

Accounting for Insurance

Ravi Rambarran

CAA Trinidad

December 2011

Topics

- Objective
- Model Issues
- Profit
- Transition
- Presentation
- Positives
- Implications

Objective

- Comparability across companies and countries

Company	A	B
Insurance liabilities	1819	2663
Value of in force as an asset	99	0
Net income	30	16
Comprehensive income	42	50

Model Issues

- Expected cash flows exclude incremental expenses (issue 1)
- Risk free yield curve (issue 2)
- Illiquidity premium curve which is aimed at reducing liabilities by considering the stickiness of the insurer's contracts (issue 3)

Model Issues

- Risk margins (akin to MFADs) are remeasured(issue 4)
- Residual margin ensures that profits are recognised over the life of contract for individual life and annuity contracts where we are used to up fronting of profits (issue 5)

Profit

Change in risk margins	EV	IFRS4
Release of residual margin	DM	IFRS4
Gains and losses at initial recognition	DM	IFRS4
Non-incremental acquisition costs	DM	IFRS4
Experience adjustments	EV	IFRS4
Changes in estimates of cashflows	EV	IFRS4
Changes in discount rates	EV	IFRS5
Interest on insurance contract liabilities	EV	IFRS4
Investment return	EV	IFRS9
Items from other standards	DM	IAS18

Impact

- Change in risk margins: extent of diversification between portfolios open issue
- Release of residual margin: release and costs mismatched
- Non-incremental acquisition costs: loss at inception on profitable contracts
- Other items: volatility from measurement uncertainty and short term changes in capital markets

Transition

- Measure inforce contracts under new model excluding residual margin and compare to carrying value
- Difference immediately recognised/amortised in retained earnings (issue 6)
- Derecognise immediately deferred acquisition costs and intangibles relating to those contracts, excluding client lists & relationships (issue 7)

Presentation

- Margin based rather than volume based (issue 8)

Positives

- Uniform standard with margins explicitly shown on balance sheet
- Apart from residual margin, model closer to an economic model than PPM/CALM
- Margins analysis should explain profit drivers
- Economic mismatching in assets will be disclosed

Implications

- Delinking of assets and liabilities (CALM/PPM/APM are dead!)
- To remove accounting mismatches, need to fair value assets thru income
- Disclosed equity may rise or fall at transition. If equity falls then capital adequacy ratios, ratings, dividends and covenants affected
- Slow recognition of earnings on individual life and annuity business so disclosed profits will fall and over time increase as deferred profits emerge
- Disclosed return on equity may rise or fall and so current plans beyond 2011 require revision
- Ability to have one time releases of reserves from acquisition of portfolios and companies removed

Implications

- Greater volatility of earnings because less discretion with management and actuaries to smooth earnings
- Volatility may change shareholder composition and increase M&A activity
- Unclear whether existing capital standards will change so that same rather than more capital is required if a total capital approach is required
- Significant change in IT systems
- Significant change in how management views business
- Profit recognition should alter product design and compensation

Next Steps

- The train has left the station
- Start QISs
- Communicate and communicate to managers, boards, shareholders, regulators, analysts, rating agencies and lenders (actuaries went thru similar experience with IAS19).