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Layout & Distribution: Valéria Kozakova

IFRS and Solvency 2: The Current Challenges

Mark Swallow

The scope is different, each with
their own challenges

Swiss Re


European Union
Regulatory





International
Financial Reporting





Geneva Association
6 December 2007


Slide 2


Swiss Re 	
Timing is important, key stage in projects to make progress	<ul style="list-style-type: none">■ Both projects have extended timelines, which demand endurance from all parties■ IFRS comment period for discussion paper recently closed and work will start on the Exposure Draft■ Solvency II proposed Framework Directive is passing through the parliamentary process
Geneva Association 6 December 2007 Slide 3	


Swiss Re 	
Consensus is always a challenge	<ul style="list-style-type: none">■ IFRS comment letters show a range of views■ This reflects the global nature of IFRS and the different insurance accounting practices around the world■ The SEC's recent commitment to IFRS shows the progress made on convergence■ Solvency 2 focus on the European Union with the associated political process■ The range of views appears quite narrow around the principles, but with some significant areas to complete
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<h3>Technical challenges</h3>	
<p>Geneva Association 6 December 2007 Slide 5</p>	<ul style="list-style-type: none"> ■ Each project brings technical challenges ■ IFRS phase 2 needs to fit in with existing IASB standards and develop in line with other projects, like revenue recognition ■ Solvency 2 needs to accommodate a standard framework and company specific risk modelling, which is dynamic either as risks emerge or as analysis and experience develops ■ Despite their different scope, the projects do overlap

													
<h3>Selected technical challenges IFRS phase II</h3>													
<p>Geneva Association 6 December 2007 Slide 6</p>	<table border="0"> <tr> <td style="vertical-align: top;">Risk margins</td> <td>■ The way the risk margins work will be key to how the model looks overall</td> </tr> <tr> <td style="vertical-align: top;">Profit at inception</td> <td>■ Profit at inception is controversial, tension between accounting and value creation</td> </tr> <tr> <td style="vertical-align: top;">Portfolio definition</td> <td>■ The tentative definition of a portfolio is narrow, which affects the risk margin</td> </tr> <tr> <td style="vertical-align: top;">Participating contracts</td> <td>■ Model for deciding the split between liability and equity is difficult to pin down</td> </tr> <tr> <td style="vertical-align: top;">Policyholder behaviour</td> <td>■ Reflecting policyholder choices is difficult in principle, but generally handled in practice</td> </tr> <tr> <td style="vertical-align: top;">Own credit risk</td> <td>■ Financial instruments include this but insurance is about paying claims</td> </tr> </table>	Risk margins	■ The way the risk margins work will be key to how the model looks overall	Profit at inception	■ Profit at inception is controversial, tension between accounting and value creation	Portfolio definition	■ The tentative definition of a portfolio is narrow, which affects the risk margin	Participating contracts	■ Model for deciding the split between liability and equity is difficult to pin down	Policyholder behaviour	■ Reflecting policyholder choices is difficult in principle, but generally handled in practice	Own credit risk	■ Financial instruments include this but insurance is about paying claims
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<h3>Selected technical challenges Solvency II</h3>	
<p>Geneva Association 6 December 2007 Slide 7</p>	<ul style="list-style-type: none"> Standard formula <ul style="list-style-type: none"> ■ Standard formula should not be used as a benchmark for internal models Minimum capital <ul style="list-style-type: none"> ■ Minimum Capital Requirements to take into account all risk mitigation techniques Investment principles <ul style="list-style-type: none"> ■ Based on company's assessment of its risk profile, with minimum restrictions on asset management Reinsurance <ul style="list-style-type: none"> ■ the nature of reinsurance to be recognised appropriately Third countries <ul style="list-style-type: none"> ■ Include provision to encourage equivalence between Solvency II and third country regimes

	
<h3>Specific challenge Solvency 2 Non proportional reinsurance</h3>	
<p>Geneva Association 6 December 2007 Slide 8</p>	<ul style="list-style-type: none"> ■ Based on Article 104.6 of the Directive all risk mitigation techniques are recognized under the standard formula and for internal risk models for the calculation of the solvency capital requirements. ■ The standard formula does not fully recognised non proportional transactions. This effect of the standard formula will reduce the relief of solvency capital cedents receive ■ This could be resolved by introducing company specific parameters for the standard formula. This would require approval of the adjustment by the supervisor (Art 103.7 of the Directive).

	<p style="text-align: right;">Swiss Re </p> <h2 style="text-align: center;">Perceptions of our industry</h2>
<p>Geneva Association 6 December 2007 Slide 9</p>	<ul style="list-style-type: none">■ The stereotype of the insurance and reinsurance industry is still often negative■ Concerns about transparency, complexity and performance are common■ IFRS phase 2 and Solvency 2 are an opportunity to improve this situation■ All stakeholders will benefit from a high quality outcome of the projects