

International Financial Reporting Standard IFRS 17

Insurance Contracts

May 2017

EFFECTS ANALYSIS

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May 2017

IFRS® Standards
Effects Analysis

IFRS 17 *Insurance Contracts*

This Effects Analysis accompanies, but is not part of, IFRS 17.

What is the purpose of this Effects Analysis?

This Effects Analysis describes the likely costs and benefits of IFRS 17. The costs and benefits are collectively referred to as ‘effects’. The International Accounting Standards Board (the Board) gains insight into the likely effects of new or revised IFRS Standards through its exposure of proposals to stakeholders and through its analysis and consultation with them. This document describes the Board’s considerations of the effects of IFRS 17.

Background

The Board decided to proceed in two phases in establishing the accounting for insurance contracts:

- Phase 1—completed in 2004 by issuing IFRS 4 *Insurance Contracts*—focused on enhanced disclosure of the amount, timing and uncertainty of future cash flows from insurance contracts. IFRS 4 allows insurance companies¹ to continue to use various accounting practices, pending a fundamental reassessment of the accounting for insurance contracts.
- Phase 2—completed in 2017 by issuing IFRS 17—focused on the measurement and presentation of insurance contracts and the development of a comprehensive IFRS Standard for insurance contracts.

IFRS 17 supersedes IFRS 4 and completes the Board’s project to establish a specific IFRS model for the accounting for insurance contracts. IFRS 17 is effective from 1 January 2021. A company can choose to apply IFRS 17 before that date but only if it also applies IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*.

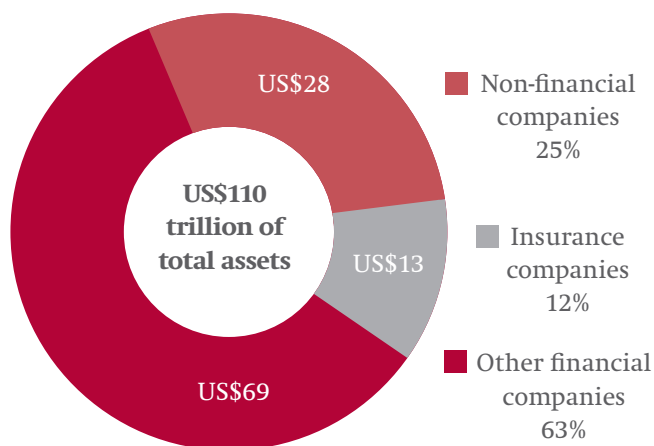
Glossary

Many terms used in this document are specific to insurance. See the glossary on pages 134–138 for definitions of those terms.

¹ In this document, the term ‘company’ refers to an entity that prepares financial statements using IFRS Standards. The term ‘insurer’ or ‘insurance company’ refers to an entity that issues insurance contracts as defined in IFRS 17.

The need for IFRS 17

The insurance industry fulfils a central role in the global economy. Insurance companies enable people and companies to transfer risks. Moreover, insurers, like other institutional investors, are important long-term investors. With US\$13 trillion in assets, insurers account for 12 per cent of the total assets of listed companies that use IFRS Standards.² Given the central economic role of the industry, proper accounting for insurance contracts is of crucial importance.



The nature of their business exposes insurers—and investors in insurers—to many risks. The financial health of insurers affects the global economy because of policyholders’ and investors’ exposure to insurers and insurers’ role as institutional investors. This is why the financial statements of insurers need to reflect insurance risks, and changes in those risks, in a timely and transparent way.

Better reflecting economic reality, improving comparability

The existing Standard, IFRS 4, allows insurers to account differently for insurance contracts they issue, even if those contracts are similar. Further, many insurers’ financial statements lack regular updates of the value of insurance obligations to reflect the effect of changes in the economic environment, such as changes in interest rates and risks.

IFRS 17 addresses many inadequacies in the existing wide range of insurance accounting practices. It requires all insurers to reflect the effect of economic changes in their financial statements in a timely and transparent way. It will also provide improved information about the current and future profitability of insurers.

The new Standard will result in a significant increase in global comparability and enhance the quality of financial information.

The timely information IFRS 17 requires will be beneficial for capital markets because it will boost investors’ understanding of insurers’ expected future profitability, risks and changes in insurance obligations. This should make the insurance industry more attractive to investors, facilitating improved capital allocation.

Improved transparency resulting from IFRS 17 is also expected to contribute to long-term financial stability by revealing useful information that will enable actions to be taken in a timely way.

IFRS 17 is the first comprehensive and truly international IFRS Standard establishing the accounting for insurance contracts issued by a company. It replaces IFRS 4—an interim Standard. IFRS 4 does not prescribe the measurement of insurance contracts and instead allows companies to use local accounting requirements (national GAAP), or variations of those requirements, for the measurement of their insurance contracts issued.

² Data based on the latest annual financial information available in the Capital IQ database for listed companies using IFRS Standards at the date of issue of IFRS 17—ie 2015 annual reports for the majority of companies.

Executive Summary

IFRS 17 sets out the requirements that a company should apply in reporting information about insurance contracts it issues and reinsurance contracts it holds.

Requirements of IFRS 17

IFRS 17 requires a company that issues insurance contracts to report them on the balance sheet as the total of:

- (a) the fulfilment cash flows—the current estimates of amounts that the company expects to collect from premiums and pay out for claims, benefits and expenses, including an adjustment for the timing and risk of those amounts; and
- (b) the contractual service margin—the expected profit for providing insurance coverage.

The expected profit for providing insurance coverage is recognised in profit or loss over time as the insurance coverage is provided. IFRS 17 requires the company to distinguish between groups of contracts expected to be profit making and groups of contracts expected to be loss making.

Any expected losses arising from loss-making, or onerous, contracts are accounted for in profit or loss as soon as the company determines that losses are expected.

IFRS 17 requires the company to update the fulfilment cash flows at each reporting date, using current estimates of the amount, timing and uncertainty of cash flows and of discount rates.

The company:

- (a) accounts for changes to estimates of future cash flows from one reporting date to another either as an amount in profit or loss or as an adjustment to the expected profit for providing insurance coverage, depending on the type of change and the reason for it; and
- (b) chooses where to present the effects of some changes in discount rates—either in profit or loss or in other comprehensive income.

IFRS 17 also requires disclosures to enable users of financial statements to understand the amounts recognised in the company's balance sheet and statement of comprehensive income, and to assess the risks the company faces from issuing insurance contracts.³

Why IFRS 17 has been developed

IFRS 4 does not address how to measure insurance contracts. Insurers currently use a wide range of insurance accounting practices for reporting on a key aspect of their business. Differences in accounting treatment across jurisdictions and products make it difficult for investors and analysts to understand and compare insurers' results. Most stakeholders, including insurers, agree on the need for a common global insurance accounting standard even though opinions vary as to what it should be. Insurance contracts often cover difficult to measure long-term and complex risks. Insurance contracts are not typically traded in markets and may include a significant deposit component, posing further measurement challenges. Some existing insurance accounting practices fail to reflect adequately the true underlying financial positions or performance arising from these insurance contracts. IFRS 17 addresses these issues. IFRS 17 will make:

- (a) insurers' financial reports more useful and transparent; and
- (b) insurance accounting practices consistent across jurisdictions.

³ See Section 2—Overview of IFRS 17 requirements.

Changes in financial statements

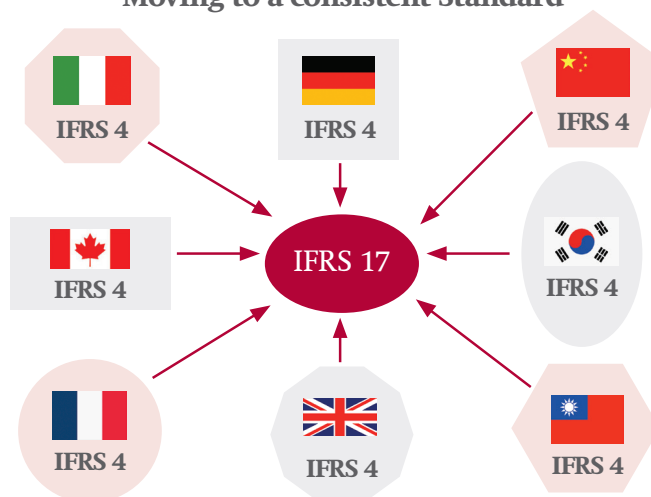
Generally, the introduction of an IFRS Standard prompts similar changes across companies. This is because all companies using IFRS Standards usually move from a common existing accounting practice to the same new practice. However, because companies have adopted different practices in applying IFRS 4 and issue a variety of insurance contracts, the effects IFRS 17 will have on a company's financial statements will vary from company to company, even within the same jurisdiction.⁴

Factors that will influence the effect that IFRS 17 will have on a company's financial statements include:

- (a) the types and nature of the insurance contracts the company issues; and
- (b) the extent to which IFRS 17 requirements differ from the accounting policies that the company currently applies for its insurance contracts.

In general, the Board expects relatively little change in the accounting for many short-term insurance contracts. The Board expects a greater change in the accounting by many companies for long-term insurance contracts.

Moving to a consistent Standard



The benefits of IFRS 17 outweigh its costs

The Board has concluded that applying IFRS 17 for the first time will result in significant costs for some companies, but overall the benefits of IFRS 17 will outweigh the costs (for discussion of the benefits of IFRS 17 refer to 'Improvements introduced by IFRS 17' on the following pages).

The Board expects that applying IFRS 17 will require many insurance companies to gather new information, employ or develop people with appropriate skills and make changes to their financial systems. Companies are also expected to incur costs in educating staff, updating internal procedures and communicating changes in their reports to external parties. Such activities may involve significant time, effort and cost.

Costs will vary for different companies in different jurisdictions, depending on the companies' existing insurance accounting practices, as well as on the measurement techniques used for management and prudential purposes.⁵

Insurance companies are also expected to continue incurring costs in applying IFRS 17 on an ongoing basis. These costs are mainly expected to arise from gathering the necessary information to update assumptions for measuring insurance contracts on a current basis. However, insurance companies with operations in multiple jurisdictions are expected to reduce costs by applying a globally consistent model for their insurance contracts.⁶

Simplifications to reduce costs

The Board has sought to provide simplifications while balancing the resultant cost savings with potential loss of information. IFRS 17 enables a company to simplify the measurement of some short-term insurance contracts—for example, contracts with a coverage period of one year or less. In addition, a company is allowed to apply the new requirements to a group of contracts rather than on a contract-by-contract basis. Furthermore, IFRS 17 does not apply to some common contracts issued by non-insurers, such as most product warranties.⁷

⁴ See Section 6—Effects on a company's financial statements.

⁵ See Section 5.1—Implementation costs.

⁶ See Section 5.2—Ongoing costs.

⁷ See Section 5.3—Key cost reliefs.

Improvements introduced by IFRS 17

IFRS 17 requires a company to measure insurance contracts using current estimates and assumptions that are updated (to be consistent with relevant market information), and that reflect the timing of cash flows and the uncertainty relating to the insurance contracts. The use of a measurement model with current inputs will provide current, updated information about the effect of insurance contracts on a company's financial position and risk exposure, and transparent reporting of changes in the insurance contract assets and liabilities.

Consequently, IFRS 17 will enable investors, analysts and others to make better economic decisions using transparent and timely information about the risks from, and variability in, obligations arising from insurance contracts.

IFRS 17 requires a company to recognise profits as it delivers insurance services, rather than when it receives premiums, as well as to provide information about insurance contract profits that the company expects to recognise in the future. This information will provide additional metrics that can be used to evaluate the performance of insurers and how that performance changes over time.⁸

⁸ See Section 4.2—Improved financial information.

| IFRS 4—little transparent or useful information | IFRS 17—more transparent and useful information |
|---|---|
| Information about the value of insurance obligations | |
| <p>Some companies measure insurance contracts using out-of-date assumptions. Assumptions at the time that the contracts were issued and that are not subsequently updated to reflect economic changes do not provide useful information about expected future cash flows. Those companies also do not fully reflect the value of interest rate guarantees in their financial statements.</p> | <p>Companies will measure insurance contracts at current value. Using updated assumptions about cash flows, discount rate and risk at each reporting date will better reflect the way a company expects to settle its insurance contract liabilities as well as reflecting the current value of interest rate guarantees. It will also make visible any economic mismatch between the current value of assets and liabilities.</p> |
| <p>Some companies do not consider the time value of money when measuring liabilities for incurred claims. The reported expense for claims may not reflect the economic expense for insurance contracts for which the settlement of a claim may take some years.</p> | <p>Companies will report estimated future payments to settle incurred claims on a discounted basis. Because the time value of money will be reflected in the measurement of insurance contracts, the reported expense for claims will better reflect the economic expense.</p> |
| <p>Some companies use the 'expected return on assets held' as the discount rate to measure insurance contracts, distorting the value of the insurance contract liabilities as these liabilities may not be directly linked to assets and may have a different duration.</p> | <p>Companies will use a discount rate that reflects the characteristics of the insurance cash flows to measure their insurance contracts. Companies' financial statements will reflect risks from insurance obligations that are not economically matched by assets of equivalent risk and duration.</p> |
| Information about profitability | |
| <p>Some companies do not provide consistent or complete information about the sources of profit recognised from insurance contracts, especially when revenue is reported on a cash basis.</p> | <p>Companies will provide information about different components of current and future profitability arising from insurance contracts. Companies will recognise revenue as they deliver insurance coverage.</p> |
| <p>Many companies provide non-GAAP measures to supplement IFRS 4 information, such as embedded value information. This information, which has been defined independently of IFRS requirements, is not presented on a consistent basis or by all companies.</p> | <p>Companies and users of financial statements will need to use fewer non-GAAP measures. Information about expected insurance contract profits will be provided in a comparable manner by all companies.</p> |

Improvements introduced by IFRS 17 (continued)

IFRS 17 supersedes IFRS 4. IFRS 4 is an interim IFRS Standard that permits companies to account for insurance contracts differently as illustrated in the table on the right.

Some practices currently used by insurance companies do not produce relevant, comparable or understandable information for users of financial statements even within a single jurisdiction.

Some insurance accounting practices have evolved in tandem with circumstances in particular jurisdictions; often the practices address only products most prevalent in the insurance industry in each of those jurisdictions. In many cases, features of the accounting models used by the insurance industry are inconsistent with the IFRS Standards applied by other industries in the same jurisdiction—limiting cross-industry comparability.

IFRS 17 provides consistent principles for all aspects of the accounting for insurance contracts. It also removes the diversity in insurance accounting for companies that have been applying IFRS Standards, enabling investors, analysts and others to meaningfully compare companies, contracts and industries.⁹

| IFRS 4—a lack of comparability | IFRS 17—a consistent framework |
|---|--|
| Comparability among companies across jurisdictions | |
| <p>Accounting for insurance contracts varies significantly between companies operating in different jurisdictions. For example:</p> <ul style="list-style-type: none"> • some companies use current discount rates to measure their insurance contracts; others use historical discount rates. • some companies capitalise and amortise over years the costs incurred in issuing new insurance contracts; others expense these costs when incurred. • some companies recognise as revenue all premiums received; others exclude from their reported revenue any deposit components received through premiums. | <p>Companies will apply a consistent accounting framework for all insurance contracts. Many insurance accounting differences will be removed, enabling investors and analysts to properly identify economic and risk similarities and differences between companies issuing insurance contracts.</p> |
| Comparability among insurance contracts | |
| <p>Some multinational companies consolidate their subsidiaries using non-uniform accounting policies for insurance contracts issued in different jurisdictions. This results in a lack of comparability between insurance contracts issued by the same group in different jurisdictions.</p> | <p>A multinational company will measure insurance contracts consistently within the group, increasing the comparability of its results by product and geographical area. This finally brings the full benefits of IFRS financial statements comparability to companies that issue insurance contracts.</p> |
| Comparability among industries | |
| <p>Some companies present cash or deposits received as revenue. This differs from the accounting applied in other industries, and in particular in the banking and investment-management industries.</p> | <p>Revenue will reflect the insurance coverage provided, excluding deposit components, like any other industry, increasing comparability and understanding of profit or loss of companies issuing insurance contracts. This will enable cross-industry comparability and facilitate understanding for non-specialist investors.</p> |

⁹ See Section 4.3—Comparability of financial information.

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1—Context

1—Context

What is an Effects Analysis?

Before the Board issues new IFRS Standards, or amends existing IFRS Standards, it considers the likely costs and benefits of the new requirements. This includes assessing the effects on the costs for both preparers and users of financial statements. The Board also considers the fact that preparers can often develop information that users of financial statements need at less cost and more accurately than those users would be able to if they had to estimate that information themselves. One of the main objectives of developing a single set of high-quality global accounting standards is to improve the allocation of capital. The Board therefore takes into account the benefits of better economic decision-making that results from improved financial reporting.

Consultation process

The Board gains insight into the likely effects of new or revised IFRS Standards through its exposure of proposals to stakeholders and through its analysis and consultations with them through outreach activities.

The Board has undertaken three public consultations on its insurance contracts proposals and held hundreds of meetings, round tables and other outreach activities. The consultations included extensive discussions with preparers and users of financial statements, actuaries, regulators, standard-setters and accounting firms worldwide.

In addition, the Board was informed by:

- (a) the work performed by its predecessor organisation—the International Accounting Standards Committee—in a project on insurance contracts between 1997 and 2001;¹⁰ and
- (b) an Insurance Working Group, established to help the Board analyse accounting issues relating to insurance contracts.¹¹

This Effects Analysis is based on the feedback received through the consultation process.

Extensive consultation process

- 2007 Discussion Paper—*Preliminary Views on Insurance Contracts*.
- 2010 Exposure Draft—*Insurance Contracts* (the 2010 Exposure Draft).
- 2013 Exposure Draft—*Insurance Contracts* (the 2013 Exposure Draft).
- More than 600 comment letters received and analysed.
- Meetings with the Board’s advisory bodies, including the Insurance Working Group.
- Over 900 meetings with individual and groups of investors, analysts, preparers, actuaries, regulators, standard-setters, accounting firms and others. The meetings with preparers included four rounds of fieldwork and testing meetings, as well as workshops discussing the costs and benefits of the proposals.
- Round-table meetings and discussion forums in 18 countries in 2010 and 2013.

¹⁰ The International Accounting Standards Committee began a project on insurance contracts in 1997. It published an *Issues Paper* in 1999 and concluded its work in 2001 by developing a report to the Board in the form of a *Draft Statement of Principles*. The Board was constituted in 2001, and it included a project on insurance contracts in its initial work plan.

¹¹ The Insurance Working Group brought together a wide range of perspectives and included among its members senior financial executives involved in financial reporting.

Methodology for assessing the effects

The evaluation of costs and benefits (effects) in this Effects Analysis is mainly qualitative, rather than quantitative. This is because quantifying costs and, particularly, benefits, is both a subjective and a difficult process. Although other standard-setters have undertaken quantitative analyses, there are no sufficiently well-established and reliable techniques for the quantification of either costs or benefits in this type of analysis.

In addition, the assessment is of the likely effects of the new accounting requirements for insurance contracts rather than the actual effects, because these will not be known until after the new requirements have been applied. The actual effects are one aspect that is considered through the Board's Post-implementation Review process.¹²

In evaluating the likely effects of IFRS 17, the Board has considered:

- (a) how relevant activities will be reported in the financial statements of those applying IFRS Standards;
- (b) how comparability of financial information will be affected both between different reporting periods for the same company and between different companies in a particular reporting period;
- (c) how the ability of users of financial statements to assess the amount, timing and uncertainty of a company's future cash flows, as well as the company's financial position and performance, will be affected;
- (d) whether better economic decision-making will be possible as a result of improved financial reporting;
- (e) how compliance costs for preparers will be affected, both on initial application and on an ongoing basis; and
- (f) how costs of analysis for users of financial statements will be affected.

Limitations of statistics

When assessing the number of insurance contracts that are expected to be affected by IFRS 17, the Board observed that there are different definitions of insurance products between jurisdictions. Insurance products also have a variety of forms. This raises difficulties in developing a globally accepted classification of insurance products and in presenting statistics by type of product on an international basis.

In addition, because IFRS 4 permits the use of a wide range of practices in the accounting for insurance contracts, there are differences in the existing measurement of insurance contract liabilities and in the presentation of revenue arising from insurance contracts. These differences cause difficulties in aggregating and comparing data for companies operating in different jurisdictions and with different products.

Consequently, statistics about insurance companies and products presented in this document should be considered with these limitations in mind.

The following sections of this document describe the Board's analysis of the effects that are likely to result from IFRS 17.

¹² The Board carries out a Post-implementation Review of each new IFRS Standard or major amendment. This is normally carried out two years after the new requirements have become mandatory and have been implemented globally. Such reviews are normally limited to consideration of important issues identified as contentious during the development of the new requirements, and any unexpected costs or implementation problems encountered.

2—Overview of IFRS 17 requirements

IFRS 17 establishes the requirements that a company must apply in reporting information about insurance contracts it issues and reinsurance contracts it holds. As IFRS 4 does not provide specific requirements for most aspects of the accounting for insurance contracts, companies using IFRS Standards typically have been developing and applying accounting policies for insurance contracts based on local accounting requirements (national GAAP). In this document, these accounting policies are referred to as ‘existing insurance accounting practices’.

Section 2—*Overview of IFRS 17 requirements* discusses the key requirements of IFRS 17, including:

- the definition of contracts to which IFRS 17 applies;
- the separation of non-insurance components;
- the recognition and measurement of insurance contracts issued and reinsurance contracts held, highlighting particular requirements for contracts with a variable fee;
- reporting performance of insurance contracts; and
- disclosures.

2—Overview of IFRS 17 requirements

IFRS 17 sets out the requirements that a company must apply in reporting information about insurance contracts. This new IFRS Standard supersedes IFRS 4 and is effective from 1 January 2021.

What is the scope of IFRS 17?

IFRS 17 substantially retains the scope of IFRS 4, so, essentially, the new requirements affect the same population of contracts accounted for when applying IFRS 4. Like IFRS 4, IFRS 17 does not apply to insurance contracts in which the company is the policyholder; the only exception is when those contracts are reinsurance contracts.

IFRS 17 applies to contracts that are:

- (a) insurance contracts issued (ie sold);
- (b) reinsurance contracts held (ie acquired); or
- (c) investment contracts with discretionary participation features issued.

IFRS 17 substantially retains the existing definitions of insurance contracts, reinsurance contracts and investment contracts with discretionary participation features.

Appendix A to this document includes an overview of insurance products commonly issued by insurance companies throughout the world.

IFRS 17 includes definitions that should be used to identify the insurance products to which the new requirements apply.

It is likely that some products regarded as insurance products (based on local law and regulation) will not be treated as insurance contracts accounted for applying IFRS 17.

Insurance and reinsurance contracts

IFRS 17 carries forward from IFRS 4 the definition of an insurance contract and that of a reinsurance contract, together with the related guidance that explains how to apply those definitions.

As in IFRS 4, an insurance contract is defined by the presence of significant insurance risk—that is, a risk, other than a financial risk, transferred from the holder of the contract to the issuer (ie from the policyholder to the insurer).

The Board expects that IFRS 17 will not change conclusions about whether contracts are insurance contracts or reinsurance contracts. Therefore, a contract that is an insurance contract in applying IFRS 4 is expected to be an insurance contract in applying IFRS 17. Companies are unlikely to need to develop internal new guidance and interpretations relating to applying the insurance contract definition in IFRS 17.

Discretionary investment contracts

IFRS 17 also applies to investment contracts with discretionary participation features issued by a company, if the company also issues insurance contracts.¹³

These contracts have similar economic characteristics as insurance contracts (for example, long duration, recurring premiums, the amount or timing of the return is contractually determined at the discretion of the issuer) and they are commonly linked to the same pool of assets as, or share in the performance of, insurance contracts. Applying insurance contracts accounting to these contracts is therefore expected to provide useful information to users of financial statements.

¹³ Companies that do not issue insurance contracts apply the requirements in IFRS 9 to account for their investment contracts with discretionary participation features.

The definition of an investment contract with discretionary participation features in IFRS 17 is similar to the equivalent definition in IFRS 4.

However, unlike IFRS 4, IFRS 17 applies only to investment contracts with discretionary participation features that are issued by a company that also issues insurance contracts. Other companies apply IFRS 9 to such contracts. Feedback received by the Board indicated that few investment contracts with discretionary participation features are issued by non-insurers. As a result, most of these contracts are expected to continue to be accounted for as insurance contracts rather than as financial instruments applying IFRS 9.

Scope exclusions

Refer to the discussion in Section 3—*Companies affected* about the contracts that can be accounted for applying other IFRS Standards, such as product warranties, financial guarantee contracts and fixed-fee service contracts.

Separate components

An insurance contract typically creates a number of rights and obligations that together generate a package of cash inflows and cash outflows. Some insurance contracts include features in addition to the transfer of significant insurance risk, such as derivatives, deposits and asset management services. These features are known as non-insurance components. Under some circumstances, IFRS 17 requires a company to:

- (a) separate the non-insurance components from an insurance contract if a separate contract with the same features would be within the scope of another IFRS Standard; and
- (b) account for those non-insurance components applying that other IFRS Standard.

IFRS 17 requirements to separate non-insurance components are summarised in the following table.

Summary of IFRS 17 requirements to account for non-insurance components of an insurance contract separately

| Non-insurance component | When they are accounted for separately | Applicable IFRS Standard |
|--|--|--------------------------|
| Embedded derivatives | If required by IFRS 9 ¹⁴ | IFRS 9 |
| Deposits (investment components or deposit components) | If distinct ¹⁵ | IFRS 9 |
| Goods and non-insurance services | If distinct ¹⁵ | IFRS 15 |

IFRS 17 prohibits the separation of non-insurance components if the specified criteria are not met.

¹⁴ IFRS 17 requires a company to apply IFRS 9 to determine whether an embedded derivative should be accounted for separately from an insurance contract.

¹⁵ In essence, a non-insurance component in a contract is distinct if: (a) it is not highly interrelated with the insurance component; and (b) a contract with equivalent terms could be sold separately in the same market.

IFRS 17 requirements about the separation of non-insurance components of contracts differ from existing practice mainly by requiring separation of deposits, goods and non-insurance services when specified requirements are met and by prohibiting separation when those requirements are not met.

IFRS 4 requires insurers to separate embedded derivatives and deposits from insurance contracts in some circumstances. However, IFRS 4 does not require insurers to separate from the insurance contract any distinct obligation to provide goods or non-insurance services that are embedded within the insurance contract.

Although IFRS 4 permits insurers to voluntarily change their accounting policies to separate contracts with customers for goods and non-insurance services from their insurance contracts when first implementing IFRS 15, the Board does not expect that many companies have done this (or that they will do so).¹⁶

Consequently, the Board expects that, when IFRS 17 is first applied, a few goods and non-insurance services embedded within insurance contracts will be accounted for separately for the first time.

IFRS 17 accounting model

IFRS 17 provides a consistent framework for accounting for all insurance contracts issued.

A company is allowed to apply the requirements of IFRS 17 to a group of contracts rather than on a contract-by-contract basis (see Section 5.3—*Key cost reliefs*). In grouping insurance contracts, a company is required to identify portfolios of contracts and to divide each portfolio into:

- (a) a group of contracts that are onerous at initial recognition, if any;
- (b) a group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and
- (c) a group of remaining contracts, if any.

In addition, a group of contracts cannot include contracts issued more than one year apart.

Recognition

IFRS 17 requires a company to recognise a group of insurance contracts it issues from the earliest of the following:

- (a) the beginning of the coverage period;
- (b) the date on which the first payment from a policyholder is due; and
- (c) for a group of onerous contracts, when the group becomes onerous.

Explanations of some terms used

Portfolio of contracts

Insurance contracts that are subject to similar risks and that are managed together.

Onerous contracts

A group of contracts becomes onerous if its estimated cash outflows exceed its estimated cash inflows.

Discount rates

Discount rates reflect the characteristics of the cash flows arising from the group of insurance contracts (for example, the timing, currency and liquidity of the cash flows). They are based on current observable interest rates, with adjustments being made to these observable rates to align them with the characteristics of the group of insurance contracts.

Risk adjustment

The risk adjustment is an explicit adjustment to reflect the uncertainty in timing and in amount of future cash flows.

¹⁶ A company is required to apply IFRS 15 from 1 January 2018. Early application is permitted.

Initial measurement

A company issuing insurance contracts assesses the rights and obligations arising from groups of contracts and reflects them net on its balance sheet, on a discounted basis.

All insurance contracts are initially measured as the total of:

- 1 the fulfilment cash flows; and
- 2 the contractual service margin, unless the contracts are onerous.

Fulfilment cash flows

The fulfilment cash flows are the current estimates of the amounts that an insurer expects to collect from premiums and pay out for claims, benefits and expenses, adjusted to reflect the timing and the uncertainty in those amounts. The adjustment for uncertainty is called the risk adjustment.

The cash flows of a group of contracts may be affected by cash flows of other groups of contracts as specified in the terms of the contracts. This factor—sometimes referred to as ‘mutualisation between contracts’—is considered in the measurement of the fulfilment cash flows.

Contractual service margin

The contractual service margin represents the profit that the company expects to earn as it provides insurance coverage. This profit is recognised in profit or loss over the coverage period as the company provides the insurance coverage.

At initial recognition of the contracts, the contractual service margin is the present value of risk-adjusted future cash inflows less the present value of risk-adjusted future cash outflows. In other words, it is the amount that, when added to the fulfilment cash flows, prevents the recognition of unearned profit when a group of contracts is first recognised.

Onerous contracts

If contracts are onerous, losses are recognised immediately in profit or loss. No contractual service margin is recognised on the balance sheet on initial recognition.

Subsequent measurement

The fulfilment cash flows are measured using current assumptions. Those assumptions are updated at each reporting date, using current estimates of the amount, timing and uncertainty of cash flows and of discount rates.

The way in which changes in estimates of the fulfilment cash flows are treated depends on which estimate is being updated:

- (a) changes that relate to current or past coverage are recognised in profit or loss.
- (b) changes that relate to future coverage are recognised by adjusting the contractual service margin. However, if the contractual service margin is zero, the changes are recognised in profit or loss.

The contractual service margin is recognised in profit or loss over the coverage period based on the quantity of coverage provided by the contracts in the group and their expected duration.

Interest for the passage of time is accreted on the contractual service margin, using discount rates at initial recognition of the contracts.¹⁷

Optional simplified approach

A company can use a simplified approach to measure some short-term insurance contracts (see Section 5.3—*Key cost reliefs*).

¹⁷ Except for contracts with a variable fee as discussed in the following pages.

Contracts with a variable fee

IFRS 17 has a specific approach for ‘insurance contracts with direct participation features’.

Insurance contracts with direct participation features may be regarded as creating an obligation to pay policyholders an amount that is equal to the fair value of the underlying items, less a variable fee for service. Consequently, these contracts provide investment-related services which are integrated with insurance coverage.

Contracts with direct participation features

An insurance contract with direct participation features is a contract that includes all of the following features:

- (a) the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items;
- (b) the company expects to pay the policyholder an amount equal to a substantial share of the fair value returns on the underlying items; and
- (c) the company expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items.

The variable fee:

- (a) represents the consideration a company receives for providing investment-related services.
- (b) is based on a share in the underlying items for which the value varies over time. Consequently, the variable fee reflects both the investment performance of the underlying items and the other cash flows needed to fulfil the contracts.

The approach for insurance contracts with direct participation features is referred to as the variable fee approach. The variable fee approach modifies the accounting model in IFRS 17 (referred to as the general accounting model) to reflect that the consideration that a company receives for the contracts is a variable fee.

The general accounting model and the variable fee approach measure the fulfilment cash flows in the same way. At initial recognition, there is no difference between the contractual service margin determined applying the general accounting model and that determined applying the variable fee approach. Moreover, subsequent changes in estimates of the fulfilment cash flows that relate to future coverage adjust the contractual service margin.¹⁸ Other changes, including those that relate to current or past coverage, are recognised in profit or loss.

Differences arise for changes in fulfilment cash flows due to changes in discount rates and other financial variables. All such changes are reported in the statement of comprehensive income (profit or loss or other comprehensive income) for the general accounting model. However, in the variable fee approach, the contractual service margin is adjusted to reflect the changes in the variable fee, which includes some changes in discount rates and other financial variables.

An option is available when a company mitigates its financial risks associated with contracts with direct participation features. If such insurance contracts contain complex features, such as minimum payments guaranteed to the policyholder, and the company chooses to use derivatives to mitigate the financial risk created by those features, the company may elect to recognise changes in that financial risk in profit or loss instead of adjusting the contractual service margin. This partially offsets the effect of fair value changes of the relevant derivatives recognised in profit or loss in applying IFRS 9 and reduces potential accounting mismatches.

¹⁸ If the contractual service margin became negative, the effect of changes in excess of the contractual service margin would be recognised in profit or loss.

When applying the general accounting model, the interest expense on the contractual service margin is explicitly accreted using rates at the initial recognition of the contracts. In contrast, for contracts with direct participation features, the interest expenses are implicit in the changes in the insurer's variable fee (its share of the underlying items and other cash flows needed to fulfil the contracts).

The following table summarises the key differences between the general accounting model and the variable fee approach.

| Differences between the general accounting model and the variable fee approach | |
|--|--|
| General accounting model | The contractual service margin at initial recognition is updated to reflect changes in cash flows related to future coverage and accreted using interest rates at initial recognition. |
| Variable fee approach | The contractual service margin at initial recognition is updated to reflect changes in the amount of the variable fee, including those related to changes in discount rates and other financial variables. ¹⁹ |

¹⁹ If a company chooses to use derivatives to mitigate the financial risks reflected in insurance contracts, the company can elect to recognise changes in those financial risks in profit or loss rather than by adjusting the contractual service margin.

²⁰ However, a company cannot apply the variable fee approach to its reinsurance contracts issued or to its reinsurance contracts held.

Reinsurance contracts held

Insurers typically manage some risks assumed by issuing insurance contracts by transferring a portion of the risk on those underlying insurance contracts to another insurance company, by entering into reinsurance contracts.

IFRS 17 generally requires a company to account for reinsurance contracts held using an approach consistent with that for the underlying insurance contracts.²⁰ Reinsurance contracts held are accounted for using the general accounting model modified for:

- (a) recognition date. A group of reinsurance contracts held is recognised from either the beginning of the coverage period of the group of reinsurance contracts or the initial recognition of the underlying insurance contracts, whichever is the later date, or from the beginning of the coverage period if the reinsurance coverage is not for the proportionate losses of a group of underlying insurance contracts.
- (b) estimation of the fulfilment cash flows. For reinsurance contracts held, the fulfilment cash flows reflect the risk of non-performance by the issuer of the reinsurance contract.
- (c) measurement of the contractual service margin at initial recognition. Any net gain or loss at initial recognition is recognised as a contractual service margin, unless the net cost of purchasing reinsurance relates to past events, in which case the company is required to recognise the net cost immediately in profit or loss.

Financial performance

A company recognises in the statement of comprehensive income:

- (a) an insurance service result, comprising:
 - (i) insurance revenue; less
 - (ii) insurance service expenses.
- (b) insurance finance income or expenses.

Insurance revenue

Revenue from insurance contracts represents the consideration that a company expects to be entitled to in exchange for services provided under the contracts. It includes the consideration that covers the amount of contractual service margin recognised in profit or loss for the period and the amount of insurance expenses incurred in the period.

Many insurance contracts with investment features include a deposit component—ie an amount paid by the policyholder that is repaid by the insurer even if an insured event does not occur. Deposit components are excluded from profit or loss—ie the collection of a deposit is not revenue and the repayment of that deposit is not an expense.

Insurance service expenses

Insurance service expenses reflect the costs incurred in providing services in the period, including incurred claims, and exclude the repayment of deposit components.

Insurance finance income or expenses

IFRS 17 requires a company to account for the fulfilment cash flows and the contractual service margin on a discounted basis that reflects the timing of cash flows. As time passes, the effect of the time value of money reduces and this reduction is reflected in the statement of comprehensive income as an insurance finance expense. In effect, the insurance finance expenses are akin to interest paid on an advance payment and reflects the fact that policyholders typically pay premiums up front and receive benefits only at a later date.

Insurance finance income or expenses also include the effect on the carrying amount of insurance contracts of some changes in financial assumptions (ie discount rates and other financial variables).

A company recognises the effect of those changes in discount rates and other financial variables in the period in which the changes occur. The company can choose where to present this—either in profit or loss, or disaggregated between profit or loss and other comprehensive income. This choice is made by portfolio of contracts (see Section 5.3—*Key cost reliefs*).

The Board expects that a company is likely to choose the option that best corresponds to the accounting for financial assets relating to insurance contracts—ie the option that is most likely to minimise accounting mismatches between investment income (from financial assets) and insurance finance expenses (from insurance contract liabilities) recognised in profit or loss (see Section 7.1—*Interaction with IFRS 9*).

Disclosures

IFRS 17 requires a number of disclosures. They provide additional information about the amounts recognised in the balance sheet and in the statement of comprehensive income, the significant judgements made when applying IFRS 17, and the nature and extent of the risks that arise from issuing insurance contracts.

Explanation of recognised amounts

IFRS 17 requires a company to provide reconciliations between the opening and closing balances of insurance contracts issued and reinsurance contracts held, broken down into the following components:

- (a) liabilities for remaining coverage (with separate identification of amounts immediately recognised in profit or loss for onerous contracts) and liabilities for incurred claims; and
- (b) the estimates of the present value of future cash flows, the risk adjustment and the remaining contractual service margin.²¹

²¹ This reconciliation is not required for the liability for remaining coverage of contracts accounted for applying the simplified approach discussed in Section 5.3—*Key cost reliefs*.

IFRS 17 also requires a company to provide:

- (a) an explanation of when the remaining contractual service margin is expected to be recognised in profit or loss; and
- (b) an analysis of:
 - (i) the insurance revenue;
 - (ii) insurance finance income or expenses; and
 - (iii) new business (ie contracts initially recognised in the period).

Significant judgements

The disclosures required by IFRS 17 about significant judgements made in applying IFRS 17 include:

- (a) the methods used to measure insurance contracts and the processes used for estimating inputs to those methods, including quantitative information about those inputs when practicable;
- (b) any changes in the above methods and processes, together with an explanation of the reason for each change and the type of contracts affected; and
- (c) the yield curve (or range of yield curves) used to discount the cash flows.

If a company uses a technique other than the confidence-level technique for determining the risk adjustment, it is required to disclose a translation of the result of that technique into a confidence level, to allow users of financial statements to see how the company's own assessment of its risk aversion compares to that of other companies.²³

Nature and extent of risks arising from insurance contracts

The disclosures about insurance and financial risks arising from insurance contracts are similar to the disclosures about financial risks arising from financial instruments in IFRS 7 *Financial Instruments: Disclosures* that are incorporated in IFRS 4 by cross-reference.

These include a sensitivity analysis for insurance risk and for each type of market risk, together with disclosures about:

- (a) exposures to risks and how they arise;
- (b) objectives, policies and processes for managing risks and the methods used to measure those risks;
- (c) concentrations of risk arising from insurance contracts;

- (d) the claims development—ie actual claims compared with previous estimates of the undiscounted amount of the claims;
- (e) the credit quality of reinsurance contract assets; and
- (f) liquidity risk, including a maturity analysis showing the estimated cash flows arising from insurance contracts.

IFRS 17 also requires a company that issues insurance contracts to disclose information about the effect of the regulatory frameworks in which it operates (for example, such information might include minimum capital requirements or required interest rate guarantees). This is in addition to the disclosure requirements included in IAS 1 *Presentation of Financial Statements* for all companies applying IFRS Standards.²⁴

²³ The confidence-level technique expresses the likelihood that the actual outcome will be within a specified interval. This technique is sometimes referred to as 'value at risk'.

²⁴ IAS 1 requires a company to disclose: (a) information about externally imposed capital requirements; (b) the nature of those requirements; (c) how the requirements are incorporated into the management of capital; and (d) whether during the reporting period the company has complied with any externally imposed capital requirements to which it is subject, and if not, the consequences of such non-compliance.

3—Companies affected

IFRS 17 essentially applies to the same population of contracts that IFRS 4 applies to. Like IFRS 4, IFRS 17 applies to all companies that issue insurance contracts and not only to insurance companies. However, insurance contracts are generally not issued by companies outside of the insurance industry.

Because IFRS 17 is expected to affect companies primarily in the insurance industry, Section 3—*Companies affected* focuses on insurance companies (listed and unlisted). This section provides information about the number and the size of listed insurers using IFRS Standards, by geographical region and by primary business, as well as an overview of the use by jurisdictions of IFRS Standards for unlisted insurers.

This section also discusses the less significant effects of IFRS 17 on banks and investment companies, and on non-financial companies. Non-financial companies providing insurance services are generally not expected to apply IFRS 17 because of the scope exclusions in the Standard.

3—Companies affected

Who will be affected by IFRS 17?

IFRS 17 applies to insurance contracts. Although this means that IFRS 17 affects any companies that issue contracts meeting the definition of an insurance contract, the Board expects that IFRS 17 will primarily affect companies in the insurance industry. This is because:

- (a) most insurance contracts are issued by insurance companies;
- (b) although insurance companies can continue to apply the accounting requirements for insurance contracts to financial guarantees that they issue, all other companies are expected to continue to apply the accounting requirements for financial instruments to them;²⁵ and
- (c) although some fixed-fee service contracts meet the definition of an insurance contract (for example, automobile roadside assistance), IFRS 17 provides an option to use IFRS 15 to account for them in the same way as other contracts with customers are accounted for.

The Board expects that, to implement IFRS 17, most insurance companies will to some extent need to revise their accounting for the insurance contracts they issue. For many insurance companies the revision required will be extensive. Consequently, the analysis in this document focuses on insurance companies.

Listed insurance companies

Because of limitations on the availability of relevant information, and because of the different classification criteria used by companies and jurisdictions, the information in this section is analysed using a number of assumptions, set out in Appendix C to this document. The Board used information gathered about insurance companies by the Capital IQ database as a basis for the analysis.²⁶

The Board has assessed the number of insurance companies that are expected to be affected by IFRS 17 by analysing information available about listed companies.²⁷

The Board identified 672 listed insurance companies captured by the Capital IQ database, of which 46 were classified as ‘insurance brokers’.

Insurance brokers are not expected to be directly affected by IFRS 17 as they do not typically issue insurance contracts. Their main activity is to arrange insurance cover with an insurer on behalf of their customers. Consequently, the Board excluded insurance brokers from the analysis.

²⁵ Some financial guarantee contracts result in the transfer of significant insurance risk and therefore meet the definition of an insurance contract in IFRS 17. However, a company shall not apply IFRS 17 to financial guarantee contracts unless it has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts.

²⁶ The Capital IQ database provided by Standard & Poor compiles financial information available in the financial statements of companies.

²⁷ In this section, all listed companies referred to are those captured by the Capital IQ database at the date of assessing the effects of IFRS 17.

Listed insurance companies by region

The following table provides an overview by geographical region of the listed companies operating in the insurance sector that were used as a basis for this analysis.

| Listed insurance companies only | Geographical region | Number of companies | Total assets ²⁸ (US\$ trillions) |
|---------------------------------|------------------------|---------------------|---|
| | Europe | 95 | 8.6 |
| | Asia Pacific | 191 | 7.2 |
| | North America | 110 | 5.8 |
| | Africa and Middle East | 184 | 0.3 |
| | Latin America | 46 | 0.2 |
| | Total | 626 | 22.1 |

Note: this table excludes insurance brokers.

The geographical information in this section is based on the location of each company's headquarters. This means that, for example, an insurance group with operations in Europe, North America and Asia and a holding company based in Europe is reported as a European company.

Accounting standards used by listed insurance companies

An analysis of the accounting standards used by these listed insurance companies reveals that:

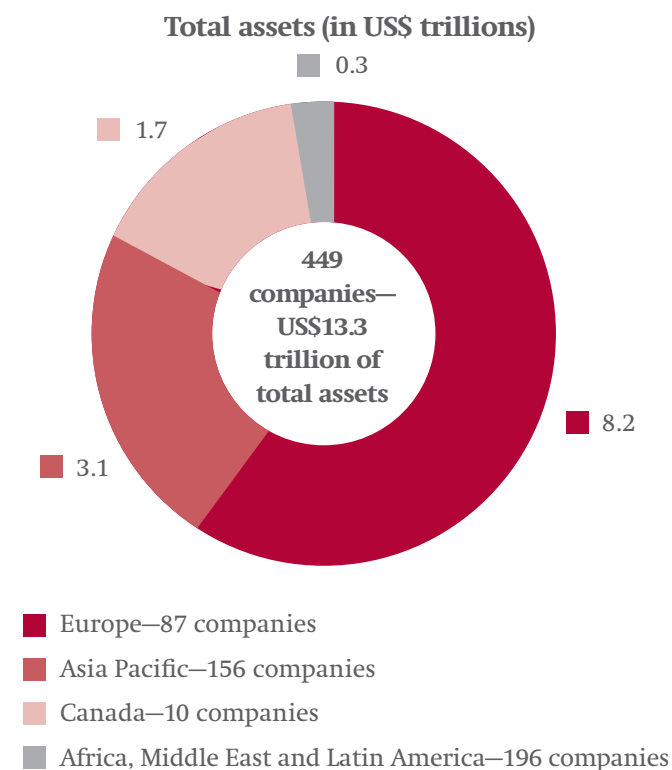
- the majority (72 per cent—449 of 626) use IFRS Standards;
- a minority (20 per cent—128 of 626) use US generally accepted accounting principles (US GAAP);
- few (2 per cent—11 of 626) use Japanese GAAP; and
- the remainder use national requirements other than US GAAP and Japanese GAAP (other national GAAP).

| Listed insurance companies only | Reporting framework | Number of companies | Total assets ²⁸ (US\$ trillions) |
|---------------------------------|---------------------|---------------------|---|
| | IFRS Standards | 449 | 13.3 |
| | US GAAP | 128 | 4.7 |
| | Japanese GAAP | 11 | 4.0 |
| | Other national GAAP | 38 | 0.1 |
| | Total | 626 | 22.1 |

Note: this table excludes insurance brokers.

Listed insurance companies using IFRS Standards by region

The following chart provides an overview by geographical region of the total assets of the 449 listed insurance companies using IFRS Standards, excluding insurance brokers.



²⁸ The relative size of these companies is best reflected by total assets. Because IFRS 4 permits the use of a wide range of practices in the accounting for insurance contracts, there are significant differences in the measurement of insurance contract liabilities—and, therefore, in shareholders' equity—and in the presentation of revenue arising from insurance contracts. Consequently, insurance contract liabilities, shareholders' equity and revenue have not been shown in the table.

Accounting policies applied to insurance contracts issued

Because IFRS 4 does not provide specific requirements for most aspects of the recognition and measurement of insurance contracts, companies using IFRS Standards typically have been developing and applying accounting policies for insurance contracts based on the requirements of the national GAAP that existed at the time of first applying IFRS 4.

The following analysis of the accounting policies applied to insurance contracts examines the potential effects of IFRS 17. The analysis focuses on a sample of the 20 listed insurance companies with the highest total assets. On the basis of information in those companies' latest annual reports, those companies hold approximately 68 per cent of the total assets of the 449 listed insurance companies using IFRS Standards.

The analysis reveals that 40 per cent of those companies (ie 8 of 20) are multinational companies that prepared their consolidated financial statements as at 31 December 2015 using a variety of different policies to account for insurance contracts. As permitted by IFRS 4, even within the same group, those companies accounted for insurance contracts issued in different jurisdictions using accounting policies based on requirements of national GAAP for each jurisdiction.

| Top-20 listed insurance companies using IFRS Standards | | |
|--|---------------------|-------------------------------|
| Accounting policies applied to insurance contracts issued | Number of companies | Total assets (US\$ trillions) |
| Based on guidance in: | | |
| • a mix of national GAAP* | 8 | 4.1 |
| • US GAAP | 3 | 1.6 |
| • Canadian GAAP | 4 | 1.4 |
| • other national GAAP | 5 | 2.0 |
| Total | 20 | 9.1 |
| * These companies had subsidiaries in different jurisdictions. They accounted for the insurance contracts they issued in different jurisdictions using accounting policies based on requirements of national GAAP for each jurisdiction. | | |

The remainder of the companies in the sample (ie 60 per cent—12 of 20) accounted for the insurance contracts they issued using accounting policies based on requirements of a specific set of national GAAP. Many of those companies typically have insurance operations concentrated in one jurisdiction. Others apply consistent accounting policies for domestic and foreign insurance operations.

Comments about the effects of IFRS 17 frequently focus on the different effects by jurisdiction. However, on the basis of this analysis, the Board expects that, in some cases, different insurance contracts, even within a single insurance company, will be affected in different ways by IFRS 17 depending on the different accounting policies currently applied to those contracts by the same company in different jurisdictions.

This illustrates the complexity caused by the diversity in existing insurance accounting practices. See Section 4.3—*Comparability of financial information* for further information about different accounting policies used by a single company to account for similar insurance contracts when applying IFRS 4.

The effects of IFRS 17 will depend significantly on how much the requirements in IFRS 17 differ from the accounting policies currently applied by a company to its insurance contracts.

Insurance companies by type of business

As existing insurance accounting practices typically differentiate between types of contracts (such as short-term and long-term insurance contracts or non-life and life insurance contracts), the effects of IFRS 17 are expected to be different for each of those types of contracts (see Section 4.1—*Improved requirements introduced by IFRS 17*).

Accordingly, companies issuing different types of insurance contracts are expected to be affected in different ways by the new requirements.

Four broad categories of insurance companies can be identified, based on a common industry classification:

- (a) property and casualty insurers;
- (b) life and health insurers;
- (c) multi-line insurers; and
- (d) reinsurers.²⁹

| Listed IFRS insurance companies only | Primary business | Number of insurance companies | Total assets (US\$ trillions) |
|--------------------------------------|-----------------------|-------------------------------|-------------------------------|
| | Property and casualty | 150 | 0.6 |
| | Life and health | 96 | 7.5 |
| | Multi-line | 181 | 4.7 |
| | Reinsurance | 22 | 0.5 |
| | Total | 449 | 13.3 |

Property and casualty

Property and casualty insurers—also called general insurers or non-life insurers—typically issue insurance contracts providing insurance coverage over a relatively short period of time, such as one year. The Board expects that most of these companies will apply the simplified approach for the majority of their contracts (see Section 5.3—*Key cost reliefs*). The Board expects that the greatest effect of implementing IFRS 17 for these companies will come from the need to consider the requirement to discount and apply an explicit risk adjustment for incurred claims.

Life and health

Life and health insurers typically sell products that cover risks over longer periods, possibly many decades. These companies are expected to be the most affected by IFRS 17. This is because, although there are significant differences between the methods used currently to account for such long-term contracts, typically these companies do not measure their insurance contracts using fully updated information, which is a requirement of IFRS 17.

Multi-line

Multi-line insurers may have diversified interests in property and casualty, life and health and reinsurance. The effects of IFRS 17 on these companies will largely depend on the mix of the insurance contracts they issue.

For multi-line insurers, segment reporting typically provides relevant information about operating segments. The Board expects that when IFRS 17 is effective, those companies will continue to provide appropriate disclosures applying IFRS 8 *Operating Segments*.

Reinsurance

IFRS 17 generally requires reinsurers to account for reinsurance contracts they issue in the same way to insurance contracts issued by insurers. Consequently, the effects of IFRS 17 on these companies will depend on the type of reinsurance contracts they issue (ie whether they are short-term or long-term contracts).

Unlisted insurance companies

IFRS 17 will also affect unlisted insurance companies using IFRS Standards, including, for example, mutual insurers³⁰ and subsidiaries of banking groups. However, representative and reliable financial information about such companies is difficult to obtain, and therefore information about the number and the size of unlisted companies is not included in the analysis.

The Board has considered the effect that IFRS 17 might have on unlisted insurance companies by analysing information about the use of IFRS Standards across jurisdictions.

²⁹ See Appendix C to this document for the classification system used in this document.

³⁰ A mutual insurer is an insurance company which is collectively owned by its members who are at the same time its customers (policyholders).

To obtain a perspective of the level of insurance activity by jurisdiction, the analysis considered the geographical information about premiums written in 2015 according to the publication Swiss Re, *sigma* No 03/2016.

The analysis focused on 46 jurisdictions, which represented 98 per cent of those premiums.³¹ These 46 jurisdictions each had a total premium volume of more than US\$5 billion.

Unlisted insurers affected by IFRS 17

The analysis revealed that at the time of publication of IFRS 17, 12 jurisdictions required the use of IFRS Standards for all unlisted insurers.

These jurisdictions, listed in descending order of premiums written in 2015, were: South Korea, Canada, Australia, South Africa, Malaysia, Portugal, Turkey, United Arab Emirates, Saudi Arabia, New Zealand, Iran and Venezuela.

The analysis also showed that seven jurisdictions required the use of IFRS Standards only for some unlisted insurers. For example, Italy, Brazil, Sweden and Belgium required the use of IFRS Standards only for consolidated financial statements of unlisted insurers.

Unlisted insurers that might be affected by IFRS 17

There were 18 other jurisdictions, including Japan, the United Kingdom, the Netherlands and Switzerland, that permitted unlisted insurers to use IFRS Standards to some extent. Unlisted insurers in France and Germany were permitted to use IFRS Standards only for consolidated financial statements.

Overview of the use of IFRS Standards for unlisted insurers

| Geographical region | Jurisdictions | | | | |
|------------------------|----------------------|--|---|--|---|
| | Number in the region | Number that require IFRS Standards for all unlisted insurers | Number that require IFRS Standards for some unlisted insurers | Number that permit IFRS Standards for some unlisted insurers | Number that neither require nor permit IFRS Standards for unlisted insurers |
| Europe | 19 | 1 | 4 | 13 | 1 |
| Asia Pacific | 13 | 4 | 1 | 3 | 5 |
| North America | 2 | 1 | – | – | 1 |
| Africa and Middle East | 6 | 5 | – | 1 | – |
| Latin America | 6 | 1 | 2 | 1 | 2 |
| Total | 46 | 12 | 7 | 18 | 9 |

³¹ Jurisdictions representing 98 per cent of premiums written in 2015 according to 'World insurance in 2015: steady growth amid regional disparities', Swiss Re, *sigma* No 03/2016. These premiums are the aggregate for listed and unlisted companies.

Unlisted insurers not directly affected by IFRS 17

In contrast, nine jurisdictions, including the United States, China and India, required insurers to apply national GAAP and/or specific accounting requirements issued by local regulators.

In some of these jurisdictions, such as China and India, national GAAP are substantially converged with IFRS Standards.

The Board acknowledges that a change in IFRS Standards might subsequently result in a similar change in national GAAP applied by unlisted insurance companies when preparing financial statements.

Although the Board's role does not include addressing territory-specific or company-specific regulations, it has an ongoing dialogue with national standard-setters. The Board will continue working with national standard-setters to raise awareness of potential issues so that they can be addressed in a timely way.

Given that the use of IFRS Standards for unlisted companies varies by jurisdiction, the number of unlisted insurance companies that will be affected by IFRS 17 will vary accordingly.

Banks and investment companies

For banks and investment companies with significant insurance operations, such as banking groups with insurance subsidiaries, their insurance operations will be affected by IFRS 17 in the same way that insurers with the same operations will be affected.

Banks

The Board does not expect that banks without significant insurance operations will be particularly affected by IFRS 17. This is because, although a bank may issue insurance contracts, the vast majority of these contracts are not expected to be accounted for using the IFRS 17 requirements for the reasons given in the following paragraphs related to financial guarantees and other banking agreements.

Financial guarantees

Banks often issue contracts that require them to compensate the contract holders for losses they incur because a debtor fails to make loan payments when due. These contracts may have many different legal forms and names, and are sometimes called financial guarantee contracts. These contracts meet the definition of an insurance contract if the insurance risk transferred is significant.

If a bank has previously explicitly asserted that it regards such contracts as insurance contracts and has used accounting that is applicable to insurance contracts, it may elect to apply the requirements either in IFRS 9 or IFRS 17 to such financial guarantee contracts. The bank may make that election on a contract-by-contract basis, but the election for each contract is irrevocable.

The Board expects that banks will apply the requirements in IFRS 9 to their financial guarantee contracts. This is because those requirements are expected to result in consistent accounting for economically similar contracts issued by the same company. The option to apply the requirements for financial instruments to such contracts has been carried forward to IFRS 17 from IFRS 4 as it has worked in practice.

Accordingly, the Board expects that only insurance companies will apply IFRS 17 to financial guarantee contracts.

Other banking agreements

IFRS 17 confirms that other common banking agreements such as credit-related guarantees that require payments to be made even if the holder of the contract has not incurred a loss are not insurance contracts. This is because they do not transfer significant insurance risk from the holder of the contract to the issuer. Therefore, IFRS 17 will not affect such contracts.

Investment companies

Investment companies typically issue contracts that are similar to some insurance contracts but that are not expected to be accounted for applying IFRS 17. However, the Board expects some investment companies without significant insurance operations, such as asset managers, to still be indirectly affected by IFRS 17. This is because the presentation of insurance contracts will be more comparable to products issued by investment companies when insurers apply IFRS 17. See Section 4.3—*Comparability of financial information* for an analysis of the effects of IFRS 17 on comparability between industries.

Non-financial companies

The Board does not expect that IFRS 17 will significantly affect non-financial companies. This is because, in many circumstances, non-financial companies providing insurance services are not expected to apply IFRS 17 as discussed in the following paragraphs.

Principal versus agent considerations

Many non-financial companies offer insurance services but this may be incidental to the main services provided. For example, airlines typically offer travel insurance as part of flight booking. Car rental companies typically offer car insurance coverage alongside the rental of a vehicle.

A non-financial company may either:

- (a) provide the insurance coverage itself—ie the company is acting as a principal; or
- (b) arrange for another party to provide the insurance service—ie the company is acting as an agent.

IFRS 17 will affect non-financial companies providing insurance coverage by issuing insurance contracts (ie companies acting as a principal). Those companies will be affected by IFRS 17 in the same way that insurers with similar insurance operations will be affected.

In contrast, IFRS 17 is not expected to change the accounting practices applied by non-financial companies acting as agents of insurers (for example, collecting premiums on behalf of an insurer). This is because those companies do not issue insurance contracts.

Product warranties

Many consumer products, such as fridges and washing machines, are sold with warranties that provide customers with protection against defects that were not identified during the manufacturing process. These product warranties (sometimes called ‘quality assurance warranties’) are typically issued by the manufacturer, dealer or retailer of the product and last for one or two years.

Although these product warranties meet the definition of an insurance contract in IFRS 17 (as they do in IFRS 4), IFRS 17 does not apply to product warranties issued by a manufacturer, dealer or retailer. Instead, a manufacturer, dealer or retailer accounts for those warranties applying other IFRS Standards (namely IFRS 15 and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*).

In contrast, IFRS 17 applies to product warranties issued by another party for goods sold by a manufacturer, dealer or retailer. Those warranties typically provide coverage to the customer for faults that arise after the product is transferred to the customer (sometimes called ‘insurance warranties’). In some jurisdictions, these warranties might be considered incidental or complementary to the issuing company’s business and as such they might not be regulated as insurance contracts issued by insurance companies.

This means that IFRS 17 may apply to some contracts that are not considered insurance contracts when applying local regulations. The effect of IFRS 17 on companies issuing insurance warranties will vary. The Board expects that the majority of insurance warranties will be issued by insurance companies.

Fixed-fee service contracts

Non-financial companies may also sell fixed-fee service contracts. Examples of such contracts include roadside assistance programmes and maintenance contracts in which the company providing the service agrees to repair specified equipment after a malfunction, in exchange for a fixed premium. These contracts might expose the company providing the service to risk because the level of service depends on an uncertain event.

A significant majority of fixed-fee service contracts are expected to be accounted for applying other IFRS Standards than IFRS 17.

This is because IFRS 17 permits a company to choose to account for a fixed-fee service contract using the revenue recognition requirements in IFRS 15 if the primary purpose of the contract is the provision of services.

The Board expects that many non-financial companies will choose to continue to apply the revenue recognition requirements to the fixed-fee service contracts they issue. This is because they are expected to conclude that that accounting provides relevant information for the users of their financial statements.

Accordingly, the Board expects that only insurance companies will apply IFRS 17 to fixed-fee service contracts.

4—Benefits

IFRS 17 will address many inadequacies in existing insurance accounting practices. This is because IFRS 17:

- (a) introduces current, transparent and consistent financial information about insurance contracts; and
- (b) removes the diversity in accounting for insurance contracts that exists when applying IFRS 4.

Section 4.1—*Improved requirements introduced by IFRS 17* provides an overview of the improved accounting requirements introduced by IFRS 17 in comparison with common existing insurance accounting practices.

Section 4.2—*Improved financial information* discusses the financial reporting benefits introduced by IFRS 17. In particular, this section discusses the useful information about insurance obligations and risks, as well as about the profitability of insurance contracts, that IFRS 17 will provide.

Section 4.3—*Comparability of financial information* discusses the benefits introduced by IFRS 17 relating to the comparability among companies, contracts and industries.

4.1—Improved requirements introduced by IFRS 17

Section 2—*Overview of IFRS 17 requirements* discusses the key requirements of IFRS 17 which are expected to address many inadequacies in insurance accounting practices currently applied by many companies.

Existing insurance accounting practices typically differentiate between short-term and long-term insurance contracts. Changes introduced by IFRS 17 are therefore expected to differ between these two types of contracts.

Examples of insurance contracts

Short-term

A one-year policy covering the risk of collision or theft of a car.

Long-term

A policy that will pay a one-off amount after a term of 30 years, or on the death of the policyholder if that occurs earlier.

The illustrations in Appendix B to this document show the effect and extent of some changes introduced by IFRS 17.

Short-term insurance contracts

In general, the Board expects little change in the accounting for many short-term insurance contracts (typically non-life contracts, such as car and home insurance).

The main changes for short-term insurance contracts, depending upon companies' existing insurance accounting practices, concern:

- (a) the requirement to discount the liability for incurred claims and to include an explicit risk adjustment when measuring it;
- (b) the way to assess and determine groups of onerous contracts;
- (c) the requirement to present a single insurance contract asset or liability on the balance sheet for a group of contracts; and
- (d) the increase in the information provided in the notes to the financial statements about claims liabilities, changes in risk and the effects of discounting.

Many companies are expected to apply the simplified approach to the measurement of the short-term insurance contracts they issue (see Section 5.3—*Key cost reliefs*).

Companies apply different requirements to account for their insurance contracts in different jurisdictions. There are some substantial differences between national practices, particularly for long-term insurance contracts. Consequently, the extent and the effects of changes introduced by IFRS 17 will differ between jurisdictions.

Long-term insurance contracts

There is more difference between the accounting models currently applied for long-term insurance contracts than between those applied for short-term insurance contracts.

Changes introduced by IFRS 17 are expected to be most pronounced for long-term insurance contracts.

The following table summarises the main improvements introduced by IFRS 17 in comparison with common existing insurance accounting practices allowed by IFRS 4 for long-term insurance contracts.

| IFRS 17 improvement | Existing insurance accounting practices | IFRS 17 |
|---|--|---|
| <p>1 Use of current estimates</p> | <p>Currently, the majority of insurers use estimates that are not fully updated after contract inception. Typically, some or all of these assumptions are only updated in specified circumstances—for example, when the contracts are deemed onerous. Insurers operating in a few jurisdictions use mainly current estimates but only for specified products.</p> | <p>To provide transparent and timely information about insurance risks, and changes in those risks, IFRS 17 requires the use of current estimates based on the most up-to-date information available and disclosure of the relevant assumptions.</p> |
| <p>2 Appropriate discount rates</p> | <p>Currently, many insurers discount the future cash flows from insurance contracts using discount rates that are based on the expected return on assets backing the insurance contract liability. Some insurers use a discount rate specified by law or a regulator. A few use a risk-free discount rate. Some do not discount at all.</p> | <p>IFRS 17 requires a company to discount the cash flows from insurance contracts using discount rates that reflect the characteristics of the cash flows arising from the insurance contract liability rather than rates based on the characteristics of the assets backing that liability. As a result, IFRS 17 will help to report economic mismatches between insurance contract liabilities and assets backing them which otherwise might remain obscured.</p> |
| <p>3 Explicit risk adjustment</p> | <p>Currently, insurers' approaches to reflecting risk differ:</p> <ul style="list-style-type: none"> (a) some use an explicit or, more commonly, an implicit allowance for risk (risk margin); (b) some use a risk adjustment for some contract types but not for others; and (c) some use a risk margin only for regulatory purposes, and do not use it for financial reporting. | <p>IFRS 17 requires a company to always include an explicit, current risk adjustment in the measurement of insurance contracts and to provide relevant disclosures.</p> <p>Explicit risk adjustments provide useful insight into the company's view of the economic burden imposed by the risks associated with the company's insurance contracts and how that risk changes over time.</p> |
| <p>4 Current value of financial options and guarantees</p> | <p>Currently, the accounting for financial options³² and guarantees embedded in insurance contracts (for example, minimum interest rate guarantees) is inconsistent. For example:</p> <ul style="list-style-type: none"> (a) in some cases, embedded financial options and guarantees are not recognised until current rates fall below the guaranteed minimum (ie until the embedded options and guarantees are in the money and therefore worth exercising). (b) in other cases, embedded financial options and guarantees are recognised and their measurement reflects the possibility that they might become worth exercising (ie reflects intrinsic value and time value). However, in some cases, their measurement is inconsistent with relevant market prices. | <p>IFRS 17 requires a company to include all financial options and guarantees embedded in insurance contracts in the measurement of the fulfilment cash flows, in a way that is consistent with observable market prices for such options and guarantees. This provides users of financial statements with more relevant information about the company's insurance obligations.</p> |

continued...

³² See the Glossary for a definition of financial option.

| IFRS 17 improvement | Existing insurance accounting practices | IFRS 17 |
|---|--|---|
| <p>5 Grouping contracts at initial recognition in a way that reflects profitability</p> | <p>Currently, most insurers do not specify whether or on what basis insurance contracts are aggregated for measurement purposes. This means that some insurers can offset losses arising from some insurance contracts with gains arising from other insurance contracts. A similar practice may obscure differences in profitability between different insurance contracts.</p> | <p>IFRS 17 requires a company to identify portfolios of insurance contracts and to divide each portfolio into:</p> <ul style="list-style-type: none"> (a) a group of contracts that are onerous at initial recognition, if any; (b) a group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and (c) a group of remaining contracts, if any. <p>Each group can only include contracts issued no more than one year apart. Grouping contracts is necessary to ensure timely recognition of losses when they arise and relevant and timely allocation of profit (contractual service margin). It also provides information about the development of the profitability over time.</p> |
| <p>6 Making onerous contracts visible in a timely way</p> | <p>Currently, most insurers do not specify how they test whether insurance contracts have become onerous. IFRS 4 contains only minimal requirements for the assessment of the possibility of insurance contracts becoming onerous.</p> | <p>IFRS 17 requires a company to identify onerous contracts at initial recognition. The company is required to recognise losses on those contracts immediately in profit or loss. Subsequently, the company is required to regularly update the fulfilment cash flows and to:</p> <ul style="list-style-type: none"> (a) recognise in profit or loss additional losses for groups of onerous contracts. (b) adjust the contractual service margin for other groups of contracts. If the contractual service margin for those groups of contracts is reduced to zero, changes for additional expected outflows are recognised in profit or loss. <p>These requirements in IFRS 17 are needed to achieve a timely recognition of losses arising from insurance contracts.</p> |

continued...

| IFRS 17 improvement | Existing insurance accounting practices | IFRS 17 |
|--|--|--|
| <p>7 Consistent recognition of profit for insurance services</p> | <p>Currently, insurers recognise profits inconsistently over time. The timing of recognition of profit for insurance services can vary significantly by jurisdiction and by product. Some insurers recognise profit immediately when an insurance contract is written. Other insurers recognise profit only when the contract terminates. Other insurers recognise profit over the duration of the insurance contract on the basis of the passage of time.</p> | <p>IFRS 17 requires a company to recognise profit according to the way it is earned from:</p> <ul style="list-style-type: none"> (a) the contractual service margin—recognised as profit as the company provides services over the coverage period; and (b) the risk adjustment—recognised in profit or loss as the company is released from risk over the coverage period and the settlement period. <p>IFRS 17 requires a consistent approach for the recognition and measurement of the contractual service margin, and for the determination of explicit risk adjustments.</p> |
| <p>8 Consistent treatment of acquisition costs</p> | <p>Currently, most insurers recognise deferred acquisition cost assets for costs associated with writing new insurance contracts (for example, broker commissions). Some apply complex mechanisms for recognising these costs as expenses over time and in assessing impairment, while others recognise all acquisition costs as an expense when they are incurred.</p> | <p>IFRS 17 requires a company to include in the measurement of insurance contracts all fulfilment cash flows, including directly attributable acquisition cash flows. Therefore, a separate asset associated with the acquisition of insurance contracts is not recognised. When applying IFRS 17, any lack of recoverability of the acquisition cash flows will be reflected in the measurement of the insurance contracts, eliminating complex mechanisms to deal with deferral, amortisation and impairment of the separate asset.</p> |
| <p>9 Comparable revenue</p> | <p>Currently, most insurers present the premiums received, or receivable, as revenue in profit or loss, although some do not report deposit components as revenue. This practice is inconsistent with principles in other IFRS Standards applicable to other industries.</p> | <p>IFRS 17 requires a company to report as insurance revenue the consideration for services on an earned basis. This is comparable to revenue recognition for other industries. As a result, when applying IFRS 17, insurance revenue will exclude deposit components which represent policyholders' investments, not consideration for services.</p> |
| <p>10 Understandable claims and other expenses</p> | <p>Currently, most insurers present in profit or loss expenses for claims, as well as a line called 'change in insurance contract liabilities'. This line incorporates multiple factors such as changes for new insurance contracts written and changes in methods and assumptions used in measuring insurance contracts.</p> | <p>IFRS 17 requires a company to report as insurance expenses only items that reflect insurance service expenses (ie incurred claims and other insurance service expenses arising from insurance contracts it issues). As a result, when applying IFRS 17, repayment of deposits will not be presented as insurance expenses, but rather as a settlement of a liability.</p> |

continued...

| IFRS 17 improvement | Existing insurance accounting practices | IFRS 17 |
|---|--|--|
| <p>11 Consistent accounting policies</p> | <p>IFRS 4—as an interim Standard issued in 2004—was meant to limit changes to then existing insurance accounting practices to a minimum. Hence, IFRS 4 allows insurers to depart from the general requirement in IFRS Standards to apply uniform accounting policies for similar transactions. As a result, many multinational companies currently use different accounting policies to measure similar insurance contracts they issue in different jurisdictions.</p> | <p>IFRS 17 removes the practice permitted by IFRS 4 of using non-uniform accounting policies for similar insurance contracts. This means that IFRS 17 is the first truly international IFRS Standard for insurance contracts. This introduces the key benefit of IFRS Standards for companies that issue insurance contracts.</p> |
| <p>12 Consistent accounting for non-insurance components</p> | <p>Currently, some insurers separate some deposit components (ie explicit account balances) embedded in an insurance contract and measure them as financial instruments. Similarly, some insurers separate some non-insurance services and account for them in accordance with revenue recognition requirements. In contrast, other insurers measure the whole insurance contract, including any non-insurance components, as a group of rights and obligations.</p> | <p>Consistently with the requirements in other IFRS Standards, IFRS 17 requires all insurers to use the same approach to separation. When applying IFRS 17, deposit components, goods and non-insurance services will be separated from insurance contracts if they are distinct from the insurance component.</p> |
| <p>13 Single approach for all insurance components</p> | <p>Currently, some insurers apply different measurement and presentation approaches to the various insurance components comprising an insurance contract. For example, some insurers treat acquisition costs as intangible assets and premium receivables as financial assets.</p> | <p>When applying IFRS 17, the measurement of insurance contracts will reflect all insurance components of the contracts. As a result, insurance contracts will be presented on the balance sheet as insurance contract liabilities (or as insurance contract assets) (see Section 6.1—<i>Effects on the balance sheet</i>). This presentation, together with detailed reconciliations of opening and closing balances provided in the notes to the financial statements, is expected to improve the understanding of amounts related to insurance contracts in the financial statements.</p> |
| <p>14 More useful information</p> | <p>IFRS 4—as an interim Standard—allows insurers to depart from the requirement in IFRS Standards to develop accounting policies for insurance contracts that provide relevant and reliable information to investors and analysts.</p> | <p>IFRS 17 removes this exemption in IFRS 4 so that, when applying IFRS 17, accounting policies for insurance contracts must result in information that is useful for users of financial statements.</p> |

The Feedback Statement on IFRS 17 includes information about the feedback on the proposals that preceded IFRS 17 and how the Board responded to that feedback in developing IFRS 17.

4.2—Improved financial information

The Board expects IFRS 17 to provide transparent and timely information about the risks from, and the variability in, obligations arising from insurance contracts, as well as about the profitability of insurance contracts. This is because, when applying IFRS 17, insurers will:

- (a) measure insurance contracts using current estimates and assumptions that are consistent with market information, and that reflect the timing of cash flows and uncertainty relating to the insurance contracts; and
- (b) recognise profits as they deliver insurance services and provide information about profits that they expect to recognise in the future.

IFRS 17 is expected to bring transparency by enhancing the quality of financial information, enabling investors and other market participants to make informed economic decisions.

Improved transparency resulting from IFRS 17 is also expected to contribute to long-term financial stability by revealing useful information that will enable actions to be taken in a timely way.

Changes introduced by IFRS 17 will make the insurers' financial position and performance significantly easier to understand and will enable meaningful comparison to be made among companies, contracts and industries (see Section 4.3—*Comparability of financial information*).

Present value of future cash flows

Although different insurance contracts have different characteristics, in most insurance contracts an insurer:

- (a) collects premiums from policyholders at the start of the coverage period; and
- (b) delivers insurance coverage and settles claims in the future.

Consequently, the timing of cash inflows and cash outflows typically affects the insurer's results.

Reflecting the time value of money

When applying IFRS 4, insurers typically consider the timing of cash flows arising from insurance contracts by discounting cash flows when measuring life insurance contracts which may provide insurance coverage for decades.

In contrast, non-life insurers may report liabilities for claims incurred on either a discounted or an undiscounted basis. For example, in applying US GAAP, non-life insurance contract liabilities are generally not discounted. In contrast, in applying Australian GAAP, non-life insurers report insurance contract liabilities on a discounted basis.

Extract from a multi-line insurer's notes to its IFRS financial statements

Claims reserves [insurance contract liabilities] are generally not discounted, except in cases such as disability annuities.

Extract from a property and casualty insurer's notes to its IFRS financial statements

The outstanding claims liability is measured as the central estimate of the present value of expected future payments relating to claims incurred at the reporting date with an additional risk margin to allow for the inherent uncertainty in the central estimate.

Typically, for some insurance contracts, it may only be a matter of weeks or months between the date of the insured event (such as accidental damage to a motor vehicle) and when the resultant claim is paid. In contrast, for other insurance contracts, such as those related to medical malpractice, the settlement of a claim may take a number of years.

Consequently, for some non-life insurers, omitting the time value of money in the measurement of insurance contract liabilities means that the reported expense for claims may overstate the economic expense in the period in which the claim is incurred.

This distortion may be significant to a greater or lesser degree, depending on the length of time between when claims are incurred and when they are settled (generally referred to as the settlement period or tail), and also depending on the current market interest rate.

IFRS 17 requires a company to report estimated future payments to settle incurred claims on a discounted basis to better reflect the economic expense.

Reflecting the timing of future payments in measuring claims is consistent with the accounting for expenses that give rise to liabilities applying other IFRS Standards such as pensions, share-based payments and provisions.

The actual effect of IFRS 17 on the reported insurance contract liabilities of companies that do not currently discount their insurance contract liabilities will depend on the length of settlement periods, the size of the claims and the discount rate, as well as on any risk allowance currently added by the company to its undiscounted insurance contract liabilities. Consequently, the effect of IFRS 17 on these liabilities will depend on facts and circumstances.

Extract from a user of financial statements' comment letter to the 2013 Exposure Draft

I view the time value of money as a fundamental economic concept that should be considered in financial reporting. As an analyst, I have long discounted reserves [insurance contract liabilities] to calculate adjusted book values, so it seems the right approach to have the companies do it in their reporting.

IFRS 17 includes some simplifications for the measurement of short-term insurance contracts, such as an option for a company not to discount the liability for incurred claims if it expects the claims to be settled in a year or less. See Section 5.3—*Key cost reliefs* for details about this optional simplification and the benefits for companies.

Updated information

When applying IFRS 17, an insurer will update the assumptions, including the discount rates, used to measure its insurance contracts at each reporting date. The insurer will therefore report updated financial information about the obligations arising from the insurance contracts it issues and updated information about its financial position.

Currently, when applying IFRS 4, many insurance companies measure insurance contract liabilities using out-of-date assumptions (applying a 'locked-in' approach).

For example, in its 2015 financial statements, an insurance company might still measure insurance contracts issued in 1990 using an assumed interest rate of 6 per cent (ie the rate used to calculate premiums when the contracts were issued, thus the rate implicitly paid to policyholders), whereas the market interest rate is significantly lower than 6 per cent in the company's economic environment in 2015.

As a result, the effects of changes in interest rates on insurance contract liabilities are not fully visible in the company's 2015 financial statements. The amount of the liability would be understated. The 2015 financial statements would not show the effect of the company paying interest at 6 per cent to policyholders even though the current market rate of interest on assets is much less than that.

When applying IFRS 4, minimum return guarantees and other complex features are typically reflected in the measurement of the insurance contract liability only when they become worth exercising (ie when they are in the money), and even then often at an amount that does not reflect their economic value.

The effects of changes in interest rates are revealed only progressively in the insurer's financial statements through, for example, a change in financial income (due to lower or higher returns on the investments held). The difference between the reported and the economic value would be particularly pronounced if a guarantee is written at a rate higher than current interest rates.

An analysis of the top-100 listed insurance companies by total assets using IFRS Standards in 2015 reveals that 57 per cent of the companies in the sample (ie 41 of 72)³³ used historical discount rates to measure all or some of their insurance contracts. The analysis shows that, for the sample of companies analysed, the use of historical discount rates is more prevalent for companies based in Europe and in Asia Pacific.

For those companies, IFRS 17 will introduce significant changes to the measurement of insurance contracts through a requirement to update discount rates at each reporting date.

In contrast, companies based in Canada already update discount rates used to measure long-term insurance contracts on a regular basis.

However, in common with many companies using current discount rates, companies in Canada currently use discount rates based on the expected return on assets backing the insurance contract liabilities. IFRS 17 requires the use of discount rates that reflect the characteristics of the cash flows arising from the insurance contract liabilities (refer to the discussion on page 41 for further details about the improvements introduced by IFRS 17 on the determination of discount rates).

| Top-100 listed insurance companies using IFRS Standards | | | | | |
|---|-------------------------------|----------|-----------|---------------|------------|
| Discount rates used | Number of companies by region | | | | |
| | Asia Pacific | Canada | Europe | Other regions | Total |
| Current rates | 11 | 7 | 9 | 4 | 31 |
| Historical rates | 6 | – | 15 | 4 | 25 |
| Mix of rates ³⁴ | 1 | – | 15 | – | 16 |
| Sub-total | 18 | 7 | 39 | 8 | 72 |
| Information not available | 6 | – | 1 | 1 | 8 |
| Non-life business | 11 | 2 | 6 | 1 | 20 |
| Total | 35 | 9 | 46 | 10 | 100 |

³³ Within the top-100 listed insurance companies, 80 companies issue long-term insurance contracts. For 8 of those companies the annual report is not available in English. The remaining 20 companies are property and casualty insurers (ie non-life business).

³⁴ As discussed in Section 3—*Companies affected*, currently, some multinational companies apply different accounting policies to insurance contracts issued in different jurisdictions. This means that some contracts are measured using current rates, others using historical rates (referred to as 'mix of rates' in the table).

In addition, changes in interest rates can affect insurance companies' performance because they affect the assumptions companies make about the expected duration of insurance contracts to determine premiums due from policyholders.³⁵

Changes in interest rates do not typically have a significant effect on short-term insurance contracts because those contracts are typically renewed or repriced annually—ie the premiums change with current market conditions.

In contrast, changes in interest rates affect the value of many long-term insurance contracts, in particular the value of contracts with a guaranteed return to the policyholder. Low rates increase the current value of guaranteed returns. Policyholders may react to a decrease in market interest rates by:

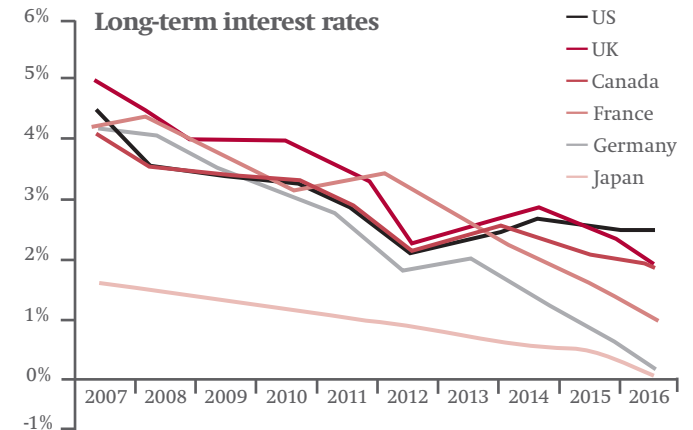
- (a) holding insurance contracts longer than originally expected by the insurer;
- (b) increasing premium payments on existing contracts (if permitted by the contract terms); or
- (c) acquiring fewer new contracts.

On the other hand, high interest rates may encourage policyholders to hold insurance contracts for less time than originally expected if they decide that better returns are available in the market—the policyholders may enter into new insurance contracts or switch to alternative savings products.

| The possible effect of interest rate changes on the current value of long-term insurance contracts with guaranteed returns | | |
|--|---|--|
| Interest rate | ↑ Increase | ↓ Decrease |
| Current value of insurance contracts with guaranteed return | ↓ Decrease | ↑ Increase |
| How policyholders may react | They may hold insurance contracts for less time than expected to switch to more profitable products | They may hold insurance contracts longer than expected to benefit from a guaranteed return |

As discussed above, measuring insurance contracts using non-current value does not faithfully represent the challenges that insurers face when there are changes in the economic environment. During periods when interest rates are declining, insurers that do not update the assumptions they use to measure their insurance contracts tend to report better performance than insurers measuring similar contracts using current estimate and assumptions. The opposite is true during periods when interest rates are rising.

As shown in the following chart, in major economies, interest rates have declined since 2008.³⁶



³⁵ A policyholder may terminate an insurance contract before its maturity date. For example, early terminations may occur when (a) the policyholder stops paying premiums (often called 'lapses') or (b) the policyholder opts to terminate the contract before maturity in exchange for a cash amount (often called 'surrenders').

³⁶ Data provided by the Organisation for Economic Co-operation and Development (OECD). Long-term interest rates in the chart refer to government bonds maturing in ten years.

The following example illustrates how interest rate exposure can be obscured when companies fail to use current estimates for measuring insurance contracts when interest rates are declining.

The insurer in this example has significant long-term insurance contracts with guaranteed returns. The insurer measures its insurance contracts on a current value basis in its financial statements applying GAAP A.

However, in 2010, it also presented some additional financial information developed using GAAP B showing the estimated effect on its profit or loss of measuring the same insurance contracts without reflecting changes in market conditions (ie using non-current value accounting for insurance contracts).

The following table shows that for the year 2010 the insurer reported a negative comprehensive income of 537 currency units (CU) when measuring insurance contracts on a current value basis and a positive comprehensive income of CU1,666 when using assumptions not updated after the inception of its insurance contracts.

This example illustrates that measuring insurance contracts using current value provides an early indication about the potential long-term effects of market changes. In contrast, non-current value accounting generally fails to reflect the potential long-term effects of market changes until the underlying assumptions are viewed as unsustainable. The difference between current value and non-current value can be substantial, as the example shows.

| (in millions of currency units) | 2010 ³⁷ | | |
|---|---------------------------------------|---|----------------|
| | GAAP A Current value accounting | GAAP B Non-current value accounting | Differences |
| Revenue ³⁸ | 26,083 | 24,167 | (1,916) |
| Expenses | (26,310) | (22,317) | 3,993 |
| Of which changes in assumptions ³⁹ | (1,753) | (125) | 1,628 |
| Income taxes | 223 | (240) | (463) |
| Profit or loss | (4) | 1,610 | 1,614 |
| Other comprehensive income | (533) | 56 | 589 |
| Comprehensive income | (537) | 1,666 | 2,203 |
| Equity | 20,373 | 25,584 | 5,211 |

37 Figures presented in the table are estimated average data for companies providing financial information using the same two reporting frameworks for the same periods. These figures are based on companies' annual reports for 2010 and on comparative information for 2010 included in companies' annual reports for 2011. Figures for the lines 'revenue' and 'expenses' are estimated using some assumptions about the income tax rate and about presentation differences between the two reporting frameworks.

38 In this example revenue includes premiums and investment income. The companies accounted for some unrealised gains on assets within revenue, when applying GAAP A, and within other comprehensive income when applying GAAP B.

39 The companies updated the assumptions used to measure insurance contracts only when applying current value accounting (GAAP A). They accounted for the effect of changes in assumptions immediately in profit or loss. When applying non-current value accounting (GAAP B), the companies did not update assumptions to measure insurance contracts unless they determined that for an insurance contract its future income is no longer adequate to recover its expenses.

Making changes visible

IFRS 17 requires the use of current value accounting, including the current value of minimum interest rate guarantees and financial options (ie both their time value and their intrinsic value). This requirement is expected to make visible any improvement or deterioration in insurers' financial statements in a timely way. This means major changes in the risks an insurer faces as a result of changes in the economic environment, such as a change in interest rates, will be reflected in the financial statements of the insurer in a timely way through the change in insurance contract liabilities and the timely recognition of gains and losses from changes in financial variables in the statement of comprehensive income.

IFRS 17 will provide timely information to enable mitigating action to be taken. This information is expected to facilitate improved decision-making by both users of financial statements and the management of companies that currently do not use current value information about insurance contracts to monitor risks.

Japanese life insurance insolvency cases

Some Japanese life insurance insolvency cases show what can happen when interest rates decrease and stay low for an extended period of time, and the time value of minimum interest rate guarantees is not taken into account when measuring rights and obligations arising from insurance contracts. The yield on Japanese government bonds decreased rapidly during the course of the 1980s and again in the 1990s (from 9.2 per cent in 1980 to 1.1 per cent in 1998).⁴⁰ At the same time, to compete with other financial institutions, insurers continued to offer policyholders guarantees above those rates (in the order of 5.5 per cent) until the mid-1990s.⁴¹

The low government bond yields together with a decrease in stock market returns and losses on foreign currency holdings, following the market downturn and the appreciation of the yen, made it difficult for insurers to meet their guarantees. As a result, insurers started decreasing their guaranteed rates for new insurance contracts issued. However, insurers could not change the guaranteed rates for existing contracts and had to hold them even in the severe investment environment. Consequently, seven life insurance companies went bankrupt in Japan around the year 2000.

There were some differences in the reasons for the bankruptcies. Nonetheless, all of the bankrupt companies had issued a large number of insurance contracts with high guaranteed interest rates during Japan's higher interest rate environment, and there were significant negative spreads in the ensuing low-interest-rate environment. Although a liability adequacy test⁴² was introduced by the Japanese financial services regulator in 1996, prior to the default, the reported insurance contract liabilities of those companies did not fully reflect market conditions or the value of the guarantees that had been written. As a result, those companies' critical financial situation was not visible in their financial statements in a timely way.

Although life insurance companies in Japan are now required to report an additional liability, if needed, to reflect the risk of changes in expected cash flows (for example actual investment results being lower than the amount guaranteed to policyholders relating to minimum interest rate guarantees), those companies have basically continued to measure insurance contracts using historical assumptions from the inception of the contracts.

⁴⁰ International Monetary Fund, *International Financial Statistics*.

⁴¹ European Central Bank, *Financial Stability Review*, November 2015.

⁴² A liability adequacy test is intended to provide confirmation that the reported insurance contract liability is equal to or greater than current estimates of all contractual cash flows. If a deficiency is identified, an additional liability is required to be recognised on the balance sheet with a corresponding expense in the statement of comprehensive income.

Discount rates reflecting the characteristics of the cash flows

Currently, many companies measure insurance contract liabilities using a discount rate based on the ‘expected return on assets held’ to match the insurance contract liabilities even when the insurance contract cash flows do not vary with the cash flows from the assets.

Discounting insurance contract liabilities using such rates could:

- (a) obscure economic exposures. Changes in interest rates affect assets and liabilities to the same extent only if the cash flows of the assets are fully matched with those of the liabilities—ie if the cash flows from the assets vary in exactly the same way, and by the same amount, as the cash flows from the liabilities, and over the same periods. In practice, the match is often imperfect because the duration of the insurance contract liabilities typically exceeds, often significantly, that of the assets held.
- (b) misstate those liabilities, as illustrated in the following example.

Assume someone borrows CU100,000 to buy a house.⁴³ The lender charges interest at a fixed rate of 5 per cent a year, and both principal and interest are repayable in a single instalment of CU265,330 after 20 years. The house costs CU100,000. The borrower expects house prices to increase by an average of 8 per cent a year over the 20 years of the loan, to an amount of CU466,096. If the payments under the loan (CU265,330 in 20 years) are discounted at the expected annual house price increase of 8 per cent, their present value is only CU56,926. This is because it includes the effect of the uncertain future profit the individual expects (or hopes) to make on the eventual realisation of the house. Measuring the loan liability at CU56,926 would understate it by CU43,074 (43 per cent).

| Amount to be paid after 20 years | Present value | | Difference |
|----------------------------------|-----------------------|-----------------------|------------|
| | with 5% discount rate | with 8% discount rate | |
| CU | CU | CU | CU |
| 265,330 | 100,000 | 56,926 | 43,074 |

Similarly, for insurance contracts, a discount rate based on the estimated return on assets that is higher than a discount rate based on the insurance contract cash flows results in lower insurance contract liabilities.

IFRS 17 requires a company to use a discount rate that reflects the characteristics of the insurance cash flows. This means that an asset return premium should be included in the discount rate only if, and to the extent that, the liability cash flows are themselves linked to those assets. An example of this might be a contract with participation features in which a substantial proportion of the amount that the company anticipates it will pay to the policyholder is expected to vary with the cash flows from the underlying assets.

Consequently, IFRS 17 is expected to significantly improve the relevance of information reported in the financial statements by increasing the transparency of economic mismatches (ie the difference arising if the values of, or cash flows from, assets and liabilities respond differently to changes in economic conditions).

IFRS 17 will result in financial statements that give greater visibility to the risks relating to insurance contracts that are not economically matched by assets.

⁴³ In this example, currency amounts are denominated in ‘currency units’ (CU).

Risk adjustment

When applying IFRS 4, many insurers include a risk margin in their measurement of insurance contract liabilities (ie an implicit or explicit allowance for risk) in addition to their estimate of the future cash flows. The extent of the risk margin is typically not disclosed.

Extract from a credit rating agency's comment letter to the 2013 Exposure Draft

To varying degrees, insurers already recognise risk margins and discount in their liabilities implicitly, but we consider consistency and transparency to be poor.

IFRS 17 requires a company to calculate and disclose an explicit risk adjustment, as well as to disclose an impartial (unbiased) estimate of the present value of the future cash flows arising from its insurance contracts.

The fieldwork performed by the Board when developing IFRS 17 revealed that the risk adjustment varies significantly with the specific type of insurance contract. For example, the risk adjustment is typically higher, and therefore more significant, for long-tail insurance contracts—ie contracts with claims that require many years to be settled (for example, contracts that cover asbestos, catastrophe and environmental risks). These contracts are more common in the non-life insurance industry than in the life insurance industry.

Accordingly, the Board expects IFRS 17 to improve the quality of financial information about risk.

Information about profitability

The Board expects IFRS 17 to significantly improve the quality of information about the current and future profitability of insurance contracts.

In particular, IFRS 17 will improve transparency about the sources of profit recognised from insurance contracts. IFRS 17 introduces a comprehensive framework which provides information that distinguishes the two key drivers of insurance contract profitability, whereby insurers typically earn profits through:

- (a) insurance service results, which provide information about the profit earned from providing insurance coverage; and
- (b) investment results from managing financial assets.

When applying IFRS 17, the main drivers of profitability from insurance contracts will be presented separately.

Information about current and future profitability

IFRS 17 requires a company to:

- (a) recognise profits as it delivers insurance services; and
- (b) disclose:
 - (i) the insurance revenue recognised in the current period;
 - (ii) an explanation of when the company expects to recognise the remaining contractual service margin in profit or loss in the future; and
 - (iii) changes in the contractual service margin and in the risk adjustment during the reporting period.

IFRS 17 also requires a company to analyse groups of insurance contract assets and liabilities showing separately:⁴⁴

- (a) the estimates of the present value of the future cash flows to fulfil the contracts;
- (b) the risk adjustment; and
- (c) the contractual service margin.

The risk adjustment depicts the remaining expected profit for bearing risk. The risk adjustment is recognised in profit or loss as the risk is released.

⁴⁴ Except when the simplified approach is used (see Section 5.3—*Key cost reliefs*).

The contractual service margin for a group of insurance contracts depicts the remaining expected profitability for providing the coverage of that group. The contractual service margin is recognised in profit or loss over time as the insurance coverage is provided. The amounts recognised in profit or loss provide information about profitability in the period arising from providing insurance coverage and bearing risk in that period.

The explanation of when the company expects to recognise in profit or loss the contractual service margin that remains on the balance sheet at the end of the reporting period will provide information about the expected future profitability of insurance contracts for providing insurance coverage. That explanation may be either quantitative or qualitative.

Changes in the contractual service margin primarily represent the recognition of the contractual service margin in profit or loss reflecting the provision of services in the period. However, they may arise for a number of other reasons.

IFRS 17 requires a company to provide a reconciliation of the opening and closing balances of the contractual service margin, as well as similar reconciliations for the other components of insurance contract assets and liabilities. The reconciliation will show what caused changes in the contractual service margin balance (see Illustration 4 in Appendix B to this document).

For example, the contractual service margin may increase as a result of new groups of contracts being written (the value of new business). The contractual service margin may decrease as the expected profitability of an existing group of contracts falls because of, for example, worsening mortality expectations. If mortality rates change, expectations of the cost of providing future service also change. The profitability of the group of contracts is affected and the contractual service margin is adjusted to reflect updated assumptions about mortality.

The Board expects that such information about the current and future profitability of insurance contracts will significantly improve the transparency of reporting for insurance contracts and provide important additional information for investors and other users of financial statements for their decision-making.

Information about current and future profitability will provide investors and analysts with additional metrics that can be used to evaluate the performance of companies that issue insurance contracts.

See Section 6.4—*Effects on key financial metrics* for further details.

Non-GAAP information

Particularly for long-term insurance contracts, existing insurance accounting practices often do not provide sufficient information to users of financial statements about the future profitability of such contracts and the effects on an insurer's cash flows (and on its distributable profits).

Consequently, many insurers rely on non-GAAP measures, such as embedded value information, to meet the needs of the users of their financial statements. Those measures provide additional information about long-term insurance contracts, including information about the value added from the sale of those contracts.

Embedded value reporting—example

The example is based on information disclosed by an insurer. The insurer issues long-term insurance contracts and provides information about its financial position using various measures, including:

- (a) net assets—ie the shareholders' equity reported applying IFRS Standards;
- (b) its tangible net assets—ie the reported shareholders' equity excluding goodwill and intangible assets (such as deferred acquisition cost assets); and
- (c) embedded value—the tangible net assets plus the value of insurance contracts issued, or the value of the in-force business.

The insurer also provides information about annual changes in its embedded value resulting from issuing new contracts (ie the value of new business) and changes in the expected profits from insurance contracts due to, for example, changes in the economic environment.

The components of the insurer's embedded value can be analysed as shown on the next page.

In this example, the company determines its embedded value by adding the value of in-force business to the shareholders' equity, net of goodwill and intangibles (ie $CU11.3 + CU29.1 - CU7.8 = CU32.6$). The value of in-force business represents the present value of profits arising from insurance contracts that will be recognised in the future, net of the time value of options and guarantees and of the cost of capital.

As illustrated in the following table, the company also discloses the changes in the value of in-force business that occurred during Year 2. The increase of CU1.4 is mainly due to the additional expected profit from issuing new insurance contracts during the year and to changes in the economic environment affecting the existing insurance contracts, including changes in assumptions.

| (in millions of currency units) | Year 2 | Year 1 | Change |
|--------------------------------------|-------------|------------|------------|
| Present value of future profits | 19.0 | 17.6 | 1.4 |
| Time value of options and guarantees | (5.1) | (5.1) | – |
| Cost of capital | (2.6) | (2.6) | – |
| Value of in-force business | 11.3 | 9.9 | 1.4 |

Although changes in embedded value over time may provide useful information to users of financial statements about changes in future profitability arising from insurance contracts, the methodology used to determine the current value of insurance contracts when providing embedded value information varies significantly between companies.⁴⁵

⁴⁵ See, for example, *2016 Mid-Year Embedded Value Results: Europe and Japan*, a report published by Milliman Research in December 2016. The report highlights the following about the value of new business provided by some insurance companies: 'some caution is required in comparing results, due to methodology differences among companies. In particular, some companies use point-of-sale assumptions to value new business, whereas some companies use end-of-year assumptions. In a typical situation, one might not expect materially different results. In the current extraordinary interest rate environment, the difference can be substantial'.

Embedded value reporting—example

| | | | | |
|--|-----------------------------------|---|--|--------------------------|
| Year 2—Reconciliation between shareholders' equity and embedded value (in millions of currency units) | | | | |
| Shareholders' equity (IFRS 4) CU29.1 | Tangible net assets CU21.3 | 3 Present value of future profits CU19.0 + | 4 Time value of options and guarantees (CU5.1) — | Embedded value CU32.6 |
| | Goodwill and intangibles CU7.8 | 2 Free surplus CU9.9 | 5 Cost of capital (CU2.6) | |
| | | 1 Required capital CU11.4 | Value of in-force business CU11.3 | |
| | | Net worth CU21.3 | | |

- 1** The required capital is set by reference to regulatory capital requirements that may differ by jurisdiction.
- 2** The free surplus is the amount of shareholders' equity exceeding the minimum required capital after deduction of goodwill and intangibles.
- 3** The present value of future profits is the present value of cash flows arising from insurance contracts and from assets linked to insurance contract liabilities. It considers the intrinsic value of financial options and guarantees, but not their time value.
- 4** The time value of options and guarantees is the additional value of financial options and guarantees above their intrinsic value.
- 5** The cost of capital represents the additional costs of investing the required capital amount in assets held by the insurer and that, therefore, cannot be distributed to shareholders immediately.

Similarities and differences between IFRS 17 and embedded value reporting

Embedded value reporting uses the present value of future cash flows from insurance contracts issued to value insurance business. The present value of future cash flows:

- (a) is similar to the measurement required by IFRS 17 in some respects because it generally reflects a current estimate of the cash flows; and
- (b) may differ from the measurement required by IFRS 17 in other respects, including the discount rate, the manner of reflecting risk and the treatment of embedded guarantees and financial options.

The present value of future profits corresponds broadly to the contractual service margin determined in applying IFRS 17, though the amount would differ because of differences in the underlying measurement.

A feature of embedded value reporting is that, unlike IFRS 17, the embedded value of the insurance business incorporates any unearned profits. Consequently, the expected profit is recognised in the value of the business at inception. It is then periodically changed when assumptions change—ie there is no systematic release of profits in an embedded value model, other than as determined by the passage of time.

When applying IFRS 17, the unearned profit, or contractual service margin, is classified as a liability reflecting the associated obligation to provide insurance coverage.

Reduced need for non-GAAP information

The reconciliation of the opening to closing balance of the contractual service margin required by IFRS 17 will provide information about the amount of contractual service margin added by new contracts written in the period. This will therefore give consistent information about the value added from new business, which is considered by many insurers as an important measure.

Embedded value reporting typically provides information only about the total amount of expected future profits and not about the way in which the future profits will be recognised in profit or loss. This information will be required to be disclosed by IFRS 17.

The information IFRS 17 will provide about the current and future profitability of all long-term insurance contracts and about the value added by new business will be more comparable than the information provided by existing non-GAAP measures. This might, in time, replace performance measures computed using embedded value or similar measures.

Extract from a user of financial statements' comment letter to the 2013 Exposure Draft

Already today, analysts are paying a lot of attention to embedded value numbers published especially by listed European insurance companies. These numbers are estimates of discounted future cash flows on the profitability of the insurance business. Any changes in estimates are booked against the profit margin. However, these measures are based on non-GAAP principles. IFRS 4 [IFRS 17] could harmonize and improve the transparency of these measures if a distinction could be made between future and past events.

While the objective of an IFRS Standard is not to reduce non-GAAP measures, the Board expects that IFRS 17 will reduce the need to present some non-GAAP information, potentially reducing costs for companies in this respect. However, it is expected that many companies are likely to continue to prepare existing non-GAAP information, at least until the new information provided by IFRS 17 becomes familiar to the users of their financial statements. Some companies may also continue to provide non-GAAP measures to suit their individual needs after IFRS 17 is effective.

Usefulness of the statement of comprehensive income

The following illustration shows how an insurer's statement of comprehensive income prepared in applying IFRS 17 will provide more useful information for users of financial statements (see Section 6.2—*Effects on the statement of comprehensive income*).

The illustration compares the presentation in the statement of comprehensive income for a group of 100 insurance contracts.

Compared to IFRS 4, IFRS 17 does not change the total profit or loss of a group of insurance contracts recognised over the duration of the insurance contracts, but it is expected to change the amounts recognised in each reporting period and their presentation.⁴⁶

The diversity that exists in the recognition and presentation of revenue and expenses related to insurance contracts, and that will be removed when IFRS 17 is first applied, is discussed in Section 4.3—*Comparability of financial information*.

Illustration—assumptions

This illustration assumes that:

- (a) the insurance contracts have a coverage period of three years.
- (b) each policyholder pays a single premium of CU150⁴⁷ at the beginning of the coverage period.
- (c) the insurer purchases a specified pool of assets (the fund) and measures the pool at fair value through profit or loss. In addition, the insurer sells assets to pay annual charges and claims.
- (d) beneficiaries of the insurance contracts will receive either:
 - (i) CU170 or the value of the investment in the fund if it is higher, if the policyholder dies during the coverage period. The insurer expects at initial recognition that one policyholder will die at the end of each year and claims are settled immediately; or
 - (ii) the value of the investment in the fund at the end of the coverage period (maturity value) if the policyholder survives until the end of the coverage period.
- (e) the insurer calculates the value of the investment in the fund for each contract (underlying items) at the end of each year as premiums received increased by an investment return from the specified pool of assets and decreased by an annual charge at the end of each year equal to 2 per cent of the investment in the fund.
- (f) all investment income and insurance finance expenses are recognised in profit or loss (and not in other comprehensive income).
- (g) at initial recognition of the contracts, the insurer:
 - (i) expects that the fund will yield an annual return of 10 per cent; and
 - (ii) determines that the risk-free discount rate is 6 per cent a year.

⁴⁶ The total profit or loss of a group of insurance contracts is the difference between total cash inflows and outflows arising from the contracts.

⁴⁷ In this illustration, currency amounts are denominated in 'currency units' (CU).

| IFRS 4 | | | | | IFRS 17 | | | | |
|--|------------|------------|------------|--------------|------------------------------------|------------|------------|------------|--------------|
| | Year 1 | Year 2 | Year 3 | Total | | Year 1 | Year 2 | Year 3 | Total |
| Premiums | 15,000 | – | – | 15,000 | Insurance revenue | 320 | 339 | 386 | 1,045 |
| Investment income ⁴⁸ | 1,500 | 1,281 | 1,677 | 4,458 | Incurred claims and other expenses | (8) | – | – | (8) |
| Incurred claims and other expenses | (170) | (171) | (18,080) | (18,421) | Insurance service result | 312 | 339 | 386 | 1,037 |
| Change in insurance contract liabilities | (16,048) | (744) | 16,792 | – | Investment income | 1,500 | 1,281 | 1,677 | 4,458 |
| Profit or loss | 282 | 366 | 389 | 1,037 | Insurance finance expenses | (1,500) | (1,281) | (1,677) | (4,458) |
| Other comprehensive income | – | – | – | – | Net financial result | – | – | – | – |
| Comprehensive income | 282 | 366 | 389 | 1,037 | Profit or loss | 312 | 339 | 386 | 1,037 |
| This table illustrates a common method of presentation in the statement of comprehensive income for a group of contracts when applying IFRS 4. Because of the wide variety of practices to account for insurance contracts when applying IFRS 4, the presentation in this table may not be representative of any specific practice of a company or jurisdiction. | | | | | Other comprehensive income | – | – | – | – |
| | | | | | Comprehensive income | 312 | 339 | 386 | 1,037 |

This table illustrates two significant changes. In particular, it illustrates that IFRS 17:

- removes the existing common practice of reporting premiums both as income and, effectively, as expenses when written or due (as part of a line for ‘change in insurance contract liabilities’)—insurance revenue reflects the services provided and excludes deposits, as is the case for any other industry; and
- enables companies to present the two main drivers of profit separately—namely the ‘insurance service result’⁴⁹ and the ‘net financial result’—to explain the profitability of a group of contracts.

⁴⁸ When applying IFRS 4, some companies present in the statement of comprehensive income a sub-total line named ‘total revenue’. Some companies include in that sub-total line premiums only. Other companies include in that sub-total line the sum of premiums and investment income.

⁴⁹ When applying IFRS 17, for most companies the insurance service result will be a new metric comprising insurance revenue less insurance service expenses.

Implications for capital markets

The Board expects that the improved financial information introduced by IFRS 17 will provide more insight into the risks associated with issuing insurance contracts and the financial performance of insurance companies.

The requirements to measure insurance obligations using current assumptions, to disclose the allowance for risk reflected in the measurement of those obligations and recognise any losses arising from insurance contracts in a timely way are expected to provide useful information to investors and other market participants. This information will enable them to better assess the risks and performance of insurance companies.

Some investors and analysts consulted by the Board noted that some existing insurance accounting practices for the recognition of insurance revenue and of insurance profit do not provide them with transparent and comparable information about the performance of insurance companies.

Extract from an investor representative body's comment letter to the 2010 Exposure Draft

We believe that this standard provides an opportunity to make the business models and performance of insurers more comprehensible (or at least more transparent) to investors in general.

The Board expects that the increased transparency about risks and profitability arising from insurance contracts introduced by IFRS 17 will make insurers' financial position and performance significantly easier to understand. This should make the insurance industry more attractive to non-specialised investors. Overall the insurance industry should benefit from greater availability of capital at lower costs.

The Board also expects that transparent information about risks faced by each insurance company will facilitate a more efficient allocation of capital. Such a benefit is similar to the one expected with the implementation of some risk-based prudential requirements.

Extract from European Commission's memo about Solvency II⁵⁰

Capital requirements under Solvency II will be forward-looking and economic, i.e. they will be tailored to the specific risks borne by each insurer, allowing an optimal allocation of capital across the EU.

Financial stability and volatility

The IFRS Foundation's mission statement states that the Board's work serves the public interest by fostering long-term financial stability.

Improved transparency resulting from IFRS 17 is expected to contribute to long-term financial stability by revealing useful information that will enable actions to be taken in a timely way.

To reflect economic reality for insurance contracts, transparency requires timely recognition of the effects of changes in economic conditions in a company's financial statements. If an insurer's assets and liabilities are economically matched and are both measured using current value principles, the insurer's financial statements should not show any volatility arising from economic or accounting mismatches.

Although it may not be possible to align the accounting treatment for all insurance contracts with the accounting for assets backing these contracts, IFRS 17 offers options to address most accounting mismatches (see discussion on pages 85–87 within Section 6.2—*Effects on the statement of comprehensive income*).

The Feedback Statement on IFRS 17 includes information about the concerns expressed by stakeholders on the volatility that would have resulted from the proposals that preceded IFRS 17, as well as how the Board addressed those concerns.

⁵⁰ Solvency II Overview – Frequently asked questions, European Commission – Fact Sheet, 12 January 2015.

4.3—Comparability of financial information

The Board expects IFRS 17 to improve significantly the comparability of the financial statements of insurance companies. This is because companies will apply a consistent accounting framework for all insurance contracts and therefore the diversity that currently exists in accounting for insurance contracts among companies applying IFRS Standards around the world will be removed.

IFRS 17 will improve comparability between:

- (a) companies issuing the same type of insurance contracts;
- (b) similar insurance contracts issued by the same group in different jurisdictions; and
- (c) companies operating in the insurance industry and companies operating in other industries.

Comparability between companies

As discussed in Section 3—*Companies affected*, IFRS 4 allows companies to apply different practices, largely based on local insurance accounting requirements, to account for their insurance contracts.

When companies account for similar transactions in different ways, investors and analysts typically adjust companies' financial statements. For example, they attempt to improve the comparability of a company's financial statements with those of its peers by aligning accounting principles with what they consider to be the highest quality alternative for their analytical purposes. However, for insurance contracts, the information needed to do this has rarely been available.

As a result, existing insurance accounting practices make it difficult for investors and analysts to understand and compare the financial statements of insurance companies in a meaningful way.

Extract from Moody's rating methodology⁵¹

We are aware of significant differences among reporting regimes that cannot be addressed via adjustment. An example of such a difference for insurers is reported insurance reserve balances [insurance contract liabilities]. US GAAP, US SAP,⁵² IFRS [Standards], and various local GAAPs prescribe differing reserving standards. It would be impossible for a financial statement user to determine, with any degree of precision, the amounts by which reserves [liabilities] determined under one reporting framework would need to be adjusted to be wholly comparable to that which would be determined under a different framework.

Particular areas of diversity in practice are in:

- (a) the recognition of revenue for the insurance service provided;
- (b) the measurement of the insurance contract liabilities; and
- (c) the accounting for insurance acquisition costs (ie costs incurred to issue new insurance contracts).

⁵¹ Financial Statement Adjustments in the Analysis of Financial Institutions, Moody's Investors Service, 12 February 2016.

⁵² Statutory Accounting Principles, also known as SAP, are used to prepare the statutory financial statements of insurance companies in the United States.

Example of a dual-reporting company

The following example illustrates how difficult it can be to compare the financial position and performance of two companies and the significance of the differences that can arise as a result of applying different accounting requirements for insurance contracts.

The company:

- (a) operates an insurance business;
- (b) is a subsidiary of a group preparing consolidated financial statements applying GAAP 1; and
- (c) prepares its statutory financial statements applying GAAP 2.

Consequently, at each reporting date the company prepares two sets of accounts, applying both GAAP 1 (for the purposes of consolidation by its parent company) and GAAP 2 (for its statutory financial statements).

GAAP 1 and GAAP 2 represent national GAAP applied in leading insurance markets and are currently permitted to be used by insurers as a basis for developing their insurance accounting policies when applying IFRS 4. Their key features are summarised in the following paragraphs.

Recognition of revenue

Applying GAAP 1, the company excludes from its reported revenue the deposit components of its insurance contracts (which are accounted for as deposits), whereas, applying GAAP 2, the company recognises as revenue all premiums paid by policyholders (including deposit components).

Measurement of insurance contract liabilities

Applying GAAP 1, insurance contract liabilities mainly comprise the present value of future payments to policyholders estimated using actuarial assumptions (such as future investment yield, mortality rates, morbidity rates, contingency rates and other factors) that are reviewed on a periodic basis. Applying GAAP 2, liabilities for the fulfilment of insurance obligations are based on an accumulation method and on actuarial assumptions defined by local regulators. With respect to the measurement of liabilities for minimum guaranteed benefits, the relevant insurance accounting policies also differ between GAAP 1 and GAAP 2.

Accounting for insurance acquisition costs

Applying GAAP 1, the company defers acquisition costs and amortises them over the expected duration of the insurance contracts, whereas applying GAAP 2, the company recognises the acquisition costs as expenses in profit or loss when incurred.

Same company, different pictures

Differences in the accounting for insurance contracts between GAAP 1 and GAAP 2 result in a significant difference in the operating income⁵³ reported in the annual financial statements of the company as illustrated in the following table.

| Reconciliation of operating income between GAAP 1 and GAAP 2 | | |
|--|--------------|--------------|
| (in millions of currency units) | Year 2 | Year 1 |
| Operating income GAAP 1 | 1,606 | 1,416 |
| Different measurement of insurance contract liabilities | (645) | (505) |
| Net impact of deferral and amortisation of acquisition costs | (199) | (264) |
| Other differences ⁵⁴ | (14) | (14) |
| Operating income GAAP 2 | 748 | 633 |

⁵³ Operating income is one of the key performance measures, based on GAAP 1 and GAAP 2, disclosed by the company in this example. The company provides supplementary information about the differences between the two sets of accounting standards to help its investors understand the company's operating performance.

⁵⁴ 'Other differences' mainly refers to the different accounting treatment of financial instruments, including derivatives.

| (in millions of currency units) | Year 2 | | | | Year 1 | | | |
|------------------------------------|--------|--------|------------|-------|--------|--------|------------|-------|
| | GAAP 1 | GAAP 2 | Difference | | GAAP 1 | GAAP 2 | Difference | |
| Revenue | 9,010 | 11,244 | (2,234) | (25%) | 8,263 | 10,979 | (2,716) | (33%) |
| Operating income | 1,606 | 748 | 858 | 53% | 1,416 | 633 | 783 | 55% |
| Net income | 1,256 | 452 | 804 | 64% | 965 | 337 | 628 | 65% |
| Total equity | 10,375 | 4,567 | 5,808 | 56% | 8,977 | 3,872 | 5,105 | 57% |

Accumulated differences in operating income contribute to different amounts of equity between GAAP 1 and GAAP 2, as illustrated in the table above. This example shows that even the same company can appear significantly different due to the different accounting requirements it applies to the insurance contracts it issues.

This example shows how different insurance accounting provides significantly different pictures of financial position and performance even when applied to the same transactions.

Because IFRS 4 allows companies to account for insurance contracts based on their national GAAP, the financial statements of an insurance company that accounts for its insurance operations applying, for example, GAAP 1 cannot be compared directly with those of a similar company applying, for example, GAAP 2.

Consequently, companies with similar insurance activities and risks might look different in both their reported financial position and their financial performance. Economic differences and differences in risk between companies are obfuscated by different accounting practices.

Extract from a credit rating agency's comment letter to the 2010 Exposure Draft

We generally support the accounting changes proposed by the IASB [Board] simply because current accounting practices vary across jurisdictions and the quality of information provided is inconsistent, impeding analytical comparability. Partly because of the accounting and financial reporting inconsistencies we have experienced, and the need for further information, our analysis incorporates other sources of information and does not rely solely on general-purpose financial statements.

Levelling the playing field

When applying IFRS 17, companies using IFRS Standards will apply a consistent accounting framework for all their insurance contracts. This will enable investors and analysts to more easily identify economic differences between companies issuing insurance contracts.

Extract from an Insurance Europe's letter to the European Commission⁵⁵

The introduction of IFRS [Standards] was generally very beneficial to increase comparability at a global level. However, for insurance companies, IFRS has yet to provide a comprehensive set of requirements. This is because the currently applicable IFRS 4 "insurance contracts" is only a stop-gap measure and does not deliver comparable accounting for all insurance contracts across Europe. The replacement for IFRS 4 is very important because it should provide principles regarding the core business model of insurers and be aligned in its implementation date with IFRS 9 (financial instruments), but it is still being developed and will not be applied for a few years yet. We expect that insurers' cost of capital will fall only if the IASB [Board] issues a high quality successful replacement for IFRS 4.

⁵⁵ See the letter addressed to the Accounting and Financial Reporting Unit of the European Commission by the Economic and Finance Department of Insurance Europe on 7 February 2014.

Comparability between similar contracts

When applying IFRS 10 *Consolidated Financial Statements*, a company is required to prepare consolidated financial statements using uniform accounting policies for similar transactions. This requirement is because the use of non-uniform accounting policies in consolidated financial statements reduces the relevance of financial information.

Nonetheless, as discussed in Section 3—*Companies affected*, IFRS 4 allows insurers to depart from this general requirement and consolidate their subsidiaries using non-uniform accounting policies for their insurance contracts (and related acquisition costs). This means that identical insurance contracts in the same group are allowed to be measured using different local accounting requirements.

Extract from Swiss Re, *sigma No 06/2012*

The significant cross-border differences for valuing insurance liabilities remained unaddressed. When it comes to insurance, IFRS [Standards] in Europe is currently a mixed bag of grandfathered standards. Multinational companies are often forced to compile aggregates based on subsidiaries reporting under different local GAAP, even though they may involve very different underlying valuation bases.

Example of a multinational company

The issue of diversity of accounting policies for similar contracts issued by the same company is illustrated in the following table, which contains an example of a multinational insurance company that consolidates its insurance contracts in Asia and Europe using non-uniform accounting policies for similar contracts.

Similar insurance contracts are accounted for in a different way only because of the different geographical location of the company's insurance operations. Consequently, currently, there is a lack of comparability not only between companies as discussed on pages 50–52, but also between insurance contracts within a single company. Aggregated numbers thus also comprise amounts measured on an inconsistent basis.

| When applying IFRS 4, not everything that carries the IFRS label is consistent | | | |
|--|---------------------------------------|---|---|
| Insurance contract type and location ⁵⁶ | What accounting policies are based on | How insurance contract liabilities are measured ⁵⁷ | How acquisition costs are accounted for |
| Term contracts in various Asian countries | Local GAAP with some adjustments | Gross premium method with best estimate assumptions for all cash flows discounted at the risk-free rate | Deferred and amortised explicitly or implicitly through insurance contract liabilities |
| Non-participating contracts in the UK | UK GAAP | Gross premium method with cash flows discounted at rates based on the yields on the related assets | Deferred and amortised explicitly over the period in which they were expected to be recoverable |
| Non-linked business in India, Japan and Taiwan | US GAAP | Net premium method with various interest rates and an allowance for maintenance and claims expenses | Deferred and amortised in line with expected profits |

⁵⁶ Despite different terminology, all insurance contracts listed in the table are similar.

⁵⁷ The gross and net premium valuation methods are forms of actuarial valuation of insurance contract liabilities. The gross method considers full amounts of premium receivable and expense payable under a contract, whereas the net method considers only the premium that will exactly provide for the benefits guaranteed.

The use of different insurance accounting practices results in financial information about similar insurance contracts that cannot be easily compared. This problem has increased over time as insurers have been increasing their geographical reach and product range to benefit from scale and scope economies as well as from diversification.

Similar products, different jurisdictions, same accounting

IFRS 17 removes the practice of using non-uniform accounting policies for insurance contracts.

Consequently, IFRS 17 is expected to eliminate much of the diversity in practice for insurance contracts with similar characteristics and economic features.

For multinational insurance companies, IFRS 17 will provide a common measure to assess the performance of subsidiaries. For those companies, the use of consistent accounting policies is expected to contribute to an efficient use of systems and human resources.

When applying IFRS 17, a multinational company will apply a consistent accounting model for similar insurance contracts, increasing the comparability of its results by product and by geographical area.

Comparability between industries

Although insurance contracts have unique features, some long-term insurance contracts incorporate investment features that are economically similar to non-insurance financial service products. In addition, the businesses of a company that provides insurance, banking or asset management products to its customers are often compared to a stand-alone insurer, bank or asset manager.

Existing insurance accounting practices means financial information about products with economic similarities cannot be easily compared with the information produced by companies in other industries. Particular areas of inconsistency are insurance practices that:

- (a) account for deposits as revenue; and
- (b) recognise revenue on a cash basis.

In contrast, the requirements in IFRS 17 apply commonly understood IFRS principles to many aspects of the accounting for insurance contracts, such as the recognition of revenue when a service is provided to a customer.

Accordingly, IFRS 17 is expected to improve comparability between the relevant aspects of the accounting for insurance contracts and the accounting for other types of contracts. This is because IFRS 17 will reduce the differences between the requirements for insurance contracts and those for other contracts with customers, except where there are economic differences.

Deposits

Unlike non-life insurers, which compete primarily with other non-life insurers, life insurers compete not only with other life insurers but also with banks and other financial institutions.⁵⁸ Many insurance premiums contain a deposit component because many insurance products combine insurance coverage with investment.⁵⁹ The deposit component obliges the insurer to pay cash to policyholders or their beneficiaries regardless of whether an insured event occurs—the collection (and repayment) of the deposit component does not relate to the provision of insurance services to the customer.

⁵⁸ See, for example, the article 'Performance of the life insurance industry under pressure: efficiency, competition, and consolidation', Jacob A. Bikker, *Risk Management and Insurance Review*, 2016, Vol. 19, No. 1, 73–104.

⁵⁹ See Appendix A to this document for an overview of insurance products.

Currently, some insurance companies recognise all deposits received as revenue (and the return of these investment amounts as expenses). This is contrary to the accounting applied in comparable circumstances in the banking and investment management industries.

IFRS 17 requires that some non-insurance components—such as distinct deposit components, distinct goods and services and some embedded derivatives—are separated from the insurance contract and accounted for applying other relevant IFRS Standards (see Section 2—*Overview of IFRS 17 requirements*). This means that, when applying IFRS 17, distinct deposit components will be accounted for by applying IFRS 9 in the same manner as for any other deposits.

In contrast, deposit components that are not considered distinct will not be accounted for separately. Nonetheless, these deposit components must be excluded from both revenue and claims presented in profit or loss. For insurance contracts with deposit components that are not distinct, profit or loss will show—more clearly than today—the profitability of the insurance coverage and of the investment-related service provided by the insurance company.

How is a life insurance premium determined?

A life insurance premium typically consists of four key elements:

- | | |
|--|---|
| 1 Mortality and morbidity charge —the amount the insurer charges for the benefits it expects to pay the policyholder in the event of death and illness. | ✓ |
| 2 Expenses recovery —the amount the insurer charges to recover costs incurred to issue and administer the insurance contract. | ✓ |
| 3 Deposit —the amount the insurer repays the policyholder regardless of whether the insured event occurs. | ✗ |
| 4 Profit for service and bearing risk —the amount the insurer expects to earn from providing services, including a risk premium for bearing the risk caused by variability in cash flows. | ✓ |

✓ Included in insurance revenue, when applying IFRS 17.

✗ Excluded from profit or loss, when applying IFRS 17.

For example, compare the following banking and insurance products.

A bank collects a deposit from a customer of CU10,000.⁶⁰ The bank pays 2 per cent a year to the customer on the amount deposited.

An insurer issues a five-year insurance contract with a single premium of CU10,000. The premium is invested in a fund. Charges are deducted from the fund periodically to pay for insurance and investment management services. The insurer promises to pay:

- (a) a death benefit of CU20,000, or the value of the investment in the fund, if higher, if the policyholder dies during the five-year period; or
- (b) the value of the investment in the fund at the end of the fifth year if the policyholder does not die during the five-year period.

For both contracts, at inception, the companies collect the same amount (ie a deposit or an insurance premium of CU10,000). The bank accounts for an asset (cash) and a liability (due to the customer) for the amount deposited by the customer into the account. The bank's profit or loss is not affected by the receipt (or repayment) of the deposit.

⁶⁰ In this example, currency amounts are denominated in 'currency units' (CU).

In contrast, many insurance companies currently account for:

- (a) the entire insurance premium (including the deposit receipt) as income; and
- (b) all payments to the policyholders (including the repayment of the deposit) as an expense.

As shown in the following table, as a result of applying these practices, the amounts presented in profit or loss of the bank and the insurer are different despite the fact that they issued similar savings contracts.

In contrast, when applying IFRS 17, the insurer's and the bank's profit or loss will be comparable for this type of transaction.

| | Bank savings account | Insurance contract | |
|--|----------------------|----------------------|----------|
| | | IFRS 4 ⁶¹ | IFRS 17 |
| At the inception of the contract⁶² | | | |
| Income | – | 10,000 | – |
| Expense | – | (10,000) | – |
| Asset | 10,000 | 10,000 | 10,000 |
| Liability | (10,000) | (10,000) | (10,000) |

IFRS 17 will result in profit or loss for insurance contracts that is more comparable to economically similar transactions.

Revenue

Currently, insurance companies use a variety of methods to recognise and present revenue and expenses related to insurance contracts in profit or loss. A common approach is to present all premiums received (or due) in the period as revenue. This means that currently revenue is typically reported on a cash (or near-cash) basis.

For example, consider an insurance contract with a single premium paid by the policyholder at the beginning of the contract in return for fixed regular monthly payments for the remainder of the policyholder's life. Recognising the premium for the contract as revenue at the inception of the contract when the insurance services could be provided over a number of years does not reflect the economics of the transaction. In contrast, in all other transactions involving the provision of a service, the cash received from customers is recognised as revenue only when it has been earned through the delivery of that service.

IFRS 17 requires that insurance revenue reflect the services provided. While this may add complexity for preparers of financial statements (in comparison with using the premiums written or due approach), the Board expects that the cost of this complexity will be outweighed by the improved clarity of insurance-sector financial statements and by enhanced comparability with other industries. While some investors focus only on insurers' financial statements, some investors consider alternative investments across industries.

IFRS 17 requires premiums received to be disclosed in the notes to the financial statements. Therefore, this metric, which is typically used to analyse the insurance sector, will not disappear with the implementation of IFRS 17.

Revenue will reflect the services provided and will exclude deposits, just as it does for any other industry.

⁶¹ This example assumes that, applying IFRS 4, the deposit component is not accounted for separately. The expense line represents the change in insurance contract liability.

⁶² This example ignores any initial fees.

5—Costs

The implementation of IFRS 17 will require many insurance companies to gather new information and make changes to their financial systems. These implementation activities are likely to require significant time, effort and cost for many insurance companies. Costs will vary for different companies in different jurisdictions, depending on the companies' existing risk management and insurance accounting practices.

Section 5.1—*Implementation costs* discusses costs that insurers and other stakeholders are expected to incur when IFRS 17 is implemented. The likely implementation costs that the Board has identified relate mainly to changes in systems and processes for the accounting for insurance contracts.

Section 5.2—*Ongoing costs* discusses costs that insurers are expected to incur in applying IFRS 17 on an ongoing basis. These costs arise from gathering the necessary information to update the assumptions required to measure insurance contracts on a current basis, adjusting the contractual service margin and providing disclosures.

Section 5.3—*Key cost reliefs* discusses simplifications introduced to reduce the costs of applying IFRS 17. IFRS 17 enables a company to simplify the measurement of some short-term insurance contracts (for example, contracts with a coverage period of one year or less). In addition, a company is allowed to apply the new requirements to a group of contracts rather than on a contract-by-contract basis. Also IFRS 17 does not apply to some common contracts issued by non-insurers, such as most product warranties.

5.1—Implementation costs

The Board expects that both preparers and users of financial statements will incur costs when IFRS 17 is implemented (ie when preparers first apply IFRS 17). This is because most companies issuing insurance contracts or holding reinsurance contracts are expected to change how they account for those contracts to a greater or lesser extent.

Although the Board expects that most companies issuing insurance contracts will incur significant costs in implementing IFRS 17, the benefits introduced by the new requirements are expected to outweigh these costs (see Section 4—*Benefits*).

Extract from a global accounting firm's comment letter to the 2013 Exposure Draft

Entities transitioning to the final standard [IFRS 17] may incur significant costs to comply with the new requirements. However, we believe the need for a comprehensive standard for the accounting for insurance contracts outweighs these costs.

Costs for companies

Generally, when a new IFRS Standard is introduced, all companies using IFRS Standards move from one accounting practice to a new accounting practice. The resulting changes in accounting are therefore to some extent similar across companies.

The significance of the costs to implement any new accounting requirement for a company largely depends on the company's transactions affected by the changes in accounting (for example, volume, terms and conditions of the contracts affected) and on the changes needed to systems already in place to account for those transactions.

Although for any new IFRS Standard the implementation costs typically vary by company, for IFRS 17 this variability is even more pronounced. This is because the wide range of existing insurance accounting practices used by companies in applying IFRS 4 involves different levels of change in accounting for insurance contracts across companies.

The implementation costs for a company depend significantly on:

- (a) the extent to which the requirements in IFRS 17 differ from the approaches currently applied by the company;
- (b) the number and type of insurance contracts the company has; and
- (c) the existing systems used by the company for other purposes, such as regulatory reporting.

Extract from a global accounting firm's comment letter to the 2013 Exposure Draft

Normally, when an accounting standard is updated, all companies have costs that are somewhat comparable. However, the current IFRS 4 is not a comprehensive model and the cost for companies to implement any update to IFRS 4 will be impacted by the information that they maintain today to prepare their financial statements.

Quantifying the costs involved in implementing new accounting requirements is difficult as they depend on specific circumstances and improvements that are made at the time of implementation.

For example, a report issued by the European Commission in connection with the assessment of the effects of the 10-year adoption of IFRS Standards in the European Union notes:

The effects of IFRS adoption during the period under review were difficult to isolate as there were other significant regulatory changes; the effects also varied depending on the national GAAPs used before IFRS [Standards]. It was also difficult to obtain quantitative data on companies applying IFRS [Standards] and on costs and benefits.⁶³

The likely implementation costs of IFRS 17 that the Board has identified for companies will be in:

- (a) project design and implementation;
- (b) systems set-up;
- (c) process changes; and
- (d) education and communication.

Project design and implementation

The implementation of IFRS 17 is expected to be carried out by project teams comprising individuals with accounting, actuarial and systems knowledge and experience. The extent of available resources is expected to affect implementation costs for companies. Those insurance companies that have used less rigorous and less sophisticated measurement techniques for management, prudential or financial reporting purposes may have a greater need to employ and develop additional people with appropriate skills.

Systems set-up

The Board expects that companies will incur costs in setting up systems to obtain, store and analyse the information needed to apply IFRS 17. In particular, to apply IFRS 17, it is expected that companies will need to set up systems to:

- (a) analyse data with sufficient granularity to identify and maintain consistent groups of contracts (see Section 2—*Overview of IFRS 17 requirements*);
- (b) track information about inception dates and the coverage period of those groups of contracts;
- (c) determine the contractual service margin, accrete interest on the contractual service margin and recognise the contractual service margin for each group of contracts in profit or loss; and
- (d) store information about historical, current and future cash flows, about discount rates and about risk adjustments for each group of contracts.

The costs of implementing or modifying systems are expected to vary depending on the type of information currently collected and produced for management, prudential or financial reporting purposes.

For example, companies that already measure insurance contracts using information that is consistent with current market information, even if not for financial reporting purposes, are expected to incur lower costs in implementing IFRS 17 (see discussion about non-GAAP information within Section 4.2—*Improved financial information* and Section 7.2—*Interaction with regulatory frameworks*).

Similarly, companies that are in the process of implementing, or that have recently implemented, new regulatory requirements demanding information similar to that needed to apply IFRS 17 are expected to have already changed their systems or be in the process of changing them. Consequently, such companies are expected to incur lower incremental costs related to applying IFRS 17 if they implement new financial reporting and new regulatory requirements at (or nearly at) the same time.

⁶³ *Evaluation of Regulation (EC) N° 1606/2002 of 19 July 2002 on the application of International Accounting Standards*, Report from the European Commission to the European Parliament and the Council, 18 June 2015.

In contrast, the implementation of IFRS 17 requirements is expected to be more expensive for companies that have not collected information similar to that needed to apply IFRS 17 or that do not measure insurance contracts using an approach similar to that in IFRS 17 for regulatory purposes (see Section 7.2—*Interaction with regulatory frameworks*).

Process changes

Because IFRS 17 requires a company to measure insurance contracts issued to reflect probability-weighted cash flows, as well as the timing and the risk of those cash flows (see Section 2—*Overview of IFRS 17 requirements*), the implementation of IFRS 17 is expected to require a high level of integration between finance, actuarial and risk processes.

Data extracted from source systems will typically be included in actuarial and risk systems. The resulting valuations will then be recorded in a company's accounting system.

IFRS 17 information process



A company is expected to align the reporting processes with the new requirements for the balance sheet and the statement of comprehensive income. The new disclosure requirements introduced by IFRS 17 (concerning, for example, estimation approaches and risk information) are also expected to require changes to a company's reporting processes (see Section 6—*Effects on a company's financial statements*).

Implementation activities may involve significant time and effort if a company chooses to run parallel systems and processes to understand detailed differences between IFRS 17 and IFRS 4 data and perform consistency checks for a few years.

The adoption of any new process for financial reporting is expected to require the design and testing of controls and governance to ensure the quality of a company's reporting infrastructure.

Use of actuarial techniques

The Board expects companies to incur incremental costs in measuring insurance contracts when applying IFRS 17, both on implementation and on an ongoing basis. This is mainly due to the need to use actuarial techniques to determine:

- (a) probability-weighted cash flows arising from insurance contracts;
- (b) discount rates reflecting the characteristics of those cash flows; and
- (c) risk adjustments reflecting the uncertainty in timing and amount of cash flows.

The effects of IFRS 17 on a company's finance and actuarial processes will depend on a number of factors, including:

- (a) the company's existing reporting basis for insurance contracts;
- (b) the complexity and maturity of the company's business;
- (c) whether the company has recently undergone a major finance transformation (for example, for regulatory purposes); and
- (d) whether information similar to that required by IFRS 17 is already required to be produced (for example, for regulatory purposes).

Accounting policies

IFRS 17 removes the possibility of applying different accounting policies to similar insurance contracts issued by different companies within the same group. Consequently, the Board expects that some multinational companies will incur costs to align accounting manuals and provide guidance to local accounting teams.

IFRS 17:

- (a) requires a company to account for insurance contracts with direct participation features applying the ‘variable fee approach’ (see Section 2—*Overview of IFRS 17 requirements*); and
- (b) permits a company to use a simplified approach to measure some short-term insurance contracts (see Section 5.3—*Key cost reliefs*).

Consequently, the Board expects some companies to incur costs in assessing whether contracts meet the criteria needed to use those approaches. Costs are expected to relate mainly to developing a process to assess whether different types of contracts meet some specified criteria and, accordingly, they are expected to be incurred primarily when first implementing IFRS 17 and should diminish afterwards.

Education and communication

The Board expects that companies with significant insurance operations will incur costs in educating internal stakeholders and updating internal procedures. For some companies IFRS 17 might be a fundamental change to insurance accounting practices currently applied. Those companies are expected to need to train their management and staff to enable them to understand new concepts introduced by IFRS 17.

The Board also expects that companies will incur costs in communicating significant changes to their reported information to external parties (for example, to the investor community). Most of these costs are expected to be incurred when first communicating the changes and, accordingly, are expected to be incurred mainly when first implementing IFRS 17.

As for any new IFRS Standard, when first applying IFRS 17, companies are expected to distinguish the effect of movements caused by changes in accounting policies from those related to underlying business performance in explanations to management and users of financial statements. Companies may therefore incur costs in making such a distinction.

Costs for other stakeholders

As with all new requirements, there will be a period of education and adjustment for users of financial statements, during which they may incur costs. However, the costs are likely to be non-recurring and are expected to be significantly outweighed by the longer-term benefits of having more comparable, useful and transparent information about insurance contracts (see Section 4—*Benefits*).

Investors and analysts

Many users of financial statements consulted by the Board noted that it is difficult for them to understand:

- (a) the rights and obligations of companies that issue insurance contracts;
- (b) the risks faced by those companies; and
- (c) the financial performance of those companies.

These difficulties arise as a result of two distinct matters:

- (a) different financial reporting for insurance contracts among insurers using IFRS Standards; and
- (b) different financial reporting for insurance contracts and for other similar transactions.⁶⁴

In addition, many investors and analysts view the existing financial reporting for insurance contracts as opaque and outdated, particularly with respect to how risks facing a company issuing insurance contracts are reflected.

⁶⁴ See the discussion about the comparability between industries within Section 4.3—*Comparability of financial information*.

Extract from a credit rating agency's comment letter to the 2010 Exposure Draft

Our analysts in Europe and Asia, working with financial statements prepared in accordance with IFRS [Standards], continue to be challenged by the inconsistency and opaqueness of financial information provided (especially by life insurers). These analysts have turned to relying on supplementary financial information (including embedded value) voluntarily provided by insurers. A common starting point for their analysis will be a welcome improvement.

The Board expects that there will be a need to educate users of financial statements to help them understand the results of applying IFRS 17. The extent of differences between existing insurance accounting practices and IFRS 17 is likely to affect the costs for users of financial statements. In particular, users of financial statements will need to distinguish between:

- (a) changes caused by new accounting requirements as opposed to economic differences that have arisen; and
- (b) differential effects on different insurers, in the light of the characteristics of their insurance contracts.

IFRS 17 will provide more transparent information about the profitability of insurance contracts (see Section 4.2—*Improved financial information*). In addition, IFRS 17 will provide improved information about changes in circumstances and the different sources of earnings from insurance contracts. Such information is expected to reduce the cost of analysis for investors and analysts as it will be provided directly to users of financial statements.

Users of financial statements that analyse companies from different jurisdictions incur costs trying to make diverse insurance accounting comparable. These costs will be alleviated by IFRS 17.

As discussed in Section 4.3—*Comparability of financial information*, investors and analysts are rarely able to adjust insurers' financial statements to make meaningful comparisons when companies apply IFRS 4 because the necessary information is often lacking.

It is expected that information about insurance contracts reported by companies applying IFRS 17 will be more accurate than estimates (where they are possible to determine) currently developed by investors and analysts to compare companies using different accounting policies for similar insurance contracts. This is because companies have access to a more accurate and relevant set of data for the measurement of the insurance contracts.

A change in established practice typically results in the loss of trend data. IFRS 17 addresses this in respect of volume metrics by requiring information about premiums received in a period to be available from the notes to the financial statements. Consequently, users of financial statements will be able to continue to assess trend volume data relating to a company issuing insurance contracts by using information about premiums received made available by IFRS 17 (see Section 6.4—*Effects on key financial metrics*).

Regulators and tax authorities

IFRS 17 is not designed with the objective of being suitable for regulatory and tax frameworks. Nonetheless, in some jurisdictions, some of the amounts reported in accordance with IFRS Standards support regulatory and tax objectives. Accordingly, changes in IFRS financial reporting for insurance contracts might have effects on regulatory and tax treatments for some companies.

Regulators and tax authorities use different frameworks in different jurisdictions, and different effects are expected in those different jurisdictions. The associated costs are expected to vary by jurisdiction on the basis of local requirements.

The Board expects regulators and tax authorities to incur costs relating to IFRS 17 if their respective requirements depend on financial reporting requirements. This is because they may need to consider the effect on their requirements of any change in accounting, including changes introduced by IFRS 17.

Nonetheless, the use of consistent accounting policies for accounting for insurance contracts is expected to reduce the costs of analysing differences between financial reporting data and regulatory or tax reporting data of insurance companies that may be currently incurred by regulators and tax authorities.

Extract from a regulator's comment letter to the 2010 Exposure Draft

The establishment of a final standard on insurance contract accounting will bring consistency of accounting requirements for European insurance companies and their supervisors facilitating easier analysis and comparison of the differences of valuation and accounting which will exist between their financial statements and those regulatory statements that will be prepared under the Solvency II framework.

The Board continues to maintain an ongoing dialogue with regulators to raise awareness of the likely effects of IFRS 17 and, in so doing, to enable them to deal with the consequences (if there are any) of changes introduced by IFRS 17 on regulatory requirements.

Other considerations

As noted within the *Preface to International Financial Reporting Standards*, when financial statements are used to monitor compliance with contracts and agreements, a new IFRS Standard may have consequences that were not foreseen when the contract or agreement was entered into. For example, covenants contained in banking and loan agreements may impose limits on measures shown in a borrower's financial statements. The Board believes that the evolution of financial reporting requirements is well understood and would be known to the parties when they entered into the agreement. The parties can determine whether the agreement should be insulated from the effects of a future IFRS Standard, or, if not, the manner in which it might be renegotiated to reflect changes in reporting rather than changes in the underlying financial condition.

5.2—Ongoing costs

The Board expects companies to incur incremental costs in applying IFRS 17 on an ongoing basis.

Once a company has updated its systems and processes to obtain the information required by IFRS 17, the Board expects the main ongoing costs to arise from gathering the information needed to:

- (a) update the assumptions required to measure insurance contracts on a current basis;
- (b) adjust the contractual service margin; and
- (c) provide disclosures, particularly about movements in the insurance contract assets and liabilities.

Ongoing costs to maintain accounting and actuarial systems, processes and internal controls are expected to be higher for many companies compared with those incurred when applying IFRS 4. The increase in costs depends significantly on how much the requirements in IFRS 17 differ from a company's existing accounting practices and information already used for other purposes.

For example, ongoing incremental costs to apply IFRS 17 are expected to be less significant for companies that already measure insurance contracts using information that is consistent with current market information to meet prudential requirements, to report embedded value information or for risk management purposes.

Updating estimates

As discussed in Section 2—*Overview of IFRS 17 requirements*, IFRS 17 requires a company to update its assumptions about cash flows, discount rates and risk at each reporting date. Accordingly, a company should:

- (a) maintain data from previous periods;
- (b) gather actuarial information in a timely way so that assumptions are updated at each reporting date;
- (c) run actuarial models; and
- (d) analyse changes since previous periods, splitting:
 - (i) changes related to previous and current coverage; from
 - (ii) changes related to future coverage.

The significance of the ongoing costs is expected to depend on the frequency of the change in estimates, the complexity of contracts issued, the number of contracts affected and the systems used to capture this information.

The Board expects that the costs of remeasuring insurance contracts will arise mainly for long-term insurance contracts. In addition, contracts with options and guarantees will be more affected than other contracts. This is because changes in market variables will affect estimated cash flows for those contracts more significantly than for simpler contracts.

Costs incurred in providing current measurement are expected to be outweighed by the benefits of providing users of financial statements with a more relevant measurement of insurance obligations and enhanced information about performance, reflecting the long-term nature of some insurance contracts. In addition, IFRS 17 will provide more timely information about risk exposure (for example, as a result of economic mismatches between assets held and insurance obligations).

Contractual service margin

When applying IFRS 17, a company will typically measure the contractual service margin at a group level. The Board expects that the requirements on grouping insurance contracts mean that many companies will need to run systems to collect more granular information than they currently do, incurring some incremental costs. However, the Board has provided cost relief by setting requirements on grouping contracts that respond to the practical concerns raised by many stakeholders to the extent possible while meeting the Board's objective for improved information from the contractual service margin (see Section 5.3—*Key cost reliefs*).

In addition, a company is expected to incur costs to adjust the contractual service margin for changes related to future coverage. This is because, in response to feedback received, IFRS 17 requires a company to separate changes in estimates affecting profit or loss from changes adjusting the contractual service margin so that some changes in estimates are recognised over the coverage period.

Once a company has set up systems to provide the required discount rates, the IFRS 17 requirement to accrete the contractual service margin is not expected to involve additional costs.

Disclosures

IFRS 17 carries forward from IFRS 4 some requirements to provide information about the nature and extent of risks that arise from insurance contracts (see Section 2—*Overview of IFRS 17 requirements*). IFRS 17 also introduces more specific disclosures about:

- (a) the drivers of changes in insurance contract assets and liabilities; and
- (b) the changes in the contractual service margin and the risk adjustment during the reporting period.

These new disclosures are expected to provide new and useful information for users of financial statements and to assist insurers in communicating their results.

Once a company has set up systems to provide the disclosures required by IFRS 17, the Board expects the main ongoing cost to arise from the analysis of information provided by those systems.

The costs of applying the disclosure requirements in IFRS 17 will depend on:

- (a) the characteristics of a company's insurance contracts;
- (b) systems used to collect information to be disclosed; and
- (c) whether processing of information about insurance contracts is decentralised within subsidiaries.

Higher costs will be incurred by companies that have a large number of groups of contracts, that do not use integrated systems on an ongoing basis and that need to collect information about insurance contracts from their subsidiaries.

Companies are expected to determine which disclosures—both nature and extent—meet the needs of users of their financial statements. Companies are not expected to incur costs to provide disclosures that are not material (although they may incur initial costs to evaluate the materiality of disclosures).

Mitigation of costs

IFRS 17 should reduce costs currently incurred by companies in some areas.

One accounting framework

As discussed in Section 4.3—*Comparability of financial information*, IFRS 17 removes the diversity in accounting for insurance contracts for companies using IFRS Standards that operate in different jurisdictions. This means that, for a multinational company, IFRS 17 will provide a common measure to assess the performance of its insurance subsidiaries, enhancing the benefits of the use of IFRS Standards for the company and its group.

The use of consistent accounting policies also improves efficiency in the use of systems and in training people.

Extract from *IFRS Adoption Report in Japan*⁶⁵

The adoption of IFRS [Standards] would contribute to proper management resource allocation and performance assessment. It is because the adoption of IFRS [Standards] would provide a common “measure” for business management across the corporate group, including overseas subsidiaries, and enables the company to accurately measure and compare business performance of business segment and regional segment.

Consequently, IFRS 17 is expected to reduce the costs for those companies that have to maintain different accounting approaches and systems in applying IFRS 4.

Reduced need to produce non-GAAP information

As discussed in Section 4.2—*Improved financial information*, the Board expects that IFRS 17 will reduce the need to present some non-GAAP information, potentially reducing costs for companies in this respect.

Enhanced integration between risk management and financial reporting

As discussed in Section 5.1—*Implementation costs*, IFRS 17 is expected to require a high level of integration between finance, actuarial and risk processes. On an ongoing basis, the use in financial reporting of data which is relevant for financial and risk management purposes is expected to have positive effects in terms of cost and quality of internal controls, and usefulness of financial information.

Liability adequacy test no longer needed

As discussed in Section 6.1—*Effects on the balance sheet*, IFRS 4 requires insurers to perform a liability adequacy test at each reporting date to provide confirmation that the reported insurance contract liability is equal to or greater than current estimates of all contractual cash flows of insurance contracts.

Changes introduced by IFRS 17 means that a liability adequacy test is no longer required given that the fulfilment cash flows are measured at current value.

⁶⁵ *IFRS Adoption Report* issued on 15 April 2015 by the Financial Services Agency in Japan. This report discusses the main reasons for the voluntary adoption of IFRS Standards by Japanese companies.

5.3—Key cost reliefs

IFRS 17 includes many simplifications and practical expedients to provide cost relief for companies both when first applying IFRS 17 and on an ongoing basis.

Scope exclusions

As discussed in Section 3—*Companies affected*, a company is not required to apply IFRS 17 to the following contracts it issues:

- (a) product warranties issued by a manufacturer, dealer or retailer—these contracts are accounted for by applying IFRS 15 and IAS 37;
- (b) financial guarantee contracts—the company can choose to account for some financial guarantee contracts using the requirements for financial instruments in IFRS 9; and
- (c) fixed-fee service contracts—the company can choose to account for some fixed-fee service contracts using the revenue recognition requirements in IFRS 15.

For these contracts, IFRS 17 does not change existing accounting practices, so no incremental costs result from IFRS 17.

The Board concluded that requiring IFRS 17 to be applied to these contracts would have imposed costs for companies without any significant benefits to investors and analysts. Accounting for these contracts in the same way as either other contracts with customers or other financial instruments already provides relevant information to users of financial statements of companies that issue such contracts.

Grouping contracts

A key cost relief is that IFRS 17 allows a company to group insurance contracts for measurement purposes, based on the characteristics of the contracts and the company's approach to managing them.

Generally, IFRS Standards specify accounting for an individual contract to provide the most transparent information. Some IFRS Standards, such as IFRS 15 and IFRS 16 *Leases*, as a practical expedient, permit a company to apply the requirements of those Standards to a portfolio of contracts with similar characteristics.

The Board concluded that grouping insurance contracts is appropriate and provides useful information to users of financial statements.

As discussed in Section 2—*Overview of IFRS 17 requirements*, IFRS 17 treats differently the changes in the estimates of future cash flows depending on whether they give rise to expected gains or losses. Expected gains are recognised in profit or loss over the coverage period through the recognition of the contractual service margin, while expected losses are recognised immediately in profit or loss, once the contractual service margin is exhausted.

Consequently, grouping contracts means that favourable and unfavourable changes in estimates from the individual contracts in the group of contracts are offset, and it is only any net change in estimates that is adjusted in the contractual service margin of the group or recognised in profit or loss.

In principle, to achieve its objective of reporting profits and losses in appropriate periods, groups should be based on notions of similar profitability. However, in determining the requirements on grouping contracts, the Board has sought to balance this principle with the provision of cost relief to companies applying IFRS 17. As a result, as discussed in Section 2—*Overview of IFRS 17 requirements*, IFRS 17 requires a company to identify the following groups (if there are any) by product line:

- (a) contracts that are onerous at initial recognition;
- (b) contracts that have no significant possibility of becoming onerous subsequently; and
- (c) other profitable contracts.

The requirement to divide contracts that are not onerous at initial recognition on the basis of their degree of resilience to becoming onerous is expected to be beneficial in reducing costs without resulting in a significant loss of information.

In determining these groups, there is an exemption in IFRS 17 for economic differences that arise as a result of regulation. For example, in some jurisdictions, local regulations may prohibit a company from charging different premiums to policyholders because of a specific characteristic (for example, gender, age, race or location of residence). These regulations may prevent companies from pricing a contract to reflect the risk of a particular policyholder based on that characteristic. In these circumstances, IFRS 17 allows such contracts to be grouped.

In addition, to ensure that profits and losses are allocated to the appropriate period, the Board restricted grouping to contracts that are issued within one year of each other. The restriction to contracts issued within one year of each other is an operational simplification given cost-benefits reasons.

Option for changes in discount rates

When applying IFRS 17, an insurer can choose to present the effects of changes in discount rates and other financial variables either in profit or loss or disaggregated between profit or loss and other comprehensive income. This choice is made on a portfolio-by-portfolio basis.

On the basis of the feedback received, the Board concluded that:

- (a) this option provides substantial cost relief for companies that consider it complex to disaggregate the effects of changes in discount rates and other financial variables between profit or loss and other comprehensive income; and
- (b) this relief does not significantly reduce the improvements introduced by IFRS 17.⁶⁶

Extracts from an accounting body's comment letter to the 2013 Exposure Draft

Overall, we believe that the costs of complying with the proposed requirements are justified by the benefits that the information will provide, apart from the presentation of the impact of interest rate changes in OCI [other comprehensive income] [...] our proposal to provide entities a choice to recognise changes in discount rates within P&L or directly in OCI will be less costly and complex to apply.

Optional simplified approach

An insurance contract liability can be analysed as comprising:

- (a) the liability for remaining coverage—the company's obligation for insured events that will occur in the future and that are covered by the existing contracts; and
- (b) the liability for incurred claims—the company's obligation to pay claims for the insured events that have already occurred and for which there are unsettled claims.

When applying IFRS 17, a company can use a simplified approach to measure some simpler insurance contracts—ie contracts for which the company does not expect significant changes in estimates before the claims are incurred, or for which the coverage period is less than a year.

⁶⁶ During the project to develop IFRS 17, the Board proposed requiring a company to present the effect of discount rate changes in other comprehensive income. The option to present these changes in profit or loss was introduced following the feedback received on that proposal.

This approach, which is referred to as the ‘premium allocation approach’, is expected to be substantially less costly to apply than the general accounting model in IFRS 17, while causing minimal loss of useful information for those contracts that qualify for this approach.

In the simplified approach, a company measures the liability for remaining coverage as follows:

- (a) on initial recognition, the company measures the liability for remaining coverage at the premiums received under the contract, less any acquisition cash flows paid.⁶⁷
- (b) subsequently, as the company provides coverage, the measurement of the liability for the remaining coverage reduces to reflect the coverage provided during the period. The reduction is calculated over the coverage period on the basis of the passage of time (or on the basis of the expected timing of incurred claims and benefits, if that pattern better reflects the company’s release from risk). In addition, the company:
 - (i) reports as revenue the amount paid by the policyholder for the coverage provided during the period; and
 - (ii) accretes interest on the liability.⁶⁸

- (c) if a group of contracts is onerous, the company increases the carrying amount of the liability for remaining coverage to the amount of the fulfilment cash flows.

Even when using the simplified approach, the liability for incurred claims is measured using the general accounting model in IFRS 17, except that a company is not required to discount the liability for incurred claims if it expects the claims to be settled in a year or less.

In most cases, the Board does not expect the effect of discounting for payments to be made in less than one year to be material. Nonetheless, this practical expedient is expected to provide cost relief for companies because they do not have to demonstrate that the effect of discounting is immaterial.

Although the outcome of the simplified approach is similar to the outcome of the general accounting model, the simplified approach does not require a company to:

- (a) measure the unearned profit of the contracts (contractual service margin) explicitly; or
- (b) update the liability for remaining coverage for changes in discount rates and other financial variables.

Thus, when a company applies the simplified approach it is expected to incur fewer costs, without creating significant issues of comparability between insurance contracts.

The use of the simplified approach is optional. Consequently, if a company considers it less costly to measure all its insurance contracts using the general accounting model in IFRS 17 it can do so.

Extract from a regulator’s comment letter to the 2010 Exposure Draft

We would support a modified measurement approach [premium allocation approach], provided that such an approach would be less onerous for preparers without compromising the integrity of the reported information.

Extract from an insurance representative body’s comment letter to the 2010 Exposure Draft

We believe that, under a principle-based standard, a simplification of the building block approach [general accounting model] is appropriate for relatively straightforward contracts, and so we support the IASB’s [Board’s] premium allocation approach as a proxy that may be used but not that it should be compulsory.

⁶⁷ Unless the coverage period at initial recognition is no more than a year and the company chooses to recognise any acquisition cash flows as an expense in profit or loss when it incurs those cash flows.

⁶⁸ Interest is accreted using the discount rates that applied when a group of contracts was initially recognised only if there is a significant financing component.

Transition reliefs

As for other new IFRS Standards, a company is required to account for its insurance and reinsurance contracts as if IFRS 17 had always been applied unless this is impracticable (for example, if, after making every reasonable effort, the company is unable to gather historical data for contracts issued many years before).

However, when this is impracticable, a company can measure existing insurance contracts when it first applies IFRS 17 using either:

- (a) a modified retrospective approach—which can be used only if reasonable and supportable information is available; or
- (b) a fair value transition approach.

The use of these optional approaches when a company first applies IFRS 17 is expected to reduce a company's costs as they will reduce the need for the company to gather complete historical information for contracts written many years before.

These choices reduce comparability. To introduce some comparability, IFRS 17 requires a company to provide some specific disclosures, to help users of its financial statements understand the effects of decisions made when first applying IFRS 17.

In addition, IFRS 17 permits a company to reassess classifications for financial assets (ie how they are measured) under IFRS 9 based on facts and circumstances that exist at the date of initial application of IFRS 17. IFRS 17 also enables the use and reassessment of options usually only available on first application of IFRS 9 (see Section 7.1—*Interaction with IFRS 9* for further information).

6—Effects on a company’s financial statements

The effect of a new IFRS Standard on a company’s financial statements always depends on a company’s facts and circumstances. In the case of IFRS 17 this is even more pronounced because of the wide range of different accounting practices adopted by companies in applying IFRS 4 and the wide variety of insurance contracts issued.

In general, the Board expects relatively little change as a result of IFRS 17 in the accounting for many short-term insurance contracts. In contrast, a greater change is expected in the accounting by many companies for long-term insurance contracts.

Section 6.1—*Effects on the balance sheet* discusses the effects on a company’s balance sheet of IFRS 17 requirements for the measurement and presentation of insurance contracts, including the effects on reported equity when first applying IFRS 17.

Section 6.2—*Effects on the statement of comprehensive income* discusses the effects that IFRS 17 will have on a company’s statement of comprehensive income. In particular, this section discusses the presentation of premiums and of finance expenses related to insurance contracts, the recognition of the contractual service margin and of the change in the risk adjustment, and the total amounts recognised in profit or loss.

Section 6.3—*Effects on note disclosures* discusses the effect that the disclosure requirements of IFRS 17 will have on a company’s notes to the financial statements. IFRS 17 improves the disclosures relating to the amounts reported in the financial statements, significant judgements made in measuring those amounts and risks arising from insurance contracts.

Section 6.4—*Effects on key financial metrics* discusses the effect of IFRS 17 on a wide variety of financial metrics reported by insurance companies, including non-GAAP measures. This section also highlights the new measures introduced by IFRS 17 that are expected to be closer to some non-GAAP measures currently reported by insurers.

6.1—Effects on the balance sheet

The Board considered the effects that IFRS 17 will have on a company's balance sheet, in particular, on:

- (a) the measurement of insurance contracts;
- (b) the presentation of insurance contracts; and
- (c) the reported equity when first applying IFRS 17.

Measurement of insurance contracts

As mentioned in Section 4.1—*Improved requirements introduced by IFRS 17*, existing insurance accounting practices typically differentiate between short-term and long-term insurance contracts. The Board therefore has considered the effects of IFRS 17 on the measurement of insurance contracts for each of those types of contracts.

When IFRS 17 is first applied, it is likely that the amount recognised on the balance sheet for a company's insurance contract assets and liabilities will change. The change for a particular company will depend on how different the existing accounting policies are from IFRS 17.

Short-term insurance contracts

Currently, a company can measure estimates of future claim payments for short-term insurance contracts on either a discounted or an undiscounted basis. For many companies, these estimates include a risk margin (ie an implicit or explicit allowance for risk) determined by management in addition to the estimate of future cash flows. The extent of the risk margin is typically not disclosed (see discussions about the risk adjustment within Section 4.2—*Improved financial information* and about the risk adjustment within Section 6.2—*Effects on the statement of comprehensive income*).

In contrast, IFRS 17 requires a company to:

- (a) discount future cash flows for incurred claims; and
- (b) apply an explicit risk adjustment to those cash flows.⁶⁹

| Expected effects of IFRS 17 for short-term insurance contracts | | |
|--|--|------------|
| Existing accounting practices used | Insurance contract liabilities | Equity |
| Liabilities for incurred claims are not discounted | ↓ Decrease | ↑ Increase |
| Liabilities for incurred claims are discounted | Depends on the length of settlement periods ⁷⁰ and on the discount rates used | |
| Risk margin higher than risk adjustment in IFRS 17 | ↓ Decrease | ↑ Increase |
| Risk margin lower than risk adjustment in IFRS 17 | ↑ Increase | ↓ Decrease |

⁶⁹ When applying IFRS 17, a company can use a simplified approach to measure some simpler insurance contracts—ie contracts for which the company does not expect significant changes in estimates before the claims are incurred, or for which the coverage period is less than a year (see Section 5.3—*Key cost reliefs*).

⁷⁰ When using the simplified approach in IFRS 17, a company is not required to discount the liability for incurred claims if it expects the claims to be settled in a year or less (see Section 5.3—*Key cost reliefs*).

The actual effect of IFRS 17 on insurance contract liabilities of companies that issue short-term insurance contracts will depend on the length of settlement periods, the size of the claims and the discount rate, and the risk adjustment applied by the company. The effect is expected to be more significant for companies that do not discount future claim payments and do not include any risk adjustment.

Given the range of existing practices, IFRS 17 may result in either an increase or a decrease of assets and liabilities for short-term insurance contracts when IFRS 17 is first applied.

Long-term insurance contracts

For long-term insurance contracts, the Board observed even less consistency in existing accounting practices.

Existing insurance accounting practices that might have a significant influence on the effect of IFRS 17 on the measurement of a company's insurance contracts include the following:

- (a) whether insurance contract assets and liabilities are measured using current or historical assumptions;
- (b) the extent to which the measurement basis includes risk margins in addition to the estimate of future cash flows;
- (c) the basis on which financial options and guarantees are measured; and
- (d) whether acquisition costs are deferred or expensed.

Current or historical assumptions

IFRS 17 requires a company to use current estimates in measuring insurance contracts issued. Consequently, for the many companies that currently use assumptions determined at contract inception, IFRS 17 is expected to affect the carrying amount of insurance contract assets and liabilities.

For example, if an insurance contract liability is currently measured using historical discount rates that are higher than the current rates, when applying IFRS 17 the measurement of the insurance contract liability is expected to increase. This is because the effect of discounting would be less significant due to a lower discount rate.

| Discount rate currently used | Expected effects of IFRS 17 | |
|---|--------------------------------|------------|
| | Insurance contract liabilities | Equity |
| Historical rate, lower than current rate | ↓ Decrease | ↑ Increase |
| Historical rate, higher than current rate | ↑ Increase | ↓ Decrease |

IFRS 4 requires insurers to perform a liability adequacy test at each reporting date. This test is intended to provide confirmation that the reported insurance contract liability is equal to or greater than current estimates of all contractual cash flows—estimated claims, unearned premiums and investment returns on relevant assets. If a deficiency is identified, an additional liability is required to be recognised on the balance sheet with a corresponding expense in the statement of comprehensive income. In contrast, there is no requirement to reverse any excess estimate of the value of insurance contracts.

Accordingly, the Board expects that for some companies the way the liability adequacy test is applied may influence the overall effect of IFRS 17 on the measurement of insurance contracts. If the liability adequacy test is inadequate, insurance contract liabilities are underestimated when applying IFRS 4 and would be expected to increase when IFRS 17 is first applied.

Risk margins

IFRS 17 requires a company to reflect uncertainty about the amount and timing of the future cash flows in the measurement of insurance contracts through an explicit risk adjustment. Currently, most companies include a risk margin (ie an implicit or explicit allowance for risk) in the measurement of their insurance contracts.

However, a lack of transparency often makes it difficult to determine the basis on which these margins are recognised. This in turn makes it difficult to predict the effects of IFRS 17 requirements relating to the risk adjustment.

Nonetheless, the Board expects that IFRS 17 will affect risk margins included in the measurement of insurance contracts. Risk margins might increase or decrease depending on existing practice and on the newly adopted approach when applying IFRS 17.

| Risk margin currently used | Expected effects of IFRS 17 | |
|--|--------------------------------|------------|
| | Insurance contract liabilities | Equity |
| Risk margin higher than risk adjustment in IFRS 17 | ↓ Decrease | ↑ Increase |
| Risk margin lower than risk adjustment in IFRS 17 | ↑ Increase | ↓ Decrease |

Most importantly, as discussed in Section 4.2—*Improved financial information*, the Board expects IFRS 17 to improve the transparency and availability of information about the effect of risk on insurance contract liabilities and about the effect on profitability of the release from that risk.

Financial options and guarantees

IFRS 17 requires a company to reflect the full current value of embedded financial options and guarantees in the measurement of insurance contracts (ie both their time value and their intrinsic value).

A common form of financial option and guarantee is a minimum interest rate guarantee (ie an insurer guarantees a policyholder a minimum return on a deposit component). Currently, there is a lack of information about how these guarantees have been taken into account when measuring insurance contract liabilities, or when testing their adequacy. Consequently, it is difficult to estimate the effects of IFRS 17 requirements on the measurement of embedded financial options and guarantees.

Currently, many companies do not fully reflect minimum interest rate guarantees in the measurement of their insurance contracts. For these companies, the effect of IFRS 17 on the carrying amount of insurance contract assets and liabilities is expected to be more significant due to the need to reflect in the measurement of insurance contracts the current value of such guarantees.

For other companies, the effect of IFRS 17 relating to minimum interest rate guarantees (if any) is expected to be less significant and will depend on the existing practices used to reflect the value of minimum interest rate guarantees in the measurement of insurance contracts.

| Current value of minimum interest rate guarantees | Expected effects of IFRS 17 | |
|---|--------------------------------|--------------|
| | Insurance contract liabilities | Equity |
| Not fully reflected in measurement of insurance contracts | ↑ Increase | ↓ Decrease |
| Fully reflected in measurement of insurance contracts | ↔ Low effect | ↔ Low effect |

Acquisition costs

IFRS 17 requires a company to include acquisition cash flows in the measurement of insurance contracts as part of estimated cash outflows.

For those companies that currently expense acquisition costs when incurred, IFRS 17 is expected to affect the carrying amount of insurance contract assets and liabilities.

For companies that currently defer and amortise acquisition costs, the effect of IFRS 17 depends on the type of costs that are deferred, the amortisation method currently used, and how these compare with the requirements in IFRS 17.

| Existing treatment of acquisition costs | Expected effects of IFRS 17 | |
|---|--------------------------------|-----------------------|
| | Insurance contract liabilities | Equity |
| Expensed as incurred | ↓ Decrease | ↑ Increase |
| Deferred and amortised | Depends ⁷¹ | Depends ⁷² |

Presentation of insurance contracts

IFRS 4 does not require any specific presentation for assets and liabilities arising from insurance contracts. The Board observed that some companies choose to present some items on the face of the balance sheet because this is either:

- required by the national GAAP previously applied by the company to account for insurance contracts; or
- considered useful by the company.

In contrast, IFRS 17 includes specific requirements for the presentation of insurance contracts on the balance sheet. Consequently, IFRS 17 is expected to result in a more consistent presentation of assets and liabilities arising from insurance contracts as discussed in the following paragraphs.

Insurance contract assets and liabilities

IFRS 17 requires a company to present groups of insurance (or reinsurance) contracts that are in an asset position separately from groups of insurance (or reinsurance) contracts that are in a liability position.⁷³

When applying IFRS 4, most insurers net insurance contract assets and liabilities and present them in a single line, typically as insurance contract liabilities (and as reinsurance contract assets). Consequently, IFRS 17 is expected to result in the separate presentation of assets and liabilities that are currently netted.

⁷¹ Currently, many companies present deferred acquisition costs as assets on the balance sheet, separately from insurance contract liabilities. When applying IFRS 17, the amount of those acquisition costs will be included in the measurement of insurance contract liabilities.

⁷² There is only limited consistency by companies in their approach to the recognition and amortisation of deferred acquisition costs when applying IFRS 4. Consequently, IFRS 17 may result in either an increase or a decrease of equity.

⁷³ IFRS 17 requires a company to measure the present value of cash inflows and outflows of a group of insurance contracts. The subsequent measurement of the group may lead to it being reported as an asset or a liability, depending on the timing of the cash flows.

Intangible assets, other assets and other liabilities

Currently, some companies:

- (a) defer costs incurred in acquiring insurance contracts and present them on the balance sheet as ‘deferred acquisition cost assets’;
- (b) defer up-front fees for some insurance contracts and present these separately from insurance contract liabilities; and
- (c) present as an intangible asset differences between the fair value of insurance contracts acquired in a business combination, and their value measured in accordance with the company’s accounting policies, described using terms such as ‘value of business acquired’.⁷⁴

In addition:

- (a) most insurers present premiums receivable and claims payable as financial assets and liabilities, separately from other assets and liabilities for insurance contracts issued and reinsurance contracts held; and
- (b) some insurers present unearned premiums on the face of the balance sheet, separately from insurance contract liabilities.

When applying IFRS 17, the above amounts will be included in the measurement of insurance contracts issued and reinsurance contracts held resulting in an overall simplified and consistent presentation on the balance sheet.

Policy loans

Like IFRS 4, IFRS 17 does not include specific requirements for accounting for a policy loan (ie an amount lent by an insurer to a policyholder that typically offsets a deposit component of the related insurance contract).

Currently, insurers account for a policy loan as either:

- (a) part of the insurance contract; or
- (b) a separate financial asset.

IFRS 17 requires a company to take into account a policy loan when determining the amount to be returned to the policyholder. A policy loan will therefore be included in the measurement of insurance contracts. Accordingly, information about policy loans will be disclosed in the notes to the financial statements—when relevant—rather than presented separately on the balance sheet.

Summary of the expected changes

The following table summarises the expected changes in the presentation of insurance contracts in the balance sheet introduced by IFRS 17.

⁷⁴ The Board observed the use of a variety of terms to describe this item, such as: ‘value of business acquired’ (VOBA), ‘present value of in-force business’ (PVIF), ‘acquired value of in-force business’ (AVIF), ‘present value of future profits’ (PVFP), ‘value of purchased business in-force’ (VIF), ‘value of business in-force’ (VBI), ‘present value profits’ (PVP), ‘purchased interest in long-term business’ and ‘intangible insurance asset’.

Presentation of insurance contracts

| | IFRS 4 | | IFRS 17 | |
|--|---|---|--|---|
| ↔ | Insurance contract liabilities | Typically presented separately | Insurance contract liabilities | No change in presentation compared with IFRS 4 |
| ↔ | Reinsurance contract assets | Typically presented separately | Reinsurance contract assets | No change in presentation compared with IFRS 4 |
| ✓ | Insurance contract assets | Typically netted with insurance contract liabilities | Insurance contract assets | Presented separately on the balance sheet |
| ✓ | Reinsurance contract liabilities | Typically netted with reinsurance contract assets | Reinsurance contract liabilities | Presented separately on the balance sheet |
| ✗ | Deferred acquisition costs | Presented separately in some cases | Insurance contract assets and liabilities | Acquisition cash flows are included in the measurement of insurance contracts and are disclosed in the notes ⁷⁵ |
| ✗ | Value of business acquired | Presented separately in some cases | Insurance contract assets and liabilities | The value of new business is included in the measurement of insurance contracts and is disclosed in the notes ⁷⁶ |
| ✗ | Premiums receivable | Typically presented separately as financial assets | Insurance contract assets and liabilities | Premiums are included in the measurement of insurance contracts and are disclosed in the notes ⁷⁷ |
| ✗ | Policy loans | Presented separately in some cases | Insurance contract assets and liabilities | Policy loans are included in the measurement of insurance contracts and potentially disclosed in the notes ⁷⁸ |
| ✗ | Unearned premiums | Typically presented separately for non-life insurance contracts | Insurance contract assets and liabilities | Unearned premiums are included in the measurement of insurance contracts and are disclosed in the notes ⁷⁷ |
| ✗ | Claims payable | Typically presented separately as financial liabilities | Insurance contract assets and liabilities | Claims payable are included in the measurement of insurance contracts and are disclosed in the notes ⁷⁹ |
| ↔ line items unchanged (for presentation purposes) ✓ expected 'new' line items ✗ line items not required by either IFRS 4 or IFRS 17 | | | | |

75 IFRS 17 requires a company to disclose insurance acquisition cash flows in a reconciliation from the opening to closing balances of insurance contracts. See Illustration 4 in Appendix B to this document.

76 IFRS 17 requires a company to disclose the value of contracts acquired on initial recognition. Subsequently, this value will be included within the contractual service margin.

77 IFRS 17 requires a company to disclose premiums received for insurance contracts issued in a reconciliation from the opening to closing balances of insurance contracts. See Illustration 4 in Appendix B to this document.

78 Policy loan balances are expected to be disclosed if they are a key metric for the company of relevance to users of its financial statements.

79 IFRS 17 requires a company to disclose claims paid in a reconciliation from the opening to closing balances of insurance contracts. See Illustration 4 in Appendix B to this document.

Effects on reported equity

When first applying IFRS 17, any existing balances relating to insurance contracts issued and reinsurance contracts held will be replaced with assets and liabilities for insurance contracts issued and reinsurance contracts held, measured in accordance with IFRS 17, with some optional simplifications (see Section 5.3—*Key cost reliefs*).

The effect on a company's reported equity will depend on a number of factors, including:

- (a) the measurement approaches used when first applying IFRS 17;⁸⁰
- (b) the nature of insurance contracts in force at the date of first application of IFRS 17;⁸¹
- (c) the insurance accounting policies currently applied; and
- (d) the differences between market conditions on the date of inception of the contracts and when IFRS 17 is first applied.

The effect on a company's reported equity is expected to be more significant for companies that currently measure insurance contracts based on the companies' expectations when they entered into contracts, possibly decades previously, and that have not subsequently been updated.

When applying IFRS 17, a company will measure its insurance contracts on the basis of current market information. Consequently, the magnitude of the effect on a company's financial statements will also depend on the prevalent economic conditions at the time of first applying IFRS 17 and the extent to which this information is already reflected in the existing accounting.

When first applying IFRS 17, the effects on a company's reported equity will largely depend on whether insurance contracts are currently measured on the basis of historical or current information.

Short-term insurance contracts

The first application of IFRS 17 could result in either an increase or a decrease in reported equity in respect of short-term insurance contracts. This will depend on whether incurred claims liabilities are currently discounted, and, if so, what rates are used to discount those liabilities, and what the relative size of the existing risk margins is compared with IFRS 17 (see the previous discussion about the measurement of short-term insurance contracts on pages 72–73).

Long-term insurance contracts

For long-term insurance contracts, the differences in existing insurance accounting practices, discussed on pages 73–75, are also expected to affect a company's reported equity when first applying IFRS 17 (ie differences in current or historical assumptions, risk margins, financial options and guarantees, and acquisition costs).

In addition, other differences in existing insurance accounting practices that could influence the effect of IFRS 17 on reported equity when a company first applies IFRS 17 include:

- (a) whether gains can be recognised at inception and the extent to which onerous and profitable contracts are aggregated; and
- (b) any other factors that accelerate, or delay, the recognition of profits or losses.

The following table summarises the expected effect on a company's reported equity of first applying IFRS 17 with reference to the measurement of long-term insurance contracts.

⁸⁰ See Section 5.3—*Key cost reliefs* for further information about measurement options available on the first application of IFRS 17.

⁸¹ Contracts in force are those that give rise to existing obligations or existing rights for an insurance company.

| | |
|---|--|
| Long-term insurance contracts | ↑ Factors that are expected to increase reported equity |
| | Acquisition costs are currently expensed as incurred. |
| | Fees for insurance contracts with participation features are currently based on account balances and recognised when deducted, or when discretionary payments to policyholders are declared. |
| | Insurance contracts are currently measured using historical interest rates that are lower than market rates when first applying IFRS 17. |
| | Risk margins currently used are higher than risk adjustments used to apply IFRS 17. |
| | ↓ Factors that are expected to decrease reported equity |
| | Profits are currently recognised at contract inception. |
| | Aggregation of onerous and profitable contracts is currently permitted. |
| | Discount rates are currently based on assets backing insurance contract liabilities. ⁸² |
| | Value of guaranteed rates (ie both time value and intrinsic value) is currently not fully included in the measurement of insurance contract liabilities. |
| Insurance contracts are currently measured using historical interest rates that are higher than market rates when first applying IFRS 17. | |
| Risk margins currently used are lower than risk adjustments used to apply IFRS 17. | |

⁸² The effect of IFRS 17 on discount rates is discussed in Section 4.2—*Improved financial information*.

6.2—Effects on the statement of comprehensive income

The Board considered the effect that IFRS 17 will have on a company's statement of comprehensive income, in particular, on:

- (a) the presentation of premiums;
- (b) the presentation of insurance finance expenses;
- (c) the recognition of the contractual service margin and of the risk adjustment; and
- (d) the total amounts recognised in profit or loss.

Premiums

When applying IFRS 17, many companies issuing insurance contracts will present, for the first time, an item described as 'insurance revenue' in their statement of comprehensive income. This item will replace items variously described as 'premium income', 'written premiums' or 'earned premiums' in their existing statement of comprehensive income (see Section 6.4—*Effects on key financial metrics*).

Insurance revenue will be determined and presented in a way that is consistent with the approach in IFRS 15 for the recognition of revenue from contracts with customers. Consistently with that approach, the insurance revenue recognised will reflect the amount that the company expects to receive for the services it has provided in the period (such as the provision of insurance coverage). As discussed in Section 4.3—*Comparability of financial information*, this approach is expected to facilitate comparisons between companies operating in the insurance industry and companies operating in other industries, in particular other financial service companies.

Currently, many insurers present premiums for long-term insurance contracts separately from premiums for short-term insurance contracts. This is because they are typically accounted for using different accounting policies. In contrast, when applying IFRS 17, insurance revenue will be measured using the same approach for all types of insurance contracts.

Consequently, insurers will be able to present insurance revenue in a single line in their statement of comprehensive income.

Short-term insurance contracts

For short-term insurance contracts, the insurance revenue presented in each period is not expected to be significantly different from the earned premiums currently presented under most measurement models.

For contracts with a coverage period of one year or less measured using the simplified approach in applying IFRS 17 (see Section 5.3—*Key cost reliefs*), the amount recognised as insurance revenue need not be adjusted for the time value of money. Consequently, for most insurers, the amount of revenue recognised over the coverage period is expected to be the same as the amount currently recognised (see Illustration 3 in Appendix B to this document on pages 122–123).

Long-term insurance contracts

For long-term insurance contracts, the insurance revenue presented in each period, and over the duration of a contract, may be significantly different from the premiums presented when applying IFRS 4. This will be the case in particular for:

- (a) contracts containing a deposit component;
- (b) annuities and other single premium contracts (for example, a multi-year contract for which the premium is paid by the policyholder only at the inception of the contract); and
- (c) other contracts in which the pattern of premium payments differs from the pattern of coverage (for example, long-term life insurance contracts with fixed premiums and fixed death benefits).

Currently, many companies recognise premiums due in full, including deposit components. IFRS 17 excludes from profit or loss deposit components that many companies currently include in premium income (and claims expenses). This is because the obligation to repay deposit components is not an obligation to provide services.

As discussed in Section 4.3—*Comparability of financial information*, this is expected to enhance comparability between revenue recognised by insurers and revenue recognised by banks. Banks do not recognise deposits received as revenue applying IFRS Standards.

When applying IFRS 17, the amount recognised as insurance revenue over the coverage period will typically be greater than the premiums received. This is because premiums are typically received before the related services are provided, and insurance revenue includes an adjustment for the time value of money to reflect the effect of that early receipt on the pricing of premiums (see the illustration on page 83).

Key expected changes in insurance measures in the statement of comprehensive income

| | IFRS 4 | IFRS 17 | Effects of IFRS 17 |
|---------------------|---|--|---|
| Deposit component | Typically included within premiums (as income) and within 'change in insurance contract liabilities' (as expense) | Excluded from insurance revenue and from incurred claims and other expenses | Deposit components are excluded from profit or loss (see discussion about comparability between industries in Section 4.3— <i>Comparability of financial information</i> and the illustration on page 48) |
| Time value of money | When relevant, typically included within 'change in insurance contract liabilities' | Accretion of interest on insurance contract liabilities included within insurance finance expenses | The effect of the timing of cash flows is presented separately as insurance finance expenses (see the illustration on page 83) |

Insurance finance expenses

As discussed in Section 2—*Overview of IFRS 17 requirements*, when applying IFRS 17, the effect of changes in discount rates and other financial variables on the measurement of insurance contracts may either be presented in profit or loss or be disaggregated between profit or loss and other comprehensive income.

For most companies that choose to present the effect of changes in discount rates in other comprehensive income, this presentation will differ from the existing presentation of such changes, if they are recognised. When applying some existing insurance accounting practices, some companies measure insurance contracts on a discounted basis using updated discount rates and present such changes in profit or loss. Others do not update the discount rates and others do not discount.

When applying IFRS 17, interest accreted on insurance contracts (insurance finance expenses) will be presented together with the return on the related investments rather than as part of a new metric called ‘insurance service result’.

In contrast, when applying IFRS 4, if amounts are discounted, the effect of discounting is often not presented separately from other movements in insurance contract assets and liabilities.

The Board expects that the requirement to present insurance finance expenses together with the investment return on related investments that the company holds will provide a clearer depiction of the effects of investments and of market interest rates.

The table on the next page compares the presentation in the statement of comprehensive income for a group of contracts that, in return for a single premium, promise to make regular payments to policyholders for the remainder of their lives.⁸³

The table illustrates that, when applying IFRS 17:

- (a) the effect of discounting is reported as ‘insurance finance expenses’ within the ‘net financial result’; and
- (b) insurance revenue includes an equivalent adjustment to reflect the effect of the early receipt of premiums.

Illustration—assumptions

The illustration assumes that:

- (a) all cash flows expected at the inception of the contracts occur as anticipated;
- (b) there is no change in market interest rates;
- (c) there are no acquisition costs;
- (d) all policyholders die within 20 years;
- (e) premiums collected (CU5,000),⁸⁴ net of claims paid (CU520 for each policyholder), are invested in a financial asset generating a return of 5 per cent a year; and
- (f) the related financial asset is measured at fair value with gains and losses recognised through profit or loss in applying IFRS 9.

When applying IFRS 4 in this illustration, the implicit allowance for risk is set at a level such that no gain or loss arises at the inception of the group of contracts.

⁸³ This type of contract is sometimes called a ‘fixed benefit immediate annuity contract’.

⁸⁴ In this illustration, currency amounts are denominated in ‘currency units’ (CU).

| IFRS 4 | | | | | | | IFRS 17 | | | | | | | |
|--|-----------|-----------|-----------|--------------|-----------|----------------|------------------------------------|-----------|-----------|-----------|--------------|-----------|----------------|---|
| | Year 1 | Year 2 | Year 3 | Years 4-19 | Year 20 | Total | | Year 1 | Year 2 | Year 3 | Years 4-19 | Year 20 | Total | |
| Premiums | 5,000 | – | – | – | – | 5,000 | Insurance revenue | 550 | 534 | 516 | 4,946 | 39 | 6,585 | |
| Investment income | 250 | 236 | 223 | 2,124 | 86 | 2,919 | Incurred claims and other expenses | (520) | (504) | (487) | (4,605) | (36) | (6,152) | |
| Incurred claims | (520) | (504) | (487) | (4,605) | (36) | (6,152) | Insurance service result | 30 | 30 | 29 | 341 | 3 | 433 | |
| Change in insurance contract liabilities | (4,644) | 354 | 351 | 3,901 | 38 | – | Investment income | 250 | 236 | 223 | 2,124 | 86 | 2,919 | |
| Profit or loss | 86 | 86 | 87 | 1,420 | 88 | 1,767 | Insurance finance expenses | (191) | (177) | (163) | (1,052) | (2) | (1,585) | |
| Other comprehensive income | – | – | – | – | – | – | Net financial result | 59 | 59 | 60 | 1,072 | 84 | 1,334 | |
| Comprehensive income | 86 | 86 | 87 | 1,420 | 88 | 1,767 | Profit or loss | 89 | 89 | 89 | 1,413 | 87 | 1,767 | |
| This table illustrates a common method of presentation in the statement of comprehensive income for a group of contracts when applying IFRS 4. Because of the wide variety of practices to account for insurance contracts when applying IFRS 4, the presentation in this table might not be representative of any specific practice of a company or jurisdiction. | | | | | | | Other comprehensive income | – | – | – | – | – | – | – |
| | | | | | | | Comprehensive income | 89 | 89 | 89 | 1,413 | 87 | 1,767 | |

Compared with IFRS 4, changes in the statement of comprehensive income in this illustration include the following:

- when applying IFRS 17, the amount recognised as ‘insurance revenue’ over the contracts’ coverage period is greater than the premiums received for the effects of discounting (CU6,585 – CU5,000 = CU1,585). Because premiums are received in Year 1 (before the related services are provided), insurance revenue includes the effect of the time value of money for the early receipt of premiums.
- the effect of discounting (CU1,585) is reported as ‘insurance finance expenses’ within the ‘net financial result’ when applying IFRS 17, rather than within ‘change in insurance contract liabilities’, as it is in applying IFRS 4 in this illustration. This new presentation provides a clearer depiction of the effects of investments and of market interest rates.
- when applying IFRS 17, key drivers of profit of the group of insurance contracts—namely the ‘insurance service result’ and the ‘net financial result’—are presented separately to better explain the profitability of that group.

Contractual service margin and risk adjustment

When applying IFRS 17, if all cash flows estimated at the initial recognition of a group of contracts occur as anticipated, the insurance service result in each reporting period will consist solely of the recognition of:

- the contractual service margin earned for insurance services provided; and
- the change in the risk adjustment.

Consequently, the principles applied when determining the recognition of the contractual service margin in profit or loss and of the change in the risk adjustment will have a direct effect on the amounts recognised by a company in its statement of comprehensive income in each reporting period.

Contractual service margin recognition in profit or loss

IFRS 17 requires a company to recognise the contractual service margin in profit or loss over the coverage period based on the coverage units, reflecting the expected duration and size of the contracts in the group.

If the number of contracts is expected to reduce over time, the contractual service margin recognised in profit or loss in each period will also reduce over time. Similarly, interest accreted on the contractual service margin will reduce over time as the remaining contractual service margin balance reduces.

Risk adjustment

When applying IFRS 17, the risk adjustment will reflect the company's own assessment of risk. It will be remeasured at the end of each reporting period and, unlike the contractual service margin, it will not be based largely on an allocation of an amount determined at the initial recognition of a group of insurance contracts. Differences between the current estimates and previous estimates of the risk adjustment that relate to future service will be added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin cannot be negative. The effect of other differences in the risk adjustment will be recognised immediately in profit or loss.

As discussed in Section 4.2—*Improved financial information*, risk varies significantly between insurance contracts. This is because the uncertainty about the amount and timing of cash flows varies between insurance contracts. The risk margin is typically more significant for contracts with claims that require many years to be settled. These contracts are common in the non-life insurance industry.

A significant part of profit or loss recognised by companies in applying IFRS 4 is derived from the change in risk margins included in the measurement of insurance contract liabilities.

This is illustrated in the following example based on an insurer's financial statements. The insurer operates in one of the few jurisdictions where existing insurance accounting practices already result in companies calculating and disclosing an explicit allowance for risk for the measurement of insurance contracts.

Example based on a property and casualty insurer's financial statements

The profit or loss includes risk margin releases of CU184 million in 2014⁸⁵ (compared with risk margin increases of CU266 million in the previous year).

| | 2014 CU millions | 2013 CU millions |
|--|------------------------|------------------------|
| Net earned premiums | 14,084 | 15,396 |
| Claims and expenses | (13,537) | (15,055) |
| —amount of which = risk margin release (strengthening) | 184 | (266) |
| Net investment income on policyholders' funds | 527 | 500 |
| Insurance profit | 1,074 | 841 |
| Other income (expense) | (143) | (1,289) |
| Profit (loss) before tax | 931 | (448) |
| Insurance profit margin* | 7.6% | 5.5% |
| Combined ratio** | 96.1% | 97.8% |
| Risk margin / insurance profit | 17.1% | (31.6%) |

* Insurance profit / net earned premiums

** Claims and expenses / net earned premiums

⁸⁵ In this example, currency amounts are denominated in 'currency units' (CU).

Because these risk margins are generally not disclosed and are often implicit (ie they are not separately identifiable), it is difficult to determine the effect that their release has on profit or loss. IFRS 17 will improve the transparency of information about the effect on profitability of the release from risk.

The Board expects that for some companies, in applying IFRS 17, the recognition of profit for a group of contracts will differ from existing practice. That profit will arise from the recognition in profit or loss of the contractual service margin as a company provides insurance services and of the risk adjustment as the company is released from risk.

Profit or loss

The total profit or loss of a group of insurance contracts is the difference between total cash inflows and outflows arising from the contracts.

IFRS 17 does not change the total profit or loss of a group of insurance contracts recognised over the duration of the contracts. IFRS 17 changes the amounts recognised in each reporting period and how the components of the profitability of the contracts are disaggregated in the statement of comprehensive income.

The Board considered the effect that IFRS 17 will have on the total amounts recognised in profit or loss in each reporting period, compared with IFRS 4. The wide variety of accounting practices adopted by companies in applying IFRS 4 made this comparison difficult to make.

Some practices currently used by companies could influence the directional effect of IFRS 17 on profit or loss in each reporting period, depending on:

- (a) whether insurance contract assets and liabilities are measured using current or historical assumptions;
- (b) whether estimates of outstanding claims payments are measured on a discounted or undiscounted basis;
- (c) the extent to which onerous and profitable contracts are aggregated;
- (d) the basis on which financial options and guarantees are measured;
- (e) the basis for recognising profits or losses from insurance contracts; and
- (f) whether any market risk is hedged—because policyholders retain either some or all of that risk (for example, through variable rate products)—or the insurance company acquires assets with a similar risk profile or enters into hedging derivatives.

Changes to financial assumptions

As discussed in Section 2—*Overview of IFRS 17 requirements*, IFRS 17 requires a company to update, at each reporting date, the measurement of insurance contracts issued and reinsurance contracts held, using updated assumptions consistent with current prices in financial markets (ie the fulfilment cash flows are updated using current assumptions about cash flows, discount rates and risk).

Contracts without a variable fee

When applying IFRS 17, the company will:

- (a) recognise the effect of changes in estimates of the fulfilment cash flows in profit or loss, if such changes relate to current or past coverage; and
- (b) adjust the contractual service margin and recognise the net difference over future periods, if such changes relate to future coverage.

The company will recognise the effects of changes in discount rates and other financial variables in the period in which the changes occur. The company can choose, by portfolio, where to present the effects—either in profit or loss or disaggregated between profit or loss and other comprehensive income.

When applying IFRS 17 the key performance metric of the insurance activity (ie the insurance service result) will not be affected by market volatility. This is because a company's insurance service result will not be affected by financial variables (including discount rates) and their changes. The effect of discounting and changes in financial variables will be reflected within the insurance finance expenses. The illustration on page 83 shows this.

The net effect of changes in discount rates and other financial variables on profit or loss will depend on:

- (a) the extent to which a company chooses to present changes in discount rates and other financial variables in profit or loss or disaggregated between profit or loss and other comprehensive income; and
- (b) the way that financial assets held to back the insurance contract liabilities are measured and whether changes in the value of those assets are presented in profit or loss or in other comprehensive income (see Section 7.1—*Interaction with IFRS 9*).

For example, when applying IFRS 17, the effect of changes in discount rates and other financial variables on the measurement of insurance contract liabilities is expected to be:

- (a) recognised outside profit or loss if a company chooses to present some changes in discount rates and other financial variables in other comprehensive income; or
- (b) offset, partially or totally, if a company:
 - (i) recognises some changes in discount rates and other financial variables in profit or loss; and
 - (ii) holds financial assets measured at fair value with gains and losses recognised in profit or loss.

When applying IFRS 17:

- (a) an increase in the risk-free rate would not result in any effect on profit or loss if financial assets are matched with insurance contract liabilities and the effect of changes in rate is recognised in profit or loss; and
- (b) an increase in default risk of financial assets would result in a negative effect on profit or loss if changes in the fair value of financial assets are recognised in profit or loss, making visible the economic mismatch (risk) between financial assets and insurance contract liabilities.

The following table shows the effect of changes in discount rates and other financial variables on profit or loss if all such effects are recognised in profit or loss.

| Effects of changes in discount rates | | |
|--|----------------------------|--------------------------------|
| | Scenarios | |
| | Increase in risk-free rate | Increase in asset default risk |
| Value of financial assets measured at fair value | ↓ Decrease | ↓ Decrease |
| Value of insurance contract liabilities | ↓ Decrease | ↔ No change |
| Effect on profit—IFRS 4 ⁸⁶ | ↓ Decrease | ↓ Decrease |
| Effect on profit—IFRS 17 | No effect if matched | ↓ Decrease |

IFRS 17 provides flexibility in allowing the effects of changes in discount rates and other financial variables to be either presented in profit or loss or disaggregated between profit or loss and other comprehensive income, individually for each portfolio of insurance contracts. Consequently, companies are expected to be able to align the accounting treatment of each portfolio of insurance contracts with the accounting treatment of the assets held to back that portfolio.

Although it may not be possible to align the accounting treatment for all portfolios of insurance contracts exactly with the accounting for assets backing these contracts, the Board expects that any residual volatility in profit or loss is more likely to arise from economic mismatches than from accounting mismatches.

| Economic and accounting mismatches |
|---|
| An economic mismatch arises if the values of assets and liabilities respond differently to changes in economic conditions. |
| Transparency requires that economic mismatches are fully displayed in a company's financial statements. |
| An accounting mismatch arises if changes in economic conditions affect the value of assets and liabilities to the same extent, but the carrying amounts of those assets and liabilities do not respond equally to those economic changes because they are measured on different bases. |
| Accounting mismatches distort a company's financial position and performance and therefore should be eliminated where possible. |

⁸⁶ Assuming there is no discounting of insurance contract liabilities.

IFRS 17 is expected to reveal economic volatility of insurance contracts, making the performance of insurance companies more transparent. At the same time, the insurance service result will not be affected by changes in discount rates.⁸⁷ IFRS 17 also permits companies to report the effects of changes in discount rates in other comprehensive income.

Accounting mismatches arise in accounting for insurance contracts before IFRS 17. In some cases, and to a limited extent, a practice sometimes described as ‘shadow accounting’ may mitigate volatility caused by differences between the measurement basis for assets and the measurement basis for insurance contract liabilities in profit or loss.⁸⁸

IFRS 17 offers options to address most accounting mismatches. Consequently, the Board expects that, when applying IFRS 17, the volatility of amounts recognised in profit or loss, if any, will depict changes in economic conditions.

For those companies that already use current estimates to measure their insurance contracts and recognise the effects of changes in those estimates in profit or loss, the Board expects that IFRS 17 will reduce the volatility of amounts recognised in profit or loss. This is because of the options available in IFRS 17 for the presentation of the effects of changes in financial variables.

Contracts with a variable fee

Insurance contracts with direct participation features have returns based on the fair value of some underlying items. The insurer and its policyholders share those returns, which are affected by market-driven changes in the underlying items.

For those contracts, IFRS 17 has a specific approach—the variable fee approach.

Importantly, the variable fee approach enables an insurer to recognise the changes in insurance contract liabilities due to changes in returns by adjusting the contractual service margin of the groups of contracts affected by changes, rather than in profit or loss.

IFRS 17 also provides choices to manage the accounting mismatches that may arise, for example, if an insurer holds derivatives to manage the risk arising from guarantees embedded in insurance contracts and the effects of changes in the value of those guarantees are not recognised in profit or loss (see Section 2—*Overview of IFRS 17 requirements*).

Onerous contracts

When applying IFRS 17, the contractual service margin for a group of insurance contracts will be increased or decreased by changes in the estimates of future cash flows and in the risk adjustment that relate to future service. The effect of such changes in estimates will then be recognised in profit or loss over the remaining coverage period as the contractual service margin is earned by providing insurance services. If the estimates of future cash outflows plus the risk adjustment exceed the estimates of future cash inflows, either at the inception of the contracts or subsequently, the contracts are onerous and the difference will be recognised immediately in profit or loss.

The treatment of changes in estimates of future cash flows applying IFRS 17 will typically differ from existing practice.

Currently, a company may measure its insurance contract assets and liabilities using either current or historical estimates of future cash flows. If current assumptions are used, changes in current estimates are typically recognised immediately in profit or loss. If historical assumptions are used, the typical existing accounting treatment is similar to IFRS 17, in that changes in estimates are recognised immediately in profit or loss only if the contract (or the group of contracts, if this is the unit of measure) is onerous.

⁸⁷ This is not the case when the variable fee approach is applied.

⁸⁸ Shadow accounting is a practice permitted by IFRS 4 to adjust insurance contract liabilities to reduce accounting mismatches that could arise when unrealised gains and losses on assets held by a company are recognised in the financial statements but corresponding changes in the measurement of the insurance contract liabilities are not.

IFRS 4 contains only minimal requirements for the assessment of the possibility of insurance contracts becoming onerous. As discussed in Section 6.1—*Effects on the balance sheet*, IFRS 4 requires insurers to perform a liability adequacy test at each reporting date. If the current estimate of the net contractual cash outflows is greater than the carrying amount of the insurance contract liabilities, IFRS 4 requires a company to recognise an additional liability and an expense in the statement of comprehensive income, revealing the existence of losses on onerous contracts. However, the way the test is performed varies significantly between companies. If, for example, the test is performed at portfolio level, losses on some contracts are offset by gains on others such that the overall portfolio is profitable and no losses on onerous contracts are recognised.

As discussed in Section 2—*Overview of IFRS 17 requirements*, at initial recognition, IFRS 17 requires a company to identify onerous contracts and to group those contracts separately from insurance contracts that are expected to be profitable. The company will recognise:

- (a) losses on onerous contracts immediately in profit or loss when they are expected; and
- (b) profits on contracts that are expected to be profitable over the coverage period—by recognising the contractual service margin in profit or loss as insurance services are provided and profit is earned.

Subsequently, the company is required to regularly update the fulfilment cash flows and to:

- (a) recognise in profit or loss additional losses for groups of onerous contracts; and
- (b) adjust the contractual service margin for other groups of contracts. If the contractual service margin for those groups of contracts is reduced to zero, changes for additional expected outflows are recognised in profit or loss.

Because insurance contracts are aggregated into groups, IFRS 17 will result in some losses on contracts (within a group) that individually become onerous being offset by gains on other contracts (within the group). However, when applying IFRS 4, contracts may be aggregated at a higher level, allowing more losses on onerous contracts to be offset against profits on profitable contracts.

The Board therefore expects that IFRS 17 may result in some companies recognising losses on onerous contracts earlier than when applying IFRS 4.

Extract from a global accounting firm's report discussing the proposals in the 2013 Exposure Draft

Some insurers currently use a higher grouping level for the current premium deficiency test [liability adequacy test] than would be permitted under the onerous contracts test in the proposed standard. For example, some non-life insurers might consider their grouping for premium deficiency purposes to be commercial versus personal lines contracts, but this grouping would need to be broken down into products with different risks and pricing under these proposals.

6.3—Effects on note disclosures

IFRS 17 disclosure requirements—in brief

The disclosure requirements in IFRS 17 will provide the following type of information:

- (a) explanation of recognised amounts;
- (b) significant judgements when applying IFRS 17; and
- (c) nature and extent of risks arising from insurance contracts.

Many of the disclosures required by IFRS 17 about significant judgements and the nature and extent of risks arising from insurance contracts are similar to the requirements in IFRS 4. Consequently, a company will continue to provide those disclosures when applying IFRS 17.

The disclosures providing further explanation of recognised amounts are designed to improve the understanding of the amounts recognised in a company's financial statements and make them easier to understand, and to facilitate comparisons. Illustration 4 in Appendix B to this document, on pages 124–127, illustrates one possible way of presenting some of those disclosures.

IFRS 17 also requires some disclosures about effects of decisions made when first applying IFRS 17.

Further information about the disclosures required by IFRS 17 is included in Section 2—*Overview of IFRS 17 requirements*.

The Board considered the effect that IFRS 17 will have on a company's notes to the financial statements. The notes provided about insurance contracts are fundamental to an understanding of:

- (a) the amounts recognised and measured; and
- (b) the risks arising from insurance contracts.

The disclosure requirements in IFRS 17 are designed to facilitate the provision of information that will enable investors and analysts to assess the effects on a company's financial position, performance and cash flows of insurance contracts issued and of reinsurance contracts held by the company.

These disclosures improve on the existing disclosures in IFRS 4 relating to the amounts reported in the financial statements, significant judgements made when applying IFRS 17 and risks arising from insurance contracts.

Accordingly, the Board expects that IFRS 17 will improve the quality of information provided in the notes to the financial statements about insurance contracts.

Extract from a user of financial statements' comment letter to the 2010 Exposure Draft

Given the complex nature of insurance contracts and the greater use of accounting principles in lieu of more prescribed guidance, the importance of comprehensive disclosures in this area becomes ever more evident.

The Board expects that a company will use judgement in determining what information is material (and hence needs to be disclosed) and the level of detail necessary to satisfy the above disclosure objective. Information should be disaggregated if this is necessary to show items that have different characteristics. It should be aggregated if this is necessary to avoid obscuring useful information with a large amount of insignificant detail.

Although companies are required to use judgement in a similar way as they would in applying IFRS 4, the transition to IFRS 17 will provide a company with an opportunity to reassess the level of detail that is necessary to satisfy the disclosure objective.

The Board expects that some companies might conclude that, to meet the disclosure objective in IFRS 17, they need to present some of their disclosures on a more disaggregated level than they currently do. For example, a company may provide information about changes in insurance contract balances by major product lines or by geographical area if this detail is relevant for users of its financial statements.

Transition disclosures

IFRS 17 requires a company to provide some specific disclosures to help users of its financial statements understand the effects of the first application of IFRS 17, including the effects that result from decisions made when first applying IFRS 17 (transition disclosures). These specific disclosures supplement the disclosures required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* that apply on the application of all new IFRS Standards.

This is because of:

- (a) the extent of the transition reliefs provided by IFRS 17 (see Section 5.3—*Key cost reliefs*).
- (b) the consequences that those reliefs might have after the first application of IFRS 17 in the light of the significant length of time that could elapse between:
 - (i) the date of first applying IFRS 17; and
 - (ii) the date on which some of the insurance contracts in place at transition will be removed from an insurance company's balance sheet.
- (c) the significant change in perspective regarding the accounting for insurance contracts that will result for many companies (for example, concerning the need to reflect market changes in the measurement of insurance contracts in a timely way).

In particular, IFRS 17 requires a company to disclose—not only on transition but also in subsequent periods—information about any insurance contract assets and liabilities reported in the financial statements at transition that were determined using either the modified retrospective approach or the fair value transition approach. This requirement is intended to enable users of financial statements to monitor the effects of using those approaches, rather than the full retrospective approach.

6.4—Effects on key financial metrics

The Board also considered the effect that IFRS 17 might have on the key financial metrics of a company issuing insurance contracts.

The Board analysed key financial metrics highlighted by a sample of insurers in their presentations to investors and analysts as part of their results announcements. The analysis reveals that insurance companies—in particular, those issuing long-term insurance contracts—currently report a wide variety of financial metrics. Most of these financial measures are non-GAAP measures. Many companies report an alternative profit measure that is derived from profit or loss reported applying IFRS Standards, but there is little consistency between the measures reported by different companies.

Because IFRS 17 will increase the comparability, relevance and consistency in the financial information presented by insurers, the Board thinks that this is likely to lead to the introduction of new financial performance measures, and to a reduction in the number of non-GAAP measures reported. Nonetheless, as discussed in Section 4.2—*Improved financial information*, the Board also expects that many companies will continue to prepare some existing non-GAAP measures, at least until the new information provided by IFRS 17 becomes familiar to the users of their financial statements. Some companies may also continue to provide non-GAAP measures to suit their individual needs after IFRS 17 is effective.

Insurance revenue

Written or earned premiums are typically used as a key financial metric by insurers issuing short-term insurance contracts. For contracts measured using the simplified approach (see Section 5.3—*Key cost reliefs*), insurance revenue will be similar to the earned premiums currently reported by companies when applying IFRS 4.

IFRS 17 introduces a consistent treatment for the measurement of revenue arising from insurance contracts, which will eliminate the different methods currently used by insurers when applying IFRS 4. Insurance revenue will be reported on an earned basis that excludes deposit components.

As discussed in Section 4.1—*Improved requirements introduced by IFRS 17*, this will constitute a major change for many insurers issuing long-term insurance contracts. Although the Board has observed companies using premium revenue as a key financial metric when applying IFRS 4, premium revenue is typically adjusted, for example, to convert single premiums to an annual premium equivalent (annual premium equivalent is typically determined to equal 100 per cent of regular premiums and 10 per cent of single premiums collected in the period). Consequently, a similar metric might continue to be presented by insurers as a non-GAAP measure when applying IFRS 17.

Contractual service margin

Some new measures introduced by IFRS 17 are expected to be closer to some non-GAAP measures reported by many insurers, such as embedded value information (see Section 4.2—*Improved financial information*).

For example, the Board expects that disclosure about the contractual service margin initially recognised in the period will provide a measure of the value added from new contracts that might, over time, replace ‘new business performance’ measures currently provided by some insurers.

Combined ratio

A key profitability measure typically reported by companies issuing short-term insurance contracts is the combined ratio (ie incurred claims and operating expenses expressed as a percentage of earned premiums). Since companies typically measure incurred claims on a different basis when applying IFRS 4, IFRS 17 is expected to affect this key financial ratio.

The Board expects that the combined ratio will continue to be a key ratio for short-term insurance contracts, but that it will be calculated using the IFRS 17 measurement for incurred claims. Because the combined ratio will be calculated in a more consistent way, the Board expects that it will be more relevant for users of financial statements.

Overview of the expected effects of IFRS 17

The following table sets out the expected effects of IFRS 17 on some of the financial metrics presented by insurers.

The effects of IFRS 17 on key financial metrics are expected to differ from company to company, and will depend on differences between IFRS 17 requirements and the accounting policies for insurance contracts currently applied, as well as on differences in calculating similar non-GAAP measures.

There are no standardised methods for computing the non-GAAP measures included in the table.

| Metric | Common method of calculation | Expected effects of IFRS 17 on metric | Explanation |
|--|--|---------------------------------------|---|
| Volume | | | |
| Earned premiums⁸⁹ (IFRS 4) and insurance revenue (IFRS 17) | As reported in financial statements (measurement methods vary when applying IFRS 4) | Depends | Depends on existing insurance accounting practices applied by a company. Many companies will present insurance revenue for the first time when applying IFRS 17. For companies that currently include within earned premiums any deposit component on long-term insurance contracts, when they apply IFRS 17, insurance revenue is expected to be significantly lower. See Section 6.2— <i>Effects on the statement of comprehensive income</i> |
| Gross premiums (or premiums written) | Premiums expected to be collected over the contracts' duration (ie not only premiums already received) | ↔ No change | This metric could be disclosed in the notes to the financial statements, but is not permitted to be presented on the face of the statement of comprehensive income as a measure of insurance revenue. |
| Premiums due | Invoiced or receivable premiums, which are unconditionally due to the insurer | ↔ No change | The premiums-due metric is similar to the premiums received in a period. When applying IFRS 17, premiums received for insurance contracts issued are required to be disclosed in the notes to the financial statements, but are not permitted to be presented on the face of the statement of comprehensive income as a measure of insurance revenue. |

⁸⁹ When applying IFRS 4, this item is variously described as 'premium income', 'written premiums' or 'earned premiums' in the statements of comprehensive income of insurance companies.

| Metric | Common method of calculation | Expected effects of IFRS 17 on metric | Explanation |
|--|---|---------------------------------------|--|
| Profitability | | | |
| Contractual service margin added from new contracts | Contractual service margin initially recognised in the period | New metric | This will be a new metric provided by all insurers in a consistent manner. IFRS 17 requires its disclosure in the notes to the financial statements. This metric is similar to the value added from new business, a metric provided by some insurers within their embedded value reporting. See Section 4.2— <i>Improved financial information</i> |
| Insurance service result | As reported applying IFRS 17 | New metric | This will be a new metric comprising insurance revenue less insurance service expenses. See Section 6.2— <i>Effects on the statement of comprehensive income</i> |
| Profit or loss | As reported applying IFRS Standards | Depends | Depends on the existing insurance accounting practices applied by a company. See Section 6.2— <i>Effects on the statement of comprehensive income</i> |
| Return On Equity (ROE) | $\frac{\text{Profit or loss}}{\text{Equity}}$ | Depends | Depends on the effects on profit or loss and on equity, which depend on the existing insurance accounting practices applied by a company. For effects on profit or loss, see Section 6.2— <i>Effects on the statement of comprehensive income</i> . For effects on equity, see Section 6.1— <i>Effects on the balance sheet</i> |
| Earnings Per Share (EPS) | $\frac{\text{Profit or loss}}{\text{Number of shares outstanding}}$ | Depends | Depends on the effects on profit or loss, which depend on the existing insurance accounting practices applied by a company. IFRS 17 does not change the denominator. See Section 6.2— <i>Effects on the statement of comprehensive income</i> |
| Net investment return | Investment return less insurance finance expenses | New metric | The investment margin earned in the period will be presented in the statement of comprehensive income and will provide an important new profitability measure. |

| Metric | Common method of calculation | Expected effects of IFRS 17 on metric | Explanation |
|---|--|---------------------------------------|--|
| Operating profit and underlying profit | Various methods—earnings from ordinary activities before income taxes, excluding earnings from investments | Depends | The effects of applying IFRS 17 will depend on the existing insurance accounting practices applied by a company and on the nature of the adjustments made to profit or loss reported applying IFRS Standards to derive these non-GAAP measures. |
| Combined ratio | $\frac{\text{Incurred claims and other expenses}}{\text{Earned premiums}}$ | Depends | Incurred claims will be reported discounted and adjusted for risk. The change in ratio will depend on particular facts and circumstances. |
| Liquidity | | | |
| Net operating cash flow | Various methods—cash flow from operating activities does not include cash related to equity and borrowing | Depends | Insurers are expected to review the cash flow classification in their operating, financing and investing activities in the light of the changes introduced by IFRS 17 in the presentation of information about insurance contracts in the statement of comprehensive income. |

7—Other effects

Changes introduced by IFRS 17 in insurers' financial statements may interact with some aspects of the insurance business, such as the management of financial assets held, the capital requirements of insurers and the type of insurance products offered by insurers.

Section 7.1—*Interaction with IFRS 9* discusses the effect of applying IFRS 17 in conjunction with IFRS 9. Investing activities are important for insurance companies. A company will be required to account for insurance contracts issued applying IFRS 17 and for financial assets held applying IFRS 9. This section also considers whether changes introduced by IFRS 17 might drive changes in a company's asset and liability management.

Section 7.2—*Interaction with regulatory frameworks* discusses the interaction between changes introduced by IFRS 17 and regulatory frameworks. Although accounting and regulatory frameworks have different objectives, in some cases there are similarities between accounting and regulatory requirements.

Section 7.3—*Effects on the insurance market* discusses the effects that changes introduced by IFRS 17 may have on insurance products available in the market. This section highlights that a change in accounting does not affect the underlying economic reality within the business. Changes in insurance product design, price and demand are therefore not expected to occur as a direct result of applying IFRS 17.

7.1—Interaction with IFRS 9

Investing activities are important for insurance companies. For some long-term insurance contracts, the spread between the return on investments and the interest expenses on insurance contract liabilities is typically the primary source of profit or loss. For other insurance contracts, the time gap between the collection of premiums and the payment of claims enables insurance companies to accumulate funds that are invested to generate investment income.

IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement* from 1 January 2018. IFRS 17 is effective from 1 January 2021. Some insurance companies can elect to continue to apply IAS 39 until 1 January 2021.

The Board has considered the effect of applying IFRS 17 in conjunction with IFRS 9. This is because a company is required to account for:

- (a) insurance contracts issued applying IFRS 17; and
- (b) financial assets held applying IFRS 9.

Classification of financial assets

IFRS 9 sets out how a company must classify its financial assets. Classification determines how those assets are accounted for in financial statements and, in particular, how they are measured on an ongoing basis.

As a result of applying IFRS 9, financial assets are measured at either:

- (a) amortised cost; or
- (b) fair value.

When assets are measured at fair value, gains and losses are recognised either entirely in profit or loss (fair value through profit or loss), or partially in other comprehensive income (fair value through other comprehensive income for debt instruments and other comprehensive income presentation for equity instruments).⁹⁰

When applying IAS 39, financial assets are also measured either at amortised cost or at fair value with value changes in profit or loss or other comprehensive income. Nonetheless, IFRS 9 changes the criteria that an asset must meet to be measured in a particular way.

When applying IFRS 9, the classification of financial assets will be driven by their cash flow characteristics and by the business models in which the assets are held. In contrast, the classification in applying IAS 39 is determined on the basis of the combination of the nature of the instrument, its manner of use and management choice.

IAS 39 also allows some complex financial assets to be accounted for in parts—with embedded derivatives separately accounted for—whereas IFRS 9 requires whole financial assets to be classified.

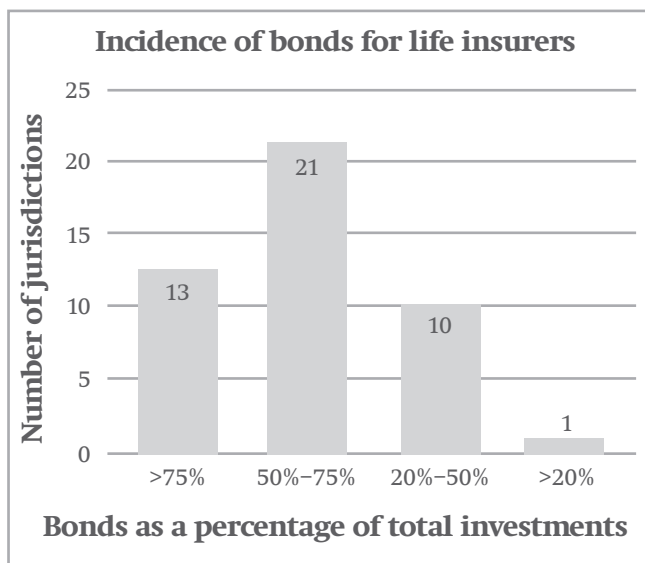
⁹⁰ Equity instruments are normally measured at fair value through profit or loss. However, IFRS 9 permits a company to present in other comprehensive income changes in the fair value of some equity instruments.

Financial assets held by insurers

The type of financial assets held by an insurer typically depends on the characteristics of the liabilities or obligations for which the assets are being held and invested.

For example, financial instruments held by insurers issuing long-term insurance contracts typically comprise bonds, as shown in the following chart for a sample of 45 jurisdictions.⁹¹

Although the amount of bonds as a percentage of the total investments of life insurers varied by jurisdiction, in 2014, insurers in the majority of jurisdictions in the sample allocated more than 50 per cent of their investments to bonds. Life insurance sectors in 13 jurisdictions⁹² allocated over 75 per cent of their investments to bonds. In contrast, in one jurisdiction⁹³ the life insurance sector's allocation to bonds was less than 20 per cent. The majority of insurers in the sample allocated between 50 per cent and 75 per cent of their investments to bonds.⁹⁴



The Board expects that some companies will change the classification of their financial assets when they apply IFRS 9. This depends on the choices made by a company in applying IAS 39 and when IFRS 9 is applied, as well as on its business models for managing the financial assets and on the contractual cash flow characteristics of its financial assets.

IFRS 9 in brief—classification of debt instruments

If a financial asset is a simple debt instrument and the objective of the company's business model within which it is held is to collect its contractual cash flows, the financial asset is measured at amortised cost.

If the simple debt instrument is held in a business model the objective of which is achieved by both collecting contractual cash flows and selling financial assets, then the financial asset is measured at fair value in the balance sheet, and amortised cost information is provided in profit or loss. Gains and losses result from the difference between amortised cost and fair value, and those differences are reported in other comprehensive income.

If the business model is neither of these, or the financial asset is not a simple debt instrument, then fair value information is provided both in profit or loss and in the balance sheet.

⁹¹ *Global Insurance Market Trends 2015*, report issued by the Organisation for Economic Co-operation and Development (OECD).

⁹² Austria, Colombia, France, Hungary, Italy, Mexico, Peru, Portugal, Puerto Rico, Slovak Republic, Spain, Uruguay and Turkey.

⁹³ In South Africa, equity investments represented the majority of investments (64 per cent).

⁹⁴ 21 jurisdictions, including Australia, Japan, South Korea, the United Kingdom and the United States.

IFRS 17 and IFRS 9

| Financial assets measurement | IAS 39 categories | IFRS 9 categories |
|--|--|--|
| Amortised cost | Loans and receivables and held to maturity | Amortised cost |
| Fair value with gains and losses in other comprehensive income | Available for sale | Fair value through other comprehensive income for debt instruments and other comprehensive income presentation for some equity instruments |
| Fair value with gains and losses in profit or loss | Held for trading ⁹⁵ and fair value option | Fair value through profit or loss and fair value option |

IFRS 4 permits:⁹⁶

- (a) companies whose activities are predominantly connected to insurance contracts to temporarily defer the application of IFRS 9 and instead apply IAS 39; and
- (b) all companies issuing insurance contracts to apply the so-called overlay approach when those companies apply IFRS 9.⁹⁷

Accordingly, the Board expects both of the following scenarios to arise when IFRS 17 is first applied:

- (a) companies that initially apply IFRS 9 and IFRS 17 at the same time (ie those companies that continue to apply IAS 39 before initially applying IFRS 17); and
- (b) companies that apply IFRS 9, with or without the overlay approach, before they initially apply IFRS 17.

Applying IFRS 9 and IFRS 17 together for the first time

A company that has decided to defer the application of IFRS 9 until IFRS 17 is effective will be affected, at the same time, by changes introduced by IFRS 9 and by changes introduced by IFRS 17. In that case, the transition provisions in IFRS 9 and in IFRS 17 apply at that time.

As discussed above, the classification of some financial assets may change when IFRS 9 is applied. For insurers, these changes may include the following:

- (a) some bonds that are classified as available for sale in applying IAS 39 might be eligible for measurement at amortised cost or at fair value through other comprehensive income or may be required to be measured at fair value through profit or loss, depending on the company's business model within which they are held;⁹⁸

⁹⁵ Including stand-alone derivatives and embedded derivatives separately accounted for.

⁹⁶ IFRS 4 as amended in September 2016.

⁹⁷ The overlay approach enables a company to reclassify from profit or loss to other comprehensive income any difference between amounts recognised in applying IFRS 9 and amounts that would have been recognised in applying IAS 39 for financial assets: (a) designated as related to insurance contracts; and (b) measured at fair value through profit or loss in applying IFRS 9 that would not be measured at fair value through profit or loss in applying IAS 39.

⁹⁸ For example, some bonds that were classified as available for sale because they were traded in active markets might be eligible for measurement at amortised cost in applying IFRS 9.

- (b) some bonds that are classified as available for sale in applying IAS 39 might be classified as fair value through profit or loss because they might not have the cash flow characteristics to be measured at amortised cost or fair value through other comprehensive income in applying IFRS 9; and
- (c) many equity investments that are classified as available for sale in applying IAS 39 might be classified as fair value through profit or loss because companies might choose not to apply the presentation election in IFRS 9 to present changes in their fair value in other comprehensive income rather than in profit or loss.

IFRS 17 requires insurers to discount their insurance contracts using a current interest rate and the effect of changes in that interest rate can be reported in profit or loss. Thus, the income and expenses reported in profit or loss, as a result of changes in current interest rates, are expected to offset, at least to some extent, the volatility in profit or loss that may arise from financial assets accounted for at fair value through profit or loss.

IFRS 9 also allows a company to elect to measure financial assets at fair value through profit or loss where this addresses an accounting mismatch.

Applying IFRS 9 before IFRS 17

When applying IFRS 4 together with IFRS 9 (ie before IFRS 17 is applied), companies that issue insurance contracts can decide to adopt the overlay approach to remove from profit or loss the additional volatility that might be caused by some changes in the measurement of financial assets.

This temporary measure has been introduced by the Board to enable insurers to address the accounting mismatches and the volatility that might arise when a company applying IFRS 4 also applies IFRS 9.

When applying IFRS 4 and IAS 39, many companies measure insurance contracts on a cost basis, and if financial assets are measured at amortised cost or at fair value through other comprehensive income using the available for sale category, moving these assets to fair value through profit or loss in applying IFRS 9 would introduce new accounting volatility in profit or loss.

A large part of that new accounting volatility would be expected to be minimised again once an insurance company starts applying IFRS 17. As discussed in Section 6.2—*Effects on the statement of comprehensive income*, when applying IFRS 17, the effect of changes in discount rates and other financial variables on the measurement of insurance contract liabilities is expected to be either:

- (a) removed from profit or loss if a company chooses to present the effects of changes in discount rates and other financial variables disaggregated between profit or loss and other comprehensive income; or
- (b) offset, partially or totally, if a company holds financial assets measured at fair value with gains and losses recognised in profit or loss and recognises changes in discount rates and other financial variables in profit or loss.

IFRS 17 transition provisions if IFRS 9 is applied first

The Board acknowledged that the classifications and designations of financial assets made on initial application of IFRS 9 might not be the same as those that a company would have made if it initially applied IFRS 17 and IFRS 9 at the same time. In addition, a company's business model for managing financial assets might be different at the time IFRS 17 is applied.

As discussed in the following paragraphs about asset and liability management,⁹⁹ the introduction of current measurement for the accounting for insurance contracts may lead some companies to change how they manage their assets. This change may in turn change a company's business model for managing financial assets in accordance with IFRS 9.

For example, when applying IFRS 17, an insurer may need to address mismatches between the carrying amounts of assets and liabilities, by measuring some financial assets—eligible for measurement at amortised cost or at fair value through other comprehensive income—at fair value through profit or loss, using the fair value option in IFRS 9.

Consequently, the transition requirements of IFRS 17 address how to deal with those potential changes. IFRS 17 enables, but does not require, insurers to reassess the classifications of their financial assets on the basis of facts and circumstances that exist when first applying IFRS 17.¹⁰⁰

⁹⁹ Asset liability management (ALM) is used to describe a mechanism to address the risk faced by a company due to a mismatch between assets and liabilities due either to liquidity or to changes in interest rates.

¹⁰⁰ The reassessment of the classification of a financial asset when first applying IFRS 17 is not a reclassification of a financial asset in accordance with paragraph 4.4.1 of IFRS 9. Therefore, IFRS 9 requirements for the reclassification of financial assets do not apply in these circumstances.

Asset and liability management

Insurance companies typically seek to match the characteristics of their assets with their liabilities to minimise economic mismatches between the two—ie differences arising if the values of assets and liabilities respond differently to changes in economic conditions (see Section 6.2—*Effects on the statement of comprehensive income*). Economic matching depends on several factors (for example, the availability of assets of sufficient duration, the uncertainty as to when payouts on insurance contracts will be required, and the company's desire to generate higher returns).

Accounting for insurance contracts (and reinsurance contracts) and financial assets that a company holds using consistent measurement approaches is expected to result in a company's financial statements reporting transparent information about the company's asset and liability management practices. For example, if an insurer's liabilities and assets are economically matched the accounting does not show mismatches, whereas if they are not matched the economic mismatch will be apparent.

As a result of changes introduced by IFRS 17 and IFRS 9, some companies may decide to reassess how they carry out their asset and liability management. This is because the measurement of financial assets and insurance contract liabilities may change in applying IFRS 9 and IFRS 17. The Board believes that the combination of IFRS 9 and IFRS 17 will provide clearer information about the effects of a company's asset and liability management.

The extent to which the introduction of current value principles for the measurement of insurance contract liabilities will change existing asset and liability management practice will vary depending on the extent to which:

- (a) a company currently measures its insurance contracts at current value; and
- (b) the accounting effect drives management decisions.

For example, existing insurance accounting practices in Continental Europe, Asia and the United States do not tend to include current value accounting. The discount rate used to measure an insurance contract liability is not updated after the initial recognition of the insurance contract to reflect changes in market conditions. Some insurers operating in these jurisdictions may decide to change their asset and liability management practices in the light of the requirement, introduced by IFRS 17, to measure insurance contract liabilities using current discount rates. On the other hand, new regulatory requirements recently implemented in some of those jurisdictions (for example, Solvency II within the European Union, see Section 7.2—*Interaction with regulatory frameworks*) involve greater use of current measurement for insurance contracts. Consequently, they may also result in changes in asset and liability management practices.

In contrast, in Australia, Canada, China, Denmark, South Africa and the United Kingdom, existing accounting practices tend to measure insurance contract liabilities on a current value basis. Accordingly, the changes introduced by IFRS 17 are not expected to involve significant changes in accounting and investment practices to manage accounting volatility in those jurisdictions.

The three-year implementation period between the issuance of IFRS 17 and its effective date is expected to be adequate for companies to consider the combined effects of applying IFRS 9 and IFRS 17. A timely analysis by companies of the requirements of the two IFRS Standards is expected to allow companies sufficient time to implement changes in asset portfolios, if necessary and desired.

7.2—Interaction with regulatory frameworks

The primary objectives of many regulatory frameworks are to protect consumers, ensure availability of insurance products and support economic stability, rather than to provide useful information to users of general purpose financial statements.

Accounting and regulatory frameworks have different objectives, although in some cases there are similarities. Consequently, IFRS 17 requirements are designed with a different objective to those of regulatory frameworks.

In some jurisdictions, amounts reported by insurers applying IFRS Standards may provide some of the information needed for regulatory purposes. Nonetheless, it is likely that some regulators will decide that they continue to need additional information. Accordingly, changes introduced by IFRS 17 may affect amounts used for regulatory purposes by insurers applying IFRS Standards in those jurisdictions, subject to consequent changes in those regulatory requirements.

In contrast, the Board observed that most jurisdictions have developed their regulatory requirements independently from accounting requirements. Accordingly, IFRS 17 is not expected to directly affect regulatory reporting of insurers applying IFRS Standards in those jurisdictions.

Risk-based Global Insurance Capital Standard

At the time of issuing IFRS 17, the Board is aware that the International Association of Insurance Supervisors¹⁰¹ is developing a Risk-based Global Insurance Capital Standard.¹⁰² Once finalised, this standard may be used as a base for capital adequacy requirements for some insurers, such as internationally active insurance groups.

The valuation basis of not only liabilities but also assets is a major component of the Risk-based Global Insurance Capital Standard. To achieve comparability across jurisdictions of the measures used for calculating the capital requirement as well as the amount of capital resources, the International Association of Insurance Supervisors has been developing two valuation bases.¹⁰³ Both valuation bases begin with financial statements based on applicable accounting requirements but both make significant adjustments to the valuation of insurance contract liabilities to arrive at a current estimate similar to IFRS 17.

Solvency II

The Board also observed that, in some jurisdictions, insurers have made significant efforts to measure risks to comply with prudential requirements. For example, in the European Union, insurers have made significant investments in new systems to comply with Solvency II from January 2016.

Jurisdictions outside the European Union, such as Australia, Brazil, Canada, Japan, Switzerland and the United States, have also adopted similar risk-based prudential requirements.

¹⁰¹ The International Association of Insurance Supervisors is a voluntary membership organisation of insurance supervisors and regulators from more than 200 jurisdictions. As part of its mission to promote effective and globally consistent supervision of the insurance industry, it develops supervisory material (principles, standards and guidance).

¹⁰² According to the work plan as of 19 July 2016, the Risk-based Global Insurance Capital Standard is expected to be adopted by the International Association of Insurance Supervisors by the end of 2019.

¹⁰³ 'Market adjusted valuation' specifies the valuation of liabilities independently from national or international accounting requirements including using current discount rates prescribed by the International Association of Insurance Supervisors. 'GAAP with adjustments' is more closely tied to existing accounting standards and will need to be respecified for jurisdictions that will implement IFRS 17.

About Solvency II

The term ‘Solvency II’ refers to a Regulation adopted by the European Union to harmonise and improve the prudential framework for insurers within the European Union. This substantially concerns the amount of capital that insurance companies with operations within the European Union must hold considering their risk profile. The riskier an insurer’s business, the more capital it is required to hold. Solvency II has three so-called pillars:

- (a) the first pillar sets out quantitative requirements, including the rules for valuing assets and liabilities, calculating capital requirements and identifying the insurer’s available funds to cover those requirements;
- (b) the second pillar sets out requirements for risk management and governance, as well as the details of the supervisory process with competent authorities; and
- (c) the third pillar addresses transparency, reporting to supervisory authorities and disclosure to the public.

Similarities and differences between IFRS 17 and Solvency II

Although Solvency II and IFRS 17 requirements have different objectives, there are some similarities regarding the measurement of insurance contract liabilities, including using:

- (a) estimates of future cash flows;
- (b) discount rates consistent with current rates in the financial markets; and
- (c) adjustments for risk.

As discussed in Section 5.1—*Implementation costs*, some companies that have recently implemented new regulatory requirements demanding information similar to that needed to apply IFRS 17, such as Solvency II, are expected to have recently changed their systems and processes.

Because of the investments made in new systems and processes and the potential for synergies with IFRS 17 in areas such as data collection, modelling systems and reporting lines, the Board expects that companies required to comply with Solvency II requirements or other similar prudential regimes will use systems and processes already in place as the starting point for IFRS 17 implementation.

Nonetheless, those systems and processes are expected to require some additional developments to meet the requirements of IFRS 17.

The following elements of IFRS 17 illustrate the key differences between IFRS 17 and Solvency II:

- (a) the requirement to calculate and maintain a contractual service margin, except when the simplified approach is used;
- (b) the requirement to calculate the insurance revenue measure; and
- (c) the need to analyse movements in fulfilment cash flows between those that will be presented in profit or loss, those that will be presented in other comprehensive income and those that will be offset against the contractual service margin.

Solvency II is not designed as a performance reporting metric. It focuses on capital required. Consequently, any comparison between Solvency II and IFRS 17 is meaningful for balance sheet information only.

The following table presents a summary of similarities and differences between IFRS 17 and Solvency II requirements for the measurement of insurance contracts.

| Topic | IFRS 17 | Solvency II | Comments |
|--|---|--|--|
| Scope | | | |
| Companies affected | Companies using IFRS Standards that issue insurance contracts. | Insurers with operations within the European Union. ¹⁰⁴ | Solvency II applies to regulated companies in specific jurisdictions in Europe. |
| Contracts affected | Insurance contracts (and investment contracts with discretionary participation features, but only for companies that also issue insurance contracts). | All contracts regulated as insurance. ¹⁰⁵ | Contracts within the scope may differ between industry sectors depending on the type of regulated activities. |
| Separating contract components | Separate accounting for non-insurance components (distinct deposit components, some embedded derivatives and some goods and services). | Solvency II requires market-consistent valuation for all assets and liabilities, which reduces the need for separation. However, the recognition and derecognition requirements take into account the fact that contracts may have different components. | When non-insurance components are separated applying IFRS 17 then the contract measurement may be different to that in Solvency II. |
| Definition of contract boundary¹⁰⁶ | A company no longer has substantive rights to receive premiums or obligations to provide services because it can reassess the risks of the policyholder or portfolio in setting the price or level of benefits. | A company has a unilateral right to terminate the contract, to reject premiums payable under the contract or to amend the premiums so that they fully reflect the risks of the contract (or, if applicable, of the portfolio). | The contract boundary might be different for some insurance contracts. |
| Contract measurement | | | |
| Acquisition costs | Included in the measurement of insurance contracts. | Only future cash flows are taken into account in the calculation of insurance obligations. | When applying IFRS 17, there is an implicit deferral of acquisition costs. There is no concept of deferred acquisition costs in Solvency II as the insurance obligations only take into account future expense cash flows. |
| Recognition point | Whichever is earlier—the date coverage begins, or the date the first premium is due, except for onerous groups of contracts. ¹⁰⁷ | Whichever is earlier—the date that the insurer becomes party to the contract, or the date the coverage begins. | For many contracts the recognition point will be the same. |

¹⁰⁴ Refer to Directive 2009/138/EC of the European Parliament and of the Council for details about the scope of Solvency II.

¹⁰⁵ All activities pursued by entities within the scope of Directive 2009/138/EC of the European Parliament and of the Council.

¹⁰⁶ The point after which cash flows are not included in the measurement of insurance contracts.

¹⁰⁷ IFRS 17 requires a company to recognise a group of onerous contracts earlier when the group of contracts becomes onerous.

| Topic | IFRS 17 | Solvency II | Comments |
|--|---|--|--|
| Grouping of contracts | Insurance contracts are measured by dividing portfolios of insurance contracts into groups of contracts that are issued no more than one year apart. Grouping is based on contracts' profitability. | If grouped data are used for the calculation, the grouping of contracts needs to create homogeneous risk groups that appropriately reflect the risks of the individual contracts. | The level of aggregation might be different. |
| Cash flows (excluding acquisition cash flows) | Cash flows incurred to fulfil a group of contracts (gross of reinsurance). | The cash flow projection used in the calculation of best estimate liabilities takes account of all the cash inflows and cash outflows required to settle the insurance and reinsurance obligations over the lifetime thereof (gross of reinsurance). | Different cash flows might be included. For example, there might be differences in some overhead expenses (included in Solvency II cash flows, but not in IFRS 17 cash flows). |
| Discount rates | Either a top-down or a bottom-up approach. ¹⁰⁸ | Derived on the basis of swap rates (or, if those are not available, government bond rates), adjusted to take account of credit risk. | The top-down approach in IFRS 17 is similar to Solvency II. Two sets of discount rates (current and at initial recognition) are required for IFRS 17 presentation in profit or loss if a company chooses to present the effect of some changes in discount rates in other comprehensive income. |
| Risk adjustment | A company's own view of risk and diversification benefits. | Cost of capital approach linked to the Solvency Capital Requirement, calculated at the level of the entire portfolio and broken down into lines of businesses (prescribed approach using 6 per cent cost of capital). | Solvency II requirements are more prescriptive, and differences may arise in comparison with IFRS 17 (for example, in the technique applied and the calibration adopted). When applying IFRS 17, a company may elect to align the risk adjustment with that required under Solvency II (referred to as Risk Margin). |

¹⁰⁸ IFRS 17 requires an insurer to use a discount rate that reflects the characteristics of the cash flows arising from a group of insurance contracts. In a bottom-up approach, the insurer captures the characteristics of the cash flows by starting from a risk-free discount rate and adding to that rate an adjustment to reflect the extent of illiquidity present in the group of insurance contracts. In a top-down approach, the insurer reflects the characteristics of the cash flows by starting with the expected current market return on assets and deducting from that expected current market return the premium that market participants require for bearing the risks, including credit risk, that are associated with those asset returns but are not present in the liability (or are excluded from the measurement of the liability). In a top-down approach, the insurer does not need to adjust the expected current market return for differences in liquidity characteristics of the insurance contracts and the assets.

| Topic | IFRS 17 | Solvency II | Comments |
|--|--|---|---|
| Profit or loss recognition | The contractual service margin eliminates day-one gains and defers the recognition of profit over the coverage period. The contractual service margin is adjusted for some changes to assumptions. Losses on onerous groups of contracts are recognised immediately in profit or loss when they are expected. | Solvency II does not specify requirements on profit or loss recognition. | Solvency II is not designed as a performance-reporting metric. The contractual service margin is a key driver in the timing of profit recognition when applying IFRS 17. |
| Short-term insurance contracts | Optional simplified approach for measuring the liability for remaining coverage (pre-claims liability). See Section 5.3— <i>Key cost reliefs</i> . | Different approaches for life and non-life insurance contracts. | The use of the simplified approach in IFRS 17 is optional. The measurement of short-term insurance contracts might be different. |
| Insurance contracts with participation features | Cash flows from contracts with participation features are included in the measurement of insurance contract liabilities. IFRS 17 includes specific requirements for insurance contracts with direct participation features. | Expected cash flows used to calculate best estimate liabilities include future discretionary benefits. | No significant differences are expected for the cash flows. The treatment of insurance contracts with participation features is expected to be similar, with the exception of profit recognition, as Solvency II is not designed as a performance-reporting metric. |
| Reinsurance contracts held—presentation and measurement | Insurance contract liabilities are presented gross of reinsurance and a separate reinsurance asset is recognised. | Insurance contract liabilities are presented gross of reinsurance and a separate reinsurance asset is recognised. | Reinsurance recoveries are recognised, measured and presented separately in both Solvency II and IFRS 17. |
| Others | | | |
| Derecognition | Occurs when obligations are extinguished, or upon some contract modifications. | Occurs when obligations are extinguished, discharged or cancelled or when they have expired. | No significant differences are expected. |

7.3—Effects on the insurance market

Some stakeholders questioned whether IFRS 17 might give rise to changes to the design and price of insurance products that would affect the insurance products available to policyholders.

For example, because IFRS 17 provides more transparent information about the profitability of insurance contracts, some could argue that an insurer might decide to change either:

- (a) the range of products available to its policyholders; or
- (b) the price of those products.

In addition, because IFRS 17 requirements are arguably more complicated for contracts with complex features, some might expect an insurer to stop issuing insurance contracts with such features and only issue insurance contracts that can be accounted for more easily.

IFRS 17 is not expected to affect insurance products as long as, in applying IFRS 4, insurers price and design contracts based on an accurate assessment of their underlying economics.

Changes in the accounting for insurance contracts introduced by IFRS 17 are intended to have insurers report in a timely way the effects of economic events. However, a change in accounting requirements does not affect the underlying economic reality within the business. Changes in insurance product design, price or demand should therefore not occur as a direct result of applying IFRS 17.

Changes in the products available on the insurance market typically occur because of either:

- (a) changes in the economic environment; or
- (b) regulatory changes.

For example, in some jurisdictions, a prolonged low-interest-rate environment has affected the availability of insurance products with high guaranteed interest rates.

The 2016 implementation of Solvency II requirements within the European Union and the recent introduction of similar frameworks in other jurisdictions, was also expected to affect the design and price of some insurance products.

Many stakeholders have already noted this effect in jurisdictions that adopted similar frameworks in earlier periods, for example, in Australia.

Europe—extract from 2015 European Insurance and Occupational Pensions Authority's report¹⁰⁹

The majority of insurers currently move away from traditional fixed guaranteed interest rate contracts. [...] Indeed, new business product strategies often see decreasing guarantee levels or even the complete stop of commercialising certain guaranteed products.

Asia—extract from Moody's report¹¹⁰

South Korean life insurers [and] Taiwanese insurers sold products with high guaranteed rates (over 6%) until the early 2000s. [...] South Korean life insurers have shifted their product mix from fixed rate guaranteed products into floating rate and protection products, which are subject to less interest rate risk.

¹⁰⁹ 'EIOPA Financial Stability Report', December 2015. The European Insurance and Occupational Pensions Authority (EIOPA) is a European Union financial regulatory institution.
¹¹⁰ *Global Insurance Themes: 'Low Interest Rates Are Credit Negative for Insurers Globally, but Risks Vary by Country'*, Moody's Investors Service, 26 March 2015.

Solvency II—extract from European Commission impact assessment¹¹¹

A revision of product design in some insurance segments is a likely outcome of Solvency II, implying a change in the range and/or prices of products offered. In this process, insurers might review profit sharing arrangements and the need for options and long-term guarantees. [...] Solvency II would mean a shift to more 'risk-based' pricing. While insurers might try to limit the impact on prices by redesigning products, price increases (potentially significant) could be unavoidable, especially for 'low-frequency, high-severity' risks. In extreme cases (especially for non-life insurance), some products might disappear from the market because consumers would be unwilling to pay the required price. The opposite could be the case for products covering 'high-frequency, low-severity' risk, where the reduced capital requirement and competitive pressure could lead to lower prices. More accurate product pricing could also give the industry less incentives for cross-subsidisation between market segments and could encourage greater product differentiation and market segmentation. It is, however, difficult to predict the overall effect of Solvency II on product prices.

Product design

Some companies might be able to make better strategic decisions about whether or how to continue offering specific product lines after IFRS 17 is effective. This is because IFRS 17 requires a company to:

- (a) measure at current value complex features, such as interest rate guarantees embedded in some insurance contracts;
- (b) calculate risk and contractual service margins (expected profits); and
- (c) improve the sophistication of its techniques to measure insurance contracts.

As discussed in Section 6.2—*Effects on the statement of comprehensive income*, IFRS 17 is expected to reveal economic mismatches making the performance of insurance products more transparent.

The additional information that will become available to management from applying IFRS 17 is expected to provide more insight into the profitability of insurance contracts issued and the extent to which assets and liabilities are economically matched. IFRS 17 also requires collaboration, understanding and consistency across the actuarial, risk and finance functions.

This is expected to support efforts by insurance companies to gain a better understanding of the risks and uncertainties associated with individual product lines or groups of contracts.

The greater sophistication that will be required of the tools used to measure insurance contracts in applying IFRS 17 is expected to enable companies to improve efficiency in using information that may be relevant for both risk management and financial reporting purposes. The availability of more sophisticated tools may also give management greater insight into the profitability and risk profile of some insurance contracts issued.

Consequently, the Board expects that some companies will re-examine their insurance activity as a result of applying IFRS 17. This may result in changes to the features of products offered. Nonetheless, these changes (if there are any) are expected to be the result of informed business decisions, rather than motivated solely by accounting outcomes.

Long-term products

Some stakeholders consulted by the Board during the development of IFRS 17 were concerned that IFRS 17 would result in fewer long-term insurance contracts being offered. Those stakeholders thought that the IFRS 17 requirements to reflect economic changes in the measurement of insurance contracts in a timely way would result in volatility that they saw as artificial in insurers' performance.

However, as discussed in Section 6.2—*Effects on the statement of comprehensive income*, the Board does not expect that IFRS 17 will result in increased accounting mismatches. Any volatility reflected in profit or loss should represent economic mismatches between assets and liabilities.

¹¹¹ *Impact Assessment: 'Possible macroeconomic and financial effects of Solvency II'*, Contribution of Directorate General for Economic and Financial Affairs (DG ECFIN), March 2007.

Product price

The Board has not identified any reasons for a company to systematically change the price of the insurance products it issues after IFRS 17 is effective. Nonetheless, if, because of an inaccurate or incomplete estimation of their value, an insurance company has historically not fully or explicitly charged for some product features, such as financial options and guarantees on long-term insurance products, the additional information resulting from the application of IFRS 17 may lead the company to more accurately price these features. As a result, it is possible that some insurance products may be discontinued, redesigned or priced differently after IFRS 17 is effective. Changes in product prices might in turn result in changes in product demand from customers because some customers might not be willing to pay the revised prices.

Product demand

The Board expects that customers will continue to demand insurance products that suit their needs.

As discussed in Section 4.3—*Comparability of financial information*, the Board expects that the accounting for insurance contracts with a deposit component will be more comparable with investment alternatives such as those offered by asset management companies. Insurance companies are expected to continue to match their customers' demand with product design after IFRS 17 is effective.

Like IFRS 4, IFRS 17 focuses on identifying and measuring risk. Consequently, it is possible that insurance companies might review their demand for reinsurance products, or hedging instruments, as part of their overall management of risk. The Board expects that insurance companies will continue to seek ways to mitigate their risks and potentially focus on reducing volatility in financial reporting, so it is possible that the demand for reinsurance products might change after IFRS 17 is effective.

IFRS 17 will provide more transparent information about the profitability and complexity of insurance products. Although the improved transparency may indirectly affect the design and price of some insurance contracts, such transparency will provide better information to policyholders, insurers, investors and analysts, and will be beneficial for capital markets.

Appendix A—Overview of insurance products

Overview of insurance products

IFRS 17 includes a definition of insurance contracts and guidance setting out how to apply the definition. Not all insurance products illustrated in this appendix meet the definition of an insurance contract given in IFRS 17.

How insurance works

A company providing insurance is known as an insurer or insurance company. A person or company buying insurance is known as a policyholder.

The insurer issues a contract, often called the insurance policy, which details the conditions and circumstances under which the policyholder will be compensated (ie which risks are covered by the policy and which are not).

The amount of money charged by the insurer to the policyholder for the coverage provided by the insurance policy is called the premium.

If the policyholder experiences a loss which is potentially covered by the insurance policy (a covered loss), the policyholder submits a claim to the insurer for processing.

Any risk that can be quantified can potentially be insured. The insurance transaction involves the policyholder assuming a guaranteed and known relatively small loss in the form of payment to the insurer in exchange for the insurer's promise to compensate the policyholder in the event of a covered loss. The loss may or may not be financial, but it must be possible to express it in financial terms, and it must involve something in which the policyholder has an insurable interest established by ownership, possession, or a pre-existing relationship.

Although different insurance products have different characteristics, for all types of insurance products the policyholder pays a premium (a known amount) in exchange for an insurer assuming the financial consequences of uncertain future events. The contracts are priced and are often paid for at the start of the coverage period, with the insurance coverage being delivered in the future. Consequently, the ultimate profits of the insurer are not known until the risks are diminished, settled or eliminated.

Types of insurance products

Although products vary by jurisdiction, the risks covered by insurance contracts largely determine their classification. Three broad categories of risks can be identified:

- (a) life- and health-related risks;
- (b) non-life-related risks; and
- (c) credit risks.

Life and health insurance is typically purchased by people to protect them and their dependants against financial difficulties when the policyholder dies or becomes ill. Many life and health insurance products also allow policyholders to accumulate savings. Life and health insurance can cover risks over many decades. Consequently, this type of insurance is also called 'long-term insurance'.

Non-life insurance is typically defined as any insurance that is not life or health insurance. It is also called general insurance or property and casualty insurance. It can cover both people and property, including homeowners and automobiles. The premium does not usually include a deposit component, and the coverage period usually covers a shorter period, such as one year. Consequently, this type of insurance is also called ‘short-term insurance’.

Credit insurance typically refers to guarantees issued by insurance companies or banks to provide credit protection if a debtor fails to make payments when due.

Life and health insurance

Life and health insurance products have various functions—for example:

- (a) to provide financial support:
 - (i) for the policyholder’s family after his or her death;
 - (ii) if the policyholder suffers a serious illness or becomes incapacitated; and
 - (iii) during the policyholder’s life combined with a death benefit.
- (b) to provide security for loans and life insurance in connection with other commercial transactions.
- (c) to be part of a pension scheme for the policyholder.

Accordingly, life insurance products may adopt a variety of forms. A broad classification of life insurance products includes the following three main categories:

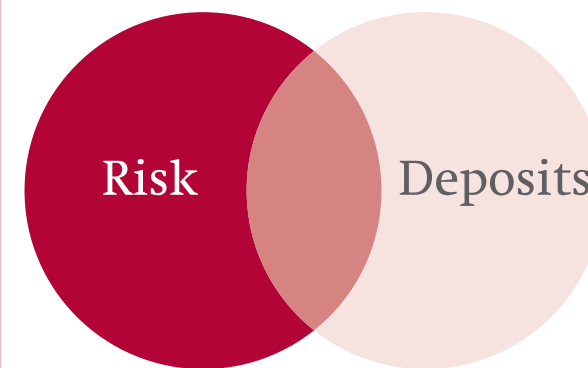
1—Pure risk policies provide financial protection for the policyholder in case of death, serious illness, disability or old age, in the form of payment of either:

- (a) a single amount of money; or
- (b) several instalments—often called annuities (ie a fixed or variable sum of money is paid to someone each year, typically for the rest of their life).

2—Pure deposit policies are issued as investment products to enable policyholders to participate in the performance of designated assets usually held by the insurer. These policies are also called ‘investment contracts’.

3—Mixed policies contain both a risk and a deposit element and mature either on the death of a person or on his or her survival to a certain date.

Components of insurance products



Because risk and deposit components are often mixed in various contractual forms of products, there are different national legal definitions of life insurance. This raises difficulties in finding a globally accepted classification of life insurance products.

Defining the different forms of a life insurance product is difficult. This is because there are many elements that characterise an insurance product, such as:

- (a) the determination of the duration of the contract (for example, term¹¹² or whole life¹¹³);
- (b) the payment of premiums either in a single amount of money or in instalments;
- (c) whether the amount of premiums is constant or flexible throughout the duration of the policy;
- (d) the definition of the insured event;
- (e) the risk distribution with regard to the investment portion of the premium;
- (f) the time when payment becomes due—ie at the occurrence of the insured event or at a later date; and
- (g) the mode of payment of the insurance money (for example, in a single amount or in instalments).

In addition, the various elements of life insurance are treated in different ways in different jurisdictions.

Pension products

Pension products differ from other life insurance products because they have an explicit retirement objective and provide an income generally after retirement. Thus, pensions are a specific type of ‘life savings insurance contract’ with a maturity at retirement age and the ability to be converted (either automatically or through a new contract with the same or another provider) into an annuity; some can also be paid out as a single amount in whole or in part.

Products with participation features

Insurance policies can be purchased by policyholders on a participating or non-participating basis.

Insurance contracts provide payments to policyholders on the occurrence of an insured event. Sometimes these payments do not vary with the return on underlying items. However, many insurance contracts also provide payments to policyholders that vary with the return on underlying items. Features in contracts that result in such payments are typically described as participation features.

Contracts with participation features provide policyholders, in addition to insurance protection, the opportunity to share the risks and benefits of the underlying items. Consequently, they may give exposure to investment returns, mortality, or expenses and other sources of earnings arising from a pool of underlying items to which the contracts are linked or belong. In addition to a guaranteed amount, these benefits typically include a return on the pooled underlying assets managed over the long term, paid annually and on claim (death, survival or policy cancellation) or on maturity of the contracts. The assets underlying contracts with participation features are typically held and managed by the insurers to provide a return to the policyholders.

A common characteristic of contracts with participation features is the presence of options or guarantees embedded in insurance contracts. Such options and guarantees specify the payments that the company will not be able to avoid making to policyholders in particular circumstances.

112 Term insurance policies provide life insurance coverage for a specified period, sometimes greater than one year. Term policies provide no further benefits when the term expires, and no build-up of cash value occurs. If this insurance is not renewed at the end of its term, coverage lapses (ie expires) and no payment would be made to the beneficiary in the event of death.

113 Whole-life (or permanent) insurance provides protection for as long as the policyholder lives. Permanent life policies also have a deposit component, building cash value that can be accessed by the policyholder in specified circumstances.

Examples of guarantees

Guaranteed death benefit—the insurer makes a payment on the death of the policyholder. The death benefit does not depend on the amount the policyholder has invested.

Guaranteed minimum accumulation benefit—the insurer makes a payment on early termination or maturity. The insurer guarantees a payout of a minimum amount at a point in time.

Guaranteed annuity option—the policyholder invests premiums which accumulate over time. The accumulated funds are then converted to an annuity at a rate at least as favourable as a rate agreed at inception. The insurer then makes annuity payments until the policyholder dies.

Contracts with participation features include many different types of insurance products. Examples of broad categories of contracts with participation features include: unit-linked contracts sold in many European countries, with-profits-style contracts written in Europe and Asia, and universal life contracts that are offered globally. The features within these categories can vary significantly within and between jurisdictions.

Non-life insurance

Unlike life insurance, non-life insurance contracts are usually annual contracts, although some are multi-year contracts. The annual contracts may renew automatically at the end of each year until cancelled by one of the parties. Non-life insurance policies provide payments that depend on the loss from a particular event. Examples of common non-life insurance products in the market are set out in the following paragraphs.

Vehicle insurance protects the policyholder against financial loss in the event of an incident, such as a collision, involving his or her vehicle. Coverage typically includes:

- (a) property coverage—for damage to or theft of the vehicle;
- (b) liability coverage—for the legal responsibility to others for bodily injury or property damage; and
- (c) medical coverage—for the cost of treating injuries and rehabilitation, and sometimes for lost wages.

Health insurance policies cover the cost of medical treatments.

Dental insurance policies cover the cost of dental treatments.

Property insurance provides compensation for the risk of loss to property from events, such as fire, theft or weather damage. This may include specialised forms of insurance such as fire insurance, flood insurance, earthquake insurance, inland marine insurance and boiler insurance.

Liability insurance covers claims against the policyholder (for example, cover for doctors against malpractice claims made by their patients). The protection offered by a liability insurance policy is typically twofold, consisting of:

- (a) a legal defence in the event of a lawsuit against the policyholder; and
- (b) indemnification (payment on behalf of the policyholder) with respect to a settlement or court verdict.

Income protection insurance pays benefits to policyholders who are incapacitated, and therefore unable to work due to illness or accident.

Credit insurance

Credit insurance may have various legal forms, such as mortgage guarantees, letters of credit and credit default contracts.

Mortgage guarantees protect lenders in the event that a customer is not able to meet the repayments of a property loan.

Letters of credit provide collateral for securities and commodities borrowed. Also, they are commonly used in international trade to provide coverage for a company against non-payment for merchandise that has been shipped.

Credit default contracts allow for the transfer of credit risk (ie risk of non-payment) without the transfer of an underlying asset. The most widely used type of credit default insurance is a credit default swap when the terms of the contract specify that the counterparty holds the debt.

Reinsurance

Reinsurance is insurance that is purchased by an insurance company (the ceding company) from another insurance company (the reinsurer), typically as a means of risk transfer. The ceding company and the reinsurer enter into a reinsurance contract which details the conditions upon which the reinsurer would pay a share of the claims incurred by the ceding company. The reinsurer is paid a 'reinsurance premium' by the ceding company, which issues insurance policies to its own policyholders.

Examples of reinsurance products include the following:

Proportional reinsurance, or pro-rata reinsurance, is a type of contract in which the reinsurer shares a stated proportion of the premium and losses of the ceding company.

Excess of loss reinsurance, or non-proportional reinsurance, is a type of contract in which the reinsurer indemnifies the ceding company for losses that exceed a specified limit.

Appendix B—Illustrations

Illustrations

Illustrations 1–3 in this appendix show the effects of IFRS 17 by comparing the information resulting from the accounting for some groups of insurance contracts when common existing insurance accounting practices are applied with the information that is expected to result when applying IFRS 17.

Various assumptions have been made when preparing the effects of applying IFRS 17. In particular, because of the wide variety of practices used in applying IFRS 4 to account for insurance contracts, the illustrations showing existing insurance accounting practices might not be representative of any specific practice of a company or jurisdiction.

While the effects discussed in Illustrations 1–3 show an effect of one application of IFRS 4, there could be different effects if IFRS 4 had been applied in a different way.

Illustrations 1–3 assume the contracts are initially recognised at inception.

Key assumptions are reported on a ‘background information’ table for each illustration.

Illustration 4 provides examples of how some of the disclosures required when applying IFRS 17 might be presented.

In the illustrations in this appendix, amounts are denominated in ‘currency units’.

Illustration 1—General model | base case

This illustration shows the effects of IFRS 17 on the balance sheet and the statement of comprehensive income for a group of contracts issued on the same date that provide insurance coverage over a four-year period. No changes in estimates and assumptions occur after contract inception.

Illustration 1—background information

- The contracts are life insurance contracts. All contracts are expected to remain in force over the entire coverage period, unless a claim occurs.
- Claims are payable only on the death of the policyholder.
- The premiums collected are invested in financial assets generating a return of 5 per cent a year. Financial assets are measured at fair value with gains and losses recognised in profit or loss.
- All investment income and insurance finance expenses are recognised in profit or loss (and not in other comprehensive income).
- For the purposes of this illustration, when applying IFRS 17:
 - (a) the risk adjustment is calculated as 2 per cent of the undiscounted future cash outflows.
 - (b) the discount rate at the inception of the contracts is 4 per cent a year. The discount rate remains unchanged over the coverage period.
- For the purposes of this illustration, when applying IFRS 4:
 - (a) premiums are accounted for as revenue when received;
 - (b) claims and expenses are accounted for as an expense when incurred;
 - (c) insurance contracts are measured using current estimates;
 - (d) an implicit allowance for risk (risk margin) is made by increasing the claim estimate by 8 per cent of the discounted future cash outflows; and
 - (e) the discount rate applied to the future cash flows is 4.5 per cent, and it is based on the expected return on the financial assets less a margin.
- The expected cash flows are summarised in the following table.

| Expected cash flows | | | | |
|---------------------------------------|---------------|---------------|---------------|---------------|
| | Year 1 | Year 2 | Year 3 | Year 4 |
| Opening balance of cash | – | 23,750 | 40,190 | 48,855 |
| <i>Insurance contract cash flows:</i> | | | | |
| Premiums | 100,000 | 99,000 | 97,900 | 96,700 |
| Claims | (75,000) | (82,500) | (90,000) | (97,500) |
| Commission expense | (5,000) | (4,950) | (4,895) | (4,835) |
| Other expenses | (1,000) | (1,000) | (1,000) | (1,000) |
| <i>Financial asset cash flows:</i> | | | | |
| Investment income | 4,750 | 5,890 | 6,660 | 7,036 |
| Closing balance of cash | 23,750 | 40,190 | 48,855 | 49,256 |

Illustration 1 assumes that all premiums and commission cash flows occur at the beginning of the year. All other claims and expense cash flows occur at the end of the year.

| IFRS 4 | | | | | | IFRS 17 | | | | | |
|---|------------------|---------------|---------------|---------------|---------------|---------------------------------------|------------------|---------------|---------------|---------------|---------------|
| Balance sheet—Illustration 1 | | | | | | | | | | | |
| | Inception | Year 1 | Year 2 | Year 3 | Year 4 | | Inception | Year 1 | Year 2 | Year 3 | Year 4 |
| Financial assets | - | 23,750 | 40,190 | 48,855 | 49,256 | Financial assets | - | 23,750 | 40,190 | 48,855 | 49,256 |
| Insurance contracts | 12,737 | (3,466) | (11,310) | (10,320) | - | Insurance contract liabilities | - | (12,868) | (17,442) | (13,298) | - |
| | | | | | | - Present value of cash flows | 37,714 | 16,423 | 2,768 | (2,847) | - |
| | | | | | | - Risk adjustment | (7,374) | (5,754) | (3,985) | (2,067) | - |
| | | | | | | - Contractual service margin | (30,340) | (23,537) | (16,225) | (8,384) | - |
| Equity | 12,737 | 20,284 | 28,880 | 38,535 | 49,256 | Equity | - | 10,882 | 22,748 | 35,557 | 49,256 |
| Statement of comprehensive income—Illustration 1 | | | | | | | | | | | |
| | Year 1 | Year 2 | Year 3 | Year 4 | Total | | Year 1 | Year 2 | Year 3 | Year 4 | Total |
| Premiums | 100,000 | 99,000 | 97,900 | 96,700 | 393,600 | Insurance revenue | 90,547 | 98,579 | 106,606 | 114,628 | 410,360 |
| Investment income | 4,750 | 5,890 | 6,660 | 7,036 | 24,336 | Incurred claims and other expenses | (76,000) | (83,500) | (91,000) | (98,500) | (349,000) |
| Incurred claims | (75,000) | (82,500) | (90,000) | (97,500) | (345,000) | Acquisition expenses | (4,910) | (5,056) | (5,199) | (5,341) | (20,506) |
| Change in insurance contract liabilities | (3,466) | (7,844) | 990 | 10,320 | - | Insurance service result | 9,637 | 10,023 | 10,407 | 10,787 | 40,854 |
| Acquisition costs | (5,000) | (4,950) | (4,895) | (4,835) | (19,680) | Investment income | 4,750 | 5,890 | 6,660 | 7,036 | 24,336 |
| Other expenses | (1,000) | (1,000) | (1,000) | (1,000) | (4,000) | Insurance finance expenses | (3,505) | (4,047) | (4,258) | (4,124) | (15,934) |
| Profit or loss | 20,284 | 8,596 | 9,655 | 10,721 | 49,256 | Net financial result | 1,245 | 1,843 | 2,402 | 2,912 | 8,402 |
| Other comprehensive income | - | - | - | - | - | Profit or loss | 10,882 | 11,866 | 12,809 | 13,699 | 49,256 |
| Comprehensive income | 20,284 | 8,596 | 9,655 | 10,721 | 49,256 | Other comprehensive income | - | - | - | - | - |
| | | | | | | Comprehensive income | 10,882 | 11,866 | 12,809 | 13,699 | 49,256 |

Effects on the balance sheet

As explained in Section 2—*Overview of IFRS 17 requirements*, in applying IFRS 17, no gain is recognised at inception for a group of insurance contracts. In contrast, in this illustration, a gain is recognised at inception when applying IFRS 4. When applying IFRS 17, the insurance contract liability is calculated as the sum of (a) the present value of probability-weighted future cash flows; (b) the explicit risk adjustment for insurance risk; and (c) the unearned profit (contractual service margin). [IFRS 17 requires a breakdown of the insurance contract liability to be presented not on the face of the balance sheet, but rather in notes to the financial statements; the amounts shown here are for illustrative purposes.]

Effects on the statement of comprehensive income

The total comprehensive income recognised over the years is unchanged, but, when applying IFRS 17, the effect of the timing of cash flows changes the amounts recognised in each year and their presentation. As explained in Section 6.2—*Effects on the statement of comprehensive income*, when applying IFRS 17, (a) premiums collected are not accounted for as revenue, and (b) the effect of discounting is presented in a way that highlights the relationship between the finance expenses on the insurance contracts and the investment return on the related financial assets that the company holds.

Illustration 2—General model | change in claims

This illustration shows the effects of IFRS 17 on the balance sheet and the statement of comprehensive income for a group of contracts issued on the same date that provide insurance coverage over a four-year period. The expected cash flows are the same as in Illustration 1, except that the amount of claims expected to be paid to the policyholders in Year 3 and in Year 4 changes at the end of Year 2.

Illustration 2—background information

- The contracts are life insurance contracts. All contracts are expected to remain in force over the entire coverage period, unless a claim occurs.
- Claims are payable only on the death of the policyholder.
- The premiums collected are invested in financial assets generating a return of 5 per cent a year. Financial assets are measured at fair value with gains and losses recognised in profit or loss.
- All investment income and insurance finance expenses are recognised in profit or loss (and not in other comprehensive income).
- For the purposes of this illustration, when applying IFRS 17:
 - (a) the risk adjustment is calculated as 2 per cent of the undiscounted future cash outflows.
 - (b) the discount rate at the inception of the contracts is 4 per cent a year. The discount rate remains unchanged over the coverage period.
- For the purposes of this illustration, when applying IFRS 4:
 - (a) premiums are accounted for as revenue when received;
 - (b) claims and expenses are accounted for as an expense when incurred;
 - (c) insurance contracts are measured using current estimates;
 - (d) an implicit allowance for risk (risk margin) is made by increasing the claim estimate by 8 per cent of the discounted future cash outflows; and
 - (e) the discount rate applied to the future cash flows is 4.5 per cent, and it is based on the expected return on the financial assets less a margin.
- The expected cash flows are the same as in Illustration 1 except that at the end of Year 2 an additional claim of CU7,500 is expected to be paid at the end of Year 3 and a further additional claim of CU7,500 is expected to be paid at the end of Year 4. The revised expected cash flows are summarised in the following table.

Revised expected cash flows

| | Year 1 | Year 2 | Year 3 | Year 4 |
|---------------------------------------|---------------|---------------|---------------|---------------|
| Opening balance of cash | - | 23,750 | 40,190 | 41,355 |
| <i>Insurance contract cash flows:</i> | | | | |
| Premiums | 100,000 | 99,000 | 97,900 | 96,600 |
| Claims | (75,000) | (82,500) | (97,500) | (105,000) |
| Commission expense | (5,000) | (4,950) | (4,895) | (4,830) |
| Other expenses | (1,000) | (1,000) | (1,000) | (1,000) |
| <i>Financial asset cash flows:</i> | | | | |
| Investment income | 4,750 | 5,890 | 6,660 | 6,656 |
| Closing balance of cash | 23,750 | 40,190 | 41,355 | 33,781 |

Illustration 2 assumes that all premiums and commission cash flows occur at the beginning of the year. All other claims and expense cash flows occur at the end of the year.

| IFRS 4 | | | | | | IFRS 17 | | | | | |
|---|------------------|----------------|---------------|---------------|---------------|---------------------------------------|------------------|---------------|---------------|---------------|---------------|
| Balance sheet—Illustration 2 | | | | | | | | | | | |
| | Inception | Year 1 | Year 2 | Year 3 | Year 4 | | Inception | Year 1 | Year 2 | Year 3 | Year 4 |
| Financial assets | - | 23,750 | 40,190 | 41,355 | 33,781 | Financial assets | - | 23,750 | 40,190 | 41,355 | 33,781 |
| Insurance contracts | 12,737 | (3,466) | (26,570) | (18,167) | - | Insurance contract liabilities | - | (12,868) | (22,344) | (15,774) | - |
| | | | | | | - Present value of cash flows | 37,714 | 16,423 | (11,469) | (10,153) | - |
| | | | | | | - Risk adjustment | (7,374) | (5,754) | (4,285) | (2,217) | - |
| | | | | | | - Contractual service margin | (30,340) | (23,537) | (6,590) | (3,404) | - |
| Equity | 12,737 | 20,284 | 13,620 | 23,188 | 33,781 | Equity | - | 10,882 | 17,846 | 25,581 | 33,781 |
| Statement of comprehensive income—Illustration 2 | | | | | | | | | | | |
| | Year 1 | Year 2 | Year 3 | Year 4 | Total | | Year 1 | Year 2 | Year 3 | Year 4 | Total |
| Premiums | 100,000 | 99,000 | 97,900 | 96,600 | 393,500 | Insurance revenue | 90,547 | 93,677 | 109,219 | 117,094 | 410,537 |
| Investment income | 4,750 | 5,890 | 6,660 | 6,656 | 23,956 | Incurred claims and other expenses | (76,000) | (83,500) | (98,500) | (106,000) | (364,000) |
| Incurred claims | (75,000) | (82,500) | (97,500) | (105,000) | (360,000) | Acquisition expenses | (4,910) | (5,056) | (5,201) | (5,337) | (20,504) |
| Change in insurance contract liabilities | (3,466) | (23,104) | 8,403 | 18,167 | - | Insurance service result | 9,637 | 5,121 | 5,518 | 5,757 | 26,033 |
| Acquisition costs | (5,000) | (4,950) | (4,895) | (4,830) | (19,675) | Investment income | 4,750 | 5,890 | 6,660 | 6,656 | 23,956 |
| Other expenses | (1,000) | (1,000) | (1,000) | (1,000) | (4,000) | Insurance finance expenses | (3,505) | (4,047) | (4,443) | (4,213) | (16,208) |
| Profit or loss | 20,284 | (6,664) | 9,568 | 10,593 | 33,781 | Net financial result | 1,245 | 1,843 | 2,217 | 2,443 | 7,748 |
| Other comprehensive income | - | - | - | - | - | Profit or loss | 10,882 | 6,964 | 7,735 | 8,200 | 33,781 |
| Comprehensive income | 20,284 | (6,664) | 9,568 | 10,593 | 33,781 | Other comprehensive income | - | - | - | - | - |
| Comprehensive income | 20,284 | (6,664) | 9,568 | 10,593 | 33,781 | Comprehensive income | 10,882 | 6,964 | 7,735 | 8,200 | 33,781 |
| Effects on the balance sheet | | | | | | | | | | | |
| See the effects discussed in Illustration 1. In addition, when applying IFRS 17, (a) changes in estimates of the present value of future cash flows that relate to future coverage, and (b) changes in the risk adjustment that relate to future coverage are offset by a corresponding reduction in the contractual service margin. When applying IFRS 4, in this illustration, all changes in the estimates of the present value of future cash flows are recognised immediately in profit or loss. As a consequence, there is a reduction in equity at the end of Year 2 when the change in estimates is recognised. [IFRS 17 requires a breakdown of the insurance contract liability to be presented not on the face of the balance sheet, but rather in notes to the financial statements; the amounts shown here are for illustrative purposes]. | | | | | | | | | | | |
| Effects on the statement of comprehensive income | | | | | | | | | | | |
| See the effects discussed in Illustration 1. In addition, as further illustrated on page 121, when applying IFRS 17, the effect of the changes in estimates at the end of Year 2 is recognised in profit or loss in Year 2, Year 3 and Year 4 through a reduction in the amount of the contractual service margin recognised in profit or loss in these periods. When applying IFRS 4, in this illustration, the full effect of the change of estimates is recognised in Year 2. | | | | | | | | | | | |

Illustration 1 compared with Illustration 2

The following table illustrates the incremental effects on the statement of comprehensive income of the change in claims, by comparing the statement of comprehensive income in Illustration 1 with that in Illustration 2. Illustration 2 assumes that at the end of Year 2 expectations change and an additional claim of CU7,500 is expected to be paid at the end of Year 3 and a further additional claim of CU7,500 is expected to be paid at the end of Year 4.

| IFRS 4 | | | | | | IFRS 17 | | | | | |
|--|------------------|---------------|---------------|---------------|---------------|---------------------------------------|------------------|---------------|---------------|---------------|---------------|
| Balance sheet—Illustration 1 compared with Illustration 2 | | | | | | | | | | | |
| | Inception | Year 1 | Year 2 | Year 3 | Year 4 | | Inception | Year 1 | Year 2 | Year 3 | Year 4 |
| Financial assets | - | - | - | (7,500) | (15,475) | Financial assets | - | - | - | (7,500) | (15,475) |
| Insurance contracts | - | - | (15,260) | (7,847) | - | Insurance contract liabilities | - | - | (4,902) | (2,476) | - |
| | | | | | | - Present value of cash flows | - | - | (14,237) | (7,306) | - |
| | | | | | | - Risk adjustment | - | - | (300) | (150) | - |
| | | | | | | - Contractual service margin | - | - | 9,635 | 4,980 | - |
| Equity | - | - | (15,260) | (15,347) | (15,475) | Equity | - | - | (4,902) | (9,976) | (15,475) |
| Statement of comprehensive income—Illustration 1 compared with Illustration 2 | | | | | | | | | | | |
| | Year 1 | Year 2 | Year 3 | Year 4 | Total | | Year 1 | Year 2 | Year 3 | Year 4 | Total |
| Premiums | - | - | - | (100) | (100) | Insurance revenue | - | (4,902) | 2,613 | 2,466 | 177 |
| Investment income | - | - | - | (380) | (380) | Incurred claims and other expenses | - | - | (7,500) | (7,500) | (15,000) |
| Incurred claims | - | - | (7,500) | (7,500) | (15,000) | Acquisition expenses | - | - | (2) | 4 | 2 |
| Change in insurance contract liabilities | - | (15,260) | 7,413 | 7,847 | - | Insurance service result | - | (4,902) | (4,889) | (5,030) | (14,821) |
| Acquisition costs | - | - | - | 5 | 5 | Investment income | - | - | - | (380) | (380) |
| Other expenses | - | - | - | - | - | Insurance finance expenses | - | - | (185) | (89) | (274) |
| Profit or loss | - | (15,260) | (87) | (128) | (15,475) | Net financial result | - | - | (185) | (469) | (654) |
| Other comprehensive income | - | - | - | - | - | Profit or loss | - | (4,902) | (5,074) | (5,499) | (15,475) |
| Comprehensive income | - | (15,260) | (87) | (128) | (15,475) | Other comprehensive income | - | - | - | - | - |
| | | | | | | Comprehensive income | - | (4,902) | (5,074) | (5,499) | (15,475) |

When applying IFRS 17 the effect of the changes in estimates at the end of Year 2 is recognised in profit or loss in Year 2, Year 3 and Year 4 through a reduction in the amount of the contractual service margin recognised in profit or loss in these periods. When applying IFRS 4, in this illustration, the full effect of the change of estimates is recognised in Year 2.

The claims paid in Year 3 reduce the number of contracts in force and, therefore, the amount of premiums collected in Year 4, as well the commission expense (acquisition costs or expenses).

Illustration 3—Simplified approach

This illustration shows the effects of IFRS 17 on the balance sheet and the statement of comprehensive income for a group of contracts accounted for using the simplified approach (see Section 5.3—*Key cost reliefs*).

Illustration 3—background information

- The group of insurance contracts is composed of one-year contracts.
- All claims are incurred at the end of the coverage period. Cash outflows for those claims are paid in subsequent years. No changes in estimates occur after contract inception.
- The explicit risk adjustment, in applying IFRS 17, is calculated as 4 per cent of the outstanding undiscounted claims for each year to their expected settlement.
- The discount rate is 2 per cent a year.
- The premiums collected, net of expenses incurred, are invested in financial assets generating a return of 2.5 per cent a year. Financial assets are measured at fair value with gains and losses recognised in profit or loss.
- All investment income and insurance finance expenses are recognised in profit or loss (and not in other comprehensive income).
- When applying IFRS 17, no interest is accreted on the liability for remaining coverage as permitted by IFRS 17 for contracts with a coverage period of one year or less.
- When applying IFRS 4:
 - (a) liabilities for incurred claims are not discounted; and
 - (b) an implicit allowance for risk (risk margin) is made by increasing the best estimate of claims; this risk margin is calculated as 2 per cent of the undiscounted future claims for each year to their expected settlement.

- Expected and actual cash flows are summarised in the following table.

| Expected and actual cash flows | | | | | |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|
| | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
| Opening balance of cash | – | 9,840 | 4,910 | 2,439 | 1,465 |
| <i>Insurance contract cash flows:</i> | | | | | |
| Premiums | 10,000 | – | – | – | – |
| Claims | – | (5,000) | (2,500) | (1,000) | (500) |
| Commission expense | (400) | – | – | – | – |
| Other expenses | – | (50) | (30) | (10) | (5) |
| <i>Financial asset cash flows:</i> | | | | | |
| Investment income | 240 | 120 | 59 | 36 | 24 |
| Closing balance of cash | 9,840 | 4,910 | 2,439 | 1,465 | 984 |

Illustration 3 assumes that all premiums and commission cash flows occur at the beginning of the year. All other claims and expense cash flows occur at the end of the year.

| IFRS 4 | | | | | | IFRS 17 | | | | | | | |
|---|---------------|---------------|---------------|---------------|---------------|---------------------------------------|------------------------------------|---------------|---------------|---------------|---------------|--------------|------------|
| Balance sheet—Illustration 3 | | | | | | | | | | | | | |
| | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | | |
| Financial assets | 9,840 | 4,910 | 2,439 | 1,465 | 984 | Financial assets | 9,840 | 4,910 | 2,439 | 1,465 | 984 | | |
| Insurance contract liabilities | (9,395) | (4,165) | (1,555) | (515) | - | Insurance contract liabilities | (9,401) | (4,167) | (1,555) | (515) | - | | |
| | | | | | | - Present value of cash flows | (8,801) | (3,927) | (1,475) | (495) | - | | |
| | | | | | | - Risk adjustment | (600) | (240) | (80) | (20) | - | | |
| Equity | 445 | 745 | 884 | 950 | 984 | Equity | 439 | 743 | 884 | 950 | 984 | | |
| Statement of comprehensive income—Illustration 3 | | | | | | | | | | | | | |
| | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Total | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Total | |
| Earned premiums | 10,000 | - | - | - | - | 10,000 | Insurance revenue | 10,000 | - | - | - | - | 10,000 |
| Claims and expenses | (9,395) | 180 | 80 | 30 | 10 | (9,095) | Incurred claims and other expenses | (9,401) | 360 | 160 | 60 | 20 | (8,801) |
| Acquisition costs | (400) | - | - | - | - | (400) | Acquisition expenses | (400) | - | - | - | - | (400) |
| | | | | | | | Insurance service result | 199 | 360 | 160 | 60 | 20 | 799 |
| Investment income | 240 | 120 | 59 | 36 | 24 | 479 | Investment income | 240 | 120 | 59 | 36 | 24 | 479 |
| | | | | | | | Insurance finance expenses | - | (176) | (78) | (30) | (10) | (294) |
| | | | | | | | Net financial result | 240 | (56) | (19) | 6 | 14 | 185 |
| Profit or loss | 445 | 300 | 139 | 66 | 34 | 984 | Profit or loss | 439 | 304 | 141 | 66 | 34 | 984 |
| Other comprehensive income | - | - | - | - | - | - | Other comprehensive income | - | - | - | - | - | - |
| Comprehensive income | 445 | 300 | 139 | 66 | 34 | 984 | Comprehensive income | 439 | 304 | 141 | 66 | 34 | 984 |

Effects on the balance sheet

When applying IFRS 17, the liability for incurred claims is discounted and includes an explicit risk adjustment. When applying IFRS 4, the liability for incurred claims is not discounted, but it includes an implicit allowance for risk. In this illustration, the difference between the explicit risk adjustment in applying IFRS 17 and the implicit allowance for risk in applying IFRS 4 is similar to the effect of discounting the liability for incurred claims in applying IFRS 17.

Effects on the statement of comprehensive income

The patterns of profit recognition in this illustration are similar. If the effect of discounting was more significant than the effect of increasing the risk adjustment, the recognition of profits in applying IFRS 17 would be accelerated. If the effect of discounting was less significant than the effect of increasing the risk adjustment in applying IFRS 17, the recognition of profits would be deferred. The main effect of IFRS 17 is on the presentation of the effects of risk and discounting. The interest accreted on the discounted claims liabilities is presented as part of the net financial result, and not as part of the insurance service result. In both presentations, claims and expenses recognised in Years 2-5 represent the reduction of the risk adjustment as the company is released from risk.

Illustration 4—Disclosures

The tables in this illustration show one possible way of presenting disclosures that analyse movements in insurance contract liabilities, new business and insurance revenue, for an insurance company issuing a mix of life contracts and contracts with participation features, when applying IFRS 17.

IFRS 17 requires separate analyses for insurance contracts issued and reinsurance contracts held. Only the analyses for insurance contracts issued are included in this illustration. The illustration shows only current period information. IAS 1 requires a company to also present comparative information.

Table 1 shows items included in the company's balance sheet and statement of comprehensive income. Only items that are derived from the movements in the insurance contract liabilities are shown in this table. The items included in the statement of comprehensive income are those that are required to be presented separately in applying IFRS 17.

When applying IFRS 17, a company will disclose reconciliations of insurance contract liabilities from the opening balances to the closing balances separately for each of:

- (a) the estimates of the present value of future cash flows, the risk adjustment and the contractual service margin; and
- (b) liabilities for remaining coverage, separately analysing amounts recognised in profit or loss for onerous contracts and incurred claims.

These reconciliations are illustrated in Table 2 and Table 3 on pages 125–126.

Table 1—extracts from balance sheet and statement of comprehensive income

Balance sheet line item

| | 20X1 | 20X0 |
|--------------------------------|---------|---------|
| Insurance contract liabilities | 205,724 | 178,818 |

Items included in the statement of comprehensive income

| Profit or loss | 20X1 |
|---|----------------|
| Insurance revenue | 9,856 |
| Insurance service expenses | (8,621) |
| Insurance service result | 1,235 |
| Insurance finance expenses | (7,391) |
| Other comprehensive income | 20X1 |
| Insurance finance expenses | (1,917) |
| Total other comprehensive income | (1,917) |

Table 2—movements in insurance contract liabilities analysed between liabilities for remaining coverage and incurred claims

| | Liabilities for remaining coverage | | Liabilities for incurred claims | Total |
|--|---------------------------------------|-----------------------------|---------------------------------|----------------|
| | Excluding onerous contracts component | Onerous contracts component | | |
| Insurance contract liabilities 20X0¹¹⁴ | 161,938 | 15,859 | 1,021 | 178,818 |
| Insurance revenue¹¹⁵ | (9,856) | | | (9,856) |
| Insurance service expenses | 1,259 | (623) | 7,985 | 8,621 |
| Incurred claims and other expenses | | (840) | 7,945 | 7,105 |
| Acquisition expenses | 1,259 | | | 1,259 |
| Changes that relate to future service: losses on onerous contracts and reversals of those losses | | 217 | | 217 |
| Changes that relate to past service: changes to liabilities for incurred claims | | | 40 | 40 |
| Investment components | (6,465) | | 6,465 | - |
| Insurance service result | (15,062) | (623) | 14,450 | (1,235) |
| Insurance finance expenses | 8,393 | 860 | 55 | 9,308 |
| Total changes in the statement of comprehensive income | (6,669) | 237 | 14,505 | 8,073 |
| Cash flows | | | | |
| Premiums received | 33,570 | | | 33,570 |
| Claims and other expenses paid | | | (14,336) | (14,336) |
| Acquisition cash flows paid | (401) | | | (401) |
| Total cash flows | 33,169 | - | (14,336) | 18,833 |
| Insurance contract liabilities 20X1 | 188,438 | 16,096 | 1,190 | 205,724 |

114 The opening and closing balances are analysed between groups of contracts in an asset position and groups of contracts in a liability position. The company does not have any groups of contracts in an asset position.

115 An analysis of insurance revenue is provided in Table 5 on page 127.

Table 3—movements in insurance contract liabilities analysed by components¹¹⁶

| | Estimates of the present value of future cash flows | Risk adjustment | Contractual service margin | Total |
|---|---|-----------------|----------------------------|----------------|
| Insurance contract liabilities 20X0¹¹⁷ | 163,962 | 5,998 | 8,858 | 178,818 |
| Changes that relate to current service | 35 | (604) | (923) | (1,492) |
| Contractual service margin recognised for service provided | | | (923) | (923) |
| Risk adjustment recognised for the risk expired | | (604) | | (604) |
| Experience adjustments | 35 | | | 35 |
| Changes that relate to future service | (784) | 1,117 | (116) | 217 |
| Contracts initially recognised in the period ¹¹⁸ | (2,329) | 1,077 | 1,375 | 123 |
| Changes in estimates reflected in the contractual service margin ¹¹⁹ | 1,452 | 39 | (1,491) | – |
| Changes in estimates that result in onerous contract losses | 93 | 1 | | 94 |
| Changes that relate to past service | 47 | (7) | | 40 |
| Adjustments to liabilities for incurred claims | 47 | (7) | | 40 |
| Insurance service result | (702) | 506 | (1,039) | (1,235) |
| Insurance finance expenses¹²⁰ | 9,087 | – | 221 | 9,308 |
| Total changes in the statement of comprehensive income | 8,385 | 506 | (818) | 8,073 |
| Cash flows¹²¹ | 18,833 | | | 18,833 |
| Insurance contract liabilities 20x1 | 191,180 | 6,504 | 8,040 | 205,724 |

116 The reconciliation analysing the movement between (a) the estimates of the present value of future cash flows, (b) risk adjustment and (c) contractual service margin is not required for the liability for remaining coverage for contracts measured using the simplified approach.

117 The opening and closing balances are analysed between groups of contracts in an asset position and groups of contracts in a liability position. The company does not have any groups of contracts in an asset position.

118 An analysis of the contracts initially recognised in the period is provided in Table 4 on page 127.

119 The difference between the change in the present value of estimates of future cash flows (calculated using current discount rates) and the amount adjusted against the contractual service margin (calculated using the discount rates that applied when the contracts were initially recognised) is included in insurance finance expenses.

120 The company does not disaggregate a change in the risk adjustment to present an insurance finance component and an insurance service component.

121 Cash flows are analysed in the reconciliation presented in Table 2 on page 125.

Table 4—analysis of contracts initially recognised in the period

| Contracts initially recognised in 20X1 | | Of which contracts acquired | Of which onerous contracts |
|---|-----------------|------------------------------------|-----------------------------------|
| Estimates of the present value of future cash inflows | (33,570) | (19,155) | (1,716) |
| Estimates of the present value of future cash outflows | | | |
| Insurance acquisition cash flows | 401 | 122 | 27 |
| Claims payable and other expenses | 30,840 | 17,501 | 1,704 |
| Risk adjustment | 1,077 | 658 | 108 |
| Contractual service margin | 1,375 | 896 | - |
| Total | 123 | 22 | 123 |

Table 5—analysis of insurance revenue

| | 20X1 |
|--|--------------|
| Amounts related to liabilities for remaining coverage | 8,597 |
| Expected incurred claims and other expenses ¹²² | 7,070 |
| Contractual service margin for the service provided | 923 |
| Risk adjustment for the risk expired | 604 |
| Recovery of acquisition cash flows | 1,259 |
| Insurance revenue | 9,856 |

¹²² Expected incurred claims and other expenses of CU7,105 minus experience adjustment of CU35.

Appendix C—Sources

Sources

The Board used Standard & Poor's Capital IQ database to gather information about the number and size of listed companies primarily working in the insurance industry and using IFRS Standards (such as information about total assets).

The Capital IQ database provided by Standard & Poor compiles financial information available in the financial statements of companies.

The Board relied upon the information contained in that database and did not independently verify its accuracy.

Because of limitations on the availability of relevant information and the different classification criteria used by companies and jurisdictions, information about insurance companies is prepared using various assumptions. Consequently, the information included in this document should be viewed considering the following:

- (a) statistics are based on individual listed companies; if within a group both the parent company and some of its subsidiaries are listed, both the parent company and those subsidiaries are included in the statistics; financial information for the parent company is typically based on the consolidated financial statements.
- (b) information by geographical region and by industry sector is based on classifications of companies available in the Capital IQ database.
- (c) all data are based on information in the latest annual reports available in the Capital IQ database at the date of assessing the effects of IFRS 17—ie 2015 annual reports for the majority of companies.
- (d) all amounts are shown in US\$. Amounts in other currencies are translated to US\$ using the exchange rate at the date of the latest annual report.

- (e) insurance companies are classified applying the Global Industry Classification system¹²³ as follows:
 - (i) **life and health insurers**—companies providing primarily life, disability, indemnity or supplemental health insurance;
 - (ii) **property and casualty insurers**—companies providing primarily property and casualty insurance;
 - (iii) **multi-line insurers**—companies with diversified interests in life, health, property and casualty insurance;
 - (iv) **reinsurers**—companies primarily providing reinsurance; and
 - (v) **insurance brokers**—companies providing insurance and reinsurance brokerage services.

¹²³ In 1999, MSCI and Standard & Poor developed the Global Industry Classification Standard. This is a four-tiered, hierarchical industry classification system. It consists of sectors, industry groups, industries and sub-industries. Companies are classified quantitatively and qualitatively. Each company is assigned a single Global Industry Classification Standard classification at the sub-industry level according to its principal business activity. MSCI and Standard & Poor use revenues as a key factor in determining a company's principal business activity. Earnings and market perception, however, are also recognised as important and relevant information for classification purposes, and are taken into account during the annual review process.

Appendix D—IFRS 17, Japanese GAAP and US GAAP comparison

IFRS 17, Japanese GAAP and US GAAP comparison

IFRS 17 introduces a consistent accounting framework for all insurance companies applying IFRS Standards. Since IFRS 17 will result in more comparable reporting relative to IFRS 4, it will enable users of financial statements to more easily identify the accounting differences between companies using IFRS Standards and companies using another financial reporting framework. This enhanced consistency among companies using IFRS Standards is therefore expected to reduce the costs of analysis for users of financial statements.

As discussed in Section 3—*Companies affected*, at the time of assessing the effects of IFRS 17, listed companies representing most of the insurance industry (by total assets) used IFRS Standards, US GAAP or Japanese GAAP.

The table on the next page includes a high-level summary of similarities and differences between IFRS 17, US GAAP and Japanese GAAP.

Many simplifications were used in preparing that table. This is mainly because both US GAAP and Japanese GAAP requirements diverge by type of contracts (such as short-term and long-term insurance contracts or non-life and life insurance contracts). The classification criteria of different types of contract also vary between US GAAP and Japanese GAAP.

The information reported on the table on the next page focuses on the following key accounting requirements for insurance contracts:

- (a) the recognition of insurance revenue;
- (b) the measurement of insurance contracts; and
- (c) the accounting treatment of insurance acquisition costs.

Proposed changes to US GAAP

When the analysis in this appendix was developed, the US Financial Accounting Standards Board (FASB) was working on a project to improve, simplify and enhance the financial reporting requirements for long-term insurance contracts issued by companies using US GAAP.¹²⁴ Some of the proposed changes to US GAAP, if confirmed, are expected to reduce the differences between IFRS 17 and existing US GAAP.

Similarly to IFRS 17, the proposed changes to US GAAP would result in insurance contract liabilities arising from long-term insurance contracts referred to as ‘universal life contracts’ (for example, annuities) and ‘traditional life contracts’ (for example, whole-life insurance) being reported using current assumptions. These changes to US GAAP also mean that a provision for changes in assumptions referred to as a ‘provision for adverse deviation’ would no longer be required given that assumptions used to measure those contracts would be regularly updated.

However, the proposed changes to US GAAP for traditional life contracts would require future cash flows to be discounted using a current high-quality fixed-income instrument yield that maximises the use of market-observable inputs. This determination of the discount rate is inconsistent with the requirements in IFRS 17.

¹²⁴ The proposed changes to US GAAP discussed in this appendix are based on the proposed Accounting Standards Update, *Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*, published by the FASB on 29 September 2016.

| | IFRS 17 | US GAAP | | | Japanese GAAP | |
|------------------------------------|--|---|---|----------------------------|---------------------------------------|--------------------------------------|
| | | Short-term insurance contracts | Long-term insurance contracts | | Short-term insurance contracts | Long-term insurance contracts |
| | | | Traditional life contracts | Universal life contracts | | |
| Insurance revenue | Consideration for insurance coverage provided in the period | ✓ Earned premiums | ✗ Premiums | ✗ Premiums | ✗ Premiums | ✗ Premiums |
| Deposit components | Excluded from revenue ¹²⁵ | n.a. ¹²⁶ | ✗ Included | ✓ Excluded | n.a. ¹²⁶ | ✗ Included |
| Insurance contracts | | | | | | |
| • cash flows | Required to fulfil the contracts | ✓ | ✓ ¹²⁷ | ✓ ¹²⁷ | ✓ | ✓ ¹²⁷ |
| • discount rates | Reflect the characteristics of the cash flows arising from the insurance contracts | ✗ Typically not discounted ¹²⁸ | ✗ Expected yield on assets (✗ proposed change) | ✗ Expected yield on assets | ✗ Not discounted | ✗ Prescribed by regulators |
| • risk | Explicit risk adjustment | ✗ Risk margin (implicit) | ✗ Provision for risk of adverse deviation ¹²⁹ (✓ proposed change) | ✗ Risk margin (implicit) | ✗ Catastrophe reserves ¹³⁰ | ✗ Contingent reserves ¹³¹ |
| • assumptions | Updated | ✓ Updated | ✗ Historical (✓ proposed change) | ✓ Updated | ✓ Updated | ✗ Historical |
| Insurance acquisition costs | Included in the measurement of the fulfilment cash flows | ✓ Deferred and amortised | ✓ Deferred and amortised | ✓ Deferred and amortised | ✗ Expensed as incurred | ✗ Expensed as incurred |

✓ Similarity to IFRS 17 ✗ Difference from IFRS 17

125 Deposit components of insurance contracts are excluded from both insurance revenue (when deposits are collected) and incurred claims (when repayments of deposits are due).

126 Characteristics of short-term contracts vary by company and by jurisdiction. For the purpose of this analysis, it is assumed that short-term insurance contracts do not include significant deposit components.

127 There might be differences in cash flows for some insurance contracts that include complex features such as options and guarantees. Differences may also arise for a different definition of contract boundary.

128 Non-life insurance contracts are typically not discounted in applying US GAAP, except for some contracts for which the settlement of claims may take many years (such as those related to medical malpractice).

129 The provision for the risk of adverse deviation is a notion similar to an implicit allowance for risk (risk margin). It reflects possible unfavourable changes in assumptions for investment yields, mortality, etc.

130 Non-life insurance companies in Japan are required to account for a provision based on premium income to cover losses due to catastrophic events.

131 Contingent reserves reflect the risk of changes in expected cash outflows due to several risks, such as higher-than-expected mortality and morbidity rates and actual investment results being lower than the amount guaranteed to policyholders relating to minimum interest rate guarantees.

Glossary

Glossary

This glossary contains short definitions of terms used in this document.

| Term | Definition |
|--|--|
| Accounting mismatch | The difference that arises if changes in economic conditions affect assets and liabilities to the same extent, but the carrying amounts of those assets and liabilities do not respond equally to those economic changes because they are measured on different bases. |
| Annuity | A contract issued by a life insurance company that, in exchange for premiums, offers a choice of payout options to meet a policyholder's needs, generally in retirement, such as income for life. |
| Company's share | In a contract with direct participation features, the returns from the underlying items that are expected to be for the benefit of the insurance company issuing the contract, rather than for the benefit of the policyholders. |
| Comprehensive income | The sum of the profit or loss and the other comprehensive income. |
| Contractual service margin | Defined term in IFRS 17 for the expected profit of a group of insurance contracts. It is a component of the asset or liability for a group of insurance contracts representing the unearned profit that the company will recognise as it provides services under the insurance contracts in the group. |
| Earned premiums | The portion of premiums written that is intended to cover losses occurring during the reporting period. In other words, the accrued portion of premiums written. Applying many national GAAP, this is typically the definition of revenue in non-life insurance. |
| Economic mismatch | The difference that arises if the values of assets and liabilities respond differently to changes in economic conditions. |
| Existing insurance accounting practices | Policies adopted by companies to account for insurance contracts issued when applying IFRS 4. Because IFRS 4 does not provide specific requirements for most aspects of the recognition and measurement of insurance contracts, companies using IFRS Standards typically have been developing and applying accounting policies for insurance contracts based on requirements of national GAAP. |

| Term | Definition |
|-------------------------------------|---|
| Experience adjustment | Defined term in IFRS 17. In essence, a difference between: (a) the estimate at the beginning of the period of premium receipts expected in the period, and the actual premiums received or (b) the estimate at the beginning of the period of insurance service expenses expected to be incurred in the period, and the actual insurance service expenses incurred in the period. |
| Financial option | A derivative financial instrument, the value of which typically includes two components: (a) the intrinsic value (ie the value that the option would have if it were exercised today); and (b) the time value (ie the amount an investor would pay over its intrinsic value, based on the possibility that it will increase in value before expiry). |
| Fulfilment cash flows | Defined term in IFRS 17. In essence, an explicit, unbiased, probability-weighted and risk-adjusted estimate of the present value of the future cash outflows minus inflows that will arise as the company fulfils insurance contracts. |
| Gross premiums | All premiums falling due for payment during the year (often referred to as premiums written). There are no standardised methods for computing this measure. |
| Group of insurance contracts | Defined term in IFRS 17. A set of insurance contracts resulting from the division of a portfolio of insurance contracts into, at a minimum, contracts written within a period no longer than one year that, at initial recognition: (a) are onerous, if any; (b) have no significant possibility of becoming onerous subsequently, if any; or (c) do not fall into either (a) or (b), if any. |
| In-force business | Insurance contracts which give rise to existing obligations or existing rights for a company. |
| Insolvency | Insurer's legal inability to pay its future policyholder obligations. Insurance insolvency standards and the regulatory actions taken vary by jurisdiction. |
| Insurance contract | Defined term in IFRS 17. 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. |
| Insurance revenue | Consideration that a company expects to be entitled to in exchange for services provided under an insurance contract. |

| Term | Definition |
|---|---|
| Insurance contracts with direct participation features | Defined term in IFRS 17. An insurance contract for which, at initial recognition: <ul style="list-style-type: none"> (a) the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items; (b) the company expects to pay the policyholder an amount equal to a substantial share of the fair value returns on the underlying items; and (c) the company expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items. |
| Insurer or insurance company | An entity that issues insurance contracts as defined in IFRS 17. |
| Lapse | Termination of an insurance contract because of non-payment of premiums. |
| Modified retrospective approach | Method described in paragraphs C6–C8 of IFRS 17 that a company can use when first applying IFRS 17 to determine the contractual service margin for contracts written prior to the first application of IFRS 17. |
| Morbidity | A term used to describe how often a disease occurs in a specific area. Morbidity rate is a broad statistic that relates to the likelihood of developing or contracting a specified illness. |
| National GAAP | Generally accepted accounting principles applied in one or more jurisdictions. |
| Non-GAAP measures | Alternative performance measures. Calculations or presentations that are not required by IFRS Standards or national GAAP. There are no standardised methods for computing these measures. |
| Other comprehensive income | The gains and losses of a company recognised outside profit or loss. |

| Term | Definition |
|---|---|
| Participation feature | A feature in an insurance contract that provides the policyholder, in addition to insurance protection, the opportunity to share the risks and benefits of the underlying items. Some, but not all, contracts with participation features are ‘contracts with direct participation features’ as defined in IFRS 17. |
| Policy | The document that a company issues to the policyholder, which states the terms of the insurance contract. |
| Policyholder | A person or company buying insurance. Defined term in IFRS 17 as a party that has a right to compensation under an insurance contract if an insured event occurs. |
| Portfolio of insurance contracts | Defined term in IFRS 17. Insurance contracts that are subject to similar risks and managed together. |
| Premium | The payment, or one of the periodic payments, that a policyholder makes to be covered by an insurance policy. |
| Premium allocation approach | The simplified approach described in paragraphs 53–59 of IFRS 17 that a company can apply for measuring some insurance contracts. |
| Product warranty | A type of guarantee that a manufacturer or similar party typically makes regarding the condition of its product. It also typically refers to the terms and situations in which repairs or exchanges will be made in the event that the product does not function as originally described or intended. |
| Reinsurance | The transfer of some or all of the insurance risk to another insurer. The company transferring the risk is called the ceding company; the company receiving the risk is called the assuming company or reinsurer. |
| Risk adjustment | Risk adjustment for non-financial risk in IFRS 17. The compensation a company requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the company fulfils insurance contracts. |

| Term | Definition |
|---------------------------------|---|
| Risk margin | Allowance for risk that some companies reflect in the measurement of insurance contracts in applying IFRS 4 together with the future cash flows. Also referred to in this document as ‘implicit or explicit allowance for risk’. |
| Solvency II | Regulation adopted by the European Union. Solvency II substantially concerns the amount of capital that insurance companies with operations within the European Union must hold considering their risk profile. |
| Underlying item | An item, such as a bond, a share or a property, generating an investment return that is shared between the insurance company and the policyholder. Underlying items are defined in IFRS 17 as items that determine some or all of the amounts payable to a policyholder. |
| Unit-linked contract | A contract for which some or all of the benefits are determined by reference to the price of units in an internal or external investment fund (ie a designated pool of assets held by the insurer or by a third party and operated in a manner similar to a mutual fund). |
| Universal life insurance | An insurance contract that provides insurance coverage for as long as the policyholder lives. It typically allows the policyholder to vary premiums at various times and in varying amounts, subject to certain minimums and maximums. |
| US GAAP | US generally accepted accounting principles. |
| Whole-life insurance | An insurance contract that typically provides insurance coverage for as long as the policyholder lives. It typically includes a deposit component. |

Important information

This Effects Analysis accompanies IFRS 17 *Insurance Contracts* (issued May 2017; see separate booklet) and is published by the International Accounting Standards Board (the Board).

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Other relevant documents

IFRS 17 *Insurance Contracts*—specifies the requirements for the accounting for insurance contracts.

Basis for Conclusions on IFRS 17—summarises the Board’s considerations in developing the requirements in IFRS 17.

Illustrative Examples on IFRS 17—illustrate aspects of IFRS 17 but provide no interpretative guidance.

Project Summary of IFRS 17—provides an overview of the project to develop IFRS 17.

Feedback Statement on IFRS 17—summarises feedback on the proposals that preceded IFRS 17 and the Board’s response.



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30 Cannon Street | London EC4M 6XH | United Kingdom

Telephone: +44 (0)20 7246 6410 | Fax: +44 (0)20 7246 6411

Email: info@ifrs.org | Web: www.ifrs.org

Publications Department

Telephone: +44 (0)20 7332 2730 | Fax: +44 (0)20 7332 2749

Email: publications@ifrs.org

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