



IFRS 17

Insurance Contracts

ARC meeting 20 April 2017

Martin Edelmann, IASB Board Member

The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board (the Board) or IFRS Foundation.

Copyright © IFRS Foundation. All rights reserved

- Industry concern 1: Onerous contracts at inception
 - Industry concern 2: Annual cohorts
 - Industry concern 3: Mandatory restatement of one period of comparatives on transition
-
- 1 and 2 relate to the level of aggregation

Level of aggregation

- Does not affect the measurement of the cash flows
- Affects the measurement of unearned profit (contractual service margin (CSM)) because:
 - losses from onerous contracts are recognised immediately in profit or loss
 - unearned profit is recognised in profit or loss over the period the service earned
- A portfolio could have contracts with significantly different profitability
 - IFRS 17 requires a portfolio to be divided into 1-3 groups

Level of aggregation

- Grouping averages the unearned profit and the losses of contracts within each group and allocates that average to profit or loss based on the services provided
- Consequently, level of aggregation affects:
 - information about losses from contracts onerous at inception
 - information about losses when previously profitable groups of contracts become onerous
 - the timing of recognition of profits from profitable contracts

1. Onerous contract assessment

- Industry concern: drafting would not allow a ‘top-down’ approach for assessing onerous contracts at inception
- IASB Board response: IFRS 17 permits a ‘top-down’ approach in assessing contracts onerous at inception
 - An entity can measure a set of contracts if reasonable and supportable information indicates that those contracts are all onerous or none are onerous. The entity is not required to check if each individual contract in that group is onerous
 - An entity cannot offset profitable with onerous contracts when there is reasonable and supportable information

1. Examples on the level of aggregation

- The examples in this presentation are simplified to illustrate specific aspects on the level of aggregation
- Example 1: 100 ‘identical’ contracts are written with a probability that 5 of the policyholders will claim
 - IFRS 17: 100 contracts are a group
 - An entity does not treat the 5 contracts as a separate group

1. Examples on the level of aggregation

- Example 2: Company issues 500 contracts. There is information that 200 ‘identical’ contracts are under priced, but the company expects that the 300 profitable ‘identical’ contracts will cover losses (or possible losses) on the 200 under-priced contracts
 - IFRS 17: Group 1—losses on the 200 under-priced contracts are recognised immediately
 - IFRS 17: Group 2—profits on 300 contracts recognised over the coverage period

1. Onerous contract assessment

- Industry recommendation: That the conditional presumption applicable for the premium allocation approach is applied to all insurance contracts
- IASB Board response: The simpler premium allocation approach is permitted for only simple, short-term contracts
 - The difference in recognising losses immediately and gains over the coverage period is less significant for short-term contracts
 - Accordingly, for longer-term contracts, that simplification is not appropriate because those contracts are more complex and have more risks

2. Annual cohorts requirement

- Industry recommendation: that the requirement that a group shall not include contracts issued more than one year apart (ie annual cohort) be removed
- IASB Board response:
 - The annual cohort requirement will provide useful trend information about profitability of contracts written in different periods
 - The profit of a group of contracts will be recognised in the period the service is provided—and not averaged with profits of other groups and recognised over the period of which service is provided for all the groups

2. Background: annual cohorts

- The Board's objective is to provide information on the trend in profitability of contracts written at different times on a timely basis
- One of the conditions for grouping in the testing draft (summer 2016) is that the contracts have similar profitability
- Feedback indicated that the 'similar profitability' criterion was interpreted as requiring excessively large number of groups
- The Board revised the level of aggregation requirements. In particular,
 - removed the 'similar profitability' criterion
 - unearned profit is allocated using coverage units, coverage units averages the contracts' profitability within the group
- But, to fulfil the Board's objective, 'annual cohorts' is a necessary criterion

2. Annual cohorts affect the timing of recognition of profit (or loss)

- Suppose a company writes the following contracts:
 - In Years 1-2, 5-year contracts with premiums of 100 and unearned profit (CSM) of 10
 - In Years 3-4, 5-year contracts with premiums of 100 and CSM of 2
- Without the annual cohort requirement:
 - The CSM of contracts written in years 1 and 2 would persist beyond year 6; because the profitability of the contracts written in years 1-2 is averaged with the lower profitability of contracts written in years 3-4 and recognised over years 3-9
 - Information about the change in profitability would not be reflected in financial statements on a timely basis

2. Annual cohorts affects the timing of losses

- Suppose in Year 1, an insurer writes:
 - 5-year contracts with premiums of 100 and CSM of 20
- Suppose in Year 3:
 - the group of contracts written in Year 1 are now onerous, loss of 2, due to changes in expectations in this period
 - the insurer writes 5-year contracts with premiums of 100 and CSM of 5
- Without the annual cohort requirement:
 - the insurer would not recognise the losses in profit or loss for contracts that are no longer profitable (eg Year 1 contracts) by grouping those contracts with newly written profitable contracts (eg Year 3 contracts)
 - the CSM of 3 ($=5-2$) is recognised in Years 3-8

3. Mandatory restatement of one period of comparatives on transition

- IFRS 17 requires the restatement of one comparative period (ie 2020) when IFRS 17 is first applied in the 2021 annual financial statements
- Industry recommendation: restatement of 2020 comparative period should be optional

3. Mandatory restatement of one period of comparatives on transition

- IASB response:
 - IFRS 17 is a fundamental change to amounts presented in profit or loss and balance sheet from various, existing requirements
 - Trend information is important for users of financial statements to understand that change
 - Restatement of one comparative period provides information on the change
 - Transition reliefs are provided to reduce the cost of providing IFRS 17 information, including comparative information

Contact us

15

Keep up to date



@IFRSFoundation



IFRS Foundation



www.ifrs.org



IFRS Foundation

Comment on our work



go.ifrs.org/comment