IFRS 4 Phase II: Solvency II with a twist?
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Agenda
1. Introduction
2. What the Standard requires from Reserving
3. A bit of history
4. Isn’t this just SII with a twist?
5. A lot to do
6. Big decisions
7. Learning from Solvency II
8. Conclusion

What the Standard requires from Reserving
Measurement modes for expired risk

Acronyms for alternative models
BBA: Building Block Approach
PAA: Premium Allocation Approach

Only for contracts where the cashflows are all expected within one year or less
What the Standard requires from Reserving
Measurement models unexpired and expired risk

Overview of measurement model
Contractual service margin

- Represents unearned profit in contract
- Unlocked for changes in cash flows related to future services
- Amortized over coverage period in systematic way reflecting services provided
- Service is provided on basis of passage of time (stand ready obligation) and reflecting the expected number of contracts in force
- Contractual service margin cannot be negative, but can be reinstated
- Previous losses have to be reversed before reinstating the CSM
- Locked in reserve should be used for accretion of interest and calculation of changes in cash flows that offset the CSM

What the Standard requires from Reserving
Measurement models unexpired and expired risk

For contracts with a coverage period of one year or less, or where PAA is a "reasonable approximation" to BAA
Income Statement – Building Block Approach

A bit of history
Background and timeline

...and how we've got to where we are now (1)

- Today wide variety in insurance contracts reporting and estimates are not updated.
- IASB intends to have one building block model for all contracts
- IASB believes market-consistent approach provides best information
- ...but willingness to respond to feedback, such as introduction of PAA approach
...and how we’ve got to where we are now (2)

Principles of the model
- Market value approach
- Avoiding recognition of profits before earned
- Update of assumptions and improved measurement of guarantees

...and how we’ve got to where we are now (3)

Why the premium allocation approach?
- Current GI model not considered ‘broken’
- Request from GI insurers to develop simplified model
- IASB and FASB struggled whether PAA is a separate model or an approximation of the building block approach
- Wish to have one model, so IASB view is PAA should be an approximation of the building block approach
- This leads to potential issues around PAA eligibility for multi-year contracts

Isn’t this just SII TPs with a twist?
The numbers will be different
Isn't this just SI with a twist? So why is this a big deal?

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<tr>
<th>External</th>
<th>Internal</th>
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<tr>
<td>- Managing the messages to market</td>
<td>- MI: the metrics for performance management</td>
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<td>- Preparing investors for change</td>
<td>- Data requirements</td>
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<td>- More detailed disclosures</td>
<td>- Processes</td>
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<td>- Increased volatility in results</td>
<td>- Unit of account</td>
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<td>- Consistency with regulatory messaging</td>
<td>- Risk adjustment calcs</td>
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A lot to do….

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<tr>
<th>Stage</th>
<th>Description</th>
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<tbody>
<tr>
<td>2014</td>
<td>Financial reporting and performance measurement</td>
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<td>2015</td>
<td>Systems implementation</td>
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<td>2016</td>
<td>Actuarial, Risk and Finance Modernisation</td>
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<tr>
<td>2017</td>
<td>Strategic consultation</td>
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Big decisions

Top 4 issues

- Financial reporting and performance measurement
- Systems implementation
- Actuarial, Risk and Finance Modernisation
- Strategic consultation
Big decisions
Presentation and Disclosure Requirements

- Detailed roll forward schedules and reconciliation
- Summarisation of processes of PAA
- Contracts written in the period
- Relationship interest and investment returns

Significant Judgements
- Proportionate inputs in methods
- Effects of changes in methodologies
- Confidence for internal controls and justification

Nature and extent of ORS
- Nature and extent of risks
- Economic risk on gross/net basis
- Concentrations of insurance risk and claim developments
- Qualitative disclosure about non-insurance risks

Amounts
- Detailed roll forward schedules and reconciliation
- Reconciliation of sources of profit
- Contracts written in the period
- Relationship interest and investment returns

Big decisions
PAA vs BBA

PAA?
- The financial impact of each approach, or combination of approaches, will need to be measured against increment investment required.

BBA?
- Not all contracts may be eligible for the PAA and so, to apply the PAA, you would need to develop both methods...

Both?
- Operational benefits exist if adopting PAA in a standalone environment... But these benefits may be reduced if you adopt a mixture of the PAA and BBA.

Life in transition to an IFRS 4 Phase II world
A naive view of how reserving will feed...
Learning from Solvency II

- Silos need to be broken:
  - Capital functions have a key role to play
  - Actuaries need to be integrated and integral to Finance process
  - Leaving things to the last minute can be expensive and painful
  - Technical issues can be surprisingly time consuming

- Controls need to be updated
- Don’t forget documentation… especially if SOx applies
- Reconciliation can be time consuming
- Train, train and train again

Conclusion

- IFRS 4 Phase II will mean big changes for general insurers
- …but, unlike SII, not everyone will convert at the same time
- Actuaries will have a key role to play
  - …in key decisions for the insurer during implementation
  - …in implementation, and
  - …in the IFRS 4 Phase II world
- It may feel far away, but it really isn’t if you are an IFRS reporter
- We need to learn the lessons from SII implementation