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IFRS 17 Overview

June 2021

Agenda

IFRS 17 Background

Introduction to IFRS 17

Objective of the Standard

The main aim of IFRS 17 is to standardize insurance accounting where IFRS is adopted to ensure that users of IFRS Financial Statements are able to compare companies (even between insurers and other companies), their past performance and their current financial position.

The key objectives of IFRS 17:

- Introduce for the first time a single IFRS accounting model for all types of insurance contracts;
- Make the new accounting model highly transparent; and
- Align as much as possible the insurance accounting with the general IFRS accounting of other industries.

Introduction to IFRS 17

Current vs IFRS 17

Key Differences in IFRS 4 and IFRS 17

IFRS 4

- **Up-fronting** of profit permitted
- Reinsurance is modelled on a net basis
- Change in value of **market variables** goes through P&L
- **Disclosures** help users understand amounts in the issuer's financial statements

IFRS 17

- **Up-fronting** of profit not permitted
- Reinsurance is modelled separately
- Change in value of **market variables** may go through P&L or OCI
- **Disclosures** are more detailed and granular as the Standard has a significant amount of optionality
- **Separation** of components is required if distinct

Existing issues vs How IFRS 17 improves accounting

Existing issues	How IFRS 17 improves accounting
Variety of treatments depending on type of contract and company	**Consistent accounting** for all insurance contracts by all companies
Estimates for long-duration contracts not updated	**Estimates** updated to reflect current market-based information
Discount rate based on estimates does not reflect economic risks	**Discount rate** reflects characteristics of the cash flows of the contract
Lack of discounting for measurement of some contracts	**Measurement** of insurance contract reflects **time value** where significant
Little information on economic value of embedded options and guarantees	**Measurement** reflects information about full range of possible outcomes

Introduction to IFRS 17

Background

Measurement Models

Current IFRS/GAAP	IFRS 17
UPR less DAC	Building Block Approach (General Model)
	Variable Fee Approach
Undiscounted reserves for past claims (including IBNR)	Premium Allocation Approach

Who will be affected by IFRS 17?

Listed insurance companies only

Geographical region	Number of companies	Total assets (US$ trillions)
Europe	95	8.6
Asia Pacific	191	7.2
North America	110	5.8
Africa and Middle East	184	0.3
Latin America	46	0.2
Total	**626**	**22.1**

Listed insurance companies only

Reporting Framework	Number of companies	Total assets (US$ trillions)
IFRS Standards	449	13.3
US GAAP	128	4.7
Japanese GAAP	11	4.0
National GAAP’s	38	0.1
Total	**626**	**22.1**

Scope

Scope of IFRS 17

Stakeholder Awareness is Growing Quickly

IFRS 17 definition of insurance contract aligned to IFRS 4:

> *"A contract under which one party (the* ***issuer****) accepts* ***significant insurance risk*** *from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the* ***insured event****) adversely affects the policyholder."*

"**Issuer**" has replaced the word "**Insurer**"

- The key step in identifying if a contract meets the **definition of an insurance contract** is the **significant insurance risk** arising for the contract issuer.

- Significant where:
  - Issuer could **suffer loss** caused by insured event and
  - **Pay significant additional amounts** beyond what would have been paid had the insured event not occurred

IFRS 17 applies to:
- Insurance and reinsurance contracts issued by the company;
- Reinsurance contracts that the company holds ("ceded reinsurance"); and
- Investment contracts with discretionary participation features ("DPF") that it issues, provided that the entity also issues insurance contracts

IFRS 17 scope exclusions = IFRS 4

Scope elections:
- Financial guarantee contracts which can be measured under IFRS 9 and
- the addition of fixed fee service contracts (e.g. roadside assistance) which can be scoped out of IFRS 17 into IFRS 15 by accounting policy choice, provided conditions are met

Scope of IFRS 17

List of IFRS 17 Dimensions:

1 Contract Definition and Scope

2 Unbundling

3 Level of Aggregation

4 Measurement Models

5 Best Estimate Cash Flow

6 Discounting

7 Risk Adjustment

8 Contractual Service Margin

9 Premium Allocation Approach

10 Variable Fee Approach

11 Onerous Contract

12 Reinsurance Measurement

13 Presentation

14 Disclosure

15 Transition

Definition and Measurement

Definition and Measurement

Topic-wise summary of Insurance Contracts

Unbundling

Contracts Level of Aggregation

Measurement Models

- **Building Block Approach**
- **Variable Fee Approach**
- **Premium Allocation Approach**

Comparison of Measurement Models

Definition and Measurement

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Comparison of Measurement Models

Definition and Measurement

Unbundling Overview

What about contracts which contain features of both insurance and non-insurance contracts?

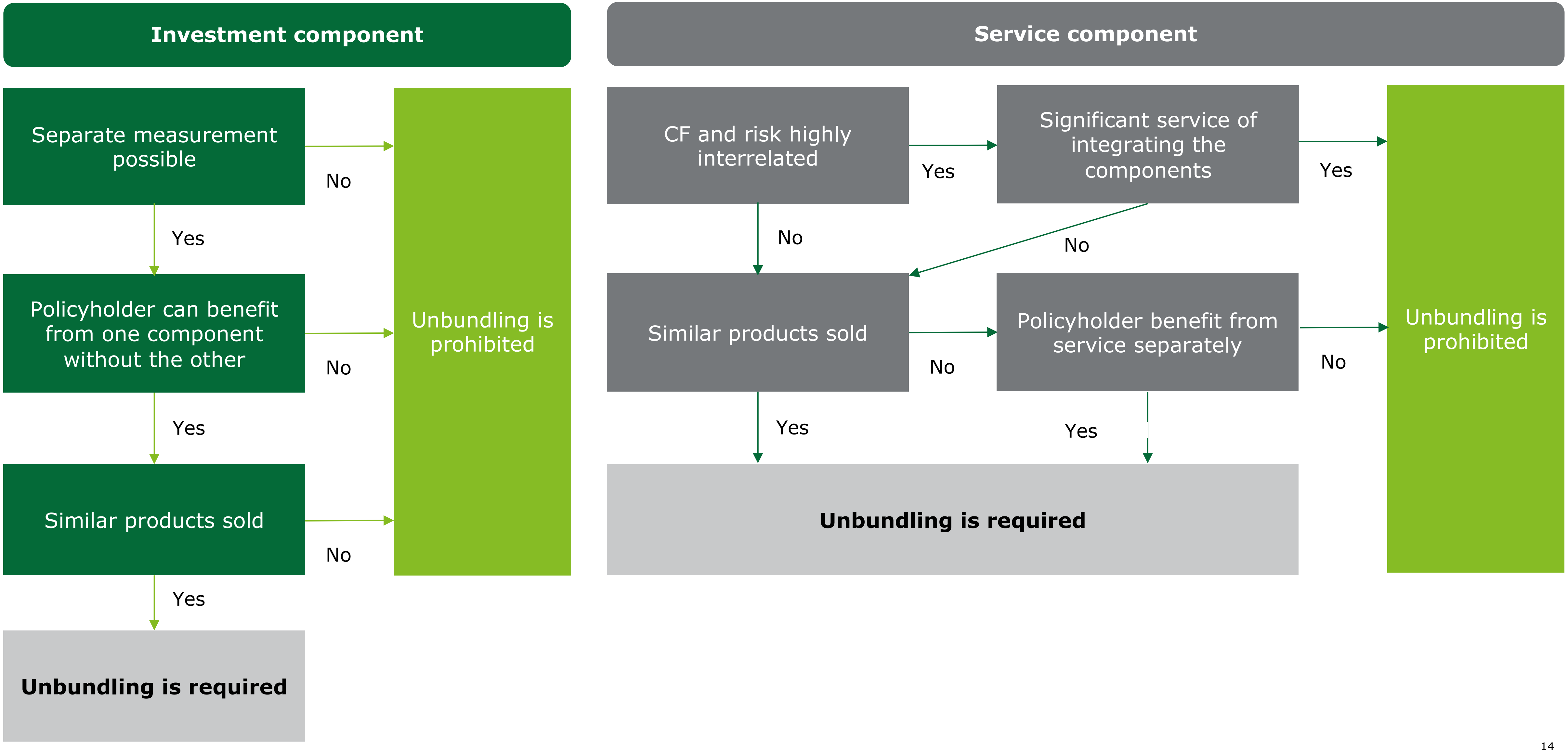
- Entities often have products that have **insurance and non-insurance** components
- Necessary to separate **non-insurance components** from host contract – required
- Process is referred to as **Unbundling**

- Under IFRS 4, unbundling was required under certain tests being passed. It could also be adopted on a voluntary basis given certain criteria.
- However under IFRS 17, unbundling is prohibited unless it can be shown that it is required.

IFRS 4
vs
IFRS 17
difference

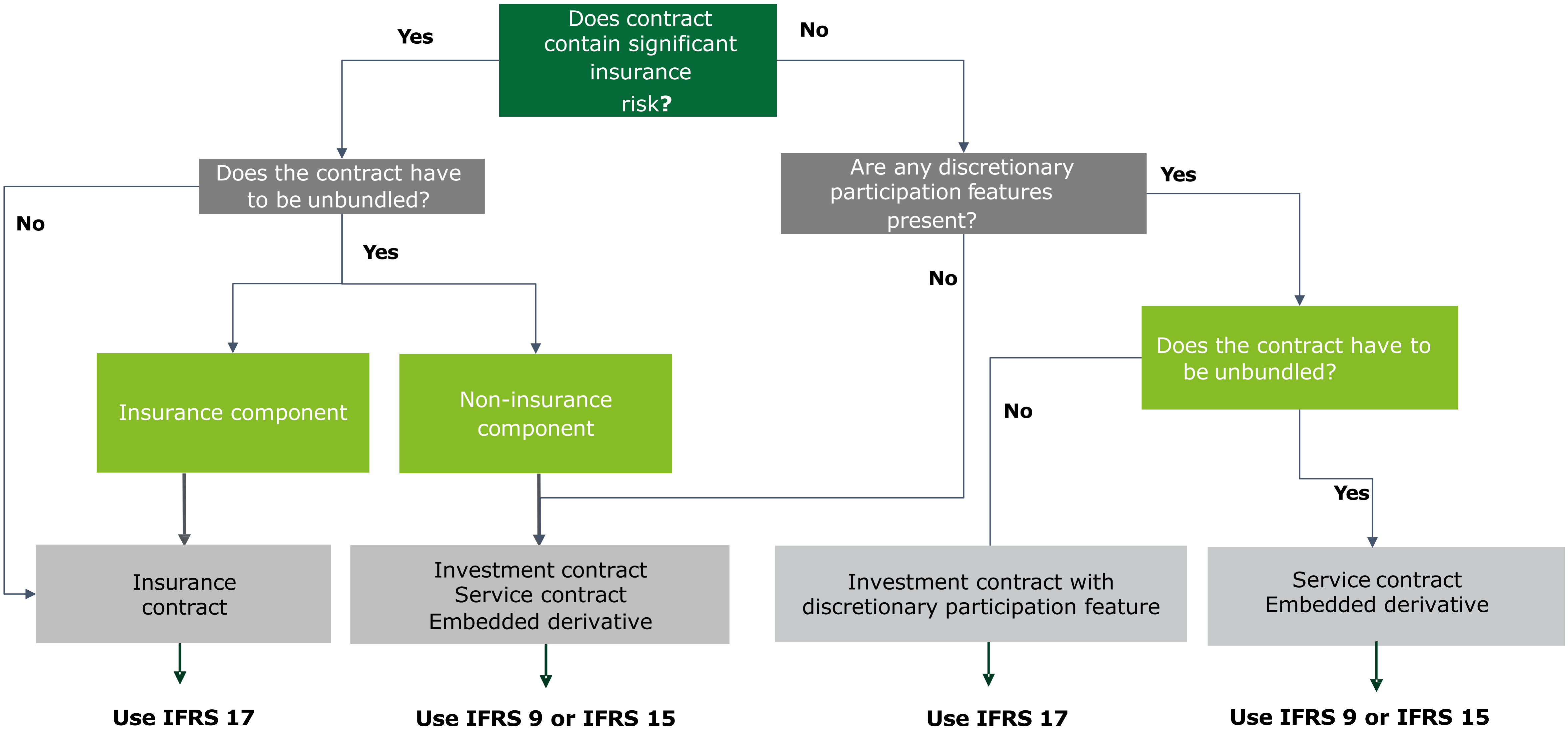
Definition and Measurement

Unbundling Overview



Definition and Measurement

Unbundling Overview



Definition and Measurement

Topic-wise summary of Insurance Contracts

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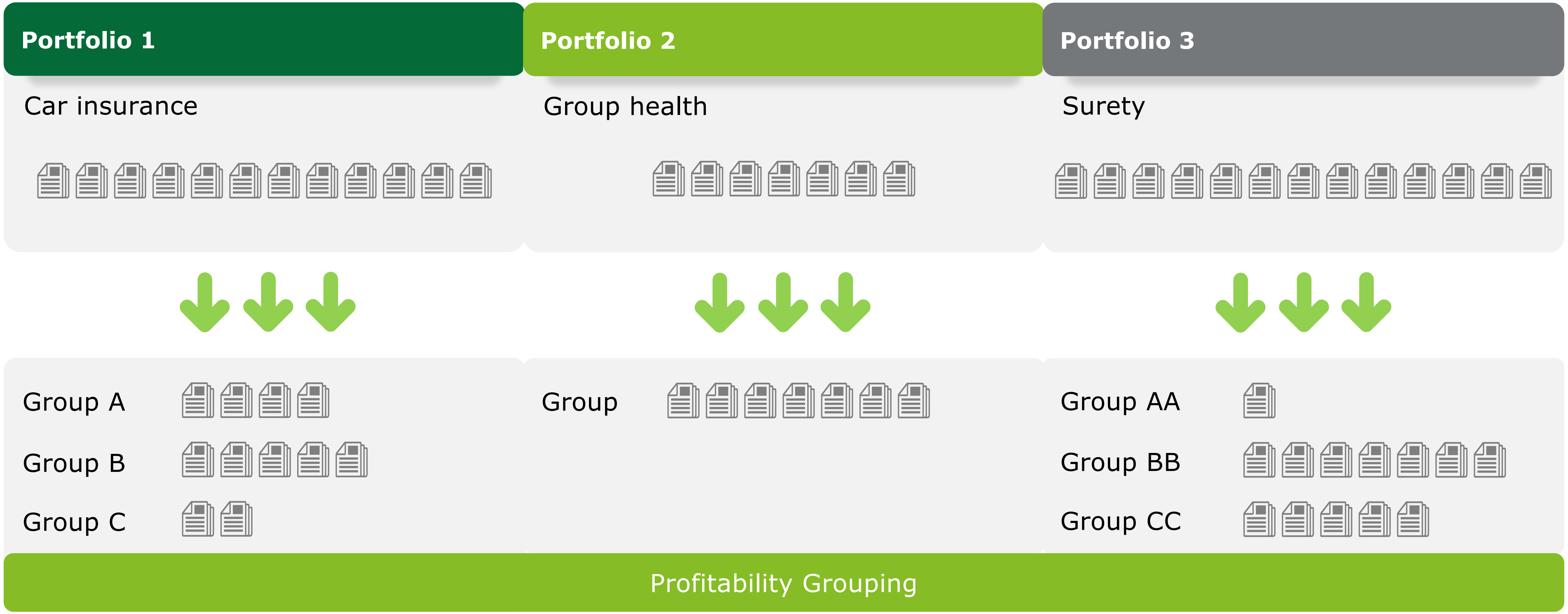
- Building Block Approach
- Variable Fee Approach
- Premium Allocation Approach

Comparison of Measurement Models

Definition and Measurement

Contracts Level of Aggregation

- **A *portfolio*:** Insurance contracts subject to **similar risks** and **managed together**.
- Entity divides each portfolio of contracts into ***groups*** based on **profitability** and **cohort** based on **initial recognition date.**



Definition and Measurement

Topic-wise summary of Insurance Contracts

Unbundling

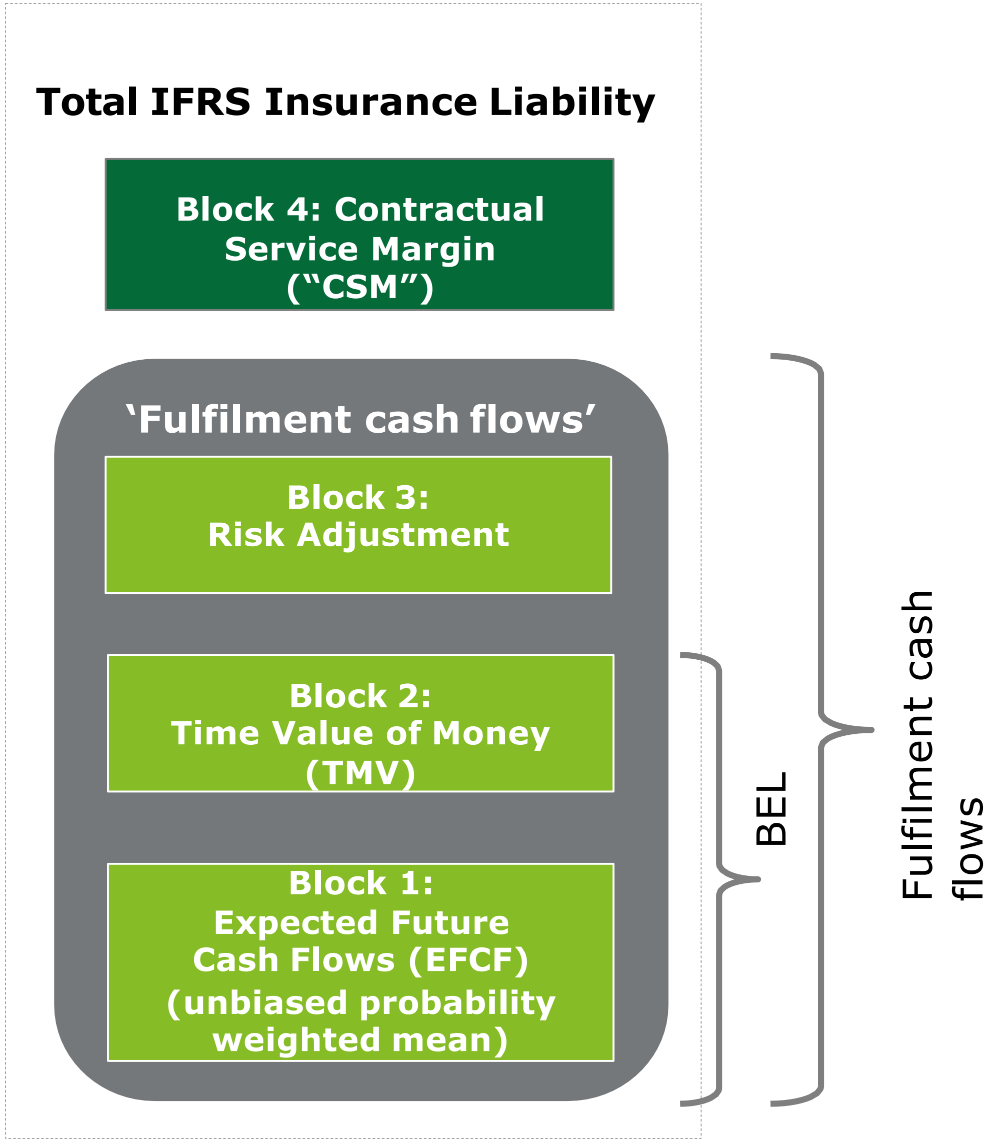
Contracts Level of Aggregation

Measurement Models	**Building Block Approach**
	Variable Fee Approach
	Premium Allocation Approach

Comparison of Measurement Models

Definition and Measurement

Building Block Approach



- We refer to the combination of 1 and 2 as the **"Best Estimate Liability" (BEL)**
- Central to the new accounting is the amount defined as the "fulfilment cash flows"
- It is made of **future outflows and inflows** as well as an allowance for risk.
- The "fulfilment cash flows" is composed of the following three components:
    - **Undiscounted probability-weighted cash flows**
    - **Discount rate curve**
    - **Risk adjustment**
- This is an amount that gives the **accounting representation of all rights and obligations** from an insurance contract. It is always present even when there is no CSM.

Definition and Measurement

Key Features

The **main features of the IFRS 17** general measurement model are as follows:

- Estimates and assumptions on future cash flows are always current;
- Reflection of the time value of money;
- Maximum use of observable market consistent information;
- Expected profit is deferred and aggregated in groups of insurance contracts at initial recognition; and
- Expected profit is recognized over the coverage period
- Current and explicit measurement of risk;

Definition and Measurement

Building Block Approach (Expected Future Cash Flows – Admissible / Inadmissible)

Cash Flow	To be Included	To be Excluded
Premium	• Premiums and cash flows	• Future insurance contracts • Unbundled components
Claims	• Claims and benefits • Surrender and participating benefits	• Future insurance contracts • Unbundled components
Expense	• **Overhead-type costs** • Policy administration and maintenance costs • Costs of selling, underwriting and initiating • Claims handling costs • Options and guarantees cash flows • **Directly attributable insurance acquisition cash flows**	• Payments to and from reinsurers • **Non-Directly attributable acquisition costs**
Tax	• Premium taxes and levies	• Income tax payments
Other		• Investment returns

Systematic and rational allocation

- CFs **are not directly attributable to groups of contracts**, estimated at a higher level and then allocated to groups of contracts.
- CFs that are directly attributable to an individual contract can also be estimated at a **higher level** and **then allocated** to individual contracts or groups of contracts.

Definition and Measurement

Building Block Approach (Risk Adjustment)

What is a risk adjustment liability?

- Risk adjustment for non-financial risk (RA) measures the **compensation** that the entity requires for it to be **indifferent/neutral between** fulfilling a liability that:

    1. Has a **range** of possible outcomes arising from non-financial risk; and
    2. Will generate **fixed** cash flows with the same expected present value as the insurance contracts.

- RA is the **compensation** that the entity requires for bearing **uncertainty** about the **amount and timing** of CFs that arise from non-financial risk
- It reflects **all non-financial risks** associated with the insurance contracts

It shall **not** reflect

a. Financial risk, as it is included in the estimates of the future cash flows or the discount rate used;

b. Risks that do **not** **arise from the insurance contracts** (e.g. general operational risk).

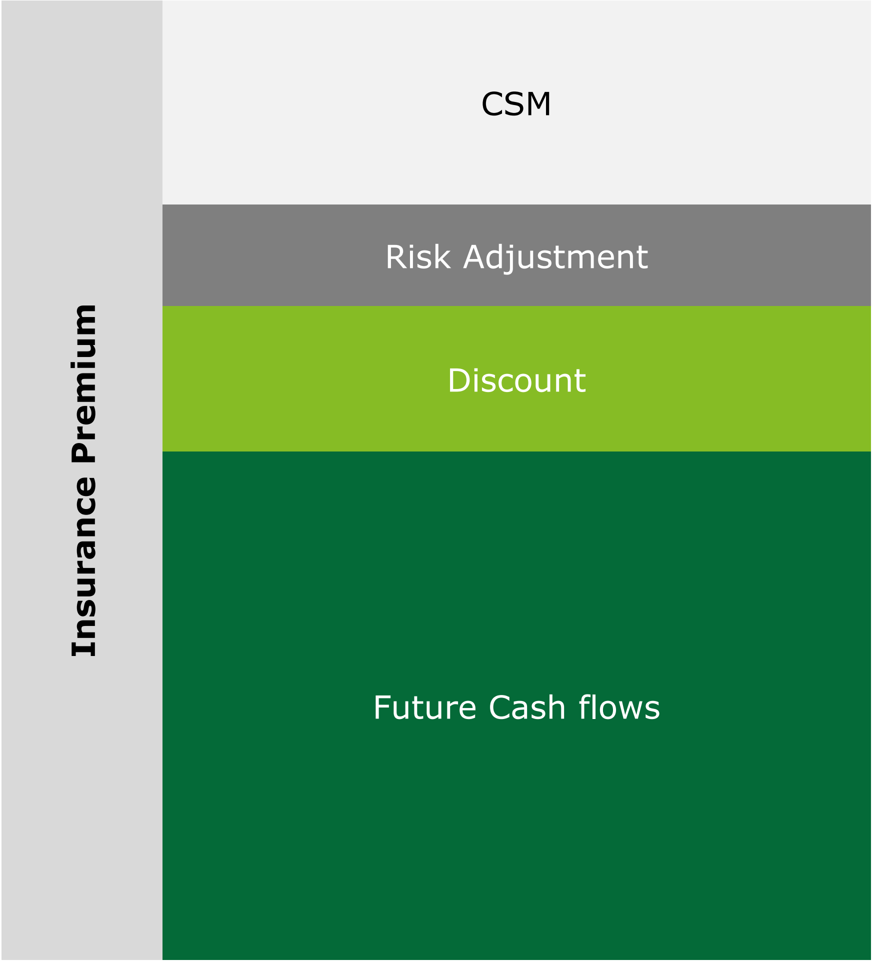
Definition and Measurement

Building Block Approach (CSM)

An accounting mechanism for **recognizing profit** over the **coverage period** of the contract:

- It represents the **expected profit** for the issuer as it sells an insurance contract
- **Absorbs changes** in future cash flow expectations for release over time.
- The accounting result is that it **defers immediate recognition of profit** from the initial recognition of an insurance contract to future periods based on an accounting mechanic that releases the CSM balance over the coverage period stipulated in the contract.

CSM at initial recognition of an insurance contract results in **no income or expenses** (no impact to P&L for profitable contracts)



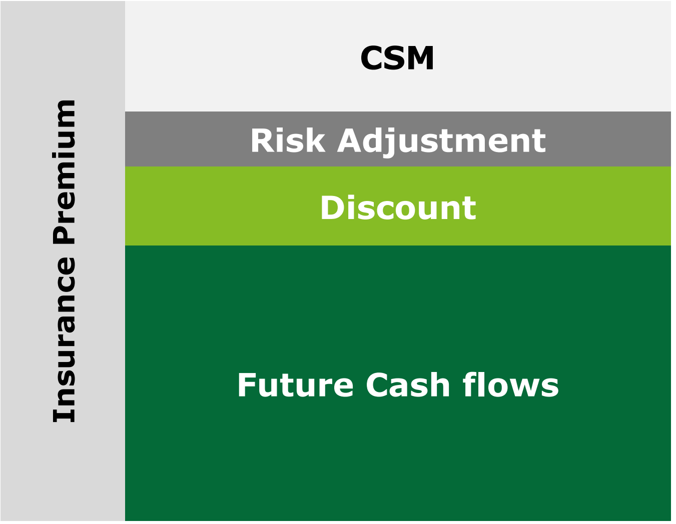
Definition and Measurement

Building Block Approach (CSM)

CSM is set up at inception of contract and is added to the liability:

- If a contract is profitable/”not onerous” (i.e. BEL + RA < 0), the CSM is set so that the **profit recognized at inception is zero:**

Liability = BEL (negative) + RA (positive) + CSM (positive) = 0



- If a contract is not profitable (i.e. BEL + RA > 0), the CSM is set to zero, so that at inception the entity **recognises a loss:**

Liability = BEL (positive) + RA (positive) + CSM (=zero) > 0

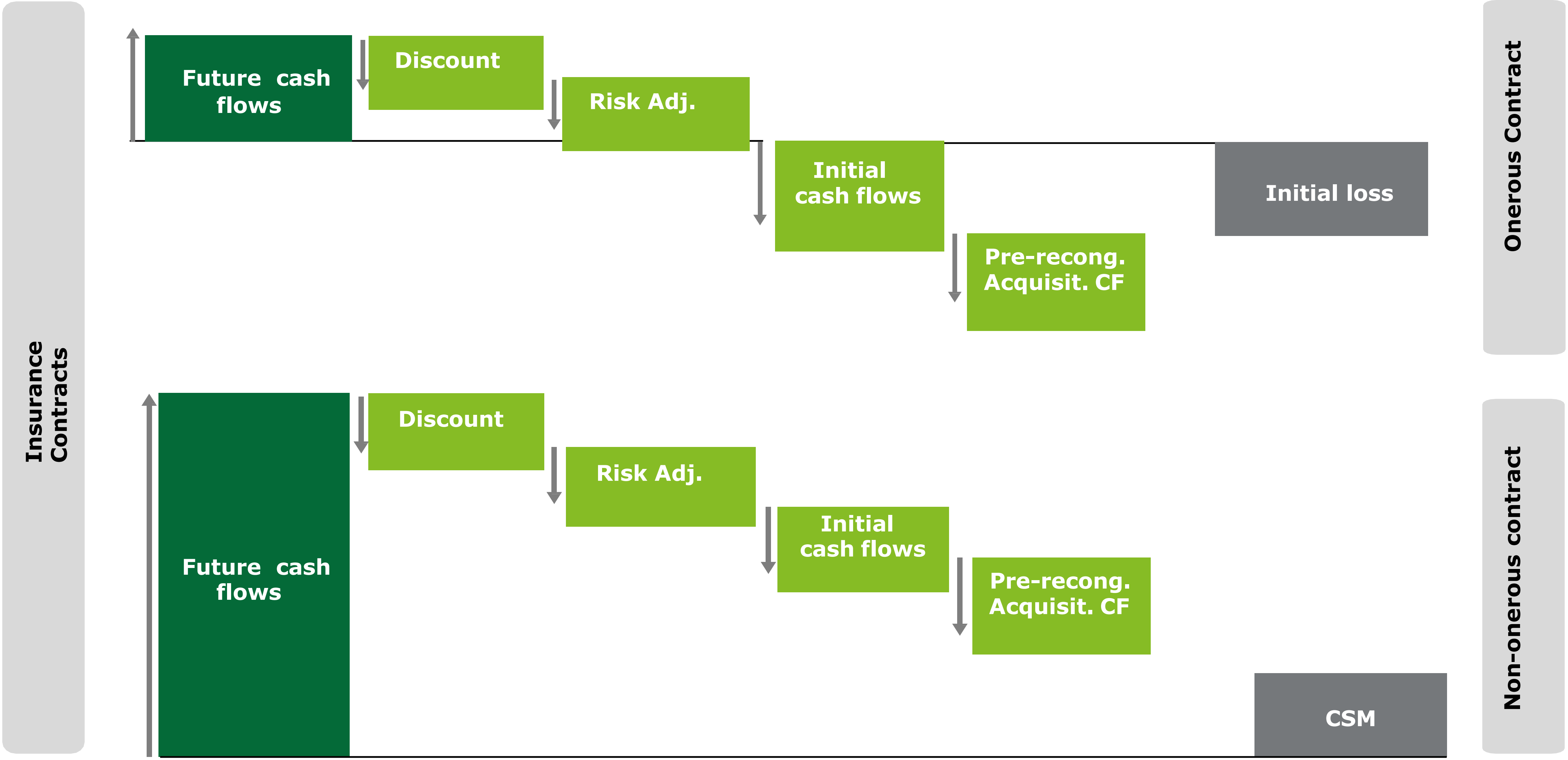
Onerous Contract

Thus CSM is determined so that profit emerges in line with general accounting principles:

- Recognises profit over the life of contract/group of contracts
- Recognises a loss if contract is onerous at inception

Definition and Measurement

Onerous Contracts



Definition and Measurement

Topic-wise summary of Insurance Contracts

Unbundling

Contracts Level of Aggregation

Measurement Models

- Building Block Approach
- Variable Fee Approach
- **Premium Allocation Approach**

Comparison of Measurement Models

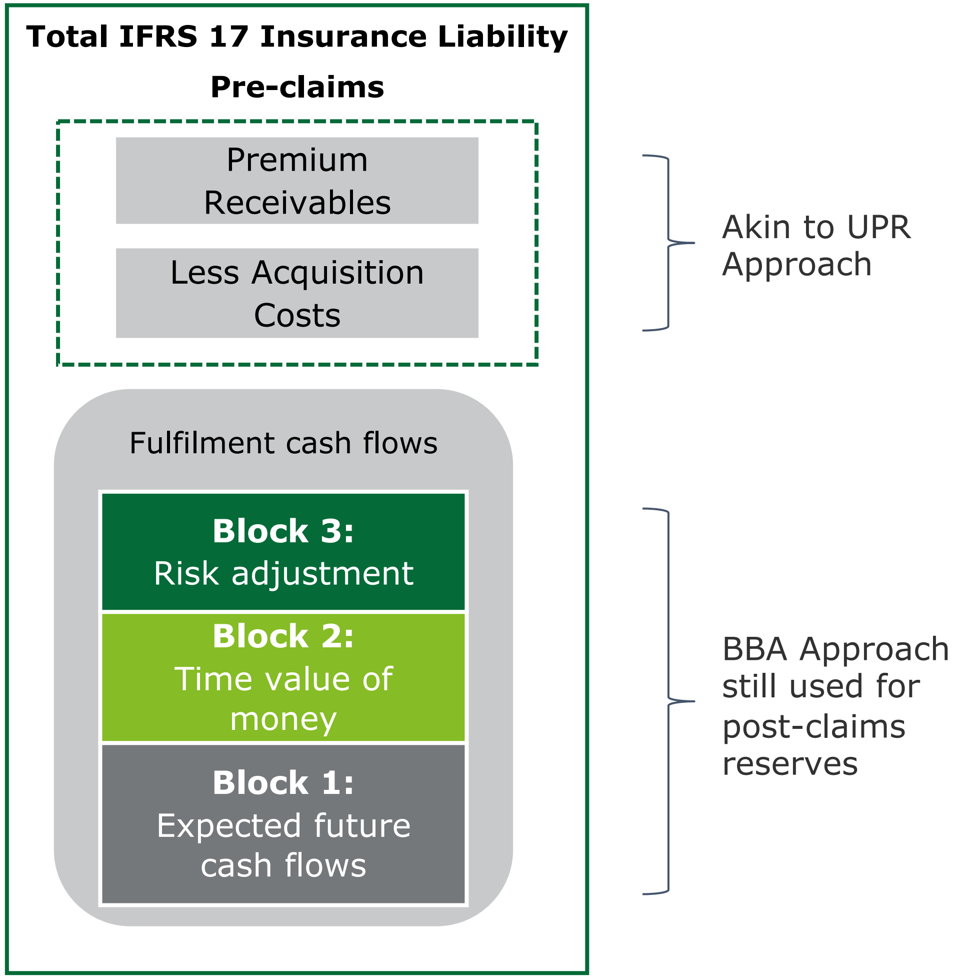
Definition and Measurement

Premium Allocation Approach (Overview)

- Simplified approach to measuring the LRC only
- The key simplification is **exemption to issuer** from **calculating and explicitly accounting for the CSM**, the main component of the liability for remaining coverage
- **Not applicable for LIC** for which the general measurement model/**BBA always** apply
- Contracts with **investment components** are also eligible to use the PAA, but revenue needs to be reported the same way as in the general model (i.e. disaggregate the investment components for presentation purposes)

Simplified approach:
Premium Allocation Approach (PAA)

Simplified approach to measuring the value of insurance contracts if eligibility criteria is met



Definition and Measurement

Premium Allocation Approach (Specifics)

Requirement	Description	Impact
Premium Allocation Approach	• **Simplification** • **Coverage period**, <u>not</u> over the settlement period • An **option** which is permitted for contracts with **coverage of 1 year or less** <u>or</u> otherwise where the entity can demonstrate it is a **reasonable approximation to BBA** • Accrete interest unless the term from coverage to incurred loss event is less than 1 year	• The primary impact of this is that it allows **non-life insurers to continue to use their process and systems** for calculating unearned premiums amounts • It will still be necessary to set up processes to **calculate claims reserves under BBA** • Key consideration is whether PAA can apply to all business in coverage period and whether it is preferable to use PAA or move all contracts to BBA, which will require a new process for CSM.
Onerous contracts	• An insurer will need to hold an additional liability for onerous contracts where PAA is used over the coverage period and for signed but not yet incepted contracts that are onerous	• Evolution of existing approach to assessing unexpired risk reserves • New measurement of onerous contracts based on BBA • Applies for groups measured using PAA and for signed but not yet incepted contracts that are onerous

Definition and Measurement

Premium Allocation Approach (Criteria)

When to use the Premium Allocation Approach:

Applies to liability for remaining coverage only

1. If it would be a **reasonable approximation** to BBA and the coverage period at initial recognition is more than one year

OR

2. If the **coverage period** at initial recognition is **one year or less**

Applicable for yearly- renewable term life and short-term products

1 is not met if at the inception of the group an entity expects **significant variability** in the fulfilment cash flows that would affect the measurement of the liability for remaining coverage during the period before a claim is incurred.

Presentation and Disclosure

IFRS 17

Presentation and Disclosure

The new IFRS Insurance requirements have a very ambitious goal

Make insurance revenue presentation comparable to all other types of revenue under IFRS

This results in a brand new set of requirements that will be very expensive to implement for life insurers.

- General insurers will have an easier job

These requirements have a pervasive effect on insurers because this new presentation is likely to require the re-design of management information reports

Unlike the IFRS Insurance measurement requirements, the presentation requirements will go deep into the IT architecture and will demand modification at policy administration system level

On top of the presentation requirements the new IFRS Insurance will impose a much greater set of disclosure requirements than under current IFRS

- Insurers will face a serious data management problem and the external reporting dimension is just the tip of the iceberg

The top disclosure requirements in terms of new data demand are:

- The new detailed roll-forward tables that would need to be published as a minimum at operating segment level and
- The reconciliation of the balance sheet items and movements to the cash flow and the income statements and in particular the reconciliation of the movements with the new insurance revenue amount

IFRS 17

Presentation and Disclosure

Changes in Presentation from Current standard – Profit and Loss account

Current Presentation	
Gross written premium	X
Reinsurance cessions	(X)
Net written premium	**X**
Change in unearned premium	X/(X)
Net earned premium	**X**
Claims paid	(X)
Reinsurance recoveries	X
Net claims paid	**(X)**
Change in claims reserves/IBNR	X/(X)
Net claims incurred	**(X)**
Other operating expenses	(X)
General and admin expenses	(X)
Investment income	X
Profit or loss before tax	**X/(X)**
Income tax expense	(X)
Profit or loss for the year	**X/(X)**

IFRS 17 Presentation	
Insurance revenue	X
Insurance service expense	(X)
Net expenses from reinsurance contracts	(X)
Insurance service results	**X**
Investment return	**X**
Net finance expenses from insurance contracts	(X)
Net finance income from reinsurance contracts	X
Movement in investment contract liabilities	X/(X)
Net investment result	**X**
Other income	X
Other operating expenses	(X)
Other finance costs	(X)
Profit or loss before tax	**X/(X)**
Income tax expense	(X)
Profit or loss for the year	**X/(X)**

In addition, new disclosures, such as BEL, RA, and CSM roll forwards, will be required. Please note that most disclosures will also require explicit separate disclosure of direct business and reinsurance amounts. The illustration above only shows lines gross of reinsurance. Reinsurance lines will have to be separately presented whenever they are material to the reporting entity.

IFRS 17

Presentation and Disclosure

Changes in Presentation from Current standard – Balance Sheet

Assets
Deferred acquisition costs
Insurance debtors (Premium receivable)
Reinsurance contract assets

Liabilities
Unearned premiums
Insurance contract liabilities
Insurance creditors (Premium payable to reinsurers)

Assets
Insurance contract assets
Reinsurance contract assets

Liabilities
Insurance contract liabilities
Reinsurance contract liabilities

- Groups of insurance and reinsurance contracts in an asset position presented separately from those in a liability position
- Acquisition cost cash flows, premiums receivable and unearned premiums are included in the measurement of insurance contract asset/liability

IFRS 17

Presentation and Disclosure

An entity shall disclose qualitative and quantitative information about:

Explanation of recognized amounts	• The amounts recognized in its financial statements that arise from insurance contracts
Significant judgements	• The significant judgements, and changes in those judgements
Risks	• The nature and extent of the risks that arise from contracts within the scope of the Standard

These 3 areas will be elaborated upon in subsequent slides

Examples of disaggregation bases that might be appropriate when presenting this information include:

- Type of contract (e.g. major product lines);
- Geographical area (e.g. country or region); or
- Reportable segment, as defined in IFRS 8 Operating Segments.

IFRS 17

Presentation and Disclosure

Disclosure highlights (refer details in appendix):

- **Explanation of recognized amounts – reconciliations on:**
  - Net carrying amounts
  - Disaggregate assets/liabilities, direct/reinsurance
  - Disaggregate liabilities for remaining coverage component, loss component, and incurred claims
  - Separate disclosure for PV of future cash flows, RA, and CSM
  - Separate disclosure for past service, current service, and future service
  - Investment components, premiums received, acquisition cash flows
- **Significant judgments**
  - Methods used to measure insurance contracts: discretion, RA, investment components, discount rate, etc.
  - Translation to confidence level
- **Risks**
  - Quantitative risk exposure, risk concentration
  - Sensitivity analysis
  - Market risk, credit risk, liquidity risk
  - Claims development
  - Regulatory framework

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