Key Insurers Indicators in the Reports of Insurance Companies: Russian and Italian Experience*

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Abstract. The aim of this article is to analyze the main indicators of insurance companies which can be identified in the financial statements in accordance with Russian accounting standards, the first results of IFRS introduction in Russia; to analyze the first issues coming from the introduction of IAS-IFRS in Russian and Italian insurance companies in light of oncoming new standards and amendments.

Аннотация. В статье представлены основные показатели финансового состояния страховых компаний, которые могут быть определены по данным финансовой отчетности в соответствии с российскими стандартами учета; даны первые результаты внедрения МСФО на страховом рынке — российский и итальянский опыт.

Key words: Insurance companies, key insurance characteristics, Russian accounting standards, IFRS, Italian experience.

Under the draft regulations (the industry standard) of accounting for insurance organizations and mutual insurance societies, insurers should be guided by the federal accounting standards, IFRS, IAS explanations recognized in the territory of the Russian Federation, the actuarial standards.

Annually insurance companies prepare financial statements and reports for supervision. The main reports are published on the website of insurance supervision and contain the following characteristics of the insurance company[1]:

- Short and full name of the subject of the insurance business; organizational and legal form; location; registration number from the Unified State Register of insurance entities;
- Financial statements with the auditor's report (contains the auditor's opinion on the reliability of the reflection of significant facts):
  - Balance sheet of the insurer (f.1);
  - Report on financial results of the insurer (f.2);
  - Report on changes in equity of the insurer (and the net assets) (f.3);
  - Report on the cash flows of the insurer (f.4);
  - Notes to the balance sheet of the insurer and the report on the financial results of the insurer.
- Statistical reports;
- Report about shareholders (participants).

Insurance companies also represent to the insurance supervisor reports on:

- Composition and the structure of assets (f. 7-insurer);
- Insurance reserves (f. 8-insurer);
- Solvency (f. 9-insurer);
- Reinsurance operations (f. 10-insurer);
- Structure of the financial results of insurance (f. 11-insurer);
- Branches and representations (f. 12-insurer);

[1] Order of the Ministry of Finance of May 11, 2010 N 41H "Forms of Financial Statements of insurance companies and reporting for supervisory review".

* Основные показатели финансового состояния в отчетах страховых компаний: российский и итальянский опыт.

Table 1. Main characteristics of insurance companies.*

Direction of assessment	Capital	Assets	Reinsurance	Solvency	Profit and Profitability	Cost of doing business	Business activity, Management
Characteristics	Structure, volume change of equity own insurance reserves loan.	Placement of insurance reserves. Covering the assets own funds. Placement of available assets. Investment policy in general. Presence of high-risk assets. Loans.	Availability of reinsurance program. Payments under the reinsurance contracts. Ratings of reinsurers. Reinsurance in Russia.	Regulatory compliance. Solvency for not insurance liabilities. Cost loans of credit institutions.	Profit and profitability of insurance operations and non-insured. Profit from insurance operations. Profitability of insurance reserves ROI as a whole.	Costs of the proceedings. Commissions to insurance agents. Salary of management. Dividends to shareholders.	Volume of premiums and payments. Regional networks. Sales channels. The absence of compromising information. Number of complaints by insurants. Bankruptcy procedures.
Form of the original data	Balance sheet of the insurer (f.1) Report on changes in equity of the insurer (and the net assets) (f.3) The insurance reserves (f.8-insurer)	Balance sheet of the insurer (f.1) Report on financial results of the insurer (f.2)	Reinsurance operations (f.10-insurer) Report on financial results of the insurer (f.2)	Balance sheet of the insurer (f.1) Report on financial results of the insurer (f.2) The solvency (f.9 — insurer)	Balance sheet of the insurer (f.1) Report on financial results of the insurer (f.2) Report on changes in equity of the insurer (and the net assets) (f.3) The structure of the financial results of insurance (f.11-insurer)	Report on financial results of the insurer (f.2) The structure of the financial results of insurance (f. 11-insurer)	Balance sheet of the insurer (f.1) Statistical Report No 1 “Data on key indicators of insurer” the branches and representations (f. 12-insurer) Shareholders (members) and other affiliated entities (f.13-insurer)

* The author’s method has been implemented at Magnitogorsk Iron & Steel Works.

• Shareholders (members) and other affiliated entities (f. 13-insurer).

Insurers must comply with the control relationships indicators of the annual financial (accounting) statements and statements in the order of supervision.

Statistical Report No.1 “Data on key indicators of insurer” includes the following important characteristics:

• Premiums and claims on insurance contracts, number of insurance contracts within and outside Russia;

• Insurance premiums on insurance contracts, concluded without brokers and agents or with their participation, commissions to intermediaries;

• Direct compensation for compulsory civil liability insurance of vehicle owners;

• Information about the number of members of a mutual insurance company.

The balance sheet of insurer contains three sections: assets, capital and reserves, liabilities.

In the profit and loss statement income and expenses are divided into:

• Life insurance;

Figure 1. Significant factors in the insurance protection.

- Insurance other than life insurance;
- Income and expenses not related to the insurance operations.

It is easy to see formation of the financial result of the insurance company from this form. In general it can be represented as follows:

Income	Expenses
Premiums	Claims under insurance contracts
Changes in insurance reserves	
Income from investments	Loss of investments
Income and expenses of insurance operations	
Other income	Operation expenses

Thus, interested persons may identify comprehensive information about financial condition of insurers from the reports of insurance companies, see Fig. 1, 2.

We can take the main characteristics of insurance companies in these areas from financial reports (under Russian accounting standards), see Table 1.

All these measures can be calculated according to the forms, which are published on the website of the insurance supervision[2] and according to the data found in open publications. Nevertheless, the Russian standards are incomprehensible for foreign contractors. Russian insurance companies introduced the insurance supervisory authority reports under IFRS for the first time in 2012.

Under the draft regulations (the industry standard) on accounting for insurance organizations and mutual insurance societies, insurers should be guided by the federal accounting standards, IFRS, IAS explanations recognized in the territory of the Russian Federation, the actuarial standards. According to the analysis of the 20 largest insurance companies serving the Bank of Russia on the financial markets, insurers have become more successful: the net profit exceeds the results according to Russian accounting standards by 50%. During preparation a company is facing some problems: the need to identify additional data, such as claims settlement, the formation of the consolidated financial statements; recruitment and training of personnel. However, many companies have had enough experience with IFRS: Ingosstrakh since 2000, SOGAZ since 2001, PPF — life insurance since 2002, Energogarant since 2005, Uralsib since 2007, Transneft since 2010.

Out of twenty largest companies on volume premiums for 2012 (71.5% of total premiums in the amount of 812.5 billion rubles) 15 insurers demonstrated a net profit, five demonstrated loss, according to the study by Central Bank of Russia; the total volume of net profit of 20 leaders reached 25.1

[2] The Central Bank of the Russian Federation, http: www.cbr.ru.

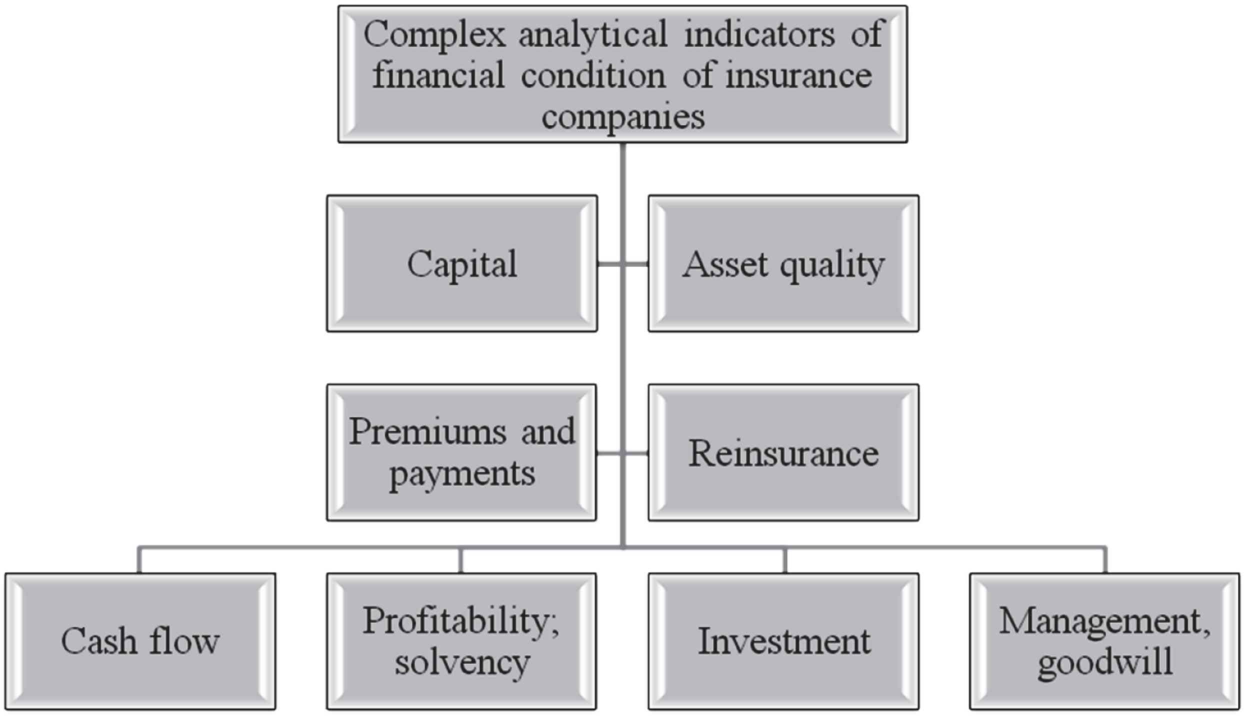

Figure 2. Main directions of financial state evaluation of insurance companies.

billion rubles or, according to Russian accounting standards, 15.3 billion rubles. The total capital of the top 20 under IFRS amounted to 177.2 billion rubles, volume insurance reserves — 472.4 billion rubles, total assets — 876.1 billion rubles. Total insurance reserves under IFRS of the top 20 was about 30–40% higher than under RAS.

According to the results of comparison of two types of reporting in 96 companies by the Expert RA rating agency, the average combined loss ratio of insurers, which account for 80% of the market, in accordance with IFRS has reached 103.2% against 98.8% with RAS; return on equity transactions under IFRS is five times less than that under RAS: 3.2% against 15.7% for the year 2012; more correctly assessed reserves, overdue receivables reaching an average of 12%, under RAS — 8–9%.

Experts estimate that a significant difference in the results is determined by the basic principle of IFRS — substance over form, which is more strictly regulated in IFRS: IFRS not only describe the principles of accounting operations, but also have a requirement to disclose more information. IFRS clearly reflect the assets and liabilities of the company associated with the insurance and general activities. In the assets IAS is based on the concept of control, RAS — on the concept of ownership. Insurance reserves are estimated in RAS under certain formalized procedures; assessment of receivables is formalized. In reporting under IFRS insurance liabilities are estimated in accordance with the forecast of payments. IAS represents a choice of estimation methods, statistical information, different approaches to the estimation of the value of assets and liabilities (fair value, amortized cost, the cost of acquisition).

However, now a full transition to IFRS in Russia is not possible: this requires changes in the accounting of many participants; Russian accounting standards also are more consistent with the goals of control, including statistical data. At the same time, a more stringent approach in IFRS does not guarantee a completely adequate reflection of the assets, liabilities and operations of the company. In Italian insurance financial IAS-IFRS have been introduced in statements by European Act No. 1606 of 2002 and by Italian Act No. 58/98, then introduced in Italy for insurance companies by Law Act No. 209/2005 ("Insurance Code") from annual reports of 2007. They are mandatory for consolidated financial reports and for reports of listed companies.

Previous empirical studies show that IAS-IFRS introduction have generated significant impacts on listed companies results (Callao, Jarne, Laìnez, 2007; Horton, Serafeim, 2010; Hung, Subramanya, 2007; Mechelli, 2009; Stent, Bradbury, Hook, 2010; Alali, 2012). In particular, an increase in volatility is recorded in financial results and in equity value.

These effects are correlated to financial instruments evaluation, which is mainly based on a fair value approach. Actually, IAS-IFRS framework provides four financial portfolios by IAS 39 which are classified by how the entity manages its financial instruments regardless to their features: a) investments held for trading (fair value to profit or loss); b) investments held to maturity); c) investments available for sale, d) loans and receivables. These options can have different impact on results, so we have investigated Italian insurance companies choices on investments.

We have analyzed consolidated financial reports of the seven insurance companies placed on the top 20 of Italian market for total direct premiums collected (six listed and one mutual non-listed (source: ANIA, Italian National Association of Insurance Companies)). We have chosen only Italian ones and entities not held by bank (bancassurance) to understand specific investments policies of domestic market. As financial groups they represent more than the 35% of total market in terms of direct premiums collected (source: ANIA).

Their trends in the financial portfolios composition from 2005 to 2013 (Figure 3) show that, since the introduction of IAS-IFRS, Italian insurance companies opted for a prudent behavior concentrating main part of their investments on the "available for sale" portfolio for a share of the 58% of total financial assets. This share has been increasing the years after for few percentage point reaching peak in 2012 and 2013 up to 70% in the last year. The "financial assets at fair value through profit or loss" had in 2005 the 27% of total financial assets keeping the same values in the following years to decrease in the second part of the period up to 13% in 2012 and 2013. Loans and receivables reported for some years less than 10% up to stabilize on 13% in 2012 and 2013.

If we analyze standard deviation from the average, to understand homogeneity of investment behavior, we see a certain degree of heterogeneity in the composition of financial portfolios. This lack of uniformity remains until the financial crisis of 2007–2008 while, after 2011, there is a strong reduction of the dispersion and a very uniform behavior in investment decisions of analyzed companies. Just two groups, Generali and Unipol, have a high share of loans and receivables due, for Unipol Group, to direct control of a bank.

So we can say that Italian insurance groups have had throughout the analyzed period a prudential approach in investment choices, even compared to companies of other countries like United Kingdom, and they have intensified this behavior during and after the second crisis of 2011.

The concentration of financial assets on the "available for sale" portfolio has emphasized the

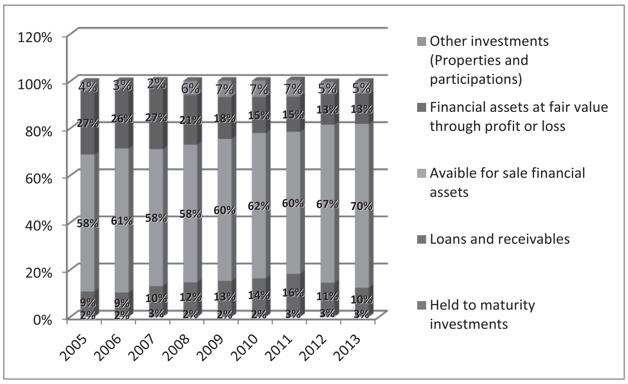

Figure 3. Trend of composition of IAS-IFRS portfolios on total financial assets: 2005–2013 (sample of seven Italian companies, no bancassurance).
Source: Financial statement documents of sample companies.

application of impairment test that, thanks to the framework base principle of IAS-IFSR, has allowed Italian companies to apply different thresholds for the depreciation, in terms of amount and duration, reported in the loss of value of financial assets from one company to each other.

This heterogeneity of companies' behavior has created a lack of comparability among financial reports and has limited the full application of fair value from some companies delaying the losses through the use of "available for sale" portfolio to the following years. Some studies show how the IAS-IFRS adoption, even giving its flexibility, enables earning management, and smoothing in particular (Capkun, Collins, Jeajean, 2012; Ahmed, Neel, Wang, 2013).

Rules No. 14 were introduced in Italy by IVASS (IVASS is Supervisory Authority of Italian Insurance Market) to improve impairment process disclosure, providing a better specification of fair value hierarchy in light the evaluation criteria adopted, and a specific statement for assets not measured at fair value.

Taking to account what has happened during the financial crisis, IASB intended, in 2008, to emend IAS 39, and published in November 2009 a new accounting standard IFRS 9 "Financial Instruments" which was subsequently emended. This standard shall be applied from January 1, 2015 retrospectively, and it is a part of phased process that aims to replace IAS 39 and introduce new requirements for the classification and measurement or financial assets and liabilities. In particular, with regard to financial assets, the new standard uses a single approach based on business model and on contractual cash flows characteristics of the financial asset in order to determine the criteria replacing many different rules in IAS 39. For the financial liabilities, however, the main change concerns the accounting treatment of changes in fair value of financial liabilities designed as "fair value through profit or loss" in the event that the change is due to changes in credit risk of the liability. Under the new standard such changes shall be recognized in the other comprehensive income (OCI) and no longer in income statement.

Still on IFRS 9, in March 2013 IASB published the exposure draft "Expected credit loss" that introduced expected credit losses approach for financial asset measured at amortised cost. So, if, at the reporting date, effective credit losses exceed those expected at initial recognition, an impairment loss shall be recognized in the profit or loss. The exposure draft indicates three stages which reflect the deterioration of credit quality.

Finally, on IFRS 9, in November 2013 IASB published Financial Instruments — Hedge Accounting and Amendments to IFRS 9, IFRS 7 and IAS 39 to complete section relating to hedge accounting of the project to replace IAS 39. The most important new features relate to the effectiveness test of hedging relationships, the extension of possible hedging instruments and hedge items, and the conclusion and/or modification of the hedging relationship IFRS 9 will be applicable starting from 2018.

Regarding to liabilities, actually, IFRS 4 (Insurance contracts) provides for insurance liabilities and, in particular for technical reserves, a measurement according to Local GAAP and based on a cost approach. It provided a liability adequacy approach (LAT) and shadow accounting to mitigate the evaluation mismatch between financial asset carried at fair value according to IAS 39 and insurance provisions, which are accounted with Local GAAP. This accounting practice is applied to insurance contracts and investment contracts with discretionary participation features and provides and attributes to policyholders part of the margin coming from the difference between IAS-IFRS valuation on the basis on which the profit sharing is calculated and valuation used to determine the profit sharing actually paid. This kind of contracts are very important for Italian insurance balance sheets; more than 80% of life technical reserves is related to it.

Regarding to income statement, IASB published in June 2013 the Re-Exposure Draft, which proposed a new model for measurement insurance contracts that will replace the current IFRS 4. The valuation method is structured on a building block

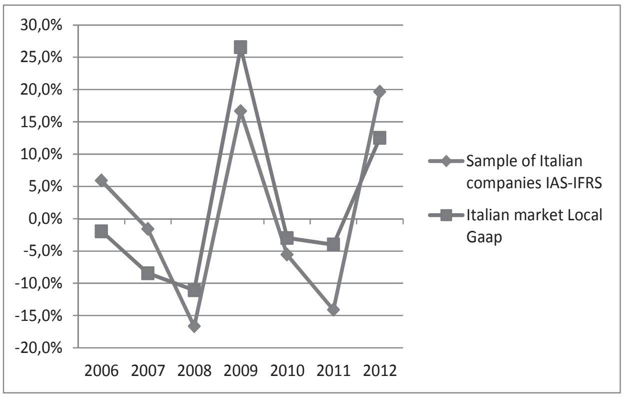

Figure 4. Comparison of changes on equity in Local and IAS-IFRS GAAP financial statements (%).
Source: Financial statement documents of sample companies and ANIA Report 2013–2014.

approach based on the expected value of future cash flows weighted by probability of occurrence, on a risk adjustment and on a margin for services provided within the contracts. The contractual service is a component of the compensation that the insurer requires for its activity, and that is characterized by uncertainty and various types of risks. A simplified approach is permitted ("Premium Allocation Approach") if the coverage period of the contracts is less than one year or if the model used for the assessment provides a reasonable approximation compared to the building block approach. The effective date is three years after the publication of the final standard. Early application is permitted.

A second issue of this article is to analyze comparison of equity trends under IAS-IFRS financial reporting and under Local GAAP financial reporting from 2005–2012, to see if they have reported different changes. We have used two different perimeters of analysis because different are the entities obliged or not obliged to use International Financial Reporting Standards, but we think that observation of the two trends could be a good proxy of the impact of IAS-IFRS on equity levels. For IAS-IFRS financial reporting we have used the same sample of the top seven groups — Italian only, and not of bancassurance. For Local GAAP we took the data of all the companies, which belong to Italian Association of Insurance Companies (ANIA).

Figure 4 shows how, during the period 2005–2008, the two clusters present a similar trend, even if in 2008 the decrease for IAS-IFRS equity change is more than five percent lower than for Local GAAP equity then, with the better financial market trend of 2009, companies of Italian market with Local GAAP show better performance (a greater increase in equity change of almost ten percentage point) then, in 2010, they both report a decrease in equity and, from 2011, the two trends are more separated (in 2011 the IAS-IFRS equity changes is ten percentage points lower and then in 2012 is higher of seven percentage points). So we can say that Local GAAP financial statements report a better situation during and after 2007–2008 crisis while, from 2011 to the end of analyzed period, for the IAS-IFRS sample changes in equity become more volatile.

First general evidence is that the impact of IAS-IFRS introduction in Italian insurance sector is influenced by their partial implementation because fair value is not still applied for technical reserves, which are among the most important items of insurance balance sheet. Another pillar of these standards, former IAS 39, showed, during the crisis in particular, limits and a procyclical effect that led IASB to amend it and to replace it with IFRS 9. This consolidation is the prerequisite to realize that comparability which is the basis and one of the most important pillars for the IAS-IFRS introduction.

From the other hand the introduction and the implementation of the Other Comprehensive Income statements could be very useful to improve disclosure quality of financial report of insurance companies by bringing out some potential losses not reported in profit or loss statement and by showing the different impact of the cost view evaluation in profit or loss compared to the application of interest rate changes in OCI. At the same time we have to be careful not to make more difficult reading and interpretation of performance coming from financial reports. One risk is to put in Other Comprehensive Statements what we don't want to report in Profit or Loss Statement. From this point of view the proposal to put revenue and expenses in the statement of OCI improves disclosure providing a gross performance view, not included in the previous draft, but trying to find a difficult comparison among disclosure across many, very different industries.

The principle based approach of IAS-IFRS requires high attention to setting the guidelines of the evaluation also due to the fact that, following the fair value approach, we are not always aligned with the long term feature of main part of insurance liabilities. Giving the specific features of insurance industry, the accounting system applied has to connect assets to related liabilities in measuring their value. This point of view has been emphasized by practitioners and by exponents of insurance industry (Demaria, Rigot, 2014).

From a positive point of view the IAS-IFRS Phase II has realized a strong convergence between accounting criteria of evaluation and Solvency II implementation. This convergence is very important to ensure a stronger alignment between financial results and capital strength and solvency.

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