



APAC IFRS 17 webcast - Implementation challenges and opportunities for insurers in Asia-Pacific

Tuesday 13 June 2017

Today's moderator



Martyn van Wensveen

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Partner, EY (Malaysia)



Today's presenters



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EY (Singapore)



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Director
EY (Australia)



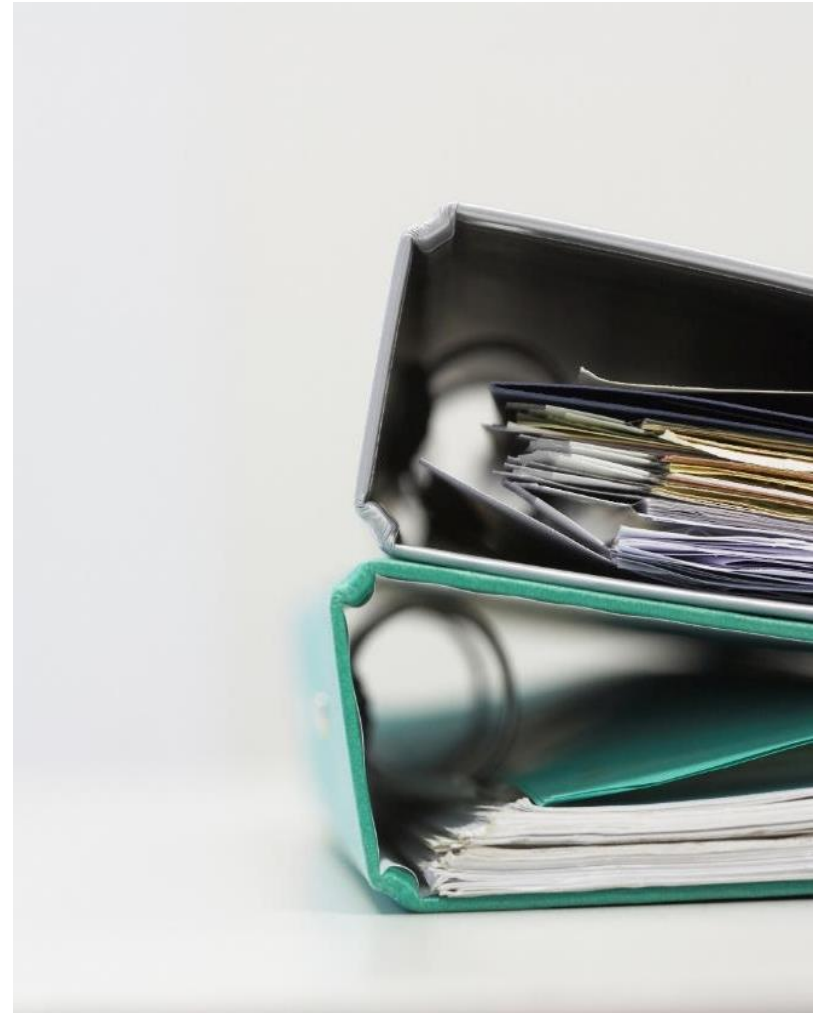
Tze Ping Chng

Partner
EY (Hong Kong)

Today's agenda

1. **Conor: IASB viewpoint**

2. **Patrick:** The basic principles of the new IFRS 17 standard
3. **Brendan:** Key changes in financial statements presentation and disclosure requirements (relative to current practice)
4. **Tze Ping:** Insights on how insurance companies may publically report their financial results in the future, including likely impact on KPIs and value drivers under IFRS 17
5. **Martyn:** Key implementation challenges and opportunities for insurers operating in the Asia-Pacific region



IASB viewpoint

Conor Geraghty, IASB Practice Fellow

- ▶ What has been the reaction of the insurance industry and investors to the release of the new standard?
- ▶ What are the most contentious and/or difficult items for insurers to implement?
- ▶ What can we expect going forward from the IASB and other influential advisory groups like EFRAG?

Polling Question 1

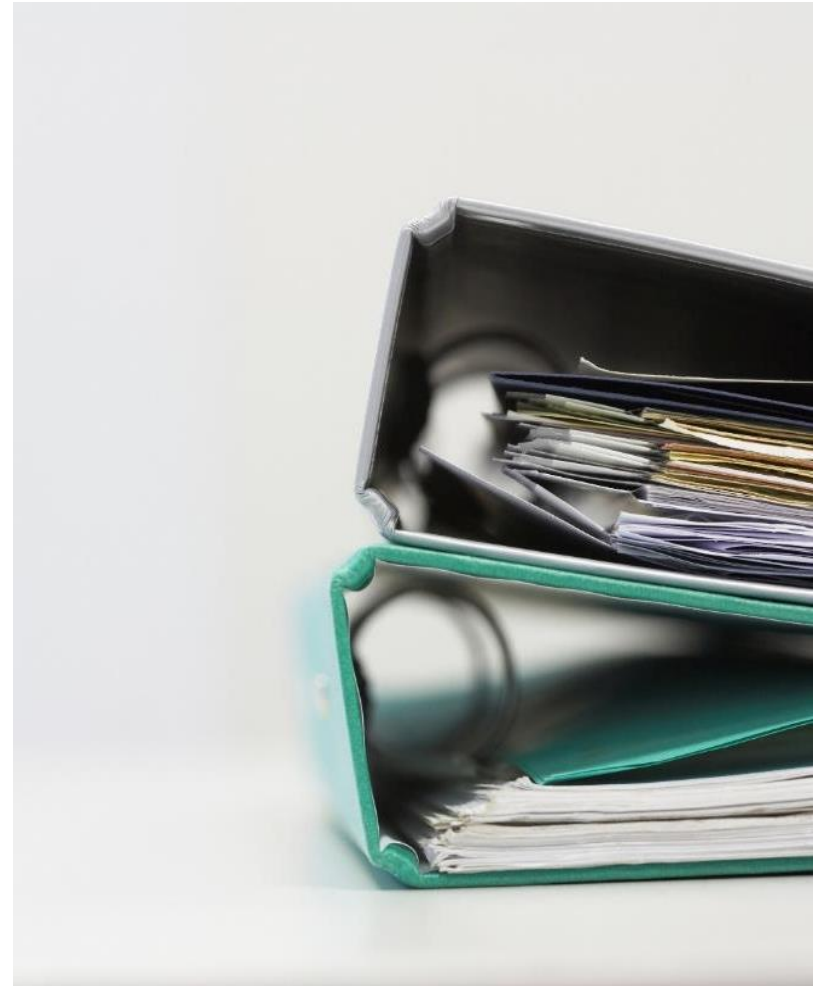
Now that the standard has been issued, when do you intend to start implementation activities?

- A. Already started
- B. In the next 3 months
- C. By the end of this year (2017)
- D. Next year (2018)
- E. Later
- F. Does not apply
(EY, faculty, other)

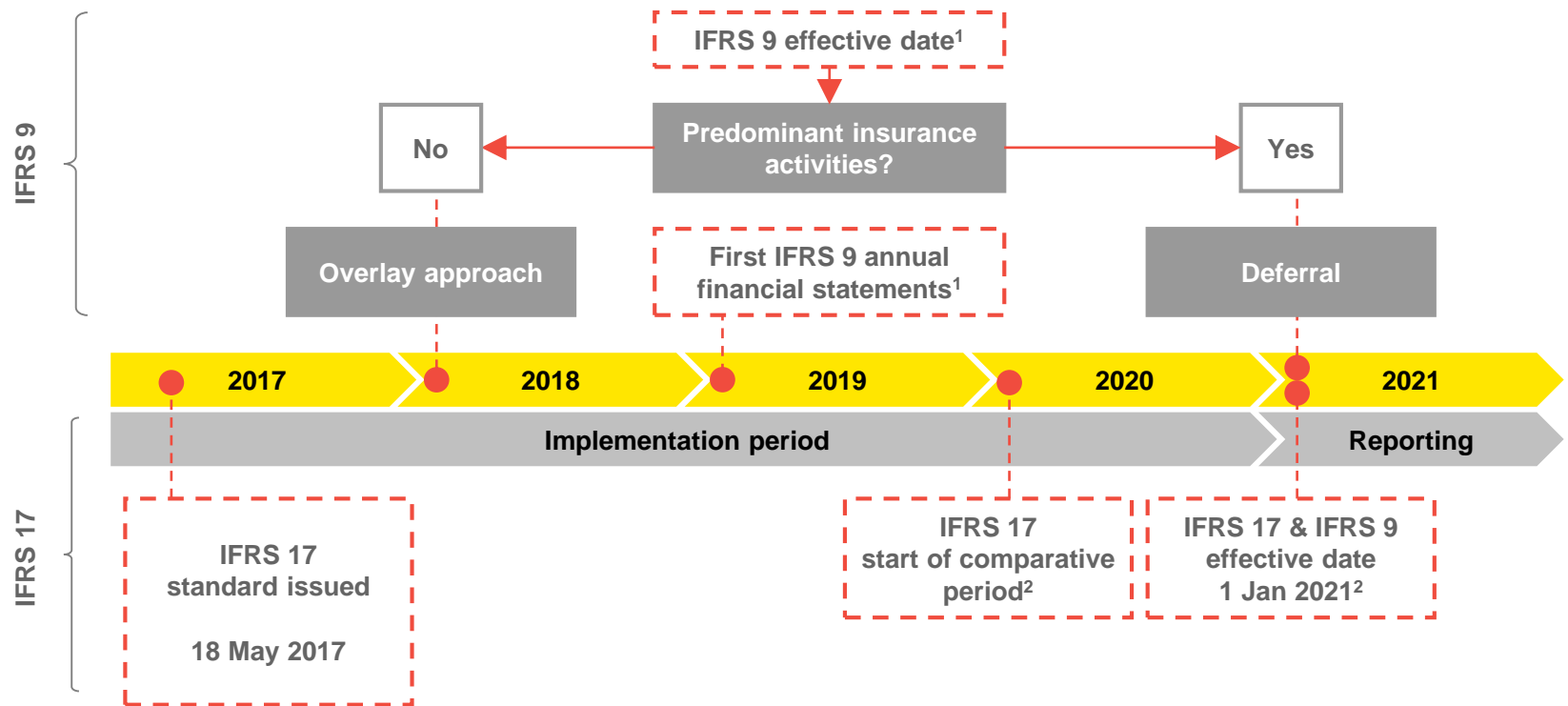


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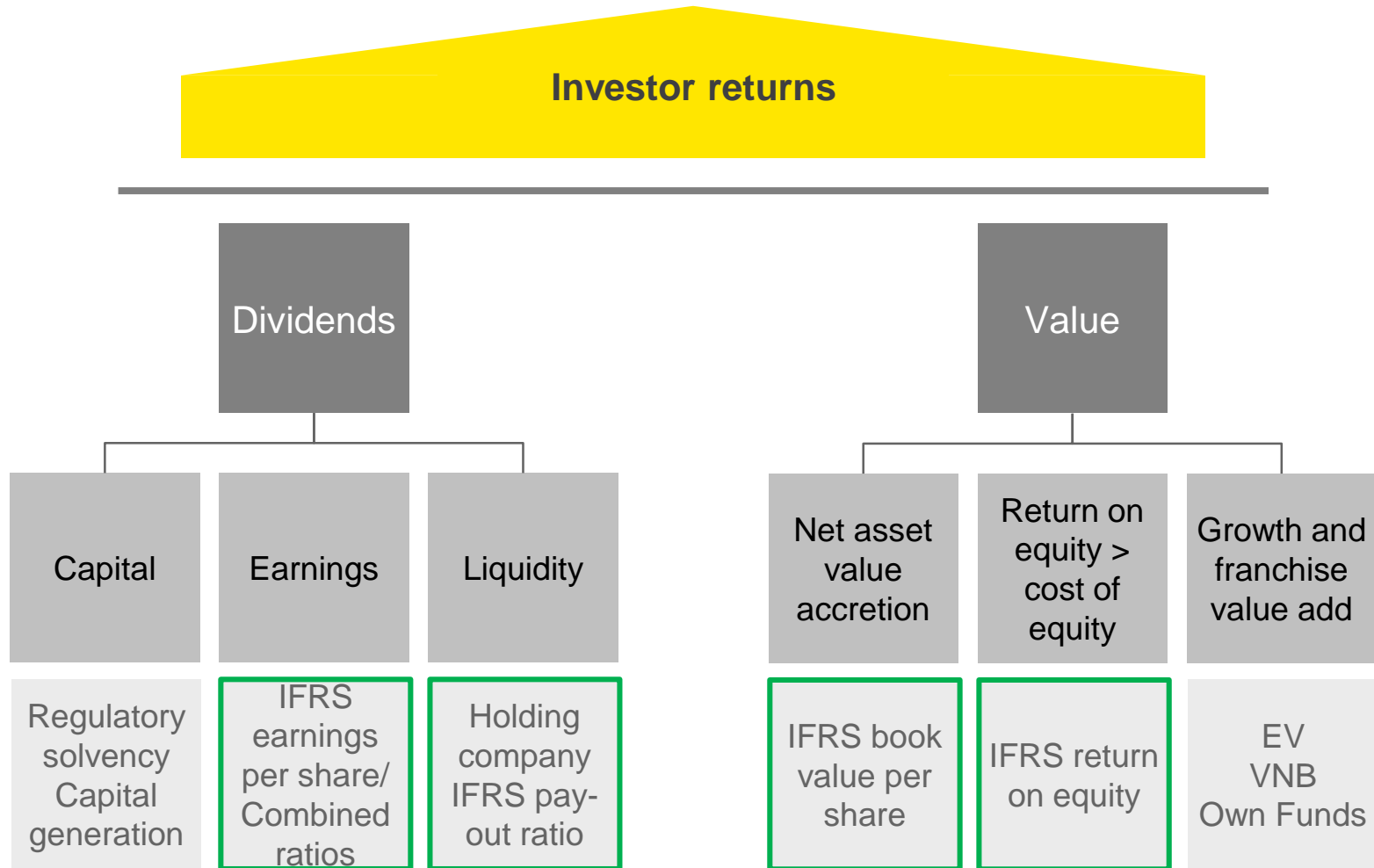
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IFRS 17 and IFRS 9 timelines



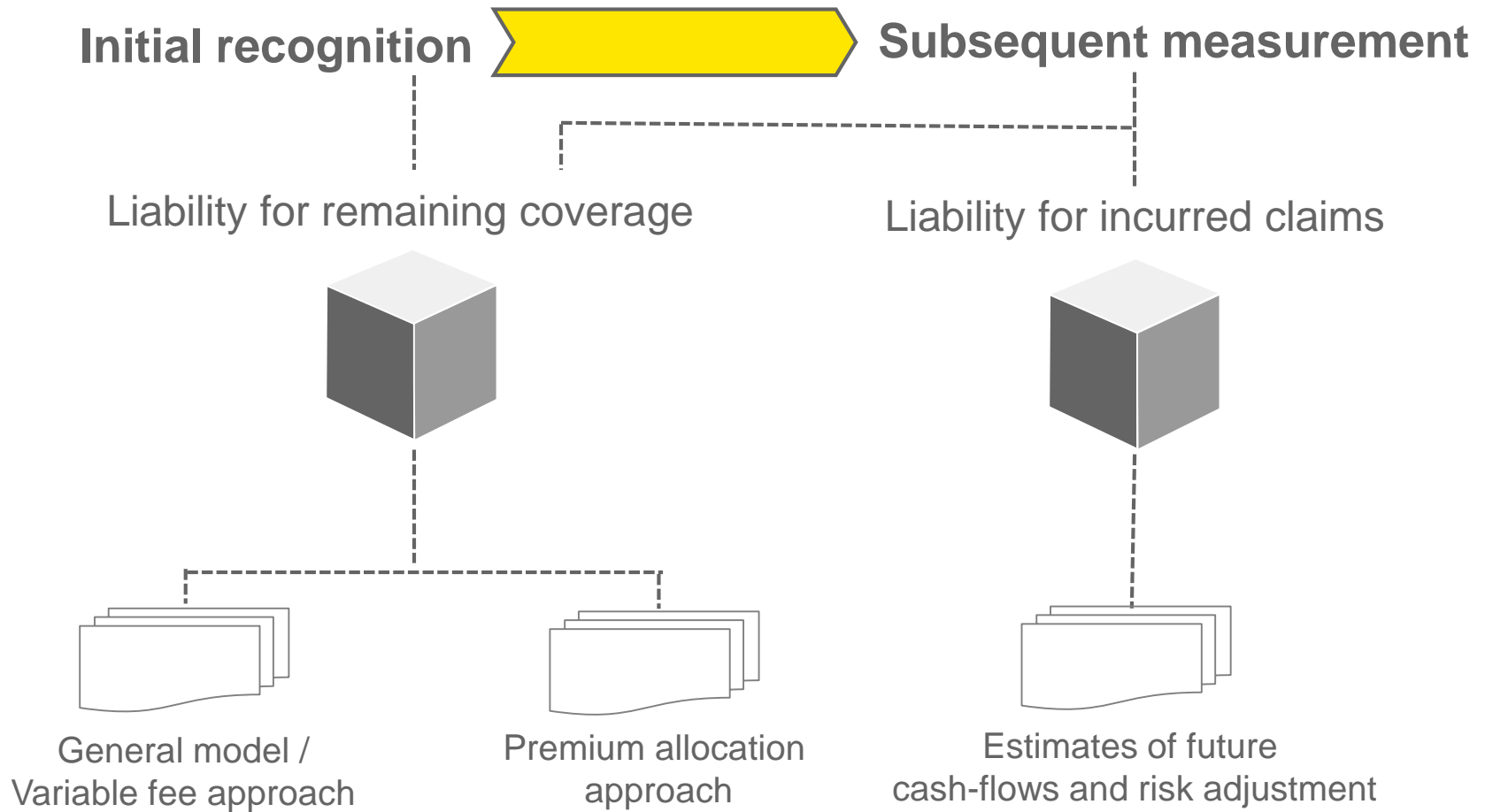
IFRS is an important pillar of the insurance investment proposition for investors



Why the change was necessary

Current practice	Forthcoming practice	Key steps in transition
<ul style="list-style-type: none">▶ Mix of different local Generally Accepted Accounting Principles (GAAPs)▶ Limited comparability between insurers and inconsistency with other industries▶ Limited use for steering the business and understanding the sources of profit▶ Some key metrics based on IFRS (e.g., RoE and pay-out ratios) but ...▶ ... significant use of secondary metrics (e.g., EV, VNB etc)	<ul style="list-style-type: none">▶ Consistent accounting rules across geographies▶ Current assumptions for each reporting period▶ Impact likely to be most significant for life insurance products▶ Exposure approach to recognition of profit and revenue — as insurance or investment services are provided▶ Significant changes in disclosures▶ Greater insight into sources of profit within the business (e.g., underwriting, expenses, investment return)	<ul style="list-style-type: none">▶ Operational implementation<ul style="list-style-type: none">▶ Opportunity to make current financial reporting processes more efficient▶ Compliance-only vs. “catalyst for change”▶ Accounting decisions<ul style="list-style-type: none">▶ Implementation choices▶ Design principles▶ Trade-off between operational simplicity and optimisation▶ Implications for messaging to the market place (investor relations)▶ Strategic decisions

Overview of the available IFRS 17 measurement models



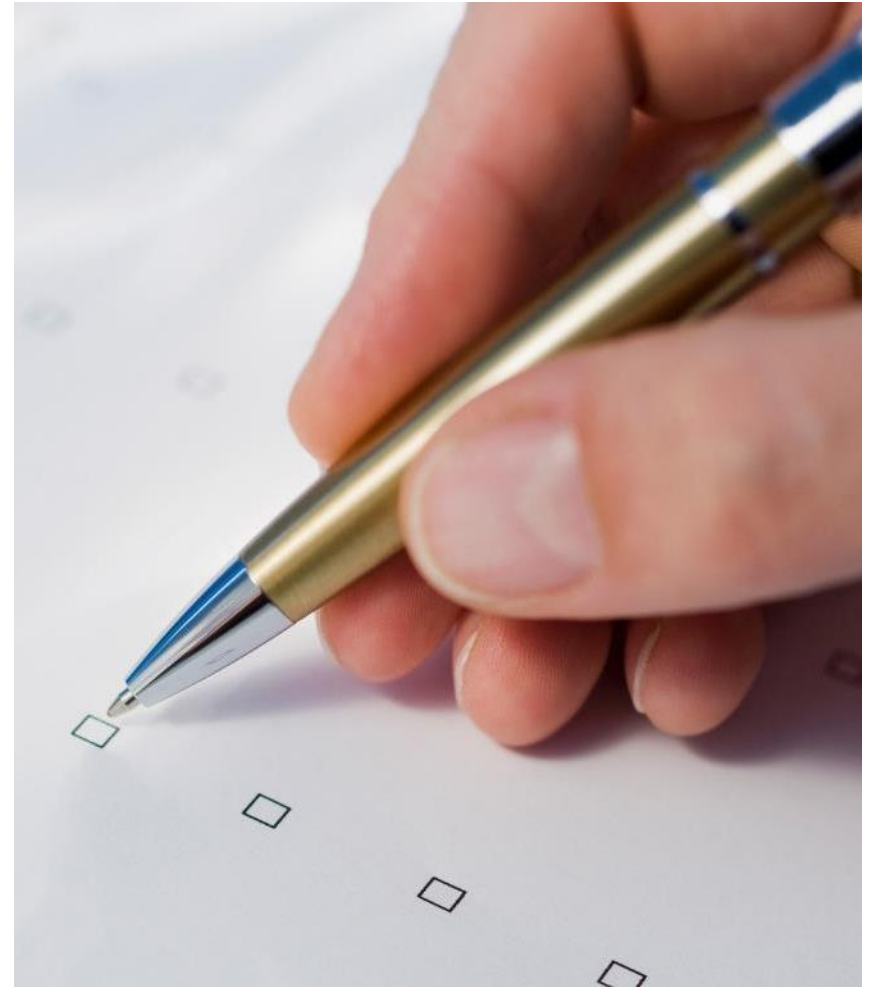
IFRS 17 measurement models explained

	Key features	Example products
Building block approach (General Model)	<ul style="list-style-type: none">▶ Default model in IFRS 17▶ Probability weighted discounted cash flows▶ Market-based valuation of options and guarantees▶ Contractual service margin (CSM): to spread recognition of profit and impact of changes▶ Risk adjustment	<ul style="list-style-type: none">▶ Annuities▶ Protection▶ Long-duration non-life business
Variable fee approach	<ul style="list-style-type: none">▶ Based on the building block approach, but with additional features for direct participating contracts▶ Market volatility on shareholder share passes through CSM vs Statement of Comprehensive Income (P&L /OCI) for building block approach	<ul style="list-style-type: none">▶ With-profit business▶ Unit-linked business▶ Variable annuity business?
Premium allocation approach	<ul style="list-style-type: none">▶ Optional approach for short-duration contracts (pre-claims liability)▶ BBA approach used to determine remaining exposure (once claim incurred)	<ul style="list-style-type: none">▶ Short-duration contract (mostly non-life insurance)

Polling Question 2

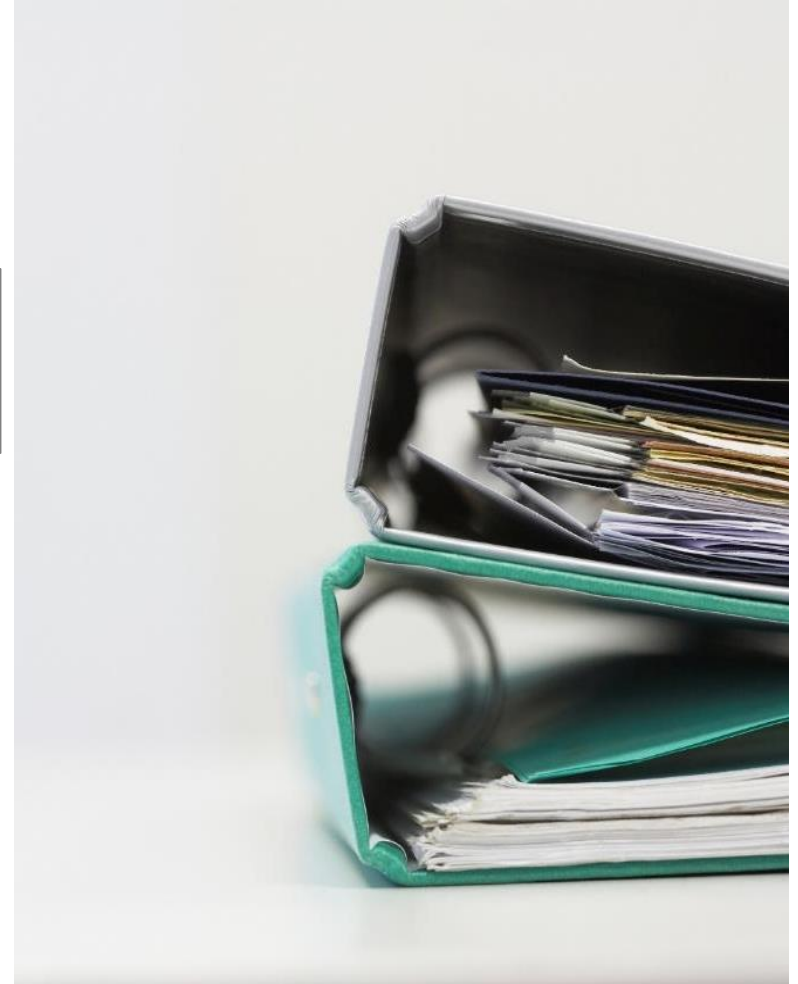
Will IFRS 17 bring greater comparability between insurers globally?

- A. Yes
- B. No, there are too many policy options (e.g. discount rate in OCI/P&L, measurement model choice for short-term contracts)
- C. There was already sufficient comparability before IFRS 17
- D. No, US GAAP differences will remain
- E. No, other reason
- F. Does not apply (EY, faculty, other)



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Contract boundary

Definition

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

A substantive obligation to provide coverage or other services ends when:

- ▶ The entity has the practical ability to reassess the risks of the **particular policyholder or of the portfolio of insurance contracts that contains the contract** and, as a result, can set a price or level of benefits that **fully reflects the risk of that portfolio**, and
- ▶ 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 future periods (after the reassessment date)

Aggregation of Contracts

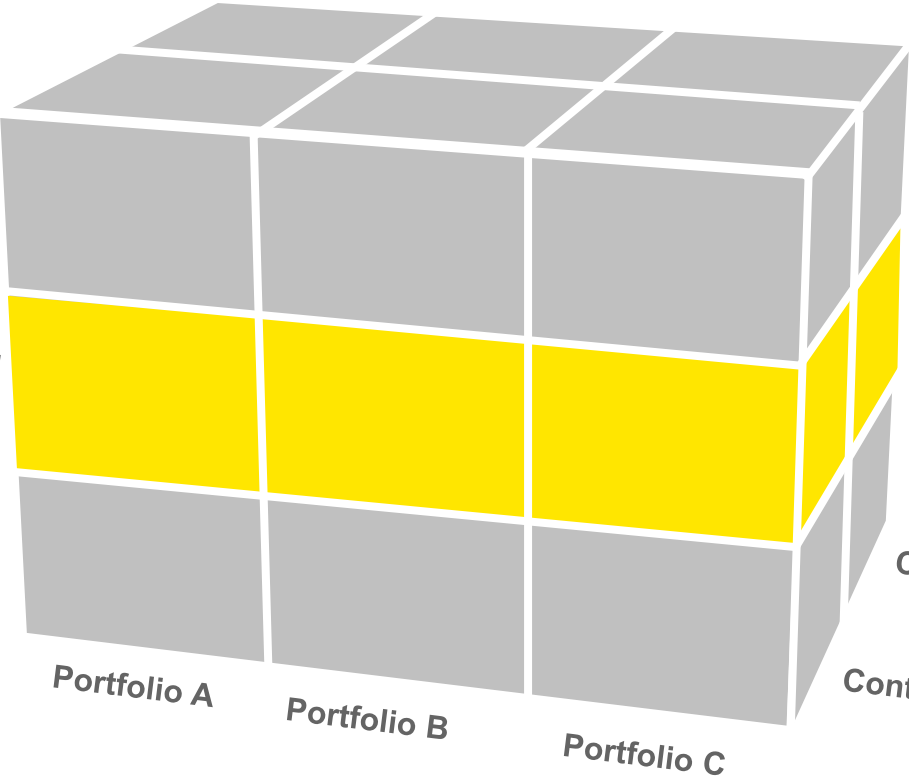
Need to group insurance contracts according to three basic criteria

By expected resilience to becoming onerous as at initial recognition

Expected to be onerous at initial recognition

No significant possibility of being onerous as at initial recognition

Other expected resilience at initial recognition

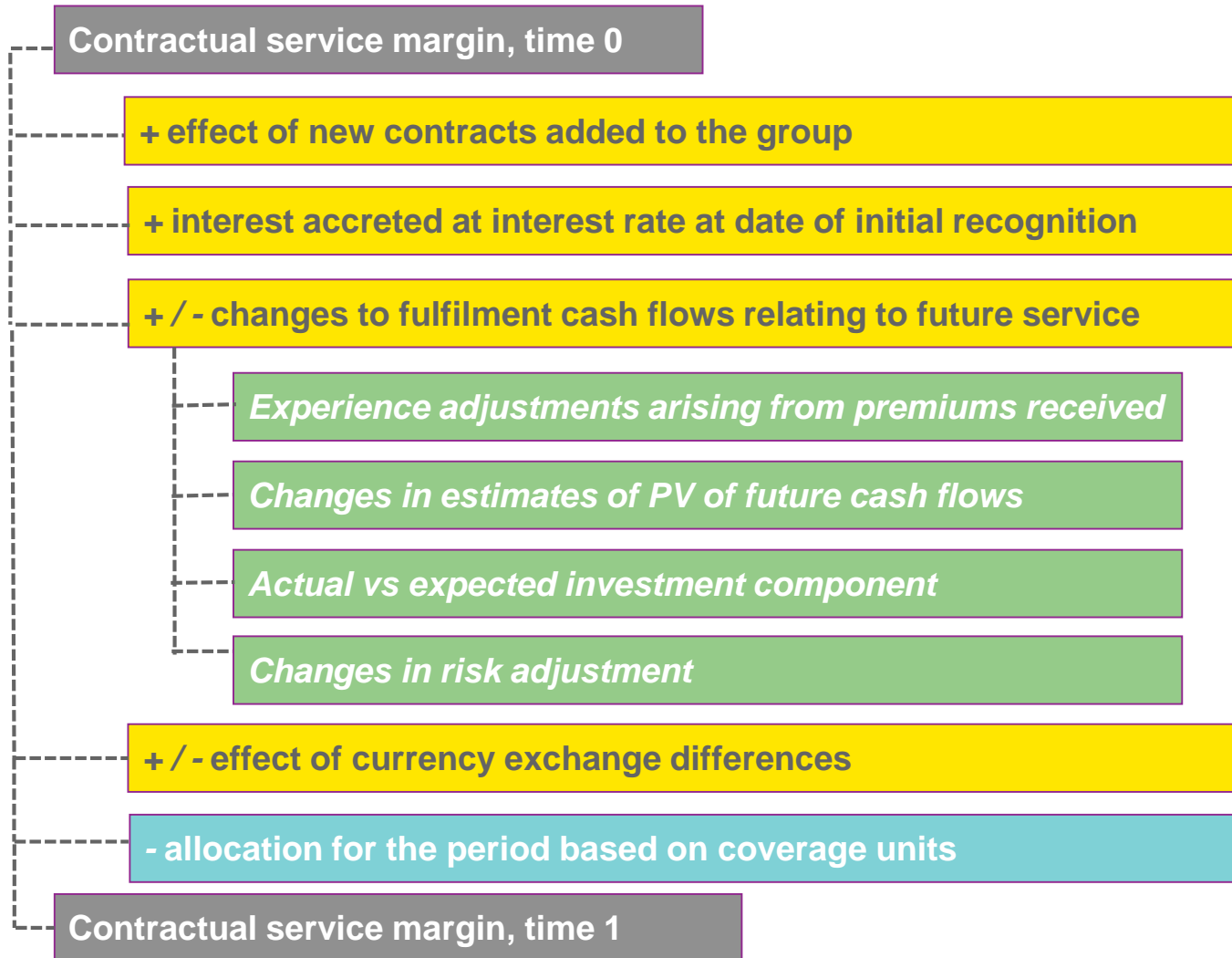


By annual cohorts

By portfolio

Contractual service margin

A significant change to the pattern of future profit recognition



How presentation will change: Balance Sheet

IFRS 4 (old standard)

Assets

Reinsurance contract assets

Deferred acquisition costs

Value of business acquired

Premiums receivable

Policy loans

Liabilities

Insurance contracts liabilities

Unearned premiums

Claims payable

IFRS 17 (new standard)

Assets

Reinsurance contract assets

Insurance contract assets

Liabilities

Insurance contracts liabilities

Reinsurance contracts
liabilities

Key changes

- ▶ Groups of insurance (or reinsurance) contracts that are in an asset position presented separately from groups of insurance (or reinsurance) contracts that are in a liability position
- ▶ Acquisition cost cash flows, premiums receivable and unearned premiums included in the measurement of insurance contract liability

How performance reporting will change: Statement of Comprehensive Income

IFRS 4 (old standard)	IFRS 17 (new standard)	Key changes																	
<table border="1"> <tr><td>Premiums</td></tr> <tr><td>Investment income</td></tr> <tr><td>Incurred claims and expenses</td></tr> <tr><td>Change in insurance contract liabilities</td></tr> <tr><td>Profit or loss</td></tr> </table>	Premiums	Investment income	Incurred claims and expenses	Change in insurance contract liabilities	Profit or loss	<table border="1"> <tr><td>Insurance revenue</td></tr> <tr><td>Insurance services expense</td></tr> <tr><td>Incurred claims and expense</td></tr> <tr><td>Acquisition costs</td></tr> <tr><td>Gain/loss from reinsurance</td></tr> <tr><td>Insurance service result</td></tr> <tr><td>Investment income</td></tr> <tr><td>Insurance finance expense</td></tr> <tr><td>Net financial result</td></tr> <tr><td>Profit or loss</td></tr> <tr><td>Discount rate changes on insurance liability (optional)</td></tr> <tr><td>Total comprehensive income</td></tr> </table>	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	Discount rate changes on insurance liability (optional)	Total comprehensive income	<ul style="list-style-type: none"> ▶ Insurance revenue excludes investment components ▶ Revenue and expense recognized as earned or incurred ▶ Insurance finance expense excluded from insurance service result and presented (i) fully in P/L or (ii) in P/L and OCI, depending on accounting policy ▶ Written premiums disclosed in the notes
Premiums																			
Investment income																			
Incurred claims and expenses																			
Change in insurance contract liabilities																			
Profit or loss																			
Insurance revenue																			
Insurance services expense																			
Incurred claims and expense																			
Acquisition costs																			
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Implications for earnings, cash and capital

Comparability	One IFRS	<ul style="list-style-type: none">▶ Current IFRS composed of a number of local GAAPs▶ Yet valuation based on 11x – 12x earnings▶ Anticipate greater comparability across groups (e.g., return on equity)
Cash and sources of dividends	Accounting mismatch remains	<ul style="list-style-type: none">▶ Cash generation and payback periods will remain unclear▶ Likely mismatch between IFRS 17 (economic view) and statutory accounting (retrospective view)▶ Local book value accounting often determines dividend paying capacity
Economic valuation	Alignment with Solvency II/ Economic capital	<ul style="list-style-type: none">▶ Guarantees now valued on an economic basis, but may create more volatility▶ Potential for IFRS to be more helpful in understanding movement in Own Funds▶ Components likely to be closer and reconciliations more intuitive▶ Anticipate MCEV VNB will be replaced by CSM on new business
Margins	Greater visibility as to sources of earnings	<ul style="list-style-type: none">▶ Greater insight into sources of earnings within the business (for group and investors)▶ Investment margin vs expense margin vs. underwriting margin▶ Anticipate focus on analysis of CSM change

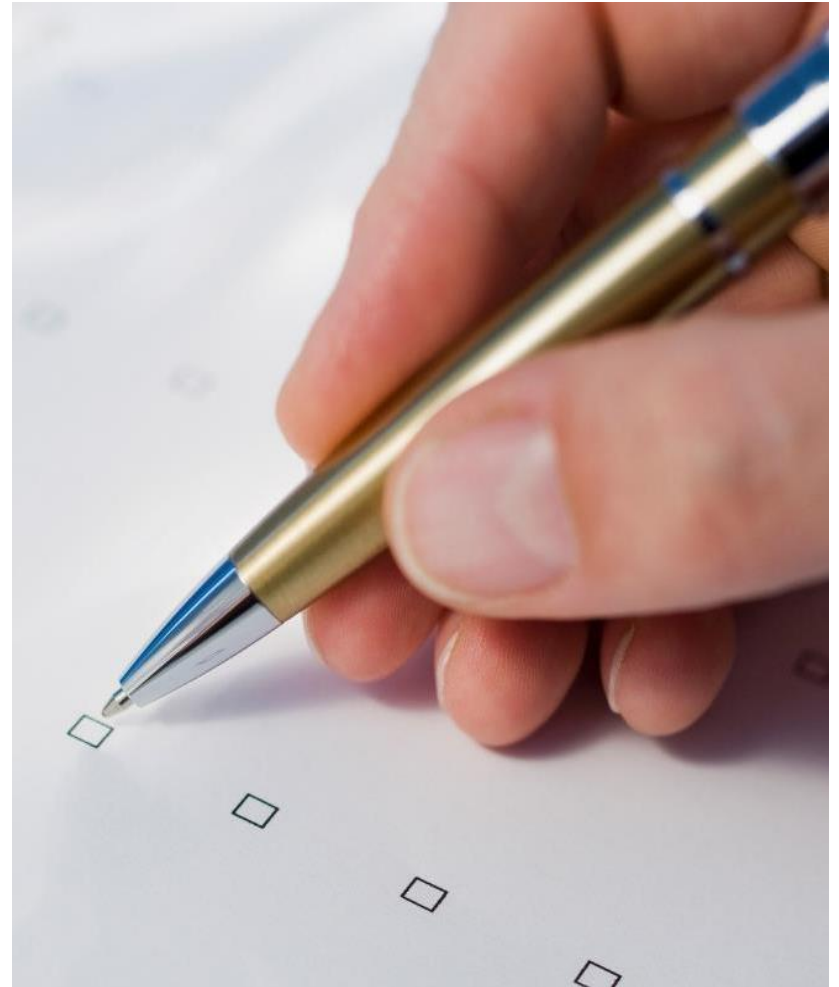
Specific implications: products & metrics

P&C	Premium allocation approach	<ul style="list-style-type: none">▶ Short-duration contracts likely to be least impacted▶ Reserves now discounted with an explicit risk adjustment▶ Link between income statement and combined ratio metrics may be less straightforward to reconcile
Reinsurance	Benefit recognition	<ul style="list-style-type: none">▶ Some products (e.g., protection) are unprofitable gross of reinsurance▶ Best estimate of reinsurer is lower than best estimate of primary writer▶ Gross loss recognised on Day 1 benefit of reinsurance spread over life of contract
Ratings agency metrics	Analysis principally IFRS based	<ul style="list-style-type: none">▶ Uncertain how ratings agencies will incorporate into their analysis▶ May lead to a change in the binding constraint for capital (rating agency vs. regulatory)▶ Rebasing of financial leverage metrics▶ Rebasing of interest coverage metrics, which are often IFRS- rather than cash-based

Polling Question 3

What is the main benefit that the introduction of IFRS 17 will bring to investors...

- A. More transparency about the performance of insurers
- B. A more consistent basis of accounting and reporting
- C. A more relevant accounting model reflecting uncertainty and current estimates
- D. All of the above
- E. I don't see significant benefits
- F. Does not apply (EY, faculty, etc)



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Operational implications due to IFRS 17 – the big picture

1. Policy

- ▶ New accounting policies/procedures and control documentation
- ▶ IFRS 17 methodology guidance and reporting instructions
- ▶ GL Chart of Accounts changes and account mappings
- ▶ Assumptions setting (modeling)
- ▶ Investment policy changes (IFRS 9)

2. Performance Management

- ▶ Changes in MI reports and KPI's
- ▶ Planning, budgeting and forecasting processes need to be adjusted
- ▶ VBM, scorecards and incentive schemes

3. People

- ▶ Training
- ▶ Cross functional collaboration (especially for Finance & Risk)
- ▶ Project resourcing & budget
- ▶ Managing change fatigue

4. Organization

- ▶ Roles and responsibilities between Actuarial and Finance departments
- ▶ Technical Provisions Assumptions/ Expert Judgement Committee
- ▶ Impact on outsourcing contracts

5. Data

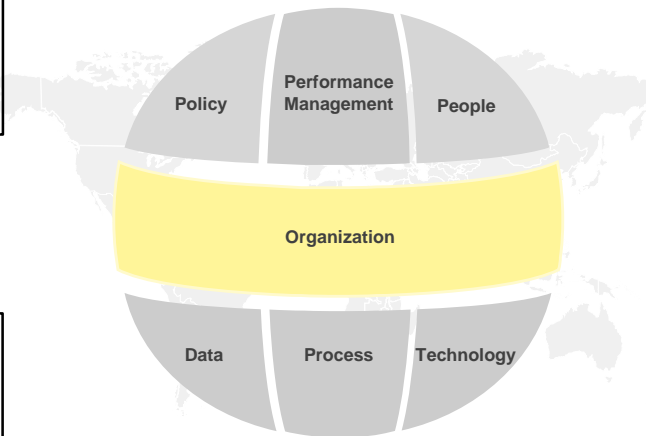
- ▶ Refinement, upgrading, conversion and migration of (complex) actuarial valuation models
- ▶ New financial reporting data requirements (input/output)
- ▶ Data reconciliations at different levels
- ▶ Data quality, storage and archiving
- ▶ Data security & controls
- ▶ Data governance and master data management

6. Processes


- ▶ Materiality concepts/guidelines
- ▶ Updating closing and reporting processes, planning processes, actuarial processes, risk management etc.
- ▶ Internal and external reporting templates including group reporting packages
- ▶ Internal controls and audit trail


7. Technology

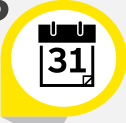
- ▶ Core systems, investment system, actuarial systems, pricing systems, etc.
- ▶ Posting logic/engines
- ▶ General Ledger, consolidation and reporting systems
- ▶ System interfaces
- ▶ Current system capacities & capabilities (agile technology)
- ▶ New functionalities/features

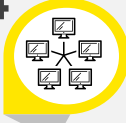



Key lessons learnt so far


- 


1 IFRS17 is much more than an accounting change, it has a major impact on the entire organization (front-, middle- and back-office)
- 

2 If you think the IFRS17 standard is difficult, wait till you try to implement this in real life!
- 


3 Don't underestimate the amount of time it takes to find the required data to fulfil the extensive IFRS17 primary financials and disclosure requirements
- 

4 The biggest amount of work sits in the end-to-end Data, Systems & Process (DSP) changes – need to make sure IT does not become the bottleneck!
- 


5 Follow a proven IFRS implementation methodology (with structured and centrally prepared input templates)
- 

6 Important to emphasize both the content and process skills needed to get the job done (difficult to find people who master both skills equally well)
- 


7 Need to appoint a separate **accounting lead** (IFRS17 specialist), **actuarial lead** (financial & business impact models), **systems lead** (ERP/EPM) and **conversion project lead** (finance change specialist) to jointly manage the IFRS17 conversion



Language & Culture



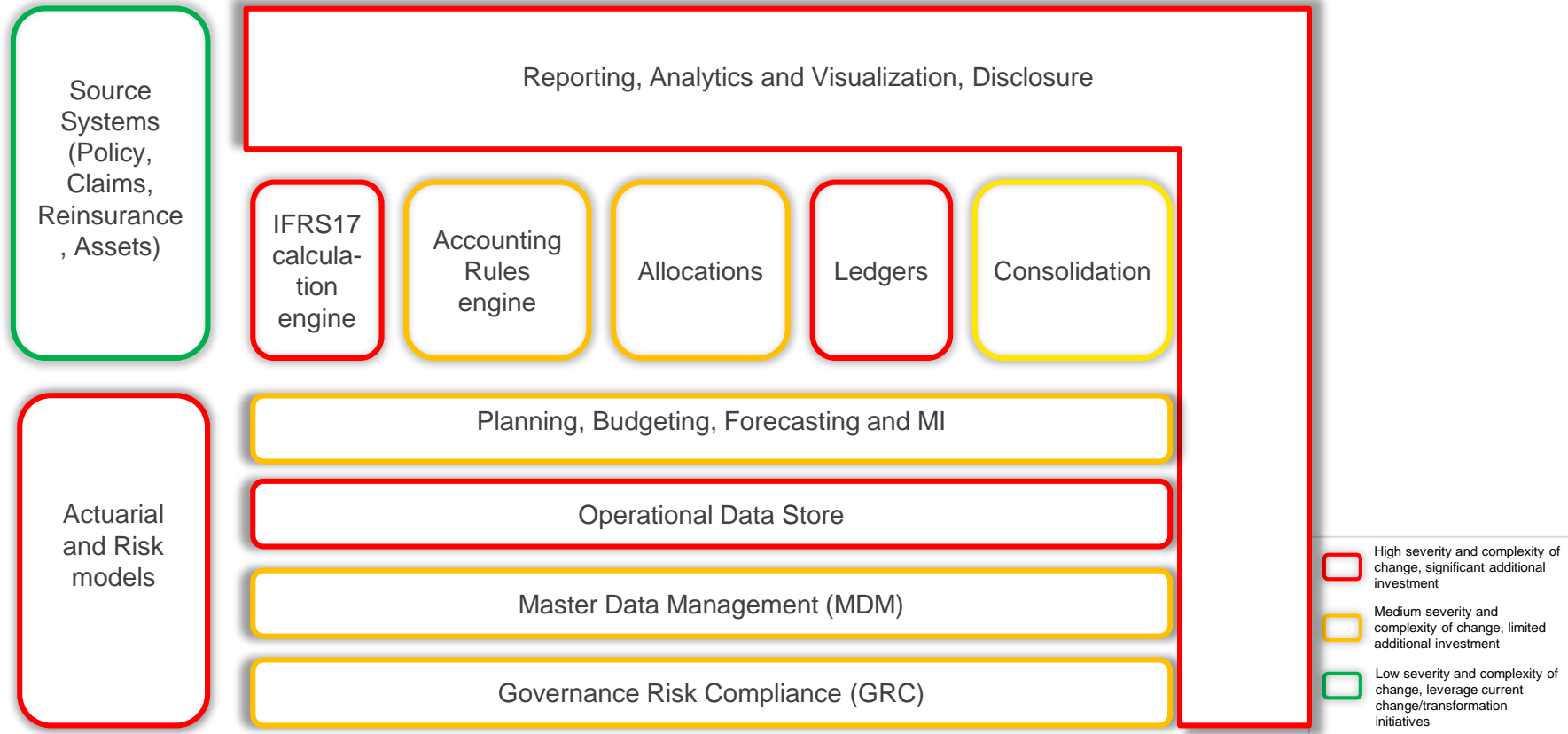
Communication



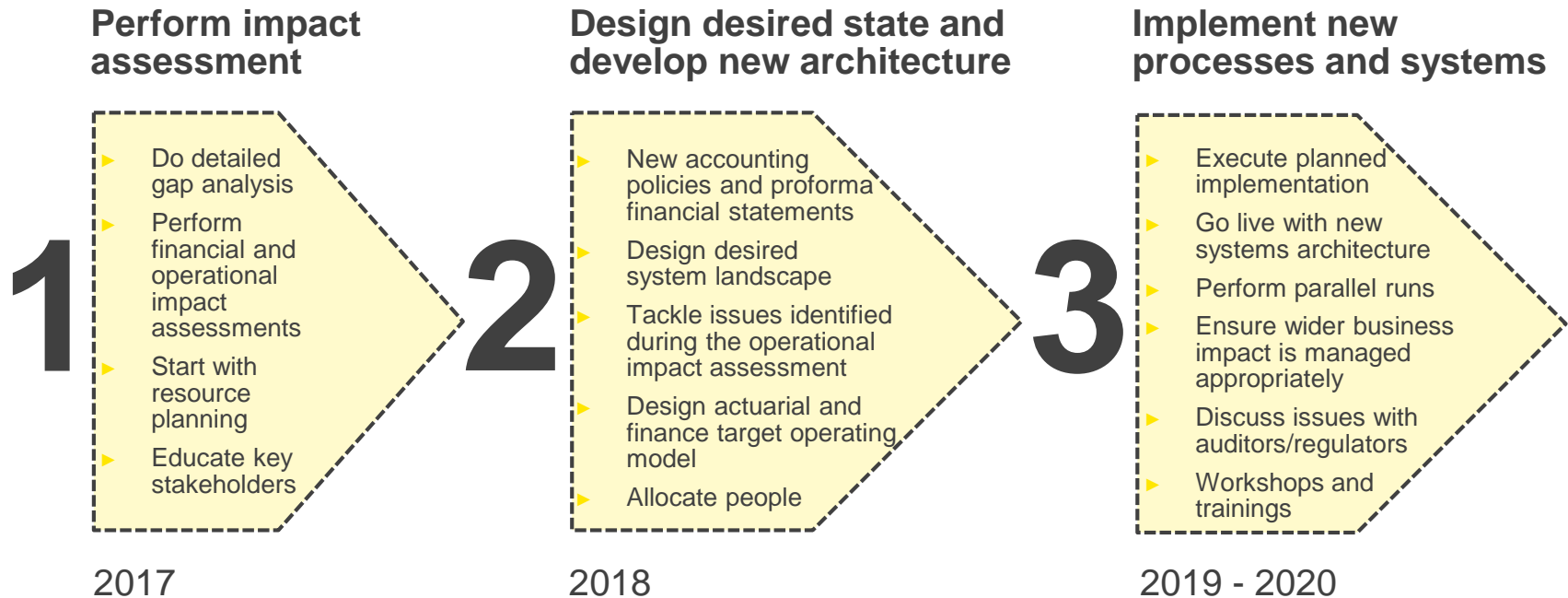
Scoping & Planning

Due consideration is required across the entire systems architecture

High to Medium complexity across Data, System and Processes

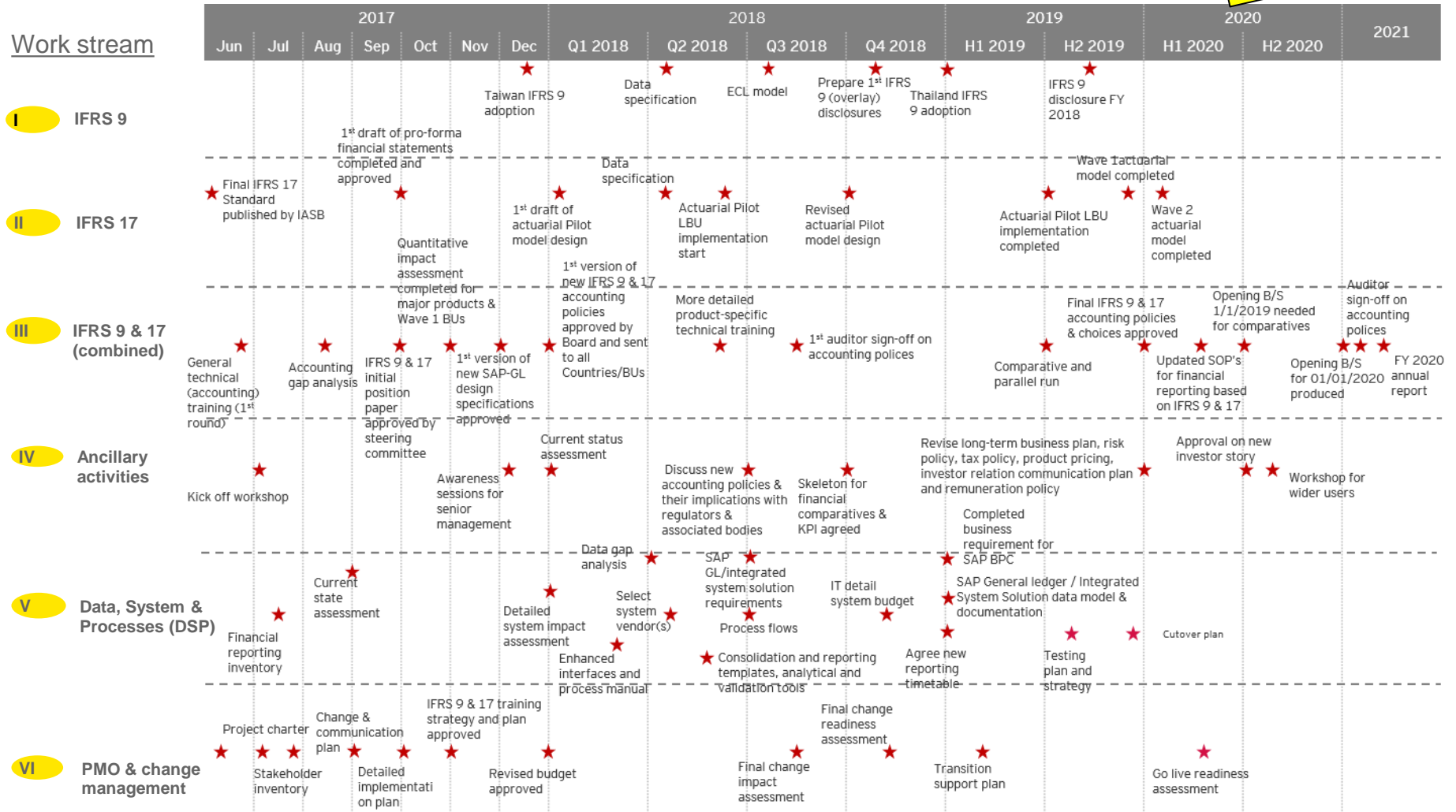


We recommend a phased approach to manage the timely implementation of IFRS 17



IFRS Insurance Accounting implementation work plan (2017-2021)

example



Recommended next steps (in 2017)

- ✓ Start your local IFRS 17&9 impact assessment project(s)
- ✓ Mobilize project resources & key stakeholders
- ✓ Conduct core team training (covering content & process)
- ✓ Perform gap analysis (using pre-populated structured templates)
- ✓ Conduct impact assessments (financial, products, systems & processes, people)
- ✓ Determine realistic implementation roadmap & budget (including IT)
- ✓ Report findings to internal stakeholders (MT, Board, Group etc)
- ✓ Discuss findings with external auditor and regulator(s)
- ✓ Seek approval for next phase (Design)

Questions & Answers



Our IFRS 17 thought leadership publications and reference tools

Thought leadership

- ▶ IFRS 17 Insurance Accounting Alert (May 2017)
- ▶ IFRS 17 transition considerations (May 2017)
- ▶ IFRS 17 Insurance contracts: Ready, set ... Implications for Hong Kong insurers (March 2017)
- ▶ IFRS 17: Shining a light into the value of insurers? (December 2016)
- ▶ IFRS 17: Illustrative example of life contract without participation features (June 2015)

Reference tools

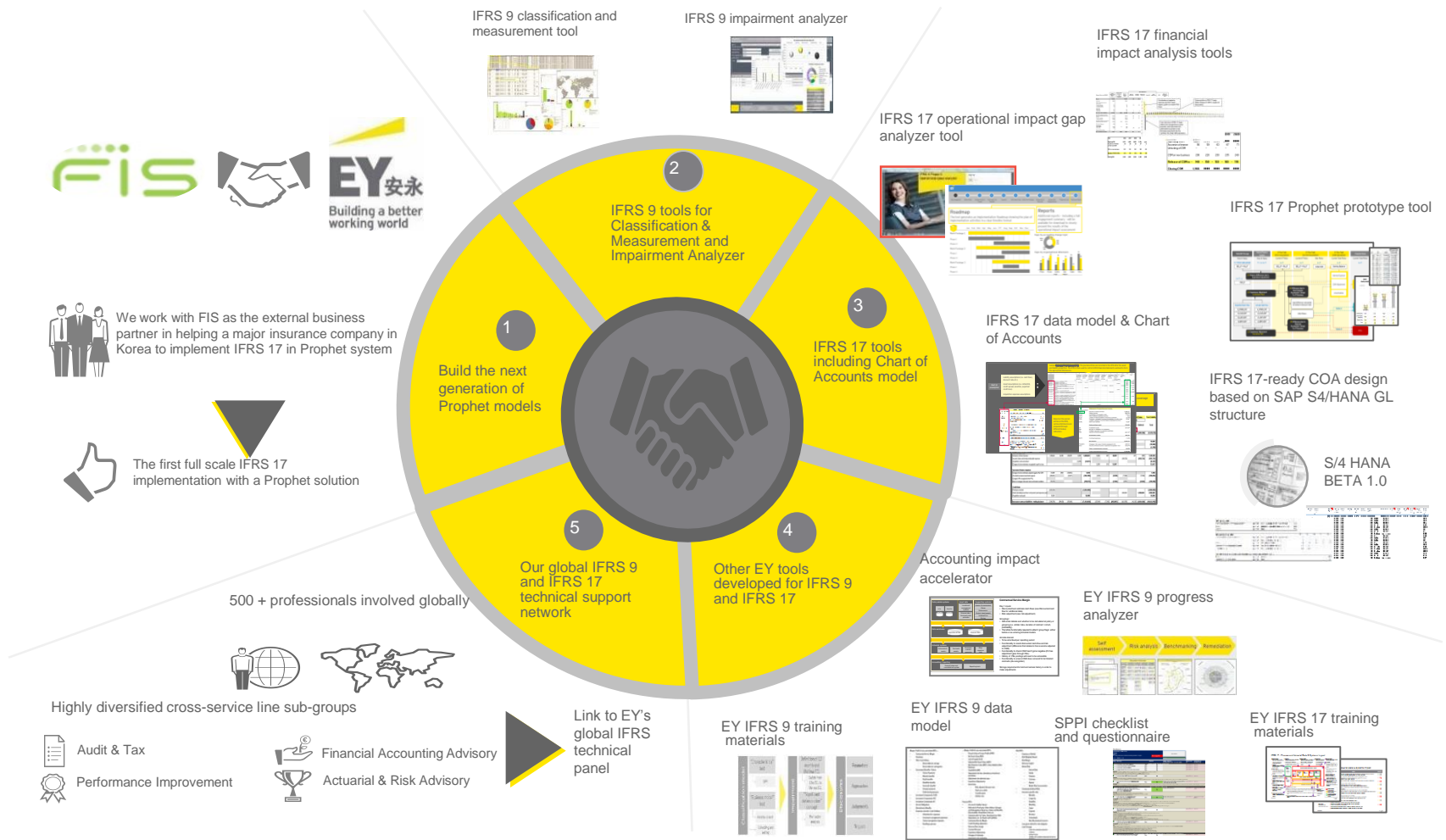
We regularly publish thought leadership on IFRS 17 providing valuable insights for your business.

Visit us on

<http://www.ey.com/gl/en/industries/financial-services/insurance/ey-frac-accounting-change> to read about our latest insights and view points.



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