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What will IFRS 4 Phase II mean in practice?

IFoA IFRS 4 Phase II for General Insurers Working Party

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IFRS 4 Phase II - what is it and who does it impact?

New accounting standard for valuation of insurance contracts for both Life and General Insurers...it's different to current accounting and Solvency II.

Publication of the IFRS 4 Phase II insurance contracts standard expected in late 2016/early 2017 ... with an effective date of approximately 2020/21.

Will impact all current IFRS reporters immediately from implementation (excluding US).


The impact will vary by firm depending on the business you write and the level of maturity of your business processes.


UK accounting rules likely to change as well ... so will impact virtually all in the UK in time.



A brief history

IASB

| | | | | | |
|----------------|--------------------------|--|--|--|---|
| 2015 and prior | 1997 to 2007 | May 2007 | July 2010 | June 2013 | June 2013 to now |
| | IFRS 4 project started | Discussion paper (DP) published | Phase II Exposure Draft (ED) | IASB revised ED | Lobbying and discussions |
| | Up to now | August & September | October | November | December |
| | Lobbying and discussions | IASB's field work testing with targeted participants by 23 rd September  | IASB to resolve 'sweep issues' from field work testing | IASB to complete drafting of Standard and associated Basis of Conclusion | Final standard issued end 2016 / early 2017 |
| | Post 2016 | 2017 to 2021 | | 2021? | Post 2021 |
| | | Implementation | | Effective date of Standard | New world under IFRS 17 |

 = tomorrow

FASB decided to only make limited amendments to US GAAP. Timing of final standard and effective date unclear.



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Why and how?

Why:

- Current IFRS 4 Insurance Contracts Standard is only an interim Standard => diverse practice and differing treatments
- Comparisons are difficult for different products, companies and jurisdictions

How:

- Global insurance Standard
- IASB wants consistency across industry and consistent accounting for all insurance contracts by all companies
- IASB intention is to have one Building Block Approach (BBA) for all contracts
- IASB believes market-consistent approach provides best information

For General Insurance:

- Current GI model not considered 'broken'
- Request from general insurers to develop simplified model => Premium Allocation Approach (PAA)
- PAA should be an approximation of the BBA
- Can only be used under certain circumstances => This leads to potential issues around PAA eligibility for multi-year contracts



Principal features

| Basis | Features |
|-----------------|---|
| Current IFRS | <ul style="list-style-type: none">• Wide variety of methods in current accounting treatment• Unearned Premium Reserve + Claims Outstanding* (including IBNR) (+ Equalisation Provision + Additional Unexpired Risk Reserve)• Usually undiscounted• Not necessarily a best estimate basis |
| IFRS 4 Phase II | <ul style="list-style-type: none">• To ensure that the presentation of the accounts for insurance companies is consistent with the approach used for other non-insurance companies globally• ...and thus to enable investors etc. to compare all types of companies on a like-for-like basis• No gain on policy inception but losses must be recognised immediately => recognition of profit deferred until earned |
| Solvency II | <ul style="list-style-type: none">• To provide enhanced security to policyholders• ...by ensuring insurance companies have a robust approach to risk management• ...and hold sufficient capital (based on those risks) to reduce the probability of failure to at least 1 in 200 in a one-year timeframe across the EU• Immediate recognition of profit |

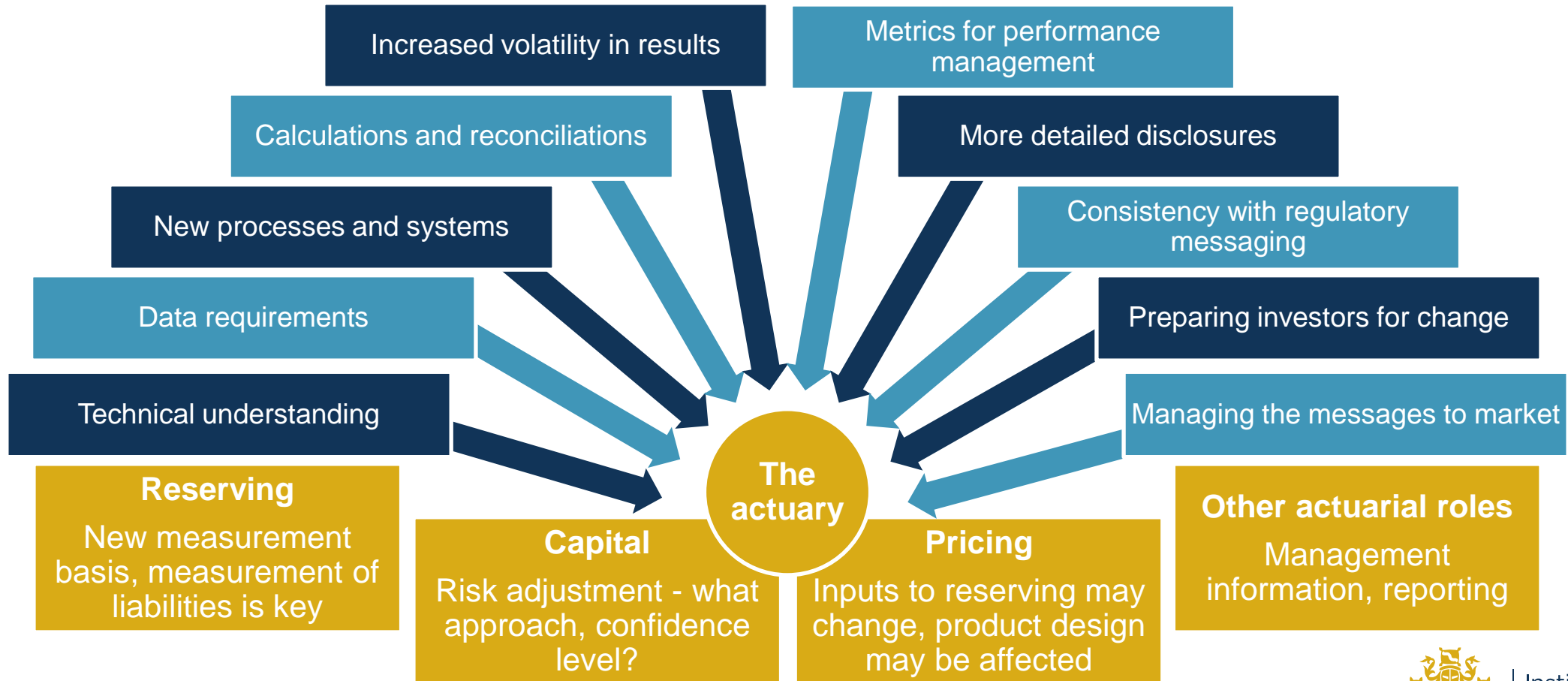


IFRS 4 Phase II vs Solvency II

| Topic | IFRS 4 Phase II | Solvency II |
|---------------------------------------|--|---|
| Recognition | Earliest of start of coverage and premium receipt (plus onerous contract test) | Date party to contract |
| Measurement model | Building Block Approach (BBA), or Premium Allocation Approach (PAA) for eligible contracts | No choice |
| Discount Rate | Company specific, principles based | Prescribed |
| Risk Allowance | Risk Adjustment - no prescribed method | Risk Margin - prescribed 6% cost of capital |
| Contractual Service Margin | Eliminates day-one gain (measure of unearned profit) | No similar concept |
| Other Comprehensive Income (optional) | Removes impact of discount rate changes from P&L | No similar concept |



Why is this such a big deal?



Big decisions



Simplified measurement model (PAA)

Will all your products qualify? Even then, do you want to use it?



Systems implementation

Can you leverage your current systems? Save time, effort and costs now by integrating IFRS 4 Phase II implementation plans into existing systems upgrades



Performance measurement

New KPIs will be critical for day to day business management right through to investor communications. What will they look like?



Financial reporting and disclosure

Greater level of detail (e.g. reconciliations and confidence level). How do you want to be seen to the market?

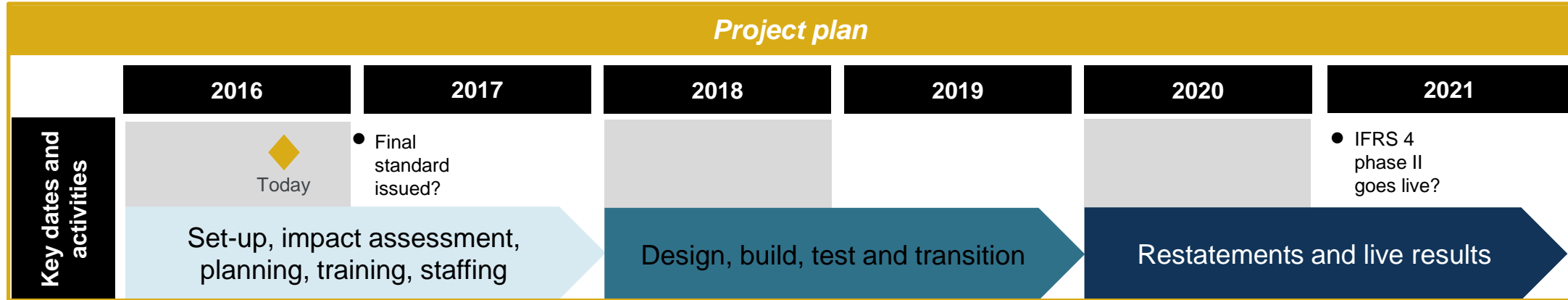


Actuarial, Risk and Finance Modernisation

Greater collaboration, understanding, knowledge sharing will be required. How streamlined are you?



A lot to do...



Summary

- IFRS 4 Phase II will mean big changes for general insurers
 -but, unlike SII, not everyone will convert at the same time, impact will vary by firm
- Actuaries will have a key role to play
 - ...in key decisions for the insurer during implementation
 - ...in implementation, and
 - ...in the IFRS 4 Phase II world
- We need to learn the lessons from SII implementation
- It may feel far away, but it really isn't if you are an IFRS reporter
 - ...you need to start preparing now



What should your firm be doing and how can you help?

| | |
|---|--|
| Stakeholder management <i>Knowledge</i> | <ul style="list-style-type: none">• Increase awareness• Technical training |
| Impact studies <i>Identify hot spots</i> | <ul style="list-style-type: none">• Financial and operational impact assessment• Assessment of system, modelling, data flow and process implications• Product assessment – establish PAA eligibility• Identify relevant existing and planned projects to leverage |
| Implementation planning <i>Plan for a plan</i> | <ul style="list-style-type: none">• Identify key stakeholders and create project governance structure• Cost estimation for business case• Search for skilled resources• Detailed impact assessment across your business |
| = future opportunities for general insurance actuaries | |



Questions

Comments

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

The views expressed in this presentation are those of the presenter.



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