

IASC Foundation
IFRS Conference

Wednesday 23 and Thursday 24 June 2010
Hilton London Metropole, United Kingdom

Special Interest Workshop

IFRS for Insurance Contracts

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Chair:
WARREN MCGREGOR
Member
IASB

IASC Foundation
Special Interest Session

IFRSs for Insurance Contracts

24 June 2010—at the Hilton London Metropole (United Kingdom)

Programme

13:00 ***Registration***

14:00 ***Introduction***

Warren McGregor

Member

IASB

14:05 ***Technical update***

Peter Clark

Director of Research

IASB

14:35 ***Preparer's Perspective***

Hugh Francis, *Director of External Reporting Developments, Aviva plc*

15:10 ***Analyst's Perspective***

Rob Jones, *Managing Director, Standard & Poor's*

15:45 ***Round-table Q&A***

Chair:

Warren McGregor, *Member, IASB*

Panellists

- Peter Clark, *Director of Research, IASB*
- Hugh Francis, *Director of External Reporting Developments, Aviva plc*
- Rob Jones, *Managing Director, Standards & Poor's*

16:25 ***Concluding comments***

Warren McGregor

Member

IASB



IASB/FASB project on Insurance Contracts

A technical update

Peter Clark, Director of Research

IASB Foundation

The views expressed in this presentation are those of the presenter, not necessarily those of the IASC Foundation or the IASB



Agenda

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IASB project on Insurance Contracts

- Project basics
- (Tentative) Decisions reached
 - Measurement model
 - Recognition
 - Presentation and disclosures



Project basics

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Project history

- IFRS 4 *Insurance Contracts*
 - started in 1997
 - standard issued in 2004 ('Phase I')
 - aimed at making only limited improvements
- Discussion Paper *Preliminary Views on Insurance Contracts* ('Phase II')
 - issued in 2007
 - further discussed since early 2008
 - 162 comment letters received



Project basics continued

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- FASB
 - joint project since 2008
 - intensified efforts
- Due process documents
 - Exposure Draft: expected for Q3 2010
 - Standard: expected for Q2 2011



Related projects

- Financial Instruments
 - Classification and measurement
- Revenue Recognition
 - Contracts with customers
- Liabilities (Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*)
 - Measurement of uncertain liabilities



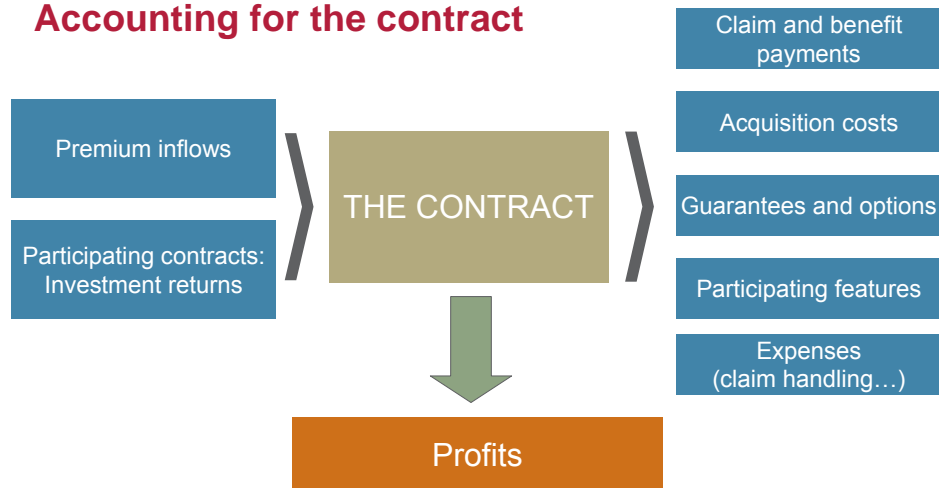
Scope of the project

- Accounting for insurance contracts
 - The contract
 - Combination of rights and obligations
 - Presented on a net basis
 - One model for all insurance types
 - Not about the insurer's other assets or liabilities
 - For the time being: not policyholder accounting



Project basics continued

Accounting for the contract



(Tentative) Decisions reached

overview

- Measurement model
 - inputs and estimates
 - building blocks
- Recognition
 - acquisition costs
 - contract boundaries
 - participating contracts
 - unbundling
- Presentation and disclosures



Measurement model

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- Current measurement of an insurance contract
 - remeasured each reporting period
 - not locked-in
 - not updated for own credit risk
- Reflect insurer's fulfilment of the contract
- Building block approach
 - Four (or three) building blocks
- No deposit floor



Measurement model continued

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Inputs and changes in estimates

- Inputs
 - Financial market variables: consistent with observable market prices
 - Other variables: use all available information
 - unbiased
- Changes in insurance liabilities
 - profit or loss



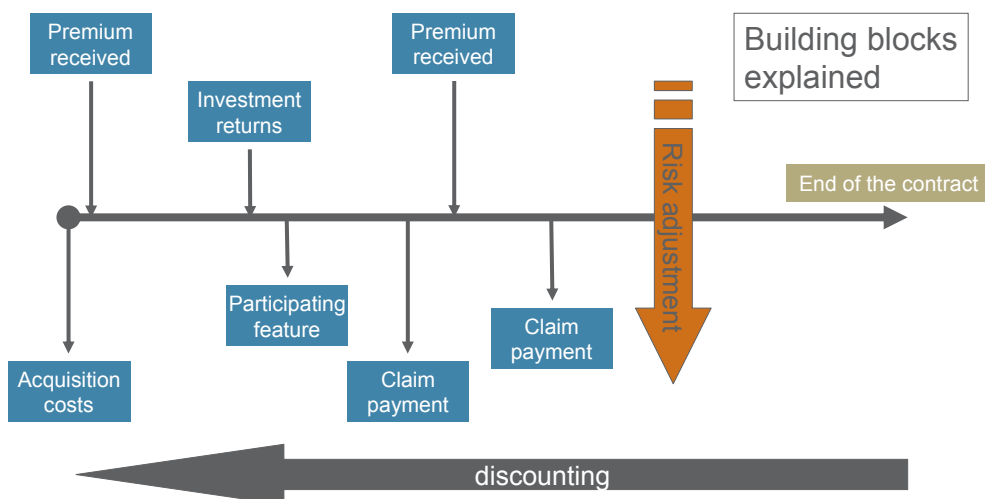
Building blocks

- Expected (probability-weighted) future cash flows
- Time value of money
- Margin
- Amount to eliminate 'day-one gains'

- 'Day-one losses' are recognised in profit or loss



Building blocks explained



Expected (probability-weighted) future cash flows

- current estimates
- expected to arise as the insurer fulfils the contract
- scenario based
- policyholder behaviour/ future premiums
 - ‘Looking through’ options



Time value of money

- Discount rate:
 - Reflecting characteristics of the insurance contract
 - Non-participating: risk-free plus adjustment for illiquidity
 - Participating: consider performance of assets
- Excluded: non-performance risk



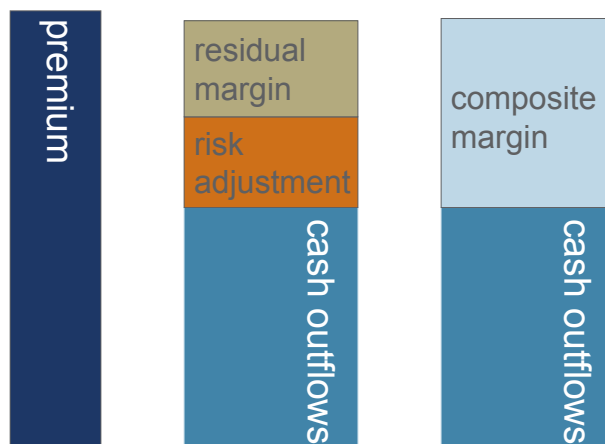
Margin

- Two approaches:
 - Risk adjustment and residual margin
 - (explicit) risk adjustment plus an amount that eliminates 'day-one gains'
 - Composite margin
 - amount that eliminates 'day-one gains'



Margin continued

Two approaches considered



Risk adjustment [IASB]

“The maximum amount an insurer would rationally pay to be relieved of the risk”

- Measures the effects of uncertainty associated with future cash flows
 - insurer’s view of uncertainty
- Remeasured each reporting period
- Measured at portfolio level
- Permitted measurement techniques



Residual margin [IASB]

- Allocation of ‘day-one gain’
- ‘Day-one loss’ exists when:
cash inflows < cash outflows + risk adjustment

Premium received 12



Expected claim payments 10

Risk adjustment 3

- Releasing it to profit or loss over the coverage period in a systemic way
 - passage of time, or
 - pattern that better reflects the occurrence of benefits and claims



Composite margin [FASB]

- Allocation of 'day-one gain'
- 'Day-one loss' exists when:
cash inflows < cash outflows

Premium received 12 < Expected claim payments 13

- Subsequent release to profit or loss
 - over coverage period plus claims handling period
 - amortisation according to the exposure from
 - providing insurance coverage
 - uncertainties related to future cash flows



Simplified approach

- Premium allocation model ('unearned premium')
- Required application
 - pre-claims liability for short-duration contracts



Recognition

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Recognition

- At the earlier of
 - the insurer being on risk to provide insurance coverage
 - the signing of the contract



Recognition continued

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Acquisition costs

- Expense when incurred
- IASB:
 - At inception exclude from the residual margin an amount equal to the incremental acquisition costs
- FASB:
 - Not recognise any revenue (or income) at inception



Contract boundaries

- Where does an 'existing contract' end?
- Existing contract ends if insurer
 - is no longer required to provide coverage, or
 - can reassess the risk for a particular policyholder and change the pricing accordingly



Participating contracts

- Cash flows from participating features
 - cash flows like any other (IASB)
 - recognise only to the extent a legal or constructive obligation exists (FASB)
- Mutual insurers?



Unbundling

- Account for components of a contract as if they were separate contracts
- Basis: significant interdependence between components (to be further refined)
- Required:
 - Account-driven contracts
 - Some embedded derivatives
 - IASB: existing bifurcation guidance (IAS 39)
 - FASB: interdependence (future insurance standard)
- Not permitted otherwise



Reinsurance

- One model for all insurance and reinsurance contracts
 - No anti-abuse rules necessary
- Cedant: same measurement as used for underlying direct insurance contracts
 - Follow-up (initial measurement, impairment)
- No offsetting
 - unless requirements for offsetting are met
- No derecognition of ceded contracts
 - unless obligation is discharged, cancelled or expired



Derecognition

- When the insurance liability no longer qualifies as a liability
 - IASB: Derecognition principle from IAS 39
 - FASB:
 - no longer on risk
 - no longer required to transfer economic resources for that obligation



Presentation of Income Statement

- Rejected model that recognises revenue on the basis of written premiums
- Measurement approach should drive presentation
- Staff will develop margin approach



Presentation and disclosures continued

Presentation example

	<i>Inception</i>	<i>six months</i>	<i>six months</i>
	<i>1 Jan</i>	<i>to 30 Jun</i>	<i>to 31 Dec</i>
Revenue		123	125
Policyholder benefits		(50)	(65)
Expenses		(40)	(40)
Release of benefits/expenses accrued in previous periods		0	20
Insurance margin		33	39
Experience adjustments		(10)	(10)
Changes in estimates		(20)	0
Acquisition costs	0		
Net gain at inception	0	0	0
Investment income		40	38
Interest on insurance liability		(25)	(23)
Net interest and investment	0	15	15
Profit	0	19	44



Presentation and disclosures continued

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Disclosures

- Disclosure principle aims at
 - explaining **the amounts** recognised in the financial statements arising from insurance contracts; **and**
 - **the nature and extent of risks** arising from those contracts.
- Auditable information about effectiveness in risk management practices (vs. non-audited MD&A info)
- Risk disclosures similar to IFRS 7
 - Sensitivity analyses



Transition - measurement

- At that date determine:
 - the expected present value of cash flows arising from the portfolio of the contracts and
 - a risk adjustment
- Compare with the amount recognised according to previous accounting
- Record the difference in retained earnings
- The risk adjustment on transition is treated as risk or composite margin going forward



Transition – other issues

- Redesignation of financial assets
 - permitted
 - measured at fair value through profit or loss
 - to reduce inconsistency in measurement or recognition
 - adjustment to retained earnings
- Disclosure exemption
 - previously undisclosed claim development information
 - > 5 years



How do I get in contact?

- Staying up to date
 - www.iasb.org
 - go.iasb.org/insurance_contracts
 - IASB Update
 - Board meeting webcasts
 - Comment on the proposal
- Contacts
 - Peter Clark
Director of Research
email:
pclark@iasb.org
 - Hans van der Veen
Practice Fellow
email:
hvanderveen@iasb.org



Questions or comments?

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Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.





IFRS Conference: London 2010
IFRS for Insurance Contracts – Preparer's perspective

24 June 2010

Hugh Francis
Director of External Reporting Developments, Aviva Plc



- IFRS Phase II is critical for the insurance industry
- The industry has been involved in the debate from the outset
- Strong response on 2007 DP from industry groups, companies and other key stakeholders
- IFRS Phase II is reaching a critical stage as the IASB move towards an exposure draft

Challenging times

- A challenging time for standard setters
- Recent IASB/FASB priorities framed by the financial crisis
- The IASB has an ambitious change agenda
 - Addressing issues arising from the financial crisis
 - Creating a mid-2011 stable platform
 - Potential move by the US to transition to IFRS
- Welcome the IASB/FASB ongoing commitment to address insurance

What does this mean for Insurance Phase II?

- Influence of FASB
- Differences in views are yet to be fully resolved
- The IASB's target of a final standard by 2011 remains a challenge
- It is difficult to see any effective date before 2014
- Interaction with financial instruments and other developments critical

A single model for life and non-life

Reflect the insurance business model

- Profit recognised in line with release from risk

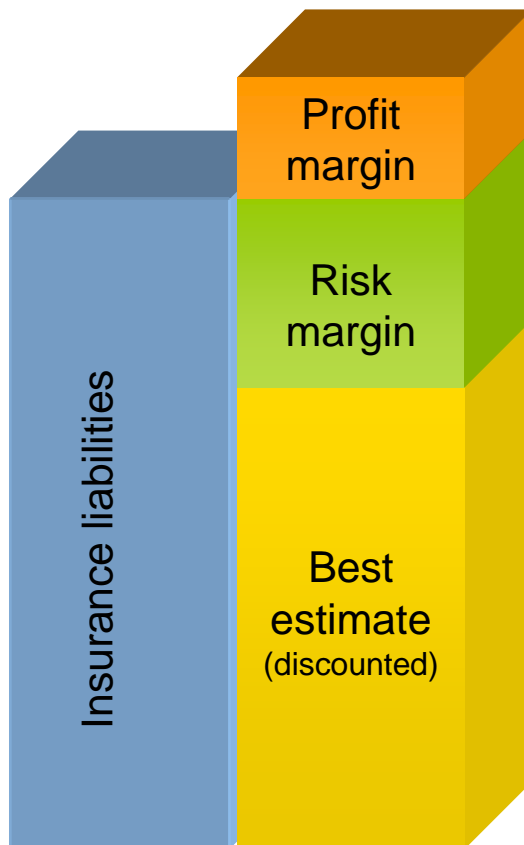
Market consistent valuation of liabilities

- Present value of future cash flows with allowance for risk and uncertainty
- Risk free discount allowing for liquidity, with recognition of options and guarantees

Reflect how insurance companies manage risk

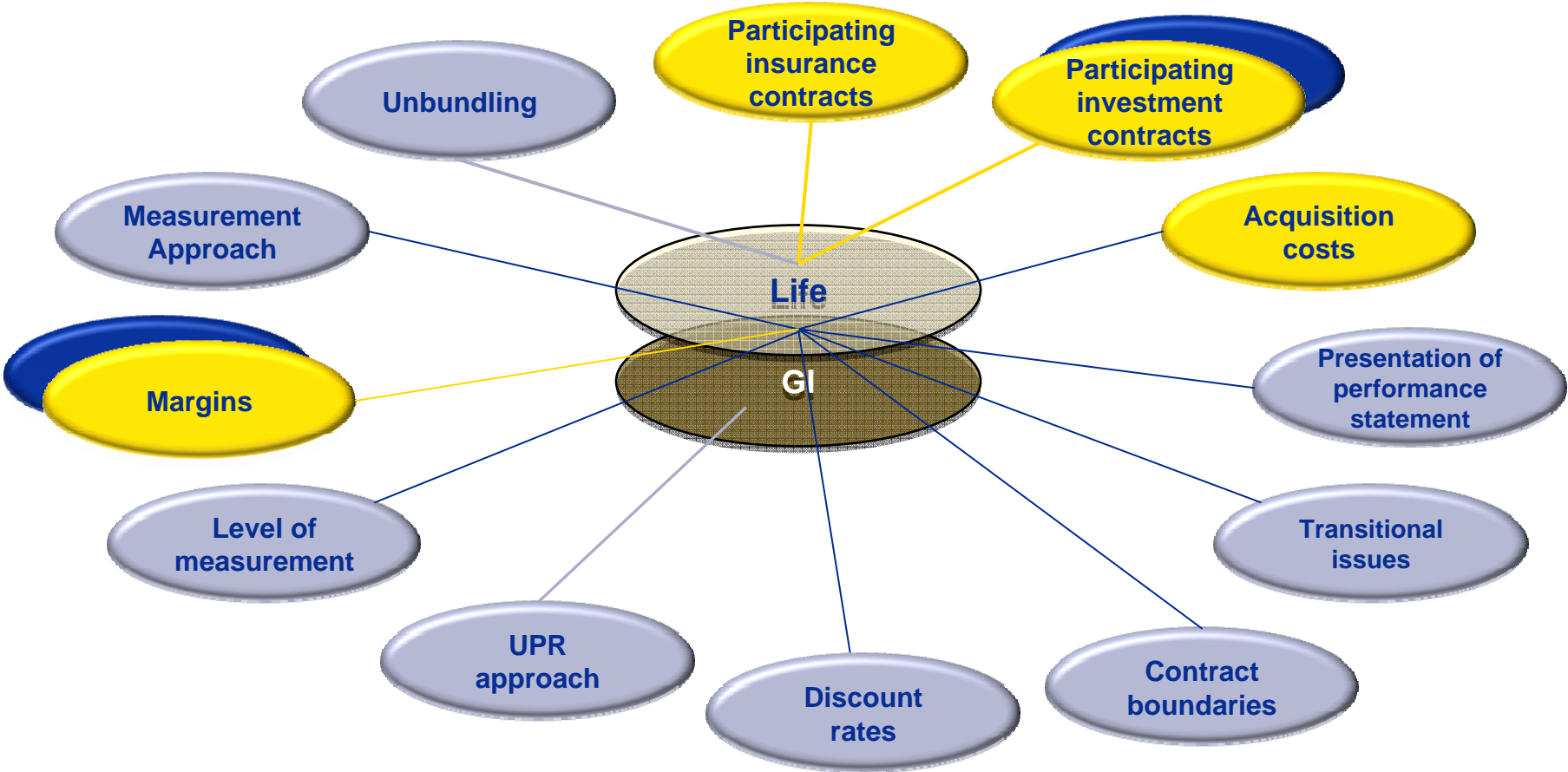
- Liabilities measured on a portfolio basis reflecting policy-holder behaviour
- Assets and liabilities measured on a consistent basis

European Industry perspective of insurance liabilities



- Market consistent fulfilment cost
- Active measurement of insurance liabilities
- No “day one” gain, but recognises profit in line with release from risk
- Insurance liabilities represents best estimate plus margin for risk and uncertainty
- Profit margin should be presented separately within the liabilities section of the balance sheet

Key issues – areas of focus



■ Alternative approaches expected in IASB's ED

■ Different views between IASB & FASB

Non par investments	IFRS 9
Participating Investments	IFRS 4 – IASB FI for FASB
Participating Insurance	IFRS 4 / IFRS 9?
Non participating insurance	IFRS 4 / IFRS 9?

Significant analysis required on potential impact of unbundling

- **Significant Interdependence**
- **“Account Balance” contracts**
- **Is IFRS 9 any more relevant?**

IASB - Payments to policyholders from participating features will be included in the contract liability on the same basis as other expected payments to policyholders

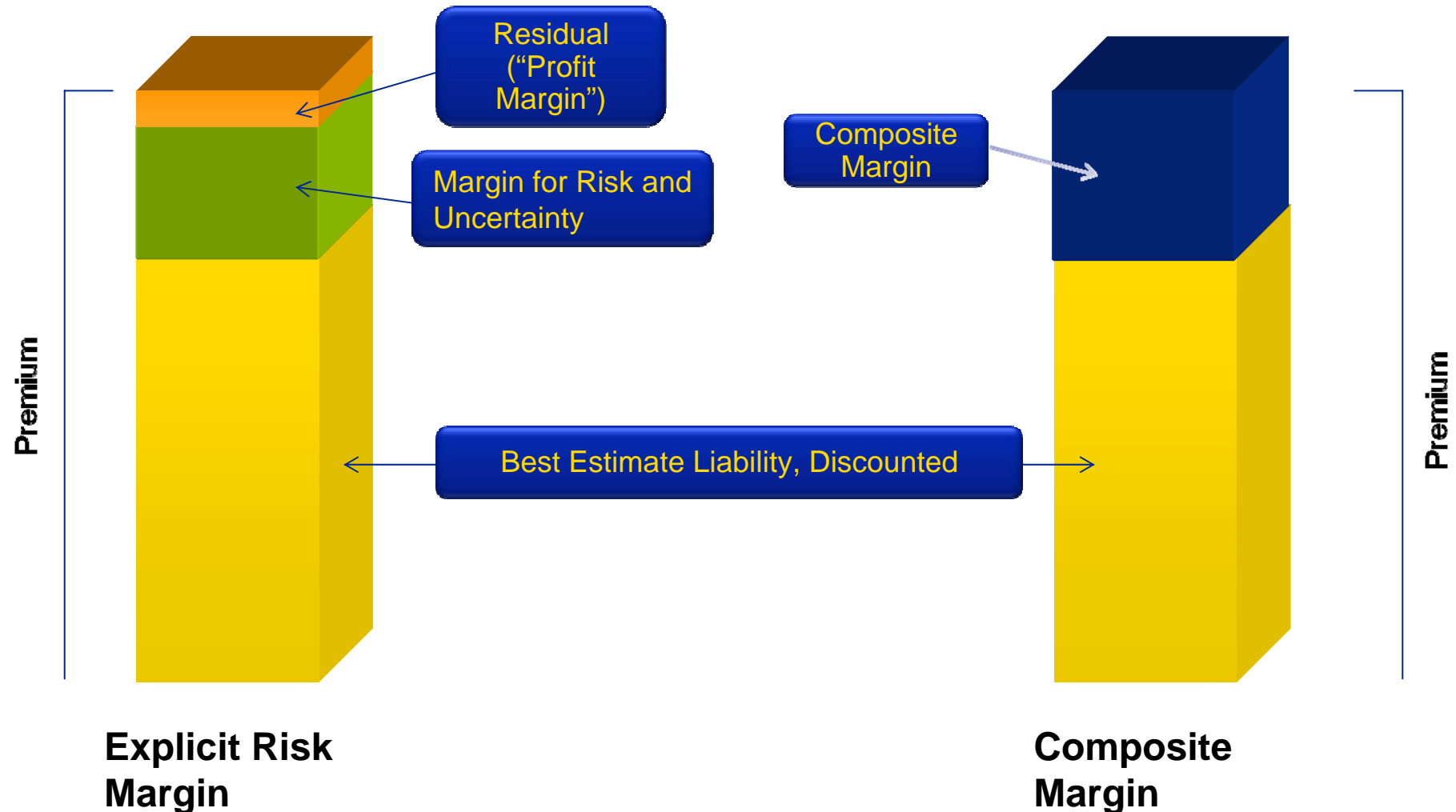
FASB – cash flows only included if a legal or constructive obligation

IASB - Investment contracts with participating features – will fall into the scope of IFRS 4, if the contracts are invested in the same pool of assets as insurance contracts with participating features

FASB – all investment contracts fall under financial instruments

Treatment of participating contracts is a critical issue for most life insurers

Explicit Risk Margin vs. Composite Margin



Explicit Risk Margin

Composite Margin

- For us, the issue is transparency
- Risk is an integral part of our business – hence relevant information for investors
- Profit emergence and liability adequacy
- Treatment of changes in assumptions

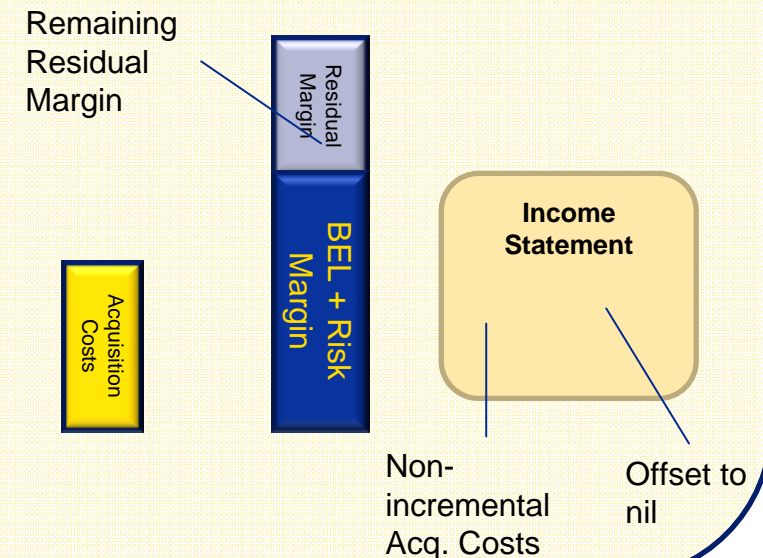
Acquisition Costs



- Under Phase I grandfathered practice, acquisition costs are deferred as an asset,
- Amortised to the income statement



- IASB proposal for Phase II, acquisition costs are expensed to the income statement,
- Incremental costs are matched by recognition of revenue and excluded from the residual margin
- FASB no offset with revenue

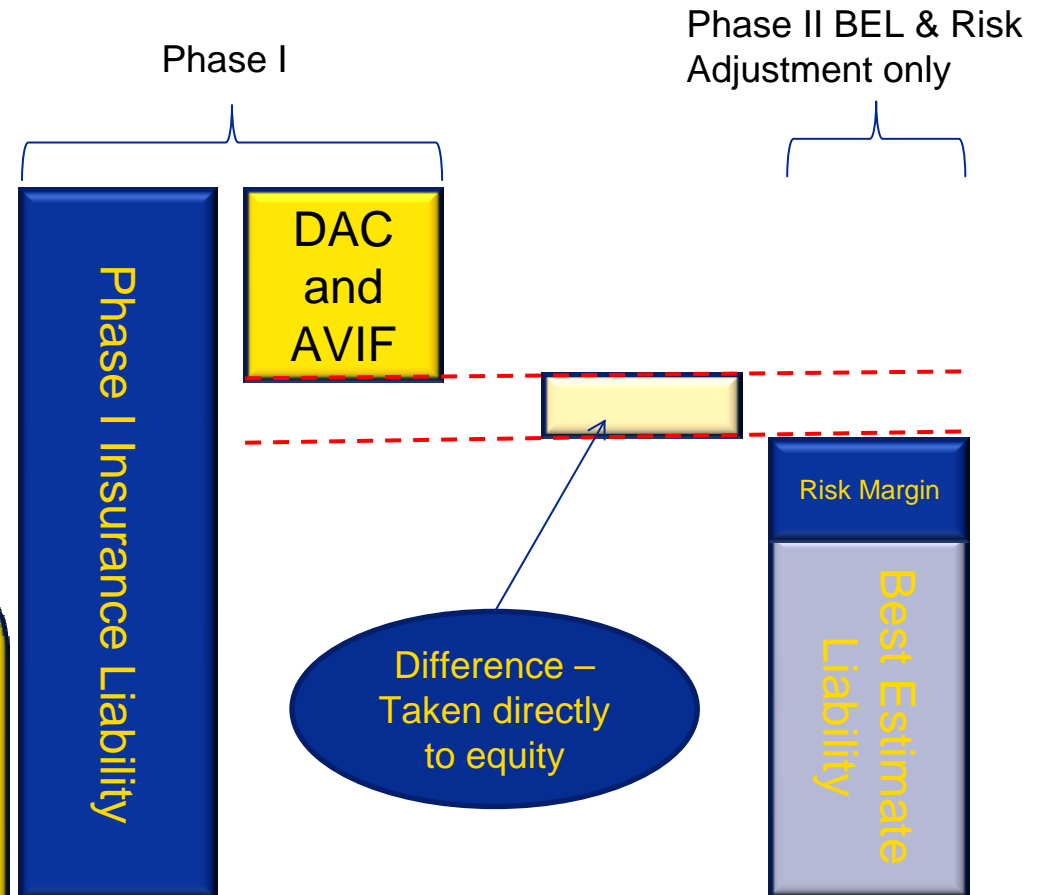


- Support offset of acquisition costs - How will incremental be defined?

Current IASB Proposal:

Post transition Insurance Liability will be on a Phase II basis, excluding risk margin.

The difference between these liabilities and pre transition insurance liabilities, net of DAC and AVIF, will be recognised as a gain or loss directly in equity.



Significant Implications

- Relevant to users? – on transition and ongoing
- Principle should be fully retrospective application
- Unintended impact on market behaviour

Presentation – Examples of Margin approach



Example 1 Summarised Margin presentation

	<i>Inception</i> 1 Jan	<i>six months</i> to 30 Jun	<i>six months</i> to 31 Dec
Risk adjustment		21	26
Residual margin		13	13
Insurance margin	0	33	39
Experience adjustments		(10)	(10)
Changes in estimates		(20)	0
Acquisition costs	0		
Net gain at inception	0	0	0
Investment income		40	38
Interest on insurance liability		(25)	(23)
Net interest and investment	0	15	15
Profit	0	19	44
Balance sheet			
	<i>1 Jan</i>	<i>30 Jun</i>	<i>31 Dec</i>
Cash	1,000	940	63
Insurance liabilities	(1,000)	(921)	
Equity	0	19	63

Example 2 Expanded Margin presentation

	<i>Inception</i> 1 Jan	<i>six months</i> to 30 Jun	<i>six months</i> to 31 Dec
Revenue		123	125
Policyholder benefits		(50)	(65)
Expenses		(40)	(40)
Release of benefits and expenses accrued in previous periods		0	20
Insurance margin		33	39
Experience adjustments		(10)	(10)
Changes in estimates		(20)	0
Acquisition costs	0		
Net gain at inception	0	0	0
Investment income		40	38
Interest on insurance liability		(25)	(23)
Net interest and investment	0	15	15
Profit	0	19	44
Balance sheet			
	<i>1 Jan</i>	<i>30 Jun</i>	<i>31 Dec</i>
Cash	1,000	940	63
Insurance liabilities	(1,000)	(921)	
Equity	0	19	63

IFRS Phase II is nearly here

As preparers we need to step back and consider the proposals holistically

The key questions we are asking:

Do the proposals reflect our business and meet the needs of users?

How will the outstanding differences between IASB and FASB be resolved?

Is Phase II a step forward or a missed opportunity?

Phase II is critical to the future of insurance industry reporting and represents fundamental change

To be a success we need sufficient time to consider the impact on our financial reporting, communication to market and wider issues



A Credit Analyst's Perspective on IFRS for Insurers

IASC Foundation IFRS Conference
London 24 June 2010

Rob Jones
Managing Director

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Agenda

- **User context**
- **Importance of accounting for insurance credit analysis**
- **Usefulness of current financial statements**
- **Phase II issues**

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User Context

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User Context

- **Public information (pi) ratings**
- **Interactive ratings: Rely on public information plus confidential information and dialogue with management**
- **Intensive corporate credit analysis**
- **Ratings on 400 companies in Europe**
- **50 analysts**

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Compared to Other Users

- **Global criteria**
- **Stronger emphasis on balance sheet**
- **Access to confidential information**
 - Typically lower analytical credibility than public and audited information

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Importance of Accounting for Credit Analysis

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Importance of Accounting for Credit Analysis

- **Foundation for communicating financial performance and financial position**
- **Basis of much quantitative analysis**
- **Absolute amounts, derived ratios and trends therein**
- **Peer analysis**
 - Similar insurers
 - Within countries
 - Different countries
 - Similarly rated insurers
 - Any country

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Influence of Accounting on Analysis Categories

Overall rating is a blend of S&P's opinion of:

- 1. Operating performance**
- 2. Capitalisation**
 - Capital adequacy
 - Investments
 - Reserves
 - Ceded reinsurance
 - Quality of capital
- 3. Liquidity**
- 4. Financial flexibility**
- 5. Competitive position**
- 6. Industry risk**
- 7. Enterprise risk management**
- 8. Management and corporate strategy**

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Usefulness of Current Financial Statements

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Usefulness of Current Financial Statements to Analysts

- **Non-life: Reasonable but lack of consistency in, and transparency around, reserving practices**

Our approach: Adjust capital adequacy and results for reserve deficits/surpluses

- **Life: Limited value**

Our approach: Revert to supplementary embedded value information, statutory profit analysis and regulatory returns

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S&P Total Adjusted Capital

Reported equity/surplus	X
Add: Equalisation/catastrophe reserves	X
Add: 50% of life insurance value of in-force (VIF)	X
Add: Hybrid capital	X
Deduct: Goodwill	X
Add/deduct: Over/under reserving	X
Add/deduct: Unrealised gains/losses	X
Total Adjusted Capital	X

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Post IFRS 4 Assessment

- **Better disclosure**
- **Non-life**
 - Eliminated deferred annual/fund accounting
 - Codified unexpired risks/premium deficiency
 - Eliminated investment valuation options
- **Life**
 - Remains poor from a global perspective
 - National GAAPs grandfathered
 - Mismatches added although shadow accounting permitted
 - Voluntary supplementary EV disclosures
 - More rigour provided but financial crisis undermined market confidence

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Phase II Issues

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Phase II - Off The Table?

- **Renewal premiums**
- **Deposit floors**
- **Own credit risk**
- **Use of building blocks in the non-life pre-claims period**

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Phase II Standard Issues

- **Convergence**
 - Key benefit for our analysis
- **Building blocks (including unearned premium)**
- **Acquisition expenses**
 - Economic value recognised by FASB in 1982
- **Risk Margin versus Composite Margin**
 - Preferences
 - Permitted risk margin methods

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Phase II - Related Issues

- **Financial instruments**
 - Options available
 - Different mismatches
- **Performance statement**
 - Traditional non-life ratios
 - Economic loss/combined ratios
- **Cash flow statements**
 - Operating cash flows discernable from income statement
 - Most operating insurers have strong liquidity in our opinion
 - Direct method cash flow statement would have low analytical value in our opinion
 - Holding company cash flow statement would have high analytical value in our opinion

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Phase II Practical Issues – Solvency II

- **Most insurers focused on Solvency II matters and expected to remain so until QIS 5 submission in our opinion**
- **Close alignment of Own Funds under Solvency II and IFRS equity/surplus would likely reduce the industry’s burden – in Europe and beyond**

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Phase II - Industry Concerns

- **Change – especially US**
- **Volatility**
- **Subjectivity**
 - Governance
 - Auditability
- **Distributability**
- **Tax**
- **Complexity**
 - Resources
 - Skills

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Phase II: The Opportunity For Insurers

- **Comparability**
- **Industry management**
- **Investor understanding**
- **Supervisory burden**

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