The Actuarial Profession
making financial sense of the future

Life Conference 2012
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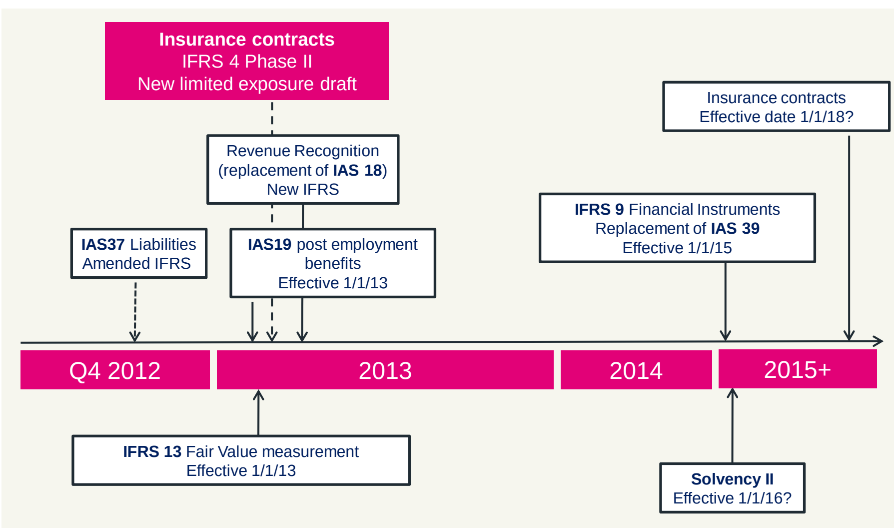
Leveraging IFRS from Solvency II implementation investment

5 November 2012

The IFRS 4 Phase II landscape

Wider IASB projects



Insurance Contract accounting standard

Summary of current proposals

- Project **objectives**: improve comparability and increase transparency
- Current IFRS 4 **definition** of "insurance" carried forward, with some scope changes
- Standard **applicable** to :
  - ➢ insurance contract issued
  - ➢ reinsurance contracts held
  - ➢ financial instruments with Discretionary Participating Features issued by insurers
- Single prospective model where insurance contracts **liability measured** as the sum of:
  - ➢ PV of best estimate fulfillment cash flows
  - ➢ Risk adjustment to compensate insurer for uncertainty in cash flows
  - ➢ Residual margin to eliminate accounting profit at inception

Insurance Contract accounting standard

Summary of current proposals *(continued)*

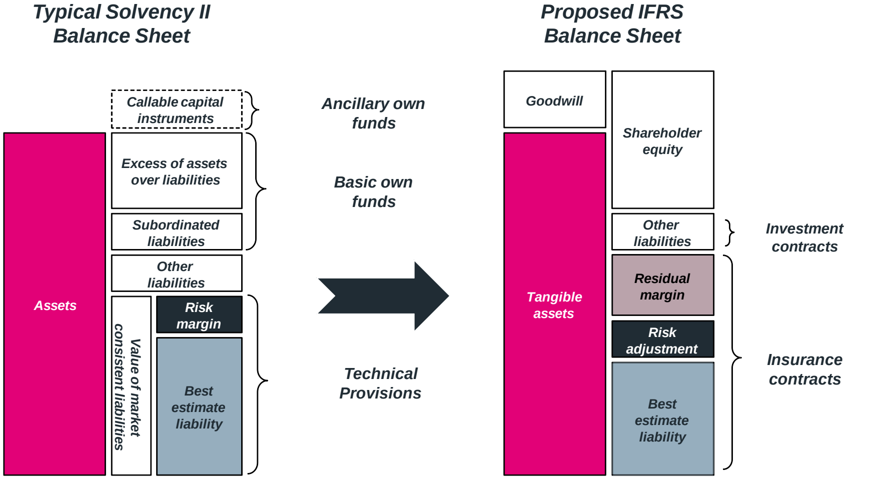
- Premium allocation approach for **short term contracts**
- **Unbundling** of embedded derivatives and distinct investment components
- Presentation and disclosures:
  - ➢ Premium information on face of income statement, excluding investment component
  - ➢ Changes in insurance liability arising from changes to discount rate through OCI
  - ➢ Changes arising from changes to non-economic assumptions => will be offset by a change to residual margin

New limited exposure draft

Areas of focus

- IASB to publish a new exposure draft in first half of 2013
- Comment period of 3 to 4 months
- European commission requires a gap of 3 years between standard and compulsory effective date
- Feedback being sought on a limited range of questions:
  - Treatment of participating contracts
  - Presentation of premiums in the statement of comprehensive income
  - Unlocking of the residual margin
  - Presenting the effects of changes in the discount rate in OCI
  - Transitional arrangements

Components of Solvency II and IFRS balance sheet



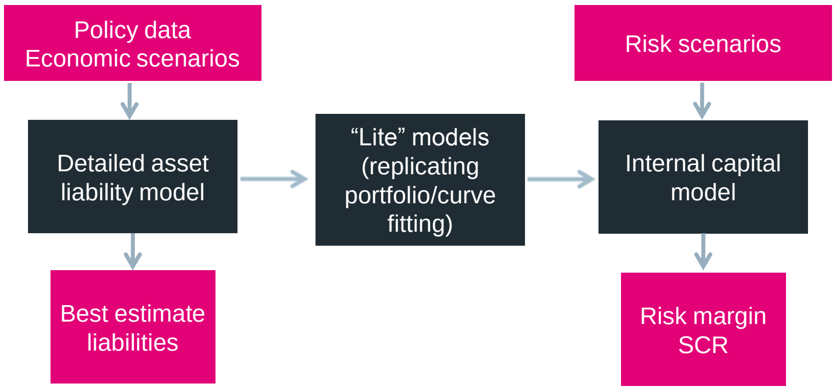
Potential differences between Solvency II and Phase II liabilities

- Scope
- Contract boundaries
- Unbundling
- Expenses
- Risk adjustment (capital amount, cost of capital, confidence interval)
- Discount rate
- Residual margin (models and granularity of data)

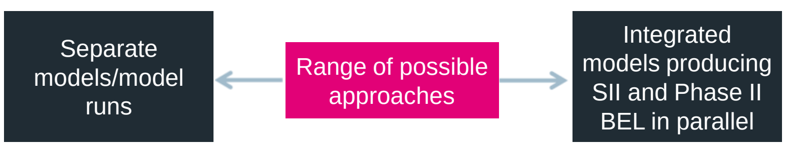
Phase II features

- Focus on income statement rather than balance sheet
- Audited
- SOX compliant (if applicable)
- Market pressure for granular information
- Need to integrate with Solvency II reporting timetable

Typical Solvency II Infrastructure



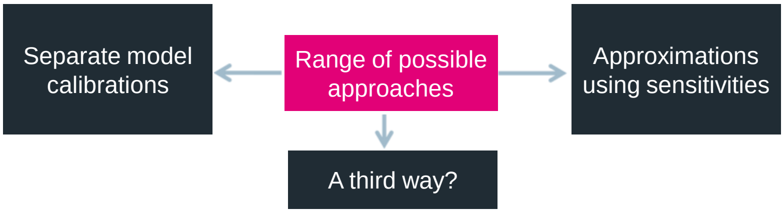
Using Solvency II detailed models to calculate IFRS Phase II best estimate liability



Key considerations:

- Development cost
- IT constraints
- BAU timetables and resources

Using Solvency II models to calculate IFRS Phase II risk adjustment



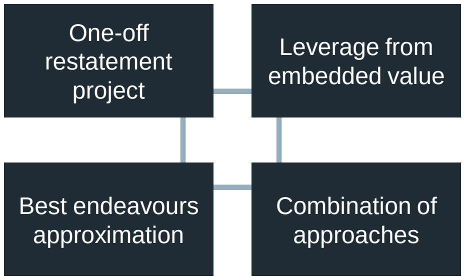
Key considerations:

- Are separate calibrations credible given resource and IT constraints?
- Do approximations offer a sufficiently robust solution?
- Will non-EEA companies build Solvency II type infrastructure solely for Phase II?

Determining the Phase II residual margin - New business

- No equivalent to residual margin under Solvency II
- Point of sale calculations
- Complexity due to unlocking of the residual margin (i.e. Offsetting with change in assumptions)
- Current proposals could lead to complex data/models
- Simplifications could mitigate system complexity

Transition - Range of possible approaches



IFRS 4 Phase II actuarial survey in industry

Is the industry getting ready?

- Some engagement at Senior Management level although not a priority
- Most have plans to do an impact assessment but no work done yet
- Not formally considered and unlikely to do so before new ED published
  - *Classification:* little change expected
  - *Best estimate CFs:* expected to be largely similar to SII
  - *Discounting:* alignment expected once SII settles, i.e. top down
  - *Risk Adjustment:* likely to be aligned to SII, i.e. Cost of Capital
  - *Risk adjustment:* disclosure of confidence interval is significant issue
  - *Residual margin:* all aspects expected to have significant impact
  - *Unbundling:* not considered yet or expected to have minimal impact
  - *Contract boundaries:* expected to have minimal impact
  - *Timing:* no early adopters

Deloitte Global IFRS Insurance survey key findings

Covering over 200 insurers headquartered in Europe & North America

- **Uncertainty is a big problem**. Insurers main concern (52%) is the uncertainty as to when they will have to adopt the proposed changes. Executives fear that a confusing transition will put off investors and potentially damage the sector's market valuation.
- **Insurers fear political meddling**. Standards have been beset by delays and insurers fear this could happen again.
- **Insurers want a global framework**. Overwhelmingly, insurance companies want to be able to use one set of global accounting standards.
- **Companies are stuck in a 'wait and see' mode**. Little preparation for the new standard has been done to date.
  - One-half have not conducted a business impact assessment
  - One-quarter of largest companies have not allocated a budget to the transition

Deloitte Global IFRS Insurance survey key findings

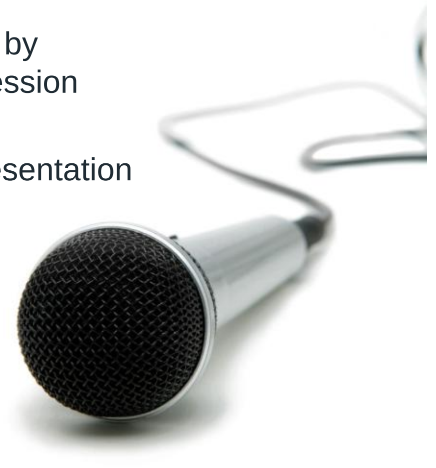
Covering over 200 insurers headquartered in Europe & North America *(continued)*

- **Little awareness of changes at Board level**. Executives at two-fifths of insurance companies say their board has no awareness of or involvement in the proposed accounting changes.
- **Investor engagement has yet to start**. Insurance executives fear that the transition to the new accounting rules will confuse investors. Yet few of them have been talking to the investors. Just 11% of western European companies and virtually none in the US have started an investor engagement programme.
- **Insurers have doubts about the benefits**. With the exact nature and timing of the required changes still uncertain, companies are finding it hard to work out whether the benefits will justify the costs. 21% thought the insurance contracts accounting changes will not be worthwhile.

Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenters.



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