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# IFRS 17

## Current hot topics

Graham Oswald, PwC

# Objectives and overview

#1

Current timetable – where are we now?

#2

Which of the recently proposed amendments are relevant to P&C insurers?

#3

What are the current areas of focus for P&C insurers?

#4

What are the current challenges facing P&C insurers around PAA eligibility, Risk Adjustment and Reinsurance?



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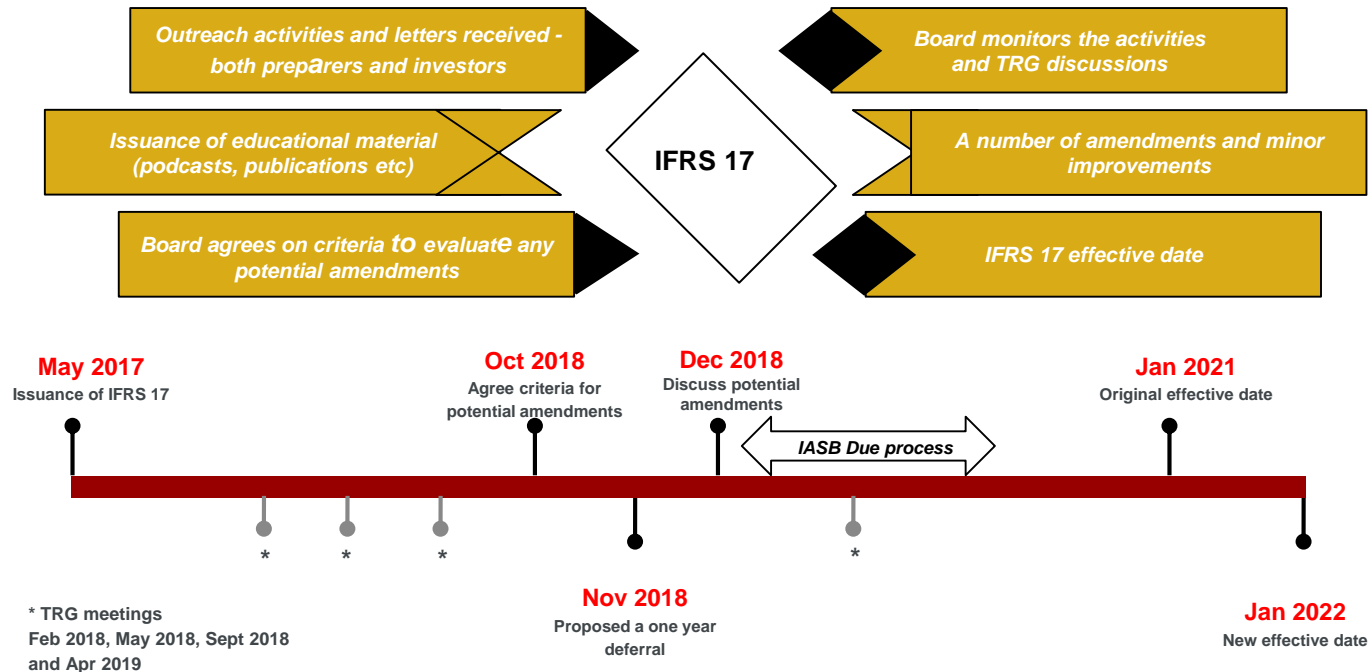
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## Where are we now?

Proposed amendments / clarifications relevant to  
P&C insurers

07 October 2018

# Where are we now?



## Next steps

- End of first half of 2019: Exposure Draft of the amendments to IFRS 17
- Comment period
- Discussion of comments
- Finalisation of amendments



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# Current issues most relevant to P&C insurers

- Treatment of premium receipts / receivables – LFRC and brokerage
- Reinsurance held: initial recognition for onerous contracts
- Risk adjustment – should the effect of reinsurance be considered in calculating the risk adjustment for contracts that have been reinsured?
- Acquisition cashflows for renewals
- Consideration of potential investment components





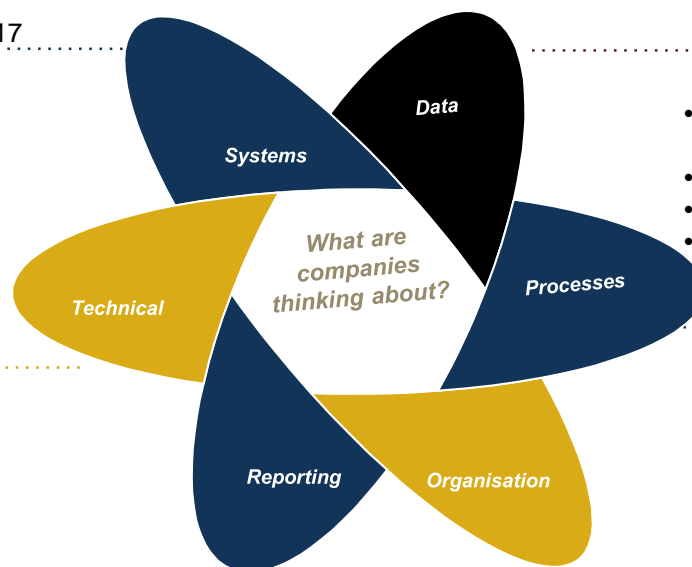
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# Current areas of focus for P&C insurers

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# Key areas of focus identified from implementation projects to date



- How tactical should CSM solution be?
- Adapting legacy architecture
- Workarounds translated quickly into BAU and then IFRS17
- Vendors moving on their propositions
- Join Finance Transformation with IFRS17

- New data items
- Workarounds
- Data quality issues
- Data previously not used
- Data governance

- Risk Adjustment – how to set, allocate
- Expenses – treatment of expense items
- CSM – amortisation patterns
- Reinsurance
- Opening balance sheet

- LFRC (Liability for Remaining Coverage) for PAA (Premium allocation Approach)
- Onerous contract calcs
- Expenses
- Working Day Timetable

- Chart of Accounts
- Disclosure requirements
- Dealing with multi-basis accounting requirements
- FP&A - how to run business?
- KPIs/discussions with Analysts
- Taxation

- Education, demystifying terminology (eg Unit of Account)
- Global vs Functional
- Ownership of assumptions
- Handoffs (actuarial, accounting, FP&A, FinOps)
- Removing silos
- Change Management
- Training



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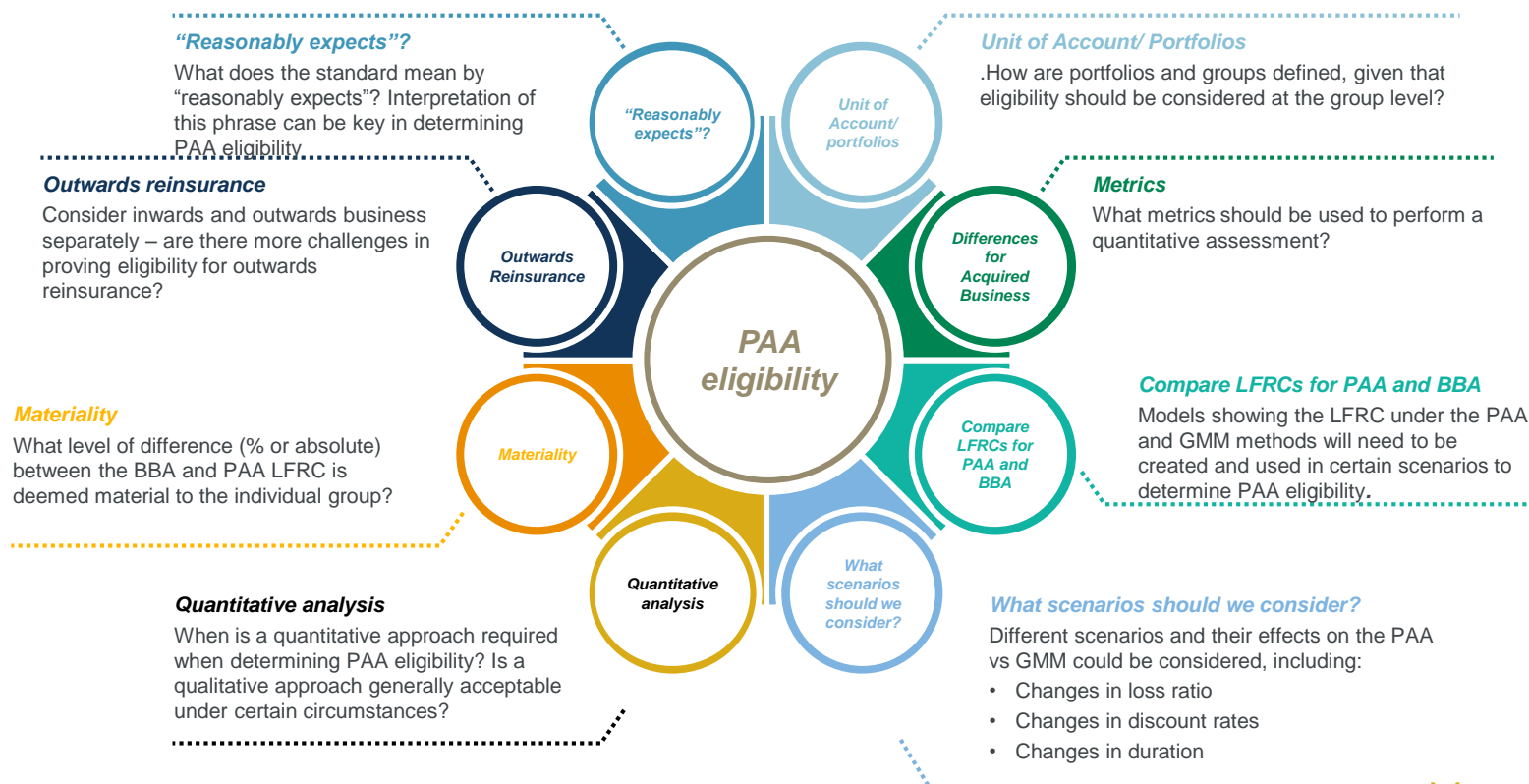
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# Deep dive – PAA eligibility

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# Interpreting the standard for PAA eligibility testing





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# Deep dive – Risk adjustment

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# Risk adjustment

## Introduction

*'The compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.'*

- No limitation on techniques or prescribed level of diversification.
- Approaches include but are not limited to:
  - confidence level techniques,
  - cost of capital, and
  - scenario analysis.
- Irrespective of the method used, IFRS requires disclosure of the implied confidence level.
- Need to consider ease and speed of calculation, and communication of approach to key stakeholders.



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# Risk adjustment

## Key issues and practical considerations

The IFRS 17 Standard is principles based and does not mandate a single approach for determining the risk adjustment. But (i) it will necessary that what ever approach is used does arrive at the compensation that the entity actually requires for risk; and (ii) that whatever approach is adopted the resulting risk adjustment is required to have the characteristics set out in B91.

As such there are some areas of uncertainty, as well as other wider practical considerations which entities will need to conclude on. These areas include:

### **Risk adjustment for LFRC business under PAA**

- RA not disclosed within the IFRS 17 accounts for LFRC business under the PAA approach. However, entities may still wish to allow for LFRC business when calculating the risk adjustment in order to:
  - Ensure consistency between LFIC RA under GMM and PAA approaches;
  - Since the LFRC risk adjustment is required in order to calculate the loss component for onerous business.

### **One year vs ultimate**

- No explicit time horizon over which the RA should be measured. However, IFRS 17 paragraph B87 references the risk associated with “fulfilling a liability”. This potentially infers that an ultimate view of risk should be considered.

### **Risks and contracts in scope**

- Adjustments required to capital model outputs including:
  - The inclusion of bound but not incepted business;
  - The recognition of outwards reinsurance business; and
  - Non-financial risk only

### **Diversification**

- RA should reflect level of diversification benefit considered when determining the compensation required for bearing the risk
- Consider consistency between risk adjustment at an entity and group level
- Transparency and ability to communicate approach
- Stability of the risk adjustment

### **Allowance for reinsurance**

- Interpretation of recent TRG clarifications regarding allowance for reinsurance in inwards RA

### **Disclosure / confidence level considerations**

- What choice of confidence level is appropriate?
- Will the disclosed level be constant or vary over time?
- Need to establish formal accounting policies with regards to the risk adjustment.
- Disclosure of risk adjustment methodology.



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# Deep dive – Reinsurance

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# A key change for reinsurance

“Under IFRS 17, **a reinsurance contract held is accounted for as a standalone contract**, independent of the accounting for the underlying insurance contracts.

For many entities, IFRS 17 represents a significant change. Common existing practice is to account for reinsurance contracts held using a ‘mirroring approach’, essentially matching reinsurance contract revenue, costs, assets and liabilities to the underlying insurance contracts.

In determining the IFRS 17 approach to reinsurance, the Board took note of existing practice. However, the Board concluded that separate accounting is necessary to truly reflect the economics of an entity’s rights and obligations under insurance contracts it issues and reinsurance contracts it holds.”

*Darrel Scott in the IASB’s “IFRS 17 - Pocket Guide on reinsurance contracts held” July 2018*



Increased potential for mismatching between the value placed on RI and the value placed on underlying contracts for IFRS 17



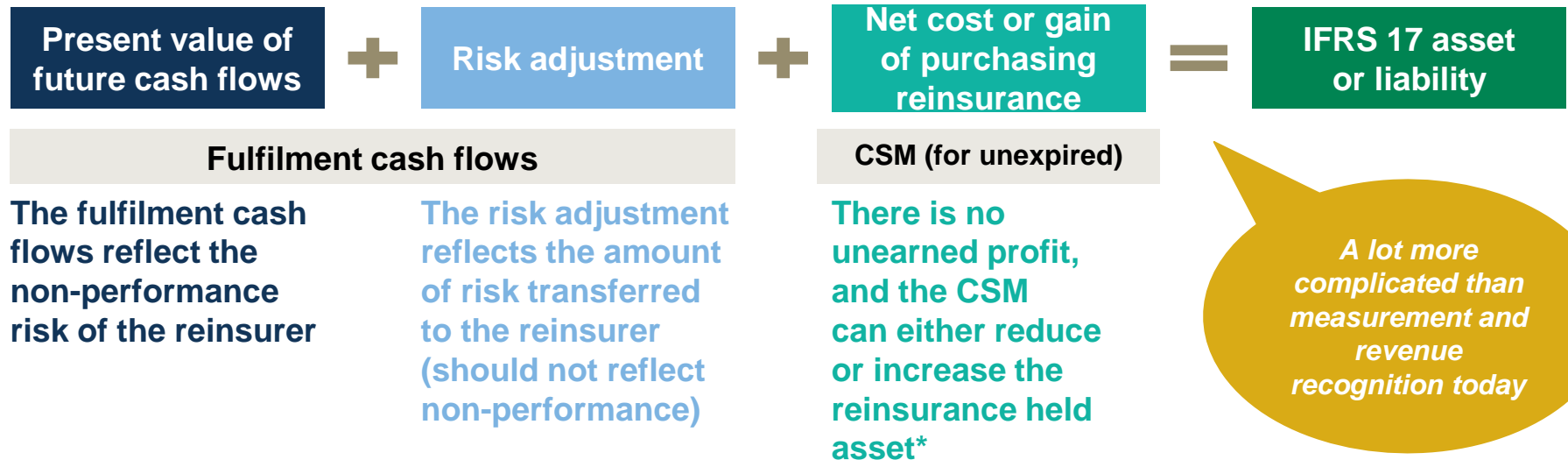
It is no longer as simple as just “netting down”



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# Accounting for RI: Measurement under the GMM



- Assumptions consistent with those for underlying contracts
- Valuation requires estimation of volumes of future underlying business

\*Except for ADC, when the cedant needs to recognise the loss immediately



# Some IFRS 17 ‘basics’ are a challenge for RI

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	
Valuation must be at a <b>unit of account</b> level which reflects the profitability of the contracts (insurance and reinsurance)	We aggregate, mixing loss making and profitable contracts	We don't have the data or processes set up to do the reinsurance calculations separately for reinsurance held at the level of granularity required
Additional requirements: <ul style="list-style-type: none"> <li>• Risk adjustment specifically for RI</li> <li>• CSM under the GMM</li> </ul>	Neither of these! Even under SII, RA is only calculated net	

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.



# Examples of potential differences and mismatches

<b>Multiple underlying units of account</b>	<ul style="list-style-type: none"><li>• Multiple underlying units of account feed fully or partially into a single reinsurance unit of account (assuming no separation) – <i>Wide-ranging implications</i></li></ul>
<b>Valuation assumptions / bases may differ</b>	<ul style="list-style-type: none"><li>• Separate treatment of inwards and outwards business means that there is no guarantee of a link between discount rate or Risk Adjustment assumptions between outwards and the underlying inwards business</li><li>• Under GMM, potential for different reinsurance and underlying CSM amortisation profiles due to different recognition dates, exposures, locked-in rates, coverage periods, interactions when unlocking etc.</li></ul>
<b>Underlying measured using PAA</b>	<ul style="list-style-type: none"><li>• Risk attaching reinsurance will not automatically be eligible for PAA, even when the underlying contracts are automatically eligible</li></ul>
<b>Day 1 profit asymmetry</b>	<ul style="list-style-type: none"><li>• Losses from 'Loss'-making underlying contracts need to be recognised immediately, but any off-setting profit from reinsurance needs to be deferred [<b><i>subject to change following recent IASB meetings</i></b>]</li></ul>
<b>Underlying contains investment contracts</b>	<ul style="list-style-type: none"><li>• Reinsurance in the scope of IFRS 17 could have underlying investment contracts (e.g. unit linked pensions) that are accounted under IFRS 9/15 resulting in potentially more significant mismatches than today</li></ul>
<b>Retroactive reinsurance</b>	<ul style="list-style-type: none"><li>• <i>Emergence of profit / loss from gross business may be accelerated vs the corresponding retroactive reinsurance treatment, leading to profit/loss emergence at a net level that is offset in the future</i></li></ul>
<b>No principle of correspondence</b>	<ul style="list-style-type: none"><li>• Value placed on reinsurance may be very different from the Solvency II value</li></ul>





# Reinsurance – Other areas to think about

1

## Risk adjustment

- IFRS 17 Parag. 64 : “...it represents the amount of risk being transferred by the holder of the group of insurance contracts to the issuer of those contracts.”
- Gross less ceded equals net

OR

- Gross less net equals ceded

OR

- Ceded plus net equals gross

2

## PAA eligibility

- Coverage periods may be longer than coverage period of underlying insurance
- Insurers' views about eligibility are currently split
- Reinsurers mostly do not plan to use PAA

3

## Issued reinsurance

- Insurance revenue will be reduced for the amounts of non-distinct investment components such as:
  - Profit sharing commissions
  - Reinstatement Premiums

4

## Fronting/Captive Arrangements

- What is the role of the insurance company in a fronting or captive arrangement?
- Revenue recognition may fall under IFRS 15 if the insurer is acting as an agent
- Corporate captives may be accounted for on a net basis

5

## Retroactive reinsurance

- Exception to reinsurance contracts held requirements for the measurement of the CSM at initial recognition.
- Some reinsurance contracts cover events that have already occurred but effect is still uncertain.
- Net cost of reinsurance coverage that relates to events that occurred before purchase is recognised immediately in profit or loss as an expense at initial recognition.



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# Big business decisions



## **Simplified measurement model (PAA)**

*Will all your products qualify? Even then, do you want to use it?*



## **Systems implementation**

*Can you leverage your current systems? Save time, effort and costs now by integrating IFRS 17 implementation plans into existing systems upgrades*



## **Performance measurement**

*New KPIs will be critical for day to day business management right through to investor communications. What will they look like?*



## **Financial reporting and disclosure**

*Greater level of detail (e.g. reconciliations and confidence level). How do you want to be seen to the market?*



## **Actuarial, Risk and Finance Modernisation**

*Greater collaboration, understanding, knowledge sharing will be required. How streamlined are you?*



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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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