Introduction to IFRS 17

C1- Public

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Presenter

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Mogomotsi is a Senior Actuarial Analyst within the Munich Re of Africa Life Corporate Actuarial team with the primary responsibility of managing the valuation modelling aspects amongst other reporting responsibilities. With over six years' experience in the life insurance industry, Mogomotsi has been involved in capital requirement exercises, business steering consulting, in-force management as well as the management of technical projects.

Mogomotsi is fully involved in the implementation and result responsibility of IFRS 17 for Life Actuarial and Reinsurance Accounting for Munich Re of Africa.

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What is IFRS 17?
Why is it being introduced?
How does it work?
Why is it important to me?
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Agenda

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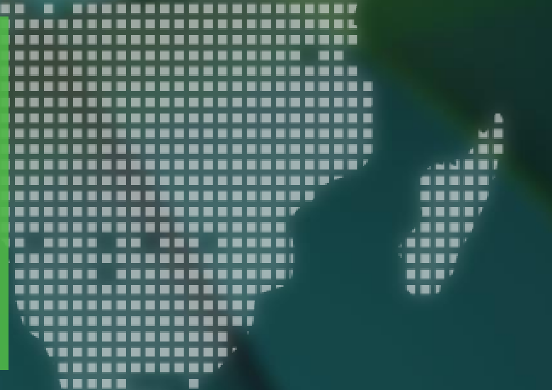
05 Transition

06 Impacts and Considerations



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Background and Overview
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Background and Overview

Objectives and Timelines

"IFRS 17 will undoubtedly represent the most significant change to insurance requirements in over 20 years and will likely be the biggest insurance change of our lifetimes"[1]

Background of the Standard:
After years of intensive discussions and overcoming the major concerns by the insurance industry, IASB has issued its new insurance contracts Standard IFRS 17 (formerly known as IFRS 4 Phase II) on May 18, 2017. IFRS 17 supersedes IFRS 4. IFRS 17 is effective for annual periods beginning on or after 1 January 2023; one year restated comparative information plus early adoption is permitted.

Need for a change

- IFRS 4 was an interim Standard that allowed entities to use a wide variety of accounting practices
- The differences in accounting treatment made it difficult for investors and analysts to understand and compare insurers' results

Objectives of IFRS 17

- Improve comparability
- Improve quality of information

… to ensure that entities provide relevant information in a way that faithfully represents insurance contracts. The users of the financial statements could assess clearly the impact those contracts have on the financial position, performance and cash flows of the entity.

2001	2004	2017	2019	2020	2021	2023
Added to IASB Agenda	*IFRS 4 issued*	*May: IFRS 17 Final standard*	*Exposure draft ED/2019/4*		*EU endorsement* *Start of comparative period*	*IFRS 17 effective date 1 Jan 2023*

[1]Impacts of IFRS 17 insurance contracts accounting standard - EY

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Background and Overview

Why does IFRS 17 replace IFRS 4

- IFRS standards are established in order to have a common accounting language, so business and accounts can be understood and compared from company to company and from country to country.
- IFRS 4 explains how to disclose insurance contracts, but to put it simple, there are too many issues with IFRS 4 to make a good comparison among insurance companies and to compare an insurance company to a non-insurance company, therefore IFRS 17 is needed.
- This gives a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows.

IFRS 4	IFRS 17
Different accounting policies per insurance contract	One accounting policy for all insurance contracts
Lack of comparability of insurance companies across countries	Insurance companies across countries become better comparable
Lack of comparability of insurance vs non-insurance companies	Similar accounting methods for insurance and non-insurance companies
Estimates are not required to be updated	Estimates are updated each reporting period
Difficult to see key drivers of profit	Key drivers of profit (investment vs underwriting) are made transparent
Discount rate based on investment	Discount rate based on the cash flows of the contract

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Background and Overview

Why does IFRS 17 replace IFRS 4 (cont.)

Why are there issues?

- FRS 4 was introduced in 2004 and was meant to be an interim standard, so there were limited changes to existing insurance accounting practices.
- Insurance companies were still able to measure similar insurance contracts with different accounting policies.
- These practices evolved based on specific insurance contracts in a specific country, which also resulted into a deviation between accounting models used by the insurance industry and IFRS standards applied by other industries.

How does IFRS 17 solve this?

- IFRS 17 requires companies to measure insurance contract on updated estimates and assumptions which reflects timing of cash flows (the discount rate) and the uncertainty of insurance contracts (the risk adjustment).
- Insurers need to indicate the expected (yet unearned) profit with the contractual service margin (CSM), and only recognize the profit when it delivers the insurance service.
- All this information will make it easier to evaluate the performance of insurers against each other, over time and among industries

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Background and Overview

Scope

IFRS 17 will apply to a range of different contracts, which fall under the following categories:

- Insurance and reinsurance contracts issued by the company; and
- Reinsurance contracts that the company holds ("ceded reinsurance"); and
- Investment contracts with discretionary participation features ("DPF") that it issues, provided that the entity also issues insurance contracts

"An insurance contract is 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"

"Reinsurance contract is an insurance contract issued by one entity (the reinsurer) to compensate another entity (the "cedant") for claims arising from one or more insurance contracts issued by the cedent"

"Investment components are those amounts that an insurance contract requires an entity to repay to a policyholder, even if an insured event does not occur"

IFRS 17 will lead to the implementation of new systems/processes or at least lead to major adjustments / upgrades of existing processes or systems

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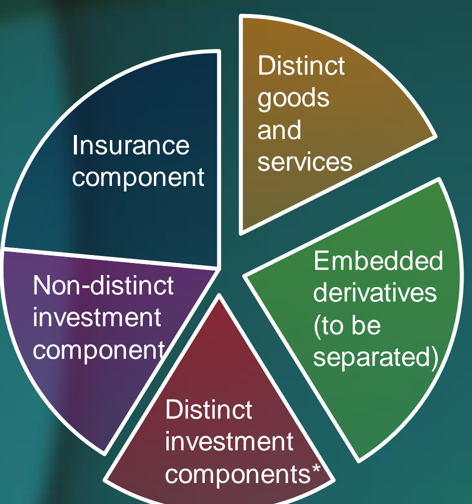
Background and Overview

Unbundling

Insurance contracts usually consist of various components (see pie chart). The entity must identify which of the components need to be separated from the original contract under IFRS 17.



Insurance components and non-distinct investment components are not separated and are measured under IFRS 17.

Embedded derivatives (that have to be separated) and distinct investment components must be separated and are measured under IFRS 9.

Distinct goods and services must be separated and are measured under IFRS 15.

Investment component = amounts that are repaid to the policyholder even if an insured event does not occur

Investments components are distinct if the two following criteria are met:

- the investment and the insurance component are not highly interrelated, i.e. the components can be measured without considering the other or the policyholder can benefit from one component independently of the other
- a contract with equivalent terms is (or could be) sold separately.

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Background and Overview

Classification

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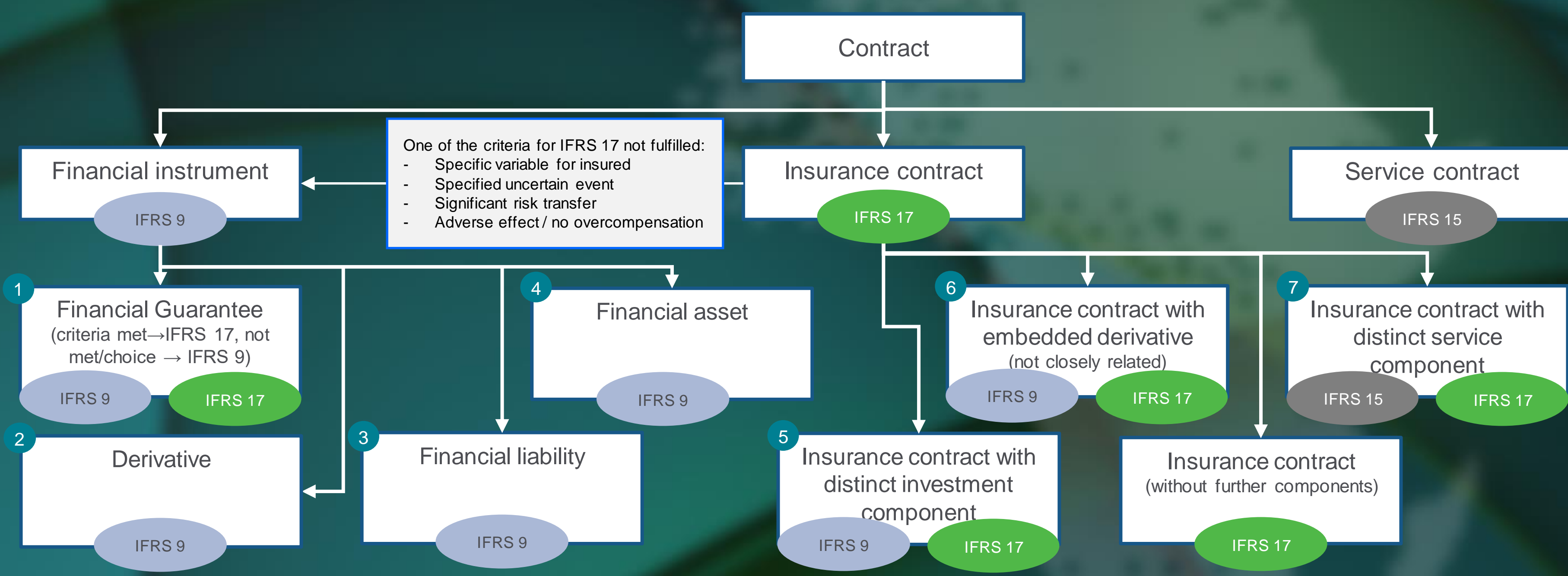

Examples:

1. Credit insurance
2. Weather Derivatives
3. Revenue Guarantee
4. Funds withheld contract without significant risk transfer
5. Not applicable
6. Funds wiithheld structure with interest referring to the return of the underlying investment portfolio
7. Assistance services integrated in an insurance contract

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IFRS 17 Recognition and Derecognition
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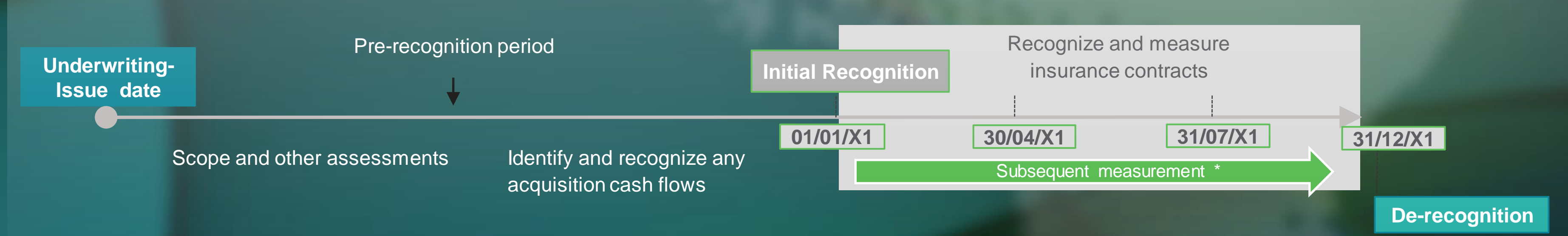
Recognition and Derecognition

When to recognize and derecognize insurance contracts

Under IFRS 17 insurance contracts are to be initially recognized at the earliest of

- the beginning of coverage period **or** when the first payment becomes due; or
- the date **when** facts/circumstances indicate the contract is **onerous**



Derecognition:

- Insurance contracts are to be derecognized when
  - the insurance contract is extinguished - when the obligation is discharged or cancelled or expired
  - OR when specified modifications of the terms of the contract are met, e.g. the modified contract does no longer meet the criteria for simplified accounting

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IFRS 17 Measurement
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IFRS 17 Measurement

Level of Aggregation [1/3]

IFRS 17 Insurance Contracts establishes specific principles for grouping contracts together (LoA). This grouping is particularly relevant for the determination of the contractual service margin (CSM) and the limitation of offsetting effects for subsequent measurement.

An entity shall identify portfolios of insurance contracts.

Top-down approach

A portfolio comprises contracts subject to similar risks and managed together.

An entity shall divide a portfolio of insurance contracts issued into a minimum of

- a group of contracts that are onerous at initial recognition, if any;
- a group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any;
- a group of the remaining contracts in the portfolio, if any.

=> Expected gains and losses are treated differently under IFRS 17

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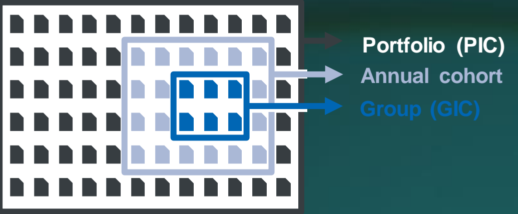
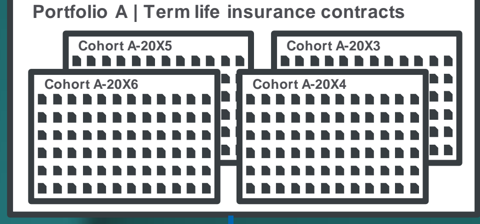
IFRS 17 Measurement

Level of Aggregation [2/3]

Overview of portfolio, annual cohorts and groups of insurance contracts



- The CSM is determined for groups of insurance contracts
- Insurers will need to account for their business performance at a more granular level
- In the PIC, groups are limited to contracts issued no more than one year apart (cohorts)
- Each portfolio needs to be divided into 3 groups unless no contracts fall into one or more of the groups



Cohort A-20X6

Group	Description
Group A-20X6-1	Contracts that are onerous at initial recognition
Group A-20X6-2	Contracts that at initial recognition have no significant risk of becoming onerous afterwards
Group A-20X6-3	All remaining contracts in Cohort A-20X6

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IFRS 17 Measurement

Level of Aggregation [3/3]

Simple Examples

1

100 'identical' contracts are written with a probability that 5 of the policyholders will claim.

IFRS 17

100 contracts are a group; company does not treat the 5 contracts as a separate group

2

A company issues 500 contracts; there is information that 200 'identical' contracts are onerous (loss making), but the company expects that the 300 profitable 'identical' contracts will cover losses on the 200 onerous contracts.

IFRS 17: Group A

Losses on the 200 onerous contracts are recognised immediately

IFRS 17: Group B

Profits on 300 contracts recognised over the coverage period

- Companies will need to set a definition of 'similar risks' and 'managed together' and complete profitability analysis
- Significant impact on modelling and data storage requirements
- Unit of account granularity can impact profit levels and increase volatility of profit

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IFRS 17 Measurement

Measurement Approaches

Three different ways to measure insurance contracts under IFRS 17: general measurement model (GMM / BBA); premium allocation approach (PAA); and variable fee approach (VFA).

General Measurement Model

- Default model to measure insurance contract liabilities under IFRS 17
- Also known as building blocks approach (BBA)
- Losses recognized in P&L at inception and gains capitalized
- Total carrying amount = liability for the remaining coverage (LRC) + liability for incurred claims (LIC)

> - Long-term business
> - Whole life business
> - Term assurance
> - Protection business

Premium Allocation Approach

- Option to apply PAA, if and only if
  - Coverage period one year or less
  - Or measurement differs not materially from BBA
- May be applied to liability for the remaining coverage **(LRC) only**
- BBA to be applied to liability for incurred claims (LIC)

> - Short-term insurance
> - Short-term life and certain group contracts

Variable Fee Approach

- Modification of BBA
- for contracts with direct participation features
- Not admitted for reinsurance held

> Only valid for some insurance contracts

> - Unit-linked contracts
> - Variable annuities
> - Equity index-linked contracts

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IFRS 17 Measurement

General Measurement Model (GMM)

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The General Measurement Model (GMM), also known as Building Block Approach (BBA), is the general accounting approach for the measurement of insurance contracts under IFRS 17.

According to the GMM the total carrying amount of a group of insurance contracts is made up of the following two basic components:

Liability for remaining coverage (LRC)

relating to coverage that will be provided to the policyholder for **insured events that have not yet occurred**

\+

Liability for incurred claims (LIC)

relating to claims and expenses for **insured events that have already occurred**

Definition of the four building blocks of the GMM

Building block	Definition
Contractual Service Margin	Contractual service margin (CSM) quantifies the unearned profit (in excess of the RA) the insurer expects to earn as it fulfils the contract- elimination of gain at inception
Risk Adjustment	Explicit estimate of the effects of uncertainty about the amount and timing of future cash flows
Discounting	Discount rates that adjust cash flows for the time value of money. Generally, use of current discount rates (lowest: OCI option on a portfolio level)
Expected Cash Flows	Estimation of all future cash inflows and outflows within the boundary of each contract in the group

Present value of fulfillment cash flows (Risk Adjustment, Discounting, Expected Cash Flows)

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IFRS 17 Measurement

Subsequent Measurement

Subsequent Measurement under the BBA – the recognition of changes in estimates and assumptions

IFRS 17 Insurance Contract Liability

4) Contractual Service Margin

3) Risk Adjustment

2) Discounting

1) Expected Cash Flows

CSM (block 4) is adjusted by changes in estimates and is allocated to profit or loss on basis of passage of time.

In each reporting period, an entity re-measures the fulfilment cash flows (block 1 – 3) using updated assumptions about cash flows, discount rate and risk.

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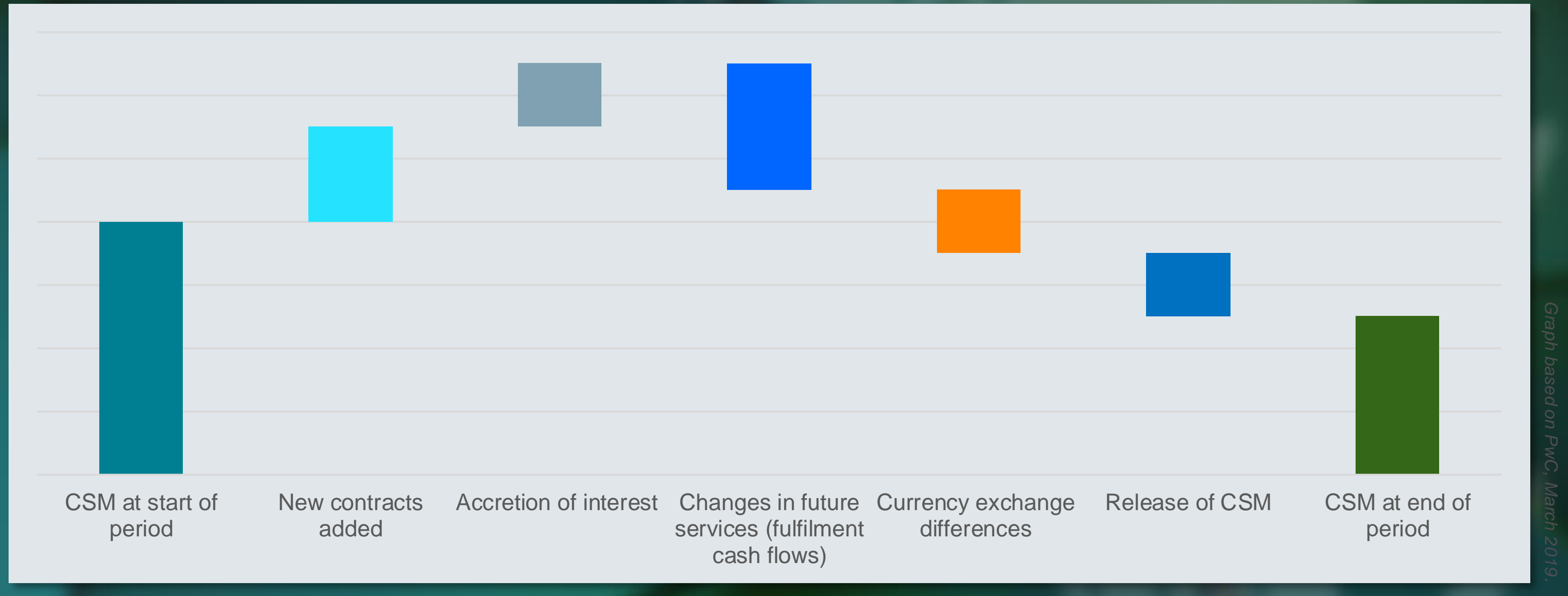
IFRS 17 Measurement

Progression of CSM from inception



Graph based on PwC, March 2019.

When looking at the CSM, all steps need to be considered.

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IFRS 17 Measurement

Premium Allocation Approach (PAA)

A simplification method (premium allocation approach, PAA) is allowed for the measurement of the liability for the remaining coverage (LRC), if:

- the coverage period of the insurance contract at initial recognition is one year or less or
- doing so, would lead to a measurement that is a reasonable approximation to those that would be produced if the GMM was applied (the measurement of LRC under PAA is a reasonable approximation of the measurement of LRC under GMM).

The Simplified measurement (PAA)

LRC

Received premium

Insurance revenue recognised

Other adjustments*

Recognition of loss component is required:

- at initial recognition or subsequently
- facts and circumstances indicate that a group of contracts is onerous
- Measured using the GMM
- Part of the liability for remaining coverage

* **Examples include:** *Insurance acquisition costs*, *Amortization of insurance acquisition costs*, Investment component

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IFRS 17 Measurement

Variable Fee Approach (VFA)

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- Modification to the general approach for valuing insurance contracts with payments that vary with return on underlying items, e.g.
  - Unit-linked (with insurance risk)
  - With-profits
- Treats returns on the assets underlying these contracts as part of the fee that the entity charges the policyholder for the services provided.
- CSM at inception is the same as general model. CSM subsequently differs from general model:
  - CSM adjusted for financial assumption changes
  - Includes changes to the value of risk mitigation for guarantees, unless these are 'formalised'
  - CSM has interest accretion at current rates
- The CSM under VFA cannot be calculated prospectively
- Benefit of VFA is that it eliminates artificial volatility in the Profit & Loss

Under VFA, CSM at the reporting date equals:

CSM at the beginning of the period

\+ Effect of new contracts added to the group

+/− Entity's share of the change in the fair value of underlying items*

+/− Change in fulfilment cash flows relating to future service*

+/− Effect of currency exchange differences

− Amount of CSM recognised in profit or loss as insurance revenue because of the transfer of services in the period

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IFRS 4 vs IFRS 17 Presentation
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IFRS 4 vs IFRS 17 Presentation

From written premium to services provided

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Income statement under IFRS 4

Written premiums (Gross, Ceded and Net)	
1. Net earned premium	**15,505**
- Gross	16,321
- Ceded	(816)
2. Technical interest income	**9,902**
3. Total income (1 - 2)	25,407
4. Gross incurred claims and benefits	(8,178)
5. Gross operating expenses	(5,649)
6. Ceded incurred claims, benefits and expenses	368
7. Acquisition costs armortised	(1,259)
8. Change in ins cont liab	(9,308)
9. Total expenses (4 - 8)	(24,026)
10. Technical result (3 + 9)	1,381
11. Net investment income	105
12. Other operating components	(506)
13. Non technical result (11 - 12)	(401)
14. Operating result (10 + 13)	980

Income statement under IFRS 17

1. Gross insurance contracts revenue	**10,672**
2. Gross insurance service expenses	**(9,437)**
- Incurred claims and ins cont exp	(8,178)
- Insurance acquisition costs	(1,259)
3. Gain or (loss) from Reinsurance	**(448)**
4. Insurance service result (1 - 3)	787
5. Insurance finance income	9,902
6. Insurance finance expenses	(9,308)
7. Insurance finance result (5 - 6)	594
8. Net investment income	105
9. Other operating components	(506)
10. Non technical result (8 - 9)	(401)
11. Operating result (4 + 7 + 10)	980

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IFRS 4 vs IFRS 17 Presentation

From written premium to services provided (cont.)

Income statement under IFRS 17

1.	**Gross insurance contracts revenue**	**10,672**
2.	**Gross insurance service expenses**	**(9,437)**
	- Incurred claims and ins cont exp	(8,178)
	- Insurance acquisition costs	(1,259)
3.	**Gain or (loss) from Reinsurance**	**(448)**
4.	Insurance service result (1 - 3)	787
5.	Insurance finance income	9,902
6.	Insurance finance expenses	(9,308)
7.	Insurance finance result (5 - 6)	594
8.	Net investment income	105
9.	Other operating components	(506)
10.	Non technical result (8 - 9)	(401)
11.	Operating result (4 + 7 + 10)	980

The **Total Comprehensive Income** consists of the following:

- Insurance Service Result
- Insurance Finance Result
- Other Comprehensive Income

The **Insurance Service Result** consists of two components:

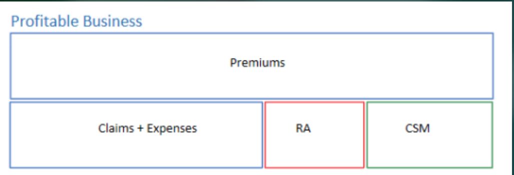
- Insurance Revenue
- (less) Insurance Service Expense

Insurance Contracts Revenue includes:

- Expected claims + expenses (excl. acquisition costs)
- Release of RA
- Release of CSM
- Premium variance related to current and past service (plus future service if onerous)

Insurance Service Expense includes:

- Actual claims + expenses
- Loss on onerous contracts
- Release of LC
- Reversal of loss
- New LIC and changes to LIC



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IFRS 4 vs IFRS 17 Presentation

Balance sheet changes

IFRS Balance Sheet (Today)	
RI Contract Assets	Equity
Deferred acquisition costs	Other liabilities
Accounts receivable	Accounts payable
Other assets	Unearned premium provision
	Insurance contract liabilities

IFRS Balance Sheet (IFRS 17)	
RI contract assets	Equity
Insurance contract assets	Other liabilities
	RI contract liabilities
Other assets	Insurance contract liabilities

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5
Transition
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Transition

Transition Approaches

Standard should be applied retrospectively **unless impracticable,** then either**:** modified retrospective approach (if possible) **OR** fair value approach.

Can apply different approaches for different groups of contracts, if appropriate

Full Retrospective Approach

- Requires company to go back in time and explicitly generate CSM roll-forward from initial recognition to transition date
- Required unless impractical

If Full Retrospective Approach is impractical, choose between

Modified Retrospective Approach

- Approximation to full retrospective
- Limited number of simplifications allowed
- Must be based on reasonable and supportable information

Fair Value Approach

- Total carrying value at transition date set equal to Fair Value of in-force contracts

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Impacts and Considerations
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Impacts and Considerations

An understanding of the Standard is paramount for the successful management of Re(Insurers) as well as a clear understanding of each our contribution towards our individual and collective success

- Valuation models, controls and processes
- Auditor requirements
- IT infrastructure
- Access to other capital markets
- Data requirements
- Management reporting and steering
- Profit release/loss recognized at transition
- New business initiatives
- Tax implications
- Product design
- Risk management
- Experience analysis and parameter updates
- KPIs, forecasting and budgeting
- Investment strategy
- Accounting
- Training, development and knowledge transfer

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7 Conclusion

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Conclusion

What is IFRS 17?

The newest accounting standard outlining how a company should account for insurance contracts, improving on the known limitations of IFRS 4 (relevance, comparability, transparency)

Why is it being introduced?

It gives a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows, making it easier to evaluate the performance of insurers against each other, over time and among industries.

How does it work?

Providing a principle-based framework for the calculation and disclosure of results of a company providing insurance contracts in a consistent manner.

Why is it important to me?

With one and a half years to implement IFRS 17, it is important to appreciate the boundless implications it has on the management and health on our company – as such, we each need to interrogate and anticipate the changes coming in our working areas.

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Thank you!

May 2021
Phetogo Mabaso / Mogomotsi Phage

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