Deloitte.

SAf IFRS 17 seminarieserie

IFRS 17 för skade- och riskförsäkring samt avgiven återförsäkring

Thomas Ringsted, 25 April 2019

Audit & Assurance

Agenda

- An example
  - Loss Component, recognition and Acquisition Costs
  - The journal entries
  - Some accounting choices
- Reinsurance held

An insurance contract example

Short coverage period

Non-life insurance contract example

Description of case

10 insurance contracts with coverage period 1 January 2021 until 31 December 2021

Contracts are issued at the end of 2020.

Premiums per contract:

- 100 EUR in premiums is due and paid in total on 1 January 2021

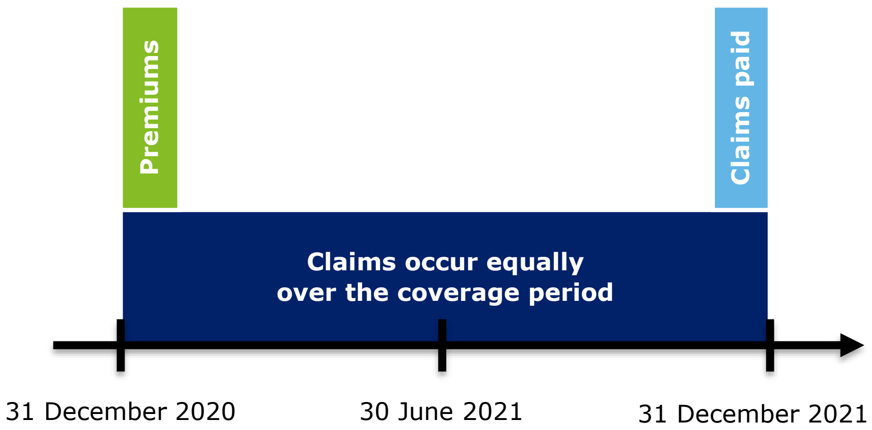
Contract characteristics:

- 9 profitable contracts with expected claims of 55 EUR
- 1 onerous contract with expected claims of 105 EUR

Charges and expenses per contract:

- 10 EUR in annual administrative expenses
- 10 EUR in acquisition expenses

Risk adjustment is 10% of expected future claims cash flows



Company and interest rates

The company has 200 EUR in initial capital

Interest rates are 2%

Non-life insurance contract example

Balance sheet - S GAAP vs IFRS 17

S GAAP balance sheet	2020 H2	2021 H1	2021 H2
Investment assets	204	1.076	448
ASSETS	204	1.076	448
SHAREHOLDER EQUITY	204	243	448
Premium provisions	0	500	0
Claims provisions	0	294	0
INSURANCE LIABILITIES	0	794	0
LIABILITIES INCL. SHR. EQUITY	204	1.076	448

IFRS 17 balance sheet	2020 H2	2021 H1	2021 H2
Investment assets	204	1.076	448
ASSETS	204	1.076	448
SHAREHOLDER EQUITY	173	286	448
<u>Remaining coverage period:</u>			
Liability for remaining coverage	31	467	0
- hereof loss component	31	17	0
<u>Incurred claims:</u>			
Best estimate liability		294	0
Risk adjustment		29	0
Liability for incurred claims		324	0
INSURANCE LIABILITIES	31	790	0
LIABILITIES INCL. SHR. EQUITY	204	1.076	448

Non-life insurance contract example

Balance sheet - S GAAP vs IFRS 17

S GAAP balance sheet	2020 H2	2021 H1	2021 H2
Investment assets	204	1.076	448
ASSETS	204	1.076	448
SHAREHOLDER EQUITY	204	243	448
Premium provisions	0	500	0
Claims provisions	0	294	0
INSURANCE LIABILITIES	0	794	0
LIABILITIES INCL. SHR. EQUITY	204	1.076	448

IFRS 17 balance sheet	2020 H2	2021 H1	2021 H2
Investment assets	204	1.076	448
ASSETS	204	1.076	448
SHAREHOLDER EQUITY	173	286	448
Remaining coverage period:			
Liability for remaining coverage	31	467	0
- hereof loss component	31	17	0
Incurred claims:			
Best estimate liability		294	0
Risk adjustment		29	0
Liability for incurred claims		324	0
INSURANCE LIABILITIES	31	790	0
LIABILITIES INCL. SHR. EQUITY	204	1.076	448

Insurance liabilities are different
Caused by e.g. unit of account and recognition of acquisition expenses

Non-life insurance contract example

Income statement - S GAAP vs IFRS 17

S GAAP income statement	2020 H2	2021 H1	2021 H2
Gross premiums		1.000	
Change in premium provisions	226	-500	500
Premium income	0	500	500
Claims paid			-600
Change in claims provisions		-294	300
Claims		-294	-300
Acquisition expenses		-100	
Administrative expenses		-50	-50
Total operating expenses		-150	-50
TECHNICAL RESULT	0	56	150
Investment income	4	22	22
Interest on insurance liabilities	0		-6
INVESTMENT RESULT	4	22	16
PROFIT OR LOSS	4	78	166

IFRS 17 income statement	2020 H2	2021 H1	2021 H2
Amortization of premium (PAA)		450	450
Acquisition expenses		50	50
Insurance revenue	0	500	500
Incurred claims and expenses		-374	-321
Acquisition expenses		-50	-50
Changes related to future service	-31	14	17
Insurance service expenses	-31	-409	-354
INSURANCE SERVICE RESULT	-31	91	146
Investment income	4	22	22
Insurance finance income or expenses	0	0	-6
NET FINANCIAL RESULT	4	22	16
PROFIT OR LOSS	-27	113	162

Non-life insurance contract example

Income statement - S GAAP vs IFRS 17

Revenue spread over coverage period, and paid premiums are not presented. However, similar to premiums earned.

S GAAP income statement	2020 H2	2021 H1	2021 H2
Gross premiums		1.000	
Change in premium provisions	226	-500	500
Premium income	0	500	500
Claims paid			-600
Change in claims provisions		-294	300
Claims		-294	-300
Acquisition expenses		-100	
Administrative expenses		-50	-50
Total operating expenses		-150	-50
TECHNICAL RESULT	0	56	150
Investment income	4	22	22
Interest on insurance liabilities	0		-6
INVESTMENT RESULT	4	22	16
PROFIT OR LOSS	4	78	166

[illegible] 17 income statement	2020 H2	2021 H1	2021 H2
Amortization of premium (PAA)		450	450
Acquisition expenses		50	50
Insurance revenue	0	500	500
[illegible]		-374	-321
[illegible]		-50	-50
[illegible]anges related to future service	-31	14	17
Insurance service expenses	-31	-409	-354
INSURANCE SERVICE RESULT	-31	91	146
Investment income	4	22	22
Insurance finance income or expenses	0	0	-6
NET FINANCIAL RESULT	4	22	16
PROFIT OR LOSS	-27	113	162

Acquisition expenses are deferred by default

Loss from onerous contracts recognized immediately

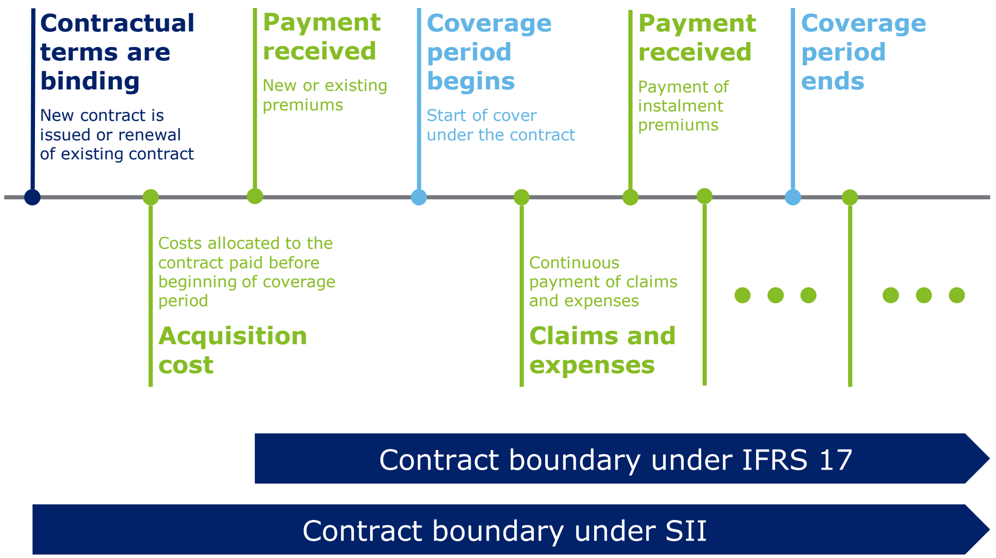
Non-life insurance contract example

Contract boundary

Contract boundary is used to determined which cash flows should be considered in the measurement of an insurance contract

The initial recognition of a contract is the earliest of:

- The beginning of the coverage period
- The date the first payment form the policyholder is due
- When facts and circumstances show the contract is onerous



Non-life insurance contract example

Unit of account - aggregation of contracts

Portfolio
A **portfolio** is a group of contracts subject to **similar risks** and **managed together** as a single pool

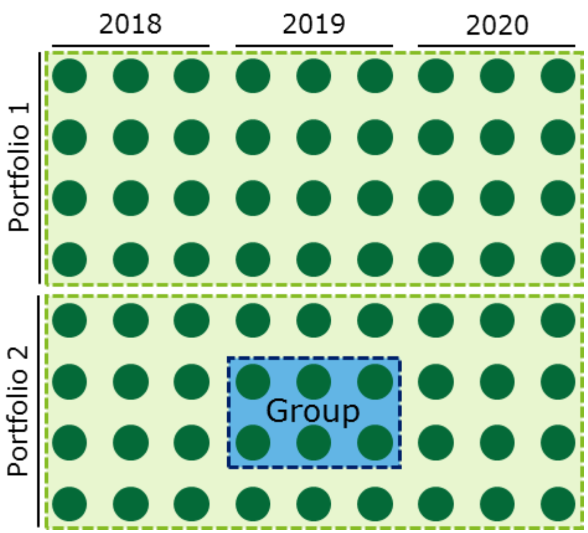
Groups
The portfolio is then required to be disaggregated into **groups** of insurance contracts that at inception are:

- Onerous,
- Profitable with no significant risk of becoming onerous,
- Other profitable contracts

Only contracts issued **within the same twelve-month period** are permitted to be grouped. Groups for shorter periods are permitted. This period does not need to coincide with the annual reporting period of an entity.

Further disaggregation of the specified groups is permitted.

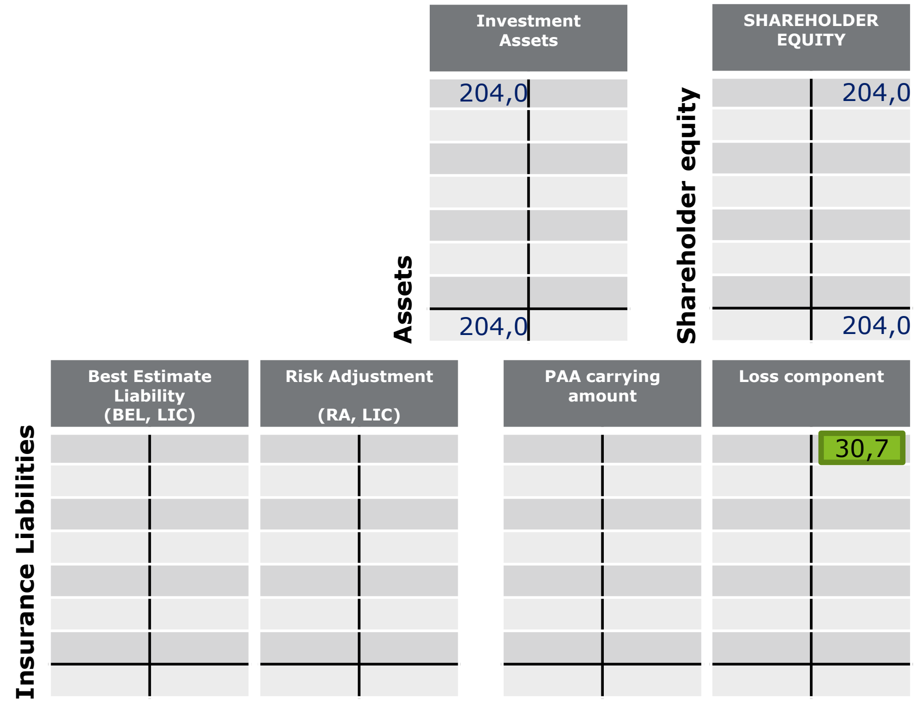
Reassessment
An entity shall establish the groups at initial recognition, and **shall not reassess** the composition of the group subsequently.



Single-premium fixed annuities [and] regular term assurance [are expected to be in different portfolios]

Non-life insurance contract example

Loss component – accounting



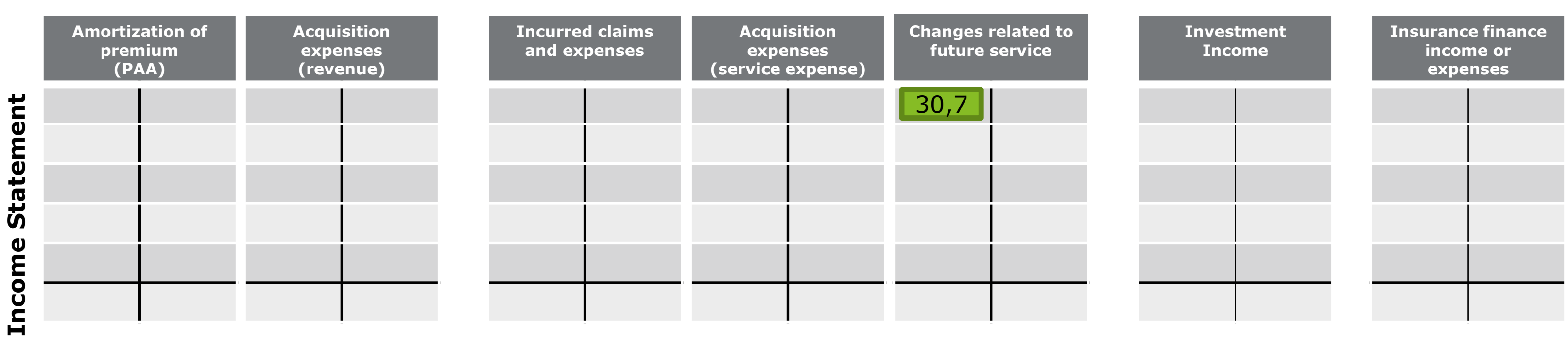
31 December 2020

Recognition of the single onerous contract

- Expected loss are estimated and recorded in the income statement

Expected premium	100,0
Expected claims	-100,9
Expected costs	-19,7
Risk adjustment (10%)	-10,1
Expected loss	**-30,7**

Loss Component



Non-life insurance contract example

Balance sheet - S GAAP vs IFRS 17

S GAAP balance sheet	2020 H2	2021 H1	2021 H2
Investment assets	204	1.076	448
ASSETS	204	1.076	448
SHAREHOLDER EQUITY	204	243	448
Premium provisions	0	500	0
Claims provisions	0	294	0
INSURANCE LIABILITIES	0	794	0
LIABILITIES INCL. SHR. EQUITY	204	1.076	448

IFRS 17 balance sheet	2020 H2	2021 H1	2021 H2
Investment assets	204	1.076	448
ASSETS	204	1.076	448
SHAREHOLDER EQUITY	173	286	448
Remaining coverage period:			
Liability for remaining coverage	31	467	0
- hereof loss component	31	17	0
Incurred claims:			
Best estimate liability		294	0
Risk adjustment		29	0
Liability for incurred claims		324	0
INSURANCE LIABILITIES	31	790	0
LIABILITIES INCL. SHR. EQUITY	204	1.076	448

Insurance liabilities are different
Caused by e.g. unit of account and recognition of acquisition expenses

Non-life insurance contract example

Income statement - DK GAAP vs IFRS 17

Revenue spread over coverage period, and paid premiums are not presented. However, similar to premiums earned.

DK GAAP income statement	2020 H2	2021 H1	2021 H2
Gross premiums		1.000	
Change in premium provisions	226	-556	350
Change in profit margin and risk margin	-226	66	170
Premium income	0	510	520
Claims paid			-600
Change in claims provisions		-294	300
Change in risk margin		-29	30
Claims		-324	-270
Acquisition expenses		-100	
Administrative expenses		-50	-50
Total operating expenses		-150	-50
TECHNICAL RESULT	0	36	200
Investment income	4	22	22
Interest on insurance liabilities	0	-20	-17
INVESTMENT RESULT	4	2	5
PROFIT OR LOSS	4	39	205

IFRS 17 income statement	2020 H2	2021 H1	2021 H2
Amortization of premium (PAA)		450	450
Acquisition expenses		50	50
Insurance revenue	0	500	500
Incurred claims and expenses		-374	-321
Acquisition expenses		-50	-50
Changes related to future service	-31	14	17
Insurance service expenses	-31	-409	-354
INSURANCE SERVICE RESULT	-31	91	146
Investment income	4	22	22
Insurance finance income or expenses	0	0	-6
NET FINANCIAL RESULT	4	22	16
PROFIT OR LOSS	-27	113	162

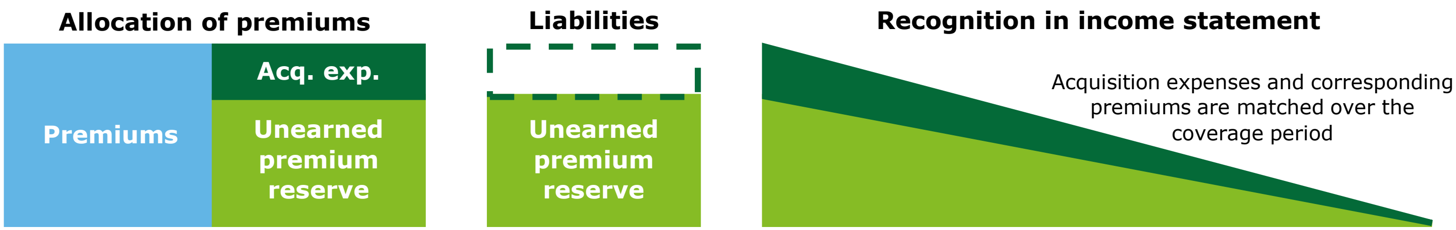
Acquisition expenses are deferred by default

Loss from onerous contracts recognized immediately

Non-life insurance contract example

Acquisition expenses - accounting policy choice

Default method for revenue recognition



Simplification: Recognize acquisition expenses when incurred

Available only when applying **premium allocation approach** and when coverage period is **not longer than 12 months**

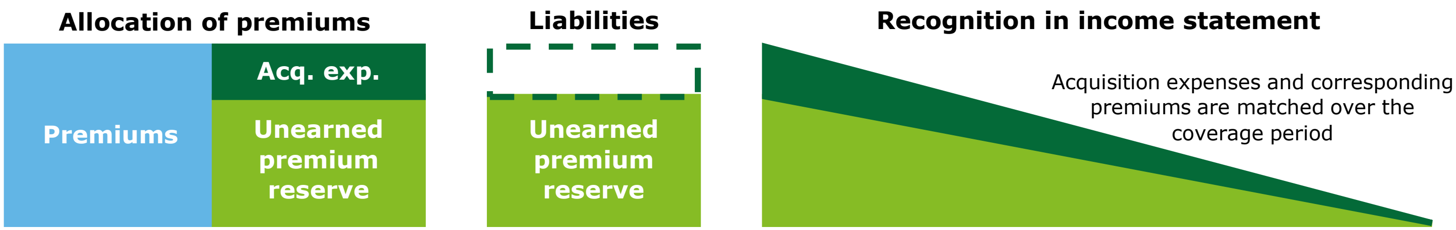
Acquisition expenses are expensed when incurred and premiums are recognized as if there was no acquisition expenses

Non-life insurance contract example

Acquisition expenses - accounting policy choice

IFRS 17 is expected to change to amortise acquisition expenses over anticipated contract life time

Default method for revenue recognition



Simplification: Recognize acquisition expenses when incurred

Available only when applying **premium allocation approach** and when coverage period is **not longer than 12 months**

Acquisition expenses are expensed when incurred and premiums are recognized as if there was no acquisition expenses

Non-life insurance contract example

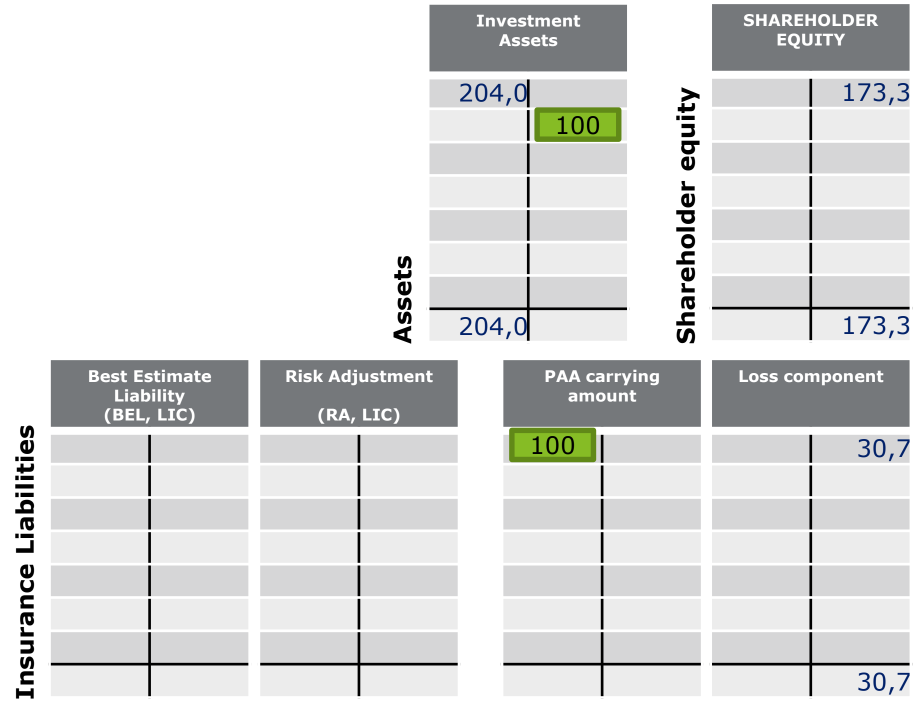
Payment of acquisition expenses

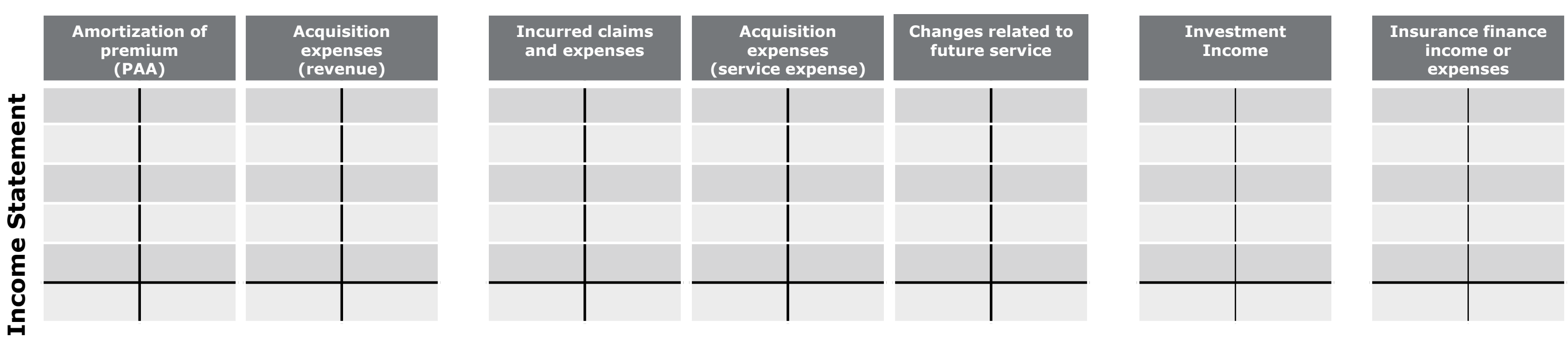
1. januar 2021

Payment of acquisition expenses

- Every contract pays 10 EUR in acquisition cost
  10 EUR x 10 Contracts = 100 EUR

Payment of acquisition expenses are not booked in the income statement





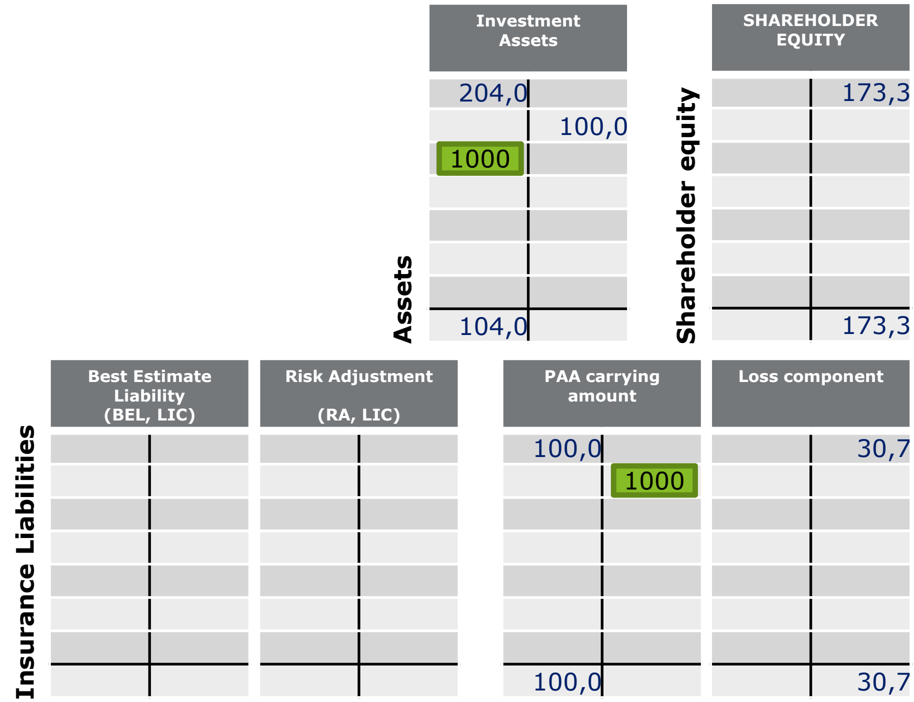
Non-life insurance contract example

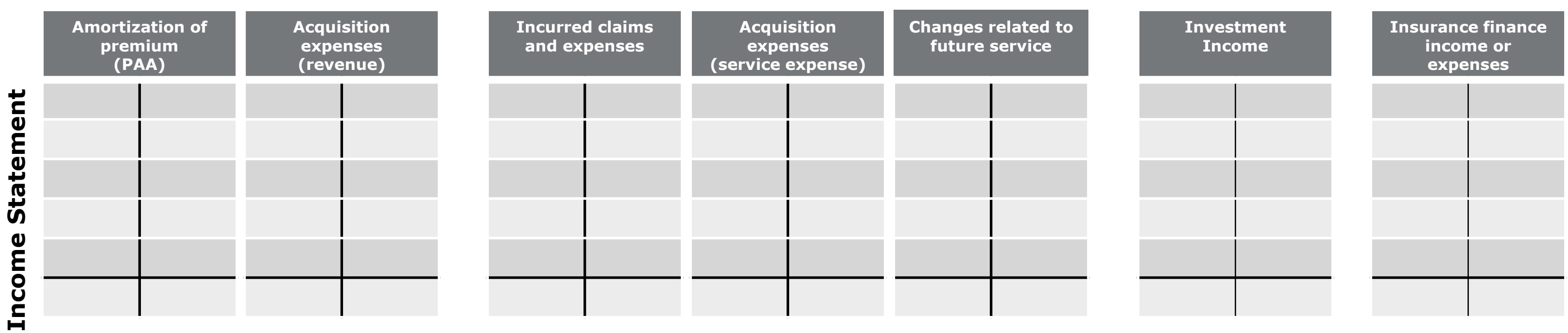
Premium payments

1. januar 2021
Premium payments

- Every contract pays 100 EUR in premium
  100 EUR x 10 Contracts = 1.000 EUR

Premium payments are not booked in the income statement





Non-life insurance contract example

Amortisation of premiums less acquisition expenses

30. juni 2021
Amortisation of premiums less acquisition expenses

- The period share of the premium (1.000 EUR / 2 periods) less acquisition costs (100 EUR / 2 periods) is recognized as income, resulting in an income of 450.

Premiums are recognized over the contract period

Assets

Investment Assets	
204,0	
	100,0
1.000,0	
22,1	
	50,0
1.076,1	

Shareholder equity

SHAREHOLDER EQUITY	
	173,3
	173,3

Insurance Liabilities

Best Estimate Liability (BEL, LIC)	
	294,1
	294,1

Risk Adjustment (RA, LIC)	
	29,4
	29,4

PAA carrying amount	
100,0	
	1.000,0
450	
	900,0

Loss component	
	30,7
	30,7

Income Statement

Amortization of premium (PAA)	
	450

Acquisition expenses (revenue)	

Incurred claims and expenses	
50,0	
294,1	
29,4	
373,5	

Acquisition expenses (service expense)	

Changes related to future service	

Investment Income	
	22,1
	22,1

Insurance finance income or expenses	

Non-life insurance contract example

Systematic allocation of acquisition expenses and revenue

30. juni 2021
Systematic allocation of acquisition expenses

- Acquisition expenses for the period 100 EUR / 2 periods = 50 EUR is recognized as costs
- Related revenue is recognized as income

Systematic allocation of acquisition expenses and related revenue

Assets

Investment Assets	
204,0	
	100,0
1.000,0	
22,1	
	50,0
1.076,1	

Shareholder equity

SHAREHOLDER EQUITY	
	173,3
	173,3

Insurance Liabilities

Best Estimate Liability (BEL, LIC)		Risk Adjustment (RA, LIC)		PAA carrying amount		Loss component	
	294,1		29,4	100,0			30,7
					1.000,0	14,2	
				450,0			
				50	50		
	294,1		29,4		450,0		16,5

Income Statement

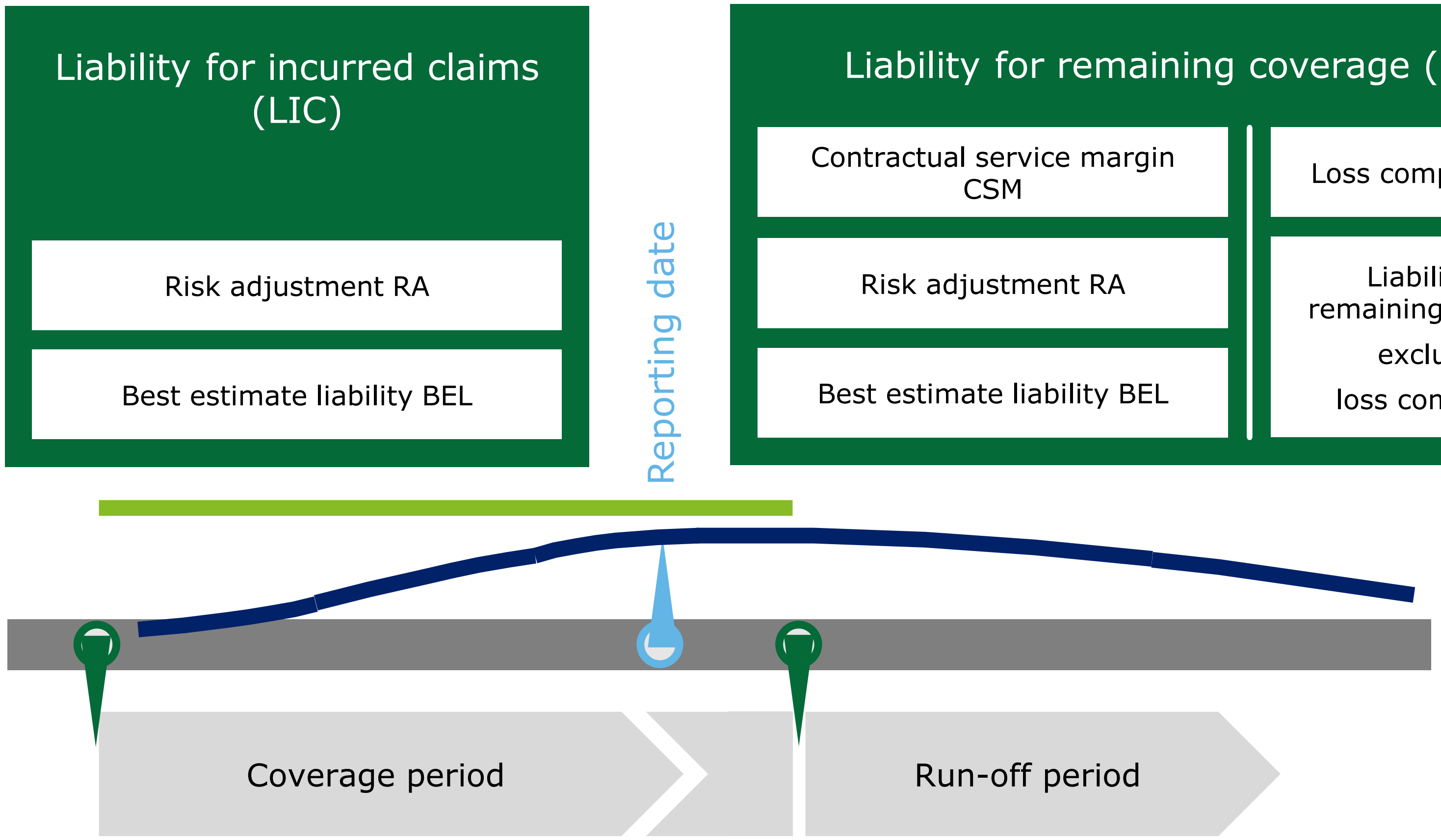
Amortization of premium (PAA)		Acquisition expenses (revenue)		Incurred claims and expenses		Acquisition expenses (service expense)		Changes related to future service		Investment Income		Insurance finance income or expenses	
	450,0			50,0					14,2		22,1		
				294,1									
				29,4									
			50			50							
	450,0			373,5					14,2		22,1		

Insurance liabilities

Decomposition in LRC and LIC for all contracts (both life and non-life)

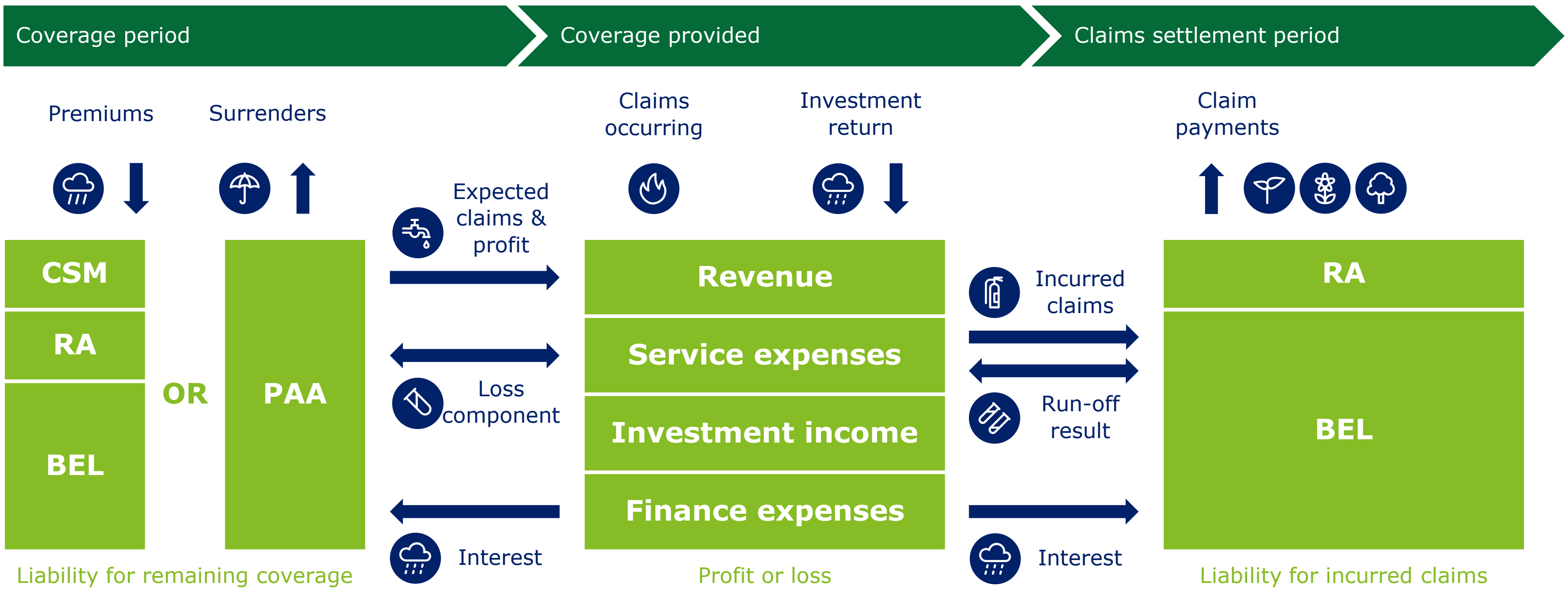
Liabilities relating to claims occurred before reporting date

Liabilities relating to claims covered in remaining coverage period



Non-life insurance contract example

Cash flows and recognition in income statement



Investment component and acquisition expenses are not fully reflected

Non-life insurance contract example

Balance sheet - S GAAP vs IFRS 17

S GAAP balance sheet	2020 H2	2021 H1	2021 H2
Investment assets	204	1.076	448
ASSETS	204	1.076	448
SHAREHOLDER EQUITY	204	243	448
Premium provisions	0	500	0
Claims provisions	0	294	0
INSURANCE LIABILITIES	0	794	0
LIABILITIES INCL. SHR. EQUITY	204	1.076	448

IFRS 17 balance sheet	2020 H2	2021 H1	2021 H2
Investment assets	204	1.076	448
ASSETS	204	1.076	448
SHAREHOLDER EQUITY	173	286	448
Remaining coverage period:			
Liability for remaining coverage	31	467	0
- hereof loss component	31	17	0
Incurred claims:			
Best estimate liability		294	0
Risk adjustment		29	0
Liability for incurred claims		324	0
INSURANCE LIABILITIES	31	790	0
LIABILITIES INCL. SHR. EQUITY	204	1.076	448

Insurance liabilities are different
Caused by e.g. unit of account and recognition of acquisition expenses

Non-life insurance contract example

Income statement - S GAAP vs IFRS 17

Revenue spread over coverage period, and paid premiums are not presented. However, similar to premiums earned.

S GAAP income statement	2020 H2	2021 H1	2021 H2
Gross premiums		1.000	
Change in premium provisions	226	-500	500
Premium income	0	500	500
Claims paid			-600
Change in claims provisions		-294	300
Claims		-294	-300
Acquisition expenses		-100	
Administrative expenses		-50	-50
Total operating expenses		-150	-50
TECHNICAL RESULT	0	56	150
Investment income	4	22	22
Interest on insurance liabilities	0		-6
INVESTMENT RESULT	4	22	16
PROFIT OR LOSS	4	78	166

IFRS 17 income statement	2020 H2	2021 H1	2021 H2
Amortization of premium (PAA)		450	450
Acquisition expenses		50	50
Insurance revenue	0	500	500
[illegible]		-374	-321
[illegible] expenses		-50	-50
Changes related to future service	-31	14	17
Insurance service expenses	-31	-409	-354
INSURANCE SERVICE RESULT	-31	91	146
Investment income	4	22	22
Insurance finance income or expenses	0	0	-6
NET FINANCIAL RESULT	4	22	16
PROFIT OR LOSS	-27	113	162

Acquisition expenses are deferred by default

Loss from onerous contracts recognized immediately

Accounting choices
In particular relevant for contracts with a short coverage period

Choice of model BBA vs PAA IFRS 17.53	PAA discounting LRC IFRS 17.56	PAA < 12 month Acquisition Expenses IFRS 17.59 (a)	PAA discounting LIC IFRS 17.59 (b)
PAA for R/I IFRS 17.69	Disaggregation of RA IFRS 17.81	P&L or OCI IFRS 17.88	PAA revenue allocation IFRS 17.B126

Accounting choices
In particular relevant for contracts with a short coverage period

- Choice of model
BBA vs PAA
IFRS 17.53
- PAA discounting
LRC
IFRS 17.56
- PAA < 12 month
Acquisition
Expenses
IFRS 17.59 (a)
- PAA discounting
LIC
IFRS 17.59 (b)
- PAA for R/I
IFRS 17.69
- Disaggregation of
RA
IFRS 17.81
- P&L or OCI
IFRS 17.88
- PAA
revenue allocation
IFRS 17.B126

Non-life insurance contract example

Accounting policy choices – Accounting policy choice regarding interest rate effect on Risk Adjustment

IFRS 17.81

An entity is not required to disaggregate the change in the risk adjustment for non-financial risk between the insurance service result and insurance finance income or expenses. If an entity does not make such a disaggregation, it shall include the entire change in the risk adjustment for non-financial risk as part of the insurance service result.

Impact of paragraph 81

- Choosing to disaggregate the change in risk adjustment will affect both the insurance service result and the financial result for the given reporting period. However, when the interest rate is small the impact is small as well.
- The disaggregation will not lead to changes in the balance sheet, only the income statement is affected.
- The following two slides presents the changes when applying paragraph 81 for the income statement and the balance sheet.

Non-life insurance contract example

Income statement – Accounting policy choice regarding interest rate effect on Risk Adjustment

IFRS 17 income statement	2020 H2	2021 H1	2021 H2
Amortization of premium (PAA)		450	450
Acquisition expenses		50	50
Insurance revenue	0	500	500
Incurred claims and expenses		-374	-321
Acquisition expenses		-50	-50
Changes related to future service	-31	14	17
Insurance service expenses	-31	-409	-354
INSURANCE SERVICE RESULT	-31	91	146
Investment income	4	22	22
Insurance finance income or expenses	0	0	-5,9
NET FINANCIAL RESULT	4	22	16
PROFIT OR LOSS	-27	113	162

IFRS 17 income statement – w/interest RA	2020 H2	2021 H1	2021 H2
Amortization of premium (PAA)		450	450
Acquisition expenses		50	50
Insurance revenue	0	500	500
Incurred claims and expenses		-374	-320
Acquisition expenses		-50	-50
Changes related to future service	-31	14	17
Insurance service expenses	-31	-409	-353
INSURANCE SERVICE RESULT	-31	91	147
Investment income	4	22	22
Insurance finance income or expenses	0	0	-6,5
NET FINANCIAL RESULT	4	22	15
PROFIT OR LOSS	-27	113	162

The insurance service result and the net financial result changes slightly, but the total is unchanged.

Non-life insurance contract example

Balance sheet – Accounting policy choice regarding interest rate effect on Risk Adjustment

IFRS 17 balance sheet	2020 H2	2021 H1	2021 H2
Investment assets	204	1.076	448
ASSETS	204	1.076	448
SHAREHOLDER EQUITY	173	286	448

IFRS 17 balance sheet – w/ interest RA	2020 H2	2021 H1	2021 H2
Investment assets	204	1.076	448
ASSETS	204	1.076	448
SHAREHOLDER EQUITY	173	286	448

Remaining coverage period:			
Liability for remaining coverage	31	467	0
- hereof loss component	31	17	0
Incurred claims:			
Best estimate liability		294	0
Risk adjustment		29	0
Liability for incurred claims		324	0
INSURANCE LIABILITIES	31	790	0
LIABILITIES INCL. SHR. EQUITY	204	1.076	448

Remaining coverage period:			
Liability for remaining coverage	31	467	0
- hereof loss component	31	17	0
Incurred claims:			
Best estimate liability		294	0
Risk adjustment		29	0
Liability for incurred claims		324	0
INSURANCE LIABILITIES	31	790	0
LIABILITIES INCL. SHR. EQUITY	204	1.076	448

Choosing to disaggregate the changes in RA does not lead to changes in the balance sheet.

Non-life insurance contract example

Accounting policy choices – Accounting policy choice regarding interest rate effect on Risk Adjustment

IFRS 17.56

If insurance contracts in the group have a significant financing component, an entity shall adjust the carrying amount of the liability for remaining coverage to reflect the time value of money and the effect of financial risk using the discount rates specified in paragraph 36, as determined on initial recognition. The entity is not required to adjust the carrying amount of the liability for remaining coverage to reflect the time value of money and the effect of financial risk if, at initial recognition, the entity expects that the time between providing each part of the coverage and the related premium due date is no more than a year.

Impact of paragraph 56

- For contracts with short duration (no more than a year), the entity can choose whether to adjust the liabilities for remaining coverage for the time value of money or not.
- Choosing to adjust the LRC leads to an increase in the liabilities. Initially, this causes financial expenses, but the build-up is later released as revenue increasing the total revenue from contracts. The total profit does not change.
- The changes in profit earnings temporarily affect the shareholder equity, but the total is the same.
- The following two slides presents the income statement and the balance sheet when applying paragraph 56, and when not applying the paragraph.

Non-life insurance contract example

Income statement – Accounting policy choice regarding discounting under PAA

Increased insurance revenue due to the inclusion of interest on premiums.

IFRS 17 income statement	2020 H2	2021 H1	2021 H2
Amortization of premium (PAA)		450	450
Acquisition expenses		50	50
Insurance revenue	0	500	500
Incurred claims and expenses		-374	-321
Acquisition expenses		-50	-50
Changes related to future service	-31	14	17
Insurance service expenses	-31	-409	-354
INSURANCE SERVICE RESULT	-31	91	146
Investment income	4	22	22
Insurance finance income or expenses	0	0	-6
NET FINANCIAL RESULT	4	22	16
PROFIT OR LOSS	-27	113	162

[illegible] income statement – w/ [illegible] PAA	2020 H2	2021 H1	2021 H2
Amortization of premium (PAA)		459	468
Acquisition expenses		50	50
Insurance revenue	0	509	518
Incurred claims and expenses		-374	-321
Acquisition expenses		-50	-50
Changes related to future service	-31	15	16
Insurance service expenses	-31	-408	-355
INSURANCE SERVICE RESULT	-31	101	163
Investment income	4	22	22
Insurance finance income or expenses	0	-18	-15
NET FINANCIAL RESULT	4	4	6
PROFIT OR LOSS	-27	105	170

The profit earning pattern changes but the total stays the same

Non-life insurance contract example

Balance sheet – Accounting policy choice regarding discounting under PAA

IFRS 17 balance sheet	2020 H2	2021 H1	2021 H2
Investment assets	204	1.076	448
ASSETS	204	1.076	448
SHAREHOLDER EQUITY	173	286	448
Remaining coverage period:			
Liability for remaining coverage	31	467	0
- hereof loss component	31	17	0
Incurred claims:			
Best estimate liability		294	0
Risk adjustment		29	0
Liability for incurred claims		324	0
INSURANCE LIABILITIES	31	790	0
LIABILITIES INCL. SHR. EQUITY	204	1.076	448

IFRS 17 balance sheet – w/disc. PAA	2020 H2	2021 H1	2021 H2
Investment assets	204	1.076	448
ASSETS	204	1.076	448
SHAREHOLDER EQUITY	173	278	448
Remaining coverage period:			
Liability for remaining coverage	31	475	0
- hereof loss component	31	16	0
Incurred claims:			
Best estimate liability		294	0
Risk adjustment		29	0
Liability for incurred claims		324	0
INSURANCE LIABILITIES	31	798	0
LIABILITIES INCL. SHR. EQUITY	204	1.076	448

The shareholder equity changes because of the changes in profit earnings.

Insurance liabilities increases because of the change in LRC.

Reinsurance

Requirements of the standard

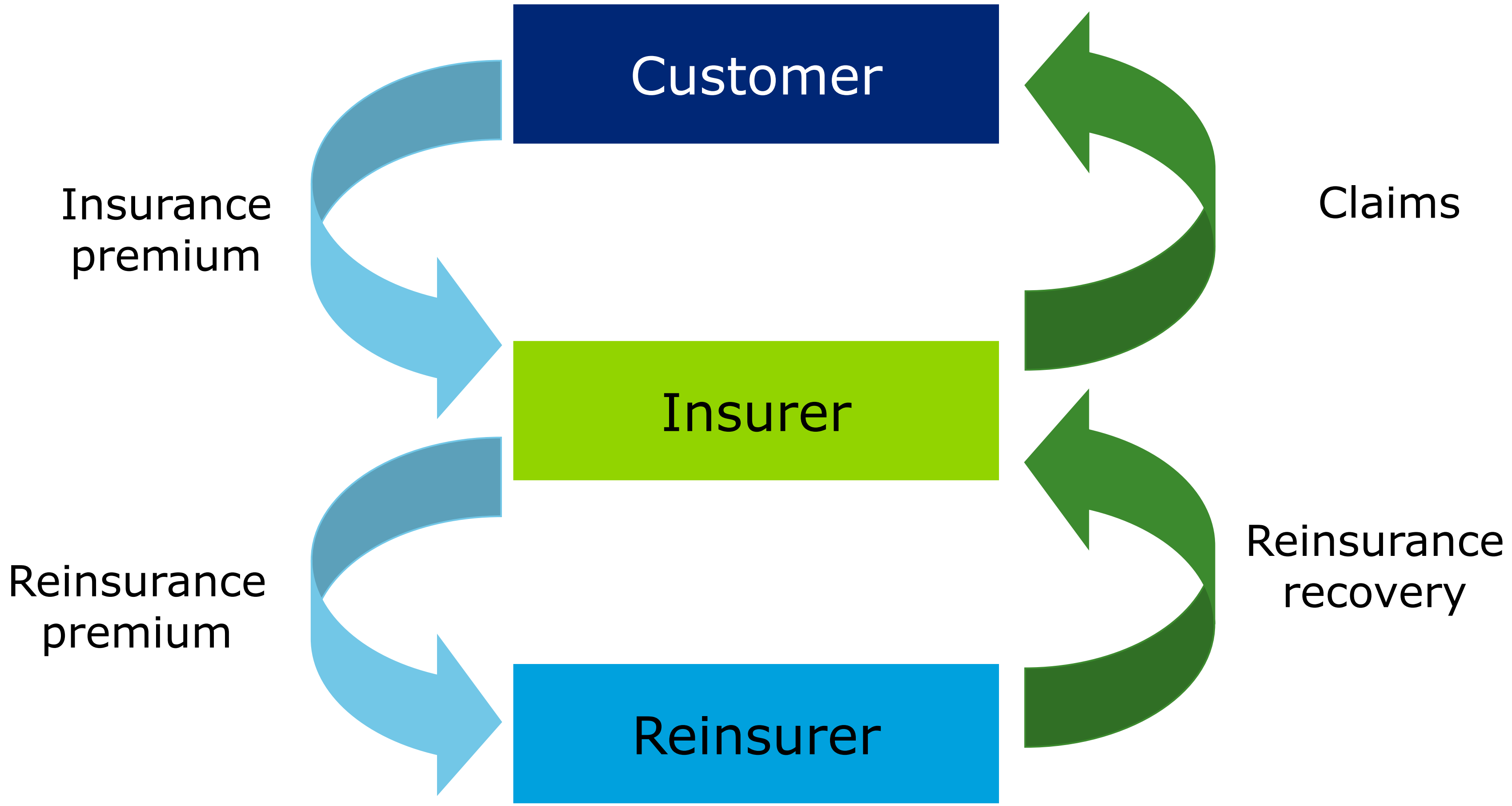
What is reinsurance?

Official IFRS 17 definition and other useful definitions

What is reinsurance	*"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)."*
What does it do	An entity that holds a reinsurance contract pays a **premium** and receives reimbursement if it pays valid **claims** arising **from underlying** contracts. This entity used to be defined as the "cedant" in IFRS 4. This term has been deleted in IFRS 17.
Inward reinsurance	This defines reinsurance from the reinsurer's perspective, i.e. from the view of the company receiving the premiums to **assume the risk.** In IFRS 17, inward reinsurance is handled like direct insurance business.
Outward reinsurance	This defines reinsurance from the cedant's perspective, i.e. for the view of the company paying the premiums and **ceding the risk.** Several key differences from direct business, and the focus of most of this section.

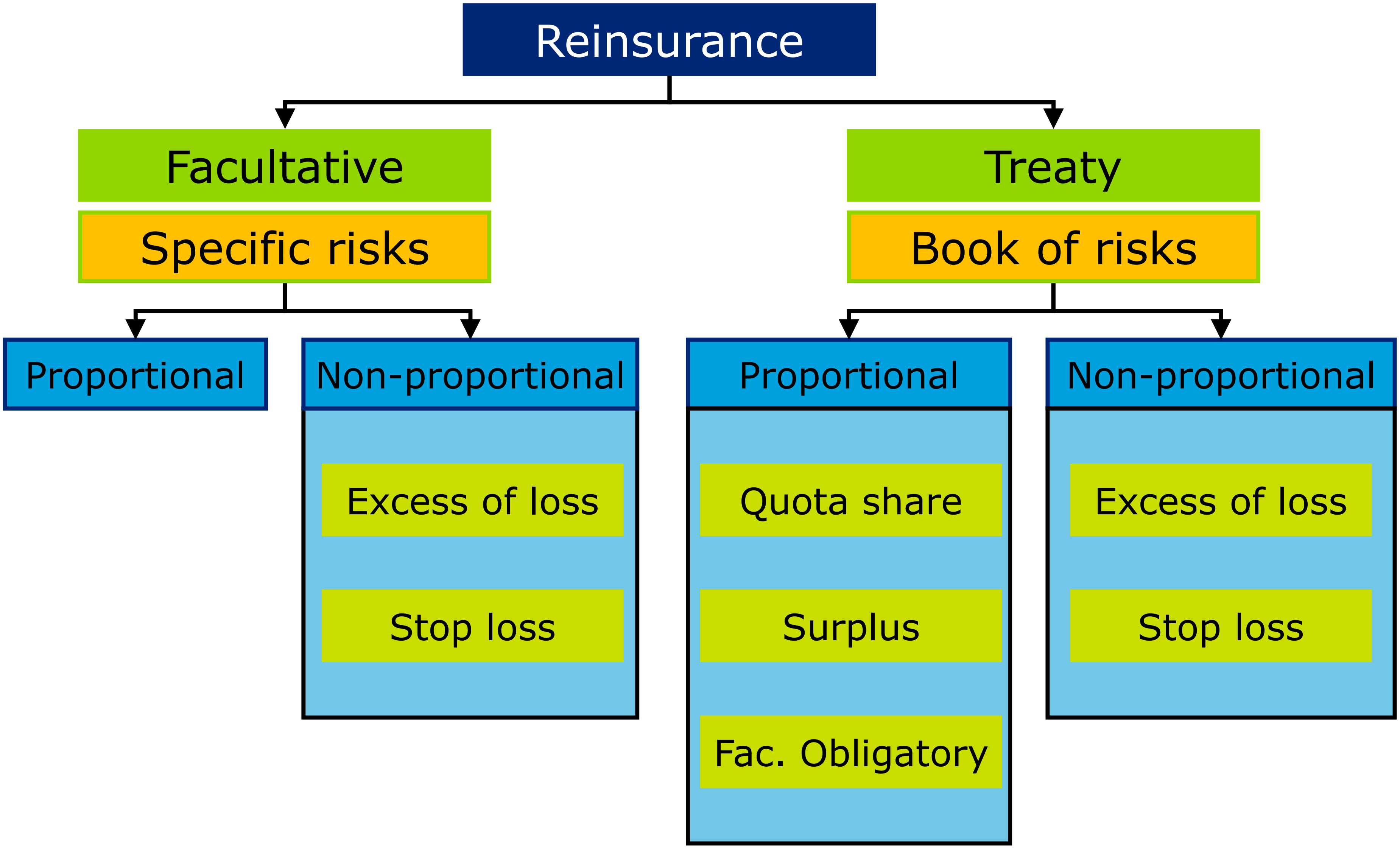
What is reinsurance?

Principal transaction flows



What is reinsurance?

Types of reinsurance



Reinsurance guidance
Risk transfer

Reinsurance contracts must **transfer risk** in order to be accounted for under IFRS 17. There is a more rigorous analysis necessary for reinsurance.

From Paragraph B19:

*"a contract transfers significant insurance risk only if there is a scenario that has **commercial substance** in which the issuer has a possibility of a loss on a present value basis.*

*However, even if a reinsurance contract does <u>not</u> expose the issuer to the possibility of a significant loss, that contract is **deemed to transfer significant insurance risk** if it **transfers** to the reinsurer **substantially all** the insurance risk **relating to the reinsured portions of the underlying insurance contracts**."*

Reinsurance guidance
Coverage period

Coverage period is slightly different for reinsurance contracts held. Paragraph 62 is slightly different from Paragraph 25:

An entity shall recognise a group of reinsurance contracts held:

a) if the reinsurance contracts held provide **proportionate coverage**—at the **beginning** of:

   i. the coverage period of the group of **reinsurance contracts** held; <u>or</u>

   ii. at the **initial recognition of any underlying contract**

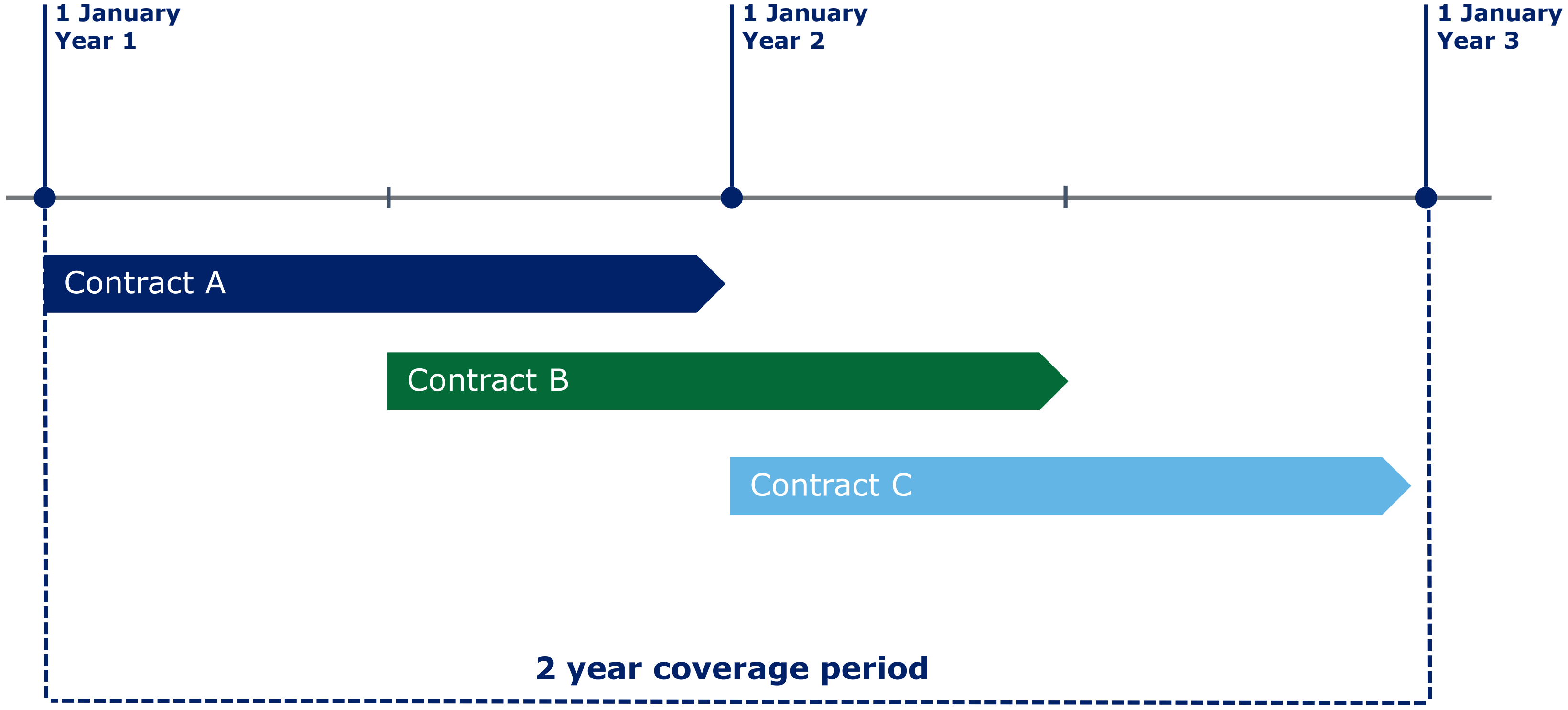
   whichever is the **later**; and

b) in all other cases—from the **beginning of the coverage** period of the group of reinsurance contracts held.

Reinsurance guidance

Recognition and coverage period

3 contracts across a 1 year period:

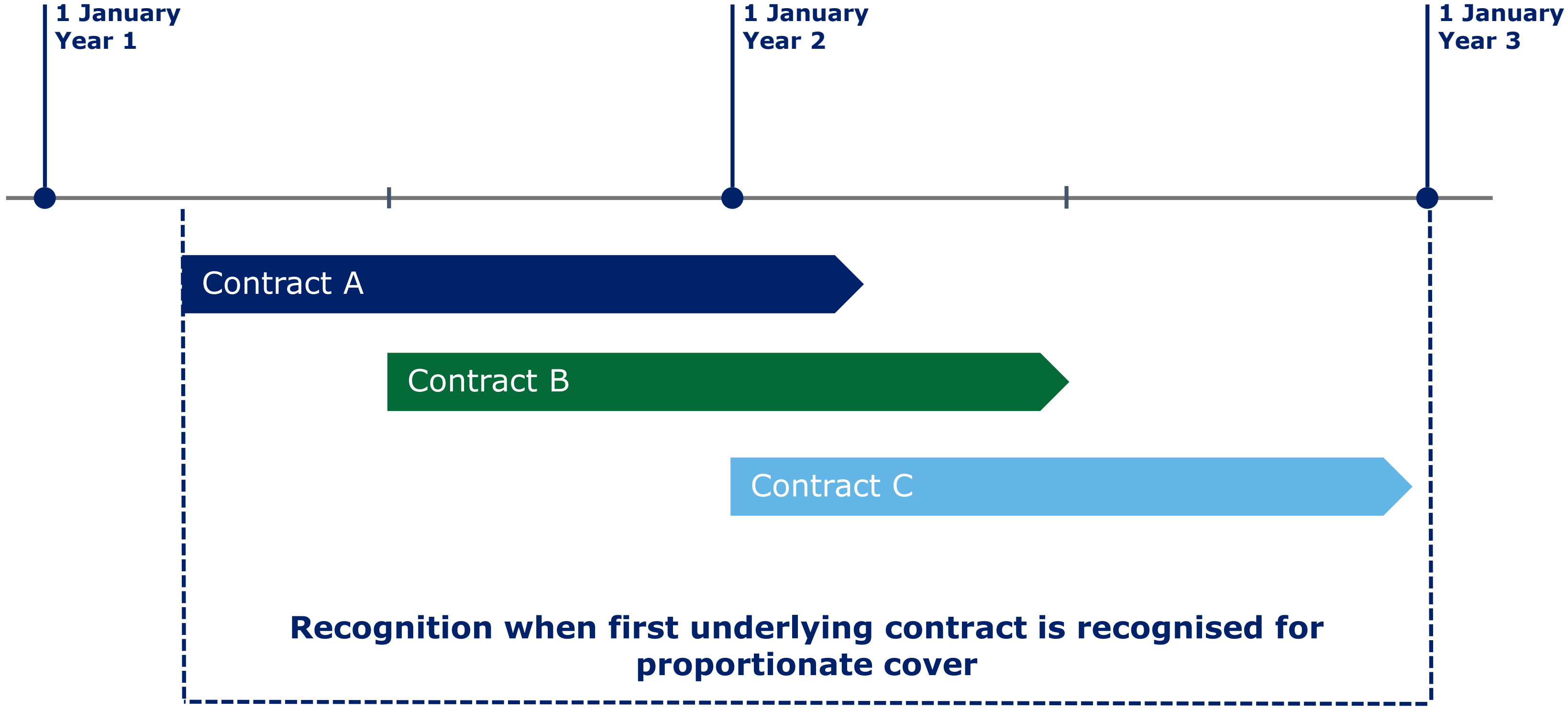


Source: IFRS Reinsurance contracts held: an example of proportionate reinsurance cover

Reinsurance guidance

Recognition and coverage period

3 contracts across a 1 year period:



Reinsurance – general requirements
Same as direct

- Generally speaking, the requirements for reinsurance are the same as for direct business:
  - Determine coverage period, assess risk, unbundle if necessary, etc.
  - Determine assumptions, discount rate, etc.
  - Calculate balances – BEL, RA, CSM, OCI
  - Track the CSM adjustments for unlocking
  - Determine revenue and expenses, including investment components disaggregation
  - Create disclosure

Reinsurance – specific requirements
Variations

Components	Paragraph	Standard	Explanation
Cash flows	63	*"use **consistent assumptions** to measure the estimates of the present value of the future cash flows for the group of **reinsurance contracts** held <u>and</u> the estimates of the present value of the future cash flows for the group(s) of **underlying** insurance contracts."*	The reinsurance contracts and underlying contracts should have consistent assumptions
Risk adjustment	64	*"determine the **risk adjustment** for **non-financial risk** so that it represents the amount of **risk being transferred** by the holder of the group of reinsurance contracts **to the issuer** of those contracts."*	The **risk adjustment** for outward reinsurance **is an asset that should reflect risk transferred** from the underlying contracts, not the variability of the reinsurance cash flows themselves

Reinsurance – specific requirements (cont’d)

Variations

Components	Paragraph	Standard	Explanation
Level of aggregation	61	*“divide portfolios of reinsurance contracts held applying paragraphs 14–24 (**same as direct**), except that the references to **onerous contracts** in those paragraphs shall be **replaced with** a reference to contracts on which there is a **net gain** on initial recognition.”*	Level of aggregation is **similar to direct** business, except that there are **no onerous** contracts for reinsurance
Credit risk	63	“include in the estimates of the present value of the future cash flows for the group of reinsurance contracts held the effect of any risk of **non-performance** by the issuer of the **reinsurance** contract, including the effects of collateral and losses from disputes”	Unlike a **direct** contract which **prohibits own credit risk** adjustments, fulfilment cash flows for **outward reinsurance must reflect the credit risk of the relied upon reinsurer**

Reinsurance

CSM – initial recognition

- From paragraph 65(a) – "*… at initial recognition … the entity shall recognise any net cost or net gain on purchasing the group of reinsurance contracts held as a contractual service margin measured at an amount equal to the sum of the fulfilment cash flows, the amount derecognised at that date of any asset or liability previously recognised for cash flows related to the group of reinsurance contracts held, and any cash flows arising at that date;*"

- Reinsurance CSM can be **positive or negative** at initial recognition, but is **still** equal to **opposite of BEL plus RA.**

- From paragraph 65(b) – "*… at initial recognition … [recognise cost as above] unless … the net cost of purchasing reinsurance coverage relates to events that occurred before the purchase of the group of reinsurance contracts...the entity shall recognise such a cost immediately in profit or loss as an expense*"

- In the case of a retrospective element to the reinsurance contract, the **cost** relating to the **retrospective** component is **recognised** as loss **immediately** at initial recognition.

Illustrative example 1
Different CSM treatments

Reinsurance fulfilment CF > 0	
RI premiums	(70)
RI commissions	7
Expected RI payments	80
Discounting	(15)
RA	10
Negative RI asset	12

Positive CSM (defer profit)

Reinsurance fulfilment CF < 0	
RI premiums	(100)
RI commissions	7
Expected RI payments	80
Discounting	(15)
RA	10
Positive RI asset	(18)

Negative CSM (defer loss)

Reinsurance
CSM – subsequent measurement

- Per paragraph 66, the requirements for subsequent measurement of CSM are **generally the same as for direct business**, e.g. interest is accreted using the rate when the contract was initially recognised.

- However, after inception, an entity should **recognise** in **P&L** any changes in estimates of fulfilment cash flows for a **reinsurance** contract held **when** those changes arise as a result of changes in estimates of fulfilment cash flows for an **underlying** direct insurance contract that are **recognised** immediately in P&L.

Onerous situation – treatment

- Recognises a loss on the group of underlying insurance contracts.
- Corresponding changes in estimates of cash flows from a group of reinsurance contracts held should **not adjust CSM**
- Gross reporting of the **net effect** of the loss and gain in P&L for the period, no offsetting (i.e. underlying and reinsurance must be presented separately)
- Reinsurance contracts held cannot be onerous, their net cost is taken immediately to P&L only when the coverage is for retrospective reinsurance. e.g. the reinsurance of liability for incurred claims

Reinsurance subsequent measurement

30% proportionate cover

	Insurance contract liability	Reinsurance contract asset
Fulfilment cash flows	300	-90
Contractual service margin	100	-25*
Immediately before the end of Year 1	400	-115

* Reinsurance cover is less costly than profit on under which would indicate a CSM of -30

Source: Illustrative Examples 12

Reinsurance subsequent measurement
Fulfilment cash flows increase 50 (not onerous)

	Insurance contract liability	Reinsurance contract asset
Fulfilment cash flows	350	-105
Contractual service margin	50	-10
At the end of Year 1	400	-115
P&L effect	0	0

Reinsurance subsequent measurement
Fulfilment cash flows increase 160 (become onerous)

	Insurance contract liability	Reinsurance contract asset
Fulfilment cash flows	460	-138
Contractual service margin	0	5
At the end of Year 1	460	-133
P&L effect	-60	18

Source: Illustrative Examples 12

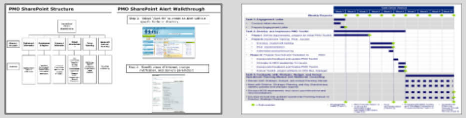
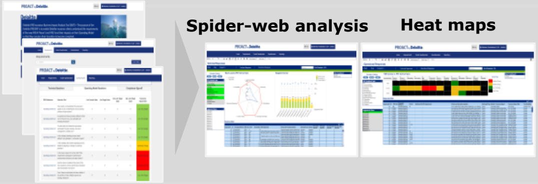
Reinsurance
Other requirements

Particularly referenced requirements include:

- Paragraph 69: PAA requirements similar to direct business
- Paragraph B109: An entity should <u>not</u> apply VFA to reinsurance contracts issued or reinsurance contracts held
- Disclosure

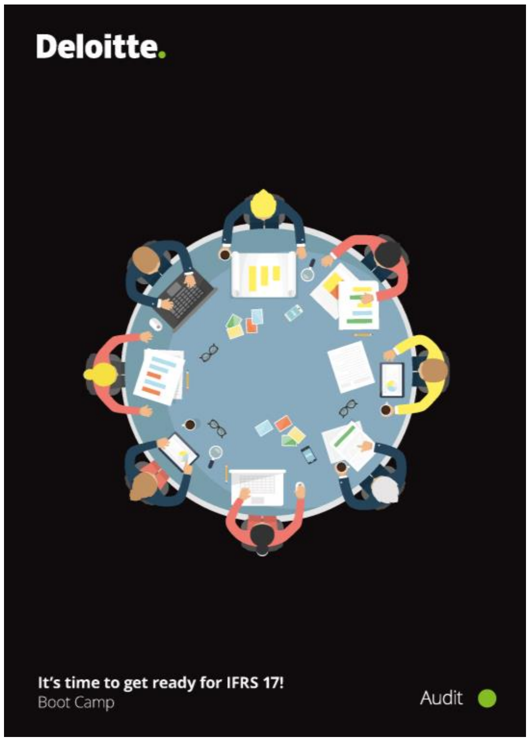
Deloitte products

Deloitte products

Product	Description	Sample Output
Planning	We have extensive knowledge of the impact on systems, data and processes and can assist you in designing a proper project organisation to engage the activities in a timely manner. We can help you mobilise, secure funding, plan and PMO.	
Training	We can help you with both initial training and specialist questions on IFRS 17 and interactions with current GAAP, Solvency II and your business model. Our two-day boot camp is an effective way to bring common understanding and insights to different business units in your organisation	
Business Impact Assessment Tool (BIAT)	We have analysed the IFRS 17 technical requirements against the operating model dimensions of insurers, and have captured this in our proprietary Business Impact Assessment Tool (BIAT), which contains several structured and interdependent questionnaires and checklists. The BIAT contains over 500 questions where all dimensions are tested.	
Financial Impact Assessment Tool (FIAT)	FIAT is an Excel-based cash flow model which generates outputs that will help you to: • Understand the impact on the assets and liabilities on your balance sheet • Understand the impact on future profits and how your profit profile may change over time • Understand the impact of different implementation choices • Highlight areas of high impacts to prioritise efforts.	

Deloitte IFRS 17 Boot camp

Two-day training



Background and purpose

The IASB has announced that it will issue the new Standard on insurance contracts in the first half of 2017 and has set 1 January 2021 as the effective date of IFRS 17 *Insurance Contracts*. This allows 3.5 years from the issuance of IFRS 17 to the mandatory effective date, and early IFRS 17 movers will benefit greatly from a structured approach.

The course is relevant for decision makers and key people working in an actuarial, risk, finance or accounting department. The purpose of the course is to give course participants an overview of the IFRS 17 Standard, to ensure a sufficient level of understanding and engagement within your organisation.

"By participating in Deloitte's Boot Camp, the employees acquire essential IFRS 17 skills and are ready to implement the new standard effectively."

Benefits

- The possibility of customising/extending the Boot Camp agenda by including company specific products and groupings in the discussions.
- The participants will after completing the course be able to assess the impact of IFRS 17 within their own organisation.
- The participants will after the course be able to participate effectively in financial and business impact analyses.
- An interactive learning experience, with the use of case studies makes the learning experience easier and more enjoyable.
- An opportunity to discuss company specific challenges in a confidential environment.
- Two tutors with a deep understanding of the new Standard, along with local accounting practice and Solvency II experience.

Example Agenda – Day 1

- Background and timeline of IFRS 17
- The multiple facets of insurance contract classification
- Measurement - building block approach (BBA)
  The objective is to quantify the notion of the insurer's "fulfilment of obligations under the contract".
- Risk adjustment
- Discount rate
- CSM amortisation, unlocking and revenue reporting
  Defers immediate recognition of profit and represents expected profit for selling an insurance contract.
- Premium Allocation Approach

Example Agenda – Day 2

- Other Comprehensive Income (OCI)
  Used to present the effect of changes in discount rates on the measurement of insurance contracts.
- Variable Fee Approach (VFA) and indirect participating contracts
  Modification to the general approach for valuing insurance contracts that vary with the return on underlying assets.
- Transition into IFRS 17
- Presentation and disclosures
  Profit and loss recognition differs substantially within IFRS 17.
- Interaction between IFRS 17 and Solvency II
- IFRS 9 in short
  New standard for financial instruments, same effective date as for IFRS 17 (for insurance companies).

Contact details

Thomas Ringsted
Deloitte Nordic IFRS Insurance Lead Partner
+45 27 14 20 44
tringsted@deloitte.dk

Henrik Persson
Senior manager, AFR audit
+46 70 080 33 46
hpersson@deloitte.se

Deloitte Insights into IFRS Insurance (i2ii)

www.deloitte.com/i2ii

Insurance Centre of Excellence:
insurancecentreofexc@deloitte.co.uk