Challenges applying IFRS 17 *Insurance Contracts*

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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 2023

The views expressed in this presentation are my own and not necessarily those of any organization with which I am associated.

Objective

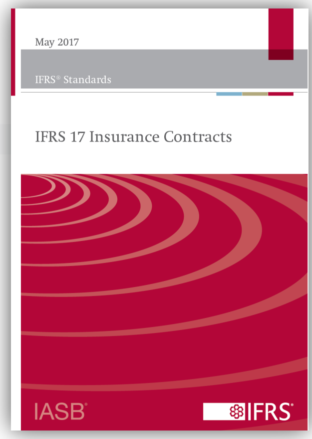
Objectives of this presentation

- To provide an understanding of IFRS 17 and its implications on insurance contract accounting
- To explore the specific challenges that organizations may encounter/have necountered during their initial IFRS 17 adoption process
- To highlight the importance of proactive planning and collaboration within organizations to successfully navigate these challenges
- To highlight areas where regulators can facilitate the process

Introduction to IFRS 17

Insurance contracts

Introduction to IFRS 17



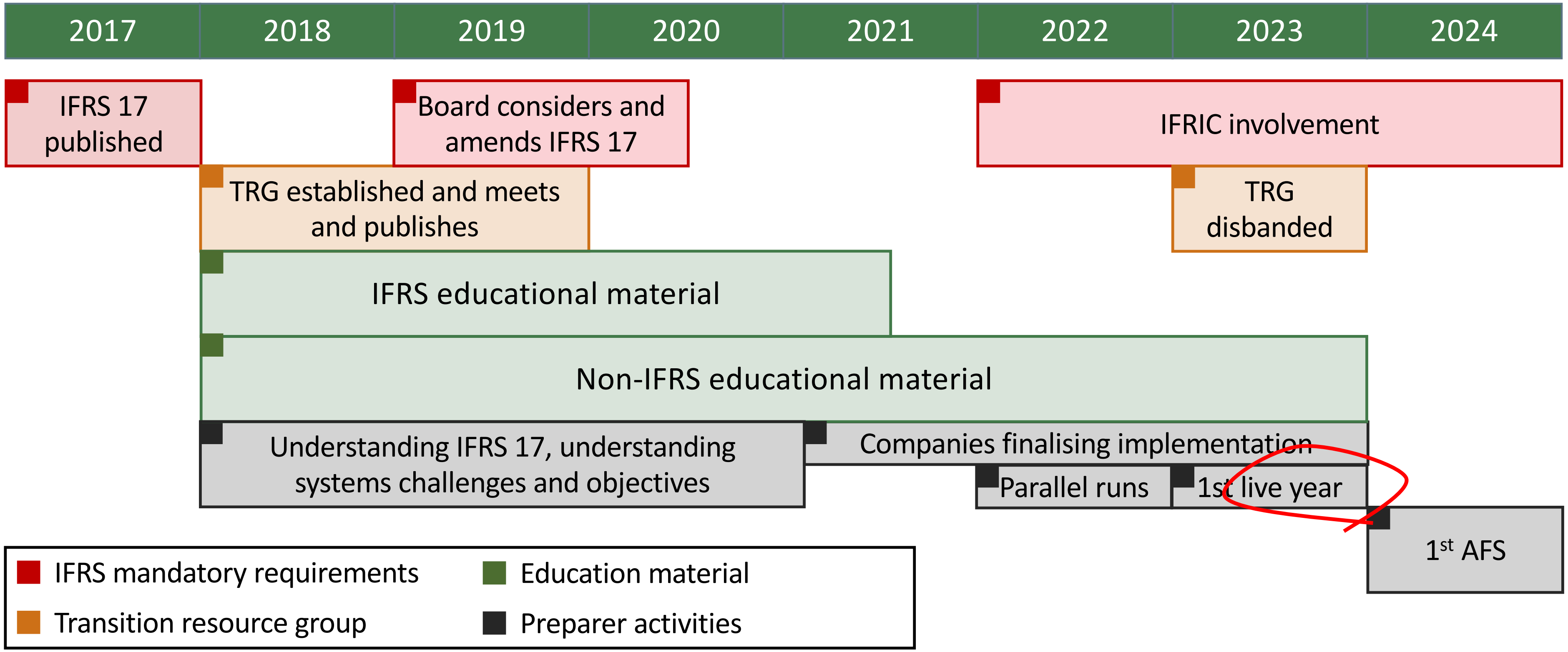
- IFRS 17 is a fundamental transformation of insurance accounting
  - impacts most aspects of an insurer's operations
  - replaces a variety of accounting methods previously used
- Objective is to provide relevant and consistent information to stakeholders, and improve understanding of insurer's financial position and performance
- Most IFRS jurisdictions are adopting the standard this year
- However, some jurisdictions have delayed mandatory application
- Adoption of IFRS 17 is challenging and early preparation is critical

Introduction to IFRS 17

Project History

- **1997** IASC starts insurance project
- **2004** IFRS 4 published
- **2007** Discussion paper published
- **2010** Exposure draft published
- **2013** 2nd Exposure draft published
- **2017** IFRS 17 published
- **2020** Amended published
- **2023** Effective date

Introduction to IFRS 17
Project Implementation



Introduction to 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

Introduction to IFRS 17

Phase 1: Insurance Accounting - IFRS 4 Insurance contracts

- IFRS 4 grandfathered much previous jurisdictional practice:
  - Wide range of accounting stemming from original practices
  - Differences across jurisdictions and products make it difficult for investors and analysts to understand and compare results
  - Insurers use multiple practices in a set of consolidated results
- Some existing practices fail to reflect true underlying financial position or performance of insurance contracts
- Most stakeholders agreed on need for a common standard (opinions varied as to what it should be)

Introduction to IFRS 17

IFRS 4 - Recognition of revenue and profitability

» Two regular anomalies in revenue (premium) recognition

Cash premium received	Or	Premium due or Premium receivable	AND	Deposit amounts included

» Profit is recognised in various ways

Immediately contract is written	OR	Only when the contract ends	OR	Over the duration of the contract

» Use of many non-GAAP measures

Introduction to IFRS 17

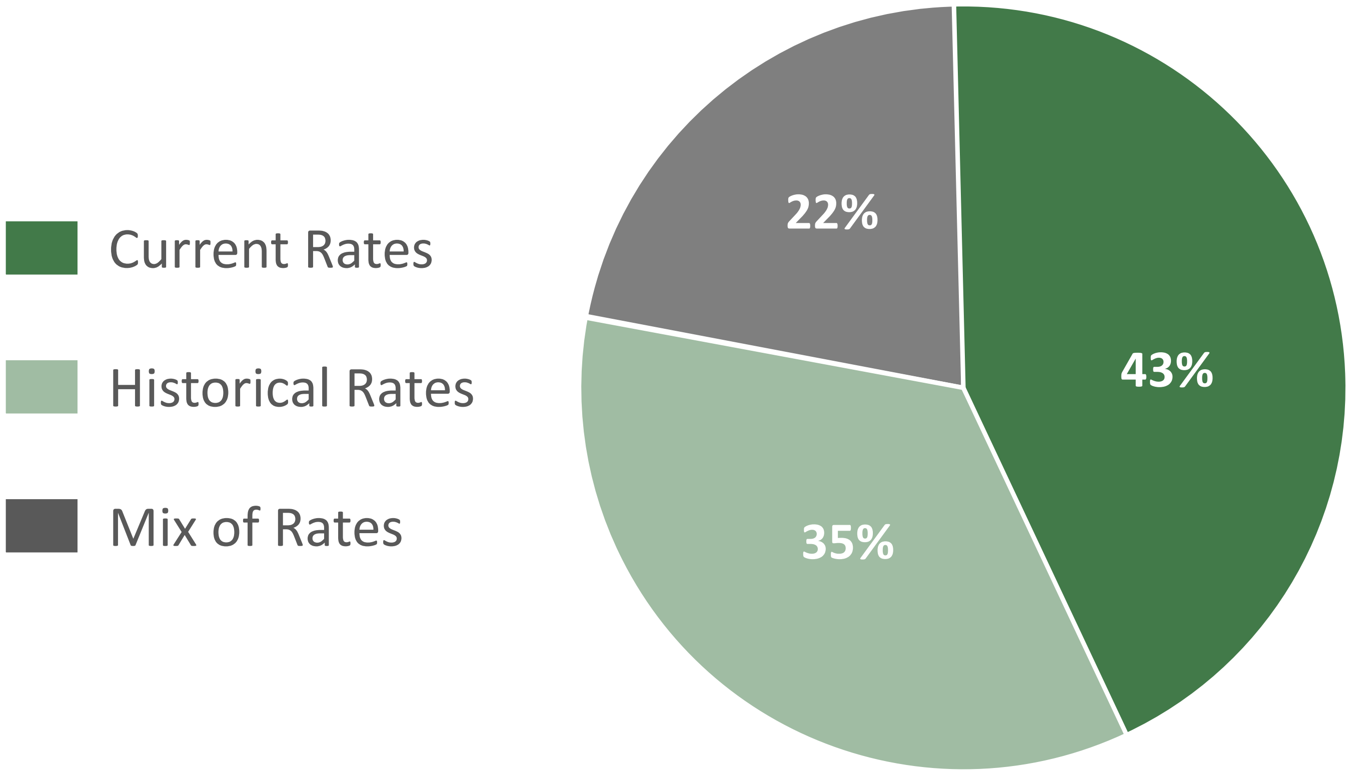
IFRS 4 - Lack of comparability

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

Introduction to IFRS 17

IFRS 4 - Discount rates currently used



Source: Effects Analysis on IFRS 17

Introduction to IFRS 17

IFRS 4 - 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

Introduction to IFRS 17

IFRS 17 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
- Present comparable information across companies
- Assist investors to to understand performance

Introduction to IFRS 17

IFRS 17 Objectives - Useful information

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

Introduction to IFRS 17

IFRS 17 improvements - performance reporting

Applying IFRS 4[1]	Applying IFRS 17	Key Changes
Premiums	Insurance revenue	• Insurance revenue excludes deposits • Revenue recognised as earned, expenses as incurred • Insurance finance expenses presented with corresponding income (in P&L or OCI) • 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

Introduction to IFRS 17

IFRS 17 Improvements - Comparability

Applying IFRS 4	Applying IFRS 17
Lack of comparability • IFRS reporters use different practices for insurance	• New framework replaces variety of accounting treatments • Required consistency within a group • Limited options
Inconsistent within groups • Subsidiaries consolidated using different practices	
Inconsistency with other IFRSs • Revenue include deposits • Revenue on a cash basis	• Revenue reflects service, and excludes deposits, like any other industry

What investors think about IFRS 17

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

Overview of IFRS 17

Overview of the standard

- IFRS 17 requires
  - Recognition and accounting for insurance contracts at a group level
  - Measurement of unbiased, time value adjusted future cash flows based on current assumptions, with a transparent risk margin
  - Recognition of revenue over the duration of the group
  - Immediate recognition of losses on loss making groups
  - Simplifications and/or modifications for defined contract types
- IFRS 17 imposes extensive presentation and disclosure requirements
- IFRS 17 provides transition reliefs available in defined circumstances

Overview of the standard

General model

Cash flows

Discount rate

Risk adjustment

Present value future cash flows

Fulfilment cash flows

CSM

IFRS 17 asset or liability

Current value incorporating all available information, consistent with observable market info. **Updated each** period using current assumptions about cash flows, discount rate and risk.

Unearned profit of a group of contracts. Adjusted by changes in estimates and recognised in P&L as coverage is provided.

All insurance contracts are measured as the sum of:

- **fulfilment cash flows**; and
- contractual service margin

Overview of the standard

Snapshot of IFRS 17 Models and Approaches

General Model

Modifications for contract Types

- Insurance contracts with direct participation features
- Reinsurance contracts held
- Investment contracts with discretionary participation features

Simplifications: Premium Allocation Approach

Effective date

» IFRS 17 is effective for years commencing on or after 1 January 2023

» However, various jurisdictions have postponed this date for some or all insurers operating in the jurisdiction

» IFRS 17 offers significant benefits, including enhanced transparency and consistency in financial reporting, improving investor confidence and a more accurate understanding of an insurer's financial health

» However, there are also significant challenges and costs to implementing the standard

Role of regulators

IFRS 17 Implementation
Role of regulators

» Regulators play a crucial role in successful adoption of IFRS 17 by insurers

Key Responsibilities

» Provide clear guidance and interpretation of jurisdiction specific issues

» Assess insurers' implementation plans, methodologies, and assumptions

» Require insurers to maintain accurate data, provide transparent disclosures, and report financial information in a standardized manner

» Provide centralised sources of data

» Promote collaboration with industry associations, standard-setting bodies, and accounting authorities

IFRS 17 Implementation
Impact of delayed implementation

» Some jurisdictions have delayed implementation of IFRS 17. Others have staggered implementation by initially requiring it only for large insurers

Advantages

» Observe and learn from experiences and challenges of earlier adopters

» Leverage expertise and guidance of earlier adopters

» Tailor implementation to characteristics of local insurance market

» Prepare more thoroughly, reducing the initial disruption

» Issue more comprehensive guidance

» Adopt more advanced and cost-effective technology solutions

IFRS 17 Implementation
Impact of delayed implementation

» Some jurisdictions have delayed implementation of IFRS 17. Others have staggered implementation by initially requiring it only for large insurers

Disadvantages

» Disadvantages insurers seeking international investors or clients

» Loss of operational advantages insurers and regulators are achieving

» Retains discredited approach – risks market scepticism and uncertainty

» Result in operational inefficiencies if parallel systems and processes are required (for example for local subsidiaries of international companies)

» Results in operational risk as existing system support is discontinued

IFRS 17 Implementation

Impact of delayed implementation - Proportionality

» Regulatory authorities should provide clear guidance on which entities are subject to IFRS 17, taking proportionality into account

Consider

» Size and Complexity of insurers

» The impact of disclosures on decisions of stakeholders, including investors, policyholders, and regulators

» The risk profiles of entities (systemic risk)

» Regulatory requirements including requirements for advanced information

Roadmaps

Approach

- » Complimenting existing reporting for financial statements where feasible
- » Consider international reporting developments
  - » Regional adoption
  - » Global sustainability reporting frameworks
- » Develop and adopt a sustainability framework that:
  - » Leverages existing efforts in Cambodia
  - » Applies a methodology that is complaint and consistent with international developments, but
  - » Is relevant to Cambodian needs and resources

Objectives

- Acknowledge
  - The benefits of mandating sustainability reporting,
  - The impracticability of implementing the requirements in Cambodia without first developing and building local capacity.
- A tiered, phased implementation balances ambition with market readiness
  - Extended, transparent and robust road map paces implementation
  - Considering the compliance burden, while
  - Providing time for capacity building, but
  - Uses milestones to ensure progress over time

Objectives

Using the time from delayed implementation

» Build up practical capability and capacity

» Develop short- and longer-term study courses

» Embed compliance review policies and practices in relevant domestic regulatory functions

» Require utilities (such as electricity, gas and water) develop and publish standard tables of emission data

» Develop and implement emissions disclosures on invoices

» Develop a public database of ‘standard emissions’ data

Principles of the roadmap

- » Phases: clear and defined transition stages that allow entities to integrate sustainability reporting progressively over time in a robust, planned way
- » Materiality and proportionality: prioritize the disclosures that matters most
- » Baseline Metrics: begin with indicators that are reasonably available, well understood and meaningful
- » Progressive Disclosures: increase required disclosures over time to allow for the development of reporting capabilities and meaningful metrics at a manageable pace
- » Data availability and Sharing: flexible data aggregation, data generation and data sharing streamline reporting process

Principles of the roadmap *continued*

- Templates and Guidelines: simplify the reporting process and improve data consistency
- Capacity Building Support: maximize the use of internal resources
- Collaboration and Peer Learning: encourage entities to pool expertise, share solutions, and collectively contribute
- Regulatory Flexibility: ensure that sustainability reporting remains feasible, relevant, and impactful, while still driving transparency and accountability across diverse entities and sectors
- Feedback: apply constant learning including a pilot study to refine and improve the process in real time

Key performance indicators

General findings

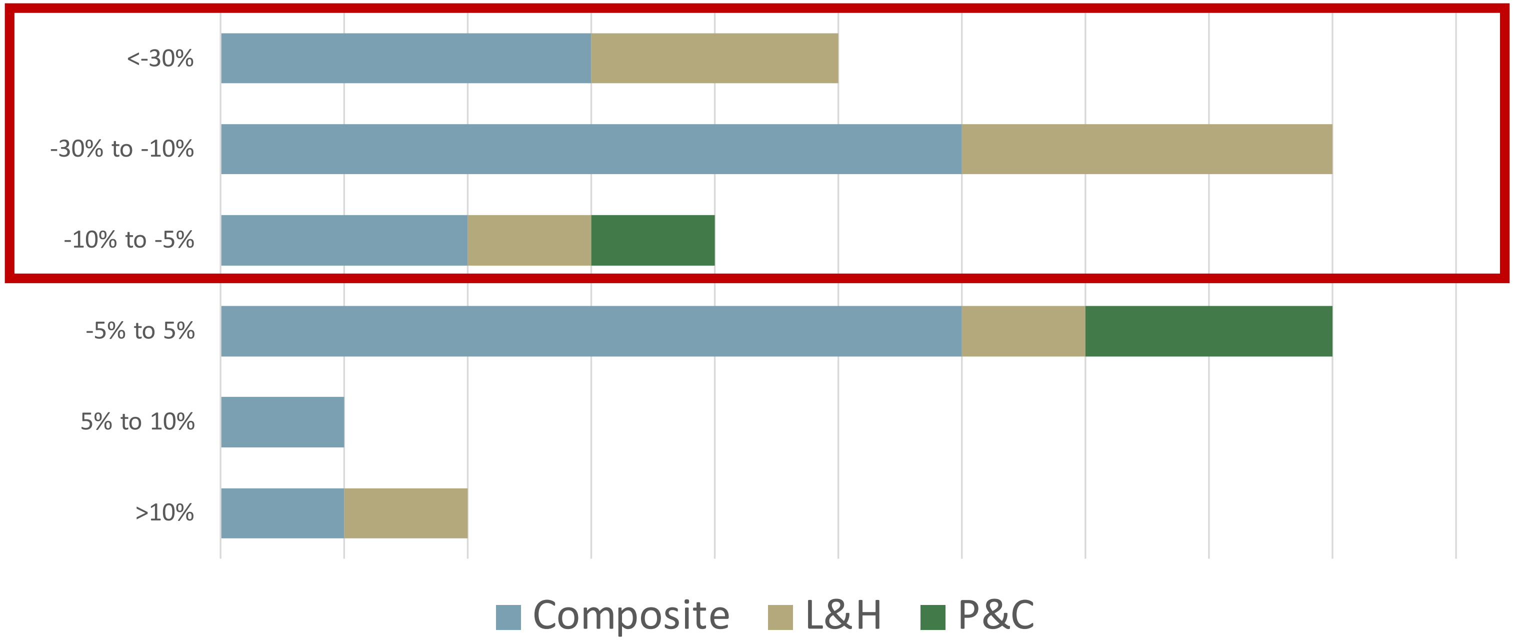
- There is still a lot of development occurring
  - Even insurers that have experimented with a lot of new metrics have been hesitant to set targets
  - Some secondary changes observed, particularly in response to changes in the market
- New KPIs far more prevalent in life business, and there tend to be based around CSM
- Most insurers have developed prior (sometimes multiple) comparatives
- Most insurers have retained some or all prior KPIs

Transition
Change in Opening equity

- This is the primary focus of transitional disclosures
- Of considerable interest to investors because of:
  - Differences in previous accounting under IFRS 4
  - A key barometer of whether pervious accounting was aggressive, conservative of balanced
  - Some indication of future profitability (and repeat profitability)
- Many entities provided this information early.

Transition
Change in Opening equity

» Indicative numbers from a sample of 30



Key Challenges

Relevance

Jurisdictions applying IFRS 17 on effective date	Jurisdictions that have postponed IFRS 17
• Understanding of process and challenges that have occurred • Understanding why differences exist • Understanding of why disclosures and presentation will still evolve • Rationale for continued support	• Rationale for continued support • Insight into where assistance can be provided • Rationale to keep driving progress • Understanding of risks of later adoption

Jurisdictions applying IFRS 17 on a staggered basis

Challenges
Data

- IFRS 17 requires insurers to collect, manage, and analyse data, including
  - Historical and current contractual terms and application of those terms
  - Expectations for future cash flows, and
  - Risks, assumptions and drivers of possible changes

Key challenges

- Ensuring data accuracy, consistency, and completeness
- Retrieving and integrating from various systems and formats
- Accessing data stored in non-digital formats or that require significant manual effort to retrieve

Challenges
Systems

» IFRS 17 necessitates robust IT systems capable of processing and handling large volumes of data efficiently

Key challenges

» Implementation of new systems or upgrading of existing ones is typically costly and time-consuming

» Understanding and testing the information produced by new systems

» Using the opportunity to implement comprehensive data management strategies and systems that resolve for more than just IFRS 17

Challenges
Interpretative uncertainty

» IFRS 17 is a significant new standard, and addresses a topic previously accounted for inconsistently

» Many jurisdictions have unique products

» IFRS 17 is to some extent principle based, and to some extent rules based

Key challenges

» Significant interpretations are required to implement the standard

» Differences in existing products, accounting and regulation mean that many interpretations are unique to countries or regions

» Regional or multi- disciplinary collaboration is not always well established

Challenges
Insurance contract classification

» Insurance contracts have evolved independently with unique features

» IFRS 17 requires classification of contracts based on these unique features

Key Challenges

» Determining the unit of account (separating or combining contracts)

» Determining the boundaries of contracts

» Assessing implied terms arising from law, regulation and past practice

» Analysing and understanding the economic and accounting impact of contracts

Insurance contract classification

Combination of contracts

IFRS 17 sets explicit requirements:

» A set of contracts with same or related counterparty may achieve, or be designed to achieve, an overall commercial effect

» To report substance, may be necessary to treat the set as a single contract

» For example, if rights or obligations in one contract entirely negate rights or obligations in another contract entered into at the same time with the same counterparty, the combined effect is that no rights or obligations exist.

IFRS 17.9

Insurance contract classification
Separation of contracts

General rule of separation

Not **explicit** in IFRS 17, discussed at **TRG**:

» Lowest unit of account is the contract (includes all components)

» Contract with legal form of single contract generally considered a single contract

» Separation could be appropriate if legal form does not reflect substance of contractual rights and obligations

» Assessment of all facts and circumstances, not policy choice

» Reinsurance contract held: fact that underlying contracts are included in different groups is not sufficient to conclude that accounting as a single contract does not reflect its substance

TRG February 2018, Paper 1

Insurance contract classification

Separation of contracts

Specific rules of separation

- A contract may contain components that could/should be accounted for under another IFRS. Insurer should separate:
  - embedded derivatives applying IFRS 9 guidance
  - Investment components if the component is distinct
  - Non insurance goods and services if distinct
- After separation as above, insurer must apply IFRS 17 to all remaining components

IFRS 17.11 to 13, 17.B31 to B35

Insurance contract classification
Contract boundaries

- Cash flows are in the boundary if they
  - arise from substantive rights and obligations which
  - allow the insurer to compel the policyholder to pay premiums **or**
  - substantially oblige entity to provide insurance services

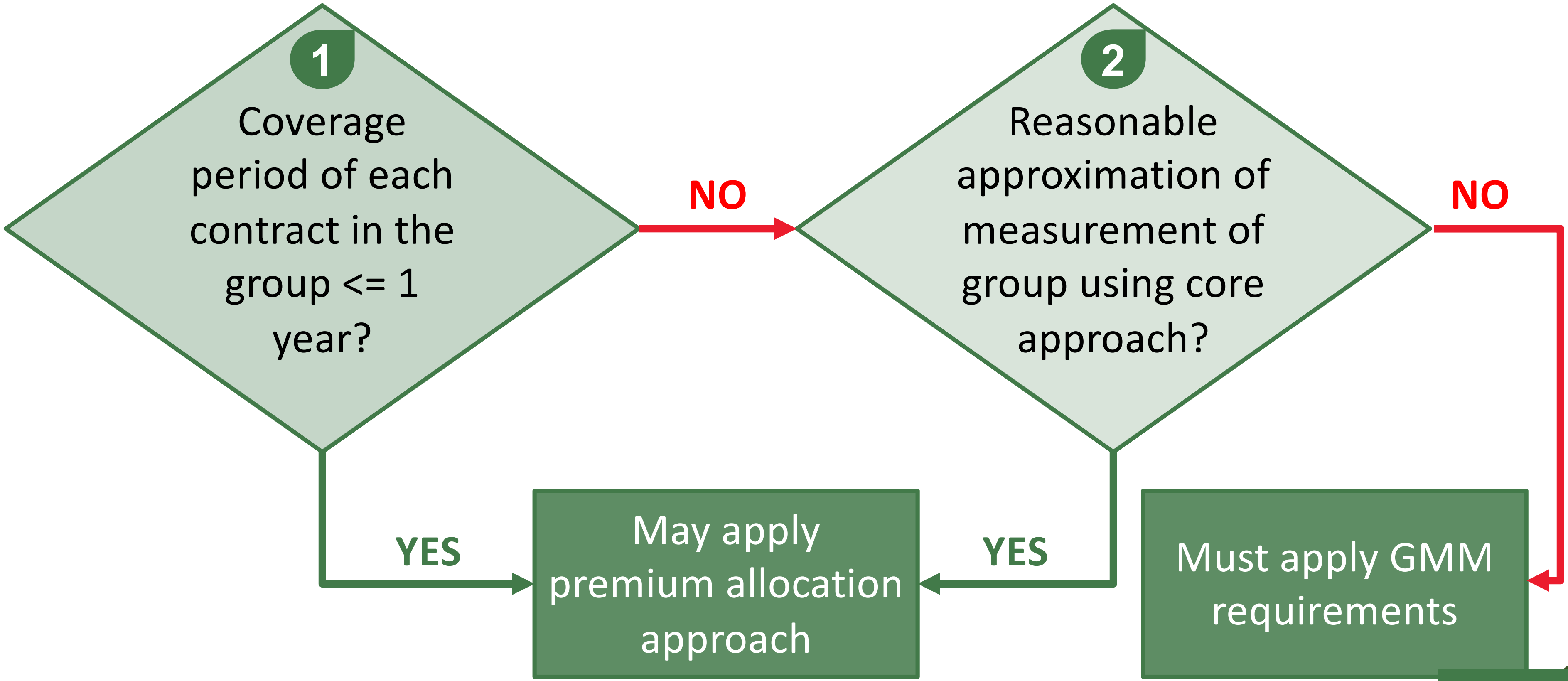
Insurance contract classification
Contract boundaries

A substantive obligation ends when:

- the insurer has the practical ability to reassess risks of a policyholder and can set/reset price or benefits to fully reflects those risks; **or**
- both of the following:
  - the insurer has the practical ability to reassess risks of the **portfolio** and can set/reset price or benefits to fully reflects those risks; and
  - the pricing of the premiums up to reassessment date does not consider risks for periods after that date

Insurance contract classification

Simplified approach



Variable fee approach
Criteria

Criteria for insurance contracts with direct participation features:

a) Contractual terms **specify** that the policyholder participates in a share of a clearly identified pool of underlying items;

b) The entity expects to pay to the policyholder an amount equal to a substantial share of the fair value returns on the underlying items; and

c) The entity expects a substantial proportion of any changes in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items

Reinsurance issued and held is not permitted to apply this approach

Challenges
Assumptions and estimates

» IFRS 17 requires a wide range of assumptions and estimates, including the assessment of future cash flows, risk factors, and contract boundaries.

Key challenges

» Estimating future cash flows is inherently uncertain, requiring assumptions about policyholder behaviour, lapse rates, claims, and other variables

» Risk factors such as the impact of a pandemic or changes in mortality rates need to be considered

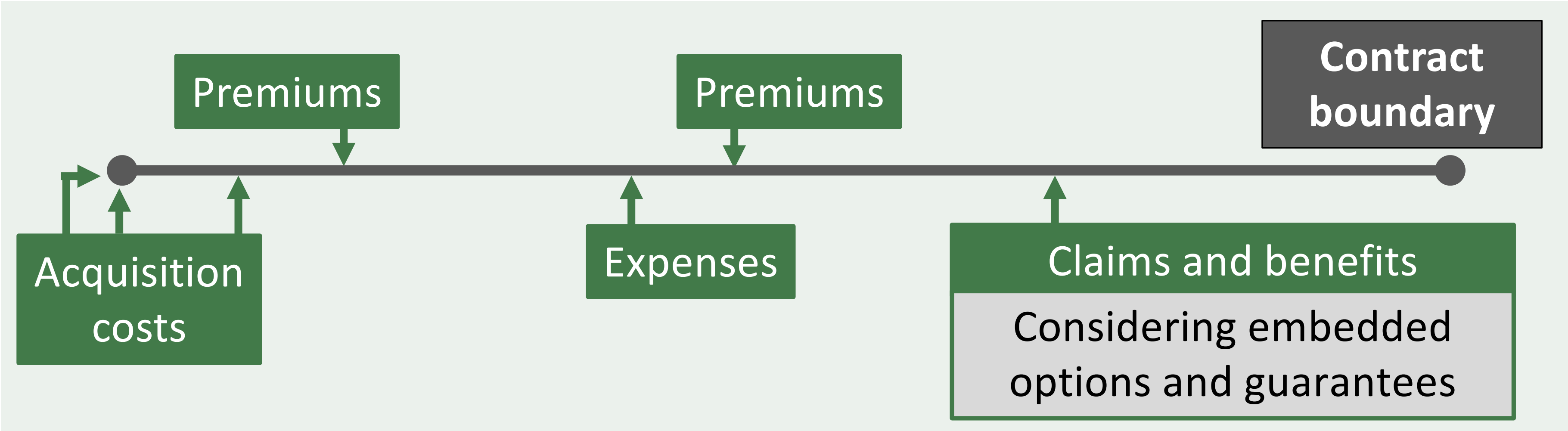
» Changes in competitive landscape, cultural and social norms and general well-being can impact lapses and claims

Assumptions and estimates
Current environment

- In general data is built off past-experience
- Assumptions and estimates supplement past-experience to build future expected cash flows
  - However, past-experience as a predictor must always be challenged
  - Increasingly in the case considering:
    - Pandemic experience
    - Climate related changes
    - Other global uncertainties
- Obliges care and challenge for forecasts at inception and subsequently

Assumptions and estimates
Present value of future cash flows

- **Current estimate** of future cash flows in contract boundary



- Probability weighted and unbiased
- Stochastic modelling for financial options and guarantees, where relevant

Challenges
Discount rates and risk margins

» IFRS 17 requires the discounting of future cash flows and determination of an explicit insurance risk margins

Key challenges

» Contracts expose insurers to varying degrees of risk, and accurately quantifying these risks is a new process for some insurers

» IFRS 17 requires market consistent discount rates. Where market data is limited, determining these rates can be challenging.

» Some discount rates are 'locked-in' for the life of an insurance group requiring tracking over potentially a long period of time

Discount rates and risk margins
Current environment

- Challenges in the current environment affect
  - Long term interest rate forecasts
  - Increases insurance and financial risks
    - Increase the uncertainty of insurance
    - Increase the uncertainty in financial market drivers
- Current risk assumptions (and pricing) may be inappropriate affecting measurement and onerous contract recognition

Discount rates and risk margins

Discount rates

Reflect time value of money and financial risks

» Characteristics of the cash flows

» Liquidity of the insurance contracts

» To extent that financial risks are included in the cash flows

Consistent with observable market prices (if any)

Timing

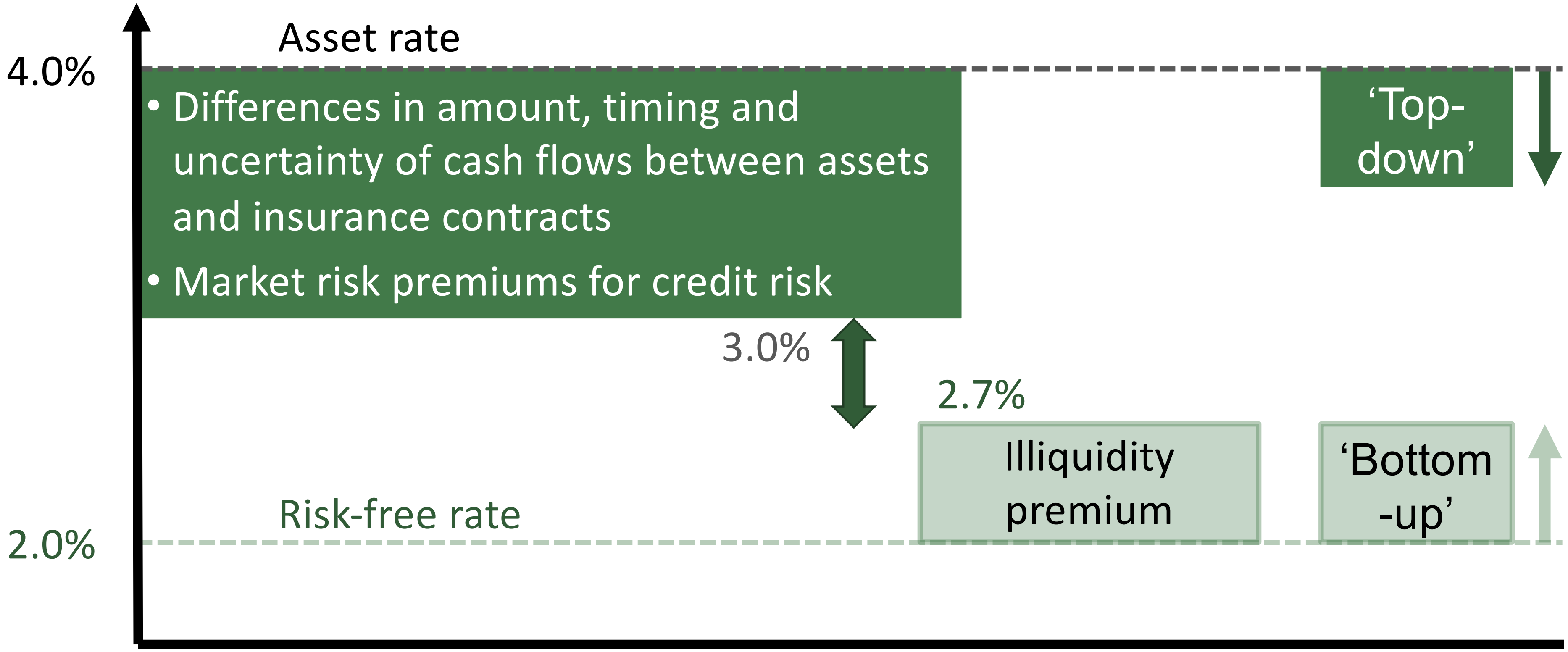
Currency

Liquidity

Exclude the effect of factors in the observable market prices not relevant to insurance contracts eg credit risk

Discount rates and risk margins

Determining the discount rates



Discount rates and risk margins

Risk adjustment

» Explicit, current adjustment for compensation insurer requires for bearing non-financial risk (eg insurance risk)

» Compensation that makes a company indifferent between:

  » fulfilling a liability that has a range of possible outcomes; and

  » fulfilling a liability that will generate fixed cash flows

Group A	
Probability	Pay-off
50%	1 000 000
50%	0

Group B	
Probability	Pay-off
100%	500 000

Probability weighted average (0.5 x 1m)+(0.5 x 0) = CU0.5m 1 x 0.5m = CU0.5m

Challenges
Communication with stakeholders

» IFRS 17 significantly changes insurance accounting and disclosures

» It may be challenging for users of financial statements to fully grasp the implications – misunderstandings may negatively impact value

Key challenges

» Communication of a complex topic in a clear, understandable manner

» Communicating to directors, executives, actuaries, strategists, and marketing teams (among others), on how IFRS 17 affects business strategy

» Communicating to shareholders, regulators, and analysts on how the standard affects perceived financial health and performance

Challenges
Costs of implementation

» Implementing IFRS 17 involves financial and operational costs that must be carefully managed

» Costs includes investment in IT systems, hiring or training staff, engaging external consultants or advisors and other expenses associated with change management

Key Challenges

» Appropriately resourcing the change when there are competing priorities

» Extracting maximum and long-term benefits from the change

» Avoiding short-term unsustainable ‘fixes’

Costs of implementation
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

Costs of implementation
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.

Challenges

Change management

» IFRS 17 involves significant organizational and cultural changes that can challenge the status quo within an entity

Key challenges

» Teams must adapt to new ways of thinking and operating.

» Cross-functional collaboration between areas like finance, actuarial, and IT is necessary to implement and sustain IFRS 17 requirements

» Employees require training to understand the standard, its implications, and how to use the necessary tools and systems

» Employees may resist changes due to perceived challenges and disruptions

Challenges

Summary

- Managing and processing extensive data requirements
- Accurately categorizing insurance contracts
- Making precise assumptions and estimates in financial reporting
- Assessing and utilizing risk factors and discount rates
- Effectively conveying changes and engaging various stakeholders
- Managing the financial and operational costs
- Navigating organizational and cultural shifts

Challenges

Planning and collaboration

- Successfully addressing the challenges requires a strategic approach
- Organizations must start planning for IFRS 17 compliance early - delays can lead to rushed implementations and increased costs
- A systematic approach facilitates a clear compliance roadmap
- Collaboration is essential both internally and externally
- Regulatory authorities and industry peers can provide valuable insights and best practices to navigate the challenges effectively
- Continuous learning and adaptation are vital for ongoing compliance

Thank you