CLRS
IFRS 17: What's the Punchline?

September 2022

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Introduction

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Agenda

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1 Overview of IFRS 17

What is IFRS 17?

IFRS17 is the new International Financial Reporting Standard ('IFRS') for insurance contract accounting, effective 01/01/2023.

On 18 May 2017, the International Accounting Standards Board ('IASB') finished its long-standing project to develop an accounting standard on insurance contracts and published IFRS17, 'Insurance Contracts'. On 25 June 2020, the IASB modified IFRS 17 for selected changes requested by industry.

IFRS17 replaces IFRS4, which currently permits a wide variety of practices. IFRS17 will fundamentally change the accounting by all entities that issue insurance contracts

For insurers, the transition to IFRS17 will have significant impact on financial statements, key performance indicators, financial reporting process and operations

The standard applies to annual periods beginning on or after 1 January 2023, with earlier application permitted if IFRS15, 'Revenue from Contracts with Customers', and IFRS9 'Financial Instruments', are also applied

IFRS 17 – The basics

1

Who/Where affected?

Applies to insurance contracts issued, reinsurance contracts, and certain investment contracts issued by entities applying IFRS

2

What's required?

Current value measurement model, with recognition of profit from a 'group of insurance contracts' over the period the entity provides insurance coverage and as the entity is released from risk

3

When?

1 January 2023, requiring retrospective adoption, but with options if impracticable; comparative balance sheets needed for both December 31, 2023 and 2022; earlier application permitted

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Why?

To drive consistency and comply with IASB guidance; IFRS 4 was an interim standard that allowed entities to use a wide variety of accounting practices reflecting local accounting practices and variations of those practices

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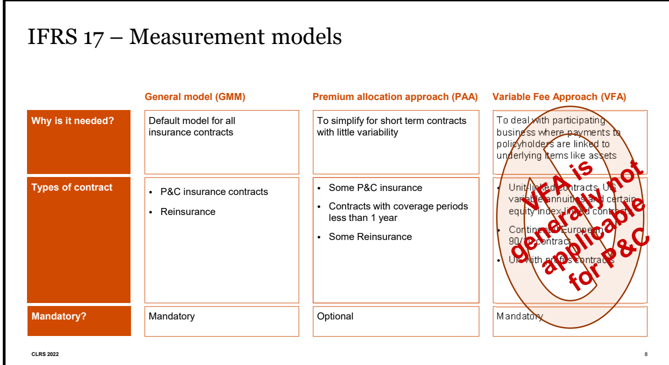
IFRS 17 – Measurement models



	General model (GMM)	Premium allocation approach (PAA)	Variable Fee Approach (VFA)
Why is it needed?	Default model for all insurance contracts	To simplify for short term contracts with little variability	To deal with participating business where payments to policyholders are linked to underlying items like assets
Types of contract	• P&C insurance contracts • Reinsurance	• Some P&C insurance • Contracts with coverage periods less than 1 year • Some Reinsurance	• Unit-linked contracts, US variable annuities and certain equity index-linked contracts • Continental European 90/10 contract • UK with profits contracts
Mandatory?	Mandatory	Optional	Mandatory

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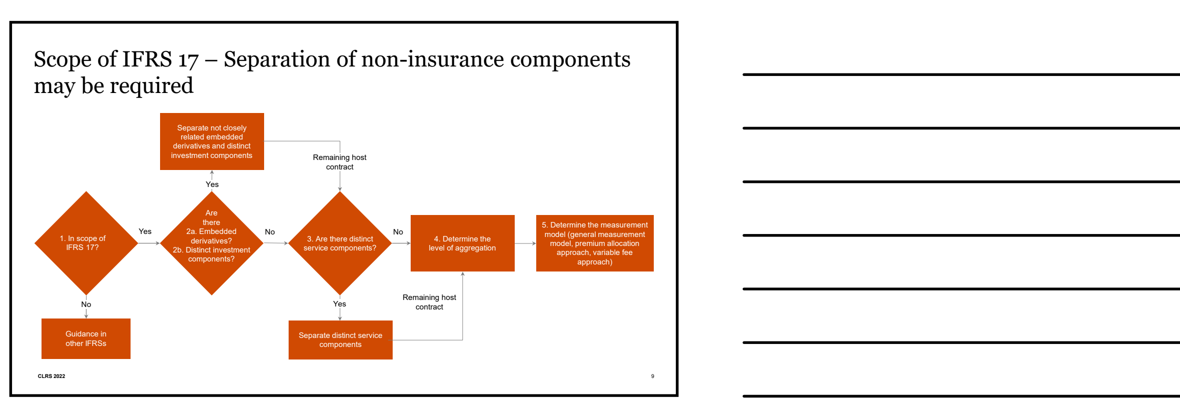
Scope of IFRS 17 – Separation of non-insurance components may be required



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Questions for Audience

What's the effective date of IFRS 17?
- A. 1/1/2022
- B. 1/1/2023
- C. 1/1/2024
- D. 1/1/2025

What model will the majority of P&C contracts fall under?
- A. General Model
- B. Premium Allocation Approach
- C. Variable Fee Approach

What are your IFRS reporting requirements?
- Group reporting
- Local regulatory reporting
- No IFRS Reporting requirements

2 Premium Allocation Approach (PAA)

Polling Question

Has your organization started performing PAA eligibility testing?
1. Not started
2. Identified units of account that will require eligibility testing
3. Identified units of account that will require eligibility testing and have started or performed limited analysis
4. Completed quantitative eligibility analysis
5. Not applicable

PAA - What IFRS 17 means for most P&C contracts

- The "Premium Allocation Approach" (PAA) option is expected to be applicable to and elected for most property/casualty (P&C) contracts – the IASB views the PAA as a simplification of the General Model for the Liability for Remaining Coverage (LFRC)
- For most P&C contracts, IFRS 17 using the PAA for LFRC is similar to common accounting frameworks in place today, but with several key differences:
  - Use of "mean" rather than undefined "best estimate" for incurred claims
  - Discounting of incurred claims through finance
    - At statement date rates for balance sheet
    - Option to use rates at incurred loss date for the income statement (OCI Option)
  - A "risk adjustment" reflecting uncertainty in amount/timing of unpaid claims
  - Earned revenue pattern based on timing of expected incurred losses, if the expected pattern of release of risk (i.e., decrease of expected incurred losses) during the coverage period differs significantly from the passage of time
  - Other key differences include (1) exclude deposit component from revenue and claims incurred expense, (2) ceding commissions netted against reinsurance premiums, (3) present DAC net against LFRC, and (4) more granular level of onerous contract testing (akin to UPR deficiency test)

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PAA eligibility criteria

Paragraph 53

An entity **may** simplify the measurement of a group of insurance contracts using the premium allocation approach if, and only if, at the inception of the group:

a. The entity **reasonably expects** that such simplification would produce a measurement of the **liability for remaining coverage** for the group that would **not differ materially** from the one that would be produced applying the General Model; or

b. The coverage period of each contract in the group (including coverage arising from all premiums within the contract boundary determined at that date) is **one year or less.**

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

1 What is the unit of account?

2 What are the coverage units?

3 What is materiality?

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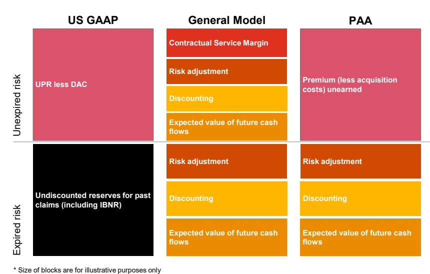
Comparison of the Measurement Models



PAA

Premium (less acquisition costs) unearned

Risk adjustment

Discounting

Expected value of future cash flows

Qualifying for the PAA

Automatically available for contracts with coverage period twelve months or less.

Unlikely that all contracts will automatically qualify for PAA model.

Mixed measurement models within a reportable segment may make results difficult to interpret.

Drivers of profit

Changes to yield curves may require closer asset liability matching to manage income statement volatility.

No prescribed method for measuring the risk adjustment but entity required to disclose methodology and confidence level and expected to be consistent year on year.

* Size of blocks are for illustrative purposes only

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PAA

Why is it a useful simplification of the general model?

LRC is accounted for using an Unearned Premium Reserve methodology (similar to current US GAAP):

- Under the General Model, an entity is required to establish an estimate of the expected value of future cash flows for both the expired and unexpired risk (and determine a CSM).
- Under the PAA, estimating the expected value of future cash flows is required only for the Liability for Incurred Claims, unless the contract is deemed onerous (which would then require the measure of the unexpired risk using the General Model framework to quantify the loss amount that must be recognised).

Do not need to calculate a CSM:

- Do not need to determine the estimated lifetime profitability of the contract at issue date.
- No need to continue to solve for unlocked CSM at future valuation dates.

In most cases, there are a reduced amount of calculations needed for the PAA):

- Onerous contract determination simplified (i.e., no need to project future incurred losses unless facts & circumstances indicate that a group of contracts is onerous)
- Discounting is not required if the future cash flows are expected to be paid/received within a year from the date incurred

Companies can leverage current US GAAP reserve estimates, with applicable adjustments:

- Unbiased mean, discounting, risk adjustment.
- System updates are still needed to quantify and track these adjustments through time.

PAA eligibility

Key characteristics impacting eligibility

1. Coverages in which the pattern of incurred claims is either highly seasonal or otherwise differs significantly from an even release over the coverage period
1. Longer coverage period, in general
1. Long payout patterns for incurred claims, particularly in higher and/or more volatile interest rate environments
1. High level of profitability expected (ie large CSM)

Questions for Audience

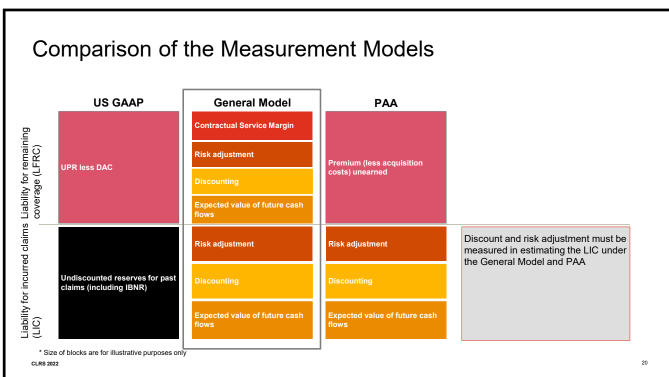
Which of the following is simplified when using the PAA as compared to the GMM?

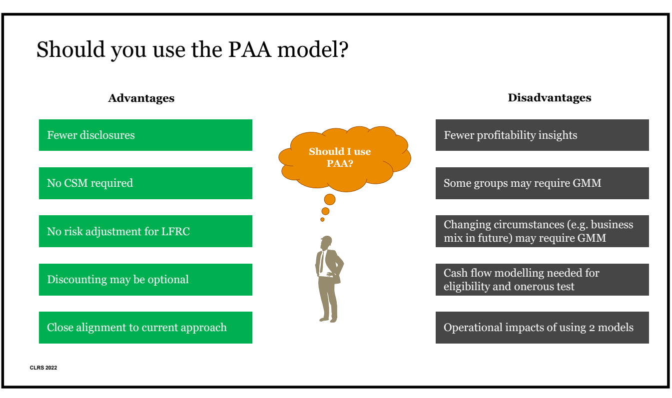
- Liability for remaining coverage
- Liability for incurred claims

Which of the following does NOT need to be calculated under the PAA?

- Best estimate of fulfilment cash flows
- Discounting
- Risk Adjustment
- Contractual Service Margin

3 General model (GMM)





Default model for all in-scope insurance contracts

		Impact
• Contractual service margin to prevent gain on policy inception. **Unearned profits** recognised over coverage period.	Contractual service margin	• **No equivalent today.** Unearned profit in the contract, released based on coverage units.
• **Reflect compensation entity requires** for uncertainty. Quantifies the value difference between certain and uncertain liability.	Risk adjustment (non-financial)	• **Methodology could be similar to current practices**. Explicit allowance for risk; differences with Solvency II likely.
• Discounting future cash flows using 'top-down' or 'bottom-up' approach for **discount rates to reflect characteristics of the liabilities**.	Discounting	• Traditional methods could support cash flow projection; **presentation requirements may require additional build / effort**.
• Estimated cash flows – **explicit**, unbiased and probability weighted estimate of fulfilment cash flows.	Expected value of future cash flows	• Methodology similar to current practices, differences in assumptions (e.g. expenses or discount rates) and contract boundaries. **Current models and methods can likely be used**, especially for LIC.

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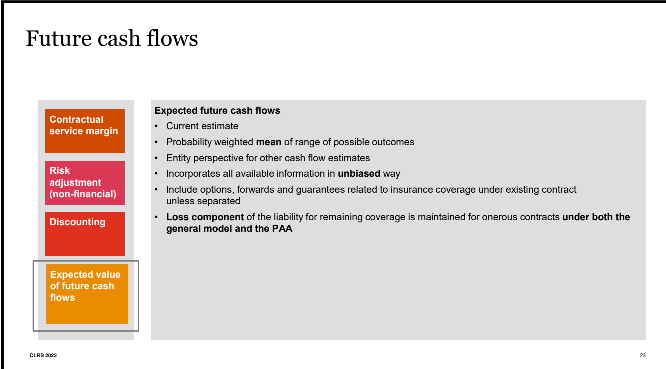
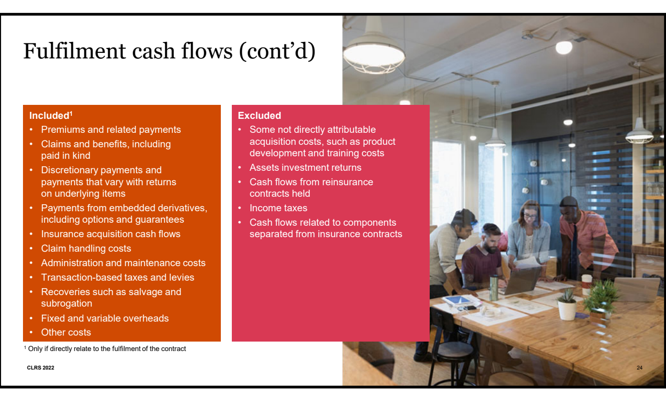




Discount rates (approach to determining discount rates)

- Contractual service margin
- Risk adjustment (non-financial)
- **Discounting**
- Expected value of future cash flows

General background:

- Measuring liabilities on a present value basis is theoretically consistent with measurement of assets, therefore providing more relevant information about an insurers financial position
- Discounting must use rates consistent with observable market prices for financial instruments having characteristics consistent with insurance liabilities

Key question: How should discount rates be determined for insurance liabilities?

Common practice today under IFRS 4:

Expected return on assets held…however, this means the fundamental economics of the business are not necessarily reflected in the IFRS reserves, for example:

- Different liability values can be obtained depending on the choice of assets (open to manipulation!)
- Duration mismatches can be hidden from users of the results
- May not meet IFRS 17 requirements to be consistent with insurance liabilities

- **Options Under IFRS 17:** Either a top-down or bottom-up approach are allowed

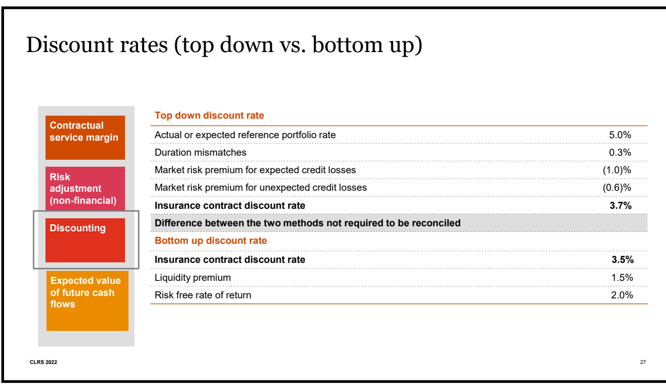
IFRS 17 requirements:

- Paragraph 36
- Application Guidance paragraphs B72 – B85
- Basis for Conclusions paragraphs BC185 – BC205

Discount rates

Discount rates are applied in IFRS 17 for multiple items:

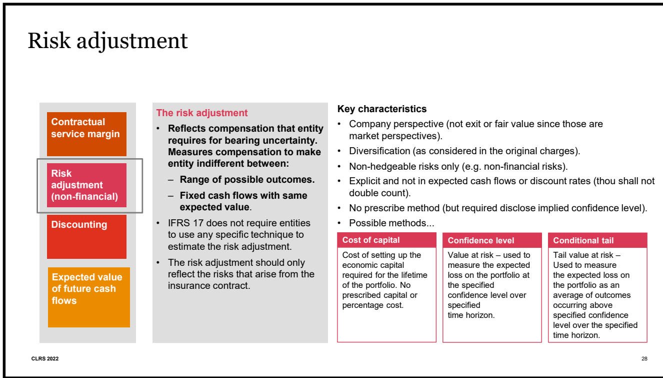
	Use	Update of assumption
Current (best estimate) discount rates	Used for the measurement of the liability for the reporting period	**Updated:** Each reporting period
Locked-in discount rates (the discount rate at inception)	**Set at inception** Used for (in General Approach) • Calculation of the impact of assumption changes • Interest accretion on CSM	**Not updated:** Locked-in at inception



Discount rates (top down vs. bottom up)

- Contractual service margin
- Risk adjustment (non-financial)
- **Discounting**
- Expected value of future cash flows

Top down discount rate	
Actual or expected reference portfolio rate	5.0%
Duration mismatches	0.3%
Market risk premium for expected credit losses	(1.0)%
Market risk premium for unexpected credit losses	(0.6)%
Insurance contract discount rate	**3.7%**
Difference between the two methods not required to be reconciled	
Bottom up discount rate	
Insurance contract discount rate	**3.5%**
Liquidity premium	1.5%
Risk free rate of return	2.0%


Risk adjustment
Contractual service margin
Risk adjustment (non-financial)
Discounting
Expected value of future cash flows
The risk adjustment
• Reflects compensation that entity requires for bearing uncertainty. Measures compensation to make entity indifferent between:
– Range of possible outcomes.
– Fixed cash flows with same expected value.
• IFRS 17 does not require entities to use any specific technique to estimate the risk adjustment.
• The risk adjustment should only reflect the risks that arise from the insurance contract.
Key characteristics
• Company perspective (not exit or fair value since those are market perspectives).
• Diversification (as considered in the original charges).
• Non-hedgeable risks only (e.g. non-financial risks).
• Explicit and not in expected cash flows or discount rates (thou shall not double count).
• No prescribe method (but required disclose implied confidence level).
• Possible methods...
Cost of capital
Cost of setting up the economic capital required for the lifetime of the portfolio. No prescribed capital or percentage cost.
Confidence level
Value at risk – used to measure the expected loss on the portfolio at the specified confidence level over specified time horizon.
Conditional tail
Tail value at risk – Used to measure the expected loss on the portfolio as an average of outcomes occurring above specified confidence level over the specified time horizon.
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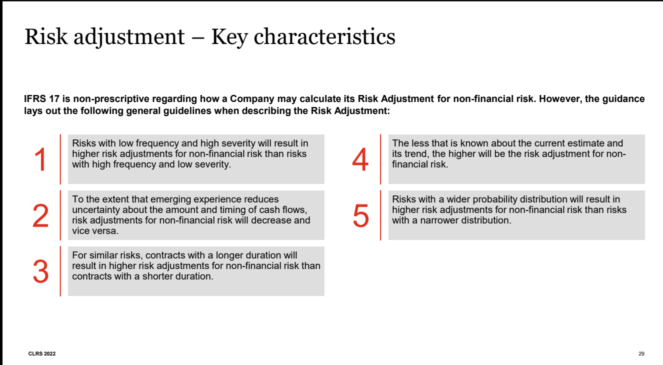
Risk adjustment – Key characteristics
IFRS 17 is non-prescriptive regarding how a Company may calculate its Risk Adjustment for non-financial risk. However, the guidance lays out the following general guidelines when describing the Risk Adjustment:
1
Risks with low frequency and high severity will result in higher risk adjustments for non-financial risk than risks with high frequency and low severity.
2
To the extent that emerging experience reduces uncertainty about the amount and timing of cash flows, risk adjustments for non-financial risk will decrease and vice versa.
3
For similar risks, contracts with a longer duration will result in higher risk adjustments for non-financial risk than contracts with a shorter duration.
4
The less that is known about the current estimate and its trend, the higher will be the risk adjustment for non-financial risk.
5
Risks with a wider probability distribution will result in higher risk adjustments for non-financial risk than risks with a narrower distribution.
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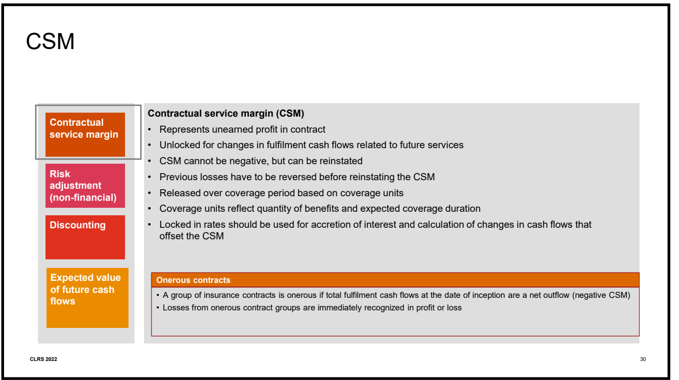
CSM
Contractual service margin
Risk adjustment (non-financial)
Discounting
Expected value of future cash flows
Contractual service margin (CSM)
• Represents unearned profit in contract
• Unlocked for changes in fulfilment cash flows related to future services
• CSM cannot be negative, but can be reinstated
• Previous losses have to be reversed before reinstating the CSM
• Released over coverage period based on coverage units
• Coverage units reflect quantity of benefits and expected coverage duration
• Locked in rates should be used for accretion of interest and calculation of changes in cash flows that offset the CSM
Onerous contracts
• A group of insurance contracts is onerous if total fulfilment cash flows at the date of inception are a net outflow (negative CSM)
• Losses from onerous contract groups are immediately recognized in profit or loss
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CSM – Coverage units

- Coverage units are used to determine the CSM portion to be recognised in the P&L. It should accurately depict the different levels of service provided in different periods.
- Determined by considering the **quantity of the benefits** provided and the expected coverage duration for each contract.

Determining the 'quantity of benefits'

Quantity of Benefits requires the entity to consider expected benefits **received by the policyholder,** and not the **cost of providing these benefits.**

Options include (but not limited to):

- Maximum contractual cover.
- Amount the entity expects a policyholder can validly claim in each period.

Quantity of Benefits based on premiums or expected cash flows could be appropriate if they provide a reasonable proxy for services provided in the period.

Judgment is required to determine a quantity of benefits that meet the measurement objective of the standard.

Implementation considerations:

- Coverage units are not easily determinable for all products
- Many life products typically look to a face value amount

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Questions for Audience

Which building block prevents gain on policy inception and ensures profit is recognized over the coverage period?

- Best estimate of fulfilment cash flows
- Discounting
- Risk Adjustment
- Contractual Service Margin

What is the term for the quantity of benefits that is used to amortize the CSM over the coverage period?

- Cash flows
- Coverage units
- Acquisition expenses
- Revenue recognition

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4 Level of aggregation

Level of Aggregation

1. **Objective**
   - Profitable vs onerous contracts
   - No CSM at the end of the coverage period
2. **Considerations**
   - Portfolios must be comprised of contracts with similar risks that are managed together
   - Within a portfolio, contracts are grouped at a more granular level based on profitability and issue date considerations
   - The characteristics of the contracts comprising a particular group will determine the appropriate measurement model to be used (Premium Allocation Approach or General Model)
   - The overall aggregation decision will determine the recognition and amortization of Contractual Service Margin (CSM)

3. Aggregation requirements*

Top-down approach:
Start at portfolio level
(similar risks, managed together)

3 groups at inception **:
- Onerous;
- Profitable with no significant risk of becoming onerous; and
- Other profitable contracts

Risk of contracts becoming onerous:
- Internal reporting
- Sensitivity of fulfilment cash flows

Requires that a group shall not include contracts issued more than one year apart

4. Effect of regulation

Some laws or regulations prevent insurers from pricing for certain risk indicators (e.g., gender)

If a law or regulation specifically constraints
- insurer's practical ability to set a different price or level of benefits for policyholders with different characteristics,
- then ignore that characteristic for grouping (e.g., male or female drivers)

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The requirements

What are the requirements?

A portfolio of insurance contracts are contracts:
- Subject to similar risks.
- Managed together as a single pool.

And then apply grouping below the portfolio: A group of contracts
- That are onerous at initial recognition.
- That at recognition have no significant possibility of becoming onerous.
- Remaining contracts in the portfolio.

An entity shall not include contracts issued more than one year apart in the same group.

Example:

Note that aggregation occurs on inception and that it never changes.
Note that the IFRS 17 OCI option can be elected at portfolio level.

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Level of Aggregation - Guidance - Paragraph 24

An entity shall apply the recognition and measurement requirements of IFRS 17 to the groups of contracts issued determined by applying paragraphs 14–23. An entity shall **establish the groups at initial recognition**, and shall not reassess the composition of the groups subsequently. To measure a group of contracts, **an entity may estimate the fulfilment cash flows at a higher level of aggregation than the group or portfolio**, provided the entity is able to include the appropriate fulfilment cash flows in the measurement of the group, applying paragraphs 32(a), 40(a)(i) and 40(b), by allocating such estimates to groups of contracts.

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Level of Aggregation - To What Degree does it Really Matter?

- Regardless, because of Paragraph 24, companies may utilize the same (or very similar) reserve segmentation as is used today under US GAAP.
- Allocation based on unit of account needed if:
  - General model – CSM determination and amortization
  - Onerous contracts – recognition of loss in P/L
  - Presentation of groups in asset vs. liability positions
- When is allocation back to unit of account not needed?
  - PAA eligible
  - Not onerous

Why is it so important?

Profit emergence

- For general model groupings, CSM is calculated at the group level. For PAA groupings, profit emergence considers seasonality within a group. Therefore, the level of aggregation is one of the key drivers of profit emergence
- Enhanced granularity could have adverse financial impacts resulting in potentially more onerous contracts. Losses on onerous contracts are recognised immediately in P&L
- Losses due to unfavorable assumption updates could be recognised faster under IFRS 17 than under IFRS 4. IFRS 4 allows a higher level of aggregation for Liability Adequacy Testing (LAT)

Operational considerations

- Level of aggregation requirements will result in operational challenges for adopters. New capabilities and enhancements to the data and systems architecture will be required to store and process large volumes of data
- Maximising the number of contract groupings that qualify for PAA can reduce operational complexity

Financial reporting impacts

- Decisions on the level of aggregation will impact valuation, but also financial reporting and disclosure requirements. A particular reporting challenge is that groups of contracts in an asset position are not offset by those in a liability position
- The appropriate level of aggregation will result in better information on performance, profitability and drivers of change providing management the ability to make well informed decisions

Questions for Audience

What is the term for a group of contracts where expected cash outflows exceed expected cash inflows?

- Onerous
- Deficient
- Negative
- Adverse

A group should not include contracts written more than how many years apart?

- 1
- 2
- 3
- 5

5 Ceded Reinsurance

Reinsurance contracts

Introduction

- Insurance contract held.

- Insurance contract issued
- Reinsurance contract held

- Reinsurance contract issued

Accounting:
- Reinsurance contracts issued = Insurance contracts issued
- Reinsurance contracts held => Special requirements

Overview & Challenges

Reinsurance contracts issued (i.e., assumed) = insurance contracts issued
- Note that ceding commissions are netted against premiums, with the net amount treated as revenue under the contract
- Investment components and certain other cash flows are accounted for on a net basis

Reinsurance contracts held (i.e., ceded reinsurance) -> special requirements
- F/S presentation is gross (i.e., not netted on the balance sheet or the income statement), thus measurement (& other considerations) are separate for ceded reinsurance.
- This can create challenges:
  - Consistency with gross cash flows - level of aggregation, contract boundary, measurement model, CSM release pattern (if General Model), onerous contract measurement
  - Risk attaching contracts, even when the underlying contracts have coverage periods of 1 year or less, would need to be tested for PAA eligibility
  - Investment components and net presentation of certain other cash flows – identification, measurement, tracking
  - Program structures with special considerations for net impacts

Reinsurance contracts
Measurement and recognition

Initial recognition date
- Non-Proportional Reinsurance
  – When the coverage period of the reinsurance contract begins, or when the entity recognizes an onerous group of underlying contracts (if the reinsurance contract was entered into before that date), whichever is earlier
- Proportional reinsurance
  – As above, except never before the first underlying insurance contract is recognized.

Onerous gross insurance contracts
- When a loss component is booked on gross insurance contracts underlying ceded reinsurance contracts held, a ceded loss recovery component is measured by multiplying the underlying gross loss component by the percentage of gross claims expected to be recovered from the reinsurer

Cash flows measurement
- Assumptions consistent with underlying insurance contracts.
- Non-performance risk affects cash flows.
- Risk adjustment needs to reflect risk transferred to reinsurer (for held contracts)

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Reinsurance
Why reinsurance is an issue?

Some IFRS 17 'basics' are a challenge for reinsurance

There are some basic reasons as to why reinsurance is more challenging to value in the IFRS 17 world, and it is not all down to IFRS 17 requirements. It has a lot to do with how we do things today.

IFRS 17 requirement	What we do under IFRS 4	Implementation issue
Reinsurance held asset/liability must be valued (and shown) separately.	We present our results net of reinsurance.	Companies may not have the data or processes set up to do the reinsurance held at the level of granularity required.
Valuation must be at a unit of account level which reflects the profitability of the contracts (insurance and reinsurance).	We aggregate, mixing loss making and profitable contracts.	Companies may not have the data or processes set up to do the reinsurance calculations separately for reinsurance held at the level of granularity required.
Gains are spread over the coverage period, while losses are recognised immediately.	We apply this requirement at the net of reinsurance level.	Companies will have to apply this requirement at the unit of account level and separately for reinsurance. For example, we will have to recognise gross losses up front, but defer an associated loss recovery component corresponding to a reinsurance policy.

In addition, there are some IFRS 17 requirements on the models that can be used, the calculation of the CSM and specific reinsurance requirements that mean a generic/automated approach to valuing reinsurance contracts will be more challenging.

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Reinsurance
Why reinsurance is an issue?

Examples of potential differences and mismatches

Feature	Impact
Underlying measured using PAA	• Risk attaching reinsurance will not automatically be eligible for PAA, even when the underlying contracts are automatically eligible.
Loss component recognition	• Losses from 'Loss'-making underlying contracts need to be recognised immediately, but any off-setting profit from reinsurance needs to be deferred.
Multiple underlying units of account	• Multiple underlying units of account feed fully or partially into a single reinsurance unit of account (assuming no separation) – Wide-ranging implications.

(*) Subject to change following July 2019 Exposure Draft

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Reinsurance

Why reinsurance is an issue?

Examples of potential differences and mismatches (cont'd)

Feature	Impact
CSM amortisation	• Potential for different reinsurance and underlying CSM amortisation profiles due to different recognition dates, exposures, locked-in rates, coverage periods, interactions when unlocking etc.
Reinsurance valuation needs to allow for future new underlying business.	• CSM will rely on estimated future business volumes, which may have little relation to actual underlying business.
Complex contracts with addenda	• Careful consideration of the detailed terms of the contract is required (e.g. new risk, past/future events etc.) • Addenda may not meet the requirement to be treated as separate units of account making valuation more complex.
Retroactive reinsurance	• Ceded contract boundary is the claim settlement period regardless of the underlying gross coverage periods.

Investment Components

(Net Cash Flows)
What are They?

Examples:
- Reinstatement premium (mandatory)
- Ceding/profit commissions
- Retrospectively rated contracts

- An investment component represents the amounts that an insurance contract requires the Company to repay to the policyholder even if an insured event does not occur.
- If an investment components is **not distinct** then it is accounted for under IFRS 17, but the income statement – both revenue and incurred expense – is net of the impact. This net treatment is the same for cash flows that based on premiums and losses and are settled net (such as mandatory reinstatement premiums).
  - Mandatory reinstatement premiums are netted against losses and not considered premium revenue or expense.
  - Profit commissions are typically accounted for in a manner similar to deposits.
  - Sliding scale commissions have a similar impact under IFRS 17.
- If an investment component is **distinct**, then should be separated from the host insurance contract and accounted for under IFRS 9; typically observed with certain life contracts.

Transition

- **Effective date is 1 January 2023, but at least one year of comparative numbers required**
- **Transition is retrospective, so historic data is required.**
- **Transition is aimed at determining the CSM on the transition date.**
- **Impact of transition is recognized in opening equity**

Approach:

Full retrospective approach
When historical data exists and hindsight is not required

If impracticable

Modified retrospective approach
When not all historical information is available but information about historical cash flows is available or can be constructed

Measurement at fair value
When no historical information about cash flows is available to determine the CSM

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Transition

Approaches

Required for annual reporting periods beginning on or after 1 January 2023 (applied to in-force policies starting 1 January 2022).

1 Full retrospective

- At transition, each group of insurance contracts **(Unit of Account) should be reported as the sum of the fulfilment cash flows** (including onerous contract liability if required), **risk adjustment and CSM.**
- Current CSM = initial CSM at inception and adjusting it to reflect the experience until the transition date at locked in rates.
- Capture the cumulative amount of insurance finance income or expenses recognised in other comprehensive income at transition.

2 Modified retrospective

- Closest outcome to full without undue cost or effort
- Allowed to adopt each simplification below only if there is insufficient data:
  - **Grouping of contracts** (e.g. more than one underwriting year).
  - **Use of yield curves** (e.g. discount rate specified as of Transition instead of at inception of contract).
  - **Cash Flows** estimated at inception = FCF at Transition, adjusted by CF known to have occurred since inception.
  - **Risk Adjustment** estimated at inception = RA at Transition, adjusted by expected release based on other similar contracts.
  - Approach to capture cumulative impact in **other comprehensive income** at transition.

3 Fair value

- IFRS 13 market participant price to transfer the asset or liability = FV at Transition.
- Fulfilment CF and risk adjustment liabilities measured based on IFRS 17 measurement approach at Transition date.
- CSM balance or loss component at Transition is set as the difference of the above 2 items.
- Fair value could be derived by adjusting IFRS 17 fulfilment and risk adjustment liabilities to reflect a market participants viewpoint and include other non-attributed expenses that a market participant would expect to be covered by the premium.
- Not required to separate contracts into underwriting year.

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7 Practical implementation

Presentation and disclosure

Key changes in reporting insurance contracts

1

Income statement

- IFRS 17 tries to align the **presentation of revenue** with other industries.
- **Investment components and net investment income** are exclude from the underwriting result and presented as a separate line item.
- Investment result includes investment income and the discounting of the insurance liabilities
- IFRS 17 provides an **accounting policy choice** to recognise the impact of changes in discount rates in profit or loss or in other comprehensive income ('OCI')

2

Balance sheet

- IFRS 17 estimates **are re-measured** in each reporting period.
- The measurement is based on the **building blocks of discounted, probability-weighted cash flows, a risk adjustment, and a contractual service margin ('CSM').**
- **Separate lines for:**
  - Insurance contract assets and insurance contract liabilities.
  - Reinsurance contract assets and reinsurance contract liabilities.
  - No separate lines for insurance payables/receivables, policy loans, etc.

3

Insurance contract revenue

Insurance contract revenue replaces premiums

Calculated under the GMM as the sum of:

- Expected change in cash flows from claims and expenses (As at the beginning of the year).
- Change in risk adjustment.
- Amortisation of contractual service margin.
- Amortization of acquisition costs.

4

Disclosures

- IFRS 17 **disclosures** are more detailed than required under current reporting frameworks, providing additional insight into key judgements and profit emergence and thus allowing for greater comparability across entities.
- Significantly expanded granular reconciliations of changes in each component of insurance contract assets and liabilities, including margins.
- Confidence level of insurance liabilities.

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Presentation and disclosure

Disclosure

Under IFRS 17 more disclosures will be required compared to IFRS 4

Amounts

Balance sheet

Reconciliations:

- Present value of probability-weighted estimated value of future cash flows
- Risk adjustment
- Contractual service margin for general model and VFA
- Liability for the remaining coverage (PAA)

Income statement

- Underwriting revenue
- Underwriting expense
- Finance income/expense

Judgements

- Measurement methods
- Processes for estimating the inputs
- Changes in methods and processes
- Methods used to calculate finance income/expense if OCI option is used
- Confidence level for risk adjustment measurement
- Yield curves

Risks

- Nature and extent of risks
- Exposure
- Procedures used to manage risks
- Concentration of risks
- Insurance risk: sensitivity analysis, claims development
- Credit risk
- Liquidity risk: maturity analysis by estimated timing of cash flows
- Market risks:
  - Interest rate risk
  - Foreign currency risk
  - Prices risk

New disclosures compared to IFRS 4 are highlighted in red.

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Presentation and disclosure

How will IFRS 17 impact insurance results?

The new requirements will significantly impact performance measures including top line revenue and the timing of earnings.

Revenue

- Timing of revenue is no longer based on premiums received.
- Revenue is determined based on the change in the liability for insurance coverage during the period.
- The portion of premiums related to cash values/surrender values are excluded from revenue.

Onerous contracts

- Loss making (onerous) contracts are grouped separately at inception.
- Losses are recognised immediately through the P&L.
- No offsetting with profitable contracts, more losses are expected to be recognised.
- Losses recognised for onerous contracts are offset by gains from reinsurance contracts

Timing of earnings

- Profits no longer recognised at inception.
- Profits are deferred in the contractual service margin and earned over the life of the contract.
- Subsequent changes in assumptions for future coverage are not recognised immediately, but over the remaining coverage period.

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Presentation and disclosure

Statement of financial position – Example

Assets (Currently)	Assets (New under IFRS 17)
Cash and cash equivalents	Cash and cash equivalents
Financial investments	Financial investments
Segregated fund assets	Segregated fund assets
Accrued investment income	Accrued investment income
Investment property	Investment property
Investments in associates	Investments in associates
Receivables from insurance business	**Insurance contracts assets[1]**
Reinsurance assets	**Reinsurance contracts assets[1]**
Deferred acquisition costs (where applicable)	...
Property and equipment	Property and equipment
Goodwill and other intangible assets	Goodwill and other intangible assets
Deferred income tax assets	Deferred income tax assets
Current income tax assets	Current income tax assets
Other assets	Other assets
Total assets	Total assets

Separate presentation of group of insurance contracts in an asset and liability position

Ceded reinsurance contracts are presented separately from insurance contracts

DAC, PVIF and premium receivable are not separate assets but part of fulfilment cash flows

[1]including non-distinct investment and service components

= no changes to presentation

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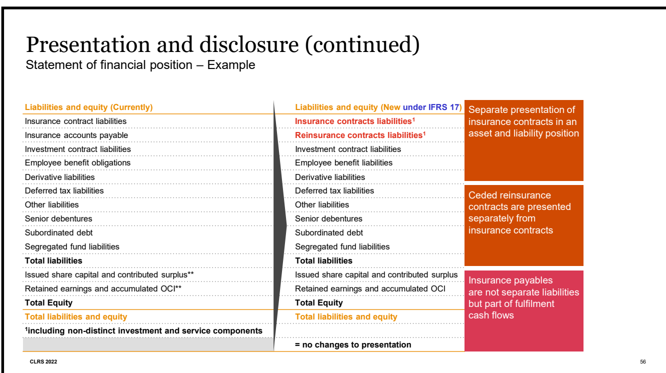
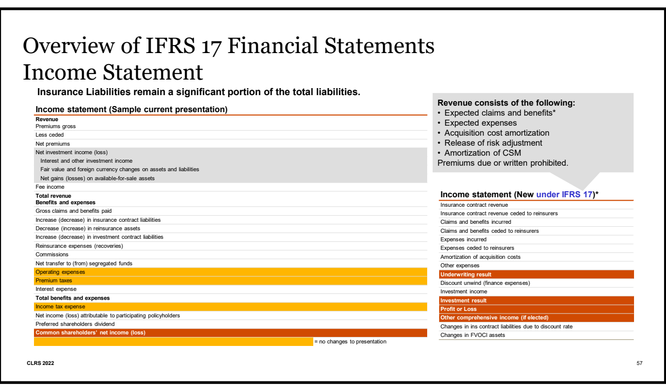
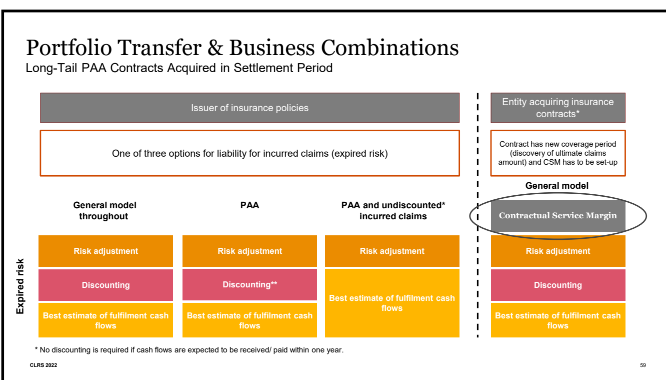




8 Other Topics

Portfolio Transfer & Business Combinations

Long-Tail PAA Contracts Acquired in Settlement Period



* No discounting is required if cash flows are expected to be received/ paid within one year.

Fronting Arrangements - Questions to Ask

Fronting (where one party is writing business and ceding substantial majority to another party) sometimes involves two insurance companies, sometimes reinsurer is a captive owned by a manufacturer, sometimes government backed programs (National Flood) where insurers write the policies but cede 100% to government for a fee (paid to the insurers for writing the business).

Fronting Arrangements - Questions to Ask

- What's the substance?
  - Fully fronted business – assuming company owns/controls the business – how does the ceding company account for the transactions?
  - Wholly owned corporate captive – insurance company provides direct coverage to the corporation, then cedes the primary layer to the captive – how does the insurance company account for these transactions?
- Key items to resolve:
  - What is the role of the insurance company? That is, **is the insurance company acting as an insurer or an agent providing some other type of service**?
  - If there are multiple contracts between the same entity, do these need to be accounted for on a combined (i.e., net) basis?
- A key considerations include the legal rights and obligations if the reinsurer does not pay, – is the insurer on the hook if the reinsurer can't pay?
  - If not on the hook – then insurer is likely just **acting as an agent, and the fronting fee falls under IFRS 15** (revenue recognition)
  - Many corporate captive arrangements may be accounted for on a net basis

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Modification and derecognition

Summary

- **Modification** – Amendment to an insurance contract.
- Exercise of rights under original terms is NOT a modification.
- Can result in derecognition, otherwise treated as a change in estimate.

- **Derecognition** – Extinguishment, transfer or modification.
- Extinguishment – Obligation expires, is discharged or cancelled.

Fulfilment cash flows	Number of coverage units
The present value of the **future cash flows** and the **risk adjustment for non-financial risk** that relate to the contract that is derecognised are eliminated.	The number of coverage units for the expected remaining coverage is adjusted to reflect the coverage units extinguished.

Adjustment of the CSM – Different requirements for:

1. **Extinguishment**
2. **Transfer**
3. **Modification**

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