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Building off Solvency II and the IFRS 17 Disclosure Requirements

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Agenda

- Building off Solvency II: IFRS 17 versus Solvency II measurement models
- IFRS 17 presentation and disclosure requirements
- Closing comments

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Building off Solvency II: IFRS 17 versus Solvency II measurement models

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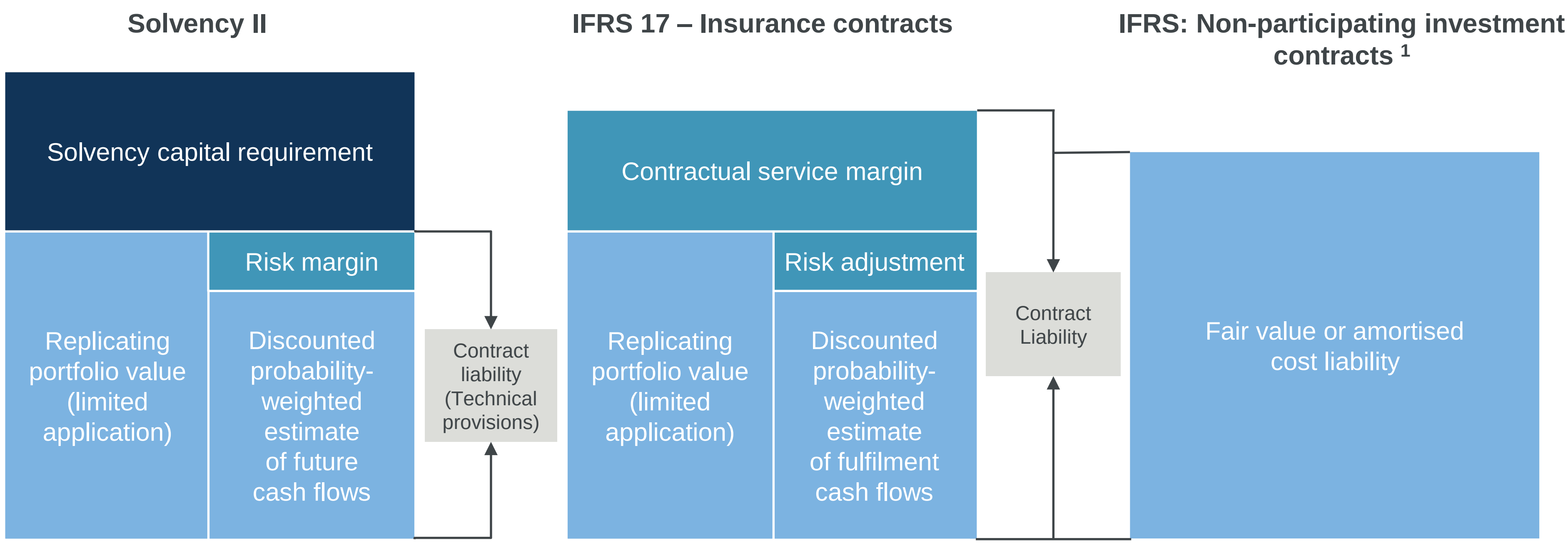
Summary of liability measurement



(1) For non-participating investment contracts (e.g. unit linked pensions):

- Contracts separated into financial instrument and investment management service component (assessed primarily in the future under IFRS 9, IFRS 15 and IAS 38).
- Investment management service model contains deferral of origination costs and fees. If acquired contracts, then acquired intangibles (AVIF) may exist.

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The relative size of the diagram is purely for illustration purposes only and could differ significantly by product and company. A number of simplifying assumptions have been made. Asset valuations may differ between Solvency II and IFRS resulting in differences in free assets and equity respectively. For insurance contracts, it assumes that there is no unbundling requirement and does not consider specific short duration contract treatment.

IFRS 17 versus Solvency II liability measurement (1)

Topic	IFRS 17	Solvency II	Significance	Observations
Definition and scope	Insurance (and participating investment, for companies that also issue insurance contracts).	All contracts regulated as insurance (in specific jurisdictions).		The measurement of non-participating investment contracts in IFRS will be significantly different to Solvency II.
Separating components	Distinct investment components, certain embedded derivatives and certain goods and non-insurance services are separated.	No separation of components.		Where components are separated in IFRS then the measurement can be different from Solvency II.
Profit recognition	CSM eliminates day-one gain and defers profit over the coverage period. Day-one losses are recognised immediately. CSM is subsequently updated for certain changes.	Day-one gains or losses are recognised for all contracts, including reinsurance.		The CSM is a key driver in the timing of profit recognition under IFRS and the reason for more granular tracking of liabilities movements over time in IFRS. There is no equivalent concept in Solvency II.
Transition	Approaches other than full retrospective application permitted, primarily in relation to the CSM on existing business.	Where approved, transitional measures smooth the impact on initial adoption for up to 16 years.		Different transitional arrangements in IFRS and Solvency II.

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IFRS 17 versus Solvency II liability measurement (2)

Topic	IFRS 17	Solvency II	Significance	Observations
Recognition	Date coverage begins or date first payment due for a 'group' of contracts (earlier for a group of onerous contacts).	Date coverage begins or date party to contract.		Potential for different recognition due to the 'first payment' (IFRS) versus 'party to' (Solvency II) condition; and the level of grouping and onerous contract test in IFRS.
De-recognition	Date obligations are extinguished or upon substantial modification of the contract.	Date obligations are extinguished, discharged, cancelled or expired.		Likely to be similar, however, there is no IFRS concept of modification in Solvency II.
Granularity/grouping of contracts	Potential for three groups (based on profitability) per portfolio per annual cohort.	Prescribed grouping by type of contract.		This will result in a significantly more granular tracking of liabilities movements over time in IFRS than Solvency II (notably for life insurers).
Contract boundary	No longer has substantive rights to receive premiums or obligations to provide services since the risks of the policyholder or portfolio in setting the price or level of benefit can be reassessed.	No longer required to provide coverage or can amend terms to 'fully reflect risk' at portfolio level (unless individual life underwriting took place).		The contract boundary definition could be different between Solvency II and IFRS.

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IFRS 17 versus Solvency II liability measurement (3)

Topic	IFRS 17	Solvency II	Significance	Observations
Cash flows (excluding acquisition costs)	Cash flows related directly to the fulfilment of the contracts.	All cash in- and out-flows required to settle the obligations over the lifetime.		There are differences in the cash flows included in the two frameworks. For example, the treatment of certain overhead expenses and participating contract cash flows (see later).
Acquisition costs	Attributable at portfolio level and included in measurement of liability.	Expensed as incurred.		Unlike in IFRS, there is no (implicit) deferral of acquisition costs under Solvency II.
Discount rate	'Top-down' or 'bottom-up' reflecting the characteristics of the liability. (Current and 'day 1' for OCI purposes where applicable).	Prescribed based on swaps less credit risk (plus matching or volatility adjustment in certain circumstances). (Current rates only).		Can the Solvency II 'risk-free' rate be used in IFRS? (e.g. UFR/entry & transition) Is top-down similar to Solvency II including matching adjustment? The volatility adjustment is not a feature of the liabilities so unlikely to apply in IFRS?
Allowance for risk	No prescribed method. Company's own view of the compensation required for uncertainty arising for non-financial risks (only). Gross of reinsurance.	Prescribed 6% cost of capital method, with defined risks, level of diversification benefit and other components. Net of reinsurance.		The Solvency II risk margin is prescribed, while the IFRS risk adjustment is principles-based. It is likely that there will be differences in the two approaches.

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IFRS 17 versus Solvency II liability measurement (4)

Topic	IFRS 17	Solvency II	Significance	Observations
'Simplified method' for certain short duration contracts	'Unearned premium' model for certain pre-claims liability, while cash flow projection required for the claims liability.	No separate model.		In IFRS, the 'unearned premium' model is optional. Depending on the nature of the contracts there could be a difference between Solvency II and IFRS.
Contracts with a participation feature (e.g. UK with-profit)	'Market consistent' measurement principle. Cash flows from the participating feature are included in the liability, including where these relate to future policyholders.	'Market consistent' measurement principle. Cash flows from the participating feature are included in the liability except for 'approved surplus funds'.		The IFRS treatment of residual assets in the participating fund and the allocation between liability and equity will depend on the specific nature of the contracts and national law. In Solvency II, national law defines 'surplus funds'.
Reinsurance contracts	All components presented gross of reinsurance; separate reinsurance asset. Specific requirements apply to reinsurance contract held.	Presented gross of reinsurance with a separate reinsurance asset (except for the risk margin). Reinsurance often mirrors the direct contract.		Unlike Solvency II, reinsurance under IFRS may not mirror the underlying direct contracts. Presentation of the allowance for risk is different between IFRS (gross and reinsured) and Solvency II (net).
Business combinations and transfers	Additional recognition and measurement principles apply at the point of combination or transfer.	Recognised and measured as if written by the reporting entity from inception.		Additional IFRS differences contrast with Solvency II where there is no difference between organic or acquired business.

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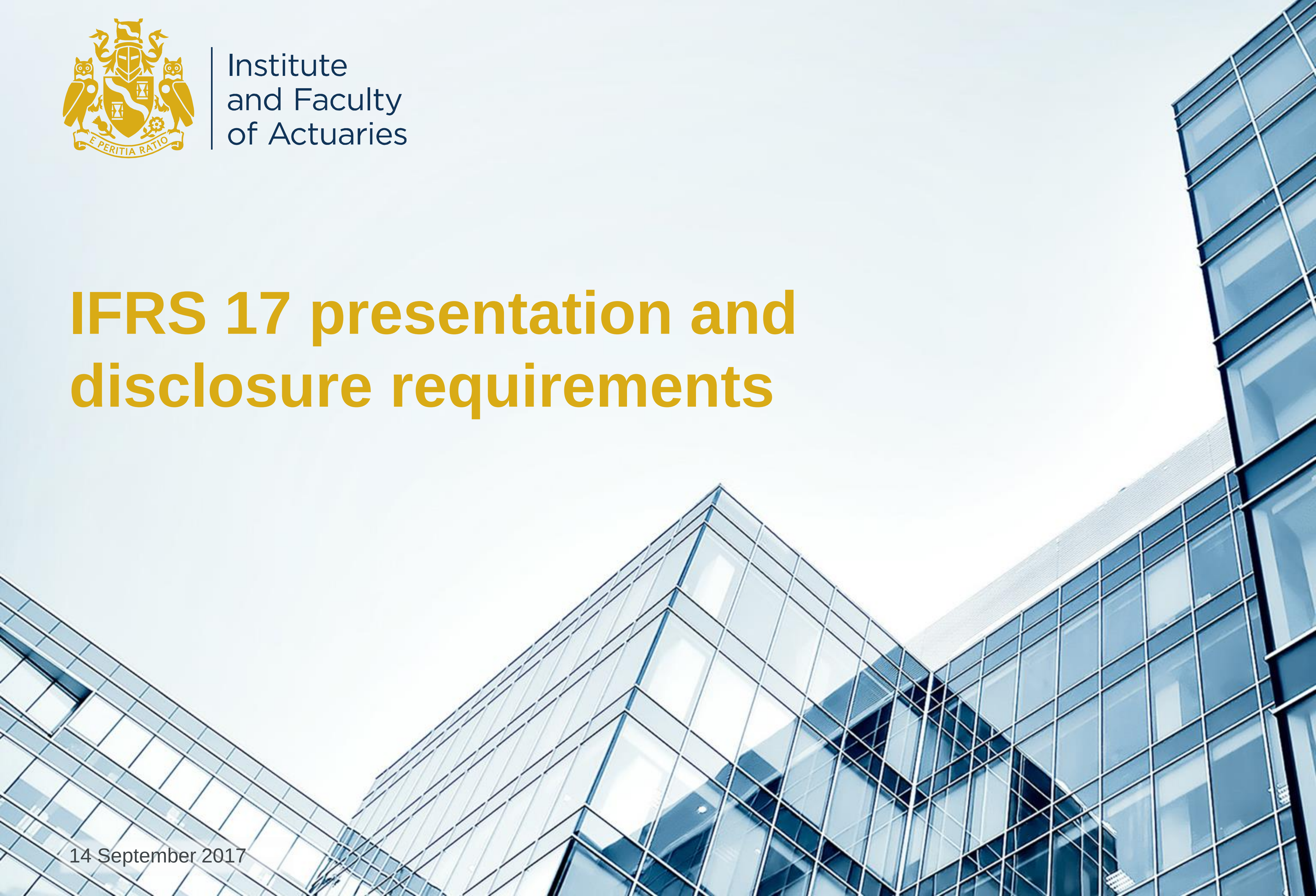
IFRS 17 presentation and disclosure requirements



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Presentation

Balance sheet – Example (assets)

Assets (Currently)
Cash and cash equivalents
Financial investments
Loans
Investment property
Investments in associates
Receivables from insurance business
Reinsurance assets
Deferred acquisition costs (where applicable)
Property and equipment
Goodwill and other intangible assets
Deferred income tax assets
Current income tax assets
Other assets
Total assets

Assets (New)
Cash and cash equivalents
Financial investments
Loans
Investment property
Investments in associates
Insurance contract assets[1]
Reinsurance contract assets[1]
…
Property and equipment
Goodwill and other intangible assets
Deferred income tax assets
Current income tax assets
Other assets
Total assets

Key changes:

- Separate presentation of group of insurance contracts in an asset and liability position.
- Ceded reinsurance contracts are presented separately from insurance contracts.
- DAC, DIR, AVIF and premium receivable are **not** separate assets but part of fulfilment cash flows. However, they **will** still exist for non-participating investment contracts (not under IFRS 17).

[1] Including non-distinct investment and service components.

= no changes to presentation

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Presentation

Balance sheet – Example (liabilities & equity)

Liabilities and equity (Currently)
Insurance contract liabilities
Unallocated divisible surplus
Investment contract liabilities [2]
Employee benefit obligations
Derivative liabilities
Deferred tax liabilities
Other liabilities
Senior debentures
Subordinated debt
Segregated fund liabilities
Total liabilities
Issued share capital and contributed surplus
Retained earnings and accumulated OCI
Total equity
Total liabilities and equity

Liabilities and equity (New)
Insurance contract liabilities [1]
Reinsurance contract liabilities [1]
Investment contract liabilities [2]
Employee benefit liabilities
Derivative liabilities
Deferred tax liabilities
Other liabilities
Senior debentures
Subordinated debt
Segregated fund liabilities
Total liabilities
Issued share capital and contributed surplus
Retained earnings and accumulated OCI
Total equity
Total liabilities and equity

Key changes:

- Separate presentation of group of insurance contracts in an asset and liability position.
- Ceded reinsurance contracts are presented separately from insurance contracts.
- **No** Unallocated Divisible Surplus (UDS or FFA).
- Insurance payables are not separate liabilities but part of fulfilment cash flows.

[1] Including non-distinct investment and service components; and insurance plus discretionary participation feature contracts.
[2] Non-participating investment contracts only.

= no changes to presentation

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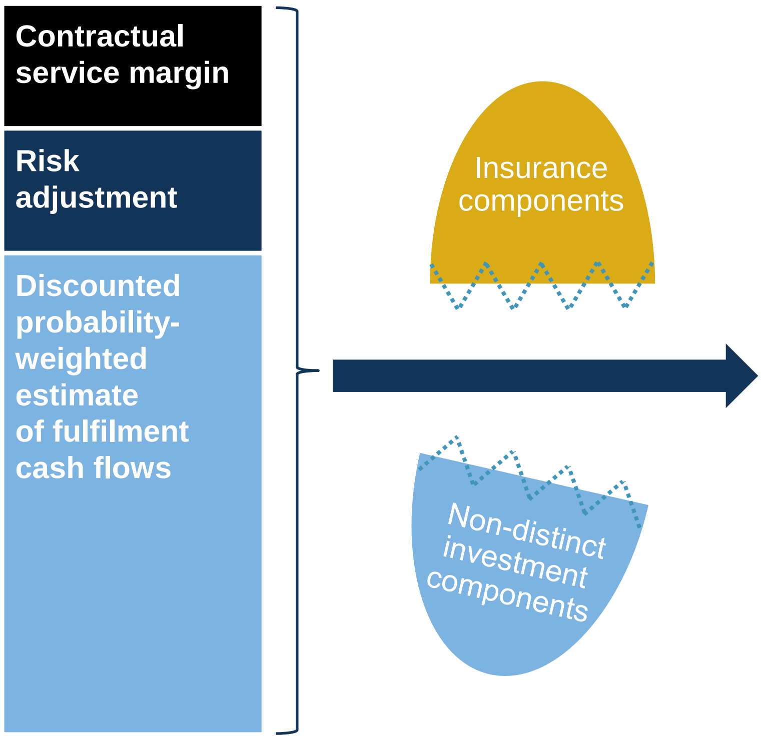
Presentation

Income statement: Summary



- Revenue and expenses are recognised as *services delivered and as incurred* respectively.
- Investment components are *excluded* from revenue.

Interest expense is based on current or locked-in rate depending on accounting policy choice.

	20XX	20XX
Insurance revenue	X	X
Insurance service expenses	(X)	(X)
Underwriting result	X	X
Investment income	X	X
Insurance finance income or expenses	(X)	(X)
Net interest and investment income	X	X
Profit or loss	X	X
Gains and losses on financial assets at FVOCI	X	X
Insurance finance income or expenses (optional)	(X)	(X)
Total comprehensive income	X	X

If OCI option is chosen, difference between current and locked-in financial variables are presented in OCI.

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Presentation

Income statement: Versus today & IFRS 17 profit drivers

Income statement (Currently)		IFRS 17 profit drivers
Income Premiums gross Less ceded Net premiums Net investment income Fee and commission income **Expenses** Claims and benefits paid (net of reinsurance recoveries) Increase (decrease) in insurance contract liabilities Decrease (increase) in reinsurance assets Increase (decrease) in investment contract liabilities	Increase (decrease) in unallocated divisible surplus Fee and commission expense Other expenses Finance costs **Profit before tax** Tax attributable to policyholders' returns. **Profit before tax attributable to shareholders' profits** Tax attributable to shareholders' profits **Profit for the period**	Release of day-1 profit (CSM amortisation). Release from risk (risk adjustment). Day-1 loss recognition. Investment margin (difference between investment and interest expense, plus return on surplus assets). Certain experience variances. Certain indirect and corporate expenses.

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‘Earned premium’ model with premium due or written prohibited

Presentation

Income statement: Definition of revenue

Revenue = Change in liability for remaining coverage		**Revenue =**
Excluding changes related to: • Premiums received; • Investment components; • Transaction-based taxes collected; • Insurance finance income or expenses; • Insurance acquisition cash flows; • Liabilities transferred to a third party; and • Loss component.	**or**	**Expected insurance service expenses excluding:** • Loss component; • Investment component; • Transaction-based taxes collected; and • Insurance acquisition expenses. **Change in risk adjustment excluding:** • Insurance finance income or expenses; • Adjustments to the CSM; • Loss component. **Release of the CSM**

plus

Release of insurance acquisition cash flows

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Interaction of IFRS 17 and IFRS 9

OCI option and mismatches between assets & liabilities

Insurers will make an accounting policy choice on whether to apply the OCI option in IFRS 17 in order to match profit or loss as much as possible with the results from assets.

	Assets (IFRS 9)	Liabilities (IFRS 17)
Equities, derivatives, debt instruments	*FVTPL*	*Discount rate changes to P&L*
Equities	*FVOCI with no recycling*	*Discount rate changes to OCI*
Debt instruments	*FVOCI with recycling*	
Debt instruments	*Amortised cost*	

But

- Regular premiums.
- Assets sold prior to maturity.
- Equities at FVOCI.
- Mixed portfolios.

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Disclosures (1)

Under IFRS 17 significantly more disclosures will be required compared to IFRS 4.

Amounts

- Opening to closing reconciliations with prescribed components:
  - Liability for remaining coverage, loss component and incurred claims.
  - Fulfilment cash flows, risk adjustment and CSM.
  - Revenue.

  (Splitting out insurance/reinsurance and asset/liability)
- New business impact on future cash in/out flows, risk adjustment & CSM

  (Splitting out transfers, bus combinations and onerous contracts)
- Quantitative (time bands) or qualitative on the expected release of CSM to P&L.
- Certain direct participating contract requirements (e.g. fair value, risk mitigation, OCI method etc.)

Judgements

- Measurement methods.
- Processes for estimating the inputs.
- Changes in methods and processes.
- Methods used to calculate finance income/expense if OCI option is used.
- Confidence level for risk adjustment measurement.
- Yield curves (discount rates).

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Disclosures (2)

Under IFRS 17 significantly more disclosures will be required compared to IFRS 4.

Risks

- Nature and extent of risks.
- Exposure.
- Procedures used to manage risks.
- Concentration of risks.
- Insurance and market risk – Sensitivity analysis and insurance claims development.
- Credit risk – Exposure and reinsurance quality.
- Liquidity risk – Maturity analysis by estimated timing of cash flows.
- Impact of regulatory regime.

Transition

Where modified retrospective and/or fair value approach is adopted:

- CSM and revenue reconciliation (under ‘Amounts’) separately for each.
- How the transition CSM was determined for each.
- Opening to closing reconciliation (where applicable) of the cumulative OCI for financial assets measured at FVOCI relating to the groups of insurance contracts.

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Closing comments

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Closing comments

- Solvency II likely to be the starting point for many insurers implementing IFRS 17, however, there will be differences (operational, technical and practical) to be considered (e.g. level of granularity, current reporting timelines, CSM 'model').
- Significant increase in disclosure requirements many of which are actuarial in nature:
  - Higher degree of automation and increased coordination within insurers likely to be required.
  - New business; CSM reconciliation and release to P&L; and extent of onerous contracts likely to be of external interest.
  - Implications of transition will be observable over business lifetime.
  - Will insurers continue to retain a separate operating profit and profit driver analysis?
  - Will this help explain the insurance 'story'? (Note: cash/dividends linked primarily to Solvency II while tax linked to the accounts (tbc))
- Don't forget that participating investment contracts (both measurement and disclosure) are unchanged from today!

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Questions

Comments

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