Setting an Appropriate Target SCR Ratio

Publishing SCR data will allow insurers in all Solvency II jurisdictions to be compared on exactly the same parameters

Transparency under Solvency II

EIOPA recently issued guidelines on the requirement for all insurers across the European Union to publish, amongst other indicators, their SCR under the new Solvency II regime. With this drive towards harmonisation and more transparent reporting Europe's insurers are going to be much more open to comparison.

EIOPA - *'the Solvency II Directive requires insurance and reinsurance undertakings to publically disclose essential information on their solvency and financial condition.'*

The time when high Solvency I ratios were touted as a sign of financial strength is rapidly coming to an end. In many cases the Solvency I ratio bears little correlation with the Solvency II SCR ratio. As the treatment of most balance sheet items is not the same under the two regimes many insurers are now realising that a good, or excellent cover under Solvency I does not necessarily translate across to Solvency II

Despite years of preparation for the comparatively complex Solvency II regime a significant number of insurers have neglected to focus in on the one key parameter they will be judged on by regulators, customers and investors, namely their SCR ratio.

What is your Target SCR Ratio?

While some insurers are well prepared to hit and publish their target SCR ratio, there are some concerns that many insurers are not yet adequately prepared. Specifically, many insurers have not yet identified a target SCR ratio and many lack a coherent plan for achieving that target in the diminishing timeframes available.

Another Method for Comparing Financial Strength

It is possible to draw some parallels with the U.S. insurance industry where most insurers carry an AM Best rating and a capital ratio metric known as the BCAR*. The rating and BCAR are the first items scrutinised when potential customers and partners look at a U.S. insurance company.

It is common practice in the U.S. for insurers to establish a target (BCAR) rating in their business plans and actively work towards achieving that.

In Europe the SCR ratio may result in a similar dynamic to the US rating and BCAR system. Insurers will be compared to their peers within their own markets and across jurisdictions to a level of transparency never before seen in Europe.

EIOPA - *'We encourage insurance and reinsurance undertakings to … actively engage in consistent, comparable and high quality communication with their stakeholders on their solvency and financial condition.'*

This solvency based comparison to other insurers will inform customers, investors and regulators and allow them to form a view on the financial strength of the insurer. Those insurance companies that do not yet have a target SCR ratio or a clear program to achieve it, may find themselves disadvantaged to those who do.

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Insurance Regulatory Capital

* BCAR, Best's Capital Adequacy Ratio. An important financial benchmark from A.M. Best that is intended to provide an indication as to whether a company has adequate capital to address its insurance and other risk exposures.