KPMG

Financial Sector Advisory

IFRS 4 – Disclosure Requirements

Simon O’Shea and Ash Ruparelia

Wednesday 19th October

Actuarial Services

AUDIT ▪ TAX ▪ ADVISORY

Agenda

- Overview – Insurance entity disclosures
- Disclosure requirements
- Assumptions
- Insurance risk
- Sensitivity analysis
- Claims development
- Financial Risk
- Other Issues
- Summary
- Discussion

KPMG

Overview - Insurance Entity Disclosures

IFRS 4	**Insurance assets/liabilities**
IAS 32	**Financial Instruments (including investments)**
Other Standards (IAS1, 14 etc)	**Formats, policies, segment reporting and other assets/liabilities**

KPMG

Disclosure requirements

Standard contains two principles:

- Principle 1 – identify and explain amounts in financial statements.
- Principle 2 – help users understand amount, timing and uncertainty of cash flows.

Disclosure requirements – Principle 1

Identify and explain amounts in financial statements:

- accounting policies
- key amounts
- significant assumptions
- changes in amounts
- reinsurance held
  - **Disclose gains and losses on buying reinsurance**
  - **If amortised under accounting policy then also disclose:**
    - amount of gains and losses amortised
    - amounts remaining unamortised at start and end of accounting period

KPMG

Disclosure requirements – Principle 2

Help users understand future cash flows:

- segment reporting
- insurer's objectives in managing risks and policies for risk mitigation
- key terms and conditions
- insurance risk (before and after reinsurance) – sensitivity analysis, concentrations, loss development
- interest and credit risk

Assumptions

- What are the material assumptions?
  - may not be practical to disclose all
  - more important to describe process
    - objective – e.g. best estimates
    - sources of data
    - consistent with market
    - use of own experience
    - allowance for future trends
    - Identification of correlations between assumptions

Assumptions

- Assumptions – quantitative disclosure, where practicable:
  - Disclose values of assumptions that have a material impact on estimates in balance sheet and income statement
  - For example:
    - discount rates
    - effect of legislative changes such as change to calculation of personal injury awards
    - overriding estimates such as IBNR:OS ratios applied to APH liabilities

Assumptions

- Changes in assumptions and impact of those changes that have a material impact on assets, liabilities, income and expense
  - can be quantitative or qualitative
  - how to disclose qualitatively?
    - start with change in estimates
    - identify sources of change
    - describe the underlying changes in assumptions in terms of e.g.
      - length of term to settlement
      - severity of claims
      - frequency of claims
  - Disclose effects of change both before and after impact of reinsurance

Nature and extent of risks arising from insurance contracts:

Insurance risk

- Objectives, policies and processes for managing insurance risk and methods used to manage those risks
- Information about insurance risk (before and after mitigation by reinsurance) including information about:
  - Sensitivity to insurance risk
    - Qualitative information about sensitivity including terms and conditions of contracts; or
    - Quantitative analysis that shows effect of changes in risk variables
  - Concentrations of insurance risk
  - Claims development

Sensitivity analysis

- Sensitivity of reported net income and equity for changes in all variables that have a material impact, e.g. interest rates, inflation rates, equity markets, mortality, persistency, frequency and severity.
- These are variables that impact measurement of assets and liabilities.
- Impact on net income is for items where change in value is through the P&I.
- Strengths and limitations of sensitivity analysis should be disclosed
- These requirements demand a strong understanding of the entity’s risk profile, in an economic and accounting sense.

Claims development

Presentation of development table:

- accident year or underwriting year
- gross and net of reinsurance
- disclose unusual claims developments separately
- could miss significant category of reserves – may need to separate presentation e.g. asbestos and environmental pollution liabilities

Nature and extent of risks arising from insurance contracts:

Financial risk (in insurance contracts)

- Risk exposures and how they were generated
- Objectives, policies and processes for managing insurance risk and methods used to manage those risks
- Information about financial risk:
  - Credit risk (eg risk of default by reinsurers)
  - Liquidity risk (eg information about the estimated timing of cash flows)
  - Market risk (interest rate risk, currency risk and other price risk):
    - Quantitative sensitivity analysis either:
      - Individually for each type of market risk; or
      - A single analysis that reflects interdependencies between each type of market risk (eg VAR or EV analysis)
- Information about exposures to market risk arising from embedded derivatives in insurance contracts

Other Issues

- There will be no existing financial statements to copy.
- There will be conflict with confidentiallity issues.
- Implementation may require significant changes to IT systems and internal processes.
- These requirements will be auditable.
- IFRS 7.

Summary

- The disclosure requirements are principles based, and the guidance is non prescriptive, merely giving examples.
- Insurer decides the level of detail it needs to give in order to satisfy the the disclosure requirements.
- Significant thought has to go into deciding how to satisfy them.
- Key message is to help users understand the amounts in the financial statements.
- Senior management input will be required at an early stage.

Discussion