The Actuarial Society of Hong Kong

FINANCIAL STATEMENT PRESENTATION

2017 Insurance IFRS Seminar

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Session 16

ACTUARIAL SOCIETY of HONG KONG
香港精算學會

Agenda

1. Introduction
2. Statement of financial position
3. Statement of comprehensive income
4. Investment component
5. Revenue recognition
6. Conclusion

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Introduction – the need for IFRS 17

- "… The financial health of insurers affects the global economy because of policyholders' and investors' exposure to insurers and insurers' role as institutional investors. This is why the financial statements of insurers need to reflect insurance risks, and changes in those risks, in a timely and transparent way. …"
- "Better reflecting economic reality, improving comparability"
  - "… It requires all insurers to reflect the effect of economic changes in their financial statements in a timely and transparent way. …
  - … It will also provide improved information about the current and future profitability of insurers. …
  - … The new Standard will result in a significant increase in global comparability and enhance the quality of financial information. …
  - … This will enable cross-industry comparability and facilitate understanding for non-specialist investors. …"

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Introduction – the need for IFRS 17

- “Improvements introduced by IFRS 17”
  - “… IFRS 17 requires a company to recognise profits as it delivers insurance services, rather than when it receives premiums, as well as to provide information about insurance contract profits that the company expects to recognise in the future. …
  - … This information will provide additional metrics that can be used to evaluate the performance of insurers and how that performance changes over time. …
  - … Revenue will reflect the insurance coverage provided, excluding deposit components, like any other industry, increasing comparability and understanding of profit or loss of companies issuing insurance contracts. …”

Statement of financial position (B/S) overview

IFRS 4	IFRS 17
Assets	**Assets**
Reinsurance contract assets	Reinsurance contract assets
Deferred acquisition costs	Insurance contract assets
Value of business acquired	
Premiums receivable	
Policy loans	
Liabilities	**Liabilities**
Insurance contracts liabilities	Insurance contracts liabilities
Unearned premiums	Reinsurance contracts liabilities
Claims payable	

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B/S – key changes

- Measurement of insurance contract liability
  - Short term contract, e.g. discounting, risk margin, etc.
  - Long term contract, e.g. current/historical assumptions, risk margin, options & guarantee, acquisition cost, etc.
- Avoid different measurement and presentation approaches (e.g. treat acquisition costs as intangible assets, and premium receivables as financial assets)
  - Insurance contracts will be presented on B/S as insurance contract liabilities (or as insurance contract assets)
  - Present groups of insurance contracts that are in an asset position separately from groups in a liability position
- Reported equity when first applying IFRS 17
  - Any existing balances relating to insurance issued and reinsurance held will be replaced with assets and liabilities for insurance issued and reinsurance held

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Statement of comprehensive income (P/L) overview

IFRS 4
Premium
Investment income
Incurred claims and benefits
Change in insurance contract liabilities
Profit or loss
Other comprehensive income
Total comprehensive income

IFRS 17
Insurance revenue
Insurance services expense
Incurred claims and expense
Acquisition costs
Gain/loss from reinsurance
Insurance service result
Investment income
Insurance finance expense
Net financial result
Profit or loss
Other comprehensive income
Total comprehensive income

P/L – key changes

- No “premium received or receivable” as revenue
  - Comparable revenue: to report as insurance revenue the consideration for services on an earned basis, which is comparable to other industries
- No “change in insurance contract liabilities” as expense
  - This incorporates multiple factors such as changes for NB contract written, changes in methods, assumptions, etc.
- Investment component should be excluded
  - Many insurance contracts with investment features include a deposit component: an amount paid by the policyholder that is repaid by the insurer even if an insured event does not occur
  - Deposit components are excluded from P/L, i.e. the collection of a deposit is not revenue and the repayment of that deposit is not an expense

P/L – key changes

- Compared to IFRS 4, IFRS 17 does not change the total profit or loss recognized over the duration of the insurance contracts
  - But it is expected to change the amounts recognized in each reporting period and their presentation

P/L – key components

- A company recognizes in the statement of comprehensive income separately:
  - Insurance service result, which depicts the profit earned from providing insurance coverage, comprising: (i) insurance revenue less (ii) insurance service expenses
  - Financial result, which captures (i) investment income from managing financial assets, (ii) insurance finance expenses
- Insurance revenue
  - Represents the consideration that a company expects to be entitled to in exchange for services provided under the contracts
- Insurance service expenses
  - Reflect the costs incurred in providing services in the period, including incurred claims

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P/L – key components

- Insurance finance income or expenses
  - Measurement is in PV basis, as time passes, the effect of the time value of money reduces and this reduction is reflected in SCI as an insurance finance expense
  - Also include the effect on the carrying amount of insurance contracts of some changes in financial assumptions (i.e. discount rates and other financial variables)
  - A company recognizes the effect of those changes in financial assumptions in the period in which the changes occur – either (i) in profit or loss, or (ii) disaggregated between profit or loss and OCI

An illustrative example

- Single pay 3-year insurance contract (100 policies)
- Single premium of 150 (for each policy) is paid at the beginning of the coverage
- Death benefit: max of 170 and account value
- Maturity benefit: account value at year 3
- Investment return = 10% p.a.
- Risk-free rate = 6% p.a.
- Investment charge = 2% p.a.
- Assume FVTPL
- Assume no DAAC

IFRS 4				
	Yr1	**Yr2**	**Yr3**	**Total**
Premiums	15,000	-	-	15,000
Investment income	1,500	1,281	1,677	4,458
Incurred claims & expenses	(170)	(171)	(18,080)	(18,421)
Change in insurance liabilities	(16,048)	(744)	16,792	-
Profit or loss	**282**	**366**	**389**	**1,037**
Other comprehensive income	-	-	-	-
Comprehensive income	**282**	**366**	**389**	**1,037**

IFRS 17				
	Yr1	**Yr2**	**Yr3**	**Total**
Insurance revenue	320	339	386	1,045
Incurred claims & expenses	(8)	-	-	(8)
Insurance service result	**312**	**339**	**386**	**1,037**
Investment income	1,500	1,281	1,677	4,458
Insurance finance expenses	(1,500)	(1,281)	(1,677)	(4,458)
Net financial result	-	-	-	-
Profit or loss	**312**	**339**	**386**	**1,037**
Other comprehensive income	-	-	-	-
Comprehensive income	**312**	**339**	**386**	**1,037**

P/L – key principles

- Initial measurement
  - No day 1 gain reflect in P/L
  - Onerous contract: losses are recognized immediately in P/L (no CSM is recognized on the balance sheet at initial recognition)

P/L – overview (key principles)

- Subsequent measurement, when estimate is being updated:
  - Changes that relate to current or past coverage -> P/L
  - Changes that relate to future coverage -> CSM (as long as non-negative)
  - Recognize in P/L additional losses for groups of onerous contracts
  - For contracts without a variable fee, recognize in P/L the effects of changes in discount rates and other financial variables in the period in which the changes occur
  - For contracts with a variable fee, recognize the effects of changes in financial variables by adjusting CSM (as long as non-negative), rather than in P/L

Investment component

- Distinct deposit components are separated from IFRS 17
- Non distinct deposit components are excluded from P/L, i.e. the collection of a deposit is not revenue and the repayment of that deposit is not an expense
- Investment component definition: The amounts that an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur

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Revenue recognition

- When applying IFRS 17, if all CFs estimated at the initial recognition occur as anticipated, the insurance service result in each reporting period will consist solely of the recognition of:
  - CSM earned for insurance service provided
  - the release of RA
- CSM: company need to recognize CSM in P/L over the coverage period based on the coverage units
  - The number of coverage unit in a group is the quantity of coverage provided by the contracts in the group, determined by considering for each contract the quantity of the benefits provided under a contract and its expected coverage duration
- RA: company's own risk assessment, and remeasured at the end of each reporting period

Revenue recognition

Statement of comprehensive income	
Insurance revenue	X
Insurance service expenses	(X)
Insurance service result	X
Investment income	X
Insurance finance expenses	(X)
Net financial result	X
Other profit and loss	X
Corporate tax	(X)
Profit after tax	X
Other comprehensive income	(X)
Total comprehensive income	X

Release in contractual service margin
Change in risk adjustment
Expected claims (in fulfilment cash flows)
Expected expenses (in fulfilment cash flows)
Allocating premium relating to the recovery of directly attributable acquisition costs
Excluding investment components

Actual claims incurred
Actual expenses incurred
Amortization of directly attributable acquisition costs
Onerous contracts
Excluding investment components

- Calculated using systematic allocation rate (if the OCI option is selected)
- Calculated using current rate (if the profit or loss option is selected)

- Difference between current rate and systematic allocation rate (if the OCI option is selected)

Conclusion

- “Better reflecting economic reality, improving comparability”
  - “… The timely information IFRS 17 requires will be beneficial for capital markets because it will boost investors’ understanding of insurers’ expected future profitability, risks and changes in insurance obligations. …
  - … Improved transparency resulting from IFRS 17 is also expected to contribute to long-term financial stability by revealing useful information that will enable actions to be taken in a timely way. …
  - … This should make the insurance industry more attractive to investors, facilitating improved capital allocation. …”

- “The benefits of IFRS 17 outweigh its costs”
- “The first truly international IFRS Standard for insurance contracts”

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International Financial Reporting Standards for Insurers - IFRS 17

Presentation

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