IFRS 17
Insurance Contracts
Measurement essentials
Parts 1 and 2
IFRS 17
Insurance Contracts
Measurement essentials
Part 1 of 2
Further information:
IFRS 17 paragraph 29
# IFRS 17 webinars

## Previous webinars

<table>
<thead>
<tr>
<th>Date</th>
<th>Topic</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 2017</td>
<td>Introducing IFRS 17</td>
</tr>
<tr>
<td>May 2017</td>
<td>Understanding IFRS 17</td>
</tr>
<tr>
<td>June 2017</td>
<td>Core requirements: scope of IFRS 17</td>
</tr>
</tbody>
</table>

## This webinar

<table>
<thead>
<tr>
<th>Date</th>
<th>Topic</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 2017</td>
<td>Core requirements: measurement essentials</td>
</tr>
</tbody>
</table>
Further information:
IFRS 17 paragraph 32
IFRS 17 Appendix A definitions:
• Contractual service margin
• Risk adjustment for non-financial risk
• Fulfilment cash flows
• Financial risk
Basis for Conclusions of IFRS 17 paragraphs BC16-BC21
Today’s topic

• Part 1: Initial measurement
  – Fulfilment cash flows
  – Contractual service margin

• Part 2: Subsequent measurement
  – Fulfilment cash flows
  – Contractual service margin
Part 1
Initial recognition
Overall principles on estimates

- Reflect the entity’s estimates
- However, estimates of any relevant market variables must be consistent with observable market prices for those variables
- For insurance contracts issued—does not reflect issuer’s non-performance risk

Further information:
IFRS 17 paragraphs 33(b), 36(b), 37 and B42-B53
Basis for Conclusions of IFRS 17 paragraphs BC153-BC154
Present value of future cash flows

Cash flows
- Current estimates of future cash flows within the contract boundary

Further information:
IFRS 17 paragraphs 33(c) and B54-B60
Basis for Conclusions of IFRS 17 paragraphs BC155-BC156
Further information:
IFRS 17 paragraphs 34, B61 and B63-B64
Basis for Conclusions of IFRS 17 paragraphs BC159-BC164
Future cash flows

Cash flows

• Includes cash flows that relate directly to contracts’ fulfilment – all reasonable and supportable information available without undue cost or effort

• Probability weighted and unbiased

• Stochastic modelling for financial options and guarantees, where relevant

Further information:
IFRS 17 paragraphs 33 and B61-B71
Basis for Conclusions of IFRS 17 paragraphs BC158-BC184
Discount rates

- Reflect time value of money and financial risks
  - Characteristics of the cash flows
  - Liquidity of the insurance contracts
  - To the extent that the financial risks are not included in the cash flows
- Consistent with observable market prices (if any)
  - Timing
  - Currency
  - Liquidity
- Exclude the effect of factors in the observable market prices not relevant to insurance contracts

**Further information:**
IFRS 17 paragraphs 36 and B74-B85
IFRS 17 Appendix A definition:
- Financial risk
IFRS 17 Basis for Conclusions paragraphs BC192-BC194
Further information:
IFRS 17 paragraphs 36 and B79-B85
Basis for Conclusions of IFRS 17 paragraphs BC193-BC197 and
BC199-BC205
Discount rates

- Use judgement to:
  - Appropriately adjust observable inputs to accommodate differences between the cash flows of observable market instruments and insurance contract cash flows
  - If there is no market data; apply an estimation technique
    - Develop unobservable inputs using best information available in all circumstances
    - Adjust those data to reflect all reasonably available information about market participant assumptions

Further information:
IFRS 17 paragraphs B81-B83
**Further information:**
IFRS 17 paragraph 32
IFRS 17 Appendix A definitions:
- Contractual service margin
- Risk adjustment for non-financial risk
- Fulfilment cash flows
- Financial risk

Basis for Conclusions of IFRS 17 paragraphs BC16-BC21
Risk adjustment

- Explicit, current adjustment for the compensation a company requires for bearing non-financial risk (e.g., insurance risk)

Further information:
IFRS 17 paragraphs 32(a)(iii), 37 and B86-B92
IFRS 17 Appendix A definition:
- Risk adjustment for non-financial risk
- Financial risk

Basis for Conclusions of IFRS 17 paragraphs BC206-BC217
### Risk adjustment

- Compensation that makes an entity indifferent between:
  - fulfilling a liability that has a range of possible outcomes; and
  - fulfilling a liability that will generate fixed cash flows with the same expected present value.

<table>
<thead>
<tr>
<th>Group A</th>
<th>Probability</th>
<th>Pay-off (CU)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0.5</td>
<td>1,000,000</td>
</tr>
<tr>
<td></td>
<td>0.5</td>
<td>0</td>
</tr>
</tbody>
</table>

**Probability-weighted average**

\[(0.5 \times 1,000,000) + (0.5 \times 0) = \text{CU}500,000\]

<table>
<thead>
<tr>
<th>Group B</th>
<th>Probability</th>
<th>Pay-off (CU)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
<td>500,000</td>
</tr>
</tbody>
</table>

**Probability-weighted average**

\[(1 \times 500,000) = \text{CU}500,000\]

---

**Further information:**
IFRS 17 paragraph B87
Risk adjustment

- Entity specific measure:
  - Entity’s level of risk aversion
  - Degree of diversification benefit considered
  - Techniques/methods

Further information:
IFRS 17 paragraphs B86-B92
Basis for Conclusions of IFRS 17 paragraphs BC213-BC217
Further information:
IFRS 17 paragraph 32
IFRS 17 Appendix A definitions:
• Contractual service margin
• Risk adjustment for non-financial risk
• Fulfilment cash flows
• Financial risk
Basis for Conclusions of IFRS 17 paragraphs BC16-BC21
Further information:
IFRS 17 paragraphs 32(b) and 38
IFRS 17 Appendix A definition:
• Contractual service margin
Basis for Conclusions of IFRS 17 paragraphs BC218-BC219
CSM at initial recognition—a simple example

Consider a group of contracts, risk adjustment = CU750 and PV of future cash out flows = CU4,250

If premiums CU5,500
- Contracts profitable at inception
- CSM = CU500 [CU5,500 – CU750 – CU4,250]

If premiums CU3,500
- Contracts onerous at inception
- Day-one loss CU1,500 recognised in profit or loss [CU3,500 – CU750 – CU4,250]. No CSM.

Further information:
IFRS 17 paragraphs 32(b) and 38
Basis for Conclusions of IFRS 17 paragraphs BC218-BC219
Illustrative Examples of IFRS 17 Example 1
Unearned profit—contractual service margin

At initial recognition

1. Fulfilment cash flows
2. Insurance acquisition cash flows (pre-coverage)

Actual cash flows at the date

CSM = the amount that results in no gain in P&L

Further information:
IFRS 17 paragraphs 27 and 38
Further information:
IFRS 17 paragraph 27
IFRS 17 Appendix A definition:
• Insurance acquisition cash flows
• Coverage period
Basis for Conclusions of IFRS 17 paragraphs BC181-BC184
# IFRS 17 core requirements

- All insurance contracts measured as the sum of:
  - **Fulfilment cash flows (FCF)**
    1. Present value of probability-weighted expected cash flows—reflects financial risk
    2. Plus an explicit risk adjustment for non-financial risk (e.g., insurance)
  - **Contractual service margin (CSM)**
    3. The unearned profit from the contracts

<table>
<thead>
<tr>
<th>1</th>
<th>PV of future cash flows</th>
<th>2</th>
<th>Risk adjustment</th>
<th>3</th>
<th>Unearned profit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Fulfilment cash flows</td>
<td></td>
<td>Contractual service margin</td>
<td></td>
<td>IFRS 17 asset or liability</td>
</tr>
</tbody>
</table>

### Further information:
- IFRS 17 paragraph 32
- IFRS 17 Appendix A definitions:
  - Contractual service margin
  - Risk adjustment for non-financial risk
  - Fulfilment cash flows
  - Financial risk

Basis for Conclusions of IFRS 17 paragraphs BC16-BC21
IFRS 17
Insurance Contracts

Measurement essentials
Part 2 of 2
Today’s topic

- Part 1: Initial measurement
  - Fulfilment cash flows
  - Contractual service margin

- Part 2: Subsequent measurement
  - Fulfilment cash flows
  - Contractual service margin
Part 2
Subsequent measurement
Further information:
IFRS 17 paragraph 32

IFRS 17 Appendix A definitions:
• Contractual service margin
• Risk adjustment for non-financial risk
• Fulfilment cash flows
• Financial risk

Basis for Conclusions of IFRS 17 paragraphs BC16-BC21
### Snapshot on subsequent measurement

<table>
<thead>
<tr>
<th></th>
<th>Initial measurement</th>
<th>Subsequent measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>PV of future cash flows</td>
<td>Current assumptions</td>
</tr>
<tr>
<td>2</td>
<td>Risk adjustment</td>
<td>Current assumptions</td>
</tr>
</tbody>
</table>
| 3 | Unearned profit / Contractual service margin | The amount that results in no gain recognised in profit or loss | Update by reflecting:  
- Time value of money  
- Adjustments related to future service  
- Allocation of the amount earned for services provided |

### Further information:
IFRS 17 paragraphs 40, 44, 45 and B54  
Basis for Conclusions of paragraphs BC20, BC155 and BC220-BC221
**Further information:**
IFRS 17 paragraphs 41-42, 80-81, 83-85 and 87-89
Basis for Conclusions of IFRS 17 paragraphs BC24
Further information:
IFRS 17 paragraphs 43-44 and B96-B100
Basis for Conclusions of IFRS 17 paragraphs BC22-BC24 and BC220-BC224
## Contractual Service Margin

**Subsequent measurement**

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accretion of interest</td>
<td>- Discount rate at inception—nominal cash flows that do not vary based on returns on underlying items</td>
</tr>
<tr>
<td>Changes relating to future service</td>
<td>- Changes in the present value of cash flows relating to future service determined using discount rate at inception applicable to FCF</td>
</tr>
<tr>
<td></td>
<td>- Changes in the risk adjustment relating to future service</td>
</tr>
<tr>
<td>Insurance service provided—</td>
<td>- Based on coverage units</td>
</tr>
<tr>
<td>recognised in P&amp;L</td>
<td>- Quantity of benefits</td>
</tr>
<tr>
<td></td>
<td>- Expected coverage period</td>
</tr>
</tbody>
</table>

**Further information:**
IFRS 17 paragraphs 43-44, B96-B100 and B119
<table>
<thead>
<tr>
<th>Adjustments to the CSM</th>
<th>Where is the adjustment recognised?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accretion of interest</td>
<td>• Insurance finance income and expenses—profit or loss</td>
</tr>
<tr>
<td>Changes relating to future service</td>
<td>• Fulfilment cash flows—balance sheet</td>
</tr>
<tr>
<td>Profit recognised—insurance service provided</td>
<td>• Insurance service result—profit or loss</td>
</tr>
</tbody>
</table>
**A simple example**

**Subsequent measurement**

After one year, the insurer revises the expected risk-adjusted discounted cash outflows and the change relates to future service

- CSM at beginning of year 1 is CU400
- CSM adjusted by CU300, i.e. remaining CSM is CU100
- Insurer recognises CSM of CU100 over the coverage period

**Further information:**

IFRS 17 paragraphs 44 and 48-49

Illustrative Examples of IFRS 17 Example 2
Onerous contracts—loss component
Onerous loss at initial recognition

* a simple example (repeated) *

Consider a group of contracts, risk adjustment = CU750 and PV of future cash outflows = CU4,250

- Contracts onerous at inception
- Day-one loss CU1,500 recognised in profit or loss [CU4,250+CU750-CU3,500]. No CSM.
- The total liability for remaining coverage is CU5,000 [CU4,250+CU750] comprising of
  - Non-loss component of CU3,500
  - Loss component of CU1,500

Further information:
Illustrative Examples of IFRS 17 Example 1
What adjusts the loss component?

1. Any increase/decrease in estimates relating to future service
   - Cash flows determined using the discount rate applicable for those cash flows at initial recognition
   - Risk adjustment

2. All other subsequent changes in estimates of the fulfilment cash flows of the liability for remaining coverage must be systematically allocated between:
   - Non-loss component
   - Loss component

Further information:
IFRS 17 paragraphs 50-51
Loss component

- The adjustments must result in the loss component equalling zero by end of the coverage period
- If decreases in estimates of fulfilment cash flows relating to future coverage exceed the loss component:
  - they are allocated to the loss component to reduce it to zero, and
  - the excess of the decrease establishes a contractual service margin

Further information:
IFRS 17 paragraphs 50-52
**Snapshot on how changes show up in performance for onerous contracts**

<table>
<thead>
<tr>
<th>Line item</th>
<th>Which changes are included in line item</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurance service result</td>
<td>cash flows and risk adjustment that relate to future, current and past service *</td>
</tr>
<tr>
<td>Investment income</td>
<td>Returns on financial assets (IFRS 9)</td>
</tr>
<tr>
<td>Insurance finance expenses</td>
<td>effect of time value of money and financial risk (eg discount rates)**</td>
</tr>
<tr>
<td>Net financial result</td>
<td></td>
</tr>
<tr>
<td>Profit or loss</td>
<td></td>
</tr>
</tbody>
</table>

* To the extent that changes in cash flows and risk adjustment that relate to future service decrease the loss component to zero. Further changes establishes a contractual service margin

** Option to present some of these effects in other comprehensive income

---

**Further information:**
IFRS 17 paragraphs 41-42, 49-51, 80-81, 83-85, 87-89 and 103(b)(iv)
Basis for Conclusions of IFRS 17 paragraph BC24
**Further information:**

IFRS 17 paragraph 32

IFRS 17 Appendix A definitions:

- Contractual service margin
- Risk adjustment for non-financial risk
- Fulfilment cash flows
- Financial risk

Basis for Conclusions of IFRS 17 paragraphs BC16-BC21
Contact us

Keep up to date
- @IFRSFoundation
- IFRS Foundation
- www.ifrs.org
- IFRS Foundation

Comment on our work
- go.ifrs.org/comment