IFRS 17
Current hot topics

Hariharan Mani
30 August 2019

pwc

Objectives and overview

01 Current timetable - where are we now?

02 Which of the recently proposed amendments are relevant to P&C insurers?

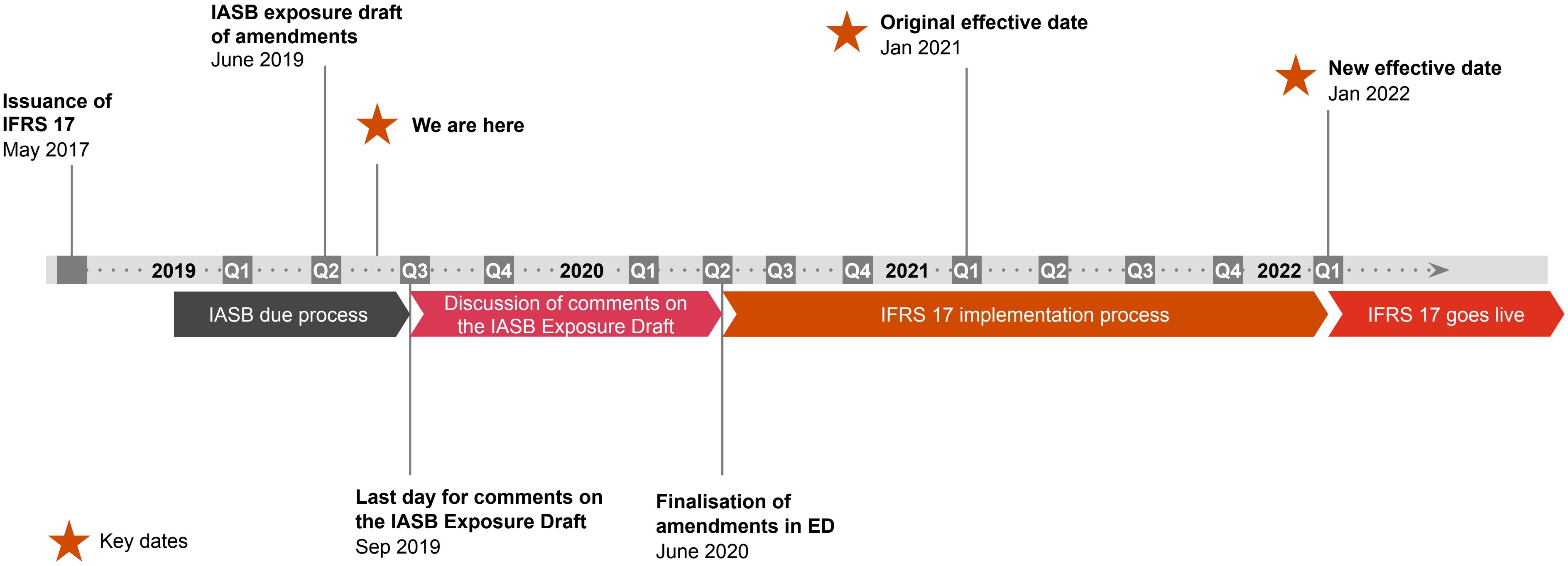
03 What are the current areas of focus for P&C insurers?

04 What are the current challenges facing P&C insurers around PAA eligibility, Risk Adjustment and Reinsurance?

1

Where are we now?

Where are we now?



2

Current areas of focus for P&C insurers

Key issues for P&C insurers

Liability for remaining coverage (LFRC)

Treatment of premium receipts / receivables.

1

PAA eligibility

Issues regarding the PAA eligibility assessment for products with coverage period more than one year.

.

2

Reinsurance contracts held

Initial recognition for onerous contracts, treatment of investment component etc.

3

Risk adjustment

Should the effect of reinsurance be considered in calculating the risk adjustment for reinsured direct contracts?

4

Level of aggregation

Insurers will need to set its definition of 'similar risks' and 'managed together' and complete a 'profitability' analysis.

5

Miscellaneous

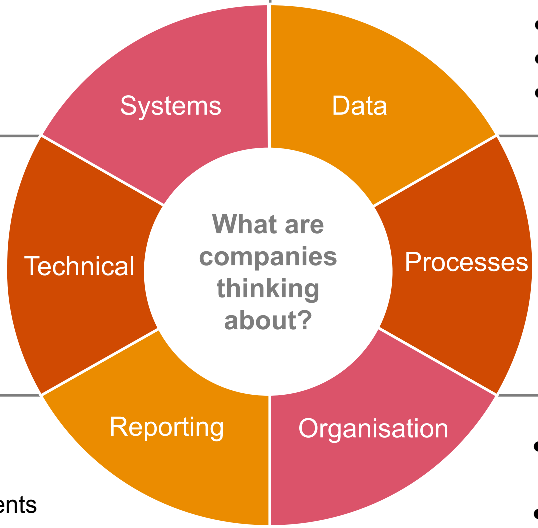
- Treatment of acquisition cash flows for renewals
- Implications on capital.

6

Implementation challenges: Data, Process, Systems

Key areas of focus identified from implementation projects

- How tactical should CSM solution be?
- Adapting legacy architecture
- Workarounds translated quickly into BAU and then IFRS 17
- Vendors moving on their propositions
- Join Finance Transformation with IFRS 17



- New data items
- Workarounds
- Data quality issues
- Data previously not used
- Data governance

- Risk Adjustment – how to set, allocate
- Expenses – treatment of expense items
- CSM – amortisation patterns
- Reinsurance
- Opening balance sheet

- LFRC (Liability for Remaining Coverage) for PAA (Premium allocation Approach)
- Onerous contract calculations
- Expenses
- Working Day Timetable

- Chart of Accounts
- Disclosure requirements
- Dealing with multi-basis accounting requirements
- FP&A - how to run business?
- KPIs/discussions with analysts
- Taxation

- Education, demystifying terminology (eg Unit of Account)
- Global vs Functional
- Ownership of assumptions
- Handoffs (actuarial, accounting, FP&A, FinOps)
- Change management
- Training

3

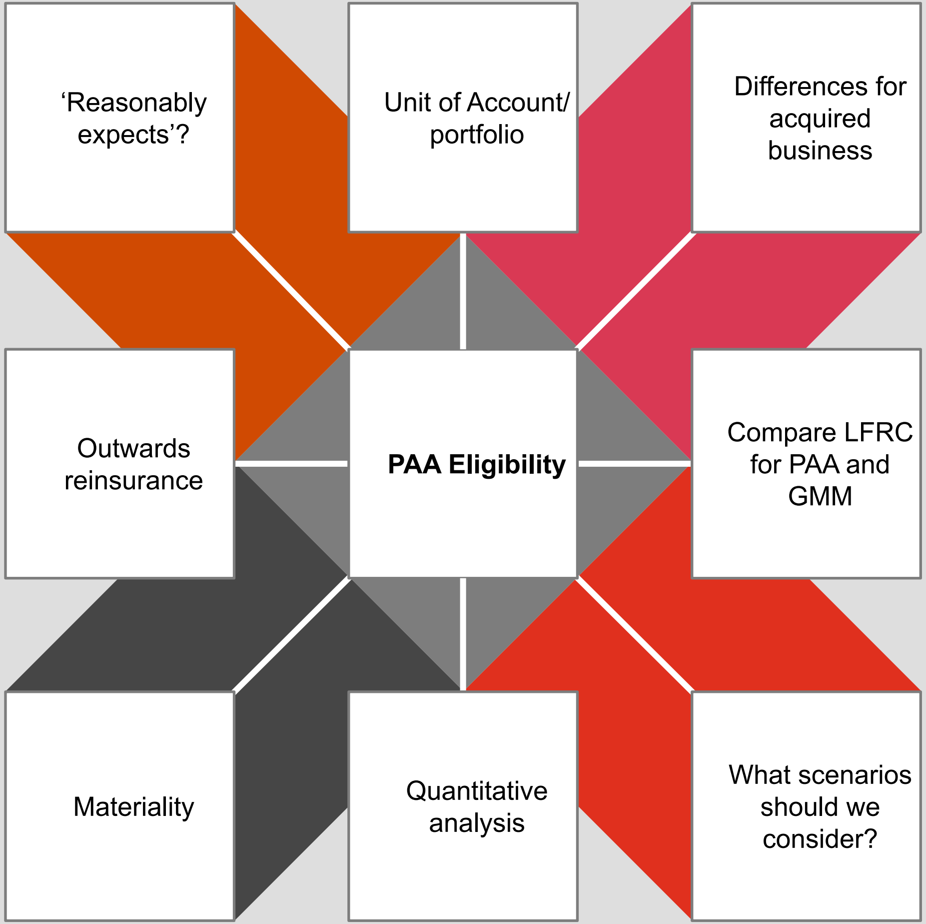
Deep dive - PAA eligibility

Interpreting the standard for PAA eligibility testing

The PAA may be applied when:

'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 [the GMM]'.

The above is not met if at the inception of the group an entity **expects significant variability** in the fulfilment of cash flows that would affect the measurement of the liability for remaining coverage during the period before a claim is incurred.



Performing a PAA eligibility assessment

Tougher than it looks…

Factors to consider	Decision tree			Impact on lines of business
Coverage period under IFRS 17	Is the coverage period one year or less?	Yes	PAA is automatically applicable	All (re)insurance contracts with coverage period of one year or less (e.g. medical, motor etc.)
Variability in your expectation of the present value of future cash flows No definition of 'material' or 'significant'	No At inception, would the PAA differ materially from the GMM (LFRC only)? Is significant variability in the fulfilment cash flows expected?	No ?	May be possible to construct an argument that PAA is applicable More difficult to construct an argument that PAA is applicable	Multi-year policies of up to 3 years, some reinsurance contracts (e.g. risk attaching) Construction, energy, engineering, and multi-year policies

4

Deep dive - Risk adjustment

Introduction

No limitation on techniques or prescribed level of diversification.

1

Approaches include but are not limited to:

- confidence level techniques
- cost of capital
- scenario analysis.

2

Irrespective of the method used, IFRS requires disclosure of the implied confidence level.

3

Need to consider ease and speed of calculation, and communication of approach to key stakeholders.

4

“

The compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.

Key issues and practical considerations

The IFRS 17 standard is principles-based and does not mandate a single approach for determining the risk adjustment. As such there are some areas of uncertainty, as well as other wider practical considerations which entities will need to conclude on. These areas include:

1 **Not required under PAA, but entities may still wish to allow for risk adjustment while calculating PAA LFRC in order to:**
- Ensure consistency between the LFIC risk adjustment under the GMM and the PAA approaches
- Since the LFRC risk adjustment is required in order to calculate the 'loss component' for onerous business.

2 **One year vs ultimate**
- No explicit time horizon over which the RA should be measured. However, IFRS 17 paragraph B87 references the risk associated with "fulfilling a liability". This potentially infers that an ultimate view of risk should be considered.

3 **Risks and contracts in scope**
- The inclusion of bound but not incepted business
- The recognition of outwards reinsurance business

4 **Diversification**
- RA should reflect level of diversification benefit considered when determining the compensation required for bearing the risk
- Consider consistency between risk adjustment at an entity and group level

5 **Allowance for reinsurance**
- Interpretation of recent TRG clarifications regarding allowance for reinsurance in inwards RA

6 **Disclosure/confidence level considerations**
- What choice of confidence level is appropriate?
- Will the disclosed level be constant or vary over time?

5

Deep dive - Reinsurance

A key change for reinsurance

- **A reinsurance contract held is accounted for as a standalone contract**, independent of the accounting for the underlying insurance contracts, which represents a significant change for many entities.
- Common existing practice is to account for reinsurance contracts held using a **'mirroring approach'**, essentially matching reinsurance contract revenue, costs, assets and liabilities to the underlying insurance contracts.
- According to IASB, **separate accounting is necessary to truly reflect the economics of an entity's rights and obligations** under insurance contracts it issues and reinsurance contracts it holds.

Increased potential for mismatching between the value placed on RI and the value placed on underlying contracts for IFRS 17

It is no longer as simple as just "netting down"

Some IFRS 17 'basics' are a challenge for RI

There are some basic reasons as to why reinsurance is more challenging to value in the IFRS 17 world, and it is not all down to IFRS 17 requirements. It has a lot to do with how we do things today.

IFRS 17 requirement	***What is done under IFRS 4***	***Implementation issue***
• Reinsurance held asset/liability must be valued (and shown) separately • Valuation must be at a unit of account level which reflects the profitability of the contracts (insurance and reinsurance) • Additional requirements: ○ Risk adjustment specifically for RI ○ CSM under the GMM	• We present our results net of reinsurance • We aggregate, mixing loss making and profitable contracts • Neither of these! Even under SII, RA is only calculated net	• We don't have the data or processes set up to do the reinsurance calculations separately for reinsurance held at the level of granularity required

There are some IFRS 17 requirements on the measurement models that can be used, the calculation of the CSM and specific reinsurance requirements that mean a generic/automated approach to valuing reinsurance contracts will be more challenging.

Reinsurance – Other areas to think about

1
Risk adjustment

- IFRS 17 Parag. 64 : "...it represents the amount of risk being transferred by the holder of the group of insurance contracts to the issuer of those contracts."
- Gross less ceded equals net

OR

- Gross less net equals ceded

OR

- Ceded plus net equals gross

2
PAA eligibility

- Coverage periods may be longer than coverage period of underlying insurance
- Insurers' views about eligibility are currently split
- Reinsurers mostly do not plan to use PAA

3
Issued reinsurance

- Insurance revenue will be reduced for the amounts of non-distinct investment components such as:
    - Profit sharing commissions
    - Reinstatement premiums

4
Fronting / Captive Arrangements

- What is the role of the insurance company in a fronting or captive arrangement?
- Revenue recognition may fall under IFRS 15 if the insurer is acting as an agent
- Corporate captives may be accounted for on a net basis

5
Retroactive reinsurance

- Exception to reinsurance contracts held requirements for the measurement of the CSM at initial recognition.
- Some reinsurance contracts cover events that have already occurred but effect is still uncertain.
- Net cost of reinsurance coverage that relates to events that occurred before purchase is recognised immediately in profit or loss as an expense at initial recognition.

Questions?

Hariharan Mani, FSA
Director, PwC AIMS, Mumbai
Email: hariharan.mani@pwc.com
Mobile: +91 98678 33318

pwc.com

190614-183125-TR-OS