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GMAC IFRS 17 Technical Webinars:
Portfolios, Groups of Contracts and Mutualization

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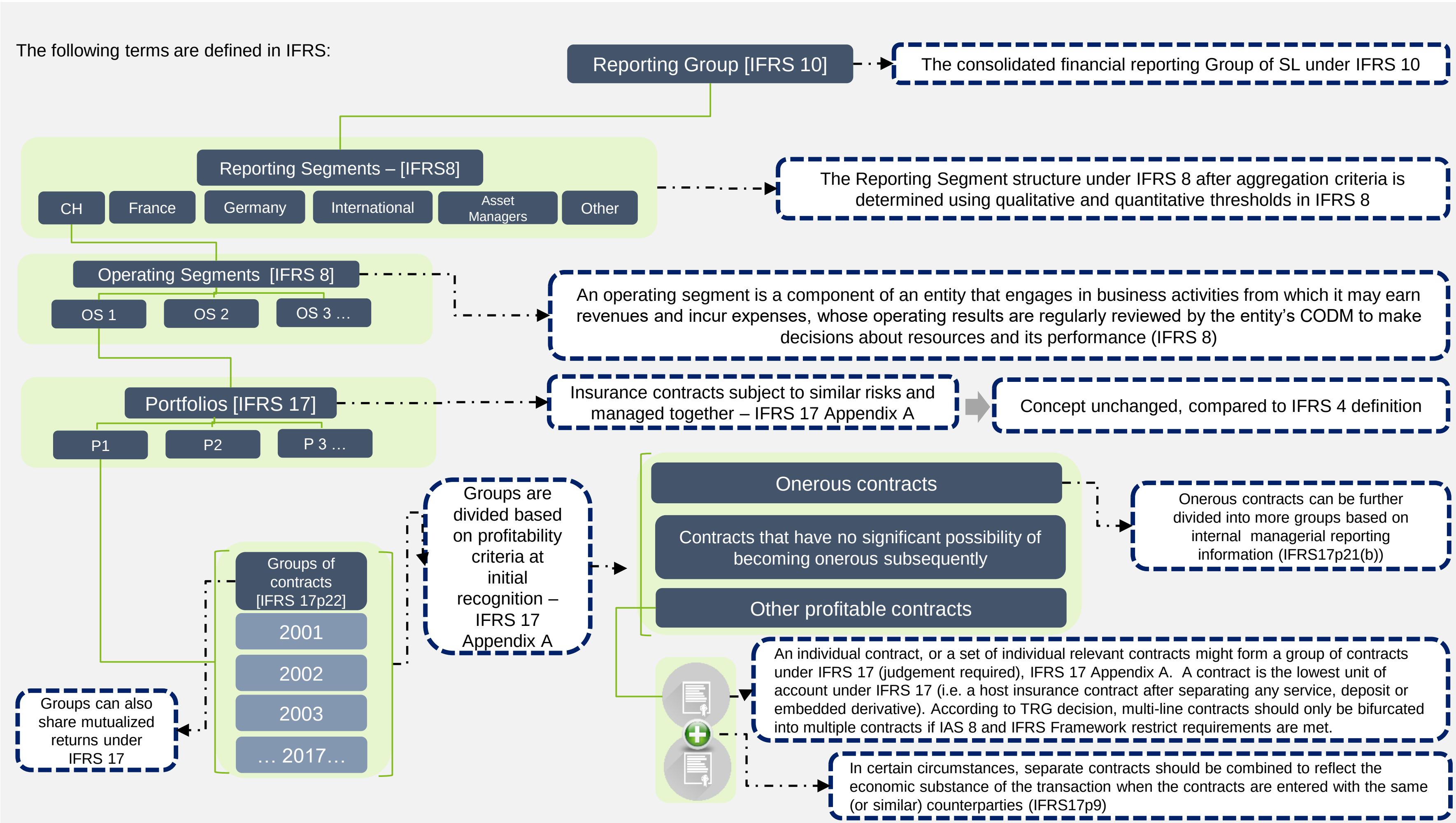
General Concepts and Definitions

IFRS 17

Overview of the Core principles in IFRS 17 and IFRS 8 - Defined Terms



IFRS 17 – Level of aggregation

Accounting to reflect economics

"The requirements for determining the unit of account in IFRS 17 reflect the economic practice of the insurance industry. When insurers apply IFRS 17 in 2021, insurers will account for the contracts with their customers on an aggregated basis rather than on a contract-by-contract basis. (Darrel Scott, IASB member, April 2018)"

When insurers apply IFRS 17 in 2021, they will initially account for loss-making contracts, contracts with low profitability and other profitable contracts in three separate buckets, so that gains on profitable contracts will not obscure losses on other contracts.

Over time gains on some insurance contracts will offset losses on other insurance contracts within the same bucket. However, contracts may not be grouped if they are written more than 12 months apart. As a result, differences in the profitability development of contracts written in different periods will be visible in insurers' financial statements, providing insights that investors do not have today.

IFRS 17

Why does the unit of account in IFRS 17 matter so much?

The unit of account was a controversial issue during the development of IFRS 17 because it affects the timing of recognition of profit for insurance services

Pattern of profitability
It aims to ensure that trends in the profitability of a portfolio of contracts are reflected in the financial statements of insurers in a timely way, by reporting profit when the insurance coverage is provided and losses as soon as it becomes apparent that losses are expected

Cost relief
The unit of account provides cost relief to insurers and a better reflection of the insurance economic practice, by allowing them to group insurance contracts for measurement purposes, based on the characteristics of the contracts and the insurers' approach to managing them

IFRS 17

Overview about Grouping and Unit of Account Principles in IFRS 17

Background

IFRS 4 presents very little guidance in respect to grouping of insurance contracts for measurement and disclosure purposes. In general terms, IFRS 4 discusses grouping criteria for classification of contracts using an approach "by class" and requires a Liability Adequacy Test (LAT) on a "portfolio basis". In IFRS 4, disclosures are generally presented "by class" of contracts. The new guidance in IFRS 17 introduces new **unit of account** concepts for different elements arising from insurance contract assets and liabilities.

IFRS 17 Elements	Level
A- IFRS 17 scope	Contract level
B- Contract modification/derecognition	Contract level
C- Insurance acquisition costs	Portfolio level
D- Contractual Service Margin measurement	Group of contracts
E- Contractual Service Margin "release"	Group of contracts, units of coverage
F- Risk Adjustment	Up to entity-wide (Group)
G- Onerous Contract Test	Group of contracts
H - Mutualisation	Between groups of contracts
I – Reinsurance assets held	Group of contracts, with adaptation from core requirements
J – Combination of contracts	Contracts with same (or related) counterparties might be combined to reflect the commercial substance of the transaction if certain criteria is met
K- OCI Option in IFRS 17 and determination of discount rates	Portfolio level

In IFRS, the unit of account is the level that assets and liabilities should be grouped for measurement purposes in accordance to specific guidance in each IFRS

IFRS 17 introduces different units of account for measurement of the various elements of the component of an insurance contract

IFRS 17 – Level of aggregation

Analysis performed in three stages

Stage 1

Insurance contracts are grouped by risk type and way of management (Portfolio level)

IFRS 17 requires an entity to identify portfolios of contracts subject to similar risks and being managed together. This aggregation of insurance contracts is done when contracts are issued and is not subsequently revised.

Contracts in different business lines are expected to be managed in different ways because the underlying risks are different.

Stage 2

By time of issuance
(one year issuing period)

IFRS 17 requires a portfolio of contracts to be divided into annual 'cohorts' or time buckets. As a result, a group may not include contracts issued more than one year apart. A cohort can however be based on an issuing period that is less than one year.

The role of cohorts is closely related to the release of the CSM to insurance revenue over time.

Stage 3

By degree of profitability of contracts (i.e. onerous, highly profitable and other contracts)

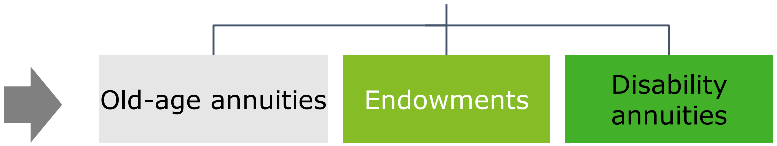
The additional subdivision based on degree of profitability of contracts provides beneficial information for investors based on expectation of future profitability analysed on a more granular level

IFRS 17 – Level of aggregation

Portfolios and groups

Following definitions and criteria are relevant for aggregating contracts:

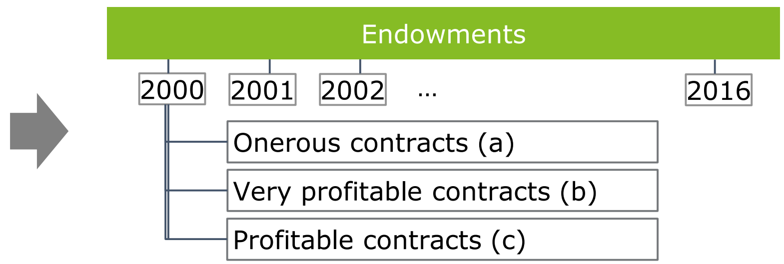
- **Portfolio:**
  §14 An entity should identify portfolios of insurance contracts. A portfolio comprises contracts subject to similar risks and managed together.



- **Groups of contracts:**
  §16 An entity shall divide a portfolio of insurance contracts issued into a minimum of:
  a) A group of contracts that are **onerous at initial recognition**, if any;
  b) A group of contracts that at initial recognition have **no significant possibility of becoming onerous subsequently**, if any; and
  c) A group of the **remaining contracts** in the portfolio, if any.

§22 An entity shall not include contracts issued **more than one year apart** in the same group.

- Introduction of the implicit concept of cohort through §22
- Introduction of the concept of groups



IFRS 17 – Level of aggregation
Portfolios and groups

Where do we use these portfolios and groups:

Portfolios:

- Determine how to group at a high-level contracts by aggregation of similar risks
- Use of the OCI option at portfolio level

Groups:

- Break-down portfolios into smaller units by type of profitability and by “generation” / cohort.
- **Recognition and measurement** of contracts is performed at **group level**, i.e.. the application of the model is at group level.
- Aggregation of the various results at group level into portfolios

Measurement:

- At group level

Disclosure:

- At a **higher level of aggregation than group** in order to have a readable report
- Aggregate information according to IAS 1 and IFRS 8, e.g. by major product lines, geography, reportable segment.
- **Possibly more aggregated than portfolios**

IFRS 17

Why do annual cohorts benefit investors with better information?

The annual cohort requirement in IFRS 17 **aims to prevent perpetual open portfolios** where the duration of each group of contracts is extended by the ongoing underwriting of new policies (insurance contracts).

Perpetual open portfolios cause the profitability of old contracts to be averaged with the, likely different, profitability of new contracts.

Once IFRS 17 is applied, investors will be able to analyse the development of the profitability of contracts written in different years.

Implementing the annual cohort requirement will result in two main benefits in terms of information about insurers' financial performance:

1. A timely recognition of losses
2. The recognition of profit when insurance coverage is provided.

IFRS 17

Example: Group or Individual Contract Level

Example:

An insurer writes three insurance contracts with a coverage period of three years;

Each policyholder pays a single premium of CU10 at inception;

The insurer expects each contract to be subject to a claim of CU3.5 each year until termination of the contract; and

The insurer expects **one contract to be terminated at the end of each year.**

After one year, the insurer knows that Contract A has terminated. Depending on the perspective taken about the unit of account, the profit recognised in the insurer's financial statements in each year may differ.

Amounts in currency units (CU)	Contract A	Contract B	Contract C	Total	Average per contract
Expected term	1 year	2 years	3 years	6 years	2 years
Premiums	10.0	10.0	10.0	30.0	10.0
Claims	(3.5)	(7.0)	(10.5)	(21.0)	(7.0)
Profit or (loss)	6.5	3.0	(0.5)	9.0	3.0

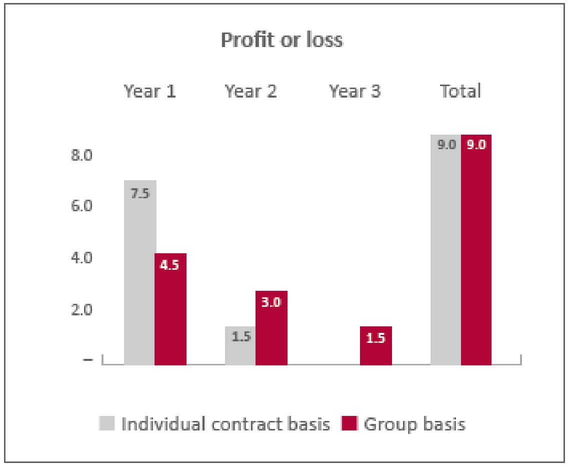
(source, IASB April 2018)

IFRS 17

Example: Group or Individual Contract Level (cont.)

Accounting at a Group Level (better reflection of the economics)
There is a better reflection of the economics of the contracts would be observed. When Contract A has terminated, the group of contracts behaved as expected and there is consequently no change in expectations. The insurer still expects to recognise the total expected profit of CU9 over the duration of the contracts. **This is done in proportion to the coverage provided over the expected duration of the contracts within the group.** By allocating the expected profit in proportion to the coverage years provided for the period, the insurer will recognise CU4.5 of expected profit in Year 1. This is because the proportion of the coverage provided for the period equals half of the expected coverage to be provided for the whole group (three contracts for one year over a total of six coverage years) and half of the expected profit of CU9 is equal to CU4.5. On a group basis, there is no change compared to the expectations after one year. However, on an individual contract basis, there is a change in expectations for all three contracts.

Accounting at an Individual Contract Level (more volatile results)
On an individual contract basis, there is a change in expectations for all three contracts. If the insurer were to account for each individual contract on a separate basis, the average assumption would apply to each contract individually. Thus, when Contract A terminated there would be a change in expectations for all contracts. This is because Contract A has performed better than the average, and Contracts B and C are now expected to perform correspondingly worse than the average.



Note: on individual contract basis, at the end of Year 2 the insurer knows that one contract is onerous; the profit or loss in Year 2 reflects the expected loss on that contract.

Mutualization and Level of Aggregation

IFRS 17 - Mutualization

What does IFRS 17 say about risk sharing?

- IFRS 17 refers to sharing of risks to describe **situations in which the insurance contracts in one group include conditions that affect the cash flows to policyholders in a different group** (IFRS 17, paragraphs B67-B71)
- Risk sharing as referred to in IFRS 17 applies when the contracts that share risks are **in the same or in different units of account or 'groups'**
- **When insurance contracts that share risks are in different units of account or groups, IFRS 17 requires that the cash flow estimates for each group should reflect the expected transfers of cash between groups.**
- This is important for the purposes of identifying onerous contracts and **measurement of CSM.**
- **The Basis for Conclusions to IFRS 17 notes that for contracts that "fully share risks", division into groups would result in the same outcome as using a single portfolio. However, to avoid complexity, IFRS 17 does not provide an exception to the grouping requirements for contracts that fully share risks. In addition, IFRS 17 does not explain exactly what is meant by "fully share risks".**
- IFRS 17's guidance also acknowledges the sharing of cash flows between existing policyholders and future generations of policyholders. Specifically, IFRS 17 explains that, after all the coverage has been provided to the contracts in a group, the fulfilment cash flows may still include payments expected to be made to current policyholders in other groups or future policyholders. IFRS 17 goes on to state that an entity is not required to continue to allocate such fulfilment cash flows to specific groups but can instead recognise and measure a liability for such fulfilment cash flows arising from all groups (IFRS 17, paragraph B71).

IFRS 17 – Mutualization

Core requirements

Contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts

The "core principle"

B67 Some insurance contracts affect the cash flows to policyholders of other contracts by requiring:

(a) the policyholder to share with policyholders of other contracts the returns on the same specified pool of underlying items; and

(b) either:

(i) the policyholder to bear a reduction in their share of the returns on the underlying items because of payments to policyholders of other contracts that share in that pool, including payments arising under guarantees made to policyholders of those other contracts; or

(ii) policyholders of other contracts to bear a reduction in their share of returns on the underlying items because of payments to the policyholder, including payments arising from guarantees made to the policyholder.

There is an "and" condition (risk sharing between policyholders)

IFRS 17 – Mutualization

Core requirements

B68 Sometimes, such contracts will affect the cash flows to policyholders of contracts in other groups. The fulfilment cash flows of each group reflect the extent to which the contracts in the group cause the entity to be affected by expected cash flows, whether to policyholders in that group or to policyholders in another group. Hence the fulfilment cash flows for a group:

(a) include payments arising from the terms of existing contracts to policyholders of contracts in other groups, regardless of whether those payments are expected to be made to current or future policyholders; and

(b) exclude payments to policyholders in the group that, applying (a), have been included in the fulfilment cash flows of another group.

Mutualisation can occur between policyholders in different groups

Covers current and future policyholders

IFRS 17 – Mutualization

Core requirements

B69 For example, to the extent that payments to policyholders in one group are reduced from a share in the returns on underlying items of CU350 to CU250 because of payments of a guaranteed amount to policyholders in another group, the fulfilment cash flows of the first group would include the payments of CU100 (ie would be CU350) and the fulfilment cash flows of the second group would exclude CU100 of the guaranteed amount.

Mutualisation methodology transfers fulfilment cash flows from one group to another group to subsidise financial impacts of movements on underlying items

IFRS 17 – Mutualization

Core requirements

B70 Different practical approaches can be used to determine the fulfilment cash flows of groups of contracts that affect or are affected by cash flows to policyholders of contracts in other groups. In some cases, an entity might be able to identify the change in the underlying items and resulting change in the cash flows only at a higher level of aggregation than the groups. In such cases, the entity shall allocate the effect of the change in the underlying items to each group on a systematic and rational basis.

Different methodologies and practical approaches can be used in mutualization

B71 After all the coverage has been provided to the contracts in a group, the fulfilment cash flows may still include payments expected to be made to current policyholders in other groups or future policyholders. An entity is not required to continue to allocate such fulfilment cash flows to specific groups but can instead recognise and measure a liability for such fulfilment cash flows arising from all groups.

Practical expedient when fulfilment cash flows impact groups of future policyholders

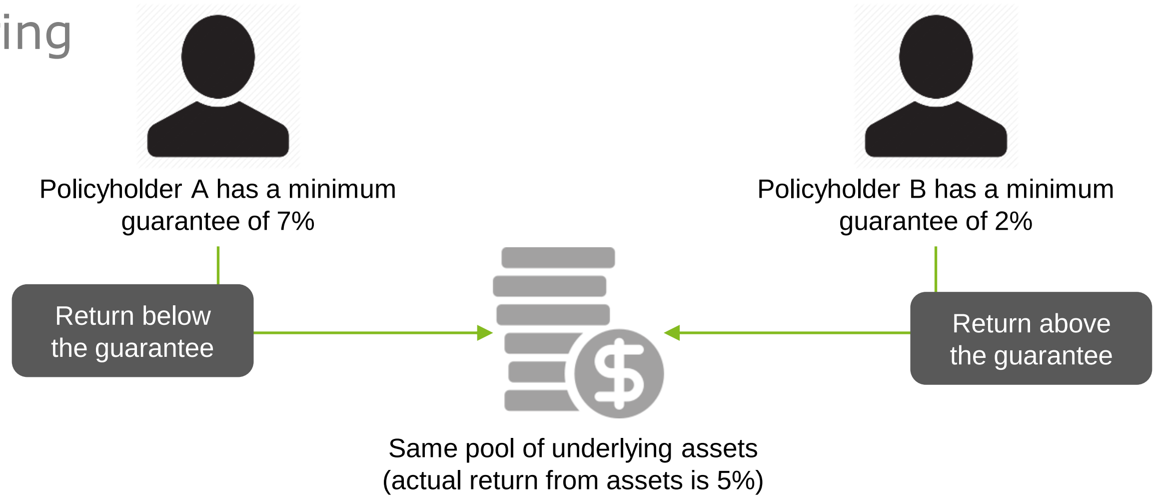
IFRS 17 - Mutualization

IFRS 17 introduces the following principles:

- When cash flows from insurance contracts in one group are affected by the cash flows to policyholders of contracts in a different group, the unlocking of the CSM must take this into account
- Effectively, the presence of these features expands the unit of account for the CSM unlocking to comprise all the groups being mutualised
- Risks shared could be insurance risk (e.g. death occurring), financial risk (e.g. the investments produce insufficient return to pay out the minimum guaranteed return) or expense risk (e.g. costs related to the insurance contract other than those related to the insurance or financial risk).

IFRS 17

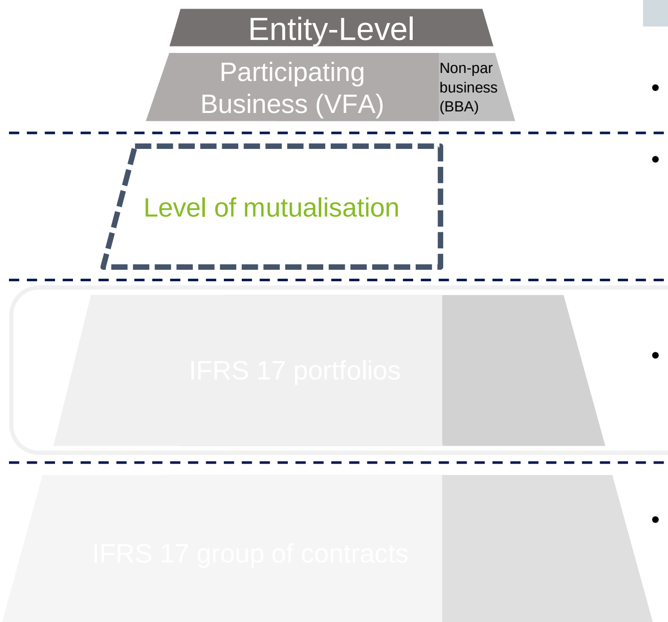
Example – Risk Sharing and Guarantees



- The insurer has issued participating contracts to two policyholders (A and B) that share in the same pool of underlying assets.
- The insurer has discretion on how to share the returns of the underlying assets but is bound by the minimum return guarantee in each individual contract. The terms of the contracts are the same, except that A’s minimum return guarantee is 7% and B’s is 2%. The pay-out of the returns to policyholder A and B are related as explained below.
- Actual return from the underlying items is 5%.
- **For A, the 5% of actual return from the underlying items is less than the minimum return guarantee of 7%. The opposite is true for B.** Based on the contractual terms for both policyholders, A receives 7% (minimum return guarantee), and B receives the residual return of 3% (5% less 2% additional return paid to A). Thus, the amount that in theory could be paid to B (if they participated equally in the returns i.e. 5%) is reduced in order to satisfy the minimum return promised to A, i.e. there is interdependency between the two pay-outs. So, policyholder B misses out on an opportunity gain.
- The insurer does not have to pay the difference between the actual returns and the minimum return guarantee to B. At the insurer’s discretion the “surplus” above the minimum return guarantees (i.e. 1%) could be paid either to A or to B or retained by the insurer.
- However, the insurer would need to pay from other sources of funds where the return from the underlying assets is insufficient to pay the minimum return guarantee to both policyholders. In this case, if the return is less than 4.5%. B would be unable to absorb the additional losses and the insurer would need to step in.

Overview of IFRS 17 granularity levels and portfolio definition

Level of Aggregation – German Business



IFRS 17 requirements and interpretations

- Contracts subject to different measurement approaches might not be included in one portfolio.

- In order to take dependencies in cash flows across IFRS 17 groups of contracts and portfolios into account, the IFRS 17 standard allows the CSM-unlocking to be determined at a higher level of aggregation than the IFRS 17 groups of contracts (level of mutualisation). The level of mutualisation is a calculation level only.

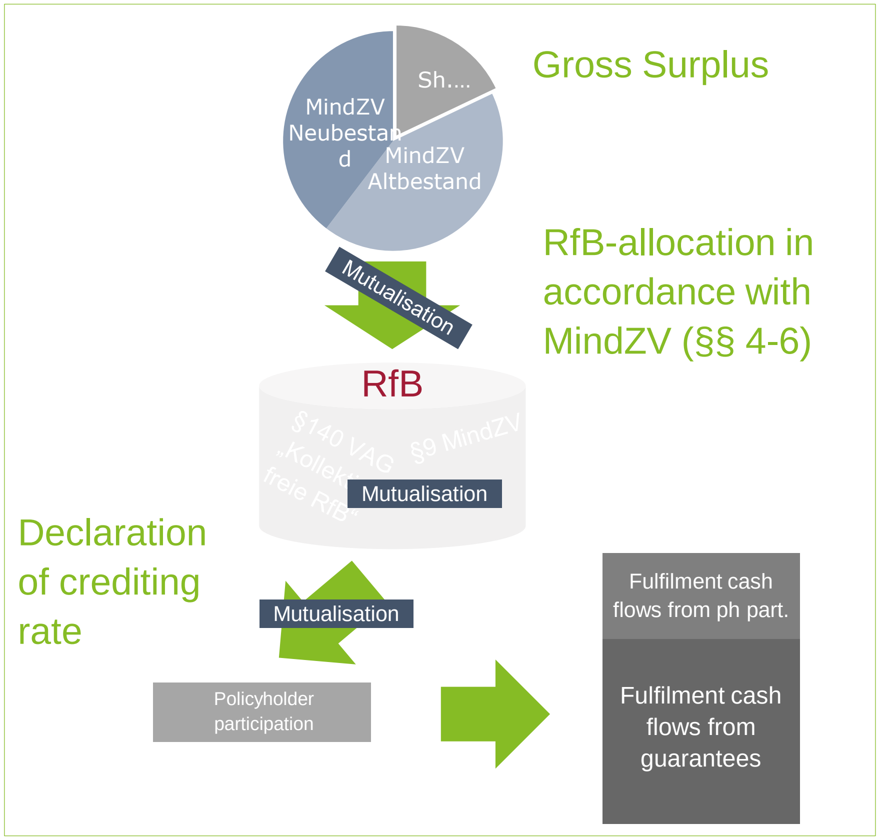
- **Requirement by the IFRS 17 Standard:** An entity shall identify IFRS 17 portfolios of insurance contracts comprising contracts subject to similar risks and managed together.

- **Requirement according to IFRS 17:** Each IFRS 17 portfolio shall be further split in a minimum of three groups of different levels of profitability, contracts issued more than one year apart shall not be included in the same group. Onerousness is determined at group-level.

The definition and composition of IFRS 17 portfolios influences the granularity of stochastic projections, IFRS 17 calculations and the values disclosed in P&L. The principles set by IFRS 17 regarding the level of aggregation allow for multiple definitions and compositions of IFRS 17 portfolios.

Mutualisation

Where does mutualisation apply to contracts?



Occurence

- German Life business with participation features is subject to mutualization.
- Mutualization occurs across IFRS 17 group of contracts and portfolios and at various points within the mechanism of allocating surplus to policyholders.

Similar risks and managed together

Impact of local regulation on IFRS 17 portfolio definition

	General interpretation	Legal basis for German Life business		Impact on IFRS 17 portfolio definition
Managed Together	• Focus on internal steering and reporting as well as portfolio management • Steering, reporting and portfolio management is often driven by law, legislation and regulatory requirements which should be taken into account	§124 - §129 VAG	Asset management with regard to “Sicherungsvermögen”, quarterly reporting to BaFin disaggregated with respect to “Sicherungsvermögen”	• Disaggregation with regard to “Sicherungsvermögen”. • Disaggregation of regulated and deregulated business • Financial risk and option measured with TVOG, so aggregation with regard to financial risk
		MindZV	Separation of regulated and deregulated business with regard to profit sharing	
Similar Risk	• Focus on insured risks within each segment (i.e. biometric risks for Life business) • Grouping of homogeneous risks taking into account local reporting requirements • Separate Profit participation from non-profit participation contacts?	BerVersV (NW 218)	Reporting of analysis of surplus for: Mortality Risk – Term-life Longevity Risk – Annuities and FRV Disability Risk – Pure disability and disability-riders Long-term Risk – Nursing care Dread Disease – Cancer, Alzheimer's, dementia	• Disaggregation of risks in accordance with BerVersV • Consideration of additional risks: Accident Risk; “Heiratsrisiko”; Surrender; Gender; Financial Risk w.r.t. guarantees; Financial Risk w.r.t. UL tariffs; IFRS 17 measurement models

IFRS 17 – Level of aggregation

Issues raised by the industry (EFRAG position Feb 2018)

- Applying the annual cohorts' requirement would require significant changes to systems and increase costs;
- Currently profitability is monitored internally based on a higher level of aggregation than required by IFRS 17;
- Applying IFRS 17 will affect how onerous contracts are identified compared to current practices, and may also affect the pricing of some contracts;
- The splitting of 'mutualised' amounts into groups of contracts is seen as artificial and different from current practices and how the business is managed. It is also seen as complex and costly to implement; and
- Today, some insurers use portfolios for the insurance liability where insurance contracts are added or removed continuously for as long as those insurers consider this useful. The same applies for the underlying assets. The proposed requirements would change current practice of some insurers.

Transition and Level of Aggregation

IFRS 17 – Level of aggregation

Transition relief in IFRS 17

Full Retrospective Approach (FRA)	Modified Retrospective Approach (MRA)	Fair Value Approach (FVA)
No practical expedient available for transition and insurer must comply with all grouping requirements under IFRS 17p22	An entity is permitted to apply a modification to the general requirements only to the extent that it does not have reasonable and supportable information to apply the Full Retrospective Approach (IFRS17C8) An entity can group contracts issued more than one year apart (IFRS 17C10)	The entity has to determine "impracticability level" to use the Fair Value Approach based on reasonable and supportable information (IFRS 17C10). An entity may include in a group contracts issued more than one year apart (IFRS 17C23). Different generations of contracts are only divided (1yr or less) if there is reasonable and supportable information (IFRS 17C23)

IFRS 17 – Level of aggregation

Transition relief in IFRS 17

Transition date

t — ***Impracticability level arises***

Fair Value Approach (FVA)

- Used based on documentation of impracticability criteria
- Different annual generations of contracts **may be grouped if reasonable and supportable information is not available**
- CSM is calculated at transition date as the difference between FV and Fulfilment Cash Flows of the contracts

Modified Retrospective Approach (MRA)

- Model used as a modification to achieve the closest outcome to the Full Retrospective Approach
- Requires retrospective calculation of the CSM based on all information available
- **To the extent of information available entity does not divide groups issued more than one year apart to generate CSM**

Full Retrospective Approach (FRA)

- CSM is fully calculated retrospectively for all groups of contracts
- No transition relief

Transition
Full Retrospective Approach

- Currently in discussion which role plays mutualisation for German Life and Health business
  - The application of different approaches for different groups of contracts might be impractical if mutualization occurs between these groups
  - Mutualisation between groups of contracts needs to be considered if the full retrospective approach is applied
- The application of the full retrospective approach under the variable fee approach would require the identification of the change of the underlying items for all reporting periods before transition

Independently of the availability of historical data and assumptions,
the application of the **full retrospective approach** seems to be rather impracticable
for **German Life and Health business with profit participation**

Level of Aggregation/Unit of Account

Appendix A- Other relevant items covered by IFRS 17

IFRS 17

Contract Modifications and Derecognition

Unit of Account for treatment of Contract Modifications and application of rules of Derecognition for insurance contracts:

Contract Level

Implications:
- To discuss with BUs the existence of relevant options available for policyholders for contracts modifications (i.e. switch options from a UL to non-UL contract, modification in period of coverage, other)
- To discuss if there are controls in place to capture contract modifications
- Discuss relevant modifications that would lead to the application of a different accounting model under IFRS 17

General principle introduced by IFRS 17

The original contract should be derecognised and a new contract should be recognised if certain conditions are met [IFRS 17p72]

Conditions

If the modified terms had been included at contract inception:
- A modification that scopes the contract out of IFRS 17 (i.e. change in level of risk)
- A modification that requires the separation of new components (i.e. unbundling)
- The modification introduces new contract boundary (i.e. extension of duration, renewal options)
- The modified contract should be included in a different group of contracts

A situation where the modification scopes a contract out (or into) the scope of VFA contracts (i.e. the policyholder hold a switching option from a UL to a non-UL contract)

If as a result of the modification, SL would have to apply the GMM and leave the PAA model.

Note: If the modification meets none of the conditions above, the change should be reflected in the estimation of fulfilment cash flows and not as a derecognition of the original contract

IFRS 17

Insurance Acquisition Costs

Unit of Account for allocation of Insurance Acquisition Costs under IFRS 17

Portfolio Level, with subsequent reasonable allocation to Groups of Contracts using consistent and systematic basis in order to generate the CSM

Implications:

- To obtain, for each BU, a list of all insurance acquisition costs, including fixed and variable overheads. To discuss if f MCEV methodology can be used as an accelerator to identify and measure such costs under IFRS 17
- To discuss with BUs the definition of portfolio in the context or directly attributable costs to fulfilment cash flows
- The criteria that will be used to allocate these costs to group level for CSM measurement by each BU
- The accounting policy choice for origination costs when the PAA model is used

IFRS 4 permits the use of previous accounting practice for capitalization and amortisation of Deferred Acquisition Costs (DAC). Before IFRS 17, these costs were disclosed as an intangible asset under IAS 38 and measured under IFRS 4, in the context of the Liability Adequacy Test. SL uses the US GAAP Codification for capitalisation of origination costs, as its previous GAAP, as permitted by IFRS 4.

IFRS 17 introduces the new concept of not recognising the DAC as an asset of the entity, but instead, recognising origination costs which are directly attributable to a portfolio (including fixed and variable overheads) as part of the fulfilment cash flows of the group of contracts when the GMM is used or as a reduction of the Liability for Remaining Coverage (LRC) if the PAA Model is used. Alternatively, if PAA Model is used, SL can expense these costs immediately, when incurred, as a practical expedient (depending on its accounting policy choice under IFRS 17).

If PAA Model is used	If GMM is used
• Acquisition costs can be expensed immediately as incurred, provided the coverage period of each contract in the group is less than 1 year [IFRS 17p59-b]; **or** • Recognise the insurance acquisition costs as a reduction of the Liability for Remaining Coverage (LRC), with subsequent amortisation	Insurance acquisition costs which are directly attributable to a portfolio of contracts are included in the fulfilment cash flows

Notes:

- If acquisition costs are incurred before the contract meets the initial recognition criteria in IFRS 17, the cost is deferred as an asset until the contract is recognised. To discuss with BUs if there are transactions that would fall in this situation. SL currently applies the guidance under **SFAS 120** and **SFAS 97** and **SFAS 60** under US GAAP for measurement of insurance acquisition costs, according to *Section 6 of the SL Corporate Accounting and Reporting Manual*
- The TRG addressed in paper 4 of the meeting held on the 6th of Feb 2018 situations regarding allocation of costs that are part of newly issued business during the year and allocation of costs for future contracts. In this meeting, the TRG also clarified that when the entity uses the FV Approach for transition, only the expectation of future, and not past costs, would be taken in to consideration in the determination of the cash flows in the IFRS 13 methodology.

IFRS 17

Risk Adjustment

Unit of Account for RA

Up to entity-wide and further allocated to Groups of Insurance Contracts

Implications:

- SL has to determine the level of diversification benefits that will be taken into account
- Different levels of RA might arise for entities reporting standalone individual financial statements under IFRS (consider diversification level up to the perimeter of financial reporting of each entity)
- Methodology for RA calculation should be determined for each BU

IFRS 17 introduces the following principles for RA:

- The RA includes only the adjustment for non-financial risk
- Shall not reflect risks that do not arise from insurance contracts, such as operational risk
- The discount rate that is used for discounting shall not include any implicit adjustment for non-financial risk
- The RA is remeasured at each reporting period
- Effects of diversification between portfolios is allowed; both favourable and unfavourable outcomes in a way that reflects the entity's degree of risk aversion
- No technique specified in IFRS 17, but translation into Confidence Level required (should be disclosed)
- Solvency II risk margin approach could be leveraged

Type of changes		Impact
Changes in the RA that relate to past and current services	→	In P&L as entity is "released from risk"
Changes in the RA that relate to future service	→	Unlock CSM

IFRS 17

Reinsurance Contracts Held

Unit of Account for Reinsurance Contracts Held

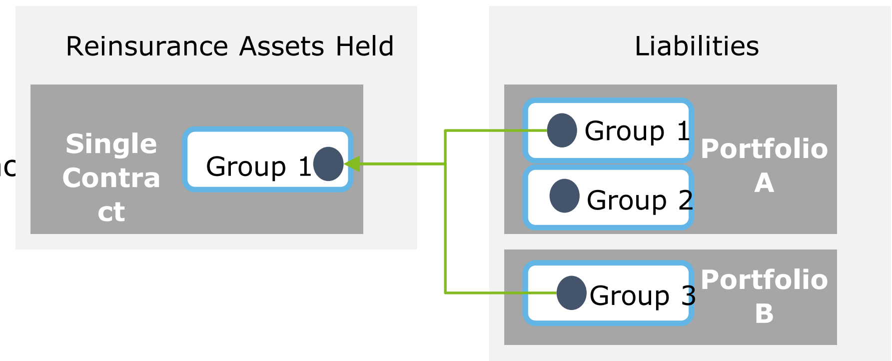
Groups of Contracts, with adaptations from core requirements in IFRS 17

Implications:

- BUs will have to determine grouping criteria for reinsurance contracts held considering adaptations to the core requirements used to group the underlying insurance contract liabilities in IFRS 17
- To discuss materiality level for grouping

- The core requirements in IFRS 17 for grouping of contracts arising from reinsurance contracts held are modified in a way that applying the grouping requirements in IFRS 17p14-21 will result **in a group that comprises a single contract [IFRS17p60-61]**

Example, risks of separate groups in contract liabilities are reinsured and repackaged into a single group of contrac



Note:

- The TRG also discussed the Boundaries of Contracts of Reinsurance Contracts held on the meeting of the 6th of February. The TRG agreed with the staff observation on that meeting that the boundary of a reinsurance contract held could include cash flows from underlying contracts covered by the reinsurance contract that are expected to be issued in the future. The contract is the lowest unit of account in IFRS 17 and consequently all the principles of IFRS 17 should be applied to each single contract, including reinsurance contracts held. It was further clarified that while there is a special concession for proportional reinsurance contracts in IFRS 17p62, it applies only as far as the initial recognition is concerned and measurement follows the general principle applicable to all contracts in IFRS 17.
- The TRG also observed that for reinsurance contracts held, the inclusion of fulfilment cash flows from expected future underlying reinsured insurance contracts affects the CSM, but does not necessarily result in an entity having an asset or a liability when the group of reinsurance contract held is initially measured. However, the unlocking of the CSM in the group of reinsurance contracts held and the different discount rate used for calculating the unlocking adjustments compared to the discount rate utilised to measure the changes in future cash flows will create an asset or a liability in subsequent measurement of the group of reinsurance contracts held.

IFRS 17
Combination of Contracts

Unit of Account for Combination of Contracts

Contracts with same (or related) counterparties might be combined to reflect the commercial substance of the transaction if certain criteria is met

Implications:
- Analysis of policyholder loans (including mortgage contracts) negotiated in combination with life insurance policies. To confirm if policyholder can benefit from the loan even if it can cancel or lapse the life insurance policy.
- Interpretation of the principles of combination of contracts for Captive Arrangements
- Any other complex arrangements/contracts, to be discussed with the BUs

The guidance in IFRS for combination of contracts:

- IFRS 17 improved the previous guidance in IFRS 4 for combination of insurance contracts
- IFRS 4 guidance in Appendix B, Footnote 7, only described that for classification purposes, contracts entered into simultaneously with a single counterparty (or contracts that are otherwise interdependent) would form a single contract.
- IFRS 17p9 states that a series of insurance contract with the same (or related counterparty) may achieve, or be designed to achieve, an overall commercial effect. In order to report the substance of such contracts, it may be necessary to treat the set or series of contracts as a whole.
- In practice, if the rights and obligations in one contract do nothing other than entirely negate the rights and obligations in the other contract entered into at the same time with the same counterparty, the combined effect is that no rights or obligations exist.

IFRS 17

OCI Option in IFRS 17 and determination of discount rates

Unit of Account for the election of the OCI Option and determination of discount rates

Portfolio Level

Implications:

- The determination of the number of portfolios for each BU is an important step in order to develop the methodology for SL in respect to the extent of the use of the OCI option and discount rates for each portfolio
- Key accounting decisions will also depend on the IFRS 9 classification work conducted for SL and definition of BM + SPPI tests

The guidance in IFRS 17 and 9:

- IFRS 17 requires an entity to **make an accounting policy choice portfolio-by-portfolio** of whether to recognise all insurance finance income or expenses for the reporting period in profit or loss or to recognise some of that income or expenses in other comprehensive income, commonly known as the use of the OCI Option (IFRS 17 IN6)
- IFRS 9 requires the analysis of the business model of the entity using the concept of **"pools of assets"** which are managed in a way to "hold-to-collect" and/or "sell the assets" in the future. Only assets that pass SPPI tests in IFRS 9 and has a business model of both holding and selling the financial assets in the future can be classified in the FVTOCI category, providing ground for SL to eliminate volatility in profit or loss and design a strategy to use the OCI option available in IFRS 17
- IFRS 17 does not specify restrictions on the reference portfolio of assets to determine the discount rates. However, fewer adjustments would be required to eliminate factors that are not relevant to the insurance contracts when the reference portfolio of assets has similar characteristics.

Practical Questions

IFRS 17 – Level of aggregation

Practical questions

- How to define the **number of portfolios** for all Business Units (based on criteria of contracts managed together and with similar risks)?
- To which extent the **impracticability criteria** will impact the grouping of contracts for transition (i.e. use of the Modified Retrospective Approach or Fair Value Approach)?
- **How many portfolios** (or groups of contracts) will be impacted by the mutualization principles?
- Definition of the **current tools in place to capture complex transactions or arrangements** that would trigger the application of the requirements of “combination of contracts” or further disaggregation (or subdivisions or groups of contracts)
- What is the methodology that will be used to **define the level of profitability expected in portfolios** for grouping (onerous, highly profitable, other profitable groups)?

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