

# Preview of IFRS 17 *Insurance Contracts*

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- Why has IFRS 17 been developed
- How IFRS 17 works
- What this means for investors
  
- Appendix—some additional features
  - Reinsurance
  - Simplified approach for short-term contracts
  - Adjustments applicable to contracts with a ‘variable fee’

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• Use of old or outdated assumptions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

- Lack of comparability today is a multi-level problem

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

# Typical existing Income Statement

P&L	20X1	20X0	
Gross premiums	16,321	13,567	→ Cash based and includes collection of deposits. Inconsistent with other industries
Premiums ceded to reinsurers	(816)	(678)	
Investment income	9,902	9,030	
<b>Total income</b>	<b>25,407</b>	<b>21,919</b>	
Gross claims, benefits and expenses	(13,827)	(12,012)	→ Includes repayment of deposits
Claims and expenses ceded to reinsurers	368	351	
Acquisition costs amortisation	(1,259)	(1,150)	
Change in insurance contract liabilities	(9,308)	(8,377)	→ Confusing adjustment that incorporates multiple factors
<b>Total expenses</b>	<b>(24,026)</b>	<b>(21,188)</b>	
<b>Profit before tax</b>	<b>1,381</b>	<b>731</b>	→ Inconsistent measurement reduces comparability

**‘Source of earnings’ difficult to identify**

# Typical existing Balance Sheet

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
<b>Total assets</b>	<b>293,752</b>	<b>257,398</b>
Insurance contract liabilities	211,010	185,545
Unearned premiums	5,595	4,796
Other liabilities	51,431	44,705
Equity	25,716	22,352
<b>Total liabilities and equity</b>	<b>293,752</b>	<b>257,398</b>

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

# Understanding IFRS 17

# IFRS 17 Income Statement

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>
<i>Gain or (loss) from reinsurance</i>	<i>(448)</i>	<i>(327)</i>
<b>Insurance service result</b>	<b>787</b>	<b>78</b>
Investment income	9,902	9,030
Insurance finance expenses	(9,308)	(8,377)
<b>Net financial result</b>	<b>594</b>	<b>653</b>
<b>Profit before tax</b>	<b>1,381</b>	<b>731</b>

**Richer information content**

**With amounts that will be more relevant and  
more comparable**

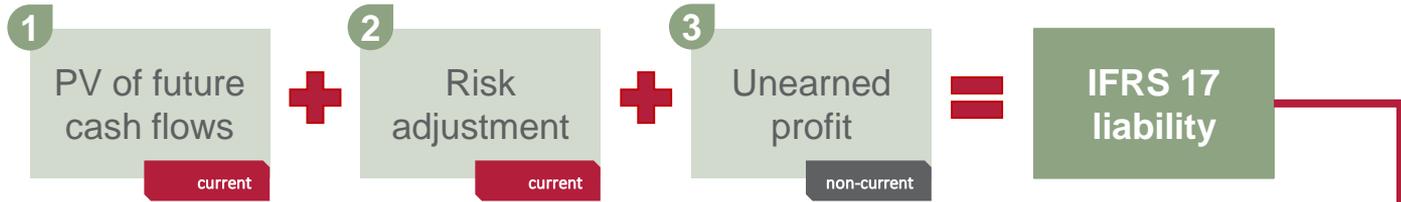
# IFRS 17 Balance Sheet

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

\* 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

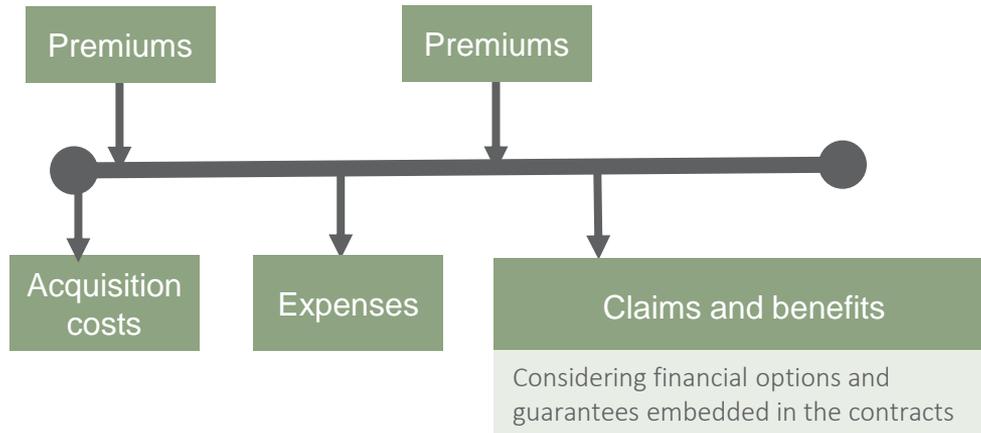
# Measuring insurance liabilities



Balance sheet	20X1	20X0
Financial assets	226,297	196,700
Reinsurance contract assets	20,572	17,882
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<b>Total assets</b>	<b>282,871</b>	<b>245,875</b>
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# 1 Future cash flows

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



# 1 Discount rates

- 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

## 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

- Unearned risk-adjusted expected profit
  - New CSM in the period = risk-adjusted value of new business
  - Unearned CSM adjusted where assumptions change
- CSM released to P&L as insurance services are provided over the coverage period
  - No day 1 profit
- If the CSM would be negative → onerous contracts
  - Onerous contract loss recognised immediately and subsequently adjusted

# Liability roll forward 1

	Estimates of the present value of future cash flows	Risk adjustment	Contractual service margin	Total
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 <sup>^</sup>	(702)	506	(1,039)	(1,235)
④ Insurance finance expenses <sup>1</sup>	9,087	-	221	9,308
TOTAL CHANGES IN P&L <sup>1</sup>	8,385	506	(818)	8,073
⑤ CASH FLOWS	18,833	-	-	18,833
END OF PERIOD	191,180	6,504	8,040	205,724

<sup>^</sup> Excl. the effects of reinsurance

<sup>1</sup> 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	Total
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
<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
- Current service provided in the period	35	(604)	(923)	(1,492)
- Past service – adjustment to past claims	47	(7)	-	40
<b>Insurance service result<sup>^</sup></b>	<b>(702)</b>	<b>506</b>	<b>(1,039)</b>	<b>(1,235)</b>

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

<sup>^</sup> 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	Total
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)
Contractual service margin earned			(923)	(923)
Release from risk		(604)		(604)
Experience loss	35			35
- Past service – adjustment to past claims	47	(7)	-	40
Insurance service result <sup>^</sup>	(702)	506	(1,039)	(1,235)

Etc ... <sup>^</sup> Excl. the effects of reinsurance

### 3 Past service—adjusting past claims

	Estimates of the present value of future cash flows	Risk adjustment	Contractual service margin	Total
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 <sup>^</sup>	(702)	506	(1,039)	(1,235)

Etc ... <sup>^</sup> 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	Insurance contract liabilities
Etc ...				
Insurance finance expenses	9,087	-	221	9,308
<i>Accretion at historical rate* – P&amp;L</i>	<i>7,170</i>	-	<i>221</i>	<i>7,391</i>
<i>Assumption changes (P&amp;L or OCI)</i>	<i>1,917</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 certain par contracts

## 5 Cash flows

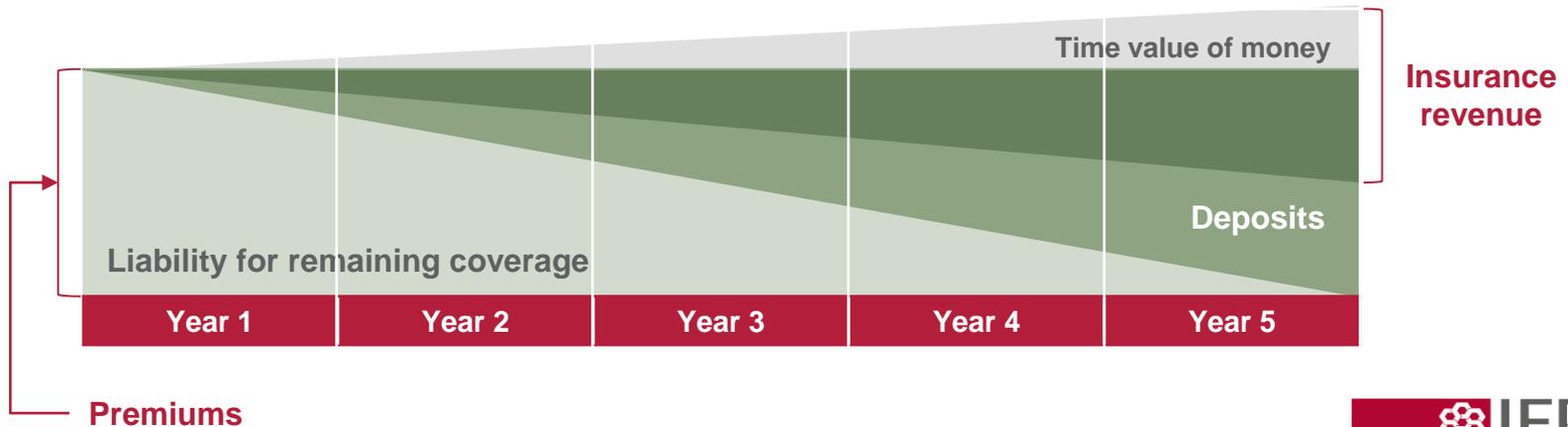
- Gross premiums received still reported as part of the liability roll-forward
  - But not in profit and loss as ‘revenue’

Etc ...	Estimates of the present value of future cash flows	Risk adjustment	Contractual service margin	Insurance contract liabilities
<b>Cash flows</b>	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)
<b>END OF PERIOD</b>	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



# Liability roll forward 2

	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
<b>Insurance revenue*</b>	(9,856)			(9,856)
<b>Insurance service expenses</b>				
Claims incurred in the period			7,985	7,985
Onerous contracts losses and (reversals)		(623)		(623)
Insurance acquisition costs expensed*	1,259			1,259
<b>Investment components</b>	(6,465)		6,465	0
Insurance service result <sup>^</sup>	(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
<b>Cash flows</b>				
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

<sup>^</sup> Excl. the effects of reinsurance

\* Insurance revenue includes recovery of insurance acquisition costs

# 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
- Intuitive accounting that will be more understandable

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



# Appendix

Some of the detail

# Reinsurance

P&L	20X1	20X0
Insurance revenue	9,856	8,567
Insurance service expenses	(9,069)	(8,489)
<i>Incurring claims and insurance contract expenses</i>	(7,362)	(7,012)
<i>Insurance contract acquisition costs</i>	(1,259)	(1,150)
<i>Gain or (loss) from reinsurance</i>	(448)	(327)
<b>Insurance service result</b>	<b>787</b>	<b>78</b>

Similar accounting but in reverse

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Separate roll forward provided

- Simplified ‘premium allocation approach’ option for many short term non-par contracts
- Key difference compared with above...
  - Liability for remaining coverage not analysed into cash flows, risk and unearned profit
  - Short term nature means analysis of unearned profit and new business less important
- For many non-life businesses IFRS 17 will not produce fundamental change
  - Except that the application of the PAA will be more consistent

# Additional CSM adj. for some contracts

- ‘Variable fee’ approach applicable to contracts with ‘direct participation features’
- CSM balance adjusted for the shareholders’ share of the change in underlying items
  - In effect a remeasurement of CSM for changes in financial variables (in addition to the non-financial variables applicable to all contracts)
  - Change in value of options and guarantees adjusts CSM and hence future release of CSM
- Does not affect the structure of P&L or roll forwards, just the numbers

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