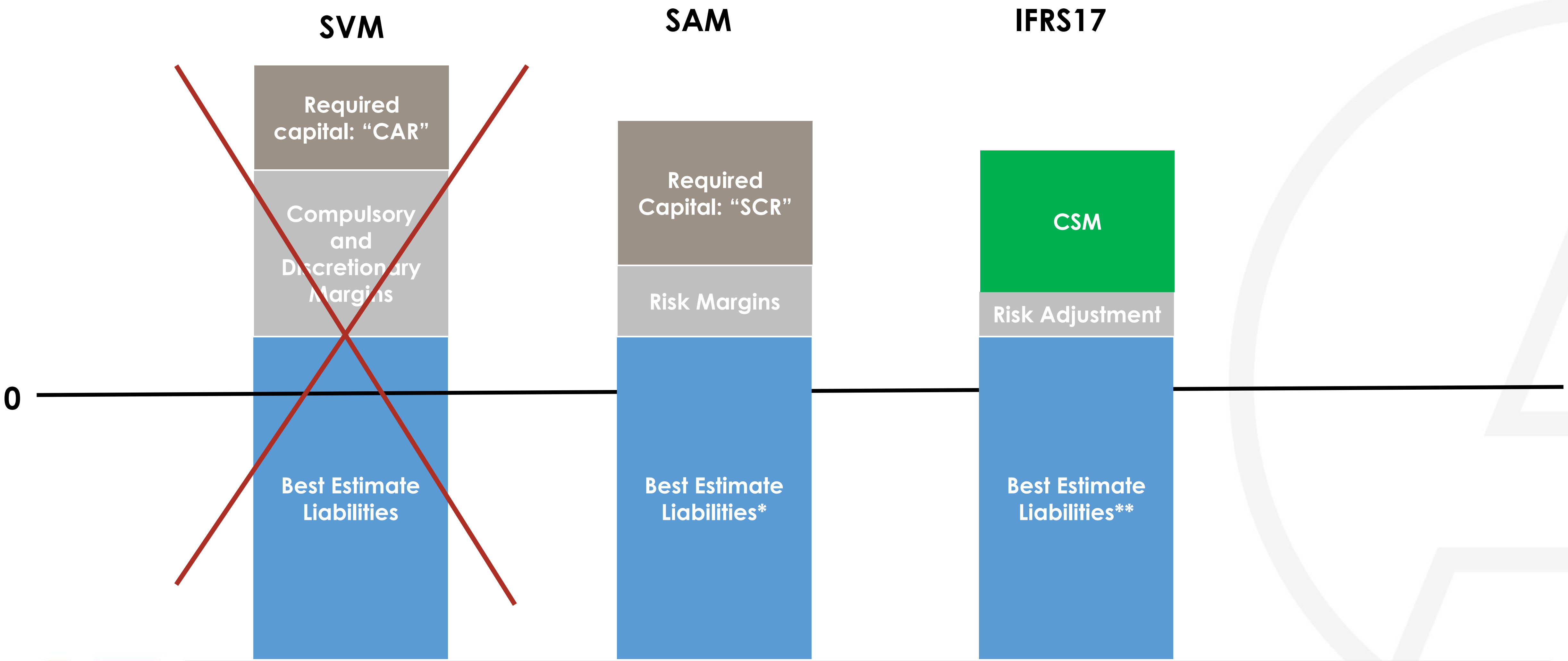
EV IS DEAD… LONG LIVE EV!

Peter Tripe, Gert van den Berg, Musa Malwandla,
Vivek Moodley, Riaan van Reenen,


SVM
SAM
IFRS17
Required capital: “CAR”
Compulsory and Discretionary Margins
Best Estimate Liabilities
Required Capital: “SCR”
Risk Margins
Best Estimate Liabilities*
CSM
Risk Adjustment
Best Estimate Liabilities**
0

YOUR PANEL

ACTUARIAL SOCIETY OF SOUTH AFRICA

1. The conductor. Peter Tripe

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2. The thinker. Sets the Standards. Gert van den Berg

5 YOUR PANEL

1. The conductor. Peter Tripe

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3. The doer. Does the numbers. Riaan van Reenen

6 YOUR PANEL

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4. The presenter. Presents the results to market. Vivek Moodley

7 YOUR PANEL

1. The conductor. Peter Tripe
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3. The doer. Does the numbers. Riaan van Reenen
4. The presenter. Presents the results to market. Vivek Moodley
5. The client. Uses the results. Musa Malwandla

APN107: KEY CHANGES

- **ALTERNATIVE LIABILITY MEASURES** e.g. IFRS or Tax Basis
- **REQUIRED CAPITAL:** Consider the use of the company's Internal Model
- **CONTRACT BOUNDARIES:** Reflect SH Economic Value
- **RISK MARGIN:** EV Cost of Capital approach vs SAM Risk Margin
- **OTHER CHANGES:** *For noting*

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ALTERNATIVE LIABILITY MEASURES

OLD

3.2.3 Liabilities of the in-force *covered business* **should be determined according to local regulatory requirements**. For South African insurers the **Statutory Valuation Method** ("SVM") basis contains margins for prudence as required and allowed under the relevant FSB Board Notice (Directive 140.A.ii. (LT) "*Prescribed requirements for the calculation of the value of the assets, liabilities and capital adequacy requirements of long-term insurers*") and SAP 104. Thus it is expected that, over time, experience should be more favourable than assumed under the SVM basis, and consequently operating profits should emerge. (paragraph deleted)

NEW *(new paragraph inserted)*

2.7.2 The level required by **local regulators has been the norm for the liability measure**. This may contain margins from which cash flows to shareholders would be expected to emerge over time. The guidance however **does not preclude the use of other liability measures such as an IFRS basis or tax basis (or any justifiable basis)**. The actuary **must adequately disclose** the basis being used as well as the **justification** for using that basis.

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ALTERNATIVE LIABILITY MEASURES - CONTINUED

OLD

2. …. Accordingly, statutory reserves must be established in order for the company to be able to fulfil its obligations.

NEW

2. Accordingly, policy reserves must be established in order for the company to be able to fulfil its obligations ….

4. CROSS-BORDER WORK

1.4.1 ….

1.4.2 Often, such standards and requirements have been carefully crafted to take account of product features that are popular in that country. The actuary should be aware of resulting difficulties in cross-border work. ~~For example, statutory valuation bases applicable in other countries are likely to differ from the Statutory Valuation Method ("SVM") applicable in South Africa.~~

REQUIRED CAPITAL – NOT JUST STATUTORY CAPITAL

OLD

3.5.2 Thus, the level of *required capital* should be the greater of:

- …statutory capital at which the regulator is empowered to take action (i.e. **the insurer's statutory Capital Adequacy Requirement**) ….; and
- Amounts required to meet internal objectives, such as those based on an internal risk assessment, a specified multiple of *Statutory CAR* or that required to obtain a targeted credit rating….

NEW

3.5.3 The required capital should **include amounts required to meet internal objectives**, for example internal objectives could be based on an **internal risk assessment** or that **capital required** to obtain a targeted cover ratio (1.5 times CAR/SCR cover). Where the required capital reflects internal objectives the approach used to determine the required capital should be disclosed.

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REQUIRED CAPITAL – NOT JUST STATUTORY CAPITAL - CONTINUED

Similarly, 2.5.3 added

2.5.3 The level of required capital must be based on the insurer's own internal capital targets. It should be noted that, **regardless of the method used** to determine this capital target, the combined value of the EVM internal capital target and EVM policy liabilities **must always exceed** the combined value of actuarial liabilities and solvency capital on the **regulatory solvency basis**. *(multiple dimensions, but regulatory underpin)*

Consistency of liability and capital frameworks is necessary

3.5.2 Where the EVM has been aligned to the SAM methodology and assumptions, the required capital **may be aligned to the SAM Solvency Capital Requirement** provided the **liability metric is also aligned with the SAM liability metric.** *(consistency of liability and capital)*

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CONTRACT BOUNDARIES

2.7.4. PVIF includes the value of expected renewals of the in-force business (for example group risk business renewals). The actuary needs to determine whether the contract boundaries used when determining the liabilities are suitable for use in an EV calculation, for instance, in some cases regulatory solvency calculations may be based on short or zero contract boundaries **whereas longer contract boundaries may more appropriately reflect shareholder economic value** where renewals are reasonably expected.

(completely new – key difference from other value frameworks – focus on economic value)

SAM RISK MARGIN AS A POTENTIAL MEASURE OF COST OF CAPITAL – IMPORTANT HEALTH WARNING

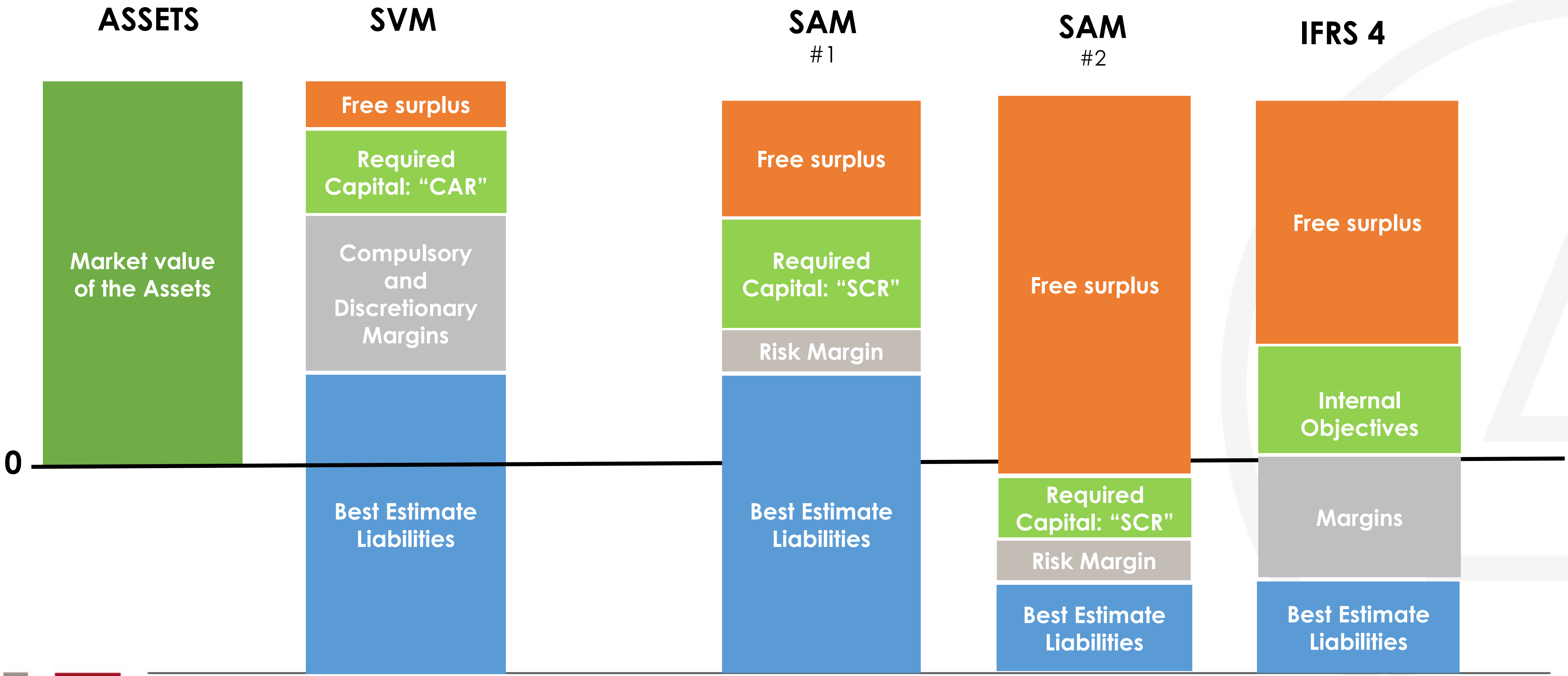
2.8.2. The SAM risk margin provides a measure of the additional cost a reference insurer would require as compensation for accepting the non-hedgeable portion of risk to take over the obligations to policyholders. In some cases there are **similarities between the SAM risk margin and the EV Cost of Requirement Capital** concepts (e.g. where both are calculated using a cost of capital approach) but there may also be some important differences. Thus, where companies want to base the Cost of Required Capital on the SAM risk margin the actuary needs to consider whether:

- The risk margin is a **suitable measure** of the Cost of Required Capital from a shareholder perspective and adjust appropriately;
- The **SAM cost of capital rate is appropriate** and if not, determine an appropriate rate;
- He/she is **comfortable that the frictional cost of capital** (e.g. cost of double taxation and asset management costs) on the total targeted level of capital (including internal buffers) **has been adequately allowed for** in the risk margin and adjust appropriately; and
- The Cost of Required Capital must allow appropriately for any changes made to **contract boundaries.**

OTHER CHANGES

- 4.1.6 **VNB** – greater freedom in choice of opening or closing assumptions
- 4.1.5 Additional guidance on anticipating changes in **unit costs**
- 3.5.6 Required capital – Discretion in treatment of **minimum capital requirements**
- 3.4.2 Guidance on treatment of **intangibles**
- 1.2.2 & 3.1.5 **MCEV** still explicitly allowed – retains the guidance and informational note from Version 8
- 5.10 Disclosure requirements - encouraging compliance with APN107: **Statement from the Directors**
- 3.11.3, 3.11.4 & 3.11.7 Disclosure requirements – **Sensitivities** – some updates (more dynamic)

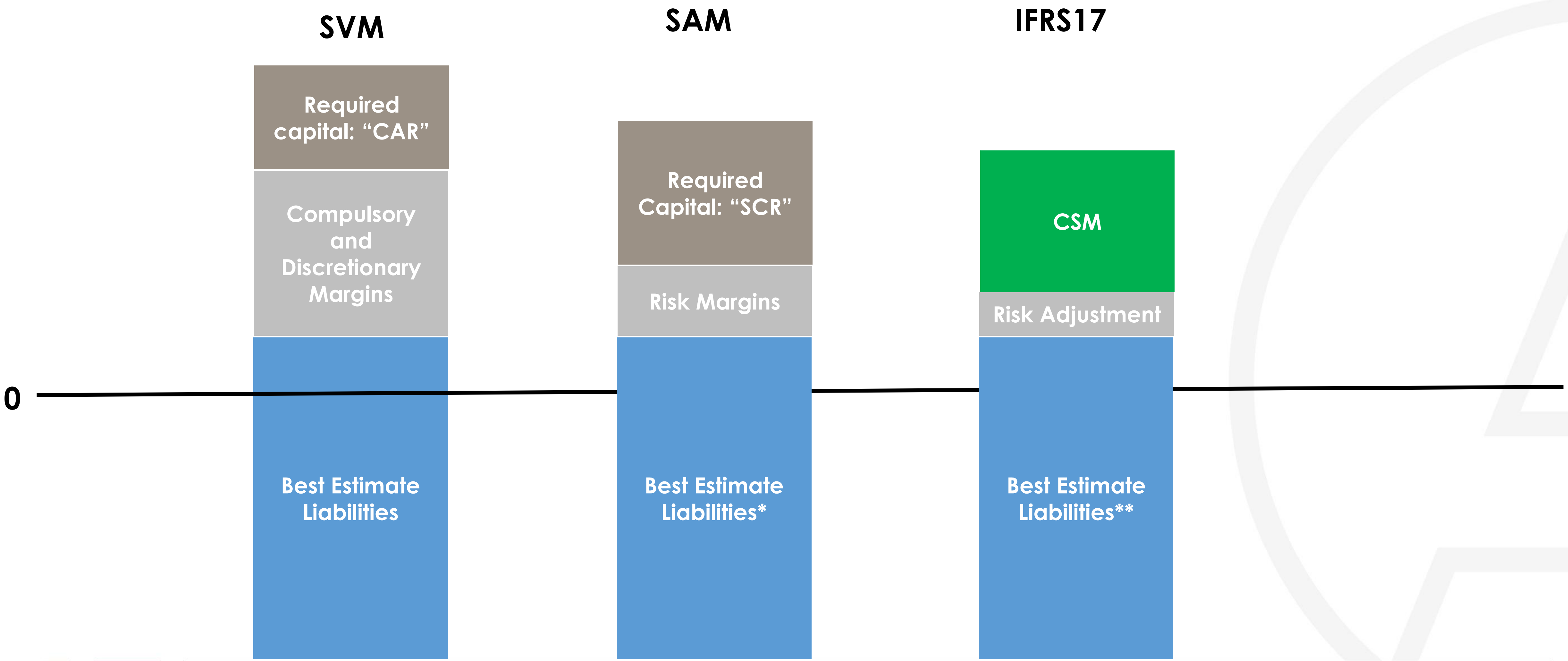
EV - ALTERNATIVE LIABILITY AND CAPITAL FRAMEWORKS



DISCUSSION – CURRENT CHANGES

- Likely options? (SAM, IFRS, old SVM, Tax, other?)
- Factors to consider
- Moving to SAM
- Comparability/Consistency
- Practicalities
- At the end of the day

LIABILITY FRAMEWORKS: SVM, SAM & IFRS17



DISCUSSION – FUTURE CHANGES – IFRS17

- Current IFRS
- Criticisms of EV
- Is CSM the new VIF?
- Gaps in IFRS17
- Good enough? What then for EV

CONCLUSION

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- EV likely to live on post-SAM
- IFRS17 may not be the ultimate answer, but strong drive for consistency likely to increase its prominence
- EV is another ‘lens’ and many of the additional insights it provides are likely to live on in some form