



**The Actuarial Profession**

making financial sense of the future

# Going Global

The IFRS Journey Continues ...

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# Agenda

- Insurance accounting in 2009 in an international context
- The interaction of accounting and regulation
  - Solvency II vs. IFRS 4 Phase II
- Other international developments
- Implications and challenges for actuaries and insurers

# Insurance accounting in 2009 in an international context

## Global

- IASB begins its deliberation for a draft IFRS 4 Phase II, February 2009

## EU and EEA

- Solvency II Framework Directive approved, April 2009
- CEIOPS publishes draft advice on implementing measures, March-October 2009
- First results based on CFO Forum MCEV published, February-April 2009

## USA

- FASB begins its joint work on a new US GAAP convergent with IFRS 4 Phase II, February 2009
- NAIC continues its work on Principle-Based-Reserving for US insurance regulations, January-October 2009

## Japan

- FSAJ publishes a draft roadmap to move Japan to IFRS, June 2009

# The interaction of accounting and regulation – Solvency II vs. IFRS 4 Phase II

- Scope
  - Block 1 – different estimation for future premiums
  - Block 2 – illiquidity conundrum
  - Block 3 – principle based v. prescriptive approach
- Residual and Composite Margins – Solvency II treatment

# The interaction of accounting and regulation

## – Solvency II vs. IFRS 4 Phase II –

### (continued)

Block 2 – Discount rate selection and the adjustment for illiquidity

- IFRS will require a principle-based selection from market interest rates that match the characteristics of the liability in relation to:
  - Currency;
  - Duration; and
  - Illiquidity
- Solvency II prescribes a curve that is completely risk free (from both credit or illiquidity spreads)
- Are claims payable illiquid? IBNR? Latent claims?

# The interaction of accounting and regulation

## – Solvency II vs. IFRS 4 Phase II –

### (continued)

Block 3 – principle based v. prescriptive approach

- Phase II does not prescribe a method
- Solvency II prescribes cost-of-capital with flat premium across all entities
- Phase II introduces a principle based definition of portfolio for the measurement of the risk margin
- Solvency II prescribe segments and these should be used to calculate technical provisions, entity specific portfolios can only be at a lower level (CEIOPS CP27)

# The interaction of accounting and regulation

## – Solvency II vs. IFRS 4 Phase II –

### (continued)

#### Residual and Composite Margins – Solvency II treatment

- Phase II decisions to date prohibit day one profit
- The result is an additional liability if the contract is priced for profit (premium higher than sum of three-building-blocks) with a Residual Margin liability
- Phase II may even contemplate an IFRS with no risk margin (Composite Margin) if the new US GAAP proposals are eventually favoured
- Solvency II always requires a margin for risk based on cost-of-capital
- Solvency II tier I capital would be reduced by any residual margin liability unless treated differently

# Other international developments

## International Actuarial Association (IAA)

- Research paper on “Measurement of Liabilities for Insurance Contracts: Current Estimates and Risk Margins”, 15 April 2009
- Conclusions on Risk Margin
- Cost of capital method is the most risk sensitive and the most closely related method to pricing risk in other industries
- Conditional Tail Expectation methods are more sound than confidence level approaches
- Confidence level could work in conjunction with cost of capital methods
- Explicit assumptions and discount approaches could be used as approximations for other methods



# Role of Actuaries

- Complex modelling
  - Stochastic
  - Data
- Interaction with business functions
- Independence
- Actuarial Function role under Solvency II
- Judgement
- Expertise

# Implications and challenges for insurers

## Short term

- Uncertainty of final standard

## Medium/Long term

- Realisation of synergies with Solvency II
- Managing earnings volatility
- Transparency
- Removal of excessive margins?
- Systems

# Implications and challenges for insurers

## Medium/Long term (contd.)

- Additional data required?
- Measure of business performance
- Arbitrage

# Q&A