risk and subsequently hold sufficient capital reserves. The second pillar focuses on management and control of these risks and the third pillar details requirements for disclosure and transparency of information to both supervisors and the public domain. Understandably, much of the focus to date has been on the first pillar but the second pillar will also have a significant impact on the overall capital reserve requirement.
The headline objectives of Solvency II involve facilitating the development of a single market in insurance services in Europe, promoting confidence in the financial stability of the insurance sector, and securing an adequate level of consumer protection by reducing the chance of an insurer being unable to meet claims in full. Fundamentally however, Solvency II is about a change of behaviour, managing your business better and proving that you are doing so.

The impact of operational risk

Operational risk, one type of risk indentified in the Solvency II framework, involves the capital charge for 'the risk of loss arising from inadequate or failed internal processes, people, systems or external events'. This type of risk is the largest threat to insurers primarily due to the complex interactions between risk, business processes, and subsequent losses incurred. Whether through claims management, underwriting, renewals, invoice handling, or help desk procedures, process inefficiencies and operational losses can occur across the business. If the processes inherent within an organisation are poorly implemented, inefficient, or difficult to enforce and audit, then the regulator can deem there to be an operational risk issue. This in turn can cause them to negatively weight the capital adequacy requirement and so increase the level of capital the business requires to hold.

Simply complying with the directives outlined in Pillar 1 and Pillar 2 and practicing successful risk management is not necessarily sufficient as Pillar 3 demands a volume and granularity of data that *proves* to supervisory and public audiences that the organisation is truly transparent and accountable. However since measurement, management, and disclosure of operational risk exposure across all areas of the business has not been routinely conducted in the past, gaining a comprehensive view of operational risk represents one of the greatest challenges for insurers.

Why process management will be key

In terms of operational viability, for those with poor business process management the implications are twofold. Not only will competitive advantage be hindered by increased capital adequacy requirements calculated from operational risk, but overall operating costs will be higher than necessary due to process inefficiencies. Combined, these issues have the potential to create significant changes in the competitive positioning of insurers within the industry. Add to this other considerations such as quality of customer service, risk based pricing, and product viability in a Solvency II world, and it becomes apparent why business process management will undoubtedly be a key influence in who resurfaces as winners in the new regime.

Traditionally business process management within insurers has focused on the end customer as organisations strive to improve and differentiate through customer service provision whilst also trying to meet internal productivity, quality and cost targets. With risk management underpinning the Solvency II regime, organisations need to look beyond the use of traditional tools employed in the past such as Excel, ad hoc reports and email archives and instead begin to utilise more sophisticated solutions that can orchestrate access to these disparate sources of information and provide the Board with a holistic view of the organisation's business processes and operational risk factors.

While Solvency II demands Boardroom accountability, all employees across the organisation must share the responsibility for operational risk and understand their roles and interdependencies. The additional administrative demands that meeting Solvency II requirements places on employees has the potential to cause rejection of new procedures, particularly if these demands are impacting on the ability for employees to deliver service standards expected within day-to day operations.

Deploying a solution that enables the end-to-end automation, distribution, and recording of processes not only enforces the use of these processes and facilitates adoption, but allows production of audit trails and digital documentation that demonstrates that these processes have actually been adhered to. This degree of operational insight enables proactive, timely decisions to be made to reduce operational risk and subsequent capital adequacy requirements, but also serves to highlight other process inefficiencies across the business where further cost savings can be made.

With news of Omnibus II finalisation being delayed, setbacks to internal model approval deadlines, and uncertainty surrounding the future availability of currently deployed Solvency II consultants, the demands associated with Solvency II are constantly evolving. Deploying a scalable solution which has sufficient flexibility to cope with future legislative, organisational and market change is key for long-term success. Despite the dynamic state of Solvency II requirements and the complications this presents, insurers should remain focused on making strategic changes which will improve day-to-day operational control, efficiency and the overall performance of their business.

In conclusion

Solvency II should be seen as a competitive imperative rather than merely a tick-box exercise, and those who embrace the regime and are able to demonstrate sound operational control and efficiency will not only benefit from reduced operational risk and capital adequacy requirements, but also lower operating costs, improved customer service and greater operational insight. Insurers able to meet this challenge will find themselves in a position to achieve significant competitive advantage and improved stakeholder confidence. The solution in place to address operational efficiency needs to have the flexibility to take your organisation to Solvency II *and* beyond, providing a platform for continuous process improvement and operational viability.

DST Global Solutions is a leading provider of technology solutions to the world's top financial institutions, serving over 400 clients in some 45 countries. Used by leading insurers and brokerages, AWD provides a proven, scalable process management solution which can help enable organisations to meet Solvency II requirements, increase their control over their business processes, reduce costs and improve customer service.

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