Society of Actuaries in Ireland

SAI Working Party
Emerging Solvency II issues for life companies

03.03.2015

Agenda

- Introduction
- SII transposition and implications
- SII harmonisation
- SII implications for accounting and tax
- Conclusions

Disclaimer:
The material, content and views in the following presentation are those of the presenters.

Working party membership

- Adrian Cooper
- Michael Culligan
- Shane Fahey
- Niall Naughton
- Tony O’Riordan (Chair)

Terms of reference

- Objective: to monitor Solvency II implementation and assess / record emerging impacts in a number of areas:
  - Irish legislation enabling Solvency II, i.e. transposition of the Directive and repeal of existing laws
  - Inconsistencies between regulatory regimes
  - Accounting / audit implications, incorporating reserving
  - Taxation implications
- Concentrated on issues relevant to life companies
- Not exhaustive!

SII transposition and implications

Quick recap on framework

- Solvency II ‘rule book’ comprises following levels of rules/guidelines

Level	Description	Purpose	Responsible
1	Directive	Sets out overall framework	Council & Parliament
2	Delegated Acts	Specify in greater detail precisely how provisions in Directive will operate	Commission (with approval of Council & Parliament)
2.5	Technical Standards	Determine the conditions of application of Delegated Acts in relation to purely technical matters (no strategic decisions or policy choices)	Adopted by Commission based on EIOPA submissions
3	Guidelines	Aim to ensure consistent implementation. Not legally binding – comply or explain.	EIOPA

Level 1:Transposition of Directive

- Responsibility of Department of Finance
  - With input from CBI
- Supposed to be in place by 31 March
- Statutory Instrument to replace 3 existing SIs
  - Life / Non-Life / Re
- Maximum harmonisation
  - Very limited scope for national discretions
- Department of Finance looking at implications on other legacy regulations/legislation
  - Not clear what will be impacted
  - Not planning on consulting in advance

Level 2 & below

- Level 2 (DAs) do not require transposition
- Level 2.5 (ITSs, RTSs) do not require transposition
  - Or do they?
- Level 3 (EIOPA Guidelines)
  - Addressed to NCAs (national supervisors)
  - National supervisors expected to make every effort to comply
  - National supervisors needs to comply or explain
  - If complying, then need to “incorporate them into national framework in an appropriate manner”

Alternative regime

- For companies not subject to Solvency II
- Will need primary legislation
- Needs to be in place by 31 December 2015
- Will only apply to small number of firms
  - Article 4: Exclusions from Solvency II due to size
  - Article 12: Reinsurers in run-off since 10 December 2007
  - Article 308b: (Re)insurers closed to new business and planning to cease activity by 1 Jan 2019
- New ‘alternative regime’ likely to preserve aspects of current regime

Other

- What happens to existing "non-legislative aspects" of current regime
  - e.g. CBI Guidance?

- Understand that CBI is currently reviewing
  - CBI guidelines
  - Dear CEO/Compliance Officer/Actuary letters
  - etc.

SII harmonisation

Solvency II - Harmonisation

- Solvency II aims to have maximum harmonisation of requirements across Europe
  - Directive, Delegated Acts, ITS, RTS, Guidelines
- However, there are some requirements that differ between countries
- Consider some of these:
  1. Areas of potential differences across all 3 pillars
  2. Implications for actuarial roles

Pillar I

- Options available for calculation of Technical Provisions and Capital Requirements
  - Many require approval of national supervisor
  - Long-term guarantee measures (LTGs)
  - Transitional measures
- Internal Model Approval Process (IMAP)
- Potential for different technical interpretations
  - National supervisors, insurers, reviewers?
- Different requirements for external audit / assurance?

Pillar II

- Supervisory Review Process (SRP)
  - EIOPA have issued guidelines to national supervisors on SRP
  - However, potential for different approaches to how national supervisors interact with companies
- Corporate Governance
  - Interaction of Solvency II and Corporate Governance Code
  - Defined roles / Fitness and probity requirements
- Own Risk and Solvency Assessment (ORSA)
  - Different requirements from national supervisors
  - CBI has different reporting requirements depending on PRISM rating

Pillar III – Quantitative Reporting

Quantitative Reporting Templates (QRTs)	Financial Stability Templates	National Specific Templates (NSTs)
80 templates covering: • Accounting • Assets • Technical Provisions • Own Funds • SCR / MCR • Reinsurance • Groups	Additional templates for companies with balance sheet > €12 billion	Number and content of templates specified by national supervisor
Specified by EIOPA	Specified by EIOPA	Specified by National Supervisor

- Extent of any external audit / assurance of templates is still unclear
- Preparatory guidelines - subset of QRTs required for year-end 2014 and Q3 2015

Pillar III - National Specific Templates (NSTs)

NST	**Ireland** Central Bank of Ireland (CBI)	**UK** Prudential Regulation Authority (PRA)
Life *	1	4
With Profits	-	4
Variable Annuities	4	-
Non-Life	5	3
Total	**10**	**11**

- Irish NSTs apply to HIGH and MEDIUM-HIGH impact firms under PRISM
- Life template required by CBI is an <u>income statement</u> and is required quarterly from 2016

Pillar III – Narrative Reporting

Narrative Reports	Status
Regular Supervisory Report (RSR)	Private
Solvency and Financial Condition Report (SFCR)	Public

- Frequency and content of RSR determined by national supervisor
- Extent of any external audit / assurance of reports is still unclear
- Some narrative reporting required during preparatory phase

Actuarial Function in Solvency II

Area of work	Scope
1. Technical Provisions	• Co-ordination of calculation • Ensure appropriate models and assumptions used • Data quality • Comparison of best estimates against experience
2. Opinions	• Underwriting policy • Reinsurance arrangements
3. Risk Management	• Contribute to risk-management system

The actuarial function shall be carried out by persons who have knowledge of actuarial and financial mathematics, commensurate with the nature, scale and complexity of the risks inherent in the business of the insurance or reinsurance undertaking, and who are able to demonstrate their relevant experience with applicable professional and other standards.

Actuarial roles in Ireland

- Current Appointed Actuary regime to be replaced by Actuarial Function under Solvency II
- Questions to be resolved:
  - A single "Head of Actuarial Function"? PCF role?
  - Will CBI retain elements of current Appointed Actuary regime?
  - Requirement for certification of technical provisions?
  - Actuarial guidance / Practising certificates for SAI members fulfilling these roles?
  - Actuarial peer review / CP73?
- Expect consultation paper in coming months

Actuarial roles in UK

- UK PRA consultation on Senior Insurance Managers Regime ("SIMR") framework
  - "Chief Actuary" responsible for Actuarial Function
  - Fitness and probity requirements

- Institute and Faculty of Actuaries (IFoA) consultation papers
  - <u>Compulsory</u> practising certificate for member fulfilling Chief Actuary role
  - <u>Voluntary</u> practising certificate for member fulfilling the CRO role

Actuarial Association of Europe (AAE) survey (1)

Will there be a reserved role (“appointed actuary”) in your legislation after the implementation? If not, what would be needed to support having a fully qualified actuary in the company or the actuarial function?

Yes	No	Unclear
Austria	Estonia	Belgium
Croatia	France	Ireland
Denmark	Iceland	Poland
Finland	Italy	Romania
Germany	Netherlands	Sweden
Hungary	Norway	Cyprus
Portugal	Slovakia	
	Spain	
	UK	

Source: AAE survey, September 2014

Actuarial Association of Europe (AAE) survey (2)

In your jurisdiction, who certifies technical provisions and the SCR? Please supply details if certification differs between life, nonlife and health

Actuary signs	Actuary does not sign	Unclear	External actuary signs
Croatia	Austria	Cyprus	Belgium
Denmark	Estonia	Finland	Germany
Poland	France	Hungary	
	Netherlands	Iceland	
	Norway	Ireland	
	UK	Italy	
		Portugal	
		Slovakia	
		Sweden	

Source: AAE survey, September 2014

SII implications for accounting and tax

Recap on current accounting standards

- Local reporting
  - IFRS or Irish GAAP
  - 1996 Insurance Accounts Regulations relevant to existing accounting policies for insurance contracts*

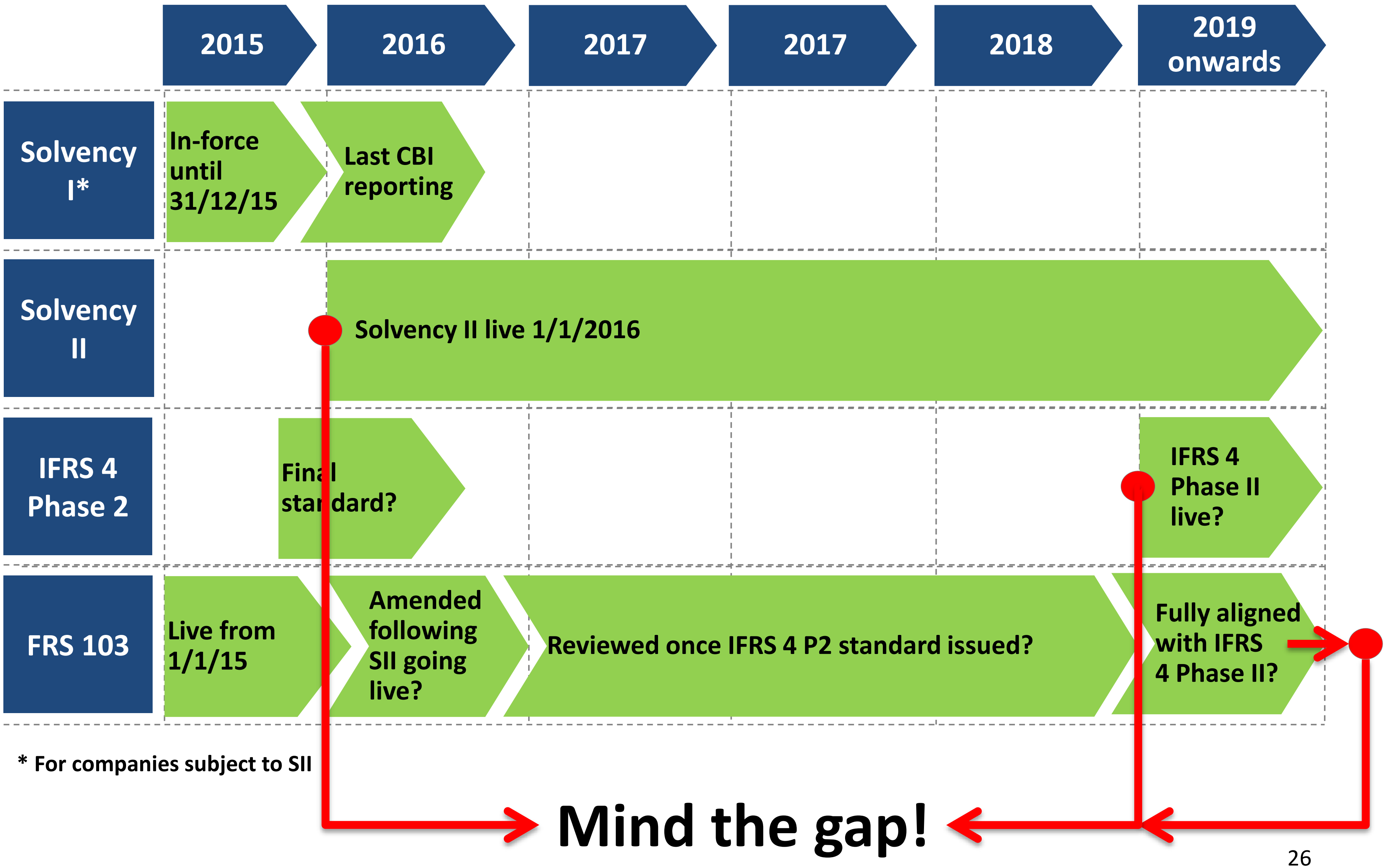
- IFRS group reporting
  - Insurance contract* accounting can differ for group reporting compared to local reporting
  - E.g. US GAAP, French GAAP, EV, Canadian GAAP

*Insurance references include contracts classified as "with DPF" (i.e. with profits)

Overview of new Irish GAAP (FRS 100 to 103)

- All companies who are not using EU IFRS for their local reporting have to move from 1/1/2015 to “new Irish GAAP”, i.e. FRS 100 to FRS 103
- FRS 103 is the standard for insurance contracts
- FRS 103 includes IFRS 4 contract classification requirements, i.e. splitting business between insurance and investment contracts
- Limited impact for those already subject to contract classification under existing Irish GAAP
- Investment classified contracts valued as per IFRS reporting, e.g. “fair value” reserves and deferrals

Timeline for solvency and accounting



* For companies subject to SII

Why does this gap matter?

What won't change in accounting as a result of SII?

What are some of the options to fill the insurance accounting gap?

What could change in accounting as a result of SII?

Financial statements may be based on figures from Solvency I <u>and</u> may include related disclosures

What are the key challenges in changing insurance accounting?

Can I leave insurance accounting unchanged?

What are the tax implications of making changes and of SII?

What won't change as a result of SII?

Area	Example approach before SII going live	Expected changes due to SII going live	
		Accounting requirements	Insurers' approach
Contract classification	Investment classified per FRS 103 / IFRS 4	No change	No change
Investment contract accounting	Bid value of units, deferred origination costs, deferred origination fees	No change	No change
Assets	Market value	No change	No change
Stated compliance in accounts	FRS / IFRS	No change	No change

What could change as a result of SII?

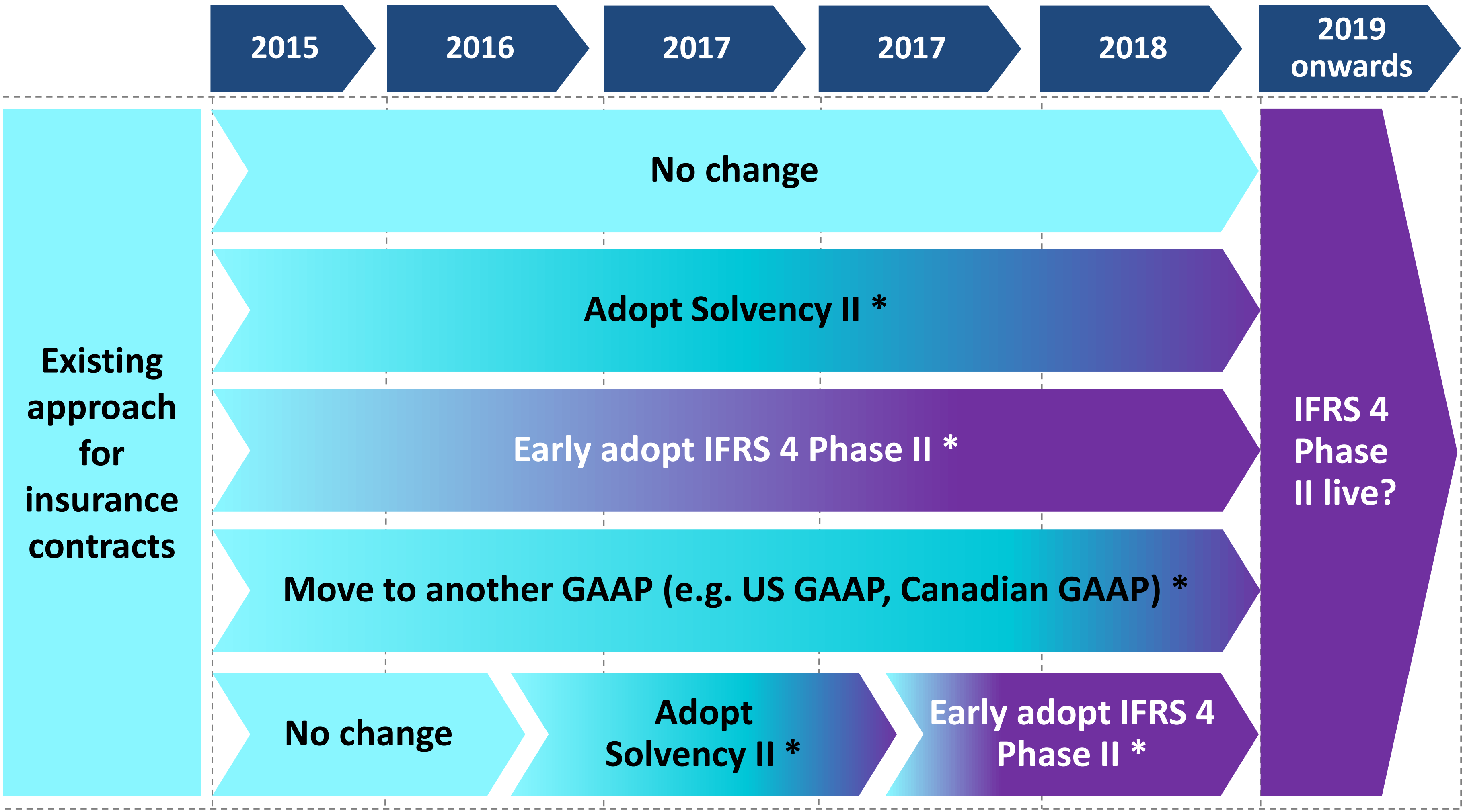
Area	Example approach before SII going live	Expected changes due to SII going live	
		Accounting requirements	Insurers' approach
Insurance contract accounting	(Modified) Solvency I reserves, deferred acquisition costs asset - accounted for under FRS 103 / IFRS 4	No change*	May change
Tax	FRS / IFRS profit, I-E basis	No change	May change
Required disclosures	FRS / IFRS	No change	May change

* Subject to any changes to FRS 103 as a result of SII going live

Can I leave insurance accounting unchanged?

- Does SII mean my insurance accounting must change?
  - Need to understand what my “existing accounting policies” are
- View that can leave unchanged
  - E.g. can continue to hold Solvency I reserves and a DAC asset
  - Need to consider governance and stakeholders
- Some practical considerations of leaving accounting unchanged
  - Dual reporting, e.g. processes, systems, people, reporting timescales
  - P&L volatility (i.e. assets matched on SII basis but not on accounts basis)
  - Impact of SII ALM on determination of accounting reserves discount rates
  - Approach may be chosen by parent for group reporting
  - Desire for consistency between group and local reporting?
- Consider external communications and financial statements disclosures

Options to fill the insurance accounting gap?

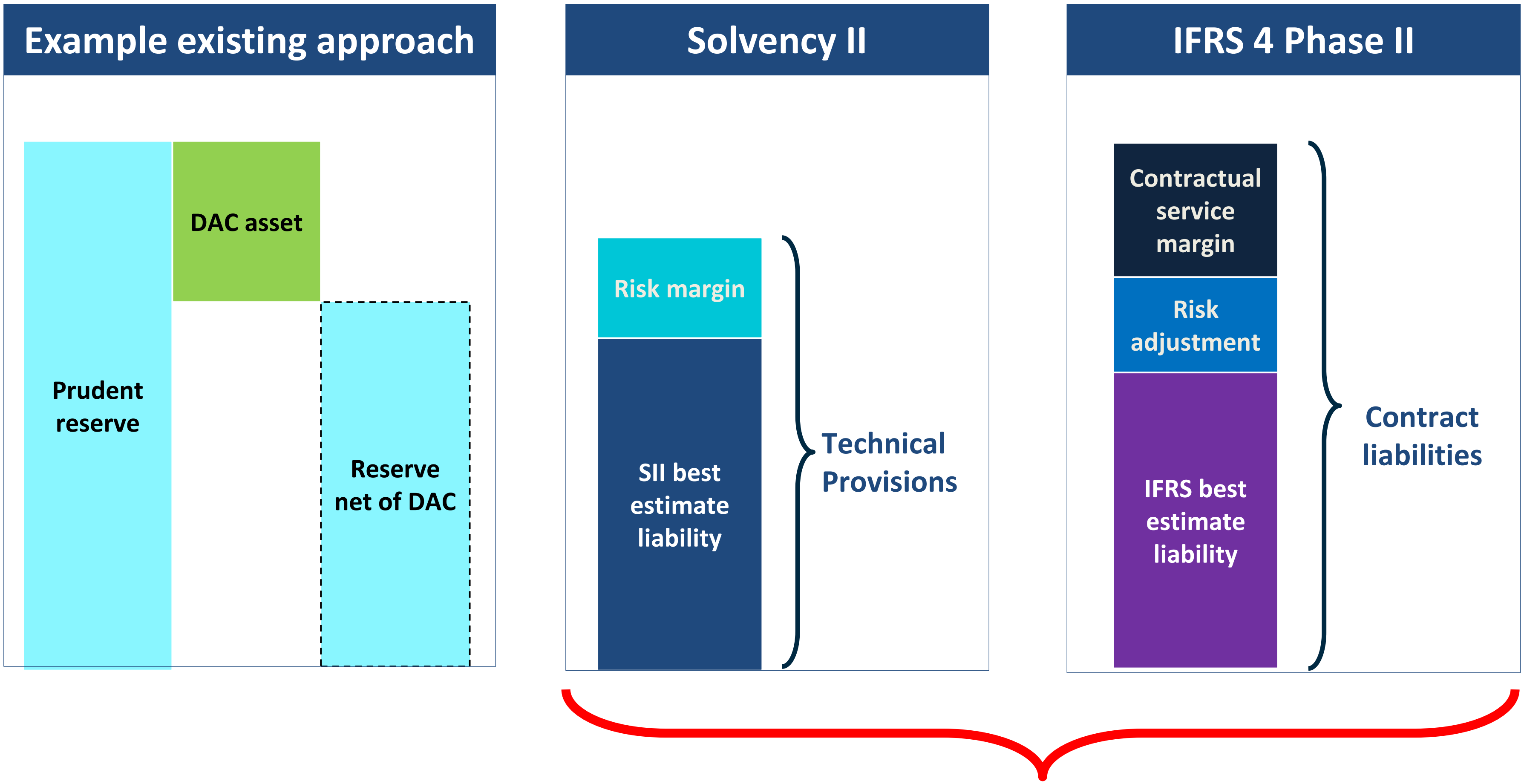


* Subject to requirements for changes in accounting policy

Which option(s) will you pursue and when?

Comparing insurance contract methodologies

NB: relative component sizes are for illustration purposes only!



Similar methodologies
but some significant differences!

Challenges in changing insurance accounting

- Judgement required to determine if accounting policy or accounting estimate change (FRS 102 / IAS 8)
  - Determination can impact ability to make the change
  - Impacts whether comparative figures required

- Must meet FRS / IFRS criteria for changes
  - "No less relevant / reliable" criteria (FRS 103 / IFRS 4)
  - Shall not introduce additional prudence
  - Need to consider uniformity of changes to accounting policies

- Methodology changes in context of IFRS 4 Phase II?
  - Negative reserves not consistent with contractual service margin
  - Potential differences vs SII (e.g. discount rates, contract boundary definitions, risk margin vs risk adjustment, contractual service margin)

- Need to consider any adjustments required to SII reserves
  - What are the impacts of zeroising negative SII reserves?
  - Should the risk margin be included? How much relates to insurance contracts?
  - Are SII reserves sufficiently robust for opening or comparative position, e.g. 2014?

Implications for tax

- Changes in valuation may give rise to initial tax gains or losses
  - "New-basis" (gross roll-up) business: based on portion of accounts profit
  - "Old-basis" (I-E) business: will there continue to be a declared surplus under SII?
  - Ability to spread tax gains / losses?

Driver of change	Tax allowance
Moving to new Irish GAAP	Allowed to spread tax impact over 5 years
Moving from FRS to IFRS	Allowed to spread tax impact over 5 years
Changes from SII going live	TBD – 5 year spreading? 2015 Finance Act?
IFRS 4 Phase II	TBD – spreading may be sought closer to date

- Deferred tax under SII
  - SII value of deferred tax can differ from financial statements
  - Stressing deferred tax for SCR can be particularly complex

Summary implications

- Lots of additional complexity
- Difficult to leverage SII reserves for insurance contract accounting
- Another reporting basis and with tight reporting timescales
- Challenge to explain numbers across different metrics
  - requirements for additional MIS, reconciliations, disclosures
  - What basis are you managing your business on?
- Actuaries may be looked to more
- All adds time, resources, costs
- A lot to land in the next few years – need to keep a watching brief!

Conclusions

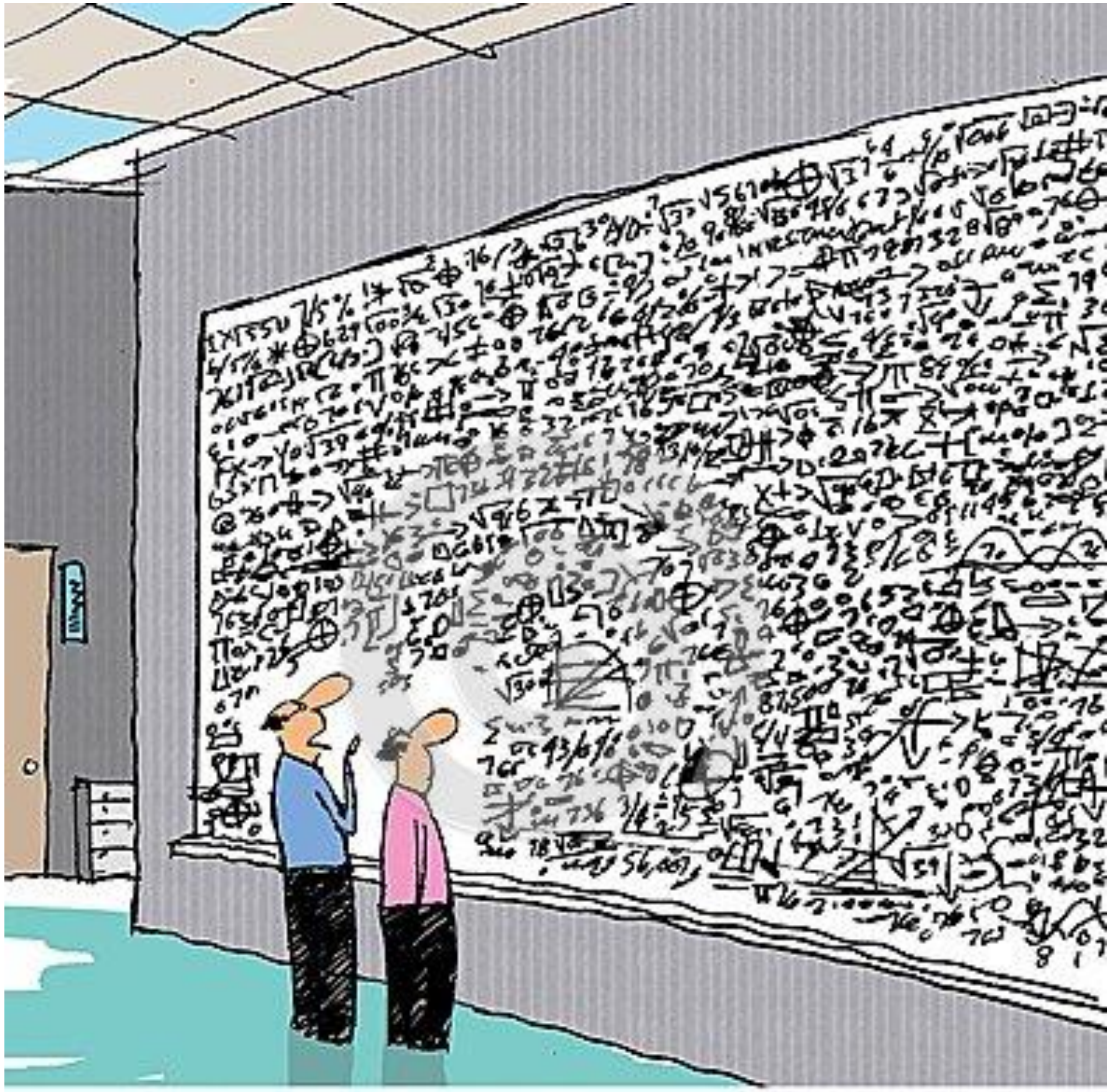
Wider challenges arising from implementation

- Complexity of framework
- “Solvency I” continuation
- Ongoing uncertainty re:
  - CBI guidance
  - Actuarial roles
- Different interpretation / implementation across borders, e.g. NSTs
- Accounting options and IFRS 4 Phase II
- Change in emergence of taxable profit

….and all the business challenges!

Business challenges

- Target SCR ratio
- Types of Capital
- Reporting timescales
- SCR and RM projections
- DB pension schemes
- New business
- Movement analysis
- Remuneration / bonuses
- Reinsurance
- Processes, systems, people
- Standard formula suitability
- Director training / suitability
- Asset liability matching
- Rating agencies
- Risk reporting and risk appetite
- Managing volatility
- Transitional measures
- Dividend policy



"....And that, in a nutshell, is our presentation. Any questions?