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IFRS 17
Pivoting towards implementation

Darrel Scott, Board Member
Iza Ruta, Technical Manager

Windsor, June 2017
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

<table>
<thead>
<tr>
<th>Lack of comparability among insurers</th>
<th>Non-uniform reporting within groups</th>
<th>Inconsistency with other industries</th>
<th>IFRS 17—a consistent framework</th>
</tr>
</thead>
</table>
| • IFRS companies report insurance contracts using different practices | • Insurance contracts of subsidiaries are consolidated using different practices | • Revenue include deposits  
• Revenue reported on a cash basis | • A new framework will replace huge variety of accounting treatments  
• Revenue will reflect the services provided, and exclude deposits, like any other industry |
### To improve financial information

<table>
<thead>
<tr>
<th>IFRS 4—little transparent or useful information</th>
<th>IFRS 17—more transparent and useful information</th>
</tr>
</thead>
</table>
| **Lack of useful information about insurance obligations** | • 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 |
| • Use of old or outdated assumptions  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 |  |
| **Lack of transparency about profitability** | • Unearned profit recognised as the insurance coverage is provided  
• Additional metrics to evaluate performance will be available |
| • Revenue recognised on a cash basis  
• Use of many non-GAAP measures |  |
More information than that provided by regulatory requirements alone

<table>
<thead>
<tr>
<th>Accounting frameworks — IFRS Standards</th>
<th>Primary objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Provide</td>
<td>• Provide</td>
</tr>
<tr>
<td>- useful information to investors and</td>
<td>- useful information to investors and analysts</td>
</tr>
<tr>
<td>analysts</td>
<td>- information on how a company earns profits</td>
</tr>
<tr>
<td>- information on how a company earns</td>
<td>- comparable information across IFRS</td>
</tr>
<tr>
<td>profits</td>
<td>jurisdictions</td>
</tr>
<tr>
<td>• comparable information across IFRS</td>
<td></td>
</tr>
<tr>
<td>jurisdictions</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Regulatory frameworks — Solvency II</th>
<th>Primary objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Protect customers</td>
<td>• Protect customers</td>
</tr>
<tr>
<td>• Ensure availability of insurance</td>
<td>• Ensure availability of insurance products</td>
</tr>
<tr>
<td>products</td>
<td>• Support economic stability within the</td>
</tr>
<tr>
<td>• Support economic stability within</td>
<td>European Union</td>
</tr>
<tr>
<td>the European Union</td>
<td></td>
</tr>
</tbody>
</table>
Understanding IFRS 17
How the model works
What is an insurance contract?

- Significant insurance risk
- Compensates on the occurrence of an insured event

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

Core requirements

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

Modifications to achieve IFRS 17’s fundamental objectives

Simplifications: premium allocation approach
# Regulatory reporting: similar insurance liability measurement

<table>
<thead>
<tr>
<th></th>
<th>IFRS 17</th>
<th>Solvency II</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash flows</strong></td>
<td>Similar</td>
<td>Similar</td>
</tr>
<tr>
<td><strong>Discount rates</strong></td>
<td>Liability-specific rate, market consistent</td>
<td>Swap rate until year 20 and Ultimate Forward Rate</td>
</tr>
<tr>
<td><strong>Risk</strong></td>
<td>Company’s own view of risk (possible use of Solvency II risk margin)</td>
<td>Prescribed approach (risk margin—cost of capital set at 6%)</td>
</tr>
<tr>
<td><strong>Unearned profit</strong></td>
<td>Recognised in P&amp;L over time</td>
<td>Fully included in equity at inception—day one gain</td>
</tr>
</tbody>
</table>
IFRS 17 provides information about long-term performance

**Solvency II**
- Assets
  - PV of cash flows
  - Risk margin
  - Equity (excess of assets over liabilities)

**IFRS Standards**
- Assets
  - PV of cash flows
  - Risk adjustment
  - Unearned profit
  - Equity

**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

<table>
<thead>
<tr>
<th>IFRS 4*</th>
<th>IFRS 17</th>
<th>Key changes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reinsurance contract assets</td>
<td>Reinsurance contract assets</td>
<td>- 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</td>
</tr>
<tr>
<td>Deferred acquisition costs</td>
<td>Insurance contract assets</td>
<td></td>
</tr>
<tr>
<td>Value of business acquired</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Premiums receivable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Policy loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance contracts liabilities</td>
<td>Insurance contract liabilities</td>
<td>- 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</td>
</tr>
<tr>
<td>Unearned premiums</td>
<td>Reinsurance contract liabilities</td>
<td></td>
</tr>
<tr>
<td>Claims payable</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(*) Common presentation in the balance sheet in applying IFRS 4
## Changes to financial performance presentation

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

(*) Common presentation in the balance sheet in applying IFRS 4
## Disclosures—overview

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

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

- **Balance sheet**

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurance contract liability</td>
<td>xx</td>
<td>xx</td>
</tr>
</tbody>
</table>

- **Notes to the financial statements**

**Reconciliation 1**

<table>
<thead>
<tr>
<th>Description</th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>PV of expected cash flows</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Risk adjustment</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Contractual service margin</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td><strong>Total insurance contract liability</strong></td>
<td>xx</td>
<td>xx</td>
</tr>
</tbody>
</table>

**Reconciliation 2**

<table>
<thead>
<tr>
<th>Description</th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liability for remaining coverage</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Liability for incurred claims</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td><strong>Total insurance contract liability</strong></td>
<td>xx</td>
<td>xx</td>
</tr>
</tbody>
</table>

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

**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

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

<table>
<thead>
<tr>
<th>Liabilities for remaining coverage</th>
<th>Excluding onerous contracts component</th>
<th>Onerous contracts component</th>
<th>Liabilities for incurred claims</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>BEGINNING OF PERIOD</td>
<td>161,938</td>
<td>15,859</td>
<td>1,021</td>
<td>178,818</td>
</tr>
<tr>
<td>Insurance revenue</td>
<td>(9,856)</td>
<td></td>
<td></td>
<td>(9,856)</td>
</tr>
<tr>
<td>Insurance service expenses</td>
<td>1,259</td>
<td>(623)</td>
<td>7,985</td>
<td>8,621</td>
</tr>
<tr>
<td>Investment components</td>
<td>(6,465)</td>
<td></td>
<td>6,465</td>
<td>0</td>
</tr>
<tr>
<td>Insurance service result</td>
<td>(15,062)</td>
<td>(623)</td>
<td>14,450</td>
<td>(1,235)</td>
</tr>
<tr>
<td>Insurance finance expenses</td>
<td>8,393</td>
<td>860</td>
<td>55</td>
<td>9,308</td>
</tr>
<tr>
<td>Total changes in P&amp;L and OCI</td>
<td>(6,669)</td>
<td>237</td>
<td>14,505</td>
<td>8,073</td>
</tr>
</tbody>
</table>

### Cash flows

- **Premiums received**: 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) (14,336) 18,833

**END OF PERIOD**: 188,438 16,096 1,190 205,724
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.
# IASB implementation support—overview

<table>
<thead>
<tr>
<th>May 2017</th>
<th>3.5 years</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Issue of IFRS 17</strong></td>
<td><strong>Support implementation</strong></td>
<td><strong>Mandatory effective date of IFRS 17</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>2017 - Early 2019</strong></td>
<td><strong>Late 2019</strong></td>
</tr>
<tr>
<td></td>
<td>Some entities begin implementation process</td>
<td>Entities are finalising implementation</td>
</tr>
<tr>
<td></td>
<td>General questions</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Contentious / specific implementation questions</td>
<td></td>
</tr>
<tr>
<td><strong>Objectives:</strong></td>
<td></td>
<td><strong>Objective:</strong> <strong>provide period of calm for implementation</strong></td>
</tr>
<tr>
<td><strong>Supporting materials:</strong></td>
<td></td>
<td><strong>Mostly monitor</strong></td>
</tr>
<tr>
<td>- articles</td>
<td>TRG, IFRS IC and/or Board discussions</td>
<td>Light touch on implementation / educational activities</td>
</tr>
</tbody>
</table>
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Appendix

Why has IFRS 17 been developed?
## Accounting policies used today

### Top-20 listed insurance companies using IFRS Standards

<table>
<thead>
<tr>
<th>Accounting policies applied to insurance contracts issued</th>
<th>Number of companies</th>
<th>Total assets (US$ trillions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Based on guidance in:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>. a mix of national GAAP*</td>
<td>8</td>
<td>4.1</td>
</tr>
<tr>
<td>. US GAAP</td>
<td>3</td>
<td>1.6</td>
</tr>
<tr>
<td>. Canadian GAAP</td>
<td>4</td>
<td>1.4</td>
</tr>
<tr>
<td>. other national GAAP</td>
<td>5</td>
<td>2.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>20</strong></td>
<td><strong>9.1</strong></td>
</tr>
</tbody>
</table>

* 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

<table>
<thead>
<tr>
<th>Discount rates used</th>
<th>Number of companies by region</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Asia Pacific</td>
<td>Canada</td>
</tr>
<tr>
<td>Current rates</td>
<td>11</td>
<td>7</td>
</tr>
<tr>
<td>Historical rates</td>
<td>6</td>
<td>-</td>
</tr>
<tr>
<td>Mix of rates</td>
<td>1</td>
<td>-</td>
</tr>
<tr>
<td>Sub-total</td>
<td>18</td>
<td>7</td>
</tr>
<tr>
<td>Information n.a.</td>
<td>6</td>
<td>-</td>
</tr>
<tr>
<td>Non-life business</td>
<td>11</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>35</td>
<td>9</td>
</tr>
</tbody>
</table>

Source: Effects Analysis on IFRS 17
Same company, different pictures

<table>
<thead>
<tr>
<th>(in millions of currency units)</th>
<th>Year 2</th>
<th>Year 1</th>
<th>Difference</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>GAAP 1</td>
<td>GAAP 2</td>
<td>GAAP 1</td>
<td>GAAP 2</td>
</tr>
<tr>
<td>Revenue</td>
<td>9,010</td>
<td>11,244</td>
<td>(2,234)</td>
<td>(2,716)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(25%)</td>
<td>(33%)</td>
</tr>
<tr>
<td>Operating income</td>
<td>1,606</td>
<td>748</td>
<td>858</td>
<td>783</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>53%</td>
<td>55%</td>
</tr>
<tr>
<td>Net income</td>
<td>1,256</td>
<td>452</td>
<td>804</td>
<td>628</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>64%</td>
<td>65%</td>
</tr>
<tr>
<td>Total equity</td>
<td>10,375</td>
<td>4,567</td>
<td>5,808</td>
<td>5,105</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>56%</td>
<td>57%</td>
</tr>
</tbody>
</table>

Source: Effects Analysis on IFRS 17
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
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)

Diagram:

- Premiums
  - Acquisition costs
  - Expenses
- Claims and benefits
  - Considering financial options and guarantees embedded in the contracts
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
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%

‘Top-down’ approach

1.0%

0.5%

0.5%

2.0%

‘Bottom-up’ approach

IFRS
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
Unearned profit—contractual service margin

- **Accretion of interest**
- **P&L**: Insurance finance expenses
- **Changes in estimates that relate to future service**
- **Recognition in P&L as insurance service is provided**
- **Insurance revenue**

- **Value of the new business**
- **CSM balance**
- **Remaining unearned profit**

- **Opening balance for group A**
- **Closing balance for group A**

- **Initial recognition**
- **Reporting period**
- **Reporting date**

---

**Unearned profit** refers to the earnings from insurance service provided, which are recognized in the P&L as insurance service is provided. The changes in estimates that relate to future service and insurance finance expenses also affect the unearned profit.
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
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
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

<table>
<thead>
<tr>
<th>Portfolio 1</th>
<th>Portfolio 2</th>
<th>Portfolio 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Whole-life insurance</td>
<td>Annuities</td>
<td>Car insurance</td>
</tr>
<tr>
<td>Group A</td>
<td>Group</td>
<td>Group AA</td>
</tr>
<tr>
<td>Group B</td>
<td>Group BB</td>
<td>Group BB</td>
</tr>
<tr>
<td>Group C</td>
<td>Group C</td>
<td>Group CC</td>
</tr>
<tr>
<td>Group D</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Portfolio 1</th>
<th>Entity divides each portfolio into groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>Whole-life insurance</td>
<td>contracts issued within the same year</td>
</tr>
<tr>
<td></td>
<td>information about the contracts’ resilience</td>
</tr>
<tr>
<td></td>
<td>consistent with internal reporting</td>
</tr>
<tr>
<td></td>
<td>exemption for regulatory pricing</td>
</tr>
<tr>
<td></td>
<td>group not reassessed after initial recognition</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Profitable contracts</th>
<th>Group A</th>
<th>Contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Group B</td>
<td>Unearned profit is recognised as part of the liability and is released as insurance services are provided</td>
</tr>
<tr>
<td></td>
<td>Group C</td>
<td>Other profitable contracts, if any</td>
</tr>
<tr>
<td>Onerous contracts</td>
<td>Group D</td>
<td>Contracts that are onerous at initial recognition, if any</td>
</tr>
<tr>
<td></td>
<td></td>
<td>A loss is recognised in P&amp;L</td>
</tr>
</tbody>
</table>
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
Snapshot of IFRS 17 models

Core requirements

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

Modifications to achieve IFRS 17’s fundamental objectives

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

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

= IFRS 17 liability

### Simplified measurement

- Split in three blocks not required

### 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

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

Modifications to achieve IFRS 17’s fundamental objectives

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

<table>
<thead>
<tr>
<th></th>
<th>PV of future cash flows</th>
<th>Risk adjustment</th>
<th>Unearned profit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Initial recognition</strong></td>
<td>✓ No difference</td>
<td>✓ No difference</td>
<td>✓ No difference</td>
</tr>
<tr>
<td><strong>Subsequently</strong></td>
<td>✓ No difference</td>
<td>✓ No difference</td>
<td>✗ Difference in how CSM is adjusted for changes in financial variables</td>
</tr>
</tbody>
</table>
CSM for direct participating features

Value of the new business

Changes in the variable fee

Recognition in P&L as insurance service is provided

Remaining unearned profit

Opening balance for group B

Closing balance for group B

Initial recognition

Reporting period

Reporting date
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
Reinsurance contracts held

- **Reinsurer**
  - Reinsurance contracts
  - Reinsurance premiums
  - Reimbursement based on claims and expenses

- **Entity (cedant)**
  - Underlying insurance contracts

- **Policyholders**
  - Insurance premiums
  - Compensation for claims
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
## Applying IFRS 17 for the first time

<table>
<thead>
<tr>
<th></th>
<th>PV of future cash flows</th>
<th>Risk adjustment</th>
<th>Unearned profit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Existing contracts</strong> (issued before transition date)</td>
<td>✓ Usual IFRS 17 measurement</td>
<td>✓ Usual IFRS 17 measurement</td>
<td>✗ Transitional measures</td>
</tr>
<tr>
<td><strong>New business</strong> (issued after transition date)</td>
<td>✓ Usual IFRS 17 measurement</td>
<td>✓ Usual IFRS 17 measurement</td>
<td>✓ Usual IFRS 17 measurement</td>
</tr>
</tbody>
</table>
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

3. Fair value approach

Insufficient reasonable and supportable information available
### IFRS 9 and insurance

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial instruments</strong></td>
<td>IAS 39</td>
<td></td>
<td></td>
<td>IFRS 9</td>
<td></td>
</tr>
<tr>
<td><strong>Insurance contracts</strong></td>
<td>IFRS 4</td>
<td>IFRS 4 as amended in September 2016</td>
<td>IFRS 17</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Overlay approach
- Available to all issuers of insurance contracts
- Available until IFRS 17 is applied
- 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)

#### Temporary exemption from IFRS 9
- Available to companies whose activities are predominantly connected with insurance (assessment at reporting entity level)
- Available until 2021 (or until IFRS 17 is applied if that is earlier)
- IAS 39 is applied rather than IFRS 9
- Additional disclosures are provided to enable some comparisons with companies applying IFRS 9