IFRS 17 *Insurance Contracts*

1-Overview :

IFRS 17 was issued in 2017 and is mandatorily applicable for the period starting on or after ***1 January 2023***.

It replaced "temporary" standard IFRS 4 Insurance Contracts, which is no longer applicable.

2-Objective :

IFRS 17 establishes the **principles** for recognition, measurement, presentation and disclosure of the **contracts within the scope of IFRS 17** .

The objective is to ensure that entities provide **relevant information** faithfully representing insurance contracts.

This information gives a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows.

3-scope : IFRS 17 applies to the **following types of contracts**, regardless who issued them:

a)Insurance contracts, including reinsurance contracts issued;

b)Reinsurance contracts held; and

c)Investment contracts with discretionary participation features, if the entity issues also insurance contracts.

As a result, if any entity issues the insurance contract, IFRS 17 applies.

And, it may not necessarily be titled "insurance contract" – if it meets the definition in IFRS 17, it must be applied.

IFRS 17 sets a few exception which are as follow :

(a) warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer (IFRS 15 Revenue from Contracts with Customers).

(b) employers' assets and liabilities from employee benefit plans (see IAS 19 Employee Benefits and IFRS 2 Share-based Payment) and retirement benefit obligations reported by defined benefit retirement plans (IAS 26 Accounting and Reporting by Retirement Benefit Plans).

(c) contractual rights or contractual obligations contingent on the future use of, or the right to use, a non-financial item (for example, some licence fees, royalties, variable and other contingent lease payments and similar items: see IFRS 15, IAS 38 Intangible Assets and IFRS 16 Leases).

(d) residual value guarantees provided by a manufacturer, dealer or

retailer and a lessee's residual value guarantees when they are embedded in a lease (IFRS 15 and IFRS 16).

(e) financial guarantee contracts, unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts.The issuer shall choose to apply either IFRS 17 or IAS 32 , IFRS 7: Disclosures and IFRS 9. The issuer may make that choice contract by contract, but the choice for each contract is irrevocable.

(f) contingent consideration payable or receivable in a business combination (IFRS 3).

(g) insurance contracts in which the entity is the policyholder, unless those contracts are reinsurance contracts held (see 3b).

(h) credit card contracts, or similar contracts that provide credit or payment arrangements, that meet the definition of an insurance contract.

4-Definition:

Insurance contract : is a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policy holder if a specified uncertain future event (insured event)adversely affects the policyholder.

The **key elements** of the insurance contract are:

Significant insurance risk; and Insured event .

A reinsurance contract : is an insurance contract issued by the reinsurer to compensate another entity for claims arising from one or more insurance contracts it holds as an issuer.

Portfolio of insurance contracts : Insurance contracts subject to similar risks and managed together.

Contractual service margin :A component of the carrying amount of the asset or liability for a group of insurance contracts representing the unearned profit the entity will recognise as it provides services under the insurance contracts in the group.

Insurance risk : Risk, other than financial risk, transferred from the holders of a contract to the issuer.

Fulfilment cash flows : An explicit, unbiased and probability-weighted estimate (i.e. expected value) of the present value of the future cash out-flows less the present value of the future cash inflows that will arise as the entity fulfils insurance contracts, including arisk adjustment for non-financial risk.

Risk adjustment for non-financial risk : The compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows arising from non-financial risk as the entity fulfils insurance contracts.

5-Separating components from an insurance contract :

An insurance contract may contain one or more components that would be within the scope of another Standard if they were separate contracts. For example, an insurance contract may include an *investment component* or a component for services other than *insurance contract services* (or both). An entity shall identify and account for the components of the contract

An insurance contract can contain some components besides the insurance. These components can be:

Embedded derivative – in this case, we need to separate it and account for the embedded derivative under IFRS 9 if criteria are met;

Investment component – here; if it is:

Distinct: separate it and apply IFRS 9;

Not distinct: account for the whole contract under IFRS 17, but exclude results from the investment component from the insurance results.

Distinct goods or services – separate them and account for them under IFRS 15 Revenue from Contracts with Customers.

6- **<u>Level of aggregation of insurance contracts</u>**

An entity shall identify portfolios of insurance contracts. A portfolio comprises contracts subject to similar risks and managed together.

- Contracts within a product line would be expected to have similar risks and hence would be expected to be in the same portfolio if they are managed together.
- Contracts in different product lines (for example single premium fixed annuities compared with regular term life assurance) would not be expected to have similar risks and hence would be expected to be in different portfolios.

IFRS 17 requires insurers to measure the insurance contracts and their profitability **by portfolios, or groups** of contracts.

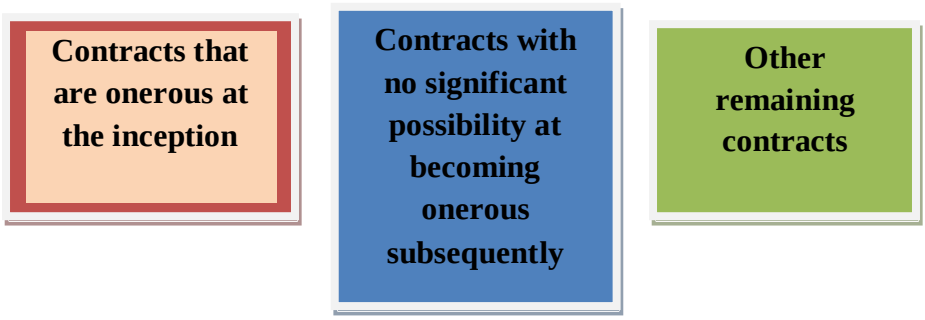
NOT individually, contract by contract (unless there is some significant material insurance contract that is managed separately from others).

Therefore, insurer needs to define the **level of** aggregation (grouping) of the insurance contracts.

Step 1: Initial recognition-Assign an insurance contract to specific portfolio
Here, portfolio is some larger grouping of contracts with similar risks that are managed together. For example, this can be different product lines like portfolio of **vehicle** insurance contracts or **life** insurance contracts.

Step 2: Divide that portfolio into at least three groups according to the minimum requirements in IFRS:

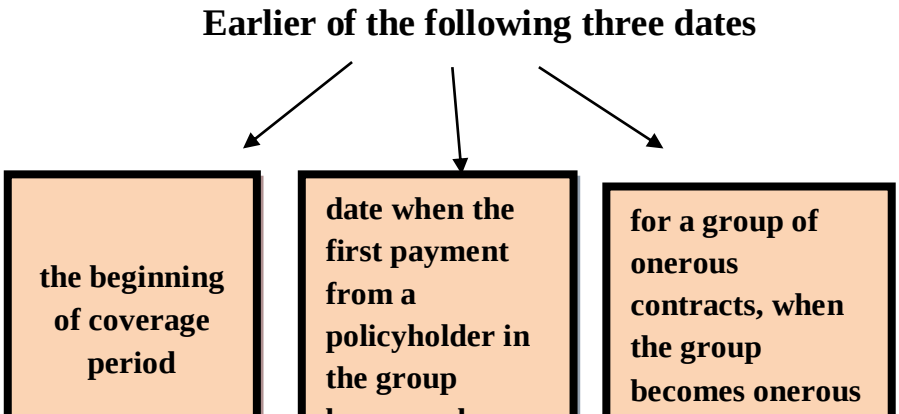
1. Contracts that are onerous at the inception;
2.Contracts with no significant possibility at becoming onerous subsequently, after initial recognition;
3.Other remaining contracts (that are profitable.



Step 3: Create separate groups of the same portfolio at least annually, since IFRS 17 prohibits including the contracts issued more than one year apart to the same group.

7-Recognition

A group of insurance contracts shall be recognized at the **earliest** of the followingthree dates (IFRS 17.25):
-The beginning of its coverage period ,
-The date when the **payment from policyholder becomes due** (if the contract does not set that date, then when the first payment is received);
-For a group of onerous contracts,the date when the group becomes onerous**(as shown below)**



8-Measurement of Insurance Contracts

IFRS 17 introduces ***a few measurement models*** to apply to different types of insurance contracts:
- General model(default);
- Simplified model, called premium allocation approach;
-Variable fee approach;
-General model with modifications applicable to certain types of contracts.

8.1-General model : Apply to all Insurance Contracts(with some exceptions)
* Contrats that do not distinguish between Insurance products [1](Types, Durations).

The **main principle** of the general model is to :

- Recognize the loss on onerous contracts immediately in profit or loss; and
- Do not recognize immediately at initial recognition profit on other contracts over the coverage period,.

Under the general model, a group of insurance contracts is measured as the total of:

- **Liability for the remaining coverage:** in fact, this is the liability for the coverage starting at the reporting date to the end of the coverage period. This is the **future**service;
- **Liability for the incurred claims:** this is the liability for the past service, for theclaims incurred in the period from the initial recognition until the reporting date.

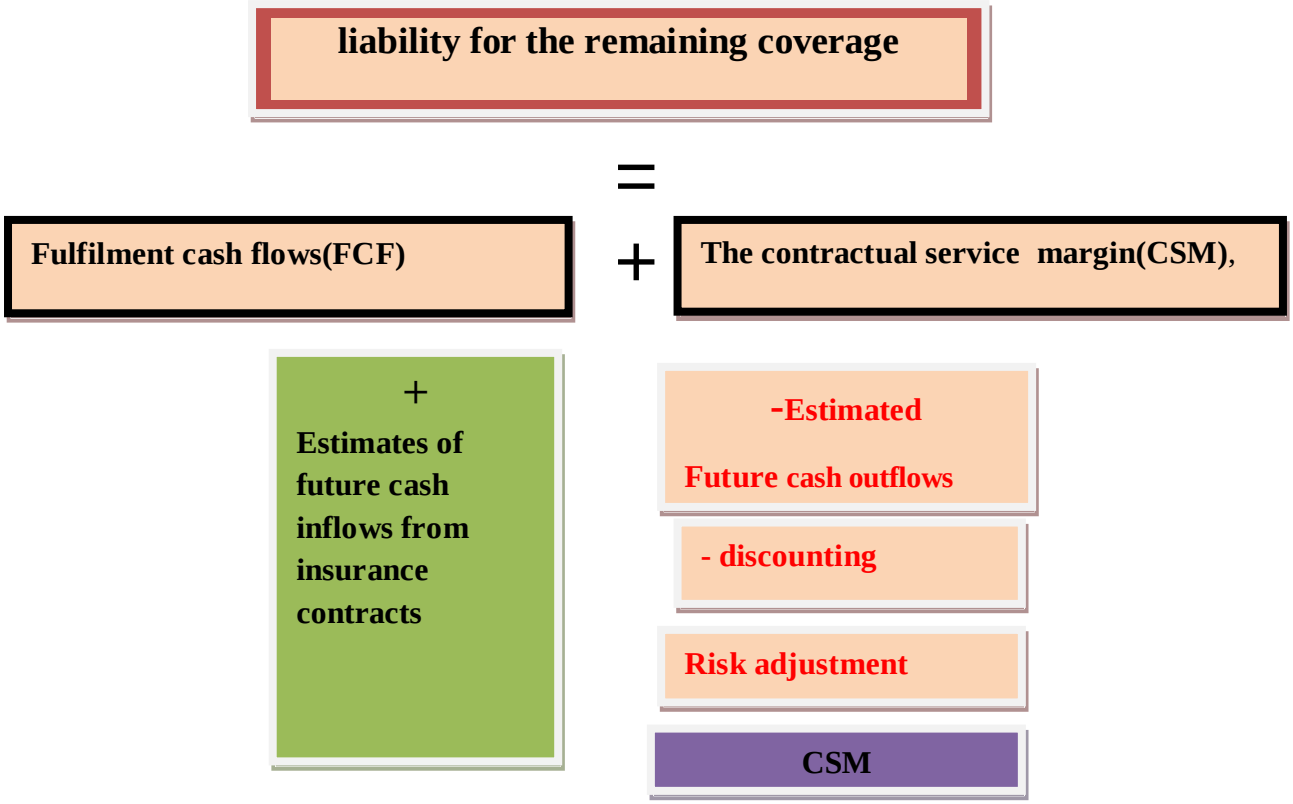
8.2-Initial measurement under the general model:

At initial recognition, there is no past, therefore the liability for incurred claims is zero.

[1]) short/long term, life/ non- life

The liability for the remaining coverage is calculated as **the sum** of:

- **Fulfilment cash flows(FCF)** – those comprise:Estimates of future cash inflows and outflows, for example insurance premiums, claims payments, claim servicing costs, etc.;
  Adjustment to reflect time value of money and financial risks related to future cash flows – discounting to present value;
  Risk adjustment for non-financial risk
- **The contractual service margin(CSM)**, which is at initial recognition:
  -The negative value of fulfilment cash flows for contracts other than onerous);
  -Zero for onerous contracts.



Unearned profit

As a result, at initial recognition, the insurance contracts are measured at:
Zero, if the contracts are NOT onerous;
Insurance contracts liability equal to the **net cash outflows**, if the contracts are onerous .

Subsequent measurement under the general model:

The carrying amount of a group of insurance contracts at the end of each reporting period is the sum of/

- **Liability for the remaining coverage**: which is the sum of:Fulfilment cash flows related to the future service, and
- Remaining balance of **contractual service margin** (that will be released inprofit or loss in the future periods.
- Liability for the incurred claims: it is equal to the fulfilment cash flows related tothe past service.

Subsequently, the insurance contracts are measured at **the sum of**:
Liability for the remaining coverage: which is the sum of:**Ful**fi**lment cash** fl**ows related to the future service**, and
Liability for the incurred claims: it is equal to the fulfilment cash flows related tothe past service.

EX1- Insurance contracts that are NOT onerous(profitable)

the insurance company X, issues **200 insurance contracts** with a coverage period of **4 years**, starting at the issuance date.You are given The following information :

-The insurance premium is **15 CU** per contract for the whole coverage period, payable within one month after its issuance;

-The annual future cash outflows are estimated at **3 CU** per contract;

-The discount rate is **5%**;

-Estimated risk adjustment for non-financial risk upon initial recognition is **200 CU**.

Required : How to measure the group of insurance contracts initially in line under IFRS 17?

Assume that no contracts will lapse within the coverage period (i.e. all of them will be completed).

Solution :According to IFRS 17, the insurance contracts are initially measured at the sum of:

-Fulfilment cash flows; in this example, we have:

*** Estimates of future cash inflows**, being premiums expected to receive from policyholders amounting to 15 CU per contract. That gives us **3 000 CU** for the whole group of 200 contracts;

***Estimates of future cash outflows**; being the insurance claims payments, servicing costs, etc. In this example, these amount to 3 CU per contract per year. That gives us **600 CU per year in the years 1 – 4**.

***Discounting**: It is necessary to bring these cash flows to the present value using the discount rate of 5% ,

***Risk adjustment for non-financial risks: 200 CU ,**

***Contractual service margin**: the negative value of the sum of all above items (fulfilment cash flows adjusted by discounting and risk adjustment) for non-onerous contracts.

The calculation is illustrated in table01:

Year	Cash in	Cash out	Net cash flow	Discount factor	PV of cash flows
0	**3 000**	**0**	**3 000**	**1.000**	**3 000**
1	**0**	**-600**	**-600**	**0.952**	**-571**
2	**0**	**-600**	**-600**	**0.907**	**-544**
3	**0**	**-600**	**-600**	**0.864**	**-518**
4	**0**	**-600**	**-600**	**0.823**	**-494**
Total	***3 000***	***-2 400***	***600***		***872***
Less risk adjustment					**-200**
The fulfilment cash flows					***672***
Contractual service margin					***-672***
Initial measurement of group of insurance contracts:					**0**

Notes:

- **The discount factor for the particular year is calculated using the formula 1/((1+5%)to the power of year);**

- **PV (present value) of future cash flows is calculated as Net cash flow multiplied with the discount factor;**
- **Contractual service margin is calculated as the negative value of the fulfilment cash flows after risk adjustment.**

As a result, **initial measurement of insurance contracts other than onerous is zero and no journal entry is passed**.

Then, when company X **collects the premiums** from policyholders amounting to 3 000 CU, the following entry is passed :

	Debit	**Credit**
Bank accounts	**3.000**	
Insurance contracts liability		**3.000**

As a result, the measurement of the insurance contracts liability after initial recognition is a liability of 3 000 CU, which is shown in table02::

Year	Cash in	Cash out	Net cash flow	Discount factor	PV of cash flows
0	**0**	**0**	**0**	**1.000**	**0**
1	**0**	**-600**	**-600**	**0.952**	**-571**
2	**0**	**-600**	**-600**	**0.907**	**-544**
3	**0**	**-600**	**-600**	**0.864**	**-518**
4	**0**	**-600**	**-600**	**0.823**	**-494**
Total	***0***	***-2 400***	***-2 400***		***-2 128***
Less risk adjustment					**-200**
The fulfilment cash flows					***-2 328***
Contractual service margin					***-672***
Insurance contracts liability immediately after initial recognition:					**-3 000**

Note :Table 02 is identical as table01, with one exception: the estimates of future cash inflows changed to zero, because no more premiums are expected to be received in the future.

8.2-Premium allocation approach

Premium allocation approach (PAA) is a **simplified model** for measurement of insurance contracts.

It is **optional**, not mandatory.

PAA can be applied only if the **following conditions** are met (see IFRS 17.53):

- Either the liability for remaining coverage under this approach **does not materially differ** from the liability for remaining coverage under the general model – so here, you would need to test it and compare; or
- If the coverage period of all contracts within the group is **one year or less**.

Initial measurement under PAA:

The liability for the remaining coverage is **the sum of**:

- **Premiums received** at initial recognition; minus
- **Any insurance acquisition cash flows** at that date.

The liability for incurred claims at initial recognition is zero.

Subsequent measurement under PAA:

The liability for the remaining coverage at the end of the reporting period is **the sum** of:

- Liability for the remaining coverage brought forward (at the beginning of the reporting period); plus
- The premiums received during the reporting period; minus
- Insurance acquisition cash flows during the period; plus
- Amortization of insurance acquisition cash flows in that period; plus
- Adjustment to a financing component (for contracts over 1 year); minus
- The amount recognized as an insurance revenue for services provided in that period; minus
- Any part of investment component that was paid or transferred to the liability for incurred claims.

The liability for the incurred claims is calculated in the same way as under the general model.

8.3-Other measurement models

The standard IFRS 17 requires application of other measurement models, as follows:

- **Variable fee approach*:*** for contracts with direct participation features;
- ***General model with modifications:*** for reinsurance contracts held.

9-Modifications and derecognition

9.1- Modifications of insurance contracts

If the parties modify the insurance contract, then if the **modification is substantive**, an entity shall:

- Derecognize the original contract; and
- Recognize the modified contract as new.

IFRS 17 contains the guidance on what is substantive modification, too.

9.2-Derecognition of insurance contracts

An insurance contract shall be **derecognized** when:

-It is extinguished; or

-The conditions for substantive modifications are met

10-Presentation and disclosures

10.1-Presentation of insurance contracts

The presentation in the statement of financial position is on a portfolio level. The presentation describes how to show the numbers related to the insurance contracts in the financial statements.

In the **statement of financial position** :Separate presentation is required of insurance and reinsurance contracts issued, further separated into those that are assets and those that are liabilities ,it is necessary to present :

- Insurance contract assets;
- Reinsurance contract assets;
- Insurance contract liabilities;
- Reinsurance contract liabilities.

Recognition and presentation in the statement(s) of financial performance
An entity shall disaggregate the amounts recognised in the statement(s) of financial performance into: [IFRS 17:80]

(a) **an insurance service result**, comprising **insurance revenue** and **insurance service expenses**; and
(b) **insurance finance income or expenses**.

Income or expenses from reinsurance contracts held shall be presented separately from the expenses or income from insurance contracts issued.

Disclosure
Quantitative and qualitative information is required about the amounts recognised in the financial statements that arise from insurance contracts, the significant judgements, and changes in those judgements, made when applying IFRS 17 and the nature and extent of risks arising from insurance contracts

An entity shall disclose qualitative and quantitative information about :

(a) the amounts recognised in its financial statements that arise from insurance contracts;
(b) the significant judgements, and changes in those judgements, made when applying IFRS 17; and
(c) the nature and extent of the risks that arise from insurance contracts

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Insurance service expenses comprise:
• Incurred claims (excluding repayments of investment components) and other incurred insurance service expenses
• Amortisation of insurance acquisition cash flows
• Changes that relate to past service, i.e. changes in fulfilment cash flows relating to the liability for incurred claims
• Changes that relate to future service, i.e. losses on groups of contracts and reversals of such losses.

Income or expenses from reinsurance contracts held are presented separately from the expenses or income from insurance contracts issued.
Insurance finance income or expenses reflects changes from the effect of the time value of money and financial risk (excluding any such changes for groups of insurance contracts with direct participating insurance contracts that would instead adjust the CSM). Entities can choose to present all insurance finance income or expenses in profit or loss or to present in profit or loss only an amount determined by a systematic allocation of the expected total insurance finance income or expenses over the duration of a group of contracts. If the latter option is taken, the remaining insurance finance income or expense is presented in other comprehensive income

FRS 17 Example: Initial Measurement of Insurance Contracts

Trying to make IFRS 17 complexity a bit easier, here's the practical numerical solved example of initial measurement of insurance contracts, using the general model under IFRS 17 Insurance Contracts.

Principles: How to measure insurance contracts initially

The **main principle** of the general model for measurement of insurance contracts under IFRS 17 is to

- Recognize the **loss on onerous contracts immediately** in profit or loss; and
- Recognize the **profit on other contracts over the coverage period**, not immediately at initial recognition.

As a result, at initial recognition, the insurance contracts are measured at:

- Zero, if the contracts are NOT onerous;
- Insurance contracts liability equal to the net cash outflows, if the contracts are onerous.

Ex2: Insurance contracts that are onerous

The same question as in EX1, just with one difference – the estimated future cash outflows changed from 3 CU to 5 CU.you are given the following information:

-200 insurance contracts issued with the coverage period of 4 years;

-The insurance premium is 15 CU unit per contract for the whole coverage period, payable within one month after its issuance;

-The annual future cash outflows are estimated at 5 CU per contract;

-The discount rate is 5%;

-Estimated risk adjustment for non-financial risk upon initial recognition is 200 CU.

Required :How to measure the group of insurance contracts initially in accordance of IFRS 17?

Assume that no contracts will lapse within the coverage period (i.e. all of them will be completed).

Solution

Similarly as in the example #1, according to IFRS 17, the insurance contracts are initially measured at the sum of:

-Fulfilment cash flows; in this example, we have:

***Estimates of future cash inflows**, being premiums expected to receive from policyholders amounting to 15 CU per contract. That gives us 3 000 CU for the whole group of 200 contracts;

***Estimates of future cash outflows**; being the insurance claims payments, servicing costs, etc. In this example, these amount to 5 CU per contract per year. That gives us 1 000 CU per year in the years 1 – 4.

***Discounting**: It is necessary to bring these cash flows to the present value using the discount rate of 5% (given in question above);

***Risk adjustment for non-financial risks**: 200 CU (given in question above);

***Contractual service margin: zero for onerous contracts**.

The calculation is illustrated in table03:

Year	Cash in	Cash out	Net cash flow	Discount factor	PV of cash flows
0	3 000	0	3 000	1.000	3 000
1	0	-1 000	-1 000	0.952	-952
2	0	-1 000	-1 000	0.907	-907
3	0	-1 000	-1 000	0.864	-864
4	0	-1 000	-1 000	0.823	-823
Total	3 000	-4 000	-1 000		-546
Less risk adjustment					-200
The fulfilment cash flows					-746
Contractual service margin					0

Initial measurement of group of insurance contracts:	**-746**

Loss on onerous contracts shall be recognized immediately.

Therefore, on initial recognition, the following journal entry is passed:

	Debit	**Credit**
Profit or loss – Insurance service expenses	**746**	
Insurance contracts liability		**746**

When company x **collects the premiums** from policyholders amounting to 3 000 CU, the following entry is passed ☹ same entry as in ex1)

	Debit	**Credit**
Bank accounts	**3.000**	
Insurance contracts liability		**3.000**

As a result, the measurement of the insurance contracts liability after initial recognition is a liability of 3 746 CU, which is shown in table04:

Year	**Cash in**	**Cash out**	**Net cash flow**	**Discount factor**	**PV of cash flows**
0	0	0	0	1.000	0
1	0	-1 000	-1 000	0.952	-952
2	0	-1 000	-1 000	0.907	-907
3	0	-1 000	-1 000	0.864	-864
4	0	-1 000	-1 000	0.823	-823
Total	***0***	***-4 000***	***-4 000***		***-3 546***
Less risk adjustment					-200
The fulfilment cash flows					***-3 746***

Contractual service margin	***0***
Initial measurement of group of insurance contracts:	**-3 746**