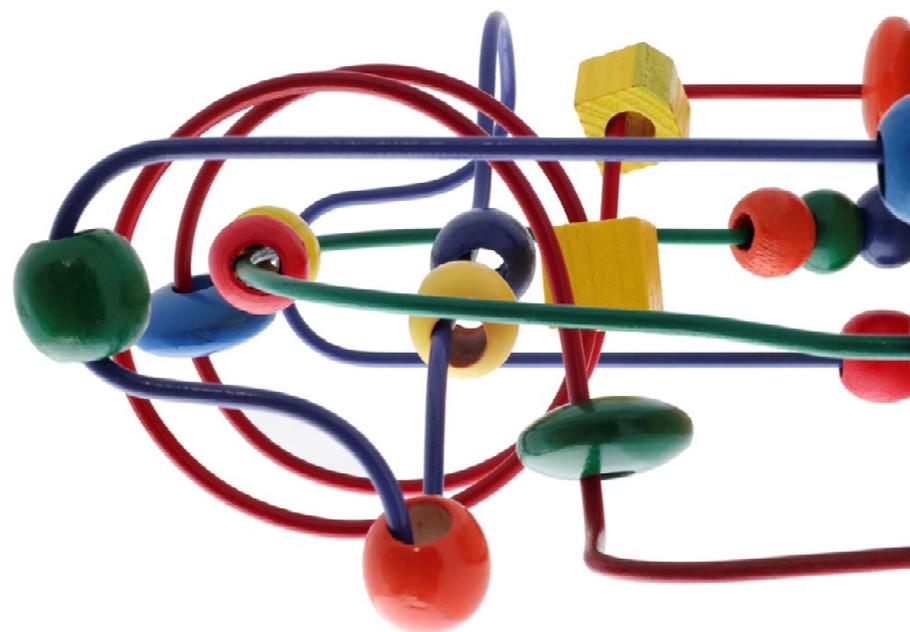


ACTUARIAL
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QUANTIFYING RISK, ENABLING OPPORTUNITY

IFRS 4 Phase II

Examples for Short Term Insurance



Karl Meissner-Roloff

November 2014

Discussion points

- Areas considered / Scope
- Valuation Method - considerations in application
- Product based examples
- Concluding remarks

Disclaimer

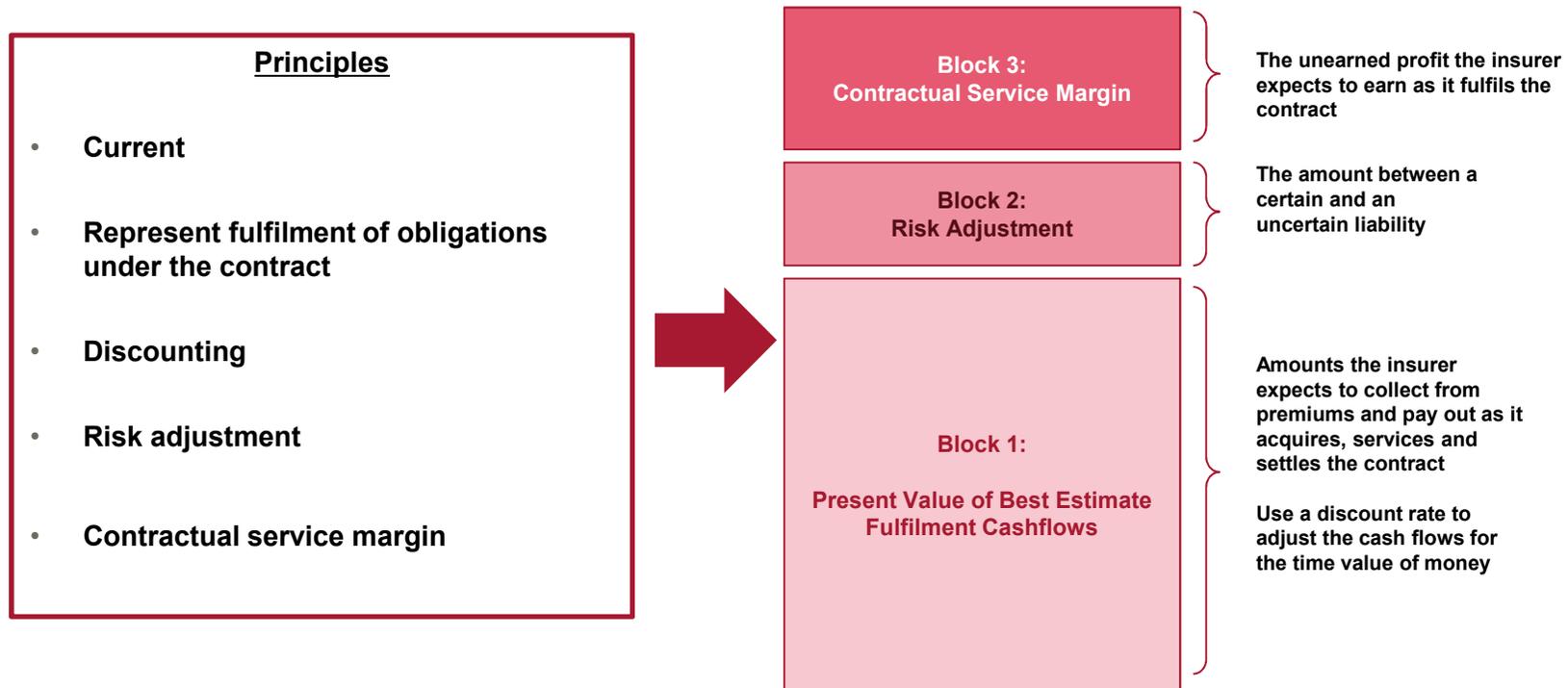
Contents of this presentation represent my own views and not that of my employer. Areas considered in this presentation represent on a portion of the changes required under IFRS4 Phase II and should therefore not be taken as an exhaustive demonstration of all requirements.

Scope / Approach

- Consideration of a few typical Short Term (ST) insurance contracts
- Simple examples used to illustrate points – does not cover all eventualities
- Identify some of the considerations / pitfalls in switching from existing practice to IFRS4 Phase II
- Not going to go into details of OCI – but something that can be used for ST insurers

Valuation Method

Building Block Approach (BBA)



Valuation Method

Premium Allocation Approach (PAA)

- **What is it?**

Approach which is very similar to current 365ths method for UPP

- **When can it be used?**

“Practical Expedient” for cases where:

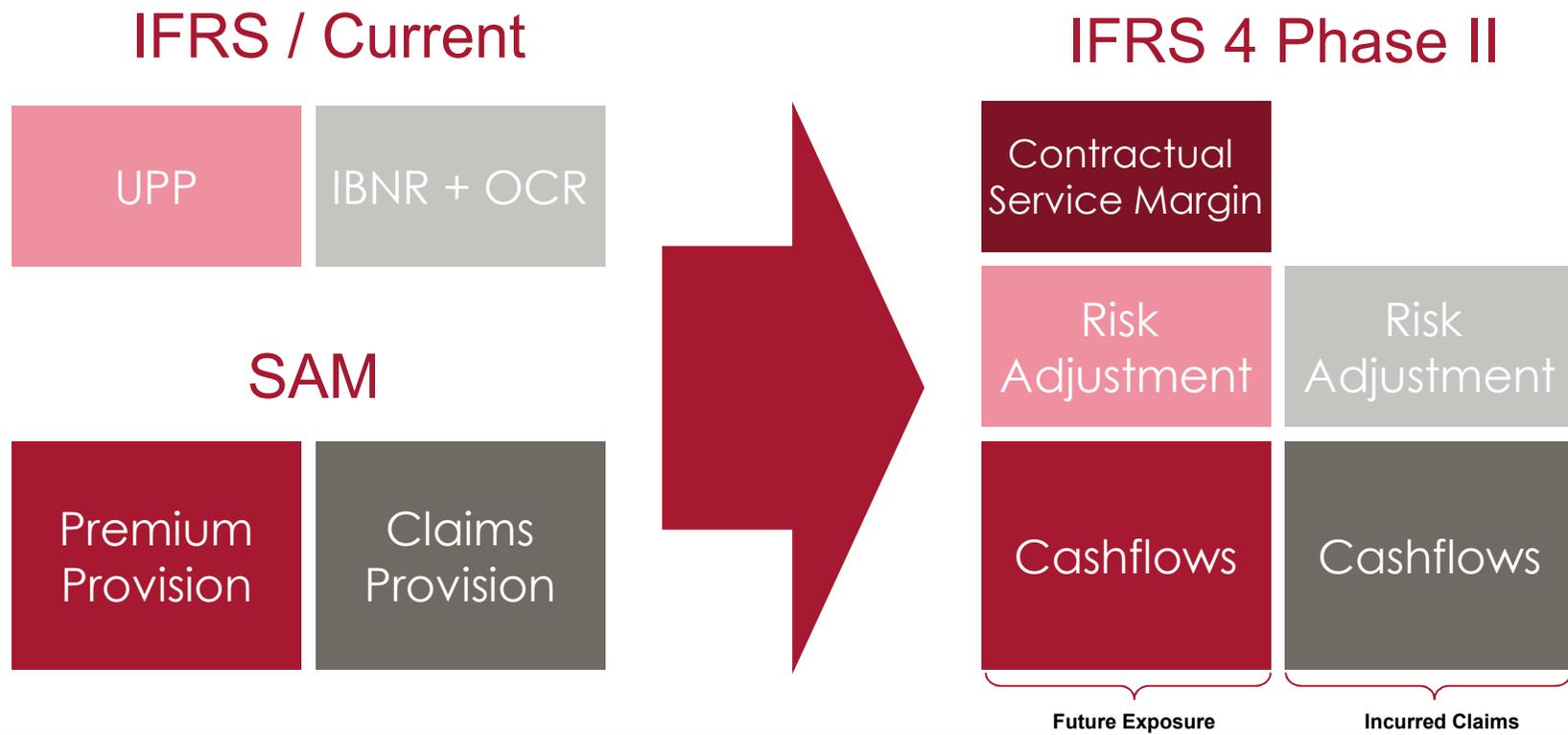
- Term less than 1 year (and thus also no discounting)
- Results would resemble Building Block Approach

- **Where can it be used?**

Only for ‘unearned’ portion of premium

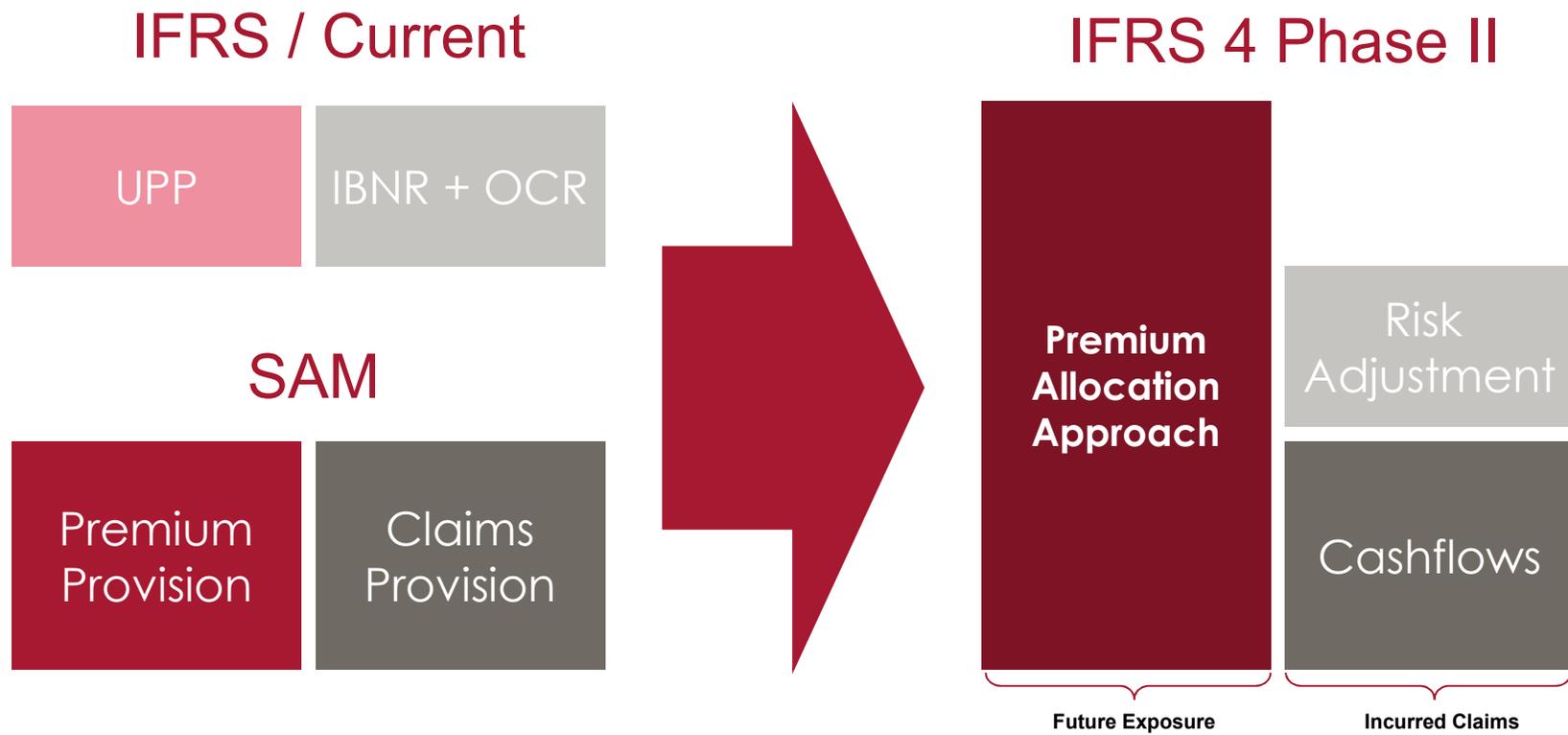
Example 1

Monthly Policy – e.g. Motor



Example 1

Monthly Policy – e.g. Motor



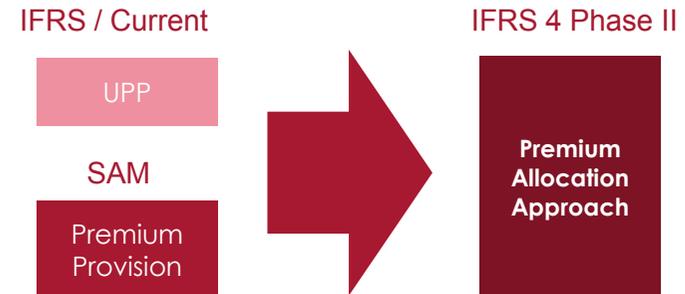
‘Unearned Premium’

Monthly Policy

IMPACT: Minimal

Considerations:

- Almost same as UPP profile over time
- ‘Implicitly allow’ for acquisition cost
- Given small size of amount, likely not worth effort of performing BBA
- Contract boundary similar to SAM – based on coverage period, but also up to point where policy can be re-priced



Incurring Claims

Monthly Policy

IMPACT: Moderate

Considerations:

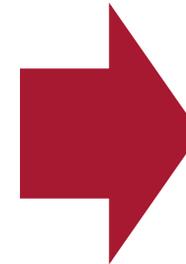
- Best estimate cash flows – almost the same... although no allowance for overhead expenses / ULAE
- Risk Margin:
 - Could use percentile from reserve distribution
 - Alternatively use cost of capital approach, HOWEVER: wont be same amount as SAM:
 - SAM Risk margin based on 6% cost of capital, and depending on approach might differ (calculated per line of business, after diversification).
 - NB: As part of disclosures will have to indicate implied level of confidence

IFRS / Current

IBNR + OCR

SAM

Claims
Provision



IFRS 4
Phase II

Risk
Adjustment

Cashflows

Example 2

Annual Policy

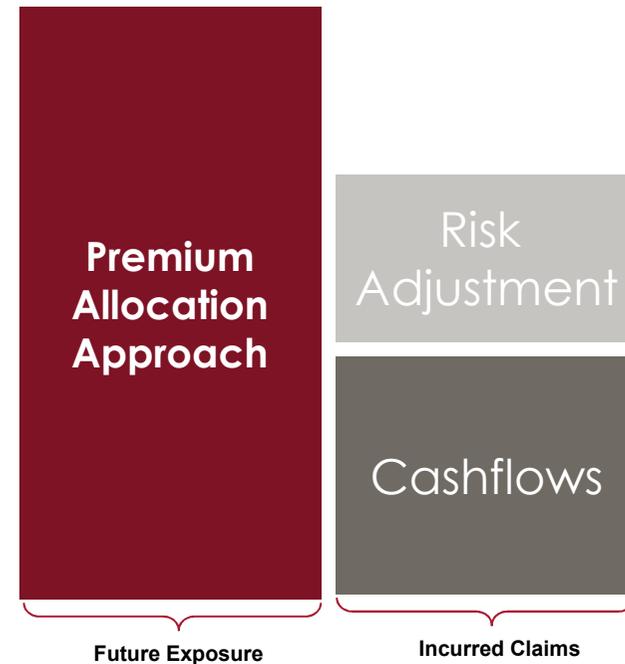
IMPACT: Minimal / Moderate

Incurred claims:

- Treated similar to monthly policies
- If run-off longer than 12 months, discounting will likely be required
- Disclosures include yield curve used for discounting

Future Exposure:

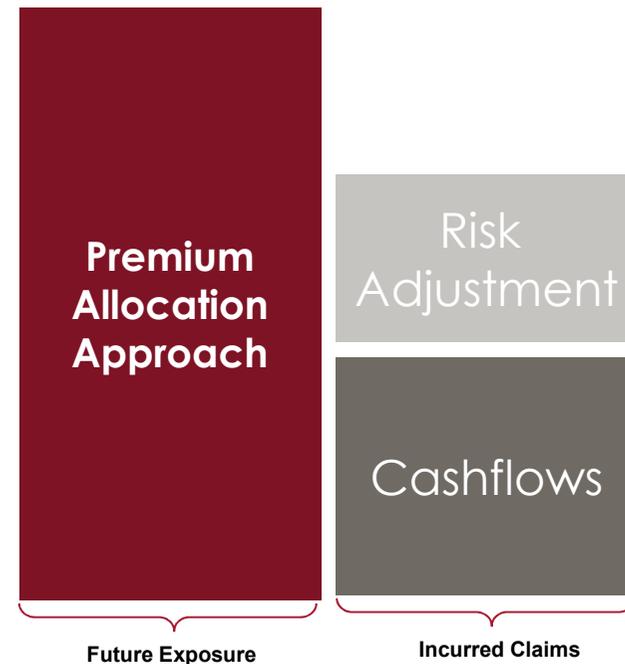
- PAA still most practical



Example 3

Motor Monthly Policy + CASH BACK

- Still some uncertainty around where exactly cash back will be accounted for...
- Latest from IASB seems to indicate:
 - Need to accrue for future cash back – similar to claims beyond coverage period / risks attaching
 - Seems likely to be accrued under Incurred claims
 - Actuarial estimate to be used (claim, lapse decrements, etc.) ***
- Definition of cash back to be considered carefully – must be ‘insurance liability’



*** to be confirmed – not in line with current exposure draft

Other Key Consideration

- If reward / cash back is certain:
 - Seen as non-distinct investment component - split out from insurance revenue
- I have SAM BE cash flows and risk margin – why not use BBA?
 - Maintenance of CSM over time is not a trivial task – adds complexity
 - Level at which calculation done becomes more important
 - Need to allocate risk margin between future exposure and incurred claims – wont be a straight forward calculation from SAM risk margin

Concluding remarks

- Changes are not as significant for Short Term as it is for Life, but... Devil is in the detail.
- Selection of methodology has further implications – disclosure, tracking of historical calculations...
- Consider Income Statement impact of guaranteed rewards
- Worth it to start early with implementation:
 - Early adoption likely to be allowed in transition period
 - ED largely finalised for short term contracts

Questions

