IFRS 17
Insurance Contracts

May 2019

Objectives of today’s session

Introductions

Purpose

Objectives

Agenda

1. Background to IFRS 17
2. Technical implications
3. Operational implications
4. Market insight

1

Background to IFRS 17

What is IFRS 17?

IFRS17 is the new International Financial Reporting Standard ('IFRS') for insurance contract accounting, expected to be effective 01/01/2022. It applies to all entities that issue insurance contracts, reporting under IFRS – estimated to impact 186 countries worldwide.

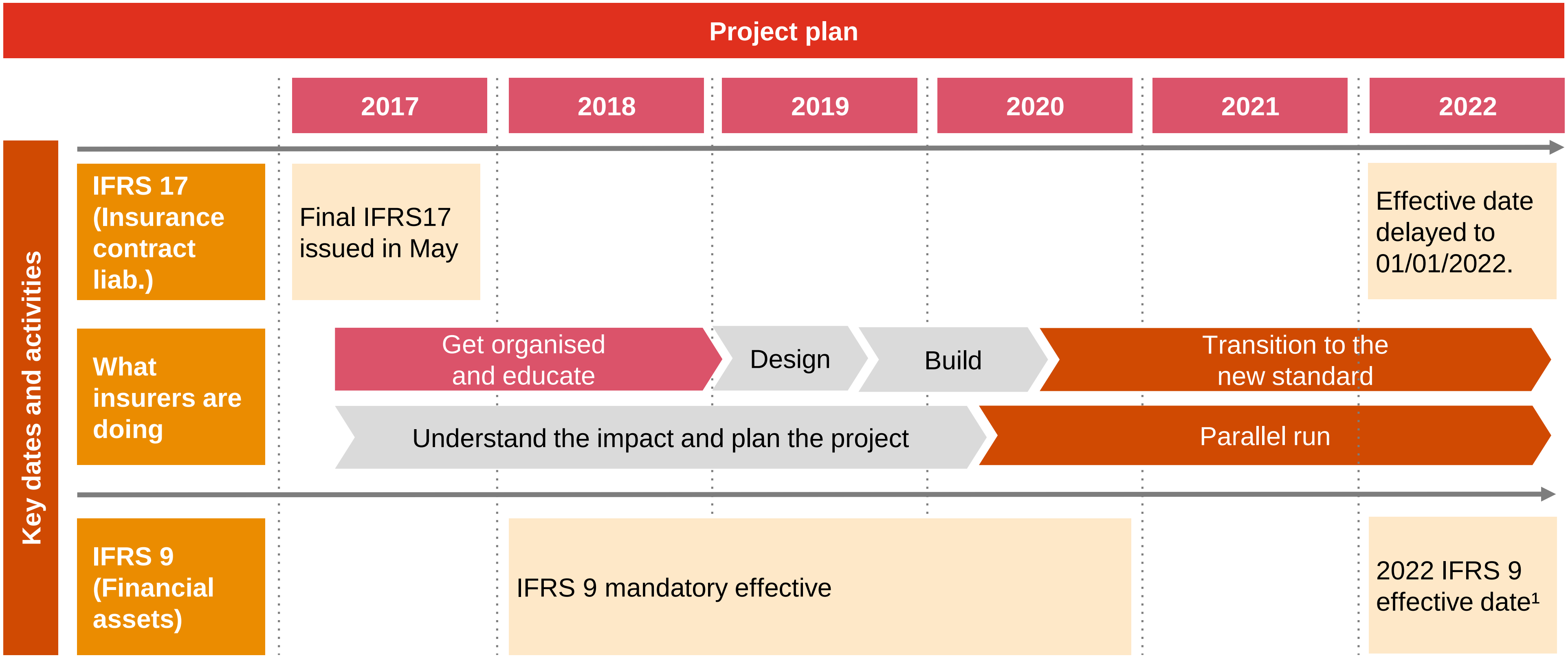
On 18 May 2017, the International Accounting Standards Board ('IASB') finished its long-standing project to develop an accounting standard on insurance contracts and published IFRS17, 'Insurance Contracts'.

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

IASB working with stakeholders through TRG to explore potential amendments to the standard. The exposure draft of proposed amendments to IFRS 17 is expected to be published at the end of June 2019.

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

IFRS 17 timeline



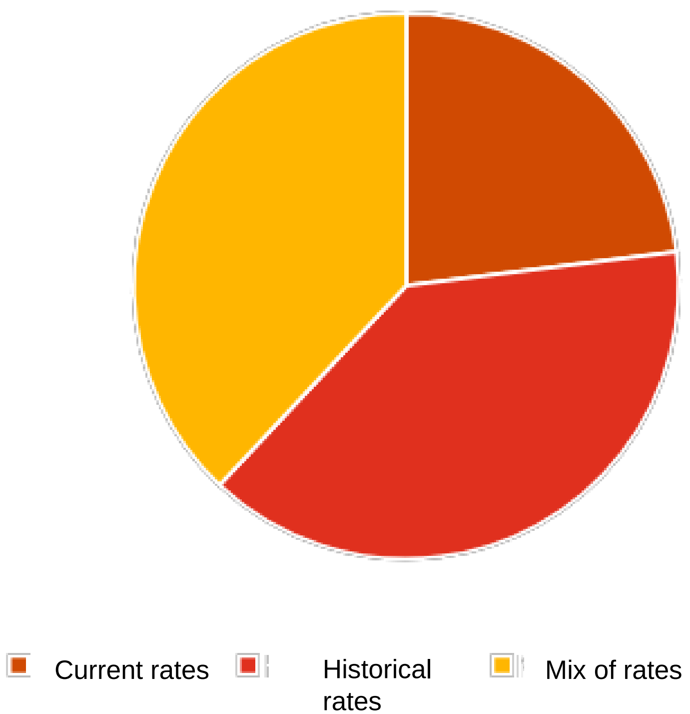
[1] Deferral of final mandatory effective date for insurers to align with IFRS 17 effective date.

2

Technical implications

Insurance contracts accounting today

Insurance liabilities measurement today



Insurance contract accounting today:

- Use of old or outdated assumptions.
- Cash or deposits received presented as revenue (inconsistent with other industries).
- Profit is recognised in various ways.

Immediately when insurance contract is written	Only when the contract ends	Over the duration of the contract

IFRS 17 – Key features

IFRS 4 shortcomings

IFRS 4 is an interim standard.

No transparent information for users

Existing policies make comparison across products, companies and jurisdictions difficult

What are the key features of IFRS 17 to address these?

Current estimates of future cash flows.

Market consistent discount rates.

Explicit allowance for risk.

Profit recognised as services are provided.

Greater depth and transparency in disclosures. Revenue excludes deposits.

How is this addressed in this presentation?

Measurement approaches & their building blocks

Contractual Service Margin

Presentation & Disclosure

Level of Aggregation

Transition

Overview of the measurement approaches

	General Approach (GA)	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	• Long-term insurance, protection business. • Annuities. • Reinsurance written. • Long-term general insurance contracts.	• General insurance, short term. • Short-term life and certain group contracts. • Reinsurance written.	• Unit-linked contracts. • Certain profit sharing contracts.
Mandatory?	Mandatory	Optional	Mandatory

Granularity of reporting

In contrast to current reporting contracts must be grouped into 'units of account'.

subject to *"similar risks"* and are *"managed together"*…

divided into three subgroups according to profitability…

issued no more than one year apart

Significant impact on modelling and data storage requirements

Unit of account granularity can impact profit levels and increase volatility of profit

Level of aggregation – In practice

Portfolio 1	Onerous	Annual layer
	Profitable with no significant risk of becoming onerous	Annual layer
	Other profitable contracts	Annual layer
Portfolio 2	Onerous	Annual layer
	Profitable with no significant risk of becoming onerous	Annual layer
	Other profitable contracts	Annual layer
Portfolio 3	Onerous	Annual layer
	Profitable with no significant risk of becoming onerous	Annual layer
	Other profitable contracts	Annual layer

Impact / Decisions needed

Portfolios:

- What is “similar risk”?
- What is “managed together”?

Profitability groups:

- What is “profitable”?
- Consider the likelihood of changes in assumptions and internal reporting.
- *Note:* If, using reasonable and supportable information about a set of contracts, the insurer can determine that the set of contracts will either all be onerous or will contain no onerous contracts.
- *Note:* In grouping contracts under the PAA, an entity can assume that no contracts in the portfolio are onerous, unless facts and circumstances indicate otherwise

Annual layers:

- Shorter intervals possible.
- Long term business: significant impact.

Level of aggregation – Number of groups going forward

Existing reporting

IFRS 17 grouping

Example: 2 portfolios *

Portfolio 1: Closed book

Grouping by profitability

Year 1	Year 2	Year 3
Onerous	Onerous	Onerous
In-between	In-between	In-between
Profitable	Profitable	Profitable

Portfolio 2: Open book

Year 1	Year 2	Year 3
In-between	In-between	In-between
Profitable	Profitable	Profitable

New business added during the year

Requirement: new group

Year 2	Year 3
In-between	In-between
Profitable	Profitable

New business added during the year

Requirement: new group

Year 3
Onerous
In-between
Profitable

Number of groups is growing over the years (if new contracts are written)

IFRS 17 portfolio requirements

A portfolio of insurance contracts are contracts:

- Subject to similar risks (e.g. contracts within each product line); and
- Managed together as a single pool

* It is assumed that the portfolio 2 does not include onerous contracts

Transition

What is transition?

- Transition is the mechanism by which contracts measured using the IFRS 4 standard 'move' to a measurement on an IFRS 17 basis.

Why is it important?

- It is aimed at, amongst others, determining the size of the CSM for the existing business at the date when the Standard is implemented.
- The magnitude of the CSM is important because:
- (i) it dictates the amount of revenue and hence profit that will be reported in future; and
- (ii) it enables comparisons to be made between business sold after the Standard has been implemented with that sold beforehand.

Who does it affect?

- In theory everyone as it is a requirement of the IFRS 17 Standard, but particularly those with long multi-year business where significant profit might remain.
- Even companies who only write short-term contracts (i.e. most General Insurers) will still be affected because all companies need to produce comparative period results when first implementing the Standard.

Transition

Need to assess the current CSM for business written before the implementation of IFRS17.

The three permitted approaches to assessing the 'future profits' on existing business

Full retrospective

- Have to apply this approach where it is not 'impracticable' for a group of contracts.
- Very extensive data requirements – requires day 1 data and assumptions and full history to date of transition.
- How to define 'impractical'?

'Modified' retrospective

- Retrospective with prescribed simplifications relating to:
  BEL, risk adjustment,
  discount rate,
  unit of account.
- Modifications can be applied on a piecemeal basis (e.g. where only one aspect can't be obtained).
- **Option** between modified and fair value approaches.

Fair value

- Comparison of 'IFRS17 fulfilment value' to 'fair value'.
- How is the fair value derived?
- Differing views of fair value will result in different future profits and current levels of shareholder equity.

Transition – Timeline for financial reporting

2020 | 2021 | 2022 | 2023

Key milestones

**1 Jan 2021,
30 June 2021 &
31 Dec 2021**

Opening and closing IFRS 17 balances required

1 January 2022
IFRS 17 becomes effective for annual reporting periods beginning on or after this date

30 June 2022

First IFRS 17 compliant interim financial statements during 2022 (with comparative figures for 2021)

31 December 2022

First full IFRS 17 financial statements for 31 December year-ends

Things to consider

Cheat sheet

- Under IFRS 17 – There are no day 1 profits. Losses on onerous contracts are however recorded immediately.
- Profits on establishment of contracts will be recorded as the Contractual Service Margin (CSM), almost akin to deferred profits.
- CSM adjusted until the liability is settled and profits will be recognised over that period.
- Emergence of profits is expected to be smoother and less erratic.
- Categorisation and measurement of insurance contracts is done in groupings by risk and issue date (no more than a year apart). This will impact data storage and processing capacity requirements.
- Transition requirements – can be very onerous.
- Impact on regulatory ratios – previously recognised profits may be recycled to the CSM on day one. Capital available may decrease.
- Impact on taxation – Amounts in retained earnings already taxed. These will be recognised again as CSM is released as profits. Will this be taxed again?
- Stakeholder education and impact. Consider profits, dividends, regulators, analysts etc.

3

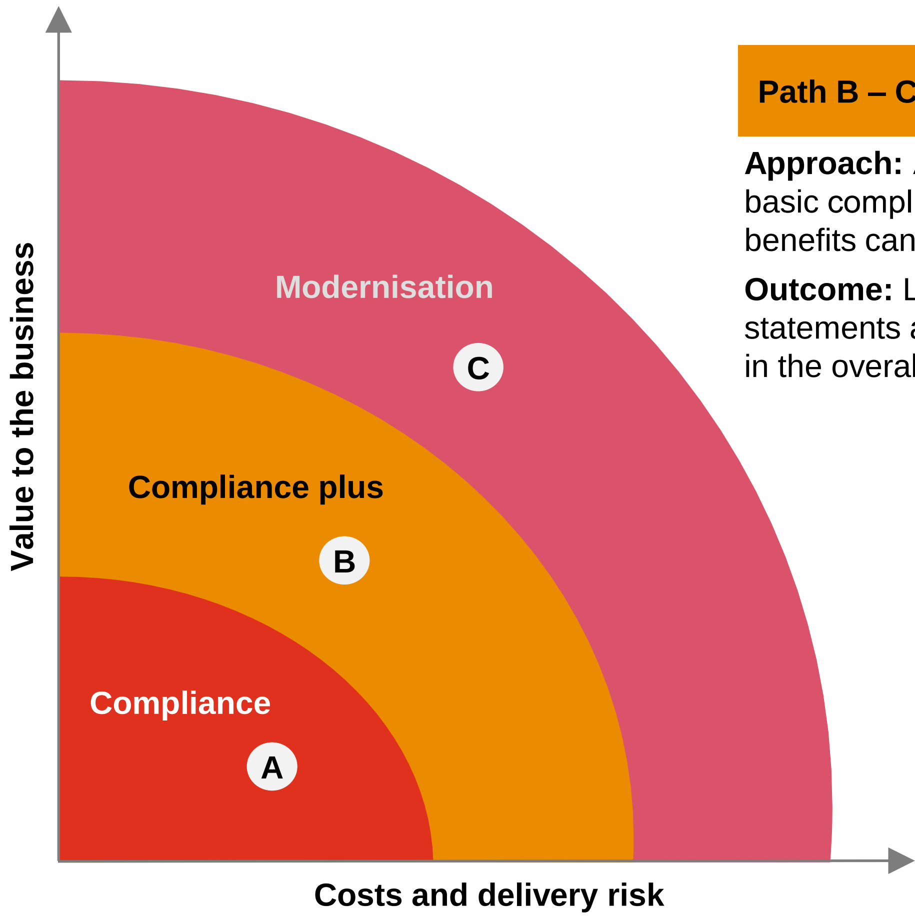
Operational implications

Potential approaches to implementing IFRS 17 differ depending on ambition level and desired target state

Path A – Basic compliance

Approach: Aim to identify and implement pragmatic solutions to ensure compliance across the region by leveraging or extending existing capabilities with minimum investment of time and resources.

Outcome: Lowest cost, low risk program to deliver auditable IFRS financial statements and footnotes supported by new processes and controls and a Contract Service Margin ('CSM') solution.



Path B – Compliance plus

Approach: Aim to make targeted investments beyond those needed to achieve basic compliance only on a 'no regrets', cost efficient basis in which tangible benefits can be achieved with only minimal increase in overall delivery risk.

Outcome: Low risk, cost efficient program delivering auditable IFRS financial statements and footnotes while also delivering targeted efficiency improvements in the overall financial reporting cycle.

Path C – Finance and actuarial modernisation

Approach: Use IFRS17 as an opportunity to modernise and optimise the finance function by standardising and streamlining end-to-end finance processes and applications with a focus on adding value back to the business. Embracing new technologies, such as workflow management, analytics, cloud and robotics, will be necessary

Outcome: IFRS compliance and a future proof, technology enabled financial reporting function driving business insights and value through the use of data visualisation and advanced analytics

What might change under IFRS 17?

Significant financial and operational changes

Financial performance and remuneration

- Transformation in **presentation of the balance sheet and income statement.**
- Different patterns for **emergence of profit** over time and volatility of profits, which could impact dividends, tax and remuneration.
- Change in **Internal Management Information –** Data collated and processes driven by MI will change. This can result in changes in remuneration structure.

What your investors will read about you

- Change in **detailed disclosures**, including confidence level of reserves, analyses of change and future release pattern of profits.

Finance, actuarial and risk functions

- **Training** to cope with the new demands of IFRS 17.
- Enhanced actuarial **models.**
- Greater collaboration, understanding, knowledge sharing across the company.

Processes, data and system

- Change in **reserving processes** likely to be fundamental.
- Capture and store significantly more **data** with an increased level of complexity of data.
- New **controls** required to manage the new processes.

Valuation methodology and approach

- How insurers **measure their liabilities** may fundamentally change**.**
- New concepts to be applied - risk margins, CSM.

Other consequences

- Reconsider **pricing**
- Impact of **volatility of asset portfolio** on IFRS 17 and the interaction with IFRS 9.
- Implication on **third party arrangements**, e.g. reinsurance.

Practical impact on your business

Some of your staff will need new skillsets to accommodate the changes of moving to IFRS 17

- You will need people across all functions – especially **IT, Actuarial and Finance** – to learn about and understand the full requirements of IFRS 17 on their and other areas of specialism.
- Your **IT specialists, actuaries and accountants** will need to learn and work together to produce new systems architecture and processes and ensure data capture and storage is adapted appropriately.
- Your **Actuarial and Finance teams** will need to learn about and understand the financial reporting and disclosure process in order to support the Finance team in meeting the new requirements.
- Your **reporting, planning and MI** staff will need to learn about and understand the reserving/capital processes to ensure they meet their new reporting needs.

4

Market insight

Market insight

Status of market progression

The majority of regional insurers do not have significant activities underway.

Strategy and assess

Impact assessment

- Identify the high-level impacts of IFRS 17.
- Define the high-level TOM, project plan.

Strategy and architecture

- Define the scope of the initiative, plan for the detailed GAP analysis

Design

High level design

- Understand and design requirements.
- Identify system capabilities to acquire.
- Prepare detailed project plans, resource profiles and budgets.

Detailed design

- Business requirements specification.
- Functional and technical design specification.

Impact studies will then be used to undertake a detailed study of requirements.

Some of the **larger insurers in the region are completing** first phase impact studies.

Construct and implement

Parallel run

- Simulation of the P&L, OCI and balance sheet as if IFRS17 is already in effect.

Construct and test

- Build and test the changes to the TOM.

Operate, review and deployment

Transition

- Adjust the opening balance sheet of the comparative period disclosed.

Business as usual

- Ensure continuity and flexibility in the quarterly disclosure.

Market insight
Challenges already identified

Financial and operational implications of adoption will vary by insurer and operations within.

Areas *already* identified by insurers who have begun the process include the following:

- Length of implementation project required.
- Challenges to year end reporting timetables.
- Data collection and storage.
- System implications across wider Group and local function.
- Lack of knowledge and lack of certainty over interpretation.
- Resource planning.
- Other areas of the business may be impacted such as product design, remuneration policies and business planning.
- Managing market expectations before and after adoption will be crucial.

Adopting Significant Accounting standards

Lessons learned

1. **Start early**
2. **Plan for data challenges**
3. **Education for those charged with governance**
4. **Get representatives from different departments involved**
5. **Take ownership**
6. **Implement internal controls for permanent change**

Questions?

pwc.com