IFRS 17
IND AS 117

Insurance Contracts

January 23, 2021

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Background

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Accounting for insurance contracts is established in a **phased manner by IASB-**

PHASE 1

- Completed in 2004
- IFRS 4-Interim Standard
- focused on enhanced disclosure
- allows insurance companies to continue to use various accounting practices, pending a fundamental reassessment of the accounting for insurance contracts.

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PHASE 2

- Completed in 2017
- IFRS 17-Comprehensive Standard
- focused on measurement and presentation

Effective date

Effective date

	IFRS 17	IND AS 117 (Converged standard)
Issue date	May 2017	Yet to be notified, Cleared by the Council
Amendment date	June 2020	Exposure draft stage
Supersede	IFRS 4 (Interim standard)	Ind AS 104
Effective date	Annual reporting periods beginning on or after January 1, 2023 Early application is permitted	Not yet issued Applicability of other IND AS is deferred by IRDAI for Insurance Companies

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Need for IFRS 17

Need for IFRS 17

- **To Improve comparability**: The existing IFRS 4 (Interim standard) does not prescribe the measurement of insurance contracts and allows insurers to account differently for insurance contracts they issue, even if those contracts are similar.

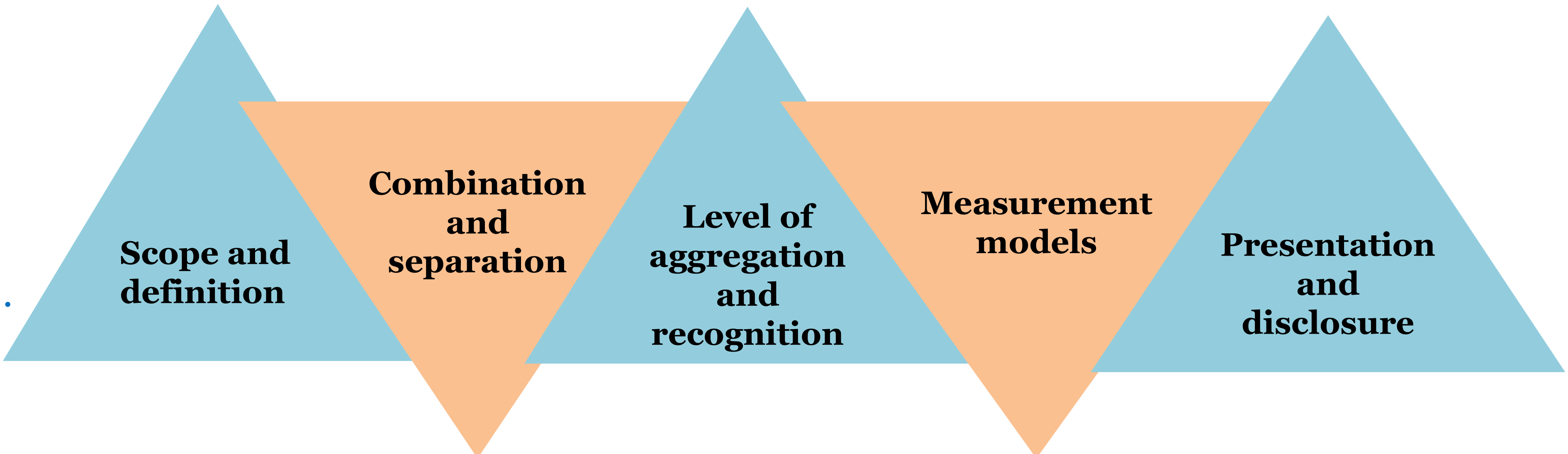
- Inadequacies in the wide range of insurance accounting practices used applying IFRS 4 hence need for a **common global** insurance **accounting standard** on Insurance Contracts

- **To reflect economic reality in a better way**: Many insurers' financial statements lack regular updates of the value of insurance obligations to reflect the effect of changes in the economic environment, such as changes in interest rates and risks.

- To provide **improved information** about the **current and future profitability** of insurers.

Overview of IFRS 17

Overview of the new standard on "Insurance Contracts"



Scope

IFRS 17 has **retained the scope** of IFRS 4 .i.e. new requirements affects the same population of contracts

Scope	**Exclusions**
Insurance contracts issued (sold); All reinsurance contracts held (acquired); Investment contracts with discretionary participation features issued, provide the entity also issues insurance contracts.	The contracts that can be accounted for applying other IFRS Standards such as: • Product warranties • Financial guarantee contracts • Assets and liabilities from employee benefit plans • Retirement benefit obligations • Residual value guarantees • Fixed-fee service contracts • Insurance contracts in which the Company is the policy holder, with the exception of reinsurance contracts.

Definition

Insurance contract

A contract under which one party (the issuer) accepts **significant insurance risk** from another party (the **policyholder**) by agreeing to compensate the policyholder if a specified uncertain future event (the **insured event**) adversely affects the **policyholder**.

Reinsurance contract

An **insurance contract** issued by one entity (the reinsurer) to compensate another entity for claims arising from one or more **insurance contracts** issued by that other entity (underlying contracts).

Contractual service margin

A component of the carrying amount of the asset or liability for a group of insurance contracts representing the unearned profit the entity will recognise as it provides services under the insurance contracts in the group.

Definition

Fulfilment cash flows

An explicit, unbiased and probability-weighted estimate (i.e. expected value) of the present value of the future cash outflows minus the present value of the future cash inflows that will arise as the entity fulfils insurance contracts, including a risk adjustment for non-financial risk.

Investment contract with discretionary participation features

A financial instrument that provides a particular investor with the **contractual right to receive**, as a supplement to **an amount not subject to the discretion of the issuer**, additional amounts:

(a) that are expected to be a significant portion of the total contractual benefits;

(b) the timing or amount of which are contractually at the discretion of the issuer; and

(c) that are contractually based on:

(i) the returns on a specified pool of contracts or a specified type of contract;

(ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or

(iii) the profit or loss of the entity or fund that issues the contract.

Combination and separation

- **Separate the non-insurance component** if a separate contract with the same features would be within the scope of another IFRS standard.
- Non-insurance component like derivatives, distinct investment, custody services, asset management services and account for applying other IFRS standard.
- IFRS17/ IND AS 117 prohibits the separation of non-insurance components if the specified criteria are not met.

Non-insurance component	When to account for separately	Applicable Standard
Embedded derivatives	If required by IFRS 9/ IND AS 109	IFRS 9/ IND AS 109
Investment components or deposits components	If distinct*	IFRS 9/ IND AS 109
Goods and non-insurance services	If distinct**	IFRS 15/ IND AS 115

* Distinct only if the investment component and insurance component are not highly inter-related and a contract with comparable terms is sold or could be sold, separately in the same market or jurisdiction.

** Goods and non-insurance services are distinct if the policyholder can get benefit from the goods or services on their own or together with other resources readily available to the policy holder.

Level of aggregation and recognition

AGGREGATION

- At the commencement, to apply the recognition, measurement and other principles,
- **Group the insurance contracts** (similar risks and are managed together- like annuity, term insurance, endowment) into a minimum of three in the table below.
- A group of contracts becomes onerous if its estimated cash outflows exceed its estimated cash inflows.
- Identification of contracts with similar risks, aggregation and measurement **requires management judgement.**
- **Requirements to be applied on a group of contracts** rather than on contract by contract basis.

Portfolio of contracts		
Year 1	**Year 2**	**Year 3**
Onerous contracts	Onerous contracts	Onerous contracts
Not onerous contracts	Not onerous contracts	Not onerous contracts
Residual contracts	Residual contracts	Residual contracts

Level of aggregation and recognition

RECOGNITION

Importance of determination of the timing of recognition:

To determine

- Contractual service margin since fulfilment cash flows are measured as its initial recognition.
- Discounting rate to be used in measurement.

An entity to **recognize a group of contracts** it issues from the **earliest of** the following:

a. The beginning of the coverage period of the group of the contracts;
b. The date when the first payment from a policyholder in the group becomes due; and
c. For a group of onerous contracts, when the group becomes onerous.

Measurement models

Three measurement models for Insurance contracts

THREE MEASUREMENT MODELS FOR INSURANCE CONTRACTS		
GENERAL MEASUREMENT MODEL	**PREMIUM ALLOCATION APPROACH (PAA)**	**VARIABLE FEE APPROACH(VFA)**
Default model-Building blocks Model	Simplified Model for insurance contracts	Applicable to Direct participation contracts
Measure the liability for insurance contracts as a sum of: ▪ Contractual service margin ▪ Fulfilment cash flows which comprise estimate of future cash flows and adjustments for time value of money and non-financial risks. Loss is immediately recognized in case of no contractual service margin.	▪ Many non-life insurance products would fall under this category. ▪ General insurance (Property and casualty) ▪ Coverage period =/<1 year	▪ Modification of the treatment of contractual service margin in general measurement model above. ▪ No interest accretion is required since the CSM is remeasured for changes in financial risk.
Core principles underlying these models are expected to result in major financial transformation and provide **better insights into the financial results** for Analysts and users.		

Impact on Companies

Impact on companies

Property and casualty-General insurers

Typically provides coverage for a short period of time, such as one year. It is expected that most of these companies will go for the simplified approach for the majority of their contracts.

- The Greatest effect of implementing the new standard will come from the **need to consider** the **requirements to discount** and **apply an explicit risk adjustment for incurred claims.**

Life and health

Cover risk under longer period-many decades. We expect these Companies to be the **most affected Companies** by IFRS 17/ Ind AS 117.

- Typically these companies do not measure their insurance contracts using fully updated information, which is a requirement of IFRS 17/ Ind AS 117.

Multi line

For these Companies, segment reporting typically provides the relevant information about operating segments. The effects of IFRS 17/Ind AS 117 on these companies will **largely depend on the mix** of the insurance contracts they issue.

Impact on companies

Reinsurance

The effects of IFRS 17/Ind AS 117 on these companies will depend on the type of reinsurance contracts they issue (i.e. whether they are short-term or long-term contracts).

We expect that to implement IFRS 17/Ind AS 117, most insurance companies will to some extent need to **revise their accounting for the insurance contracts they issue**. For many insurance companies the revision required will be extensive.

Investment Companies

Investment companies typically issue contracts that are similar to some insurance contracts but we do not expect these to be accounted for applying IFRS 17/Ind AS 117.

Some **investment companies without significant insurance operations**, such as asset managers, to still be **indirectly affected**. This is because the presentation of insurance contracts will be more comparable to products issued by investment companies when insurers apply IFRS 17/Ind AS 117.

Impact on companies

Banks

We **do not expect that banks without significant insurance operations will be particularly affected** by IFRS 17/Ind AS 117. Banks often issue contracts that require them to compensate the contract holders for losses they incur because a debtor fails to make loan payments when due. These contracts meet the definition of an insurance contract if the insurance risk transferred is significant.

- Financial guarantees

  Banks may elect to apply the requirements either in IFRS 9 or IFRS 17 and we expect that banks will apply the requirements in IFRS 9 to these contracts. This is because those requirements are expected to result in consistent accounting for economically similar contracts issued by the same company.

- In other banking arrangements

  IFRS 17/Ind AS 117 confirms that other **common banking agreements** such as **credit-related guarantees** that require payments to be made even if the holder of the contract has not incurred a loss **are not insurance contracts.** This is because they do not transfer significant insurance risk from the holder of the contract to the issuer. Therefore, IFRS 17 /Ind AS 117 will not affect such contracts.

Impact on companies

Non-financial Companies

We do not expect that IFRS 17/Ind AS 117 will significantly affect non-financial companies. This is because, in many circumstances, non-financial companies providing insurance services **are not expected to apply IFRS 17/Ind AS 117.**

- Principal Vs agent considerations

  If acting as agents of insurers-no effect-they do not issue insurance contracts.

  If acting as Principal –Will effect in the same way as insurers with similar business.

- Product warranties
  - These warranties **meet the definition** of an insurance contract in IFRS 17/Ind AS 117, **but does not apply** to product warranties **issued by a manufacturer, dealer or retailer.**
  - IFRS 17/Ind AS 117 applies to product warranties issued by another party.

Impact on companies

- Fixed fee service contracts

  A company providing the service agrees to repair specified equipment after a malfunction, in exchange for a fixed premium.

  IFRS 17/Ind AS 117 **permits a company to choose** to account for a fixed-fee service contract **using the revenue recognition requirements in IFRS 15/Ind AS 115** if the **primary purpose** of the contract is the **provision of services.**

Impact on companies

- Significant changes in the reported top and bottom line numbers.
- Investment component and cash received- no longer considered in topline.
- CSM calculations based on actuarial models and risk adjustments -will replace current revenue and cost accounting practices. May have an impact on the way products are currently being priced.
- Now, insurance revenue will exclude deposit components which represent policyholders' investments, not consideration for services.
- Requirement to report as insurance expenses only items that reflect insurance service expenses. Repayment of deposits will not be presented as insurance expenses, but rather as a settlement of a liability.
- Making onerous contracts visible in a timely way
- Insurance regulators and the industry to find synergies and sort out the implementation challenges well in advance.
- IFRS 17/Ind AS 117 may trigger a second wave of activity by local tax authorities and regulators.
- Co-ordination between various functions-Finance, Actuarial, IT will be essential and important to educate business users and investors on what to expect.

User point of view

User point of view

- **Clearer picture of the profit drivers**-separation of underwriting and investment results.

- The measurement of insurance contracts will reflect all insurance components of the contracts. This presentation, together with **detailed reconciliations** of opening and closing balances provided in the notes to the financial statements, is expected to **improve the understanding of amounts related to insurance contracts** in the financial statements.

- **Grouping contracts** is necessary to ensure timely recognition of losses when they arise and relevant and timely allocation of profit (contractual service margin). It also provides information about the **development of the profitability over time.**

- **Disclosures on explicit, current risk adjustment** in the measurement of insurance contracts- Explicit risk adjustments provide useful insight into the company's view of the economic burden imposed by the risks associated with the company's insurance contracts and how that risk changes over time.

User point of view

- To provide **transparent and timely information about insurance risks**, and **changes** in those risks, IFRS 17 requires the **use of current estimates** based on the **most up-to-date information** available and disclosure of the relevant assumptions.

- Use of **discount rates** that reflect the **characteristics of the cash flows** arising from the insurance **contract liability** rather than rates based on the characteristics of the assets backing that liability-help to report economic mismatches.

Disclaimer: