The Actuarial Profession
making financial sense of the future

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The future of value reporting post Solvency II

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Recap from last year's debate

EV is dead!

Long live EV!

Conclusion

- Solvency II provides a lot of useful information...
- ...but not everything.
- Therefore, supplementary reporting will still be required, but not to the lengths it currently is.

What does SII provide?

- A “realistic” / “market consistent” value of the company that incorporates future profits
- An explicit cost of the non hedgeable risks within the company
- Greater understanding of risk
- An analysis of the movement in the value
- ...but not everything

What does SII not provide?

- A value that companies believe is a true market value
  - Contract boundaries
  - Discount rates
  - Inflated view of cost of capital
- New business profitability
- A real world measure
- A cash flow analysis

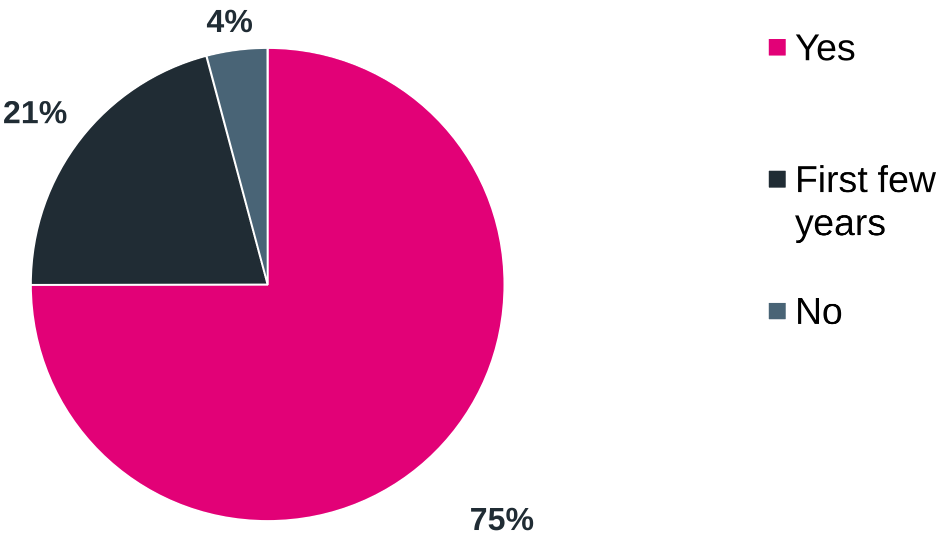
- Therefore, supplementary reporting will still be required, but not to the lengths it currently is.

What are companies planning?

All but one out of 24 companies plan to continue to produce EV results post Solvency II, at least in the first few years.

75% will do so beyond the first few years.

Do you intend to produce EV post Solvency II

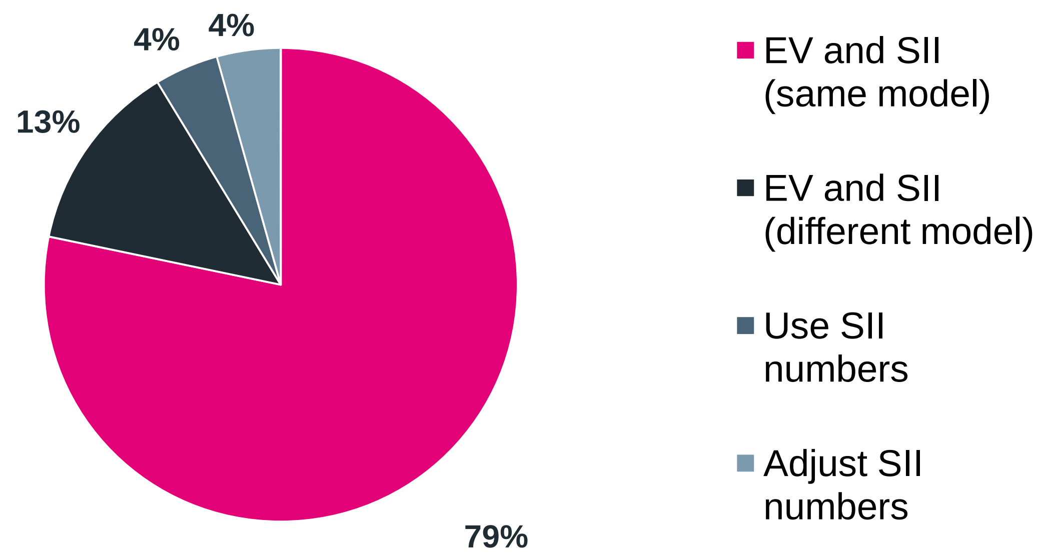


Source: KPMG Technical Practices Survey 2012

What are companies planning?

Nearly all companies plan to produce their EV in the same model as their Solvency II results with only a couple using or adjusting the Solvency II numbers

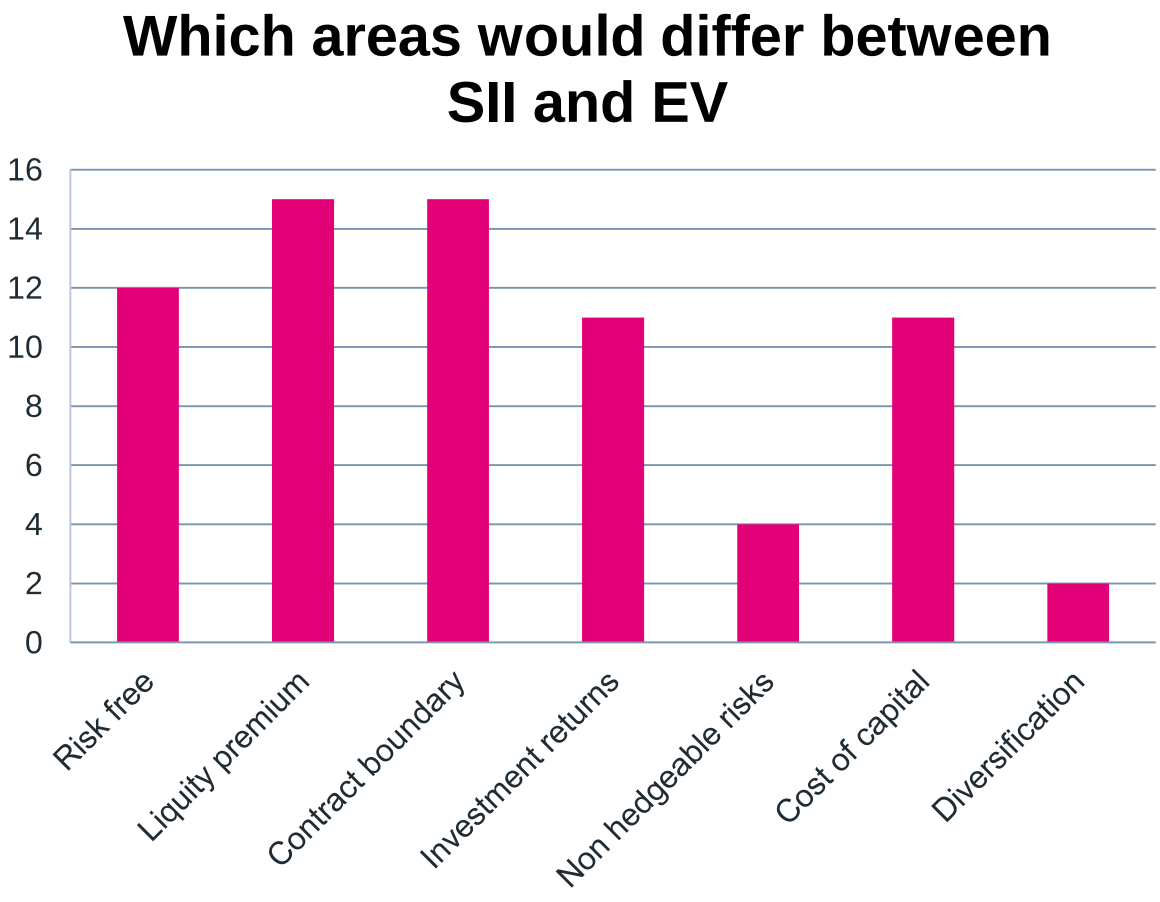
How will you produce EV?



Source: KPMG Technical Practices Survey 2012

What are companies planning?

The areas where companies have differences between SII and EV are around contract boundaries and discount rates, as well as the risk margin.



Source: KPMG Technical Practices Survey 2012

So what options are there?

1. Continue to run a full EV as well as Solvency II
   – Separate models
   – One model

2. Run Solvency II results and provide additional EV-style supplementary information

3. Run only Solvency II and stop EV altogether

Continue to run full EV and Solvency II

What does this mean?

- Effectively keep the EV model as it is and add SII to the workload. Continue to publish EV in the same manner.

Practicalities

- Inputs will be different, e.g.
  - VIF = run off of "prudence" in SII best estimate liabilities and run off of risk margin

Advantages

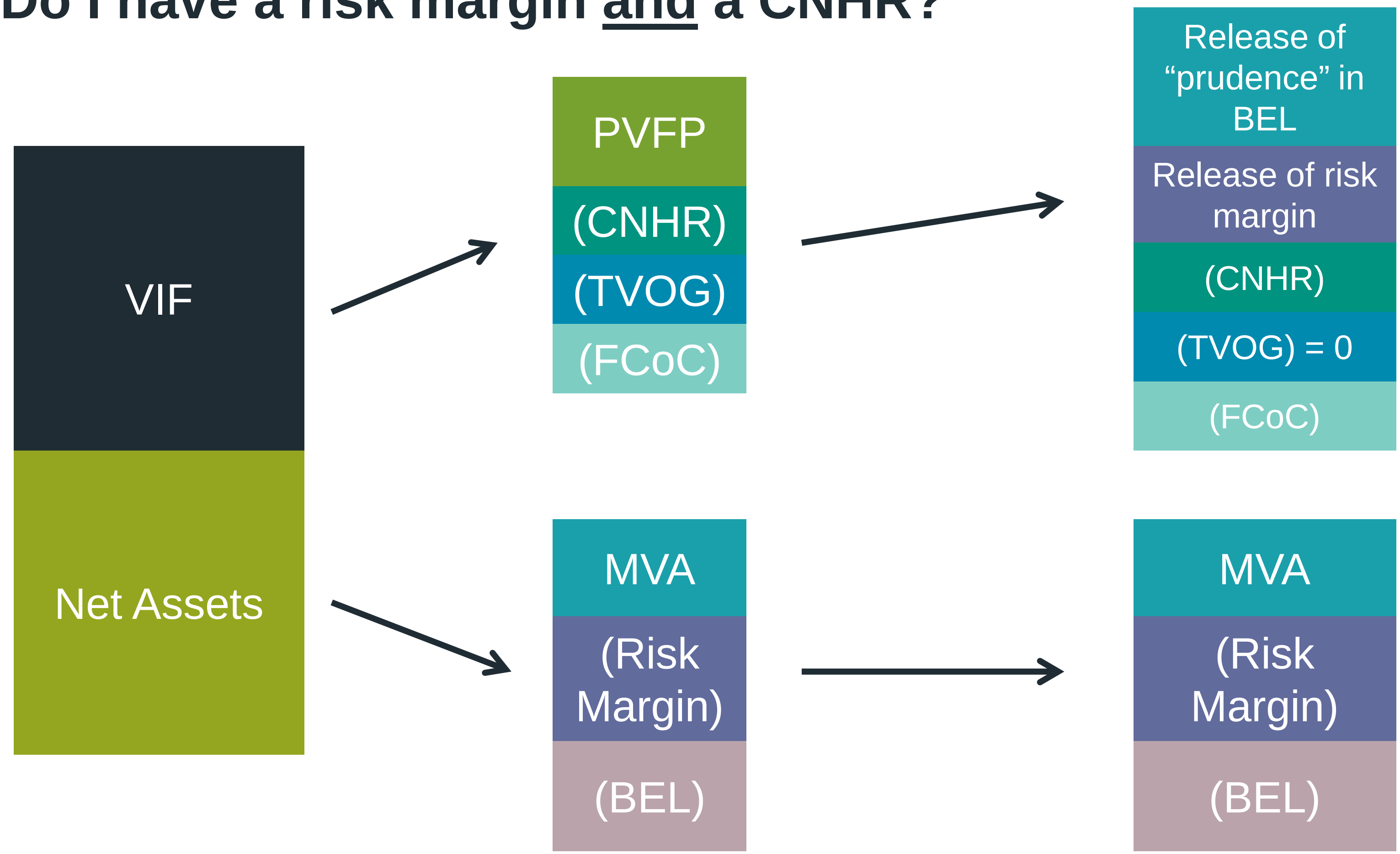
- Results are easy to explain
- Minimal development costs

Disadvantages

- Will continue to have two runs, increasing resource and time requirements

Practicalities continued

Do I have a risk margin <u>and</u> a CNHR?



Use Solvency II model and create other supplementary information

What does this mean?

- No EV balance sheet is created but instead additional information is produced for where Solvency II is lacking

Practicalities

- Use the Solvency II model but then perform “sensitivities”, e.g.
  - Change 6% CoC in Risk Margin to something else
  - Change diversification of capital in risk margin calculation
  - Lengthen contract boundaries

Advantages

- Less effort and resource
- Produce the relevant information

Disadvantages

- Needs industry buy in.
- Potentially difficult to explain initially

What would it look like?

	£m
Market value of assets	2,000
Best estimate liabilities	1,000
Risk margin	300
Solvency II value	**700**
Management view of Cost of Capital	100
Additional VIF from contract boundary lengthening	100
Reduction in BEL due to management view of liquidity premium allowance	100
Management view of diversification within risk margin	100
Allow for frictional cost of capital	(20)
Use of real world rather than market consistent economics	100
Management view of value	**1,180**

Note: these number are purely for presentational purposes and are not intended to represent reality in any way.

How many runs would I need to do?

Run no.	
1	Base Solvency II run
2	Change cost of capital parameter in risk margin calculation
3	Switch to allow VIF to be calculated for “short” boundary contracts
4	Change liquidity premium parameter / curve
5	Switch to different capital requirement in risk margin calculation
6	Calculate frictional cost of capital
7	Switch real world vs market consistent

What are we missing?

- New business value
- Split between PVFP and TVOG
- Detailed analysis of movements
- Cash flow analysis

New business value

- Assuming models can output results for new business separately, can add to previous table:

£m	All	VNB
Market value of assets	2,000	
Best estimate liabilities	1,000	
Risk margin	300	
Solvency II value	**700**	**70**
Management view of Cost of Capital	100	5
Additional VIF from contract boundary lengthening	100	5
Reduction in BEL due to management view of liquidity premium allowance	100	5
Management view of diversification within risk margin	100	5
Use point of sale assumptions	(5)	5
Use of real world rather than market consistent economics	100	5
Management view of value	**1,200**	**95**

Note: these number are purely for presentational purposes and are not intended to represent reality in any way.

Split of PVFP and TVOG

- <u>**Question:**</u> Is this necessary for analysts?
- SII can give a view on this through market risk sensitivities and discretionary vs guaranteed split
- *But if yes, then:*
- **PVFP:** still need to produce EPIFP separately under Solvency II. Though not the same – gives indication of future profits allowed for within BEL.
- **TVOG:** Likely to be fully in BEL. Is effort of splitting it out from BEL worthwhile? Could provide qualitative assessment.

Detailed analysis of movement

- Profit & Loss Attribution requires this for IM companies
- Some form of AoM should be part of the SII governance / validation process for <u>all</u> companies
- Can state an abridged version using the output from the above, giving key items, including:
  - Value of new business
  - Unwind
  - Operating variances
  - Operating profit
  - Non operating variances
  - Non operating profit etc.

Cash flow analysis

- To provide analysts with a view of future profit / dividend flows
- Use outputs from the final real world run of the model
- Present this however management feels is best, e.g.

£m	2013	2014	2015	2016	2017	2018	2019	2020
Unwind								
Release of prudence								
Earnings on surplus								
Undiscounted free surplus emergence								

- Too much detail?

Benefits of this approach

- Give the analysts and management exactly what they want
- Minimise the amount of effort and resource required
- Very clear as to what areas of value the company does not believe are reflected in Solvency II

- Analysts look for consistency, so may look to Solvency II to provide this. Giving clear steps from SII to the management view of “reality” is a good way of achieving consistency plus the information analysts need.

Solvency II uncertainty

- Last few weeks – further uncertainty
- Expect EV to be around for a while until settled
- But not expecting Solvency II developments within companies to completely fall away
- Now is a good time to start looking for the efficiencies between Solvency II and MCEV

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 presenter.

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