INTERNATIONAL ACTUARIAL ASSOCIATION
ASSOCIATION ACTUARIELLE INTERNATIONALE

**Statement of Intent (SOI) for an International Standard of Actuarial Practice in relation to IFRS X Insurance Contracts (ISAP [4])**

*(Ratified by Council on 13 September 2014)*

***Submitted by: The Actuarial Standards Committee (ASC)***

## 1. Background

IFRS X Insurance Contracts will prescribe the accounting and disclosure requirements for contracts covered by IFRS X for preparing IFRS reports of entities ('*reporting entities*[1]').

On 20 June 2013, the IASB published a re-exposure draft of its (Phase II) Insurance Contract standard. The ultimate standard is expected to be applicable for accounting periods beginning on or after a date to be determined but unlikely to be before 1 January 2018, with early adoption permitted. This replaces the existing standard, IFRS 4, which required limited changes to, but largely endorsed, prior applied accounting policies.

Even though major changes between the current re-exposure draft and the final IFRS are possible as a result of the IASB's consultation, these changes are not expected to substantially change the topics of ISAP [4]. Given the time needed to develop an International Standard of Actuarial Practice (ISAP) under the IAA Due Process for ISAPs, the IAA would not be able to adopt ISAP [4] prior to the first application date of IFRS X if the approval for the SOI were to be deferred until after the IASB publishes the final IFRS X. Therefore, the approval of this, or an appropriately amended, SOI based on the IASB's re-exposure draft, rather than on the final standard, is imperative for the IAA. If the final IFRS warrants substantial changes to the topics of ISAP [4], these changes will be communicated and addressed appropriately when drafting ISAP [4].

Any subsequent reference to IASB's IFRS X refers to both the re-exposure draft and the expected final standard.

IFRS X applies to *insurance contracts*, rather than insurance entities (e.g., insurers as defined by national law). The scope includes:

- *insurance contracts* issued, including *reinsurance contracts*;
- *reinsurance contracts* held; and
- *investment contracts with discretionary participation features*, provided the entity concerned also issues *insurance contracts*.

[1] Italicized words represent words or phrases used in the IFRSs or the 2013 ED Insurance Contracts

Its scope does not include *insurance contracts* held as a *policyholder*, other than reinsurance. There is limited provision for separation of embedded derivatives or other components that are not insurance components.

The primary measurement approach is the *Building Block Approach*, comprising:

- an explicit, unbiased and probability-weighted estimate (i.e. expected value) of the present value of the future cash outflows less the present value of the future cash inflows that will arise as the entity fulfils the *insurance contract*, adjusted to recognize risk; and

- a *contractual service margin* that is set to absorb any gain at initial recognition and that runs off over the *coverage period*.

The alternative approach, intended mainly for contracts with short *coverage periods*, is the *Premium Allocation Approach*, which spreads the premium, less applicable acquisition expenses, over the *coverage period*. It may be used for *coverage periods* up to one year or when it gives an acceptable approximation to the *Building Block Approach*. Claim liabilities, including those for contracts where the *Premium Allocation Approach* is used for pre-claim liabilities, use the *Building Block Approach*.

The *reporting entity* is ultimately responsible for the values reported in its IFRS reports, including the choice of methods and assumptions, within the guidelines set by IFRS X. The re-exposure draft does not require *reporting entities* to take advice from an actuary. *Reporting entities*, however, normally seek advice from an actuary on the choice of methods and assumptions. As such, actuaries typically play a central role in the calculation of reported amounts relating to *insurance contracts* and in the drafting of various disclosures for long-term *insurance contracts* and liabilities for long-tail claims. Some *reporting entities* seek actuarial advice in respect of all assets and liabilities associated with *insurance contracts*. The actuary may also discuss these items with the auditor before the *reporting entity* finalizes its financial statements.

Auditors, too, may seek advice from an actuary in assessing the choice of methods and assumptions used in relation to IFRS.

In some instances, there may be a need to reconcile statements prepared under other reporting requirements with IFRS reports and to explain the material differences between the two statements. With respect to the IFRS reports, the actuary should apply the proposed ISAP [4].

## *2. Purpose*

Actuarial services in relation to IFRS X is a clearly defined area of actuarial work. Because actuaries in many jurisdictions, with many different types of *insurance contracts*, will be providing actuarial services in relation to IFRS X, an ISAP is the most effective means to facilitate widely accepted convergence of principle-based actuarial standards within and across jurisdictions (as per Council decision in Vienna in October 2010 and the IAA Strategic Objective 3[2]). We also understand that IASB staff is supportive of such a development. Hence ISAP [4] is expected to:

- Provide useful and high quality guidance to actuaries providing actuarial services in relation to IFRS X, to facilitate widely accepted convergence of principle-based actuarial standards within and across jurisdictions;
- Increase public confidence in actuaries' services in relation to IFRS X, especially for the users of actuarial services in relation to IFRS X and other stakeholders having an interest in the quality of financial statements of insurers – thereby contributing to the public good;
- Increase *reporting entities*' and auditors' confidence in actuaries' services in relation to IFRS reporting of *insurance contracts*;
- Promote the development of the actuarial profession, as *reporting entities*' greater confidence leads them to expand their use of actuaries for IFRS reporting of *insurance contracts*; and
- Demonstrate the IAA's commitment to support the work of the IASB in achieving useful financial statements.

Appropriate guidance and high level principles are intended to allow, *inter alia*, for simplification in appropriate circumstances and use of judgment.

The guidance provided in ISAP [4] is intended to motivate Member Associations of the IAA and their standard-setters to consider adopting or adapting ISAP [4] for their membership.

The IAA will give the IASB staff opportunity to comment on the draft ISAP [4], thus complying with the Memorandum of Understanding between the IAA and the IASB and with the expectations of the IASB.

## 3. ***Scope, roles and content***

The proposed ISAP [4] will provide guidance to actuaries providing actuarial services in relation to IFRS X Insurance Contracts to be adopted by the IASB on the basis of its deliberations following the consultation of the re-exposure draft of IFRS X Insurance Contracts issued on 20 June 2013.

[2] Establish, maintain and promote common standards of actuarial education and common principles of professional conduct. Promote the development and issuance of actuarial standards in the jurisdictions of all Full Member Associations, and the global convergence of actuarial standards.

ISAP [4] is expected to address the following aspects of actuarial services in relation to IFRS X, to the extent not covered in ISAP 1:

- Scope;
- Potential roles of the actuary in providing actuarial services in relation to IFRS X to organizations including, but not limited to, preparers and auditors;
- Requirements with respect to parts the actuary is responsible for, such as:
  - Knowledge of and compliance with IFRS X, those aspects of other IFRSs relevant to the engagement, and the *reporting entity*'s accounting policies;
  - Knowledge and consideration of the *reporting entity*'s specifications regarding materiality for the engagement;
  - Knowledge and consideration of the *reporting entity*'s products and operations;
  - Knowledge and consideration of the *reporting entity*'s appetite for and approach to pricing risk;
  - Knowledge of how the *reporting entity*'s regulatory environment(s) interface(s) with IFRS X;
- Principles for determining the classification of contractual obligations *vis-à-vis* the definitions of *Insurance Contract* and *investment contracts with discretionary participation feature* in IFRS X (Contract Classification);
- Considerations when combining or separating components of *insurance contracts*;
- Considerations when defining portfolios and determining the level of aggregation of contracts in measurement;
- Considerations when determining the pattern of recognition of the *contractual service margin*;
- Considerations regarding the various initial and subsequent measurement approaches, including:
  - Contract boundaries;
  - Contracts that have a link to returns on underlying items;

  - Simplified approach for measuring the liability for the remaining coverage, including when its use is appropriate;
  - *Reinsurance contracts* held;
  - Portfolio transfers and business combinations;
  - *Investment contracts with a discretionary participation feature*.

- Considerations for the selection and revision of actuarial methods and assumptions for current estimates, *risk adjustments* and *contractual service margins*;
- Considerations for determining current interest rates which reflect the characteristics of the liability;
- Considerations for determining locked-in interest rates, including any appropriate cohort structure;
- Considerations for the treatment of embedded derivatives;
- Considerations for determining the assumptions for the reinsurance asset, in line with the assumptions of the ceded part of the liability; and identifying the assumptions of that part;
- Considerations about the recognition, modification, and derecognition of an *insurance contract;*
- Considerations for the actuary in supporting the *reporting entity* in complying with the presentation and disclosure requirements of IFRS X;
- Considerations when handling transition;
- Process and model governance;
- Quality and completeness of data;
- Materiality;
- Trade-off between costs and benefits.

The ASC believes that some specific actuarial issues such as the following items are better addressed by one or more IANs rather than in an ISAP:

- Detailed choice of assumptions and methods for *current estimates*;

- Detailed procedures and assumptions for *risk adjustment*;
- Detailed procedures and assumptions for time value of money;
- Detailed procedures and assumptions for re-measurement of *contractual service margin*;
- Detailed procedures and assumptions for the *Premium Allocation Approach* in non-trivial cases;
- Detailed measurement of non-separated embedded derivatives, applying the three building blocks;
- Detailed determination of value of separated components in line with IFRS 9, IAS 37 and IAS 18;
- Detailed procedures for transition.

A key requirement for inclusion in ISAP [4] is whether the guidance is likely to influence actuaries' behaviour in a way that promotes compliance with IFRS X reporting of *insurance contract* financial statement values (which can be very significant and material in the context of the *reporting entity* as a whole) as far as it is specific for IFRS X.

The contents of ISAP [4] will be drafted in accordance with the criteria and guidelines approved by the Actuarial Standards Committee.

### *4. __Principle of Subsidiarity__*

The ASC considered whether the proposal for a model ISAP [4] conflicts with the principle of subsidiarity and concluded that it did not. The ASC confirms its intent that the proposed ISAP [4] is to comply with the principle of subsidiarity.