

Strawberries and Cream Insurance Company Limited

Using the balance sheet given here in IFRS format on a Solvency I basis, complete the pro-forma balance sheet provided on the Solvency II basis. Make the following assumptions:

- The gross combined ratio on unearned premium will be 75%
- 20% of future gross claims and expenses are expected to be recoverable from reinsurance
- The effect of any risk margin is eliminated exactly by discounting
- The rate of corporation tax is 28%

B/S row	Assets	Solvency I Balances	Solvency II Balances	REMARKS
1	Cash & cash equivalents	200	200	Assuming no change to valuation is needed, these carry across to the SII B/S.
2	Financial assets	2,600	2,600	
	Reinsurance assets			
3	- reinsurers' share of outstanding claims	400		In SII B/S, this is a component of line 5. See working 3(b). Accrual accounting adjustment. Ignored in SII B/S. Being future cash flows on outwards R/I. Working 3.
4	- reinsurers' share of unearned premium	70		
5	- recoverables from reinsurance contracts		490	
		470	490	
	Insurance and reinsurance receivables			
	Inwards business			
6	- due in future in respect of past events	50		These 3 balances are not separately disclosed in SI, but are analysed here to identify amounts relating to provisions for outstanding claims and premiums provisions in the SII B/S. In SII, these are overdue cash inflows, transferred from line 8.
7	- due in future in respect of future events	525		
8	- overdue	25		
9	- Insurance recoverables		25	
	Outwards business			
10	- reinsurance debts	15	15	
11		615	40	
12	Deferred acquisition costs	150		Accrual accounting adjustment. Ignored in SII B/S. Consider whether appropriate for setting off against line 24.
13	Deferred tax assets	10	10	
14	Total assets	4,045	3,340	
	Equity and reserves			
15	Share capital	100	100	
16	Other reserves	120	120	
17	Retained earnings / balance of own funds	405	563	
18	Total equity and reserves	625	783	
	Liabilities			
	Insurance liabilities			
19	- outstanding claims	2,400		Becomes a component of line 20 in SII B/S. Working 2(b) Working 2 Accrual accounting adjustment. Ignored in SII B/S. Working 1. Negative amount means receipts exceed payments. No reclassification of creditors. Working 4.
20	- provisions for outstanding claims		2,350	
21	- unearned premium	800		
22	- premiums provisions		(75)	
23	Insurance and reinsurance payables	220	220	
24	Deferred tax liabilities	-	62	
	Total liabilities	3,420	2,557	
	Total equity, reserves and liabilities	4,045	3,340	

Workings

SII Technical provisions workings

1 Premium provisions

a Future cash inflows - receivables in respect of future events 525 From line 7

Future cash outflows

Gross claims and expenses

b UPR x gross combined ratio 800 x 75% 600 From line 21

c Less deferred acquisition costs (150) From line 12

d Estimated future claim and expense outflows 450

Net cash (inflow) and premium provisions (75) To line 22

2 Provisions for outstanding claims

a Future cash inflows - receivables in respect of past events 50 From line 6

Future cash outflows

b Estimated future claim and expense outflows 2,400 From line 19

Net cash outflow and provisions for outstanding claims 2,350 To line 20

3 Recoverables from reinsurance contracts

On premium provisions

a Future gross claims x 20% recovery rate 450 x 20% 90 From Working 1(d)

On provisions for outstanding claims

b Reinsurers share of outstanding claims 400 From line 3

Total recoverables from reinsurance contract 490 To line 5

4 Deferred tax charge

Future taxable profit

a Gross UPR x (1-combined ratio) 800 x 25% 200 From line 21

b Add reinsurance recoveries anticipated 90 From Working 3(a)

c Less reinsurers' share of unearned premium (70) From line 4

d Future taxable profit 220

Tax thereon at 28% = deferred tax liability 62 To line 24

Reconciliation of movement in Total equity and reserves

Solvency I Balance sheet 625 Line 18 SI

Add: Future taxable profit not recognised in SI 220

Less: tax thereon (62) From Working 4(d)

Future profit, net of tax 158 From Working 4

Solvency II Balance Sheet 783 Line 18 SII