

Life Convention 2006  
IFRS Phase II: Sorting out Insurance  
Accounting Once and For All?  
November 2006

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Section one

Background  
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Background

### History of IASB insurance discussions

- Draft Statement of Principles published in 2001
- In 2002, EU requirement to implement IFRS in 2005 meant project split into Phase 1 and Phase 2
- Phase 1 = IFRS 4
  - Insurance contracts and participating contracts on existing accounting
  - Investment contracts under IAS 39/IAS 18
  - Minor modifications to some current accounting approaches
  - Substantial qualitative and quantitative disclosure requirements

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Background

### Status of the IASB Phase II project on insurance contracts

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Background

### Status of the IASB Phase II project on insurance contracts

#### Key players

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Background

### What is the purpose of accounting?

- Giving transparent and comparable information of a company's financial position
- Providing for optimal understanding and guidance for shareholders, investors and other users

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Background

### Where are we today? An insurer's perspective

- No full harmonisation
- Inadequate picture of financial situation
- Accounting mismatch
- No options & guarantees
- No policyholder behaviour

Inaccurate perception of risk of investment & lack of comparability of accounts

- Higher cost of capital
- Reduced competitiveness & ability to fulfill economic roles

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Background

### What should we aim to achieve?

What we are seeking in our financial statements... ..and how it will benefit users and other stakeholders

- Understandability
- Comparability
- Relevance
- Reliability

- Better reflection of insurance business model
- Transparency and comparability of insurance contract accounting
- Global convergence of insurance accounting
- Level playing field for companies
- Reconcilability with Solvency II

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Section two

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Recent IASB discussions and tentative decisions

Overview of current tentative decisions  
Measurement

- Several models being considered
  - Entry value
  - Exit value
- Current value inputs
  - current estimates of future cash flows
  - current market discount rates
  - risk margin and service/profit margin
- Gains on inception?

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Recent IASB discussions and tentative decisions

Overview of current tentative decisions  
Measurement (cont)

- Current exit value
  - "amount insurer would expect to have to pay today if it transferred all its remaining contractual rights and obligations immediately to another entity"
- No conclusion yet whether this is fair value
- Credit characteristics

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Recent IASB discussions and tentative decisions

Overview of current tentative decisions  
Future Premiums and Policyholder Behaviour

- Future premiums are usually optional
- Future premiums cash flows included if either:
  - value of future benefits exceeds value of future premiums
  - right to enforce payment of premiums
  - right to guaranteed insurability
    - Customer relationship identified
    - Include as part of liability

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Recent IASB discussions and tentative decisions

Overview of current tentative decisions  
Participating Contracts

- Definition of Discretionary Participating Feature unchanged
- Policyholder participation rights
  - Liability when an unconditional obligation to transfer economic benefits to policyholders
    - Legally or equivalently compels
    - A prior claim on distributions not enough by itself
    - If no unconditional obligation exists, report as equity
  - Participating insurance and investment contracts same treatment

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Recent IASB discussions and tentative decisions

Overview of current tentative decisions  
Other matters

- Acquisition costs
- Unit of account
  - Risk margins
- Unbundling
  - Unless so interdependent that any split is arbitrary

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Section three

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Recent IASB discussions and tentative decisions  
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Industry response

CFO Forum – Who are we?

We are a group of 20 leading European insurers from 8 countries

Set up in 2002 to pursue the harmonisation of financial reporting with the IASB, the Commission and other stakeholders to enhance stability, consistency and transparency for investors.

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Industry response

CFO Forum - Development of the Elaborated Principles

July 2005

Publication of *Principles for an IFRS Phase II Insurance Accounting Model*, a set of *high level* principles that outline the direction that the CFO Forum believes the new IFRS standard should take.

June 2006

Publication of *Elaborated Principles for an IFRS Phase II Insurance Accounting Model*. Since the initial publication of high level principles, the CFO Forum has worked to expand and clarify them by creating the *Elaborated Principles*. The Basis for Conclusions provide insight into the rationale for the *Elaborated Principles*.

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Industry response

Overview of areas where differences exist between IFRS Phase II and industry proposals

- \* Initial calibration – Day 1 gain
- \* Credit standing
- \* Customer relationship asset
- \* Participating liabilities based on expected future payments

? Deposit floor not necessary

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Industry response

What are the CFO Forum proposing? A coherent framework

Market value of assets

Assets Backing Liabilities

ASSET

LIABILITIES Accounting

LIABILITIES Solvency

Equity

Profit Margin\*

Risk Margin\*

Best Estimate Liability

Customer Intangible Asset\*\*\*

Market value margin

Best Estimate Liability

Available capital for solvency purposes

MVL (market consistent) = Exit Value\*\*

Market-consistent Accounting Liabilities

\* CFO Forum Total margin including allowance for risk and future profits  
 \*\* CFO Forum Market value of liabilities being for non-hedgeable risks the best estimate plus the market value margin (with a cost of capital as a proxy)  
 \*\*\* CFO Forum CIA = Customer Intangible asset (for accounting purpose, shown as an asset together with gross liabilities)

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Industry response

Overview of areas where convergence exists between IFRS Phase II and Insurance Regulators' proposals

- ✓ Best estimate of future cash flows
- ✓ Discounted at current market interest rates
- ✓ Explicit risk margin
- ✓ Options and guarantees are included
- ✓ Use of all other market inputs available
- ✓ Acquisition costs are expensed as incurred
- ✓ Potential Day 1 gains

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Industry response

Overview of areas where differences exist between IFRS Phase II and Insurance Regulators' proposals

- !! Discretionary bonuses of participating contracts
- !! Own credit standing
- ? Unit of account based on portfolios of similar risks
- ? Deposit floor not necessary
- ? Margins

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IFRS Phase II: Sorting out Insurance Accounting Once and For All

Summary – Impact on life actuaries

- Risk margins
  - Conceptual basis and quantification
- Future Premiums
  - Identification of premiums that may be included
- Participating contracts
  - Identification of enforceable obligations and valuation
- Consistency with other measurement bases
  - Solvency II and EEV

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IFRS Phase II: Sorting out Insurance Accounting Once and For All

Summary

- Getting the right answer matters
- Still a long road ahead
  - But formative discussions being held now
  - Don't take obvious things for granted
- Q1 07 Discussion paper will be relatively high-level
  - Profession need to consider how and to what extent it will respond

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