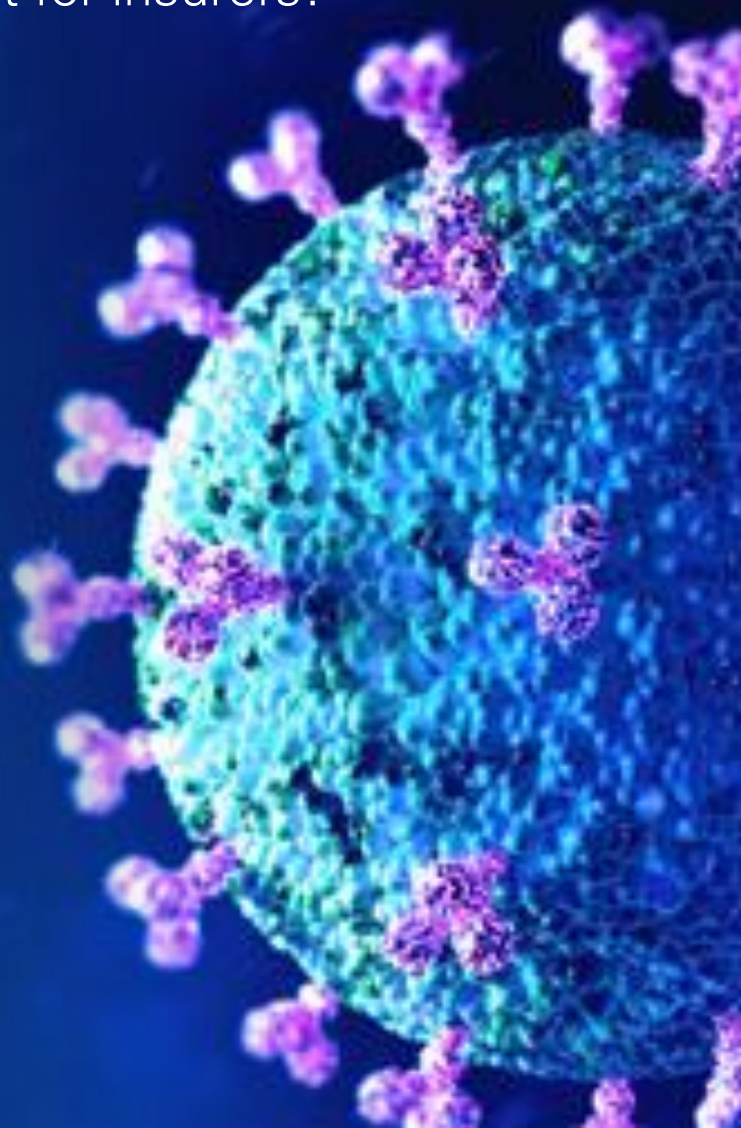
COVID-19 Financial Reporting Implications

What is the impact for insurers?



Part 06

KPMG in Sri Lanka

Content

The World Health Organisation has declared the COVID-19 coronavirus outbreak to be a pandemic. Since March 20, many governments are taking stringent steps to contain and/or delay the spread of the virus.

Actions taken in response to the spread of COVID-19 have resulted in significant disruption to business operations and a significant increase in economic uncertainty, with more volatile asset prices and currency exchange rates, and a marked decline in long-term interest rates in developed economies.

These events and conditions create a level of uncertainty and risk that companies may not have encountered before, and may result in significant financial reporting implications for preparers of financial statements. KPMG focuses on the potential financial reporting impacts for 2020 period ends.

The KPMG Team has put together this summary which we believe, can help you better understand the potentially significant accounting and disclosure implications for your company, and the actions management needs to take now.

The following section is covered in this Guidance:

01. What are the specific accounting implications for insurers?

Insurers should assess possible impairments in investment portfolios and the impact of COVID-19 on their accounting for insurance liabilities, including the liability adequacy test.

What is the Issue?

When assessing the impact on insurance liabilities, insurers should consider the coverage provided under the terms and conditions of issued insurance contracts. In a number of countries, regulators and governments are taking specific actions – e.g. grace periods for premium collection, non-cancellation of insurance coverage during the pandemic and waiving co-pays.

These actions may impact assumptions about the timing of premium cash flows, the frequency or severity of claims or the continued use of historical trends (e.g. loss ratios) to estimate future claims. Also, stay-at-home regulations and resulting operational challenges may affect the claim settlement process and patterns. For example, claims payments may take more time and could result in a change in the paid-claim patterns used in some actuarial methods for calculating insurance liabilities. However, claims could be paid more quickly in the near term because insurers may face regulatory pressure to 'take care of the policyholder' during the pandemic; they may also forego regular claim adjudication procedures and question fewer claims before paying.

When determining their obligations, insurers need to evaluate the precise extent of coverage and the impact of exclusions and limitations on coverage. This includes an assessment of new directives, laws and regulations that may require insurers to provide coverage or incur claims for events related to COVID-19 in addition to those required by the existing terms and conditions in the insurance contract.

Further, when current demographic and market estimates (including discount rates) are reflected under existing accounting practices, an insurer should assess the extent to which the current developments around COVID-19 require a reassessment of those estimates. As a consequence, an insurer may have to update the demographic and market assumptions used when measuring its insurance liabilities.

Regulation or contractual terms may provide for profit participation by policyholders. Insurers should therefore consider the impact on their obligations, including deferred bonuses and shadow accounting policies.

What is the impact on your type of business?

In general, policyholder behaviour may change because of COVID-19 – e.g. it may affect surrender probabilities and insurance fraud. This may impact the recoverability of deferred acquisition costs (DAC). Measures taken by government and regulator/s to slow down the spread of the pandemic may limit sales activity and could impact premium income.

In non-life or general insurance, many policies will have exclusion clauses for pandemic risks, which were strengthened for products such as business interruption and travel insurance after the SARS coronavirus outbreak in 2003. Event cancellation coverage may cause greater losses for insurers because some policies cover pandemic risk. The following types of insurance may also be affected.
Trade credit insurance – covering businesses against debts that cannot be paid by their customers or suppliers.
Workers' compensation insurance – workers claiming they were not adequately protected by their employers against exposure to the virus.
Insurers should evaluate the impact on liabilities for reported claims, incurred but not reported claims, future claims liabilities (including claims handling costs) and related assets for reinsurance recoveries.

Reinsurers will need to respond to losses ceded by direct insurers and will need to perform similar evaluations. For some specialised reinsurers, this could have a major impact.

Mortality or morbidity rates from COVID-19 could affect the insurance liabilities for **health insurers**. These insurers should monitor the developments and assess whether they need to revise their assumptions at the reporting date.

Life insurers will probably face the most significant impact. The further decline in interest rates and the downturn in financial markets could lead to impairments of financial assets. Legacy businesses or products that are highly sensitive to market variables are likely to feel the effects more deeply – e.g. variable and fixed annuities, long-term care insurance and universal life insurance. This applies especially to insurance contracts that contain minimum interest rate guarantees. The measurement of the insurance liabilities could be affected directly if these guarantees are measured on a current basis; or indirectly, if a deficit arises in the liability adequacy test that should be recognised in profit or loss.
If information affecting the values of assets and liabilities becomes available after the reporting date, then insurers will need to distinguish between events that provide evidence of conditions that existed at the reporting date (adjusting events) and those that are indicative of conditions that arose after the reporting date (non-adjusting events).

Disclosures : Interim Reporting

LKAS 34 *Interim Financial Reporting* does not contain specific disclosure requirements for insurance contracts. However, the general principles apply and the interim financial statements should explain events that are significant to understanding changes in financial position and performance, including changes in estimates, since the last annual financial statements.

A company should consider whether the interim report needs to include an update to information disclosed in the last annual financial statements because of the pandemic.

Disclosures : Annual Report

Insurers should disclose assumptions for, and sensitivities in, the measurement of insurance liabilities. This may involve explaining the impact of COVID-19 risks on your type of insurance business, how experience to date from the COVID-19 outbreak varies from existing assumptions about pandemic risk and how those risks are managed. These disclosures should also include considerations around risk concentrations, claims development tables and credit, liquidity and market risk.

The COVID-19 situation may increase the level of estimation uncertainty when measuring insurance liabilities. This may require enhanced disclosures and may also affect sensitivity analysis disclosures.

For investment portfolios, insurers should disclose the nature and extent of risks arising from financial instruments and how they manage those risks. This means that insurers will need to explain the significant impacts of COVID-19 on those risks and how they are managing them. Insurers will need to exercise judgement to determine the specific disclosures that are relevant to their business and necessary to meet these objectives.

Decreases in asset valuations arising from the COVID-19 outbreak may impact regulatory capital and solvency calculations and disclosures about how the entity manages capital.

Disclosures may also be required about non-adjusting events occurring after the reporting date that impact subsequent financial asset or insurance liability measurements. For some insurers, further disclosures around potential **going concern** issues may be required.

Actions for Management to take NOW

- Evaluate the specific implications for your company based on the accounting policies applied under SLFRS 4 and assess the impact on assumptions for measuring liabilities for reported claims, incurred but not reported claims, future claims and reinsurance recoveries.
- Ensure that your liability adequacy test (including DAC recoverability) is based on current estimates of future cash flows and evaluate whether any deficit should be recognised in profit or loss..
- Evaluate whether a significant or prolonged decline in fair value has arisen for any available-for-sale equity investments.;
- Assess whether there is a loss event that has affected the estimated future cash flows of any debt investments and whether to recognise an impairment loss.
- Consider expanding disclosures about pandemic risk management, key demographic and market assumptions, sensitivities in the assumptions, major sources of estimation uncertainty, and liquidity, market and credit risks.
- Consider your capital disclosures, especially where there are concerns about the capital position relative to regulatory requirements or implications for debt covenants.

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