

IFRS 17

Insurance Contracts

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IFRS Regulators Forum

CFRR 

**Centre for Financial
Reporting Reform**



WORLD BANK GROUP

 **STAREP**

Strengthening Auditing and Reporting in
the Countries of the Eastern Partnership



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FOR SMEs**



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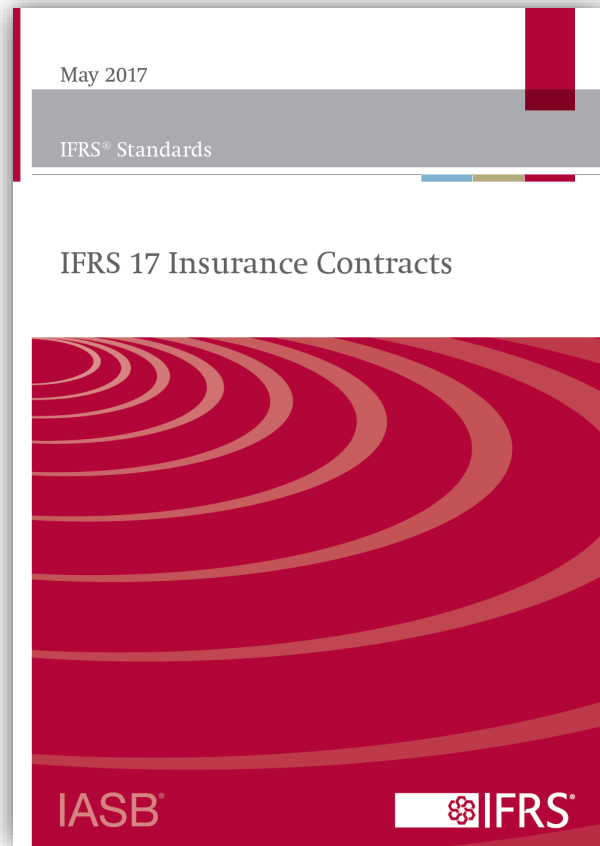
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The views expressed in this presentation are my own and not necessarily those of any organization with which I am associated.

Introduction

IFRS 17 Insurance Contracts



» IFRS 17

- » replaces an interim Standard—IFRS 4
 - » requires consistent accounting for all insurance contracts based on a current measurement model
 - » will provide useful information about profitability of insurance contracts
- ### » Effective 2023
- » one year restated comparative information
 - » early application permitted

Reasons and objectives for IFRS

17

Insurance Accounting

Phased approach

Two phases for accounting for insurance contracts:

Phase 1

- » 2004: issue of IFRS 4 *Insurance Contracts*, focus on enhanced disclosure of amount, timing and uncertainty of cash flows.
- » IFRS 4 allows entities to continue using various recognition, measurement and presentation (grandfathering)

Phase 2

- » 2017: issue (2020 amendment) of IFRS 17 *Insurance Contracts*, focus on consistent recognition, measurement and presentation of insurance contracts.

IFRS 17 supersedes IFRS 4



Phase 1: Insurance Accounting

IFRS 4 Insurance contracts

- » IFRS 4 grandfathered much previous jurisdictional practice:
 - » Wide range of accounting stemming from original practices
 - » Differences across jurisdictions and products make it difficult for investors and analysts to understand and compare results
 - » Insurers use multiple practices in a set of consolidated results
- » Some existing practices fail to reflect true underlying financial position or performance of insurance contracts
- » Most stakeholders agreed on need for a common standard (opinions varied as to what it should be)

Phase 1: Insurance Accounting

Lack of comparability

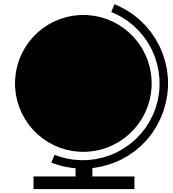
CU Millions	Year X			
	GAAP 1	GAAP 2	Difference	
Revenue	8 263	10 979	(2 716)	(33%)
Operating income	1 416	633	783	55%
Net income	965	337	628	65%
Total equity	8 977	3 872	5 105	57%

Source: *Effects Analysis on IFRS 17*

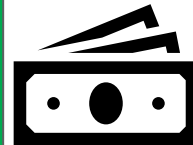
Phase 2 Overview

IFRS 17 Insurance contracts

One accounting model for
all insurance contracts



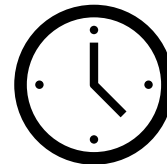
450 listed insurers on
IFRS Standards



\$13 Trillion of assets



2023 mandatory
effective date



5.5 years to implement

IFRS 17 Improvements

Transparency and useful information

Applying IFRS 4	Applying IFRS 17
<ul style="list-style-type: none">• Old or outdated assumptions• Options and guarantees not fully reflected in measurement• Time value of money not considered for incurred claims• Use of asset rate for discounting	<ul style="list-style-type: none">• Current assumptions• Options/guarantees fully reflected• Estimated claims measured on a discounted basis.• Discount rate reflects insurance liability characteristics
<ul style="list-style-type: none">• Revenue recognised on cash basis• Use of non-GAAP measures	<ul style="list-style-type: none">• Unearned profit recognised as insurance coverage is provided• Additional metrics available



Cost versus benefit

Simplifications to reduce costs

- » Simplifications must balance cost savings with potential loss of information
- » For example, IFRS 17:
 - » Allows **simplified measurement** of some short-term insurance contracts
 - » Enables requirements to be applied to a **group of contracts** rather than on a contract-by-contract basis
 - » **does not apply** to some common contracts issued by non-insurers, such as most product warranties

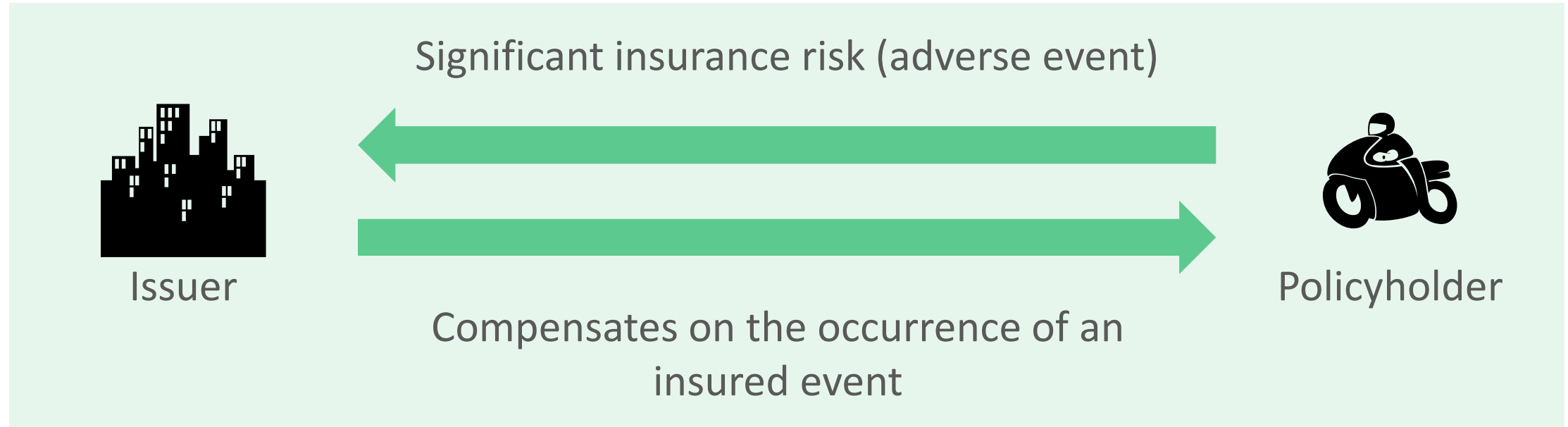


Cost versus benefit

- » Board concluded IFRS 17 will result in **significant first time costs**, but that overall **benefits outweigh the costs**
- » Board expected that applying IFRS 17 will require
 - » insurers to gather **new information**
 - » **employ or develop skills** and change financial systems
 - » updating **internal procedures**, and
 - » **communicating changes** in their reports to external parties
- » Costs will **vary by jurisdiction** - depends on existing practices
- » Insurers are also expected to **continue incurring costs** in applying IFRS 17 on an ongoing basis.

Scope of IFRS 17

What is an insurance contract



↔ IFRS 17 and IFRS 4—same definition

↔ IFRS 17 two minor changes to guidance but no expected changes in assessments for majority of contracts

↔ No change from IFRS 4

⚡ Change from IFRS 4

Scope exclusions

Mandatory exclusions

Some insurance contracts remain in the scope of other IFRSs

» For example:

↔ warranties issued by manufacturers, dealers or retailers

↔ retirement benefit obligations

↔ some residual value guarantees

↔ insurance contracts held by an entity, unless those contracts are reinsurance contracts

⚡ some credit card and similar contracts if insurance risk is not assessed in pricing

↔ No change from IFRS 4

⚡ Change from IFRS 4



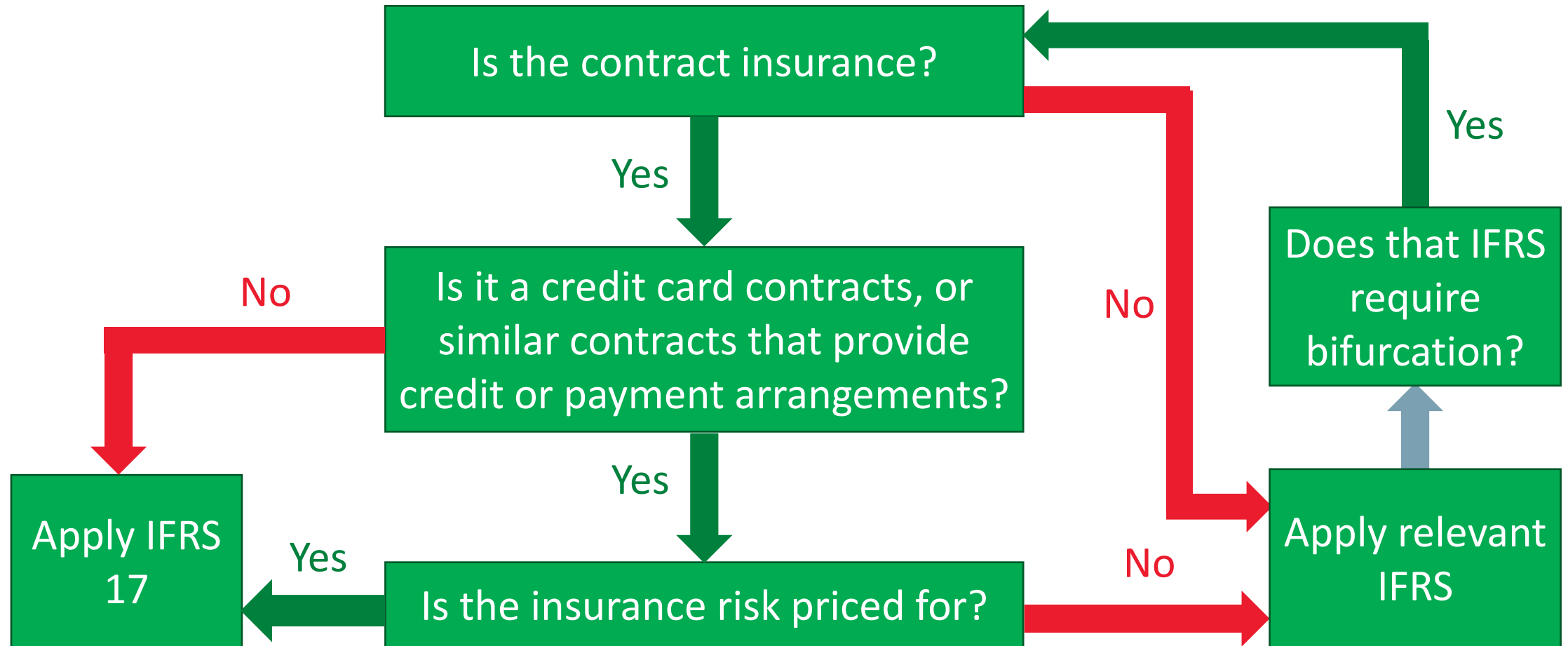
Mandatory exclusions

Banking products

- » Credit card contracts, or similar contracts that provide credit or payment arrangements,
- » if, and only if, the entity doesn't price for the individual customer risk
- » if, and only if, IFRS 9 requires an entity to separate an insurance component, then entity apply IFRS 17 to that component.

Mandatory exclusions

Credit cards and similar products





Scope

Optional exclusions

Option to account for some insurance contracts using either IFRS 17 or other IFRS Standards

- ↔ Financial guarantee contracts—IFRS 17 or IFRS 9 *Financial Instruments*
- ⚡ Specified fixed-fee service contracts—IFRS 17 or IFRS 15 *Revenue from Contracts with Customers*
- ⚡ Specified loan contracts—IFRS 17 or IFRS 9 *Financial Instruments*



Optional exclusions

Banking products

- » Some contracts limit compensation to amount required to settle the policyholder's obligation created by the contract
- » Entity can choose
 - » to apply either IFRS 17 or IFRS 9
 - » at portfolio level , and
 - » is irrevocable.



Level of aggregation

Why group contracts?

- » Typically, under IFRS contracts are measured on an individual contract basis
- » IFRS 17 and insurance accounting is an exception to this general principle:

Objective of insurance

- » Insurance aggregates uncertain future events
- » This changes a binary risk into a probability risk
- » Allows insurer to manage risk where individual couldn't

Asymmetry of IFRS 17

- » Treatment of gains and losses is asymmetric
 - » Losses recognised immediately
 - » Gains recognised as earned
- » Contradicts objective

Why group contracts?

Example

100 2 yr contracts: premium 50 pa, expect 2 contracts to claim 3 500 each year, all expected claims emerge day 1.

Whole contract	Grouped	Individual contracts	
		Profitable	Loss making
Share of premium	10 000	9 800	200
Claims	(7 000)	-	(7 000)
Cumulative Profit/loss	3 000	9 800	(6 800)
Day 1 Profit/(loss)	-	-	(6 800)
Year 1 Profit/(loss)	1 500	4 900	(6 800)
		Year 1 loss: (1 900)	

Why not group contracts?

Example

2 product lines, car and house, car premium 5 000, expected claims 1 500, house premium 5 000, claims 5 500.

Whole contract	Grouped	Sub groups	
		Car	House
Share or premium	10 000	5 000	5 000
Claims	(7 000)	(1 500)	(5 500)
Cumulative Profit/loss	3 000	3 500	(500)
Day 1 Profit/(loss)	-	-	(500)
Year 1 Profit/(loss)	1 500	1 750	(500)
		Year 1 profit: 1 250	

Why not group all similar contracts?

Example

2 year car insurance, written year 1: premium 5 000, actual claims 750pa,
year 2 premium 5 000, actual claims 2 750pa.

Whole contract	Grouped Year 2	Sub groups Year 2	
		Issue year 1	Issue year 2
Share or premium	5 000	2 500	2 500
Claims	(3 500)	(750)	(2 750)
Cumulative Profit/loss	1 500	1 750	(250)
Year 2 Profit/(loss)	1 500	1 750	(250)
			Year 2 profit: 1 500

Why group contracts

Grouping objectives

- » Balance nature of insurance with risk of loss of information
- » Trends matter:

Product line loss making

- » Bad contracts subsidised by good
- » Good subject to cherry picking by competitors
- » Can indicate risk or pricing problems in a unit




Profitability falls over time

- » New contracts subsidised by old
- » May indicate:
 - » an underwriting change failure
 - » increased competition
 - » deteriorating customer base

How are contracts grouped?

Step #1

- » Identify **portfolios** of insurance contracts
- » A portfolio: insurance contracts subject to similar risks and managed together




Portfolio 1	Portfolio 2	Portfolio 3
Eg Personal accident	Eg Health	Eg Motor
		
<ul style="list-style-type: none">✓ Similar risks✓ Managed together	<ul style="list-style-type: none">✓ Similar risks✓ Managed together	<ul style="list-style-type: none">✓ Similar risks✓ Managed together



How are contracts grouped?

Step #2

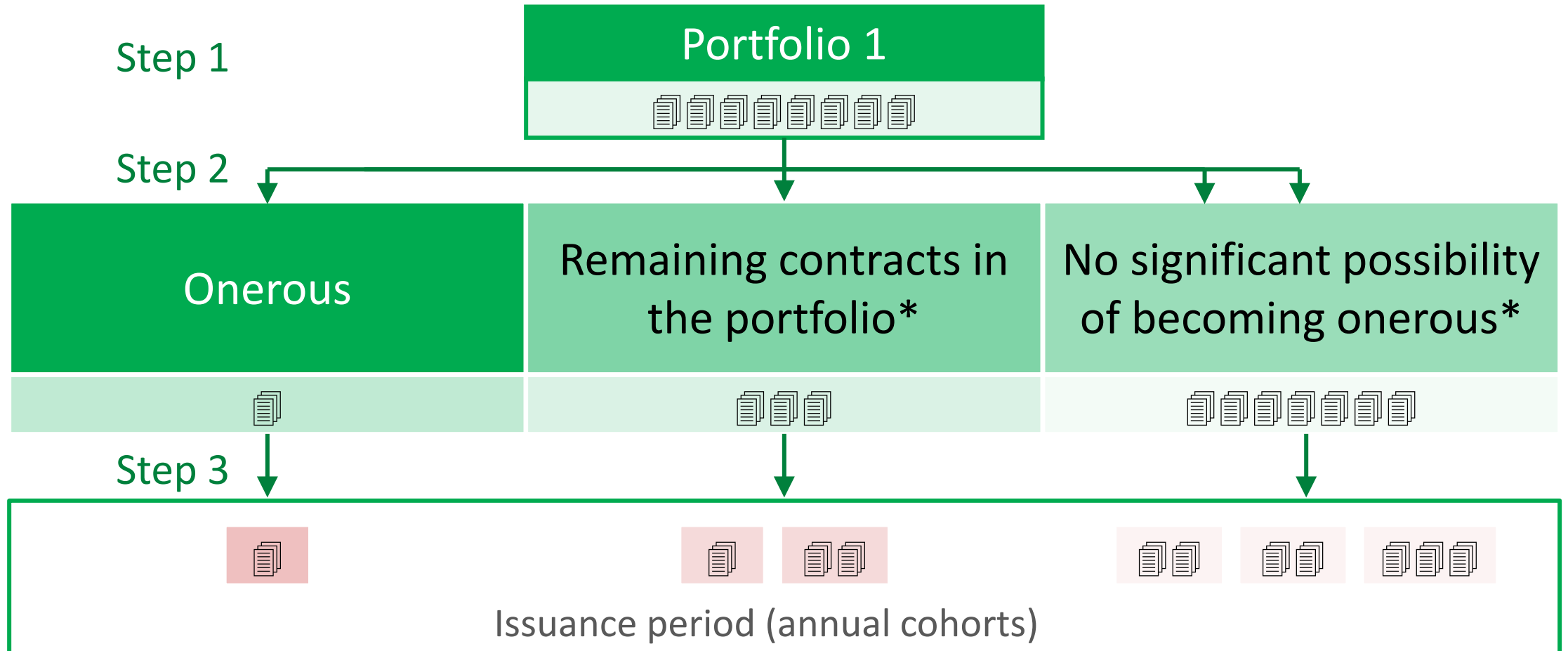
Divide a portfolio into a minimum of:

Onerous	Remaining contracts in the portfolio*	No significant possibility of becoming onerous*
		
Recognise <u>loss</u> immediately in P&L	<u>Unearned profit</u> recognised as part of the liability and is <u>released as insurance services are provided</u>	

* At initial recognition, if any

How are contracts grouped?

Step #3

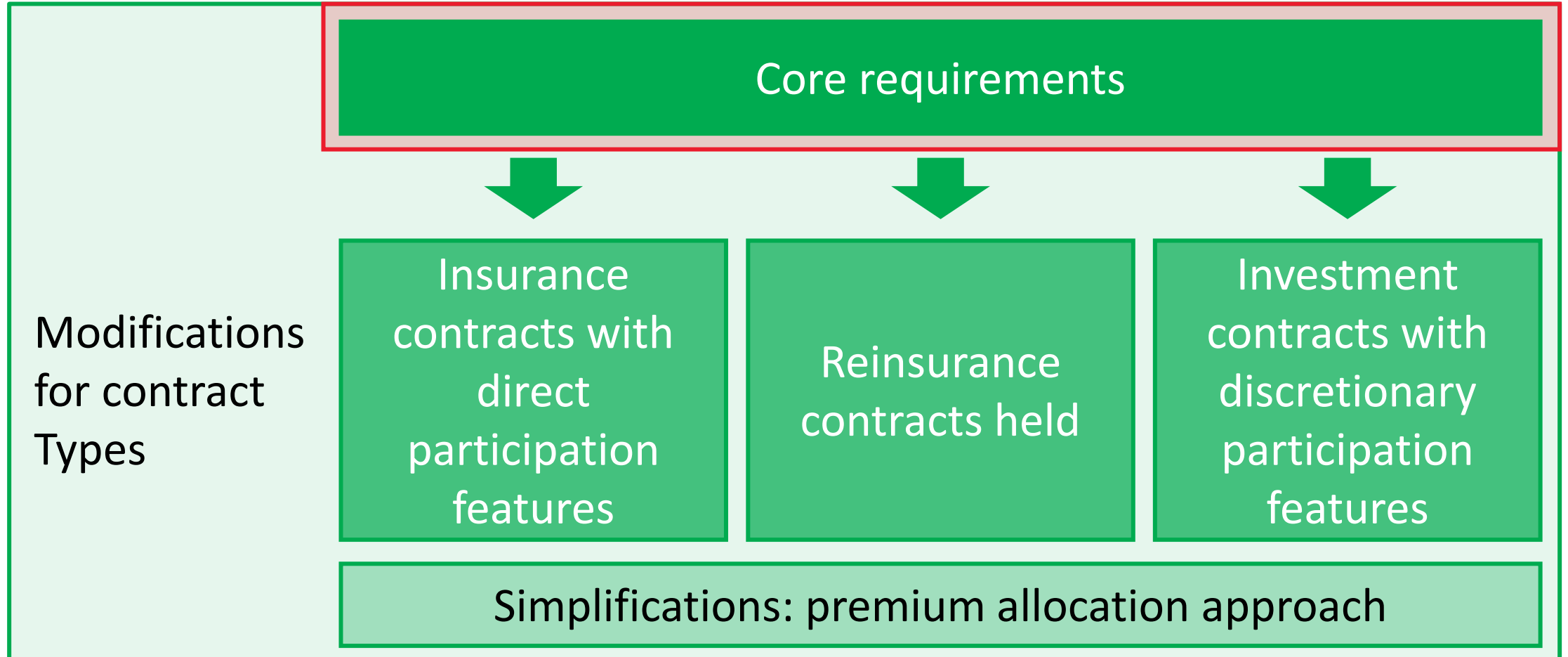


* At initial recognition, if any

Core requirements

Core Requirements

Snapshot of IFRS 17 Approaches



Core Requirements

'Building block Approach'

All insurance contracts measured as **the sum of:**

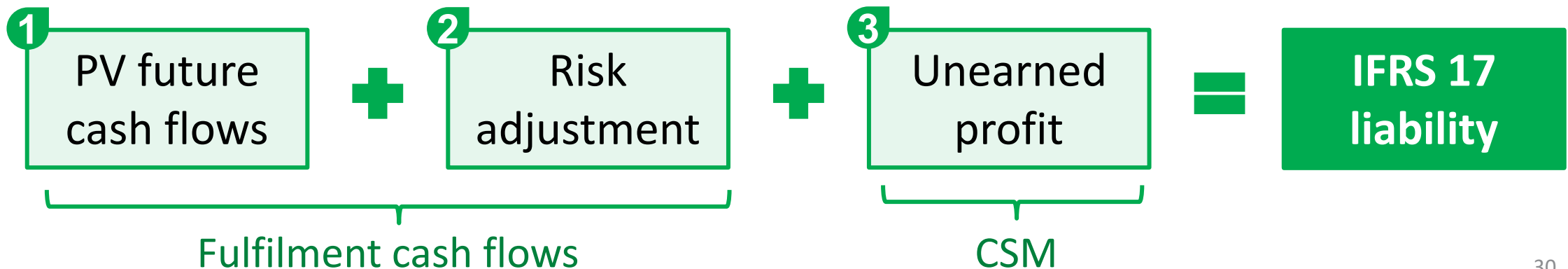
» Fulfilment cash flows (FCF)

1. Present value of probability-weighted expected cash flows

2. Plus an explicit risk adjustment for non-financial risk (eg insurance risk)

» Contractual service margin (CSM)

3. The unearned profit from the contracts



Regulatory regimes

Comparison

	IFRS 17	Solvency II
Cash flows	Similar	Similar
Discount rates	<u>Liability-specific rate</u> , market consistent	<u>Swap rate (yr 20) and</u> <u>ultimate forward rate</u>
Risk	Company's <u>own view of</u> <u>risk</u> (possible use of Solvency II risk margin)	<u>Prescribed approach</u> (risk margin—cost of capital set at 6%)
Unearned profit	Recognised in <u>P&L over</u> <u>time</u>	Included in <u>capital at</u> <u>inception</u> —day 1 gain

Regulatory regimes

Performance

IFRS 17		Solvency II	
Assets	PV of cash flows	Assets	PV of cash flows
	Risk margin		Risk margin
	Unearned profit	Capital (excess of assets over liabilities)	
	Equity		

Unearned profit

- recognised in P&L when coverage is provided
- provides a measure of future profitability

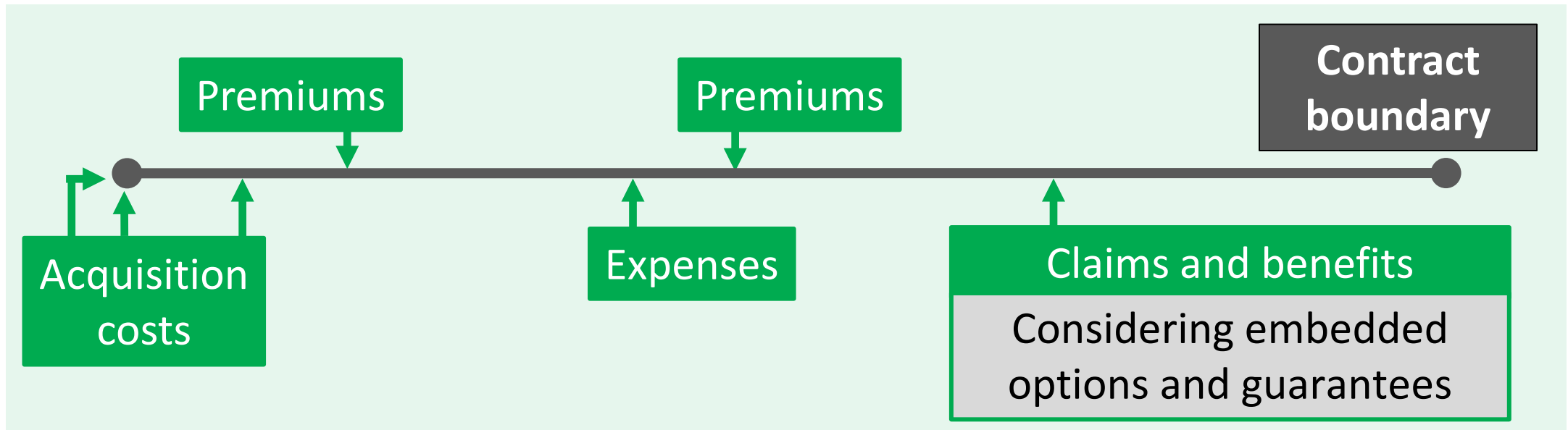
Changes in unearned profit provide information about:

- profitability of new business
- changes in profitability of existing contracts

1 Present value of future cash flows

Cash flows

- » Current estimate of future cash flows in contract boundary



- » Probability weighted and unbiased
- » Stochastic modelling for financial options and guarantees, where relevant

1

Present value of future cash flows

Discount rates

Reflect time value of money and financial risks

- » Characteristics of the cash flows
- » Liquidity of the insurance contracts
- » To extent that financial risks are included in the cash flows

Consistent with observable market prices (if any)

Timing

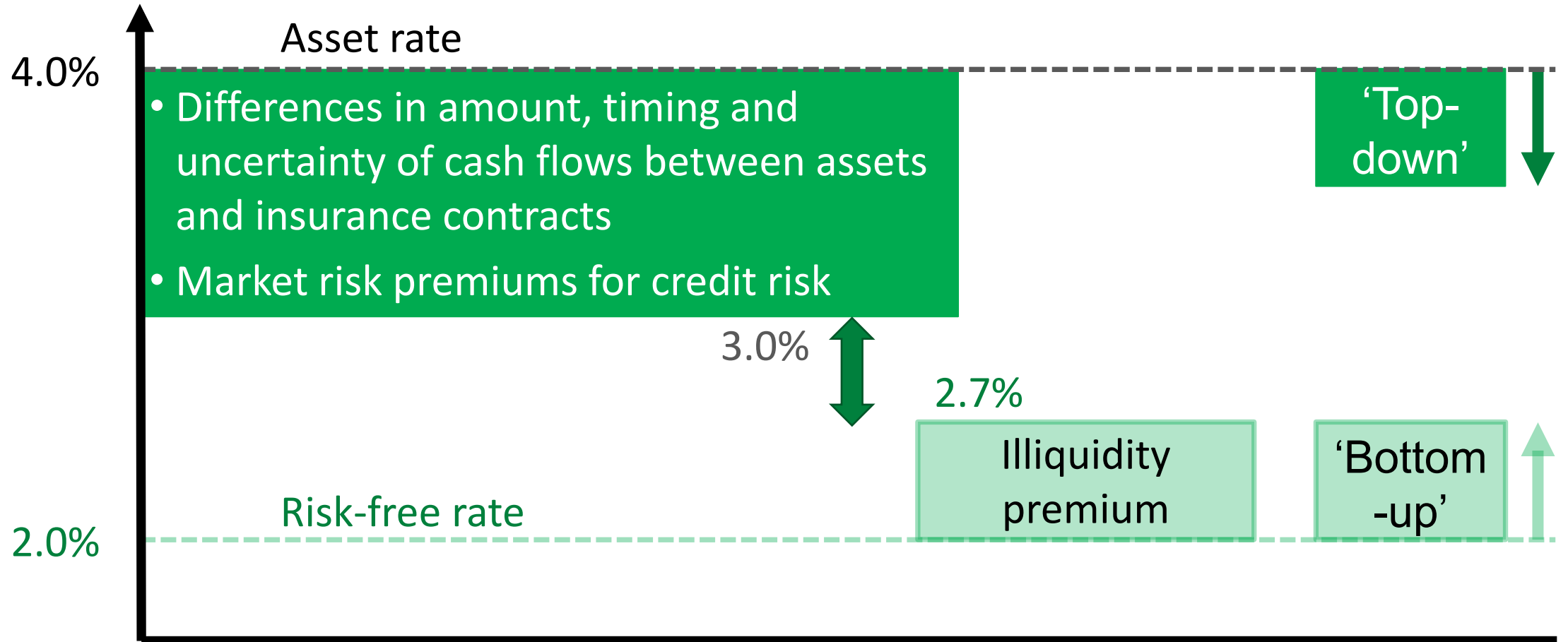
Currency

Liquidity

Exclude the effect of factors in the observable market prices not relevant to insurance contracts eg credit risk

1 Present value of future cash flows

Determining the discount rates



2 Risk adjustment

- » Explicit, current adjustment for compensation insurer requires for bearing non-financial risk (eg insurance risk)
- » Compensation that makes a company indifferent between:
 - » fulfilling a liability that has a range of possible outcomes; and
 - » fulfilling a liability that will generate fixed cash flows

Group A	
Probability	Pay-off
50%	1 000 000
50%	0

Probability weighted average

$$(0.5 \times 1\text{m}) + (0.5 \times 0) = \text{CU}0.5\text{m}$$

Group B	
Probability	Pay-off
100%	500 000

$$1 \times 0.5\text{m} = \text{CU}0.5\text{m}$$

3

Contractual Service Margin (CSM)

Initial measurement

The unearned profit of the group of contracts that relates to future service to be provided

The amount determined so that no gains are recognised in profit or loss on initial recognition

Example—Consider a group of contracts with PV of future cash flows of CU4,250 and risk adjustment of CU750

If premiums
CU5,500

- Contracts profitable at inception
- $CSM = CU500 [CU5,500 - CU750 - CU4,250]$

If premiums
CU3,500

- Contracts onerous at inception
- Day-one loss CU1,500 recognised in P&L – No CSM



Subsequent measurement

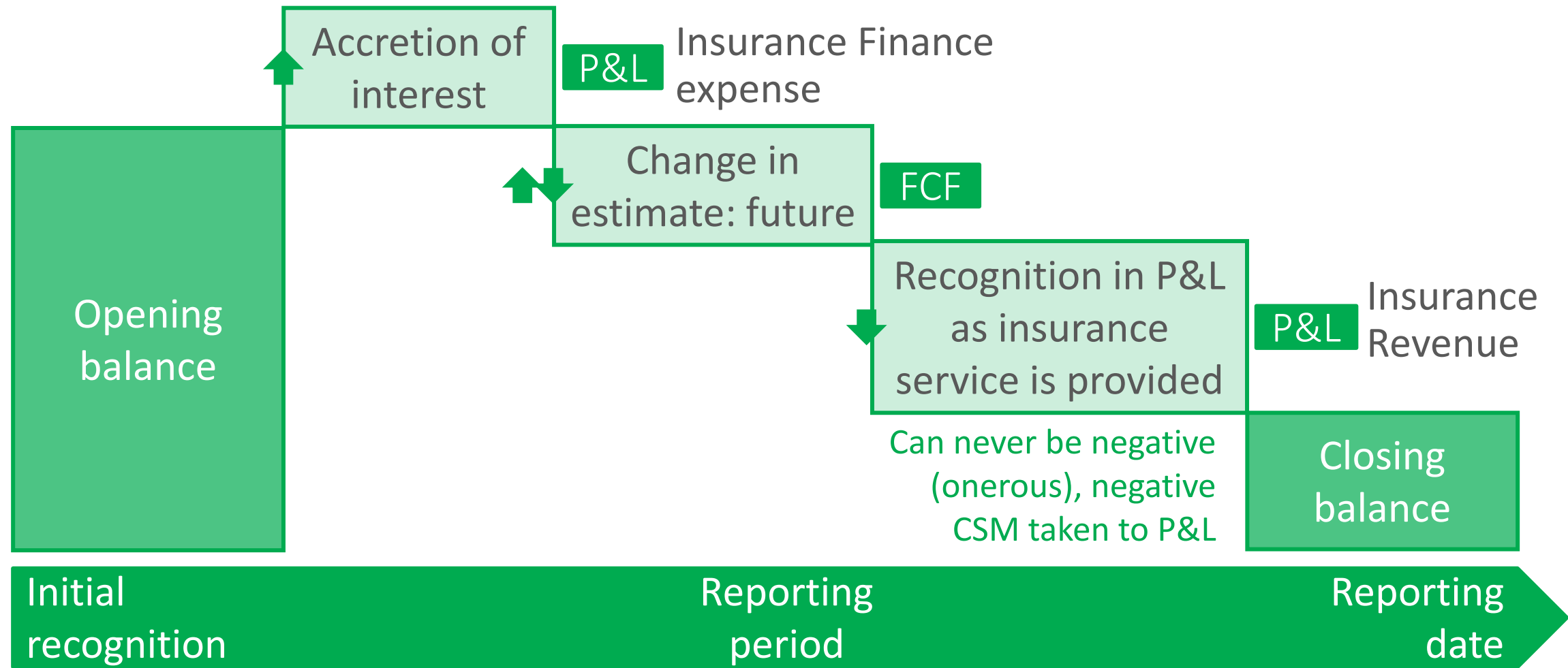
Subsequent Measurement

	Initial Measurement	Subsequent Measurement
1 PV future cash flows	Current assumptions	Current assumptions
2 Risk adjustment	Current assumptions	Current assumptions

Subsequent Measurement

	Initial Measurement	Subsequent Measurement
1 PV future cash flows	Current assumptions	Current assumptions
2 Risk adjustment	Current assumptions	Current assumptions
3 Unearned profit	The amount <u>that results in no gain recognised in profit or loss</u>	<u>Update</u> by reflecting: <ul style="list-style-type: none"> • <u>Time value Adjustments</u> for future service (<u>fixed</u>) • <u>Allocation</u> of the amount earned

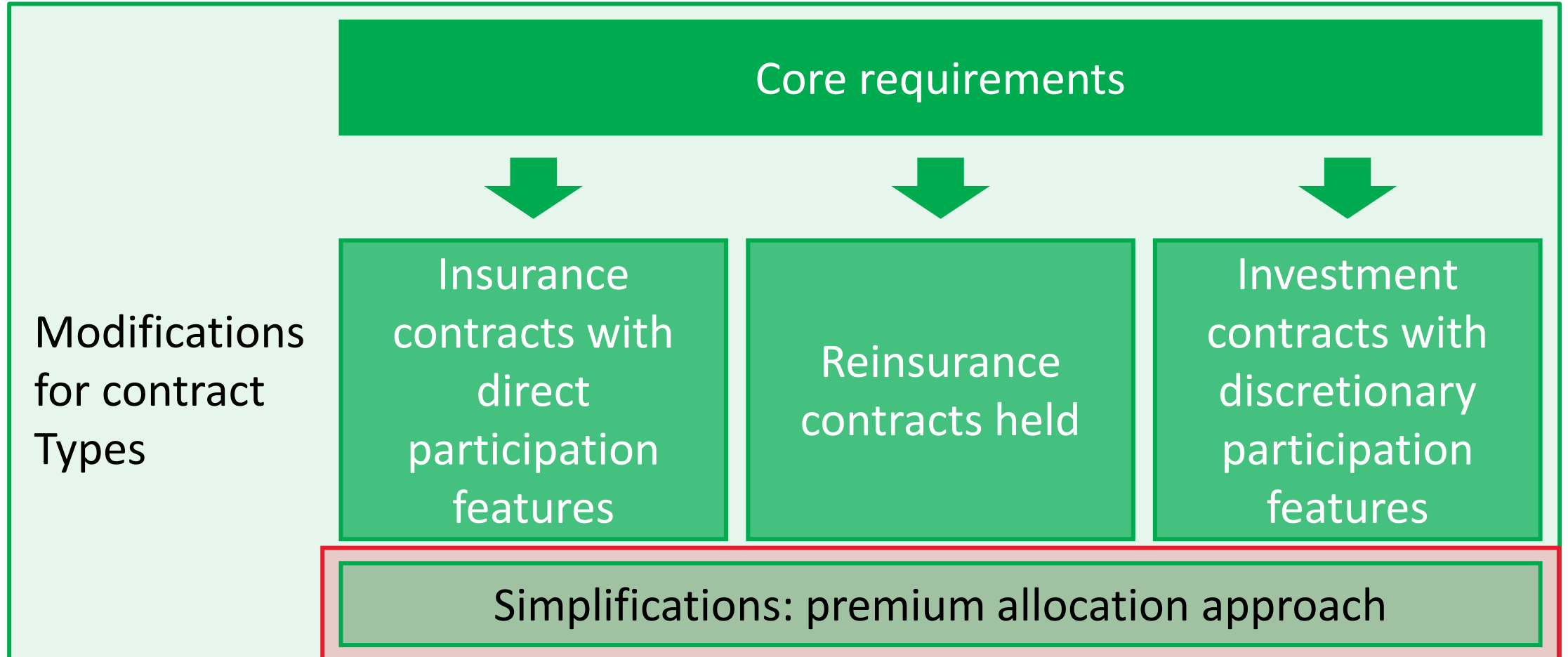
3 Contractual Service Margin (CSM) *Subsequent measurement*



Premium Allocation Approach

Core Requirements

Snapshot of IFRS 17 Approaches



Premium allocation approach

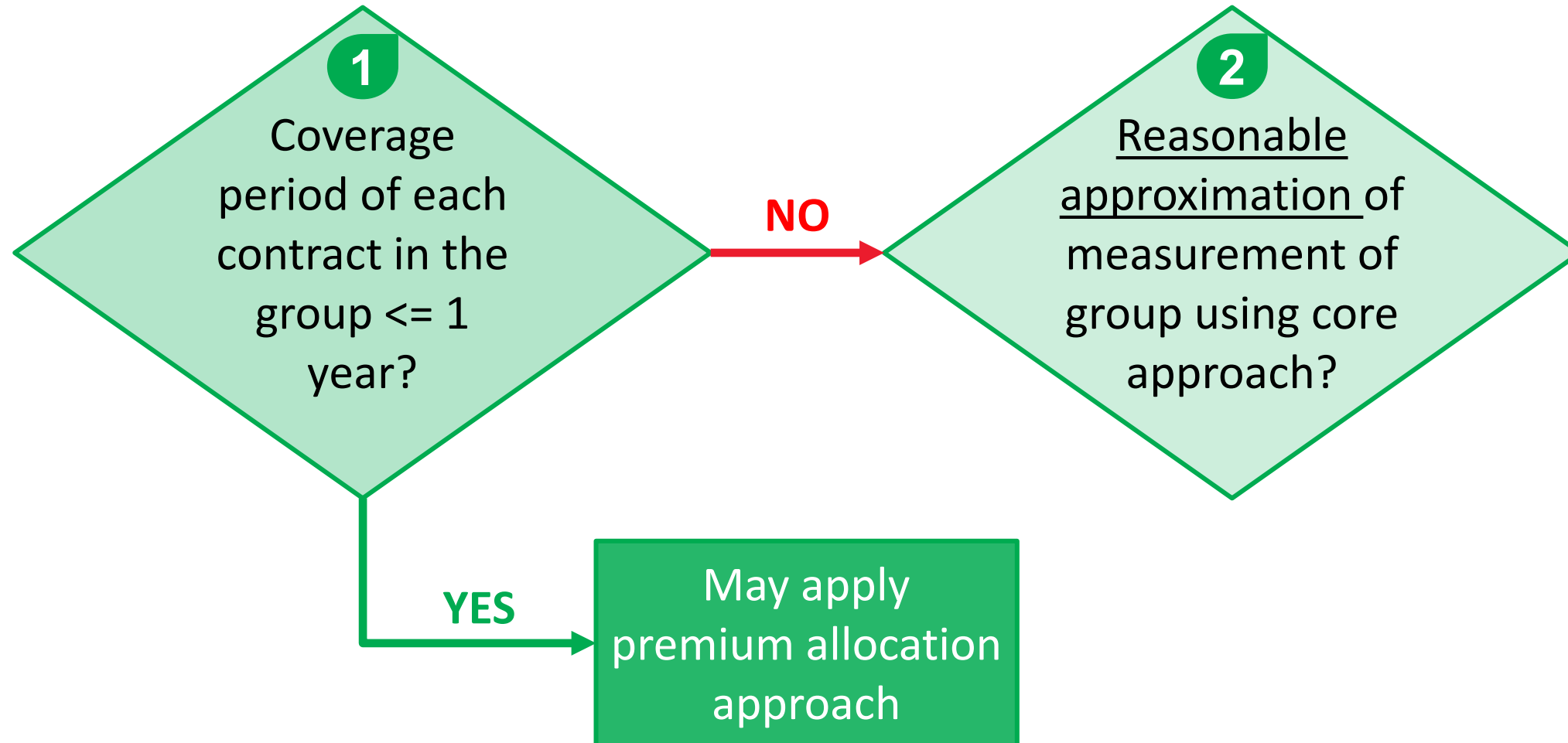
Criteria

1

Coverage
period of each
contract in the
group \leq 1
year?

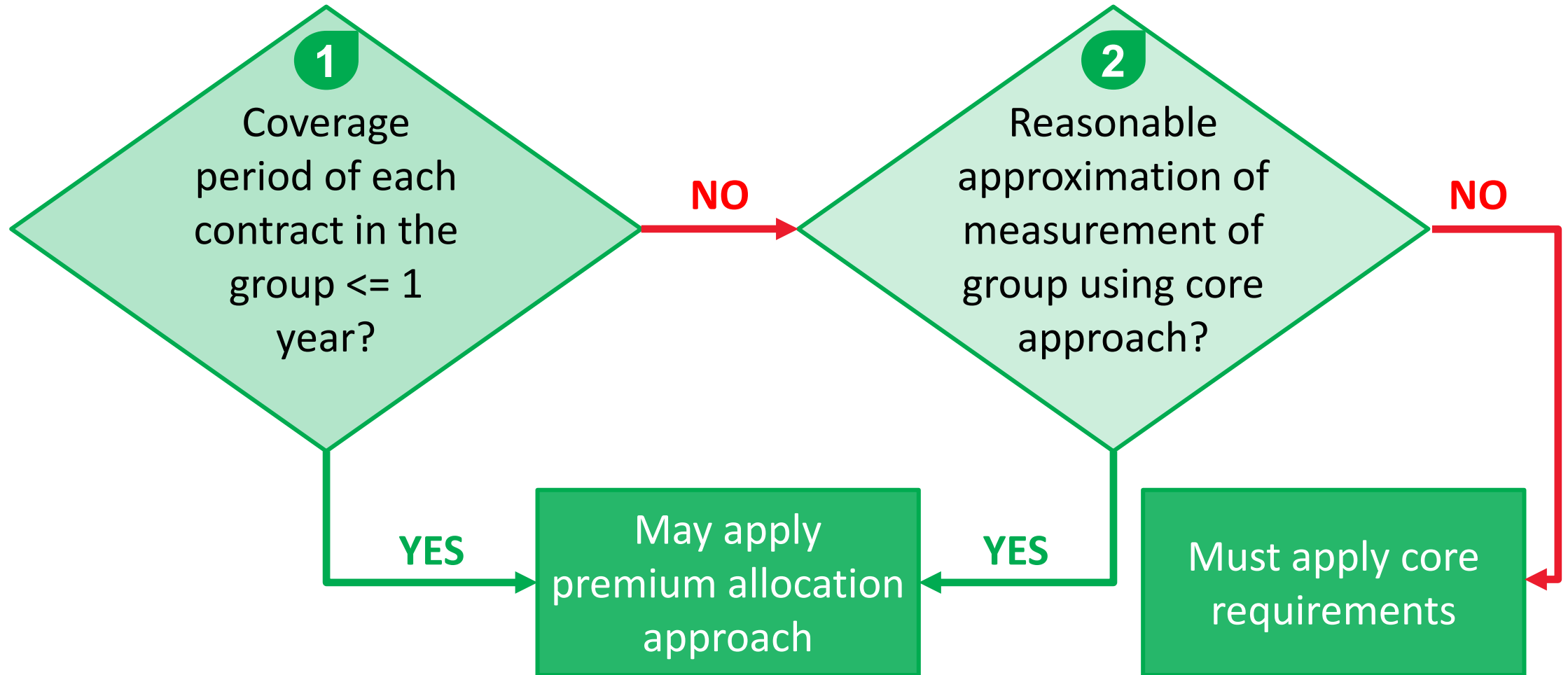
Premium allocation approach

Criteria



Premium allocation approach

Criteria



Premium allocation approach

Simplifications - initial measurement

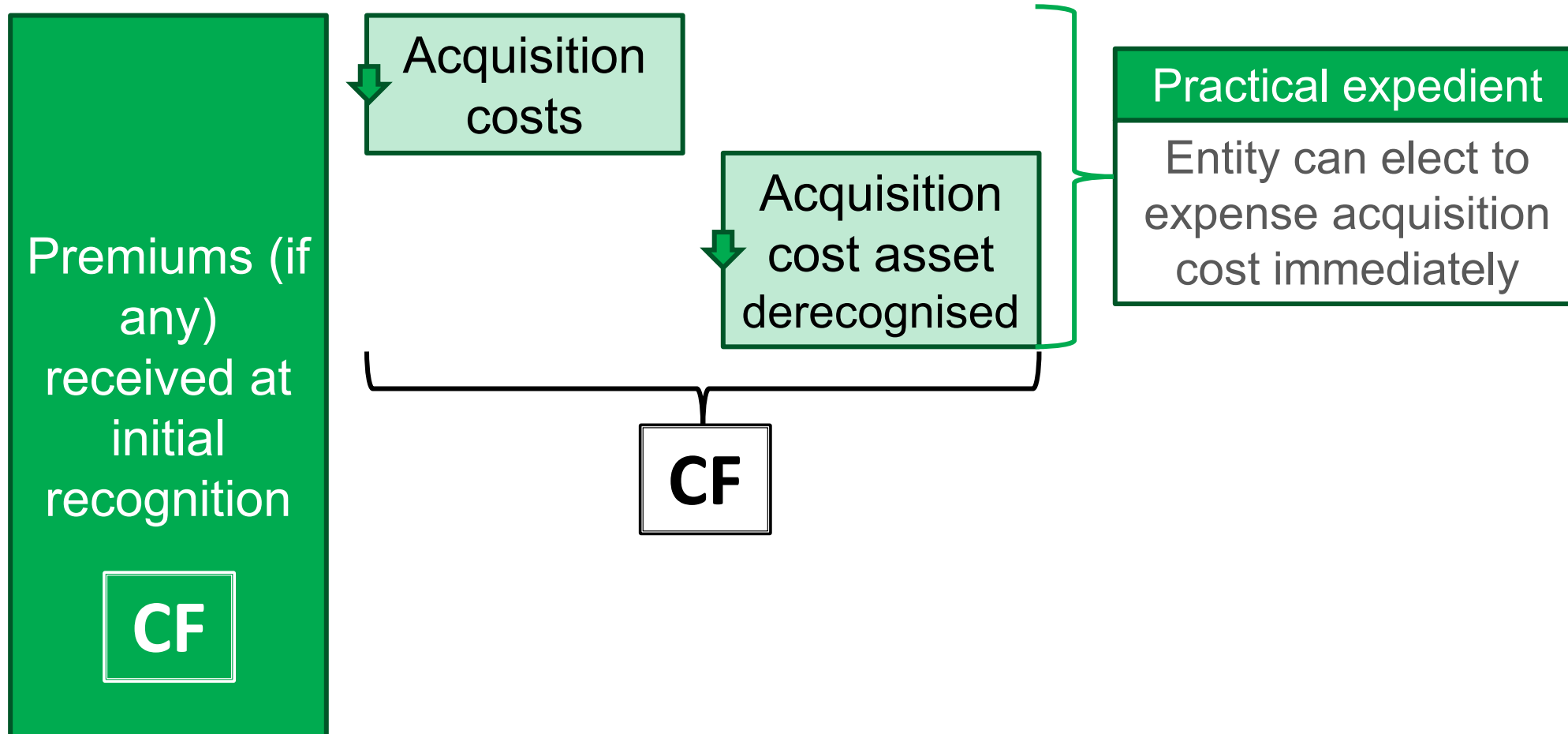
Premiums (if any)
received at
initial
recognition

CF

Cash premium
received at initial
recognition
creates/increases
liability

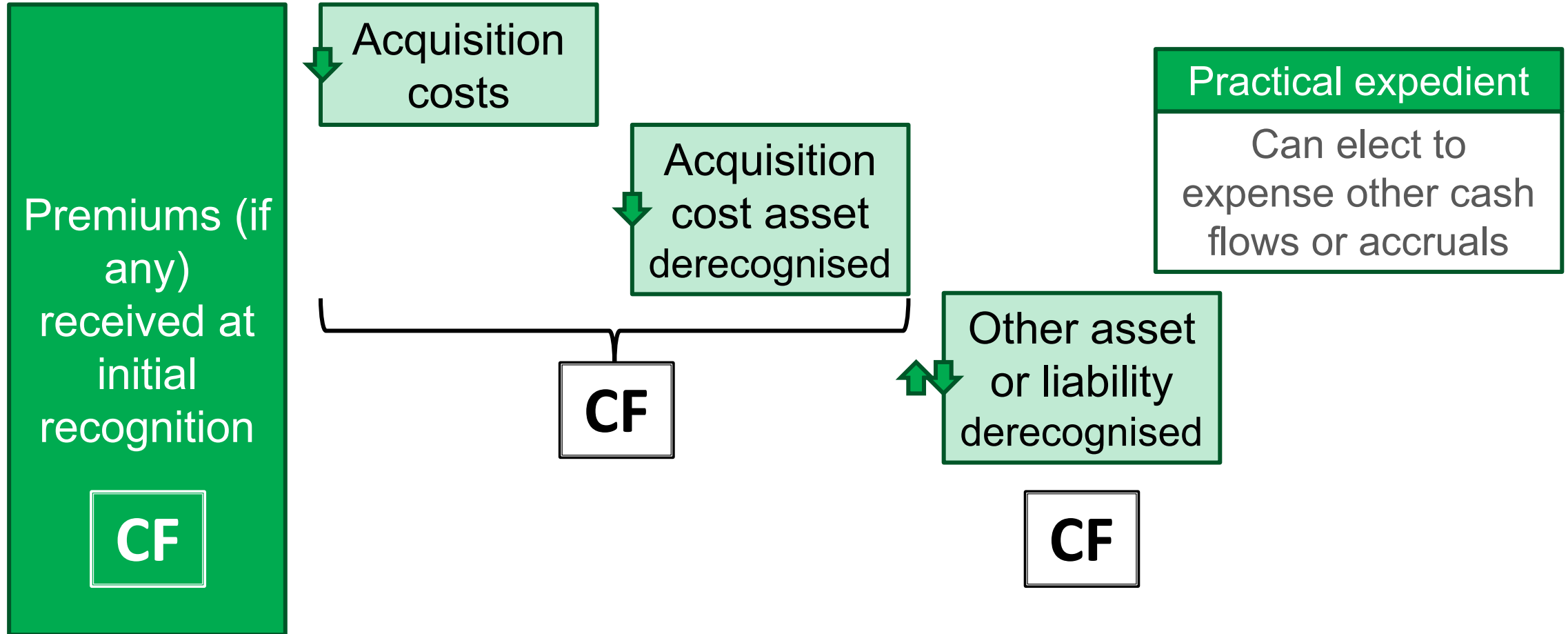
Premium allocation approach

Simplifications - initial measurement



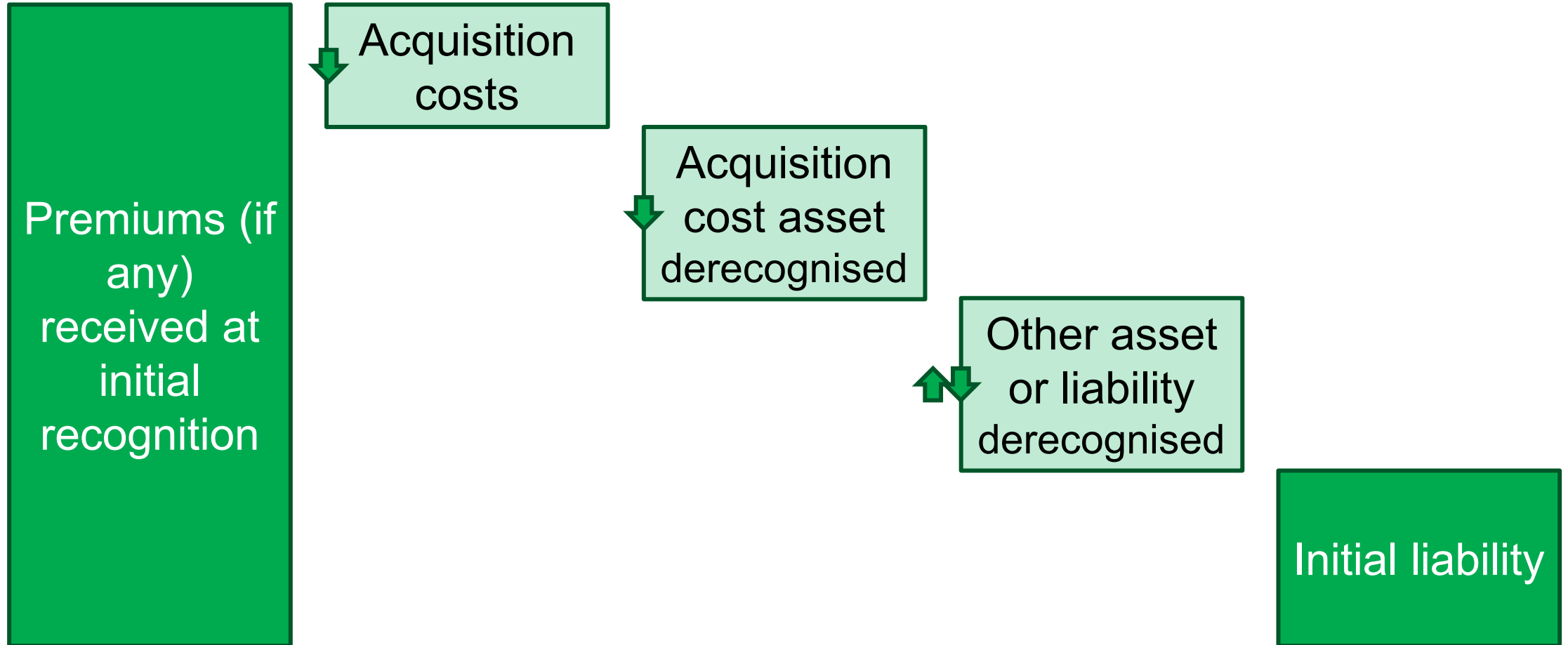
Premium allocation approach

Simplifications - initial measurement



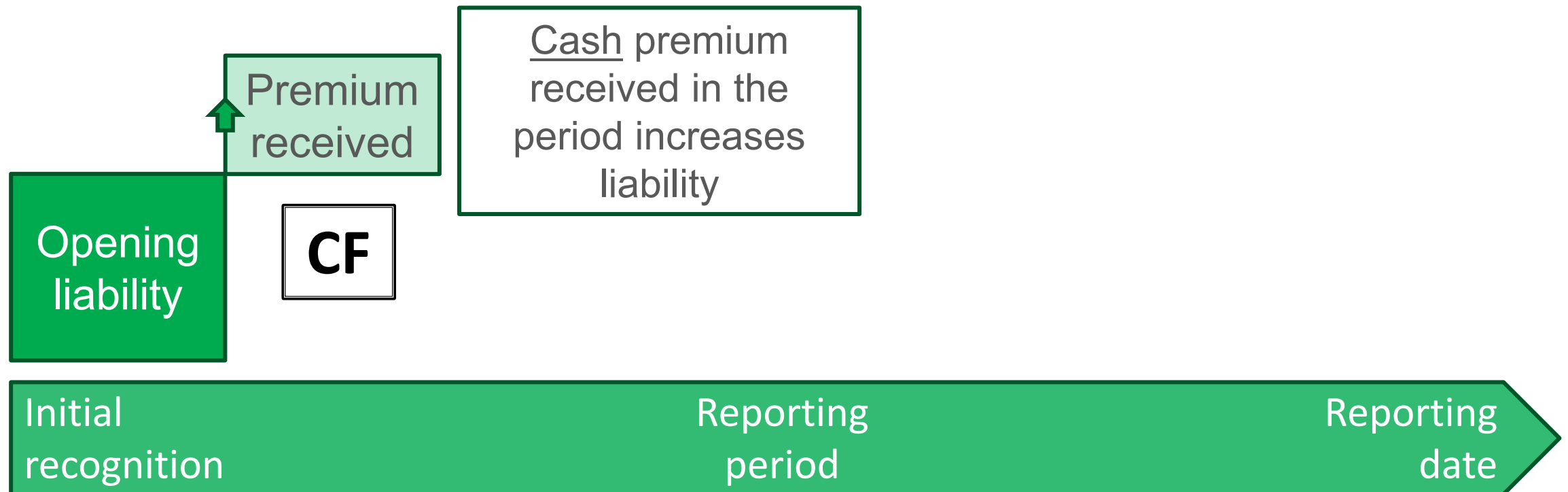
Premium allocation approach

Simplifications - initial measurement



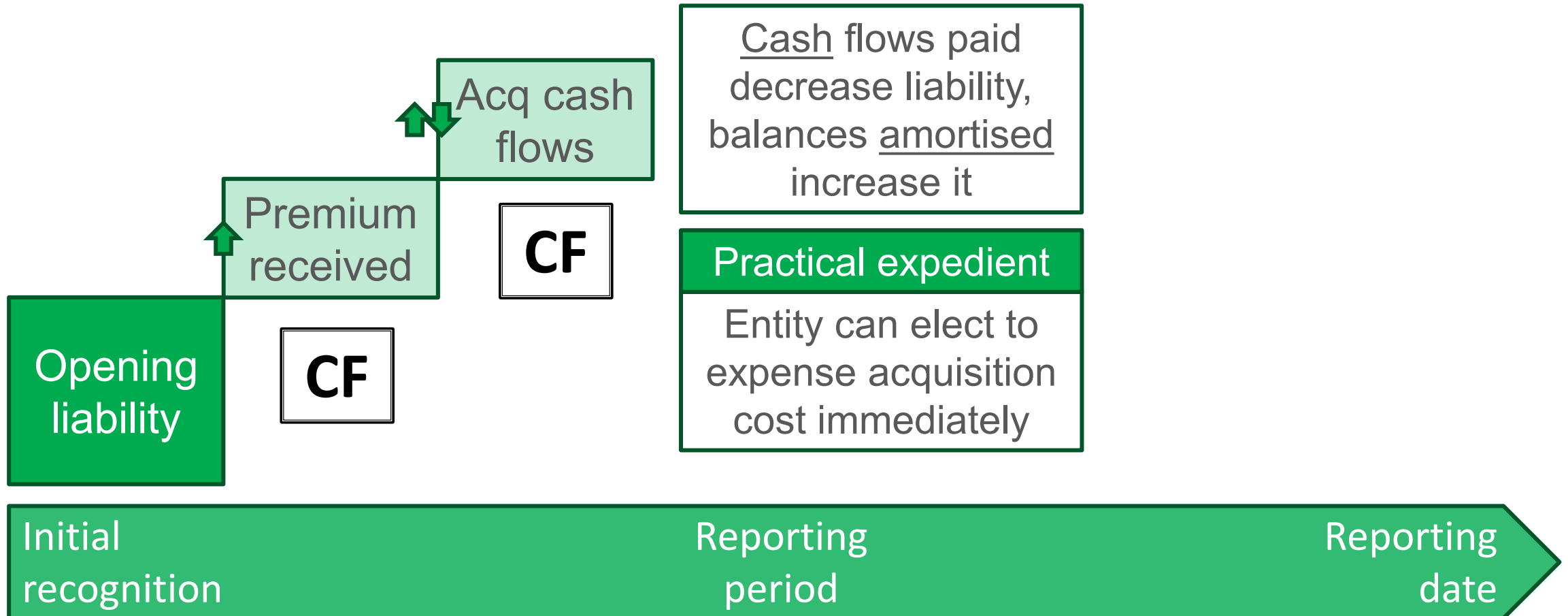
Premium allocation approach

Simplifications - subsequent measurement



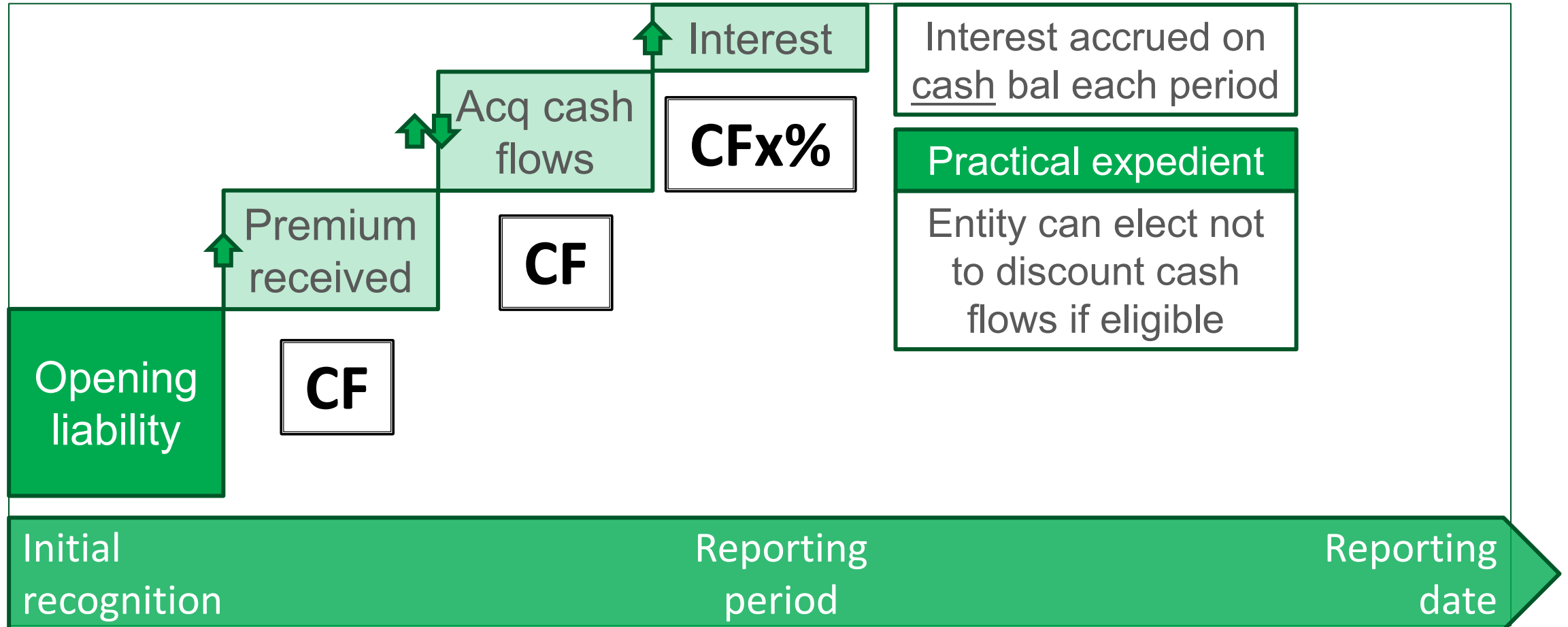
Premium allocation approach

Simplifications - subsequent measurement



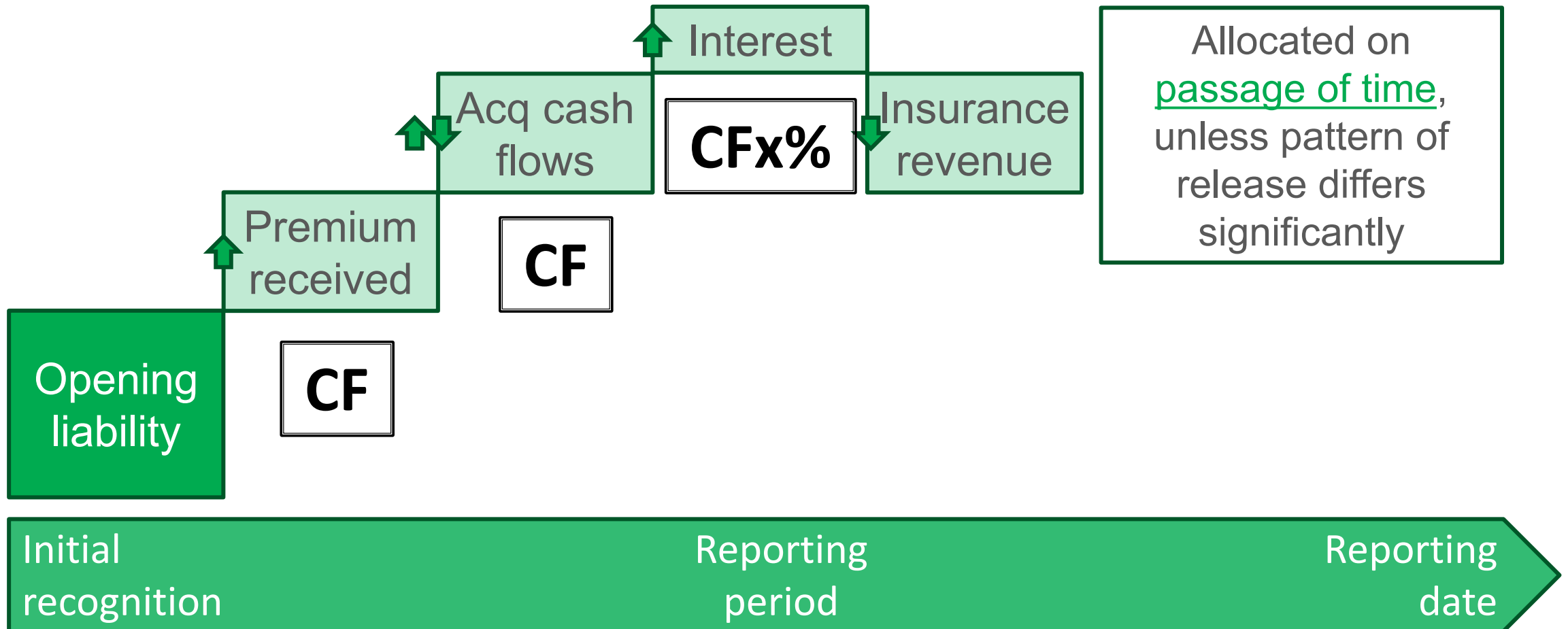
Premium allocation approach

Simplifications - subsequent measurement



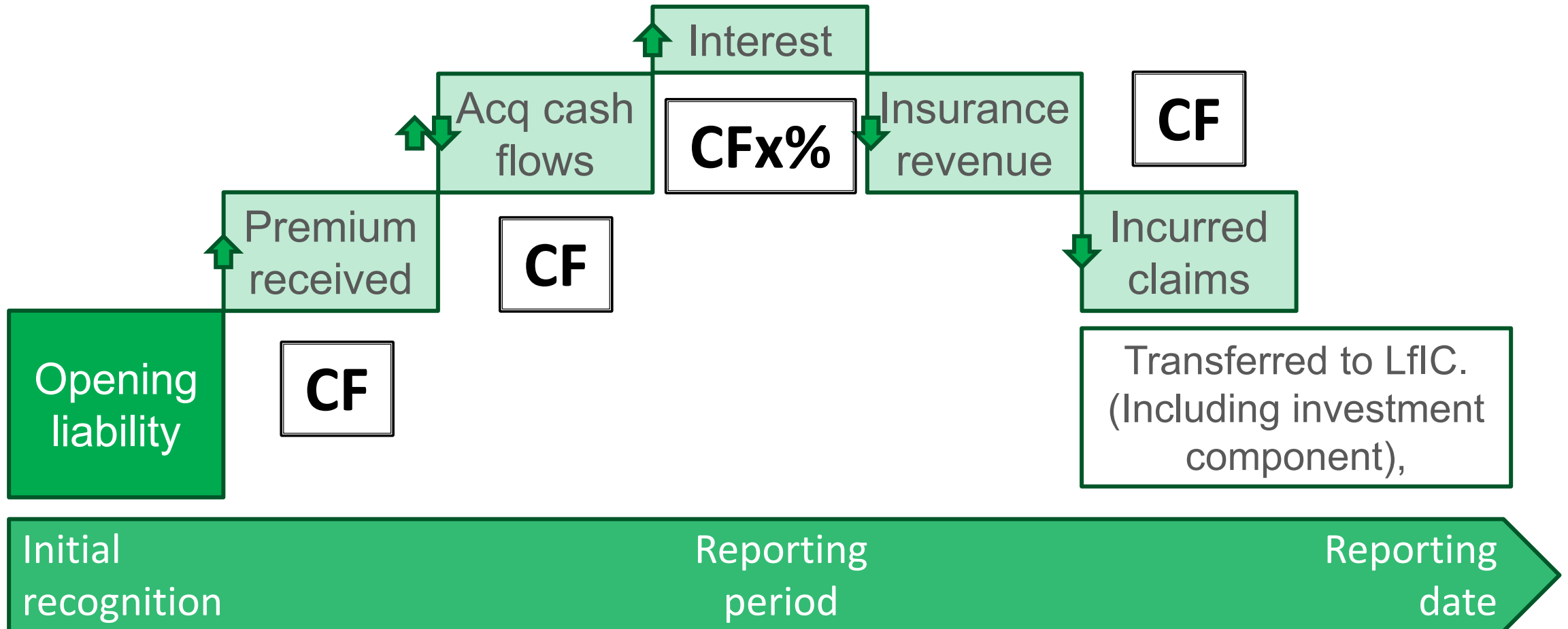
Premium allocation approach

Simplifications - subsequent measurement



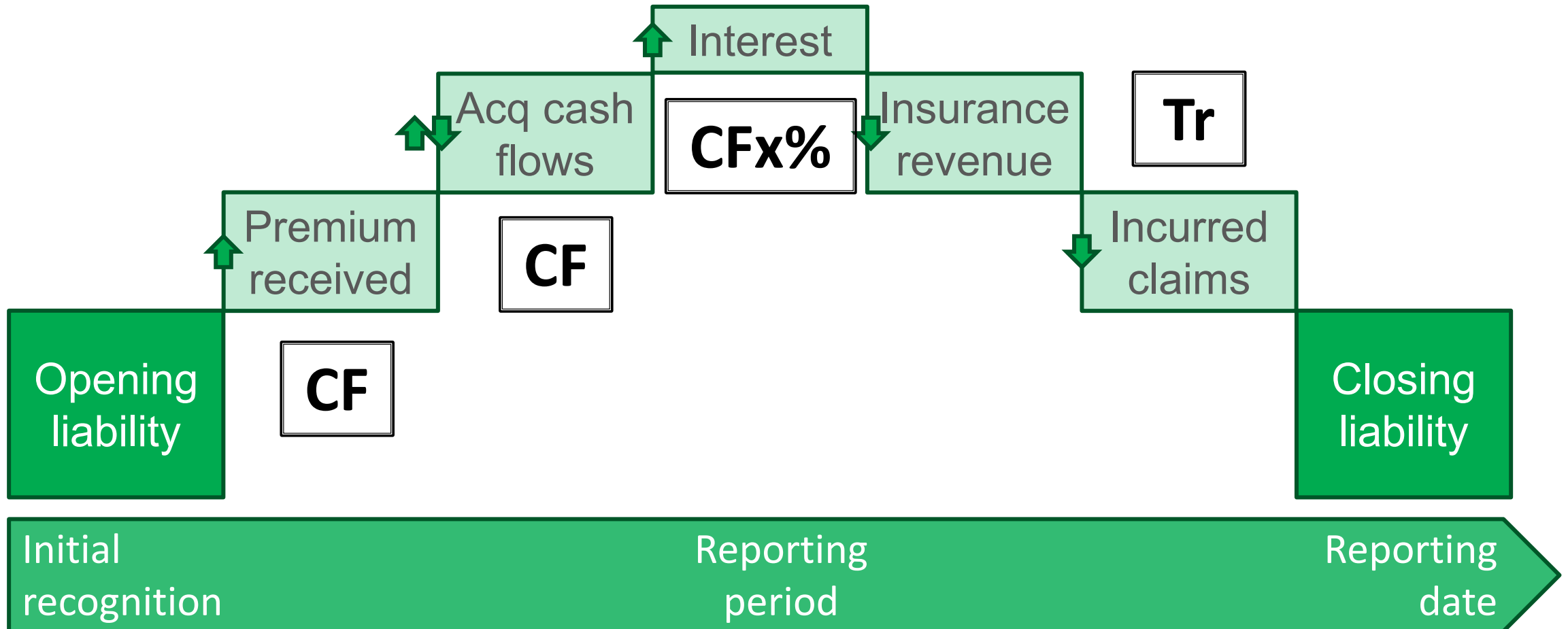
Premium allocation approach

Simplifications - subsequent measurement



Premium allocation approach

Simplifications - subsequent measurement



Interpretations



IFRS 17 Programme

Session 10

Interpretations

IFRS 17 Transition Resource Group

IFRS Interpretations committee



IFRIC Committee

Due Process

Interpretations Committee

Committee receives a question



Is matter widespread/expected to have a material effect?

Yes ↓

Is it necessary to change IFRS Standards?

Yes ↓

Can matter be resolved efficiently and is it sufficiently narrow in scope?

Yes ↓

Narrow scope standard-setting
(ie narrow scope amendment or Interpretation)

Discussed and approved by IASB



No →

Agenda decision
Reports decision and often includes explanatory material*

* The publication of an agenda decision is subject to IASB not objecting to its publication



Transfer of benefits

Agenda decision

- » A method based on:
 - » amount policyholder is able to validly claim meets the principle by:
 - » assigning quantity of benefits to periods entity has obligation to investigate and pay valid claims; and
 - » aligning quantity of benefits with amount validly claimable
 - » the pv of future payments does not meet the principle because it:
 - » assigns quantity of benefits to periods for which the entity has no obligation to investigate and pay valid claims; and
 - » misrepresents quantity of benefits provided in a period.



Applying foreign currency to group of contracts

Agenda decisions

- » Group of insurance contracts that generate cash flows in a foreign currency
- » Standard is not prescriptive, entity can either:
 - » Group contracts according to currency (easiest)
 - » Account for contract in its currency
 - » Then translate result, or
 - » Group contracts with mixed currencies
 - » Determine the CSM for each currency
 - » Then aggregate the CSM



Transition resource group

Purpose of Transition Resource Group



5 meetings held

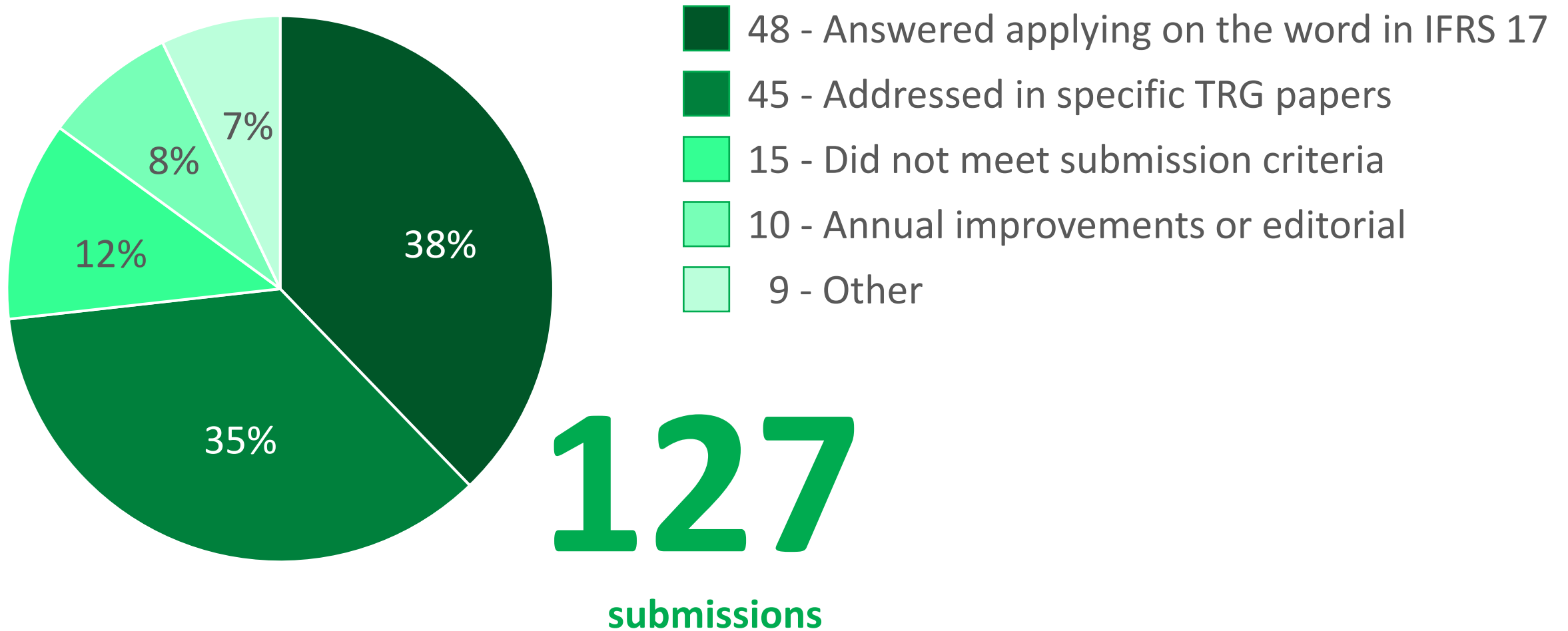
Public forum for discussion of submitted questions

Helps companies to implement IFRS
17

Helps the Board to identify if more support is needed

Webcasts, papers and summaries available for each meeting

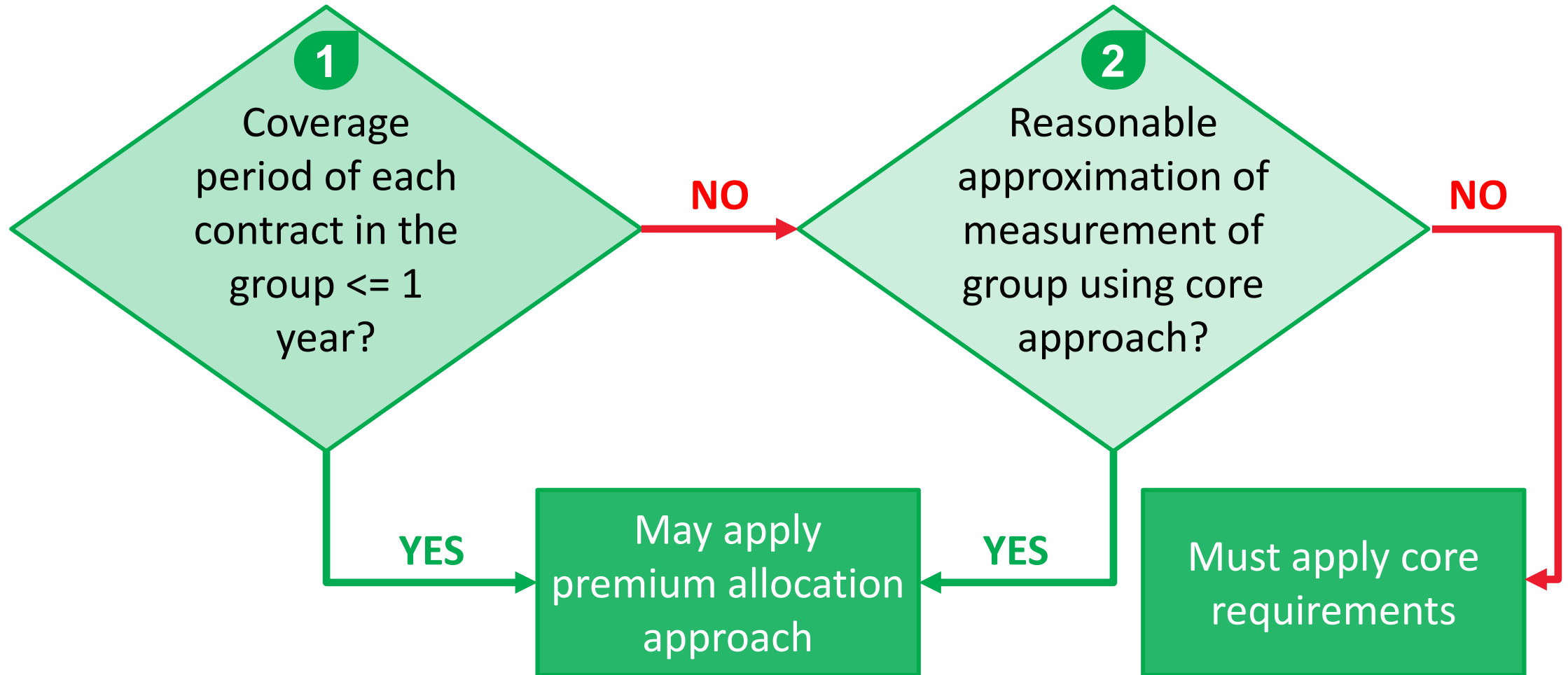
Overview of submissions received



Some questions

Premium allocation approach

Criteria



Example 1: *Contract Boundaries*

- » Entity issues a whole life, stable premium contract. Contract includes right to reprice individual contracts every year. Insurer is not however permitted to re-underwrite.
- » A substantive obligation ends when:
 - » the insurer has the **practical ability to reassess risks** of a policyholder and can **set/reset price or benefits** to fully reflect those risks

Example 1: *Contract Boundaries*

- » Entity issues a whole life, stable premium contract. Contract includes right to reprice individual contracts every year. Insurer is not however permitted to re-underwrite.
- » A substantive obligation ends when:
 - » the insurer has the practical ability to reassess risks of a policyholder and can set/reset price or benefits to fully reflect those risks
- » Insurer can reprice to reflect risk However can't re-underwrite (ie can't test changed risk), most jurisdictions would not be able to price for risk therefore contract boundary is longer than 10 years
- » May depend on strength of regulator

Example 2: *Contract Boundaries*

- » Entity issues 1 year health contracts. Insurer can be forced to renew yearly
 1. Insurer cannot reprice renewed contracts
 2. Insurer cannot reprice individual repriced contracts, but can fully reprice the portfolio each year
- » A substantive obligation ends when:
 - » practical ability to reprice reassessed risks; or
 - » both:
 - » practical ability to reprice portfolio reassessed risk; and
 - » reassessment pricing doesn't consider risks for periods after that date

Example 2: *Contract Boundaries*

- » Entity issues 1 year health contracts. Insurer can be forced to renew yearly
 1. Insurer cannot reprice renewed contracts
 2. Insurer cannot reprice individual repriced contracts, but can fully reprice the portfolio each year
 - » A substantive obligation ends when:
 - » practical ability to reprice reassessed risks; or
 - » both:
 - » practical ability to reprice portfolio reassessed risk; and
 - » reassessment pricing doesn't consider risks for periods after that date
1. Long boundary, 2. short boundary

Example 3: *Contract Boundaries*

- » Entity issues one year vehicle insurance contracts. The insurer prices the contracts on the expectation that 90% of policyholders will renew. The insurer can fully reprice the contracts on renewal, but in practice only does so if it has specific information to indicate this is appropriate.
- » A substantive obligation ends when:
 - » the insurer has the practical ability to reassess risks of a policyholder and can set/reset price or benefits to fully reflect those risks

Example 3: *Contract Boundaries*

- » Entity issues one year vehicle insurance contracts. The insurer prices the contracts on the expectation that 90% of policyholders will renew. The insurer can fully reprice the contracts on renewal, but in practice only does so if it has specific information to indicate this is appropriate.
- » A substantive obligation ends when:
 - » the insurer has the practical ability to reassess risks of a policyholder and can set/reset price or benefits to fully reflect those risks
- » Intent not relevant, it is whether has the right/obligation
- » Does not appear to have either, but is an obligation created by its practice?

Example 4: *Contract Boundaries*

- » Entity issues 1 year motor vehicle contracts. If the policyholder remains claim-free for 3 years, the insurer will pay a premium rebate equal to 10% of gross premiums paid.
- » A substantive obligation ends when:
 - » the insurer has the practical ability to reassess risks of a policyholder and can set/reset price or benefits to fully reflect those risks

Example 4: *Contract Boundaries*

- » Entity issues 1 year motor vehicle contracts. If the policyholder remains claim-free for 3 years, the insurer will pay a premium rebate equal to 10% of gross premiums paid.
- » A substantive obligation ends when:
 - » the insurer has the practical ability to reassess risks of a policyholder and can set/reset price or benefits to fully reflect those risks

Can the insurer cancel or reprice the contract at any point? This may depend on local consumer law.

Example 5: *Contract Boundaries*

» Insurer issues a Funereal policy product. No underwriting occurs – everyone gets the same price. Insurer reprices every year but only for inflation. The same pricing is offered to new policies

Example 5: *Contract Boundaries*

- » Insurer issues a Funereal policy product. No underwriting occurs – everyone gets the same price. Insurer reprices every year but only for inflation. The same pricing is offered to new policies
- » One year contract. Although insurer does not reprice for underwriting., it doesn't do underwriting anyway. The price is the same as for a new customer.



Expected future cash flows

Control of premiums – PAA Approach

Insurers use ledger to control unpaid premiums. PAA Is cash only. Can ledger still be used as a control account?

Expected future cash flows

Control of premiums – PAA Approach

Insurers use ledger to control unpaid premiums. PAA Is cash only. Can ledger still be used as a control account?

Premiums receivable	X	
Insurance liability (LfRC)		X
Accounts for premiums from due date		
Cash received	X	
Premiums receivable		X
Captures receipt of premium		

Yes. Above, premiums receivable recorded on same line of balance sheet as insurance liability (offset)



Expected future cash flows *Incurring but not reported*

Please give an example of claims for events that have occurred but for which claims have not been reported. How they can be assessed?

Expected future cash flows *Incurred but not reported*

Please give an example of claims for events that have occurred but for which claims have not been reported. How they can be assessed?

- » There is frequently a period that lapses between the occurrence of an event and the reporting of an event. So for example, many health insurers allow a period of 60 days between a treatment occurring and the submission of the related invoice.
- » An insurer typically uses historical data to estimate average daily claims and the average period between the event occurring and the submission of the invoice.

Comparison to UPR

- » 12 month motor insurance contract
- » **Single premium** of 12 000, expect that service will be provided evenly over 12 month period:

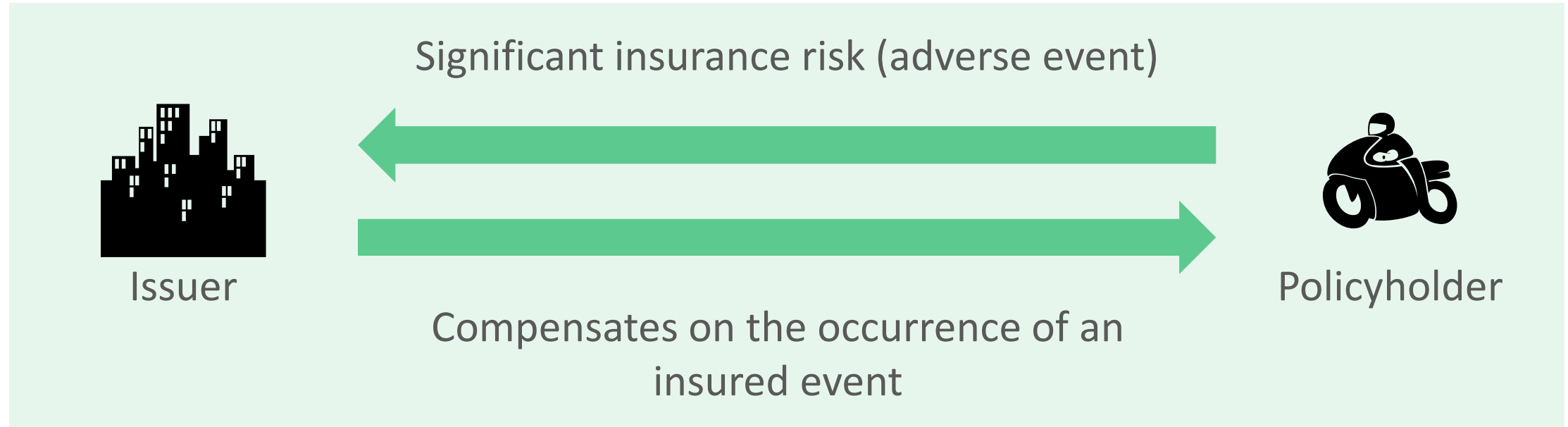
	UPR	PAA
Premium/Revenue	-12 000	-1 000
Transfer to UPR	11 000	-
Profit or loss	-1 000	-1 000
Cash	12 000	12 000
Insurance liability	-11 000	-11 000

Comparison to UPR

- » 12 month motor insurance contract
- » 12 monthly premiums of 1 000, expect that service will be provided evenly over 12 month period:

	UPR	PAA
Premium/Revenue	-12 000	-1 000
Transfer to UPR	11 000	-
Profit or loss	-1 000	-1 000
Cash	1 000	1 000
Insurance premium receivable	11 000	-
Insurance liability	-11 000	-

What is an insurance contract?



↔ IFRS 17 and IFRS 4—same definition

↔ IFRS 17 two minor changes to guidance but no expected changes in assessments for majority of contracts

↔ No change from IFRS 4

↗ Change from IFRS 4

Definition of insurance

Example: Longevity swap

» Is a **longevity swap** based on a longevity index an insurance contract?

Does the counterparty accept

» **significant insurance risk** by

» agreeing to **compensate the policyholder** if

» a **specified uncertain future event adversely** affects the policyholder

Definition of insurance

Example: Payment in kind

» Is a **health contract** that provides medical services at the issuer's hospital network an insurance contract?

Does the counterparty accept

» **significant insurance risk** by

» agreeing to **compensate the policyholder** if

» a **specified uncertain future event adversely** affects the policyholder

Definition of insurance

Example: New for old

» Is a contract that **replaces a damaged vehicle** with a brand new vehicle an insurance contract?

Does the counterparty accept

» **significant insurance risk** by

» agreeing to **compensate the policyholder** if

» a **specified uncertain future event adversely** affects the policyholder

Definition of insurance

Example: Annuity

» Is an **annuity contract** an insurance contract?

Does the counterparty accept

» **significant insurance risk** by

» agreeing to **compensate the policyholder** if

» a **specified uncertain future event adversely** affects the policyholder

Definition of insurance

Example: Credit derivative

» Is a **credit derivative** instrument an insurance contract?

Does the counterparty accept

» **significant insurance risk** by

» agreeing to **compensate the policyholder** if

» a **specified uncertain future event** adversely affects the policyholder

Definition of insurance

Example: A mutual

» Does a mutual entity accept insurance risk?

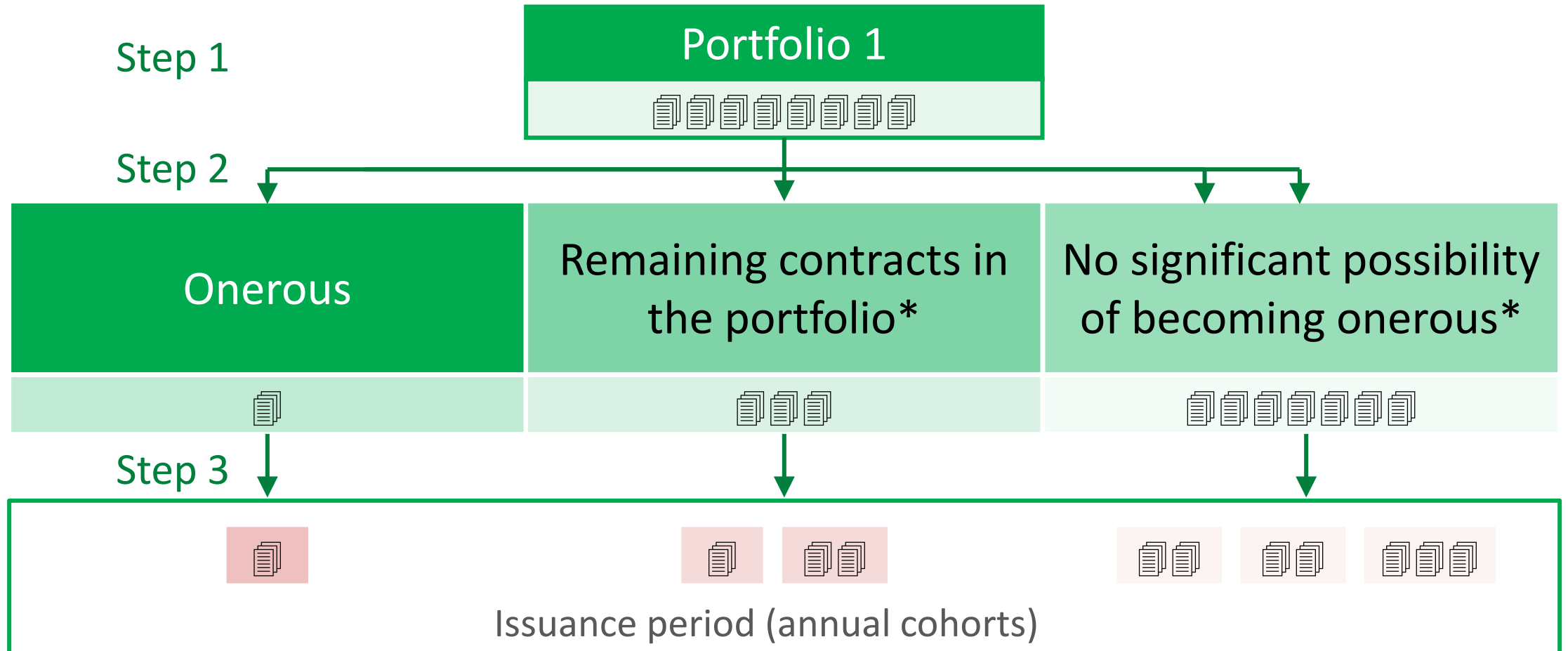
A mutual pools risk for the benefit of participants. It is a separate entity from the participants. It distributes first to those that submit valid claims but ultimately distributes the residual to policyholders.

Does the mutual accept

- » significant insurance risk by
- » agreeing to compensate the policyholder if
- » a specified uncertain future event adversely affects the policyholder

How are contracts grouped?

Step #3



* At initial recognition, if any

Why group contracts?

Example

100 2 yr contracts: premium 50 pa, expect 2 contracts to claim 3 500 each year, all expected claims emerge day 1.

Whole contract	Grouped	Individual contracts	
		Profitable	Loss making
Share of premium	10 000	9 800	200
Claims	(7 000)	-	(7 000)
Cumulative Profit/loss	3 000	9 800	(6 800)
Day 1 Profit/(loss)	-	-	(6 800)
Year 1 Profit/(loss)	1 500	4 900	(6 800)
		Year 1 loss: (1 900)	

Why not group contracts?

Example

2 product lines, car and house, car premium 5 000, expected claims 1 500, house premium 5 000, claims 5 500.

Whole contract	Grouped	Sub groups	
		Car	House
Share or premium	10 000	5 000	5 000
Claims	(7 000)	(1 500)	(5 500)
Cumulative Profit/loss	3 000	3 500	(500)
Day 1 Profit/(loss)	-	-	(500)
Year 1 Profit/(loss)	1 500	1 750	(500)
		Year 1 profit: 1 250	

Why not group all similar contracts?

Example

2 year car insurance, written year 1: premium 5 000, actual claims 750pa, year 2 premium 5 000, actual claims 2 750pa.

Whole contract	Grouped Year 2	Sub groups Year 2	
		Issue year 1	Issue year 2
Share or premium	5 000	2 500	2 500
Claims	(3 500)	(750)	(2 750)
Cumulative Profit/loss	1 500	1 750	(250)
Year 2 Profit/(loss)	1 500	1 750	(250)
		Year 2 profit: 1 500	

How are contracts grouped?

Example 1

» A set of 100 vehicle contracts written in the same 12 month period. The entity expects that 5 policyholders will claim, but does not know which 5

How are contracts grouped?

Example 1

- » A set of 100 vehicle contracts written in the same 12 month period. The entity expects that 5 policyholders will claim, but does not know which 5
- » The 100 contracts are a group; the company does not treat the 5 contracts as a separate group, either at issue or subsequently when the claims emerge

How are contracts grouped?

Example 2

- » A company issues 500 vehicle contracts;
 - » 100 are issued to young drivers at a promotional rate
 - » 400 are priced normally
 - » The 500 contracts are otherwise identical.
 - » Insurer believes profitable contracts will cover possible losses on under-priced contracts

How are contracts grouped?

Example 2

- » A company issues 500 vehicle contracts;
 - » 100 are issued to young drivers at a promotional rate
 - » 400 are priced normally
 - » The 500 contracts are otherwise identical.
 - » Insurer believes profitable contracts will cover possible losses on under-priced contracts
- » Group A: Under-priced contracts (any losses are recognised immediately)
- » Group B: profits are recognised over the coverage period

Questions

In this example it will be 2 groups. The reason for splitting young drivers and normal drivers is the fact that contracts for young drivers are underpriced, isn't it? Are underpriced contracts onerous at initial recognition?

Questions

In this example it will be 2 groups. The reason for splitting young drivers and normal drivers is the fact that contracts for young drivers are underpriced, isn't it? Are underpriced contracts onerous at initial recognition?

Correct

How are contracts grouped?

Example 3

- » A company issues 500 vehicle contracts; by law it cannot discriminate based on gender
 - » 250 issued to male drivers under-priced relative to risk
 - » 250 issued to female drivers over-priced relative to risk
 - » 500 contracts are otherwise identical.

How are contracts grouped?

Example 3

- » A company issues 500 vehicle contracts; by law it cannot discriminate based on gender
 - » 250 issued to male drivers under-priced relative to risk
 - » 250 issued to female drivers over-priced relative to risk
 - » 500 contracts are otherwise identical.
- » The 500 contracts are a group; the regulatory requirement means the company does not have to split the contracts into two groups.

Core Requirements

'Building block Approach'

All insurance contracts measured as **the sum of:**

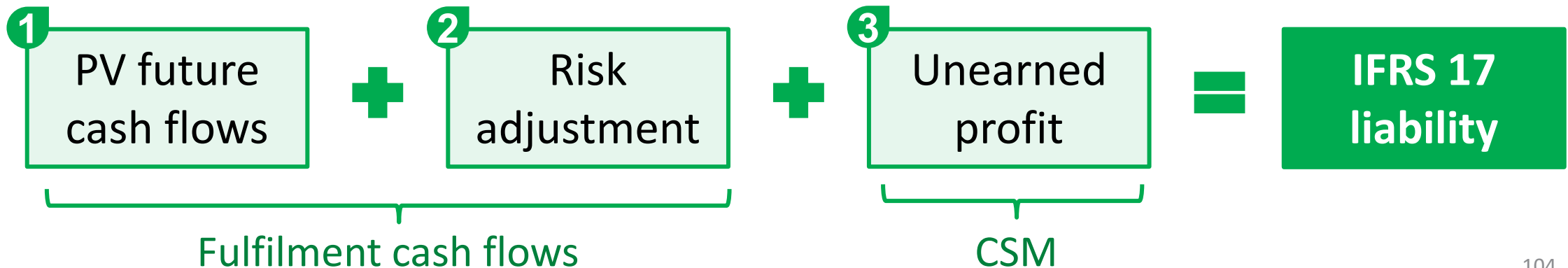
» Fulfilment cash flows (FCF)

1. Present value of probability-weighted expected cash flows

2. Plus an explicit risk adjustment for non-financial risk (eg insurance risk)

» Contractual service margin (CSM)

3. The unearned profit from the contracts



Questions

» IFRS 17 liability includes fulfillment cash flows and contractual service margin. So, they are elements of the carrying amount of the liability. Is it mean that initial carrying amount is = 0?

Questions

- » IFRS 17 liability includes fulfillment cash flows and contractual service margin. So, they are elements of the carrying amount of the liability. Is it mean that initial carrying amount is = 0?
- » Potentially. Risk adjusted present value of all cash flows plus the risk adjustment is exactly offset by the CSM, so that will often mean that the day one initial carrying amount is zero.
- » The first cash flow that occurs will result in that changing.
- » However sometimes the first cash flow happens before initial recognition which will mean that the day 1 is not zero

Questions

» But we should account(include) these liabilities in our accounting systems/books (reflect in our accounts), shouldn't we? And after initial recognition carrying amount will not = 0 because of regular adjustments/"amortization", isn't it?

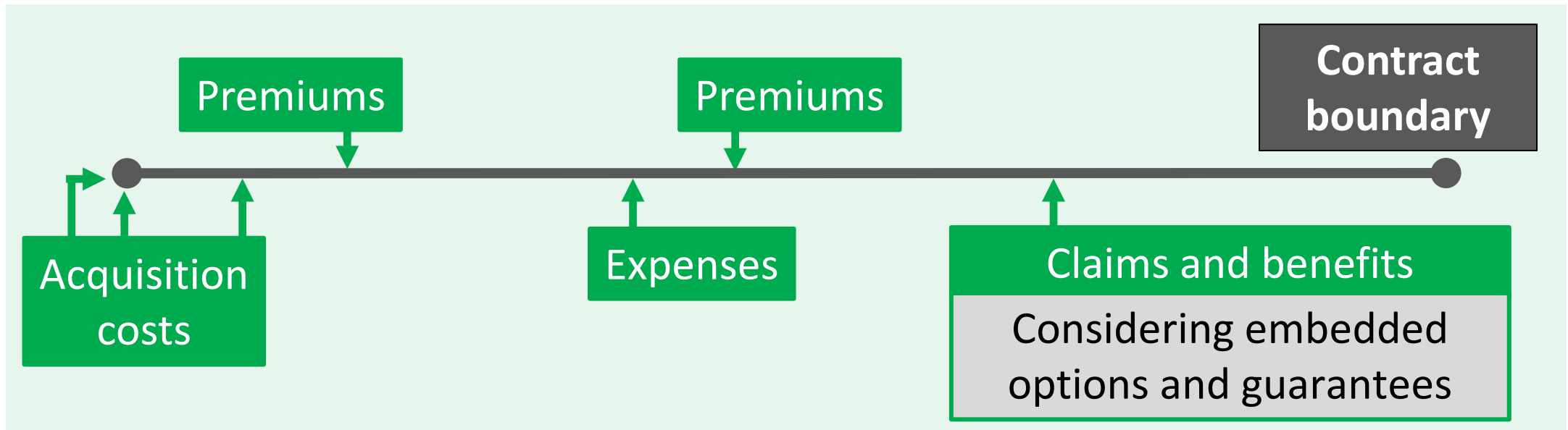
Questions

- » But we should account(include) these liabilities in our accounting systems/books (reflect in our accounts), shouldn't we? And after initial recognition carrying amount will not = 0 because of regular adjustments/"amortization", isn't it?
- » Correct. The day one carrying amount is adjusted for at least:
 - » Actual cash flows
 - » Changes in expectations
 - » Unwinding of discount rates

1 Present value of future cash flows

Cash flows

- » Current estimate of future cash flows in contract boundary



- » Probability weighted and unbiased
- » Stochastic modelling for financial options and guarantees, where relevant

Questions

» Cash flows should include probability-weighted estimate (ie expected value) of the future cash flows. Should we “weight” both – cash inflows and cash outflows? Should we define/use ALL or the most probable scenarios?

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- » Cash flows should include probability-weighted estimate (ie expected value) of the future cash flows. Should we “weight” both – cash inflows and cash outflows? Should we define/use ALL or the most probable scenarios?
- » Probability weighting should be applied to both inflows and outflows. It is not necessarily necessary to weight all scenarios, but the weighted scenarios should be representative and should not exclude any significant scenarios.
- » B37 to B40 provide guidance

Questions

» Should we include subsequent expenses (e.g. administrative, salary of our personnel) in fulfillment cash flows? Should we reassess them subsequently?

Questions

- » Should we include subsequent expenses (e.g. administrative, salary of our personnel) in fulfillment cash flows? Should we reassess them subsequently?
- » Yes, to the extent that they that relate directly to the fulfilment of the contract.
- » **B65** of the standard has a list of what must be included, eg **B65(h)** includes policy administration and maintenance costs.
- » **B66** contains a a list of what must not be included eg. **B66(d)** excludes cash flows relating to costs that cannot be directly attributed such as training costs.

Questions

If a company wants to include some administrative costs into fulfillment cash flows, but its sum can be estimated approximately, should it do it at the initial recognition and then adjust it, if needed, or adjust the fulfillment cash flows when the sum can be defined accurately after initial recognition.

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If a company wants to include some administrative costs into fulfilment cash flows, but its sum can be estimated approximately, should it do it at the initial recognition and then adjust it, if needed, or adjust the fulfilment cash flows when the sum can be defined accurately after initial recognition.

An insurance company is required to include certain expected admin cash flows (see [B65](#)).

This will always be a 'best estimate' like most future cash flows, and must be updated at each reporting period.

Present value of future cash flows

Example 1: Contract Boundaries

- » Entity issues a whole life, stable premium contract. Contract includes right to reprice individual contracts after ten years. Insurer is not however permitted to re-underwrite.
- » A substantive obligation ends when:
 - » the insurer has the **practical ability to reassess risks** of a policyholder and can **set/reset price or benefits** to fully reflect those risks

Present value of future cash flows

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- » Insurer can reprice to reflect risk However can't re-underwrite (ie can't test changed risk), most jurisdictions would not be able to price for risk therefore contract boundary is longer than 10 years
- » May depend on strength of regulator

Present value of future cash flows

Example 2: Contract Boundaries

- » Entity issues 1 year health contracts. Insurer can be forced to renew yearly
 1. Insurer cannot reprice renewed contracts
 2. Insurer cannot reprice individual repriced contracts, but can fully reprice the portfolio each year
- » A substantive obligation ends when:
 - » practical ability to reprice reassessed risks; or
 - » both:
 - » practical ability to reprice portfolio reassessed risk; and
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Present value of future cash flows

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 - » both:
 - » practical ability to reprice portfolio reassessed risk; and
 - » reassessment pricing doesn't consider risks for periods after that date
1. Long boundary, 2. short boundary

Present value of future cash flows

Example 3: Contract Boundaries

- » Entity issues one year vehicle insurance contracts. The insurer prices the contracts on the expectation that 90% of policyholders will renew. The insurer can fully reprice the contracts on renewal, but in practice only does so if it has specific information to indicate this is appropriate.
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Present value of future cash flows

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- » Does not appear to have either, but is an obligation created by its practice?

Present value of future cash flows

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Present value of future cash flows

Cash flows

IFRS 17 requires defined expenses be included in FCF. What accounting if different expenses included in prudential?

Present value of future cash flows

Cash flows

IFRS 17 requires defined expenses be included in FCF. What accounting if different expenses included in prudential?

» If IFRS 17 higher, no action required (regulator considers 'higher of').

» If IFRS 17 reserve is lower, then insurer:

- Must typically 'top up' prudential requirements; and
- Can create an IFRS equity reserve for difference between IFRS 17 reserve and prudential reserve.



Questions

Are regressive payments from third parties (guilty driver on the auto insurance) included in fulfillment cash flows?

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Are regressive payments from third parties (guilty driver on the auto insurance) included in fulfillment cash flows?

It reduces the expected net pay-out of claims, so it is modelled as part of claims experience in Liability for remaining coverage. Once a claim is incurred, then the net expected claim is 'transferred' to Liability for incurred claims.

Present value of future cash flows

Cash flows

IFRS 17 has no restrictions on the size of expected Salvage and subrogation (S&S) flows. Should S&S be calculated using the same approach as other components of FCF?

Reasonable to require that S&S not exceed outgoings?

Present value of future cash flows

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» Yes, it is a cash flow like other cash flows.

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» Yes, it is a cash flow like other cash flows.

Reasonable to require that S&S not exceed outgoings?

» No. Typically not expected that recovery cash flows exceed claim cash flows, but if they do and insurer can retain surplus, that should be captured



Present value of future cash flows

Cash flows

IFRS 17 permits the recognition of S&S as a separate asset. When is S&S a separate asset, and when is it FCF?

Present value of future cash flows

Cash flows

IFRS 17 permits the recognition of S&S as a separate asset. When is S&S a separate asset, and when is it FCF?

- » Typically remain FCF until all obligations to policyholder satisfied. If S&S still not settled and policyholder has no further rights, then consider recording as a separate asset
- » Some ambiguity in scope definitions of IFRS 9 and IFRS 17. Some argue IFRS 9 should apply if a contract right exists
- » In practice, both approaches are being applied

Present value of future cash flows

Cash flows

Premium taxes/VAT are included in FCF when FCF is recognized. When due, FCF decreases, and IT is not considered to be insurance revenue.

So when premium taxes/VAT are deducted from LRC, do we have the postings as: DT LRC – CR Cash?

Present value of future cash flows

Cash flows

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Correct

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Correct



Present value of future cash flows

Acquisition costs

Acquisition costs may after initial recognition. Can it be adding new contracts to a group of contracts? Should we estimate such future acquisition cash flows at initial recognition?

Present value of future cash flows

Acquisition costs

Acquisition costs may after initial recognition. Can it be adding new contracts to a group of contracts? Should we estimate such future acquisition cash flows at initial recognition?

- » This is an expected future cash flow,
- » It is (likely) directly related to the insurance contract
- » So like other expected future cash flows:
 - » it is estimated at initial recognition
 - » And included in the initial measurement of FCF



Expected future cash flows *Boundary*

Should we include subsequent expenses (e.g. administrative, salary of our personnel) in fulfillment cash flows? Should we reassess them subsequently?

Expected future cash flows

Boundary

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Expected future cash flows

Weighting

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Expected future cash flows

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- » **B37 to B40** provide guidance



Expected future cash flows

Loans to policyholders

How are loans to policyholders accounted for?

Expected future cash flows

Loans to policyholders

How are loans to policyholders accounted for?

Journals	Debit	Credit
FCF (Decrease in future benefits)	X	
Cash Paid		X
Accounting for advanced loan (Note: If decrease in benefits not equal to loan, there may also be an experience adjustment)		
FCF (Expected repayment of loan)	X	
FCF (Increase in future benefits)		X
Accounting for expected future repayments		



Expected future cash flows

Loans to policyholders

How are repayments of loans accounted for?

Expected future cash flows

Loans to policyholders

How are repayments of loans accounted for?

Journals	Debit	Credit
Cash received	X	
FCF (Expected repayment of loan)		X

Receipt of cash reduced the amount of future cash to be received (consistent with FCF elsewhere)



Present value of future cash flows

Discount rate

Available observable discount rate yield curve is shorter than the duration of some insurance products

Present value of future cash flows

Discount rate

Available observable discount rate yield curve is shorter than the duration of some insurance products

- » Some jurisdictions have considered a comply or explain approach. Under this approach, the regulator
 - » publishes a risk-free curve
 - » Entities are allowed to deviate from the curve, but if they do so, they must explain in their financial statements why it is considered appropriate to do so



Present value of future cash flows

Discount rate

Discount rates: Should (or can) we use one single rate for discounting all cash flows from the contract or number of rates? Should (or can) we use one rate for discounting of cash flows from all contracts within one group?

Present value of future cash flows

Discount rate

Discount rates: Should (or can) we use one single rate for discounting all cash flows from the contract or number of rates? Should (or can) we use one rate for discounting of cash flows from all contracts within one group?

- » In theory, you should use a different rate for each set of cash flows that have different risk characteristics (so for example, you could use a risk free rate for the claims assumptions, a rate for premiums that considers policyholder credit risk, etc.
- » However, IFRS 17 envisages the use of a 'blended' rate, or a risk free rate that can be applied to all flows (see for eg B77)



Present value of future cash flows

Discount rate

For the recognition of finance expenses – do we use the same rate (defined at initial recognition) for each period during the all “life” of contract or the rate is reassessed each period?

Present value of future cash flows

Discount rate

For the recognition of finance expenses – do we use the same rate (defined at initial recognition) for each period during the all “life” of contract or the rate is reassessed each period?

» Interest rate curves are reset at the end of each period to reflect market consistent views at that point in time.



Risk adjustment

Can/must you use the regulatory risk adjustment?

Risk adjustment

Can/must you use the regulatory risk adjustment?

- » IFRS 17 defines RA as ‘the compensation the entity requires for bearing the uncertainty’.
- » Entity specific measure and provides some latitude
- » Many have concluded regulation does establish RA, because prudential requirements are a constraint of doing business
- » However, this does require that entity explicitly consider these requirements when considering appropriateness of pricing



Contractual service margin

When the insurance contract is recognized, any other asset or liability previously recognized should be derecognized through correcting CSM?

Contractual service margin

When the insurance contract is recognized, any other asset or liability previously recognized should be derecognized through correcting CSM?

» Correct. See examples on next slides

Core model

Journals

» Expect premium 2 500, claims 1 500, risk 150, interest 0%,

Journals	Debit	Credit
FCF (PV of future all cash flows)	1 000	
FCF (Risk margin)		150
CSM		850
Initial recognition of an insurance contract		

Core model

Journals

» Expect premium 2 500, claims 1 500, risk 150, interest 0%, pre-contract expenses of 200

Journals	Debit	Credit
Prepaid expenses asset	200	
Cash Paid		200
Prepaid expenses cash flow (before contract recognised)		
FCF (PV of future all cash flows)	1 000	
Prepaid expense asset		200
FCF (Risk margin)		150
CSM		650
Initial recognition of an insurance contract		

Contractual service margin

For example, insurance companies use clinics and pharmacies. If bills are paid before recognition of insurance contract, should prepaid expense be recognized and included in CSM when the insurance contract recognized?

Contractual service margin

For example, insurance companies use clinics and pharmacies. If bills are paid before recognition of insurance contract, should prepaid expense be recognized and included in CSM when the insurance contract recognized?

» To the extent that the prepaid expense qualifies an asset (or liability), and would have been recognized FCF applying IFRS if incurred after recognition, then the asset/liability must be collapsed into CSM when insurance contract is recognized (see **IFRS 17.38(c)(ii)** and **B66A**).



Contractual service margin *Interest accretion*

The discount rate determined at initial recognition is used to accrete interest on CSM. Does this mean that no matter how many contracts I will add to the group and what ever else happens to the group, the discount rate will always be the same?

Contractual service margin

Interest accretion

The discount rate determined at initial recognition is used to accrete interest on CSM. Does this mean that no matter how many contracts I will add to the group and what ever else happens to the group, the discount rate will always be the same?

- » The locked in rate is based on the average rate over the period new contracts are added (see **B73**: To determine the discount rates at the date of initial recognition of a group of contracts an entity may use weighted-average discount rates over the period that contracts in the group are issued).
- » The rate stops being adjusted when no new contracts are added.



Present value of future cash flows

Changes

Where do we recognize changes in estimates of the future cash flows?

Present value of future cash flows

Changes

Where do we recognize changes in estimates of the future cash flows?

- » Changes in estimates of future cash flows are recognized by:
 - » adjustment to Fulfilment cash flows , and
 - » A corresponding change to unearned profit (CSM) if there is CSM available, otherwise adjust profit and loss
- » Note you can 'rebuild' CSM.
- » Change in expected future cash flows changes FCF and CSM, and usually has a net zero impact on total liability
- » But note also experience adjustments (changes to current)



Experience adjustments

Experience adjustments on premiums. If expected premiums weren't received (and don't relate to future services), do we decrease insurance revenue?

Experience adjustments

Experience adjustments on premiums. If expected premiums weren't received (and don't relate to future services), do we decrease insurance revenue?

Yes, with a caveat.

- » If an entity does not receive a premium expected,
- » **but** expects to receive that premium in a future period,
- » then it does not adjust insurance revenue.

Contract Liability or asset

IFRS 17.78 states that insurance contracts may be assets or liabilities. When will an insurance contract be an asset?

Contract Liability or asset

IFRS 17.78 states that insurance contracts may be assets or liabilities. When will an insurance contract be an asset?

At initial recognition, the total would typically be zero (CSM offsets fulfilment cash flows).

Thereafter, it depends on the order of cash flows.

- » If a premium is paid first then it becomes a liability (policyholder has fulfilled their obligation, but insurer hasn't).
- » However, if eg acquisition cash flows are first, then asset (Insurer has fulfilled part of obligation, policyholder not)