



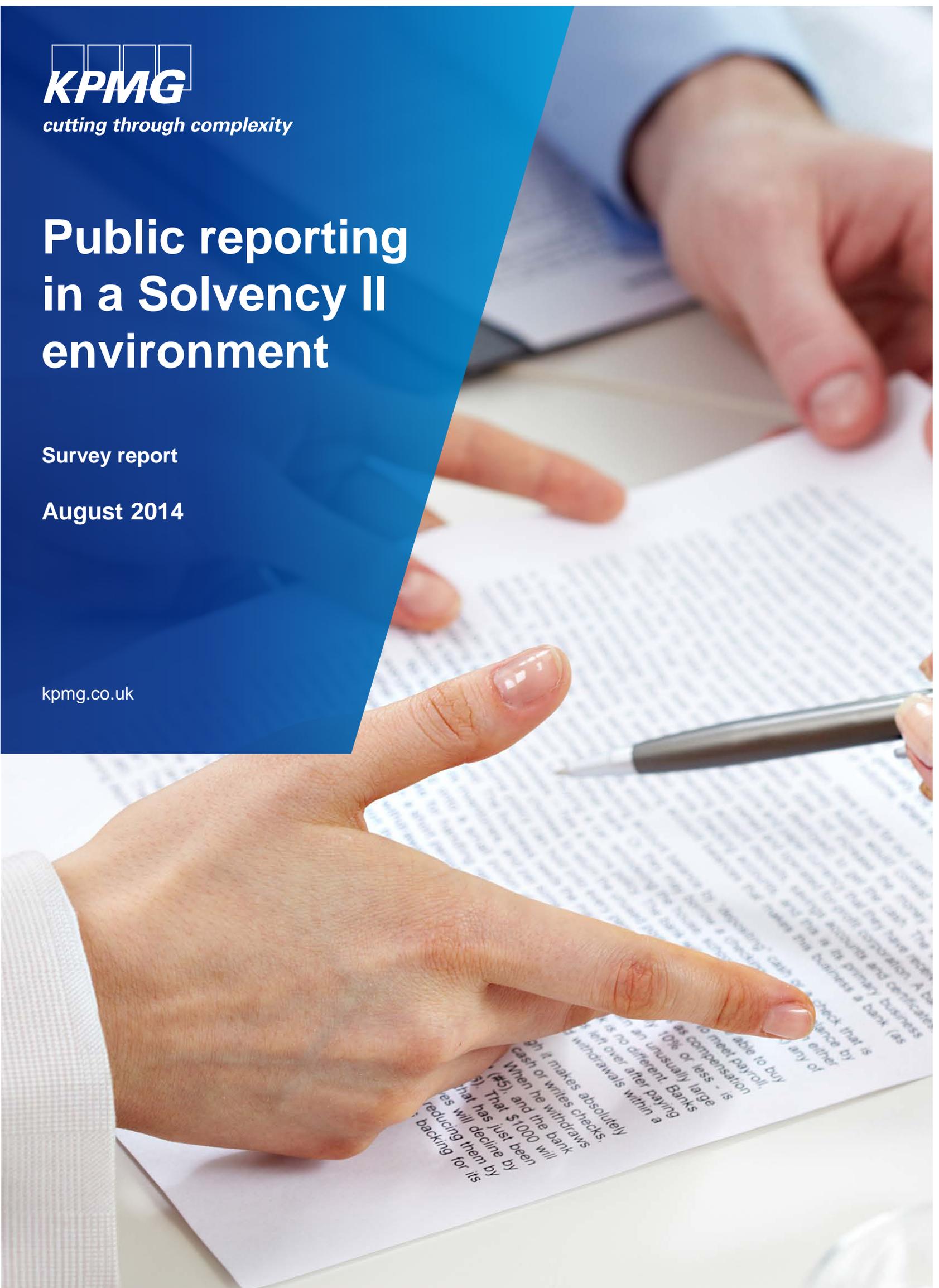
cutting through complexity

# Public reporting in a Solvency II environment

Survey report

August 2014

[kpmg.co.uk](http://kpmg.co.uk)



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# 1 Introduction

**Eleven large quoted insurance groups based in the UK and continental Europe participated in this KPMG survey. We would like to thank all of those who took the time to respond.**

## Objectives

Our aim is to provide analysis and insights on the implications of Solvency II (SII) on the public reporting that European quoted insurance companies will produce for investors.

In particular, the analysis covers what firms intend to disclose for SII prior to and after SII implementation on 1 January 2016 and the changes firms expect to make to their financial framework in light of SII.

## Survey methodology

We asked 11 quoted multinational insurance companies in the UK and continental Europe to complete a survey in July 2014. The companies consisted of a mix of life insurers, composite insurers and reinsurers. The survey contained a mixture of multiple choice and open response questions and was designed to be completed quickly.

For data protection and commercial confidentiality reasons, individual responses have been treated with the strictest confidence. The results published here are presented in aggregate format or have been made anonymous.

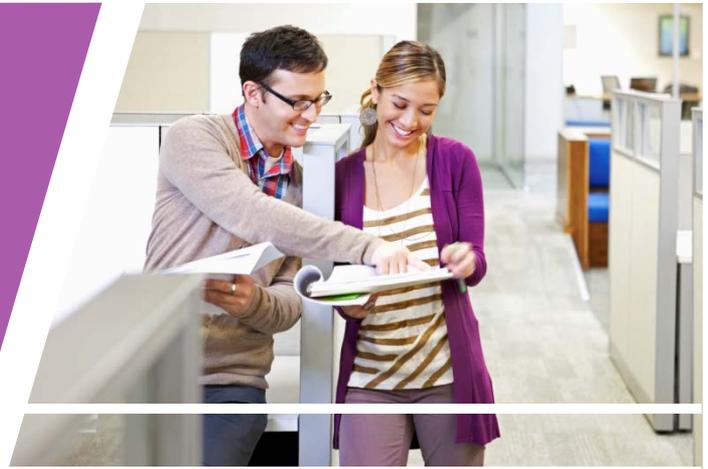
## Note on the interpretation of the results

We would like to point out that the information contained in this report is of a general nature and it is not intended to address the circumstances of any particular individual or entity.

Although we have tried to provide timely and accurate information we cannot guarantee that this information was accurate at the date it was received or that it will continue to be accurate in the future. Indeed, as firms continue to evolve their thinking on the subject, we would expect their views to evolve as well.

No one should act on any information contained in this report without appropriate professional advice and a thorough examination of their particular situation.

# 2 Executive Summary



Just over a year before SII implementation, the insurance industry is beset with uncertainty. Firms fear that guidance, and/or regulator stance, could change ahead of SII implementation and are keen to avoid disclosing either too much or too little information as a result. The majority are also yet to finalise how their financial framework (e.g. cash and embedded value) will change.

As SII is still evolving, we expect that the firms' approach will also develop in the run up to implementation. Flexibility to change as (or if) guidance changes will be the key to success. But for the moment, we have identified the following themes:

## Solvency II public disclosures

- **Only a small number of firms surveyed plan to publish estimated SII results before it is implemented.**
- Firms that are not planning to disclose SII results before implementation are **concerned that there could be material changes** to their SII results due to uncertainty in SII guidance or from the internal model approval process (IMAP).
- Increasing appetite from analysts to see SII results, together with more firms publishing **may create sufficient momentum for other firms to reconsider their plans.** Firms must ensure they have the right capabilities to respond in a timely manner.
- **There is still considerable uncertainty** in terms of exactly what will be disclosed - and when.
- **Few firms appear to have fully considered how Pillar 3 processes will be aligned to deliver SII results for public reporting.** Those that have, recognise the potential for results to diverge in the first few years after implementation. A long term ambition is that the same process and numbers will be used for Pillar 3 and public reporting.
- **Almost all firms surveyed are expecting IMAP approval before SII implementation.** Although we expected firms to have contingency plans for delays or non-approval, our survey suggests very few firms have considered what this means for public reporting.

## Changes to financial framework

- Most firms surveyed plan to have an 'internal view of capital' which is different to Pillar 1. However **only a few intend to disclose this publicly, with a small number still considering their position.** We are not convinced that investors will give credit for multiple capital disclosures from a capital adequacy perspective.
- **Cash is becoming more important.** Firms that are planning to review their definition of cash currently base it on statutory profits, sometimes with allowance for capital. Some firms are now planning to align their definition of cash to IFRS.
- **Divergence in cash definitions is likely to continue post SII,** including whether cash includes an allowance for capital requirements and buffers respectively.
- **Embedded value is becoming less important. Most firms surveyed plan to stop reporting embedded value after FY15.** Those which intend to continue say embedded value will be less important or that they will disclose it less frequently.
- **It is less clear what the plans are for any replacement for embedded value.** Some firms intend to measure 'value' using SII own funds, based on a SII Pillar 1 basis or an 'adjusted' basis to reflect a more economic approach.
- They will **report new business metrics** instead of embedded value.
- **Almost all firms surveyed are not planning to change their approach to calculating IFRS liabilities as a result of Solvency II, ahead of IFRS 4 Phase 2.** A very small number of firms reviewing their position.
- Apart from the above, firms **do not intend to make any significant changes to the disclosures around their financial framework.**

# 3 Solvency II Public Disclosures



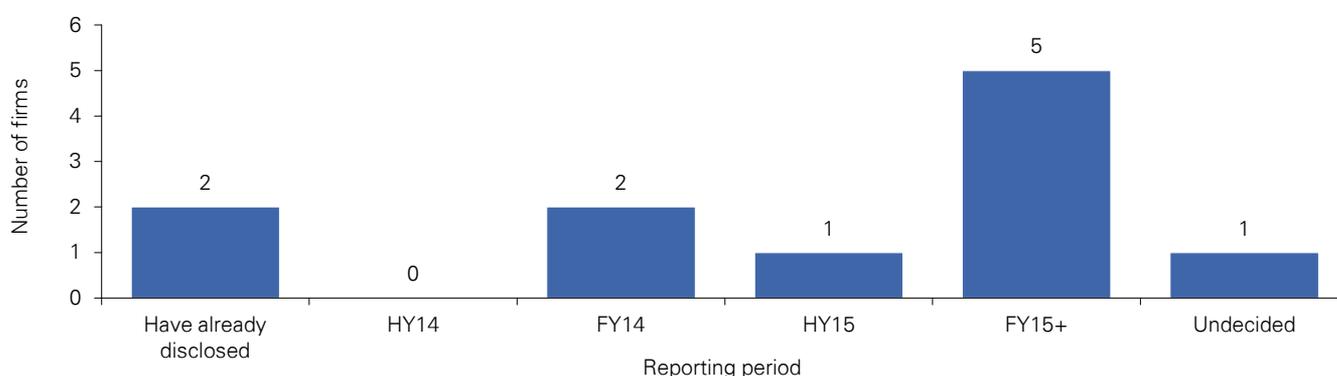
Only a small number of firms surveyed plan to publish estimated SII results prior to SII implementation.

Firms remain concerned about material changes to their SII results from the uncertainty in SII guidance or from IMAP. Increasing appetite from analysts to see SII results, together with more firms publishing may create sufficient momentum for other firms to reconsider their plans.

### 3.1 SII disclosures prior to SII implementation

Firms are increasingly considering what SII disclosures are needed before SII implementation so they manage expectations and educate the investor and analyst community. Firms are weighing up what they should reveal and when. We expect to see greater appetite from analysts for some form of SII results as implementation draws closer. Indeed, analysts are taking a strong interest in firms' likely coverage under SII and are using firms' economic capital (EC) ratios, where available, as a proxy for this.

**Graph 3.1.1: Timing of first time SII disclosures**



Two firms surveyed have already disclosed their estimated SII results. Three more intend to disclose estimated SII results for the first time prior to SII implementation. Five firms surveyed do not plan on disclosing SII results before implementation.

Respondents indicate concerns about potential material changes to results due to uncertainty in SII guidance or from the internal model approval process (IMAP). However, one firm plans to use their internal model to disclose EC results for the first time in HY14.

But overall, we see concerns. Firms are cautious about disclosing too much, or disclosing the wrong thing, so they have to backtrack if guidance changes. One interpretation of our survey is that the two firms that have already published some results arguably hope to gain some form of competitive advantage by showing leadership in a critical strategic issue for the industry. They are indicating how they intend not just to comply with regulations that will eventually apply to them, but to embrace them.

# 3

## Public reporting in a Solvency II environment

# Solvency II Public Disclosures

Considerable uncertainty remains about exactly what SII results will be disclosed and when.

Firms tend to focus on Own Funds, SCR and surplus.

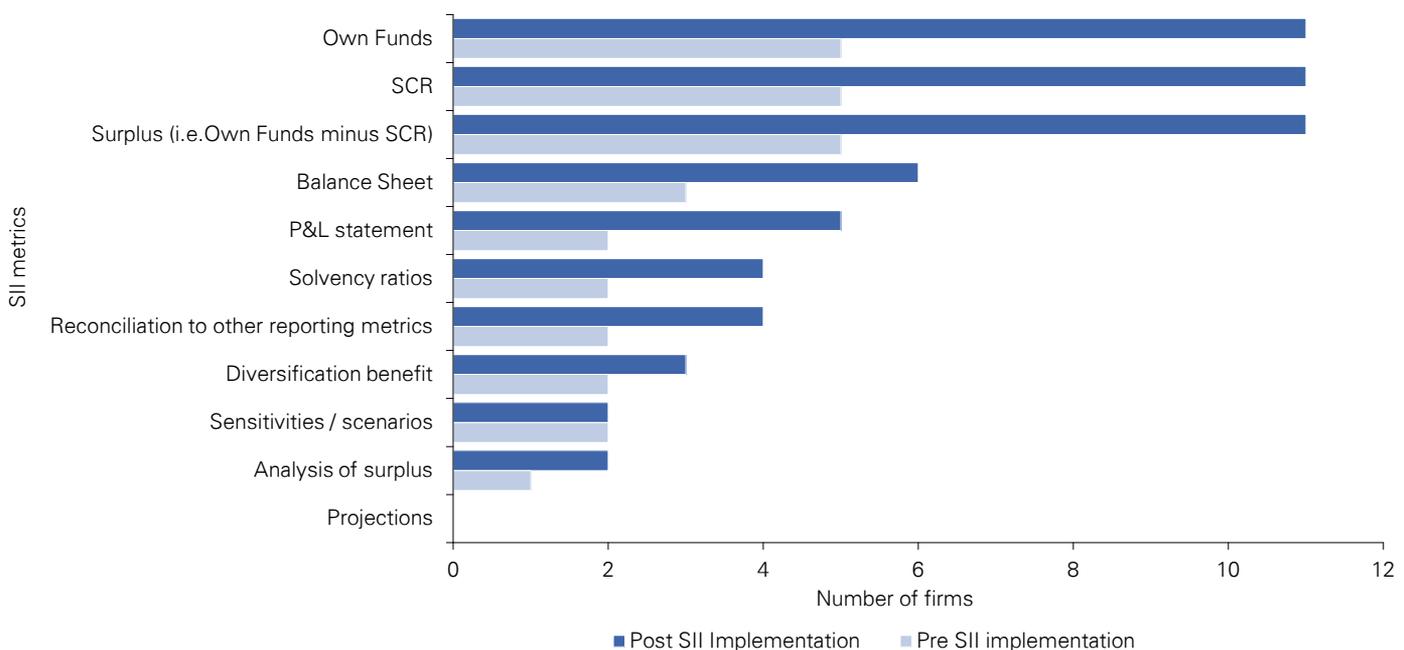
None of the firms surveyed intend to disclose SII capital projections.

### 3.2 Level of public SII disclosures

At the time of this survey in July 2014, firms are still developing their thinking around exactly what their SII disclosures will look like. There is still considerable uncertainty as to exactly what form the disclosures will take and how it will evolve.

Some precedence has been set by the firms that have already disclosed their estimated SII results to date. We would expect that, to some extent, this will influence the design of other firms' disclosures.

**Graph 3.2.1: SII metrics publicly disclosed**



Own funds, SCR and surplus are the most common metrics that firms intend to disclose, both before and after SII implementation. This is to be expected given that these are the basic metrics for SII and are also required for the Pillar 3 Solvency and Financial Condition Report (SFCR).

Just two firms plan on producing more detailed disclosures such as reconciliation to other reporting metrics and Profit & Loss statements.

To a large degree, such restrictions are driven by a desire to manage the potential uncertainty in the SII results because of uncertainty in certain areas of the SII guidance, as well as potential changes in methodology arising from the outcomes of IMAP. To a much lesser degree, the restriction for a minority of firms relates to their capability to perform more detailed calculations robustly enough (e.g. P&L Statement and reconciliations to other metrics). No firms surveyed plan to disclose projected capital requirements.

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## Public reporting in a Solvency II environment

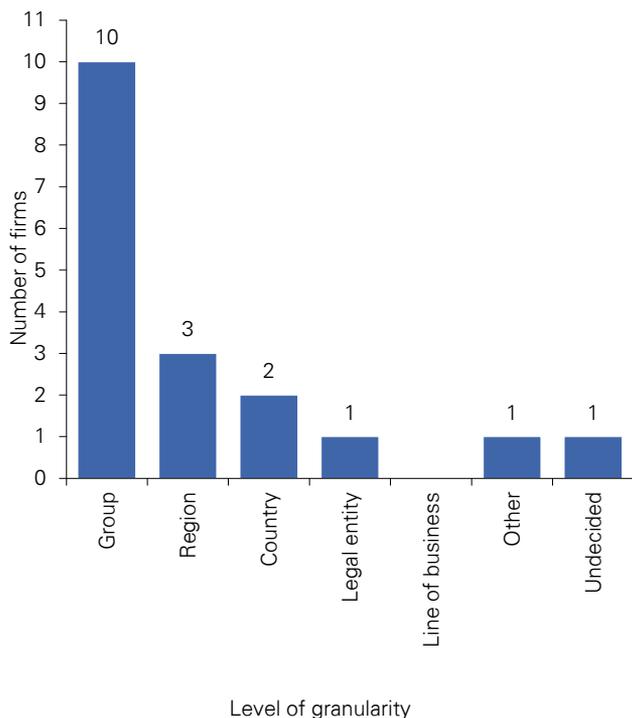
# Solvency II Public Disclosures

Firms tend to have a clear view of granularity and the types of qualitative information they intend to disclose. Most do not plan to disclose their SII results beyond the Group level. Two intend to include commentary on the future outlook of the firm on a SII basis.

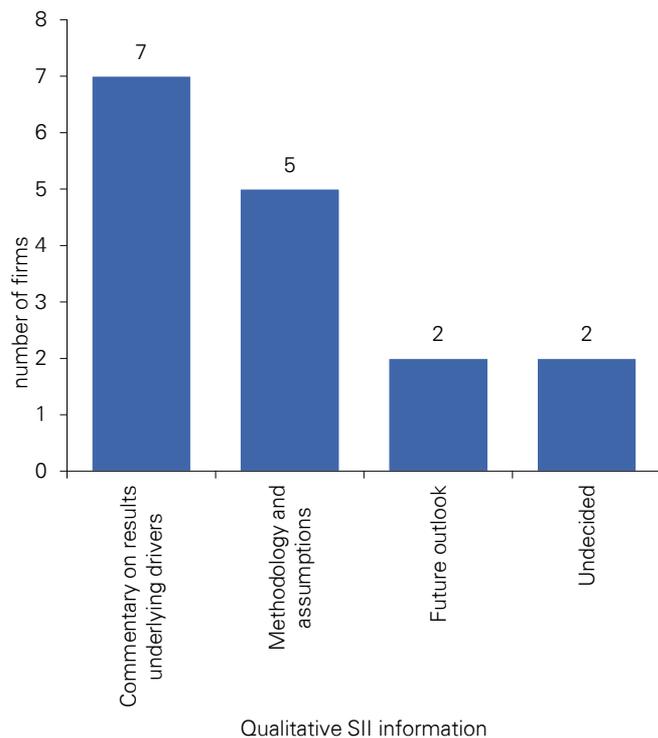
### 3.2 Level of public SII disclosures (cont.)

Whilst there is considerable uncertainty in exactly what quantitative metrics firms plan to disclose, there appears to be more clarity in terms of the level of granularity of SII results and the types of qualitative information that firms plan to disclose with their SII results.

**Graph 3.2.2: Granularity of SII disclosures**



**Graph 3.2.3: Qualitative SII disclosures**



Only six firms surveyed plan to disclosing results below Group level. One plans to disclose its SII results for each material legal entity and another intends to disclose at the risk level too. All except one firm that plans to disclose its SII results prior to SII implementation will maintain the same level of granularity post implementation.

As expected, most will include commentary on the underlying drivers that affect results. Firms that do not intend to disclose a quantitative reconciliation of SII results to other reported metrics will provide qualitative commentary to guide readers on key differences in methodology. And two firms intend to include commentary on the future outlook of the firm on a SII basis.

# 3

## Public reporting in a Solvency II environment

# Solvency II Public Disclosures

All firms will find FY15 reporting challenging. Few appear to have considered fully how their Pillar 3 processes will be aligned to deliver SII results for public reporting.

Some firms may use approximations to calculate their SII results in the timescales required, but none intend to extend public reporting deadlines.

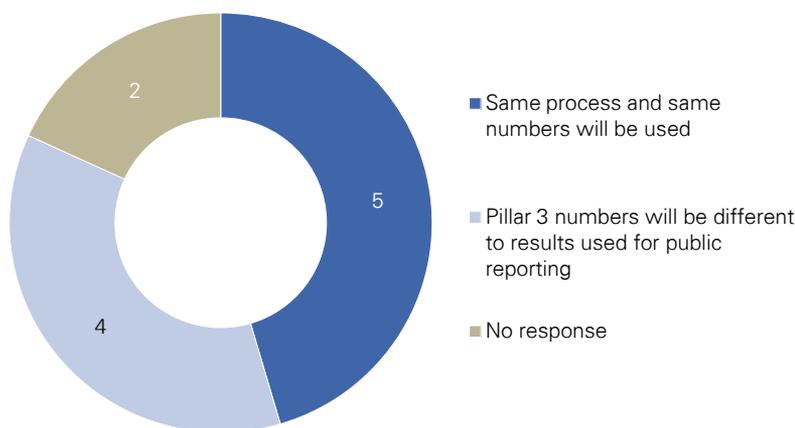
### 3.3 SII public reporting versus Pillar 3 reporting

Many firms are still focused on developing capability to satisfy Pillar 3 requirements within the required timescales. Further consideration is needed about how the processes required to deliver the results for public reporting can be aligned to those required for Pillar 3.

Whilst much of the information one might disclose publicly might be taken from the regulatory disclosures, the public disclosures are likely to be required in advance of the regulatory information. For example, in the earlier years after SII implementation, division reporting is likely to need to deliver results to Group for public reporting before they need to deliver solo quarterly QRTs.

We expect reporting for FY15 to be challenging for all firms. This is because they will be expected to report their SII results and comparatives in addition to all existing reporting requirements. Some firms may use approximations to calculate their SII results in the timescales required, but none intend to extend public reporting deadlines.

#### Graph 3.3.1: Alignment of public disclosures and Pillar 3 reporting



**None** of the firms surveyed plan to extend their public reporting timetable to cope with additional reporting for FY15

Five firms indicate they plan to use the same process and same numbers for public reporting and Pillar 3 post implementation. Even then, they recognise this will be challenging and perhaps not even possible.

Four respondents indicate that SII results used for public reporting and Pillar 3 will differ. This is either due to the SII results for public reporting being taken at a point in time, with subsequent adjustments made before the results are used for Pillar 3 or a different reporting process is used. That said, all firms indicate that the long term ambition will be to use the same processes and same numbers for Pillar 3 and public reporting.

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## Public reporting in a Solvency II environment

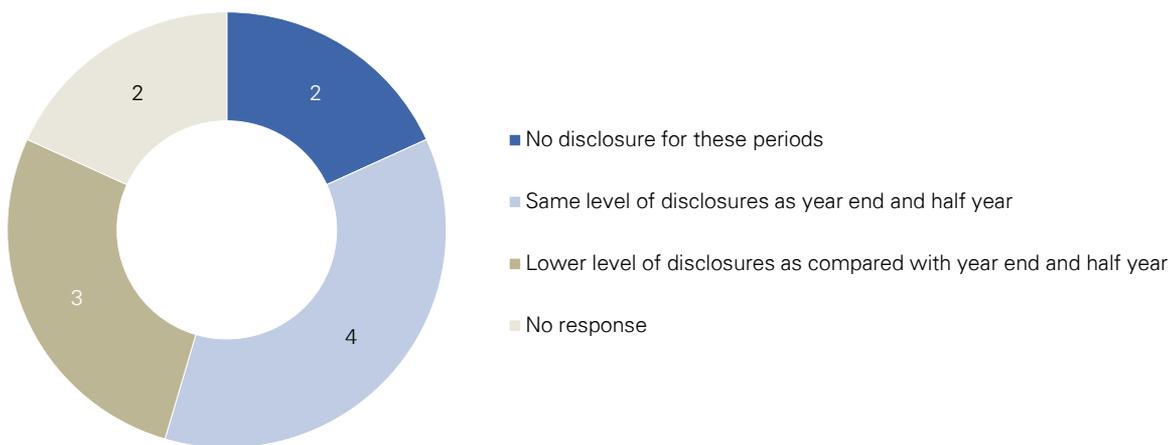
# Solvency II Public Disclosures

There is no clear consensus about the level of reporting at Q1 and Q3. However the majority will make some form of disclosure.

Although we expected firms to have contingency plans for delays or non-approval, our survey suggests very few firms have considered what this means for public reporting.

### 3.3 SII public reporting versus Pillar 3 reporting (cont.)

Graph 3.3.2: Quarterly disclosures



Four firms say they plan to make the same level of disclosures in Q1 and Q3 as they would for their year end disclosures. Three indicate that they plan to disclose SII results in Q1 and Q3 on a slimmed down basis compared to year ends. The Q1 and Q3 SII disclosures will be limited to high level summary metrics such as own funds, capital requirements, surplus and coverage ratios. Two firms don't plan to make any disclosures for SII for Q1 and Q3.

### 3.4 Delays in internal model approval

Internal model firms need to consider what course of action they might take if they do not receive internal model approval by SII implementation. This includes having sufficiently robust contingency plans for a firm's internal model application.

Although we expected firms to have contingency plans for delays or non-approval, survey responses suggest that very few firms have considered what this means for public reporting. We expect that firms will have no choice other than to at least disclose their Standard Formula results.

If the Internal Model is not approved in time for SII implementation, **two** firms say they will disclose standard formula results, **two** will disclose an internal EC view, **one** will disclose both standard formula and EC. The other **six** did not indicate if they have planned for this eventuality.

# 3

## Public reporting in a Solvency II environment

# Solvency II Public Disclosures

The majority of firms surveyed plan to have an internal view of capital which is different to SII Pillar 1.

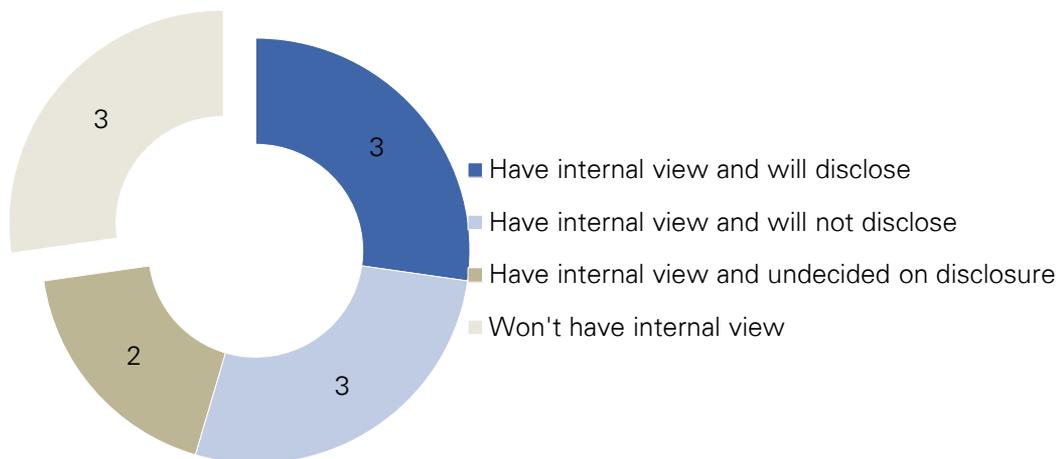
Of these firms, less than half intend to disclose this publicly with some still considering their position on this.

We are not convinced that investors will give credit for disclosing multiple capital measures for capital adequacy.

### 3.5 SII Pillar 1 versus Pillar 2

A number of survey respondents already disclose an internal view of capital (i.e. economic capital (EC)). Post SII implementation, we expect many firms will continue to use their EC models in producing their ORSA which may differ from SII Pillar 1.

#### Graph 3.5.1: Disclosure of internal view of capital



- Eight firms plan to have an internal view of capital which is different to Solvency II Pillar 1. They also intend to use this as a basis for their Own Risk and Solvency Assessment (ORSA). Of these firms, only three have definite plans to disclose this internal view publicly.

# 3

## Public reporting in a Solvency II environment

# Solvency II Public Disclosures

Although there will be a number of areas where firms have a different view of capital compared to Pillar 1, in practice, firms will only make adjustments for the areas material to their business. This will vary depending on the nature of their business and views on methodology.

### 3.5 SII Pillar 1 versus Pillar 2 (cont.)

Although SII Pillar 1 is meant to represent an economic view of capital, there are a number of areas where firms have a different view of the true 'economic' position. Of the eight firms that have an internal view of capital different to SII Pillar 1, these are the key differences:

Table 3.5.2: Differences between SII Pillar 1 and 'internal view of capital'								
	Co. A	Co. B	Co. C	Co. D	Co. E	Co. F	Co. G	Co.H
Removal of SII contract boundaries	✓	✗	✓	✓	✓	✓	✗	✓
Risk free rate adjustments	✗	✓	✗	✗	✗	✓	✓	✓
Removal of SII fungibility restrictions	✓	✗	✗	✗	✗	✓	✗	✓
Removal of SII capital tiering limits	✓	✗	✗	✗	✗	✓	✗	✓
Allowance for pension scheme valuations	✗	✗	✓	✗	✗	✗	✗	✓
Treatment of non-insurance subsidiaries	✓	✗	✗	✗	✗	✓	✗	✓
Different confidence intervals used in risk calibrations	✗	✗	✗	✗	✗	✗	✗	✗
Risk definition	✗	✓	✗	✗	✗	✗	✗	✓
Inclusion of equivalence	✓	✗	✗	✗	✗	✓	✗	✓
Removal of Risk Margin	✗	✗	✓	✓	✗	✗	✗	✓
Risk margin cost of capital assumption	✓	✗	✗	✗	✗	✓	✗	✓

The most common adjustments that firms intend to make are the removal of contract boundaries. This is a reflection of the survey participants for whom regular premium savings products form a significant part of the product portfolio, which is most affected by the SII contract boundary rules. Some firms say further investigations will be required to understand some of the possible differences before deciding on the final list of adjustments that will be made.

# 4 Changes to Financial Framework

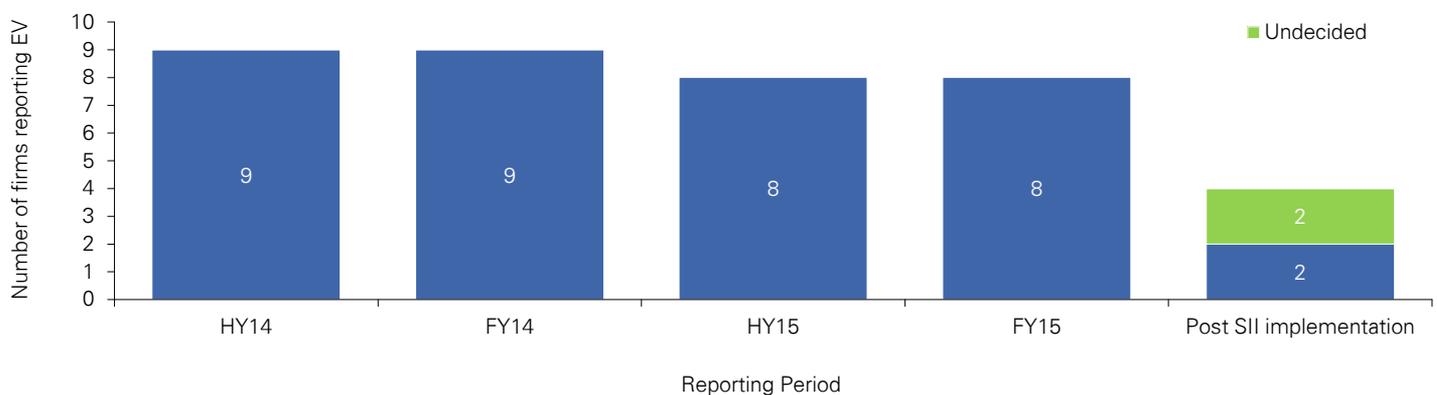


**Embedded value reporting is becoming less important. Most firms plan to drop embedded value after FY15. Those that will continue say it will be less important or that they will disclose it less frequently. It is less clear what will replace embedded value.**

## 4.1 Future of embedded value reporting

Embedded value reporting existed in the Solvency I regime primarily to quantify shareholder value locked up in the margins within Solvency I prudent reserves. In SII, liabilities will be valued on a best estimate basis rather than on a prudent basis. This puts into question the relevance of embedded value reporting in future. Some firms already feel that embedded value is not widely used by investors and analysts given inconsistencies in industry practices. This leads to difficulty in comparing firms.

**Graph 4.1.1: Embedded Value reporting**



- Apart from two respondents, all firms surveyed currently report embedded value either based on European Embedded Value (EEV) or Market Consistent Embedded Value (MCEV) for their life business.
- Five firms plan to stop reporting embedded value. Four plan to stop after FY15 disclosures and one firm will stop after FY14.
- Of the five that indicated that they will drop embedded value, four plan to replace this by SII own funds with a mixture of firms planning to do this based on a SII Pillar 1 basis or an 'adjusted' basis to reflect a more economic approach.
- Two firms remain undecided on their plans for embedded value reporting. One has indicated that they are likely to drop embedded value but it is unclear when.

# 4

## Public reporting in a Solvency II environment

# Changes to Financial Framework

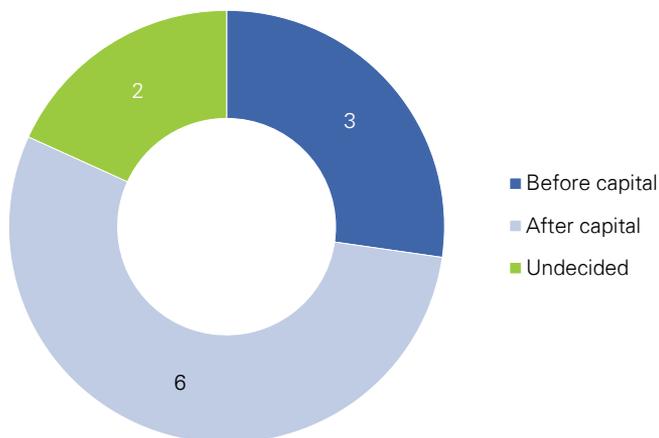
Cash is becoming more important. A divergence in cash definitions is likely to continue post SII, including whether cash includes an allowance for capital requirements and buffers respectively.

### 4.2 Future of cash reporting

All firms report cash generation but they use a range of definitions.

Cash generation or remittance to Group is typically calculated on the current regulatory Solvency basis, not economic capital. It can represent actual dividends from entities to Group or be based on operating profit with potential adjustments for capital requirements. SII may provide the opportunity to standardise the definition of cash generation but this is unlikely in the short term. Indeed, short-term divergence is possible initially.

**Graph 4.2.1: Disclosure of cash before or after capital**



**Three** firms are taking the opportunity to reconsider how they define 'cash' post implementation of SII

Of the firms who are planning to review their definition of cash, two are currently using a definition based on statutory profits, with or without capital requirements. Some plan to align their definition of cash to IFRS.

# 4

## Public reporting in a Solvency II environment

# Changes to Financial Framework

All firms surveyed plan to continue reporting their new business metrics, including those that plan to stop embedded value reporting. A number intend to base their value of new business reporting on SII own funds. However, it is unclear whether this should be based on SII Pillar 1 or an adjusted basis.

There isn't consensus on whether new business strain will allow for capital requirements or not, and if it does, whether it should allow for capital buffers.

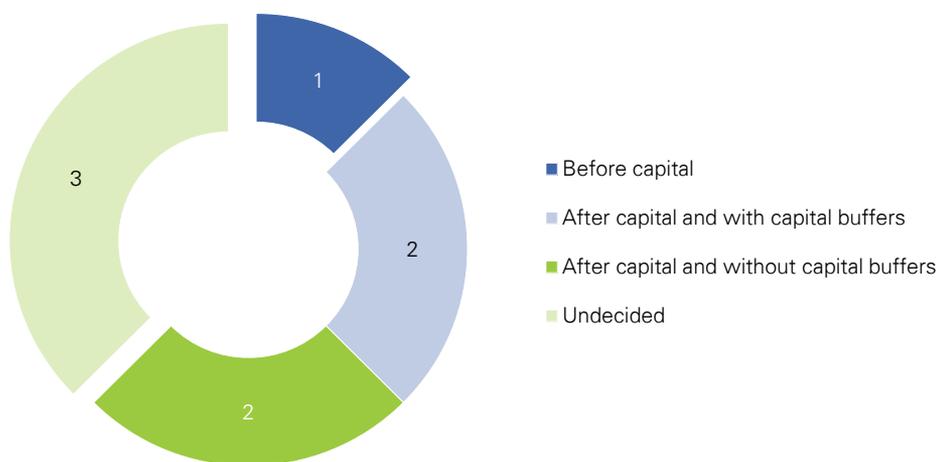
### 4.3 Future of new business reporting

Even though a large proportion of firms surveyed are planning to stop embedded value reporting, all firms plan to continue reporting their new business metrics as per their current framework. However the value of new business reporting and new business strain metric will need to be aligned to SII.

All firms surveyed intend to continue reporting their new business metrics and in particular, new business value

- Firms who plan to replace embedded value reporting with the value of SII own funds will also use this for their value of new business reporting

**Graph 4.3.1: Disclosure of new business strain and allowance for SII capital requirements**



- Four firms currently report new business strain after allowing for capital requirements. After SII implementation, these firms plan to align their value of new business to SII Pillar 1 capital requirements. However, of these firms, only two plan to allow for capital buffers.

# 4

Public reporting in a Solvency II environment

## Changes to Financial Framework

Almost all firms surveyed do not plan to make changes to their approach to determining IFRS liabilities ahead of the implementation of IFRS 4 Phase 2.

### 4.4 Future of IFRS reporting

**Nine** of the firms do not plan on changing approach to determining IFRS liabilities ahead of IFRS 4 Phase 2, with the remaining **two** undecided

**Firms are maintaining their current approach to determining their IFRS liabilities. This is because:**

- The early adoption of the insurance contract standard is not at this stage considered an option given its level of uncertainty.
- There are still potential technical challenges with the IFRS 4 Phase 2 requirements- for example, recognising immediate profits on new business which is prohibited under the current proposals.
- If firms adopt Solvency II as a basis for the liability calculation, this will lead to two basis changes in a number of years as there will be the need to move to IFRS 4 Phase II insurance contract standards and IFRS 9 (currently expected in 2018). This would involve a lot of work to manage the messaging to the investor and analyst community.
- Adopting SII as a basis for the liability is expected to lead to more volatility in the results. Firms are still considering how they will manage this. This would bring certain components of the Solvency II Balance Sheet into audit requirements.

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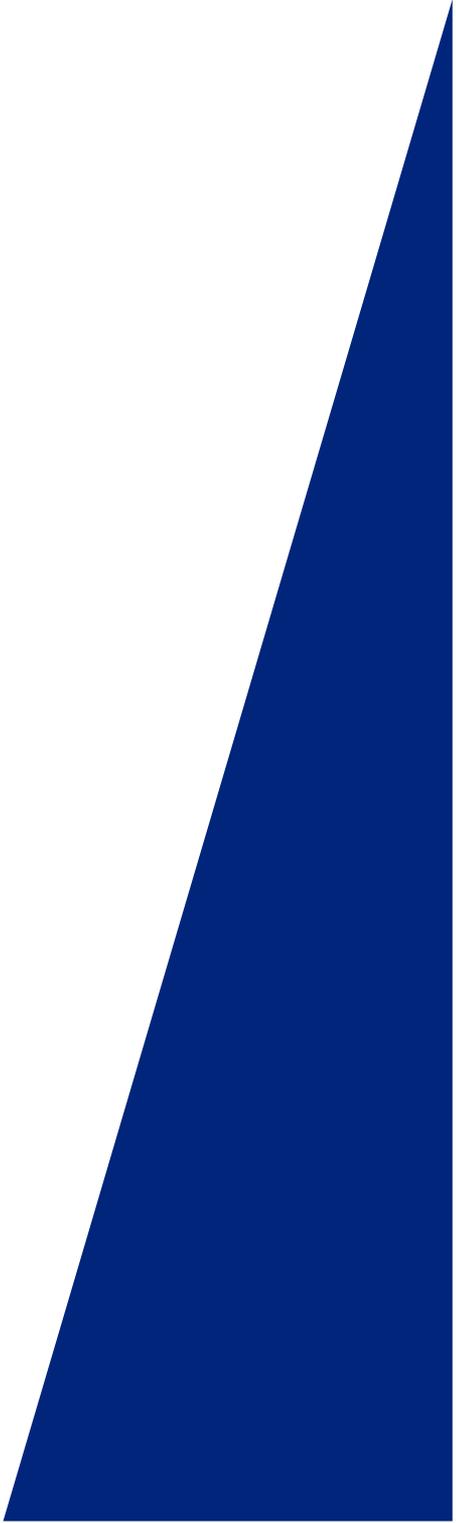


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