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Phase II of insurance IFRS: Is a Solution Emerging?

Nigel Masters

IFRS 4 Phase II: Is a Solution Emerging?

There is broad agreement on many key areas. Zurich supports CFO Forum approach:

- Supports use of future cash flows
- Accepts the “discounting and margins” approach for Life and GI
- Accepts the need for consistency in the financial market where available
- Sees Unearned Premiums approach as consistent with Principles

IFRS 4 Phase II: Is a Solution Emerging?

BUT ... there are still fundamental areas to resolve:

- Setting the Margins
- Participating Plans
- Credit rating of liabilities

AND ... the practical challenges cannot be ignored

IFRS 4 Phase II: Is a Solution Emerging?

How to set the margins?

- Risk margin difficult to quantify in practice
- Service margin ill-defined
- CFO Forum solution – use margins in premium basis unless margins clearly inadequate
- IAIS similar but would test if margin clearly wrong up or down
- One approach is to amortise in line with RBC run off

IFRS 4 Phase II: Is a Solution Emerging?

How to treat Participating Plans?

- Current IASB proposals create expected future losses
- If economic conditions are favourable, then obligations enforceable in most territories, usually through regulators
- If economic conditions are unfavourable, then there may not be a payment
- This is same as a financial option and should be recognised in the same manner
- Treat country by country but most insurers would hold 'fair value' style liability

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IFRS 4 Phase II: Is a Solution Emerging?

Should the liabilities be reduced to reflect possible default?

- IFRS inconsistent on treatment of non-insurance liabilities
- Insurance regulated so default much less likely than many commercial liabilities
- Theoretical solution is not reduce liability but introduce separate default asset
- In practice, IASB should park until consistent approach developed

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IFRS 4 Phase II: Is a Solution Emerging?

There are many practical challenges:

- : Implementing reliable economic models
- : Policyholder behaviour in stochastic conditions
- : The limits on management actions
- : Projecting Economic/SST/Solvency II capital requirements
- : Interim reporting and Forex
- : Analysis of change and diminishing materiality
- : Reconciliation to non-insurance balances (eg IAS 19, IAS 39)
- : Running up to 10 million complex calculations per policy

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IFRS 4 Phase II: Is a Solution Emerging?

Yes, but painfully slowly – and the chances remain high that a golden opportunity will be wasted.



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