IFRS Phase II
Exposure Draft

…through the eyes of two non-life insurance practitioners

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2 June 2011

Introduction

- *This session aims to provide an overview of IFRS Phase II Exposure Draft: Insurance Contract ("ED") and how it may impact actuarial assessment of insurance liabilities for non-life insurance companies in Asia*
- Singapore, Malaysia currently operate under IFRS
- In July 2010, the IASB released ED
- ED proposes the standardised approach that insurance contracts are recognised, measured and disclosed
- Planned finalisation of ED by mid-2011
- No confirmation on the implementation date

Claims liability

The MAS definition

The value of expected future payments…. plus *provision for any adverse deviation…based on 75 per cent level of sufficiency*

VS

ED components

An explicit, unbiased and probability–weighted estimate of future cash inflows and outflows

Time value of money for future cash flows

Risk adjustment

Claims liability: Probability-weighted cash flow

Explicit cash flow based

Ok for payment based models (PPCI, PPCF, PCL) but will be a problem for incurred based models (ICL, IBF, ECR) for small portfolios in Asia

Probability based

Requires to identify all possible scenarios and make an unbiased estimate of probability of each scenario. Not a single point estimate!

Currently actuaries do this **implicitly** but does not specify scenarios with probabilities

May use a distribution if insufficient data

Claims liability: Time value of money

The discount rate shall reflect the yield curve in the appropriate currency for instruments that expose the holder to no or negligible credit risk with an adjustment for illiquidity

Risk-free rate

- Generally the impact of discounting is low in Asia due to the short-tail nature of non-life business
- However, for Hong Kong and Malaysian (motor insurers), the impact may be material
- May use a distribution if insufficient data

Illiquidity

- Insurance liabilities are highly illiquid!

The impact is likely to be material

Claims liability: Risk adjustment

Maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected

Similar to PAD, PRAD

Three approaches suggested

- Confidence interval: **BUT DOES NOT SPECIFY THE PERCENTILE**
- Conditional Tail Expectation: TVaR based
- Cost of capital

Diversification

- Within a portfolio only: **BUT NO DEFINITION OF PORTFOLIO**
- If taken as a class of business: **NO DIVERSIFICATION**

Pre-claims liability

ED definition

An insurer's obligation to pay valid claims for future insured events arising under existing contracts

Consistent with premium liability

An approximation approach allowed for *short-duration contracts*

Consistent with current practice

- **Pre-claims liability = UPR**
- **Onerous test: same as LAT**
- **Recognition of loss at the start**

HOWEVER....

Pre-claims liability: Aggregation

Aggregated into portfolio and similar inception dates

No offsetting between portfolios

- Under the MAS, offsetting between risk classes are allowed
- Under ED, no offsetting between “portfolios”

Onerous test result depends on how an insurer defines a portfolio

Underwriting period based?

- In Asia, it is common to analyse balance sheet UPR by class
- If UPR originates from multiple underwriting periods with different features, a more comprehensive approach will be required

Long-term contracts

A more comprehensive approach for long-term contracts

Residual margin

Define the initial “profit” and earn it over a period of insurance

- Long-term Personal Accident
- Engineering
- Mortgage Insurance
- Long-term products in Korea
- Others

Significant work required to estimate the insurance liability for these products

Conclusion

- Clear discrepancies exist between ED and RBC frameworks in Asia (MAS, BNM, OIC)
- From non-life insurance perspective, further clarifications will be required for ED to be practical:
  - What is a portfolio?
  - Probability of sufficiency in setting the risk adjustment
  - Probability-weighted cash flow
- Some components will have financial consequences
- Non-life insurance companies writing long-term contracts will require significant work