# IFRS 17
## *Insurance Contracts*

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## Disclaimer



Unless specified otherwise, the accounting requirements that are the subject matter of this presentation are the IFRS Standards as issued by the IASB that are applicable on or after 1 January 2023

The views expressed in this presentation are my own and not necessarily those of any organization with which I am associated.

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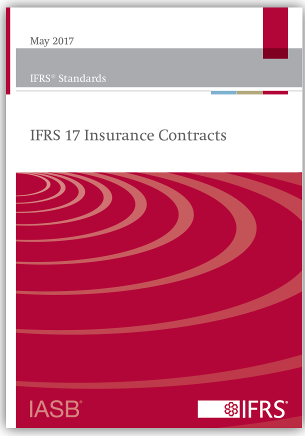
## Introduction
## *IFRS 17 Insurance Contracts*




- IFRS 17
  - replaces an interim Standard—IFRS 4
  - requires consistent accounting for all insurance contracts based on a current measurement model
  - will provide useful information about profitability of insurance contracts
- Effective 2023
  - one year restated comparative information
  - early application permitted

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# Programme

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## IFRS 17 Programme

| | |
|---|---|
| Session 1 | Recap: Core model and premium allocation approach (PAA) |
| Session 2 | Disclosure and presentation requirement |
| Session 3 | Transition, transition presentations and disclosures |
| Session 4 | PAA with comparison to unearned premium |
| Session 5 | Challenges in applying PAA |
| Session 6 | Audit reports and compliance with IFRS |
| Session 7 | |

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# Introduction to IFRS 17

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# Timeline

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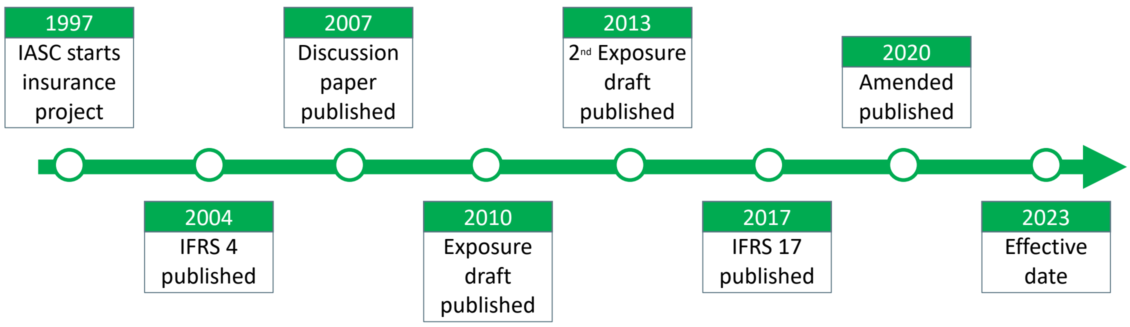
## Project History

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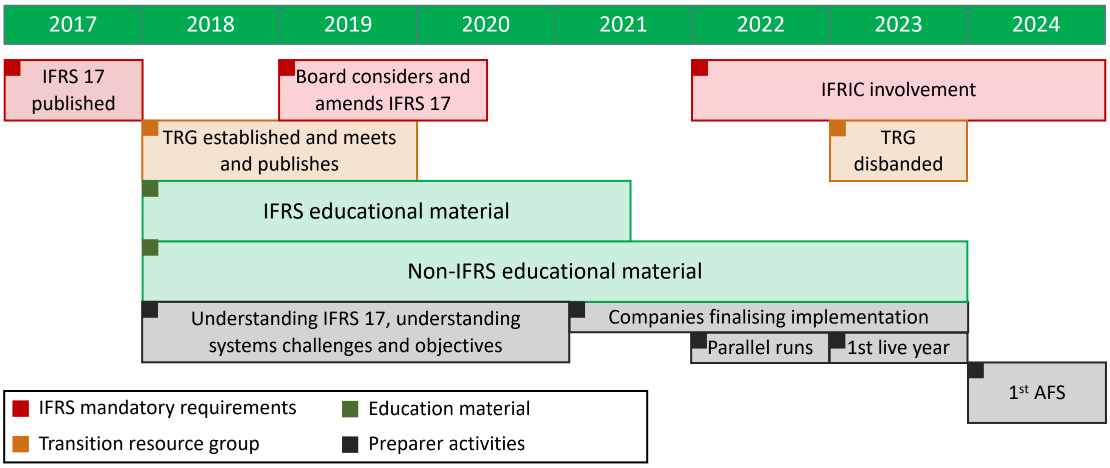
## Project Implementation

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# Reasons and objectives of IFRS 17

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## Insurance Accounting
### *Phased approach*

Two phases for accounting for insurance contracts:

| | |
|---|---|
| Phase 1 | » 2004: issue of IFRS 4 *Insurance Contracts*, focus on enhanced disclosure of amount, timing and uncertainty of cash flows.<br>» IFRS 4 allows entities to continue using various recognition, measurement and presentation (grandfathering) |
| Phase 2 | » 2017: issue (2020 amendment) of IFRS 17 *Insurance Contracts*, focus on consistent recognition, measurement and presentation of insurance contracts. |

IFRS 17 **supersedes** IFRS 4

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## Phase 1: Insurance Accounting
### *Recognition of revenue and profitability*

» Two regular anomalies in revenue (premium) recognition

Cash premium received — Or — Premium due or Premium receivable — AND — Deposit amounts included

» Profit is recognised in various ways

Immediately contract is written — OR — Only when the contract ends — OR — Over the duration of the contract

» Use of many non-GAAP measures

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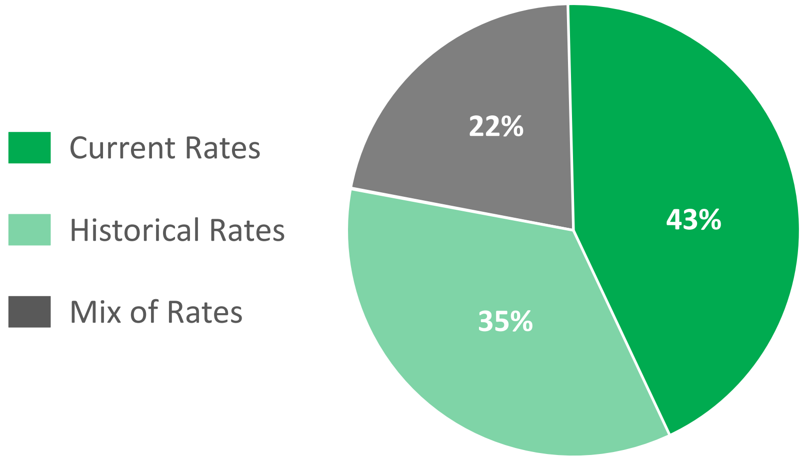
## Phase 1: Insurance Accounting
*Discount rates currently used*




*Source: Effects Analysis on IFRS 17*

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## Phase 1: Insurance Accounting
*Lack of comparability*

| | Year X | | | |
|---|---|---|---|---|
| CU Millions | GAAP 1 | GAAP 2 | Difference | |
| Revenue | 8 263 | 10 979 | (2 716) | (33%) |
| Operating income | 1 416 | 633 | 783 | 55% |
| Net income | 965 | 337 | 628 | 65% |
| Total equity | 8 977 | 3 872 | 5 105 | 57% |

*Source: Effects Analysis on IFRS 17*

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## IFRS 17 Improvements

*Improved performance reporting*

| Applying IFRS 4[1] | Applying IFRS 17 | Key Changes |
|---|---|---|
| Premiums | Insurance revenue | • Insurance revenue excludes deposits<br>• Revenue recognised as earned, expenses as incurred<br>• Insurance finance expenses presented with corresponding income (in P&L or OCI)<br>• 2 drivers of profit presented separately |
| Incurred claims/expenses | Incurred claims/expenses | |
| Change in insurance liability | Insurance service result | |
| | Investment income | |
| Investment income | Insurance finance expense | |
| Profit or loss | | |
| | Net financial result | |
| | Profit or loss | |
| | OCI: Income & Insurance finance expense | |

[1] Common IFRS 4 presentation in statement of comprehensive income

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## Scope of IFRS 17

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## Scope

» IFRS 17 is applied to:

- » *Insurance contracts* issued,
- » *Reinsurance contracts* held and
- » Investment contracts with *discretionary participation features*.

» Contracts issued and held include contracts acquired in business combinations and transfers

» IFRS 17 includes optional and mandatory scope exemptions

*IFRS 17.3 to IFRS 17.8A*

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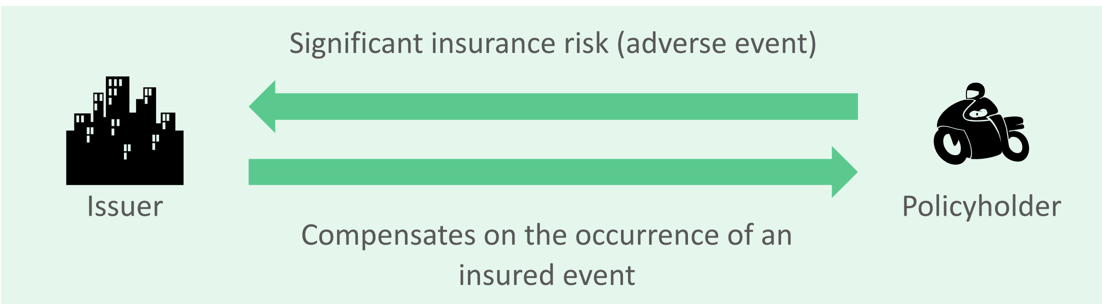
## What is an insurance contract




⇔ IFRS 17 and IFRS 4—same definition

⇔ IFRS 17 two minor changes to guidance but no expected changes in assessments for majority of contracts

⇔ No change from IFRS 4
Change from IFRS 4

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## Definition of insurance
*Example: Longevity swap*

» Is a longevity swap based on a longevity index an insurance contract?

Does the counterparty accept

» significant insurance risk by

» agreeing to compensate the policyholder if

» a specified uncertain future event adversely affects the policyholder

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## Definition of insurance
*Example: Payment in kind*

» Is a health contract that provides medical services at the issuer's hospital network an insurance contract?

Does the counterparty accept

» significant insurance risk by

» agreeing to compensate the policyholder if

» a specified uncertain future event adversely affects the policyholder

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## Definition of insurance
*Example: New for old*

» Is a contract that replaces a damaged vehicle with a brand new vehicle an insurance contract?

Does the counterparty accept

» significant insurance risk by

» agreeing to compensate the policyholder if

» a specified uncertain future event adversely affects the policyholder

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## Definition of insurance
*Example: Annuity*

» Is an annuity contract an insurance contract?

Does the counterparty accept

» significant insurance risk by

» agreeing to compensate the policyholder if

» a specified uncertain future event adversely affects the policyholder

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## Definition of insurance
### *Example: Credit derivative*

» Is a credit derivative instrument an insurance contract?

Does the counterparty accept

- » significant insurance risk by
- » agreeing to compensate the policyholder if
- » a specified uncertain future event adversely affects the policyholder

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## Scope exclusions
### *Mandatory exclusions*

Some insurance contracts remain **<u>in the scope of other IFRSs</u>**

» For example:

- ⇔ warranties issued by manufacturers, dealers or retailers
- ⇔ retirement benefit obligations
- ⇔ some residual value guarantees
- ⇔ insurance contracts held by an entity, unless those contracts are reinsurance contracts
- ⚡ some credit card and similar contracts if insurance risk is not assessed in pricing

*IFRS 17.7*

⇔ No change from IFRS 4
⚡ Change from IFRS 4

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## Mandatory exclusions
*Banking products*

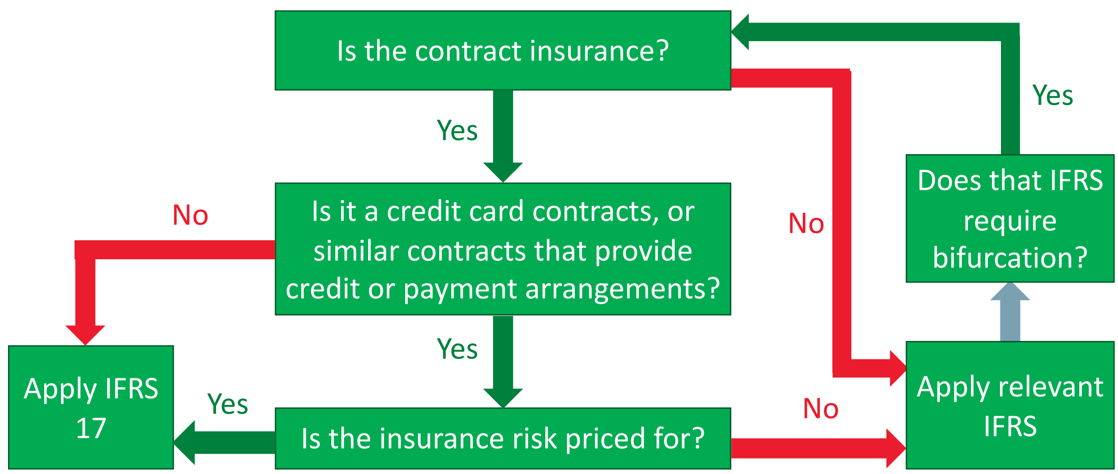
- » Credit card contracts, or similar contracts that provide credit or payment arrangements,
- » if, and only if,  the entity doesn't price for the individual customer risk
- » if, and only if, IFRS 9 requires an entity to separate an insurance component, then entity apply IFRS 17 to that component.

*IFRS 17.7(h)*





## Mandatory exclusions
*Credit cards and similar products*




*IFRS 17.7(h)*

## Scope
### *Optional exclusions*

Option to account for some insurance contracts using either IFRS 17 or other IFRS Standards

- ⇔ Financial guarantee contracts—IFRS 17 or IFRS 9 *Financial Instruments*
- 〽 Specified fixed-fee service contracts—IFRS 17 or IFRS 15 *Revenue from Contracts with Customers*
- 〽 Specified loan contracts—IFRS 17 or IFRS 9 *Financial Instruments*

*IFRS 17.8 and 8A*

⇔ No change from IFRS 4
〽 Change from IFRS 4

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## Optional exclusions
### *Banking products*

» Some contracts limit compensation to amount required to settle the policyholder's obligation created by the contract

» Entity can choose

  » to apply either IFRS 17 or IFRS 9

  » at portfolio level , and

  » is irrevocable.

*IFRS 17.8A*

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# Concepts in the standard

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## Level of aggregation

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## Why group contracts?

» Typically, under IFRS contracts are measured on an individual contract basis

» IFRS 17 and insurance accounting is an exception to this general principle:

| Objective of insurance | Asymmetry of IFRS 17 |
| --- | --- |
| » Insurance aggregates uncertain future events<br>» This changes a binary risk into a probability risk<br>» Allows insurer to manage risk where individual couldn't | » Treatment of gains and losses is asymmetric<br>» Losses recognised immediately<br>» Gains recognised as earned<br>» Contradicts objective |

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## Why group contracts
### *Grouping objectives*

» Balance nature of insurance with risk of loss of information

» Trends **matter**:

| Product line loss making | Profitability falls over time |
| --- | --- |
| » Bad contracts subsidised by good<br>» Good subject to cherry picking by competitors<br>» Can indicate risk or pricing problems in a unit | » New contracts subsidised by old<br>» May indicate:<br>» an underwriting change failure<br>» increased competition<br>» deteriorating customer base |

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## How are contracts grouped?
*Step #1*

» Identify portfolios of insurance contracts

» A portfolio: insurance contracts subject to similar risks and managed together

| Portfolio 1 | Portfolio 2 | Portfolio 3 |
|---|---|---|
| Eg Personal accident | Eg Health | Eg Motor |
| 🗐🗐🗐🗐🗐🗐🗐🗐🗐🗐🗐 | 🗐🗐🗐 | 🗐🗐🗐🗐🗐 |
| ✓ Similar risks<br>✓ Managed together | ✓ Similar risks<br>✓ Managed together | ✓ Similar risks<br>✓ Managed together |





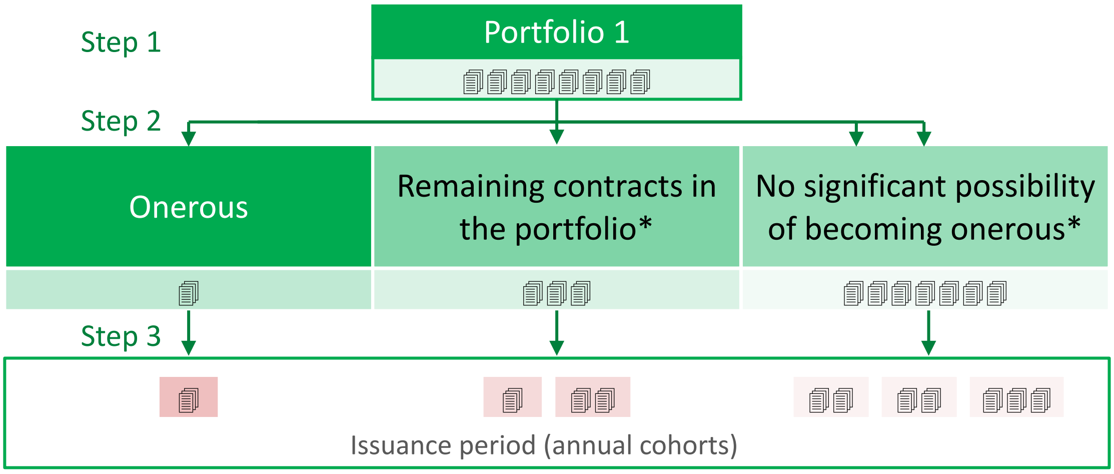
## How are contracts grouped?
*Step #2*

Divide a portfolio into a minimum of:

| Onerous | Remaining contracts in the portfolio* | No significant possibility of becoming onerous* |
|---|---|---|
| 🗐 | 🗐🗐🗐 | 🗐🗐🗐🗐🗐🗐🗐 |
| Recognise loss immediately in P&L | Unearned profit recognised as part of the liability and is released as insurance services are provided | |

* At initial recognition, if any

## How are contracts grouped?
***Step #3***




* At initial recognition, if any

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# Core requirements

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## Core Requirements
*Snapshot of IFRS 17 Approaches*

Core requirements

Modifications for contract Types

- Insurance contracts with direct participation features
- Reinsurance contracts held
- Investment contracts with discretionary participation features

Simplifications: premium allocation approach

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## Core Requirements
*'Building block Approach'*

All insurance contracts measured as the sum of:

» Fulfilment cash flows (FCF)

1. Present value of probability-weighted expected cash flows
2. Plus an explicit risk adjustment for non-financial risk (eg insurance risk)

» Contractual service margin (CSM)

3. The unearned profit from the contracts

(1) PV future cash flows + (2) Risk adjustment + (3) Unearned profit = IFRS 17 liability

Fulfilment cash flows (1 + 2) | CSM (3)

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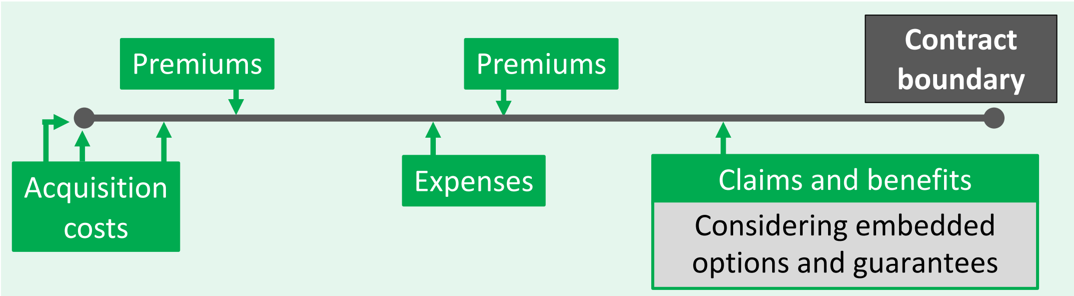
## Present value of future cash flows
*Cash flows*

» **Current estimate** of future cash flows in contract boundary




» Probability weighted and unbiased

» Stochastic modelling for financial options and guarantees, where relevant

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## Present value of future cash flows
*Discount rates*

**Reflect time value of money and financial risks**

» Characteristics of the cash flows

» Liquidity of the insurance contracts

» To extent that financial risks are included in the cash flows

**Consistent with observable market prices (if any)**

Timing | Currency | Liquidity

**Exclude the effect of factors in the observable market prices not relevant to insurance contracts eg credit risk**

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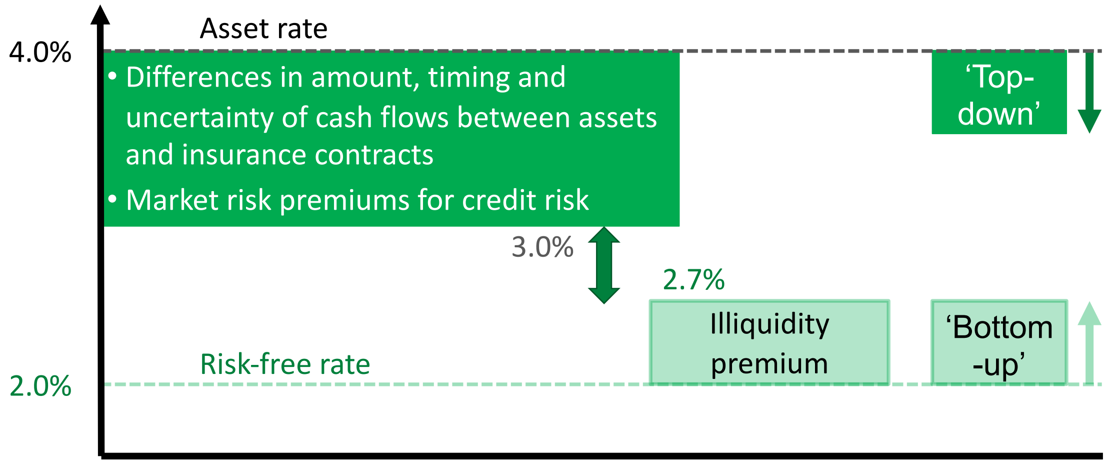
## 1 Present value of future cash flows
### *Determining the discount rates*

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## 2 Risk adjustment

» Explicit, current adjustment for compensation insurer requires for bearing non-financial risk (eg insurance risk)

» Compensation that makes a company indifferent between:

  » fulfilling a liability that has a range of possible outcomes; and

  » fulfilling a liability that will generate fixed cash flows

| | Group A | | Group B | |
|---|---|---|---|---|
| | Probability | Pay-off | Probability | Pay-off |
| | 50% | 1 000 000 | 100% | 500 000 |
| | 50% | 0 | | |
| Probability weighted average | (0.5 x 1m)+(0.5 x 0) = CU0.5m | | 1 x 0.5m = CU0.5m | |

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## 3 Contractual Service Margin (CSM)
### *Initial measurement*

The unearned profit of the group of contracts that relates to future service to be provided

The amount determined so that no gains are recognised in profit or loss on initial recognition

Example—Consider a group of contracts with
PV of future cash flows of CU4,250 and risk adjustment of CU750

If premiums CU5,500

If premiums CU3,500

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## Example
### *Contractual service margin*

» What is the unearned profit?

| | | Example 1 | Example 2 |
|---|---|---|---|
| 1 | Present value of future payments | 4 250 | 4 250 |
| 2 | Risk adjustment | 750 | 750 |
| 3 | Total outflow | 5 000 | 5 000 |
| | | | |
| 4 | Premium receivable | 5 500 | 3 500 |
| 5 | Contractual service margin (Unearned profit) | ? | ? |

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## Example
*Contractual service margin*

» What is the unearned profit?

| | | Example 1 | Example 2 |
|---|---|---|---|
| 1 | Present value of future payments | 4 250 | 4 250 |
| 2 | Risk adjustment | 750 | 750 |
| 3 | Total outflow | 5 000 | 5 000 |
| | | | |
| 4 | Premium receivable | 5 500 | 3 500 |
| 5 | Contractual service margin (Unearned profit) | 500 | -1 500 |

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*Initial measurement*

The unearned profit of the group of contracts that relates to future service to be provided

The amount determined so that no gains are recognised in profit or loss on initial recognition

Example—Consider a group of contracts with
PV of future cash flows of CU4,250 and risk adjustment of CU750

If premiums CU5,500
- Contracts profitable at inception
- CSM = CU500 [CU5,500 – CU750 – CU4,250]

If premiums CU3,500
- Contracts onerous at inception
- Day-one loss CU1,500 recognised in P&L – No CSM

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# Onerous contracts

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## Onerous contract
### *Initial recognition*

- An insurance contract is onerous at date of initial recognition if sum of
  - fulfilment cash flows allocated to the contract,
  - any previously recognised acquisition cash flows and
  - any cash flows at the date of initial recognition

  in total **are a net outflow**
- An entity shall group such contracts separately from contracts that are not onerous
- An entity shall recognise a loss in profit or loss for the net outflow for the group of onerous contracts

*IFRS 17.47*

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## Subsequent measurement
### *Onerous contract*

- A group of insurance contracts becomes onerous (or more onerous) if:
  - unfavourable changes relating to future service from changes in estimates of future cash flows and risk adjustment; and/or
  - for VFA contracts, the decrease in the amount of the entity's share of the fair value of the underlying items

  **exceed the carrying amount of the contractual service margin**
- An entity shall recognise a loss in profit or loss to the extent of that excess.

*IFRS 17.48*





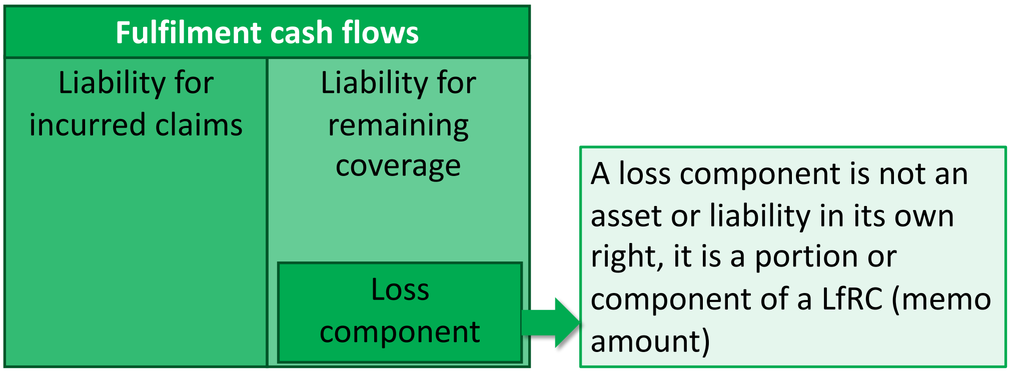
## Loss component
### *Onerous contract*

- Loss component created (increased) ***within*** FCF for onerous loss recognised
- Loss component determines amounts in P&L as reversals of losses (excluded from revenue)
- After recognising a loss, allocate
  - subsequent changes in FCF on a systematic basis between:
    - the loss component; and
    - the non-loss component
  - subsequent decrease relating to future service solely to loss component

*IFRS 17.49 to 50*

## Loss component
*Onerous contract*

» Fulfilment cash flows consist of two elements

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## Loss component
*Onerous contract*

» An entity shall establish (or increase) a loss component within FCF for an onerous group depicting losses recognised

» Loss component determines amounts in P&L as reversals of losses (excluded from revenue)

» After an entity has recognised a loss, it allocates:

- » subsequent changes in FCF on a systematic basis between:
  - » the loss component; and
  - » the non-loss
- » subsequent decrease relating to future service solely to loss component

*IFRS 17.49 to 50*

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# Income recognition

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## When is group profit recognised
*Coverage units*

The recognition in P&L of profits and losses for insurance services is based on 'coverage' units in the group

Under groups, contracts are **not tracked individually**
Objective is to reflect different levels of service

**Quantity of benefits**
- Expected benefits received
- Stand by, not actual claims
- Sum assured reasonable basis
- Must consider **valid claims**

**Expected coverage duration**
- Average expected duration for the group
- Can be discounted

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## When is group profit recognised
*Example: Coverage units*

» Insurer writes 5-year life contracts and treats as a single group:
  » 5 contracts with expected total profit of 50, 5 contracts with expected total profit of 40, all contracts provide the same level of cover per year

» Insurer expects that one contract will claim per year

| | Initial | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
|---|---|---|---|---|---|---|
| Remaining coverage units | 40 | 40 | 30 | 21 | 13 | 6 |
| Coverage units per year | | 10 | 9 | 8 | 7 | 6 |
| Unearned profit | 90.0 | 90.0 | 67.5 | 47.2 | 29.2 | 13.5 |
| Earned profit | | 22.5 | 20.3 | 18.0 | 15.8 | 13.5 |

90 x (10/40) 47.2 x (8/21)
67.5 x (9/30)

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# Premium Allocation Approach

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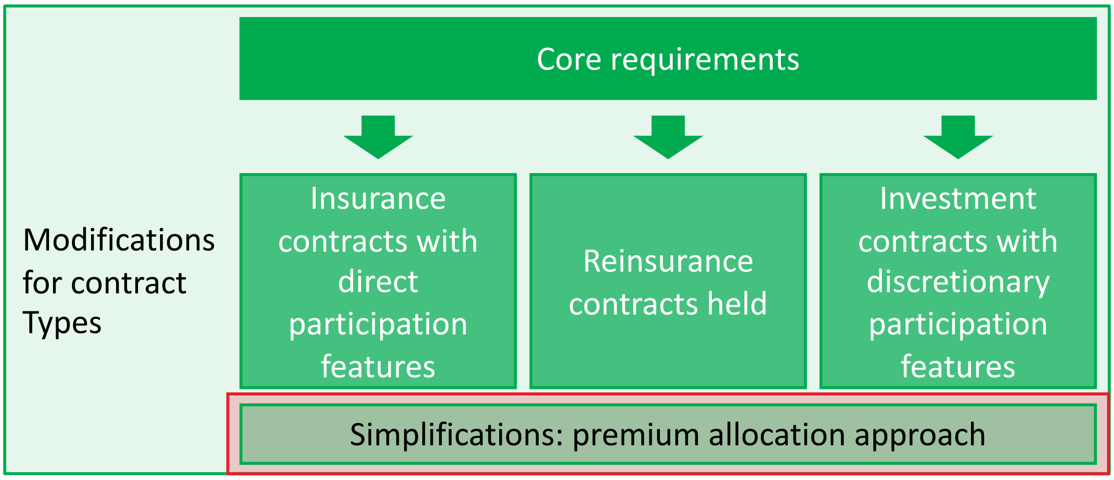
## Core Requirements
*Snapshot of IFRS 17 Approaches*

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## Introduction

- » Optional simplified approach for eligible contracts
  - » Similar outcome to core model but in a simplified, less costly way
- » Decision made at inception of the group based on assessment at that date
- » The decision is:
  - » made on a group by group basis, and
  - » is irrevocable

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## Premium allocation approach
### *Criteria*

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Coverage period of each contract in the group <= 1 year?



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## 1 Present value of future cash flows
### *Reminder: Contract Boundaries*

- Cash flows are in the boundary if they
  - arise from substantive rights and obligations which
  - allow the insurer to compel the policyholder to pay premiums **or**
  - substantially oblige entity to provide insurance services



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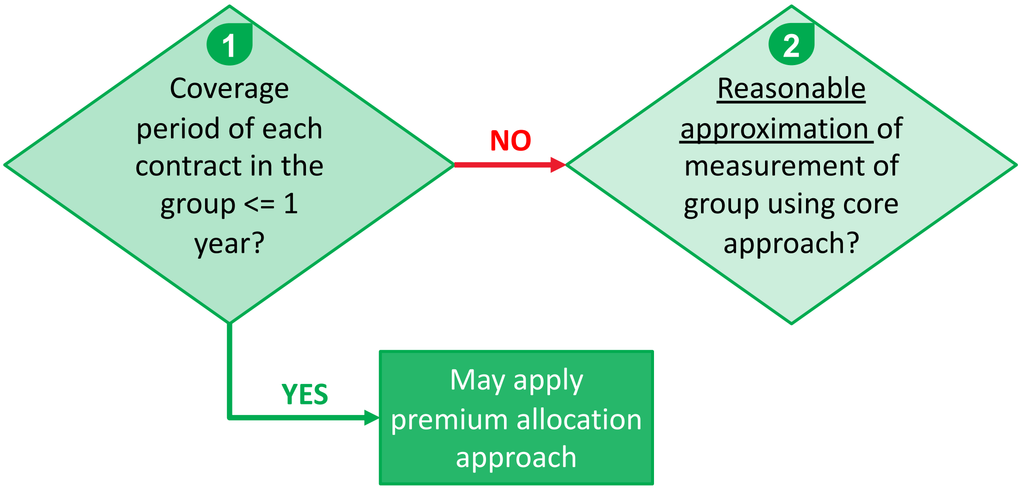
## Premium allocation approach
*Criteria*

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## 1 Present value of future cash flows
*Criteria: reasonable approximation*

- Reasonable approximation is **not** met if entity expects significant variability in the fulfilment cash flows before claims are incurred
- Variability in estimates increases for example with:
  - Extent of future cash flows relating to embedded derivatives in the contract
  - Length of coverage period

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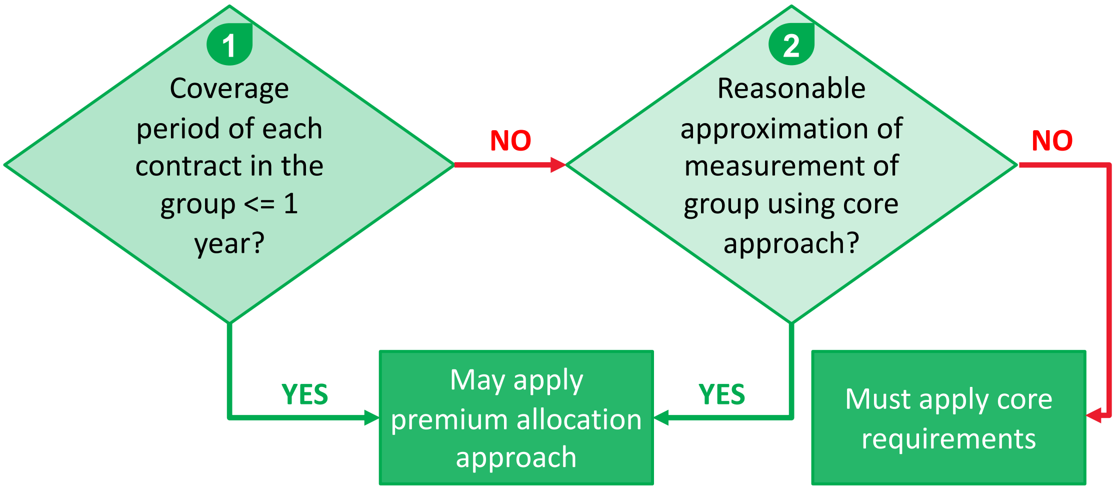
## Premium allocation approach
*Criteria*

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## Level of aggregation

- For contracts <u>applying premium allocation approach</u>
  - assume <u>no contracts are onerous unless</u> facts and circumstances indicate otherwise
  - assess whether contracts  not onerous have no significant possibility of becoming onerous subsequently by assessing likelihood of changes in applicable facts and circumstances

*IFRS17.18*

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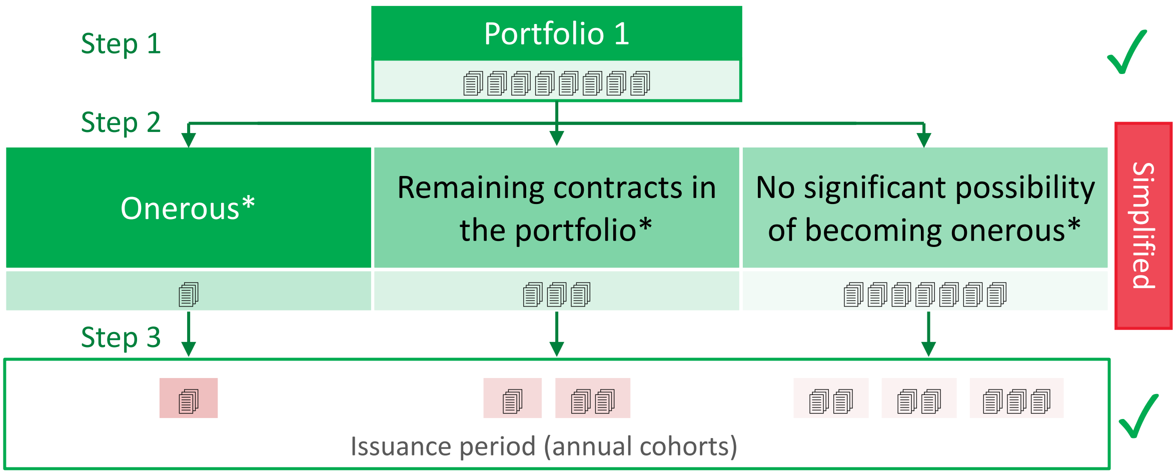
## How are contracts grouped?
***Step***




* At initial recognition, if any

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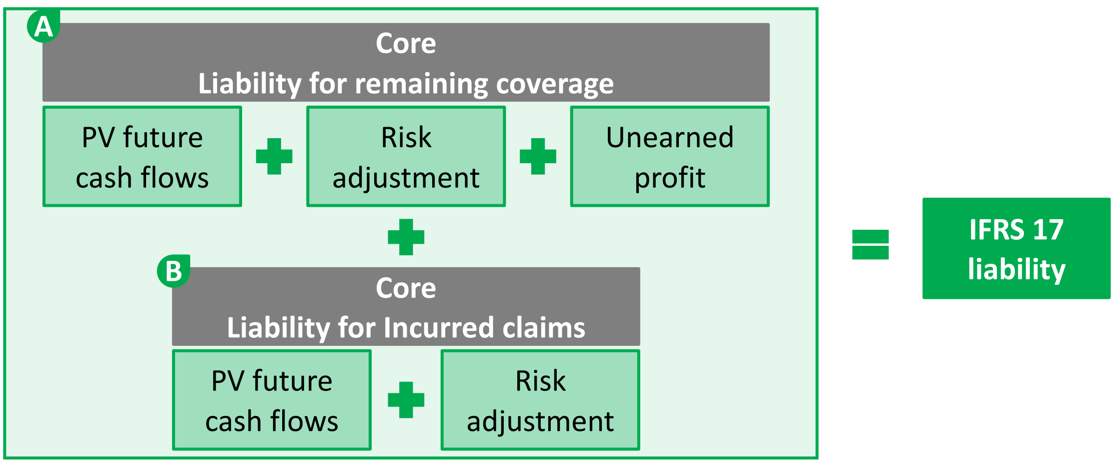
## Core requirements
***Reminder***

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## Premium Allocation Approach
*Simplifications*

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**Core**
**Liability for remaining coverage**

PV future cash flows + Risk adjustment + Unearned profit

| Simplifications | Optional practical expedients |
|---|---|
| » <u>No split</u> required<br>» Limited use of <u>future estimates</u><br>» <u>optional</u> practical expedients | » If coverage less then 1 year, then:<br>» not required to accrete interest<br>» recognise acq cash flows as expense |

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## Recognition

» Insurance contracts are recognised from the earliest of:
- » beginning of coverage period of first contract in group
- » date when first payment from a policyholder becomes due, or
- » for onerous contracts, when the group becomes onerous <u>(facts and circumstances)</u>

» If no contractual due date, then date received

» Acquisition cash flow asset or liability is recognised when incurred, and derecognised when the group of insurance contracts to which the cash flows are allocated is recognised

*IFRS 17.25 to 28*

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## Premium allocation approach
### *Simplifications - initial measurement*

Premiums (if any) received at initial recognition

CF

Cash premium received at initial recognition creates/increases liability

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## Premium allocation approach
### *Simplifications - initial measurement*

Premiums (if any) received at initial recognition

CF

Acquisition costs

Acquisition cost asset derecognised

CF

**Practical expedient**

Entity can elect to expense acquisition cost immediately

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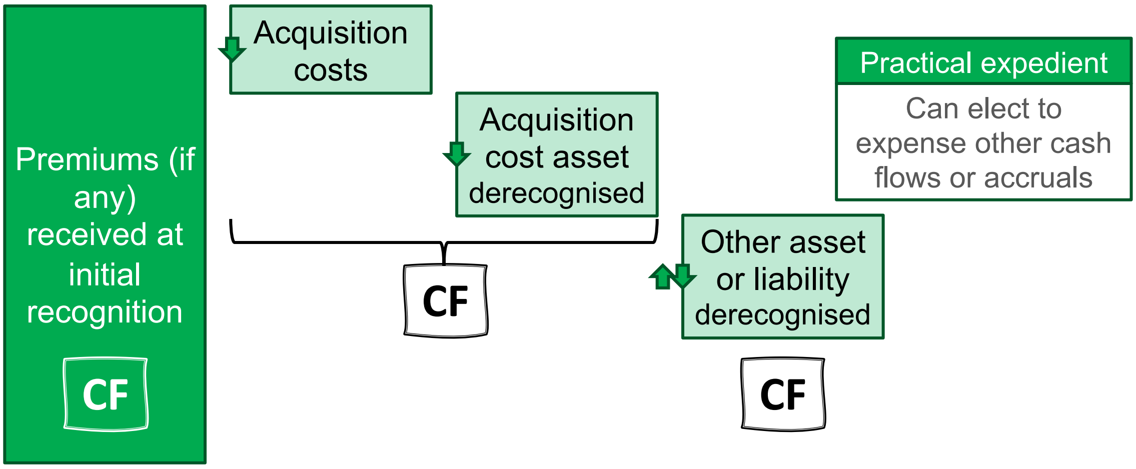
## Premium allocation approach
*Simplifications - initial measurement*

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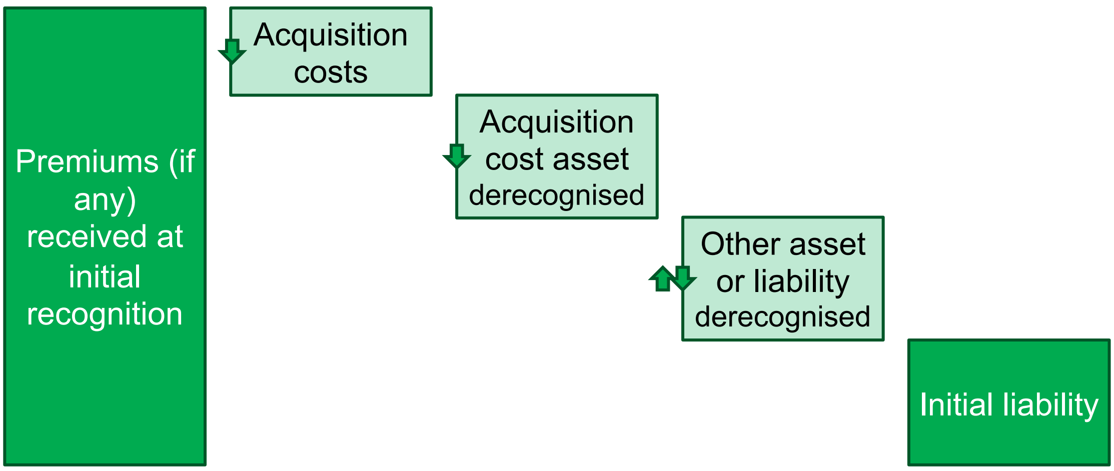
## Premium allocation approach
*Simplifications - initial measurement*

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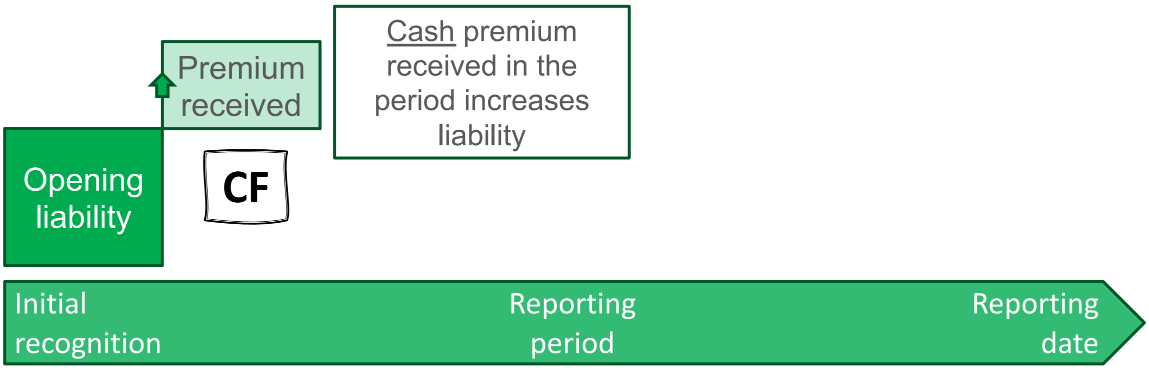
## Premium allocation approach
### *Simplifications - subsequent measurement*

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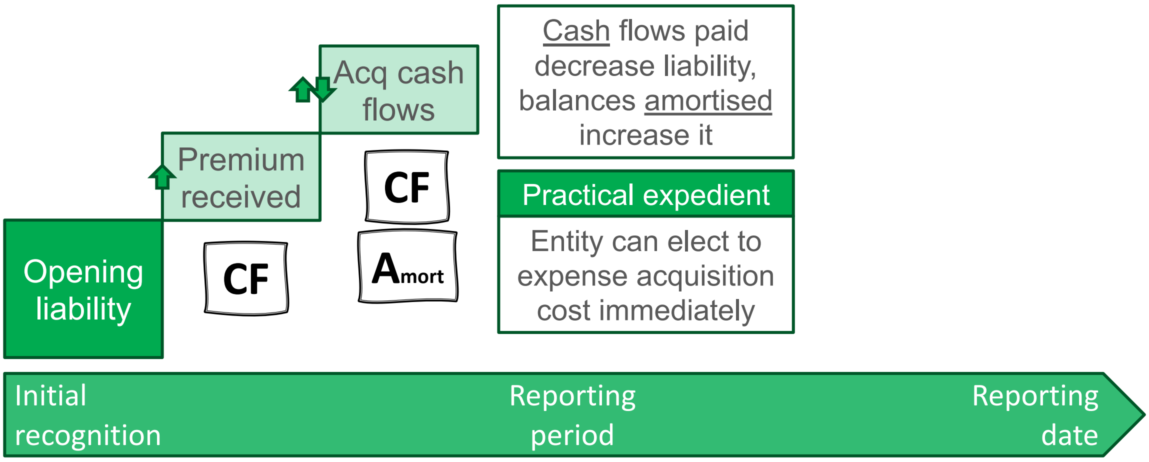
## Premium allocation approach
### *Simplifications - subsequent measurement*

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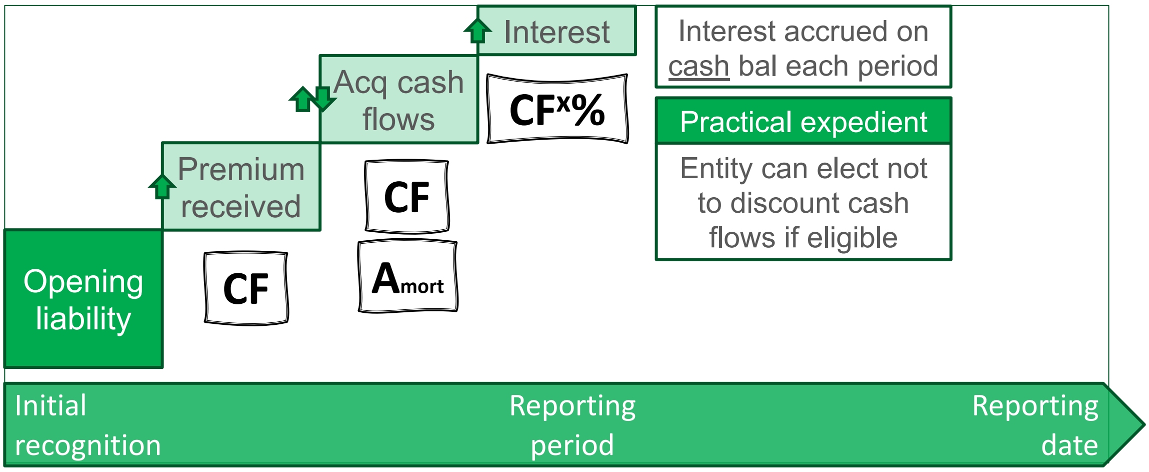
## Premium allocation approach
### *Simplifications - subsequent measurement*

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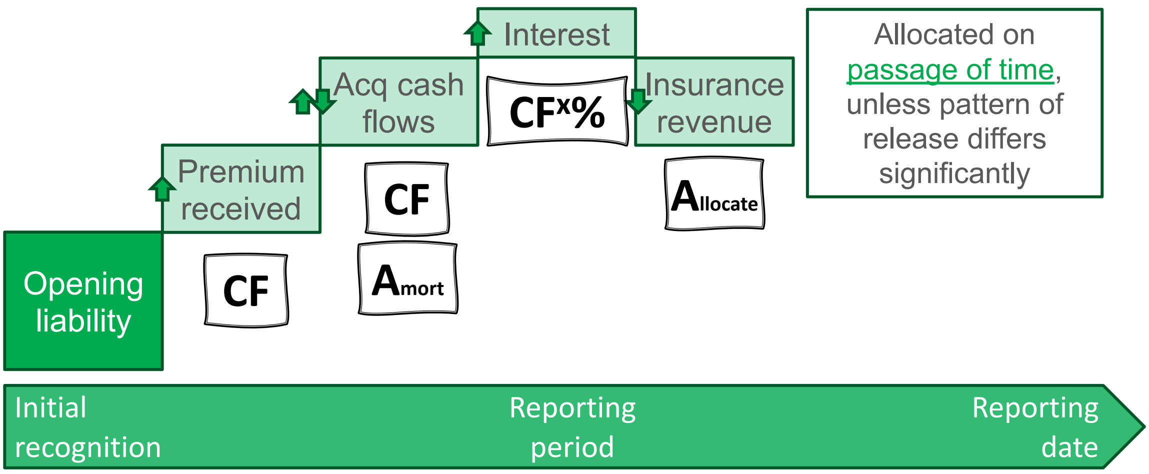
## Premium allocation approach
### *Simplifications - subsequent measurement*

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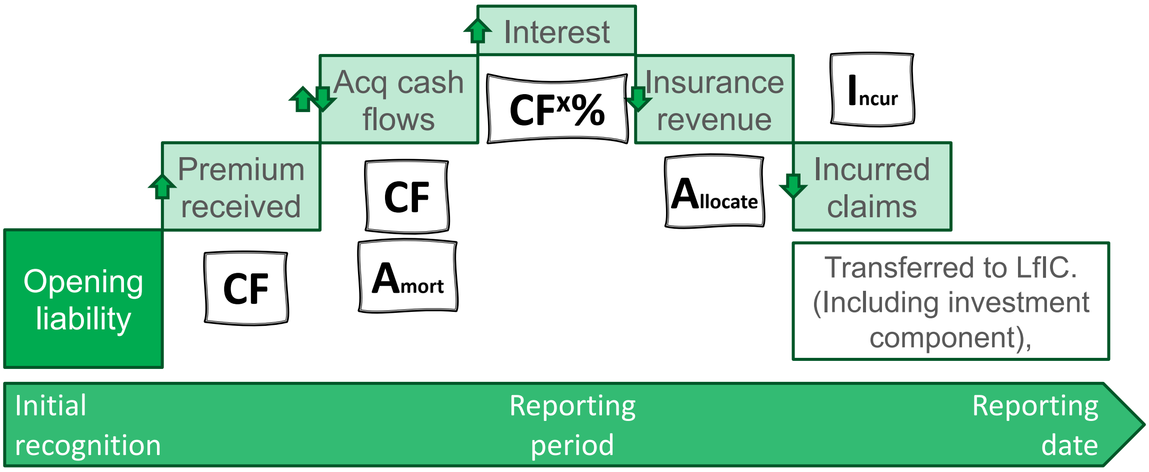
## Premium allocation approach
### *Simplifications - subsequent measurement*

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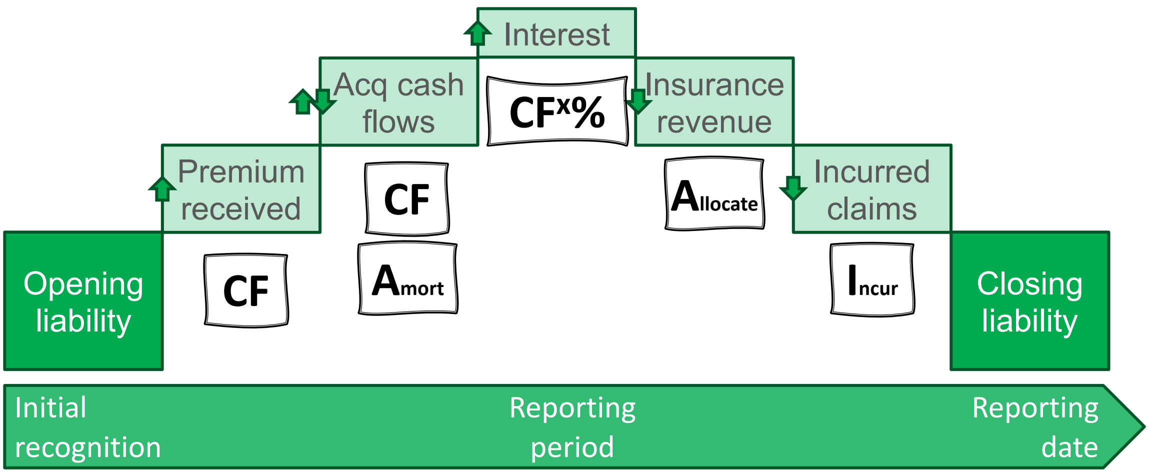
## Premium allocation approach
### *Simplifications - subsequent measurement*

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## Core requirements

A **Core**
**Liability for remaining coverage**

PV future cash flows + Risk adjustment + Unearned profit

+

B **Core**
**Liability for Incurred claims**

PV future cash flows + Risk adjustment

= **IFRS 17 liability**

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## Premium Allocation Approach
### *Simplifications*

B **Core**
**Liability for Incurred claims**

PV future cash flows + Risk adjustment

| Simplifications | Optional practical expedient |
| --- | --- |
| » Consistent with core model, but<br>» Optional practical expedient | » Discount claims at current rate <u>unless</u> settlement expected in no more then 1 year |

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## Premium Allocation Approach
*Simplifications*

| Core<br>Liability for remaining coverage | | | + | Core<br>Liability for Incurred claims | | = | IFRS 17 liability |
|---|---|---|---|---|---|---|---|
| PV future cash flows | Risk adjustment | Unearned profit | | PV future cash flows | Risk adjustment | | |

| Premium allocation<br>Liability for remaining coverage | + | Premium allocation<br>Liability for incurred claims | = | IFRS 17 liability |
|---|---|---|---|---|
| » No split required<br>» Cash flows based, limited forecasting<br>» Other practical expedients | | » Consistent with core<br>» Practical expedient for discount rate | | |

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# Onerous Contracts

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## Onerous contracts
### *Recognition*

- *If at any time during the coverage period, facts and circumstances indicate that a group of insurance contracts is onerous, an entity shall calculate the difference between:*
  - The carrying amount determined above and
  - The fulfilment cash flows calculated applying the core model (ignoring discounting if that is what the entity has elected)
- Determined:
  - **Only if** facts and circumstances indicate (don't have to test otherwise)
  - At a group level
  - At initial inception or subsequently

*IFRS17.57*

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## Onerous contracts
### *Loss component*

- If a PAA contract is initially or subsequently onerous, entity recognises the expected loss in profit or loss immediately (*loss component*)
- General requirements of IFRS 17 require establishing, tracking and running-off of a 'loss component'
  - Loss component is 'amortised' over the life of the contract until it is zero (it must be zero at the end of the contract)
  - The standard does not specify the pattern for the pattern of recognition.

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Thank you

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