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Emerging Risks... Daring Solutions

IFRS Project – Insurance Contracts

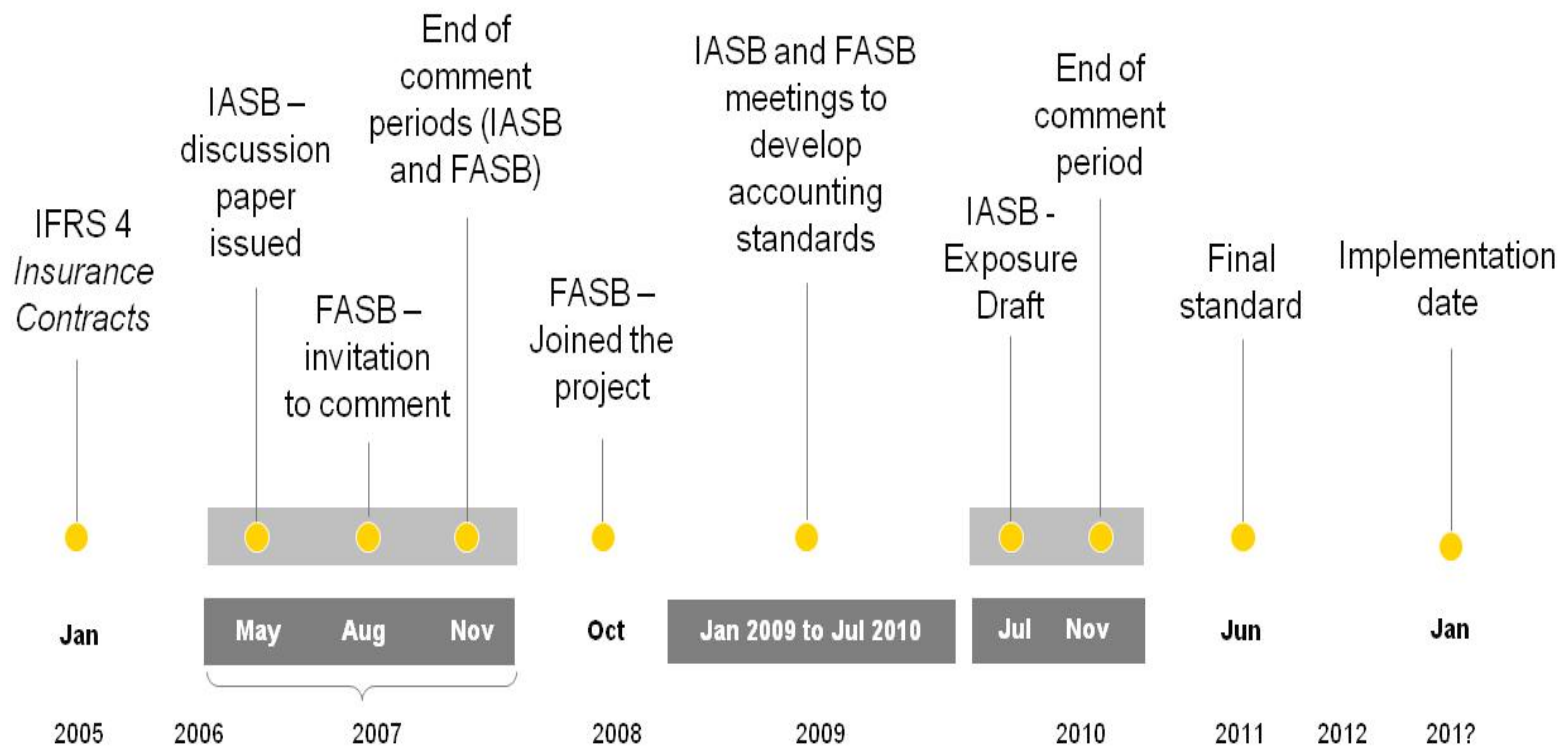
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IFRS Insurance Contracts Project

Project timelines



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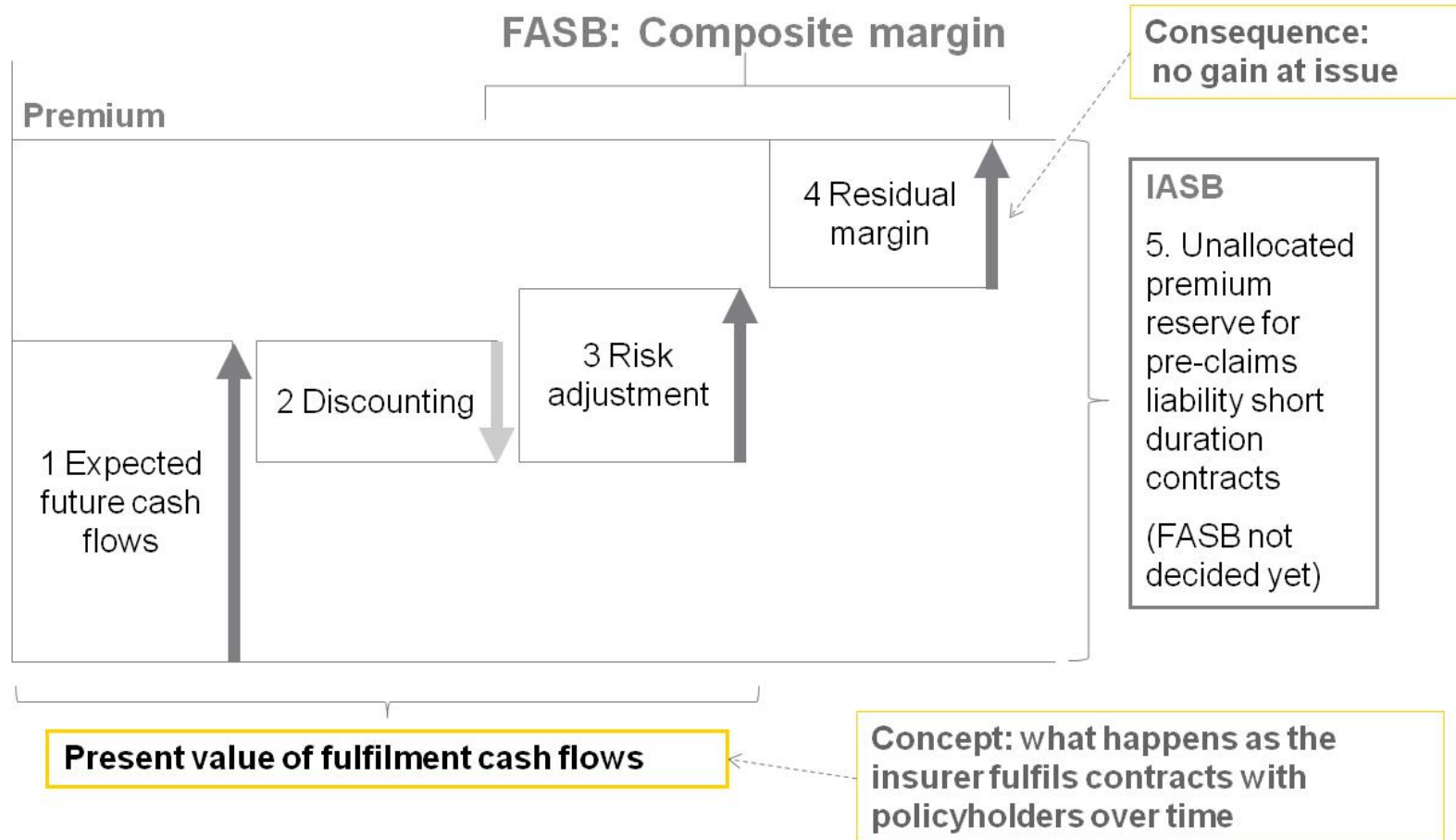
Overview

- Single model for all types of insurance contracts
 - A ‘building block’ approach to measuring insurance liabilities
- A margin approach to reporting performance (income statement)
 - Modification for some short-duration contracts
 - Character of non-life reporting retained but significant changes too (e.g. claims discounting and interest accretion)
- Implementation will be complex, but other projects can be leveraged
 - Economic capital
- Adoption of IFRS 9
 - A ‘big bang’ change for insurers



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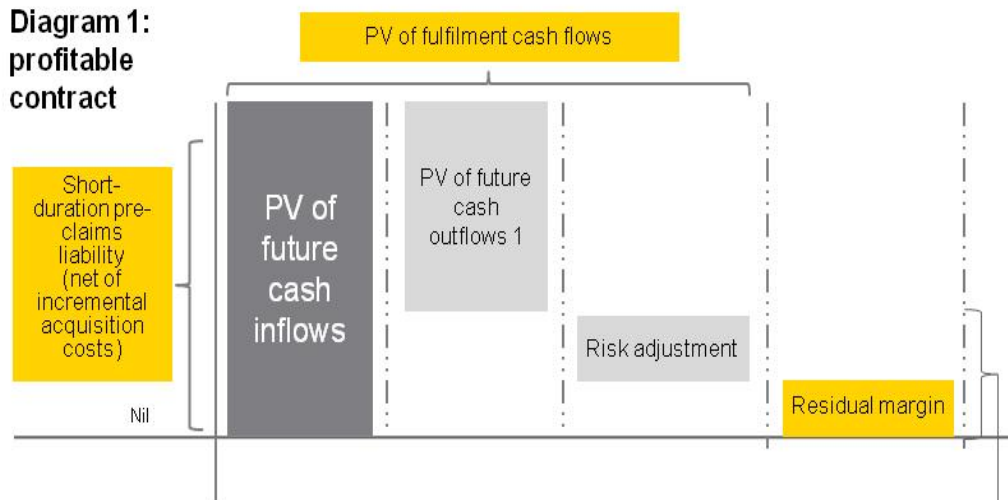
Building blocks



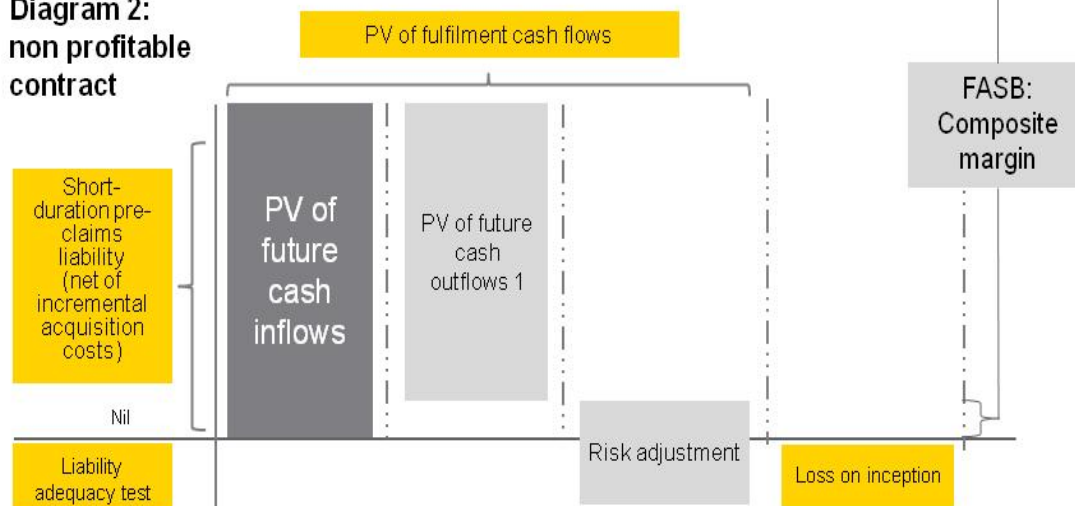
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How does it work?

**Diagram 1:
profitable
contract**



**Diagram 2:
non profitable
contract**



Cash inflows

- ▶ Premiums, including initial premiums and future premiums within contract boundary
- ▶ Potential recoveries (e.g., salvage and subrogation)

Cash outflows

- ▶ Payments to (or on behalf of) policyholders, including payments in kind and IBNR
- ▶ Claim handling costs
- ▶ Cash flows that will result from options and guarantees embedded in the contract
- ▶ Payments to policyholders as a result of a contractual participation term
- ▶ Transaction-based taxes and levies (VAT, premium tax)
- ▶ Incremental costs of selling, underwriting, and initiating successful insurance contracts
- ▶ Policy administration and maintenance costs

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Income Statement- Margin model

Summarized margin- overview	
(A 1) Risk adjustment	
(A 2) Residual Margin	
Underwriting Margin	
(B) Losses on initial recognition	
(C) Experience adjustment	
(D) Changes in estimates	
(E) Interest on insurance liability	
(F) Investment income	
Profit	

- ▶ Premium, claims and expenses are deposit accounted
- ▶ Change in estimates flow through income statement
- ▶ Investment income included in income statement
- ▶ Short-duration contracts
 - ▶ Premiums, claims and expenses can still be shown in the income statement



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Comment letters- Key observations

- IASB received 247 comment letters
- Discount rate
 - Interaction with IFRS 9- ED perceived as push towards ‘current – current’
 - Concerns about volatility of earnings (credit spreads, duration mismatches)
 - Responses provide a number of alternatives (eg OCI, ‘locked-in’ rate)
- Residual margin
 - Generally a preference for using it as an ‘absorber’
- Cash flows
 - May be too limited on some aspects (acquisition costs, overhead)
 - Health insurance- contract boundary too broad
- Risk Adjustment
 - Concerns on how to estimate it (reliability, techniques, diversification)



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Comment letters- Key observations (continued)

- Modified measurement for short-duration contracts
 - Generally supported, but further simplification requested
 - Most prefer it as an option
- Presentation- summarised margin model
 - Concerns about usefulness- premiums and claims are not shown in the income statement
- Transition
 - Strong disagreement with not having a residual margin on transition
- Timing and implementation
 - Final standard- June 2011 deadline realistic?
 - Effective date
 - Alignment with IFRS 9



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Recent developments and next steps

- IASB's target for final standard: still June 2011
- FASB recently affirmed commitment to work jointly on a converged accounting standard
- Boards commenced re-deliberations based on responses to ED/DP
- February 2: Acquisition costs
 - Move towards portfolio-level, but with a number of issues to come back
- February 14/18: various key topics on the agenda
 - Project assumptions, discount rate, risk adjustment, cash flows, discounting of claims liabilities, day one gains and losses.
- With many more meetings to come over the next few months



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