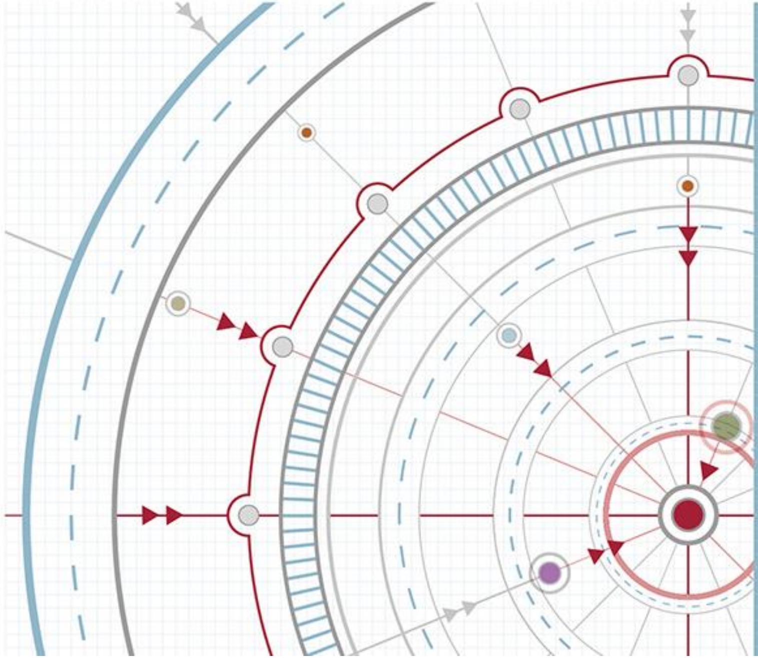


# IFRS 17
# *Insurance Contracts*

The Foundation for Promotion of the Actuarial Profession
30 November 2017

The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board (Board) or IFRS Foundation.

# 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<br>Current value accounting | GAAP B<br>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



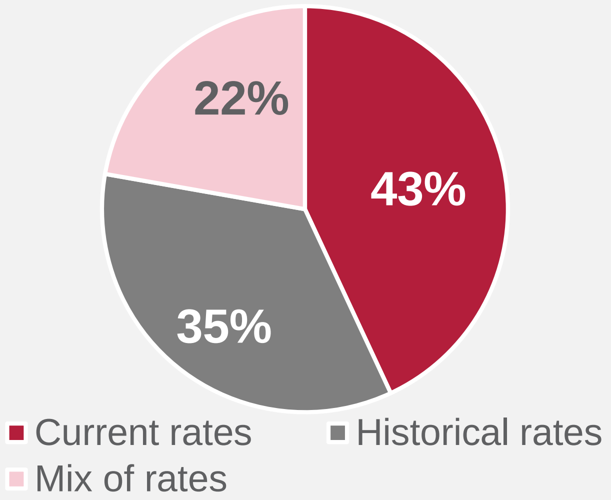
## Today

- Use of old or outdated assumptions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**<br>• IFRS companies report insurance contracts using different practices<br>**Non-uniform reporting within groups**<br>• Insurance contracts of subsidiaries are consolidated using different practices | • New framework will replace huge variety of accounting treatments |
| **Inconsistency with other industries**<br>• Revenue include deposits<br>• Revenue reported on a cash basis | • Revenue will reflect the services provided, and exclude deposits, like any other industry |

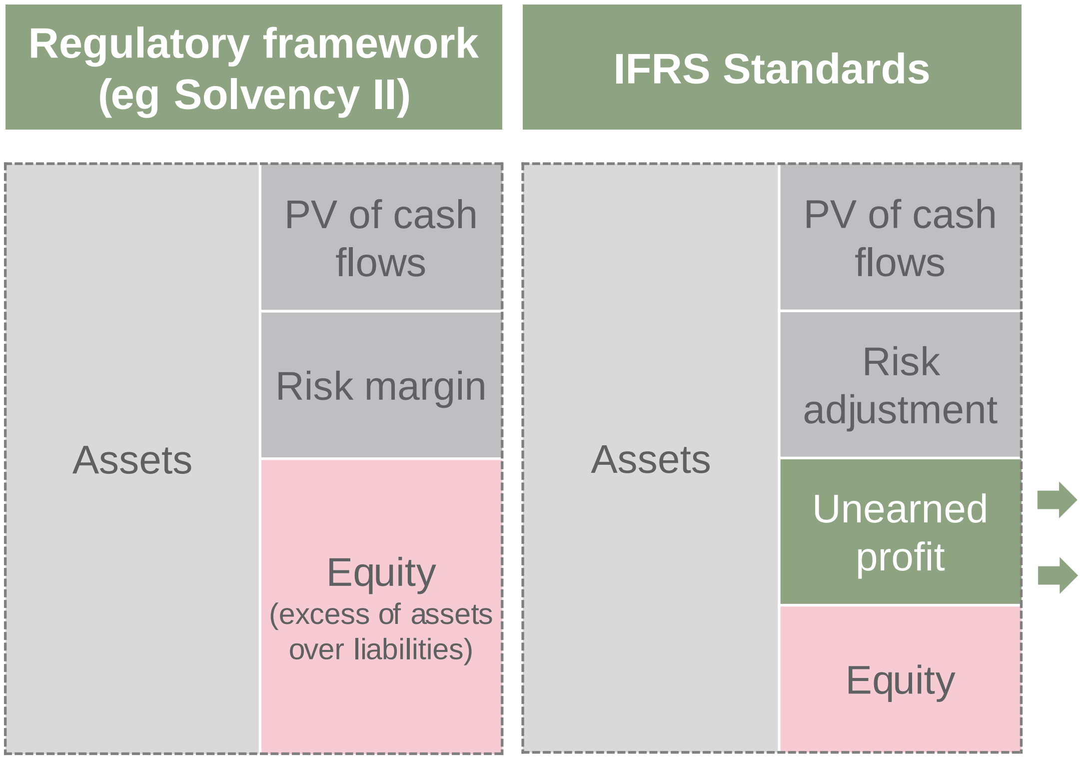
# Interaction with regulatory frameworks



| | 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

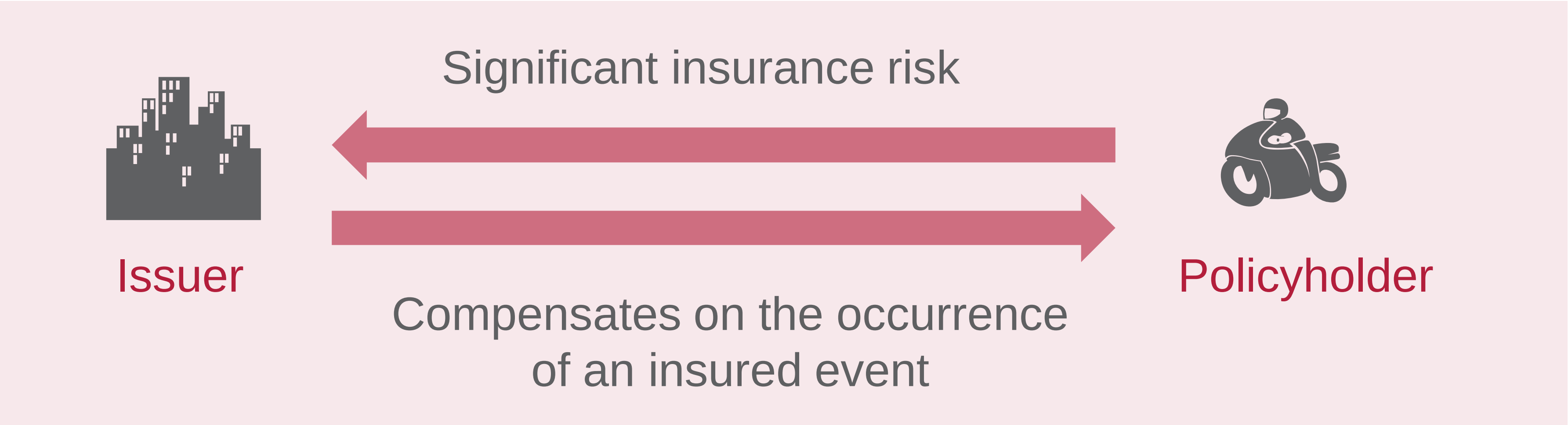
**4**
rounds of fieldwork and testing

# 3

# Who is affected by the change

# What is an insurance contract?



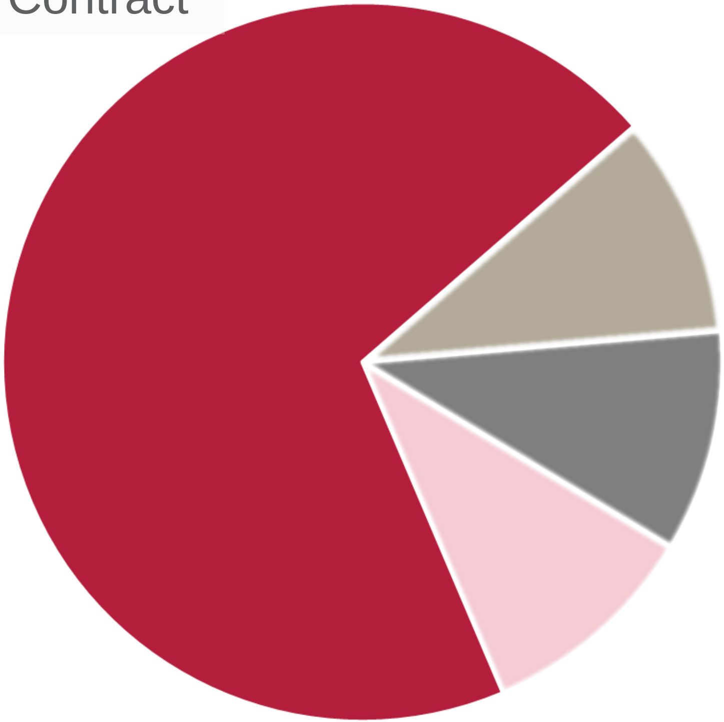



- IFRS 17 and IFRS 4—same definition
- IFRS 17 two minor changes to guidance but no expected changes in assessments for majority of contracts

# What is measured under IFRS 17?



Contract



- 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<br>• Most common banking agreements do not typically transfer significant insurance risk |
| **Investment companies** | • Issue contracts that are similar to some insurance contracts<br>• 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<br>• IFRS 17 does not apply to product warranties issued by a manufacturer, dealer or retailer<br>• 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:<br>• Time value of money<br>• Adjustments related to future service<br>• 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** |

# 5

# 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

Board and IFRS Interpretations Committee discussions

Informal technical discussions with

- regulators
- standard-setters
- audit firms

Dedicated website page

# Transition Resource Group



Public forum for discussion

- Meetings webcast
- Papers and summaries publicly available

Limited life during the transition period to the new requirements

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

Helps the Board to determine whether actions needed to address questions

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

# 6

## Q&A

IFRS