IFRS AT A GLANCE

IFRS 17 *Insurance Contracts*

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Effective Date
Periods beginning on or after 1 January 2021

DEFINITIONS

Insurance risk – Risk, other than financial risk, transferred from the holder of a contract to the issuer.
Financial risk – The risk of a possible change in one or more of a specified interest rate, financial instrument price, commodity price, currency exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a aprty yto the contract
Insurance contract – A contract under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.
Reinsurance contract - An insurance conract issued by one entity (the reinsurer) to compensate another entity for claims arising from one or more insurance contracts issued by that other entity (underlying contracts)
Group of insurance contracts – A set of insurance contracts resulting from the division of a portfolio of insurance contracts into, at a minimum, contracts written within a period of no longer than one year and that at initial recognition:
- (a) Are onerous, if any;
- (b) Have no significant possibility of becoming onerous subsequently, if any; or
- (c) Do not fall into either(a) or (b), if any.

Portfolio of insurance contracts – Insurance contracts subject to similar risks andmanaged together
Fulfilment cash flows - An explicit, unbiased and probability-weighted estimate (i.e. expected value) of the present value of the future cash outflows minus the present value of the future cash inflows that wuill arise as the entity fulfils insurance contracts, including a risk adjustment for non-financial risk
Investment contract with discretionary participation featueres – A financial instrument that provides a particular investor with the contractual right to receive, as a supplement to an amount not subject to the discretion of the issuer, additional amounts:
- (a) That are expected to be a significant portion of the total contractual benefits;
- (b) The timing or amount of which are contractually at the discretion of the issuer; and
- (c) That are contractually based on
  - (i) The returns on a specified pool of contracts or a specified type of contract;
  - (ii) Realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or
  - (iii) The profit or loss of the entity or fund that issues the contract

Liability for incurred claims – An entity's obligation to investigate and pay valid claims for insured events that have already occurred, including events that have occurred but for which claims have not been reported, and other incurred insurance expenses.
Liability for remaining coverage - An entity's obligation to investigate and pay valid claims under existing insurance contracts for insured events that have not yet occurred (ie the obligation that relates to the unexpired portion of the coverage period).
Risk adjustment for non-financial risk – The compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity filfils insurance contracts.

MANDATORY SCOPE INCLUSIONS

IFRS 17 applies to:
- (a) Insurance contracts and reinsurance contracts issued;
- (b) Reinsurance contracts held; and
- (c) Investment contracts with discretionary participation features if the entity also issues insurance contracts.

OTHER SCOPE INCLUSIONS

IFRS 17 may apply to:
- (a) Financial guarantee contracts if the entity has asserted it regards such contracts as insurance contracts (otherwise such contracts are within the scope of IFRS 9); and
- (b) Some service contracts, such as separately priced warranties on consumer goods that are serviced by third parties rather than the manufacturer (otherwise such contracts are within the scope of IFRS 15);

UNIT OF ACCOUNT

IFRS 17 is applied at the level of groups of insurance contracts and not individual insurance contracts (though it is possible for groups of insurance contracts to consist of only a single contract). The composition of the group is not subsequently reassessed.

At a minimum, contracts written within a period of no longer than one year are sub-divided at initial recognition into groups that contain contracts that are:

- (a) Onerous, if any;
- (b) Have no significant possibility of becoming onerous subsequently, if any; and
- (c) Do not fall into either (a) or (b), if any.

An insurance contract is onerous if the fulfilment cash flows, any previously recognised acquisition cash flows and any cash flows arising from the contract are a net outflow.

MODELS FOR APPLICATION OF THE REQUIREMENTS

General model - applies to all insurance contracts in the scope of IFRS 17, except for those covered by the premium allocation approach and the variable fee approach. The general model is also modified for reinsurance contracts held.

Premium allocation approach ("PAA") - a method that simplifies the measurement of the liability for remaining coverage. The PAA is available for groups of contracts where the coverage period for all contracts is one year or less or if the entity reasonably expects that the PAA would produce a measurement of the liability for remaining coverage for the group that would not differ materially from the general model.

Variable fee approach ("VFA") - insurance contract liability is measured based on the obligation to pay the policyholder an amount equal to the value of the underlying items, net of consideration charged for the contract ("a variable fee"). Approach applies to direct participating contracts, based on policyholders being entitled to a significant share of the profit from a clearly identified pool of underlying items.

GENERAL MODEL

		COMPONENT	INITIAL MEASUREMENT	SUBSEQUENT MEASUREMENT	EFFECT ON COMPREHENSIVE INCOME
Insurance Contract Assets / Liabilities	Liability of Remaining Coverage	**Present value of future cash flows -** estimate of all cash flows within the boundary of each contract in the group (e.g. premiums, acquisition cash flows, claims payments, claims handling costs, etc.). If certain requirements are met, fulfilment cash flows may be estimated at a higher level and then allocated to individual groups.	Estimate must be unbiased, reflect the perspective of the entity and be a current measure using all reasonable and supportable information available without undue cost or effort, discounted to reflect the time value of money.	Updated at each reporting period based on information available, with the effect of the discount unwinding over time.	Accretion of the discount reflected in profit or loss (or OCI -> see Discounting).
		Risk adjustment for non-financial risk - The compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity fulfils insurance contracts.	The risk adjustment must be an explicit estimate and will be entity-specific, which should be the amount of compensation an entity would require to make itself indifferent between a fixed series of cash flows and uncertain cash flows in the group of contracts.	Updated at each reporting period based on information available, with the effect of the discount unwinding over time. The release from risk may occur evenly over time or not depending on the nature of the risks insured.	Release of risk over time is reflected as insurance revenue, unless accounting policy choice is elected to reflect the accretion of the discount in insurance finance expense (see Discounting).
		Contractual service margin ("CSM") - represents the unearned profit the entity will recognise as it provides services under the insurance contracts in the group.	The CSM is set at an amount that makes a group of insurance contracts zero at the time of initial recognition (i.e. offsets fulfilment cash flows). If the fulfilment cash flows are negative (i.e. an onerous group of contracts exists), the loss is recognised immediately and no CSM exists.	CSM is updated for the effect of the discount unwinding and the unwinding of the CSM as services are provided in the period based on the allocation of the CSM over the current and remaining coverage period.	Accretion of the discount reflected in profit or loss (or OCI -> see Discounting), with the movement related to services provided reflected as insurance revenue.
	Liability for Incurred Claims	**Present value of future cash flows -** once a loss event occurs, the best estimate of the cash flows required to settle the claim, including investigation, handling and settlement costs.	Same methodology as liability for remaining coverage.	Same methodology as liability for remaining coverage.	Accretion of the discount reflected in profit or loss (or OCI -> see Discounting). The effects of changes in estimates are recorded in insurance services expenses.
		Risk adjustment for non-financial risk - same methodology as liability for remaining coverage.	Same methodology as liability for remaining coverage.	Same methodology as liability for remaining coverage.	The effects of changes in estimate are reflected in insurance services expenses.

<table>
<tr><th colspan="3">PREMIUM ALLOCATION APPROACH</th><th rowspan="2">VARIABLE FEE APPROACH</th></tr>
<tr><th></th><th>MEASUREMENT AT INITIAL RECOGNITION</th><th>SUBSEQUENT MEASUREMENT</th></tr>
<tr><td>Insurance Contract Liabilities – Remaining Coverage</td><td>If certain conditions are met, simplified measurement equal to:
(a) Premiums received at initial recognition
(b) Minus insurance acquisition cash flows *; plus
(c) Plus or minus any amount arising from the derecognition at that date of the asset or liability recognised for insurance acquisition cash flows
*May elect to expense acquisition cash flows as incurred.
Conditions required to be met:
(a) There is a reasonable expectation that the measurement of the liability will not be materialiy different from measurement using the full model in IFRS 17; and
(b) The coverage period of each contract in the group is one year or less</td><td>If certain conditions are met, simplified measurement equal to:
(a) Carrying amount at start of period
(b) Plus premiums received in the period
(c) Minus insurance acquisition cash flows *
(d) Plus any amounts relating to the periodic amortisation of insurance acquisition cash flows recognised as an expense
(e) Plus adjustment for financing component
(f) Minus the amount recognised as insurance revenue **
(g) Minus any investment component paid or transferred
*May expense acquisition cash flows as incurred
**Expected premiums are allocated to revenue on the basis of the passage of time unless the expected pattern of release of risk during the coverage period differs significantly from the passage of time.</td><td>Similar to the general model, except that changes in estimates relating to the future fees an entity expects to earn from direct participating contract policyholders are adjusted against the contractual service margin.

The contractual service margin on direct participating contracts is recognised in profit or loss as part of insurance service results on the basis of the passage of time.

The accretion of interest relating to the contractual service margin is based on a current rate included in balance sheet measurements of specific assets, rather than a locked in rate as required in the general model.</td></tr>
<tr><td>Insurance Contract Liabilities – Incurred Claims</td><td colspan="2">Measurement is consistent with the general model. However, discounting is not required if the cash flows on incurred claims are expected to be paid in one year or less from the date the claims are incurred.</td><td>Measurement is consistent with the general model.</td></tr>
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<tr><td>INVESTMENT CONTRACTS WITH DISCRETIONARY PARTICIPATION FEATURES</td><td>General model is modified as follows:

(a) the date of initial recognition is the date the entity becomes party to the contract.
(b) the contract boundary is modified so that cash flows are within the contract boundary if they result from a substantive obligation of the entity to deliver cash at a present or future date. The entity has no substantive obligation to deliver cash if it has the practical ability to set a price for the promise to deliver the cash that fully reflects the amount of cash promised and related risks.
(c) the allocation of the CSM is modified so that it is recognised over the duration of the group of contracts in a systematic way that reflects the transfer of investment services under the contract.</td></tr>
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<tr><td>REINSURANCE CONTRACTS HELD</td><td>General model is modified as follows:

Group of reinsurance contracts held recognised:

(a) Proportionate coverage: later of the beginning of the coverage period of the group or at initial recognition of the underlying contract;
(b) All other cases: the beginning of the coverage period of the group of reinsurance contracts held.

The net cost or net gain from a group of reinsurance contracts is deemed to be the CSM, unless the net cost relates to events that occurred before the purchase of the group of reinsurance contracts, in which case, the cost is recognised immediately.</td><td>The CSM is subsequently measured as the previous carrying amount adjusted for:

(a) The effect of any new contracts;
(b) Interest accrued on the CSM;
(c) Changes ni the fulfilment cash flows;
(d) The effect of any foreign exchange; and
(e) The allocation of the CSM.

Changes in fulfilment cash flows that result from changes in the risk of non-performance by the issuer of the reinsurance contracts held do not relate to future service and therefore do not adjust the CSM.

The premium allocation approach may be used for reinsurance contracts held if certain criteria are met.</td></tr>
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DISCOUNTING

For components of insurance contracts that must be discounted, the discount rate must:

(a) reflect the time value of money;
(b) be consistent with observable market prices for an instrument with cash flows whose characteristics are consistent with the insurance contracts; and
(c) exclude the effect of factors that influence such observable market prices, but do not affect the future cash flows of the insurance contracts.

Entities may elect to reflect in profit or loss only the finance expense related to a systematic allocation of the expected total finance expense over the duration of the group of insurance contracts. The other impact of the discount on the insurance contracts being a current measure is reflected in other comprehensive income.

MODIFICATIONS

Derecognise original contract only if any of the following apply:

(a) Had the modified terms been included at contract inception:
   (i) It would have been outside the scope of IFRS 17;
   (ii) Different components would have been separated from the host contract;
   (iii) It would have had a substantially different contract boundary; or
   (iv) It would have been included in a different group of insurance contracts.
(b) The original, but not modified, contract met the definition of an insurance contract with direct participation features (or vice versa).
(c) The premium allocation approach was applied to the original contract, but the eligibility criteria for that approach is not met for the modified contract.

If none of the above apply, do not derecognise the contract and instead treat changes in cash flows caused by the modification as changes in estimates of fulfilment cash flows.

DERECOGNITION

Derecognise only when:

(a) It is extinguished, i.e. when the obligation expires, is discharged or cancelled; or
(b) A modification meets any of the conditions for the insurance contract to be derecognised.

The purchase of reinsurance results in the derecognition of the underlying insurance contract(s) only when the underlying insurance contract(s) is (or are) extinguished.

Accounting for the derecognition of of insurance contract from within a group of contracts requires an adjustment to fulfilment cash flows, and contractual service margin of the group. and remaining coverage units

Specific requirements apply to the accounting on the derecognition of an insurance contract arising from either:

- A modification that meets any of the conditions for the insurance contract to be derecognised; or
- The transfer of the insurance contract to a third party.

PRESENTATION

Separately for both insurance contracts issued and reinsurance contracts held, by group:

Statement of Financial Position

(a) Insurance contracts issued that are assets;
(b) Insurance contracts issued that are liabilities.

Statement of Financial Performance

(a) Insurance revenue;
(b) Insurance service expenses (e.g. incurred claims, other incurred insurance service expenses, amortisation of acquisition cash flows, etc.)
(c) Insurance finance income or expenses

The difference between (a) and (b) comprises the insurance service result which must be presented in the statement of financial performance.

DISCLOSURE

Overall objective is to disclose sufficient information to gives a basis for users to assess the effect that insurance contracts have on an entity.

Disclosure requirements are significant and include both quantitative and qualitative disclosures about the amounts recognised in the statements of financial position, performance and cash flows, including reconciliations of amounts and the components comprising insurance contract assets and liabilities and significant judgments concerning their recognition and valuation.

For entities applying the premium allocation approach, some disclosure simplifications exist, however, disclosure requirements concerning the liability for incurred claims remain extensive, including the level used to determine the risk adjustment, the yield curve used for discounting, and the nature and extent of risks by major groups of contracts.

TRANSITION

Effective for periods beginning on or after January 1, 2021. Early adoption is permitted, however, entities must also adopt IFRS 9 and IFRS 15 on or before the date of initial application of IFRS 17.

IFRS 17 must be applied retrospectively unless it is impracticable, with the net effect of adoption being recognised in equity as at the beginning of the comparative period.

If it is impracticable for an entity to adopt IFRS 17 retrospectively, it may apply:

(a) Modified retrospective approach: several simplifications relating to the initial application are offered (e.g. CSM, insurance finance expense, etc.); or
(b) Fair value approach: determine the CSM (or loss component) at the date of initial application as the difference between the fair value of a group of contracts and the fulfilment cash flows.

CONTACT

For further information about how BDO can assist you and your organisation, please get in touch with one of our key contacts listed below.

Alternatively, please visit **www.bdo.global** where you can find full lists of regional and country contacts.

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