Triglav Group

Understanding IFRS 17/9

Introductory guide for investors and analysts

Building a
Safer Future.

February 2023

Introduction to IFRS 17

2001	2004	2017	2019	2021	2023
On IASB Agenda	IFRS 4 issued	IFRS 17	Draft ED/2019/4 (Amendments to IFRS 17)	EU endorsement	**IFRS 17 effective date 1 Jan 2023**

IFRS 17 / 9 in a nutshell: More transparent reporting of insurers' financial position and performance. Increased comparability of financial statements both between insurers and with other industries. Consistent treatment of assets and liabilities and detailed disclosures explaining company's performance and changes in carrying amounts.

IFRS 17 Insurance contracts (replacing IFRS 4): Insurance contracts are measured using current value approach with explicit allowance for uncertainty for non-financial risks and profit is recognised as insurer provides services to policyholders while loss from onerous contracts is recognised immediately in the full amount. The profit or loss earned from underwriting activities is reported separately from financing activities.

IFRS 9 Financial instruments (replacing IAS 39): Financial assets are measured at fair value or at amortised cost. *IFRS 9 and its amendments can be first applied with the first application IFRS 17.*

IFRS 4 vs. IFRS 17

IFRS 4	IFRS 17
▪ **Wide variety of accounting practices** for reporting insurance contracts. Non-uniform reporting within groups. Inconsistency with other industries (revenues include deposits, revenue reported on cash basis).	▪ **One accounting policy** for all insurance contracts brings better **comparability** of insurers against each other, over time and also among industries (revenue will reflect services provided, and exclude deposits, like any other industry).
▪ **Complicated data**: No explicit requirement on measurement and updates of estimates and assumptions. Discount rate is often based on investment (use of „expected return on assets held"). Options and guarantees are not fully reflected in measurement of insurance contracts. No requirement for separate presentation of profitable and onerous contracts.	▪ **Insurance contracts are measured and disclosed on regularly updated, current estimates and assumptions** which reflect time value of money (**discount rate**) and uncertainty related to non-financial risks (**risk adjustment**). Insurers need to indicate the expected (yet unearned) profit with **contractual service margin** (CSM) and only recognize profit when they deliver insurance service. Onerous contracts are measured separately from profitable contracts.
▪ **Lack of transparency about profitability**: Difficult to see key drivers of profit.	▪ **Key drivers of profit** (investment vs. underwriting) are made **transparent.**

P&L Comparison (theoretical example*)

Structure of P&L changes significantly. GWP is no longer presented. P&L includes insurance service result (comprising insurance revenue and insurance service expense) and insurance finance expense. Insurance revenue and insurance service expenses are presented net of investment components.

IFRS 4 / IAS 39 P&L	20XX
Gross premiums	16,321
Premiums ceded to reinsurers	-816
Investment income	9,902
Total income	**25,407**
Gross claims, benefits, expenses	-13,827
Claims & expenses ceded to reinsurers	368
Aquisition costs amortisation	-1,259
Change in insurance contract liabilities	-9,308
Total expenses	**24,026**
Profit before tax	**1, 381**

→ Gross premiums: Includes collection of deposits (investment component). Inconsistent with other industries

→ Gross claims, benefits, expenses: Includes repayment of deposits (investment component)

→ Change in insurance contract liabilities: Confusing adjustment that incorporates multiple factors

→ Profit before tax: **Source of earnings difficult to identify**

IFRS 17 / 9 P&L	20XX
Insurance revenue	9,856
Insurance service expenses	-9,069
Incurred claims and insurance contract expenses	*-7,362*
Insurance contract acquisition costs	*-1,259*
Gain or loss from reinsurance	*-448*
Insurance service result	**787**
Investment income	9,902
Insurance finance expenses	-9,308
Net financial result	594
Profit before tax	**1, 381**

* IFRS Foundation, National Standard-Setters webinar

Balance Sheet Comparison (theoretical example*)

Other comprehensive income will be more stable. New accounting regime more adequately reflects economic status of assets and liabilities *(e.g., strong increase of interest rates in 2022 has resulted in significant devaluation of investments, in both regimes, but under current regime claims reserves are not discounted to reflect change in interest rates).*

IFRS 4 / IAS 39 Balance Sheet	20XX
Financial assets	226,297
Deffered acquisition costs	8,083
Premium receivable	2,798
Reinsurance contract assets	20,572
Other assets	36,002
Total assets	**293,752**
Insurance contract liabilities	211,010
Unearned premiums	5,595
Other liabilities	51,431
Equity	25,716
Total liabilities and equity	**293,752**

IFRS 17 / 9 Balance Sheet	20XX
Financial assets	226,297
Reinsurance contract assets[1]	20,572
Other assets	36,002
Total assets	**282,871**
Insurance contract liabilities[2]	205,724
Other liabilities	51,431
Equity	25,716
Total liabilities and equity	**282,871**

[1] Groups of insurance and reinsurance contracts in asset position presented separately from those in liability position

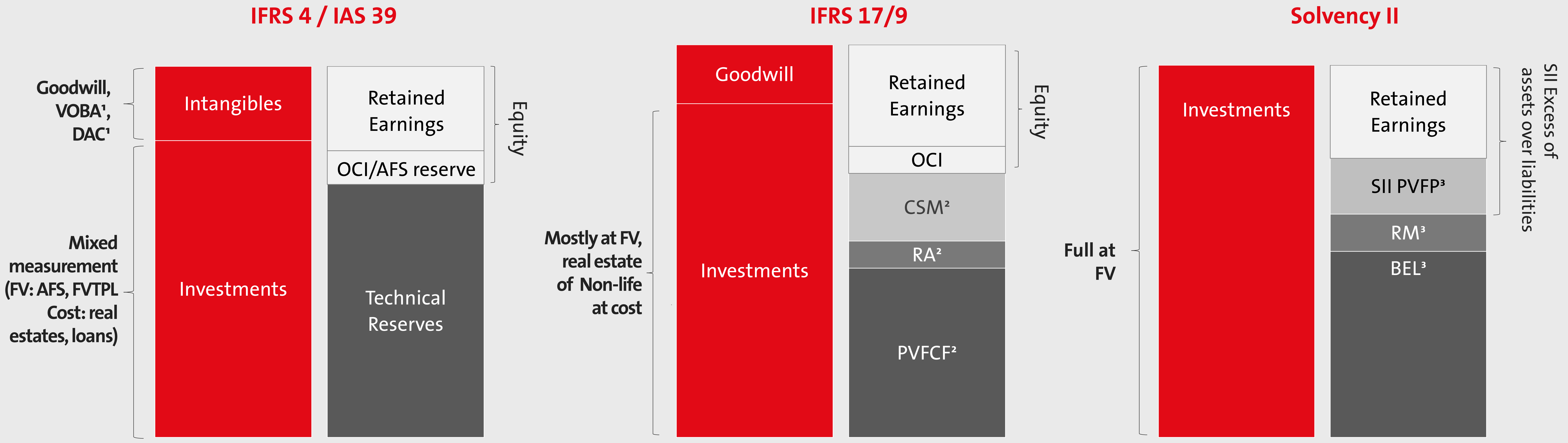
[2] Acquisition cost cash flows, premiums receivable and unearned premiums are included in measurement of insurance contracts.

IFRS 17 Liability	=	PV of future cash flows (PFCF)	+	Risk adjustments	+	Unearned profit

* IFRS Foundation, National Standard-Setters webinar

Balance Sheet Comparison (theoretical example*)

Under IFRS 17 insurance liabilities are measured at fair value with discounting effects in equity to ensure consistency with valuation effects on investments under IFRS 9, avoiding accounting mismatch seen under IFRS 4 & IAS 39. Main effects on balance sheet: More stable comprehensive income and better alignment of insurance liabilities between IFRS and Solvency II



[1] DAC - Deferred acquisition costs
VOBA - Value of business acquired

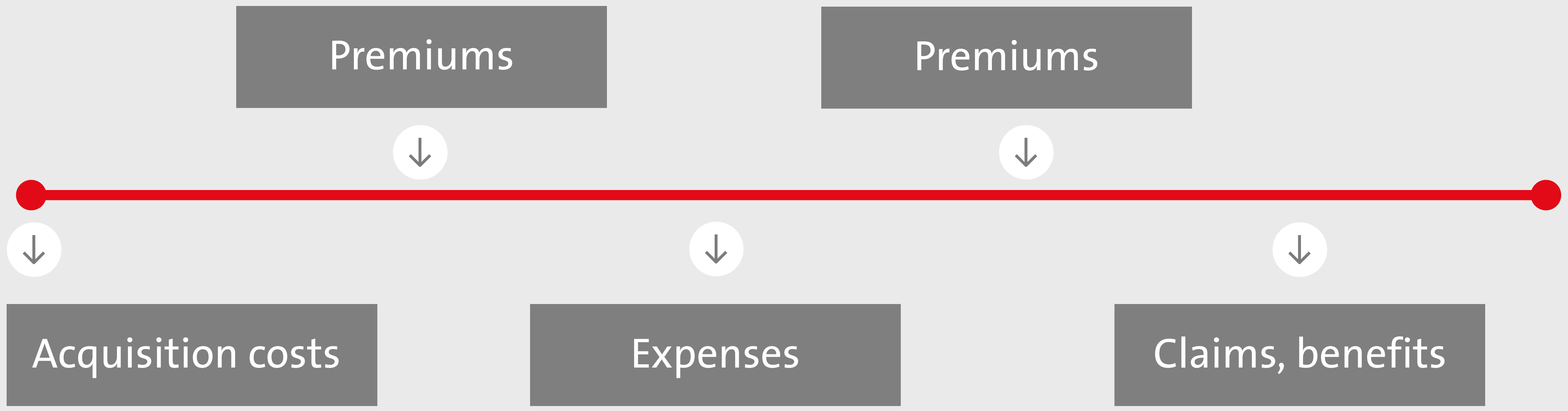
* IFRS Foundation, National Standard-Setters webinar

[2] CSM – Contractual service margin
RA – Risk adjustment
PVFCF - Present value of future cash flows

[3] SII PVFP - Present value of future premiums
RM – Risk margin
BEL - Best estimate liability

Present Value of Future Cash Flows

IFRS 17 Liability = Present value of future cash flows (PFCF) + Risk adjustment (RA) + Unearned profit (CSM)



Considering financial options and guarantees embedded in contracts

FUTURE CASH FLOWS:

- Current estimates of future cash flows
- Probability weighted and unbiased
- Stochastic modelling where necessary for financial options and guarantees

DISCOUNT RATES:

- Current market-consistent discount rates relevant to liability
- Return premium on assets included only to extent that liability cash flows are themselves linked to those assets
- Disclosures about rates used and judgements made by company

Risk Adjustment and Contractual Service Margin

IFRS 17 Liability	=	Present value of future cash flows (PFCF)	+	Risk adjustment (RA)	+	Unearned profit (CSM)

RISK ADJUSTMENT:

- **Explicit adjustment for compensation company requires for bearing insurance risk**

  No more implicit risk adjustments to expected cash flows and lack of transparency regarding reserve releases

- **Part of total unearned profit**

  Recognized in P&L as company is released from risk

CONTRACTUAL SERVICE MARGIN (CSM):

- **Unearned risk-adjusted expected profit**

  Unearned CSM adjusted where assumptions change

- **CSM released to P&L as services are provided over coverage period**

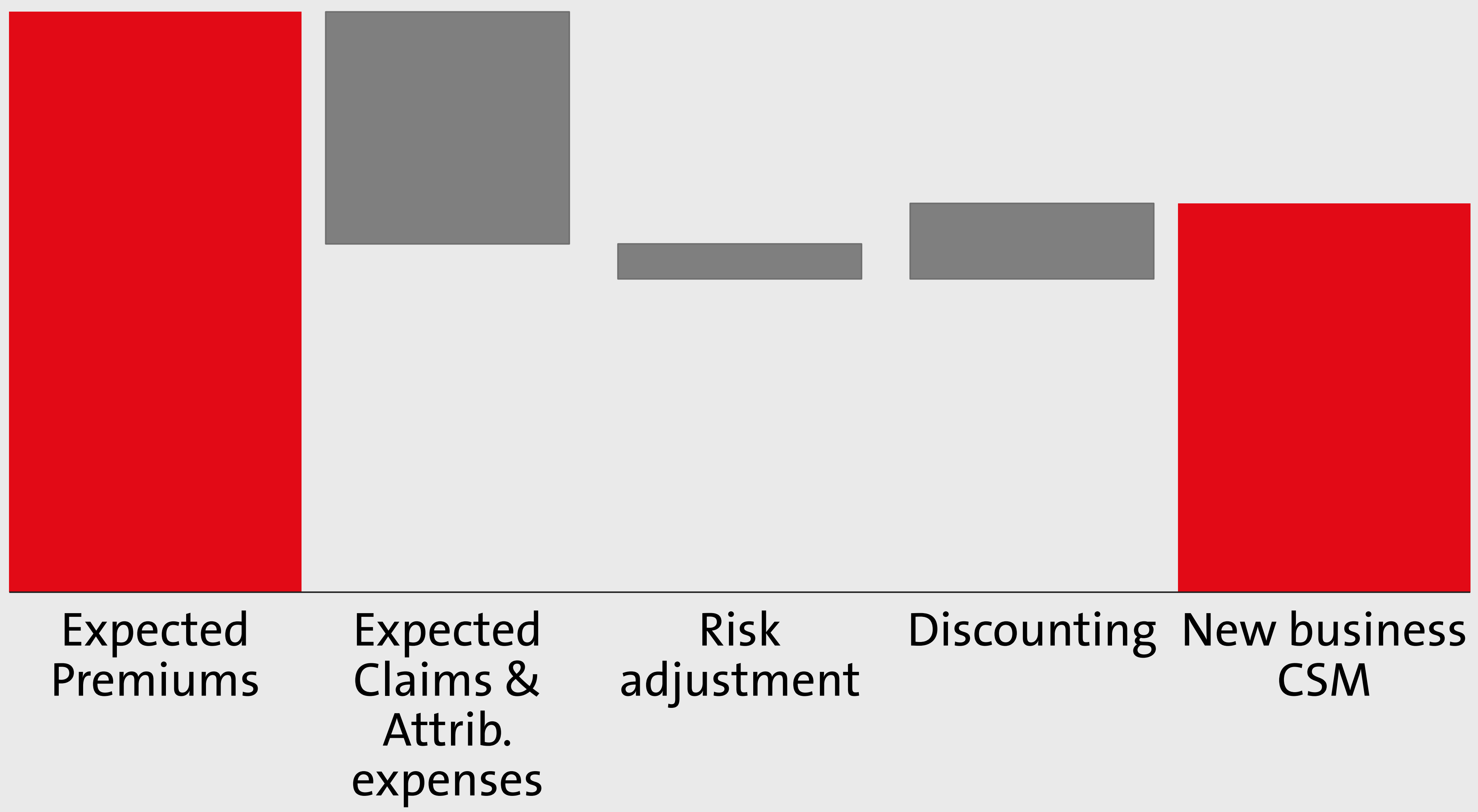
  No day 1 profit

- **If CSM was negative –> onerous contracts**

  Onerous contract loss recognized immediately in the full amount (and further excluded from expense to avoid double counting)

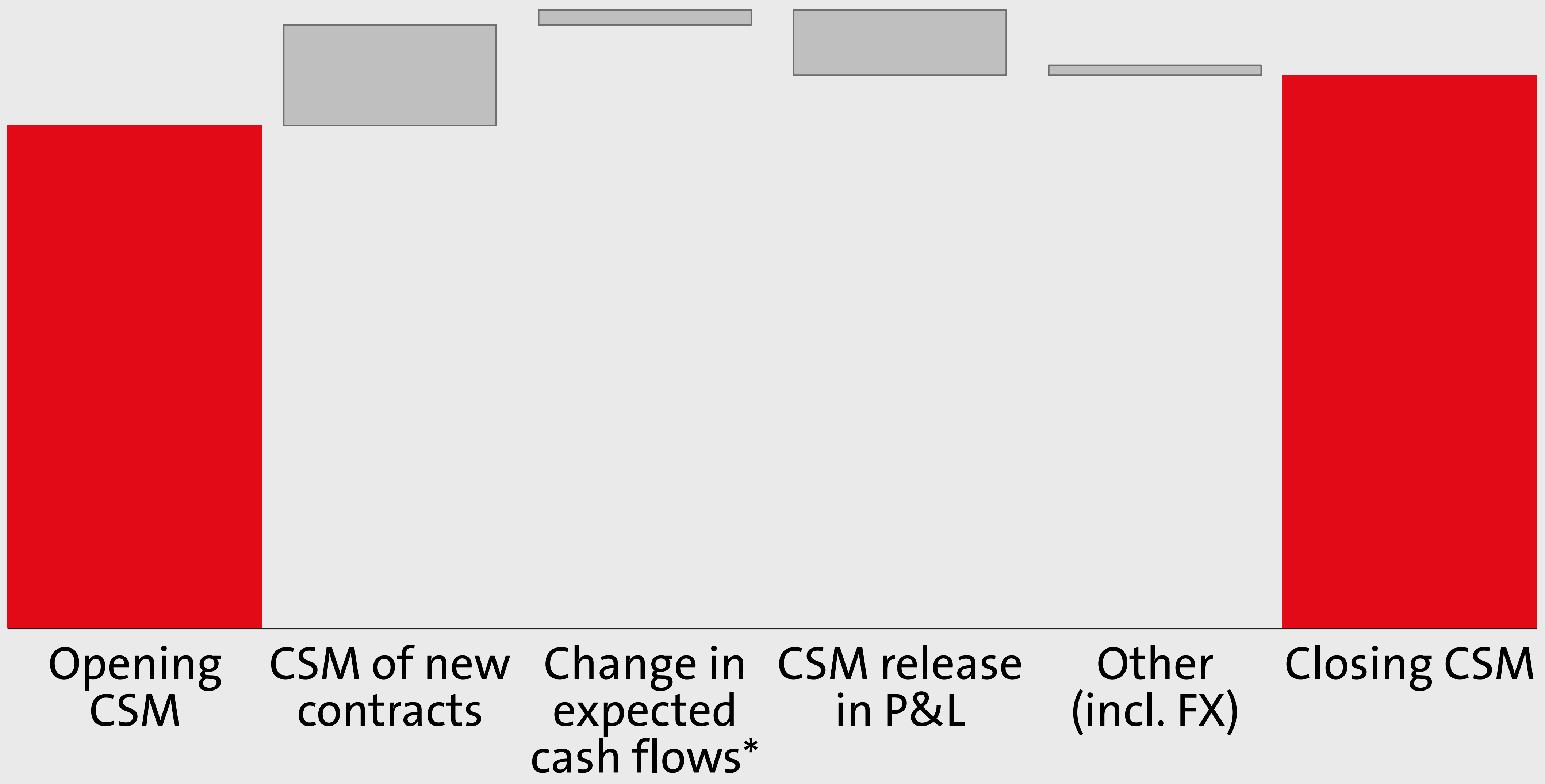
Contractual Service Margin Initial Recognition and Roll-forward

Recognition of new CSM (example)



Cash flows *(premiums received, paid claims, benefits, other expenses, acquisition cash flows)* **are probability weighted current estimates of future cash flows.**

Roll-forward of CSM (example)



Insurance service result reflects changes in insurance liability *(CSM release etc.)* but **presented in P&L as insurance revenue less insurance service expenses.**

* Experience adjustment and changes in technical assumptions

Key Accounting Choices

Accounting choices	Options	
Discount rates (Goal: Better alignment with Solvency II)	**Top-down approach** (portfolio yield less allowance for unexpected losses)	**Bottom-up approach** (risk free rates + liquidity premium)
Changes in discount rates (Goal: Consistent asset & liability approach of OCI option)	**Through P&L** (changes in rates to be recorded „1 for 1 in P&L)	**Through OCI** (changes in rates to be recorded in OCI)
Risk adjustment (Goal: Prudent reserve level)	**No specific method prescribed.** One of options is percentile approach in Primary insurance (e.g., 65% - 75% percentile) & pricing margin approach in reinsurance (non-financial risk loadings in premiums)	
Fair value investments (Goal: Mitigation of P&L volatility)	**Fair value through P&L** (Mark-to-market and realized gains/losses to flow through P&L)	**Fair value through OCI** (Mark-to-market to flow through OCI except for SPPI-fail assets)
Measurement of listed equity investments (Goal: Mitigation of P&L volatility)	**Fair value through P&L** (Mark-to-market and realized gains/losses to flow through P&L)	**Fair value through OCI** (Mark-to-market to flow through OCI with no recycling in P&L)
Transition approach	**Fair value approach or modified retrospective approach where full retrospective not applicable** (e.g., due to lack of detailed yield curve data)	

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***Triglav** is the highest mountain in Slovenia and the highest peak of the Julian Alps (2,864 meters/9,396 ft).*