Accounting and Solvency Developments – What you Need to be Worried About!

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28th Annual Giro Convention
The Imperial Hotel, Blackpool

Agenda

Issues:
- IFRS
- Solvency II
- SarBox

IFRS - Timetable

- Insurance Contracts – Phase 1/IFRS 4: effective date – 2005 year-ends
- Phase II – 2008?
IFRS Phase 1: Key Issues

- Disclosures
- Prudence
- Differences in asset and liability valuation
- Definition of insurance contract
- Provisions for future claims not permitted

IFRS Phase 2: Key Issues

FAIR VALUES?

- Discounting
- Risk margin
- Volatility
- Profit recognition
- Impact on strategy

IFRS Phase 2: Key Issues (contd.)

Risk Margin

- Transparency
- Prudential margin or market-based?
- Methods – exit, entry or something else?
SarbOx

It's not just about spreadsheets!

Solvency II - Aims
- Establish solvency standard to match risks and encourage proper risk control in line with IAIS principles
- Harmonise across EU
- Assets and liabilities on fair value basis consistent with IASB if possible
- Set higher solvency standard than currently to permit timely intervention
- 3 Pillar approach broadly consistent with Basel II

Solvency II – Three Pillars

Pillar 1 – technical rules for valuation of assets, liabilities and solvency margin (both SCR and MCR)
Pillar 2 – supervisory review process including individual capital adjustments having regard to effectiveness of risk management and corporate governance arrangements
Pillar 3 – public and private disclosures to the regulator; little debate on Pillar 3 to date
Quantitative Impact Studies

- Two QISs will take place before the Framework Directive is implemented
- QIS 1 will run from October 2005 to December 2005 and will request details of technical provisions for both life and general insurance
  - Inclusion of 75% and 90% risk margins and impact of "deposit floor"
  - Risk margins do not apply to financial elements of basis
  - Confirmed use of swap yields for risk free rates – no exemption for illiquid liabilities
- QIS 2 in spring 2006 and will focus on SCR and MCR

Main Reference Points for Solvency II Framework

- Technical Provisions – may include some element of prudence
- Solvency Capital Requirement (SCR) – level of capital that enables an institution to absorb significant unforeseen losses that gives reasonable assurance to policyholders
- Minimum Capital Requirement (MCR) – level of capital below which ultimate supervisory action would be triggered
Different definitions of the technical provisions

- Best Estimate Liability
- Market Value Margin
- Prudential 90th percentile
- 75th percentile
- 90th percentile
- Other definitions

Note: For illustrative purposes. Diagram is not to scale.

Solvency Control Levels: The SCR

- Formula
- Partial models
- Internal models

Increasing sophistication

Risk aggregation

- Market risk
- Credit risk
- Insurance risk
- Operational risk
- Liquidity risk

Solvency II – Issues

- SCR and MCR to be defined
- Definition of time horizon
- Treatment and definition of prudence
- Acceptability of internal models
- Group Diversification
- VaR or TailVaR
- Harmonisation
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