Society of Actuaries in Ireland

IFRS 17 – where to from here?

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Disclaimer

The views expressed in this presentation are those of the presenter(s) and not necessarily those of the Society of Actuaries in Ireland or their employers.

Introduction

- Recap on latest developments and next steps
- Deep dive into “Transition”
- Practical issues to consider with implementation

Proposed amendments to IFRS 17

1	Deferral of the effective date by one year (IFRS 17 and IFRS 9)
2	CSM release for investment services under the General Model
3	Acquisition cash flows for expected future renewals
4	Mismatches arising from reinsurance held on onerous underlying contracts
5	Changes to the transition requirements
6	Excluding credit cards and loans with a transfer of insurance risk from scope
7	Allowance of reinsurance held as a risk mitigation option
8	Changes to the level of aggregation for reporting purposes

3 Acquisition cash flows for expected future renewals

Issues raised by the industry

- Commissions paid unconditionally on contracts that have been issued are not able to be allocated to expected future renewals
- Commissions can exceed the initial premium resulting in onerous contracts
- This does not reflect the economics of the contract and is inconsistent with the treatment of similar contracts under IFRS 15

Discussion points

- There is an economic exposure if the commission is paid unconditionally
- Expected renewals are outside the contract boundary
- This is consistent treatment with loss-leading contracts

IASB decision

- Extend Paragraph 27 to also apply to unconditional commissions
- Requires an impairment test to ensure the acquisition costs asset is supported by sufficient renewals

4 Mismatches arising from reinsurance held on onerous underlying contracts

Issues raised by the industry

- Where an group of insurance contracts are onerous at initial recognition they are recognised as a loss in the P&L
- Where such contracts are reinsured, any gain on the reinsurance contract is recognised over the coverage period of the reinsurance contract
- Mismatches arise as a result

Discussion points

- Changes to the treatment of reinsurance contracts held could lead to disruption of implementation projects
- Paragraph 66(c)(ii) allows an insurer to recognise an offsetting profit from a reinsurance contract should the underlying contracts become onerous after initial recognition

IASB decision

- Extend Paragraph 66(c)(ii) to allow the same offset for underlying contracts that are onerous at outset, for proportional reinsurance contracts only
- Only applies in the reinsurance contract was entered into at the same time, or prior, to the underlying contracts

7 Allowance of reinsurance held as a risk mitigation option

Issues raised by the industry

- Entities may use derivatives or reinsurance contracts to mitigate the financial risk associated with contracts with direct participation features
- Reinsurance contracts held (or issued) are specifically excluded from the scope of the variable fee approach
- Risk mitigation option applies for entities that have used derivatives but it does not apply for reinsurance contracts held

Discussion points

- The scope of the variable fee approach could be extended to allow its application to reinsurance contracts or the risk mitigation option could be extended
- Reinsurance contracts held/issued do not meet the requirements of the variable fee approach

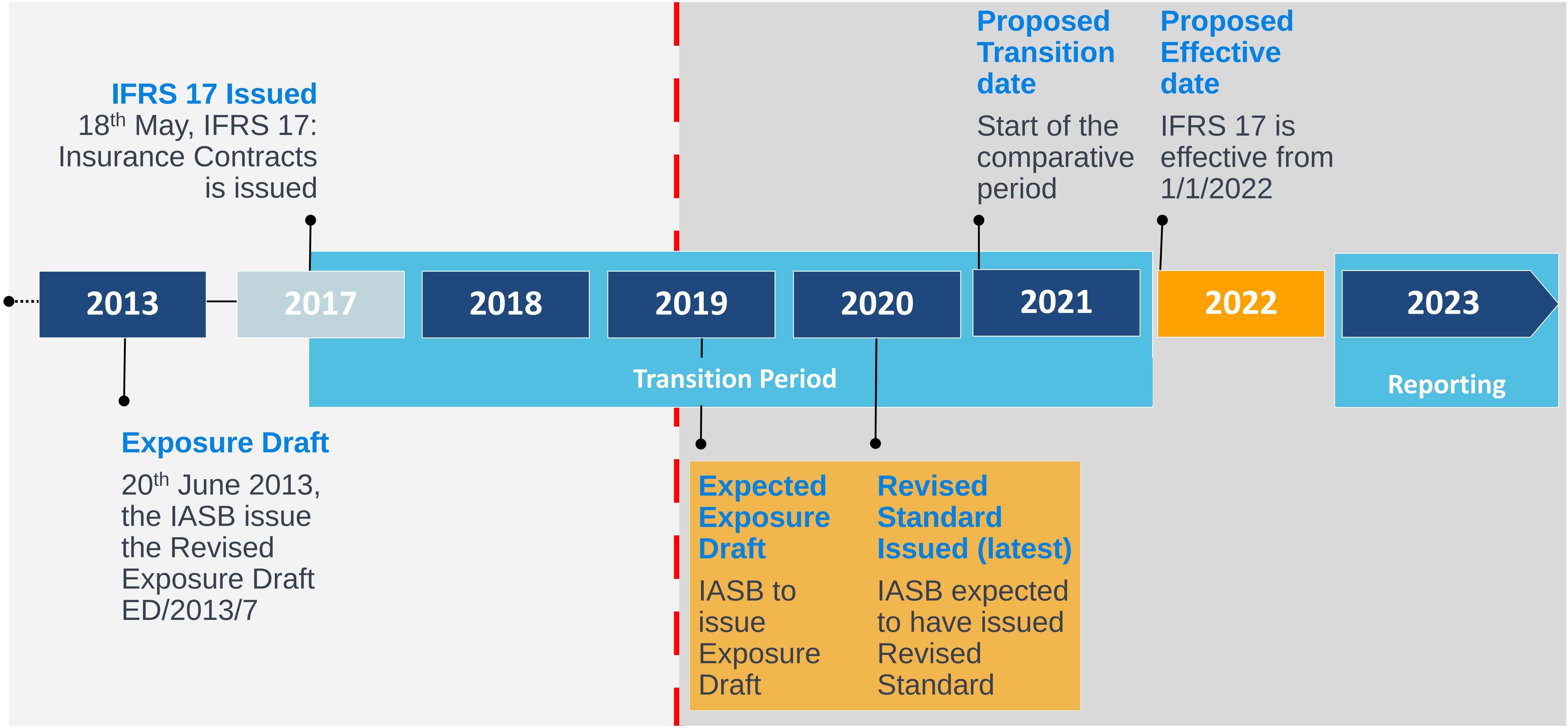
IASB decision

- For contracts with direct participation features, the risk mitigation option can be extended to include reinsurance contracts held that mitigate financial risks

Industry perspective - CFO Forum presentation to EFRAG

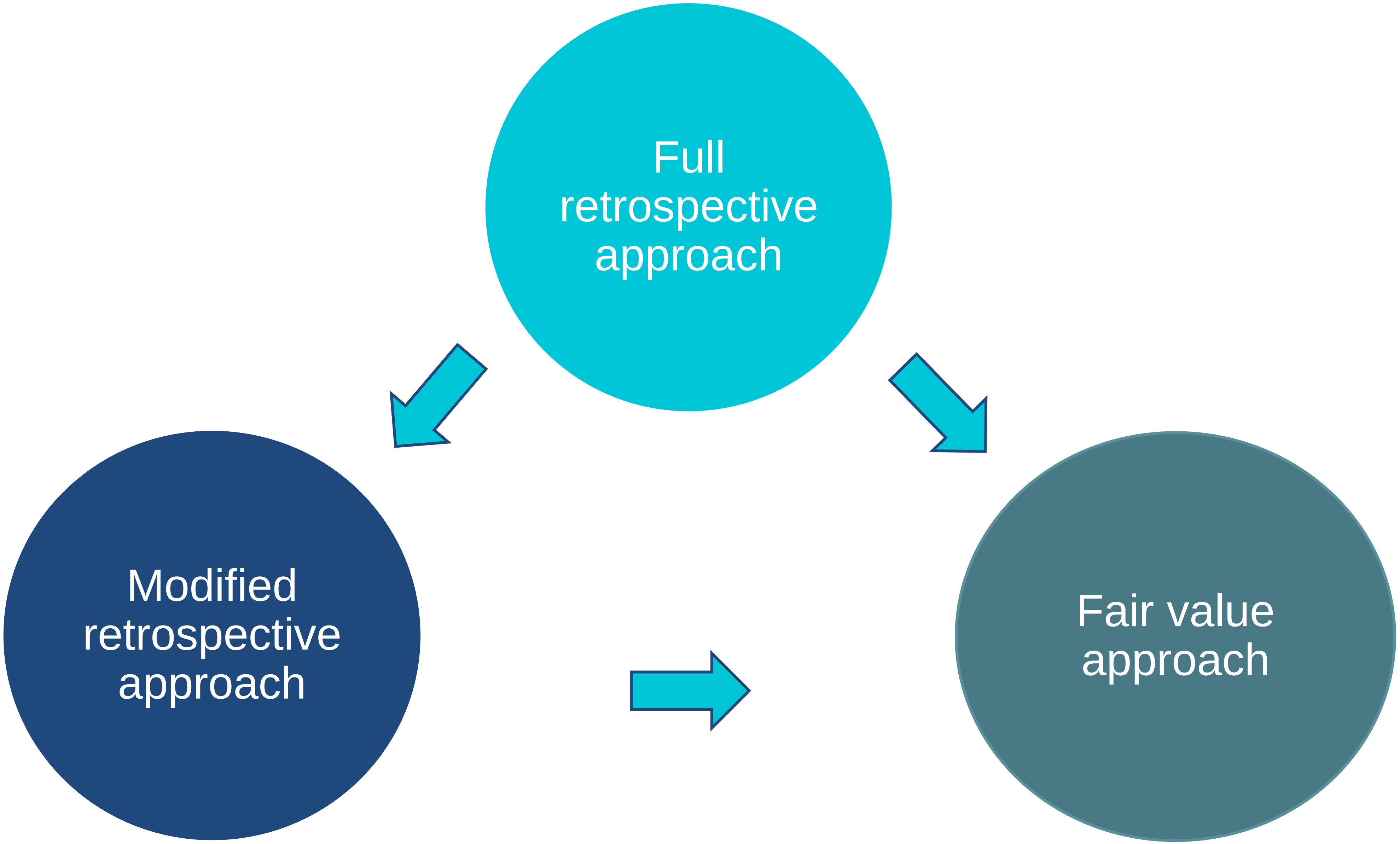
	Complexity & Cost	Financial Reporting	Comparability
Transition	X	X	
Aggregation	X		
CSM Amortisation		X	X
Reinsurance	X	X	
Presentation	X		
Valuation model		X	
Discount rates	X	X	
Hedging adjustment		X	X
Business combinations	X		X

IFRS 17 Timeline



Deep dive on Transition

Transition – three approaches recap



5 Changes to the transition requirements

Transition issues raised by the industry	IASB decision
23. Optionality	• Risk mitigation option can be applied from the date of transition (rather than implementation date) • An entity can use the fair value approach to transition if it has used derivatives or reinsurance to mitigate financial risk before the transition date
24. Modified retrospective approach: further modifications	✗ ✓
25. Fair value approach: OCI on related financial assets	✗

Retrospective challenges

- Complexity
- Inflexibility
- Resources
- Time
- Methodology needed first?
- Availability of past data, assumptions, models
- Granularity
- Allocation of past cashflows

Fair Value vs Fulfilment Cash Flows

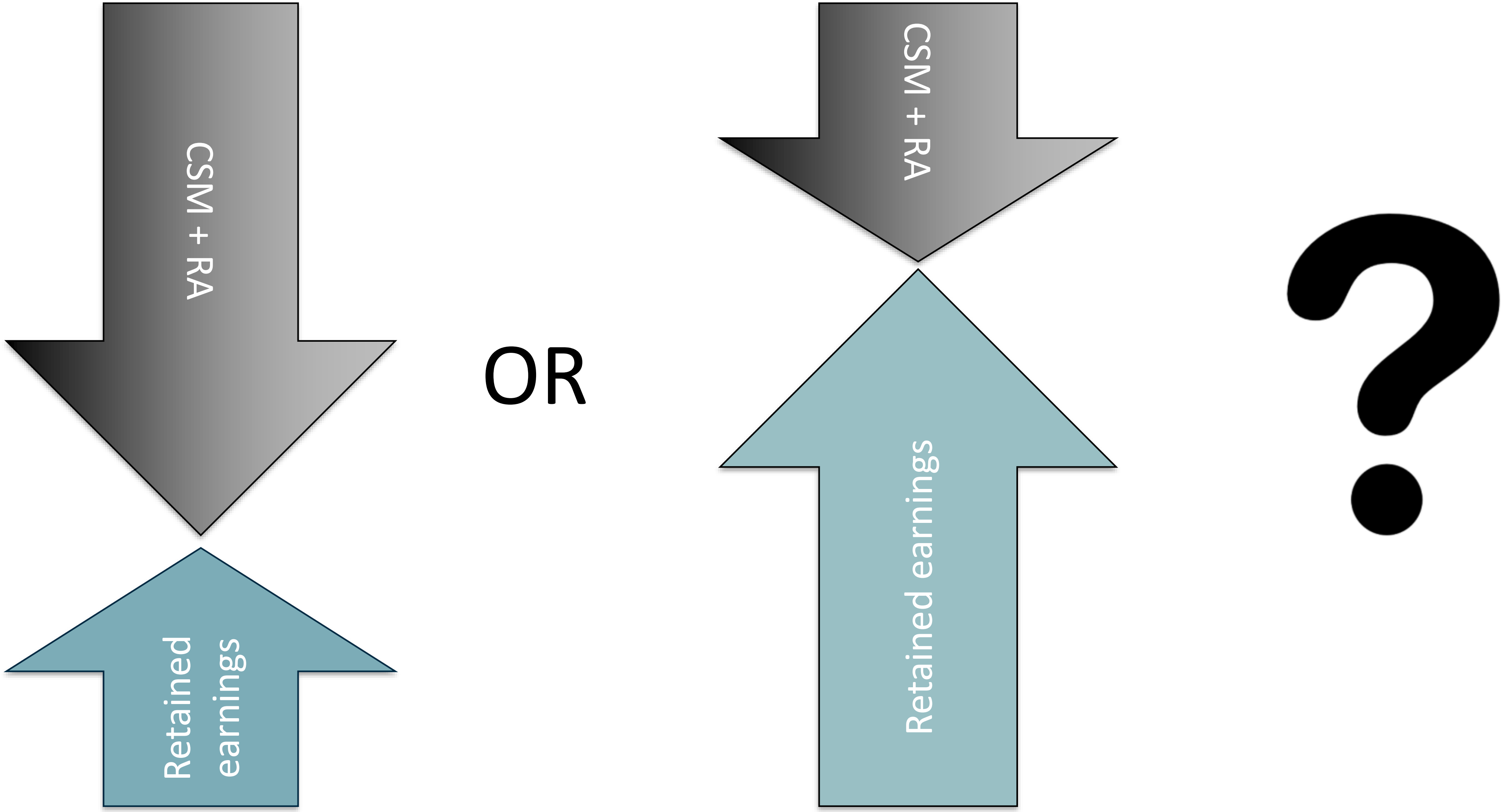
	FCF	FV
Standard	IFRS 17	IFRS 13
Renewals	Not included	May be included i.e. different contract boundaries
Expenses	Directly attributable	All
Non-performance risk	Not included	Must be included

- Others
  - Discount rates
  - Risk adjustment, diversification benefits, cost of capital rate
  - Investment expenses

- Most companies using some form of Embedded Value for Fair Value

- Lots of levers

Transition outcomes



Transition outcomes

- No simple approach!

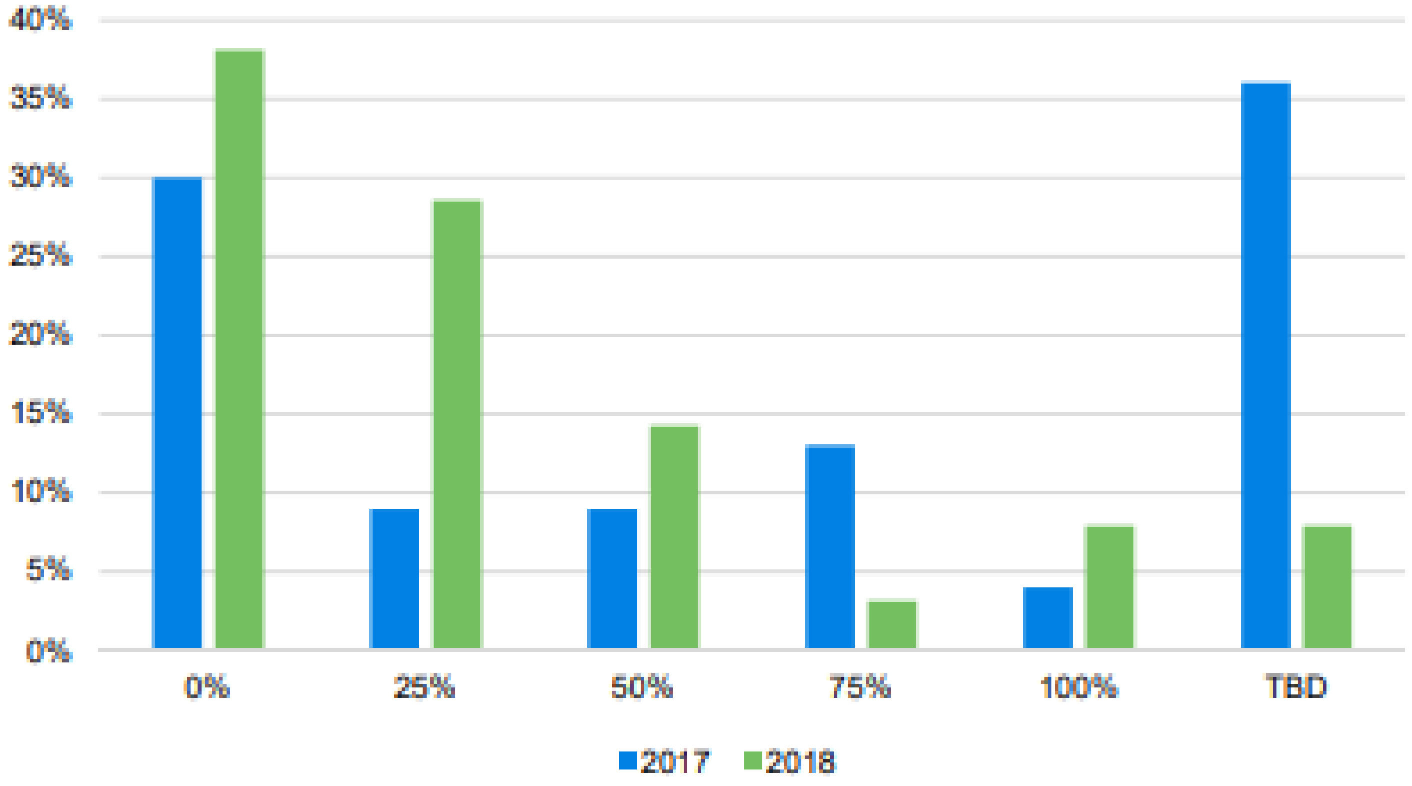
- Frustration with inflexibility of retrospective approaches

- Most companies will pick a mix of approaches:
  - Apply full retrospective for business written between now and transition date and generally business written in last few years too
  - Modified retrospective / fair value for older business, especially if materiality relatively low

- Some just using fair value

Milliman IFRS 17 survey results – Full retrospective

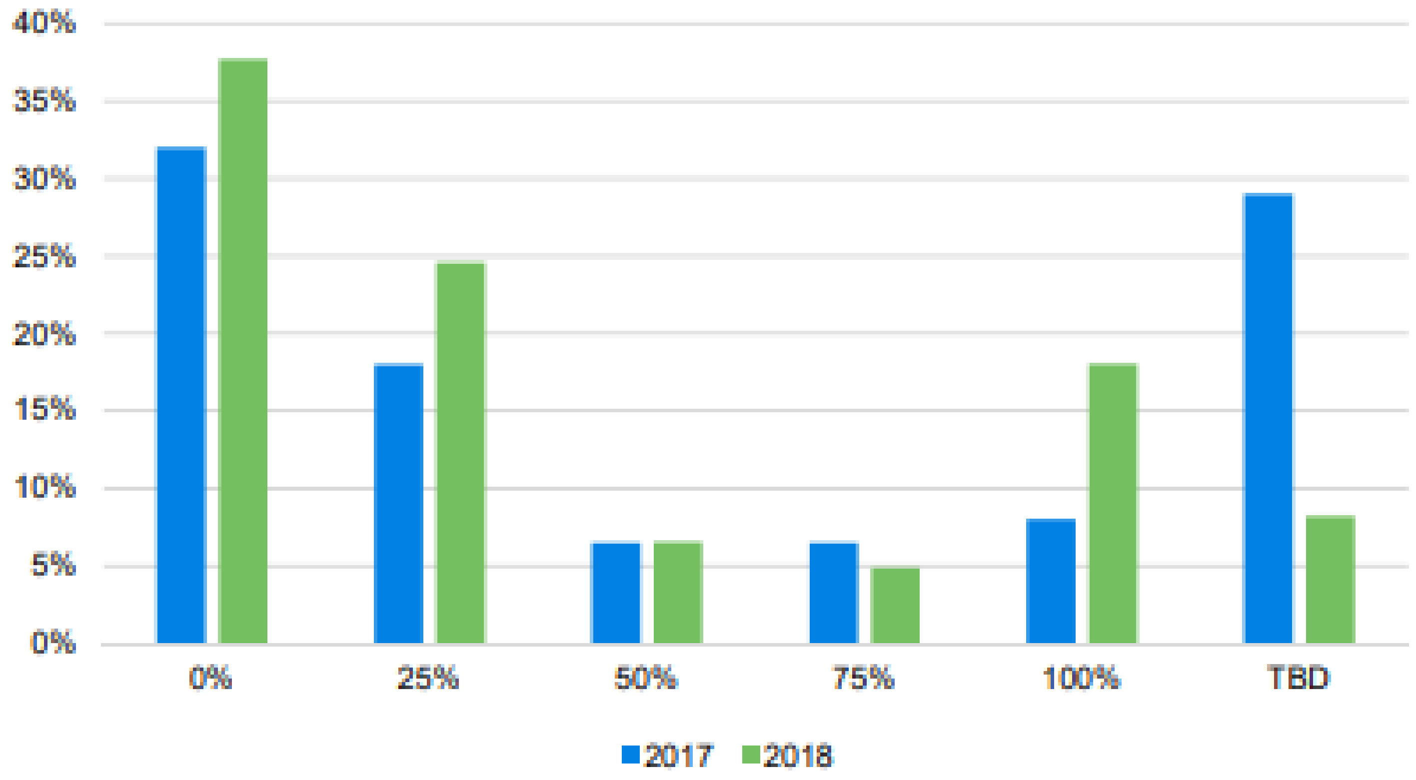
Portion of business – full retrospective approach?



Source: [Milliman IFRS 17 preparedness survey 2018]()

Milliman IFRS 17 survey results – Modified retrospective

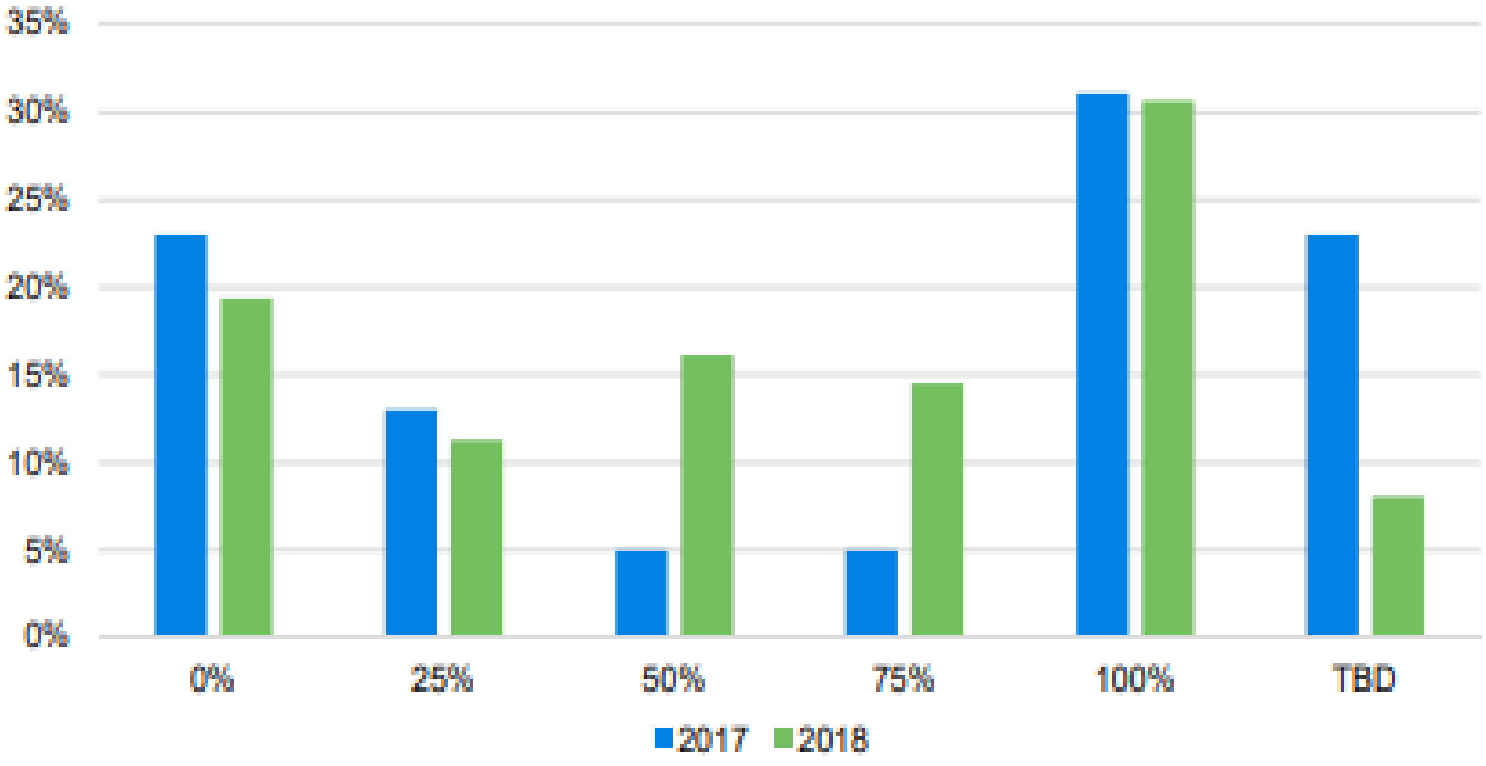
Portion of business – modified retrospective approach?



Source: Milliman IFRS 17 preparedness survey 2018

Milliman IFRS 17 survey results – Fair value

Portion of business – fair value approach?



Source: Milliman IFRS 17 preparedness survey 2018