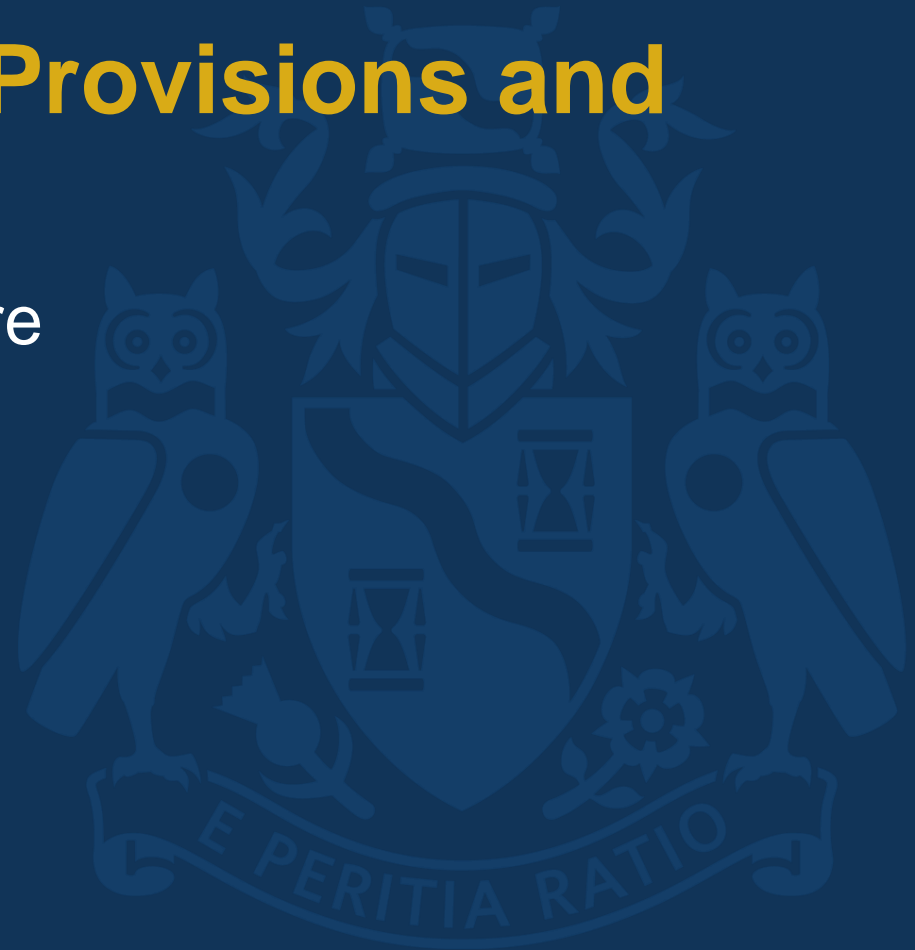




Institute  
and Faculty  
of Actuaries

# Solvency II Technical Provisions and Balance Sheet

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# Key points to share:

## **PRA thematic review of technical provisions**

- Key messages from the thematic review

## **Supervisory Statement: SS5/14**

- Key messages on the calculation of TPs

## **Actuarial Working Party Report on TPs**

- Highlight areas where the PRA's view differs from the report

## **PRA review of SII Technical Provisions**

- Assurance that firms are calculating SII TPs in line with requirements

# PRA thematic review of SII TPs

## Background of the Review

- PRA wanted to gain insight into how firms implemented SII TP requirements
- We asked 44 IMAF firms up to 43 questions on key TP areas

## Aims of the Review

- To aid PRA understanding of how firms are interpreting the Solvency II requirements
- To form an initial view on the firm's approach to technical provisions
- Confirm we are happy with the firm's progress and ensure their interpretation of the Solvency II requirements are not out of line with our expectations (and to raise issues early if they are)
- Assist us in our preparations for further reviews.

## Outcomes

Information received was very useful in furthering our own thoughts on TPs

In April 2014 we published feedback from our review

# Feedback on the 2012 thematic review of technical provisions

## Best Estimate

- Probability weighted average and inclusion of ENIDs
- Payments falling due
- Premium cash-flows for expired risk

## Assumptions

- Justification of techniques and approaches used
- Use of Simplifications
- Validation of assumptions

## Risk Mitigation

- Allocation of outwards reinsurance cash-flows
- Consistency of boundaries

## Events not in data

- Binary events and extreme events do not describe requirement sufficiently
- Varying methods used to calculate

## Risk Margin

- Lack of assessment of appropriateness to uncertainties in run-off of liabilities

## Discounting

- Use of EIOPA discount rate

## Expenses

- Inclusion of all expenses on going concern basis

## Segmentation

- Bundled cover
- Currency splits
- Justification of HRG

[www.bankofengland.co.uk/prd/Documents/solvency2/Feedback2012TPsthematicreview.pdf](http://www.bankofengland.co.uk/prd/Documents/solvency2/Feedback2012TPsthematicreview.pdf)

# Supervisory Statement | SS5/14 (TP section)

## Realistic assumptions and adequate methods

- Article 77(2) requires 'realistic assumptions and adequate methods' in TPs
- Article 77(3) extends this requirement to include the risk margin

## Risk Margin

- Important part of TPs and part of the balance sheet and therefore important
- Methods should not be used unless can be shown to be adequate

## ENID

- Use only of existing data unlikely to satisfy the probability weighted average approach

## Premium Provisions

- Use of optimistic business plan loss ratio to set premium provisions will not be best estimate

## Approximations

- Should be shown individually and cumulatively to not be material

[www.bankofengland.co.uk/prd/Documents/publications/policy/2014/ss5-14.pdf](http://www.bankofengland.co.uk/prd/Documents/publications/policy/2014/ss5-14.pdf)

# Institute Working Party Paper on TPs

- PRA support and encourage the promotion of developing thinking on SII TPs
- Institute TPs paper very insightful and progresses thinking on difficult issues
- Strongly recommend that reserving teams and wider staff read the paper
- There are areas where further guidance has been published by EIOPA or where the PRA has alternative views

<http://www.actuaries.org.uk/sites/all/files/documents/pdf/paper-sii-tp-gi2.pdf>

# Institute Working Party Paper on TPs

- Components need to be reported at Solvency II homogeneous risk groups level
- Policies which cover multiple SII lines of business need to be reported within each SII line of business
  - WP paper says no need for each component of claim and premium provision to be calculated separately.
  - WP paper suggests that unbundling of policies which cover multiple SII lines of business may not be required
  - Where a line of business or currency can be shown to be not material then a proportional approach to the calculation of this amount would be acceptable
  - This allocation, if appropriate, can happen at the end of the reserving process for the purpose of reporting
- ENID (as discussed in the supervisory statement) includes all events not in data whether extreme or small in severity, frequent or uncommon, favorable or costly
  - WP paper definition seems to focus more on extreme events

# Institute Working Party Paper on TPs

- Directive requires technical provisions to be calculated from future cash-flows
  - WP paper suggests including the residual value of existing reinsurance contracts that are outside of the boundary of the technical provisions as a reinsurance debtor
  - This is out of line with the cash-flow approach of Solvency II which does not permit prepayment or accrual type adjustments relating to TPs
  - Undertakings should not apportion the reinsurance premium payable between those underlying risks which are on the balance sheet currently and those risks which have yet to be written. The whole cash-flow should be included within the technical provisions
- The EIOPA Guidelines on valuation of TPs and on contract boundaries is expected to be consulted on in August this year.
- Until then, the GIRO WP document remains the most comprehensive single source of guidance, but the Guidelines may change our views about some of the practices suggested in the WP.

# PRA review of 2014 year end balance sheets

- Solvency II balance sheets contains some significantly different calculations methods compared to the way insurance balance sheets have been produced traditionally
- There is a significant risk that a firm could undervalue its liabilities or over value its assets thereby overstating its capital resources
- Technical provisions are the largest liability on most insurers' balance sheets and for this reason the PRA cannot approve a firm's internal model without being satisfied that the SII balance sheet is being calculated in accordance to the SII requirements
- Julian Adams said 27th February 2012 "Our view is that we would not be able to approve a model under Solvency II without having reasonable assurance as to the accuracy of the underlying balance sheet" and "We are considering the approach that we may take to our review of technical provisions, which may include the use of external review"
- The delays to the publication of Omnibus II led to the deferral of this review. The PRA is planning to conduct the second stage of its review on a year-end 2014 balance sheet. We expect to provide more information in Q3 2014.

# Useful links

- Feedback on the 2012 thematic review of technical provisions
  - <http://www.bankofengland.co.uk/prd/Documents/solvency2/Feedback2012TPsthematicreview.pdf>
- SS5/14 - calculation of technical provisions and the use of internal models for general insurers
  - <http://www.bankofengland.co.uk/prd/Documents/publications/policy/2014/ss5-14.pdf>
- Working party paper on SII technical provisions
  - <http://www.actuaries.org.uk/sites/all/files/documents/pdf/paper-sii-tp-gi2.pdf>



**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.