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?
Agenda

• Dispelling the myth
• IFRS Phase II – what is happening?
• Why you should care
• How this affects reserving process
• To summarise…
Dispelling the myth
### Myth: IFRS Phase II is the same as Solvency II

#### Different objectives

<table>
<thead>
<tr>
<th>Primary objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Solvency II</strong></td>
</tr>
<tr>
<td>• To provide enhances security to policyholders</td>
</tr>
<tr>
<td>• …by ensuring insurance companies have a robust approach to risk management</td>
</tr>
<tr>
<td>• …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</td>
</tr>
<tr>
<td><strong>IFRS Phase II</strong></td>
</tr>
<tr>
<td>• To ensure that the presentation of the accounts for insurance companies is consistent with the approach used for other non-insurance companies</td>
</tr>
<tr>
<td>• …and thus to enable investors etc to compare all types of companies on a like-for-like basis</td>
</tr>
</tbody>
</table>
## Myth: IFRS Phase II is the same as SII
Similarities but key differences

<table>
<thead>
<tr>
<th>Solvency II</th>
<th>IFRS Phase II</th>
</tr>
</thead>
</table>
| • 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) | • 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 |
IFRS Phase II – What is happening?

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

<table>
<thead>
<tr>
<th>Year</th>
<th>IFRS 4 Phase II</th>
<th>Solvency II</th>
<th>IFRS 9</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>ED published in June 2013</td>
<td>Long term guarantees issues being addressed</td>
<td>Classification &amp; Measurement re-deliberations in Q2 2013</td>
</tr>
<tr>
<td>2015</td>
<td></td>
<td>Implementation date 1 January 2016</td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td></td>
<td></td>
<td>Effective from 1 January 2018</td>
</tr>
<tr>
<td>2017</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

IFRS 4 Phase II mandatory?

Implementation date 1 January 2016

Effective from 1 January 2018
### IFRS II Measurement Models for GI

<table>
<thead>
<tr>
<th>Unexpired Risk</th>
<th>Current IFRS/GAAP</th>
<th>BBA throughout</th>
<th>PAA*</th>
<th>PAA and undiscounted incurred*</th>
</tr>
</thead>
<tbody>
<tr>
<td>UPR less DAC</td>
<td>Contractual Service Margin</td>
<td>Risk adjustment</td>
<td>Discounting</td>
<td>Best estimate of fulfilment cash flows</td>
</tr>
<tr>
<td>Undiscounted reserves for past claims (including IBNR)</td>
<td>Risk adjustment</td>
<td>Discounting</td>
<td>Risk adjustment</td>
<td>Discounting</td>
</tr>
</tbody>
</table>

* 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

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

**Reserving elements**
- Actuarial Modelled Estimate including Reserve Uncertainty
  - Management Booked Reserve
    - UK GAAP Reserve
      - Management Basis
    - US GAAS Aus GAAP etc...
    - Reserves for Solvency
    - UK Modified Basis
    - IFRS2 Reserve
  - S2 Technical Provisions
  - Capital Model/Calculation Kernel
    - Risk Margin
  - Model Validation

**Uses**
- Report & Accounts
  - Information for Analysts*
- Management Accounts
  - Group reporting
- Lloyd’s reporting
  - QMA223
  - Schedule P
  - Lloyd’s reporting
  - IFRS2 Report & Accounts
  - S2 Report to Supervisor
  - S2 Balance sheet
    - Member capital
    - SFCR/Public Disclosure
    - MCR
    - Risk Management Framework
  - Business Plan
  - Standard formula SCR
    - [ICA]
  - Underwriting policy
  - ORSA
  - AFH Report
  - Reinsurance Arrangements

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

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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?
To summarise...
To summarise

• 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!
Start having conversations with Finance now – You can lead!

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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.