The Actuarial Society of Hong Kong

TRANSITION

2017 Insurance IFRS Seminar

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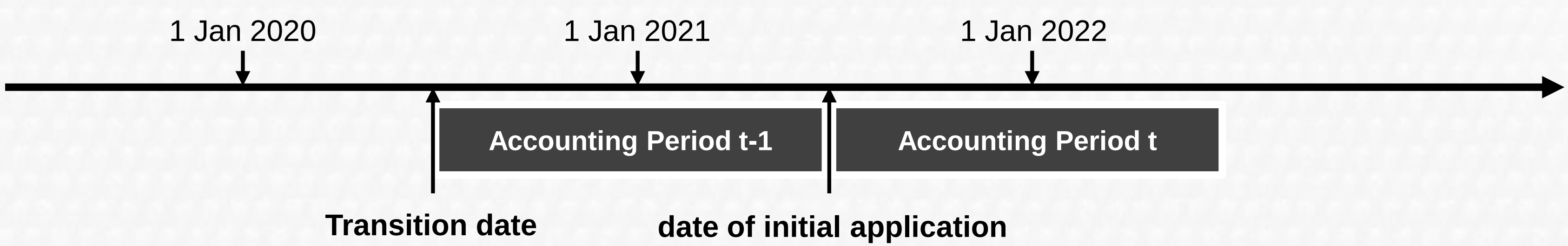
Session 20

ACTUARIAL SOCIETY of HONG KONG 香港精算學會

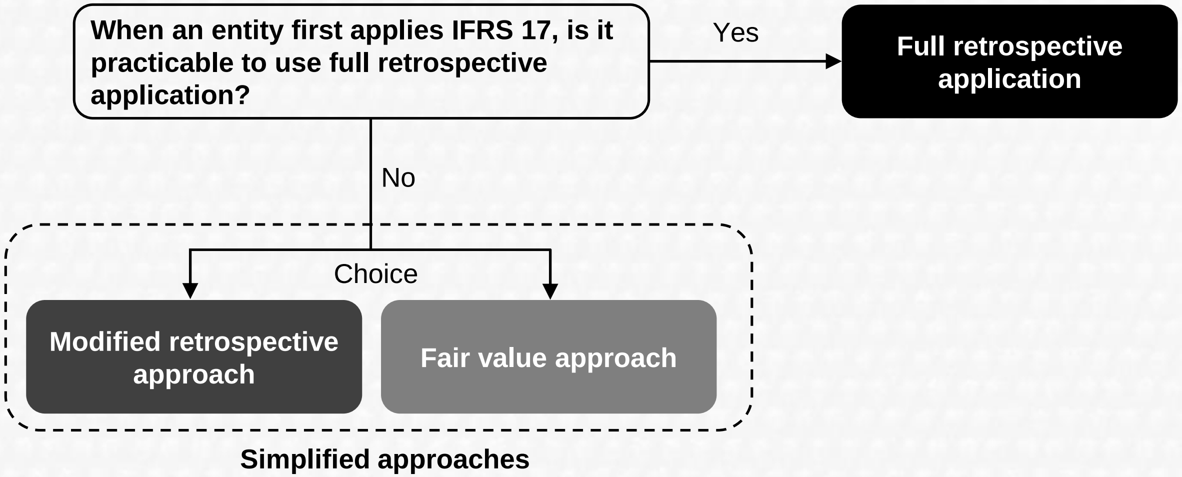
Effective date

- IFRS 17 is applied for annual reporting periods **beginning on** or **after** **1 January 2021**.
  - the **date of initial application** is the beginning of the annual reporting period in which an entity first applies IFRS 17; and
  - the **transition date** is the beginning of the annual reporting period immediately preceding the date of initial application.
- **Early application is permitted** for entities that apply **IFRS 9 and IFRS 15** **on or before** the date of initial application of IFRS 17.



Transition Options

The new standard will be **applied retrospectively**, with insurance contracts in existence at the beginning of the earliest period presented being measured in accordance with the new standard. The IASB recognises that in some cases full retrospective application will be difficult and therefore practical expedients are available:



- Before any of the modified options are taken, insurers will need to demonstrate that it is **impracticable** to take full retrospective application.
- Significant amounts of historical data may be required on transition, particularly for the full and modified retrospective approaches.

Impracticability and simplified approaches

- According to **IAS 8**, it's **impracticable** to apply IFRS 17 retrospectively , if the application requires :
  - assumptions about what **management's intent** would have been in that period; or
  - **significant estimates of amounts** and it is **impossible to distinguish objectively** information about those estimates from other information
- The objective of the **modified retrospective approaches** is to achieve **the closest outcome** to retrospective application possible using **reasonable and supportable information available** **without undue cost or effort**. **Minimum modifications** should be used for modified retrospective approach.
- When there is **no form of retrospective application available** based on reasonable and supportable information available without undue cost or effort, an entity shall apply **fair value approach**.

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Full retrospective approach

At transition date, an entity is required to:

- **recognise and measure** each group of insurance contracts **as if IFRS 17 had always applied**;
- **derecognise** any existing balances **that would not exist** had IFRS 17 always applied;
  (e.g. deferred acquisition costs and intangible assets related solely to existing contracts)
- **recognise** any resulting **net difference in equity**.

Components in the measurement model

Best estimates of future cash flows

- Expected present value of future cash flows arising from the insurance portfolio using best estimates and discount curve as per the transition date

Risk adjustment

- Based on risk adjustments calculation the entity employs as per transition date

Contractual service margin

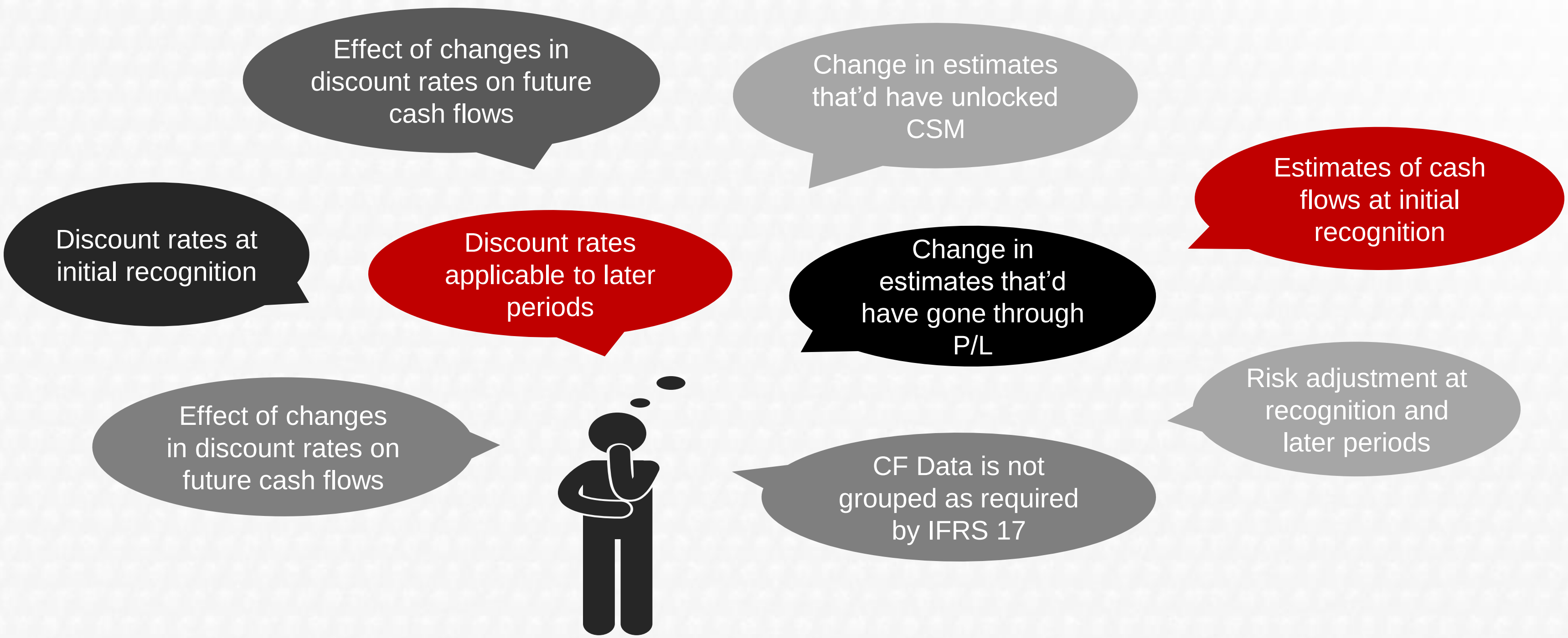
- Based on the best estimates of fulfilment cash flows (i.e. future cash flow, discount rate effect and risk adjustment) on initial recognition and considering the developments to the transition date as if IFRS 17 had always been applied.

Discount rate effect

- The effect of changes in discount curve from initial recognition to transition date on present value of future cash flows
- Changes can be reflected on either CSM (in case of DPF products), OCI or P/L.

Practicability for the full retrospective approach

- At transition date, calculation of **fulfilment cash flow** (i.e. present value of future cash flows and RA) should be rather straight forward.
- What about **the developments of CSM** up to the date…?



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Modified retrospective approach

- Under the condition that **full retrospective approach is impracticable**, an entity shall:
  - use **reasonable and supportable information**, and
  - **maximise** the use of information that would have been used to apply a fully retrospective approach **without undue cost and effort**.

Permitted Modifications

- Estimation of cash flows
- Definition of DPF contracts
- Development of CSM
- Discount rate
- Risk Adjustment
- Grouping of contracts
- Identifying discretionary cash flows

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Modified retrospective approach

Assessments at initial recognition:

- An entity may determine the following matters **using information available at transition date** (rather than at initial recognition):
  - **grouping of contracts**
  - whether an contract has **direct participating features**
  - identification of **discretionary cash flows**

- Under modified retrospective approach, there is **no requirement** to divide the groups of contracts into **annual cohorts**, unless the entity has reasonable and supportable information to justify the divisions.

Modified retrospective approach

Determining CSM for groups of contracts without direct participating features

Permitted Modifications

Future Cash Flows

Use future cash flows
at transition date
(or earlier date, if possible)

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Adjust for cash flows known to have occurred

Discount Curves (2 options)

Use an observable yield curve that is (at least) 3 years prior to transition

or

Apply an average spread to an observable yield curve

Risk Adjustments

Use risk adjustment
at transition date

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Adjust for expected release

Contractual Service Margin at Initial Recognition

Accrete interest based on the discount rates that were determined to apply on initial recognition

Reflect the transfer of service before the transition date by determining the amount that would have been recognised in P/L

Contractual Service Margin at transition date

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Modified retrospective approach

Determining CSM for groups of contracts with direct participating features

Permitted Modifications

CSM at Transition = **Fair value of the underlying items at transition date** − **Fulfilment cash flows measured at transition date** ± **Adjustments for…**

- **Amounts charged to policyholders before the dates of transition**
- **Amounts paid before transition date that would not have varied based on the underlying items**
- **change in the risk adjustment caused by the release from risk before transition date**

− **The amount of CSM that relates to services provided before transition date**

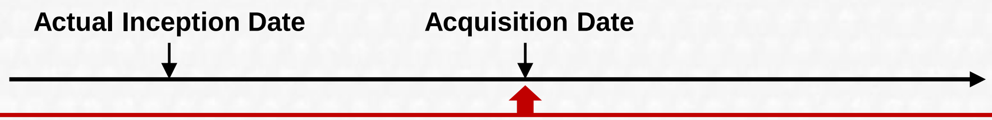
- Proxy for the total CSM for all services (past and future) provided under the contract
- If resulting in a loss component, adjust the loss component to zero and increase the liability for remaining coverage, excluding the loss component by the same amount

Fair value approach

CSM at transition = Fair value of the group of insurance contracts − Fulfilment cash flows measured at transition

Recap: Business combinations / transferred portfolio

- An entity shall use the **consideration received or paid** for the contracts in the transaction as a **proxy for the premiums received**. In a business combination, the consideration received or paid is the **fair value of the contracts** at that date.
- An entity shall take **the acquisition date as the date of initial recognition** in the measurement of acquired business.



- Take this date as the point of initial recognition
- Apply applicable measurement accordingly
- Include consideration received or paid in the measurement of future cash flows as a proxy of premium
- In a business combination, consideration received or paid is the fair value of the contracts
  (which essentially makes it equivalent to a fair value approach performed at the date of acquisition)

Transition disclosure

- An entity shall provide disclosures about the **CSM and insurance revenue** separately for insurance contracts that existed at the transition date and to which it has applied:
  - **modified retrospective approach**;
  - **fair value approach**;
  - all other insurance contracts.
- For all periods the above disclosures are required, the entity shall disclose **how it determined the measurement** of the insurance contract at the transition date.
- An entity is not required to disclose**,** for current or each prior periods,
  - information about **claim development**
  - amount of adjustment for each **financial statement line items affected**

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Re-designation of financial asset

For entity that have already applied IFRS 9 before IFRS 17, it may reassess assets based on the facts and circumstances that exist at the date of initial IFRS 17 application. (otherwise, reclassification is only allowed under IFRS 9 upon a change in business model)

An entity is **permitted** to:

- designate eligible assets under fair value option – if new accounting mismatches arise
- elect to use OCI for changes in fair value of equity instruments not held for trading
- revoke previous OCI designation of equity instrument.

And is **required** to:

- revoke previous designations of a financial asset as measured at FVTPL if accounting mismatches no longer exists.

- An entity shall **apply retrospectively** those designations and classifications with relevant transitional requirements in IFRS 9.
- The date of initial application for that purpose shall be deemed to be the date of initial application of IFRS 17.

An entity shall either:

- **Restate all comparatives** in prior periods, if possible without hindsight, or
- **Adjust opening equity** by the difference between previous carrying amount and the carrying amount at the date of initial application.

And it shall **disclose**:

- Carrying amount of affected assets, and
- Qualitative information of relevant judgements.

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Thank You

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