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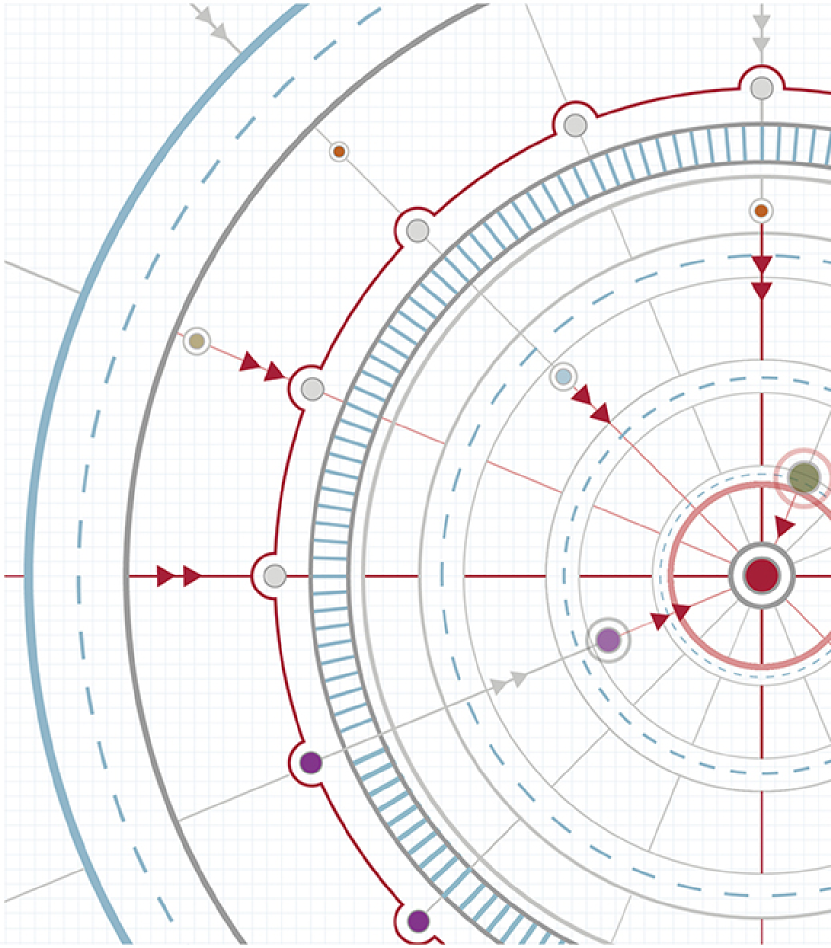

CMAC meeting, March 2017

Agenda paper 7

Insurance Contracts

Education session

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.

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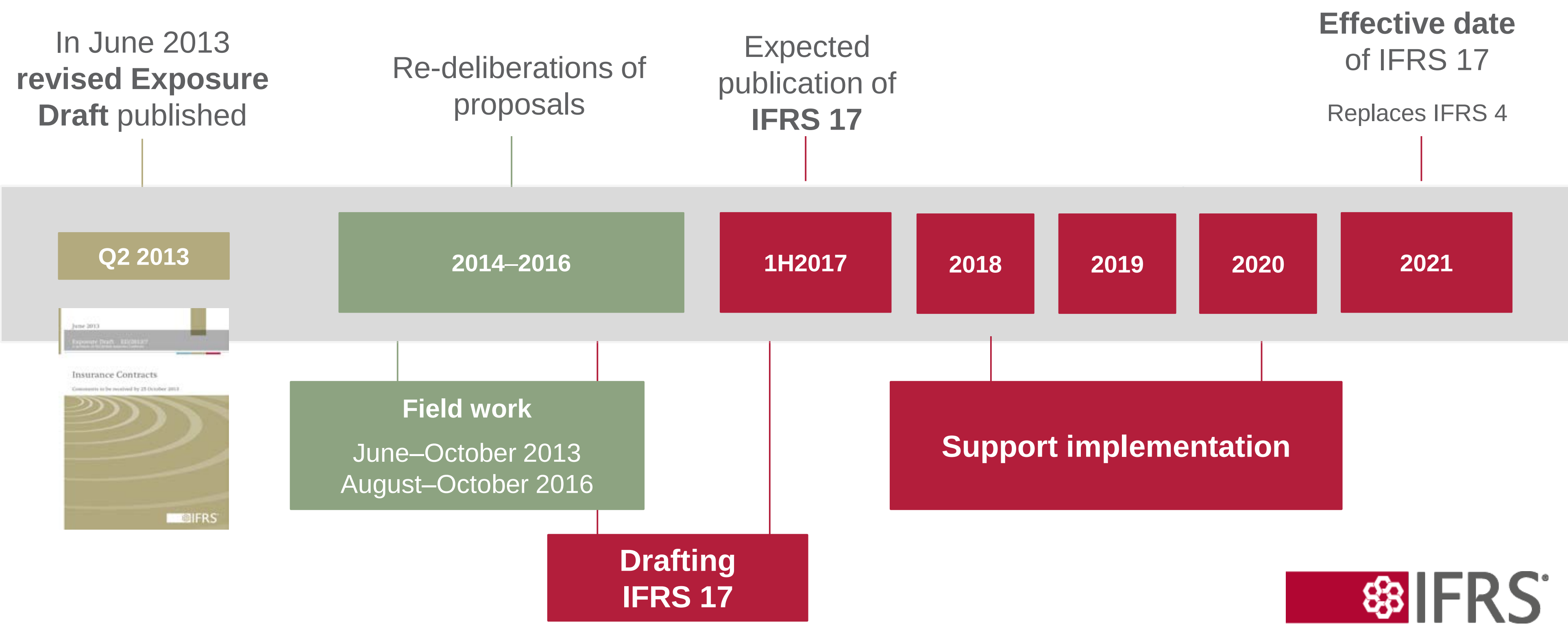
Where we are

- The Board plans to issue IFRS 17 in May 2017
- Effective date 1 January 2021
- More than 3 years to implement the new requirements



Agenda

- Why IFRS 17 has been developed and issues that it will fix
- The new approach and what it means
- What will change on a company’s financial statements
- Contracts and companies that are less and more affected
- Key implications for investors

Why change the accounting?

The need for change

Why change the accounting?

1—To improved comparability

Today wide variety of practices to account for insurance contracts

Issues today	Solution / Benefits
Lack of comparability between 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

Why change the accounting?

2—To improve quality of financial information

Today lack of relevant and transparent information

Issues today	Solution / Benefits
Lack of useful information • Use of old or outdated assumptions • Options and guarantees not fully reflected in measurement of insurance contracts • Use of ‘expected return on assets held’ as discount rate	• Insurance contracts will be measured using current assumptions and will reflect options and guarantees • Discount rate will reflect characteristics of the insurance contract - risks not matched by assets will be reflected in the accounts
Lack of transparency about profitability • Profits recognised on a cash basis • Use of many non-GAAP measures	• The unearned profit will be recognised as the insurance coverage is provided • Additional metrics to evaluate performance will be available

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The new requirements

Overview

The new approach

- All insurance contracts measured as the sum of:
  - **Fulfilment cash flows** (updated at each reporting date)
    - The 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
- Profits are recognised over time as insurance services are provided
- Losses are recognised immediately when expected
- Insurance contracts are aggregated in groups for measurement

Groups of contracts

<table>
<tr><th rowspan="3">Portfolios of contracts</th><th colspan="4">At inception</th></tr>
<tr><td>❶ Onerous contracts</td><td colspan="3">A loss is recognised in P/L</td></tr>
<tr><td rowspan="2">❷ Non-onerous contracts</td><td>⇨</td><td>Contracts that have no significant possibility of becoming onerous subsequently</td><td rowspan="2">Unearned profit is recognised as liability and is released as insurance services are provided</td></tr>
<tr><td></td><td>⇨</td><td>Other profitable contracts</td></tr>
</table>

A **portfolio** includes contracts:

1) subject to similar risks (eg contracts in a product line, such as annuities and whole-life); and
2) managed together as a single pool.

Only contracts that are issued within 12 months can be included in the same group

Dealing with changes

- Fulfilment cash flows are updated each reported period

- Changes in estimates of future cash flows:
  - If related to past coverage → P/L
  - If related to future coverage → adjust unearned profit

- Changes in financial market assumptions (eg interest rates)
  - Accounting policy choice for presentation of insurance finance expense:
    - (i) in P/L or
    - (ii) disaggregated in P/L and OCI

Simplified approach and variable fee approach

- Optional simplified ‘premium-allocation approach’ for short-term contracts
  - Similar outcome but no separate identification of unearned profit
  - Discounting of liability for incurred claims not required if expected to be settled within 12 months
- ‘Variable fee approach’ for ‘contracts with direct participation features’
  - The insurer’s share of income from underlying items adjusts unearned profit
    - Treated as a “variable fee” for investment management services

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 contracts liabilities	
Unearned premiums	Reinsurance contracts liabilities	
Claims payable		

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

Reporting performance

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

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

Disclosures

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

Disclosures—reconciliations

- **Balance sheet**

	20X1	20X0
Insurance contract liability	xx	xx

- **Notes to the financial statements**

Reconciliation 1	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

Reconciliation 2	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

Applying IFRS 17 for the first time

DECIDE TRANSITION METHOD BY GROUP OF CONTRACTS

Full retrospective approach (apply IAS 8)

if impracticable

Modified retrospective approach

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

if impracticable

OR

Fair value approach

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

Likely effects of the new Standard

Contracts and companies affected

What does this change mean for short-term contracts?

	New requirements	Expected effects
Short-term contracts / Property and casualty	• Simplified approach available for contracts with coverage period of one year or less	• No significant change • Need to consider discounting and apply a risk adjustment for incurred claims

What does this change mean for long-term contracts?

	New requirements	Expected effects
Long-term contracts / Life products	• Single accounting model	• Same approach for all products increasing comparability by companies and by jurisdictions
	• Deposit components excluded from P/L	• Insurance contracts with investment components on the same playing field as investment contracts
	• Options and guarantees are reflected in the measurement of contracts	• Current value of insurance contracts reflected in the accounts
	• Estimates are updated regularly	• Actual financial position of insurers (and risks) reflected in the accounts

How will companies be affected?

Multi-national groups applying IFRS Standards		• Harmonisation of accounting policies
Companies issuing long-term / life insurance contracts		• Changes in insurance contract liabilities for companies that did not fully consider (i) options and guarantees (ii) current assumptions • Significant reduction in revenue and expenses for companies that reported premiums as revenue and cash surrenders as expenses
Non-life companies with short-term contacts		• No significant change in revenue • Liabilities for claims discounted • Explicit risk adjustment added

Key implications for investors

Key implications for investors

- Consistent information for all insurers and all insurance contracts
- Current measurement model will make visible any improvement or deterioration in risks on a timely basis (eg changes in interest rates)
- Additional metrics to evaluate performance (eg information about current and future profitability)
- No loss of trend information (eg written premiums will be available in the notes)
- Disclosures available to assess effects of transition options

For more information…

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Web resources

- Project podcasts and webcasts
- Article ‘the need for change’
- IASB® *Update*
- Investor resources
- High-level summary of the project

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