

Solvency II Where does quality assurance come in?

Solvency II will have major impacts on the way insurance organisations, across the European Union, define and demonstrate their capital adequacy. It is the responsibility of senior management to specify the risk appetite for the firm and put in place policies and practices to measure and monitor risk across their businesses.

Insurance organisations are gearing up right now to meet the requirement of Solvency II. The regulation prescribes changes in corporate governance, risk quantification and management. In addition, the way capital adequacy is audited and reported to the FSA will be affected. The sheer volume and tempo of reporting will increase and will involve a cultural shift in the way insurers do business.

According to recent research by the Economist Intelligence Unit, of 346 risk managers in financial services, around 40% of their respondents say they do not have a clear risk strategy in place. Meanwhile, less than one-half of the respondents are confident that they understand the interaction of risks across business lines, and poor communication between departments is seen as a key barrier to effective risk management.

The survey concludes that risk managers recognise that data quality and availability need to improve but collecting, storing and aggregating data is an area of weakness for many firms, with only 39% of respondents believing that they are effective at these activities.

So it is easy to see why some organisations are looking not simply to comply with Solvency II but to see how these regulatory changes can be harnessed to make their operations more efficient and to manage their risk more effectively as well as to support compliance.

How will this impact on systems?

As a key element of Solvency II is providing the right data at the right time and reporting it in the right way, applications will need to reflect the necessary changes. New products or product movements will still need to go through accounting systems from product engines but the nature of the data feeds, the structure of the information and its timing will change.

This will put a lot of strain onto the finance and actuarial functions as well as on operations. We all know organisations where departments use spreadsheets holding key information that are not integrated. This will be a challenge in the Solvency II world. Straight Through Processing and the use of ERP systems have both been brought into play in the past when organisations look to integrate data across divisional or regional boundaries. Can they be used again as a tool in meeting the challenges of Solvency II in addition to helping the organisation to be more joined up by implementing a more transparent risk management culture?

Where does quality assurance come in?

Solvency II has the potential to be a massive business change programme. Implementing best practice by creating a governance layer will give insurance companies the best chance of shaping the programme to achieve the outcomes they want and need whilst also demonstrating control to the regulator.

First of all, in a new programme, it is essential to ensure that time is invested up front so that the requirements are properly articulated so business change and IT are aligned. It is important to be realistic about what you can achieve and focus on the essential outcomes to meet the Solvency II requirements. People who are involved in the programme need to be engaged right from the start so that they are clear about their involvement and how the way they work and report has to change. This has to be a two-way process and involves the executives who are responsible and all the way down the organisation.

In a large and complex programme, not everything will go according to plan first time so it will pay dividends to identify, analyse, mitigate and manage potential risks in the usual cycle. What are the absolutely critical outcomes that are needed? It is crucial in any programme to be able to focus on these and be able to report on progress against achieving them. This will also provide early warning of any issues that arise - and they will - so that remedial action can be taken.

Insurance companies will need to work very closely with the regulator - that goes without saying. However it is how and when they communicate on progress and control that is fundamental. It is important that organisations do not present the regulator with any surprises or unmanaged risks, having gone too far down the track in implementing their solution before reporting.

The fundamental nature of quality assurance is that it enables an organisation to demonstrate control and governance to the regulator. This will enable the company senior management as well as the regulator to be assured that the approach is correct, conforms to a plan and method and that there is a robust audit trail.

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Implications for testing

The sheer complexity of Solvency II requirements and the breadth of impact on applications and their integration mean that software quality could be a real concern. This could be compounded by the complexity of an organisation's IT systems, especially where legacy systems are involved. As with all testing, starting early in the change delivery lifecycle and providing early warning on any potential issues enables the organisation to reduce re-work effort and cost. Failure is not an option.

In order to be ahead of the game, insurance companies should be considering now how to maximise the benefits of a risk-based approach which can handle the increase in requirements. This approach targets effort in the highest risk areas where the potential impacts can be mitigated.

Other areas to consider include testing the business processes to ensure that these and the systems are mutually supportive in the new regime. Test teams can partner actuaries to improve quality and deliver the best outcomes by applying the rigours of software engineering to modelling; creating structured walkthroughs of algorithms as well as using automation techniques to test systems changes. This leverages the skills of the actuarial department.

Insurance is about handling uncertainty and managing risk. Solvency II programmes can make high quality deliverables an increased probability by integrating governance, QA and testing as early as possible into their process.

