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Layout & Distribution: Valéria Kozakova

IFRS Phase 2 and Solvency 2 - Challenges

Alex Finn

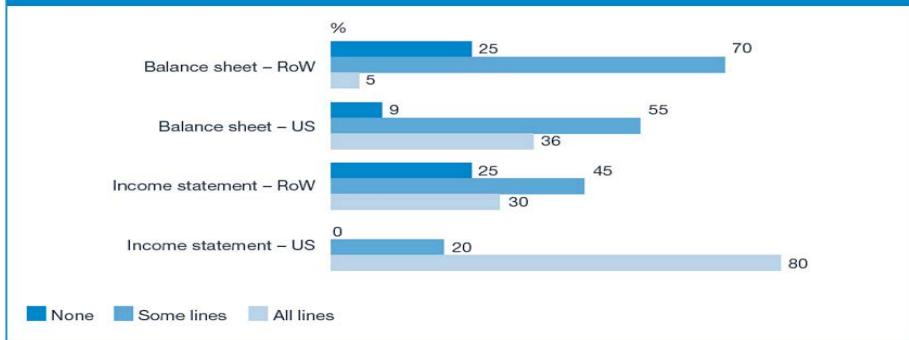
Themes

- Existing bases of financial reporting and solvency regulation are inadequate
- The response letters show that there is a potential way forward....but there are challenges
- Solvency 2 is overtaking IFRS 2 and this could become an issue for companies

Results from our analysts survey – Life insurers

- In Europe IFRS is generally ignored and EV is used. Would like greater consistency in EV methodologies
- In the US, Analysts are satisfied with US GAAP. EV considered too subjective, lacking in consistency.

Figure 3: Use of life insurers' financial statements for valuation purposes (which lines do you forecast?)



Source: PricewaterhouseCoopers

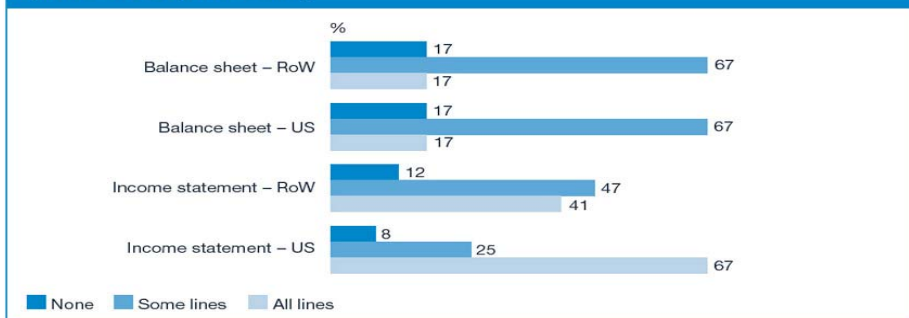
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Results from our analysts survey – Non life insurers

- Current financial statement information is considered more useful and adequate
- Companies and analysts are more satisfied with current accounting models

Figure 8: Use of non-life insurers' financial statements for valuation purposes (which lines do you forecast?)



Source: PricewaterhouseCoopers

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Professional firms – high level snapshot of responses

	Firm 1	Firm 2	Firm 3	Firm 4	Firm 5
Supportive of the three building blocks?	Yes, with important changes	Yes, with important changes	Yes, with important changes	Yes, with important changes	Yes, with important changes
Supportive of market consistent assumptions?	Financial only (plus)	Financial only	Financial only	Financial only	Financial only
Calibration of the margin & day 1 profit	Await revenue recognition project	Calibration margin	Day 1 profit	Day 1 profit	Day 1 profit
Cash flow definition?	All cash flows	Needs more thought	Broadly commercial substance	Commercial substance	More restrictive?
Single measurement model?	Yes	Yes	Yes	Yes	Yes
Presentation approach?	Undecided/ premiums in p&l	Undecided/ premiums in p&l	Undecided/ 3 building blocks?	3 building blocks	Premiums in p&l

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Actuarial profession – high level snapshot of responses

	1	2	3	4
Supportive of the three building blocks?	Yes, with changes	Yes, with important changes	Yes	Yes, with important changes
Supportive of market consistent assumptions?	Financial only	Financial only	Yes, where reliable	Financial only
Calibration of the margin & day 1 profit	Day 1 profit	Calibrate to premium	Day 1 profit	Day 1 profit, premiums irrelevant
Cash flow definition?	All cash flows	All cash flows	Commercial substance	All cash flows
Single measurement model?	Yes	Yes	Yes	Yes
Presentation approach?	Reconcile liability	Premiums in p&l	Premiums in p&l	n/a – premiums in p&l

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Industry Groups – high level snapshot of responses

	GNAIE	CFO	Japan LIA	Canada L&H	ACLI
Supportive of the three building blocks?	No (non-life) and partial yes (life)	Yes, with important changes	Yes, with reservations	Yes, with exceptions	Yes (life), with important changes
Supportive of market consistent assumptions?	No	Financial only	Financial only	Yes, but not discount rates	Financial only – except for discount rates
Calibration of the margin & day 1 profit	Calibrate to premium (b)	No calibration, but defer initial profit (d)	Calibrate explicitly to premium (a)	Day 1 profit (c)	Calibrate explicitly to premium (a)
Cash flow definition?	All cash flows	All cash flows	All cash flows	All cash flows	All cash flows
Single model?	No	Yes	Yes (but they are life association)	Yes (but they are life association)	No
Presentation approach?	Premiums in P&L	Undecided – esp. for non-life	Premiums in P&L	Premiums in P&L	Undecided

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Standard setters – high level snapshot of responses

	UK	US (AICPA)	Canada	Australia	S.Africa
Supportive of the three building blocks?	Yes, with important changes	Yes, subject to below	Yes	Yes, with important changes	Yes with important changes
Supportive of market consistent assumptions?	Financial only	Yes, where available	Yes	Financial only	Financial only
Calibration of the margin & day 1 profit	Calibration to premium (b)	Calibrate to premium (b)	Day 1 profit	Day 1 profit	Day 1 profit
Cash flow definition?	All cash flows	No comment – OK?	All cash flows	All cash flows	Commercial substance
Single measurement model?	Yes	Yes	Yes	Yes	Yes
Presentation approach?	Premiums in P&L	Await FS presentation project	Premiums in P&L	Premiums in P&L	Tending to P&L (non-life) and margin (life)

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There is a way forward..... (based on the previous sample!)

Supportive of the three building blocks?	Other than US, bulk seem generally supportive of the three building blocks
Supportive of market consistent assumptions?	General criticism worldwide about the use of theoretical market values and favour entity specific
Calibration of the margin & day 1 profit	Commentators split – with industry largely against Day 1 profit recognition
Cash flow definition?	General view that cash flows should include all cash flows arising from the contract
Single measurement model?	US and pure non-life companies favour dual model. Bulk seem to favour single model
Presentation approach?	Still a lot of work to do – but generally commentators favour recognition of premiums as revenue

.....But can the IASB (and the US) wear it?

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- But Solvency 2 is slipping more slowly than IFRS Phase 2
- Getting the best out of S2 means:
 - Passing the use tests – need to embed in organisations globally
 - Basel 2 experience showed this to be much more troublesome than companies thought
 - How can one align S2/economic capital implementations with IFRS Phase 2 and MCEV?
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The Rumsfeld Dilemma

“Reports that say that something hasn't happened are always interesting to me, because as we know, there are "known knows"; there are things we know we know. We also know there are "known unknowns"; that is to say we know there are some things we do not know. But there are also "unknown unknowns" — the ones we don't know we don't know.”

**Donald Rumsfeld, State Department
Briefing February 12, 2002**

Financial reporting for insurers in the future

Unknown unknowns



Known unknowns

Known knows

- What cash flows are included in the valuation – future premiums, par contracts, expenses etc.?
- What is the risk margin being calibrated to?
- Investment contracts?
- Disclosures and other additional requirements?
- Prospective best estimate cash flow valuation methodologies
- Some form of risk margin
- Discount rate (likely to be market)

