An Introduction to IFRS 17 for P&C Actuaries

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Abstract

IFRS 17 Insurance Contracts establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard. The objective of IFRS 17 is to ensure that an entity provides relevant information that faithfully represents those 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. In this paper, the authors provide a basic introduction to IFRS 17 with a focus on the key implications for property & casualty actuaries.

Keywords. insurance contracts, portfolio, group, cohort, General Measurement Model, Premium Allocation Approach, liability for remaining coverage, liability for incurred claims, risk adjustment.

1. OVERVIEW OF IFRS 17

1.1 What is IFRS 17?

IFRS 17 Insurance Contracts[1] is a new accounting standard developed by the International Accounting Standards Board (IASB) and published in May 2017 after two decades in the making, followed by a subsequent exposure draft in June 2019. The effective date of IFRS 17 is currently set for January 1, 2023.

The initial phase of the insurance accounting standard was IFRS 4 Insurance Contracts, which is being superseded by Phase II, called IFRS 17. IFRS 17 standardizes profit emergence and measurement of liabilities; theoretically, making capital markets for insurance companies more efficient. The stated goal of adopting an international financial reporting standard for insurance contracts was to improve comparability between insurance companies operating in different jurisdictions. This impacts the life insurance industry more than the P&C industry, which is already more standardized.

Insurance contracts are treated for accounting purposes as both a financial instrument and a service contract. In addition, insurance contracts can generate cash flows with substantial variability over a long period of time. To provide useful information about those contracts,

[1] Source: https://www.ifrs.org/issued-standards/list-of-standards/ifrs-17-insurance-contracts/

IFRS 17 aims to recognize profit over the insurance coverage period and to present insurance service results separately from investment income.

Under the key principles of IFRS 17, a company must:

1. identify insurance contracts under which it accepts significant insurance risk from a policyholder by agreeing to compensate the policyholder if a specified uncertain future event adversely affects the policyholder;
2. divide the insurance contracts into groups that it will recognize and measure;
3. recognize and measure groups of insurance contracts at:
    a. a risk-adjusted present value of the future cash flows (the "fulfilment cash flows") that incorporates all of the available information about the fulfilment cash flows in a way that is consistent with observable market information; plus
    b. an amount representing what is described as the unearned profit in the group of contracts;
4. recognize the profit from a group of insurance contracts:
    a. If a group of contracts is profitable, profits are recognized over the period the contracts provide coverage.
    b. If a group of contracts is or becomes loss-making, losses are recognized immediately when the contracts are recognized;
5. present insurance revenue (e.g., premium), insurance service expenses (e.g., claims and loss adjustment expenses) and investment income separately in the financial statements; and
6. disclose information to enable users of the financial statements to assess the effect that contracts within the scope of IFRS 17 have on the financial position, financial performance and cash flows of the company.

IFRS 17 includes an optional simplified measurement approach, or premium allocation approach (PAA), for simpler insurance contracts, generally applicable to most non-life insurance contracts.

2. DEFINITIONS

The IFRS 17 standard defines several key terms that are referenced throughout the standard. The table below identifies the key terms relevant to this paper:

Term	Definition
Contract Boundary	Cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the entity can compel the policyholder to pay the premiums or in which the entity has a substantive obligation to provide the policyholder with insurance contract services.
Cohorts of Insurance Contracts	Subdivisions of a group of insurance contracts based on date of issue (no more than 12 months apart).
Contractual Service Margin (CSM)	A component of the carrying amount of the asset or liability for a group of insurance contracts representing the unearned profit the entity will recognize as it provides insurance contract services under the insurance contracts in the group.
Coverage Period	The period during which an entity provides insurance contract services (namely insurance coverage for insured events).
Financial Risk	The risk of a possible future 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.
Fulfillment Cash Flow (FCF)	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 will arise as the entity fulfils insurance contracts, including a risk adjustment for non-financial risk.
Group of Insurance Contracts	A set of insurance contracts resulting from the division of a portfolio of insurance contracts into, at a minimum, contracts issued no longer than one year apart 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.
Insurance Acquisition Cash Flows	Cash flows arising from the costs of selling, underwriting and starting a group of insurance contracts (issued or expected to be issued) that are

	directly attributable to the portfolio of insurance contracts to which the group belongs. Such cash flows include cash flows that are not directly attributable to individual contracts or groups of insurance contracts within the portfolio.
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.
Insurance Risk	Risk, other than financial risk, transferred from the policyholder of an insurance contract to the issuer.
Insured Event	An uncertain future event covered by an insurance contract that creates insurance risk
Liability for Incurred Claims (LIC)	An entity's obligation to: (a) 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; and (b) pay amounts that are not included in (a) and that relate to: i. insurance contract services that have already been provided; or ii. any investment components or other amounts that are not related to the provision of insurance contract services and that are not in the liability for remaining coverage. This is similar to the loss reserves, unpaid claims or claim liabilities under other accounting systems.
Liability for Remaining Coverage (LRC)	An entity's obligation to: (a) investigate and pay valid claims under existing insurance contracts for insured events that have not yet occurred (i.e., the obligation that relates to the unexpired portion of the insurance coverage); and (b) pay amounts under existing insurance contracts that are not included in (a) and that relate to: i. insurance contract services not yet provided (ie the obligations that relate to future provision of insurance contract services); or ii. any investment components or other amounts that are not related to the provision of insurance contract services and that have not

	been transferred to the liability for incurred claims. This is similar to the unearned premium reserve or premium liability under other accounting systems.
Policyholder	A party that has a right to compensation under an insurance contract if an insured event occurs.
Portfolio of Insurance Contracts	Highest level grouping of insurance contracts subject to similar risks and that are deemed to be managed together.
Reinsurance Contracts	An insurance contract issued by one entity (the reinsurer) to compensate another entity (the insurer) for claims arising from one or more insurance contracts issued by that other entity (underlying contracts). The contract is classified as reinsurance held by the insurer, and reinsurance written by the reinsurer.
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.

3. SCOPE

3.1 Scope

IFRS 17 applies to all insurance and reinsurance contracts, no matter if they are issued by an insurer or another type of company or entity. Nonetheless, some specific types of contracts are excluded from the scope of IFRS 17. The list of excluded contract types includes, amongst others[2]:

- warranties provided by a manufacturer, dealer, or retailer in connection with the sale of goods or services to a customer (but not excluding other types of warranties);
- benefit plans and retirement benefits, such as group insurance plans or defined benefits retirement plans, offered by employers to their employees; and
- insurance contracts where the entity is the policyholder, unless those contracts are reinsurance contracts held.

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[2] The complete list of contract types excluded from IFRS 17 includes:

i. warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer;
ii. employers' assets and liabilities from employee benefit plans and retirement benefit obligations;
iii. contractual rights or contractual obligations contingent on the future use of, or the right to use, a non-financial item (for example, some license fees, royalties, variable and other contingent lease payments and similar items);
iv. residual value guarantees provided by a manufacturer, dealer or retailer and a lessee's residual value guarantees when they are embedded in a lease;
v. 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;
vi. contingent consideration payable or receivable in a business combination;
vii. insurance contracts in which the entity is the policyholder, unless those contracts are reinsurance contracts held; or
viii. contingent consideration payable or receivable in a business combination;
ix. insurance contracts in which the entity is the policyholder, unless those contracts are reinsurance contracts held; or
x. credit card contracts, or similar contracts that provide credit or payment arrangements, that meet the definition of an insurance contract if, and only if, the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer.

Some contracts meet the definition of an insurance contract but have as their primary purpose the provision of services for a fixed fee. An entity may choose to apply IFRS 15 instead of IFRS 17 to such contracts that it issues if, and only if, specified conditions are met. The entity may make that choice contract by contract, but the choice for each contract is irrevocable. Examples of such contracts might include roadside assistance contracts (that cover tow truck and other assistance to the insured's disabled vehicle) and an appliance service contract sold by someone other than the manufacturer or dealer.

3.2 Separating Components of an Insurance Contract

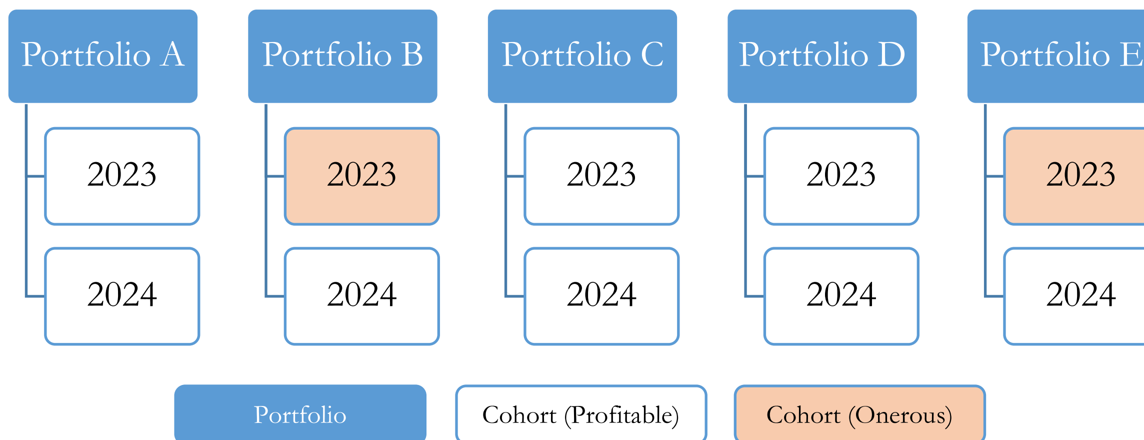
Insurance contracts may contain one or more components that would be within the scope of another standard if they were separate contracts. For example, an insurance contract may include an investment component or a component for services other than insurance contract services (or both). In those situations, IFRS 17 requires the measurement and reporting of those distinct components[3] separately, under their respective standards as appropriate.

[3] IFRS 17 does not apply to distinct service components, distinct embedded derivatives and distinct investment components.

4. LEVEL OF AGGREGATION OF INSURANCE CONTRACTS

4.1 Overview

Under IFRS 17, entities are required to aggregate insurance and reinsurance contracts in mutually exclusive units. The groupings must be performed at different levels, as illustrated below and further expanded on in the illustrative example in the Appendix:



The units and different aggregation level are then used for reporting and measurement at a prescribed level. Portfolios, groups or cohorts could include as few as one insurance contract if that is the result of applying the aggregation requirements of IFRS 17. There is no guidance on the maximum number of insurance contracts in a portfolio, group or cohort. Insurance contracts are assigned a portfolio, group and cohort at initial recognition and are not reassigned at subsequent measurements.

4.2 Portfolios

Entities must identify portfolios of insurance contracts. A portfolio comprises contracts covering similar risks deemed to be 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 would not be expected to have similar risks and hence would be expected to be in different portfolios. How this concept is implemented would depend on the particular facts and circumstances of the entity implementing IFRS 17.

IFRS 17 does not define what is meant by "managed together," but it is a general consensus that entities should rely on the facts and circumstances of its operations to evaluate the "managed together" criteria. Potential facts and circumstances that can be looked at to evaluate the criteria include, but are not limited to: financial planning, marketing and sales, underwriting, pricing, internal reporting, product development, claims management, portfolio management, expense allocation, governance framework, risk management including reinsurance. For example, automobile insurance contracts and homeowner insurance contracts for many insurers would probably not be combined within the same portfolio since they cover different risks, although they might be for an insurer that combines these products in a package or that is predominately involved with other products (with common management and risk analysis for a relatively small personal lines operation).

As reinsurance contracts can provide coverage to underlying policies covering different risks, the level of aggregation for reinsurance contracts must be assessed independently of the direct contracts. There are various options for assigning reinsurance contracts to portfolios including by predominant exposure covered, by creating a portfolio of treaties that cover multiple risks, or by individual reinsurance contract. Separating the reinsurance contracts into sub-contracts and assigning the sub-contracts to different groups and portfolios may be acceptable but only if the insurer can prove that a single treaty was issued solely for convenience and the price is simply the aggregate of the standalone prices.

4.3 Groups

Entities must further divide portfolios into different groups based on whether they are onerous. Groups of contracts must be tested for onerousness at initial recognition. An insurance contract is onerous at the date of initial recognition if the fulfilment cash flows allocated to the contract, any previously recognized acquisition cash flows and any cash flows arising from the contract at the date of initial recognition in total are a net outflow.

At initial recognition, contracts are classified in one of three possible groups:

1. Onerous at initial recognition (i.e., expected to be unprofitable)
2. No significant possibility of becoming onerous (i.e., very profitable)
3. Remaining contracts (i.e., expected to be profitable)

If contracts within a portfolio fall into different groups only because law or regulation

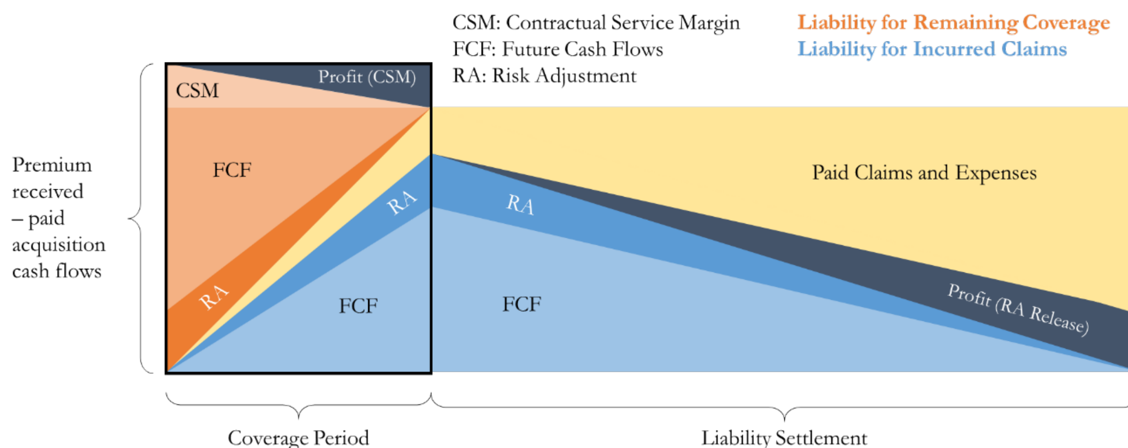
specifically constrains the entity's practical ability to set a different price or level of benefits for policyholders with different characteristics (e.g., inability to use credit score in the pricing of auto insurance), the entity may include these contracts in the same group.

4.4 Cohorts

Insurance contracts issued more than one year apart cannot be in the same group. To achieve this, an entity must further divide the groups, by year issued for example, into cohorts.

5. GENERAL MEASUREMENT MODEL

The measurement of an insurance contract under the General Measurement Model (GMM) can be visualized with the aid of the following diagram that represents measurement under the GMM for one insurance contract.



The diagram assumes that premium is collected upfront, that acquisition costs are paid at inception and that there are no changes to the valuation assumptions. This is a simplified illustration of an insurance contract for the purposes of this paper and does not fully account for all aspects and complexities within the liability calculation.

On initial recognition under the GMM, an entity must measure a group of insurance contracts at the total of:

1. The fulfilment cash flows, which comprise of:

    a. Estimates of future cash flows;

    b. An adjustment to reflect the time value of money and the financial risks related to the future cash flows; and

    c. A risk adjustment for non-financial risk.

2. The contractual service margin (explained below), whose purpose is to prevent recognition of earnings before any service is provided (otherwise known as "gain at issue").

This initial value is a liability for remaining coverage. On each subsequent measurement (i.e., vertical cross-section of the diagram), the carrying amount of a group of insurance contracts is the sum of:

1. The liability for remaining coverage or "LRC" (orange in the diagram above), which comprise of:
    a. The fulfilment cash flows related to **future** services allocated to the group at that date; and
    b. The contractual service margin of the group at that date.
2. The liability for incurred claims or "LIC" (blue in the diagram above), which comprise of:
    a. The fulfilment cash flows related to **past** services allocated to the group at that date.

5.1 Estimates of Future Cash Flows

An entity must include in the measurement of a group of insurance contracts all the future cash flows within the boundary of each contract in the group. The estimates of future cash flows shall:

1. Incorporate all information available without undue cost or effort about the amount, timing and uncertainty of those future cash flows;
2. Reflect the perspective of the entity, provided that the estimates of any relevant market variables are consistent with observable market prices for those variables;
3. Be current—the estimates must reflect conditions existing at the measurement date, including assumptions at that date about the future; and
4. Be explicit—the entity must estimate (a) the future cash flows, (b) the time value and financial risk adjustment and (c) the risk adjustment for non-financial risk separately.

These future cash flows include (where applicable), but are not limited to: premiums, payments to policyholders and claimants, payments on future claims on unexpired risks, an allocation of acquisition costs, claims handling costs, and policy administration and maintenance costs.

Acquisition costs, unlike most other fulfilment cash flows, are typically paid before or at policy inception. IFRS 17 allows for the deferral of acquisition costs and the associated revenue to smooth out the recognition of profits. Paid acquisition costs are an asset that is amortized (or derecognized) when they are included in the measurement of the related group of insurance contracts.

IFRS 17 explicitly states that to comply with (1) above, an entity shall produce an estimate of the expected value (i.e., the probability-weighted mean) for the full range of possible future cash flow outcomes. Several deterministic methods (Chain-Ladder, Expected Losses, etc.) used to estimate the future cash flow of insurance products already produce an estimate of the expected value for those future cash flows. As such, current methods remain relevant under IFRS 17.

5.2 Adjustment to Reflect Time Value of Money and Financial Risks

Under IFRS 17, both LRC and LIC must include an adjustment for the time value of money and financial risk[4]. The discount rate applied to the future cash flow to account for the time value of money must:

1. reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts;
2. be consistent with observable current market prices (if any) for financial instruments with cash flows whose characteristics are consistent with those of the insurance contracts, in terms of, for example, timing, currency and liquidity; and
3. exclude the effect of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts.

Under IFRS 17, discount rates for cash flows do not vary with the return on assets that a company holds to support its LRC and LIC.

Two possible approaches can be used to derive a discount rate under IFRS 17:

- **Bottom-up approach**: an illiquidity premium[5] is added to a risk-free yield curve to

[4] To the extent that the financial risks are not included in the estimates of cash flows

[5] An illiquidity premium is an additional return demanded by an investor when an investment cannot be easily and efficiently sold for its fair market value.

reflect the liquidity characteristics of the underlying insurance contract liabilities. Different approaches can be considered to select a liquid risk-free yield curve and an appropriate discount rate (government bond rates, swap curves, corporate bond rates, expert judgement)

- **Top-down approach**: a reference portfolio of assets with characteristics similar to those of the insurance contract liabilities is selected. The yield of the reference portfolio is then adjusted downward to remove any characteristics of the assets that are not consistent with the insurance contract liabilities, such as credit risk and market risk.

Property/casualty claim liabilities in most cases are considered to be illiquid, as they cannot be called (forced to be paid "on-demand" outside the normal settlement process). Property/casualty premium liabilities may be considered to be illiquid or liquid to some degree depending on cancelation provisions and other considerations (that may vary materially by contract and by jurisdiction).

5.3 Risk Adjustment for Non-Financial Risks

An entity shall adjust the estimate of the present value of the future cash flows to reflect the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk. We note that, contrary to the estimates of future cash flows and time value of money and financial risk, the risk adjustment for non-financial risk is entity-specific whereas the former would be entity-agnostic in theory.

The risk adjustment for non-financial risk for insurance contracts measures the compensation that the entity would require to make the entity indifferent between:

a) fulfilling a liability that has a range of possible outcomes arising from non-financial risk; and,

b) fulfilling a liability that will generate fixed cash flows with the same expected present value as the insurance contracts.

Because the risk adjustment for non-financial risk reflects the compensation the entity would require for bearing the non-financial risk arising from the uncertain amount and timing of the cash flows, the risk adjustment for non-financial risk also reflects:

a) the degree of diversification benefit the entity includes when determining the

compensation it requires for bearing that risk; and

b) both favorable and unfavorable outcomes, in a way that reflects the entity's degree of risk aversion.

IFRS 17 does not specify the estimation technique(s) used to determine the risk adjustment for non-financial risk. However, to reflect the compensation the entity would require for bearing the non-financial risk, the risk adjustment shall have the following characteristics:

a) risks with low frequency and high severity will result in higher risk adjustments than risks with high frequency and low severity;

b) for similar risks, contracts with a longer duration will result in higher risk adjustments than contracts with a shorter duration;

c) risks with a wider probability distribution will result in higher risk adjustments than risks with a narrower distribution;

d) the less that is known about the current estimate and its trend, the higher will be the risk adjustment; and

e) to the extent that emerging experience reduces uncertainty about the amount and timing of cash flows, risk adjustments for non-financial risk will decrease and vice versa.

Methods to consider include stochastic modeling and cost of capital approaches. No matter the technique used to derive the risk adjustment for non-financial risk, an entity must disclose the confidence level corresponding to the results of the selected technique, with the goal to help readers of the financial statements to understand and compare different companies.

5.4 Contractual Service Margin

The contractual service margin is a component of the asset or liability for the group of insurance contracts under the LRC for the GMM that represents the unearned profit the entity will recognize as it provides insurance contract services in the future. Once the coverage period has ended, the CSM falls to zero.

It is measured at initial recognition as the excess (if any) of the expected present value of cash inflows over cash outflows after adjustment for non-financial risk to eliminate any "gain at issue." It is amortized over the coverage period for the group based on "coverage units,"

which aim to measure the quantity of coverage provided over a given period of time. For example, a straight-line allocation of coverage units over the passage of time may be appropriate for some insurance products.

At inception, before any cash flows, the CSM is estimated as:

$$\begin{aligned} &Initial\ CSM \\ &= Premium\ Receivable - Expected\ Claims\ Payable - Expected\ Expenses\ Payable - Risk\ Adjustment \end{aligned}$$

At subsequent measurement, assuming no changes in assumptions, the CSM is estimated as:

$$CSM = Initial\ CSM \cdot (1 - Earned\ Coverage\ Units\ /\ Total\ Coverage\ Units)$$

At both inception and subsequent measurement, the CSM has a floor of zero.

5.5 Onerous Contracts and Loss Component

If there is no excess of inflows over outflows at inception (i.e., the CSM is zero), the contract is onerous and a loss component is calculated. As discussed above, onerous contracts must be grouped separately from non-onerous contracts.

An entity must recognize a loss for the net present value outflow for the group of onerous contracts, resulting in the carrying amount of the liability for the group being equal to the fulfilment cash flows of the group.

A group of insurance contracts becomes onerous (or more onerous) on subsequent measurement if unfavorable changes to the estimates of future cash flows and the risk adjustment for non-financial risk exceed the carrying amount of the contractual service margin. The loss component decreases proportionally to the LRC and reaches 0 once the coverage for the underlying insurance contracts expires. A group can also become non-onerous with a positive CSM if in the future the present value of future cash flows decreases sufficiently.

6. VARIATIONS TO THE GENERAL MEASUREMENT MODEL

6.1 Premium Allocation Approach

Under IFRS 17, the LRC of insurance contracts that satisfy certain criteria can be measured using a simplified approach called the Premium Allocation Approach (PAA). This is particularly relevant for non-life products since a large portion of them meet the criteria for the PAA. Note that the PAA does not impact the measurement of the LIC.

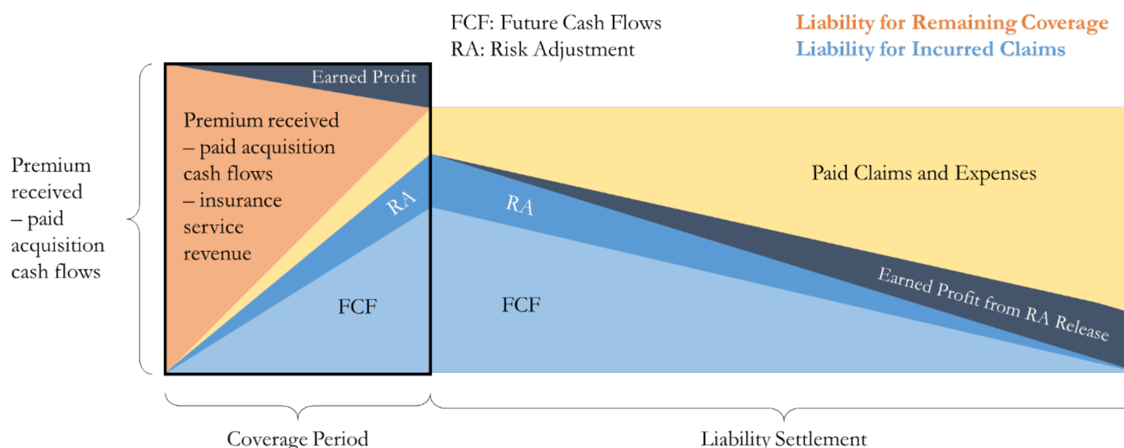
An entity may simplify the measurement of a group of insurance contracts by using the premium allocation approach if, and only if, at the inception of the group:

a) the entity reasonably expects that such simplification would produce a measurement of the LRC for the group that would not differ materially from the one that would be produced by applying the GMM; or

b) the coverage period of each contract in the group is one year or less.

For contracts not immediately eligible for the PAA under (b) above, the potential eligibility for the PAA has to be tested to see if it meets the criteria under (a) above. This requires understanding the mechanics of both the PAA and GMM for the type(s) of contracts being tested, including how the CSM is measured over the life on a contract under the GMM. Many contracts over 12 months long have been found to be eligible for the PAA, but the longer the contract the less likely that they will be eligible for the PAA.

The measurement of a single insurance contract under the PAA can be visualized with the aid of the following diagram:



The diagram assumes that premium is collected upfront, that acquisition costs are paid at inception and that there are no changes to the valuation assumptions. This is a simplified illustration of an insurance contract for the purposes of this paper and does not fully account for all aspects and complexities within the liability calculation.

If an entity elects to use the PAA instead of the GMM for a group of insurance contracts, it shall measure the LRC as follows:

On initial recognition, the carrying amount of the LRC is composed of:

a) the premiums received at initial recognition, if any;

b) minus any insurance acquisition cash flows at that date, unless the entity chooses to recognize the payments as an expense; and

c) plus or minus any amount arising from the derecognition at that date of any asset for insurance acquisition cash flows and any other asset or liability previously recognized for cash flows related to the group of contracts.

At each subsequent reporting period, the carrying amount of the LRC is composed of:

a) the carrying amount of the LRC at the start of the period

b) plus the premiums received in the period;

c) minus insurance acquisition cash flows; unless the entity chooses to recognize the payments as an expense applying;

d) plus any amounts relating to the amortization of insurance acquisition cash flows recognized as an expense in the reporting period; unless the entity chooses to recognize insurance acquisition cash flows as an expense;

e) minus the amount recognized as insurance service revenue in that period (which would primarily be composed of premium earned in the period).

Under PAA, the entity assumes that contracts are not onerous at initial recognition unless facts and circumstances indicate otherwise. However, if at any time during the coverage period, facts and circumstances indicate that a group of insurance contracts is onerous, an entity shall calculate the difference between the current LRC under the PAA and the fulfilment cash flows that relate to the remaining coverage of the group under the GMM. To the extent that the fulfilment cash flows exceed the current LRC under the PAA, the entity shall recognize a loss

and increase the LRC.

An entity that elects to use the PAA may choose to recognize any insurance acquisition cash flows as expenses when it incurs those costs, provided that the coverage period of each contract in the group at initial recognition is no more than one year. Under the GMM, acquisition cash flows must be deferred over the coverage period of the contract.

An entity shall measure the liability for incurred claims for the group of insurance contracts as the fulfilment cash flows relating to incurred claims, the same as under the GMM. However, the entity is not required to adjust future cash flows for the time value of money and the effect of financial risk if those cash flows are expected to be paid or received in one year or less from the date the claims are incurred.

6.2 Reinsurance Held

Similarly to insurance contracts, an entity shall divide portfolios of reinsurance contracts held into portfolios, groups and cohorts, except that the references to onerous contracts are replaced with references to contracts on which there is a net gain on initial recognition (i.e., profitable from the cedant's perspective).

An entity shall recognize a group of reinsurance contracts held from the earlier of the following:

a) the beginning of the coverage period of the group of reinsurance contracts held; and

b) the date the entity recognizes an onerous group of underlying insurance contracts, if the entity entered into the related reinsurance contract held in the group of reinsurance contracts held at or before that date[6].

In applying the measurement requirements, the entity shall use consistent assumptions to measure the estimates of the present value of the future cash flows for the group of reinsurance contracts held and the estimates of the present value of the future cash flows for the group(s) of underlying insurance contracts. In addition, the entity shall include in the estimates of the present value of the future cash flows for the group of reinsurance contracts held the effect of any risk of non-performance by the issuer of the reinsurance contract, including the effects

[6] A loss recovery needs to be recorded at the same time as a loss component is reported for the underlying contracts, if the insurer expects to recover on the underlying contracts.

of collateral and losses from disputes. An entity shall determine the risk adjustment for non-financial risk so that it represents the amount of risk being transferred by the holder of the group of reinsurance contracts to the issuer of those contracts.

An entity may use the premium allocation approach to simplify the measurement of a group of reinsurance contracts held, if at the inception of the group:

a) the entity reasonably expects the resulting measurement would not differ materially from the GMM; or

b) the coverage period of each contract in the group of reinsurance contracts held (including insurance coverage from all premiums within the contract boundary determined at that date) is one year or less.

7. RECOGNITION, MODIFICATION AND DERECOGNITION

7.1 Recognition

Insurance contracts must be recognized at the earliest of the following:

1. The beginning of the coverage period of the group of contracts;
2. The date when the first payment from a policyholder in the group becomes due; or,
3. For a group of onerous contracts, when the group becomes onerous.

For example, if a portion of the premium is due before the effective date of the policy, the insurance contracts would be recognized on the date the premium is due. The premium due date would then be used to separate the groups of insurance contracts into yearly cohorts. If there is no contractual due date, the first payment from the policyholder is deemed to be due when it is received.

7.2 Modification

If the terms of an insurance contract are modified, for example by agreement between the parties to the contract or by a change in regulation, an entity must derecognize the original contract and recognize the modified contract as a new insurance contract if and only if one of the following conditions is satisfied:

1. If the modified terms had been included at contract inception:
    a. The modified contract would have been excluded from the scope of IFRS 17,
    b. An entity would have separated different components (distinct service components, distinct embedded derivatives, distinct investment components) from the insurance contract to which IFRS 17 would have applied,
    c. The modified contract would have had a substantially different contract boundary, or,
    d. The modified contract would have been included in a different group of contracts.

2. The original contract met the definition of an insurance contract with direct participation features, but the modified contract no longer meets that definition, or vice versa; or
3. The entity applied the premium allocation approach to the original contract, but the modifications mean that the contract no longer meets the eligibility criteria for this simplified approach.

If a contract modification meets none of the conditions above, the entity shall treat changes in cash flows caused by the modification as a change in the estimate of fulfilment cash flows. The exercise of a right included in the terms of a contract is not a modification.

Examples of common modifications that might exist for property/casualty contracts include adding a car to a personal automobile/motor policy, replacing an old car with a new car for such a policy, or adding a property to the commercial property policy for a large business. In many cases these would not lead to derecognition of the prior policy.

7.3 Derecognition

An entity shall derecognize an insurance contract when, and only when:

1. it is extinguished, i.e., when the obligation specified in the insurance contract expires or is discharged or cancelled; or
2. any of the conditions for modifications leading to derecognition are met.

When an insurance contract is extinguished, the entity is no longer at risk and is therefore no longer required to transfer any economic resources to satisfy the insurance contract. It is important to note that since P&C insurance contracts are rarely extinguished, derecognition rarely applies to P&C insurance contracts.

An entity derecognizes an insurance contract from within a group of contracts by applying the following requirements in IFRS 17:

1. the fulfilment cash flows allocated to the group are adjusted to eliminate the present value of the future cash flows and risk adjustment for non-financial risk relating to the rights and obligations that have been derecognized from the group; and,
2. the contractual service margin of the group is adjusted for the change in fulfilment cash flows.

8. PRESENTATION AND DISCLOSURE

Below are examples of a simplified statement of profit or loss and a statement of financial position for an insurance company reporting under IFRS 17.

Consolidated Statement of Profit or Loss

	2023	2024
Insurance revenue	50,890	54,269
Insurance service expenses	(42,459)	(43,104)
Net expenses from reinsurance contracts	(1,125)	(1,230)
Insurance service result	**7,306**	**9,935**
Net investment income	**23,800**	**29,169**
Net finance expense from insurance contracts	(20,160)	(24,166)
Net finance income from reinsurance contracts	279	337
Net insurance finance expenses	**(19,881)**	**(23,829)**
Net insurance and investment result	**11,225**	**15,275**
Other income	(5,500)	(5,536)
Profit before income tax	**5,725**	**9,739**
Income tax expenses	(1,603)	(2,644)
Profit for the year	**4,122**	**7,095**

Consolidated Statement of Financial Position

	2023	2024
Assets		
Cash	16,337	16,899
Financial investments	392,821	421,291
Receivables	8,470	7,609
Insurance contract assets	668	717
Reinsurance contract assets	12,375	13,775
Other assets	1,501	1,561
Total assets	**432,172**	**461,852**
Liabilities		
Payables	11,305	10,401
Insurance contract liabilities	360,829	379,951
Reinsurance contract liabilities	834	884
Other liabilities	612	652
Total Liabilities	**373,580**	**391,888**
Equity		
Share capital and share premium	19,014	23,291
Retained earnings	39,578	46,673
Total equity	**58,592**	**69,964**
Total liabilities and equity	**432,172**	**461,852**

Insurance service revenue should primarily be composed of the amount of premium earned in the period. Insurance service expenses should contain incurred claims, acquisition costs and costs required to fulfill insurance contracts under PAA and GMM. Net expenses from reinsurance contracts can either be shown as a single line item netting premium and expense, or by showing separate reinsurance premium and reinsurance service expenses. It is important to note that reinsurance premium is often shown net of ceding commission for both reinsurance assumed and reinsurance ceded which may distort historical key performance indicators.

Insurance finance income / expense captures the unwind of the discount and other financial risk related insurance measurements. LRC and LIC are included in insurance and reinsurance contracts assets and liabilities.

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David Mamane is a director in RSM's actuarial consulting practice, where he provides a diverse range of P&C actuarial, insurance management, and enterprise risk management advisory services to insurance companies and financial institutions. He is a Fellow of the Casualty Actuarial Society and the Canadian Institute of Actuaries. David is a frequent speaker and panelist at actuarial and insurance conferences on the topics of insurance strategic decision-making, capital modeling, ERM, data & analytics, and IFRS 17, as well as an active member in insurance industry committees related to leadership development, learning enhancement and effective presentations, and actuarial education. David is also a senior analyst in RSM's cutting edge Industry Eminence Program, which positions its industry senior analysts to understand, forecast and communicate economic, business and technology trends shaping the insurance industry.

Liam Neilson (CPA) is a director in RSM's insurance practice serving insurance businesses in Canada and the US. He has twenty years of focused experience across second and third lines of defense with financial institutions. Part of Liam's role is to provide advisory services on internal controls and governance around risk management processes and frameworks for insurance clients. Liam also supports financial services compliance and technical accounting analysis (IFRS 17 Insurance Contracts). He volunteers at the Insurance Bureau of Canada IFRS 17 working groups where he has co-lead the discount rates working group and is a contributing author of expenses position paper. Liam is also the insurance audit leader for RSM's Canadian practice.

APPENDICES

Differences between IFRS 4 and IFRS 17

IFRS applies to any contract classified as insurance contracts, regardless of the issuing company. Contract classification under IFRS 17 is largely the same as IFRS 4.

IFRS 17 maintains the presentation and disclosure themes of IFRS 4 but reduces the number of line items in the P&L and balance sheet, while expanding detailed disclosure requirements. The new standard introduces new measurement requirements for insurance contracts. IFRS 4 did not contain measurement requirements and deferred to local accounting practices.

This in turn impacts how actuaries must project future insurance cash flows, determine risk margins and estimate liabilities with regards to expired, inforce and future insurance policies.

Illustrative Example – Portfolio aggregation, LRC and LIC under PAA

To assist the reader in understanding the concepts of IFRS 17, the authors have provided an illustrative example in appendix, and as an Excel workbook, that covers topics from the following sections of the paper:

- 4. Level of Aggregation of Insurance Contracts
- 5. General Measurement Model
- 6. Variations to the General Measurement Model
- 8. Presentation and Disclosure

In some cases, the derivation of assumptions underlying IFRS 17 calculations is not trivial and requires extensive amounts of data and actuarial analysis. For the purposes of this paper, the authors have simplified the example to focus on the core mechanics of the IFRS 17 calculations. The list of simplified assumptions include expected loss ratios, unpaid claims, present value factors, and risk adjustment factors. Should the reader wish to dive deeper into the technical approaches used to derive these assumptions, the authors would refer them to other published papers on these topics.