KPMG

Accounting for insurance contracts is changing

What's the impact for general insurers?

May 2016

The new insurance contracts standard – expected around the end of this year – will significantly impact general (non-life) insurers. It is much more than just an accounting change as it will impact the business as a whole.

The new standard could impact:

- the level of volatility in profit or loss and equity
- measurement and reporting of operational performance
- broad business decisions
- capital management
- systems and processes
- your people and skills

Implementing the requirements will be very complex, so – now that the IASB have concluded their substantive discussions – it's time to engage.

It's imperative that general insurers make this a business priority, particularly those that do not currently discount their non-life contracts.

If you:

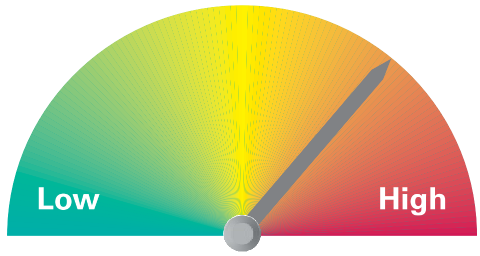
- issue insurance or reinsurance contracts
- issue certain financial guarantee contracts
- issue contracts meeting the definition[1] of an insurance contract, including fixed-fee service contracts

… it's time to start assessing how the new accounting requirements will affect your business.

Engage with your stakeholders to build expectations of how your KPIs or business practices may change.

1. 'A contract under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.' – Appendix A of the IASB's 2013 exposure draft *Insurance Contracts*.

Determining the impact



Volatility in profit or loss and equity

Potential impact

- Volatility in profit or loss and equity may result from the new model's general requirement to reflect the time value of money, with the use of market discount rates that are not linked to the insurer's investment portfolio.
- If IFRS 9 *Financial Instruments* is applied before the new insurance contracts standard, it may create a temporary increase in volatility.
- Accounting for reinsurance contracts held will change.
- The requirement to reflect the time value of money may create an incentive for asset-liability management.

Actions to consider

- Identify sources of volatility under the new insurance contracts model and where it will be presented – i.e. profit or loss or other comprehensive income (OCI).
- Assess how the new insurance contracts standard interacts with the application of IFRS 9 and identify possible accounting mismatches.
- Determine whether to use the accounting policy choice to present changes in discount rates in OCI rather than in profit or loss.
- Consider the temporary relief options that will be available under the proposed amendments to IFRS 4 *Insurance Contracts* where IFRS 9 is implemented before the new insurance contracts standard.
- Assess whether redesignating financial assets upon transition may reduce volatility.
- Evaluate reinsurance programmes for their impact on profit or loss and equity.
- Consider the appropriateness of asset-liability management under the new standard.

Measurement and reporting of operational performance

Potential impact

- While the simplified premium allocation approach is similar to the unearned premium method that many insurers currently use, there are important differences related to:
  - recognising policy acquisition costs; and
  - reflecting the time value of money, when required.
- The new measurement model will change the way insurance liabilities are measured and presented.
- Level of aggregation may be a complex judgemental area, impacting comparability with peers.
- New presentation and disclosure requirements are expected to change the way performance is communicated.
- Analysts and investors may need support to gain familiarity with new reporting methods.

Actions to consider

- Perform a comprehensive review of insurance contracts to assess how they will be measured under the new model.
- Plan the accounting policy decisions to be made and judgements to be exercised.
- Consider how best to communicate performance, given less familiar performance metrics and results presentation.
- Develop ways to communicate profitability to policyholders and reinsurers.
- Consider benchmarking against peers.
- Develop ways to help analysts and investors to understand the new reporting measures.

Broad business decisions

Potential impact

- Measurement and unbundling requirements may require changes in product profile, features or pricing.
- The new reporting basis may have implications for tax and profit distribution in some jurisdictions.

Actions to consider

- Review product profiles and consider changes to product design and pricing.
- Consider entering into reinsurance arrangements.
- Assess the impact on key performance metrics.
- Assess the impact on taxation.
- Identify possible impacts from unbundling components of insurance contracts that are within the scope of IFRS 15 *Revenue from Contracts with Customers* – e.g. estimating the stand-alone selling price.

Capital management

Potential impact

- Potential for increased volatility and surplus constraints may impact capital positions.

Actions to consider

- Understand the differences and assess possible ways to align reporting under the new insurance contracts standard with solvency and regulatory reporting.
- Identify the magnitude of any impact the new insurance contracts standard may have on regulatory capital requirements.

Systems and processes

Potential impact

- Significant resources are likely to be needed to develop, test and implement new processes and controls.
- Actuarial models will need to be updated or replaced.
- Systems may need upgrading to ensure that they can handle the new requirements.
- There may be data gaps to address.
- Retrospective application may require early planning and parallel runs during the transition phase.
- Implementation of the new insurance contracts standard and IFRS 9 will need to be synchronised.

Actions to consider

- Evaluate and address data gaps and collection needs.
- Create a budget for necessary changes to processes and systems.
- Upgrade systems to handle the new requirements around accounting, actuarial modelling, valuation and financial reporting.
- Identify processes affected by the new standard and establish new processes – e.g. regarding contract classification and measurement.
- Evaluate changes needed to key internal controls and regulatory reporting.
- Consider outsourcing options to reduce costs and improve process efficiencies.
- Develop a transition plan for parallel runs.
- Review reporting processes to remove duplication and consider optimal team structure, including offshoring options.

People and skills

Potential impact

- Additional resources and interaction with actuaries may be needed to manage transition and reporting processes.
- Changes to organisational structures may be needed to reflect reduction in reporting metrics and remove process duplication.
- Compensation arrangements and performance targets may need to be changed.

Actions to consider

- Determine staff needs and invest in training relevant departments.
- Budget for necessary people-related changes.
- Communicate changes to help stakeholders understand new metrics and performance results.
- Develop appropriate organisational structures and consider increasing collaboration between teams.
- Assess how changes to processes may impact how work is performed.
- Evaluate the impact on compensation arrangements and performance targets.

How KPMG can help

Assess the impacts → Design a tailored approach → Help implement a future state

A robust assessment phase is critical to laying the framework for a successful project. It is also important to start the assessment early to provide flexibility during the implementation phase. KPMG member firms can help accelerate the assessment and design phases using our purpose built tools, such as the ones below.

Activities	Tools	Description	Benefits
Initial assessment	Quickscan	– A top down summary assessment to identify areas of change and further investigation.	– Highlights areas of further investigation to prioritise and focus on.
Disclosures	Opening the black box: Demystifying IFRS 4 Phase 2	– A report setting out the expected presentation and disclosure requirements.	– Helps develop understanding of the disclosures, the scale of changes and how your processes and systems will be impacted.
Detailed assessment	Gap analysis tool	– Identifies gaps across the organisation between current policies and the new requirements.	– Helps deliver comprehensive gap analysis, which supports programme planning and scoping.
Financial impact assessment	'What if' models and financial impact methodology	– These tools use cash flow projections to illustrate the underlying impact to financial results and actuarial calculations.	– Provides early insight into areas of complexity and high-level estimates of the financial impact.
Operational impact and data flow	Qlikview data flow tool	– Helps visualise data flow from data sources to the financial statements.	– Supports training and understanding. Helps with designing processes and data flows.
Data requirements	Data taxonomy	– Identifies and defines data gaps to prepare financial statements under the new standard.	– Provides early insight into data gaps and level of complexity. Supports programme planning.

Visit our IFRS – Insurance hot topics page for recent publications, including market-leading views on the forthcoming insurance contracts disclosure requirements.

Contact us

If you have any concerns about the impact of the new insurance contracts standard, or any other accounting issues, please speak to your usual KPMG contact or any of the following.

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