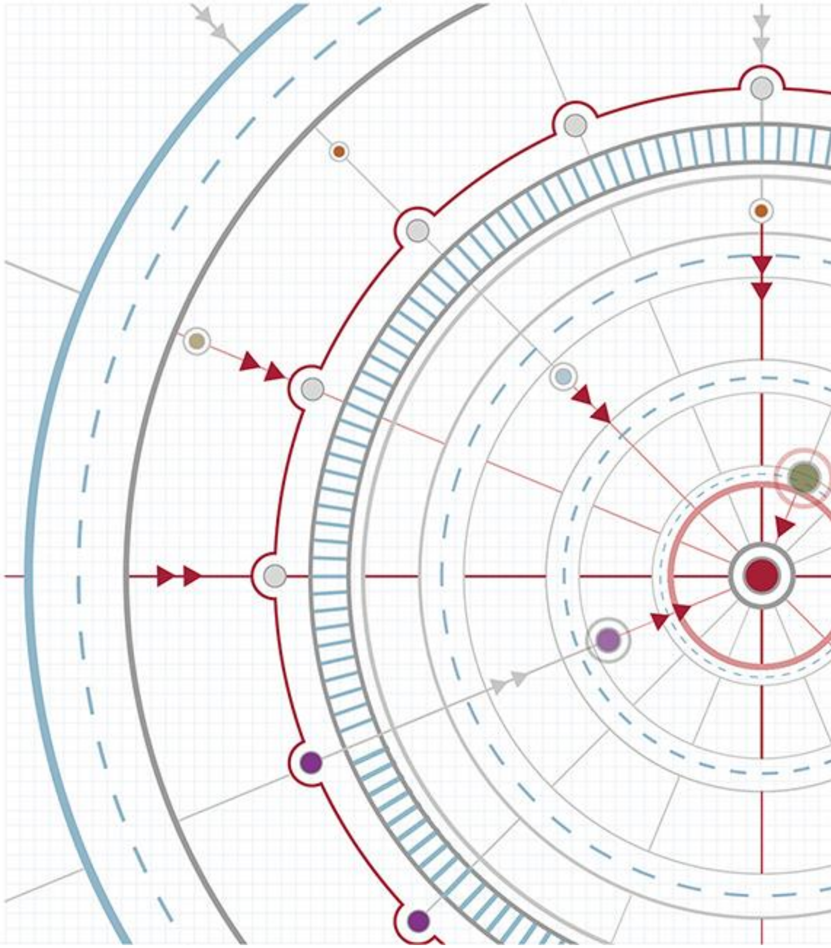

IFRS 17
the first truly international IFRS Standard for insurance contracts

Melbourne, 29 May 2017

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International Accounting Standards Board

The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board (the Board) or IFRS Foundation.

IFRS 17 *Insurance Contracts*

- IFRS 17 issued on 18 May 2017
  - 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 on 2021
  - early application permitted
  - one year comparative information

IFRS®

Today's agenda

- IFRS 17 measurement model
- Level of aggregation
- Changes in primary financial statements
- Optional simplified approach for short-term contracts
- Transition and implementation support
- Appendix
  - Approach for contracts with a variable fee
  - Summary of changes since the Exposure Draft published in June 2013 (2013ED)

IFRS 17 measurement model

General accounting model

IFRS 17 measurement model

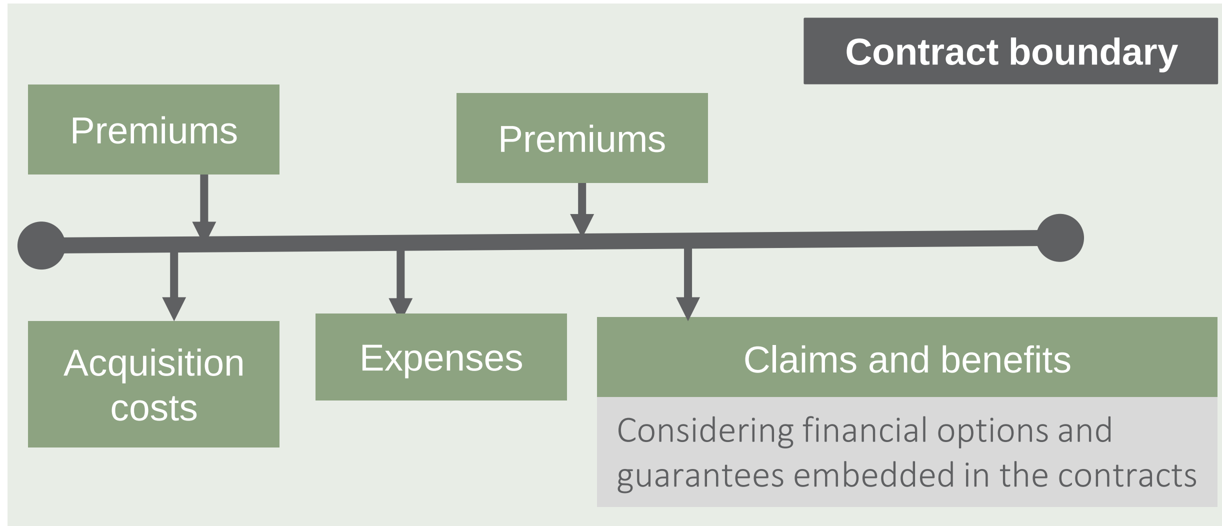
- All insurance contracts measured as the sum of:
  - **Fulfilment cash flows**
    - Present value of probability-weighted expected cash flows
    - Plus an explicit risk adjustment for insurance risk
  - **Contractual service margin**
    - The unearned profit from the contracts

1 PV of future cash flows + 2 Risk adjustment + 3 Contractual service margin = **IFRS 17 asset or liability**

Fulfilment cash flows (1 + 2)

1 Present value of future cash flows

Cash flows



- Current estimates of future cash flows
- Probability weighted and unbiased
- Stochastic modelling for financial options and guarantees (where necessary)

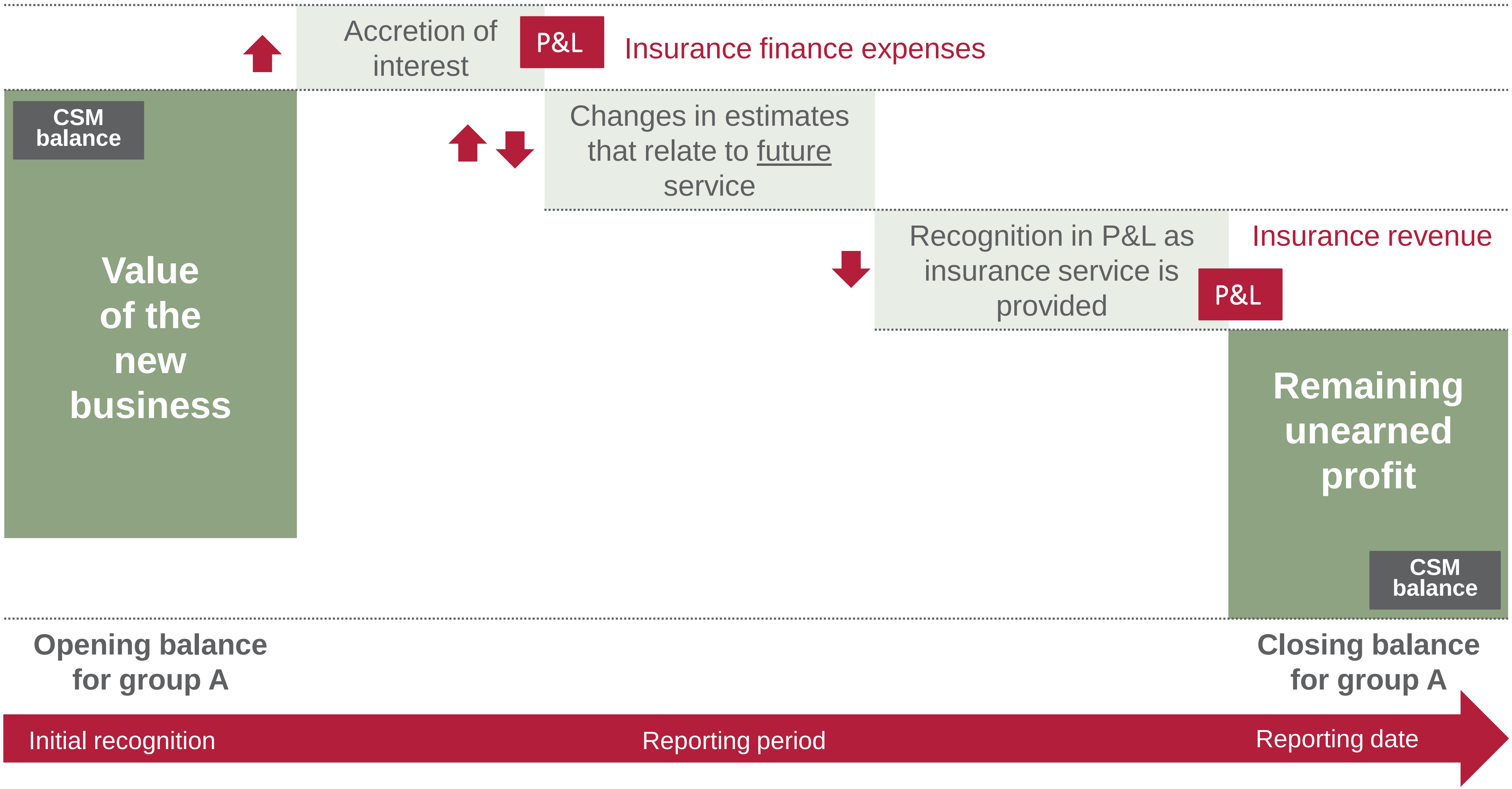
Discount rates

- Current market-consistent discount rates relevant to the liability
- Return premium on assets included only to the extent that the liability cash flows are themselves linked to those assets

Risk adjustment

- Explicit adjustment for the compensation a company requires for bearing insurance risk
- Part of total unearned profit
  – Recognised in P&L as the company is released from risk

3 Unearned profit—contractual service margin



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Unearned profit—allocation pattern

- IFRS 17 recognises profit when coverage is provided (usually evenly over time)
- Unearned profit is allocated over the coverage provided in the current period and expected remaining future coverage
  - on the basis of coverage units, reflecting the expected duration and quantity of benefits provided by contracts in a group of contracts
- IFRS 17 differs from existing practice in Australia where the release of profit is based on service provided using an appropriate profit carrier

Level of aggregation

Annual cohorts

Level of aggregation
Introduction

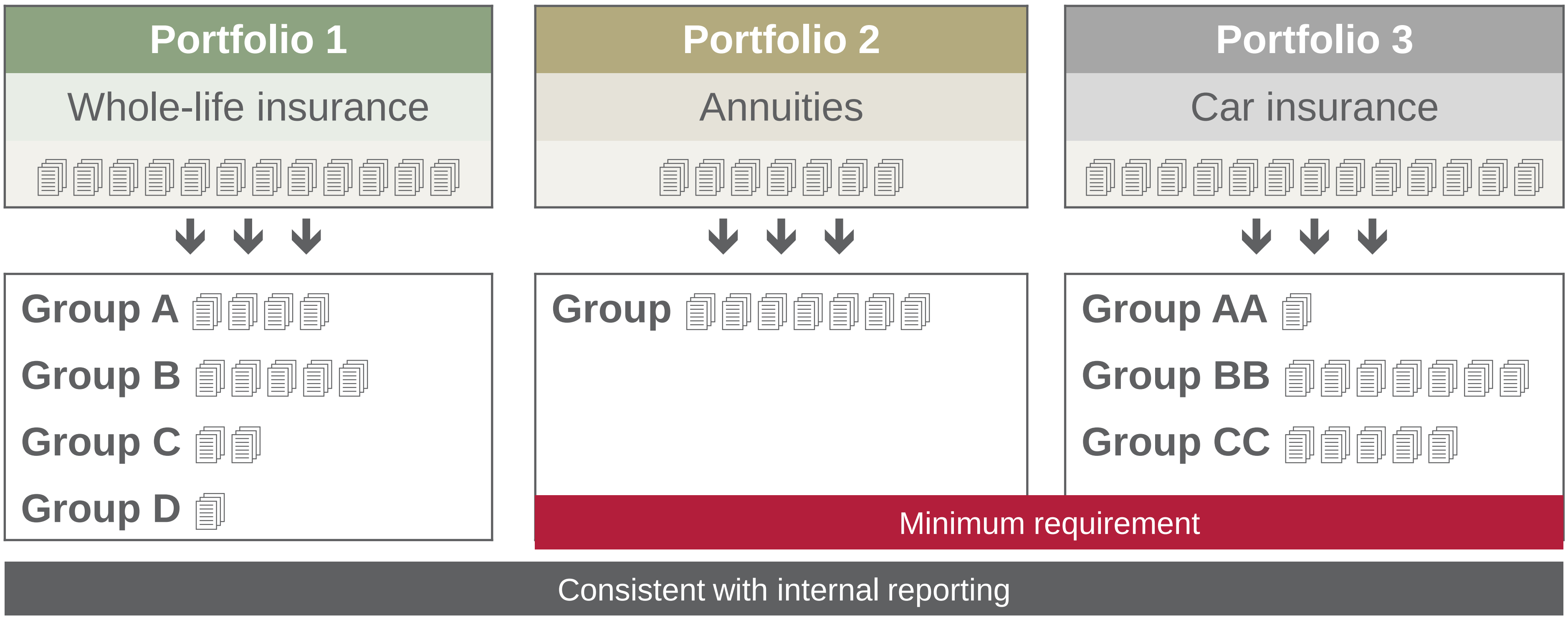
- Does not affect the measurement of the cash flows
- Affects the measurement of unearned profit (contractual service margin)
- A portfolio could have contracts with significantly different profitability
  - Grouping averages the unearned profit and the losses of contracts within each group and allocates that average to profit or loss based on the services provided

Level of aggregation
Background

- The Board's objective is to provide information on the trend in profitability of contracts written at different times on a timely basis
- One of the conditions for grouping in drafts and proposals preceding IFRS 17 was that the contracts have similar profitability
- Feedback indicated that the 'similar profitability' criterion was interpreted as requiring excessively large number of groups
- The Board revised the level of aggregation requirements. In particular:
  - the 'similar profitability' criterion has been removed
  - unearned profit is allocated using coverage units, coverage units averages the contracts' profitability within the group

Level of aggregation
Portfolios and groups of contracts

- A portfolio: insurance contracts subject to similar risks and managed together
- Entity divides each portfolio of contracts into groups



Level of aggregation
Grouping objectives

- IFRS 17 requires a portfolio to be divided into 1-3 groups
  - timely recognition of losses
  - resilience of the contracts in a group to becoming onerous
  - consistent with requirements in other IFRS Standards
- IFRS 17 will provide:
  - information about losses from contracts onerous at initial recognition
  - information about losses when previously profitable groups of contracts become onerous

Level of aggregation
Grouping illustration for a portfolio

Portfolio 1

Whole-life insurance

Entity divides each portfolio into groups

- contracts issued within the same year
- information about the contracts' resilience
- consistent with internal reporting
- exemption for regulatory pricing
- group not reassessed after initial recognition

Profitable contracts	**Group A**	Contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any	Unearned profit is recognised as part of the liability and is released as insurance services are provided
	Group B		
	Group C	Other profitable contracts, if any	
Onerous contracts	**Group D**	Contracts that are onerous at initial recognition, if any	A loss is recognised in P&L

Level of aggregation
Effect of regulation

- Some laws or regulations prevent insurers from pricing for certain risk indicators eg gender
- If a law or regulation specifically constrains
  - insurer's practical ability to set a different price or level of benefits for policyholders with different characteristics,
  - then ignore that characteristic for grouping (eg male or female drivers)
- Reflects that constraints in law or regulation that affect all market participants in a jurisdiction in the same way creates an economic effect for that jurisdiction

Level of aggregation
Examples 1 and 2

- **Example 1**: 100 ‘identical’ contracts are written with a probability that 5 of the policyholders will claim
  - IFRS 17: 100 contracts are a group; company does not treat the 5 contracts as a separate group
- **Example 2**: a company issues 500 contracts; there is information that 200 ‘identical’ contracts are under priced, but the company expects that the 300 profitable ‘identical’ contracts will cover losses (or possible losses) on the 200 under-priced contracts
  - IFRS 17: Group A—losses on the 200 under-priced contracts are recognised immediately
  - IFRS 17: Group B—profits on 300 contracts recognised over the coverage period

Level of aggregation
Annual cohorts

- IFRS 17 requires that a group shall not include contracts issued more than one year apart (ie annual cohort)
- The annual cohort requirement will provide useful trend information about profitability of contracts written in different periods
- The profit of a group of contracts will be recognised in the period the service is provided—and not averaged with profits of other groups and recognised over the period of which service is provided for all the groups

Level of aggregation
Annual cohorts—Example 3

- Suppose a company writes the following contracts:
  - In Years 1-2, 5-year contracts with premiums of 100 and unearned profit (CSM) of 10
  - In Years 3-4, 5-year contracts with premiums of 100 and CSM of 2
- Without the annual cohort requirement:
  - The CSM of contracts written in years 1 and 2 would persist beyond year 6; because the profitability of the contracts written in years 1-2 is averaged with the lower profitability of contracts written in years 3-4 and recognised over years 3-9
  - Information about the change in profitability would not be reflected in financial statements on a timely basis

Level of aggregation
Annual cohorts—Example 4

- Suppose in Year 1, an insurer writes:
  - 5-year contracts with premiums of 100 and CSM of 20
- Suppose in Year 3:
  - the group of contracts written in Year 1 are now onerous, loss of 2, due to changes in expectations in this period
  - the insurer writes 5-year contracts with premiums of 100 and CSM of 5
- Without the annual cohort requirement:
  - the insurer would not recognise the losses in profit or loss for contracts that are no longer profitable (eg Year 1 contracts) by grouping those contracts with newly written profitable contracts (eg Year 3 contracts)
  - the CSM of 3 (=5-2) is recognised in Years 3-8

Changes in primary financial statements

Balance sheet and performance

Changes to balance sheet presentation

IFRS 4*	IFRS 17	Key changes
Assets		- Groups of insurance (or reinsurance) contracts that are in an asset position presented separately from groups of insurance (or reinsurance) contracts that are in a liability position - Other assets and other liabilities included in the measurement of insurance contracts issued and reinsurance contracts held resulting in an overall simplified presentation on the balance sheet
Reinsurance contract assets	Reinsurance contract assets	
Deferred acquisition costs	Insurance contract assets	
Value of business acquired		
Premiums receivable		
Policy loans		
Liabilities		
Insurance contracts liabilities	Insurance contract liabilities	
Unearned premiums	Reinsurance contract liabilities	
Claims payable		

(*) Common presentation in the balance sheet in applying IFRS 4

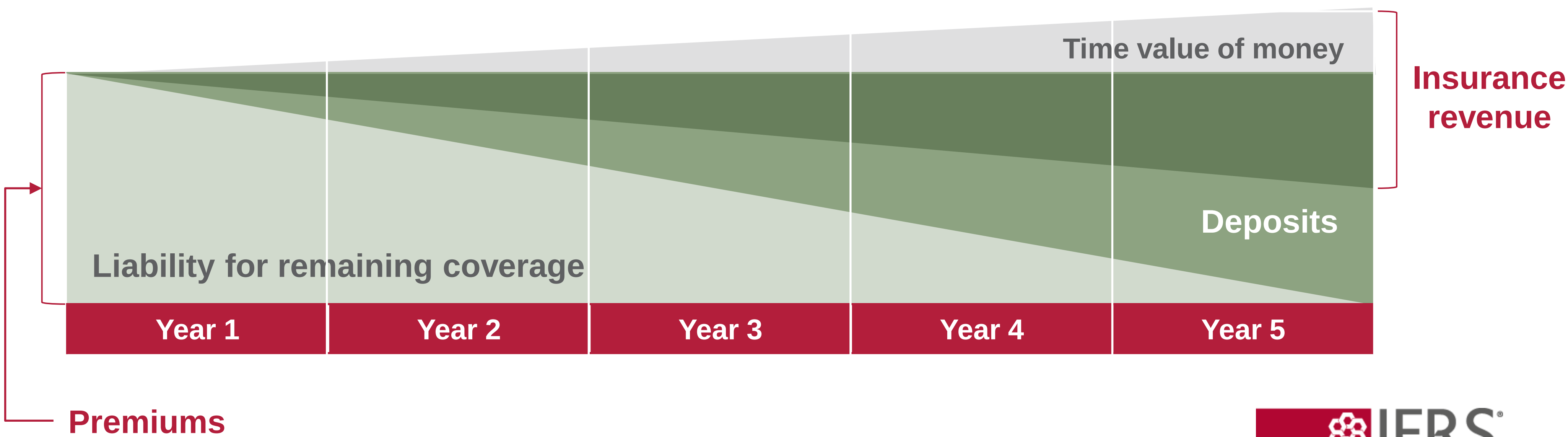
Changes to performance presentation

IFRS 4*	IFRS 17	Key changes
Premiums	Insurance revenue	- Two drivers of profit presented separately
Investment income	Incurred claims and expenses	
Incurred claims and expenses	**Insurance service result**	- Insurance revenue excludes deposits [written premiums disclosed in the notes]
Change in insurance contract liabilities	Investment income	
Profit or loss	Insurance finance expenses	- Revenue and expense are recognised as earned or incurred
	Net financial result	
	Profit or loss	
	Insurance finance expenses *(optional)*	- Insurance finance expenses are excluded from insurance service result and are presented (i) fully in P&L or (ii) in P&L and OCI, depending on accounting policy
	Total comprehensive income	

(*) Common presentation in the statement of comprehensive income in applying IFRS 4

Insurance revenue

- Revenue recognised reduces liability for remaining coverage
- Equals premiums received (adjusted for time value of money) attributable to services provided in the period
- Payments to policyholders unrelated to insured event (return of ‘deposits’) are not revenue



Optional simplified approach for short-term contracts

Premium allocation approach

Optional simplified approach
Eligibility

- Eligible for contracts with
  - coverage of one year or less; or
  - no variability in the fulfilment cash flows affecting the liability for remaining coverage

- IFRS 17 contract boundary requirements apply for the assessment of the coverage period
  - practical ability to reassess risks of the policyholder; or
  - practical ability to reassess risks of the portfolio that contains the contract and the pricing reflects risks up to the reassessment date

Optional simplified approach

Overview

A Liability for remaining coverage
- PV of future cash flows
- Risk adjustment
- Contractual service margin

Split in three blocks not required

\+

B Liability for incurred claims
- PV of future cash flows
- Risk adjustment

=

IFRS 17 liability

A Simplified measurement

B Measurement under the general model, but discounting of claims to be settled within 1 year not required

Optional simplified approach
Further simplifications

- When applying the simplified approach, there is a conditional presumption that there are no contracts in the portfolio are onerous at initial recognition unless facts and circumstances indicate otherwise
- The simplified approach is permitted for only simple, short-term contracts
  - the difference in recognising losses immediately and gains over the coverage period is less significant for short-term contracts
  - that simplification is not appropriate for longer-term contracts because those contracts are more complex and have more risks

Transition and implementation support

2017—2021

Applying IFRS 17 for the first time

DECIDE TRANSITION METHOD BY GROUP OF CONTRACTS

Full retrospective approach (apply IAS 8)

if impracticable

Modified retrospective approach

- Modifications available if necessary given reasonable and supportable information
- Maximise the use of the information needed for full retrospective approach

If no sufficient reasonable and supportable information available

OR

Fair value approach

- Separate disclosures for each transition method
- Opportunity to reassess the classifications for financial assets under IFRS 9

Tools for implementation questions

- Transition Resource Group
- Discussions at the Board meetings and/or at the IFRS Interpretation Committee meetings
- Supporting material (eg webcasts, articles)
- Interaction with submitters
- Research and documentation

IASB implementation support—overview

May 2017	3.5 years			2021
	Support implementation			
	2017 - Early 2019	Late 2019	2020	
Issue of IFRS 17	**Some entities begin implementation process General questions** / **Contentious / specific implementation questions**	Entities are finalising implementation		**Mandatory effective date of IFRS 17**

Objective: **monitor and proactively support implementation**	Objective: **provide period of calm for implementation**
Supporting materials: **- articles** **- webinars** **TRG, IFRS IC and/or Board discussions**	Mostly monitor Light touch on implementation / educational activities

Appendix

Approach for contracts with a variable fee

Modifications to general model
Variable fee approach

- Variable fee approach only when insurer shares return on specified assets
- Insurer’s share of return on underlying items treated as ‘variable fee’ for investment-related services
  - Change in variable fee adjusts unearned profit
- Liability measurement reflects value change of those assets

Key effects

- Reflects the investment nature of the contracts
- Clearly reflects the extent of asset mismatch

Variable fee approach
A simple example

- Contract promises policyholder 90% of return on underlying items with return of 5%
- Insurer's share of 10% is treated as variable fee
- At inception, insurer receives premium of $1000. At the end of 1 year, the underlying items are $1050
  - Policyholder share is $45 (90%)
  - Insurer share is $5 (10%)
- Thus
  - Fulfilment cash flows increase by $45 (policyholder share)
  - CSM increase by $5 (insurer share)
- If entity invests premium in assets with return of 5% then there is no net effect in P&L

Variable fee approach
Scope

- Variable fee approach makes accounting outcome more consistent with that of asset management contracts
- Scope identifies contracts that provide a variable fee for investment-related services
  - Policyholder participates in share of clearly identified pool of underlying assets
  - Insurer expects to pay policyholder a substantial share of the return from those underlying assets
  - Cash flows expect to vary substantially with underlying assets

Variable fee approach
Scope

- Difference with general model: changes in the estimate of fee insurer expects to earn are adjusted in CSM
  - Fee equal to company's expected share of returns on underlying items, less
  - Expected cash flows that do not vary with underlying items

Subsequent measurement of the CSM		
	General model	Variable fee approach
Changes due to market variables	In P/L or OCI	In CSM (1)
Accretion of interest expense on the CSM	Explicitly using rates at inception	Included in remeasurement

Variable fee approach
Risk mitigation by insurers

- Accounting mismatches arise when measurement basis differ for different assets and liabilities
  - eg amortised cost for loans, fair value for derivatives and current value for insurance contracts
- Some accounting mismatches can be avoided by:
  - using general hedge accounting requirements in IFRS 9
  - using optional ‘turning off’ of variable fee approach
  - using optional OCI
- ‘Residual’ mismatches better addressed in existing broader project for all industries on hedging

Appendix

Changes since Exposure Draft (June 2013)

Key changes since 2013 ED

1 Fixed-fee service contracts

- An entity is permitted to apply IFRS 15 to some fixed-fee service contracts (rather than required as proposed in the 2013 ED)

2 Level of aggregation

- Required disaggregation of a portfolio of insurance contracts at initial recognition into groups of insurance contracts that are onerous, profitable with no significant possibility of becoming onerous and other profitable contracts, with a narrow exemption for the effects of law or regulatory constraints on pricing.
- Groups cannot contain contracts that are written more than one year apart.
- A portfolio of insurance contracts is defined as insurance contracts subject to similar risks and managed together.

Key changes since 2013 ED

3 Contractual service margin

- For contracts other than investment contracts with discretionary participation features, an entity shall recognise the contractual service margin in P&L on the basis of coverage units (clarification of the principle for the recognition pattern of the contractual service margin).
- An entity shall adjust the contractual service margin for the changes in risk relating to future service, consistent with the changes in estimates of cash flows.
- Favourable changes in estimates that arise after losses were previously recognised in profit or loss are recognised in P&L to the extent that they reverse previously recognised losses.

4 Presentation of insurance finance income or expenses

- Accounting policy choice for an entity to: (a) include insurance finance income or expenses for the period in P&L; or (b) disaggregate insurance finance income or expenses for the period into an amount recognised P&L and an amount recognised in OCI.

Key changes since 2013 ED

5 Insurance contracts with participation features

- Eliminated the mirroring approach proposed in the 2013ED.
- Introduced a definition of an insurance contract with direct participation features.
- For insurance contracts with direct participation features, changes in the estimate of the fee (equal to the entity's expected share of the returns on underlying items, less any expected cash flows that do not vary directly with the underlying items) that the entity expects to earn from a group of insurance contracts adjust the contractual service margin.
- Option for an entity not to adjust the contractual service margin for changes in fulfilment cash flows or the entity's share of underlying items for which an entity uses derivatives to mitigate their financial risk in specified circumstances.

Key changes since 2013 ED

6 Transition

- Further simplifications for groups of insurance contracts for which retrospective application is impracticable, including allowing entities to choose between a modified retrospective approach and a fair value approach.
- The modified retrospective approach allows an entity specified simplifications to retrospective application, to the extent necessary because the entity lacks reasonable and supportable information to apply IFRS 17 retrospectively.
- The fair value approach requires an entity to determine the contractual service margin by reference to the fair value of the group of insurance contracts at the transition date.

7 IFRS 9 reassessment

- When first applying IFRS 17 after having applied IFRS 9, an entity is permitted to newly assess the business model for eligible financial assets based on facts and circumstances applicable at the date of initial application.

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