What will IFRS 17 mean in practice?

IFoA IFRS 17 for General Insurers Working Party
Alice Boreman, Deloitte
Laura Barella (Chair), PwC

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

449 companies – US$13.3tr of total assets

IFRS 17 Technical Overview

**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

**Current IFRS/GAAP**

<table>
<thead>
<tr>
<th>Liability for remaining unexpired risk</th>
<th>PAA*</th>
</tr>
</thead>
<tbody>
<tr>
<td>UPR less DAC</td>
<td>Risk adjustment</td>
</tr>
<tr>
<td>Discounting</td>
<td>Best estimate of fulfilment cash flows</td>
</tr>
<tr>
<td>Contractual Service Margin</td>
<td>Akin to premium (less acquisition costs) unearned</td>
</tr>
</tbody>
</table>

**BBA throughout**

<table>
<thead>
<tr>
<th>Liability for incurred expired risk</th>
<th>PAA*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Undiscounted reserves for past claims (including IBNR)</td>
<td>Risk adjustment</td>
</tr>
<tr>
<td>Discounting</td>
<td>Best estimate of fulfilment cash flows</td>
</tr>
</tbody>
</table>

**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

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

**Simplified approach (PAA)**

- 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.

**Objective:** Practical expedient for short-term contracts

When are contracts eligible for the PAA?

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

**Level of aggregation / onerous contracts**

**Contractual service margin (BBA only)**

**Reinsurance measurement**

**Presentation and disclosure**

**Transition**

**Colour palette for PowerPoint presentations**

- Dark blue: R17 G52 B88
- Gold: R217 G171 B22
- Mid blue: R64 G150 B184
- Secondary colour palette:
  - Light grey: R220 G221 B217
  - Pea green: R121 G163 B42
  - Forest green: R0 G132 B82
  - Bottle green: R17 G179 B162
  - Cyan: R0 G156 B200
  - Light blue: R124 G179 B225
  - Violet: R128 G118 B207
  - Purple: R143 G70 B147
  - Fuscia: R233 G69 B140
  - Red: R200 G30 B69
  - Orange: R238 G116 29
**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

- 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 from regulatory pricing
- Group not reassessed after inception

<table>
<thead>
<tr>
<th>Profitable contracts</th>
<th>Contracts that at inception have no significant possibility of becoming onerous subsequently, if any</th>
<th>Unearned profit is recognised as liability and is released as insurance services are provided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other profitable contracts, if any</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Onerous contracts</th>
<th>Contracts that are onerous at inception, if any</th>
<th>A loss is recognised in P/L</th>
</tr>
</thead>
</table>

**PAA:**

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

---

**Value at Risk (VaR)**

- Dark blue: R17G52B88
- Gold: R217G171B22
- Mid blue: R64G150B184

**Secondary colour palette**

- Light grey: R220G221B217
- Pea green: R121G163B42
- Forest green: R0G132B82
- Bottle green: R17G179B162
- Cyan: R0G156B200
- Light blue: R124G179B225
- Violet: R128G118B207
- Purple: R143G70B147
- Fuscia: R233G69B140
- Red: R200G30B69
- Orange: R238G116B29
How does this impact the reserving actuary?

**Objective:**

- 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 be likely to require actuarial input
- Additional qualitative disclosures including:
  - Risk adjustment method and confidence level
  - Yield curves used to discount cashflows

<table>
<thead>
<tr>
<th>Statement of comprehensive income</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurance revenue</td>
<td>X</td>
</tr>
<tr>
<td>Insurance service expenses</td>
<td>(X)</td>
</tr>
<tr>
<td>Reinsurance expenses</td>
<td>(X)</td>
</tr>
<tr>
<td>Insurance service result</td>
<td>X</td>
</tr>
<tr>
<td>Insurance finance income / (expense)</td>
<td>X/ (X)</td>
</tr>
<tr>
<td>Investment income</td>
<td>X</td>
</tr>
<tr>
<td>Investment expenses</td>
<td>(X)</td>
</tr>
<tr>
<td>Net financial result</td>
<td>X</td>
</tr>
<tr>
<td>Administrative expenses</td>
<td>(X)</td>
</tr>
<tr>
<td>Other expenses</td>
<td>(X)</td>
</tr>
<tr>
<td>Profit or loss</td>
<td>X</td>
</tr>
<tr>
<td>Effect of discount rate changes on insurance liabilities</td>
<td>X</td>
</tr>
<tr>
<td>Total comprehensive income</td>
<td>X</td>
</tr>
</tbody>
</table>
IFRS 17 project timeline

The ideal timeline for implementing IFRS 17 will depend on the complexity of the changes required to the underlying 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

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
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:

- IASB website publishes lots of detail on Board deliberations, there is also a series of webinars delving into the different elements of the standard

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.