

# IFRS 17

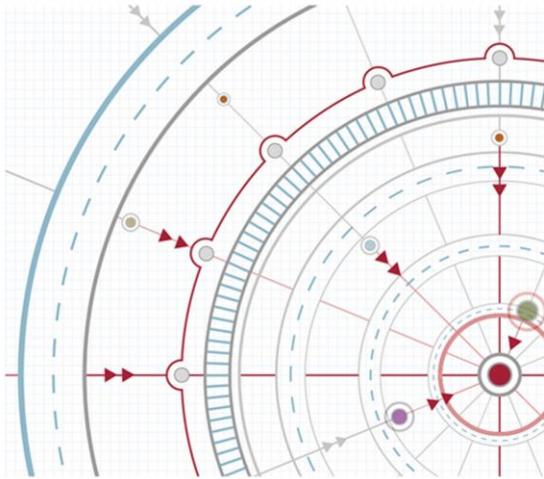
## *Insurance Contracts*

Measurement essentials  
Parts 1 and 2

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# IFRS 17

## *Insurance Contracts*

Measurement essentials  
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

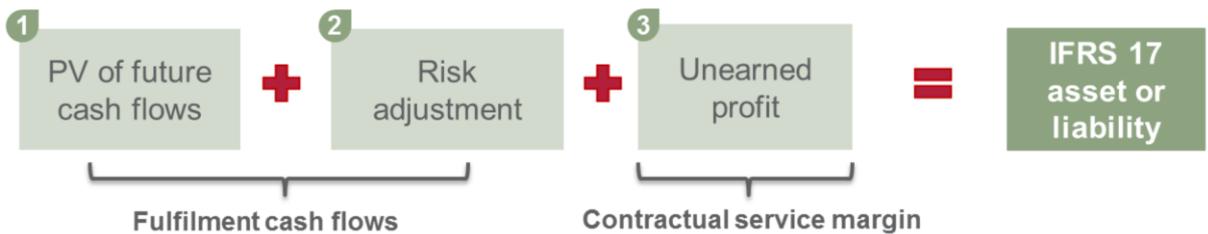
- May 2017  Introducing IFRS 17
- May 2017  Understanding IFRS 17
- June 2017  Core requirements: scope of IFRS 17

## This webinar

- July 2017  Core requirements: measurement essentials



- 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

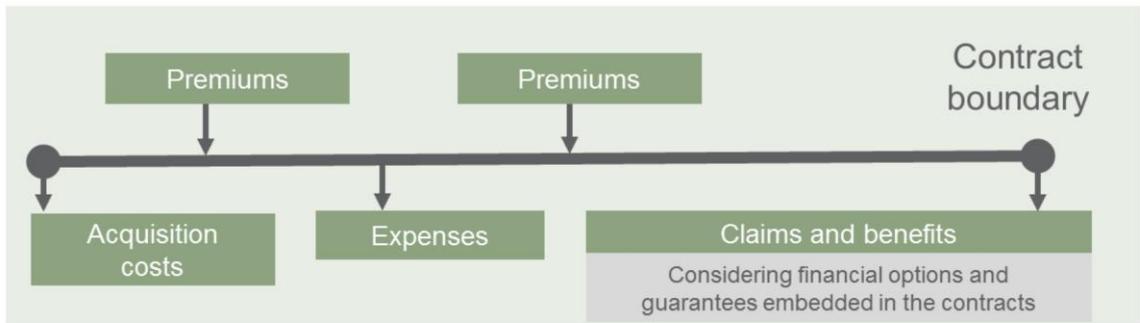
Basis for Conclusions of IFRS 17 paragraphs BC153-BC154

# 1 Present value of future cash flows

9

## Cash flows

- Current estimates of future cash flows within the contract boundary



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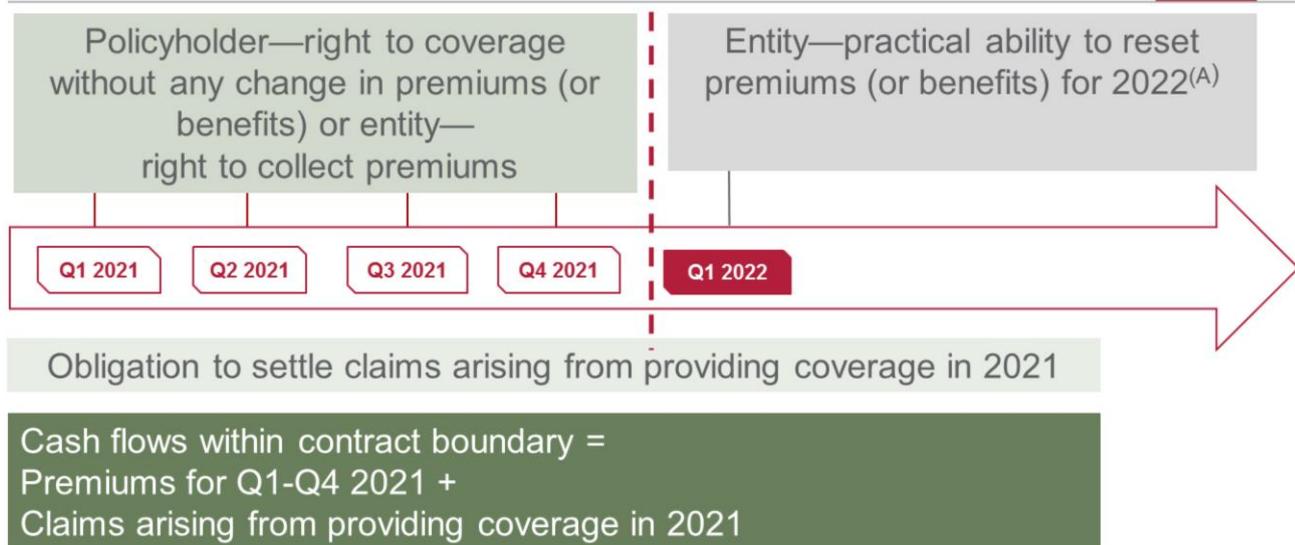
### Further information:

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

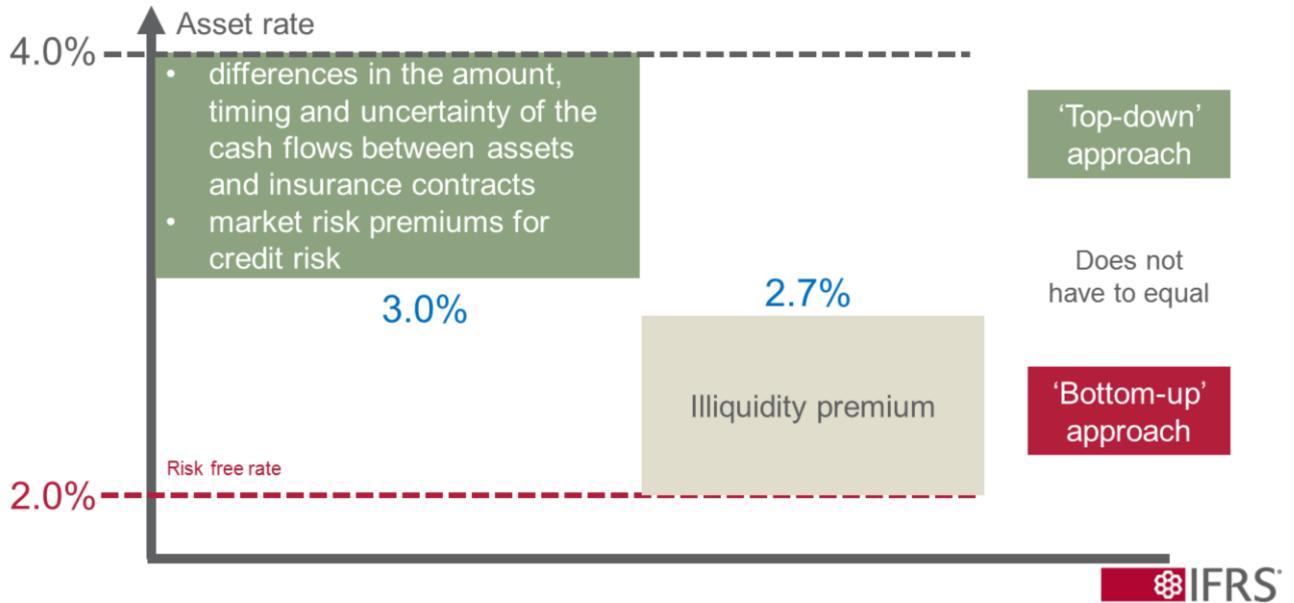
IFRS 17 Appendix A definition:

- Financial risk

IFRS 17 Basis for Conclusions paragraphs BC192-BC194

# 1 Determining discount rates

13



## Further information:

IFRS 17 paragraphs 36 and B79-B85

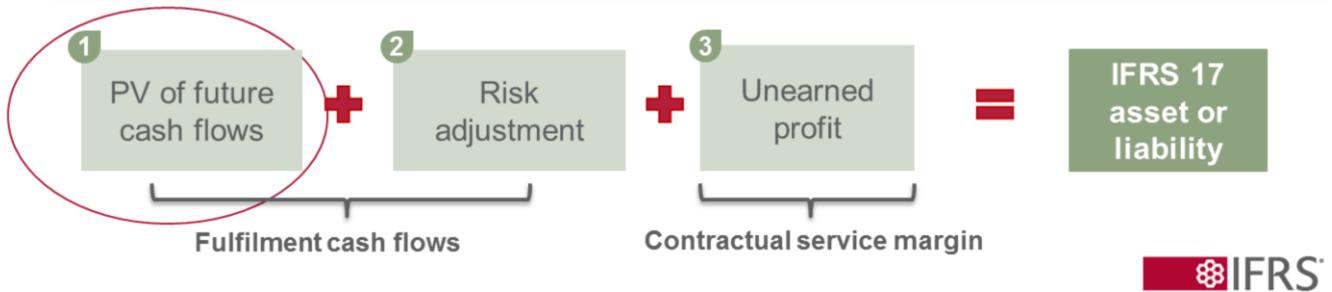
Basis for Conclusions of IFRS 17 paragraphs BC193-BC197 and

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

<b>Group A</b>	<table><thead><tr><th>Probability</th><th>Pay-off (CU)</th></tr></thead><tbody><tr><td>0.5</td><td>1,000,000</td></tr><tr><td>0.5</td><td>0</td></tr></tbody></table>	Probability	Pay-off (CU)	0.5	1,000,000	0.5	0
Probability	Pay-off (CU)						
0.5	1,000,000						
0.5	0						
Probability-weighted average	$(0.5 \times 1,000,000) + (0.5 \times 0) = \text{CU}500,000$						
<b>Group B</b>	<table><thead><tr><th>Probability</th><th>Pay-off (CU)</th></tr></thead><tbody><tr><td>1</td><td>500,000</td></tr></tbody></table>	Probability	Pay-off (CU)	1	500,000		
Probability	Pay-off (CU)						
1	500,000						
Probability-weighted average	$(1 \times 500,000) = \text{CU}500,000$						

**Further information:**  
IFRS 17 paragraph B87

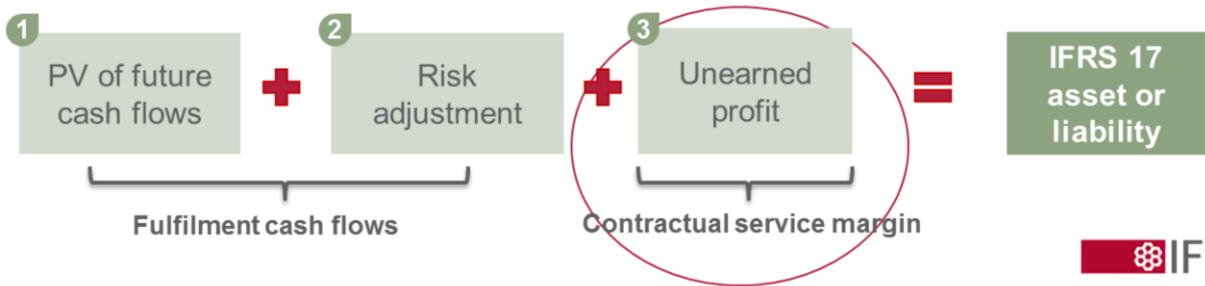
- Entity specific measure:
  - Entity's level of risk aversion
  - Degree of diversification benefit considered
  - Techniques/methods

**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.



#### Further information:

IFRS 17 paragraphs 32(b) and 38

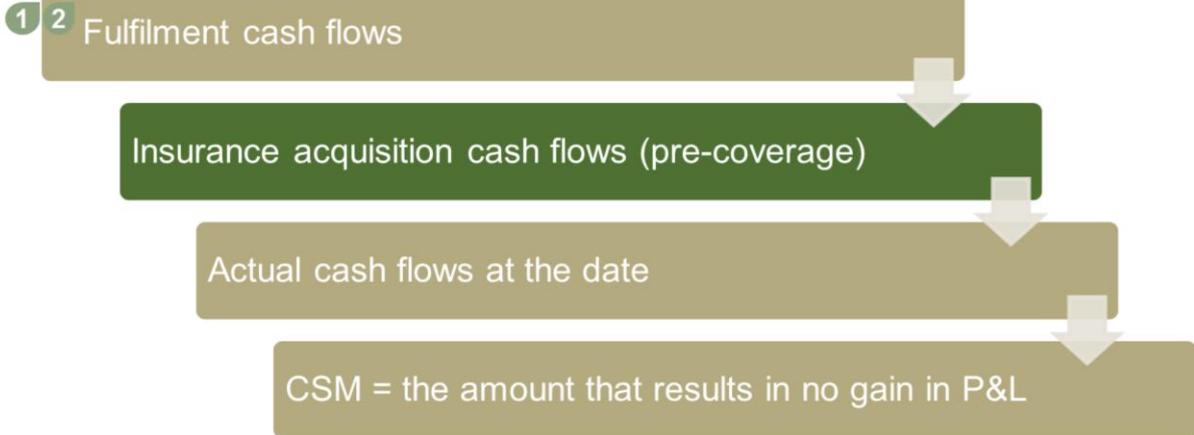
Basis for Conclusions of IFRS 17 paragraphs BC218-BC219

Illustrative Examples of IFRS 17 Example 1

# Unearned profit— contractual service margin

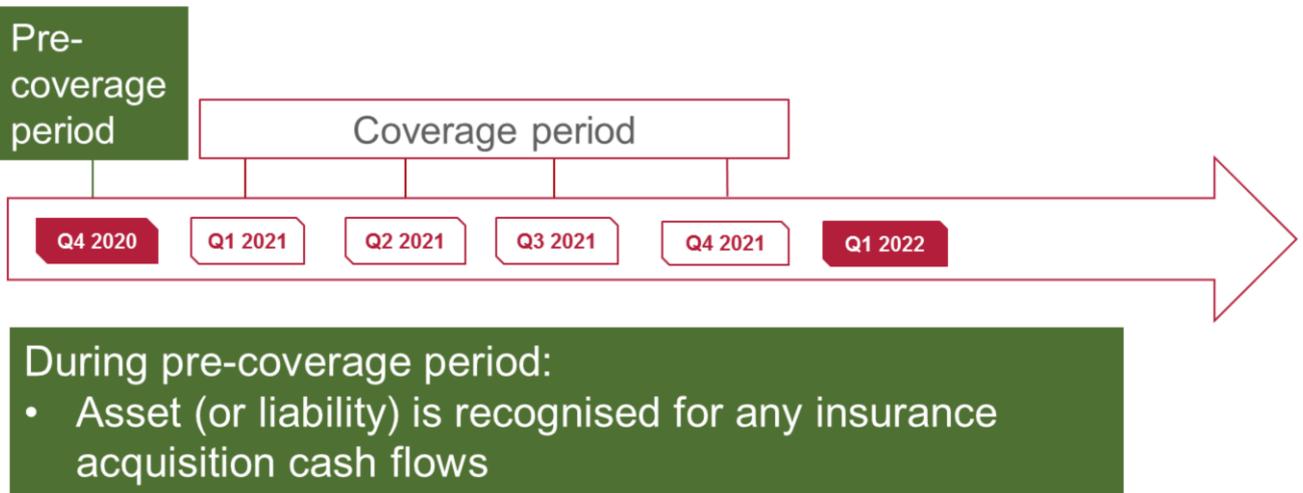
22

At initial recognition



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

**Further information:**

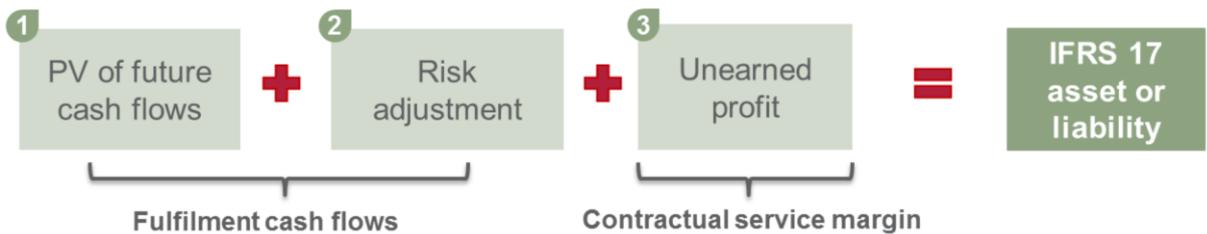
IFRS 17 paragraph 27

IFRS 17 Appendix A definition:

- Insurance acquisition cash flows
- Coverage period

Basis for Conclusions of IFRS 17 paragraphs BC181-BC184

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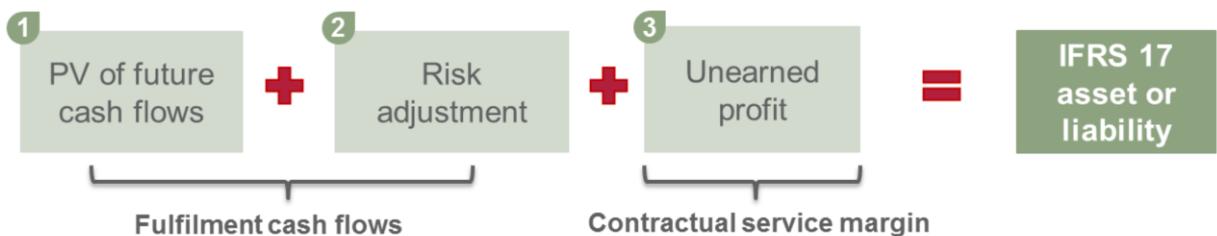
- Part1: Initial measurement
  - Fulfilment cash flows
  - Contractual service margin
- Part 2: Subsequent measurement
  - Fulfilment cash flows
  - Contractual service margin



# 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	<i>Returns on financial assets (IFRS 9)</i>
Insurance finance expenses	effect of time value of money and financial risk (eg <b>discount rates</b> ) **
<b>Net financial result</b>	
<b>Profit or loss</b>	

\* 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



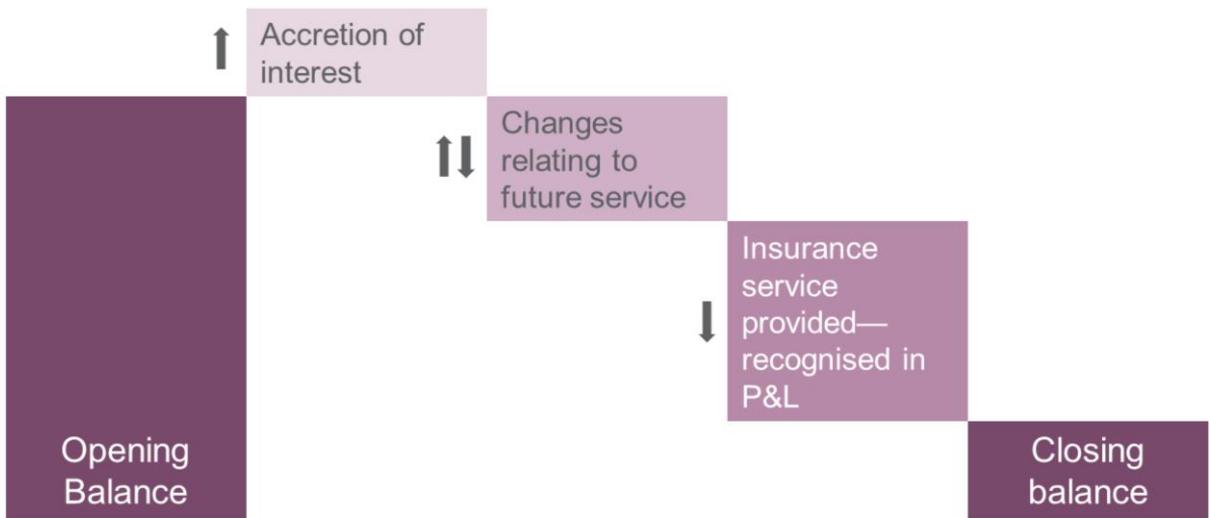
**Further information:**

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*



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

- Discount rate at inception—nominal cash flows that do not vary based on returns on underlying items

Changes relating to future service

- 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

Insurance service provided—  
recognised in P&L

- Based on coverage units
  - Quantity of benefits
  - Expected coverage period



#### **Further information:**

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

# Contractual Service Margin

## 3 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

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#### **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	← <b>cash flows and risk adjustment</b> that relate to future, current and past service *
Investment income	← <i>Returns on financial assets (IFRS 9)</i>
Insurance finance expenses	← effect of time value of money and financial risk (eg <b>discount rates</b> ) **
<b>Net financial result</b>	
<b>Profit or loss</b>	

\* 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

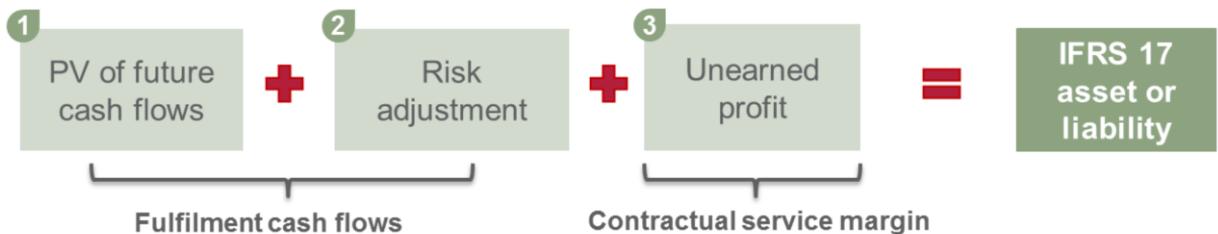
\*\* Option to present some of these effects in other comprehensive income



**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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