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INSURANCE

The New World for Insurance

Preparation and readiness
for accounting change – an industry survey

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Accounting change – what are insurers doing?

The efforts of the IASB and the FASB to draft a comprehensive insurance contract standard ('Phase II') have continued throughout 2011. The timetable was deferred earlier in the year, and the IASB decided to postpone the implementation of their proposals for the overhaul of financial instrument accounting; this allowed the Boards to continue to deliberate key issues and potentially achieve greater convergence between the IASB's and the FASB's proposals.

While deliberations continue, one of the questions that we often get asked by insurers is – what are my peers doing to prepare for accounting change? Faced with multiple challenges, in particular seeking opportunities for profitable growth while battling continuing economic headwinds, has future accounting change dropped off the corporate radar? To help answer this question, we surveyed a number of insurers operating around the world. In this short update to our *New World for Insurance* series, we present the findings from that survey, focusing on some of the largest international insurance groups.

Some of the answers were striking.

- Despite the standards not being finalised, significant training and preparatory work had already started for the majority of participants. Several participants planned to undertake more detailed assessments when there is further certainty on the ultimate timeline. Only one of our participants questioned whether a final standard would eventually emerge.

- Many of our participants were frustrated in their attempts to link reporting change with changes in risk and capital management, in particular because of the divergence with the timeline for Solvency II, which for many insurers with European operations remains 'front of mind' and has first call on scarce resources. Perhaps as a result, almost half of participants had not yet linked consideration of the Boards' financial instruments proposals into an integrated project plan with Phase II. Given insurers' concerns about increased volatility of earnings and reported balance sheet strength, we believe that an integrated approach will become increasingly important.
- As expected, the majority of our participants thought the quality of the future standard was of the upmost importance for internationally active insurers and that the timeline should not compromise that quality.

The proposals continue to evolve as the Boards deliberate the remaining open topics. For a full summary of the Boards' proposals and changes to date, see our publication *IFRS – Insurance Newsletter*. We expect that the Boards will publish revised proposals towards the end of the first half of 2012, after which we expect activity by insurers preparing for the new standard to ramp up significantly.

Combined with the changes to financial instruments and regulatory developments, we expect that adapting to the new proposals will be a significant undertaking and will be a catalyst for change affecting many parts of the business, while insurers continue to adapt to the evolving business and economic environment.



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Global Head of Insurance



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Partner, Financial Services

Survey basis

During March 2011 and September 2011, we issued our publications *The New World for Insurance – Business perspectives on Phase II* and *The New World for Insurance – Progress report on Phase II*. In these publications, we discussed the potential business impacts for the insurance industry, investors and regulators of the forthcoming financial reporting changes impacting the sector. This is based on the Boards' re-deliberations on *Insurance Contracts*, and other forthcoming reporting developments, particularly in respect of financial instruments. This publication follows in our *New World for Insurance* series, highlighting what insurers around the world are doing to start preparing for these changes.

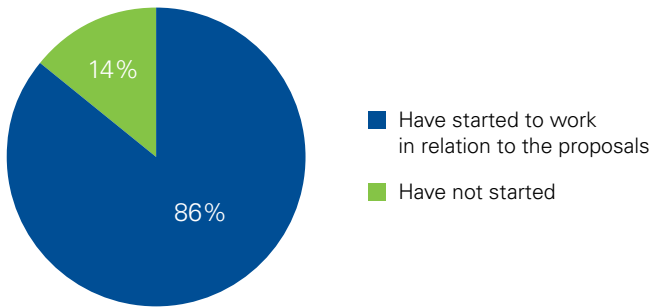
The IASB has not indicated a target date for a final standard on insurance contracts in its most recently published timetable and we currently expect deliberations to run into early 2012, with a final IFRS before 2013 unlikely if the IASB re-exposes its current proposals. Whether the IASB re-exposes partially or fully depends on the eventual extent of the change from the original Exposure Draft (ED). The FASB is aiming for an ED in the first half of 2012. To understand what insurers are currently doing, or are planning to do, to prepare for these forthcoming reporting changes, during September and October 2011, KPMG member firms conducted a survey of fourteen leading insurance groups with headquarters in seven countries and operations throughout the world. Their responses are shared in the next few pages.

Highlights

- 86% of our participants had started work to prepare for Phase II, with all but two starting internal technical training.
- A large majority of participants had started preparatory work such as developing high-level impact assessments, modelling of the potential impacts for key product types, lobbying through industry groups, preparing comment letters, and developing detailed implementation plans.
- 21% of participants had already committed a budget to Phase II activities.
- However, almost half of participants had not yet linked consideration of financial instruments proposals into an integrated project plan with Phase II.
- The majority of participants thought that the quality of the future standard was of the upmost importance and that the timeline should not compromise that quality. Several of these participants thought that convergence between the proposals of the IASB and FASB should be of high importance, and was critical for those insurers operating in global markets.



Phase II preparation – despite delays, now is not too soon



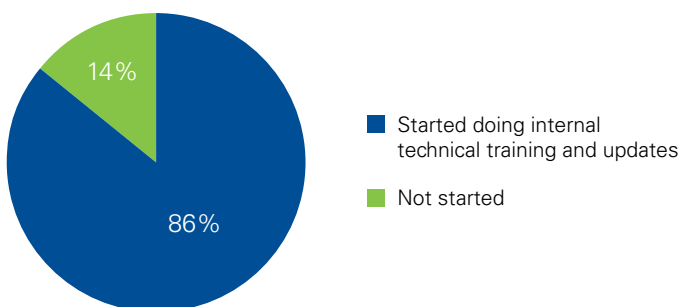
86% of the participants indicated that they had already begun work in relation to the Phase II proposals. The 14% that had not started work commented that, due to changes in the proposals, they did not think there was enough certainty as to the shape of the final insurance model to start preparatory work.

Observations

The 3–5 year implementation period suggested by many commentators on the ED may be challenging for insurers with geographically diverse operations or wide product ranges. A number of our participants suggested that a 2016 implementation date would be needed if a final standard emerged towards the end of 2012.

What form are preparations taking?

Internal technical training and updates

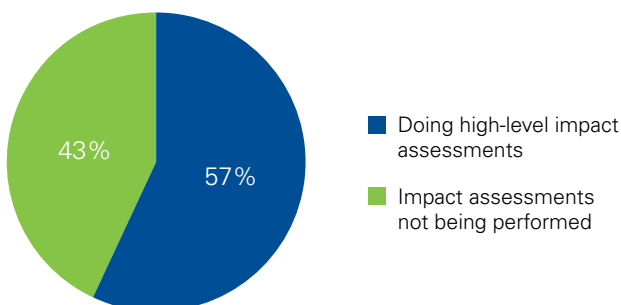


86% of participants had started providing internal technical training, and in many cases this is being performed several times a year.

Internal training includes:

- high-level technical updates for CFOs and controllers as well as chief actuaries and risk officers on the latest insurance project developments;
- regular monitoring of developments and educational sessions for country business units;
- comprehensive technical training for finance, actuarial and risk management teams;
- monthly technical discussions and internal workshops with business and country units on developments; and
- high-level education and information sessions for audit committees.

High-level impact assessments

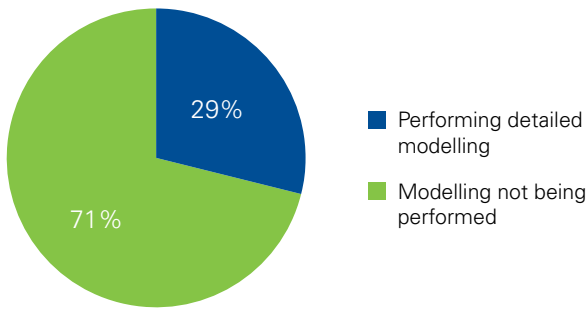


57% of participants stated that they are performing high-level impact assessments of the proposals as they are being developed, although some participants had halted performing further assessment until there is greater certainty on the final proposals and the timeline.

The nature of impact assessments varied among participants and included:

- high-level financial analysis of the proposals and modelling of key products;
- exploring the capability of systems to comply with disclosure requirements; and
- evaluating the implications of re-measurement with current assumptions, specifically discount rates, for long-term business.

Detailed modelling



29% of participants stated that they were already performing detailed modelling of the impact of the proposals.

Some participants commented that detailed modelling had not been undertaken because, from a practical standpoint, the actuarial resources that would have been required to undertake modelling for Phase II had been fully involved in Solvency II work.

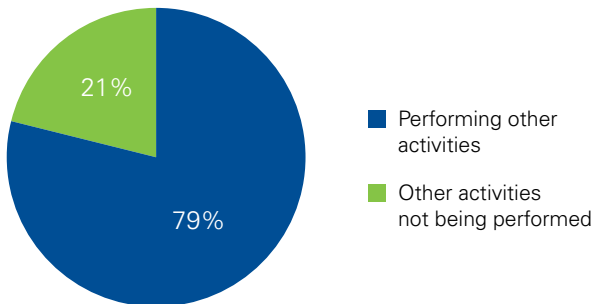
Other activities

79% of participants stated they were doing other types of work to prepare for Phase II.

These include:

- participating in discussions with other large insurers and with industry groups such as the European CFO Forum and American Council of Life Insurers to discuss project developments and related issues;
- holding discussions with analysts on the proposed changes and potential impacts;
- lobbying the IASB and FASB to amend their proposals;
- analysing potential impacts and issues for products;

- developing detailed implementation plans based on current proposals and timelines;
- performing a gap analysis comparing measurement requirements under Solvency II and Phase II;
- involvement in the IASB field testing activities;¹
- responding to IASB and FASB staff enquiries and clarifying of issues/concerns with proposals; and
- participating in educational sessions and round tables held by accounting firms.

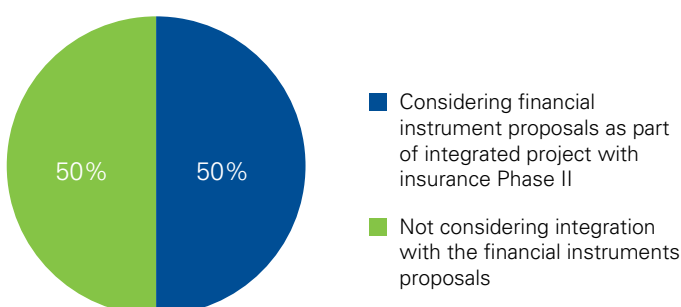


Observations

The responses illustrate the range of approaches adopted by insurers. There is no single 'right' answer to the question of what insurers should be doing – it depends on their circumstances, resources and other priorities.² For the larger groups, as elements of the proposals become clearer, we believe that there is greater opportunity to start high-level evaluation, in particular if major investment in finance, risk, capital management or systems is being contemplated.

Is Phase II being considered with other key reporting changes?

Integration with financial instruments proposals³



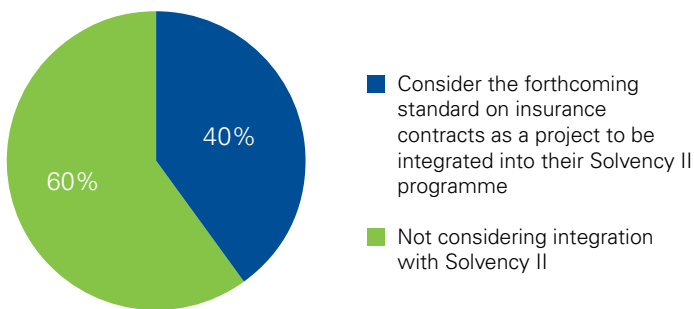
50% of participants were considering financial instruments developments as part of an integrated project with insurance Phase II.

¹ 43% of participants participated in the IASB's field testing activities.

² Although the standard is not in its final form, the changes identified to date, coupled with the reporting changes in respect of financial instruments and regulatory developments under way, warrant planning now. See the *The New World for Insurance – Progress report on Phase II* for possible approaches to beginning your implementation of Phase II.

³ The IASB has decided to delay the effective date of IFRS 9 *Financial Instruments* (formerly effective for annual periods beginning on or after 1 January 2013) to annual periods beginning on or after 1 January 2015.

Integration with Solvency II



Approximately 79% of participants have European operations that will be impacted by Solvency II. 40% of these participants stated that they would consider the forthcoming standard on insurance contracts in conjunction with their Solvency II program.

Those considering an integrated approach see potential synergies between Solvency II and Phase II in order to minimise cost; they are considering whether actuarial and reporting systems currently being revamped for Solvency II will require additional features to address Phase II. Some of the participants also stressed the importance of linking both Phase II and Solvency II into their asset-liability management processes.

Those participants considering the two initiatives separately stated that they are primarily influenced by the different timelines of the projects, and a number expressed frustration at the diverging timelines.⁴

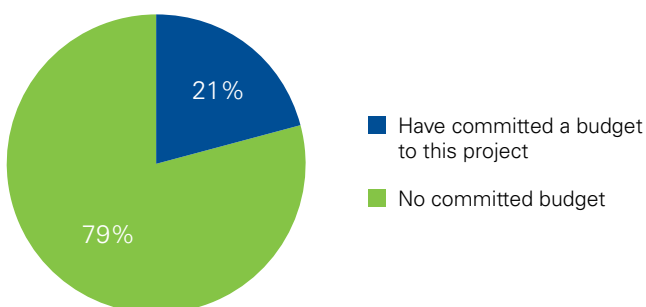
Observations

We think that there will be significant interaction between the insurance contracts and the financial instruments proposals. The IASB's recent decisions to consider targeted improvements to IFRS 9 *Financial Instruments*, in part based on the interaction with the insurance contracts proposals, reflects the connected nature of these topics.⁵ Not only will insurers need to consider the appropriate measurement basis of their financial assets under the proposed financial instruments standards and how this interacts with the measurement of liabilities under the insurance proposals, but also the impact on their asset liability management. At the heart of this lies a potential

question over how to manage their economic, regulatory and accounting positions, each of which may be different. To ensure a successful transition in this tremendous wave of change for insurers, it will become increasingly important to manage these positions in an integrated way.

Many insurers are acutely aware of the potential synergies from aligning investment in solvency changes with investment in Phase II developments, but are finding these difficult to capture as the timing of financial reporting and solvency developments diverge.

When should I start thinking about the cost?



Only 21% of participants stated that they had committed a budget to Phase II.

Most participants are of the view that until a final standard is released and the effective date of transition is clear, they won't commit to a formal budget for the project.

⁴ Current expectations are that supervisors and EIOPA (the European Insurance and Occupational Pensions Authority) will gain their Solvency II responsibilities on 1 January 2013, and that insurance firms will have the Solvency II rules 'switched on' on 1 January 2014. Phase II does not yet have an effective date. Based on the feedback received on the ED, most insurers expect to require at least a three-year lead time for implementation. Considering this feedback, an effective date for the final standard prior to 2016 appears unlikely.

⁵ The IASB unanimously agreed to consider making improvements to IFRS 9 and, in particular, to consider the interaction with the insurance contracts project and the FASB's classification and measurement model. Specifically, the IASB may look at the accounting for financial assets backing insurance contracts and whether some consideration should be given to remeasuring some assets through other comprehensive income rather than profit or loss. The IASB also decided to make any changes as soon as possible and to limit the scope of the project to minimise potential disruption to those who have already applied, or who are close to applying, IFRS 9, and to assist in timely completion of the project.

Observations

Given the current uncertainty over the details and timing of the final proposals, many large insurers are 'watching and waiting' – focusing on assessing the high-level impact of the evolving developments, educating core stakeholders and lobbying the standard setters. While detailed implementation planning requires a final standard, insurers are beginning work on assessing what

resources and support they will need in critical areas (such as accounting, actuarial, IT, HR, product development and investor relations). They are also considering the implications for other project activity such as enhancements to management information and investment in more sophisticated asset-liability management.

What are the views on the delay in the timeline for a final standard?

Several of our participants commented that the quality of the future standard was of the utmost importance and thought that further delays to the timetable were justified if the result would be a high-quality standard. Reflecting the global reach of many of our participants, several thought convergence

between the proposals of the IASB and FASB to be of critical importance for insurers operating in global markets. Notably, only one of our participants questioned whether a standard would eventually emerge.

KPMG: *An experienced team*

Your transition to Phase II

As a network of member firms across 150 countries with experience of more than 1,500 IFRS transition projects around the world, we can help you identify the issues early, and can share leading practices to help avoid potential pitfalls. KPMG firms have extensive experience and the capabilities needed to support you through your Phase II education, evaluation and assessment process.

Our network of specialists can advise you on your preparation for the forthcoming accounting changes. We are committed to providing a uniform approach to deliver consistent, high-quality services for clients across geographies. Our multi-disciplinary experience in accounting, actuarial, risk and asset-liability management, regulatory, IT and tax topics can assist you in analysing what the new standards will mean for you. Subject to independence constraints, we can assist you with:

- performing a readiness and impact assessment;
- reviewing selected products modelled on a Phase II basis;
- performing a gap analysis addressing current systems and processes;
- managing and executing the transition project; and
- training and educating employees.

A Phase II readiness assessment is an entry-level analysis of the standard's requirements and their impact on your company. The assessment forms the basis for the development of further options to proceed. Project interdependencies with Solvency II, developments in financial instruments accounting, and other projects all need to be taken into account to the extent they are relevant.

KPMG's global insurance practice

KPMG's global insurance practice is dedicated to supporting insurers in understanding industry trends and business, regulatory and financial reporting issues at global and local levels. Our professionals, working for member firms around the world, offer skills, insights and knowledge based on substantial experience.

KPMG's global insurance practice is a network of highly qualified professionals in the Americas, Europe, the Middle East, Africa and Asia Pacific and offers industry-tailored Audit, Tax and Advisory services that can lead to comprehensive value-added assistance for the most pressing business and reporting requirements.

For more information, visit www.kpmg.com

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