

Project Insurance Contracts

Paper topic Example of investor handout on IFRS 17 *Insurance Contracts*

CONTACT(S)	Frederick Nieto	fnieto@ifrs.org	+44 (0) 20 7246 6956
	Roberta Ravelli	rravelli@ifrs.org	+44 (0) 20 7246 6935

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IFRS 17 *Insurance Contracts*

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IFRS 17 Insurance Contracts



- IFRS 17 issued on 18 May 2017
 - replaces an interim Standard—IFRS 4
 - requires **consistent accounting** for all insurance contracts, based on a **current measurement** model
 - will provide useful information about **profitability** of insurance contracts
- Effective on **2021**
 - early application permitted
 - one year comparative information

Why has IFRS 17 been developed?

Economics of business poorly depicted

- Lacking relevant and transparent information from some accounting today

Issues today	How this undermines analysis
Lack of useful information <ul style="list-style-type: none">• Use of old or outdated assumptions• Options and guarantees not fully reflected in measurement of insurance contracts• Use of 'expected return on assets held' as discount rate	<ul style="list-style-type: none">• Fundamental economics are not necessarily reflected in the reported IFRS numbers
Lack of transparency about profitability <ul style="list-style-type: none">• Profits recognised at different points• Use of many non-GAAP measures	<ul style="list-style-type: none">• Comparing companies by source of profitability is a needlessly difficult task

- Lack of comparability today is a multi-level problem

Issues today	Solution / Benefits
Lack of comparability among insurers <ul style="list-style-type: none">• IFRS companies report insurance contracts using different practices Non-uniform reporting within groups <ul style="list-style-type: none">• Insurance contracts of subsidiaries are consolidated using different practices	<ul style="list-style-type: none">• New framework will replace huge variety of accounting treatments
Inconsistency with other industries <ul style="list-style-type: none">• Revenue include deposits• Revenue reported on a cash basis	<ul style="list-style-type: none">• Revenue will reflect the services provided, and exclude deposits, like any other industry

Typical existing Income Statement

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P&L	20X1	20X0
Gross premiums	16,321	13,567
Premiums ceded to reinsurers	(816)	(678)
Investment income	9,902	9,030
Total income	25,407	21,919
Gross claims, benefits and expenses	(13,827)	(12,012)
Claims and expenses ceded to reinsurers	368	351
Acquisition costs amortisation	(1,259)	(1,150)
Change in insurance contract liabilities	(9,308)	(8,377)
Total expenses	(24,026)	(21,188)
Profit before tax	1,381	731

➔ Cash based and includes collection of deposits.
Inconsistent with other industries

➔ Includes repayment of deposits

➔ Confusing adjustment that incorporates multiple factors

➔ Inconsistent measurement reduces comparability

‘Source of earnings’ difficult to identify

Typical existing Balance Sheet

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Balance sheet	20X1	20X0
Financial assets	226,297	196,700
Deferred acquisition costs	8,083	8,941
Premiums receivable	2,798	2,582
Reinsurance contract assets	20,572	17,882
Other assets	36,002	31,293
Total assets	293,752	257,398
Insurance contract liabilities	211,010	185,545
Unearned premiums	5,595	4,796
Other liabilities	51,431	44,705
Equity	25,716	22,352
Total liabilities and equity	293,752	257,398

**Multiple line items, inconsistent terminology
and inconsistent measurement, difficult to
understand changes**

Understanding IFRS 17

IFRS 17 Income Statement

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P&L	20X1	20X0
Insurance revenue	9,856	8,567
Insurance service expenses	(9,069)	(8,489)
<i>Incurred claims and insurance contract expenses</i>	<i>(7,362)</i>	<i>(7,012)</i>
<i>Insurance contract acquisition costs</i>	<i>(1,259)</i>	<i>(1,150)</i>
Insurance service result before reinsurance [^]	1,235	405
<i>Gain or (loss) from reinsurance</i>	<i>(448)</i>	<i>(327)</i>
Insurance service result	787	78
Investment income	9,902	9,030
Insurance finance expenses	(9,308)	(8,377)
Net financial result	594	653
Profit before tax	1,381	731

[^] Sub-total not required – presented here to reconcile with numbers presented in next slides

Richer information content
With amounts that will be more relevant and
more comparable



IFRS 17 Balance Sheet

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Balance sheet	20X1	20X0
Financial assets [#]	226,297	196,700
Reinsurance contract assets [*]	20,572	17,882
Other assets	36,002	31,293
Total assets	282,871	245,875
Insurance contract liabilities ^{**}	205,724	178,818
Other liabilities	51,431	44,705
Equity	25,716	22,352
Total liabilities and equity	282,871	245,875

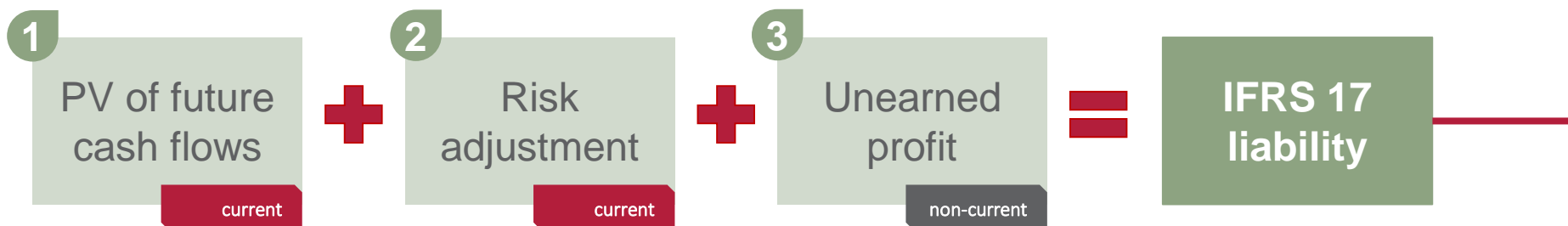
IFRS 17 does not affect the measurement of financial assets as they are measured applying IFRS 9

* Groups of insurance and reinsurance contracts in an asset position presented separately from those in a liability position

** Acquisition cost cash flows, premiums receivable and unearned premiums are included in the measurement of insurance contracts

Measuring insurance liabilities

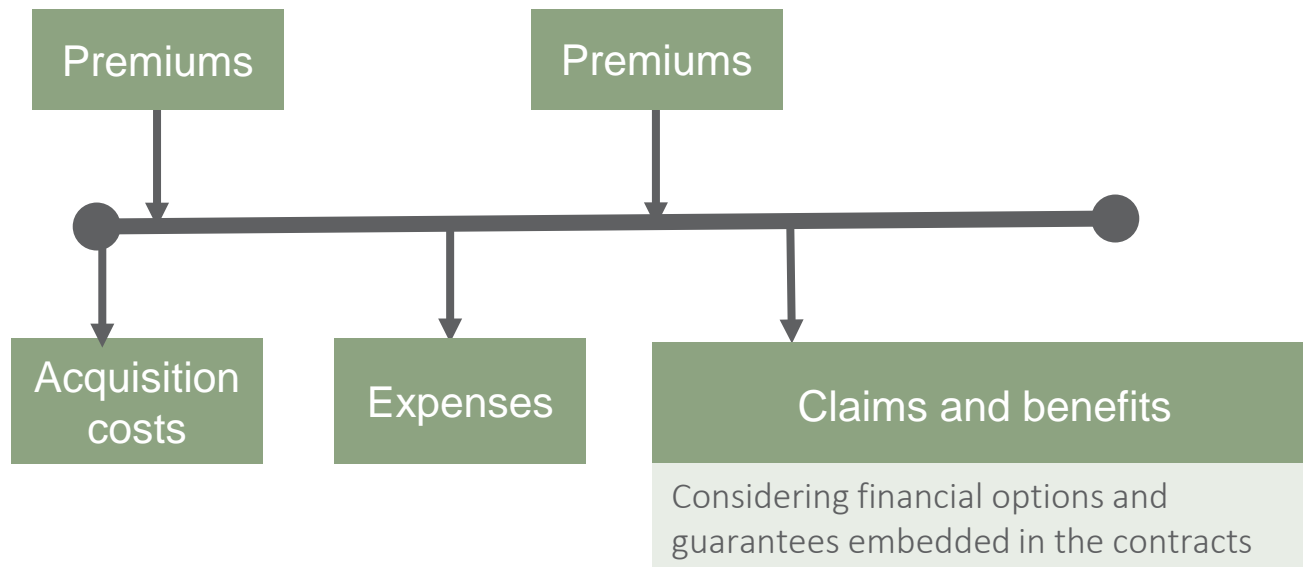
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Balance sheet	20X1	20X0
Financial assets	226,297	196,700
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Insurance contract liabilities	205,724	178,818
Other liabilities	51,431	44,705
Equity	25,716	22,352
Total liabilities and equity	282,871	245,875

1 Future cash flows

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



- Current market-consistent discount rates relevant to the liability
- Return premium on assets included only to the extent that the liability cash flows are themselves linked to those assets
- Disclosures about the rates used and the judgements made by the company

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%

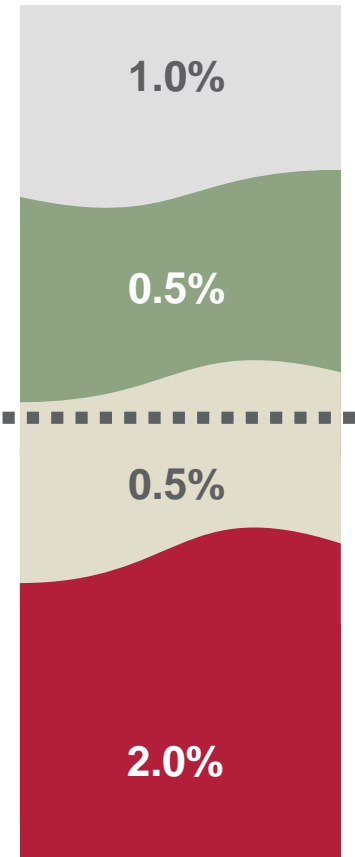
Liquidity premium of 0.5%

Risk-free rate of return of 2%

'Top-down'
approach



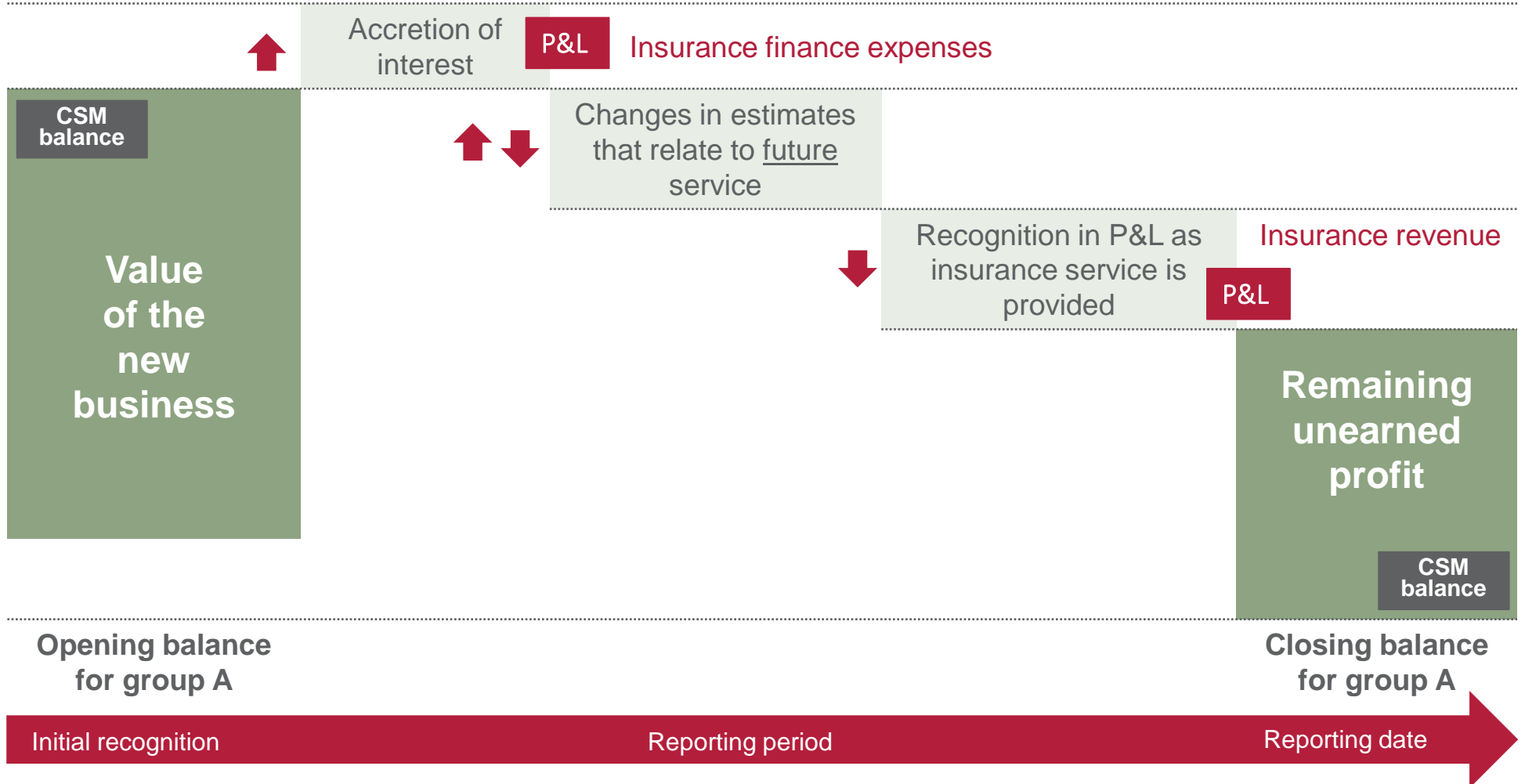
'Bottom-up'
approach



2 Risk adjustment

- Explicit adjustment for the compensation a company requires for bearing insurance risk
 - No more implicit risk adjustments to expected cash flows and lack of transparency regarding ‘reserve releases’
- Part of total unearned profit
 - Recognised in P&L as the company is released from risk

3 Contractual Service Margin



Insurance contract liability roll forward

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	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
<i>Changes related to:</i>				
① - Future service yet to be provided	(784)	1,117	(116)	217
② - Current service provided in the period	35	(604)	(923)	(1,492)
③ - Past service adjustment to past claims	47	(7)	-	40
Insurance service result [^]	(702)	506	(1,039)	(1,235)
④ Insurance finance expenses ¹	9,087	-	221	9,308
TOTAL CHANGES IN P&L ¹	8,385	506	(818)	8,073
⑤ CASH FLOWS	18,833	-	-	18,833
END OF PERIOD	191,180	6,504	8,040	205,724

[^] Excl. the effects of reinsurance

¹ Some insurance finance expenses may be presented in Other Comprehensive Income—see later

1 Future service—incl. new business

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	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
<i>Changes related to:</i>				
- <i>Future service yet to be provided*</i>	(784)	1,117	(116)	217
<i>New profitable contracts recognised</i>	(2,344)	969	1,375	-
<i>Estimate changes - profitable contracts</i>	1,452	39	(1,491)	-
<i>New onerous contracts recognised</i>	15	108	-	123
<i>Estimate changes - onerous contracts</i>	93	1	-	94
- <i>Current service provided in the period</i>	35	(604)	(923)	(1,492)
- <i>Past service – adjustment to past claims</i>	47	(7)	-	40
Insurance service result[^]	(702)	506	(1,039)	(1,235)

Etc ... * Note: Positive number in total column = increase in liability = loss in P&L

[^] Excl. the effects of reinsurance

2 Current service—profit recognised

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	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
<i>Changes related to:</i>				
- Future service yet to be provided	(784)	1,117	(116)	217
- Current service provided in the period	35	(604)	(923)	(1,492)
<i>Contractual service margin earned</i>			(923)	(923)
<i>Release from risk</i>		(604)		(604)
<i>Experience loss</i>	35			35
- Past service – adjustment to past claims	47	(7)	-	40
Insurance service result [^]	(702)	506	(1,039)	(1,235)

Etc ... [^] Excl. the effects of reinsurance

3 Past service—adjusting past claims

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	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
<i>Changes related to:</i>				
- 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)

Etc ... [^] Excl. the effects of reinsurance

4 Insurance finance expenses

- Discount unwind plus effect of changes in discount rates and other financial assumptions
- Recognise as gain or loss in period; option to present part in OCI

	Estimates of the present value of future cash flows	Risk adjustment	Contractual service margin	Liability
Etc ...				
Insurance finance expenses	9,087	-	221	9,308
<i>Accretion at historical rate* – P&L</i>	<i>7,170</i>	-	<i>221</i>	<i>7,391</i>
<i>Assumption changes (P&L or OCI)</i>	<i>1,917</i>	-	<i>- **</i>	<i>1,917</i>

Etc ...

* Systematic allocation of finance cost using ‘locked-rate’ accretion applies to non-par, for par contracts the allocation allows for participation effects

** CSM adjusted for ‘variable fee’ effect for some par contracts

5 Cash flows

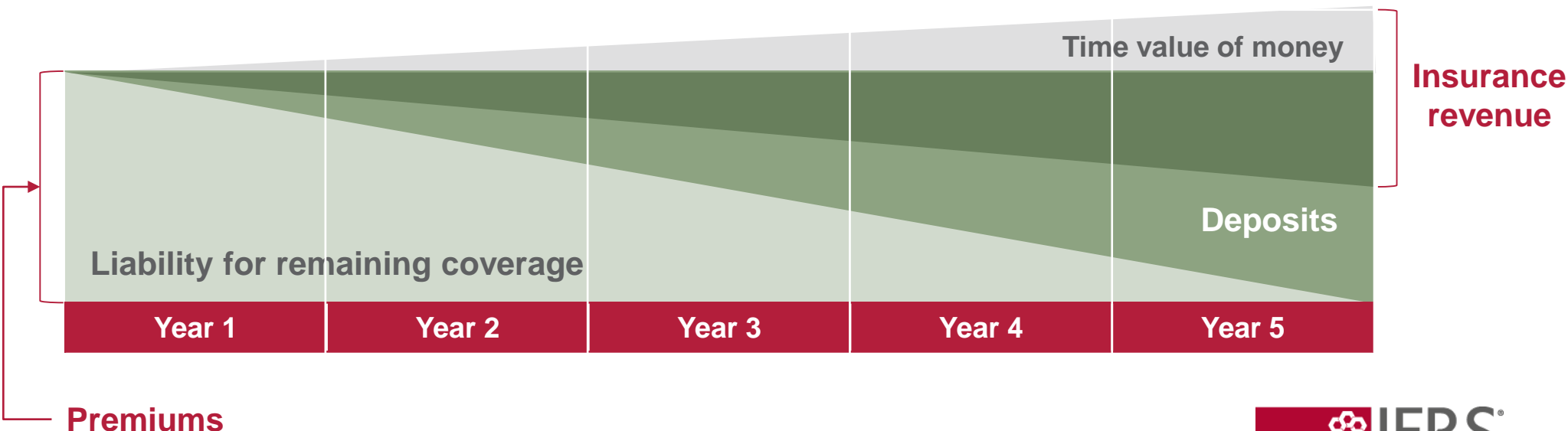
- Gross premiums received still reported as part of the liability roll-forward
 - But not in profit and loss as ‘revenue’

	Estimates of the present value of future cash flows	Risk adjustment	Contractual service margin	Liability
Etc ...				
Cash flows	18,833			18,833
<i>Premiums received</i>	33,570			33,570
<i>Claims, benefits and other expenses paid</i>	(14,336)			(14,336)
<i>Insurance acquisition cash flows</i>	(401)			(401)
END OF PERIOD	191,180	6,504	8,040	205,724

- The insurance service reflects changes in the insurance liability (CSM release etc.)
- BUT presented in P&L as ...
 - Insurance revenue, less
 - Insurance service expenses
- Requires the total insurance liability to be split into ...
 - Liability for remaining coverage
 - With separate identification of that related to onerous contracts
 - Liability for incurred claims

**A familiar approach for non-par at present –
now applicable to all insurance contracts**

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



Revenue and expenses reconciliation

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	Liabilities for remaining coverage		Liabilities for incurred claims	Total
	Excluding onerous contracts component	Onerous contracts component		
Insurance contract liabilities 20X0	161,938	15,859	1,021	178,818
Insurance revenue*	(9,856)			(9,856)
Insurance service expenses				
Claims incurred in the period			7,985	7,985
Onerous contracts losses and (reversals)		(623)		(623)
Insurance acquisition costs expensed*	1,259			1,259
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 the statement of comprehensive income	(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
Insurance contract liabilities 20X1	188,438	16,096	1,190	205,724

[^] Excl. the effects of reinsurance

* Insurance revenue includes recovery of insurance acquisition costs

Transition

Applying IFRS 17 for the first time

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	1 PV of future cash flows	2 Risk adjustment	3 Unearned profit
Existing contracts (eg contracts written before 2020)	✓ Usual IFRS 17 measurement	✓ Usual IFRS 17 measurement	✗ Transitional measures
New business (eg contracts written after 2020)	✓ Usual IFRS 17 measurement	✓ Usual IFRS 17 measurement	✓ Usual IFRS 17 measurement

- Transitional measures (by group of contracts)
 - Full retrospective approach
 - Modified retrospective approach—proxy of full retrospective approach
 - Fair value approach
- Separate disclosures for each transition method



Summary of benefits of IFRS 17

Summary: the benefits of IFRS 17

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- Global comparability for the first time
- Relevant and updated measurement of liabilities
- Financial risks and economic mismatches revealed
- Source of earnings approach to performance
- Value of new business integrated with the accounting
- Enhanced disclosure and greater transparency
- Existing KPIs remain, but more relevant and comparable
- New KPIs available
- Intuitive accounting that will be more understandable

**IFRS 17: a game changer for the
global insurance industry?**

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