

Reinsurance contracts held: an example of proportionate reinsurance coverage

IFRS 17 Insurance Contracts

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This example illustrates the requirements in IFRS 17 *Insurance Contracts*:

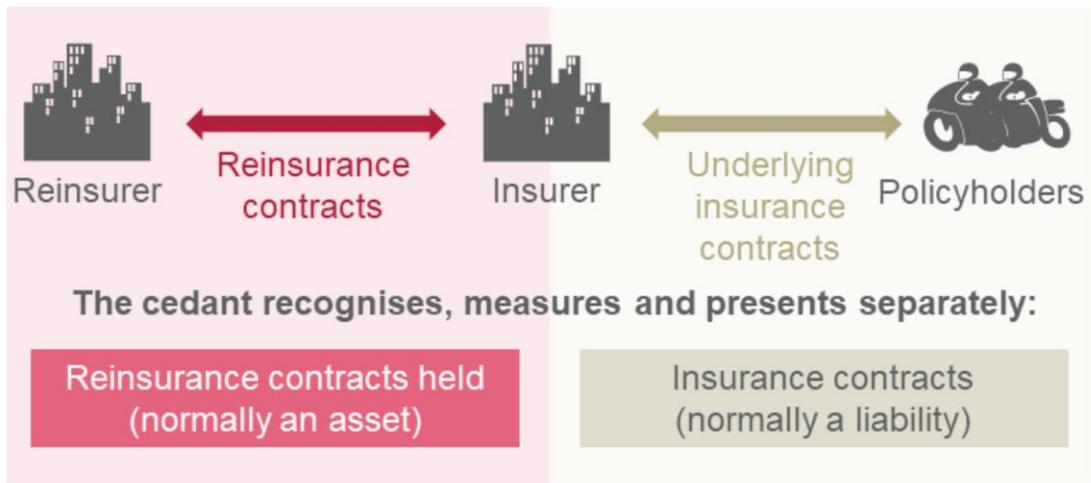
- a) applied to a group of underlying insurance contracts; and
- b) applied to a group of reinsurance contracts held that provides proportionate coverage for that group of underlying insurance contracts

This example demonstrates that:

- the measurement of a group of reinsurance contracts held is consistent with the measurement of any underlying insurance contracts
- the timing of cash flows do not directly affect the recognition of reinsurance income or expenses

Reminder: IFRS 17 requirements

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Further information

Paragraphs 60-70 of IFRS 17 *Insurance Contracts*

Paragraphs BC296-BC315 of the Basis for Conclusions on IFRS 17 *Insurance Contracts*

Webcast *Reinsurance contracts held* available at: go.ifrs.org/IFRS-17-implementation

Assumptions

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- IFRS 17 general model (not PAA)
- Risk adjustment for non-financial risk is nil
- Discount rate 0%
- Services are provided by the insurer evenly over the contract term for each contract
- All events occur as expected at initial recognition

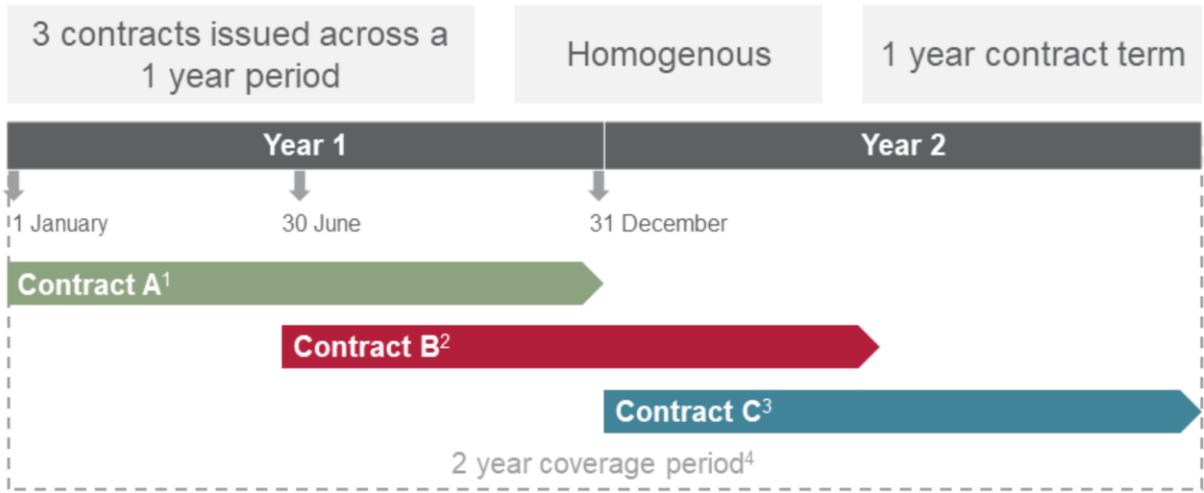


Further information

The objective of this example is to demonstrate the mechanics of the IFRS 17 requirements for reinsurance contracts held. For simplicity, a number of assumptions have been made. This example is not intended to reflect a real fact pattern.

Group of underlying insurance contracts

A group of insurance contracts issued



Further information

¹ Contract A is issued on 1 January in year 1

² Contract B is issued on 30 June in year 1

³ Contract C is issued on 31 December in year 1

⁴ Initial recognition of the group of insurance contracts: 1 January in year 1 is the beginning of the coverage period of the group of insurance contracts (paragraph 25(a) of IFRS 17). The coverage period for the group of insurance contracts is from 1 January in year 1 to 30 December in year 2. For simplicity, in this example the coverage period is referred as 2 years.

Cash flows

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	Year 1			Year 2		Total
	1 Jan	30 June	31 Dec	30 June	31 Dec	
Premiums ¹	300	300	300	-	-	900
Claims ²	-	(100)	(200)	(200)	(100)	(600)
Net cash inflow						300



Further information

All events occur as expected at initial recognition.

¹ Premiums of 300 are expected on day 1 for each of the 3 underlying insurance contracts.

² Claims of 600 are expected for the group of insurance contracts. Claims are incurred equally by each of the 3 underlying insurance contracts. For each underlying insurance contract, claims occur evenly over the 1 year contract term as services are provided and are paid immediately after incurred. The claims cash flows at each reporting date can be analysed as:

- Year 1 30 June – Contract A 100
- Year 1 31 December – Contract A 100 + Contract B 100
- Year 2 30 June – Contract B 100 + Contract C 100
- Year 2 31 December – Contract C 100

Statement of financial position

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	Year 1			Year 2	
	1 Jan ¹	30 June ²	31 Dec ³	30 June ⁴	31 Dec ⁵
Fulfilment cash flows	(200)	(300)	(300)	(100)	-
Contractual service margin	(100)	(150)	(150)	(50)	-
Insurance contract asset / (liability)	(300)	(450)	(450)	(150)	-



Further information

¹ At 1 January in year 1 the group is recognised and consists of the cash flows for Contract A only.

- FCF: premiums of 300 for Contract A are received on 1 January. The fulfilment cash flows at this date reflect expected claims of 200.
- CSM: the CSM of 100 at initial recognition is the amount that results in no income or expenses arising from the initial recognition of the fulfilment cash flows of 200 and the premiums received on that date of 300.

² At 30 June in year 1 the cash flows for Contract B are added to the group.

- FCF: premiums of 300 for Contract B are received on 30 June. The fulfilment cash flows reflect expected claims of 300 (opening balance of 200 plus 200 expected claims for Contract B minus 100 claims paid in the period).
- CSM: the balance of the CSM is 150 (opening balance of 100 plus 100 for Contract B minus 50 recognised as revenue in the period (see profit or loss slide 9)).

³ At 31 December in year 1 the cash flows for Contract C are added to the group.

- FCF: premiums of 300 for Contract C are received on 31 December. The fulfilment cash flows reflect expected claims of 300 (opening balance of 300 plus 200 expected claims for Contract C minus 200 claims paid in the period).
- CSM: the balance of the CSM is 150 (opening balance of 150 plus 100 for Contract C minus 100 recognised as revenue in the period).

⁴ At 30 June in year 2 no new cash flows are added to the group.

- FCF: the fulfilment cash flows reflect expected claims of 100 (opening balance of 300 minus 200 claims paid in the period).
- CSM: the balance of the CSM is 50 (opening balance of 150 minus 100 recognised as revenue in the period).

⁵ At 31 December in year 2 the group is derecognised.

- FCF: the fulfilment cash flows reflect expected claims of 0 (opening balance of 100 minus 100 claims paid in the period).
- CSM: the balance of the CSM is 0 (opening balance of 50 minus 50 recognised as revenue in the period).

Statement of profit or loss

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	Year 1		Year 2	
	1Jan-30Jun	1Jul-31Dec	1Jan-30Jun	1Jul-31Dec
Expected claims incurred ¹	100	200	200	100
Contractual service margin	50 ²	100	100	50
Insurance revenue	150	300	300	150
Actual claims incurred ¹	(100)	(200)	(200)	(100)
Insurance service expenses	(100)	(200)	(200)	(100)
Insurance service result	50	100	100	50



Further information

¹ In this example, for each underlying insurance contract, claims are incurred evenly over the 1 year contract term as services are provided and are paid immediately when incurred. All events occur as expected. See cash flows slide 7.

² At 30 June in year 1, the CSM before recognising any amount in profit or loss is 200. The CSM recognised for the period of six months ending 30 June in year 1 is 50. 50 reflects the amount allocated to coverage provided in the period (contract 1 was in force for six months) while the remaining 150 reflects coverage expected to be provided in the future (contract 1 is expected to be in-force for six months and contract 2 expected to be in force for a year). The CSM recognised in the remaining periods is determined in the same way.

Reinsurance contract held:
timing of cash flows match timing of
cash flows for the underlying
insurance contracts

Facts

Proportionate reinsurance contract held



Further information

¹ The reinsurance contract held is recognised on 1 January in year 1. In this example the reinsurance contract held, as a single contract, is identified as a group of insurance contracts. In this example, the group is referred to as the reinsurance contract held.

² Initial recognition of reinsurance contract held: 1 January in year 1 is the beginning of the coverage period for the reinsurance contract held and is also the initial recognition of the first underlying insurance contract added to the group (paragraph 62(a) of IFRS 17). The coverage period for the reinsurance contract held is equal to the coverage period for the group of underlying insurance contracts, from 1 January in year 1 to 30 December in year 2. For simplicity, in this example the coverage period is referred to as 2 years.

Cash flows

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	Year 1			Year 2		Total
	1 Jan	30 June	31 Dec	30 June	31 Dec	
Premiums ¹	(300)	(300)	(300)	-	-	(900)
Claims ²	-	100	200	200	100	600
Net cash outflow						(300)



Further information

¹ Premiums expected to be paid to the reinsurer are equal to the premiums received from the policyholder on the underlying insurance contracts. Premiums are expected to be paid to the reinsurer on the same day that premiums are received from the policyholder.

² Claims expected to be received from the reinsurer are equal to the claims expected to be paid to the policyholder on the underlying insurance contracts. Claims are expected to be received from the reinsurer on the same day that claims are paid to the policyholder.

See slide 7 for the cash flows arising from the group of underlying insurance contracts.

Statement of financial position

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	Year 1			Year 2	
	1 Jan ³	30 June ⁴	31 Dec ⁵	30 June ⁶	31 Dec ⁷
Fulfilment cash flows ¹	0	200	300	100	-
Contractual service margin ²	300	250	150	50	-
Reinsurance contract asset / (liability)	300	450	450	150	-



Further information

¹The fulfilment cash flows of the reinsurance contract held reflect all future cash flows expected to arise within the boundary of the reinsurance contract held. In this example, those cash flows relate to all underlying insurance contracts expected to be covered by the reinsurance contract including underlying insurance contracts that have not been issued yet.

²The CSM for the reinsurance contract held represents the net cost of purchasing reinsurance.

³At 1 January in year 1 the reinsurance contract held is recognised.

- FCF: the fulfilment cash flows are 0 (opening balance of 0 plus 900 expected premiums minus 600 expected claims minus 300 premiums paid relating to Contract A).
- CSM: the CSM of 300 at initial recognition is the amount that results in no income or expenses arising from the initial recognition of the fulfilment cash flows of 0 and the premiums paid on that date of 300.

⁴At 30 June in year 1:

- FCF: the fulfilment cash flows are 200 (opening balance of 0 minus 100 claims received plus 300 premiums paid relating to Contract B).
- CSM: the balance of the CSM is 250 (opening balance of 300 minus 50 recognised as reinsurance contract expenses in the period (see profit or loss slide 14)).

⁵At 31 December in year 1:

- FCF: the fulfilment cash flows are 300 (opening balance of 200 minus 200 claims received plus 300 premiums paid relating to Contract C).
- CSM: the balance of the CSM is 150 (opening balance of 250 minus 100 recognised as reinsurance contract expenses in the period).

⁶At 30 June in year 2:

- FCF: the fulfilment cash flows are 100 (opening balance of 300 minus 200 claims received)
- CSM: the balance of the CSM is 50 (opening balance of 150 minus 100 recognised as reinsurance contract expenses in the period).

⁷At 31 December in year 2 the reinsurance contract held is derecognised.

- FCF: the fulfilment cash flows are 0 (opening balance of 100 minus 100 claims received).
- CSM: the balance of the CSM is 0 (opening balance of 50 minus 50 recognised as reinsurance contract expenses in the period).

Statement of profit or loss

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	Year 1		Year 2	
	1Jan -30Jun	1Jul-31Dec	1Jan-30Jun	1Jul-31Dec
Reinsurance premiums ¹ :				
Expected claims recovered ²	(100)	(200)	(200)	(100)
Contractual service margin ³	(50)	(100)	(100)	(50)
Amounts recovered from reinsurance ²	100	200	200	100
Net expense from reinsurance contracts	(50)	(100)	(100)	(50)

Further information

¹ The breakdown of the reinsurance premiums amount is given in the slide to explain the results in this example. Applying IFRS 17, revenue does not arise from reinsurance contracts held. Accordingly, the requirements for revenue, including the related disclosures, do not apply.

² In this example, claims received from the reinsurer are equal to the claims paid to the policyholder on the underlying insurance contracts. Claims are received from the reinsurer on the same day that those claims are paid to the policyholder. All events occur as expected. See expected cash flows - slide 12.

³ To determine the amount of the contractual service margin to be recognised in profit or loss in the period for the reinsurance contract held, in this example, the insurer considers the relevant facts and circumstances related to the underlying insurance contracts and determines that the amount and timing of services received under the reinsurance contract held are consistent to the amount and timing of services provided under the underlying insurance contracts (see slide 9).

Statement of financial position:

the whole picture

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	Year 1			Year 2	
	1 Jan	30 June	31 Dec	30 June	31 Dec
Fulfilment cash flows	(200)	(300)	(300)	(100)	-
Contractual service margin	(100)	(150)	(150)	(50)	-
Insurance contract asset / (liability)	(300)	(450)	(450)	(150)	-
Fulfilment cash flows	0	200	300	100	-
Contractual service margin	300	250	150	50	-
Reinsurance contract asset / (liability)	300	450	450	150	-



Further information

FCF: in this example, the cash flows for the reinsurance contract held are equal to the cash flows for the group of underlying insurance contracts and they occur at the exact same time.

CSM: in this example, the insurer provides service equally over the contract term for each underlying insurance contract. In this example, the insurer determines that the amount and timing of services received under the reinsurance contract held are equal to the amount and timing of services provided under the underlying insurance contracts.

As a result of the above, the balance of the reinsurance contract asset is equal to the balance of the insurance contract liability.

Statement of profit or loss

the whole picture

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	Year 1		Year 2	
	1Jan-30Jun	1Jul-31Dec	1Jan-30Jun	1Jul-31Dec
Insurance revenue	150	300	300	150
Insurance service expenses	(100)	(200)	(200)	(100)
Net expense from reinsurance contracts	(50)	(100)	(100)	(50)
Insurance service result	-	-	-	-



Further information

This is a simplified example of 100% proportionate reinsurance coverage. In this example, the services provided by the insurer under the underlying insurance contracts in each period are consistent with the services received from the reinsurer under the reinsurance contract held in each period. Also, the consideration to which the insurer expects to be entitled to in exchange for the services provided under the underlying insurance contracts is equal to the consideration the insurer expects to pay to the reinsurer in exchange for the services received under the reinsurance contract held.

As a result, there is a nil impact on the statement of profit or loss.

Reinsurance contract held:
cash flows are settled net at
the end of the coverage
period

Cash flows

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Same fact pattern, expect that all reinsurance contract cash flows are settled net at the end of the coverage period

	Year 1			Year 2		Total
	1 Jan	30 June	31 Dec	30 June	31 Dec	
Premiums	-	-	-	-	(900)	(900)
Claims	-	-	-	-	600	600
Net cash outflow						(300)



Further information

A net amount of 300 is expected to be paid to the reinsurer at the end of the coverage period (900 premiums minus 600 claims).

Statement of financial position

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	Year 1			Year 2	
	1 Jan	30 June	31 Dec	30 June	31 Dec
Fulfilment cash flows ¹	(300)	(300)	(300)	(300)	-
Contractual service margin ²	300	250	150	50	-
Reinsurance contract asset / (liability) ³	-	(50)	(150)	(250)	-



Further information

¹ The fulfilment cash flows at each reporting date is 300 until the end of the coverage period. This reflects that the insurer expects to make one payment of 300 to the reinsurer at the end of the coverage period.

² The contractual service margin is measured and recognised in the same way as in the previous example (see slides 13–14) because the services provided under the reinsurance contract held are the same. The only difference in this example is the timing of the cash flows.

³ In this example, the balance is a reinsurance contract liability because the expected future cash flows are a net outflow.

Statement of profit or loss

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	Year 1		Year 2	
	1Jan-30Jun	1Jul-31Dec	1Jan-30Jun	1Jul-31Dec
Reinsurance premiums:				
Expected claims recovered	(100)	(200)	(200)	(100)
Contractual service margin	(50)	(100)	(100)	(50)
Amounts recovered from reinsurance	100	200	200	100
Net reinsurance contract expenses	(50)	(100)	(100)	(50)

Further information

The statement of profit or loss in this example is the same as the statement of profit or loss in the previous example (see slides 13–14) because the services provided under the reinsurance contract held are the same. The only difference in this example is the timing of the cash flows. The timing of cash flows may impact insurance finance income or expenses however, for simplicity in this example, the discount rate is 0%.

Statement of financial position: *the whole picture*

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	Year 1			Year 2	
	1 Jan	30 June	31 Dec	30 June	31 Dec
Fulfilment cash flows	(200)	(300)	(300)	(100)	-
Contractual service margin	(100)	(150)	(150)	(50)	-
Insurance contract asset / (liability)	(300)	(450)	(450)	(150)	-
Fulfilment cash flows	(300)	(300)	(300)	(300)	-
Contractual service margin	300	250	150	50	-
Reinsurance contract asset / (liability)	-	(50)	(150)	(250)	-



Further information

FCF: in this example, the cash flows for the reinsurance contract held are equal to the cash flows for the group of underlying insurance contracts, however the cash flows occur at different times.

CSM: as with the previous example, the insurer provides service equally over the contract term for each underlying insurance contract. Also in this example, the insurer determines that the amount and timing of services received under the reinsurance contract held are equal to the amount and timing of services provided under the underlying insurance contracts.

As a result of the above, the balance of the reinsurance contract liability is not equal to the balance of the insurance contract liability. This reflects the fact that, at each reporting period, the expected future cash flows under the reinsurance contract held are different to the expected future cash flows under the group of underlying insurance contracts.

Statement of profit or loss

the whole picture

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	Year 1		Year 2	
	1Jan-30Jun	1Jul-31Dec	1Jan-30Jun	1Jul-31Dec
Insurance revenue	150	300	300	150
Insurance service expenses	(100)	(200)	(200)	(100)
Net expense from reinsurance contracts	(50)	(100)	(100)	(50)
Insurance service result	-	-	-	-



Further information

See slide 16.

In practice

- In practice it is likely that there will be differences between the cash flows arising from:
 - a) the rights and obligations of the underlying insurance contracts; and
 - b) the rights and obligations of the reinsurance contract held.
- These differences may exist, for example, because:
 - a) the timing of cash flows can vary, which can also impact insurance finance income or expenses; or
 - b) the reinsurer prices the reinsurance contract differently to the pricing of the underlying contracts.

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