



Institute  
and Faculty  
of Actuaries

# Inconsistencies in Solvency II

And how to cope with them?

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# Agenda

- 1 – Consistency between asset and liability valuation
- 2 – Matching adjustment issues
- 3 – Equity Release
- 4 – Future premiums on unit linked contracts
- 5 – Volatility of the risk margin
- 6 – Treatment of shareholder transfers
- 7 – Treatment of deferred taxes
- 8 – Treatment of the pension scheme
- 9 – Risks missing from the Standard Formula
- 10 – Direction of the stresses in the Standard Formula
- 11 – Double counting of management actions in the Standard Formula
- 12 – Group issues

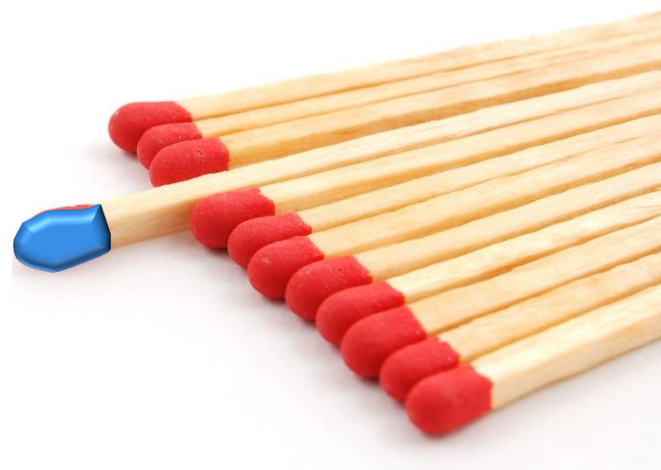
# Topic 1: Consistency between asset and liability valuation

- Solvency II breaks the explicit link between yield on assets and liabilities
- Potential for valuation strains?
  - invest in gilts and/or applies for the Volatility Adjustment
- Greater potential volatility in results even with VA as VA is based on average UK portfolio:
  - Move from gilt to swap based hedges?
  - Monitor as part of the ORSA
  - Move assets holdings to be more in line with the VA portfolios?



## Topic 2: Matching adjustment issues

- Impact of the BBB cliff under stress
- Gilt-swap spread risk
- Different approaches to the cost of downgrade
- Negative matching adjustments
- Impact of LTAS on the stressed position



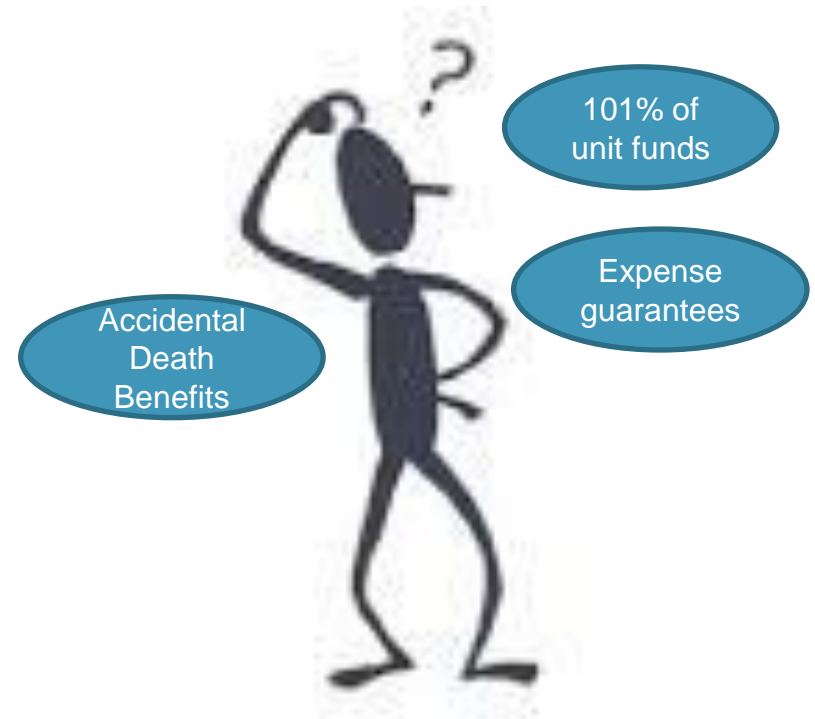
# Topic 3: Equity release

- What is the fair value?
- Impact on matching adjustment
- Standard formula versus internal model



# Topic 4: Future premiums on unit linked contracts

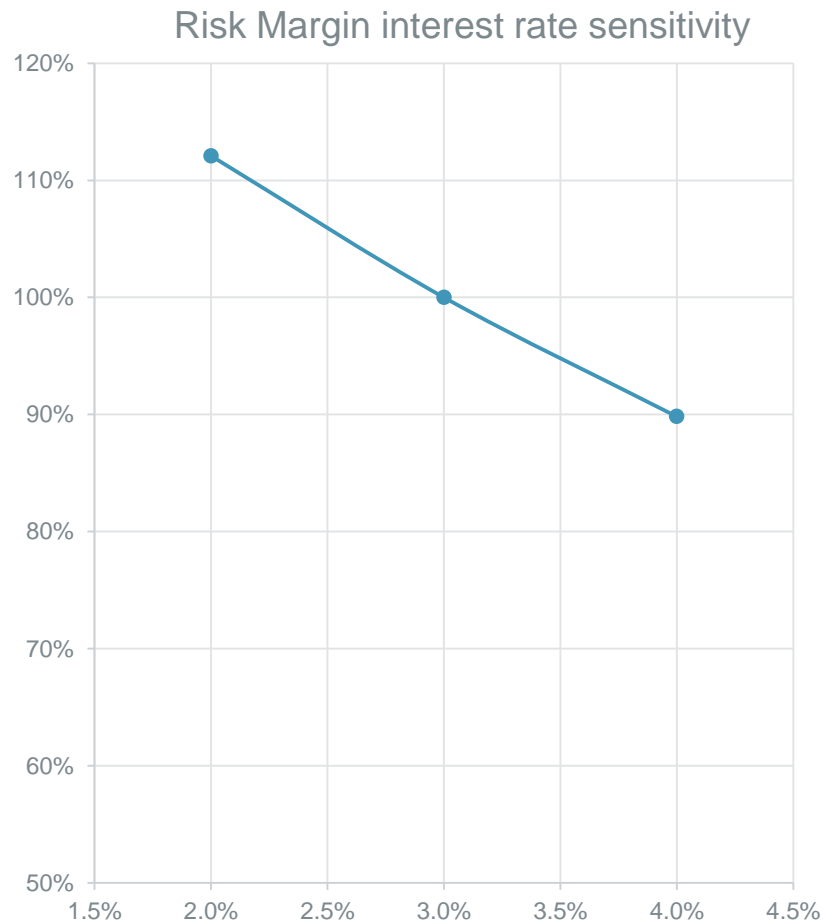
- Solvency II specific requirements in order to recognise future premiums within the contract boundary
  - Does this make economic sense?
  - Implications for product design?
  - Implications for consumers?





# Topic 5: Volatility of the risk margin

- Large potential interest rate sensitivity
  - To Hedge or not to hedge?
- Article 83 Delegated acts states that risk margin does not change in SF scenarios
  - Transitional deduction as a temporary solution?
  - Different approach for Internal Model?



# Topic 6: Treatment of shareholder transfers

- What do the rules say about unrestricted transfers?
  - Recognised in BEL
  - What about the estate?
- Complications and inconsistencies
  - Different treatment whether open or closed
  - Need to avoid double counting of SCR
- How do the changes impact the cost of bonus





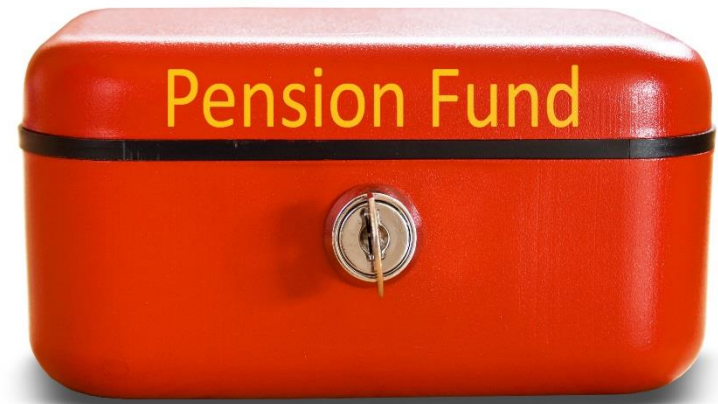
# Topic 7: Deferred Tax treatment

- Recoverability
  - Can we release the risk margin into profit
  - Can we use real world assumptions
  - Future new business
    - On what basis
    - And stressed volumes



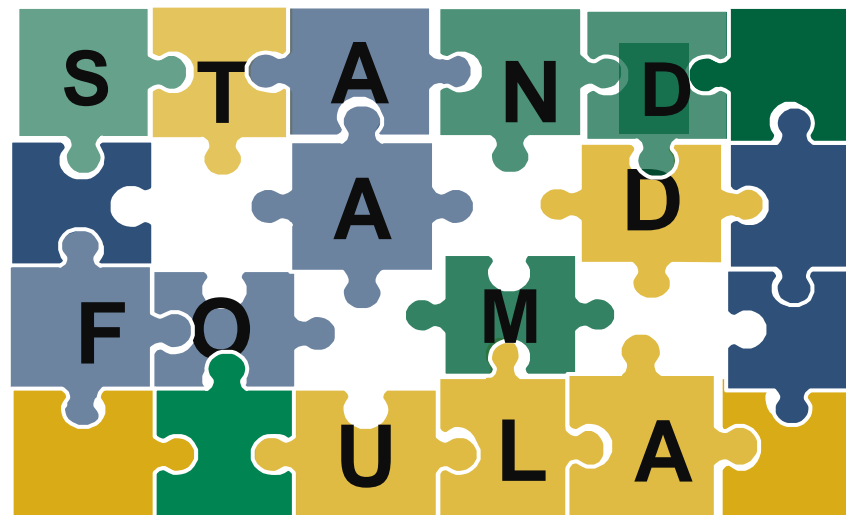
# Topic 8: Treatment of the pension scheme

- IAS 19 used in base balance sheet
  - Not considered 'fair value'
- Under stress are AA bonds still high quality
- Inconsistent stresses between IM and SF
  - Longevity
  - Inflation stress on indexed pensions
  - SF has no credit stress
- No risk margin
- Can you use the pension scheme as a loss absorber?



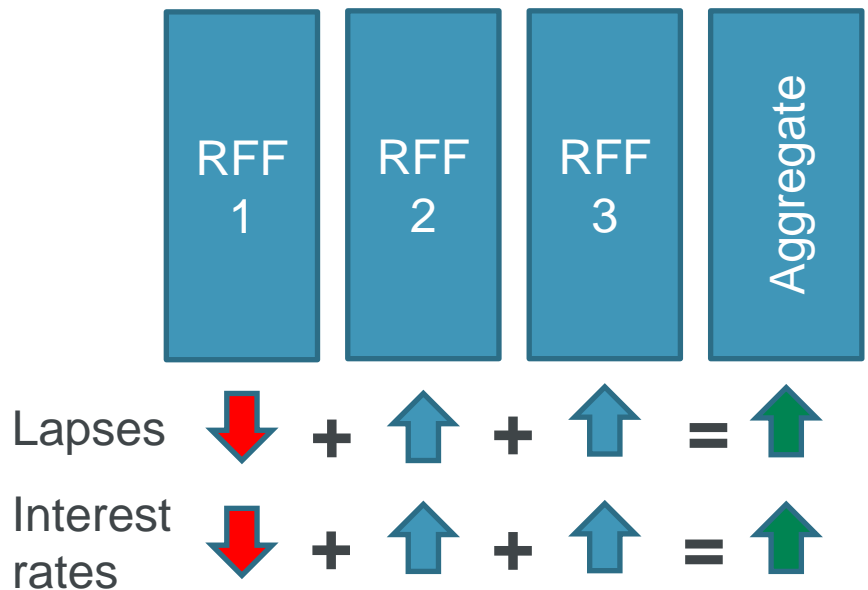
# Topic 9: Risks missing from the Standard Formula

- Risks missing
  - Inflation risk
  - Volatility risk
  - Life New business over 1 year
  - Pension scheme risks
- Combined impacts of the risks?
- Greater reliance on ORSA or PIM?



# Topic 10: Direction of stresses in the Standard Formula

- Direction of stresses determined at aggregate level
- Can lead to counter-intuitive results
  - Internal Model solution?
  - Capital add-ons?



# Topic 11: Double counting of management actions in Standard Formula

Capital requirements	Equity	Interest	Longevity	Total		Combined scenario
Before management actions	40	60	75	104		104
Management actions	(50)	(50)	(50)			(50)
After management actions	0	10	25	27		54

Implied value of management actions of 77

Actual value of management actions should be limited to 50

# Topic 12: Group issues

- Consolidation is different between IFRS and S2
- Equivalence
- Fungibility and transferability



# Questions

# Comments

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