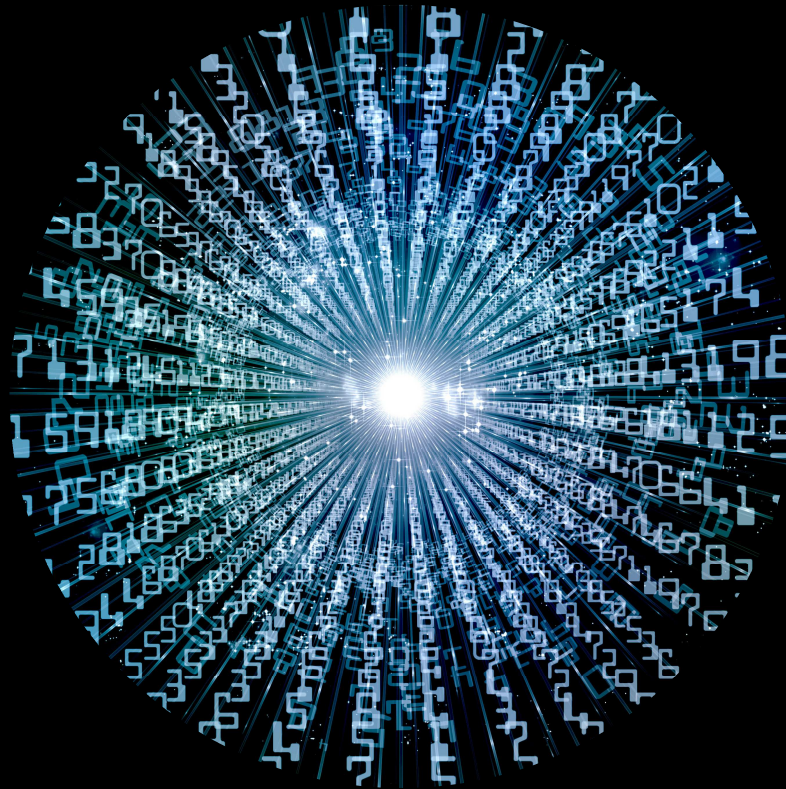


**Deloitte.**



**IFRS 17 basics**  
Refreshment Training  
October 2017

# Agenda

## Part 1: Introduction to IFRS 17

## Part 2: Measurement methodology

- Overview
- General model (BBA)
- Variable Fee Approach (VFA)
- Premium Allocation Approach

## Part 3: Key considerations

- Unit of Account
- New financial statements and KPIs

## Part 4: Challenges



# Part 1: Introduction to IFRS 17

# **Introduction to IFRS 17**

## Aim and history of the project

# Implementation of IFRS 17

## Why new standard for insurers?



### Comparability

#### 1. Lack of comparability among insurers

Varying practices in applying IFRS 4

Various approaches even within insurance Groups

#### 2. Lack of comparability between sectors of economy

Revenues include deposits

Different approach to revenue recognition



### Updated assumptions

#### 1. Outdated biometric assumptions

Assumptions are not adjusted to changing market environment

No lapse assumptions

#### 2. Outdated Economic assumptions

Fixed technical rates, effects of changes not disclosed



### Transparency

#### 1. Lack of important disclosures

Not enough information on analysis of change and its sources

#### 2. Cashflow-based accounting

Financial reporting based on cashflows, and not on providing service during insurance period

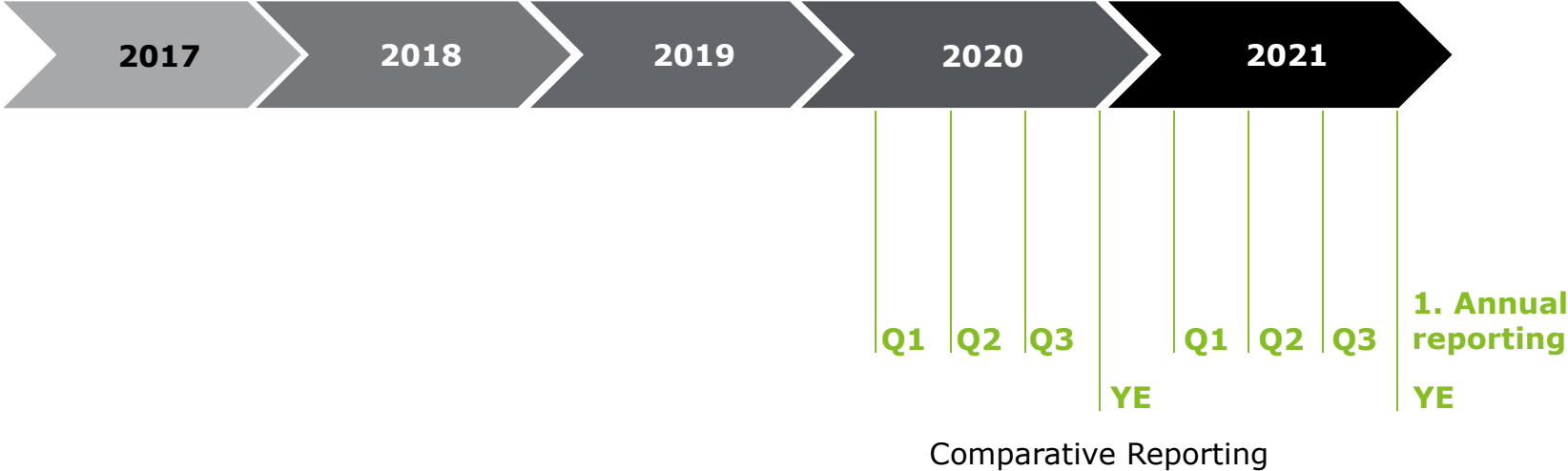
# Implementation of IFRS 17

## What do we know today?

**Publication of the standard**  
18 May 2017

**Implementation of IFRS 9**  
Possibility of deferral of IFRS9 if insurance activity is prevailing.

**Implementation of IFRS 17**



# **Introduction to IFRS 17**

What is an insurance contract?

# Implementation of IFRS 17

## Characteristics of contracts in IFRS 17

### **Types of contracts**

Contracts under IFRS 17



### **Contract boundaries**

Defining what is the scope of cashflows to be included in the valuation



### **Components of contracts** („unbundling“)

Components of insurance contracts which will have to be excluded from IFRS 17 (i.e. service components or investment components)



# Implementation of IFRS 17

## Contracts in terms of IFRS 17 (1 / 2)



Contracts in terms of IFRS 17

**Insurance contract**

**Reinsurance contract (active)**

**Reinsurance contract (passive)**

An investment contract with a discretionary participation feature

“

### **Insurance contract:**

A contract under which one party (**the issuer**) accepts significant **insurance risk** from another party (the **policyholder**) by agreeing to compensate the policyholder if a specified uncertain future event (the **insured event**) adversely affects the **policyholder**.”

“

### **Reinsurance contract:**

An **insurance contract** issued by one entity (the 'reinsurer') to compensate another entity (the 'cedant') for claims arising from one or more **insurance contracts** that are issued by the cedant (underlying contracts).”

- ✓ Risk transfer
- ✓ Significant insurance risk
- ✓ Uncertain event
- ✓ Negative impact on the policyholder or the cedant

# Implementation of IFRS 17

## Contracts in terms of IFRS 17 (2 / 2)



Contracts in terms of IFRS 17

Insurance contract

Reinsurance contract  
(active)

Reinsurance contract  
(passive)

**An investment contract  
with a discretionary  
participation feature**

“

### **Investment contract with a discretionary participation feature:**

*A financial instrument that provides a particular investor with the contractual right to receive, as a supplement to an amount that is not subject to the discretion of the issuer, additional amounts:*

*(a) that are expected to be a significant portion of the total contractual benefits;*

*(b) the timing or amount of which are contractually at the discretion of the issuer; and*

*(c) that are contractually based on:*

*(i) the returns on a specified pool of contracts or a specified type of contract;*

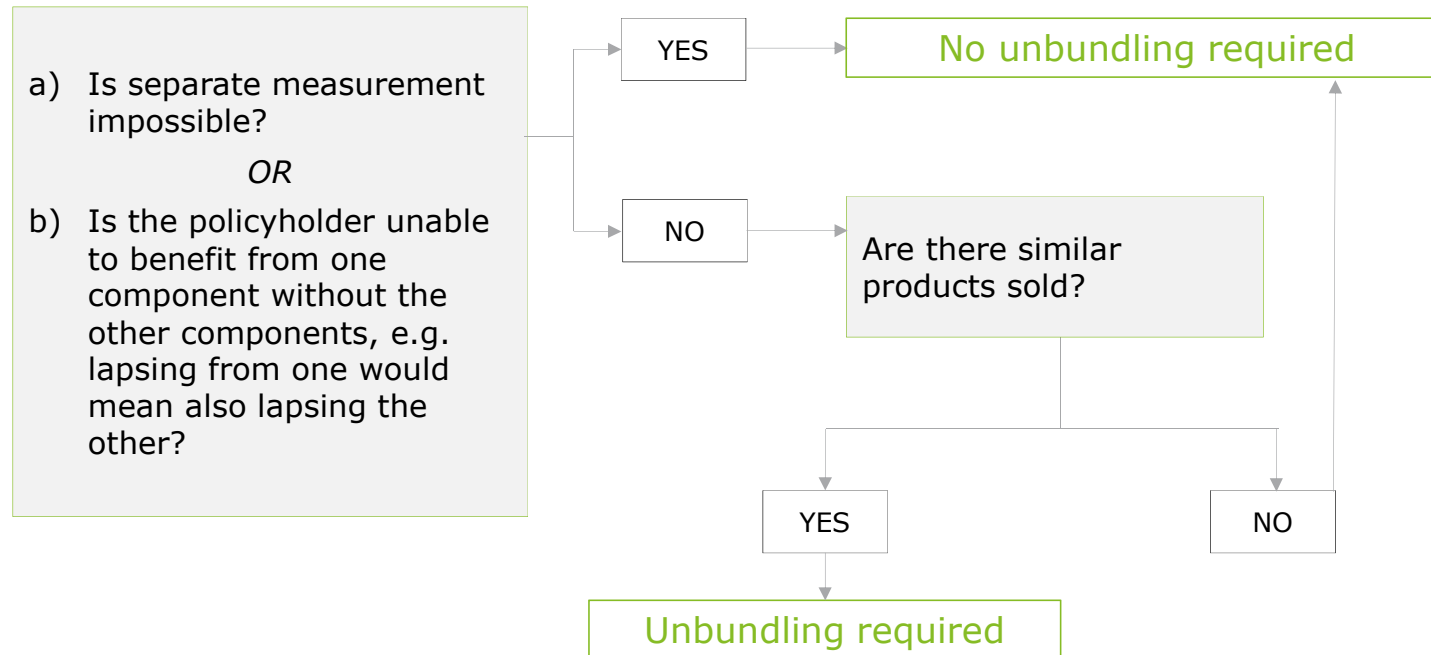
*(ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or*

*(iii) the profit or loss of the entity or fund that issues the contract.”*

- ✓ Additional amounts expected to be a significant portion of the total contractual benefits
- ✓ Possible discretionary element
- ✓ Specified pool of underlying items

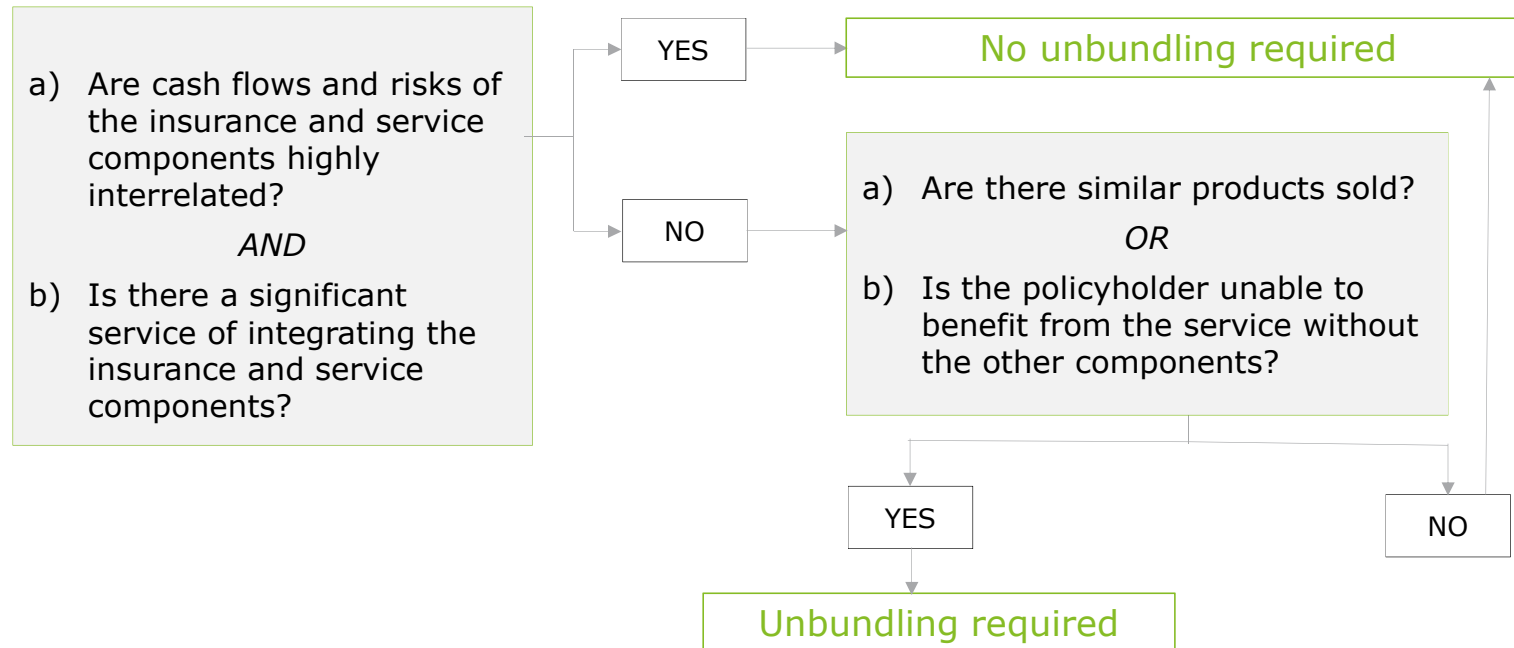
# Implementation of IFRS 17

## Unbundling – investments components



# Implementation of IFRS 17

## Unbundling – service components

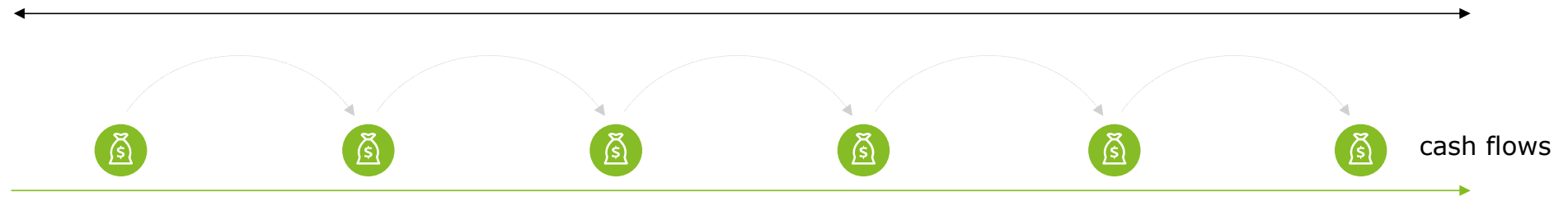


# Implementation of IFRS 17

## Contract Boundaries

### Within the boundary

The policyholder is obliged to pay the premium



### Substantive obligation

An insurer needs to provide coverage or other services to policyholders

**Contract Boundary**  
(beginning)

**The earliest of :**

- the beginning of coverage; or
- the date on which first premium is due,
- date when facts and circumstances indicate that a contract can be onerous

1 Insurer has the right or practical ability to reassess the risks **of the particular policyholder** and, as a result, can set a price or level of benefits to fully reflect the risks.

2a Insurer has the right or practical ability to reassess the risks **for the portfolio of insurance contracts** that contain the contract and set a price or level of benefits to fully reflect the risks of that portfolio, and;

2b Pricing for coverage up to the date that the risks are reassessed **does not take into account the risks that relate to future periods.**

**Contract Boundary**  
(end)

# Part 2: Measurement methodology

# Measurement Methodology

## Overview of methods

# Basic methods

## Overview



### BUILDING BLOCK APPROACH (BBA)

Basing method applied to all products both life non-life insurance.

Possible one exemption – PAA and two modifications (VFA):

- VFA (obligatory)
- PAA (optional)



### VARIABLE FEE APPROACH (VFA)

Applied in life insurance

Permissible only in products satisfying specific rules (products with clearly defined profit sharing and „UL“ contracts

Close to „BBA“ enables several modifications



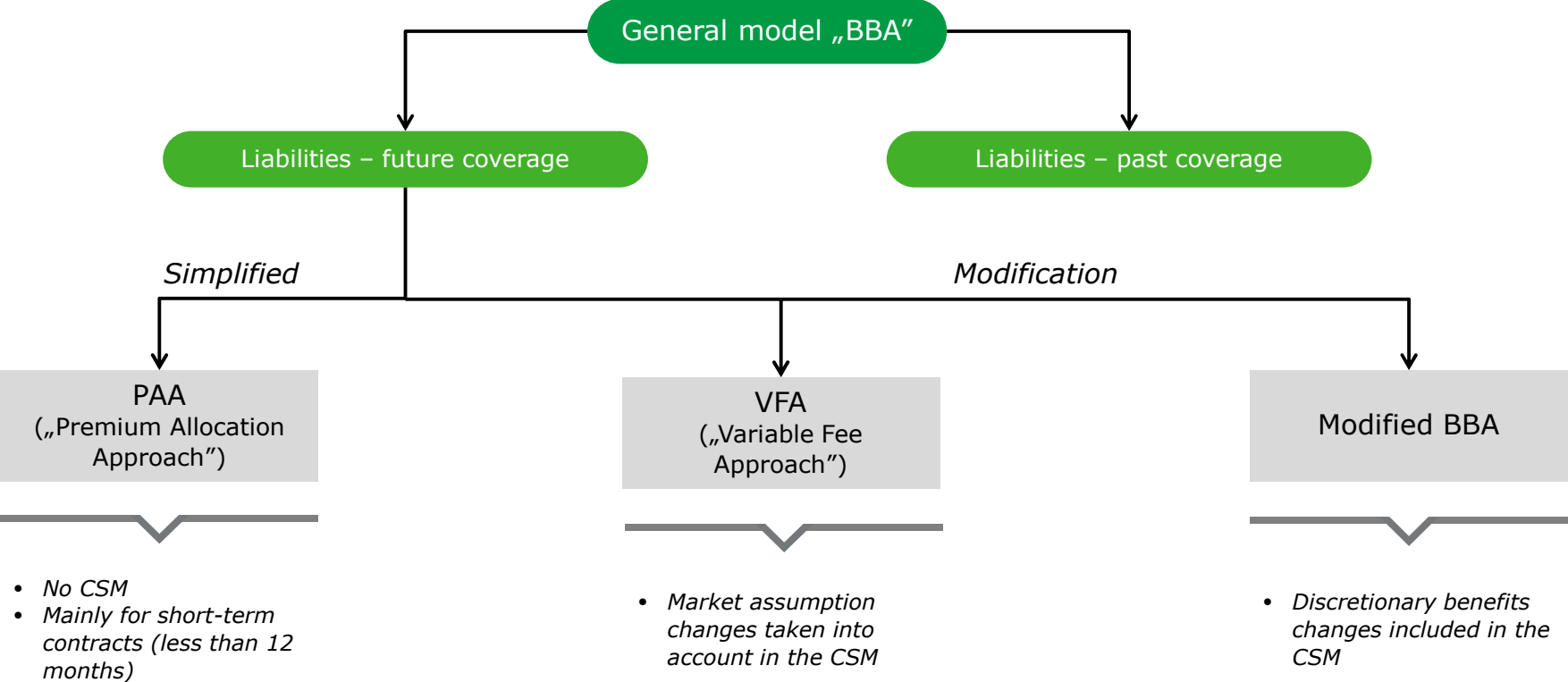
### PREMIUM ALLOCATION APPROACH (PAA)

Method for short-term contracts, applied mainly in non-life insurance

Permissible only for liabilities with future cover

Produkt	BBA	VFA	PAA
Life insurance	●		
Endowment with no profit sharing	●		
Endowment with profit-sharing	●	●	
Unit-linked	●	●	
Group products	●		●
Non-life insurance – future coverage	●		●
Non-life insurance – future coverage	●		

# Basic methods Diagram

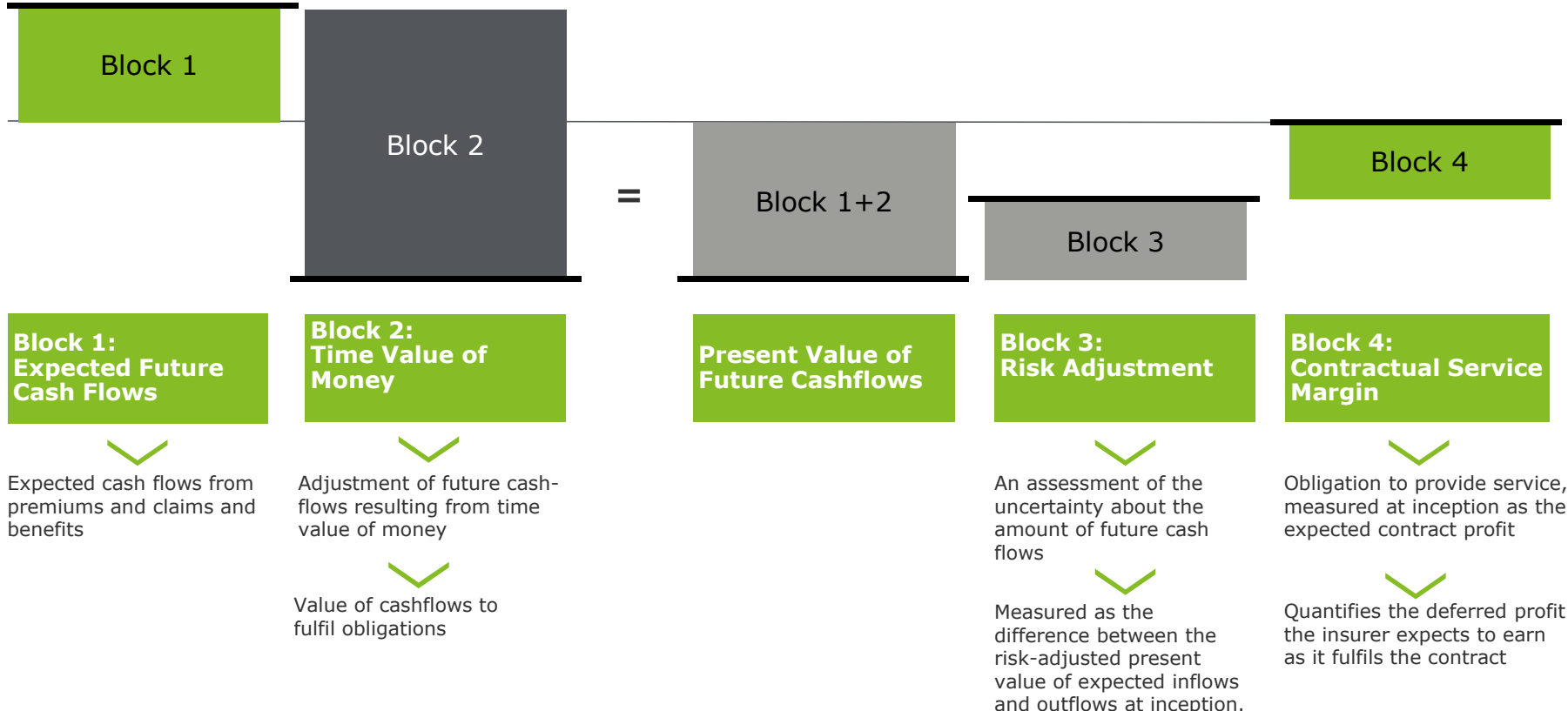


# Measurement Methodology

## General model

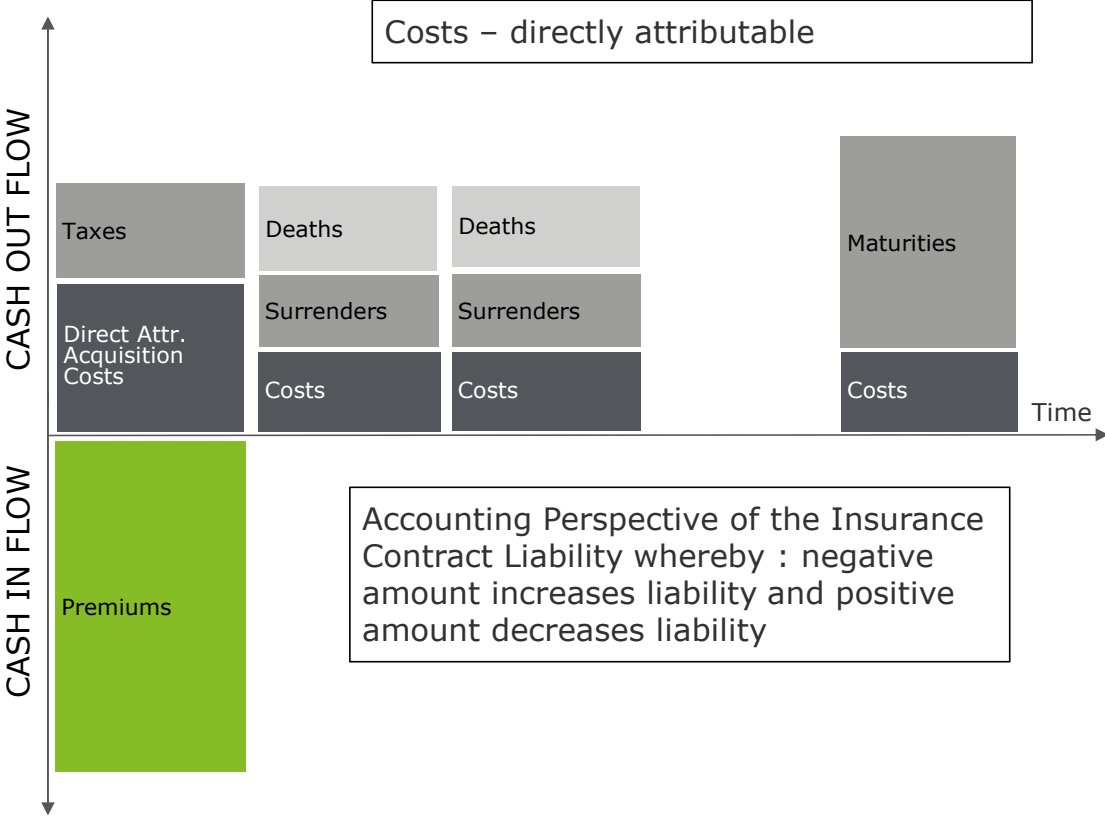
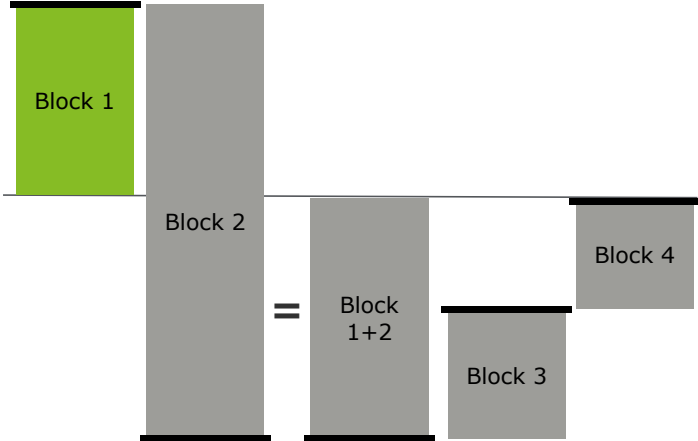
# Building Block Approach

## Overview measurement at initial recognition



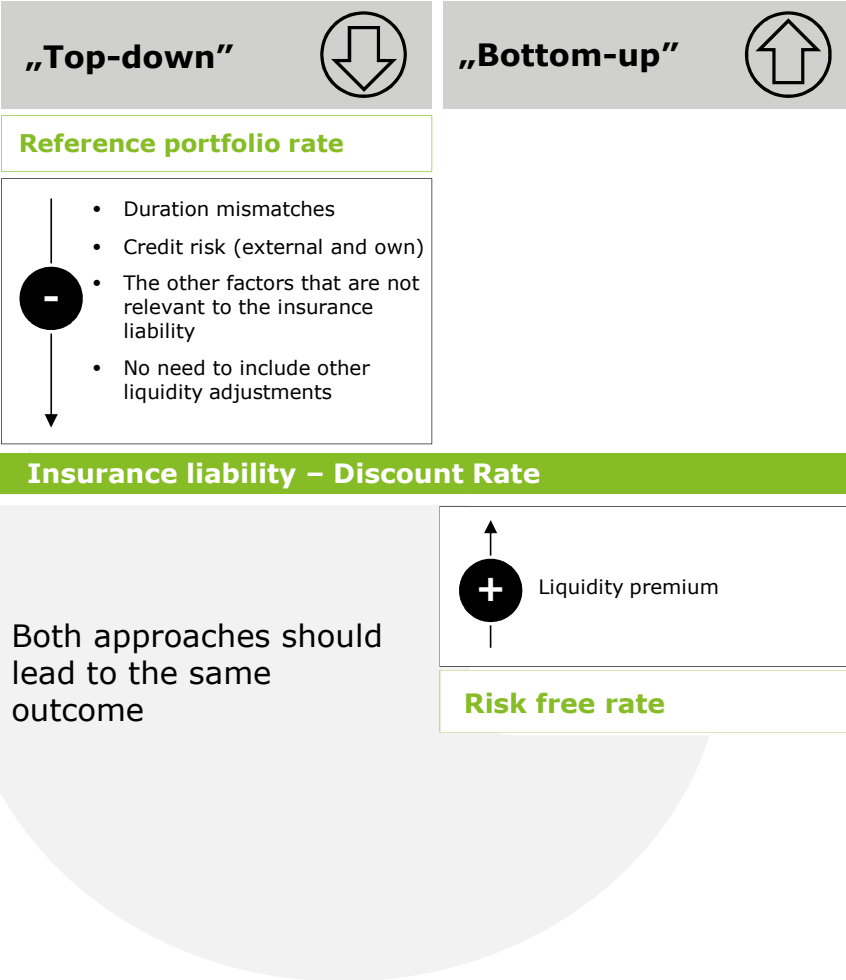
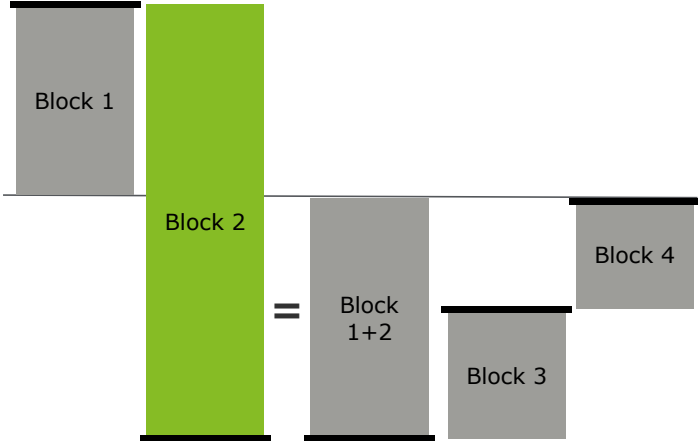
# Building Block Approach

## Block 1: Future cash flows



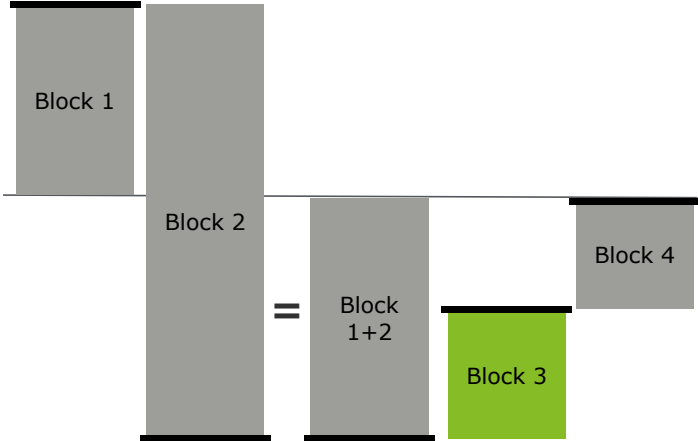
# Building Block Approach






## Block 2: Time value of money



# Building Block Approach

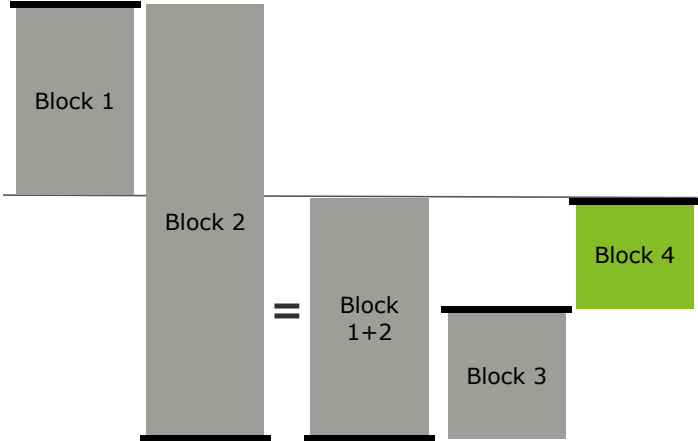
## Block 3: Risk adjustment



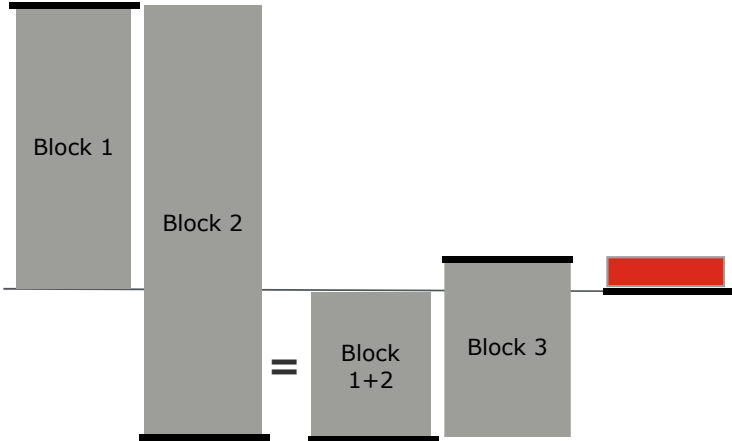
-  Measure of uncertainty
-  Principle-based approach
-  Specific for each insurer
-  Diversified
-  Comprehensive

# Building Block Approach

## Block 4: CSM



Block 1 + Block 2 + Block 3 < 0  
Recognise Contractual Service Margin

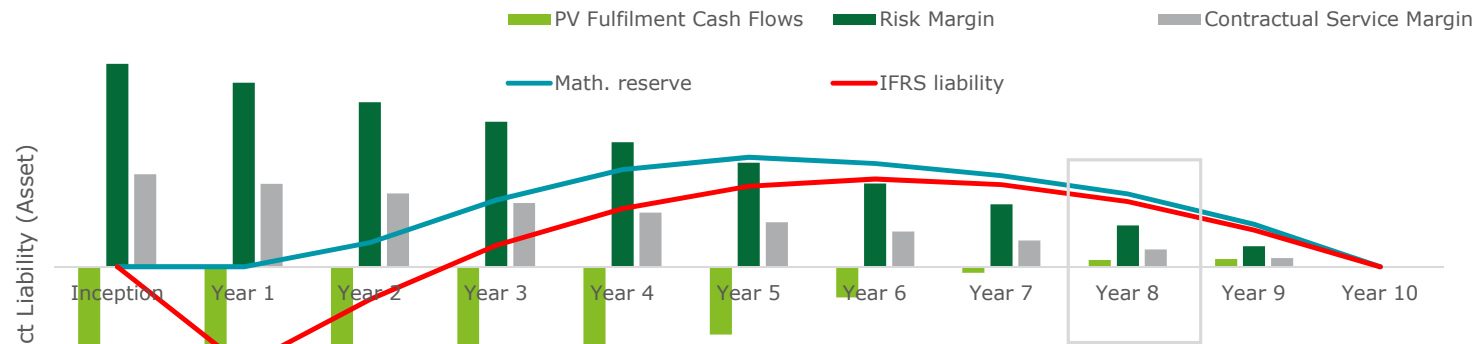


Block 1 + Block 2 + Block 3 > 0  
Recognise Day One Loss (Onerous Contract)

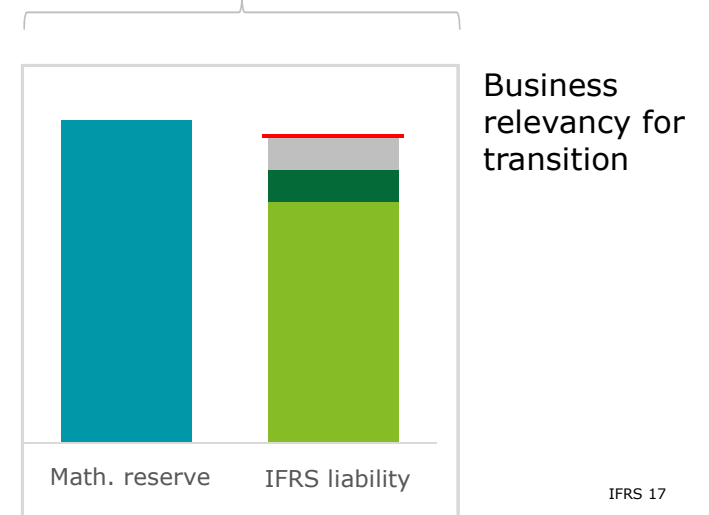
# Life insurance provisions (traditional & UL) accounting

Life: Building Block Approach or Variable Fee Approach

Provision development for one contract



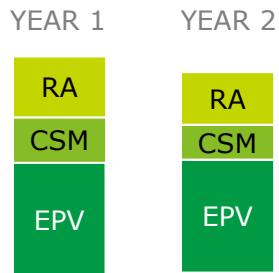
- Profit (CSM) is locked at interception
- Risk of unbundling – saving component may be accounted as investment contract



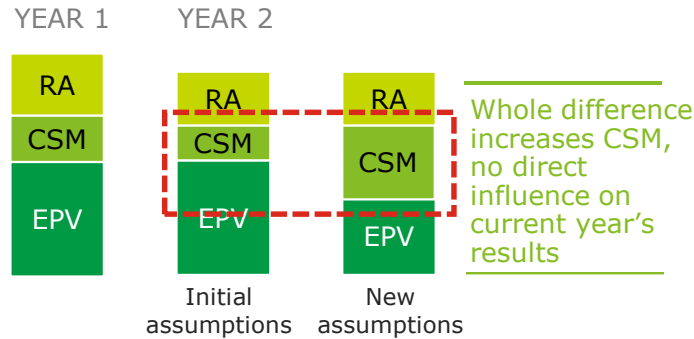
# General Model of IFRS 17 liabilities measurement

## Building Block Approach: assumption changes may affect profit

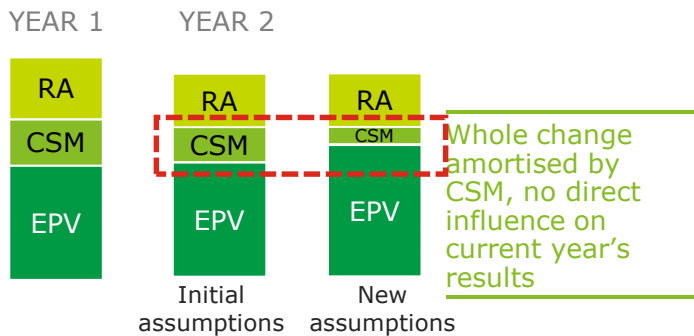
### Example 1: No assumption changes



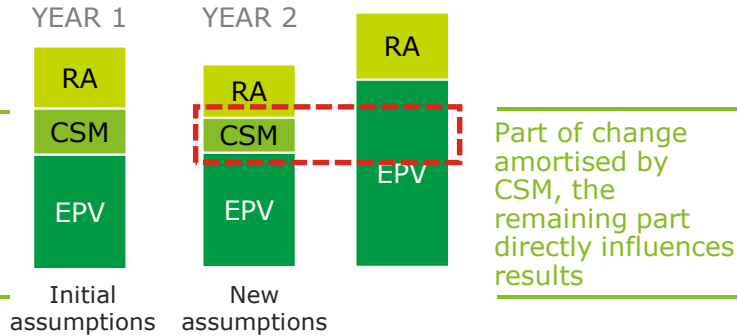
### Example 2: Favourable assumption change as of 2nd year



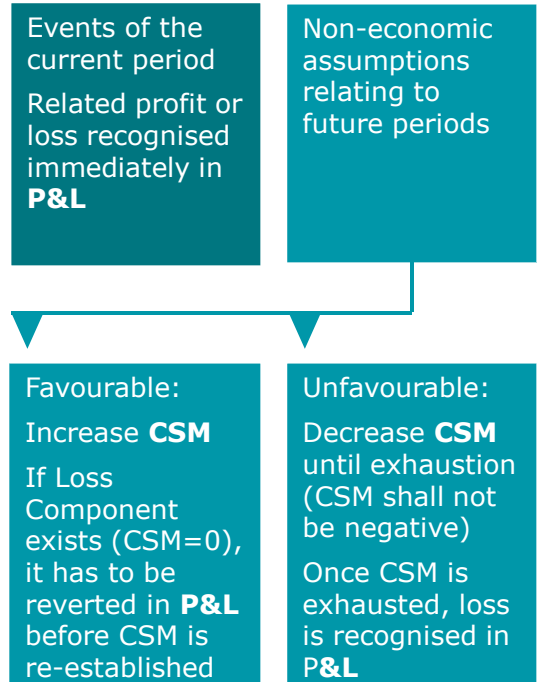
### Example 3a: Unfavourable assumption change as of 2nd year



### Example 3b: Unfavourable assumption change as of 2nd year



### Change of EPV and RA



# Building Block Approach

## Summary of changes in estimates

	CSM	OCI	P&L
Lapse/Surrender	●		
Mortality	●		
Morbidity and recovery	●		
Directly attributable maintenance and acquisition expenses	●		
Expense inflation	●		
Risk Adjustment	●		●
Discount rate		●	●
Expected credit losses on RI assets			●
IBNR			●
Other assumptions in respect of past coverage			●

# Key P&L items will disappear (GWP) or change (bottom line)

Life: Building Block Approach (BBA)

## P&L as now

Gross Written Premium	28 000	<b>X</b>
Claims	-14 000	
Expenses	-6 500	
Change in insurance liability	-3 500	<b>X</b>
<b>Technical profit</b>	<b>4 000</b>	
Investment income	2 000	
<b>Profit</b>	<b>6 000</b>	
<b>Other Comprehensive income</b>	<b>100</b>	



% of GWP used as deposit for future claims

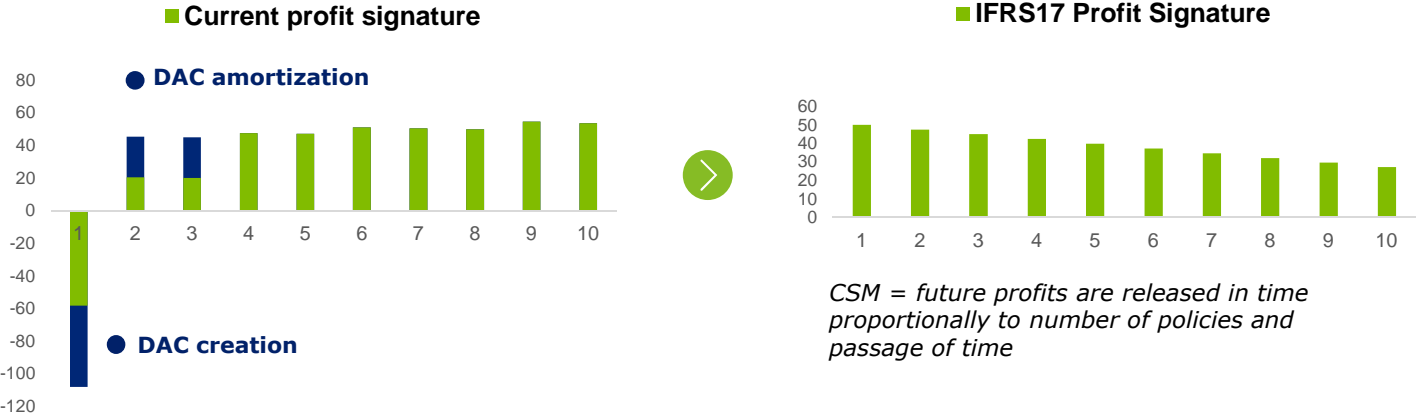
## P&L under IFRS17

Expected CF payouts over period (claims, expenses, surrenders,...)	20 000
Release of risk margin	2 000
Release of contractual service margin	4 000
<b>Revenue</b>	<b>26 000</b>
Actual CF (claims,...)	-14 000
Actual expenses	-6 500
<b>Underwriting result</b>	<b>4 500</b>
Interest income	500
<b>Profit</b>	<b>5 000</b>
<b>Other Comprehensive Income</b>	<b>500</b>

- Similar to profit by source method
- No much difference between single and regular premium products

# Profitability pattern of long-term contracts

Profit pattern will change – smooth release, sum of profits through policy lifetime is same – timing (and present value) is different



**Impact on new business planning, possibly as soon as 2018 (planning of 2019-2021)**

**Product profitability measurement – break event not valid, to define new measure of product performance (such as CSM/premium)**

# Measurement Methodology

## Variable Fee Approach

## Variable Fee Approach („VFA“)

### Conditions for eligibility

**Variable Fee Approach (“VFA”)** is applied for contracts with direct participation feature.

Above contracts meet the following conditions:

- i. the contractual terms** specify that the policyholder participates in **a share of a clearly identified pool of underlying items**
- ii. the entity expects to pay to the policyholder an amount equal to **a substantial share of the fair value returns** on the underlying items; and
- iii. the entity expects a substantial proportion of any change in the amounts to be paid to the policyholder to **vary with the change in fair value of the underlying items.**

VFA is not applicable to reinsurance contracts.

Understood as:

1. Contractual liabilities,
2. Law and regulations
3. Constructive obligation

Eg.

1. Unit Linked product: 100% of fund return in
2. 90% policyholder fund's surplus

Np.

1. Unit Linked product: Death benefit = Max(Fund Value, Sum Assured)
2. Reversionary Bonus, Terminal Bonus

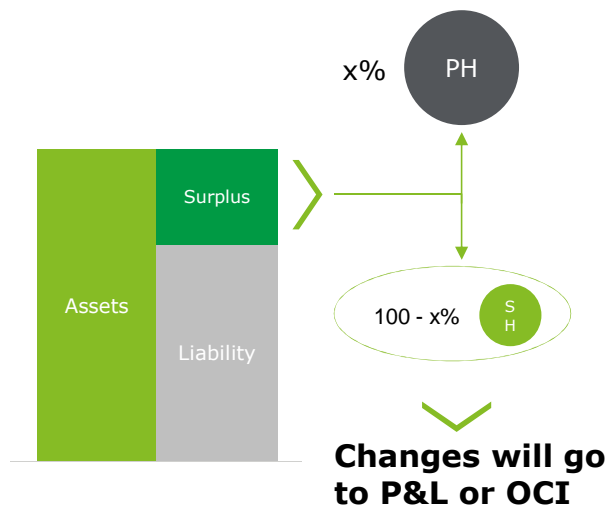
**Examples:** endowment insurance with profit sharing based on yield rate, endowment insurance with profit sharing based on biometric variables, unit-linked

# Variable Fee Approach

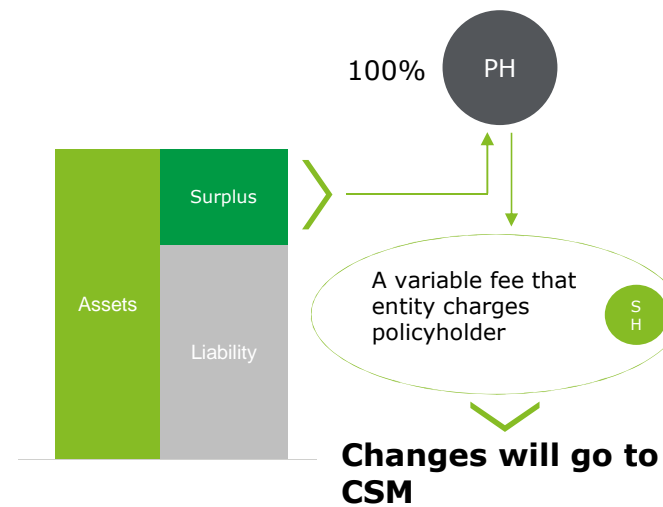
## Different underlying model

In variable fee approach, **the 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, rather than as a share of returns from a standalone investment.

### Building Block Approach



### Variable Fee Approach



### Acronym Key

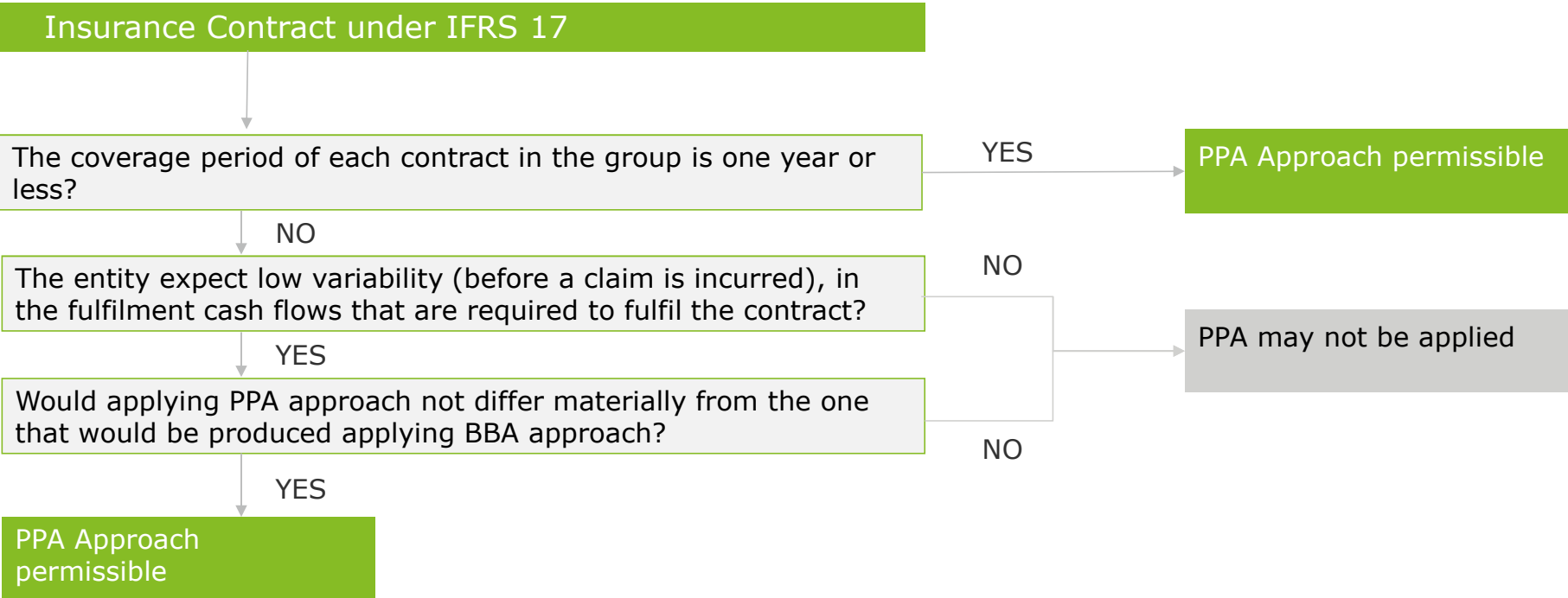
PH	Policyholder	SH	Insurer
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# Measurement Methodology

## Premium Allocation Approach

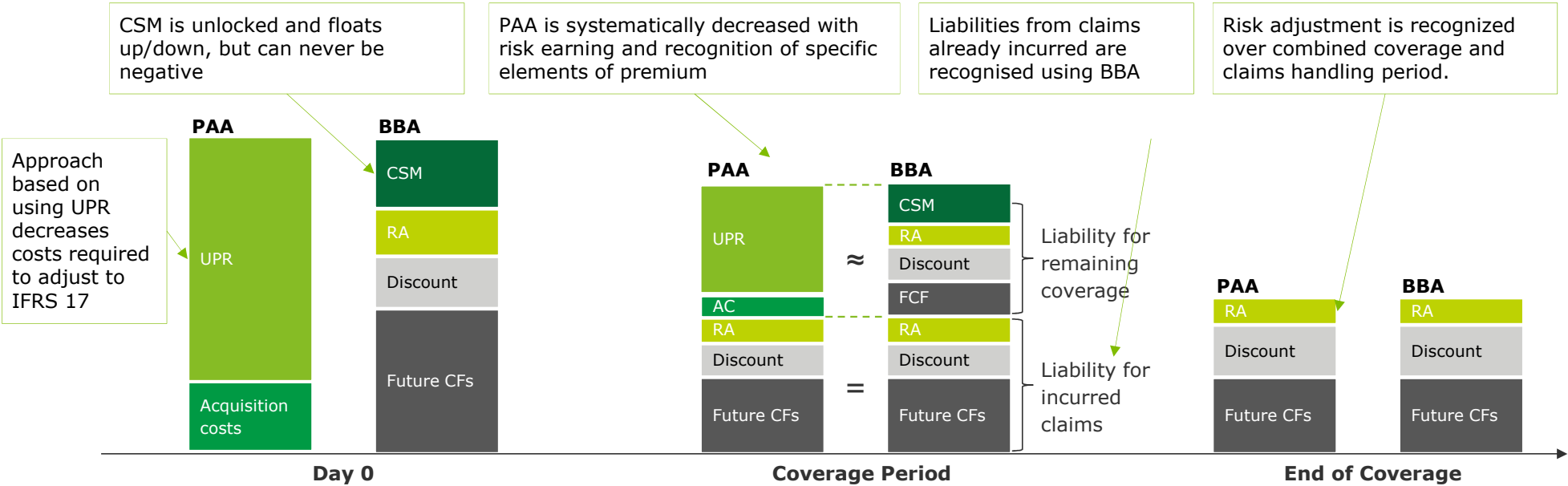
# Premium Allocation Approach

## Decision tree



# Premium Allocation Approach

## General rules



### Acronym Key

AC	Acquisition costs
FCFs	Future cash flows
CSM	Contractual service margin
RA	Risk Adjustment
UPR	Unearned premium reserve

As BBA approach has to be applied to incurred claims, using both approaches might ultimately still be expensive for a company. Therefore the decision to apply PPA has to be analysed in detail.

If the contract is onerous („onerous contract”), the UPR and acquisition costs estimate will have to be increased by the amount required to fulfil the obligation. This estimate will have to be done based on BBA.

# Other considerations

## Reinsurance

## Reinsurance

### Key challenges related to IFRS 17 implementation for passive reinsurance



**Modeling on a stand alone basis** - eligibility for methods, valuation techniques, BEL, RA and CSM requirements, units of accounts etc. – the key requirements are consistent with insurance contracts



**Contract boundary** – reinsurance contract based on UY may have a 2-year coverage and will not automatically qualify for PAA



**CSM aspects** – modification of CSM calculation requirements (can be negative, other calculation approach in case when underlying contract becomes onerous)



**Accounting mismatches** – VFA issue, onerous contracts issues etc.



**CDA requirements** – additional component not adjusting the CSM but affecting the P&L



**Forecasts and consistency** – to value contracts one may need to model future business

# Part 3: Other considerations

# Other considerations

## Unit of Account

# Aggregation levels for calculations in IFRS 17

## Unit of account



granularity of calculations & reporting (tens or hundreds)

---

### PORTFOLIO

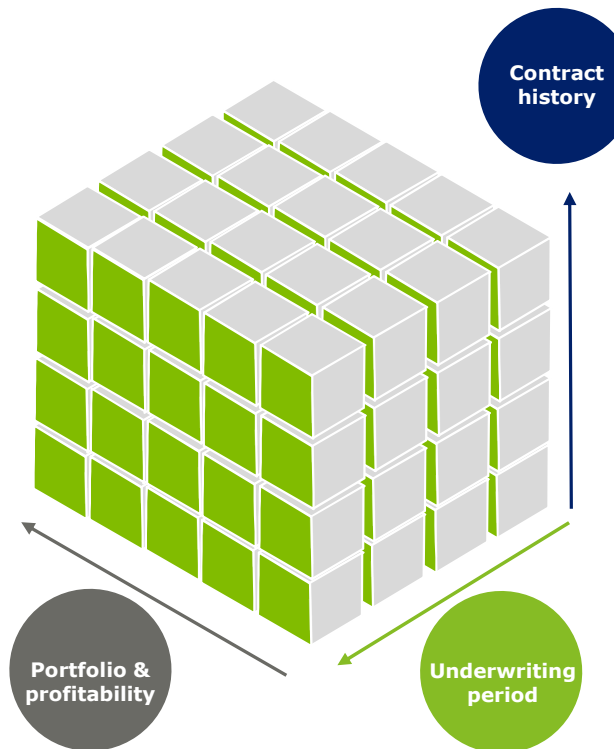
Insurance contracts subject to similar risks and managed together

Product or group of products may be a good example

### GROUP

Set of insurance contracts resulting from the division of a portfolio of insurance contracts into:

- split by profitability at initial recognition
- contracts written within a period of no longer than one year



# Aggregation levels for calculations in IFRS 17

## Unit of account

### Expected future cashflows

Could be measured at the level of **portfolio of contracts**

### Risk adjustment

Measured at the level enabling to include all **expected diversification effects**

**Main goal:**  
Aggregation level should not impact the level of present value of expected future cashflows measured at the individual policy level

**...but...**

*some calculations on individual level may be impracticable or impossible*

### CSM the point of contract recognition

It is permissible to group contracts of similar profitability, which will respond in similar ways to key drivers of risk



### CSM at subsequent periods

The level to be consistent with initial recognition guaranteeing that at the end policy term, CSM is fully recognised

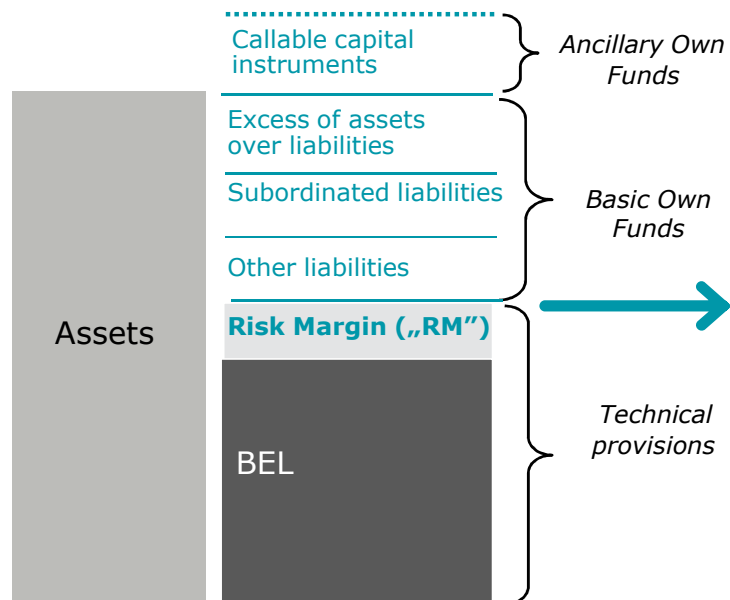
# **Other considerations**

## Solvency II and IFRS 17

# Solvency II and IFRS 17

## Solvency II

### Typical balance sheet

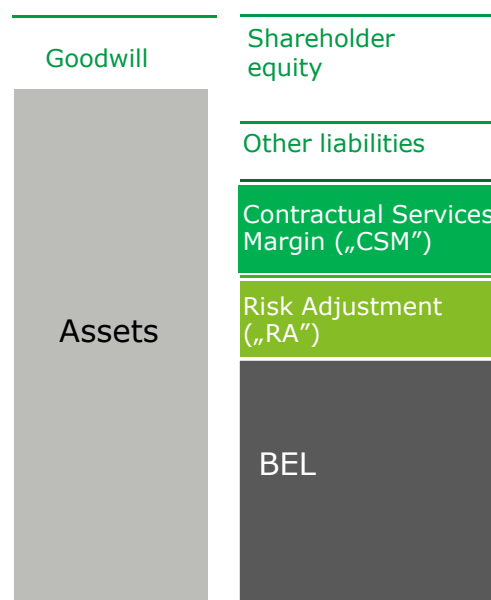


### POTENTIAL FINANCIAL IMPACTS

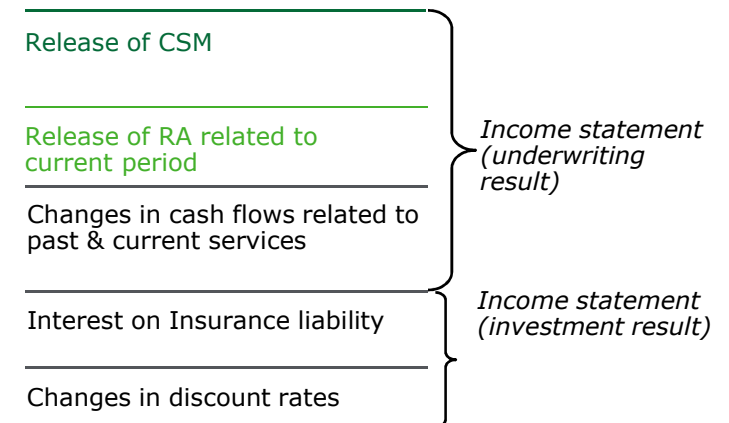
- No „first-day profit“ thanks to its deferral through CSM
- Much smoother profit profile

## IFRS17

### Typical balance sheet



### Income statement

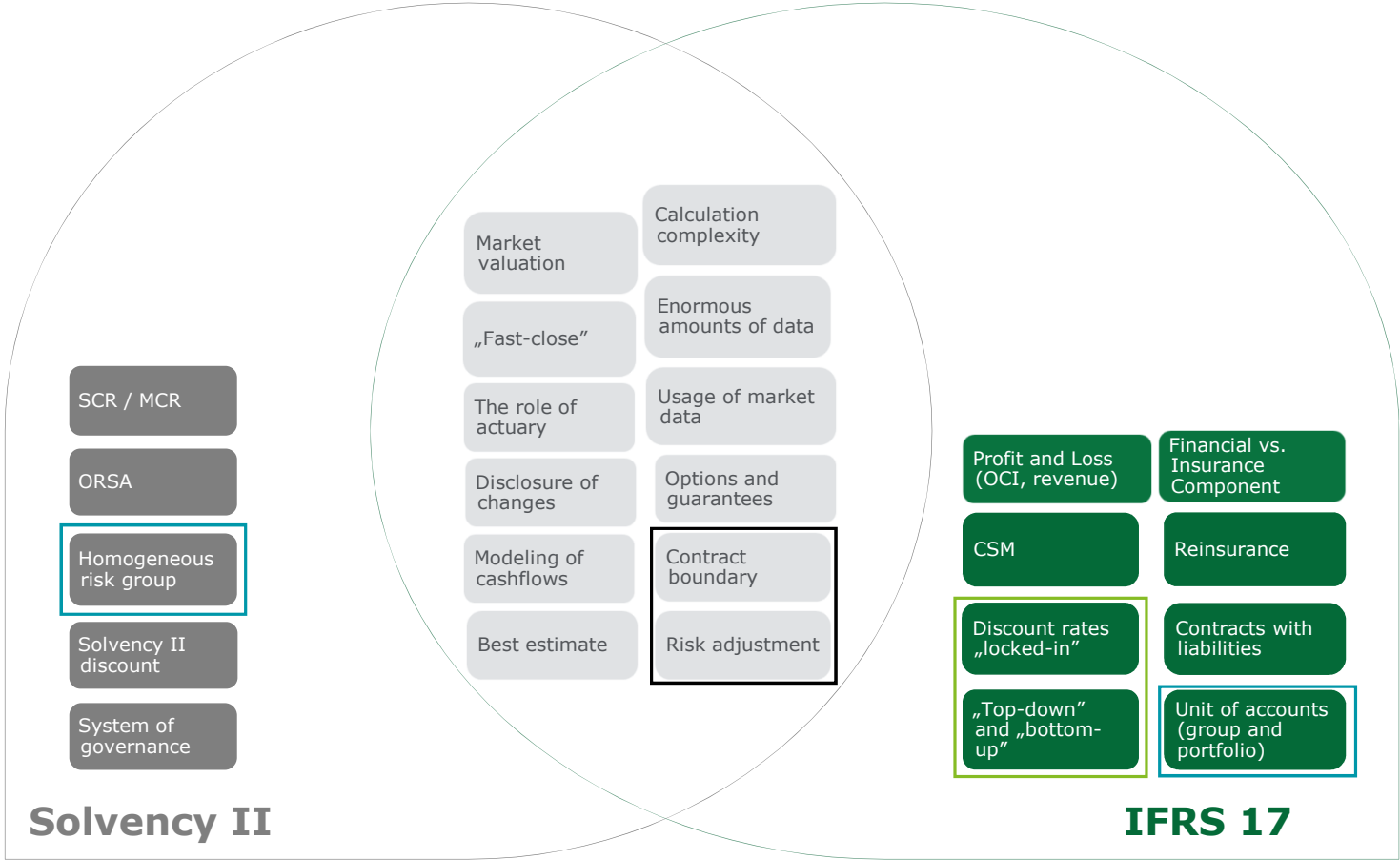


### POTENTIAL BUSINESS IMPACTS

- Significant volumes of data to be stored
- Actuarial assumptions changes directly affecting profit profile
- Actuarial valuation models to be integrated with accounting systems
- Level of granularity for required disclosures

# Solvency II vs. IFRS 17

## Synergies and differences



















# Part 4: Challenges

# Conclusions

## IFRS 17 influence on life and non-life insurers

High  Medium  Low 



No	Aspect	Life insurance	Non-Life insurance
1	Choosing the measurement method		
2	BEL <i>yield curve, contract boundary etc.</i>		
3	Risk adjustment		
4	CSM		
5	Unit of account		
6	Transition		
7	Reinsurance		
8	New statements and disclosure		

# Conclusions

## Challenges



IT systems - actuarial, policy, IT, accounting systems adjustments



New reporting requirements – new reporting, high level of transparency, additional disclosures, need to set new KPIs, reporting timeline



Transition – approach and implications



Unit of account – approach and implications



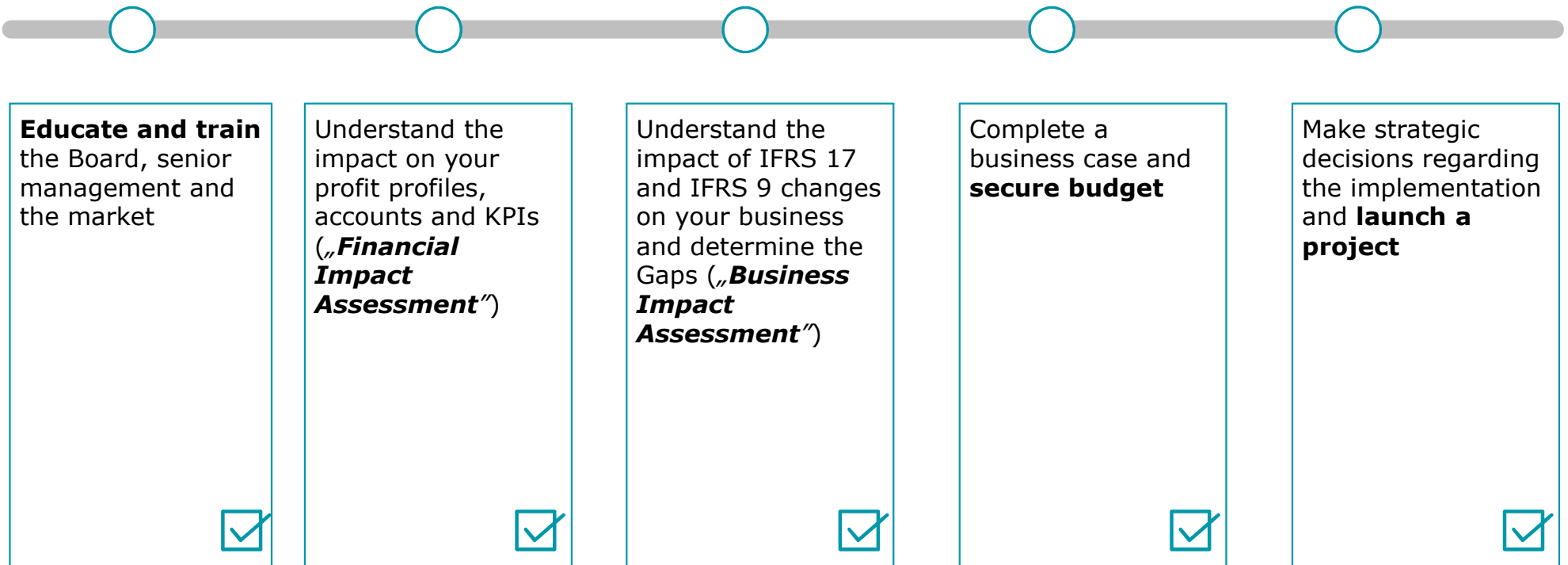
Human resources – actuarial, accounting and IT



More significant dependency of the financial result on the set of valuation assumptions (significant change for life insurers)

## Conclusion

*„Start early, start smart and keep it simple“*





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