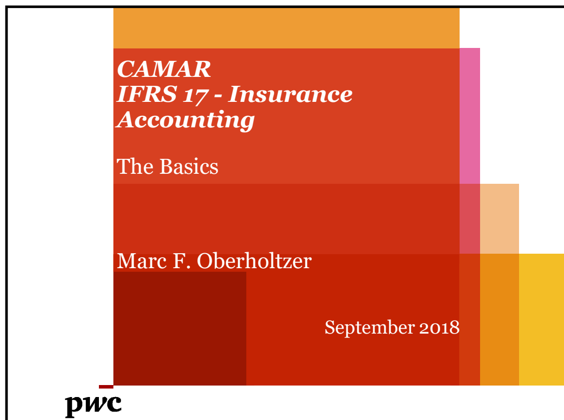



## *Background*
### Overview of the guidance

IFRS 17 is the proposed new international accounting standard for insurance contracts which replaces the existing IFRS 4 standard. The new standard provides a single global accounting standard for insurance and reinsurance contracts.

**What is changing?**

**Balance sheet**
- IFRS 17 requires a current measurement model for life contracts as well as P&C, where estimates are re-measured in each reporting period.
- The measurement is based on the building blocks of discounted, expected value cash flows, a risk adjustment, and a contractual service margin ('CSM') representing the unearned profit of the contract plus certain fixed costs.

**Income statement**
- Requirements in IFRS 17 align the presentation of revenue with other industries. Investment components are excluded from revenue, and revenue is not reduced for ceded reinsurance.
- Entities have an accounting policy choice to allow for the impact of changes in discount rates in profit or loss or in other comprehensive income ('OCI') to reduce some interest rate fluxuation volatility in profit or loss.

**Disclosures**
- IFRS 17 disclosures will be more detailed than required under most current reporting frameworks.
- Disclosures were intended to provide additional insight into key judgements and profit emergence, and at least in theory to allow greater comparability across entities.

PwC 2

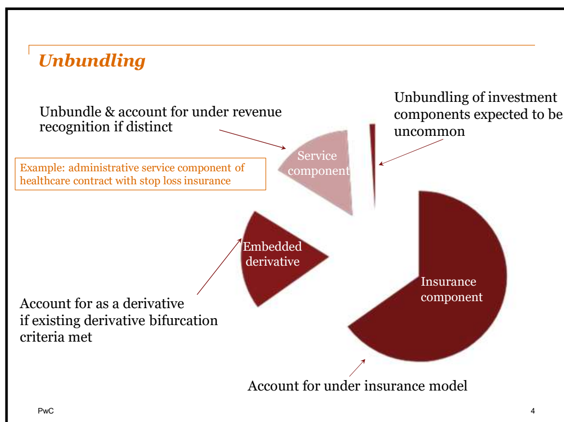
## *Insurance contracts and insurance risk*

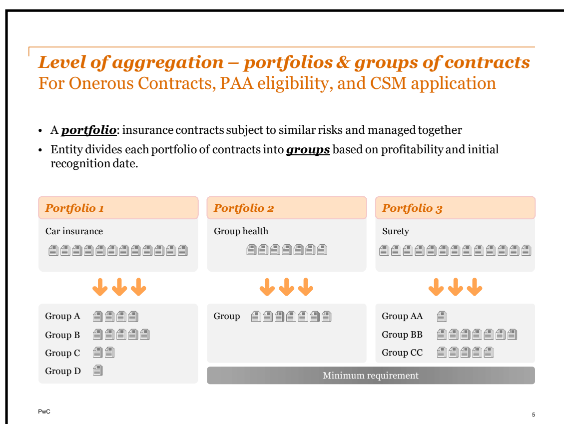
IFRS 17 defines **insurance contracts** as contracts under which significant insurance risk is transferred.

What is ***significant*** insurance risk?

Insurance risk is significant if, and only if, an insured event could cause the issuer to pay additional amounts that are significant in any single scenario, excluding scenarios that have no commercial substance

PwC 3




## *IFRS 17 measurement models*

Overview

| | General model/ Building Block Approach (BBA) | Premium allocation approach (PAA) | Variable fee approach |
|---|---|---|---|
| **Why is it needed?** | Default model for all insurance contracts | To simplify for short term contracts | To deal with participating business where payments to policyholders are linked to underlying items like assets |
| **Types of contract** | • Long-term and whole life insurance, protection business<br>• Certain annuities<br>• US style universal life<br>• Certain reinsurance written<br>• Certain general insurance contracts | • Most general insurance contracts<br>• Most short-term life and certain group contracts | • Unit-linked contracts, US variable annuities and equity index-linked contracts<br>• Continental European 90/10 contract<br>• UK with profits contracts |
| **Mandatory?** | Mandatory | Optional | Mandatory |

PwC 6

## *General model*
### Overview

- Default model for all insurance contracts
- Starts with an estimate of the expected value of discounted future cash flows
- Discounting – option to use yield curves at date contract issued (OCI option)
- Explicit margins:
  - CSM – to prevent gain on policy inception
  - Risk adjustment – reflect uncertainty (non-financial risk)
- Day 1 loss recognized in income statement
- Cash flow approach for all liabilities: past claims (including IBNR) and future cover

| Component | Description |
| --- | --- |
| Contractual service margin (CSM) | Profit and certain fixed costs recognized over coverage period (embedded in the unearned premium under the PAA). |
| Risk adjustment | Reflect compensation entity requires for uncertainty. Quantifies the value difference between certain and uncertain liability. |
| Discounting | Discounting future cash flows reflecting liquidity characteristics of the liabilities. |
| Expected value of future cash flows | Expected value (explicit, unbiased, mean estimate) of the future cash flows that will arise as the insurer fulfills the insurance contract. |

Expired and unexpired risk

PwC 7

## *Background*
### Measurement models

| | Current IFRS/GAAP | General Model | PAA |
| --- | --- | --- | --- |
| Unexpired risk | UPR less DAC | Contractual Service Margin<br>Risk adjustment<br>Discounting<br>Expected value of future cash flows | Premium (less acquisition costs) unearned, reduced for premiums receivable |
| Expired risk | Undiscounted reserves for past claims (including IBNR) | Risk adjustment<br>Discounting<br>Expected value of future cash flows | Risk adjustment<br>Discounting<br>Expected value of future cash flows |

**Qualifying for the PAA**

Automatically available for contracts with coverage period twelve months or less.

Unlikely that all contracts will automatically qualify for PAA model.

Mixed measurement models within a reportable segment may make results difficult to interpret.

**Drivers of profit**

Changes to yield curves will require close asset liability matching to manage income statement volatility.

No prescribed method for measuring the risk adjustment but entity required to disclose methodology and confidence level and expected to be consistent year on year.

* Size of blocks are for illustrative purposes only

PwC 8

## *Premium allocation approach*
### Overview

- Expected to apply to most property/casualty contracts and annual health contracts
  - Simplification that may be applied when the entity reasonably expects that it would produce a measurement of the liability for remaining coverage for the group that would not materially differ from the general model or when the coverage period on the product is one year or less
- Similar to current US GAAP unearned premium approach, but:
  - Use of "mean" rather than "best estimate" for incurred claims
  - Discounting of incurred claims is generally required at a rate reflective of the underlying liabilities-a risk-free rate with an adjustment for liquidity (OCI option – able to lock in yield curve at date of incurred loss)
  - Inclusion of "risk adjustment" to reflect uncertainty in amount/timing of unpaid claims
  - Revenue pattern based on the passage of time or expected timing of incurred insurance service expenses, if the expected pattern incurred losses significantly differs from straight line
  - Other key differences include (1) gross presentation as regards reinsurance in income statement (e.g., revenue is not "netted" for ceded reinsurance), (2) exclude "investment components" from revenue and claims incurred expense, (3) ceding commissions netted against reinsurance premiums, (4) present liability for remaining coverage (UPR) net of DAC and premiums receivable , (5) more granular level of onerous contract testing

Liability for remaining coverage (DAC, Onerous) + Discounted liability for incurred claims = Insurance liability

PwC 9

## *Premium allocation approach*

Eligibility criteria

An entity **may** simplify the measurement of a group of insurance contracts 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 **liability for remaining coverage** for the group that would **not differ materially** from the one that would be produced applying the General Model; or

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

Criterion (a) above is **not** met if at the inception of the group an entity expects **significant variability** in the fulfilment of cash flows that would affect the measurement of the liability for remaining coverage during the period before a claim is incurred.

What is the unit of account? | What are the coverage units? | What is materiality?



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