IASB MEETING, JUNE 2006
AGENDA PAPER 6B
INFORMATION FOR OBSERVERS
INSURANCE CONTRACTS [EDUCATION SESSION]

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.
These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

CEIOPS
Committee of European Insurance and Occupational Pensions Supervisors

Paul Sharma

Chair of CEIOPS Pillar 1 Working Group

IASB Meeting
London, 22 June 2006

Solvency 2

Valuation of Technical Provisions

Approach

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The current CEIOPS placeholder approach to evaluating technical provisions can be summarised as follows:

<u>Hedgeable risks</u>

Market consistent values to be used for risks where hedges are readily available.

<u>Non-hedgeable risks</u>

Best estimate plus a risk margin for risks where hedges are not readily available.

Best Estimate

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- **Calculated as the expected present value of the future cashflows, using the relevant risk free yield curve, based upon current and credible information and realistic assumptions.**
- **Estimates may use reasonable actuarial methods and approximations, based on policy-by-policy data.**
- **There are a number of issues that are being worked through to provide guidance for calculating the best estimate (for both life and non-life), examples include:**
  - Large losses
  - Diversification / segmentation
  - Allowance for reinsurance
  - Premium provisions
  - Longevity assumptions
  - Treatment of financial guarantees and other embedded options

Risk Margin

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- **The objective of the risk margin is:**
  - To provide a margin above the best estimate of technical provisions reflecting the level of uncertainty within this best estimate calculation.
  - This should make optimal use of information provided by financial markets.
- **Currently two working hypotheses to calculate the risk margin are being considered within CEIOPS:**
  - Percentile approach
  - Cost of capital approach

Risk Margin – Percentile approach

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- **Difference between the 75th percentile and the best estimate of the present value of the future cashflows projections arising from insurance liabilities until run-off.**

- **Margin: as a minimum, equal to half a standard deviation in order to take account of strongly skewed distributions.**

Risk Margin – Cost of capital approach

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- **Risk margin is calculated by projecting the capital needed, and provides for the present value of the future cost of holding that capital.**

- **Capital requirements are based on an optimal portfolio of replicating assets – assumes firm moves to a matched and hedged position (as much as is possible).**

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QUESTIONS?

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