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IFRS 4 Phase II: Solvency II with a twist?

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Agenda

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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
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8. Conclusion

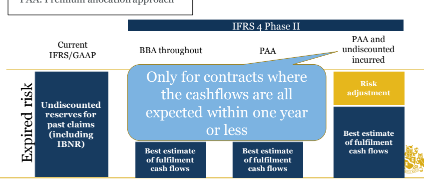
What the Standard requires from Reserving

Measurement modes for expired risk

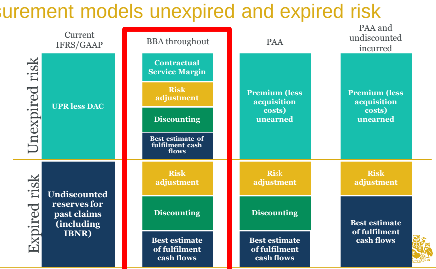
Acronyms for alternative models

BBA: Building block approach

PAA: Premium allocation approach



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



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Overview of measurement model
Contractual service margin

- Represents unearned profit in contract
- Unlocked for changes in cash flows related to future services
- Amortised 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 rates should be used for accretion of interest and calculation of changes in cash flows that offset the CSM

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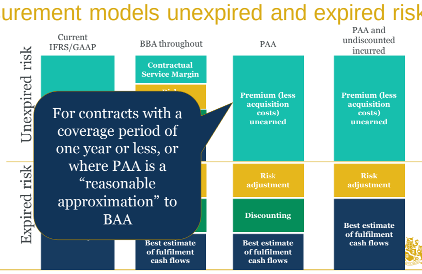
What the Standard requires from Reserving
Measurement models unexpired and expired risk



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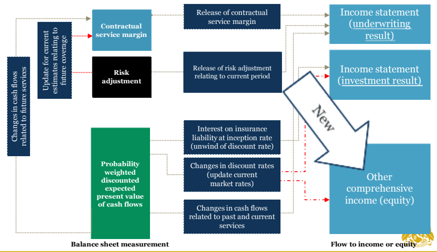
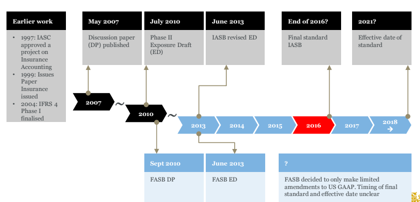
Income Statement – Building Block Approach



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

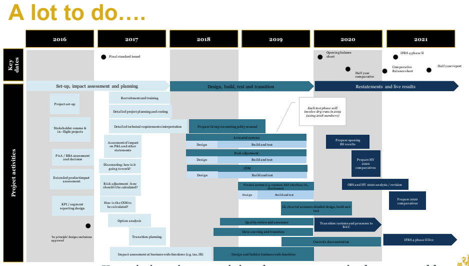
Topic	IFRS	Solvency II	Significance	Observations
Definition and scope	Insurance and participating investment	All contracts		• The measurement of investment contracts in IFRS may be significantly different to Solvency II.
Recognition	Date coverage begins (plus onerous contact test)	Date party to contract		• There is a difference but unlikely to be difficult to deal with.
Cash flows (excluding acquisition)	Incurred directly to fulfil portfolio of contracts	Prescribed		• There is a risk of differences in the cash flows included in the two frameworks. For example, the treatment of certain overhead expenses.
Acquisition costs	Directly attributable at portfolio level	Expensed as incurred		• In IFRS, there is 'implicit' deferral of acquisition expenses. No equivalent concept in Solvency II.
Discount rate	Top down or bottom up (Current and locked-in for OCI purposes)	Likely to be prescribed for most non-life insurers		• It is unclear how the Solvency II discount rate will compare to the principle based approach in IFRS.
Risk allowance	No prescribed method	Prescribed 6% cost of capital		• The Solvency II risk margin is highly prescribed, while the IFRS risk adjustment is principle-based.
Contractual service margin	Eliminate day-one gain (update for certain changes)	No similar concept		• There is no concept of deferring day one profit in Solvency II.
Other Comprehensive Income	Optional: Removed impact of interest rate changes from P&L	No similar concept		• Designed to reduce volatility in P&L, but will it?

Isn't this just SII with a twist?
So why is this a big deal?

External	Internal

• Managing the messages to market
• Preparing investors for change
• More detailed disclosures
• Increased volatility in results
• Consistency with regulatory messaging
	• MI: the metrics for performance management
	• Data requirements
	• Processes
	  ◦ Unit of account
	  ◦ Risk adjustment calcs
	  ◦ Producing disclosures
	  ◦ Greater reliance on actuaries
	  ◦ Tax
	• Getting used to the new world

A lot to do….



Key missing piece – training: how to operate in the new world

Big decisions
Top 4 issues

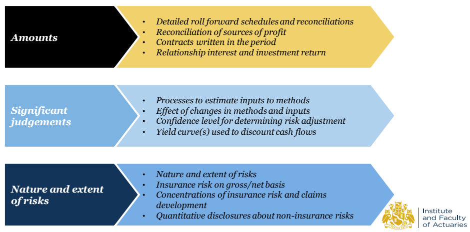
Financial reporting and performance measurement
What will this look like in the new world of IFRS 4 Phase II? How do you want to be seen to the market? New KPIs will be critical for day to day business management right through to investor communications so it's vital to start thinking about this now.

Systems implementation
Do you have sufficiently granular data? Do you have lots of legacy systems? Can you leverage your current systems? Are you going through systems changes now? Save time, effort and costs now by integrating IFRS 4 Phase II implementation plans into existing systems upgrades, e.g. Solvency II projects.

Actuarial, Risk and Finance Modernisation
Are your processes as streamlined as they could be? Do you have harmonisation between these functions? Greater collaboration, understanding, knowledge sharing will be required and in this time of change now is the opportunity to make sure that you factor in all the changes that will be required.

Simplified measurement model
Can you identify your multi-year policies and their terms and conditions? Do you know how many you have and how material they are to your business? Multi-year policies don't automatically qualify for the simplified measurement model (the PAA) so you need to start investigating now to assess if the simplified measurement model is right for you.

Big decisions
Presentation and Disclosure Requirements



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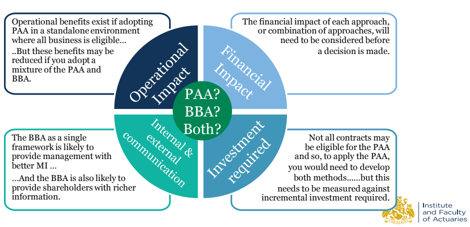
Big decisions
PAA vs BBA



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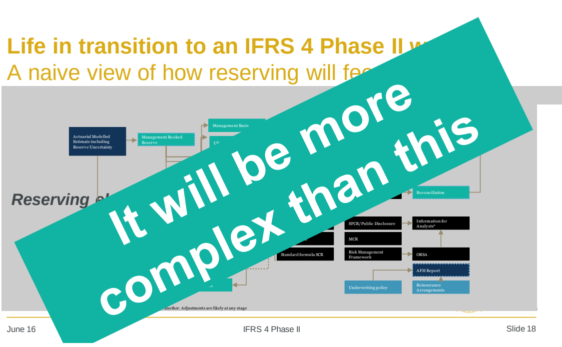
Life in transition to an IFRS 4 Phase II w
A naive view of how reserving will fe



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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

Opportunity for the Reserving Actuary?

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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

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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 presenters.

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