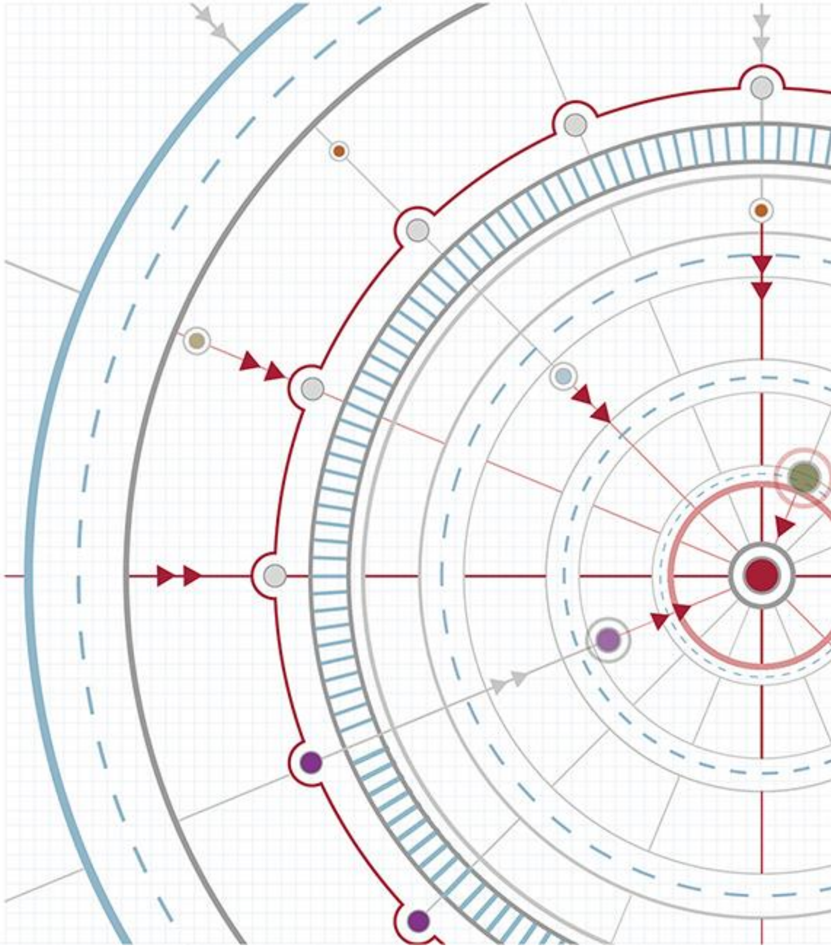
IFRS® Foundation



IFRS 17
Pivoting towards implementation

Darrel Scott, Board Member
Iza Ruta, Technical Manager

Windsor, June 2017

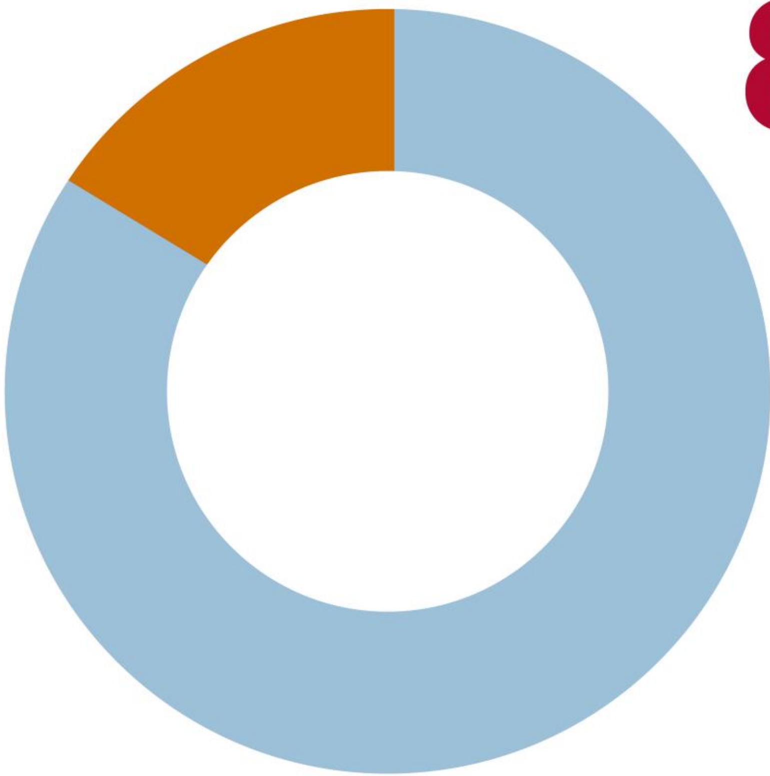
The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board (the Board) or IFRS Foundation.

Contents

- Why has IFRS 17 been developed
- Understanding IFRS 17
  - How the model works
  - Expected changes in the financial statements
- Next steps
  - Implementation support
- Appendix
  - More details

Why has IFRS 17 been developed?

IFRS adoption in the world



84%

126 of 150 jurisdictions require IFRS Standards for all or most publicly accountable companies

What is IFRS 17?

One

accounting model for all insurance contracts in all IFRS jurisdictions

To improve comparability

IFRS 4—a lack of comparability	IFRS 17—a consistent framework
Lack of comparability among insurers • IFRS companies report insurance contracts using different practices **Non-uniform reporting within groups** • Insurance contracts of subsidiaries are consolidated using different practices	• A new framework will replace huge variety of accounting treatments
Inconsistency with other industries • Revenue include deposits • Revenue reported on a cash basis	• Revenue will reflect the services provided, and exclude deposits, like any other industry

To improve financial information

IFRS 4—little transparent or useful information	IFRS 17—more transparent and useful information
Lack of useful information about insurance obligations • Use of old or outdated assumptions • Options and guarantees not fully reflected in measurement of insurance contracts • Time value of money not considered when measuring liabilities for incurred claims • Use of ‘expected return on assets held’ as discount rate	• Current assumptions regularly updated • Options and guarantees fully reflected • Estimated future payments to settle incurred claims reported on a discounted basis. • Discount rate reflect characteristics of the insurance liability - risks not matched by assets will be reflected in the accounts
Lack of transparency about profitability • Revenue recognised on a cash basis • Use of many non-GAAP measures	• Unearned profit recognised as the insurance coverage is provided • Additional metrics to evaluate performance will be available

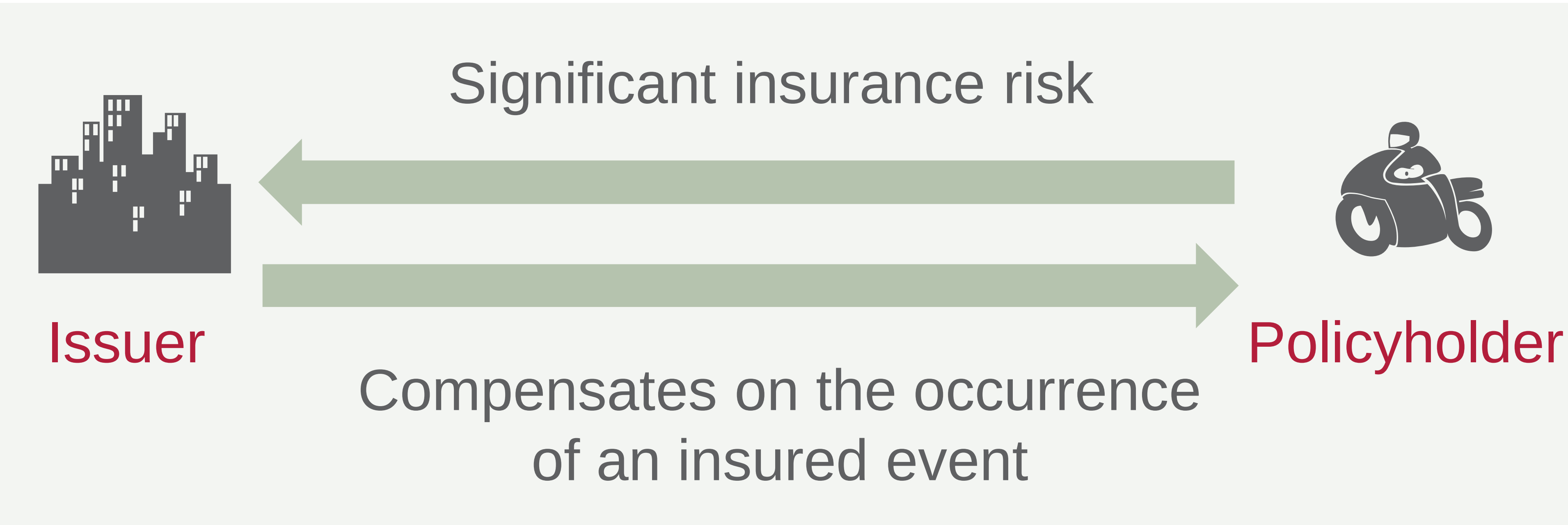
More information than that provided by regulatory requirements alone

	Primary objectives
Accounting frameworks —IFRS Standards	• Provide - useful information to investors and analysts - information on how a company earns profits - comparable information across IFRS jurisdictions
Regulatory frameworks —Solvency II	• Protect customers • Ensure availability of insurance products • Support economic stability within the European Union

Understanding IFRS 17

How the model works

What is an insurance contract?



- ⇔ IFRS 17 and IFRS 4—same definition
- ⇔ IFRS 17 two minor changes to guidance but no expected changes in assessments for majority of contracts

IFRS 17 core requirements

All insurance contracts measured as the sum of:

- Fulfilment cash flows
  - Present value of probability-weighted expected cash flows
  - Plus an explicit risk adjustment for insurance risk
- Contractual service margin
  - The unearned profit from the contract

1 PV of future cash flows + 2 Risk adjustment + 3 Unearned profit = Asset or liability

Fulfilment cash flows (1 + 2)

CSM (3)

Snapshot of IFRS 17 models

Core requirements

Modifications to achieve IFRS 17's fundamental objectives

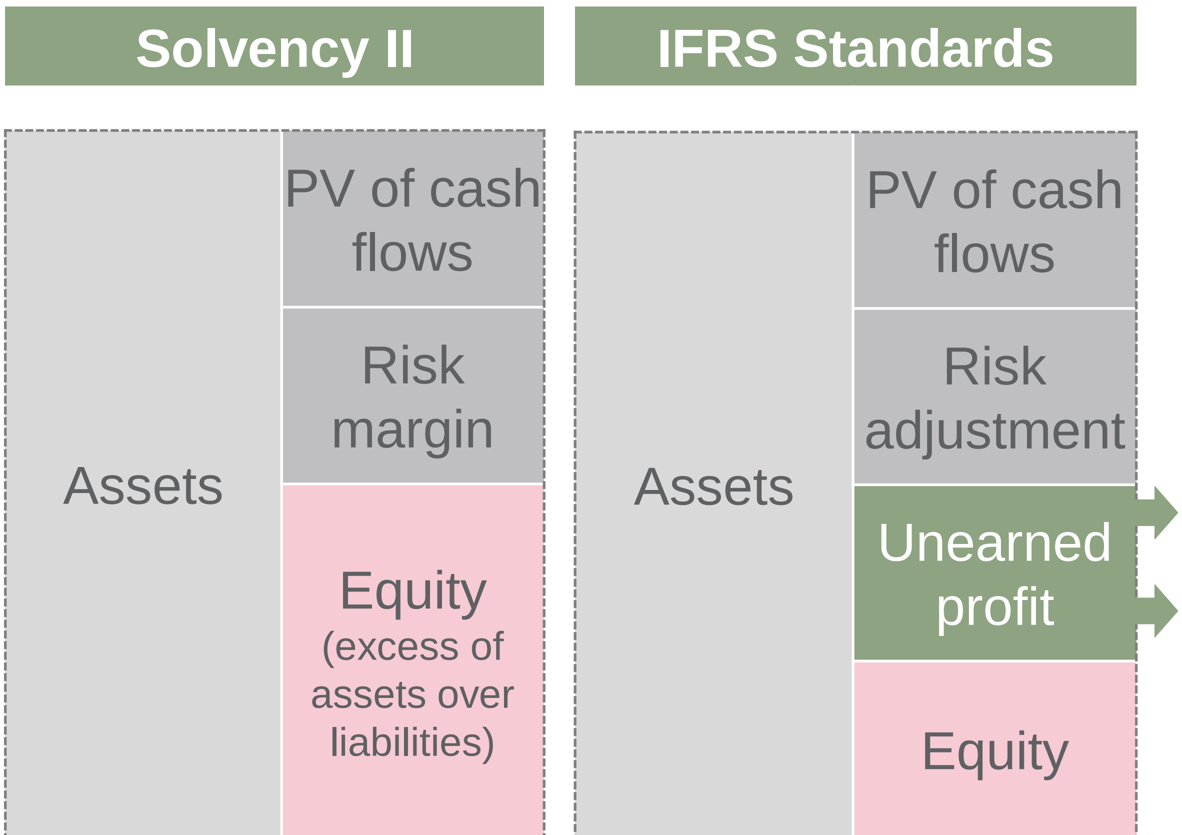
Insurance contracts with direct participation features	Reinsurance contracts held	Investment contracts with discretionary participation features

Simplifications: premium allocation approach

Regulatory reporting: similar insurance liability measurement

	IFRS 17	Solvency II
Cash flows	Similar	Similar
Discount rates	Liability-specific rate, market consistent	Swap rate until year 20 and Ultimate Forward Rate
Risk	Company's own view of risk (possible use of Solvency II risk margin)	Prescribed approach (risk margin—cost of capital set at 6%)
Unearned profit	Recognised in P&L over time	Fully included in equity at inception—day one gain

IFRS 17 provides information about long-term performance



Unearned profit

- is recognised in P&L when insurance coverage is provided
- provides a measure of future profitability

Changes in unearned profit provide information about

- profitability of new business
- changes in profitability of existing contracts

Understanding IFRS 17

Changes expected in the financial statements

Changes to balance sheet presentation

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

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

Changes to financial performance presentation

<table>
<tr><th>IFRS 4*</th><th>IFRS 17</th><th>Key changes</th></tr>
<tr><td>Premiums</td><td>Insurance revenue</td><td rowspan="9">- Two drivers of profit presented separately

- Insurance revenue excludes deposits [written premiums disclosed in the notes]

- Revenue is recognised as earned and expenses are recognised as incurred

- Insurance finance expenses are excluded from insurance service result and are presented (i) fully in P&L or (ii) in P&L and OCI, depending on accounting policy</td></tr>
<tr><td>Investment income</td><td>Incurred claims and expenses</td></tr>
<tr><td>Incurred claims and expenses</td><td>Insurance service result</td></tr>
<tr><td>Change in insurance contract liabilities</td><td>Investment income</td></tr>
<tr><td>Profit or loss</td><td>Insurance finance expenses</td></tr>
<tr><td></td><td>Net financial result</td></tr>
<tr><td></td><td>Profit or loss</td></tr>
<tr><td></td><td>Insurance finance expenses (optional)</td></tr>
<tr><td></td><td>Comprehensive income</td></tr>
</table>

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

Disclosures—overview

Amounts	Judgements	Risk
• Expected PV of future cash flows • Risk and the contractual service margin • New contracts written in the period	• Estimating inputs and methods • Effects of changes in the methods and inputs used • Reason for change, identifying the type of contracts affected	• Nature and extent of risks arising • Extent of mitigation of risks arises from reinsurance and participation • Quantitative data about exposure to credit, market and liquidity risk

Compared to IFRS 4, additional disclosures relating to the amounts reported in the financial statements

IFRS

Disclosures—reconciliations

- **Balance sheet**

	20X1	20X0
Insurance contract liability	xx	xx

- **Notes to the financial statements**

Reconciliation 1	20X1	20X0
PV of expected cash flows	x	x
Risk adjustment	x	x
Contractual service margin	x	x
Total insurance contract liability	xx	xx

Roll forward of the 3 components
- Shows new contracts
- Shows recognition of profit in P&L

Reconciliation 2	20X1	20X0
Liability for remaining coverage	x	x
Liability for incurred claims	x	x
Total insurance contract liability	xx	xx

Liability for remaining coverage **roll forward**
- Represents unearned premiums plus investment component
- Shows recognition of earned premiums in P&L

Liability for incurred claims **roll forward**
- Shows recognition of claims and expenses in P&L

Example—insurance contract liability roll forward

	Estimates of the present value of future cash flows	Risk adjustment	Contractual service margin	Liability
BEGINNING OF PERIOD	163,962	5,998	8,858	178,818
Changes related to:				
- Future service yet to be provided	*(784)*	*1,117*	*(116)*	*217*
- Current service provided in the period	*35*	*(604)*	*(923)*	*(1,492)*
- Past service adjustment to past claims	*47*	*(7)*	*-*	*40*
Insurance service result	(702)	506	(1,039)	(1,235)
Insurance finance expenses	9,087	-	221	9,308
TOTAL CHANGES IN P&L AND OCI	8,385	506	(818)	8,073
CASH FLOWS	18,833	-	-	18,833
END OF PERIOD	191,180	6,504	8,040	205,724

Example—revenue and expenses reconciliation

	Liabilities for remaining coverage		Liabilities for incurred claims	Total
	Excluding onerous contracts component	Onerous contracts component		
BEGINNING OF PERIOD	161,938	15,859	1,021	178,818
Insurance revenue	(9,856)			(9,856)
Insurance service expenses	1,259	(623)	7,985	8,621
Investment components	(6,465)		6,465	0
Insurance service result	(15,062)	(623)	14,450	(1,235)
Insurance finance expenses	8,393	860	55	9,308
Total changes in P&L and OCI	(6,669)	237	14,505	8,073
Cash flows				
Premiums received	33,570			33,570
Claims, benefits and other expenses paid			(14,336)	(14,336)
Insurance acquisition cash flows	(401)			(401)
Total cash flows	33,169	-	(14,336)	18,833
END OF PERIOD	188,438	16,096	1,190	205,724

Next steps

Implementation support

Supporting implementation

- Accompanying materials to IFRS 17
  - Basis for Conclusions
  - Illustrative Examples
- Educational material
  - Webcasts introducing new Standard, focusing on specific areas
  - Other education materials for investors, regulators and national-standard setters
- Transition resource group

Further information about implementation support is available at go.ifrs.org/IFRS-17-implementation.

IFRS

IASB implementation support—overview

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

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

Contact us

Keep up to date

@IFRSFoundation

IFRS Foundation

www.ifrs.org

IFRS Foundation

Comment on our work

go.ifrs.org/comment

Appendix

Appendix

Why has IFRS 17 been developed?

Accounting policies used today

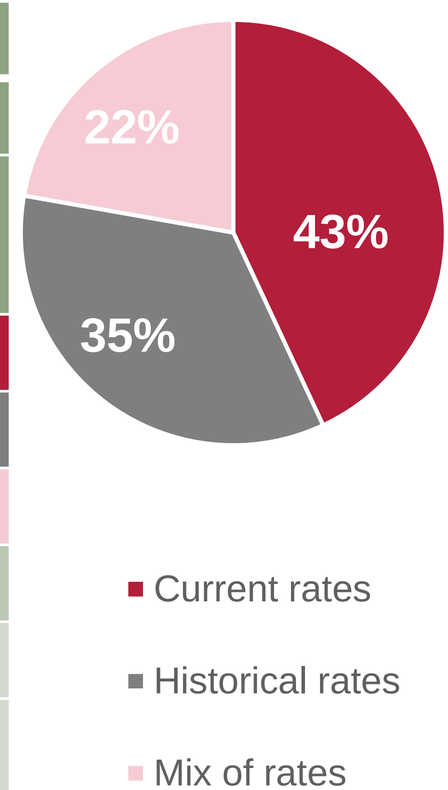
Top-20 listed insurance companies using IFRS Standards		
Accounting policies applied to insurance contracts issued	Number of companies	Total assets (US$ trillions)
Based on guidance in:		
• a mix of national GAAP*	8	4.1
• US GAAP	3	1.6
• Canadian GAAP	4	1.4
• other national GAAP	5	2.0
Total	**20**	**9.1**

*** 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.**

Source: Effects Analysis on IFRS 17

Discount rates used today

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	1	-	15	-	**16**
Sub-total	**18**	**7**	**39**	**8**	**72**
Information n.a.	6	-	1	1	**8**
Non-life business	11	2	6	1	**20**
Total	**35**	**9**	**46**	**10**	**100**



Source: Effects Analysis on IFRS 17

Same company, different pictures

(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%

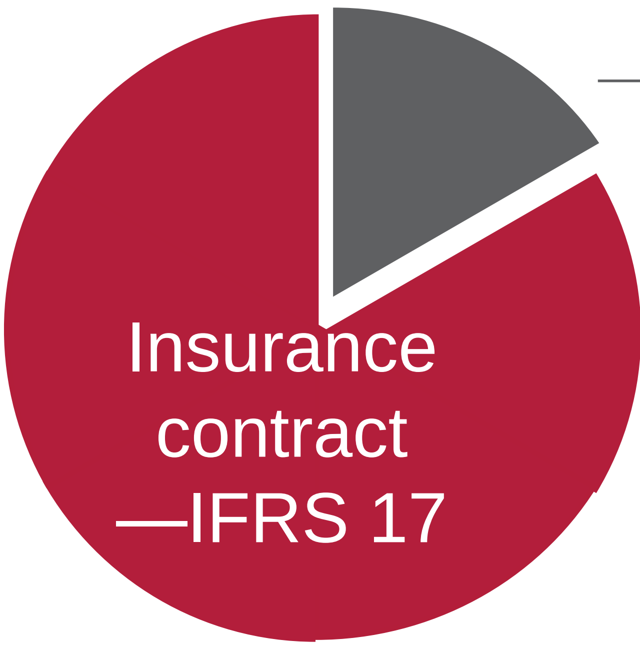
Source: Effects Analysis on IFRS 17

Appendix

How IFRS 17 works

What is measured under IFRS 17?

For measurement purposes, an insurance contract is the cash flows remaining after specified non-insurance components are separated



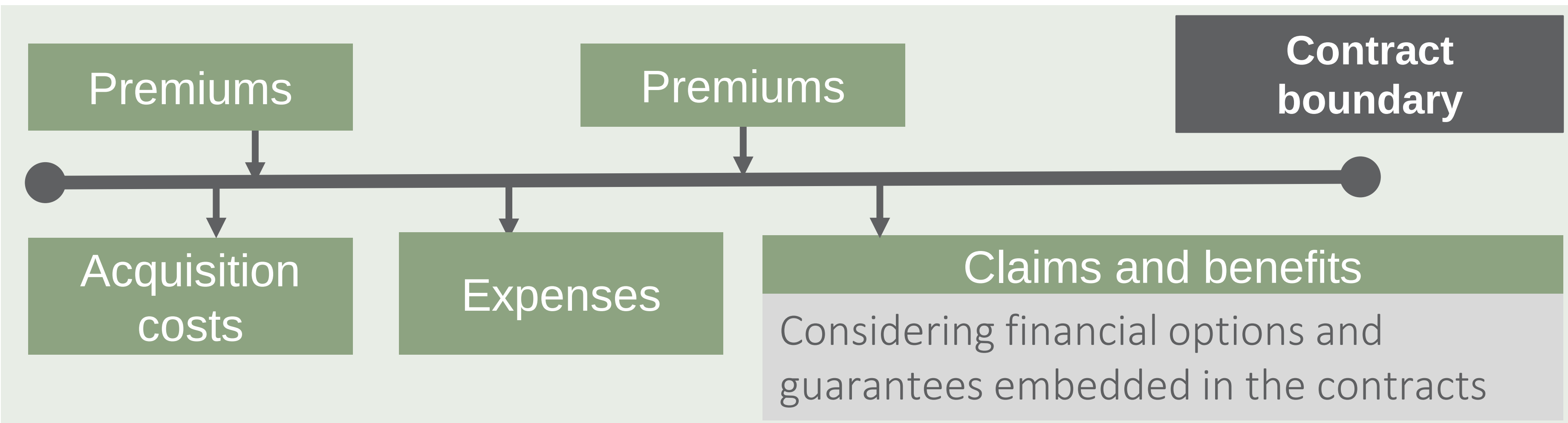
Measure separated components under other IFRS Standards:

- Specified embedded derivatives—IFRS 9
- Distinct investment components—IFRS 9
- Distinct goods or non-insurance services—IFRS 15

IFRS

1 Cash flows

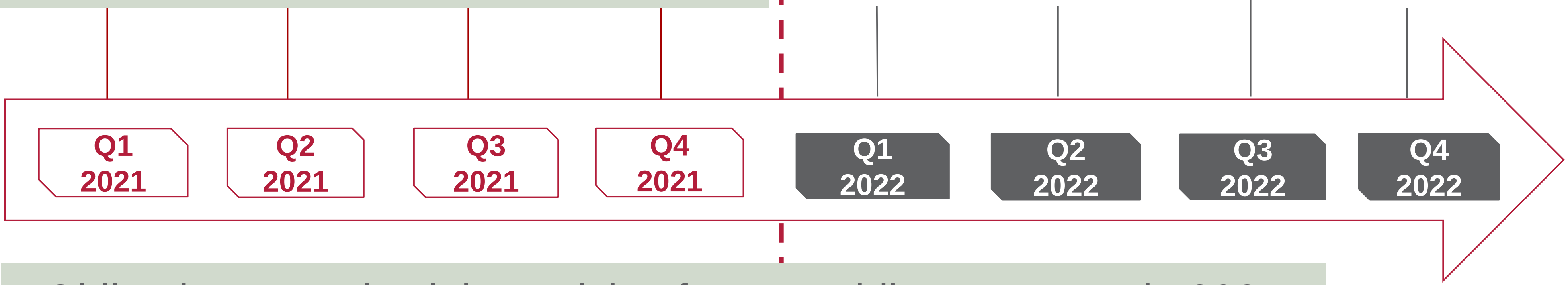
- Current estimates of future cash flows that directly relate to the fulfilment of the contract within the contract boundary
- Probability weighted and unbiased
- Stochastic modelling for financial options and guarantees (where necessary)



1 Determining cash flows within contract boundary

Policyholder—right to coverage without any change in premiums(or benefits) or entity—right to collect premiums

Entity—practical ability to reset premiums (or benefits) for 2022^(A)



Obligation to settle claims arising from providing coverage in 2021

Cash flows within contract boundary = premiums for Q1-Q4 2021 + claims arising from providing coverage in 2021

(A) For an assessment at the contract level. An additional criterion must be satisfied when the assessment is at a portfolio level—the pricing of premiums does not take into account risks that relate to periods after the reassessment date

Discount rates

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

1 Liability-specific discount rate

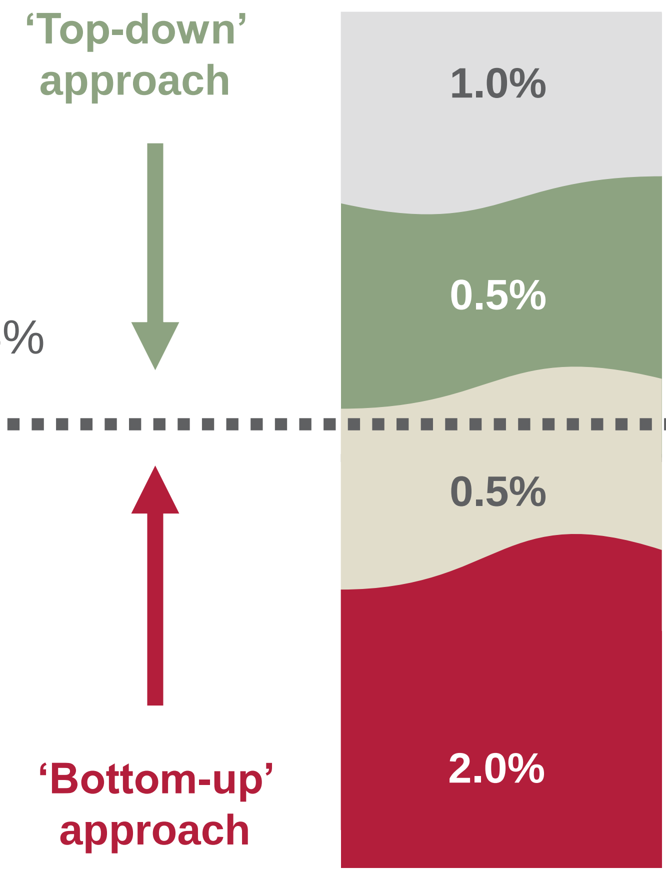
- Assume a current asset yield of a reference instrument of 4% composed of:

Market risk premium expected losses of 1%

Market risk premium for unexpected losses of 0.5%

Liquidity premium of 0.5%

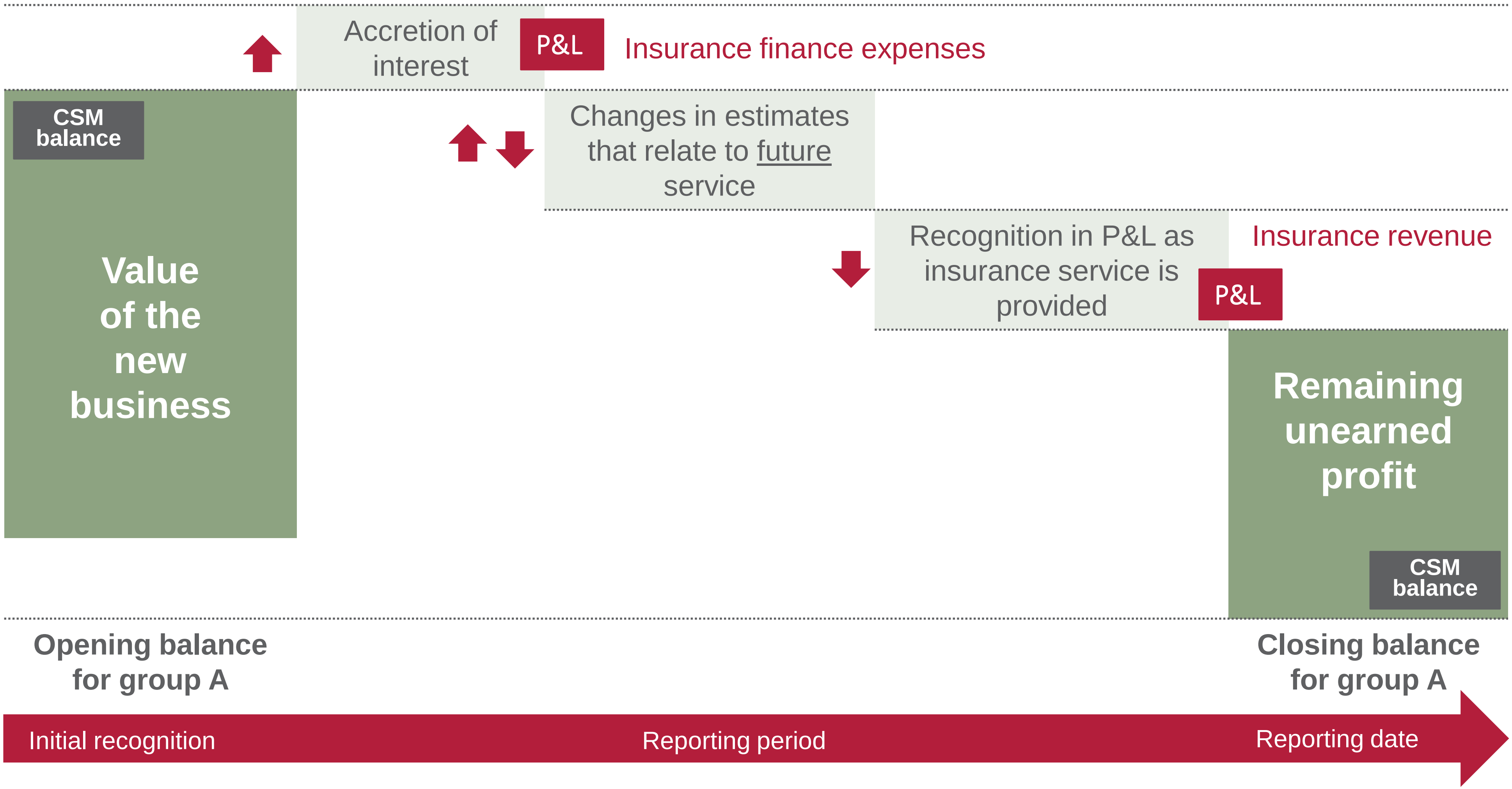
Risk-free rate of return of 2%



Risk adjustment

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

3 Unearned profit—contractual service margin



3 Unearned profit—accretion and estimate changes

- Accretion of interest
  - Use the risk-free discount rate at inception (locked-in)
  - Recognised in P&L as insurance finance income or expenses
- Changes in estimates that relate to future service
  - Use the liability-specific discount rate at inception (locked-in) to determine the amount that adjusts the contractual service margin

3

Unearned profit—allocation pattern

- IFRS 17 recognises profit when coverage is provided
- Unearned profit is allocated over the coverage provided in the current period and expected remaining future coverage
  - on the basis of coverage units, reflecting the expected duration and quantity of benefits provided by contracts in a group of contracts

Appendix

Level of aggregation

Level of aggregation—introduction

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

Portfolios and groups of contracts

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

Portfolio 1	Portfolio 2	Portfolio 3
Whole-life insurance	Annuities	Car insurance
Group A	Group	Group AA
Group B		Group BB
Group C		Group CC
Group D		

Minimum requirement

Consistent with internal reporting

Level of aggregation—grouping objectives

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

Grouping illustration for a portfolio

Portfolio 1

Whole-life insurance

Entity divides each portfolio into groups

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

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

Level of aggregation—effect of regulation

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

Level of aggregation
Examples 1 and 2

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

Level of aggregation
Annual cohorts

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

Level of aggregation
Annual cohorts—Example 3

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

Level of aggregation
Annual cohorts—Example 4

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

Appendix

Modifications to the general model

Snapshot of IFRS 17 models

Core requirements

Modifications to achieve IFRS 17’s fundamental objectives

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

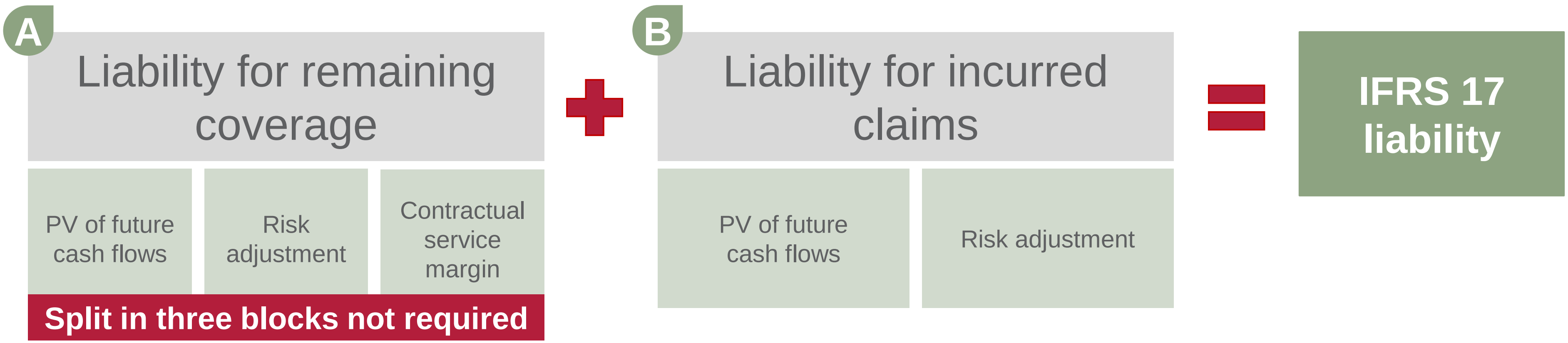
Simplifications: premium allocation approach

Optional simplified approach—eligibility

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

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

Optional simplified approach—overview



- **A** Simplified measurement
- **B** Measurement under the general model, but discounting of claims to be settled within 1 year not required

Optional simplified approach
Further simplifications

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

Snapshot of IFRS 17 models

Core requirements

Modifications to achieve IFRS 17's fundamental objectives

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

Simplifications: premium allocation approach

Variable fee approach—scope

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

Variable fee approach—overview

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

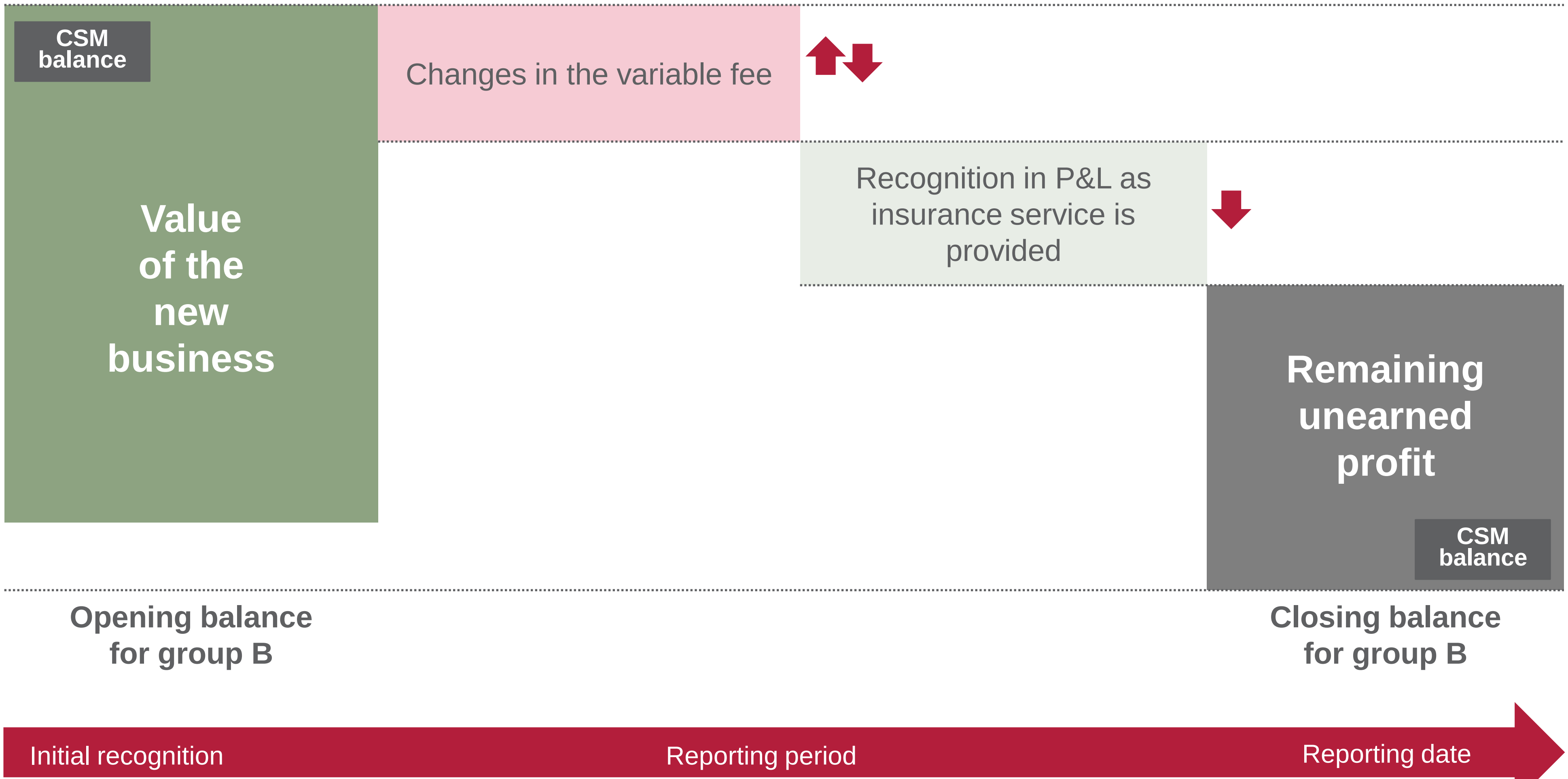
Key effects

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

Variable fee approach compared with general model

	1 PV of future cash flows	2 Risk adjustment	3 Unearned profit
Initial recognition	✓ No difference	✓ No difference	✓ No difference
Subsequently	✓ No difference	✓ No difference	× Difference in how CSM is adjusted for changes in financial variables

CSM for direct participating features



Variable fee approach—a simple example

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

Variable fee approach—risk mitigation

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

Snapshot of IFRS 17 models

Core requirements

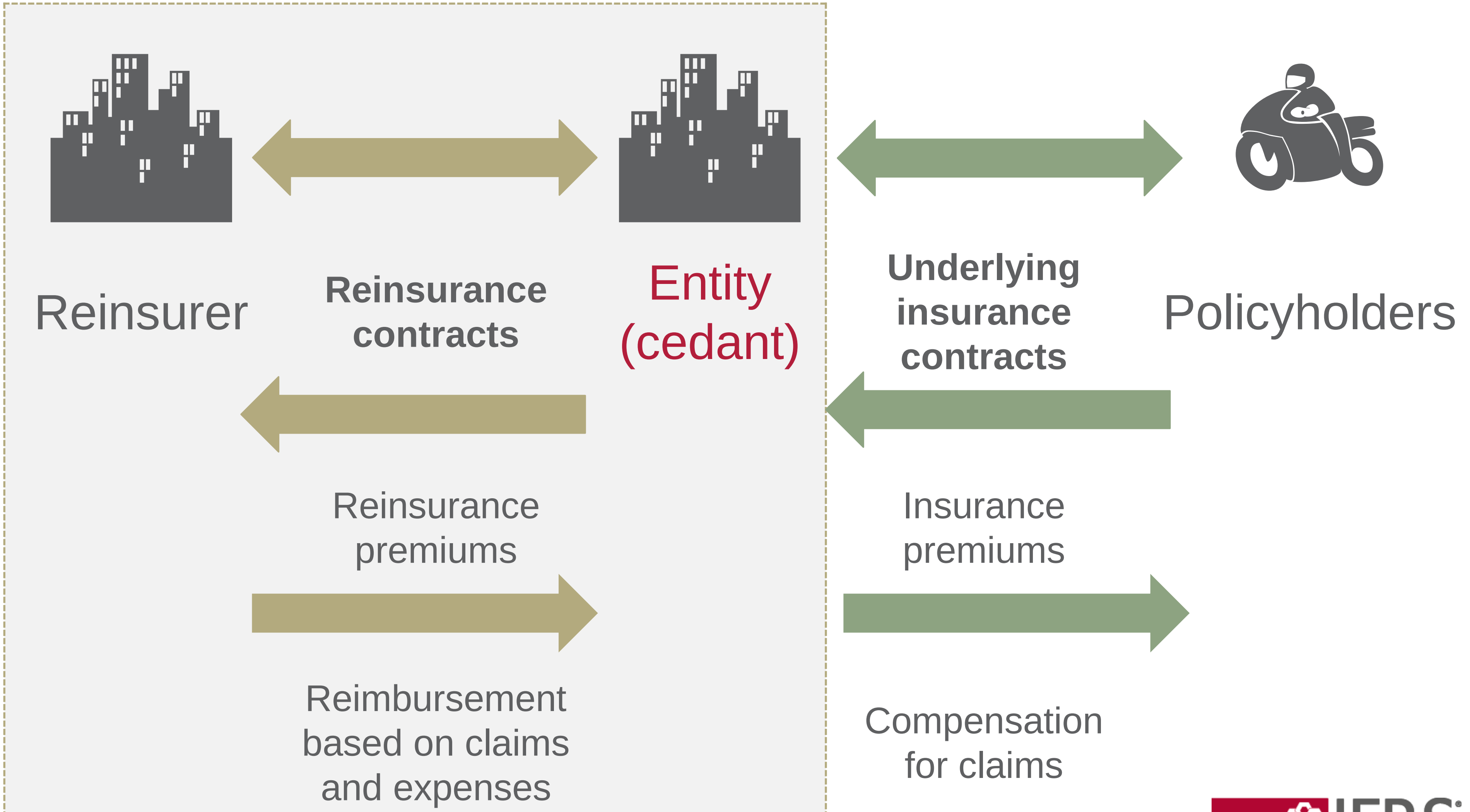
Modifications to achieve IFRS 17's fundamental objectives

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

Simplifications: premium allocation approach

IFRS

Reinsurance contracts held



Reinsurance contracts held—overview

- Separate accounting for reinsurance contracts held and the underlying insurance contracts to which they relate
- No mirror accounting for reinsurance contracts and underlying insurance contracts
- Apply general model approach to measurement of fulfilment cash flows
  - use consistent estimates about cash flows, but
  - differences in estimates may arise because of access to different information, and different adjustments for diversification effects

Reinsurance contracts held—overview

- Apparent gains or losses on initial recognition of reinsurance contract recognised over coverage period of the reinsurance contract as services received
- After inception:
  - recognise in CSM changes in estimates of fulfilment cash flows relating to future service (consistent with general model), except
  - recognise in profit or loss those changes which arise as a result of changes in estimates of fulfilment cash flows of underlying direct insurance contract, and which are recognised immediately in P&L

Appendix

Transition

Applying IFRS 17 for the first time

	1 PV of future cash flows	2 Risk adjustment	3 Unearned profit
Existing contracts (issued before transition date)	✓ Usual IFRS 17 measurement	✓ Usual IFRS 17 measurement	× Transitional measures
New business (issued after transition date)	✓ Usual IFRS 17 measurement	✓ Usual IFRS 17 measurement	✓ Usual IFRS 17 measurement

Transitional measures

DETERMINE TRANSITION METHOD BY GROUP OF CONTRACTS

1 Full retrospective approach (apply IAS 8)

if impracticable

2 Modified retrospective approach

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

Insufficient reasonable and supportable information available

OR

3 Fair value approach

IFRS

IFRS 9 and insurance

	2017	2018	2019	2020	2021
Financial instruments	IAS 39	**IFRS 9**			
Insurance contracts	IFRS 4	IFRS 4 as amended in September 2016			**IFRS 17**

Overlay approach	Temporary exemption from IFRS 9
• Available to all issuers of insurance contracts	• Available to companies whose activities are predominantly connected with insurance (assessment at reporting entity level)
• Available until IFRS 17 is applied	• Available until 2021 (or until IFRS 17 is applied if that is earlier)
• Recognises in OCI, rather than P&L, the volatility that could arise when IFRS 9 is applied before IFRS 17 (for assets moved to FVPL)	• IAS 39 is applied rather than IFRS 9 • Additional disclosures are provided to enable some comparisons with companies applying IFRS 9