Application of IFRS 17 in Korea

Non-Life Insurance

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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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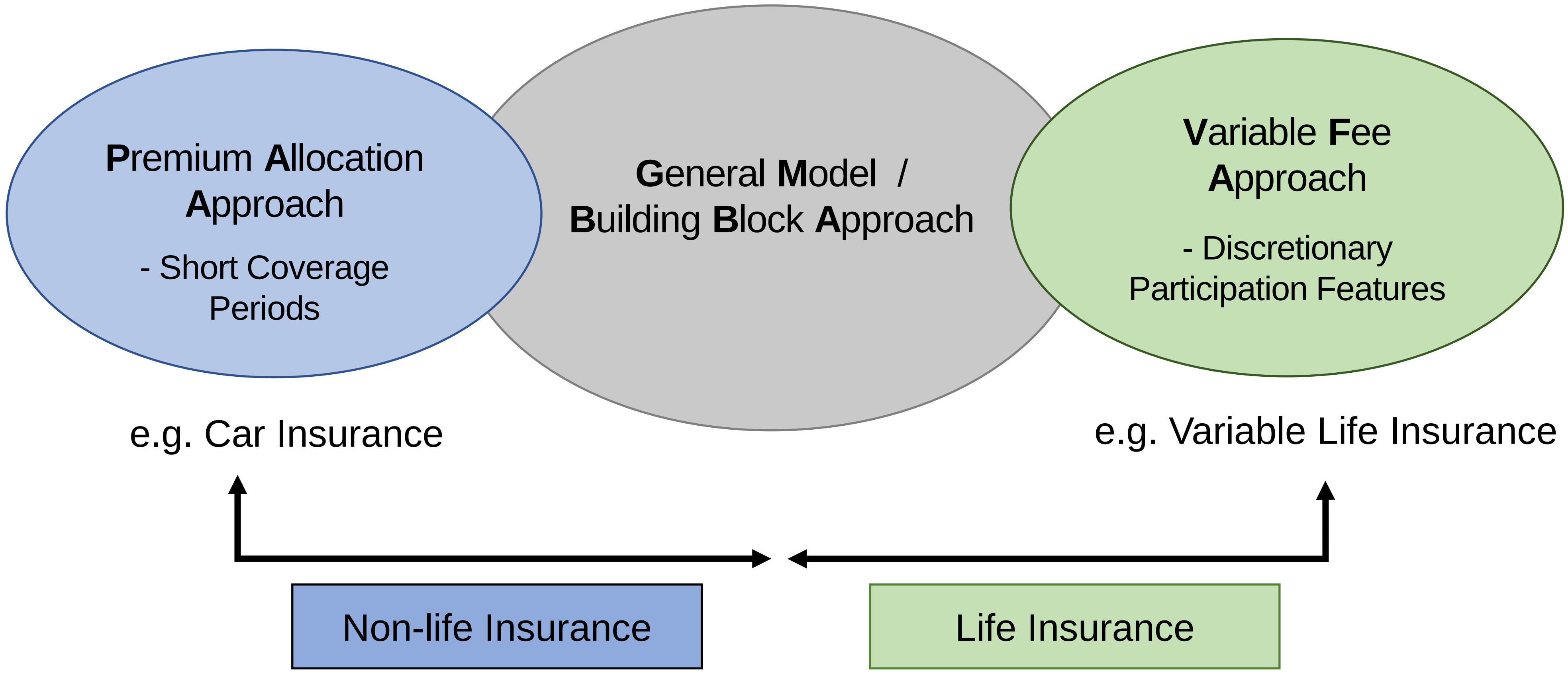
1. Overview
of PAA Requirements in IFRS 17

01 Overview of PAA in IFRS 17

- There are three measurement approaches under IFRS 17 for different types of insurance contract.



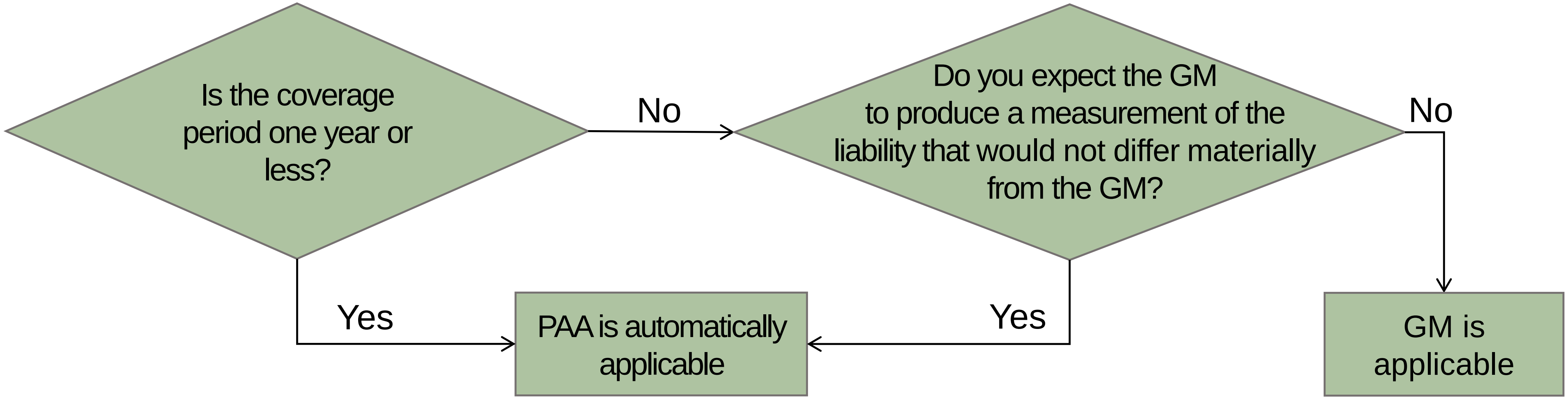
1.1. GM vs. PAA

	GM(or BBA)	PAA
LRC Liability for Remaining Coverage	**Contractual Service Margin** **Risk Adjustment** **Discouting** **Future Cash Flows**	**Premium Unearned (less acquisition costs)**
LIC Liability for Incurred Claims	**Risk Adjustment** **Discounting** **Future Cash Flows**	**Risk Adjustment** **Discounting** **Future Cash Flows**

Under PAA, LRC is initially recognised as the premiums received less insurance acquisition cash flows, with no requirement under IFRS 17 to disaggregate into components.
LIC is measured on the same basis as under GM.

1.2 PAA Eligibility

- IFRS 17 allows insurers to use PAA as a simpler method subject to eligibility



IFRS 17 paragraph 53, BC291

…To simplify its application, the Board also decided to provide guidance that <u>an entity could assume, without further investigation, that the approach provides a reasonable approximation of the general requirements of IFRS 17 if the coverage period of each contract in the group is one year or less. (§ BC291)</u>

1.2. PAA Eligibility

- Determining reasonable approximation
  - ‘Reasonable approximation’ means that applying PAA should produce a liability measurement that would not differ materially from the one applying GM
  - The ‘Reasonable approximation’ criterion is not met if the entity expects significant variability in the fulfilment cash flows before claims are incurred.
  - Variability in estimates increases, for example, with:
    - The extent of future cash flows relating to embedded derivatives in the contract
    - The length of the coverage period

IFRS 17 paragraphs 53(a) and 54

01 Overview of PAA in IFRS 17

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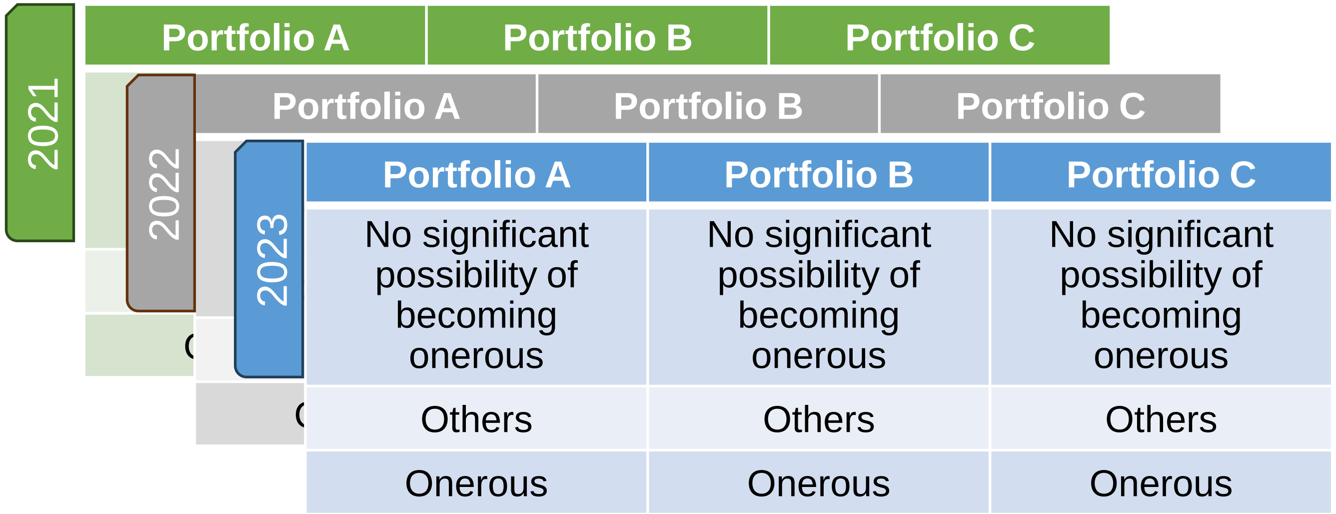
1.3 Level of Aggregation



Portfolio	A portfolio comprises contracts subject to similar risks and managed together.
Group	For contracts issued to which an entity applies PAA, an entity shall assume no contracts in the portfolio are onerous at initial recognition, unless facts and circumstances indicate otherwise.
Cohort	Groups cannot include contracts issued more than one year apart. A cohort can be based on an reporting period that is less than one year. An entity is permitted to divide portfolios into more groups than required above.

1.3 Level of Aggregation

- Portfolios identified in accordance with the「Regulation on Supervision of Insurance Business」

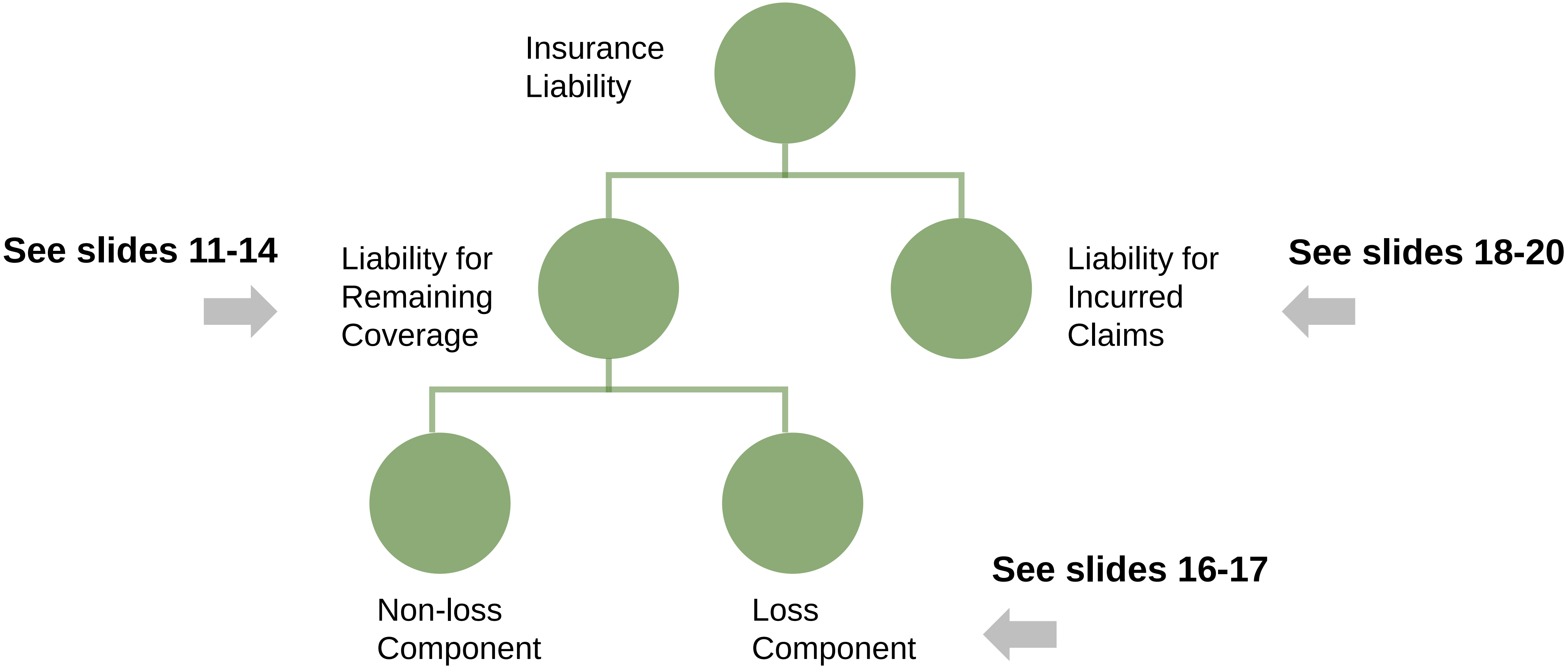
General Non-life Insurance	Fire, Comprehensive, Marine, Worker's Compensation, Liability, Personal Accident, Technology, Guarantee, Car, Others, Overseas
Long-term Non-life Insurance	Personal Accident, Disease, Property, Pension/Savings, Others

- Case: Accounting Model Decision by Business Line

Business Line	Portfolio	Accounting Model
General Insurance (Other than car)	Fire, Marine, Guarantee, Special Risk Insurance(*), Others, Overseas	PAA
Car Insurance	Car	PAA
Long-term Insurance	Pension/Savings, Others	GM

(*) Covers a variety of risks; including liability, personal accident, technology insurance, etc.

1.4. Measurement: Liability for Remaining Coverage



1.4. Measurement: Liability for Remaining Coverage

- Initial Recognition

Liability for remaining coverage	=	Premium received	−	Insurance acquisition cash flows (Practical expedient)	−/+	Insurance acquisition cash flows recognized as asset or liability

- Premium received
  - Actual premium received, not expected premium (TRG, February 2018)
- Insurance acquisition cash flows
  - Cash flows arising from the costs of selling, underwriting and starting a group of insurance contracts
  - Deferred by deducting liabilities on initial recognition, and recognized as an expense applying the methods of systematic allocation
- Insurance acquisition cash flows recognized as assets or liabilities
  - Any other asset or liability previously recognised for cash flows related to the group of contracts

1.4. Measurement: Liability for Remaining Coverage

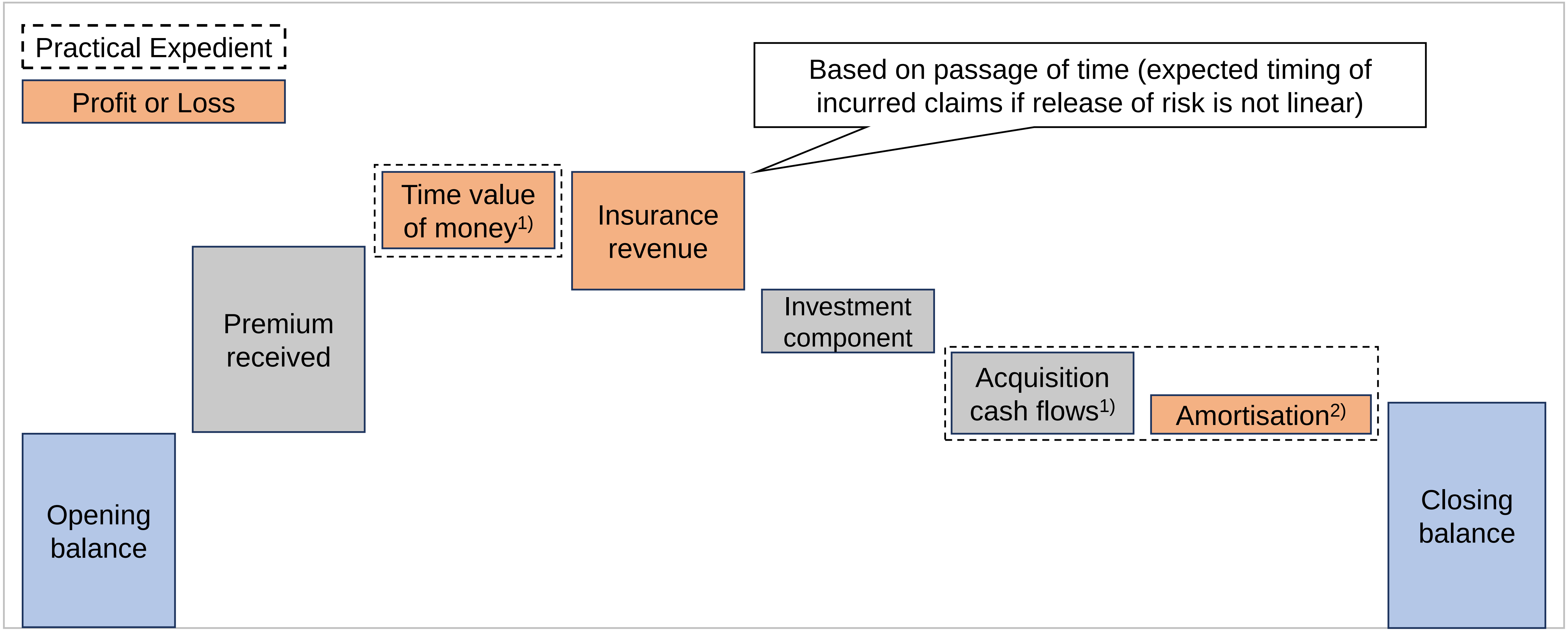
- Subsequent Measurement

Liability for remaining coverage = Opening balance + Premium received + Adjustment to a financing component [1)] − Insurance revenue

− Investment component paid or transferred to the liability for incurred claims − Insurance acquisition cash flows [2)] + Amortisation of insurance acquisition cash flows [2)]

1) If contracts have a significant financing component & an entity chooses to reflect the time value of money applying § 56
2) Unless the entity chooses to recognize the payments as an expense applying § 59 (a)

1.4. Measurement: Liability for Remaining Coverage



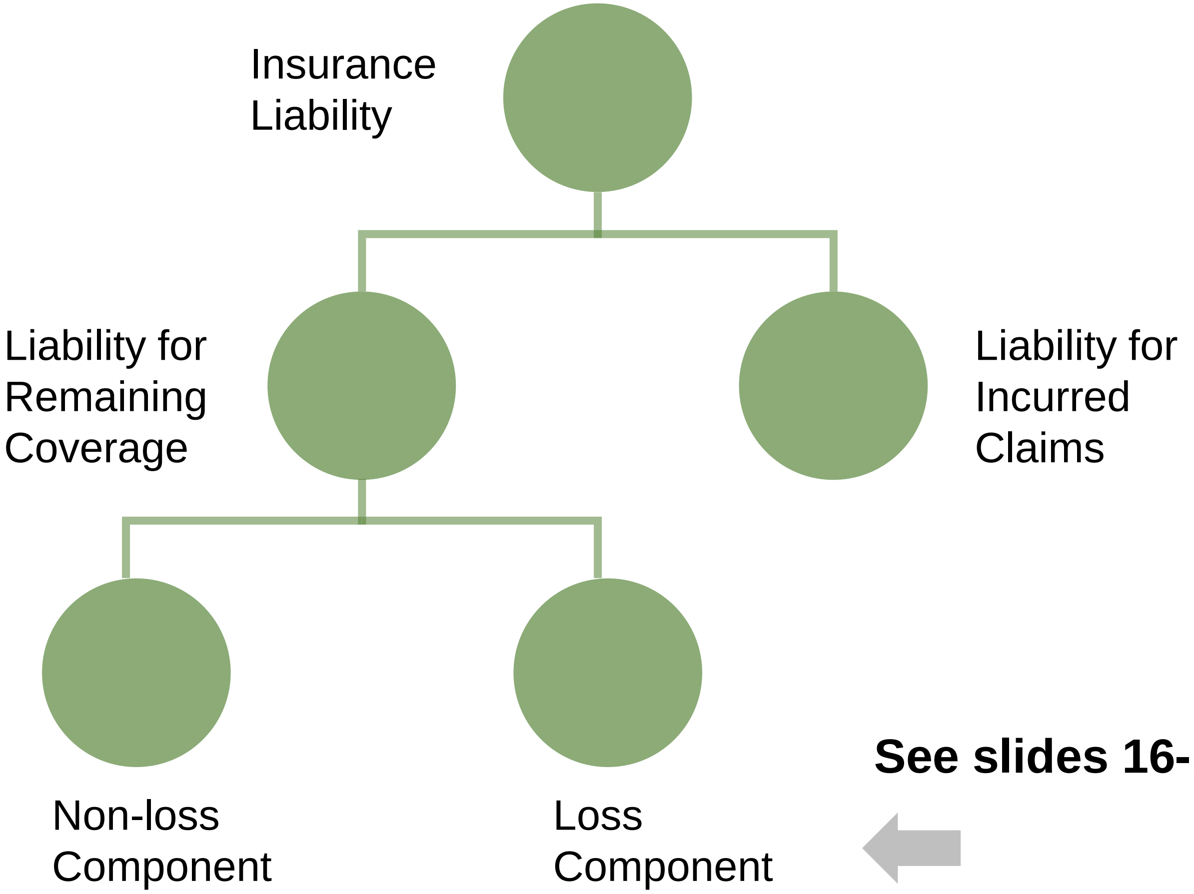
1.4. Measurement: Liability for Remaining Coverage

- Premium Allocation Approach: Simplified approach
  - Simpler than the general model requirements because there is no need to calculate blocks and update estimates made at initial recognition
- Premium Allocation Approach: Practical expedients

Time value of money	If insurance contracts have a significant financing component, an entity reflect the time value of money and the effect of financial risk. An entity may choose not to accrete interest if the coverage period is no more than one year. (§ 56)
Insurance acquisition cash flows	An entity may choose to recognise any insurance acquisition cash flows as expenses when it incurs If coverage period is no more than one year (§ 59)

IFRS 17 paragraphs 55, 56, 59, BC289, BC292, BC293 and appendix A definitions

1.5. Measurement: Onerous Contracts



See slides 16-17

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1.5 Measurement: Onerous Contracts

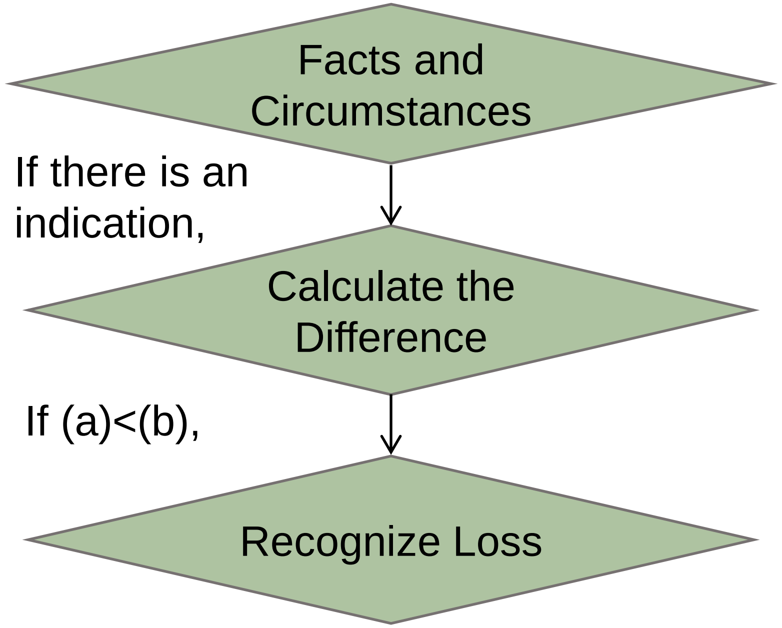
- (1st step) Entity identifies portfolios of contracts
  - Insurance contracts subject to similar risks and managed together, e.g. based on product lines

Portfolio 1	Portfolio 2	Portfolio 3
Pet insurance	Worker's compensation	Car insurance

- (2nd step) Entity divides each portfolio of contracts into groups
  - Groups not reassessed after inception

Group A	Contacts that at inception have no significant possibility of becoming onerous
Group B	Other contracts
Group C	Onerous contracts

1.5. Measurement: Onerous Contracts



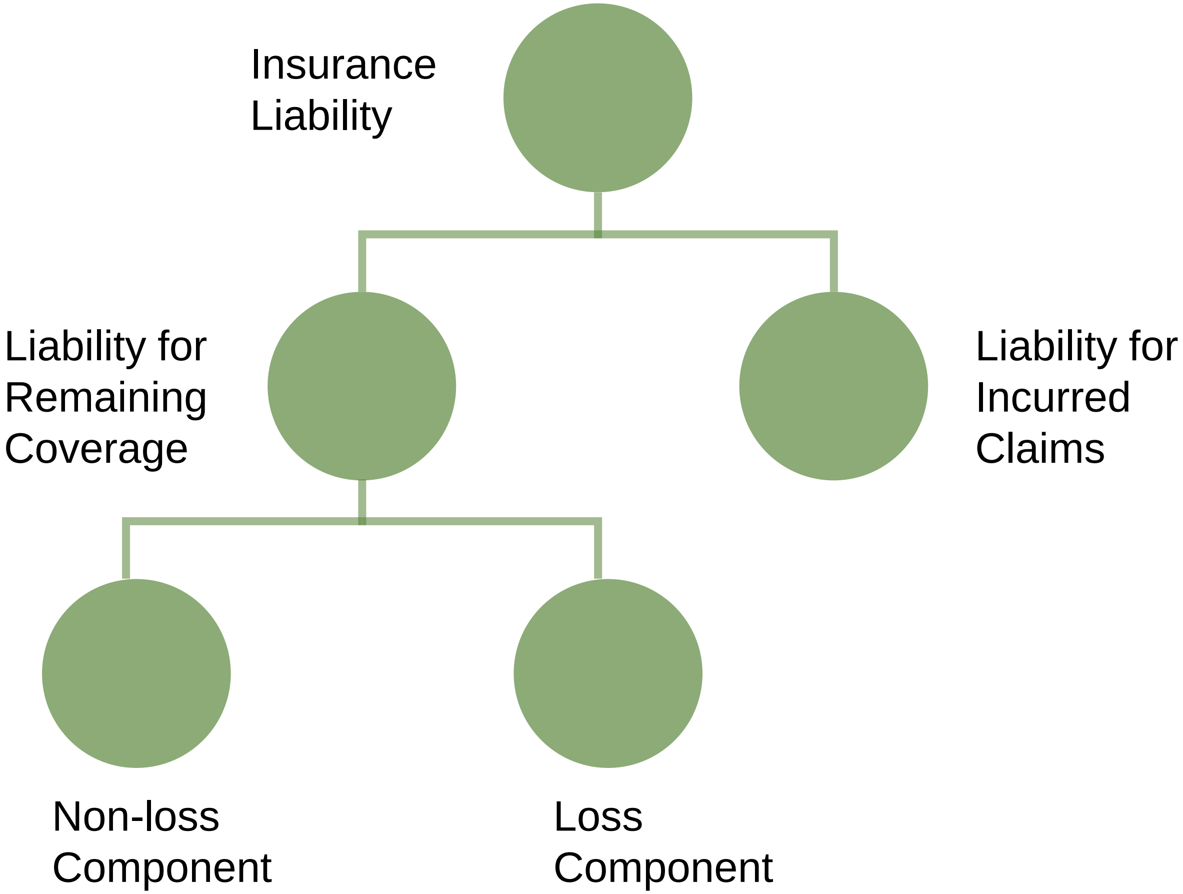
1. Do facts and circumstances indicate that a group of contracts is onerous?

2. Calculate the difference between
   (a) PAA LRC
   (b) Fulfilment cash flows

3. If (a) < (b), a loss is recognized immediately.
   (Insurance service expense XXX / LRC(PAA) XXX)

- Example:
  - Carrying amount of the liability for remaining coverage is CU 500
  - Fulfillment cash flows(same as for BBA) are CU 800
  - The entity accounts for the loss as CU 300(=800-500)
- Subsequently, the loss component must be zero at the end of the coverage period.

1.6. Measurement: Liability for Incurred Claims



See slides 19-20

1.6. Measurement: Liability for Incurred Claims

- LIC Measurement in Line with the General Model

  - Comprises ① Fulfilment cash flows for the settlement of incurred claims and expenses; and
    ② Risk adjustment
  - Discounted using the current discount rates
  - (insurance service expense XXX / liability for incurred claims XXX)

- Discount Rates Reflect:

  - The time value of money;
  - The cash flow characteristics of the insurance contracts;
  - The liquidity characteristics of the insurance contracts.

- Practical Expedient

  - If settlement expected in no more than one year, no need to discount incurred claims

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1.6. Measurement: Liability for Incurred Claims

- Investment Component

• The investment component reduces LRC by the amount actually incurred and increases LIC
• Differences between expected and actual investment components are not recognized

- Risk Adjustment(RA) for Non-financial Risk

• In line with the General Model
• Measured as the compensation for bearing the uncertainty arising from non-financial risk regarding:
  - the timing
  - the amount of cash flows
• Apply the same discount rates that were used in the measurement of future cash flows
• How do you measure it?
  - explicitly
  - entity-specific measure
  - no technique prescribed
• Have the option to disaggregate changes in RA into insurance service results, and insurance finance income and expenses.

1.7. Presentation and Disclosures

- Changes to Balance Sheet Presentation

IFRS 4*	IFRS 17	Key Changes
Assets		• Contracts that are assets are separately presented from those that are liabilities • Simplified presentation is consistent with the economics
Reinsurance contract assets	Reinsurance contract assets	
Deferred acquisition costs	Insurance contract assets	
Value of business acquired		
Premiums receivable		
Policy loans		
Liabilities		
Insurance contracts liabilities	Insurance contract liabilities	
Unearned premiums	Reinsurance contract liabilities	
Claims payable		

** Common presentation in the balance sheet applying IFRS 4*

1.7. Presentation and Disclosures

- Changes to Presentation of Performance

IFRS 4*	IFRS 17	Key Changes
Premiums	Insurance revenue	• Two drivers of profit • Fewer key changes compared to life insurers
Investment income	Incurred claims and expenses	
Incurred claims and expenses	Insurance service result	
Profit or loss	Investment income	
	Insurance finance expenses	
	Net financial result	
	Profit of loss	
	Insurance finance expense *(optional)*	
	Total comprehensive income	

** Common presentation in the statement of comprehensive income applying IFRS 4*

1.7. Presentation and Disclosures

- Presentation in Other Comprehensive Income(OCI)

  - OCI option for the liability for incurred claims includes:
    - In profit or loss: systematic allocation of total insurance finance expenses(*) to the period
    - In OCI: the effect of discount rate changes

  (*) Using locked-in rate at the date of incurred claims (x%)

New look to the statement of financial performance	
Insurance revenue	X
Incurred claims and other expenses	(X)
Insurance service result	**X**
Investment income	X
Insurance finance expenses	(X)
Net financial result	**X**
Profit or loss	**X**
Other comprehensive income:	
Insurance finance expenses	(X)
Fair value movements on FVOCI assets	X
Total comprehensive income	**X**

1.7. Presentation and Disclosures

General model disclosure requirements

−

Most General Disclosures on:
- Presentation value of cash flows
- Risk adjustment
- Contractual service margin

+

PAA-specific Disclosures:
- Eligibility[1)]
- Practical expedients used[2)]

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All PAA disclosures

1) Which of the criteria in paragraphs 53 and 69 it has satisfied
2) Time value of money, insurance acquisition cash flows

IFRS 17 paragraphs 97-100, 102-105, 110 and 114-132

2. Key Accounting Policies Developed by Non-life Insurers in Korea

2.1. Insurance Contracts – Significant Risk

Definition of significant insurance risk → **How to define 'significant' insurance risk?**

- 'Additional Benefit Premium' represents the difference between the amount paid when an insurance event occurs and the amount paid when an insurance event does not occur
- If Additional Benefit Premium Rate(*) ≥ XX% → insurance risk is considered 'significant'
- Korean regulatory guidance sets this rate at 10%

(*) Additional benefit premium rate = Additional benefit premium / The payment made when no insured event occurs

Additional benefit premium = The payment made upon the occurrence of an insured event – The payment made when no such event occurs

IFRS 17 paragraphs B17-B23 and appendix A definitions

2.2. Portfolio – Identification

In Korea, portfolios are identified in accordance with the「Regulation on Supervision of Insurance Business」, and companies are allowed to further disaggregate them.

「Detailed Regulations on Supervision of Insurance Business, Appendix 35」(Appendix 35)

General Insurance	Fire, Comprehensive, Marine, Worker's Compensation, Liability, Personal Accident, Technology, Guarantee, Car, Others, Overseas
Long-term Insurance	Personal Accident*, Disease*, Property*, Pension/Savings*, Asset-Linked Pension/Savings, Others* * Divided into participating and non-participating

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2.3. Insurance Contracts Group

The criteria for distinguishing groups according to profitability

How to define the criteria for onerous groups?

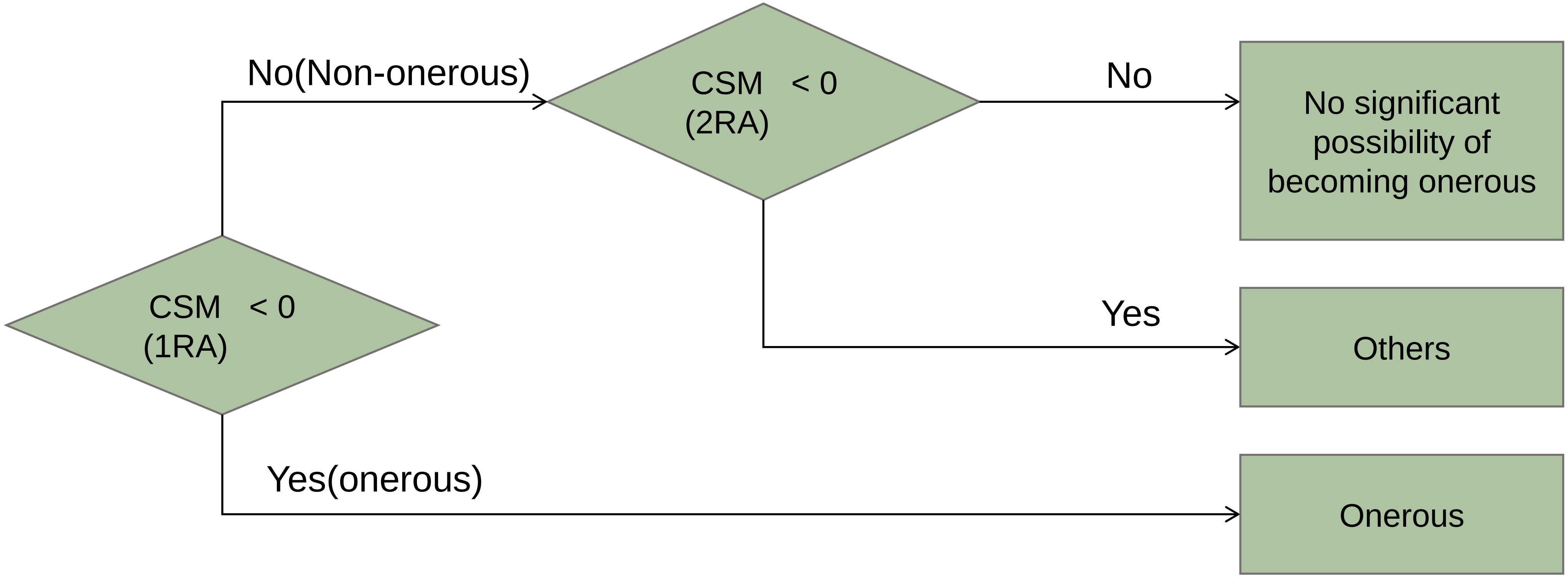
- When using the confidence level method to calculate Risk Adjustment(RA), one of the viable alternatives is to assess profitability using confidence

	Initial Recognition	Subsequent Measurement
Onerous	BEL + RA < 0	BEL + RA > PAA LRC
No significant possibility of becoming onerous	BEL + 2RA > 0	BEL + 2RA < PAA LRC
Others	BEL + RA > 0 and BEL + 2RA < 0	Others

* BEL(Best Estimate Liability): Present value of expected future cashflows
|BEL+RA|= |CSM|

2.3. Insurance Contracts Group

- Flowchart for profitability assessment are as follows:



* |BEL+RA|= |CSM|

2.4 Onerous Contracts Assessment

How to establish the accounting policy for onerous contracts assessment?

(1) Timing of assessment

- Possible alternatives include:

  (A) When facts and circumstances indicate potential losses (e.g. quantitative benchmarks)

  Combined ratio(*) exceeding 100% could be indicative of potential losses.
  (*) Combined ratio = (Incurred claims + Incurred expenses) / earned premium

  (B) Periodic assessments (e.g. at each reporting period)

(2) Allocation of loss component

- Possible alternatives include:

  (A) Allocate the loss consistent with General Measurement (GM) model, using the loss ratio

  (B) Allocate the loss according to LRC movement pattern under PAA

  (C) Either recognize or reverse the loss based on recalculated amount of loss

2.5. PAA Eligibility Testing

'Reasonable Approximation' → **How should 'would not materially differ' be interpreted?**

(1) Determining whether to test for groups of insurance with mixed coverage durations

- Possible alternatives include:
  - (A) Evaluate all contracts within the group to ensure a comprehensive coverage assessment.
  - (B) Determine the ratio of contracts that exceed one-year duration within the group and perform testing for groups above a specific threshold.
  - (C) Initiate testing when at least one contract in the group exceeds one year

(2) Setting materiality in approximation test (e.g. |BBA-PAA| ≤ XX)

- Possible alternatives include:
  - (A) Apply PAA when |BBA-PAA| ≤ BBA * 10%
  - (B) Apply PAA when |BBA-PAA| ≤ insurance premium * 5%

2.5. PAA Eligibility Testing

Analysis of Eligibility

Contracts may also be eligible for PAA provided that PAA enables a measurement that is a reasonable approximation to the BBA (§ 53 (a)) over the coverage period at each financial reporting date.

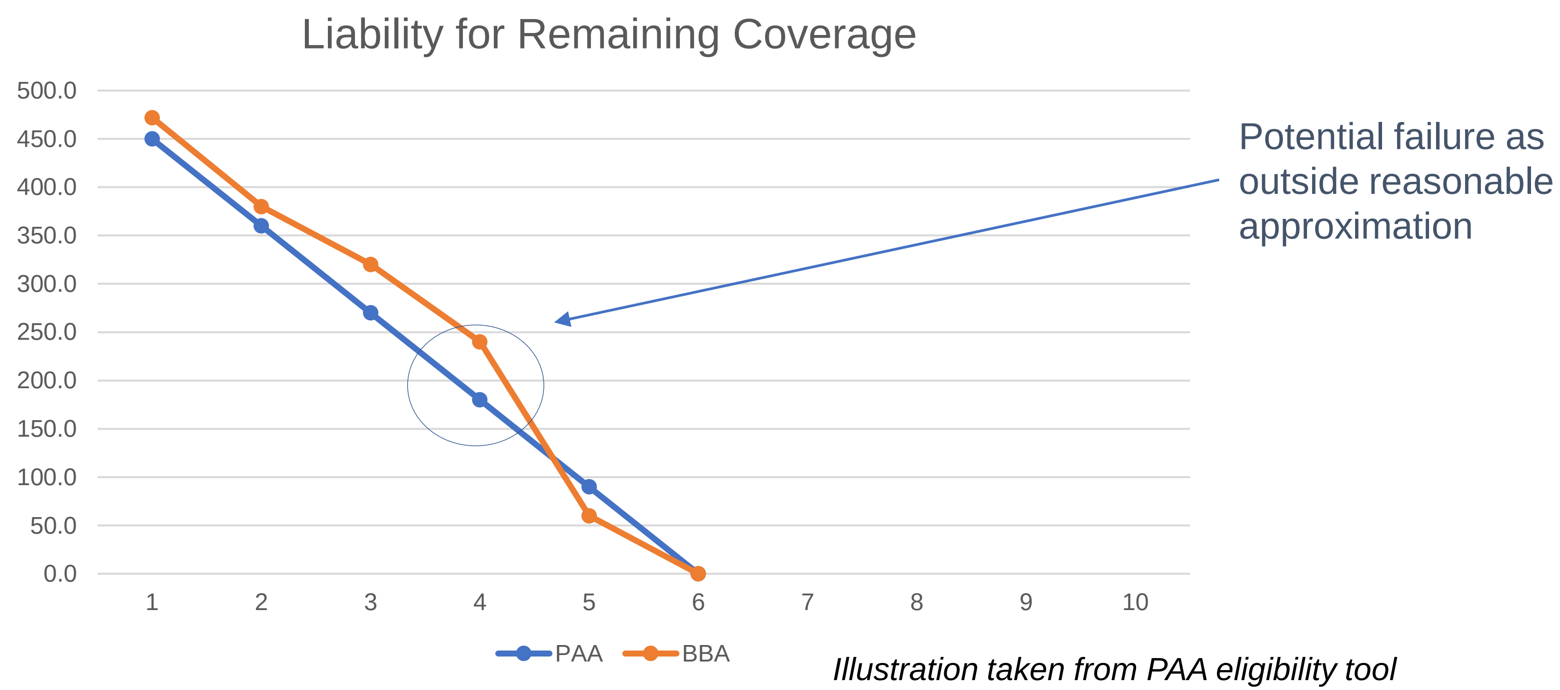


Illustration taken from PAA eligibility tool

A qualitative assessment may be sufficient instead of a detailed quantitative analysis.

Liability patterns mirror the movements of liabilities, which essentially represent the pattern of revenue recognition. By aligning the allocation of insurance revenue to each period in PAA, we can match the outflow patterns of the Premium Allocation Approach (PAA) with the Building Block Approach (BBA), eliminating the need for a detailed quantitative benchmark

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2.6 Revenue Recognition

How is revenue recognised under Premium Allocation Approach?

Insurance revenue is recognized on the basis of:

The passage of time	Time-proportional • Daily rate, monthly rate, etc.
The expected pattern of risk release	Risk-proportional • In cases where the pattern of risk release during the coverage period significantly differs from the passage of time, • Patterns of past claims experience, expected future loss ratios, etc. • Use simplified methods such as the sum-of-days-method(*)

(*) The sum-of-days method aggregates the number of days that a particular contract is exposed to risk over a specified period, enabling assessment of the risk as it accumulates over time.

IFRS 17 paragraphs B126

2.6. Revenue Recognition

(Example) Time-Proportional vs. Risk-Proportional

	t	0	1	2	3	4	5
Time-Proportional	Current Period Return	-	20%	20%	20%	20%	20%
	Cumulative Return	0%	20%	40%	60%	80%	100%
Risk-Proportional(*)	Current Period Return	-	7%	13%	20%	27%	33%
	Cumulative Return	0%	7%	20%	40%	67%	100%

(*) Using simplified method(e.g. Sum-of-days-method):
Revenue recognized at time point $i = i / (1+2+3+\cdots+n) \times$ total expected premium receipts (n: coverage period, 5 in this example)

※ Notes on the Application of Simplified Methods

1) Applicable when the exposure to risk increases or decreases over time.
2) It's necessary to ensure that there are no significant differences when compared with actual historical claim data.

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2.7. Insurance Acquisition Cost

How to allocate deferred insurance acquisition costs over the remaining coverage period?

- Possible alternatives include:

(A) Allocate total expected insurance acquisition costs over the entire coverage period.

- Given the diverse nature of insurance acquisition cash flows, accurately estimating them in practice can be challenging. Accounting policies are required to reconcile differences between expected and actual amounts.

(B) Allocate actually incurred insurance acquisition costs over the remaining coverage period.

- As expenses are only recognized during the remaining coverage period after they occur, revenue and expense may not be appropriately matched.

→ *Utilise " release pattern of LRC "*

Thank you very much for listening!
Any Questions?

THANK YOU

We bring the finest expertise and insight to our work.
We maintain our independence and fairness.
We are transparent in our decision-making process.
We pursue honesty and integrity.
We trust, communicate openly and cooperate with each other.