Canadian Institute of Actuaries
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Canadian Methods for the Valuation of Public Personal Injury Compensation Plans to Satisfy the Requirements of IFRS 4.14

IFRS

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INTRODUCTION

International Financial Reporting Standard 4 (IFRS 4) deals with the measurement of liabilities for insurance contracts. It is still a preliminary standard (often called "Phase 1"), but will apply in Canada when we move to IFRS in 2011. IFRS 4 allows company management to continue to use their current accounting policy for the measurement of insurance contract liabilities, provided certain criteria are met. The criteria are described in paragraph 14 of IFRS 4. This document deals with the measurement of Public Personal Injury Compensation Plan (PPICP) benefits in compliance with IFRS 4.

SUMMARY OF THE PRACTICE COUNCIL'S POSITION

In Canada, current accounting policies for the measurement of the insurance contract liabilities of PPICPs follow the methods of valuation described in Part 5000 of the Standards of Practice that govern actuarial practice for PPICPs in Canada. The Practice Council of the CIA believes that current methods of valuation satisfy the requirements of paragraph 14 of IFRS 4, and hence PPICPs may continue to use current methods for the measurement of PPICP benefits in Canada after IFRS is adopted.

BASIS FOR CONCLUSIONS

Paragraph 14 of IFRS 4 contains five criteria that must be satisfied by the accounting policy for insurance contracts. It states:

"An insurer:

(a) shall not recognise as a liability any provisions for possible future claims, if those claims arise under insurance contracts that are not in existence at the end of the reporting period (such as catastrophe provisions and equalisation provisions).

(b) shall carry out the *liability adequacy test* described in paragraphs 15–19.

(c) shall remove an insurance liability (or part of an insurance liability) from its statement of financial position when, and only when, it is extinguished, i.e., when the obligation specified in the contract is discharged or cancelled or expires.

(d) shall not offset:

    i. *reinsurance assets* against the related insurance liabilities; or

    ii. income or expense from reinsurance contracts against the expense or income from the related insurance contracts.

(e) shall consider whether its reinsurance assets are impaired (see paragraph 20)."

A discussion of how methods of valuation described in Part 5000 of the Standards of Practice meet each of these criteria follows.

(a) No catastrophe or equalization provisions

Paragraphs BC87–BC93 of IFRS 4 provide further information about the intent of paragraph 14(a), and imply that the focus is on catastrophe provisions and equalization provisions, neither of which are held as liabilities under Part 5000 of the Standards of Practice.

Furthermore, paragraph 5300.01 of the Standards of Practice makes it clear that the value of the benefits is the value of the cash flow after the calculation date on account of claims incurred before that date. This complies with IFRS 4, paragraph 14(a).

(b) Liability adequacy test

Paragraph 16 of IFRS 4 says:

> "If an insurer applies a liability adequacy test that meets specified minimum requirements, this IFRS imposes no further requirements. The minimum requirements are the following:
>
> (a) The test considers current estimates of all contractual cash flows, and of related cash flows such as claims handling costs, as well as cash flows resulting from embedded options and guarantees.
>
> (b) If the test shows that the liability is inadequate, the entire deficiency is recognised in profit or loss."

The relevant benefits for the valuation are those that correspond to claims incurred before the calculation date, and that will generate cash flow after the balance sheet date.

According to paragraph 5300.01 of the Standards of Practice, current Canadian valuation methods clearly make provision for all cash flows. Further, the entire change in liability is recognized in profit or loss at each reporting date. Hence, Part 5000 of the Standards of Practice includes a "built-in" liability adequacy test that meets the minimum requirements of IFRS 4 paragraph 16.

Though the term "current estimate" is not defined in IFRS 4 (and does not appear in the IFRS glossary), IASP 5 of the International Actuarial Association (IAA) defines it as "the estimation of the expected value based on current knowledge". Further, section 4.1.5 of IASP 6 indicates that a current estimate would be based on continuously updated assumptions, and that both estimates with and without adjustments for risk and uncertainty would be acceptable for a test to meet the minimum requirements. Subsection 1730 of the Standards of Practice indicates that the assumptions used in the PPICPs valuation are acceptable in this context.

It is worth noting that paragraph 16 of IFRS 4 does not specify any basis for choosing the discount rate that would be used in the liability adequacy test, as reinforced by IFRS 4 BC101. Thus, we are free to assume that the discount rate implicit in the Standards of Practice for PPICP claim liabilities is acceptable.

(c) Derecognition

Due to the nature of PPICP claims, no future cash flow is generated by a claim which has been discharged, cancelled or expired. Hence, we conclude that valuation of PPICP benefits under Part 5000 of the Standards of Practice complies with paragraph 14(c) of IFRS 4.

(d) Separate presentation of reinsurance ceded assets

As reinsurance is generally not used with PPICP benefits, there is no need to consider compliance with this provision.

(e) Impairment of reinsurance assets

As reinsurance is generally not used with PPICP benefits, there is no need to consider compliance with this provision.