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What will IFRS 17 mean in practice?

IFoA IFRS 17 for General Insurers Working Party
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IFRS 17 is now published

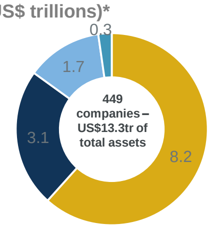
- The standard was published by the IASB on **18th May 2017** with an effective date of **1 January 2021**
- IFRS 17 replaces IFRS 4 – an Interim Standard that allowed widely divergent practices in different regions

What does IFRS 17 bring?

- Consistent accounting for all insurance contracts
- Updated information about obligations, risks and performance of insurance contracts
- Increases transparency in financial information reported by insurance companies

Total assets of listed IFRS insurers (in US$ trillions)*

- Europe - 87 companies
- Asia Pacific - 156 companies
- Canada - 10 companies
- Africa, Middle East and Latin America - 196 companies



IFRS 17 published	• Some entities begin implementation process • General questions • Contentious/specific implementation questions		Entities finalising implementation	Effective date of IFRS 17
18 May 2017	Early 2018	Early 2019	2020	2021

* Source: http://www.ifrs.org/news-and-events/2017/05/live-presentations-on-new-insurance-standard/

IFRS 17 Technical Overview

IFRS 17 starts with a few **key principles**:

- Current market-consistent valuation of expected future cash flows
- Reflects risk associated with those cash flows

=> discounted, risk-adjusted cash flows

- No recognition of profit until services are provided, losses recognised immediately
- Transparency through disclosures
- Revenue metrics consistent with other non-insurance industry revenue metrics

Overview:

- General measurement model often referred to 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 (level of aggregation)
- Detailed disclosure requirements

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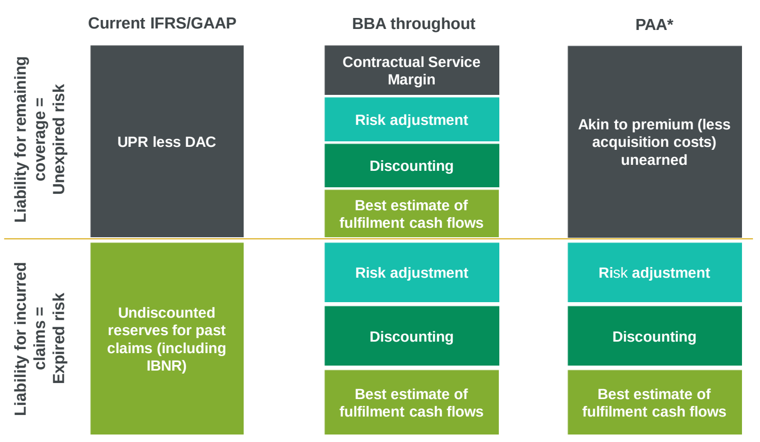
IFRS 17 Technical Overview



Size of boxes for illustrative purposes only. Specific conditions must be met for PAA (*)

The are a number of **key changes**:

- Move to a best estimate basis, no reserve margins will be permitted
- Driver of profit and recognition of profit over time will change due to new best estimate valuation model, unwind of discount, release of risk adjustment and release of CSM (unearned profit under BBA only)
- Underwriting result and finance result will have a new 'feel' and presentation.
- New KPIs, strategy, incentives and education are required as well as system changes
- Expansion of disclosure requirements

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Key areas of the standard

- Simplified approach (PAA) ★
- Best estimate cash flows
- Discounting
- Risk adjustment ★
- Level of aggregation / onerous contracts ★
- Contractual service margin (BBA only)
- Reinsurance measurement
- Acquired portfolios
- Presentation and disclosure ★
- Transition

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Simplified approach (PAA)

Objective:
Practical expedient for short-term contracts

Applies equally to insurance and reinsurance *(both inwards and outwards)* contracts, but they will need to be assessed separately

When are contracts eligible for the PAA?

If at inception the coverage period is **one year or less**

OR

If at inception, reasonably expect that measurement **would not differ materially from applying the BBA**

Not met if expect **significant variability** in the fulfilment cash flows before a claim is incurred

Variability increases with

- Length of contract coverage
- Embedded derivatives

- Expected to be adopted for the majority of general insurance contracts
- However for those contracts with a coverage period greater than 12 months;
  - Need to consider contract boundaries, and when insurer has practical ability to reassess and reprice the risk.
  - Multi year policies such as construction, retrospective reinsurances (LPTs / ADCs), risk attaching reinsurance, extended warranty etc may not be eligible.

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Risk Adjustment

Objective:
Compensation the insurer requires to make it indifferent between the present value of the uncertain cash flows and the present value of certain cash flows

Possible methods…?

- Value at Risk (VaR)
- Tail Value at Risk (tVaR)
- Cost of Capital (CoC)

- No prescribed approach
- Risk adjustment required on a gross and reinsurance basis separately
- Re-measured at each reporting period
- Allows for effect of diversification between portfolios within a reporting entity
- Regardless of the method chosen, a confidence level equivalent must be calculated and disclosed (i.e. VaR percentile)

Level of aggregation / onerous contracts

Objective:
Separate profitable and loss making contracts
No CSM at end of coverage period

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 (considered on a gross basis)*
- *consistent with internal reporting*
- *exemption for regulatory pricing*
- *group not reassessed after inception*

Profitable contracts		Contracts that at inception have no significant possibility of becoming onerous subsequently, if any	Unearned profit is recognised as liability and is released as insurance services are provided
		Other profitable contracts, if any	
Onerous contracts		Contracts that are onerous at inception, if any	A loss is recognised in P/L

Fulfilment cash flows may be estimated at a **higher level of aggregation** than the group or portfolio => then need to **allocate estimates to groups of contracts**

PAA:
At inception: Assume no contracts in the portfolio are onerous, unless **facts and circumstances** indicate otherwise

Presentation and disclosure

Objective:
Transparency through disclosures
Revenue metrics consistent with other non-insurance industry revenue metrics

Statement of comprehensive income	
Insurance revenue	X
Insurance service expenses	(X)
Reinsurance expenses	(X)
Insurance service result	**X**
Insurance finance income / (expense)	X/ (X)
Investment income	X
Investment expenses	(X)
Net financial result	**X**
Administrative expenses	(X)
Other expenses	(X)
Profit or loss	**X**
Effect of discount rate changes on insurance liabilities	X
Total comprehensive income	**X**

- New look and feel to financial statements including:
  - Volume based metric of reporting premiums as income is replaced with an insurance revenue line item
  - Insurers will now split out insurance service result and net financial result when explaining profitability of insurance policies to stakeholders
- Additional quantitative reconciliations will are likely to require actuarial input
- Additional qualitative disclosures including:
  - Risk adjustment method and confidence level
  - Yield curves used to discount cashflows

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How does this impact the reserving actuary?

Technical

- **Measurement model choice (PAA vs BBA)**
- **Risk adjustment approach**
- **Level of aggregation / onerous contracts**
- **Understanding the impact on profitability**

The Reserving Actuary

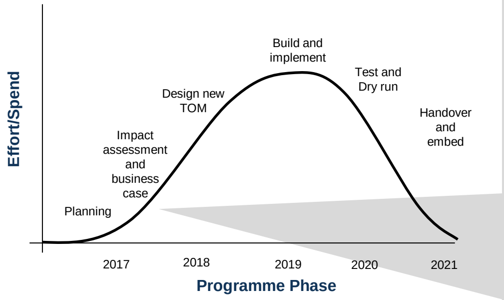
- Increased volatility in results
- Metrics for performance management
- Calculations and reconciliations
- More detailed disclosures
- New processes and systems
- Consistency with regulatory messaging
- Data requirements
- Preparing investors for change
- Technical understanding
- Managing the messages to market

Operational

- **Impact on WDT** – Ability to leverage SII data will vary by company, additional processes will need to be performed within financial close
- **Change in role** – More involved with final reporting and disclosures
- **KPI's and MI** – New KPI's needed to be inline with external reporting and internal MI including reserving outputs
- **Interaction with Pricing and Capital** – Not just a user of their data, as now influence product design and distribution fitting

IFRS 17 project timeline

The ideal timeline for implementing IFRS 17 will depend on the complexity of the changes required to the underling systems and processes for financial reporting.



Focus for 2017

- Identify and agree key design decisions
- Deep dive in operational and financial impact of key design decisions
- Define systems and data requirements
- Design target state operating model and gaps from current state
- Develop implementation plan and business case

Don't forget lessons learned from Solvency II…

- Silos need to be broken - Actuaries need to be integrated and integral to Finance process
- Controls and documentation need to be updated
- Leaving things to the last minute can be expensive and painful
- Reconciliations can be time consuming
- Technical issues can be surprisingly time consuming
- Train, train and train again

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

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Where to find out more…?

- IFoA working party papers, industry events:
  - https://www.actuaries.org.uk/practice-areas/general-insurance/research-working-parties/ifrs-17

- The Actuary article on the implications for General Insurers:
  - http://www.theactuary.com/features/2017/06/the-wide-ranging-implications-of-ifrs-17/

- IASB website publishes lots of detail on Board deliberations, there is also a series of webinars delving into the different elements of the standard
  - http://www.ifrs.org/Current-Projects/IASB-Projects/Insurance-Contracts/Pages/Insurance-Contracts.aspx

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Questions

Comments

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.

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