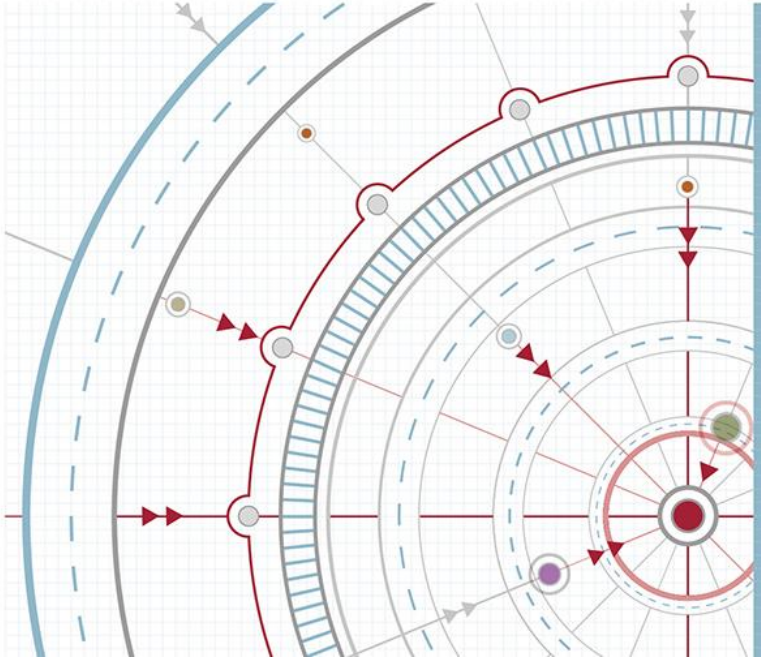
IFRS® Foundation



IFRS 17
Insurance Contracts

AOSSG Insurance Working Group

28 November 2017

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

1 Introduction

Today's topics

1. Introduction
2. Why is there a need for change in insurance accounting
3. Who is affected by the change
4. How does the Standard work in practice
5. Where do we go from here?
6. Q&A

2 Why is there a need for change in insurance accounting

Accounting policies applied under IFRS 4

Top-20 listed insurers using IFRS Standards		
Accounting policies applied to insurance contracts issued	Number of companies	Total assets (US$ trillions)
Based on guidance in:		
• a mix of national GAAP	8	4.1
• US GAAP	3	1.6
• Canadian GAAP	4	1.4
• other national GAAP	5	2.0
Total	**20**	**9.1**

Source: Effects Analysis on IFRS 17

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Same insurer—two different GAAP

(in millions of currency units)	GAAP A Current value accounting	GAAP B Non-current value accounting	Differences
Revenue	**26,083**	**24,167**	**(1,916)**
Expenses	**(26,310)**	**(22,317)**	**3,993**
Of which changes in assumptions	(1,753)	(125)	1,628
Income taxes	**223**	**(240)**	**(463)**
Profit or loss	**(4)**	**1,610**	**1,614**
Other comprehensive income	**(533)**	**56**	**589**
Comprehensive income	**(537)**	**1,666**	**2,203**
Equity	**20,373**	**25,584**	**5,211**

Improved information about the value of insurance obligations

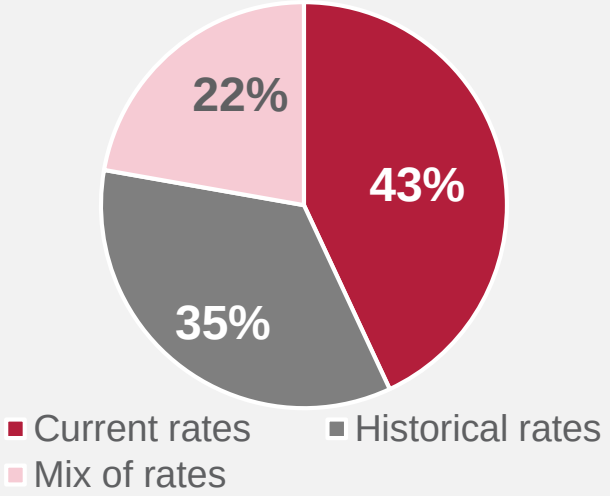
Today

- Use of old or outdated assumptions
- Options and guarantees not fully reflected
- Inappropriate use of ‘expected return on assets held’ as discount rate

IFRS 17

- Current assumptions regularly updated
- Options and guarantees fully reflected
- Discount rates reflect the characteristics of the insurance cash flows

Discount rates used today by IFRS insurers



Discount rates used for a sample of life insurers using IFRS Standards in 2015
Source: Effects Analysis on IFRS 17

Improved information about profitability

Today

- Timing of profit recognition is inconsistent
- Premiums received presented as revenue—revenue reported on a cash basis
- Use of many non-GAAP measures

IFRS 17

- Consistent recognition of profit for insurance services
- Insurance revenue reflects the services provided
- Additional consistent metrics to evaluate performance

Recognition of profit today by IFRS insurers

immediately when an insurance contract is written

or

only when the contract ends

or

over the duration of the contract

Improved comparability of financial information

Issues today

Lack of comparability among insurers

- IFRS companies report insurance contracts using different practices

Non-uniform reporting within groups

- Insurance contracts of subsidiaries are consolidated using different practices

Inconsistency with other industries

- Revenue include deposits
- Revenue reported on a cash basis

Improvements introduced by IFRS 17

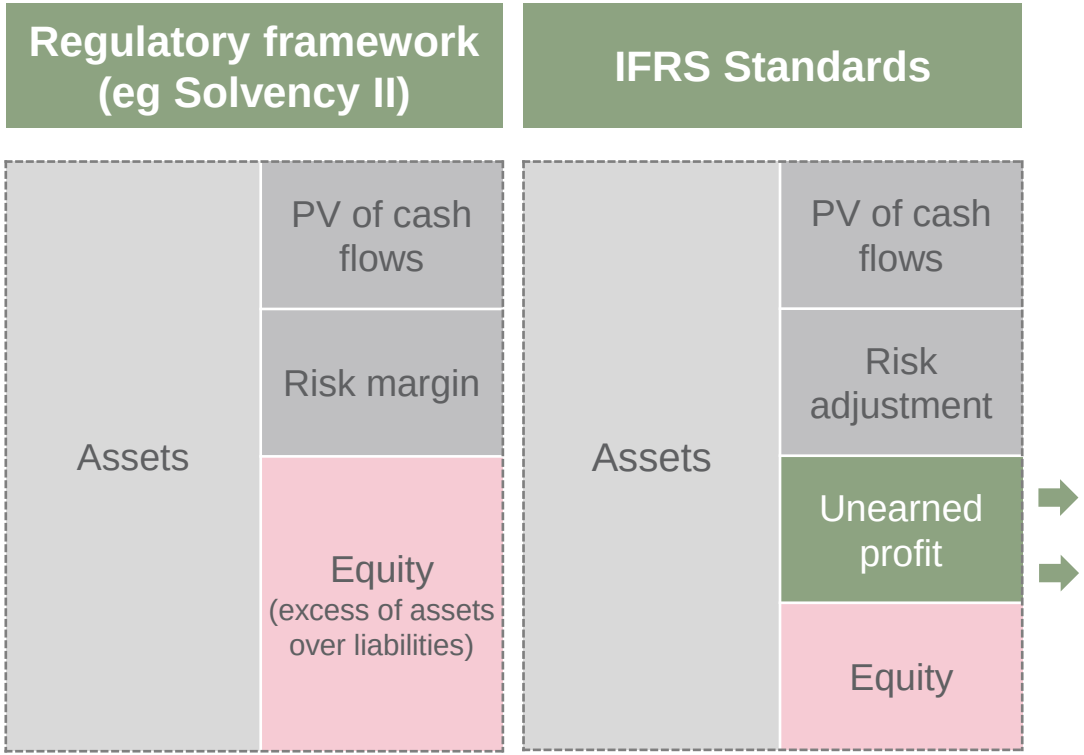
- New framework will replace huge variety of accounting treatments
- Revenue will reflect the services provided, and exclude deposits, like any other industry

Interaction with regulatory frameworks

	IFRS Standards	Regulatory frameworks
Balance sheet	✓	✓
Profit or loss	✓	✗ (1)

(1) For example, Solvency II does not prescribe performance reporting. It only requires disclosures for (a) variation of excess of assets over liabilities, (b) premiums, claims and expenses and (c) assets' profitability

IFRS 17 provides information about financial performance



Unearned profit (CSM)

- is recognised in P&L when insurance coverage is provided
- provides a measure of future profitability

Changes in unearned profit provide information about

- profitability of new business
- changes in profitability of existing contracts

Extensive consultation process

1997	2004	2007	2010	2013	2017
IASC starts project on insurance contracts	**IFRS 4 *Insurance contracts***	**Discussion paper** *Preliminary views on Insurance Contracts*	**Exposure Draft** *Insurance Contracts*	**Exposure Draft** *Insurance Contracts*	**IFRS 17 *Insurance Contracts***
	Interim Standard issued	162 comment letters received	253 comment letters received	194 comment letters received	Replaces IFRS 4

900 meetings, round-tables and discussion forums

600 comment letters

4 rounds of fieldwork and testing

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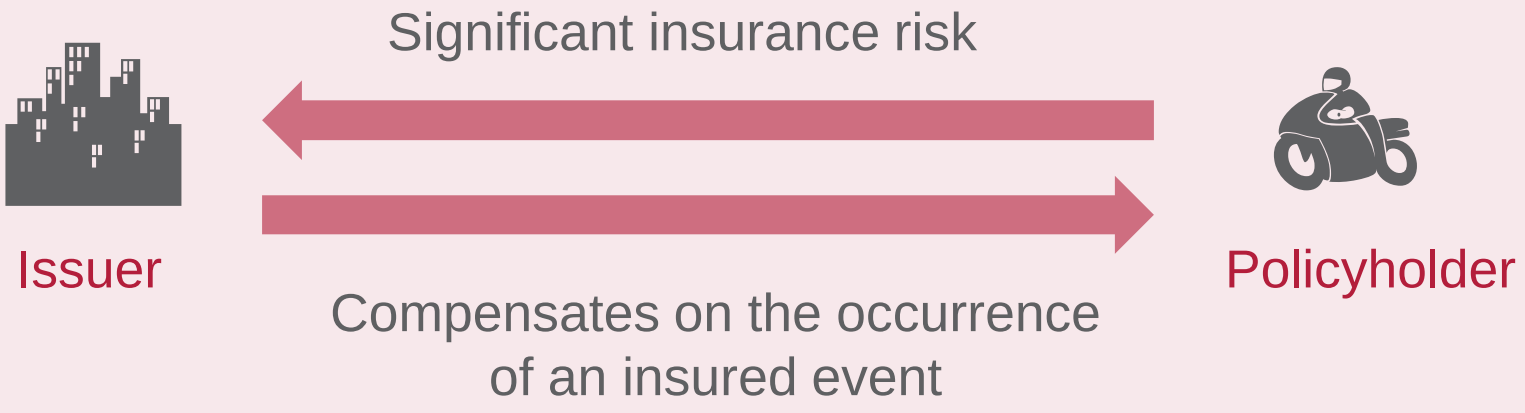
3 Who is affected by the change

What is an insurance contract?



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

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Scope exclusions

- Some insurance contracts remain in the scope of other IFRS Standards and not IFRS 17

  ⇔ No change from IFRS 4

- For example:
  - warranties issued by manufacturers
  - retirement benefit obligations
  - insurance contracts held by an entity, unless those contracts are reinsurance contracts

Options for some insurance contracts

Two options to account for some insurance contracts using IFRS 17 or other IFRS Standards

- Financial guarantee contracts—IFRS 17 or IFRS 9 *Financial Instruments*

  ⇔ No change from IFRS 4

- Specified fixed-fee service contracts—IFRS 17 or IFRS 15 *Revenue from Contracts with Customers*

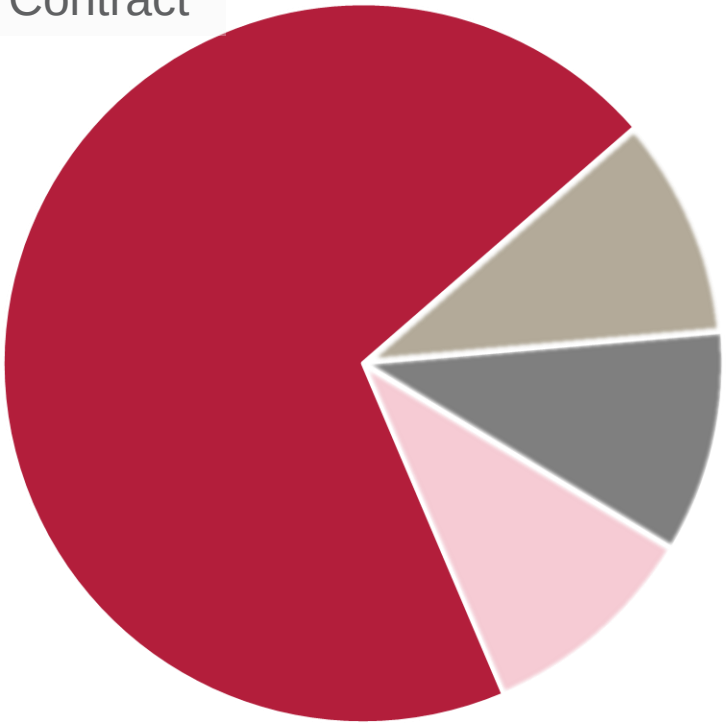
  ↯ Change from IFRS 4

Other contracts within the scope of IFRS 4

- IFRS 17 scope includes:
  - reinsurance contracts held
  - investment contracts with discretionary participation features issued by an entity that issues an insurance contract:
    A financial instrument with discretionary payments

What is measured under IFRS 17?

Contract



- Insurance components—IFRS 17
- Distinct goods or non-insurance services—IFRS 15
- Distinct investment components—IFRS 9
- Specified embedded derivatives—IFRS 9

What is measured under IFRS 17?

10 An insurance contract may contain one or more components that would be within the scope of another Standard if they were separate contracts. For example, an insurance contract may include an *investment component* or a service component (or both). An entity shall apply paragraphs 11–13 to identify and account for the components of the contract.

11 An entity shall:

(a) apply IFRS 9 to determine whether there is an embedded derivative to be separated and, if there is, how to account for that derivative.

(b) separate from a host insurance contract an investment component if, and only if, that investment component is distinct (see paragraphs B31–B32). The entity shall apply IFRS 9 to account for the separated investment component.

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What is measured under IFRS 17?

B31 Paragraph 11(b) requires an entity to separate a distinct investment component from the host insurance contract. An investment component is distinct if, and only if, both the following conditions are met:

(a) the investment component and the insurance component are not highly interrelated.

(b) a contract with equivalent terms is sold, or could be sold, separately in the same market or the same jurisdiction, either by entities that issue insurance contracts or by other parties. The entity shall take into account all information reasonably available in making this determination. The entity is not required to undertake an exhaustive search to identify whether an investment component is sold separately.

B32 An investment component and an insurance component are highly interrelated if, and only if:

(a) the entity is unable to measure one component without considering the other. Thus, if the value of one component varies according to the value of the other, an entity shall apply IFRS 17 to account for the combined investment and insurance component; or

(b) the policyholder is unable to benefit from one component unless the other is also present. Thus, if the lapse or maturity of one component in a contract causes the lapse or maturity of the other, the entity shall apply IFRS 17 to account for the combined investment component and insurance component.

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Non-insurance companies potentially affected

Banks

- Banks are expected to apply IFRS 9 to their financial guarantee contracts
- Most common banking agreements do not typically transfer significant insurance risk

Investment companies

- Issue contracts that are similar to some insurance contracts
- Indirectly affected by IFRS 17 because of the increased comparability between industries

Non-financial companies

- IFRS 17 will affect only those non-financial companies providing insurance coverage by issuing insurance contracts
- IFRS 17 does not apply to product warranties issued by a manufacturer, dealer or retailer
- Option to apply IFRS 15 to some fixed-fee service contracts

4 How does the Standard work in practice

One measurement model

IFRS 17 measurement model (general model)

+ Optional simplifications for short-term contracts = Optional approach for short-term contracts

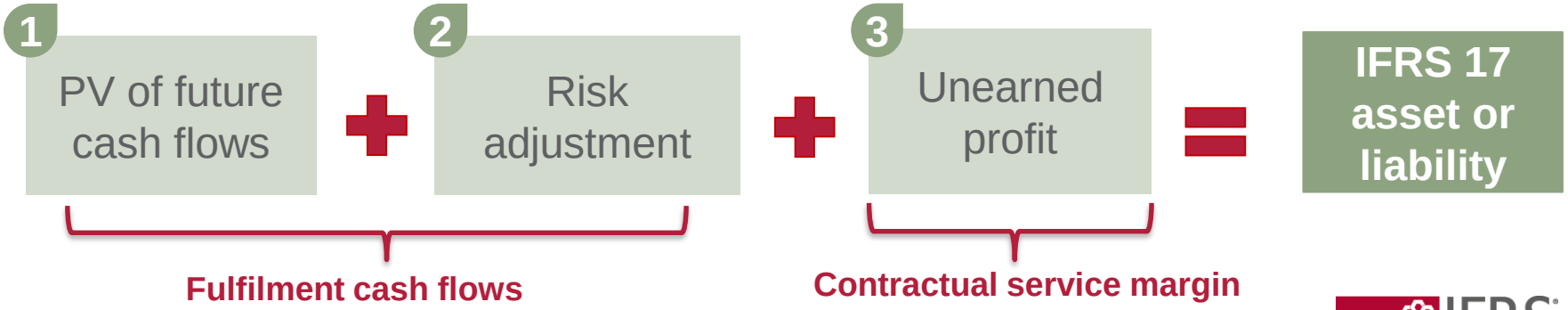
+ Modifications for reinsurance contracts held = Required accounting for reinsurance contracts held

+ Modifications for direct participation features = Required variable fee approach

IFRS 17 measurement model

All insurance contracts measured as the sum of:

- **Fulfilment cash flows (FCF)**
  1. Present value of probability-weighted expected cash flows—reflects financial risk
  2. Plus an explicit risk adjustment for non-financial risk (eg insurance risk)
- **Contractual service margin (CSM)**
  3. The unearned profit from the contracts



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Snapshot on measurement

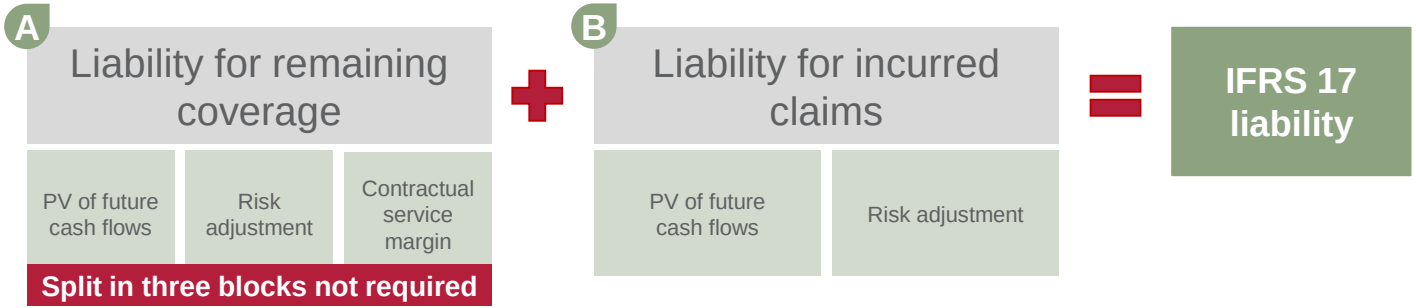
	Initial measurement	Subsequent measurement
1 **PV of future cash flows**	Current assumptions	Current assumptions
2 **Risk adjustment**	Current assumptions	Current assumptions
3 **Unearned profit—contractual service margin**	The amount that results in no gain recognised in profit or loss	Update by reflecting: • Time value of money • Adjustments related to future service • Allocation of the amount earned for services provided

Optional simplified approach—eligibility

- Eligible for contracts with
  - coverage of one year or less; or
  - no variability in the fulfilment cash flows affecting the liability for remaining coverage

- IFRS 17 contract boundary requirements apply for the assessment of the coverage period
  - practical ability to reassess risks of the policyholder; or
  - practical ability to reassess risks of the portfolio that contains the contract and the pricing reflects risks up to the reassessment date

Optional simplified approach—overview



A Simplified measurement

B Measurement under the general model, but discounting of claims to be settled within 1 year not required

Variable fee approach—overview

- Variable fee approach only when insurer shares return on specified assets
- Insurer's share of return on underlying items treated as 'variable fee' for investment-related services
  - Change in variable fee adjusts unearned profit
- Liability measurement reflects fair value change of those assets

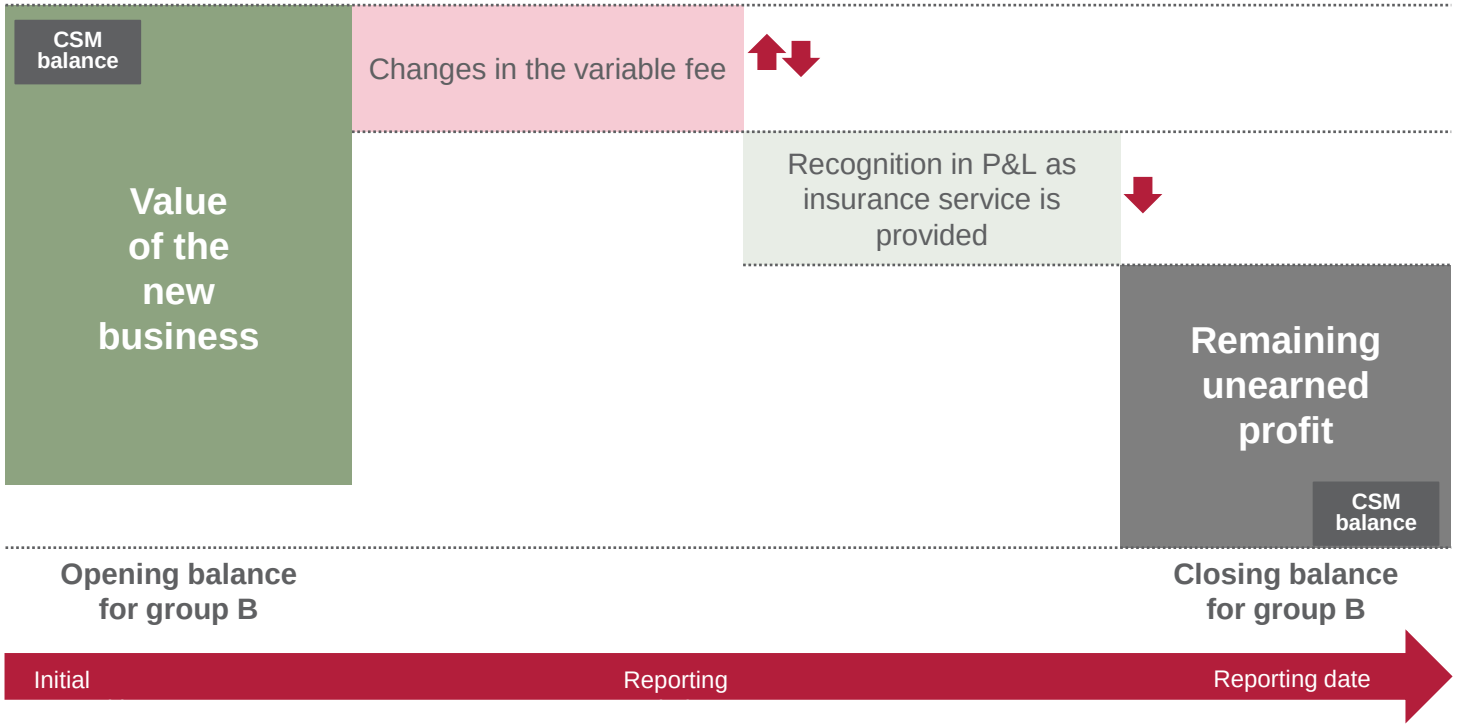
Key effects

- Reflects the investment nature of the contracts
- Clearly reflects the extent of asset mismatch

Variable fee approach compared with general model

	1 PV of future cash flows	2 Risk adjustment	3 Unearned profit
Initial recognition	✓ No difference	✓ No difference	✓ No difference
Subsequently	✓ No difference	✓ No difference	× Difference in how CSM is adjusted for changes in financial variables

CSM for direct participating features



Grouping objectives

- IFRS 17 requires portfolio be divided into 1-3 groups
- IFRS 17 will provide:
  - information about losses from contracts onerous at initial recognition
  - information about losses when previously profitable groups of contracts become onerous

Grouping contracts is relevant for the recognition in P&L of profits and losses for insurance services

The level of aggregation does not affect the measurement of the fulfilment cash flows

How are insurance contracts grouped?

1. **Portfolio**
   - ✓ Similar risks
   - ✓ Managed together

2. Onerous at initial recognition

   Remaining contracts in the portfolio

   At initial recognition, have no significant possibility of becoming onerous

3. Issuance period

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Level of aggregation
Examples 1 and 2

- **Example 1**: A set of 100 ‘identical’ contracts are written with a probability that 5 of the policyholders will claim
  - 100 contracts are a group; company does not treat the 5 contracts as a separate group
- **Example 2**: a company issues 500 contracts; there is information that a set of 200 ‘identical’ contracts are under priced, but the company expects that a set of 300 profitable ‘identical’ contracts will cover losses (or possible losses) on the set of 200 under-priced contracts
  - Group A—losses on the 200 under-priced contracts are recognised immediately
  - Group B—profits on 300 contracts are recognised over the coverage period

Level of aggregation

Coverage units

The recognition in P&L of profits and losses for insurance services is based on coverage units in the group

- Quantity of benefits
- Expected coverage period

Level of aggregation
Coverage units example

By grouping, there is no need to track contracts individually

Consider the following simplified assumptions:

- an insurer writes some 5-year contracts that IFRS 17 requires, at a minimum, to treat as a single group:
  - 5 contracts issued in January with an expected total profit of 50
  - 5 contracts issued in February with an expected total profit of 40
  - all contracts provide the same level of cover per year
- the insurer expects that one contract will claim at the end of Year 4

	Inception	Year 1	Year 2	Year 3	Year 4	Year 5
Remaining unearned profit (end of year)	90	71.6	53.2	34.8	16.4	-
Coverage units per year		10	10	10	10	9
Profit recognised in P&L		18.4	18.4	18.4	18.4	16.4
		10 / 49	10 / 39	10 / 29	10 / 19	9 / 9

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Why annual cohorts?

Example 1

- Timely recognition of losses

	Y1	Y2	Y3	Y4	Y5	Total profit
With annual cohorts						
Contracts written in Y1	30	30	(20)*	0	-	**40**
Contracts written in Y2	-	9	9	9	9	**36**
	30	**39**	**(11)**	**9**	**9**	**76**
Without annual cohorts						
Contracts written in Y1 and Y2	**30**	**36**	**4**	**4**	**2**	**76**

* Due to changes in expectations

Why annual cohorts?

Example 2

- Preventing phantom profit*

	Y1	Y2	Y3	Y4	Y5	Total profit
With annual cohorts						
Contracts written in Y1	30	30	30	30	-	**120**
Contracts written in Y2	-	9	9	9	9	**36**
	30	**39**	**39**	**39**	**9**	**156**
Without annual cohorts						
Contracts written in Y1 and Y2	**30**	**36**	**36**	**36**	**18**	**156**

* Contracts written in different years

Insurers vs other industries

	IFRS 4	Other industries	IFRS 17
Recognition of revenue	Varies by local practices	As service is provided	As service is provided
Recognition of losses on onerous contracts	Varies by local practices	When expected	When expected
Unit of account	Varies by local practices	Contract-by-contract basis	Grouping is permitted
Trend information about profitability	✗	✓	✓

Applying IFRS 17 for the first time

	1 PV of future cash flows	2 Risk adjustment	3 Unearned profit
Existing contracts (issued before transition date)	✓ Usual IFRS 17 measurement	✓ Usual IFRS 17 measurement	× Transitional measures
New business (issued after transition date)	✓ Usual IFRS 17 measurement	✓ Usual IFRS 17 measurement	✓ Usual IFRS 17 measurement

Transitional measures

DETERMINE TRANSITION METHOD BY GROUP OF CONTRACTS

1 Full retrospective approach (apply IAS 8)

if impracticable

2 Modified retrospective approach

- Modifications available if necessary given reasonable and supportable information
- Maximise the use of the information needed for full retrospective approach

Insufficient reasonable and supportable information available

OR

3 Fair value approach

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Example of IFRS 17 statement of comprehensive income

	Statement of comprehensive income	20X1
1	Insurance revenue	9,856
	Insurance service expenses	(8,621)
2	Insurance service result	1,235
	Investment income	7,787
3	Insurance finance expenses	(7,391)
	Net financial result	396
	Profit or loss	1,631
	Other comprehensive income	
	Investment income	2,115
3	Insurance finance expenses *(optional)*	(1,917)
	Total other comprehensive income	198
	Comprehensive income	1,829

Two drivers of profit presented separately

Insurance coverage

Investment activities

Example of IFRS 17 balance sheet

1 PV of future cash flows + 2 Risk adjustment + 3 Unearned profit = **IFRS 17 asset or liability**

Balance sheet	20X1	20X0
Financial assets at fair value through profit or loss	185,152	160,936
Financial assets at fair value through OCI	41,145	35,764
Other assets	34,467	31,293
Total assets	260,764	227,993
Insurance contract liabilities	205,724	178,818
Other liabilities	30,859	26,823
Equity	24,181	22,352
Total liabilities and equity	260,764	227,993

Insurance contract liability reconciliation

	Estimates of the present value of future cash flows	Risk adjustment	Contractual service margin	Liability
BEGINNING OF PERIOD	163,962	5,998	8,858	178,818
Changes related to:				
- Future service yet to be provided	*(784)*	*1,117*	*(116)*	*217*
- Current service provided in the period	*35*	*(604)*	*(923)*	*(1,492)*
- Past service adjustment to past claims	*47*	*(7)*	*-*	*40*
Insurance service result	(702)	506	(1,039)	(1,235)
Insurance finance expenses	9,087	-	221	9,308
TOTAL CHANGES IN P&L AND OCI	8,385	506	(818)	8,073
CASH FLOWS	18,833	-	-	18,833
END OF PERIOD	191,180	6,504	8,040	205,724

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Revenue and expenses roll forward

	Liabilities for remaining coverage		Liabilities for incurred claims	Total
	Excluding onerous contracts component	Onerous contracts component		
BEGINNING OF PERIOD	161,938	15,859	1,021	178,818
Insurance revenue	(9,856)			(9,856)
Insurance service expenses	1,259	(623)	7,985	8,621
Investment components	(6,465)		6,465	0
Insurance service result	(15,062)	(623)	14,450	(1,235)
Insurance finance expenses	8,393	860	55	9,308
Total changes in P&L and OCI	(6,669)	237	14,505	8,073
Cash flows				
Premiums received	33,570			33,570
Claims, benefits and other expenses paid			(14,336)	(14,336)
Insurance acquisition cash flows	(401)			(401)
Total cash flows	33,169	-	(14,336)	18,833
END OF PERIOD	188,438	16,096	1,190	205,724

5 Where do we go from here?

IASB implementation support for IFRS 17

Webinars

Articles and other materials

Conferences

Transition Resource Group

Education for

- investors
- regulators
- standard-setters

Board and IFRS Interpretations Committee discussions

Informal technical discussions with

- regulators
- standard-setters
- audit firms

Dedicated website page

Transition Resource Group

Public forum for discussion

- Meetings webcast
- Papers and summaries publicly available

Limited life during the transition period to the new requirements

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

Helps the Board to determine whether actions needed to address questions

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

6

Q&A