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IFRS 17
Svenska Aktuarieföreningen
Start Early. Start Small. Keep it Simple.

Thomas Ringsted, 20 September 2017

Audit & Assurance

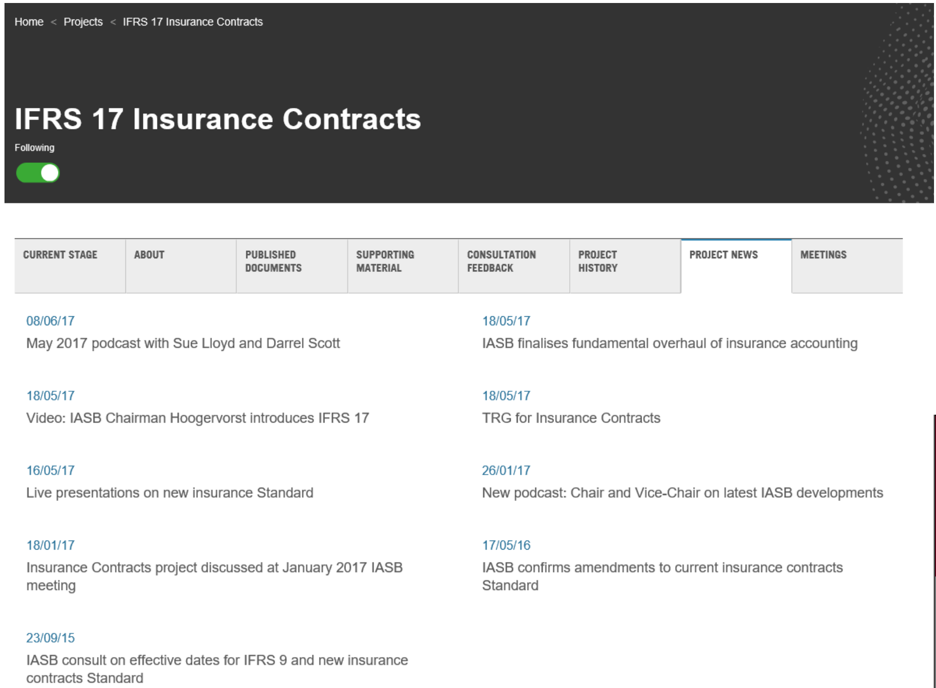
Agenda

Topic
Introduction to the IFRS 17 Standard
IFRS 17 topics and comparison with SII
The general model – building block approach (BBA)
Exercise
Modifications to BBA - Premium allocation approach (PAA)
Modifications to BBA - Variable Fee Approach (VFA)
Interaction between IFRS 17 and IFRS 9
Business impact
Q&A

Hans Hoogervorst, IASB Chairman about IFRS 17

IFRS 17

Available from IASB



IFRS 17 time line

Phase I | **Phase II** | **Implementation** | **In force**

1997
IASC starts project on insurance contracts

2004
IFRS 4 Insurance Contracts
'Phase I' Interim standard issued

2007
Discussion paper
Preliminary views on Insurance Contracts

2010
Exposure Draft
Insurance Contracts

2013
Exposure Draft
Insurance Contracts

2016
IFRS 4 Insurance Contracts amendment
Applying IFRS 9 with IFRS 4 Insurance Contracts

2017
IFRS 17
Publication
May

2017-2020
Preparation for the new standard

2021
IFRS 17
Becomes effective

IFRS 17

Terms defined in the standard

IFRS 17 Term	Abbreviation	Swedish
Building Block Approach	BBA	Byggstensmetoden
Contractual Service Margin	CSM	Vinstmarginal
Risk Adjustment	RA	Riskmarginal
Fulfilment Cash Flows	FCF	N/A
Contract Boundary		Kontraktsgränser
Premium Allocation Approach	PAA	Den förenklade metoden
Insurance Contracts Revenue		Försäkringsintäkter
Liability for Remaining Coverage	LRC	Avsättning för återstående täckning
Liability for Incurred Claims	LIC	Avsättning för inträffade skador

IFRS 17

Terms used in connection with the standard but not defined in it

IFRS 17 Term	Abbreviation	Swedish
Best Estimate Liability	BEL	Avsättning enligt bästa skattning
General Method		Den generella metoden
Variable Fee Approach	VFA	Rörliga avgiftsmetoden
Statement of Comprehensive Income	SCI	Summa totalresultat
Profit and Loss	P&L	Resultat
Other Comprehensive Income	OCI	Övrigt totalresultat
Fair Value through Profit & Loss	FVPL	Verkligt värde över resultaträkningen
Fair Value through Other Comprehensive Income	FVOCI	Verkligt värde över Övrigt totalresultat

IFRS 17 topics

IFRS 17 Topics

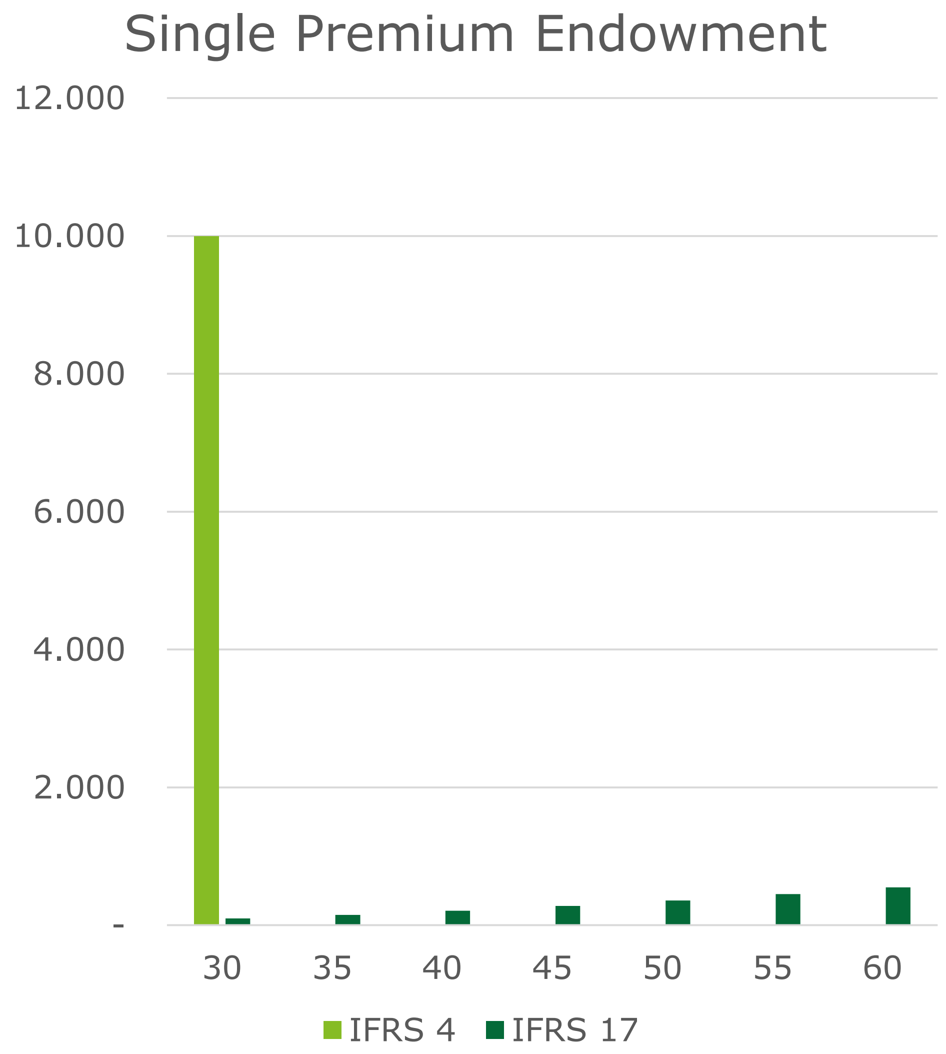
Overview

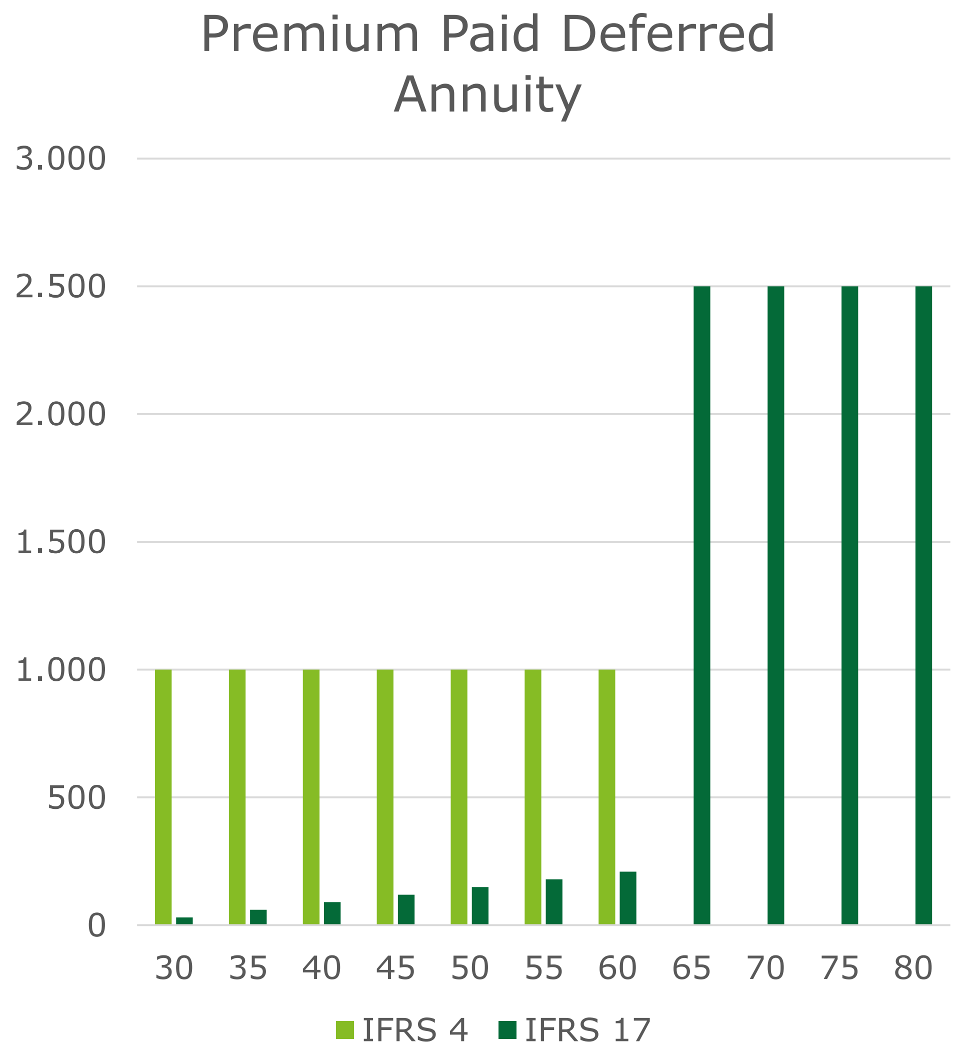
Close to solvency II

Different from solvency II

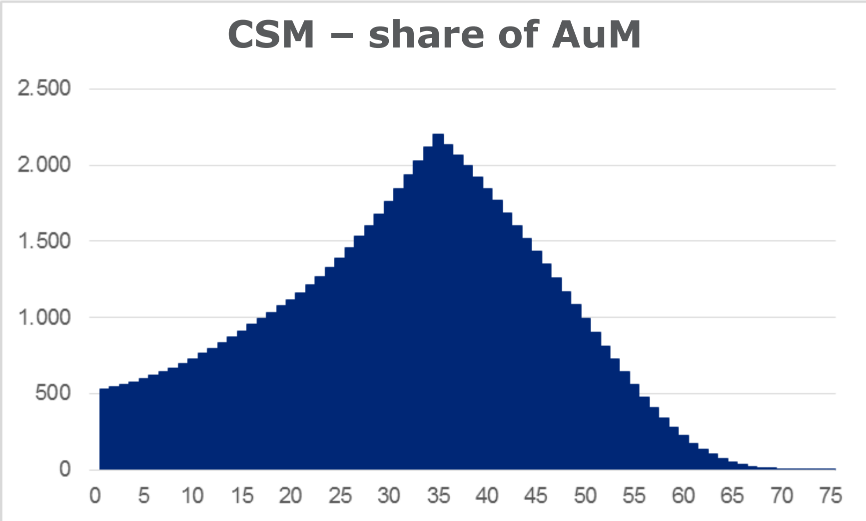
Specific for IFRS 17

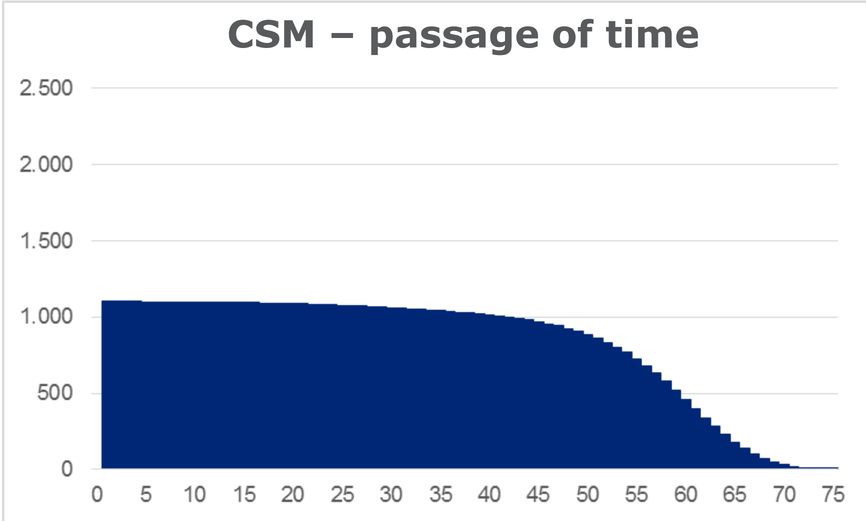
Revenue examples





Release of CSM example





The general model – building block approach (BBA)

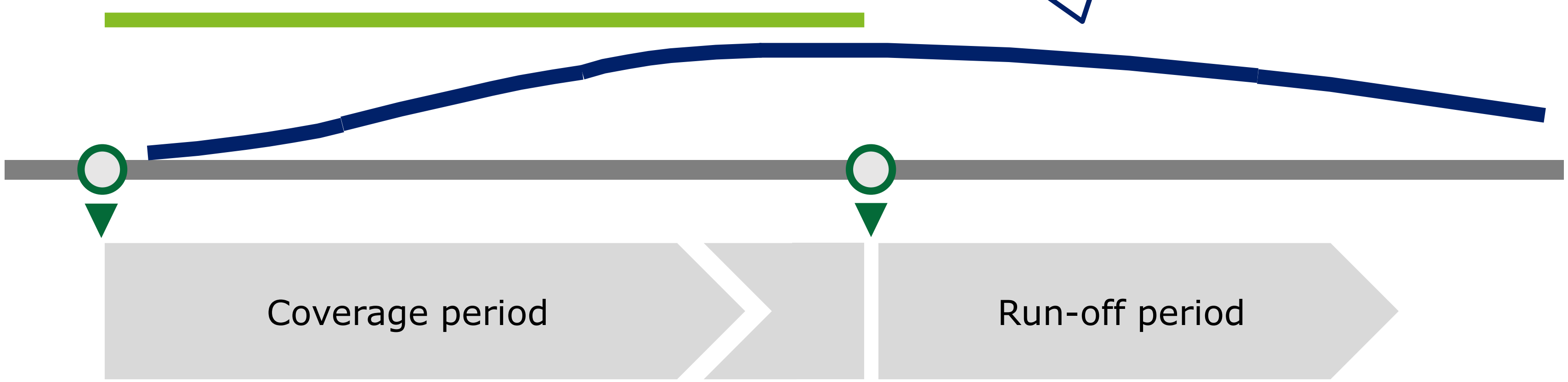
Insurance liabilities

Characteristics of payments for an insurance contract

Premiums are paid in advance as either a single premium or in more instalments.

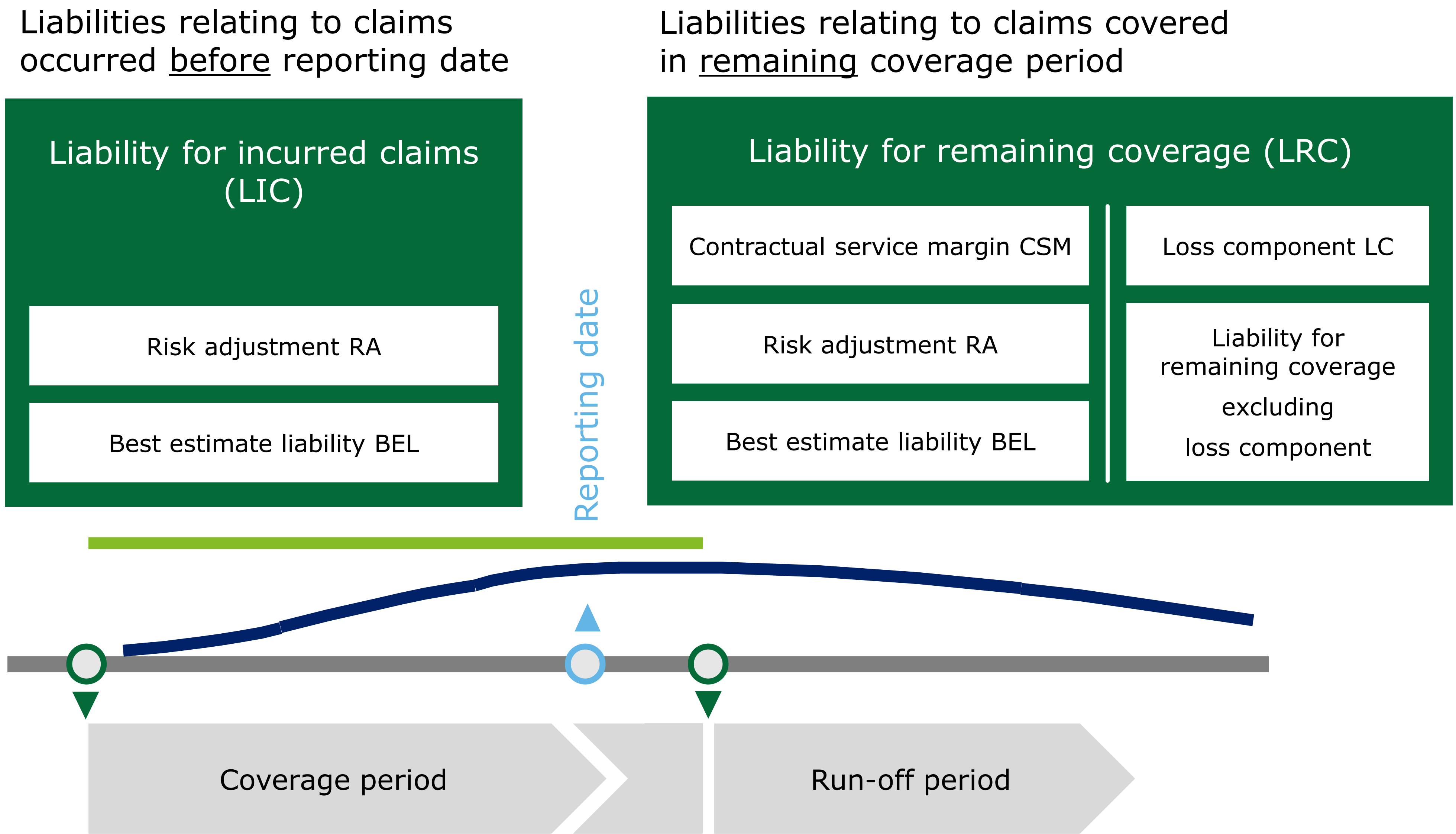
The revenue is earned over the coverage period.

Claims and benefits can be paid during the coverage period or in the run-off period after the end of the coverage period.



Insurance liabilities

Decomposition in LRC and LIC for all contracts (both life and non-life)



Insurance liabilities

Measurement

Measurement

- Liabilities are in general measured using the Building Block Approach (BBA)
- Variations of the BBA applies in some cases:
    - Premium Allocation Approach (PAA): Simplification to Liability for remaining coverage (LRC) for short term contracts
    - Variable Fee Approach (VFA): Variation of subsequent measurement of Contractual Service Margin (CSM)
    - Reinsurance held

Unit of account

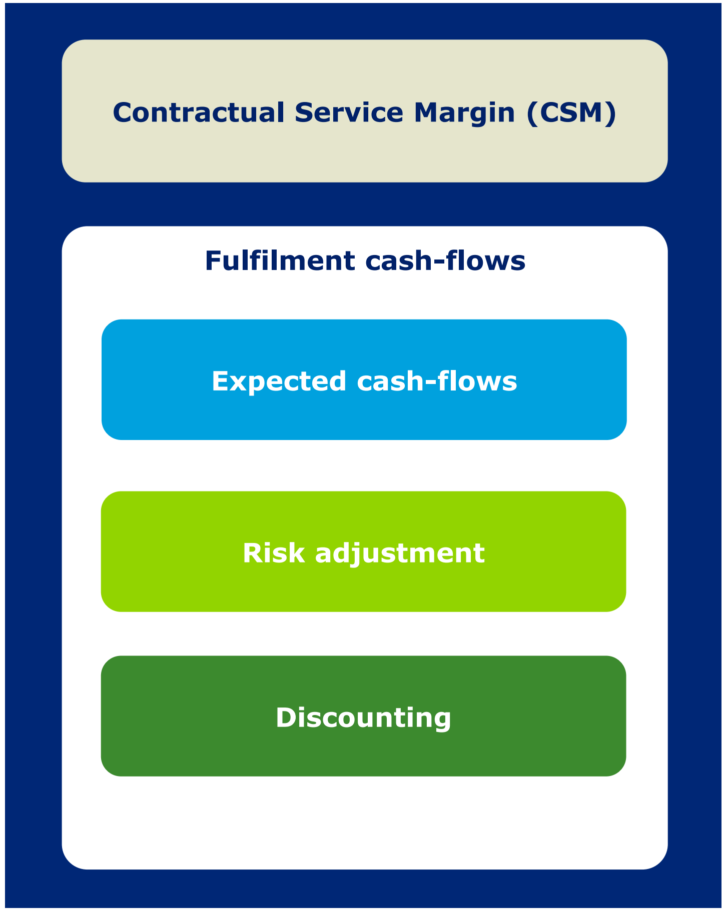
- All contracts are split into *portfolios*, which are further divided into *groups*
- The liabilities must be measured for each *group*
- In some cases, the calculations may be performed at higher level and allocated to each group

General model

A current balance sheet

The value of a **group** of insurance contracts consists of **the risk-adjusted present value of future cash flows** (fulfilment cash flows) and an **amount representing the unearned profit in the group** (Contractual Service Margin).

The fulfilment cash flows include a risk adjustment for non-financial risk, which reflects the uncertainty in the future cash flows.



General model

Liability for Remaining Coverage

Calculation of Contract Service Margin

$$\text{CSM} = -\left(\text{Expected Cash-flows} + \text{Risk Margin}\right)$$

$$0 = \text{Expected Cash-flows} + \text{Risk Margin} + \text{CSM}$$

$$0 = \text{PV Claims \& Expenses} - \text{PV Premium} + \text{Risk Margin} + \text{CSM}$$

$$\underbrace{\text{PV Premium}}_{\text{PV of Revenue Collected}} = \underbrace{\text{PV Claims \& Expenses} + \text{Risk Margin} + \text{CSM}}_{\text{PV of Revenue Recognized}}$$

Note: for simplicity, acquisition costs are ignored in this example.

Acquisition costs and the implicit DAC would be included in the revenue measure in a systematic way determined by the company (no P&L effect).

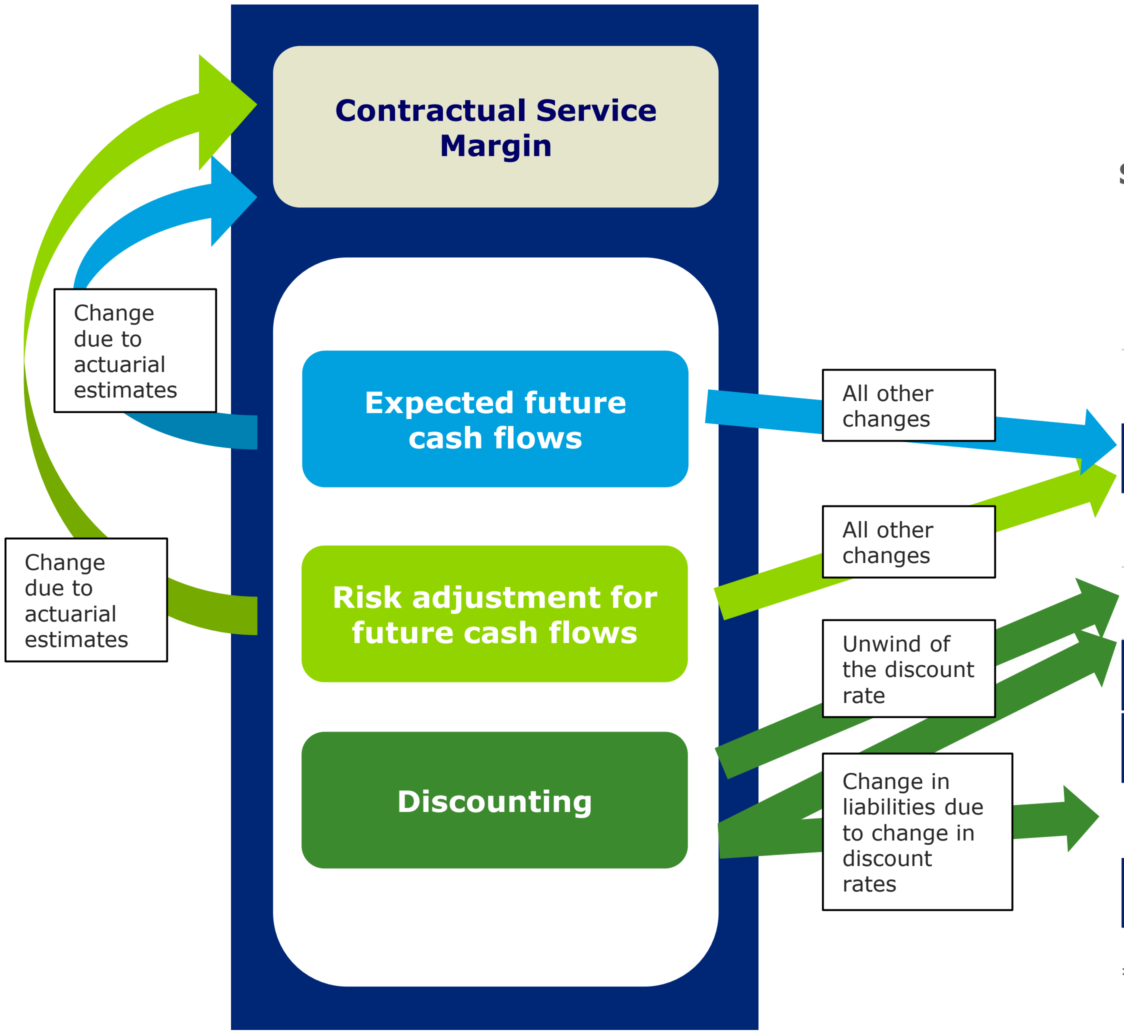
Recognition of Revenue in Profit and Loss

$$\underbrace{\text{Revenue}}_{\text{Revenue recognized in period}} = \underbrace{\text{Claims \& Expenses}}_{\text{Value of expected coverage and services provided in period*}} + \underbrace{\Delta\ \text{Risk Margin}}_{\text{Release of risk margin in period}} + \underbrace{\Delta\ \text{CSM}}_{\text{Profit recognized in period}}$$

* Excluding investment component

General model

A P&L at amortised cost



Statement of Comprehensive Income

	20XX
Insurance contracts revenue*	x
Incurred claims and expenses*	(x)
Insurance Service Result	x
Investment income	x
Insurance finance income or expenses	(x)
Net Financial Result	x
Profit or loss	**x**
Effect of discount rate changes	(x)
Total comprehensive income	**xx**

* Excluding investment component

Exercise

Exercise

Deduction of Profit & Loss from Solvency II balance sheet

Exercise

Assume the Solvency II balance sheet has been calculated according to the numbers on the right.

There has been no cash flows (premiums, benefits, investment returns) over the year.

What is the IFRS 17 profit over the year?

Exercise - solution

Deduction of Profit & Loss from Solvency II balance sheet

Exercise

Assume the Solvency II balance sheet has been calculated according to the numbers on the right.

There has been no cash flows (premiums, benefits, investment returns) over the year.

What is the IFRS 17 profit over the year?

Solution

The IFRS 17 profit cannot be deduced from the Solvency II balance sheet alone.

Assume e.g. the contract was sold at the start of the year for a single premium of 120:

- The CSM at initial recognition can be calculated (in this simple example) from the BEL and RM, such that $CSM_{initial} = 120 - 100 - 10 = 10$.
- the CSM at end of the first year depends on the duration of the contracts, as the CSM is released to revenue over the duration of the contract.
- Solvency II releases CSM immediately to OF.

Premium Allocation Approach (PAA)

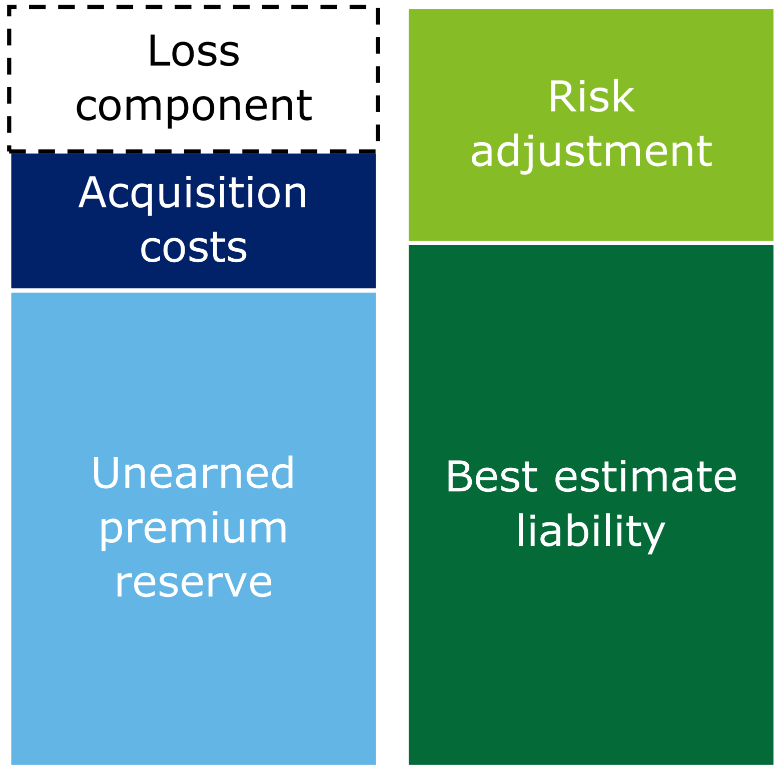
Premium Allocation Approach (PAA)

Simplified approach

PAA is a simplified approach for the liability for remaining coverage

Liability under PAA

- Based on unearned premium reserve
- May be adjusted for acquisition costs
- Must perform a liability adequacy test to identify onerousness
  - Facts and circumstances
  - Test against BBA including RA
  - Discounting required if liability for incurred claims is discounted
  - Test performed on group level
- Loss component is recognised in P&L



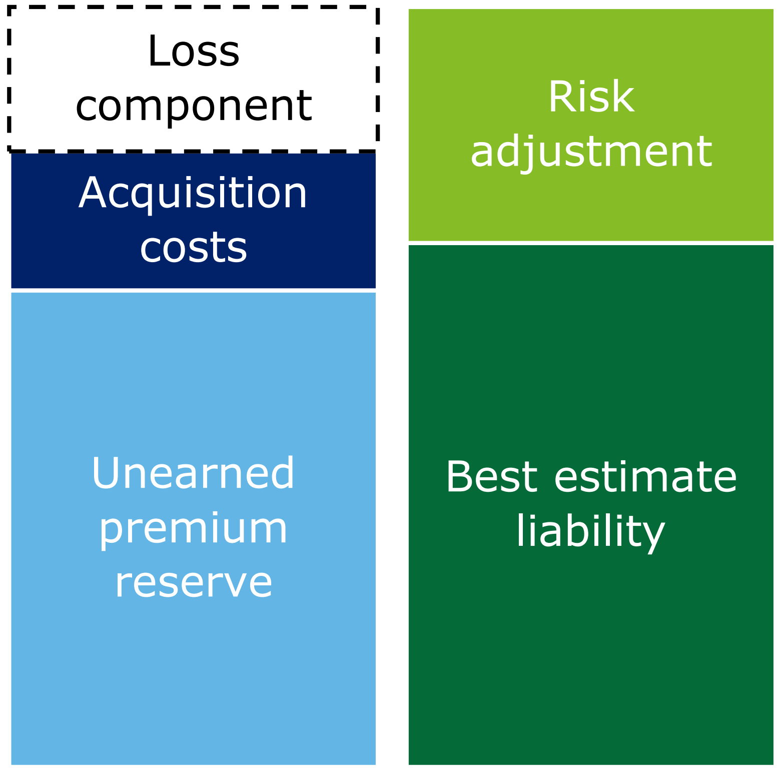
Premium Allocation Approach (PAA)

When to use the Premium Allocation Approach

1. If it would be a reasonable approximation to the Building Block Approach (applies to liability for remaining coverage only)

2. If the coverage period at initial recognition is one year or less

! This criteria is **not** met if at the inception of the group, an entity expects **significant variability** in the fulfilment cash flows that would affect the measurement of the liability for remaining coverage during the period before a claim is incurred.



Variable Fee Approach (VFA)

Contracts with direct participation features

Variable Fee Approach

Modification to the general approach for valuing insurance contracts with payments that **vary with the return on underlying items**, e.g.

- Unit-linked (with **insurance** risk)
- With-profits

Treats returns on the assets underlying these contracts as part of the fee that the entity charges the policy holder from the **service provided.**

!

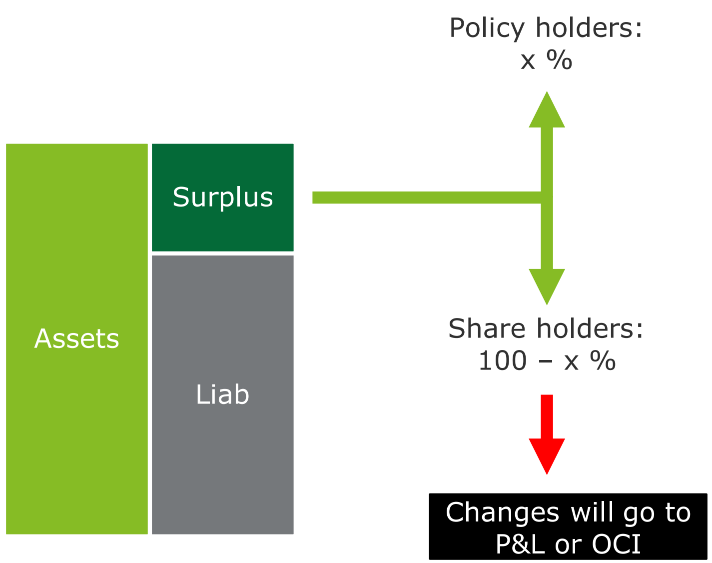
Benefit of VFA is that it **eliminates artificial volatility** in the Profit & Loss.

Variable Fee Approach

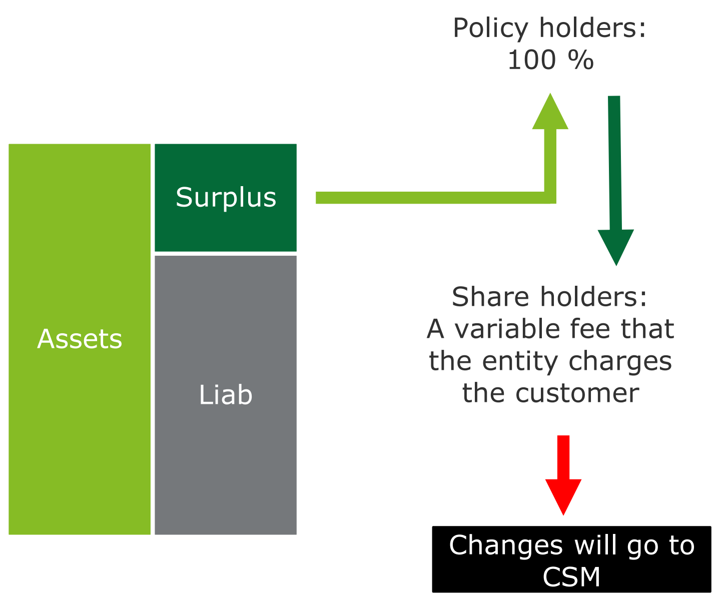
Introduction

- In the general measurement model the net gains and losses that the entity retains from invested premiums are treated as if they were share of economic returns from the investment portfolio.
- In the variable fee approach, the returns to the entity arising from participating contract is viewed as part of the compensation that the entity charges the policyholder for service provided by the insurance contract, rather than as a share of returns from a stand-alone investment.
- The entity's interest in the investment portfolio is not the equivalent of a direct holding in assets, but is equivalent to a variable fee that the entity charges the policyholder, expressed as a share of returns.

General measurement model



Variable fee approach



Variable Fee Approach

Conditions for eligibility

The contractual terms specify that the policyholder participates in a **defined share of a clearly identified pool of underlying items.**

The entity expects to pay to the policyholder an amount equal to **a substantial share of the returns** from the underlying items. Examples:

- **Unit Linked products:** 100 % of fund return
- **Participating products:** Traditional profit sharing products (fair share relative to guarantees)

A substantial proportion of the cash flows that the entity expects to pay to the policyholder should be **expected to vary with the cash flows from the underlying items**

- **Unit Linked products:** Pensions = Fund values
- **Participating products:** Benefits are including bonus form the return of the underlying items

Variable Fee Approach (VFA)

Comparison of VFA to BBA

Description	Building Block Approach (BBA)	Variable Fee Approach (VFA)
Cash flows	No difference	
Discount rate	No difference	
Risk adjustment	No difference	
CSM at inception	No difference	
Allocation of CSM	No difference	

CSM:

Subsequent measurement (financial)	Changes in all financial assumptions in SCI	Changes in guarantees and shareholders share in CSM
- Except risk mitigated	Changes in all financial assumptions in SCI	Changes in shareholder share in P&L (hedged risk)
Subsequent measurement (non financial)	No difference	
Accretion	Accreted at locked in rate	'Effective' accretion at current rate

Timeline

From here to full implementation

IAS 39 & IFRS 4

Flexibility in IAS 39 and IFRS 4 results in little volatility in profit or loss

IFRS 9 & IFRS 4

Interaction of IFRS 9 and IFRS 4 may **increase** volatility in profit or loss

IFRS 9 & IFRS 17

Commonalities in IFRS 9 and IFRS 17 should **reduce** volatility in profit or loss

IFRS 9
1 January 2018

IFRS 17
Deferral approach
"sunset clause" 1 January 2021

EU top up solution for financial conglomerates

Deferral approach

Overlay approach

Other Comprehensive Income (OCI)

Volatility of P&L and Net Assets

Careful consideration will be required to address potential **measurement volatility** and **accounting mismatch**:

- Asset measured at either amortised cost or fair value (where changes to fair value are recognised in either P&L or in OCI).
- Insurance liabilities measured with general model has options to recognise changes to discount rates are recognised in either P&L or OCI.

Asset accounting	Liability accounting	P&L	Net Assets / Equity
Amortised cost	OCI	Stable	Volatile
FV through P&L	OCI	Volatile	Stable
FV through OCI	OCI	Stable	Stable
Amortised cost	No OCI	Volatile	Volatile
FV through P&L	No OCI	Stable	Stable
FV through OCI	No OCI	Volatile	Stable

Business impact

Key Performance Indicators – an example

The majority of KPIs are linked to IFRS and will change under IFRS 17

- **Profit after tax: 244m** – 1 – ✓
- **Under-writing result: 220m** – 1 – ✓
- **Gross written premiums: 6,858m** – 4 – ✓
- **Expense ratio: 15.7%** – 1 – ✓
- **Combined Operating ratio: 96.9%** – 1 – ✓
- **Capital surplus: 0.9bn** – 3 – ✗
- **Net Claims ratio: 65.3%** – 1 – ✓
- **Net Asset value: 2.8bn** – 1 – ✓
- **Net earned premium: 6,160m** – 4 – ✓
- **Net commission ratio: 15.9%** – 1 – ✓
- **Solvency ratio: 143%** – 3 – ✗
- **Return on equity: 9.7%** – 1 – ✓

Key:

- ✓ KPI expected to change
- ✗ KPI not expected to change
- 1 KPI grouping e.g. profit indicator

The KPIs will be impacted as follows:

1. **Profit KPIs –** The profit signature will change for all product lines thus impacting all profit related KPIs. The deferral of profit may result in an overall reduction in the headline figures (most notably on transition)
2. **Regulatory KPIs –** The base position of most regulatory KPIs, such as regulatory capital surplus, is the IFRS position. Therefore, the majority of regulatory KPIs will be impacted.
3. **Solvency II Surplus –** The Group's measure of capital adequacy is on an economic basis. This will not change under IFRS 17.
4. **Premiums-** Gross written premiums and net earned premiums in their current form are no longer reported under IFRS 17.

Disclosures

Reconciliations – Liability roll forward

Liability roll forward	**Estimates of the present value of future cash flows**	**Risk adjustment**	**Contractual service margin**	**Total**
Beginning of period	**163.962**	**5.998**	**8.858**	**178.818**
Changes related to:				
- Future service yet to be provided 1	(784)	1.117	(116)	**217**
- Current service provided in the period 2	35	(604)	(923)	**(1.492)**
- Past service adjustment to past claims 3	47	(7)	-	**40**
Insurance service result*	(702)	506	(1.039)	**(1.235)**
Insurance finance expenses** 4	9.087	-	221	**9.308**
Total changes in P&L**	8.385	506	(818)	**8.073**
Cash flows 5	18.833	-	-	**18.833**
End of period	**191.180**	**6.504**	**8.040**	**205.724**

* Excl. the effects of reinsurance

** Some insurance finance expenses may be presented in Other Comprehensive Income—see later

Disclosures

Reconciliations – Future services

Future service – incl. new business 1	**Estimates of the present value of future cash flows**	**Risk adjustment**	**Contractual service margin**	**Total**
Beginning of period	**163.962**	**5.998**	**8.858**	**178.818**
Changes related to:				
- **Future service yet to be provided****	**(784)**	**1.117**	**(116)**	**217**
New profitable contracts recognised	(2.344)	969	1.375	-
Estimate changes - profitable contracts	1.452	39	(1.491)	-
New onerous contracts recognised	15	108	-	123
Estimate changes - onerous contracts	93	1	-	94
- Current service provided in the period	35	(604)	(923)	**(1.492)**
- Past service adjustment to past claims	47	(7)	-	**40**
Insurance service result*	(702)	506	(1.039)	**(1.235)**

* Excl. the effects of reinsurance

** Note: Positive number in total column = increase in liability = loss in P&L

Disclosures

Reconciliations – Current services

Current service—profit recognised 2	**Estimates of the present value of future cash flows**	**Risk adjustment**	**Contractual service margin**	**Total**
Beginning of period	**163.962**	**5.998**	**8.858**	**178.818**
Changes related to:				
- Future service yet to be provided	(784)	1.117	(116)	**217**
- **Current service provided in the period**	**35**	**(604)**	**(923)**	**(1.492)**
Contractual service margin earned			(923)	(923)
Release from risk		(604)		(604)
Experience loss	35			35
- Past service adjustment to past claims	47	(7)	-	**40**
Insurance service result*	(702)	506	(1.039)	**(1.235)**

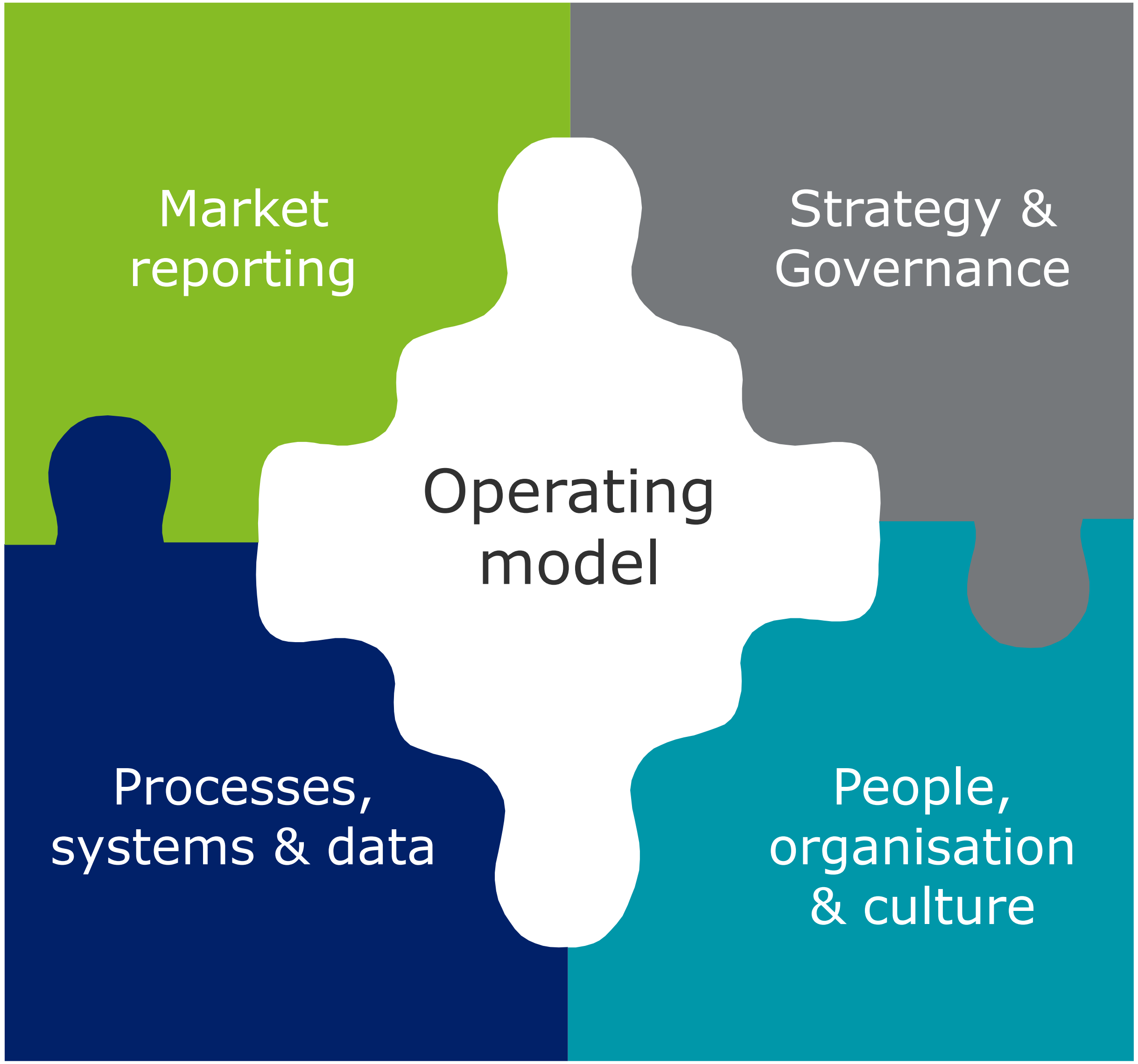
* Excl. the effects of reinsurance

Business impact

How will IFRS 17 impact the insurers?

IFRS 17 will have a **pervasive impact on the operating model** of the insurers. Six groups of stakeholders will be affected and insurers need to manage these relationships effectively to ensure the overall market impact is beneficial. Stakeholders:

- ✓ Policy holders
- ✓ Rating agencies
- ✓ Regulators
- ✓ Investors buy side
- ✓ Analysts sell side
- ✓ Internal stakeholders



Q&A

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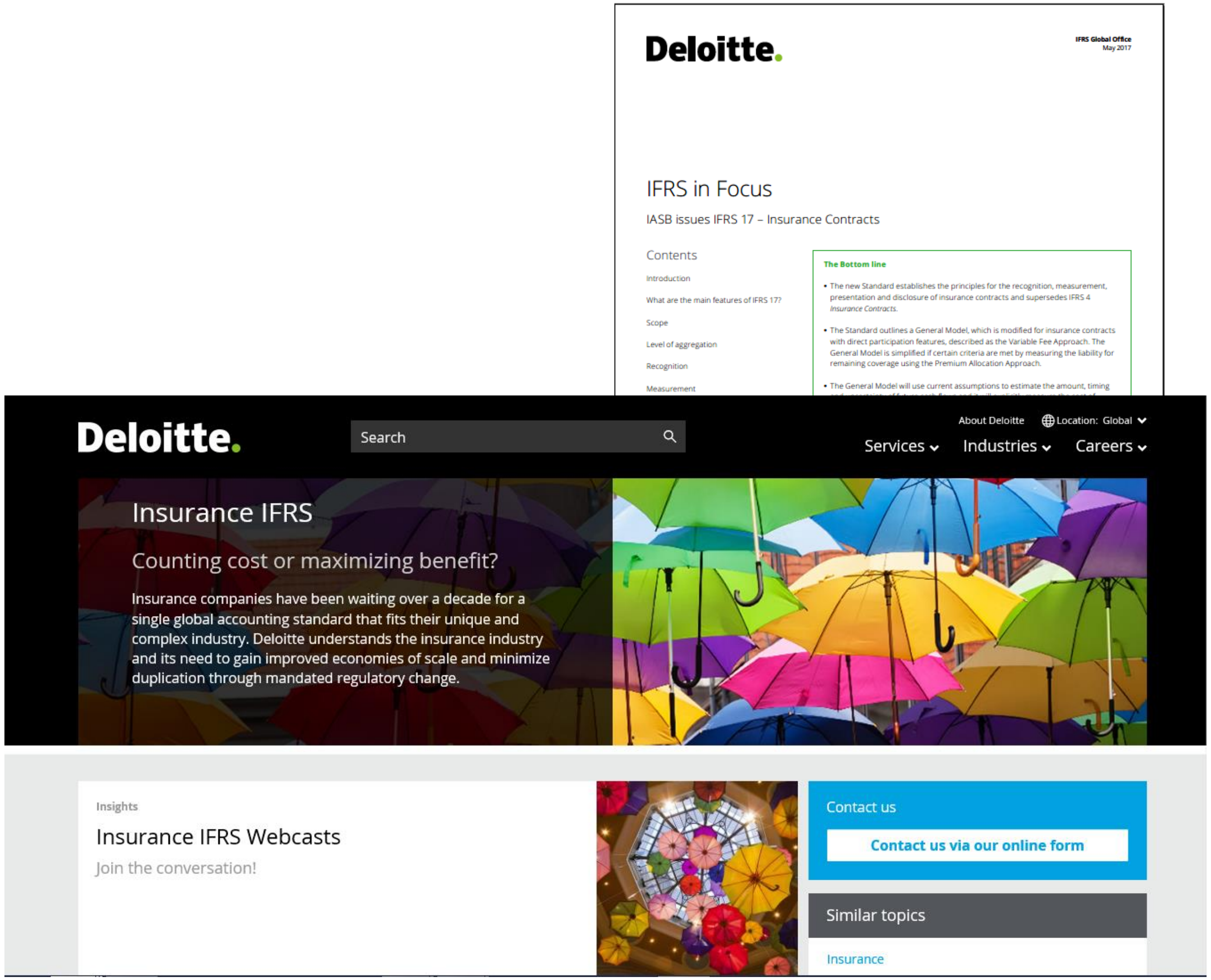

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