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AUSTRIAN DEVELOPMENT COOPERATION

Federal Ministry of Finance
Republic of Austria
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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 2021.
Purpose of session

The purpose of this session is to discuss preparations for regulating the implementation of IFRS 17 (and the implementation of IFRS 9 by qualifying insurers).

The session aims to enhance understanding of the key judgments management must make in implementing IFRS 17 and the disclosures insurers must make in their companies’ 2021 annual financial statements about their progress in implementing IFRS 17.
IFRS for SMEs

» The IFRS for SMEs standard is not considered relevant for insurance activities

» The scope of IFRS for SMEs excludes entities that:
  » hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this second criterion).

» To the extent that entities conclude they are within the scope of IFRS for SMEs, the standard is silent so they can choose but are not required to apply IFRS 17 by analogy
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 information¹
  » early application permitted

¹ Subject to current discussion in regard IFRS 9
Reasons and objectives for IFRS 17
Two phases for accounting for insurance contracts:

» Phase 1:
  » 2004: issue of IFRS 4 *Insurance Contracts*, focus on enhanced disclosure of amount, timing and uncertainty of cash flows.
  » IFRS 4 allows entities to continue using various recognition, measurement and presentation (*grandfathering*).

» Phase 2:
  » 2017: issue (2020 amendment) of IFRS 17 *Insurance Contracts*, focus on consistent recognition, measurement and presentation of insurance contracts.

» IFRS 17 **supersedes** IFRS 4
### Phase 1: Insurance Accounting

#### Lack of comparability

<table>
<thead>
<tr>
<th>Accounting policies applied to insurance contracts issued</th>
<th>Number of companies</th>
<th>Total assets (US$ trillion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Based on guidance in</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Other National GAAP</td>
<td>5</td>
<td>2.0</td>
</tr>
<tr>
<td>- US GAAP</td>
<td>3</td>
<td>1.6</td>
</tr>
<tr>
<td>- Canadian GAAP</td>
<td>4</td>
<td>1.4</td>
</tr>
<tr>
<td>- Mix of national GAAP</td>
<td>8</td>
<td>4.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>20</strong></td>
<td><strong>9.1</strong></td>
</tr>
</tbody>
</table>

*Source: Effects Analysis on IFRS 17*
Phase 1: Insurance Accounting

*Discount rates currently used*

- **Current Rates**: 43%
- **Historical Rates**: 35%
- **Mix of Rates**: 22%

*Source: Effects Analysis on IFRS 17*
# Phase 1: Insurance Accounting

## Lack of comparability

### Year X

<table>
<thead>
<tr>
<th>CU Millions</th>
<th>GAAP 1</th>
<th>GAAP 2</th>
<th>Difference</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>8 263</td>
<td>10 979</td>
<td>(2 716)</td>
<td>(33%)</td>
</tr>
<tr>
<td>Operating income</td>
<td>1 416</td>
<td>633</td>
<td>783</td>
<td>55%</td>
</tr>
<tr>
<td>Net income</td>
<td>965</td>
<td>337</td>
<td>628</td>
<td>65%</td>
</tr>
<tr>
<td>Total equity</td>
<td>8 977</td>
<td>3 872</td>
<td>5 105</td>
<td>57%</td>
</tr>
</tbody>
</table>

**Source:** Effects Analysis on IFRS 17
Phase 2 Objectives
*Transparency and quality*

- Require **consistent accounting** for all insurance contracts
- Base on a **current measurement** model
- Provide insight into the **profitability/sustainability** of insurance model
- Present **comparable** information across companies
- Assist investors to **understand performance**
### IFRS 17 Improvements

#### Transparency and useful information

<table>
<thead>
<tr>
<th>Applying IFRS 4</th>
<th>Applying IFRS 17</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Old or outdated assumptions</td>
<td>• Current assumptions</td>
</tr>
<tr>
<td>• Options and guarantees not fully reflected in measurement</td>
<td>• Options/guarantees fully reflected</td>
</tr>
<tr>
<td>• Time value of money not considered for incurred claims</td>
<td>• Estimated claims measured on a discounted basis.</td>
</tr>
<tr>
<td>• Use of assets rate for discounting</td>
<td>• Discount rate reflects insurance liability characteristics</td>
</tr>
<tr>
<td>• Revenue recognised on cash basis</td>
<td>• Unearned profit recognised as insurance coverage is provided</td>
</tr>
<tr>
<td>• Use of non-GAAP measures</td>
<td>• Additional metrics available</td>
</tr>
</tbody>
</table>
**IFRS 17 Improvements**

*Improved performance reporting*

<table>
<thead>
<tr>
<th>Applying IFRS 4(^1)</th>
<th>Applying IFRS 17</th>
<th>Key Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premiums</td>
<td>Insurance revenue</td>
<td>• Insurance revenue excludes deposits</td>
</tr>
<tr>
<td>Incurred claims/expenses</td>
<td>Incurred claims/expenses</td>
<td>• Revenue recognised as earned, expenses as incurred</td>
</tr>
<tr>
<td>Change in insurance liability</td>
<td>Insurance service result</td>
<td>• Insurance finance expenses presented with corresponding income (in P&amp;L or OCI)</td>
</tr>
<tr>
<td>Investment income</td>
<td>Investment income</td>
<td>• 2 drivers of profit presented separately</td>
</tr>
<tr>
<td>Profit or loss</td>
<td>Insurance finance expense</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Net financial result</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Profit or loss</td>
<td></td>
</tr>
<tr>
<td></td>
<td>OCI: Income &amp; Insurance finance expense</td>
<td></td>
</tr>
</tbody>
</table>

\(^1\) Common IFRS 4 presentation in statement of comprehensive income
## IFRS 17 Improvements

*To improve comparability*

<table>
<thead>
<tr>
<th>Applying IFRS 4</th>
<th>Applying IFRS 17</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Lack of comparability</strong></td>
<td>• New framework replaces variety of accounting treatments</td>
</tr>
<tr>
<td>• IFRS reporters use <strong>different practices</strong> for insurance</td>
<td></td>
</tr>
<tr>
<td><strong>Inconsistent within groups</strong></td>
<td>• Required <strong>consistency within a group</strong></td>
</tr>
<tr>
<td>• Subsidiaries consolidated using different practices</td>
<td>• <strong>Limited options</strong></td>
</tr>
<tr>
<td><strong>Inconsistency with other IFRSs</strong></td>
<td>• Revenue <strong>reflects service, and excludes deposits</strong>, like any other industry</td>
</tr>
<tr>
<td>• Revenue include deposits</td>
<td></td>
</tr>
<tr>
<td>• Revenue on a cash basis</td>
<td></td>
</tr>
</tbody>
</table>
Cost versus benefit

Simplifications to reduce costs

» Simplifications must **balance cost savings with potential loss of information**

» For example, IFRS 17:
  » Allows **simplified measurement** of some short-term insurance contracts
  » Enables **requirements to be applied to a group** of contracts rather than on a contract-by-contract basis
  » **does not apply** to some common contracts issued by non-insurers, such as most product warranties
Cost versus benefit

» Board concluded IFRS 17 will result in significant first time costs, but that overall benefits outweigh the costs

» Board expected that applying IFRS 17 will require
  » insurers to gather new information
  » employ or develop skills and change financial systems
  » updating internal procedures, and
  » communicating changes in their reports to external parties

» Costs will vary by jurisdiction - depends on existing practices

» Insurers are also expected to continue incurring costs in applying IFRS 17 on an ongoing basis.
IFRS 17 Improvements

Summary

More useful and transparent information

- Current assumptions regularly updated
- Options and guarantees fully reflected
- Discount rates reflect characteristics of the insurance liability - risks not matched by assets will be reflected in the accounts

Consistent recognition of revenue and profits for insurance contract services

- Revenue recognition more consistent with other IFRS Standards / other industries
- Profits recognised as the insurance contract services are provided
- Additional metrics to evaluate performance
What investors think about IFRS 17

<table>
<thead>
<tr>
<th>Areas of support</th>
<th>Areas of concern</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Information about insurers’ performance</td>
<td>• Entity-specific judgements</td>
</tr>
<tr>
<td>• Consistency with other industries</td>
<td>• Options</td>
</tr>
<tr>
<td>• Comparability</td>
<td>BUT disclosures will help to assess the effects of judgements and options on comparability</td>
</tr>
<tr>
<td>• Disclosures</td>
<td></td>
</tr>
<tr>
<td>• Transparency</td>
<td></td>
</tr>
</tbody>
</table>

BUT disclosures will help to assess the effects of judgements and options on comparability.
Scope of IFRS 17
IFRS 17 is applied to:

- Insurance contracts issued,
- Reinsurance contracts held and
- Investment contracts with discretionary participation features.

Contracts issued and held include contracts acquired in business combinations and transfers.

IFRS 17 includes optional and mandatory scope exemptions.
What is an insurance contract

éis IFRS 17 and IFRS 4—same definition

稔 IFRS 17 two minor changes to guidance but no expected changes in assessments for majority of contracts

稔 No change from IFRS 4

밵 Change from IFRS 4
Core requirements
‘General’ Approach
Core Requirements
Snapshot of IFRS 17 Approaches

Modifications for contract types:
- Insurance contracts with direct participation features
- Reinsurance contracts held
- Investment contracts with discretionary participation features

Simplifications: premium allocation approach
Core Requirements ‘Building block Approach’

All insurance contracts measured as **the sum of:**

- **Fulfilment cash flows (FCF)**
  1. Present value of *probability-weighted expected cash flows*—reflects financial risk
  2. Plus an *explicit risk adjustment* for non-financial risk (eg insurance risk)

- **Contractual service margin (CSM)**
  3. The *unearned profit* from the contracts

\[ \text{IFRS 17 liability} = \text{PV future cash flows} + \text{Risk adjustment} + \text{Unearned profit} \]
### Regulatory regimes

**Comparison**

<table>
<thead>
<tr>
<th></th>
<th>IFRS 17</th>
<th>Solvency II</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash flows</strong></td>
<td>Similar</td>
<td>Similar</td>
</tr>
<tr>
<td><strong>Discount rates</strong></td>
<td>Liability-specific rate, market consistent</td>
<td>Swap rate (yr 20) and ultimate forward rate</td>
</tr>
<tr>
<td><strong>Risk</strong></td>
<td>Company’s own view of risk</td>
<td>Prescribed approach</td>
</tr>
<tr>
<td></td>
<td>(possible use of Solvency II risk margin)</td>
<td>(risk margin—cost of capital set at 6%)</td>
</tr>
<tr>
<td><strong>Unearned profit</strong></td>
<td>Recognised in P&amp;L over time</td>
<td>Included in capital at inception—day 1 gain</td>
</tr>
</tbody>
</table>
## Regulatory regimes

### Performance

<table>
<thead>
<tr>
<th>IFRS 17</th>
<th>Solvency II</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>Assets</td>
</tr>
<tr>
<td>PV of cash flows</td>
<td>PV of cash flows</td>
</tr>
<tr>
<td>Risk margin</td>
<td>Risk margin</td>
</tr>
<tr>
<td>Unearned profit</td>
<td>Capital (excess of assets over liabilities)</td>
</tr>
<tr>
<td>Equity</td>
<td>Equity</td>
</tr>
</tbody>
</table>

### Unearned profit
- is recognised in P&L when insurance coverage is provided
- provides a measure of future profitability

Changes in unearned profit provide information about:
- profitability of new business
- changes in profitability of existing contracts
## Measurement Summary

<table>
<thead>
<tr>
<th></th>
<th>Initial Measurement</th>
<th>Subsequent Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>PV future cash flows</td>
<td>Current assumptions</td>
</tr>
<tr>
<td>2</td>
<td>Risk adjustment</td>
<td>Current assumptions</td>
</tr>
</tbody>
</table>
| 3 | Unearned profit     | The amount that results in no gain recognised in profit or loss | **Update** by reflecting:  
  - Time value  
  - Adjustments for future service  
  - Allocation of the amount earned |

1. Current assumptions
2. Current assumptions
3. Current assumptions

The amount that results in no gain recognised in profit or loss

Update by reflecting:
- Time value
- Adjustments for future service
- Allocation of the amount earned
Key Regulatory Considerations
Understanding the standard
Considerations

» Insurance is a complex business
  » Uncertain future events
  » Long time lines
  » Interaction of liability management and asset strategy

» Insurance products vary significantly within jurisdictions and across jurisdictions

» Base of IFRS 17 is simple (building block model), but
  » Requires forecasting cash flows, discount rates and risk
  » Requires experience studies
  » Profit recognition can be complex
  » Significant judgement required
Understand the standard
Regulators

Preparers need to comprehensively understand IFRS 17
Apply it in context of unique jurisdictional regulation and products

Education initiatives
Regulators can facilitate
Quantify average effects

Socialisation of challenges
Publish guidance (including data)
Understanding the standard
Regulators

Flood of new information

- Reinforce existing views
- Contradict existing views

Regulators need to understand IFRS 17 so as to:

- Anticipate
- Understand
- Amend/confirm

Confidence to push back against undesirable practices, and communicate proactively with market
<table>
<thead>
<tr>
<th>Regulatory regimes</th>
<th>Reconciliation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IFRS 17</strong></td>
<td><strong>Solvency II</strong></td>
</tr>
<tr>
<td>Assets</td>
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<tr>
<td>Equity</td>
<td>Equity</td>
</tr>
</tbody>
</table>

* For example in a low interest environment
» Why does reconciliation matter
  » IFRS 17 provides additional insight (especially relative to cost models)
  » Can provide contradictory views to prudential information
  » May be inappropriate to ignore additional information

» Market confidence will be based on understanding contradictory information
Industry readiness

- Systems
- Internal resources
- External resources

Risks posed by poor implementation
- Confidence in system
  - Audit reputation
- Domestic vs international
  - Regulatory reputation

Data

Industry readiness
Industry readiness

Regulators

» Regulators have the power to encourage readiness through:
  » Information requests
  » Quantitative impact assessments
  » Communications with Management and Boards
  » Encouragement of communication and education initiatives

» Regulators have an interest in ensuring industry readiness
Summary

» Promotion of regular interaction between industry stakeholders
» Encouraging education initiatives for both:
  » Industry and
  » Regulators
» Proactively revisiting existing regulatory processes and understanding differences
» Monitoring readiness
Thank you
Questions and Discussion