IFRS 17 Implementation Timeline, Solution Options and Issues

Institute of Actuaries of India (IAI)

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A Typical IFRS 17 Implementation Roadmap

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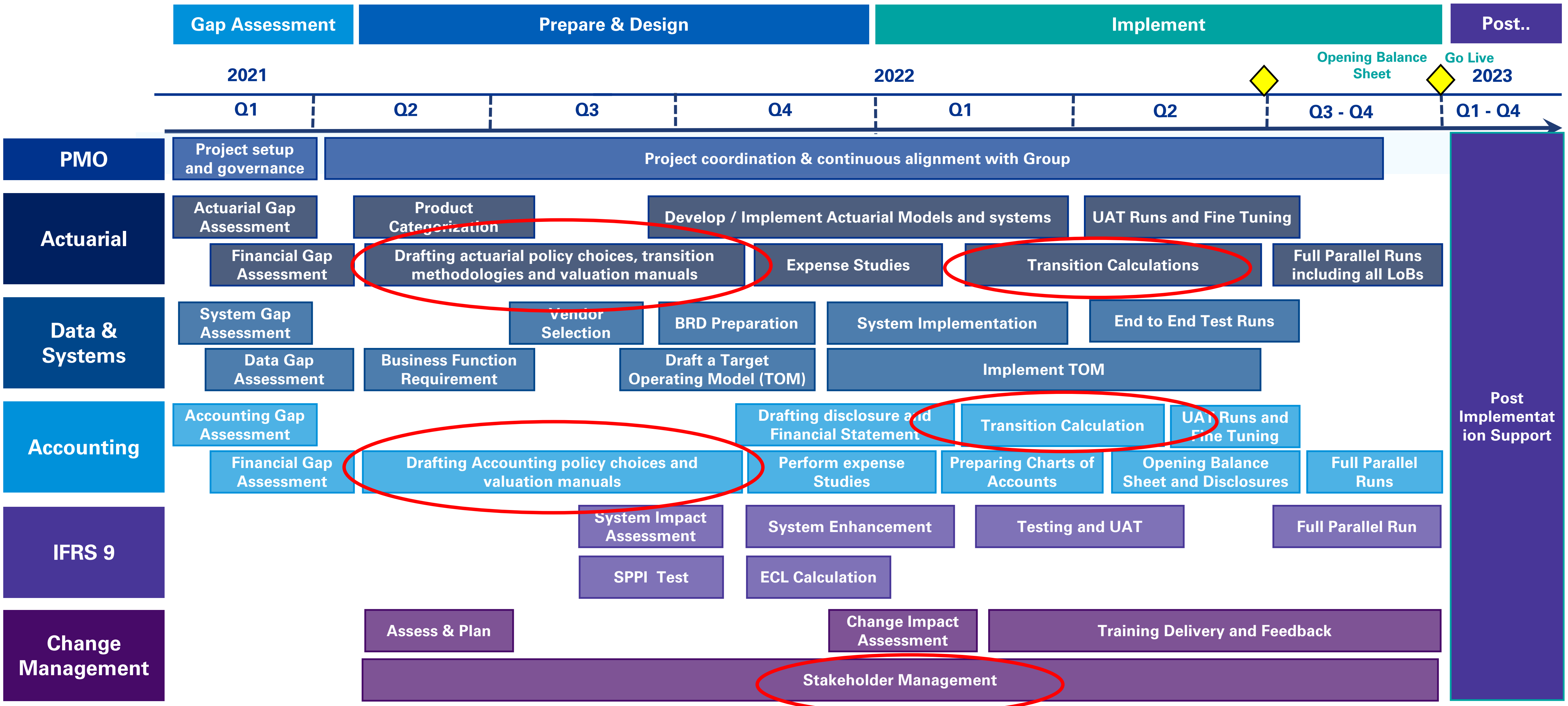

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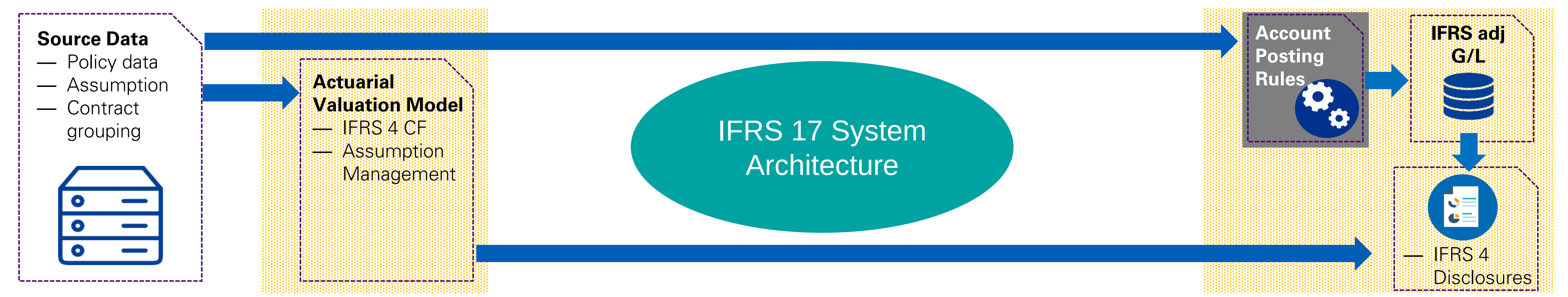
IFRS 17 System solution - Alternatives

Current System Architecture

Solution structure



Current Structure Overview

- ➢ Policy level data is fed into Actuarial models
- ➢ The actuarial models will calculate the liability cashflows and provide liability related accounting entries
- ➢ The accounting systems will help prepare IFSR 4 Disclosures and General Ledgers

IFRS 17 System solution - Alternatives

Making an informed decision on key technology components forms the foundation for the subsequent IT and Finance design activities. From our experience, there are three core options available for the introduction of the Contractual Service Margin calculation within the Finance Systems landscape.

Option	Description	Cost	Synergy
Option 1: IFRS 17 solution integrated with existing actuarial models & accounting environments	• Leverage actuarial modelling tool to perform CSM calculation at inception and run-off • Develop a standalone CSM data management solution to support run-off and AoC • Update accounting engine to enable CSM posting logic	Low	Medium
Option 2: Complete Actuarial IFRS 17 solution integrated with current Accounting environments	• Develop custom solution that enables CSM calculation and data management capabilities • Solution uses actuarial modelling tool's fulfilment CFs as inputs • Posting engine needs to updated separately to enable CSM posting logic	Medium	High
Option 3: Complete IFRS 17 solution with accounting sub-ledger & rules engine	• Build complete CSM including CSM calculation, data management and posting logic • Solution uses actuarial modelling tool's fulfilment CFs as inputs • Solution is able to perform CSM posts to GL or interface with current component	High	High

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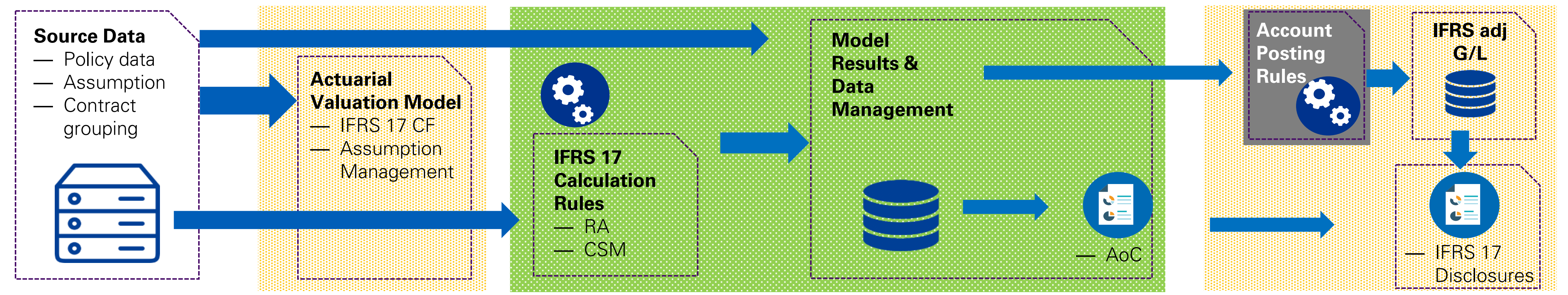
IFRS 17 Solution Options (1/3)

Option 1: IFRS 17 solution integrated with existing actuarial models and accounting environment

Solution structure



Solution overview

- CSM calculation and release takes place within the IFRS 17 calculation engine
- Supplemented with a data storage solution to allow for storing and referencing historical data
- Does not cover generation of accounting postings.
- Additional modules need to be developed to cover the E2E IFRS 17 requirements.

Key considerations

- How much of IFRS 17 requirements exist and can be met from existing actuarial valuation models?
- What is the best approach to build the data management capabilities? Leverage existing components or use new technologies?
- How can we ensure alignment across models and entities?

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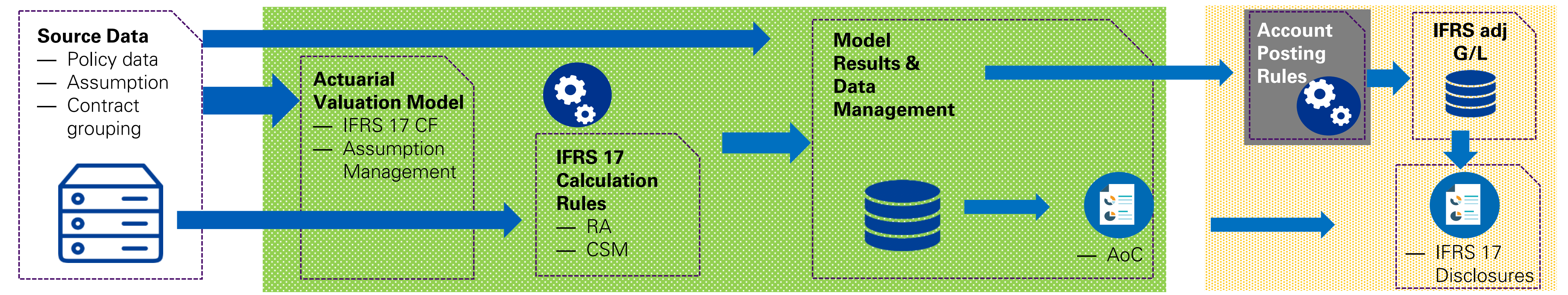
IFRS 17 Solution Options (2/3)

Option 2: Complete Actuarial IFRS 17 solution integrated with current Accounting environment

Solution structure



Solution overview

- CSM calculation and release takes place within a module, which is either part (or very close) to the actuarial platform
- CSM module is based around a data storage solution, which closely interacts with the model
- Does not cover generation of accounting postings.

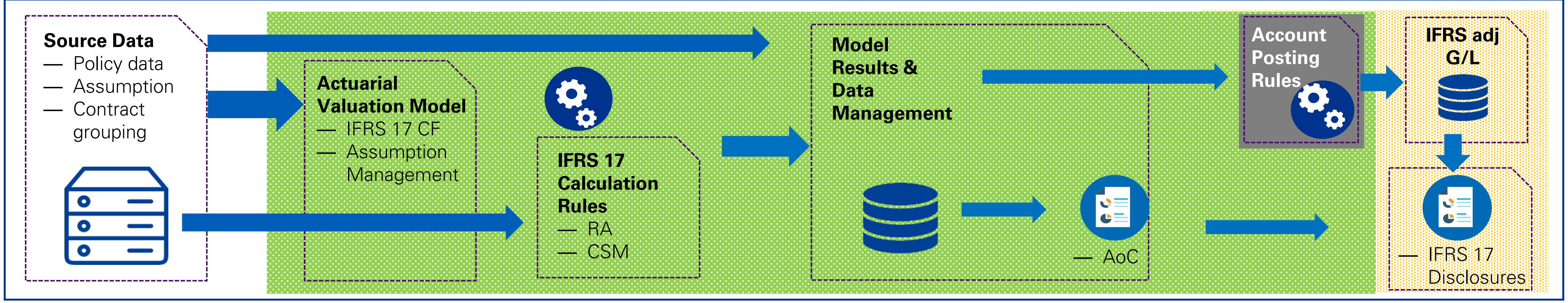
Key considerations

- What is the best approach to deliver the calculation and data mart? (build vs buy)
- Does the solution fit in with the overall IT strategy?
- What would be the implications of this option for a global deployment?

IFRS 17 Solution Options (3/3)

Option 3: Complete IFRS 17 solution with accounting sub-ledger & rules engine

Solution structure



Solution overview

- CSM calculation and release takes place within an events-based accounting sub-ledger platform
- The platform receives undiscounted estimated cashflows from actuarial models, and can receive either transactional events (preferred) or pre-accounted data
- IFRS 17 balances and movements stored in sub-ledger, with aggregated results posted to the GL.

Key considerations

- Can this scenario be delivered within the desired implementation timeline?
- Does it warrant a change in the existing systems and remapping some of them?

Important Considerations for Life & Non-Life Insurers

Important Considerations for Life Insurance (1/2)

1. Top Line:

Premiums will be replaced by **"Insurance contract revenue"**

KPIs such total premium as the revenue to be realigned

2. Contractual Service Margin:

CSM is an estimate of present value of future profits calculated as –ve of (BEL + RA)

Subsequent measurement and storage of CSM is operationally challenging for each cohorts

3. Treatment of Acquisition cash flows:

Acquisition cash flows to be **amortized** as part of insurance liabilities and will be allocated in the same period and pattern in which revenue is recognized.
Components of expenses that are 'directly attributable' has been a challenge.

4. Reinsurance:

A typical contract that is loss making at gross level, but what if the reinsurance cashflows make it profitable?

Income or expense from reinsurance contracts held is presented separately from expense or income from insurance contracts issued.

Important Considerations for Life Insurance (2/2)

5. Onerous Contracts:

Onerous contracts (Loss making) need to be separately identified and losses recognized on day one

No inherent **cross-subsidies** permitted

6. Models for Participating Contracts:

GMM or VFA?

VFA eligibility assessment at a contract level

7. Other Comprehensive Income:

Option to recognize impact on insurance liabilities due to changes in discount rate in OCI.
Helping in reducing P&L volatility due to market fluctuation.

8. Grouping of contracts and recognition of losses under Onerous contracts:

More granularity in contract groupings for valuation purposes which may require substantial effort, and new or upgraded systems, processes and controls.

9. Presentation & Disclosures:

Detailed disclosures pertaining to insurance contracts issued.
Investment and insurance components are separately disclosed in the BS / P&L statement.

Important Considerations for Non-Life Insurance (1/2)

1

PAA Eligibility:

Is a 15- or 18-month contract eligible for PAA?

What if it is a 2 years contract?

2

Grouping of contracts and recognition of losses under Onerous contracts:

Group the contracts based on the issue year or issue month at a line of business level or a product level? How do we separate the loss-making contracts from the profit-making contracts?

3

Discounting of Insurance liability ('LRC' and 'LIC'):

Would a separate statutory valuation be required for IFRS 17 and IRDAI reporting (undiscounted basis)?

4

Treatment of Acquisition cash flows:

Acquisition costs are deferred and recognized as an expense over time in a systematic way.

Policy choice available for contracts with a coverage period of less than 12 months.

Important Considerations for Non-Life Insurance (2/2)

5

Pattern of revenue recognition:

Recognition of revenue inline with the insurance service provided.

6

Estimating explicit Risk Adjustment calculation & eliminating excessive prudence from liability:

The standard required explicit risk adjustment for non-financial risk and explicit discounting.

This may reduce any excessive prudence in the liability measurement because of not discounting it.

7

Impact of contract boundaries

Contract boundaries requires special consideration (**especially renewable health insurance contracts**) to assess whether only this year cash flows should be considered or future year cash flows should also be considered for measuring Insurance liabilities.

8

Reinsurance

Under IFRS 17, reinsurance contracts will be treated as separate contracts with separate measurement model. Depending on the model used, one may end up using BBA model for measuring reinsurance contracts, while the base policy is being measured under PAA.

Implementation simplified - How recent Amendments help further?

Presentation at portfolio level

What was the challenge?

IFRS 17 (2017) required groups of insurance contracts that are assets and groups of insurance contracts that are liabilities to be presented separately on the balance sheet. The same applied for reinsurance contracts held.

This is operationally difficult for some insurers because of system limitations, especially as some groups of contracts may be in an asset position at some points in time and a liability position at others.

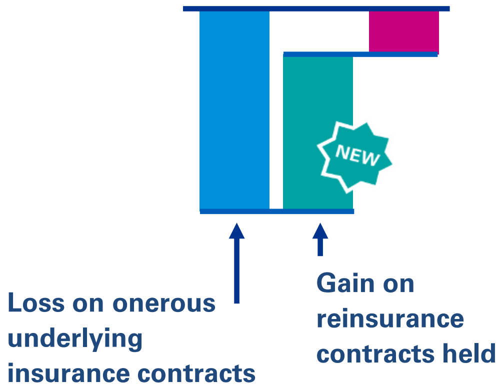
How was IFRS 17 amended?

The requirements will now apply at the portfolio level instead of at the group of contracts level.

What does this mean for you?

- Significant practical relief and reduced operational challenges
- Portfolios of insurance contracts are generally expected to be in a liability position most of the time

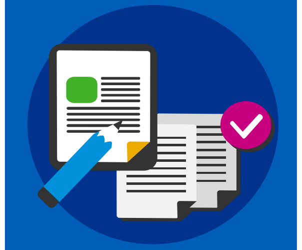
Loss recovery from reinsurance contracts held – initial losses on underlying insurance contracts



What was the issue?

IFRS 17 (2017) required an insurer to **recognise losses** when it initially recognises **onerous (direct) contracts**, but no corresponding gains if the losses are covered by reinsurance contracts recognised at the same time.

How was IFRS 17 amended?



- ➢ An insurer that recognises losses on underlying contracts on initial recognition also recognises a gain at the same time in profit or loss on reinsurance contracts held.
  - – Applies to reinsurance contracts recognised before or at the same time as the onerous underlying contracts are recognised.
  - – Applies to all types of reinsurance contracts.
  - – Insurer will establish a loss recovery component depicting the recovery of losses recognised
- ➢ Gain calculated as percentage of claims covered by reinsurance contract multiplied by loss on underlying contracts.

Considerations:

➢Uncertainties have been resolved and insurers can move forward with reinsurance implementation plans

➢Amendment is broad and assumes that the loss on underlying insurance contracts is caused solely by claims

Critical Implementation challenges – *Food for Thought*

Issue 1: Threshold for PAA Eligibility Criteria

Issue

Paragraph 53: An entity may simplify the measurement of a group of insurance contracts using the premium allocation approach if, and only if, at the inception:
(a) the entity reasonably expects that such simplification would produce a measurement of the liability for remaining coverage for the group that would not differ materially from the one that would be produced applying the requirements in paragraphs 32–52; or
(b) the coverage period of each contract in the group (including insurance contract services coverage arising from all premiums within the contract boundary determined at that date applying paragraph 34) is one year or less.

Valuation of LRC under General Measurement Model (GMM)

Contractual Service Margin + PV of Future Cashflows (includes Acquisition Costs) + Risk Adjustment = LRC

Valuation of LRC under Premium Allocation Approach (PAA)

Unearned Premium − Deferred Acquisition Costs + Financing Component = LRC

Presented views

View A:

Threshold can be an absolute amount e.g., less than INR10 Mn

View B:

Threshold can be in percentage terms e.g., 5% difference between LRC arising from GMM and PAA

View C:

Combination of the above.

Issue 2: VFA Eligibility Assessment

Issue	Presented views
***VFA** is used for the insurance contracts with **direct participating features**. An insurance contract is considered to be a **direct participating contract** when-* *i. The contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items* *ii. The entity expects to pay to the policyholder an amount equal to a substantial share of the fair value returns on the underlying items* *iii. The entity expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items.* Some entities believed that the VFA eligibility assessment under IFRS 17 (2017) should be made at a group level. Some entities expressed the view that performing the assessment at the contract level would be burdensome and would disrupt implementation of IFRS 17. **Amendment** : The Board confirmed that the VFA eligibility assessment is to be performed at a contract level. **Question 1:** How are the insurers planning to assess the VFA eligibility criteria at the contract level? **Question 2:** How are the insurers planning to allocate the undistributed surplus, estate, etc. at contract level?	**View**: Can the VFA eligibility assessment still be done at cohort or group level? **Important Considerations:** Evaluate what is required Re-design systems and processes Test and Apply Insurers should review and adjust working assumptions (VFA model applicability) and implementation plans if necessary.

Poll question

What is your organisation's view of the major challenges of Transition?

1. **Lack of availability of historical data**

2. **Difficulty in determining the correct Transition approach**

3. **Significant / material divergence between Transition and post-Transition methodology for IFRS17 measurements**

Issue 3: Transition - What happens to current Unallocated Estate?

Issue

There are a number of asset pools, each supporting a portfolio of Participating contracts. The policyholders receive a share of the assets in each asset pool.

There is an additional pool of unallocated profit, which can support any of the asset pools/portfolios at the discretion of the insurer.

Question : Can the pool of unallocated profit form part of the clearly identified pool of underlying items under B101(a)?

Current view: No, because the portion of any unallocated profit to a portfolio is not clearly identified.

Presented views

View A:

Yes, on the basis that each portfolio has, in effect, an interest in the unallocated profits.

View B:

No. Provided there isn't a legal or contractual link between the Participating contracts and the unallocated profit, the unallocated profit may be considered a part of a separate group with no members (and be measured under para B71).

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Issue 4: Transition – Fair Value Approach (FVA)

Issue

Determining fair values

The fair value of a group of contracts under the FVA is to be determined in accordance with IFRS 13 (Fair Value Measurement). Although IFRS 13 sets out a number of principles for fair value measurement, it does not contain detailed guidance in relation to the exact nature of this calculation.

This is expected to be extremely important area for the insurance industry in implementing IFRS 17 and an area where there is a potential for divergence in practice. Neither IFRS13 (Fair Value Measurement), nor IFRS 17, provide any real guidance on what fair value measurement means in relation to insurance contracts.

As a result, this issue has been identified a hot topic by EFRAG and the Insurance Accounting Committee of the International Actuarial Association. Both organisations are conducting outreach and research to identify how the FVA may work in practice.

CSM at transition = Fair value of the group of insurance contracts - Adjusted fulfilment cash flows measured at transition

Presented views

This is an area where industry views may emerge over time. However, initial considerations in this area include:

Many insurers already have experience of fair valuing insurance contracts as this is required when accounting for business combinations under IFRS13.

Further, determining the appropriate 'fair value' of the liabilities and assets may have challenges. Especially the liabilities, since there is precedence in the Indian insurance space for computing a fair value of liabilities.

Case Study - PAA LRC Projection

Case Study: Insurance Revenue and Acquisition Cashflow

- A contract is issued with a period of insurance coverage 1 July 2021 – 30 June 2022. The contractually agreed premium is INR 1,200. Insurance acquisition cash flows of INR 180 (15% of Premiums) are paid on 1 July 2021.

- The premium is paid at different timing in the following three scenarios:
  1) Premium paid upfront
  2) Premium paid at the end of the coverage period
  3) Premium paid on a monthly basis.

- The example assumes that no claims are incurred (the liability for incurred claims is part of the insurance contract liability or asset)
- In India, this is very much relatable with Crop Insurance. In some of the other countries, insurers offer such premium paying frequency for some Motor, Property and other assets insurance policies
- Acquisition costs amortised on a systematic basis based on the passage of time (in this example on a straight-line basis)

Case Study: Scenario 1 – Premium Paid Upfront

Reporting date	01.04.21	30.06.21	30.09.21	31.12.21	31.03.22
Opening balance	0	(1,020)	(765)	(510)	(255)
Premium received on initial recognition	(1,200)				
Insurance acquisition cash flows	180				
Premiums received in the period		0	0	0	0
Amortisation of insurance acquisition cash flows		(45)	(45)	(45)	(45)
Insurance revenue		**300**	**300**	**300**	**300**
Closing balance of insurance contract asset / (liability)	**(1,020)**	**(765)**	**(510)**	**(255)**	**0**

Case Study: Scenario 2 – Premium Paid at the end of the Coverage Period

Reporting date	01.04.21	30.06.21	30.09.21	31.12.21	31.03.22
Opening balance	0	180	435	690	945
Premium received on initial recognition	0				
Insurance acquisition cash flows	180				
Premiums received in the period		0	0	0	(1,200)
Amortisation of insurance acquisition cash flows		(45)	(45)	(45)	(45)
Insurance revenue		**300**	**300**	**300**	**300**
Closing balance of insurance contract asset / (liability)	**180**	**435**	**690**	**945**	**0**

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Case Study: Scenario 3 – Premium Paid on Month-end Basis

Reporting date	01.04.21	30.06.21	30.09.21	31.12.21	31.03.22
Opening balance	0	180	135	90	45
Premium received on initial recognition	0				
Insurance acquisition cash flows	180				
Premiums received in the period		(300)	(300)	(300)	(300)
Amortisation of insurance acquisition cash flows		(45)	(45)	(45)	(45)
Insurance revenue		**300**	**300**	**300**	**300**
Closing balance of insurance contract asset / (liability)	**180**	**135**	**90**	**45**	**0**

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Case Study: Comparison of LRC

Reporting date	LRC 01.04.21	LRC 30.06.21	LRC 30.09.21	LRC 31.12.21	LRC 31.03.22
Premium paid up front	**(1,020)**	**(765)**	**(510)**	**(255)**	**0**
Premium paid at the end of the coverage period	**180**	**435**	**690**	**945**	**0**
Period paid month-end	**180**	**135**	**90**	**45**	**0**

Revenue and acquisition costs recognised in profit or loss is the same for all three scenarios.

Wrapping up

Wrapping up

- The new accounting standard (IFRS 17) for insurers will represent a significant change both in terms of measuring and reporting its financial results as well as its underlying business operations.
- These new requirements will reshape the primary financial statements and introduce many new disclosures in the entity's current reporting.
- The IFRS 17 Implementation is a time-consuming exercise ranging anywhere from 18-24 months.
- The insurers would have multiple solution options covering data, actuarial calculations and accounting activities.
- It is high time that the insurers start addressing some of the key issues that they may face with the advent of the new reporting standard.
- The actuarial and accounting options need to be agreed with the auditors.

Thank you

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