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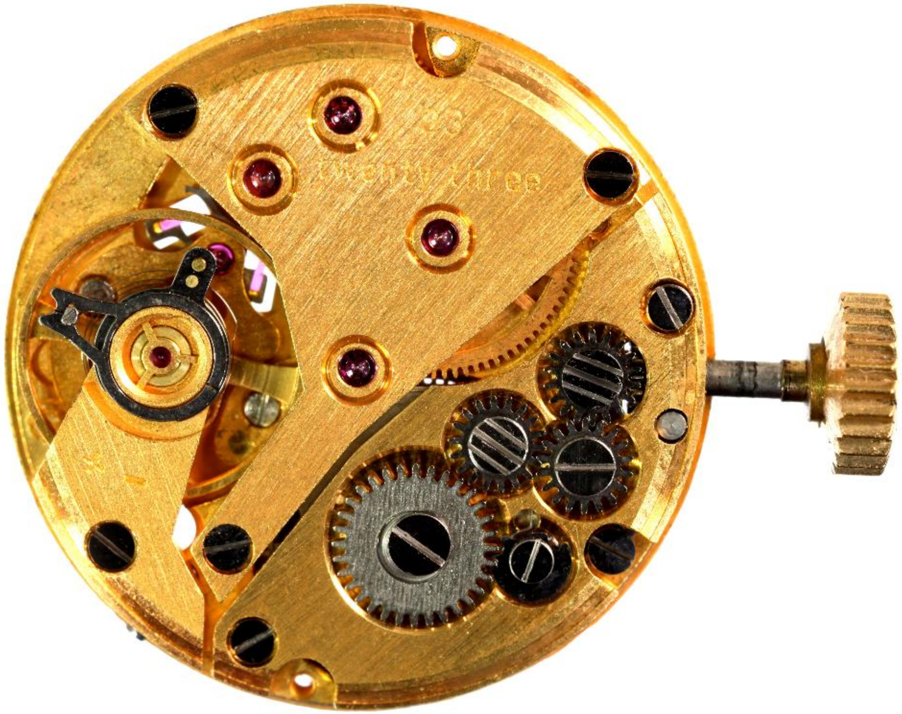


The IASB publishes IFRS 17

An overview of the key requirements

Francesco Nagari, Deloitte Global IFRS Insurance Leader | 25 May 2017

Agenda

- Scope of IFRS 17
- Unbundling of non-insurance components
- Measurement requirements
- Level of aggregation
- Insurance revenue
- Transition
- Next steps

Scope of IFRS 17

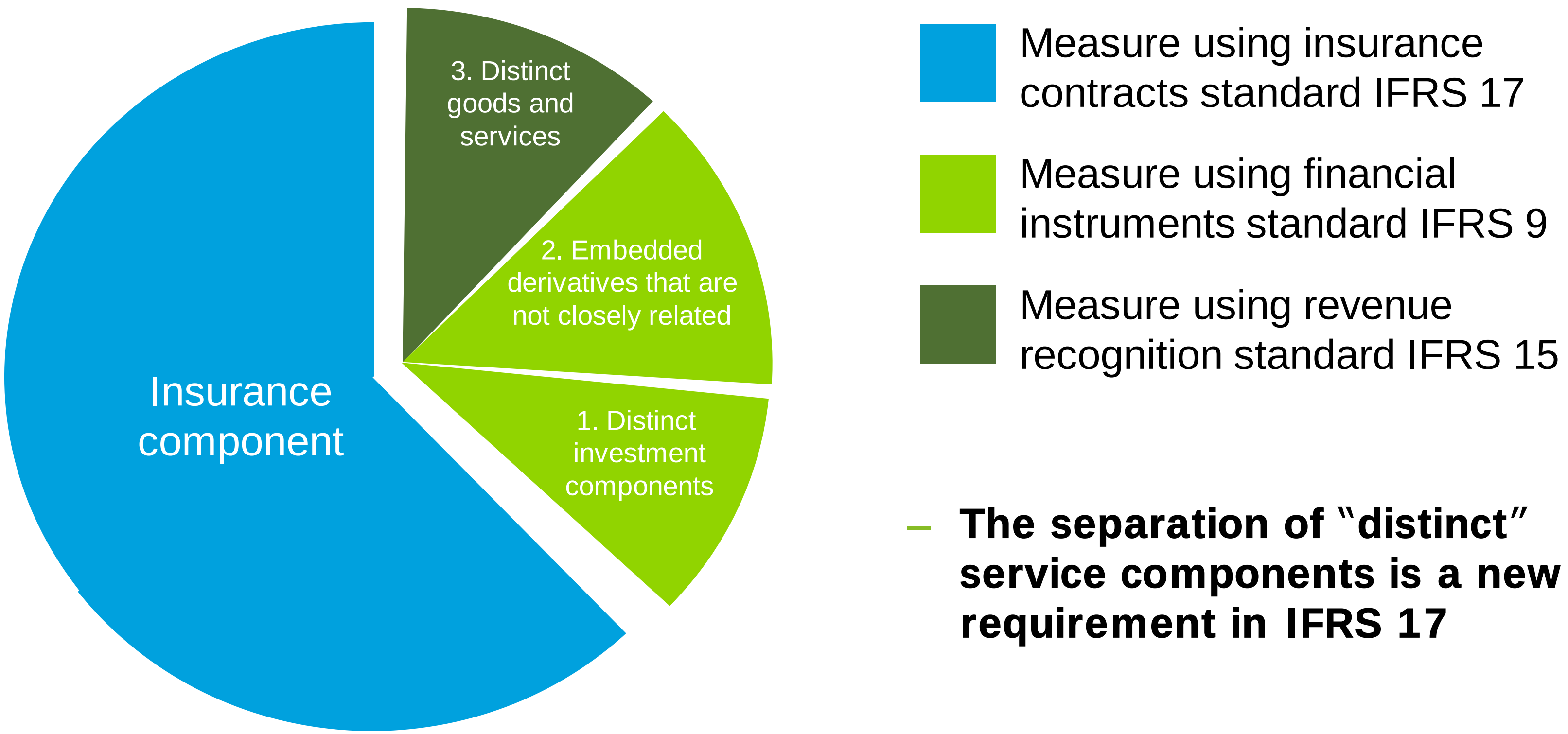
IFRS 17 will apply to a range of different contracts, which fall under the following categories:

- **Insurance and reinsurance contracts issued;**
- **Investment contract with a discretionary participation feature ("DPF") issued, provided that the entity also issues insurance contracts**
- **Reinsurance contracts that an entity holds ("ceded reinsurance"); and**

IFRS 17 substantially carries forward the scope exclusions from IFRS 4 with the addition of fixed fee contracts (e.g. roadside assistance contracts) which can be scoped out of IFRS 17 into IFRS 15 by accounting policy choice.

Unbundling of non-insurance components

- An insurer may need to separate/unbundle "distinct" non-insurance components from an insurance contract and account for them under a different IFRS.
- IFRS 17 has three different tests to determine whether these non-insurance components are "distinct". If they are, they would be accounted for outside IFRS 17.



- The separation of "distinct" service components is a new requirement in IFRS 17

Unbundling of non-insurance components

Illustrative example : Investment component + service component (1/2)

Product structure

Insurance component + Account balance

- + Policyholder's contribution
- ± Asset returns
- − Management fees

- **Premium: CU1,000**
- **Benefits**
  - **Death benefit: CU5,000 + Account balance**
  - **Surrender benefit: Account balance (no surrender charges)**

The entity has a claims processing and asset management departments

– **An investment product that has equivalent terms to the account balance, but without the insurance coverage, is sold by another financial institution in the same market.**

– **The entity tests under IFRS 17 whether to separate the non-insurance components from the insurance contract.**

Example adopted from IFRS 17- Illustrative examples by IASB

Unbundling of non-insurance components

Illustrative example : Investment component + service component (2/2)

Is the account balance distinct?	– **The existence of an investment product with equivalent terms indicates that the components may be distinct.** – **If the right to death benefits provided by the insurance coverage either lapses or matures at the same time as the account balance, the insurance and investment components are highly interrelated and are therefore not distinct.**
Is the claims processing and asset management service distinct?	– **Claims processing and asset management activities are part of the activities the entity must undertake to fulfil the contract and therefore are not distinct goods or services to a policyholder because he cannot benefit from them either on its own or together with other resources readily available to the policyholder.**

Consequently, the entity would <u>not separate</u> these non-insurance components from the insurance contract.

Measurement requirements

The General Model a.k.a. the Building Block Approach ("BBA")

Principles

- Measurement uses current estimate assumptions
- Contracts are grouped by portfolio, year of sale and one of the three possible profitability levels
- Profit measured and reported based on the delivery of the "insurance coverage service"
- Deferred profit absorbs assumption changes for future coverage ("Unlocking")
- Discount rates based on market interest rates (currency, duration, liquidity)
- Expected profit from participating contracts revalued based on assets

Total IFRS Insurance Liability

Block 4: Contractual Service Margin ("CSM")

Measured at inception as the expected contract profit to be earned as services are fulfilled. It is adjusted for changes in non-financial variables affecting future coverage cash flows. It accretes interest based on day 1 discount rate (locked-in rate)

'Fulfilment cash flows'

Block 3: Risk Adjustment

An entity-specific assessment of the uncertainty about the amount and timing of future cash flows

Block 2: Time Value of Money

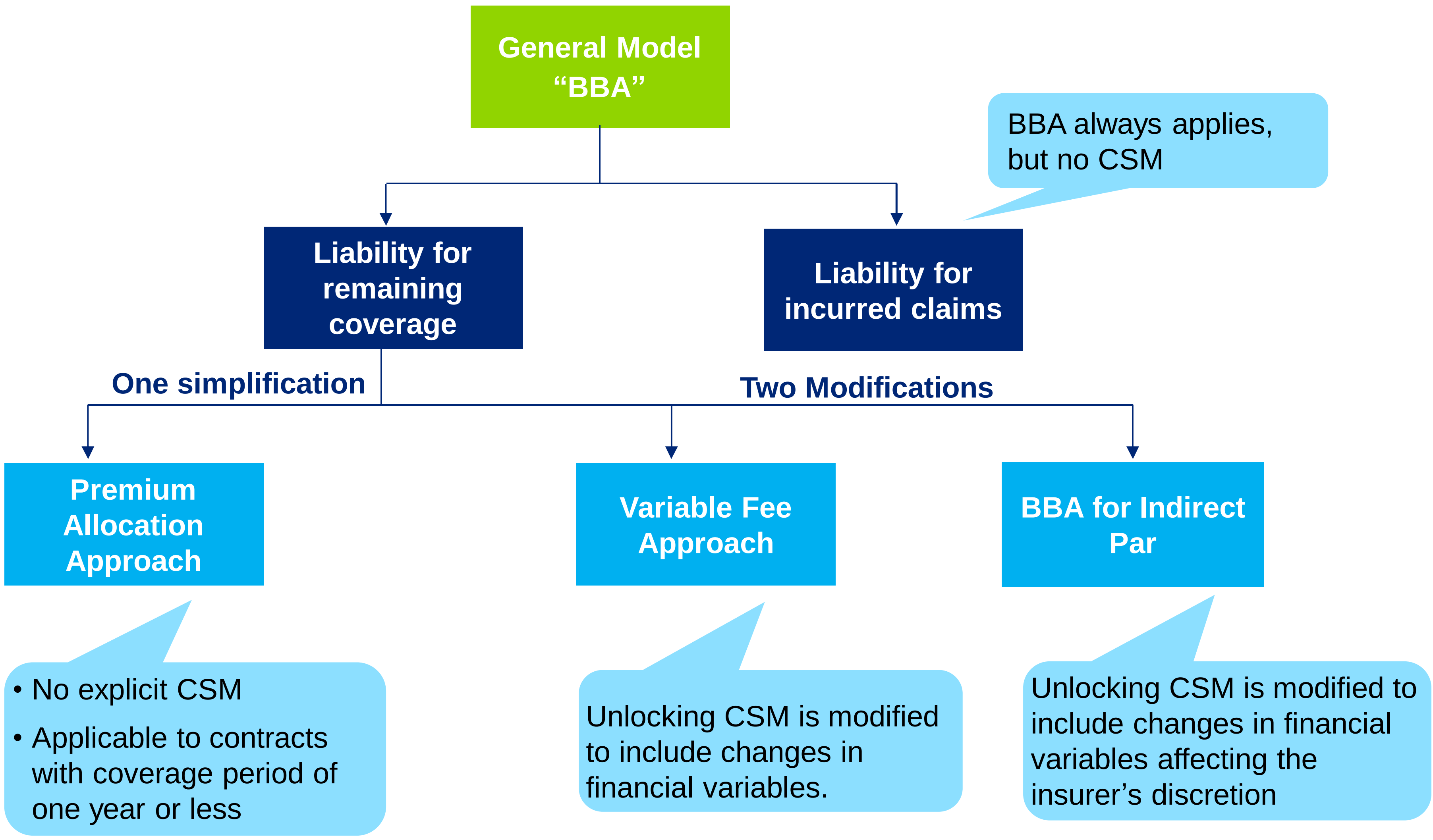
An adjustment that converts future cash flows into current amounts

Block 1: Expected Future Cash Flows (unbiased probability weighted mean)

Expected (probability-weighted) cash flows from premiums, claims, benefits, expenses and acquisition costs

Measurement requirements

Modification and simplification of the General Model



Measurement requirements

Variable Fee Approach (VFA)

- This is a new requirement introduced after the 2013 exposure draft to replace the "mirroring approach".

- The insurance contract is viewed as creating an obligation to pay the policyholder an amount equal to the value of the underlying items less a variable fee for service.

- VFA modifies the General Model where:

  - The CSM is adjusted/unlocked to reflect changes in entity's share of underlying items which represent the variable fees for future services (financial variables); and

  - The interest accreted on the CSM balance and arising from the change of the variable fee reflects current interest rates (financial variables).

Measurement requirements
Indirect par

- These are contracts where the entity's interest in underlying items is viewed as a share of economic returns.
- A change in the estimate of the proportion of investment returns that an entity would pay its policyholders compared to what it would retain is referred to as a change in the entity's discretion.
- The General Measurement Model is modified as follows:
  - The contractual service margin is adjusted/ unlocked with changes in financial variables that cause a change in discretion (financial variables)
- The accretion of interest on the CSM balance is done using the day 1 locked-in discount rate, in line with the General Model.

Level of aggregation

IFRS 17 unit of account for the CSM

- A portfolio is a group of contracts subject to similar risks and managed together as a single pool
- A portfolio is required to be disaggregated into groups of insurance contracts that at inception are:
  - Onerous, if any;
  - profitable with significant risk of becoming onerous, if any; and
  - other profitable contracts.
- Only contracts issued within the same twelve months period are permitted to be grouped together.
- Further disaggregation in smaller groups beyond these minimum requirements is permitted. Groups for shorter periods are also permitted.
- Groups are established at the inception of the contracts and not subsequently reassessed. Unlocking of the CSM and its attribution to the P&L is always done at group level making the group the single unit of account for the CSM.
- The aggregation requirements for VFA and indirect par are the same as the General Model.

Level of aggregation

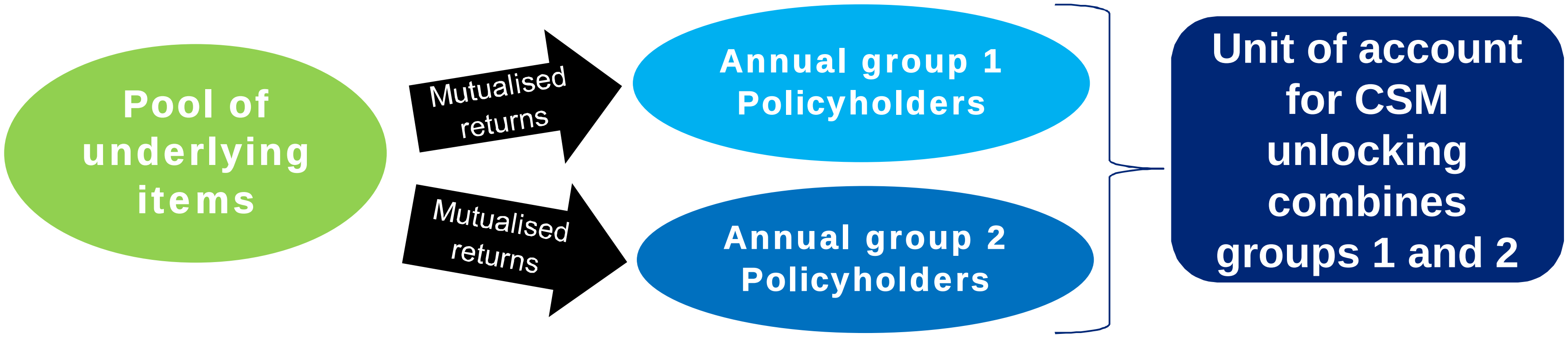
IFRS 17 unit of account – Special cases for the CSM

PAA

- An entity shall assume no PAA contracts in the portfolio are onerous at initial recognition, unless facts and circumstances indicate otherwise.
- The aggregation of profitable contracts in two separate PAA groups if there is a significant risk of some contracts becoming onerous is also done only if facts and circumstances dictate it.

"Mutualisation"

- When cash flows from insurance contracts in one group are affected by the cash flows to policyholders of contracts in a different group the unlocking of CSM must take this into account.
- Effectively the presence of these features expands the unit of account for CSM unlocking to comprise all the groups being "mutualised"



Insurance revenue

Brand new insurance revenue and expenses – disaggregation of investment components

Statement of Profit or Loss

Insurance revenue

+ Expected net cash outflows during the period (excl. inv. component)
± Change in risk adjustment rem. coverage
+ Release of CSM grossed up for acq. costs amort.

Insurance service expenses

− Actual net cash outflows during the period (excl. inv. component)
− Amort. of acquisition costs (CSM gross up)

Other Items of the Insurance Service Result

− Loss recognition on onerous contracts (incl. initial)
± Change in cash flows from liabilities for incurred claims (BEL+RA)
± Experience variance from loss components and liabilities for incurred claims

Insurance finance income or expenses

± Expected unwind of discount rates on insurance liabilities (P&L disc. rates)

Investment income

± Actual investment earnings on assets backing liabilities

Other Comprehensive Income (optional)

+ Present value of projected cash flows using current discount rates
− Present value of projected cash flows using P&L discount rates

Transition

Full restatement is mandatory but simplifications are available

<u>Three possible approaches to be applied</u>

1. **The retrospective approach must be applied to all groups of insurance contracts, unless it is impracticable or if groups at inception of contracts in force on transition date cannot be identified.**
2. **If applying the retrospective approach is impracticable, an entity is then permitted to choose between the modified retrospective approach and the fair value approach.**

Modified retrospective approach

- **The objective of the modified retrospective approach is to approximate full restatement by;**
  - **Using reasonable and supportable information available without undue cost or effort**
  - **Maximising the use of information that would have been used to apply a retrospective approach without undue cost or effort**
- **Comprises of General Model and VFA modifications.**

Transition

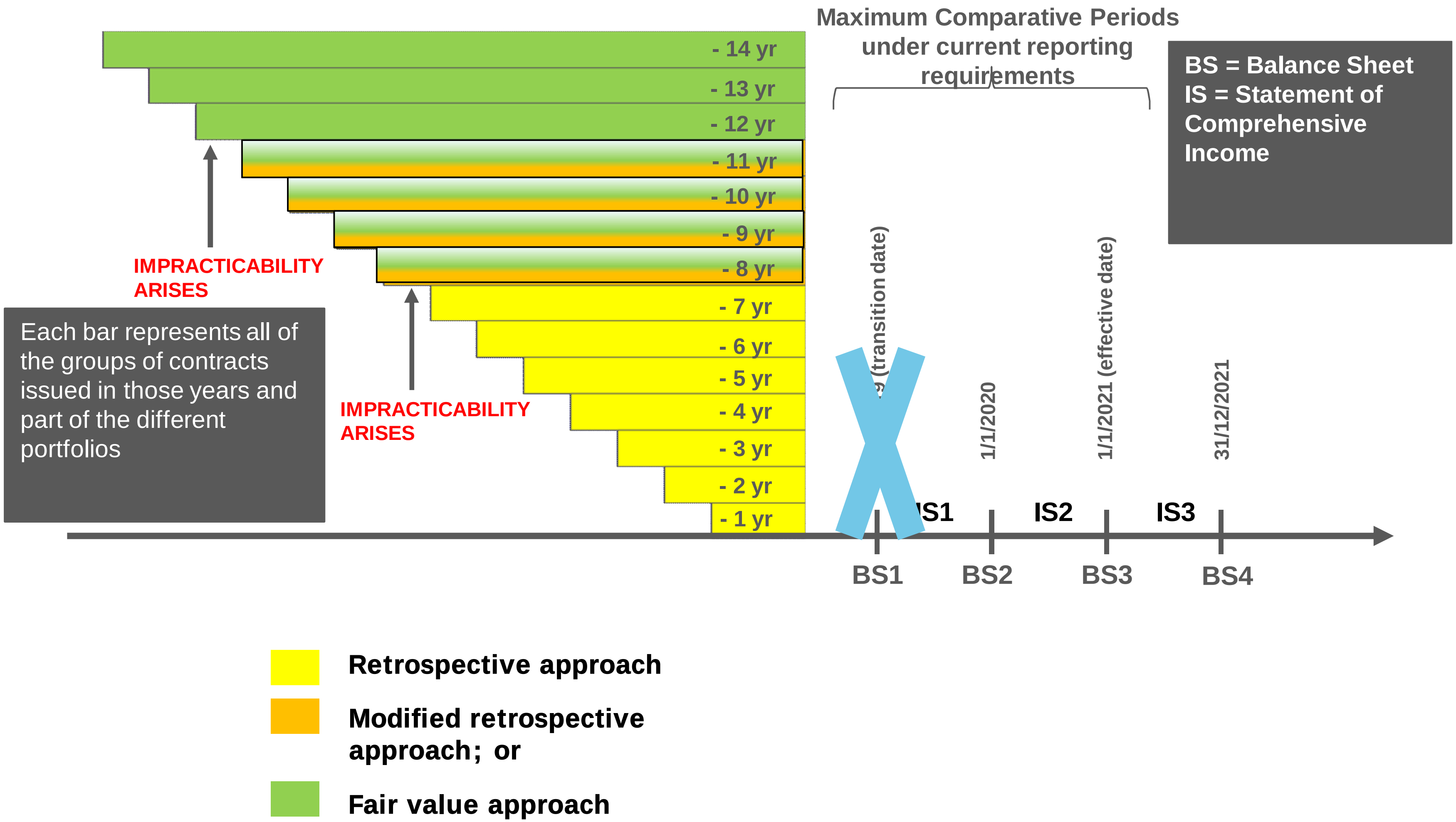
Full restatement is mandatory but simplifications are available

Simplifications when grouping contracts

- Under modified retrospective approach, an entity can group contracts issued **more than one year apart** in the same group if the entity does not have reasonable and supportable information to apply a retrospective approach.

- Under fair value approach, an entity is not required to group contracts issued **more than one year apart** in different groups unless it has reasonable and supportable information to make further divisions to ensure that contracts within a group are issued within the **same twelve months**.

Transition
Illustration (effective date: 1/1/2021)



Transition

IFRS 17 and IFRS 9 transition considerations

- Some insurance companies can elect to continue to apply IAS 39 until 1 January 2021.
- If an insurer applied IFRS 9 before, the following options are available to an insurer at date of initial application of IFRS 17 (1/1/2021 for calendar year reporting entities):

Permitted but not required

- To designate financial assets to be measured at FVTPL if doing so would eliminate or significantly reduce an accounting mismatch.
- To assess the business model for IFRS 9 classification for assets designated as related to insurance contracts with reference to facts and circumstances that exist on 1/1/2021
- To restate comparatives based on these options but only without using hindsight
- To designate or revoke a previous designation of an investment in an equity instrument as at FVOCI

Required

- To revoke previous designations at FVTPL if the accounting mismatch that led to previous designation is now eliminated.

Next steps

IASB

- **IASB will be establishing a Transition Resource Group (TRG) to support the implementation of IFRS 17 *Insurance Contracts.***
- **IASB to announce the TRG members after 31 July 2017.**

Deloitte

- **Launch of a new series of "on demand webcasts" and eminence papers on topical issues that will follow the insurers' IFRS 17 journey to implementation.**
- **Publication of the IFRS 17 practical guide**
- **Deloitte interpretative guidance on IFRS 17 will be released continuously on our online accounting research tool**

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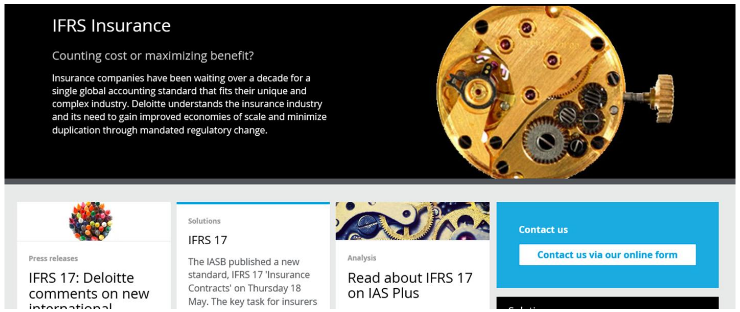

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