IFRS 17 *Insurance Contracts*

08 October 2019

Building a better working world

Agenda

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3 Separation
4 Recognition, modification and derecognition
5 Level of aggregation
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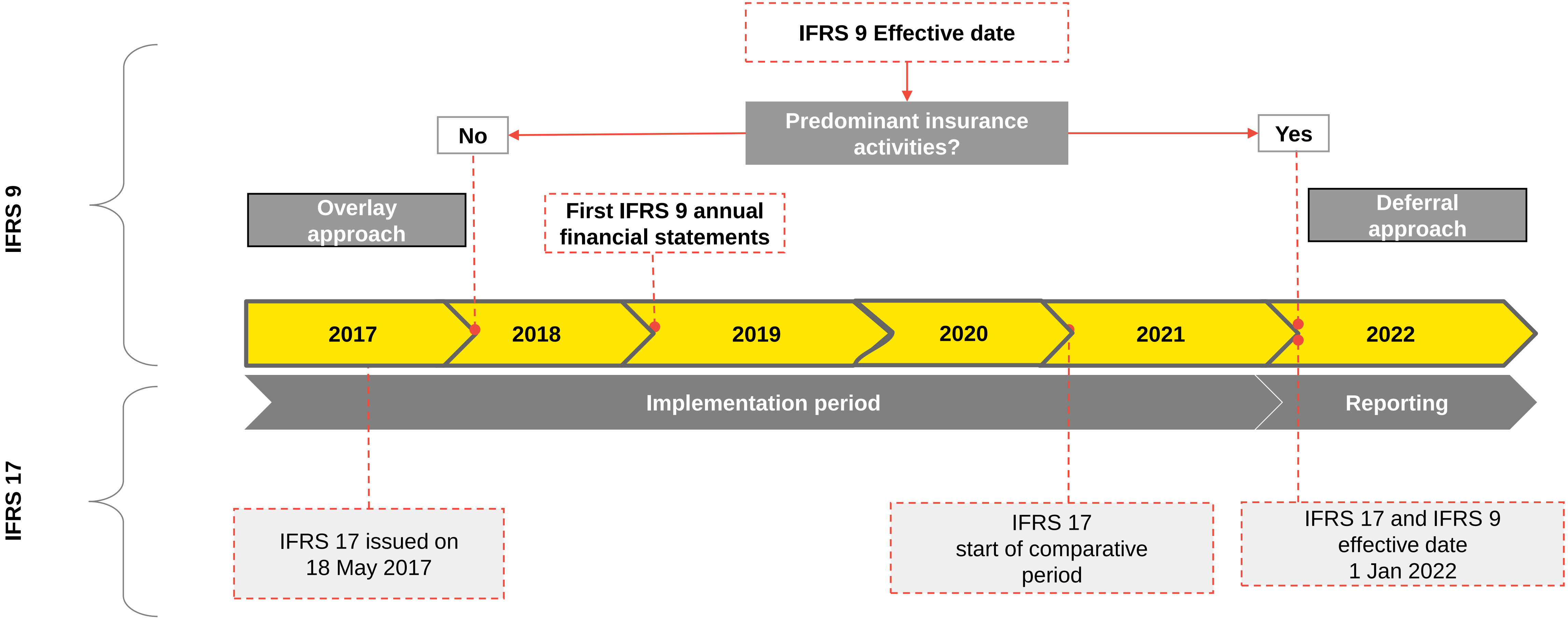
Section 1

IFRS 17 timeline

IFRS 17 and IFRS 9 – timeline



Section 2

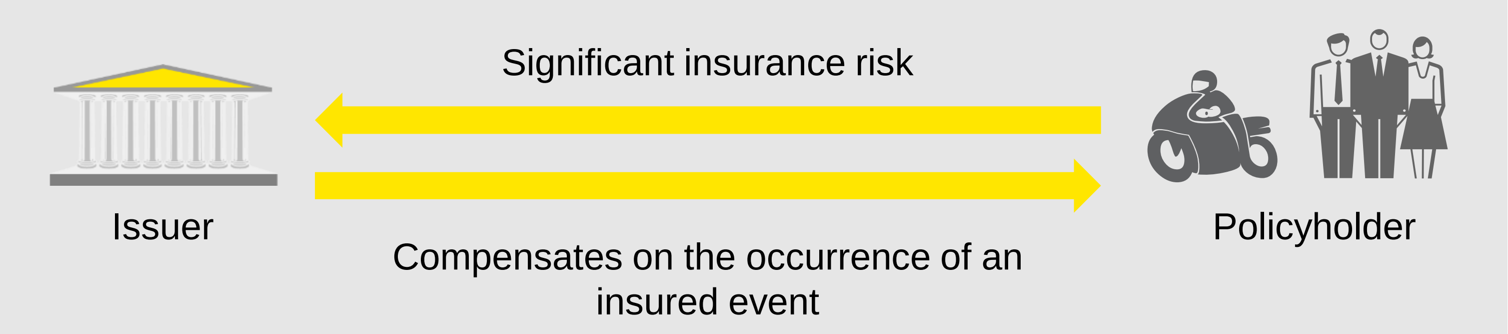
Definition and scope

Definition of insurance contract under IFRS 17:

A contract under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

Significant insurance risk:
Significant if and only if an insured event could cause an additional **amount** that has commercial substance in any single scenario; consider in a present value basis, but not the probability of the event.

Significant insurance risk only occurs when there is a possibility that an issuer will incur a loss on a present value basis.



EY insights

01 The definition of insurance contract applies to a contract instead of a company under IFRS 17.

02 The definition of an insurance contract under IFRS 17 is consistent with the definition under IFRS 4.

03 For determination of significant insurance risk transfer, any scenarios that have no commercial substance are excluded.

04 This means that an insurance contract transfers insurance risk only if there is a scenario that has commercial substance in which the issuer has a possibility of a loss on present-value basis.

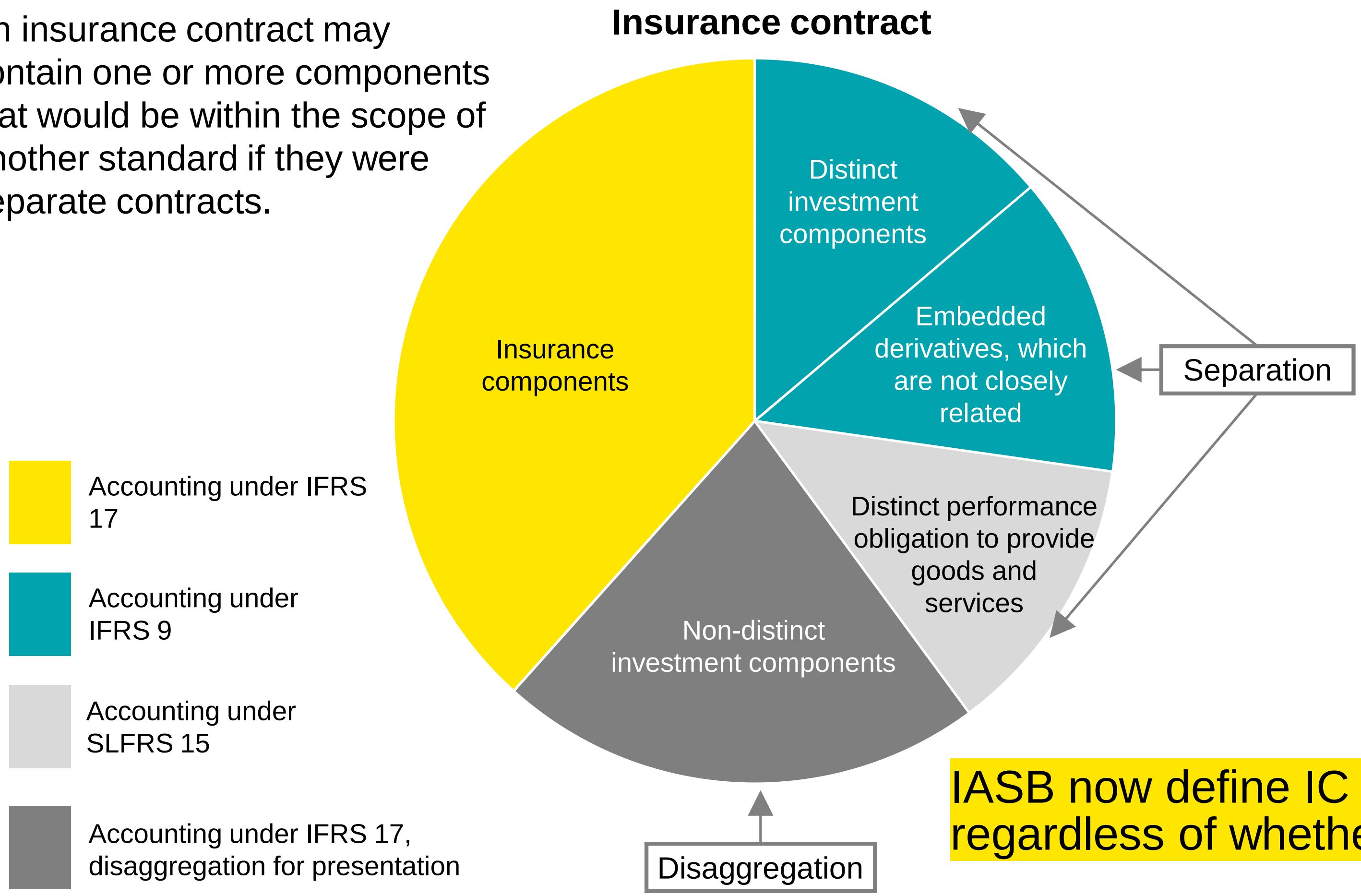
Section 3

Separation

Disaggregate non-distinct investment component

For measurement purposes, an insurance contract is the cash flows remaining after non-insurance components are separated.

An insurance contract may contain one or more components that would be within the scope of another standard if they were separate contracts.



EY insights

01 Investment component is defined as:
The amounts that an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur.

02 An investment component is distinct if, and only if, both the following conditions are met:

(i) it is not highly interrelated with the insurance component; and

(ii) a contract with equivalent term is sold or can be sold separately in the same market or same jurisdiction.

03 **There is an indicator that an investment component is highly interrelated if the policyholder is unable to benefit from one component unless the other is also present.**

04 **Disaggregation is the exclusion of an unseparated investment component from insurance contracts revenue in the statement of comprehensive income.**

IASB now define IC as the amount <u>paid in all circumstances</u> regardless of whether the insurance event occurs.

Section 4

Recognition, modification and derecognition

Impacts on the recognition, modification and derecognition should be assessed

The IFRS 17 standard indicates the earliest date when an insurance contract is recognised. It also gives guidance on how contract modifications are treated and the subsequent implications for derecognising an insurance contract.

Recognition	Modification	Derecognition
Earliest of the three dates ▪ Beginning of the coverage period ▪ Due date of first payment from the policyholder ▪ Indication that group of contract is onerous	**Modification examples** ▪ Separation results in a different insurance contract ▪ Results in a different group of contracts ▪ Results in a different contract boundary	**Effect of derecognizing a contract** Derecognition within a group of insurance contracts by adjusting: ▪ Fulfilment cash flow of the group ▪ CSM of the group

EY insights

01 If the terms of an insurance contract are modified, an entity shall derecognize the original contract and recognize the modified contract as a new contract applying IFRS 17 or other applicable standards if certain conditions are met.

02 Change of the measurement model (i.e. GM, PAA, VFA) is another example of the modification.

03 Derecognition of an insurance contract happens when, and only when, the insurance contract expires or is discharged or cancelled or when modifications meet certain criteria.

Section 5

Level of aggregation

Significant judgement is required for the level of aggregation

At Contract Inception

1 **Portfolio**

Portfolio = A group of contracts
(a) subject to similar risks
(b) managed together

2

Onerous contracts at inception

Contracts not onerous at inception

Other profitable contracts

No significant possibility of becoming onerous subsequently

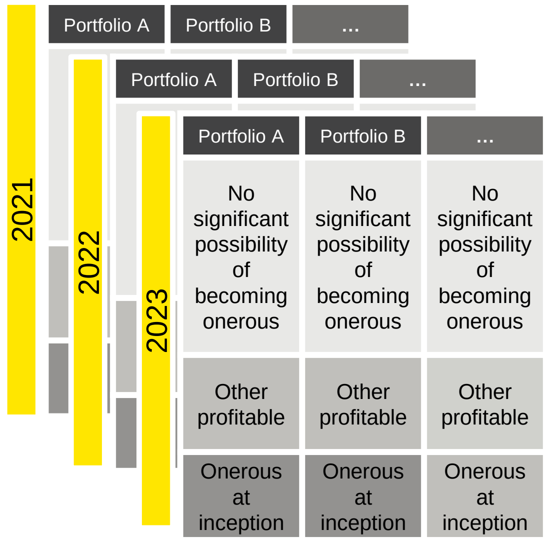
Assessment based on:
(a) Likelihood of changes in assumptions (PAA: facts and circumstances) which, if they occurred, would result in the contracts becoming onerous.
(b) Using internal information about changes in estimates (consistent with internal reporting)

3 **Annual cohorts**

Permitted to group only contracts issued no more than one year apart

A loss is recognized in the P&L at inception

CSM is recognized and released as insurance service is provided



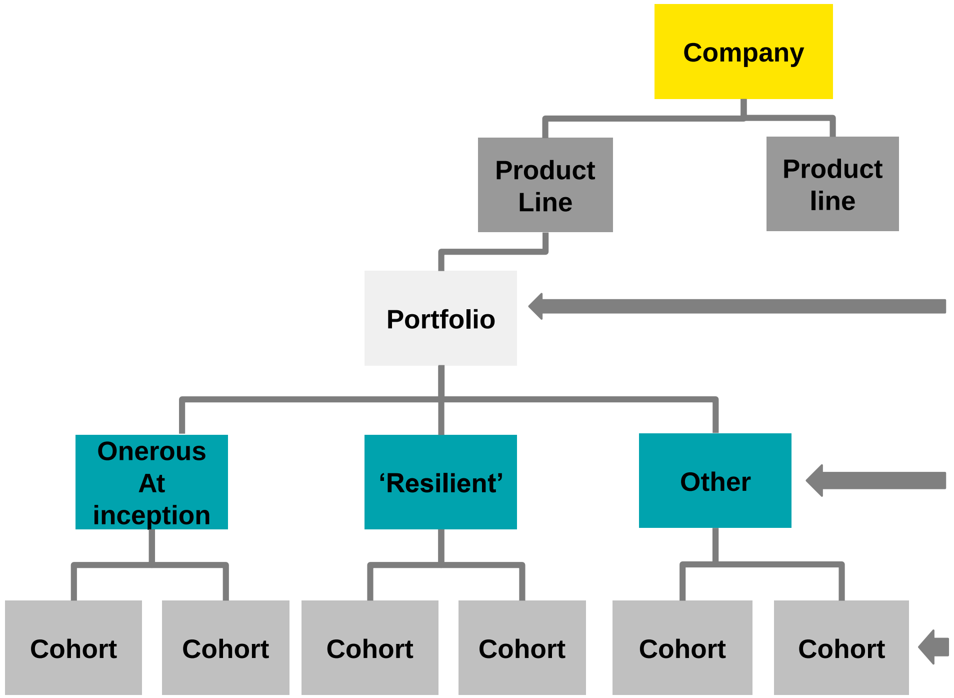
Assessment is done at contract inception – no subsequent re-assessment

Significant judgement is required for the level of aggregation

An entity shall identify portfolios of insurance contracts that are subject to similar risks and managed together.

Contracts in different product lines would not be expected to have similar risks and hence would be expected to be in different portfolios. An entity shall divide a portfolio of insurance contracts issued into a minimum of:

- A group of contracts that are onerous at initial recognition
- A group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently
- A group of the remaining contracts in the portfolio



Assessment could be top-down for 'sets' of contracts based in reasonable and supportable information, otherwise based on individual contracts.

Contracts subject to similar risks and managed together. Contracts in different product lines will be in different portfolios, but a product line could have multiple portfolios.

Onerous contracts at inception to be identified separately. Additional disaggregation based on whether there is a significant possibility of becoming onerous subsequently.

Disaggregation based on contracts written no more than a year apart ('cohorts'). Basis for subsequent tracking and releasing of CSM.

EY insights

01 Groups of contracts shall be established at the inception of the contracts, and the composition shall not be reassessed subsequently.

02 Onerous contract test at initial recognition can be conducted by measuring:

(i) any sets of contracts using reasonable and supportable information; or

(ii) individual contracts.

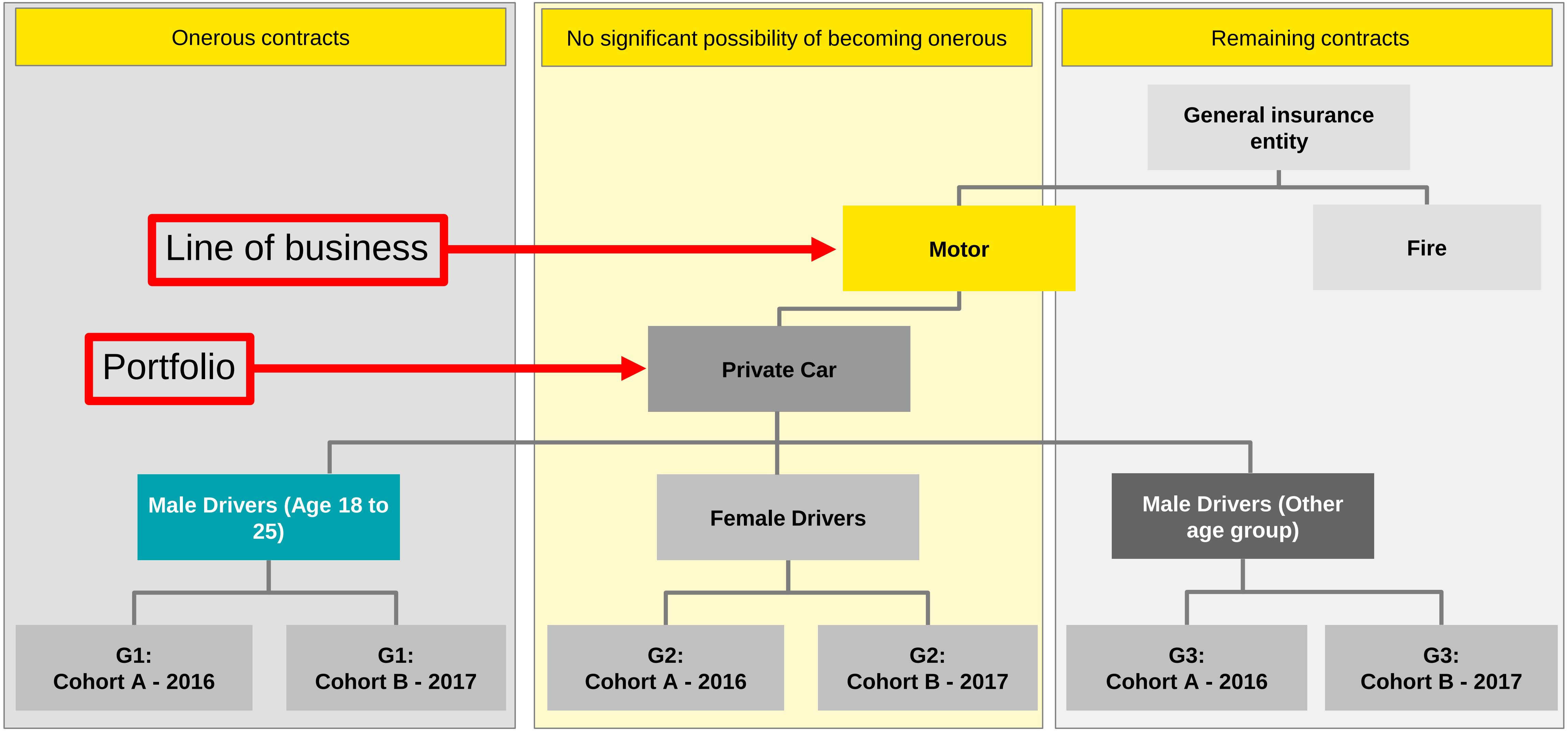
03 Non-onerous contracts are determined to have no significant possibility of becoming onerous based on:

(i) the likelihood of changes in assumptions; or

(ii) information about estimates provided by the entity's internal reporting.

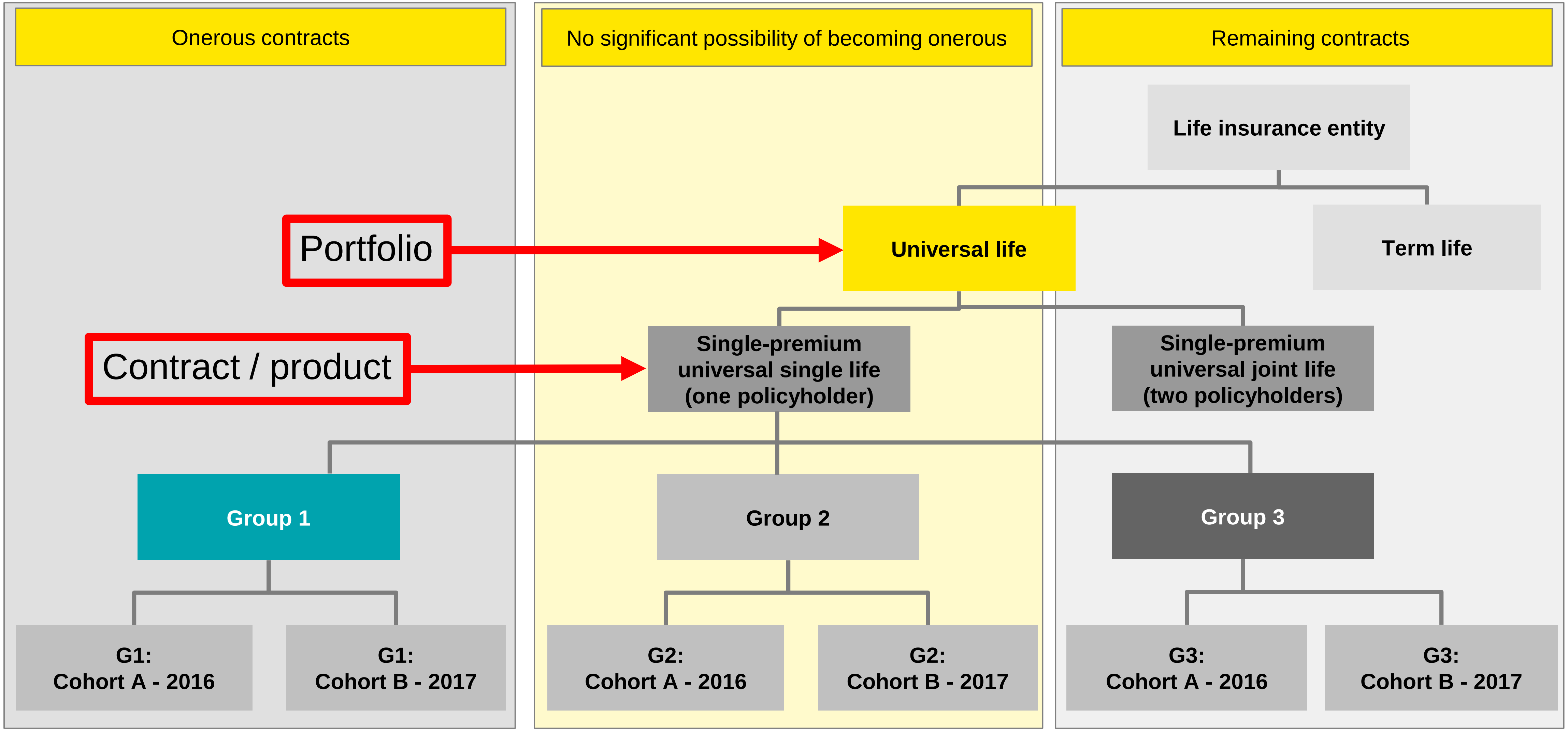
Level of aggregation

Example…..



5 Level of aggregation

Example…..



Section 6

Measurement model

Measurement model

Measurement Model

General Model (GM)	Default model for all insurance contracts	General model should be applied to all insurance contracts, unless they have direct participation features or the contract is eligible for, and the entity elects to apply, the premium allocation approach.
Variable Fee Approach (VFA)	Model for direct participating business	Variable fee approach should be applied to insurance contracts with direct participation features. This approach deals with participating business where payments to policyholders are contractually linked and substantially vary with the underlying items
Premium Allocation Approach (PAA)	Simplified measurement for short-term contracts	Premium allocation approach is an optional simplification for measurement of liability for remaining coverage for insurance contracts with short-term coverage.

Section 7

General model

Overview

Contractual service margin

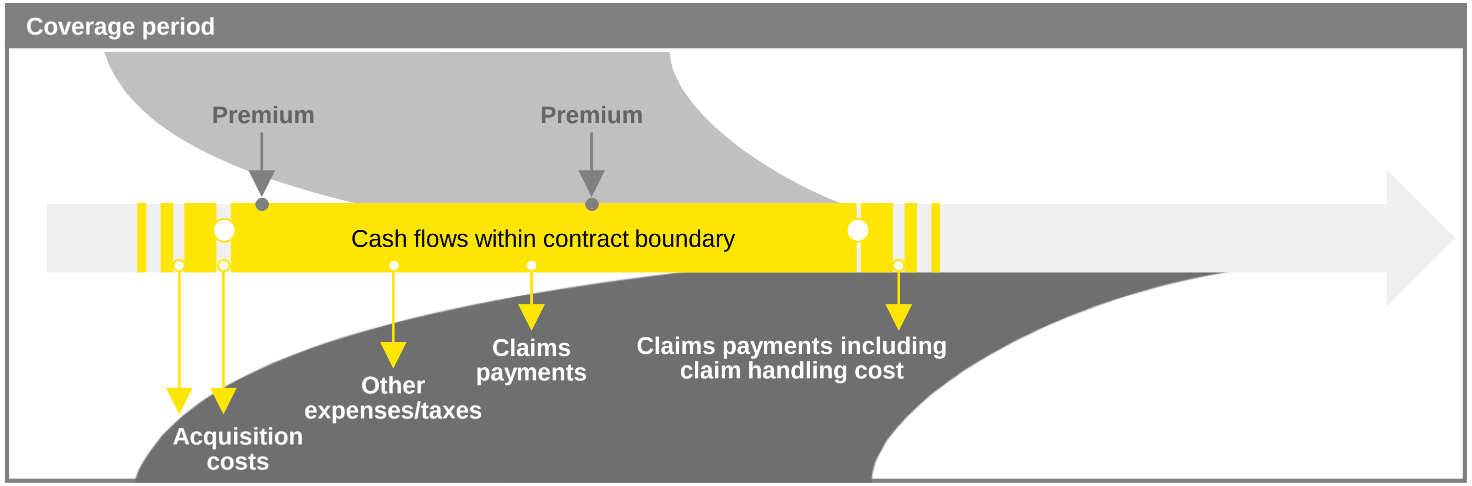
Risk adjustment

Time value of money

Future cash flows

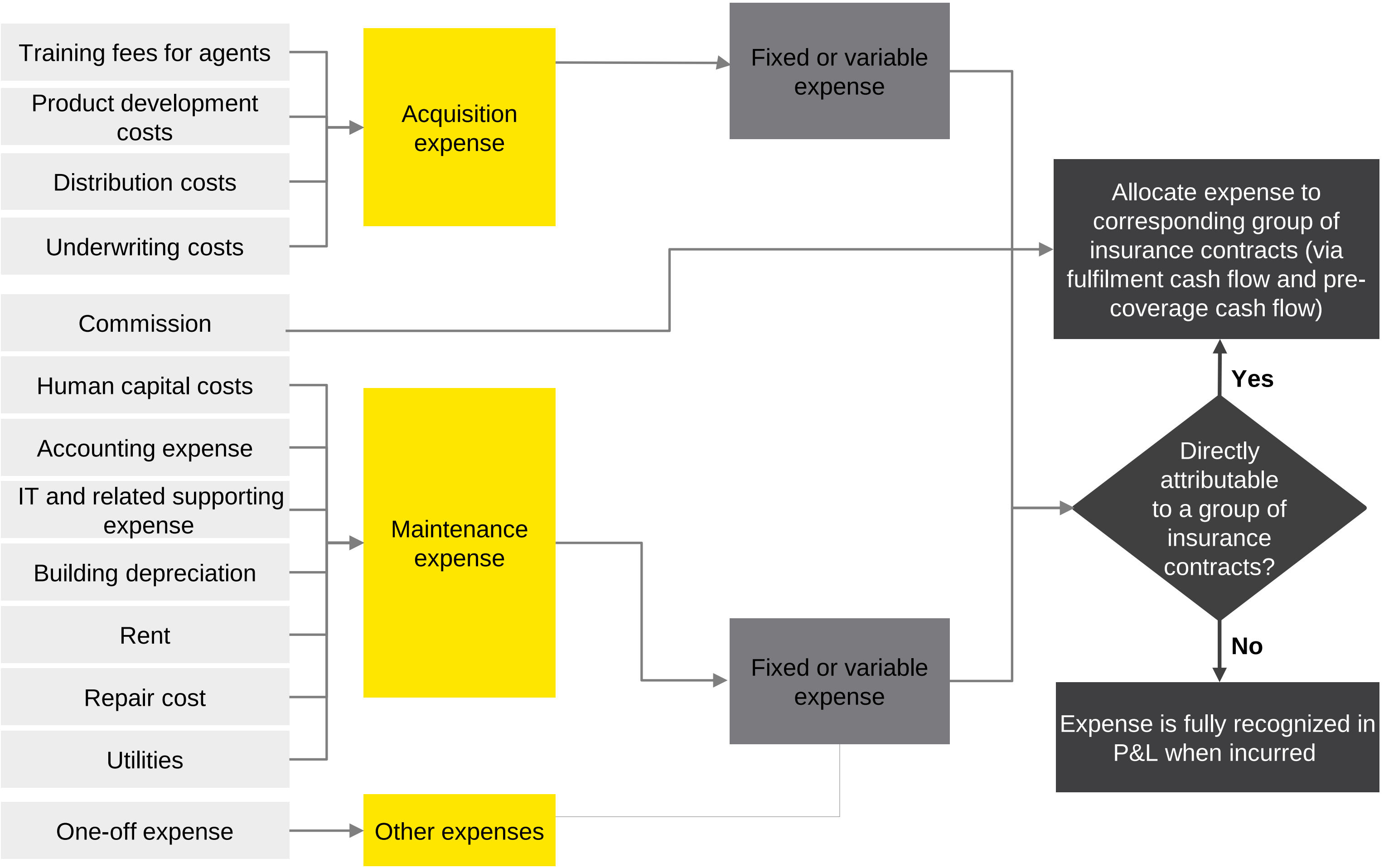
The estimates of CFs used to determine the fulfilment CFs shall include all cash inflows and outflows that relate directly to the fulfilment of the portfolio of contracts:

- Current and explicit (separate from discount rate and risk adjustment)
- Incorporate all available information in an unbiased manner (including trends)
- Include all CFs within contract boundary
- Perspective of the entity



Future cash flows - The definition of attributable expense is extremely important

A systematic, appropriate apportionment method should be used to allocate expenses into groups of contract. Expenses with similar features should be treated systematically and consistently.



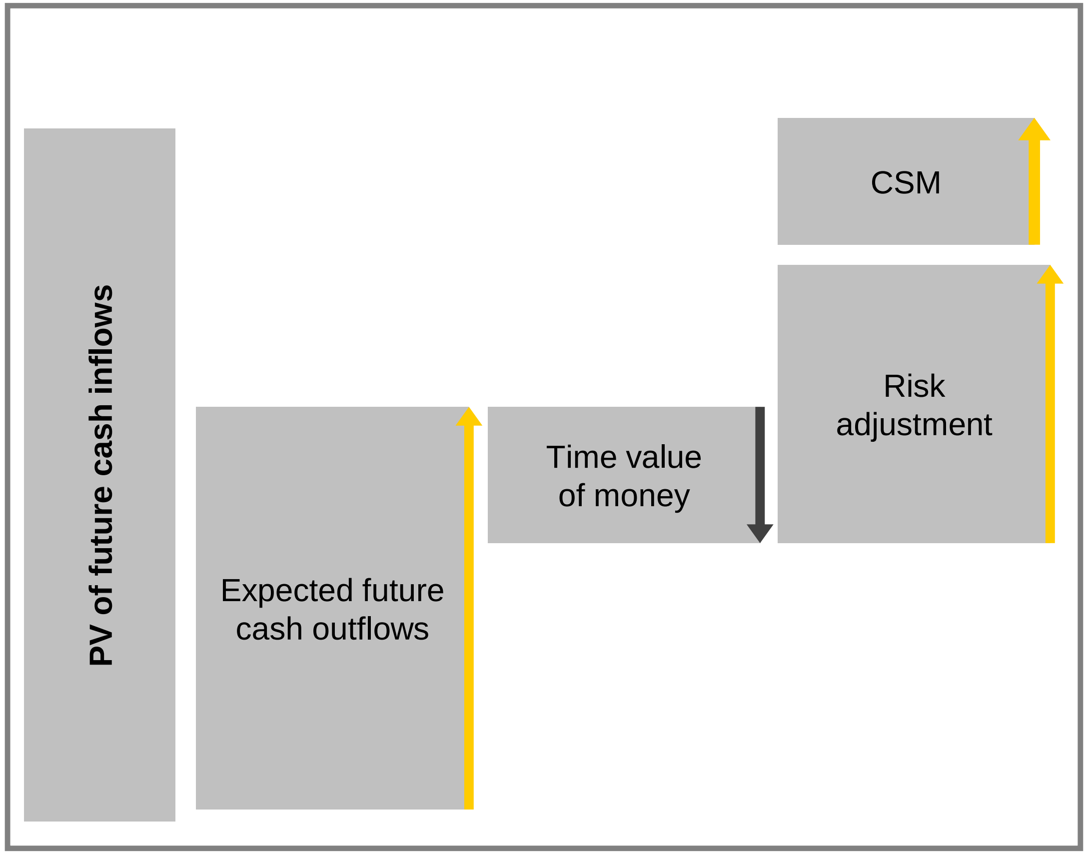
EY insights

01 The entity should establish the attributable expense assumptions based on your current expense policy, and assess the corresponding impact on the FCF.

02 The expense granularity, allocation of the fixed and variable overheads directly attributable to fulfilling insurance contract would require systematic and rational expense record and study.

General model

Overview



The unearned profit that the entity recognises as it provides services

The compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils the insurance contract

Discount rate that reflects the characteristics of the liabilities (in particular the time value of money)

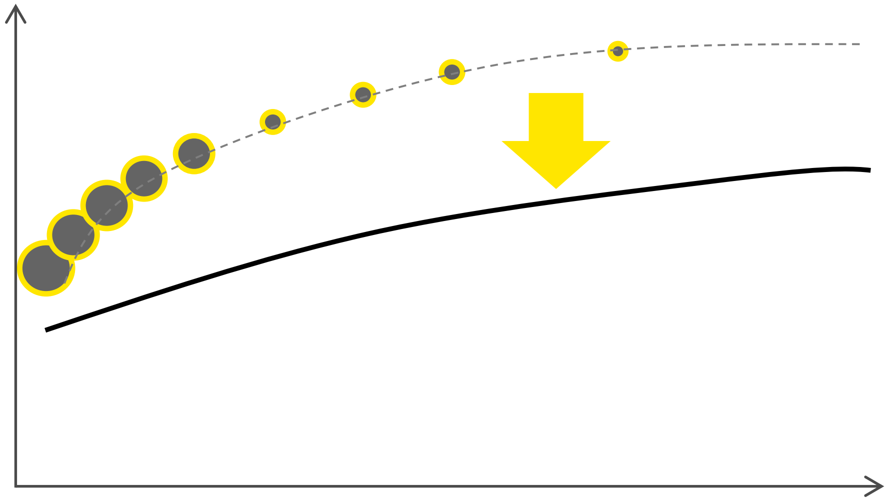
An explicit, unbiased and probability-weighted estimate of future net cash flows that will arise as the entity fulfils the insurance obligations

Time value of money - The discount rates used may impact results significantly

Top-down approach
Current market rates of returns:
either of own asset portfolio or a reference portfolio

Adjust for **risks that are not relevant to the insurance contract**, e.g., default risk, market risk

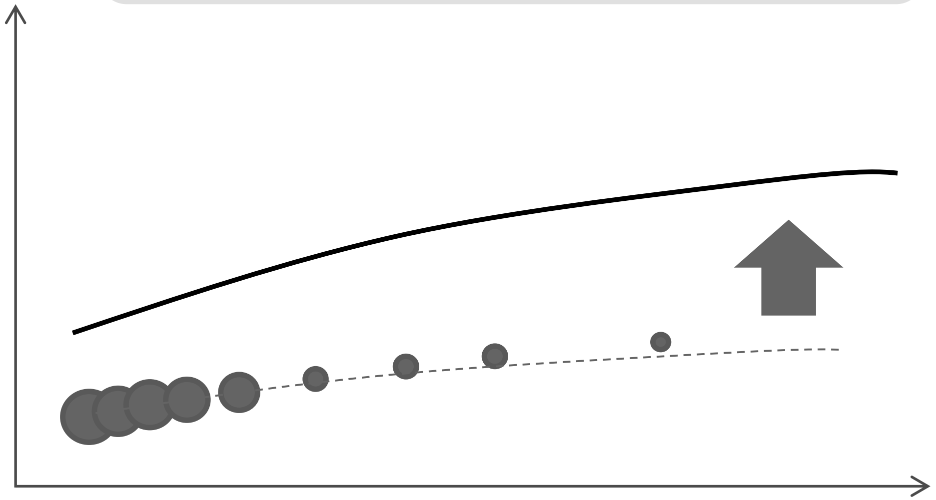
Adjust for **duration differences** if necessary
(No need to adjust for the difference due to liquidity)



Adjust for **other characteristics** of the insurance contracts if necessary

Illiquidity premium: Adjust for liquidity characteristics of the insurance contracts

Bottom-up approach
Risk-free yield curve with similar characteristics
(e.g., duration, currency)

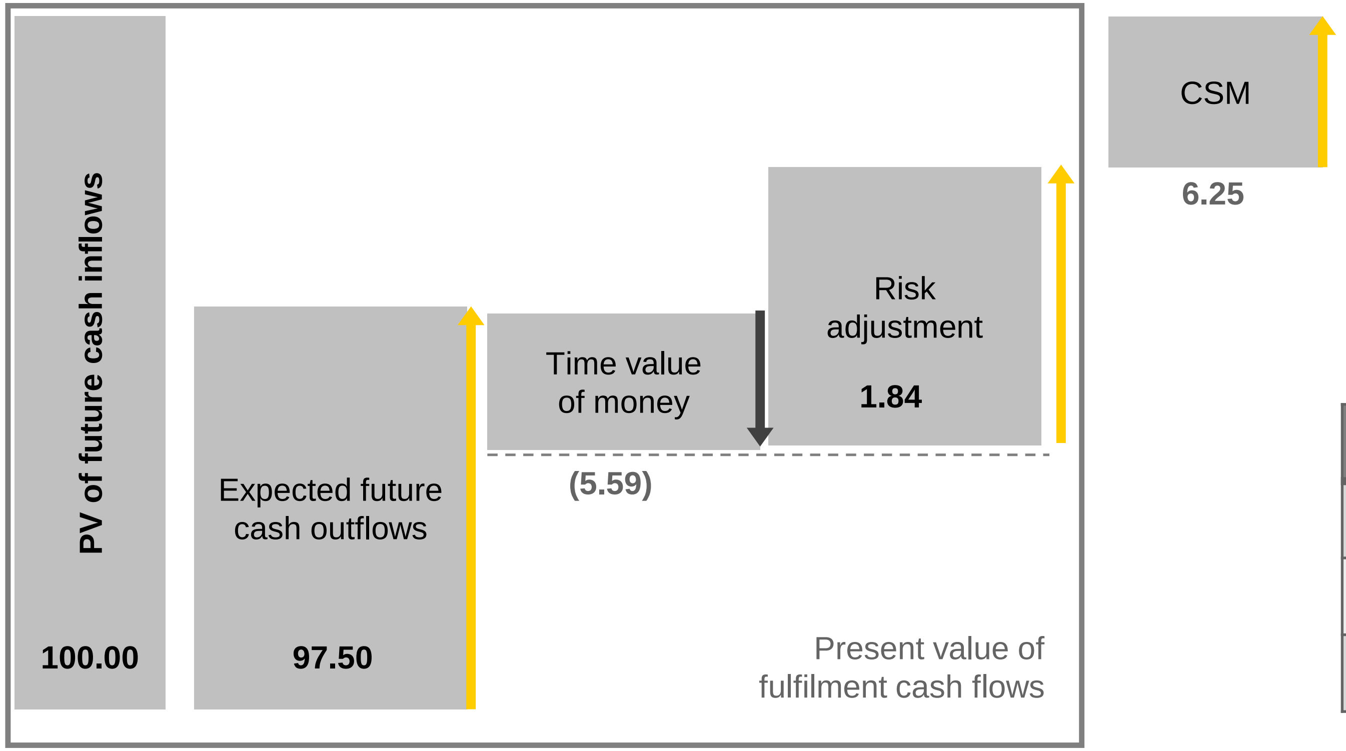


Sample contract – Contract data

- Portfolio of term life contracts
- Duration: 5 years
- Single premium: 100
- Due at inception on Jan 1 (t = 0)
- Regular claim outflows each year Due at the end of each period, for the first time on Dec 31 (t = 1)
- Discount rate: 2%
- Risk adjustment = 2% of the PV of expected cash outflows

t	Cash inflows (expected t = 0)	Cash outflows (expected t = 0)
0	100	0
1	0	19.5
2	0	19.5
3	0	19.5
4	0	19.5
5	0	19.5
	100	**97.5**

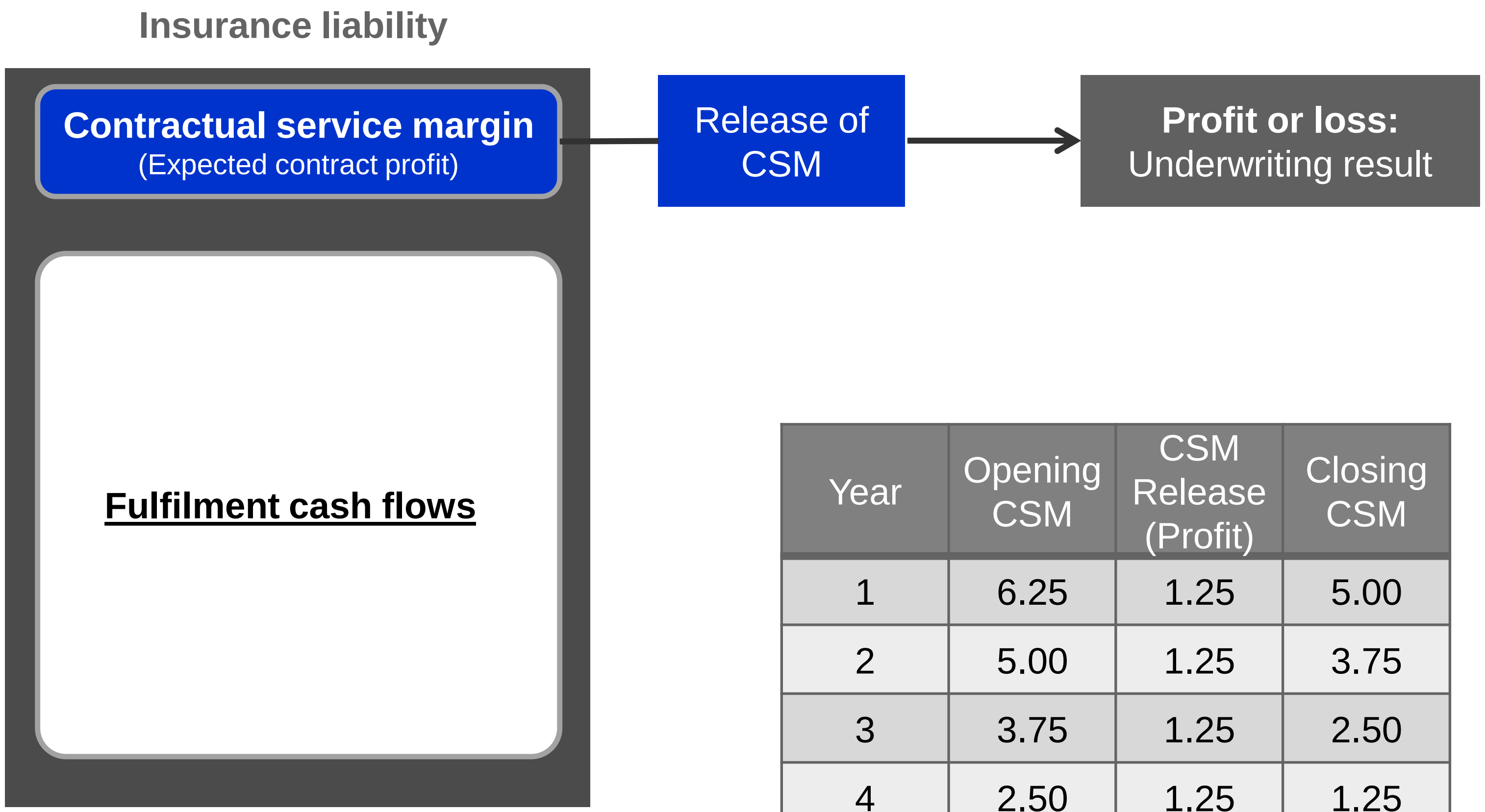
Sample calculation - BBA



- CSM – 6.25
- RA – (97.5 – 5.59)*2% = 1.84
- Discount effect – 5.59
- FCF – (100 – 6.25 – 1.84)= 91.94

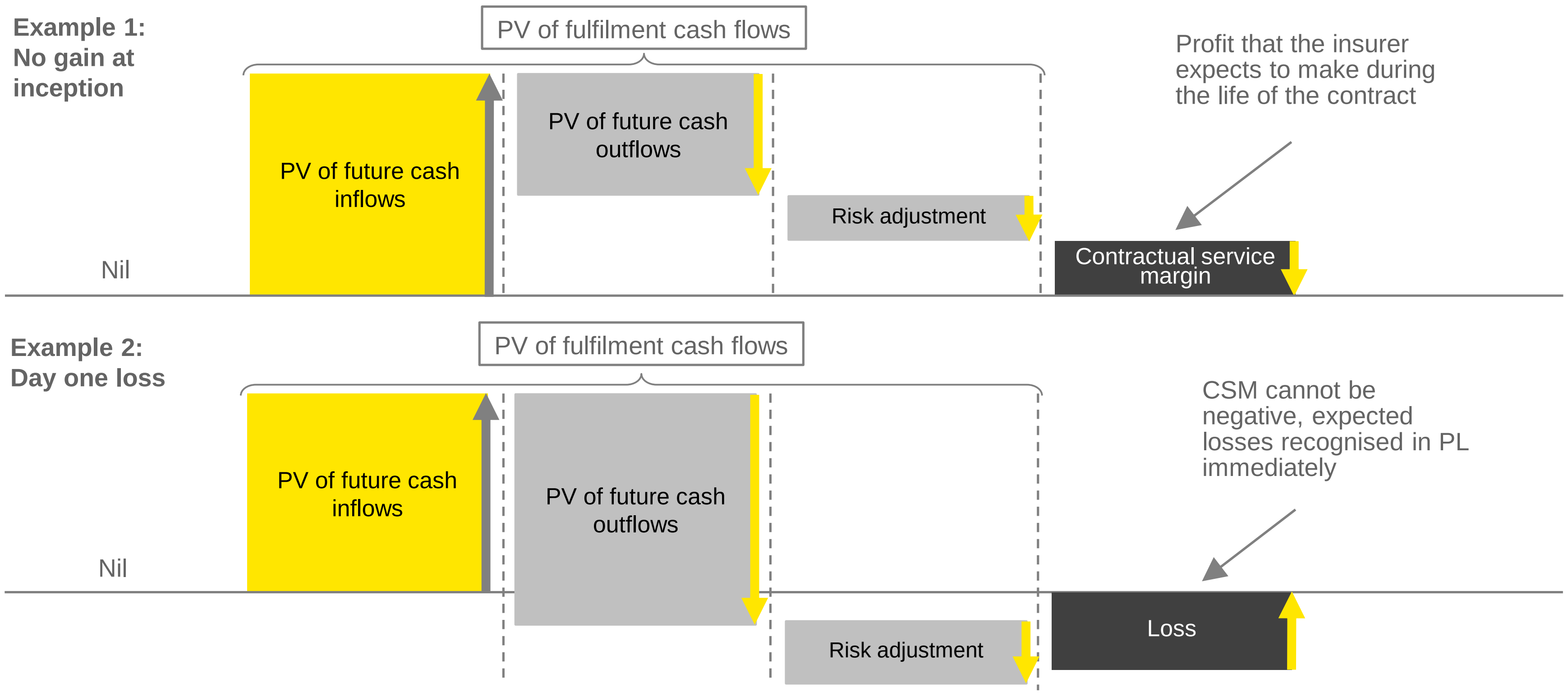
BBA – Initial Measurement	
CSM	6.25
RA	1.84
Fulfillment CF	91.94

Sample calculation - BBA
Assuming no variability in fulfilment cash flows



Year	Opening CSM	CSM Release (Profit)	Closing CSM
1	6.25	1.25	5.00
2	5.00	1.25	3.75
3	3.75	1.25	2.50
4	2.50	1.25	1.25
5	1.25	1.25	-

BBA – Measurement on initial recognition



Section 8

Variable fee approach

Variable fee approach

Overview

	Continuum of insurance contracts		
Type of contract	**Non-participating**	**Indirect participating**	**Direct participating**
Measurement	**General model**		**Variable fee model**
Interest expense	**General model – Effective yield**		**Current period book yield**

Variable fee approach

Three criteria for applying the variable fee approach:

1. The contract specifies a participation in clearly identifiable underlying pools of assets (or other underlying items).

2. The entity expects that a substantial proportion of the cash flow from the contract will vary with underlying items.

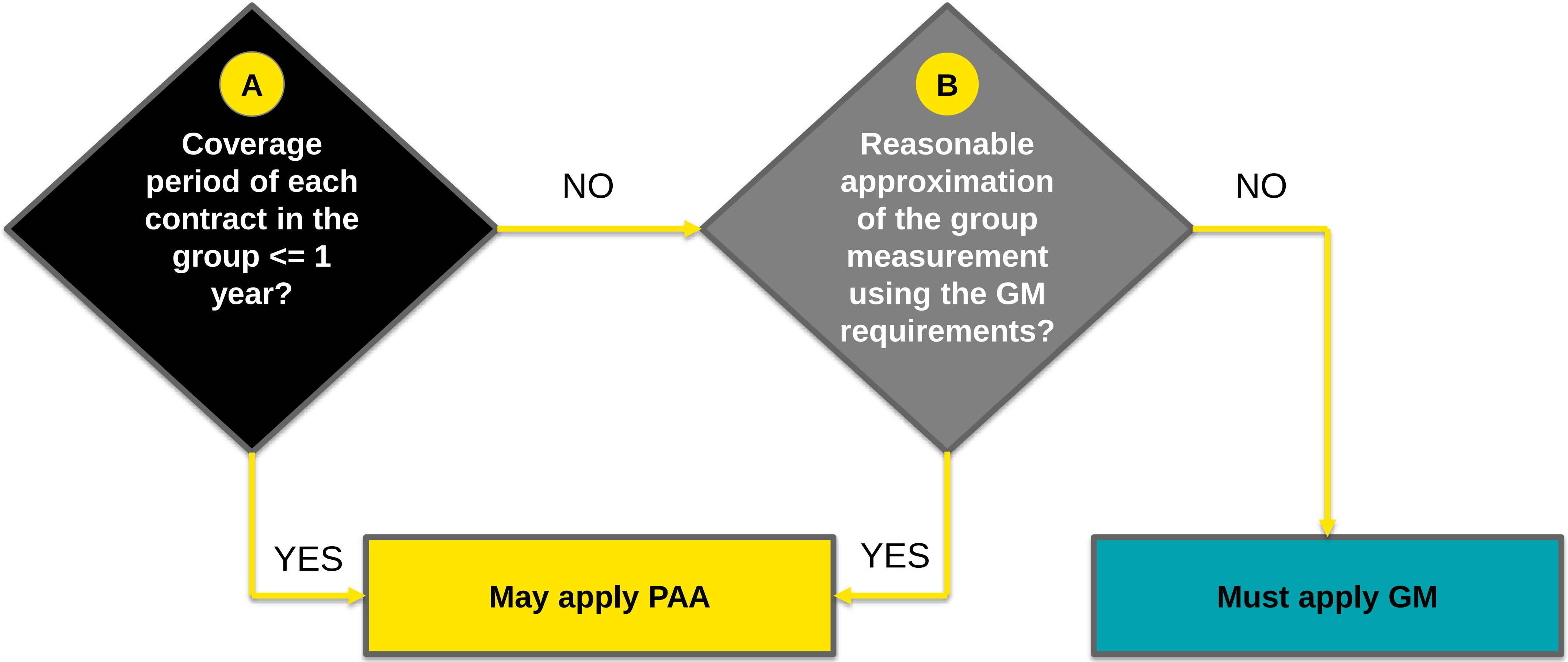
3. The entity expects that the policyholder will receive a substantial share of the returns.

Section 9

Premium allocation approach

Premium allocation approach

What are the eligibility criteria?



Premium allocation approach

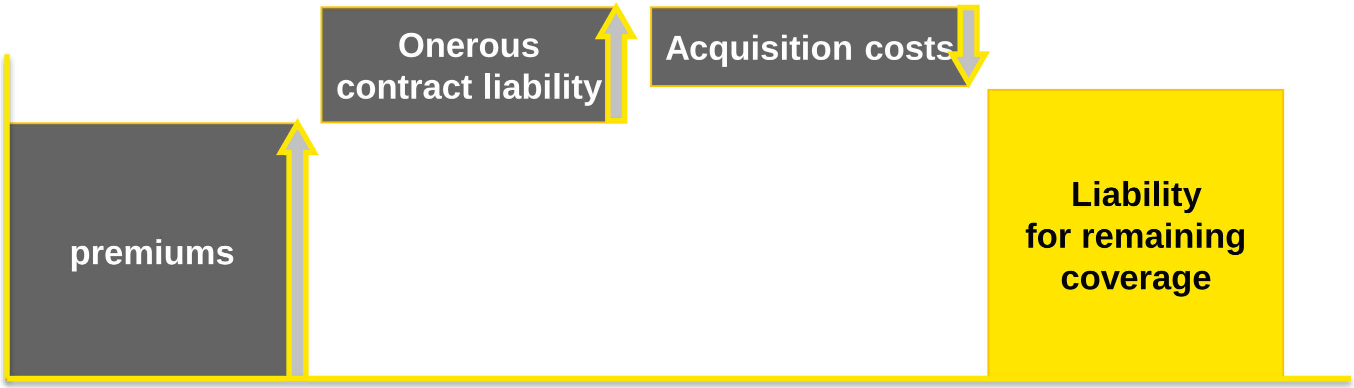
Measurement basis

Initial recognition, note on the carrying amount of the liability

- includes the premium, pre-coverage CFs, any onerous contract liability recognised
- may elect to recognise the directly attributable acquisition costs as an expense when it incurs, provided that the coverage period is one year or less

Subsequent reporting period, note on the carrying amount of the liability

- include premium received, any change in onerous contract liability



- When an entity applies PAA for which it:
  (a) discounts the liability for incurred claims and
  (b) chooses to present the effect of discount rates changes in OCI

  Then the interest expense in P&L should be determined using the locked-in rate at the date the incurred claim is recognised.

- Entity should recognise insurance contract revenue in P&L on the basis of:
  (a) passage of time; or
  (b) expected timing of incurred claims benefits (if this is deemed more appropriate)

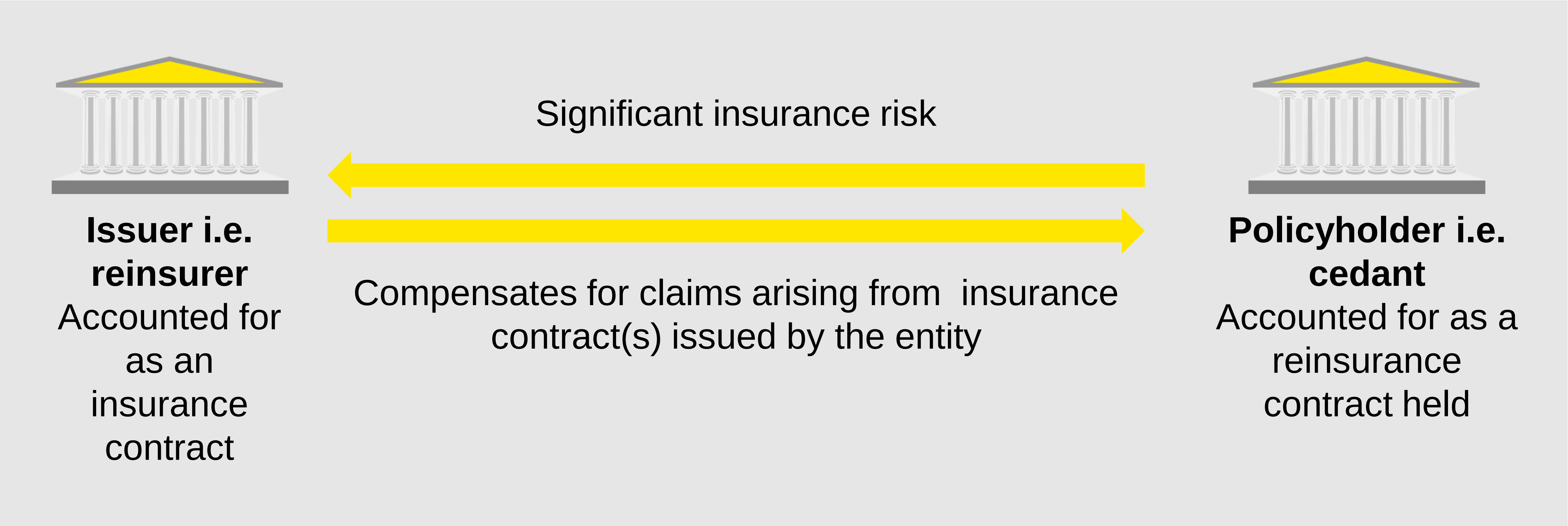
Section 10

Reinsurance

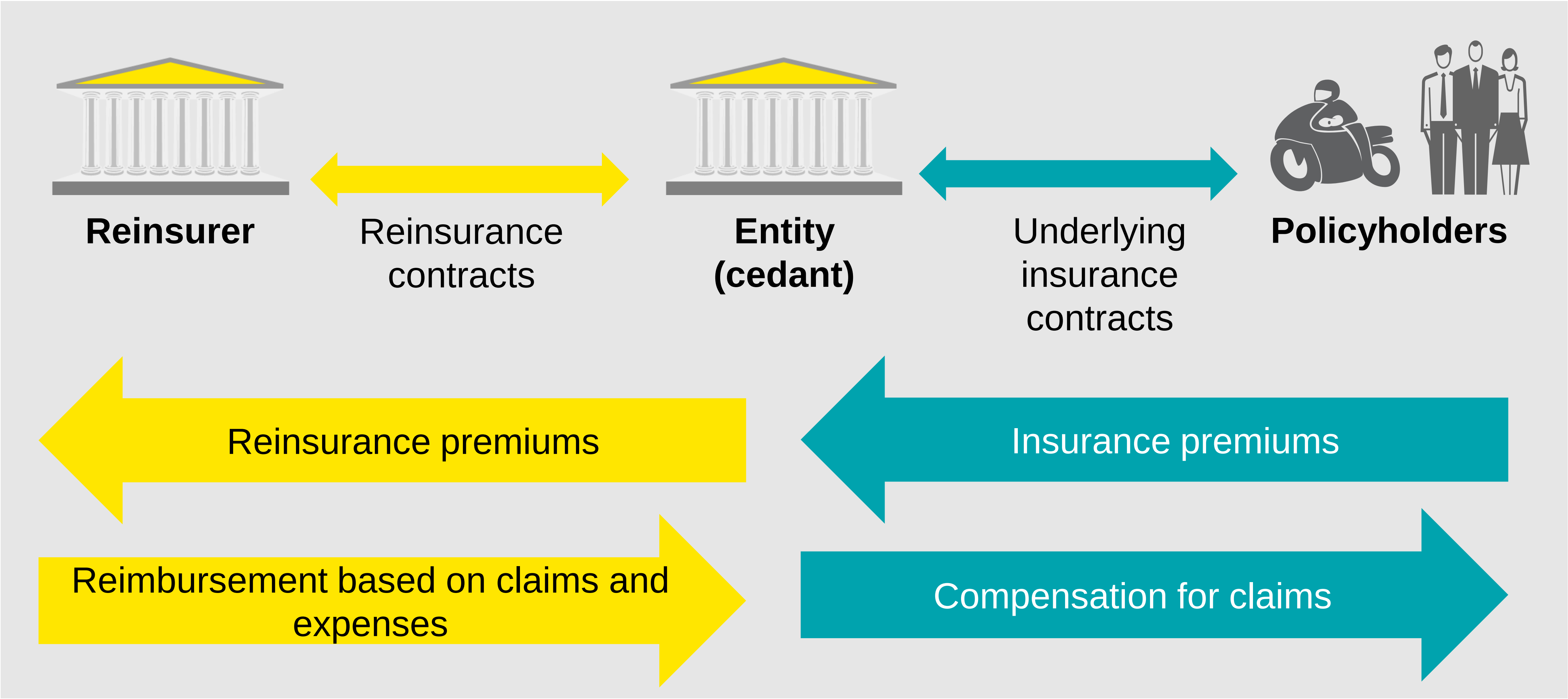
Reinsurance

Definition and scope

Reinsurance contract: *"An insurance contract issued by one entity (the reinsurer) to compensate another entity for claims arising from one or more insurance contracts issued by that other entity (underlying contracts)."*



Reinsurance contracts held



Definition and scope

Reinsurance contract: *"An insurance contract issued by one entity (the reinsurer) to compensate another entity for claims arising from one or more insurance contracts issued by that other entity (underlying contracts)."*

Scope of application of IFRS 17:

Reinsurance contracts "issued"	Reinsurance from the perspective of the reinsurer	Generally treated the same as direct insurance contracts
Reinsurance contracts "held"	Reinsurance from the perspective of the insurer	Some differences compared to direct insurance

Section 11

Presentation and disclosure

Statement of Comprehensive Income: A huge change from today

Statement of Comprehensive Income	
Insurance revenue	X
Insurance service expenses	(X)
Insurance service result	**X**
Investment income	X
Insurance finance expenses	(X)
Finance result	**X**
Other profit and loss items	**X**
Corporate tax	(X)
Profit after tax	**X**
Other comprehensive income	(X)
Total comprehensive income	**X**

Expected

- **Release in contractual service margin**
- **Change in risk adjustment**
- Expected claims (in fulfilment cash flows)
- Expected expenses (in fulfilment cash flows)
- Allocating premium relating to the recovery of directly attributable acquisition costs
- Excluding investment components

Actual

- Actual claims incurred
- Actual expenses incurred
- Allocating premium relating to the recovery of directly attributable acquisition costs
- **Onerous contracts**
- Excluding investment components

How performance reporting will change? A comparison

IFRS 4	Comment
Premiums	Cash based and includes collection of deposits. Inconsistent with other industries
Investment income	
Incurred claims and expenses	
Change in insurance contract liabilities	Confusing adjustment that incorporates multiple factors
Profit or loss	Inconsistent measurement

IFRS 17	Comment
Insurance revenue	Recognized when earned. Excludes deposits
Insurance claims and expenses	
Insurance service result	Two drivers of profits presented separately
Investment income	
Insurance finance expenses	
Net financial result	Two drivers of profits presented separately
Profit or loss	
Insurance finance expenses (optional)	
Total comprehensive income	

Changes in financial assumptions do not affect insurance service result

Presentation and disclosure

Disclosure requirements will change significantly

Amount

Reconciliation for insurance service

- Opening balance
- Closing balance

Net liabilities for remaining coverage

Any loss component

Liabilities for incurred claims

Reconciliation for liabilities valued by General model

- Opening balance
- Closing balance

Expected present value of future cash flows

RA for non-financial risk

CSM

More to be disclosed, including but not limited to:

Analysis of insurance contract revenue recognized in the period, comprising:

- CSM release to profit or loss,
- Expected insurance service expense
- RA release
- Recovery of insurance acquisition CFs

CSM and related quantities for in-force business at transition

Amount of insurance finance income or expenses (IFIE)

Judgement

Significant judgements and changes to those include:

- Methods to measure contracts
- Process for estimating the inputs for those methods

- Any changes to the methods and process, reason for each change
- Types of contracts affected

Confidence level used to determine RA for non-financial risk

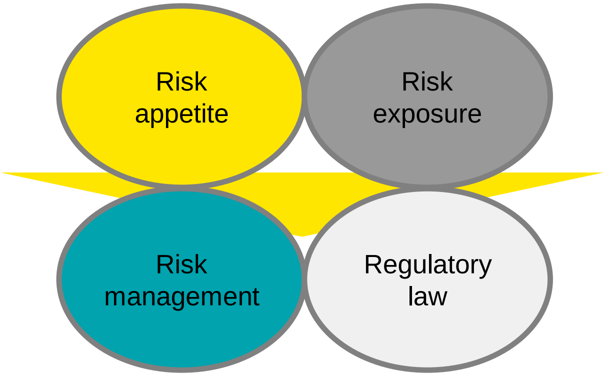
Yield curve(s) to discount cash flows that do or do not vary based on returns of underlying items

The approach to determine:

- how to distinguish changes in estimates of future cash flows from the exercise of discretion from other changes, for contracts without participation features
- composition and fair value of underlying items for contracts with direct participation features
- RA for non-financial risk, discount rates and investment components

Risk

Disclosure for each type of risk



Type and extent of risks

Insurance risks	Financial risks
Risk concentrations	Risk concentrations
Sensitivity analysis concerning insurance risks	Sensitivity analysis concerning market risks
Claims development	Credit and liquidity risks

Section 12

Transition

Applying IFRS 17 for the first time

2021

Transition date
Beginning of the annual reporting period immediately preceding the date of initial application

2022

Date of initial application
Beginning of the annual reporting period in which an entity first applies IFRS 17

Overview

Decide transition method by group of contracts

Full retrospective approach

If impracticable

Modified retrospective approach	OR	**Fair value approach**
▶ When fully retrospective approach is impracticable ▶ Not all historical information is available ▶ Several modifications are included (e.g., level of aggregation, cash flows, discount rates) ▶ Modifications to be applied to the extent **'reasonable and supportable information**' (*) is available		▶ When fully retrospective approach is impracticable ▶ Insurance liability "calibrated" to fair value ▶ CSM is positive difference between fair value and fulfilment value

(*) If no reasonable and supportable information available, use fair value approach

Estimating CSM on transition – Key requirements

Full retrospective approach

- Required when sufficient historical data exists and hindsight is not required

Modified retrospective approach

- When full retrospective approach is impracticable
- Not all historical information is available
- Several modifications are included (e.g. level of aggregation, cash flows, discount rates)
- Modifications to be applied to the extent ‘reasonable and supportable information’ is available

“Fair value-based approach”

- When full retrospective approach is impracticable
- No historical information about cash flows is available to calculate the CSM
- Insurance liability “calibrated” to fair value
- CSM is positive difference between fair value and fulfilment value


Thank You!