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THEME:
IFRS 17

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2

WHY HAS THE IASB ISSUED IFRS 17?



4

ARE ACTUARIES INDEPENDENT
GUARDIANS OR ...?



7

GDPR, WHAT DOES IT MEAN
FOR ACTUARIES?



10

THE XII NATIONAL ACTUARIAL
CONGRESS IN ROME ON IFRS17



12

IFRS 17 - GROUPING OF CONTRACTS
AND REQUIREMENTS



14

TRANSITION TO IFRS 17:
FAIR VALUE APPROACH



16

LONGEVITY IMPROVEMENTS:
A NEWTONIAN PERSPECTIVE



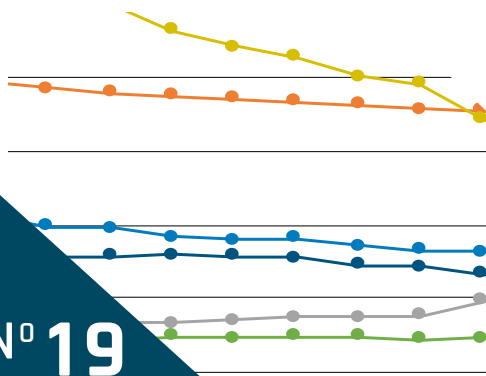
19

IFRS 17 IS ANOTHER CHALLENGE TO
INSURERS, AUDITORS AND ACTUARIES



22

FIRST AAE CRO ROUND TABLE



25

ACTUARIAL VIEWS ON BREXIT
(LONGREAD)



30

COLUMN:
SUSTAINABLE VOLUNTEERS

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WHY HAS THE IASB ISSUED IFRS 17?

French politician and former Member of the European Parliament, Jean-Paul Gauzès, is well known throughout the continent, and on 1 July 2016, was appointed as European Financial Reporting Advisory Group (EFRAG) Board President.

INTERVIEW BY **JENNIFER BAKER**

During his time as an MEP, Mr Gauzès sat on the Committee on Economic and Monetary Affairs. He has been the rapporteur on various important dossiers including the Directive on Alternative Investment Fund Managers (2010); the Regulation on the supervision of credit rating agencies (2010); and the Regulation on the strengthening of economic and budgetary surveillance of Member States experiencing or threatened with serious difficulties with respect to their financial stability in the euro area (2012).

He brings that wealth of knowledge to his role at EFRAG – a private association established in 2001 with the encouragement of the European Commission to serve the public interest.

Mr Gauzès explained to *The European Actuary* why the International Accounting Standards Board (IASB) has issued IFRS 17.

‘The current standard for insurance contracts is IFRS 4. IFRS 4 has been widely criticized as ‘not being a standard’ because it allows a range of practices that conflict

with many of the principles in IFRS (International Financial Reporting Standards) generally. The effect of this diversity is that it is very difficult for investors to compare the performance of different insurance companies when making investment decisions,’ he said.

‘It is important to remember that IFRS 4 was developed in a hurry in 2004 as the European Union had decided to adopt IFRS Standards for listed companies in Europe. Although the IASB’s insurance project had been under way for some years, it was not possible for it to be completed in time for European adoption. That is why the IASB permitted insurance companies to continue most of their existing practices. The IASB considered that it was not appropriate to ask insurance companies to incur the double costs of making one change to reporting by moving to an interim standard and then a second change in reporting when the final standard was issued,’ he added.

Part of the role of EFRAG is to prepare endorsement advice for the European Commission.

Mr Gauzès said this is something it takes seriously: ‘EFRAG has been actively working to ensure that the European financial reporting community is informed about IFRS 17. We have also been collecting information to be used in the draft endorsement advice and impact assessment. To assist stakeholders in understanding IFRS 17, early last year we prepared three bulletins explaining some of the more controversial topics: Level of Aggregation, Release of the Contractual Service Margin and Transition Requirements of IFRS 17.’

‘We collected information through an extensive case study for large insurers and a simplified case study for less well-resourced insurance companies. These two case studies provided very valuable information on the expected impact of IFRS 17 – although both EFRAG and the participants are mindful of the fact that the information is a best estimate and may not reflect what will actually happen on implementation of IFRS 17. We are aware that investors will be the beneficiaries of any improvements to financial reporting. To get some early indication of expected

benefits we interviewed investors who follow insurance companies and investors who follow the market more generally,' said Mr Gauzès.

He further explained that certain issues had come up in this process: 'In the process of collating the information from a wide range of sources, including our specialist working groups, a number of concerns with IFRS 17 were raised, mostly by insurance companies. EFRAG wrote to the IASB early in September raising six issues that, in EFRAG's view, merited further consideration by the IASB. The IASB is now considering a number of issues, including those identified by EFRAG.'

SO, HOW IS THE IASB RESPONDING TO THESE CONCERNS?

'As already mentioned, the IASB has a list of issues and is considering the extent to which these issues could be addressed. The IASB has identified criteria for assessing which of these issues could be considered for possible amendments to IFRS 17,' he explained.

Mr Gauzès predicted that we could see proposals soon: 'The IASB's latest work plan shows that we can expect the IASB to issue an Exposure Draft proposing changes to IFRS 17 in the second quarter of 2019. We expect that this Exposure Draft will contain the deferral of the effective date of IFRS 17 from 2021 to 2022 as well as other amendments currently under discussion at the IASB.'

'We are actively monitoring the IASB's work and seeking early views from our technical bodies so that we are prepared to move

quickly when the Exposure Draft is issued,' he added.

The European Actuary asked how EFRAG views the actuarial profession. 'With its significant role in measuring insurance liabilities, the actuarial profession provides a key input into the financial reporting by insurance companies,' replied Mr Gauzès. 'Our technical work covers the principles that are set in IFRS 17, but not the practice. However we are aware of the development of the professional guidance that actuaries apply, including International Actuarial Notes and International Standards of Actuarial Practice. We also receive significant support from actuaries, principally through membership of our Insurance Accounting Working Group. The EFRAG Board also benefited from a presentation in 2018 by representatives of the Actuarial Association of Europe on their views on IFRS 17. These views will be considered during the

development of the EFRAG's draft endorsement advice.'

Mr Gauzès also revealed what EFRAG is working on in the coming months: 'We see two major steps in the coming year. Firstly, we expect to see an exposure draft in the second quarter of this year. We will follow our normal due process in responding by first preparing a draft comment letter and seeking the views of our constituents – which includes preparers of financial statements, users of those statements, auditors and, for IFRS 17, actuaries. Once the IASB has issued a revised IFRS 17, we expect to continue with the next stage of our endorsement work including the preparation of a draft endorsement advice, which will be updated for comments received from our stakeholders before being finalised for the European Commission. We welcome the input of actuaries on each of these draft documents,' he concluded. ●



ARE ACTUARIES **INDEPENDENT GUARDIANS** OF FINANCIAL SECURITY **OR JUST TELLING A CONVENIENT TALE?**

BY **MICHAEL FACKLER**



Actuaries assess and manage risks in the insurance industry, risks often associated with high levels of uncertainty. This is especially true when the risks relate to rare events, as is the case with solvency issues and in the reinsurance industry. It makes their work demanding, both technically (mathematics, statistics, data) and on the human side. We want to cast light on the latter, employing findings from fields such as psychology and sociology.

Things can get uncomfortable for actuaries, especially when they consider a risk to be more critical than all others (would like to) believe it is. High levels of uncertainty when assessing risks often lead us to underestimate them – and, because optimism is the easier option in such cases, it is defended tooth and nail against the opinions of “overly pessimistic” actuaries. Three phenomena drive this conflict:

1. CONFIRMATION BIAS:

It is harder to crack prejudice than an atom.

Albert Einstein

People cling to their convictions. To avoid constant doubt, they are selective in their perception and evaluation of reality. It is an unconscious psychological mechanism in the interests of their own well-being. As confirmation bias even exists in the worlds of science and politics, experts and managers in insurance, too, are likely subject to it.

2. PEER PRESSURE:

In order to be an immaculate member of a flock of sheep, you must, above all, be a sheep.

Albert Einstein

Evolution has made human beings specialists in cooperating in (small) groups. Being excluded from one's community once meant certain death. As people today are still keen to avoid that fate, they tend to give in to peer pressure when faced with strong differences of opinion. We even adapt our personal convictions to suit the social group.

3. SOCIAL TRUST:

Trust is the foundation of society.

Frederick Douglass

Nowadays, most of us live and work in large, highly complex social groups and have to collaborate with many strangers. That calls for social trust: the belief that, in principle, the community (or system) functions properly. Social trust relies on convictions and narratives shared by the group. When nations were created, the shared narrative was often a founding myth, suggesting a common origin or superiority over neighbours. So shared narratives do not necessarily have to reflect reality.

Sociology teaches us that social trust is much easier to destroy than create, so preserving it is a constant battle. The decisive factor is that the community is *perceived* to be functioning properly. Making *real* improvements is an arduous way of doing this, but sometimes

clever communication is enough to achieve *perceived* improvements. Both approaches are pursued, e.g. in the political sphere.

The following example shows that perceived quality is not always just about (self-)deception, but can generate genuine quality.

FIAT MONEY:

Such paper's convenient, for rather than a lot Of gold and silver, you know what you've got.

Mephistopheles,
in Goethe's Faust, Part II

The money we use today is not backed by gold; it is basically “only” a promise that the current economic system will function in future. For decades, our economic system has been based on belief in this promise. In terms of social trust, we could say this *subjective* belief is the *objective* foundation of our economy. Fiat money is probably the most important mass illusion of the modern age; when crises occur, political leaders employ well-chosen words in its defence, as the financial crises of the last decade show (“whatever it takes”). ►



Transparency can undermine perceived security.

The insurance industry, too, hinges crucially on the collective trust of industry insiders and of the outside world, because it is a complex, money-based, long-term enterprise. What is more, even when properly managed, insurance is undeniably a business marked by high levels of volatility and uncertainty. But, if your aim is to engender and maintain trust in it, you face a dilemma at the centre of which stands the actuary – we call it the *transparency dilemma*.

The actuary's role, especially (but not solely) in the regulatory context, is to ensure transparency as regards risks and uncertainty. But the more transparency you achieve, the more problems you may uncover. While that is good for *real* security (visible risks can be managed), it can undermine *perceived* security: too much bad news erodes social trust and cooperation. This could affect single insurers or the entire industry. No one wants such distrust to arise, and it is this pressure that the actuaries ultimately feel.

Two very difficult questions arise in this situation:

1. WHAT IS THE OPTIMUM AMOUNT OF TRANSPARENCY?

Given the concept of social trust, the answer could in certain cases be:

quite a bit less than 100 percent.

If that is so:

2. WHO DECIDES WHAT IS RENDERED TRANSPARENT AND WHAT ISN'T?

Sometimes actuaries are the ones who (have to) make decisions like this. Presumably, they are not too bad at that – and some of them don't even mind the task. But actuaries should be aware that, in making such decisions, they are essentially managing social trust. That belongs to the domain of management / politics and is not part of the conventional "expert" role.

CONCLUSION:

Managing complex risks in large communities involves striking a balance between *self-critical transparency* and *cultivating an image that builds trust*. Independent experts have a key role to play in this, but it is one that – whether they like it or not – can merge with a political role. ●

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GDPR, WHAT DOES IT MEAN FOR ACTUARIES?

BY **KIRSTEN SASADY**

Effective from 25 May 2018, the European General Data Protection Regulation (GDPR) is now fully in force. The GDPR has changed the way in which businesses handle customer data, creating new rules around customer consent, profiling, data portability and the customer's "right to be forgotten". Any company handling European citizens' data will have to comply with this regulation, and the GDPR is going to have a huge impact on many sectors, including insurance.

As key data users, actuaries will be highly impacted, and we will have to change the way we store and treat data, the way we model and the way we communicate. The default quick fix is deletion of data – which will clearly not be a helpful solution for actuaries as some of the most prominent data users and analysts in insurance companies.

The European General Data Protection Regulation¹ (GDPR) came into force on the 25 May 2018 and applies to all EEA and non-EEA organisations offering goods and services to persons in the EEA. The aim of the GDPR is to protect all EEA citizens from privacy and data breaches. Although the key principles of data privacy are still consistent with the previous directive (established in

1995), many changes have been implemented.

The European Actuarial Association has set up a GDPR task force to raise awareness of GDPR within the actuarial community and to help actuaries to be on the forefront of the implementation of GDPR-compliant data handling solutions in the insurance sector. Legal experts, for whom data deleting initially may seem like the easiest way to comply with the comprehensive requirements, primarily drive the GDPR agenda. It is thus essential for actuaries to be consulted on the matter before hasty decisions are made – and for them to explain their current and potential future data needs in a clear and easily understandable manner. ►

1. Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC

IMPORTANT FEATURES OF THE GDPR

The GDPR applies to any company, regardless of its location, processing the “personal data” (means any information relating to an identified or identifiable natural person i.e. the “data subject”) of people residing in the EEA, and organisations in breach of GDPR can be fined up to 4% of annual global turnover or €20 million (whichever is greater). Some of the key rights given to the “data subjects” via the GDPR are

- **Right to access:** Data subjects have the right to obtain from the data controller confirmation as to whether or not personal data concerning them is being processed, where and for what purpose.
- **Right to be forgotten:** The right to be forgotten entitles the data subject to have the data controller erase his/her personal data, cease further dissemination of the data, and potentially have third parties halt processing of the data.
- **Data Portability:** Data portability is the right for a data subject to receive the personal data concerning them which they have previously provided, in a “commonly used and machine-readable format” and have the right to transmit that data to another controller.
- **Data processing:** The GDPR gives data subjects the right to object to data processing. That means organisations will be required to show they have a legal and compelling reason to continue processing data relating to that particular



subject. Citizens now also have the right to question and fight decisions that affect them if they have been made on a purely algorithmic basis.

WHAT DOES IT MEAN FOR INSURERS AND ACTUARIES?

Because data is the raw material of actuarial tasks, the GDPR has a significant impact on the insurance sector and on the daily work of most actuaries.

The areas where most actuaries are likely to encounter GDPR limitations are

1) use of data for statistical analysis

First of all the client relationship will have to be handled with much more care due to the extended customer data rights. Insurers now have to make sure that consent exists to use and profile a customer's data, and they will have to state how they intend to use the data.

Insurers must delete personal data on request under a number of specified grounds, including where the personal data is no longer necessary for the original purpose for which it was collected or ►

processed, and if the data subject withdraws their consent and no other legal ground for processing applies. Thus insurers no longer “own” the data, and they will have to take extra steps to ensure further use of customer data for actuarial analysis.

A good option in this case is anonymization of the data, since GDPR does not apply to data, where the subject is no longer identifiable. Actuaries will however need to think carefully on how to anonymize in a clever way, so the essential features are saved and available for future statistical analysis.

Pseudonymization (the separation of data from direct identifiers so that linkage to a person is not possible without additional information held separately) is another tool available for easier handling of data in day-to-day work. It is different to anonymization, since it is still possible to reverse the procedure and reveal the personal data again and thus GDPR still applies to the use of pseudonymised data.

2) decisions based automated processing including profiling

Under the GDPR, insureds have the right not to be subject to a decision based solely on automated processing. The insurance sector makes many decisions using machines without human intervention in the decision-making process. For example, some underwriting applications are designed to price risks and

allocate premiums automatically. These are decisions based on automated processing without human intervention.

However, this right is not applicable if automated processing is necessary for entering into a contract between the data subject and a data controller – and this could very well be the case for insurance contracts. But it is important to note that the automated processing should then be related to the contract execution only. Where there is other processing, which is not related to the contract, a compliance issue could arise.

Under normal circumstances, processing of “sensitive personal data” from the special categories (such as racial or ethnic origin, genetic and biometric data or data concerning health) is prohibited unless the data subject has given explicit consent. Actuaries must ensure compliance with this requirement. They must use measures appropriate to ensure that personal data is secured in a manner which takes account of the potential risks involved for the interests and rights of the data subject, and which prevents discriminatory effects on natural persons on the basis of these data of the special category.

It is also worth noticing, that GDPR gives the insureds the right to know and obtain communication in particular with regard to the purposes for which the personal data are processed. This is also true in the case of automated

decision-making, where the data subject possesses the right to access “meaningful information about the logic involved, as well as the significance and the envisaged consequences of such processing for the data subject”. In order to enable this, actuaries should communicate and explain clearly to their stakeholders what they do with personal data. The undertaking should then be able to explain clearly and simply how the personal data of the insured is used, so he or she can make an informed decision to potentially opt out.

This is a challenge for actuaries, especially where individual decisions are made using for instance machine learning techniques. Good machine learning models are very difficult to train and even harder to explain, and considerable thought will be required to explain outcomes effectively. The data subject needs to be educated to a degree that enables intelligent deselection of the processing of their data. Actuaries could consider describing the logic behind the model and the data it was trained on, before moving on to clearly listing the benefits of allowing the automated-processing and the downsides of opting out. ●

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THE XII NATIONAL ACTUARIAL CONGRESS IN ROME ON IFRS17

BY **GIAMPAOLO CRENCA** AND **CRISTINA ALFIERI**



Italian actuaries met in Rome in November last year for their National Actuarial Congress, full of interesting topics and actuarial discussions. One of these, IFRS 17, was skeptically discussed in a specific session through two general basic but very important speeches (an expert Italian actuary, Francesco Cuzzucra, and Thomas Behar, the immediate Past President of AAE).



These two speeches had the aim of introducing the topic so that the next round table was able to deepen the matter through different experts (actuaries and exponents of Ania - the Italian Insurance Association, Ivass - the Italian Insurance Supervisory Authority, OIC - the Accounting Association and Moody's Analytics) and was coordinated by a journalist expert in the insurance field.

It is not so simple to summarize all the speeches and the discussion but two aspects of the discussions stand out:

- the strategic and macro impact aspects and
- the micro management aspects.

On strategic issues many people said clearly: 'We had not any kind of exigences to implement IFRS 17', and then: 'Why, above all from the accounting point of view, must the insurance approach be changed?' 'Why, after all the strong efforts and costs to implement solvency II must insurance companies continuously change?'

On the second point the most important questions substantially were the management processes which involve much efforts, time and cost in order to implement IFRS 17, above all in order to organize and classify the contracts' portfolio.

Another further point derived from the previous one was the accounting because the philosophy of the previous balance-sheet will completely change; the risk is a greater volatility of the results, difficulties of comparison among insurance companies due to an increase of the evaluation items with different criteria also, and hence effects on dividends and also on fiscal accounts and results.

Moreover, many people hoped that the application of IFRS 17 would be further postponed in order to have more time to be prepared, other people were persuaded and hoped that a good number of rules will be modified towards a necessary simplification. About one point all however agreed: actuaries are ready and prepared to face and to

solve all the technical and related accounting problems.

Giampaolo Crenca, closing the session, added: 'There is also another risk: really to consider insurance business on an annual basis instead of on a long basis means to change completely the 'sense and the concept' of insurance and it is not good news, also because a comparison among insurance balance-sheets and the balance-sheet of other kind of firms is not useful and is without sense, because the business is completely different; moreover nobody asked for this change!' ●

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IFRS 17 – GROUPING OF INSURANCE CONTRACTS AND DISCOUNTING REQUIREMENTS

BY **STEFAN ENGELÄNDER**



The International Accounting Standards Board (IASB) introduced at the last minute groups of insurance contracts (GICs) as the unit of account for the subsequent measurement of the Contractual Service Margin (CSM). The purpose is to allow entities to mitigate individually adverse developments of the prospects of originally similar contracts in a certain extent instead of presenting such contracts becoming onerous in the course of completion on a contract-by-contract basis. The artificial aggregation of contracts for accounting purposes causes significant issues for implementation.

The guidance in IFRS 17.14 and 16 prescribes the conceptual idea of grouping but not the steps to be followed in practice. In practice, grouping applies period by period to the initial recognition of each new contract and once done, it is never changed (IFRS 17.24). Once established, a new GIC is open for further additions of new contracts for up to 12 months only (IFRS 17.22). For adding a new contract to such an open GIC, the entity considers two aspects of the new contract and

those already in the GIC based on its current perspective, i.e. its current understanding of being “similar risks” and what it currently “manages together” (IFRS 17.14). The entity’s approach in the past regarding “similar risk” and “managed together” as applied to already closed GICs does not matter for grouping of new contracts. Hence, there is no need for the purposes of grouping new contracts to identify the entire portfolio of insurance contracts (PIC). The entity has simply to ensure that there are no two

new contracts grouped together which do not have under current understanding “similar risks” or are currently not “managed together”.

In practice, grouping is applied by considering technical criteria which might be more granular than demanded by the minimum accounting requirements (IFRS 17.21). Particularly, all contracts in a GIC should be subject to the same accounting approach, be it Premium Allocation Approach (PAA), Variable Fee Approach (VFA), Other Comprehensive Income ▶

(OCI) options etc. Accordingly, it is advisable to define PICs, i.e. their defining conditions “similar risk” and “managed together”, as broadly as possible, while the intended granularity of the GICs can be achieved by applying the options in IFRS 17.21. IFRS 17.B129 indicates that two contracts should not be assumed to be “managed together”, if the entity intends to apply the OCI option differently to the contracts.

A key issue in the discussions was the identification of initially onerous contracts. The onerous characteristic has to be identified conceptually on a contract-by-contract basis, of course considering the existence of effects arising from current and future expected business regarding future economy of scales and risk mitigation in a pool. As far as the entity has “mutualization” rights (IFRS 17.B67), they are also considered to the extent necessary. Even if sets of contracts are homogeneous, the entity has to ensure considering each contract that all contracts in the set fall in the same category of IFRS 17.16. However, a contract-by-contract measurement under IFRS 17 is on a statistical basis, i.e. the differentiation of the peculiarities of each contract would not normally be more granular than the statistical clusters applied by the entity in managing the contracts, particularly in pricing.

IFRS 17 REQUIREMENTS REGARDING DISCOUNTING

One of the key features of IFRS 17 is a conceptual approach to discounting. It is not the purpose to represent the returns which

the entity can theoretically or may realistically expect to earn on available assets (IFRS 17.BC201). As in the fair value discounting, both the time value of money and the adjustment for financial risk is based on the perspective of a market participant (IFRS 17.36), while the risk adjustment for non-financial risk represents the perspective of the entity (IFRS 17.37).

As a first step, discounting shall represent the time value of money (IFRS 17.36 (a)). Time value of money, for say 10 years, can be described, in analogy to IFRS 17.B87, as the amount which makes a market participant indifferent between a receipt of a cash flow today and of the same cash flow in 10 years, both cash flows without any uncertainty of amount or timing. The sole characteristics of each deterministic cash flow are its agreed timing, amount and currency. Accordingly, IFRS 17.B84 refers to a “single illiquid risk-free yield curve” to represent the time value of money for a given currency.

The wording of IFRS 17.36 needs, as any guidance, to be read in the entire context, particularly including IFRS 17.B74. The reference to “characteristics of the cash flows and the liquidity of the insurance contracts” cannot be read in isolation. All characteristics of the cash flows and of the contract resulting from non-financial risk, e.g. lapse risk (IFRS 17.B53), are to be considered in the estimate of the expected cash flows and of the risk adjustment for non-financial risk. IFRS 17.B74 prohibits double counting of those characteristics in discounting. Regarding

estimating the discount rates, IFRS 17 relies on IFRS 13. More detailed explanations regarding the issue of double counting are found in IFRS 13.B14 (c). Applying an expected present value technique, as required in IFRS 17, demands discount rates corrected for all characteristics already considered elsewhere in measurement. Just uncertainties of amount or timing subject to financial risk are to be considered either in the estimate of expected cash flows or in the discount rate (IFRS 17.36). Accordingly, most if not all liquidity characteristics of the contract would not be considered in the discount rate.

Objections against the guidance of IFRS 17, e.g. from Wüthrich (EAJ 2011, 93-195), referring to the impossibility of determining such a fully illiquid yield curve, do not permit a deviation from accounting guidance. I.e. it might not be seen permissible to choose the discount rates reflecting the liquidity of covering assets as a principle. Limited supportable information needs to be considered in making the accounting estimates applying the guidance. Accordingly, the illiquidity adjustment demanded by IFRS 17.B80 or being optional by IFRS 17.B81 would be determined considering any supportable market information about illiquidity premiums charged in markets but the preparer of the report would not add speculative adjustments to the resulting yield curve to represent full illiquidity. ●

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TRANSITION TO IFRS 17: FAIR VALUE APPROACH

BY **HENNY VERHEUGEN** AND **KURT LAMBRECHTS**

From 2022 a significant number of insurance companies will be required to apply IFRS 17 for their financial reporting. Since the transition to IFRS 17 is a change of accounting standard, IAS 8 “*Accounting Policies, Changes in Accounting Estimates and Changes in Accounting Policies*” requires a full retrospective application to determine the financial position for the earliest prior period presented.

This requirement is far from simple to fulfil. For the Contractual Service Margin (CSM), in particular, this means that the cash flow estimates, risk adjustment and applicable discount rates at the initial recognition of each group of contracts must be derived, together with all subsequent changes that have since occurred to the best estimates and discount rates.

The IASB is however aware of these complexities and therefore, if an insurer can demonstrate that full retrospective application is impracticable, it may instead choose between applying either a modified retrospective approach (MRA) or a Fair Value Approach (FVA), for a specific group of insurance contracts.

While the MRA is meant to create a measurement as close as possible to the full retrospective approach, the FVA is fundamentally different in two ways:

- First of all, the FVA is entirely *prospective*. This provides relief to the insurer from achieving the necessary historical information required for the other approaches.
- Secondly, the Fair Value (which must be derived in accordance with IFRS 13) is based on an exit price principle, rather than the fulfilment perspective of IFRS 17.

Fair value is defined in IFRS 13 as “the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date”. A comparison can be made with transactions where entities, or portfolios, are acquired or sold.

Under the FVA, the CSM at the transition date is then determined as the difference between the Fair Value of the insurance contract and the sum of (i) the present value of fulfilment cash flows (which are determined in accordance with IFRS 17) plus (ii) the Risk Adjustment measured as at transition. ►



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Differences between the FVA and the fulfilment cash flows can occur for various reasons but most importantly, there are methodological differences between the two approaches. Obviously, the fulfilment value from IFRS 17 has not yet been used in any insurance transactions: market participants would typically refer to established methods such as (Market Consistent) Embedded Value, or perhaps a Solvency 2 Exit Value, as a basis for a transaction price.

A number of the key differences are listed in the table below.

On a more fundamental level, under IFRS 17, an insurer is free to choose what it considers to be the most appropriate method and level for the Risk Adjustment. The chosen approach and level may therefore differ materially from some of the more common techniques, such as Value at

Risk or Cost of Capital. If an insurer chooses to take a more conservative approach then the difference relative to a more market-consistent risk margin may well give a negative contribution to the CSM.

Last but not least however, IFRS 13 offers, in paragraph 41, the possibility to base the fair value on how market participants would currently price an identical item. This approach would normally include some level of profit margin for the buyer, on top of the Risk Adjustment. If an entity can justify that its CSM on new business is market-consistent, it may for instance opt to include the same profit margin on existing business at transition. The IFRS 13 fair value may in some situations then be higher than the current amount on the balance sheet, which implies that the insurance liabilities would increase at the expense of company equity. ●



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Topic	Fair value	Fulfilment cash flows
Discount rate – risk neutral	Risk free rate, without the application of an ultimate forward rate (UFR) but with a constant spot rate.	The same rate is possible, but the Standard appears to allow an UFR or averaging technique for long term liabilities (IFRS17. B82ci).
Expense levels	Non attributable expenses and, to a certain extent, incidental expenses are included in the fair value as well as investment expenses for the assets backing the liabilities. If own expenses are used as a basis then an assessment is required to verify whether these are at a market level.	Non attributable expenses are not allowed. For contracts with direct participation features, inclusion of investment expenses may be appropriate but for other products it is not clear. Fulfilment expenses should reflect only the actual expense level of the entity.
Renewals	IFRS13.B31 refers to a fulfillment value similar as in IFRS 17, but without further detail on contract boundaries.	Renewals are not included, unless the in force contracts meet the explicit requirements of the contract boundary (IFRS17.34).
Own credit standing	IFRS 13 requires the usage of a risk premium for non-performance risk.	The credit premium of the entity is not included in the determination of the fulfilment cash flows.

LONGEVITY IMPROVEMENTS: A NEWTONIAN PERSPECTIVE

BY **MATTHEW EDWARDS**

Most of us are familiar with Newton's laws of motion, if not from schoolday memories then from the common sense of everyday life: essentially, things change only if something causes them to change.

In the case of longevity, the very material longevity improvements of the 1980s, 1990s and 2000s had very specific causes. These were:

- the major reduction in smoking;
- an explosion in health spending (a real-terms increase of around 8-fold in the last 60 years); and
- a revolution in cardiovascular medicine with the development of now taken-for-granted techniques such as angioplasty and keyhole surgery, in addition to whole ranges of pharmaceuticals that proved extremely effective in secondary care.

The vital, Newtonian question is this: will we see any such drivers for mortality change in the future?

So let us see if any of these effects will continue?

- Smoking reductions in the 65+ age range have been slight in recent years, with people of that age much more set in their habits;
- healthcare funding has been less expansionary per capita but what counts for older people is the expenditure per person over 65, the demographics of an ageing population do not help when each more "senior" year of age saved costs considerably more than the previous year of age; ►



MATTHEW EDWARDS

Matthew Edwards is a Director at Willis Towers Watson, leading mortality/longevity in the Insurance Consulting and Technology practice. He is also Deputy Chair of the CMI. The article is not a WTW or CMI view.

- we also need to take into account that medical cost inflation is in excess of standard inflation.

Figure 1 (January 2017) shows the estimated effect of age on the cost of providing public healthcare in the UK.

Finally, largescale medical breakthroughs have dried up – it has been many years since a large-scale medical innovation was rolled out with a material effect across the population, in the same way that we saw with cardiovascular breakthroughs. What do we have on the cards now? Are there other drivers for mortality change? Well, yes, there are, but they seem to be generally negative – drivers of higher mortality, not drivers of higher longevity.

One of the primary “bad drivers” relates to diabetes (note that very similar points could be made regarding obesity).

DIABETES

Diabetes is a chronic condition which can (unless managed carefully) have significant impacts on the long-term health of sufferers and a consequent negative impact on their mortality risk.

Projections indicate that the proportion of the population with diabetes will continue to increase over the next 15-20 years; as diabetes prevalence typically increases with age well into retirement, we can expect to see an increasing proportion of pensioner populations suffering from diabetes in the medium-to-long-term future.

This will, in the absence of a significant (and affordable) breakthrough in diabetes care, result in a significant downward pressure on mortality improvement rates for pension-aged individuals.

NEUROLOGICAL CONDITIONS

Neurological diseases are also showing a worry upward trend,

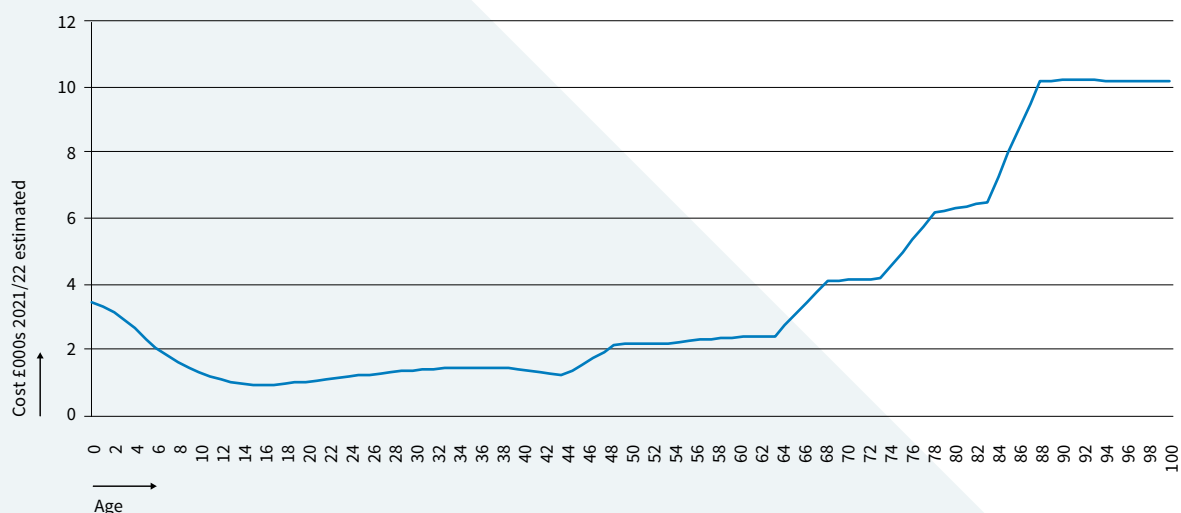
both incidence and total number of deaths, with the number of deaths having more than doubled over the last ten years. The cause of death graph on the next page shows this increase very clearly (in contrast to the gradual reduction in cancer mortality, and material reductions in cardiovascular mortality):

This trend seems likely to continue, given the lack of successful research so far into the causes of Alzheimer’s, Parkinsons and dementia, and the linkage that is now thought to exist between Alzheimer’s and diabetes.

CANCER

Cancer is the second leading cause of death worldwide. One of the great questions of the moment is whether cancer mortality is set to experience reductions of similar order to what cardiovascular mortality has in the last 20-30 years. As the graph above shows, progress so far has been tangible but slight, averaging around 1% per annum. ►

FIGURE 1: AVERAGE ANNUAL COST PER PATIENT BY AGE - UK



Source: <http://obr.uk/fsr/fiscal-sustainability-report-january-2017/>

Over the last 5-10 years, hopes of lowering cancer mortality have ridden on three main strands: immunotherapy, genetic targeting, and “blasting” techniques (eg proton beam).

Two interesting facts about immunotherapy that are not generally appreciated are that (i) it has been in progress for around 15 years, and so is not as new as it sounds, and (ii) where it is successful, it is increasing survival time by of the order of 6 months or more, and not generally curing cancer. On the other hand, immunotherapy is extremely expensive.

Genetic targeting has also been in progress for a long time and has so far shown relatively small effects on survival times.

None of these “workstreams” leads to great hopes for cancer revolution (noting that there have been many such revolutionary

headlines appearing in the news for very many years) – especially given the upward pressure on cancer incidence from obesity and diabetes

THE POLYPHARMACY PHENOMENON – A NEW SOURCE OF PESSIMISM

Polypharmacy (literally, “many pills”) is thought to be responsible for a staggering 75 per cent increase in recent years in emergency hospital admissions for adverse drug reactions. It can also be fatal.

For the very elderly, the age range which is key to how mortality statistics have been moving recently, there can be a very large number of different medications – each of which has generally been trialled in isolation, but then recommended on top of an existing cocktail of other drugs. Between 1995 and 2010 the proportion of adults dispensed more than five drugs doubled to 20% and the

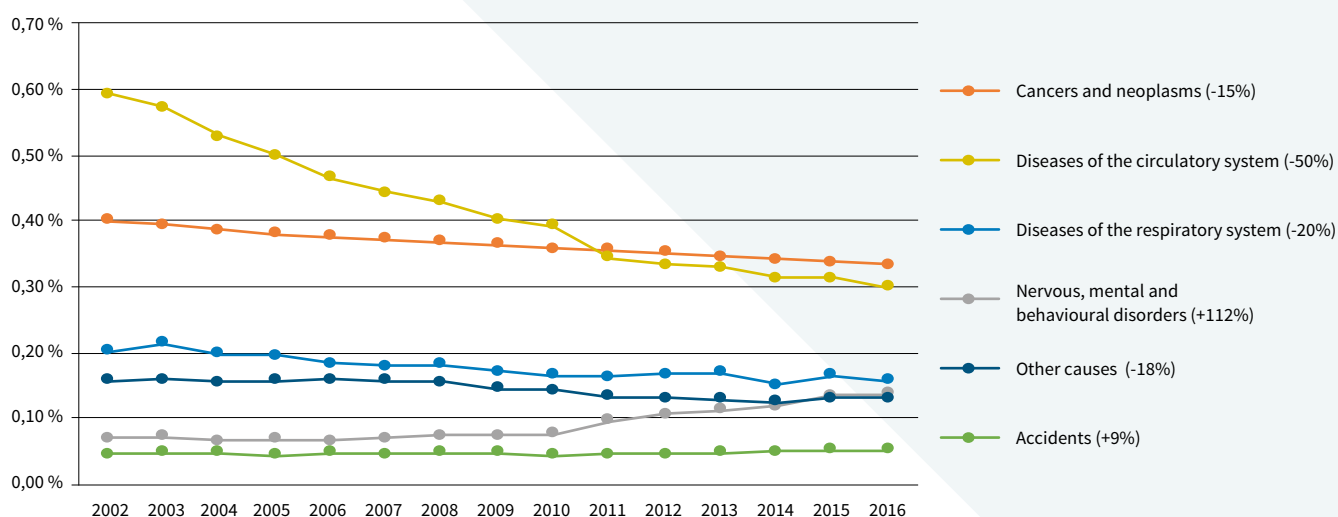
proportion dispensed more than ten tripled to 6% - and these cases will generally be concentrated in the elderly.

There has been a steady rise in the number of adverse drug reaction cases (and associated deaths) and a high cost for the polypharmacy generated: a doubling or more of prescriptions for statins, blood pressure-lowering medication and diabetes drugs ...

LOOKING FORWARD

If we look at the causes for change, whether positive or negative, it seems hard to conclude anything but a medium-term horizon with mortality improvements struggling to become positive. And this “U-turn” situation for pensioners is mirrored at younger ages; a recent Health Foundation report stated that millennials will be the first generation to have worse health problems than their parents when they reach middle age. ●

FIGURE 2: AGE-STANDARDISED MORTALITY RATES BY MAIN CAUSE OF DEATH MALES IN ENGLAND & WALES



Source: Willis Towers Watson based on data published by ONS.
SMRs are estimates based on age banded data.

IFRS 17 - ANOTHER CHALLENGE TO INSURERS, AUDITORS AND ACTUARIES

BY **KRISTOFFER BORK**

The Actuarial Association of Europe (AAE) and its members have already put a significant amount of voluntary effort into the preparation of the new accounting standard, and providing input to IASB and to the European Financial Reporting Advisory Group (EFRAG) on technical issues and questions (see interview with Jean-Paul Gauzes in this issue), and the AAE will continue to provide input and insights in the final phase of the implementation.

In order to be able to respond to various stakeholders, the AAE has established an IFRS 17 Working Group to focus on the many technical aspects of the new reporting standard, and the AAE intends to continue its contributions to the ongoing development and implementation of IFRS17 by:

- responding to technical issues raised by EFRAG
- providing actuarial input to the up-coming exposure process from IASB
- responding to the implementation analysis of the European Insurance and Occupational Pensions Authority (EIOPA)
- producing an educational note to support European actuaries in their work on IFRS 17
- reaching out to affected organisations, e.g. Accountancy Europe, to share views and potentially cooperate on technical points.

Overall, the AAE welcomes many aspects of the new regime including

its market consistency, allowance for risk, greater anticipated consistency and comparability across the accounts of different insurers and reinsurers, and release of profits in line with the underlying earnings profile. However, we do also recognise the challenges of the implementation, and the concern in relation to complexity, data requirements and professional judgement required.

TIME LINE

In that context, the AAE welcomes the recent one-year postponement of the implementation date. If the time is spent wisely, this will provide time both for IASB to reconsider some of the more challenging parts of the new standard that have been criticised the most and for insurers to establish sound reporting processes, IT systems, governance structures, and establish the required dataflow for high quality reporting.

Here, the AAE finds it important to keep up the momentum in the discussions and to finalise

decisions in order to give the industry as much time as possible to prepare for the new standard. It is our experience that most organisations have difficulties with preparing for new regulation if the regulation has not been finalised. In some cases, resources are not spent efficiently because companies try to prepare for different outcomes and in other instances it becomes too convenient for insurers to postpone the planning and preparations until both the implementation date and the standard are finalised – which may prove to be too late.

Thus, we can only encourage IASB and European regulators to finalise the standard as fast as possible to give the industry the best possible time for preparation and respect that the implementation is not only about getting the figures right, but also requires considerations in terms of fast close, documentation, validation, IT, and data quality etc.

IFRS 17 AND SOLVENCY II

In terms of structure and overall methodology, there are many ►



Good reasons for a more conservative approach

similarities between Solvency II and IFRS 17. They are both fair value based, and the balance sheet is established by valuing future expected cash-flows, but they are also different in a number of aspects.

For European insurers, differences between the reporting standard (IFRS 17) and the risk measures and risk management (Solvency II) are specific challenges.

Personally, I can see many good reasons for a more conservative approach in the reporting standard to recognising profit using a non-symmetric recognition of future profits and losses whereas the risk management system measures all future results and incorporate all future values in the risk management decisions. Solvency II focuses on risk management, and the different risk categories are central in Solvency II whereas IFRS 17 focuses on the valuation of insurance contracts. Different focus results in different decisions, different levels of aggregation, and subsequently different numbers.

Thus, I can find good reasons for some of the differences between the IFRS 17 and the Solvency II balance sheet, although a single balance sheet for both risk management and reporting would have simplified things a great deal, and not all discrepancies can be contributed to the different perspectives. To put it bluntly, some of the discrepancies between

the IFRS 17 balance sheet and the Solvency II balance sheets are there for good reasons, but other differences are complicating matters for no specific reasons, which is just inconvenient for all stakeholders.

In relation to the latter, we can only encourage both IASB and EIOPA to revisit some of the choices made and to reconsider if the differences can be eliminated by adjusting the regulation and ensuring greater uniformity between the two balance sheets. Examples of issues where uniformity would be an advantage could be definitions of contract boundaries, risk margins, treatment of reinsurance, and potentially on the discounting of future cash-flows, if the EIOPA curves end up not being recognised under IFRS 17.

It is in the interest of all European stakeholders to eliminate all discrepancies between IFRS 17 and Solvency II definitions that cannot be clearly justified by the different purposes of the frameworks.

GOVERNANCE STRUCTURE

As already mentioned, the underlying approaches to establish the balance sheet of an insurance company are quite similar in Solvency II and IFRS 17. In the European implementation of Solvency II, the governance system with three lines of defence is an important aspect of the improved risk management regulation.

Specific requirements for the actuarial function are defined to ensure high quality in reporting and quantification of risk. The AAE certainly recognises that one way of securing a more harmonised approach and improved comparability between entities is to use standardised methodologies and actuarial principles in assessing the value of insurance contracts.

To the AAE, it seems reasonable to require the same level of professionalism in the reporting process as in the risk management process. As part of the European adoption of IFRS 17, the AAE recommends mitigating some of the complexity of the reporting standard by requiring a similar governance structure as required under Solvency II.

Further, we believe that actuaries will play a leading role in the implementation of IFRS 17 and the preparation of IFRS 17 accounts, and actuaries should have a more formal (enacted) responsibility for closing the accounts given this leading role. Actuarial professional bodies and associations are committed to preparing their members to play a leading role in IFRS 17 through the provision of standards, educational materials and training events.

More specifically, the AAE recommends incorporating two requirements inspired by the Solvency II regulation as part of

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the European adoption of the IFRS 17 reporting standard.

1. OBLIGATIONS ON THE ACTUARY IN THE COMPANY:

In order to allow the management of the insurer to have the necessary insight and understanding of the work of the actuary in relation to IFRS 17, the actuary who is responsible for the work should be required to prepare an internal report to the management of the insurer covering at least the applied methodology, the assumptions used, the data used, identification of the judgments applied, and the results including their sensitivities.

2. OBLIGATIONS ON THE ACTUARY AT THE AUDITOR:

Further, in making judgements and drawing conclusions in order to perform audits of financial statements prepared under IFRS17, the auditor should be required to have a report prepared by the auditor's actuarial expert in order to ensure that the nature and complexity of the actuarial contribution to the audit work is fully reflected. This report should reflect the auditor's requirements and should cover at least the areas mentioned in 1 above.

The actuaries in 1 and 2 above should in our view be required to meet fit and proper requirements, e.g. as per Solvency II Directive, Article 42.



The AAE believes that such reporting and sign-off would enhance the credibility of the audit opinion on financial statements of insurers prepared under IFRS 17 and contribute to the public good as well as providing support

for the work of the supervisor. They would also increase quality and consistency in the reporting and thereby mitigate some of the concerns raised by European regulators. ●

FIRST AAE CRO ROUND TABLE BRINGS TOGETHER ACTUARIES & CHIEF RISK OFFICERS

BY **KAREL GOOSSENS** AND **AD KOK**



KAREL GOOSSENS Chair of the Task Force on the Roles of Actuaries (TFRoA).



AD KOK is Chief Executive.

RISK MANAGEMENT IS AN IMPORTANT ACTIVITY DOMAIN FOR ACTUARIES

The initiative for a CRO Round Table originates from the observations made as a result of the TFRoA survey on the roles of actuaries under Solvency II in insurance (AAE Paper: “The Role of Actuaries under Solvency II”, June 2016).

One of the conclusions from that survey is that 1 in 4 actuaries working in insurance (estimate about 5,000 actuaries in Europe) are active in the field of risk management and that therefore the professional actuarial associations and the AAE must provide a professional framework for those members.

The first recommendation was to expand the Investment and Financial Risk (IFR) Committee and transfer it to a Risk Management Committee, which was unanimously approved by the AAE General Assembly in 2017. A second recommendation was to involve the actuaries in a CRO role in Europe, and thus in a leading position, and to ask for

their input in establishing this framework. However, the most important question still needs to be answered: are risk managers actuaries or are actuaries risk managers?

THE CRO ROUND TABLE BRINGS ACTUARIES IN THE ROLE OF CRO TOGETHER

A working party including Roberto Muscogiuri, Gábor Pasztor, Kartina Thomson and Karel Goossens took the initiative of organizing a CRO Round Table with the aim of creating a European network of actuaries in their role of Chief Risk Officer in insurance. The AAE wants to investigate how the actuarial profession, and more specifically the AAE, can help to provide an appropriate professional framework for actuaries working in risk management.

Twenty-seven actuaries/ CROs from across Europe have discussed the upcoming changes in the regulatory framework, the viewpoint of the Administrative, Management or Supervisory Board, the position of the CRO, what Risk Management means for ►

PROFILE CRO INSURANCE COMPANY

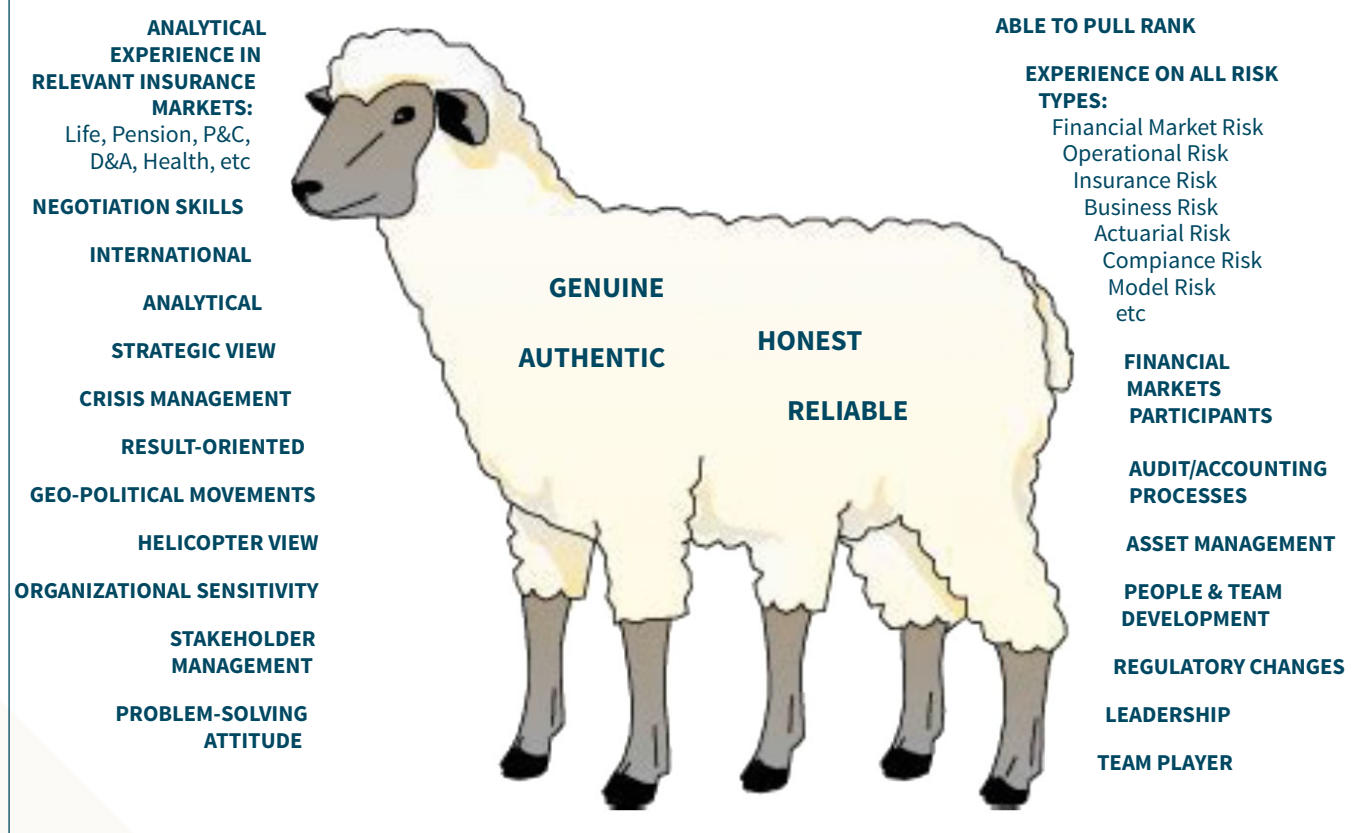


Figure : ACTUARIAL ASSOCIATION OF EUROPE – Annemarie Mijer AAG, RBA

actuaries and what actuaries mean for Risk Management and tried to give an answer on questions such as

- What is the added value of having actuaries in Risk Management?
- How do we promote the need for actuaries in Risk Management?
- What skill set and education is needed for actuaries to fulfill a role in Risk Management?
- How can the actuarial profession help you as a CRO?
- How can the actuarial profession interact with other professional organisations?

THE SHEEP WITH THE FIVE LEGS

The CRO Round Table conference examined the skills required to fulfil the role of the CRO and concluded that an actuarial background can help but that other features such as

- good business orientation
 - understanding what is behind the figures
 - good communication skills
 - out of the box thinking
 - being independent
 - having an open mind
- are even important.

The challenge for the actuarial profession to prepare for the role of CRO/Actuary is to find out how we can bring the actuary as close as possible to the “sheep with five legs”, knowing that the necessary conditions (technical know-how) are met but not necessarily the adequate ones (business context, communication, understanding and open mind).

THE AAE OFFERS A PLATFORM

Connectivity between actuaries in the role of CRO is facilitated by the Round Table and this not only ►

between the actuaries who were present on November 16, 2018 but also by encouraging others to join and contribute.

A related forum will be set up on the AAE website, specific events and meetings will be organized and views will be expressed at the political level.

The skills needed to bring actuaries to CRO level are promoted by determining the right career path and completing the syllabus. The Round Table has established that in order to be successful in a CRO role, it is preferable to build up business and management experience before entering the risk management area.

One of the biggest challenges for the actuarial profession is

not just to focus on technical matters but also to create the right environment (code of conduct, professional skills, etc.) so that actuaries are prepared to take on positions such as Chief Risk Officer, to adapt the evolution of the needs of the industry.

CONCLUSION

Because Risk Management is recognized as one of the axes of the profession, it is important to involve the key players in the area with the colleagues in the role of CRO, so that the AAE and its Member Associations can create the environment that provides comfort and support to the large group of actuaries active in the field of Risk Management. ●



MALCOLM KEMP, Chair of the Risk Management Committee, welcomes the participants.



EXTRA (LONGREAD): ACTUARIAL VIEWS ON BREXIT

BY **PETER TOMPKINS**

Brexit is nearly with us. The U.K. is currently scheduled to leave the EU on 29 March 2019. We discussed the issues facing the insurance sector with **Jennifer Strickland** of Milliman at a particularly uncertain time for business planning.

We began by asking what should the most important changes be to the way in which insurance business is managed by UK companies assuming that there is no “deal” and the UK ceases to be tied to the EU straight after 29 March 2019.

‘UK firms that haven’t obtained authorisation to have a branch or subsidiary within the EU are unlikely to be able to sell any new business in the EU, so I should think any firms that haven’t applied for authorisation should be rethinking their business plans and considering how losing access

to this market might affect their business, not just from a sales point of view but from a risk management point of view as well.

We’ve seen a real uptick in the number of Brexit-related M&As and portfolio transfers and most UK firms are doing a really good job of preparing for Brexit. Saying that, according to **EIOPA**, as of November 2018, 124 UK or Gibraltar insurance companies had insufficient contingency plans – or just no contingency plans at all – for a ‘no-deal’ Brexit, potentially affecting 9.1 million policyholders. EIOPA recommended that the ►



Most UK firms are doing a really good job of preparing

competent authorities in each EU country allow the finalisation of portfolio transfers from UK insurers to an EU insurer (or subsidiary) provided that the transfer had been started in advance of the withdrawal date, so there's still time – although admittedly a very limited amount of time - for firms that have, until now, adopted a “wait and see” approach to start making a move.

Communication with policyholders will also be key. Even for those firms that do have plans in place, I think it's important to keep policyholders informed and reassured that their policies will carry on as normal after Brexit. Clear and regular communication with policyholders before and after the Brexit date is going to be really important.

Aside from passporting issues and the need to develop a post-Brexit business strategy, I think the most important thing for firms to do is give some serious thought to the risks that could arise as a result of Brexit. This is likely to require a more in-depth consideration of the operational, market and other risks that could result from the various potential Brexit outcomes in both the short- and long-term. In particular, firms might want to rethink their ORSA scenarios and emerging risk analysis.'

Will Brexit make any difference to non-UK insurers within the EU?

'EU firms that write business in the UK should already be

engaging with the UK regulators to move towards authorisation as either a third-country branch or a subsidiary. Some UK branches may be required to subsidiarise, particularly those with large amounts of liabilities covered by the UK's Financial Services Compensation Scheme.

For other EU firms, the impact of Brexit will perhaps not be as direct as it could be for those that conduct cross-border business, but I think they will still need to consider the impacts that Brexit might have on their business.

Without the UK's influence on discussions, Solvency II could move in a very different direction in future. During the development of Solvency II, the UK was seen by many as an influential campaigner for various aspects of Solvency II, with the Matching Adjustment being a prime example. My colleague Kyle Audley and I discuss this in more detail in our paper ***[“Brexit: Beyond Passporting.”](#)***

It's also worth noting that Brexit could be viewed as an opportunity. One possibility is that there are likely to be fewer UK insurers writing business in the EU, which could give EU27 insurers the opportunity to increase their market share.'

Do you expect the UK approach to insurance solvency to change?

'The UK's previous solvency regime was also risk-based and had many

similarities to Solvency II - due in no small part to the UK's influence in developing Solvency II - so I can't see the general approach changing much, unless Solvency II is changed materially and the UK regulators no longer see it as being appropriate for the UK market.

Additionally, the costs of implementing Solvency II were very high, as were the resource requirements, so there does not seem to be any particular demand in the UK for a wholesale regime overhaul.'

Will Solvency II continue to apply essentially in the same way as it would if the UK and EU27 were still part of a single market?

'In the short term at least, I think the most likely scenario is that the UK will continue to exactly replicate Solvency II. Solvency II is being written into UK law as a starting point and, in my view, the PRA are unlikely to make any significant unilateral changes straight away.

But a key difference that is that the UK is expected to become a “third country” from the perspective of Solvency II as soon as it leaves the EU, and the EU27 countries are expected to become third countries from the perspective of the UK's solvency regime. This could have immediate effects in terms of how EU/UK assets are treated under Solvency II. For example, EU sovereign debt does not attract spread or ►

concentration risk charges under the Standard Formula, but this would no longer apply to UK government bonds – although admittedly the credit rating of UK government debt is (at the moment) strong enough to offset this. There are also likely to be implications for the impact of sterling-denominated assets on the Matching Adjustment and Volatility Adjustment. Additionally, UK credit ratings agencies are unlikely to continue to qualify as external credit assessment institutions after Brexit, so their credit ratings are unlikely to be allowed in Solvency II calculations. Aspects such as these could catch some EU insurers unawares, so I would encourage firms to think about how immediate changes such as these could affect their portfolios, and similarly for UK insurers with euro-denominated assets in their portfolios.’

Do you think Brexit is likely to see regulatory competition emerge – either as competing to the bottom or competing for the top?

‘I think this depends on the balance between regulatory desire to maintain the security of the market and the political pressure to encourage a competitive market and attract overseas firms – this balance will vary between countries.

In terms of EU countries trying to attract UK firms looking to relocate as a result of Brexit, I wouldn’t be surprised if some countries used some regulatory discretion in order to increase the appeal of



their markets, but only to a limited extent. EIOPA is making its best efforts to prevent any relaxation of regulatory standards, and released [an Opinion](#) on regulatory convergence in light of the UK’s withdrawal from the EU. They seem really keen to avoid “letterbox” style operations in the EU, where ►

JENNIFER STRICKLAND
is a consulting actuary
with Milliman based in
London.



The most likely scenario is that the UK will continue to exactly replicate Solvency II

firms have a registered address but minimal real presence.

The PRA in the UK does have an objective to act in a way that facilitates effective competition when making policies, but this is a secondary objective that comes after the PRA's primary objectives of safety and soundness, and policyholder protection.

So personally, I would be surprised if a historically prudent PRA relaxed its standards in order for the UK to become more competitive, but wider political pressures could mean that this changes in the future.

One interesting aspect of Brexit is that the UK is likely to have have its own body responsible for endorsing IFRS 17 and so could be able to make its own decisions on whether to fully endorse it or not. There's a potential for this to lead to a competitive advantage for UK firms but, given it's a global accounting standard and most of the larger London-based insurers are multinational firms, I imagine it would be difficult to not go along with it.'

Will EU27 members want the UK's continued participation (business as usual) in solvency developments?

'I wouldn't want to speculate on what the views of the EU27

members might be, but in terms of what the UK's involvement in the development of Solvency II might look like following Brexit, my expectation is that after Brexit the UK will become an "observer" of the discussions around any developments to Solvency II, and so I imagine would no longer have as active a voice as it did before.

The issue is that if the UK wants to obtain and maintain equivalence to Solvency II, it's likely the UK would have to go along with the decisions on the development of the regime, and without a seat at the table that allows the UK to influence the outcomes, the regime may become slowly less applicable to the UK. If at some point changes were implemented that were excessively onerous for UK insurers or, alternatively, which the PRA saw as materially weakening the Solvency II requirements, there may reach a point where the PRA decides not to implement these changes.

Many other countries that have been granted equivalence have very different regimes to Solvency II, but if you're starting at a point where you exactly match and start to actively edge away from that point, it becomes very hard to say 'we're equivalent' because you've made active choices to be different.'

How do you expect the FCA to respond if given the freedom to diverge from other EU member state rules?

'What I wouldn't be surprised to see changing reasonably early on is the PRA's official interpretation of certain discretionary aspects of Solvency II, which are not prescribed but approaches are generally based on EIOPA opinions, a key example being the use of a dynamic volatility adjustment in internal models. Following Brexit, I can imagine the PRA starting to be a bit bolder with its views in the areas where it has discretion.

In my view, the likelihood of the UK developing an entirely new solvency regime is very low. In the medium-term, what I think is a more reasonable scenario is that the UK gradually "drifts" away from Solvency II, either by making adjustments to the current regime or by not adopting changes that EIOPA implements if they aren't appropriate for the UK market.

In 2017, the UK Treasury Select Committee held an enquiry into the impact of Solvency II on the UK insurance industry, which the PRA and several industry representatives gave evidence to. This indicated several areas where the industry and the PRA both see potential merit in changing the current regulations - calls for changes to the Risk Margin ►

being the main example that springs to mind. Sam Woods, the PRA's chief executive, once called it the **"biggest and most obvious bug"** with the current regime.

So far, though, as far as I'm aware the PRA has only publicly considered actions it can take within the bounds of Solvency II, but there's a chance it will start to act more unilaterally following Brexit.

However, whilst there are changes that could be made to make the regime a bit more tailored to the UK insurance industry, what I wouldn't expect is for the UK regulators to make any changes that materially weaken the rules or make the regime less onerous – the PRA is historically prudent and it is unlikely to make any changes that put the soundness of insurers or the level of policyholder protection at risk.'

What do you think will be the likely main responses to Brexit within the UK's own insurance market?

'I think initially most firms will just be concentrating on avoiding any service discontinuities or balance sheet volatility as much as possible, for example, through insurance business transfers, setting up of subsidiaries or branches in EU27 countries and

so on, as well as putting in place strategies to manage the various market-related risks of Brexit.

Further down the line, those who don't already may start to look a little further afield for overseas expansion opportunities if the EU is no longer an "easy" expansion option, but this will depend on the firm in question.

One thing I think we are likely to start seeing is stronger lobbying within the UK on aspects of Solvency II that UK insurers don't like – such as certain aspects of the Risk Margin and the Matching Adjustment. We've already seen some discussions between the Treasury Select Committee, the regulators and the industry around potential changes to Solvency II, but I expect that once the Brexit date is passed and things have settled down, the industry will start petitioning in earnest. Although, as I've discussed earlier, whether the regulators respond to this or not is a very different question.

There are also other regulations which are derived from the EU which could potentially be changed by the UK regulators once the UK is outside of the EU – for example, the Insurance Distribution Directive or the Pre-packaged Retail Insurance and Investment Products (PRIIPs) rules that have led to a variety of concerns being raised by insurers.

The post-Brexit period will definitely be an interesting time to be an actuary, both in the UK and in the EU27. Personally, I'm looking forward to finding out how the insurance industry will develop and what new challenges we'll come across on the way.' ●

SUSTAINABLE VOLUNTEERS

In a world with climate challenges and limited resources, with global social problems and sometimes inappropriate governance, sustainable development is becoming increasingly important¹.

Actuaries can play an important role in increasing the understanding of the potential impact of Environment, Society and Governance (ESG) on insurers and pensions, and facilitating the integration of ESG criteria into both asset and liability considerations in business and/or investment decisions. ESG factors have been included in the IORP stress test of 2018 and the AAE encourages to include these factors also in stress tests from other sectors. Actuaries will be happy to contribute to further work in this area.

In the area of climate change the AAE works together with the IAA. Actuaries in North-America have created a tool called "Actuaries' Climate Index" and the AAE is trying to find ways to introduce this in Europe as well.

The AAE wants to emphasize that sustainability is needed in many areas and would like to see the discussions on the sustainability and adequacy of social security pension systems in the EU Member States intensified.

Actuaries can contribute, among other things, to the analysis of inter-generational fairness, intentional and non-intentional transfers between subsets of insured persons and the assessment of generosity or adequacy of the systems. The AAE wants to encourage Member States to implement a statutory requirement for regular monitoring and actuarial reporting on the finances of their social security systems, as this can be an important factor in ensuring the sustainability of social security pension promises.

On average between 100-200 experienced actuaries continuously contribute to these initiatives in the various AAE (sub) committees, task forces and working groups. Many more initiatives can be found on the AAE website www.actuary.eu and will be discussed during the upcoming 3rd European Congress of Actuaries.

The AAE is grateful that it can count on these actuarial sustainable volunteers to do all this work.

Ad A.M. Kok AAG Hon FIA
Chief Executive
Actuarial Association of Europe

1. AAE Messages in face of EU Parliamentary Election and the new Commission

COLOPHON

The European Actuary (TEA) is the triannual magazine about international actuarial developments. TEA is written for European actuaries, financial specialists and board members. It will be released primarily as e-mail newsletter.

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Please check

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