Introduction to IFRS 17

Will you be ready for 2021?

IFRS 17 Working Party

Helen Cooper, Hiscox
Overview

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

- Increased volatility in results
- Calculations and reconciliations
- New processes and systems
- Data requirements
- Technical understanding
- Reserving: New measurement basis, measurement of liabilities is key
- Capital: Risk adjustment - what approach, confidence level?
- Pricing: Inputs to reserving may change, product design may be affected
- Other actuarial roles: Management information, reporting
- Metrics for performance management
- More detailed disclosures
- Consistency with regulatory messaging
- Preparing investors for change
- Managing the messages to market

The actuary
# IFRS 17 timeline

<table>
<thead>
<tr>
<th>Area</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
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<tbody>
<tr>
<td>IFRS 17 timeline</td>
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<tr>
<td>Revised exposure draft</td>
<td>H1</td>
<td>H2</td>
<td>H1</td>
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<td>Final standard issued</td>
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<td>IFRS 17 Live (01/01/2022)</td>
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<td>H1</td>
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<td>IFRS 17 HY and FY reporting</td>
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<td>(including comparatives)</td>
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## Illustrative implementation timeline

- **Impact assessment and plan**
- **Design, implementation & Remediation**
  - Testing
  - Dry Runs YE 19/ HY 20
- **Prepare Comparatives**
  - Speed Run YE 20
  - Speed Run HY 21
- **IFRS 17 live**
- Opening BS
- Half year
- Year end

**24 April 2019**
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 (*)
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.

<table>
<thead>
<tr>
<th>Liability for remaining coverage</th>
<th>Akin to premium (less acquisition costs) unearned</th>
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<tbody>
<tr>
<td>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 &gt; 0) and record an asset as the PV of premiums receivable.</td>
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<td>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</td>
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Summary:

Size of boxes for illustrative purposes only.
Technical - Revenue recognition: PAA

- Liability for remaining coverage
  - Akin to premium (less acquisition costs) unearned
  - Release unearned premium relating to period and exposure
  - Release of risk adjustment relating to current period
    - Interest on insurance liability at inception rate (unwind of discount rate)
    - Changes in discount rates (update current market rates)
    - Changes in cash flows related to past and current services

- Liability for incurred claims
  - Probability weighted discounted expected present value of cash flows
    - Elected options
  - Liability for remaining coverage
  - Other comprehensive income (equity)

Flow to income or equity

Institute and Faculty of Actuaries
## The Building Block Approach (BBA)

The building block approach is the standard measurement model

### Contractual Service Margin

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<td>Contractual service margin (CSM) <strong>eliminates the recognition of any future accounting profit at inception</strong>. 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.</td>
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Size of boxes for illustrative purposes only.
Technical - Revenue recognition: BBA

- Contractual service margin
  - Changes in estimates related to future services
  - Probability weighted discounted expected present value of cash flows
  - Balance sheet measurement
- Risk adjustment
- Release of contractual service margin
- Release of risk adjustment relating to current period
- Interest on insurance liability at inception rate (unwind of discount rate)
- Changes in discount rates (update current market rates)
- Changes in cash flows related to past and current services
- Flow to income or equity
- Other comprehensive income (equity)
- Income statement (underwriting result)
- Income statement (investment result)

Elected options
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

### PAA
- Premium Allocation Approach (PAA)

- 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

24 April 2019
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

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

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<tr>
<th>1</th>
<th>Premium Allocation Approach or Building Block Approach</th>
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<td>Balance Sheet</td>
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<td>Insurance contract liabilities – unexpired (aka “UPR”)</td>
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<td>Reinsurance assets - unexpired</td>
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<th>Risk Adjustment – policy, method and assumptions</th>
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## 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
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.