Deloitte.

IFRS 17

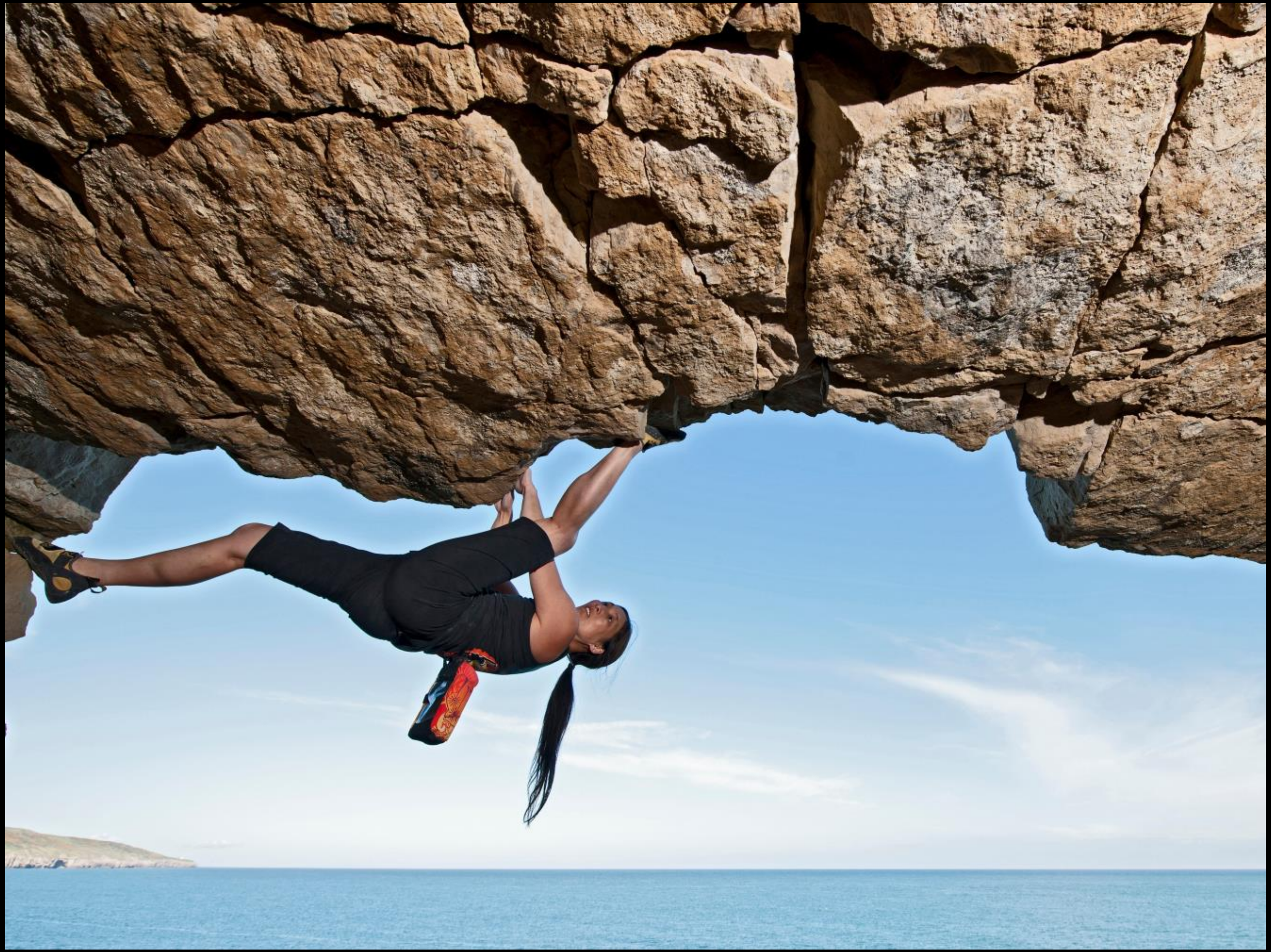
New reality of actuarial reporting

11 April 2017

Introduction
Objectives of actuarial seminarium

- Introduction to IFRS 17 (in relations to IFRS 4)
- New mechanism of profit recognition
- Actuarial aspects
- Focus on IFRS 17 not other related standards (e.g. IFRS 9)
- Synergy with Solvency II, MCEV and IFRS 4
- Challenges

Agenda



Introduction to IFRS 17

Implementation of IFRS 17

Why new standard for insurers?

Comparability

1. **Lack of comparability among insurers**

   Varying practices in applying IFRS 4

   Various approaches even within insurance Groups

2. **Lack of comparability between sectors of economy**

   Revenues include deposits

   Different approach to revenue recognition

Updated assumptions

1. **Outdated biometric assumptions**

   Assumptions are not adjusted to changing market environment

   No lapse assumptions

2. **Outdated Economic assumptions**

   Fixed technical rates, effects of changes not disclosed

Transparency

1. **Lack of important disclosures**

   Not enough information on analysis of change and its sources

2. **Cashflow-based accounting**

   Financial reporting based on cashflows, and not on providing service during insurance period

Implementation of IFRS 17
What do we know today?

Publication of the standard

Expected date:
May 2017

Implementation of IFRS 9

Possibility of deferral of IFRS9 if insurance activity is prevailing.

Implementation of IFRS 17

2017 **2018** **2019** **2020** **2021**

YE **Q1** **Q2** **Q3** **YE** **Q1** **Q2** **Q3** **YE**

1. Annual reporting

Comparative Reporting

Implementation of IFRS 17

Characteristics of contracts in IFRS 17

Types of contracts

Contracts under IFRS 17

Contract boundaries

Defining what is the scope of cashflows to be included in the valuation

Components of contracts („*unbundling*”)

Components of insurance contracts which will have to be excluded from IFRS 17 (i.e. service components or investment components)

Implementation of IFRS 17

Contracts in terms of IFRS 17 (1 / 2)

Insurance contract | **Reinsurance contract (active)** | **Reinsurance contract (passive)** | An investment contract with a discretionary participation feature

Insurance contract:

*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:

*An **insurance contract** issued by one entity (the 'reinsurer') to compensate another entity (the 'cedant') for claims arising from one or more **insurance contracts** that are issued by the cedant."*

- Risk transfer
- Significant insurance risk
- Uncertain event
- Negative impact on the policyholder or the cedant

Implementation of IFRS 17

Contracts in terms of IFRS 17 (2 / 2)

Insurance contract | Reinsurance contract (active) | Reinsurance contract (passive) | **An investment contract with a discretionary participation feature**

“

Investment contract with a discretionary participation feature:

A financial instrument that provides a particular investor with the contractual right to receive, as a supplement to an amount that is not subject to the discretion of the issuer, additional amounts:

(a) that are likely to be a significant portion of the total contractual benefits;

(b) whose amount or timing is contractually at the discretion of the issuer; and

(c) that are contractually based on:

*(i) the returns from a specified pool of **insurance contracts** or a specified type of **insurance contract**;*

(ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or

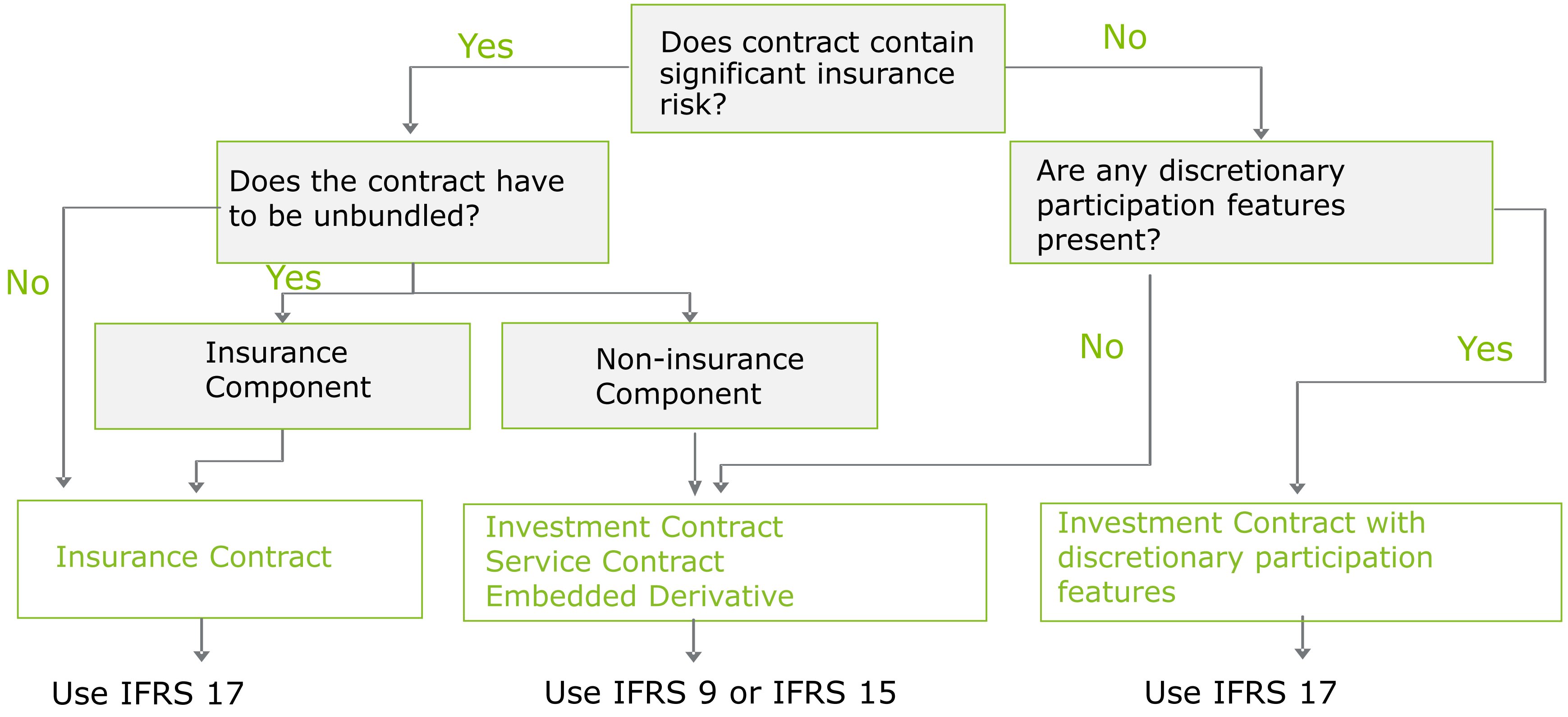
(iii) the profit or loss of the entity or fund that issues the contract.”

- Additional amounts likely to be a significant portion of the total contractual benefits
- Possible discretionary element
- Specified pool of underlying items

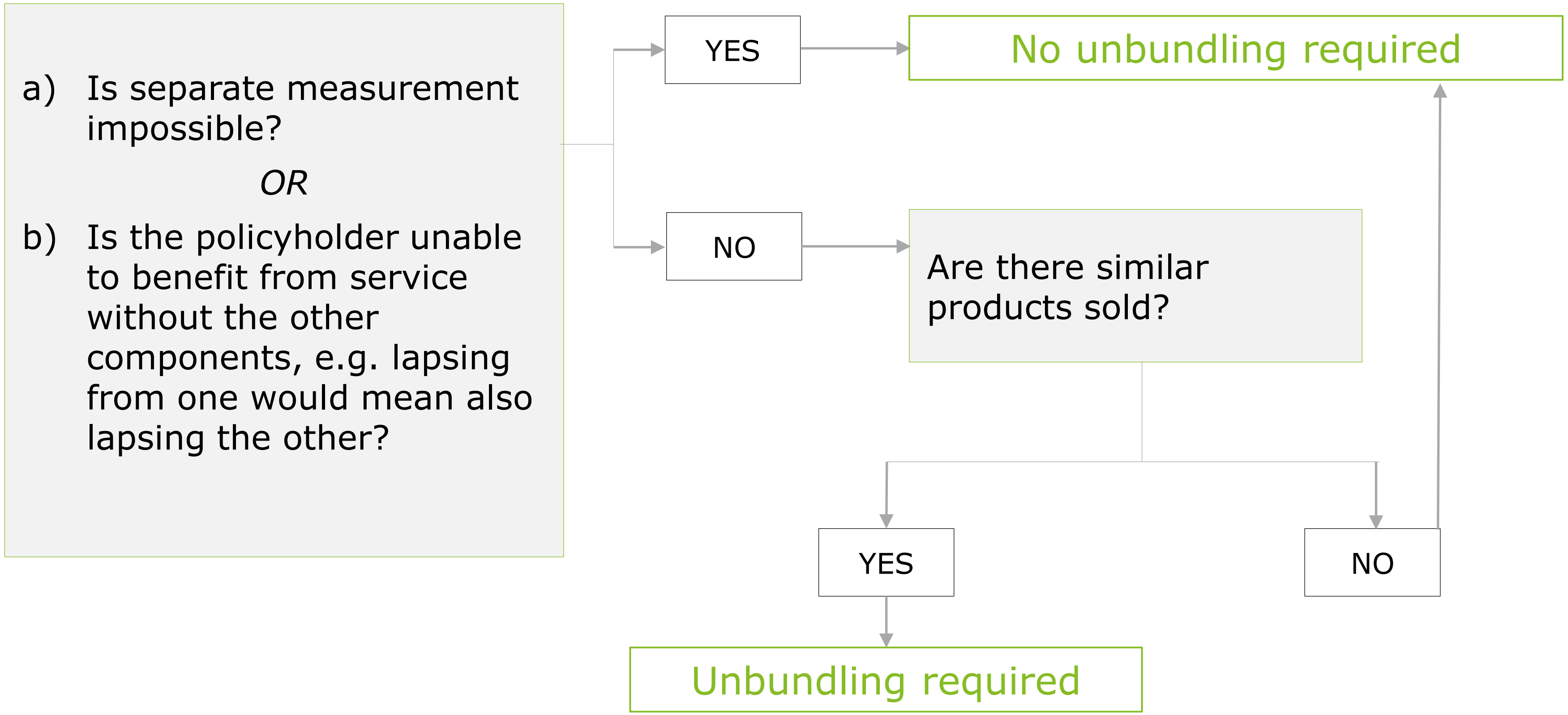
Implementation of IFRS 17

Unbundling - Product classification

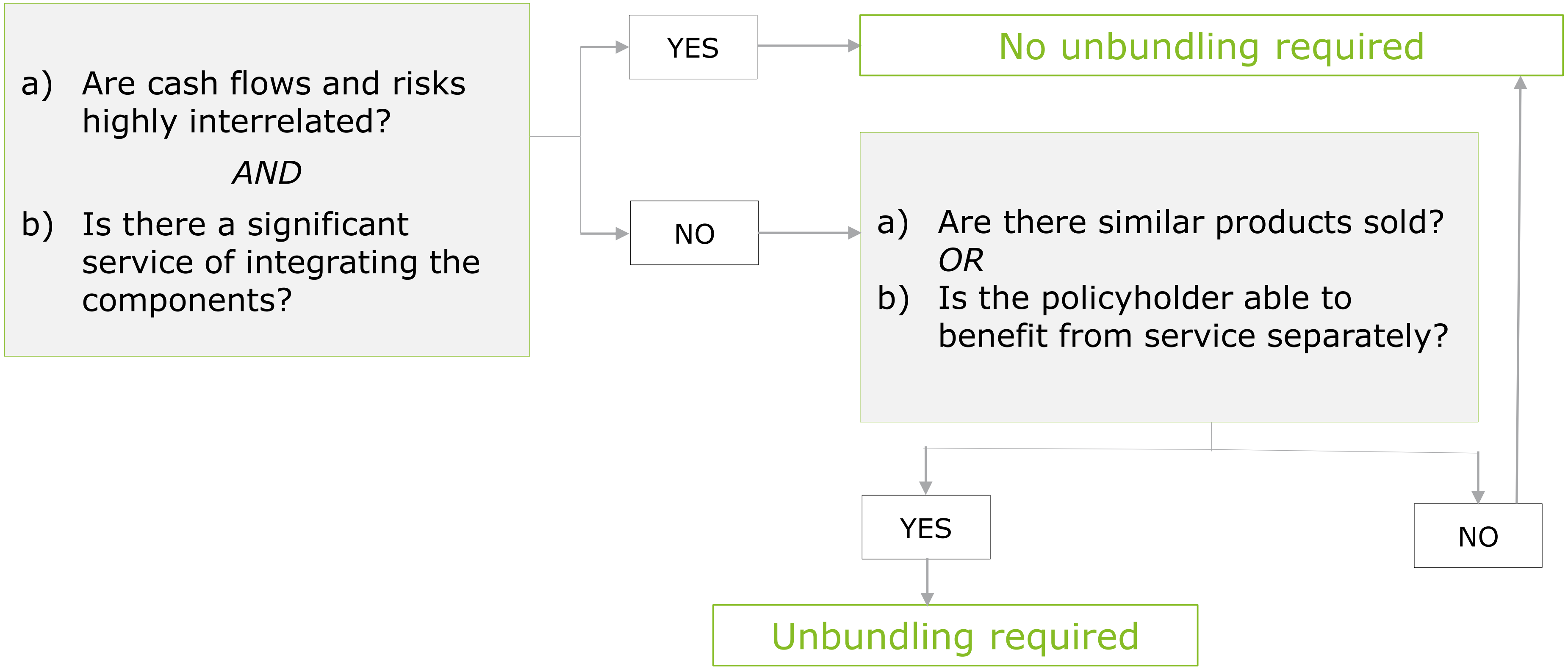
How do we know whether a contract issued by an insurance company is under the scope of IFRS 17, or is under the scope of IFRS 9?



Implementation of IFRS 17
Unbundling – investments components



Implementation of IFRS 17
Unbundling – service components



Implementation of IFRS 17

Contract Boundaries

Within the boundary
The policyholder is obliged to pay the premium

cash flows

Substantive obligation
An insurer needs to provide coverage or other services to policyholders

Contract Boundary
(beginning)

The earliest of :

- the beginning of coverage; or
- the date on which the first premium is due,
- (onerous contract)

1 Insurer has the right or practical ability to reassess the risks **for particular policyholder** and, as a result, can set a price or level of benefits to fully reflect the risks.

2a Insurer has the right or practical ability to reassess the risks **for the portfolio of insurance contract** and set a price or level of benefits to fully reflect the risks, and;

2b Pricing for coverage up to the date that the risks are reassessed **does not take into account the risks that relate to future periods**.

Contract Boundary
(end)

Methodology

Basic methods
Overview

Building Block Approach (BBA)

- Basing method applied to all products both life non-life insurance
- Possible two exemptions – VFA and PAA

Variable Fee Approach (VFA)

- Applied in life insurance
- Permissible only in products satisfying specific rules (products with clearly defined profit sharing and Unit-linked products)
- Close to „BBA” enables several modifications

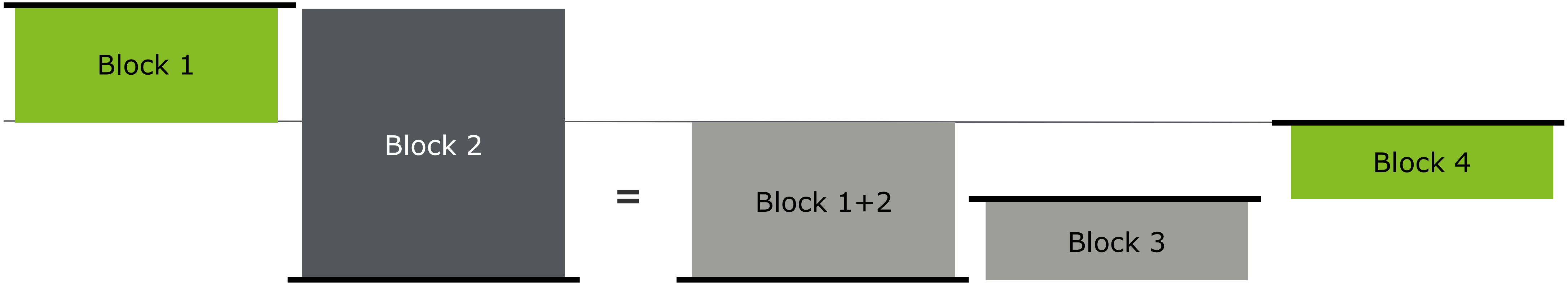
Premium Allocation Approach (PAA)

- Applied in non-life insurance
- Permissible only for liabilities with future cover

Product	BBA	PAA	VFA
Life insurance	●		
Term and Endowment Insurance without profit sharing	●		
Term and Endowment Insurance with profit sharing	●		●
Unit-linked	●		●
Group Life Insurance	●	●	
Non-Life Insurance – future cover	●	●	
Non-Life Insurance – cover terminated	●		

Building Block Approach

Overview measurement at initial recognition



Block 1: Expected Future Cash Flows

Expected cash flows from premiums and claims and benefits

Block 2: Time Value of Money

Adjustment of future cash-flows resulting from time value of money

Value of cashflows to fulfil obligations

Present Value of Future Cashflows

Block 3: Risk Adjustment

An assessment of the uncertainty about the amount of future cash flows

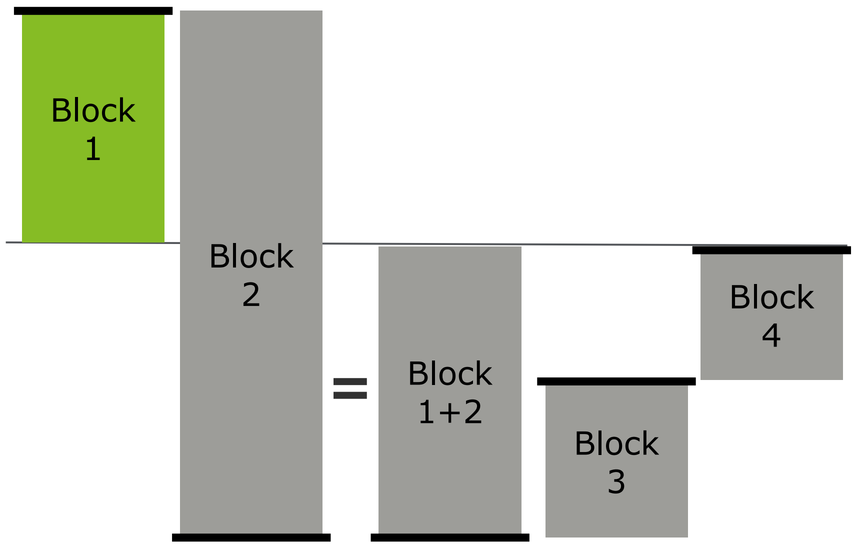
Measured as the difference between the risk-adjusted present value of expected inflows and outflows at inception.

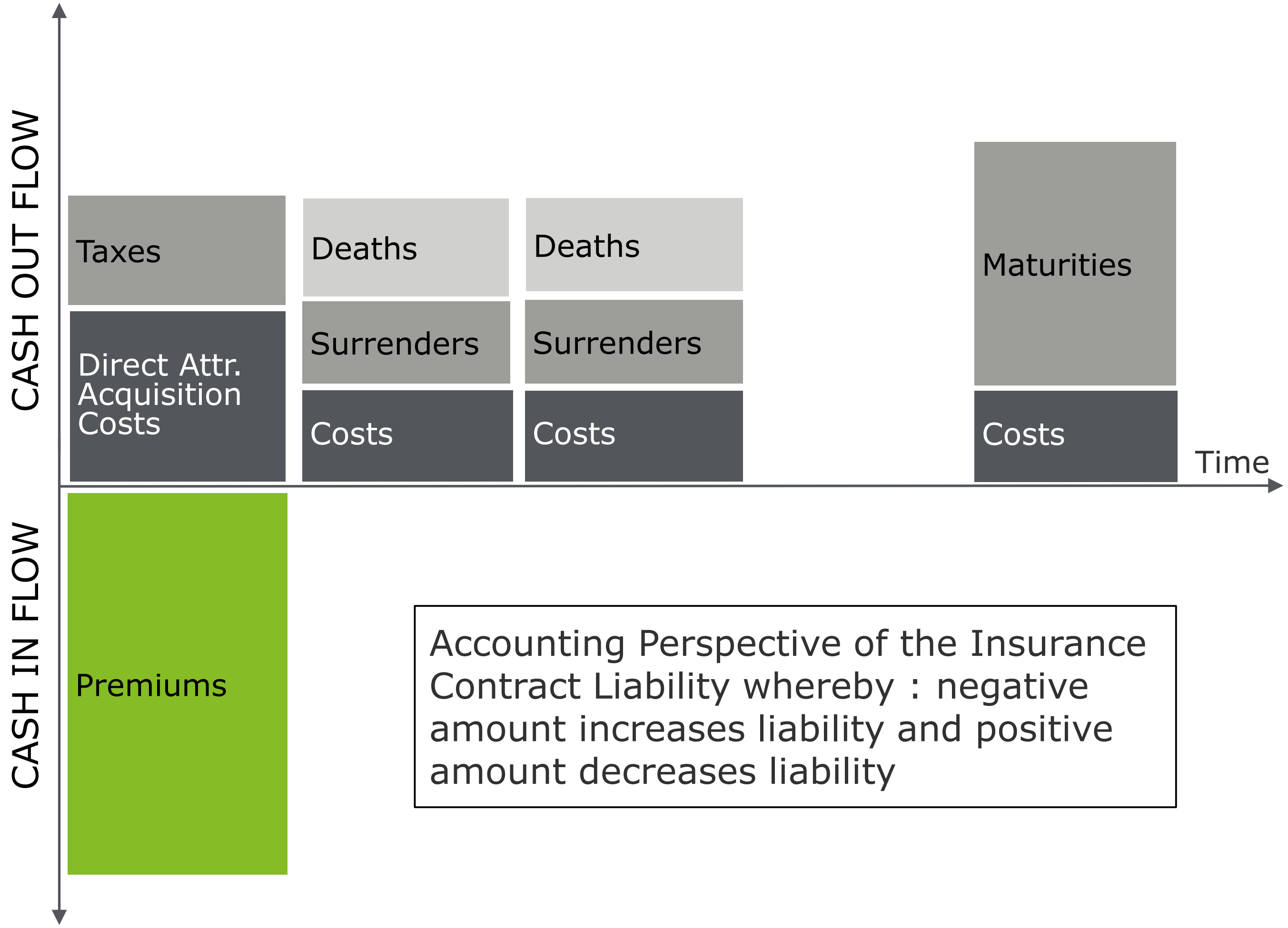
Block 4: Contractual Service Margin

Obligation to provide service, measured at inception as the expected contract profit

Quantifies the deferred profit the insurer expects to earn as it fulfils the contract

Building Block Approach
Block 1: Future cash flows

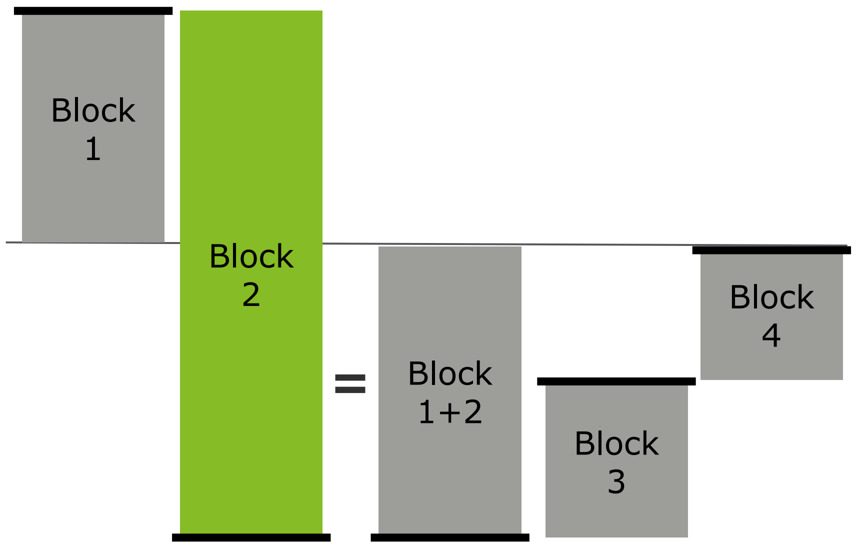




Accounting Perspective of the Insurance Contract Liability whereby : negative amount increases liability and positive amount decreases liability

Building Block Approach

Block 2: Time value of money



„Top-down"

„Bottom-up"

Reference portfolio rate

-

- Duration mismatches
- Credit risk (external and own)
- The other factors that are not relevant to the insurance liability
- No need to include other liquidity adjustments

Insurance liability – Discount Rate

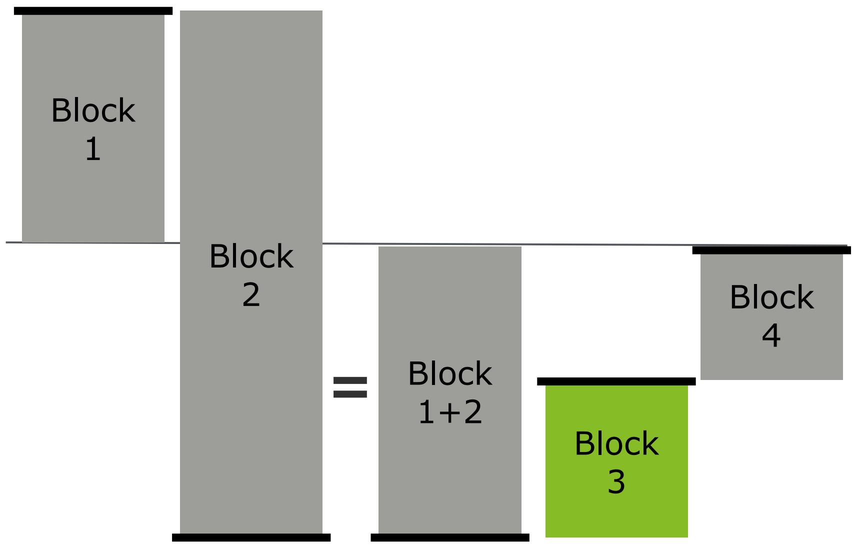
+ Liquidity premium

Risk free rate

Both approaches should lead to the same outcome

Building Block Approach

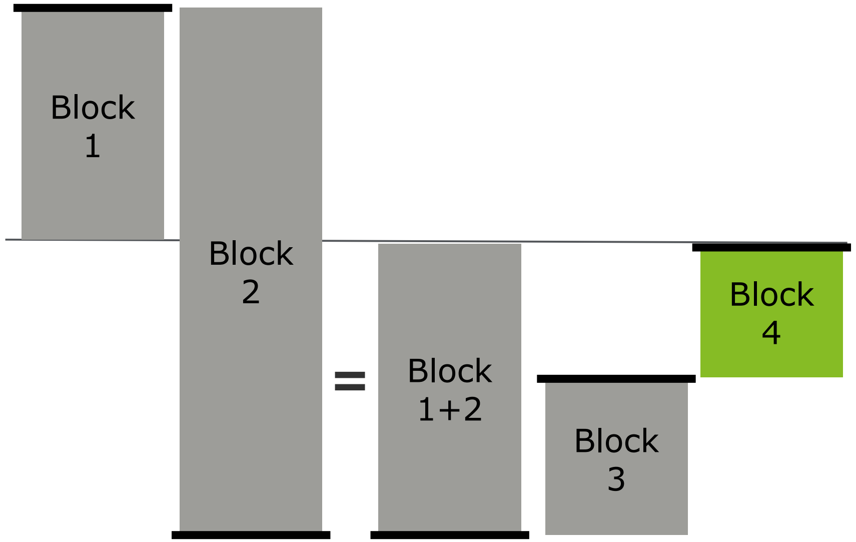
Block 3: Risk adjustment

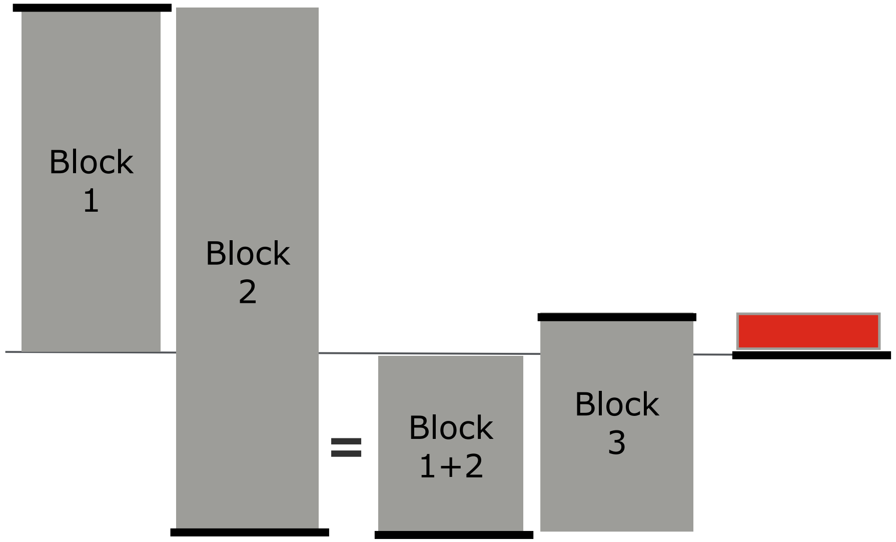


- Measure of uncertainty
- Principle-based approach
- Specific for each insurer
- Diversified
- Comprehensive

Coffee Break

Building Block Approach
Block 4: CSM





Block 1 + Block 2 + Block 3 < 0

Recognise Contractual Service Margin

Block 1 + Block 2 + Block 3 > 0

Recognise Day One Loss (Onerous Contract)

Building Block Approach
Summary of changes in estimates

	CSM	OCI	P&L
Lapse/Surrender	●		
Mortality	●		
Morbidity and recovery	●		
Directly attributable maintenance and acquisition expenses	●		
Expense inflation	●		
Risk Adjustment	●		●
Discount rate		●	●
Expected credit losses on RI assets			●
Salvage and subrogation			●
IBNR			●
Other assumptions in respect of past coverage			●

Variable Fee Approach („VFA”)

Conditions for eligibility

Variable Fee Approach (“VFA”) is applied for contracts with direct participation feature.

Above contracts meet the following conditions:

- **i. the contractual terms** specify that the policyholder participates in **a defined share of a clearly identified pool of underlying items**
- ii. the entity expects to pay to the policyholder an amount equal to **a substantial share of the returns** from the underlying items; and
- iii. a substantial proportion of the cash flows that the entity expects to pay to the policyholder should be **expected to vary with the cash flows from the underlying items.**

VFA is not applicable to reinsurance contracts.

Understood as:
1. Contractual liabilities,
2. Law and regulations
3. Constructive obligation

Eg.
1. Unit Linked product: 100% of fund return in
2. 90% policyholder fund’s surplus

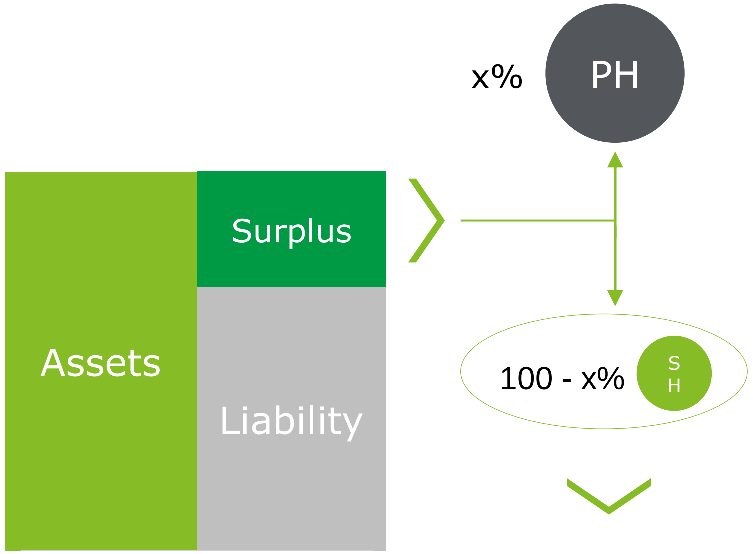
Np.
1. Unit Linked product: Death benefit = Max(Fund Value, Sum Assured)
2. Reversionary Bonus, Terminal Bonus

Examples: endowment insurance with profit sharing based on yield rate, endowment insurance with profit sharing based on biometric variables, unit-linked

Variable Fee Approach
Different underlying model

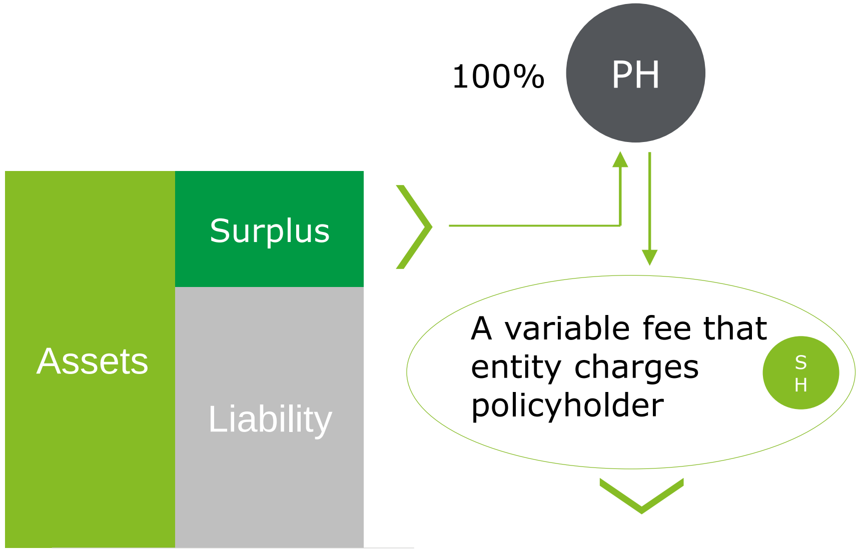
In variable fee approach, the returns to the entity arising from participating contract is viewed as part of the compensation that the entity charges the policyholder for service provided by the insurance contract, rather than as a share of returns from a standalone investment.

Building Block Approach



Changes will go to P&L or OCI

Variable Fee Approach

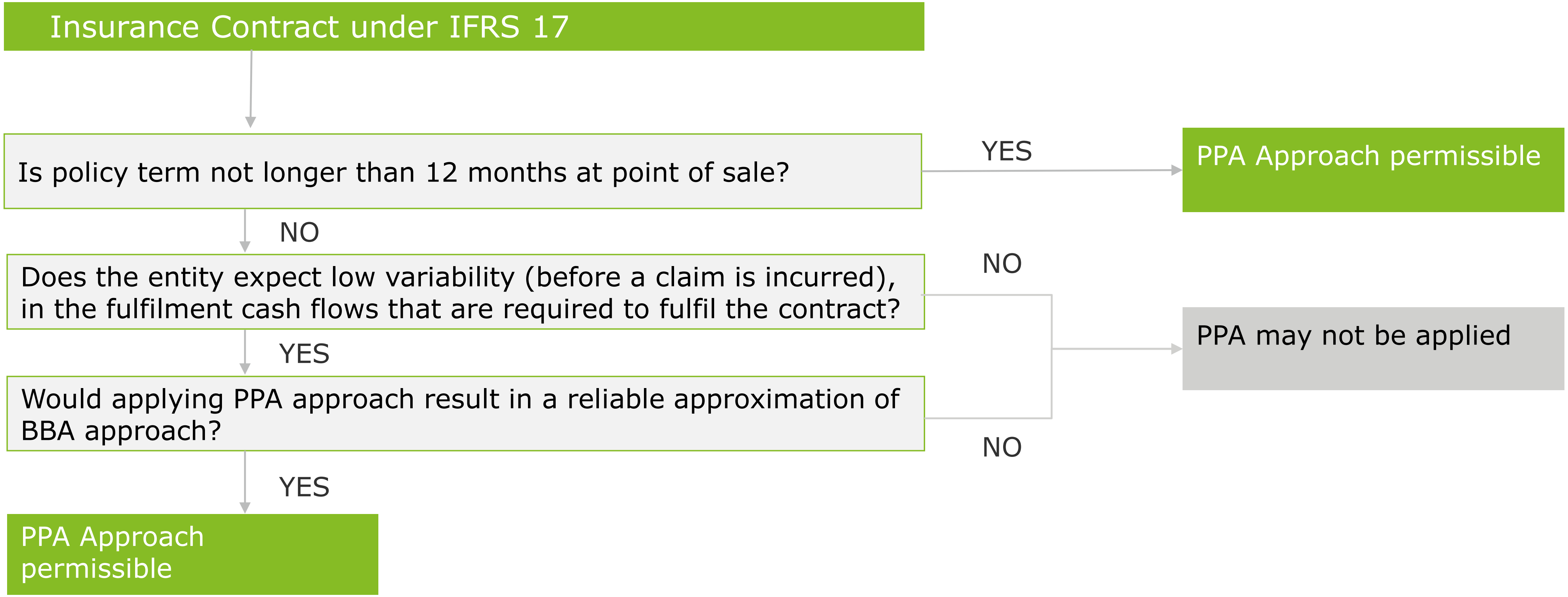


Changes will go to CSM

Acronym Key

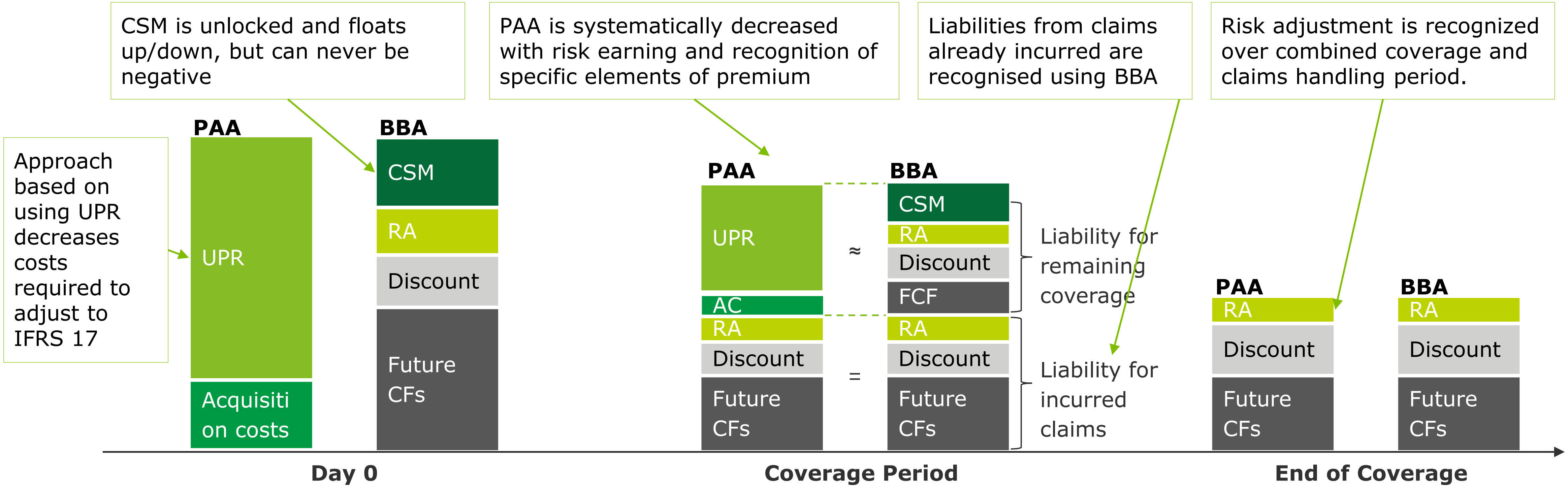
PH	Policyholder	SH	Insurer

Premium Allocation Approach
Decision tree



Premium Allocation Approach

General rules



Acronym Key

AC	Acquisition costs
FCFs	Future cash flows
CSM	Contractual service margin
RA	Risk Adjustment
UPR	Unearned premium reserve

As BBA approach has to be applied to incurred claims, using both approaches might ultimately still be expensive for a company. Therefore the decision to apply PPA has to be analysed in detail.

If the contract is onerous („onerous contract”), the UPR and acquisition costs estimate will have to be increased by the amount required to fulfil the obligation. This estimate will have to be done based on BBA.

Other relevant aspects

Aggregation levels for calculations in IFRS 17

Unit of account

Expected future cashflows

Could be measured at the level of **portfolio of contracts**

Risk adjustment

Measured at the level enabling to include all **expected diversification effects**

Main goal:
Aggregation level should not impact the level of present value of expected future cashflows measured at the individual policy level

…but…

some calculations on individual level may be impracticable or impossible

CSM the point of contract recognition

It is permissible to group contracts of similar profitability, which will respond in similar ways to key drivers of risk

?

CSM at subsequent periods

The level to be consistent with initial recognition guaranteeing that at the end policy term, CSM is fully recognised

Aggregation levels for calculations in IFRS 17

Unit of account – final proposals

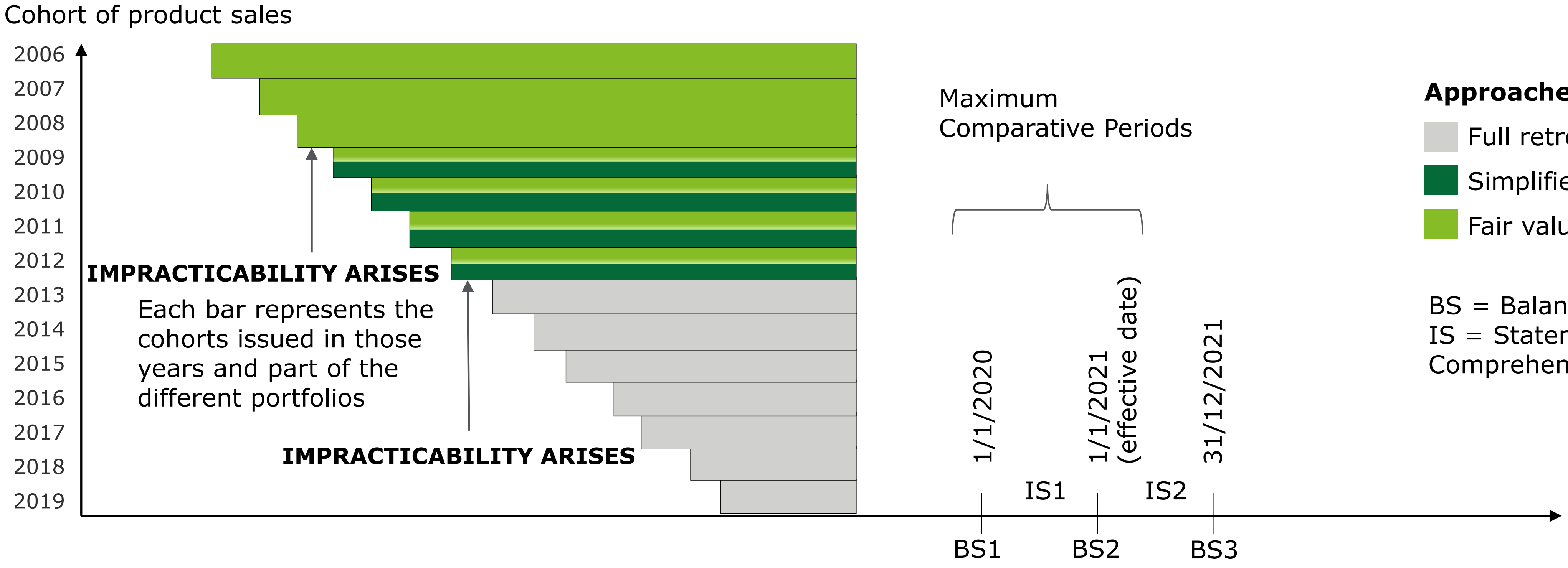
Portfolio - characteristics

- Product or group of products
- Open to new risks
- May consist of many closed groups
- Groups contain policies:
    - Similar in risk factors
    - With similar profitability

Year of Sales X	Year of Sales X + 1	Year of Sales X + 2
Group of policies with high profitability	Group of policies with high profitability	Group of policies with high profitability
Group of other profitable policies	Group of other profitable policies	Group of other profitable policies
	Group of onerous policies	

Transition
Overview (1/2)

- Full retrospective application of the new requirements is required, unless this is impracticable.
- Where impracticable, the Company can either apply:
  - the simplified approach, described in the 2013 ED, and fair value approach from next impracticability point onwards, or
  - the fair value approach.



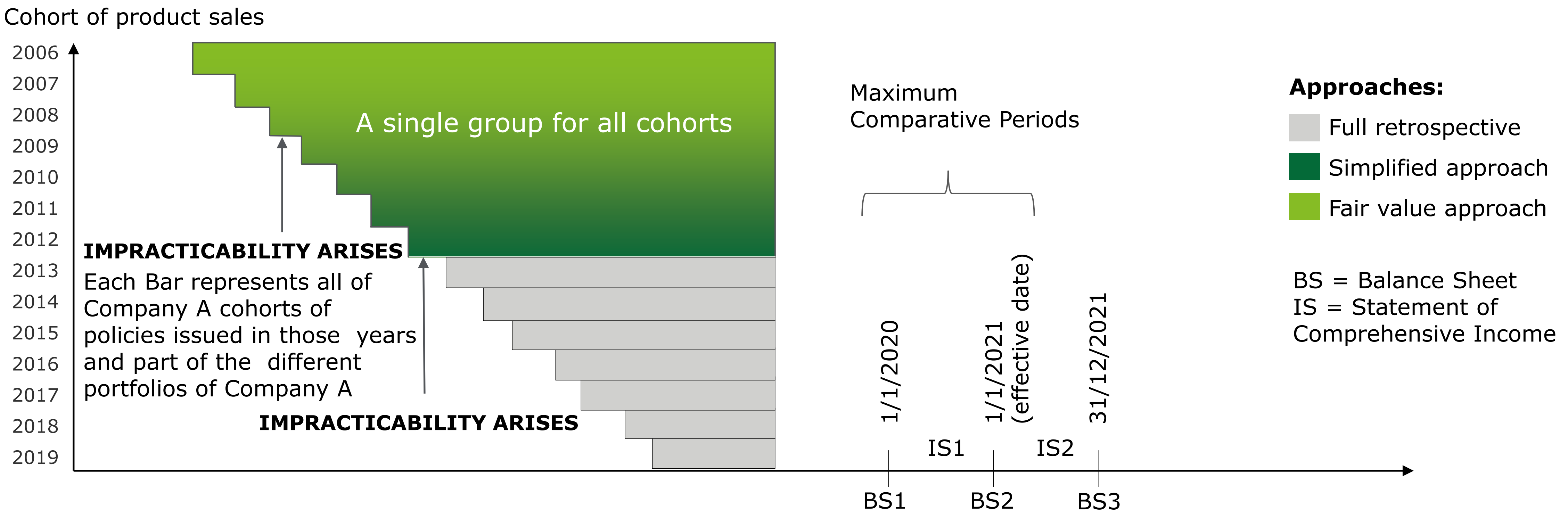
Transition

Overview (2/2)

Grouping by sales periods may not always be possible (e.g. IT system limitations, loss of data).

Such situation may prevent from setting CSM amortisation factor and discount rate curves „locked-in”.

For such documented cases, simplification is permissible.



New Presentation and Disclosure
Statement of Comprehensive Income

Operating Result	**(OR) = (a) - (f)**
Insurance Contracts Revenue	(a) = (b) + (c) +(d) + (e)
Change in CSM	(b)
Change in Risk Adjustment	(c)
Amortisation of acquisition costs	(d)
Expected claims and expenses	(e)
Insurance expenses	(f) = (g) + (h) +(i) + (j)
Incurred expenses and paid claims	(g)
Incurred acquisition costs	(h)
Recognised losses from onerous contracts	(i)
Changes in insurance liabilities	(j)
Investment Result	**(IR) = (k) – (l)**
Investment income	(k)
Investment expenses	(l) = (m) + (n) + (o)
Accretion of CSM	(m)
Accretion of RA	(n)
Accretion of insurance liabilities	(o)
Total Income	**(OR) + (IR)**

Release of part of CSM allocated to current period

Release of part of RA related to risk expired in the current period

Expected claims and expenses in the current period

Actual incurred claims and expenses in the current period

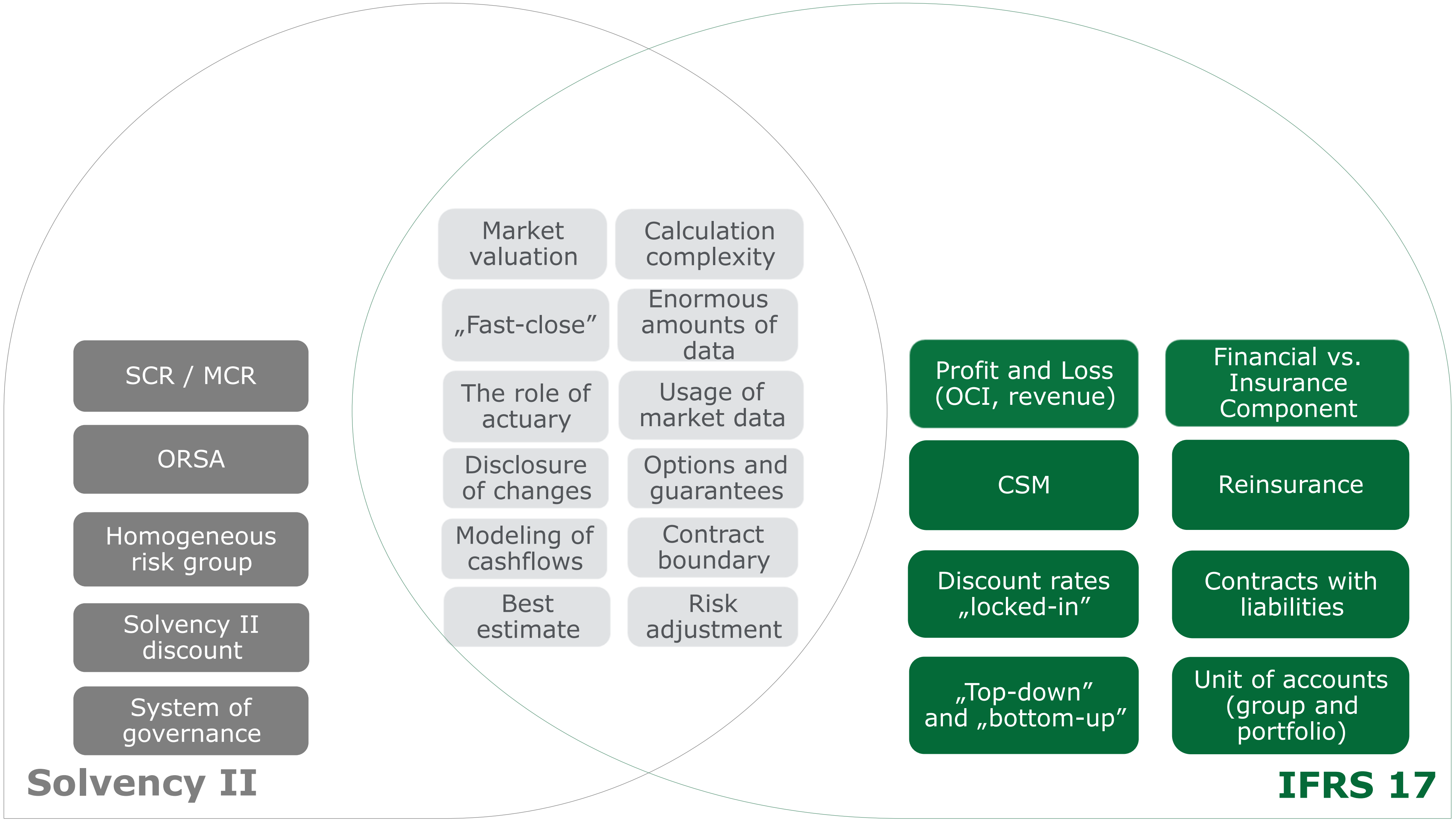
Loss for „onerous contracts"

In case of changes in liabilities for expired cover or in case when CSM cannot absorb negative deviations

Cost related to the unwind of the discount rate in valuation of liabilities

Solvency II vs. IFRS 17

Do you have to start all over again?!



The IFRS 4 Phase II Journey

Data/policy admin systems
- Point of sale cash flows/model points
- Expenses

Assumptions/methodology
- Best estimate cash flows
- Discount rates
- Risk adjustment
- Contractual Service Margin

Actuarial models
- Significant development for new calculations

Data storage
- Cohort/portfolio level data (unit of account)
- Historical data from policy inception

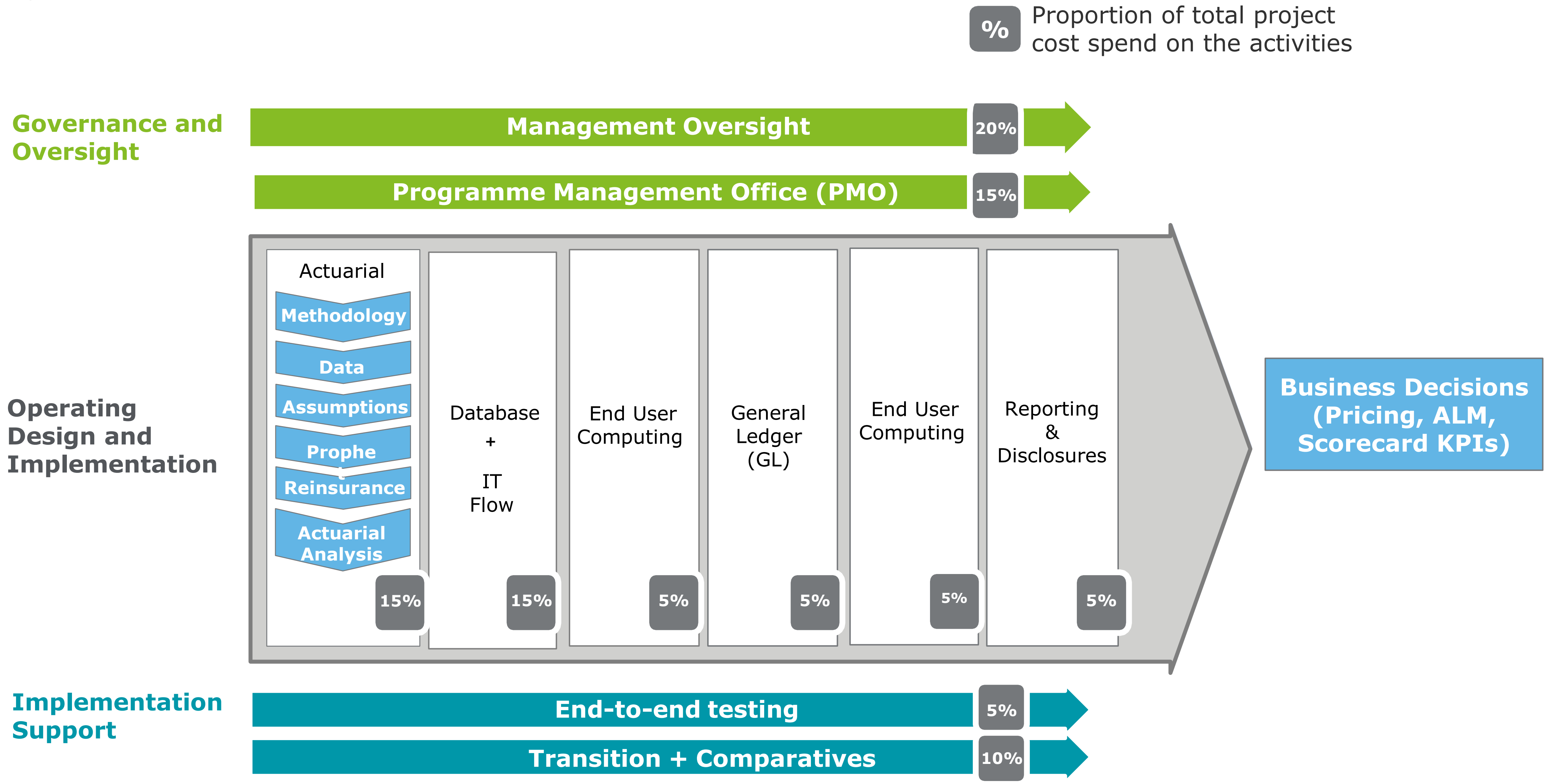
General ledger/Consolidation
- Transition
- New income statement
- New balance sheet
- OCI vs. P&L
- More disclosure requirements

Internal reporting
- Management Information/ KPIs
- Budgeting/forecasting

Ancillary processes
- ALM
- Pricing/product development
- Risk management
- Tax
- Remuneration
- Investor relations

Impact on Operating Model

More than just Actuarial & Finance



What should you do next?

Start early, start small and keep it simple

- Understand the impact of IFRS 17 changes on your business.
- Understand the impact on your profit profiles, accounts and KPIs.
- Make a strategic decision around timing of adoption.
- Complete a business case and secure budget.
- Educate senior management and the market.
- Future-proof in-flight initiatives.

Affected infrastructure

Systems

Cashflow model
(Prophet)

Accounting system
(SAP)

Database software

Reporting, visualisation, analysis tool
(ARIA)

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