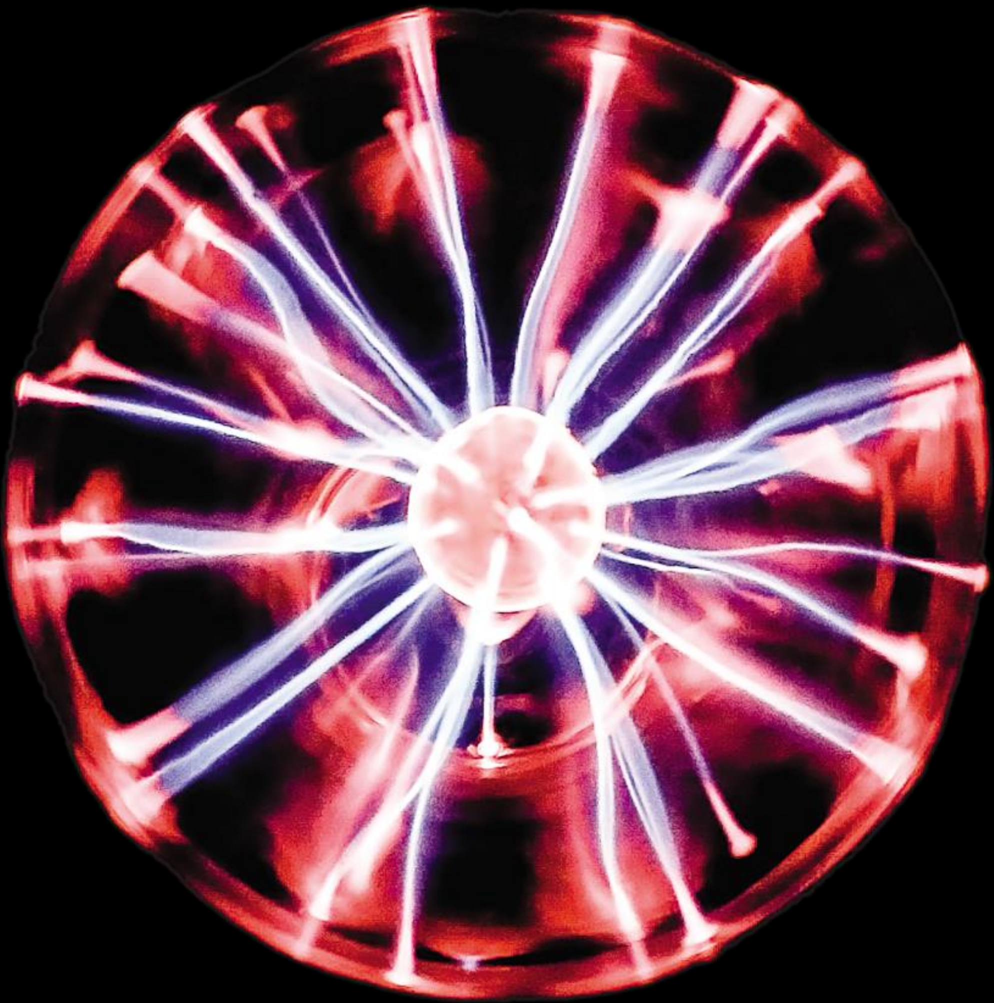


IFRS 17

IFoA - Mauritius

23rd April 2018

Background and timelines

Effective date is January 2021

1996-2017: Develop (IFRS4 2005; ED 2010; ED 2013)

Feb 2017: IASB voted to begin the balloting process

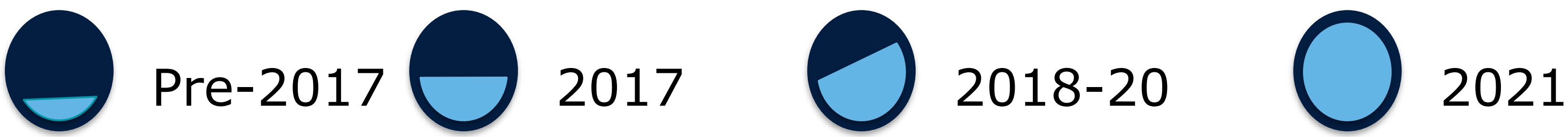
May 2017: IASB publishes IFRS17 *Insurance Contracts*

2018- 2020 Insurers prepare themselves for IFRS implementation readiness

1/1/2021: Effective date for periods beginning on or after this date

With 1 year comparatives, 1st date of IFRS17-ready balance sheet will need to be 1/1/2020

- 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

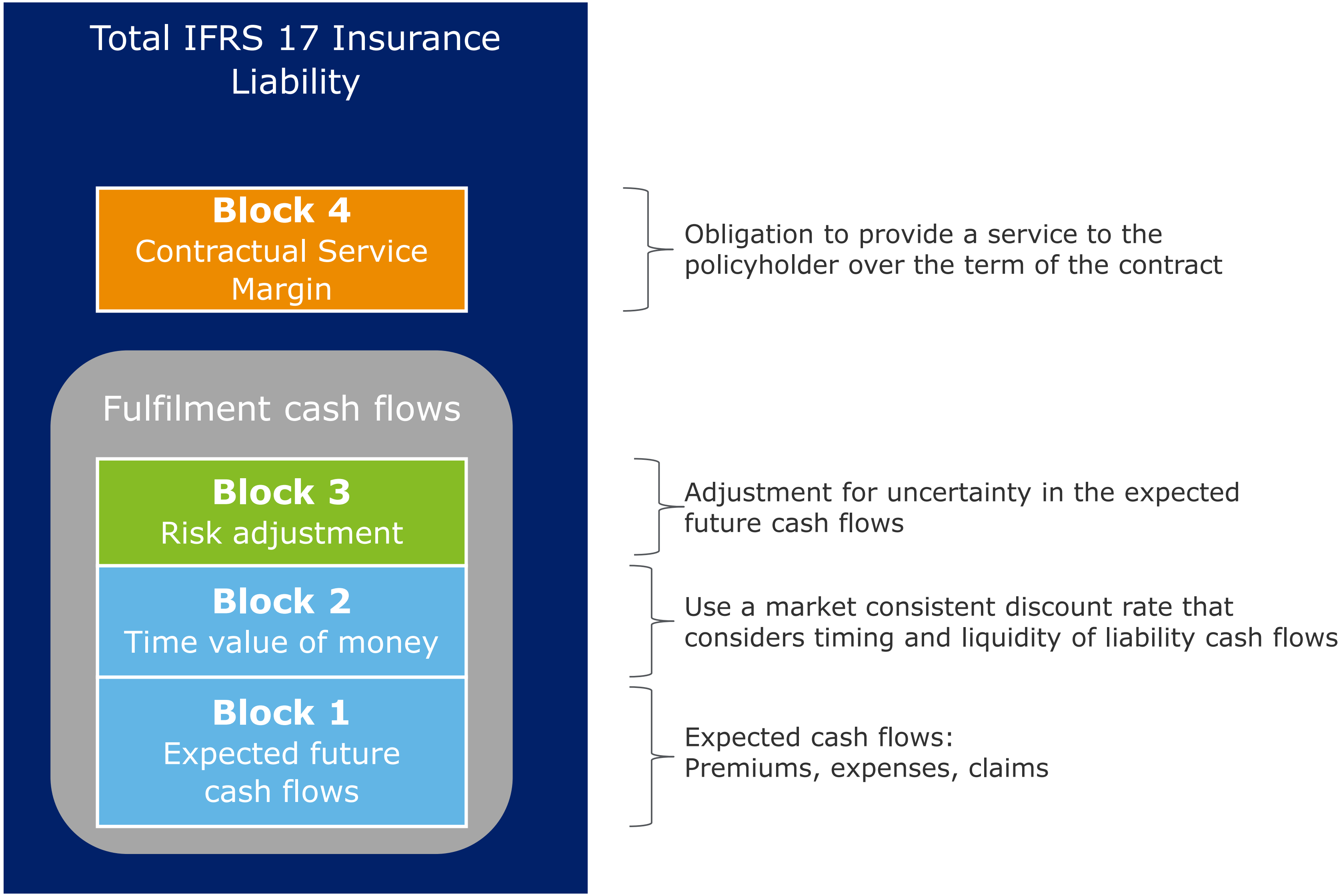
− **Increase in net liability**
  Increase in actuarial reserves

+ **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

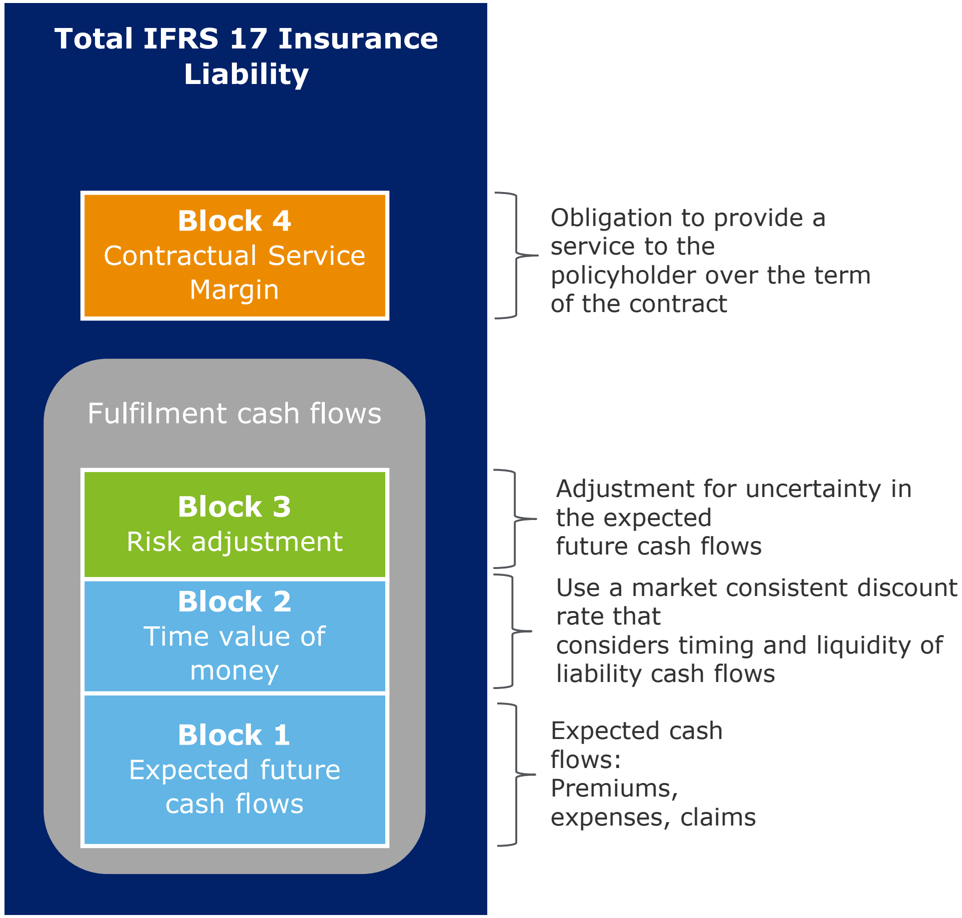


BBA vs. PAA Model

The Requirements

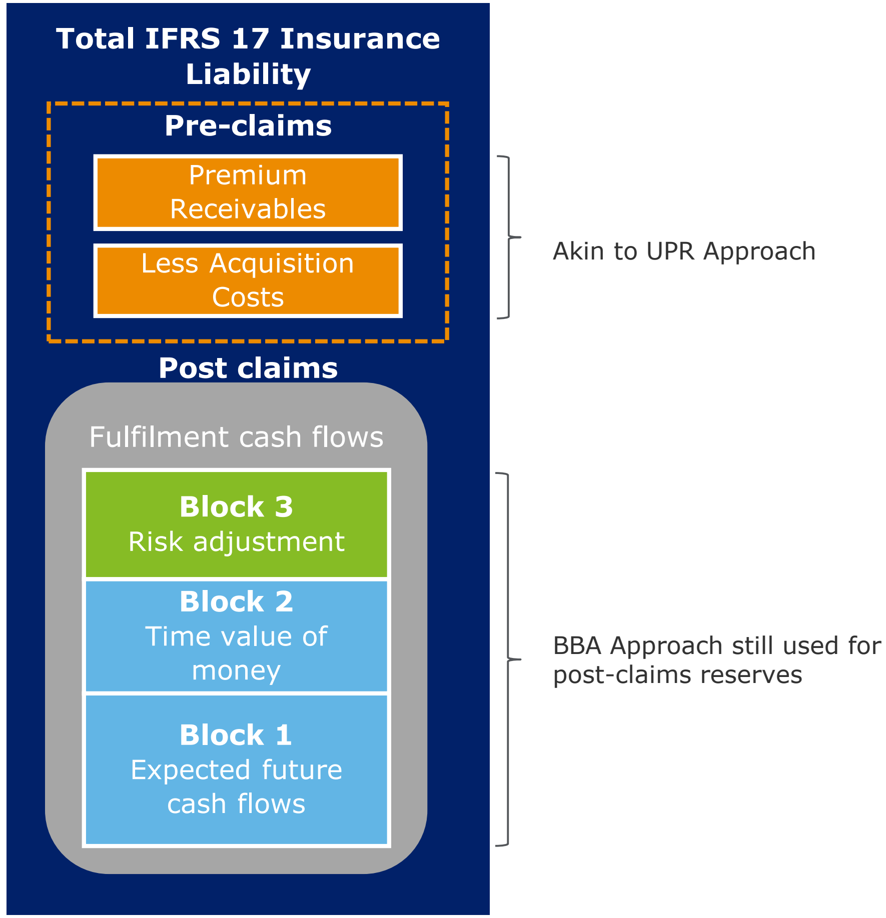
The general model: Building Blocks Approach (BBA)

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:

  Liability = BEL (negative) + RA (positive) + 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:

  Liability = BEL (positive) + RA (positive) + 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

CSM level of aggregation

Cross subsidies need to be managed

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**

CSM level of aggregation

Limited cross subsidy of onerous contracts with profitable contracts allowed

Portfolio

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

Contract boundary, Cash flows & Discount rate

Year X	Year X+1	Year X+2
Highly profitable group*	Highly profitable group*	Highly profitable group*
Other profitable group	Other profitable group	Other profitable group
	Onerous group	

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

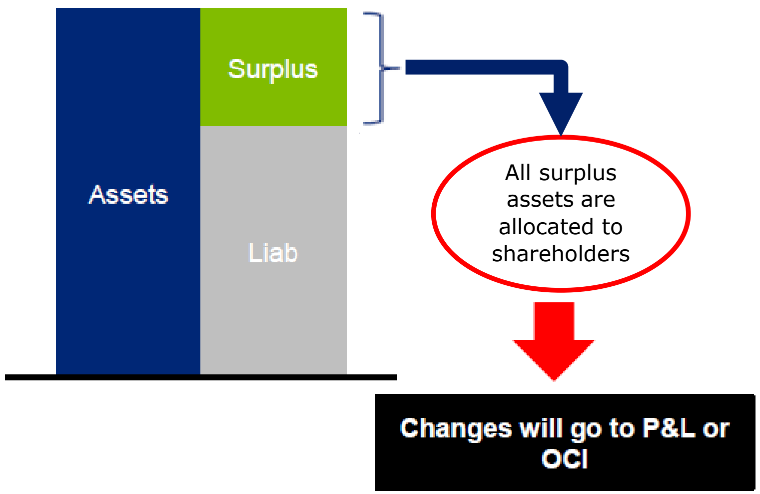
- When contractual terms specify that the policyholder participates in a defined share of a clearly identified pool of underlying items (e.g. unit linked policies) **insurers must use VFA**
- In the general measurement model (BBA approach), the net gains and losses that the entity retains from invested 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.

VFA – Variable Fee Approach

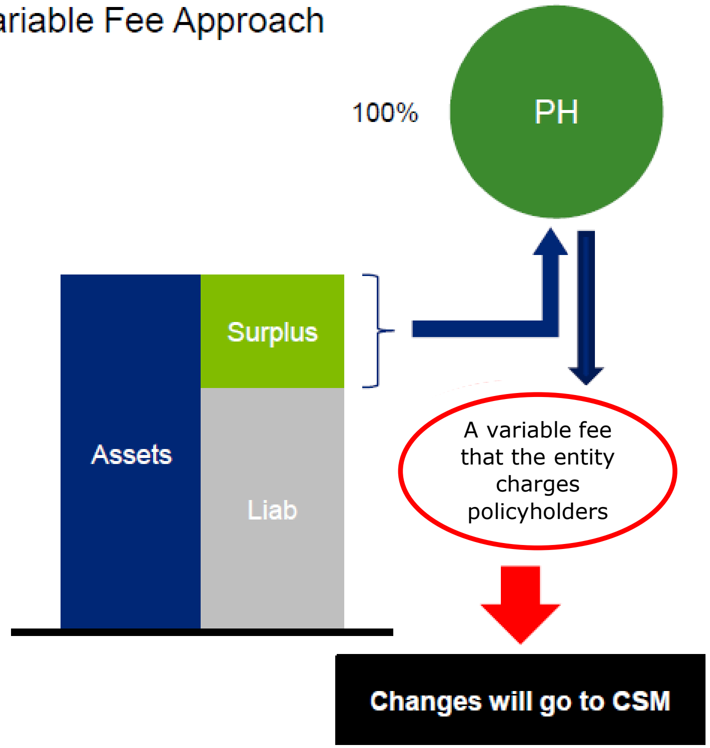
Different approach to profit recognition

- 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



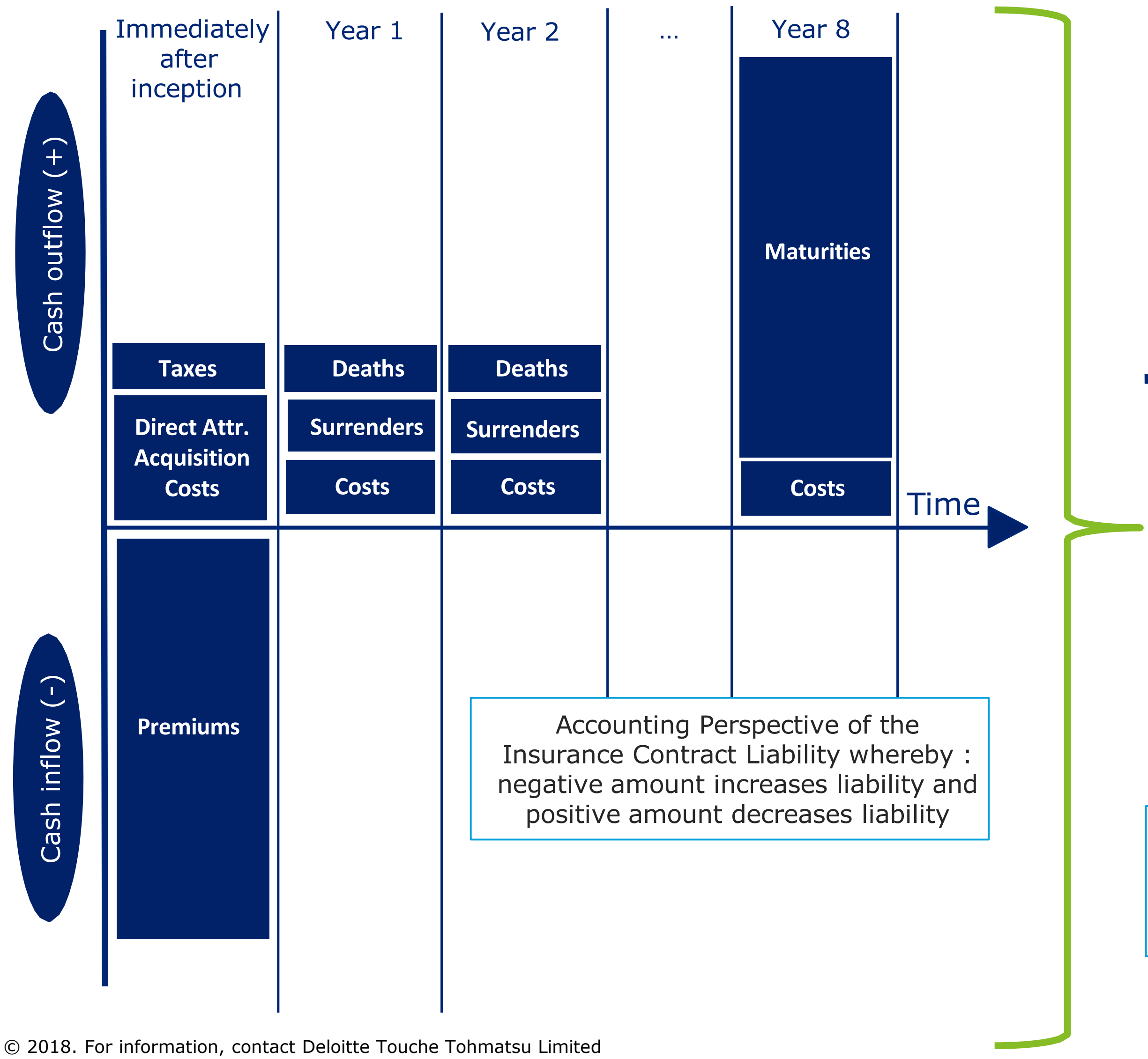
Variable Fee Approach



Balance Sheet
Illustrative Examples

Measurement requirements

Overview measurement at initial recognition



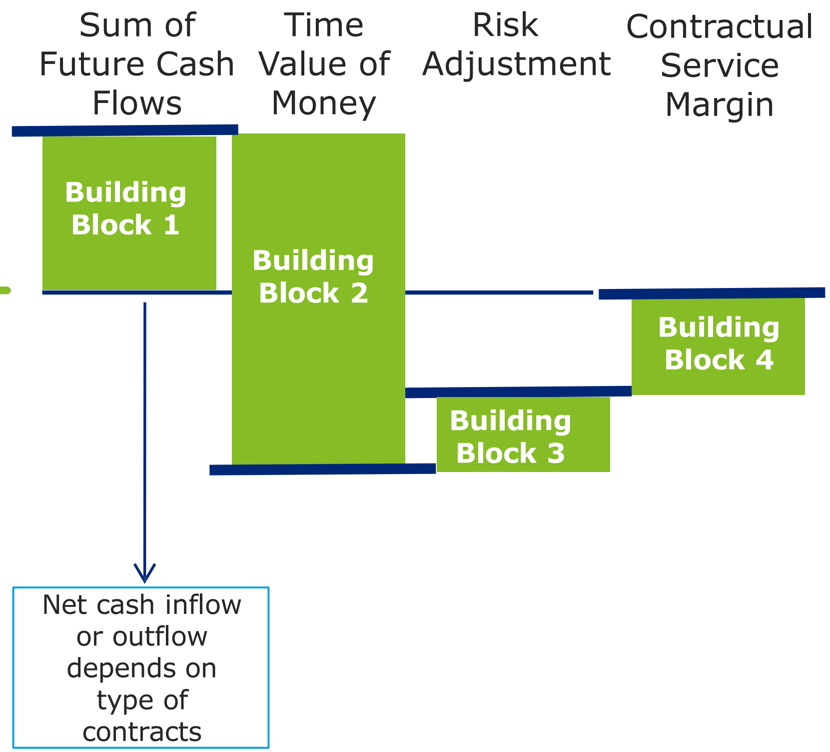
Balance Sheet Liability

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)

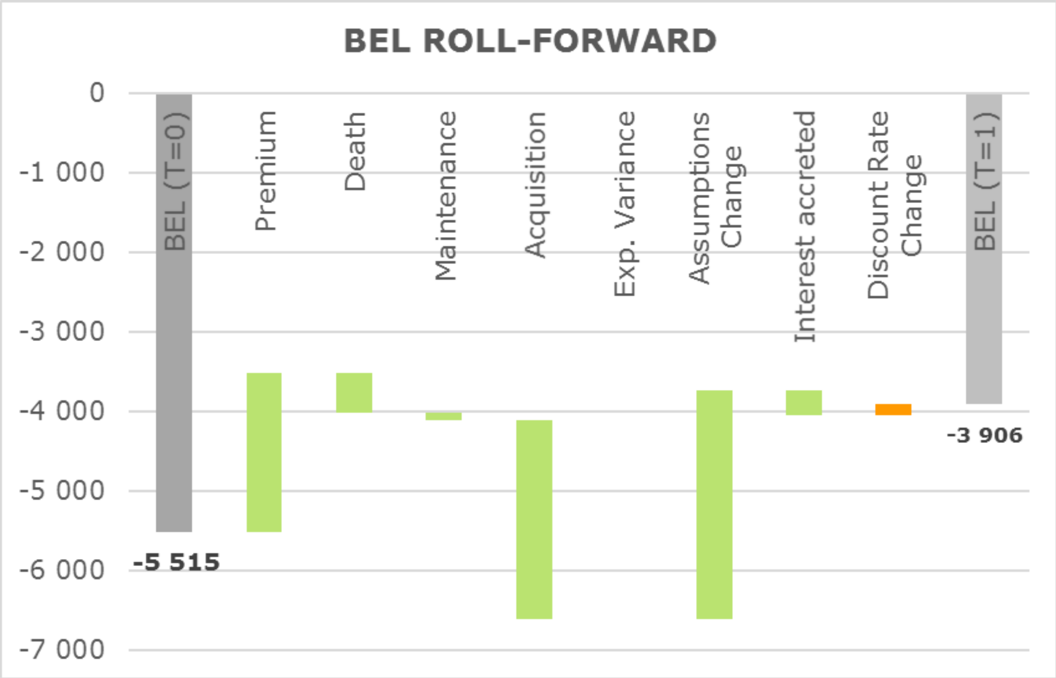
Block 1 + Block 2 + Block 3 > 0

Recognise Day One Loss (Onerous Contract)



Illustrative Example
Roll-forward of BEL from T0 to T1

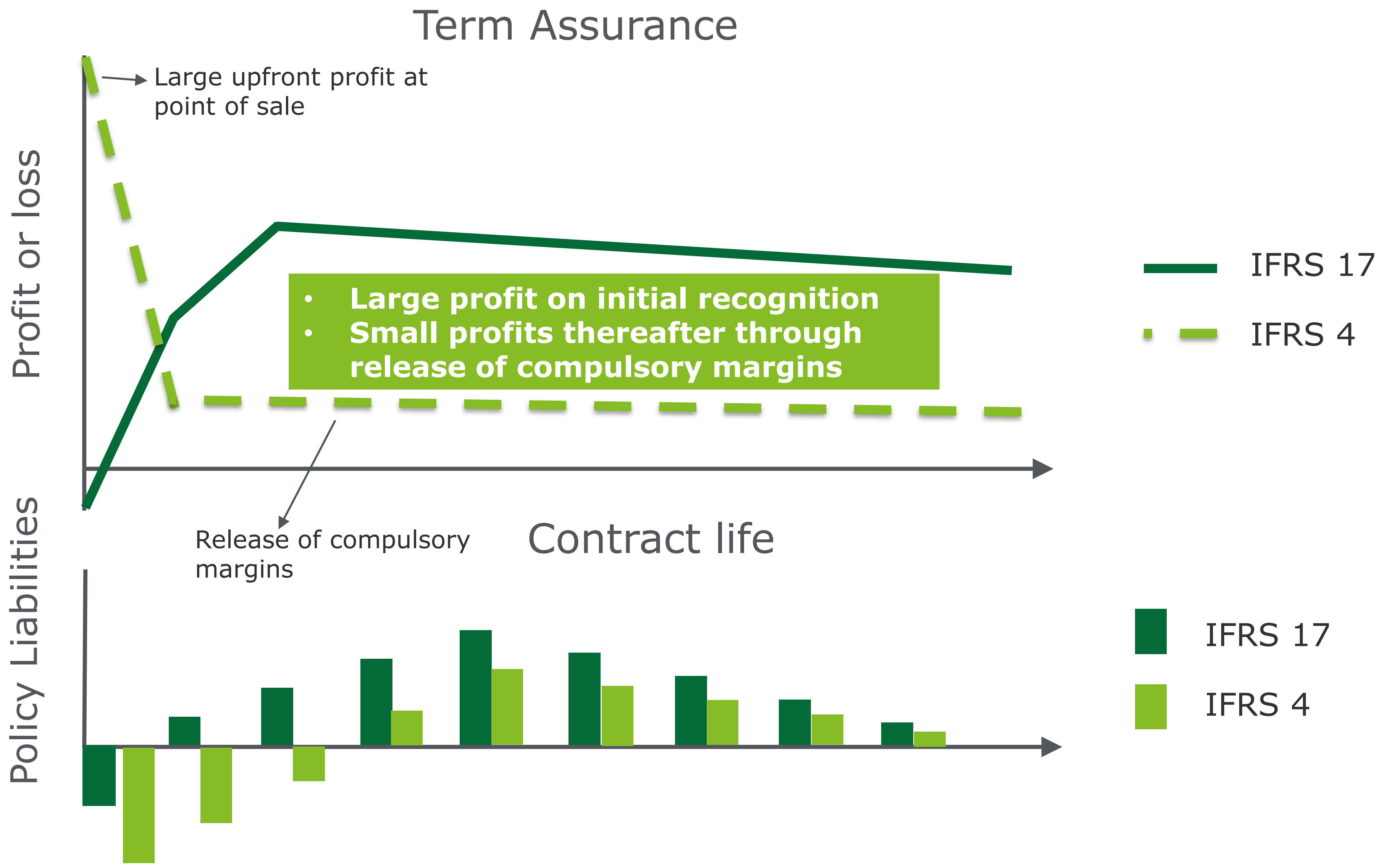
BEL Roll-Forward	Year 1 1
Opening balance	**-5 515**
Premiums received (Actual)	2 000
Death benefits - expected	-500
Surrender benefits - expected	0
Maturity benefits - expected	0
Maintenance expenses	-100
Acquisition expenses	-2 500
Experience variance due to premium (E-A)	0
Changes in estimates (exp. Or Assumptions)	2 872
Interest accreted	-303
Change in discount rates	140
Ending balance	**-3 906**



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)



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
+ Release of CSM
± Change in RA
+ 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
± Impact of change in investment assumptions on BEL and RA
± Actual investment earnings on assets backing liabilities
± Impact of changes to assets values due to interest rate changes

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 profit / loss

Insurance Service Result

Revenue

+ Release of CSM
± Change in RA
+ 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

Insurance Finance Income / Expense

Investment gain / loss

± Unwind of discount rates on insurance liabilities
± Impact of change in investment assumptions on BEL and RA

IFRS 17 income statement

Illustrative example

SCENARIO: ACTUAL = EXPECTED

Statement of Comprehensive Income	T1 31-Dec-16
Insurance Contract Revenue	**1 519.65**
Expected claims	1 500.00
Expected insurance service expenses	100.00
Acquisition costs amortised	250.00
Change in Risk Adjustement	163.95
CSM amortisation	-
Loss component Adj.	- 494.30
Insurance services daims and expenses incurred	**(2 477.35)**
Claims inccured	(1 500.00)
Attributable expenses incurred	(100.00)
Amortisation fo acquisition costs	(250.00)
Initial Loss recognition on onerous contract	(1 121.65)
Losses recognised	-
Reversal of Loss	-
Loss component Adj.	494.30
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

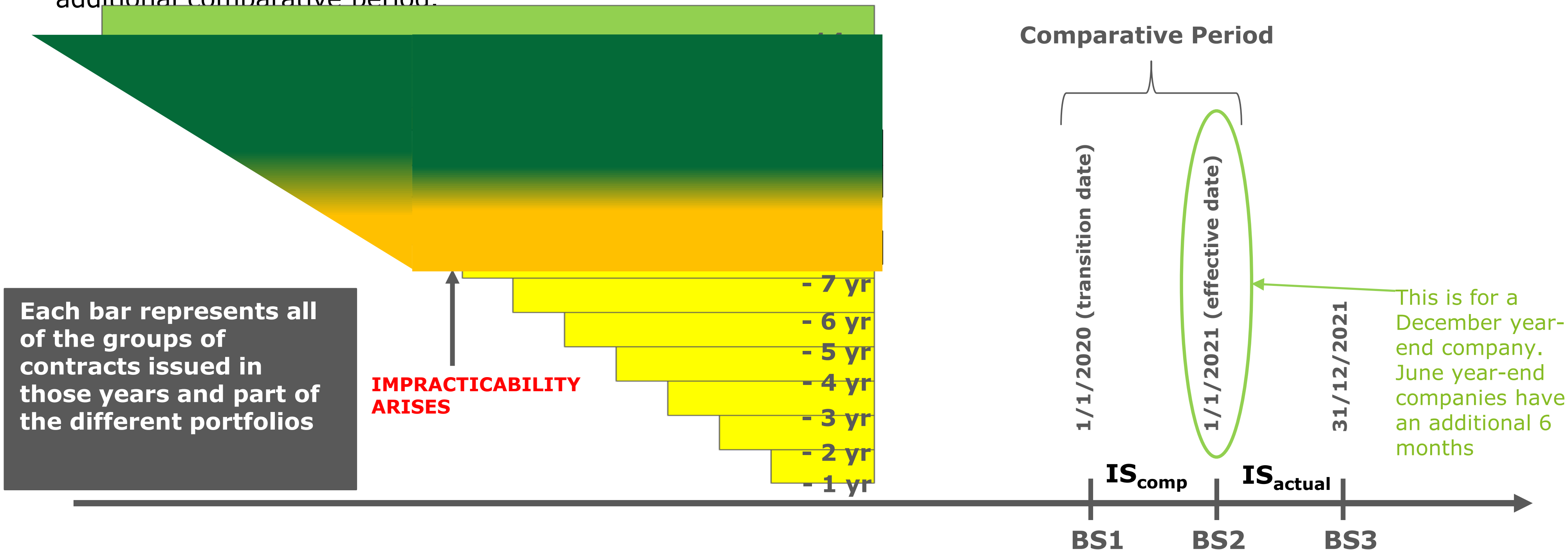
Insurers need to estimate what the CSM would have been at policy inception and what it is on IFRS17 date

- 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.

Retrospective approach

Modified retrospective approach

Fair value approach



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)

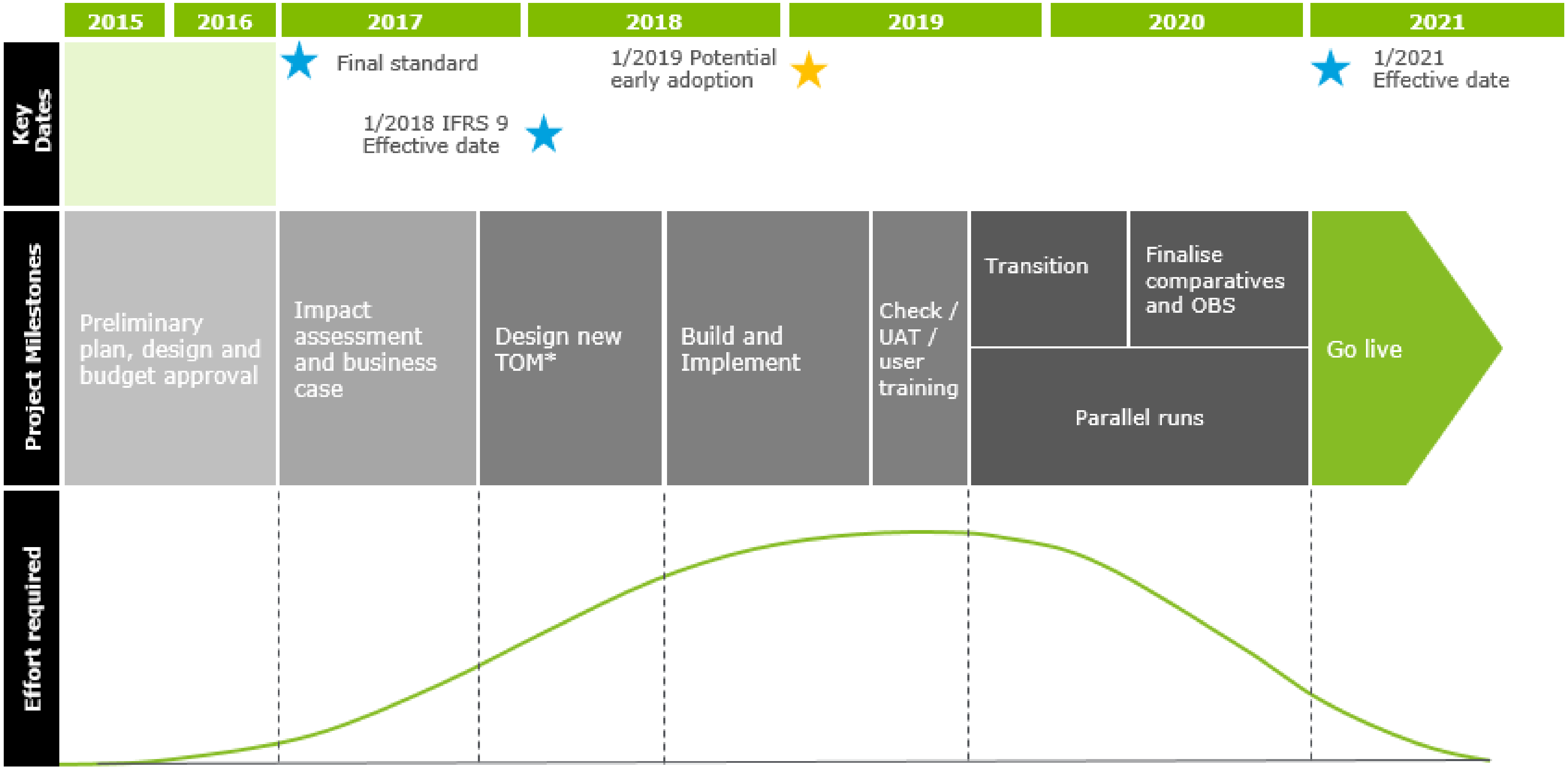
- HR impacts:
  - Finance and Actuarial working together more
  - Actuaries more involved in audits

- 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

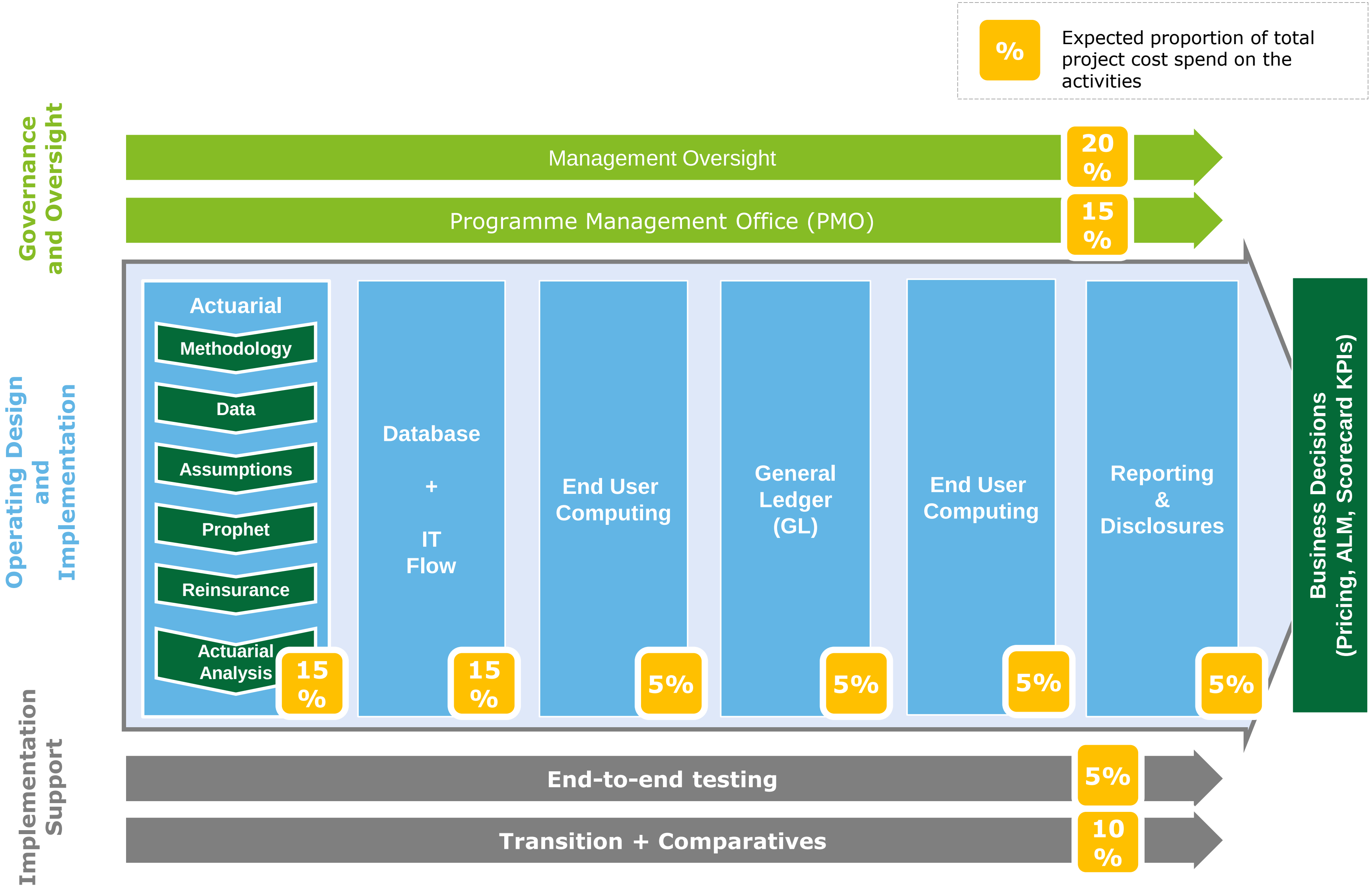
Expected effort mapping



* Target Operating Model

Project Effort

More than just Actuarial & Finance



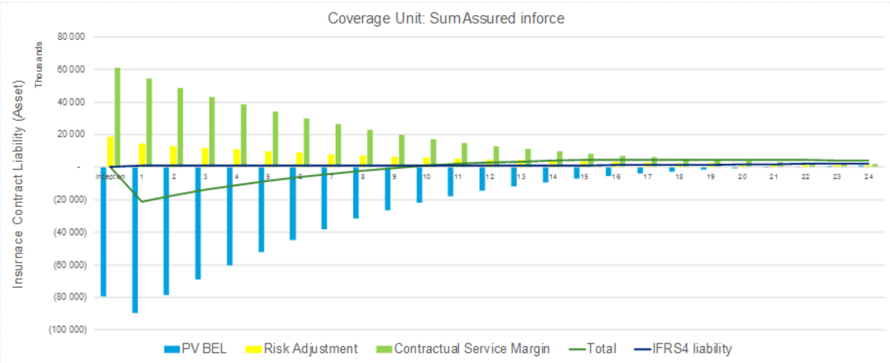
Practical Steps Forward

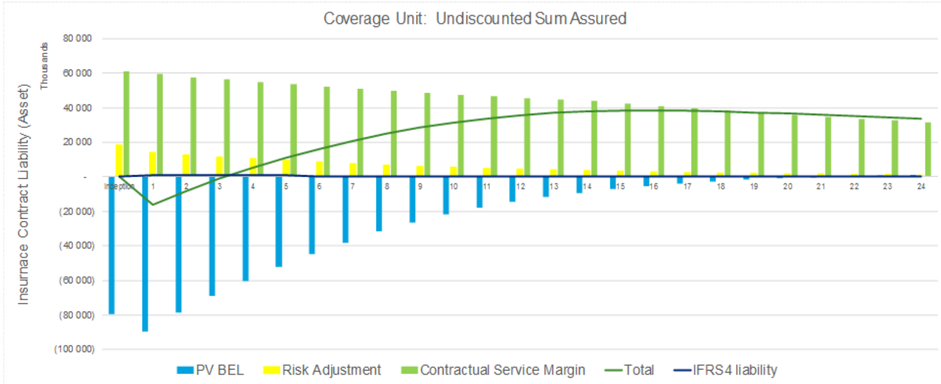
Practical Steps

Financial Impact Analysis

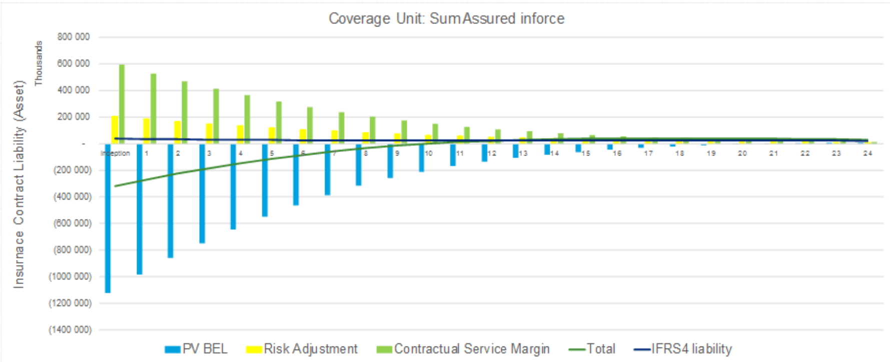
Product X – Reserve profiles

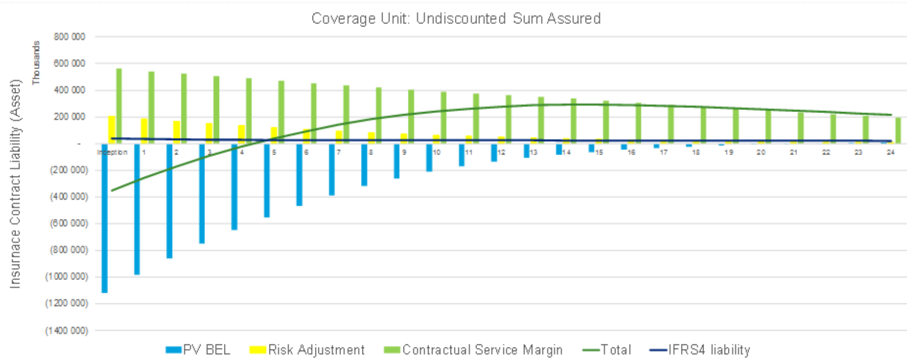
2017 New business





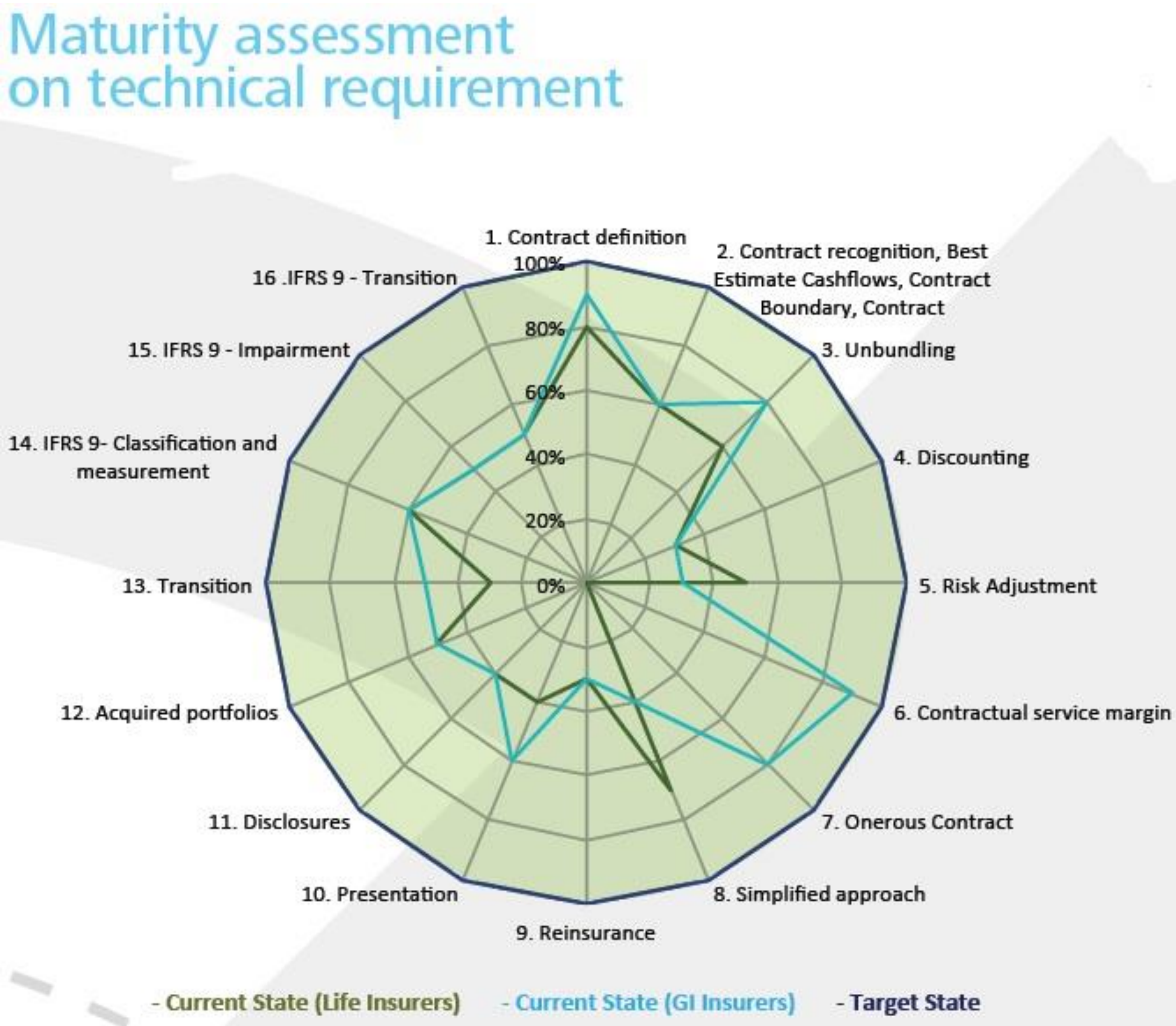
2017 In force book





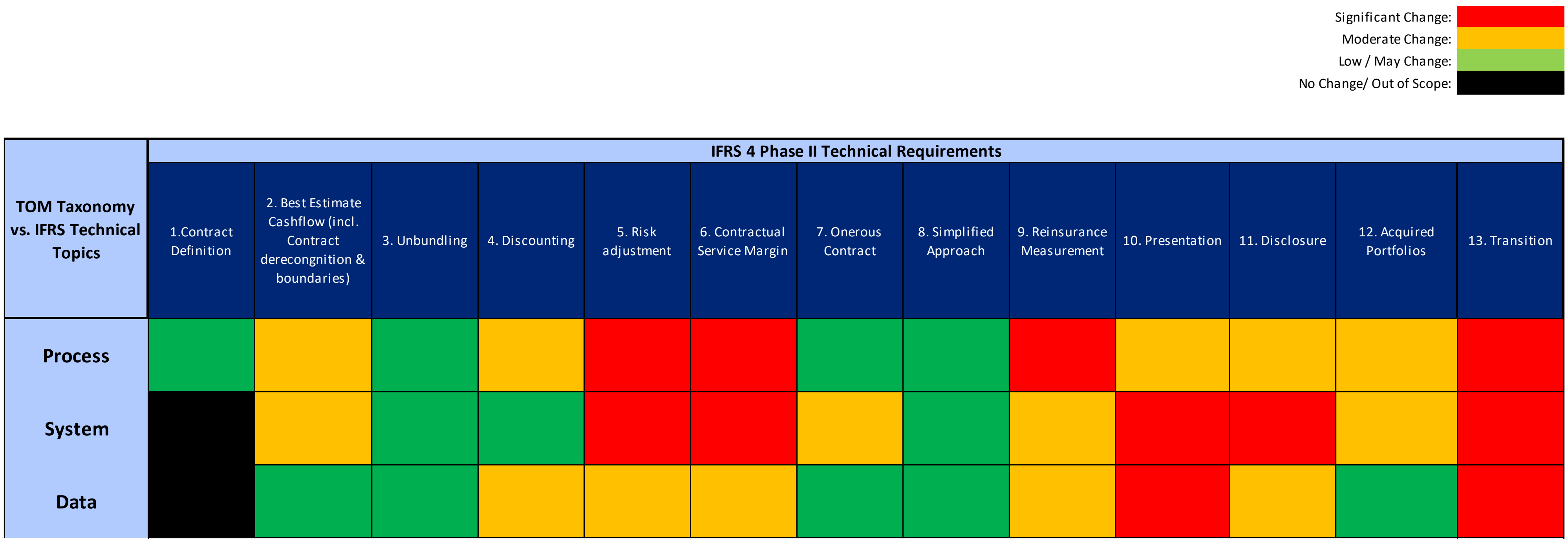
Practical Steps

Business Impact



Practical Steps

Business Impact



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.

1. Presentation and Disclosure

2. Simplified approach (PAA)

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

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.

3. Contractual service margin

4. Best estimate cash flow

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

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.

5. Discounting

6. Risk adjustment

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.

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

7. Level of aggregation/ onerous contract

8. Reinsurance measurement

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

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

9. Business Combinations

10. Transition

New balance sheet position needed as at 31/12/19 rolled forward to 31/12/20 under IFSR 17. **Financial Impact and operational challenges both** need to be considered when selecting the approach at transition.