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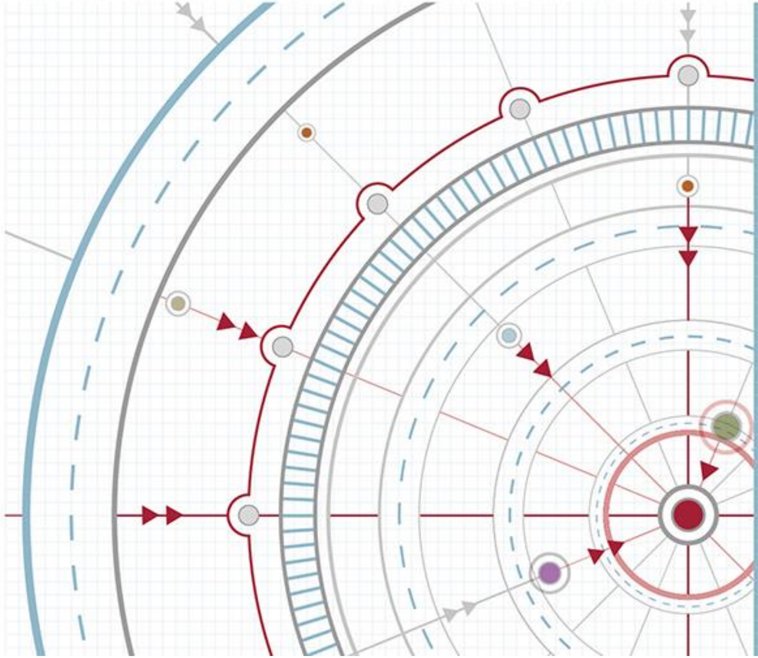

IFRS 17
Insurance Contracts

The Foundation for Promotion of the Actuarial Profession
30 November 2017

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IFRS Foundation.

IFRS

1 Introduction

Today's topics

1. Introduction
2. Why is there a need for change in insurance accounting
3. Who is affected by the change
4. How does the Standard work in practice
5. Where do we go from here?
6. Q&A

2 Why is there a need for change in insurance accounting

Accounting policies applied under IFRS 4

Top-20 listed insurers using IFRS Standards		
Accounting policies applied to insurance contracts issued	Number of companies	Total assets (US$ trillions)
Based on guidance in:		
• a mix of national GAAP	8	4.1
• US GAAP	3	1.6
• Canadian GAAP	4	1.4
• other national GAAP	5	2.0
Total	**20**	**9.1**

Source: Effects Analysis on IFRS 17

Same insurer—two different GAAP

(in millions of currency units)	GAAP A Current value accounting	GAAP B Non-current value accounting	Differences
Revenue	**26,083**	**24,167**	**(1,916)**
Expenses	**(26,310)**	**(22,317)**	**3,993**
Of which changes in assumptions	(1,753)	(125)	1,628
Income taxes	**223**	**(240)**	**(463)**
Profit or loss	**(4)**	**1,610**	**1,614**
Other comprehensive income	**(533)**	**56**	**589**
Comprehensive income	**(537)**	**1,666**	**2,203**
Equity	**20,373**	**25,584**	**5,211**

Improved information about the value of insurance obligations

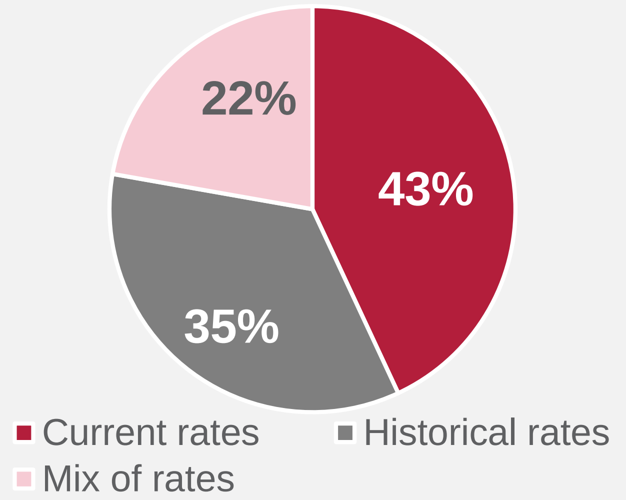
Today

- Use of old or outdated assumptions
- Options and guarantees not fully reflected
- Inappropriate use of 'expected return on assets held' as discount rate

IFRS 17

- Current assumptions regularly updated
- Options and guarantees fully reflected
- Discount rates reflect the characteristics of the insurance cash flows

Discount rates used today by IFRS insurers



Discount rates used for a sample of life insurers using IFRS Standards in 2015
Source: Effects Analysis on IFRS 17

Improved information about profitability

Today

- Timing of profit recognition is inconsistent
- Premiums received presented as revenue—revenue reported on a cash basis
- Use of many non-GAAP measures

IFRS 17

- Consistent recognition of profit for insurance services
- Insurance revenue reflects the services provided
- Additional consistent metrics to evaluate performance

Recognition of profit today by IFRS insurers

immediately when an insurance contract is written

or

only when the contract ends

or

over the duration of the contract

Improved comparability of financial information

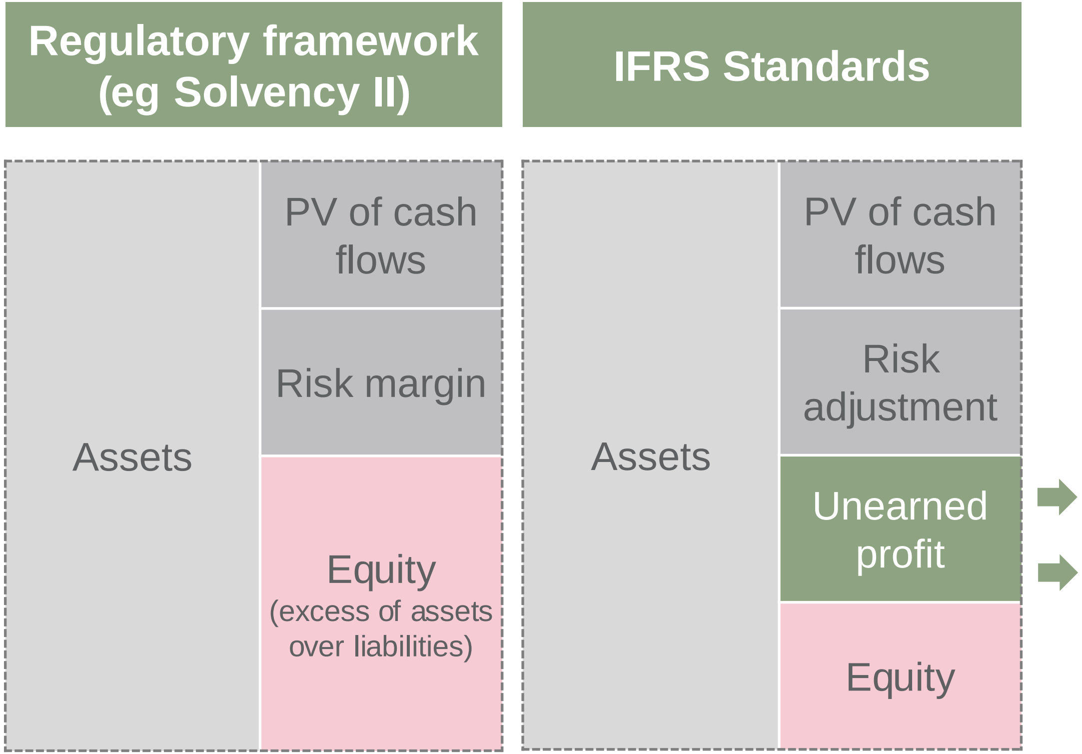
Issues today	Improvements introduced by IFRS 17
Lack of comparability among insurers • IFRS companies report insurance contracts using different practices **Non-uniform reporting within groups** • Insurance contracts of subsidiaries are consolidated using different practices	• New framework will replace huge variety of accounting treatments
Inconsistency with other industries • Revenue include deposits • Revenue reported on a cash basis	• Revenue will reflect the services provided, and exclude deposits, like any other industry

Interaction with regulatory frameworks

	IFRS Standards	Regulatory frameworks
Balance sheet	✓	✓
Profit or loss	✓	✗ (1)

(1) For example, Solvency II does not prescribe performance reporting. It only requires disclosures for (a) variation of excess of assets over liabilities, (b) premiums, claims and expenses and (c) assets' profitability

IFRS 17 provides information about financial performance



Unearned profit (CSM)

- is recognised in P&L when insurance coverage is provided
- provides a measure of future profitability

Changes in unearned profit provide information about

- profitability of new business
- changes in profitability of existing contracts

Extensive consultation process

1997	2004	2007	2010	2013	2017
IASC starts project on insurance contracts	**IFRS 4 *Insurance contracts***	**Discussion paper** *Preliminary views on Insurance Contracts*	**Exposure Draft** *Insurance Contracts*	**Exposure Draft** *Insurance Contracts*	**IFRS 17 *Insurance Contracts***
	Interim Standard issued	162 comment letters received	253 comment letters received	194 comment letters received	Replaces IFRS 4

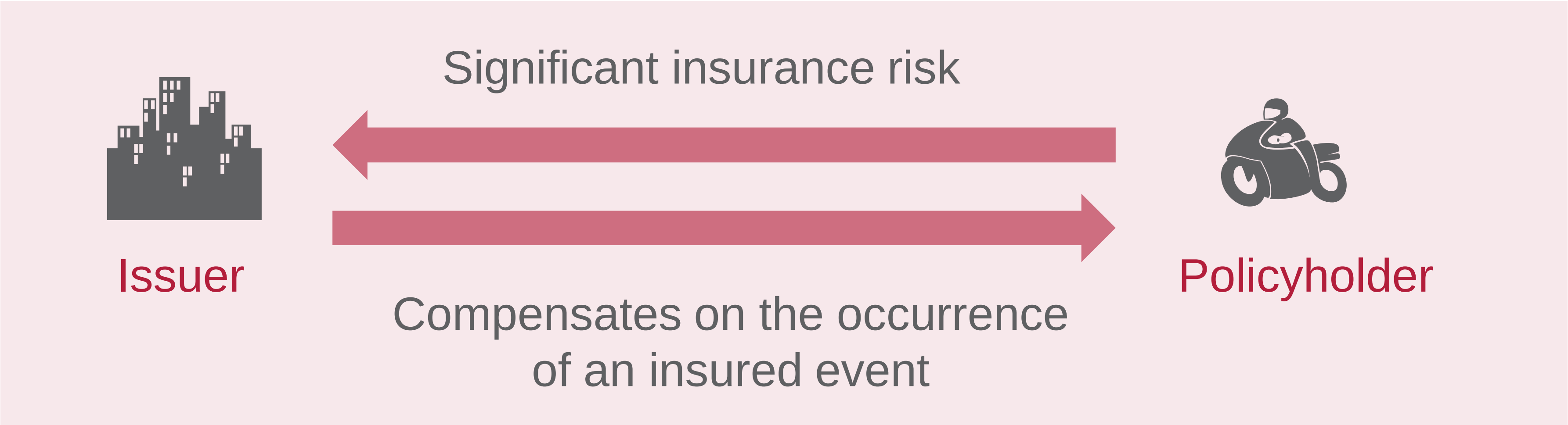
900
meetings, round-tables and discussion forums

600
comment letters

4
rounds of fieldwork and testing

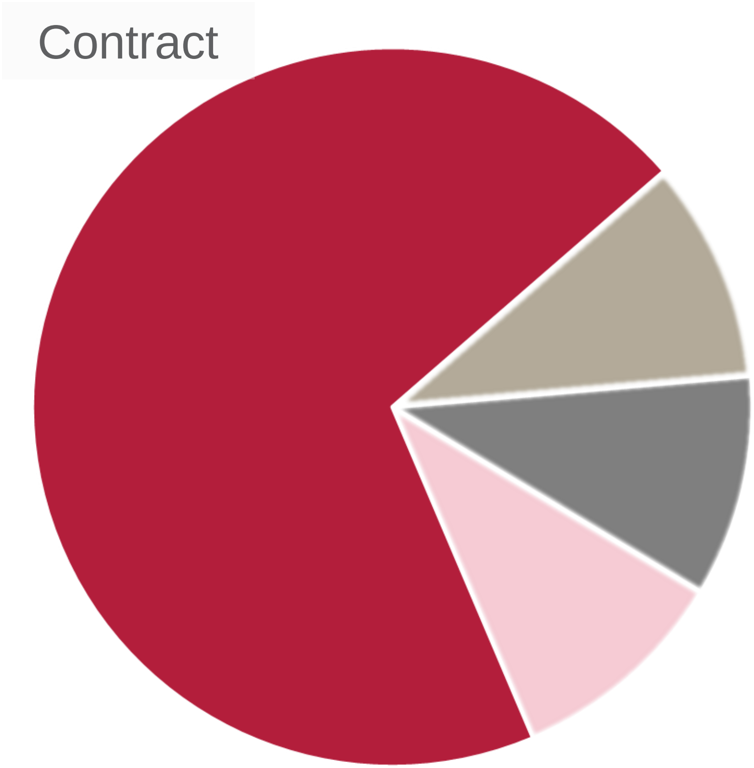
3 Who is affected by the change

What is an insurance contract?



- IFRS 17 and IFRS 4—same definition
- IFRS 17 two minor changes to guidance but no expected changes in assessments for majority of contracts

What is measured under IFRS 17?



- Insurance components—IFRS 17
- Distinct goods or non-insurance services—IFRS 15
- Distinct investment components—IFRS 9
- Specified embedded derivatives—IFRS 9

Non-insurance companies potentially affected

Banks	• Banks are expected to apply IFRS 9 to their financial guarantee contracts • Most common banking agreements do not typically transfer significant insurance risk
Investment companies	• Issue contracts that are similar to some insurance contracts • Indirectly affected by IFRS 17 because of the increased comparability between industries
Non-financial companies	• IFRS 17 will affect only those non-financial companies providing insurance coverage by issuing insurance contracts • IFRS 17 does not apply to product warranties issued by a manufacturer, dealer or retailer • Option to apply IFRS 15 to some fixed-fee service contracts

4 How does the Standard work in practice

One measurement model

IFRS 17 measurement model (general model)

+ Optional simplifications for short-term contracts = Optional approach for short-term contracts

+ Modifications for reinsurance contracts held = Required accounting for reinsurance contracts held

+ Modifications for direct participation features = Required variable fee approach

IFRS 17 measurement model

All insurance contracts measured as the sum of:

- **Fulfilment cash flows (FCF)**
  1. Present value of probability-weighted expected cash flows—reflects financial risk
  2. Plus an explicit risk adjustment for non-financial risk (eg insurance risk)
- **Contractual service margin (CSM)**
  3. The unearned profit from the contracts

1 PV of future cash flows + 2 Risk adjustment + 3 Unearned profit = IFRS 17 asset or liability

$\underbrace{\text{PV of future cash flows} + \text{Risk adjustment}}_{\text{Fulfilment cash flows}} + \underbrace{\text{Unearned profit}}_{\text{Contractual service margin}}$

Snapshot on measurement

	Initial measurement	Subsequent measurement
1 **PV of future cash flows**	Current assumptions	Current assumptions
2 **Risk adjustment**	Current assumptions	Current assumptions
3 **Unearned profit—contractual service margin**	The amount that results in no gain recognised in profit or loss	Update by reflecting: • Time value of money • Adjustments related to future service • Allocation of the amount earned for services provided

Optional simplified approach—eligibility

- Eligible for contracts with
  - coverage of one year or less; or
  - no variability in the fulfilment cash flows affecting the liability for remaining coverage

- IFRS 17 contract boundary requirements apply for the assessment of the coverage period
  - practical ability to reassess risks of the policyholder; or
  - practical ability to reassess risks of the portfolio that contains the contract and the pricing reflects risks up to the reassessment date

Optional simplified approach—overview

A Liability for remaining coverage
- PV of future cash flows
- Risk adjustment
- Contractual service margin

Split in three blocks not required

+

B Liability for incurred claims
- PV of future cash flows
- Risk adjustment

=

IFRS 17 liability

A Simplified measurement

B Measurement under the general model, but discounting of claims to be settled within 1 year not required

Grouping objectives

- IFRS 17 requires portfolio be divided into 1-3 groups
- IFRS 17 will provide:
  - information about losses from contracts onerous at initial recognition
  - information about losses when previously profitable groups of contracts become onerous

Grouping contracts is relevant for the recognition in P&L of profits and losses for insurance services

The level of aggregation does not affect the measurement of the fulfilment cash flows

How are insurance contracts grouped?

1. **Portfolio**
   - ✓ Similar risks
   - ✓ Managed together

2. Onerous at initial recognition | Remaining contracts in the portfolio | At initial recognition, have no significant possibility of becoming onerous

3. Issuance period

Level of aggregation
Examples 1 and 2

- **Example 1**: A set of 100 ‘identical’ contracts are written with a probability that 5 of the policyholders will claim
  - 100 contracts are a group; company does not treat the 5 contracts as a separate group
- **Example 2**: a company issues 500 contracts; there is information that a set of 200 ‘identical’ contracts are under priced, but the company expects that a set of 300 profitable ‘identical’ contracts will cover losses (or possible losses) on the set of 200 under-priced contracts
  - Group A—losses on the 200 under-priced contracts are recognised immediately
  - Group B—profits on 300 contracts are recognised over the coverage period

Why annual cohorts?

Example 1

- Timely recognition of losses

	Y1	Y2	Y3	Y4	Y5	Total profit
With annual cohorts						
Contracts written in Y1	30	30	(20)*	0	-	**40**
Contracts written in Y2	-	9	9	9	9	**36**
	30	**39**	**(11)**	**9**	**9**	**76**
Without annual cohorts						
Contracts written in Y1 and Y2	**30**	**36**	**4**	**4**	**2**	**76**

* Due to changes in expectations

Why annual cohorts?
Example 2

- Preventing phantom profit*

	Y1	Y2	Y3	Y4	Y5	Total profit
With annual cohorts						
Contracts written in Y1	30	30	30	30	-	**120**
Contracts written in Y2	-	9	9	9	9	**36**
	30	**39**	**39**	**39**	**9**	**156**
Without annual cohorts						
Contracts written in Y1 and Y2	**30**	**36**	**36**	**36**	**18**	**156**

* Contracts written in different years

Insurers vs other industries

	IFRS 4	Other industries	IFRS 17
Recognition of revenue	Varies by local practices	As service is provided	As service is provided
Recognition of losses on onerous contracts	Varies by local practices	When expected	When expected
Unit of account	Varies by local practices	Contract-by-contract basis	Grouping is permitted
Trend information about profitability	✗	✓	✓

Applying IFRS 17 for the first time

	1 PV of future cash flows	2 Risk adjustment	3 Unearned profit
Existing contracts (issued before transition date)	✓ Usual IFRS 17 measurement	✓ Usual IFRS 17 measurement	× Transitional measures
New business (issued after transition date)	✓ Usual IFRS 17 measurement	✓ Usual IFRS 17 measurement	✓ Usual IFRS 17 measurement

Transitional measures

DETERMINE TRANSITION METHOD BY GROUP OF CONTRACTS

1 Full retrospective approach (apply IAS 8)

if impracticable

2 Modified retrospective approach

- Modifications available if necessary given reasonable and supportable information
- Maximise the use of the information needed for full retrospective approach

Insufficient reasonable and supportable information available

OR

3 Fair value approach

Typical existing profit or loss statement

P&L	20X1	20X0
Gross premiums	16,321	13,567
Premiums ceded to reinsurers	(816)	(678)
Investment income	9,902	9,030
Total income	**25,407**	**21,919**
Gross claims, benefits and expenses	(13,827)	(12,012)
Claims and expenses ceded to reinsurers	368	351
Acquisition costs amortisation	(1,259)	(1,150)
Change in insurance contract liabilities	(9,308)	(8,377)
Total expenses	**(24,026)**	**(21,188)**
Profit before tax	**1,381**	**731**

- Cash based and includes collection of deposits. Inconsistent with other industries
- Includes repayment of deposits
- Confusing adjustment that incorporates multiple factors
- Inconsistent measurement reduces comparability

‘Source of earnings’ difficult to identify

IFRS 17 Income Statement

P&L	20X1	20X0
Insurance revenue	9,856	8,567
Insurance service expenses	(9,069)	(8,489)
Incurred claims and insurance contract expenses	*(7,362)*	*(7,012)*
Insurance contract acquisition costs	*(1,259)*	*(1,150)*
Gain or (loss) from reinsurance	*(448)*	*(327)*
Insurance service result	**787**	**78**
Investment income	9,902	9,030
Insurance finance expenses	(9,308)	(8,377)
Net financial result	**594**	**653**
Profit before tax	**1,381**	**731**

Two drivers of profit presented separately

Insurance coverage

Investment activities

Richer information content
With amounts that will be more relevant and more comparable

Typical existing Balance Sheet

Balance sheet	20X1	20X0
Financial assets	226,297	196,700
Deferred acquisition costs	8,083	8,941
Premiums receivable	2,798	2,582
Reinsurance contract assets	20,572	17,882
Other assets	36,002	31,293
Total assets	**293,752**	**257,398**
Insurance contract liabilities	211,010	185,545
Unearned premiums	5,595	4,796
Other liabilities	51,431	44,705
Equity	25,716	22,352
Total liabilities and equity	**293,752**	**257,398**

Multiple line items, inconsistent terminology and inconsistent measurement, difficult to understand changes

Example of IFRS 17 balance sheet

1 PV of future cash flows + 2 Risk adjustment + 3 Unearned profit = IFRS 17 asset or liability

Balance sheet	20X1	20X0
Financial assets at fair value through profit or loss	185,152	160,936
Financial assets at fair value through OCI	41,145	35,764
Other assets	34,467	31,293
Total assets	**260,764**	**227,993**
Insurance contract liabilities	205,724	178,818
Other liabilities	30,859	26,823
Equity	24,181	22,352
Total liabilities and equity	**260,764**	**227,993**

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Where do we go from here?

IASB implementation support for IFRS 17

- Webinars
- Articles and other materials
- Conferences
- Transition Resource Group

Education for

- investors
- regulators
- standard-setters

Informal technical discussions with

- regulators
- standard-setters
- audit firms

Board and IFRS Interpretations Committee discussions

Dedicated website page

Transition Resource Group

Public forum for discussion	Limited life during the transition period to the new requirements	Helps the Board to determine whether actions needed to address questions

- Meetings webcast
- Papers and summaries publicly available

- Membership announced in September 2017
- First meeting on 13 November 2017

- Educative material from TRG discussions
- Very high hurdle for amendments

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Q&A