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Project	**Amendments to IFRS 17 *Insurance Contracts***
Paper topic	Appendix to reinsurance contracts held—onerous underlying insurance contracts

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Purpose

1. This paper is an appendix to Agenda Paper 2B which discusses the accounting for reinsurance contracts held when the underlying insurance contracts are onerous.

2. This paper includes examples of accounting for reinsurance contracts held when the underlying insurance contracts are onerous.

Examples

3. This paper includes the following examples:

   (a) **Example A**—existing exception for adverse changes in fulfilment cash flows (paragraphs 5–10 of this paper)

   (b) **Example B**—Scenario 1—when a reinsurance contract held is in a net gain position and provides coverage for an underlying onerous group of insurance contracts (paragraphs 11–20 of this paper):

      (i) applying IFRS 17 (paragraphs 15–17 of this paper); and

      (ii) applying IFRS 17 with amendment recommended by staff (paragraphs 18–20 of this paper).

   (c) **Example C**—Scenario 2—when a reinsurance contract held is in a net cost position and provides coverage for an underlying onerous group of insurance contracts and an underlying profitable group of insurance contracts (paragraphs 21–30 of this paper):

(i) Applying IFRS 17 (paragraphs 25–27 of this paper); and

(ii) applying IFRS 17 with amendment recommended by staff (paragraphs 28–30 of this paper).

(d) **Example D**—when a reinsurance contract held and an underlying onerous group of insurance contracts are measured applying the PAA (paragraphs 31–43 of this paper):

(i) applying IFRS 17 (paragraphs 36–39 of this paper); and

(ii) applying IFRS 17 with amendment recommended by staff (paragraphs 40–43 of this paper).

4. For simplicity, the following assumptions apply in all examples:

(a) discount rates are 0% and the risk adjustment for non-financial risk is zero;

(b) services are provided evenly over the coverage period, claims are incurred evenly over the coverage period and claims are paid when incurred;

(c) reinsurance premiums are paid to the reinsurer at the same time premiums are received from the policyholder of the underlying insurance contracts;

(d) claims reimbursements are received from the reinsurer at the same time claims are paid to the policyholder of the underlying insurance contracts; and

(e) the effect of any risk of non-performance by the reinsurer on the expected future cash flows is ignored.[1]

[1] Applying paragraph 63 of IFRS 17, an entity shall include in the estimates of the present value of future cash flows for a group of reinsurance contracts held the effect of any risk of non-performance by the issuer of the reinsurance contract, including the effects of collateral and losses from disputes.

Example A—existing exception for adverse changes in fulfilment cash flows

5. At the beginning of Year 1, an entity issues a set of insurance contracts with a coverage period of two years. At initial recognition, the entity receives premiums of 1,000. The entity expects future cash outflows of 800. The entity treats the set of contracts as a group of insurance contracts. Applying paragraph 38 of IFRS 17 the entity measures the contractual service margin at initial recognition as 200 (1,000 – 800).

6. At the same time, the entity enters into a reinsurance contract that provides 50% proportionate coverage for the group of underlying insurance contracts. At initial recognition, the entity pays reinsurance premiums of 500. The entity expects future cash inflows of 400. Applying paragraph 65 of IFRS 17, the entity measures the contractual service margin at initial recognition as a net cost of 100 (500 – 400).

7. At the end of year 1, everything has occurred as expected for the group of underlying insurance contracts and the entity has incurred and paid 400 of claims. However, the group of underlying insurance contracts is now expected to be onerous due to an expected increase in claims in Year 2. The entity revises its expectations about Year 2 and now expects to incur 700 of cash outflows, compared to 400 expected at initial recognition. The revised total expected cash outflows are 1,100 (400 incurred in Year 1 + 700 expected in Year 2), which is 300 higher than the 800 total expected cash outflows at initial recognition.

8. All events in Year 2 occur as expected in Year 1. The change in the insurance contract liability for Year 1 following initial recognition can be analysed as follows:

	CF	**CSM**	**Total**
Beginning of Year 1	800	200	1,000
Changes related to future service	300	(200)	100
Changes related to current service	0	0	0
Cash outflows	(400)	0	(400)
End of Year 1	**700**	**0**	**700**
Cash outflows	(700)	0	(700)
End of Year 2	**0**	**0**	**0**

9. The change in the 50% proportionate coverage reinsurance contract asset for year 1 following initial recognition can be analysed as follows:

	CF	**CSM**	**Total**
Beginning of Year 1	400	100	500
Changes related to future service (exception applies here - see footnote)	**150**	**(100)**[2]	**50**
Changes related to current service	0	0	0
Cash inflows	(200)	0	(200)
End of Year 1	**350**	**0**	**350**
Cash inflows	(350)	0	(350)
End of Year 2	**0**	**0**	**0**

[2] The CSM for a reinsurance contract held can be in a net cost or a net gain position (ie the contractual service margin *can* be lower than zero). However, 50 of the total 150 changes related to future service results from a change of 100 in the fulfilment cash flows of the group of underlying insurance contracts that does not adjust the CSM of that group (ie the loss component). Therefore, applying the exception in paragraph 66(c)(ii) of IFRS 17, that 50 does not adjust the CSM of the reinsurance contract held.

10. Calculation of the insurance service result:

	Year 1	Year 2
Insurance revenue[3]	400	600
Insurance service expenses[4]	(500)	(600)
Insurance contracts issued total	**(100)**	**0**
Reinsurance premiums[5]	(200)	(300)
Amounts recovered from reinsurance[6]	250	300
Reinsurance contracts held total	**50**	**0**
Insurance service result	**(50)**	**0**

Example B—Scenario 1—when a reinsurance contract held is in a net gain position and provides coverage for an underlying onerous group of insurance contracts

11. At the beginning of Year 1, an entity issues a set of insurance contracts with a coverage period of two years. At initial recognition, the entity receives premiums of 1,000. The entity expects future cash outflows of 1,200. The entity treats the set of contracts as a group of insurance contracts. Applying paragraph 47 of IFRS 17 the entity measures the loss component at initial recognition as 200 (1,000 – 1,200).

12. At the same time, the entity enters into a reinsurance contract that provides 50% proportionate coverage for the group of underlying insurance contracts. At initial

[3] Year 1 400 (change in liability for remaining coverage (LRC) excluding the loss component of 100) and Year 2 600 (change in liability for remaining coverage excluding 100 reversal of loss component).

[4] Year 1 500 (400 claims + 100 loss component) and Year 2 600 (700 claims – 100 reversal of loss component).

[5] Year 1 200 (change in asset for remaining coverage (ARC) plus 50 applying paragraph 66(c)(ii) of IFRS 17) and Year 2 300 (change in ARC minus 50 applying paragraph 66(c)(ii) of IFRS 17).

[6] Year 1 250 (200 claims reimbursed + 50 applying paragraph 66(c)(ii) of IFRS 17) and Year 2 300 (350 claims reimbursed – 50 applying paragraph 66(c)(ii) of IFRS 17).

recognition, the entity pays reinsurance premiums of 500. The entity expects future cash inflows of 600.

13. Everything occurs in Year 1 and Year 2 as expected at initial recognition.

14. The change in the insurance contract liability following initial recognition can be analysed as follows:

	CF	**CSM**	**Total**
Beginning of Year 1	1,200	0	1,200
Cash outflows	(600)	0	(600)
End of Year 1	**600**	**0**	**600**
Cash outflows	(600)	0	(600)
End of Year 2	**0**	**0**	**0**

(i) Applying IFRS 17

15. Applying paragraph 65 of IFRS 17, the entity measures the contractual service margin of the reinsurance contract held at initial recognition as a net gain of 100 (500 – 600).

16. The change in the 50% proportionate coverage reinsurance contract asset following initial recognition can be analysed as follows:

	CF	**CSM**	**Total**
Beginning of Year 1	600	(100)	500
Changes related to current service	0	50	50
Cash inflows	(300)	0	(300)
End of Year 1	**300**	**(50)**	**250**
Changes related to current service	0	50	50
Cash inflows	(300)	0	(300)
End of Year 2	**0**	**0**	**0**

17. Calculation of the insurance service result:

	Year 1	Year 2
Insurance revenue[7]	500	500
Insurance service expenses[8]	(700)	(500)
Insurance contracts issued total	**(200)**	**0**
Reinsurance premiums[9]	(250)	(250)
Amounts recovered from reinsurance[10]	300	300
Reinsurance contracts held total	**50**	**50**
Insurance service result	**(150)**	**50**

(ii) Applying IFRS 17 with amendment recommended by staff

18. Applying IFRS 17 with the amendment recommended by staff, the entity measures the reinsurance contract held at initial recognition as being in a net gain position of 100 (500 – 600). 100 of the cash inflows that the entity expects to receive from the reinsurer correspond to 200 cash outflows that the entity expects to pay to policyholders of the underlying insurance contracts that have contributed to the 200 loss expected on those underlying insurance contracts. The 200 loss component on the underlying insurance contracts is recognised immediately and, applying the recommended amendment, a 100 gain on the reinsurance contract held is also recognised immediately.

[7] Year 1 500 (change in LRC excluding loss component) and Year 2 500 (change in LRC excluding loss component).

[8] Year 1 700 (600 claims + 200 loss component at initial recognition – 100 reversal of loss component subsequently) and Year 2 500 (600 claims – 100 reversal of loss component).

[9] Year 1 250 (change in ARC) and Year 2 250 (change in ARC of 250).

[10] Year 1 300 (300 claims reimbursed) and Year 2 300 (300 claims reimbursed).

19. The change in the 50% proportionate coverage reinsurance contract asset following initial recognition can be analysed as follows:

	CF	**CSM**	**Total**
Beginning of Year 1	600	0	600
Cash inflows	(300)	0	(300)
End of Year 1	**300**	**0**	**300**
Cash inflows	(300)	0	(300)
End of Year 2	**0**	**0**	**0**

20. Calculation of the insurance service result:

	Year 1	**Year 2**
Insurance revenue	500	500
Insurance service expenses	(700)	(500)
Insurance contracts issued total	**(200)**	**0**
Reinsurance premiums[11]	(250)	(250)
Amounts recovered from reinsurance[12]	350	250
Total reinsurance contracts held	**100**	**0**
Insurance service result	**(100)**	**0**

[11] Year 1 250 (change in ARC *minus 50 applying amendment recommended by staff*) and Year 2 250 (change in ARC *minus 50 applying amendment recommended by staff*).

[12] Year 1 350 (300 claims reimbursed *plus 100 at initial recognition and minus 50 subsequently applying amendment recommended by staff*) and Year 2 250 (300 claims reimbursed *minus 50 applying amendment recommended by staff*).

Example C—Scenario 2—when a reinsurance contract held is in a net cost position and provides coverage for an underlying onerous group of insurance contracts and an underlying profitable group of insurance contracts

21. At the beginning of Year 1, an entity issues a set of insurance contracts with a coverage period of two years. At initial recognition, the entity receives premiums of 1,000. Some of the contracts are expected to be profitable and some are expected to be onerous. The entity recognises two groups of contracts: the group that is onerous at initial recognition; and a group of remaining contracts in the portfolio (ie the profitable contracts). The entity measures the groups at initial recognition as follows:

	Profitable group	**Onerous group**
Premiums received	800	200
Expected cash outflows	(600)	(300)
Contractual service margin / (loss component)	**200**	**(100)**

22. At the same time, the entity enters into a reinsurance contract that provides 50% proportionate coverage for the two groups of underlying insurance contracts. At initial recognition, the entity pays reinsurance premiums of 500. The entity expects future cash inflows of 450.

23. Everything occurs in Year 1 and Year 2 as expected at initial recognition.

24. The change in the insurance contract liability following initial recognition can be analysed as follows:

	Profitable Group			Onerous Group		
	CF	**CSM**	**Total**	**CF**	**CSM**	**Total**
Beginning of Year 1	600	200	**800**	300	0	**300**
Changes related to current service	0	(100)	**(100)**	0	0	**0**
Cash outflows	(300)	0	**(300)**	(150)	0	**(150)**
End of Year 1	**300**	**100**	**400**	**150**	**0**	**150**
Changes related to current service	0	(100)	**(100)**	0	0	**0**
Cash outflows	(300)	0	**(300)**	(150)	0	**(150)**
End of Year 2	**0**	**0**	**0**	**0**	**0**	**0**

(i) Applying IFRS 17

25. Applying paragraph 65 of IFRS 17, the entity measures the contractual service margin of the reinsurance contract held at initial recognition as a net cost of 50 (500 – 450).

26. The change in the 50% proportionate coverage reinsurance contract asset following initial recognition can be analysed as follows:

	CF	**CSM**	**Total**
Beginning of Year 1	450	50	500
Changes related to current service	0	(25)	(25)
Cash inflows	(225)	0	(225)
End of Year 1	**225**	**25**	**250**
Changes related to current service	0	(25)	(25)
Cash inflows	(225)	0	(225)
End of Year 2	**0**	**0**	**0**

27. Calculation of the insurance service result:

	Year 1	**Year 2**
Insurance revenue[13]	500	500
Insurance service expenses[14]	(500)	(400)
Insurance contracts issued total	**0**	**100**
Reinsurance premiums[15]	(250)	(250)
Amounts recovered from reinsurance[16]	225	225
Reinsurance contracts held total	**(25)**	**(25)**
Insurance service result	**(25)**	**75**

(ii) Applying IFRS 17 with amendment recommended by staff

28. Applying IFRS 17 with amendment recommended by staff, the entity measures the reinsurance contract held at initial recognition as being in a net cost position of 50 (500 reinsurance premiums – 450 reinsurance claims). 50 of the cash inflows that the entity expects to receive from the reinsurer correspond to 100 cash outflows that the entity expects to pay to policyholders of the underlying insurance contracts that have contributed to the 100 loss expected on the onerous group of underlying insurance contracts. The 100 loss component on the onerous group is recognised immediately and, applying the recommended amendment, a 50 gain on the reinsurance contract held is also recognised immediately. The contractual service margin of the reinsurance

[13] Year 1 500 (change in LRC excluding loss component) and Year 2 500 (change in LRC excluding loss component).

[14] Year 1 500 (450 claims + 100 loss component at initial recognition – 50 reversal of loss component subsequently) and Year 2 400 (450 claims – 50 reversal of loss component).

[15] Year 1 250 (change in ARC) and Year 2 250 (change in ARC).

[16] Year 1 225 (225 claims reimbursed) and Year 2 225 (225 claims reimbursed).

contract held is a net cost of 100 (500 reinsurance premiums – 400 reinsurance claims excluding the amount that relates to the loss component).

29. The change in the 50% proportionate coverage reinsurance contract asset following initial recognition can be analysed as follows:

	CF	**CSM**	**Total**
Beginning of Year 1	450	100	550
Changes related to current service	0	(50)	(50)
Cash inflows	(225)	0	(225)
End of Year 1	**225**	**50**	**275**
Cash inflows	(225)	**(50)**	(275)
End of Year 2	**0**	**0**	**0**

30. Calculation of the insurance service result:

	Year 1	Year 2
Insurance revenue	500	500
Insurance service expenses	(500)	(400)
Insurance contracts issued total	**0**	**100**
Reinsurance premiums[17]	(250)	(250)
Amounts recovered from reinsurance[18]	250	200
Reinsurance contracts held total	**0**	**(50)**
Insurance service result	**0**	**50**

Example D—when a reinsurance contract held and an underlying onerous group of insurance contracts are measured applying the PAA

31. This example is the same as Example B, except that the entity applies the PAA to both the underlying insurance contracts and the reinsurance contract held. At the beginning of Year 1, an entity issues a set of insurance contracts with a coverage period of two years. At initial recognition, the entity receives premiums of 1,000. The entity treats the set of contracts as a group of insurance contracts. At initial recognition, facts and circumstances indicate that the group of insurance contracts is onerous. Applying paragraph 57 of IFRS 17 the entity calculates the difference between:

[17] Year 1 250 (change in ARC *minus 25 applying amendment recommended by staff*) and Year 2 250 (change in ARC *minus 25 applying amendment recommended by staff*).

[18] Year 1 250 (225 claims reimbursed *plus 50 at initial recognition minus 25 subsequently applying amendment recommended by staff*) and Year 2 200 (225 claims reimbursed *minus 25 applying amendment recommended by staff*).

The carrying amount of the liability for remaining coverage applying paragraph 55 of IFRS 17 (PAA)	1,000
The fulfilment cash flows that relate to remaining coverage applying the general model[19]	1,200
Difference	**200**

32. Consequently, at initial recognition the entity recognises a loss of 200 and increases the liability for remaining coverage to 1,200.

33. At the same time, the entity enters into a reinsurance contract that provides 50% proportionate coverage for the group of underlying insurance contracts. At initial recognition, the entity pays reinsurance premiums of 500.

34. In each of Year 1 and Year 2 the entity pays claims of 600 and receives claims reimbursements from the reinsurer of 300.

35. The change in the insurance contract liability following initial recognition can be analysed as follows:

	Total
Beginning of Year 1	1,200
Insurance revenue applying paragraph 55(b)(v) of IFRS 17	(500)
Reversal of loss applying paragraphs 57-58 of IFRS 17	(100)
End of Year 1	**600**
Insurance revenue applying paragraph 55(b)(v) of IFRS 17	(500)
Reversal of loss applying paragraphs 57-58 of IFRS 17	(100)
End of Year 2	**0**

[19] With a relief relating to the practical expedient in paragraph 59(b) of IFRS 17.

(i) Applying IFRS 17

36. Applying paragraph 55 of IFRS 17 adapted to reflect the features of reinsurance contracts held, the entity measures the reinsurance contract held at initial recognition as an asset of 500.

37. The change in the 50% proportionate coverage reinsurance contract asset following initial recognition can be analysed as follows:

	Total
Beginning of Year 1	500
Allocation of reinsurance premiums applying paragraph 55(b)(v) of IFRS 17	(250)
End of Year 1	**250**
Allocation of reinsurance premiums applying paragraph 55(b)(v) of IFRS 17	(250)
End of Year 2	**0**

38. Calculation of the insurance service result:

	Year 1	Year 2
Insurance revenue[20]	500	500
Insurance service expenses[21]	(700)	(500)
Insurance contracts issued total	**(200)**	**0**
Reinsurance premiums[22]	(250)	(250)
Amounts recovered from reinsurance[23]	300	300
Reinsurance contracts held total	**50**	**50**
Insurance service result	**(150)**	**50**

39. Note that the outcome of applying the PAA to this fact pattern in Example D is the same as the outcome of applying the general model to this fact pattern in Example B.

[20] Total expected premium receipts of 1,000/2.

[21] Year 1 700 (600 claims incurred + 200 loss at initial recognition – 100 loss reversal) and Year 2 500 (600 claims incurred – 100 loss reversal).

[22] Total expected premium payments of 500/2.

[23] Year 1 300 (300 claims reimbursed) and Year 2 300 (300 claims reimbursed).

(ii) Applying IFRS 17 with amendment recommended by staff

40. Applying paragraph 55 of IFRS 17 adapted to reflect the features of reinsurance contracts held and with the amendment recommended by staff, the entity measures the reinsurance contract held at initial recognition as an asset of 600 (500 premiums paid + 100 gain recognised in profit or loss applying the amendment recommended by saff, at the same time as the 200 loss recognised on underlying insurance contracts).

41. The change in the 50% proportionate coverage reinsurance contract asset following initial recognition can be analysed as follows:

	Total
Beginning of Year 1 (initial recognition)	600
Allocation of reinsurance premiums applying paragraph 55(b)(v) of IFRS 17	(250)
Applying amendment recommended by staff	(50)
End of Year 1	**300**
Allocation of reinsurance premiums applying paragraph 55(b)(v) of IFRS 17	(250)
Applying amendment recommended by staff	(50)
End of Year 2	**0**

42. Calculation of the insurance service result:

	Year 1	**Year 2**
Insurance revenue	500	500
Insurance service expenses	(700)	(500)
Insurance contracts issued total	**(200)**	**0**
Reinsurance premiums[24]	(250)	(250)
Amounts recovered from reinsurance[25]	350	250
Reinsurance contracts held total	**100**	**0**
Insurance service result	**(100)**	**0**

43. Note that the outcome of applying the PAA to this fact pattern in Example D is the same as the outcome of applying the general model to this fact pattern in Example B.

[24] Total expected reinsurance premium payments of 500/2.

[25] Year 1 350 (300 claims reimbursed *plus 100 at initial recognition minus 50 subsequently applying amendment recommended by staff*) and Year 2 250 (300 claims reimbursed minus 50 applying amendment recommended by staff).