IFRS 17

Insurance Contracts

March 2023

Addis Ababa

WORLD BANK GROUP

AABE

Accounting and Audit Board of Ethiopia

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Established under proclamation no 847/2006

1

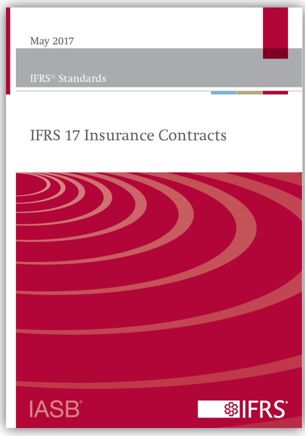
Disclaimer

Unless specified otherwise, the accounting requirements that are the subject matter of this presentation are the IFRS Standards as issued by the IASB that are applicable on or after 1 January 2023

The views expressed in this presentation are my own and not necessarily those of any organization with which I am associated.

2

Introduction
IFRS 17 Insurance Contracts



- IFRS 17
  - replaces an interim Standard—IFRS 4
  - requires consistent accounting for all insurance contracts based on a current measurement model
  - will provide useful information about profitability of insurance contracts
- Effective 2023
  - one year restated comparative information
  - early application permitted

3

3

IFRS 17 Programme

Session 1	Introduction to IFRS 17 and Important concepts
Session 2 & 3	Measurement of contracts (general approach)
Session 4	Examples and Q&A
Session 5	Measurement of contracts (premium allocation approach)
Session 6	Reinsurance
Session 7	Transition
Session 8	Examples and Q&A

4

4

IFRS 17 Programme

Session 1 & 2	Introduction to IFRS 17 and Important concepts	Examples/QA
Session 3 & 4	Measurement of contracts (general approach)	Examples/QA
~~Session 4~~	~~Examples and Q&A~~	
Session 5 & 6	Measurement of contracts (PAA))	Examples/QA
Session 7	Reinsurance	Examples/QA
Session 8	Transition	Examples/QA
~~Session 8~~	~~Examples and Q&A~~	

5

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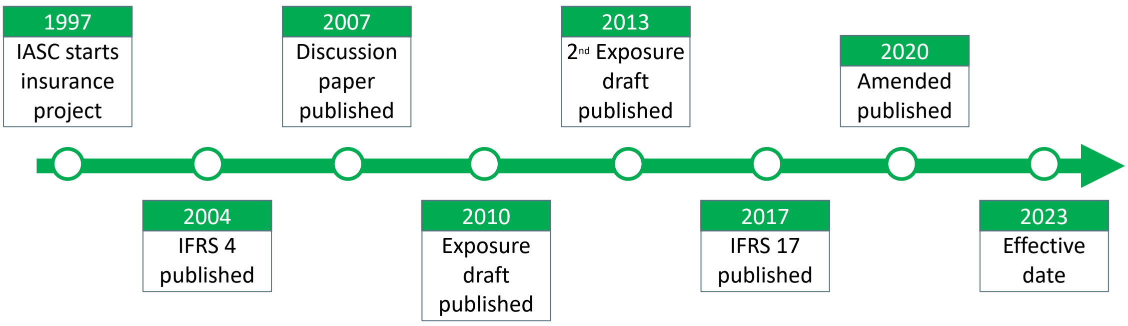
Introduction to IFRS 17

6

Timeline

7

Project History



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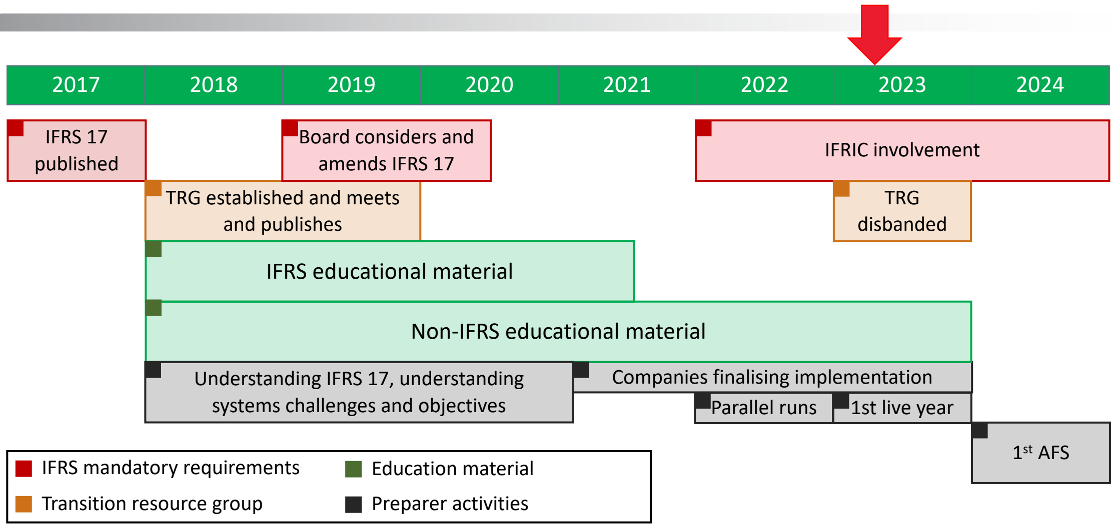
Project Implementation



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Reasons and objectives of IFRS 17

10

Insurance Accounting
Phased approach

Two phases for accounting for insurance contracts:

Phase 1	» 2004: issue of IFRS 4 *Insurance Contracts*, focus on enhanced disclosure of amount, timing and uncertainty of cash flows. » IFRS 4 allows entities to continue using various recognition, measurement and presentation (grandfathering)
Phase 2	» 2017: issue (2020 amendment) of IFRS 17 *Insurance Contracts*, focus on consistent recognition, measurement and presentation of insurance contracts.

IFRS 17 **supersedes** IFRS 4

11

11

Phase 1: Insurance Accounting
Recognition of revenue and profitability

» Two regular anomalies in revenue (premium) recognition

Based on cash or premium due — **AND** — Deposit amounts included

» Profit is recognised in various ways

Immediately contract is written — **OR** — Only when the contract ends — **OR** — Over the duration of the contract

» Use of many non-GAAP measures

13

13

Phase 1: Insurance Accounting
Lack of comparability

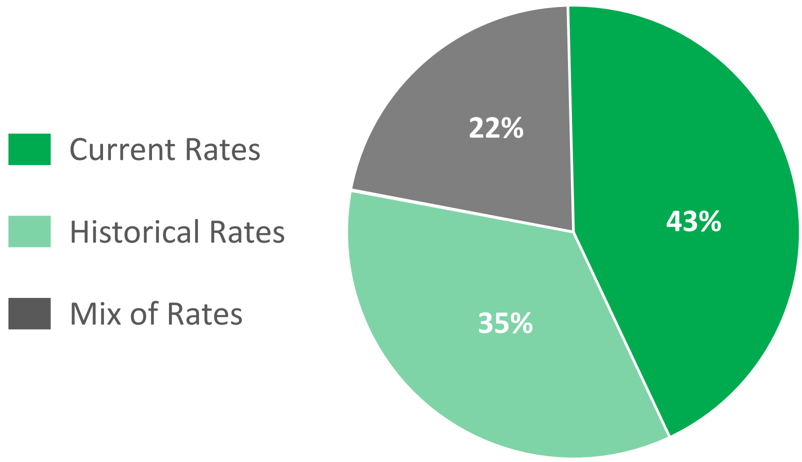
Top-20 listed insurance companies using IFRS Standards		
Accounting policies applied to insurance contracts issued	Number of companies	Total assets (US$ trillion)
Based on guidance in		
- Other National GAAP	5	2.0
- US GAAP	3	1.6
- Canadian GAAP	4	1.4
- Mix of national GAAP	8	4.1
Total	20	9.1

Source: Effects Analysis on IFRS 17

14

14

Phase 1: Insurance Accounting
Discount rates currently used



Source: Effects Analysis on IFRS 17

15

15

Phase 1: Insurance Accounting
Lack of comparability

	Year X			
CU Millions	GAAP 1	GAAP 2	Difference	
Revenue	8 263	10 979	(2 716)	(33%)
Operating income	1 416	633	783	55%
Net income	965	337	628	65%
Total equity	8 977	3 872	5 105	57%

Source: Effects Analysis on IFRS 17

16

16

Phase 2 Overview
IFRS 17 Insurance contracts

One accounting model for all insurance contracts

450 listed insurers on IFRS Standards

$13 Trillion of assets

2023 mandatory effective date

5.5 years to implement

Source: Effects Analysis on IFRS 17

19

19

IFRS 17 Improvements
Transparency and useful information

Applying IFRS 4	Applying IFRS 17
• Old or outdated assumptions • Options and guarantees not fully reflected in measurement • Time value of money not considered for incurred claims • Use of asset rate for discounting	• Current assumptions • Options/guarantees fully reflected • Estimated claims measured on a discounted basis. • Discount rate reflects insurance liability characteristics
• Revenue recognised on cash basis • Use of non-GAAP measures	• Unearned profit recognised as insurance coverage is provided • Additional metrics available

20

20

IFRS 17 Improvements
Improved performance reporting

Applying IFRS 4[1]	Applying IFRS 17	Key Changes
Premiums	Insurance revenue	• Insurance revenue excludes deposits • Revenue recognised as earned, expenses as incurred • Insurance finance expenses presented with corresponding income (in P&L or OCI) • 2 drivers of profit presented separately
Incurred claims/expenses	Incurred claims/expenses	
Change in insurance liability	Insurance service result	
	Investment income	
Investment income	Insurance finance expense	
Profit or loss		
	Net financial result	
	Profit or loss	
	OCI: Income & Insurance finance expense	

[1] Common IFRS 4 presentation in statement of comprehensive income

21

21

IFRS 17 Improvements
Improved comparability

Applying IFRS 4	Applying IFRS 17
Lack of comparability • IFRS reporters use different practices for insurance **Inconsistent within groups** • Subsidiaries consolidated using different practices	• New framework replaces variety of accounting treatments • Required consistency within a group • Limited options
Inconsistency with other IFRSs • Revenue include deposits • Revenue on a cash basis	• Revenue reflects service, and excludes deposits, like any other industry

22

22

Cost versus benefit
Simplifications to reduce costs

» Simplifications must balance cost savings with potential loss of information

» For example, IFRS 17:

- » Allows simplified measurement of some short-term insurance contracts
- » Enables requirements to be applied to a group of contracts rather than on a contract-by-contract basis
- » does not apply to some common contracts issued by non-insurers, such as most product warranties

23

23

Cost versus benefit

- Board concluded IFRS 17 will result in significant first time costs, but that overall benefits outweigh the costs
- Board expected that applying IFRS 17 will require
  - insurers to gather new information
  - employ or develop skills and change financial systems
  - updating internal procedures, and
  - communicating changes in their reports to external parties
- Costs will vary by jurisdiction - depends on existing practices
- Insurers are also expected to continue incurring costs in applying IFRS 17 on an ongoing basis.

24

24

IFRS 17 Improvements
Summary

More useful and **transparent** information	» Current assumptions regularly updated » Options and guarantees fully reflected » Discount rates reflect characteristics of the insurance liability - risks not matched by assets will be reflected in the accounts
Consistent recognition of revenue and profits for insurance contract services	» Revenue recognition more consistent with other IFRS Standards / other industries » Profits recognised as the insurance contract services are provided » Additional metrics to evaluate performance

25

25

What investors think about IFRS 17

Areas of support	Areas of concern
» Information about insurers' performance » Consistency with other industries » Comparability » Disclosures » Transparency	» Entity-specific judgements » Options BUT disclosures will help to assess the effects of judgements and options on comparability

26

26

Scope of IFRS 17

27

Scope

» IFRS 17 is applied to:

  » *Insurance contracts* issued,

  » *Reinsurance contracts* held and

  » Investment contracts with *discretionary participation features*.

» Contracts issued and held include contracts acquired in business combinations and transfers

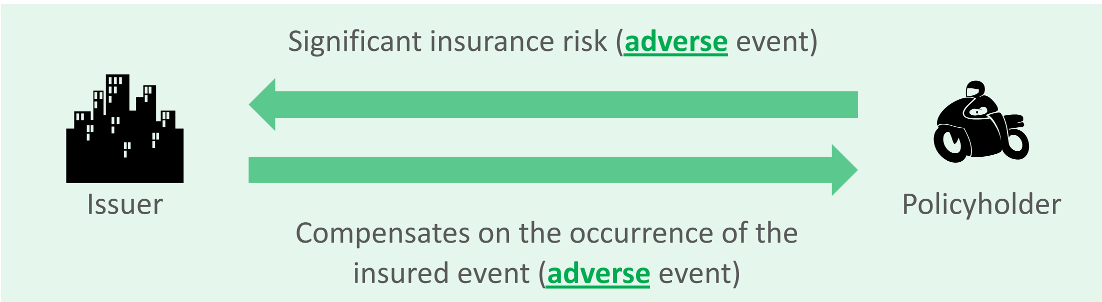
» IFRS 17 includes optional and mandatory scope exemptions

IFRS 17.3 to IFRS 17.8A

28

28

What is an insurance contract



⇔ IFRS 17 and IFRS 4—same definition

⇔ IFRS 17 two minor changes to guidance but no expected changes in assessments for majority of contracts

⇔ No change from IFRS 4
Change from IFRS 4

29

29

Definitions
Extracts from the standard

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

Insurance risk: Risk, other than financial risk transferred from the holder of a contract to the issuer

Financial risk: The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, currency exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract

Definitions
Extracts from the standard

Insured event: An uncertain future event covered by an insurance contract that creates insurance risk

Policyholder: A party that has a right to compensation under an insurance contract if an insured event occurs

Insurance contracts
Uncertain future event

- Uncertainty is the essence of an insurance contract:
  - probability of an event occurring;
  - timing of an event occurring; and/or
  - value payable if an event occurs.
- Insured event can be:
  - discovery of a loss, even if event occurred before inception or
  - occurrence of an event during term of contract, with loss discovered after end of contract term.
- Some insurance contracts cover events that have already occurred but the financial effect of which is still uncertain.

IFRS 17.B3 to B5

32

32

Insurance contracts
Insurance risk

✗ Contract with only financial risk

✓ Contract with non financial risk specific to contracted party

✓ Risk entity accepts from the policyholder - a risk the policyholder was already exposed to

✗ New risk created by the contract eg credit risk

✓ The requirement of compensation for an adverse effect doesn't limit payment to the financial effect of event

✗ Some contracts do not require an adverse effect on the policyholder as a precondition for the payment

IFRS 17.B7 to B16

33

33

Examples
Are the following contracts insurance as defined?

#	Contract that ….	Yes/No
1	Pays a fixed amount if vehicle is damaged	
2	Provide towing service when needed for fixed monthly payment	
3	Replace a damaged vehicle with a brand new vehicle	
4	Pays a third party that is injured by the policyholder	
5	Pay out if a nominated company's credit rating decreases	
6	Forgives a loan on death of the borrower	

34

34

Examples
Are the following contracts insurance as defined?

#	Contract that ….	Yes/No
1	Pays a fixed amount if vehicle is damaged	Yes
2	Provide towing service when needed for fixed monthly payment	Yes
3	Replace a damaged vehicle with a brand new vehicle	Yes
4	Pays a third party that is injured by the policyholder	Yes
5	Pay out if a nominated company's credit rating decreases	No
6	Forgives a loan on death of the borrower	Yes

35

35

Examples
Are the following contracts insurance as defined?

#	Contract that ….	Yes/No
1	Pays a pension amount only if the policyholder lives	
2	Pays a monthly pension for a defined period. If policyholder dies, pays value of remaining pension to estate.	
3	Is compulsory third party insurance for all drivers in a country	
4	Pays a fixed amount to a policyholder at the end of a defined period	
5	Buys a brand new car for someone if their name is drawn	

36

36

Examples
Are the following contracts insurance as defined?

#	Contract that ….	Yes/No
1	Pays a pension amount only if the policyholder lives	Yes
2	Pays a monthly pension for a defined period. If policyholder dies, pays value of remaining pension to estate.	No
3	Is compulsory third party insurance for all drivers in a country	Yes
4	Pays a fixed amount to a policyholder at the end of a defined period	No
5	Buys a brand new car for someone if their name is drawn	No

37

37

Scope exclusions
Mandatory exclusions

Some insurance contracts remain **in the scope of other IFRSs**

» For example:

- ⇔ warranties issued by manufacturers, dealers or retailers
- ⇔ retirement benefit obligations
- ⇔ some residual value guarantees
- ⇔ insurance contracts held by an entity, unless those contracts are reinsurance contracts
- ⚡ some credit card and similar contracts if insurance risk is not assessed in pricing

⇔ No change from IFRS 4
⚡ Change from IFRS 4

IFRS 17.7

45

45

Mandatory exclusions
Banking products

» Credit card contracts, or similar contracts that provide credit or payment arrangements,

» if, and only if, the entity doesn't price for the individual customer risk

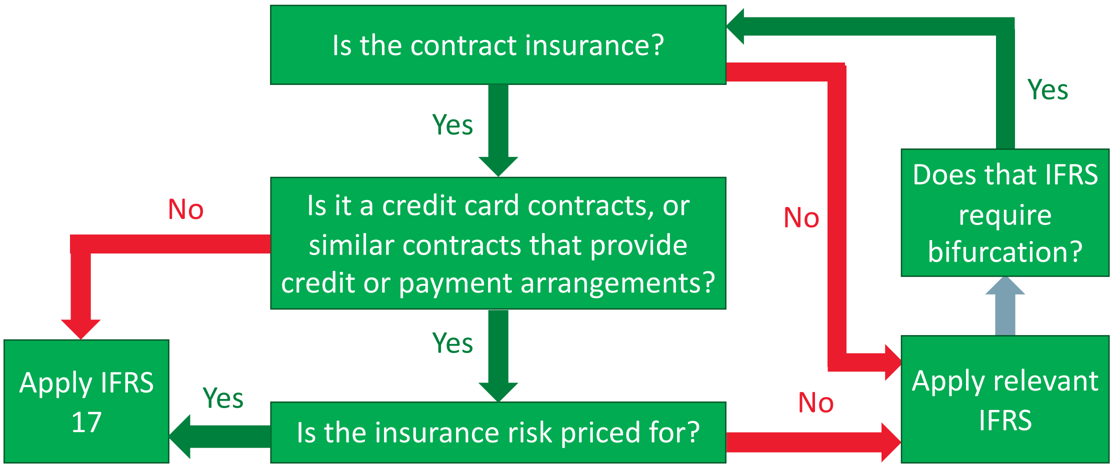
» if, and only if, IFRS 9 requires an entity to separate an insurance component, then entity apply IFRS 17 to that component.

IFRS 17.7(h)

46

46

Mandatory exclusions
Credit cards and similar products



IFRS 17.7(h)

47

47

Scope
Optional exclusions

Option to account for some insurance contracts using either IFRS 17 or other IFRS Standards

- ⇔ Financial guarantee contracts—IFRS 17 or IFRS 9 *Financial Instruments*
- ✓ Specified fixed-fee service contracts—IFRS 17 or IFRS 15 *Revenue from Contracts with Customers*
- ✓ Specified loan contracts—IFRS 17 or IFRS 9 *Financial Instruments*

IFRS 17.8 and 8A

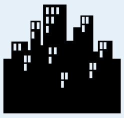
⇔ No change from IFRS 4
✓ Change from IFRS 4

48

48

Scope
Reinsurance contracts held

Significant insurance risk



Issuer

Reinsurer

Compensates for claims arising from insurance contract(s) issued by entity

Policyholder

Insurance entity

- ⇔ IFRS 17 and IFRS 4—same definition
- ⇔ IFRS 17 two minor changes to guidance but no expected changes in assessments for majority of contracts

⇔ No change from IFRS 4

Change from IFRS 4

50

50

Concepts in the standard

59

Purpose of insurance

60

Insurance Accounting
Purpose of insurance

- Insurance customers experience binary risk for uncertain future events
- Insurance entities aggregate uncertain future events
  - This changes a binary risk into a probability risk
  - Allows insurer to manage risk where individual couldn't

61

61

Purpose of insurance
Example

1 000 policyholders, risk of event occurring is 1%, cost of event occurring is loss of 2 000

	Uninsured		Insured	
	No event	Event	No event	Event
Individual Saving	19 800	200	-	-
Individual premium	-	-	19 800	200
Event occurring	-	-20 000	-	-20 000
Transfer	-	-	-19 800	19 800
Net saving	19 800	-19 800	-	-

62

62

Contracts and contract terms

63

Terms of contracts

- » Consider all substantive rights and obligations from the contract, law or regulation
- » Contracts are agreements between parties that create enforceable rights and obligations
- » Contracts can be written, oral or implied
- » Include all terms in a contract, explicit or implied, disregarding terms that have no commercial substance (implied include those imposed by law or regulation)
- » The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities

IFRS 17.2

64

64

Scope

Combination of contracts

IFRS 17 sets explicit requirements:

- » A set of contracts with same or related counterparty may achieve, or be designed to achieve, an overall commercial effect
- » To report substance, may be necessary to treat the set as a single contract
- » For example, if rights or obligations in one contract entirely negate rights or obligations in another contract entered into at the same time with the same counterparty, the combined effect is that no rights or obligations exist.

IFRS 17.9

65

65

When should contracts be separated?

General rule of separation

Not **explicit** in IFRS 17, discussed at **TRG**:

- Lowest unit of account is the contract (includes all components)
- Contract with legal form of single contract generally considered a single contract
- Separation could be appropriate if legal form does not reflect substance of contractual rights and obligations
- Assessment of all facts and circumstances, not policy choice
- Reinsurance contract held: fact that underlying contracts are included in different groups is not sufficient to conclude that accounting as a single contract does not reflect its substance

TRG February 2018, Paper 1

66

66

When do you separate components?

Specific rules of separation

- A contract may contain components that could/should be accounted for under another IFRS. Insurer should separate:
  - embedded derivatives applying IFRS 9 guidance
  - Investment components if the component is distinct
  - Non insurance goods and services if distinct
- After separation as above, insurer must apply IFRS 17 to all remaining components

IFRS 17.11 to 13, 17.B31 to B35

67

67

When do you separate components?
Embedded derivative

- An embedded derivative is:
  - A component of a hybrid contract
  - Causes some cash flows of a contract to vary similar to a stand-alone derivative
- An embedded derivative is accounted for under IFRS 9 **if**
  - Economic characteristics & risk not closely related to insurance contract,
  - Separate contract with features of embedded element would meet the definition of a derivative, and

IFRS 17.11(a), IFRS 9.4.3

When do you separate components?
Investment component

- An investment component is distinct if:
  - Insurance and investment components are not highly interrelated
  - The investment component is sold or could be sold separately in the same market
- Investment and insurance components are highly interrelated if:
  - an entity is unable to measure one without measuring the other, **or**
  - policyholder is unable to benefit from one without the other.

IFRS 17.11(b), 17.B31 to B32

When do you separate components?
Goods and services

- A good or service is distinct if:
  - It is **not** an activity an entity must undertake to fulfil the insurance contract eg admin tasks or claims handling
  - Cash flows and risks are **not** highly interrelated eg car hire
  - Entity does **not** provide a significant service integrating the components eg asset management
  - **It is** a good or service policyholder can benefit from either on its own or together whether other readily available resources eg free television

IFRS 17.12, 17.B33 to B35

70

70

Level of aggregation

74

Why group contracts?

» Typically, under IFRS contracts are measured on an individual contract basis

» IFRS 17 and insurance accounting is an exception to this general principle:

Objective of insurance	Asymmetry of IFRS 17
» Insurance aggregates uncertain future events » This changes a binary risk into a probability risk » Allows insurer to manage risk where individual couldn't	» Treatment of gains and losses is asymmetric » Losses recognised immediately » Gains recognised as earned » Contradicts objective

75

75

Why group contracts?
Example

100 2 yr contracts: premium 50 pa, expect 2 contracts to claim 3 500 each year, **all expected claims emerge day 1**.

		Individual contracts	
Whole contract	Grouped	Profitable	Loss making
Share of premium	10 000	9 800	200
Claims	(7 000)	-	(7 000)
Cumulative Profit/loss	3 000	9 800	(6 800)
Day 1 Profit/(loss)	-	-	(6 800)
Year 1 Profit/(loss)	1 500	4 900	(6 800)
		Year 1 loss: (1 900)	

76

Why not group contracts?
Example

2 product lines, car and house, car premium 5 000, expected claims 1 500, house premium 5 000, claims 5 500.

Whole contract	Grouped	Sub groups	
		Car	House
Share or premium	10 000	5 000	5 000
Claims	(7 000)	(1 500)	(5 500)
Cumulative Profit/loss	3 000	3 500	(500)
Day 1 Profit/(loss)	-	-	(500)
Year 1 Profit/(loss)	1 500	1 750	(500)
		Year 1 profit: 1 250	

77

Why not group all similar contracts?
Example

2 year car insurance, written **year 1**: premium 5 000, actual claims 750pa, **year 2** premium 5 000, actual claims 2 750pa.

Whole contract	Grouped Year 2	Sub groups Year 2	
		Issue year 1	Issue year 2
Share or premium	5 000	2 500	2 500
Claims	(3 500)	(750)	(2 750)
Cumulative Profit/loss	1 500	1 750	(250)
Year 2 Profit/(loss)	1 500	1 750	(250)
		Year 2 profit: 1 500	

78

78

Why group contracts
Grouping objectives

- Balance nature of insurance with risk of loss of information
- Trends **matter**:

Product line loss making	Profitability falls over time
» Bad contracts subsidised by good » Good subject to cherry picking by competitors » Can indicate risk or pricing problems in a unit	» New contracts subsidised by old » May indicate: » an underwriting change failure » increased competition » deteriorating customer base

79

79

How are contracts grouped?

- IFRS 17 requires portfolio be divided into up to 3 groups
- IFRS 17 will provide:
  - information about losses from contracts onerous at initial recognition
  - information about losses when previously profitable groups of contracts become onerous

Grouping contracts is relevant for the **recognition in P&L** of profits and losses for insurance services

The level of aggregation does **not affect the measurement** of the fulfilment cash flows

80

80

How are contracts grouped?
Step #1

» Identify portfolios of insurance contracts

» A portfolio: insurance contracts subject to similar risks and managed together

Portfolio 1	Portfolio 2	Portfolio 3
Eg Personal accident	Eg Health	Eg Motor
🗐🗐🗐🗐🗐🗐🗐🗐🗐🗐🗐	🗐🗐🗐	🗐🗐🗐🗐🗐
✓ Similar risks ✓ Managed together	✓ Similar risks ✓ Managed together	✓ Similar risks ✓ Managed together

81

81

How are contracts grouped?
Step #2

Divide a portfolio into a minimum of:

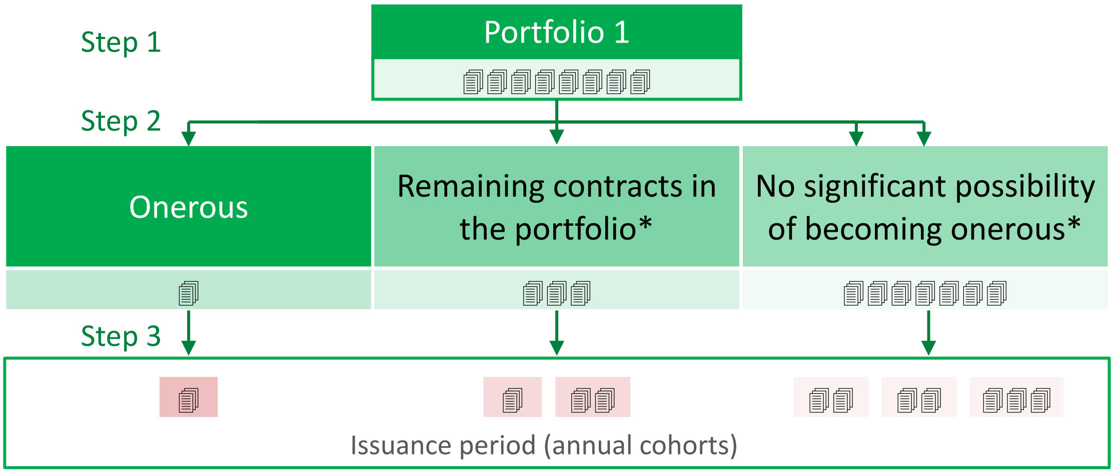
Onerous	Remaining contracts in the portfolio*	No significant possibility of becoming onerous*
🗐	🗐🗐🗐	🗐🗐🗐🗐🗐🗐🗐
Recognise loss immediately in P&L	Unearned profit recognised as part of the liability and is released as insurance services are provided	

* At initial recognition, if any

82

82

How are contracts grouped?
Step #3



* At initial recognition, if any

83

83

How are contracts grouped?
General requirements

» The requirements set the maximum size of a group, an insurer can elect smaller groups

» Contracts are grouped at inception based on information available at that point in time

» Contracts are **not subsequently regrouped** if/when new information emerges

» Exceptions to grouping requirement:

  » Regulatory pricing

  » BC138: If the same outcome can be achieved more simply, then the simpler approach can be used

84

84

Examples
Grouping contracts

#	Set of 100 vehicle contracts ….	How many groups
1	That are written within 12 month. Insurer expects 5 policyholders will claim, but doesn't know which 5	
2	10 of which are issued to young drivers at a discount and are expected to be loss making	
3	50 issued to female drivers (much less risky) and 50 to male drivers (much more risky), all priced the same	
4	Same as three, but priced the same because it is a legal requirement	

85

85

Examples
Grouping contracts

#	Set of 100 vehicle contracts ….	How many groups
1	That are written within 12 month. insurers expects 5 policyholders will claim, but doesn't know which 5	One
2	10 of which are issued to young drivers at a discount and are expected to be loss making	Two
3	50 issued to female drivers (much less risky) and 50 to male drivers (much more risky), all priced the same	Two
4	Same as three, but priced the same because it is a legal requirement	One

86

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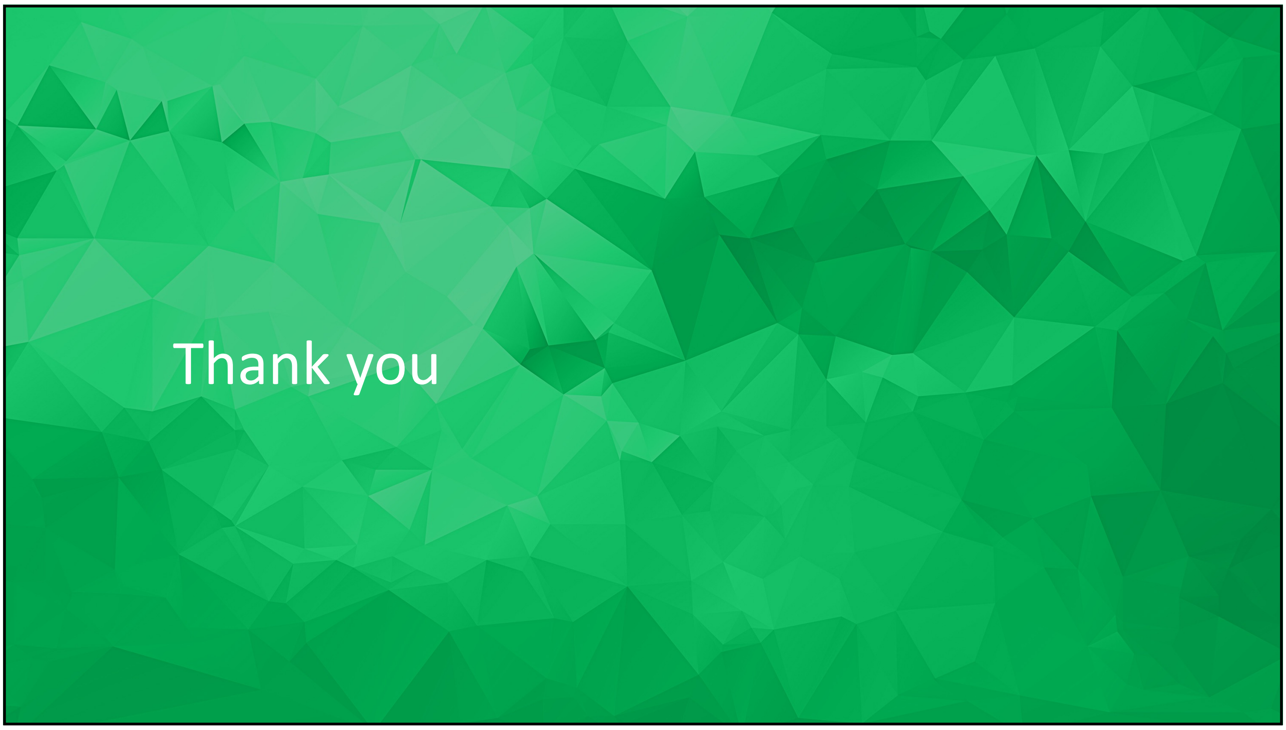

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