
In brief

A look at current financial reporting issues

IFRS 17 marks a new epoch for insurance contracts accounting

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Issue

On 18 May 2017, the IASB finished its long-standing project to develop an accounting standard on insurance contracts and published IFRS 17, 'Insurance Contracts'. IFRS 17 replaces IFRS 4, which currently permits a wide variety of practices. IFRS 17 will fundamentally change the accounting by all entities that issue insurance contracts and investment contracts with discretionary participation features.

The standard applies to annual periods beginning on or after 1 January 2021, with earlier application permitted if IFRS 15, 'Revenue from Contracts with Customers', and IFRS 9, 'Financial Instruments', are also applied.

Key provisions

Scope

IFRS 17 applies to insurance contracts issued, to all reinsurance contracts and to investment contracts with discretionary participating features if an entity also issues insurance contracts. For fixed-fee service contracts whose primary purpose is the provision of services, entities have an accounting policy choice to account for them in accordance with either IFRS 17 or IFRS 15. Similar to the position under IFRS 4, financial guarantee contracts are allowed to be within the scope of IFRS 17 if the entity previously asserted explicitly that it regarded them as insurance contracts. Insurance contracts (other than reinsurance) where the entity is a policyholder are not within the scope of IFRS 17.

Embedded derivatives and distinct investment and service components should be 'unbundled' and accounted for separately in accordance with the related IFRSs. Voluntary unbundling of other components is prohibited.

The measurement model

IFRS 17 requires a current measurement model, where estimates are remeasured in each reporting period. The measurement is based on the building blocks of discounted, probability-weighted cash flows, a risk adjustment and a contractual service margin ('CSM') representing the unearned profit of the contract. A simplified premium allocation approach is permitted for the liability for the remaining coverage if it provides a measurement that is not materially different from the general model or if the coverage period is one year or less. However, claims incurred will need to be measured based on the building blocks of discounted, risk-adjusted, probability-weighted cash flows.

For presentation and measurement, entities are required at initial recognition to disaggregate a portfolio (that is, contracts that are subject to similar risks and managed together as a single pool) into three groups of contracts: onerous; no significant risk of becoming onerous; and remaining contracts. Contracts that are issued more than one year apart should not be in the same group.

Changes in cash flows related to future services should be recognised against the CSM. The CSM cannot be negative, so changes in future cash flows that are greater



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than the remaining CSM are recognised in profit or loss. Interest is accreted on the CSM at rates locked in at initial recognition of a contract. To reflect the service provided, the CSM is released to profit or loss in each period on the basis of passage of time.

Under IFRS 17, entities have an accounting policy choice to recognise the impact of changes in discount rates and other assumptions that relate to financial risks either in profit or loss or in other comprehensive income ('OCI'). The OCI option for insurance liabilities reduces some volatility in profit or loss for insurers where financial assets are measured at amortised cost or fair value through OCI under IFRS 9.

The variable-fee approach is required for insurance contracts that specify a link between payments to the policyholder and the returns on underlying items, such as some 'participating', 'with profits' and 'unit linked' contracts. The interest on the CSM for such contracts is accreted implicitly through adjusting the CSM for the change in the variable fee. The variable fee represents the entity's share of the fair value of the underlying items less amounts payable to policyholders that do not vary based on the underlying items. The CSM is also adjusted for the time value of money and the effect of changes in financial risks not arising from underlying items such as options and guarantees.

Requirements in IFRS 17 align the presentation of revenue with other industries. Revenue is allocated to periods in proportion to the value of expected coverage and other services that the insurer provides in the period, and claims are presented when incurred. Investment components (that is, amounts repaid to policyholders even if the insured event does not occur) are excluded from revenue and claims.

Insurers are required to disclose information about amounts, judgements and risks arising from insurance contracts. The disclosure requirements are more detailed than currently required under IFRS 4.

On transition to IFRS 17, an entity applies IFRS 17 retrospectively to groups of insurance contracts, unless it is impracticable. In this case, the entity is permitted to choose between a modified retrospective approach and the fair value approach. In applying a modified retrospective approach, the entity achieves the closest outcome to retrospective application using reasonable and supportable information and choosing from a list of available simplifications. Alternatively, the CSM at transition can be based on fair value at transition. In practice, using different approaches to transition could result in significantly different outcomes that will drive profit recognised in future periods for contracts in force on transition.

Impact and insights

IFRS 17 will impact businesses well beyond the finance, actuarial and systems development areas (for example, product design and distribution, development of revised incentive and wider remuneration policies and reconfigured budgeting and forecasting methodologies feeding into business planning). There could also be an impact on the cash tax position and dividends, both on transition and going forward.

IFRS 17 might require more than three years to implement. Gap analysis and impact assessments to develop an implementation roadmap will enable entities to begin the detailed implementation project. A fundamental shift might be required in the way in which data is collected, stored and analysed, changing the emphasis from a prospective to a retrospective basis of analysis and introducing a more granular level of measurement and additional disclosures. Before the effective date, insurers will need to carefully consider their 'IFRS 17 story' for investors and analysts, as well as the key metrics that they will apply in the new world.



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