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Solvency II: A paradigm shift for mutual insurers

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When Solvency II came into force in 2016, it provided mutual insurers with a golden opportunity: the chance to truly grow up.

The regulatory framework marked a paradigm shift that introduced new approaches to assessing capital needs, more detailed risk assessment, stronger governance, and better reporting standards. For smaller mutuals, the new rules came with the good and the bad, as meeting the requirements of Solvency II was a monumental task. But those who had to do so are stronger for it.

While many mutual directors have been focused on implementing the technical compliance aspects of Solvency II, they can no longer neglect the area that usually has one of the largest impacts on capital – investments.

Cultural shift

For many mutual directors, Solvency II has hastened a cultural shift that challenges the traditional relationship between the insurer and its asset managers.

Asset managers have often operated as though they own the investments they are managing. But they must now accept that the assets they manage belong to the insurer client and must be managed accordingly.

Implementing change

A major impetus for this cultural shift is the three pillars of Solvency II, which give mutual boards greater responsibilities and therefore a much bigger role to play in managing their destiny than in the past.

For starters, a mutual's board must be able to show it has a detailed understanding of the risks embedded in the investment portfolio and how this contributes to enterprise risk. They also need to have a clear appreciation of how the portfolio will look under Solvency II's standard model (particularly in respect to duration, credit and foreign exchange), an auditable and documented decision-making process for the investment portfolio and, finally, to be able to access detailed, timely, reports.

Any insurers (including mutuals) that outsource asset management responsibilities to third parties must ensure that management agreements address these regulatory governance requirements.

Therefore, to successfully transform, mutuals need to define who is responsible for asset allocation, operations, and monitoring, and set parameters for risk appetite, return targets and risk management.

Managing the asset manager

Solvency II sets out that asset managers must be treated like any other external service provider, with the insurer owning the assets and having the obligation to exercise proper governance over them.

This is why it is vital for mutual boards to become fully educated on the contents of their portfolio and take full responsibility for its strategic direction, parameters and risk profile. The asset manager, meanwhile, has responsibility for tactical implementation of investment ideas, optimisation to the mutual's parameters, compliant portfolio construction, and creating an audit trail on all decisions.

This is a significant shift in mutual board's culture and responsibilities. Asset managers can help educate the directors to make this change. But until they fully embrace it themselves, the shift in the relationship between the insurer and their asset manager entailed in Solvency II will not be complete.

Conclusion

Solvency II created plenty of headaches for mutual insurers. Implementing the wide-ranging requirements was no easy feat, especially for smaller insurers with limited resources. But the resultant transformation has been a positive for the sector and mutuals are now in a stronger position.

But the transformation is not over yet. The new regulatory regime has sowed the seeds of a cultural shift whereby mutual boards can take control of their investment management. Only when this process is complete will mutuals gain full control over their governance and investment management, and leverage this to maximise the value a mutual delivers.