IFRS 17 - Only 2 years to go, where are we and what are the key issues for the UK market?

Speakers: Richard Olswang, Gail Tucker and Anthony Coughlan

Chair: Kamran Foroughi

Members of the Financial Reporting Group, IFoA

Agenda

• Industry developments
• IASB & TRG developments
• Current focus areas for UK Life products
• IFoA and IAA response to IFRS 17
IFRS 17 required in the consolidated accounts of publicly traded companies when endorsed by the EU

Technical Endorsement Criteria:
- Relevance
- Reliability
- Comparability
- Understandability
- Conducive to the European Public Good

EFRAG Process

**Evidence gathering**
- Detailed case study: 11 submissions, of which 9 CFO Forum
- Simplified case study: 49 submissions, of which 11 CFO Forum
- User outreach: 27 users

**Economic study**
- Competition
- Products & pricing
- Asset allocation
- Funding of insurance undertakings

**Presentations to EFRAG Board**
- CFOs, users, audit profession, actuarial profession, reinsurers
- CFO Forum Chairman presented summary of case study results

**Development of advice**
- Draft endorsement advice
- Two month public consultation period
- Final advice then sent to European Commission
CFO Forum findings

• Testing provided evidence of 11 significant issues and their impact:

- Measurement
- Operational complexity
- Implementation challenges

⚠ These issues need to be resolved in IFRS 17 before endorsement

• In addition, the implementation timelines are very challenging

Total implementation cost for 12 companies providing estimates of €1.9 bn

EFRAG response: Letter to IASB

• EFRAG preparing draft endorsement advice on IFRS 17
• EFRAG has conducted significant outreach
• Constituents have raised a number of concerns
• EFRAG has not yet determined impact of issues on draft endorsement advice
• EFRAG Board identified 6 issues that merit further consideration by IASB
### Concerns & implementation challenges (1)

<table>
<thead>
<tr>
<th>Scope of IFRS 17</th>
<th>CFO Forum finding</th>
<th>In EFRAG letter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans that transfer insurance risk</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Level of aggregation</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Annual cohorts, profitability groups</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Acquisition cash flows</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Allocation to future renewals</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Discount rate</td>
<td>✓</td>
<td>✗</td>
</tr>
<tr>
<td>Locked in rate under General Model</td>
<td>✓</td>
<td>✗</td>
</tr>
<tr>
<td>Prescribed approach</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Risk adjustment</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Assessment at group level vs. entity level</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>CSM: Coverage units</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Allowance for investment services outside VFA</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>CSM: Hedging</td>
<td>✓</td>
<td>✗</td>
</tr>
<tr>
<td>Scope of hedge adjustment</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Premiums received</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Identification for groups of contracts</td>
<td>✗</td>
<td>✗</td>
</tr>
</tbody>
</table>

### Concerns & implementation challenges (2)

<table>
<thead>
<tr>
<th>Business combinations</th>
<th>CFO Forum finding</th>
<th>In EFRAG letter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Classification of contracts</td>
<td>✓</td>
<td>✗</td>
</tr>
<tr>
<td>Contracts acquired during settlement period</td>
<td>✓</td>
<td>✗</td>
</tr>
<tr>
<td>Reinsurance</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Asymmetry in profit recognition</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Ineligibility for VFA</td>
<td>✓</td>
<td>✗</td>
</tr>
<tr>
<td>Inconsistent contract boundaries</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Presentation</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Separation of contracts in asset / liability position</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Cash paid vs. received</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Permitting OCI accounting</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Exclusion of investment component from revenue(^1)</td>
<td>✓</td>
<td>✗</td>
</tr>
<tr>
<td>Offseting liability by funds withheld(^1)</td>
<td>✓</td>
<td>✗</td>
</tr>
</tbody>
</table>

\(^1\)Not included in IASB Board papers
Concerns & implementation challenges (3)

<table>
<thead>
<tr>
<th>Concern</th>
<th>CFO Forum finding</th>
<th>In EFRAG letter</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Scope of VFA</strong></td>
<td>Inconsistent treatment of economically similar products</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Interim accounts</strong></td>
<td>Leads to dual accounting</td>
<td>✗</td>
</tr>
<tr>
<td><strong>Effective date</strong></td>
<td>Implementation challenges</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>Requirement for comparatives</td>
<td>✗</td>
</tr>
<tr>
<td></td>
<td>Deferral of IFRS 9</td>
<td>✗</td>
</tr>
<tr>
<td><strong>Transition</strong></td>
<td>Optionality</td>
<td>✗</td>
</tr>
<tr>
<td></td>
<td>Modifications to the Modified Retrospective Approach</td>
<td>✓</td>
</tr>
<tr>
<td></td>
<td>OCI balance under the Fair Value approach</td>
<td>✓</td>
</tr>
</tbody>
</table>

Other developments in October 2018

<table>
<thead>
<tr>
<th>Development</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>European Parliament</strong></td>
<td>Adopted IFRS 17 motion</td>
</tr>
<tr>
<td><strong>CFO Forum</strong></td>
<td>Letter to IASB proposing solutions to issues identified</td>
</tr>
<tr>
<td><strong>Global insurance industry</strong></td>
<td>Letter from 9 insurance associations</td>
</tr>
<tr>
<td></td>
<td>Supports issues raised by CFO Forum and calls for 2 year delay</td>
</tr>
<tr>
<td><strong>EIOPA/ESMA/EBA</strong></td>
<td>Calls for transparency in endorsement process</td>
</tr>
<tr>
<td></td>
<td>Reiterates need for implementation in 2021</td>
</tr>
<tr>
<td><strong>EIOPA</strong></td>
<td>IFRS 17 beneficial to European public good</td>
</tr>
<tr>
<td></td>
<td>Options in IFRS 17 may lead to lack of comparability</td>
</tr>
<tr>
<td></td>
<td>Reinsurance and level of aggregation require further consideration</td>
</tr>
<tr>
<td><strong>EFrag</strong></td>
<td>Letter to EIOPA/ESMA/EBA clarifying its approach to the endorsement process</td>
</tr>
</tbody>
</table>
IASB response

- Concerns and implementation challenges discussed at October IASB meeting:
  - IFRS 9 for insurers link and status key Board concern
- Board agreed criteria to assess whether there is a need to amend IFRS 17:
  a) amendments would not result in significant loss of useful information
  b) amendments would not unduly disrupt implementation processes already under way
  c) New evidence required to justify changes to previous decisions
- Board agreed at November 2018 meeting to defer IFRS 17 & IFRS 9 to 2022
- From December 2018 onwards:
  - Staff will assess how each issue stacks up against the criteria for change.
  - Board will be asked for direction on what to do next.

Purpose of the TRG

1. Established to support IFRS 17 implementation - Enhance the quality and consistency of implementation
2. Public forum for stakeholders to follow the discussion of questions submitted
3. Helps the Board to identify if more support is needed
4. Webcasts, papers, podcasts and other educational material
TRG meetings
Meetings 6 February, 2 May, 26-27 September 2018, 4 April 2019 and ...

**Guidance**
- TRG does not issue guidance, but assists Board in identifying actions to take
- Very high hurdle for amendments

**Membership**
- 6 auditors and 9 preparers. Preparers: 4 from Europe, 3 from Asia, 1 each from Canada / Australia
- Observers from IAA, IAIS and IOSC

**Papers and minutes**
- IASB papers available 2 weeks in advance. Minutes and podcast on IASB website

**Submissions**
- Anyone can submit an issue if it relates to IFRS 17, may result in diversity in practice and expected to be pervasive

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TRG Submissions and discussions

- 42 submissions (20 technical papers) subject to detailed TRG discussions
- 33 submissions not subject to detailed discussions – reported to the TRG and commented by exception only:
  - 24 answered by applying the words in the standard
  - 6 do not meet the submission criteria
  - 3 resulted in proposed annual improvements
- 2 submissions related to mutuals led to educational material
- 4 submissions reported to Board as operational challenges
  - Presentation of assets and liabilities
  - Premiums received in applying PAA
  - Treatment of contracts acquired in settlement period

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November 2018
Some TRG discussions relevant for life insurers

Gail’s top 4 TRG topics for UK life insurers

- Top down discount rate
- Contracts with mutualisation
- Coverage units to amortise CSM
- Combination and separation of insurance components

Other considerations

- Ongoing implementation
- Frequency of financial crises

Figure 11: Occurrence of Financial Crises through history (binary variable: 1 = Crisis)
Current topics for UK life products (1/2)

**Annuities**
- Discount rates – Reference portfolio, default allowance and implications
- CSM/profit released over deferred period
- Treatment of annuity guaranteed periods – distinct investment component?
- Investment expenses – excluded?
- Bulk transfers from ‘buy in’ to ‘buy out’ – new contract(s)?
- Reinsurance mismatch – longevity risk

**Protection**
- Reinsurance – Mismatches and P&L volatility
- Mismatch from day 1 lock-in for CSM
- Definition of portfolio and extent of offsetting
- Assessment of the illiquidity premium
- Transition – Separate consideration of gross and reinsured CSM

Current topics for UK life products (2/2)

**With profits**
- Practical application of the variable fee approach
- Definition of underlying item and implications
- Aggregation and grouping including mutualisation
- Illiquidity premium and stochastic modelling
- Treatment of non-profit contracts within funds – mismatches?

**Other topics**
- Practical approaches to the risk adjustment and related disclosures
- Transition – Application of FRA & MRA and what is fair value?
- Onerous contracts and profitability groups
- Dual reporting – Interims, expense look-through etc.
- Approach to hybrid (unit linked/with profit) contracts
- Eligibility for the variable fee approach

November 2018
**IFoA cross-practice Financial Reporting Group**

**Current focus:**
- Steering IFoA activity related to financial reporting
- Supporting IAA ISAP 4 / IAN 100 development & IFoA response
- Engaging with external stakeholders (IASB, EFRAG, FRC, HRMC etc.) as appropriate

**Past materials:**
- Life Conference presentations 2010-2018
- July & September 2017 Staple Inn seminars
- 2011 Staple Inn paper critiquing 2010 ED
- 2013 published IFoA response to 2013 ED

**Current membership:**
- Kamran Foroughi (Chair)
- Anthony Coughlan
- Nick Dexter
- Richard Olswang
- Tony Silverman
- Gail Tucker
- Martin White
- Derek Wright
- Murray Wright

**IFoA Life IFRS 17 working parties recently established**

<table>
<thead>
<tr>
<th>Future of discount rates</th>
<th>Contractual Services Margin</th>
<th>Transversal issues</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Chair:</strong> Richard Olswang</td>
<td><strong>Chair:</strong> Rebecca Brown</td>
<td><strong>Chair:</strong> Dom Veney</td>
</tr>
</tbody>
</table>

November 2018
IFoA support & response to ISAP 4 & IAN 100

• **International Standard of Actuarial Practice 4:**
  - Purpose to increase confidence that IFRS 17 related actuarial services IFRS 17 carried out professionally and with due care
  - Less than 10 pages covering: Standards across knowledge requirements, GMM, VFA, disclosures and transition.
  - Exposure draft period in H1 2018 with revised (final) draft expected February 2019 for publication in 2019.

• **International Actuarial Note 100:**
  - Non-binding educational document c. 100-200 pages.
  - 17 chapters divided into 4 sections: GMM, Model variations (PAA, participating, reinsurance), Uses of fair value, Other
  - Includes Q&A
  - All chapters drafted with exposure draft targeted late 2018.

**Current volunteers:**
- Anthony Coughlan (Chair)
- Derek Wright (IAA)
- Tamsin Abbey
- Darren Clay
- Greg Douglas
- Sophia Ch’ng Sok Heang
- Joanne Lonergan
- Natalia Mirin
- Erica Nicholson
- Ainsley Normand
- Michael Reid
- Lucinda Parlett
- Mark Sweetenham
- Nick Walker
- Martin White

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**Questions**

**Comments**

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