



# IFRS 17 Implementation challenges

## Executive workshop for supervisors

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June 2024





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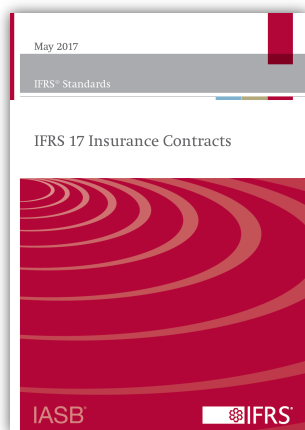
Unless specified otherwise, the accounting requirements that are the subject matter of this presentation are the IFRS Standards as issued by the IASB that are applicable on or after 1 January 2023

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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## Discussion

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## Objective

- » Update of slide deck of December 2023
- » What have we observed from the **financial statements available** to date?
  - » In the **key judgements and estimates** we identified in December?
  - » **Quality** of reporting
  - » **Surprises**
- » Where do we see **future changes** happening?
- » **Not** a discussion of KPIs (will hold until next session) – but see reports distributed

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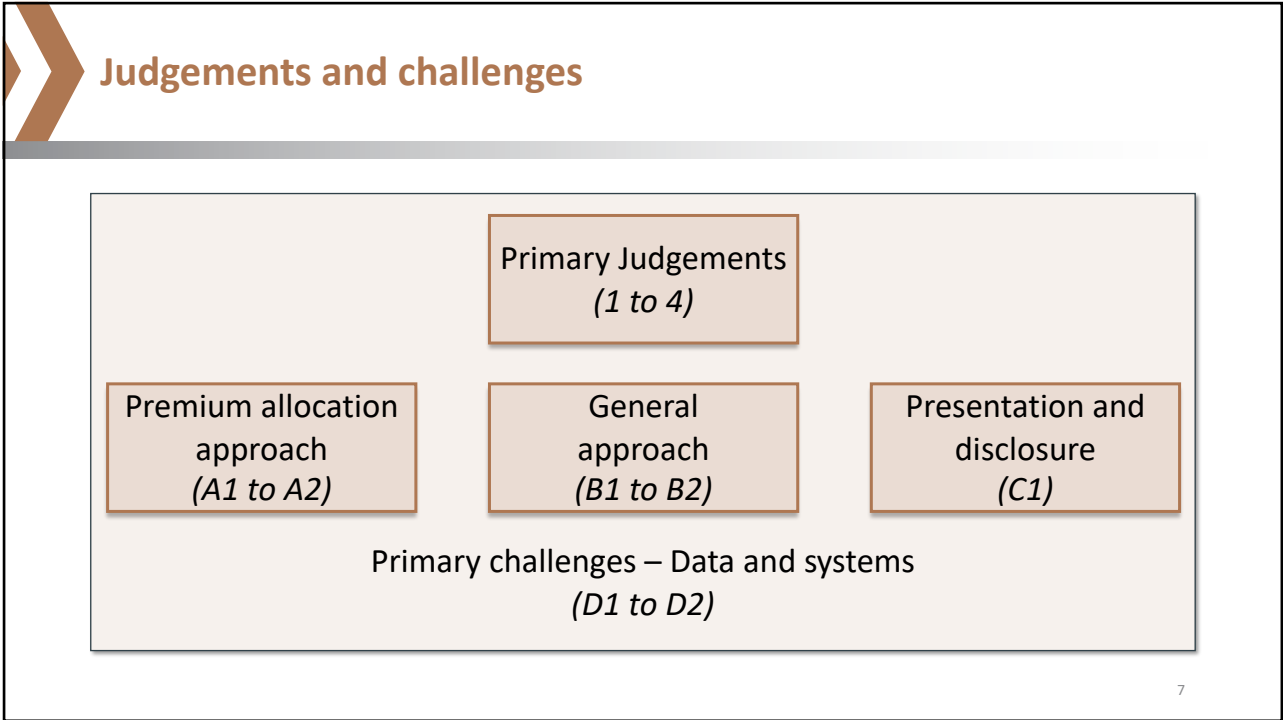
## Principles

*From December 2023*

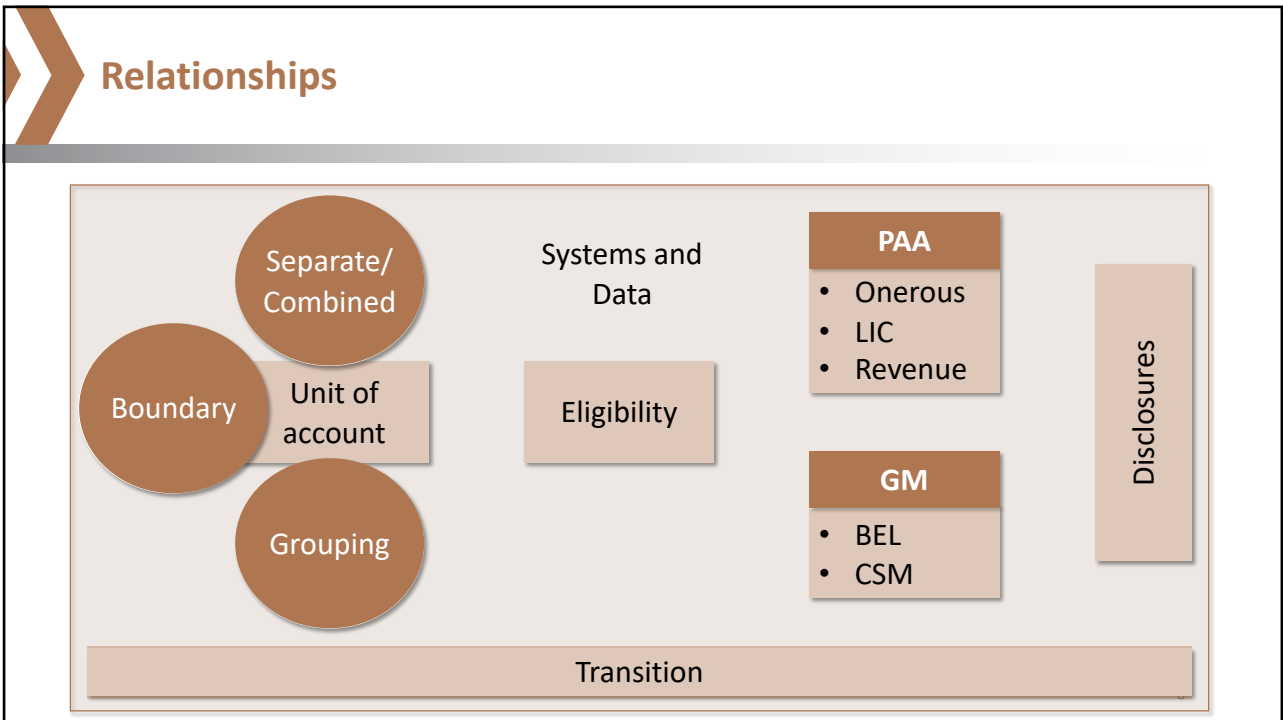
- » Described **10 key judgments or challenges** faced by insurance companies
- » Every key judgment
  - » Is a **decision or decision process** required by an entity
  - » Requires **data or a systems** or both
  - » Presentation assumes that **data and systems are separately** considered
- » Clearly these are **not the only judgements and challenges** in IFRS 17

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Judgement  
Combination and separation
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| Key Judgements  | Audit response   | Regulator response   |
|---|--|--|
| Unit of account<br>1. Explicit contract wording<br>2. Substance over form (implied terms): <ul style="list-style-type: none"> <li>• Past practice</li> <li>• Law and regulation</li> <li>• Other materials</li> <li>• Hurdle is high</li> </ul> | Audit focuses on: <ul style="list-style-type: none"> <li>• <b>Actual wording and substance</b></li> <li>• Jurisdictional practice</li> <li>• Documentation of decision</li> <li>• Management bias</li> </ul> | <ul style="list-style-type: none"> <li>• Monitor <i>disputes and inconsistencies</i></li> <li>• Facilitate insurer <i>collaboration</i></li> <li>• <i>Comparative analysis</i> <ul style="list-style-type: none"> <li>• Common contracts</li> </ul> </li> </ul> <p><b><u>Unlikely to</u></b> change regulatory reporting</p> |

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Findings  
Combination and separation

- » Minimal judgement disclosures, although there are some
- » Primary issue for *contracts issued in a 'rider' format*
  - » Key question is whether to *maintain single contract* for all riders, or
  - » Separate out each individual rider
    - » Complexities with *cost and CSM allocation*

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## Findings – cost allocations Combination and separation

- » IFRS 17 requires that cash flows that considered in valuing a contract include *‘those that relate directly to the fulfilment of the contract....’* (Paragraph B65)
- » These are defined to include **both** direct costs **and** *‘an allocation of fixed and variable overheads directly attributable to fulfilling insurance contracts .... allocated to groups of contracts using methods that are systematic and rational.....’* (paragraph B65(i))

Key area of judgement and one that was overlooked by many insurers

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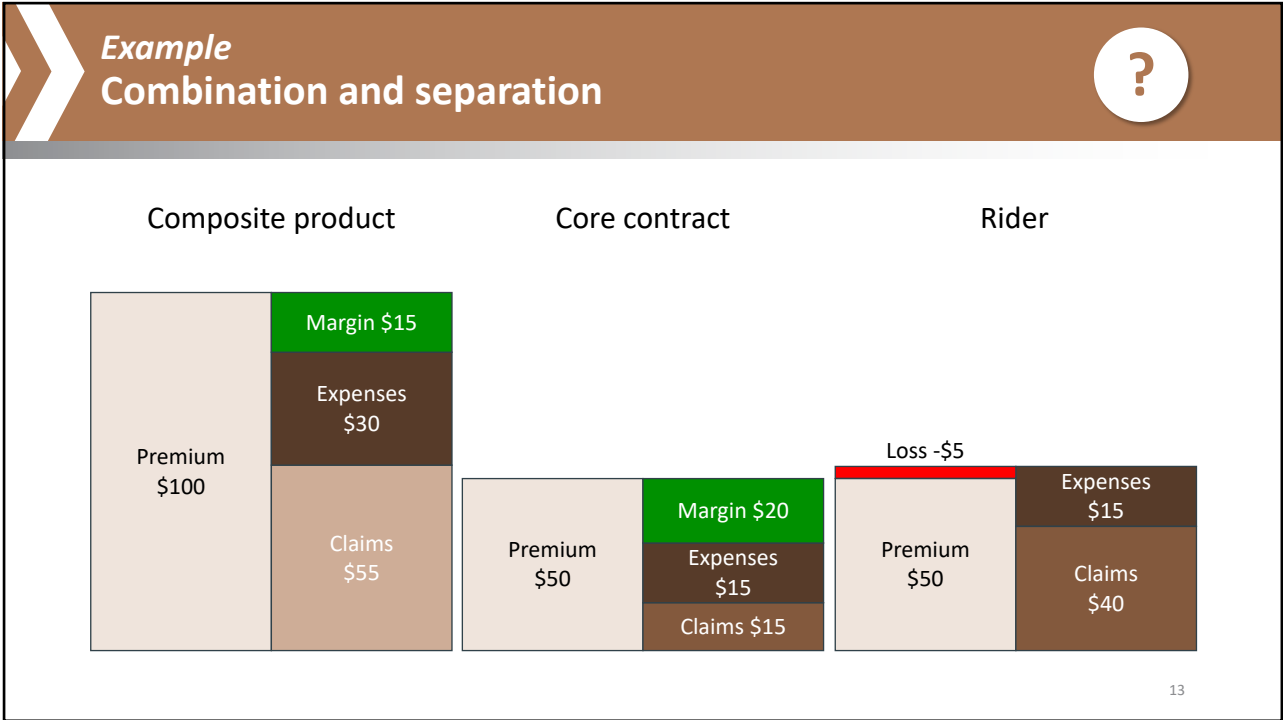
## Findings Combination and separation

- » Minimal judgement disclosures, although there are some
- » Primarily arises for contracts issued in a ‘rider’ format
  - » Key question is whether to maintain single contract for all riders, or
  - » Separate out each individual rider
    - » Complexities with cost and CSM allocation
    - » Results in some riders that are counter-intuitively onerous under IFRS 17

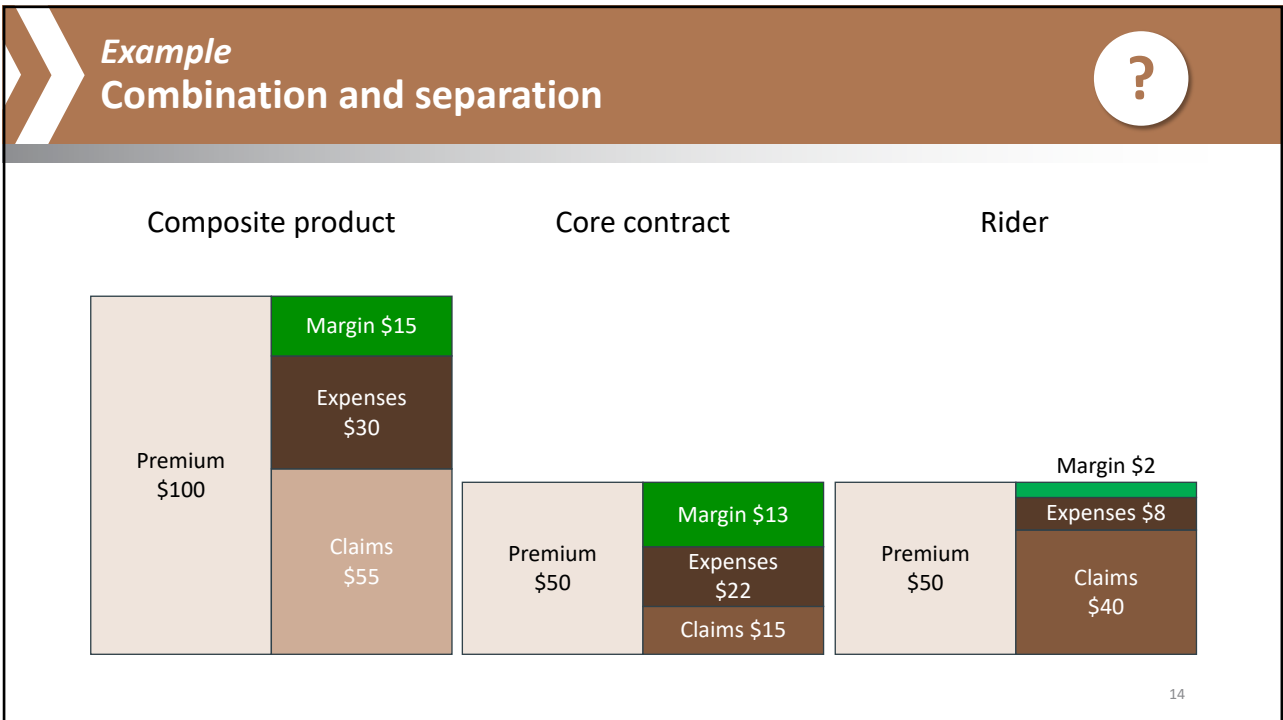
Relooking at separations to ensure separations are correct and that cost allocations are correct

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**Judgement Contract boundary** 2

| Key Judgements   | Audit response   | Regulator response   |
|--|--|--|
| Duration of coverage<br>1. Contractual terms<br>2. Substance over form <ul style="list-style-type: none"> <li>• Past practice</li> <li>• Law and regulation</li> <li>• Insurance and</li> <li>• Consumer law</li> <li>• Other materials</li> </ul> | Audit focuses on: <ul style="list-style-type: none"> <li>• <b>Actual wording as well as substance</b></li> <li>• <b>Management bias</b></li> <li>• Documentation of decision</li> <li>• Jurisdictional practice</li> </ul> | <ul style="list-style-type: none"> <li>• <i>Consider inclusion in Impact assessment</i></li> <li>• <b>Comparative</b> analysis                             <ul style="list-style-type: none"> <li>• Common contracts</li> </ul> </li> <li>• <b>Interact</b> with other regulators</li> </ul> <p><b>May</b> change regulatory reporting</p> |

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**Present value of future cash flows**  
*Cash flows*

» Current estimate of future cash flows in contract boundary

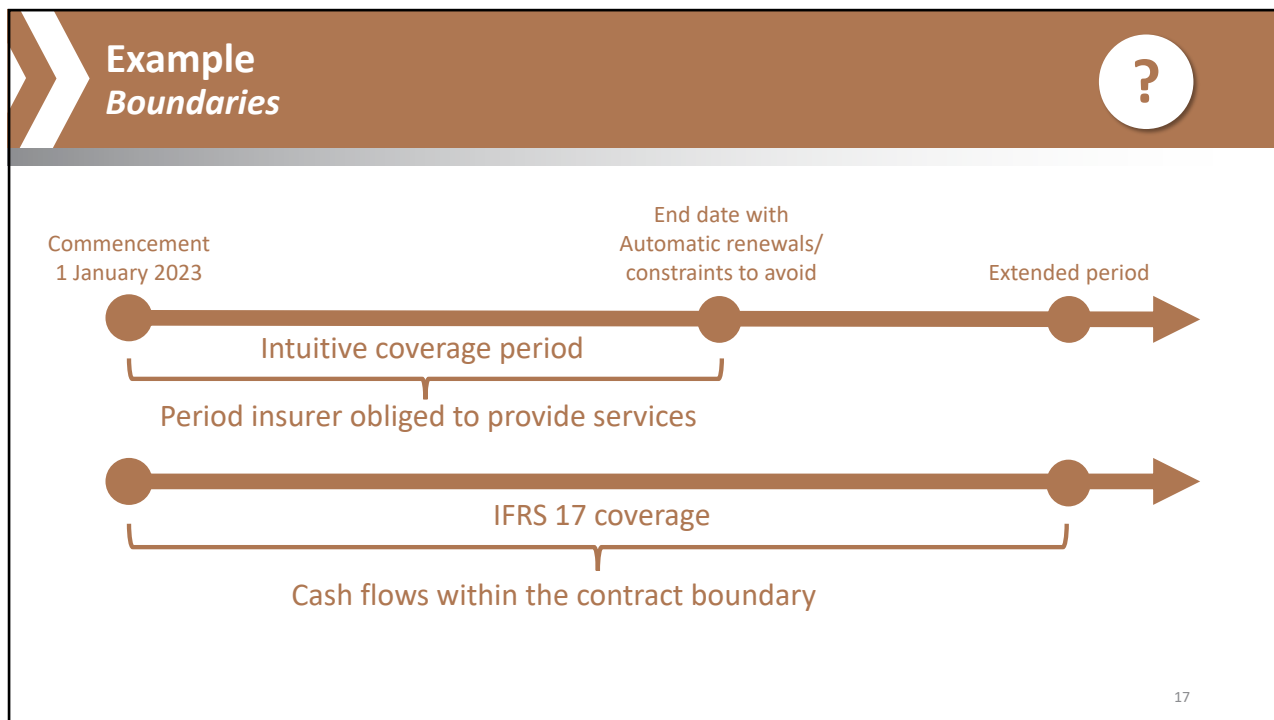
» Probability weighted and unbiased

» Stochastic modelling for financial options and guarantees, where relevant

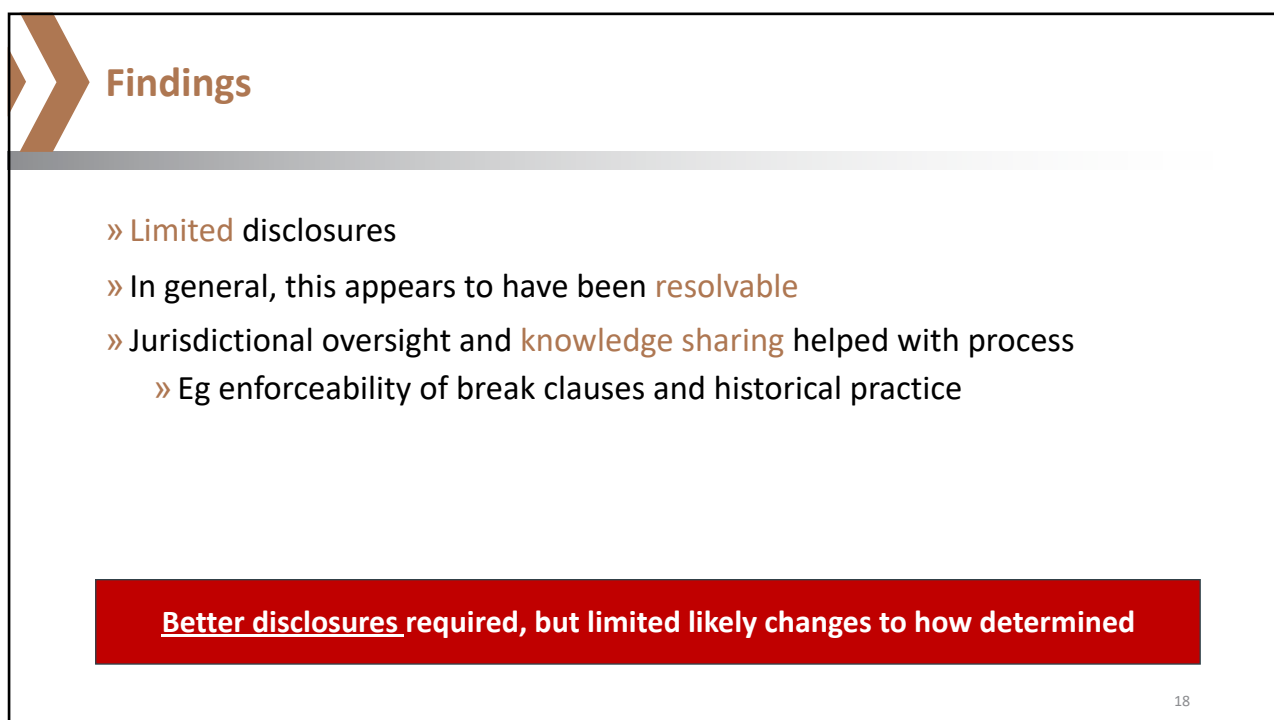
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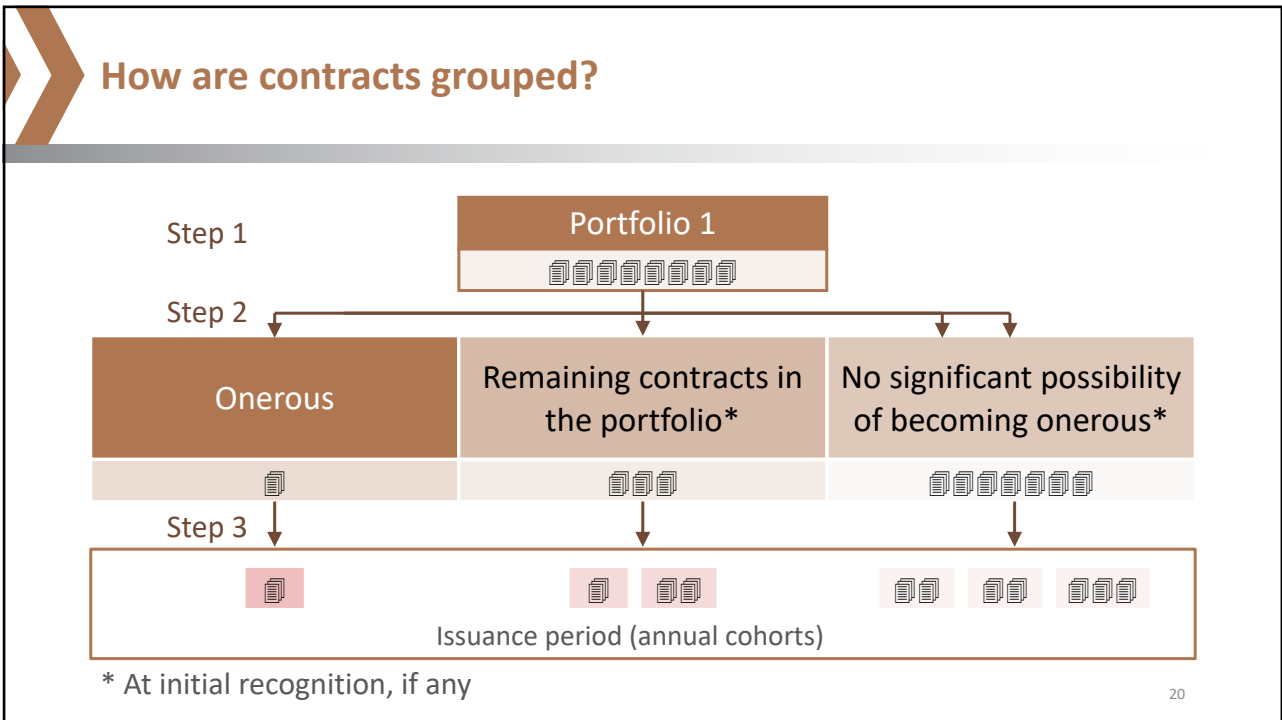


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| Judgement Level of aggregation <span style="float: right; border: 1px solid black; border-radius: 50%; padding: 5px;">3</span>  |  |   |
|---|--|---|
| Judgement   | Audit response   | Regulator response  |
| 1. Portfolio designation <ul style="list-style-type: none"> <li>Evidenced by internal accounts</li> <li>Similar risks</li> </ul> 2. Initial profitability <ul style="list-style-type: none"> <li>Either full test (GM or VFA), or</li> <li>Facts and circumstances</li> </ul> | Audit focuses on: <ul style="list-style-type: none"> <li><b>Internal reporting</b></li> <li>Review of internal modelling</li> <li>Inclusion of experts</li> <li>Documentation of decision</li> <li><b>Management bias</b></li> </ul> | <ul style="list-style-type: none"> <li>Interaction with other regulators (price regulation)</li> <li>Comparative analysis                             <ul style="list-style-type: none"> <li>Similar risks</li> </ul> </li> </ul> <p><b>Unlikely to</b> change regulatory reporting</p> |

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## Findings

- » High degree of **apparent diversity** and poor disclosure of judgements
- » Not always **obvious how portfolios** are determined
- » In general, initial profitability test **produces more onerous contracts** than expected:
  - » Cost allocations matter especially **where policies differ in size**

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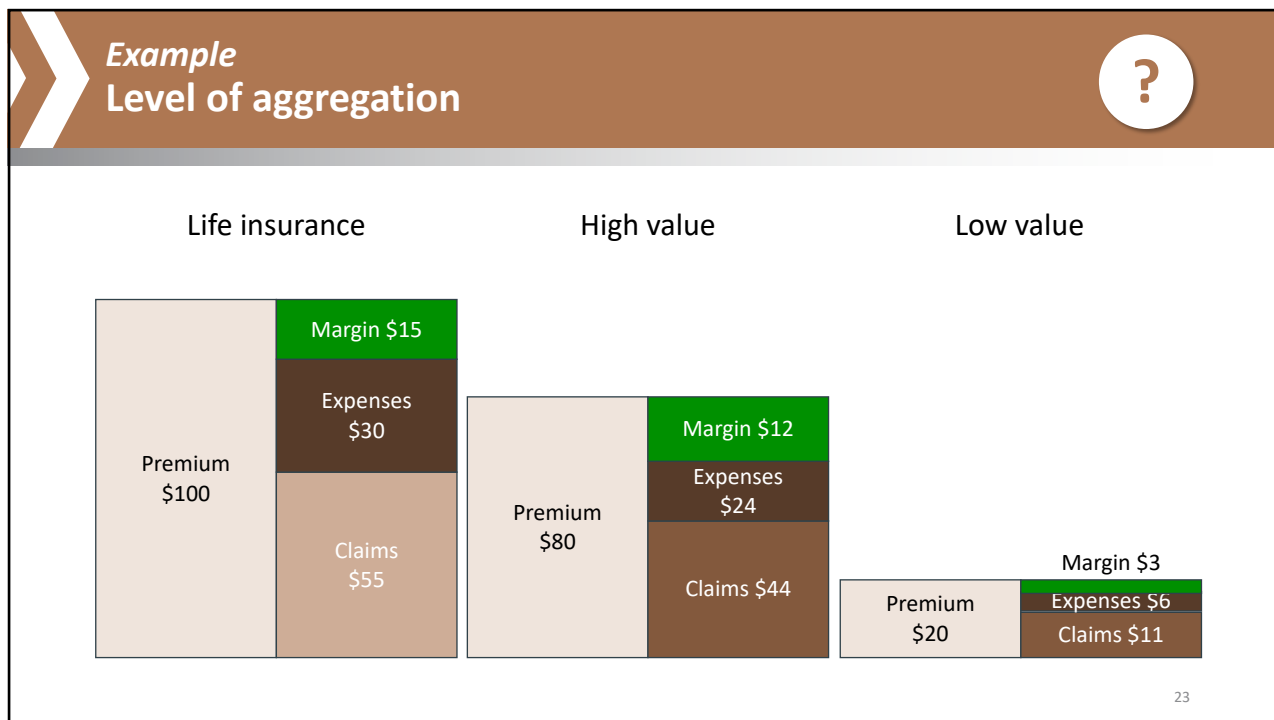
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## Example Level of aggregation ?

| Life insurance   | High value  | Low value  |
|--|---|--|
| <div style="display: flex; justify-content: space-between;"> <div style="width: 45%; border: 1px solid black; background-color: #f0e6d3; padding: 5px;">Premium \$100</div> <div style="width: 50%; border: 1px solid black; padding: 5px;"> <div style="background-color: #008000; color: white; padding: 2px;">Margin \$15</div> <div style="background-color: #4b3621; color: white; padding: 2px;">Expenses \$30</div> <div style="background-color: #c09070; padding: 5px;">Claims \$55</div> </div> </div> | <div style="display: flex; justify-content: space-between;"> <div style="width: 45%; border: 1px solid black; background-color: #f0e6d3; padding: 5px;">Premium \$80</div> <div style="width: 50%; border: 1px solid black; padding: 5px;"> <div style="background-color: #008000; color: white; padding: 2px;">Margin \$21</div> <div style="background-color: #4b3621; color: white; padding: 2px;">Expenses \$15</div> <div style="background-color: #654321; padding: 5px;">Claims \$44</div> </div> </div> | <div style="display: flex; justify-content: space-between;"> <div style="width: 45%; border: 1px solid black; padding: 5px;"> <div style="background-color: #ff0000; color: white; padding: 2px;">Loss -\$6</div> <div style="background-color: #f0e6d3; padding: 5px;">Premium \$20</div> </div> <div style="width: 50%; border: 1px solid black; padding: 5px;"> <div style="background-color: #4b3621; color: white; padding: 2px;">Expenses \$15</div> <div style="background-color: #654321; padding: 5px;">Claims \$11</div> </div> </div> |

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**Findings**

- » High degree of apparent diversity and poor disclosure of judgements
- » Not always readily apparent how portfolios are determined
- » In general, initial profitability test produces more onerous contracts than expected:
  - » Cost allocations matter especially where policies differ in size
  - » Unexpected cross subsidies have also been identified (small contracts, contracts for minority groups etc)

**Better disclosure required**  
**Insurers are revisiting cost-allocation, however aggregation levels appear settled**

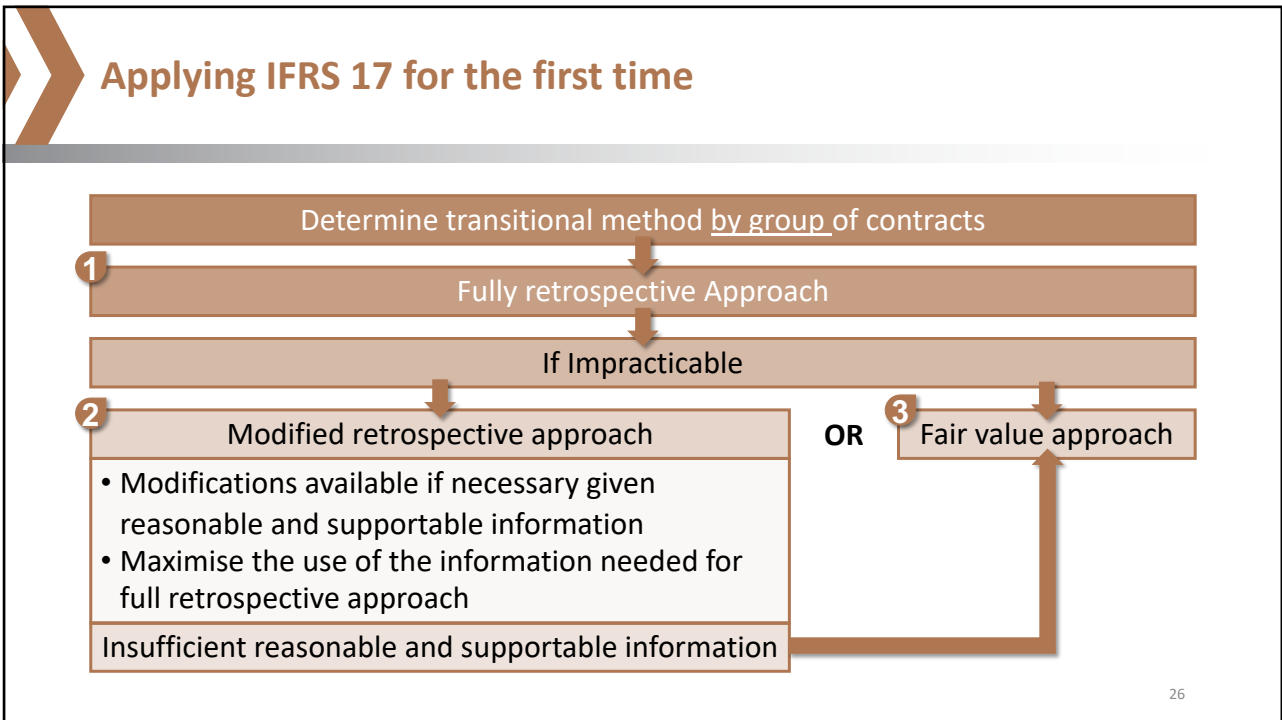
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| Judgement Transition <span style="float: right; border: 1px solid black; border-radius: 50%; padding: 2px 10px;">4</span>   |  |   |
|---|--|---|
| Judgement   | Audit response   | Regulator response  |
| 1. Fully retrospective unless Impracticable<br>2. Choice between modified retrospective and fair value <ul style="list-style-type: none"> <li>• Best available approach</li> <li>• Estimations</li> <li>• Fair value</li> </ul> | Audit focuses on: <ul style="list-style-type: none"> <li>• Actual data available</li> <li>• Elections made by management</li> <li>• <b>Documentation of decision</b></li> <li>• <b>Management bias</b></li> <li>• Jurisdictional practice</li> </ul> | <ul style="list-style-type: none"> <li>• Comparative analysis</li> <li>• Chosen method</li> <li>• Data sharing</li> </ul> <p><b>Unlikely to</b> change regulatory reporting</p> |

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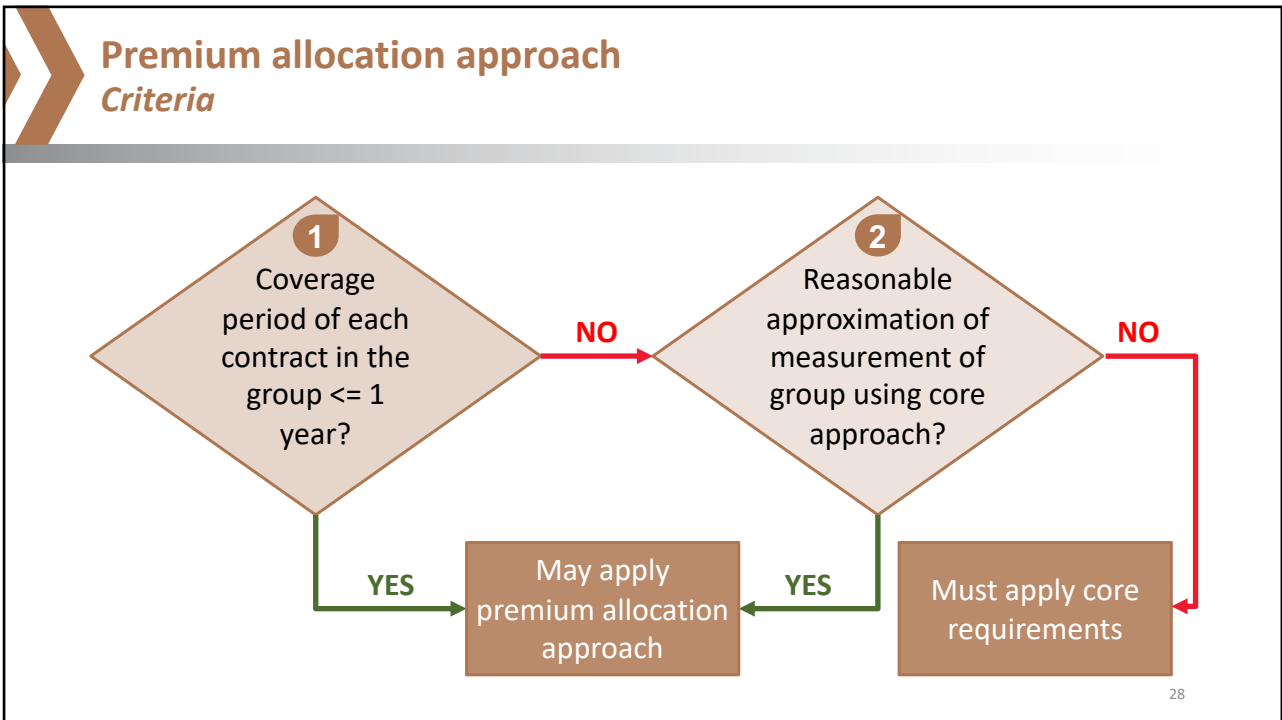
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| <b>Judgement Eligibility for Simplified approach</b> <span style="float: right; border: 1px solid black; border-radius: 50%; padding: 2px 10px;">A1</span>   |   |   |
|--|---|---|
| Judgement  | Audit response  | Regulator response  |
| Subject to contract boundary and separation/combination<br>1. Contract boundary decision is key <ul style="list-style-type: none"> <li>• Automatic renewal</li> <li>• Long dated claims</li> </ul> 2. If longer than 1-year, significant judgement | Audit focuses on: <ul style="list-style-type: none"> <li>• Actual data available</li> <li>• Management analysis</li> <li>• Internal scenarios</li> <li>• <b>Documentation of decision</b></li> <li>• <b>Management bias</b></li> <li>• Jurisdictional practice</li> </ul> | <ul style="list-style-type: none"> <li>• Interaction with other regulators</li> <li>• Comparative analysis                             <ul style="list-style-type: none"> <li>• Thresholds</li> </ul> </li> </ul> <p><b>Unlikely to</b> change regulatory reporting</p> |

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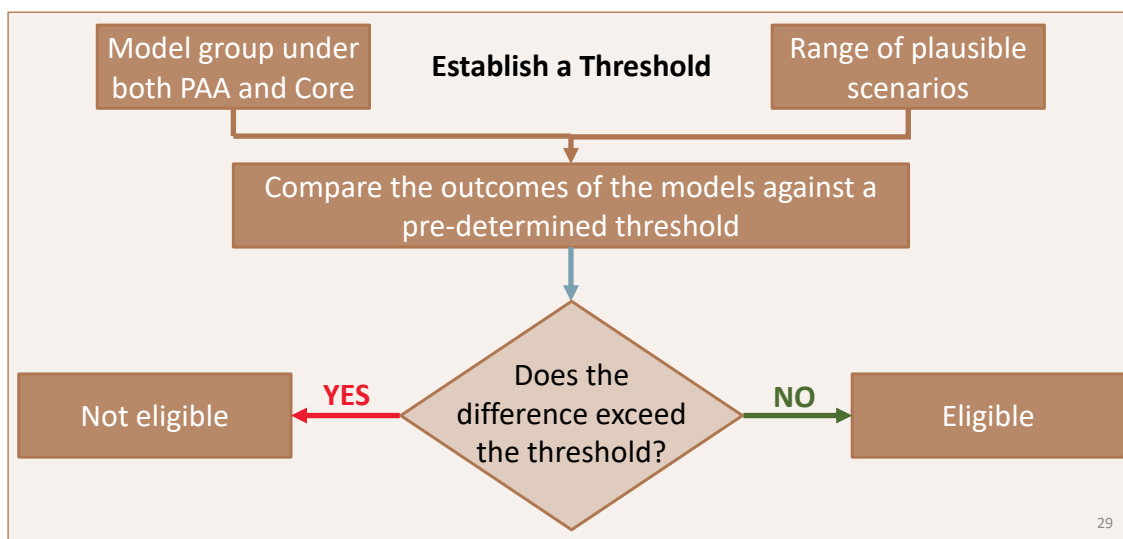
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## Reasonable approximation Testing



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## Findings

- » Significant, and typically well disclosed area of judgement
- » Considerably more contracts 'qualify' than may have been expected
  - » Some contracts in excess of 5 years
- » Key area of judgement is requirement for 'reasonable approximation' and the determination of an appropriate threshold
  - » Often references back to materiality
  - » Materiality sometimes based on contract group
  - » Other times (incorrectly?) based on entity materiality

**Refinements in disclosures and methods expected**

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**Example Reasonable approximation**

- » Insurer has 50% whole of life and 50% other insurance
- » Within other insurance 70% has a contract boundary of one year or less
- » Within the greater than one year group of contracts, it identifies three groups of contracts, each of the same size
- » Insurer applies reasonable approximation test to establish whether it can use the simplified approach
- » It defines the threshold as balance sheet materiality – for this insurer, balance sheet materiality is 1% of total balance sheet (total assets = \$1 billion)

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**Example Reasonable approximation**

| \$1 billion of total assets          |  |                                     |     |
|--------------------------------------|--|-------------------------------------|-----|
| \$0.5 billion of whole of Life       | \$0.5 billion of other insurance           |                                     |     |
|                                      | \$0.35b < 1 year (70%)                     | \$0.15b > 1 year)                   |     |
|                                      |  | .05                                 | .05 |
| Materiality @ individual group level | Materiality for all groups subject to test | Materiality at entity level         |     |
| Test                                 | 1% of \$50 million = \$0.5 million         | 1% of \$150 million = \$1.5 million |     |
|                                      |  | 1% of \$1 billion = \$10 million    |     |

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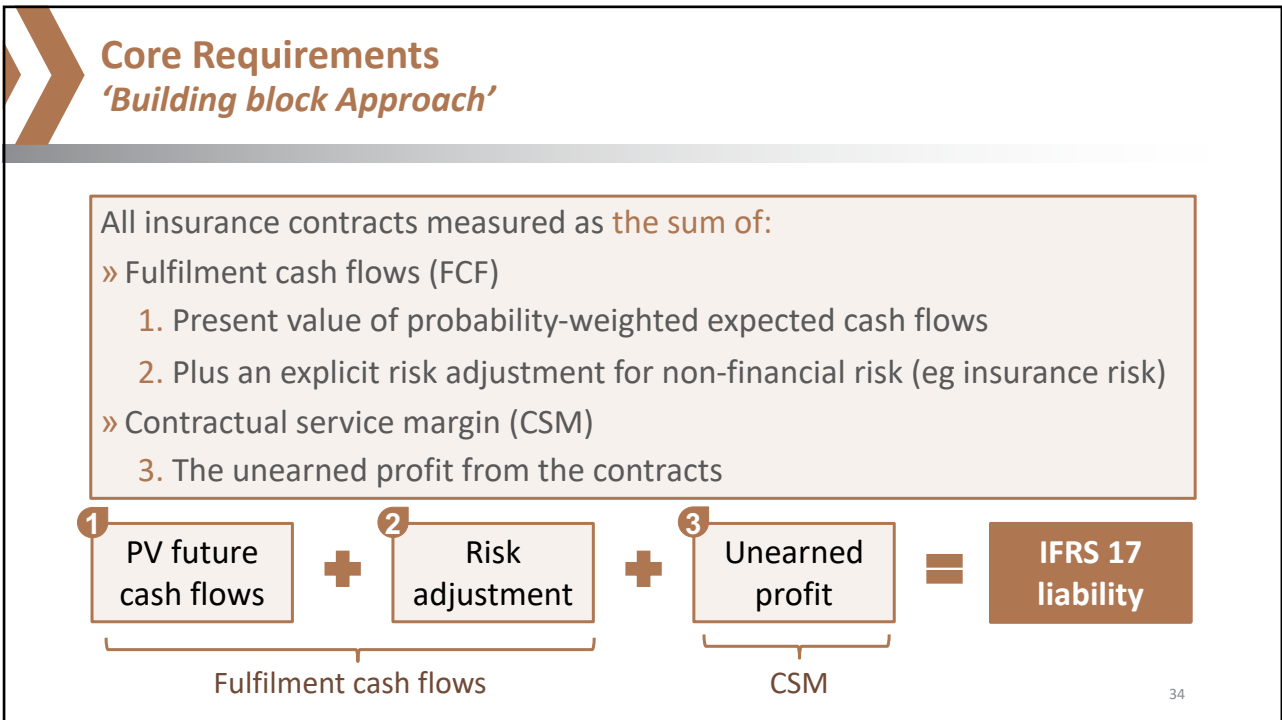
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| <b>Judgement</b><br><b>General measurement model - BEL</b>   |  |   |
|--|--|---|
| <span style="border: 1px solid black; border-radius: 50%; padding: 5px 15px; font-weight: bold;">B1</span>   |  |   |
| Judgement  | Audit response   | Regulator response  |
| Comprises <ul style="list-style-type: none"> <li>• future cash flows</li> <li>• discount rate</li> <li>• Risk margin</li> </ul> 1. Modelling cash flows<br>2. Sourcing reliable external data<br>3. Activity costing | Audit focuses on: <ul style="list-style-type: none"> <li>• <b>Historical data</b></li> <li>• <b>Compatibility with IFRS 17</b></li> <li>• <b>Actuarial calculations</b></li> <li>• Management bias</li> <li>• Documentation</li> <li>• Market data and practice</li> </ul> | <ul style="list-style-type: none"> <li>• Supplementary data (eg interest rates)</li> <li>• Comparative analysis                             <ul style="list-style-type: none"> <li>• Which interest rate curves etc</li> </ul> </li> <li>• Consider how output will be used</li> </ul> <b>Likely to</b> change regulatory reporting |

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## Findings

- » Significant reliance on **actuarial data and models**
- » Typically **good** disclosures, although **poor disclosure of sensitivity**
- » Strong **correlation** with prudential reporting

But

- » 'Break' occurs because of:
  - » **Grouping (level of aggregation)**, not done for actuarial or prudential (for CSM and cost allocation purposes)
  - » **Accounting mismatch** where BEL stays a net asset

**Considerable effort been expended to limit mismatch where there is a net asset**

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## Examples ?

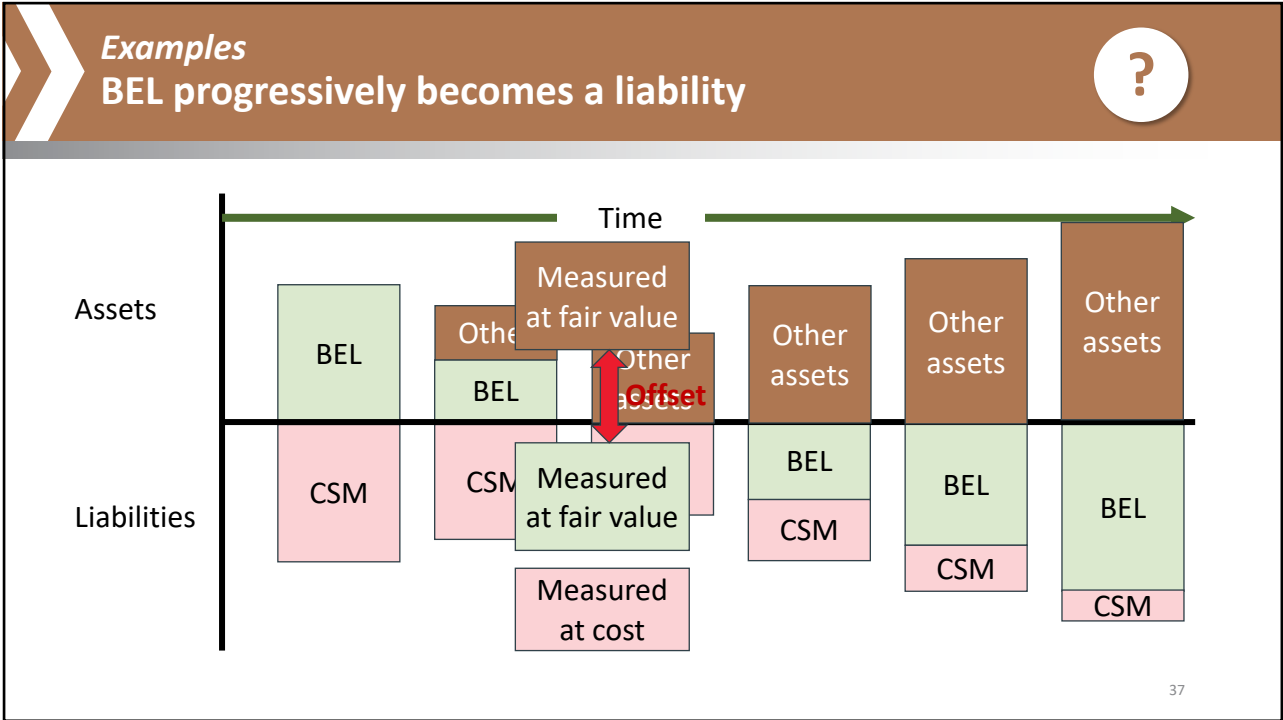
### BEL progressively becomes a liability

Time →

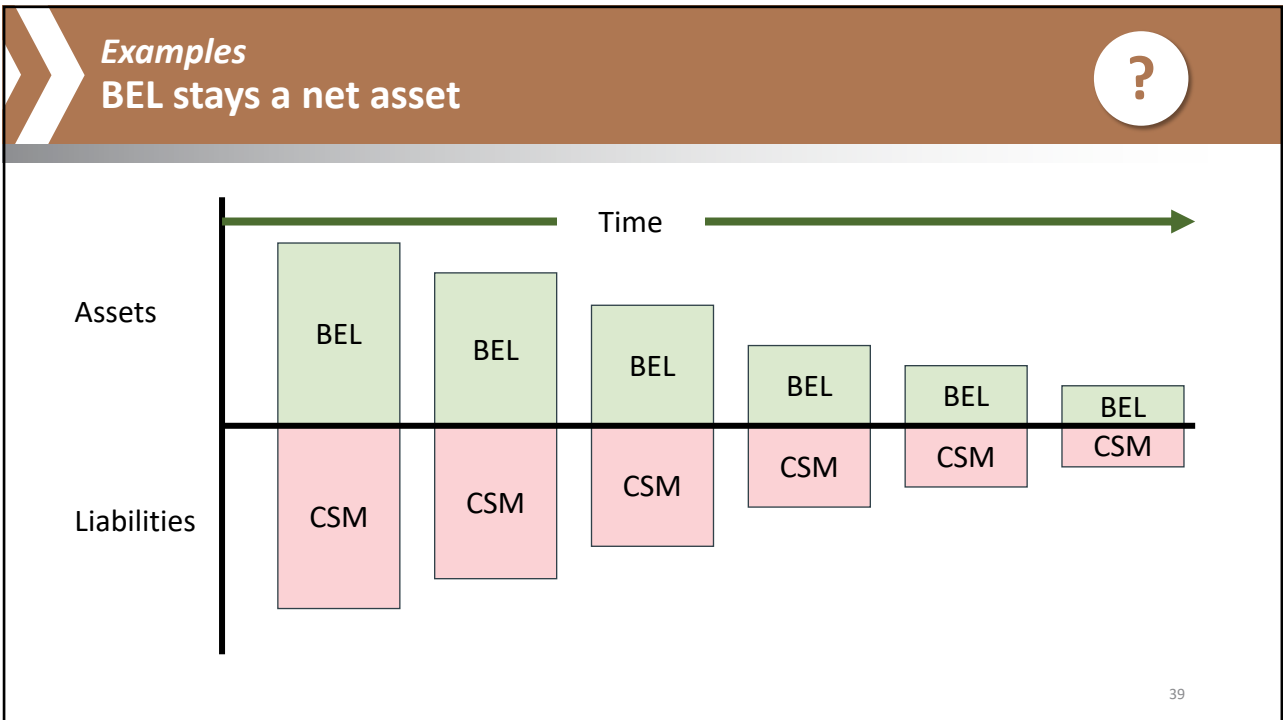
|             | Time 1 | Time 2       | Time 3       | Time 4       | Time 5       |
|-------------|--------|--------------|--------------|--------------|--------------|
| Assets      | BEL    | Other<br>BEL | Other assets | Other assets | Other assets |
| Liabilities | CSM    | CSM          | CSM          | BEL<br>CSM   | BEL<br>CSM   |

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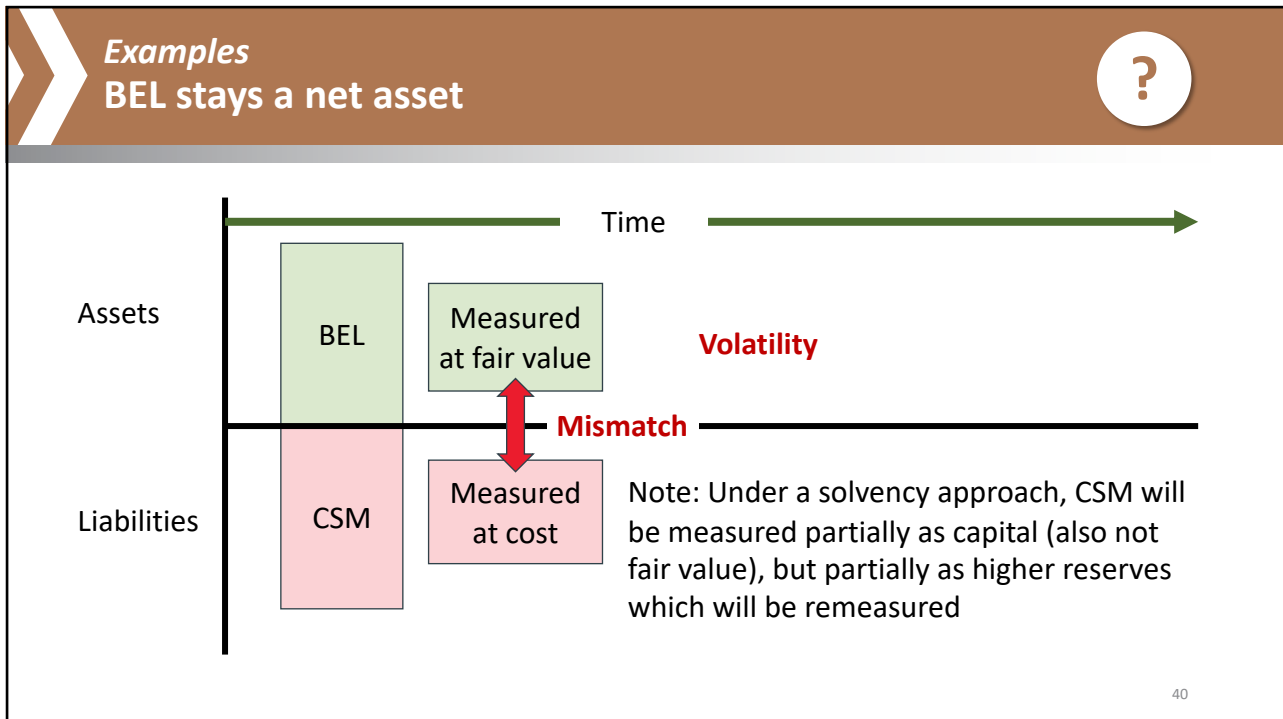
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**Findings**

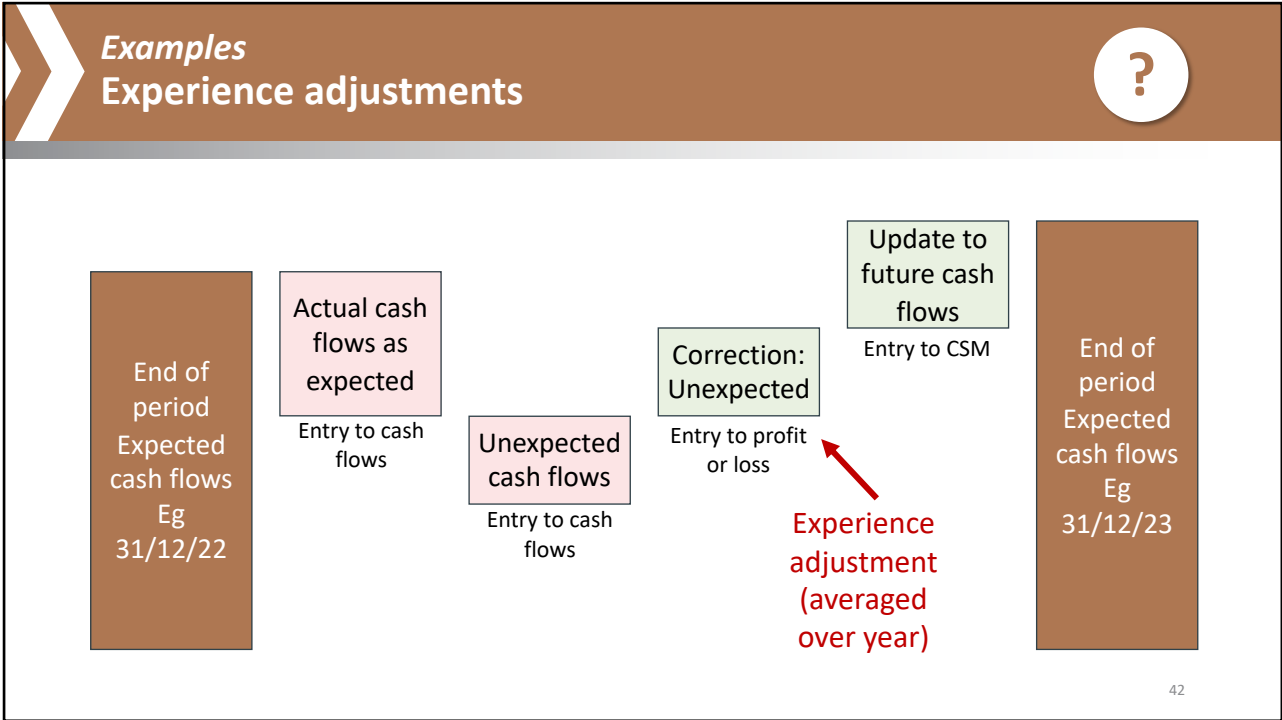
But

- » 'Break' occurs because of:
  - » Grouping (level of aggregation), not done for actuarial or prudential
  - » Accounting mismatch where BEL stays a net asset
  - » Risk margins (elective difference)
  - » Onerous contract tracking
  - » Experience adjustments (monthly)

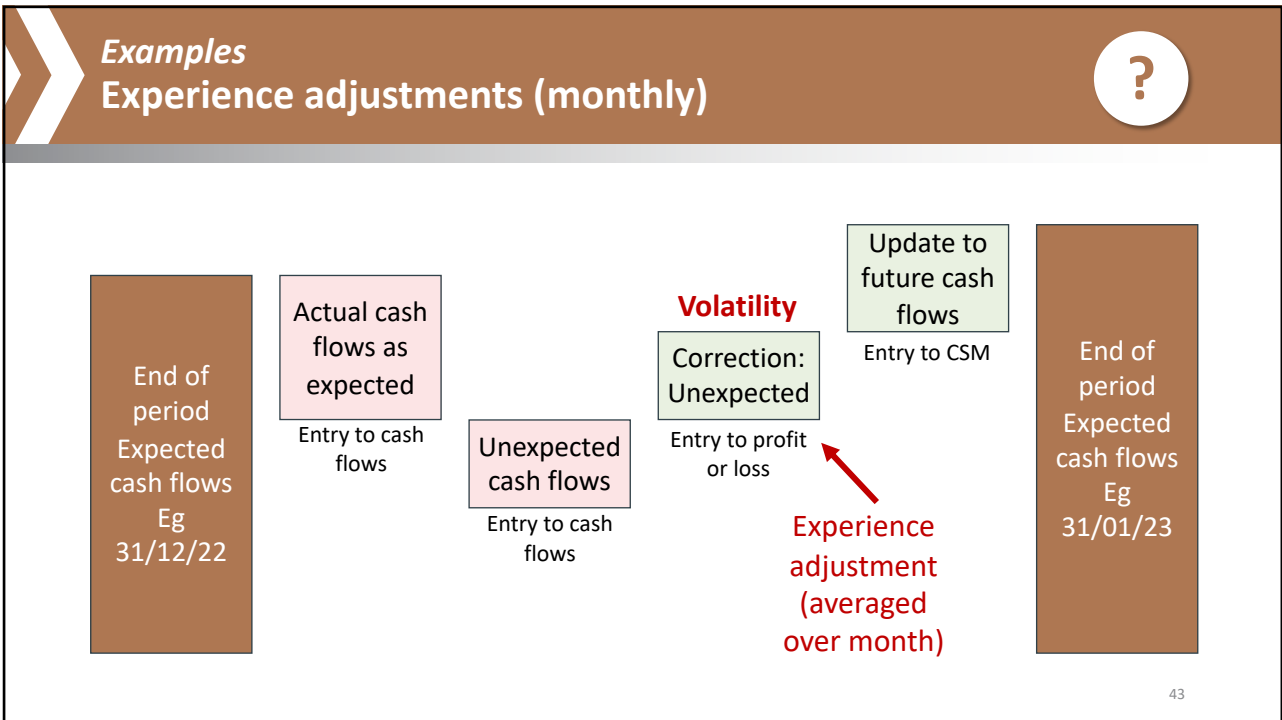
**Consideration of moving to less frequent remeasurement**

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**Judgement**  
**General measurement model - CSM**

**B2**

| Judgement   | Audit response  | Regulator response   |
|---|---|--|
| Calculated at inception, tracked thereafter<br>1. Allocation of CSM over time<br>2. Distinction between experience and future adjustments | Audit focuses on:<br>• <b>Systems and data tracking</b><br>• <b>Compatibility with IFRS 17</b><br>• Management bias<br>• Documentation<br>• Market practice | • Comparative analysis<br>• CSM allocation methods for common products<br><br><b>Unlikely to</b> change regulatory reporting |

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**Findings**  
**General measurement model - CSM**

- » Area of **significant change** from previous accounting and from regulatory
- » Challenges with:
  - » **Cost allocation** (see discussion above)
  - » **Measurement** at 'cost' (see discussion above)
  - » **Allocation** of CSM over time
    - » **Pattern of benefits** method

**Insurers now 'comparing notes' to better align release pattern**

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| Judgement C1 Disclosure   |   | C1   |
|---|---|--|
| Key Judgements  | Audit response  | Regulator response   |
| <ol style="list-style-type: none"> <li>1. Forward looking disclosures</li> <li>2. Risk discussion and analysis</li> <li>3. Completeness of disclosures</li> <li>4. Description of policy choices</li> </ol> | Audit focuses on: <ul style="list-style-type: none"> <li>• <b>Understanding of underlying data</b></li> <li>• Reviewing disclosures:               <ul style="list-style-type: none"> <li>• Accuracy</li> <li>• Completeness</li> <li>• Relevance</li> <li>• Understandability</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>• Facilitate market communication</li> <li>• Anticipate systemic issues</li> <li>• <b><u>Clarify IFRS reviews</u></b></li> </ul> <p><b><u>Unlikely to</u></b> change regulatory reporting</p> |

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| Findings   |
|--|
| <ul style="list-style-type: none"> <li>» Disclosures about judgements and estimates have generally been poor:               <ul style="list-style-type: none"> <li>» not unexpected</li> <li>» generally improve over time in response to questions and queries</li> </ul> </li> <li>» Risk margins:               <ul style="list-style-type: none"> <li>» Risk margin disclosure is useful to contextualise approach taken (prudential versus pricing versus internal risk)</li> <li>» Disclosure limited</li> </ul> </li> <li>» Risk concentration disclosure particularly poor</li> </ul> <p style="text-align: center;"><b>Will improve with time as market and regulator discipline ramps up</b></p> |

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Challenge D1  
Data
D1

| Key Challenges  | Audit response   | Regulator response  |
|---|--|---|
| <p>1. Existing data</p> <ul style="list-style-type: none"> <li>• Robustness/reliability</li> <li>• Verifiability</li> <li>• Consistency with IFRS</li> </ul> <p>2. New data</p> <ul style="list-style-type: none"> <li>• Source</li> <li>• Back testing</li> <li>• Plus same for existing data</li> </ul> | <p>Audit focuses on:</p> <ul style="list-style-type: none"> <li>• Sources of data</li> <li>• Processes to obtain data</li> <li>• <b>Controls over data</b> and data manipulation</li> <li>• Subjectivity</li> <li>• Management bias</li> </ul> | <ul style="list-style-type: none"> <li>• Identify data gaps</li> <li>• Supplementary data (eg interest rates)</li> <li>• Comparative analysis</li> </ul> <p><b><u>Likely to</u></b> change regulatory reporting</p> |

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Challenge D2  
Systems
D2

| Key Challenges   | Audit response   | Regulator response   |
|--|--|--|
| <p>1. Existing systems</p> <ul style="list-style-type: none"> <li>• Robustness/reliability</li> <li>• Verifiability</li> <li>• Controls</li> </ul> <p>2. New systems</p> <ul style="list-style-type: none"> <li>• Compatibility with old</li> <li>• Testing of systems</li> <li>• Plus same for existing data</li> </ul> | <p>Audit focuses on:</p> <ul style="list-style-type: none"> <li>• <b>Controls over systems</b></li> <li>• <b>Walk through of systems</b></li> <li>• Substantive testing</li> <li>• Reperformance</li> <li>• Management bias</li> </ul> | <ul style="list-style-type: none"> <li>• Monitor outcomes</li> <li>• Identify gaps</li> <li>• Set milestones</li> </ul> <p><b><u>Unlikely to</u></b> change regulatory reporting</p> |

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