



IFRS 17: recent developments and main implications

Kevin Griffith

13 September 2018

Today's agenda



1.

Introduction

2.

Fundamental
principles

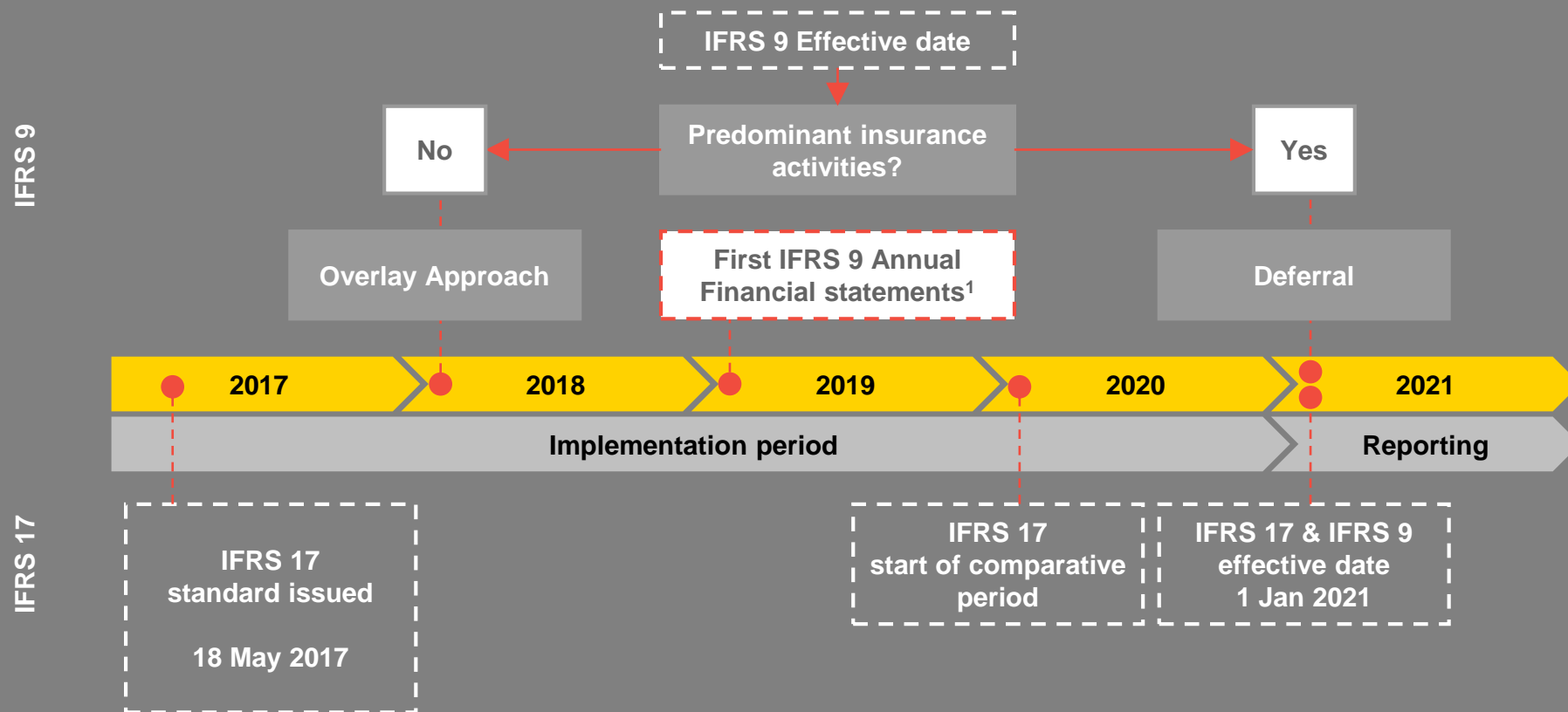
3.

What will it
look like?

4.

Implementation

IFRS 17 and IFRS 9 timelines



IFRS 17 – EU endorsement

- ▶ EFRAG advised the EU Commission on endorsement
- ▶ Initiative in EU parliament to direct EFRAG work
- ▶ EFRAG field testing in completed
 - ▶ List of key issues raised by the industry
- ▶ Due dates for EFRAG endorsement advice:
 - ▶ Draft advice Q4 2018 (unlikely)
 - ▶ Final advice Q1 2019 (unlikely)
- ▶ Possibility of deferral
- ▶ EU endorsement unlikely before the end of 2019
- ▶ Brexit impact (UK only)

EFRAG- list of key issues raised by the industry

- ▶ (a) Measurement:
 - ▶ (i) Acquisition cash flows (*)
 - ▶ (ii) CSM amortization (*)
 - ▶ (iii) Discount rates
 - ▶ (iv) Multi-component contracts
 - ▶ (v) Reinsurance (*)
 - ▶ (vi) Scope of hedging adjustment
 - ▶ (vii) Scope of the VFA vs General Model and PAA
 - ▶ (viii) Transition (*)
- ▶ (b) Operational complexity:
 - ▶ (i) Business combinations
 - ▶ (ii) Level of aggregation (*)
 - ▶ (iii) Presentational issues (*)
- ▶ (c) Other implementation challenges:
 - ▶ (i) Pressure on implementation timeline.

(*) – topics proposed
to be raised in
EFRAG letter to IASB

EFRAG letter – points of challenge



(a) Acquisition costs (for costs incurred in expectation of contract renewals)



(b) CSM amortisation (impact on contracts that include investment services)



(c) Reinsurance (onerous underlying contracts that are profitable after reinsurance, contract boundary for reinsurance contracts where underlying contracts are not yet issued)



(d) Transition (extent of relief offered by modified retrospective approach and challenges in applying fair value approach)



(e) Annual cohorts (cost-benefit trade-off, including for VFA contracts)



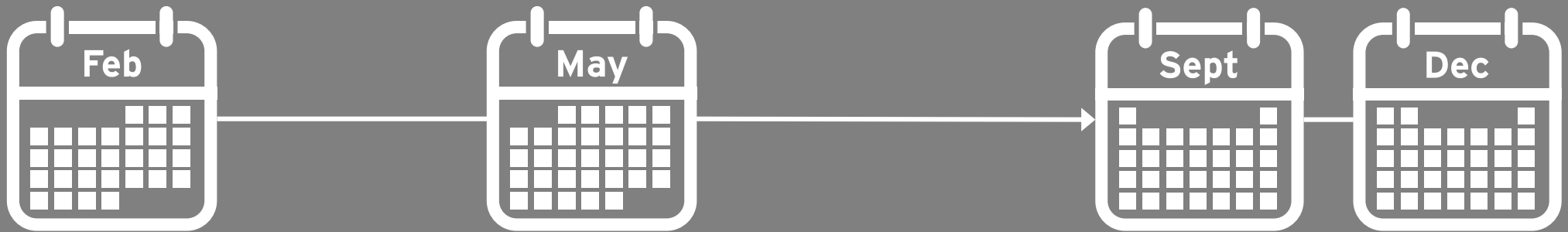
(f) Balance sheet presentation (cost-benefit trade-off of separate disclosure of groups in an asset position and groups in a liability position and non-separation of receivables and/or payables).

IFRS 17 – IASB Technical Resource Group (TRG)

- ▶ Comprises 15 insurance experts and 3 observers. Discusses implementation issue papers prepared by IASB staff from constituent submissions. Has met in February and May 2018. Next meeting 26-27 September 2018.
- ▶ 49 issues in total submitted as of 2 May 2018 of which TRG discussed 6 in detail in February and 5 in May 2018. The rest are questions that:
 - ▶ Have been answered by IASB staff applying only the words in IFRS 17; or
 - ▶ Do not meet the submission criteria; or
 - ▶ Are being considered through a process other than a TRG discussion (e.g., annual improvement or outreach)

TRG views and IASB staff views are not part of authoritative IFRS – or indeed, have been subject to formal IASB or IFRIC discussion – but generally accepted as authoritative interpretations.

Transition Resources Group (TRG)



February 2018

1. Separation of insurance contracts
2. Contract boundary for contracts re-priced at portfolio level
3. Contract boundary - reinsurance held
4. Acquisition costs
5. Coverage units
6. Fair value at transition – acquisition costs

May 2018

1. Combining insurance contracts
2. Determining risk adjustment in a group (of contracts)
3. Contract boundary – right to reassess risks and exercise of options
4. Reinsurance contract boundary where cedant can be compelled to pay premiums
5. Coverage units
6. Implementation challenges – contracts acquired in coverage period, premiums received, balance sheet presentation

September 2018

1. Insurance risk consequent to an incurred claim
2. Determining discount rates using a top-down approach
3. Commissions and reinstatement premiums in reinsurance contracts held
4. Premium experience adjustments related to current or past service
5. Cash flows outside the contract boundary at initial recognition

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Why IFRS
changing
matters

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**Fundamental
principles**

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What will it
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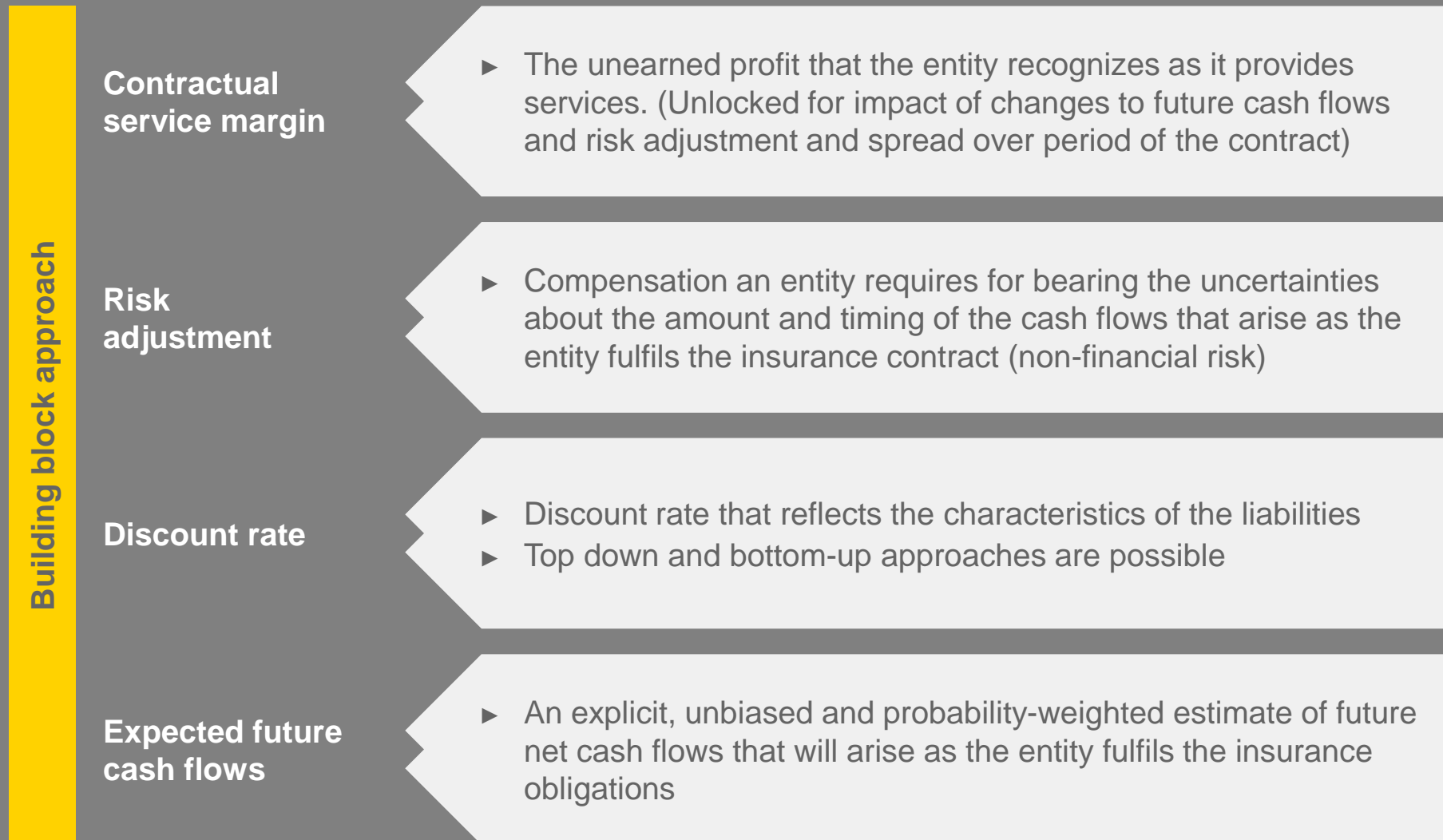
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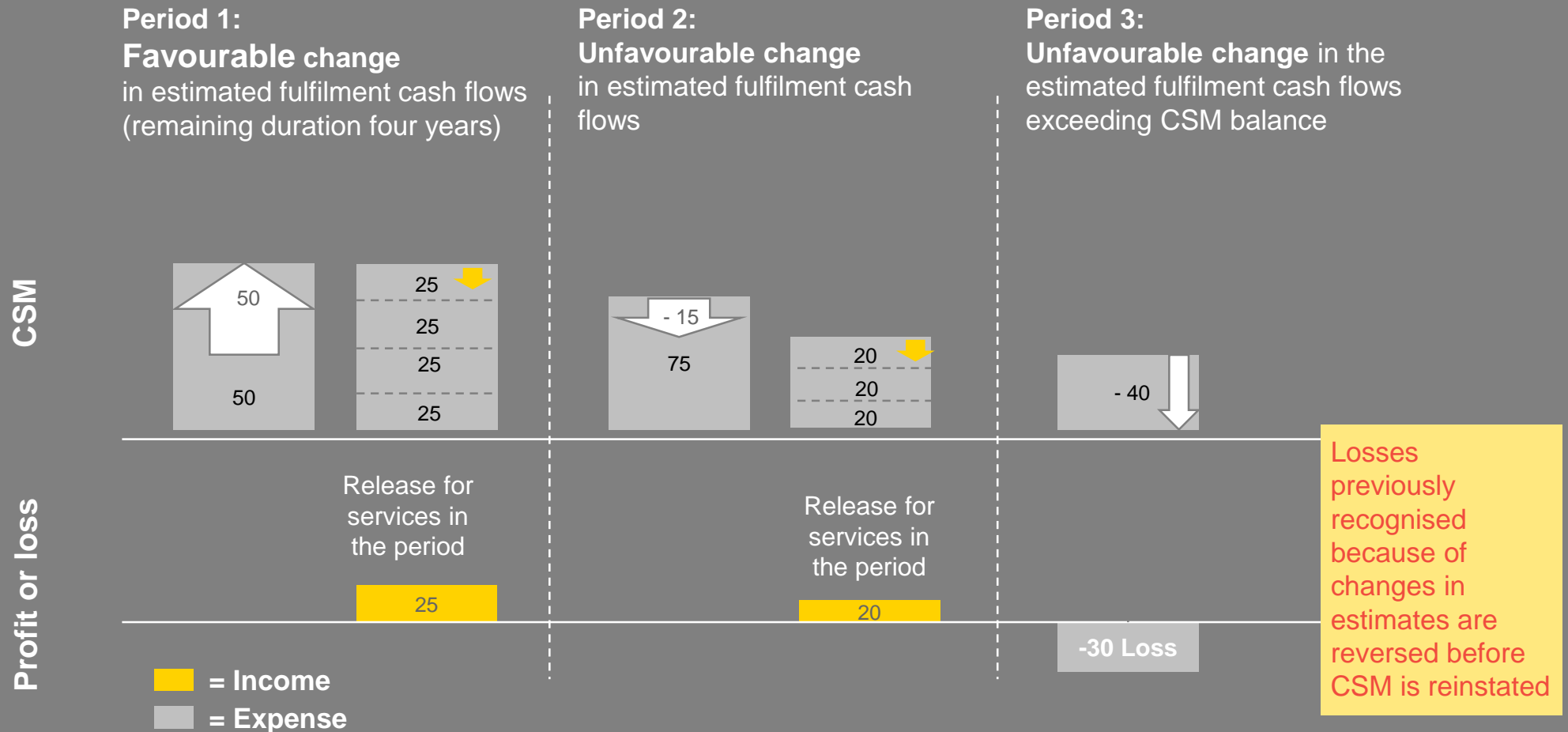
IFRS 17 measurement models

	Key features	Example products
Building block approach (BBA)	<ul style="list-style-type: none"> ▶ Default model in IFRS 17 ▶ Probability weighted discounted cash flows ▶ Market-based valuation of options and guarantees ▶ Contractual service margin (CSM): to spread recognition of profit and impact of changes ▶ Risk adjustment 	<ul style="list-style-type: none"> ▶ Annuities ▶ Protection ▶ Long-duration non-life business
Variable fee approach (VFA)	<ul style="list-style-type: none"> ▶ Based on the building block approach, but with additional features for direct participating contracts ▶ Market volatility passes through CSM vs Statement of Comprehensive Income (P&L/OCI) for building block approach 	<ul style="list-style-type: none"> ▶ With-profit business ▶ Unit-linked business
Premium allocation approach (PAA)	<ul style="list-style-type: none"> ▶ Optional approach for short duration contracts (pre-claims liability) ▶ BBA approach used for claims liability 	<ul style="list-style-type: none"> ▶ Short-duration contract (mostly non-life insurance) ▶ Motor, property. marine

Building block approach



Contractual Service Margin unlocking



Simplified example, no discounting applied

Premium Allocation Approach

Insurance contract liability split into:

Liability for remaining coverage

simplified approach based on allocation of premium
(analogous to existing UPR, net of DAC and premium receivables)



Like UPR – but net of DAC and premium receivables

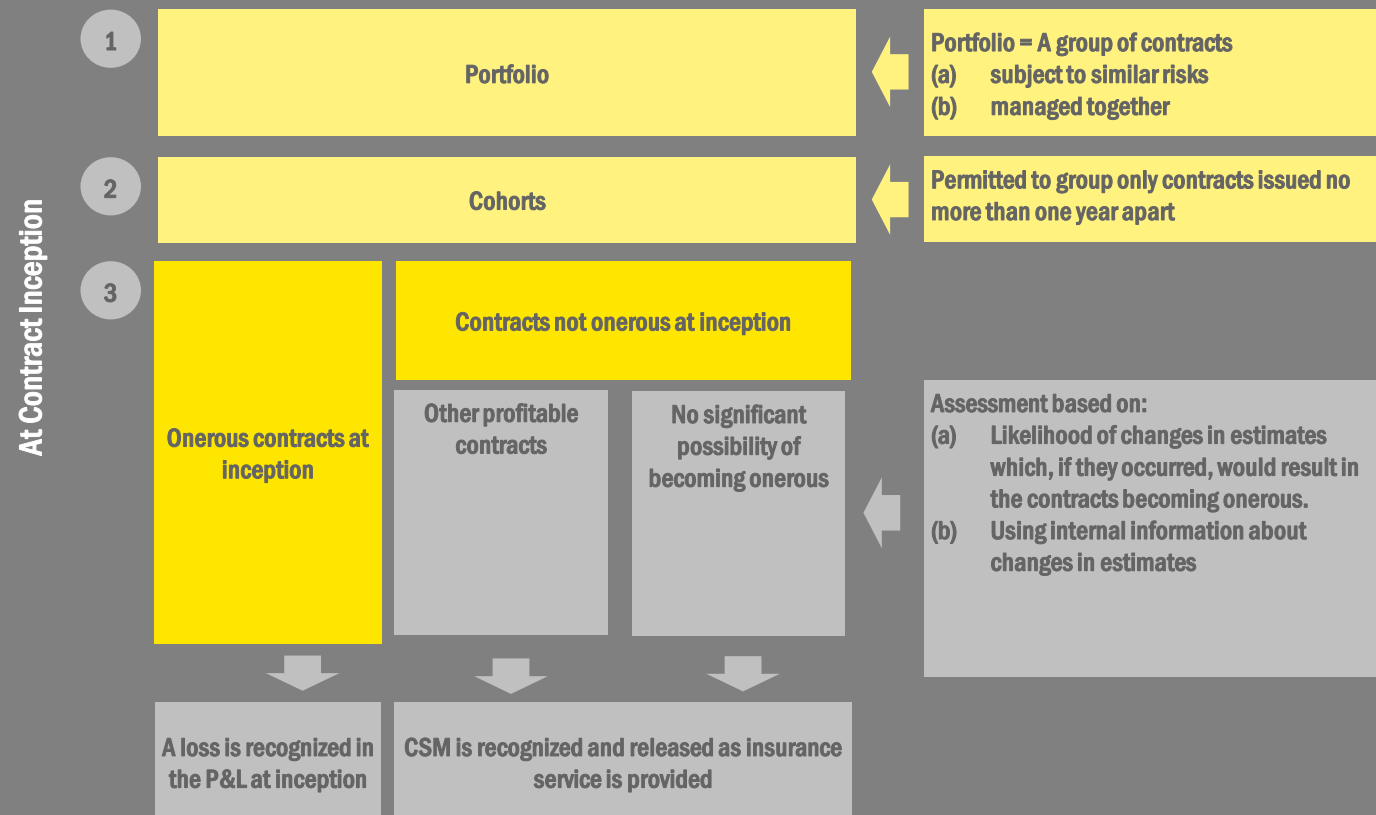
Liability for incurred claims

(analogous to existing claim reserves)



Like GAAP claim reserves – but discounted and probability weighted best estimate

Level of aggregation - fundamental ingredient for recognition and measurement



	Portfolio A	Portfolio B	...
2021	No significant possibility of becoming onerous	No significant possibility of becoming onerous	No significant possibility of becoming onerous
2022	Other profitable	Other profitable	Other profitable
2023	Onerous at inception	Onerous at inception	Onerous at inception

Assessment is done at contract inception – no subsequent re-assessment

Why unit of account/ IFRS grouping matters

Combining contracts into one group changes the value of the liability recorded

	Contract 1	Contract 2	Total	If in single group
Premium	100	100		200
Expected claims and expenses	-50	-120		-170
Expected profit	50	-20		30
Liability for remaining coverage	100	120	220	200

Groups in an asset position to be disclosed separately from groups in a liability position

	Group 1	Group 2
Premium	120	120
Received	Beginning	End
<u>At half year</u>		
Liability for remaining coverage		
Opening balance	120	0
Recognised as revenue	-60	-60
Closing balance	60	-60

Onerous contracts and transition

1

Part of a group of contracts expected to be onerous at outset

Contracts can be onerous from outset if the expected cash flows result in a net outflow.

2

Group becomes onerous after subsequent valuation

Contracts can become onerous should an unfavourable change in net cash flows exceed the carrying amount of the CSM

- ▶ The “loss component” represents the losses recognised on the group of onerous contracts.
- ▶ At subsequent valuations of the onerous contract, you should aim to revalue the:
 - ▶ Loss component cash flows
 - ▶ Liability cash flows for the remaining coverage.

Transition:

- ▶ Fully retrospective
- ▶ Modified retrospective
- ▶ Fair value

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Presentation & Disclosure: Statement of Comprehensive Income

IFRS 4

Statement of comprehensive income	
Premiums due	1,880
Claims and expenses incurred	(1,200)
Movement in deferred acquisition costs	(15)
Investment income	822
Change in insurance liability	(600)
Other income, expenses, taxes	(241)
Profit after tax	646
Other comprehensive income	
Investment income	201
Total other comprehensive income	201
Total comprehensive income	847

IFRS 17

Statement of comprehensive income	
Insurance revenue	1,608
Insurance service expense	(973)
Insurance service result	635
Investment income	822
Insurance finance income and expenses	(424)
Net financial result	398
Other income, expenses, taxes	(241)
Profit after tax	791
Other comprehensive income	
Investment income	201
Insurance finance income and expenses	(156)
Total other comprehensive income	45
Total comprehensive income	836

Insurance Revenue

	Y1	Y2	Y3	Total
Premium (A)	100	100	100	300
Acquisition cost (B)	30			30
Claims and expenses (C)	0	150	50	200
Risk adjustment (D)	2	4	4	10
				60
CSM ($E=(A-(B+C+D))$)	20	20	20	60
<i>Revenue:</i>				
C+D+E	22	174	74	270
Acquisition cost gross up	10	10	10	30
	32	184	84	300
<i>Vs existing accounting</i>	100	100	100	

How presentation will change: Balance sheet

IFRS 4

Assets

Reinsurance contract assets

Deferred acquisition costs

Value of business acquired

Premiums receivable

Policy loans

Liabilities

Insurance contracts liabilities

Unearned premiums

Claims payable

IFRS 17

Assets

Reinsurance contract assets

Insurance contract assets

Liabilities

Insurance contracts liabilities

Reinsurance contracts liabilities

Key Changes

- ▶ Groups of insurance (or reinsurance) contracts that are in an asset position presented separately from groups of insurance (or reinsurance) contracts that are in a liability position
- ▶ Acquisition cost cash flows, premiums receivable and unearned premiums are included in the measurement of insurance contract liability

Reconciliation 1

In €000	Liabilities for remaining coverage		Liabilities for incurred claims	Total
	Excluding loss component	Loss component		
Life Insurance contract liabilities 01/01	9,590	285	2,018	11,894
Life Insurance contract assets 01/01	(138)	4	42	(92)
Net life insurance contract (assets)/liabilities 01/01	9,453	289	2,060	11,802
Insurance revenue	(1,773)	-	-	(1,773)
Contracts under modified retrospective approach	(39)	-	-	(39)
Contracts under fair value approach	(4)	-	-	(4)
Other contracts	(1,730)	-	-	(1,730)
Insurance service expenses	15	(40)	1,079	1,053
Incurred claims and other expenses	-	(11)	1,082	1,070
Amortisation of acquisition cash flows	15	-	-	15
Losses on onerous contracts	-	(29)	-	(29)
Changes to claim liabilities	-	-	(3)	(3)
Investment components	(50)	-	50	-
Insurance service result	(1,808)	(40)	1,129	(719)
Insurance finance expenses	616	10	76	702
Effect of movements in exchange rates	(54)	-	-	(54)
Total changes in the statement of comprehensive income	(1,246)	(31)	1,205	(72)
Cash flows				
Premiums received	1,903	-	-	1,903
Claims and other expenses paid	-	-	(1,250)	(1,250)
Insurance acquisition cash flows	(19)	-	-	(19)
Total cash flows	1,884	-	(1,250)	634
Other movements	(0)	-	-	(0)
Life Insurance contract liabilities 31/12	10,253	255	1,957	12,465
Life Insurance contract assets 31/12	(163)	4	58	(102)
Net life insurance contract (assets)/liabilities 31/12	10,090	258	2,015	12,363

Reconciliation 2

In €000	2021			
	Estimates of the present value of future cash flows	Risk adjustment	Contractual service margin	Total
Life Insurance contract liabilities 01/01	11,283	192	419	11,894
Life Insurance contract assets 01/01	(99)	2	4	(92)
Net life insurance contract (assets)/liabilities as at 01/01	11,184	194	423	11,802
Changes that relate to current services				
Contractual service margin recognised	-	-	(280)	(280)
Risk adjustment for risk expired	-	(51)	-	(51)
Experience adjustments	(356)	-	-	(356)
Changes that relate to future services				
Contracts initially recognised	(331)	63	270	3
Changes in estimates reflected in the contractual service margin	(317)	(1)	319	-
Changes in estimates that do not adjust the contractual service margin	(31)	(1)	-	(32)
Changes that relate to past services				
Adjustments to claims liabilities	-	(3)	-	(3)
Insurance service result	(1,036)	8	309	(719)
Insurance finance expenses	687	-	15	702
Effect of movements in exchange rates	(51)	(1)	(3)	(54)
Total changes in the statement of comprehensive income	(400)	7	321	(72)
Cash flows				
Premiums received	1,903	-	-	1,903
Claims and other expenses paid	(1,250)	-	-	(1,250)
Insurance acquisition cash flows	(19)	-	-	(19)
Total cash flows	634	-	-	634
Other movements	(0)	(0)	(0)	(0)
Life Insurance contract liabilities 31/12	11,522	199	743	12,465
Life Insurance contract assets 31/12	(104)	2	1	(102)
Net life insurance contract (assets)/liabilities 31/12	11,418	201	744	12,363

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Main impacts from the new standard

Life

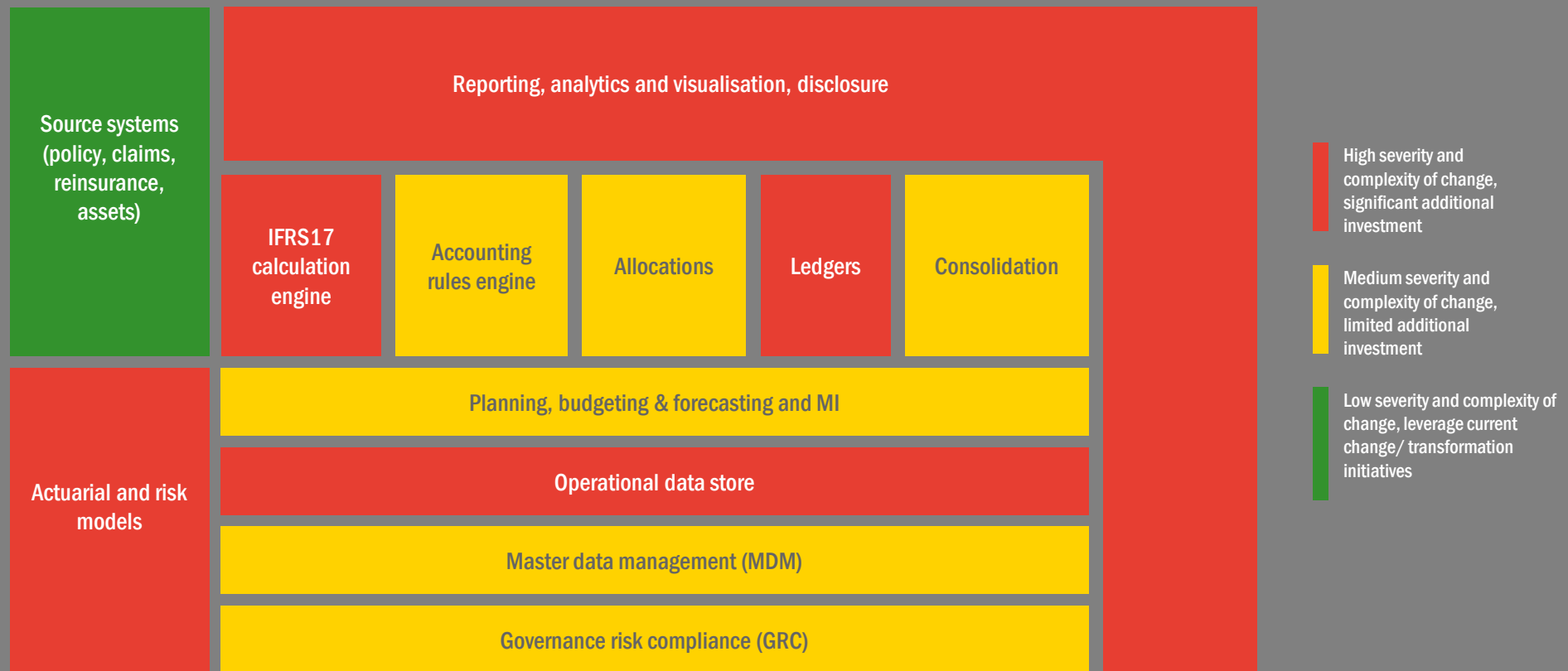
- ▶ Increased volatility of earnings
- ▶ More transparency about sources of profit, underwriting vs investment result, actual vs expected, impacts of changes in assumptions, value of new business written, margin above best estimate
- ▶ Reduction in top line Revenue – earned basis and investment components
- ▶ Spreading of profit over life of the contracts
- ▶ Liability reflect at current best estimate using updated assumptions and interest rates
- ▶ Significant new disclosures

Non life

- ▶ Changes to the look of income statement – underwriting vs investment, reinsurance changes, ratios likely to be different
- ▶ Discounting of claims liabilities
- ▶ Greater transparency around margin above best estimate, actual vs expected and changes in assumptions
- ▶ Earlier identification and recognition on loss making portfolios
- ▶ Likely mismatches between gross and reinsurance result
- ▶ New disclosures and presentational requirements

Impact across the entire systems landscape (financial & actuarial) must be understood

High to medium complexity across data, systems and processes



5 key implementation challenges



Make necessary **accounting policy** decisions and/or assumptions, eg. unit of account, measurement model, transition approach. Prepare first set of position papers for early approval, to serve as basis for solution design.



Prepare draft pro-forma **financial statements** to identify data requirements and develop Chart of Accounts/ data model enhancements



Think about the **business implications** (management reporting/ KPI's/ planning, budgeting and forecasting/ capital & dividend/ product changes etc).



Prepare a **project plan** and view of resources and costs. Involve impacted countries early in key decisions such as policy and system changes.



Plan and conduct **pilot testing** and focussed financial impact analyses – to test transition methods or impacts of key technical accounting decisions. Model impacts on examples of major products.

Progress of major global insurers

Insurer	Training	Policy decisions	Financial impact analysis	Pro forma financial statements	Target system decision
1	★ ★ ★	★ ★ ★	★ ★ ★	★ ★ ★	★ ★ ★
2	★ ★ ★	★ ★ ★	★ ★ ★	★ ★ ★	★ ★ ★
3	★ ★ ★	★ ★ ★	★ ★ ★	★ ★ ★	★ ★ ★
4	★ ★ ★	★ ★ ★	★ ★ ★	★ ★ ★	★ ★ ★
5	★ ★ ★	★ ★ ★	★ ★ ★	★ ★ ★	★ ★ ★
6	★ ★ ★	★ ★ ★	★ ★ ★	★ ★ ★	★ ★ ★

★ ★ ★ Completed
 ★ ★ ★ Significant progress
 ★ ★ ★ Some progress
 ★ ★ ★ Not started

We recommend a phased approach to manage the timely implementation of IFRS 17 & 9

1

Perform gap analysis & impact assessments

- ▶ Do a gap analysis
- ▶ Perform financial and operational impact assessments
- ▶ Start with resource planning
- ▶ Educate key stakeholders

2018

2

Design desired state and develop new architecture

- ▶ New accounting policies and proforma financial statements
- ▶ Determine desired systems landscape
- ▶ Tackle issues identified during the operational impact assessment
- ▶ Design actuarial and finance target operating model
- ▶ Allocate people

2018-2019

3

Implement new processes and systems

- ▶ Execute planned implementation
- ▶ Implement new systems architecture
- ▶ Perform parallel runs
- ▶ Ensure wider business impact is managed appropriately
- ▶ Discuss issues with auditors/regulators
- ▶ Workshops and trainings

2019 - 2021

Important next steps



1. Start local IFRS 17&9 impact assessment project



2. Mobilize project resources & key stakeholders



3. Organize core team training
(content & process)



4. Perform gap analysis
(using pre-populated templates)



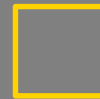
5. Conduct impact assessments
(financial, products, systems & processes, people)



6. Determine realistic implementation roadmap & budget
(including IT)



7. Report findings to internal stakeholders
(Management, Board, Group)



8. Discuss findings with external auditor and regulator(s)



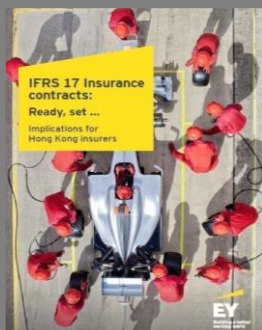
9. Seek approval for next Phase
(Design)

Auditor perspective

1. IFRS 17 and 9 audit will be challenging due to pervasive impact and significance of changes to numbers, models, systems, processes and control.
2. Lessons from audit approach to the Solvency II balance sheet.
3. Guidance on audit will come from ISA 540 (revised) 'Auditing Accounting Estimates and Related Disclosure'. Circa 60 pages covering audit approach to risks including: complexity, effect of management judgement, estimation uncertainty.
4. Early engagement around accounting policy judgements and assumptions in implementation is key.
5. Audit of opening balance sheet and comparative year disclosures can be carried out prior to 2021 depending on when these will be generated.

Our IFRS 17 perspectives

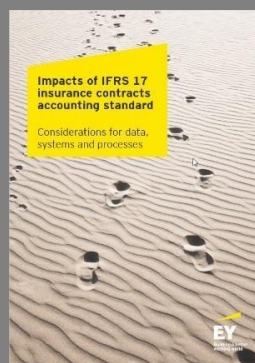
Thought Leadership



IFRS 17 Insurance contracts: Ready, set ... Implications for Asia-Pacific insurers (March 2017)



IFRS 17: what to do now. Implications for European insurers (July 2017)



Impacts of IFRS 17 - Considerations for data, systems and processes (Jan 2018)



Applying IFRS 17 – a closer look at the new Insurance Contracts Standard (May 2018)

Insurance Accounting Alert (May 2018)



Webcasts



IFRS 17: Financial statements and the investor story (June 2017)



Implementing IFRS 17: experiences from the field (October 2017)