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IFRS II/Solvency II Technical Provisions – What does the future state reserving look like?

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Agenda

What are we going to discuss today?

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Agenda

- Dispelling the myth
- IFRS Phase II – what is happening?
- Why you should care
- How this affects reserving process
- To summarise…

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Dispelling the myth

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Myth: IFRS Phase II is the same as SII
Different objectives

	Primary objectives
Solvency II	• To provide enhances security to policyholders • …by ensuring insurance companies have a robust approach to risk management • …and hold sufficient capital (based on those risks) to reduce the probability of failure to at least 1 in 200 in a one-year time frame
IFRS Phase II	• To ensure that the presentation of the accounts for insurance companies is consistent with the approach used for other non-insurance companies • …and thus to enable investors etc to compare all types of companies on a like-for-like basis

Myth: IFRS Phase II is the same as SII
Similarities but key differences

Solvency II	• A discounted best estimate • …intended to provide management and regulators with realistic, quality information upon which to base decision making • Prescriptive approach to some aspects of the calculations (e.g. risk margin)
IFRS Phase II	• A discounted best estimate basis • …but potentially not for some • Anticipation of future profits is forbidden • Less prescriptive in places • Far more actuarial disclosure than we've been used to

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IFRS Phase II – What is happening?

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What has happened so far, and what is still to come?

	2013	2014	2015	2016	2017	2018
IFRS 4 Phase II	ED published in June 2013	Final standard issued in 2014/early 2015?				IFRS 4 Phase II mandatory ?
Solvency II	Long term guarantees issues being addressed			Implementation date 1 January 2016		
IFRS 9	Classification & Measurement re-deliberations in Q2 2013	Final standard issued in July 2014?				Effective from 1 January 2018

IFRS II measurement models for GI

	Current IFRS/GAAP	BBA throughout	PAA*	PAA and undiscounted incurred*
Unexpired risk	UPR less DAC	Contractual Service Margin Risk adjustment Discounting Best estimate of fulfilment cash flows	Premium (less acquisition costs) unearned	Premium (less acquisition costs) unearned
Expired risk	Undiscounted reserves for past claims (including IBNR)	Risk adjustment Discounting Best estimate of fulfilment cash flows	Risk adjustment Discounting Best estimate of fulfilment cash flows	Risk adjustment Best estimate of fulfilment cash flows

* Specific conditions must be met

What is involved?

Amounts

- *Detailed roll forward schedules and reconciliations*
- *Reconciliation of sources of profit*
- *Contracts written in the period*
- *Relationship - interest and investment return*

Significant judgements

- *Processes to estimate inputs to methods*
- *Effect of changes in methods and inputs*
- *Confidence level for determining risk adjustment*
- *Yield curve(s) used to discount cash flows*

Nature and extent of risks

- *Nature and extent of risks*
- *Insurance risk on gross/net basis*
- *Concentrations of insurance risk and claims development*
- *Quantitative disclosures about non-insurance risks*

Other detailed differences between SII and IFRS II requirements for Reserving

Topic	IFRS	Solvency II	Significance	Observations
Definition and scope	Insurance and participating investment	All contracts		• The measurement of investment contracts in IFRS may be significantly different to Solvency II.
Recognition	Date coverage begins (plus onerous contact test)	Date party to contract		• The level of difference will depend on the onerous contract test in IFRS. For many contracts the recognition will be the same.
Cash flows (excluding acquisition)	Incurred directly to fulfil portfolio of contracts	Prescribed		• There is a risk of differences in the cash flows included in the two frameworks. For example, the treatment of certain overhead expenses.
Acquisition costs	Directly attributable at portfolio level	Expensed as incurred		• In IFRS, there is 'implicit' deferral of acquisition expenses. No equivalent concept in Solvency II.
Discount rate	Top down or bottom up (Current and locked-in for OCI purposes)	Likely to be prescribed for most non-life insurers		• It is unclear how the Solvency II discount rate will compare to the principle based approach in IFRS.
Risk allowance	No prescribed method	Prescribed 6% cost of capital		• The Solvency II risk margin is highly prescribed, while the IFRS risk adjustment is principle-based.
Contractual service margin	Eliminate day-one gain (update for certain changes)	No		• There is no concept of deferring day one profit in Solvency II.

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Why should you care?

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IFRS II changes
Why should you care?

- You will be responsible for reserving on the new basis
- UK GAAP is likely to merge with IFRS eventually
- It is NOT the same as SII
- Cost: systems development, process design
- You'll need an efficient process if you are going to meet those deadlines!
- You have an opportunity to influence things now

A stich in time….

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How this affects the reserving process

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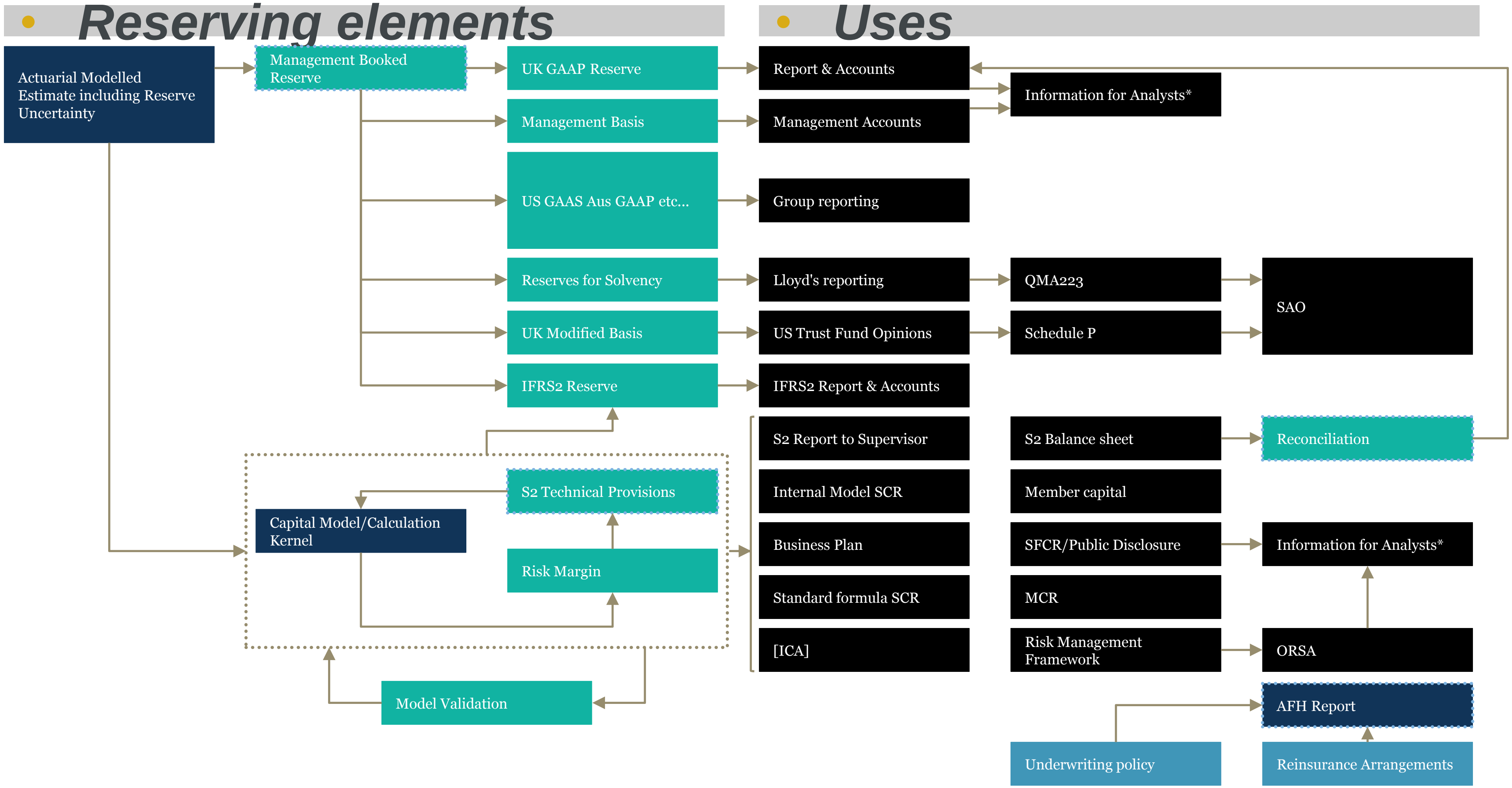
Your deliverables will be even more complex than this



Note : Arrows indicate one process feeding into another. Adjustments are likely at any stage

Things to think about?

- What will your company use to manage your business?
- Processes
- Controls and governance
- Resourcing and training
- Reporting timetable
- Interaction with Finance: should actuaries sit in Finance?
- Role of the actuary
- Potential to think out-of-the-box?

Could SII drive IFRS estimates in the future?

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To summarise…

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- It is a myth – IFRS is very different to SII
- It could come in as soon as 2018 for those already using IFRS
- …and later for those who don’t
- Actuaries have a key role to play – not least, in disclosures
- Time to rethink your processes – potential efficiency gains
- There is a one-off opportunity

You have a window of opportunity

Get in the driving seat!

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Start having conversations with Finance now – You can lead!

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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.