CLRS 2018

IFRS 17 – A deep dive into key issues

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Building a better working world

Key IFRS 17 decisions for the Company

Measurement model

- Do all P&C insurance contracts qualify for the premium allocation approach (PAA)?
- What are the implications if a new product is offered or acquired?
- How is ‘not materially different’ quantified?

Discounting

- Must use a risk free discount rate plus a risk margin; delinked from asset return.
- How will you determine your discount rate?
- Should the methodology be harmonized with the life business?
- Discount rate impact – policy choice exists; OCI or P&L?

Reinsurance

- Specific issues to consider for bother assumed and ceded

Level of aggregation and onerous contracts

- Need to group contracts into portfolios to assess onerous contracts.
- At what level of granularity will business be measured, managed and reported?
- Does this level of detail exist currently?

Policy acquisition costs

- Policy choice exists.
- Expense acquisition costs up front or defer and amortize?
- Impact on onerous contract assessment?

Presentation and disclosures

- What additional data will need to be gathered in order to meet the much more detailed disclosure requirements?
- What system changes will be needed?

Cash flows

Policy acquisition cash flows: what the standard says

IFRS 4 Definition

- *certain costs such as commissions and premium taxes, vary directly with, and are directly related to, the acquisition of business and can be associated directly with specific revenues. Other costs, such as salaries of certain employees involved in underwriting and policy issuance functions, inspection report fees, and fees paid to boards and bureaux, may vary indirectly with the acquisition of business but are directly related to the premiums written during the period in which the costs are incurred. These costs meet the criteria for deferral and association with the related premiums as they are earned, provided such costs are expected to be recovered. Certain other costs incurred during the period, such as collection expense and uncollectable accounts, professional fees and general administrative expenses, do not vary with, and are not directly related to, the acquisition of business and therefore are charged to expense as incurred.*

IFRS 17 Definition

- *cash flows arising from the costs of selling, underwriting and starting a **group of insurance contracts** that are directly attributable to the portfolio of insurance contracts to which the group belongs. <u>Such cash flows include cash flows that are not directly attributable to individual contracts or **groups of insurance contracts** within the portfolio.</u>*

- *Under the PAA, an entity may choose to recognize any insurance acquisition cash flows as expenses when it incurs those costs, provided the coverage period of each contract in the group at initial recognition is no more than one year.*

Examples of acquisition expenses and deferability under each standard

Cost	IFRS 4 (Current GAAP)	ASC 944 (US GAAP)	IFRS 17
Commissions	✓	✓	Under IFRS 17, entities may *<u>include cash flows that are not directly attributable to</u> individual contracts or groups of insurance contracts within the portfolio* so it is expected that more will qualify for deferral than under IFRS 4.
Sales bonus	×	✓	
Inspections and examinations	✓	✓	
Underwriters' salaries	✓	Practices vary	
Printing	×	×	
Cost of issuing new business	✓	✓	
Agency development	×	×	
Information systems	×	Aggressive	
Postage	×	✓	
Advertising	✓	If direct solicitation	
President's salary	×	×	
Actuarial – new products cost of set up	×	×	

Discounting

Calculating the discount rate

There's no particular method prescribed, however the standard discussed two options at the group of insurance contract level that can be applied to determine the yield curves:

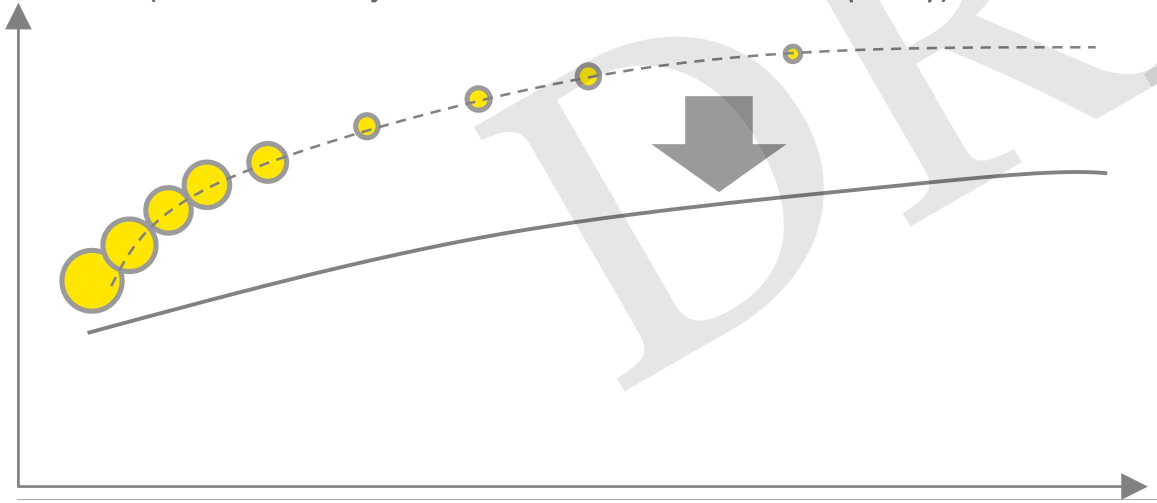
Top-down approach

Current market rates of returns:

either of own asset portfolio or a reference portfolio

Adjust for **risks that are not relevant to the insurance contract** (e.g., default risk, market risk)

Adjust for **duration differences** if necessary
(No need to adjust for the difference due to liquidity)

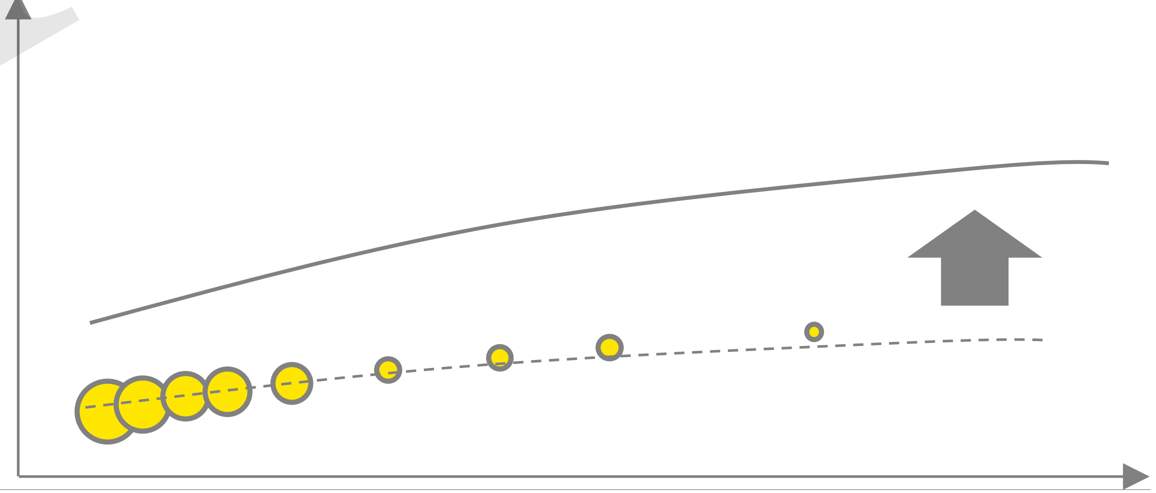


Adjust for **other characteristics** of the insurance contracts if necessary

Illiquidity premium: Adjust for liquidity characteristics of the insurance contracts

Bottom-up approach

Risk-free yield curve with similar characteristics (e.g., duration, currency)



Changes in the discount rate

Changes in discount rates – Policy election	
P&L	**OCI**
▶ Increased volatility for the Company's P&L if don't offset with IFRS 9 assets. ▶ Consistent with current accounting for changes in discount rate therefore smaller operational impact.	▶ Lower volatility for the Company's P&L. ▶ Increased operational complexity from a tracking perspective (Must track locked in discount rate from inception per year and then continue to track changes each year through OCI).

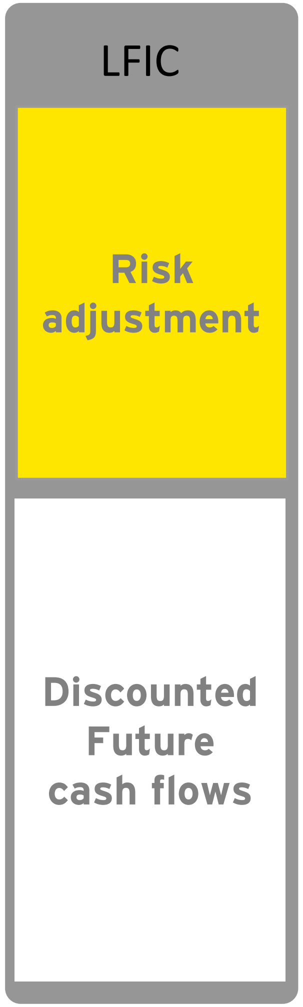
Consider

01 Appetite for volatility in underwriting results.

02 Outcome from decision helps drive choices under IFRS 9.

Risk adjustment

Measurement of Liability for Incurred Claims (LFIC)



- The Risk Adjustment is the compensation that an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils insurance contracts.
- Risk Adjustment shall be included in the measurement in an explicit way (i.e., uncertainty should not be included in the future cash flows).
- Reflects both favourable and unfavourable outcomes in a way that reflects the entity's degree of risk aversion.
- Conveys the degree of diversification benefit that is considered when determining the compensation for bearing uncertainty.
- No prescribed technique so different companies may use different techniques.
- Disclosure on the confidence-level is required if the entity uses a technique other than the confidence level technique.