


Institute
and Faculty
of Actuaries

Year end 2014

An external auditor's view


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01 October 2014

Agenda

Objectives of the audit
Key judgements
New areas for 2014
Looking forward to S2 and beyond




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What is an audit?

Audit:

"The objective of an audit of financial statements is to enable the auditor to express **an opinion** whether the **financial statements** are prepared, in all material respects, in accordance with an identified **financial reporting framework**."



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Accounting estimates

ISA 540:

Some financial statement items **cannot be measured precisely**, but can only be estimated.

The nature and reliability of information available to management to support the making of an accounting estimate varies widely

The degree of estimation uncertainty affects the risks of material misstatement of accounting estimates, including their susceptibility to unintentional or intentional management bias.



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Audit concepts

Our work is influenced by three key concepts



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Common areas of significant risk (2013 YE)

- Subjective assumptions
 - Annuitant Longevity
 - Credit default
 - Persistency (mainly for EV)
 - Other economic assumptions
 - Expenses
 - Other mortality and morbidity
- Model & modelling related
- Data
- Management bias



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Appropriateness of assumptions


Firm's own historic data

Market data

Choice of model

Known or expected future changes

Market benchmarking



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Longevity assumptions

Limited even for largest providers

Move to CMI models, but which year, and which parameters?

Consider expectation of life and relative margin over best estimate

Firm's own historic data

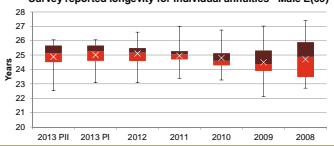
Market data


Choice of model

Known or expected future changes

Market benchmarking

Survey reported longevity for individual annuities - Male E(65)





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Credit default assumptions

Move to alternative asset classes

Short term vs long term % of spread via more complex methods

Hard to compare simply due to variety of methods

Firm's own historic data

Market data


Choice of model

Known or expected future changes

Market benchmarking

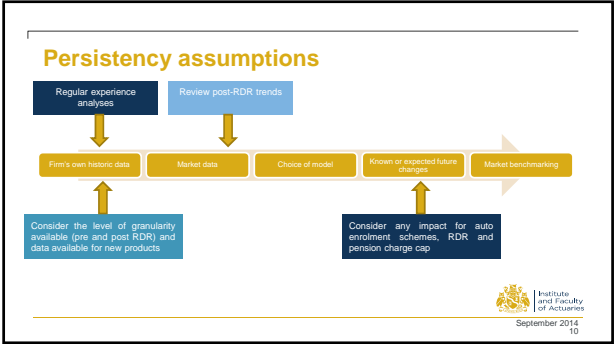
Moody's data widely used, also S&P, Bloomberg, BofE, Merrill Lynch, and own historical data

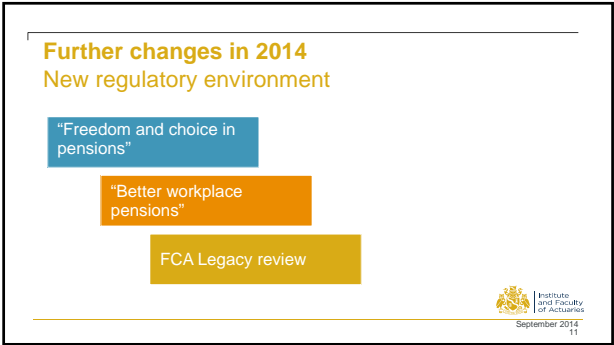
Consideration of government stocks

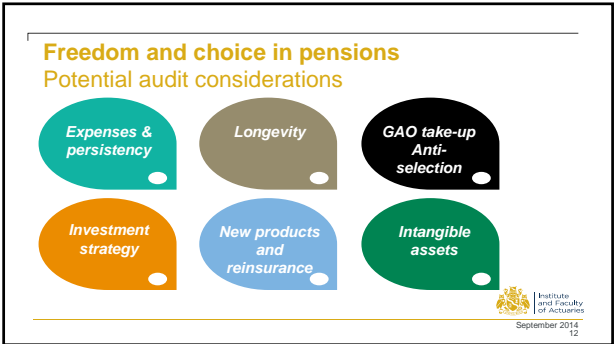


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Better workplace pensions

Potential audit considerations

IFRS


- Recoverability of intangibles
- Sterling reserves for insurance contracts
- Impact on VIF on NP business written in the WP fund.

- Loss of EV VIF where annual charge currently exceeds the cap
- Removal of active member discounts will also directly impact EV VIF
- Removal of commission and banning of consultancy charges may provide some offset to these reductions on EV VIF.

Embedded Value

- Potential effect on persistency and expenses
- Introduction of a charge cap changes the category into which the associated unit reserves fall for the calculation of the insurance expense risk capital component (LTICR).


Other



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FCA thematic review of 'legacy' business


- **Background**
 - Review of pensions, endowments, investment bonds and life insurance policies sold prior to 2001 representing over **30 million policies and more than £150bn of investments**.
 - Focus on whether life companies are operating historic products poorly or have adopted strategies that exploit existing customers unfairly.
 - Information requests have been sent to the firms included in the review with on-site visits expected to take place between now and the end of the year.
 - Findings likely to be communicated in Q1 or Q2 2015.




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FCA thematic review of 'legacy' business

Likely areas of focus





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Solvency II audit requirements

- UK currently requires audit opinion over certain Insurance annual return forms
- Solvency II significantly changes the balance sheet
- EIOPA are considering the imposition of Solvency II audit requirements to apply across Europe – these are due to be publicly consulted on later this year.
- Notwithstanding EIOPA's potential proposals, the PRA have the ability to impose UK specific requirements.



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Solvency II timescales – IMAP firm



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SII audit: potential areas to be covered?

Balance sheet	<ul style="list-style-type: none">• Audit of methodological requirements and related additional assumptions
Own funds	<ul style="list-style-type: none">• Determination, classification and eligibility of own funds (ie an insurer's capital resources)
SCR & MCR	<ul style="list-style-type: none">• SCR calculated in accordance with the regulators• Auditing the calculation (either SF / IM) rather than opining on the actual SCR itself



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SII audit: experience from Lloyd’s market

- Assurance over S2 balance sheets since June 2012
- Multiple iterations of process required
- Interaction between finance and actuarial teams
- Time taken to produce results – further improvements required



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IFRS Timeline
As at early September 2014

IFRS Standard ⁽¹⁾	2014 - 2015	2016	2017	2018 onwards
IFRS 4 Phase II – Insurance contracts	Earliest effective of 1 January 2018. May become clearer before HY15 as the IASB is currently aiming to publish a standard within this timeframe.			
IFRS 9 – Financial Instruments	Standard published in 2014 with effective date 1 January 2018 (early adoption permitted)			
IFRS 15 – Revenue recognition	Standard published in 2014 with effective date of 1 January 2017 (early adopted permitted)			

FASB decides to make only targeted changes to US GAAP, so no global insurance standard will exist!

Solvency II Go-Live in Europe!

⁽¹⁾ Subject to EU endorsement, for relevant entities



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Solvency II – Mind the gap

- ‘Old’ UK GAAP (and so legacy GAAP under IFRS 4 and FRS 103) for life insurers is largely based on the current (Solvency I) regulatory regime.
- Solvency I regulatory regime will be replaced by new Solvency II regime from 1 January 2016.
- For IFRS reporters, the timelines for Solvency II and IFRS 4 Phase II are not aligned. Phase II is expected to be mandatory no earlier than 2018.
- For UK GAAP reporters, it is not yet clear if and when the FRC will update FRS 103 for Solvency II and/or Phase II.
- Need to consider what accounting policies to apply to life insurance contracts in the ‘gap’ period starting from 1 January 2016



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Solvency II – Mind the gap

- Continuation of existing accounting policies is permitted
- IFRS 4/FRS 103 both allow changes to accounting policies if more relevant and/or reliable
- Potentially could seek to early adopt IFRS 4 Phase II (subject to endorsement); a modified Solvency II basis (subject to meeting the relevant / reliable criteria) or other more relevant/reliable policies
- Concern with using a Solvency II basis (particularly for proprietary companies) may be that it doesn't deal with profit recognition.
- Early indications are that listed groups may look to continue with existing GAAP provided gap to Phase II does not grow. Some mutuals are considering changing to a (modified) SII basis.



Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

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



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