



Application of IFRS 17 in Korea

Technical Session

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※ The views expressed in this presentation are those of the presenters. Official positions of the KASB on accounting matters are determined only after extensive due process and deliberation.

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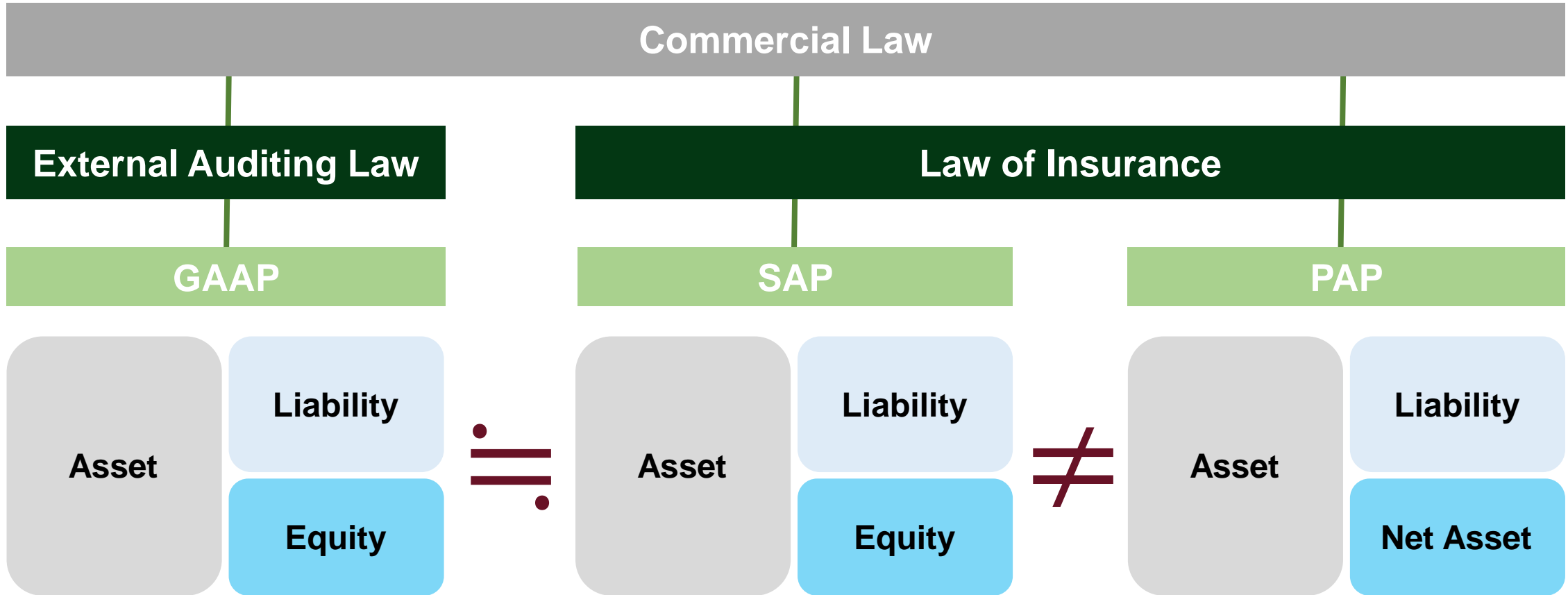
1. SAP

2. Practical interpretation issues

1. SAP



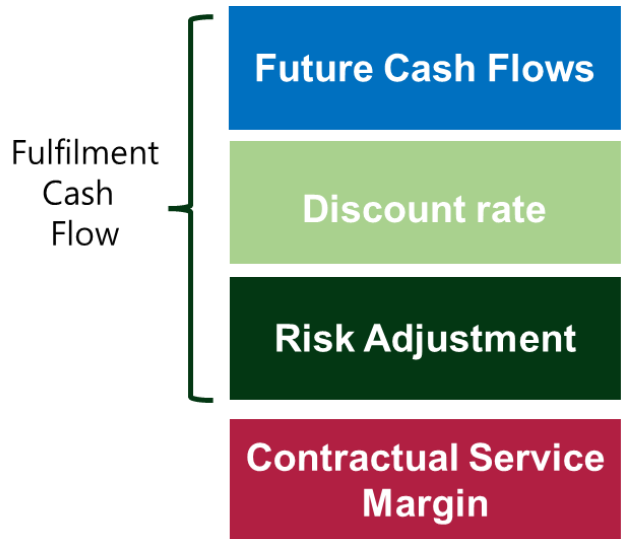
1. SAP vs GAAP : Classification of insurance accounting



2. SAP vs GAAP : Comparison of Insurance liabilities by accounting

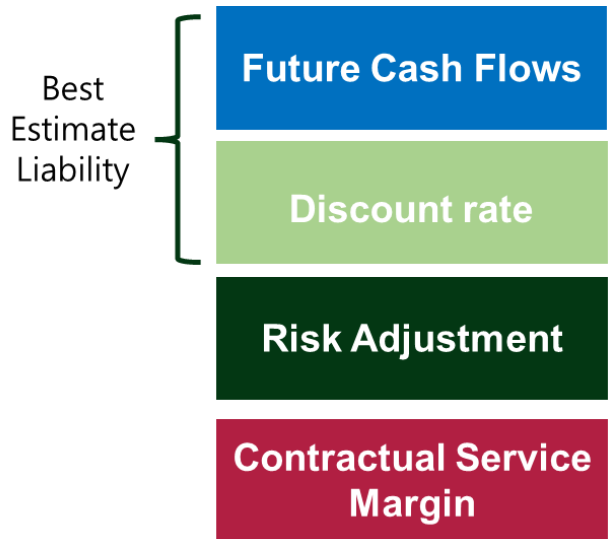
GAAP (IFRS 17)

Providing information for economic decision-making **by stakeholders such as investors and creditors**



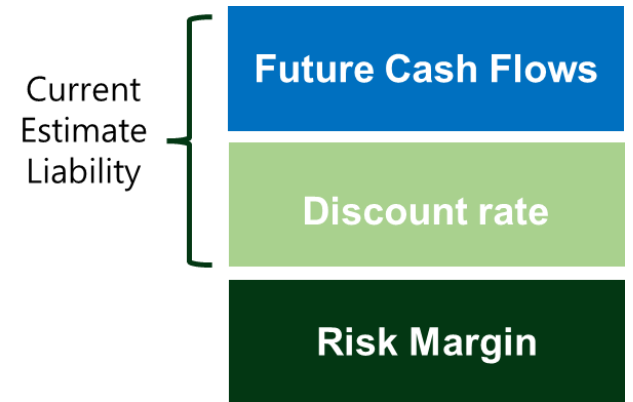
SAP

Providing information for supervisory purposes such as **maintaining financial soundness and protecting policyholders**



PAP (K-ICS)

Providing information based on **the calculation of the risk-based capital ratio**



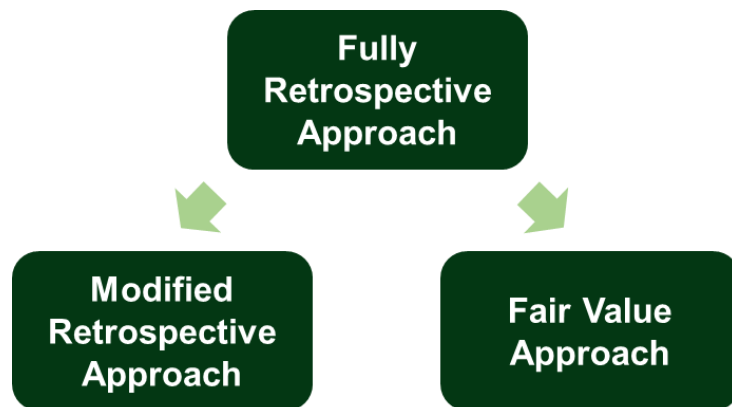
2. SAP vs GAAP : Comparison of Insurance liabilities by accounting

	GAAP (IFRS 17)	SAP	K-ICS
Scope to be applied	<ul style="list-style-type: none"> Insurance contract Significant insurance risk transfer (not quantity basis) 	<ul style="list-style-type: none"> Insurance contract Transference of significant insurance risk (Additional benefits ratio more than 10%) 	<ul style="list-style-type: none"> Insurance products Including investment contract
Future Cash Flows	<ul style="list-style-type: none"> Including cash in and out about fulfilment cash flow for insurance contract Excluding indirect expenses 	<ul style="list-style-type: none"> Prescribing calculation rules about actuarial assumptions such as lapse rates, expense and mortality rates, etc 	<ul style="list-style-type: none"> All cash flows regarding to insurance contract Including indirect expenses Separating policy loan as an asset
Discount rate	<ul style="list-style-type: none"> Adjusting time value of cash flow considering period, currency and liquidity of insurance contract 	<ul style="list-style-type: none"> Same methodology as K-ICS RF + Liquidity premium X 100% 	<ul style="list-style-type: none"> Presenting risk-free interest rate term structure (last liquidity point, long-term forward interest rate) RF + Liquidity premium X 80%
Contractual Service Margin	<ul style="list-style-type: none"> Unrealized profit from providing future insurance contract service Recognizing insurance revenue by amortizing CSM (reflecting amount and duration of insurance services) 	<ul style="list-style-type: none"> Unrealized profit from providing future insurance contract service Prescribing specific amortization rule for insurance revenue recognition 	<ul style="list-style-type: none"> Inherently included in available capital (no limitation)

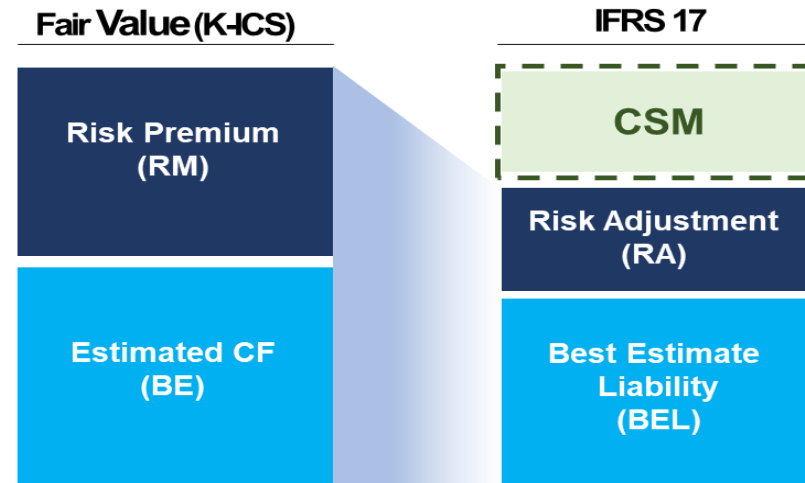
3. Guidance on transition

- For insurance contracts held at the transition date, Insurers **may choose either retrospective approach or fair value approach**, if the former is impracticable.
 - ✓ Insurers shall apply IFRS17 **retrospectively unless impracticable**.
 - ✓ **Fully retrospective approach** results into **valuation** that would have been made by IFRS17 **at the date of inception or initial recognition**.
 - ✓ **Modified retrospective approach** leads to **the closest outcome** to fully retrospective approach.
 - ✓ In the fair value approach, CSM = **Fair value of liability** – fulfilment cash flows

Accounting at the transition date



Fair Value Approach



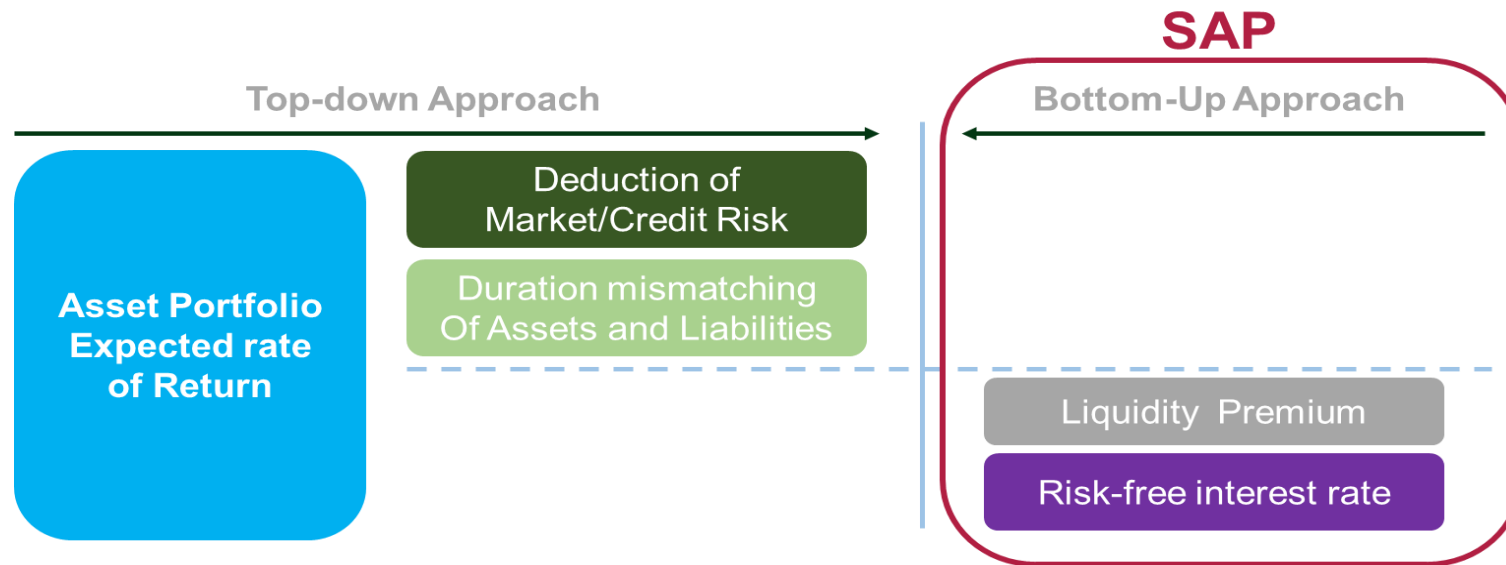
3. Guidance on transition

- For the contracts **issued 3~5 years before** the transition date (2017~2021), insurers shall apply the **retrospective approach (fully or modified)**.
 - ✓ However, if insurers' executive committee **decide to apply the fair value approach** for the above contract and **disclose the fact**, they may use the fair value approach.
- For the ones except for above, insurers shall use **the fair value approach**
 - ✓ **Fair value of insurance liability** for transition accounting **shall apply K-ICS insurance liability** with some amendments.

4. Guidance on discount rate : Bottom-up approach

- Discount rate = **Risk-free interest rate + Liquidity premium**
- **Why LP ?** → **The Treasury bond market** is a deep and liquid market that allows trading without significant transaction costs, while Insurance Contract Liabilities **are generally not traded** but **surrender penalty amount** deducted when the contracts are cancelled

< Comparison between two approaches >





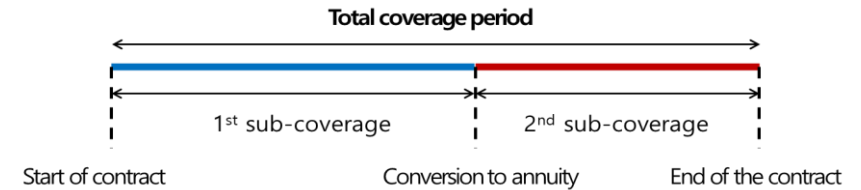
2. Practical interpretations issues



2.1. Application of VFA to a Variable Annuity Insurance Contract

Background (1/2)

- An entity issues a variable annuity insurance contract with 2 parts of sub-coverage periods and in each sub-period this contract has different characteristics



- (1st sub-coverage period) direct participating features, premiums from policyholders managed as a fund(special account), qualified for VFA
- (2nd sub-coverage) indirect participating features, managed as general account, a crediting rate^(*1) is applied to the policyholder's accumulated reserves, not qualified for VFA^(*2)

(*1) This crediting rate is determined by the insurer's discretionary adjustment to the announced benchmark rate. The announced benchmark rate is calculated as a weighted average of external indicative interest rates and the insurer's return on assets under management

(*2) No clearly-identified underlying items in 2nd sub-coverage period

- (Total coverage period) this contract meets the 3 conditions for VFA despite no qualification for VFA in the 2nd sub-coverage
- (If issued separately) 1st sub-coverage : VFA model, 2nd sub-coverage : general measurement model would be applied

2.1. Application of VFA to a Variable Annuity Insurance Contract

Background (2/2)

- The crediting rate corresponds to policyholder's share (determined by insurer's discretion)
= announced benchmark rate x adjustment ratio (insurer's discretion)
- Insurer's variable fee = announced benchmark rate – the crediting rate = insurer's share of the announced benchmark rate



IFRS 17 paragraph B101 and BC245

B101 Insurance contracts with direct participation features are insurance contracts that are substantially investment-related service contracts under which an entity promises an investment return based on underlying items. Hence, they are defined as insurance contracts for which:

(a) the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items (see paragraphs B105–B106);

...

BC245 ... The Board also decided that all the following conditions need to be met:

(a) the contract specifies a determinable fee. For this to be the case, the contract needs to specify that the policyholder participates in a share of a clearly identified pool of underlying items. Without a determinable fee, which can be expressed as a percentage of portfolio returns or portfolio asset values rather than only as a monetary amount, the share of returns on the underlying items the entity retains would be entirely at the discretion of the entity, and, in the Board's view, this would not be consistent with that amount being equivalent to a fee.

2.1. Application of VFA to a Variable Annuity Insurance Contract

Question

- How to account for the **changes in the fulfilment cash flows related to the announced benchmark rate** in the **second sub-coverage period**?

View 1

- Recognize as insurance finance income or expense in accordance with B104(a) and B111
- Even if the policyholder does not participate in a share of a 'clearly identified underlying item' as required by B101(a) because the variable fee for the investment-related service is not determinable, the announced benchmark rate meets the definition of an underlying item

View 2

- Adjust CSM in accordance with B104(b)(ii), B113 and B114
- In the second sub-coverage period, the fulfilment cash flows related to the announced benchmark rate do not meet the condition in the paragraph B101(a) of IFRS 17. Therefore, there is no clearly identifiable pool of underlying items

2.1. Application of VFA to a Variable Annuity Insurance Contract

Analysis & Conclusion



The changes in fulfilment cash flows related to announced benchmark rate in the second sub-coverage period shall adjust CSM (View 2)

- It is evident that all ‘underlying items’ terms in requirements for VFA(B101~B118) mean ‘clearly identified pool of underlying items’
- Announced benchmark rate is not ‘clearly identified pool of underlying items’ due to discretion of insurer in determining both insurer’s share and policyholder’s share
- Cash flows related to the benchmark rate is fulfilment cash flows that do not vary based on the returns on underlying items (clearly identified pool of underlying items)
- Therefore, the changes in the fulfilment cash flows should adjust the contractual service margin based on the paragraph B104(b)(ii), B113 and B114

2.1. Application of VFA to a Variable Annuity Insurance Contract

Referenced paragraphs in IFRS 17 (1/2)

IFRS 17 paragraph B104 and B111

B104 The conditions in paragraph B101 ensure that insurance contracts with direct participation features are contracts under which the entity's obligation to the policyholder is the net of:

- (a) the obligation to pay the policyholder an amount equal to the fair value of the underlying items; and
- (b) a variable fee (see paragraphs B110–B118) that the entity will deduct from (a) in exchange for the future service provided by the insurance contract, comprising:
 - (i) the amount of the entity's share of the fair value of the underlying items; less
 - (ii) fulfilment cash flows that do not vary based on the returns on underlying items

B111 Changes in the obligation to pay the policyholder an amount equal to the fair value of the underlying items (paragraph B104(a)) do not relate to future service and do not adjust the contractual service margin.

2.1. Application of VFA to a Variable Annuity Insurance Contract

Referenced paragraphs in IFRS 17 (2/2)



IFRS 17 paragraph B113 and B114

B113 Changes in the fulfilment cash flows that do not vary based on the returns on underlying items (paragraph B104(b)(ii)) comprise:

- (a) changes in the fulfilment cash flows other than those specified in (b). An entity shall apply paragraphs B96–B97, consistent with insurance contracts without direct participation features, to determine to what extent they relate to future service and, applying paragraph 45(c), adjust the contractual service margin. All the adjustments are measured using current discount rates.
- (b) the change in the effect of the time value of money and financial risks not arising from the underlying items; for example, the effect of financial guarantees. These relate to future service and, applying paragraph 45(c), adjust the contractual service margin, except to the extent that paragraph B115 applies.

B114 An entity is not required to identify the adjustments to the contractual service margin required by paragraphs B112 and B113 separately. Instead, a combined amount may be determined for some or all of the adjustments

2.2. Accounting for Changes in Risk Adjustment for Non-Financial Risk

Background

In accordance with paragraph B96(d) of IFRS 17, an entity can choose not to disaggregate the change in the risk adjustment for non-financial risk between **(i) a change related to non-financial risk** and **(ii) the effect of the time value of money and changes in the time value of money** and adjust **(i) and (ii)** in the contractual service margin (CSM).

Based on the paragraph B96(d), many insurers account for all changes in the risk adjustment for non-financial risk in the CSM.

2.2. Accounting for Changes in Risk Adjustment for Non-Financial Risk

Question

If an entity chooses not to disaggregate the change in the risk adjustment for non-financial risk in accordance with paragraph B96(d), **how to account for the effect of a change in the discount rate related to the risk adjustment?**

The effect of a change in discount rate as required by B97(a)(iii), means the effects of the difference between the current discount rate at the beginning of the period and the current discount rate at the end of the period. According to the paragraph B97(a)(iii), it is not adjusted in the CSM because it is not related to future service.

View 1 : Profit or Loss

- The effect of a change in the discount rate could occur even if there is no pure change in RA for non-financial risk. It corresponds to the change in financial risk and not included in the effect of the time value of money. → Apply B97(a)(iii)

View 2 : CSM

- The effect of a change in discount rate in B97(a)(iii) is included in the effect of the time value of money and its changes as per B96(d). At the entity's discretion, it is not required to separately disaggregate and recognize in P&L.

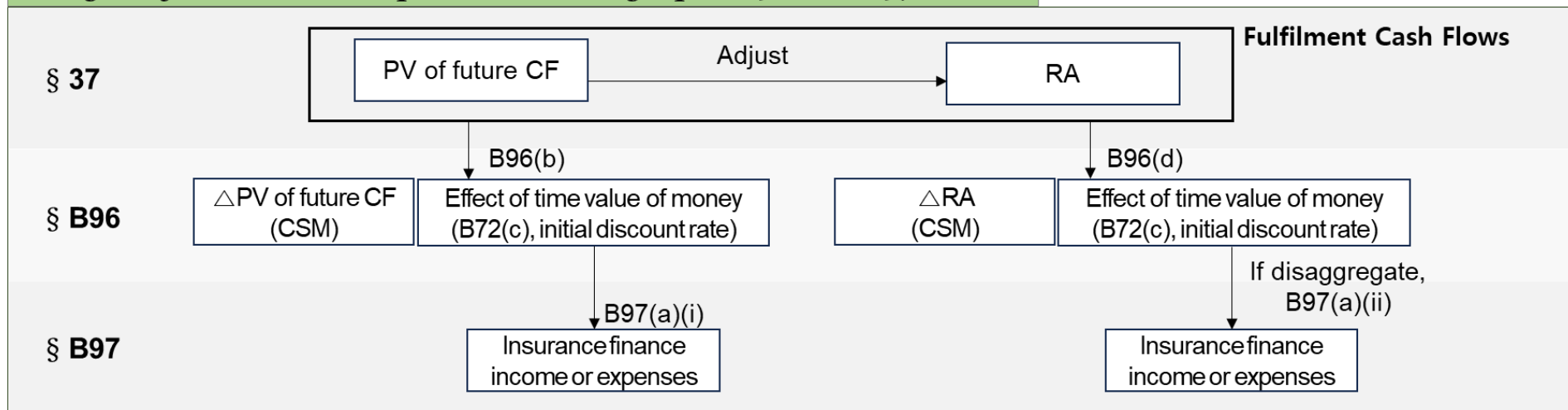
2.2. Accounting for Changes in Risk Adjustment for Non-Financial Risk

Analysis & Conclusion

 (View 2) Contractual Service Margin (April 2019 IASB Staff Paper AP 2E)

- 8. Paragraph B96(d) of IFRS 17 does not address the treatment of changes caused by the time value of money and financial risk if they are disaggregated...
- 10. The model in IFRS 17 has clear requirements for the treatment of changes in the time value of money and financial risk. The staff recommendation in Agenda Paper 2D simply explicitly extends those requirements(B97) to such changes that have been disaggregated from the risk adjustment for non-financial risk...

Analysis of the Relationship Between Paragraphs B96 and B97



2.2. Accounting for Changes in Risk Adjustment for Non-Financial Risk

Comments of IASB Staff

“ If an entity does not disaggregate the risk adjustment for non-financial risk, it is then not required to apply the requirements regarding the effects of changes in discount rates outlined in paragraph B97(a)(iii). ”



(View 2)
Contractual Service Margin(CSM)

The IASB Staff clarifies that:

- When the changes in the risk adjustment for non-financial risk are not disaggregated into 'changes related to non-financial risk' and 'the effect of the time value of money and its changes' (paragraph 81), these changes should be adjusted in the contractual service margin (paragraph B96(d)).
- 'The effect on the risk adjustment for non-financial risk'(paragraph B97(a)(ii)) includes 'the effect of changes in discount rate'(paragraph B97(a)(iii)). That is, 'the effect on the risk adjustment for non-financial risk in B97(a)(ii) is the same as the effect of the time value of money and its changes' in B96(d).



IFRS 17 paragraphs 81, B96(d) and B97(a)(iii)

2.3. Assessing 'Surrender Value' as an Investment Component Under IFRS 17

Background

An insurer pays a certain amount (hereafter referred to as 'Surrender Value') to a policyholder on termination of the contract.

* The contract consists of insurance component and investment component, with the investment component not being clearly identifiable and therefore not separated from the insurance contract in accordance with § 11 of IFRS 17

The insurer recognizes surrender value as an investment component, by:

- excluding the amount from insurance revenue and insurance service expenses (§ 85)
- adjusting CSM for the difference between the amount expected and the actual amount (§ B96(c))

2.3. Assessing 'Surrender Value' as an Investment Component Under IFRS 17

Question

Does the 'Surrender Value' meet the **definition of an investment component** in accordance with IFRS 17?

Analysis & Conclusion



Investment component is the amount that represents the accumulation in the account balance of insurance premiums paid by policyholder, similar to deposits in a savings account.

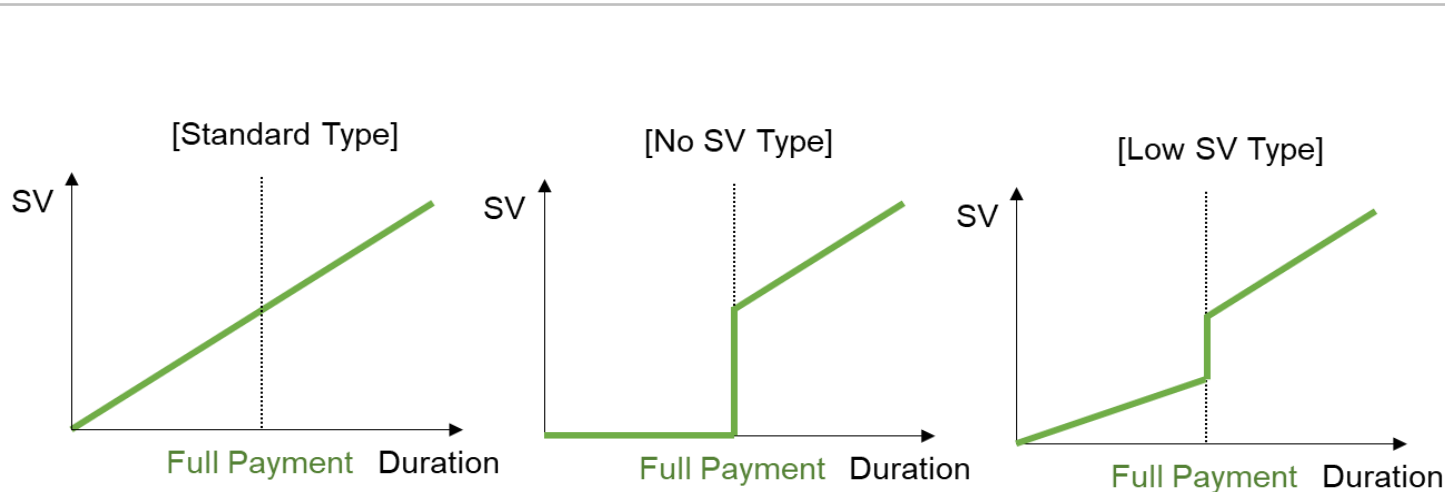
(Definition) Investment component is defined as the amount that an insurance contract requires the entity to repay to a policyholder in all circumstances, regardless of whether an insured event occurs.

(BC34) IASB decided on the definition to faithfully represent the fact that the policyholder receives the amount accumulated in the account balance through deposits in all circumstances, including in the event of the policyholder's death.

IFRS 17 does not provide specific guidance on the measurement method for the investment component; therefore, entities are required to determine the amount of investment component by applying the principles outlined in IFRS 17.

2.3. Assessing 'Surrender Value' as an Investment Component Under IFRS 17

- Policies with lower premiums but no or low surrender value if policyholders terminate before full payment



* SV: surrender value

Before full payment: Surrender value $\rightarrow 0$
 After full payment : Surrender value(including additional bonus) > 0

- Payment period is short. (e.g. 5, 7 yrs)
- Premiums are 10–40% lower than those of standard type products.
- An additional bonus is offered if the policy is maintained until a certain milestone (e.g., 5 or 10 years)
- For a 7-year policy contract, the Surrender Value Ratio* is approximately 98% upon full payment and 130% at the 10-year mark.

* Surrender Value Ratio
 = $\text{surrender value} / \text{premium} * 100$

An accounting issue arises when insurance companies fund additional benefits beyond policyholders' premiums using corporate resources without recognizing the related expenses.

2.4. Treatment for the differences between the expected and actual claims

Background

- One entity raises the question of how to account for ‘the subsequent changes in fulfillment cash flows’ (see chart) including how to recognize the profit or loss related to this specific case, when there is a difference between the expected and actual(paid) claims.
- Illustrative Example:

Fulfillment Cash Flow Schedule						
Year	1	2	3	4	5	Total
CF (t=0) ^(*)	100	100	100	100	100	500
CF (t=1)	300 (paid claims)	-	-	100 (expected amount)	100 (expected amount)	500

(*) Initial Recognition Amount (expected to be paid)

2.4. Treatment for the differences between the expected and actual claims

Question #1

- Should “actual(paid) claims ” be considered a provision of insurance contract services, and therefore be considered insurance revenue?

Analysis & Conclusion

- The contracts subject to IFRS 17 are beyond the scope for IFRS 15. Thus, the argument that IFRS 15 should be applied in accordance with IFRS 17 paragraph B123 would not be valid.
- Insurance revenue from insurance contracts is subject to IFRS 17, and an entity shall recognize insurance revenue as the reduction in the liability for the remaining coverage.
- Furthermore, an entity’s insurance service to policyholders is not the payment of claims, but rather “ standing ready “ to meet valid claims (see TRG May 2018.) Thus, “ actual(paid) claims “ should not be recognized as a service provided, and we conclude that there is no room to recognize insurance revenue.

2.4. Treatment for the differences between the expected and actual claims

Question #2

- Should “ subsequent changes in fulfillment cashflows resulting from experience adjustments ” be considered insurance revenue as well?

Analysis & Conclusion

- Experience adjustments arise from differences between the “ expected claims “, and “ actual(paid) claims. This results in a change in the estimates of future cash flows, which adjusts the “ CSM “ in accordance with IFRS 17 paragraph B96(a).
- “ Insurance service expenses ” referenced in IFRS 17 paragraph B124(a) is more likely referring to the “ insurance service expenses ” expected to be incurred in a certain period. Thus, there is no concrete evidence for the argument that “ a change in the estimates of future cash flow resulting from experience adjustments “ should be recognized as insurance revenue.

2.5. Unit of Account and Revenue Recognition Method in Applying PAA

Background

Applying Premium Allocation Approach (PAA), some insurers measure insurance liabilities on a contract basis and aggregate individual contract's revenue to recognise the amount of revenue for the group of insurance contracts.

- Premiums are recognised as revenue by aggregating the amount of each contract.
- For the contracts that are surrendered before maturity, the remaining premiums, net of surrender values, are calculated on a contract basis, and recognised as sum.

2.5. Unit of Account and Revenue Recognition Method in Applying PAA

Question

What is the appropriate unit of account and revenue recognition method when applying PAA to measure insurance contract liabilities and recognise insurance revenue?

View 1 : Group of contracts

- Insurance revenue and liabilities are recognized based on a group of insurance contracts with revenue recognized based on (1) the passage of time or (2) expected timing of incurred insurance service expenses (*)

(*) In case that the expected pattern of release of risk during the coverage period differs significantly from the passage of time.

View 2 : individual contracts

- Insurance revenue and liabilities are recognized based on individual contracts aggregating the results to recognise insurance revenue and liabilities for the group of insurance contracts.
- If there is no material difference between the liabilities measured individually and those measured for the group, revenue shall be recognized on a "passage of time" basis.

2.5. Unit of Account and Revenue Recognition Method in Applying PAA

Analysis & Conclusion



(View 1) When an entity applies PAA, unit of accounting is a group, and insurance revenue for the period is the amount of expected premium receipts allocated to the period. (§ B126)

(Unit of accounting) IFRS 17 clarifies that the unit of account for recognition and measurement is a group of contracts. The principle applies to both GM and PAA, without exception. (§ B24)

(Rationale) Due to a fundamental aspect of much insurance activity, which involves issuing a large number of similar contracts to reduce the risk, the level of aggregation is an important factor in the representation of an entity's financial performance. (§ BC51)

(Differences in accounting outcomes) Accounting result depends on the level of aggregation, because amounts that would offset each other within the measurement of a group of insurance contracts would be treated differently—and hence not offset each other—if contracts were measured individually. (§ BC115)

2.5. Unit of Account and Revenue Recognition Method in Applying PAA

- (Illustrative Example) Accounting outcomes may vary based on the level of aggregation.
- Key Assumptions:

	Contract A	Contract B
Coverage period	• 3 yrs	• 3 yrs
Premiums	• 1,500	• 1,500
Claims actually incurred	<ul style="list-style-type: none"> • Year 1: 300 • Year 2: 300 • Year 3: 300 	<ul style="list-style-type: none"> • Year 1: 400 • Year 2: 700 • Year 3: 700

- The group of insurance contracts is eligible for applying PAA in accordance with § 53(b)
- Premiums are received in full at initial recognition, and insurance revenue is recognized over time in accordance with § B126(a)
- To simplify the discussion, it is assumed that there are no lapses or surrenders of contracts and that expected cash flows will be consistent with actual cash flows
- Investment components are presumed to be nil

① Profit or Loss(P&L) on a Group Basis

	Year 1	Year 2	Year 3
Insurance revenue ^(*1)	1,000	1,000	1,000
Insurance expense ^(*2)	700	1,000	1,000
Insurance service P & L	300	-	-

(*1) 3,000(sum of premiums) * 1/3(based on passage of time)

(*2) Sum of claims actually incurred

2.5. Unit of Account and Revenue Recognition Method in Applying PAA

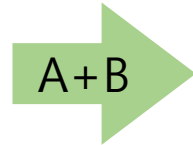
Contract A	Year 1	Year 2	Year 3
Insurance revenue ^(*1)	500	500	500
Insurance expense ^(*2)	300	300	300
Insurance service P&L	200	200	200

(*1) 1,500(premium) * 1/3(based on passage of time)
 (*2) Claims actually incurred

Contract B (Onerous)	Year 1	Year 2	Year 3
Insurance revenue ^(*1)	600	600	600
Insurance expense ^(*2)	700	700	700
Insurance service P&L	(100)	(100)	(100)

※ (Initial recognition) Cash 1,500 / Insurance Liability 1,500
 Insurance expense 300 / Insurance Liability(Loss) 300

(*1) $1,500 * 1/3 + 300(\text{onerous component}) * 1/3 = 500 + 100 = 600$
 (*2) Claims actually incurred
 A loss of 300 is recognized in addition to 700 in Year 1.



② P&L on a Contract Basis

Sum	Year 1	Year 2	Year 3
Insurance revenue	1,100	1,100	1,100
Insurance expense	1,000	1,000	1,000
Insurance service P & L	100	100	100

<P&L for the period>

	Year 1	Year 2	Year 3
① Group Basis	300	-	-
② Contract Basis	100	100	100
Difference	200	(100)	(100)

Thank you very much for listening!
Any Questions?



THANK YOU

