IFRS 17
Insurance Contracts

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National Bank of Ukraine

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Disclaimer

Unless specified otherwise, the accounting requirements that are the subject matter of this presentation are the IFRS Standards as issued by the IASB that are applicable on or after 1 January 2023

The views expressed in this presentation are my own and not necessarily those of any organization with which I am associated.

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Programme

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IFRS 17 Programme

Session 1	Recap: Core model and premium allocation approach (PAA)
Session 2	PAA with comparison to unearned premium
Session 3	Challenges in applying PAA
Session 4	Disclosure and presentation requirement
Session 5	Transition, transition presentations and disclosures
Session 6	Audit reports and compliance with IFRS
Session 7	

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Premium Allocation Approach

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Core Requirements

Snapshot of IFRS 17 Approaches

Core requirements

Modifications for contract Types

Insurance contracts with direct participation features	Reinsurance contracts held	Investment contracts with discretionary participation features

Simplifications: premium allocation approach

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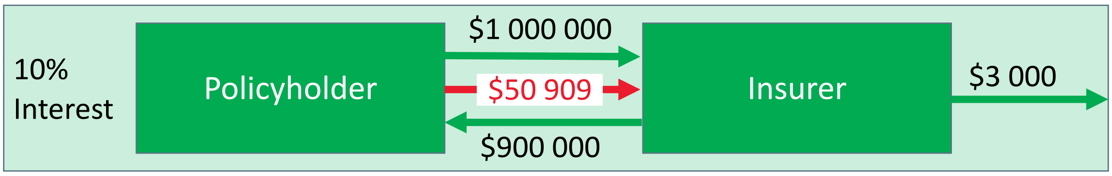
Example

- Insurer writes 100 car contracts and expects that:
  - Interest rate is 10%
  - It pays $3 000 in car inspection costs on 1 January for all contracts
  - Policyholders pay an annual premium of $10 000 each on 2 January
  - Total risk premium is $50 909
  - Insurer expects claims of $75 000 per month ($900 000 in total)



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Introduction

- Optional simplified approach for eligible contracts
  - Similar outcome to core model but in a simplified, less costly way
- Decision made at inception of the group based on assessment at that date
- The decision is:
  - made on a group by group basis, and
  - is irrevocable

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Scope
Combination of contracts

IFRS 17 sets explicit requirements:

» A set of contracts with same or related counterparty may achieve, or be designed to achieve, an overall commercial effect

» To report substance, may be necessary to treat the set as a single contract

» For example, if rights or obligations in one contract entirely negate rights or obligations in another contract entered into at the same time with the same counterparty, the combined effect is that no rights or obligations exist.

IFRS 17.9

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When should contracts be separated?

General rule of separation

Not **explicit** in IFRS 17, discussed at **TRG**:

» Lowest unit of account is the contract (includes all components)

» Contract with legal form of single contract generally considered a single contract

» Separation could be appropriate if legal form does not reflect substance of contractual rights and obligations

» Assessment of all facts and circumstances, not policy choice

» Reinsurance contract held: fact that underlying contracts are included in different groups is not sufficient to conclude that accounting as a single contract does not reflect its substance

TRG February 2018, Paper 1

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When do you separate components?

Specific rules of separation

» A contract may contain components that could/should be accounted for under another IFRS. Insurer should separate:

IFRS 17.11 to 13, 17.B31 to B35

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Premium allocation approach
Criteria

1

Coverage period of each contract in the group <= 1 year?

Starting with the contract form after separation/combination

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Present value of future cash flows
Contract Boundaries

- Cash flows are in the boundary if they
  - arise from substantive rights and obligations which
  - allow the insurer to compel the policyholder to pay premiums **or**
  - substantially oblige entity to provide insurance services

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Present value of future cash flows
Coverage period

- *The period during which the entity provides coverage for insured events. This period includes the coverage that relate to all premiums within the boundary of the insurance contract.*
  - Begins when coverage for unexpected event starts
  - Ends when the entity has the practical ability to reassess risks and reset premiums

IFRS 17 definitions

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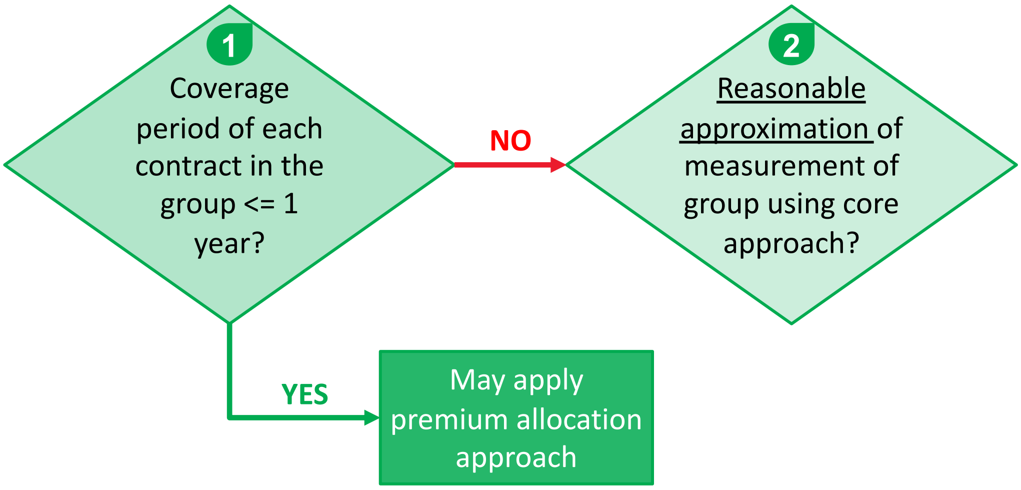
Premium allocation approach
Criteria



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Present value of future cash flows
Criteria: reasonable approximation

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- Reasonable approximation is **not** met if entity expects significant variability in the fulfilment cash flows before claims are incurred
- Variability in estimates increases for example with:
  - Extent of future cash flows relating to embedded derivatives in the contract
  - Length of coverage period

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Reasonable approximation

- Significant variability
  - Measured at the group level (ie you can consider offsetting variability)
  - Material difference
  - Need to disclose the judgements you have made
- Emerging consensus
  - Hard to apply
  - Becomes increasing hard the longer the duration of the contract
  - Some three contracts are making it
  - Beyond that, very difficult

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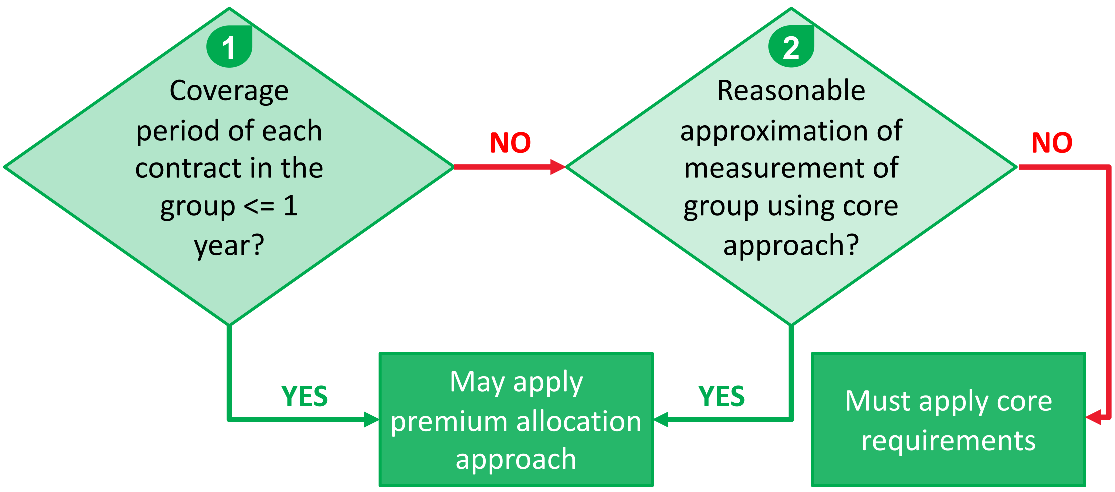
Premium allocation approach
Criteria



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Challenges with eligibility

We will cover this in more detail in a later presentation

Challenges in applying Premium allocation approach

Level of aggregation

» For contracts applying premium allocation approach

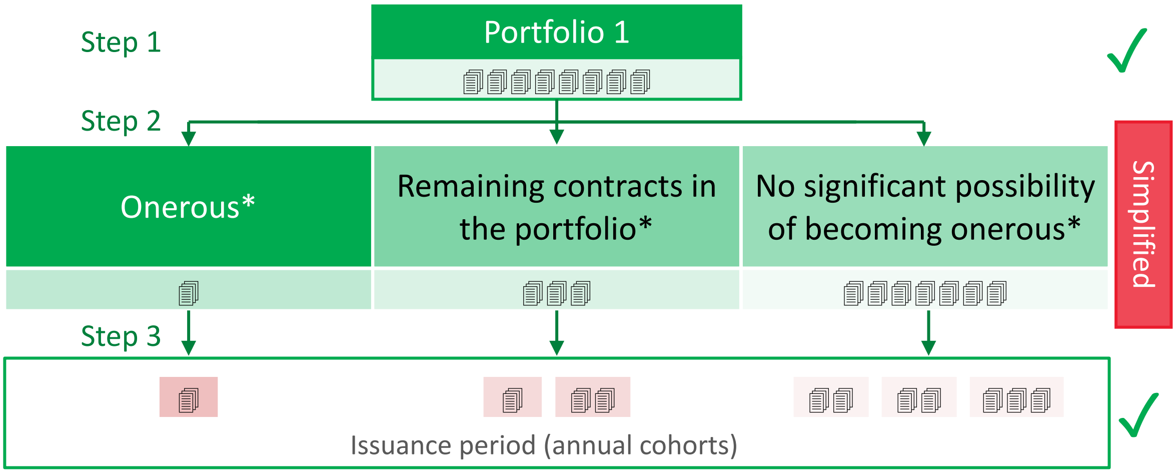
» assume no contracts are onerous unless facts and circumstances indicate otherwise

» assess whether contracts not onerous have no significant possibility of becoming onerous subsequently by assessing likelihood of changes in applicable facts and circumstances

IFRS17.18

How are contracts grouped?

Step



* At initial recognition, if any

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Core Requirements

Reminder: 'Building block Approach'

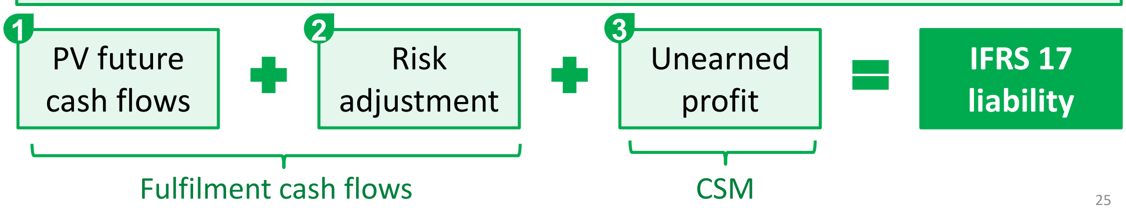
All insurance contracts measured as the sum of:

» Fulfilment cash flows (FCF)

1. Present value of probability-weighted expected cash flows
2. Plus an explicit risk adjustment for non-financial risk (eg insurance risk)

» Contractual service margin (CSM)

3. The unearned profit from the contracts



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Core Requirements
Subsequent measurement

A — **Core: Liability for remaining coverage**

PV future cash flows + Risk adjustment + Unearned profit

+

B — **Core: Liability for Incurred claims**

PV future cash flows + Risk adjustment

= **IFRS 17 liability**

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Premium Allocation Approach
Subsequent measurement - Simplifications

A — **Core: Liability for remaining coverage**

PV future cash flows + Risk adjustment + Unearned profit

Simplifications	Optional practical expedients
» No split required » Limited use of future estimates » optional practical expedients	» If coverage less then 1 year, then: » not required to accrete interest » recognise acq cash flows as expense

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Recognition

- Insurance contracts are recognised from the earliest of:
  - beginning of coverage period of first contract in group
  - date when first payment from a policyholder becomes due, or
  - for onerous contracts, when the group becomes onerous (facts and circumstances)
- If no contractual due date, then date received
- Acquisition cash flow asset or liability is recognised when incurred, and derecognised when the group of insurance contracts to which the cash flows are allocated is recognised

IFRS 17.25 to 28

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Premium allocation approach
Simplifications - initial measurement

Premiums (if any) received at initial recognition

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Cash premium received at initial recognition creates/increases liability

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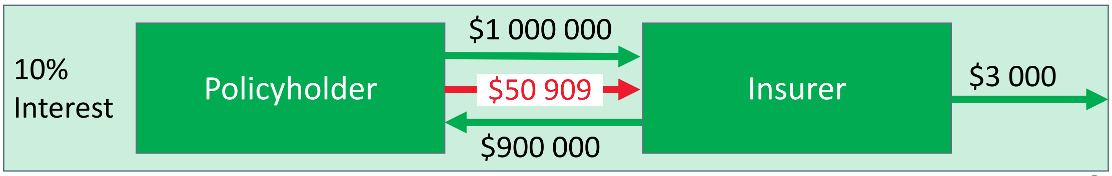
Example

» Insurer writes 100 car contracts and expects that:
- » Interest rate is 10%
- » It pays $3 000 in car inspection costs on 1 January for all contracts
- » Policyholders pay an annual premium of $10 000 each on 2 January
- » Total risk premium is $50 909
- » Insurer expects claims of $75 000 per month ($900 000 in total)



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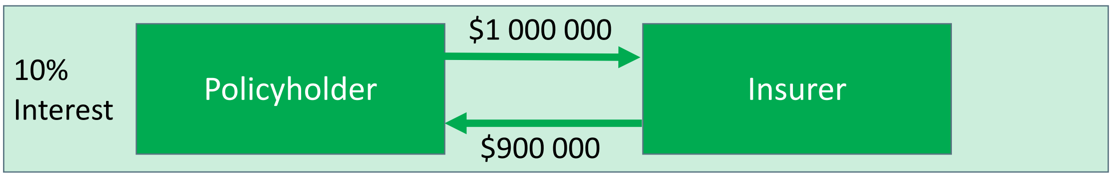
Example
One year contract

» Expects premium of $1 million (2 Jan 2022), and **claims of $75 000 per month ($900 000 for year) at end of each month**

No journal required until cash flows happen



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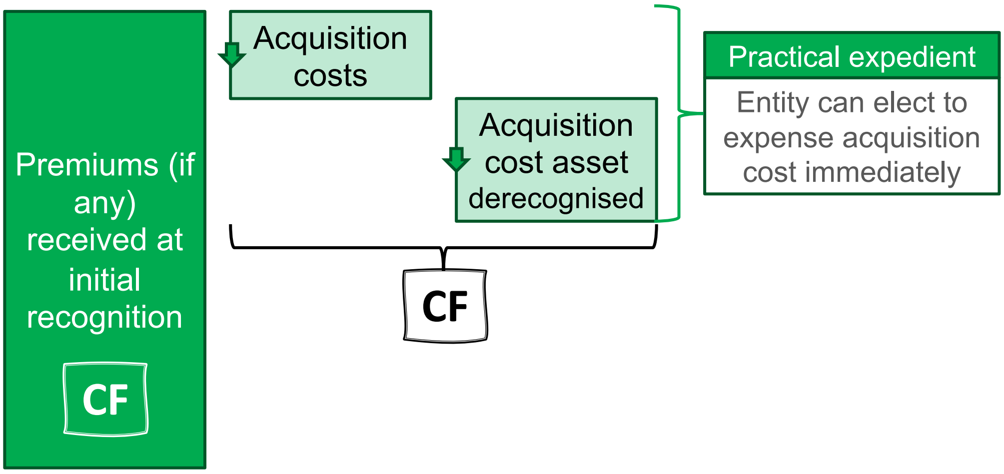
Premium allocation approach
Simplifications - initial measurement



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Example
One year contract

» Expects premium of $1 million (2 Jan 2022), and claims of $900 000, pays $3 000 in car inspection costs on 1 January

	Debit	Credit
Acquisition cost expense (1 January)	3 000	
Cash		3 000

OR

Acquisition cost asset (1 January)	3 000	
Cash		3 000
Insurance contract liability (2 January)	3 000	
Acquisition cost asset		3 000

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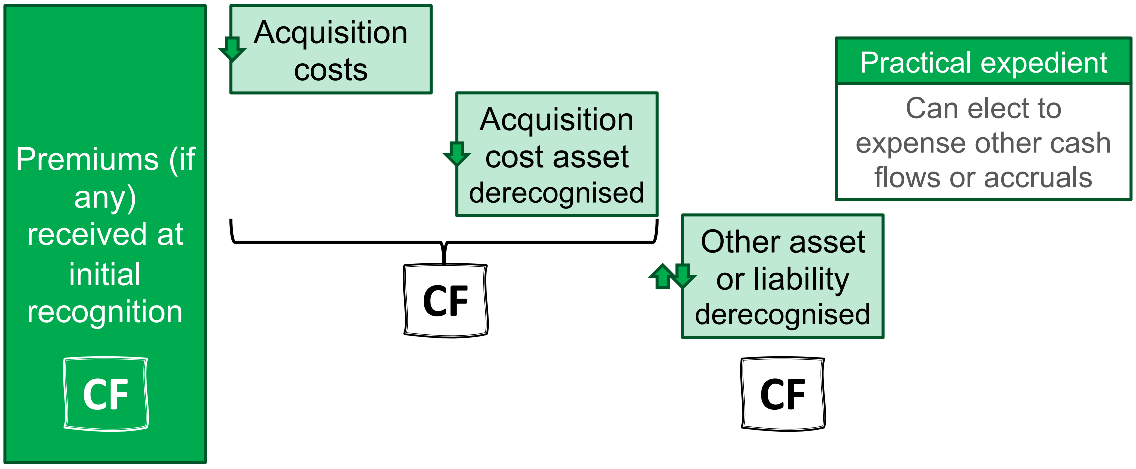
Premium allocation approach
Simplifications - initial measurement



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Other assets or liabilities

- Other assets or liabilities recognised applying other IFRSs
  - For example, if insurer pays annually a lawyer an annual retainer in advance for claims management; or
  - Incurs but does not pay a liability eg for printing of blank contracts
- The journal would be similar as for acquisition expenses:

	Debit	Credit
Prepaid expense asset (retainer) – 1 January	3 000	
Cash		3 000
Insurance contract liability (2 January)	3 000	
Prepaid expense asset		3 000

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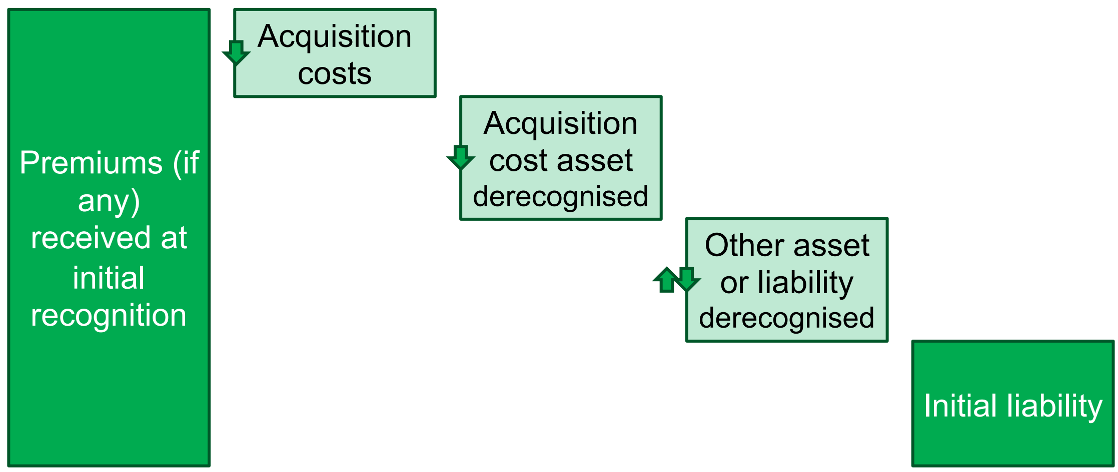
Premium allocation approach
Simplifications - initial measurement



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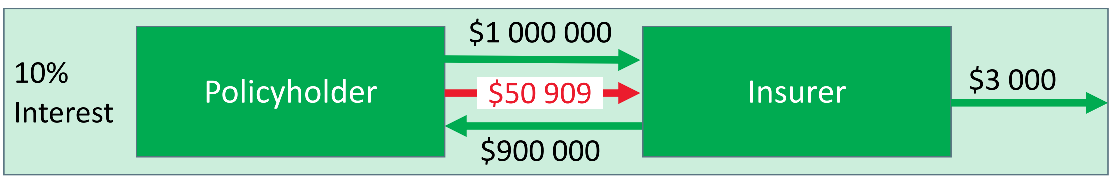
Example
Balance sheet at 2 January 2022

Dr/(cr)	Cash	Acq asset	Insure liab.
Acquisition cost paid	-3 000	3 000	
Premium received	1 000 000		-1 000 000
Acquisition cost subsumed		-3 000	3 000
2 January Total	**997 000**	**0**	**-997 000**

No entry necessary for Risk margin



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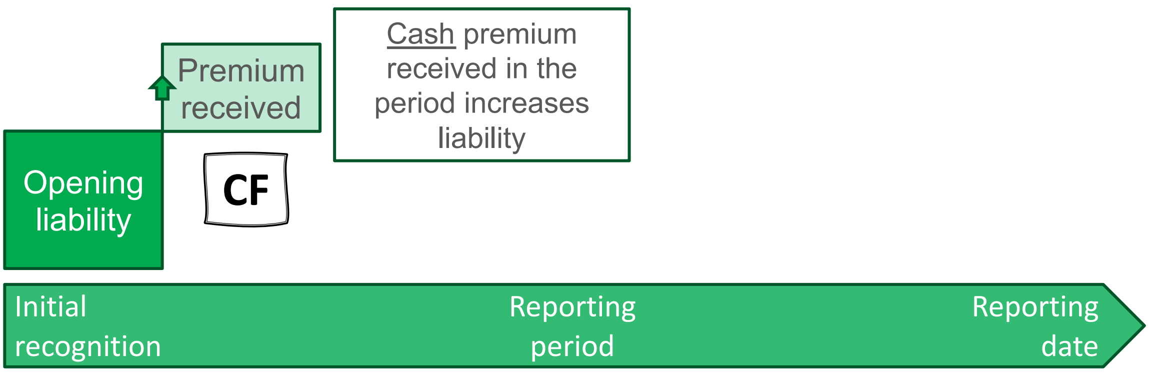
Premium allocation approach

Simplifications - subsequent measurement



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Example

6 months to June on one year contract

» Receives premium of $1 million (2 Jan 2022),

Annual premium contract, we have already recognised the premium, no further premiums received

» *What is the journal entry?*

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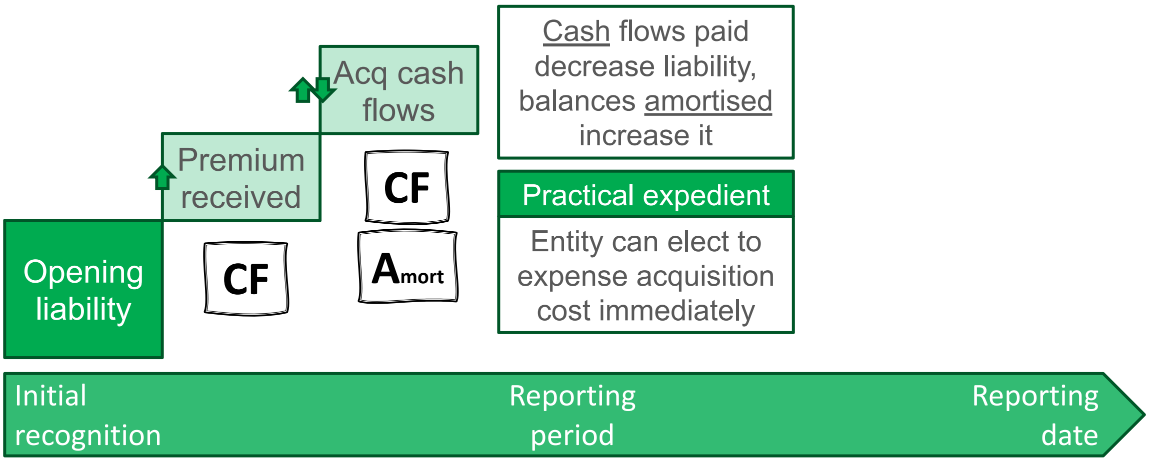
Premium allocation approach
Simplifications - subsequent measurement



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Example
6 months to June on one year contract

» Expects premium of $1 million (2 Jan 2022), and claims of $900 000, allocation of acquisition cost of <u>$3 000</u>

	Debit	Credit
Acquisition cost expense	1 500	
Insurance liability		1 500

» *<u>What is the journal entry amount?</u>*

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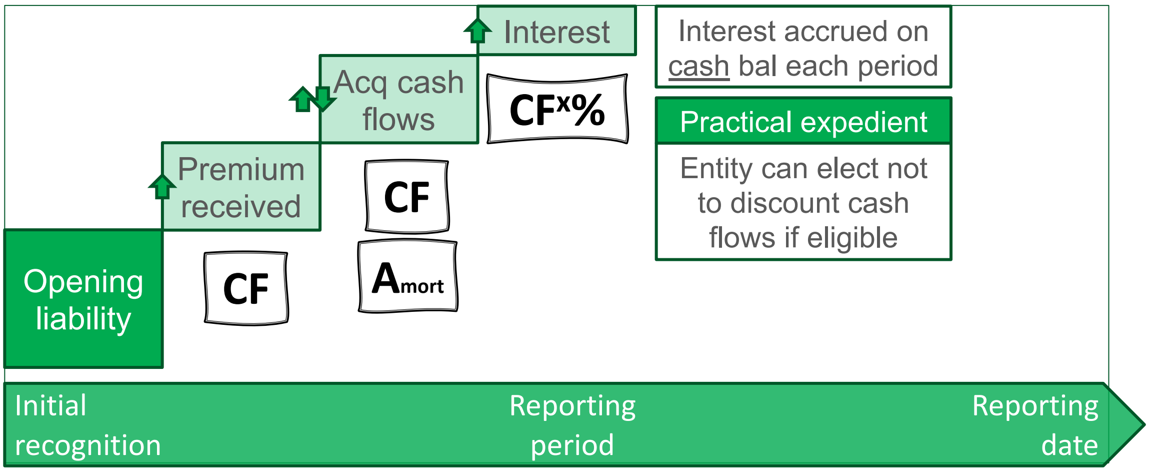
Premium allocation approach
Simplifications - subsequent measurement



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Example
6 months to June on one year contract

» Interest is at 10%, amounts to $42 617 for the 6 months

	Debit	Credit
Interest paid	0	
Insurance liability		0

What is the Journal for 1st half interest expense?

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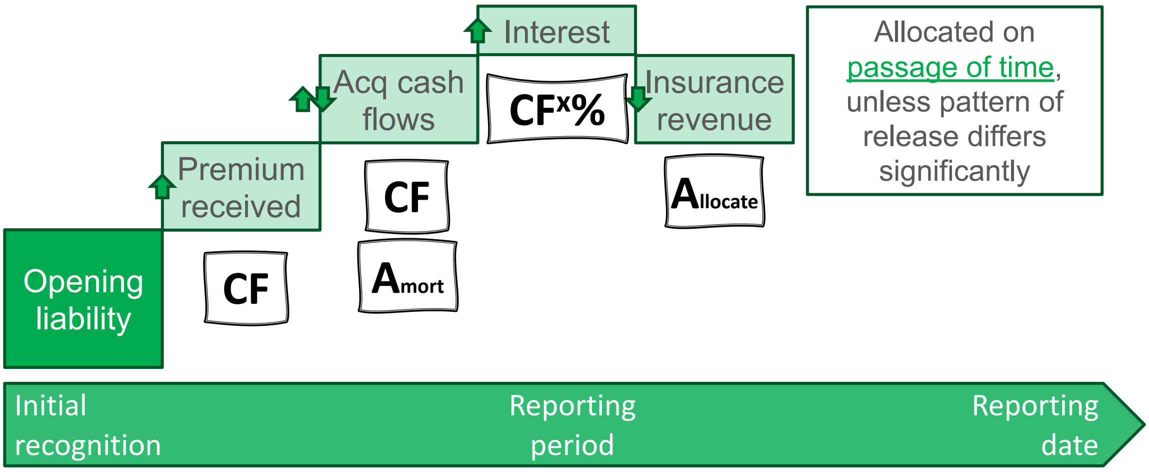
Premium allocation approach
Simplifications - subsequent measurement



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Example
6 months to June on one year contract

- Expects premium of $1 million (2 Jan 2022), claims of $900 000 spread evenly over the year

	Debit	Credit
Insurance liability	500 000	
Revenue		500 000

What is the Journal for 1st half revenue?

- Spread annually unless pattern of release is different, for example if pattern of risk release is 1/3 to 2/3 first half on second half, then:

Insurance liability	333 333	
Revenue		333 333

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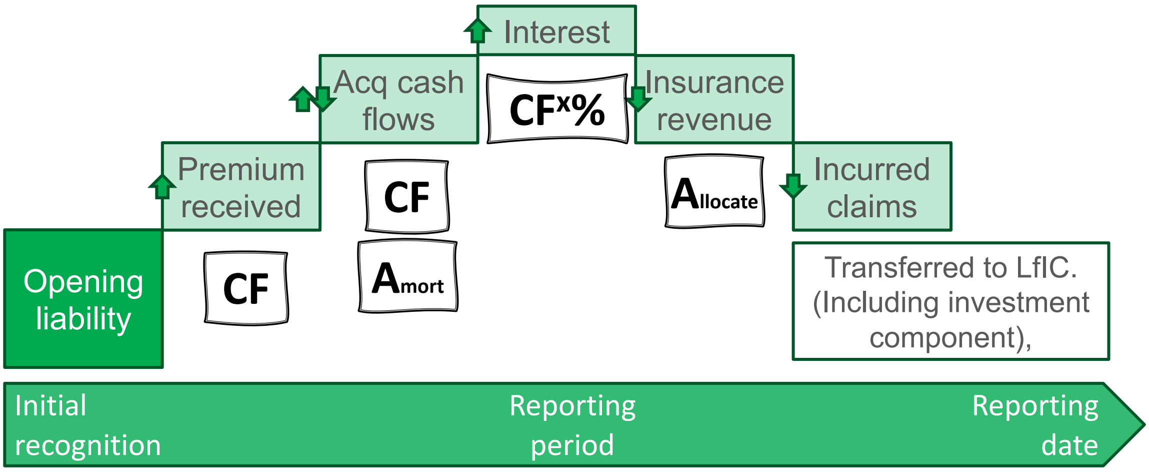
Premium allocation approach
Simplifications - subsequent measurement



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Example
6 months to June on one year contract

» Received notification of claims of Br450 000, not yet paid

	Debit	Credit
Insurance claims expense	450 000	
Insurance liability (LfIC)		450 000

What is the Journal for claims submitted (not yet paid)?

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Example
6 months to June on one year contract

» Paid claims of $450 000,

	Debit	Credit
Insurance liability (LfIC)	450 000	
Cash		450 000

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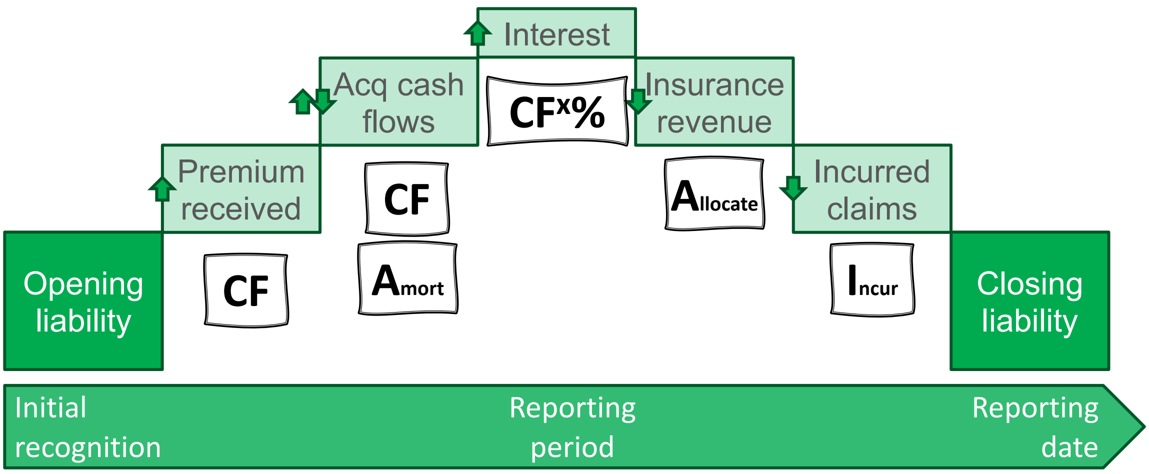
Premium allocation approach
Simplifications - subsequent measurement



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Example
Balance sheet and P&L at 30 June 2022

Dr/(cr)	Cash	Insure Liab	P&L
Opening balance (2 January)	997 000	-997 000	
Revenue		500 000	-500 000
Claims incurred		-450 000	450 000
Claims paid	-450 000	450 000	
Acquisition costs		-1 500	1 500
30 June Total	**547 000**	**-498 500**	**-48 500**

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Unearned premium reserve

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Comparison

» The simplified approach is very <u>similar</u> to the existing unearned premium reserve accounting

» The main differences are:

Premium Allocation Approach	Existing typical UPR approach
PAA accounts for premiums only when the cash is received	UPR accounts for all premiums receivable, offset against unearned premium
Claims are accounted for when incurred (including applying IBNR) applying the risk adjusted present value approach	Claims are accounted for when incurred (including applying IBNR) applying different approaches
Onerous contracts are accounted for under the core model	Onerous contracts are accounted for applying different approaches

Comparison
Averaging techniques

» Various techniques exist for estimating UPR (method ¼, 1/365, loss ratio)

» These techniques all have in common:

» Determining total premium receivable

» Estimating expected pattern of service (straight line, escalating, declining, bell curve or other)

» Recognising as revenue portion that relates to service <u>already</u> provided

» Recognising as unearned portion that relates to service <u>to be</u> provided

» These techniques are usually consistent with IFRS 17

Some techniques target <u>prudence</u> – there are **<u>not</u>** consistent with IFRS

TRG Example
Agenda paper 6, 2 May 2018 TRG

» An entity issues an insurance contract on 1 July 2023

» The coverage period is 1 year (1 July 2023 to 30 June 2024)

» The premium charged in $12 000

» Insurance acquisition cash flows of $1 800 are paid on 1 July 2023

Assumptions

- Insurance services are provided evenly over the coverage period
- No claims are incurred
- The insurance contract is accounted for as a group

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TRG Example
Agenda paper 6, 2 May 2018 TRG

Three scenarios for payment of premium:

» Premium paid up front

» Premium paid at beginning of coverage period

» Premium paid at end of coverage period

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TRG Example
Existing practice (premium paid upfront)

Reporting Date	01.07.23	[illegible]	[illegible]	31.03.24	30.06.24
Premium receivable	0	0	0	0	0
Unearned premium reserve	(12 000)	[illegible]	[illegible]	(3 000)	0
Deferred acquisition cost	1 800	[illegible]	[illegible]	[illegible]	0
Sum of insurance line items on balance sheet	(10 200)	[illegible]	[illegible]	[illegible]	0
Revenue for each period (change in UPR)	0	3 000	3 000	3 000	3 000

All received on day 1

No service provided

3 months elapsed

Paid on day 1

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TRG Example
IFRS 17 (premium paid upfront)

Reporting Date	01.07.23	30.09.23	31.12.23	31.03.24	30.06.24
Opening balance	0	[illegible]	[illegible]	(5 100)	(2 550)
Premium on initial recognition[1]	(12 000)				
Insurance acquisition cash flow[2]	1 800				
Premiums received in period[3]		[illegible]	0	0	0
Amortisation of acq. cash flow[4]		[illegible]	[illegible]	(450)	(450)
Insurance revenue applying[5]		3 000	[illegible]	3 000	3 000
Closing balance	(10 200)	[illegible]	[illegible]	[illegible]	0

All received on day 1

Paid on day 1

No servi provided

3 months elapsed

[1] Paragraph IFRS 17.55(a)(i), [2] Para 17.55(a)(ii), [3] Para 17.55(b)(i), [4] Para 17.55(b)(iii), [5] Para 17.55(b)(v) and 17.B126

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TRG Example
Existing versus IFRS 17 (premium paid upfront)

	31.12.23		31.03.24	
Income statement	**Existing**	**IFRS 17**	**Existing**	**IFRS 17**
Revenue	3 000	3 000	3 000	3 000
Balance sheet				
Unearned premium reserve	(6 000)		(3 000)	
Deferred acquisition cost	900		450	
Insurance contract liability		(5 100)		(2 550)

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TRG Example
Existing practice (premium paid monthly)

Reporting Date	01.07.23	30.09.23	31.12.23	31.03.24	30.06.24
Premium receivable	12 000	9 000	6 000	3 000	0
Unearned premium reserve	(12 000)	(9 000)	(6 000)	(3 000)	0
Deferred acquisition cost	1 800	1 350	900	450	0
Sum of insurance line items on balance sheet	1 800	1 350	900	450	0
Revenue for each period (change in UPR		3 000	3 000	3 000	3 000

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TRG Example
IFRS 17 (premium paid monthly)

Reporting Date	01.07.23	30.09.23	31.12.23	31.03.24	30.06.24
Opening balance	0	1 800	1 350	900	450
Premium on initial recognition[1]	0				
Insurance acquisition cash flow[2]	1 800				
Premiums received in period[3]		(3 000)	(3 000)	(3 000)	(3 000)
Amortisation of acq. cash flow[4]		(450)	(450)	(450)	(450)
Insurance revenue applying[5]		3 000	3 000	3 000	3 000
Closing balance	1 800	1 350	900	450	0

[1] Paragraph IFRS 17.55(a)(i), [2] Para 17.55(a)(ii), [3] Para 17.55(b)(i), [4] Para 17.55(b)(iii), [5] Para 17.55(b)(v) and 17.B126

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TRG Example
Existing versus IFRS 17 (premium paid monthly)

	31.12.23		31.03.24	
Income statement	**Existing**	**IFRS 17**	**Existing**	**IFRS 17**
Revenue	3 000	3 000	3 000	3 000
Balance sheet				
Premium receivable	6 000		3 000	
Unearned premium reserve	(6 000)		(3 000)	
Deferred acquisition cost	900		450	
Insurance contract liability		900		450

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TRG Example
Existing practice (premium paid at end of period)

Reporting Date	01.07.23	30.09.23	31.12.23	31.03.24	30.06.24
Premium receivable	12 000	12 000	12 000	12 000	0
Unearned premium reserve	(12 000)	(9 000)	(6 000)	(3 000)	0
Deferred acquisition cost	1 800	1 350	900	450	0
Sum of insurance line items on balance sheet	1 800	4 350	6 900	9 450	0
Revenue for each period (change in UPR		3 000	3 000	3 000	3 000

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TRG Example
IFRS 17 (premium paid at end of period)

Reporting Date	01.07.23	30.09.23	31.12.23	31.03.24	30.06.24
Opening balance	0	1 800	4 350	6 900	9 450
Premium on initial recognition[1]	0				
Insurance acquisition cash flow[2]	1 800				
Premiums received in period[3]		0	0	0	(12 000)
Amortisation of acq. cash flow[4]		(450)	(450)	(450)	(450)
Insurance revenue applying[5]		3 000	3 000	3 000	3 000
Closing balance	1 800	(4 350)	6 900	9 450	0

[1] Paragraph IFRS 17.55(a)(i), [2] Para 17.55(a)(ii), [3] Para 17.55(b)(i), [4] Para 17.55(b)(iii), [5] Para 17.55(b)(v) and 17.B126

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Second example

Insurer writes two groups of vehicle insurance contracts:

» Premium income of $12 000, either

  » Group 1: Paid in full in advance, or

  » Group 2: Paid In 12 monthly payments of $1 000 per month

» Service will be **provided evenly** over 12 month period,

» Expected claims for both groups is $500 per month, paid on the last day of the month

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Simple Example
IFRS 17 annual premium

» Annual premium in advance of $12 000, claims of $500 end 1st month

		Debit	Credit
Day 1	Cash	12 000	
	Insurance liability		12 000
End of Month 1	Insurance liability	1 000	
	Revenue allocation month 1		1 000
	Insurance liability	500	
	Cash claims month 1		500
	Claims expense allocation	500	
	Insurance liability		500

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Simple Example
UPE annual premium

» Annual premium in advance of $12 000, claims of $500 end 1st month

		Debit	Credit
Day 1	Cash	12 000	
	Insurance liability		12 000
End of Month 1	Insurance liability	1 000	
	Revenue allocation month 1		1 000
	Insurance liability	500	
	Cash claims month 1		500
	Claims expense allocation	500	
	Insurance liability		500

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Example
UPR vs IFRS 17 presentation

» Annual premium in advance of $12 000, claims of $500 end 1st month

Income Statement – for month 1	UPR	PAA
Premium/Revenue	-12 000	-1 000
Transfer to UPR	11 000	-
Less claims	500	500
Profit or loss	-500	-500

Balance sheet – end month 1	UPR	PAA
Cash	11 500	11 500
Insurance liability	-11 000	-11 000
Retained income	-500	-500

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Simple Example
IFRS 17 monthly premium

» Monthly premium in advance of $1 000, claims of $500 end 1st month

		Debit	Credit
Day 1	Cash	1 000	
	Insurance liability		1 000
End of Month 1	Insurance liability	1 000	
	Revenue allocation month 1		1 000
	Insurance liability	500	
	Cash claims month 1		500
	Claims expense allocation	500	
	Insurance liability		500

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Example
UPE Method

» Monthly premium in advance of $1 000, claims of $500 end 1st month

		Debit	Credit
Day 1	Cash	1 000	
	Premium receivable	11 000	
	Insurance liability		12 000
End of Month 1	Insurance liability	1 000	
	Revenue allocation month 1		1 000
	Insurance liability	500	
	Cash claims month 1		500
	Etc.....		

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Example
UPR vs IFRS 17 presentation

» Monthly premium in advance of $1 000, claims of $500 end 1st month

Income Statement – for month 1 Br 'thousands	UPR	PAA
Premium receivable/Revenue	-12 000	-1 000
Transfer to UPR	11 000	-
Less claims	500	500
Profit or loss	-500	-500

Balance sheet – end month 1 Br 'thousands	UPR	PAA
Cash	500	500
Premium receivable	11 000	-
insurance liability	-11 000	-
Retained income	-500	-500

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Liability for incurred claims

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Core requirements

A — Core
Liability for remaining coverage

PV future cash flows + Risk adjustment + Unearned profit

+

B — Core
Liability for Incurred claims

PV future cash flows + Risk adjustment

= IFRS 17 liability

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Premium Allocation Approach
Simplifications

B — Core
Liability for Incurred claims

PV future cash flows + Risk adjustment

Simplifications	Optional practical expedient
» Consistent with core model, but » Optional practical expedient	» Discount claims at current rate <u>unless</u> settlement expected in no more then 1 year

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Premium Allocation Approach
Simplifications

Core
Liability for remaining coverage

PV future cash flows	Risk adjustment	Unearned profit

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Core
Liability for Incurred claims

PV future cash flows	Risk adjustment

= **IFRS 17 liability**

Premium allocation
Liability for remaining coverage

- » No split required
- » Cash flows based, limited forecasting
- » Other practical expedients

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Premium allocation
Liability for incurred claims

- » Consistent with core
- » Practical expedient for discount rate

= **IFRS 17 liability**

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Onerous Contracts

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Onerous contracts
Recognition

- *If at any time during the coverage period, facts and circumstances indicate that a group of insurance contracts is onerous, an entity shall calculate the difference between:*
  - The carrying amount determined above and
  - The fulfilment cash flows calculated applying the core model (ignoring discounting if that is what the entity has elected)
- Determined:
  - **Only if** facts and circumstances indicate (don't have to test otherwise)
  - At a group level
  - At initial inception or subsequently

IFRS17.57

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Onerous contracts
Loss component

- If a PAA contract is initially or subsequently onerous, entity recognises the expected loss in profit or loss immediately (*loss component*)
- General requirements of IFRS 17 require establishing, tracking and running-off of a 'loss component'
  - Loss component is 'amortised' over the life of the contract until it is zero (it must be zero at the end of the contract)
  - The standard does not specify the pattern for the pattern of recognition.

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Onerous contract example
Example

- Addis issues a 2 year vehicle insurance contract:
  - Premium in advance of $24 000,
  - Expected claims year 1 & year 2 $12 500,
  - For simplicity
    - Interest is zero,
    - risk margin is zero,

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Onerous contract example
Example

- 2 year contract, premium $24 000, expected claims yr 1 & 2 $12 500, interest is zero, risk margin is zero, what is the expected loss?

	Cash flow	Present value
Cash inflow (premium)	24 000	
Immediate		24 000
Cash out flow (claims)	-25 000	
Interest rate is zero		-25 000
Risk margin (zero)		0
Expect loss		-1 000

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Onerous contracts
Example

» 2 year contract,

» Immediate premium of $1 000,

» Expected claims of $550 in year 1 and $550 year 2

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Onerous contracts
Example

2 yr contract, premium $1 000, expected claims yr 1 $550 and yr 2 $550

Balance sheet	Inception	Year 0	Year 1	Year 2	Ref
Insurance liability OB	-	-100	-1 100	-600	
Premium received	-	-1 000	-	-	17.55(a)
Revenue recognised	-	-	500	500	17.55(b)
Loss component	-100	-	50	50	17.58
Closing balance	-100	-1 100	-550	-	
Revenue	-		-500	-500	
Claims	-		550	550	
Loss component	100		-50	-50	
Underwriting loss	100		-	-	

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Thank you

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