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IFRS for Insurance is approaching
Have you started or are you still in denial?

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11 November 2014

Timeline

Interactions between IFRS and other developments (as at November 2014)

IFRS Standard [1]	2014	2015	2016	2017	2018 onwards
Insurance contracts (IFRS 4 Phase II)	IASB re-deliberation and final standard?	IASB re-deliberation and final standard?			Mandatory effective date 2018 or later?
Financial instruments (IFRS 9)	Issued mid 2014				Mandatory effective date 2018
Revenue (IFRS 15)	Issued mid 2014			Mandatory effective date 2017	Mandatory effective date 2017
Other Developments					
UK GAAP (FRS 103)	Issued in 2014	Mandatory effective date 2015	Mandatory effective date 2015	Mandatory effective date 2015	Long term future TBC?
		Solvency II Go-Live !	IFRS 4 Phase I / UK GAAP (Solvency I) accounting?	IFRS 4 Phase I / UK GAAP (Solvency I) accounting?	

[1] Subject to EU endorsement, for relevant entities

International Financial Reporting Standards

Insurance Contracts Project Update

November 2014

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The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

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Today's topics

- Need to improve existing accounting for insurance contracts
- The IASB's project on insurance contracts
- Key proposals
- Non-participating contracts
- Participating contracts
- Transition for non-participating contracts
- Next steps

IFRS™

The IASB is developing an IFRS that would be applied by all entities that issue insurance contracts

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- The new IFRS would:
  - replace IFRS 4 *Insurance Contracts*, which grandfathers existing diverse practices.
  - bring consistency to the measurement and presentation of insurance contracts, allowing comparisons across entities, jurisdictions and industries.
  - require an entity to apply relevant and reliable accounting policies to insurance contracts that reflects the full range of possible outcomes
  - provide transparent information about:
    - the way an entity makes profits or losses through underwriting activity and investing premiums from customers.
    - the nature and extent of risks from insurance contracts.

A reminder
Current, market-consistent measurement

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Contractual service margin
(Contract profit)

'Fulfilment cash flows'

Future cash flows: expected cash flows from premiums and claims and benefits

Risk adjustment: an assessment of the uncertainty about the amount of future cash flows

Discounting: an adjustment that converts future cash flows into current amounts

Contractual service margin
A component of the measurement of the insurance contract representing the risk-adjusted expected profit from the contract.

Fulfilment cash flows
A current, updated estimate of the amounts the entity expects to collect from premiums and pay out for claims, benefits and expenses, adjusted for risk and the time value of money.

A reminder
Up-to-date information about performance

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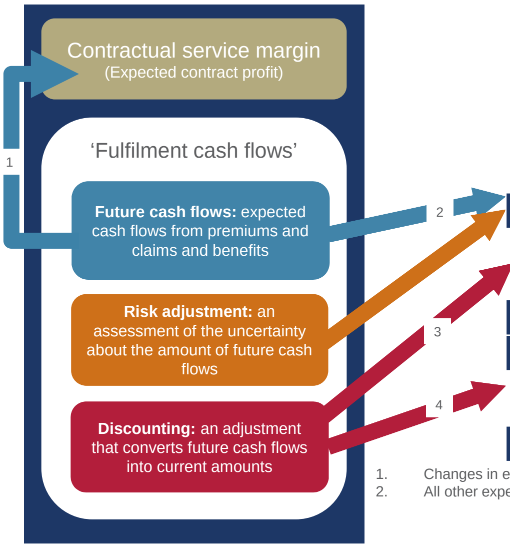

Statement of Comprehensive Income

	20XX
Insurance contracts revenue	X
Incurred claims and expenses	(X)
Operating result	X
Investment income	X
Interest on insurance liability	(X)
Investment result	X
Profit or loss	X
Effect of discount rate changes on insurance liability	(X)
Total comprehensive income	XX

1. Changes in estimates relating to future services
2. All other expected cash flow changes
3. Based on a cost view
4. Based on a current view

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Five targeted areas

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Measurement proposals

1. Unlocking
Changes in estimates relating to expected contract profit for providing coverage recognised over remaining period

2. Mirroring
Measurement and presentation exception when no economic mismatch is possible

Presentation proposals

3. Revenue
Align to presentation of revenue required for other types of contracts with customers

4. OCI proposals
Interest expense is amortised cost-based in profit or loss, current value-on the balance sheet

Approach to transition

5. Transition
Apply Standard retrospectively if practicable, or with specified simplifications if not practicable

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Redeliberations for contracts with no participating features – targeted areas

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Revenue	• An entity should present revenue as earned and expenses as incurred in the statement of comprehensive income. Revenue excludes investment components. • Presentation of premium information in the statement of comprehensive income prohibited if that information is not consistent with commonly understood notions of revenue.
Unlocking CSM	• CSM adjusted for changes between current and previous estimates of the risk adjustment and the present value of future cash flows • Recognise favourable changes in estimates in profit or loss to the extent that they reverse losses that relate to future services
OCI	• Effect of changes in discount rates presented in either profit or loss or in other comprehensive income (OCI) as an accounting policy choice

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Non targeted areas that affect the CSM of contracts with no participating features

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Allocation of the CSM	• For contracts with no participating features, the service represented by the contractual service margin is insurance coverage that: - is provided on the basis of the passage of time; and - reflects the expected number of contracts in force
Unit of account	• Clarified objectives relating to level of aggregation of the contractual service margin
Interest rate	• Confirm use of locked-in rate for accreting interest and for determining the amount that unlocks the contractual service margin

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Summary of proposed treatment of changes in estimates for non participating contracts

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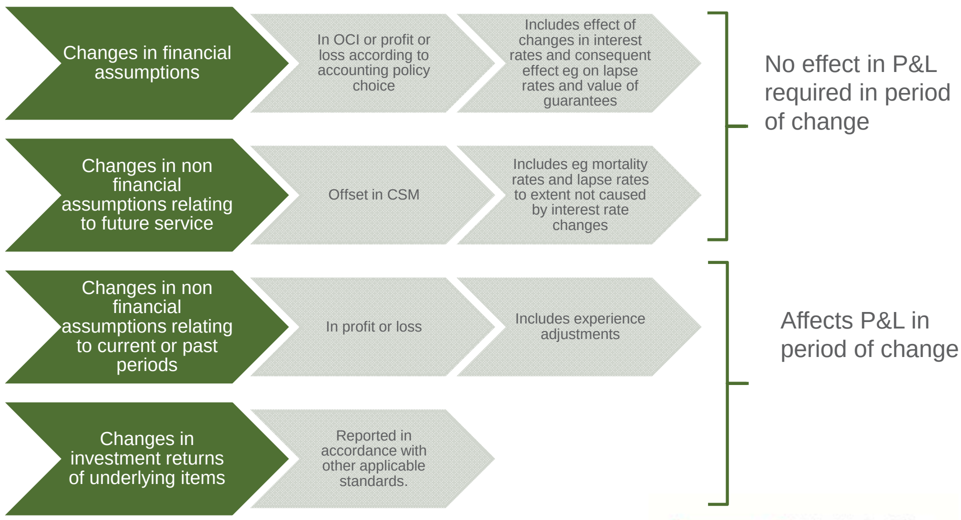

Difficult issues relating to participating contracts yet to be addressed

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Transition – non participating contracts

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Proposal
- At date of transition, measure the CSM and cumulative OCI using retrospective application
- If retrospective application impracticable, use prescribed simplified approach

Feedback
- Most agreed but some had concerns about practicability of simplifications
- Availability of cash flow data from inception to transition

Recommendation
- Confirm retrospective application
- Modify simplified approach for risk adjustment
- Introduce fair value approach when use of simplified approach is impracticable

Next steps

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- Decisions on participating contracts will be made holistically, with benefit of ongoing consultation
- Other residual topics, eg, transition for par contracts, disclosures, simplifications, etc.
- Redeliberations in 2014 /2015 with final standard expected in 2015
- IASB to consider how to support implementation

For more information…

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- Visit our website:
  - go.ifrs.org/insurance_contracts
- Sign up for our email alert

Ask questions or share your views

- Email us: insurancecontracts@ifrs.org

Resources on IASB website

- IASB Update
- Project podcasts and webcasts
- Snapshot
- Feedback statement
- Investor resources
- High level summary of project

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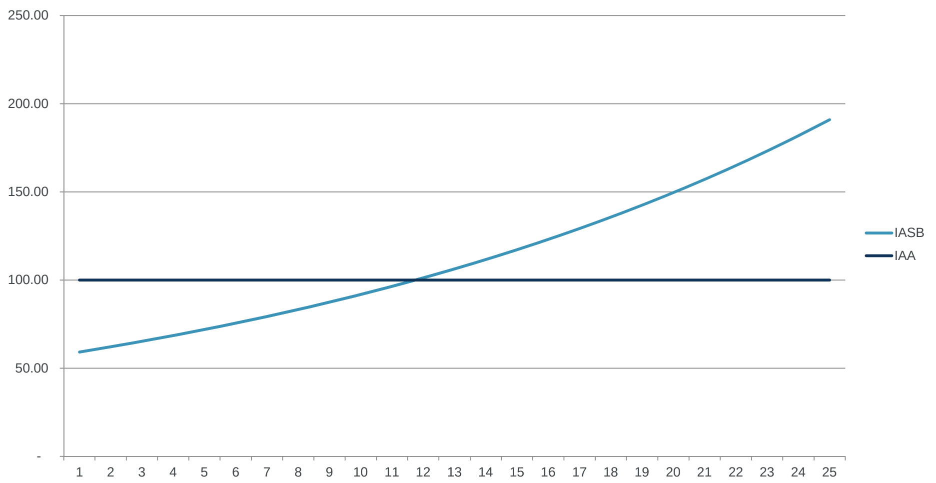
Non-participating contracts

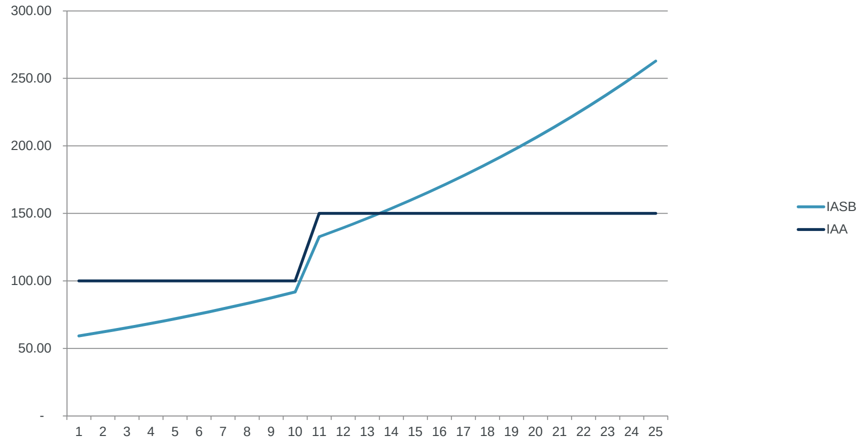
Contractual service margin

IFoA response to 2013 ED	IASB subsequent thinking
Unlocking CSM • Supported Unlocking • Unit of account proposals un-necessarily burdensome • Asymmetry around order of events • Changes to Risk Adjustment should go through CSM	The board has tentatively confirmed, **consistent** with the 2013 ED: • The CSM should be adjusted for changes in estimates of future cash flows to the extent that they are related to future coverage and service. • The CSM cannot be negative. • Changes in estimates of future cash flows that do not relate to future coverage or service should be reflected in net income. The board has tentatively confirmed, **different** from the 2013 ED: • Asymmetric treatment of gains after losses • The CSM should be adjusted for changes in estimates of the risk adjustment. • Interest accretion on CSM should be at the initial (i.e. locked-in) rate regardless as to whether one elects for OCI or P&L • Cannot aggregate onerous contracts with profit making contracts • Should run off in straight line

CSM amortisation example (i)



CSM amortisation example (ii)



The OCI solution

IFoA response to 2013 ED	IASB subsequent thinking
OCI "Solution" • Welcomed introduction of OCI • Against mandatory use of OCI	The board has tentatively confirmed, **consistent** with the 2013 ED: • Where the effects of discount rate changes are presented in OCI – Interest expense should be determined using the discount rate that applied at contract inception (the locked-in rate) – OCI should reflect the difference between the carrying amount of the liability using current discount rates and the carrying amount of the liability using locked-in discount rates The board has tentatively confirmed, **different** from the 2013 ED: • The effect of changes in discount rates may be presented either in net income or in OCI as an accounting policy choice to be made at the portfolio level.

Presentation

IFoA response to 2013 ED	IASB subsequent thinking
Presentation • Proposals OK for short term business • Proposals not suitable for long term business – Increased complexity – Lacks transparency /useful information	The Board tentatively decided: • Revenue presented in the statement of comprehensive income must be consistent with commonly understood notions of revenue. • Entities must present revenue in the statement of comprehensive income in the manner proposed in the 2013 ED. • Entities must make the disclosures relating to volume as outlined in the 2013 ED. • Summary of requirements: – Revenue = [+/- change in risk adjustment for the coverage expired in the reporting period]**+** release of CSM **+** estimate of claims and benefits for the period. – Revenue does not include non-distinct investment components that were not unbundled from the insurance contract – those components must be excluded • Expenses are actual claims benefits and expenses incurred in the period after disaggregation of non-distinct deposit components

Transition

IFoA response to 2013 ED	IASB subsequent thinking
Transition • Supported proposals to apply retrospectively • Simplifications need further work	The board has tentatively confirmed, **consistent** with the 2013 ED: • That the proposed Standard should be applied retrospectively in accordance with IAS 8 unless impracticable • If full retrospective application is impracticable that a simplified approach should be applied, but applying a modified approach to that proposed in the 2013 ED • If the simplified approach is impracticable, the IASB decided that the CSM at the beginning of the earliest period presented should be the difference between the fair value of the insurance contract and the fulfilment cash flows measured at that date • Additional disclosures when contracts have been measured in accordance with the simplified approach or the fair value approach.

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Participating contracts

2013 Exposure Draft – 'Mirroring' exception

Contracts where the benefit to the policyholder is linked to the return on an underlying item and the insurer is required to hold the underlying item.

Type of cash flow	Vary directly	Vary indirectly	Not expected to vary
Measurement	Measure cash flows at carrying amount of underlying items	Measure cash flows using building block approach	Measure cash flows using building block approach
Presentation	Present in comprehensive income consistent with underlying items	Changes in cash flows and interest at current rates in profit or loss	Interest at locked in rates in profit or loss. Includes use of OCI and unlocking of CSM

- Expected to apply to UK with-profit contracts and unit linked insurance contracts

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The Alternative 'Industry' Proposal

Topic	Alternative Proposal [1]	IASB Re-deliberations
Model	Based on the standard Building Block Approach	
Scope	[TBC]	Narrow scope? (e.g. depends on proportion of total benefit that varies with the return on the underlying items and whether there is a minimum amount insurer retains)
Balance sheet discount rate	[TBC]	Exploring approaches that do not involve the splitting of cash flows
Interest expense in P&L	[TBC]	Effective and book yield being explored
Unlock CSM for movements in assets supporting shareholders' share	[TBC]	Mixed views. If permitted then the scope of applicable contracts may be narrow
Release of CSM to P&L	[TBC]	To be re-deliberated
Measurement and presentation of options & guarantees	[TBC]	2013 ED: 'Market consistent' approach (?) with all changes to P&L. To be re-deliberated.
'Mirroring' concept	[TBC]	To be examined at the end to see if required in certain circumstances

[1] As detailed in the European Insurance CFO Forum paper to the November 2014 IASB Board Meeting

Implications for UK with-profits

- Compare to current IFRS / UK GAAP "cash" accounting
- Undistributed surplus (estate) part of liability or equity?
  - How to interpret … *"payments arising from **existing contracts** that provide policyholders with a share in the returns on underlying items … regardless of whether those payments are made to current **or future policyholders**"* (ED 2013 B66k)?
- Treatment of shareholders' share of future profits (existing contracts & estate)
  - No unlocking of the CSM results in accounting that does not reflect the service to the policyholder to smooth pay outs with similar smoothing of pay outs to shareholders.
  - Will with-profit business exhibit more P&L volatility than unit-linked?
- Non-profit business in with-profit funds
  - What does the risk adjustment and CSM represent?
  - Interaction between CSM and with-profit liabilities / flows to P&L?
- Transition?

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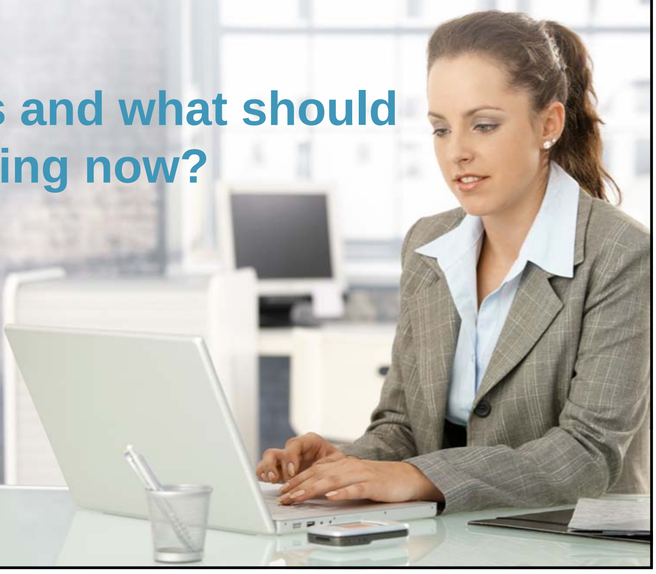
Wider linkages and what should insurers be doing now?



Solvency II vs. IFRS contract liabilities

- For insurance (including with-profits), many of the building blocks are expected to be similar, however, there are likely to be a number of differences:
  - Best estimate liability – Different cash flows (e.g. certain expenses and relevance of acquisition expenses)? Different contract boundary? Unbundling?
  - Discount rate – Restrictions in Solvency II matching adjustment versus IFRS top down approach? Applicability of the Solvency II volatility adjustment in IFRS?
  - Risk adjustment – Calibration differences due to different philosophy? (e.g. fulfilment versus transfer value)
  - CSM – Not relevant in Solvency II and new modelling systems will be required for IFRS
  - Treatment of participating contracts – Unclear; though similar building blocks?
- Non-participating investment contracts will be different to Solvency II (due to deferral / matching in IFRS).
- What does the increase divergence between regulatory and accounting measures mean for UK insurers?

What should insurers being doing now…

… is it really coming?

- Consider performing a pre-study on IFRS 4 Phase II and IFRS 9 implementation:
  - Interaction between assets / liabilities and implications if timelines are not aligned
  - Continue to monitor participating contracts debate as too early to implement?
- Consider implications of "gap" period between Solvency II and IFRS 4 Phase II
- Consider initial IFRS 4 Phase II planning:
  - Financial impact assessments
  - Assessing system and process implications; and operational impact on (pilot) operations
  - Leverage Solvency II systems and experience
  - Transition – data collection (now?) and determining approach
- To follow … detailed implementation planning and cost estimation for business case
- Don't forget IFRS 15 for non-participating investment contracts!

A future for supplementary reporting?

- Do users need a 'third view' of the business?
- Preparers are already showing appetite to streamline their embedded value disclosures with greater focus on cash generation metrics
- Where might supplementary reporting be useful?
  - New business reporting – volume and profitability measures
  - Existing business profitability – a more 'economic' view
  - Earnings recognition patterns – key drivers, timing, volatility etc.
  - Sensitivities – more 'likely' assessment of risks

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

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