

Reducing business risk in Solvency II programmes

While the FSA continues to enforce the implementation of Solvency II, various industry studies indicate that a lot of organisations are not on schedule to deliver in line with the FSA timelines. In a number of cases organisations are significantly behind schedule and are uncertain of how to control or mitigate business risk while delivering Solvency II.

Solvency II programmes are complex and require a considerable amount of technical and specialist change to take place. All levels of the organisation, in particular senior executives, must fully understand the purpose and requirements of Solvency II and assist in driving the required changes throughout their organisations. Solvency II work is also being completed at the same time as meeting current regulatory reporting requirements through to the beginning of 2013. This therefore requires stakeholders to manage both 'business as usual' and the future Solvency II state in parallel.

From the reviews on Solvency II delivery conducted by Capita, the key finding is that many organisations don't have the appropriate end-to-end business assurance strategy in place to accurately identify and mitigate business risks. This will reduce an organisation's ability to effectively manage the implementation of Solvency II within a quality assured framework.

A Solvency II question to the FSA

The following question, answer and quotes are from the FSA regarding the Solvency II delivery timelines and readiness plan. The answer and quotes clearly show that the FSA are driving towards the implementation timeframes that have been set. This further increases the need for organisations to ensure Solvency II is successfully implemented while mitigating business risk.

Question: "Should firms wait for the finalisation of the new regime to get on with their implementation plans?"

Answer: "No."

"The direction of travel for the new regime is sufficiently clear to enable firms to execute their planning and preparations for implementation. There is no need to wait for all the final details".

"Firms are reminded to allow for flexibility in their plans (incl. contingency plans) where we are still awaiting certainty".

"Solvency II is not just about the numbers and firms should be actively considering the implications of Pillars 2 and 3 for their business as they represent significant challenges which will take time to implement".

"Firms should continue to plan for implementation on 1 January 2013."

What is the FSA currently doing on Solvency II? These are FSA quotes:

Below are quotes from the FSA on what they are currently doing on Solvency II.

"We are supporting HMT in the negotiations to finalise the level 2 measures; we are actively involved in CEIOPS to deliver a successful practical implementation".

"The new rules will bite from day 1; we are preparing ourselves to be ready to supervise firms' compliance as soon as the new regime comes into force".

"We are engaging with European counterparts for the review of European cross border group internal models".

Business delivery risks

With an implementation of this size, especially given its global nature, a lot of organisations are managing the delivery from a central source (normally HQ) rather than the individual business areas delivering independently. In some organisations this means a fundamental shift in the way they deliver and manage change from individual business areas to a centralised delivery solution team.

While Capita recognises this as a good delivery approach, it is imperative that organisations ensure the central delivery function is able to clearly identify all the business risks from each business function, which in many cases are spread around multiple sites and countries.

From our reviews the key areas of business risk are identified as follows:

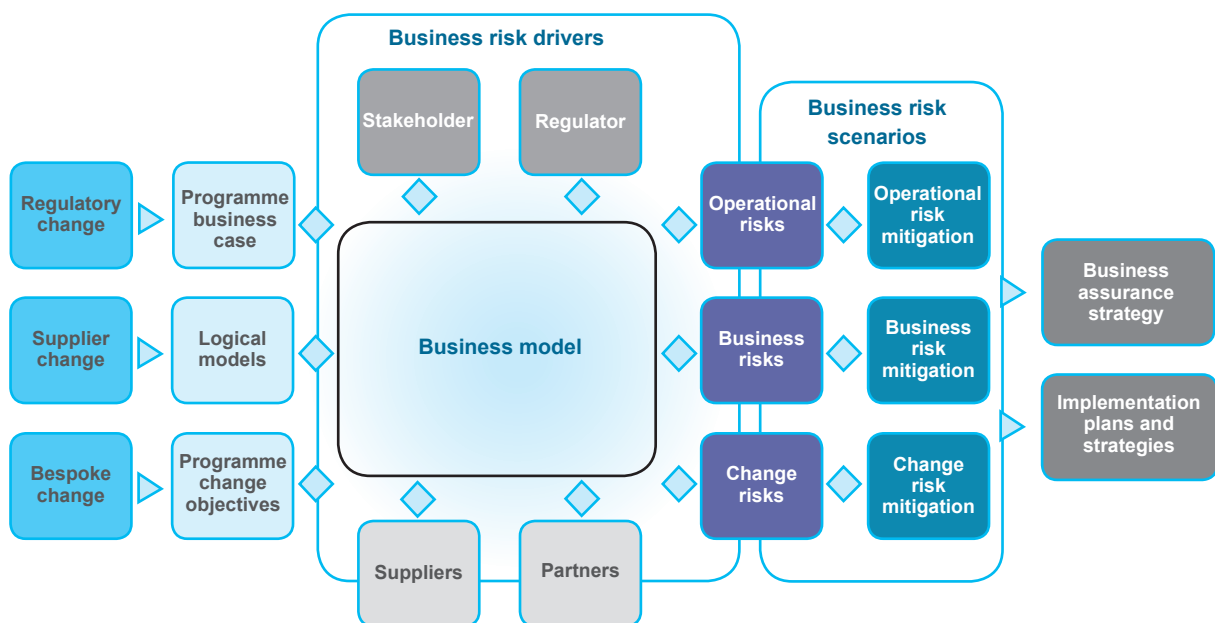
- > Identification and mitigation of risks themselves
- > Business assurance strategy / programme delivery framework

Both these areas cover a wide spectrum, which is why Capita recommends the following approaches to risk identification and business assurance strategy.

Capita business risk identification approach recommendation

Capita has designed and utilised a risk identification model specifically for Solvency II business risk identification.

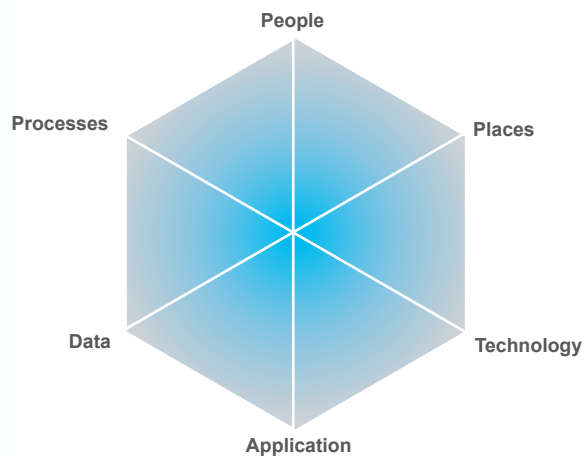
The following diagram illustrates at a high level the approach we would expect to take in understanding the firm's business risk. We would also assess the impact of the Solvency II driven change against current and future models to drive out the risk scenarios. To allow the risk scenarios to be fed into the implementation plans and strategies and the critical ones would then form the basis for the business assurance strategy.



To allow robust analysis of the risks and to drive out the appropriate scenarios we need a basis for comparison. The basis needs to capture the key characteristics of the risks and the drivers of complexity.

We use the following P³DAT model:

- > PR = Processes - Models the business processes
- > PE = People - Models the organisation that delivers the processes (includes the roles)
- > PL = Places - Models the locations where roles deliver the processes using the data and applications
- > D = Data - Models the data used by the business, processes and applications
- > A = Application - Models the applications used by the roles to deliver the processes, should include Function / Application Module mapping
- > T = Technology - Models the technology used to deliver the data and applications to the roles in their locations



This means that the current portfolio of business solutions needs to be understood against these characteristics, and the change needs to be defined on the same basis.

Challenging the Solvency II Pillars against the model allows us to understand the risks for implementation.

- > A Data / Pillar 1 risk assessment allows us to understand how data is needed to support Solvency II, and which databases and other stores will be impacted by Pillar 1
- > A People / Pillar 2 assessment allows us to understand which roles are key to delivering Pillar 2
- > A Pillar 3 / Application assessment allows us to understand how the applications support Pillar 3

	Processes	People	Places	Data	Application	Technology
Pillar 1 Demonstrating adequate financial resources						
Pillar 2 Demonstrating an adequate system of governance						
Pillar 3 Public disclosure and regulatory reporting requirements						
Supervisory review process						

The model, used in combination with the Solvency II requirements, allows us to perform comprehensive risk analysis and define a comprehensive set of risk scenarios that must be addressed.

The diagram below illustrates, at a high-level, the risk analysis areas of focus as an example following the completion of risk analysis.

- > Comparison against common and agreed characteristics means that changes can be correctly assessed for their impact
- > This means that implementation issues (testing, etc.) can be properly balanced, i.e. objectively
- > Allows focus on business critical aspects of the change and ensures that the assurance activities are similarly focused



Capita programme delivery approach recommendation

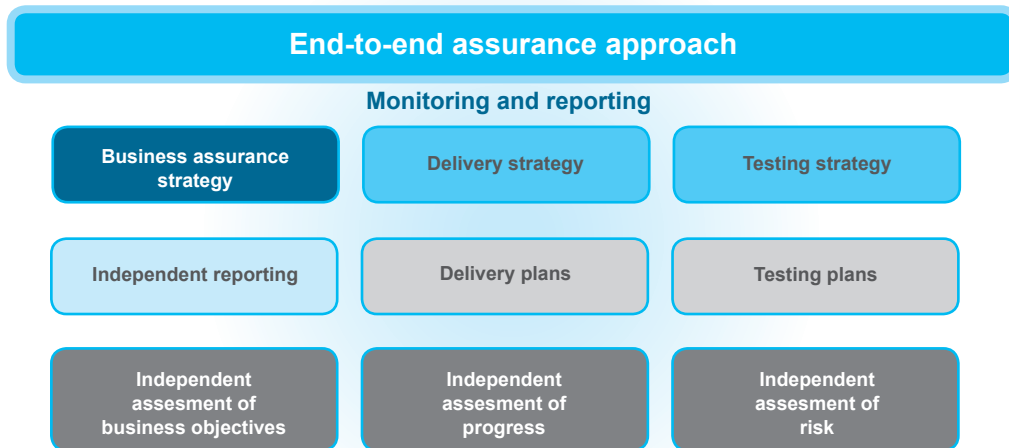
From the Solvency II readiness reviews we have conducted, one of the typical outcomes is that the client needs an end-to-end business assurance strategy. This is driven by the business risk analysis described earlier and takes an end-to-end perspective across all domains, processes and business units. It also provides the overall guiding framework for a Solvency II readiness programme.

Organisations need to have confidence that they are on track to meet regulatory requirements, and their businesses and reported financial information will stand up to close scrutiny - from regulators, shareholders and investors.

Business assurance plays an important role as organisations move towards implementing the requirements of Solvency II. Businesses simply cannot afford to make mistakes when it comes to implementing what is an evolving and therefore inherently complex set of requirements. Validation and assurance plays a key part in preventing this. The key recommendation is to implement an end-to-end business assurance approach. If it is not already present, we would always suggest that an additional team be created within the organisation to deliver this.

We would also recommend that this team should not be subordinate to any of the others in the organisation as this will weaken its ability to provide an independent voice. It will also permit the organisation to position this approach as demonstration of a unique focus on quality and meeting stakeholder expectations.

The diagram below illustrates, at a high-level, the areas of focus for the end-to-end assurance approach.



One of the areas within the end-to-end assurance model is the quality assurance framework. This governs the programme and provides the quality gates which enable decisions to be made during the delivery lifecycle based upon known risks.

The quality assurance framework is made up of a series of quality gates at defined points in the project lifecycle underpinned by ongoing monitoring and control activities.

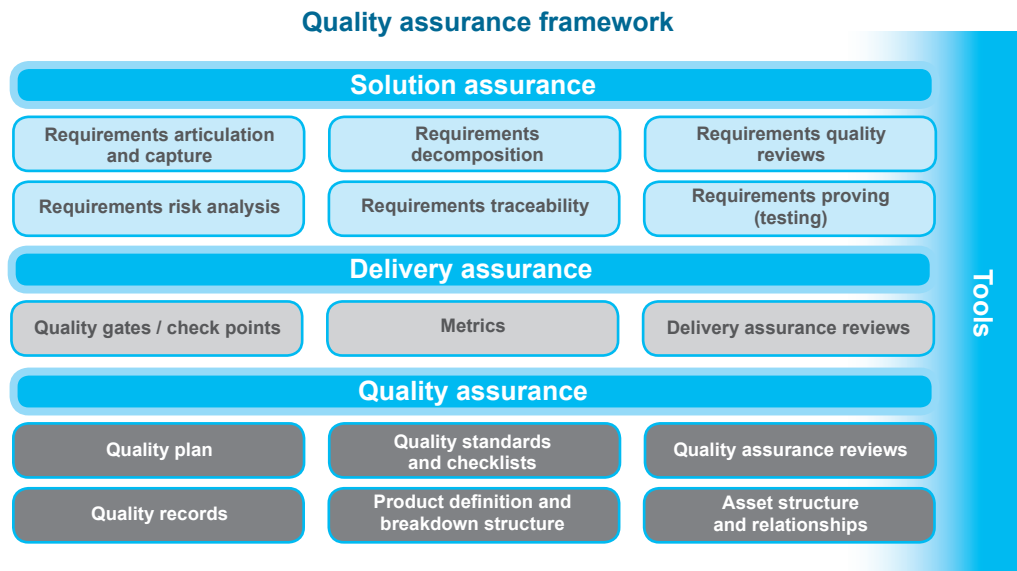
The purpose of quality gates is to enable an independent, formal, structured review of the programme deliverables at pre-defined points in the delivery lifecycle, against objective criteria (i.e. based on facts, not opinion).

Quality gates are fundamental to the programme's ability to objectively assess whether the programme is on track to meet the business' expectations and to deliver on time, to schedule and quality. Additionally, the quality gates are fundamental to the programme's ability to assess and act on the cumulative impact of risk.

Quality gates will not review and approve any project deliverables, but will focus on ensuring that the projects are producing the deliverables as expected. They will do this by reviewing the outcomes of a deliverable's agreed acceptance validation process.

The outcome of a quality gate review may be that the project controls are not effective such as a high level of change, long outstanding issues, high degree of unmitigated risks, governance processes not being followed or that the acceptance deliverables are not being produced or approved (with minimal outstanding issues) as per the agreed schedule. If this is the case, the change advisory board will make the decision to stop the project proceeding to the next phase or escalate to the project steering committee a recommendation that the project should not proceed further without resolving the identified issues. The decision regarding how the project should then proceed will be based on the assessment of the risk of failure due to the project status.

The diagram below illustrates, at a high level, the areas of focus for the quality assurance framework.



Financial services organisations are facing huge regulatory challenges, however, quality assurance frameworks combined with the right risk models can not only drive out business risks and ensure that these are managed effectively but can also make sure that Solvency II programmes deliver what they promise and can help to drive through best practice in programme delivery.

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