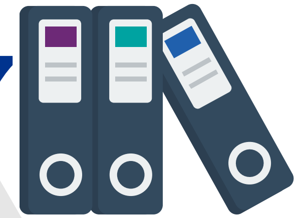
IFRS 17 Reinsurance

August 2018

Fundamentals of IFRS 17 Reinsurance



- Ceded reinsurance is referred to as reinsurance held and assumed reinsurance is referred to as reinsurance issued in the IFRS 17 standard
- Direct business and Reinsurance held are modelled separately
- Reinsurance issued is treated consistently with direct business written
- Existence of reinsurance held does not affect the fulfilment cashflows on the underlying direct contract
- Consistent assumptions must be used between reinsurance contracts held and underlying contracts
- All cashflows within the contract boundary must be included in the fulfilment cashflows
- Recognition of reinsurance contracts depends on the coverage provided

Reinsurance measurement

Treatment of gains and losses at initial recognition

	Direct contract	Reinsurance contract
Gains	**CSM (spread)**	**CSM: net gain (spread)**
Losses	**Recognise immediately**	**CSM: net cost (spread)**

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An issue arises where an insurer has a loss making direct contract and enters into a reinsurance contract which it expects to be profitable. This is because at inception of the **two contracts, the insurer will not be able to offset** the loss on the direct contract with the expected profit on the reinsurance contract entered into.

Subsequent measurement

The treatment of changes in estimates relating to the reinsurance contract mirrors the treatment of the change in estimates relating to the underlying direct contract:

Direct contract		RI contract
Changes are recognised in profit or loss	→	Changes are recognised in profit or loss
Changes adjust the CSM	→	Changes adjust the CSM

Reinsurance held is always modelled using the General Model, even if the underlying contracts are modelled using the VFA

Presentation

An entity shall present separately in the statement of financial position:

- The carrying amount of portfolios of reinsurance contracts held that are in an asset position; and
- The carrying amount of portfolios of reinsurance contracts held that are in a liability position.

The entity shall on the expected PV basis:

- Treat the cash flows including ceding commissions, that are contingent on the occurrence of claims of the underlying contracts as part of the claims that are expected to be reimbursed under the reinsurance contract;
- Treat ceding commissions that it expects to receive that are not contingent on the occurrence of claims of the underlying contracts as a reduction of the premiums to be paid to the reinsurer;
- The fulfilment cash flows need to reflect the risk of non-performance by the reinsurer, including the effect of collateral losses from disputes;
  - Changes in the fulfilment cash flows that result from changes in the risk of default of the reinsurer do not relate to future coverage or other future services and shall be recognised immediately in P&L.
- Determine the risk adjustment, so that it represents the risk being transferred by the holder of the reinsurance contract.
- If net cost of purchasing reinsurance cover relates to events that occurred before the purchase of the reinsurance contract, such a cost shall immediately be recognised in P&L as an expense.

The principles of CSM calculation, interest accretion and treatment of economic and non-economic variances are all in line with the General Model Approach.

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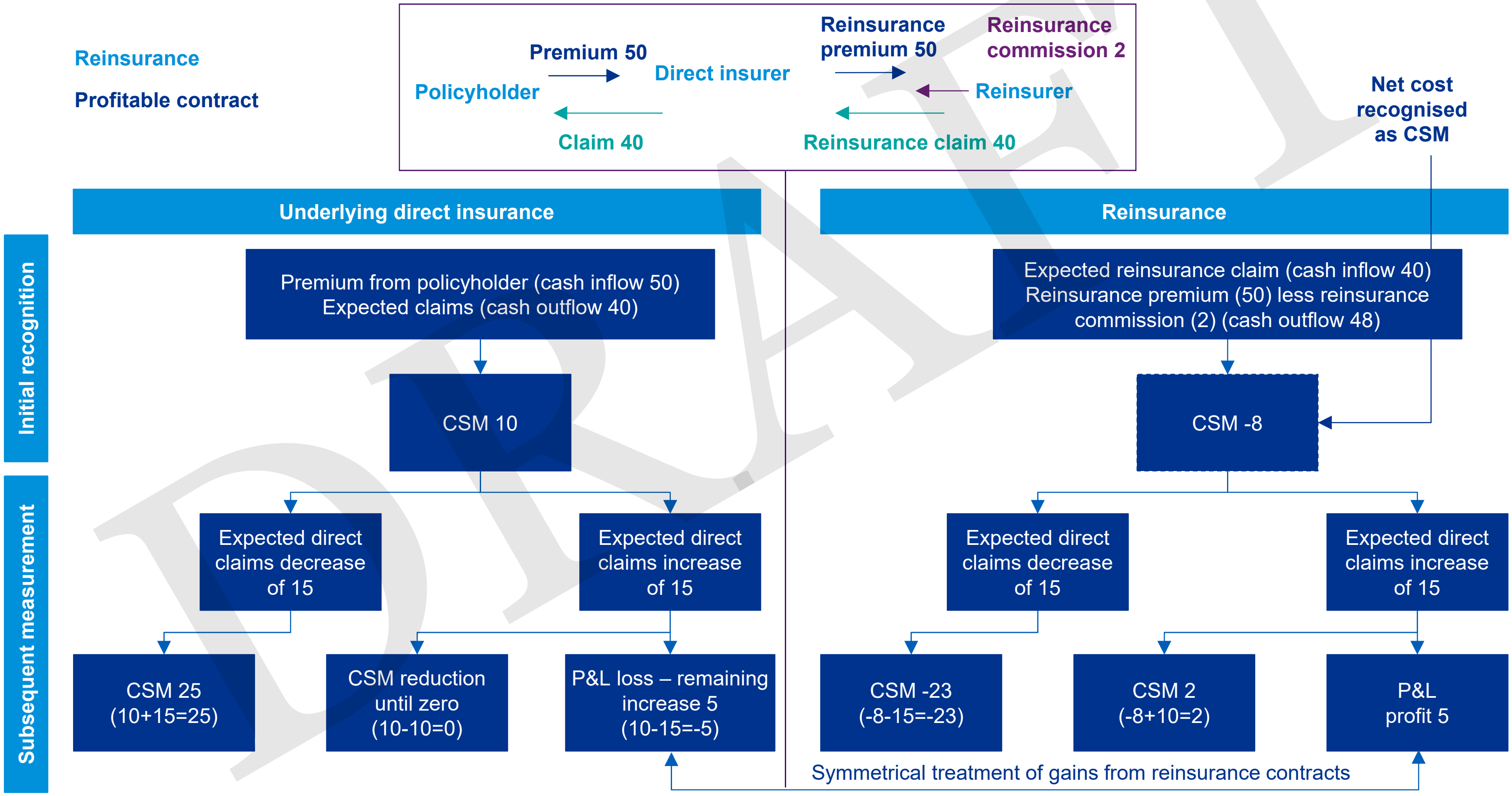
Below is an example of calculation of CSM on a reinsurance contract held with **profitable** underlying direct contracts as per the requirements set out above.



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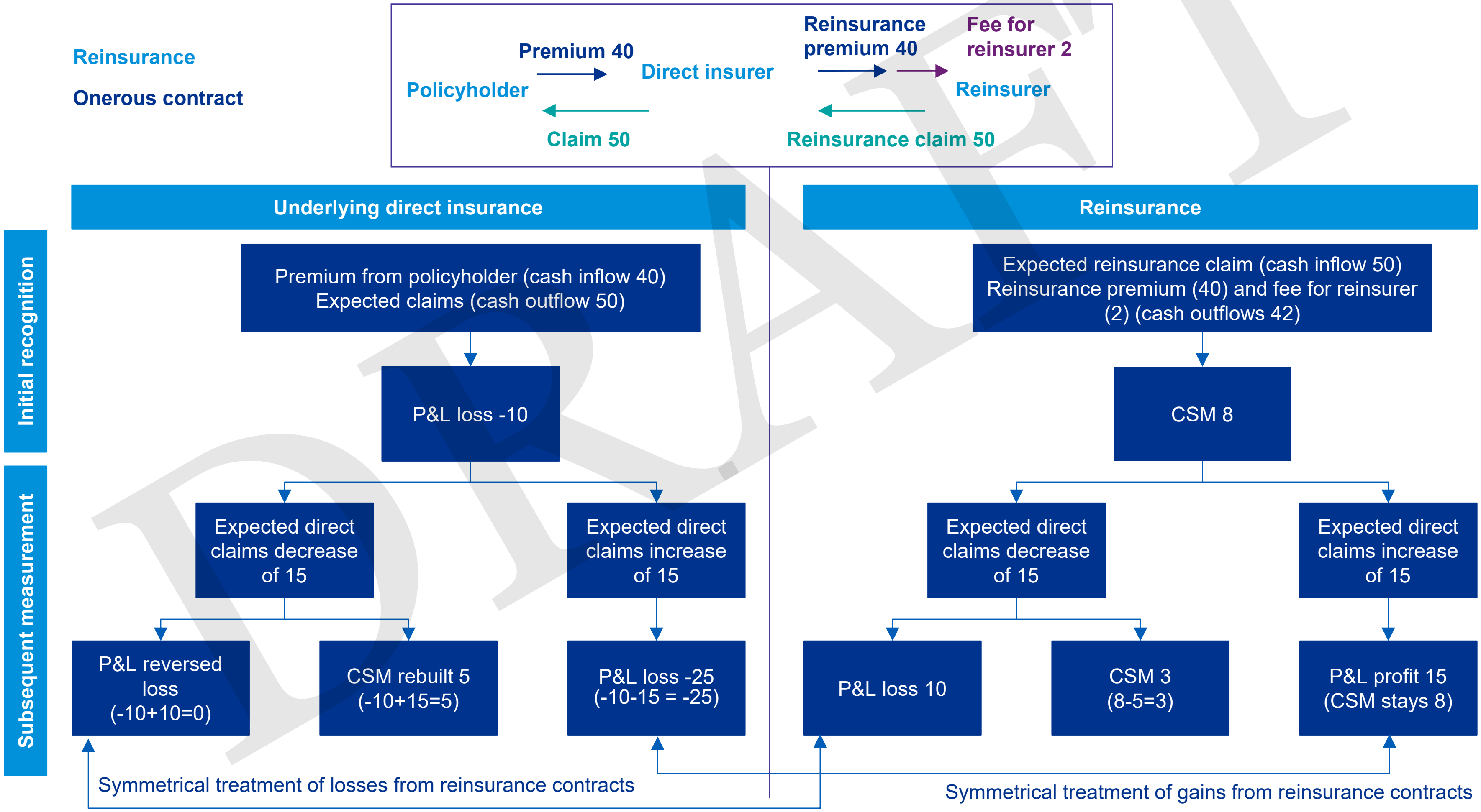
Below is an example of calculation of CSM on a reinsurance contract held with **onerous** underlying direct contracts as per the requirements set out above.



Issues and Questions

Reinsurance specific issues

The specific treatment of reinsurance under IFRS 17 can therefore cause a number of mismatches between the measurement of direct and reinsurance contracts because of:

- Different contract boundaries
- Consistent but different assumptions between the direct and reinsurance contract
- Using the PAA on the direct contract but BBA on the reinsurance contract due to different contract boundaries (or even vice versa)
- Similarly, using VFA on direct contract but BBA on the reinsurance contract

Topics	Key Questions
Contract Boundaries	• How should Reinsurance be treated when Reinsurance qualifies for PAA, but underlying contract does not, due to different contract boundaries?
Cohort Groupings	• Can multiple products / bulk schemes be unbundled from a reinsurance treaty into separate reinsurance contracts?
Risk Adjustment	• What implications are there of the risk adjustment on reinsurance being an allowance in the reduction in uncertainty?
Coverage Units	• Should the coverage units used on reinsurance contracts held be the same as for underlying contracts given this could still create a mismatch e.g. sum assured on individual surplus?
Transition	• Can you start a retrospective approach midway through a contract (e.g. if not possible when treaty incepted but possible after a given date due to improved data)?

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