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9th Capacity Building Seminar in General Insurance (GI)

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IFRS 17: Financials Under the New Regime

Institute of Actuaries of India

Speakers:
Shrenik Baid
Hasmukh Raval

Shrenik Baid

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Profile

Shrenik is a Partner with Deloitte Haskins & Sells LLP, India in Audit & Assurance practice, with more than 22 years of experience providing assistance in capital market transactions and accounting advisory services. He has also had secondment experience in the United States, South Korea, Japan and the United Kingdom.

Shrenik has helped clients by providing them with technical and project management advice on accounting and financial reporting issues associated with debt and equity offerings and conversions to and from IFRS and US GAAP.

In his present role, Shrenik focuses on financial services and infrastructure sector. He is leading financial services IFRS conversion projects and as a firm helping 17 banks (including State Bank of India), 7 insurance companies (life and non-life) and several NBFCs and HFCs on their IFRS conversion projects.

Shrenik is a Chartered Accountant and regular speaker on IFRS and US GAAP at the ICAI and various other forums. He has co-authored the publication, “Similarities and Differences: IFRS, US GAAP and Indian GAAP”.

Illustrative Experience

- Leads the Insurance IFRS advisory service practice
- Co-authored the publication “Similarities and Differences: IFRS, US GAAP and Indian GAAP”. He is a regular speaker on IFRS and US GAAP at the ICAI and various other forums.

Education

- Fellow Member of the ICAI

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Hasmukh Raval

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Profile

Hasmukh is a Director in the Audit & Assurance practice with over 12 years of experience in financial services especially insurance Sector (Life / P&C / Health / Re-insurance / Insurance Brokers).

Hasmukh has managed statutory audits for several medium to large sized companies with operations across the country and those with multinational operations and also other key assignments including implementation of Internal Control over Financial Reporting and IFRS advisory engagements in Insurance Industry.

Hasmukh has working knowledge of IFRS 9, IFRS 4 / IFRS 17 (with respect to initial business impact assessment).

Illustrative Experience

- Hasmukh is involved in quality review of ICICI Prudential Life, Max Life, HDFC Life Insurance in India member firm and also assisted transaction services for financial due diligence with respect to acquisitions in Insurance Sector.
- Hasmukh has also contributed in preparation of Guidance Note for the Institute of Chartered Accountants of India (ICAI) on Insurance (Life and Non-Life), preparation of SQC 1 for ICAI and preparing white paper for Confederation of Indian Industry(CII) on Insurance. Hasmukh is the key member for Insurance Audits and IFRS practice for Insurance Companies in India.

Education

- Associate Member of the ICAI and holds bachelor's degree from University of Mumbai.

Agenda

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1	Introduction to IFRS 17
2	Scope and fundamental changes
3	Applicability of IFRS 17
4	Key Changes
5	Application of IFRS 17 – Steps
6	Overview of Financial statement impacts
7	Disclosure
8	Implementation Methodology

Introduction to IFRS 17
Why IFRS 17?

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KEY OBJECTIVES

The main aim of IFRS 17 is to standardize insurance accounting where IFRS is adopted to ensure that users of IFRS Financial Statements are able to compare companies (even between insurers and other companies), their past performance and their current financial position.

The key objectives of IFRS 17:

a. Introduce for the first time a single IFRS accounting model for all types of insurance contracts;

b. Make the new accounting model highly transparent; and

c. Align as much as possible insurance accounting with the general IFRS accounting of other industries.

PRIMARY FEATURES

The main features of the IFRS 17 general measurement model are as follows:

- Estimates and assumptions on future cash flows are always current;
- Reflection of the time value of money;
- Maximum use of observable market consistent information;
- Current and explicit measurement of risk;
- Expected profit is deferred and aggregated in groups of insurance contracts at initial recognition; and
- Expected profit is recognized over the coverage period

Scope and Fundamental changes

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SCOPE OF IFRS 17

IFRS 17 will apply to a range of different contracts issued by companies, which fall under the following categories:

- Insurance and reinsurance contracts issued by the company;
- Reinsurance contracts that the company holds (“ceded reinsurance”); and
- Investment contracts with discretionary participation features (“DPF”) that it issues, provided that the entity also issues insurance contracts

Investment components may be present in any of these contract types.

- Investment components are those amounts that an insurance contract requires an entity to repay to a policyholder, even if an insured event does not occur.

MEASUREMENT APPROACH

The Standard uses the following measurement approaches:

- The General Model {also referred to as the Building Block Approach “BBA”} - for most long-term contracts
- Premium Allocation Approach (PAA) - for most short-term contracts
- Variable Fee Approach, and
- Modified BBA

Applicability of IFRS 17

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"IFRS 17 on Insurance Contracts is the first common global insurance accounting standard which is to be globally adopted effective 1 January, 2022."

"To prepare and report first Ind AS financial statement beginning from 1 April 2020, with Comparatives for the financial year 2019-20 i.e. early adoption by 1 year & 9 months."

IFRS 17 - Key changes

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IFRS

- Contract Assessment – Significant Risk
- Unbundling
- Contract Boundary
- Contractual Service Margin (CSM)
- Risk Adjustment and Discounting
- Reinsurance
- Presentation and Disclosures
- Transition Provisions

Current GAAP

3

Aggregation of Contracts

Onerous Contracts

Profitable

Others (Might become Onerous)

Recognition and Measurement Models

Building Block Approach

Premium Allocation Approach

Variable Fee Approach

Transition Approaches

Retrospective Approach

Modified Retrospective Approach

Fair Value Approach

Application of IFRS 17 - Steps

Unit of account – Aggregation of contracts

Contract Boundary

Initial Recognition and Measurement Models

The general model a.k.a. the Building Blocks Approach (“BBA”)

Premium allocation approach

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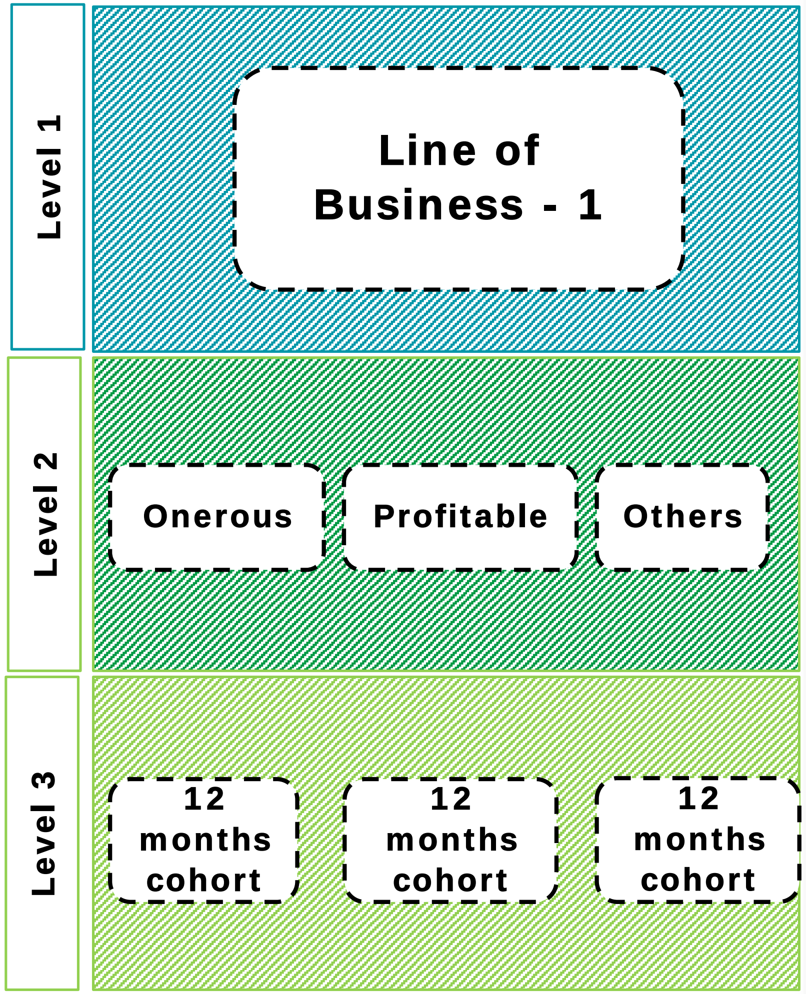
Unit of account

Aggregation of contracts

- A **portfolio** is a group of contracts subject to **similar risks and managed together** as a single pool
- The portfolio is then required to be disaggregated into **groups** of insurance contracts that at inception are
  - A. Onerous, if any
  - B. at initial recognition have **no significant possibility** of becoming onerous subsequently, if any; and
  - C. remaining contracts, if any
- There is decreasing ranking of the risk-adjusted profitability of the groups (B, C, A). B is the highest ranking risk-adjusted profitable group and A is the lowest (A is actually expected to be loss making)
- Further disaggregation of the specified groups is permitted
- Only contracts issued **within the same twelve-month period** are permitted to be grouped. Groups for shorter periods are permitted. This period does not need to coincide with the annual reporting period of an entity
- An entity shall establish the groups at initial recognition, and **shall <u>not</u> reassess** the composition of the groups subsequently



Application of IFRS 17 - Steps

Unit of account – Aggregation of contracts

Contract Boundary

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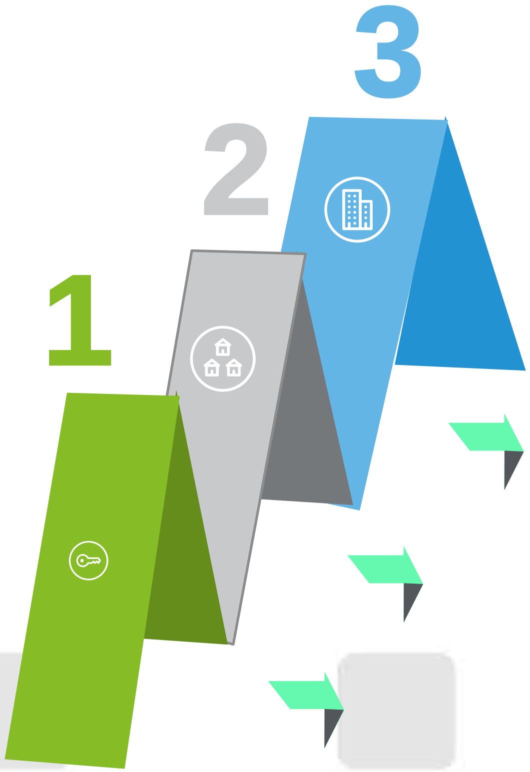
Contract boundary

Definition

Cash flows are within the boundary if they arise from substantive rights and obligations that exist during the period in which the entity can **compel the policyholder to pay premiums** or the **entity has a substantive obligation to provide the policyholder with coverage.**

These CF includes claims that might occur after the coverage period but obligations related to the coverage period (e.g. incurred claims liability)



Interpretation of the beginning of contract boundary is the earlier of:

When the facts and circumstances indicate that the contract will belong to an onerous group

The date on which the first premium is due; or

The beginning of coverage; or

Application of IFRS 17 - Steps

Unit of account – Aggregation of contracts

Contract Boundary

Initial Recognition and Measurement Models

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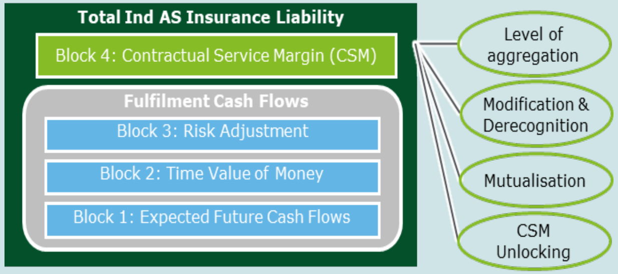
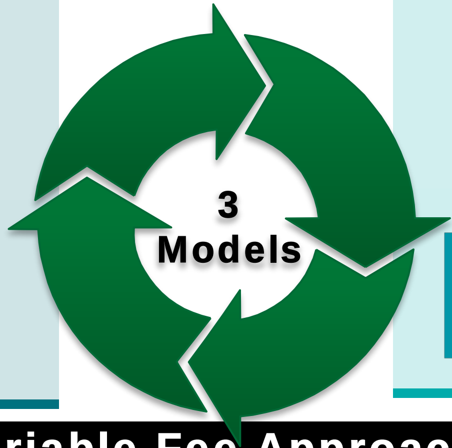
Recognition and Measurement Models

Building Block Approach

- **Current estimate** assumptions
- **Grouped by portfolio, year of sale** and one of the **three possible profitability levels**
- Profit measured and reported based on the delivery of the **"insurance coverage service"**
- **Discount rates based on market interest rates** (currency, duration, liquidity)





Premium Allocation

- The Premium Allocation Approach (PAA) is a **simplified approach** to measuring the liability for remaining coverage only
- The key simplification is to **exempt the insurer from calculating and explicitly accounting for the CSM**, the main component of the liability for remaining coverage

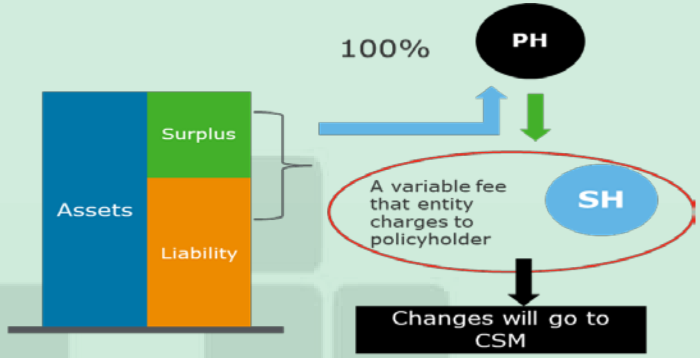
If it is a **reasonable approximation** to BBA & coverage period at initial recognition is more than 1 year

If **coverage period** at initial recognition is one year or less

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

Variable Fee Approach

- Returns to the entity arising from participating contract is viewed as part of the **compensation that the entity charges the policyholder for service provided by the insurance contract**



Application of IFRS 17 - Steps

Unit of account – Aggregation of contracts
Contract Boundary
Initial Recognition and Measurement Models
The general model a.k.a. the Building Blocks Approach (“BBA”)
Premium allocation approach
Reinsurance
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Measurement requirements

The general model a.k.a. the Building Blocks Approach ("BBA")

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PRINCIPLES

- Measurement uses current estimate assumptions
- Contracts are grouped by portfolio, year of sale and one of the three possible profitability levels
- Profit measured and reported based on the delivery of the "insurance coverage service"
- Deferred profit absorbs assumption changes for future coverage ("Unlocking")
- Discount rates based on market interest rates (currency, duration, liquidity)
- Expected profit from participating contracts revalued based on assets

Total IFRS Insurance Liability

Block 4
Contractual Service Margin ("CSM")

Measured at inception as the expected contract profit to be earned as services are fulfilled. It is **adjusted for changes in non-financial variables** affecting future coverage cash flows. It **accretes interest based on day 1 discount rate** (locked-in rate)

'Fulfilment cash flows'

Block 3:
Risk Adjustment

An entity-specific assessment of the uncertainty about the amount and timing of future cash flows

Block 2:
Time Value of Money

An adjustment that converts future cash flows into current amounts

Block 1:
Expected Future Cash Flows (unbiased probability weighted mean)

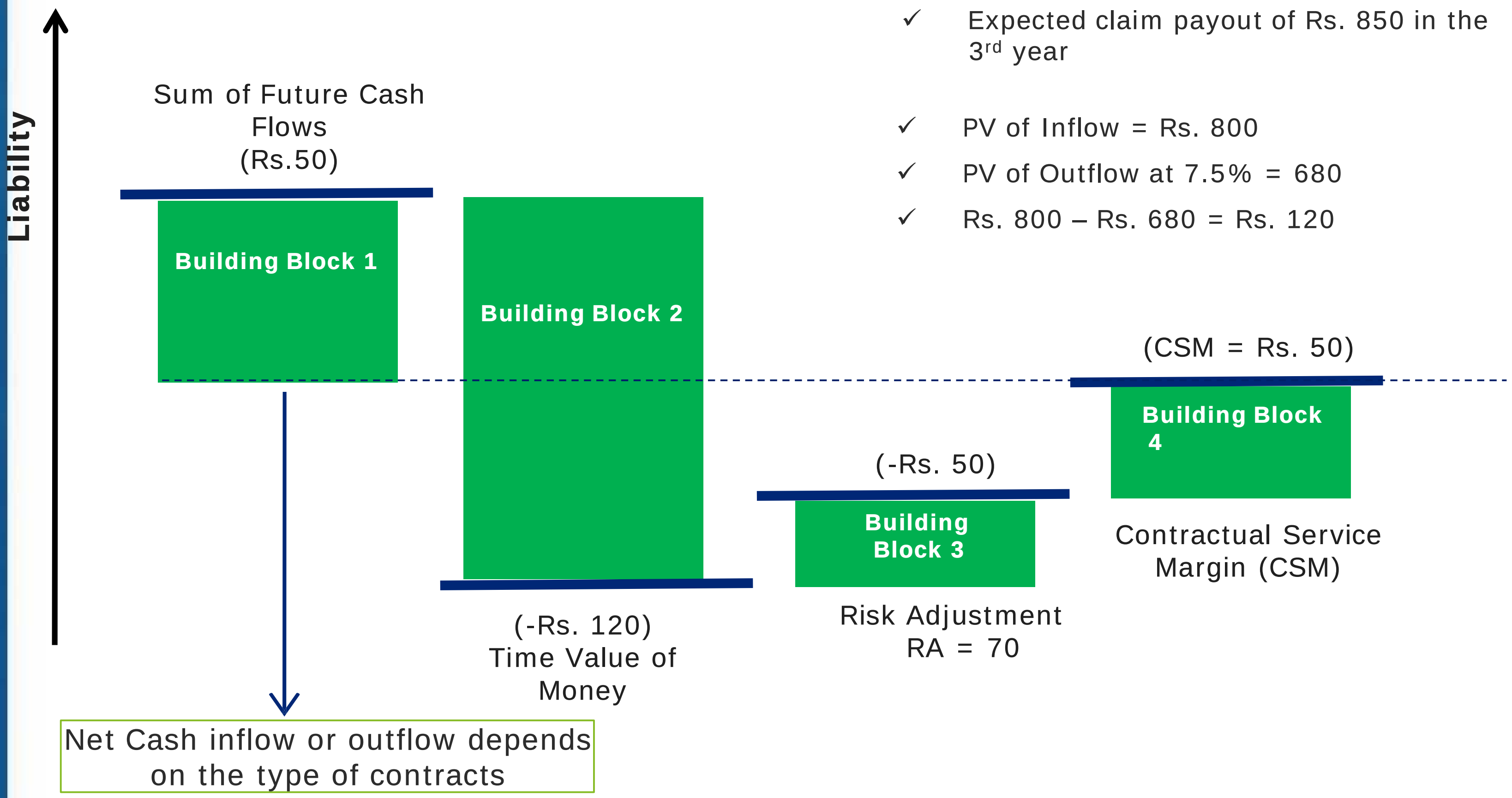
Expected (probability-weighted) cash flows from premiums, claims, benefits, expenses and acquisition costs

Building Block Approach ('BBA')

Overview measurement

- ✓ 4 year insurance contract
- ✓ Upfront premium of Rs. 800
- ✓ Expected claim payout of Rs. 850 in the 3rd year

- ✓ PV of Inflow = Rs. 800
- ✓ PV of Outflow at 7.5% = 680
- ✓ Rs. 800 – Rs. 680 = Rs. 120



Balance Sheet Liability

Block 1 + Block 2 + Block 3 < 0

Recognise Contractual Service Margin (= Block 4) to eliminate Day One Gain (at inception before any cash flows are received or paid)

Block 1 + Block 2 + Block 3 > 0

Recognise Day One Loss (Onerous Contract)

Application of IFRS 17 - Steps

Unit of account – Aggregation of contracts

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The general model a.k.a. the Building Blocks Approach (“BBA”)

Premium allocation approach

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Premium allocation approach

Overview

It does not apply to the liability for incurred claims for which the general measurement model / BBA always apply

The Premium Allocation Approach (PAA) is a simplified approach to measuring the liability for remaining coverage only

The key simplification is to exempt the insurer from calculating and explicitly accounting for the CSM, the main component of the liability for remaining coverage

Premium allocation approach

Criteria

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When to use the Premium Allocation Approach:

Applicable for yearly products and short-term health rider products

01

If the **coverage period** at initial recognition is **one year or less**

OR

02

If it would be a **reasonable approximation** to BBA and the coverage period at initial recognition is more than one year

Applies to liability for remaining coverage only

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

Premium Allocation Approach

Optional simplified approach for short term contracts

- **Optional practical expedient** to the general model
- Similar to current UPR method, but with presentational changes
- Eligibility criteria must be met (safe harbour exists for contracts with coverage period of 1 year or less)

Liability for remaining coverage + **Liability for incurred claims** = **IFRS 17 liability**

Simplified measurement

Premiums, if any, received

Directly attributable acquisition costs

Option to expense when incurred if coverage period is one year or less

Earned premiums recognised in revenue

Liability for remaining coverage

Insurance contract revenue is based on the unwind of the expected premium receipts (similar to current earned premiums approach)

Follows the building blocks approach – but no CSM

Risk adjustment

Discounting

Unbiased probability weighted mean CF

Fulfilment cash flows

Discounting of claims to be settled within 1 year not required

Application of IFRS 17 - Steps

- Unit of account – Aggregation of contracts
- Contract Boundary
- Initial Recognition and Measurement Models
- The general model a.k.a. the Building Blocks Approach (“BBA”)
- Premium allocation approach
- **Reinsurance**
- Transition Approach
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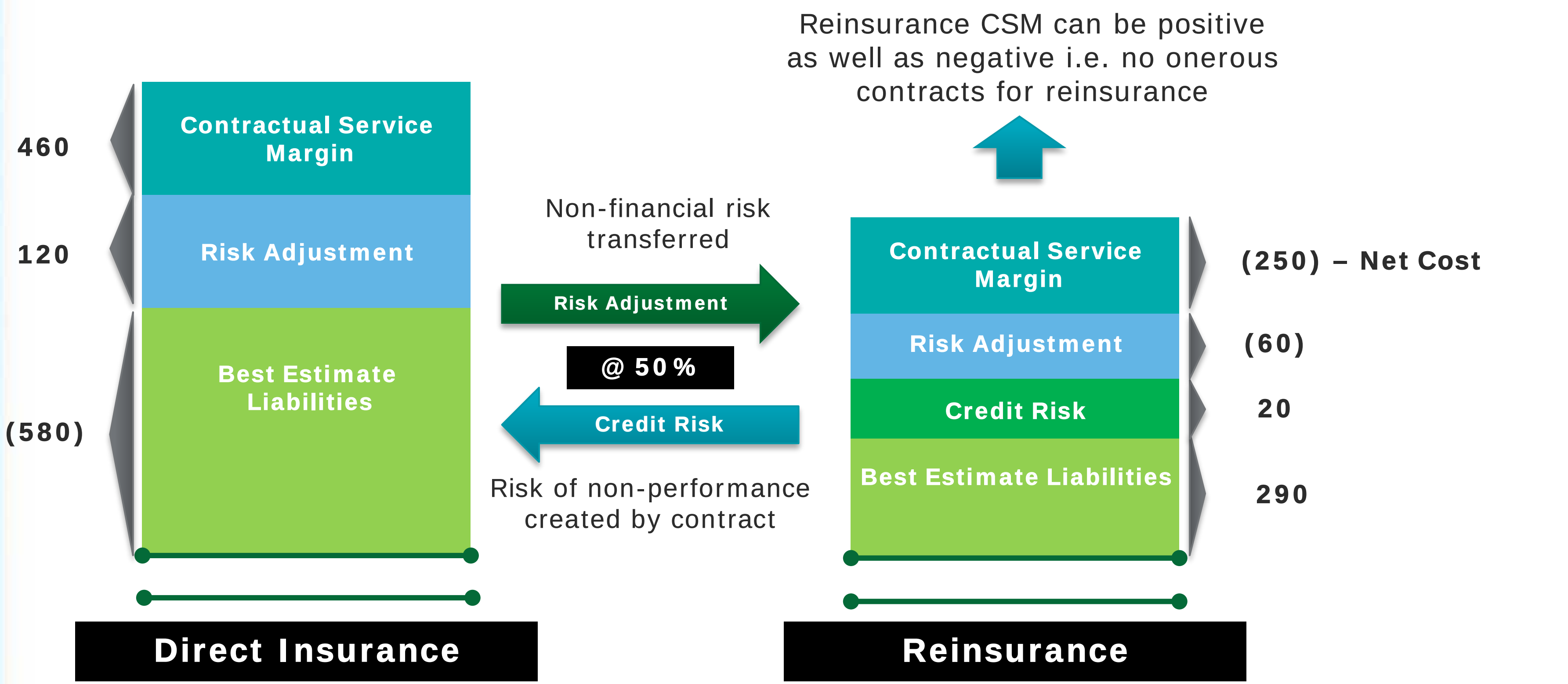
Reinsurance contracts



Credit Risk

The expected PV of future CFs includes an adjustment for the risk that the reinsurer may fail to satisfy its obligations under the RI contract held. Changes in the FCF that result from changes in the risk of non-performance by the reinsurer do not adjust the CSM. Instead, these changes are reflected in P&L when they occur.

Application of IFRS 17 - Steps

Unit of account – Aggregation of contracts

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IFRS 17 Transition Approach

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The following are the three transition approaches:

01

Retrospective Approach

- The retrospective approach **must be applied** to all groups of insurance contracts, **unless it is impracticable** or if groups of contracts in force on transition date cannot be identified (e.g. the inception date has been lost).
- Recognise and measure each group of insurance contracts as if IFRS 17 had always applied i.e. since **inception of the contracts**
- If applying the retrospective approach is impracticable, an entity is then permitted to choose between the **modified retrospective approach** and the **fair value approach**.

02

Modified Retrospective Approach

- Objective is to achieve the **closest outcome to retrospective application** possible **using reasonable and supportable information** (which is available without undue cost or effort)
- Assessment to be made at inception of contract or at transition date;

03

Fair Value Approach

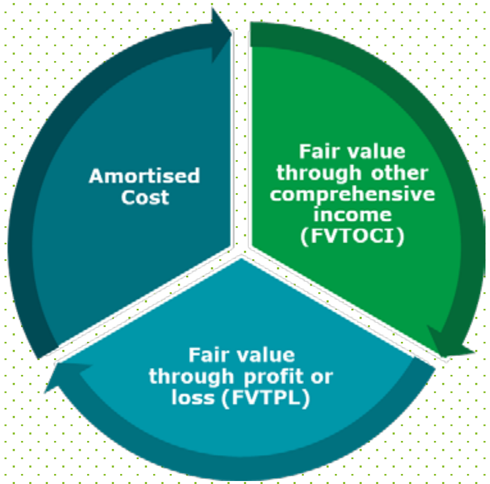
- Fair value approach deals with situations where there is **lack of historical information**
- Application is **same as modified retrospective approach** however, the Companies are allowed to make assessments **either as at inception date of a contract or transition date.**

Application of IFRS 17 - Steps

IFRS 17 – Balance sheet overview

IFRS 9 requires that a financial asset be classified into one of three categories for measurement and income recognition on the basis of:

- Business model for managing Financial Assets, and
- Contractual cash flow characteristics.



IFRS 9

Assets

Fair Market Value / Amortised cost

Liabilities

Equity

Insurance Contract Liabilities

IFRS 17

Contractual Service Margin

Risk Adjustment

Best Estimate Liabilities

Overview of Financial Statement impacts

Statement of financial position

Current presentation (extracts)
Asset Section
Investments
Loans
Fixed Assets
Cash and Bank Balances
Advances and Other assets
Liabilities Section
Fair Value Change A/c
Borrowings
Claims Outstanding (included under current liabilities schedule 12)
Provisions
Share Capital
Reserves and Surplus

IFRS 17 presentation (extracts)
Asset Section
Cash and cash equivalents
Investments
Loans
Other Financial Assets
Investment property
Insurance contract assets
Reinsurance contract assets
Property, plant and equipment
Liabilities Section
Insurance contract liabilities
Reinsurance contract liabilities
Borrowings
Other Financial Liabilities
Provisions
Equity
Other Equity

Above is gross of reinsurance and reinsurance lines will have to be separately presented as assets or liabilities. Any investment contracts with discretionary participating feature will have to be separately presented as well.

In addition, new disclosures, such as BEL, RA, and CSM roll forwards, will be required.

Overview of Financial Statement impacts

Statement of comprehensive income

Current presentation (extracts)	IFRS 17 presentation (extracts)
Gross Written Premium	**Insurance revenue**
Add / Less: Reinsurance	**Insurance service expenses**
Add / Less: Unearned Reserve Movement	Incurred claims and expenses
Net Earned Premium	Amortisation of acquisition costs
Income from Investments	Experience adjustment - liability for incurred claims
Other Income	Change in estimates - liability for incurred claims
Total Income	Amounts recovered from reinsurers
	Allocation of reinsurance premiums
Commission	**Insurance service results**
Operating Expenses	Investment income
Claims Paid	Insurance finance income or expense
Total Expenses	**Finance results**
	Profit or Loss
Surplus / (Deficit)	Other comprehensive income - insurance finance income or expense
	Total comprehensive income

Application of IFRS 17 - Steps

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- The general model a.k.a. the Building Blocks Approach (“BBA”)
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- **Disclosure requirements**
- Implementation Methodology

IFRS 17 disclosure requirements

The disclosure requirements under IFRS 17 can be categorized as follows:

General Disclosures

- Explanation of recognised amounts
- Significant judgments
- Risk

Specific Disclosures

- Premium Allocation Approach
- Transition

IFRS 17 – A recap

- Contract assessment – Significant risk
- Unbundling
- Contract Boundary
- Measurement models
- Reinsurance
- Presentation and Disclosures
- Transition provisions

Application of IFRS 17 - Steps

Unit of account – Aggregation of contracts

Contract Boundary

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IFRS 17 Implementation Journey

The transformation journey involves complex and multi dimensional disciplines.

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Impact analysis

Identify the impacts of each option on the business and model the financial impacts

General Implementation Vision

Roadmap of activities for implementation

Deep Dive analysis

Operational and Financial impact analysis

Design Approach

Identify the implementation options

Solution Implementation

Implement significant technical changes, quality analysis and validation

Dry Run

Transition data preparation and pilot testing

Restatement And Comparatives

Enhanced governance and control

Reporting & Sustenance

Provisioning operational reports per new financial statements & operationalize applications

IFRS project approach
Implementation Model

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Phase I
Diagnostic and Impact Analysis

1 Business Impact Assessment (BIA)

2 Financial Impact Assessment (FIA)

Phase III
Generation of IFRS Financials

4 Implementation Roadmap

5 Parallel Implementation

Phase II
System Changes

3A System Assessment

3B System Development

Refer separate slide for System Assessment

"A phased approach would enable a seamless transition from the existing structure to the new operating model"

Project Management Office (PMO)

IFRS project approach

System assessment and development

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3A **Phase II** System Changes

Phase II System Development 3B

Initial Review

- As-is assessment of data, systems and models
- Identify policy decisions
- Pilot model assessment for material portfolios and high level analysis
- Communication of results

Design
Policy and methodology design

- Explore policy decisions
- Propose model methodology
- Develop model specification requirements (incl. data & systems)
- Engagement with stakeholders
- Agree program plan

Systems
Data and systems review

- As-is assessment of data availability
- Develop data specification requirements

- Feasibility study of infrastructure platforms
- Select platform

Develop
Model development and validation

- Extract required data for model development
- Cleansing and preparation of data
- Model build
- Calibrate models across all portfolios
- Impact analysis
- Internal model governance process
- Establish model monitoring reports

Deploy
Systems deployment and end user reporting

- Develop business requirement
- Deployment of models into selected platform
- Model testing – parallel runs
- User acceptance testing
- End user reporting and communication
- Training and education on the interpretation of results

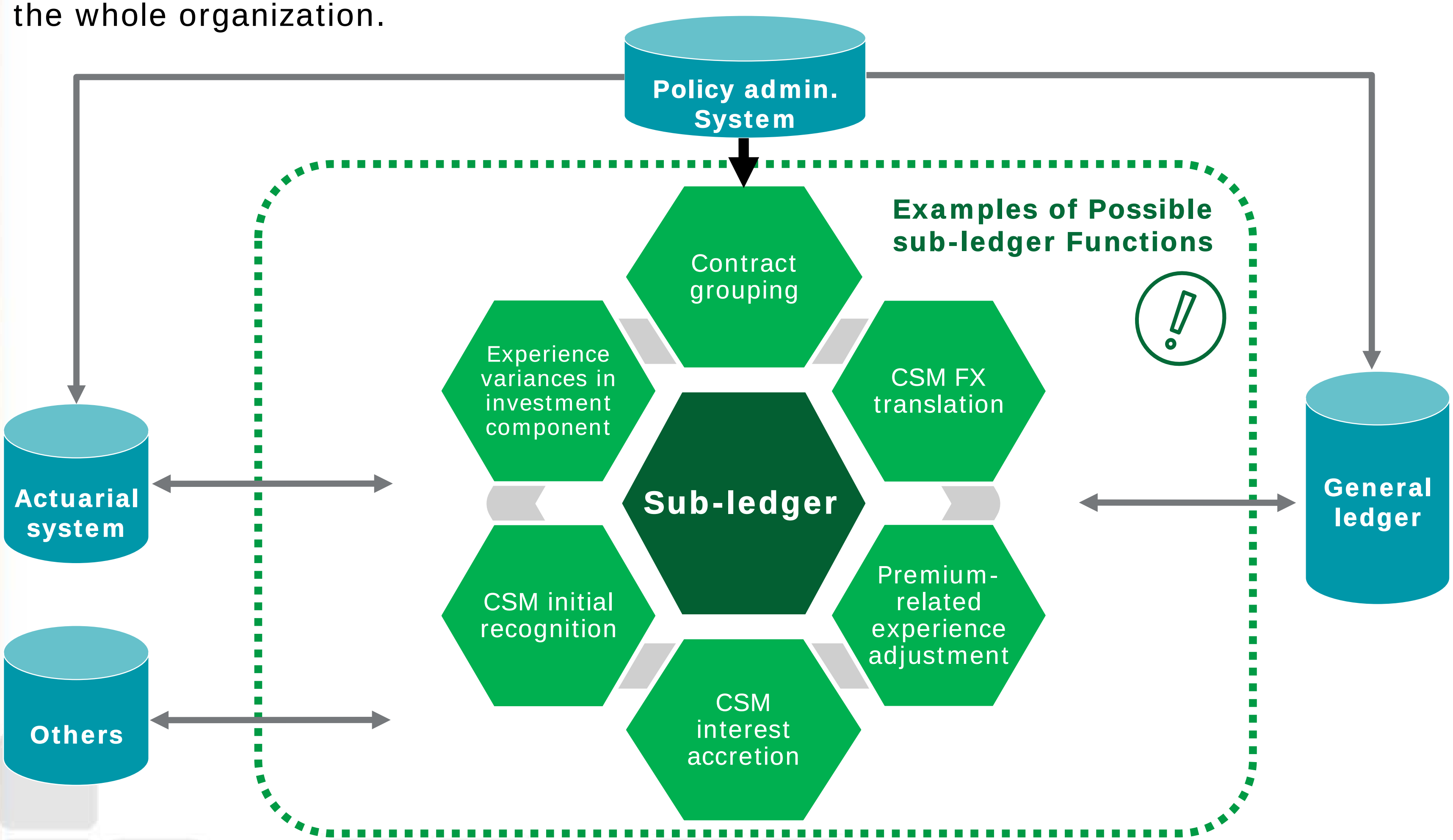
Benefits

Time

System Assessment

IT Infrastructure blueprint

Based on our market understanding, majority of global insurance companies are going to adopt **a sub-ledger** to bridge the gap between financial and actuarial data to improve analytics capabilities, strengthen controls, manage compliance and ultimately increase the performance of the whole organization.



Thank You