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IFRS 4 – Insurance contracts

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Agenda

*IFRS 4 Phase I:
key impacts*

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*IFRS 4 Phase II:
Measurement
models*

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*Financial
reporting vs
Regulatory
framework*

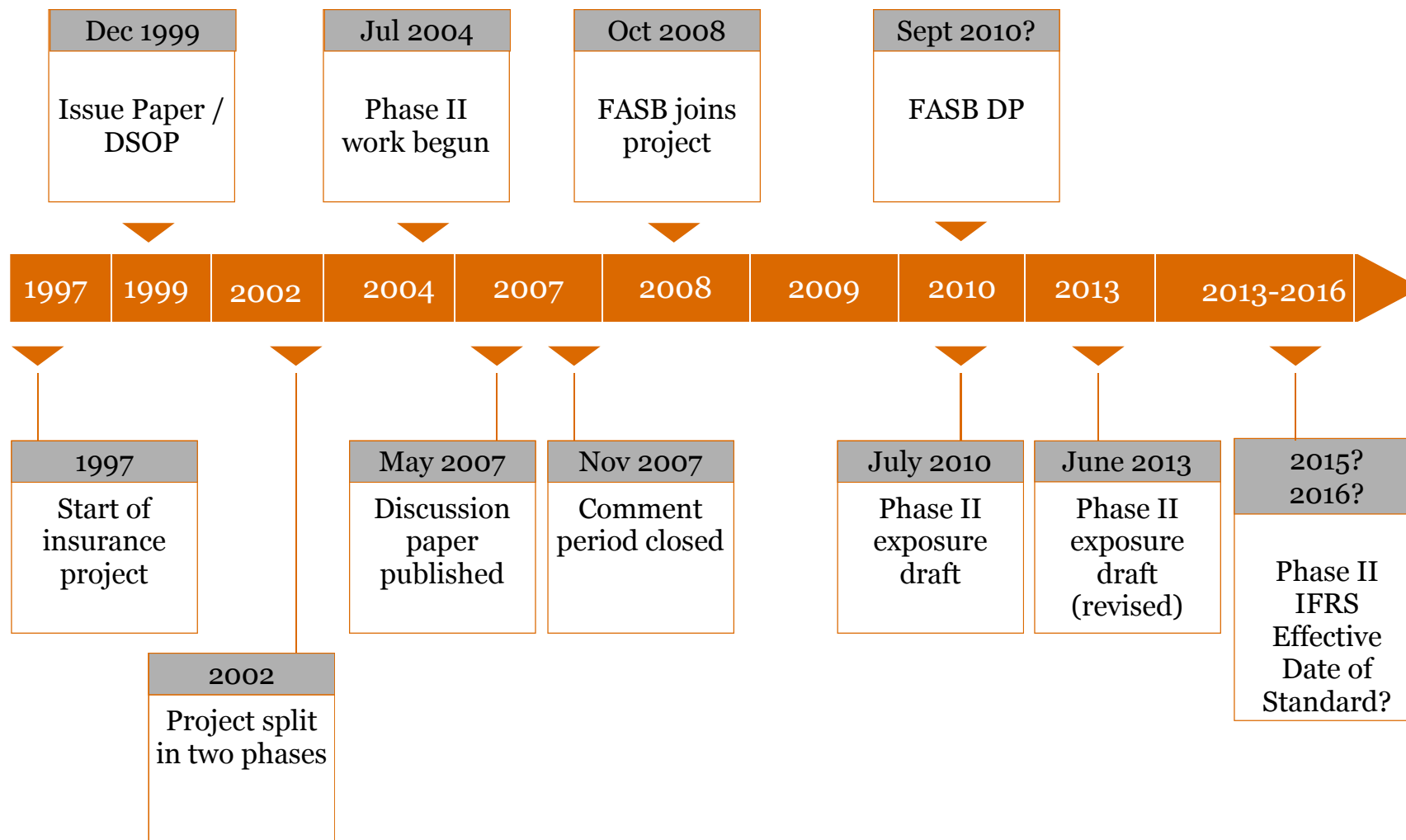
4

*Implications for
insurers*

5



Almost a 20 year journey, so far...



1

IFRS 4 Phase I: Key impacts

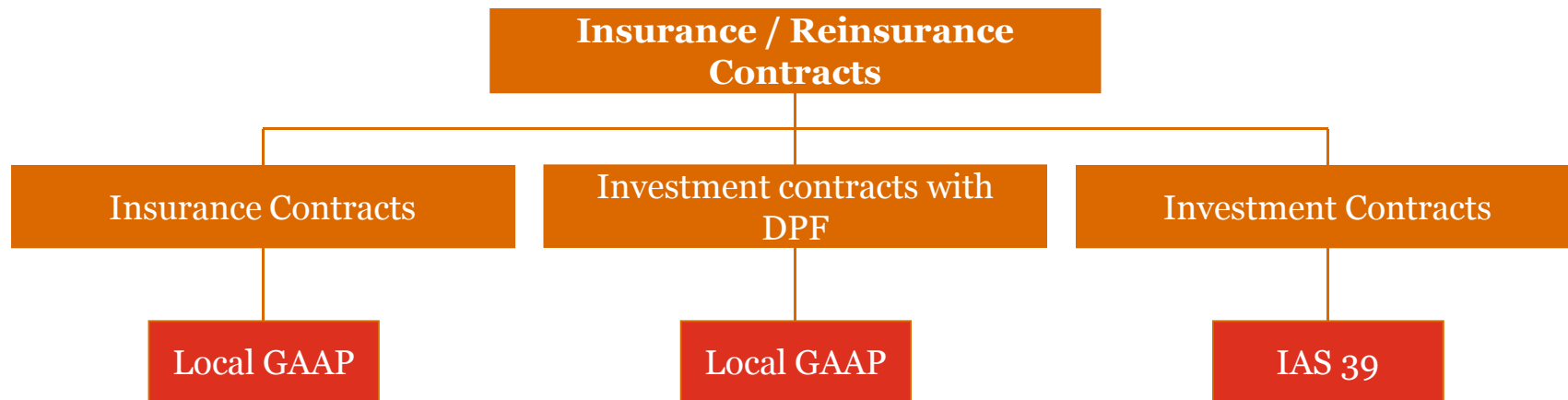
Definition of an Insurance Contract

“A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.”

- Insurance risk = other than financial risk
- Uncertainty: if, when or how much
- Same definition for reinsurance

Key Impacts

Classification determines measurement (three categories)



IFRS 4 permits use of existing accounting policies for insurance contracts (including non-uniform policies)

IFRS 4 permits accounting policy “improvements” so long as.... more relevant and no less reliable, or more reliable and no less relevant

Key Impacts

Changes introduced by IFRS 4

- ‘Insurance contract’ defined – determines if contract in IFRS 4 or IAS 39
- Equalisation provisions - eliminated
- Liability adequacy test – introduced and required
- Embedded derivatives – accounting in certain cases
- Discretionary participation feature - introduced
- Unbundling – introduced and required in certain cases
- No offsetting of reinsurance against related insurance - balance sheet and in P&L
- Reinsurance asset impairment testing - required
- Accounting policy improvements - introduced to assist insurers during Phase I.

Disclosures

- Accounting policies
- Assumptions used in determining insurance liabilities
- Effect of changes in assumptions
- Management of Insurance risk (incl. financial risk, currency risk, credit risk)
- Movement in insurance liabilities and reinsurance assets
- Claims development tables
- Other

2

IFRS 4 Phase II: Measurement models

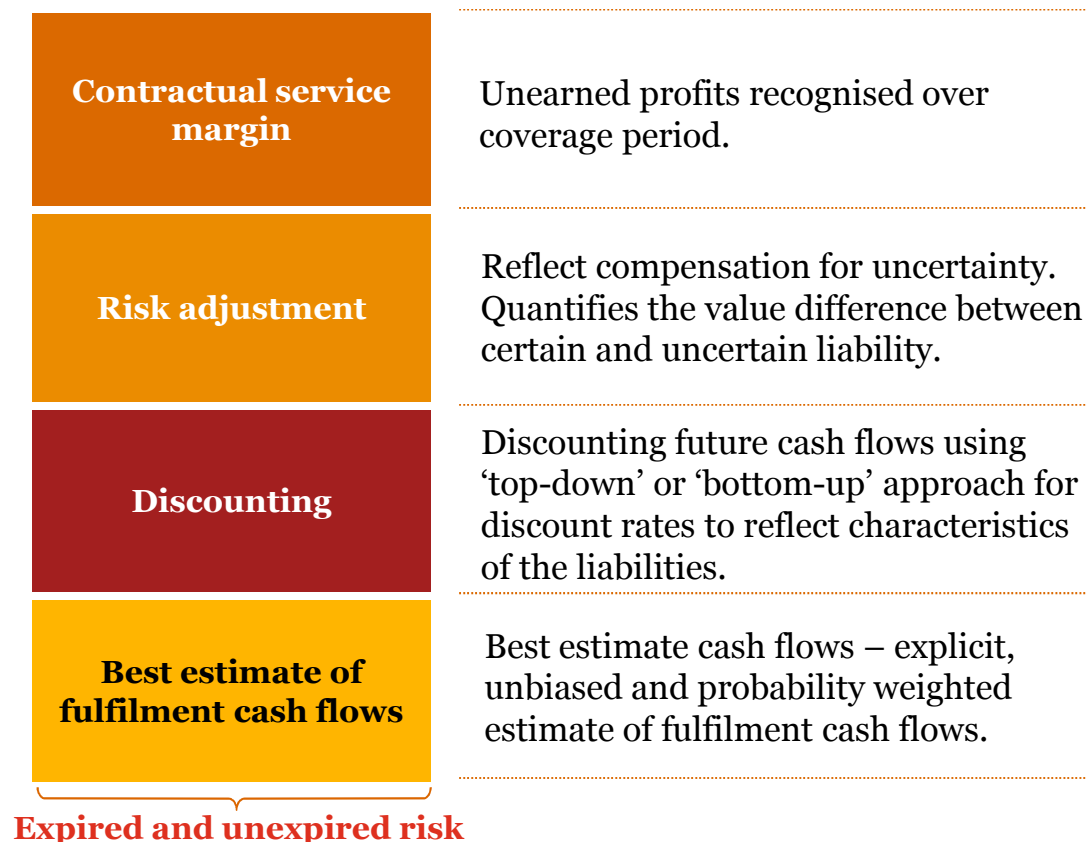
Measurement models

| | Current IFRS/GAAP | BBA throughout | PAA | PAA and undiscounted incurred claims |
|----------------|--|--|--|---|
| Unexpired risk | UPR less DAC | Contractual Service Margin Risk adjustment Discounting Best estimate of fulfilment cash flows | Premium (less acquisition costs) unearned | Premium (less acquisition costs) unearned |
| Expired risk | Undiscounted reserves for past claims (including IBNR) | Risk adjustment Discounting Best estimate of fulfilment cash flows | Risk adjustment Discounting Best estimate of fulfilment cash flows | Risk adjustment Best estimate of fulfilment cash flows |

Default measurement model in IFRS 4 Phase II

Overview of building block approach ‘BBA’

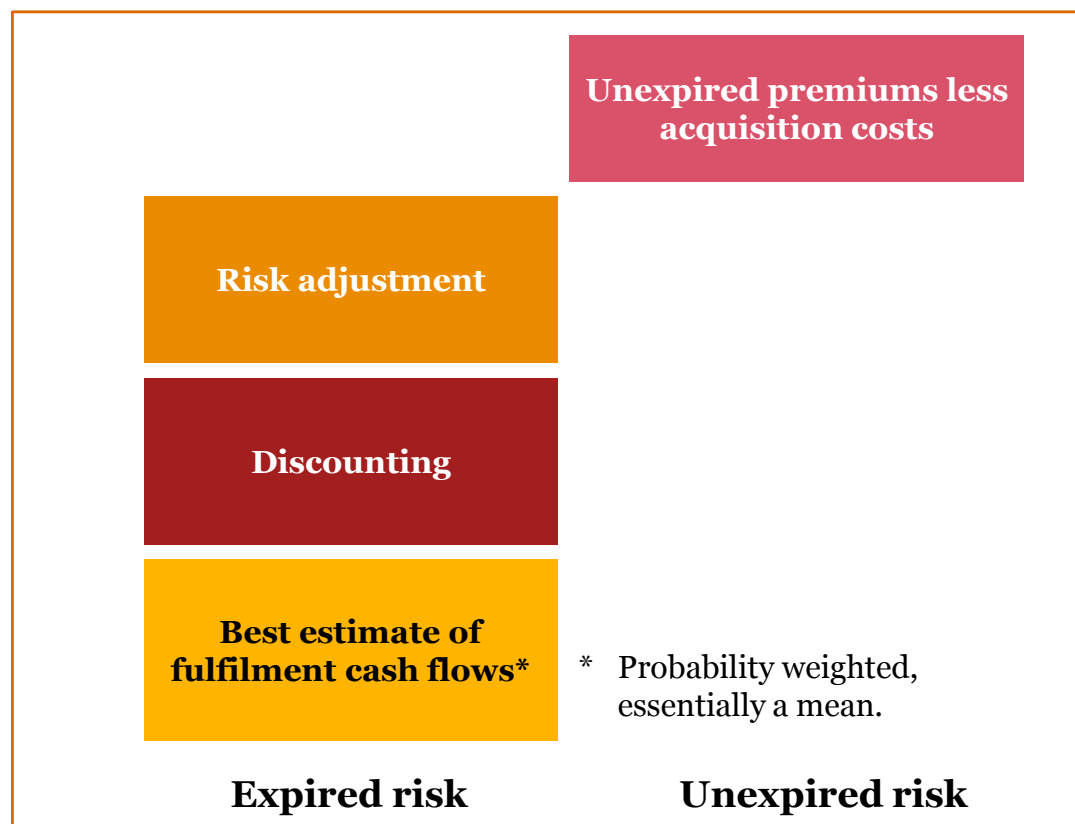
- Default model for all insurance contracts.
- Based on discounted best estimate of future cash flows.
- Explicit margins:
 - Contractual service margin to prevent gain on policy inception.
 - Risk adjustment.
- Day 1 loss recognised in income statement.
- Cash flow approach for all liabilities: past claims (including IBNR) and future cover.



Optional model for short term contracts

Premium Allocation Approach 'PAA'

- Optional simplified model for future cover based on the unearned premium.
- Permitted for short duration contracts (period of cover ≤ 1 year) or where a 'reasonable approximation' of BBA.
- 'Reasonable approximation' does not apply when entity expects significant variability in cash flows – No further guidance on what this means.
- Incurred claims liability (including IBNR) calculated in the same way as for the BBA approach.

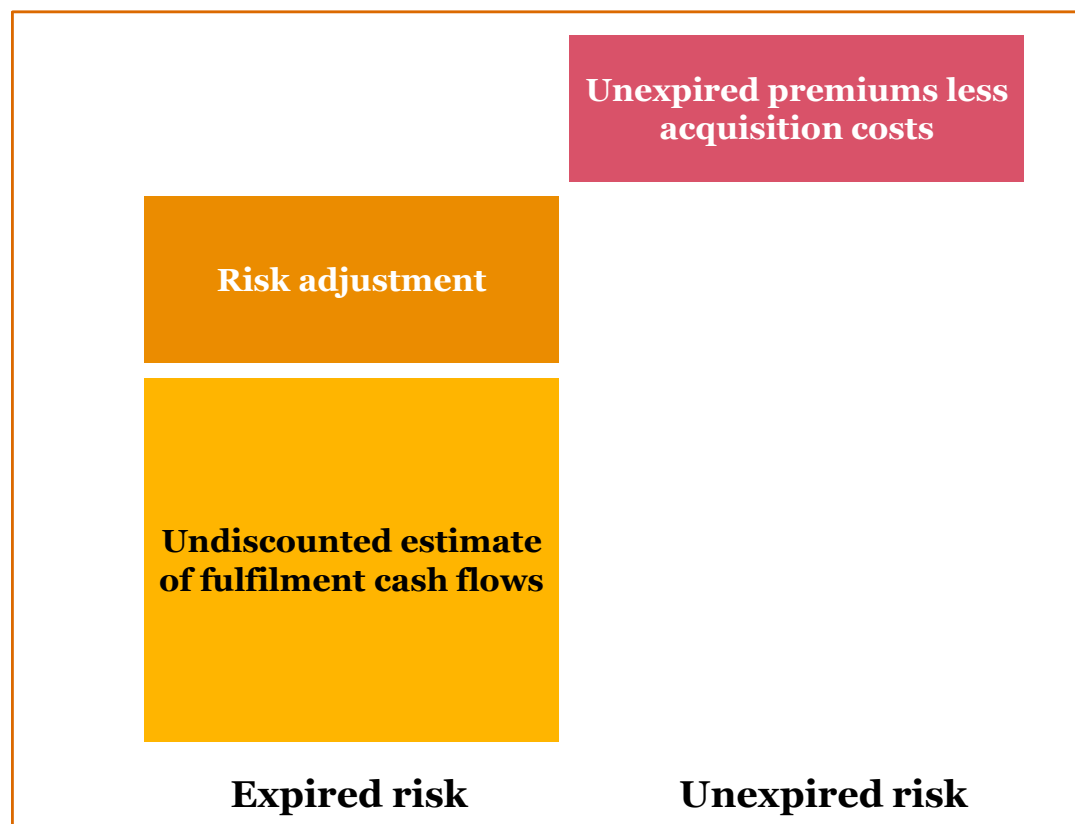


Optional model for very short tail contracts

PAA and undiscounted liabilities

- PAA for unexpired risk.
Incurred claim liabilities (inc. IBNR) are undiscounted.
- Permitted for short duration contracts (period of cover ≤ 1 year) or where a 'reasonable approximation' of BBA, and claim liability cash flows are expected to be paid or received in one year or less.

**Avoids discounting entirely
for very short-tail contracts**



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Transition & Disclosures

Transition

- Each portfolio measured using BBA with contractual service margin
- Difference between BBA and current carrying value reflected in opening retained earnings
- Retrospective application unless impracticable
- If impracticable, simplifications required for building blocks:
- Derecognise balances for deferred acquisition costs

Disclosures

Amounts

- *Detailed roll forward schedules and reconciliations*
- *Reconciliation of sources of profit*
- *Contracts written in the period*
- *Relationship interest and investment return*

Significant judgements

- *Processes to estimate inputs to methods*
- *Effect of changes in methods and inputs*
- *Confidence level for determining risk adjustment*
- *Yield curve(s) used to discount cash flows*

Nature and extent of risks

- *Nature and extent of risks*
- *Insurance risk on gross/net basis*
- *Concentrations of insurance risk and claims development*
- *Quantitative disclosures on non-insurance risks*

4

Financial reporting vs Regulatory framework

Financial reporting vs Regulatory framework

- Financial reporting and regulatory reporting under IFRS in Lebanon (impacted by local laws and Decrees for measurement of insurance liabilities)
- No separate regulatory framework (ie Solvency II or equivalent)
- IFRS 4 Phase II: introduction of major changes to the measurement of insurance contracts and significant impact on financial statements
- Current regulatory framework not aligned to IFRS 4 Phase II
- Requirement to introduce a new regulatory framework (equivalent to Solvency II as mostly aligned to IFRS 4 Phase II)
- Significant implications on local insurance market and little time left

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Implications for insurers

Implications

- Impact on financial statements will vary for entities depending on nature of contracts and current local GAAP
- Likelihood of increased volatility since measurements reflect current estimates
- Profit recognition on transition for existing contracts
- Measuring and communicating business performance
- Practical implementation issues (e.g. definition of cash flows, discount rate, risk margin, scope of stochastic modelling)
- Need for new systems and data and related staff training

Thank you

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