



**Actuaries
Institute**

IFRS - Insurance Standard Developments

Presented by the
International Accounting Standards Committee
(IASC)

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- **Introduction – Grant Robinson**
- Overview & Time Line
- **Building Blocks – Hoa Bui**
 - Cash flows
 - Discount Rates
 - Risk Adjustment
 - Residual Margins
- **Premium Allocation Approach (PPA) – Bob Buchanan**
- Reinsurance
- **Presentation – Brendan Counsel**
- Other Comprehensive Income (OCI)
- Transition
- **Participating Business – David Rush**
- Unbundling & Contract modifications
- **Submission – Grant Robinson**

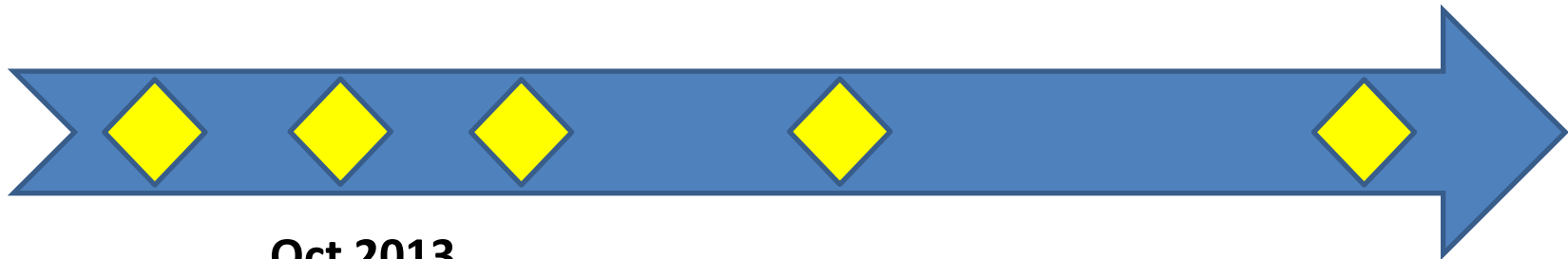
- Proposed IFRS for Insurance has a long history,
- Phase One – effective 2005 - Defined Insurance and grandfathered existing accounting subject to certain minimums being met.
- IASB began work on Phase Two “A Full IFRS insurance Standard” over ten years ago
- IASB formed an Insurance Working Group to advise it and two actuaries have been involved on this group from outset (Sam Gutterman from IAA, Tony Coleman from Australia)
- Discussion Document was issued in May 2007
- Exposure Draft was issued in July 2010
- Attempt to fully co-ordinate IASB & FASB approach failed in 2012
- Revised Exposure Draft now expected early June 2013
- Significant changes from current Australian practice are proposed, especially for life insurance, but generally, changes are more significant for non-Australian insurers
- IASB only seeking comment on limited number of topics, not revisiting other aspects.

IFRS Insurance – Time Line

**June 2013
Targeted
Exposure
Draft**

**Nov 2013 IASB
Redeliberations
begin**

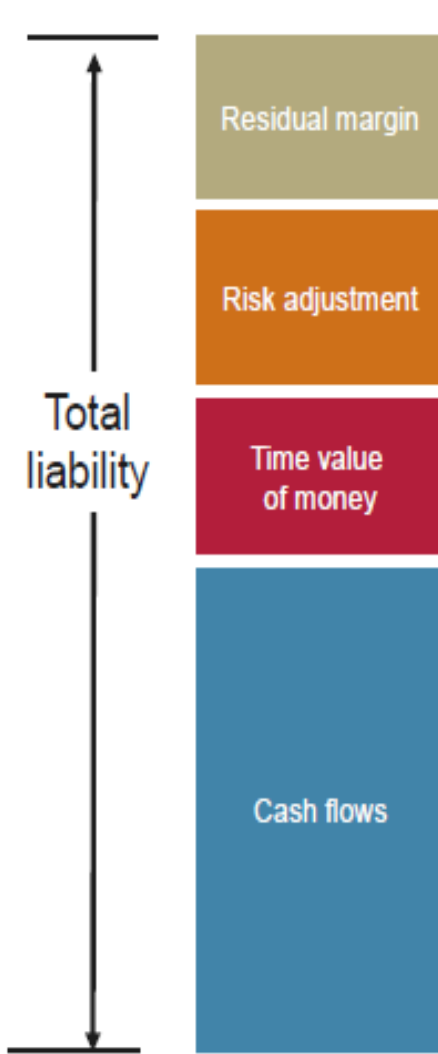
**1 January 2018?
Proposed
Effective Date**



**Oct 2013
Submissions
Close**

**2H 2014
New
Standard
Published**

IFRS Insurance - Overview



- Insurance Contracts Liability remains a Current Value Measurement based on the key Building Blocks (BB):
 - Cash flows – expected value not best estimate
 - Time value of money – discounted present value
 - Risk adjustment – the compensation the insurer requires for bearing risk
- Insurance Contracts Liability also :
 - includes an unlocked Residual Margin (eliminating profit at inception) which is released over the coverage period consistent with the transfer of services.
 - for onerous contracts includes the risk adjustment.
- Premium Allocation Approach (PPA) permitted when reasonable approximation to BB or if coverage period is twelve months or less.

Volatility in Profit and Loss Concerns raised by many in response to the 2010 ED have been addressed by:

- Allowing top down approaches to determining discount rates, which can reduce impacts of credit rate spread changes (in practice).
- Unlocking the residual margin for changes in estimates.
- Presenting the change in Insurance Liabilities due to discount rate changes in Other Comprehensive Income (OCI).
- Introduced mirroring where there is a contractual link to assets and liabilities underlying insurance contract.

Contract Boundary has also changed :

- Ends when no longer required to provide coverage or can fully reprice the contract or portfolio.
- Means that Health Insurance and yearly renewable insurance contracts are now short term contracts.

- Based on expected values, i.e. a mean that considers all relevant information without necessarily quantifying all possible scenarios.
- Includes all costs that insurer will directly incur as it fulfils the insurance portfolio, in particular:
 - Costs that relate directly to the fulfilment of the contracts in the portfolio.
 - Costs (including fixed and variable overheads) that are attributable to fulfilment of the contracts in the portfolio and can be allocated to the portfolio.
 - Other costs chargeable to the policyholder under the contracts.
 - Proxy Policyholder Taxes.
- For Acquisition costs allow all direct costs incurred in acquiring the contracts in the portfolio but not indirect costs

- Discount rate to be consistent with observable market prices for instruments with cash flows whose characteristics reflect those of the insurance contract liability.
- Discount rates can be based on expected returns on backing assets only when there is a contractual link between liability cash flows and the performance of specific backing assets (e.g. par business).
- Method for determining the discount rate will not be prescribed – i.e. ‘bottom-up’ and ‘top-down’ approaches both acceptable.
 - ‘Bottom up’: e.g. risk free rate adjusted for illiquidity.
 - ‘Top-down’: e.g. asset yields adjusted for credit.
- Current discount rate used each period. i.e. rate will not be ‘locked in’, but impact of changes to the discount rate at inception reflected in other comprehensive income rather than the base income statement (see later slides on presentation and OCI).

- An explicit Risk Adjustment remains a necessary element of Insurance Liability Measurement.
- Now defined as: “The compensation the insurer requires for bearing the uncertainty inherent in the cash flows that arise as the insurer fulfils the insurance contract”.
- No longer:
 - Limiting the range of techniques and inputs.
 - No longer limiting diversification to the portfolio level, can now recognise to extent considered in pricing.
- Has retained:
 - The Confidence Interval equivalent disclosure.
 - The list of characteristics that risk adjustments should exhibit, e.g. higher for low frequency high severity, longer durations, wider distributions and if less is known, and reduces as experience reduces uncertainty

- Residual margin included to eliminate profit at inception and recognise as earned (\equiv MoS).
- Residual margin is determined after risk margins (\neq MoS), which means loss (onerous contracts) recognition cuts in earlier than under MoS
- Residual margin is released over coverage period (\approx MoS, no residual margin on claim but otherwise the same) consistent with the pattern the transfer of services (\equiv MoS)
- Residual margin unwinds at the locked in discount rate from contract inception (\neq MoS)
- Portfolio is the unit of account for the residual margin, defined as contracts that are:
 - subject to similar risks (\equiv MoS) and priced similarly relative to the risk taken on (\neq MoS); and
 - managed together as a single pool (\equiv MoS)

- Cannot avoid loss recognition by grouping profitable business with loss making business (\neq MoS).
=> Lot more tranching possibly even by year, given locked discount rate (\neq MoS).
- Re-measurement of the residual margin:
 - Adjust prospectively for changes in estimates of cashflows related to future coverage and future services (\equiv MoS)
 - Do not adjust for changes in risk adjustment, recognised in P&L (\neq MoS)
 - Do not adjust for changes in estimates related to current coverage and services, recognised in P&L e.g. IBNR assumptions and open claims (\neq MoS)
- For participating business, the residual margin is not adjusted for investment experience and changes in investment assumptions (\neq MoS)



- Allowed, not required:
 - for coverage \leq 12 months; or
 - reasonable approximation to BBA.
- Similar to current unearned premium approach
 - Coverage \leq 12 months
 - net of all acquisition costs
 - Longer
 - net of acquisition costs as for BBA
 - interest accretion if significant financing
 - Don't go there!
- Onerous contracts test
 - only when facts and circumstances indicate

- Recognition and coverage period
 - Matches individual underlying direct contracts, except aggregate loss business based on treaty period
- Inwards Reinsurance as for direct
- Outwards Reinsurance
 - Expected present value of cash flows – assumptions consistent with direct
 - Risk adjustment reflects reduction in risk
 - Residual margin spreads profits and losses
 - Premium Adjustment Approach as for direct
 - Non-performance on expected basis (not impairment)
- Presented as an asset – not netted off
 - Non-contingent commission netted off premium

- 2010 ED proposed that income statement would show:
 - ‘earned premium’ presentation for PAA, and
 - ‘summarised margin’ presentation for BBA.
- Feedback on the ED indicated a preference to also include volume information for BBA – premiums, claims etc.
- Income statement for BBA to be made consistent with that proposed under PAA – i.e. premiums, claims, expenses etc to be presented.
- ‘Earned premium’ approach to present premiums related to the services provided over the period.
 - Requires additional calculation for level premium style contracts.
- Claims incurred over the period presented as an expense.
- Investment income and interest on insurance liability (at ‘locked’ discount rate).
- Effect of changes in discount rates presented in other comprehensive income (OCI).

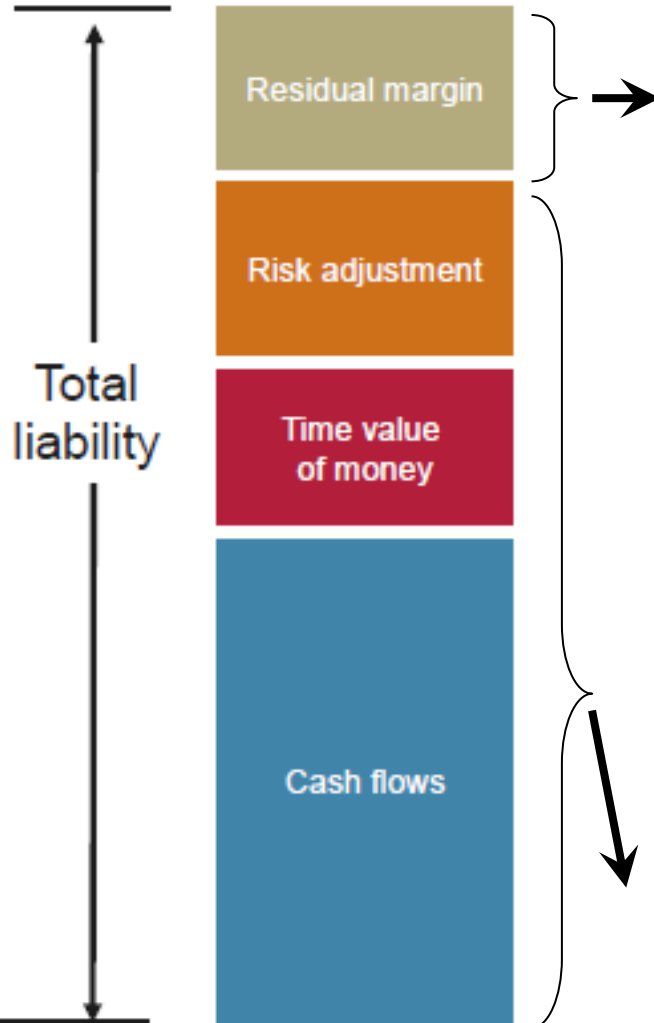
➤ Statement of comprehensive income: example

	20XX	Notes
Insurance contracts revenue	A	Earned premium presentation
Incurred claims and expenses	(B)	
Underwriting result	$C = A + (B)$	
Investment income	D	
Interest on insurance liability	E	Based on 'locked' discount rate at inception
Net interest and investment	$F = D + E$	
Profit or loss	$G = C + F$	
Effect of discount rate changes on insurance liability (OCI)	H	Two components: <ol style="list-style-type: none"> 1. Effect of changes in current period. 2. Unwind of amounts recognised in previous periods.
Total comprehensive income	$G + H$	



- Feedback on the 2010 ED indicated that many had concerns re increased profit volatility compared to their current reporting regimes.
- Other Comprehensive Income (OCI) was introduced to address this volatility by segregating the effects of changes in discount rates in the income statement.
- The amount recorded in OCI will be the difference between the liability calculations for contracts in-force at the valuation date based on:
 - The discount rate determined at inception, and
 - The current discount rate at the valuation date.
- Currently unclear as to the level of grouping of policy cohorts when setting discount rates at contract inception .

**IFRS liability at
Transition Date**



IFRS Insurance - Transition

- Determine retrospectively as far as practicable (e.g. for past periods where retrospective assumptions and acquisition costs are available)
 - Where not practicable due to lack of objective data, estimate maximising use objective data available for those earlier periods
 - Assume all changes in cash flow estimates since inception, known at inception
 - Also need inception discount rates (yield curves) for unwind of residual margin and to put to OCI the cumulative effect of the difference from current discount rates at transition.
 - Beyond three years, can calibrate discount rate (over the first three years) as a margin over a yield curve observable further back and use it.
- Calculate using transition date assumptions, including for risk adjustment.

- When liability contractually based on performance of underlying pool then use 'mirroring approach' – cash flows measured and presented on same basis as underlying items
 - Adjust cash flows to reflect the measurement basis of the items underlying participation
 - Present changes in estimates consistently with equivalent changes in underlying items
 - Discount rate reflects dependence of cash flows on specific assets
 - Residual margin adjusted for changes in value of underlying items from fair value under IFRS
- Otherwise the residual margin is not allowed to “float” (i.e. absorb) for changes in market discount rates and investment experience.

- Participating Business also includes:
 - Investment Linked business if there is an insurance rider (not able to unbundle)
 - Includes investment contracts (with no insurance component) if they have discretionary participation features.
- As for non-par, changes in discount through OCI and interest expense based on discount rate at inception. But mirroring takes precedence!
- If residual margin goes negative then losses immediately recognised in P&L
- Asymmetric risk (i.e. options and guarantees) should be reflected and measured on a current basis
- Include cash flows paid to both current and future policyholders
- Can use expected bonuses as profit carrier if reflects provision of services

- Unbundling now prohibited unless required by the accounting standards.
- Unbundling is only required where the investment component is distinct from the insurance, so that:
 - Both components can lapse and mature independently;
 - No interdependency between components (e.g. not insuring gap between defined benefit and AUM).
- Policy loans can not be unbundled unless the investment component to which they relate can be unbundled.
- Unbundling of the Investment Component must be done on a standalone basis, i.e. any cross-subsidies, discounts or supplements must fall into the insurance component.

- Disaggregation - as not able to unbundle, the whole contract is measured as Insurance but the investment component needs to be disaggregated as follows:
 - The investment component is defined as the amount payable regardless of whether an insured event occurs.
 - The present value of the above amount is to be excluded from aggregate premium in comprehensive income.
 - The investment component is not required to be presented separately in the position of financial position
 - Will need to disclose both:
 - the proportion of the insurance liability that represents the aggregated proportion of premiums received (and claims & benefits paid) that were excluded ; and
 - The amounts payable on demand

- A contract modification is substantial if it affects whether :
 - The contract falls under the Insurance Standard.
 - The Premium Allocation Approach or Building Block applies.
 - It is included in a different portfolio.
- For a substantial contract modification:
 - The existing contract is extinguished and new contract established.
 - The resulting profit or loss is determined using the current-entity specific price the insurer would charge for a contract equivalent to the newly established contract.
- For a non-substantial contract modification, if it:
 - Reduces benefits, derecognise that portion of the liability including any related proportion of the residual margin.
 - Increases benefits, treat the amendment as a new stand alone contract independent of the original contract.

- ED will include full text of proposed standard
- Limited number of Questions will be asked to avoid re-opening issues decided that have been sufficiently deliberated.
- Focus of IASB targeted re-exposure is:
 - Presentation proposals
 - Other Comprehensive Income
 - Unlocking the Residual Margin
 - Approach to transition
 - Participating Contracts
- IASC will lead drafting of submission:
 - Strong links and involvement of practise committees (LIWMPC, GIPC & HIPC);
 - Input and suggestions welcome, but note:
 - Needs to work for General, Health & Life Insurance
 - It is an accounting standard and very political process for changes.

- My contact details: grant_robinson@amp.com.au
- IASB website: www.ifrs.org
- Most recent overview paper from IASB are from Feb 2013 Board (available from site above from meeting page, click to Feb 2013 meeting and all papers for that meeting are on site):
 - Paper 2B “Overview of the Board’s proposals” – Good Overview
 - Paper 2C “Comparison of the IASB’s tentative decisions to the comment letter summary” – gives more details, rationale and for those who really want the detail lists relevant staff papers to board on the key decisions
- Major accounting firms have news letters on this topic, e.g. www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/ifrs-newsletters/Pages/insurance-newsletter-2013-35.aspx