IFoA Life Conference 2020

Milliman's Topical Issues Update and Q&A

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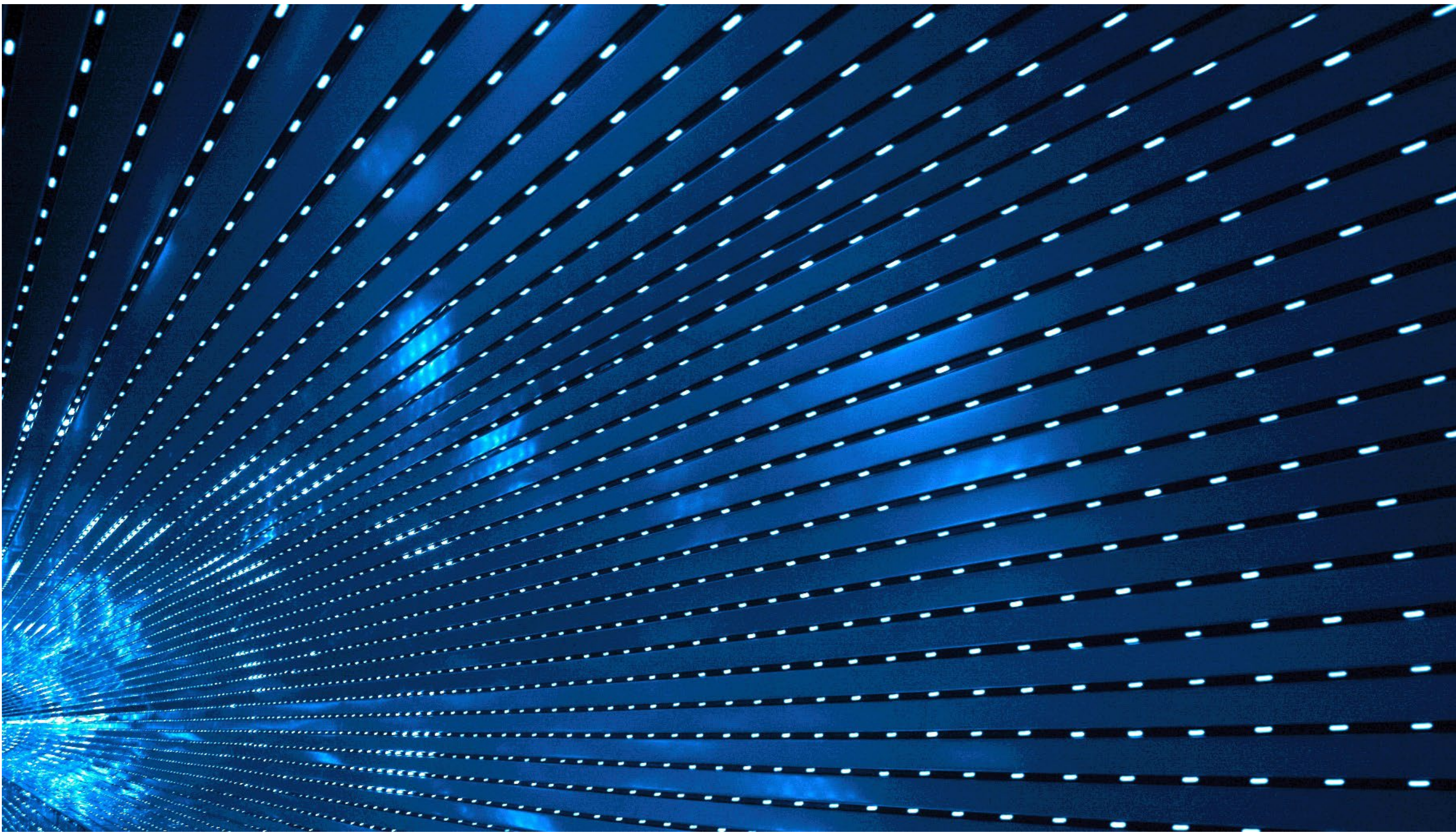

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As it was not possible to answer all questions posted in the Q&A, this document sets out all the questions asked and our answers to them. The names of those asking the questions have been deleted for reasons of anonymity.

Insurance Capital Standards and Solvency Reform (Phil Simpson)

Q: Should it be a concern to policyholders that the ICS regime is less onerous than SII particularly where the asset allocation is to lower quality assets? Presumably the comparison is against SII SF, would it look significantly different under IM?

A: Yes, the comparisons shown are against SII SF. The IAIS has indicated that an IM version of ICS may be allowable, but it is unclear how this would work and how/whether any such IM would be approved. We don't believe that there should be any concern to policyholders given that, generally speaking, ICS is addressing some of the well-known criticisms of SII (e.g. onerousness of the risk margin). We note that some parts of ICS are more onerous than SII SF (e.g. the interest rate stresses which are more akin to IM stresses).

Q: Do you have a view on how ICS might look compared to regulatory regimes in other territories, such as the US?

A: No, we have not looked into this aspect yet.

Q: How do these conclusions vary for other product types?

A: Based on initial work to date, some variation in conclusions, but still generally beneficial.

Q: Does ICS also suggest outcomes at 99.5% confidence level? The famous 1/200

A: Yes, ICS is intended to represent 1 in 200.

Q: For those IAIGs which have to calculate ICS, are they likely to change what they disclose to markets where their key reporting metric is SII currently?

A: Once ICS becomes a formal requirement for IAIGs, we would expect the ICS results to be disclosed as additional or supplementary information alongside the Solvency II results. It remains to be seen how much detail the relevant companies will provide.

Q: Is it still unclear whether IAIGs have to use the Risk Adjustment to the Risk Free Rate (through the liability buckets), or they can opt to be prudent and just use the Risk Free Rate to discount the cashflows?

A: This is still unclear, but we agree that companies should be allowed to use a more prudent bucket where they wish to – with disclosure where this would be material.

Q: How much appetite do you think there would be from UK insurers to move to ICS, given the amount of resource put into SII compliance just a few years ago?

A: For the IAIGs this will be an additional requirement. For others, it depends on whether the PRA incorporates or moves to ICS as part of UK Solvency post 1/1/21. To the extent ICS addresses some of the areas of rough justice embedded in the current incarnation of the SII SF we would expect insurers to be broadly supportive.

Q: EIOPA chair stated that 'endorse the ICS and make any necessary adjustments to Solvency II to ensure that European IAIGs are required to use only one capital framework that meets international standards' so are we expecting the two standards to converge?

A: This would be desirable we agree, but it's not guaranteed to happen and we believe it would take time to achieve this.

Solvency & Covid Updates (Neil Christy)

Q: Can you elaborate on why you consider the VA may need some improvement, given that it is linked to spread movements (and, rightly or wrongly, we haven't really seen significant spread movements during Covid)?

A: The VA is known to "overshoot" and "undershoot" when spreads vary. Our understanding is that EIOPA accepts this and is considering how to address this point.

Q: To what extent are these high coverage's influenced by dividend cancellations? Might we see a fall in coverage as dividends are released in 2021?

A: Yes, we agree that some of the high coverages have benefited from dividend cancellations, postponements, or reductions. Note however that some insurance groups have continued with their dividends.

Q: Does the fact that regulators have restricted or discouraged dividend payments despite healthy coverage ratios imply that they don't trust Solvency II?

A: Our guess would be that this is not the case, and it's more a question general caution from the regulators.

Q: Have you seen credit risk increase significantly as a result of Covid-19?

A: Yes, we saw credit spread widenings, particularly when Covid first broke around end March, early April 2020, with some recovery since then. It is more difficult to say on fundamental credit risk.

Q: Has Covid led to firms to revise their pandemic / mort cat stresses?

A: Not immediately to our knowledge, but some have said they will take this into account at their next full update.

Q: To what extent has solvency been supported by companies taking on sub-debt and increasing leverage?

A: This may have happened, but our guess is that this has not been material so far due to the time taken to execute projects to raise debt. A further possibility (which could have taken place within shorter timescales) is additional management actions being assumed in the SCR.

Q: Covid-19 has led to the worst economic crisis that world has seen, yet the solvency ratios are still robust. Does this not imply that the regime is overly prudent?

A: We think it is difficult to justify such a conclusion right now. If one takes the view that most of the economic crisis has so far been due to market sentiment and short-term volatility, then the mechanisms within the regime (MA, VA, symmetric adjustment) have done their job as intended. To the extent that there has been a permanent degradation, then yes, the regime should respond to that too, but it will (and should?) take time for any permanent degradation to be confirmed as such.

Q: Would you see a change in the SF stresses based on the pandemic?

A: We would not expect any immediate change, but clear companies and regulators will need to take the Covid pandemic into account in their calibration updates going forwards.

Q: Any sense of how smaller firms did?

A: Variable, but our guess would be that smaller firms may have been hit harder due to having less sophisticated or extensive hedging or other protections in place. But this may be offset by smaller firms often being more prudent for this very reason.

M&A, Consolidation, and Outsourcing Trends (Stuart Reynolds)

Q: There seem to be lots of companies who want to divest businesses. Who are the buyers?

A: Private Equity (PE) houses are the buyers in many cases. Other buyers include consolidation type insurers, and the other party in sell-off of joint venture stakes.

Q: Any views on growth in Bermuda, particularly provision of capital to UK BPA through asset-backed reinsurance?

A: We are aware of a number of people looking at this - particularly due to the different "matching adjustment" rules. In our experience there may need to be discussions regarding the basis upon which the level of assets backing the reinsurance is set.

Q: Do you expect M&A activity to accelerate in 2021 given possible attractive valuations?

A: Based on discussions, we anticipate greater M&A activity in 2021 to pick up the "backlog" in deals from 2020. There will obviously be the potential for new deals as highlighted in the slides. We think one limiting factor is the bandwidth for deals - sellers may want a good number of potential bidders and so may delay until any "backlog" is cleared. Regarding valuations -we think this is hard to say. We had in fact started to think the opposite may be true. Potential sellers may have been reluctant to sell as the valuation would be lower than they wanted – but may now accept a lower value due to the changes to the economic environment (particularly low interest rates looking more likely for longer).

Q: How would the potential break-up of the UK impact M&A activity / disinvestment etc?

A: This is clearly difficult to say, but yes there could be some additional activity in terms of companies wishing to avoid having branches in territories other than where they are head-quartered. However, previous UK M&A activity may have already reduced the scope/need for such transactions.

Q: Do you see any regulatory issues on PE firms acquiring large blocks of business in Europe?

A: Some regulators may potentially be concerned, but we would expect them to ensure that the target has in place a well-defined capital management policy and customer fairness policy prior to giving the relevant change of control approval. Regulators can also ensure that debt/leverage is not too onerous prior to giving change of control approval.

IFRS17 Risk Adjustment & Disclosure of Confidence Level (John Jenkins & Russell Ward)

Q: How can this calculation be both significantly less volatile than a brute-force method and adequately accurate in all circumstances?

A: We think this is a question of practical timing. The closed form approach can be developed and calibrated prior to the year-end results date, and this we believe reduces the scope for volatility over the (short) period to when the results are published. Clearly there can be changes over a longer period in the results produced by the closed form solution. This we think balances accuracy with the desire for "no surprises" during the reporting period.

Q: Does the formula you mentioned mean there is an implicit assumption that the final distribution is normal regardless of the 3 moments calculated?

A: No, this is not the case. The formula does not imply or assume any final distribution, it just makes use of the "shape" information provided on the distribution via the moments determined and used.

Q: How have you performed the multi-year simulation to validate the closed form solution? Have you created an internal model based on an n year VaR?

A: Effectively, yes.

Q: Would there be an allocation of risk adjustment across portfolios/products in line with the RM on SII?

A: In practice, the confidence levels would be developed bottom up for each material product line and territory. The extent/granularity of the disclosure would then be for agreement between the company and its auditor, and would we believe take into account the granularity of disclosure being provided generally within the IFRS17 results.

Q: Is the closed form solution applicable to other types of business, e.g. WP contracts with guarantees, and if so is it more difficult to construct?

A: Yes, we believe it feasible to apply the closed form approach to all classes of business. Our work so far has considered a savings product with guarantees - the closed form expressions are more complex but can still be developed.

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