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Insurance Accounting: The Shape of Things to Come

By Graydon Bennett

Accounting standard setters have been debating the structure for accounting for insurance for many years. The International Accounting Standards Board have now voted that a new standard, IFRS 17, should be effective from January 2021.

This may seem like a long time away, but the changes required are substantial and prior year comparatives will be expected. Therefore, it is prudent for those involved in insurance to be aware of the issue and the potential implications.

PERCEIVED NEED FOR CHANGE

The current standard, IFRS 4 for insurance contracts, is an interim standard and permits a wide variety of practices. It includes a temporary exemption from the requirement that accounting policies should be relevant and reliable.

The limitations of the current approach include a lack of transparency and comparability between products, companies and across jurisdictions.

HISTORY

The potential changes have been through an extensive process of review and consultation.

In effect the development has taken around 20 years (to date) which reflects the concerns over the complexity of the requirements and the potential impact.

In view of this sensitivity, the process still will involve an extensive review of the final proposals. The standard is expected to be issued in the first half of 2017 which should give a minimum of 3.5 years for entities to prepare for implementation.

NATURE OF THE CHANGES

The changes will ultimately be defined when the standard is issued. However, the key principles have been debated in the various draft documents hence the outline is reasonably clear. The standard contemplates three models depending on the nature of the contract written. They are:

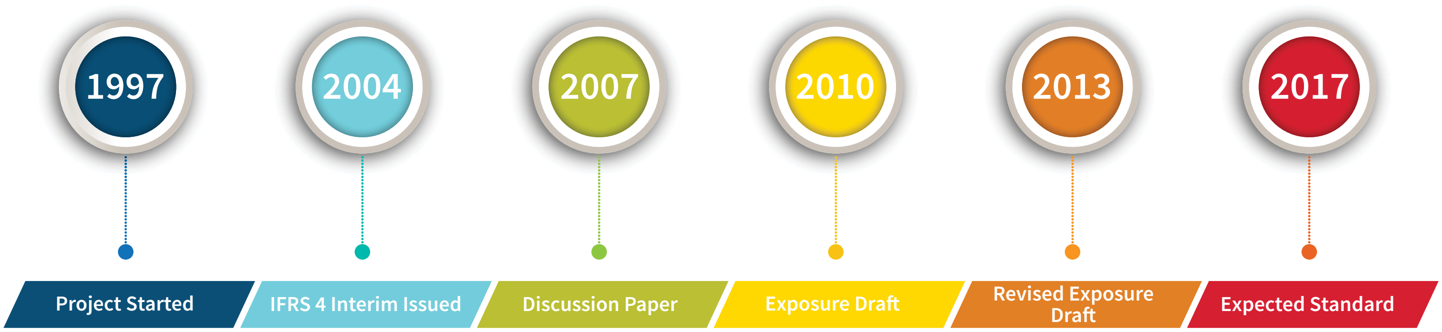
- A building block approach that will be the default and cover most long-term business
- A premium allocation approach that will probably be used for short-term business
- A variable fee approach that may apply to contracts which participate in specific pools of assets and will probably be used for both unit-linked and with-profit contracts

The building block approach has many similarities to Solvency II in requiring discounting with allowance for risk and market consistent valuation of options and guarantees.

However, it is likely that there will also be differences of interpretation and application. For example, day one profits may be eliminated under IFRS 17 unlike the position under Solvency II.

It is also worth noting that insurers may elect to defer implementation of IFRS 9 (Financial Instruments) to coincide with their implementation of IFRS 17.

Figure 1



CHALLENGES

The changes proposed are likely to involve challenges for all those involved in creating and using insurance accounts. The producers of accounts will have to adapt to a new regime with requirements very different to the current regime. Given the differences, there will be a need to collect additional data and complete new calculations.

It is likely that for many companies, the process of collecting additional data could take some time. The precise data needed will have to be defined and the collection process specified and tested. Companies will the then need to specify the new accounting calculations which will also need to be tested.

While some elements of the new regime bear some resemblance to Solvency II, the approaches are not the same. In addition, the application of the new standard will encompass insurance companies not currently required to report under Solvency II.

The new style accounts may offer greater consistency and comparability for users. However, the process is more complex and the user will need to understand the reasons for changes and the implications.

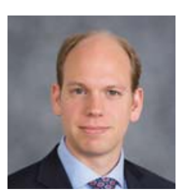
SUMMARY

The evolution of the new accounting requirements for insurance companies has already taken over 20 years. This reflects the complexity of a project that has to meet the needs of varying types of insurance.

The expected changes are summarised above but will only be finally known when the details are published.

For long-term business, the changes are likely to be fundamental and akin to the changes needed for Solvency II. For short-term business, the changes to adopt the premium allocation approach may not be so dramatic but will still require review.

Implementation is still around four years away, but given the challenges, those involved would be wise to start considering the issues once the final terms are issued. ■



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