Introduction to IFRS 17

Will you be ready for 2021?

IFRS 17 Working Party

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Overview

- Objectives
- Background
- Technical Overview
- The Premium Allocation Approach (PAA)
- The Building Block Approach (BBA)
- Next Steps

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Objectives of today

#1 Increase awareness and encourage engagement

#2 Understand key elements of the IFRS 17 exposure draft

#3 Create a common language to enable discussions

#4 Highlight areas of uncertainty, difficulty and areas of focus

#5 Encourage discussions around potential challenges for you

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IFRS 17 - what, why and how?

What?

- New accounting standard for valuation of insurance contracts for both Life and General Insurers…it's different to current accounting and Solvency II.
- Publication of the IFRS 17 revised exposure draft expected June 2019, with an effective date of 1 January 2022.
- Will impact all current IFRS reporters immediately from implementation.
- The impact will vary by firm depending on the business you write and the level of maturity of your business processes.
- UK accounting rules likely to change as well ... so will impact virtually all in the UK in time.

Why?

- Current IFRS 4 Insurance Contracts Standard is only an interim Standard => diverse practice and differing treatments
- Comparisons are difficult for different products, companies and jurisdictions

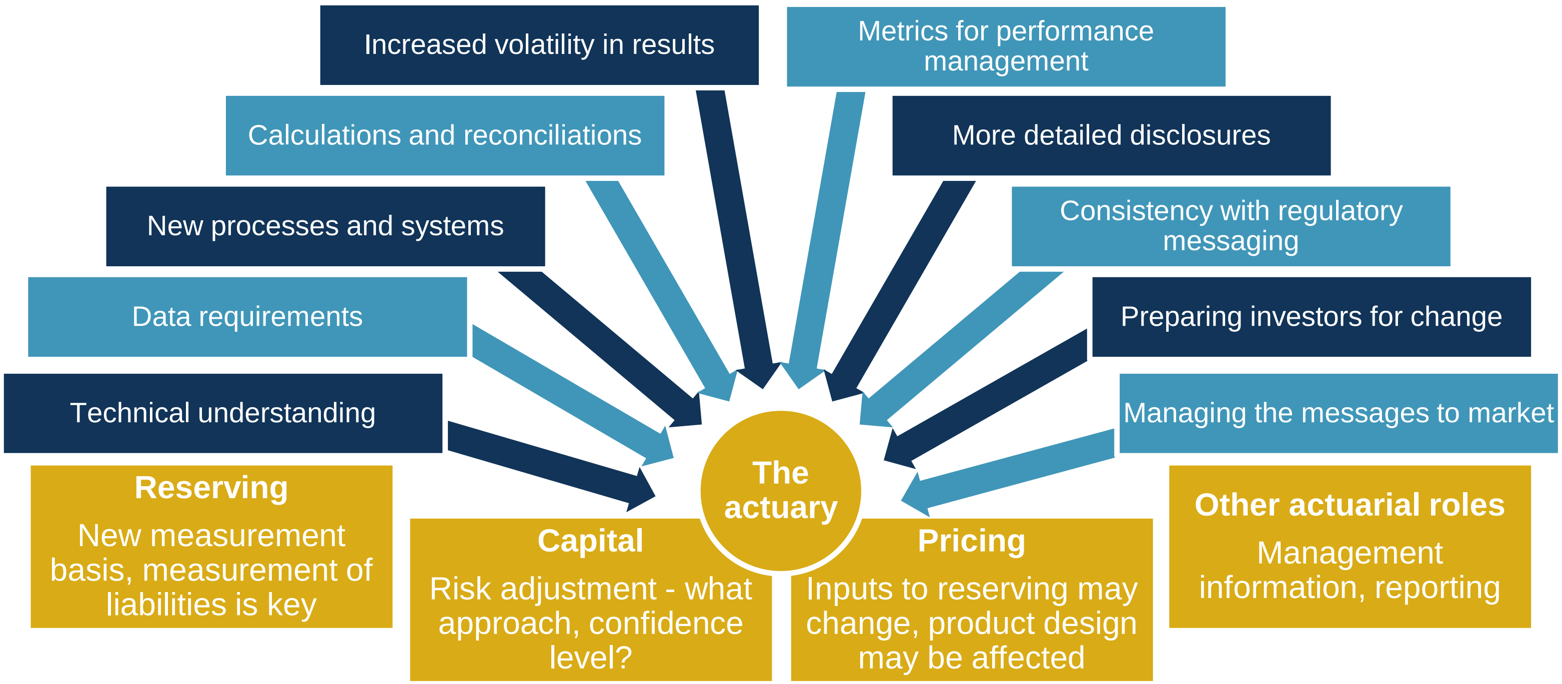
How?

- Global insurance Standard
- IASB wants consistency across industry and consistent accounting for all insurance contracts by all companies
- IASB intention is to have one Building Block Approach (BBA) for all contracts
- IASB believes market-consistent approach provides best information

For General Insurance:

- Current GI model not considered 'broken'
- Request from general insurers to develop simplified model => Premium Allocation Approach (PAA)
- PAA should be an approximation of the BBA
- Can only be used under certain circumstances = > This leads to potential issues around PAA eligibility for multi-year contracts

Why is this such a big deal?



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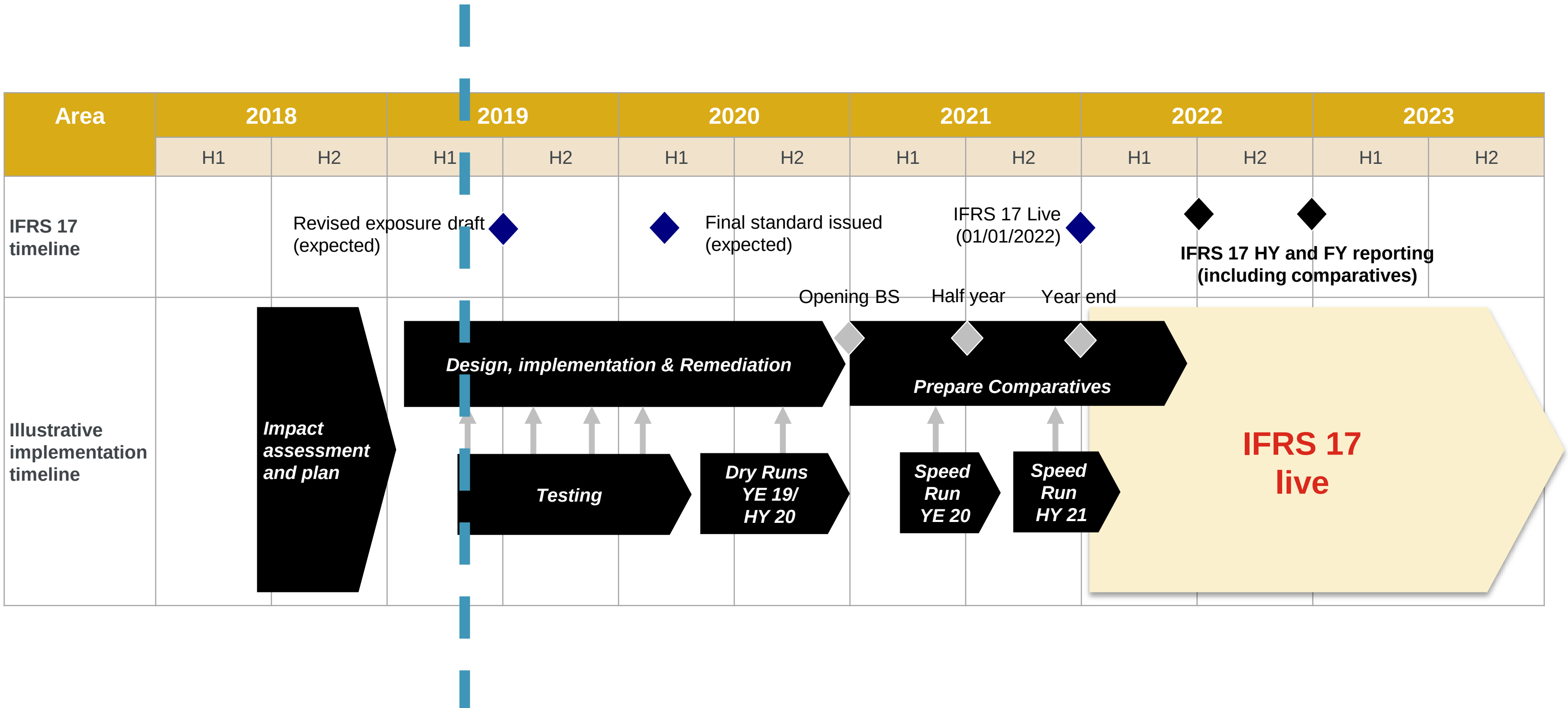
IFRS 17 timeline



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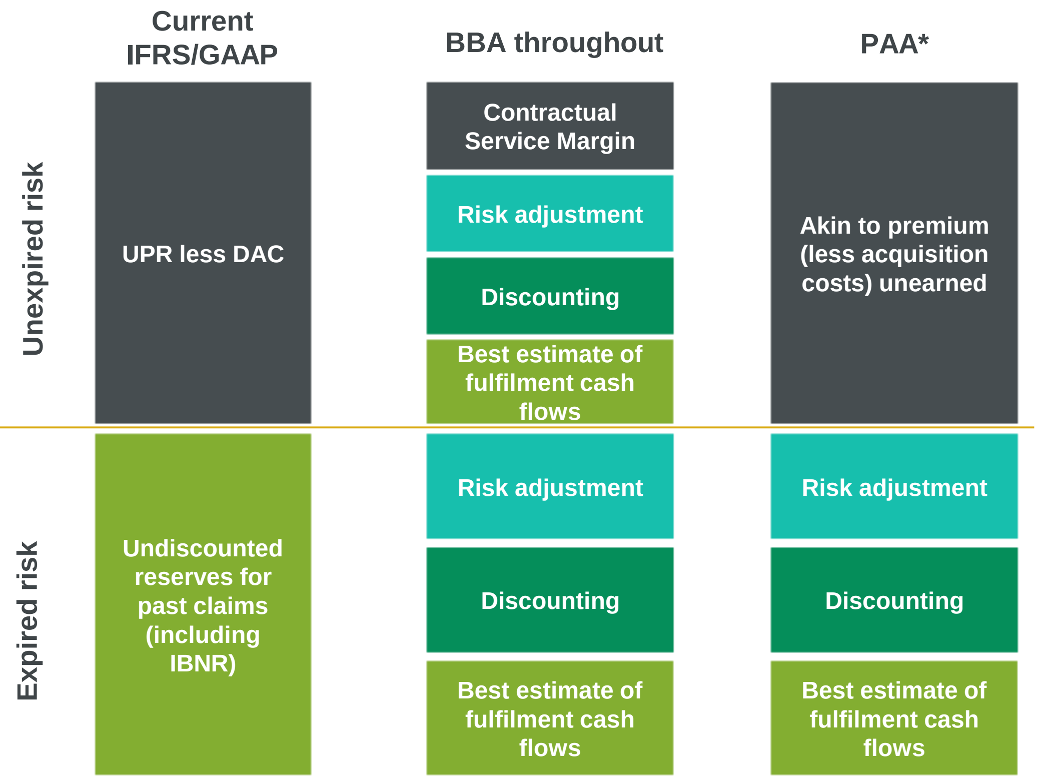
IFRS 17 Technical Overview

Overview:

- General measurement model known as the Building Block Approach (BBA)
- Simplifications exist for eligible contracts:
  - Premium Allocation Approach (PAA) for unexpired risk component
  - PAA with undiscounted expired risk
- Recognition of contracts - earliest of start of coverage and premium receipt (plus onerous contract test)
- Applies to outwards reinsurance too
- More granularity required
- Detailed disclosure requirements



Size of boxes for illustrative purposes only. Specific conditions must be met for PAA (*)

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The Premium Allocation Approach (PAA)

The premium allocation approach is **a simplification** that can be used as an alternative to the building block approach. It only applies over the coverage period, not over the settlement period. Use of the premium allocation approach is **an option which is permitted for contracts with coverage of one year or less** or otherwise where the insurer can **demonstrate it is a reasonable approximation to the building block approach.**

Liability for remaining coverage	**Akin to premium (less acquisition costs) unearned**	On initial recognition: **record a liability at the PV of premiums received, less acquisition costs, plus any onerous contract liabilities** (if sum of future cash flows > 0) and record an asset as the PV of premiums receivable. Subsequent measurement: **reduce the liability for passage of time ±** any changes in onerous contract liabilities from the previous period, reduce asset for receipt of premiums
Liability for incurred claims	**Risk adjustment**	An adjustment to reflect uncertainty in the estimate of future cash-flows. **No prescribed method** but confidence level needs to be disclosed.
	Discounting	Discount rate **not prescribed** but based on characteristics of the insurance liability (updated each reporting period) and consistent with observable current market inputs for instruments with similar cash flow characteristics.
	Best estimate of fulfilment cash flows	The estimates of cash flows used to determine the fulfilment cash flows shall include **all cash inflows and cash outflows** that relate directly to the fulfilment of the portfolio of contracts. These estimates shall be explicit, unbiased, probability-weighted and are updated at each reporting period.

Size of boxes for illustrative purposes only.

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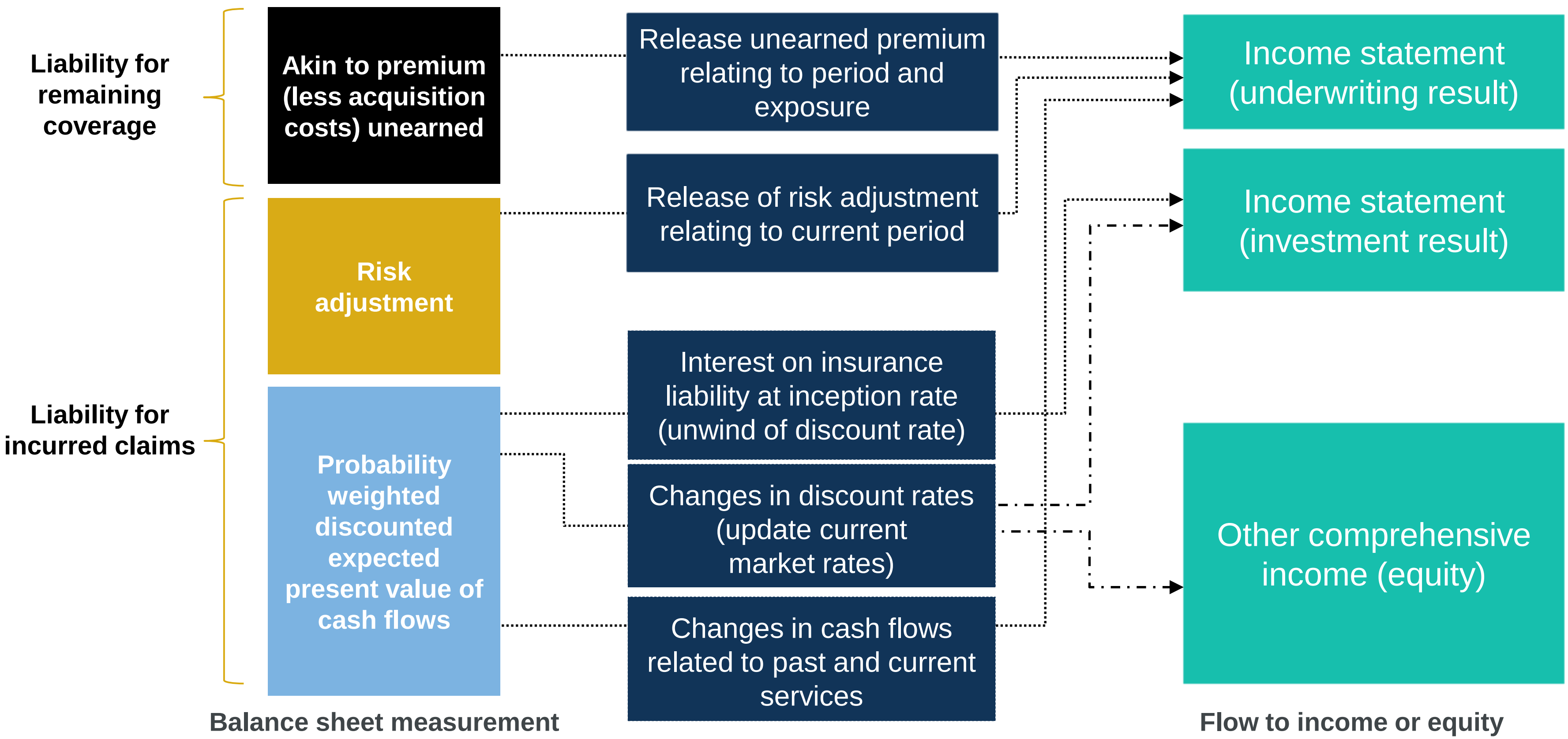
Technical - Revenue recognition: PAA



Elected options

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The Building Block Approach (BBA)

The building block approach is the standard measurement model

Unexpired risk only	**Contractual Service Margin**	Contractual service margin (CSM) **eliminates the recognition of any future accounting profit at inception.** CSM cannot be negative, i.e. the present value of losses must be charged immediately to profit or loss. Amortised over remaining coverage period in a straight line.
Expired and unexpired risk	**Risk adjustment**	An adjustment to reflect uncertainty in the estimate of future cash-flows. **No prescribed method** but confidence level needs to be disclosed.
	Discounting	Discount rate **not prescribed** but based on characteristics of the insurance liability (updated each reporting period) and consistent with observable current market inputs for instruments with similar cash flow characteristics.
	Best estimate of fulfilment cash flows	The estimates of cash flows used to determine the fulfilment cash flows shall include **all cash inflows and cash outflows** that relate directly to the fulfilment of the portfolio of contracts. These estimates shall be explicit, unbiased, probability-weighted and are updated at each reporting period. Includes **onerous contract liabilities.**

Same as expired risk for PAA

Size of boxes for illustrative purposes only.

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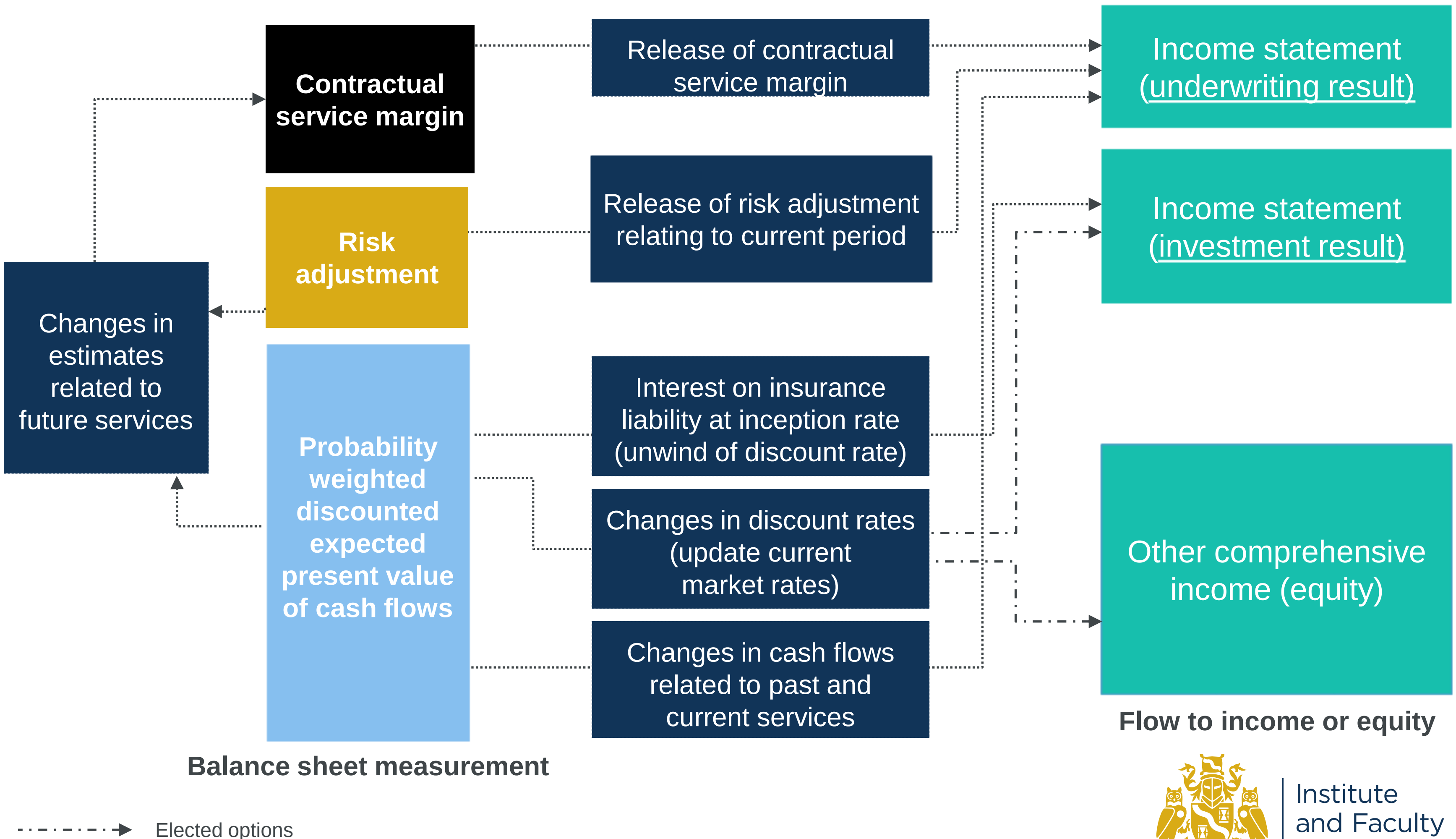
Technical - Revenue recognition: BBA



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BBA or PAA?

PAA is permitted for annual (or less) contracts, or when the PAA provides a reasonable approximation to the BBA

BBA

CSM

Risk Adjustment

Discounted probability weighted average of expected future cash flows

OR

PAA

Premium Allocation Approach (PAA)

Liability prior to date when claims are incurred - PAA liability should be equally to equivalent BBA liability at inception

- Permitted for all contracts with maximum coverage of 1 year.
- Not permitted for contracts where there is a risk of high variability of future cash flows in the pre-claims period.
- There are differences to treatment of acquisition costs in PAA compared with current UPR.
- Still need to apply BBA to post claims liabilities.
- The PAA method allows firms to make changes to existing UPR process rather than implementing new measurement model.

PAA provides a practical option to reduce implementation costs for general insurers

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Unit of Account and Onerous Contracts

Step 1: Identify portfolios
= insurance contracts subject to similar risks and managed together as a single pool

Contracts in different products lines would be in different portfolios.

Step 2: Divide each portfolio into groups:

- *contracts issued within the same 12-month period*
- *information about the contracts' resilience*
- *consistent with internal reporting*
- *exemption for regulatory pricing*
- *group not reassessed after inception*

Onerous contracts	(A) Contracts that are onerous at inception, if any	A loss is recognised in P/L
Non-onerous contracts	(B) Contracts that at inception have no significant possibility of becoming onerous subsequently, if any	Unearned profit is recognised as liability and is released as insurance services are provided
	(C) Other profitable contracts, if any	

Impact:

- Current AURR requirements consider businesses 'managed together' => broad groupings with profitability of underlying lines of business offsetting each other and reducing the likelihood of needing an AURR.
- Under IFRS 17 onerous contracts need to be identified at initial recognition and offsetting profitable contracts with unprofitable ones is not permitted. This is far more granular than the current onerous contracts test ***=> significantly increases the likelihood of requiring an onerous contract reserve***

Key choices for General Insurers

		Balance Sheet	Income Statement
1	**Premium Allocation Approach or Building Block Approach**	Insurance contract liabilities – unexpired (aka "UPR") Reinsurance assets - unexpired	Insurance contract revenue Reinsurance expense
2	**Risk Adjustment – policy, method and assumptions**	Insurance contract liabilities – • expired coverage • unexpired when BBA used • onerous contracts (unexpired on PAA and unincepted) Reinsurance assets	Insurance contract revenue Reinsurance expense
3	**Discounting – managing asset and liability mismatches**	Insurance contract liabilities • expired coverage • unexpired when BBA used • onerous contracts (unexpired on PAA and unincepted) Reinsurance assets Financial Assets	Insurance contract revenue Reinsurance expense Discount unwind expense – through profit and loss Changes in discount rates – through OCI

IMPACT

Data, systems, processes and controls	Financial: balance sheet and profit	Understanding and communication

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Get involved…!

How does this impact the company you work for?	What is the operational impact (data, systems, processes, people)?	Is there a working group already set up in your company? Who is on that?	Are there projects already underway to transform finance / actuarial processes? Are they thinking about IFRS17?

Stakeholder management
Knowledge

- Increase awareness
- Technical training

Impact studies
Identify hot spots

- Financial and operational impact assessment
- Assessment of system, modelling, data flow and process implications
- Product assessment – establish PAA eligibility
- Identify relevant existing and planned projects to leverage

Implementation planning
Plan for a plan

- Identify key stakeholders and create project governance structure
- Cost estimation for business case
- Search for skilled resources
- Detailed impact assessment across your business

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Questions

Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

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