



IFRS 17: Redefining key performance indicators

Bridging between IFRS 17 and traditional embedded value





Content page

I.	Overview	3
II.	Introduction	4
III.	Main differences between TEV and IFRS 17	5
IV.	Detailed analysis of various components of TEV and IFRS 17	7
A.	Adjusted Net Worth versus IFRS 17 Equity	7
B.	Value in Force versus Contractual Service Margin	9
C.	Fulfilment cash flows	13
V.	Conclusion	16

I. Overview

Our [PwC's IFRS 17 Health Check Survey 2021: Asia Pacific](#) revealed that 61% of respondents have yet to start detailed work around identifying IFRS 17 key performance indicators (KPIs). Many have no clear view on the extent to which currently used KPIs will change under IFRS 17.

As a starting point, we look into embedded value (EV) and its applicability in the IFRS 17 context. Traditionally, EV is one of the KPIs commonly used by life insurance companies to measure the value of shareholders' interests and track the long-term value creation for their business.

As there are several similarities between EV and IFRS 17, some insurers have started to explore the possibility of doing away with EV reporting after IFRS 17 is implemented. However, regardless of the final decision made, it is important to note that IFRS 17 serves a different purpose from EV.

IFRS 17 aims to measure the effect insurance contracts have on the company's financial position and profit or loss rather than measuring the value of shareholders' interests at a point in time.

This publication outlines the differences between traditional embedded value (TEV) and IFRS 17, given its prevalence in Asia. We have also touched on the implications of IFRS 17 on the profit emergence for some common product types.

Post transition to IFRS 17, we expect most insurers to continue with EV reporting for some time, and provide additional disclosure/information to help rating agencies, analysts and investors 'bridge' between the new key performance indicators under IFRS 17 and EV.



II. Introduction

Embedded value (EV) of an insurance company is defined as “a measure of the consolidated value of shareholders’ interests in the covered business¹”. It is determined as the present value of shareholders’ interests in the earnings distributable from assets allocated to the covered business, after sufficient allowance for the aggregate risks in the covered business.

Within the company, EV may be used to determine executive remuneration, analyse profitability of a product/line of business and support capital allocation decisions.

External parties, such as rating agencies, analysts and investors, may use EV to benchmark against other life insurance companies when assessing the financial performance and strength of the company or determining the transfer price in merger and acquisition transactions.

There are currently three commonly used EV methodologies, namely traditional embedded value² (TEV), European Embedded Value and Market Consistent Embedded Value. TEV is most commonly reported by life insurance companies in Asia. Given its prevalent use, **the focus of our analysis is to explore whether TEV could be replaced by the Contractual Service Margin (CSM) or would remain as a Key Performance Indicator (KPI) post IFRS 17 implementation.**

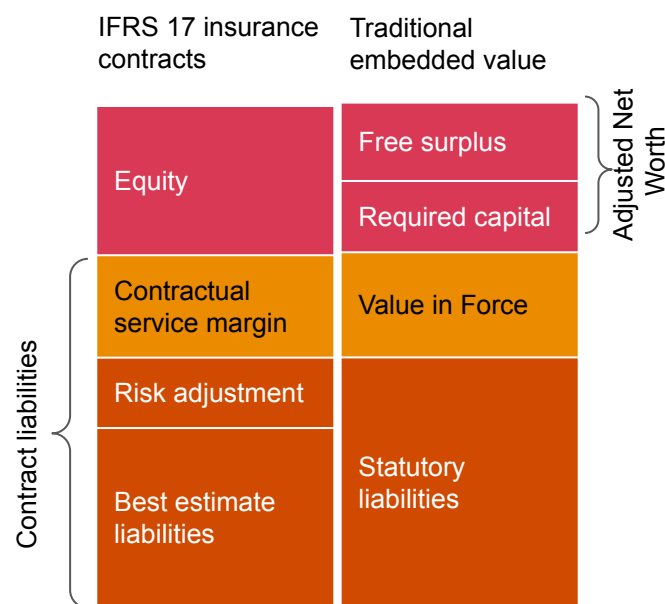
Under TEV, the value of the company is the sum of Adjusted Net Worth (ANW) and Value in Force (VIF). ANW can be broken down into free surplus allocated to the covered business and required capital.

VIF comprises the present value of future shareholder cash flows from in-force covered business, which may be reduced by the cost of holding required capital.

The comparison in Exhibit 1 shows that VIF (under TEV) is analogous with the CSM (under IFRS 17). CSM somewhat represent the value to shareholders and thus are compared together. Some took it further to view the value of the company under IFRS 17 as IFRS 17 equity plus CSM. In addition, both TEV and IFRS 17 requires a disclosure of the analysis of profits by source of earnings.

Due to these similarities, **some insurers have started to explore the possibility of doing away with EV reporting after IFRS 17 is implemented.**

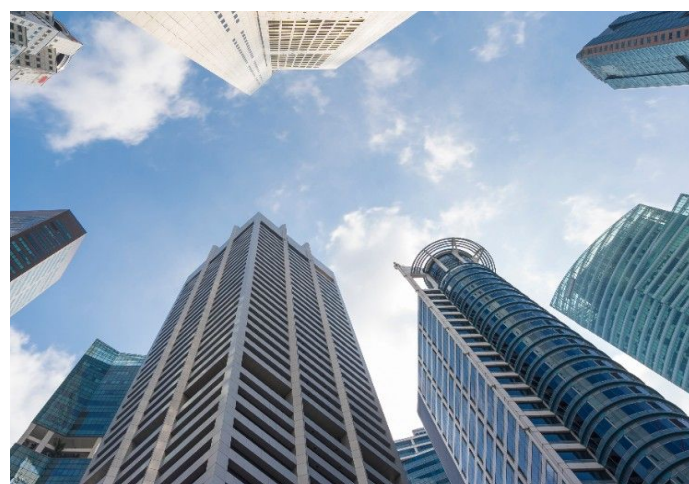
Exhibit 1³: Illustrative similarities and differences between TEV and IFRS 17



Source: 'Project Summary: IFRS 17 Insurance Contracts', May 2017 and European Insurance CFO European Embedded Value Principles, April 2016.

In perspective, CSM under IFRS 17 is the unearned shareholder profit, while Value in Force (VIF) is a value at a point in time representing the future expected shareholder cash flows to be released.

Consequently, the realisation of the CSM and VIF is fundamentally different, where the amortisation of CSM reflects the insurance contract services rendered during the period and the unwinding of VIF is essentially the release of expected shareholder cash flows arising over the period.



¹ European Insurance CFO Forum, "European Insurance CFO European Embedded Value Principles", 2016.

² Where statutory basis under TEV is mentioned, Singapore RBC2 (i.e. MAS 133) will be used as a point of reference for comparison with IFRS 17.

³ Exhibit 1 illustrates the components of the different valuation bases and is not intended to represent the likely relative levels of the constituent elements across bases.

III. Main differences between TEV and IFRS 17

Topic	Traditional embedded value (Valuation basis: Singapore RBC2)	IFRS 17	Observations
Scope of application	<p>Cover contracts written under the insurance business.</p> <p>The definition of insurance business should be in line with the local regulation.</p>	Cover contracts that meet the definition of insurance contracts under IFRS 17	<p>TEV covers a broader scope of contracts compared to IFRS 17. Insurance contracts are a subset of the covered business.</p> <p>In addition, covered business under TEV may apply to asset management operations, which is excluded from the scope of IFRS 17.</p>
ANW vs IFRS 17 Equity			
Contract boundary	<p>No concept of contract boundary (refer to observations for more details), subject to judgement.</p> <p>May align the level of renewals to the prevailing statutory contract boundary requirements or up to policy term.</p>	<p>Contract boundary set at the point where the insurer no longer has substantive rights to receive premiums or obligations to provide services since the risks of the policyholder or portfolio in setting the price or level of benefit can be reassessed.</p> <p>All cash flows outside the contract boundary are excluded.</p>	<p>Under MAS 133, the concept of contract boundary is only applicable to long-term medical policies. The criteria for contract boundary assessment is similar to IFRS 17.</p> <p>For other product types, the level of renewals included under TEV and IFRS 17 may be different.</p>
Best estimate cash flows (excluding expenses)	All future cash flows that are expected to occur over the policy term are included in the valuation.	Cash flows related directly to the fulfilment of the contract, are included in the valuation.	<p>Depending on product types, there may be some differences in the cash flows included between TEV and IFRS 17.</p> <p>For example, asset investment returns, certain income taxes and cash flows related to components separated from insurance contracts may be included under TEV, but not under IFRS 17.</p> <p>Treatment of investment management expenses and tax may be different too.</p>
Best estimate cash flows (expenses)	All future expected expenses required to manage the in-force business are included in the scope of best estimate cash flows.	Only attributable expenses are included in the scope of best estimate cash flows.	All expenses are recognised in profit and loss as incurred under TEV, while attributable expenses are implicitly deferred in the CSM and recognised as insurance contract services are rendered over the coverage period under IFRS 17.

Topic	Traditional embedded value (Valuation basis: Singapore RBC2)	IFRS 17	Observations
Discount rates for contract liabilities	<p>Discount rates are set based on a three segment approach, prescribed by the regulation:</p> <ul style="list-style-type: none"> - Segment 1: Relevant government yield - Segment 2: Extrapolation between last liquid point and ultimate forward rate - Segment 3: Ultimate forward rate. <p>Allowance for Matching Adjustment (MA) or Illiquidity Premium (IP) may be added to the base risk-free rates, depending on eligibility criteria set out in MAS 133.</p>	<p>Discount rate can be determined using either:</p> <ul style="list-style-type: none"> - Top-down approach (i.e. reference portfolio and adjust for characteristics that are irrelevant for insurance contracts) or - Bottom-up approach (i.e. risk-free discount rate plus illiquidity premium that reflect liquidity characteristics of the liabilities). 	<p>IFRS 17 requires the discount rates to be based on the latest available market information. Further assessment is required to ascertain whether the prescribed parameters are reflective of the latest market information.</p> <p>The purpose of the IP is different between MAS 133 and IFRS 17. Specific areas of differences need to be understood when performing the bridging.</p> <p>MA is analogous to the top-down approach under IFRS 17. However, limits imposed on the recognition of MA may not fully meet the requirement to reflect the characteristics of the liabilities in IFRS 17.</p>
Time value of options and guarantees	<p>May or not may be included as part of the statutory reserves, subject to the discretion of the appointed actuary</p> <p>If it is not included in the statutory reserves, it may be implicit in the Risk Discount Rate (RDR), depending on the calibration of RDR.</p> <p>RDR is used to discount the future shareholder cash flows when valuing the Value in Force.</p>	<p>Implicitly or explicitly included as part of best estimate liabilities due to the requirement of measuring the fulfilment cash flows on a probability-weighted basis.</p>	<p>Depending on the calibration of RDR, the outcome may be the same.</p>
Allowance for risk	<p>Allowance for risk captured in two areas:</p> <ul style="list-style-type: none"> - Provision for Adverse Deviation (PAD) included as part of the statutory reserves; and - Risk margin built into RDR 	<p>Allowance for risks to be explicitly accounted for in the Risk adjustment (RA). Only non-financial risks are included in the measurement of RA.</p>	<p>Likely differences between the two approaches are in the following areas:</p> <ul style="list-style-type: none"> - Scope of risks - Level of compensation - Risk horizon - Diversification benefits
VIF vs CSM			
Profit emergence	<p>Unwinding of VIF, which is the release of expected shareholder cash flows arising over the reporting period.</p>	<p>Release of CSM and RA over the coverage period. The speed of the profit emergence is largely dependent on the choice of the coverage unit and the release pattern of RA.</p>	<p>Total profits realised over the lifetime of a group of insurance contracts will be the same. However, the basis will affect the timing of profit emergence and potential earning volatility.</p>

IV. Detailed analysis of various components of TEV and IFRS 17

A. Adjusted Net Worth versus IFRS 17 Equity

ANW represents statutory equity, excluding any amounts that are not attributable to the shareholders (e.g. intangible assets, deferred acquisition costs, and assets outside the covered business). Under TEV⁴, both assets and liabilities are valued under statutory basis. **IFRS 17 equity, on the other hand, represents the market value of net assets.** Unlike ANW under TEV, IFRS 17 equity may consist of intangible assets, such as deferred acquisition costs, that are related to the insurance contracts. There are a few possible differences between ANW and IFRS 17 equity as detailed below:

1. Valuation of assets: In some territories, book value accounting is used in the valuation of certain asset classes (e.g. held to maturity bonds) under statutory basis. However, under IFRS, the value of most assets is measured based on observable market prices or market variables.

2. Fulfilment cash flows: Policy liabilities under statutory basis typically have prudence built in, in order to ensure sufficiency in meeting policyholders' obligations under adverse experience. For example, to prevent the capitalisation of future profits, some territories have mandated statutory reserves to be measured under a net premium valuation basis and/ or floored to zero at the policy level (i.e. negative statutory reserves are disallowed at an individual policy level).

Under IFRS 17, fulfilment cash flows are determined under gross premium valuation basis and is not subjected to any floor. In addition, there is a requirement for fulfilment cash flows under IFRS 17 to be reflective of the insurers' internal assessment of its own risks and business profile. As a result, the fulfilment cash flows under IFRS 17 is often less prudent than the statutory reserves.

Other key differences in the measurement of the statutory reserves under TEV and fulfilment cash flows under IFRS 17 are shown on the next page.

⁴ Where statutory basis under TEV is mentioned, Singapore RBC2 (i.e. MAS 133) will be used as a point of reference for comparison with IFRS 17.



Other key differences in the measurement of the statutory reserves under TEV and fulfilment cash flows under IFRS 17 are as follows:

2.1 Definition of cash flows: The definition of cash flows under IFRS 17 and statutory basis are largely similar. One distinct difference is the attributability of expenses: under statutory basis, all future expected expenses required to manage the in-force business are normally taken into account in the valuation. In contrast, under IFRS 17, only attributable expenses are included in the scope of fulfilment cash flows.

2.2 Concept of contract boundaries: Unlike under IFRS 17, there is no concept of contract boundary in some regulatory regimes. Thus, in some circumstances, the level of contract liabilities recognised for a group of insurance contracts may be different, even though the total profits earned over the lifetime may be the same.

2.3 Discount rates for contract liabilities: The approach for determining the discount rate under statutory basis is often prescriptive, with the rate and parameters determined by the regulator. On the contrary, IFRS 17 follows a principle-based approach (i.e. either top-down approach or bottom-up approach) where the discount rates need to be reflective of the cash flow characteristics of the insurance contracts and be based on the latest available market information. The differences in the requirements for discount rates could result in differences in contract liabilities; consequently, the speed of profit emergence may be different due to unwinding of the liabilities.

2.4 Allowance for risks: For TEV, the allowance for risks is captured in two areas: PAD included as part of the statutory reserves, and risk margin built into the RDR. IFRS 17 requires allowance for risks to be explicitly accounted for in the RA. The derivation of the allowance for risks under both bases are subjected to significant judgement. The likely differences between the two bases are: scope of risks, level of compensation, risk horizon, and diversification benefits.

2.5 Treatment of reinsurance contracts held: For reinsurance contracts held, TEV applies a 'net' approach for determining the EV. IFRS 17 requires reinsurance contracts to be measured separately from the direct insurance contracts; profits or losses of the reinsurance and underlying contracts are recognised in different time periods and hence result in accounting mismatches.

3. Introduction of CSM: CSM is a concept introduced under IFRS 17, which represents the unearned future shareholders' profits for a group of insurance contracts. CSM eliminates day one gain and defers profit over the coverage period, however day one losses are recognised immediately.



B. Value in Force versus Contractual Service Margin

VIF is calculated as the projected future shareholder cash flows arising from in-force covered business discounted using the RDR, which may be reduced by the cost of holding required capital. Thus, the unwinding of VIF is essentially the release of expected shareholder cash flows arising over the reporting period, which include the release in liabilities typically valued under the statutory basis.

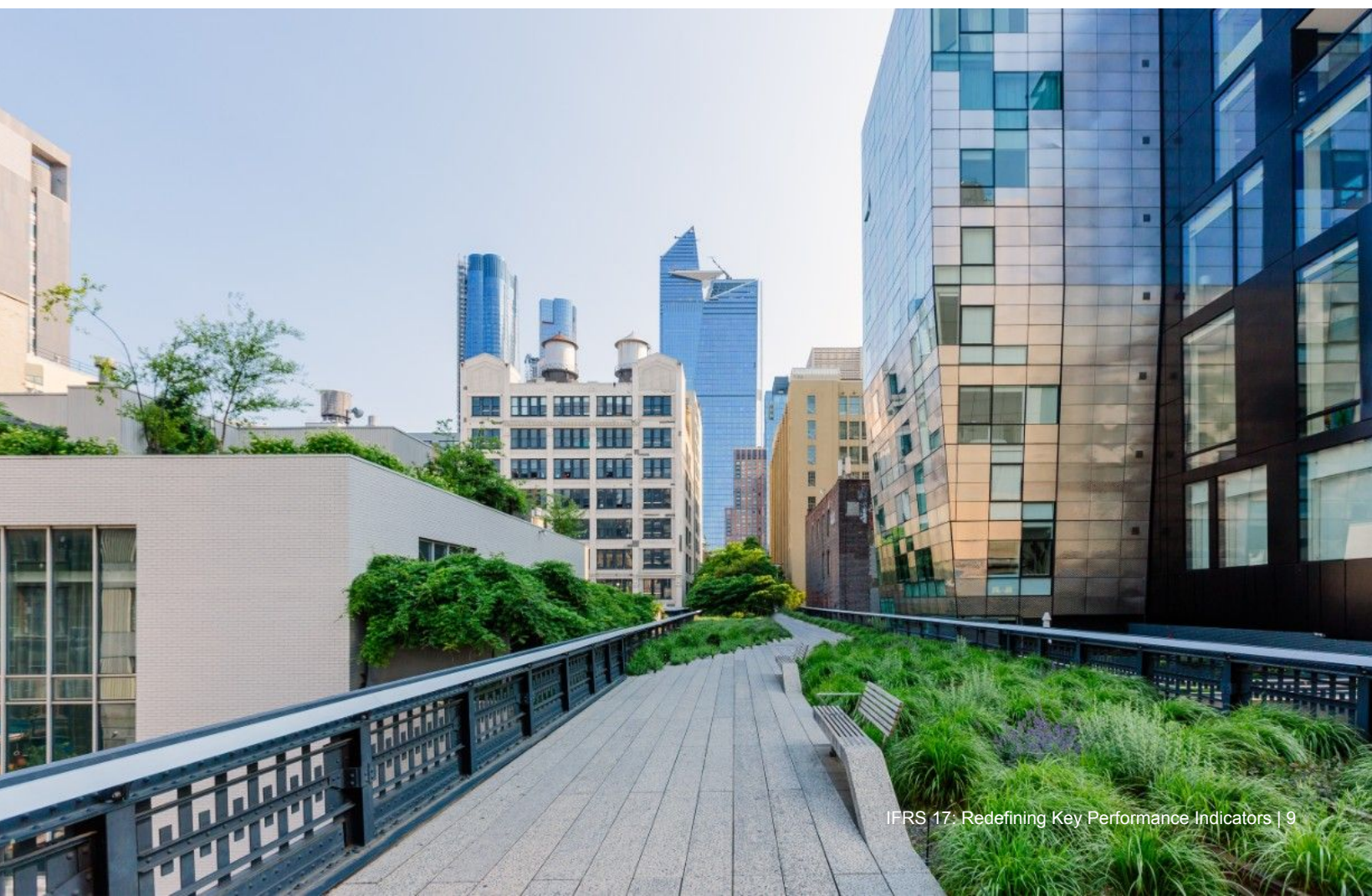
Under IFRS 17, CSM represents the unearned profit which an entity will recognise as it provides insurance contract services under the insurance contracts in the group. The profit emergence comes from the release of CSM and RA over the coverage period. The speed of the profit emergence is largely dependent on the choice of the coverage unit and the release pattern of RA.

In perspective, **CSM is the unearned shareholder profit constituting a part of IFRS 17 contractual liabilities, while VIF is a value at a point in time representing the future expected shareholder cash flows to be released**. Another nuance is that the scope of TEV applies beyond insurance contracts and is wider than IFRS 17, thus it is more compatible to compare CSM with New Business Value (NBEV), rather than VIF, for a product/ line of business. NBEV is similar to VIF, except NBEV measures the value of new business written, rather than the entire in-force business.

Among other things, it is important to note that the total profits realised over the lifetime of a group of insurance contracts will be the same. However, it will affect the timing of profit emergence and potential earning volatility.

Here, we discuss the above **implications on the profit emergence by the following product types**:

- Traditional non-participating life product (measured using the General Measurement Model)
- Traditional participating product (measured using Variable Fee approach)
- Yearly renewable term product (measured using Premium Allocation approach)



Implications on the profit emergence depending on product types

The following section discusses and illustrates the timing of profit emergence and potential earning volatility under TEV and IFRS 17.

The focus is to illustrate key product-related impacts instead of providing a comprehensive analysis of all impacts. Where reference is made to the statutory basis under TEV, Singapore RBC2 (i.e. MAS 133) will be used as a point of reference for comparison with IFRS 17.

1. Traditional non-participating life product



Single premium term profitable contracts

Under TEV, shareholder cash flows are recognised in the profit and loss as incurred as VIF unwound. For single premium term contracts, there is an upfront recognition of profits coming from the single premium collected at inception. In the subsequent period, the profit arises from underwriting margin and investment income.

Under IFRS 17, future unearned profits are captured as the CSM at initial recognition and then released over the coverage period to profit or loss. Consequently, profits are not recognised upfront; and hence profit emergence under IFRS 17 is slower and smoother than under TEV.

The amount of CSM to be recognised in profit and loss reflects the insurance contract services provided during the period, where coverage unit is a proxy to the amount of benefits provided. To a large extent, the speed of profit emergence is dependent on the choice of the coverage unit.

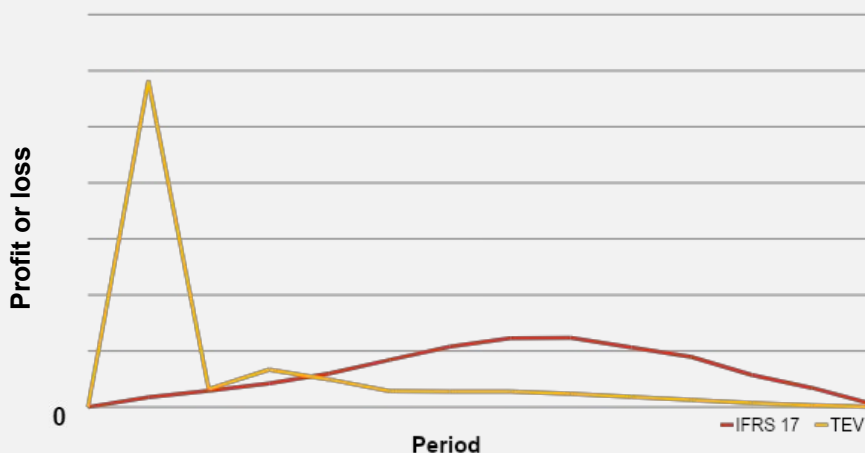


Exhibit 2: Profit projection for a group of single premium term profitable contracts



1. Traditional non-participating life product (continued)



Regular premium term profitable contracts

Similar to single premium term contracts, costs are recognised in the profit and loss as incurred. In this case, a significant loss is recognised at inception due to acquisition costs incurred. Given that VIF are actually expected profits to be released from the statutory reserve, the speed of profit emergence under TEV is controlled by the release in statutory provision.

IFRS 17 requires attributable expenses⁵ to be implicitly deferred in the CSM and recognised as insurance contract services are provided over the coverage period.

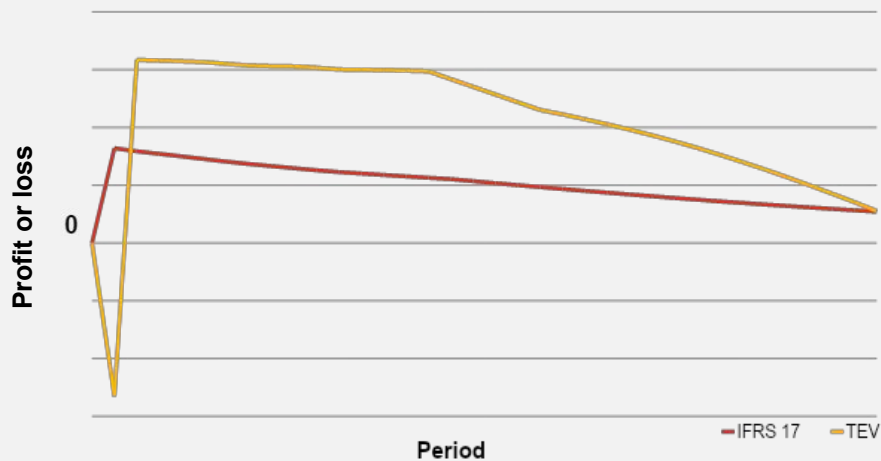


Exhibit 3: Profit projection for a group of regular premium term profitable contracts

⁵ For simplicity, all expenses are assumed to be 100% attributable under IFRS 17.



Regular premium term onerous contracts

The pattern of profit emergence for onerous contracts under IFRS 17 and TEV are largely similar, as IFRS 17 requires day one losses to be recognised immediately instead of deferring over the coverage period.

The extent of strain at inception under each basis is mainly attributed to the level of contract liabilities set up at inception. In this case, a more prudent margin is being recognised upfront (at point A) and a smaller margin is released thereafter (from point B onwards) under TEV (Exhibit 4).

Beyond inception, profit emergence is contributed by the release in PAD under TEV and risk adjustment under IFRS 17.



Exhibit 4: Profit projection for a group of regular premium term onerous contracts

2. Traditional participating life product



Whole life participating profitable contracts

For participating contracts, profit emergence under TEV is based on the actual transfer to shareholders, and is dependent on the cost of bonus declared for each year. In this example, more profits are recognised in the later durations, as the bonuses are back-loaded.

Under IFRS 17, CSM represents the future transfer to shareholders at initial recognition, and is amortised over the coverage period into the insurance revenue. Depending on the selection of the coverage unit, profit emergence under IFRS 17 may be faster or slower compared to TEV.

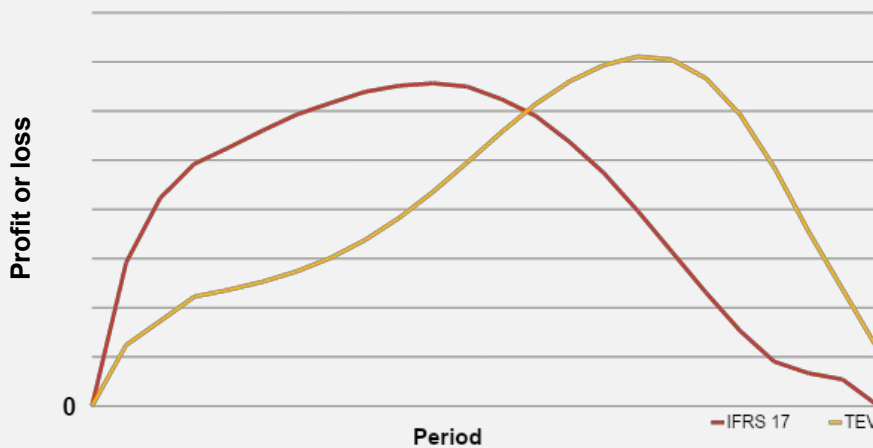


Exhibit 5: Profit projection for a group of regular premium whole life contracts

3. Yearly renewable term product



Yearly renewable profitable contracts

For yearly renewable term contracts, profit recognition due to differences in contract boundary definition is illustrated by comparing the effect of recognising the level of renewals up to the policy term under TEV and up to the pricing reassessment date (also the renewal date) under IFRS 17.

Unlike the TEV approach, profits under IFRS 17 are recognised up till the contract boundary instead of over the policy term. Given that the yearly renewable term contracts are measured using the premium allocation approach under IFRS 17, profit emergence is driven by the release of premium and claims liabilities⁶.

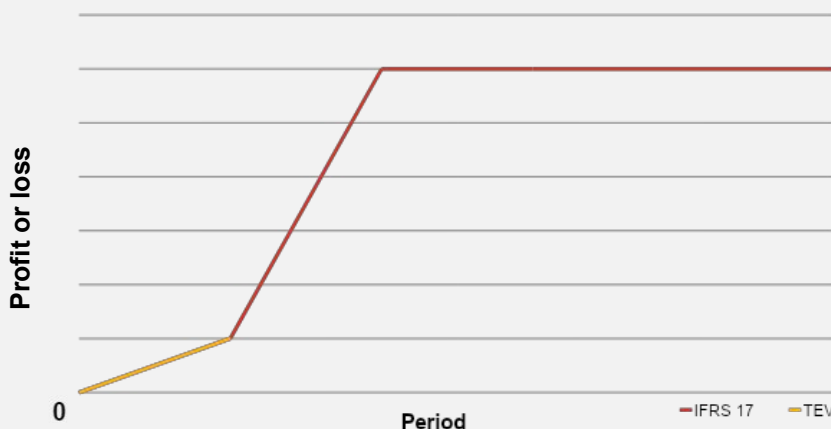


Exhibit 6: Profit projection for a group of yearly renewable term contracts

⁶ For simplicity, all expenses are assumed to be 100% attributable under IFRS 17.

C. Fulfilment cash flows

Measurement of the statutory reserves under TEV and fulfilment cash flows under IFRS 17 have the following notable differences:

01 Definition of cash flows

The definition of cash flows under IFRS 17 and statutory basis are largely similar. However, depending on product types, some cash flows (e.g. asset investment returns, income taxes and cash flows related to components separated from insurance contracts, etc.) may be included under TEV, but not under IFRS 17.

One distinct difference is the attributability of expenses. TEV uses a fully attributable expense base, i.e. all future expected expenses, required to manage the in-force business, need to be included in the scope of best estimate cash flows.

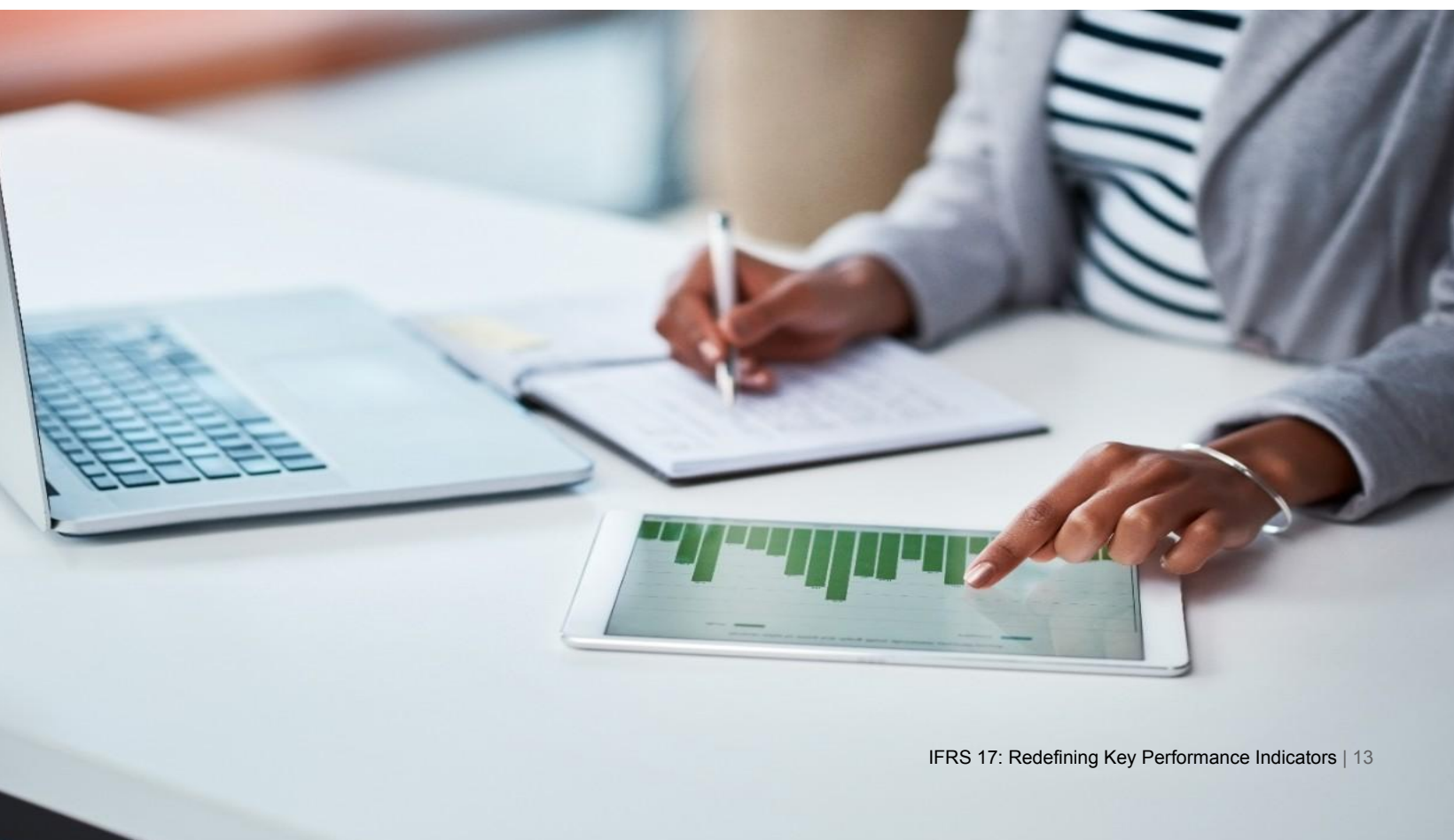
This is different from the IFRS 17 requirements, where only directly attributable expenses are included in the estimation of the BEL. In other words, non-attributable expenses included in the valuation of TEV (e.g. some product development and training costs, overhead costs and exceptional development costs incurred in start-up operations) would not be included in the scope of best estimate cash flows under IFRS 17.

02 Concept of contract boundaries

TEV does not have the concept of contract boundaries. Having said that, some insurers may choose to align the level of renewals to the prevailing statutory contract boundary requirements or recognise the level of renewals up to the policy term.

Under IFRS 17, insurers need to assess whether the contract boundary requirements are met and apply the appropriate contract boundary definition, leaving little room for subjectivity.

An example would be the valuation of yearly guaranteed renewable term insurance contracts. Under TEV, some insurers may include renewal of in-force business and value the insurance contracts as long-term business, while others choose to value the business up to the next renewal date. On the contrary, insurers need to determine the appropriate contract boundary under IFRS 17 by assessing whether it can compel the policyholder to pay the premiums or has a substantive obligation to provide the policyholder with insurance contract services.



03 Discount rates for contract liabilities

Contract liabilities under TEV are valued under statutory basis. For non-participating contracts and investment-linked contracts (i.e. non-unit portion), risk-free interest rates are used to value the statutory reserves. An allowance for the Matching Adjustment (MA) or Illiquidity Premium (IP) may be added to the base risk-free rates, depending on eligibility criteria set out in MAS 133.

For participating contracts and universal life contracts, the best estimate investment return is used to determine the best estimate reserves, providing for both guaranteed and non-guaranteed benefits. The best estimate investment return is derived based on the expected investment returns of assets backing the liabilities.

Under IFRS 17, the construction of the discount rates should be based on the latest available market information and should be reflective of the cash flow characteristics of the group of insurance contracts. The discount rate can be determined using either the top-down approach (i.e. reference portfolio with adjustment for characteristics that are irrelevant for insurance contracts) or bottom-up approach (i.e. risk-free discount rate plus illiquidity premium that reflect liquidity characteristics of the liabilities).

To bridge the gap between the two discounting bases, the key considerations are as follows:

Base risk-free interest rates: Under MAS 133, the approach used to determine the base risk-free interest rate is prescribed. This extends to the corresponding parameters used in the prescribed extrapolation technique (i.e. Smith-Wilson method), such as last liquid point, convergence period, and ultimate forward rate. These parameters need to be assessed whether they reflect the latest observable market information as per the IFRS 17 requirements.

Illiquidity premium: The IP under MAS 133 is added onto the base risk-free interest rate of eligible product types (if MA has not been applied already) for the purpose of reducing volatility in statutory surplus due to credit spread movements. On the other hand, the IP under IFRS 17 is required to reflect the liquidity characteristics of the insurance cash flows. Given the different purpose of illiquidity premium under MAS 133 and IFRS 17, they are not exactly a like-for-like comparison.

The IP under MAS 133 is calculated as the product of the proportion of corporate bonds held by the insurer and the reference rate calibrated by MAS. The reference rate is determined based on the holding pattern of investment grade bonds held by industry. Depending on the extent to which the portfolio held by the insurer to back its liabilities cash flows is similar to the reference portfolio, the cash flows of the reference portfolio may or may not be reflective of the liquidity characteristics of the insurance contracts.

Also, at the point of writing, the reference rate has yet to be updated since inception of MAS 133 on 31st March 2020. Further assessment is required to ascertain whether the reference rate still reflects the prevailing market conditions.

Matching adjustment: The derivation of the MA under MAS 133 is similar to a top-down approach described in IFRS 17, as it requires close cash flows matching between backing assets and liabilities. The MA is determined as the yield of the backing asset portfolios (subject to eligibility conditions under MAS 133) less the spread for credit default and downgrade. The credit spread is prescribed and needs to be assessed whether it is reflective of the latest available market information.

In addition, the recognition of the MA is limited through the following mechanisms: the full MA is only recognised up to the last liquid point and amortised over 10 years, after which the MA is floored at the IP, and a haircut is applied for reallocation of excess cash flows. Consequently, the resultant MA still needs to be assessed as to whether it fully meets the requirement to reflect the characteristics of the liabilities in IFRS 17.

Asset-based yield: Under IFRS 17, cash flows that vary based on the returns on underlying items are required to be adjusted or discounted using rates that reflect that variability. Thus, asset-based yield may not be appropriate in valuing both guaranteed and non-guaranteed benefits without making any adjustments.

Similarly, an assessment needs to be conducted to ascertain whether the expected investment returns of assets backing the liabilities reflects the characteristics of the liabilities.

04 Risk adjustment

The allowance for risk under the TEV approach is captured in two areas: (1) PAD is included as part of the statutory reserves, to provide for any deviation from the best estimate assumptions, and (2) allowance for a risk margin built into the RDR, where it seeks to capture any risk in relation to the shareholder cash flows that is not allowed for in other components of TEV. Amongst others, cost of options and guarantees, asset-liability mismatch risk, and credit risk may be included when calibrating the RDR.

The purpose of the RA in IFRS 17 is to determine the compensation that the entity requires for bearing the uncertainty in relation to the amount and timing of the cash flows that arise from non-financial risk. Due to the different nature of the allowance for risks under TEV and IFRS 17, there are several elements we need to be mindful of when bridging between TEV and IFRS 17:



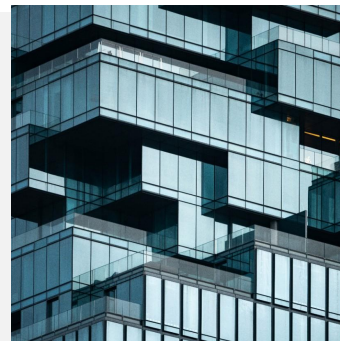
Scope of risks

Under IFRS 17, the scope of risks included in RA and time value of options and guarantees (i.e. part of BEL) capture non-financial risks and financial risks associated with the fulfillment of insurance contracts respectively. A different scope of risks may be included in the consideration of the allowance for risk (i.e. PAD and RDR) under TEV. For example, some insurers may exclude tail risks relevant to the insurance contracts, such as mass lapse risk and catastrophic risk, from PAD.



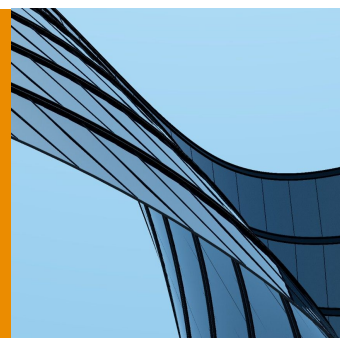
Level of compensation

While PAD is subjected to the appointed actuary's discretion, the determination of PAD is usually backed by the insurers' internal risk assessment or market benchmark (e.g. IAIS). The level of sufficiency implicit in PAD needs to be assessed whether it reflects the insurer's own degree of risk aversion as per the requirements of IFRS 17. Risk distribution used to calibrate non-financial stresses also needs to be assessed whether it reflects the uncertainty of the amount and timing of cash flows arising from non-financial risks specific to the entity.



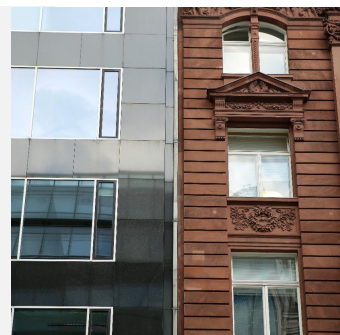
Risk horizon

IFRS 17 requires consideration of risks over the full duration of the contract or a rolling one-year perspective over the full duration of the contract when it determines the compensation that is required for non-financial risk. On the other hand, PAD may not consider the uncertainty in the cash flows over the full term of the contract for long-term insurance contracts.



Level of diversification

Under IFRS 17, the level of diversification benefit to be recognised in the RA needs to be reflective of the extent that the insurer considers diversification when determining the compensation required for bearing that risk. In determining the PAD on a statutory basis, all the non-financial stresses are applied concurrently; thus, it may not have considered the effect of diversification between the risk modules.



05 Treatment of reinsurance

Under the TEV approach, projected statutory reserves and cash flows are valued net of outward risk reinsurance. However, IFRS 17 requires reinsurance contracts to be measured separately from the direct insurance contracts. Accounting mismatches can arise because IFRS 17 requires losses from underlying insurance contracts to be recognised immediately in profit or loss, while the expected recoveries of those losses from the reinsurance contracts held are reflected in the CSM and recognised in profit or loss over time.

The June 2020 amendments introduced a modification to reduce the mismatch in the treatment of losses on underlying insurance contracts and recoveries of losses from reinsurance contracts by allowing the insurer to recognise initial losses on the underlying onerous insurance contracts covered by the reinsurance contracts in the profit and loss and tracks the recovery of those losses (or reversals of losses) that it recognised in profit or loss through a loss-recovery component⁷. This modification matches the losses on the underlying insurance contracts, and a consequent gain for the reinsurance contract held, and both are recognised in profit or loss in the same period.

Nevertheless, there is still some degree of mismatching of gains and losses from underlying insurance contracts and reinsurance contracts held. More details on other sources of mismatch between direct contracts and reinsurance contracts is outlined in [IFRS 17: reinsurance needs careful consideration](#).

⁷ International Accounting Standards Board, "IFRS 17 Insurance Contracts", 2017.

V. Conclusion

Most insurers are expected to formally adopt CSM as their main key performance indicator after IFRS 17 is implemented. Post transition to IFRS 17, we expect insurers to continue with TEV reporting for some time, while they embark on 'bridging' between the two bases.

- It is important for insurers to understand and communicate how existing KPIs are impacted by IFRS 17. To avoid any potential misinterpretation of the shareholder value, insurers are encouraged to help their investors, shareholders and management understand the differences between the two standards early.
- The key issues and risks in the design of IFRS 17 KPIs should be identified early to avoid any surprises.
- The design and implementation for the changes required for data and systems are critical to successful and timely publishing of IFRS 17 KPIs.
- Insurers are encouraged to identify, specify and communicate their IFRS 17 KPIs before the effective date.



Contacts



Antonie Jagga
Risk Consulting Leader
South East Asia Consulting
PwC Singapore
+65 9667 5825
antonie.jagga@pwc.com



Woo Shea Leen
Insurance Leader
PwC Singapore
+65 9753 1305
shea.leen.woo@pwc.com



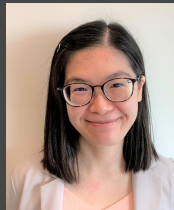
Ang Sock Sun
Insurance Accounting and Regulatory
Advisory Leader
PwC Singapore
+65 8511 7108
sock.sun.ang@pwc.com



Michel Mouton
Director
South East Asia Consulting
PwC Singapore
+65 9119 3659
michel.p.mouton@pwc.com



Amar Mehta
Director
Asia Actuarial Services
PwC Singapore
+65 9750 2140
amar.sh.mehta@pwc.com



Ng Shi Qi
Senior Manager
South East Asia Consulting
PwC Singapore
+65 9862 6744
shiqi.ng@pwc.com



At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 155 countries with more than 284,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.

© 2021 PricewaterhouseCoopers Consulting (Singapore) Pte. Ltd. All rights reserved. This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.