Introduction to IFRS-17

Presentation at GI Council

November 27, 2023

Disclaimer

Purpose:

- This document was been prepared for discussion purposes to assist with the understanding of IFRS-17 Standard.
- This document should not be construed to be a draft of the accounting policy or methodology paper, although the content may be leveraged in developing such policies in later phases of the engagement.

Distribution:

- This presentation and the opinions and conclusions contained within are that of the presenters and should not be assumed to be that of the employer.
- Presenters accepts no responsibility, liability or duty of care to any person(s) and should not be considered as a professional advice.

Reliances and limitations:

- Presenters are available to answer any queries related to the content in this document. It should be noted this is intended to be a brief presentation only and intended to be supported by oral content / discussions. Therefore, information contained herein when considered in isolation could be mis-leading.

IFRS - Overview

Common global standard for reporting to investors

What

- Global accounting standard covering insurance contracts with a consistent measurement basis
- General purpose financial reporting to meet needs of investors and creditors
- Not designed to meet requirements of supervisors/regulators

When

- Expected Implementation date for India : 1 Apr 2025
- Phase wise implementation depending on listing status and AUM

Who

- Any entity which issues (re)insurance contracts, holds reinsurance contracts and reports under IFRS
- Some geographies have opted to publish under IFRS alongside national GAAP accounts
- Subsidiaries of such entities will need to report internally under IFRS (via reporting pack or similar simplified mechanism)
- **Included**: Insurance & Reinsurance contracts and Investment contracts with discretionary participation features
- **Excluded**: Contracts covered by other standards (such as IFRS 9 for investment contracts).

IFRS will affect everyone in an insurance company

Investors will have new ways to measure company performance

- Attempt to make insurance easier to **compare to other industries**
- Forces insurance into an odd shape to **maintain consistency with accounting of other "contracts"**
- Share prices, targets, planning and bonuses will be **based on the new standard**

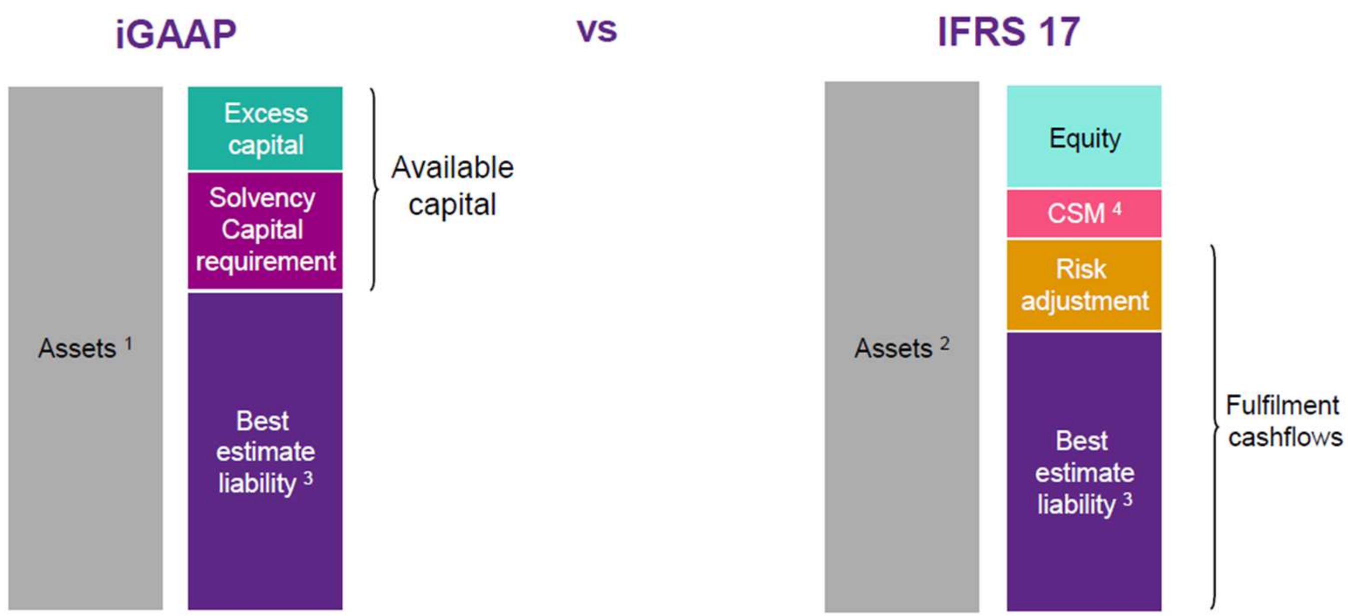
It’s not definitive

Principles based rather than rule based (at least to start with)

- **Audit firms** will have **final say**
- Interpretation of the standard is still **evolving**
- **Reduces ability to compare across companies** as each will take different approaches/ assumptions
- **Best practice is likely to emerge over time**

Balance Sheet – iGAAP v/s IFRS-17

IFRS-17 focuses on measurement of insurance contracts



[1] Fixed interest assets measured at amortised cost / book value; Equities at market value

[2] Assets measured at amortised cost / fair value complying with IFRS-9

[3] Best estimate liabilities might differ between iGAAP and IFRS-17; e.g. discounting, contract boundaries, prudence etc.

[4] Contractual services margin

IFRS-17 – What changes for us?

Insurance contracts How to design tests to test whether contract is within scope of IFRS 17?	**Level of aggregation** Aggregation of contracts into portfolios (cohorts) and disaggregation into groups core to all initial and subsequent measurement	**Onerous contracts** Multiple levels of granularity required for assessment possible: ability and effort required to identify "sets".	**Contract boundaries** How should contract boundaries be defined? Which contracts to combine and elements to separate?	**Measurement models** Which measurement model is appropriate for use – GMM or PAA?
Reinsurance contracts held Explicit treatment of contracts, cash flows and liabilities. Potential mismatch issues?	**Expense treatment** Allocation of expenses between directly attributable and other expenses, expense cashflow	**CSM** Major area of complexity. Calculation, unlocking and amortisation. Where to perform calculations and track movements?	**Discounting** Top down or bottom up? Need to update discount rates for each period. OCI or P&L for unwinding? Parallel use of historical and current rates.	**Interaction with IFRS 9** Potential mismatches? Option to defer adoption. Impact on results with/without OCI option?
Acquisition costs Attributable acquisition costs may be different to current deferrable. Expense or not (PAA only)?	**Risk adjustment** Determined at which level? Set by group? How to recognise diversification benefits? What is the confidence level?	**Presentation** What will the P&L look like? What is the impact of excluding investment components? What is impact on KPIs?	**Disclosures** Onus on the entity to meet the overall requirements. Reconciliation tables more granular than current disclosures	**Transition** Is a retrospective approach practicable? Which data do I need to collect and when? What are the alternatives?

Insurance Contracts

Currently no standard definition of an insurance contract

The definition in IFRS 17 refers to some traditional features of insurance contracts, distinguishing them from financial instruments

> "a contract under which one party (the issuer) accepts **significant insurance risk** from another party (the policyholder) by agreeing to compensate the policyholder if a specified **uncertain future event** (the insured event) **adversely affects the policyholder**"

- **significant insurance risk** – at least one insured scenario leading an insurer to pay significant additional amounts
- Assessment needed contract by contract
- A set or series of contracts with the same or related counterparty which achieve, or are designed to achieve, an overall commercial effect as one contract

Recognition

Under iGAAP - as at December 31, 2023 is the contract recognized?

Recognition – contd..

Under IFRS-17, an entity shall recognise a group of insurance contracts it issues from the ***earliest*** of the following:

(a) the beginning of the ***coverage period*** of the group of contracts;

(b) the date when the first payment from a policyholder in the group becomes due; and

(c) for a group of onerous contracts, when the group becomes onerous.

Contract Boundary

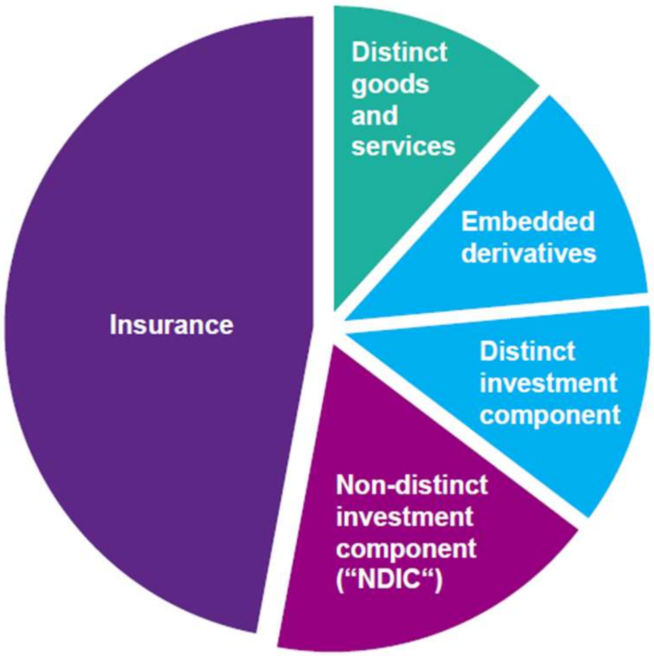
Cashflows are within the boundary of an insurance contract if they arise from **substantive rights and obligations** that exist during the reporting period in which the entity **can compel the policyholder to pay premiums or in which the entity has a substantive obligation to provide policyholder with insurance contract services**.

A substantive obligation to provide services ends when:

- the entity has the **practical ability** to **reassess the risks** of the **particular policyholder** and, as a result, can set a price or level of benefits that fully reflects those risks; or
- **both** of the following criteria are satisfied:
  - the entity has the **practical ability** to reassess the risks of the **portfolio of insurance contracts**that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio; and
  - the **pricing** of the premiums for coverage up to the date when the risks are reassessed does not take into account the **risks that relate to periods after the reassessment date**.

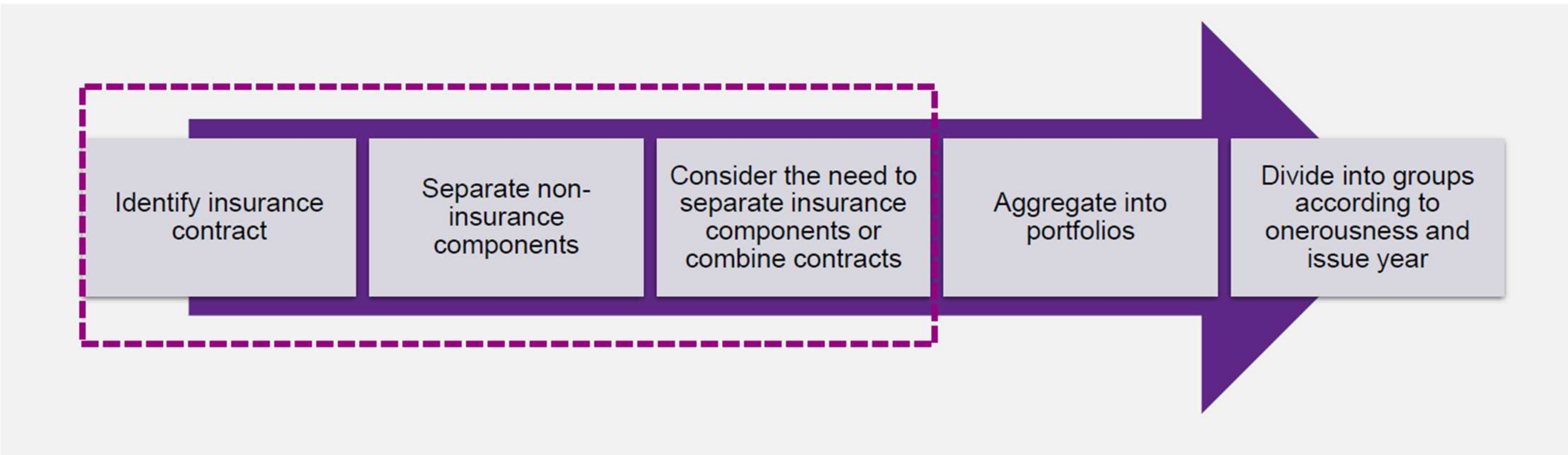
Contract boundary of a contract should be re-assessed at the end of each reporting period.

Components of insurance contracts

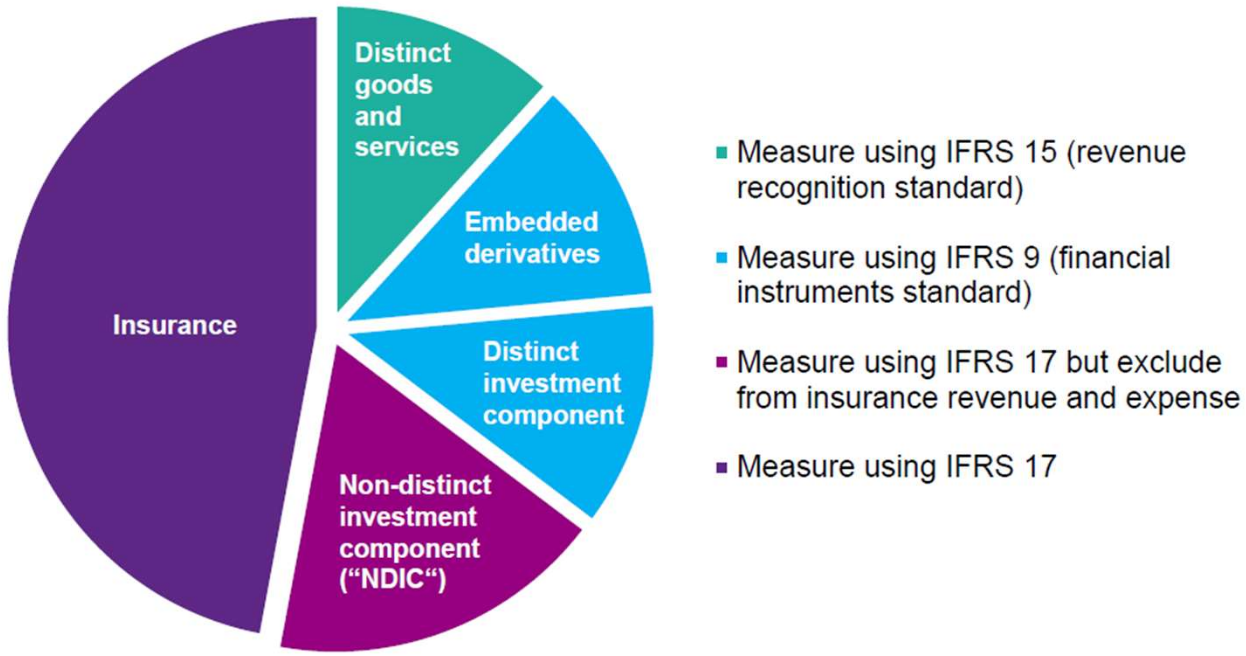


Lets determine an example for each component!!

How to determine a unit of account under IFRS-17 – Step 1



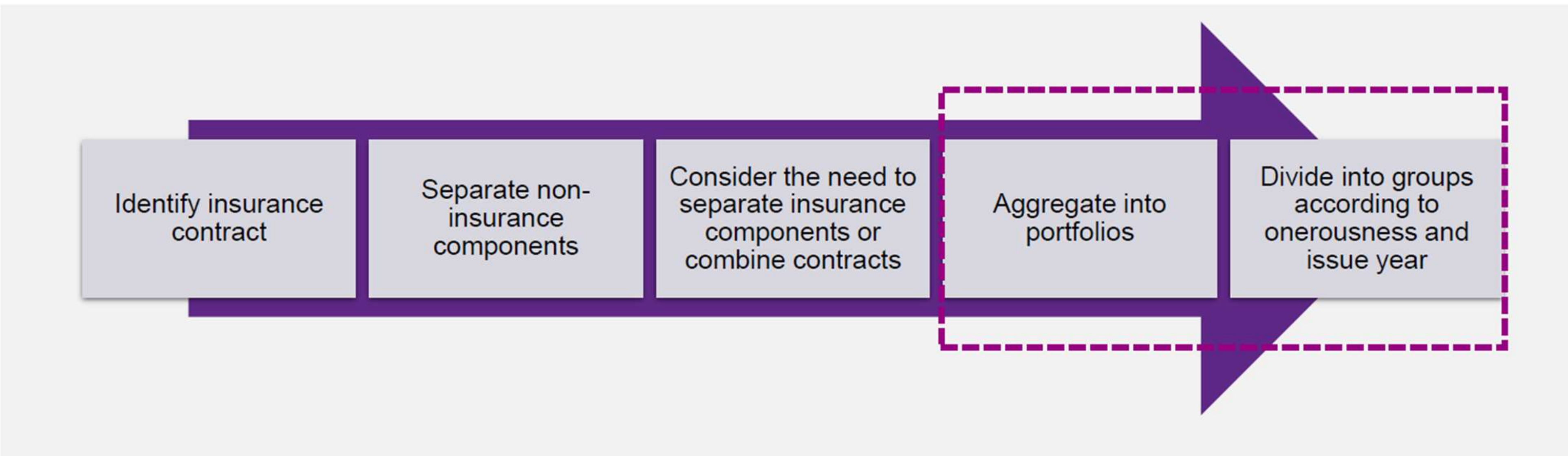
Components of insurance contracts



Mandatory separation if criteria met – no voluntary unbundling

""…an entity shall separate from the host insurance contract any promise to transfer to a policyholder distinct goods or services other than insurance contract services"

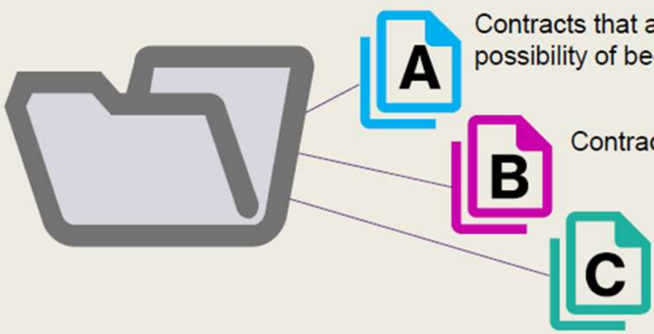
How to determine a unit of account under IFRS-17 – Step 2



Level of Aggregation

1 **Contracts initially to be split into "portfolios", meaning contracts that are subject to similar risks and managed together.**

2 **Each portfolio is then divided into three groups:**



- **A**: Contracts that at initial recognition have no significant possibility of becoming onerous subsequently
- **B**: Contracts that are onerous at initial recognition
- **C**: The remaining contracts in the portfolio

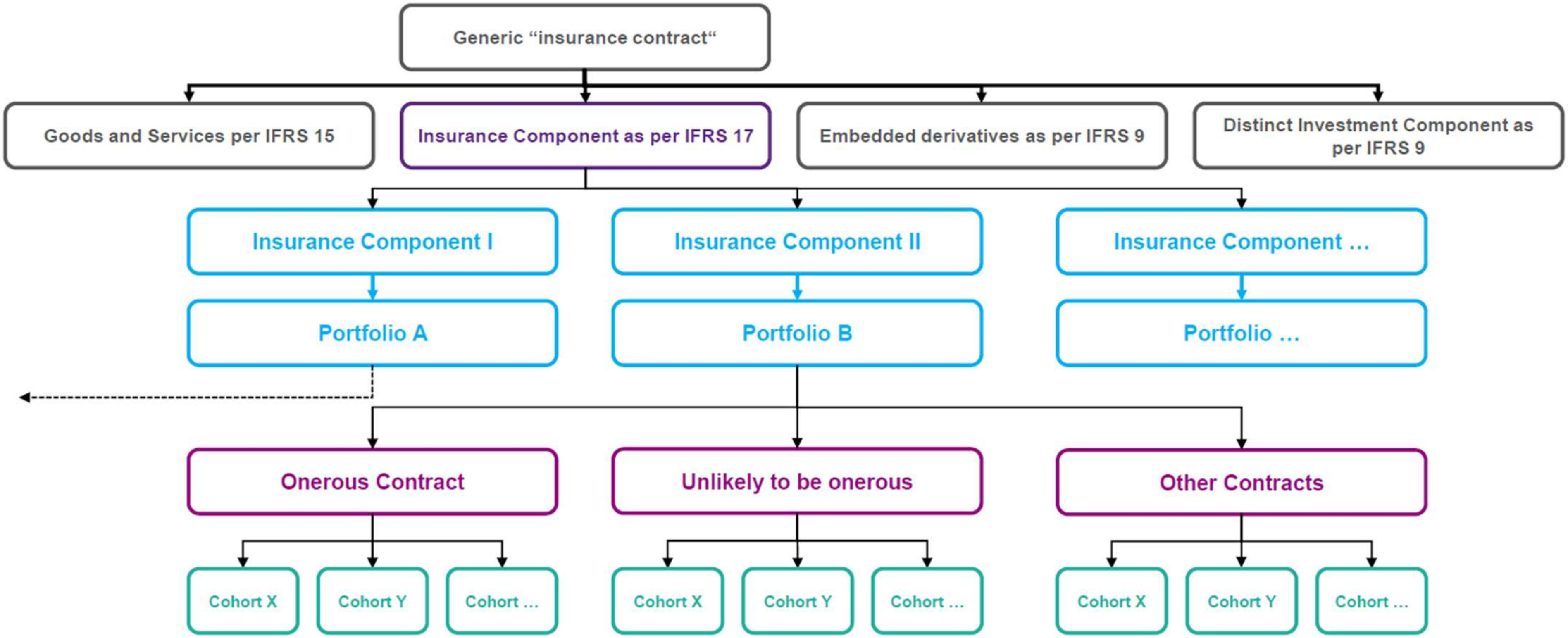
Profits are recognised as the insurance is provided

Losses are recognised immediately (excl. reinsurance)

3 **Contracts in each group need to be sub-divided into annual cohorts**

The choice of the groups materially impacts data requirements, assumptions and level of reporting. It may limit any CSM offsetting and once allocated into groups at t=0, the allocation remains fixed

Insurance Contract Summary – An example



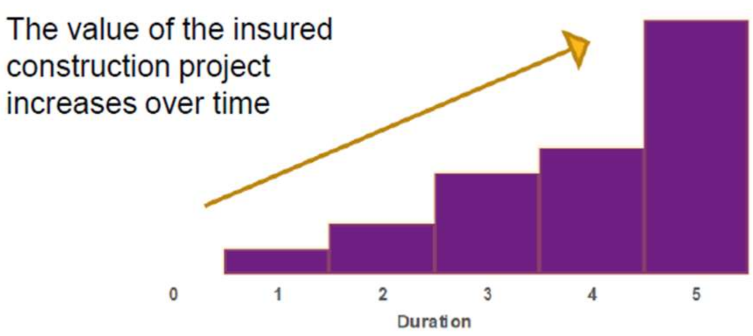
Coverage Units

IFRS 17 B119 (a):

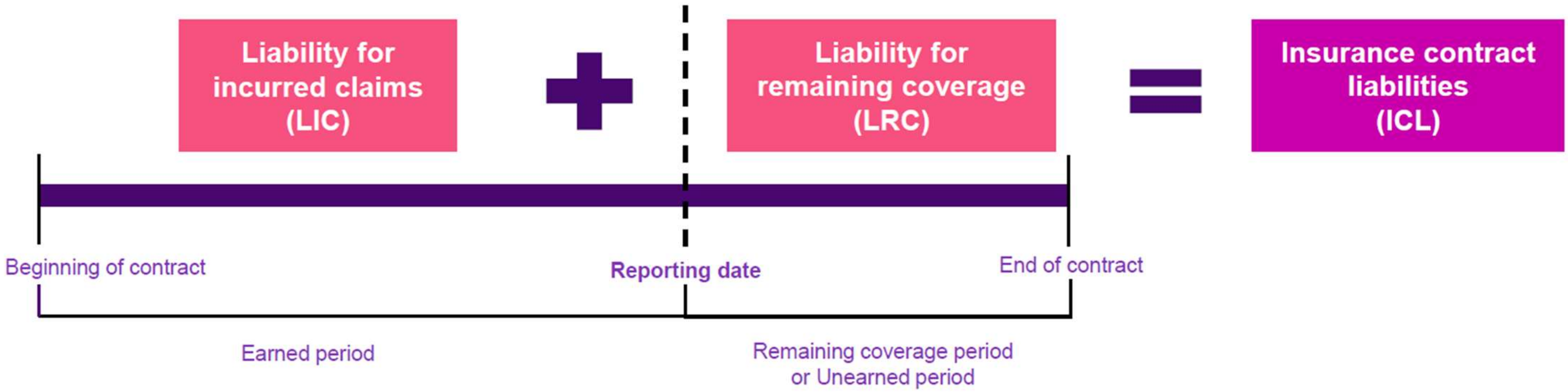
"The number of coverage units in a group is the quantity of coverage provided by the contracts in the group, determined by considering for each contract the quantity of the benefits provided under a contract and its expected coverage duration."

So, what does this mean?

- Coverage units may be even throughout the lifetime of the contract, *unless*
- The size of potential loss changes over time
- TRG discussion AP05 (2 May 18) talks about standing ready to meet valid claims
- A good example of this is with Construction policies:



Liabilities under IFRS-17

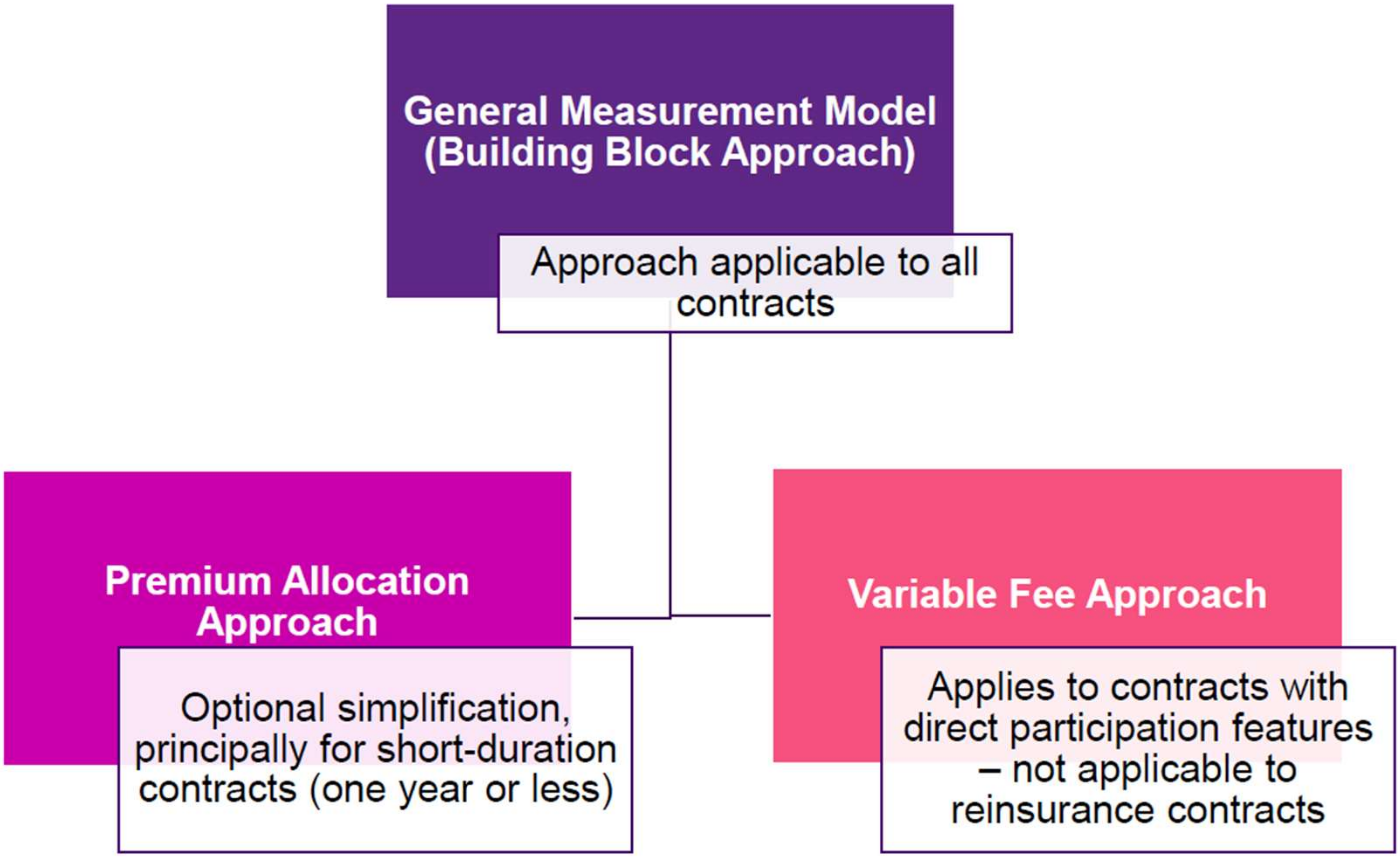


Relates to claims related to events which have already occurred, including IBNR

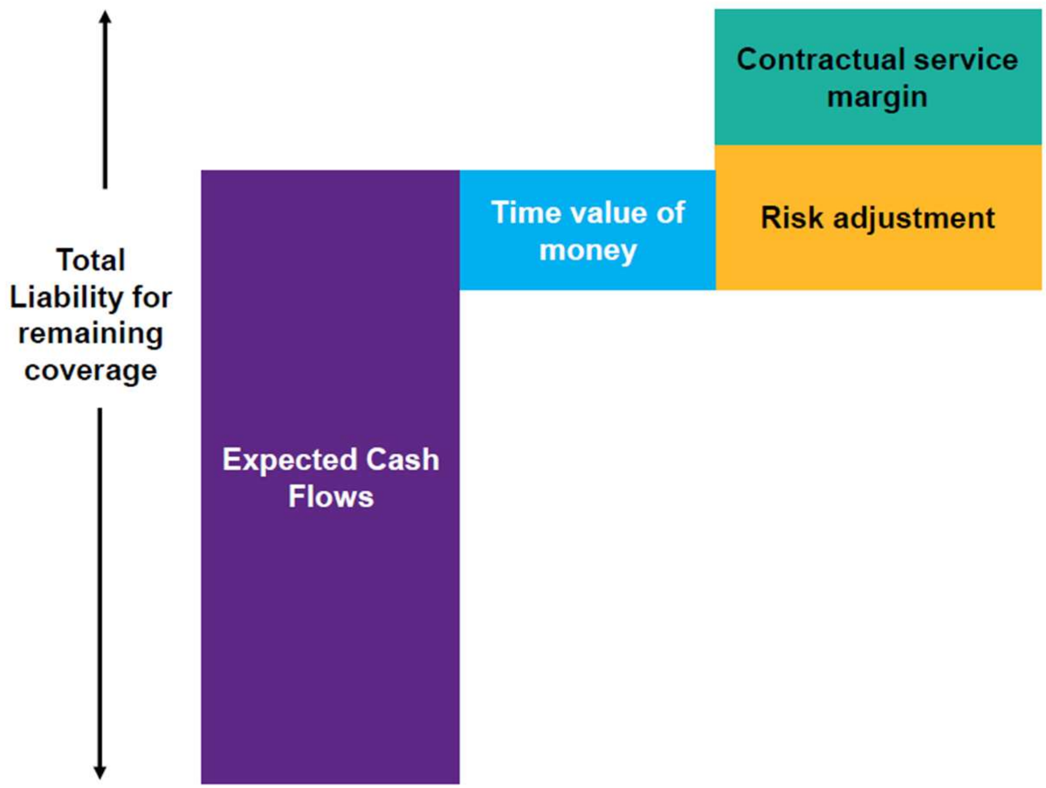
Relates to claims that have not yet occurred

The choice of measurement model is more relevant for LRC.

Measurement models



GMM or BBA – Fulfilment cash flows



Cash Flows

- Explicit
- Unbiased
- Entity perspective
- Within contract boundary

Time value of money

- Reflect characteristics of cash flows
- Consistent with observable market prices
- Exclude factors not relevant to the cash flows
- Top-down and bottom-up approaches may be used

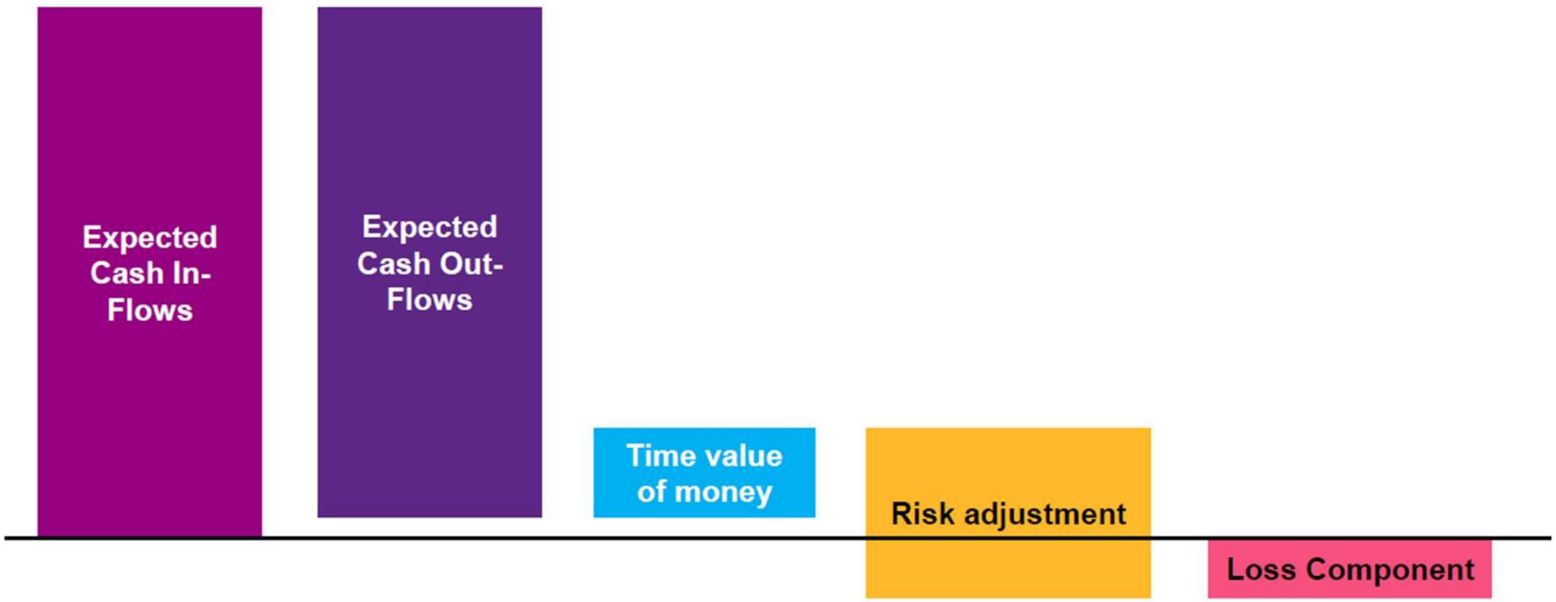
Risk Adjustment

- Compensation the insurer requires for bearing uncertainty
- May reflect diversification within and between portfolios

Contractual Service Margin (CSM)

- Quantifies the unearned profit the insurer expects to earn as it fulfils the contract
- Ensures no gain at initial recognition
- Allocated over **coverage period**

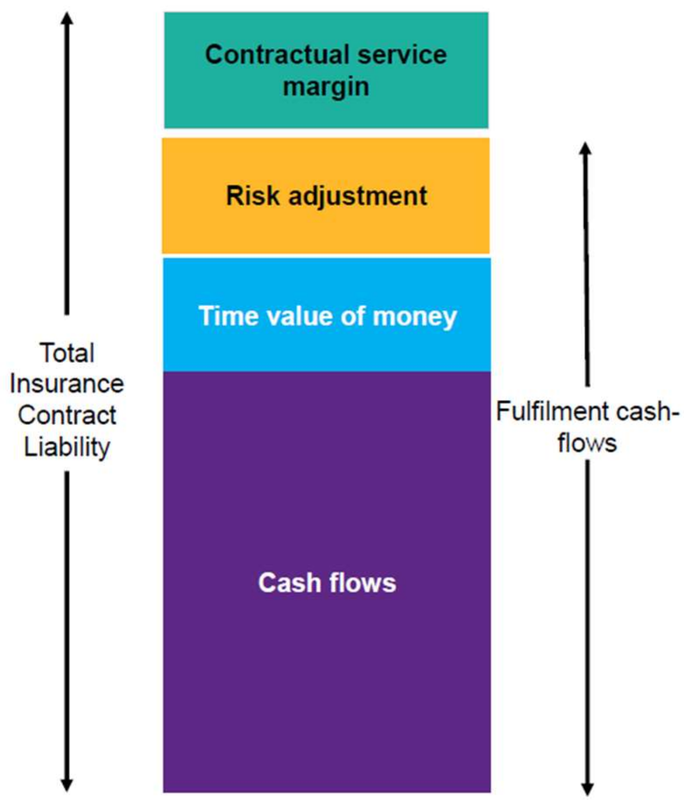
GMM - Loss Component



Loss Components are **recognised as a loss straightaway** in the Financial Statements.

A group of contracts **can move** from a position where a loss component is required and vice versa

GMM – Initial Recognition



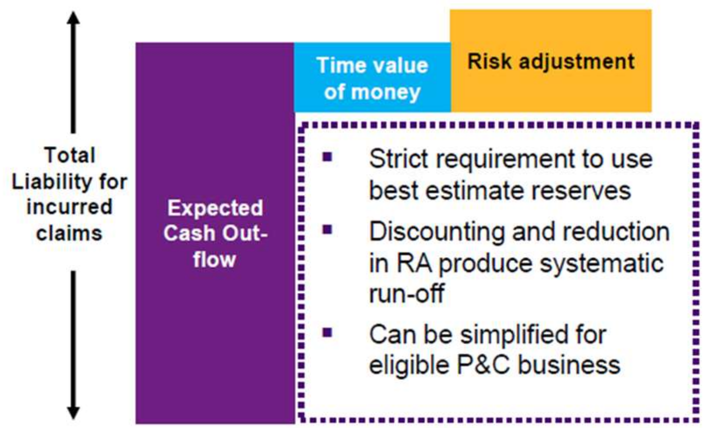
Cash Flows	Included	Excluded
▪ Unbiased ▪ Entity perspective ▪ Current ▪ Explicit ▪ Within contract boundary	▪ Premiums ▪ Claims inc recoveries ▪ Payments that vary depending on returns on underlying items ▪ Attributable acquisition cash flows ▪ Claims handling costs ▪ Policy admin and maintenance costs ▪ Premium taxes and levies ▪ Allocation of overheads*	▪ Investment returns ▪ Recoveries under reinsurance contracts held ▪ Future insurance contracts (e.g., not within contract boundary) ▪ Costs not directly attributable to portfolio (e.g., product development training) ▪ Wastage

Fulfilment cash flows: measured on a current basis

GMM – At each subsequent reporting period

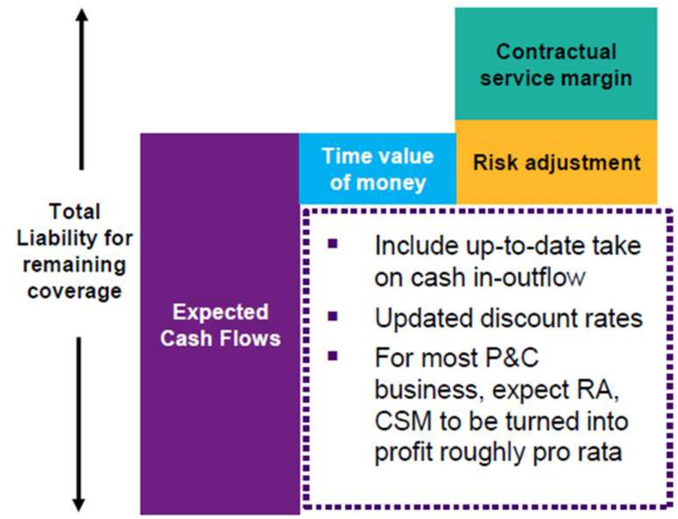
Incurred claims

- For earned exposure, no more CSM is left
- For incurred claims, discounted best estimate reserves plus risk adjustment

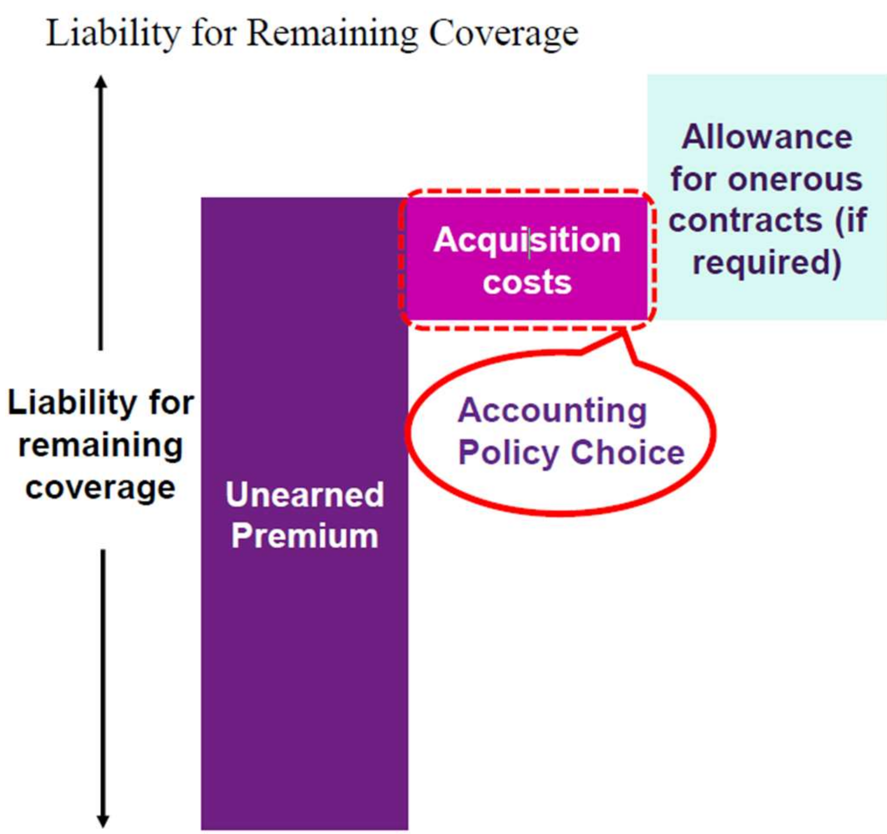


Remaining coverage

- Similar to initial measurement – fulfilment cash flow and (unearned portion of) CSM
- All relevant assumptions updated
- Apply appropriate earnings pattern to CSM and risk adjustment



Premium Allocation Approach



Optional simplified approach to calculate Liability for Remaining Coverage

Permitted, but not required, if either –

- The coverage period is one year or less and hence intended primarily for **short-duration contracts**
- It is a **reasonable approximation to the General Measurement Model** (materiality assessment)

PAA Eligibility

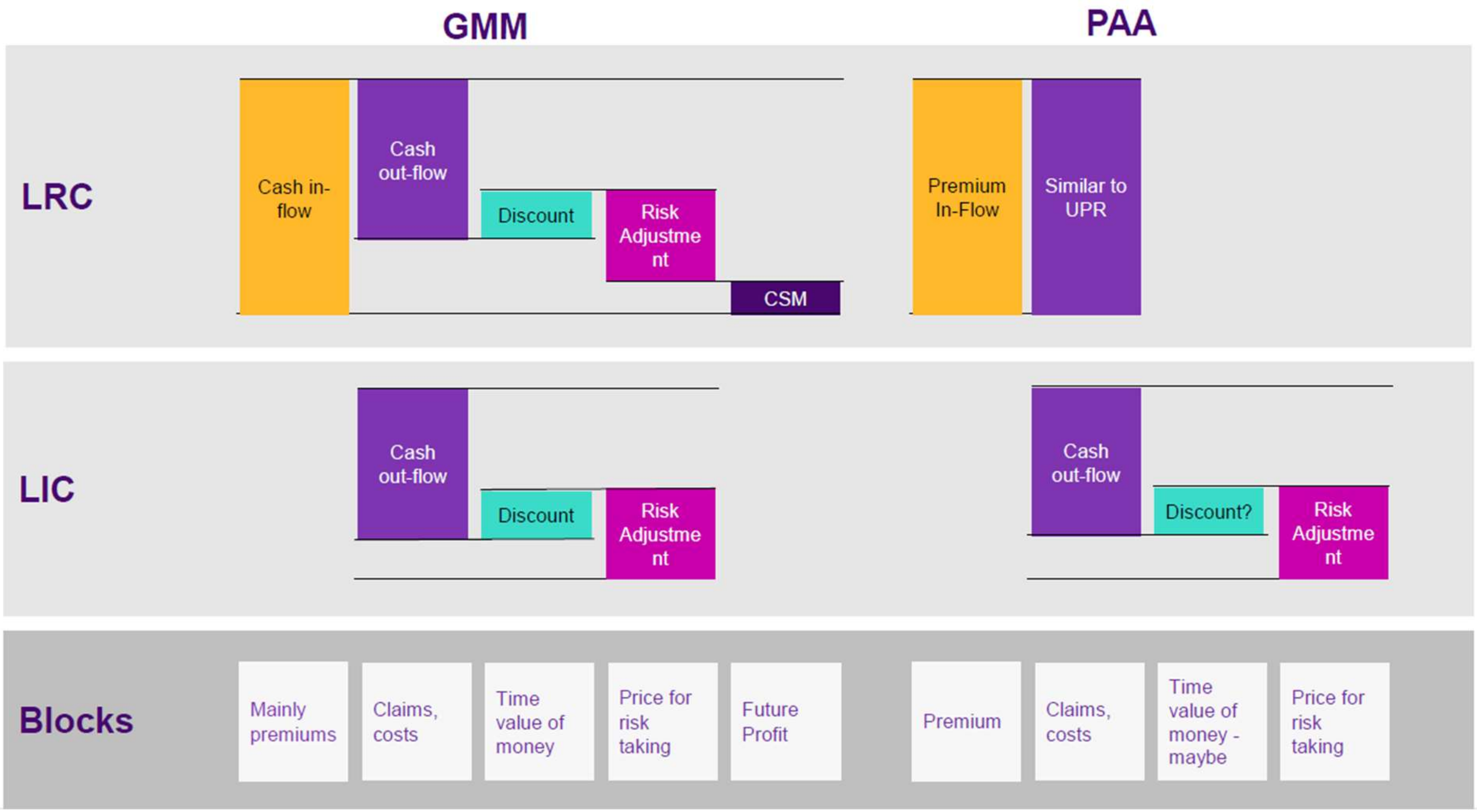
Requirements of the standard

- Under IFRS 17, the premium allocation approach (PAA) can be applied if:
  - it is a reasonable approximation of the General Measurement Model (GMM); or
  - the coverage period of each contract in the group is one year or less.
- The entity **cannot apply PAA** (for a group with policy durations > 1 year) **if it reasonably expects that there will be significant variability in the fulfillment cash-flows** that would affect the measurement of the liability for remaining coverage.

Practical considerations

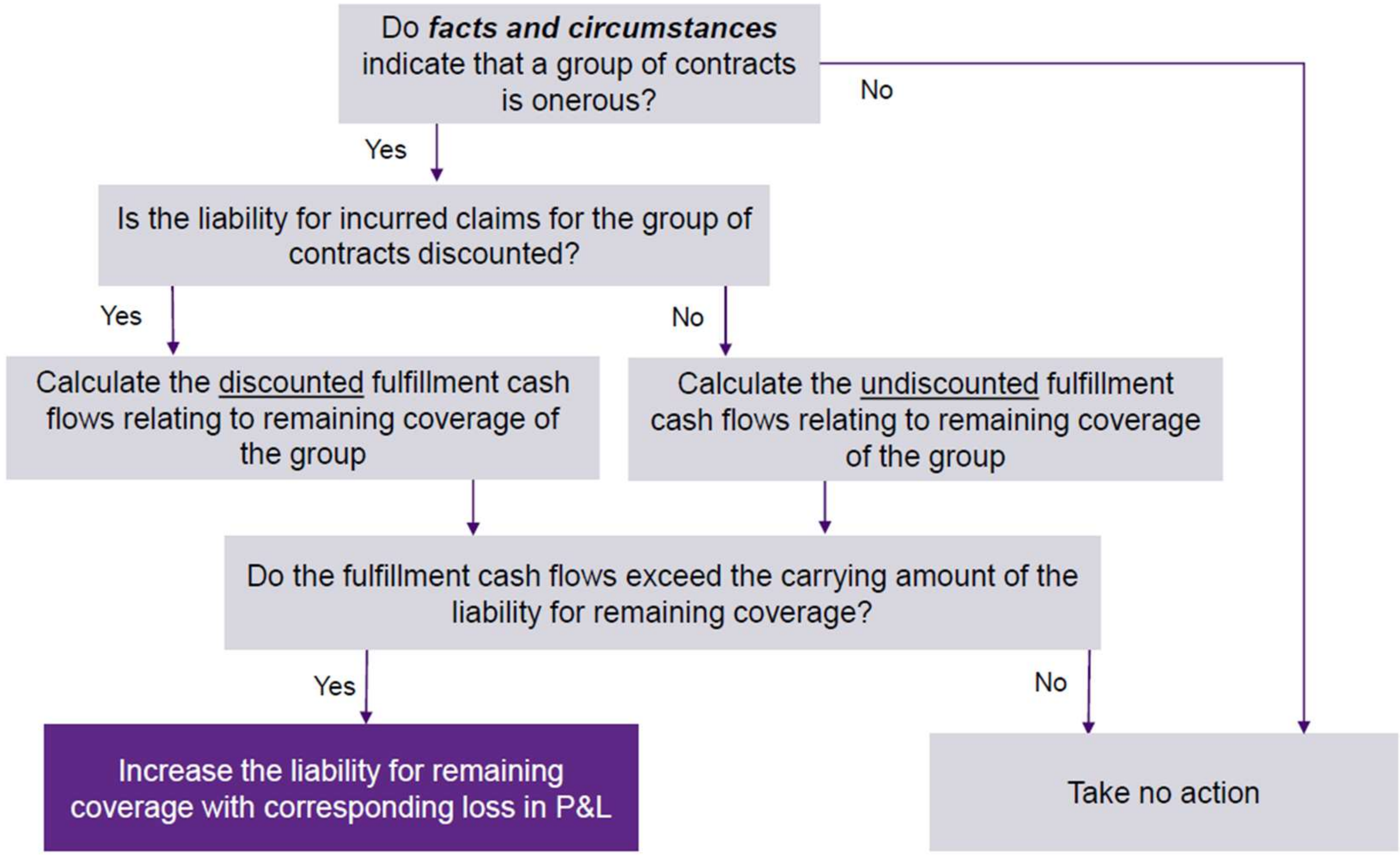
- If the coverage period of the contract is higher than 1 year, then PAA eligibility criteria is subject to significant judgment.
- In many cases, we expect that **initial calculation by both PAA and GMM would be necessary** to assess the approximation of PAA to GMM **on representative portfolio**, including testing certain scenarios.
- Consequently, **materiality threshold will need to be set**.
- The profit signature under both models may need to be assessed until the extinguishment of the coverage period.
- Once measurement type is determined for a particular portfolio, it should be kept for the entire duration of such portfolio.

GMM v/s PAA



GMM
PAA
LRC
Cash in-flow
Cash out-flow
Discount
Risk Adjustment
CSM
Premium In-Flow
Similar to UPR
LIC
Cash out-flow
Discount
Risk Adjustment
Cash out-flow
Discount?
Risk Adjustment
Blocks
Mainly premiums
Claims, costs
Time value of money
Price for risk taking
Future Profit
Premium
Claims, costs
Time value of money - maybe
Price for risk taking

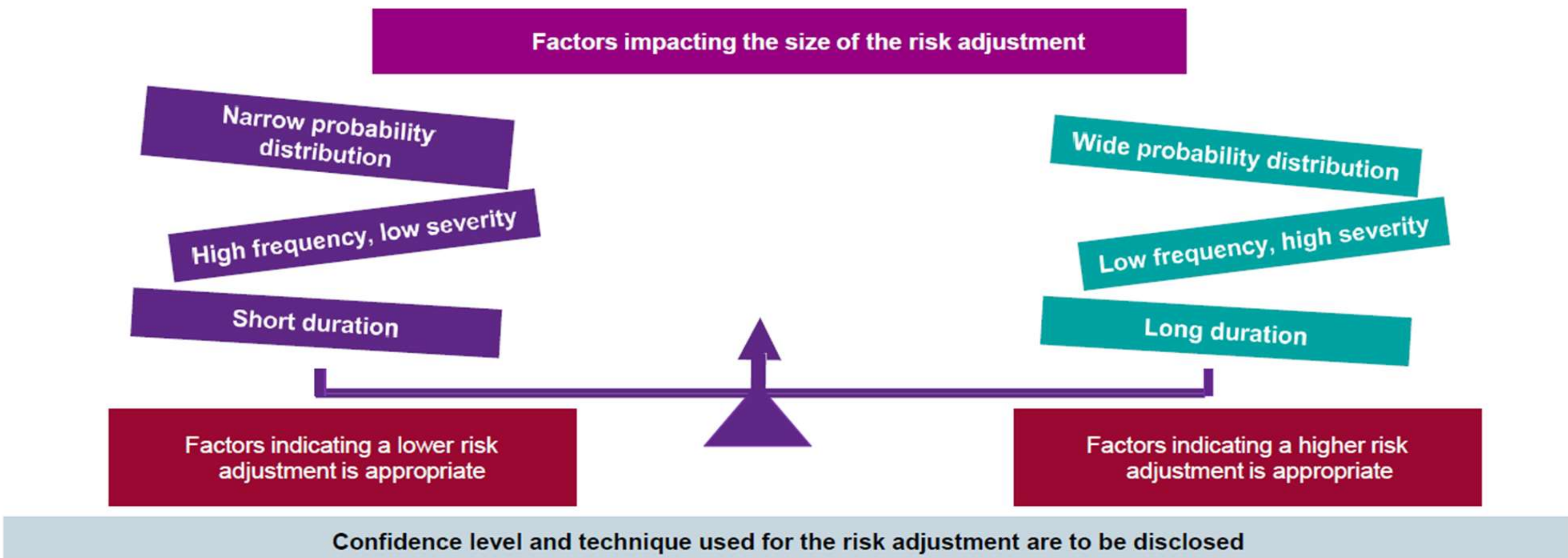
Onerous Contracts – PAA Measurement model



Risk Adjustment

Compensation that an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk such that two entities are indifferent between:

- range of possible outcomes arising from non-financial risk; and
- fixed cash flows with the same expected present value
- Allow for diversification benefits



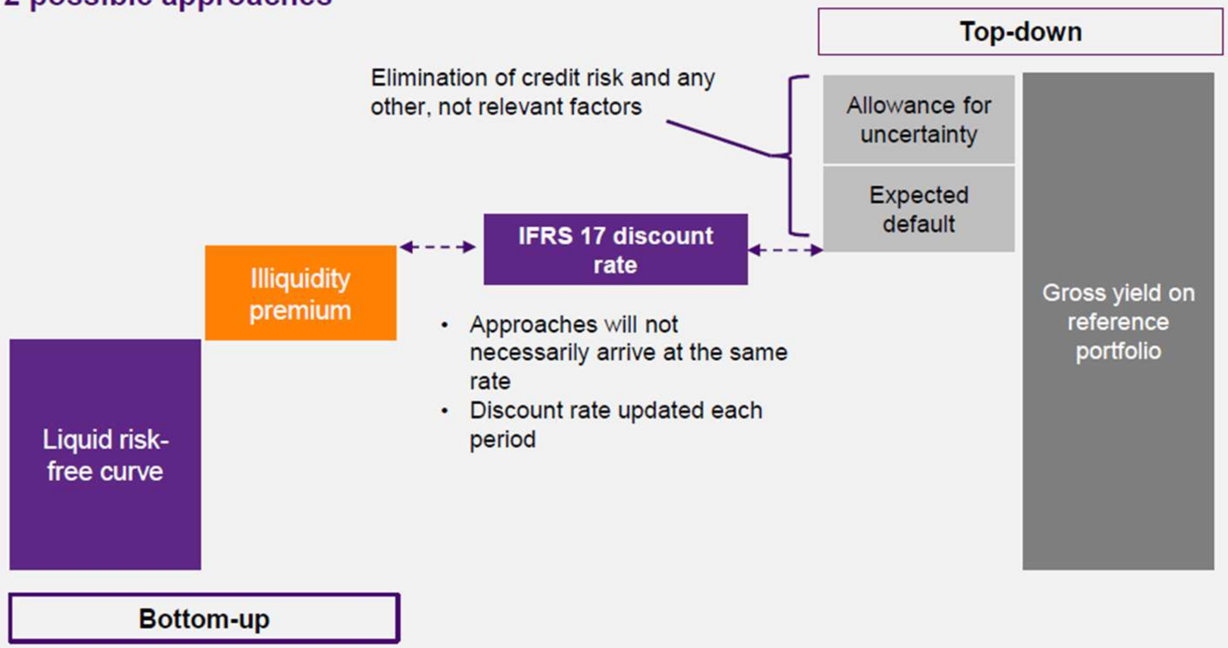
Discount Rate

Estimates of future cash flows are adjusted to reflect the time value of money and the financial risks related to those cash flows, to the extent that the financial risks are not included in the estimates of cash flows

4 main requirements

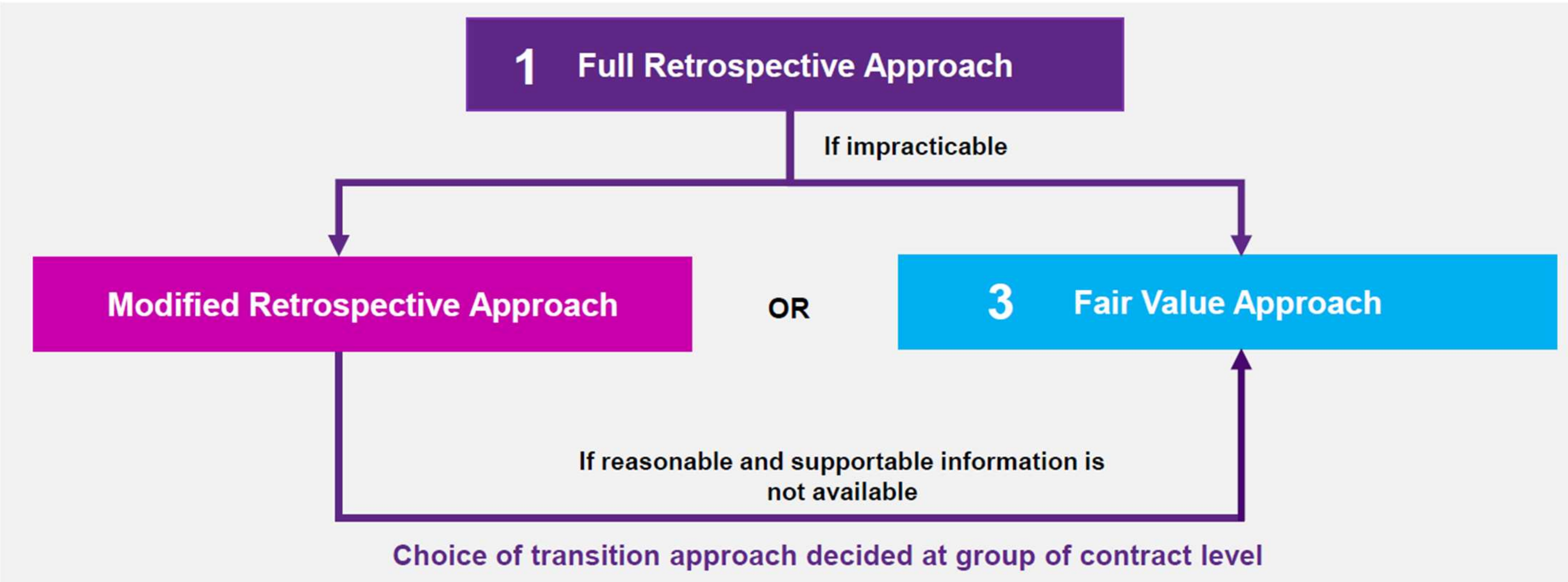
1. Reflect time value of money, characteristics of the cash flow (timing, amount)
2. Reflect the liquidity characteristics of the underlying insurance contract
3. Be consistent with observable current market prices
4. Exclude effects of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts

2 possible approaches



The different approaches will result in DIFFERENT discount rates / curves

Transition approaches



The objective of the **modified retrospective approach** is to achieve a transition amount that is as close to the retrospective application as possible using reasonable and supportable information available without undue cost or effort.

This is critical for ensuring a practical implementation (data, calculation and disclosures) but also impacts the financials. Fair value approach may be more attractive for closed book consolidators

Disclosures

- Liability for remaining coverage, showing loss components separately
- Liability for incurred claims (PAA: BE and RA separately)
- Criteria for use of PAA
- Accounting policy choices
- Confidence level for risk adjustment
- Claims development triangles (10 years)
- Yield curve used to discount FCFs
- Disaggregation of finance income (if applicable)
- Analysis of insurance revenue (GMM only)
- Components of FCFs – PV, risk adjustment and CSM (GMM only)
- Timing of recognition of remaining CSM (GMM only)
- Impact of new business on P&L by General Measurement Model (GMM only)

Thank you!!