The Actuarial Profession
making financial sense of the future

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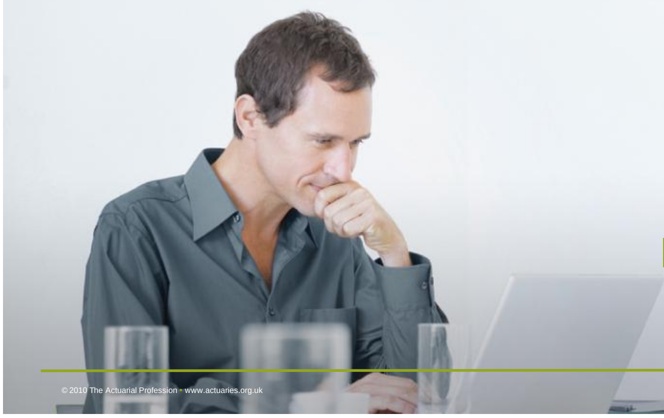


Solvency II

Pillars 1, 2, and 3

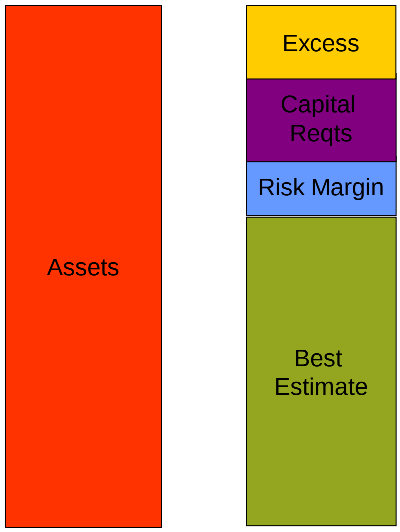
Agenda

Pillar 1 – Contract boundaries, EPIFP and VIF

Pillar 2 – System of governance, risk management, ORSA

Pillar 3 – Public and private reporting

Pillar 1 – The Balance Sheet



Pillar 1 – The state of play

- Some areas of uncertainty → lots becoming certain
- The fundamental principles are clear in many cases

Contract Boundaries

EPIFP

VIF

Pillar 1 – Contract boundaries

- Determines the split between ‘existing’ and ‘future’ business
- Can have extremely material effect on economics of business
- Defined at Level 2 – Delegated Acts
- Clarification of definitions in Level 2 – ITS

Preconsulting now!

Pillar 1 – Contract boundaries: basic definition

Basic definition

- ‘Unilateral Right’ → Out of contract
- No insurance element and no guarantee → Out of contract
- Contract can be ‘unbundled’

Caveats and clarifications

- Unilateral right to amend to fully reflect risks → Counts on portfolio basis
- But not if you can’t do the assessment
- Restrictions and guarantees that have no discernible effect on economics ignored

Pillar 1 – Contract boundaries: further clarifications

Major interpretation questions:

- How to perform unbundling
- What is a ‘unilateral right’
- What is a ‘discernible effect’
- Uniqueness of the boundary

Various definitions including:

- ‘Ability to compel’
- ‘Individual risk assessment’
- ‘Portfolio of obligations’
- ‘Full reflection of the risk’

Pillar 1 – EPIFP

EPIFP = Expected profits in future premiums

Which premiums? – Inextricably linked to contract boundaries

Q. What sort of capital quality are the profits (and losses) from future premiums

A. Question is invalid

EC Allowed in TP, but calculate and disclose separately

Pillar 1 – EPIFP: How to calculate it

Actuarial <u>guidance</u> part 2 – EPIFP expected from EIOPA

- How to do the split between paid and to come
- How to calculate EPIFP
  - Calculate TP
  - Calculate TP assuming no more premiums
    (No penalties, reductions etc in TP)

Difference = EPIFP = Disclosed to market

Caveats and clarifications

- Separately for homogeneous risk group (only offset within HRG)
- Otherwise, on a contract by contract basis

Pillar 1 – VIF: What is the place?

VIF = Present value of profits to emerge over time

VIF = DEAD

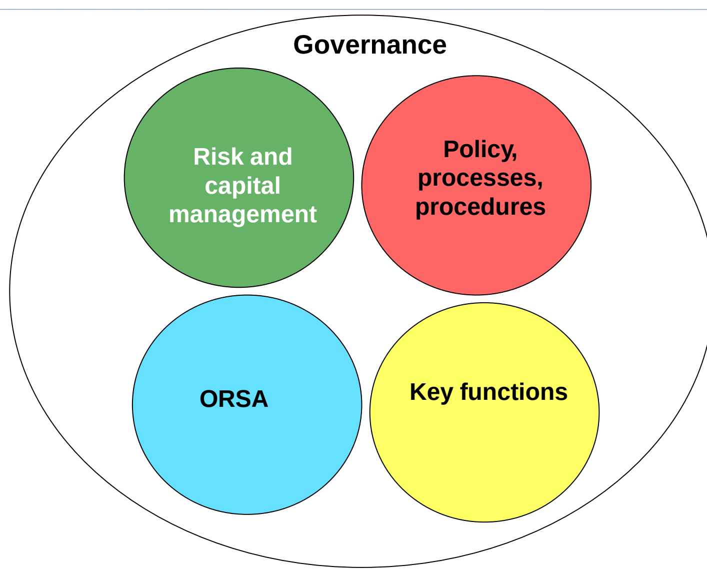
Pillar 1 – VIF: What killed VIF

VIF = Present value of profits to emerge over time

VIF = DEAD

- Solvency II is pure economic best estimate of liabilities
- So, Solvency II has no surrender value floor e.g. Unit linked business – no need to hold face value
- But if so, lapse risk is present
  - TP as a whole considerations
  - Does the contract boundary allow for economic best estimate

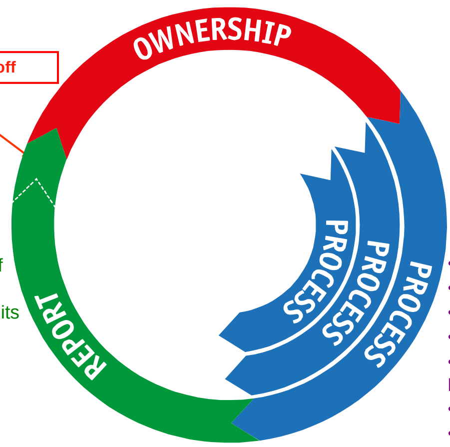
Pillar 2: Governance building blocks



ORSA – what are the key elements?

Management body
- Objectives/purpose
- Solo/group
- Scope
- Ownership
- Embedding/use
- Granularity
- Frequency

Report to supervisor – Sign off



Report
- Strategy
- Business plan
- Statement of risk appetite
- Governance and systems of risk management
- Risk tolerance: capacity, limits etc
- Assumptions
- ORSA vs. SCR
- Results/analysis
- Use of ORSA for decisions

Process
- Methodology
- Roles and responsibilities
- Data capture and flows
- Validation
- Dependencies: SFCR & RSR
- Systems and controls
- Change control

Governance and key functions

Risk Management Function

- Monitor and assist in the effective operation of the risk management system.
- For partial/full IM users, also involves design, implementation, testing, validation and documentation of model.

Internal Audit Function

- Evaluate effectiveness of internal control system and other elements of governance.
- Report to management on weaknesses and recommendations.

Compliance Function

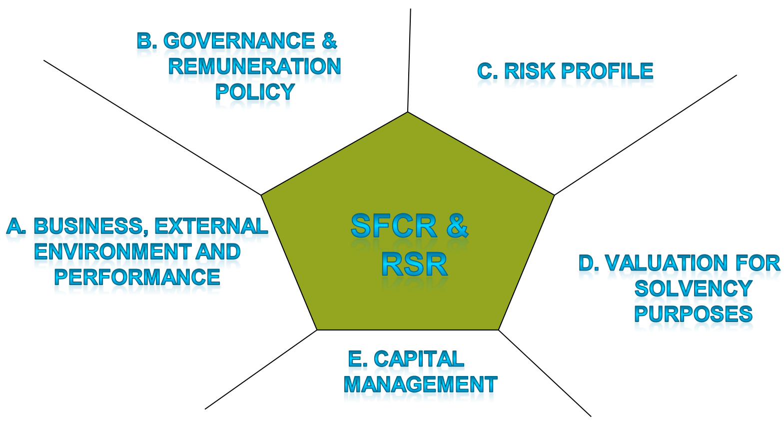
- Identify, assess, monitor and report the compliance risk exposure
- Assess appropriateness of undertaking's compliance procedures

Actuarial Function

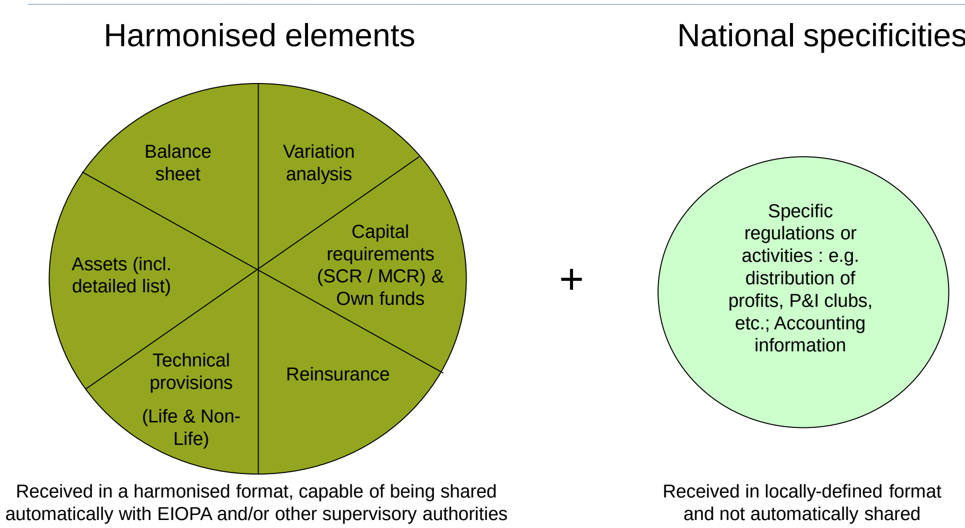
- Coordinate calculation of TP's
- Assess sufficiency of TP's, including appropriateness of methodologies, assumptions and data.

SFCR and RSR

- Narrative SFCR & RSR => similar structure, with 5 parts, to enable comparability between undertakings & SFCR / RSR



Quantitative Reporting Templates (QRT)



Consequences of the new reporting

- To firms
- To the market
- To policyholders

Challenges of the new reporting

- Deadlines
- Extent
- New supervisory approach
- Lack of certainty

Things to do now

- Dry run
- Look at the details
- Join up teams – finance, IT, actuarial etc.