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Update on IFRS Phase II of insurance

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What I intend covering

1. Overview of Phase I and Phase II for insurance
2. Overview of 2007 Discussion Paper
3. Material issues raised in responses
4. Subsequent developments:
   - Measurement bases
   - Guaranteed insurability
   - Proposed timetable

Where are we now?

- Desire for global standard for insurance businesses
- Phase I implemented (with effect from 1 January 2005)
- Phase II in progress – aiming for final standard to be published in 2011

Phase I of insurance

- Separated from Phase II due to accounting complexity of insurance contracts
- IFRS 4 defined what is and is not an insurance contract
- Investment contracts:
  - Subject to IAS 39 (financial instruments) and, where investment management services IAS 18 (revenue recognition)
  - Accumulation contracts – account balance with DAC & DRL
- Insurance contracts and all Discretionary Participating business:
  - Reliant on existing local GAAP

Phase II of insurance

- Scope – primarily insurance contracts
- Discussion paper issued in May 2007, with 6 month comment period
- Actuarial Society worked with SAICA Long-term Insurance Project Group in joint response

Phase II of insurance - *Continued*

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2008:

- IASB made slow progress
- IASB considered comments
- Isolated the key contentious areas
- Discussed alternative measurement bases
- Issued timetable

2009:

- Continued discussing measurement bases
- Discussed margins
- Discussed policyholder behaviour
- Re-issued timetable a couple of times

Phase II of insurance - *Continued*

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- Aiming for exposure draft in Dec 2009 and final standard in May 2011
- Issued numerous exposure drafts and discussion papers which impact indirectly on insurance companies (e.g. revenue recognition, leases, fair value measurement)
- October 2008: IASB announced that insurance would be joint project with FASB (Financial Accounting Standards Board in US)
- SEC (Securities & Exchange Commission in US) issued proposed roadmap in Nov 2008 for comment – could lead to mandatory use of IFRS for years ending on or after 15 Dec 2014

Overview of Discussion Paper

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- Presented two views for some issues – indicated what IASB favoured
- Current exit value approach (price to transfer remaining rights & obligations to another entity)
- Also described entry value method, where calibrate to premiums at inception.
- Single approach for ALL insurance contracts, viz. life and non-life

Overview of Discussion Paper - *Continued*

- 3 building blocks:
  - Explicit, unbiased, market-consistent, current estimate of contractual cash flows
  - Allow for time value of money using current risk-free discount rates
  - Explicit, unbiased margin that market participants require for bearing risk and for providing services
- Favour gains at inception
- Changes in assumptions reflected in P&L as they are made
- Credit characteristics of entity should be taken into account
- Acquisition costs expensed as incurred

Overview of Discussion Paper - *Continued*

- Customer intangible allowed (akin to our negative rand reserves, to offset impact of acquisition expenses)
- Guaranteed insurability – limits future premiums that may be included; impact on participating contracts
- Favour unbundling
- Participating contracts – legal or constructive obligations treated as a liability (PPFM helps in this respect)

Material issues raised in responses:

- Exit value approach
- Calibration of risk margin
- Non-economic assumptions: disagree that they should be market consistent
- Guaranteed insurability
- Gains at inception
- Unbundling
- Credit characteristics of the entity

Measurement attribute bases:

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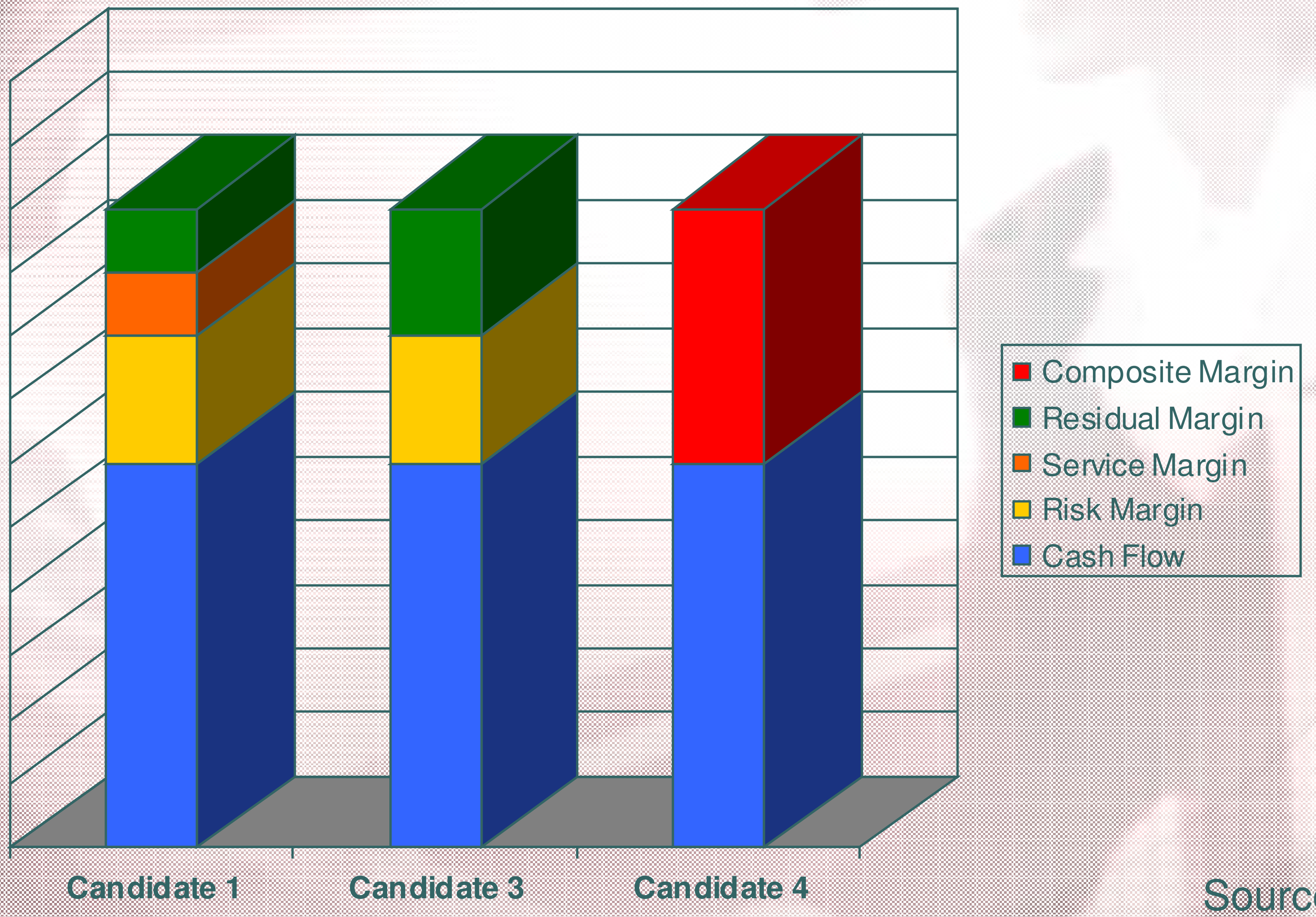
Approach 1. **Current exit value** – amount required to transfer remaining rights & obligations to another entity at the reporting date (akin to fair value)

- uses market assumptions, including for non-financial assumptions
- requires a risk margin = compensation required by market participants for bearing risk
- includes a margin for other services if market participants require such a margin
- approach may result in day one difference. IASB initial view was to allow gains at inception (viewed initially as not significant); current view (February 2009 meeting) is to prohibit a day one gain.
- allow for own credit risk
- changes in best estimate assumptions & margins included in P&L

Margins



Source: IASB

Measurement attribute bases - Continued

Current fulfillment value – the expected cost of fulfilling the obligation to the policyholder, including the cost of bearing risk. General features:

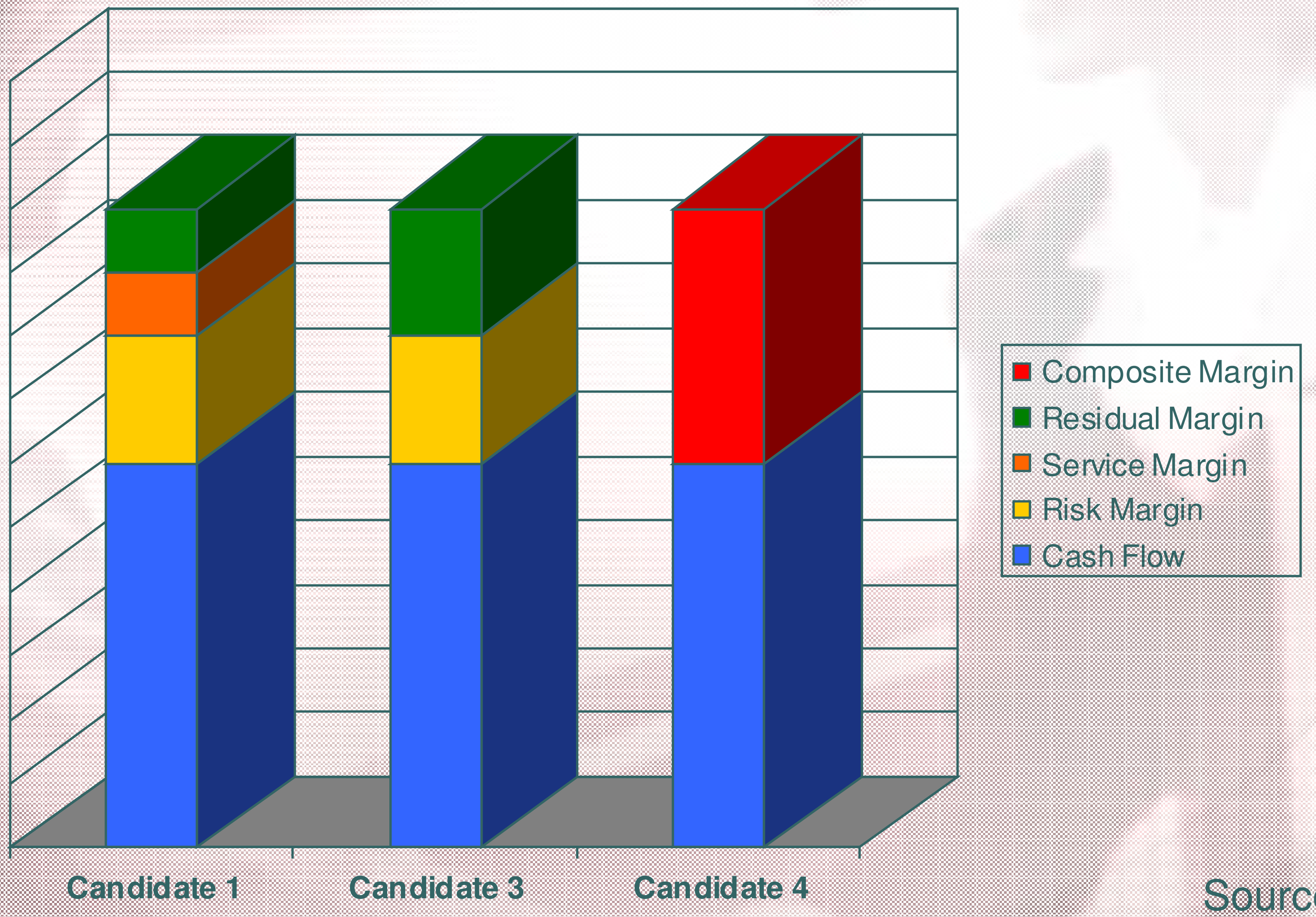
- Use entity's own estimates
- No allowance for own credit risk
- Changes in best estimate assumptions included in P&L?

Approach 2: Liability includes a risk margin based on cost of bearing risk – implies gains at inception

Approach 3: Liability includes a risk margin based on cost of bearing risk, and an additional margin between the premium and the expected value of cash flows plus risk margin – implies no gains at inception; profit margin recognized as separate item within insurance liability

Approach 4: Liability includes a single margin calibrated at inception to the premium – i.e. composite margin, therefore no gain at inception; margin locked-in (unless onerous contract); requires liability adequacy test

Margins



Source: IASB

Guaranteed insurability

Initial IASB's view:

- Only take future premiums into account if policyholder is compelled to pay future premiums or if cover will cease if premiums are not paid
- Future benefit payments must be taken into account
- Not sure how to treat discretionary participating contracts and universal life type contracts
- Constrained by the conceptual framework
- Respondents wanted to take all inbound cash flows and expected policyholder behaviour into account, without considering cash flows from possible future contracts
- Requested help as to where one insurance contract ends and a new contract begins
- Impacts, for example, annually renewable contracts (e.g. GLA, PHI, motor), automatic voluntary premium increases, contracts arising from guaranteed insurability options, annuity contracts effected at the end of RA's, universal life contracts, extensions of term, term assurance with premium reviews.

Guaranteed insurability - Continued

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CFO Forum:

Drafted Contracts Definition paper and forwarded to IASB

- Replace guaranteed insurability criteria
- Term of a contract is the shorter of the contract life and the point if any that the policy can be freely re-priced by the insurer at the individual policyholder level
- Paper co-signed by CEA, ACLI (American Council of Life Insurers), Life Insurance Association of Japan
- Shared views with IAIS who submitted a similar paper
- Discussed by the IASB in April meeting

Credit characteristics

- IASB considers that the credit standing of the insurance entity should influence the size of the contract liability
- Difficulty for IASB is that it is operating within its conceptual framework, and generally do not understand insurance. “Why is insurance different?”

Latest timetable

Measurement Attribute : education	Oct & Nov 2008
: approve features	Feb 2009
: discussed margins	Apr 2009
: discuss other issues	May 2009
: decision on approach	Deferred until July 2009
Cash flows	Mar 2009
Future premiums & policyholder behaviour (contract approach) : education & discussion	Apr 2009
: decision	May 2009
Discount rates	May 2009
Policyholder participation: classification (between equity and liability)	June 2009
Inconsistencies between IAS 39 & IAS 18	June 2009
Policyholder accounting	June 2009

Latest timetable - Continued

Policyholder participation: measurement	June 2009
Recognition & derecognition of A and L	July 2009
Definition of insurance & scope	July 2009
Disclosures	Sep 2009
Minor issues	Sep 2009
Publication of ED	Dec 2009
Publication of final standard	May 2011

Other IASB development work impacting insurance:

- Revenue Recognition
- IAS 37 Contingent Liabilities
- Fair value measurement
- Financial Instruments
- Conceptual framework
- Financial Instruments with Characteristics of Equity
- Consolidation
- IFRS 7 implementation
- Leases
- Derecognition
- Financial Statement presentation
- Post employment benefits

Vocal stakeholders:

Industry Groups

- CFO Forum – large European multi-nationals
- GNAIE – Group of North American Insurance Enterprises
- 4 largest Japanese life companies (aligned with GNAIE)

CEA - Comité Européen des Assurances – national European insurance umbrella for insurance regulators

IAA (Peter Withey represents Actuarial Society)

EFRAG – European Financial Reporting Advisory Group – advisers to EC

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2009 Convention Lite and the Pensions, Health and Life Seminars

19-20 May 2009

Sandton Convention Centre Johannesburg, South Africa