

Preparing for
changes in
IFRS
Insurance

Agenda

1.	Regulatory background and Overview of IFRS 4 phase II
2.	Comparing IFRS to RBC
3.	Risk Adjustment: techniques and approaches
4.	Transition to the new standard
5.	Q & A

1. Regulatory background and Overview of IFRS 4 phase II

The Timeline of the Insurance Reforms

Asian markets have seen a relatively limited amount of regulatory reform. This is about to change

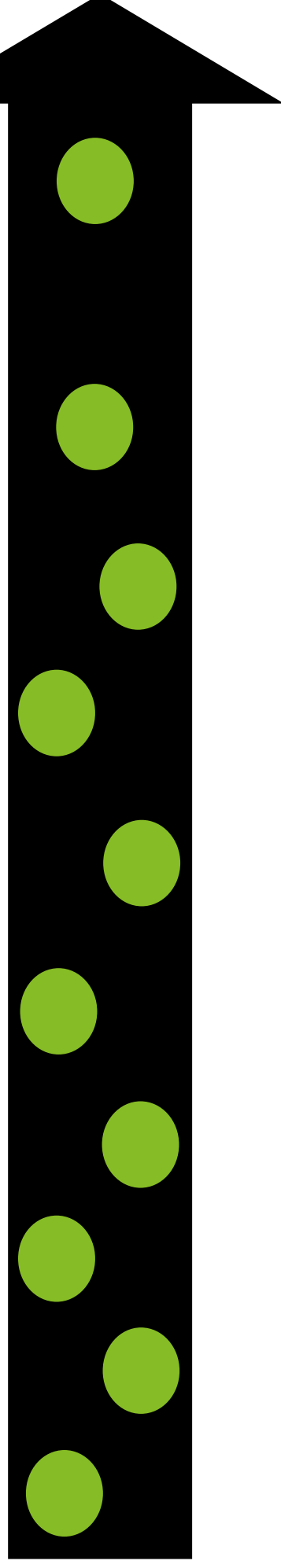
	2015	2016	2017	2018	2019	2020
	Final deliberations		New IFRS 4 Phase II issued	IFRS 9 effective		Possible IFRS 4 Phase II effective dates
	IAIS completes its field testing of the global insurance capital standard (ICS), the cornerstone of its Common Framework (ComFrame)					Full implementation of ComFrame is expected from 1/1/2020 (TBC)
	The Insurance Authority will conduct a number of consultations and quantitative impact studies to lead to a new RBC regime expected to be effective from 1/1/2020 (Deloitte estimate)					Possible effective date: 1/1/2020
	A new quantitative impact study and consultation on transitional provisions was published on 15 July 2016. MAS has not set a target effective date for RBC2					
	The Chinese Risk-oriented Solvency System (C-ROSS) is approved in February 2015					
	Korean RBC is being reconfigured to a higher confidence limit, risk by risk. Deloitte estimates that this will lead to a refinement of the current RBC regime that will remain in force until the new IFRS Insurance reform is complete following which the local regulator (the FSS) is expected to launch a complete reform of Korean solvency to align it to the new IFRS and the IAIS Insurance Core Principles.					Possible effective date: 1/1/2020
	The regulator of Malaysia is considering the possibility to modernise its solvency regulations by continuing to converge towards the IAIS new developments and by harmonising their regulations within the context of the ASEAN Economic Community.					

IFRS 4 Phase II

A long time coming – The IASB patient work to build consensus and to align asset and liability accounting rules

These dates have not been decided yet

Nov 1998	25 October 2013	9 Dec 2015	Sep 2016	1 Jan 2019/2020	1 Jan 2020/2021
Project commenced	Comment deadline	Proposal on the interaction with IFRS 9 (“decoupling”)	IFRS 9 “decoupling” published	Opening balance sheet for one-year comparative reports	Expected effective date, 3 years after the standards



20 June 2013	January 2014 – February 2016	Feb 2016	Late 2016/Early 2017
ED issued	Board re-deliberations	IFRS 4 Phase II deliberations complete, balloting begins	Expected publication date for IFRS 4 Phase II

IFRS 4 Phase II will become IFRS 17

IFRS 17 will introduce a new consistent and transparent standard

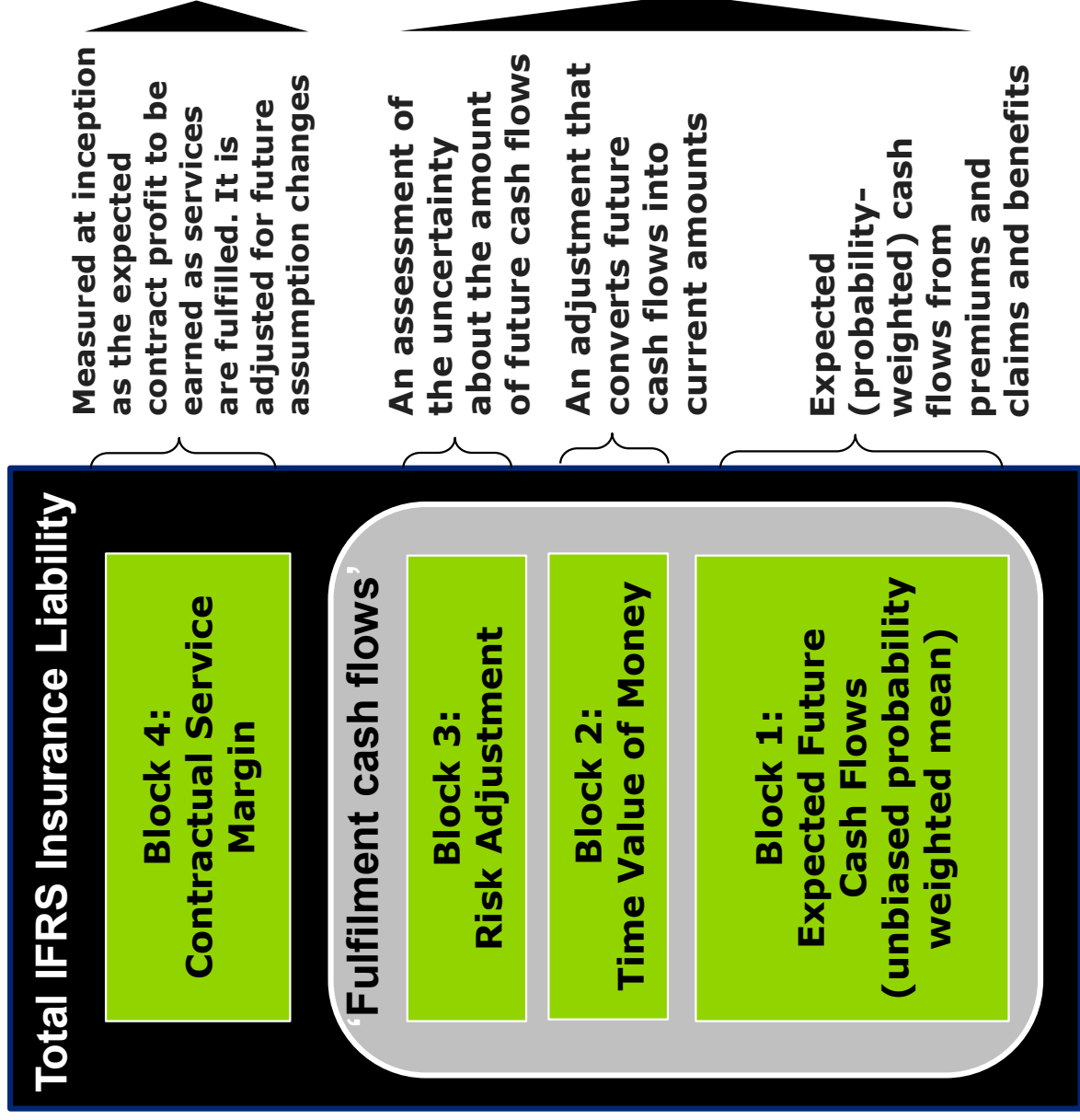


IFRS 4 Phase II - Building Block Approach ('BBA')

The whole standard in one page!

Principles

- Measurement model uses a "building block" approach
- Measurement uses current estimate assumptions
- Measurement based on notion of the entity-specific "fulfilment of obligations". Profit on sale is deferred.
- Cost of risk/uncertainty is current and explicit
- Discount rate can be developed from market interest rates whose characteristics match those of the liability (currency, duration, liquidity), using either a "top down" or "bottom up" approach



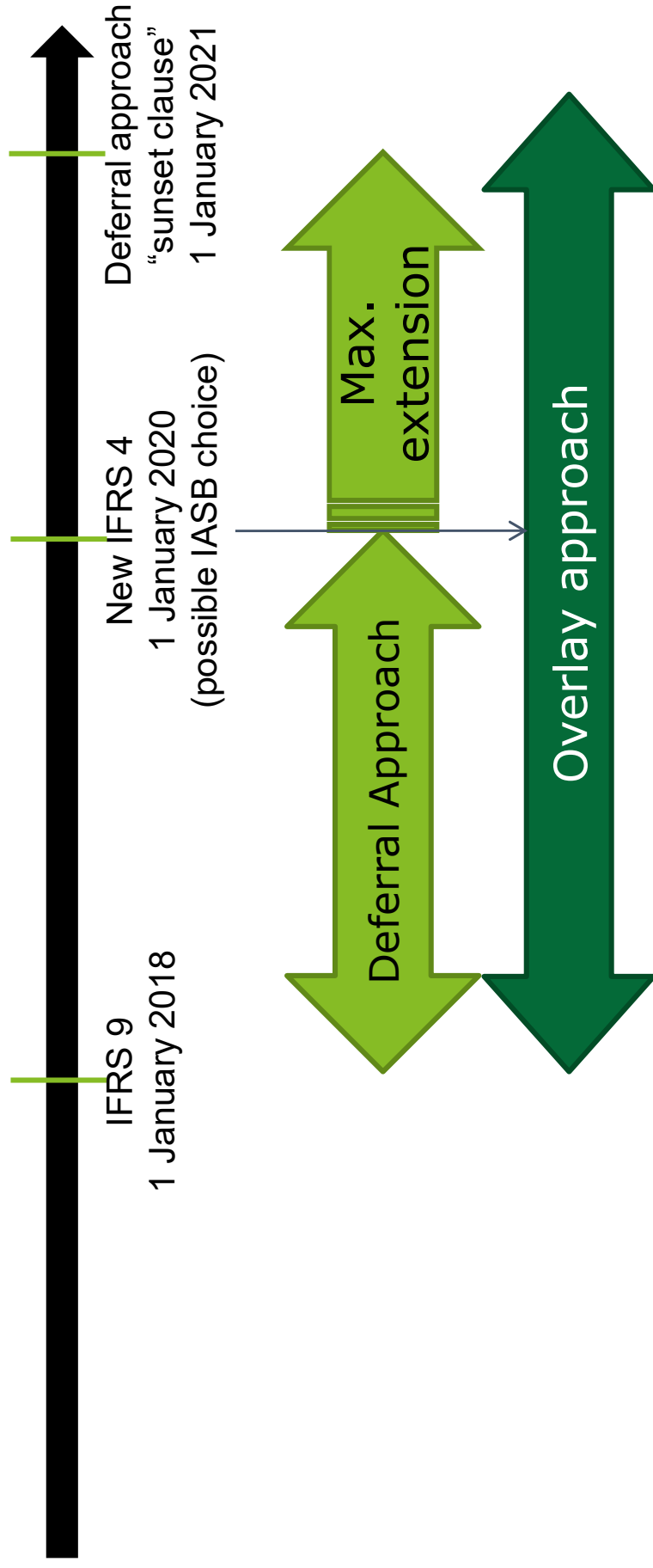
IFRS 9 and IFRS 4 Phase II

Timeline

IAS 39 & IFRS 4
Flexibility in IAS 39 and IFRS 4 results in little volatility in profit or loss

IFRS 9 & IFRS 4
Interaction of IFRS 9 and IFRS 4 may increase volatility in profit or loss

IFRS 9 & IFRS 17
IFRS 9 and IFRS 17 should reduce volatility in profit or loss



IFRS 9 Interaction with IFRS 4

Two solutions with materially different outcomes on implementation

Why?

In May 2016, the IASB completed deliberations to amend IFRS 4 to address concerns on the gap in effective dates between IFRS 9 and IFRS 4 phase II. Constituents had raised concerns that the gap leads to:

- Two consecutive major accounting changes for insurers.
- Additional volatility in profit or loss that could arise in this period.

Two optional solutions:

1. Deferral approach

Qualifying entities are permitted to defer the application of IFRS 9. A fixed expiry date is set for 1 January 2021. (IFRS 4 Phase II)

2. Overlay approach

Entities that apply IFRS 9, have an option to adjust the P&L for the additional accounting volatility. No fixed expiry date. The overlay approach expires when IFRS 4 Phase II is effective.

IFRS 9 Interaction with IFRS 4

The narrow door to be eligible for the deferral approach

Deferral approach

- The eligibility test at reporting entity level (all or nothing outcome):
 - Insurance activities are predominant if the predominance ratio is greater than 90%, or is greater than 80% and evidence that there is not a significant unrelated activity in the remaining 20%.
 - The numerator of the 'predominance ratio' now includes **liabilities related to insurance plus 'other' connected liabilities**, the denominator is kept equal to the total liabilities.
- The predominance ratio is computed between 1 April 2015 and 31 March 2016.

Overlay approach

- All assets that will **move to FVTPL in IFRS 9 and that were not required to be at FVTPL in IAS 39** and that **relate to insurance activities** can be **designated** to generate the overlay adjustment
- The presentation of the adjustment shall be one line item in P&L and one in OCI with a breakdown in the notes

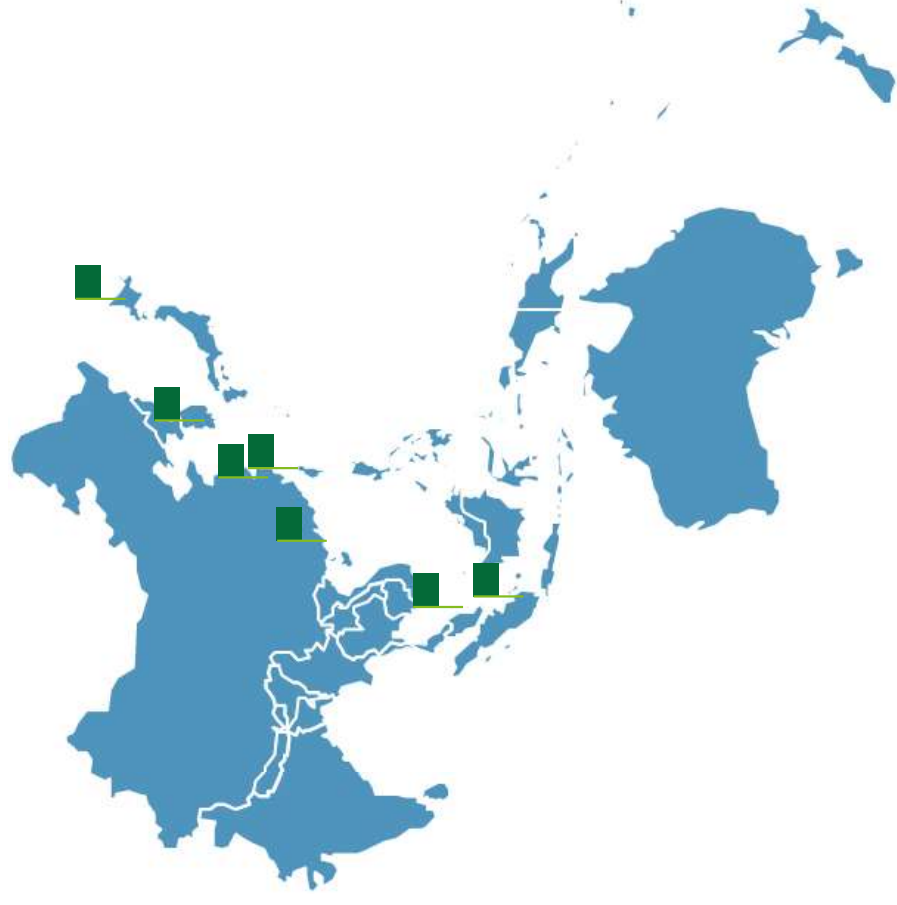
2. Comparing IFRS to RBC

Comparing IFRS to new RBC regulations

The solvency regulations across Asia are indicating that the pace of change has already picked up

The concerted efforts to move the regulations in line with the IAIS principles have received a significant spur by several factors. To name a few:

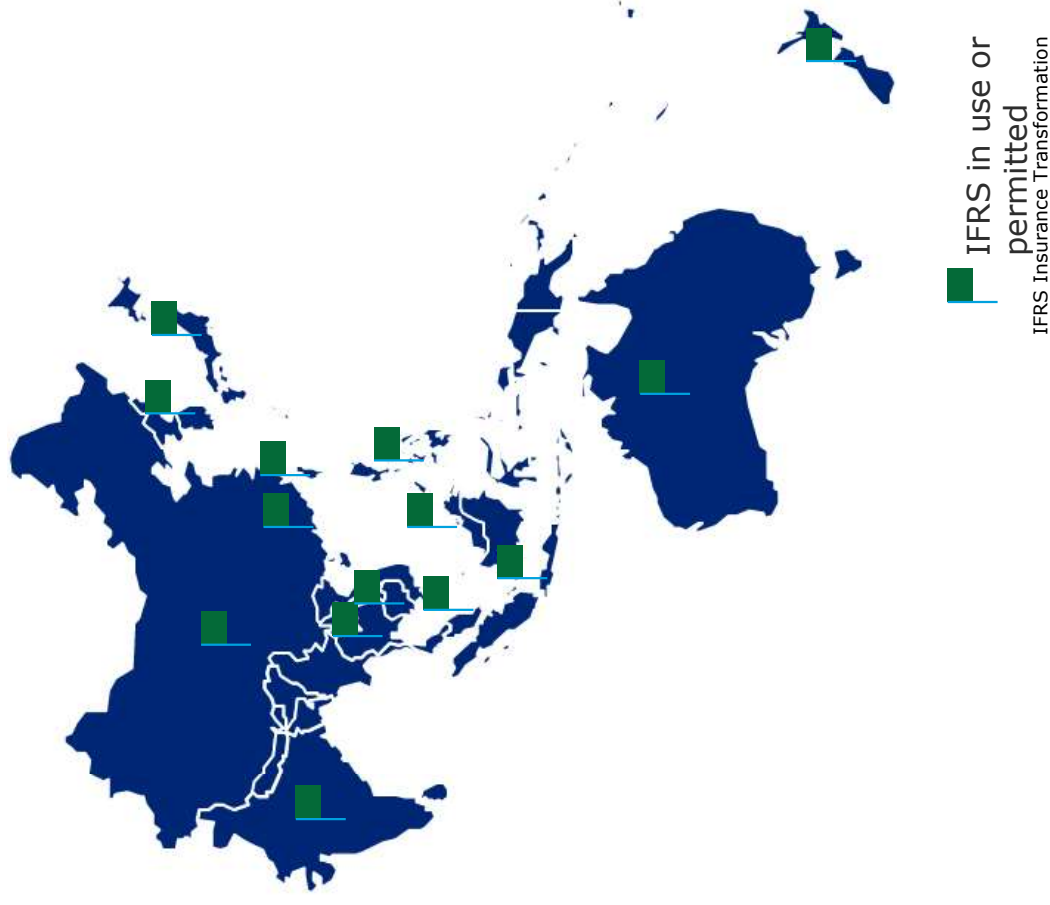
1. **Solvency 2 equivalence** (Japan, Hong Kong, Singapore, Australia and China have applied or expressed an interest)
2. **Systemic risk** initiatives (G-SII and ComFrame) and their “**trickle-down effect**” across Asia
3. **IMF** Financial Sector Assessment Programmes **focus on Asian markets** (2005-09: 2 in Asia, 2009-14: 14)
4. **ASEAN Economic Community**



Comparing IFRS to new RBC regulations

Several Asian nations embraced IFRS to report to investors with a substantially automatic endorsement

- The adoption of IFRS across the world for the past ten years has allowed many Asian companies to **expand their access to capital markets**
- Insurance IFRS has not yet provided the same benefits due to the **grandfathering of pre-IFRS practices for insurance contracts** leaving a material gap between investors and insurance companies
- A **new IFRS** to fill this gap has been in the making for a decade and is now **nearing completion** with material impact on financial reports



Comparing IFRS to new RBC regulations

Costs and benefits of RBC

Although costly and disruptive, these regulations bring an unprecedented potential for consistency and transparency.

Costs

These reforms will not be cheap.

In 2012 alone, the cost of compliance equated to a reduction of 1% in the RoE of European insurers.

Solvency 2 related implementation cost were nearly 60% of that cost. Asia should learn from these lessons and focus on cost/benefit.

Benefits

There are two common elements of RBC and IFRS reforms that are beneficial to insurance companies and their stakeholders:

- Consistent profit and capital measures across products and markets
- Transparency on the expected profit from the in-force and its contribution to solvency capital

The **liability valuation rules are the gateway** to harness these benefits and make the reforms pay a substantial regulatory dividend.

Comparing IFRS to new RBC regulations

Convergence of IFRS and RBC

Using a current, portfolio-specific cost plus an explicit margin is what the target regulations are moving towards.

Valuation of insurance liabilities for **financial reporting**

Valuation of insurance liabilities for **solvency purposes**



convergence



Current estimate of cash flows that excludes prudential margins and uses only current information with maximum use of market inputs, particularly to set the appropriate discount rates

Margins for uncertainty are added as **explicit liability components**

Net expected profit

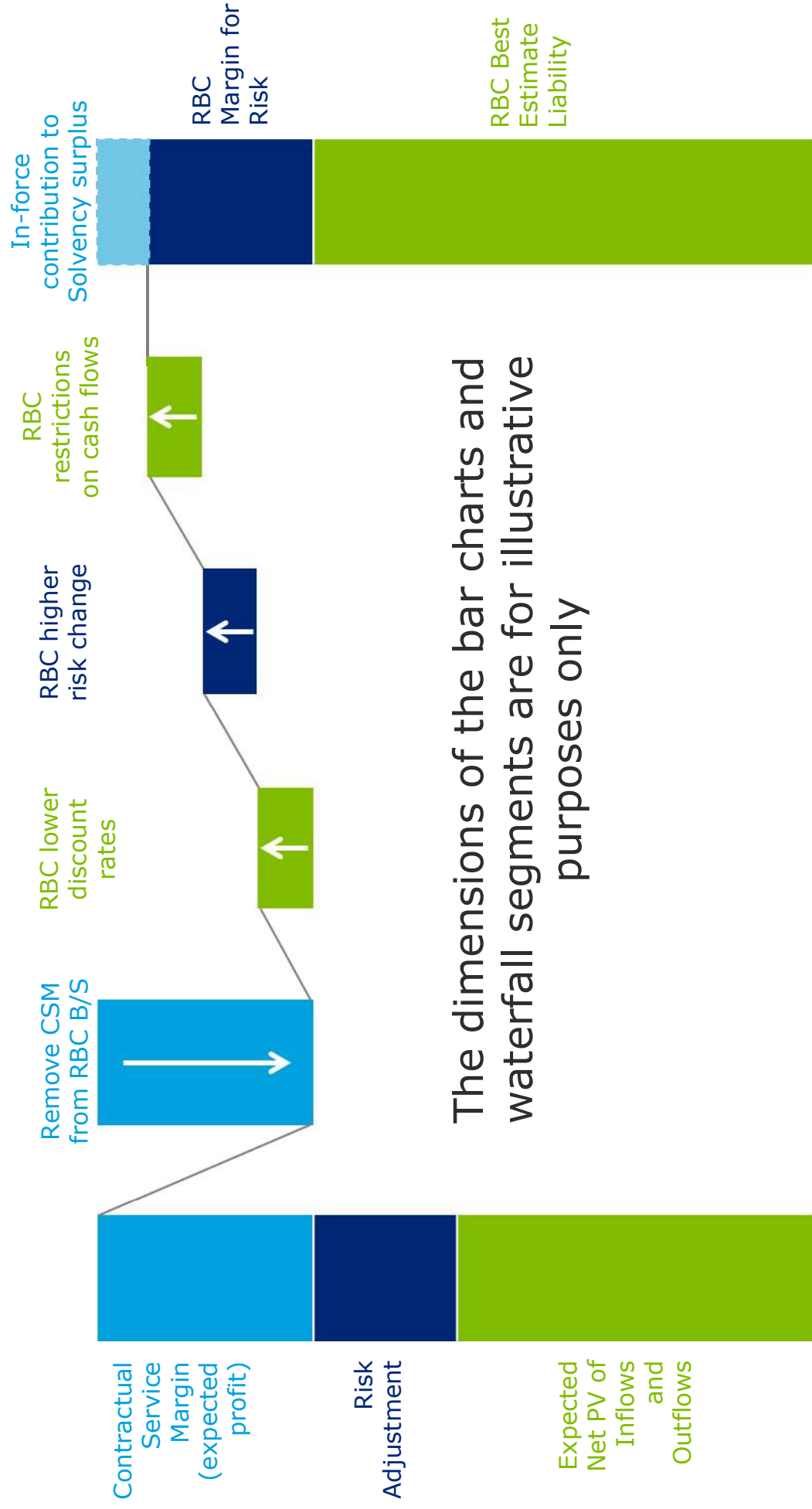
from this calculations will feed the **solvency surplus** in the new RBC regimes

These characteristics offer, for the first time, the possibility to create a common industry data and valuation model that integrates actuarial valuations with reporting and analytics.

Under the new IFRS regulations, this expected profit is an additional explicit liability margin at the point of sale **feeding reported profits over the coverage period.**

Comparing IFRS to new RBC regulations

Common industry data and valuation model put a spotlight on the reconciliation between their variances



3. Risk Adjustment: techniques and approaches

Comparison of approach profiles

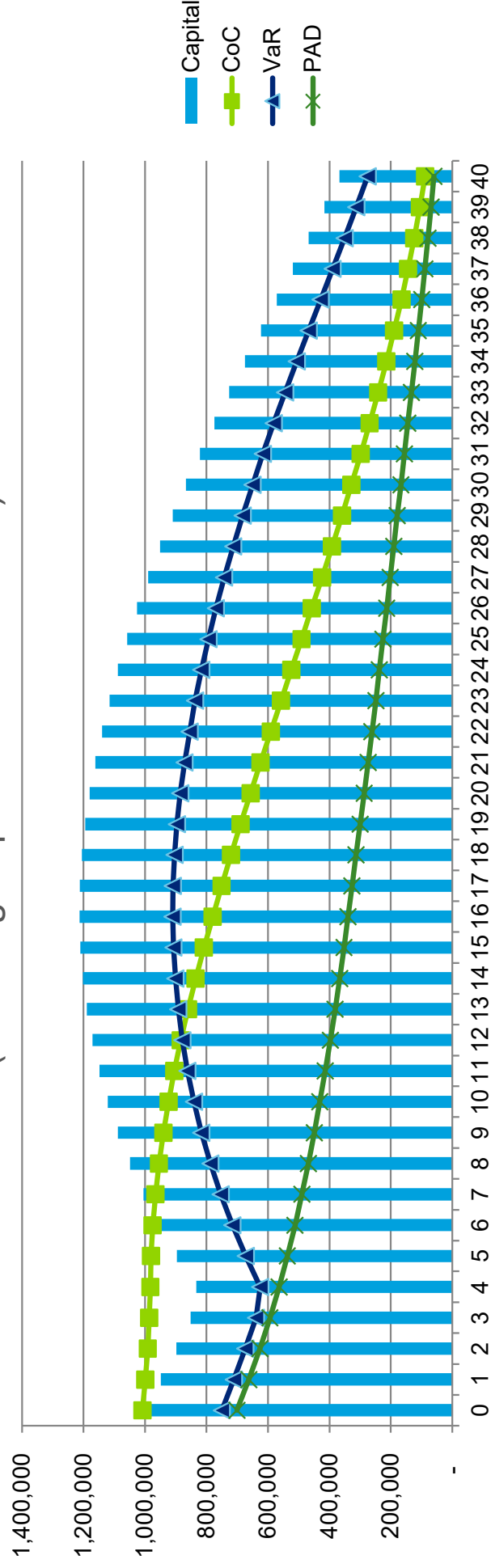
Release pattern and confidence levels vary by approach

Cost of Capital is likely to be higher than VaR for long duration contracts, but will be lower for short duration.

PADs relationship to other approaches will depend on type of contract, type and level of PADs, and other considerations that inhibit general assessments.

Steady confidence level can be seen for VaR, but other methods will vary with time.

Risk Adjustment by Calculation Approach
(Including Capital Base reference)



Criteria for suitable risk adjustments

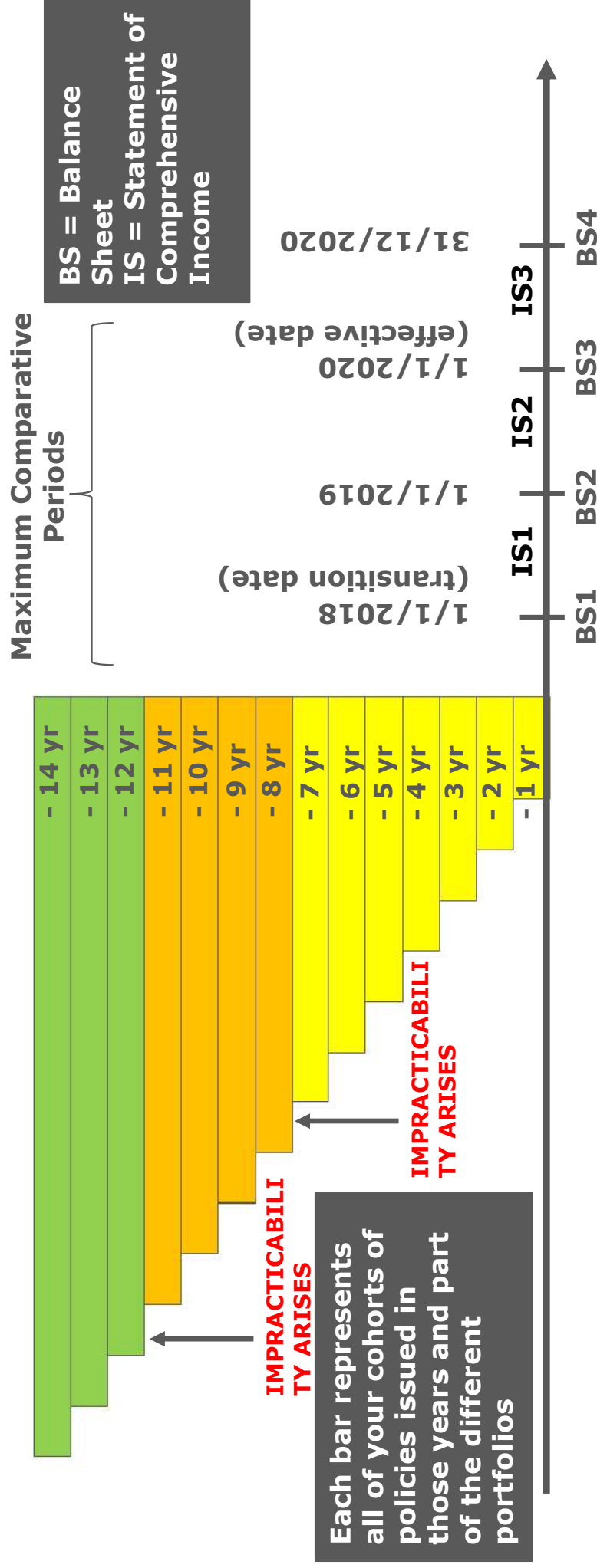
Practical considerations

- Diversification effect across portfolio and how to allocate such benefit
- Implications of financials
 - Earning patterns
 - Profitability - relationship to CSM
- Comparison to other bases risk adjustments/margins
- Group versus local entity diversification
- Systems requirements
- New business calibration
- Reinsurance risk adjustment asset
- Stochastic calculations
- Unit of account

4. Transition to the new standard

Restating the whole past of your company – the daunting task of IFRS 4 Phase II transition

- Full retrospective
- Simplified approach(es)
- Fair value approach



How the rules will make transition possible even when you lost all your data

Three Hierarchically Sequential Transition Approaches

Three possible approaches to be applied, in order

- 1) First you **must** try **the full retrospective application** of the new requirements is required, unless this is impracticable
- 2) When **impracticable**, the simplified approach in the 2013 ED must be applied. In addition a VFA simplified approach applies for direct par contracts.
- 3) When **impracticable** to apply the simplified approach, a fair value approach is applied from the date of transition

IMPRACTICABLE: applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

How to be prepared....?

Start early, start small, keep it simple!

Due to the significant financial impact, it is crucial for insurers to conduct thorough analysis on this aspect. In general, two types of analysis should be conducted:

In-force Profit Signature Analysis

- For restating the opening figures at the time of adopting the new standard
- Data intensive, as the data needed to restate may not have been captured previously under the current standard
- Deloitte has software developed to assist on this regard

New Business Profit Signature Analysis

- Can be done anytime for the new businesses / policies in question to assess the profitability over time
- Deloitte has software developed to assist on this regard

4. Q & A



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