

International Financial Reporting Standards



Project to replace IFRS 4 – *Insurance contracts* Actuarial Society of South Africa

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IASB Board member

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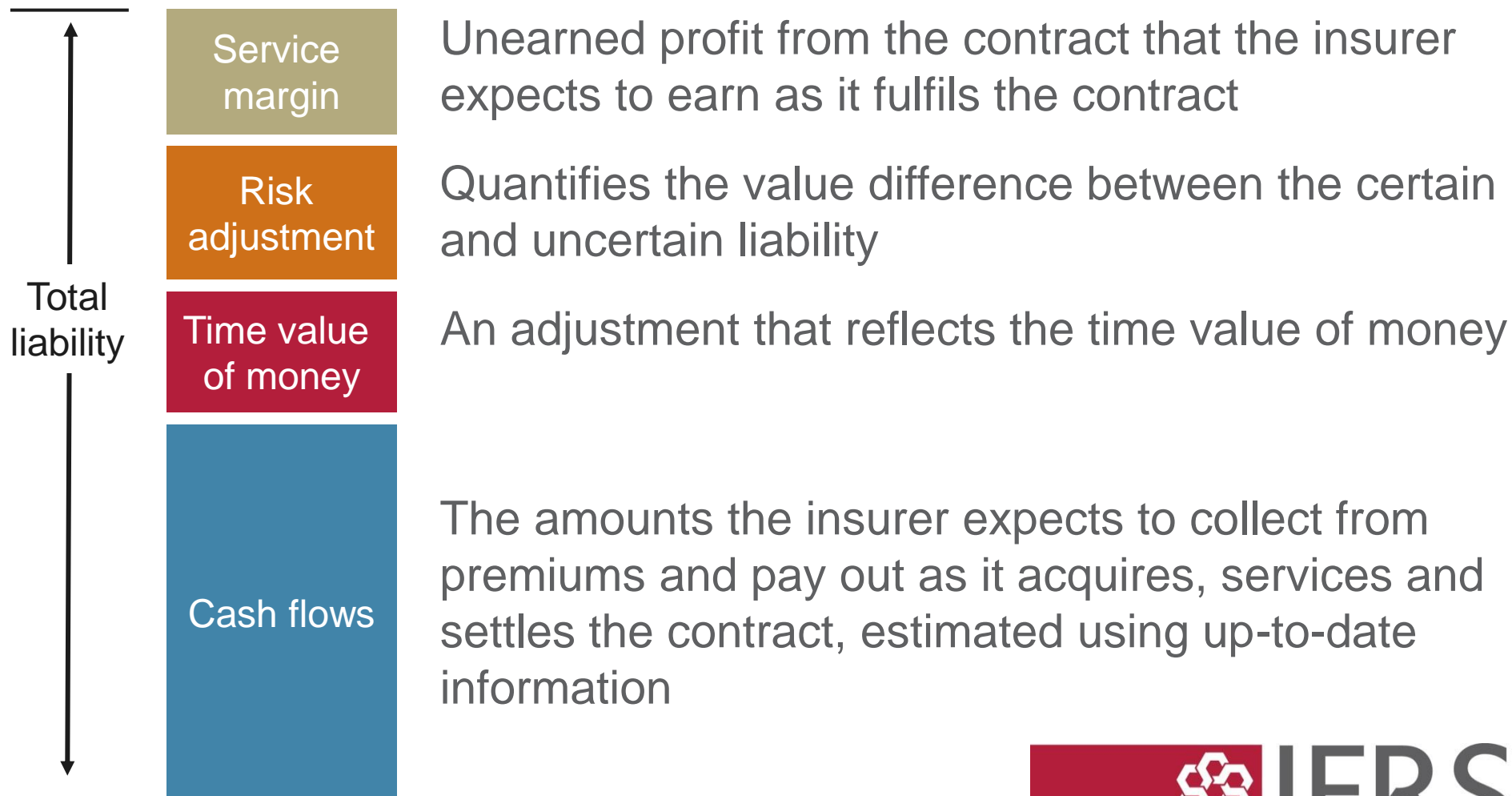


Timeline



Measurement of insurance liability

3



Targeted issues

Presentation proposals

Presenting insurance contract revenue

Presenting changes in liability due to discount rates in OCI

Measurement proposals

Adjusting unearned profit for changes in cash flows

Measuring and presenting mirrored contracts

Approach to transition

Apply standard as if always effective
Some simplifications and relief provided

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Revenue and expenses

Statement of Comprehensive Income

	20x1
Insurance contracts revenue	X
Incurred claims and expenses	(X)
Underwriting result	X
Investment income	X
Interest on insurance liability	(X)
Net interest and investment	X
Profit or loss	X
Effect of discount rate changes on insurance liability	(X)
Total comprehensive income	XX

Revenue

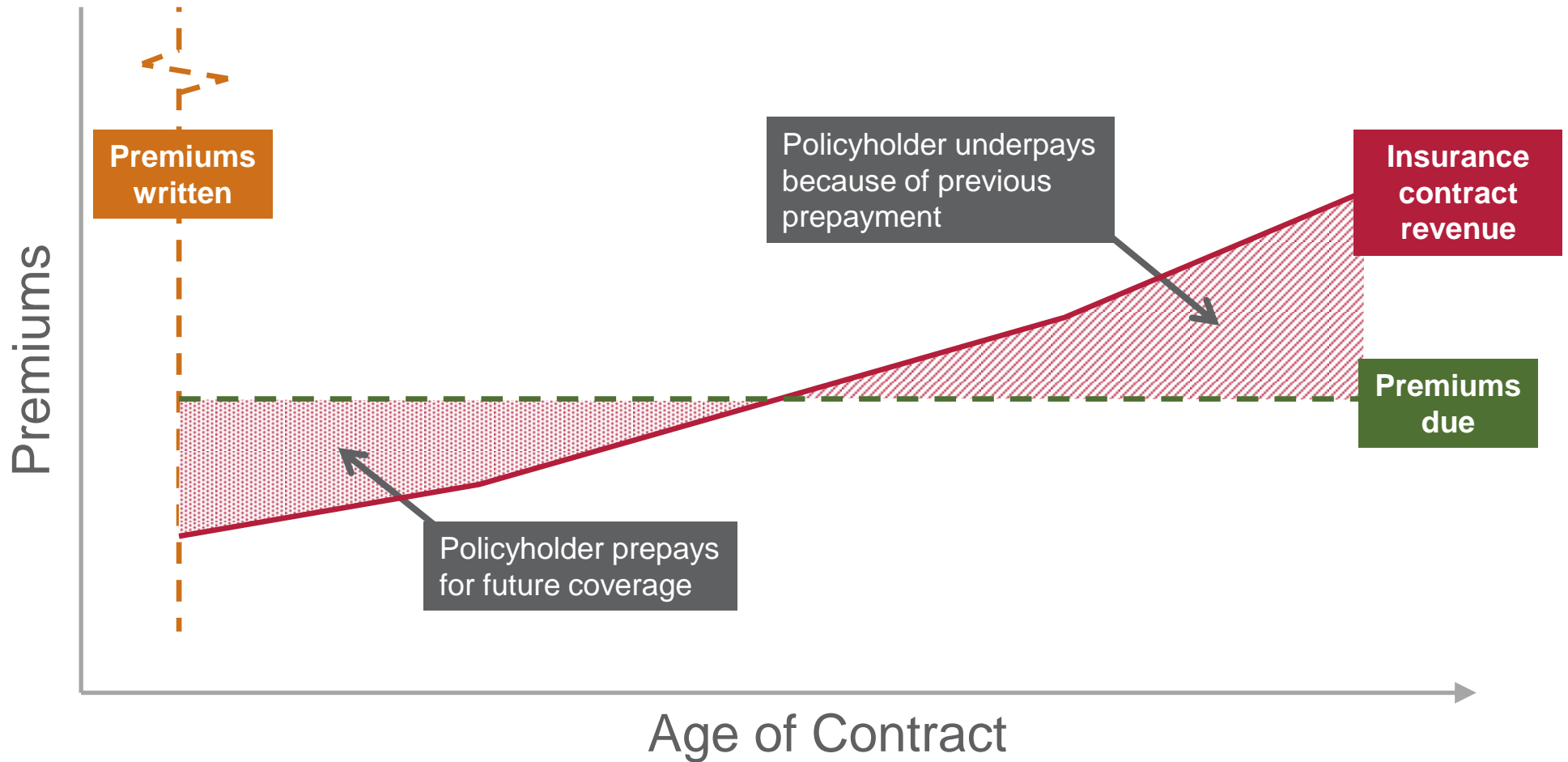
- Consistent with commonly understood notions of Revenue
- Reflects revenue earned from fulfilling obligations under contract
- Excludes deposit-like amounts

Expenses

- Consistent with commonly understood notions of expenses
- Reflects the costs incurred to provide services
- Reflects any changes in expectations for past services and when the contract is onerous
- Excludes deposit-like amounts

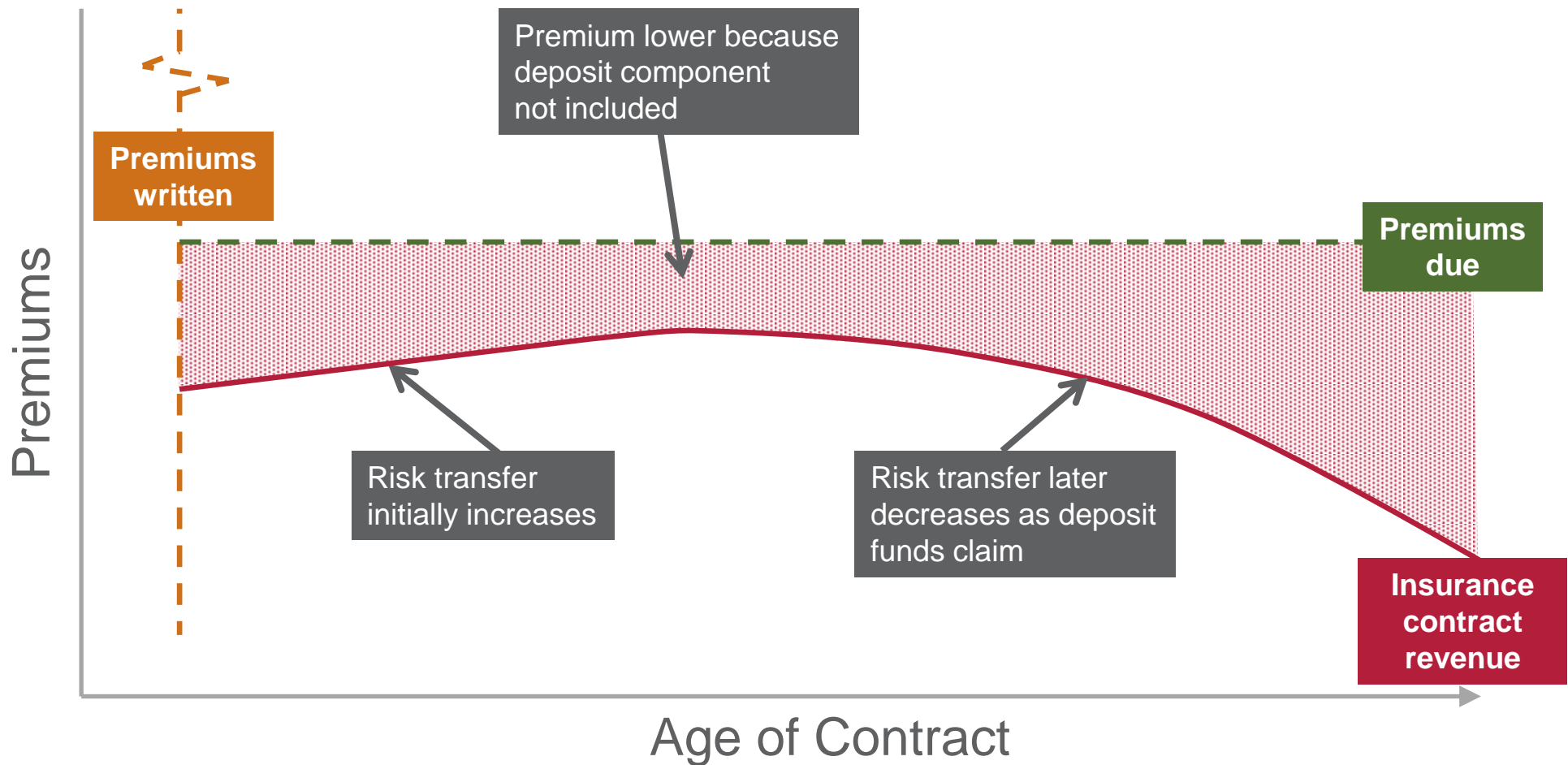
Example

Level premium term life product

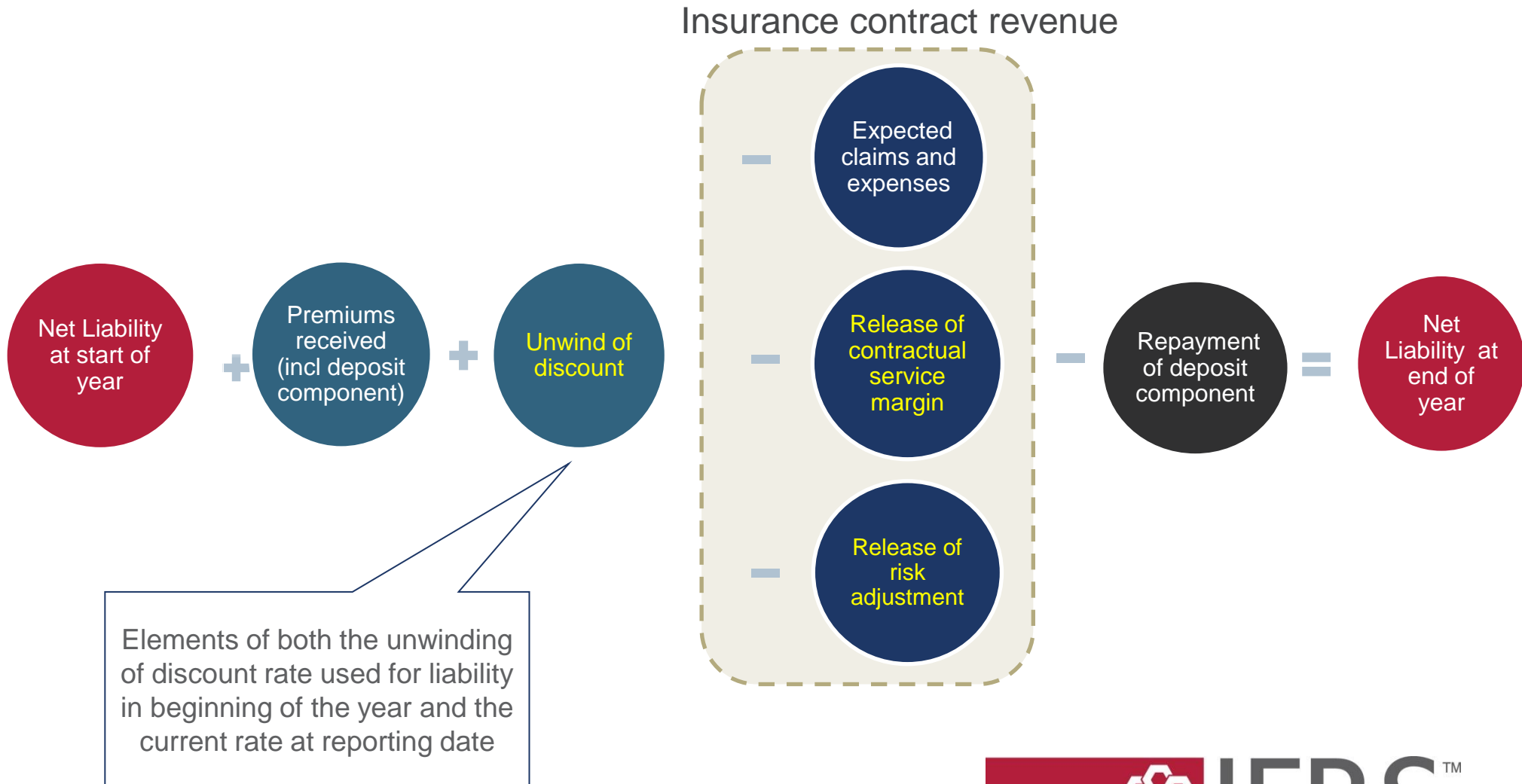


Example

Level premium term life product with deposit



Changes in insurance contract liability

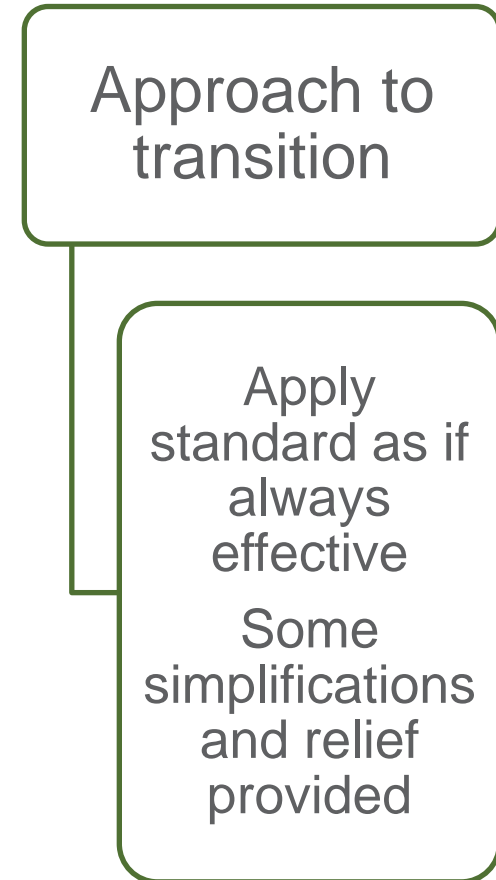
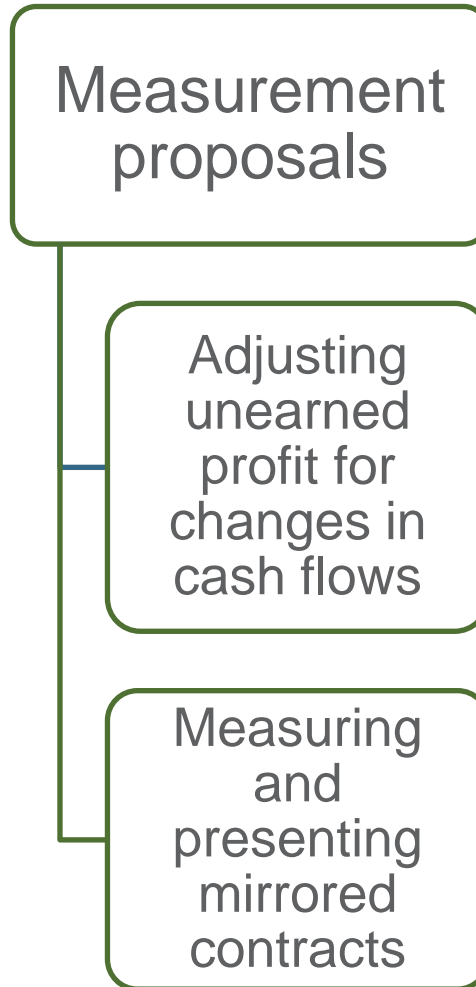
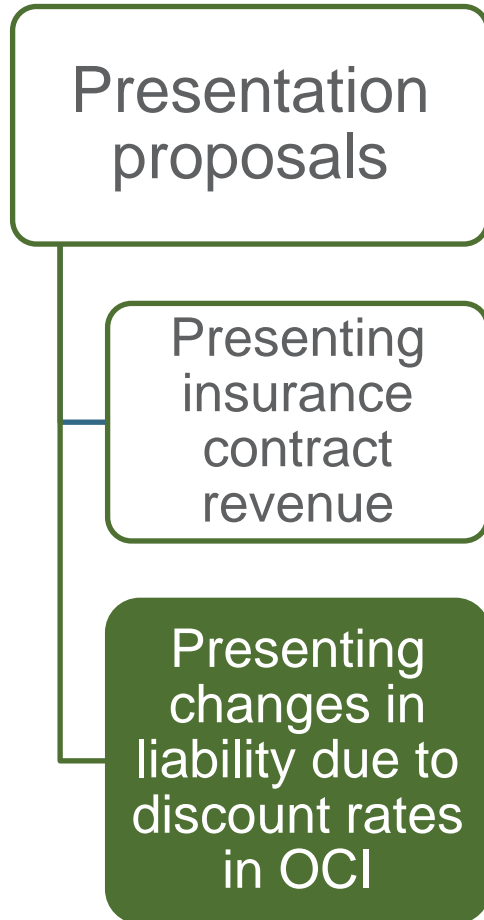


Things to consider

Revenue

- Data considerations
 - Based on building block approach
 - Limited additional data(?)
- Computational considerations
 - Not generally calculated
 - Splitting cash flows assumptions for deposit products
- Benefits
 - Consistent with other forms of revenue
 - Usefulness?

Targeted issues



Two views of performance

Statement of Comprehensive Income

	20x1
Insurance contracts revenue	X
Incurred claims and expenses	(X)
Underwriting result	X
Investment income	X
Interest on insurance liability	(X)
Net interest and investment	X
Profit or loss	X
Effect of discount rate changes on insurance liability	(X)
Total comprehensive income	XX

Net profit or loss
reflects the performance of providing services using a cost view of the time value of money (ie reflecting time value at inception)

- OCI**
- Reconciles both
 - Reflects amounts that self reverse

Total comprehensive income
reflects the performance of providing services using a current view of the time value of money

Two views of performance

- Principle
 - Profit and loss represents unwind of original discount rate
 - OCI presents changes in discount rate
- Rationale
 - All else equal, actual cash flows don't change when rates do
 - Valuation of cash flows does however change
 - Valuations changes are thus 'self reversing'
- Issues to consider
 - Need to 'split' valuation
 - Need to track original discount rates

Things to consider

OCI

- Data considerations
 - Tracking original discount rate
 - Splitting interest rate assumptions from interest sensitive assumptions
- Computational considerations
 - Splitting interest calculations
 - Different calculations for different ‘cohorts’
 - Hedging practice
- Benefits
 - Eliminates volatility?
 - Separately presents ‘reversing’ changes

Targeted issues

Presentation proposals

Presenting insurance contract revenue

Presenting changes in liability due to discount rates in OCI

Measurement proposals

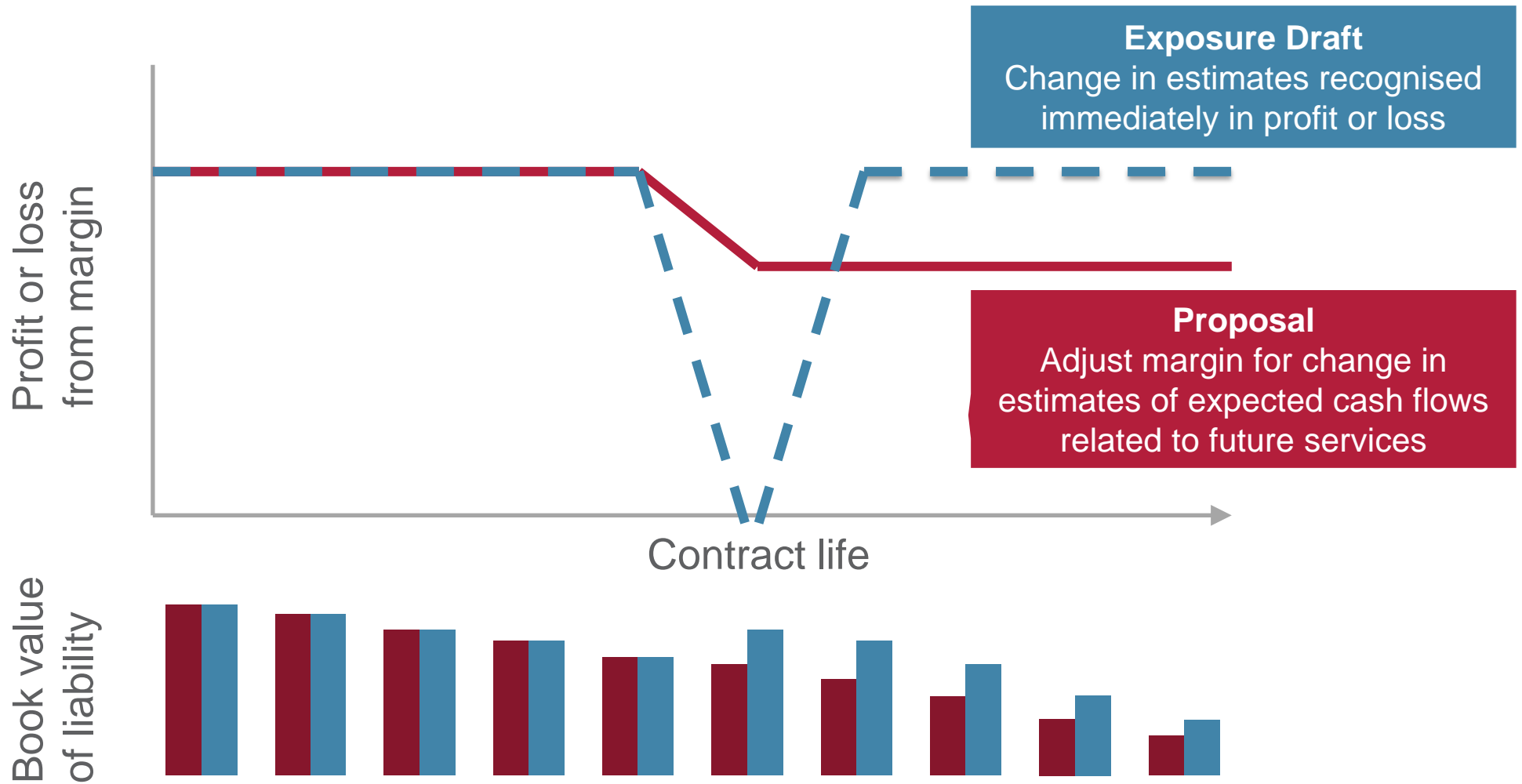
Adjusting unearned profit for changes in cash flows

Measuring and presenting mirrored contracts

Approach to transition

Apply standard as if always effective
Some simplifications and relief provided

Unlocking margin



Things to consider

Unlocked margin

- Data considerations
 - Tracking historic adjustments
 - Identification of loss scenarios
- Computational considerations
 - Splitting experience adjustments from future adjustments
 - Potential separate calculations per group
 - Accretion of interest
- Benefits
 - Eliminates volatility
 - Profit recognition

Targeted issues

Presentation proposals

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Approach to transition

Apply standard as if always effective
Some simplifications and relief provided

- No economic mismatch when contract specifies link and cash flows vary directly with those underlying items
- Example:
 - Contract promises policyholder 85% of returns on underlying pool of assets (Cash flows A)
 - Contract promises benefits in case of loss (Cash flows B)
- Measure contract as follows
 - Cash flows A measured consistent with underlying
 - Cash flows B accounted in accordance with standard
 - Market-consistent reporting for options and guarantees

Things to consider

Mirroring

- Data considerations
 - Separating cash flows:
 - Cash flows that vary directly with underlying items
 - Cash flows that vary indirectly with underlying items
- Computational considerations
 - Splitting current value calculations
 - Defined calculation method
 - Stochastic vs market value calculations
- Benefits
 - Eliminates volatility

Targeted issues

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Approach to transition

Apply standard as if always effective
Some simplifications and relief provided

- Apply requirements of proposed standard as if it had always been effective for existing contracts:
 - Introduce some simplifications and relief to assist in transition
 - Discount rate at inception
 - The risk adjustment
 - Changes in estimates of certain cash flows
- Option to redesignate certain financial assets on application of new standard

Things to consider

Transition

- Data considerations
 - Historical data
 - Reliability of sources of data
 - Acquisitions
 - Auditability
- Computational considerations
 - Recalculation effort
 - One time system costs
- Benefits
 - Eliminates volatility

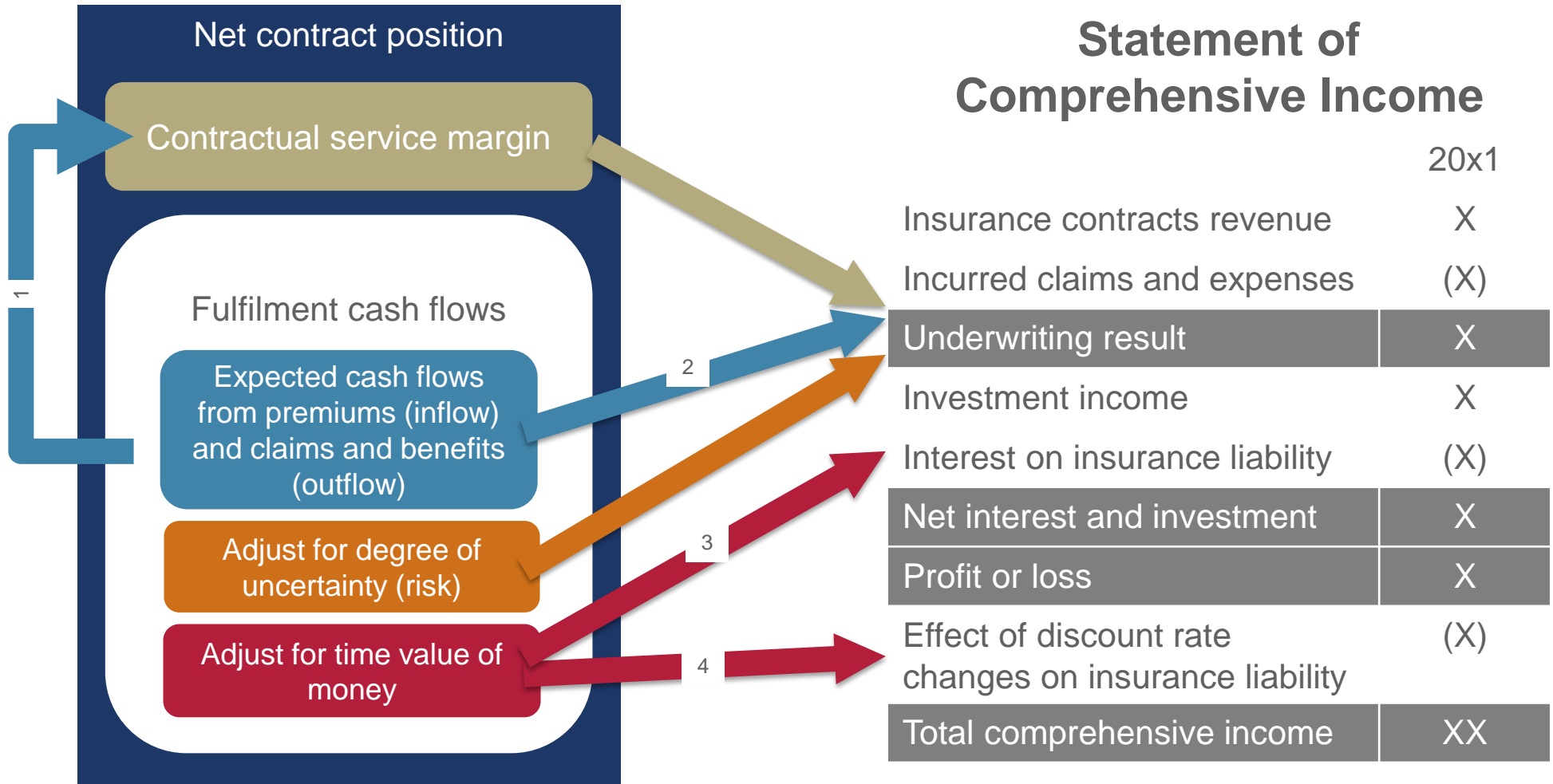
Thank you

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questions or comments
expressions of individual views
comments
question
expressions of individual views
questions and viewpoints
feedback and comments

Appendix

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...leading to information about underwriting margin



Residual margin

Risk adjustment

Time value of money

Cash flows

Profit for the provision of services for the period

Statement of Comprehensive Income

	20x1
Insurance contracts revenue	X
Incurred claims and expenses	(X)
Underwriting result	X
Investment income	X
Interest on insurance liability	(X)
Net interest and investment	X
Profit or loss	X
Effect of discount rate changes on insurance liability	(X)
Total comprehensive income	XX

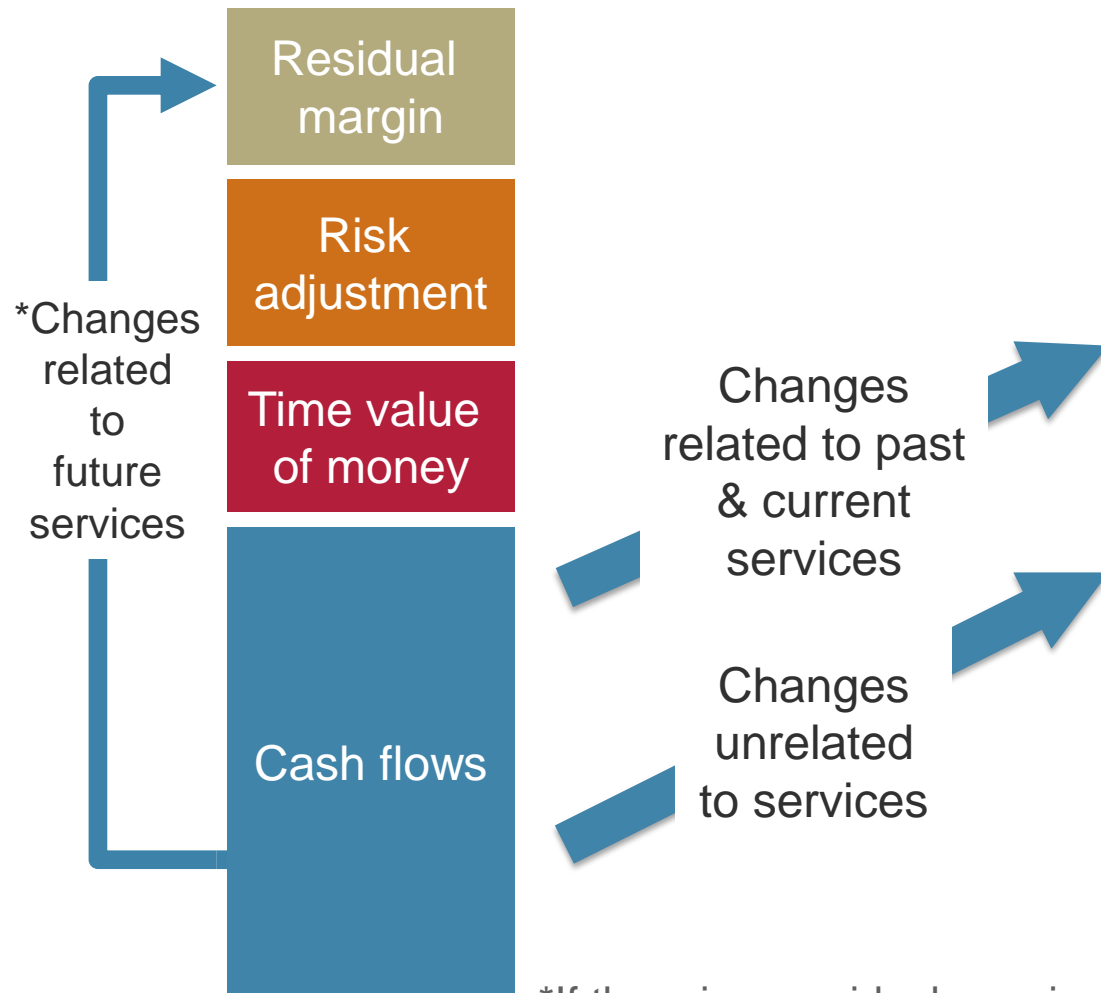


Changes in the quantity and price of uncertainty

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Reporting underwriting results



*If there is a residual margin

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Reporting underwriting results



Changes related to past current & future services

Changes unrelated to services

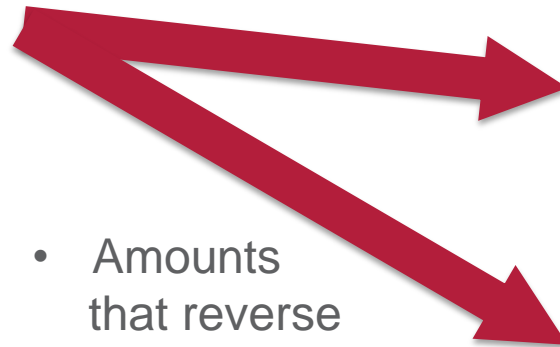
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*If there is a **no** residual margin



- Cost view of the time value of the money
- Reflects the investment returns provided to the policyholder (if any)



- Amounts that reverse
- Allows reconciliation of cost and current view of time value

Statement of Comprehensive Income

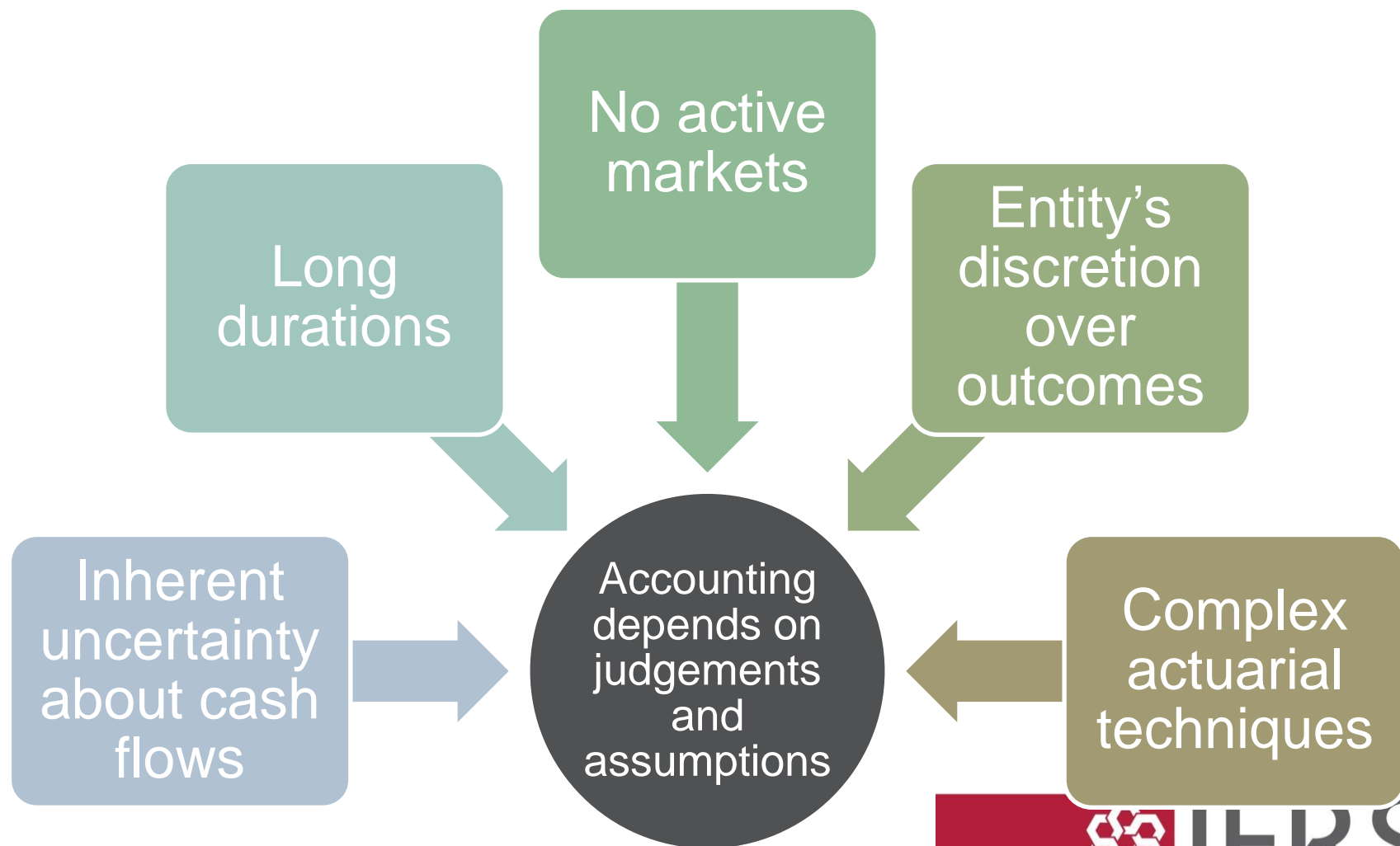
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Balance sheet	<ul style="list-style-type: none">• Simplifications<ul style="list-style-type: none">• Measurement during the coverage period• Discounting expedients
Statement of Comprehensive Income	<ul style="list-style-type: none">• Consistent with Revenue Recognition principles/ notions and also with building block approach• Current practice for non-life contracts
Disclosures	<ul style="list-style-type: none">• Relief from some disclosures

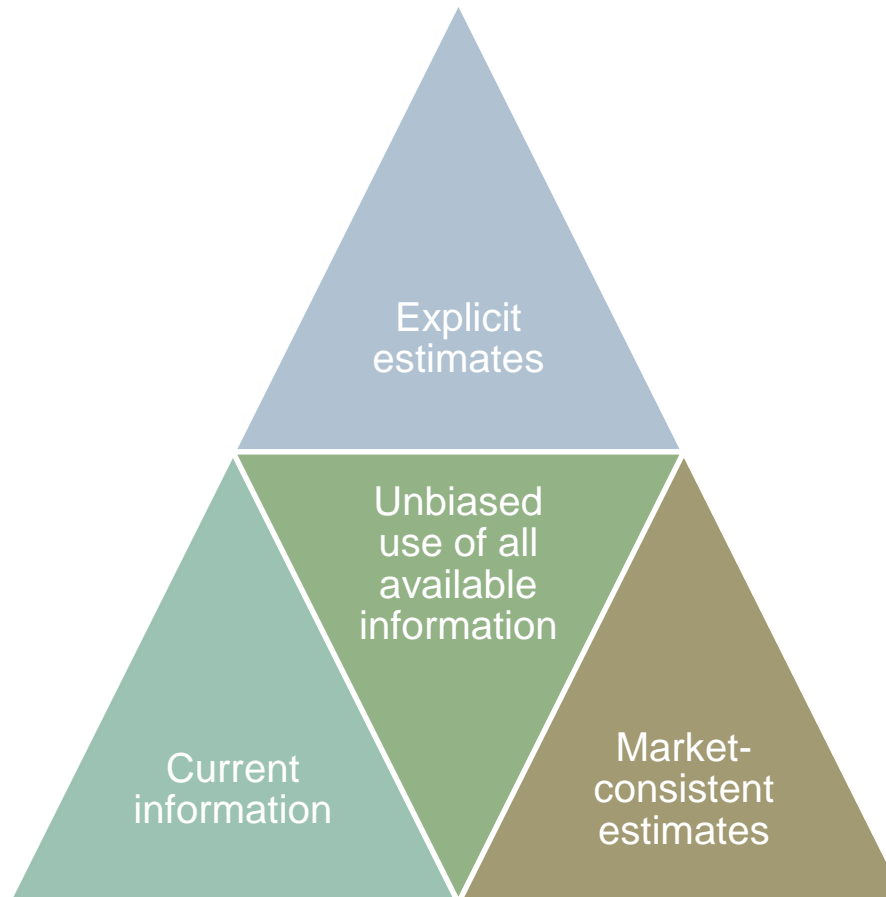
Judgements and estimates

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Characteristics of insurance contracts leads to subjectivity



Relevant information may not be verifiable



Comprehensive disclosures

Amounts

Expected present value of future payments & receipts

Changes in risk during the period

Changes in unearned profit during the period

Effects of new contracts written in period

Judgements

Processes for estimating inputs and methods used

Effect of changes on methods and inputs used

Explanation of reason for change, identifying type of contracts affected

Risks

Nature and extent of risks arising from insurance contracts

Extent of mitigation of risks arising from reinsurance and participation features

Quantitative information about exposure to credit, market and liquidity risk

Information provided by the proposals

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What will the balance sheet show?

Statement of Financial Position

20x1

Assets

Reinsurance assets

X

Other assets

X

Total assets

XX

Liabilities

Insurance contract liabilities

X

Other liabilities

X

Total liabilities

XX

Equity

X

Total equity and liabilities

XX

Reinsurance assets measured consistently with insurance liabilities

Other assets measured consistently with other IFRS entities

Insurance liabilities reflect:
Current information about amount, timing and uncertainty of all expected cash flows
Expected profit to be earned

Other liabilities measured consistently with other IFRS entities

What will revenue and expenses show?

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What will underwriting result show?

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Underwriting result reflects:

- Changes in measurement of uncertainty.
- Profit(loss) for services provided in the period
- Changes in cash flows for past services

What will net profit or loss show?

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Net spread

- Investment income reported applying other IFRS (not within the scope)
- For services provided, the cost view of the time value of the money
- Reflects the investment returns provided to policyholders, if any

Underwriting result + Net spread = Net profit or loss

Two views of performance

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