New Zealand Society of Actuaries (Inc)

Insurance Accounts – Are They Of Any Use?

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Brave New World

Big Data, Longevity and ERM

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Disclaimers

The opinions expressed in this presentation are those of the authors and do not necessarily represent the views of our respective employers.

We have a life insurance focus and don't cover participating business.

We have removed names where possible and only used publicly available information.

Note: Topical in Australia at present

Income Statement

For the year ended 31 December 2008

	Note	2008 $	2007 $
Premium revenue	5a(i)	39,565,167	27,710,373
Less: Outward reinsurance expense	5b(i)	(18,399,399)	(18,581,361)
Net premium revenue		21,165,768	9,129,012
Reassurance commission received	5a(iii)	2,718,288	9,521,827
Other revenue	6	605,434	548,711
		3,323,722	10,070,538
Claims, surrenders and maturities expense	7	(12,705,017)	(6,777,128)
Less: Reinsurance recoveries revenue	5a(iii)	7,447,416	4,393,820
Net claims expense		(5,257,601)	(2,383,308)
Decrease in net policy liabilities		54,539,882	21,408,643
Finance costs	10	0	(77,208)
Commissions and operating expenses	8 & 9	(57,694,107)	(35,121,499)
Profit before income tax expense		**16,077,664**	**3,026,178**
Income tax expense/(benefit)	11	(14,065,206)	(3,656,435)
Profit after income tax expense		**30,142,870**	**6,682,613**
Attributable to:			
Equity holders of the parent		30,142,870	6,682,613
		30,142,870	6,682,613

Questions

1. $30m profit, big improvement over last year – all good then?
2. Or do you think you need know to more?
3. What more?
4. The "Decrease in net policy liabilities" looks interesting, as do "Commissions and operating expenses".
5. How many people would believe nearly half the profit was a future income tax benefit?

New Zealand Society of Actuaries (Inc)

Balance Sheet

As at 31 December 2008

	Note	2008 $	2007 $
Assets			
Cash and cash equivalents	12	13,098,736	13,426,912
Trade and other receivables	13	5,914,382	3,191,402
Investments	14	1,535,906	1,716,101
Property, plant and equipment	15	704,267	505,548
Intangible assets	16	1,181,870	620,450
Deferred taxation benefits	11	17,721,641	3,656,435
Total Assets		40,156,802	23,116,848
Liabilities			
Trade and other payables	17	10,186,716	8,082,445
Other liabilities	18	-	-
Insurance contract liabilities - reinsurance	19	42,475,867	32,895,374
Insurance contract liabilities/(assets)	19	(151,467,313)	(87,253,409)
Investment contract liabilities	19	2,198,908	2,455,141
Total Liabilities		(96,605,822)	(43,820,449)
Net Assets		**136,762,624**	**66,937,297**
Equity			
Share capital	22	99,000,738	59,400,738
Retained earnings	23(a)	37,704,924	7,562,054
Reserves	23(b)	56,962	(25,495)
Total Equity		**136,762,624**	**66,937,297**

Questions

1. $140m equity but only $40m of assets?
2. And nearly half that $40m is future tax benefits?
3. $150m of "negative liabilities" which is dependent of a lot of assumptions.

Statement of Cash Flows

For the year ended 31 December 2008

	Note	2008 $	2007 $
Cash flows from operating activities			
Cash was provided from:			
Premium receipts		40,244,054	28,510,788
Reassurance receipts		5,191,423	3,476,470
Interest receipts		607,274	548,357
Dividend receipts		2,411	10,422
		46,045,162	32,546,037
Cash was disbursed to:			
Reassurance payments		12,315,141	9,207,839
Claim, surrender and maturity payments		14,205,406	6,742,153
Commission payments		32,725,338	17,206,390
Payments to suppliers and employees		25,715,242	14,314,920
Interest paid		0	2,724
		84,961,127	47,474,026
Net cash flows from operating activities	24	(38,915,965)	(14,927,989)
Cash flows from investing activities			
Cash was provided from:			
Proceeds from sale of financial assets		1,081,605	-
Repayment of advance to subsidiary		18,000	-
		1,099,605	-
Cash was disbursed to:			
Purchase of financial assets		844,000	62,000
Purchase of fixed assets		254,197	148,948
Purchase of computer software		1,013,619	510,392
Advance to subsidiary		0	31,239
		2,111,816	752,579
Net cash flows from investing activities		(1,012,211)	(752,579)
Cash flows from financing activities			
Cash was provided from:			
Issue of shares		39,600,000	20,200,000
Subordinated loan from parent		-	-
Net cash flows from financing activities		39,600,000	20,200,000

Questions

1. $30m profit but needed $40m injection.
2. That is equivalent to virtually all of its cash revenue (spent twice as much as it got).
3. How much will it need next year?
4. Where can you find out?
5. Would you invest your own money?
6. What would you like to know first?

What might you like to know before you buy?

- Capital – we know it needed a $40m injection, how much more cash does it need? What would happen if it didn't get it?
- Profit - when is the $30m reported profit able to be distributed to shareholders?
- Risk – what is in that $150m of negative liability i.e. the biggest asset?
- What else do I need to know?
- Let's now consider the notes to accounts.

The Notes – a gold mine or tailings?

Equity of Life Insurance business

	2008	2007
	$	$
Equity retained for solvency purposes		
Equity of shareholder	136,762,623	66,937,297
Less: Equity retained for solvency purposes	(133,519,248)	(63,512,424)
Equity available for distribution	3,243,375	3,424,873

Based on actuarial advice the Directors have determined that $133,519,248 (31 December 2007: $63,512,424) of equity is a contribution to solvency and is therefore not distributable.

Equity retained for solvency reserves has been calculated in accordance with Professional Standard No. 5 of the New Zealand Society of Actuaries.

Notes

1. Solvency looks thin.
2. Can the owners raise more capital?

The Notes – a gold mine or tailings?

Balance at 31 March 2014 *In thousands of New Zealand Dollars*	**Company $000**	**Statutory Fund $000**	**Shareholder Fund $000**
Actual Solvency Capital	54,294	32,890	21,404
Minimum Solvency Capital	47,089	31,811	15,278
Solvency Margin	**7,205**	**1,079**	**6,126**

Balance at 31 March 2013 *In thousands of New Zealand Dollars*	**Company $000**	**Statutory Fund $000**	**Shareholder Fund $000**
Actual Solvency Capital	37,129	19,093	18,036
Minimum Solvency Capital	32,172	17,523	14,649
Solvency Margin	**4,957**	**1,570**	**3,387**

Notes

1. Newer disclosure with a statutory fund.
2. Probably worth reading the words that go with it.

The Notes – a gold mine or tailings?

20 Insurance contract assets and liabilities

In thousands of New Zealand Dollars	2014 $000	2013 $000
Net insurance contract assets and liabilities contain the following components:		
Present value of future policy benefits	185,792	142,800
Present value of future expenses	141,845	101,583
Present value of future planned margins of revenues over expenses	107,462	116,311
Present value of future premiums	(476,560)	(388,133)
Business valued using an accumulation model *	2,067	8
Net insurance contract assets and liabilities	**(39,394)**	**(27,431)**

* As at 31 March 2014, "business valued using an accumulation model" includes Group Life business plus the additional reserve for options and waivers. At 31 March 2013, only the Group Life business was recorded under this heading.

Disclosed as:		
Insurance contract assets	(159,649)	(142,061)
Insurance contract liabilities - reinsurance	107,501	108,859
Deferred tax liability arising on taxable temporary differences within insurance contract assets and liabilities	12,754	5,771
	(39,394)	**(27,431)**
Estimated discounted net cash inflows from insurance contract assets and liabilities		
Less than one year	3,773	2,076
One year to five years	20,266	16,449
Later than five years	(63,433)	(45,956)
Net insurance contract assets and liabilities future net cash inflows	**(39,394)**	**(27,431)**

Notes

1. PV Profit margin down, others increasing.
2. Next 5 years of cashflow looks negative.
3. Ratio of PV Premium to premium revenue 7 to 1

The Notes – a gold mine or tailings?

Deferred Tax Asset

The Company has determined it is not probable that future taxable profits will be available prior to any potential future breach of shareholder continuity for the purpose of tax loss recognition. Accordingly, it has not recognised a deferred tax asset in respect of accumulated tax losses at balance date.

Actuarial Assumptions

- Not usually that interesting – but should it be?

Reinsurance

- Always fun to read carefully – if there is anything there!

Cash flows between the parties are recorded in an Original Experience Account ("OEA") to determine profit sharing. The OEA is a record of each specific tranche of insurance and is the net total of initial reinsurance commissions received, reinsurance recoveries received on claims, reinsurance premium payments, reinsurance commission clawbacks, interest payable on the OEA balance and administration fees payable. In the future, once the overall OEA balance is reduced to zero, the Company has the option to switch to a risk premium basis.

What is missing?

- In force block of business information.
- Future capital requirements.
- How close to moving into loss recognition and having to “write down” the policy liability.
- Distribution channel concentration (and the risk of it).

i.e. risks around that policy liability number

Other sources of information?

- FSC statistics on sales.
- Used to be able to get Life Act returns which were very useful but not anymore (and it was a battle as it was).
- Prospectus?
- Hopefully the RBNZ will fill the hole – but what will be publicly available?

What would be good to have?

- In force and sales information by product.
- Capital position going forward.
- A profit figure that is correlated to the cash result.

What is the "profit" trying to show?

- Those accounts were from 2008. It was called an "Income Statement" and showed a profit after tax. We also had a "Balance Sheet".
- Now we have a "Statement of Comprehensive Income" in which the profit is the not the bottom line, "Total Comprehensive Income" is.
- The "Balance Sheet" has become a "Statement of Financial Position".
- No-one knows what a profit is anymore: Accounting Profit, Taxable Profit, Distributable Profit, Cash Earnings or Total Comprehensive Income? What is it supposed to represent?
- Is it just all too academic?

What are the accounts supposed to tell us?

XRB's outcome goal

"To contribute to the creation of dynamic and trusted markets through the establishment of an accounting and assurance standards framework that:

- engenders confidence in New Zealand financial reporting
- assists entities to compete internationally
- enhances entities' accountability to stakeholders."

XRB Statement of Intent

"High quality financial reporting (incorporating both financial and, where relevant, non-financial elements) that **informs the decision-making of stakeholders** is therefore important to achieving effective public accountability and good corporate governance, and through them building a more competitive and productive economy."

IFRS 4

- "requires disclosure to **help users understand** the amounts in the insurer's financial statements that arise from insurance contracts, and **evaluate the nature and extent of risks** arising from insurance contracts"

- "When a life insurer is presenting the disclosures required by paragraphs 14.1.1(c) and 14.1.1(d) the insurer determines the level and extent of disclosure that is appropriate having regard to its circumstances and the qualitative **characteristics of financial statements under the New Zealand *Framework* of understandability, relevance, reliability and comparability**."

Disclosure - Explanation of recognised amounts

- Accounting policies
- Assets, liabilities, income and expense, and cashflows
- Gains and losses on buying reinsurance
- Assumptions which have the greatest effect on measurement – process used to determine plus quantification if **practicable**
- Effect of changes in assumptions (showing separately the effect of each change that has a material effect on financial statements)
- Reconciliations of changes in insurance liabilities, reinsurance assets and DAC (if any)

Disclosure - Nature and extent of risks arising from insurance contracts

- Objectives, policies and processes for managing risks and methods used to manage
- Information about insurance risk (before and after reinsurance), including sensitivity to insurance risk and concentration
- information about credit risk, liquidity risk and market risk (as per NZ IFRS 7) – including maturity analysis

Disclosure - Other

- Sensitivity Analysis
- Solvency Position
- Disaggregated Information – Statutory Fund

Variable	Change in following financial year's shareholder profit and equity net of reinsurance			
Group	2012		2011	
	+ 10% $000	- 10% $000	+ 10% $000	- 10% $000
Mortality	(1,042)	1,042	(997)	997
Morbidity claims costs	(622)	622	(635)	635
Annuitant mortality	188	(188)	(175)	175
Lapses and surrenders	(801)	801	(1,083)	1,083
Renewal expenses	(994)	994	(971)	971

What would a layman think?

- Profit = distributable profit?
- Profit margins – kind of make sense
- Experience profits - good
- Experience losses - bad

What don't they tell us? Or cover up?

- DAC – spread into profit margins
- Changes of assumptions – spread into profit margins
- RPGs – can hide poor performing groups of policies
- Reinsurance – sometimes hard to tell much about it
- Risks that aren't specifically prescribed
- Emerging challenges/risk – both within the coy and in the wider market

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IFRS Phase 2 – Better or more of the same?

- Probably predominantly more of the same!
- Long term business – looking more like MoS
- Short term business – valued like General Insurance
- Potential lack of comparability due to transition approach
- Risk margin clearly identified and disclosed

To Conclude - MoS revisited

- MoS was about a realistic profit (the P&L is dominant)
- But it gave us a messed up Balance Sheet
- We had to have solvency standards as a result
- The realistic profit is not correlated to the cash result (not intuitive)
- Isn’t all that really matters the Distributable Profit?
- As actuaries if we valued the entity using DCF that’s all we’d need?

A radical thought for a Brave New World?

- Let's go back and make the Balance Sheet dominant
- Let's make the profit equal to the change between RBNZ solvency balance sheets
- That gives us the Distributable Profit
- Isn't that what most people believe profit means?
- Concept could be adopted worldwide based on each country's solvency requirements
- Note: not the same as change in EV (but related)

What’s your opinion?