Strategic Analysis

Preparing for Solvency II: ACORD Data and Information Standards

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TABLE OF CONTENTS

Introduction

With the introduction of the Solvency II Directive in July 2007, European regulators and insurers are moving from the development phase of the new risk based solvency regime to preparation for its implementation. While the European Parliament and Council are reviewing the principles-based directive, the European Commission and Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) are continuing the development of the regulations which will fill in the details of the solvency regime.

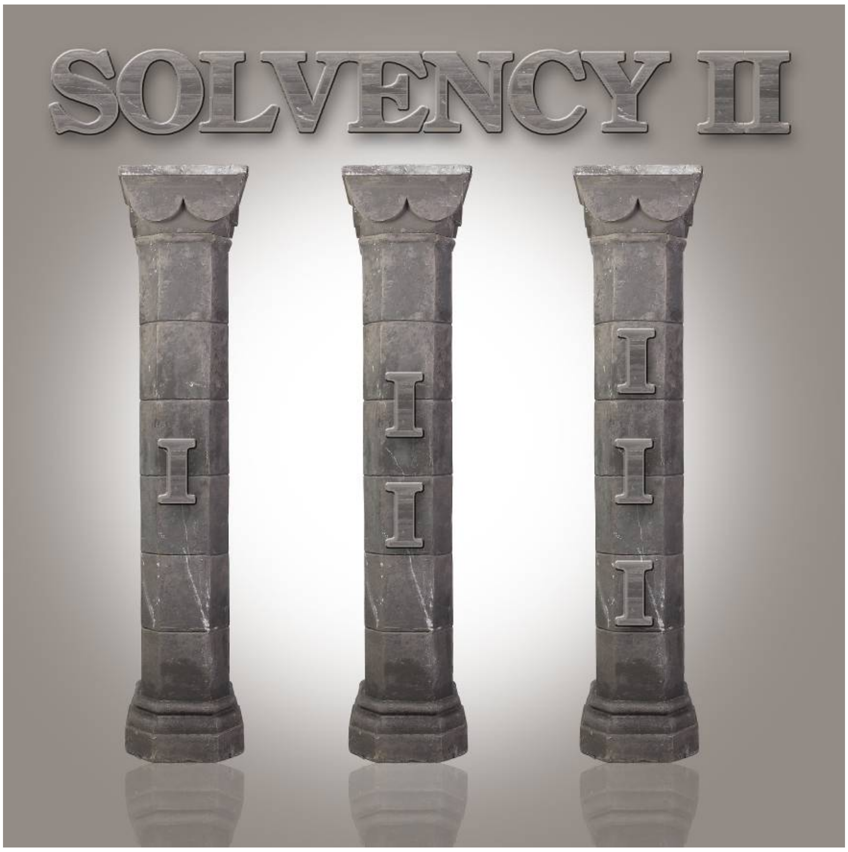
Most insurers writing in Europe are currently evaluating their internal systems with the goal of revising them to meet the requirements of Solvency II. Even if the directive is not fully implemented until 2012, forward-looking companies and regulators are already putting components of the new solvency regime in place now to ensure they will be in a position to comply and to test and refine their internal procedures

The components of Solvency II are usually described as three pillars:

- Pillar I addresses financial solvency
- Pillar II addresses corporate management and active supervision
- Pillar III addresses the role of the market.

Data quality and reliability issues are central to the effectiveness of all three pillars of the Solvency II regime. Solvency II depends upon a company's understanding of its own risks and the ability of the regulators and market to understand and compare the company's analysis.

This paper examines the ways in which ACORD standards can help companies, brokers, and supervisors prepare for Solvency II.



Introducing ACORD

Since its founding in 1970, ACORD has worked to ensure that insurance industry standards and processes provide high quality, consistent, and complete data.

Based in New York, ACORD (Association for Cooperative Operations Research and Development) is a global, non-profit insurance association whose mission is to facilitate the development and use of standards for the insurance, reinsurance and related financial services industries. With a European office in London, ACORD accomplishes its mission by remaining an objective, independent advocate for sharing information among diverse platforms. ACORD standards and services improve efficiency and expand market reach. Affiliated with ACORD are hundreds of insurance and reinsurance companies, thousands of agents and brokers, related financial services organisations, software providers, and industry organisations worldwide.

Why are Standards Needed?

Communication is, or should be, based on the use of standards. Without them, the time and effort to communicate data would be onerous, time consuming, and counter-productive. If you say `<lastname>` and I say `<last name>` and someone else uses `<surname>`, we may be discussing the same concept, but the terminology keeps changing. By using a standard, agreed upon by members of the community, we can simplify the communication and all use the same vocabulary.

ACORD data standards form the foundation for communication within the insurance industry and enable all participants across all geographies to share a common vocabulary or *lingua franca*. From the most basic data element to transactions (called ""messages"" by IT professionals) and business processes, standards establish a shared understanding, allowing participants to communicate and do business more efficiently.

Using standards-based systems to communicate increases efficiency, improves data quality, and ensures that what is transmitted is consistent and easily usable by distributors, carriers, and other business partners who also use a standards-based approach.

Reliable Information is the Core of Solvency II

In its 2007 report on Solvency II, KMPG said that, "One of the biggest challenges coming out of Solvency II will be the breadth and depth of data requirements."[1]

These issues include:

- Quality of data, including its integrity
- Efficiency of data collection and management
- Timeliness of data processing, documentation and reporting
- Consistency of data across platforms
- Integration of all aspects of the company operations including marketing, claims, and asset management
- Linkage of insurance data and accounting data
- Integration of data throughout the company and its subsidiaries
- Integration of legacy systems
- Consistency of data across the European single market

The European Commission frequently refers to the comparability and transparency of company information. In the future, the Commission will prescribe standards to ensure the appropriateness, completeness, and accuracy of data.

The Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) has charged several of its working committees with reviewing data and system needs.

[1] Solvency II Briefing, KPMG, 2 April, 2007, page 12.

Pillar I Issues

Quality of Risk & Financial Data

Under Solvency II, companies will have the option of using internal models or a standard approach to calculate capital requirements. In either case, the critical component will be the calculation of the best estimate of liabilities and the margins which are based on those estimates. In order to develop the appropriate value of liabilities, companies will need the most accurate data possible.

The Directive will require that Member States ensure that both insurance and reinsurance undertakings have internal processes and procedures in place to guarantee the appropriateness, completeness, and accuracy of the data used in the calculation of their technical provisions.[2] Quantitative impact studies have already revealed some serious data consistency problems.[3]

For companies using internal models, supervisors will be evaluating the quality of data input into the models. They will want to know that the data is consistent and comparable. Companies will need to demonstrate that they have a reliable system for developing the best estimate using existing claims data as well as forecasting tools.

Solvency II will further require that the best estimates and assumptions are regularly compared against experience.[4]

Accuracy and timeliness of claims data will be especially important in Solvency II. In order to run the sophisticated risk models which supervisors will expect from insurers, companies must ensure that the risks they undertake are accurately coded and identified.

Meeting this objective requires sharing data across departmental areas and subsidiaries within companies. Many of these separate areas use legacy systems which are not compatible or depend upon definitions developed on a single country basis.

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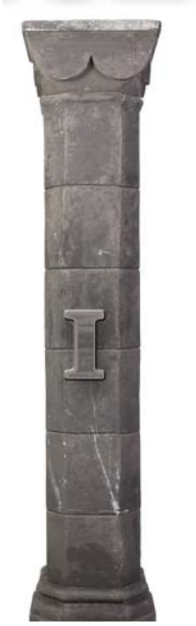
The use of an industry standard allows companies to collect data from third parties in a consistent manner, using an extensive body of industry work which will help improve their understanding of their risks.

Through the implementation of industry standards, companies can also open up legacy systems and share data with foreign and domestic subsidiaries thereby allowing companies to compare exposures, premium and loss data throughout the corporation regardless of geographic borders.

Additionally, standards streamline the communications with external partners such as agents and brokers, risk managers and reinsurers.



- *Quality of risk and financial data*
- *Links between accounting and solvency*
- *Enterprise-wide systems*

[2] Solvency II Directive Amended, 26 February, 2008, Article 81, page 101.
[3] CEIOPS Report on QIS 3 for Solvency II, November 2007, page 37.
[4] Solvency II Directive amended, 26 February 2008, Article 82, page 101.

Links between Accounting and Solvency

The Solvency II Directive specifies that accounting data will be the basis for much of the financial reporting. Although there will be some differences in the final data because of varying audiences for financial reports and prudential reports, the Directive assumes that much of the data will be based upon common components.

It is also important to Solvency II that the financial and regulatory reports can be reconciled. Therefore, the company accounting and risk management systems will need to be based upon a common set of definitions and able to be integrated and correlated.

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International financial reporting standards are currently required throughout Europe for public companies. The International Accounting Standards Board (IASB) is currently developing a standard for insurance contracts which may be implemented about the same time as Solvency II.

ACORD standards are generally compatible with financial reporting data. XBRL is one standard the IASB is exploring as a useful format for international accounting standards. As long as definitions are consistent, disparate standards can be mapped to each other providing seamless integration.

Enterprise-wide Systems

Insurance groups could receive significant credit for diversification on an enterprise-wide basis under Solvency II. To do so, companies must demonstrate that they have an understanding as to how risks in one line or geographic area can offset those in another. This requires that the company has comparable data at its fingertips.

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If a company and its trading partners are committed to basing their systems data sharing and data collection on ACORD standards, there are many benefits for their enterprise-wide systems. Common data concepts will have the same meaning across lines of business, across internal systems, and across borders making effective benchmarking possible. Data will move seamlessly throughout divisions and across new and legacy systems.

Pillar II Issues

Corporate Governance

Solvency II requires that directors and officers are appropriate and proper to serve in their roles. It also states that consultants, business service providers and brokers must be properly monitored through internal controls. All outsourced activities are subject to supervisory review.

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All types of service providers — including software developers, consultants, and outsourcers — may undergo a certification process ensuring that their work utilises data exchange formats that meet industry standards.

While agreement to a common vocabulary and grammar for business integration is essential for data sharing, companies can still have unique processes that distinguish themselves in the marketplace by extending standards to apply their unique business rules.

One method to provide such certification is ACORD's Testing and Certification Facility that allows implementers to not only test their implementation of the standards, but also build in company unique business rules that can then be used in the testing process with service providers.

In the area of agency or broker to carrier communication, ACORD has forms and electronic standards (such as the producer appointment form) to help companies ensure that the intermediaries they work with are in compliance with registration requirements. In the United States, this has allowed for the automation of appointment requests.

Risk Focused Management

Solvency II will require that all insurance and reinsurance undertakings have, as an integrated part of their business strategy, a regular practice of assessing their overall solvency needs with a view to their specific risk profile.[5] Companies will need to look not only to look at traditional underwriting risk, but consider operational risk, credit risk, liquidity risk, and market risk as well as risk mitigation.

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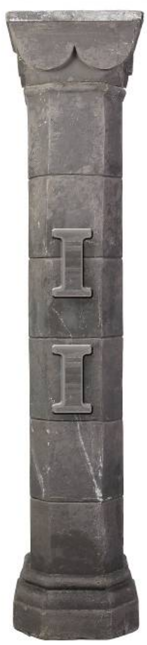
The focus on internal company management includes identifying, understanding, and managing risk. Particularly on large commercial accounts, the ability to receive data about locations electronically in a consistent and useable format can assist in aggregating risk.

ACORD's Exposure Reporting Implementation Guide which is publicly available on the ACORD website (www.acord.org), contains detailed record



- *Corporate Governance*
- *Risk Focused Management*
- *Reinsurance Management*
- *Comparability of Data Among Companies*
- *Group Supervision*
- *International Regulatory Equivalence*

[5] Solvency II Directive Amended, 26 February 2008, paragraph 19, page 21.

formats for catastrophe risk modelling elements. Risk management is also an area where data consistency helps ensure the comparability of catastrophe exposures worldwide.

One obstacle currently facing risk managers is data availability. While the need is apparent, communicating and sharing data can be problematic. Due to a proliferation of proprietary formats, data can vary between systems and between business partners (i.e., TPAs, carriers, and brokers). This ultimately delays data delivery and complicates interpretation.

The best way to facilitate the flow of information by business partners and at the same time make sure that the data being transmitted is both useful and available real-time, is through data standards. Using a common lingua franca for such basic elements makes sharing not only possible, but efficient.

Standardised data naming and definitions would also create more meaningful industry data. It would enable risk managers to benchmark practices over time, regardless of system choices.

Reinsurance Management

Solvency II will require that reinsurance is properly evaluated and managed.

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ACORD standards ensure that companies can better evaluate, document, and monitor reinsurance coverage and improve recovery of reinsurance due.

ACORD's involvement in reinsurance standards development dates back to 2001. A joint venture of organisations in the US, UK and continental Europe had been developing data standards since 1992 and needed a new home for that body of standards. ACORD assumed responsibility for that standard in 2001.

Since then, the reinsurance standards have not only been maintained by ACORD, but a great deal of new development has taken place from creation of a Global Placing Document that meets the UK regulatory requirements of contract certainty to the implementation of the standards for accounting and settlement (claims and placement), placement of new business and renewal, claims movement, bordereau and technical account.

In the area of recovery of reinsurance due, standards for claims movement between cedents, brokers and reinsurers can improve quality and consistency of data thereby speeding recovery. If the claims process were automated, the hours of manual reconciliation that go on today could be eliminated.

Comparability of Data among Companies

One of the tools supervisors will use in evaluating internal models will be comparability between companies with similar risk profiles. This will require European writers to work from a common set of terms as well as common definitions of some of the procedures. Much time has been spent on refining calculations, but little time has been expended on the detailed definition of the components to be used as the basis for the calculations.

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Comparisons cannot be effective without common data naming conventions and definitions. One example of definition confusion is the term "premium." When a company refers to premium, do they mean including or excluding taxes and surcharges? Similarly, does the definition of incurred loss include or exclude allocated loss adjustment expense?

Not all companies define premium or incurred loss in the same way. There are multiple ways to represent that data and each concept can be represented as a separate data element. Rather than expecting companies to all adhere to the same methodology of capturing these elements, having multiple data "buckets" for the different methods makes sense. The ACORD dictionary provides that consistency, allowing supervisors to conduct internal and cross border comparisons.

Group Supervision

Group supervision is a central component of the Solvency II Directive as drafted by the European Commission. Under the proposal, a lead supervisor will be responsible for coordinating the regulation of each insurance group in Europe assisted by a college of supervisors. Although the exact working relationship among the supervisors is still being developed, it is clear that the lead supervisor must be able to report data to host supervisors that is meaningful and consistent. This will mean that data definitions must be consistent throughout Europe.

Because many European insurers are part of larger financial conglomerates and because many European insurance supervisors also supervise banks and securities, it is also important that insurance data be consistent with the data being generated by banks and other financial institutions. CEIOPS is working with other regulatory bodies to harmonise reporting requirements across these sectors and issue practical guidance for the exchange of information.

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The emergence of insurance conglomerates places special demands on internal systems. Having an agreed upon industry framework, dictionary, and process and data models that allow companies to integrate internal systems and ensure consistency across platforms, geographies and lines of business is an industry best practice that brings quality, transparency and auditability to insurance data.

ACORD also works with other financial institutions in its standards development efforts to ensure cross industry consistency, eliminate redundancy, and support coordination with their standards when appropriate.

International Regulatory Equivalence

Solvency II recognises that companies work in a global market as well. Even a company writing in a single European Member State may still be buying reinsurance from a second country. For this reason, the Solvency II Directive provides a process of regulatory equivalence and the Commission and CEIOPS are establishing procedures to evaluate other supervisory regimes. In addition, the Commission has indicated a desire to ensure compatibility with international solvency standards as developed by the International Association of Insurance Supervisors (IAIS).

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ACORD standards are used in a variety of markets around the globe and the number of international members continues to grow. By working with other standards bodies, ACORD strives to harmonize its efforts facilitating implementation. This is also significant as companies continue to expand across geographic boundaries and enter new and emerging markets. As these expansions continue, the impact of ACORD standards on the global marketplace will as well.

ACORD also works in co-operation with global standard setters such as the United Nations through UN/CEFACT to ensure that its standards are consistent with and recognised by other international entities.

Pillar III Issues

Data Disclosure

One of the basic premises in the Solvency II Directive is that the market will itself act as a regulator. Companies will be required to make company risk management and performance data available to market analysts as well as consumers. Reporting data to supervisors and the public allows evaluation of a company's financial stability and market conduct.

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The ACORD data dictionary and exposure reporting can ensure that industry data is reliable, consistent, and comparable.

Often, information reported is of poor quality because of inconsistent classification practices for location and risk type. This is especially true in the reinsurance area where data on location of risks must come from the ceding companies directly. Cross company consistency is therefore vital. The failure of recent catastrophic models has been blamed on poor data.

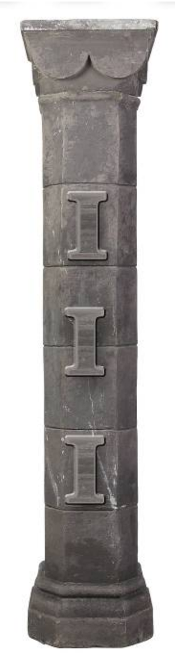
The new disclosure standards may specify that claims information be linked to business information, such as premiums. Without a consistent standard, many companies cannot match this information. The ACORD data standards facilitate this communication. The Property and Casualty Standard incorporates policy information, exposure information, first and subsequent notices of loss.

In addition to the information needed for direct supervision, government entities often decide that it is important to collect additional data derived from insurers for public policy purposes. Although insurers are generally willing to share such data, the myriad of systems make this difficult and expensive. ACORD Standards are a shared language that allows the sending and receiving of data efficiently, to and from multiple parties.

European Single Market

The European Commission in the Solvency II Directive said that it is in the interest of policyholders that policyholders should have access to the widest possible range of insurance products available in the European Community.[6] Consumers will be able to purchase products across borders with other countries within the EU in ways that they never could before. Brokers or internet portals selling insurance in multiple countries throughout the European Union need an agreed upon method for communicating data and information in order to facilitate both domestic and cross-border trade.

ACORD is in the process of creating the ACORD Standards Framework, which includes a single business dictionary, capability model, information model, and component model. ACORD is building this framework primarily to ease the standards creation process as ACORD standards grow in geographic reach. In doing so, ACORD will also release to the industry never-



- *Data Disclosure*
- *European Single Market*
- *Competition Issues*

[6] Solvency II Directive amended, 26 February 2008, paragraph 50, page 25.

before-seen models that can enable application development, Services-Oriented Architectures, and business design (among other potential benefits). In addition, the method ACORD is using will allow for clear mappings to other insurance and cross-industry standards.

It is important to note that the framework itself does not impinge upon individual business logic nor does it mandate particular methods for doing business. It is a foundation companies can use to build solutions and meet business needs while ensuring timely, accurate and transparent data.

Some European Member States have effective data standards in place. Through mapping, ACORD standards can be aligned to others, so consistent standards are in place to facilitate the cross border aspects of insurance or reinsurance.

Competition Issues

European insurers and supervisors may ask whether it is appropriate for the private sector to develop data standards for the industry. In considering this issue, it is important to recognise that there are various types of standards. ACORD does not standardise products or pricing in any way, but instead works on the definitions of the common concepts such as a common dictionary. Data standards free-up companies to focus on their core competencies — underwriting, developing products and pricing, managing claims, risk management.

These standards are:

- Developed with the support of the majority of interested stakeholders and are designed to meet the needs of a broad constituency
- Use pro-competitive methods and encourage competition
- Are technology, vendor and platform neutral
- Focused solely on the results required, not the methodology or technology used to get there

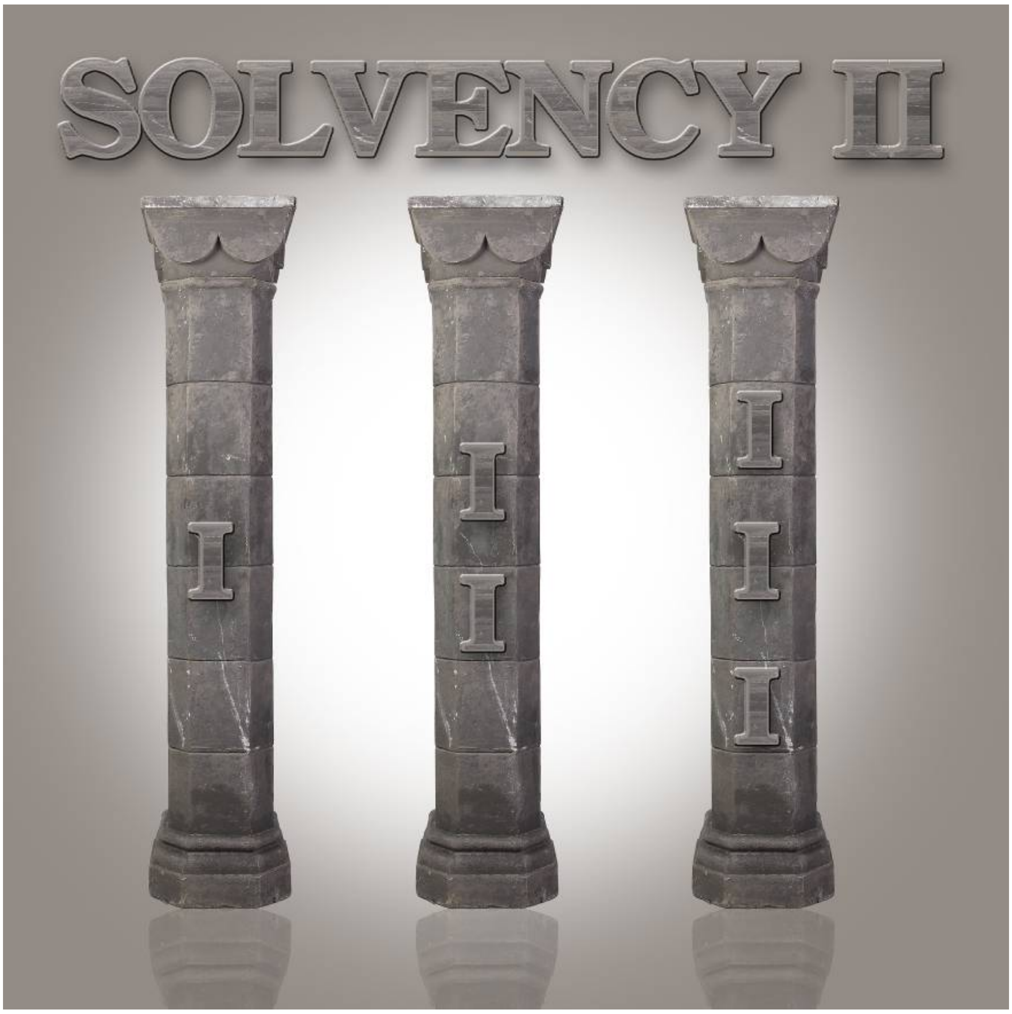
These types of standards are recognised by regulators as necessary for functioning markets and provisions have been made to allow their development. The EU Initiative on Electronic Commerce states that, "Interoperability between various electronic commerce services must be ensured, in particular, by involving European industry and users in standardisation work within the European standards bodies. ... The Commission encourages international industrial cooperation in the field of technology, infrastructure and services."[7]

[7] http://europa.eu/scadplus/leg/en/lvb/l32101.htm

Preparing for Solvency II with ACORD Data Standards

Since its 2007 introduction, the Solvency II Directive has motivated companies to prepare for its implementation. As companies that write business in Europe evaluate their internal systems to meet these requirements, the role that ACORD standards can play in supporting their efforts becomes clear.

Forward-looking companies and regulators are already putting components of the new solvency regime in place to position themselves for the future. One way that companies, brokers and supervisors can advance their efforts is by utilizing existing standards for data and information flow, internally and externally.



ACORD in Europe

Although ACORD began in the United States, ACORD standards are already used by a number of European companies.

ACORD reinsurance standards have been the international standard for years and are used by reinsurers and large commercial writers globally.

ACORD has been working with the London market on contract certainty for three years, and the ACORD Placing and Implementation Guide is used for all new business. Lloyds uses ACORD standards as part of its standardised process.

European writers with subsidiaries in the United States are familiar with ACORD and use their standards in their US operations.

Many have transferred these to their global operations as they prepare for an enterprise-wide system.

ACORD has begun discussion with a number of the leading European insurance company, broker, and customer associations regarding the development of common data standards in preparation for Solvency II.

ACORD is working with UNCEFACT and eEG7, entities working on data standards in Europe.

ACORD works closely with multiple cross industry global software and service providers who provide both insurance and financial systems to the insurance industry.

ACORD Services

As a Standards Development Organisation (SDO), ACORD and its members work to create, maintain and evolve the standards to meet the needs of industry members and to facilitate data flow and regulatory compliance.

ACORD believes it can help the European industry and supervisory community meet the goals of Solvency II. Data standards are essential if these goals are to be achieved.

ACORD is a non-profit organisation. Its standards are available to all insurers, reinsurers, intermediaries and suppliers.

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