"The delivery of a greater level of granular data will play an important role in the management of claims and the reduction of claims leakage at a stage when claims management will play an increasing role in the approach to setting solvency levels and reserving."

Effective Enterprise Claims Management will be vital for Solvency II

***Michael Kelly, CEO FINEOS Corporation**, writes that although much attention to date has been paid to Pillar One of Solvency II, focus is quickly switching to other elements of the regulation. Efficient, accurate and pro-active management of Claims will be a crucial part of this regulation for insurers, forcing a self examination of processes and systems in this area.*

Solvency II is set to create an entirely new regulatory landscape for underwriters who operate throughout the European Union, and will become the biggest single focus for underwriters and their compliance teams for the next two and a half years.

After a series of false starts and a huge amount of debate, the line in the sand for the implementation of the regulations has been set at 1 January 2013 with industry experts saying that the deadline will not be extended.

Solvency II will create the standards for the required capital for underwriters to operate in all classes of business and the regulations are built on three pillars: quantitative requirements, supervisor review and disclosure requirements.

Underwriters will have the opportunity to create their own internal capital models on which the level of the required solvency will be based, otherwise there will be a standard capital model (ICM) which many in the market believe will be more punitive in terms of capital provision because of the lack of individual data as compared to the ICM.

The man tasked with creating the Solvency II framework Karel Van Hulle, Head of Unit, Insurance Pensions and Financial Institutions within the EC's Internal Market and Services Directorate-General, has said the exact details are still to be finalised with the market able to have its say on the Quantitative Impact Study (QIS) 5 but has said "the main focus will be in good risk management".

Much of the industry's work on Solvency II has been on the issues surrounding underwriting, measuring of exposure and the potential solvency levels with or without the internal capital models.

It is not a cheap process. Syndicates at Lloyd's in London are spending £50 million per year on work to ensure their compliance with the Solvency II requirements even though the final requirements are yet to be formalised.

However there has been little focus on one area of insurers' operation which can have a profound impact on the firm's solvency level – that of Claims.

While Pillar One of the regulations is set to be based on technical provisions, investment rules and capital rules, a solid understanding of claims levels and claims reserves will have a significant impact on an underwriter's treatment under Pillars two and three of the regulations.

Pillar Two will look at internal controls and sound management while Pillar three is about disclosure in relation to risk and capital levels.

What has become clear is that those underwriters who have a clear understanding of their claims levels and can prove they have accurate data on the level and type of claims they have experienced and can expect, will find that it will pay dividends for their work on Solvency II and their eventual treatment under the regulations for a number of reasons.

Fundamentally the efficient settling and managing of claims will directly affect solvency ratios, by the fact that it leads to fewer long term outstanding reserves and accurate reserving due to the ability to gather higher levels of data.

It will also aid the ability to strip out claims volatility which is viewed as a significant imponderable by the regulators and will have a direct impact on solvency.

In the wake of the financial crisis, fraud remains a major issue for underwriters and their claims teams. The delivery of a greater

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level of granular data will play an important role in the management of claims, and the reduction of claims leakage, at a stage when claims management will play an increasing role in the approach to setting solvency levels and reserving.

The ability for an insurer to pay claims is at the very heart of the rationale for Solvency II. The regulators want to ensure that policyholders can have confidence that their risk carrier can pay a claim if it is made. Therefore anything which demonstrates to the regulator that an underwriter understands its claims levels, understands its exposures and has accurately reserved will aid how they are treated by the regulators.

This emphasis on the governance, risk and control of all operations and process presents an opportunity for Claims Departments to review their internal workings through the eyes of the Regulator. Moreover, as well as complying with the regulation, any changes that tighten the processes will have a positive knock-on effect on the Insurance company's profitability.

Lukas Ziewer, Partner, Insurance, Oliver Wyman says claims should not be ignored: "The abllity to prove to regulators that an underwriter has a detailed understanding of their claims both in terms of those outstanding and past experience will stand them in good stead. It is important in terms of establishing an enterprise risk management system which will form part of any internal capital model provided to the regulator. I think insurers are becoming aware of the importance which will be placed on the level of claims data which can be provided.

Nicolas Michellod, Analyst at strategy consultant, Celent, added: "There is a challenge in terms of the issues surrounding understanding claims incurred but not reported (IBNR) and how companies can deliver the data to support their internal models and calculations over claims levels and volatility.

"Firms will have to prove to regulators the robust nature of the figures they will use to calculate their technical reserving levels and that applies both to life and non-life underwriters. The ability to deliver accurate and timely data on claims and systems to manage claims volatility will play a role in how firms are treated under Solvency II."