Deloitte
Haskins & Sells LLP

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Understanding IFRS 17 and An ideal approach of IFRS implementation

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Institute of Actuaries of India

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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

Agenda

1	Introduction to IFRS 17
2	Scope and fundamental changes
3	Implementation methodology and transition approach

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

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.

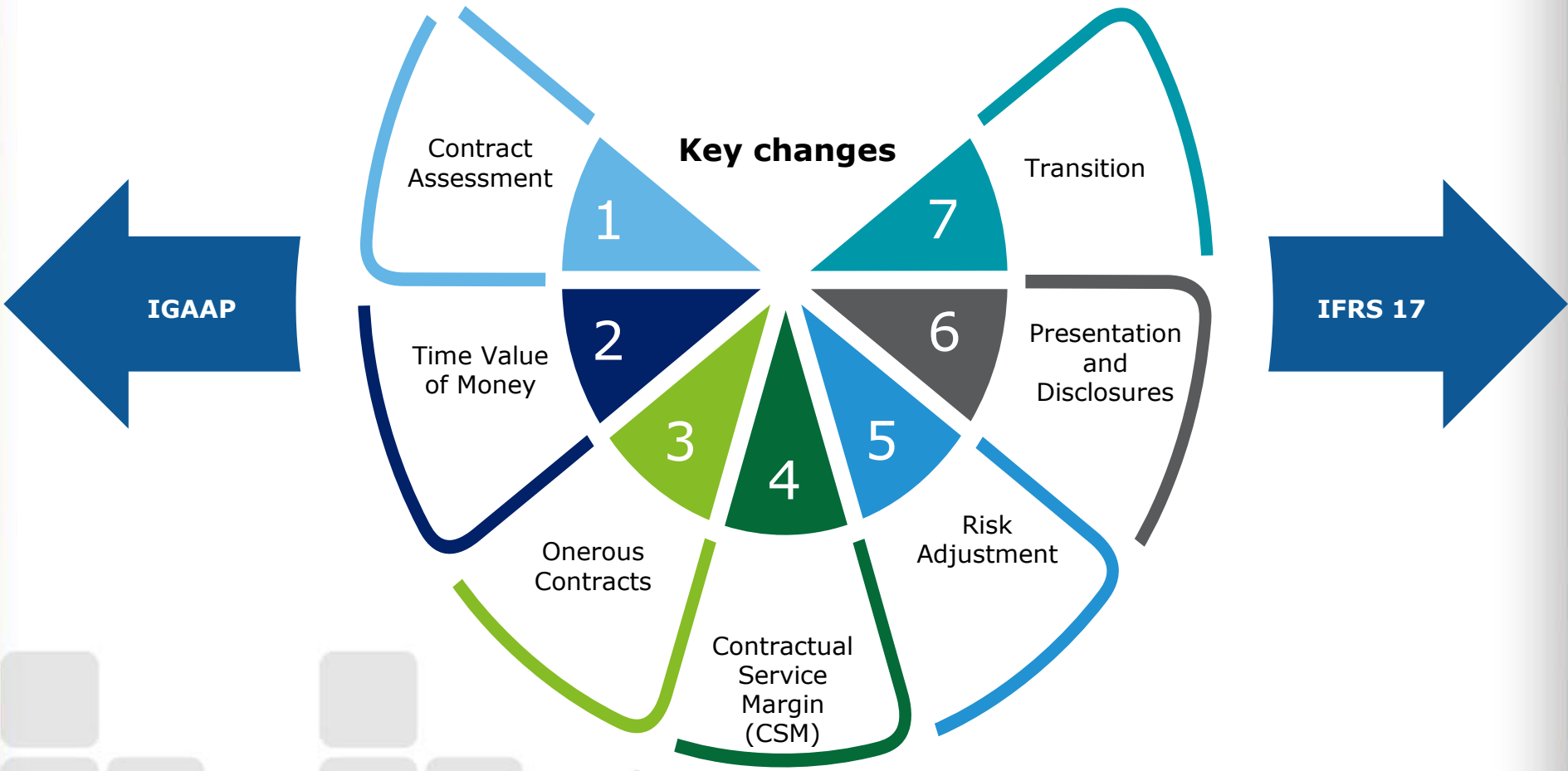
- Investment components are those amounts that an insurance contract requires an entity to repay to a policyholder, even if an insured event does not occur.

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

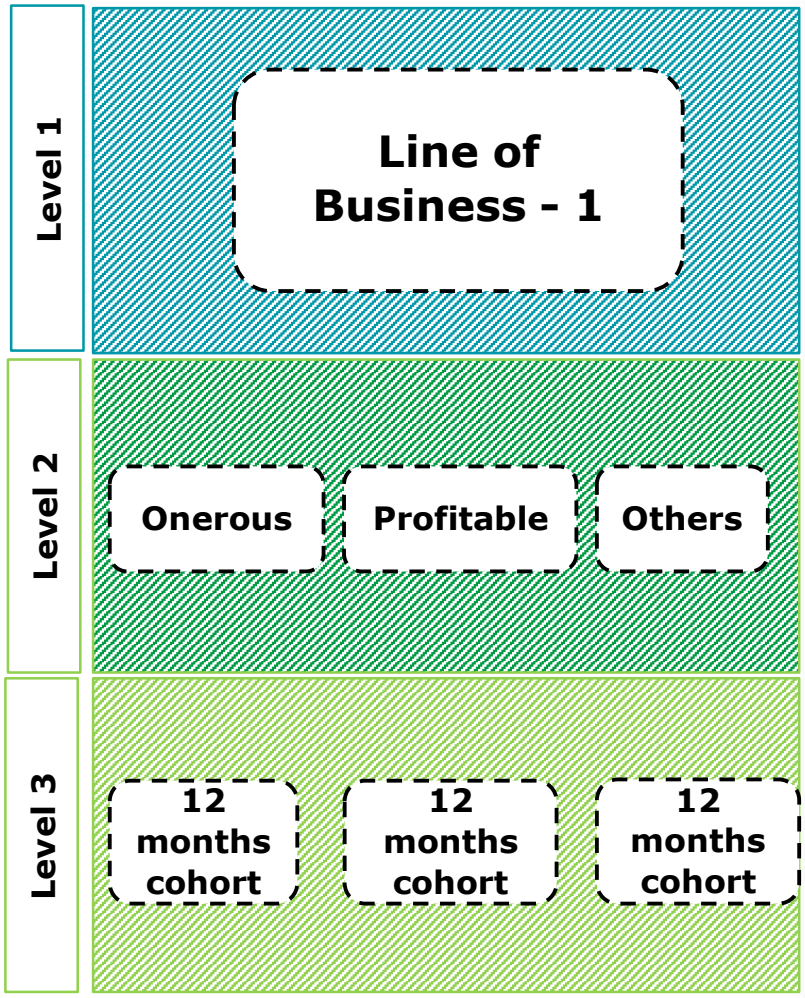
IFRS 17 - Key changes



Unit of account

Aggregation of contracts

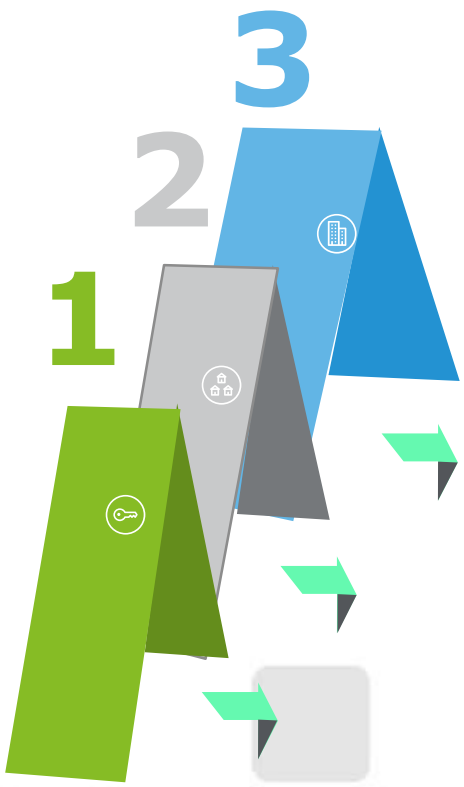
- A **portfolio** is a group of contracts subject to **similar risks and managed together** as a single pool
- The portfolio is then required to be disaggregated into **groups** of insurance contracts that at inception are
  - A. Onerous, if any
  - B. at initial recognition have **no significant possibility** 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



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:

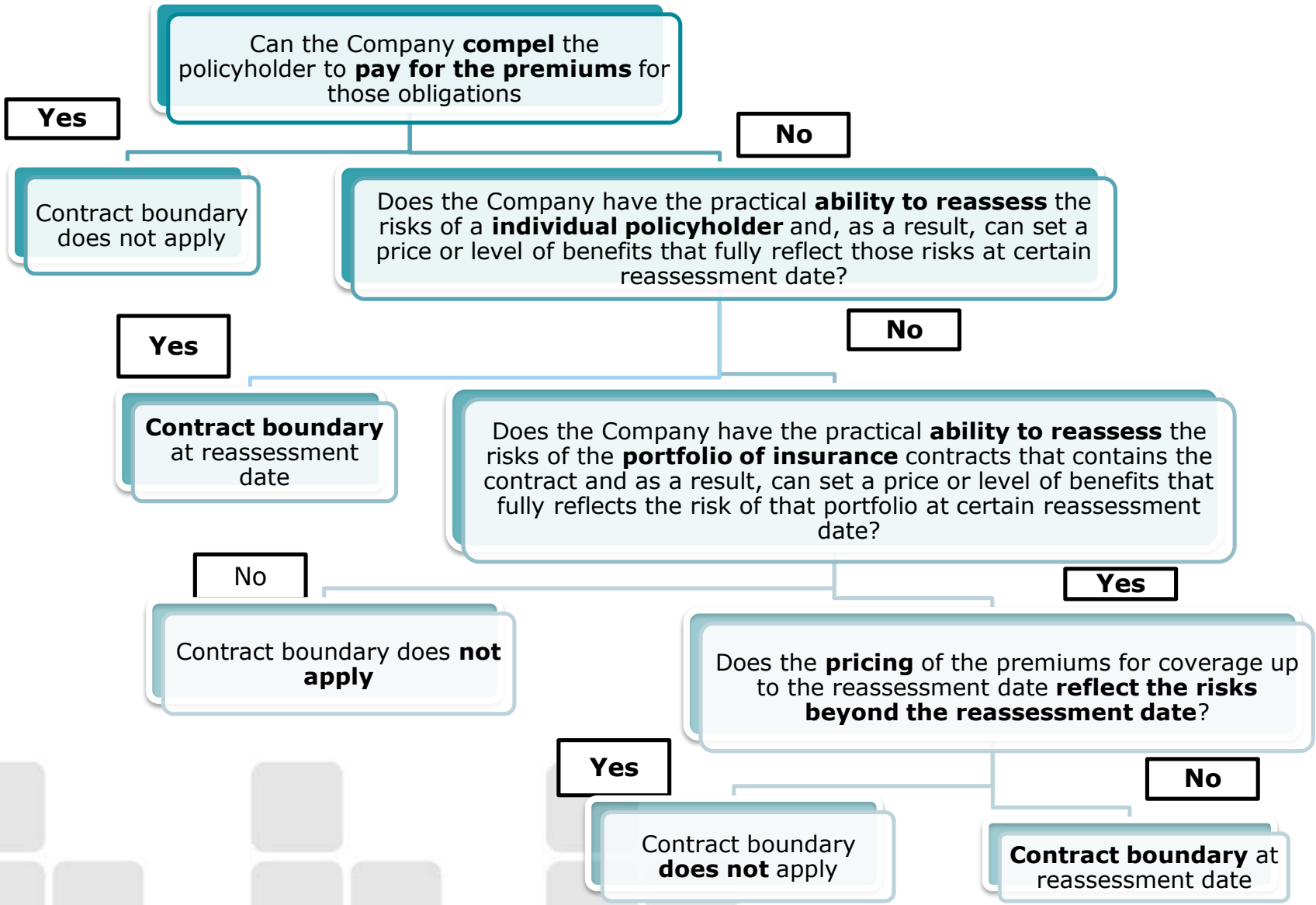
When the facts and circumstances indicate that the contract will belong to an onerous group

The date on which the first premium is due; or

The beginning of coverage; or

Contract boundary

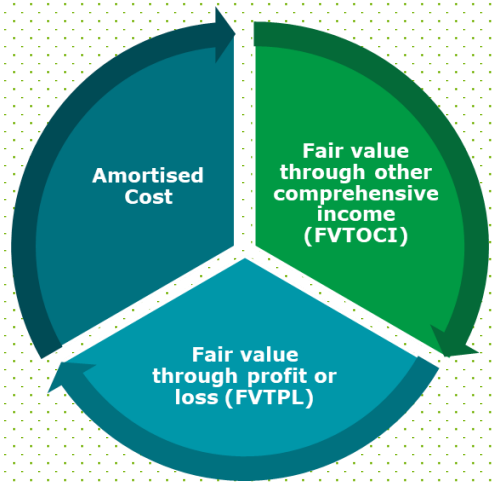
Definition



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

Liabilities

Equity

Insurance Contract Liabilities

Refer next slides for Measurement Models

IFRS 17

Contractual Service Margin

Risk Adjustment

Best Estimate Liabilities

Solvency II's goal is to establish a **common regulatory framework** to **maintain capital adequacy and risk management** standards. The aims of IFRS and Solvency II are to facilitate **comparability** and **transparency** from a regulatory and accounting perspective to external stakeholders, in contrast to the divergent practices and measures which currently characterize insurance reporting.

Recognition and Measurement Models

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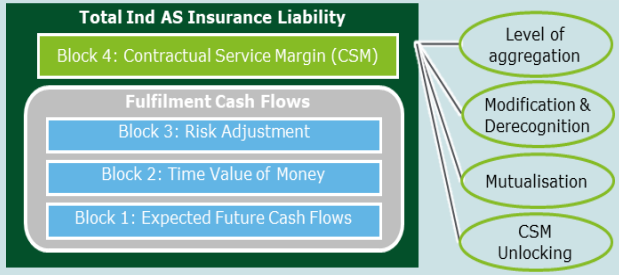
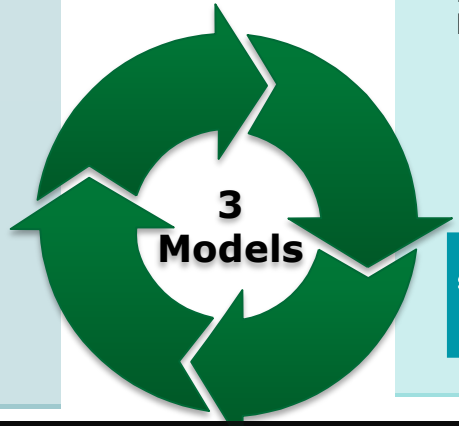
Building Block Approach

- **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

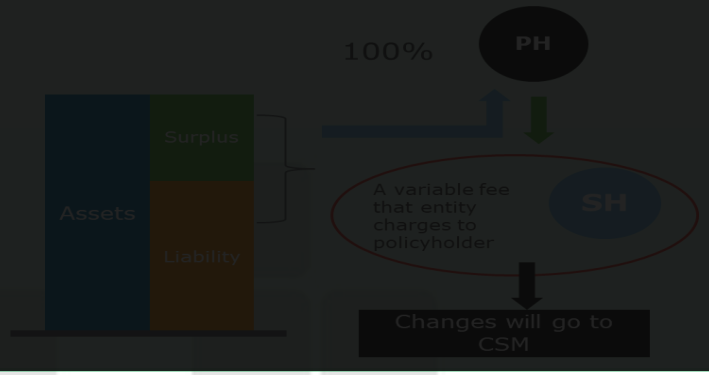
If it is a **reasonable approximation** to BBA & coverage period at initial recognition is more than 1 year

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.

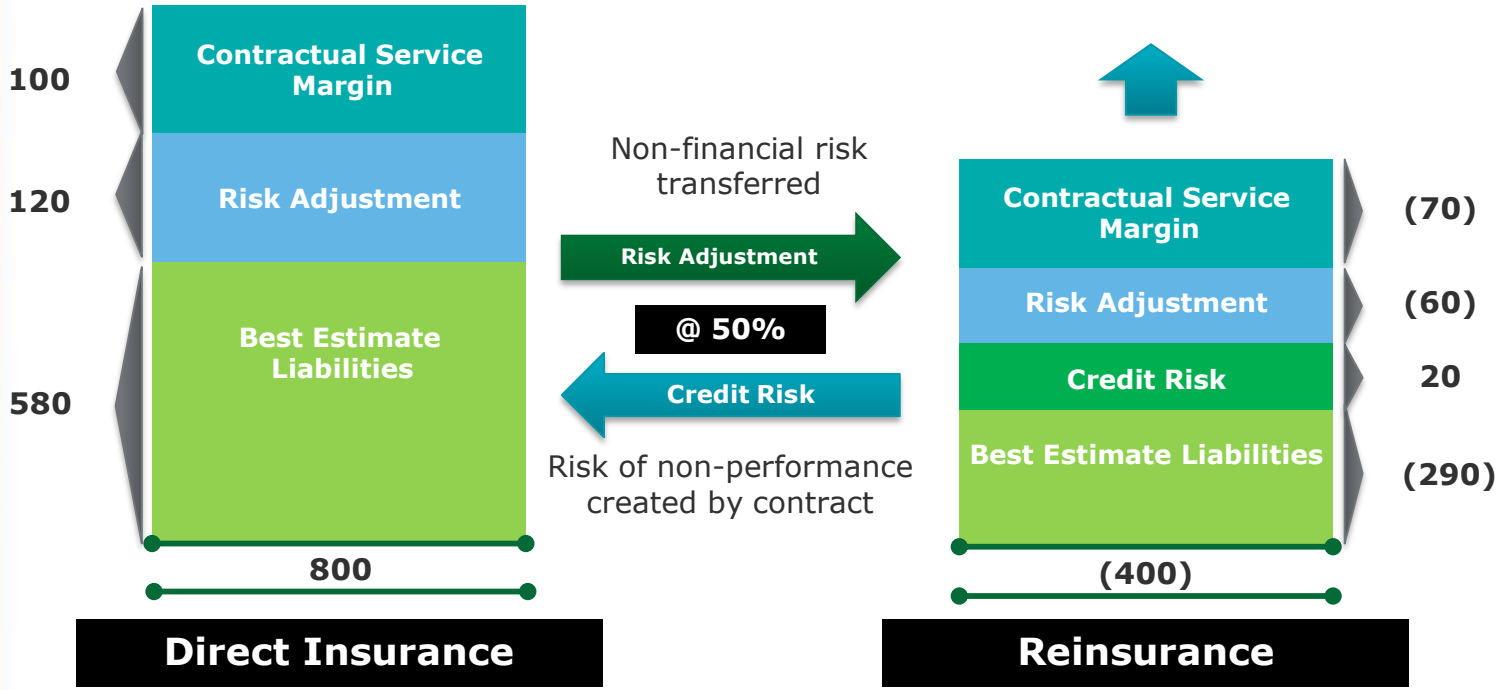
Variable Fee Approach

- 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**



Reinsurance contracts

Reinsurance CSM can be positive as well as negative i.e. no onerous contracts for reinsurance



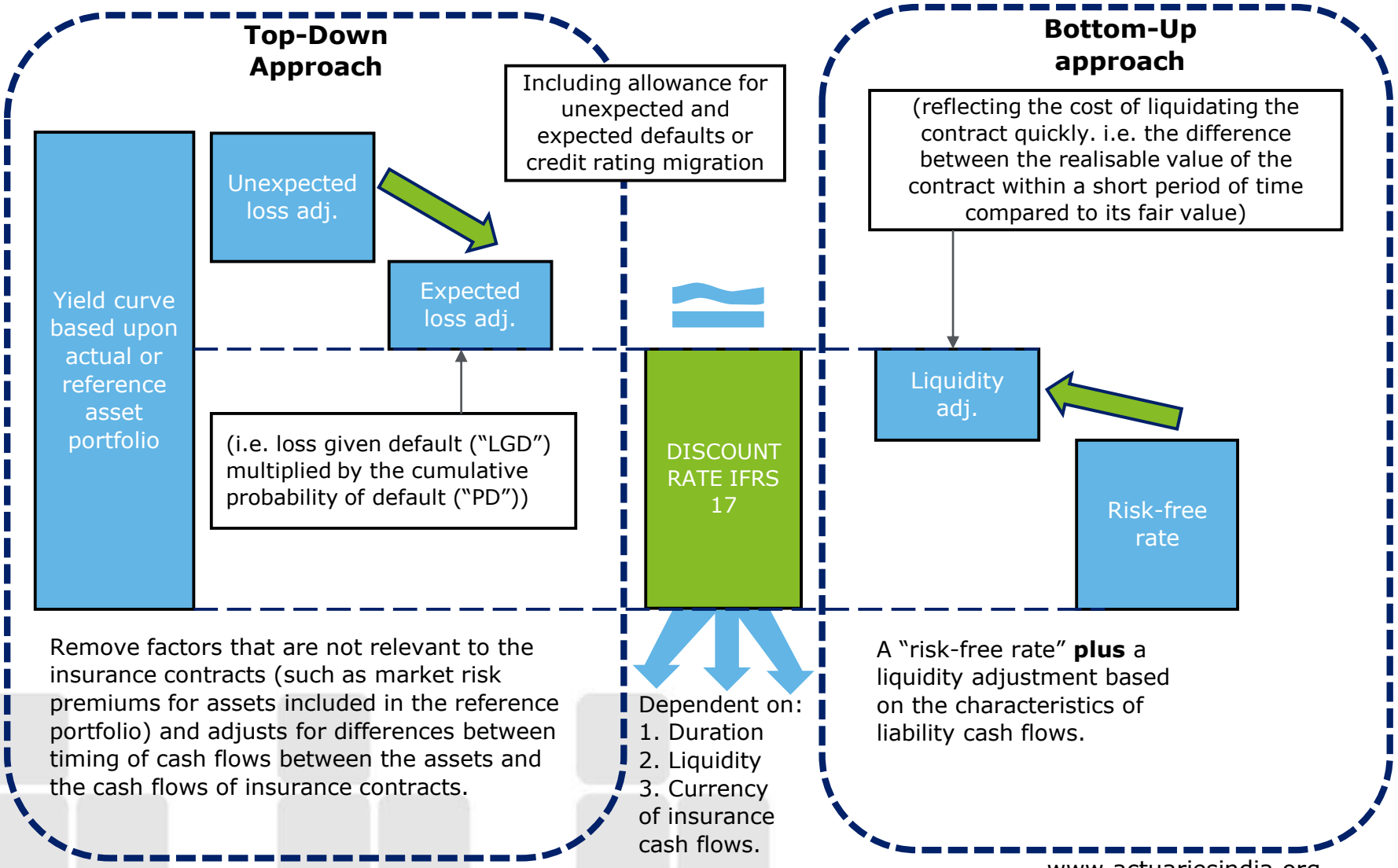
Credit Risk

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.

Discount rate

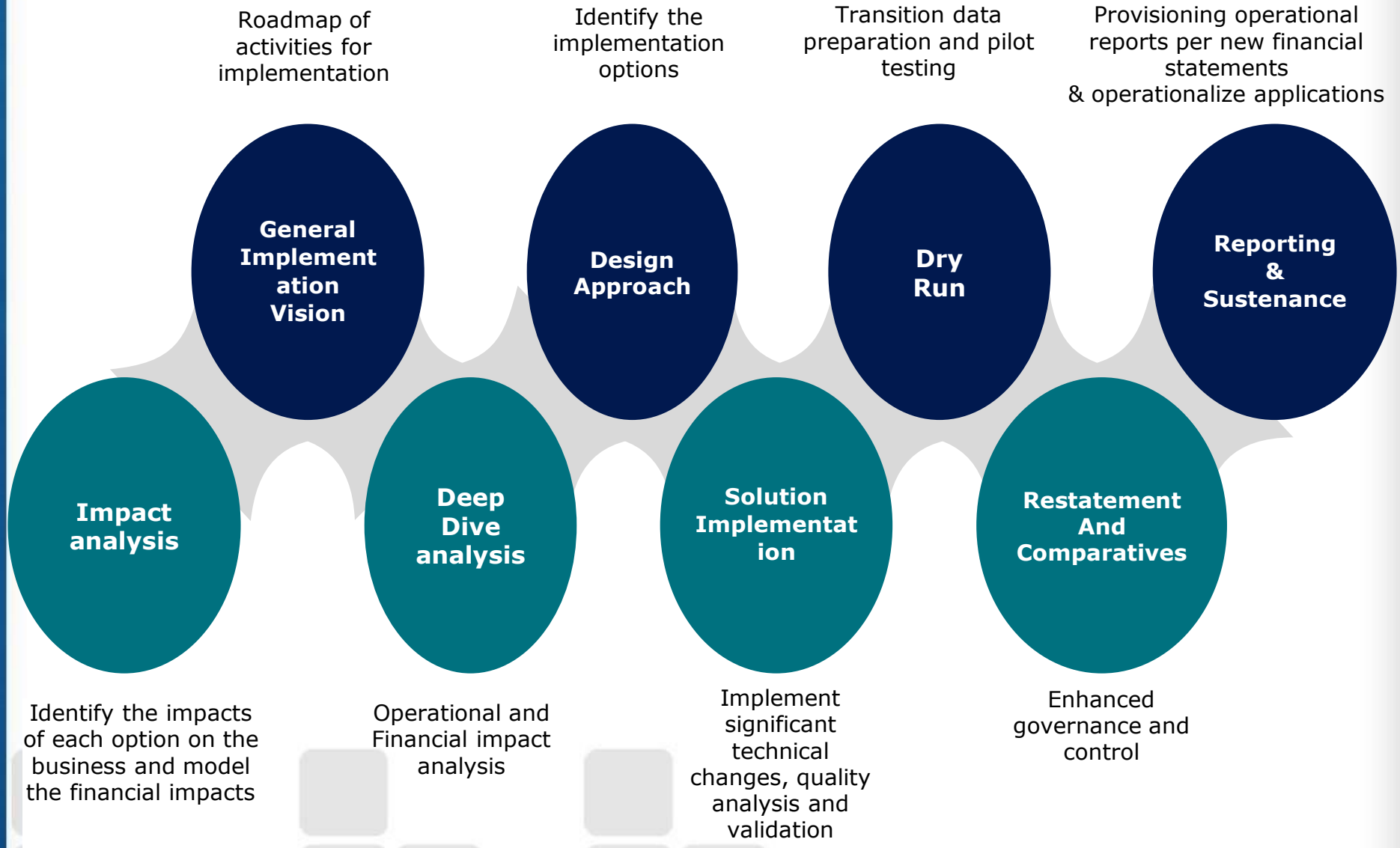
IFRS 17 requires **cash flows** that **depend** on the **return on the underlying items** to be discounted using rates that **reflect that dependence**

e.g. discount rates and bonus cash flows for traditional participating business should be consistent with each other



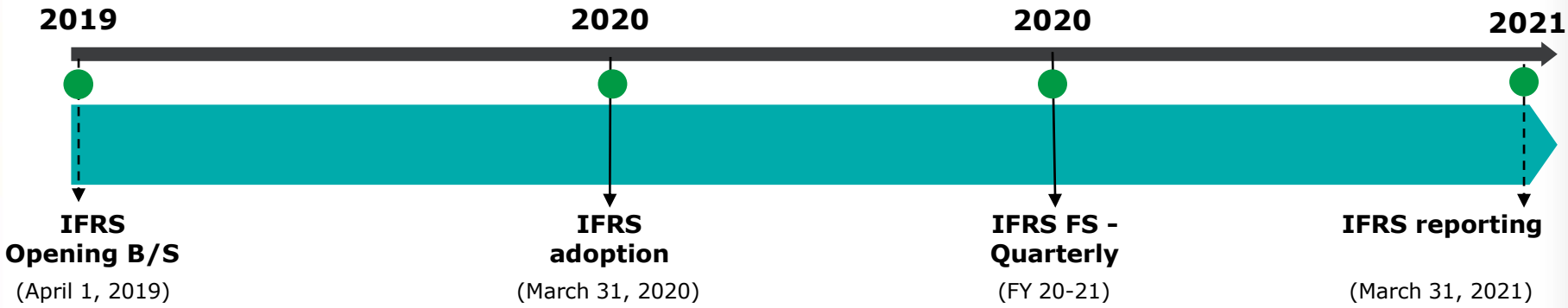
IFRS 17 Implementation Journey

The transformation journey involves complex and multi dimensional disciplines.



IFRS 17 Transition Provision

CONCURRENT APPLICATION



Following will be the requirements basis the above timeline:

- IFRS Opening Balance Sheet as at April 1, 2019
- Annual IFRS financial information for the year ended March 31, 2020
- Reconciliation of Equity as per Indian GAAP to IFRS as at April 1, 2019 and March 31, 2020
- Reconciliation of Profit and Loss as per Indian GAAP to total comprehensive income in accordance with IFRS for year ending March 31, 2020
- IFRS financial statements for the periods ended June 30, September 30 and December 31, 2020
- Annual IFRS financial information for the year ended March 31, 2021

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

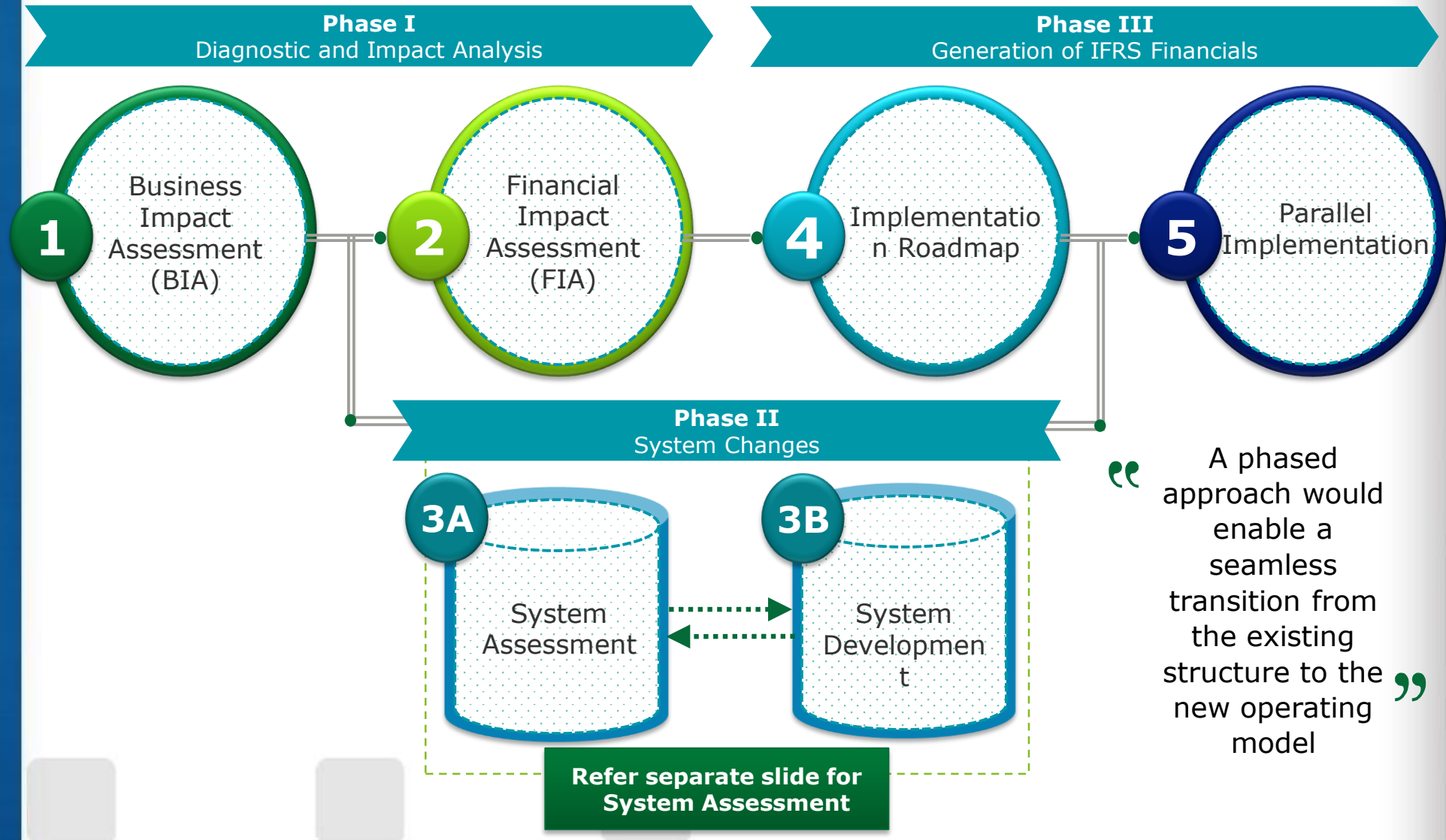
- Objective is to achieve the **closest outcome to retrospective application** possible **using reasonable and supportable information** (which is available without undue cost or effort)
- Assessment to be made at inception of contract or at 1/4/2019;

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 1/4/2019**

IFRS project approach
Implementation Model



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

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

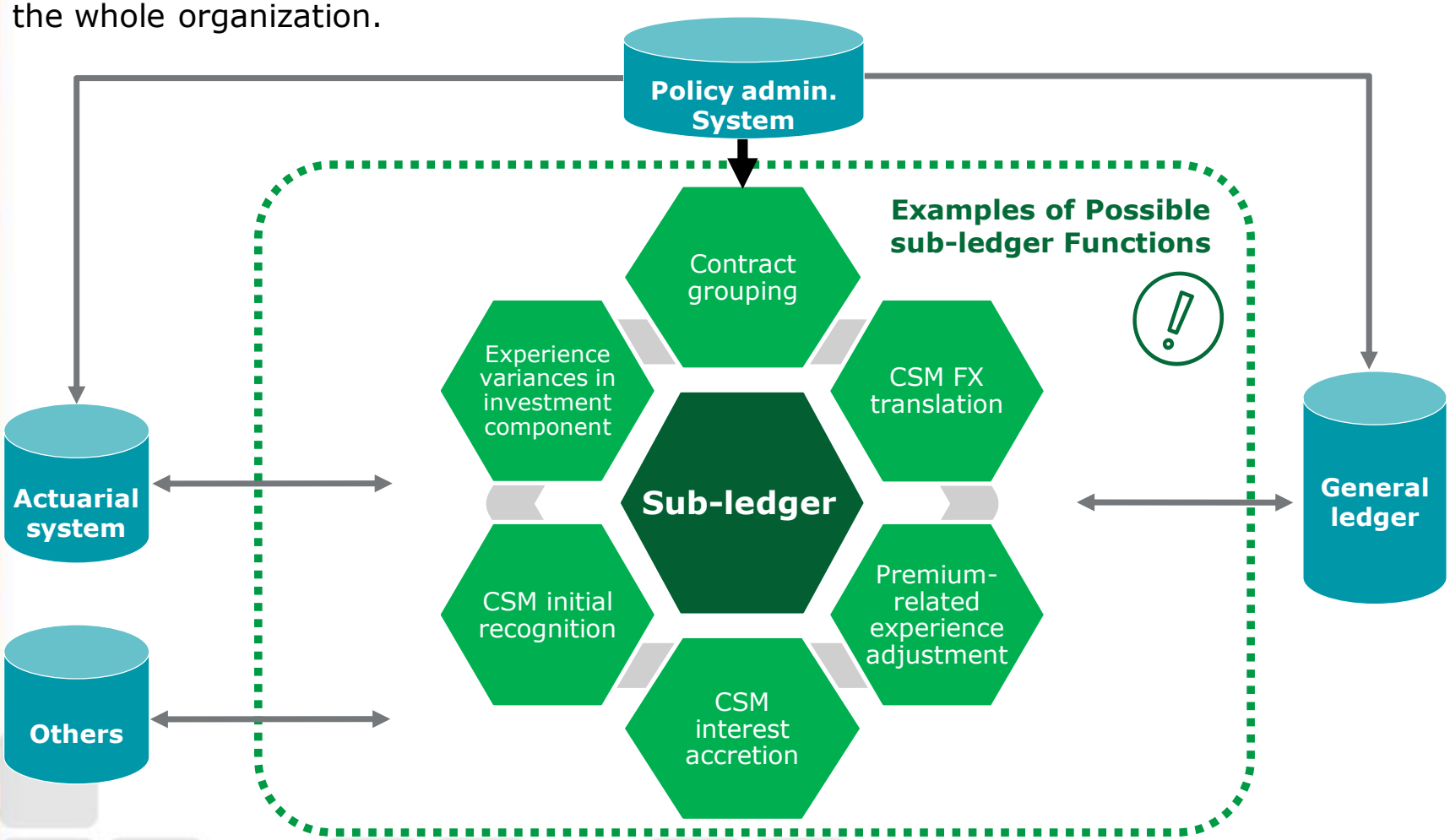
Benefits

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.



System Assessment (contd.)

Potential systems to be evaluated

Based on our experience in similar projects, the following systems (if available) will be evaluated:

Core system	Data type	Description
Front-end Systems	Others	• Insurance product quotations • Product sales proposals • e-Application data
Policy Administration System	Policy data	• Basic policy contractual data • Different policy statuses • Investment component • Onerous and non-onerous contracts
	Transaction data	• Claims payment • Expenses incurrence • Agency commission payment • Policy loan lending and collection
Investment Asset System	Economic data	• Bond data (market value, carrying value, tenor, accrued interest…etc.) • Equity market value • Derivatives market value and mark-to-market • Counterparty • Credit ratings
Actuarial System	Cash flows	• Projected cash flows at policy level
Other Back-end Systems	Others	• Underwriting data • Cheque data • Agency compensation data • Distribution management data
Spreadsheets / Access	Others	• Some assumption tables or some specific reinsurance-related data • Late adjustment calculations
GL System / Financial Module	Journal Entries	• Includes accounting rule engines that convert the asset and liability movement data into journal entries for posting • Output trial balance and financial statements
Reinsurance system	Transaction data	• Policy level data for Reinsurance accepted and ceded

Key Question

Are we ready for IFRS 17 Transition?

Risk adjustment

- Diversification effect across portfolio and how to allocate such benefit
- Reinsurance risk adjustment asset
- Stochastic calculations

Discount rates

- Methodology to factor discount rate having impact on modelling, systems and data
- OCI v/s P&L approach

Reinsurance accounting

- Transition of underlying contracts from profitable to onerous (or vice versa) on reinsurance balances
- Onerous and profitable contracts covered by a single reinsurance treaty

Key Question

Are we ready for IFRS 17 Transition?

System and data

- Excel based vs prophet system for health and short term products
- Integration of policy admin and accounting systems
- Increased data and speed requirements
- Historic data

Modelling considerations

- Product groupings and identification of cohorts
- Analysis for discount and risk adjustments
- Model points consistent with contract boundary

Presentation

- Enhanced disclosure requirements
- Identification of Granular data points

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Thank You