Background and timelines
Effective date is January 2021

- Standardised – global, industries, direct and reinsurers
- Liabilities and Profit-recognition
Overview of IFRS 17
Objective (as described by IASB)

The objective of IFRS 17 is to ensure that insurance companies provide relevant information that faithfully represents insurance contracts. This will allow users of the financials to assess the impact that insurance contracts have on the financial position, financial performance and cash flows.

On doing this, IFRS will create standards for insurers (and other entities) to:

- **Identify insurance contracts** that fall within the scope of the standard
- **Divide the contracts into groups** that it will recognise and measure
- **Recognise for each group** the amount relating to the:
  - Fulfilment cashflows: the risk adjusted present value of the future cashflows that are expected to arise as the entity fulfils the insurance contracts; and
  - Contractual service margin: the unearned profit in the group of contracts.
- **Remeasure the group** by updating the fulfilment cashflows and the contractual service margin over time

**Operational impact** - the implications of this IFRS transformation initiative are not just technical calculations, but will affect amongst others: Actuarial (reserving), Finance (general ledger, reporting processes), Tax (treatment), IT (data storage, finance systems), HR (remuneration) and Investor Relations (presentations)
Balance Sheet
What do the liabilities look like?
Current reporting approach – how an insurer currently determines profits

Actual cashflows combined with change in actuarial reserves = earnings

**Current IFRS profit / loss**

- Revenue
  - Premium Income

- Actual claims / expenses
  - Actual net cash outflows during the period

- Increase in net liability
  - Increase in actuarial reserves

+ Investment income
  - Actual investment earnings on assets backing net liabilities

- Current IFRS 4 does not specify how the actuarial reserves should be calculated.
  - In Mauritius, there is some guidance around the approach to be used...
  - however this guidance allows for a wide range of options leading to very different results between, in particular, life insurers.
  - Across the world many different approaches are used.

- IFRS 17 will specify how the actuarial reserves should be calculated, and this will then drive uniform profit recognition.
IFRS 17 now specifies how reserves should be calculated
Building Block Approach is the specified method

Total IFRS 17 Insurance Liability

- **Block 4**
  - Contractual Service Margin
  - Obligation to provide a service to the policyholder over the term of the contract

- **Fulfilment cash flows**

- **Block 3**
  - Risk adjustment
  - Adjustment for uncertainty in the expected future cash flows

- **Block 2**
  - Time value of money
  - Use a market consistent discount rate that considers timing and liquidity of liability cash flows

- **Block 1**
  - Expected future cash flows
  - Expected cash flows: Premiums, expenses, claims
BBA vs. PAA Model
The Requirements

The general model: Building Blocks Approach (BBA)
Measurement objective is to quantify the notion of the insurer’s “fulfilment of obligations under the contract”

Simplified approach: Premium Allocation approach (PAA)
Simplified approach to measuring the value of insurance contracts if eligibility criteria is met
So there are elements that are similar
But main difference is the two new components introduced into the reserving calculation

In addition to the present value of future insurance cashflows (premiums, claims, expenses), IFRS 17 will introduce two new concepts in the insurance contract reserves determined for reporting purposes:

• **Contractual Service Margin (CSM)**
  A mechanism for recognising profits on insurance contracts being earned over the life of the contract.

• **Risk Adjustment (RA)**
  A reserve which reflects the risks in the contract to which shareholders are exposed. This reserve is released over time as the risk in the future cashflows reduces.

The profiles of the release of the CSM and RA into P&L are different.
Building Block Approach for Long-term Insurance
How the components are calculated – Fulfilment Cashflows

**Discounted Best Estimate cashflows (not much change here)**

- Project all cashflows based on data from the Policy Administration System (PAS)
- Apply demographic and expense assumptions to get a best estimate assessment of the future premiums, claims, commission and expenses
- Discount the cashflows to give the best estimate actuarial liability (BEL)
- If the policies are profitable, the BEL will be negative at inception (i.e. a negative actuarial liability), and the BEL may become positive over the life of the contract

**Risk adjustment**

- The company must make an assessment of the ‘riskiness’ of the cashflows and determine an adjustment to liability to reflect this risk
- For example long term contracts will be more risky than short term contracts
- The Risk Adjustment will always be a positive liability
Building Block Approach for Long-term Insurance

How the components are calculated – Contractual Service Margin

**Contractual Service Margin**

- CSM is set up at inception of contract and is added to the liability

- If a contract is profitable (BEL + RA < 0), the CSM is set so that the profit recognised at inception is zero:

  \[
  \text{Liability} = \text{BEL (negative)} + \text{RA (positive)} + \text{CSM (positive)} = 0
  \]

- If a contract is not profitable (BEL + RA > 0), the CSM is set to zero, so that at inception the company recognises a loss:

  \[
  \text{Liability} = \text{BEL (positive)} + \text{RA (positive)} + \text{CSM (zero)} > 0
  \]

Thus CSM is determined so that **profit emerges in line with general accounting principles**:

- Recognises profit over the life of contract
- Recognises a loss if contract is onerous at inception
Insurance traditionally operates on a principle of cross subsidy, where profitable and loss making contracts offset each other’s financial performance.

In line with general accounting principles, IFRS 17 needs to ensure that there is different treatment of profitable and loss making (onerous) contracts:

- On profitable contracts, CSM is set up at inception, and acts to spread profit release over the life of the contracts (no profit at inception).
- On loss making (onerous) contracts no CSM is set up, so we incur the full loss immediately.

IFRS 17 needs to ensure consistency of treatment of profitable/loss making cross subsidies across all entities:

- IFRS 17 creates the notion of product portfolios and groups.
Limited cross subsidy of onerous contracts with profitable contracts allowed

Portfolio
- Similar risks
- Managed together
- Open-ended
- Product group is a valid example

Year X
- Highly profitable group*
- Other profitable group

Year X+1
- Highly profitable group*
- Other profitable group

Year X+2
- Highly profitable group*
- Other profitable group

Contract boundary, Cash flows & Discount rate

CSM to be recorded and released over time

Loss incurred at inception

* The actual wording in the draft standard is “…at initial recognition have no significant risk of becoming onerous…”
VFA – Variable Fee Approach

A special case of BBA for Unit-Linked (“Direct Participating”) business – a different approach to profit recognition

- When contractual terms specify that the policyholder participates in a defined share of a clearly identified pool of underlying items (e.g. unit linked policies) insurers must use VFA

- In the general measurement model (BBA approach), the net gains and losses that the entity retains from invested premiums are treated as if they were a share of economic returns from the investment portfolio (i.e. the insurance company earns the investment return)

- In the variable fee approach, the net gains and losses belong to the policyholder. The entity receives a fee for service provided to the policyholders.
Different approach to profit recognition

- Where VFA **does not** apply, changes in surplus due to economic performance or assumption changes are posted to P&L or OCI.
- Where VFA **does** apply, changes in economic performance or assumption impact the estimate of the future variable fees. The effect of this change in estimation are added to the CSM.

**General Measurement Model**

- All surplus assets are allocated to shareholders
- Changes will go to P&L or OCI

**Variable Fee Approach**

- A variable fee that the entity charges policyholders
- Changes will go to CSM
Balance Sheet
Illustrative Examples
**Measurement requirements**

Overview measurement at initial recognition

---

**Balance Sheet Liability**

- **Block 1 + Block 2 + Block 3 < 0**
  - Recognise Contractual Service Margin (= Block 4) to eliminate Day One Gain (at inception before any cash flows are received or paid)

- **Block 1 + Block 2 + Block 3 > 0**
  - Recognise Day One Loss (Onerous Contract)

---

**Accounting Perspective of the Insurance Contract Liability**

- negative amount increases liability and positive amount decreases liability

---

© 2018. For information, contact Deloitte Touche Tohmatsu Limited
### Illustrative Example

Roll-forward of BEL from T0 to T1

<table>
<thead>
<tr>
<th>Year 1</th>
<th>BEL Roll-Forward</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Opening balance</td>
</tr>
<tr>
<td></td>
<td>Premiums received (Actual)</td>
</tr>
<tr>
<td></td>
<td>Death benefits - expected</td>
</tr>
<tr>
<td></td>
<td>Surrender benefits - expected</td>
</tr>
<tr>
<td></td>
<td>Maturity benefits - expected</td>
</tr>
<tr>
<td></td>
<td>Maintenance expenses</td>
</tr>
<tr>
<td></td>
<td>Acquisition expenses</td>
</tr>
<tr>
<td></td>
<td>Experience variance due to premium (E-A)</td>
</tr>
<tr>
<td></td>
<td>Changes in estimates (exp. Or Assumptions)</td>
</tr>
<tr>
<td></td>
<td>Interest accreted</td>
</tr>
<tr>
<td></td>
<td>Change in discount rates</td>
</tr>
<tr>
<td></td>
<td>Ending balance</td>
</tr>
</tbody>
</table>

![BEL Roll-Forward Diagram](chart.png)
Income Statement
What do earnings look like?
IFRS 17 earnings and reserves compared to IFRS 4 situation

Under IFRS 4 significant earnings are realised upfront (assume no discretionary margins and a profitable contract)

Term Assurance

- Large upfront profit at point of sale
- Small profits thereafter through release of compulsory margins

Policy Liabilities

- Release of compulsory margins

Contract life

Profit or loss

© 2018. For information, contact Deloitte Touche Tohmatsu Limited
New IFRS 17 income statement
Revenue is no longer as linked to cashflows

### Current IFRS profit / loss
- **Revenue**
  - Premium Income
- **Actual claims / expenses**
  - Actual cash outflows during the period
- **Increase in net liability**
  - Increase in actuarial reserves
- **Investment income**
  - Actual investment earnings on assets backing net liabilities

### IFRS 17 profit / loss
- **Revenue**
  - Expected net cash outflows during the period (excl. investment income & adjusting to spread acquisition costs).
- **Actual claims / expenses**
  - Actual net cash outflows during the period (excl. investment income & adjusting to spread acquisition costs).
- **Other underwriting profit items**
  - Loss recognition on onerous contracts (incl. initial)
  - Experience Variance recognised in year
  - Effect of changes in credit standing of issuer of RI held
- **Investment gain / loss**
  - Unwind of discount rates on insurance liabilities
  - Actual investment earnings on assets backing liabilities
  - Impact of changes to assets values due to interest rate changes
  - Impact of change in investment assumptions on BEL and RA

Not in scope of IFRS 17 but elections under IFRS 9 exist
New IFRS 17 income statement
Separation of insurance service result and insurance financing income/expense
IFRS 17 income statement
Illustrative example

<table>
<thead>
<tr>
<th>Statement of Comprehensive Income</th>
<th>T1 31-Dec-16</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Insurance Contract Revenue</strong></td>
<td>1 519.65</td>
</tr>
<tr>
<td>Expected claims</td>
<td>1 500.00</td>
</tr>
<tr>
<td>Expected insurance service expenses</td>
<td>100.00</td>
</tr>
<tr>
<td>Acquisition costs amortised</td>
<td>250.00</td>
</tr>
<tr>
<td>Change in Risk Adjustment</td>
<td>163.95</td>
</tr>
<tr>
<td>CSM amortisation</td>
<td>-</td>
</tr>
<tr>
<td>Loss component Adj.</td>
<td>- 494.30</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Insurance services claims and expenses incurred</th>
<th>(2 477.35)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Claims incurred</td>
<td>(1 500.00)</td>
</tr>
<tr>
<td>Attributable expenses incurred</td>
<td>(100.00)</td>
</tr>
<tr>
<td>Amortisation f/ acquisition costs</td>
<td>(250.00)</td>
</tr>
<tr>
<td>Initial Loss recognition on onerous contract</td>
<td>(1 121.65)</td>
</tr>
<tr>
<td>Losses recognised</td>
<td>-</td>
</tr>
<tr>
<td>Reversal of Loss</td>
<td>-</td>
</tr>
<tr>
<td>Loss component Adj.</td>
<td>494.30</td>
</tr>
</tbody>
</table>

| Others                                        | -          |
| Experience variance from Premium             | -          |
| Net Gain (Loss) from contract derecognition  | -          |

| Underwriting Result                          | - 957.70   |

| Other expenses (Non-direct expenses)         | -          |

| Investment income/expense                   | -          |

| Insurance finance expenses and economic bases| 4.22       |
| Insurance investment expenses/income BEL    | - 39.71    |
| Insurance investment expenses RA             | 43.94      |
| Insurance investment expenses CSM            | -          |
| Economic basis change                        | -          |

| Finance Result                               | - 4.22     |

| Net financial result before taxes            | - 961.92   |

| Income taxes                                 | -          |

| Profit or loss                               | - 961.92   |
Transition
Transition
Creating a transitional balance sheet is not a trivial exercise

An opening balance sheet needs to estimate CSM’s and future profit emergence for policies sold prior to implementation date of IFRS 17. Where data is not available, various pragmatic solutions are available.

Three approaches to transition for the BBA:

1. The retrospective approach should be applied to groups of insurance contracts, unless it is impracticable or if groups at inception of contracts in force on transition cannot be identified.

2. An entity is then permitted to choose between the modified retrospective approach and the fair value approach. The modified retrospective approach comprises the building block approach and the variable fee approach for direct par contracts.

3. Where impracticable to apply the modified retrospective approach, a fair value approach is applied from the date of transition.

Key definitions in transition

Impracticable: Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. (IAS 8 P5)

Fair value: The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (IFRS 13.A)
Transition

Insurers need to estimate what the CSM would have been at policy inception and what it is on IFRS17 date

- The objective of the modified retrospective approach and FV approach is to approximate full restatement. The use should be only to the extent the entity does not have reasonable and supportable information to restate.

- The grouping for multiple periods when the fair value approach is adopted is permitted. The CSM accretion rate for non-par and indirect par contracts is locked in at transition.

- Similar to IFRS 10 and IFRS 12, a relief is given from the requirement to present an additional comparative period.

This is for a December year-end company. June year-end companies have an additional 6 months
Timeline and Implementation Considerations
Implementation Considerations
Other elements outside profit reporting will be affected
Other impacts are not just technical calculations and will take up additional project time:

- **Product strategy**
  - Product profit patterns (pricing, KPIs, business plans, results)

- **HR impacts:**
  - Finance and Actuarial working together more
  - Actuaries more involved in audits

- **Information Technology impacts:**
  - Policy Administration systems
  - Actuarial projection systems (Prophet)
  - Sub-ledgers / Database / General Ledger

- **ALM impacts:**
  - Investment margin and earnings volatility management
  - Reassess asset classes against their new profit profile and against backed insurance liabilities
Roll out plans and timelines

Expected effort mapping

<table>
<thead>
<tr>
<th>Year</th>
<th>Key Dates</th>
<th>Project Milestones</th>
<th>Effort Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>1/2018 IFRS 9 Effective date</td>
<td>Preliminary plan, design and budget approval</td>
<td>* Target Operating Model</td>
</tr>
<tr>
<td>2016</td>
<td>Final standard</td>
<td>Impact assessment and business case</td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>1/2019 Potential early adoption</td>
<td>Design new TOM*</td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td></td>
<td>Build and Implement</td>
<td></td>
</tr>
<tr>
<td>2019</td>
<td></td>
<td>Check / UAT / user training</td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td></td>
<td>Transition</td>
<td></td>
</tr>
<tr>
<td>2021</td>
<td>1/2021 Effective date</td>
<td>Finalise comparatives and OBS</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Parallel runs</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Go live</td>
<td></td>
</tr>
</tbody>
</table>

* Target Operating Model
Project Effort
More than just Actuarial & Finance

- Actuarial Methodology
- Data
- Assumptions
- Prophet
- Reinsurance
- Actuarial Analysis
- Database + IT Flow
- End User Computing
- General Ledger (GL)
- End User Computing
- Reporting & Disclosures
- Management Oversight
- Programme Management Office (PMO)
- Business Decisions (Pricing, ALM, Scorecard KPIs)

Expected proportion of total project cost spend on the activities:

- End User Computing: 15%
- General Ledger (GL): 5%
- End User Computing: 5%
- Reporting & Disclosures: 5%
- Management Oversight: 20%
- Programme Management Office (PMO): 15%
- Business Decisions (Pricing, ALM, Scorecard KPIs): 20%
- Transition + Comparatives: 10%
- End-to-end testing: 5%
Practical Steps Forward
Practical Steps

Financial Impact Analysis

Product X – Reserve profiles

2017 New business

2017 In force book
Practical Steps

Business Impact
## Practical Steps

### Business Impact

<table>
<thead>
<tr>
<th>TOM Taxonomy vs. IFRS Technical Topics</th>
<th>IFRS 4 Phase II Technical Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. Unbundling</td>
<td>4. Discounting</td>
</tr>
<tr>
<td>5. Risk adjustment</td>
<td>6. Contractual Service Margin</td>
</tr>
<tr>
<td>13. Transition</td>
<td></td>
</tr>
</tbody>
</table>

### Process

- Significant Change:
- Moderate Change:
- Low / May Change:
- No Change/ Out of Scope:

### System

- Significant Change:
- Moderate Change:
- Low / May Change:
- No Change/ Out of Scope:

### Data

- Significant Change:
- Moderate Change:
- Low / May Change:
- No Change/ Out of Scope:
IFRS 17 Technical Hot Topics
Aspects that are getting the most attention now

- Different income statement and balance sheet. This will result in new KPIs, strategy, incentives, etc. Training and education will be required at all levels. Statutory and Management bridges may become more complex.

- Current profit profiles will be impacted giving rise to potential strategic or business decisions. Longer tail and riskier business will be more affected by the IFRS 17 valuation model.

- OCI solution provides a vehicle to protect from volatility in profit or loss (P&L) due to change in yield curve. This comes at a potentially higher operational cost.

- More granular measurement of onerous losses. With-profit business could potentially be calculated at a more aggregated level due to mutualisation.

- Alternative valuation and consolidation rules for material acquired business (internal or external).

- PAA used as 100% measurement basis is a significant simplification operationally. Premiums receivable from policyholders will no longer be presented within the receivables line.

- Existing model best estimate cash flows can be leveraged for IFRS 17. However, attributable expenses need to be revisited under IFRS 17.

- The disclosure of the confidence interval for risk adjustment will introduce a new level of transparency and constrain how insurers use margins in their reserves.

- Generally, the requirements for reinsurance are the same for direct business. The direct and ceded business both need to be presented and disclosed separately.

- New balance sheet position needed as at 31/12/19 rolled forward to 31/12/20 under IFRS 17. Financial Impact and operational challenges both need to be considered when selecting the approach at transition.
Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. The more than 200 000 professionals of Deloitte are committed to becoming the standard of excellence.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this communication, rendering professional advice or services. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.

© 2018 Deloitte & Touche. All rights reserved. Member of Deloitte Touche Tohmatsu Limited