

FOCUS ON INSURANCE COMPANIES



**TRANSPARENCY: THE DATA
MANAGEMENT CHALLENGE
FACING INSURERS**



BNY MELLON

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Introducing BNY Mellon's Insurance Industry Roundtable Series

A panel of our insurance industry experts offer their insights on the evolving European insurance industry. This newsletter provides an overview of the transcript derived from one in a series of Insurance Industry Roundtable discussions in which our executive team and industry and product experts explore key trends and issues facing our insurance industry clients.

Our Insurance Industry Roundtable series considers the challenges facing Insurers in EMEA and how by accessing BNY Mellon's comprehensive Investment Management and Investment Services solutions we can help them achieve their business objectives. Other topics include:

- Seeking alpha on Insurers' efficient investment frontier
- The hidden value of specialists - Transition & Beta Management for Insurers
- Cash investments in a turbulent world
- Managing your securities financing & derivatives collateral for optimum result
- Using your Global Markets Counterparty to manage risk

PETER LUCKHURST: What challenges are insurance clients facing?

MICK MURPHY: They are operating in a difficult regulatory environment. And implementing Solvency II is clearly a challenge. The low interest rate environment has had a major impact on insurers' businesses. For the next 2-3 years, the low interest rate environment looks here to stay.

ANDREW LAPKIN: Insurers face pressure to obtain more diversification and higher risk-adjusted returns. That requires more alternative strategies. But the nature of hedge fund vehicles, with limited governance control and transparency, is problematic. Solvency II requirements on transparency, risk analytics and modelling - to get the best capital treatment and meet regulatory mandates - makes it even more difficult.

JOHN BOGGIS: Prevailing market conditions have led insurers to look for more internal transparency, following exposure to Lehman. Solvency II is simply formalising this drive for transparency.

PETER: Insurers have spent huge sums of money on Solvency II Pillar 1 & 2 requirements and are yet to fully address the robust internal data needs and reporting for Pillar 3. Do you think insurers are getting value from their technology spend?

MICK: Insurers have focused on policyholder information, lapse rates, customer behaviour and claims data. And there will be further technology spend to meet Solvency II reporting. Larger insurers have an advantage over smaller players. They have the budgets and internal expertise to create in-house solutions, with the support of external parties.

JOHN: Mick's right. Work to prepare for Solvency II is something insurers should be doing anyway; to see what assets they hold, look at their exposures, who they do business with and what their counterparty exposures are.

PETER: Vast amounts of data will have to be handed to EU regulators, and it will be touched by a wide range of individuals at insurance firms. Is there a risk of it being difficult to uncover meaningful data?

MICK: Insurers would like to use data more intelligently. They want to derive value from this significant data-gathering exercise, to translate it into business opportunities. Clients are increasing significantly their data storage capacity to support Solvency II requirements.

JOHN: Increased data typically becomes more difficult to find meaning from. That's why companies are turning to us to help with this process, to manage the volume of information and adhere to rules; taking data from different sources, in different formats and bringing it all together.

ANDREW: From the regulator side - it might be quite difficult to obtain meaningful data because of inconsistencies amongst different insurers. It is hard enough for a single Insurer to normalise data from multiple sources. The benefit is that if the regulation forces Insurers to enhance their own data enrichment processing to fill gaps and check data integrity, then when the dust settles, it will empower the Insurers as they will be able to use their own data more strategically.



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PETER: Market risk is a key element to Solvency II capital requirements. And insurers need good data governance in their modelling, to sit over asset allocation. How do they identify the required data and hold it in the right format?

ANDREW: The first step is to decide what models to use in the calculations. Insurance companies may decide to use their own internal models or select a vendor solution. The sophistication of the model dictates the data required for both individual securities and the broader market.

JOHN: We have solutions to help insurers and will help clients to identify the data points they need. We can automate and validate this data and give insurers the tools to look at a data point in a report, to understand exactly where it came from and how it moved through the system.

MICK: The Solvency Capital Requirements (SCR) can vary significantly. Asset complexity plays a big part in how detailed your data gathering solution needs to be.

PETER: Pillar 3 carries yet to be finalised regulatory reporting requirements while Pillar 2 says insurers must have a data directory to define and identify the sources. How do they verify whether data is accurate and complete, especially when managing manual and automated systems?

JOHN: We can conduct 350 tests as standard, comparing source to source, today to yesterday and a range of

sophisticated analyses. Clients can also define their own rules to customise the data verification process.

MICK: Clients are mapping data sources to understand what a data collection exercise looks like along with governance and management process around that.

PETER: BNY Mellon is ready to tackle Solvency II. But communication between insurers and service providers has lagged. Do you think their partners - asset managers, custodians, hedge funds, investment banks are prepared for Solvency II's anticipated implementation on 1st January 2014?

MICK: Engagement levels have picked up in the last six months. That trend will continue. However, insurers need to decide whether they will apply a series of tactical solutions or a strategic one.

JOHN: Communication in many cases is incomplete and Solvency II hasn't really filtered through to service providers. Insurers need to explain that service providers must deliver this information on a daily, weekly, and quarterly basis.

PETER: Are particular asset structures or classes heavily impacted by Solvency II?

MICK: Collectives, including money funds and hedge funds, and pooled vehicles will be challenged by the need to provide a security level look through and by the tight timeframes for data distribution. Certain asset classes, such as short-dated corporate bonds and covered bonds, receive good treatment under Solvency II and could become the asset classes of choice.

JOHN: Collectives, without full look-through to the underlying assets, might be shunned because of Solvency II restrictions. Also, some of the required data elements are not traditionally held by third parties in electronic form for more complex instruments such as derivatives."

ANDREW: That's where platforms carrying pooled vehicles with look-through will be attractive. There are asset classes for which pooled vehicles are still the best method of access. And platforms acting as an intermediary between a pooled vehicle and the investor will gain traction.

PETER: Solvency II data delivery has created concerns that look-through to the underlying assets could allow clients to front-run. Is that the case?

MICK: Data from the asset manager has to be delivered within three business days after quarter-end so the insurer can use it in reporting to regulators. If you provide data to an insurer two days after quarter-end, you have to make it available to be prepared to deliver it to all investors.

ANDREW: Disclosing security level data frequently, and with little time lag is a critical issue for fund managers. As a way to help safeguard their trading strategies we are working with hedge funds to aggregate data across multiple funds so line level data is not attributed to one manager. This removes most sensitivity.

PETER: Insurers will need to work with asset firms who can deliver investment performance and meet data and governance requirements. Will they rethink their current roster of asset managers, given Solvency II requirements?

MICK: Firms who want to manage money for insurers will need to be aware of the level of regulation and the types of capital sensitivities that each asset class exhibits. They could come up with some valuable solutions to insurers' requirements.

ANDREW: The solution is to minimise the number of third-parties you take data from. Insurers are going to require asset managers to work through a single custodian, fund administrator or platform to ensure access to high quality, consistent data.

JOHN: We have spoken with insurers who might change managers because existing firms can't fulfil data requirements in the timeframes they need. If you can find a manager who can deliver a return with a lower capital charge and data in the format you need, why wouldn't you work with them?

PETER: So what can you do to help insurance clients?

ANDREW: HedgeMark's hedge fund managed account platform provides insurers with a structure under which they can invest in hedge funds while obtaining access to the data required to address Solvency II reporting requirements. Additionally, HedgeMark has a risk analytics engine available for use by Insurers for those seeking to outsource the risk calculations required to meet the new Solvency II reporting requirements.

JOHN: We can help manage, understand and automate data collection so they can quickly turn data around when asked to by regulators. We can help them demonstrate data is validated, appropriate, accurate, reliable and timely and deliver the reports they need. Insurance companies can then use information to add value to their firm, produce better internal reporting and management information.

MICK: Each insurer's issues are slightly different and the nature of their business drives the way it will behave post Solvency II. We have a wide range of solutions and would be happy to talk about deployment.

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