Business Planning: Insurance

2019 CONFERENCE

EXAMINERS’ DEBRIEF AND GUIDANCE

Session contents

- Changes to syllabus and learning materials for exams in 2019
- Newly examinable elements of IFRS 17 in 2019
- Review of candidates’ performance in 2018 examinations
- Sample marking exercise from December 2018 exam
- Questions and answers throughout and at the end

Changes to syllabus and learning materials

Business Planning: Insurance paper

- Professional Level module
- 2.5 hour computer-based exam
- 3 scenario based questions with multiple requirements (Q1 c.40 marks)
- 55% pass mark
- Access to all learning materials in the exam
- Students are strongly advised to complete FAR and AA before attempting BP:I
- A bridge between Professional and Advanced levels
- June 2019 will be the tenth sitting of BPI

Syllabus changes – section 2

- h. identify and explain risks specific to life insurance and non-life insurance in the context of a given scenario and advise on appropriate measures to mitigate and manage them
- i. explain how an insurance company might manage risks using digital technologies, big data, data analytics and artificial intelligence

Syllabus changes – section 3

- d. ~~demonstrate an understanding of~~ explain, appraise and apply IFRS 17, Insurance Contracts
- i. show and appraise the IAS 39 and IFRS 9 treatments of the impairment of financial instruments, demonstrating an understanding of the relevant principles ~~and evaluating the impact of the changes from the IAS 39 treatment of impairment~~

Syllabus changes – section 4

- f. demonstrate an understanding of the auditor’s responsibilities in relation to the audit of an insurance company’s Solvency and Financial Condition Report.
- k. explain the importance of critically assessing an insurance company’s strategic report in addition to its financial statements for consistency and for the purpose of understanding the entity.

Syllabus changes – technical knowledge table

• The key ~~operational~~ risks experienced by an insurance company	A
• Asset and liability matching scenarios	A ~~B~~
• IFRS 17 – Insurance Contracts	A ~~B~~
• Hedge accounting in accordance with IAS 39 and IFRS 9	B ~~A~~
• Impairments in accordance with IFRS 9 and ~~vs~~ IAS 39	A
• Investment property – IAS 40	B
• Audit and assurance procedures for an insurer's regulatory returns	A

Learning materials

- Continuous quality improvement process – incorporates 2018 tutor feedback
- Chapter 1 – new section 1.7 on digital threats and opportunities,
- Chapter 3 – new section 3.8 on the benefits of Lloyd's
- Chapter 4 – expanded section 4 with more of IFRS 17, components of total insurance liabilities, comparison of measurement under IFRS 4 and IFRS 17 and more detail in section 7.1 embedded value
- Chapter 6 – revised section 2.2.7 on loss spirals, enhanced/reorganised section 3.2 on big data
- Chapter 13 – section 5.6 definitions added for walk-through tests and tests of controls, new section 5.9 on the strategic report and new section 8.2 on application of CASS to insurers
- Question Bank – additional 15 exam standard questions, including three on IFRS 17

Further examinability of IFRS 17

IFRS 17: Insurance Contracts




Candidates' recurring weaknesses in IFRS 17

- Lack of visible workings
- Questioning if things told to be correct actually *are* correct
- Including the PV of all outflows or inflows as cash movements for the year
- Confusing percentages: discount rate and adjustment for non-financial risk
- Confusing +/- (ie debits and credits)
- Needless disclosure of finance expense effect on ANFR (takes time and not required, though may be an easier approach, so gets full marks).

Scope

Issued insurance contracts

Issued reinsurance contracts

IFRS 17

Purchased reinsurance contracts

Investment contracts with DPFs

Mandatory implementation currently from 1 Jan 2021.

May be postponed to 1 Jan 2022.

Assume EU endorsed.

Assume applies in the UK.

IFRS 17's two methods

- Premium allocation approach
  - Contracts 12 months or less
  - Fairly simple accrual accounting
- General measurement method
  - Contracts over 12 months
  - Some similarity with MCEV

The premium allocation approach is a simplification allowed only in restricted circumstances.

The default method of IFRS 17 is the general measurement method.

GMM: Value of insurance policy at inception

Present value of expected cash inflows

CSM/ FCF

Adjustment for non-financial risk

Present value of expected cash outflows

GMM example: Blue Moon 1

- Blue Moon Insurance writes an insurance contract that incepts on 1 January 2018.
- The contract provides three years of cover, expiring 31 December 2020.
- The premium of £42,000 must be paid in full up front.
- The expected cash outflows (claims and claims handling expenses). are estimated at 1 January 2018 to be £12,020 per year, giving a present value of £34,000. This was arrived at by discounting expected payments at an annual rate of 3%.
- The company estimates that an adjustment of 6% of expected claims is appropriate, given uncertainties about the underwriting result.
- The premium was not yet paid on 1 January 2018.

Show the impact of this contract on the financial statements at 1 January 2018.

Blue Moon 1: Estimate of initial cash flows

At contract inception	£
Present value of cash inflows	
Present value of expected cash outflows	
Net present value of cash flows	
Adjustment for non-financial risk (6% x 34,000)	
Fulfilment cash flows	
Contractual service margin	

GMM example: Blue Moon 1

In year 1 of the policy, all went as expected.

- The premium was paid in full on 3 January 2018.
- In the year ended 31 December 2018, Blue Moon paid the expected claims and claims handling expenses of £12,020.
- The expected remaining cash outflows (claims and claims handling expenses) are re-estimated at 31 December 2018 as having a present value of £23,000. The discount rate of 3% was unchanged.
- The company estimates that an adjustment of 6% of expected claims remained appropriate for non-financial risk.

Show the impact of this contract on the statement of financial position and statement of profit or loss for the year ended 31 December 2018.

Blue Moon 1: End of year 1

At end of year 1	£
Present value of cash inflows	
Present value of expected cash outflows	
Net present value of cash flows	
Adjustment for non-financial risk	
Fulfilment cash flows	
Contractual service margin	
Liability for remaining coverage	

General measurement method

	PV future cash flows	Non-financial risk adjustment	Contractual service margin	Liability for remaining coverage
1 Jan 2018	0	0	0	0
Changes related to future service				
Cash inflows				
Insurance finance expense (to P/L)				
Changes related to current service (to P/L)				
Cash outflows				
31 Dec 2018				

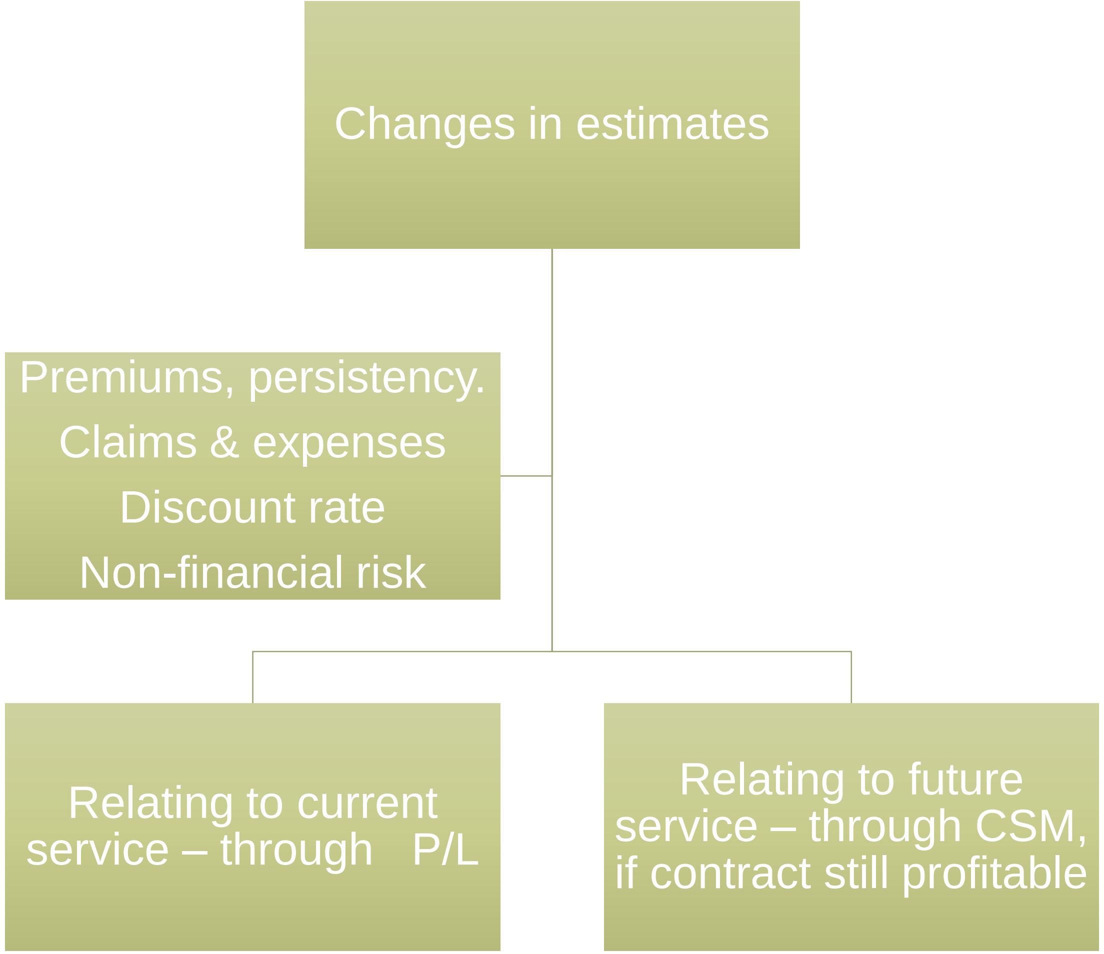
General measurement method 2018 P/L

	£	£
Insurance revenue		
Insurance service expense (claims paid)		
Insurance service result (from reconciliation)		
Insurance finance expense (from reconciliation)		
Investment income		
Investment result		
Profit for the year ended 31 December 2018		

GMM: A note on insurance liabilities

	Component of total insurance liabilities	Relates to past or future incurred claims?
1	Case reserves	Past Claims reported to the insurer
2	Claims IBNR	Past Claims incurred but not yet reported to the insurer
3	Claims IBNER	Past Claims reported to the insurer, but case reserves too low
4	Liability relating to future coverage	Future Claims not yet incurred, but expected to be incurred over the life of the policy

GMM: Changes in estimates



GMM example: Blue Moon 2

In year 2, the actual results began to differ from initial estimates:

- In the year ended 31 December 2019, Blue Moon paid claims totalling £13,000, ie £980 more than initially expected. Claims in the last year are expected also now to be £13,000.
- Now assume the expected remaining cash outflows (claims and claims handling expenses) are re-estimated at 31 December 2018 as having a present value of £12,622. The discount rate of 3% was unchanged.
- The company estimates that an adjustment of 6% of expected claims remains appropriate for non-financial risk.

Show the impact of this contract on the statement of financial position and statement of profit or loss for the year ended 31 December 2019.

Blue Moon 2: Changes in estimates

Year ended 31 Dec 2019	Was originally estimated as	Latest experience/ estimate	Adjustment	Current or future?
Claims in year 1 of 3 year policy	£12,020	£13,000	£980	
Present value of outflows in year 3	£11,670 (12,020/1.03)	£12,622 (13,000/1.03)	£952	
Remaining adjustment for non-financial risk	£700 (11,670 x 6%)	£757 (12,621 x 6%)	£57	

Blue Moon 2: End of year 2

At 31 December 2019	£
Present value of cash inflows	
Present value of expected cash outflows	
Net present value of cash flows	
Risk adjustment	
Fulfilment cash flows	
Contractual service margin (Reconciliation on next slide)	
Liability for remaining coverage	

General measurement method

	PV future cash flows	Non-financial risk adjustment	FCF	Contractual service margin	Liability for remaining coverage
1 Jan 2019	(23,000)	(1,380)	(24,380)	(4,093)	(28,473)
Changes related to future service					
Cash inflows					
Insurance finance expense (to P/L)					
Changes related to current service (to P/L)					
Cash outflows					
31 Dec 2019					

General measurement method P/L

	£	£
Insurance revenue		
Insurance service expense (claims paid)		
Insurance service result (from reconciliation)		
Insurance finance expense (from reconciliation)		
Investment income		
Investment result		
Profit for the year		

Sample exam standard question

Real exam standard question “Logan Insurance”

Requirements:

- Calculate initial contractual service margin
- A reconciliation of the liability on the contract from the start to end of the current year, comprising:
  - PV of cash flows
  - Adjustment for non-financial risk
  - Fulfilment cash flows
  - Contractual service margin
  - Liability for remaining coverage.
- Relevant extracts from the statement of profit or loss for the year ended 31 December 2018 and the statement of financial position at that date.

Review of candidates' performance in 2018

2018 exam sessions – numbers and pass rates

SESSION	JUNE	SEPTEMBER	DECEMBER
OVERALL PASS RATE	71.2%	73.3%	75.3%
NUMBER OF CANDIDATES	52	15	77
FIRST ATTEMPT	34	7	68
FIRST ATTEMPT PASS RATE	64.7%	71.4%	72.1%
RE-SIT	18	8	9
RE-SIT PASS RATE	83.3%	75.0%	100.0%

2018 exam sessions - average mark by question

	JUNE	SEPTEMBER	DECEMBER
QUESTION 1	57.1%	60.5%	63.5%
QUESTION 2	57.7%	62.3%	61.1%
QUESTION 3	55.8%	61.0%	53.2%
OVERALL	57.1%	61.4%	60.1%

Session specific issues

- First year for computer based exams
- June
  - Maiden outing for IFRS 17 polarised candidates, but generally answered fairly well
  - Responding to key words with pre-prepared answers eg ‘own credit’ whenever IFRS 9 mentioned
  - Providing factual information that failed to address ‘the problem’ in the requirement
  - Un successful candidates often provided no response to multiple requirements
- September
  - Candidates who merged requirements struggled with structure and clarity
  - Extensive copying out from learning materials. Definitions are good to anchor some analysis/ state decision rule, but limited marks for knowledge alone.
  - Risk management generally strong
  - Tendency to state that IBNR is due to policyholders being slow to report, rather than due to latency of claim itself
- December
  - IFRS 17 elements generally well answered, but signs that too much time spent by some and workings please!
  - Sub-optimal decisions occasionally taken on how to structure answers eg combining requirements
  - Still responding to key words without carefully reading requirement eg mortality bond **liability**
  - Still too much generic or factual information without relating it to the requirement

Marking sample requirements

You should have on your desk:

- *Real exam paper from December 2018*
- *Marks plan for December 2018*
- *Confidential tutor mark plan for December 2018*
- *Confidential extracts from student scripts from December 2018*

Q & A

Now, or over coffee…

ICAEW