

CONFORMANCE OR PERFORMANCE?

Peter Morgan Hare, of Eurobase, discusses the implications of Solvency II and corporate governance

The findings of PricewaterhouseCoopers' recent insurance industry survey will have surprised few. The biggest risk factor identified was the macro-economic environment, closely followed by regulation. Solvency II has taken time to evolve but now a date has been set for implementation. The issue facing the insurance industry is one of conformance or performance. Will this turn into a burdensome exercise of ticking boxes to meet regulatory requirements, or will this be an opportunity to improve the business performance? Could your risk management, compliance, audit and actuarial teams deliver not only the burden of regulation, but also provide management information to drive business performance?

Looking specifically at the governance element, an array of issues need to be reviewed. Let us start with a simple definition of corporate governance. The Organisation for Economic Co-operation and Development (OECD) defines it as "a set of relationships between a company's board, its shareholders and other stakeholders. It also provides the structure through which the objectives of the company are set, and the means of attaining those objectives, and monitoring performance, are determined."

In this context, conformance is about achieving good governance by acting within the laws, regulations, rules and codes. Performance is about enhancing business activities to affect revenue, shareholder and stakeholder value. A balance between the two must be achieved.

The main provisions of the Solvency II governance element are for sound and prudent management, effective risk management processes and the provision of high quality infor-



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mation for regulators. Delivering on these provisions necessitates a detailed framework of management and supervisory boards able to review and assess operational data.

These broad functions fall within the remit of risk management, compliance, internal audit and actuarial. Looking at just risk management, they will need to collect detailed information on underwriting, reserving and reinsurance activities, and provide an assessment of operational risks. They will need to stress test the business against potential threats and destabilising events. The same principles apply to the other functions. The scope of responsibility is vast and daunting, and the cost of implementation substantial.

However, if the processes to achieve the aims of these functions are embedded into operational activities, the task becomes manageable. It transforms from a regulatory millstone, to a proactive performance management tool. The production of information for regulators is simply another output of the process.

In Ireland, the Central Bank (CBI) has been proactive in pulling together a workable framework for the industry. A corporate gov-

ernance code was introduced in January 2011 which is being updated. The captive community is subject to a specific code of governance developed jointly by Dublin International Insurance and Management Association (DIMA) and the CBI. There are currently no plans to update the captive code.

The findings of a recent DIMA and Eurobase Insurance Solutions industry briefing on corporate governance and management information were that good corporate governance is intellectual honesty and not just about sticking to rules and regulations. It should provide a robust and embedded control framework, get into the fibre of the organisation and is not about box ticking.

Nevertheless, the CBI has deemed it necessary to backstop the new code with enforcement powers. The local industry's first response was an outcry against onerous responsibilities and the knock-on costs, but the debate has moved on. Most industry participants now appreciate the CBI's efforts in implementing a framework which will incite improvements in standards.

This change in attitude is the first step in shifting the balance from conformance to performance. A second element is recognition of the new accountabilities. Who is responsible for good governance and ensuring it meets regulatory requirements?

Under Solvency II, individual directors and non-executives will have collective and personal responsibility for good governance. Not only will the board be required to implement a balanced system of governance, but they will need to challenge the output of processes to ensure they are robust and effective.

A noteworthy case demonstrating this shift is John Pottage vs. Financial Services Author-



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ity (FSA). The FSA sought to hold the director personally liable for a governance failure, but lost on appeal. Despite this, scrutiny of the conduct of senior management will continue to be an important element of the regulator's enforcement and investigation strategy.

This evolution in emphasis means companies need a strategic approach to dealing with the regulator, specifically around demonstrating compliance. From the regulator's perspective, the board's accountability and responsibility is paramount.

Responsibility does not rest solely with the board. Managers need to be held accountable by the board. In practice, there is an element of responsibility at every touch-point in the process.

The foundation of good governance, therefore, rests in gathering the right data and processing it correctly. Data feeds all aspects of an insurance company's operations and the transparency and traceability of this data is core to ensuring consistency and integrity of reported information both internally and externally.

Research and consulting firm Celent stated in its Solvency II IT Vendor Spectrum report that: "Insurance companies that neglect the importance of IT alignment in the frame of their Solvency II preparation programme will be less inclined to gain competitive advantage."

Organisations across the industry are facing increasing volumes of data accompanied by demands to better utilise and analyse it to support the business. Whether you approach it from a business, marketing, or regulatory perspective, how data is used and analysed is critical.

A robust, yet flexible IT system is the key to unlocking the value in data. Flexibility is crucial. Technology should provide a framework, not prescriptive, rigid processes because the fact is the regulatory landscape is evolving and will continue to do so. IT systems need to be able to cope with this continuous process of change.

The issue of cost is also critical here. The cost of meeting new regulatory requirements can be significant, but an integrated seamless IT framework will ultimately save costs both in

terms of working hours spent manipulating data to achieve the right format for regulators, but also in streamlining processes.

The requirements of any system must include basics such as correctly validated data collection, a seamless flow between functions, audit trails and peer review capability and adaptable authorisation processes to accommodate different business lines and distribution channels. These characteristics will ensure consistent data quality and thereby a 'single version of the truth'.

The ultimate outcome must be a granular understanding of business performance. For example, profit and loss statements that show exactly where the business is making money and where improvements are needed, and up to the minute asset and liability statements which enable proactive management through the year.

Implementation of Solvency II governance requirements is a paradigm shifting opportunity to move away from 'spreadsheet hell' and adopt an IT strategy that delivers regulatory commitments as part of your business operations. Regulation stops being a burden. Instead it becomes part and parcel of the robust management of a business that delivers shareholder and stakeholder value. Used intelligently and properly, good technology ensures conformance without compromising performance.

As Andrew Ninian, head of corporate governance at the Association of British Insurers (ABI) said: "Good corporate governance enhances and underpins a company's long-term performance and is critical to long-term value creation and economic growth." 