Do the math

It's just another regulatory equation to figure out, but, says Fundsquare's Paolo Brignardello, the trick to Solvency II is to do your homework

Whether talking to insurers or asset managers, one thing we want to do is provide reassurance. Solvency II may seem onerous but we believe it is possible to overcome some of its most challenging aspects.

At Fundsquare we are keen to make sure that our positive message doesn't instil complacency. The evidence is that many in the industry aren't as prepared as they ought to be at this stage, with just over six months to go before the new rules come into play, and there seems to be a distinct difference in the level of preparedness between asset managers and insurers.

Re-read the question

Asset managers seem to have embraced Solvency II more enthusiastically than their insurer partners, which may seem unusual considering the regulations aren't aimed primarily at them. However, when the business case is made that Solvency II is a once-in-a-lifetime opportunity to overhaul how fund managers deal with one of their biggest client bases, initiative becomes clear.

For fund managers, there are few client groups more important than insurers. Europe's fund management companies oversee almost €17 trillion in assets, and the total assets for the European insurance industry stands at about €8.4 trillion, representing almost half the investment industry. Even if some of this money is overseen internally at insurance businesses and invested into securities directly, that still leaves a huge amount of insurance assets in the care of the fund management industry. It's also a growing sector—that €8.4 trillion is almost 55 percent higher than the €5.4 trillion invested by insurers a decade earlier.

Given the significant increase in the burden of regulatory and administrative work insurers are facing as a result of Solvency II, it does not seem controversial to say that many will try and consolidate the number of asset managers they deal with. The likely outcome of this is that there will be fewer, but more valuable, insurance fund contracts up for grabs.

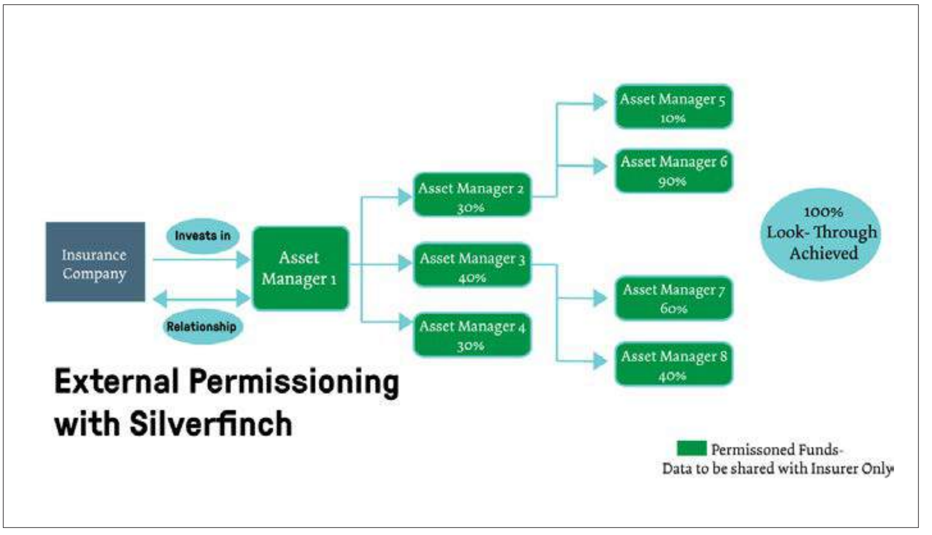
Importantly, from a business planning perspective, the number of insurance funds up for tender is expected to increase markedly in coming months as insurers restructure their portfolios. Fund managers know that those among them who can best demonstrate they can help insurers with their Solvency II requirements will be the ones most likely to get the lion's share of these new contracts.

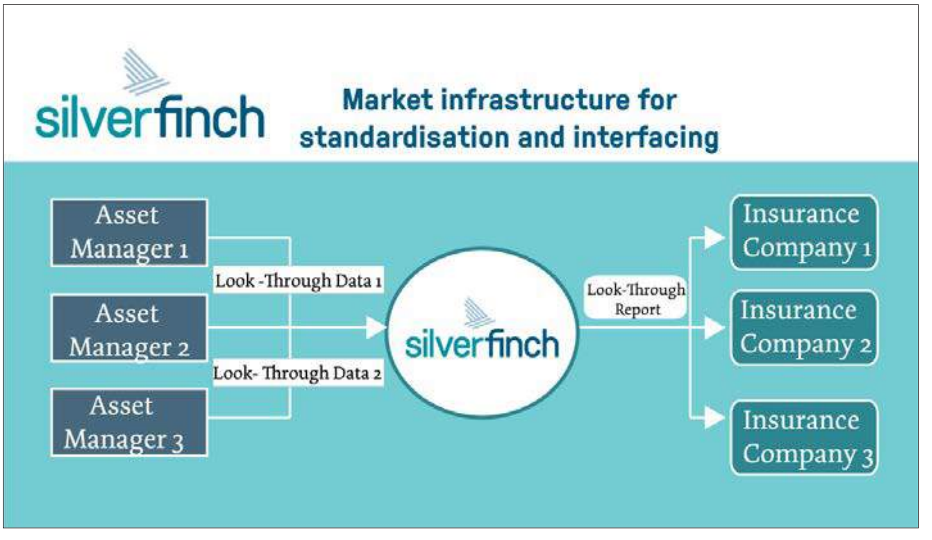
No cheating

Insurers haven't been so proactive, and we are couching our language here. We have talked to more than 200 companies in the past six months and only about half are taking steps to make sure they are fully compliant with the new rules within the deadline.

Some may be over-confident about what they can achieve in a short time, or are thinking that the regulator will be forgiving when it comes to interpreting the rules on look-through.

Indeed, some insurers have suggested that they won't need to fully outline the underlying holdings in a third-party fund and instead think a breakdown of asset allocation will suffice—it certainly won't.





Another worryingly common response to Solvency II is simple inertia. Some in the insurance industry are finding the prospect of identifying and listing their holdings so onerous that they have delayed taking any action in the hope that someone will come along and fix the problem for them.

Whatever the reasons, firms will need to get their skates on if they intend to meet the requirements of Solvency II. Luckily, while there has been procrastination among many that are the targets of the new rules, other participants have been doing their best to move Solvency II forward.

Power of three

Asset management companies are among the best businesses in the world in looking after their clients, and Solvency II, in the end, is a client-servicing issue for their insurance customers. The companies realise this, and so do the overall trade organisations. Over the past few years, industry bodies have banded together to introduce the tripartite data model, which outlines the entire range of data that asset managers will need to provide to their insurance clients to meet the Solvency II stipulations.

This set of more than 100 data points has now been adopted as the EU standard. So far so good—the fund industry has determined which data needs to be provided. The problem is that the model doesn't suggest how this data is formatted or, most importantly, how insurance companies can access the information they need. For Fundsquare, this is the biggest problem with Solvency II, which is why Silverfinch has spent the last few years formulating a viable and efficient solution.

Show your workings

The new Solvency II requirements stipulate that insurers have to be able to understand the risks within their asset books, and that in order to do this they must be able to outline the underlying assets they own. As we have pointed out, many asset managers know how important this client group is, and are therefore prepared to provide details on the holdings within their funds.

However, investing isn't as simple as it used to be. Many insurers are straying from the direct bond holdings and equity funds that have been a staple, and are accessing more exotic assets. Funds-of-funds in particular are attracting investors—43 percent of hedge fund-of-funds managers saw their assets increase in 2014, up from 39 percent in 2013. The increased use of funds-of-funds means that the connection between the insurer and the end investor is becoming ever more complex.

While fund managers are willing to give fund details to their direct clients, when an intermediary is introduced in the form of a competitor—essentially what a fund of funds is—the shutters go down. This is understandable, as asset managers feel they are being asked to share their proprietary investment strategies, effectively the secret sauce of their business, with the competition.

The solution

Fundsquare understands the needs and concerns of each party and has developed a solution that breaks the logjam. It is based around giving the asset manager control over who sees its data. The insurer who has a direct relationship with a fund-of-funds can of course get the data on the individual fund holdings with relative ease. But the insurer also needs to get details on the holdings of the individual funds within the fund-of-funds.

Fundsquare's Silverfinch solution allows an asset manager to give permission to the insurer to access this information, without ever going through the intermediary or competitor who runs the fund-of-funds. And, because the asset manager is always the gatekeeper, a fund-of-funds competitor can never inadvertently get access to this data.

We want to convey reassurance, and with Silverfinch we believe everyone will be satisfied with our solution. Insurers can access the data they need, the asset management compliance director can be content that the company's data is secure, the asset management client servicing department will be happy that their customers are satisfied, and the regulator knows that its requirements are being met. What could be more reassuring than that? **AST**

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