Reserving Seminar 2018
IFRS 17 Overview

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A work in progress

This presentation represents the views of the working party members and does not represent the views of the members' respective employers.

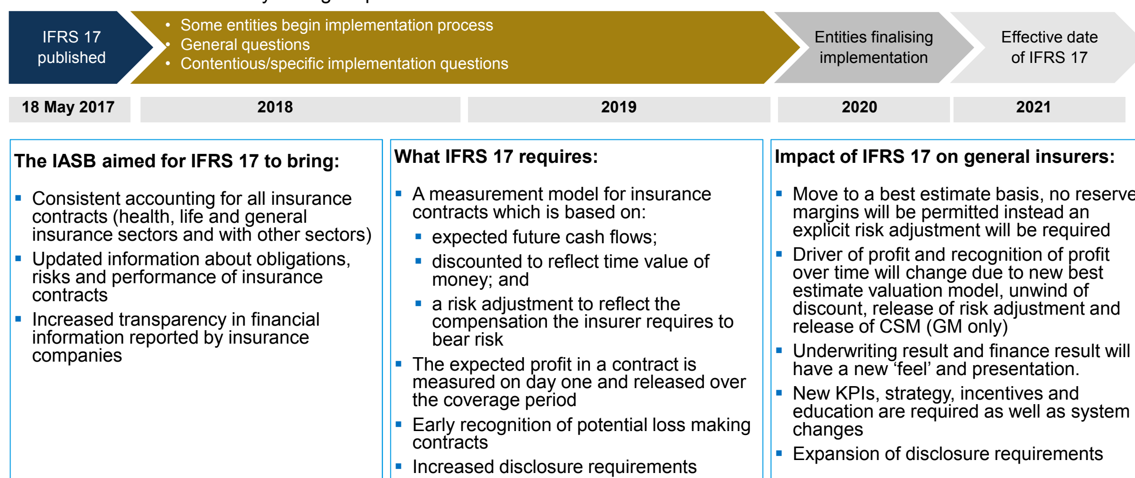
Our thinking is still a work in progress rather than agreed consensus views.

Agenda

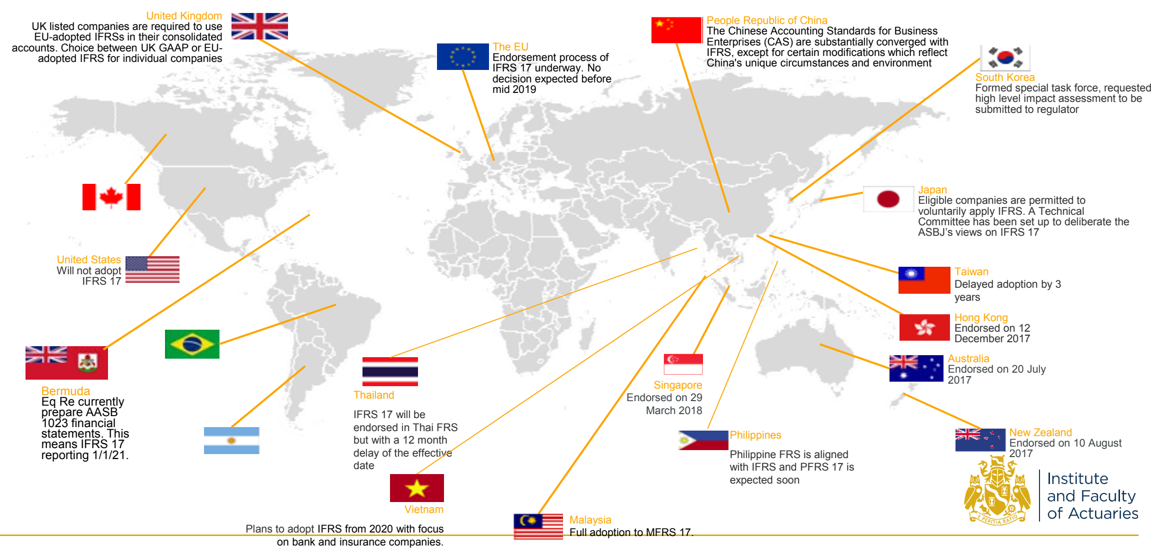
- Background to IFRS 17
- General overview of IFRS 17
- Key current practical implementation issues
  - PAA eligibility
  - Unit of account/onerous contracts
  - Risk Adjustment
  - Reinsurance

Overview of IFRS 17

IFRS 17 is the first truly international, comprehensive accounting Standard for insurance, replacing IFRS4 – an interim Standard that results in widely divergent practices



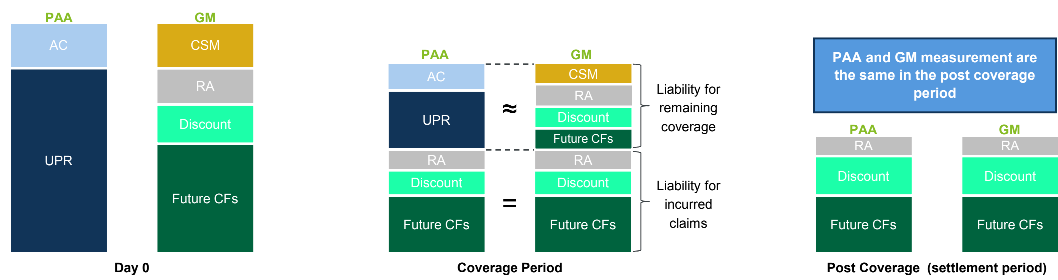
Adoption of IFRS 17 across the globe



Measurement model overview

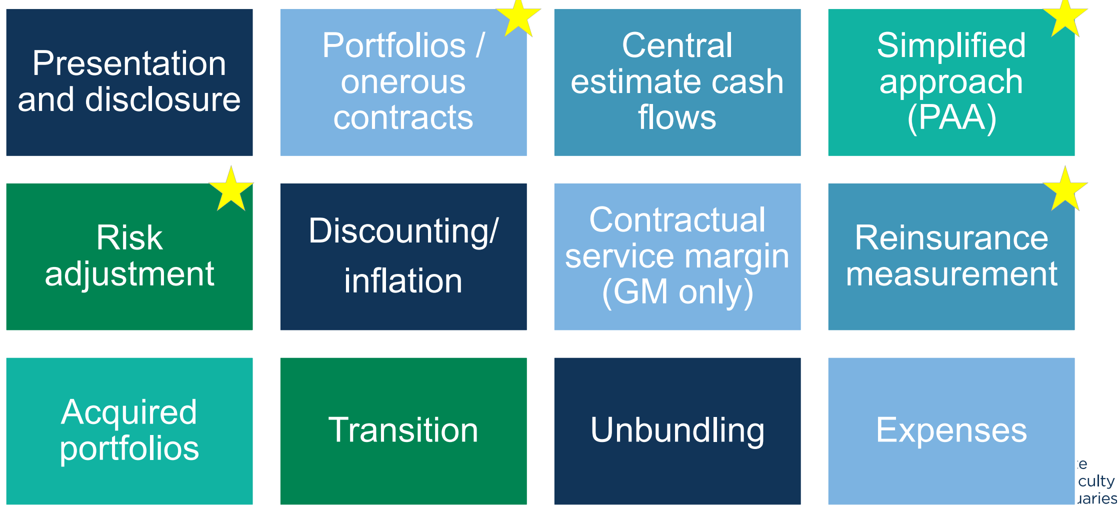
IFRS 17 introduces two measurement models:

1. **"General Model" (GM)** where unearned and earned coverage is all measured by considering discounted, risk-adjusted cash flows and profit is measured at inception by the Contractual Service Margin (CSM) which is earned out over the coverage period.
2. **"Premium Allocation Approach" (PAA)** which offers a simplified approach to measurement of unearned business.

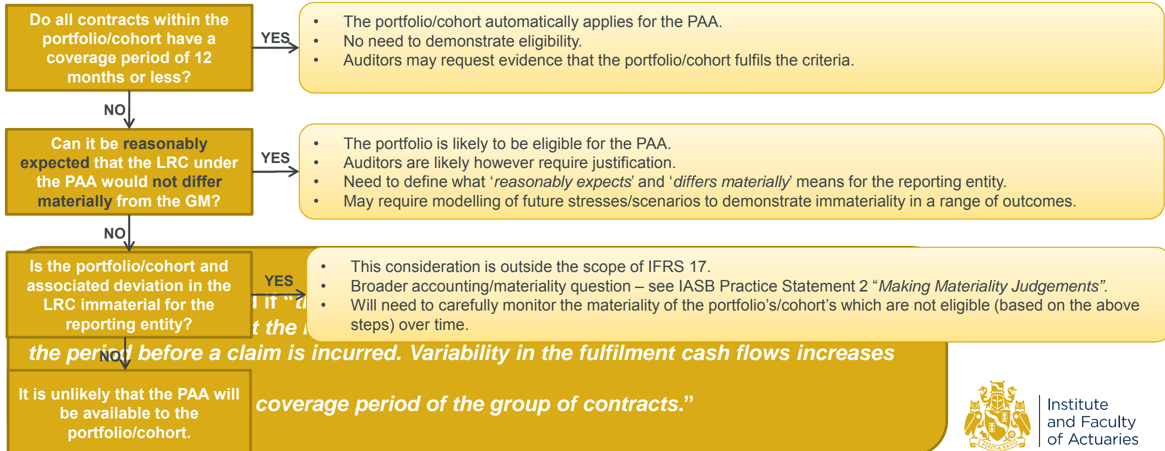


Contracts are eligible for the simplified approach if:

- the coverage period is 12 months or less; or
- if the entity reasonably expects it would produce a liability for remaining coverage for the group that would not **differ materially** from the one that would be produced under GM.



Overview of key areas of the standard
Presentation and disclosure
Portfolios / onerous contracts
Central estimate cash flows
Simplified approach (PAA)
Risk adjustment
Discounting/ inflation
Contractual service margin (GM only)
Reinsurance measurement
Acquired portfolios
Transition
Unbundling
Expenses



Premium Allocation Approach
When can it apply?
PAA Eligibility Decision
For each portfolio/cohort of contracts
Do all contracts within the portfolio/cohort have a coverage period of 12 months or less?
YES
The portfolio/cohort automatically applies for the PAA.
No need to demonstrate eligibility.
Auditors may request evidence that the portfolio/cohort fulfils the criteria.
NO
Can it be reasonably expected that the LRC under the PAA would not differ materially from the GM?
YES
The portfolio is likely to be eligible for the PAA.
Auditors are likely however require justification.
Need to define what 'reasonably expects' and 'differs materially' means for the reporting entity.
May require modelling of future stresses/scenarios to demonstrate immateriality in a range of outcomes.
NO
Is the portfolio/cohort and associated deviation in the LRC immaterial for the reporting entity?
YES
This consideration is outside the scope of IFRS 17.
Broader accounting/materiality question – see IASB Practice Statement 2 "Making Materiality Judgements".
Will need to carefully monitor the materiality of the portfolio's/cohort's which are not eligible (based on the above steps) over time.
NO
It is unlikely that the PAA will be available to the portfolio/cohort.
the period before a claim is incurred. Variability in the fulfilment cash flows increases
coverage period of the group of contracts."
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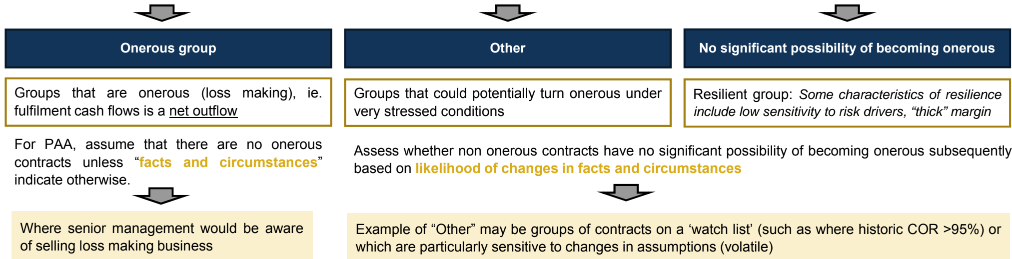
IFRS 17 introduces more rigorous measuring and reporting requirements for "groups" of loss making contracts

Measurement of insurance liabilities is (performed or allocated) at the level of a "group of insurance contracts" so that favourable and unfavourable changes in estimates from the individual contracts in the group are offset within the group but not with other groups.

IFRS 17 asks to consider profitability gross of reinsurance, and allowing for the effect of discounting and risk adjustment. For PAA groups, this is identified based on "facts and circumstances".

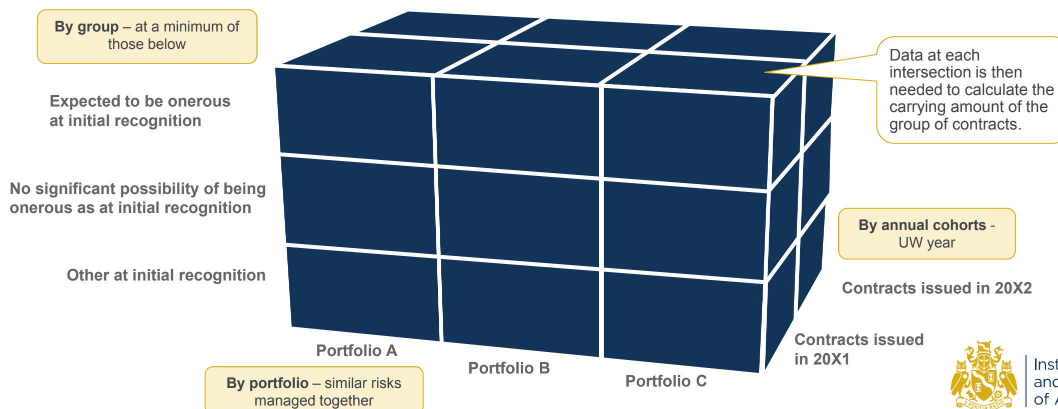
Divide a portfolio of insurance contracts into a minimum of the following (ie. consider each of the three groups below):



Identifying "groups" of insurance contracts

What the standard requires

IFRS 17 expects you to identify portfolios of insurance contracts which comprise contracts that have similar risks and are managed together. These portfolios are then divided into a minimum of three groups: a group of contracts that are onerous at initial recognition, a group of contracts that have no significant possibility of becoming onerous and a group of remaining contracts. In addition, within these groups there will be ***underwriting cohorts as a group cannot contain contracts that are issued more than one year apart.***

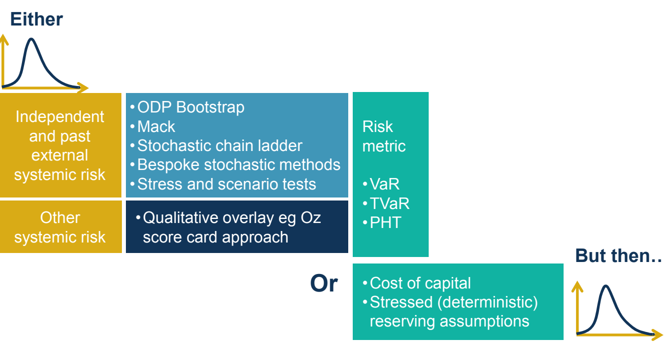


Risk Adjustment

The purpose of the risk adjustment for non-financial risk is to **measure the effect of uncertainty in the cash flows** that arise from insurance contracts, other than uncertainty arising from financial risk. [IFRS 17.B89]

Estimation technique
IFRS 17 does not mandate a method to estimate the Risk Adjustment required, but there is a requirement to publish the Confidence Level

Diversification benefits
Diversification benefits should be reflected and should be considered from the reporting entity's perspective



May TRG (Agenda Paper 2) conclusions

(1) Individual financial statements of an entity (subsidiary) that is part of a Group
Diversification benefit is only reflected to the extent it is considered by ***the subsidiary*** when determining the risk adjustment related to insurance contracts issued by the entity.

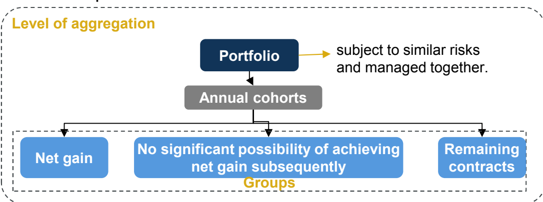
(2) Consolidated financial statements of the Group of entities
The risk adjustment at the consolidated level is the same as the risk adjustment at the individual entity level.

The level at which the target CL and hence the risk adjustment is set for each entity could have a material impact on the number of contracts being classified as onerous and will be important factors in the tests for onerous contracts.

Reinsurance

- IFRS 17 uses '**reinsurance contracts issued**' to describe inwards reinsurance contracts
- IFRS 17 describes outwards reinsurance contracts as '**reinsurance contracts held**'.
- Requirements in respect of reinsurance contracts issued are **the same as the requirements applicable to insurance contracts issued**
- These requirements are modified for reinsurance contracts held to reflect the specific features of reinsurance contracts held

Level of aggregation



Treatment of net gains and losses on reinsurance held

Net expense/loss on initial recognition	Net gain on initial recognition
On initial recognition, a **debit CSM** would typically be recognised which represents the net expense of purchasing reinsurance	If a net gain/credit CSM arises, i.e. amount paid for RI < expected PV of cash inflows plus risk adjustment

Recognise over coverage period as services are received

Exception: If reinsurance held covers events that have already occurred (e.g. ADC), recognise the whole net expense in P&L on initial recognition

PAA eligibility
Reinsurance contracts with coverage periods of a year or less are automatically eligible for the (simplified) premium allocation approach [PAA]

Coverage units for contracts applying the general model (GM)
The amount of CSM recognised in the P&L in each period is determined based on "coverage units". Coverage units are determined by considering the quantity of benefits provided under a contract and its expected coverage duration

Embedded derivatives
There may be derivatives embedded in insurance (or reinsurance) contracts that need to be accounted for separately under IFRS 9 Financial Instruments

Ceding commissions
Ceding commissions are included as one of the cash flows used to determine the gain or loss on a reinsurance contract held (rather than being recognised separately as income). If gross presentation of reinsurance income/expenses is selected, treat ceding commissions as:

a) part of the cash flows relating to claims or benefits in the underlying contracts when the commissions are contingent on claims; and otherwise
b) a reduction of the premiums to be paid to the reinsurer

* For proportional reinsurance held, the measurement on initial recognition should include all rights and obligations relating to future coverage, including in relation to underlying contracts not yet written

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