17th General Insurance Seminar

Risk and Reward

Institute of Actuaries of Australia

7 – 10 November 2010 • Sheraton Mirage, Gold Coast

International Updates

November 2010

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Partners

PwC

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Agenda

Introduction	**Lisa Simpson**
Overview of IFRS ED	Rod Balding
Implications for GI	Lisa Simpson
Questions	Lisa & Rod

Setting the scene

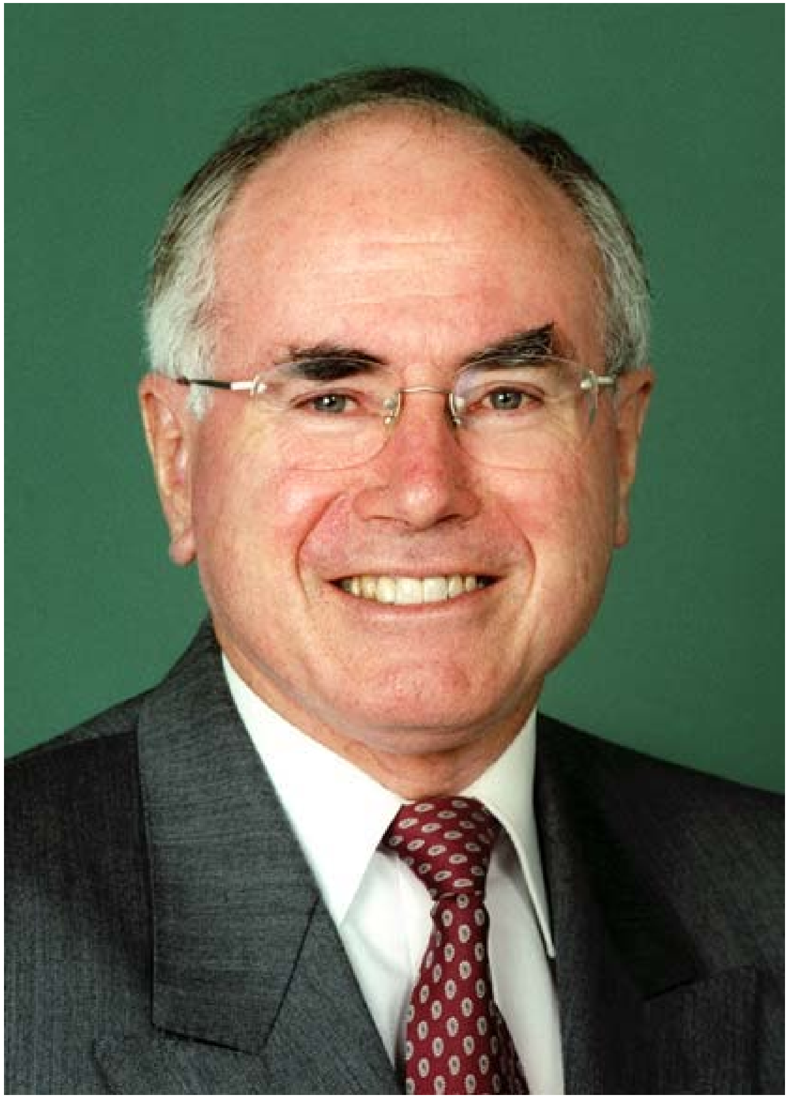
Global perspective
- US Dodd-Frank reform and Consumer Protection Act
- GFC's impact on impetus for global consistency of regulation
- Solvency II development for European insurers
- Basel II developments in banking for G20

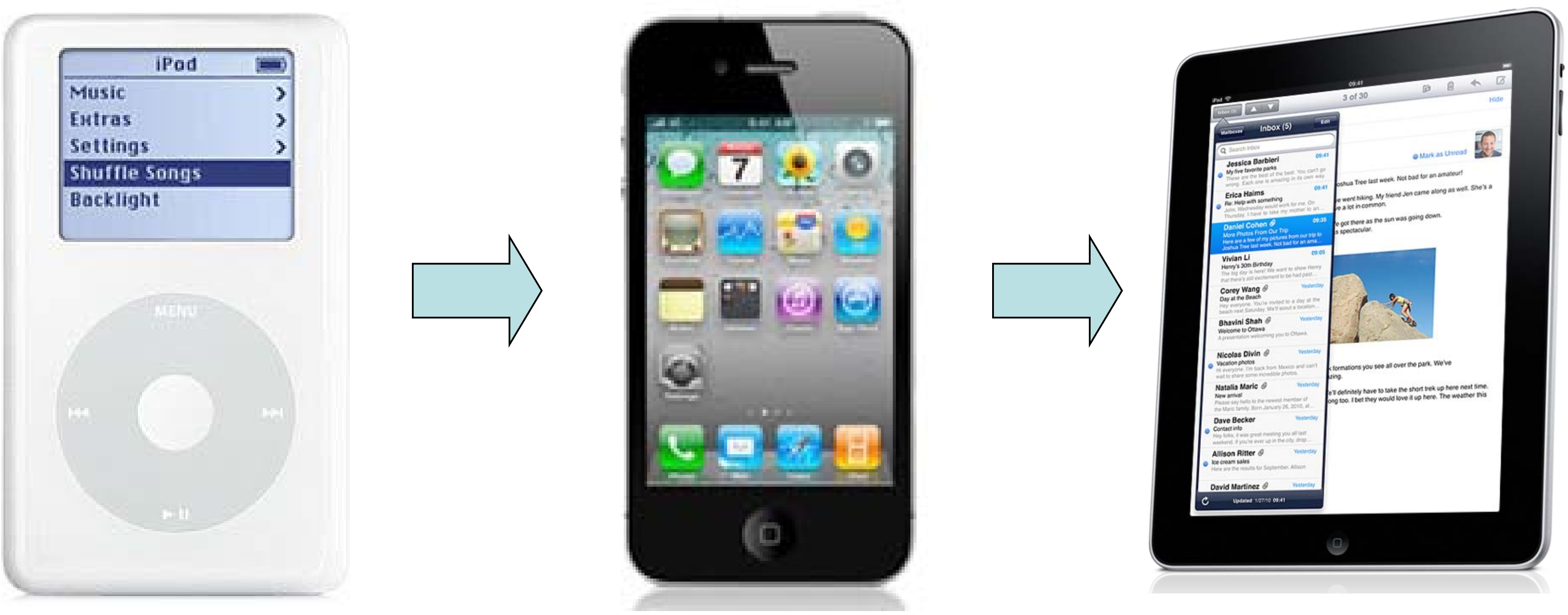
Local developments
- APRA's capital review for life and general insurers
- Ripoll enquiry and recommendations
- APRA's review of banking regulation

Themes: greater regulation, stronger capital requirements, more protection for individuals, global convergence, counter cyclical measures, increased risk responsiveness

Introduction - IFRS

- Largely based on AASB 1023
- Technical Points;
  - Contract boundary
  - Acquisition costs
  - Unit of account (Diversification, LAT)
  - Transition
  - Disclosure
- IASB Timing / Final draft
- More than just an accounting issue (systems, product design, remuneration, tax, regulation, distribution models)



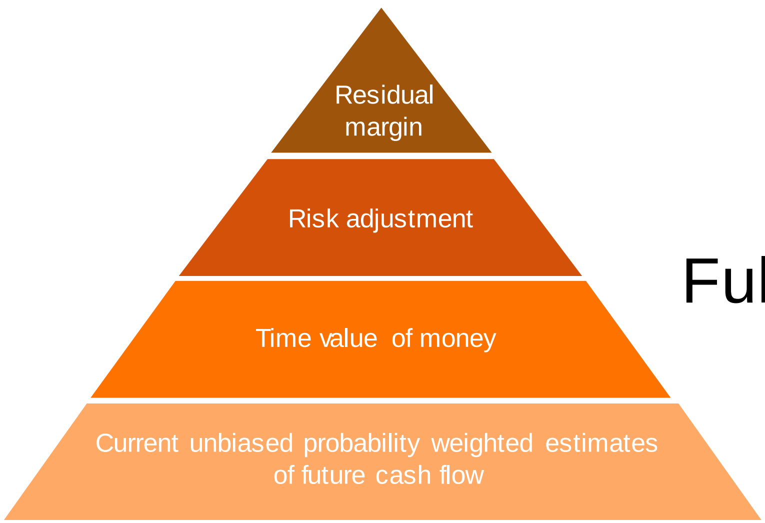

iPod
Music
Extras
Settings
Shuffle Songs
Backlight
MENU

Timeline

2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012–2015

Jul-04	Phase II work begun
May-07	Discussion paper published
Nov-07	Comment period closed
Oct-08	FASB joins project
Jul-10	Phase II exposure draft
17 Sep-10	FASB DP
Mid-11?	Phase II final IASB standard
Mid-11?	FASB ED?
2013? 2014? 2015?	IFRS Effective Date of Standard?

Measurement model - Overview



Fulfilment rather than an exit objective

- One model for all insurance contracts
- Combination of rights and objections (inflows and outflows)
- Day 1 loss in income statement, no day 1 gain
- Margins are part of liability

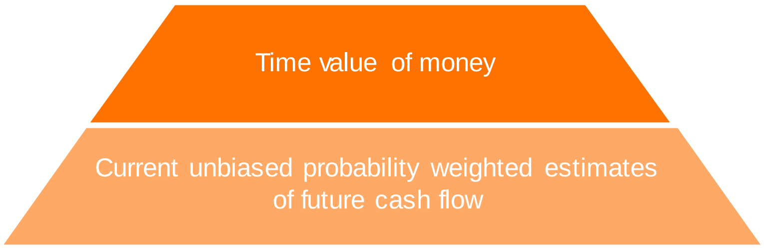
Boundary of contract

- Contract boundary is where insurer
  - Is no longer required to provide cover **or**
  - Has right or practical ability to reassess risk of particular policyholder and can reprice.
- Options and guarantees included on look through basis of expected future cash flows with no "deposit floor".

Current unbiased probability weighted estimates of future cash flow

Discount rate

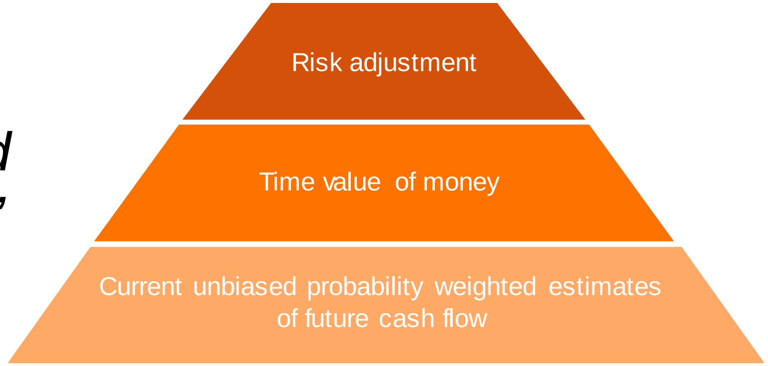
- Reflects characteristics of the liability
  - If liability independent of supporting asset, discount rate is risk free with adjustment for illiquidity
  - If liability linked to supporting assets then discount rate reflects that linkage.
- No adjustment for non-performance risk.



Risk adjustment

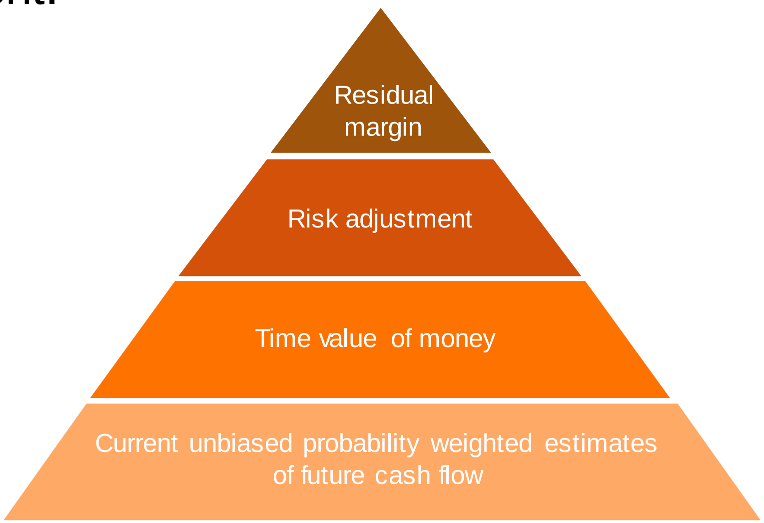
- Objective of risk margin to reflect the maximum amount that an insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected
- Limited range of permitted techniques
  - Confidence level, conditional tail expectation (or tail VAR) or cost of capital
  - Confidence level disclosures are required irrespective of technique used.
- Diversification at portfolio level.

'Subject to broadly similar risks and managed together as a single pool'

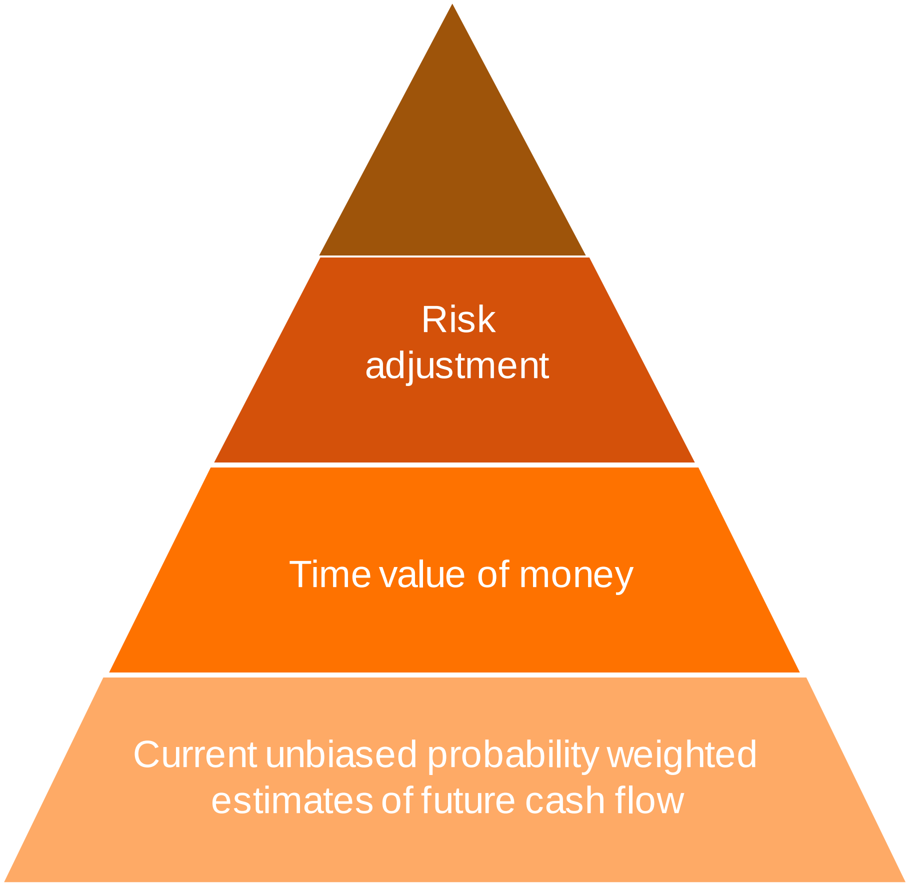


Residual margin

- Residual margin determined at inception within a portfolio by date of inception and by length of contract
- Residual margin amortised in systematic way over coverage period
- Passage of time
- Expected timing of claims and benefits if different.
- Interest accreted at locked in rate
- Residual margin cannot be negative.



Subsequent measurement



Remeasurement

X - amount initially recognised is unwound but not remeasured

- ✓ Updated for current estimates
- ✓ Updated for market rates
- ✓ Updated for current estimates

Short duration contract model

- Unearned premium method required for pre-claims liabilities of short-duration contracts
- Applies when:
  - Coverage period approximately 12 months or less
  - No embedded options or other derivatives that would significantly affect the variability of cash flows.
- Claims liabilities measured at present value of fulfillment cash flows (using the three building blocks).

Short duration contract model continued)

Initial recognition

- Premium (plus present value of any future premiums within the contract boundary) less any incremental acquisition costs
- Onerous contract test.

Subsequent measurement

- Reduce the initial liability in a systematic way
  - Passage of time
  - Expected timing of claims and benefits if different.
- Onerous contract test
- Accrete interest at current interest rate.

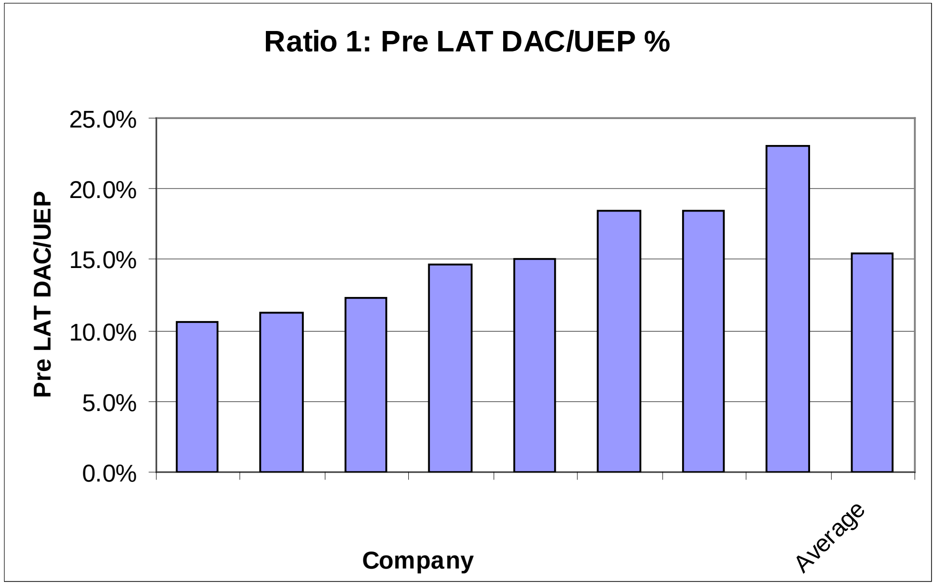
Other specific guidance

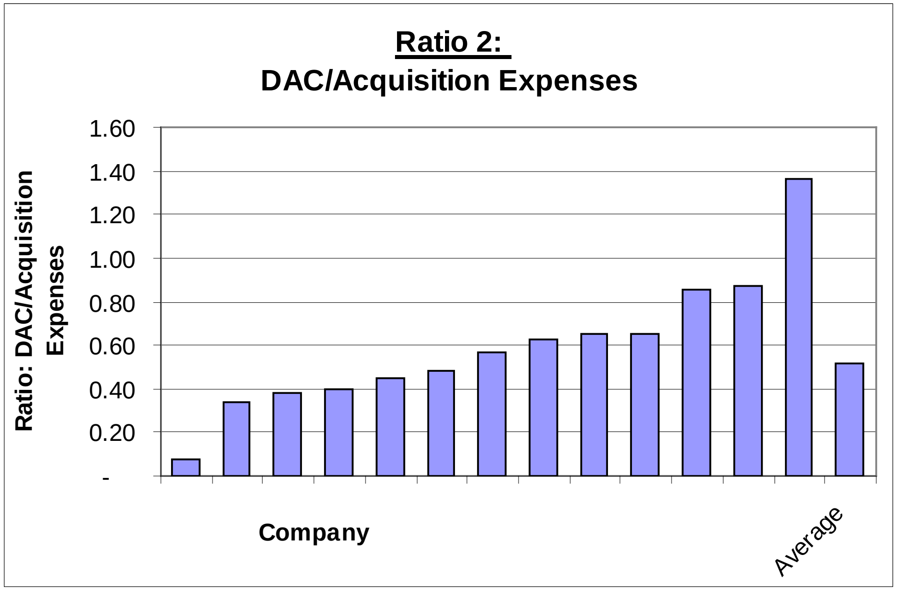
- Acquisition costs
- Level of measurement
- Recognition / derecognition
- Presentation and disclosure
- Transition

Acquisition costs

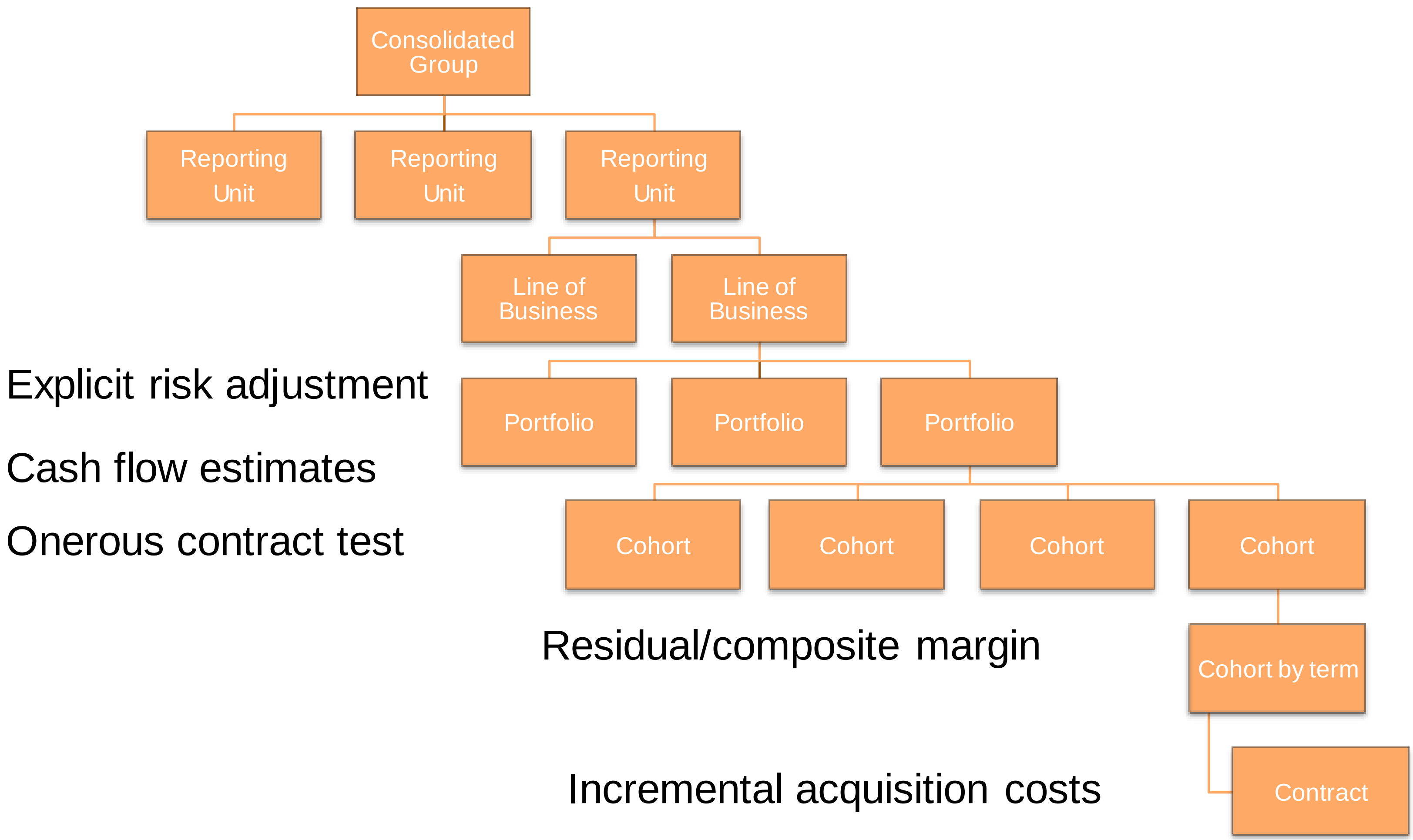
- Incremental acquisition costs at the contract level are included in the contract
  cash flows
- Reduces residual margin
- All other acquisition costs are expensed
- Different from treatment for investment contracts under IAS 18 or Revenue Recognition Exposure Draft.

Acquisition costs





Level of measurement



Recognition/de-recognition

- Recognition when insurer becomes party to a contract being <u>earlier</u> of:
  - Insurer bound by terms of contract
  - Insurer first exposed to risk (which can be before coverage commences).
- De-recognition
  - IAS 39 principle of extinguishment (discharged, cancelled or expires).

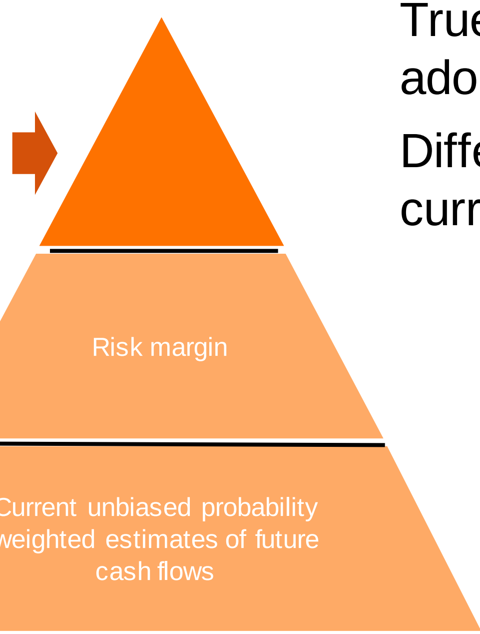
Presentation and Disclosure

	Inception 1 January	Six month to 30 June	Six months to 31 December
Change in risk margin		21	26
Residual margin		13	13
Underwriting margin	-	34	39
Acquisition costs	10	-	-
Experience adjustments		(10)	(10)
Changes in estimates		(20)	0
Net gain at inception	-	0	0
Investment income		40	38
Interest on insurance liability	-	(25)	(23)
Profit/(Loss)	(10)	19	44

Transition

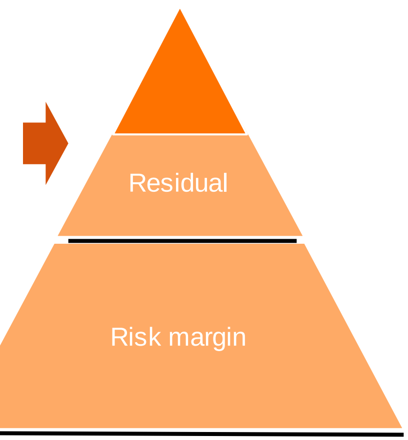
IASB proposal

Difference from current carrying value



True retrospective adoption

Difference from current carrying value



- Each portfolio measured using building block approach but with no residual margin
- Difference between this amount and the existing net insurance liability recorded under the previous GAAP is reflected in opening retained earnings

The key issues for GI from IFRS

- Lack of diversification for risk margins between portfolios
  - Link with APRA’s directions
- Once off reduction in DAC, and further expense analysis required to determine incremental expenses vs overheads
- Once off impact to retained earnings on transition
- Requirement to consider portfolio in annual tranches for onerous test, with no risk margin
- Consideration of contracts and boundaries, e.g. homeowners’ warranty
- Disclosure requirements

Question time ?

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