

# IFRS 17 *Insurance Contracts*

Measurement essentials  
Parts 1 and 2

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# IFRS 17 *Insurance Contracts*

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Part 1 of 2

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Core requirements

Modifications to achieve IFRS 17’s fundamental objectives

Insurance contracts with direct participation features

Reinsurance contracts held

Investment contracts with discretionary participation features

Simplified accounting for contracts with short coverage periods






Further information:

IFRS 17 paragraph 29

# IFRS 17 webinars

## Previous webinars

- May 2017  Introducing IFRS 17
- May 2017  Understanding IFRS 17
- June 2017  Core requirements: scope of IFRS 17

## This webinar

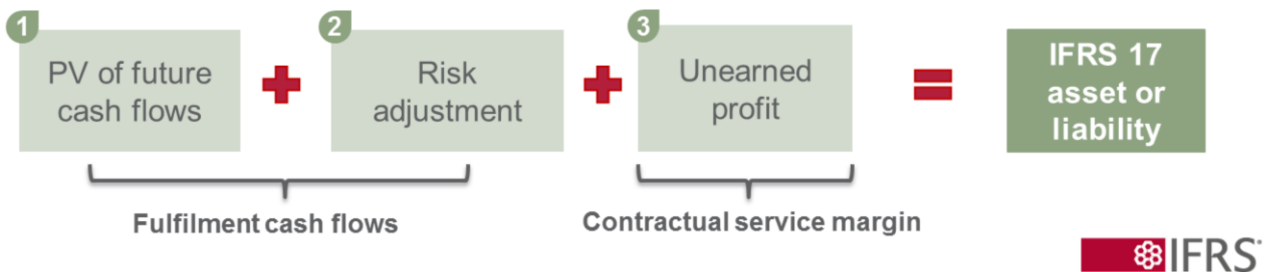
- July 2017  Core requirements: measurement essentials



# IFRS 17 core requirements

5

- 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 (eg insurance)
  - **Contractual service margin (CSM)**
    3. The unearned profit from the contracts



## 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

6

- Part1: 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

8

- 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

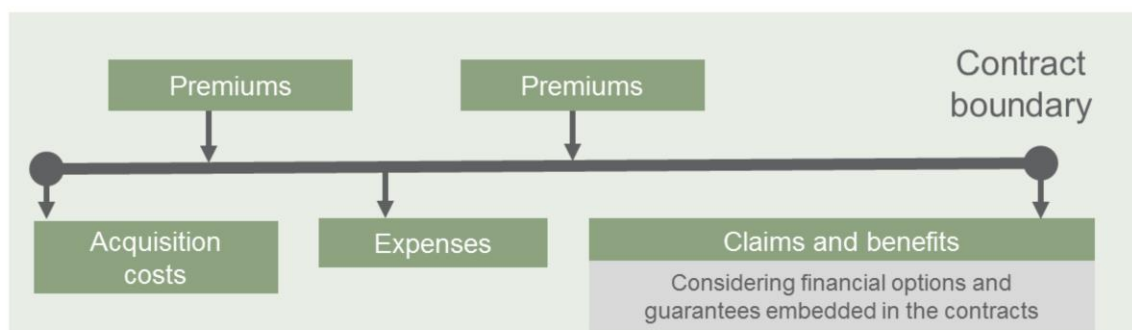


# 1 Present value of future cash flows

9

## 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

## 1 Determining contract boundary

10



(A) For an assessment at the contract level. An additional criterion must be satisfied when the assessment is at a portfolio level—the pricing of premiums does not take into account risks that relate to periods after the reassessment date.



### Further information:

IFRS 17 paragraphs 34, B61 and B63-B64

Basis for Conclusions of IFRS 17 paragraphs BC159-BC164

### 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

- 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

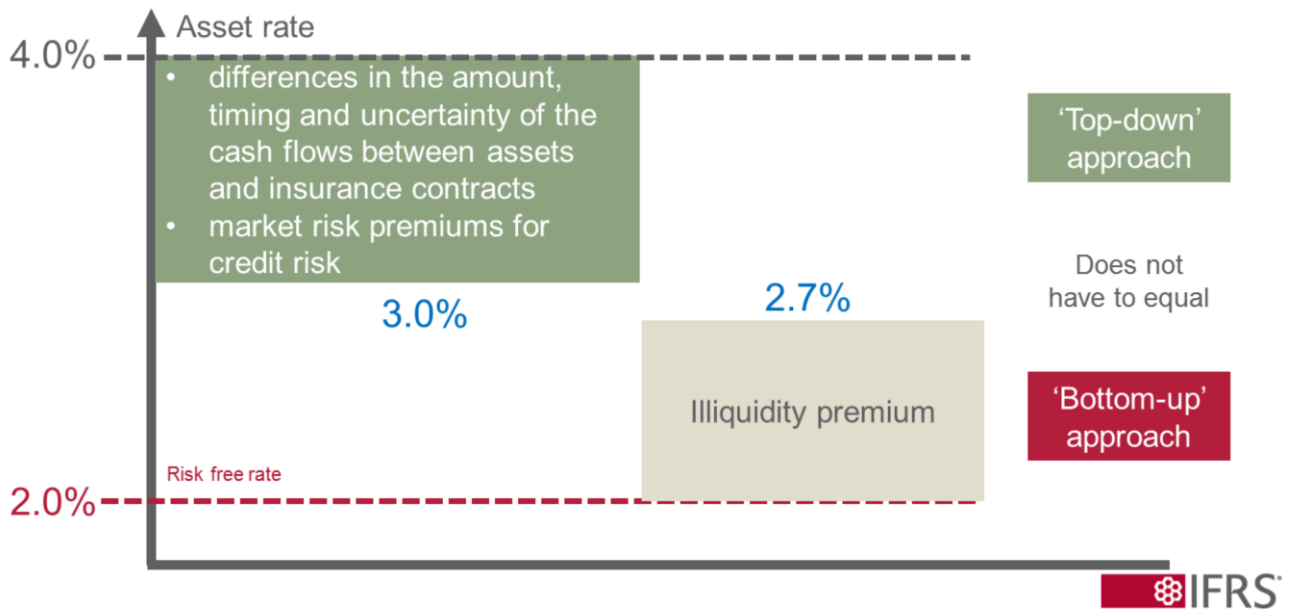
IFRS 17 Appendix A definition:

- Financial risk

IFRS 17 Basis for Conclusions paragraphs BC192-BC194

## 1 Determining discount rates

13



### Further information:

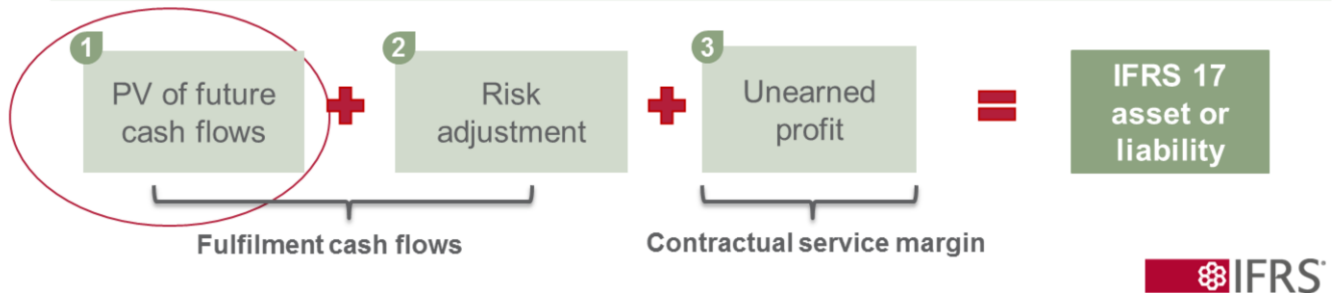
IFRS 17 paragraphs 36 and B79-B85

Basis for Conclusions of IFRS 17 paragraphs BC193-BC197 and BC199-BC205

- 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

- 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 (eg insurance)
  - **Contractual service margin (CSM)**
    3. The unearned profit from the contracts



## 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

- Explicit, current adjustment for the compensation a company requires for bearing non-financial risk (eg 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



- 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

Group A	Probability	Pay-off (CU)
	0.5	1,000,000
	0.5	0
Probability-weighted average	$(0.5 \times 1,000,000) + (0.5 \times 0) = \text{CU}500,000$	
Group B	Probability	Pay-off (CU)
	1	500,000
Probability-weighted average	$(1 \times 500,000) = \text{CU}500,000$	



Further information:  
IFRS 17 paragraph B87

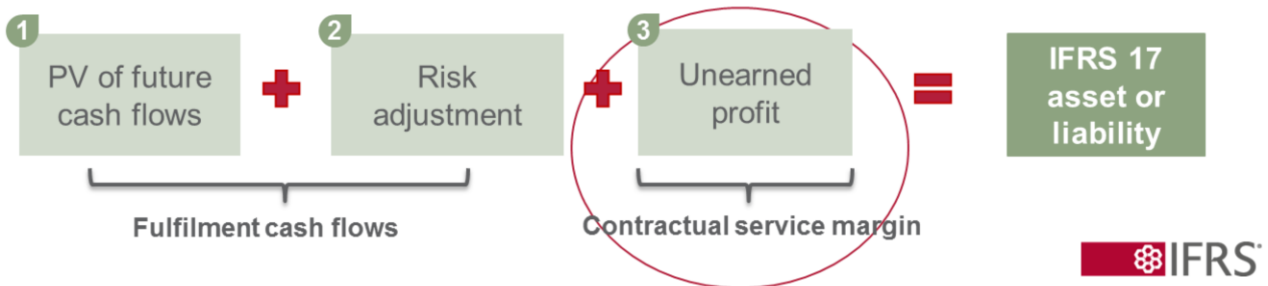
- Entity specific measure:
  - Entity's level of risk aversion
  - Degree of diversification benefit considered
  - Techniques/methods

**Further information:**

IFRS 17 paragraphs B86-B92

Basis for Conclusions of IFRS 17 paragraphs BC213-BC217

- 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 (eg insurance)
  - **Contractual service margin (CSM)**
    3. The unearned profit from the contracts



## 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

### 3 Contractual service margin

20

- The unearned profit of the group of contracts that relates to future service to be provided
- The amount determined so that no gains are recognised in profit or loss on initial recognition



**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

### 3 CSM at initial recognition— a simple example

21

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.

 IFRS

#### Further information:

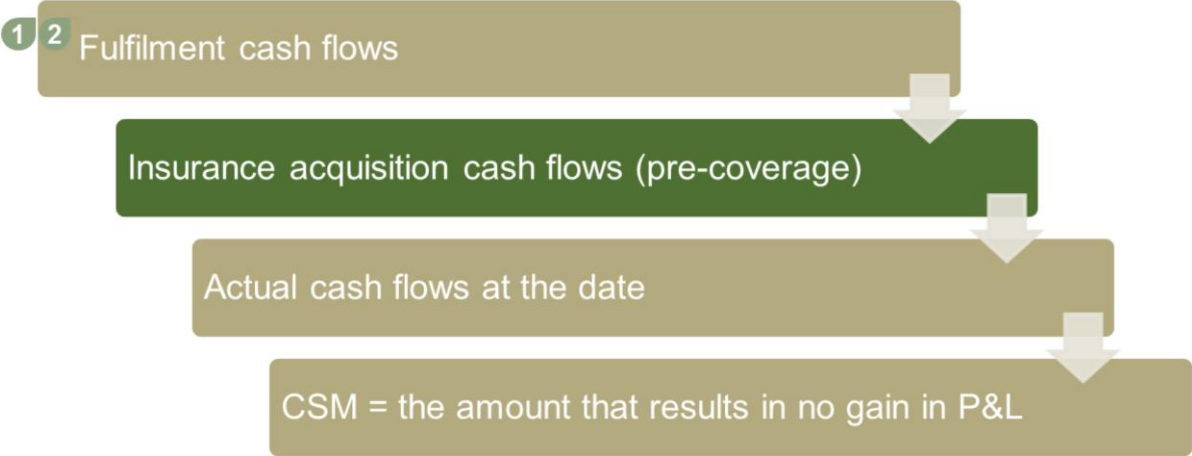
IFRS 17 paragraphs 32(b) and 38

Basis for Conclusions of IFRS 17 paragraphs BC218-BC219

Illustrative Examples of IFRS 17 Example 1

# Unearned profit— contractual service margin

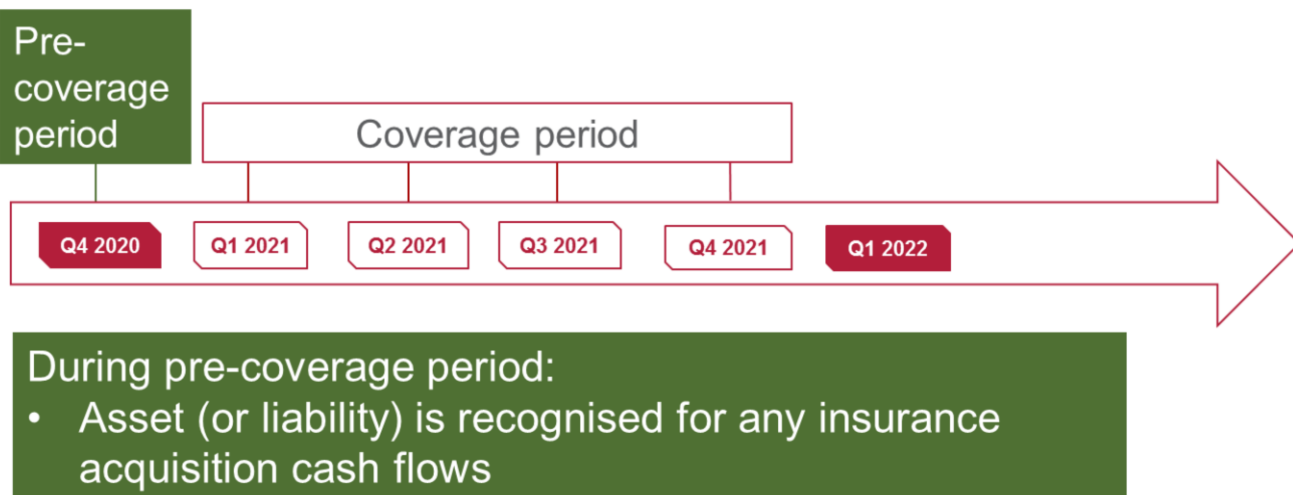
At initial recognition



**Further information:**  
IFRS 17 paragraphs 27 and 38

# Insurance acquisition cash flows

23



IFRS

## Further information:

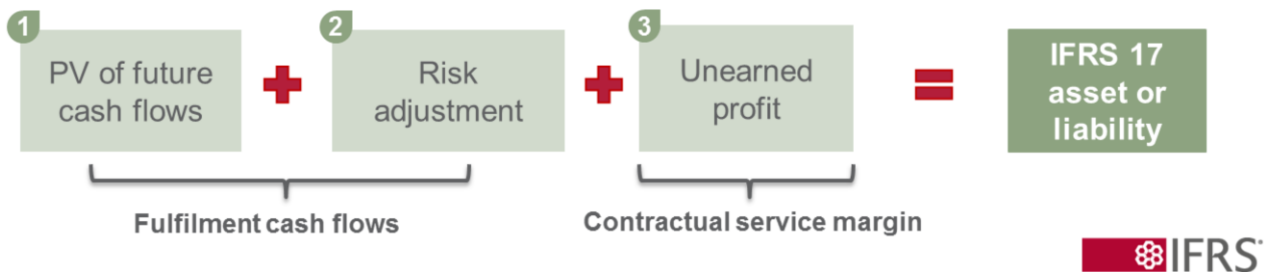
IFRS 17 paragraph 27

IFRS 17 Appendix A definition:

- Insurance acquisition cash flows
- Coverage period

Basis for Conclusions of IFRS 17 paragraphs BC181-BC184

- 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 (eg insurance)
  - **Contractual service margin (CSM)**
    3. The unearned profit from the contracts



## 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



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# IFRS 17

## *Insurance Contracts*

Measurement essentials  
Part 2 of 2

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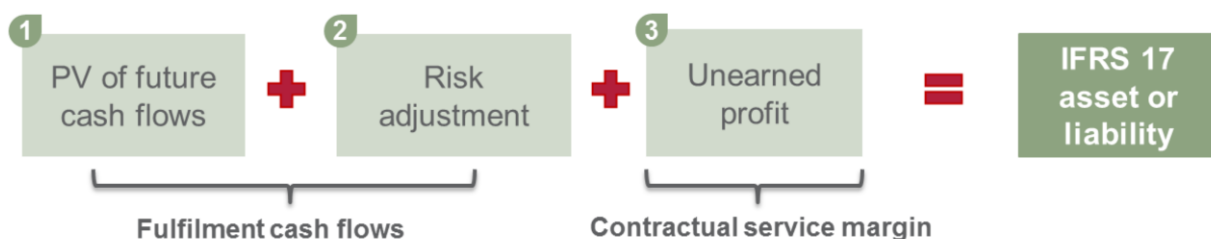
- Part1: Initial measurement
  - Fulfilment cash flows
  - Contractual service margin
- Part 2: Subsequent measurement
  - Fulfilment cash flows
  - Contractual service margin



# Part 2

## Subsequent measurement

- 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 (eg insurance)
  - **Contractual service margin (CSM)**
    3. The unearned profit from the contracts



## 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

30

	Initial measurement	Subsequent measurement
1 PV of future cash flows	Current assumptions	Current assumptions
2 Risk adjustment	Current assumptions	Current assumptions
3 Unearned profit / Contractual service margin	The amount that results in no gain recognised in profit or loss	Update by reflecting: <ul style="list-style-type: none"><li>• Time value of money</li><li>• Adjustments related to future service</li><li>• Allocation of the amount earned for services provided</li></ul>



**Further information:**  
IFRS 17 paragraphs 40, 44, 45 and B54  
Basis for Conclusions of paragraphs BC20, BC155 and BC220-BC221

# Snapshot on how changes show up in performance

Line item		Which changes are included in line item
Insurance service result	←	<b>cash flows</b> and <b>risk adjustment</b> that relate to current and past service* + allocation of <b>contractual service margin</b> for services provided
Investment income	←	Returns on financial assets (IFRS 9)
Insurance finance expenses	←	effect of time value of money and financial risk (eg <b>discount rates</b> ) **
Net financial result		
Profit or loss		

\* Changes in cash flows and changes in risk adjustment that relate to future service adjusts the contractual service margin

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

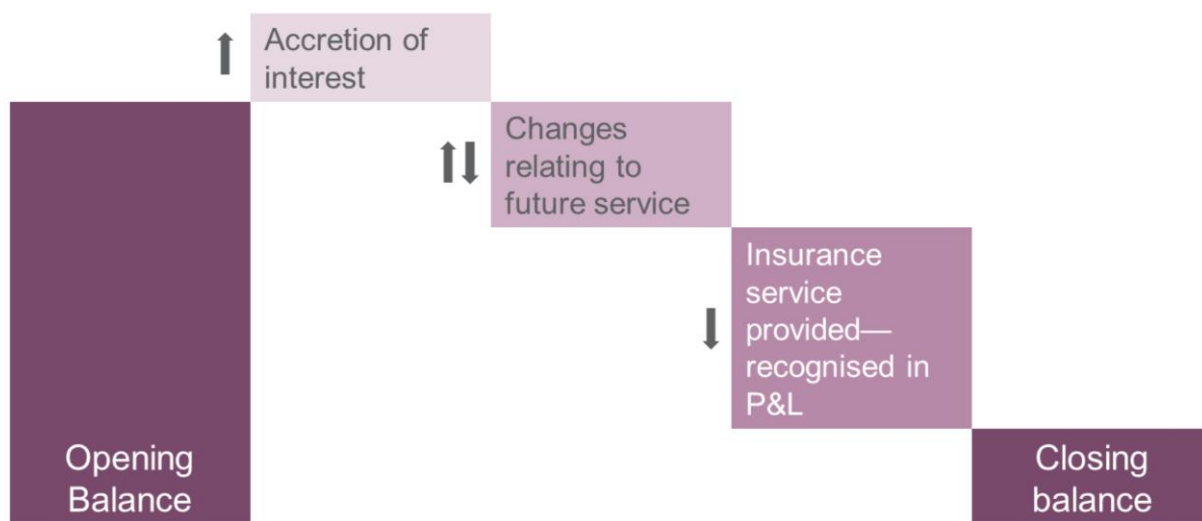


**Further information:**  
IFRS 17 paragraphs 41-42, 80-81, 83-85 and 87-89  
Basis for Conclusions of IFRS 17 paragraphs BC24

### 3 Contractual Service Margin

#### *Subsequent measurement*

32



For simplicity, foreign currency differences are not illustrated.



#### **Further information:**

IFRS 17 paragraphs 43-44 and B96-B100

Basis for Conclusions of IFRS 17 paragraphs BC22-BC24 and

BC220-BC224



## 3 Contractual Service Margin

### *Subsequent measurement*

33

Accretion of interest

Changes relating to future service

Insurance service provided—  
recognised in P&L

- Discount rate at inception—nominal cash flows that do not vary based on returns on underlying items
- Changes in the present value of cash flows relating to future service determined using discount rate at inception applicable to FCF
- Changes in the risk adjustment relating to future service
- Based on coverage units
  - Quantity of benefits
  - Expected coverage period



#### **Further information:**

IFRS 17 paragraphs 43-44, B96-B100 and B119

## 3 Contractual Service Margin

### *Subsequent measurement*

34

Adjustments to the CSM	Where is the adjustment recognised?
Accretion of interest	<ul style="list-style-type: none"><li>• Insurance finance income and expenses—profit or loss</li></ul>
Changes relating to future service	<ul style="list-style-type: none"><li>• Fulfilment cash flows—balance sheet</li></ul>
Profit recognised—insurance service provided	<ul style="list-style-type: none"><li>• Insurance service result—profit or loss</li></ul>



#### **Further information:**

IFRS 17 paragraphs 44, 83 and 87

## A simple example

### *Subsequent measurement*

35

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

Expected cash outflows revised to increase by CU300

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

Expected cash outflows revised to increase by CU700

- CSM at beginning of year 1 is CU400
- Change in estimate of CU700:
  - eliminates remaining CSM of CU400
  - results in recognition of loss of CU300 in P&L in the same 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)*

37

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

If  
premiums  
**CU3,500**

- 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?

38

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

- 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

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

\* 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

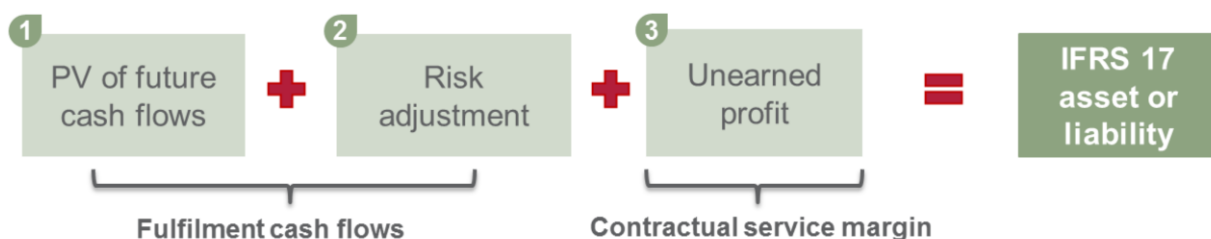
\*\* Option to present some of these effects in other comprehensive income



**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



- 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 (eg insurance)
  - **Contractual service margin (CSM)**
    3. The unearned profit from the contracts



## 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

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