IFRS 17

Insurance Contracts

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THE WORLD BANK
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Швеція
Sverige

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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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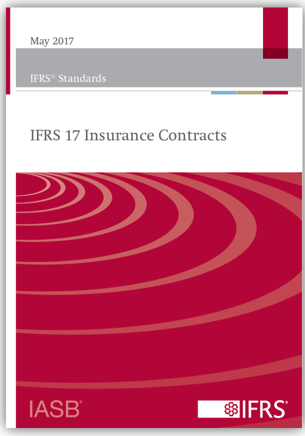
Introduction
IFRS 17 Insurance Contracts



- 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	PAA with comparison to unearned premium
Session 3	Challenges in applying PAA
Session 4	Disclosure and presentation requirement
Session 5	Transition, transition presentations and disclosures
Session 6	Audit reports and compliance with IFRS
Session 7	

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Transition

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IFRS 17 Programme
Session 9

Transition

- Applying IFRS 17 for the first time
- Fully retrospective approach
- Modified retrospective approach
- Fair value approach
- Pre-transition approaches
- Stress areas

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Core Requirements
Reminder: '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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Applying IFRS 17 for the first time

	1 PV of future cash flows	2 Risk adjustment	3 CSM
Existing contracts (eg contracts written before end 2022)	✓ Usual IFRS 17 measurement	✓ Usual IFRS 17 measurement	✗ Transitional requirements
New business (eg contracts written after 2022)	✓ Usual IFRS 17 measurement	✓ Usual IFRS 17 measurement	✓ Usual IFRS 17 measurement

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IFRS 9 and IFRS 17

	2017	2018	……	2022	2023
Financial Instruments	IAS 39	IFRS 9			
Insurance contracts	IFRS 4	IFRS 4 as amended			IFRS 17

Overlay approach

Available to all issuers of insurance contracts

Available until IFRS 17 is applied

Recognises in OCI, instead of P&L, volatility that could arise when IFRS 9 is applied before IFRS 17 (for assets moved to FVPL)

Temporary exemption from IFRS 9

Available to companies whose activities are predominantly connected with insurance

Available until IFRS 17 is applied

- IAS 39 is applied rather than IFRS 9
- Additional disclosures provided to enable comparisons with companies using IFRS 9

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Applying IFRS 17 for the first time

Annual reporting periods beginning in:

2022	2023
Transition date Beginning of immediate preceding period	**Date of initial application (DIA)** Start of annual period entity first applies 17
Activities • Measure each group of contracts applying IFRS 17 • Derecognise existing balances as if IFRS 17 always applied • Recognise net difference in equity	**Activities** • Publish first IFRS 17 financial statements • Restate at least one-year of comparatives

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At transition date

Derecognize IFRS 4	Recognise IFRS 17	Difference to equity
Assets	Assets	+/- net difference
~~Deferred acquisition costs~~	Insurance contract assets	
~~Reinsurance assets~~	Reinsurance assets	
~~Premiums receivable~~	Liabilities	
~~Policy loans~~	Insurance contract liab	
Liabilities	Reinsurance contract Liab	
~~Insurance contract liab~~		
~~Claims payable~~		
~~Unearned premiums~~		

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Applying IFRS 17 for the first time

Determine transitional method by group of contracts

1 Fully retrospective Approach

1 Fully retrospective approach

- A full retrospective approach measures in-force contracts on the transition date **as if an entity had always applied IFRS 17**
- The principle of retrospective application is set out in IAS 8 Accounting policies, Changes in Accounting Estimates and Errors
- An entity will need to assess
  - The type of contract and which model to apply
  - What group the contract would have been allocated to
- Depending on the applicable model

Fully retrospective

- Fully retrospective requires applying data and judgement as if at the date the contract was issued
- It is data intensive so:
  - The simpler the contract, the less overall data required
  - The newer the contract, the less historical data required
  - The simpler the accounting model, the less historical data required
- Data availability is influenced by data available from previous practices eg regulator reporting or UPR reporting

	P&C	Life
The simpler the contract, the less overall data required	✓	✓ ✗
The newer the contract, the less historical data required	✓	✗
The simpler the accounting model, the less historical data required	✓	✗
Data availability is influenced by data available from previous practices	✓	✓ ✗

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1 Fully retrospective approach

Determine	General Model	PAA	VFA	Reinsurance
CSM	✓	✗	✓	✓
Loss component	✓	✓	✓	✗
Discretionary cash flows	✓	✗	✗	✗
Accumulated OCI	✓	✓	✓	✓
Risk mitigation	✗	✗	✓	✗

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Fully retrospective approach

1. Assessment

Initial recognition	Each intervening reporting period	Transition date
• Which model to apply? • Which groups do contracts that exists at transition belong to? • Definition of discretionary cash flows	• No further action after initial assessment	• No further action after initial assessment

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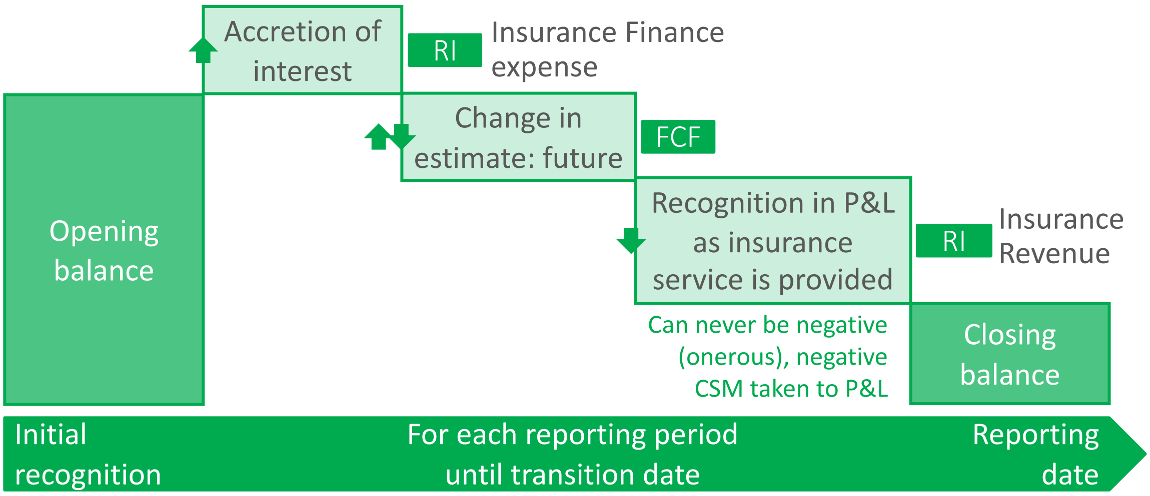
Fully retrospective approach
Contractual Service Margin (CSM)



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Fully retrospective approach

1. Determine the CSM or loss component

Initial recognition	Each intervening reporting period	Transition date
Calculate CSM/Loss comp	Calculate CSM/Loss comp	Calculate CSM/Loss comp
• Identify all contracts in each group • For each group, determine inception: • Cash flows • Discount rates • Risk adjustment To get opening balance	Adjust opening balance for changes in: • Cash flows • Risk adjustment • Accretion of interest • Allocation to P/L • To determine closing balance	Opening balance

Fully retrospective approach
OCI Option

- » Total insurance finance expenses
  - » Original carrying amount (IFRS 17)
  - » Plus or minus subsequent cash flows and adjustments
  - » Minus current carrying amount
- » Systematic allocation of expense over time in profit or loss
- » Balancing amount to OCI

Applying IFRS 17 for the first time

Determine transitional method by group of contracts

1 Fully retrospective Approach

If Impracticable

If full retrospective is impracticable

- Impracticable (defined by IAS 8) applies when:
  - It is impossible to collect data for prior periods; or
  - An entity is unable to avoid the use of hindsight
    - Requires assumptions about management's intent in the past; or
    - Requires estimates where impossible to know what information about those estimates existed when is required to occur
- For example, historical data for contracts issued many years ago is not available and/or would require use of hindsight

Applying IFRS 17 for the first time

Determine transitional method by group of contracts

1 Fully retrospective Approach

If Impracticable

2 Modified retrospective approach

- Modifications available if necessary given reasonable and supportable information
- Maximise the use of the information needed for full retrospective approach

Insufficient reasonable and supportable information

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2 Modified retrospective approach

Objective: to achieve an estimate of retrospective application using available reasonable and supportable information.

» To apply a modified retrospective approach:

  » use reasonable and supportable information.

  » maximise use of information that would have been used to apply fully retrospective approach,
  but need only use information **available without undue cost or effort**

  » to the extent there is no reasonable and supportable information, use modifications specified

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Modified retrospective approach *(continued)*

» Modifications used **<u>only to extent</u>** that entity does not have reasonable and supportable information

» Modifications permitted:

  » Assessing contract type, grouping and determining discretionary cash flows

  » Determining CSM or the loss component at the transition date

  » Determining cumulative OCI (if an entity chooses OCI presentation)

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Modified retrospective approach
<u>Initial assessments</u>

Use <u>reasonable and supportable</u> information available at the transition date to:

» Identify contracts with direct participation features

» Identify discretionary cash flows for contracts without DPF

» Determine groups

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Modified retrospective approach
Initial assessments - groups

IFRS 17 requirement		Modification
Contracts issued more than one year apart **cannot be** included in the same group	If reasonable and supportable information is not available	Contracts issued more then one year apart **can be included** in the same group

Apply **only to extent** that don't have reasonable &supportable information available

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Modified retrospective approach
Determining CSM or loss component: future cash flows

Expected future cash flows at transition date (or earlier) – forward looking

+

Adjust backwards for cash flows known to have occurred – actuals

Contracts in-force at transition + Expired contracts = Contracts in force at initial recognition

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Estimated future cash flows at initial recognition

Apply only to the extent don't have reasonable and supportable information

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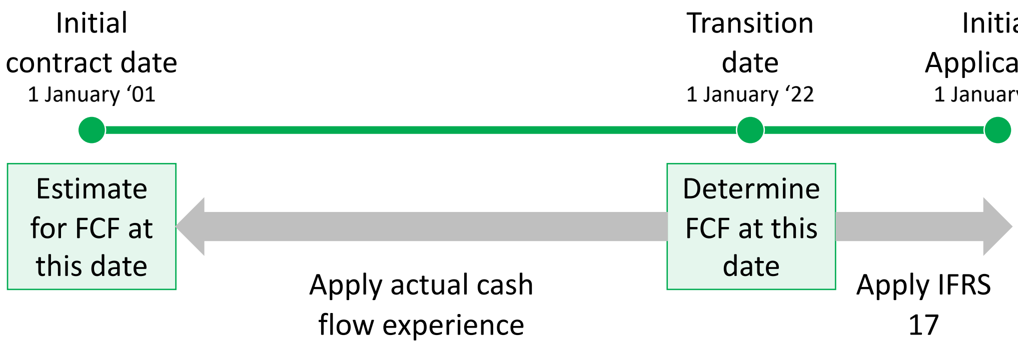
Example
Determining CSM or loss component: future cash flows



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Modified retrospective approach
Determining CSM or loss component: discount rates

Estimate the discount rate at initial recognition

Does an observable yield curve exist?

Yes → A: Use the observable yield curve

No → B: Apply an average spread

Apply only to the extent don't have reasonable and supportable information

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Modified retrospective approach
Determining CSM or loss component: discount rates

Ⓐ Use an observable rate if it approximates the yield curve estimated under the full retrospective approach for at least three years before transition date

(1) IFRS 17 yield curve	(2) Observable yield curve	Does (2) approximate (1)	Modification
T-1, T-2, T-3	T-1, T-2, T-3	Yes	Use the observable yield curve

T = Transition date

Apply only to the extent don't have reasonable and supportable information

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Modified retrospective approach
Determining CSM or loss component: discount rates

Ⓑ If no observable yield curve approximates the yield curve that would be applied under the full retrospective approach, apply the spread to the observable yield curve

Observable yield curve T-1, T-2, T-3 − Full retro curve = Average spread to apply to observable yield curve

T = Transition date

Apply only to the extent don't have reasonable and supportable information

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Modified retrospective approach
Determining CSM or loss component: risk adjustment

Risk adjustment at transition date

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Adjust 'backwards' for expected release of risk adjustment (by reference to similar contracts issued at the transition date)

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Estimated future cash flows at initial recognition

Apply only to the extent don't have reasonable and supportable information

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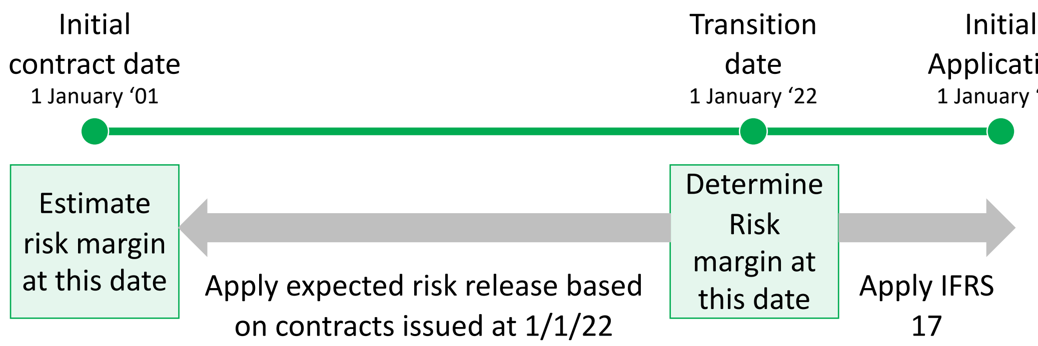
Example
Determining CSM or loss component: risk margin



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Modified retrospective approach
Determining CSM or loss component

Contractual service margin	Loss component
Allocate CSM to profit or loss based on the number of coverage units remaining at transition compared to coverage units provided before transition	Determine amounts allocated to the loss component before the transition using a systematic basis

Apply only to the extent don't have reasonable and supportable information

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Modified retrospective approach
Applying OCI option

» Groups of contracts not issued more then 1 year apart (normal treatment)

» Systematic allocation in P&L for groups applying the OCI option and subsequent the determination of CSM

IFRS 17 requirement	→	Modification
Discount rate at recognition		Discount rate as determined earlier

Apply only to the extent don't have reasonable and supportable information

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Modified retrospective approach
Applying OCI option

Alternatively

» Groups of contracts issued more then 1 year apart (modification)

» Systematic allocation in P&L for groups applying the OCI option and subsequent the determination of CSM

IFRS 17 requirement	→	Modification
Discount rate at recognition		Discount rate at transition date

Apply only to the extent don't have reasonable and supportable information

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❷ Modified retrospective approach *(continued)*
Loss component for VFA groups of contracts

» IFRS 17 normally requires an entity establish a loss component of the liability for remaining coverage for an onerous group

» Under the modified retrospective approach for groups of contracts with direct participation features, the loss component of a group of contracts estimated, at transition, to be onerous is set to nil.

» The whole of the liability for remaining coverage at transition is deemed to exclude a loss component

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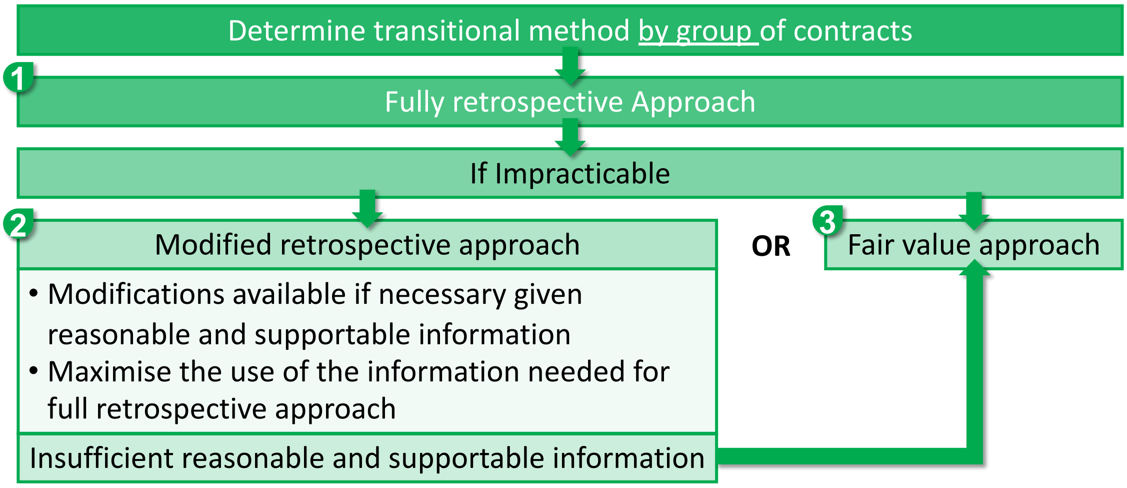
Applying IFRS 17 for the first time



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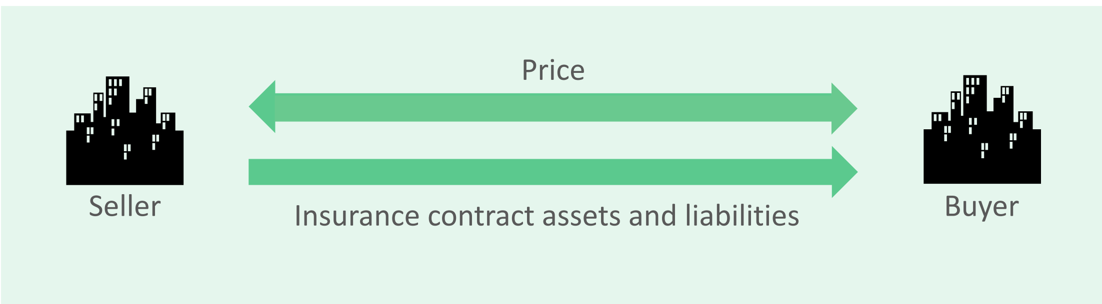
Fair value of group of insurance contracts



» The price that would be paid in a transaction between a willing buyer and a willing seller = fair value

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❸ Fair value approach

Fresh start (prospective) approach

- CSM or the loss component of the liability for remaining coverage at transition date is determined as the difference between the fair value of a group of insurance contracts at that date and the fulfilment cash flows measured at that date
- Estimate the fair value of a group of contracts not the fair value of fulfilment cash flows within the contract boundary
- Entity is permitted to apply fair value approach for risk mitigation (even when retrospective application is not impracticable)

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Fair Value
Initial assessments

To assess:

- Whether insurance contracts are contracts with DPF;
- Identify discretionary cash flows
- Determine groups

Use reasonable and supportable information available at either

Inception date or initial recognition	OR	Transition date

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Fair Value
Initial assessments - grouping

» Insurer may choose to:

Include contracts issued no more then one year apart in the same group[1]	OR	Include contracts issued more then one year apart in the same group

[1] If an only if there is reasonable and supportable information to do so

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Fair value approach *(continued)*

Not a liquidation or forced sale

Exit Price

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date

Market based view

Current price

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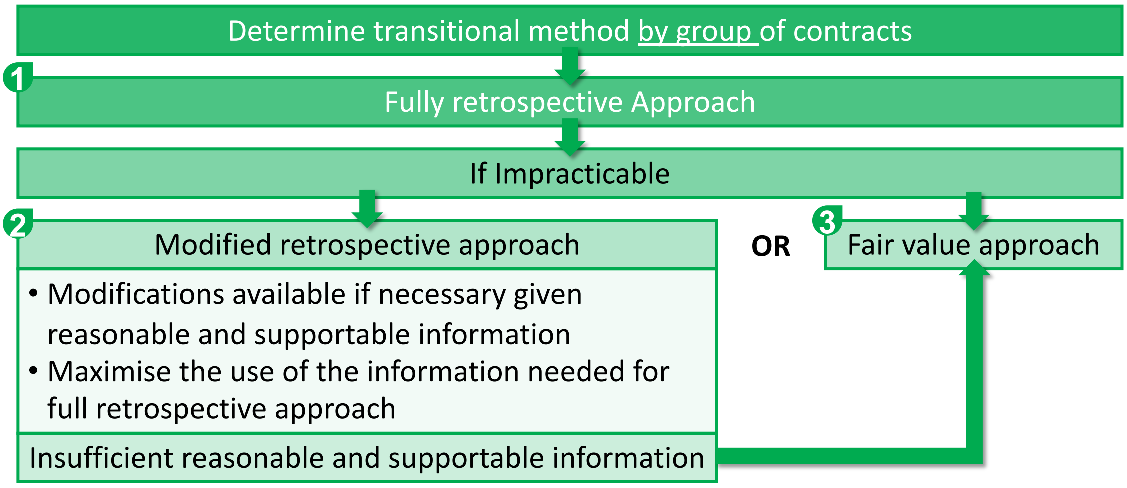
Fair value approach *(continued)*

- Entity needs reasonable and supportable information either from initial recognition or at transition to assess:
  - The level of aggregation of contracts
  - Whether a contract has direct participation features
  - How to identify discretionary cash flows
- An entity can
  - choose to include contracts issued more than one year apart in the same group at transition; or
  - Divide into groups of contracts issued within a year of each other if reasonable and supportable information available at transition

Applying IFRS 17 for the first time



Example
Different generations

	Groups of contracts issued:		
	Before 2000	2000 - 2018	After 2018
Information required applying IAS 8			Fully retrospective
Reasonable/supportable information to apply modified approach		Modified retrospective	
Lack information to apply modified approach	Fair value		

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Pre Transition disclosures

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IAS 8 Disclosures

- Description of the new standard
- Effects on:
  - Classification of contracts
  - Measurement of assets and liabilities
  - Choices made (for example in regard acquisition costs)
  - Effect on opening balances
  - Specific reliefs used

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IFRS 7 and IFRS 17 disclosures

- Reconciliation of carrying amounts of financial assets and loan loss provisions between IAS 39 and IFRS 9 (IFRS 7.42)
- Initial and ongoing disclosures to allow users to understand effect of applying simplifications at transition (IFRS 17.114):
  - Separating revenue and CSM until contracts are derecognised

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Transition disclosures

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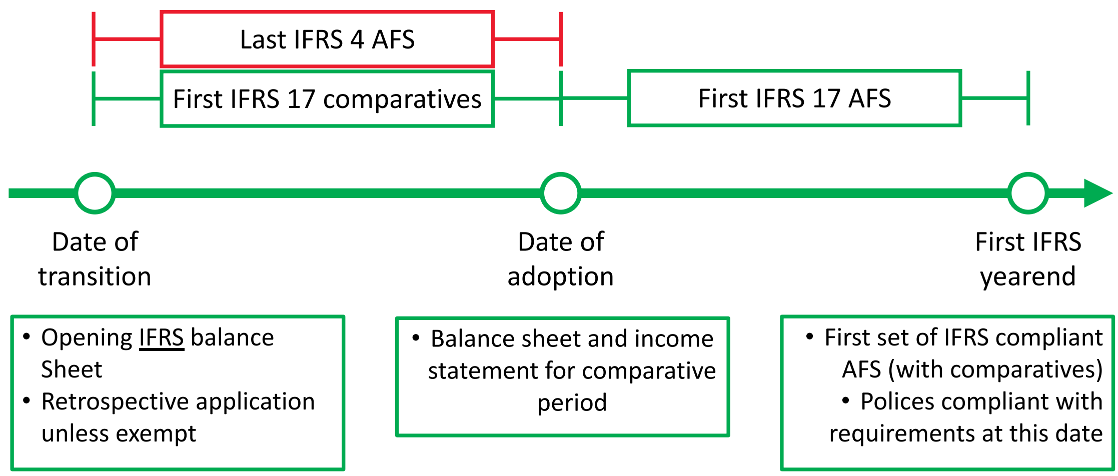
Time line



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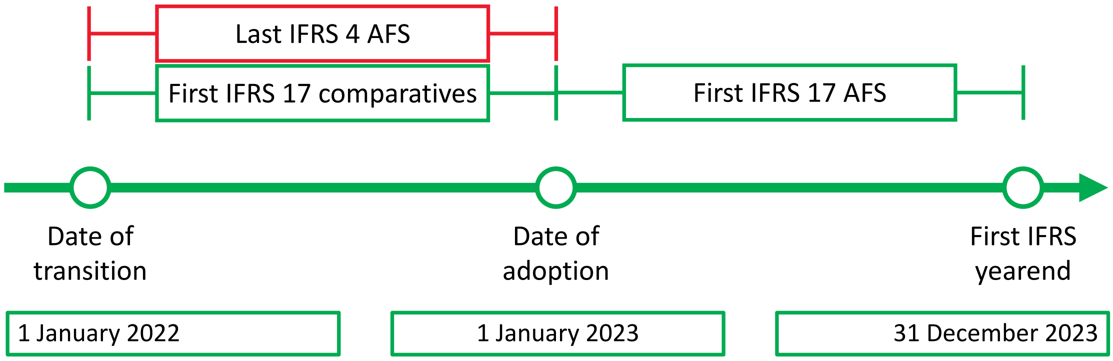
Time line for IFRS 17



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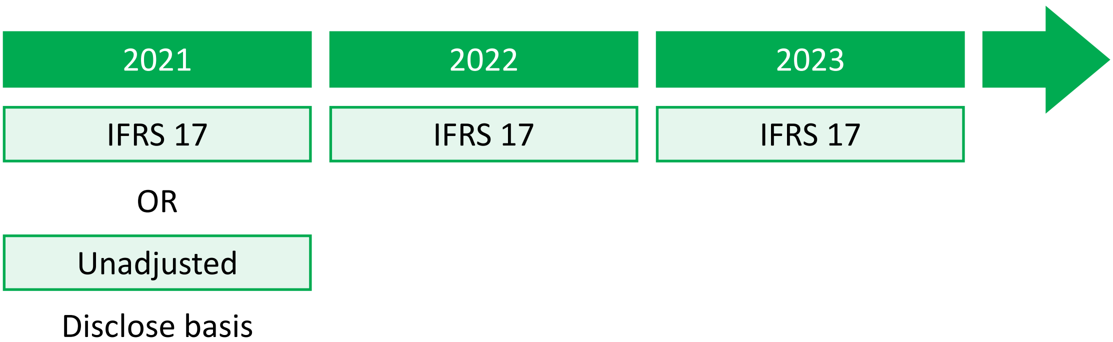
Comparatives

» If an entity chooses to present more then one comparative period, then IFRS allows a choice:



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Transition disclosures

- If applying modified retrospective or fair value approach:
  - Explain methods used and disaggregated information
  - Provide separate reconciliations of CSM, eg:

Contractual service margin reconciliation		
Fully retrospective	Modified retrospective	Fair value
Existing contracts (unless impracticable) and new business	Existing contracts if retrospective application is impracticable	Existing contracts if retrospective application is impracticable

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Stress Areas

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Experience with MCEV

- Early adaptors burnt
  - Market had learnt to expect limited volatility
  - Didn’t understand extent of volatility
- Recovery of confidence was slow
- Created significant nervousness about being first mover
- Inconsistent starting point
- Consequently limited information coming to market

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Different starting points

- Moving from different starting points
- Not initially indicative of the way the business is managed
- Will not have consistent adjustments
- Therefore:
  - Market likely will get some surprises
  - Insurers will seek to amend approaches over time
    - In response to competitors
    - In response to changes in how business is managed
- Mistakes will be made

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‘Habit’

- Natural tendency to back-solve to how the product is managed
- Some judgements (for example quantity of benefits) are subjective and will reflect perception
- Initial effect of changes may not be as significant as expected
- Disclosures of critical judgements will be key
- Benchmarks will be key (risk margins, profit emergence and experience studies)

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Inconsistency with IFRS 17

Expecting:

- Under-disclosure, especially of risk and judgements
- Potential issues with aggregation levels
- Significant initial use of non-gaap historic metrics
- Some initial inconsistency between issuers in disclosures

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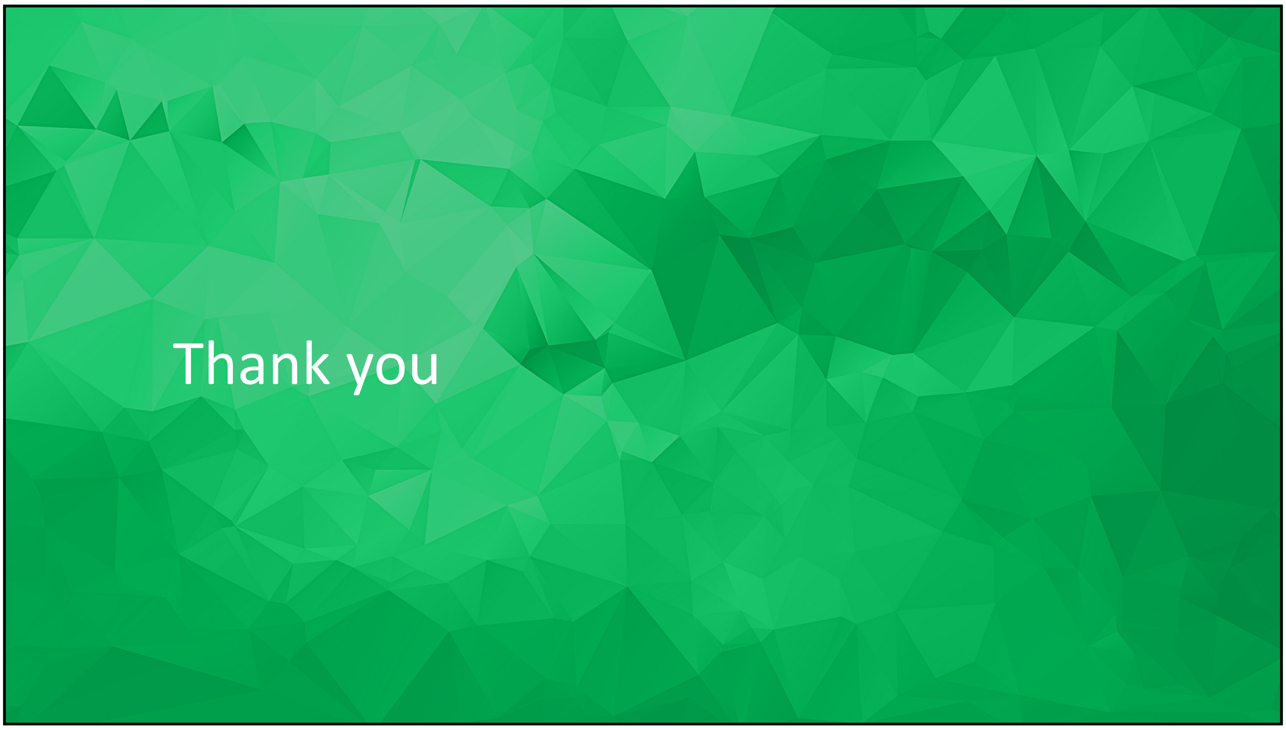

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