IFRS 17 Implementation by General Insurers in Singapore

Mehul Dave, Chair of IFRS 17 GI Working Party

17 January 2020

Contents

Introduction

Introduction to is talk

- Working party has produced a technical note on the IFRS 17 implications for general insurers in Singapore
- The paper is due to be published to the SAS website
- Prior to publishing an SAS forum needs to be held to provide further context to the document
- Discussion of the paper and contents and provide update on the activities of the working party

Introduction to is talk

Working party consists of a combination of the industry practioners and big 4 audit firms and actuarial consultancies:

- Mehul Dave – Deloitte
- See Ju Chua – Sompo
- Felicia Er – MSIG
- Anthony Atkins – EY
- Yin Lawn – Ergo
- Judy Ng – KPMG
- Sachal Gandotra – Swiss Re
- Fei Ching Yao – NTUC Income
- Darren Ma – Berkeley Re
- Bing Kun Ho – Willis Towers Watson
- Nigel Goh – Deloitte

Scope

About the IFRS 17 GI Technical Note

Purpose

- The Technical Note aims to facilitate discussion among actuaries and other stakeholders to capture the range of opinions on the application of IFRS 17 in the Singapore

Health warning

- It is **not** meant to serve as mandatory practice notes. Any interpretation of IFRS 17 set out in the Paper represents a plausible treatment given the text of IFRS 17.
- It shall neither be construed as the only possible treatment nor the agreed interpretation for Singapore insurers.
- Opinions expressed in the Technical Notes are not representative of that of the Singapore Actuarial Society.
- A number of implementation issues remain to be resolved and there is ongoing discussion and debate on various aspects of IFRS 17 interpretation. This is a working draft will be revised as understanding of IFRS 17 develops.
- This Technical Note is not a Standard of Actuarial Practice or Guidance Note of the Singapore Actuarial Society.

Introduction of IFRS 17

Introduction to IFRS 17

Brief Summary

In May 2017, the International Accounting Standards Board (IASB) released a standard to govern the accounting of insurance contracts. IFRS 17 Insurance Contracts establishes the principles for the recognition, measurement, presentation, and disclosure of insurance contracts within the scope of the Standard.

The scope of IFRS 17 covers:

- Insurance contracts, including reinsurance contracts, issued;
- Reinsurance contracts held; and
- Investment contracts with discretionary participation features issued, provided the entity also issues insurance contracts.

Timeline

IFRS 17 is effective for annual reporting periods beginning on or after 1 January 2022.

Key IFRS 17 Issues Faced by General Insurers

IFRS 17 General Framework

These are 8 main topics within the IFRS 17 Standard:

1. Contract Recognition
2. Contract Modification and De-recognition
3. Level of Aggregation
4. IFRS 17 Measurement Models
5. Risk Adjustment
6. Discounting
7. Contract Boundaries
8. Outwards Reinsurance

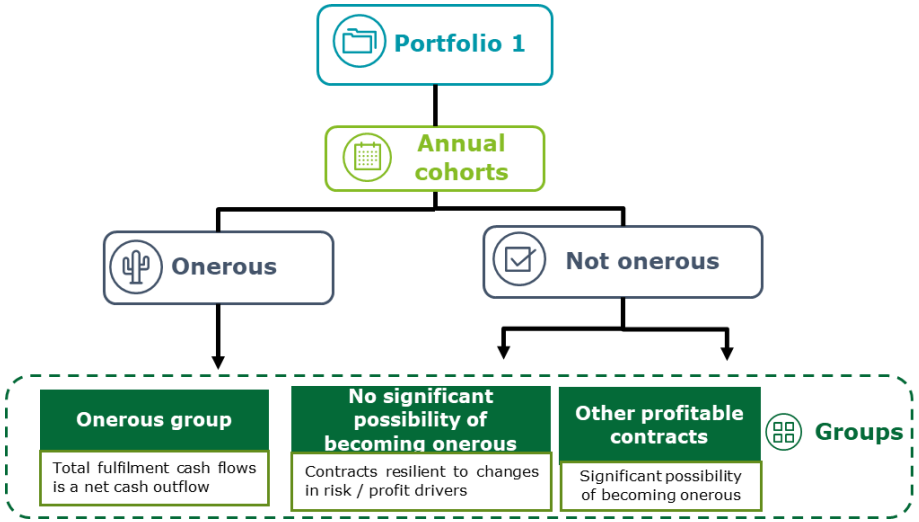
Level of Aggregation (1/3)

IFRS 17 Standard

Paragraph 14: An entity shall identify portfolios of insurance contracts. A portfolio is a group of contracts subject to similar risks and managed together as a single pool.

Paragraph 16: An entity shall divide a portfolio of insurance contracts issued into a minimum of a group of:

- Contracts that are onerous at initial recognition, if any;
- Contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and
- The remaining contracts in the portfolio, if any.



Paragraph 22: Only contracts issued within the same twelve-month period are permitted to be grouped.

Level of Aggregation (2/3)

Current Practice

- Reserving and MAS reporting classes of business
- MI and internal business groupings

Implications / Considerations

How to aggregate

- Companies will need to have a guideline to determine when risks are regarded as **similar** and to decide whether they are to be **managed together**.
- Reserving classes with similar risk characteristics and/or portfolios which are managed using the same underwriting process, sales or marketing process, administrative system, regulatory treatment and distribution channel may be treated as portfolios that are managed together. This could mean that reserving classes are split further.

Local Statutory Requirements

- The Monetary Authority of Singapore (MAS) groupings may not be appropriate for IFRS 17 level of aggregation due to differing purposes between MAS reporting and monitoring and IFRS 17 reporting.
- Grouping that is used for local reporting and/or management reporting may also be used as a factor in determining portfolios.

Onerous Contracts

- When assessing combined ratio consisting of expected fulfilment cash flows, risk adjustment and time value of money per IFRS 17 requirements, insurers need to be careful of confusing it with the conventional combined operating ratio, which does not consist of the latter two components.

Level of Aggregation (3/3)

Implications

Granularity

- The entity can calculate certain IFRS 17 requirements at a lower granularity level in terms of "unit of accounts".

IFRS 17 Requirement	Possible Level of Unit of Account
Scope	Contract
Contract Measurement and De-recognition	Contract
Acquisition Costs	Portfolio
Contractual Service Margin	Group
Contractual Service Margin Release	Group
Risk Adjustment	Up to reporting entity-wide
Onerous Contract Test	Group

Other Considerations

- If an entity has disclosed operating segments under IFRS 8, these segments should be taken into account in determining the portfolios.
- An entity may change its business model over time and therefore level of aggregation may need to be re-assessed regularly.

Contract Recognition

IFRS 17 Standard

Paragraph 25: An entity shall recognise a group of insurance contracts it issues from the earliest of the following:

- The beginning of the coverage period of the group of contracts;
- The date on which the first payment from a policyholder in the group becomes due; and
- For a group of onerous contracts, when the group becomes onerous.

Paragraph 26: If there is no contractual due date, the first payment from the policyholder is deemed to be due when it is received.

Current Practice

- Receive premiums before the start of the insurance coverage provided by a written contract
- Some GI contracts, such as open marine contracts, have no coverage commencement date

Implications

- IFRS 17 is a departure from current practice where only premiums from commenced contracts are accounted as revenue
  - Revenue recognition will have to be changed and premiums received for pre-commenced contracts will be excluded
- Some insurance contracts, such as open marine contracts, can lead to recognition difficulties as date of coverage commencement may not be immediately apparent
- Contracts should not be recognized for advanced premiums and post-dated premiums in the profit and loss statement until the beginning of the coverage period

Contract Modification and De-recognition

IFRS 17 Standard

Paragraph 72: If the terms of an insurance contract are modified, an entity shall derecognise the original contract and recognise the modified contract as a new contract if there is a substantive modification, if any of the specified criteria is met.

Paragraph 74: An entity shall de-recognise an insurance contract when it is extinguished or substantially modified.

Examples of possible modifications

- Change to the sum insured under the contract
- Extension or reduction in the duration of the contract
- Change to the benefits under the contract (e.g. decreasing the in-patient hospitalization benefit)
- Change to the coverage (e.g. adding an additional driver to a motor policy)
- Change in the contract due to changes in regulation
- Change in the premium

Implications

- It is important to note that any of above events and or any combination of events only constitutes a modification when:
  - These changes are not consequent of options stated in the contracts being exercised; and
  - Expected future cash flows will be altered
- Consideration of modifications should be made alongside the contract boundary consideration. Modification only arises from changes to terms and cashflows of the contract that are within the contract boundary.

IFRS 17 Measurement Models (1/2)

IFRS 17 Standard

The **General Measurement Model (GMM)** is the base model for measuring insurance contracts under IFRS 17. The insurance contract is valued considering the following building blocks:

- Paragraph 38: Contractual service margin – The unearned profit that the insurer recognizes as it provides services
- Paragraph 37: Risk adjustment – The compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils the insurance contract
- Paragraph 36: Discount rate – The discount rate that reflects the characteristics of the liabilities (in particular the time value of money)
- Paragraph 33: Expected future cash flows – An explicit, unbiased and probability-weighted estimate of future net cash flows that will arise as the entity fulfils the insurance obligations.

The **Premium Allocation Approach (PAA)** is an optional simplified approach for contracts with a coverage period of one year or less, or where it is a reasonable approximation to the GMM. It is similar to existing non-life insurance contract approaches or pre-claims coverage liability (unearned premium).

Paragraph 53: The simplified approach can be used if and only if at inception:

a) The entity reasonably expects that such simplification would produce a measurement of the liability for remaining coverage for the group that would not differ materially from the one that would be produced applying the GMM; or

b) The coverage period of each contract in the group of insurance contracts is one year or less.

IFRS 17 Measurement Models (2/2)

Current Practice

No similar approach under IFRS 4, although PAA is similar to UPR approach in current.

Implications

Short-term Contracts

- All contracts that are 12 months or less will subsequently be able to be approximated under the PAA approach unless they are determined to be onerous and then an approach to determine the additional liability above the pre-claims coverage liability would need to be considered.

Long-term Contracts

- For a long-term contract, the insurer would need to consider materiality on the base inception assumptions and the plausibility of future outcomes to assess whether such a simplification could be adopted.

Onerous Contracts

- If at any time during the coverage period, facts and circumstances indicate that a group of insurance contracts is onerous, liability for remaining coverage leverage the GMM.

Other Considerations

- The level of materiality in the GMM and PAA assessment will need to be considered and this would need to be discussed closely with the management alongside the external auditors.
- The assessment in terms of whether the PAA is an appropriate simplification would need to be conducted at least on an annual basis.

Risk Adjustment (1/3)

IFRS 17 Standard

Paragraph 37: An entity shall adjust the estimate of the present value of the future cash flows to reflect the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.

Application Guidance:

Paragraph B87: The risk adjustment for non-financial risk for insurance contracts measures the compensation that the entity would require to make the entity indifferent between fulfilling a liability that:

- Has a range of possible outcomes arising from non-financial risk; and
- Will generate fixed cash flows with the same expected present value as the insurance contracts.

Paragraph B88: The risk adjustment for non-financial risk also reflects both favourable and unfavourable outcomes, in a way that reflects the entity's degree of risk aversion. Degree of diversification benefits should be considered together with the level of granularity used. For example, if risk adjustment is determined at entity level, separate and additional diversification allowance might not be necessary.

Current Practice

- A provision for adverse deviation is required for reporting under Insurance (Valuation and Capital) Regulations (V&C Regulations). The required provision is based on a 75% level of sufficiency.
- Solvency II uses a prescribed Cost of Capital method, 6%, on the Solvency Capital Requirements which is calculated at 99.5% one-year Value at Risk measure.

Risk Adjustment (2/3)

Implications

Level of granularity

- Separate risk adjustments should be determined for gross risks and reinsurance held.
  - For direct quota share reinsurance held treaties, RA provision determined from gross portfolio could be used for RI held RA provision.

Methodology

- The insurer should consider a range of methodologies in estimating the risk adjustment.
- Application Guidance, paragraph 119: Methodologies used must be translated into confidence level. Additional disclosures on the confidence interval are required in order to provide concise and informative disclosures so that users of financial statements can benchmark the entity's performance against the performance of other entities as per Application Guidance, Paragraph B92.
- Application Guidance, Paragraph B88: Degree of diversification benefits should be considered and methodology should be documented.

Confidence Level

- The management should decide on the confidence level for the risk adjustment based on the company's risk appetite, CA's own risk assessment and professional judgement, industry benchmark, etc.
- The choice of confidence level should be documented.

Risk Adjustment (3/3)

Other considerations

Diversification

One perspective is that each subsidiary entity would make an assessment of the compensation it requires for its own non-financial risks, independent of any potential diversification with risks across the collective entities.

- The assumed probability distribution underlying the calculation of the confidence level of the subsidiary entity's risk adjustment (RA) would not reflect between-entity diversification.
- The parent entity would then choose whether to apply a diversification benefit at the parent-entity level, such that the RA of the parent would be less than the sum of the risk adjustments of the subsidiaries, or to simply sum up the RA of the subsidiary entities. The confidence level of the parent RA would be higher in the latter approach versus the former.

Another perspective is that the diversification benefits of the collective organization would be reflected at the subsidiary entity level.

- In this approach, the assumed probability distribution underlying the calculation of the confidence level of the subsidiary entity's RA would reflect between-entity diversification, and the degree of diversification credit reflected in the subsidiary's RA calculation would affect the confidence level of the subsidiary's RA. The parent entity RA would be the sum of the subsidiary entity risk adjustments.

The methodology used would be consistent from period to period and reflect how the entity manages/considers the level of risk.

Discounting

IFRS 17 Standard

Paragraph 36: An entity shall adjust the estimates of future cash flows to reflect the time value of money and the financial risks related to those cash flows, to the extent that the financial risks are not included in the estimates of cash flows.

Paragraph 56: The entity is not required to adjust the carrying amount of the liability for remaining coverage to reflect the time value of money and the effect of financial risk if, at initial recognition, the entity expects that the time between providing each part of the coverage and the related premium due date is no more than a year.

Paragraph 59(b): In applying the Premium Allocation Approach, an entity shall measure the liability for incurred claims for the group of insurance contracts at the fulfilment cash flows relating to incurred claims, applying paragraphs 33–37 and B36–B92. However, the entity is not required to adjust future cash flows for the time value of money and the effect of financial risk if those cash flows are expected to be paid or received in one year or less from the date the claims are incurred.

Current Practice

Currently, many general insurers in Singapore estimate the insurance liabilities on an undiscounted basis.

Implications

PAA Cohorts

- If future cash flows are expected to be paid or received one year after the date the claims are incurred, discounting is required for the liability for incurred claims

Materiality

- Develop methodology and processes to demonstrate the materiality of discounting
- Develop threshold for materiality.
- Communication with the external auditor.

Others

- Decision on the accounting policy to present the effects of changes in discount rates either in (1) profit or loss, or (2) disaggregated between profit or loss and other comprehensive income.

Contract Boundaries (1/2)

IFRS 17 Standard

Paragraph 34: Cash flows are within the boundary if they arise from substantive rights and obligations that exist during the period in which the entity can compel the policyholder to pay premiums or the entity has a substantive obligation to provide the policyholder with coverage.

Start of Contract Boundary

Paragraph 25: An entity shall recognise a group of insurance contracts it issues from the earliest of the following:

a) The beginning of the coverage period of the group of contracts;

b) The date when the first payment from a policyholder in the group becomes due; and

c) For a group of onerous contracts, when the group becomes onerous.

End of Contract Boundary

Paragraph 34: A substantive obligation to provide services ends when:

a) The entity has the practical ability to reassess the risks of the particular policyholder and, as a result, can set a price or level of benefits that fully reflects those risks; or

b) Both of the following criteria are satisfied:

   i. The entity has the practical ability to reassess the risks of the portfolio of insurance contracts…can set a price or level of benefits that fully reflects the risk of that portfolio; and

   ii. The pricing of the premiums for coverage up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date.

Contract Boundaries (2/2)

Current Practice

No similar approach under IFRS 4.

Implications

End of Contract Boundary

- It is common for general insurers to offer no-claim discounts in their Motor policies, or other products. If the discount given to the policyholder is provided on renewal, i.e. after the original policy has expired, then this cashflow exists outside of the contract boundary. However, there may be situations where experience adjustments are made at the end of the policy, before expiry. In this case, the experience adjustment cashflow would be included within the contact boundary.
- Cancellation clause embedded within the contract can trigger a contract boundary.

Reinsurance (1/4)

This section applies to outward reinsurance only. Reinsurers should account for inward business as ordinary contracts of insurance.

Under IFRS 17, reinsurance contracts held are required to be accounted for separately from the underlying insurance contracts to which it relates.

While the IFRS 17 does not state accounting treatment differences between outwards and inwards reinsurance, we note that from the Australia Accounting Standards Board 17 point of view, reinsurers should account for inwards business as ordinary contracts of insurance.

IFRS 17 Standard

Appendix A: Definition of Reinsurance Contract – A reinsurance contract is an insurance contract issued by one entity (the reinsurer) to compensate another entity for claims arising from one or more insurance contracts issued by that other entity (underlying insurance contracts).

Recognition

Paragraph 62: An entity shall recognise a group of reinsurance contracts held:

- For reinsurance contracts held provide proportionate coverage — at the beginning of the coverage period of the group of reinsurance contracts held or at the initial recognition of any underlying contract, whichever is the later; and
- In all other cases — from the beginning of the coverage period of the group of reinsurance contracts held.

Measurement

- Estimation of future cash flows
  - Use assumptions consistent with those used to estimate the present value of future cash flows of underlying contracts.

Risk Adjustment

- Non-performance risk of the reinsurer should be included in the measurement of the future cash flows. For example, reinsurer default risk and risk of dispute in claim liability of the reinsurer.

Reinsurance (2/4)

This section applies to outward reinsurance only. Reinsurers should account for inward business as ordinary contracts of insurance.

IFRS 17 Standard (Continued)

Contractual Service Margin

- A reinsurance contract held cannot be considered onerous applying IFRS 17.
- The CSM for a reinsurance contract held represents the cost of purchasing reinsurance. Where the CSM represents a net gain on purchasing reinsurance, this is treated as a reduction in the cost of purchasing reinsurance.

Current Practice

- Reinsurance asset currently not modelled and presented.

Implications

Aggregation

- Reinsurance contracts held by an insurer are individual in nature and therefore a grouping at the individual contract level is likely to make sense.
- Rather than splitting between onerous and non-onerous, an alternate grouping could be around whether a reinsurance contract expects a net gain at initial inception.
- Reinsurance contracts, such as whole account quota share or whole account excess of loss, can sometimes cover underlying insurance contracts from different groups / classes.
  - Measurement can be done on the whole account reinsurance contract and then allocated across underlying insurance contracts.
  - Where treating it as a single contract does not adequately reflect the substance of the cover, one may consider separating it into different parts.

Reinsurance (3/4)

This section applies to outward reinsurance only. Reinsurers should account for inward business as ordinary contracts of insurance.

Implications

Contract Boundary

- A risk attaching treaty would not automatically meet the Premium Allocation Approach criterion of having a coverage period of one year or less, given the nature of the treaty.
- Cash flows are within the contract boundary if the boundary of a reinsurance contract held might include cash flows related to underlying insurance contracts that are expected to be issued in the future.
  - The intention of the IASB for including expected cashflows from contracts that are expected to the issued in the future is to ensure consistency between underlying contracts and the reinsurance contracts held in respect of them.
  - Including expected future cashflows from underlying contracts issued in to future reflects the entity's substantive rights to receive services from the reinsurer related to those future underlying contracts.

Mismatch between Underlying and Reinsurance Contracts

- Mismatches will occur as a result of the Standard's requirement that reinsurance contracts are to be valued and accounted for separately from the underlying insurance contracts covered. Such mismatches include:
  - Timing issues
  - Differences in cash flow recognition dates
  - Currency
  - Non-alignment of risk transfer and/or timing between direct and reinsurance models

Reinsurance (4/4)

This section applies to outward reinsurance only. Reinsurers should account for inward business as ordinary contracts of insurance.

Implications

Reinsurance Structures

- Some of the reinsurance contracts have variable features such as **profit commissions**, **sliding scale commissions**, **loss corridors, swings, etc**.
- There may be situations in which certain structures of commission constitute **non-distinct investment components** and would therefore need to be presented differently in the financial statements.
- Aggregate or umbrella type covers e.g. coverage that "wrap around" underlying covers or that provide coverage across multiple classes or years can make allocation even more difficult.

Operational

- Insurers may need to redefine existing methods for calculating reinsurance cashflows. For example:
  - Cashflows for projected policies that have yet to be written;
  - Specific timing for reinsurance contract settlements.

Deep Dive Topics

Deep Dive Topics

- The Working Party broke off into 2 sub-groups to explore deep dive topics

- Discussions have taken place and a addendum to the main paper will be released later this year

- **<u>Topics include</u>**:

- PAA Eligibility - in progress
- Risk Adjustment – in progress
- Discounting
- Expenses (collaboration with ISCA)
- Onerous testing
- ……

PAA Eligibility Deep Dive

Work in progress

PAA

IFRS 17 Standard

An entity may simplify the measurement of a group of insurance contracts using the premium allocation approach set out in paragraphs 55–59 if, and only if, at the inception of the group:

a) The entity reasonably expects that such simplification would produce a measurement of the liability for remaining coverage for the group that would not differ materially from the one that would be produced applying the requirements in paragraphs 32–52; or

b) The coverage period of each contract in the group (including coverage arising from all premiums within the contract boundary determined at that date applying paragraph 34) is one year or less.

Comparison of PAA with GMM

Pros of PAA

- Simpler to implement and carry out as PAA is similar to UPR calculations for current financial reporting: interpretation of results and movements will be easier and familiar for stakeholders.
- Fewer and simpler disclosures under the PAA compared to the GMM.
- Not required to have explicit risk adjustment assumptions and discounting.
- Simpler testing for onerousness.

Pros of GMM

- Provide greater insight to users of financial statements through greater granularity of calculations and breakdowns.
- Detailed view of the profitability of business may be derived, which may ultimately impact how insurers price, manage, and develop products.
- Capability to calculate both measurement models need to be maintained for contracts where eligibility needs to be proven.
- Subjectivity involved in proving PAA eligibility and companies would need develop a process for testing and proving eligibility on an ongoing basis.

Considerations when designing a PAA Eligibility Test

Criteria for PAA Eligibility

- Contract boundary
- Significant variability in cashflow
- Onerous contracts

PAA Eligibility Testing

- Qualitative
- Quantitative

Additional considerations are required when measuring reinsurance contracts held cohorts held under PAA

- Onerousness
- Treatment of reinsurance recoveries
- Risk attaching basis

Risk Adjustment Deep Dive

Work in progress

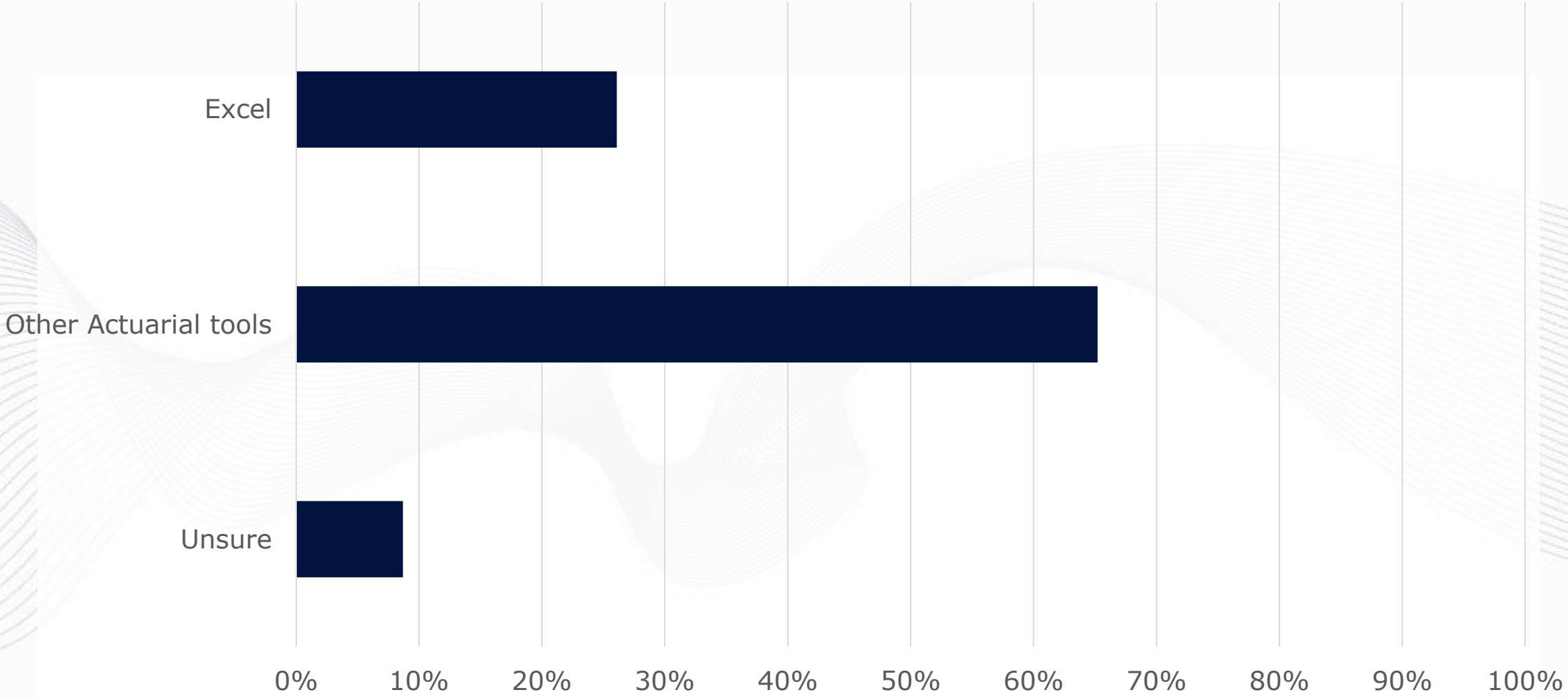
Activities planned

- Review the Risk adjustment section of the Australian Institute of Actuaries working paper and highlight 4-5 key points which will be included in the SAS paper
- Refer to the Canadian actuarial society's paper for relevant sections
- Put together a working example of risk adjustment calc using the percentile method and compare with the cost of capital method (all else being equal)
- Put together a table comparing the IFRS 17 Risk Adjustment and Statutory Risk Capital
- Put together a table comparing the IFRS 17 Risk Adjustment and current Risk margin
- Compile the key issues wrt. diversification i.e. RA at the consolidated group level = RA at the individual entity level
- Add a reinsurance section on what "should" companies be trying to do here i.e. gross & ceded, gross – net = ceded, net risk + net cost of reinsurance

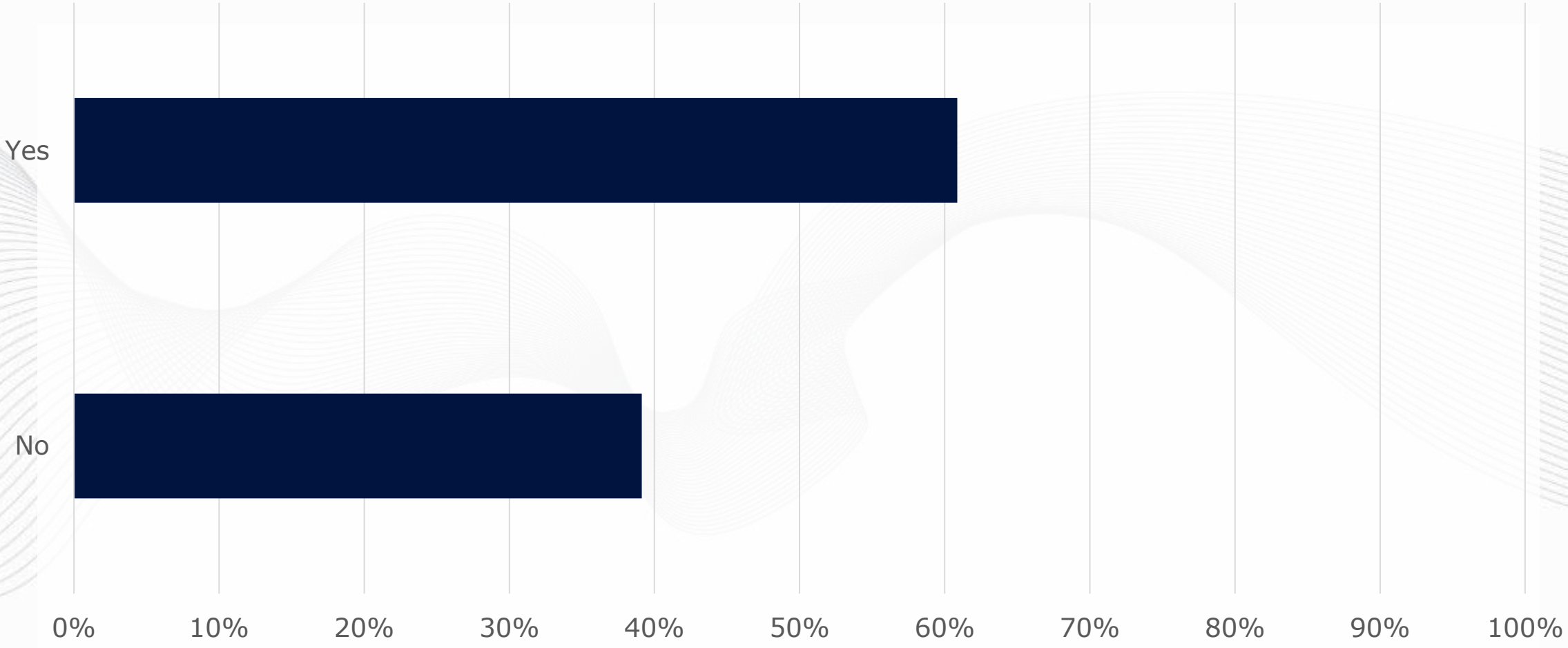
Survey results

[not part of Working Party efforts]

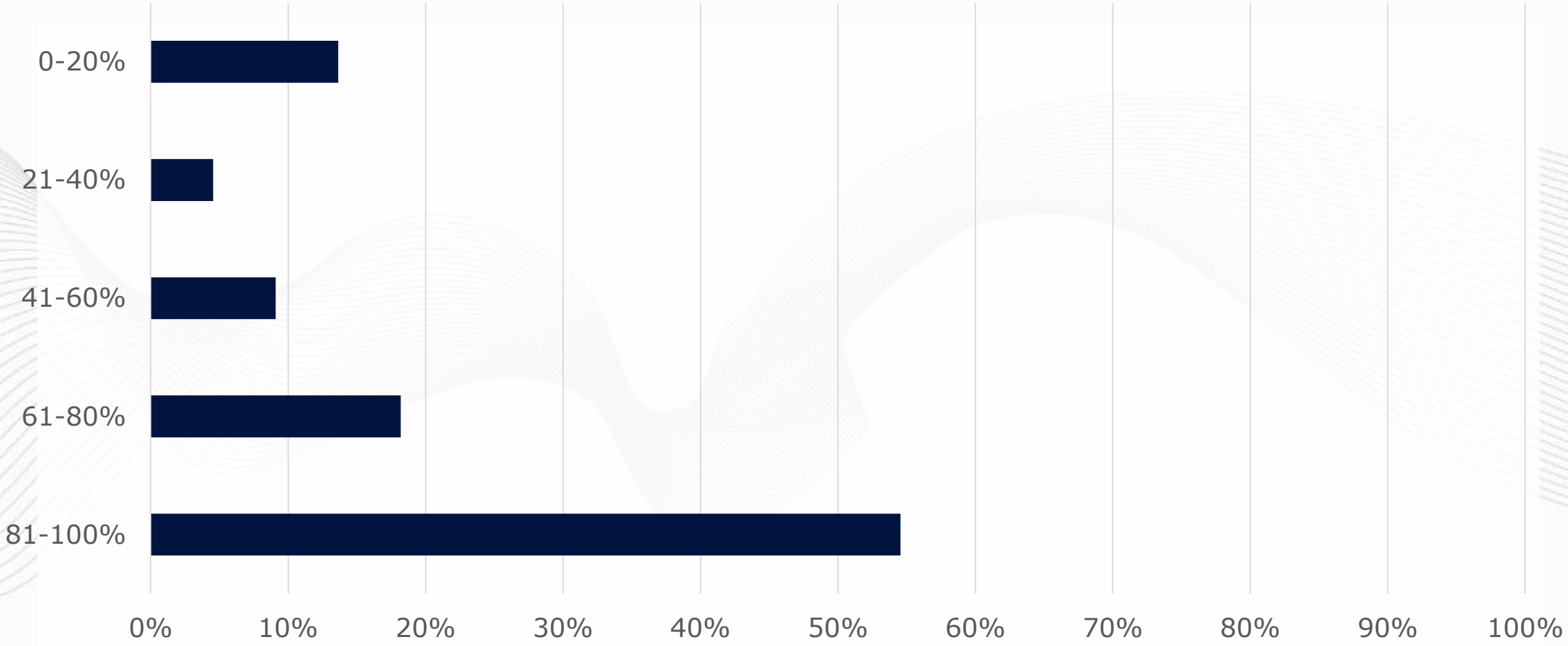
How do you think will you be calculating cashflows?



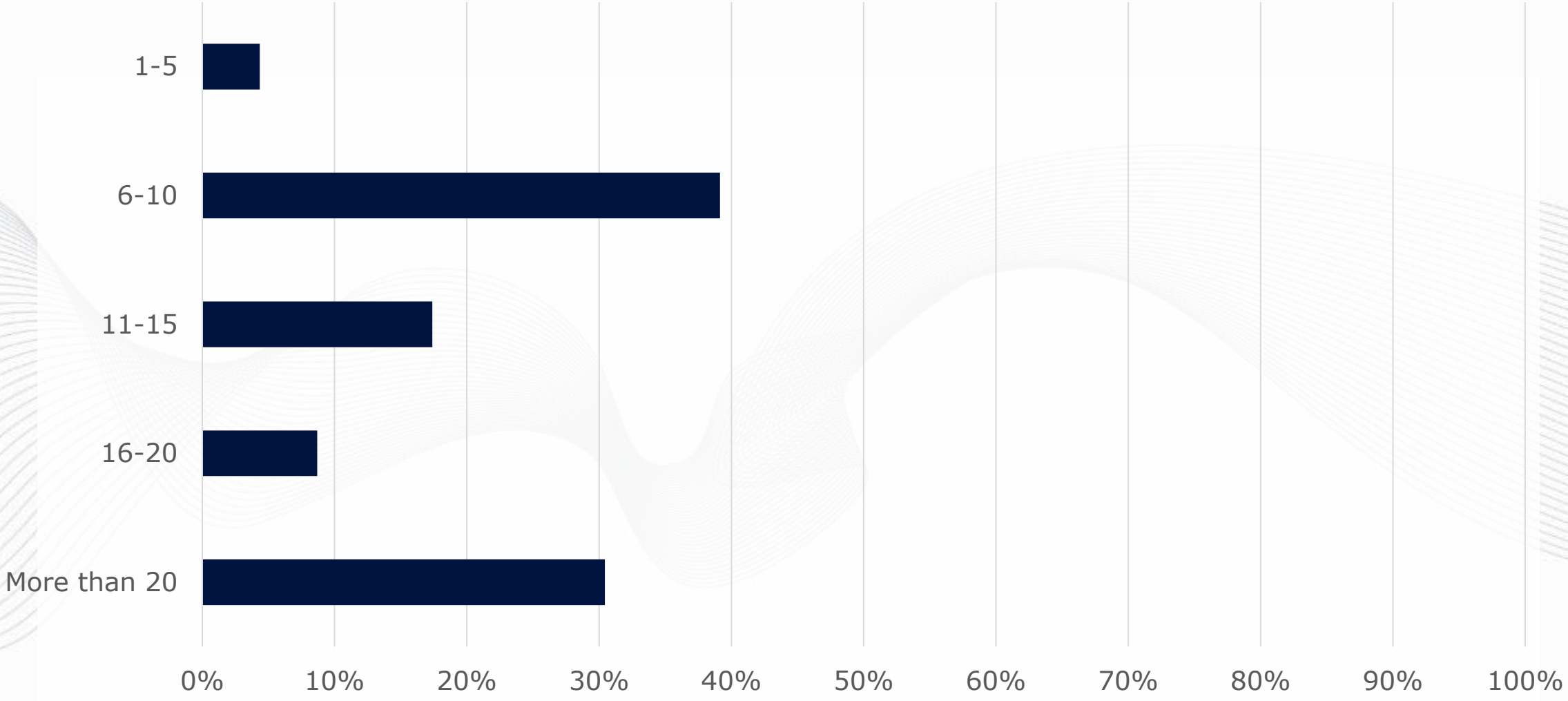
Will you be upgrading your reserving models to a specific tool in light of IFRS 17?



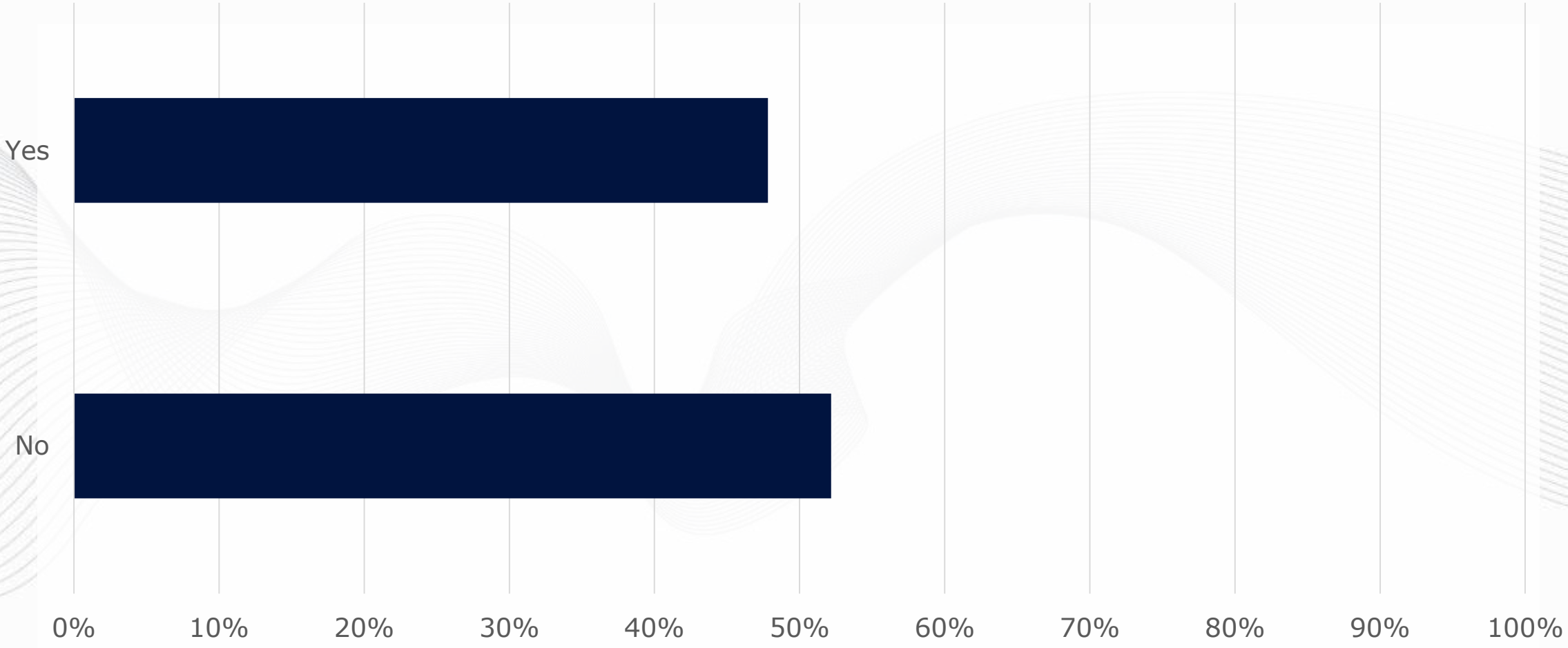
What proportion of the business will be on a PAA basis vs GMM?



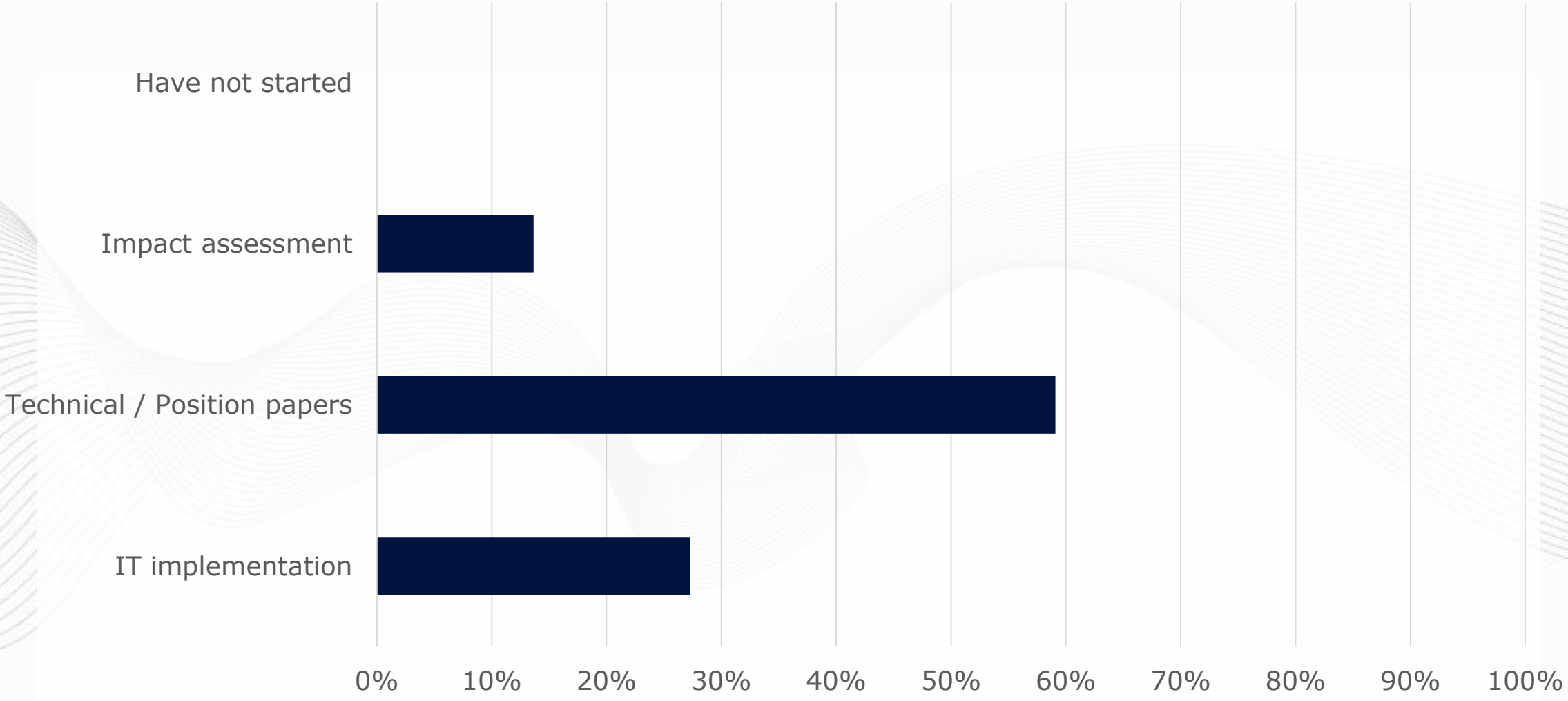
How many IFRS 17 portfolios will you end up with?



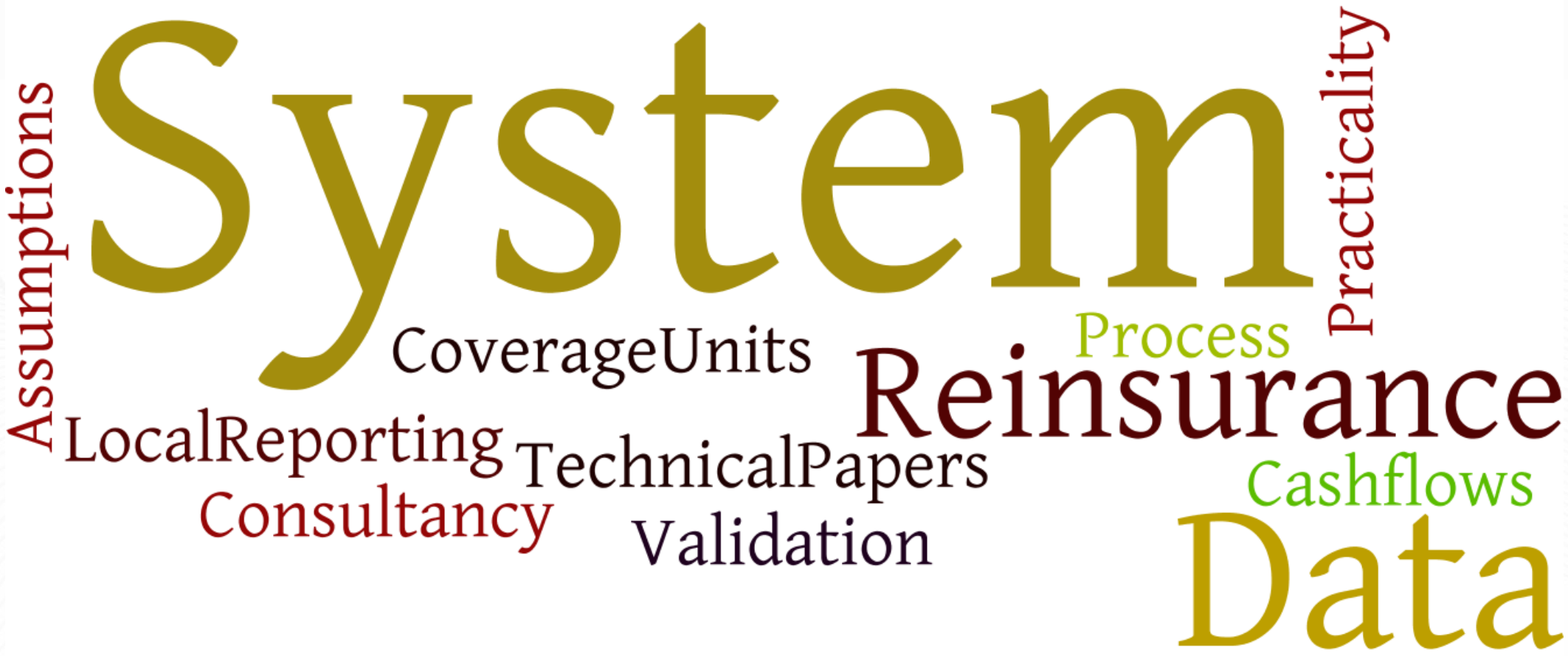
Will you align your portfolios with regulatory class groupings?



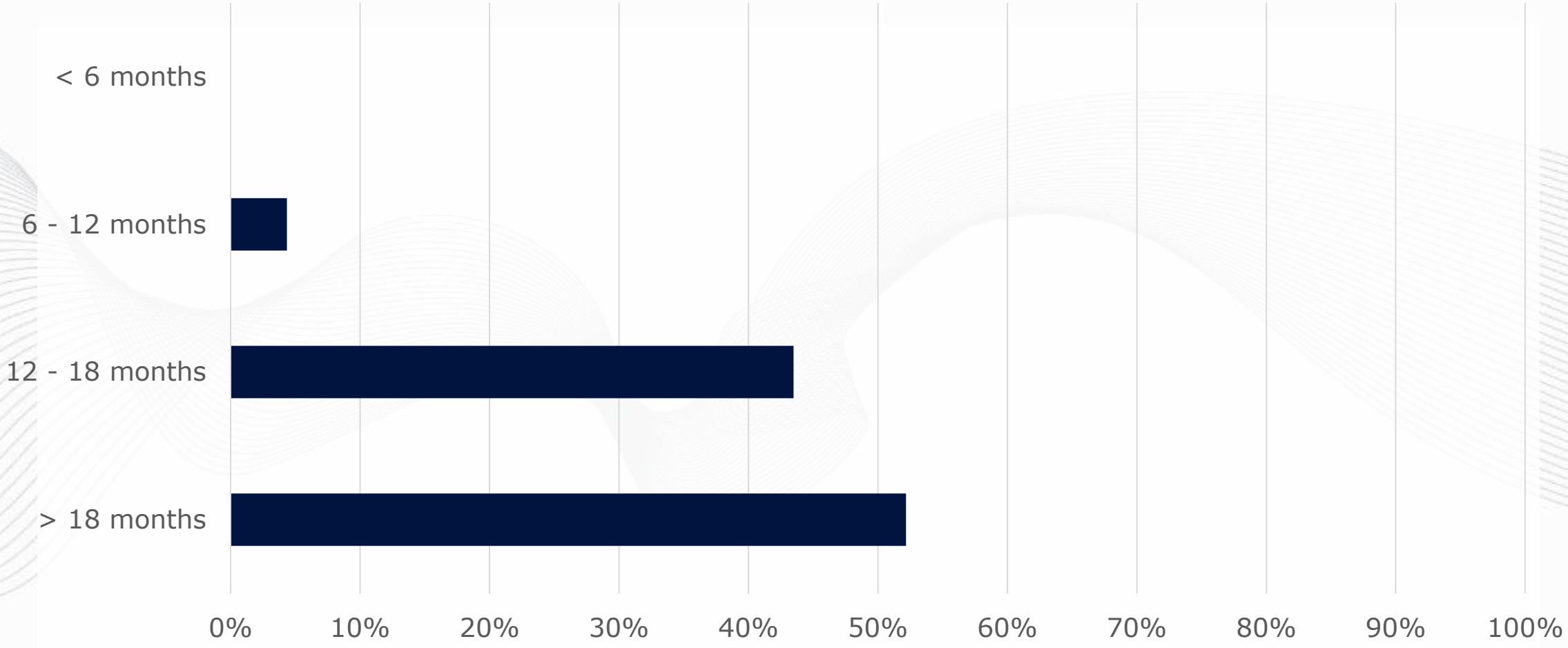
How far along in the IFRS 17 journey are you?



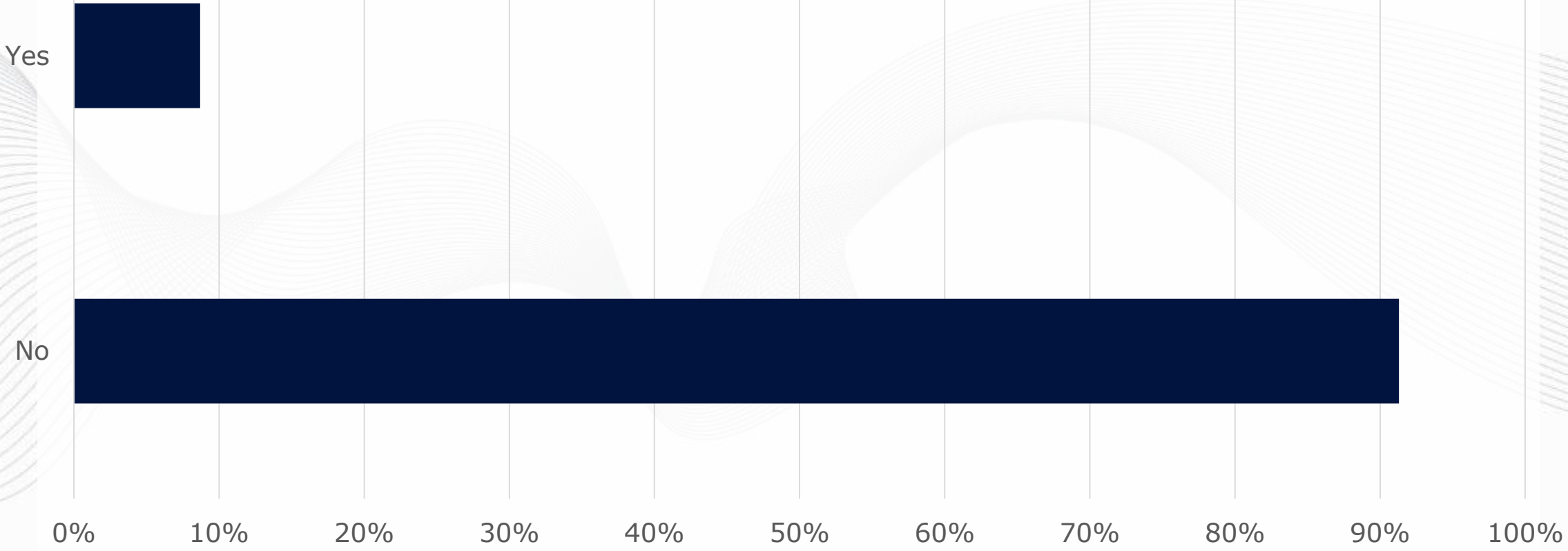
Which part of the implementation process do you expect to be most challenging?



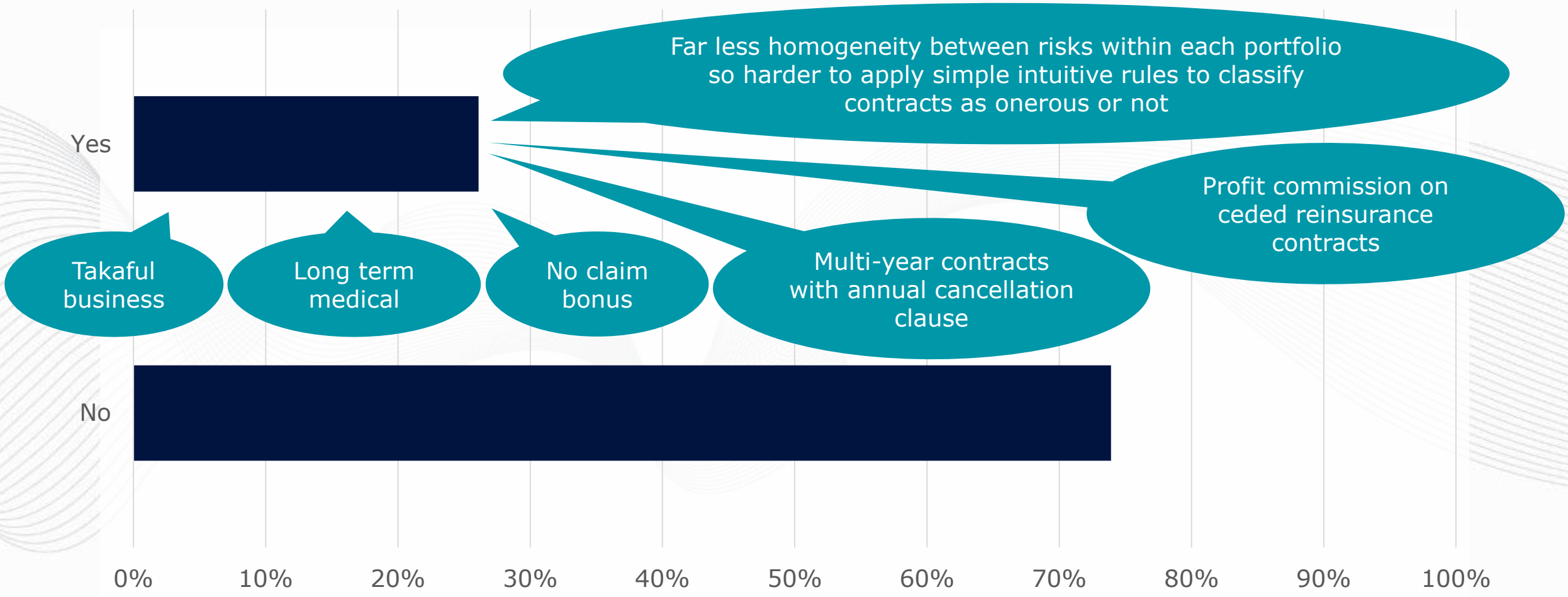
How long will your implementation take you, from end to end?



Do you expect significant changes to your product offerings or policy wordings as a result of IFRS 17?



Do you have any unique products or features that give rise to specific IFRS 17 considerations?



Q&A