# IFRS 17

# *Insurance contracts*

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*13-14 December 2021*

*IFRS UPDATE FOR REGULATORS*

CFRR Centre for Financial Reporting Reform

WORLD BANK GROUP

STAREP

REPARIS FOR SMEs

This event is co-funded by

AUSTRIAN DEVELOPMENT COOPERATION

European Union

Federal Ministry Republic of Austria Finance

# Disclaimer



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

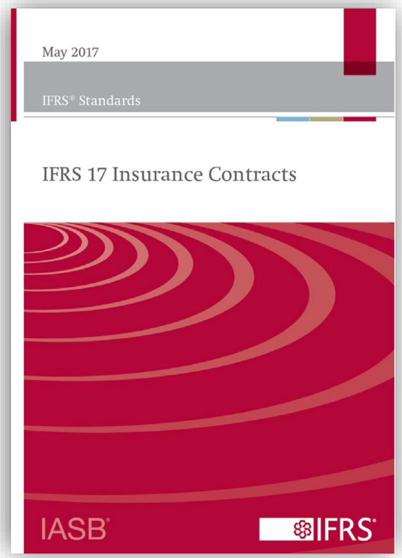
The purpose of this session is to discuss preparations for regulating the implementation of IFRS 17 (and the implementation of IFRS 9 by qualifying insurers).

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 information[1]
  - early application permitted

[1] *Subject to current discussion in regard IFRS 9*

# Reasons and objectives for IFRS 17

# Insurance Accounting
## *Phased approach*

Two phases for accounting for insurance contracts:

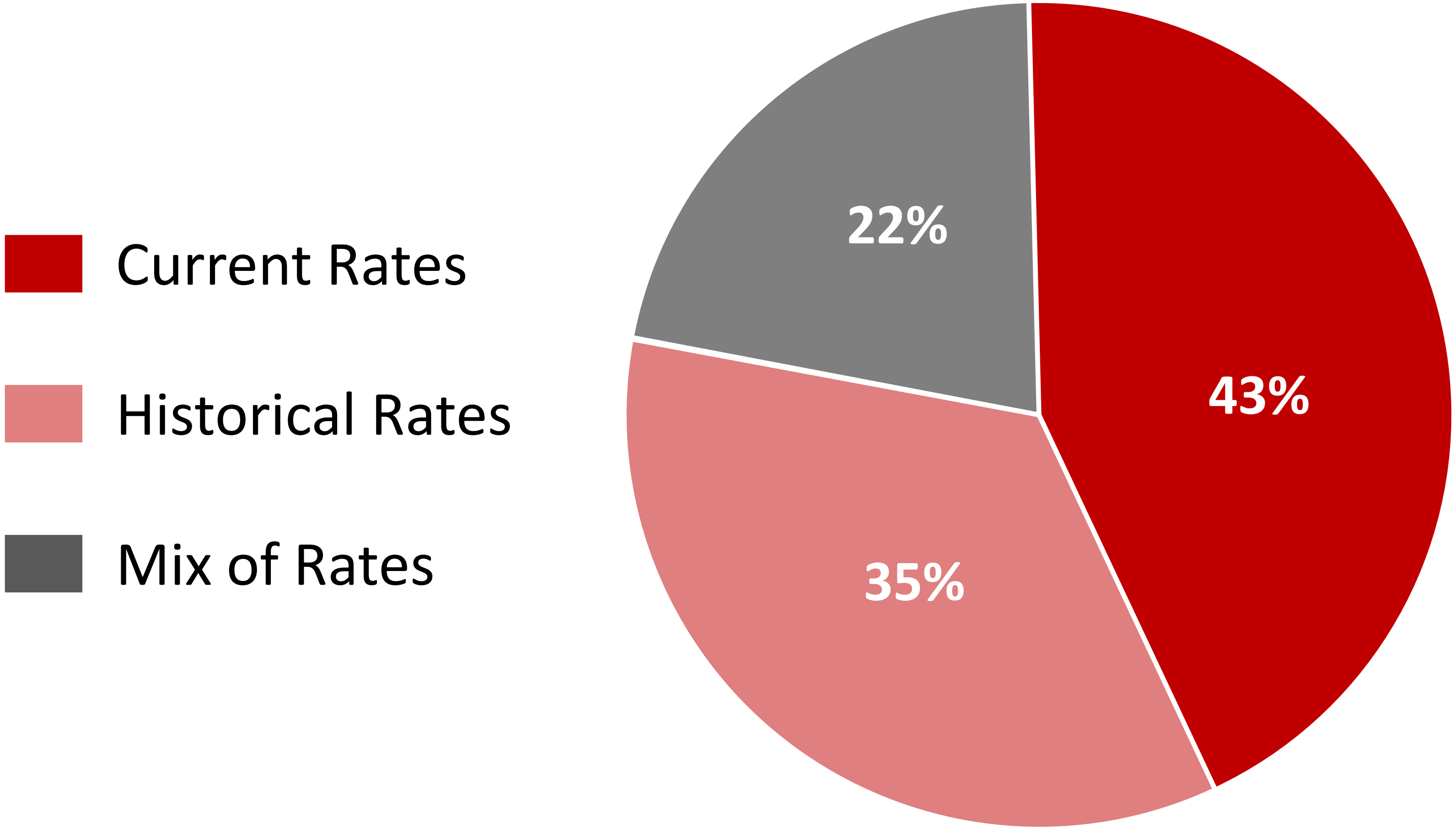
- Phase 1:
  - 2004: issue of IFRS 4 *Insurance Contracts*, focus on enhanced disclosure of amount, timing and uncertainty of cash flows.
  - IFRS 4 allows entities to continue using various recognition, measurement and presentation (grandfathering)
- Phase 2:
  - 2017: issue (2020 amendment) of IFRS 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*

| Top-20 listed insurance companies using IFRS Standards | | |
|---|---|---|
| Accounting policies applied to insurance contracts issued | Number of companies | Total assets (US$ trillion) |
| Based on guidance in | | |
| - Other National GAAP | 5 | 2.0 |
| - US GAAP | 3 | 1.6 |
| - Canadian GAAP | 4 | 1.4 |
| - Mix of national GAAP | 8 | 4.1 |
| Total | 20 | 9.1 |

*Source: Effects Analysis on IFRS 17*

# Phase 1: Insurance Accounting
## *Discount rates currently used*




*Source: Effects Analysis on IFRS 17*

# Phase 1: Insurance Accounting
## *Lack of comparability*

| | Year X | | | |
|---|---|---|---|---|
| CU Millions | GAAP 1 | GAAP 2 | Difference | |
| Revenue | 8 263 | 10 979 | (2 716) | (33%) |
| Operating income | 1 416 | 633 | 783 | 55% |
| Net income | 965 | 337 | 628 | 65% |
| Total equity | 8 977 | 3 872 | 5 105 | 57% |

*Source: Effects Analysis on IFRS 17*

# Phase 2 Objectives
## *Transparency and quality*

**More**
useful and transparent information

**Better**
information about profitability

- 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*

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

# IFRS 17 Improvements
## *Improved performance reporting*

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

[1] Common IFRS 4 presentation in statement of comprehensive income

# IFRS 17 Improvements
## *To improve comparability*

<table>
<tr><th>Applying IFRS 4</th><th>Applying IFRS 17</th></tr>
<tr><td>Lack of comparability<br>• IFRS reporters use different practices for insurance</td><td rowspan="2">• New framework replaces variety of accounting treatments<br>• Required consistency within a group<br>• Limited options</td></tr>
<tr><td>Inconsistent within groups<br>• Subsidiaries consolidated using different practices</td></tr>
<tr><td>Inconsistency with other IFRSs<br>• Revenue include deposits<br>• Revenue on a cash basis</td><td>• Revenue reflects service, and excludes deposits, like any other industry</td></tr>
</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<br>• Options and guarantees fully reflected<br>• 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<br>• Profits recognised as the insurance contract services are provided<br>• Additional metrics to evaluate performance |

# What investors think about IFRS 17

| Areas of support | Areas of concern |
| --- | --- |
| • Information about insurers' performance<br>• Consistency with other industries<br>• Comparability<br>• Disclosures<br>• Transparency | • Entity-specific judgements<br>• Options<br>BUT disclosures will help to assess the effects of judgements and options on comparability |

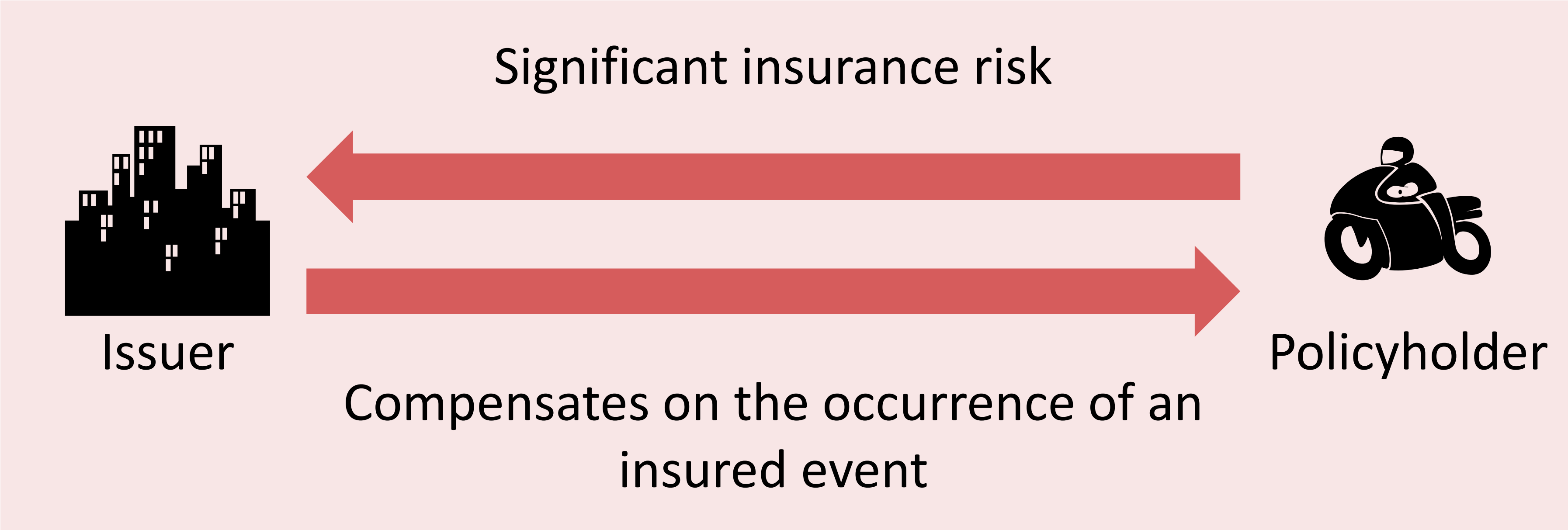
# Scope of IFRS 17

# Scope

- 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

*IFRS 17.3 to IFRS 17.8A*

# What is an insurance contract

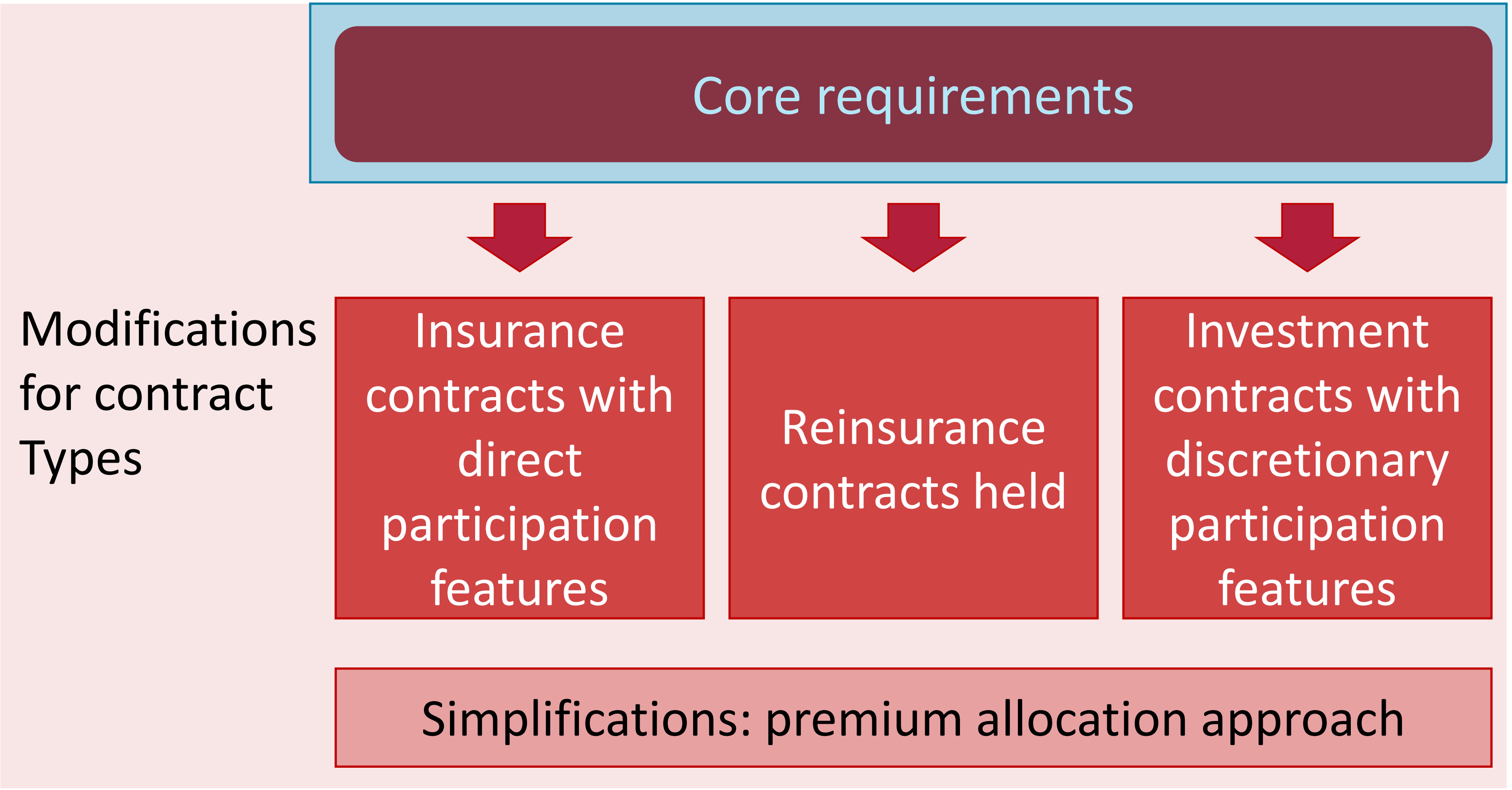



- ⇔ IFRS 17 and IFRS 4—same definition
- ⇔ IFRS 17 two minor changes to guidance but no expected changes in assessments for majority of contracts

⇔ No change from IFRS 4
Change from IFRS 4

# Core requirements
# *'General' Approach*

# Core Requirements
## *Snapshot of IFRS 17 Approaches*



# 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

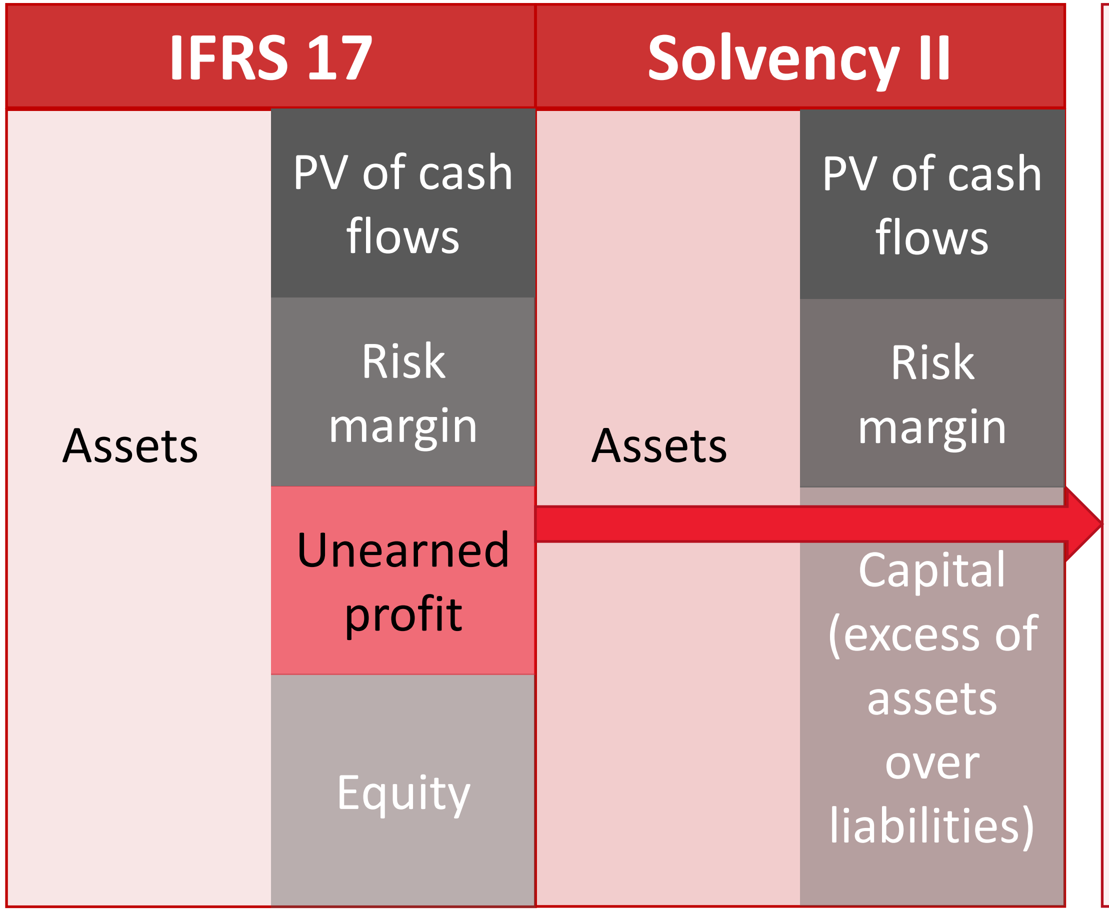
1 PV future cash flows + 2 Risk adjustment + 3 Unearned profit = **IFRS 17 liability**

Fulfilment cash flows (1 + 2) | CSM (3)

# Regulatory regimes
## *Comparison*

| | IFRS 17 | Solvency II |
|---|---|---|
| Cash flows | Similar | Similar |
| Discount rates | Liability-specific rate, market consistent | Swap rate (yr 20) and ultimate forward rate |
| Risk | Company's own view of risk (possible use of Solvency II risk margin) | Prescribed approach (risk margin—cost of capital set at 6%) |
| Unearned profit | Recognised in P&L over time | Included in capital at inception—day 1 gain |

# Regulatory regimes
## *Performance*




**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*

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

# Key Regulatory Considerations

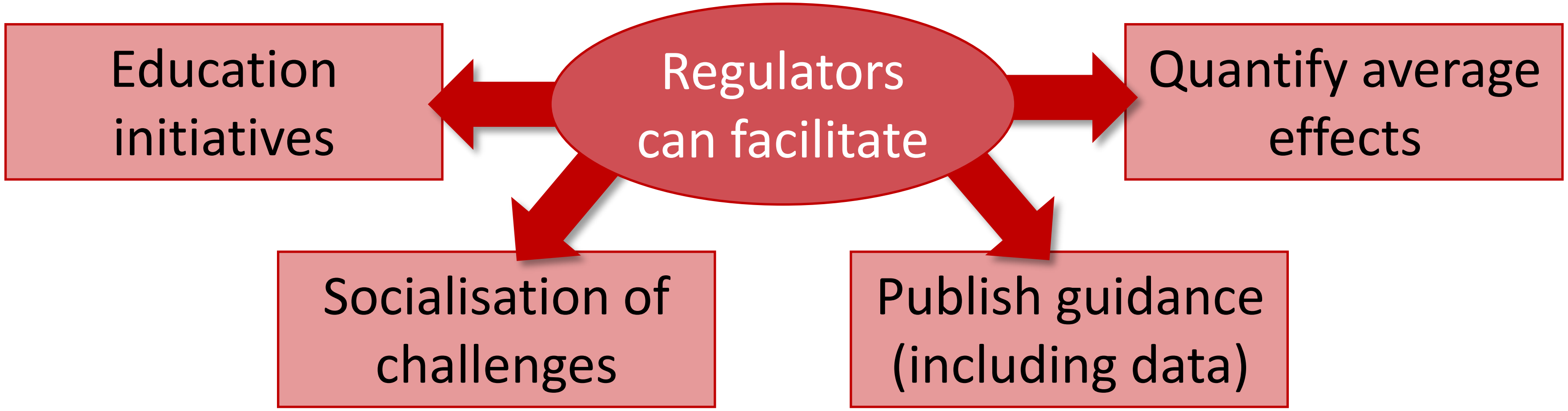
# Understanding the standard
## *Considerations*

- 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

# Understanding the standard
## *Regulators*

Preparers need to comprehensively understand IFRS 17

Apply it in context of unique jurisdictional regulation and products



# Understanding the standard
## *Regulators*

Flood of new information

Reinforce existing views

Contradict existing views

Regulators need to understand IFRS 17 so as to:

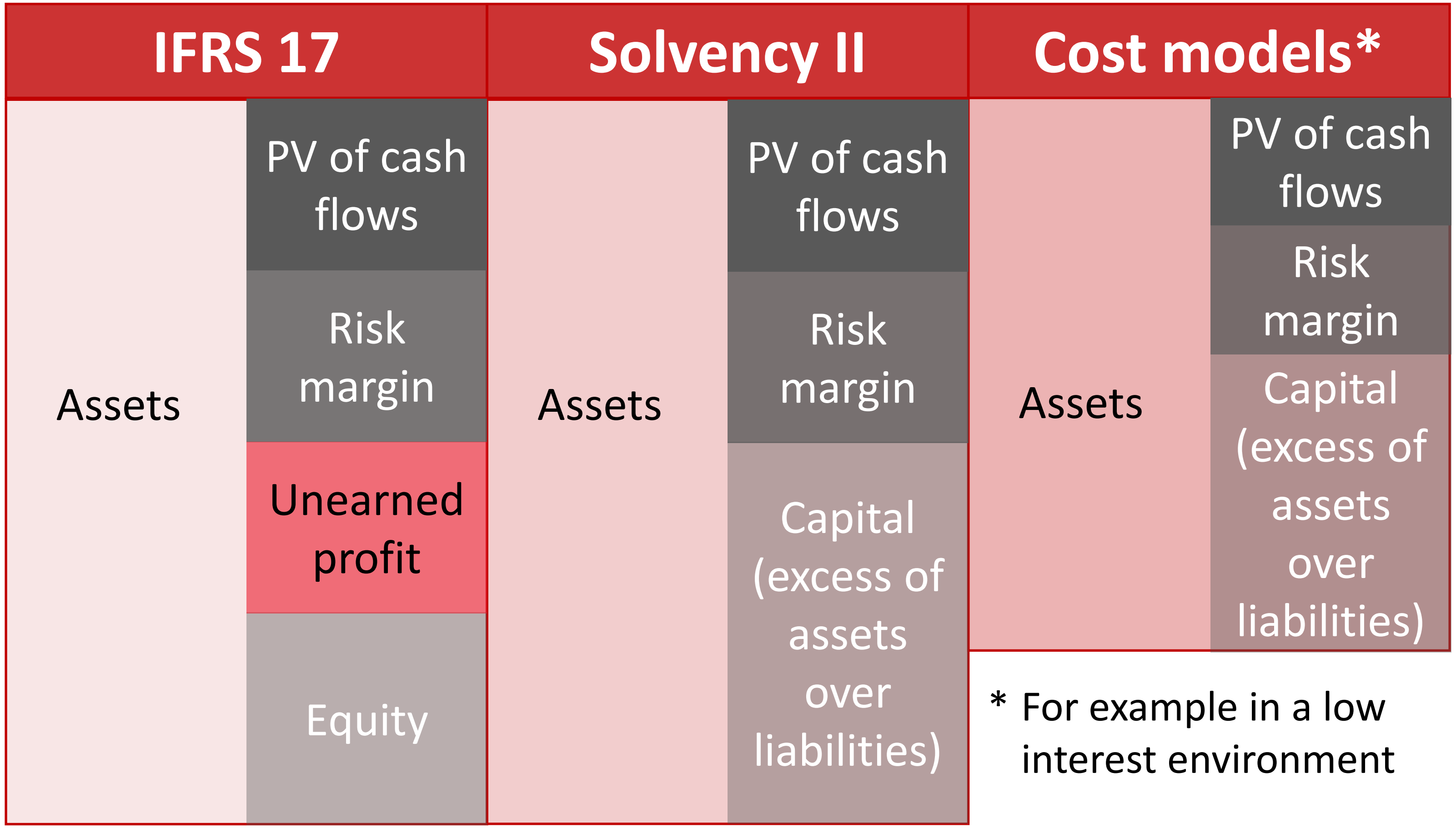
Anticipate

Understand

Amend/confirm

**<u>Confidence</u>** to push back against undesirable practices, and communicate proactively with market

# Regulatory regimes
## *Reconciliation*

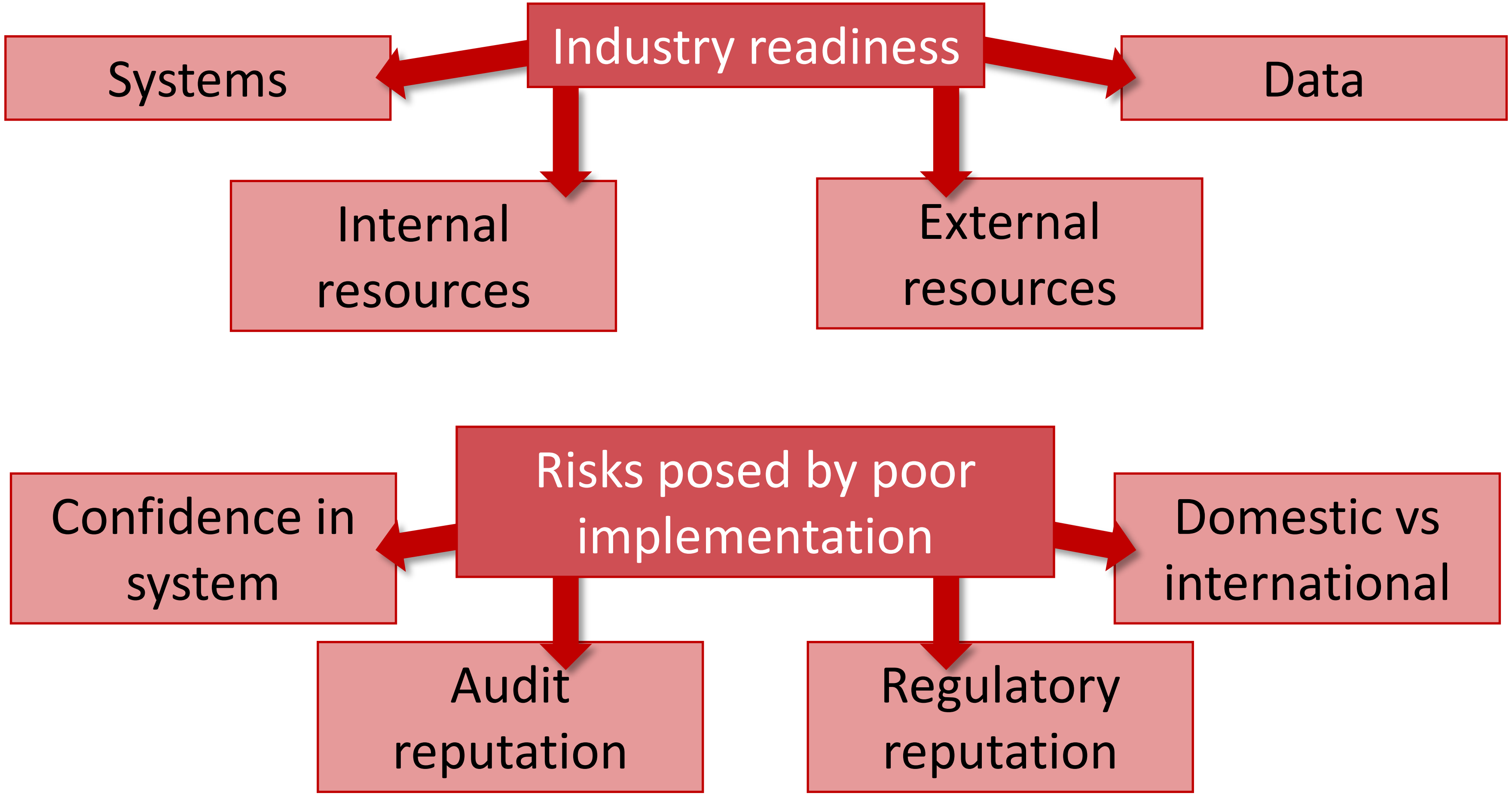



* For example in a low interest environment

# Regulatory regimes
## *Reconciliation*

- 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



# 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