IFRS17 kennisdelings- en netwerkavond voor zzp-ers
Utrecht - 19 april 2018 18.00 – 21.00 uur

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Triple A – Risk Finance B.V.

19 April 2018

Agenda

- **18:40 – 19:45 IFRS 17 and IFRS 9 background**

- **20:15 – 21:00 IFRS 17 implementation and practical considerations**

18:40 – 19:45 **IFRS 17 and IFRS 9 background**

Agenda

- **18:40 – 19:45 IFRS 17 and IFRS 9 background**
  - General overview
  - Measurement approaches
  - Example CSM
  - Grouping of contracts
  - Cash flows and contract boundaries
  - Examples
  - Transition
  - IFRS 9
- **20:15 – 21:00 IFRS 17 implementation and practical considerations**

An Introduction to Triple A – Risk Finance

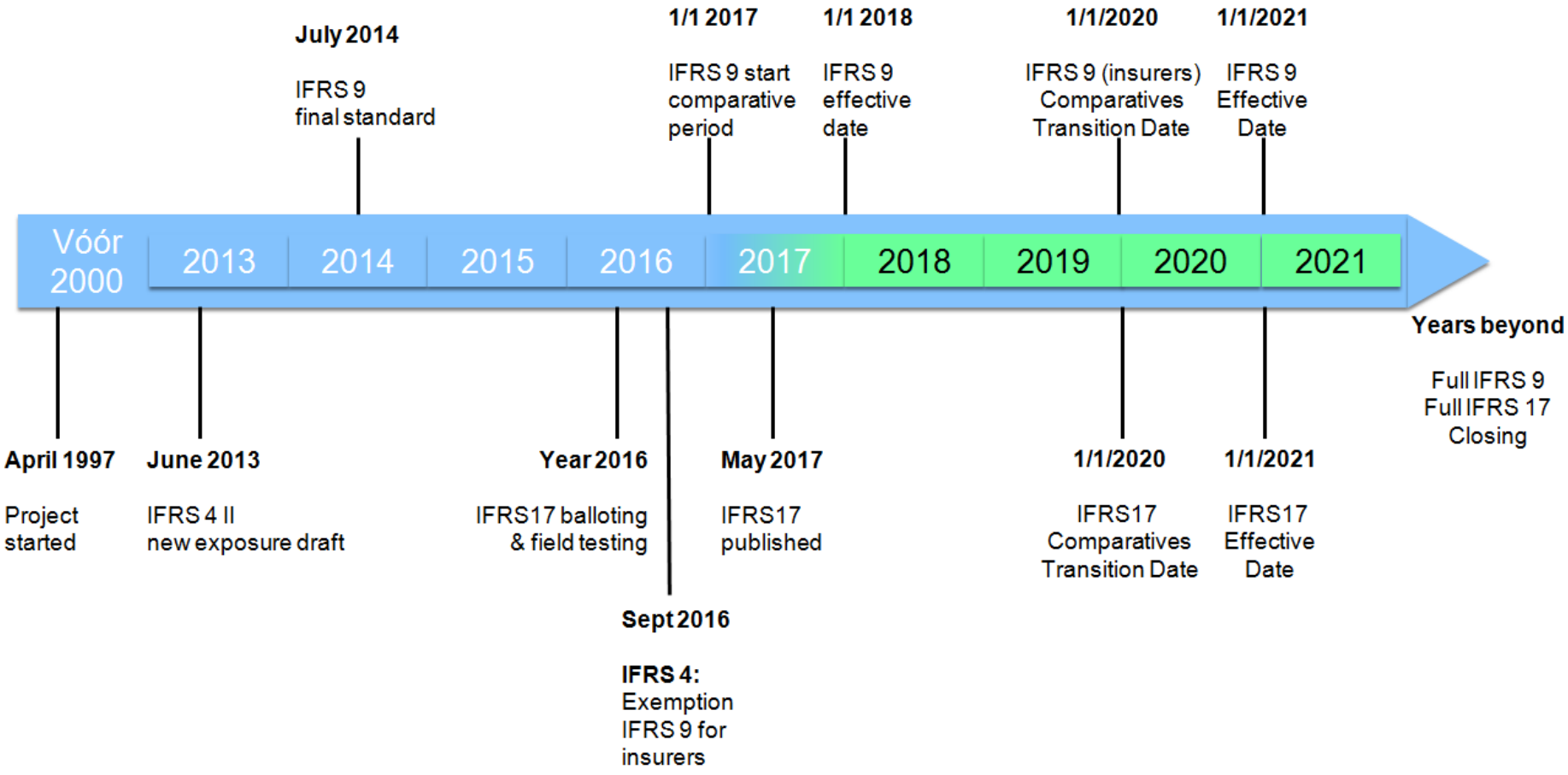
We are an independent, innovative, risk management and actuarial consultancy firm that employs insurance experts, risk professionals, actuaries and investment analysts who have gained many years of experience within insurance and pensions, combined with financial risk management in a variety of financial institutions and consultancy companies.

We currently employ over 100 professionals, located in offices in Amsterdam, The Netherlands and Warsaw, , and we are active on the European market for over 10 years now.

The professionals of Triple A - Risk Finance have an actuarial, econometrics or mathematics background combined with thorough knowledge of products and processes within insurance companies, corporate funded pension plans, pension funds and other financial institutions.

General overview

Timelines


Vóór 2000
2013
2014
2015
2016
2017
2018
2019
2020
2021
April 1997
Project started
June 2013
IFRS 4 II new exposure draft
July 2014
IFRS 9 final standard
Year 2016
IFRS17 balloting & field testing
Sept 2016
IFRS 4: Exemption IFRS 9 for insurers
May 2017
IFRS17 published
1/1 2017
IFRS 9 start comparative period
1/1 2018
IFRS 9 effective date
1/1/2020
IFRS17 Comparatives Transition Date
1/1/2021
IFRS17 Effective Date
1/1/2020
IFRS 9 (insurers) Comparatives Transition Date
1/1/2021
IFRS 9 Effective Date
Years beyond
Full IFRS 9
Full IFRS 17
Closing

IFRS 17 and IFRS 9

Debit			Credit	
Financial assets at FVtPL	31		Equity	24
AfS investments	80		Debt & borrowings	11
Loans	34		Banking liabilities	10
Banking assets	11		Insurance contracts	114
Reinsurance contracts	1		Investment contracts	2
DAC/VOBA	2		Financial liabilities	4
Other financial assets	5		Deferred tax liabilities	2
Other non-financial assets	4		Other non-financial liabilities	1
Total	168		Total	168

Accounting mismatch

Temporary exemption from IFRS 9

20A IFRS 9 addresses the accounting for financial instruments and is effective for annual periods beginning on or after 1 January 2018. However, for an insurer that meets the criteria in paragraph 20B, this IFRS provides a temporary exemption that permits, but does not require, the insurer to apply IAS 39 *Financial Instruments: Recognition and Measurement* rather than IFRS 9 for annual periods beginning before 1 January 2021. An insurer that applies the temporary exemption from IFRS 9 shall:

(a) use the requirements in IFRS 9 that are necessary to provide the disclosures required in paragraphs 39B–39J of this IFRS; and

(b) apply all other applicable IFRSs to its financial instruments, except as described in paragraphs 20A–20Q, 39B–39J and 46–47 of this IFRS.

20B An insurer may apply the temporary exemption from IFRS 9 if, and only if:

(a) it has not previously applied any version of IFRS 9[2], other than only the requirements for the presentation of gains and losses on financial liabilities designated as at fair value through profit or loss in paragraphs 5.7.1(c), 5.7.7–5.7.9, 7.2.14 and B5.7.5–B5.7.20 of IFRS 9; and

(b) its activities are predominantly connected with insurance, as described in paragraph 20D, at its annual reporting date that immediately precedes 1 April 2016, or at a subsequent annual reporting date as specified in paragraph 20G.

20D An insurer's activities are predominantly connected with insurance if, and only if:

(a) the carrying amount of its liabilities arising from contracts within the scope of this IFRS, which includes any deposit components or embedded derivatives unbundled from insurance contracts applying paragraphs 7–12 of this IFRS, is significant compared to the total carrying amount of all its liabilities; and

(b) the percentage of the total carrying amount of its liabilities connected with insurance (see paragraph 20E) relative to the total carrying amount of all its liabilities is:

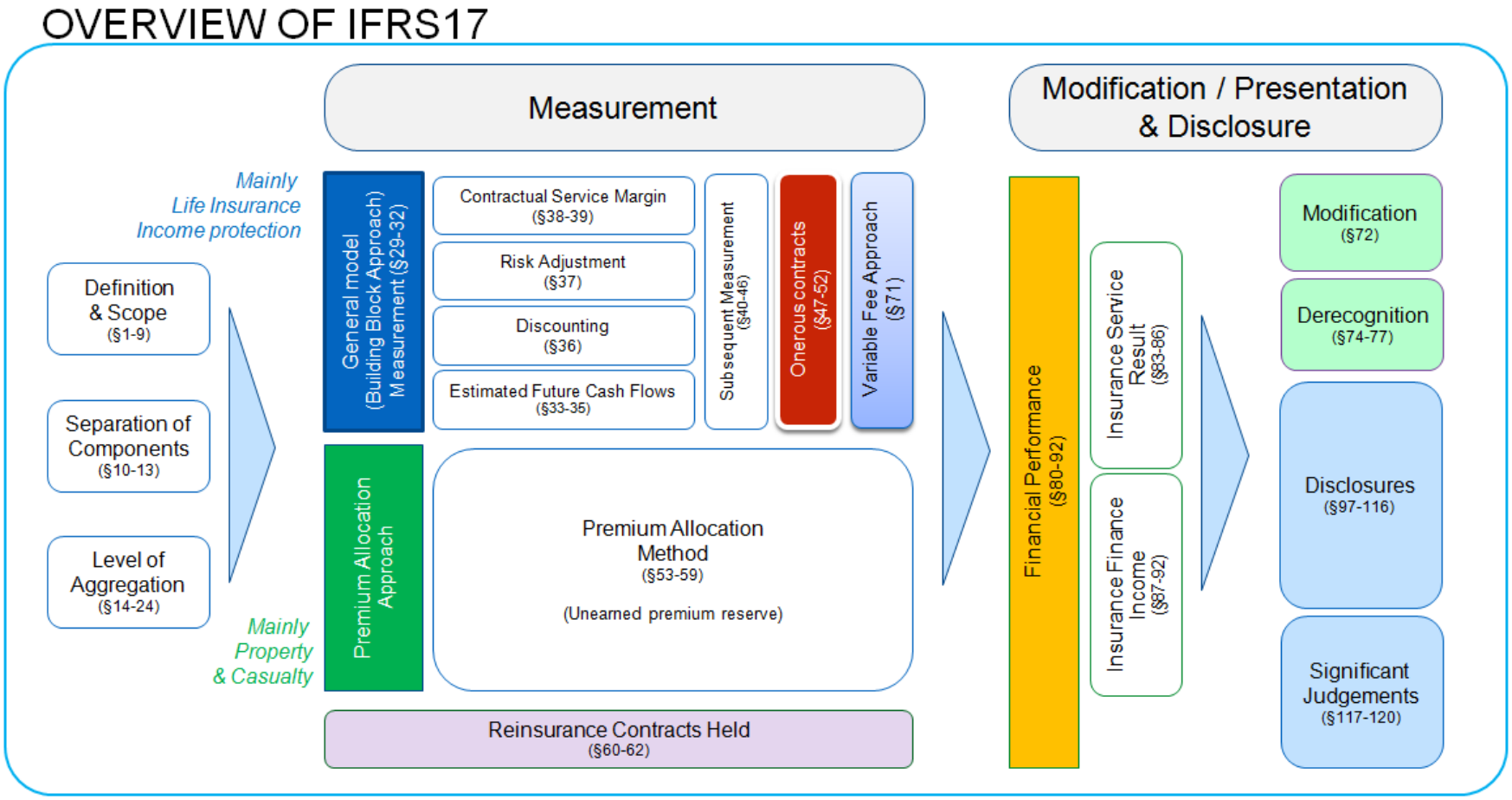
(i) greater than 90 per cent; or

(ii) less than or equal to 90 per cent but greater than 80 per cent, and the insurer does not engage in a significant activity unconnected with insurance (see paragraph 20F).

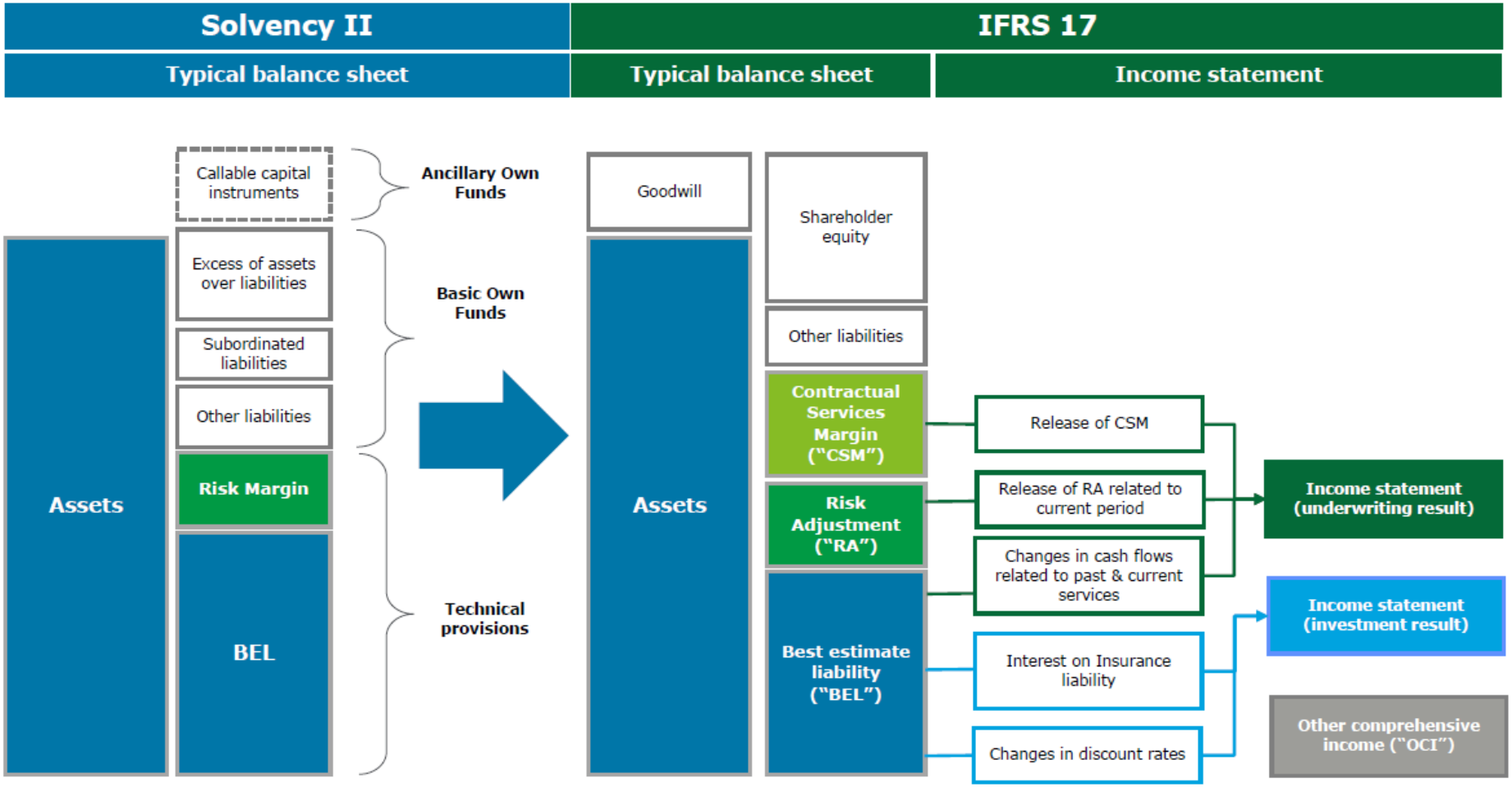
Important for:

- ❑ *bank/insurance conglomerates*
- ❑ *captives*

Overview IFRS 17

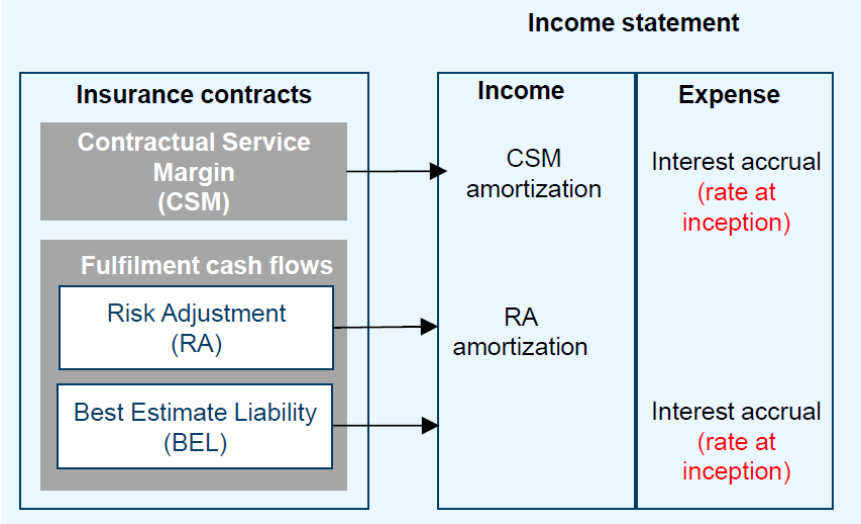


Solvency II versus IFRS 17



IFRS17 income statement and implications

- Under IFRS17, revenues and profitability are predominantly driven by releases of actuarial reserves (release of Risk Adjustment and release of CSM)



If an insurer is able to obtain more historical policy information, it is expected that it will achieve a higher future IFRS result because the release in CSM is usually higher

- In order to optimize IFRS profits, it is advisable to implement a sufficiently robust infrastructure(*) to meet the additional requirements:
  - Additional functionality needed
  - Additional data (e.g. historical policy data) needed
  - Increased number of calculations

(*) Current infrastructure does not meet the requirements and is not well-positioned to optimize future IFRS results

IFRS17 income statement and implications

Statement of comprehensive income	
Insurance contract revenues	+
Incurred claims and expenses	-
Amortisation of acquisition costs	-
Day one losses (onerous contracts)	-
Changes in estimates that do not adjust the CSM (onerous contracts)	+/-
Other expenses	-
Insurance service result	**+**
Investment income	+/-
Interest expense on insurance liability	-
Finance result	**+**
Profit or loss	**+/-**
Effect on discount rate changes on insurance liability	+/-
Other OCI items (currency, IAS19, etc)	+/-
Total comprehensive income	**+/-**

General

IFRS 17 vs SII

Topic	Differences in calculation methodology and inputs
Discount rate	• SII discount rate is set bottom-up. IFRS 17 also allows a top-down approach. • SII yield curve is prescribed. The IFRS 17 curve must be based on all market-observable data. • SII yield curve includes long-term guarantee measures (VA, MA) and a transitional adjustment. The IFRS 17 yield curve includes an illiquidity premium.
Expense assumptions	• SII expense assumption is market-consistent. IFRS 17 expense assumption is entity-specific. • SII expense assumptions includes overhead costs. IFRS 17 includes directly attributable costs only. • SII does not exclude “waste” cash flows (such as inefficiencies)
Risk margin	• SII risk margin does not assume any additional diversification benefits the level of the group. IFRS 17 risk margin includes the degree of diversification that the entity would include when pricing for the risks. • SII risk margin is net of reinsurance. IFRS 17 requires a gross calculation.
Other	• Other differences include: contract boundaries, unbundling, management action and discretion, and treatment of surplus funds on with profits business.

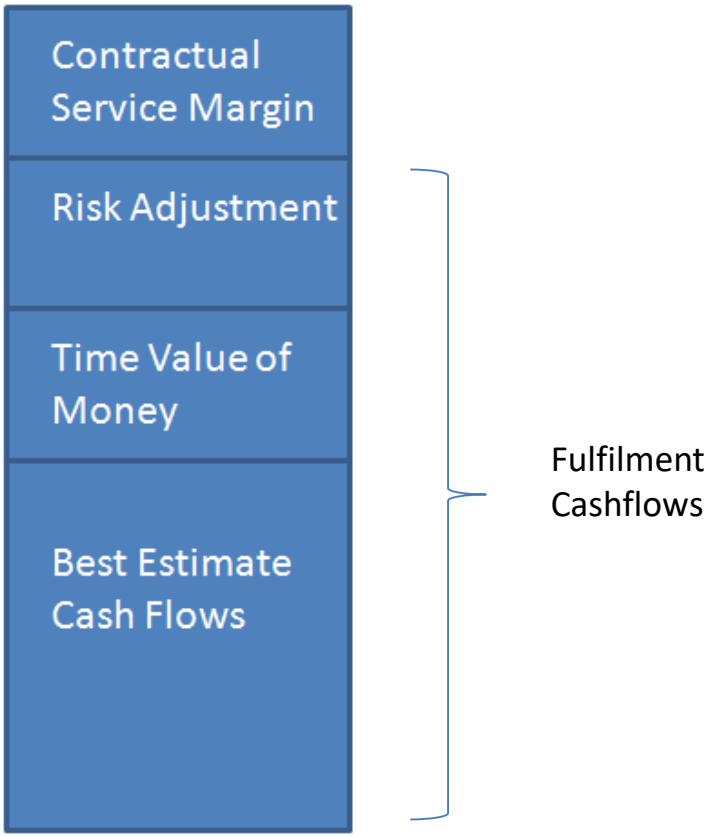
IFRS 17 Measurement approaches

Measurement approaches – BBA, VFA, PAA

Approach	Background	Types of contract
Building block approach	General model to be used	▪ Protection, endowments, whole life ▪ Group pensions business ▪ Immediate annuities ▪ Reinsurance ▪ Certain general insurance contracts (e.g. “AOV”)
Variable fee approach	Reflect participating business policyholder liability is linked to underlying items	▪ Unit-linked contracts (90/10 contract) ▪ Equity index-linked contracts ▪ Variable annuities
Premium allocation approach	Simplify for short term contracts with less variability	▪ Short-term general insurance contracts (coverage period no more than 1 year)

General model – Decomposition

- New income statement and definition of revenue
- OCI approach is optional for changes in discounting to reduce volatility in P&L
- Measurement for assets and liabilities is done independently (IFRS 9 versus IFRS 17)
- Measurement based on current assumptions
  - Best estimate actuarial assumptions *
  - Market consistent discount rates
  - Market consistent valuation of guarantees
- The 'fulfillment cash flow' is combination of the 'future cash flows', 'discounting' and the 'risk adjustment'
- No day one profits – recognised as a CSM and amortised in P&L over contract term (based on coverage units) **



(*) Unlike Solvency II, insurance acquisition cost will not arise at initial recognition

(**) At inception of a non-onerous contract, Contractual Service Margin is formed based on as present value of future profits less risk adustment

General model – Components

- Probability weighted discounted expected present value of cash flows
  - Discounting future cash flows to reflect characteristics of the liabilities
  - Apply ‘top-down’ or ‘bottom-up’ approach for discount rates
  - Best estimate cash flows, unbiased and probability weighted estimate of fulfilment cash flows.
  - Methodology could be similar to current practices: analysis needed E.g. differences in assumptions (expenses or discount rates) and contract boundaries can exist.

- Risk Adjustment
  - Reflect compensation required for uncertainty.
  - Difference between certain and uncertain liability
  - Methodology could be similar to current practices

- Contractual Service Margin
  - Unearned profits recognised over coverage period.
  - Unearned profit in the contract, released based on coverage units.
  - No equivalent under IFRS 4 phase 1.

General model – Discounting

- No prescribed method for discount rate (unlike SII)
- Discount rate consistent with market prices of financial instruments comparable with cash flows
- The discount rate can be set using the bottom-up or top-down approach
  - Top down approach: asset yield curve excluding factors irrelevant for insurance contract
  - Bottom up approach: risk-free curve including factors relevant for insurance contract

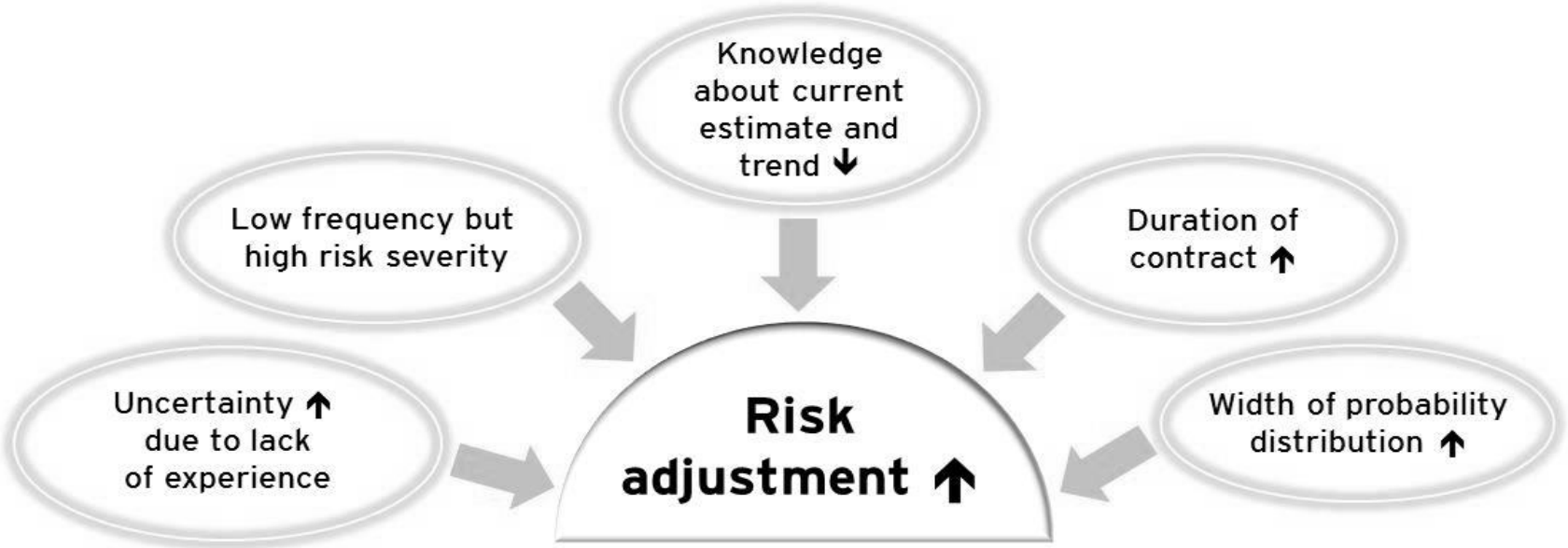
Top down	
Actual or expected reference portfolio rate	7.0%
Duration mismatches	0.3%
Market risk premium for expected credit losses	-1.0%
Market risk premium for unexpected credit losses	-0.6%
Insurance contract discount rate	**5.7%**

Bottom up	
Insurance contract discount rate	**5.5%**
Liquidity premium	1.5%
Risk free rate of return	4.0%

- Curve reflects currency and liquidity of contract and timing of cash flows
- Required interest at start locked per year by P&L and other changes in discount rate are done through (a) OCI or (b) P&L

General model – Risk Adjustment (RA)

- IFRS 17 does not specify the estimation techniques used to determine the risk adjustment. Estimation technique options considered include:
  - Cost of capital approach like Solvency II but with differences (excl. general operational risk, possibly Cost-of-Capital rate)
  - Confidence interval, depending on risk aversion
  - CTE (Conditional Tail Expectation)



General model – Contractual Service Margin (CSM)

- CSM is new concept. CSM represents profit that company expects to earn as it provides insurance coverage. Profit recognised in profit or loss over coverage period in a way that best reflects remaining .

- CSM cannot be negative, so losses from onerous contracts immediately booked in P&L

What is booked in P&L	Challenges

▪ Absorbed by CSM
  ▪ Experience variance related to future service
  ▪ Changes in non-economic assumptions
  ▪ Changes in the risk adjustment
▪ Not absorbed by CSM
  ▪ Experience variance related to current service
  ▪ Changes in the discount rate
	▪ CSM not available in current actuarial models
	▪ Increased data storage needed to
	  ▪ CSM to be calculated separately per cohort of business and discount rate used to calculate CSM is locked-in at contract issue date*
	▪ Determination of CSM at transition date is challenging: 3 allowed approaches

(*) Interest on CSM and changes in the fullfillment cash flows absorbed in the CSM are calculated using locked-in rates at contract issue date
Insurers need to keep track of (a) the CSM calculation for each of the different groups of contracts at each valuation and
(b) the locked-in discount rate for each group

- CSM amortization
  - CSM is to be amoritized based on development of coverage units
  - Relative to contract duration?
  - More advanced approach
    - Annuity: proportional to benefits (how to deal with 1L / 2L)?
    - Term / Endowments: proportional to sum assured?
    - Group Life: ? (more complex)

IFRS 17
CSM example

General model – contractual service margin subsequent measurement

- After initial recognition, the measurement of CSM works as follows:

CSM at start of the period	**200**
New contracts added to group	20
Accretion of interest	10
Changes in future CFs relating to future service - positive	-50
Changes in future CFs relating to future service - negative	30
Currency exchange differences	5
CSM release reflecting transfer of services during period	-20
CSM at end of period	**195**

- Order of the adjustments can affect the amount of the CSM recognized during reporting period
- The order in which CSM movements are to be performed is not prescribed, with the exception that release of the CSM (based on coverage units) has to occur last

General model – contractual service margin subsequent measurement

Example 1: CSM remains positive	Year 1	Year 2
CSM at start of the period	**100**	**65**
New contracts added to group	-	-
Accretion of interest	5	3
Non-financial assumption changes	-30	25
Currency exchange differences	-	-
CSM release reflecting transfer of services during period	-10	-13
CSM at end of period	**65**	**80**

Example 2: CSM becomes negative in year 1 and is reversed in year 2	Year 1	Year 2
CSM at start of the period	**100**	**-20**
New contracts added to group	-	-
Accretion of interest	5	-
Non-financial assumption changes	-125	80
Currency exchange differences	-	-
CSM release reflecting transfer of services during period	-	-8
CSM at end of period	**-20**	**52**

reported CSM end of period	**-**	**52**
loss through P&L	**20**	**-**
profit through P&L	**-**	**20**

(1) In case of positive CSM, only the release of CSM and accretion of interest affect the P&L

(2) In case of negative CSM

(a) Negative CSM reported as loss through P&L

(b) Any negative CSM amounts needs to be tracked as the CSM can be reinstated when it is above zero.

(c) No CSM until all previously recognized P&L charges have been reversed

General model – Contractual Service Margin (CSM)

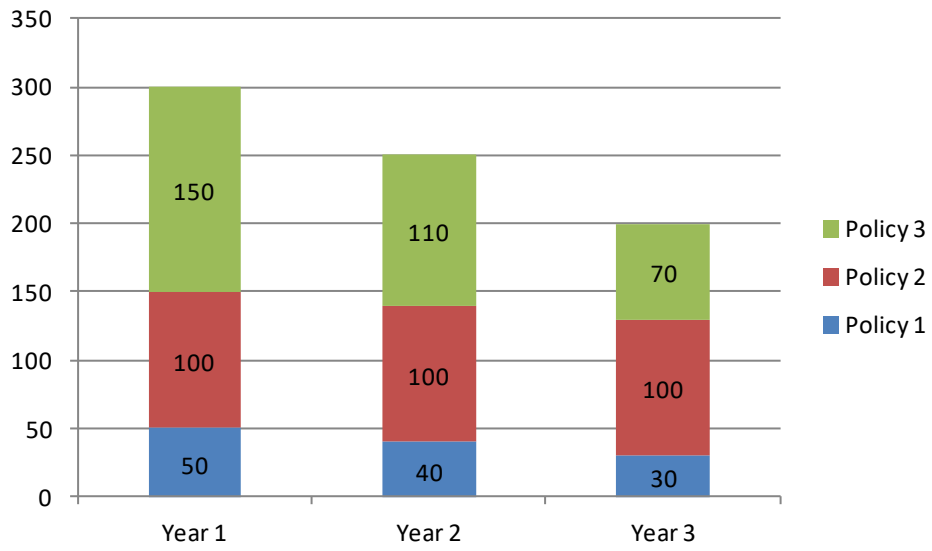
- Release of CSM per period is derived based on allocated coverage unit in reporting period
- Coverage unit: maximum amount payable to the policyholder by year

Release of CSM through P&L the amount of coverage units provided in the period

=

Coverage units in the period (i) / Total coverage units (ii)

Development maximum amount payable to policyholder (example)



Allocation of CSM per future reporting year:

1. Year 1 ➔ i/ii = 300/750 = 40%
2. Year 2 ➔ i/ii = 250/750 = 33%
3. Year 3 ➔ i/ii = 200/750 = 27%

General model – releasing CSM due to service provided

- Example for three policies with maturity at year 3 (all policies mature at T=3)
- Determining CSM at inception:

CSM at inception	Inception
PV of future cash flows	-125
Risk adjustment	25
Fulfilment cash flows	**-100**
Contractual Service Margin	100
Insurance liability	**-**

- Derive CSM release per year:

CSM	Year 1	Year 2	Year 3
CSM at start of the period	**100**	**63**	**34**
New contracts added to group	-	-	-
Accretion of interest	5	3	2
Non-financial assumption changes	-	10	-
Currency exchange differences	-	-	-
CSM release during period	-42	-42	-36
CSM at end of period	**63**	**34**	**-**
Allocation of CSM at inception	**40%**	**33%**	**27%**
Part of remaining CSM to be amortized in year	**40%**	**56%**	**100%**

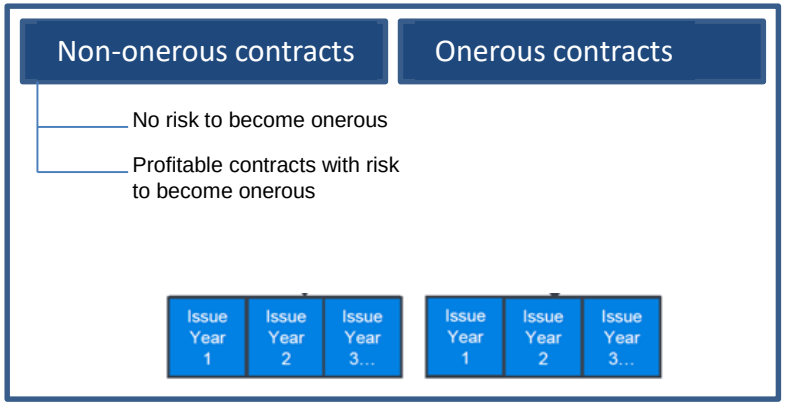
= 33% / (33% + 27%)

IFRS 17 Grouping of contracts

Aggregation – Grouping of contracts

- Grouping of contracts permitted but:
  - Onerous (loss-making) at inception and non-onerous *
  - Only permitted to group contracts written in the same year

- Calculations should be done at portfolio level:
  - Contracts with similar risks
  - Onerous contracts – risk to become onerous
  - Profitable contracts
  - Year of issue

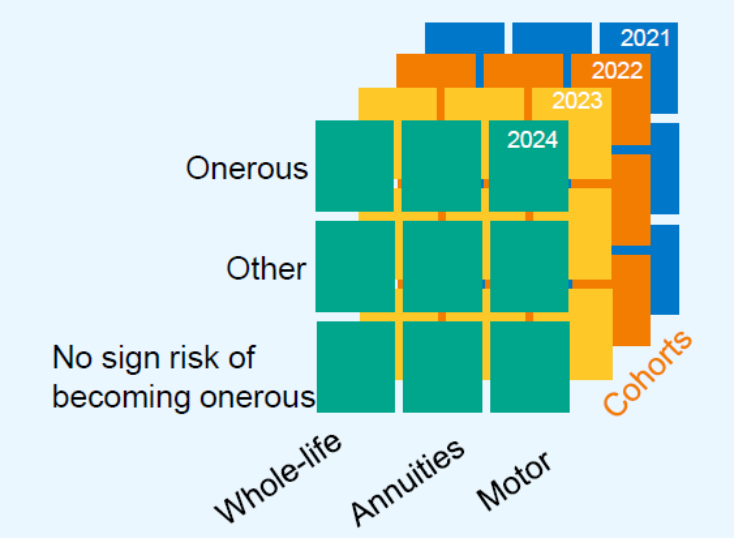


- Challenges
  - Maintaining different groups of contracts may require significant system updates
  - Account for business performance at more granular level
  - Solvency II Homogenous Risk Groups may be used as a starting point to be further disaggregated

(*) For onerous contracts, losses are immediately recognised in the P&L

Aggregation – requirements for aggregation

- Portfolio =
  - Insurance contracts subject to the same risks, and
  - managed together as a single pool
- Portfolio must be disaggregated into three groups:
  - Contracts onerous at inception
  - Contracts with no significant risk of becoming onerous
  - Other contracts
- Groups must be disaggregated into cohorts of max. 12 months
- Contracts that fall within different groups due to regulatory pricing restrictions may be grouped together
- Contracts cannot be moved from one group to another after inception



Aggregation – overview of groups

"A portfolio comprises contracts subject to similar risks and managed together"

Insurance Contracts Portfolio
(Life / Non-Life / Branches / HRG's)

"permitted to subdivide the groups, for example distinguishing different levels of profitability"

"based upon the likelyhood of changes in assumptions and using information provided by the entity's internal reporting"

I	II	III
Contracts that at initial recognition have no significant possibility of becoming onerous subsequently (if any)	Group of remaining 'profitable' contracts in the portfolio (if any)	Contracts that are onerous at initial recognition (if any)

"An entity shall not include contracts issued more than one year apart in the same group"

Year 2017	Year 2017	Year 2017
Year 2018	Year 2018	Year 2018
Year 2019	Year 2019	Year 2019
Year 2020	Year 2020	Year 2020
Year 2021	Year 2021	Year 2021
Year 2022 and beyond	Year 2022 and beyond	Year 2022 and beyond
Unearned profit is recognised as part of the liability (CSM) and released over the duration of the insurance contract		Recognise loss in P&L

Importance Annual cohorts

- The annual cohort requirement will provide useful trend information about profitability of contracts written in different periods
- The profit of a group of contracts will be recognised in the period the service is provided—and not averaged with profits of other groups and recognised over the period of which service is provided for all the groups

IFRS 17
Cash flows
and contract boundaries

Cash flows – Probability weighted discounted expected present value of cash flows

- Best estimate of the cash flows expected to fulfill the insurance contract.
- Fulfillment : ‘probability weighted estimate’ of future outgoing cashflows minus future incoming cashflows
- This estimate has to be current and unbiased
- Similar best estimate assumptions as used for Solvency II but differences in
  - IFRS17 includes directly attributable costs where Solvency II includes all expenses including overheads
  - Under IFRS 17, acquisition costs are realised over contract duration
- This value is then discounted against the current discount rate

Cash flows – Probability weighted discounted expected present value of cash flows

Cash flows to be included (related to fulfilment of the contract)	Excluded cash flows
Premiums and related payments	Not directly attributable acquisition costs, such as product development and training costs
Claims and benefits	Asset investment returns (asset returns to be paid to the policyholder are included)
Discretionary payments and payments that vary with returns on underlying items	Cash flows from reinsurance contracts held
Payments from embedded derivatives, including options and guarantees	Cash flows related to components separated from insurance contracts
Insurance acquisition cash flows	Income taxes
Claim handling costs	
Administration and maintenance costs	
Transaction-based taxes	
Fixed and variable overheads	
Selected other costs	

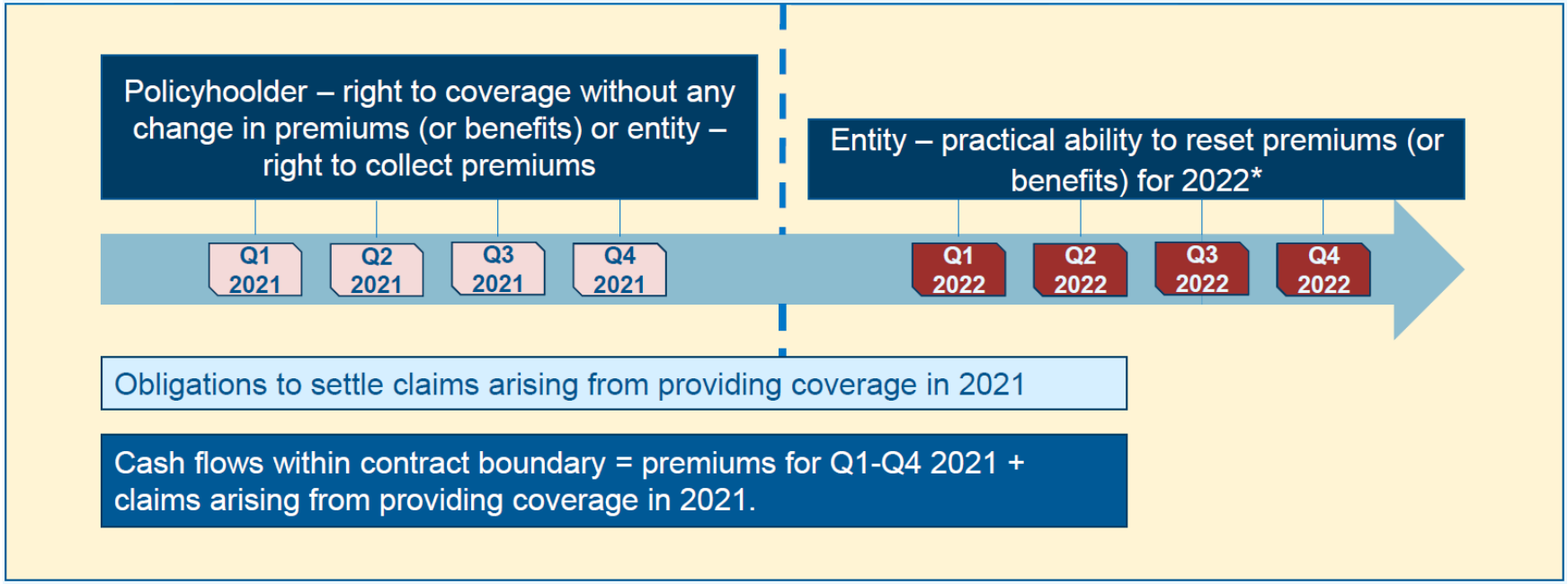
Contract boundaries – IFRS guidance

- Solvency II: Contract boundary ends in case of unilateral right to:
  - Terminate policy
  - Reject premium
  - Adjust premium to a level required to cover the risks

- IFRS 17: Contract boundary ends in case insurance company will:
  - Reinstate premium at the individual level
  - Reinstate premium at group level and premium was always determined on a risk basis

Within boundary of the contract	Outside boundary of the contract
Policyholder obliged to pay related premiums	Policyholder is not obliged to pay related premiums
Insurer is not able to reprice risks of the particular policyholder to reflect the risks	Insurer is able to reprice risks of the particular policyholder to reflect the risks
Insurer is not able to reprice portfolio of contracts to reflect the risks and premiums reflect risks beyond the coverage period	Insurer is able to reprice portfolio of contracts to reflect the risks and premiums do not reflect risks beyond the coverage period

Contract boundaries – IFRS guidance



(*) For an assesment at the contract level; And additional criterion must be satisfied whenthe assessment is at a portfolio level—the pricing of premiums does not take intoaccount risks that relate to periods after the reassessment date

Contract boundaries – Group contracts

- Group pension contracts with a term of 4 year; The contract is renegotiated after 4 years.
- Policyholder has the option to leave the accumulated defined benefit rights with the insurer.
  So effectively price changes can only relate to future rights

- IFRS 4: the original and renegotiated contracts are treated as one.
- IFRS 17 (like SII):
  - The pension contract could be seen as a series of 4-year agreements.
  - The contract has a long contract boundary (i.e. beyond 4-year period), but only for the rights that accrue in the contractual period of 4 years.
  - If the contract renews, then the rights that accrue in the second (4 year) contract period are considered a new insurance contract.

- Each “tranche” has a different locked-in rate for the calculation of the CSM and the finance income reported in P/L (if OCI option is used)

IFRS 17 Example

General model – example intial and subsequent measurement for portfolio

- Characteristics

at start

during contract

Aspect	Description
Policies	Portfolio of 1000 policies divided into 2 groups
Inception date	Inception date is 1 July 2028
Market interest rate	equals 2%
Expected return on assets	equals 2%
Profitability	No significant risk of becoming onerous and are combined in one group
Lapse	No contract will lapse during the coverage period
Coverage period	Coverage period of 10 months which ends on 30 April 2029
Premium group 1 + 2	Initial premium of all policies equals 1.000 and is fully paid on day one (1 July 2028)
Expenses	Not applicable
Claims group 1	Claims of EUR 492 (nominal value) with settlement date of 31 December 2028
Claims group 2	Claims of EUR 328 (nominal value) with settlement date of 31 December 2029
Expected present value of claims	PV of total claims equals 805 at inception date
Risk Adjustment group 1	Expected Risk Adjustment of EUR 30 with settlement date of 31 December 2028
Risk Adjustment group 2	Expected Risk Adjustment of EUR 20 with settlement date of 31 December 2029
Risk Adjustment	Risk Adjustment equals 50 (=30 +20), to be released as coverage is provided

General model – example intial measurement for portfolio of contracts

- **Initial recognition:**

Initial recognition	1 July 2028
Expected PV of cash inflows	1.000
Expected PV of cash outflows	-805
(a) Expected PV of net cash flows	**195**
(b) Risk adjustment	**-50**
Fulfilment cash flows = (a) + (b)	**145**
(c) Contractual service margin	**-145**
Asset/liability at initial recognition = (a) + (b) + (c)	**-**

- Cash inflows: initial premium of 1,000 paid at 1 July 2028 for all groups
- Cash outflows: discounted value of claims (492 and 328) at 2% equals 805
- Risk adjustment: 30 for group 1 and 20 for group 2 equals 50 in total
- CSM at initial recognition determined as such that there is no income or expenses at inception (see par 38 of the IFRS 17 Standard)

General model – example subsequent measurement for portfolio of contracts

- **Subsequent measurement:**

Subsequent measurement	PV future CFs	Risk adjustment	CSM	Total
Opening (1 July 2028)	-	-	-	-
Changes related to future services: new contracts	195	-50	-145	-
Cash inflows	-1.000	-	-	**-1.000**
Cash outflows	492			**492**
Insurance finance expense (2% per annum)	-8	-0	-1	**-10**
Changes related to current service: release RA & CSM	-	30	88	**118**
Closing (31 December 2028)	**-322**	**-20**	**-59**	**-400**

(*) It is also allowed to present entire change in risk adjustment (changes related to current service & insurance finance expenses) as part of insurance service result in PL

- New contracts: New business at inception equals values at 1 July 2028 (initial recognition)
- Cash inflows: equals initial premium of 1,000 fully paid at 1 July 2028
- Cash outflows: equals maturity benefits of 492 at 31 December 2028 for group 1
- Insurance finance expenses derived as compounded interest rate $(1{,}02^{1/2} - 1)$ times
- Insurance finance expenses on Risk Adjustment (now included in this line see footnote)
- Changes related to current service is no derived as:
  - Release of RA equals 30 (= 6 months / 10 months * [50])
  - Release of CSM equals 88 (= 6 months / 10 months * [145 + 1])

General model – determine insurance liability

- Determine liability for remaining coverage (premium reserve)

Liability for remaining coverage	31 Dec 2028
Opening (1 July 2028)	-
Plus: Cash inflows	1.000
Plus : Insurance finance expenses	10
Minus: Insurance revenues	-610
Liability for remaining coverage	**400**

- Determine liability for incurred claims (claims reserve)

Liability for incurred claims	31 Dec 2028
Opening (1 July 2028)	-
Plus: Insurance service expenses	492
Minus : Cash outflows	-492
Liability for incurred claims	**-**

General model – determine P&L

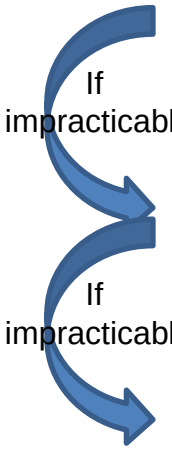
- Determine income statement
- Insurance revenues calculated using method 2

Income statement	2028
Insurance service expenses	492
Release of risk adjustment	30
Release of CSM	88
(1) Insurance revenues	**610**
(2) Less: Insurance service expenses	**-492**
(3) Less: Expenses incurred	**-**
Insurance service result (= 1 + 2 + 3)	**118**
(4) Investment income (assumption)	15
(5) Less: Insurance finance expenses	-10
Investment results (= 4 + 5)	**5**
Profit / (Loss) (= 1 + 2 + 3 + 4 + 5)	**123**

IFRS 17 Transition

Transition – measure as if IFRS 17 had always been applied

- First time application is challenging, especially the calculation of CSM at date of inception
- Hierarchy of approaches defined to determine CSM at transition date



- **Full retrospective approach** requires all pricing and historical datato estimate fullfillment cashflows and CSM at inception and roll forward to transition date.
- **Modified retrospective method**: achieve closest outcome to retrospective application possible using reasonable, supportable information. Using approximated yield curve for at least three years before transition.
- **Fair value approach**: Determine CSM at transition date as differences between fair value of the insurance contract and fullfillment cash flows measured at that date.

Transition approach – Full retrospective approach

- Entities are required to apply IFRS 17 for annual reporting periods beginning on or after 1 January 2021 ("**initial application date**")
  - **Transition date**: beginning of reporting period immediately preceding the initial application date: 1 January 2020
  - **Initial recognition date**: date on which contracts are sold and initially recognized on balance sheet.
  - **Full retrospective approach**: requires discount rate at initial recognition and all assumption changes between initial recognition date and transition date

ITEMS	FULL RETROSPECTIVE APPROACH
Best estimate of fulfilment cash flows	Expected present value for the insurance portfolio using the discount curve and best estimate assumptions as per the transition date.
Risk adjustment	Based on the RA calculations using the assumptions as per the transition date.
Contractual service margin	Based on the calculations of the best estimate and RA at the initial recognition date and taking into account developments to the transition date as if IFRS 17 had always been applied.
Discount rate effect	Expected present value of the insurance portfolio using yield curve and best estimate assumptions as per the transition date minus the expected present value of the insurance portfolio using the curve on initial recognition date and the best estimate assumptions as per the transition date. Note that this effect can be reflected in the CSM (if the variable fee approach applies), in the OCI or in the statement of profit and loss.

Transition approach – Modified retrospective approach

- **Modified retrospective approach**: achieve the closest outcome to the full retrospective approach using reasonable and supportable information at the transition date. Modifications or estimates are allowed, for example:

  - Expected cash flows as at initial recognition using current assumptions instead of assumptions as at initial recognition
  - Using known occurred cash flows between initial recognition date and transition date) to estimate expected cash flows as at initial recognition
  - Using estimates on average spreads over an observable curve to determine the discount rate as at initial recognition
  - Estimate the RA as at initial recognition by adjusting the RA as at transition date with the expected releases between those dates
  - Grouping of contracts more than one year apart

Transition approach – Fair Value Approach

- Under the **Fair Value Approach** the CSM at transition date is determined as the difference between
  - the fair value (computed in accordance with IFRS 13) and
  - the sum of the PV fulfilment CF + RA as at transition date.
  - **This may lead to a significant lower CSM compared to the (modified) retrospective approach.**

- The fair value may differ from the fulfilment value for a number of reasons, under which:
  - Fulfilment CF exclude overhead expenses but fair value does include allowance for overhead
  - Fulfilment CF discount curve excludes effects of any factors that influence observable market prices
  - The fulfilment CF and RA reflect the entity's own perception of risks, taking into account the entity's diversification, but fair value is based on the exit value principle.

Transition – possible approaches

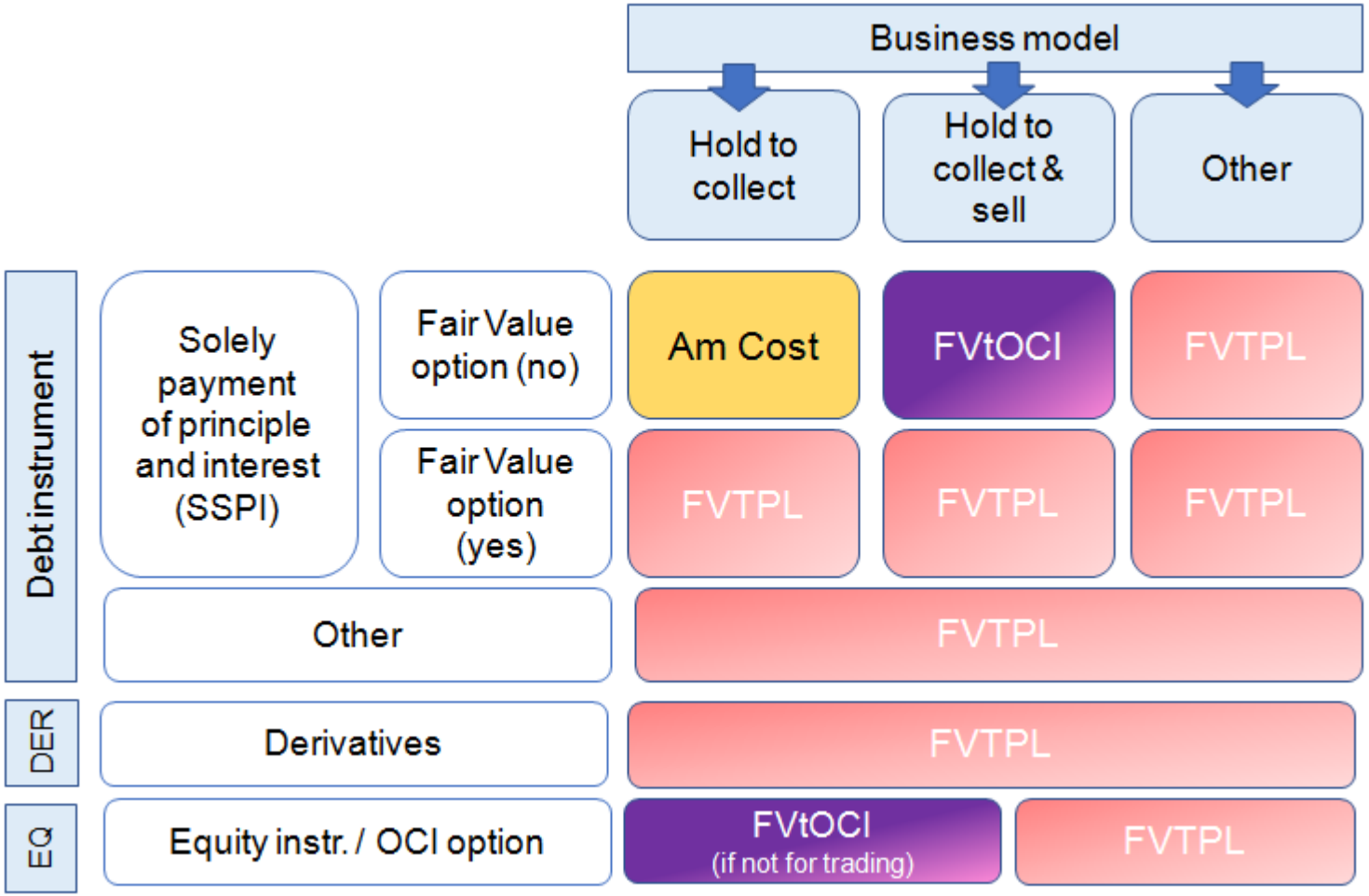
- What contracts fall under transition approach
  - All existing contracts entered into before 1 January 2020
- Approach & disclosure
  - Measure as if IFRS 17 had always been applied
  - Disclose the CSM and revenue separately for the groups where modified approach and the fair value approach is applied

Example: possible application of transition approach

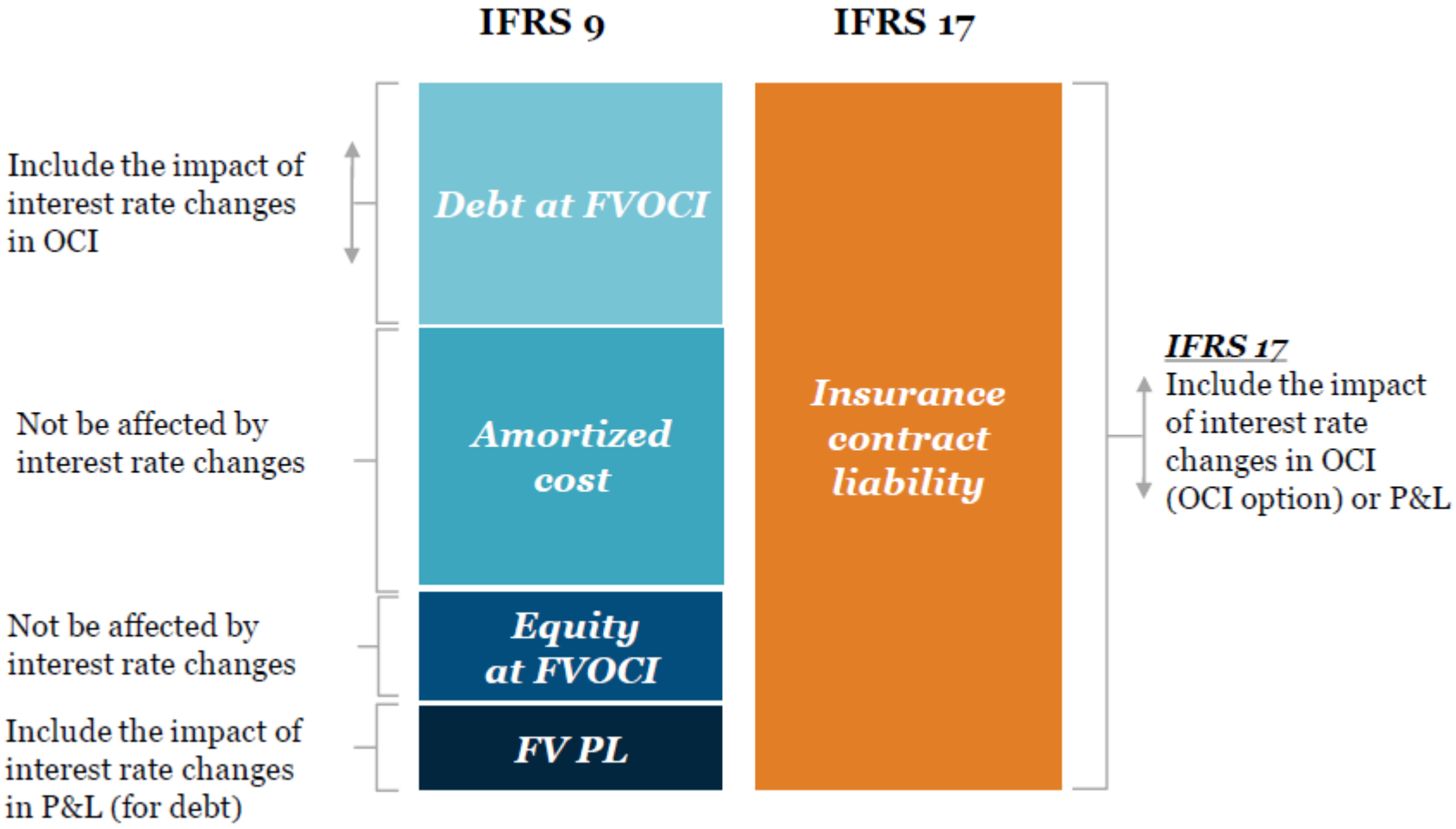
Full retrospective:	Sufficient historical data exist and	2020 2019 2018 2017
Modified retrospective:	Not all historical data is available but some information about historical cash flows is available or can be constructed	2016 2015 2014 2013 2012 2011 2010
Fair value method:	When no historical information is available	2009 2008 2007 ….

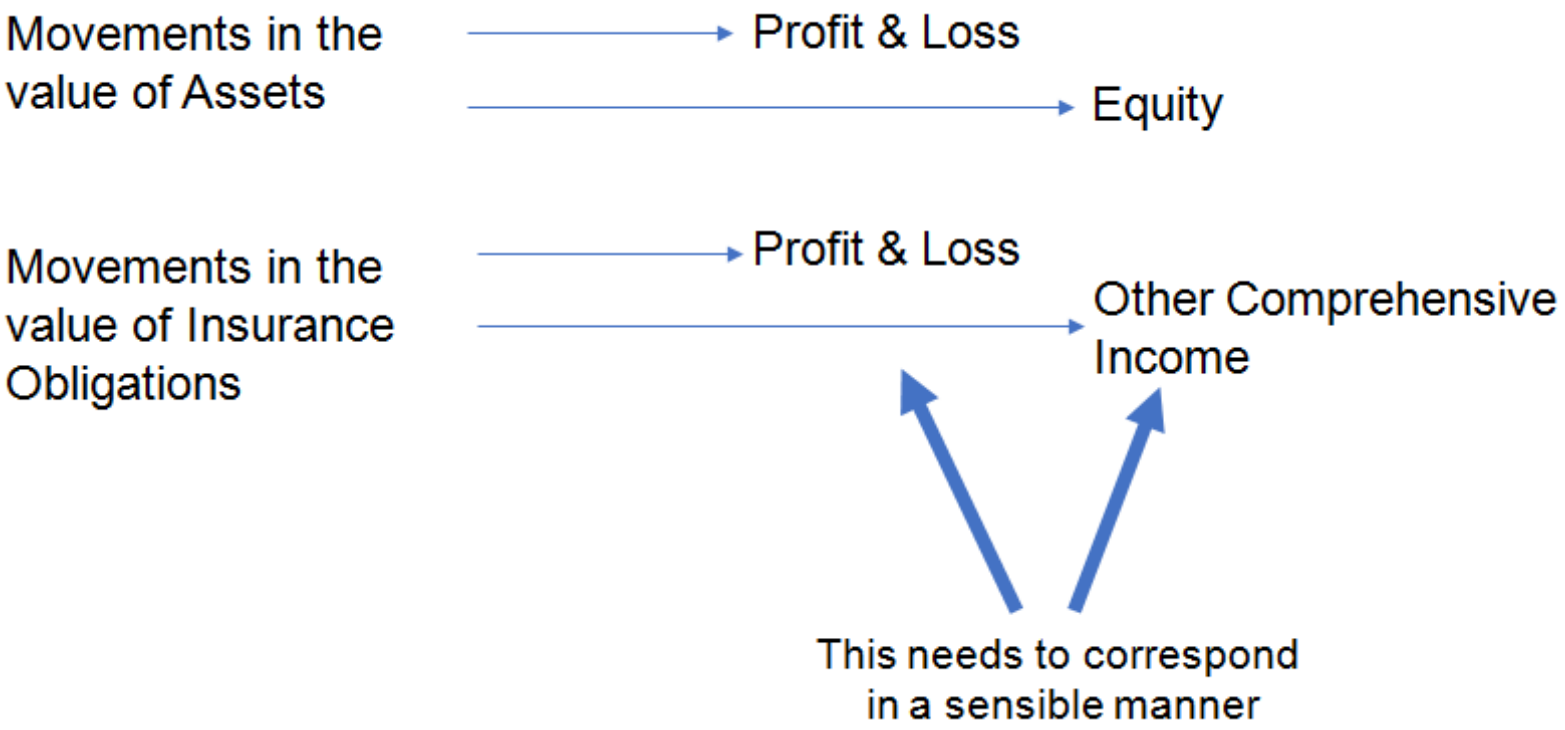
IFRS 9

IFRS 9 – general



- Main goal: reduce accounting mismatch through appropriate classification and presentation of assets and liabilities




Movements in the value of Assets
Profit & Loss
Equity
Movements in the value of Insurance Obligations
Profit & Loss
Other Comprehensive Income
This needs to correspond in a sensible manner

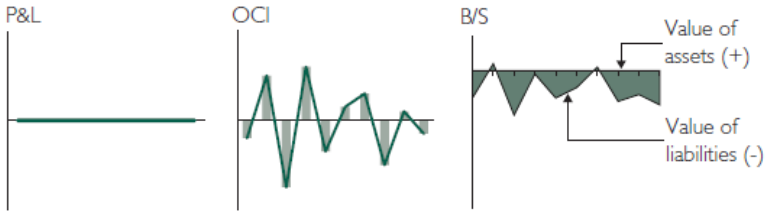
Presentation of results – "OCI option"

- For Building block approach and Premium allocation approach, insurer can select the "OCI option" as a policy choice
  - **Yes:** Change in discount rate and other financial risk variables are recognised in OCI, and interest expense at the original rate is recognised in P&L
  - **No:** determine interest expense and unwind of other financial risk variables in PL based on the current discount rate

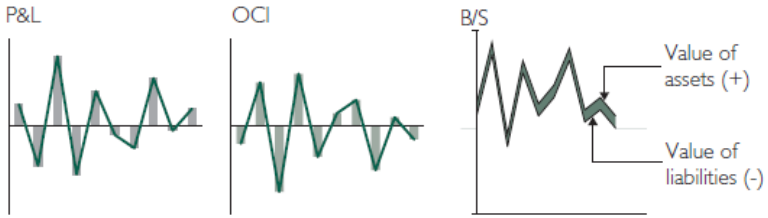
- In case the Variable Fee approach is applied, the following two options are available
  - **If underlying assets are held:** Changes in discount rate and other financial risk variables are recognised in P&L or OCI depending on the treatment of the underlying assets
  - **If underlying assets are not held:** Changes in discount rate and other financial risk variables are recognised in P&L or OCI depending on the accounting policy choice

- Options for **liabilities** [OCI (left), P&L (right)], in combination with options for **assets** [Amortised Cost (upper), FVPL (middle), OCI (lower)]

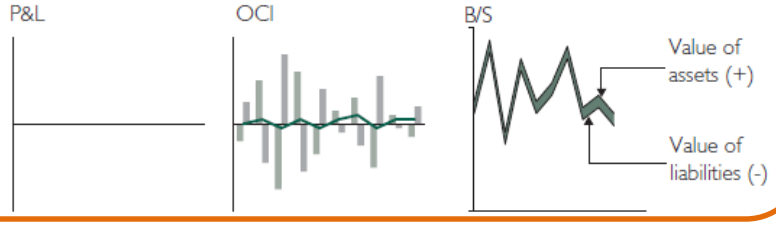
1) Amortised cost (assets) and OCI option (liabilities)
- Value of liabilities change as a result of impact of changes in the interest rate on the discount rate (change goes through OCI)
- Accounting value of assets not affected by interest rate movements (although impacted by amortisation / impairment)



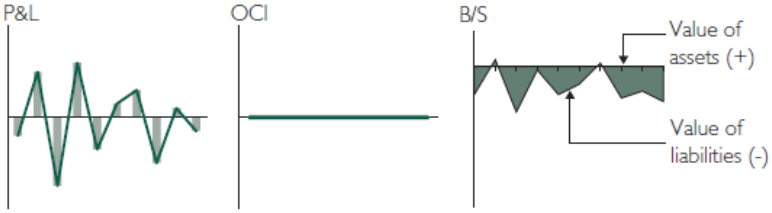
2) Fair value through P&L (assets) and OCI option (liabilities)
- Change in value of assets (as a result of changing interest rates) to P&L
- Change in the value of liabilities (discount rate) to OCI
- Impacts largely offset in balance sheet, but mismatch in P&L and OCI



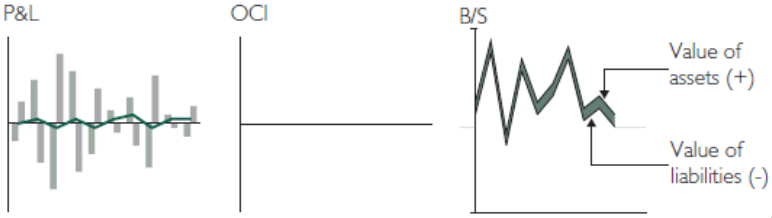
3) Fair value through OCI (assets) and OCI option (liabilities)
- Change in value of assets (as a result of changing interest rates) to OCI
- Change in the value of liabilities (discount rate) to OCI
- Impacts largely offset in balance sheet and OCI, minimal mismatch



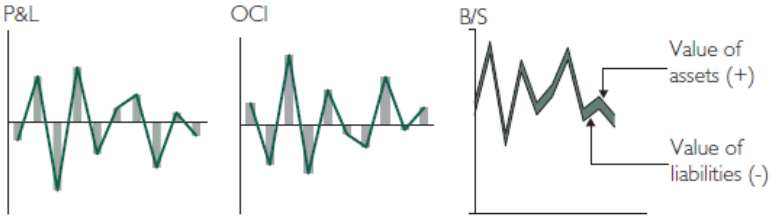
4) Amortised cost (assets) and P&L option (liabilities)
- Value of liabilities change as a result of impact of changes in the interest rate on the discount rate (change goes through P&L)
- Accounting value of assets not affected by interest rate movements (although impacted by amortisation / impairment)



5) Fair value through P&L (assets) and P&L option (liabilities)
- Change in value of assets (as a result of changing interest rates) to P&L
- Change in the value of liabilities (discount rate) to P&L
- Impacts largely offset in P&L and balance sheet, minimal mismatch



6) Fair value through OCI (assets) and P&L option (liabilities)
- Change in value of assets (as a result of changing interest rates) to OCI
- Change in the value of liabilities (discount rate) to P&L
- Impacts largely offset in balance sheet, but mismatch in P&L and OCI



IFRS 9 – general

- Classification & measurement
  - SPPI / business models
  - Accounting mismatch
- Impairment
  - Staging
  - Expected Credit Loss (ECL) models
  - Quality of modellen and data
- Deferral
  - Phased implementation

IFRS 9 – classification & measurement

- Technical requirements
  - Business model assessment (held to collect/sell)
  - Solely Payments of Principal and Interest: ‘SPPI test’

- Points of attention
  - Implement business models
  - Instruments with ‘embedded features’
  - Loans at amortized cost

- Reclassification from and to
  - Amortised cost
  - FVOCI (fair value through other comprehensive income (eigen vermogen))
  - FVTPL (fair value through profit and loss)

IFRS 9 – classification & measurement

- Business model and cash flow profiles determine classification & measurement of fixed income

- Challenges accounting mismatch

- Challenges SPPI testing and business modellen
  - SPPI test per instrument
  - Develop tooling
  - Differences Group versus BU?

- Choice equity instruments
  - Choice per instrument FVOCI of P&L: no recycling

IFRS 9 – impairment

- Applicable to:
  - Amortised cost
  - FVOCI

- Points of attention
  - Expected credit losses (modelling credit risks and staging)
  - ‘Staging’ criteria
  - Economic scenario’s
  - Availability of data

- From incurred loss to
  - Lifetime expected credit loss
  - 12-month expected credit loss

20:15 – 21:00 IFRS 17 implementation and practical considerations

Agenda

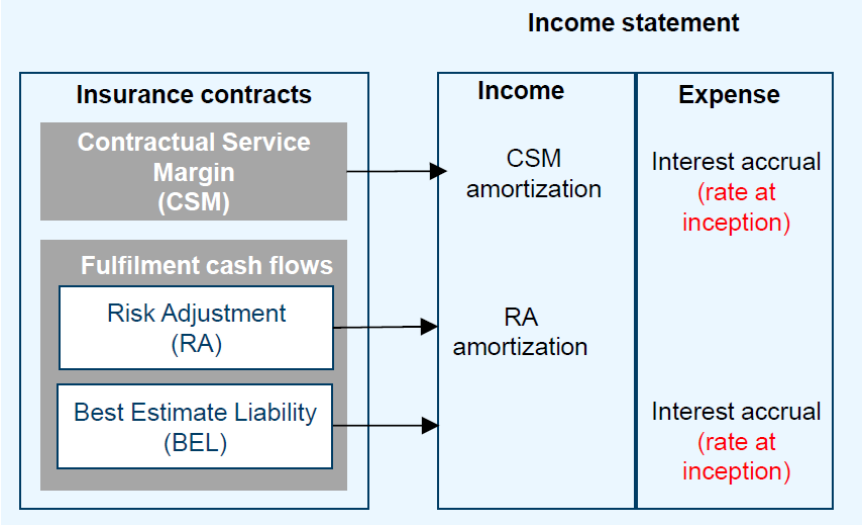
- **18:40 – 19:45 IFRS 17 and IFRS 9 background**

- **20:15 – 21:00 IFRS 17 implementation and practical considerations**
  - Overview
  - Education materials and examples
  - Newly developed IFRS17 proof modeling approach
  - How to benefit from existing operational experience variance (OEV)
  - Deep insight in general ledger systems
  - Developed shadow models

Overview

Implementation – key aspects

- Under IFRS17, revenues and profitability are predominantly driven by releases of actuarial reserves (release of Risk Adjustment and release of CSM)

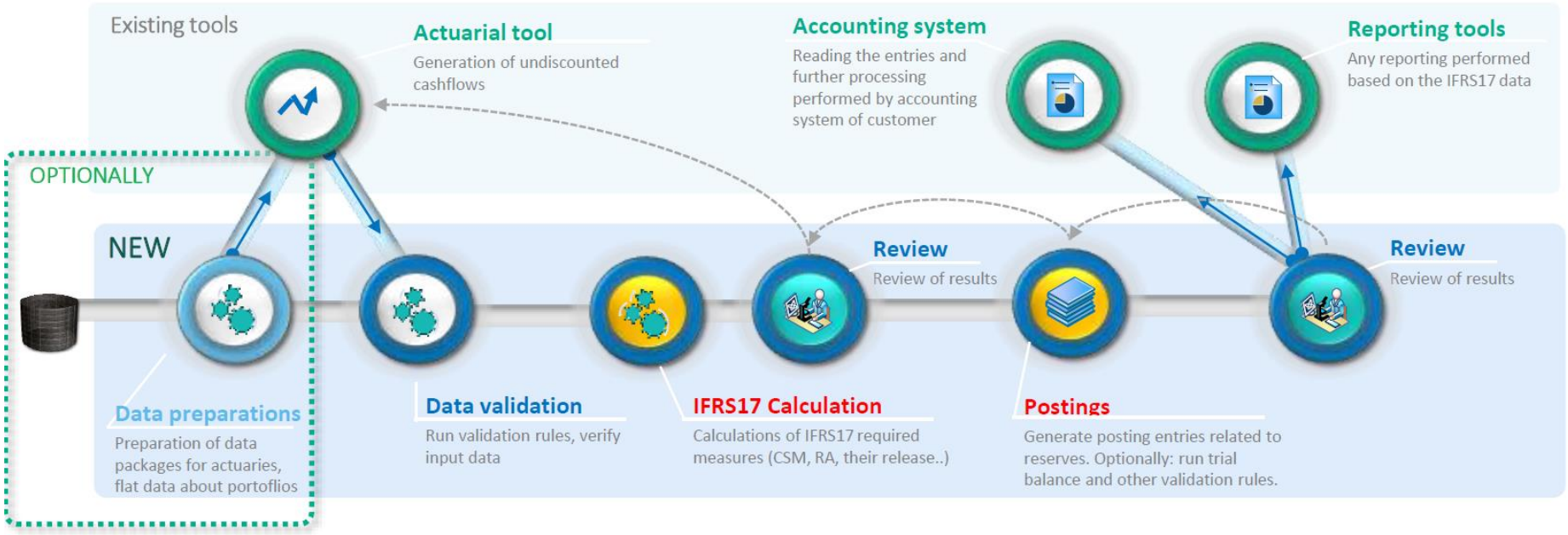


If an insurer is able to obtain more historical policy information, it is expected that it will achieve a higher future IFRS result because the release in CSM is usually higher

- In order to optimize IFRS profits, it is advisable to implement a sufficiently robust infrastructure(*) to meet the additional requirements:
  - Additional functionality needed
  - Additional data (e.g. historical policy data) needed
  - Increased number of calculations

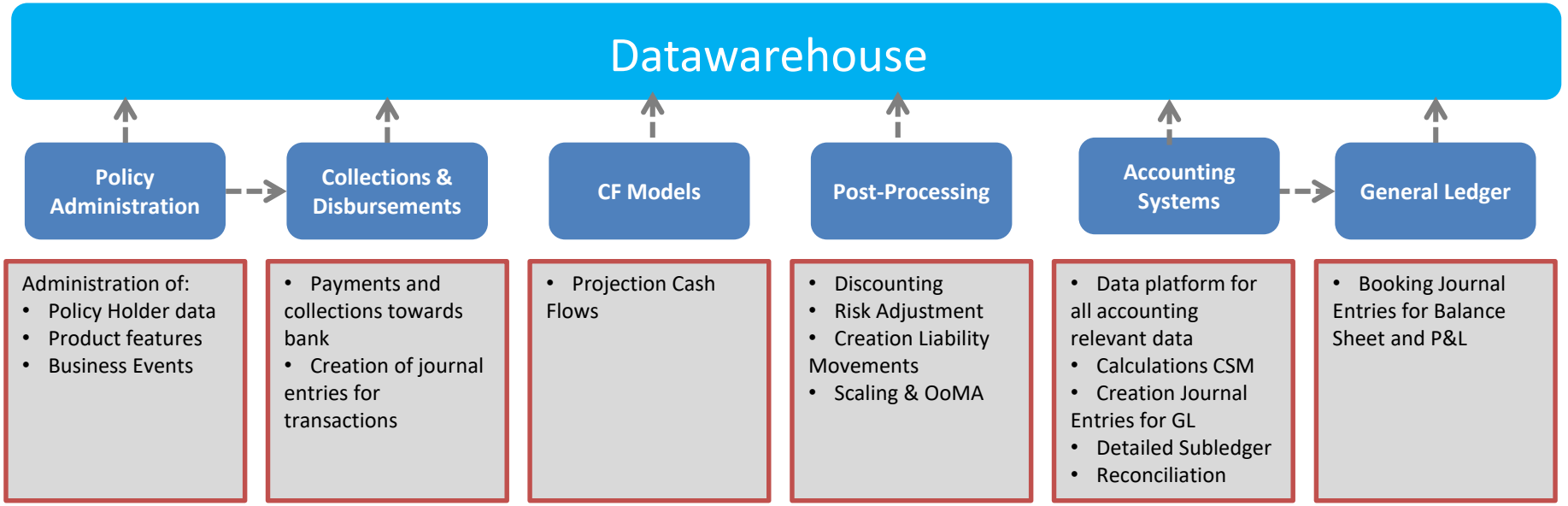
(*) Current infrastructure does not meet the requirements and is not well-positioned to optimize future IFRS results

High level business process

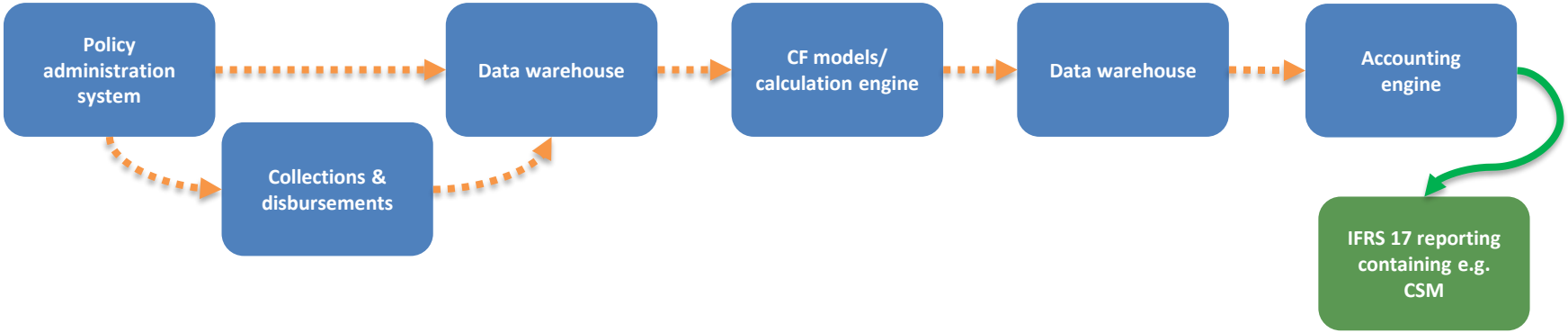


Implementation – Required infrastructure

- Required infrastructure extremely broad
- Many disciplines involved



Implementation – Required infrastructure



Policy Data

Data regarding policies and contracts on a certain moment

Mutation Data

Data regarding changes in policies and contracts during a period (e.g. # mortality, status changes)

Actuarial Data

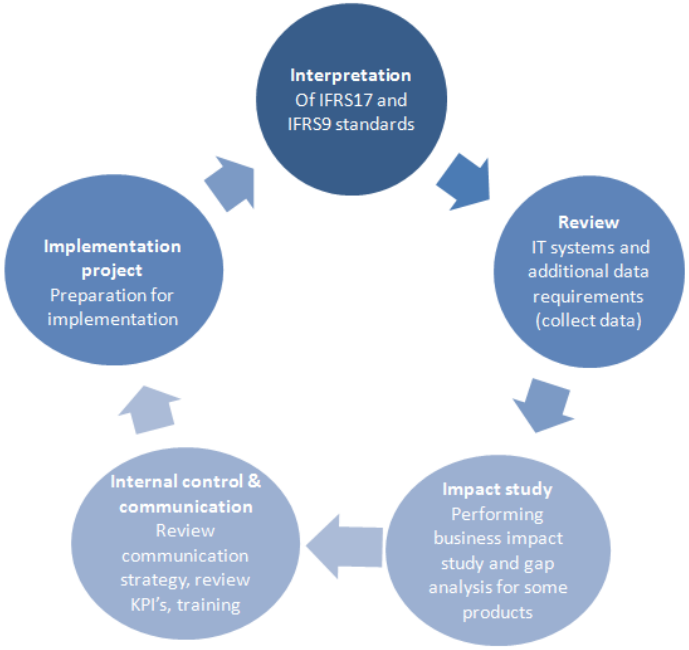
Output from the Actuarial Cash Flow Models

Accounting Data

Journaling data based on initial reserving, receival of premiums, disbursements and reserve updates during the year

Implementation – High level programme objectives

- Publication Final Standard: 2017
- Gap & impact analysis: 2017 – 2018
- Development & implementation: 2017 – 2019
- Day 1 balance sheet 1/1/2020: 2019 – 2020
- Shadow runs: 2020
- Possible first application: 2020 or 2021



Implementation – Gap analysis findings (1/2)

Topic	Solvency II	IFRS17	*Important topic in gap-analysis*
Valuation principles	One set of general rules in Delegated Acts 2015/35 Main difference: premium and claims provisions	Three methods can be applicable: - General Building Blocks Approach - Premium Allocation Approach - Variable Fee Approach	*Important*
Contractual Service Margin	Not Applicable	Important feature	*Fundamental difference*
Risk Margin / Risk Adjustment	Prescribed method based on a 6% cost-of-capital with defined risks, level of diversification benefit and other components. Net of reinsurance.	No prescribed method. Company's own view of the compensation required for uncertainty arising for non-financial risks (only).	*Important to take timely decisions on definitions*
Discounting method	Based on risk-free interest rates, supplied by EIOPA. Possible transition methods, UFR, Volatility & Matching adjustment	'Top-down' or 'bottom-up' reflecting the characteristics of the liability. Insurers need to choose / develop / test & document "own" discounting method	*Complex work, Difference may be limited, depending on insurer*
Future cashflows/ grouping of contracts	Solvency II has its own pre-described LoB-model for grouping contracts. Further detailing in homogeneous risk groups possible	The insurer's portfolio does not necessarily need to reflect Solvency II grouping. It's crucial to keep track of annual cohorts, possibly three cohorts per year	*Fundamental difference in grouping. IFRS requires much more granularity*

Implementation – Gap analysis findings (2/2)

Topic	Solvency II	IFRS17	Important topic in gap-analysis
Future cash flows Applicability of IFRS17	Solvency II includes basically all insurance contracts issued by the insurer	IFRS 17 excludes some 'insurance-like' contracts if other standards apply (like IFRS 9 for financial guarantee contracts, employee benefit plans)	Important
Future cash flows / Separating components	Solvency II includes basically the entire insurance contract issued by the insurer	IFRS 17 may require insurers to separate insurance contracts into components and apply different standards on each component	Important
Future cash flows / Included expenses	Solvency II (art. 31 DA) includes a wide range of expenses, related to settling the obligations, including administrative and overhead expenses.	IFRS 17 (Appendix B65) includes all expenses that relate directly to the fulfilment of the contract. The list of included cashflows does include administrative and fixed and variable overhead expenses. Methods must be systematic, rational and consistently applied.	Important
Future cash flows / Acquisition expenses	Acquisition expenses are recognised as they incur (no balance sheet item)	Acquisition expenses are taken into account at portfolio level (possibly separated in three cohorts), and may be taken into account in the future cash flows.	Important
Contract boundary	Specific rule-based requirement (art 18 DA): contract boundary is defined by the possibility that the insurer ends the contract or adjusts the premium	Comparable principle: period in which the insurer can compel the policyholder to pay the premiums	Important

Implementation – What support can be offered to clients

Internal	Audit Ctee / RvC	External accountant
Create awareness, training, workshops, simulation	Education sessions	Start endorsment process in time
Right timing of training is important	Monitoring progress (operational and financial impact)	
Right disciplines to be included	Benchmarking application versus relevant peers	
Apply lessons learned from Solvency 2		
Combination financial / actuarial / IT / Data Management is important		

Implementation – How can we help you?

- Different materials and approaches developed that we also offer to you as we consider you as our business partner

  - Education materials and examples
  - Newly developed modeling approach
  - Approach how to use operational experience variances
  - Shadow models
  - Deep insight in general ledger systems

Education
materials and examples

Education materials

- Triple A developed all kinds of material to assist you to getting the grips of IFRS17 and IFRS9
  - Different case studies
  - IFRS17 illustrative examples in Excel

Education materials – Different case studies

- Different case studies (xls) to improve understanding of the Standard

CASE STUDY IFRS17

DERIVE INSURANCE LIABILITY AND PROFIT AND LOSS ACCOUNT

Building Block Approach
Premium Allocation Approach

CASE STUDY 1: MEASUREMENT ON INITIAL RECOGNITION Building Block Approach
CASE STUDY 2: MEASUREMENT IMMEDIATELY AFTER INITIAL RECOGNITION Building Block Approach
CASE STUDY 3: SUBSEQUENT MEASUREMENT, MOVEMENT ANALYSIS INSURANCE CONTRACT LIABILITY Building Block Approach
CASE STUDY 4: DERIVE PROFIT AND LOSS ACCOUNT Building Block Approach
CASE STUDY 5: DERIVE BALANCE SHEET AND PROFIT AND LOSS ACCOUNT Premium Allocation Approach

- All illustrative examples worked out in excel templates

Voorbeelden zijn gebaseerd op de ‘illustrative examples’ die de IASB heeft gepubliceerd.

“These examples accompany, but are not part of, IFRS 17. They illustrate aspects of IFRS 17 but are not intended to provide interpretative guidance”

Education materials – IFRS17 Illustrative examples (1/2)

ILLUSTRATIVE EXAMPLES ON IFRS 17 *INSURANCE CONTRACTS*

Education materials – IFRS17 Illustrative examples (2/2)