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# *IFRS 17 Insurance Contracts for General Insurers*

## Why should you care?

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# Background

*IFRS 17 is the biggest shake up of insurance reporting for decades, impacting all insurers reporting under IFRS.*

*The final Standard was released in May 2017 and applies separately to all insurance and reinsurance contracts.*

*It will be effective from 1 January 2021 with prior year comparative reporting required.*

*The IASB's aim is to provide more transparency and comparability compared to current accounting standards and this means big changes for the way that financial information will be presented. The Standard is complex and adoption will require adequate planning.*

## *Why should General Insurers act now?*

**Saving you money –** Early planning is key. Ongoing or future systems and data projects should build in IFRS 17 considerations. Using existing processes such as Solvency II will avoid future duplicated effort or other inefficiencies. If you don't do this or leave planning/implementation too late, it's likely to cost you more.

**Understanding the impact on you –** IFRS 17 will impact all aspects of your business and your financial results will look and feel different. Understanding what this will mean for your own organisation will help you plan effectively and efficiently for IFRS 17 implementation.

**Minimising disruption –** against a backdrop of reducing Solvency II reporting timelines and other regulatory pressures, IFRS 17 will introduce further complexity and additional requirements on your people and your operating model. Act now in order to minimise further disruption to your business and minimise stress for your staff.

## *100+*

*We are the chief advisor to the European Insurance CFO Forum and Insurance Europe comprising over 100 insurance companies.*

## *30+*

*We are currently working with more than 30 insurers globally on IFRS 17 projects.*

# Significant financial and operational changes for General Insurers

### Financial performance

- The presentation of the balance sheet and income statement will be transformed.
- Emergence of profit over time may change, which could impact dividends, tax and remuneration.

### What your investors will read about you

- New information will be available to investors; some for the very first time. How will you tell your story to the market? Will they understand it?
- Detailed disclosures including confidence level of reserves and analyses of change will be required.

### How you measure and reward yourselves will change

- Your management information is likely to look different – it will change both what you collate and what you create.
- This will impact the processes that are driven by your management information, e.g. reward.

### Processes, data and systems – which may be expensive

- Reserving processes and the link between IFRS and Solvency II reserving processes may need to change fundamentally.
- You may need to capture and store significantly more data.

### Reserves and margins

- IFRS 17 will change how you measure your liabilities – your methodology and assumptions will change, depending on key policy decisions.
- The treatment of reserve margins will need to change.

### Finance, actuarial and risk functions

- Your staff will need training to cope with the new demands of IFRS 17.
- Greater collaboration, understanding, knowledge sharing will be required across the organisation.

# Overview of IFRS 17 for General Insurers

### *Measuring your liabilities – what's new?*

- The general measurement model (often referred to as the Building Block Approach, BBA) is based on discounted best estimate cash flows, a risk adjustment and a contractual service margin (CSM) representing unearned profit.
- An optional model, the Premium Allocation Approach (PAA) for qualifying contracts allows simplification in measuring the liability for unexpired risk (similar to current Unearned Premium Reserve approach).
- PAA is automatically available for contracts with a coverage period of twelve months or less, or where result from the PAA is not materially different from the BBA. This will be available for many general insurance contracts but multi-year contracts such as construction and engineering, risk attaching reinsurance, retrospective reinsurance and business acquired through acquisition or portfolio transfer may not be eligible.
- Under PAA, acquisition costs may be expensed as they are incurred for contracts with coverage periods of one year or less. Discounting may be ignored for liabilities which settle within one year.
- Greater level of granularity will be needed to prevent profitable contracts offsetting groups of loss-making ("onerous") contracts.
- Principles apply to all direct insurance contracts and separately to outwards reinsurance contracts held. This could lead to mismatches and traditional gross to net approaches may not be appropriate.

### *Your financial results – what's different?*

- Recognition of profit over time will change due to new best estimate valuation model, unwind of discount, release of risk adjustment, release of CSM (under BBA) or recognition of earned premium (under the PAA). Any losses, e.g. from groups of loss making contracts, however, must be recognised upfront.
- The option exists to reflect changes to discount rates in Other Comprehensive Income (OCI) to match fair value movements on financial instruments held at fair value through OCI.
- Traditional measures such as Gross Written Premium, Net Earned Premium, Unearned Premium Reserve and Deferred Acquisition Costs will disappear under IFRS 17.
- Income statement will simply comprise "insurance contract revenue" (a revenue measure to represent the transfer of services under insurance contracts), incurred claims and other expenses. The effect of changes in discount rates and discount unwind is reported as 'insurance finance expenses' alongside investment income.
- New disclosures include detailed reconciliations of the various components of insurance contract liabilities and assets and confidence level reporting of carried reserves.


*Discounting may be ignored for liabilities which settle within one year

# How do you implement IFRS 17 successfully?

*Plan early to give yourself the best chance of implementing IFRS 17 successfully and as cost effectively as possible – first time. This will help you decide how you will address the following five key strategic decisions which you will need to make and which will be key drivers in your IFRS 17 project.*

### *Choice of measurement model*

Are your contracts eligible for the simplified approach and, if so, do you want to adopt it?

The BBA is likely to present greater operational challenges as well as having wider financial implications. But, even insurers applying the PAA will need to consider discounting and apply a risk adjustment for incurred claims.

An assessment for PAA eligibility upfront can help determine the extent to which investment in systems architecture is needed.

### *Level of granularity*

How will you define "portfolios of insurance contracts" and further subdivide these portfolios into the groups required for onerous contracts and the CSM?

This is a critical assumption because it may lead to greater upfront recognition of loss making contracts and the granularity of data, storage capacity and volume of operational processes also drives implementation cost.

### *Using current capabilities*

How robust are your current processes and Solvency II capabilities and how many of these can you use?

Solvency II concepts and calculations can provide a good reference point, but there are some fundamental differences and the data requirements for IFRS 17 are more granular in detail.

Clear opportunities exist to use Solvency II but speed of reporting presents a challenge.

### *Risk adjustment*

What method will you use to calculate the risk adjustment and what level of confidence (i.e. reserve strength) will be targeted?

Reserves must be on a best estimate basis and you won't see positive run-off as a result of releasing margin. Your approach to the risk adjustment will influence the run-off of your liabilities and the emergence of profit over time. You will need a clearly defined policy which sets this out.

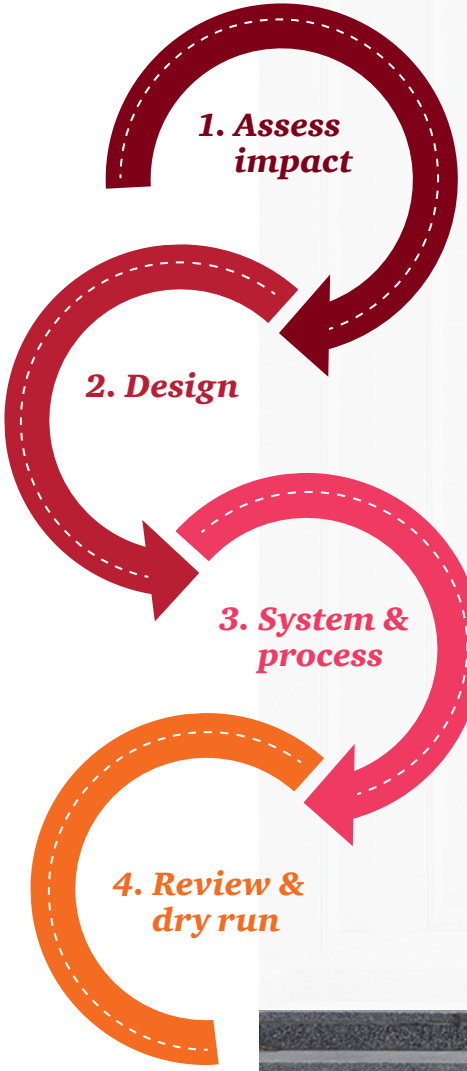
### *Discount rates*

What approach will you take to set discount rates (i.e. top down, bottom up) and how will these be updated over time?

Will you elect to recognise changes in discount rate through the income statement or through OCI?

OCI can help manage the volatility in your liabilities but it has operational consequences. You will need to consider your current accounting treatment for financial instruments and the interaction with IFRS 9, the new accounting standard for financial instruments.

# Your IFRS 17 roadmap




Understand the potential impact on all aspects of your business from financial reporting to management information. Identify unintended consequences and educate key stakeholders.

Design the outputs you want, understand the data required and validate those requirements.

Implement the required system and process changes, training for end users and continued education of key stakeholders.

User Acceptance Testing and dry run to test new systems and performance.

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