Insurance contracts issued by mutual entities

IFRS 17 Insurance Contracts
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Contracts issued by a mutual entity:
- Contracts that do not provide policyholders with a residual interest in the mutual entity (conventional insurance contracts)
- Contracts that provide policyholders with a residual interest in the mutual entity
Background

A mutual entity accepts risks from each policyholder and pools that risk.

Policyholders hold the residual interest in a mutual entity (in comparison to companies which are owned by shareholders).

The policyholders with a residual interest in the mutual entity bear the pooled risk collectively in their capacity as owners.
Mutual entities may also issue conventional insurance contracts (contracts that do not provide the policyholder with a residual interest in the mutual entity).

Determining whether a contract provides the policyholder with a residual interest in the mutual entity requires consideration of all substantive rights and obligations.

Paragraph 2 of IFRS 17: ‘An entity shall consider its substantive rights and obligations, whether they arise from a contract, law or regulation’
IFRS 17 applies to insurance contracts within its scope, regardless of the legal form of the issuing entity.

**Contracts that affect cash flows to other policyholders**

Some insurance contracts affect or are affected by the cash flows to policyholders of other insurance contracts (see slide 6). This is the case for insurance contracts that provide the policyholder with a residual interest in a mutual entity. It may also be the case for some conventional insurance contracts issued by any entity, including a mutual entity.

The fulfilment cash flows of a group of contracts reflect the extent to which the contracts in the group cause the entity to be affected by expected cash flows, whether to policyholders in that group or policyholders in another group (including both current and future policyholders).
Some insurance contracts affect or are affected by the cash flows to policyholders of other contracts by requiring:

A. the policyholder to share with policyholders of other contracts the returns on the same specified pool of underlying items

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B. Either:
   i. the policyholder to bear a reduction in their share of the returns on the underlying items because of payments to policyholders of other contracts that share in that pool, including payments arising under guarantees made to policyholders of those other contracts or
   ii. policyholders of other contracts to bear a reduction in their share of returns on the underlying items because of payments to the policyholder, including payments arising from guarantees made to the policyholder
Mutual entities may issue conventional insurance contracts that do not provide policyholders with a residual interest in the mutual entity, for example non-participating insurance contracts.

The requirements of IFRS 17 apply to these contracts regardless of the fact that they:
• have been issued by a mutual entity; and
• are underlying items for other contracts.

Consequently, groups of such contracts are expected to have a CSM.

Accounting for other assets and liabilities of a mutual entity
All other relevant IFRS Standards apply to other assets and liabilities of a mutual entity. Some IFRS Standards provide a fair value measurement option for assets and liabilities held by a mutual entity.
Payments to policyholders with a residual interest in a mutual entity vary depending on the returns on underlying items – the net assets of the mutual entity.

Paragraph B65(c) of IFRS 17: ‘Cash flows within the boundary of an insurance contract include payments to a policyholder that vary depending on returns on underlying items.’

Paragraph BC265 of the Basis for Conclusions on IFRS 17: ‘Payments to policyholders form part of the fulfilment cash flows regardless of whether those payments are expected to be made to current or future policyholders.’
Risk adjustment for non-financial risk in IFRS 17: ‘The compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk’

Although the policyholders with a residual interest as a whole bear the pooled risk collectively, the mutual, as a separate entity, has accepted risk from each individual policyholder.

The risk adjustment for contracts with policyholders that have a residual interest in a mutual entity reflects the compensation the mutual entity requires for bearing the uncertainty from the non-financial risk in those contracts.
The net cash flows of the mutual entity are eventually returned to policyholders with a residual interest (either current or future policyholders).

Applying the IFRS 17 requirements to contracts with policyholders with a residual interest in the mutual entity will result in no contractual service margin (CSM) for those contracts.
Impact on equity

Applying IFRS 17, for a mutual entity, the fulfilment cash flows include the rights of policyholders with a residual interest to the whole of any surplus of assets over liabilities. This means that, in principle, there should normally be no equity remaining.

However, the fulfilment cash flows are measured at current value whereas some other assets and liabilities are not required or permitted to be measured at fair value in accordance with IFRS Standards.

This accounting mismatch may result in reported equity for financial reporting purposes even if the mutual entity has no equity for regulatory purposes. The reported equity is likely to be negative (in a debit position).

Conceptual Framework:
‘Equity is the residual interest in the assets of the entity after deducting all its liabilities’

Examples in which fair value is not required and/or permitted by IFRS Standards:
- amortised cost financial assets;
- deferred tax balances;
- goodwill in subsidiaries.
Impact on equity

To provide useful information about its financial position and financial performance, an insurer that is a mutual entity can distinguish:

**Statement of financial position**
- Liability attributable to policyholders in their capacity as policyholders
- Liability attributable to policyholders with the most residual interest in the entity

**Statement(s) of financial performance**
- Income or expenses attributable to policyholders in their capacity as policyholders before determination of the amounts attributable to policyholders with the most residual interest in the entity
Further information

• Paragraphs 2, B16 and B67–B71 of IFRS 17
• Paragraphs BC264–BC269 of the Basis for Conclusions on IFRS 17