
Keeping you informed
Asset Management and
Solvency II

Setting the scene:

As of December 2010, European insurance undertakings have been amongst the most important investors in the EU with more than EUR 7.3 trillion invested in the global economy including EUR 3.7 trillion in debt assets, which represents 54% of the EU GDP.

Consequently the new EU Solvency Directive related to the (re) insurance section will impact the economy on a global level, and the relations between (re) insurance undertakings and asset managers.

Asset Management and Solvency II

Solvency II which we expect to be implemented on 1 January 2014 increases the governance, risk management and disclosure demands on insurers and will require them to review and possibly re-think their investment strategies. These developments are set to have a powerful knock-on impact on asset managers, a huge proportion of whose business comes from insurers. Yet, this is also a valuable opportunity for asset managers to differentiate themselves by moving early to create Solvency II-ready operational capabilities and investment strategies for their insurance clients.

Implications of Solvency II on Asset Managers and other service providers

Investment strategies

Solvency II ushers in a shake-up in how insurers calculate their solvency requirements and manage their businesses.

Under Solvency II, the 'standard formula' regulatory capital requirements are based on a specified scenario or 'shock' on the assets of the insurer. The magnitude of the shock drives the resulting capital charges. Quantitative impact study 5 (QIS 5), which assessed the capital requirements for insurers, highlighted potentially higher capital loadings as a result of stress testing for the following investments relative to assets with similar risk profiles:

- Property
- 'Other equities', which includes most hedge funds, commodities and equities not listed in the European Economic Area (EEA)
- Sovereign bonds in non-domestic currencies
- Structured products such as residential mortgage-backed securities

The new capital charges will heighten insurers' focus on the balance of risk and reward within their investment portfolio. Insurers will gravitate to asset managers that can help them to assess their investment risks and risk-adjusted returns more effectively.



“Look Through concept”

Solvency II also introduces a ‘look through’ approach to the risk evaluation of funds, under which the underlying investments are treated as if they are direct holdings.

Providing the look through information on the underlying funds may be a particular challenge for managers of funds-of-funds as the detailed portfolio of underlying funds is often only partially known. To avoid the risk of losing insurance industry investment, fund-of-fund managers will have to make sure they are able to obtain this information, or at least try to ensure all material risks are captured.

Asset and Liability Matching

Insurers will also be looking to match their assets and liabilities more closely as mismatches will attract a regulatory capital charge. Asset managers will be required to work with insurance clients to adjust asset duration or develop more effective hedging strategies to manage interest rate risk and other duration related risks.

Data and reporting

Under Solvency II, insurers will have to demonstrate to their supervisors that the data they use is sufficiently complete, accurate and appropriate for their specific needs. External data, including information from asset managers, custodians and/or administrators, will need to meet the same standards of quality, granularity and verification as internally sourced information.

Insurers will expect documented assurances from their asset managers, custodians and/or administrators that the quality, consistency and reliability of the risk information they supply and the governance and control procedures that underpin this information are up to scratch.

Insurers’ disclosures to supervisors that used to take months to produce are going to have to be collated, analysed and signed off in a matter of weeks. Detailed asset data will be a key component of the new quarterly and annual supervisory reports to supervisors. Asset managers, and/or other providers, will need to provide a range of information not currently disclosed including the profit or loss to date, the issuer or ultimate counterparty of the investment

Conclusion:

The demands of the Solvency II Directive on insurers have significant implications for asset managers, as well as fund administration, asset servicing, custodian and other service providers. For those providers that move quickly to develop products, analytical insights and strategic solutions on how to maximise returns, minimise capital requirements for existing and potential insurance clients, and deliver comprehensive and transparently quality assured information are likely to capture the lion's share of this hugely valuable market.

Giving you the edge

PwC is helping a range of insurers and asset managers to get to grips with the practicalities of Solvency II implementation. If you'd like to know more about how to gear your information systems and investment strategies to the demands of Solvency II, please contact one of our Solvency II experts below:

Regulatory

Garvan O'Neill

Tel: +353 1 792 6218

Email: garvan.oneill@ie.pwc.com

Trisha Gibbons

Tel: +353 1 792 8664

Email: trisha.gibbons@ie.pwc.com

Iarla Power

Tel: + 353 1 792 6398

Email: iarla.power@ie.pwc.com

Kaustuv Banerjee

Tel: + 353 1 792 8441

Email: kaustuv.banerjee@ie.pwc.com

Asset Management

Olwyn Alexander

Tel: + 353 1 792 8719

Email: olwyn.m.alexander@ie.pwc.com

Andrew O'Callaghan

Tel: + 353 1 792 6247

Email: andy.ocallaghan@ie.pwc.com

Ciaran Flynn

Tel: + 353 1 792 8289

Email: ciarán.flynn@ie.pwc.com

Actuarial

Paul Duffy

Tel: +353 1 792 7339

Email: paul.g.duffy@ie.pwc.com

Ronan Mulligan

Tel: +353 1 792 7505

Email: ronan.mulligan@ie.pwc.com

Niall Naughton

Tel: +353 1 792 6314

Email: niall.naughton@ie.pwc.com

David Walsh

Tel: + 353 1 792 8983

Email: david.walsh@ie.pwc.com

Advisory

Ciaran Kelly

Tel: + 353 1 792 6408

Email: ciarán.kelly@ie.pwc.com

Dervla McCormack

Tel: + 353 1 792 8520

Email: dervla.mccormack@ie.pwc.com

Jane Conroy

Tel: + 353 1 792 6041

Email: jane.conroy@ie.pwc.com

Fiona Gaskin

Tel: + 353 1 792 6923

Email: fiona.m.gaskin@ie.pwc.com

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