

IASC Insurance Issues Paper

Key General Insurance Issues

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Outline of presentation

- **Objectives and key changes**
- **Non-fair value issues**
- **Fair value issues**
- **Performance reporting**

Objectives of financial reporting

“to provide information that is useful to a wide range of users in making economic decisions”

“to show results of the stewardship of management”

“information about variability of performance is important”

“predicting the capacity of an enterprise to generate cash flows”

Why is change necessary?

Improved transparency

Consistent valuation basis

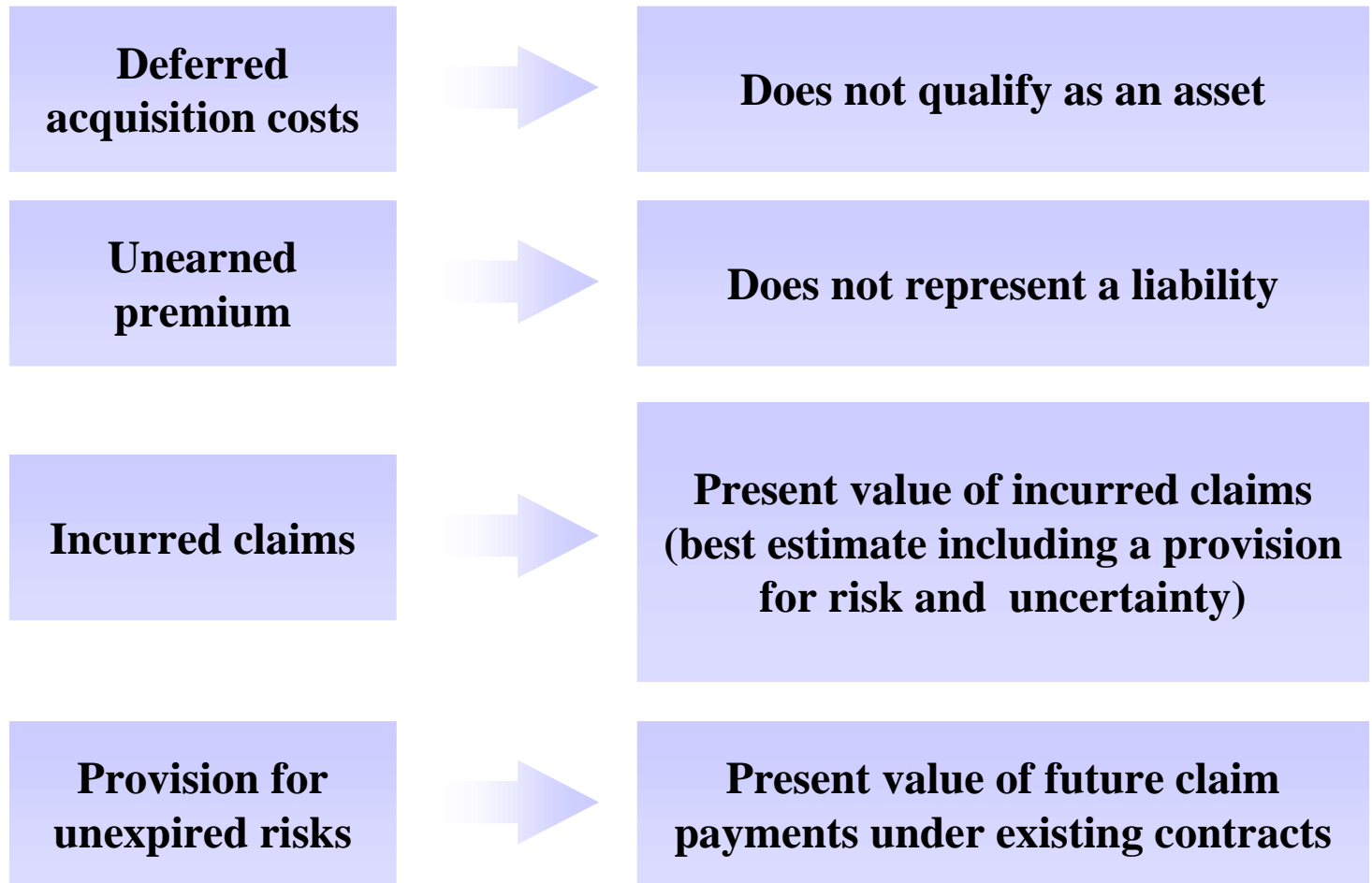
**Performance
reporting**



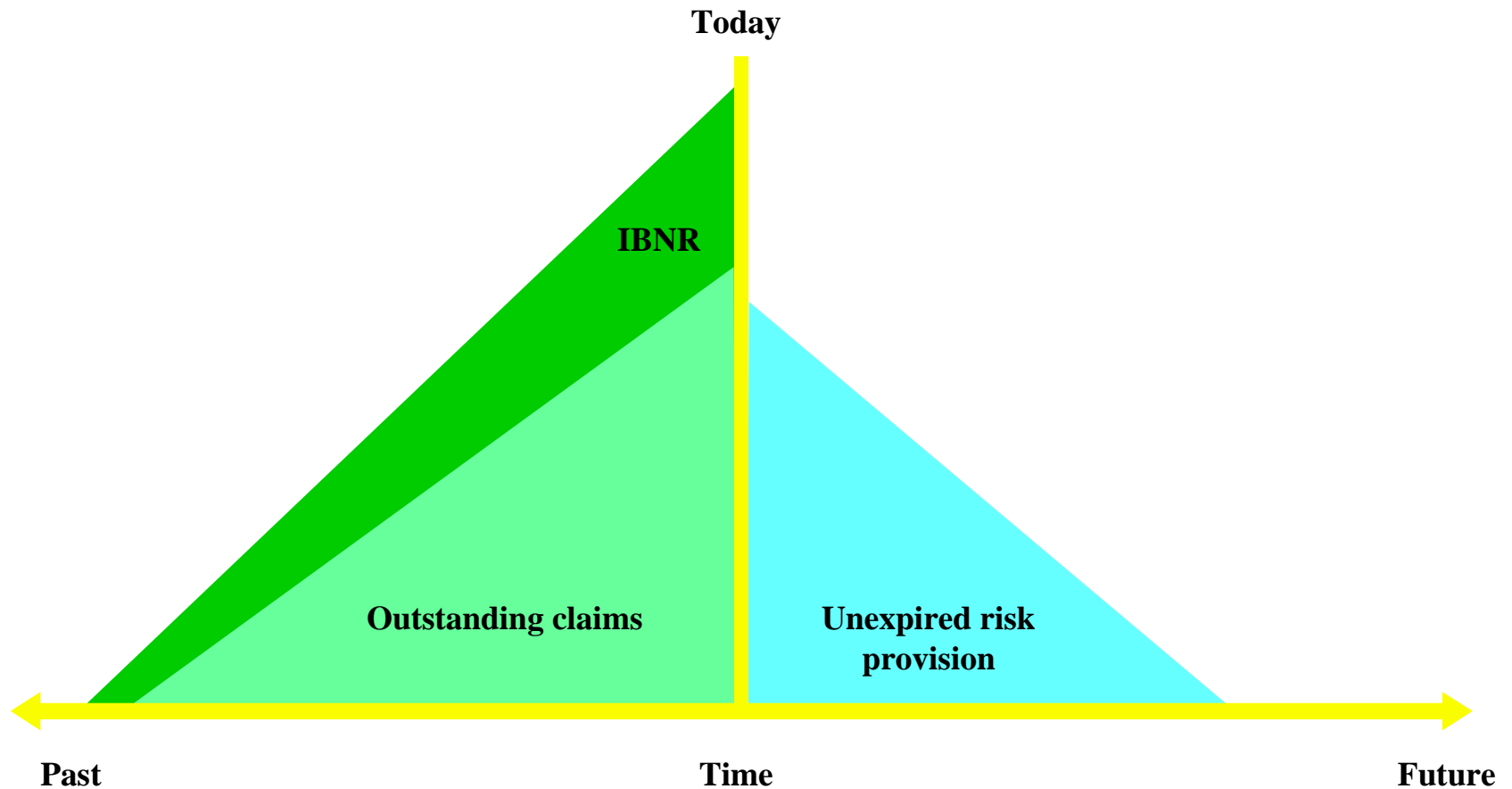
Key changes proposed

- **Definition of general insurance**
- **Unbundling in certain circumstances**
- **Asset/liability method to replace deferral and matching method**
- **Discounting of provisions**
- **Recognition of profit on sale**
- **No equalisation provisions**

Implications of A-L method



Claims provisions



Discounting and risk weighting required for each element

Example of accounting under the A-L model

At inception

Premiums written	1,000
Expected claim payments	(1,000)
Risk adjustment	(80)
Discount	<u>115</u>
Present value of claims	<u>(965)</u>
Gain on sale	<u>35</u>

Earnings profile under asset/liability model

	Year 0	Year 1	Year 2	Year 3	Year 4
Premiums written	1,000	-	-	-	-
Claims incurred	(885)	-	-	-	-
Investment return	-	60	42	24	6
Change in estimates	-	0	0	0	(100)
Risk adjustment	(80)	10	20	25	25
Unwinding of discount	-	(54)	(36)	(20)	(5)
Net profit/loss	35	16	26	29	(74)

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General vs life insurance

Steering Committee view:

Insurance should be treated as general insurance for financial reporting purposes if the insurer is committed to a pricing structure for not more than twelve months

- **Effect on general business:**
 - **Policy periods with a price commitment of over 1 year accounted for as life business**
 - **Recognition of profit on contracts with a pricing commitment for more than twelve months**

Is the asset/liability model preferable to the deferral and matching model?

- **Results on inception may reflect internal pricing and external market assumptions**
- **Possibility of recognition of gain on sale (no deferral)**
- **Income statement at later reporting dates reflects variances from assumptions**
- **Cannot defer acquisition costs to other periods**

Use of discounting in measuring liabilities

- **Arguments for discounting:**
 - **Discounting inherent in pricing insurance contracts**
 - **Consistent with the Framework and with IAS 37**
 - **Reflects differences in economic burden due to maturity profile of claims**
- **Arguments against discounting :**
 - **uncertainty remains in liability measurement**
 - **implies precision and reduces comparability**
 - **not prudent to recognise future investment earnings**
- **What rate should be used?**

Provision for risk and uncertainty

Steering committee conclusions

- **Measurement of liability should reflect risk which would be reflected in arm's length transaction**
- **Adjustment subjective - guidance to be developed**
- **Risk adjustment for small portfolio should be same as for a large portfolio**
- **Some disclosure of adjustments required**

Risk and uncertainty

Issues arising

- **Natural extension of prudence concept**
- **Measurement of liabilities consistent with pricing process**
- **Consistent with estimation of fair values**
- **Size of portfolio irrelevant**

Risk and Uncertainty

Basis of calculation

- **Market value**
 - **reinsurance markets**
 - **market transactions**
- **Statistical or Actuarial basis**
- **Judgmental**
- **Discount rate adjustment**

Catastrophe and equalisation provisions

- **Arguments for inclusion**
 - catastrophe premiums represent unearned premium deferrals
 - “true” long-term profitability under accruals concept
 - protect solvency by restricting distributions
- **Majority Steering Committee view**
 - not liabilities under the framework definition
 - inconsistent with a closed book approach

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Fair Value

- **Is fair value appropriate for general insurance?**
 - **Consistency with other standards**
 - **Assists in decision making**
 - **Practical difficulties**
- **Extension of asset/liability model**

Other fair value issues

- **Assumptions consistent with market place views**
- **May not reflect company's specific features**
- **Is an asset based discount rate justifiable?**
- **Allowance for credit risk**
- **Should contract as a whole be valued?**
- **Value of expected renewals and cross-selling opportunities to be included?**

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Performance Reporting

- **Single primary statement combining life & general business**
- **Total investment return included**
- **Separate disclosure of:**
 - **profit from current year underwriting**
 - **run off experience**
 - **changes in economic assumptions**
- **Unwinding of discount treated as interest income/expense**

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