

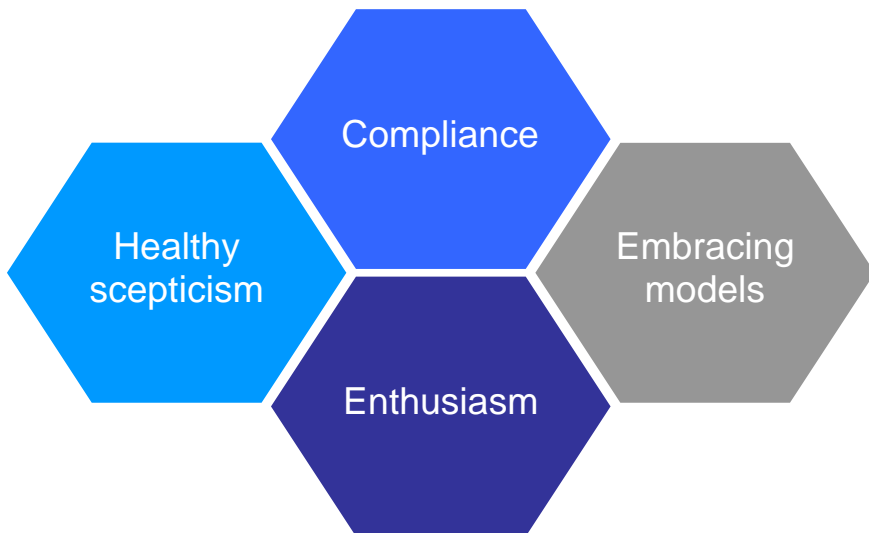
Solvency II: the 4 healthy responses/the 4 pitfalls

Solvency II is a fundamental change in the regulation of insurance companies. It will affect all areas of your business and will need managing at the highest level. It is vital that you have a clear vision for implementing Solvency II, or you will risk becoming lost in the detail. This LCP Insurance Update sets out a balanced framework for approaching Solvency II and highlights some important pitfalls to avoid.

This is the first in a series of LCP Insurance Updates considering how insurers can implement Solvency II in a way that achieves both compliance and real business benefits. This note considers the overall mindset for approaching Solvency II. Over the coming months, our further Updates will show how this structure can be practically applied to particular areas of Solvency II planning and implementation.

Overview

Based on our experiences with clients, we have identified the following 4 healthy responses to Solvency II:



Management's task is to ensure that the organisation's response is a balance between the 4 responses.

Getting the balance right is difficult. If any one of the 4 responses dominates, this will harm the organisation's ability to derive benefit from Solvency II.

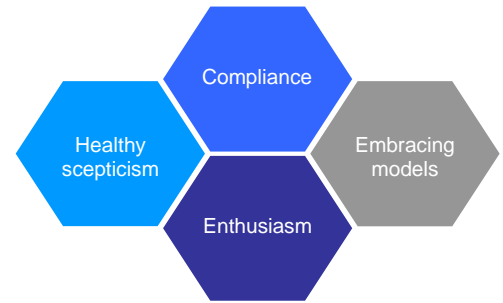
Response 1: healthy scepticism

New regulation should not simply be accepted without question. At each stage of the transition process, ask yourself "what's in it for me?" An effective Solvency II approach is one which recognises the value of investing in better processes, whilst avoiding excessive expense.

However, it is important not to let healthy scepticism turn into resistance against change (an "ostrich" approach). That may ultimately lead to a rushed Solvency II implementation as regulatory deadlines begin to approach. This will be more expensive, less flexible and provide fewer benefits to the organisation.



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Response 2: compliance

It is clearly important that any Solvency II implementation does achieve the necessary compliance. In fact, Solvency II defines a “compliance function” whose task it is to ensure this. However, if compliance becomes the only aim then Solvency II risks becoming an expensive and time consuming “**box-ticking**” exercise, incurring all the costs but missing out on the potential benefits to the organisation.

Also, the overriding concept of Solvency II is to embed risk management into your business. By taking a purely compliance route, you would risk not being able to tick the most important box of all. Regulators will look out for this and can impose extra capital requirements on those they believe are not fully complying.

Response 3: enthusiasm

Approaching Solvency II with a healthy amount of enthusiasm and drive can transform the business and create competitive advantage. However, it is also important to guard against “**overkill**”, where Solvency II becomes the chief driver of the business. The danger is that the business responds too slowly to market changes because there are too many processes to follow before decisions can be made.

The 4 pitfalls:

- Resistance to change (ostrich approach)
- Compliance-only attitude (box-ticking)
- Solvency II overkill
- Model worship

Response 4: embracing models

Actuarial models are a valuable tool if constructed well and used with care, giving new insights into the business and providing a structure for decision-making. However, this only works if the model is understood and accepted by decision makers. If models are treated as a black box and results are accepted without challenge (“**model worship**”), the result can be bad decisions causing damage to the business. A model is only a simplification of reality to aid understanding; it is not reality itself.

If you would like any assistance or further information on the contents of this Insurance Update or implementing a Solvency II framework, please contact Declan Lavelle or the partner who normally advises you, on +353 (0)1 614 4393 or email enquiries@lcpireland.com. If you need further copies of this or any other note please contact us. This Insurance Update should not be relied upon for detailed advice or taken as an authoritative statement of the law.



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Ireland

Lane Clark & Peacock
Ireland Ltd
Office 2
Grand Canal Wharf
South Dock Road
Dublin 4 Ireland
Tel: +353 (0)1 614 43 93
Fax: +353 (0)1 668 63 03

UK

Lane Clark & Peacock LLP
30 Old Burlington Street
London W1S 3NN
Tel: +44 (0)20 7439 2266
Fax: +44 (0)20 7439 0183

UK

Lane Clark & Peacock LLP
St Paul's House
St Paul's Hill
Winchester
Hampshire SO22 5AB
Tel: +44 (0)1962 870 060
Fax: +44 (0)1962 849 802

Belgium

Lane Clark & Peacock
Belgium CVBA
Marcel Thiry/laan 200
Avenue Marcel Thiry 200
B-1200 Brussel
Bruxelles, Belgium
Tel: +32 (0)2 761 45 45
Fax: +32 (0)2 761 45 46

Jersey

Lane Clark & Peacock LLP
* Oriel House
York Lane, St Helier
Jersey JE2 4YH
Tel: +44 (0)1534 887 600
Fax: +44 (0)1534 837 888

Netherlands

Lane Clark & Peacock
Netherlands BV
“Galghenwert” (9th floor)
Herculesplein 40
3584 AA Utrecht
Netherlands
Tel: +31 (0)30 256 76 30
Fax: +31 (0)30 256 76 31

Switzerland

LCP Libera AG
Stockerstrasse 34
Postfach
CH-8022 Zürich
Switzerland
Tel: +41 (0)43 817 73 00
Fax: +41 (0)43 817 73 99

Switzerland

LCP Libera AG
Aeschengraben 10
Postfach
CH-4010 Basel
Switzerland
Tel: +41 (0)61 205 74 00
Fax: +41 (0)61 205 74 99

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