



Implementing IFRS 17 in South Africa

IFRS 17 Insurance Contracts, the new profit-reporting standard for insurance contracts, has finally been published, ending many years of discussion, debate and lobbying. This comes just after the industry has had to implement the requirements of the South African Solvency Assessment and Management (SAM) regime, and many stakeholders are asking “What next?”.

This article provides an overview of IFRS 17, the **key changes affecting South African insurers**, and the **practical implications** for insurance reporting and wider functions.

Background

The new accounting standard for insurance contracts (IFRS 17), with an effective date of 1 January 2021, provides:

- a globally consistent method for insurance contract accounting;
- greater transparency of profit sources; and
- up-to-date market-consistent information about the entity's obligations.

In this article we focus on the key changes that will impact South African insurers. It reflects Deloitte's local market knowledge, our understanding of financial and business impact assessments, and our direct experience with many of the field testers that were engaged during Quarter 3 of 2016 to test the application of IFRS 17 to their products.

Key Changes affecting South Africa

There are similarities between the current financial reporting standard applied by South African insurers (IFRS 4) and IFRS 17. For life insurance companies, under both standards, insurance liabilities are built up from best estimate cashflow projections and are discounted using current market interest rates with the addition of specific margins for risk and profit release.

However, one of the key differences is that, unlike under current IFRS 4, IFRS 17 does not allow a gain at inception of the contract. Some South African life insurers have an accounting policy of setting up discretionary margins to manage Day 1 profits. However, the profit emergence under IFRS 17 will be different, even if no profit is recognised under the current accounting policies chosen.

The changes to profit recognition are expected to be less severe for non-life insurers, but there will still be some changes in methodology and reporting to report earnings in line with the new standard.

Since liabilities and the change in liabilities are the key driver of emergence of insurance profits, IFRS 17 creates the desired uniformity of profit reporting through a more prescriptive approach to determining policyholder liabilities and the approach to release these liabilities to the income statement. The key changes to the liability valuation are illustrated in Figure 1 for life insurers and Figure 2 for non-life insurers.

Figure 1. Key changes to liability valuation method for life insurers

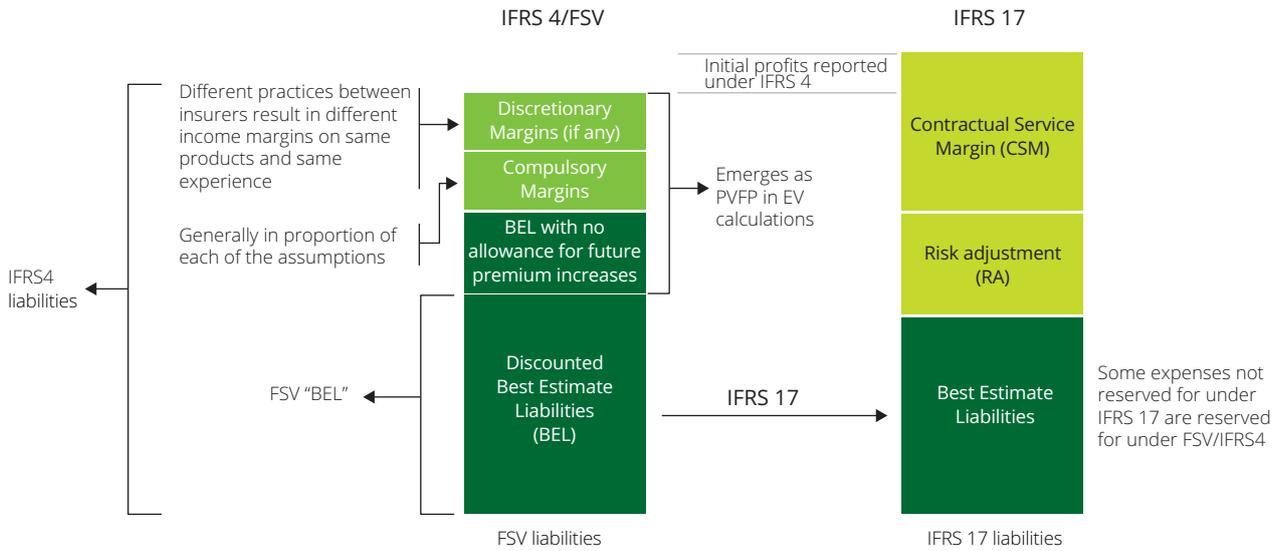
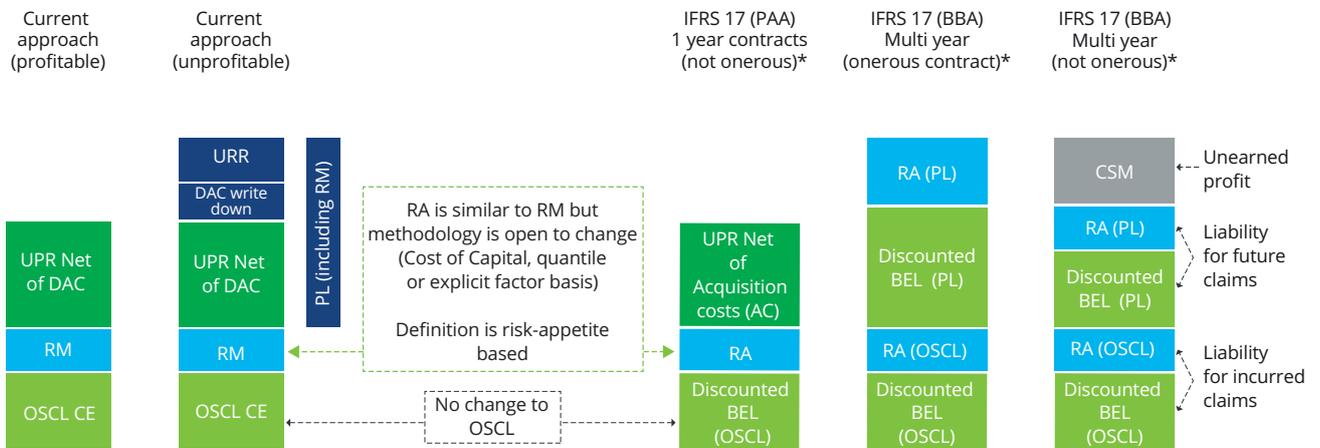


Figure 2. Key changes to liability valuation for non-life insurers



Key

- PAA: Premium Allocation Approach
- BBA: Building Block Approach
- OSCL: Outstanding Claim Liability
- CE: Central Estimate
- RM: Risk Margin
- UPR: Unearned Premium Reserve
- DAC: Deferred Acquisition Cost
- BEL: Best Estimate Liability
- LAT: Liability Adequacy Test
- PL: Premium Liability
- CSM: Contractual Service Margin
- URR: Additional unexpired risk
- RA: Risk Adjustment

* Not onerous is analogous to profitable

Practical Implications for Insurers

In Q3 2016 the IASB completed field testing with 12 globally selected insurers on a limited exposure draft of the IFRS 17 standard. Based on our work locally, and interaction with some of these insurers through the global Deloitte member firms, we identified seven focus areas for South African insurers:

1. Alignment of life and non-life financial reporting and changes to short-term vs long-term business classification;
2. Introduction of the explicit Contractual Service Margin (CSM) liability component;
3. Limited level of cross-subsidy between groups of profitable and loss-making (onerous) contracts;
4. Introduction of the explicit risk adjustment liability component;
5. Valuing all future expected contract cashflows for life insurers;
6. Implications of unbundling; where bundling a distinct investment or service component will not be permitted; and
7. Changes to reporting of reinsurance treaties.

Other implications for insurers include the interaction between IFRS 9 and IFRS 17, indirect introduction of a Deferred Acquisition Cost (DAC), changes to tax treatment, transition requirements, and presentation and disclosures.

1. Alignment of life and non-life financial reporting and changes to short-term vs long-term business classification

Like IFRS 4, IFRS 17 considers financial reporting at contract level. The primary measurement model, called the Building Blocks Approach (BBA), is the basis on which the reporting framework is built, and all future cashflows (premiums, claims and costs) in the contract boundaries are projected and discounted at the appropriate discount rate. For shorter duration contracts (less than 12 months), premiums need not be projected and discounted but can be reported using the simplified Premium Allocation Approach (PAA); however future expected claims need to be estimated and discounted. The same measurement models will also be applied on reinsurance contracts.

In the same way as under SAM, a key requirement of the BBA is to define the contract boundaries – the time limit for inclusion of the cash flows originated by an insurance contract in the projection models. The end of the contract boundary is based on identifying the earliest date when the insurer:

- can reassess the risk of a contract or a portfolio of contracts, and set a price or level of benefits that fully reflects those risks of the portfolio; and
- has priced the coverage up to the date (the contract boundary) when the risks are reassessed without taking into account the risks that relate to future periods.

These boundary conditions must be applied uniformly, whether the insurer is a life or a non-life insurance company creating comparability across the entire industry based on these conditions and not on nature of risk underwritten.

It is clear that the combination of contractual clauses and pricing practices are critical to set the contract boundary. This may mean that some contracts written by short term insurance companies might not be able to use the simplified PAA, meaning significantly increased complexity in terms of reporting requirements. While we do not expect too many differences between SAM and IFRS 17 contract boundaries, insurers will need to demonstrate that they have assessed their contracts to ensure IFRS 17 compliance.

For life insurance, we do not anticipate many instances where the current contract boundaries under IFRS 4 and SAM will be different from those under IFRS 17.

An example of the IFRS 17 contract boundary applied to premium changes would be the treatment of the premium review point at the end of the 10-year premium guarantee term on most newer generation life insurance contracts. Despite the potential premium adjustment at portfolio level at the 10-year point, because the product is priced for whole of life the contract boundary will not be the 10-year guarantee point but rather whole of life.

Two example cases where changes may be needed under IFRS 17 for life insurers would be:

- yearly renewable individual life contracts where insurers have the contractual ability to review pricing yearly; and
- group life contracts where rates have been guaranteed for longer than 12 months.

In the former, IFRS 17 would classify the contract as short term and the cashflows valued under IFRS 17 would be until the next renewal point. In the latter, contracts with longer boundaries usually fail the conditions to qualify for the PAA and they will have to apply the BBA instead. While this would require a significant change to the current accounting treatment, there are generally few instances of such contracts in the market.

In non-life insurance, cash-back components on a policy will change the contract boundary to align to the duration of the promised cash-back, rather than the 1 to 12 months typically used. This will mean a change from the current approach to the more complicated BBA approach.

Similarly, longer duration contracts written by non-life insurers such as motor warranty maintenance plans as well as reinsurance contracts such as multi-year stop loss or aggregate loss covers might need to be valued under the BBA, increasing the complexity of reporting significantly.

A smaller, albeit important, change is that IBNR and OCR calculations may need to explicitly discount future expected claim cashflows (as part of the BBA), and profit recognition will need to align with long-term insurers' unwind of the average discount rate in the period of recognition.

2. Introduction of the Contractual Service Margin (CSM)

One of the biggest changes to the reserving methodology, which drives the profit emergence from insurance contracts under IFRS 17, is the Contractual Service Margin (CSM). The CSM represents the unearned profit in the insurance contract that will be released over the passage of time. While at a first glance this may look similar to the current approach that some life insurers use of including a discretionary margin, there are two key differences:

- The future cashflows include all future premium increase options (and claims and expenses resulting from those increases); and
- The emergence of profit from the CSM follows a retrospective roll forward and not a full prospective re-valuation methodology that is currently deployed.

The release of the CSM during the coverage period will be in line with the passage of time at a contract level in pre-defined cohorts. This is different from the release of the SAP104 compulsory margins where the profit carrier is the specific valuation assumption. In addition, the new profit signature will also include the release of the Risk Adjustment ("RA"), which we will discuss in a later section.

One significant practical requirement in respect of data storage is that, under what is referred to as the General Model, the unwinding discount rate for roll-forward of the CSM must be done with the discount rate applicable at inception of the contract. This is because IFRS 17 aims to separate the underwriting profit from the investment margin. This means that insurers not applying the Fair Value through Other Comprehensive Income ("FVOCI") option will need to maintain multiple sets of discount rates at each reporting period – one set to determine the unwinding of discount rate for accretion of the CSMs (with curves for each prior period) and a current set of rates to calculate the BEL and the RA. The latter will need to be calibrated to market interest rates at the balance sheet date.

It is important to note that IFRS 17 does, however, allow the use of a current accretion rate when the contract has direct profit / participation features (e.g. unit linked contracts). In this case, the Variable Fee Approach applies, and a locked-in rate is not used because the deferred profit/CSM is revalued in line with the financial variables of the underlying assets that the contract participates in.

The CSM is a new requirement and it needs to be calculated, tracked and monitored at a granular level. While the company's Policy Administration System (PAS) has been suggested by some as the system to provide this capability, the legacy nature of many PASs will make this impractical and more likely solutions will be in a separate database or financial data warehouse in the accounting / reporting function or in the databases in the actuarial environment. However, it is imperative that this system links into the actuarial modelling system so that changes to CSM are driven by the actuarial process.

The requirement to unwind the discount rate for the accretion of CSM at the locked-in discount rate at policy inception for each defined group of non-participating contracts also materially increases the volume of data required to be accessed by actuarial systems. Assessment of system and data storage requirements will be essential to determine the extent of any IFRS 17 implementation work.

3. Limited level of cross-subsidy between groups of profitable and loss making contracts

Currently under actuarial standard SAP 104 (for long-term insurers) assumptions need to be considered separately for relatively independent groups of homogeneous policies. Also, in assessing whether policy options are expected to produce future losses, the business may be grouped into broad categories with similar expected take-up rates of the options. Outside of these grouping applications there are no other requirements for grouping of policies for reporting business performance.

Under IFRS 17 there is a requirement to create many more groups of contracts and to manage the reporting of profit emergence separately for these groups. For each set (referred to as a "portfolio" in the Standard and which can be interpreted in a similar way to the SAP104 guidance) insurers will need to create 2 or 3 groups of contracts per annum, and manage the CSM, RA and profit emergence separately for each of these groups.

The level of aggregation for reporting has been a widely debated topic, and following the IASB field testing, the final decision was to base the grouping based on profitability at point of initial recognition:

- Groups (the level at which profit emergence is determined) will be subsets of a portfolio of contracts. The portfolio is that pool of insurance contracts with similar risks that the insurer manages together as one pool. A group is a closed block of contracts that cannot include more than twelve months of new contracts sold;
- Contracts that are onerous at inception are grouped separately from contracts that are not onerous;
- Contracts that are not onerous at inception must be divided into at least two groups, being (1) a group of contracts with no significant risk of becoming onerous and (2) a group of other profitable contracts; and
- Contracts that have a mutualisation mechanism across contracts issued in different years will have a special treatment on the accounting for assumption changes.

Thus, for each year (and each product portfolio), the determination of which policies sold are in which group is driven by the determination of whether the policy is "onerous" (and loss recognition required) at point of sale, whether it might become onerous in future, or whether it is never expected to be onerous. In practice a company could have only two groups in certain portfolios as they may not have onerous contracts or contracts with a risk of becoming onerous.

Thus, insurers will need to divide their portfolio of policies into the groups as required by IFRS 17, and ensure this remains consistent over time. In addition, for each group they will need to assess, on a policy by policy basis, whether a policy is onerous; possibly onerous; or clearly not onerous. And, finally, they will need to keep track of each annual cohort of these groups over the remaining term of the policies. This has implications for an insurer's processes and systems.

Furthermore, there is now a requirement to make the 'onerous' assessment at an individual contract level. While approximate calculations to assess the onerous condition are permitted, such approximations are only allowed if they produce the result of a group that only contains loss making contracts within that particular portfolio and that no loss-making contracts are left out of this group.

The third grouping requirement will require a greater volume of sensitivity testing, to support an entity's classification of contracts as having 'no significant risk of loss'.

The fourth requirement arises from the presence of a mutualisation mechanism. This is caused by contractual terms in which policyholders share with other policyholders the return of the same specified pool of underlying items. This means that participating contracts could also have a mutualisation mechanism in place that would need to be considered in the subsequent accounting of the relevant groups.

The number of reporting groups will have an impact on modelling and reporting systems, and the supporting data requirements. This is because it will be the constant reference point for insurers who will have to account for the impact of changes in assumptions at the level of these groups. This will be necessary to establish whether or not profitable groups have become onerous in subsequent periods and to assist with the revaluation of the CSM (the impact of future changes in non-economic assumptions is absorbed by the CSM and not taken to the P&L of insurers as is currently the case under IFRS 4).

This level of aggregation requirements under IFRS 17 could cause strain on the analysis and reporting processes, particularly if current reporting deadlines are still being targeted. Insurers need to assess and understand the operational process impacts through finance, actuarial and IT / data systems.

4. Introduction of the Risk Adjustment (RA)

The Risk Adjustment will also be a new concept in financial reporting for South African life insurers. While the concept and calculation of a risk margin (RM) has become established through the SAM framework, the specific requirements of IFRS 17 and the disclosure requirements that go with this means that the current SAM RM calculations are not necessarily easily calibrated for use in the IFRS 17 RA.

For life insurers, the current compulsory margins defined by SAP104 might then be a convenient starting point, but the RA must convey the entity's perception of the effects of uncertainty about the amount and timing of cash flows that arise from insurance contracts it issues and a translation into a confidence interval is required.

Insurance liabilities for non-life insurers currently do include a risk margin in South Africa using either a quantile approach with disclosures on the confidence interval per Actuarial Practice Note (APN) 401, or are using the regulatory interim measures with an embedded and undisclosed margin. The important difference between the current state and the RA under IFRS 17 is that the RA should be based on the company's own risk appetite rather than a recommended margin from the Actuarial Society or prescribed calculation from the Financial Services Board.

IFRS 17 does not prescribe a specific technique for calculating the RA and the IASB has encouraged the industry to define the best method. However, there is additional complexity when not using a confidence level approach in the form of having to produce a confidence interval disclosure corresponding to the chosen RA technique. We do expect that the RA confidence interval will converge into an industry standard probability, particularly for those who need to disclose this metric.

5. Valuing all future contract cashflows

The current requirements of SAP104, under which the reserves of life insurers are determined, do not allow insurers to model policyholders exercising premium increase options where these are profitable for the insurer. Under IFRS 17, all future options, and their related cashflows, are to be valued, together with the expenses and claims relating to those options.

Both SAM and Embedded Value reporting allow for these future premium increases and as such this IFRS reporting requirement will not result in significant changes to the current modelling methods and the estimation of take up rates of future premium increase. However, it may result in quite different IFRS profit emergence from the insurance contracts where premium increases are prevalent.

6. Unbundling is prohibited unless proven to be required

Under IFRS 4, insurers may unbundle non-insurance components from an insurance contract in most cases. Under IFRS 17 unbundling is prohibited unless the insurer can demonstrate why it is necessary to do so.

In implementing IFRS 4 most South African life insurers chose to keep the investment (and hence non-insurance) element of their contracts bundled with the insurance contract. Therefore, fortunately, the adoption of IFRS 17 relating to the unbundling is not likely to result in significant changes.

Conversely, for South African non-life insurers who have 'value added products' attached to their insurance products, these will need to be tested against the requirements under IFRS 17 to determine whether in fact they may be unbundled. Examples include legal or vehicle towing services included as part of a contract that, depending on contract wording, might need to be unbundled and valued separately under IFRS 15 (Revenue Recognition).

7. Reinsurance

Current IFRS 4 reporting requires that actuarial liabilities are presented on the face of the balance sheet gross of reinsurance, with a corresponding reinsurance asset to reflect the value future expected recoverable reinsurance claims. For life insurers, the reinsurance asset is generally determined by performing a net liability projection which discounts the insurer's portion of claims and premiums and deducting this from the gross of reinsurance projection. Short-term insurers generally perform this calculation at a high level given overall retention levels for specific lines of business.

Under IFRS 17 the same single measurement model will be applied for reinsurance contracts, but, importantly, reinsurance contracts will be treated as separate contracts with separate measurement. Thus, insurers are required to separate out the reinsurance cashflows, and determine both a risk adjustment and CSM (where relevant) for the reinsurance asset in the same way as for the "gross of reinsurance" liability.

This may lead to different results to the current approach. For example, the contract boundary for reinsurance contracts could be very different to the business that the reinsurance contract is reinsuring. Models used in SAM to determine the impact of risk mitigation can be used, but boundary conditions will need to be assessed as the simplification of aligning contract boundaries do not necessarily apply.

This will add complexity to the determination of the reinsurance asset and the financial management and reporting of reinsurance treaties. Measurement requirements may also force insurers to relook at the reinsurance treaties and potentially look to even re-negotiate contract terms and boundaries. Where reinsurance administration is a manual process insurers will need to look at integrating these more tightly with the policy administration system to get the necessary data into the projection tools, and they will need to build the necessary modelling and financial reporting processes in the actuarial environment.

Other implications and impacts

In addition to the key areas discussed above, there are other implications and impacts of implementing IFRS 17 in South Africa. Some of the more significant of these areas are discussed below:

Alignment with IFRS 9 – Reporting Other Comprehensive Income (OCI) versus Fair Value through Profit & Loss (P&L)

Under the building block approach, the option to account for the impact of changes in the discount rate on insurance contract liabilities through OCI or Fair Value through the P&L will be new for South African insurers.

While the initial reaction for many South African insurers may be to maintain the status quo i.e. Fair Value through P&L, there may be benefits of adopting the OCI approach. This would be especially relevant when aligning with IFRS 9 requirements to ensure stability of results. The key choice to be made in this regard is whether stability of income statement or accounting balance sheet is the higher priority. For insurers for whom IFRS-earnings-at-risk is a key risk measure in their capital-at-risk management framework this will be a critical decision to make early in the implementation planning.

Deferred Acquisition Cost (DAC) reporting

IFRS 17 introduces separate disclosure of the amortisation of acquisition cash flows on the face of the statement of comprehensive income (SoCI) and in the reconciliations. This amortisation needs to be done in a systematic way based on the passage of time.

This has no effect on the total profit and loss as the amortisation is offset by the allocation of a portion of the release of liability that relates to recovering those cash flows to each accounting period and is disclosed in the insurance contract revenue line item on the face of the SoCI.

Insurers need to consider the complications that will arise on the upfront accounting and continual tracking of these “off balance sheet” cash flows (essentially a deferred acquisition cost asset (DAC)) and premium allocation (essentially and deferred revenue liability (DRL)) per portfolio grouping, which should be done in an auditable, controlled environment.

This further highlights the need for greater collaboration and linkage between the accounting and actuarial functions and importantly, the accounting and actuarial systems.

Tax implications

Life Insurers

Tax on which insurance profits is payable is currently based on the Statutory Valuation Methodology (SVM) liabilities with a move to an adjusted IFRS basis applicable for years of assessment ending on or after the date the new Insurance Act becomes effective. The adjusted IFRS basis essentially is the IFRS reserves of the company net of reinsurance plus deferred tax liabilities held in respect of policyholder funds, plus a phasing in amount of the difference between SVM and IFRS liabilities at the end of the last year when the SVM reserving basis applies. It is Deloitte’s understanding that National Treasury and SARS are looking to maintain IFRS as the basis for determining tax on profits and this will mean an adoption of IFRS 17 when this becomes effective.

Moving to IFRS 17 could result in a very different profile of tax payment to SARS from the industry. For the industry as a whole Deloitte expects that the effect on a like-for-like basis will be an overall deferral of tax payable. We expect National Treasury and SARS will take that into account when looking at any transition arrangements, and this will add complexity to the tax environment.

Engagement and consultation with National Treasury and SARS may be required at an industry level to ascertain their view on the tax treatment of, in particular, the transition to IFRS 17.

Non-life Insurers

The calculation of taxable income for a non-life insurance company is based on allowing for an unearned premium reserve and outstanding claims liability, and the Income Tax Act references to the Short-term Insurance Act in this regard. Therefore, reserves for the current tax treatment is the same as the current statutory reserving approach. This will change when the new Insurance Act becomes effective with a move to an IFRS reserving basis for tax purposes.

To the extent that non-life insurers are required to calculate their insurance liabilities under the new BBA/PAA approach set out in IFRS 17 (for example, because of changes to short-term versus long-term insurance policy classification), there may be differences between IFRS 17 and the existing basis. Notwithstanding this, our view is however overall that the tax impact is expected to be small for non-life insurers.

Presentation and disclosures

As far as the presentations and disclosures requirements are concerned, the key question is the level of granularity of the results that must be disclosed in financial statements. Some of the considerations are:

- the time and effort that will be required to train and educate financial analysts to understand the new disclosures and how they differ from the current ones;
- preparing the CEOs and CFOs on the effects on financial statements and prior year comparatives to support the market in understanding the changes in reported financial results; and
- discussing possible changes to the KPIs for management reporting and remuneration purposes.

IFRS 17 also requires presentation of the development of each building block under the BBA approach, such as:

- change of discount rates;
- change in the Risk Adjustment (especially discussion of the confidence interval which may involve providing information on the risk appetite of the insurer); and
- roll-forward tables for the CSM and the other components of the insurance contracts balance with reconciliation of balance sheet amounts to P&L and the cash flow statement.

Transition Requirements

In terms of transition requirements, insurers need to estimate the opening CSM balance as if IFRS 17 had always been in place. For example, they would need to fully restate the expected profit on in-force contracts at time of IFRS 17 go-live. This would be the balance sheet on 1 January 2020 for calendar year reporting entities.

There are three possible approaches to restate the opening balance sheet of insurance contracts, that need to be applied in the following order:

1. **Full retrospective** application of new requirements is required, unless it is impracticable.
2. Where impracticable, the insurer has a choice of two simplifications:
 - **Modified retrospective approach.** The objective of this approach is to achieve the closest outcome to the full retrospective application that is possible using reasonable and supportable assumptions, or
 - **Fair value approach**, where this is applied from the date of transition.

If it is impracticable to apply the modified retrospective approach, the insurer is required to use the fair value approach.

The IASB has indicated that demonstrating impracticability under IFRS 17 will not be more difficult than it is for other IFRSs. South African life insurers may have more data available compared to other countries because they have been applying discounted cashflow projections in their valuations over the last couple of decades; however, the quality of historical data may still make the full retrospective method impracticable.

The first simplification removes the requirement to reconstruct the CSM from inception by allowing the insurer to use known information at the earliest period it can, post inception. This information will then be used to construct the actual cash flows from the earliest period.

The second simplification, which can only be used if the first simplification is also deemed impracticable, is to estimate the CSM at transition as the difference between the fair value of the insurance contracts and the fulfilment cash flows at that date (the fair value approach). The modified retrospective approach may still have challenges for some insurers in terms of availability of cash flow and assumption data and therefore these insurers want to prove impracticability and use the fair value approach at transition. Fair value of the insurance contract would then be determined in accordance with IFRS 13, Fair Value Measurement.

The other simplifications to transition requirements include:

- Where grouping by period is not possible, contracts written in different years can be kept in a multi-year group.
- Accretion rate for CSM is set at the transition date i.e. the differential between market discount rates at the inception of the contract and those at transition date is ignored.

Both life and non-life insurers are likely to face significant implementation costs

Given the complexity and granularity of reporting requirements under IFRS 17, we envisage that there will be significant impacts on data and system implementation the next three years.

We are therefore advising insurers to start to assess what steps would be required to comply with IFRS 17. It is important to design a plan to manage the implementation effectively by applying lessons learned in recent SAM projects.

The key priorities we see for insurers over the next 12 months are:

- Understand the overall operating model and impact of IFRS changes – training a team will be essential to expand the internal implementation workforce in due course.
- Make strategic decisions around adoption / implementation (e.g. early adoption?) and target state (IFRS9 and IFRS17).
- Complete the business case and securing budget project approvals.
- Hire and on-board the right people (actuarial, finance and technology) as resources will be limited in the market.
- Educate senior management and shareholders on new profit patterns, results and KPIs.
- Ensure current and upcoming finance reporting projects take into consideration the requirements of IFRS 17.
- Consider any leverage with SAM implementation.
- Ensure actuarial and finance teams interact and are 'linked' in terms of IFRS 17 implementation.
- Consider impact on actuarial and financial reporting processes, especially if target reporting dates are to be maintained.
- Engage implementation partners – consultants and other technology partners.
- Engage with auditors.

While the timelines for implementation may seem long, we expect this to be a complex project, and starting early will yield dividends.

Appendix: Summary of key differences between IFRS 4 and IFRS 17

The table below summarises the technical differences:

| | IFRS 4 | IFRS 17 |
|--|---|---|
| Profit Emergence | For Life Insurers, change in IFRS insurance liabilities to be determined in line with actuarial SAP104. At a minimum, profit emergence after a release of significant profitability at point of sale will be in line with 1st tier (compulsory) margin. No allowance made for future policyholder options that would be profitable for the insurer. | No profit reported at contract recognition and the CSM (deferred profit) is then required to be recognised over the coverage period in a way that best reflects the remaining transfer of services that are provided. |
| Profit Emergence Drivers | A wide range of accounting policies with respect to future profit emergence, depending on treatment of implicit and explicit discretionary margins. Base case is the prescribed margins that apply to each of the major best estimate assumptions. As per SAP 104: "The discretionary margins should be used in order to defer the release of profits consistent with policy design or company practice." | CSM run-off (the primary profit emergence) should be chosen to reflect the services being provided, but must reflect <ul style="list-style-type: none"> • The passage of time. • The number of contracts in force and their expected remaining coverage periods. |
| Grouping | <ul style="list-style-type: none"> • As per SAP 104: "Best-estimate assumptions should be considered separately for relatively independent groups of homogeneous policies." • When recognizing expected losses in respect of policyholder options business may be grouped into broad categories with similar expected take-up rates of the options. • For non-life insurers, no specific grouping other than disclosure of 'Additional Unexpired Risk Reserve' for unprofitable/onerous contracts. | <ul style="list-style-type: none"> • Groups are no more than twelve months' worth of new business in each portfolio. • As a minimum, there will be two groups of profitable contracts where one includes only contracts that have a no significant risk of becoming onerous. • If there are onerous contracts in a given year they would need to be grouped separately from profitable contracts. This group will have no CSM at recognition. |
| Risk Adjustment Approach | <p>Prescribed margins for long-term insurance liabilities creates an implicit risk adjustment.</p> <p>Claims reserves for non-life insurers (notably IBNR) has margin recommended by APN401. Alternatively, usage of Regulatory Interim Measures for IBNR does have some (unquantified) margin built in.</p> | <p>An explicit liability that reflects the entity specific risk appetite calculated with a technique (or techniques) that reflects the risk appetite and the uncertainty of the insurance contracts in-force from non-financial risks. The level of aggregation is based on the entity's risk appetite.</p> <p>For entities where BBA is required for fulfilment cash flows (unearned premium), a risk adjustment will also be required.</p> |
| Policy Liability Approach | <p>Projection method - future cash flows forecast using best estimate assumptions.</p> <p>No allowance for future premium increases for life insurance products.</p> | <p>Building Block Approach (BBA) for long term non-participating business. BBA or Variable Fee Approach (VFA) are used for participating contracts expanding on contract characteristics. All future expected premiums (and corresponding expenses and claims) within contract boundary modelled.</p> <p>For contracts with short coverage (12 months or less) the option of using the Premium Allocation Approach (PAA) is granted for the liability for the remaining coverage. Incurred claims liabilities (OCR and IBNR) are always calculated using the BBA.</p> |
| Profitability/Onerous Contracts | <p>For life insurance, contracts are unprofitable once BEL uses up PV of discretionary margins.</p> <p>For non-life insurance, contracts' unexpired risk period is unprofitable once the UPR is not sufficient to cover future expected claims, expenses and commissions.</p> | <p>Contracts onerous once BEL + RA use up CSM.</p> <p>Under PAA, a contract becomes onerous once liability for remaining coverage is less than the expected future fulfilment cash flows. This implies that some sort of test needs to be performed based on future fulfilment cash flows.</p> |
| Contract boundary | All future expected cash flows under the contract, except that those that result from future policyholder options that are favourable to insurer, are considered in determining the policy liability. | Only cash flows relating to past and current "coverage periods" are to be included. This includes cash flows that may occur after the end of the coverage period, but are due to event that happened during past or current coverage periods. |

Deloitte technical assistance and insights

Please visit our Deloitte IFRS Insurance (<http://www.deloitte.com/i2ii>) dedicated website for our briefings, webcasts and newsletters. Deloitte regular technical updates on the IASB Insurance Contracts project are available on our dedicated page of IASPlus (<http://www.iasplus.com>), the #1 website for global accounting news.

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