



Insurance Contracts

First Impressions: 2020 edition

IFRS 17

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Counting down to transition

Embracing change – Seizing opportunity

Among the new and updated requirements in the revised version of IFRS 17 *Insurance Contracts* is the new effective date of 1 January 2023. For many, there is still a lot of work to do.

Implementing a major new standard inevitably presents challenges. For insurers, there is the substantial effort of installing and testing new or upgraded systems, processes and controls, and co-ordinating between functions such as finance, actuarial and information technology. For investors and other users of the financial statements, there is the need to understand what is going to change and how it will change.

But there are also opportunities. A change of this magnitude is a chance to develop a fresh perspective – to gain new insights from data and how it's reported and for insurers to enhance the efficiency of their processes.

IFRS 17 brings new levels of transparency, giving users more insight into an insurer's financial health than ever before. Investors will be able to draw on more information on the profitability of new and in-force business: the separate presentation of underwriting and financial results will provide added transparency about sources of profits and quality of earnings. The new standard will drive greater consistency globally, allowing for increased comparability between insurers.

With IFRS 17, the temporary exemption from IFRS 9 *Financial Instruments* will soon expire for insurers. The implementation of IFRS 9 will allow insurers' investment activities to be compared with other entities' once again.

This *First Impressions: 2020 edition* provides an overview of the revised standard and how it may affect insurers' financial statements. The  indicates areas that have been amended in the revised version of IFRS 17.

We hope it will help you to meet the challenges of implementing this complex standard, and to understand where some potential opportunities might lie to ensure that you and your business will be well prepared for 2023.

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1 IFRS 17 at a glance

IFRS 17 introduces a new measurement model for insurance contracts and becomes effective in 2023.

1.1 Key facts

Topic	
Scope	<ul style="list-style-type: none"> – Similar to IFRS 4 <i>Insurance Contracts</i> with some new requirements, including as to the border with financial instruments accounting
The general measurement model – Initial recognition	<ul style="list-style-type: none"> – On initial recognition, the liability of a group of insurance contracts is made up of the following components. <ul style="list-style-type: none"> - The fulfilment cash flows, which represent the risk-adjusted present value of the entity's rights and obligations to the policyholders, comprising: <ul style="list-style-type: none"> – estimates of expected cash flows; – discounting; and – a risk adjustment for non-financial risk. - The contractual service margin (CSM), which represents the unearned profit that the entity will recognise as it provides services over the coverage period. - The CSM includes the effects of cash flows occurring on the date of recognition and the effects of derecognising any assets or liabilities previously recognised before the group of contracts was recognised – e.g. asset for insurance acquisition cash flows paid. – When the above results in a net outflow on initial recognition, the total net outflow is recognised as an immediate loss.
The general measurement model – Subsequent measurement	<ul style="list-style-type: none"> – Subsequent to initial recognition, the liability of a group of insurance contracts comprises the liability for remaining coverage (fulfilment cash flows for future services – e.g. insured events that have not occurred – and the CSM) and the liability for incurred claims (fulfilment cash flows for claims and expenses already incurred but not yet paid). – The fulfilment cash flows are remeasured at each reporting date to reflect current estimates. Generally, the changes in the fulfilment cash flows are treated in a number of ways: <ul style="list-style-type: none"> - changes in the effect of the time value of money and financial risk are reflected in the statement of financial performance; - changes related to past and current service are recognised in profit or loss; and - changes related to future service adjust the CSM.

Topic	
A simplified approach and modifications to the general measurement model	<ul style="list-style-type: none"> – When certain criteria are met, a simplified approach – the premium allocation approach (PAA) – may be used. – The general measurement model is modified when it is applied to: <ul style="list-style-type: none"> - reinsurance contracts held; - direct participating contracts; and - investment contracts with discretionary participation features (DPFs).
Presentation requirements	<ul style="list-style-type: none"> – Insurance revenue is derived from the changes in the liability for remaining coverage for each reporting period that relate to services for which the entity expects to receive consideration. – Investment components and refunds of premiums are excluded from insurance revenue and insurance service expenses. – The insurance service result is presented separately from insurance finance income or expense. – Entities can choose to disaggregate insurance finance income or expense between profit or loss and other comprehensive income (OCI).
Effective date	<ul style="list-style-type: none"> – Accounting periods beginning on or after 1 January 2023 – Early adoption is permitted if IFRS 9 is also applied at the date of adoption or earlier.
Transition	<ul style="list-style-type: none"> – Full retrospective application is required to restate prior-year comparatives and to determine the CSM at transition – however, if it is impracticable, then a modified retrospective approach and a fair value approach are available. – There is a limited ability to redesignate some financial assets on initial application of IFRS 17.

1.2

Key impacts

New perspectives for analysts and users. IFRS 17 will change the way analysts interpret and compare companies. Greater global comparability and increased transparency will give users more insight into an insurer's financial health.

Volatility in financial results and equity. The effect of using current market discount rates will vary, but it is likely to be significant, resulting in greater volatility in financial results and equity. Accounting mismatches may be reduced and economic mismatches between assets and liabilities will become more visible. Insurers may wish to revisit the design of their products and their investment allocation.

Key financial metrics will change. Premium volumes will no longer drive the 'top line' in the performance statement because investment components and cash received can no longer be considered to be revenue. The new measurement model may result in profits being released over significantly different patterns for some contracts.

Clearer picture of performance. The impact that financial risks and investment income have on an insurer's results will be presented separately from insurance performance, providing a clearer picture of profit drivers.

Life sector impacts. The use of current discount rates and the end of 'locked-in' assumptions will almost certainly lead to significant accounting changes for many life insurers. The burden and time value of minimum interest guarantees will become more transparent.

Non-life sector impacts. Non-life insurers will need to navigate the criteria to qualify for the PAA in order to retain a familiar accounting model. However, the discounting of the liability for incurred claims may be a significant change from current practice.

New routines. Identifying and accounting for onerous contracts and presenting an explicit margin for non-financial risk will gain a new prominence for both life and non-life insurers. Accounting for reinsurance ceded is separate from direct insurance contracts and will have significant challenges.

Communication challenges. New presentation and disclosure requirements will change the way performance is communicated. Entities will need to redesign KPIs and educate internal and external users.

New data, systems, process and control demands. The need for new data, and updated systems and processes will be challenging given the long time-horizon over which many insurers operate and the legacy systems that many still use. Entities will also have to develop controls around any system and process changes and develop or upgrade existing controls for business as usual after transition.

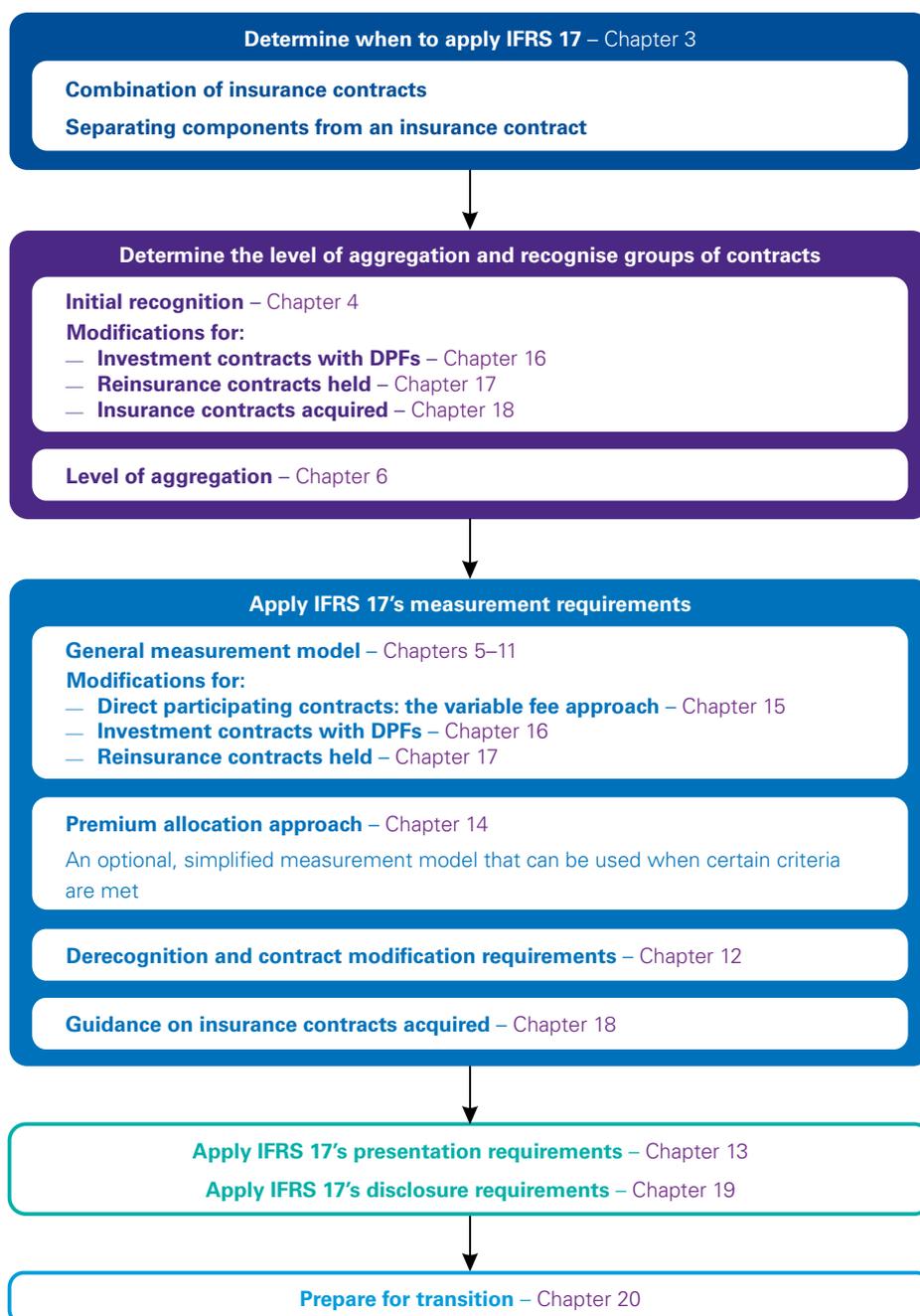
Scarce resources under pressure. The human talent required to operationalise IFRS 17's requirements and translate theory into practice is significant.

Opportunities for streamlining and greater efficiency. Change brings opportunity. Some insurers see opportunities to streamline through greater use of shared service centres and centralisation.

Watch out for second-order impacts. IFRS 17 is triggering a second wave of activity by certain local tax authorities and prudential regulators. Implementation plans need to be flexible to accommodate these second-order effects.

2

Overview



3

When to apply IFRS 17

The scope is similar to IFRS 4. However, the requirements for separating non-insurance components from insurance contracts are significantly different from IFRS 4.

3.1

Scope

Similar to IFRS 4, IFRS 17 focuses on types of contracts, rather than types of entities. Therefore, it applies to all entities, whether they are regulated as insurance entities or not.

Insurers are subject to the requirements of other applicable standards for products (or components of products) that are not insurance contracts. For example, IFRS 15 *Revenue from Contracts with Customers* applies to fees and related costs on investment management contracts.

IFRS 17.3

An entity generally applies IFRS 17 to contracts that meet the definition of an insurance contract, as follows:

- insurance or reinsurance contracts that it issues; and
- reinsurance contracts that it holds.

However, there are some exceptions to this general principle, as outlined below.

Exception	Further details	Section
Investment contracts with DPFs	Investment contracts issued with DPFs do not meet the definition of an insurance contract, but are accounted for under IFRS 17 if the entity also issues insurance contracts.	3.1.2
Scope exemptions	<p>There are some contracts that could meet the insurance contract definition but are not in the scope of IFRS 17 – e.g. product warranties or residual value guarantees issued by a manufacturer, dealer or retailer.</p> <p>There is an exemption for certain credit cards and similar products that provide insurance coverage.</p>	3.1.3
Fixed-fee service contracts	Fixed-fee service contracts meet the definition of an insurance contract but may be accounted for under IFRS 15 in certain circumstances.	3.1.4
Financial guarantee contracts	Some credit-related guarantees and credit insurance contracts meet the definition of an insurance contract but may be accounted for under the financial instruments standards.	3.1.5





Exception	Further details	Section
Contracts that limit compensation to policyholder's obligation	Entities can apply either IFRS 17 or IFRS 9 to some insurance contracts that limit the compensation for insured events to the amount otherwise required to settle the policyholder's obligation.	3.1.6

3.1.1

IFRS 17.A

Insurance contracts – Definition

An insurance contract is “a contract under which one party – the issuer – accepts ‘significant insurance risk’ from another party – the policyholder.”

If a “specified uncertain future event – the insured event – adversely affects the policyholder”, then the policyholder has a right to obtain compensation from the issuer under the contract.



This definition raises several further questions, which are discussed in this section.

- What form can an insurance arrangement take?
- What is ‘insurance risk’?
- When is insurance risk ‘significant’?
- What is an ‘uncertain future event’?
- What is an ‘adverse effect’ on the policyholder?
- What happens when the level of insurance risk changes?
- When do reinsurance contracts meet the definition?

3.1.1.1

IFRS 17.2

What form can an insurance arrangement take?

The relationship between an insurer and the policyholder is established by a contract. A ‘contract’ is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability is a matter of law. Contracts can be written, oral or implied by the entity’s customary business practices.

IFRS 17.B27(b)

Contracts that have the legal form of insurance but pass all significant insurance risk back to the policyholder are not insurance contracts. For example, some financial reinsurance contracts pass all significant insurance risk back to the cedant by adjusting payments made by the cedant as a direct result of insured losses. Some group contracts also have similar features. These contracts are normally financial instruments or service arrangements and are accounted for under IFRS 9 or IFRS 15, as applicable.

IFRS 17.B27(c)

Insurance contracts that are issued by an entity to another entity in its group are insurance contracts in the individual or separate financial statements of the issuing entity. However, in the group's consolidated financial statements there is no insurance contract.

IFRS 17.B16

Mutual entities generally accept significant insurance risk from individual policyholders and then pool these risks. Although policyholders of contracts issued by mutual entities bear the pooled risks of the contracts in their role as owners, the mutual entity is considered to be a separate entity that has accepted insurance risk.

IFRS 17.9

A set or series of insurance contracts may have the same or related counterparties and achieve or be designed to achieve, an overall commercial effect. In this situation, it might be necessary to treat the set or series as a whole in order to report the substance of the contracts. This could be the case, for example, if one contract completely negates the rights and obligations arising from another contract entered into at the same time and with the same counterparty.

3.1.1.2

What is insurance risk?

IFRS 17.A, B11

'Insurance risk' is a risk, other than financial risk, that is transferred from the policyholder to the issuer of a contract. The issuer accepts a risk from the policyholder that the policyholder was already exposed to.

The following table includes examples of insurance risk and financial risk.

IFRS 17.A, B26, B29

Insurance risk	Financial risk
Risks such as: <ul style="list-style-type: none"> – death or survival – injury – illness – disability – loss of property due to damage or theft – failure of a debtor to make a payment when it is due – a possible change in a non-financial variable that is specific to a party to the contract 	The risk of a possible future change in one or more of: <ul style="list-style-type: none"> – interest rates – financial instrument prices – commodity prices – currency exchange rates – indices of prices or rates – credit ratings or credit indices – any other variable, except for a non-financial variable that is specific to a party to the contract

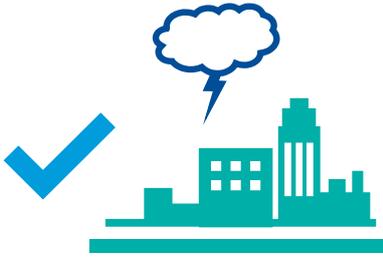
IFRS 17.B7, B9

A contract is not an insurance contract if it exposes the issuer only to financial risk but not to significant insurance risk. However, contracts that expose the issuer to both financial risk and significant insurance risk are insurance contracts.

For example, a life insurance contract with a guaranteed minimum rate of return (financial risk) and a promised death benefit that may significantly exceed the policyholder's account balance (insurance risk) is an insurance contract.

IFRS 17.B8

The risk of a possible future change in a non-financial variable is an insurance risk only if that variable is specific to a party to the contract.

	
<p>Contracts covering weather events or earthquakes that cause damage to an asset of the insured party can meet the definition of an insurance contract</p>	<p>Contracts covering such damage in a particular region – e.g. weather or catastrophe indices – are not specific to a party to the contract, so they do not meet the definition</p>

3.1.1.2.1

IFRS 17.B8, B26(j)–26(k), B27(g)–B27(h)

Catastrophe-type non-financial variables

The occurrence (or non-occurrence) of a weather event or earthquake that damages or destroys an asset of the insured party is insurance risk. Therefore, contracts that cover these risks can meet the definition of an insurance contract.

Insurance swaps and other contracts that trigger a payment depending on changes in climatic, geological or other physical variables that are specific to a party to the contract can also meet the definition.

Weather or catastrophe indices – e.g. an index of earthquake losses in a particular region – are not specific to a party to the contract, so they do not meet the definition of insurance risk.

Contracts commonly referred to as ‘catastrophe bonds’, which provide for reduced payments of principal, interest or both – depending on climatic, geological or other physical variables whose effects are not specific to a party to the contract – are not insurance contracts.



Investing in certain catastrophe bonds and subordinated loans

A loan or bond is an insurance contract if it provides for forgiveness of, or a significant reduction in, principal or interest payments when a specified uncertain event occurs that adversely affects the debtor as a result of a pre-existing non-financial risk. Examples are not limited to natural catastrophes and include:

- a loan for which the full balance is forgiven on the death of the debtor; or
- a catastrophe bond under which payments are reduced significantly if the specified triggering event includes a condition that the issuer of the bond suffers a loss.

If this type of instrument is considered to be an insurance contract, then the bondholder – i.e. the investor in the instrument – or lender is the party that issues the insurance contract.

IFRS 4 provided flexibility in accounting for these investments that are, in effect, insurance contracts, because entities could apply their previous accounting practice. However, because these instruments are in the scope of IFRS 17, entities – including non-insurers – will need to apply a new accounting model to them. There may be some exceptions to this if the loan limits the compensation for the insured event to the amount otherwise required to settle the policyholder's obligation created by the contract; see 3.1.6.

3.1.1.2.2

IFRS 17.B8

Residual value guarantee-type non-financial variables

Contracts that cover the risk of changes in the fair value of a specific non-financial asset held by a party to the contract, reflecting changes in:

- the condition of the asset; and
- market prices,

can meet the definition of an insurance contract.

Those that cover only the risk of changes in market prices are not specific to the insured party and do not meet the definition. See also 3.1.3 on the scope exemption for residual value guarantees provided by a manufacturer, dealer or retailer, and a lessee's residual value guarantee embedded in a finance lease.



Residual value guarantees

If, for example, a contract issued by an insurer, rather than by a manufacturer, dealer or retailer:

- guarantees the residual value of a vehicle owned by the holder of the contract; and
- the amount payable under the guarantee will vary depending on the specific condition of the vehicle at the date of sale,

then the contract can meet the definition of an insurance contract.

If a similar contract requires the owner to restore the vehicle to a specified condition before disposal in the market place – such that the guarantee is of a market value that does not depend on the condition of the vehicle – then, in our view, the contract is not an insurance contract.

3.1.1.3

IFRS 17.B18–B21

When is insurance risk 'significant'?

Insurance risk is significant only if there is a scenario that has commercial substance in which, on a present value basis, there is a possibility that an issuer could:

- suffer a loss caused by the insured event; and
- pay significant additional amounts beyond what would be paid if the insured event had not occurred.

To have commercial substance, a scenario has to have a discernible effect on the economics of the transaction.

IFRS 17.B23

For example, life insurance contracts in which the amount paid on death is higher than on surrender or maturity can meet the definition of an insurance contract, unless the amount contingent on death is insignificant in all scenarios.

IFRS 17.B22

The significance of insurance risk is assessed on a contract-by-contract basis. As a result, even if there is a minimal probability of significant losses for a portfolio or group of contracts, insurance risk can be significant for an individual contract.

IFRS 17.B18

In addition, insurance risk can be significant even if the insured event is extremely unlikely to occur, or if the expected probability-weighted present value of the contingent cash flows is a small proportion of the expected probability-weighted present value of all of the remaining contractual cash flows.

IFRS 17.B20

When determining whether significant additional amounts will be paid in any scenario, an entity needs to consider the impact of the time value of money, using a discount rate as discussed in [Chapter 8](#).

If a contract requires an entity to make payments earlier than expected on the occurrence of an insured event and the cash value of those payments is not adjusted to reflect the time value of money, then there may be scenarios in which additional amounts are payable on a present value basis.

For similar reasons, a contract that delays timely reimbursement to the policyholder can eliminate significant insurance risk, because the delayed payments may have a lower present value.

IFRS 17.B20



Example 1 – Fixed death benefit

Fact pattern

Entity X issues a whole-life insurance contract under which it will provide a fixed death benefit when the policyholder dies, with no expiry date for the cover.

Analysis

Although it is certain that the policyholder will die, the date of death is uncertain. If an individual policyholder dies earlier than expected, then X has to make a payment earlier than was expected. Significant insurance risk could arise because the payment of the fixed death benefit is not adjusted for the time value of money.

IFRS 17B18, B21



Unit-linked savings contracts containing guaranteed minimum death and/or survival benefits

Unit-linked savings contracts and insurance risk

Some unit-linked savings contracts contain a guaranteed minimum benefit that is payable, either on the death of the policyholder or on maturity of the contract, if it is higher than the bid value of the units (the unit value) on death or maturity.

If the contract is surrendered, then the policyholder receives cash for the value of the units surrendered (less any surrender penalties). Therefore, the benefit payable on death or maturity may exceed the benefit paid on surrender of the contract.

If there is a possible scenario, in present value terms, in which the guaranteed minimum benefit is larger than the unit value payable on surrender (before consideration of surrender penalties), then the contract transfers insurance risk. This is because additional amounts are payable by the insurer, over and above the unit value.

Significant insurance risk

For these types of contracts, the issuer determines whether insurance risk is significant, taking into account both the possibility of the insured event occurring and the possibility of the unit value being significantly below the guaranteed amount when the insured event occurs. If this insurance risk is significant, then the contract is classified as an insurance contract.

Factors to consider in this assessment include:

- the term of the contract;
- the volatility of the unit value; and
- the level of the guaranteed minimum benefit compared with the initial investment.

It might be more difficult for the issuer to conclude that the contract is an insurance contract if the contract term is relatively short, the level of the guaranteed minimum benefit is relatively low compared with the initial investment or the volatility of the unit value is relatively low.

3.1.1.4

IFRS 17B3

What is an 'uncertain future event'?

Transfer of uncertainty (or risk) is the essence of an insurance contract. Therefore, for a contract to be an insurance contract, uncertainty is required at the contract's inception over at least one of the following:

- the probability that an insured event will occur;
- when it will occur; or
- how much the insurer will need to pay if it occurs.

IFRS 17B5

Some insurance contracts cover events that have already occurred but for which the ultimate pay-out is still uncertain – e.g. insurance contracts that provide coverage against adverse development of existing claims. In these cases, the insured event is the determination of the ultimate cost of the claim.

3.1.1.5

IFRS 17.B12–B13

IFRS 17.7(g), B14–B15

What is an 'adverse effect' on the policyholder?

The definition of an insurance contract requires an adverse effect on the policyholder as a precondition for compensation.

'Lapse risk' or 'persistence risk' is the risk that the policyholder will cancel the contract at a time other than when the issuer expected when pricing the contract. This risk is not considered an insurance risk because the payment to the policyholder is not contingent on an uncertain future event that adversely affects the policyholder.

The risk of unexpected increases in the administrative costs associated with servicing a contract is known as 'expense risk'. This risk does not include unexpected costs associated with the insured event and is not an insurance risk, because an unexpected change in these expenses does not adversely affect the policyholder.

However, if the issuer of a contract:

- is exposed to lapse, persistence or expense risk; and
- mitigates those risks by using a second contract to transfer all or part of those risks to another entity,

then the second contract exposes the other entity to insurance risk.

Therefore, the second contract can meet the definition of an insurance contract from the perspective of the other entity. However, from the perspective of the entity that used this contract to transfer the risk to the other insurer, this second contract is a contract of direct insurance that it holds (the entity is a policyholder and the contract is not a reinsurance contract held) and therefore the entity does not apply IFRS 17 to it (see 3.1.3).

3.1.1.6

IFRS 17.B24–B25

What happens when the level of insurance risk changes?

Some contracts do not transfer any insurance risk to the issuer at inception, but do transfer it later. These contracts are not considered to be an insurance contract until the risk transfer occurs.

For example, a contract may provide a specified investment return and also specify that the policyholder can elect to receive a life-contingent annuity at then-current annuity rates determined by the entity when the annuity option is exercised. This will not be an insurance contract until the election is made, because it does not transfer insurance risk until that point. For a similar contract to be an insurance contract at the outset, the annuity rate or the determination basis needs to be specified at inception of the contract (unless the insurance risk is insignificant).

A contract that meets the definition of an insurance contract remains an insurance contract until all rights and obligations expire (or it is derecognised because its terms are modified – see Chapter 12).

3.1.1.7

IFRS 17.B19

When do reinsurance contracts meet the definition?

Reinsurance contracts are also insurance contracts that need to meet the definition of an insurance contract. However, even if a reinsurance contract does not expose the reinsurer to the possibility of a significant loss, it is still deemed to transfer significant insurance risk if it transfers substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts to the reinsurer.

3.1.2

IFRS 17.3, 71, A, B27(a)

Investment contracts with DPFs

An investment contract with DPFs is a financial instrument that provides an investor with a contractual right to receive, as a supplement to an amount not subject to the discretion of the issuer, additional amounts that are:

- expected to be a significant portion of the total contractual benefits;
- contractually paid at the discretion of the issuer (regarding timing or amount); and
- contractually based on returns from a specified pool of contracts or a type of contract, realised and/or unrealised investment returns on a specified pool of assets held by the issuer, or the profit or loss of the entity or fund that issues the contract.

Because these contracts do not transfer insurance risk, they do not meet the definition of an insurance contract. However, they are in the scope of IFRS 17 if they are issued by an entity that also issues insurance contracts.



IFRS 17 vs IFRS 4 – Are investment contracts with DPFs in scope?

Currently, all entities are required to apply IFRS 4 to financial instruments with DPFs, regardless of whether they also issue insurance contracts. Under IFRS 17, the scope is limited to investment contracts with DPFs issued by entities that *also* issue insurance contracts. This helps to avoid scope creep, and to avoid creating opportunities to structure contracts artificially to qualify for insurance contract accounting. However, because these contracts are generally issued by insurance entities, the scope change will not affect many entities.

Investment contracts with DPFs issued by entities that do not issue insurance contracts are in the scope of IAS 32 *Financial Instruments: Presentation*, IFRS 7 *Financial Instruments: Disclosures* and IFRS 9.



Identifying DPFs and assessing their significance

Consistent with IFRS 4, for an investment contract to be included in the scope of IFRS 17, it is necessary to identify the existence of DPFs and assess their significance compared with the total contractual benefits. This might require detailed analysis to identify the amounts that are part of the discretionary and non-discretionary benefit.

When an entity that issues insurance contracts concludes that it also issues investment contracts with DPFs, the investment contract is in the scope of IFRS 17. The key advantage of treating these contracts as insurance contracts is consistency, because they typically share similar characteristics with insurance contracts that specify a link to returns on underlying items – e.g. long maturities, recurring premiums and high acquisition costs – and sometimes they are linked to the same pool of underlying items.

3.1.3

Scope exemptions

IFRS 17 does not apply to the following contracts. The issuer accounts for these contracts under the accounting standard(s) listed.

	Not in scope	Applicable accounting standard(s), and additional explanation/ examples
IFRS 17.7(a), B26(g), BC89–BC90	Warranties issued directly by a manufacturer, dealer or retailer in connection with a sale of its goods or services to a customer	<ul style="list-style-type: none"> – IFRS 15 – IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> <p>Warranties issued directly by a manufacturer, dealer or retailer to cover any defects that were undetected in manufacturing a product, or provide coverage for the customer for faults that arise after the product is transferred to them, are not in the scope of IFRS 17 even though they may meet the insurance contract definition.</p> <p>Warranties issued by a third party for goods sold by a manufacturer, dealer or retailer are in the scope of IFRS 17 – e.g. extended car warranty cover issued by an entity that is not a manufacturer, dealer or retailer. However, if such a contract is considered a fixed-fee service contract, then it may instead be accounted for under IFRS 15 (see 3.1.4 below).</p>
IFRS 17.7(b)	Employers' assets and liabilities under employee benefit plans	<ul style="list-style-type: none"> – IAS 19 <i>Employee Benefits</i> – IFRS 2 <i>Share-based Payment</i>
IFRS 17.7(b)	Retirement benefit obligations reported by defined benefit retirement plans	<ul style="list-style-type: none"> – IAS 26 <i>Accounting and Reporting by Retirement Benefit Plans</i>
IFRS 17.7(c)	Contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item	<ul style="list-style-type: none"> – IFRS 15 – IFRS 16 <i>Leases</i> – IAS 38 <i>Intangible Assets</i> <p>Examples include some licence fees, royalties, variable lease payments and similar items.</p>

	Not in scope	Applicable accounting standard(s), and additional explanation/ examples
<i>IFRS 17.7(d)</i>	Residual value guarantees provided by a manufacturer, dealer or retailer, and a lessee's residual value guarantee embedded in a lease	<ul style="list-style-type: none"> – IFRS 15 – IFRS 16
<i>IFRS 17.7(e)</i>	Financial guarantee contracts – unless the issuer meets certain requirements and makes an irrevocable election to apply IFRS 17 to the contract	<ul style="list-style-type: none"> – IAS 32, IFRS 7 and IFRS 9 <p>See 3.1.5 for a detailed discussion.</p>
<i>IFRS 17.7(f)</i>	Contingent consideration payable or receivable in a business combination	<ul style="list-style-type: none"> – IFRS 3 <i>Business Combinations</i>
<i>IFRS 17.7(g)</i>	Insurance contracts in which the entity is the policyholder, unless these contracts are reinsurance contracts held by the entity	<ul style="list-style-type: none"> – IAS 37 addresses the accounting for reimbursement rights arising from insurance contracts for expenditure required to settle a provision. – IAS 16 <i>Property, Plant and Equipment</i> addresses some aspects of reimbursement under an insurance contract for the impairment or loss of property, plant and equipment.
<i>IFRS 17.7(h)</i>	 Credit card and similar contracts that meet the definition of an insurance contract unless the entity reflects an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer	<p>Financial instruments arising from such contracts are in the scope of IFRS 9. In line with the requirements of IFRS 9, if the entity provides the insurance coverage to the customer as a contractual term of the contract, then it separates the insurance coverage component and applies IFRS 17 to it. The entity applies applicable IFRS® Standards to the other components of the contract, which might include:</p> <ul style="list-style-type: none"> – IFRS 15; or – IAS 37

3.1.4

IFRS 17.BC95

IFRS 17.B6

IFRS 17.8

Fixed-fee service contracts

A fixed-fee service contract is a contract under which the level of service depends on an uncertain event. These contracts meet the definition of an insurance contract.

The fact that the issuer provides goods or services to the policyholder instead of cash to settle its obligation to compensate the policyholder for insured events does not preclude a contract from being an insurance contract.

IFRS 17 permits, but does not require, an entity to apply IFRS 15 to fixed-fee service contracts if the contracts' primary purpose is the provision of a service. This choice is available for contracts that meet the following conditions.

- The contract price set by the entity does not reflect an assessment of the risk associated with an individual customer.
- The contract compensates customers by providing a service, rather than by making cash payments.
- The insurance risk that is transferred by the contract arises primarily from uncertainty about the frequency of the customer's use of the service, rather than about its cost.

If a fixed-fee service contract has the characteristics specified above, then an entity may exclude it from the scope of IFRS 17 and account for it like other service contracts with customers. This choice is made on a contract-by-contract basis and is irrevocable for each contract.

IFRS 17.BC95

An example of such a contract is a fixed-fee maintenance contract in which the service provider agrees to repair specified equipment after a malfunction for a fixed fee. This is because the malfunction of the equipment adversely affects its owner and it is uncertain whether a particular machine will break down within the coverage period. Another example is a fixed-fee contract for car breakdown services in which the service provider agrees to provide roadside assistance to repair or tow the car.



Scoping criteria for fixed-fee service contracts

IFRS 17 permits some types of fixed-fee service contracts to be excluded from its scope and accounted for under IFRS 15, giving preparers a choice of whether to account for them under IFRS 17 or IFRS 15. If they are accounted for under IFRS 17, then many of these contracts may qualify for the PAA (see [Chapter 14](#)).

3.1.5

IFRS 9.A, IFRS 17.B29

IFRS 17.B27(f), B29–B30

Financial guarantee contracts

A financial guarantee contract grants the policyholder the right to be reimbursed by the issuer for a loss that it incurs when a specified debtor fails to make payment when it is due under the terms of a debt instrument. These types of financial guarantees usually meet the definition of an insurance contract.

Conversely, a credit-related contract that is structured to pay the holder even if the holder has not incurred a loss on an underlying debt does not meet the definition of an insurance contract because it does not transfer significant insurance risk.

IFRS 17.7(e), B29

An entity is not required to apply IFRS 17 to an issuer's rights and obligations under financial guarantee contracts that meet the definition of an insurance contract. However, IFRS 17 permits the issuer of these contracts to account for them under IFRS 17 if it has:

- previously asserted explicitly that it regards such contracts as insurance contracts; and
- accounted for them on that basis.

This election may be made on a contract-by-contract basis, but the election for each contract is irrevocable.

In all other cases, an issuer accounts for a financial guarantee contract in accordance with the financial instruments standards.



What does 'previously asserted explicitly' mean in practice?

Companies should already know whether they have financial guarantee contracts like the ones described above, because the requirements of IFRS 17 do not change from those in IFRS 4 in this respect.

First-time adopters of IFRS Standards will have to consider all facts and circumstances when considering if they have previously asserted explicitly that they regard such contracts as insurance contracts.

For an insurer, it is likely to be clear from previous practice, contract documents and other such information whether issued financial guarantee contracts have been regarded and accounted for as insurance contracts.

3.1.6



Contracts that limit compensation to policyholder's obligation

IFRS 17.8A

Some contracts might meet the definition of an insurance contract but limit the compensation for insured events to the amount otherwise required to settle the policyholder's obligation created by the contract – e.g. loans with death waivers.

An entity can choose to apply IFRS 17 or IFRS 9 to these contracts. The choice is made for each portfolio of insurance contracts and is irrevocable.



IFRS 17 vs IFRS 4 – Scope assessment impacts

The definition of an insurance contract has not changed significantly from IFRS 4. However, non-insurers that issue contracts that meet this definition and are either required or choose to apply IFRS 17 will no longer be able to apply their pre-existing accounting policies under IFRS 4.

These entities might need to involve actuarial resources and change their systems, processes and controls.



This might be the case for:

- financial guarantee contracts for which an entity chooses to apply IFRS 17 (see 3.1.5); and
- fixed-fee service contracts that meet the definition of an insurance contract but do not meet the conditions to apply IFRS 15 instead of IFRS 17 (see 3.1.4).

The amendments made in 2020 that allow an exemption from IFRS 17 for contracts that limit compensation to settlement of the policyholder's obligation will permit investors in catastrophe bonds and lenders under products such as lifetime mortgages to apply IFRS 9 rather than IFRS 17 for financial assets that meet the criteria for exemption. The significant insurance risk included in the contractual cash flows of these assets suggests that they would fail the 'solely payments of principal and interest' (SPPI) test in IFRS 9 and would be accounted for at fair value through profit or loss (FVTPL).

Similarly, the limited mandatory exemption for credit cards and similar arrangements that meet the definition of an insurance contract means that issuers will not have to apply IFRS 17 to the whole contract if they do not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract. This will provide a significant benefit to banks that apply IFRS 9 to these financial instruments and have developed systems to implement the IFRS 9 expected credit loss model.

However, if the exemption applies and the insurance coverage is a contractual term of the financial instrument (e.g. it does not arise solely from statute or regulation), then IFRS 17 will need to be applied to the insurance component. This also means that the insurance coverage will not impact the SPPI test for any financial asset remaining in the scope of IFRS 9 and will help preserve banks' application of amortised cost accounting for credit card receivables. If the exemption does not apply, then IFRS 17 will apply to the whole contract unless there is a component that requires separation under the general separation principles discussed in [Section 3.2](#) below.

More generally, in addition, IFRS 17 clarifies that a present value basis is used to assess whether significant insurance risk exists, and the discount rates to use. This was not specified in IFRS 4 and, therefore, may result in changes to an entity's scope assessment.

3.2

Separating components from an insurance contract

IFRS 17.10, BC98

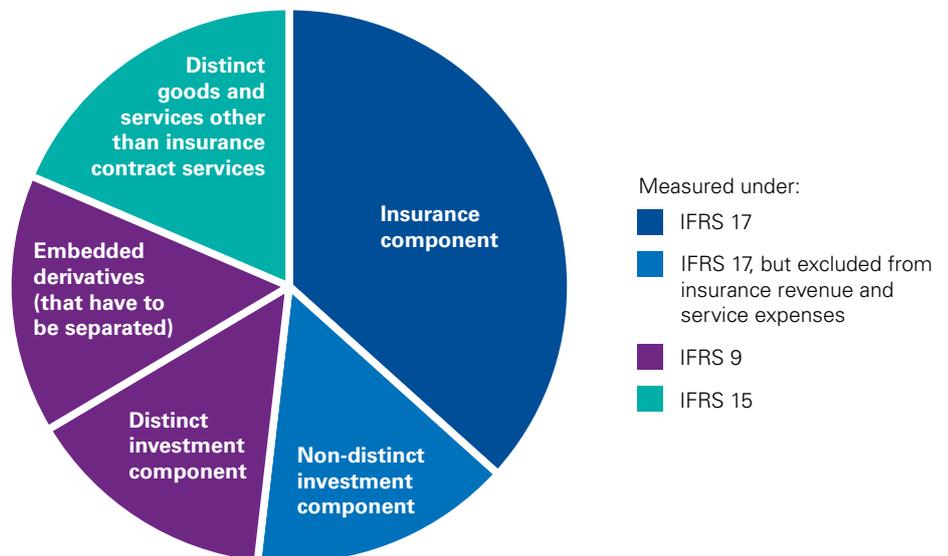
Insurance contracts create a bundle of rights and obligations that work together to generate a package of cash flows. Some types of insurance contracts only provide insurance coverage – e.g. most short-term non-life contracts.

However, many types of insurance contracts – e.g. unit-linked and other participating contracts – contain one or more components that would be in the scope of another standard if the entity accounted for them separately.

For example, some insurance contracts contain:

- *investment components*: e.g. pure deposits, such as financial instruments whereby an entity receives a specified sum and undertakes to repay that sum with interest;
- *good and service components*: e.g. services other than insurance contract services, such as pension administration, risk management services, asset management or custody services; and
- *embedded derivatives*: e.g. financial derivatives, such as interest rate options or options linked to an equity index.

The chart below shows which standards apply to each of these components. IFRS 17 makes a distinction between ‘distinct’ and ‘non-distinct’ components, which is explained in the next sections.



3.2.1

IFRS 17.11–12

IFRS 17.BC114

Identifying separate components

Investment components and goods and services components have to be separated from an insurance contract if they are distinct.

An entity is prohibited from applying IFRS 15 or IFRS 9 to components of an insurance contract in the scope of IFRS 17 when separation is not required. For example, some entities currently separate policy loans from the insurance contract to which they relate. If separation is not required because a component is not distinct, then separation is prohibited under IFRS 17.

3.2.1.1

IFRS 17.A

IFRS 17.11(b), B31–B32

Distinct and non-distinct investment components



An 'investment component' represents the amounts that an insurance contract requires the entity to repay in all circumstances.



An investment component is separated from the host insurance contract and accounted for in accordance with IFRS 9 if it is 'distinct', unless the investment component is an investment contract with DPFs (see 3.1.2).

The investment component is distinct if:

- it and the insurance component are not 'highly inter-related'; and
- a contract with equivalent terms is sold or could be sold separately in the same market or jurisdiction.

There is no need to undertake an exhaustive search to identify whether an investment component is sold separately; however, all information that is reasonably available should be considered.

Investment and insurance components are 'highly inter-related' if:

- a policyholder cannot benefit from one component without the other being present: e.g. the lapse or maturity of one component causes the lapse or maturity of the other; or
- the entity cannot measure one component without considering the other: e.g. when the value of one component varies according to the value of the other.

For example, in some unit-linked contracts the death benefit is the difference between a fixed amount and the value of a deposit component – therefore, the components could not be measured independently.

IFRS 17.B5

Investment components that are not distinct from the insurance contract are not separated from the insurance contract, but are accounted for together with the insurance component. However, receipts and payments from these investment components are excluded from insurance contract revenue and insurance service expenses presented in profit or loss (see [Chapter 13](#)).

3.2.1.2

IFRS 17.11(a)

IFRS 9.4.3.3

Embedded derivatives

An entity applies IFRS 9 to determine when an embedded derivative is separated from the host insurance contract and to account for the separated embedded derivative.

An embedded derivative is separated from the host insurance contract under IFRS 9 when:

- the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract; and

- the embedded derivative would not be an insurance contract as a stand-alone instrument – i.e. a separate financial instrument with the same terms as the embedded derivative would meet the definition of a derivative and would be in the scope of IFRS 9.

IFRS 9.4.3.3, B4.3.5–B4.3.8

Determining whether an embedded derivative is closely related to the host contract requires consideration of the nature – i.e. the economic characteristics and risks – of the host contract and the nature of the underlying of the derivative. If the natures of both the underlying and the host contract are similar, then they are generally closely related.

An embedded derivative in an insurance contract is closely related to the host contract if it and the host insurance contract are so inter-dependent that an entity cannot measure the embedded derivative separately.

IFRS 17B10

Embedded derivatives can meet the definition of an insurance contract in certain circumstances. For example, when the related payment that is affected by the derivative is made when the insured event takes place – e.g. a life-contingent annuity in which the insurance risk is the policyholder’s survival – and the amount paid is linked to a cost of living index (the embedded derivative).

In this case, the embedded derivative also transfers insurance risk, because the number of payments to which the index applies depends on the policyholder’s survival – i.e. an uncertain future event. If the insurance risk being transferred is significant, then the embedded derivative is also an insurance contract and is not separated from the host contract.

IFRS 4.IG3–IG4

The following table includes examples based on the illustrative guidance included in IFRS 4, which has not been carried forward to IFRS 17. However, it may provide some insight into the application of the above requirements.

Type of embedded derivative	Example
<p>Embedded derivatives that are not separated because they are insurance contracts</p>	<ul style="list-style-type: none"> – Death benefit that is: <ul style="list-style-type: none"> - linked to equity prices payable only on death (not on surrender or maturity); or - the greater of the unit value of an investment and a guaranteed amount. – Option to take a life-contingent annuity at a guaranteed rate. – Minimum annuity payments, if the annuity payments are linked to investment returns and: <ul style="list-style-type: none"> - the guarantee relates only to life-contingent payments; or - the policyholder can elect to receive a life-contingent payment or a fixed amount of payments at predetermined terms.

Type of embedded derivative	Example
Embedded derivatives that are not separated because they are closely related to the insurance contract	<ul style="list-style-type: none"> – Minimum interest rate to be used in determining surrender or maturity value that is at or out of the money, and not leveraged. – Option to cancel a deposit component that triggers cancellation of the insurance component and that cannot be measured separately. – Minimum annuity payments, if the annuity payments are linked to investment returns and the policyholder can elect to receive a life-contingent payment or a fixed amount of payments at predetermined terms.
Embedded derivatives that have to be separated and accounted for under IFRS 9	<ul style="list-style-type: none"> – Minimum interest rate to be used in determining a surrender or maturity value that is in the money when it is issued or leveraged (the embedded guarantee is not life-contingent). – Equity-linked return that is available on surrender or maturity and not life-contingent. – Persistency bonus paid at maturity in cash and not life-contingent.

IFRS 4.IG3–IG4



IFRS 17 vs IFRS 4 – Accounting for embedded derivatives

Under IFRS 17, unlike under IFRS 4, an entity cannot have a policy of separating embedded derivatives from an insurance contract that do not meet the criteria for separation under IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9, and accounting for them separately.

Conversely, IFRS 17 does not permit an entity to avoid separation under IAS 39 or IFRS 9 by having a policy of accounting for the whole of an insurance contract at FVTPL.

Because neither policy choice is widely applied, this change is unlikely to have a significant impact.

In addition, IFRS 4 contained an exception to the requirements in IAS 39 and IFRS 9 for a policyholder’s option to surrender an insurance contract for a fixed amount. This exception has not been carried forward to IFRS 17. Instead, the entity applies the requirements of IFRS 9 to decide whether the surrender feature qualifies as an embedded derivative and whether it should be separated.

Given that the value of a typical fixed-price surrender option and the host insurance contract are likely to be inter-dependent, it is likely that this change in requirements will have little impact in practice.

3.2.1.3

IFRS 17.12, B33–B34

Distinct goods and services other than insurance contract services components

A promise to provide goods or services other than insurance contract services is distinct, and is separated from the insurance contract, if the policyholder can benefit from the goods or services either:

- on their own; or
- with other resources that are readily available to the policyholder: i.e. resources that were already obtained or are sold separately by the entity or any other entity.



‘Insurance contract services’ are the following services that an entity provides to a policyholder of an insurance contract:

- coverage for an insured event;
- for insurance contracts without direct participation features (see Chapter 15), the generation of an investment-return service for the policyholder, if applicable; and
- for insurance contracts with direct participation features (see Chapter 15), the management of underlying items on behalf of the policyholder, if applicable.

Activities that the entity has to undertake to fulfil the contract are not considered for separation if the entity does not transfer a good or a service to the policyholder as those activities occur.

IFRS 17.12, B35

However, goods or services other than insurance contract services are not distinct, and are accounted for together with the insurance component, if:

- the cash flows and risks associated with the good or service are highly inter-related with the cash flows and risks of the insurance component; and
- the entity ‘provides a significant service of integrating the good or service with the insurance components’.

IFRS 17.IE42–IE50



Example 2 – Separating components from a life insurance contract with an account balance

Fact pattern

A life insurance contract with an account balance has the following terms.

- *Initial premium*: The policyholder pays a premium of 1,000 at contract inception.
- *Account balance*: The account balance varies over the contract life as follows.
 - It increases if annual voluntary amounts are paid by the policyholder.
 - It increases or decreases by investment returns from specified assets.
 - It decreases when fees are charged by the entity.

- *Maturity*: The contract matures on the earlier of the policyholder's death or cancellation of the contract. The pay-out comprises:
 - a death benefit of 5,000 and the account balance, if the policyholder has died; or
 - the account balance, if the policy is cancelled.

Another financial institution sells an investment product comparable to the account balance, but without the insurance coverage.

Analysis

Separating the account balance

The fact that a comparable investment product is sold by another financial institution indicates that the components may be distinct. However, the insurance and investment components are highly inter-related because the right to death benefits provided by the insurance cover either lapses or matures at the same time as the account balance.

As a result, the account balance is not considered distinct and is not separated from the insurance contract.

Separating the asset management component

The asset management activities are not distinct and are not separated from the insurance contract because they are part of the activities that the entity has to undertake to fulfil the contract, and the entity does not transfer a good or a service other than insurance contract services to the policyholder because it performs those activities.

See paragraphs IE51–IE55 of IFRS 17 for another example that illustrates these considerations.

IFRS 17.BC99–BC100



Expected impacts of separation requirements

The IFRS 17 separation criteria are intended to improve transparency because the accounting for:

- separated non-insurance components will be more comparable to similar, separate contracts; and
- risks undertaken by entities in different businesses or industries may be more comparable.

However, there are limitations on separating non-insurance components that are consistent with these objectives. If the cash flows of the components are inter-dependent, then separating them may be arbitrary and could result in complex and non-comparable accounting.

The 'highly inter-related' concept may result in limited separation of investment components, because it is unusual:

- for there not to be an inter-dependence between the values of the insurance and investment components of a contract; or
- for one component to be able to lapse or mature without the other component also lapsing or maturing.



Investment component excluded from insurance revenue and insurance service expenses

Non-distinct investment components are excluded from insurance revenue and insurance service expenses in the statement of profit or loss.

'Investment components' are the amounts that the entity is required to repay to the policyholders or their beneficiaries in all circumstances, regardless of whether an insured event occurs. Amounts such as some explicit account balances, some no claims bonuses, cash surrender values of whole-life contracts and other cash flows under endowment or annuity contracts may need to be considered for this purpose. See [Chapter 12](#) for further discussion of the issue and its practical implications.

3.2.3

IFRS 17.12–13, BC111–BC113

Allocating components

An entity attributes cash flows to a distinct investment component or to a separated embedded derivative on a stand-alone basis – i.e. it measures the investment component or embedded derivative as if it had issued that item as a separate contract.

After excluding the cash flows related to separate investment components and embedded derivatives, an entity applies IFRS 15 to separate promised goods or services other than insurance contract services from the insurance component and, on initial recognition, to attribute:

- cash inflows between the insurance component and any promise to transfer distinct goods or services other than insurance contract services: this is done based on the stand-alone selling price of the components¹;
- cash outflows based on whether they relate directly to the insurance component or the promised goods or services; and
- any remaining cash outflows between the insurance component and any promised goods or services other than insurance contract services on a rational and systematic basis, reflecting the costs that the entity would expect to incur if it had issued that component as a separate contract.

An entity then applies IFRS 17 to all remaining components of the host insurance contract.

1. Any discounts and cross-subsidies are allocated to components proportionately or on the basis of observable evidence.

4

Initial recognition

There are several criteria to determine when an entity recognises a group of insurance contracts.

4.1 When to recognise a group of contracts

IFRS 17.25–26

An entity recognises a group of insurance contracts that it issues from the earliest of:

- the beginning of the coverage period of the group of contracts;
- the date when the first payment from a policyholder in the group becomes due; and
- for a group of onerous contracts, when the group becomes onerous, if facts and circumstances indicate that there is such a group (see [Chapter 11](#)).

IFRS 17.26

If there is no due date specified in the contract, then it is considered to be the date when the first payment is received from the policyholder.

IFRS 17.28



A group of contracts initially recognised in a reporting period only includes contracts that individually meet one of these three recognition criteria by the reporting date. New contracts are added to the group in subsequent reporting periods in which any new contracts are recognised.

For the interaction of the initial recognition requirements and the level of aggregation, see [Chapter 6](#).



Example 3 – Recognition of an insurance contract

Fact pattern

- Entity X is bound by the terms of an insurance contract at 1 June 2023.
- The coverage period of the insurance contract starts on 1 January 2024, which is also the premium due date.
- This example assumes that the group comprises only this contract.

Analysis

On 1 June 2023 and at each reporting date between 1 June 2023 and 31 December 2023 – i.e. the pre-coverage period – X assesses whether any facts or circumstances indicate that the group is onerous. If it is, then X recognises the group on the date when the group becomes onerous. If it is not, then X recognises the group on 1 January 2024.



Why the recognition date is important

The date on which an entity recognises a group of insurance contracts is particularly important for the following reasons.

- **Determining the CSM:** On initial recognition, the entity measures the fulfilment cash flows arising from a group of insurance contracts and determines the CSM, which is subsequently recognised in profit or loss over the coverage period (see [Chapter 10](#)).
- **Determining the discount rate on initial recognition:** This rate is used throughout the general measurement model and could also be applicable for the PAA (see [Chapter 14](#)). For contracts without direct participation features measured applying the general measurement model, this discount rate is used to:
 - accrete the interest on the CSM (see [Chapter 10](#));
 - measure the changes in fulfilment cash flows that adjust the CSM (see [Chapter 10](#)); and
 - depending on the circumstances, present the insurance finance income or expense recognised in profit or loss (see [Chapter 13](#)).
- The determination of the CSM on initial recognition and the discount rate on initial recognition are affected by the level of aggregation of contracts to form a group (see [Chapter 6](#)).

4.2

IFRS 17.28B–28D

Insurance acquisition cash flows

An entity:



- recognises an asset for any insurance acquisition cash flows relating to a group of existing or future insurance contracts that it pays (or for which a liability has been recognised under another standard) before the related group is recognised;

- derecognises that asset (or a portion of it) when the group of insurance contracts is recognised; and



- assesses the recoverability of the asset if facts and circumstances indicate that the asset may be impaired and recognises an impairment loss at each reporting date if it is impaired.

For further discussion about insurance acquisition cash flows, see [7.3.4](#).

IFRS 17.BC145



Insurance acquisition cash flows and initial recognition

For many insurance contracts, the main cash flows paid before initial recognition of a group of contracts are the insurance acquisition cash flows.

Recognising insurance acquisition cash flows paid as assets until the related group of insurance contracts has been recognised ensures that these cash flows are not recognised immediately as an expense.

This accounting treatment may appear similar to recognising the related insurance contracts from the date on which those insurance acquisition cash flows occur. However, in many cases the initial recognition requirements for the group will not have been met at that time. Therefore, there will be no need to determine the CSM until those requirements are met.

5

The general measurement model – Overview

IFRS 17.1

The new measurement model aims to provide relevant information about the expected cash flows and profitability of insurance contracts.

5.1

Introducing the model

IFRS 17.IN5, BC18

Insurance contracts may be highly complex bundles of inter-dependent rights and obligations and combine features of a financial instrument and features of a service contract. As a result, insurance contracts can provide their issuers with different sources of income – e.g. underwriting profit, fees from asset management services and financial income from spread business (when insurers earn a margin on invested assets) – often all within the same contract.

The general measurement model introduced by IFRS 17 provides a comprehensive and coherent framework that provides information reflecting the many different features of insurance contracts and the ways in which the issuers of insurance contracts earn income from them.

IFRS 17.24, 32, 38

Under IFRS 17, insurance contracts are aggregated into groups. The reason for this and the composition of these groups are explained in [Chapter 6](#).

When measuring a group of insurance contracts, IFRS 17 identifies two key components of the liability: the fulfilment cash flows and the CSM.

For profitable groups of contracts, the CSM has an equal and opposite value on initial recognition to the fulfilment cash flows, plus any cash flows arising from the group at or before that date. This is because the entire value of the contracts relates to services to be provided in the future and, therefore, profit to be earned in the future.

IFRS 17.40–42

After inception, the fulfilment cash flows are reassessed and remeasured at each reporting date, using current assumptions, identifying those changes that are part of insurance revenue, insurance service expense and insurance finance income or expense. The CSM is allocated to profit or loss as a component of revenue.

5.2

IFRS 17.32, 40, A

Initial measurement

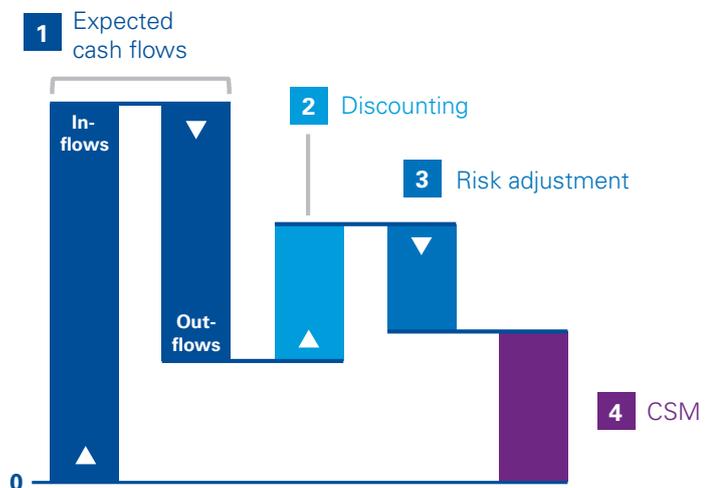
The liability (or asset) recognised for a group of insurance contracts is measured, on initial recognition and subsequently, as the sum of:

- the fulfilment cash flows, which are a risk-adjusted, explicit, unbiased and probability-weighted estimate of the present value of expected cash flows that will arise as the entity fulfils the contracts; and
- the CSM, which is the amount that represents the unearned profit that the entity will recognise in profit or loss as services are provided.

IFRS 17.32

The fulfilment cash flows consist of the following components.

- Estimates of **expected cash flows** that will arise as the entity fulfils the contracts (see [Chapter 7](#)).
- An adjustment to reflect the **time value of money** – i.e. **discounting** – and the financial risks related to the expected cash flows (to the extent that they are not already included in the estimates of expected cash flows) (see [Chapter 8](#)).
- An explicit **risk adjustment for non-financial risk**: to reflect the compensation that the entity requires for bearing the uncertainty about the amount and timing of cash flows that arise from non-financial risk (see [Chapter 9](#)).



Note: Depending on the facts and circumstances, the size and direction of the components could vary.

IFRS 17.32, 38

On initial recognition, for a group of profitable insurance contracts, the total of:

- the fulfilment cash flows;
- the derecognition of any asset recognised for insurance acquisition cash flows related to the group of contracts;
- the derecognition of any asset or liability previously recognised under other standards for cash flows related to the group of contracts; and
- any cash flows arising from the contracts in the group at that date,



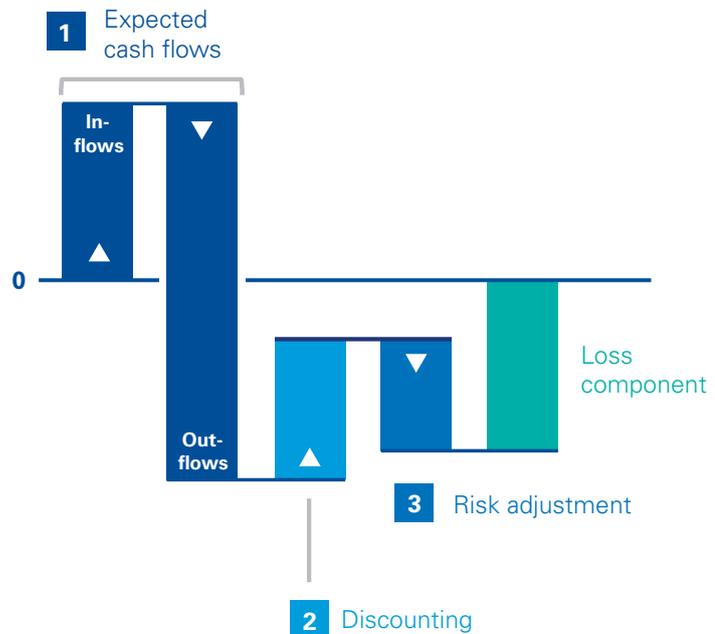
is a net cash inflow.

The CSM is the equal and opposite amount to that net inflow. It ensures that no income or expense arises from the group of contracts on initial recognition (see [Chapter 10](#)).

IFRS 17.47–49

If the total mentioned above is a net cash outflow, then the group of contracts is onerous. A loss is recognised immediately in the statement of financial performance for the entire net cash outflow.

This results in the carrying amount of the insurance liability for the group being equal to the fulfilment cash flows and the CSM of the group being zero (see [Chapter 11](#)). A loss component is created for this net cash outflow, which determines the amounts that are subsequently presented in profit or loss as reversals of losses on onerous groups. These amounts are not included in determining insurance revenue.



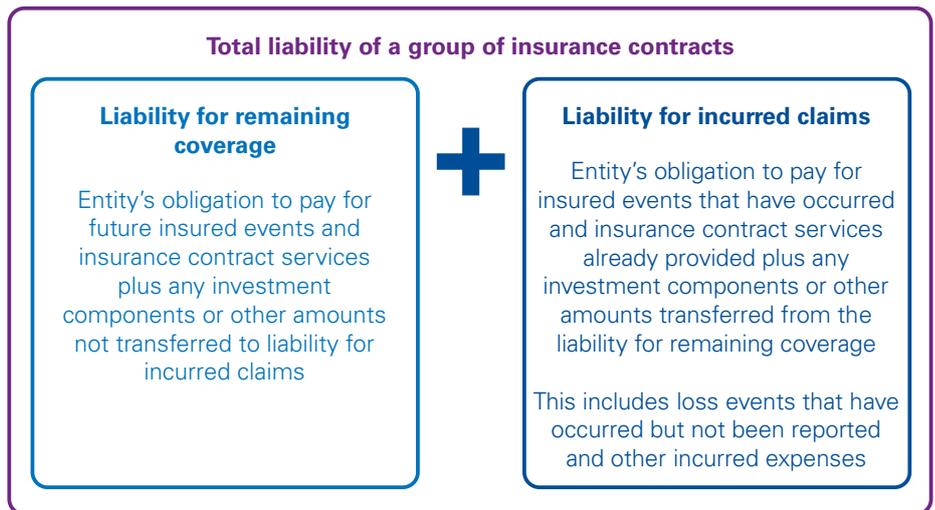
Note: Depending on the facts and circumstances, the size and direction of the components could vary.

5.3

IFRS 17.40, A, BC25

Subsequent measurement

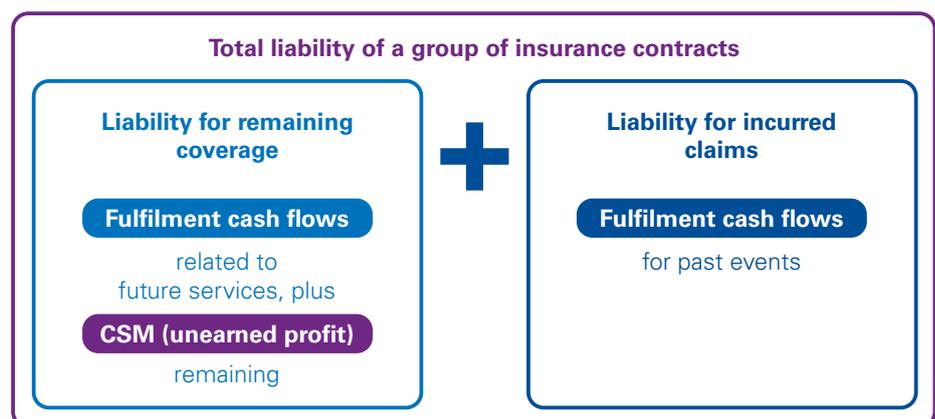
Subsequent to initial recognition, the total liability of a group of insurance contracts comprises the following.



The liability for remaining coverage is measured as the fulfilment cash flows that relate to coverage that will be provided under the contract in future periods, plus the remaining CSM.

The liability for incurred claims is measured as the fulfilment cash flows for claims and expenses already incurred but not yet paid.

Therefore, the components of the liability of a profitable group of insurance contracts are as follows.



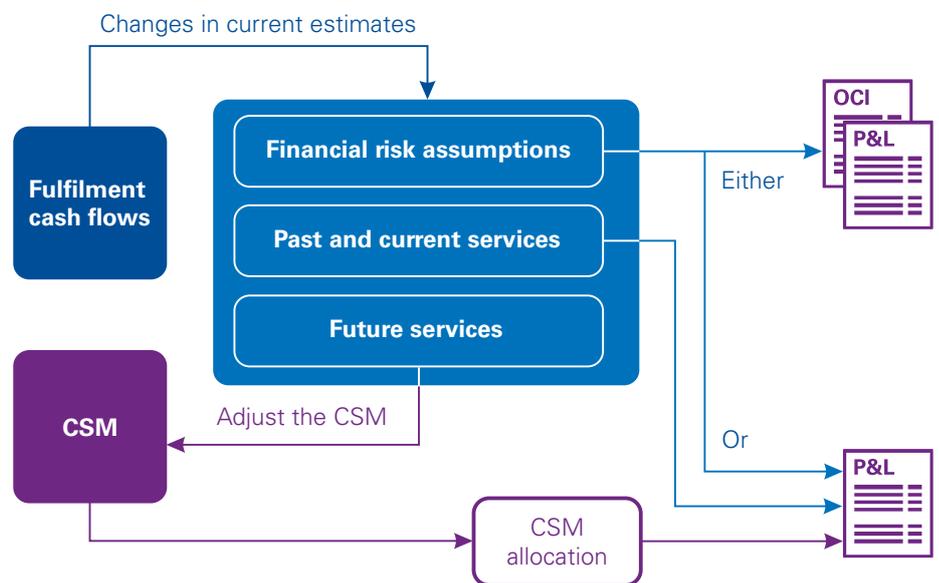
IFRS 17.43–44, BC22–BC24

The fulfilment cash flows are remeasured at each reporting date to reflect estimates based on current assumptions, applying the same requirements that apply to initial measurement. Changes in estimates of the fulfilment cash flows are reflected in either profit or loss or OCI – or, in some cases, they adjust the CSM – depending on their nature.

For contracts without direct participation features, interest is accreted on the carrying amount of the CSM during the reporting period using the discount rate applied on initial recognition to reflect the time value of money. The balance is allocated to profit or loss each reporting period to reflect the provision of insurance contract services in the period (see [Chapter 10](#)).

The CSM at each reporting date represents the profit in the group of contracts that has not yet been recognised in profit or loss because it relates to future service.

The diagram below illustrates, in a simplified manner, how the general measurement model operates for subsequent measurement.



5.4

Modifications to the general measurement model

IFRS 17.29

The general measurement model applies to all groups of insurance contracts in the scope of IFRS 17. However, simplifications or modifications apply to groups of:

- insurance contracts measured using the PAA (see [Chapter 14](#));
- investment contracts with DPFs (see [Chapter 16](#)); and
- reinsurance contracts held (see [Chapter 17](#)).

The way in which this model is applied to direct participating contracts, referred to as the 'variable fee approach', is explained in more detail in [Chapter 15](#).

6

Level of aggregation

Contracts are aggregated into groups.

6.1

Aggregating contracts into groups

IFRS 17.IN6, BC118

The aggregation of contracts into groups is required on initial recognition for all contracts in the scope of IFRS 17.

IFRS 17.BC119

The grouping of individual contracts under IFRS 17 is performed in a way that limits the offsetting of profitable contracts against onerous ones, having regard to how insurers manage and evaluate the performance of their business.

IFRS 17.24

The groups are established on initial recognition and are not reassessed subsequently.

IFRS 17.14

In determining the level of aggregation, an entity identifies portfolios of insurance contracts.

IFRS 17.16

An entity divides each portfolio into a minimum of:

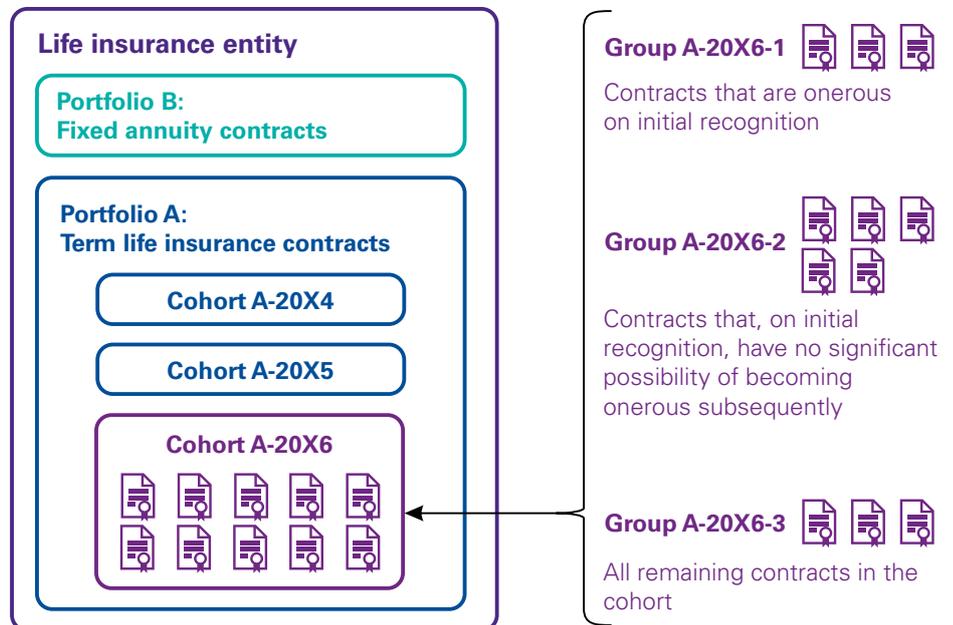
- a group of contracts that are onerous on initial recognition, if there are any (see [Chapter 11](#));
- a group of contracts that, on initial recognition, have no significant possibility of becoming onerous subsequently, if there are any; and
- a group of any remaining contracts in the portfolio.

IFRS 17.17, BC129

The objective is to identify contracts that fit into these groups at an individual contract level. This can be achieved by assessing a set of contracts if the entity can conclude, using reasonable and supportable information, that the contracts in the set will all be in the same group.

IFRS 17.22

An entity cannot include contracts issued more than one year apart in the same group. Therefore, each portfolio will be disaggregated into annual cohorts, or cohorts consisting of periods of less than one year. However, exceptions apply in certain circumstances on transition (see [Chapter 20](#)).



The process of aggregating contracts into groups can be described in the following steps. When applying these steps, or any other process for determining the groups, an entity cannot include contracts issued more than one year apart in the same group.

- *Step 1:* Identify portfolios of insurance contracts held by an entity.
- *Step 2:* Identify the contracts within each portfolio that are onerous on initial recognition.
- *Step 3:* Determine which of the remaining contracts have no significant possibility of becoming onerous subsequently.

6.2

IFRS 17.14, A

Identifying portfolios

Insurance contracts that are subject to similar risks and managed together are included within a portfolio, as defined under IFRS 17. Generally, contracts in the same product line are included within the same portfolio if they are managed together, and contracts in different product lines with dissimilar risks are included in different portfolios. For example, a set of single-premium fixed annuities is expected to be in a different portfolio from a set of term life contracts.



Identifying portfolios

Many entities have an existing structure to collate contracts for internal reporting and management purposes. Generally, entities will want to begin their IFRS 17 grouping assessment at this level. However, this is only possible if those collections of contracts meet the definition of a portfolio of insurance contracts under IFRS 17.

6.3

IFRS 17.17, BC129

Grouping onerous contracts

An entity may measure whether contracts are onerous on initial recognition for sets of contracts – i.e. higher than the individual contract level – if it has reasonable and supportable information to conclude that a set of contracts will all be in the same group. If it cannot support such a conclusion, then the entity determines the group by considering individual contracts.



Grouping onerous contracts

Generally, entities will be able to identify contracts that are potentially onerous on initial recognition. Entities usually price contracts in a way that generates a profit margin and when they do not, it is usually due to an identifiable reason – e.g. as a means of gaining market share when a new product is launched, due to competitive pressures or when regulation limits the premium that can be charged (see also [Section 6.5](#)). The contracts identified as potentially onerous are more likely to be onerous on initial recognition or have a significant possibility of becoming onerous subsequent to initial recognition.

After identifying contracts that are potentially onerous, an entity will need to identify those contracts, or sets of contracts, that are, in fact, onerous on initial recognition.

Identifying onerous contracts may be more challenging when, for example:

- individual contracts within a portfolio are priced differently from the standard tariff or pricing matrix used for that portfolio;
- a portfolio includes different underwriting practices that impact the profitability of individual contracts;
- contracts have unique features (e.g. different benefits); or
- contracts are marketed and sold through different distribution channels that impact the profitability of individual contracts.

In many cases, an entity is likely to consider whether it has reasonable and supportable information to conclude that a set of contracts will all be in the same group in order to complete the assessment at a higher level than the individual contracts. If this information does not exist, then it will measure the contracts individually to conclude whether they are onerous on initial recognition.

Once an entity has identified the individual contracts and sets of contracts that are onerous on initial recognition, those contracts will form one or more groups (see also [Sections 6.5](#) and [6.6](#) below). It will then estimate the fulfilment cash flows to determine the liability for remaining coverage and the loss that will be recognised in profit or loss for that group of contracts.

6.4

Grouping contracts that have no significant possibility of becoming onerous subsequently

IFRS 17.17, BC129

Consistent with the assessment for identifying whether contracts are onerous on initial recognition, an entity may assess whether contracts have no significant possibility of becoming onerous subsequently for sets of contracts – i.e. at a level higher than the individual contract level – if it has reasonable and supportable information to conclude that a set of contracts will all be in the same group. If it cannot support such a conclusion, then the entity determines the group by assessing individual contracts.

IFRS 17.19, BC130

An entity determines which contracts have no significant possibility of becoming onerous:

- by using information about estimates provided by the entity's internal reporting; and
- based on the likelihood of changes in assumptions that, if they occurred, would result in the contracts becoming onerous.

An entity does not disregard information provided by its internal reporting about the effects of changes in assumptions on different contracts and the possibility of them becoming onerous. However, it is not required to gather additional information beyond its internal reporting about the effects of changes in assumptions on different contracts.

IFRS 17.16

These contracts are aggregated into a second group. Once this group has been identified, the remaining contracts, if there are any, are included in a group of the remaining contracts in the portfolio.



Grouping contracts that have no significant possibility of becoming onerous subsequently

Entities will need to exercise judgement when determining what is considered to be a significant possibility of contracts becoming onerous in the future.

A contract will become onerous in subsequent periods if changes in assumptions about estimates of expected cash flows relating to future service exceed the remaining CSM.

Entities will need to identify those assumptions that are more sensitive to changes that could significantly reduce the CSM. They will also need to identify contracts with low levels of profitability on initial recognition because, for these contracts, smaller changes in assumptions could result in them becoming onerous.

Contracts that are expected to be highly profitable or profitable with relatively low sensitivity to changes in assumptions about their future performance over their remaining life are expected to have less risk of becoming onerous.

Changes in assumptions that could affect the overall economics of a contract might not result in an onerous contract under IFRS 17. For example, changes in interest rates for non-participating contracts do not affect the CSM. Therefore, these changes cannot cause the contract to become onerous.

The assessment is expected to be based on internal reporting and cannot ignore information about the effect of changes in assumptions on the possibility of contracts becoming onerous. This may be assessed through sensitivity analyses, focusing on product features and risks.

6.5

IFRS 17.20, BC133–BC134

Regulatory constraints

In some cases, law or regulation specifically constrains the entity's practical ability to set a different price or level of benefits for policyholders with different characteristics. If applying the level of aggregation requirements in [Sections 6.1–6.4](#) above would result in contracts within a portfolio falling into different groups only because of such constraints, then the entity may include those contracts in the same group.

This exemption applies only when there is a specific constraint imposed by a law or regulation. It is not available when an entity sets a price for contracts without distinguishing characteristics because:

- it thinks that using that characteristic may result in a law or regulation prohibiting the use of it in the future or because not considering it is likely to fulfil a public policy objective (sometimes referred to as 'self-regulation');
- law or regulation in a neighbouring jurisdiction explicitly prohibits the differentiation of that specific characteristic; or
- differentiating based on that characteristic may have a negative effect on the entity's brand and reputation.

This exemption cannot be applied by analogy to any other items.

IFRS 17.20



Regulatory constraints

This exemption effectively means that insurers do not need to recognise a group of onerous contracts if the *only* reason those contracts would be onerous under IFRS 17 is a specific regulatory constraint on determining the pricing or benefit levels in a way that reflects a difference in the characteristics of policyholders.

However, entities will still need to consider:

- whether other characteristics that are not constrained by law or regulation for the contracts in question are differentiated – these cannot be ignored in applying the level of aggregation requirements; and
- that contracts issued over a year apart have to be included in different groups (see [Section 6.6](#)).

6.6

IFRS 17.21

Further disaggregation

An entity is permitted to disaggregate its portfolios of insurance contracts into more than the three groups described above. For example, it can divide a portfolio into more groups of contracts that are:

- onerous on initial recognition, if the entity's internal reporting provides information at a more detailed level about the extent to which the contracts are onerous; and
- not onerous on initial recognition, if its internal reporting provides information that distinguishes between different levels of profitability or different possibilities of contracts becoming onerous after initial recognition.

It appears that an entity may use a basis other than profitability to further subdivide the minimum three groups because the standard permits further disaggregation and does not prescribe particular bases for doing so. For example, it may decide to further disaggregate based on type of coverage or currency or for operational reasons.

IFRS 17.22

An entity cannot include contracts issued more than one year apart in the same group. Therefore, each portfolio is disaggregated into annual cohorts, or cohorts of periods covering less than one year.

IFRS 17.23

A group of contracts might comprise only a single contract if that is the result of applying the principles discussed throughout this chapter.



Example 4 – Disaggregating groups

Entity H identifies its universal life insurance line of business as a portfolio of insurance contracts under IFRS 17. This portfolio is made up of two types of contracts.

- *Single-premium universal single life*: A life insurance contract that covers one individual policyholder and pays out a death benefit if they die during the coverage period.
- *Single-premium universal joint life*: A life insurance contract that covers two individual policyholders and pays out a death benefit if one of them dies during the coverage period, after which the policy ends.

For internal reporting, the data and information about this portfolio are segregated by the different types of contracts. Therefore, the information is provided – and available to be monitored and analysed – separately for each type of product.

The availability and use of product-specific data for internal management purposes results in the entity identifying which contracts are onerous on initial recognition, and their likelihood of becoming onerous after initial recognition.

Given that this data is readily available, H decides to perform its grouping assessment at a product level, instead of at a portfolio level.

Therefore, H determines that it will disaggregate each *product type* into annual cohorts of:

- contracts that are onerous on initial recognition, if there are any;
- contracts that, on initial recognition, have no significant possibility of becoming onerous, if there are any; and
- any remaining contracts in the portfolio.



Dividing a portfolio into annual cohorts

Limiting groups to contracts issued within one year or less:

- eliminates the possibility that an entity creates a CSM that is everlasting (i.e. an open group of new and existing business); and
- improves the transparency of profitability within an entity's set of financial statements, given that, generally, contracts with similar profitability will be grouped together and differences in profitability between contracts with different issuance dates will not be obscured.

Over the life of a portfolio of contracts, this will result in potentially many groups for the same portfolio of contracts. For example, a new portfolio of insurance contracts with a coverage period of 20 years may be made up of three groups during its first year in force. Assuming all else is equal, after 10 years the portfolio could potentially be made up of 30 groups of contracts.

Although the number of groups will increase as portfolios age, many entities currently track some aspect of their insurance contracts by time bucket, issue year or underwriting year. These entities may be able to leverage their existing capabilities in applying the requirements of IFRS 17 by group. For example, entities that currently group their business by issue year so that assumptions can be locked in on inception may be able to leverage this information when applying IFRS 17.

Grouping contracts based on annual cohorts will require entities to apply a fresh aggregation assessment for new business each year. Entities are expected to leverage their past grouping decisions and determine whether the division applied for the past year would also apply to the new business within that portfolio. When making this assessment, entities should consider assessing the differences between the current and the past year for pricing, benefits and guarantees offered, commissions and costs of distribution.

IFRS 17.22, BC138

**Level of aggregation – Interaction between contracts in different groups**

The requirement for groups to be limited to periods covering one year or less is based on the amounts to be reported, not necessarily the methodology used to arrive at those amounts. Therefore, it could be possible that an entity need not restrict groups in this way to achieve the same accounting outcome in some circumstances. For example, for contracts in groups that fully share risks with contracts in another group, the groups together will give the same results as a single, combined risk-sharing portfolio.

An entity that considers any deviations from the annual cohort requirements needs to demonstrate that any other measurement method applied will achieve the same accounting outcomes as applying the annual cohort requirements set out above.

6.6.1

IFRS 17.22, 28

Forming groups across reporting periods

When it is recognising a group of contracts in a reporting period, an entity includes only those contracts that individually meet one of the recognition criteria described in [Section 4.1](#) by the reporting date. However, it may include more contracts in a group after the reporting date, as long as the group is limited to contracts issued no more than a year apart.

**Annual cohorts and interim reporting**

The groups determined by an entity for the purposes of initial and subsequent measurement will be considered to be open groups for up to one year. Therefore, contracts or sets of contracts can be added to the group for a period no greater than one year.

Entities are permitted to close a group of contracts after a period of less than one year. So, some may consider closing a group on a more frequent than annual basis, for example, if they perform interim financial reporting, or measure and assess their performance based on quarterly groups in order to align the two and make it operationally simpler.

6.7

IFRS 17.24

Level of aggregation used for estimation

When measuring groups of contracts, an entity may estimate the fulfilment cash flows at a higher level of aggregation than a group, as long as it is able to include the appropriate fulfilment cash flows in the group that it is measuring by allocating these estimates to its groups of contracts.



Interaction between the level of measurement and the level of estimate development

An entity is permitted to determine the expected cash flows, discount rates and the risk adjustment for non-financial risk at a higher level than a group or portfolio, as long as it is able to allocate these estimates to groups of contracts, so that the appropriate fulfilment cash flows can be included in the measurement at the group level.

Many entities will determine the fulfilment cash flows of groups using estimates determined at a higher level than the group for some estimates, as similar methods are currently used. However, an entity using IFRS 17's groups for the first time may need to develop or update its allocation capabilities to be able to allocate the estimates to the group level, which may be more granular.



Level of aggregation – Impact on systems and processes

Entities will need to balance the benefits of aggregating large volumes of contract data, to the extent possible, against the complexity of establishing and maintaining aggregation methodologies that will comply with IFRS 17.

Some entities may already have actuarial valuation systems that support, or have the capability to support, measurements at a granular level, including, in some cases, the individual contract level. Consequently, it may be easier for these entities to determine the fulfilment cash flows at a level lower than the groups required by IFRS 17, and aggregate the measurement to a group level.

However, some entities may currently undertake policy valuations at an aggregated level that does not align with IFRS 17's grouping requirements. This could mean that significant system, data or valuation methodology changes are needed to support the measurement of the fulfilment cash flows.

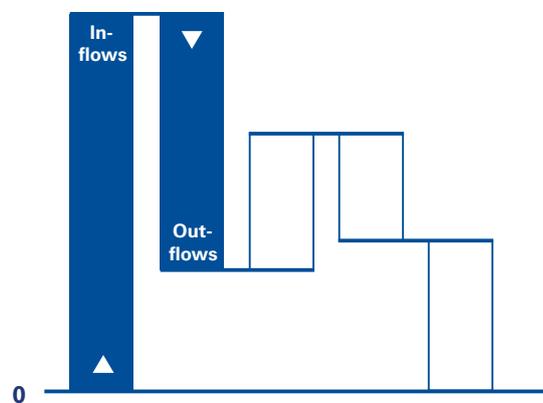
7

Expected cash flows

The first step in measuring a group of insurance contracts is to develop estimates of expected cash flows.

7.1

Estimating expected cash flows



1 Expected cash flows

Current, explicit, unbiased and probability-weighted estimates of expected cash flows within the boundary of each contract in the group.

IFRS 17.24, 33

IFRS 17 requires estimates of expected cash flows of a group of insurance contracts to:

- incorporate all reasonable and supportable information that is available without undue cost or effort about the amount, timing and uncertainty of those expected cash flows in an unbiased way;
- include all the expected cash flows within the boundary of each contract within the group;
- reflect the perspective of the entity, provided that, when relevant, the estimates are consistent with observable market prices; and
- be current and explicit.

The expected cash flows may be estimated at a higher level of aggregation and then allocated to groups of contracts.

These characteristics raise the following questions, which will be discussed in this chapter.

- How are different possible outcomes incorporated in the estimates?
- Which cash flows are included in the estimates?
- What information is used to make the estimates?

7.2 Incorporating different possible outcomes

IFRS 17.33, BC150

The requirement that estimates incorporate all reasonable and supportable information without undue cost or effort about the amount, timing and uncertainty of expected cash flows is achieved by estimating the expected value of the full range of possible outcomes – i.e. the probability-weighted mean. The risk adjustment for non-financial risk is included explicitly as a separate component of the measurement. For further information on the risk adjustment for non-financial risk, see [Chapter 9](#).

IFRS 17B38

The estimated present value of expected cash flows can be determined by:

- developing a range of scenarios that reflects the full range of possible outcomes, in which each scenario specifies:
 - the amount and timing of the cash flows for a particular outcome; and
 - the estimated probability of the outcome; and
- applying to each scenario:
 - discounting to determine the present value; and
 - a weighting based on the estimated probability of the outcome.

The objective is not to develop a most likely outcome or a more-likely-than-not outcome for expected cash flows.

IFRS 17B40

The scenarios developed exclude possible claims under possible future contracts and include unbiased estimates of the probability of catastrophic losses under existing contracts.

IFRS 17B39

When considering the full range of possible outcomes, the objective is to incorporate all reasonable and supportable information without undue cost or effort in an unbiased way, rather than to identify every possible scenario. It is not necessary in practice to generate explicit scenarios when determining the mean, if the resulting estimate is consistent with this objective.

Therefore, it could be appropriate to use a small number of parameters, or relatively simple modelling, when the measurement result is within an acceptable range of precision. However, more sophisticated, stochastic modelling is likely to be needed when the cash flows and their probabilities are driven by complex underlying factors – e.g. for cash flows generated by options inter-related with the insurance coverage.

IFRS 17B37

Information that is available from an entity's own information system is considered to be available without undue cost or effort.

IFRS 17.B62, BC152



Implications of using the expected present value model

Insurers build up cash flow projections for different products in different ways, which could be driven by several factors including:

- the complexity and diversity of the underlying factors;
- the diversity of valuation systems and models used; and
- whether the products were acquired in a business combination or a portfolio transfer.

An entity may need to review whether it has projections of cash flows that meet the objectives set out in [Section 7.1](#). Significant resources might be required to develop and implement new methodologies to develop cash flow projections or to modify existing projections to meet the objectives.

Model updates that may be required

If, for example, an entity currently uses a valuation model that attributes no value to:

- embedded options; or
- guarantees that have no intrinsic value because they are currently out of the money (from the perspective of the policyholder),

then the entity would need to adapt its model to measure both the intrinsic value and the time value of these options or guarantees. This is because the expected present value model considers *all* possible scenarios, which includes the possibility that the option will have an intrinsic value in the future.

Another example is a model that assumes a 100 percent probability that a policyholder will exercise a surrender option when the surrender value is higher than the present value of expected benefits. This model would need to be updated to reflect the possibility that the policyholder will not exercise the option.

Property and casualty contracts

Estimates of future payments on property and casualty contracts are currently based mainly on the projection of historical claims data. Although the goal of these estimates is to determine the loss provision and potentially a range of outcomes, they may not give the same results as calculating a mean using estimates of probabilities.

The use of these approaches might still be appropriate under IFRS 17 as long as the resulting estimate is consistent with the measurement objective. If such a method is used, then an entity will have to show that the measurement results in an answer that is within an acceptable range of precision. However, these approaches would be unlikely to meet the measurement objective if they include conservatism aimed at achieving a result that is more prudent than an unbiased probability-weighted mean, or ignore some uncertain future events covered by the contracts – e.g. significant natural catastrophes.

7.3 Cash flows that are included in the estimates

7.3.1 The importance of the contract boundary

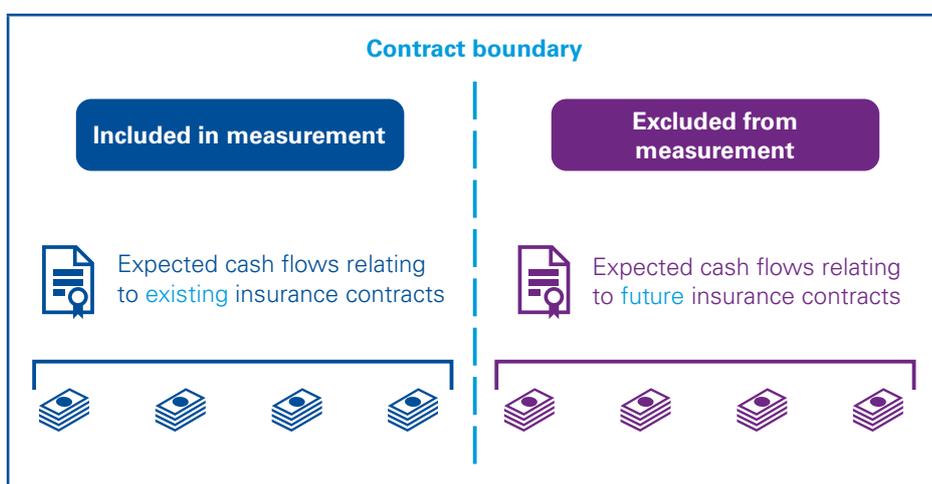
IFRS 17.33, B61

IFRS 17.35, BC164

The measurement of a group of insurance contracts includes all of the expected cash flows within the boundary of each contract within the group.

The contract boundary distinguishes the expected cash flows that relate to existing insurance contracts from those that relate to future insurance contracts.

The contract boundary is reassessed at each reporting date and, therefore, may change over time.



IFRS 17.34

Cash flows are within the contract boundary if they arise from substantive rights and obligations that exist during the reporting period in which the entity:

- can compel the policyholder to pay the premiums; or
- has a substantive obligation to provide the policyholder with insurance contract services.



This substantive obligation ends when:

- the entity has the ‘practical ability’ to reassess the risks of the particular policyholder and can set a price or level of benefits that fully reflects these reassessed risks; or
- both of the following conditions are met:
 - the entity has the ‘practical ability’ to reassess the risk of the portfolio of insurance contracts that contains the contract and can set a price or level of benefits that fully reflects the risk of that portfolio; and
 - the pricing of the premiums up to the reassessment date does not take into account the risks that relate to periods after the reassessment date.

IFRS 17.B64

An entity has the 'practical ability' to set a price at the renewal date, which fully reflects the risks in the contract from that date, when it is not restricted from:

- setting the same price as it would for a new contract issued on that date with the same characteristics as the existing contract;
- amending the benefits to be consistent with the price that it will charge; or
- setting a price for an individual contract that reflects overall changes in the risks in a portfolio of insurance contracts, even if the price set for each individual policyholder does not reflect the change in risk for that specific policyholder.

IFRS 17.2, B61

When determining the contract boundary, an entity considers its substantive rights and obligations – whether they arise from contract, law or regulation – and disregards terms that have no commercial substance.



Analysing the substance of a restriction on the entity's ability to reprice the contract

IFRS 17.BC161, BC164

When an entity has the practical ability to reassess the risks of an existing insurance contract but is restricted from repricing the contract to reflect this reassessment, the contract still binds the entity, and its related cash flows lie within the existing contract's boundary. However, if the restriction has no commercial substance, then the contract does not bind the entity.

Therefore, the substance of the restriction should be analysed to determine whether the contract binds the entity.

In some jurisdictions, repricing of renewals can be subject to regulatory review and/or approval, or can only be done within certain limitations. Entities will need to consider the substance of these restrictions carefully to conclude whether possible renewals are within the contract boundary.

This assessment is made at each reporting date. Therefore, new assessments of the effects of these restrictions can change the contract boundary over time.

An entity will need to establish processes to identify when there is a change to its previous assessment of the commercial substance of a restriction.



Implications for certain contracts

Life insurance contracts

Some life insurance contracts permit the insurer to reprice a portfolio of contracts after inception to reflect changes in risk – e.g. certain term life insurance contracts. Currently, most of these contracts are accounted for as long-duration contracts.

IFRS 17 may restrict the current contract boundary for these contracts. If it does, then an entity will have to revise its approach to generating cash flow projections to reflect the new contract boundary.

Other contracts may permit the policyholder to buy additional coverage, either at a price set out in the contract or at a price to be determined. If an insurance contract contains such features, then an entity will have to assess whether it creates a substantive obligation to provide the policyholder with insurance contract services and the related expected cash flows and coverage are within the contract boundary.

Health insurance contracts

Health insurance contracts may permit an entity to reprice a contract on the basis of the portfolio's experience – e.g. morbidity experience – but not permit the entity to reassess the risks related to the policyholder's health.

In this case, it might seem that the contract binds the entity by requiring it to provide coverage without being able to re-underwrite the contract. However, if the entity may set a new price for the contract that reflects overall changes in the risks in the portfolio of insurance contracts, then the substantive obligation to provide coverage might end from that point.

This means that the contract boundary for many health insurance contracts may not extend beyond the next repricing date.

7.3.2

IFRS 17.B65, BC168

Cash flows that are within the contract boundary

Cash flows within the boundary of an insurance contract are those that relate directly to the fulfilment of the contract, and include those over which the entity has discretion, including the following.

Cash flows	Examples
Premiums and any other costs specifically chargeable to the policyholder	<ul style="list-style-type: none"> – Premium adjustments – Instalment premiums – Any additional cash flows that result from those premiums
Payments to, or on behalf of, a policyholder	<ul style="list-style-type: none"> – Incurred claims that have not yet been paid – Incurred claims that have not yet been reported – Future claims – Payments that vary depending on returns on underlying items
Costs of providing benefits in kind	<ul style="list-style-type: none"> – Replacement of stolen articles
Payments in a fiduciary capacity to meet the policyholder's tax obligations	<ul style="list-style-type: none"> – Payment of death duties or inheritance tax

Cash flows	Examples
Potential cash inflows from recoveries on claims, as long as they have not been recognised as a separate asset	<ul style="list-style-type: none"> – Salvage and subrogation
Transaction-based taxes and levies that arise directly from existing insurance contracts or are attributable to them	<ul style="list-style-type: none"> – Premium taxes – Value-added taxes and goods and services taxes – Fire service levies – Guarantee fund assessments
Payment to, or on behalf of, a policyholder resulting from derivatives that are not separated from the contract	<ul style="list-style-type: none"> – Options and guarantees embedded in the contract
Insurance acquisition cash flows attributable to the portfolio of contracts	<ul style="list-style-type: none"> – See 7.3.4
Claim handling costs – investigating, processing and resolving claims	<ul style="list-style-type: none"> – Legal and loss adjusters' fees – Internal costs of investigating claims and processing claims payments
Policy administration and maintenance costs	<ul style="list-style-type: none"> – Costs of billing premiums – Costs of handling policy changes (e.g. conversions) – Recurring commissions expected to be paid to intermediaries if the policyholder continues paying premiums within the boundary of the insurance contract
Allocation of fixed and variable overheads directly attributable to fulfilling insurance contracts	<p>These are allocated to contracts or groups using methods that are systematic, rational and consistently applied to all costs with similar characteristics.</p> <p>These include:</p> <ul style="list-style-type: none"> – accounting – human resources – IT and support – building depreciation, rent, maintenance and utilities

Cash flows	Examples
 <p>Costs that the entity will incur:</p> <ul style="list-style-type: none"> – performing investment activity, to the extent that the entity performs that activity to enhance insurance coverage – providing investment-return services to policyholders of insurance contracts without direct participating features – providing investment-related services to policyholders of insurance contracts with direct participating features 	<p>Investment activities are those that enhance benefits from insurance coverage if the entity performs those activities expecting to generate an investment return from which policyholders will benefit if an insured event occurs</p> <p>Such costs include:</p> <ul style="list-style-type: none"> – Costs of managing certain investments
 <p>Any other costs specifically chargeable to the policyholder under the terms of the contract</p>	<ul style="list-style-type: none"> – Income tax payments and receipts specifically chargeable to the policyholder

7.3.3

IFRS 17.B66

Cash flows that are outside the contract boundary

Cash flows that are excluded from the estimates of expected cash flows include the following.

- Cash flows related to the following items (which are accounted for separately):
 - investment returns;
 - components separated from the insurance contract;
 - reinsurance contracts held; and
 - income tax payments or receipts that the entity does not pay or receive in a fiduciary capacity or are not specifically chargeable to the policyholder under the terms of the contract.
- Cash flows relating to costs that are not directly attributed to the portfolio of insurance contracts (e.g. some product development and training costs).
- Cash flows arising from abnormal amounts of wasted labour or other resources used to fulfil the contract.
- Cash flows between different components of the reporting entity that do not change the amount that will be paid to policyholders (e.g. policyholder funds and shareholder funds).
- Cash flows that may arise from future insurance contracts (e.g. those outside the boundary of existing insurance contracts).

7.3.4

IFRS 17.B65(e), A

Insurance acquisition cash flows

Insurance acquisition cash flows (IACF) may fall within the boundary of an insurance contract. They arise from selling, underwriting and starting a group of insurance contracts issued or expected to be issued.

These cash flows need to be directly attributable to a portfolio of insurance contracts to which the group belongs. Cash flows that are not directly attributable to the *groups* or *individual insurance contracts* within the portfolio are included.

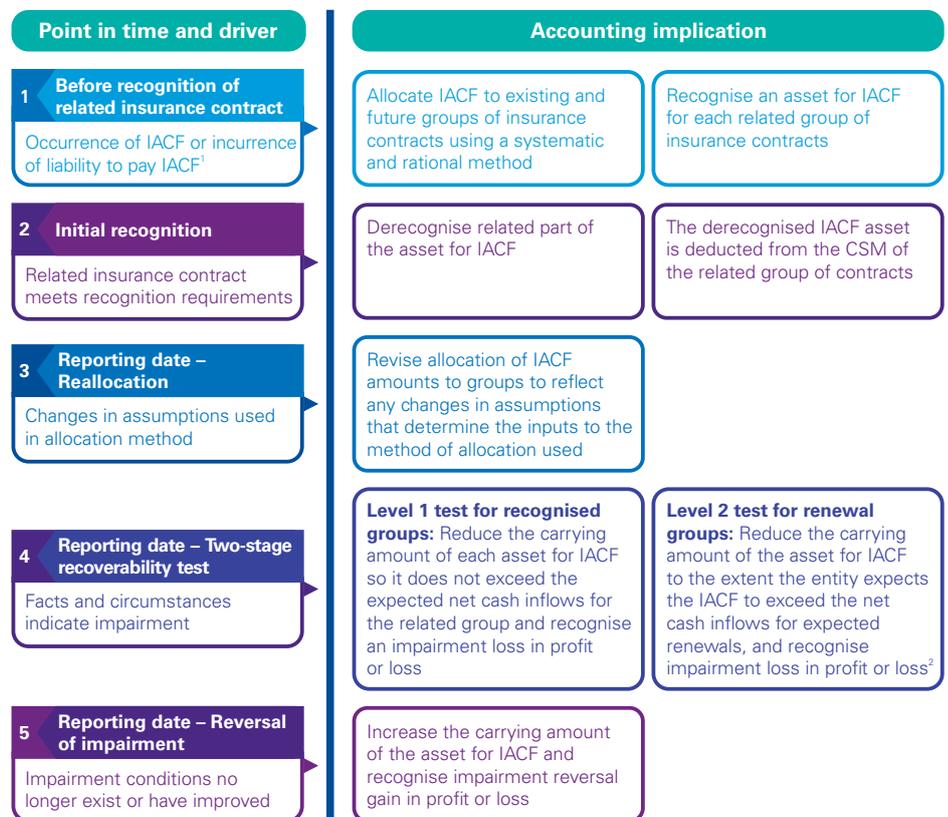
IFRS 17.BC182–BC183

Insurance acquisition cash flows:

- can arise internally (e.g. in the sales department) or externally (e.g. by using external sales agents);
- include not only the incremental costs of originating insurance contracts, but also other direct costs and a proportion of the indirect costs that are incurred in originating insurance contracts; and
- include cash flows related to both successful and unsuccessful acquisition efforts.



The following overview provides details on the accounting implications of the requirements under the general measurement model for insurance acquisition cash flows.



Notes

1. IACF may also occur on or after initial recognition. In that case, they should be allocated to recognised and future renewal groups. However, no asset is recognised for IACF because the cash flows effectively reduce the CSM of the recognised related group of contracts.
2. Unless (part of) the excess has already been recognised in the level 1 test.

IFRS 17.28B–C, 33

An entity recognises as an asset any insurance acquisition cash flows relating to a group of existing or future insurance contracts that it pays – or incurs a liability to pay – before the group is recognised. These assets and liabilities are derecognised when the group of insurance contracts to which the cash flows are allocated is recognised, as part of determining the CSM on initial recognition.

If insurance acquisition cash flows are expected to be paid after the related group is recognised, then they are included as part of the fulfilment cash flows of that group. If they are paid or the liability to pay them is incurred at the date of initial recognition of the group, then they are in effect deducted from the CSM at that date.

IFRS 17.59(a)

As an exception to the above requirements, an entity is not required to recognise an asset for insurance acquisition cash flows if it applies the PAA to the related group of contracts and chooses to expense the insurance acquisition cash flows as they are incurred, see 14.3.1.

IFRS 17.28A, B35A



When allocating insurance acquisition cash flows to groups of insurance contracts, entities need to consider, in an unbiased way, all reasonable and supportable information that is available without undue cost or effort. An entity applies a systematic and rational method to include insurance acquisition cash flows in the measurement of groups:

- if they are directly attributable to a group of contracts, then it allocates them to that group and to the groups that will include insurance contracts that are expected to arise from renewals of the insurance contracts in that group; and
- if they are directly attributable to a portfolio of contracts, but not to a group of contracts or individual contracts, then it allocates them to existing and future groups within that portfolio.

IFRS 17.B35B



At each reporting date, an entity revises the amounts of insurance acquisition cash flows allocated to groups of insurance contracts to reflect any changes in assumptions that determine the inputs to the method of allocation used. An entity does not change the amounts allocated to a group of insurance contracts once all contracts have been added to the group.

IFRS 17.B35C



If insurance contracts are to be added to a single group of insurance contracts in more than one reporting period, then an entity derecognises the portion of the asset for insurance acquisition cash flows that relates to the insurance contracts added in that period and continues to recognise an asset for insurance acquisition cash flows to the extent that the asset relates to insurance contracts expected to be added to the group in a future reporting period.

IFRS 17.28E, B35D



At each reporting date, if facts and circumstances indicate that an asset arising from insurance acquisition cash flows may be impaired, then an entity:

- (a) recognises an impairment loss so that the carrying amount of each asset does not exceed the expected net cash inflow for the related group; and
- (b) if the asset relates to groups that are expected to arise from renewals of insurance contracts in a group, recognises an impairment loss to the extent that:
 - it expects those insurance acquisition cash flows to exceed the net cash inflow for the expected renewals; and
 - the excess has not already been recognised as an impairment loss under (a).

IFRS 17.28F



A previously recognised impairment loss is reversed in a subsequent period to the extent that the impairment has improved or no longer exists.



The requirements to recognise an asset for insurance acquisition cash flows are relevant when the PAA is applied, unless the entity has an accounting policy to expense the insurance acquisition cash flows as they are incurred. See [Chapter 14](#) on the accounting policy choice available when the PAA is applied.



Types of costs included in the insurance acquisition cash flows

There is diversity in practice under IFRS 4 over the types of costs and the amounts identified as acquisition costs, depending on the type of contract or the jurisdiction.

Many entities completed an analysis to identify their acquisition costs. This analysis formed the basis for the development of a wide variety of methods used to estimate these costs under IFRS 4 – e.g. portions of the acquisition cash flows could be based on:

- a certain percentage of the premium;
- direct costs specifically related to an individual contract; or
- a portion of all of the administrative costs incurred by the entity.

Entities need to review their models for identifying and measuring acquisition cash flows, and change them if necessary to ensure that they meet the new requirements.

IFRS 17.BC180, BC183–BC184



IFRS 17 vs IFRS 4 – Recognising a separate asset for deferred acquisition costs

Changes to the accounting model

Some existing accounting models measure insurance liabilities at the amount of premium received while deferring the related acquisition costs. These acquisition costs are treated as a separate asset that is amortised over the expected life of the contract. This amount is typically subject to recoverability testing.

Other models require entities to recognise all acquisition costs as an expense when they are incurred or to differentiate between acquisition costs related to successful and unsuccessful efforts to obtain new business.

IFRS 17's approach includes insurance acquisition cash flows in the measurement of the insurance liability, thereby reducing the CSM recognised on initial recognition. This approach allocates part of the premium to recover those costs, so that both the costs and the related revenue are recognised over the same periods and in the same pattern, based on the passage of time.

IFRS 17 requires entities to recognise an asset for any insurance acquisition cash flows relating to a group of existing or future insurance contracts that it pays or liabilities incurred for acquisition cash flows to be paid before the group is recognised. These assets will be subject to recoverability testing if facts and circumstances indicate that the asset may be impaired. Once the related group of insurance contracts is recognised, the asset is derecognised and the insurance acquisition cash flows are recognised in measuring the CSM.

Implications

This means that entities:

- continue to identify, allocate and measure acquisition cash flows;
- will no longer present insurance acquisition cash flow assets separately from the related insurance contracts once the contracts have been recognised;
- similarly will only test the recoverability of these assets separately for impairment until the insurance contracts to which they relate are recognised;
- that have recognised acquisition cash flows as expenses when they are incurred will need to adapt their systems to allocate these cash flows to the related groups of contracts; and
- that report under IFRS Standards alongside other reporting frameworks may need to apply two different definitions and measurement approaches for acquisition cash flows going forward.

An entity may not experience these complexities if it elects to expense insurance acquisition costs as they are incurred for contracts measured using the PAA; see [Chapter 14](#).

Entities may experience:

- larger losses at or before inception of new business if they currently defer all costs, including some that would not be considered insurance acquisition cash flows directly attributable to a portfolio of contracts under IFRS 17; or
- smaller losses at or before inception of new business if they currently expense all acquisition costs, or all unsuccessful acquisition costs, under their current accounting policies.

7.3.5

IFRS 17.B67–B71

Cash flows to policyholders in a contract that affect or are affected by other contracts

Some contracts require the policyholder to share the returns of a specified pool of underlying items with policyholders of other contracts. Additionally, these contracts require that either:

- the policyholder bears a reduction in its share of returns on the underlying items as a result of required payments to those other policyholders that share in that pool; or
- the other policyholders bear a reduction in their share of returns on the underlying items as a result of a required payment to the policyholder.

When these contracts are in different groups, the cash flows for each group reflect the effects above on the entity. So, the fulfilment cash flows for a group:

- include payments arising from the terms of existing contracts to policyholders of contracts in other groups; and
- exclude payments to policyholders in the group that have been included in the fulfilment cash flows of another group.

To determine the fulfilment cash flows of groups that affect or are affected by contracts in other groups, different practical approaches can be used. If it is

possible to identify the change in the underlying items and resulting change in cash flows only at a higher level than the group, then the effects of the change in the underlying items are allocated to each group on a systematic and rational basis.

After all of the insurance contract services have been provided to the contracts in a group, the fulfilment cash flows may still include payments expected to be made to current policyholders in other groups or to future policyholders. In these cases, an entity can recognise and measure a liability for the fulfilment cash flows arising from all groups. Therefore, it does not have to continue to allocate these fulfilment cash flows to specific groups.



Future policyholders vs future insurance contracts

As described in 7.3.1, cash flows that may arise from future insurance contracts are outside the boundary of insurance contracts. However, cash flows to policyholders in contracts that affect or are affected by other contracts can include payments to future policyholders in the same group or other groups. This is necessary because the contractual terms of an existing contract may create an obligation for the entity to pay to policyholders amounts based on underlying items. Given that the terms of the existing contract require it to pay the amounts, even though it does not yet know when or to whom, these cash flows would be included within the contract boundary.

IFRS 17.BC172

7.4

Information used to make the estimates

IFRS 17.B41

An entity estimates the probabilities and amounts of future payments under existing contracts on the basis of:

- information about the known or estimated characteristics of the contracts;
- information about reported claims and historical data about the entity's own experience supplemented by data from other sources, if necessary; and
- current price information, if it is available.

IFRS 17.B41(c)

An entity adjusts its historical information to reflect current conditions when, for example:

- the characteristics of the insured population differ from those of the population on which the historical information is based;
- trends are expected to change (e.g. historical trends will not continue or new trends will emerge); or
- other changes occur that might affect the relevance of historical information (e.g. changes in underwriting and claims management procedures).

IFRS 17.B41(d)

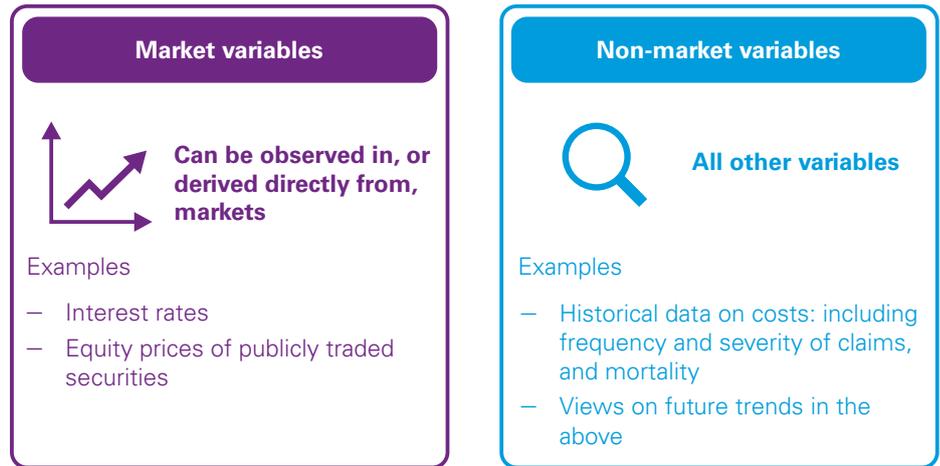
Current price information might be available to use as a basis for estimating expected cash flows. For example, prices of:

- reinsurance transactions;
- financial instruments that cover similar risks (e.g. catastrophe bonds or weather derivatives); and
- portfolio transfers.

IFRS 17.33(b), B42

Careful consideration should be given to adjusting these prices to arrive at the cash flows that would arise from fulfilling the insurance contract.

Estimates of expected cash flows reflect the perspective of the entity, provided that estimates of relevant market variables are consistent with the observable market prices for those variables.



IFRS 17.B43

Market variables generally give rise to financial risk and non-market variables generally give rise to non-financial risk. However, instances will exist in which this does not hold true – e.g. interest rates that cannot be observed in, or directly derived from, markets.

7.4.1

IFRS 17.B44

Market variables

Estimates of market variables are as consistent as possible with observable market prices at the reporting date. An entity is required to maximise the use of this information rather than substitute its own estimates.

When variables need to be derived – e.g. because there is a lack of observable market variables – they are required to be as consistent as possible with observable market variables.

7.4.1.1

IFRS 17.B46

Replicating assets

A replicating asset (or portfolio of assets) has cash flows that exactly match, in all scenarios, some of the contractual cash flows that arise from a group of insurance contracts in amount, timing and uncertainty.

When such an asset (or portfolio of assets) exists, the entity may use the replicating asset technique. Under this technique, the entity uses the fair value of the asset(s) to represent the relevant fulfilment cash flows, instead of explicitly estimating the cash flows and discount rate.

IFRS 17.B47–B48

If a replicating asset (or portfolio of assets) exists for some of the cash flows of an insurance contract, and the entity chooses not to use the replicating asset technique in determining the relevant fulfilment cash flows, then the entity needs to satisfy itself that the replicating asset technique would be unlikely to lead to a materially different measurement of those cash flows.

This might be the case when there are significant inter-dependencies between cash flows that vary based on returns on assets and other cash flows, and stochastic modelling and risk-neutral techniques may be more robust, or easier to implement, than using the replicating asset technique.



Example 5 – Using the replicating asset technique

Entity X issues an insurance contract that contains an insurance feature that generates cash flows equal to the cash flows from a put option on a basket of traded assets. Price information on the relevant put option is publicly available.

Because the replicating asset (in this case, the put option) has cash flows that exactly match the cash flows for certain cash flows relating to one feature of the insurance contract, X may use the publicly available price information – i.e. the fair value of the put option – when determining the relevant fulfilment cash flows resulting from that feature.



Applying the replicating asset technique

Insurance contract cash flows are generally dependent on insurance risk and subject to policyholder behaviour, which are not expected to be replicated by the cash flows of an asset, or portfolio of assets, in all scenarios. Therefore, the replicating asset technique will usually not be widely used for estimating the cash flows of an entire insurance contract.

7.4.2

IFRS 17B49–B50

IFRS 17B51–B53

Non-market variables

Estimates of non-market variables reflect all reasonable and supportable information – external and internal – that is available without undue cost or effort, and give greater weight to the more persuasive information.

Estimated probabilities for non-market variables are required not to contradict observable market variables. For example, estimated probabilities for future inflation rate scenarios are required to be as consistent as possible with the probabilities implied by market interest rates.

Market variables can vary independently or be correlated with non-market variables. For example, lapse rates (a non-market variable) could be correlated with interest rates (a market variable).

When they are correlated, the probabilities for scenarios and the risk adjustments for non-financial risk that relate to the market variables are required to be consistent with the observed market prices that depend on those market variables.

**Example 6 – Internal vs external information about non-market variables****Mortality information**

Mortality statistics can be available from both internal and external resources. An entity gives greater weight to the more persuasive information.

For example, internal mortality statistics may be more persuasive (if they are available) than external mortality statistics – e.g. national statistics – that relate to a population with different demographic characteristics from those of the insured population of an entity.

Conversely, if the internal mortality information is derived from a small population and external mortality information is current and believed to represent the insured population, then the external information might be given greater weight.

This assessment might result in different conclusions from product to product and between different entities operating in the same environment.

Changes in experience over time

As the portfolio of products and the related experience changes, this assessment might result in different results over time for the same product, in the same entity.

For example, Entity E may begin issuing a new insurance product with a new type of insurance risk that it has not previously issued – e.g. adding identity theft coverage to traditional property insurance contracts.

Because E lacks internal information to produce its expected cash flow estimates, it might place more weight on information found in international research performed by the reinsurance industry, or in the cost of reinsuring that element of the risk, to estimate the new risk.

As E continues issuing the products and gathers information over time in the specific environment it is operating in, it might place more weight on its internal information.

Another example is a life insurance contract with an investment component, when the policyholder has an option on retirement to either:

- receive a lump sum settlement; or
- annuitise the contract value and receive annuity payments until death.

An entity might lack internal information about policyholder behaviour at the current life cycle of the contract – e.g. if the contracts are still within the early years of the coverage period, then the policyholders will not yet have reached retirement age.

Therefore, it may need to rely on external information to develop estimates of expected policyholder behaviour – e.g. external statistics based on products with similar features.

7.4.3

IFRS 17.33(c), B54–B55

Using current estimates

An entity uses all reasonable and supportable information that is available without undue cost or effort when estimating each cash flow scenario and its probability.

At the reporting date, an entity reviews and updates its previous estimates while considering whether:

- the updated estimates faithfully represent the conditions that exist at that date; and
- the changes in estimates faithfully represent the changes in conditions during that period.

When updating estimates, an entity considers the evidence that supported its previous estimates and all of the new available evidence, and gives greater weight to the more persuasive evidence.

IFRS 17.B60, BC156

An entity takes into account current expectations of future events that might affect the cash flows, but not current expectations of future changes in legislation that would change or discharge the present obligation or create a new obligation under the existing contract. Such changes in legislation impact the expected cash flows only when they are substantively enacted.

IFRS 17.B54–B57



Considerations – Updating estimates for current information

When updating estimates for current information, it is important that the updated estimate faithfully represents:

- the conditions at the reporting date; and
- changes in the conditions during the period.

The implications of this include the following.

- Changing an estimate from one end of an acceptable range to the other end would not be appropriate if the update does not represent changes in conditions that occurred during the period.
- Updating the probabilities included in an estimate based on the occurrence of an insured event after the reporting date would not be appropriate because it would not faithfully represent the conditions at the reporting date.
- Updating mortality expectations for the full impact of a sudden change in mortality experience in the last reporting period would not be appropriate if the updated estimate would not faithfully represent the conditions at the reporting date – e.g. if the mortality experience is caused by random fluctuations.

IFRS 17B51, B59, B128, BC39, BC154



Considerations – Inflation assumptions

Inflation assumptions are relevant to various insurance products – e.g. long-term care products with inflation protection.

When assumptions about inflation are based on an index of prices or rates or on prices of assets with inflation-linked returns, they are considered to be financial assumptions. However, assumptions about inflation based on an entity's expectation of specific price changes are considered to be non-financial assumptions.

Inflation rates are likely to be correlated with interest rates. Therefore, when such a correlation exists the estimated probabilities derived by the entity for future inflation rate scenarios should be as consistent as possible with probabilities implied by market interest rates.



Data needs when using current information

The use of current estimates represents a significant change for many entities that currently measure product liabilities based on locked-in discount rates and/or estimates of cash flows at inception – e.g. traditional insurance products accounted for under US GAAP – especially for contracts that have been in force for a long time. For these entities, a wider range of data and more sophisticated modelling approaches than those applied today may be needed to comply with IFRS 17.

These entities may be able to leverage information from any liability adequacy test performed that uses current estimates of expected cash flows. However, these assessments:

- may be completed at a higher level than the level of aggregation required by IFRS 17;
- may not be integrated with actuarial valuation systems; or
- may be performed infrequently.

Entities will have to determine whether they may need to supplement the current data available to them on implementation of IFRS 17 and whether significant changes to valuation systems and controls are necessary.



Updating assumptions

IFRS 17 requires an entity, at the reporting date, to review and update its previous estimates. Currently, even when entities apply an accounting model that requires estimates of expected cash flows to be updated, some may update their forward-looking assumptions only on an annual basis. During the reporting periods between the full updates of assumptions, those entities generally complete a high-level assessment to consider whether the liability still faithfully represents the conditions (and changes in those conditions) at each reporting date.

Other entities using similar accounting models update their estimates more frequently – perhaps quarterly – incorporating new and historical information on an ongoing basis.

It could also be the case that the same entity applies both annual and quarterly updates to different types of estimates and different types of contracts.

On transition to IFRS 17, entities will need to re-evaluate their processes and controls and determine whether they meet the new standard's objectives.

Entities that have performed only limited re-evaluations of conditions at each reporting date may need to develop and implement processes and systems to determine current estimates at each reporting date.

7.4.4

IFRS 17.33(d)

Explicit cash flows

Estimates of expected cash flows are 'explicit'. This means that the adjustment for non-financial risk is estimated separately from the other estimates. The adjustments for the time value of money and financial risk are also estimated separately from the cash flow estimates, unless the most appropriate measurement technique combines those estimates.

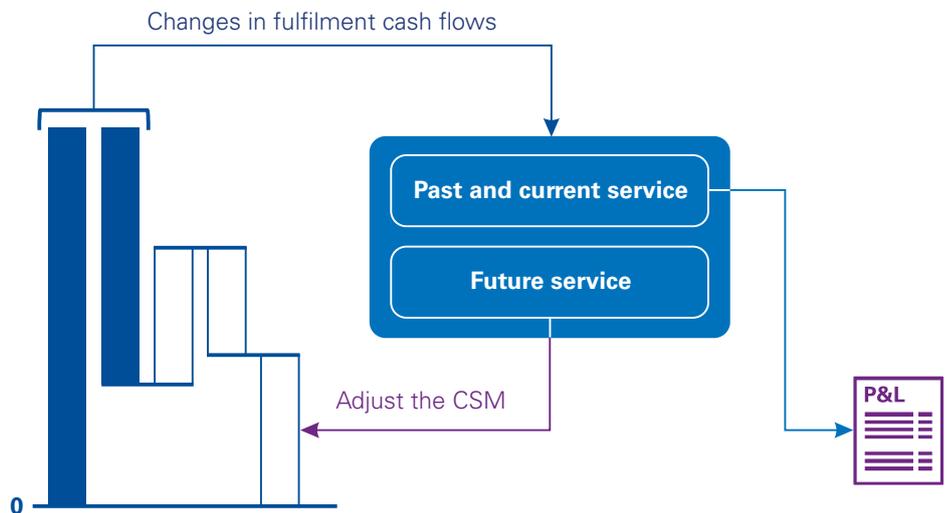
For further discussion on the adjustments for the time value of money and financial risks, and the risk adjustment for non-financial risk, see [Chapters 8 and 9](#), respectively.

7.5 Using estimates of expected cash flows in measurement

IFRS 17.32, 40, 44(c), 45(c)

An entity uses estimates of expected cash flows for measuring groups of insurance contracts both on initial recognition and subsequently, as follows:

- *in the measurement of the fulfilment cash flows*: expected cash flows of a group of insurance contracts are estimated both on initial recognition, when the CSM is determined, and in subsequent periods; and
- *in the subsequent measurement of the CSM of a group*: the CSM is adjusted for changes in estimates of expected cash flows that relate to future service. Other changes in the estimates of expected cash flows are recognised in the statement(s) of financial performance (for further detail, see [Chapter 10](#)).

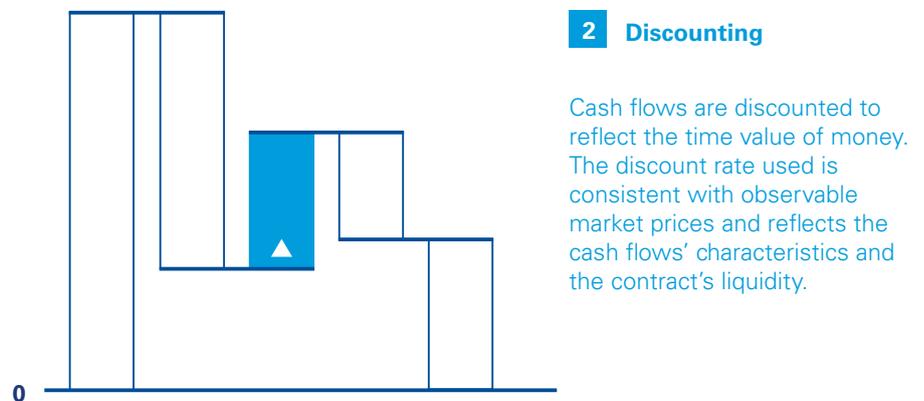


8

Discounting

The second step in measuring a group of insurance contracts is to apply discounting to reflect the time value of money.

8.1 Adjusting for the time value of money



IFRS 17.36, B86

Discounting adjusts the estimates of expected cash flows to reflect the time value of money and the financial risks associated with those cash flows (to the extent that the financial risks are not already included in the cash flow estimates).

The discount rates applied to the estimates of expected cash flows:

- reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts;
- are consistent with observable current market prices; and
- exclude the effects of factors that affect observable market prices used in determining the discount rate, but do not affect the expected cash flows of the insurance contract.



Inclusion of financial risks

Financial risks arise within an insurance contract in a variety of ways. For example, when contractual payments to and from a policyholder are:

- linked to an index of prices or exchange rates;
- determined based on a specified rate of return on an investment component of the contract (e.g. a fixed annuity); or
- linked to the rate of return from a specified pool of assets (e.g. a variable annuity).

The estimates of expected cash flows are adjusted to reflect the financial risks associated with them. This can be achieved by adjusting the estimates of expected cash flows for financial risk, or by adjusting the discount rate.

The effect of changes in financial risks is presented in a similar way when determining the amounts recognised in the statement(s) of financial performance, regardless of how they were incorporated in the estimates.

For example, if an entity issues a group of insurance contracts in which the policyholders' unit values are linked to a price index, then the financial risk may be reflected implicitly within the estimates of expected cash flows or as an adjustment to the discount rate. For presentation purposes, changes related to this variable (together with the effect of the time value of money) are included within insurance finance income or expense, which is presented separately from the insurance service result (see further discussion in [Chapter 13](#)).

Currently, an entity might be able to identify these items explicitly. However, it will need to confirm that its current methodologies are consistent with the principles of IFRS 17.

An entity that prefers to include an implicit adjustment for financial risk may need to adapt its processes in order to identify the effect explicitly for presentation purposes.

8.2

IFRS 17.B74–B75

Determining the discount rate

Discount rates are determined on a basis consistent with other estimates that are used to measure the insurance contracts. For example:

- cash flows that *do not* vary based on the returns on underlying items are discounted at a rate that *does not* reflect such variability – i.e. a risk-free rate adjusted for characteristics of the cash flows such as illiquidity;
- cash flows that *do* vary based on the returns on any financial underlying items are discounted using rates that reflect that variability (or adjusted for the effect of that variability and discounted using a rate that reflects the adjustment made);
- nominal cash flows are discounted at a rate that includes the effect of inflation; and
- real cash flows are discounted at a rate that excludes the effect of inflation.

Cash flows that vary based on the return on underlying items are discounted or adjusted to reflect that variability, regardless of whether:

- the variability arises from contractual terms or discretion of the issuer; or
- the entity holds the underlying items.

IFRS 17.B77

When some of the cash flows vary based on the return on underlying items and some do not, an entity can either:

- divide the cash flows and apply the relevant discount rates for each stream of cash flows; or
- apply discount rates appropriate for the estimated cash flows as a whole – for example, using stochastic modelling techniques or risk-neutral measurement techniques.



Determining the discount rates for contracts with embedded guarantees

Insurance contracts with embedded guarantees can result in some cash flows that are expected to vary directly with returns on underlying items, and others that are not.

For example, when the guaranteed benefit for a life insurance contract with an investment component is expected to be greater than the policyholder's account balance, the cash flows are not expected to vary directly with the returns from the underlying items. Conversely, when the guaranteed benefit is expected to be less than the account balance, the cash flows are expected to vary directly with the returns from the underlying items.

In this case, it is likely that practice will develop around a number of techniques, such as:

- discounting each cash flow scenario using a different discount rate; or
- determining one discount rate to be applied to all of the cash flows from the contract, considering the mixture of cash flow scenarios.

8.3

IFRS 17.B78

Estimation techniques

If:

- observable market prices with the same characteristics (e.g. timing, currency and liquidity) are not available; or
- similar instruments are available but do not separately identify factors of the financial instrument that differentiate it from the insurance contract,

then an entity determines the discount rate based on an estimation technique.

IFRS 17.B44, B78, 13.69, 83, 89

When applying an estimation technique, an entity uses...

Observable inputs

An entity **maximises the use** of observable inputs

Non-market variables

These should reflect **all reasonable and supportable information** available without undue cost or effort

They should **not contradict observable** market variables

Judgement to assess similarity

An entity assesses the level of similarity between the features of the **insurance contract** and those of the **instrument for which observable market prices are available**, adjusting for any differences

The discount rate does not contradict any available and relevant market information, and reflects current market conditions from the perspective of a market participant.

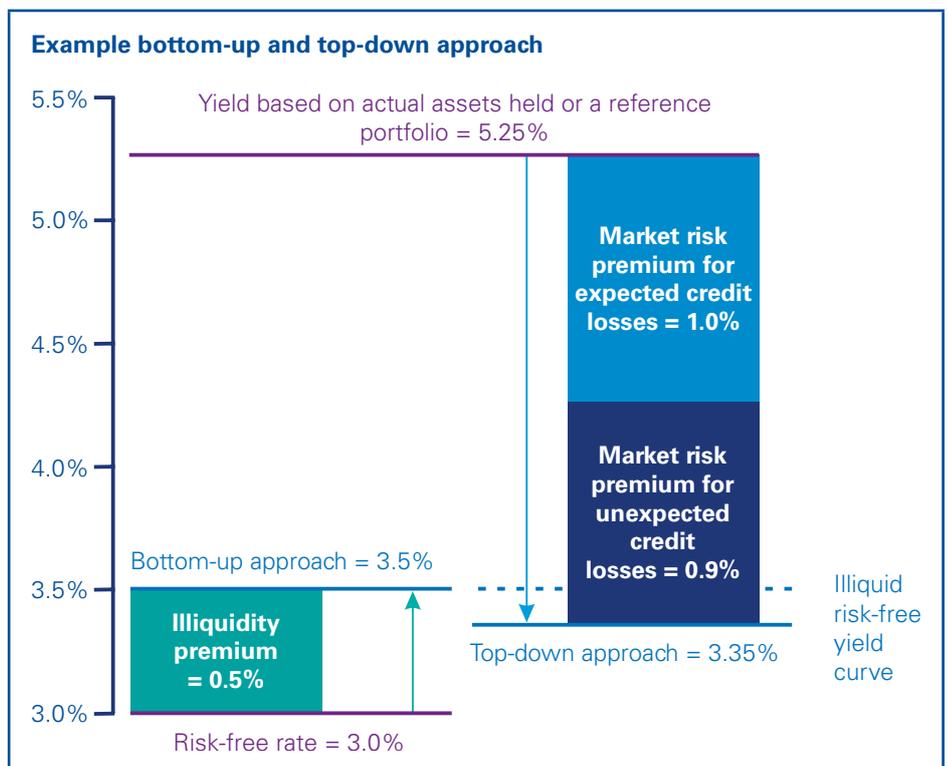
Estimation techniques

If an observable interest rate is not available for some of the cash flows, then an entity may need to use estimation techniques to determine the relevant discount rates. This may be the case if the cash flows of the insurance obligation are expected to extend beyond the period for which observable market data is available – e.g. long-duration contracts with a coverage period extending over 20 years.

Determining a discount rate is expected to require a large number of new data inputs and significant actuarial and finance involvement. Entities will have to consider the different information needed for different techniques.

IFRS 17.B80–B81, B84

IFRS 17 does not prescribe a single estimation technique to derive discount rates. However, the standard does specify that a ‘top-down’ or ‘bottom-up’ approach may be used. In theory, for insurance contracts with cash flows that do not vary based on the performance of the underlying items, both approaches should result in the same discount rate, although differences may arise in practice. The example below illustrates these approaches for an insurance contract with cash flows that do not vary based on the performance of the underlying items.



8.3.1

IFRS 17.B79–B80

Bottom-up approach

For cash flows that do not vary based on the returns on underlying items, an entity may determine the discount rate based on a liquid risk-free yield curve. This is adjusted to eliminate differences between the liquidity characteristics of the financial instruments that underlie the chosen curve and those of the insurance contract.

For example, risk-free rates are often derived from the prices of highly liquid traded bonds with no or negligible credit risk (used as a proxy for risk-free rates), which can often be sold in the market at short notice without incurring significant costs. By contrast, insurance contract liabilities cannot generally be liquidated by policyholders without incurring significant cost before contractual maturity, if at all.



The use of risk-free yield curves

Generally, the debt of countries with highly rated government bonds – e.g. the UK or the US – is considered to approximate or be a proxy for a risk-free rate for contracts issued in the country's own currency. Swap rates may also provide a proxy for risk-free rates if they are highly collateralised.

The method of deriving a liquid risk-free yield curve is not prescribed and may be problematic in some currencies or countries, or for companies operating in multiple jurisdictions, which may require economic analysis and significant expert judgement.

For example, an entity may issue insurance contracts in a country with high inflation or deflation, political uncertainty or high volatility and/or low trading volume in its government bonds.

In other jurisdictions, there may be insufficient liquidity in asset markets to generate yield curves that cover a sufficient time period over which claims payments would be made; therefore, insurers might need to extrapolate based on market-consistent assumptions. These factors should be considered by an entity when determining the discount rates used for measuring its insurance contracts.



Bottom-up approach

The starting point of the bottom-up approach is a risk-free yield curve. These curves usually reflect assets traded in active markets. To arrive at a discount rate that is applicable to insurance contract liabilities, an illiquidity premium is added to the yield curve. This is because one would expect a higher return when investing in assets that are identical except that they are non-tradable or non-redeemable.

Estimating an illiquidity premium is a complex area that will require significant judgement.

One way of estimating the illiquidity premium in current practice is to compare the risk-free yield curve for tradable bonds with a risk-free yield curve for similar but non-tradable bonds, based on estimation techniques for the assets' fair values. The spread could represent the illiquidity premium or provide insight about its size.

8.3.2

IFRS 17.B81

Top-down approach

An entity may determine the discount rates based on a yield curve that reflects the current market rates of return implicit in a fair value measurement of a reference portfolio of assets. The yield curve is adjusted to eliminate any factors that are not relevant to the insurance contracts.

IFRS 17.B81

However, an entity is not required to adjust the yield curve for differences in liquidity characteristics of the insurance contracts and the reference portfolio.

IFRS 17.B85

There are no specific requirements on how to choose the reference portfolio that forms the starting point for this approach. However, if it has assets with characteristics similar to the insurance contracts, then fewer adjustments would be needed to arrive at the relevant discount rate for the insurance contracts.

IFRS 17.B82

Once the reference portfolio of assets has been identified, a yield curve is estimated as follows:

- using observable market prices in active markets for the assets in the reference portfolio;
- if a market is not active for the assets in the reference portfolio, then observable market prices for similar assets are adjusted to make them comparable to the assets in the reference portfolio; and
- if there is no market for the assets in the reference portfolio, then an estimation technique is used in a manner consistent with the definition of fair value under IFRS 13 *Fair Value Measurement*.

IFRS 17.B83

After the yield curve has been identified, adjustments are made as necessary to arrive at the relevant discount rate for the insurance contracts. When an insurance contract's cash flows do not vary based on the cash flows of the assets in the reference portfolio, the yield curve is adjusted for:

- differences between the amount, timing and uncertainty of cash flows of the assets in the reference portfolio and the amount, timing and uncertainty of the cash flows of the insurance contract; and
- the market risk premiums for credit risk that are relevant only to the assets included in the reference portfolio.

IFRS 17.B83, B85



Top-down approach

Using a top-down approach might be challenging because of the complexities in determining the amount of market risk premium that should be excluded from the asset yield.

For example, if the cash flows from the insurance contracts do not vary based on the returns from underlying items and the top-down approach is applied, then a portfolio of debt instruments might be a good start, because fewer adjustments would be required (compared with using equity instruments).

Some adjustments might still be required to arrive at a relevant discount rate, but an adjustment for differences in liquidity characteristics between the insurance contracts and the reference portfolio is not necessary. For example, an entity may need to eliminate from the total debt instruments' yield:

- the effects of expected credit losses;
- the market risk premium for credit; and
- any other factors that are not relevant to the insurance contracts.

The measurement of credit risk in asset returns will be an important part of determining the discount rate. In some countries, market-observable data on credit spreads will be available from credit default swap markets, but in others this will not be available. Using historical default data when determining expected credit losses may be a useful starting point, but adjustments may be needed to reflect current and expected credit conditions and estimates of risk premiums, including considering market-observable inputs, if any are available.

When the cash flows from the insurance contracts vary based on the returns from underlying items and the top-down approach is applied using the underlying items as the reference portfolio, there are likely to be fewer adjustments to the yield curve derived from that portfolio.



Practical implications of discounting

Entities that do not currently discount their liabilities – e.g. non-life insurers that calculate an undiscounted loss reserve – might need to develop systems and processes to do so.

Many entities currently apply a discount rate to derive the present value of their expected cash flows; however, they do not generally determine that discount rate in accordance with IFRS 17's requirements. This change in methodology will require sourcing and tracking new and historical data and developing approaches to generate IFRS 17-appropriate yield curves. For example, entities that currently discount liabilities using an asset-based rate or using locked-in rates – such as some entities with long-duration, non-participating insurance contracts.

For entities that currently use an asset-based rate to discount their insurance liabilities, there will probably be differences between the expected returns of the underlying assets that back an insurance contract and the yield curve used for discounting the expected cash flows of the insurance contract under IFRS 17. Entities might have to consider how to explain these differences to help their users understand any volatility that arises as a result.



Leveraging regulatory-based yield curves

Currently, in some jurisdictions, risk-free yield curves or other types of yield curve are provided by regulators, actuarial associations or other organisations for different reporting purposes.

An entity that wishes to use these yield curves when applying IFRS 17 will need to demonstrate that they comply with the principles of this standard.

For example, the discount rates developed by the European Insurance and Occupational Pensions Authority (EIOPA) can include an ‘ultimate forward rate’ in some currencies that is higher than the rate implied by asset trades and may not meet IFRS 17’s requirements without adjustment.

Using these rates for IFRS 17 purposes may seem attractive to some insurers, given that they may already be widely used in some jurisdictions for regulatory or other purposes. However, an entity will need to assess whether they meet the principles described above in IFRS 17. Therefore, whether this information is used to determine the discount rate(s) applied under IFRS 17 to measure the fulfilment cash flows will need to be decided independently of its other purposes. Some entities might need to develop their capabilities and experience around IFRS 17-compliant discount rates.

When an entity leverages regulatory-based yield curves in its IFRS 17 measurement, documenting how the yield curve meets the objectives for use in the measurement of its insurance liabilities under IFRS 17, whether it requires adjustment and evidence of management’s other considerations are important.

8.4

IFRS 17.B72

Using discount rates in measurement

The following table shows when a discount rate is applied throughout the measurement of a group of insurance contracts, and the general objective of how to determine that discount rate.

IFRS 17.36–37, 44(b), 56, 59(b), B72, B96, B113

Aspect of measurement	Discount rates to be applied
Fulfilment cash flows¹	Current discount rates
CSM interest accretion for contracts without direct participation features	Discount rates determined on initial recognition of the group
Adjustments to the CSM for changes in the fulfilment cash flows for contracts without direct participation features	Discount rates determined on initial recognition of the group
Adjustments to the CSM for changes in the fulfilment cash flows for direct participating contracts that do not vary based on the returns on underlying items, excluding the change in the effect of the time value of money and financial risks	Current discount rates

IFRS 17.36–37, 44(b), 56, 59(b), B72, B96, B113

Aspect of measurement	Discount rates to be applied
For groups applying the PAA, liability for remaining coverage adjustment for the time value of money	Discount rates determined on initial recognition of the group

Note

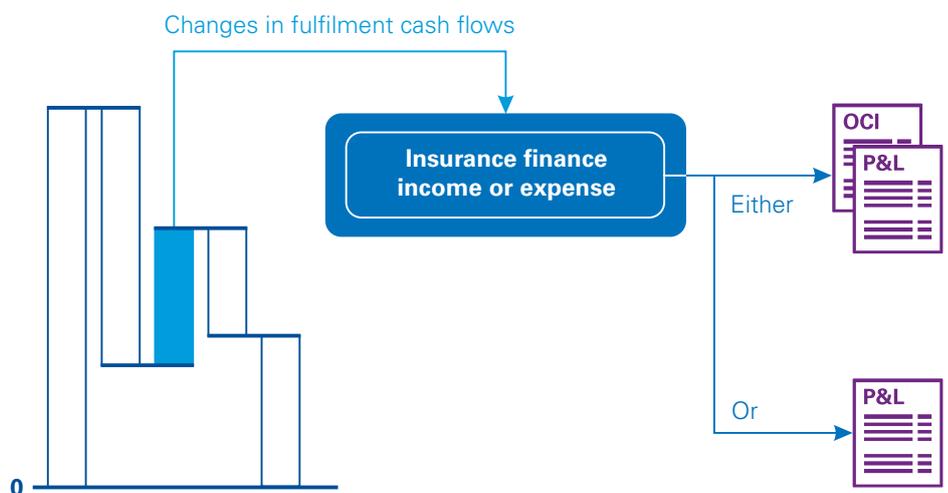
1. See [Chapter 14](#) for information on how to adjust the fulfilment cash flows relating to incurred claims when the PAA is applied.

8.5

Presentation of insurance finance income or expense

IFRS 17.87

The effect of, and changes in, the time value of money and financial risk (including that arising from the passage of time) are presented as insurance finance income or expense within the statement of financial performance (with certain exceptions for direct participating contracts; see [Chapter 15](#)).



9

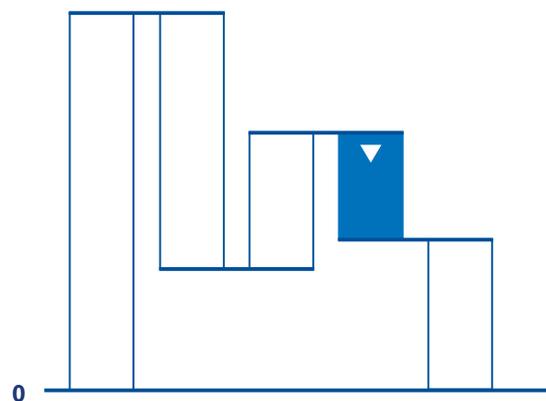
Risk adjustment

The third step in measuring a group of insurance contracts is to adjust the present value of expected cash flows for non-financial risk.

9.1

IFRS 17.37, A

Adjusting for non-financial risk



3 Risk adjustment

An adjustment to reflect the compensation an entity requires for bearing the uncertainty about the amount and timing of cash flows that arises from non-financial risk.

IFRS 17.B87

The risk adjustment conveys information to users of financial statements about the amount the entity charges for bearing the uncertainty over the amount and timing of cash flows arising from non-financial risk. It measures the compensation that the entity would require to make it indifferent between:

- fulfilling a liability that has a range of possible outcomes arising from non-financial risk; and
- fulfilling a liability that will generate fixed cash flows with the same expected present value as the insurance contract.

Example 7 – Risk adjustment

The concept of a risk adjustment for non-financial risk is illustrated below.

	Outcome A 50% probability	Outcome B 50% probability	Probability-weighted result
Contract 1	Pay 100	Pay 0	Pay 50
			
Contract 2	Pay 60	Pay 40	Pay 50
			

To determine the risk adjustment, an entity measures the compensation that it would require to make it indifferent between fulfilling a liability from each of Contracts 1 and 2, and a contract with a liability that is fixed at 50.

Given the uncertainty in the amount of cash outflows, an entity would generally require additional compensation for both Contracts 1 and 2. However, given the higher level of variability in the amount of cash outflows in Contract 1, it would generally require greater compensation for Contract 1 than for Contract 2.

IFRS 17.B86, B89

IFRS 17.33(d), 36, B86, B90

9.2

IFRS 17.B88

The risk adjustment for non-financial risk considers risks arising from an insurance contract other than financial risk. This includes insurance risk and other non-financial risks – e.g. lapse and expense risk. Risks that do not arise from the insurance contract – e.g. general operational risk – are not included. For further detail on the differences between insurance and financial risks, see 3.1.1.2.

Although risk adjustments for financial risk can be included either in the estimates of expected cash flows or in the discount rate, the risk adjustment for non-financial risk is explicit.

Entity's perspective

The risk adjustment for non-financial risk reflects:

- the degree of diversification benefit that the entity includes when determining the compensation that it requires for bearing that risk; and
- the entity's degree of risk aversion, reflected by both favourable and unfavourable outcomes.

IFRS 17.BC213(b)

The objective of the risk adjustment for non-financial risk is to reflect the entity's perception of the economic burden of the non-financial risk that it bears. Therefore, the entity specifies a level of aggregation for determining the risk adjustment for non-financial risk that is consistent with its perception of its non-financial risk burden.

IFRS 17.BC209, BC215

The risk adjustment for non-financial risk reflects an entity's own perception of its degree of risk aversion; it is not measured from a market participant's point of view. Determining the risk adjustment for non-financial risk based on the amount required by market participants would require a measurement based on an exit price – e.g. fair value – rather than a fulfilment value as required by IFRS 17.



Entity's perspective

The techniques used in measuring the risk adjustment need to consider information about the probability distribution of the underlying cash flows. This depends on how an entity determines the compensation that it requires for bearing the non-financial risk.

For example, to determine the risk adjustment for non-financial risk, entities may determine the probability distribution of the underlying cash flows in aggregate for each specific risk type (e.g. death, theft, third party liability or lapses) or based on the 'shape' of risk (i.e. all cash flows that have a particular probability distribution). Both perspectives may result in an assessment of the risk adjustment for non-financial risk based on risk-mitigating effects, which may extend beyond a single group or portfolio of insurance contracts, and potentially to the entire entity. Both perspectives are permissible as long as the measurement of the risk adjustment for non-financial risk is consistent with the objective. It is also permitted to use different methods for different risk types or for different levels of its business.

An entity is permitted to calculate the risk adjustment for non-financial risk at different levels of business – e.g. contract, portfolio, group of portfolios or entity level. The entity allocates the calculation to groups of insurance contracts.



Allocating the risk adjustment for non-financial risk to groups of insurance contracts

Although entities may assess their risk adjustment for non-financial risk at a higher level than the level at which they group insurance contracts for measurement purposes, they still need to calculate the CSM for each group of insurance contracts and account for it separately in subsequent periods.

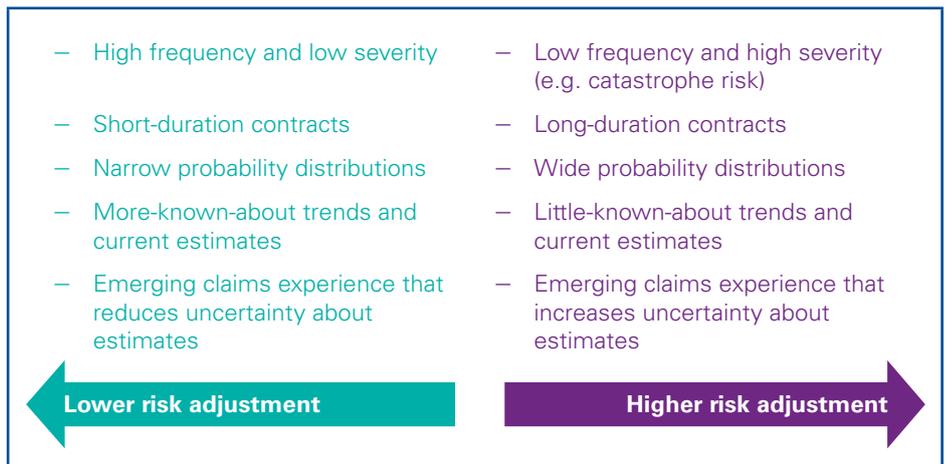
Therefore, an entity will have to allocate the risk adjustment for non-financial risk to each group of insurance contracts, including determining the risk adjustment attributable to a group of insurance contracts on initial recognition. Entities will also need to allocate changes in the risk adjustment for non-financial risk and determine the pattern of release from risk on subsequent measurement. No allocation method is prescribed by IFRS 17.

9.3

IFRS 17.B91

Estimation techniques

IFRS 17 does not prescribe methods for determining the risk adjustment for non-financial risk. Therefore, management’s judgement is necessary to determine an appropriate risk adjustment technique to use. The following characteristics are considered as part of this determination.



IFRS 17.B53

Given that some non-market variables (e.g. lapse rates) can be correlated with market variables (e.g. interest rates) when determining the risk adjustment for non-financial risk an entity needs to ensure that the risk adjustment for any non-financial risks that depend on market variables is consistent with observable market prices that depend on those market variables. For further discussion on market and non-market variables, see [Section 7.4](#).

IFRS 17.B92

When determining which technique to use, an entity considers whether it provides concise and informative disclosures that allow users of its financial statements to benchmark its performance against that of its peers.

Techniques for determining the risk adjustment

Because IFRS 17 does not prescribe a methodology, entities have a significant degree of autonomy over the method they use to determine the risk adjustment for non-financial risk. The appropriateness of a methodology will depend on the individual circumstances of each entity.

Entities are likely to leverage their current techniques to determine the risk adjustment for the purpose of applying IFRS 17. These methods may include cost of capital, confidence level and conditional tail expectation.

Some entities currently use a provision for adverse development to determine a conservative insurance liability measurement to allow for the possibility that insured claims may be higher than expected. In certain jurisdictions, this adjustment is prescribed, with no ability for interpretation. In others, it may be highly judgemental.

More detailed analysis would be needed to ensure that a risk adjustment for non-financial risk derived from currently used techniques meets IFRS 17's objective. Some examples of potential gaps are:

- level of estimation for each type of method currently used;
- regulatory requirements that do not reflect the entity's perspective;
- regulatory requirements that reflect a high level of conservatism, which is suitable for regulatory purposes but might be less in line with IFRS 17's objective;
- ignoring some relevant risks: e.g. in some cases, cost of capital methods may ignore any risk with an extremely low probability and may not be sensitive to these risks, such as catastrophe claims. These risks and their probability of occurrence have to be considered under IFRS 17; and
- the risk adjustment should reflect an allowance for diversification benefits at a higher level than the group of contracts if that reflects how the entity determines the compensation that it requires for bearing non-financial risk. This level may be different for different entities and types of contracts and there may be different methods to allocate risk-mitigating effects across different groups of contracts.



Estimation techniques – Potentially significant impacts on practice

Entities may already include implicit risk adjustments for non-financial risk in pricing practices, measuring insurance liabilities under their local GAAP or measuring insurance liabilities for regulatory purposes. These practices may be related to each other – e.g. if pricing practices are influenced by relevant regulatory capital requirements. However, an explicit risk adjustment for non-financial risk is expected to be a significant change for many entities. This may require a substantial amount of actuarial analysis and the development or adaptation of systems to measure and track the risk adjustment for non-financial risk.

As noted above, some entities already calculate an explicit risk adjustment for non-financial risk for other purposes, and may consider leveraging this technique. Entities planning to leverage techniques used for other purposes will need to consider whether adjustments to the techniques are necessary to ensure that the measurement meets the requirements of IFRS 17. They will also need to consider the availability of such information to meet their reporting timetable. In many cases, particularly for regulatory purposes, some of the computations are performed after the closing process is complete.

An entity that wishes to leverage these techniques will need to accelerate these calculations earlier in the reporting cycle, given that the CSM cannot be calculated without adjusting the present value of expected cash flows for the risk adjustment for non-financial risk.

If an entity chooses not to use a confidence level technique to determine the risk adjustment, then it is required to disclose the confidence level corresponding to the results of that technique, to provide comparability. This might have a significant impact on the choice of approach used and may be challenging for some entities to disclose. See [Section 19.4](#).

9.4

Using a risk adjustment for non-financial risk in measurement

IFRS 17.40

Consistent with the other components of the fulfilment cash flows, the risk adjustment for non-financial risk is updated at each reporting date using current assumptions.

IFRS 17.44(c), 45(c), B96(d)

An entity uses a risk adjustment for non-financial risk for measuring groups of insurance contracts, both on initial recognition and subsequently, as follows:

- *in the measurement of the fulfilment cash flows*: the risk adjustment for non-financial risk is applied both on initial recognition, when the CSM is determined, and in subsequent periods; and
- *in the subsequent measurement of the CSM of a group*: the CSM is adjusted for changes in the risk adjustment for non-financial risk that relate to future service. Other changes in the risk adjustment for non-financial risk are recognised in the statement(s) of financial performance (see [Chapter 10](#)).

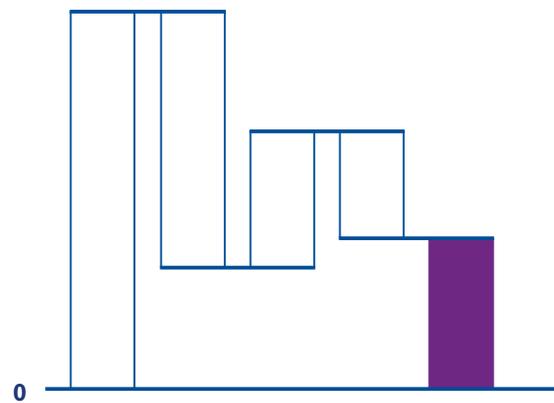
10

Contractual service margin

The final step in measuring a group of insurance contracts on initial recognition is to determine the unearned profit, represented by the CSM for profitable groups of contracts, or the loss component for groups of onerous contracts.

10.1

Initial recognition



4 CSM

The unearned profit that the entity will recognise as it provides services in the future under the insurance contracts in the group.

IFRS 17.28, 32, 38

On initial recognition of a profitable group of insurance contracts, the CSM is the equal and opposite amount of the net inflow that arises from the sum of the following:



- the fulfilment cash flows;
- the derecognition of any asset or liability previously recognised for cash flows related to the group²; and
- any cash flows arising from contracts in the group at that date.

An entity calculates a CSM for each group of insurance contracts. For further discussion of how to group insurance contracts, see [Chapter 6](#).

10.2

Subsequent measurement

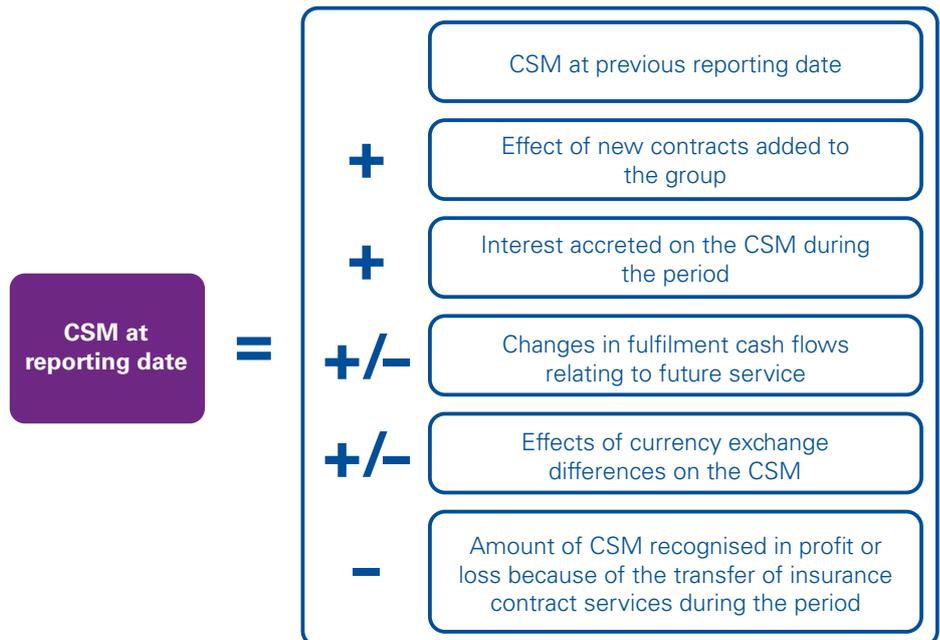
Generally, at each reporting date the carrying amount of a group of insurance contracts is remeasured by:

- estimating the fulfilment cash flows using current assumptions; and

2. Any cash flows relating to a group of issued insurance contracts, which the entity pays or receives before the group is recognised, are recognised as an asset or liability before the group is recognised. These could be insurance acquisition cash flows under IFRS 17 or any other assets or liabilities under other standards. Once the group to which the cash flows are allocated is recognised, the asset or liability related to those cash flows is derecognised; see [7.3.4](#) and [Section 4.2](#).

- updating the CSM to reflect changes in fulfilment cash flows related to future services, a financing effect and the profit earned as insurance contract services are provided in the period. The updated CSM represents the profit that has not yet been recognised in profit or loss because it relates to future services to be provided.

IFRS 17.44



The sum of the updated fulfilment cash flows and the updated CSM represents the carrying amount of the group of insurance contracts at each reporting date.

10.2.1

IFRS 17.44(b), B72(b), B73

Interest accretion

For contracts without direct participation features, interest is accreted on the carrying amount of the CSM during the reporting period using the discount rate applied on initial recognition to reflect the time value of money. Typically, insurance contracts within a group are recognised and initially measured on different dates. In determining the appropriate discount rate to accrete interest on the CSM for the group, entities can use a weighted-average discount rate over the period during which contracts in the group are issued or a rate representative for the reporting period. The objective of a weighted-average discount rate is to approximate an interest rate that would have applied had an individual interest rate been determined for each contract on the day each contract was added to the group. A discount rate that is observed on the first calendar day the group of contracts is recognised does not necessarily reflect an appropriate discount rate for accretion of interest on the CSM for the group. The discount rate is applied to nominal cash flows that do not vary based on returns on any underlying items. For further detail on determining the discount rate, see [Chapter 8](#).

IFRS 17.28

When an entity adds contracts to an existing group in a new reporting period, this may result in a change in the discount rates determined on initial recognition. In this case, the entity applies a revised weighted-average discount rate from the start of the reporting period in which the new contracts are added to the group.



Tracking discount rates

Almost all entities will find it a significant challenge to use both current discount rates and those determined on initial recognition in different phases of the measurement and recognition of groups of insurance contracts. Entities may already use at least one of these types of discount rates in measuring a product, but the use of both in the measurement and presentation of a product is not as common today.

Therefore, many entities will face significant challenges in updating their systems and processes to accommodate both sets of rates. Entities that use only (or mainly) current discount rates may find it challenging to track historical discount rates. These entities will also have to consider how to address a lack of historical discount rate information at transition (see [Chapter 20](#)).

10.2.2

IFRS 17.44(c)

Changes in fulfilment cash flows

For groups of contracts without direct participation features, the CSM is adjusted for changes during the reporting period in fulfilment cash flows relating to future service, except to the extent that:

- increases in the fulfilment cash flows exceed the carrying amount of the CSM (i.e. resulting in a loss); or
- decreases in fulfilment cash flows are allocated to a loss component of the liability (see [Chapters 11 and 13](#)).

IFRS 17.B96

Changes in fulfilment cash flows relating to future service, which adjust the CSM, may arise through:

- experience adjustments arising from premiums received in the period, including any related cash flows such as insurance acquisition cash flows and premium-based taxes, that relate to future service;
- changes in estimates of the present value of expected cash flows in the liability for remaining coverage, except for those that relate to the effect of the time value of money and the effect of changes in financial risk. To exclude the impact of changes in financial risk, the adjustment for changes in expected cash flows is measured using the discount rate determined on initial recognition;
-  – differences between actual and expected investment components or loans to a policyholder in the period, whether they are payable or repayable. These are determined by comparing the actual investment component or loan to a policyholder that becomes (re)payable with the (re)payment that was expected at the start of the period plus any insurance finance income and expenses related to that expected (re)payment before it becomes (re)payable; and
-  – changes in the risk adjustment for non-financial risk that relate to future service. An entity is not required to disaggregate the change in the risk adjustment for non-financial risk between insurance finance income and expense and the insurance service result. If the entity chooses to disaggregate it, then the entity adjusts the CSM only for the change related to non-financial risk.

IFRS 17.A

Experience adjustments arise from differences between the estimates at the beginning of the period of the amounts expected:

- for premium receipts: in the period and the actual cash flows in the period; or
- for insurance service expenses: to be incurred in the period and the actual amounts incurred in the period.

IFRS 17.B97(b), BC233

In general, experience adjustments relate to past or current service and therefore do not adjust the CSM. However, experience adjustments arising from premiums received in the period that relate to future service are an exception to this general rule – i.e. they do adjust the CSM.

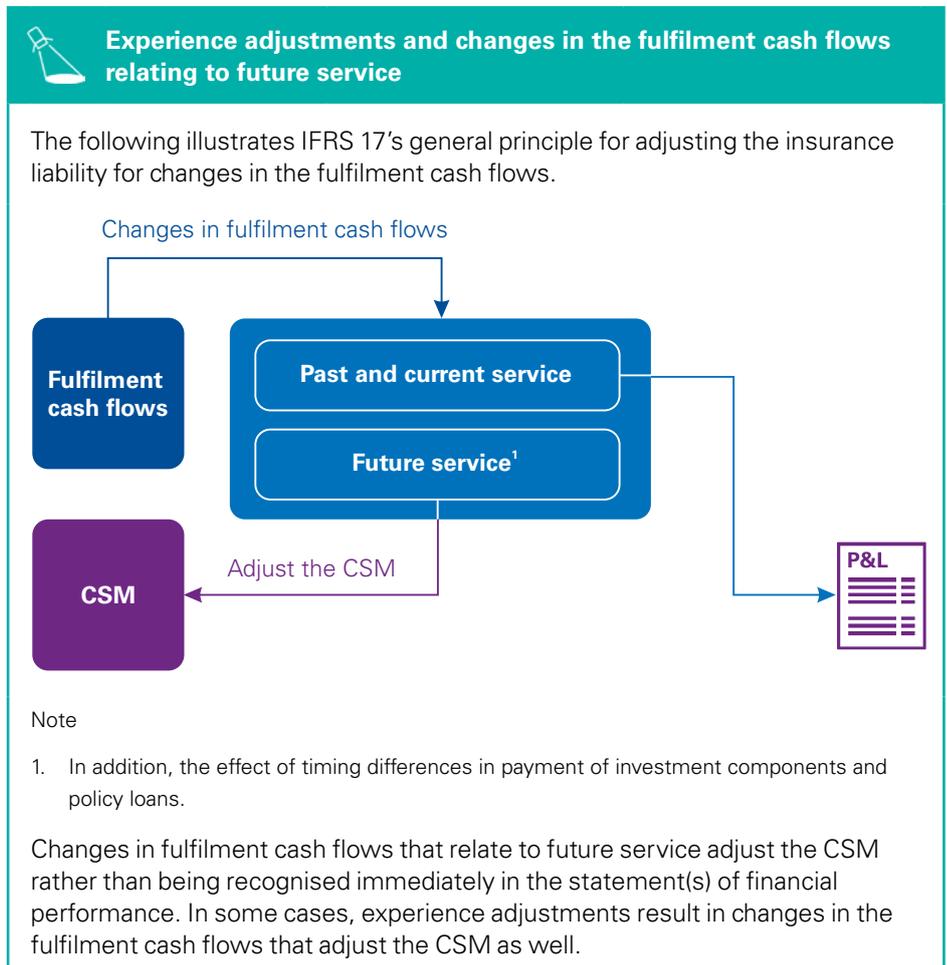
IFRS 17.A, BC235

Investment components are the amounts that an insurance contract requires the entity to repay to a policyholder in all circumstances, regardless of whether an insured event occurs. IFRS 17 requires any unexpected repayment of an investment component to adjust the CSM. However, the CSM is also adjusted for changes in future estimates of cash flows, which would include reductions in future repayments of investment components. Therefore, the net effect on the CSM represents the effect of a change in the timing of the repayment of the investment component. An entity is not required to determine the amount of an investment component until a claim is incurred (see 3.2.1.1).

IFRS 17.B97(b)

Changes in estimates of fulfilment cash flows in the liability for incurred claims relate to current or past services, so they do not adjust the CSM.

IFRS 17.BC233–BC234



For example, an entity issues a group of life insurance contracts for which premiums were received up front. In the first reporting period after initial recognition, the actual mortality is 80% of what was expected – i.e. more policyholders survived until the end of the period. The following table explains how this is reflected in the subsequent measurement of the insurance contract liability.

Impact of actual vs expected mortality	IFRS 17 requirements	Explanation
<p>Experience adjustment that impacts the actual claim events in the current period</p>	<p>The experience adjustment is recognised in profit or loss because the change relates to current coverage.</p>	<p>Although the revenue reflects expected benefit claims for the period estimated at the start of the period, the entity incurs lower than expected death benefit claims in the current period. The impact is reflected in profit or loss as claims are recognised.</p>
<p>Impact on expected future claims</p>	<p>This change adjusts the CSM because the change relates to future coverage.</p>	<p>The expected cash flows change to reflect the ongoing obligation to provide future services for more contracts than was previously estimated, because more contracts are in force for future periods than was expected at the beginning of the period.</p> <p>The impact of the experience adjustment on the current-period profit or loss is partially offset by the fact that the CSM released in the current period is calculated after adjusting for changes in the CSM during the period (see 10.2.4).</p>

10.2.2.1

IFRS 17.B98

Discretionary cash flows

Some insurance contracts without direct participation features provide an entity with discretion over the amount, timing or nature of cash flows to be paid to policyholders. A change in such cash flows due to the execution of the discretion is regarded as relating to future service and therefore adjusts the CSM. To identify these changes, at inception of the contract an entity specifies the basis on which it expects to determine its commitment under the contract – e.g. based on a fixed interest rate or on returns that vary based on specified asset returns.

IFRS 17.B99

The basis specified at inception of the contract is used to distinguish between the effect of changes in assumptions related to financial risk on that commitment and those that relate to discretionary changes to that commitment. Subsequent discretionary changes to the entity's commitment relate to future service and adjust the CSM. Conversely, subsequent changes to that commitment resulting from financial risk assumptions do not adjust the CSM.

IFRS 17.B100

At contract inception, if an entity cannot specify the basis on which it expects to determine its commitment under the contract, then its commitment is the return implicit in the estimate of fulfilment cash flows, updated to reflect current assumptions that relate to financial risk.



How to specify the basis used to determine the entity's commitment under the contract

This specification need not be limited to current market returns or interest income on assets held, but could include whatever factors the entity uses to determine the amounts due to policyholders – e.g. reference assets not held by the entity or indices. If the entity is unable to specify in advance how it will determine the amounts due to policyholders, then the default benchmark is effectively a current market return for financial risk.

Identifying the difference between the effect of changes in the financial risk assumptions relating to an entity's commitment under a contract (do not adjust the CSM) and discretionary changes to that commitment (adjust the CSM) will be complex.

Entities will need to develop a methodology for specifying how they determine the amounts due to policyholders at their discretion. Potential process complexities may arise in implementing this methodology, as well as system upgrades and new controls.

IFRS 17.IE56



Example 8 – Specifying discretion

Insurance Entity E issues an insurance contract (without a direct participation feature) with a five-year coverage period under which, in the event of the death of the policyholder, the beneficiary receives the greater of:

- a fixed death benefit; and
- the account balance.

If the policyholder survives at the end of the coverage period, then he or she receives the account balance.

The account balance receives a minimum interest return guarantee of 2%. Any additional return is at E's discretion.

At inception, E expects the return from an internally specified pool of assets to be 5%, and specifies that it expects to provide a return to the policyholder that will leave E with a 0.5% spread after meeting the guarantee. This is the initial commitment specified by E when identifying changes to the commitment that would adjust the CSM.

An actual return in the first subsequent period of 6% does not impact the CSM, because E has not changed the commitment mechanism, even though it will provide the policyholder with a higher return than expected. Rather, the effect of the financial risk will be recognised in profit or loss or OCI as part of insurance finance income or expense.

A change in the commitment in subsequent periods that results in E retaining a lower or higher spread would adjust the CSM, because it changes its commitment relating to future service to be provided.

10.2.3

IFRS 17.30, 44(d), BC278

Foreign currency exchange differences

If a group of insurance contracts generates cash flows in a foreign currency, then the group is considered a monetary item when applying IAS 21 *The Effects of Changes in Foreign Exchange Rates*. This means that the CSM is also a monetary item and it is adjusted for the effect of any currency exchange differences. This also applies when using the PAA.

10.2.4

IFRS 17.43, 44(e), B119

Release of the CSM

At each reporting date, the CSM reflects the profit in the group of insurance contracts that has not yet been recognised in profit or loss, because it relates to future service to be provided. Therefore, the CSM is released in each reporting period for an amount recognised in profit or loss to reflect the insurance contract services provided under the group of insurance contracts in that period.

This amount is determined by:

- identifying the coverage units in the group;
- allocating the CSM at the reporting date (before recognising any release to profit or loss to reflect the insurance contract services provided) equally to coverage units provided in the current period and expected to be provided in the future; and
- recognising in profit or loss the amount allocated to coverage units to reflect insurance contract services provided in the period.

IFRS 17.A, B119A–B119B



'Insurance contract services' are the services that an entity provides to the policyholder of an insurance contract. These services are:

- coverage for an insured event (insurance coverage);
- for insurance contracts without direct participation features, the generation of an investment return for the policyholder, if applicable (investment-return services); and

- for insurance contracts with direct participation features, the management of the underlying items on behalf of the policyholder (investment-related services).



An entity may provide an investment-return service if the following conditions are met:

- an investment component exists, or the policyholder has the right to withdraw an amount;
- the entity expects this component or amount to include an investment return (an investment return could be negative – e.g. in a negative interest rate environment); and
- the entity expects to perform investment activity to generate that investment return.

An investment-return service or investment-related service ends at or before the date on which all amounts due to current policyholders relating to those services have been paid, without considering payments to future policyholders included in the fulfilment cash flows.

IFRS 17B119

The number of coverage units in a group is the quantity of insurance contract services provided by the contracts in the group, determined by considering, for each contract, the quantity of benefits provided and its expected coverage period.

IFRS 17BC283

An entity recognises the CSM in profit or loss over the period for which it provides insurance contract services, rather than the period over which the liability is expected to be settled. The margin that the entity recognises for bearing risk – i.e. the risk adjustment for non-financial risk – is recognised in profit or loss as the entity is released from risk in both the coverage period and the settlement period.



Order of the CSM release

Generally, entities periodically review their recent experience coupled with that from the past – e.g. lapse rates – via experience studies. These studies are used to determine trends expected for future periods and are used in determining the estimates of expected cash flows – e.g. prospective changes in future lapse assumptions.

Although these changes in estimates are generally considered to relate to future service, they are considered in the allocation of the amount of CSM recognised in profit or loss for the reporting period in which they are made. This is because the CSM release is determined after the changes in fulfilment cash flows related to future service have been made to the carrying amount.

When a change to assumptions is made that will significantly impact the current period's performance because of the CSM allocation, an entity should consider whether additional disclosures are necessary to help users of its financial statements understand the components of the financial statements that are affected and the magnitude of that impact.



Determining the coverage units

The number of coverage units in a group is based on the quantity of coverage provided by the contracts in the group. For each contract, an entity considers the quantity of benefits provided under a contract and its expected coverage duration.

Quantity of benefits provided

Determining the quantity of benefits provided in the group involves more judgement, because there are no prescribed methods in IFRS 17. For certain types of life insurance contracts, the sum assured may result in an appropriate measure. The total premiums for coverage may also be a reasonable measure for some life and non-life groups of contracts measured under the general measurement model, given that they fund the benefits provided. However, a method based on premiums would not be considered appropriate if:

- the cash flows are expected to occur in periods different from those in which services are provided;
- they reflect different probabilities of claims for the same type of insured event in different periods, rather than different levels of service of standing ready to meet the claims; or
- they reflect different levels of profitability in contracts.

Where a group of insurance contracts contains both insurance and investment services, the coverage units will need to reflect both types of service to reflect the release from the performance obligation. The entity will need to apply judgement to determine an appropriate weighting between the insurance and investment services.



Identifying if non-direct participating contracts provide investment services

Entities will need to identify investment-return services for contracts measured under the general measurement model. For some contracts, such as some universal life contracts that do not qualify for the variable fee approach, an investment-return service is likely to exist. However, for many life contracts identifying investment services will not be a straightforward exercise.

Judgement needs to be applied to consider whether an investment component or right to withdraw exists and is expected to include an investment return.

The interpretation of what an entity views as 'performing an investment activity' to generate such an investment return will also be a factor in identifying investment services.

When entities have determined that an investment-return service exists, the next question is what the impact is on the profit emergence pattern. Both the coverage units for the insurance coverage(s) and the investment-return services need to be determined and a weighting needs to be applied to determine the coverage units for the group of contracts. IFRS 17 provides limited guidance on determining coverage units and different approaches may be acceptable as long as the chosen approach reflects the substance of the transfer of insurance contract services under the contracts. The relative weighting of the benefits that is applied needs to be disclosed as a significant judgement in the notes to the financial statements.



CSM tracking and allocation

Determining and tracking the CSM will be new for almost all entities and will require significant effort, cost, resourcing and upgrades to systems, processes and controls. Entities also should not overlook the complexity involved in allocating the CSM to profit or loss as service is provided.

Management judgements will be necessary to identify a method of allocation that is appropriate for its groups of contracts. Given the variety of insurance products that entities sell, management should consider allocation methods at a product or portfolio level. Selecting an appropriate measure that is relatively easy to determine and record might not be straightforward.

See [Example 9](#) for an illustration of initial and subsequent measurement under the general measurement model.

10.2.5

IFRS 17.B137, BC236



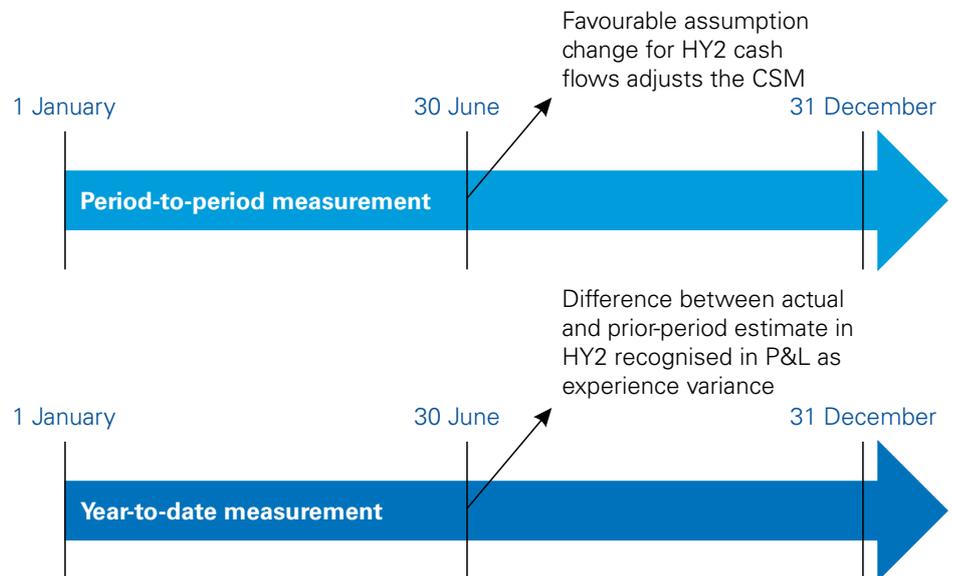
Interim reporting

If the entity publishes interim reports in accordance with IAS 34 *Interim Financial Reporting*, then it chooses an accounting policy to change or not change the treatment of accounting estimates made in previous interim financial statements when applying this standard in subsequent interim financial statements, and in the annual financial report. Once chosen, the accounting policy will need to be applied consistently.

If the entity chooses not to change the treatment of accounting estimates made in previous interim financial statements, then the results for subsequent interim periods are presented as a distinct period and the annual financial results in relation to these accounting estimates would reflect the sum of the amounts of each interim period – this may be referred to as the ‘period-to-period’ approach.

If the entity chooses to change the treatment of accounting estimates made in previous interim financial statements, then the results for each subsequent interim period and for the full year reflect the application at the current reporting date for the full period since the previous annual reporting date as if they were a single period. This may be referred to as the ‘year-to-date’ approach.

The below graphic demonstrates the two approaches.



Choosing an interim reporting approach

The amended IFRS 17 now includes an accounting policy choice over whether to change the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in subsequent interim financial statements and in the annual reporting period. Entities will mainly assess this from an operational perspective because the financial impact of the two choices will be challenging to determine. Key considerations for entities will be as follows.

- *Entities electing to change accounting estimates (period-to-period approach):* System functionality needs to be able to account for changes in accounting estimates, as a true-up adjustment may occur in subsequent interim periods and the annual reporting period, and the full retrospective approach may be impracticable to apply if a period-to-period approach was not used before IFRS 17 was adopted.
- *Entities electing not to change accounting estimates (year-to-date approach):* Potential difficulties may arise in explaining results in the current period and, in the case of significant changes in assumptions, additional disclosures for subsequent interim periods may be required under IAS 34.

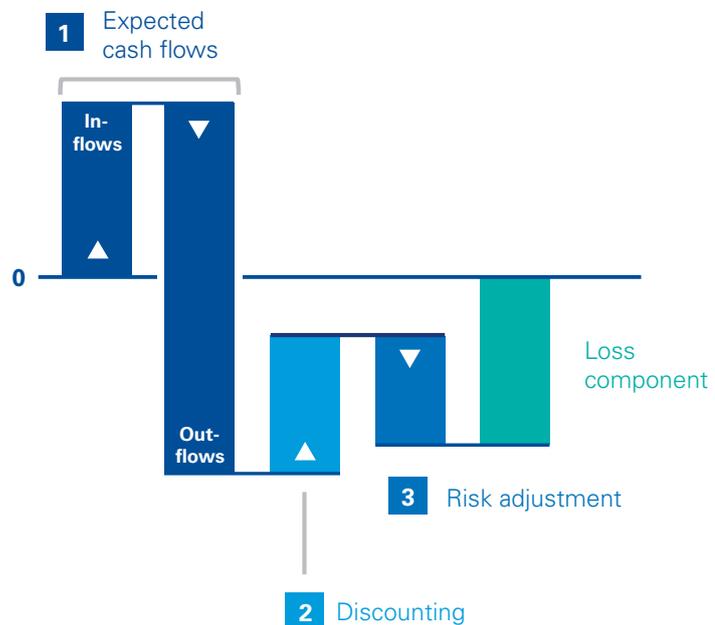
11

Onerous contracts

The fulfilment cash flows of a group of onerous contracts equate to a net outflow and the CSM is zero.

IFRS 17.47

A group of contracts that is onerous on initial recognition results in a loss being recognised immediately in the statement(s) of financial performance for the entire net cash outflow. Therefore, the carrying amount of the insurance liability for the group is equal to the fulfilment cash flows and the CSM of the group is zero.



11.1

IFRS 17.47, 49

Initial recognition

On initial recognition of a group of insurance contracts, if the sum of the following results in a net cash outflow, then the group of contracts is onerous:

- the fulfilment cash flows;
- the derecognition of any assets or liabilities previously recognised for cash flows related to the group of insurance contracts³; and
- any cash flows arising from contracts in the group at that date.



The amount of the net cash outflow is considered the loss component of the liability for remaining coverage, and is recognised as a loss in profit or loss.

3. Any cash flows relating to a group of issued insurance contracts that the entity pays or receives before the group is recognised are recognised as an asset or liability before the group is recognised. These could be insurance acquisition cash flows under IFRS 17 or any other assets or liabilities under other standards. Once the group to which the cash flows are allocated is recognised, the asset or liability related to those cash flows is derecognised; see 7.3.4 and Section 4.2.

11.2

IFRS 17.48(a), 49

Subsequent measurement

A group of contracts that has a CSM on initial recognition can become onerous in subsequent periods, if any of the following exceed the carrying amount of the CSM:

- unfavourable changes relating to future service in the fulfilment cash flows arising from changes in estimates of expected cash flows and the risk adjustment for non-financial risk; and
- for contracts with direct participation features (see [Chapter 15](#)), a decrease in the amount of the entity's share of the fair value of the underlying items.

The excess is the loss component of the liability for remaining coverage and is recognised in profit or loss when it is first measured.

The loss component determines the amounts that are subsequently presented in profit or loss as reversals of losses on onerous groups and are consequently excluded when determining insurance revenue (see [Chapter 13](#)).

IFRS 17.44(c), 50–52

Once a group of contracts has a loss component as part of its liability for remaining coverage (either on initial recognition or subsequently), subsequent changes in the fulfilment cash flows of that liability are allocated on a systematic basis between the:

- loss component of the liability for remaining coverage; and
- liability for remaining coverage, excluding the loss component.

These subsequent changes are those estimates of the present value of expected cash flows for claims and expenses released from the liability for remaining coverage because of incurred insurance service expenses, changes in the risk adjustment for non-financial risk recognised in profit or loss due to the release from risk, and insurance finance income or expense.

The systematic allocation results in the total amounts allocated to the loss component being zero by the end of the coverage period of the group of contracts.

Subsequent decreases in fulfilment cash flows arising from changes in estimates of expected cash flows relating to future service and, for contracts with direct participation features (see [Chapter 15](#)), any subsequent increases in the amount of the entity's share of fair value of the underlying items are allocated solely to the loss component, until it is reduced to zero. After it has reached zero, a CSM is created for the excess of the decrease over the amount allocated to the loss component.

IFRS 17.BC287, IE93

**Systematic allocation of the loss component**

IFRS 17 requires an entity to make a systematic allocation of changes in the fulfilment cash flows for the liability for remaining coverage that could affect either the loss component or the rest of the liability. It does not prescribe any methods for this systematic allocation.

One method could be to consider the proportion at the beginning of the period of the loss component of the liability for remaining coverage relative to the total estimate of the present value of the future cash outflows and the risk adjustment for non-financial risk.

Similar to tracking the CSM, tracking the loss component is likely to be complex. An entity will need to develop its systems and processes to be capable of allocating these changes in estimates to the loss component. This not only impacts the amount of revenue recognised in each reporting period but also affects the carrying amount of the loss component at each reporting date as well as when/if it reverses and when/if a CSM arises.

See [Example 9](#) for an illustration of the accounting for a group of contracts that becomes onerous on subsequent measurement.

IFRS 17.44(e), 45(e)

**CSM allocation when a contract becomes profitable**

IFRS 17 requires entities to release to insurance revenue an allocation of the CSM remaining at the reporting date over the current and remaining coverage period.

In some cases, a previously onerous group of contracts may become profitable during a reporting period due to favourable assumption changes. This results in the loss component being completely reversed and a CSM arising for the group of contracts. At the reporting date, the entity would release an allocation of the reinstated CSM to insurance revenue, to the extent that it is allocated to coverage units in the current period.

12

Derecognition and contract modifications

An insurance contract is derecognised when it is extinguished or – in some cases – when its terms are modified.

12.1

IFRS 17.74–75

Derecognition

An entity derecognises an insurance contract when it is extinguished – i.e. when the specified obligation in the contract expires or is discharged or cancelled. This is the point when an entity is no longer exposed to risk nor required to transfer economic resources to satisfy the contract.

IFRS 17.75, BC306

Insurance contracts are also derecognised when they are modified if certain criteria are met (see [Section 12.2](#)).

Typically, entities do not derecognise insurance contracts when purchasing reinsurance contracts because the reinsurance contracts protect the entity from losses on the underlying insurance contracts, but do not eliminate the entity's responsibility to fulfil its obligations under those contracts.

IFRS 17.BC321, IFRS 9.3.3.1

The derecognition criteria are consistent with those for financial liabilities under IFRS 9.

IFRS 17.76

An entity derecognises an insurance contract from within a group of insurance contracts by adjusting the group's:

- fulfilment cash flows to eliminate those that relate to the rights and obligations that have been derecognised from the group;
- CSM for the change in those fulfilment cash flows to the extent applicable (see [10.2.2](#)); and
- number of coverage units for the expected remaining insurance contract services to reflect the coverage units derecognised from the group (see [10.2.4](#)).

IFRS 17.77(a)

The accounting treatment differs when derecognition of an insurance contract is the result of the contract being transferred to a third party or results from a modification that leads to recognition of a new contract. In the former case – to the extent applicable – the CSM of the respective group is adjusted for the difference between the adjustment to the fulfilment cash flows and the premium charged by the third party. For the latter case, see [Section 12.2](#).



Contracts derecognised from a group

A contract derecognised from a group of contracts, either because it has lapsed or because it was transferred to a third party, will not result in direct recognition of profit or loss, unless it is the last contract in the group. This is because the change in the fulfilment cash flows adjusts the CSM of the group of contracts.

For contracts transferred, the amount paid to a third party also adjusts the CSM. This is because adjusting the CSM for the change in the fulfilment cash flows alone might increase the CSM. However, some of that increase is being paid for, and therefore does not reflect future profitability.

However, profit or loss might indirectly arise in these circumstances:

- when the CSM adjustment is determined using a different interest rate from the measure of change in the fulfilment cash flows (see 13.2.3);
- when all or some of the change in the fulfilment cash flows is allocated to a loss component of the group (including when it creates a loss component); and
- when the CSM is allocated to the period based on its adjusted amount and an adjusted number of coverage units – e.g. when the whole group of contracts is derecognised, all of the remaining CSM is recognised in the period.

12.2

IFRS 17.72

IFRS 17.72–73, BC317

IFRS 17.72

Contract modifications

Contract modification could be a result of an agreement between the parties to the contract or a change in regulation. The exercise of a right included in the contract is not a modification.

If the terms of a contract are modified in a way that would have significantly changed the accounting for the contract had the new terms always existed, then the modification triggers derecognition of the original contract and recognition of a new contract. All other contract modifications are accounted for as changes in estimates of fulfilment cash flows (see 10.2.2).

An entity derecognises an existing insurance contract and recognises the modified contract as a new contract if its terms are modified as follows.

- If the modified terms would have had any of the following effects, had they been included at contract inception:
 - the contract would have been excluded from the scope of IFRS 17;
 - the entity would have separated different components from the host insurance contract, resulting in a different insurance contract to which the standard applies;
 - the modified contract would have had a substantially different contract boundary; or
 - the modified contract would have been included in a different group of contracts.

- If the original contract is a direct participating contract (see [Chapter 15](#)), but the modified contract no longer is (or vice versa).
- If the entity applied the PAA to the original contract, but the modified contract no longer meets the eligibility criteria for it (see [Chapter 14](#)).

IFRS 17.76–77(a)

An entity derecognises an insurance contract from within a group of insurance contracts due to contract modification by adjusting:

- the fulfilment cash flows allocated to the group to eliminate those that relate to the rights and obligations of the contract derecognised from the group;
- the CSM of the group, to the extent applicable (see [10.2.2](#)), for the difference between the adjustment to those fulfilment cash flows and the premium that the entity would have charged had it entered into a contract with the new contract's terms at the date of contract modification, less any additional premium charged for the modification; and
- the number of coverage units for the expected remaining insurance contract services to reflect the coverage units derecognised from the group (see [10.2.4](#)).

IFRS 17.77(b)

An entity measures the new insurance contract as if it has received, at the date of modification, the premium used to measure the CSM adjustment above.

IFRS 17.BC319



Contracts derecognised from a group when they are modified

Contracts derecognised from a group of contracts when they are modified will not result in direct recognition of profit or loss. This is because the change in the fulfilment cash flows adjusts the CSM of the group of contracts.

Any amount that the entity has charged the policyholder to modify the contract also adjusts the CSM. This is because adjusting the CSM for the change in the fulfilment cash flows alone might increase the CSM; however, some of that increase belongs to the new contract, and therefore does not reflect future profitability of the group of contracts from which the modified contract has been derecognised.

However, profit or loss might arise indirectly in these circumstances, as discussed above.



Systems and process complexities

Entities may need to enhance existing systems and processes, or implement new ones, to assess contract modifications.

Entities might need to develop an additional process to properly assess the implications for their contract groupings. New contracts recognised as a result of contract modifications may need to be allocated to existing or new groups of contracts based on the level of aggregation requirements.

13

Presentation

There are specific requirements for presenting assets and liabilities, and revenue and expenses under the general measurement model.

13.1

IFRS 17.28B, 78–79, IAS 1.54



Statement of financial position

Portfolios of insurance contracts issued that are either assets or liabilities, and portfolios of reinsurance contracts held that are either assets or liabilities, are presented separately in the statement of financial position. Included in the carrying amounts for portfolios of insurance contracts are any assets for insurance acquisition cash flows related to the portfolio. Included in the carrying amounts for portfolios of reinsurance contracts are any assets or liabilities for cash flows related to the portfolio.



Unit of account for presentation in the statement of financial position

The level of aggregation is relevant not only for measurement purposes but also for presentation purposes. Entities must be able to identify the position – i.e. asset or liability – of each portfolio of contracts, in order to ensure the appropriate presentation, by aggregating all of the groups of contracts within each portfolio.

The carrying amount of a portfolio consists of:

- the liability (or asset) for remaining coverage for any groups within the portfolio;
- the liability for incurred claims for any groups within the portfolio;
- any assets for insurance acquisition cash flows related to the portfolio of insurance contracts; and
- any assets or liabilities for cash flows related to the portfolio of reinsurance contracts held.

Portfolios of direct insurance business are usually expected to be in a liability position – e.g. contracts for which all of the premium is received in advance. Contracts for which the premium is paid periodically do not necessarily give rise to a liability position, because this depends on the pattern of claim and expense payments compared with the pattern of premium receipts, the level of profitability, insurance acquisition cash flows and other items.

Entities must be able to associate insurance acquisition cash flows paid with the group to which they are expected to belong once the group is recognised. This information is necessary for measurement purposes in order to allocate these cash flows to the appropriate group on initial recognition.

The carrying amount of a portfolio includes both the liability for remaining coverage and the liability for incurred claims for all groups within the portfolio. This means that entities will need to be able to identify whether the liability for incurred claims belongs to a portfolio of insurance contracts that is an asset or to one that is a liability, in order to apply the presentation requirements above.

13.2

IFRS 1780, IAS 1.82

Statement(s) of financial performance

Amounts recognised in the statement(s) of financial performance are disaggregated into:

- an insurance service result comprising:
 - insurance revenue (see 13.2.1); and
 - insurance service expenses (see 13.2.2); and
- insurance finance income or expense (see 13.2.3).

IFRS 1782, 86

Income or expense from reinsurance contracts held is presented separately from expense or income from insurance contracts issued. However, income or expense from a group of reinsurance contracts held, other than insurance finance income or expense, may be presented either as a single net amount or separately as amounts recovered from the reinsurer and an allocation of the premiums paid (see Chapter 17).

IFRS 1785, BC357

Insurance revenue and insurance service expenses presented in profit or loss exclude any investment components, premium refunds and repayment of policy loans. Even though premiums charged may contain investment components, these investment components do not represent consideration for providing services and are not included in insurance revenue. In addition, an entity is prohibited from presenting premium information that is not considered insurance revenue in other line items in profit or loss.

IFRS 17.BC34



Excluding investment components from insurance service expenses and insurance revenue

Investment components need to be identified only when revenue and incurred claims are recognised, in order to be excluded from these amounts. Investment components are amounts repaid to the policyholder in all circumstances of economic substance. An example of an investment component is an amount repaid to the policyholder in all of the following events: on a claim, on surrendering the contract or when the contract reaches maturity without a claim being incurred.

Currently, investment components are not always monitored separately when setting assumptions, projecting cash flows and analysing the performance for a given period. Because investment components are not considered to be part of insurance service revenue or expense under IFRS 17, they will need to be excluded in calculating these amounts from the information previously used.

IFRS 17.41–42

The net carrying amounts of groups of insurance contracts change because of cash flows and income and expenses recognised in the statement(s) of financial performance during the period. The following table illustrates, in a simplified manner, the movements in the liabilities and the related recognition and presentation requirements over a reporting period for a profitable group of contracts without direct participation features and investment components.

IFRS 17.41–42, B120–B125

Liability for remaining coverage ¹			
	Insurance revenue	Insurance finance income or expense	Explanation
Opening balance			
Insurance service expenses expected to be incurred during the period as estimated at the beginning of the period/ initial recognition²	✓		
Changes to risk adjustment for non-financial risk that do not relate to future service	✓	*	* An entity can choose to disaggregate the changes in the risk adjustment for non-financial risk between the insurance service result and insurance finance income or expense (see 13.2.3)
CSM allocated to profit or loss in the period	✓		
Amortisation of insurance acquisition cash flows	✓ Revenue and service expenses in the same amount		This entry does not impact the liability for remaining coverage
Effect of the time value of money and financial risk – impact on fulfilment cash flows		✓	CSM adjustments for changes in fulfilment cash flows arising from changes in non-financial assumptions are measured at the discount rate on initial recognition, and fulfilment cash flows changes are measured at current discount rates. Any resulting difference is included as insurance finance income or expense
Effect of the time value of money – impact on the CSM		✓	
Premiums received			These increase the liability – they are not the revenue for a period
Closing balance			

Notes
1. For the purposes of this table, new contracts added to the group during the period are not illustrated because they do not impact the liability for remaining coverage when they are initially recognised before any premiums are received. Furthermore, it is assumed that the entity has not transferred any liabilities to third parties.
2. This relates to claims and fulfilment expenses expected to be <i>incurred</i> over the period. Cash flows related to claims incurred previously are included in the liability for incurred claims.

Liability for incurred claims			
	Insurance service expenses	Insurance finance income or expense	Explanation
Opening balance			
Actual claims and expenses incurred in the period	✓		
Changes in non-financial risk assumptions	✓		
Changes in risk adjustment for non-financial risk	✓	*	* An entity can choose to disaggregate the changes in the risk adjustment for non-financial risk between the insurance service result and insurance finance income or expense (see 13.2.3)
Effect of the time value of money and financial risk		✓	
Claims and expenses paid			These reduce the liability
Closing balance			

13.2.1

IFRS 17.B120

IFRS 17.83, B121

Insurance revenue

Generally, the total insurance revenue for a group of insurance contracts over their duration is the amount of premiums paid adjusted for a financing effect – i.e. time value of money – and excluding investment components. For direct participating contracts, the total insurance revenue includes the entity’s share of the change in the fair value of the underlying items.

Insurance revenue depicts the provision of services arising from the group of insurance contracts at an amount that reflects the consideration to which an entity expects to be entitled in exchange for those services. This amount comprises:

- amounts related to the provision of services; and
- amounts related to insurance acquisition cash flows.

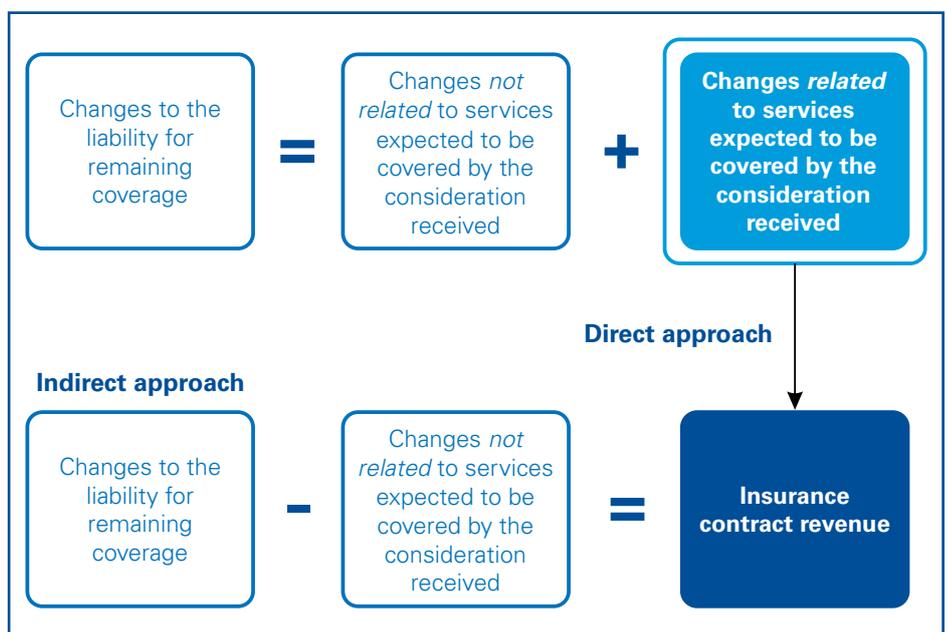
13.2.1.1

IFRS 17.B123

Amounts related to the provision of services

As an entity provides services during the period, the liability for remaining coverage decreases and is released in the form of revenue. However, the liability for remaining coverage includes components that do not relate to services expected to be covered by the total consideration received. The changes in these components are not included in the insurance revenue recognised.

Two approaches can be used to arrive at the insurance revenue for the provision of services for a period.



13.2.1.2

IFRS 17.B121(a), B124

Direct approach

The insurance revenue related to the provision of services is the sum of the changes in the liability for remaining coverage in the period that relates to services for which an entity expects to receive consideration. These changes comprise:

- insurance service expenses expected to be incurred in the period, based on the amounts expected at the beginning of the period, excluding:
 - amounts allocated to the loss component of the liability for remaining coverage;
 - repayments of investment components;
 - transaction-based taxes collected on behalf of third parties;
 - insurance acquisition cash flows; and
 - any amounts related to the risk adjustment for non-financial risk (see next bullet);
- the change in the risk adjustment for non-financial risk relating to past and current services, excluding amounts allocated to the loss component of the liability for remaining coverage or included as insurance finance income or expense;
- the amount of the CSM recognised in profit or loss in the period;

IFRS 17.B123A



- amounts related to income tax that are specifically chargeable to the policyholder; and
 - other amounts, if there are any, such as experience adjustments for premium receipts for current or past service.
- If an entity derecognises an asset other than insurance acquisition cash flows on initial recognition of a group of insurance contracts, then it recognises insurance revenue or expenses for the amount derecognised at that date.

13.2.1.3

IFRS 17.B123

Indirect approach

The insurance revenue related to the provision of services is the sum of all changes in the liability for remaining coverage minus the sum of the changes in the liability for remaining coverage that do not relate to services for which the entity expects to receive consideration. These changes comprise:

- changes that do not relate to services provided in the period:
 - cash inflows from premiums received (including those from investment components);
 - repayments of investment components;
 - cash flows from loans to policyholders;
 - transaction-based taxes collected on behalf of third parties;
 - insurance finance income or expense;
 - insurance acquisition cash flows; and
 - derecognition of liabilities transferred to a third party; and
- changes that relate to services, but for which the entity does not expect consideration – i.e. changes in the loss component of the liability for remaining coverage.

13.2.1.4

IFRS 17.B121(b)

Amounts related to insurance acquisition cash flows

IFRS 17 requires insurance acquisition cash flows to be included in determining the CSM on initial recognition. This approach reduces the CSM on initial recognition, and the insurance acquisition cash flows affect profit or loss through the CSM release process – i.e. as a reduction in insurance revenue. To reflect the fact that the insurance contracts are generally priced to recover these acquisition cash flows, an entity is required to add back the part of the premium that is intended to compensate for the acquisition cash flows to insurance revenue over the coverage period and to recognise an equal amount as an insurance service expense over the same period.

IFRS 17.B125, BC179

The amount of revenue related to recovering insurance acquisition cash flows is determined by allocating the portion of the premium that relates to recovering those cash flows to each reporting period in a systematic way based on the passage of time, with the same amount recognised as an insurance service expense. In other words, revenue and expenses are not recognised in profit or loss when the acquisition cash flows occur, but are separately identified and recognised over the coverage period (see 13.2.2).

13.2.2

IFRS 17:84–85

IFRS 17:IE4–IE29, IE81–IE98

Insurance service expenses

Insurance service expenses arising from groups of insurance contracts issued are recognised in profit or loss as they are incurred. They exclude amounts that are allocated to repayments of investment components, refunds of premiums and payment of policy loans.



Example 9 – Mechanics of revenue recognition under the general model

Entity E issues a group of insurance contracts with a coverage period of four years. The contracts have no participation features or investment components. At inception, the total premiums from the group of 1,500 are received and insurance acquisition cash flows of 100 are paid.

E expects claims and expenses of 800 to be incurred evenly over the coverage period, and no contracts to lapse. Claims are settled as they are incurred.

The risk adjustment for non-financial risk on initial recognition is 80. For simplicity, this example assumes that it is released evenly over the coverage period and that the discount rate is negligible.

Over the coverage period, all events happen as expected and E does not change any assumptions related to future periods.

E measures the insurance contract liability on initial recognition and at the end of each year as follows.

	Initial recognition	Year 1	Year 2	Year 3	Year 4
Estimates of the present value of cash inflows	1,500	-	-	-	-
Estimates of the present value of cash outflows, including acquisition cash flows	(900)	(600)	(400)	(200)	-
Risk adjustment	(80)	(60)	(40)	(20)	-
Fulfilment cash flows	520	(660)	(440)	(220)	-
CSM	(520)	(390) ¹	(260)	(130)	-
Insurance contract liability	-	(1,050)	(700)	(350)	-

Note

1. Calculated as $520 - 520 / 4 = 390$. As described in Chapter 10, an amount of the CSM for a group of contracts is recognised in profit or loss in each period to reflect the services provided under the group of contracts in that period. The amount is determined by identifying the coverage units in the group, reflecting the quantity of benefits provided under each contract in the group and its expected coverage period. In this example, the service provided in each period is the same because all of the contracts are expected to provide the same amount of benefits for all four years of coverage.

The following table shows the change in the liability for remaining coverage for each period.

	Year 1	Year 2	Year 3	Year 4
Opening balance	-	(1,050)	(700)	(350)
Premiums received	(1,500)	-	-	-
Acquisition cash flows	100			
Expected claims	200	200	200	200
Risk adjustment recognised	20	20	20	20
CSM allocation	130	130	130	130
Closing balance	(1,050)	(700)	(350)	-

The following table describes the insurance revenue calculated by using the direct approach as described above and the expense for each year.

	Year 1	Year 2	Year 3	Year 4
Expected claims	200	200	200	200
Risk adjustment recognised	20	20	20	20
CSM allocation	130	130	130	130
Revenue for services provided	350 ¹	350	350	350
Revenue to cover acquisition cash flows	25 ²	25	25	25
Insurance revenue	375	375	375	375
Service expenses	200	200 ³	200	200
Insurance acquisition expenses	25 ²	25	25	25
Insurance service expenses	225	225	225	225
Insurance service result	150	150	150	150

Notes

- Under the indirect approach described above, the insurance revenue for services provided is the total change in the liability for remaining coverage of 1,050 minus the premiums received of 1,500 plus the acquisition cash flows of 100.
- Calculated as $100 / 4 = 25$. The revenue related to insurance acquisition cash flows is recognised in a systematic way based on the passage of time. Additionally, the same amount is recognised as an expense.
- If the actual claim in Year 2 had been 250 instead of 200, then E would recognise an incurred claim of 250 as an insurance service expense, reflecting an experience adjustment of 50. The revenue for the period is determined based on the claims expectations at the beginning of the period.

Changes in assumptions related to future coverage that create an onerous group of contracts

If at the end of Year 3, the expected claims for Year 4 are estimated to be 550, then this is considered to be a change in assumptions that relate to future service. The following table shows how the estimations for Years 3 and 4 would be changed in this case. For simplicity, it is assumed that the risk adjustment for non-financial risk is not impacted by this change.

The following table shows the insurance contract liability on initial recognition and at the end of each year.

	Initial recognition	Year 1	Year 2	Year 3	Year 4
Estimates of the present value of cash inflows	1,500	-	-	-	-
Estimates of the present value of cash outflows	(900)	(600)	(400)	(550)	-
Risk adjustment	(80)	(60)	(40)	(20)	-
Fulfilment cash flows	520	(660)	(440)	(570)	-
CSM	(520)	(390)	(260)	- ¹	-
Insurance contract liability	-	(1,050)	(700)	(570)	-

Note

- Because the increase in the fulfilment cash flows (550 - 200) exceeds the CSM balance (260), the CSM is reduced to zero and the excess (90 = (550 - 200) - 260) is immediately recognised as a loss in profit or loss and is included in the liability for remaining coverage as a loss component.

The following table includes the change in the liability for remaining coverage for each period.

	Year 1	Year 2	Year 3	Year 4
Opening balance	-	(1,050)	(700)	(570)
Premiums received	(1,500)	-	-	-
Acquisition cash flows	100	-	-	-
Expected claims not allocated to loss component	200	200	200	463 ²
Risk adjustment recognised not allocated to loss component	20	20	20	17 ²
CSM allocation	130	130	-	-
Loss component	-	-	(90)	90
Closing balance	(1,050)	(700)	(570) ¹	-

Notes

1. This balance includes a loss component of 90. The loss component determines the amounts that are presented in profit or loss as reversals of losses on onerous groups (a reduction in insurance service expenses) and are consequently excluded from revenue.
2. E allocates the subsequent changes in the fulfilment cash flows of the liability for remaining coverage on a systematic basis between the loss component for the liability for remaining coverage and the liability for remaining coverage, excluding the loss component. In this example, E has based its method on the ratio of the opening balance of the loss component (90) compared with the opening balance of the total future cash outflows and the risk adjustment for non-financial risk (570). For the period, 16% (90 / 570) of subsequent changes in the fulfilment cash flows are allocated to the loss component.

Therefore, this ratio is applied to the incurred insurance claim to determine its allocation between the loss component of the liability for remaining coverage and the liability for remaining coverage, excluding the loss component (87 = 550 x 16%). Similarly, the ratio is applied to the release of the risk adjustment for non-financial risk (3 = 20 x 16%). The remaining 463 of the claims (550 - 87) and 17 of the risk adjustment for non-financial risk (20 - 3) are recognised as revenue.

The following table analyses the insurance revenue and expense for each period, calculated using the direct approach.

	Year 1	Year 2	Year 3	Year 4
Expected claims not allocated to loss component	200	200	200	463
Risk adjustment recognised not allocated to loss component	20	20	20	17
CSM allocation	130	130	-	-
Revenue for services provided	350	350	220	480¹
Revenue to cover acquisition cash flows	25	25	25	25
Insurance revenue	375	375	245	505
Incurred claims	200	200	200	550
Loss on onerous groups of contracts	-	-	90	(90)
Insurance acquisition expenses	25	25	25	25
Insurance service expenses	225	225	315	485
Insurance service result	150	150	(70)	20 ²
Notes				
1. Under the indirect approach, the insurance revenue for services provided is the total change in the liability for remaining coverage of 570 minus the amounts of expected claims and risk adjustment for non-financial risk allocated to the loss component of 90.				
2. This is effectively the risk adjustment released (17 recognised as insurance revenue and 3 recognised as a reduction in insurance service expenses).				



Revenue recognition and presentation – New performance measure

The current practice of recognising revenue as written or earned premiums will no longer apply. IFRS 17's approach could result in significantly different amounts of revenue being recognised compared with that recognised under current practice, which does not always align with the variability of claims, risks and service provided over the coverage period.

Some entities currently apply an approach similar to a fulfilment cash flows approach when measuring their liabilities. However, they usually present changes in the liability for remaining coverage in an expense line item – e.g. changes to liabilities – rather than in the revenue line item.

This new form of reporting for insurance results in greater consistency in reporting the revenues of mixed activity groups that include insurance operations and with other industries. However, it will require significant education for both insurers and users, because the way in which performance is communicated will change.



Revenue recognition and presentation – New operational complexities

Revenue recognised in the period is, to a large extent, based on the expected claims and expenses for the period.

Currently, many insurers maintain some form of embedded value reporting, based on current assumptions at each reporting date. In addition, many insurers use experience information about expectations – i.e. actual vs expected – to explain the different drivers of profit, or to explain the development of embedded value in the period. Therefore, information about previous expectations is currently used and maintained to some extent.

However, the information about previous expectations will need to be adapted to provide the basis for revenue recognition under IFRS 17. Some of the reasons for this might include:

- not all of the assumptions are current or consistent with the requirements of IFRS 17;
- insurers may not currently distinguish between financial risk assumptions and non-financial risk assumptions, whereas they are distinguished in both the measurement and presentation requirements of IFRS 17; and
- the information may not be subject to sufficiently robust internal controls.

Insurers will need to reassess the capabilities of their systems and processes to assess the level of changes and resources needed to adapt. Insurers that do not have current assumptions and expected cash flow data updated for each reporting period appropriately stored and easily accessible, and insurers that are not able to demonstrate that they track investment components separately from other cash flows, as discussed above, are likely to face the greatest challenges.

Actuaries, accountants and IT specialists will need to work closely together to produce the required information.

13.2.3

IFRS 17.87

Insurance finance income or expense

Insurance finance income or expense comprises the change in the carrying amount of the group of insurance contracts arising from the effect of, and changes in:

- the time value of money; and
- financial risk.

IFRS 17.B128(a)–(b)



For the purpose of applying the requirements of IFRS 17, assumptions about inflation based on an index of prices or rates or on prices of assets with inflation-linked returns are assumptions that relate to financial risk. Assumptions about inflation based on an entity's expectation of specific cost changes are not assumptions that relate to financial risk.

IFRS 17.87(c), B128(c), BC246–BC247



Changes in the measurement of a group of insurance contracts caused by changes in the value of underlying items (excluding additions and withdrawals) are changes arising from the effect of the time value of money and financial risk and are presented as insurance finance income or expense. However, for direct participating contracts the entity's share of the change in the value of the underlying items and the changes in fulfilment cash flows relating to future service that are allocated to the loss component of the liability for remaining coverage are recognised in profit or loss as part of insurance service expenses, rather than insurance finance income or expense. This is because these amounts are considered part of the variable fee for service, even though they are, or may be driven by, changes in financial risk assumptions (see [Chapter 15](#)).

IFRS 17.88–90, B129

An entity can choose as an accounting policy to present the insurance finance income or expense:

- in profit or loss; or
- disaggregated between profit or loss and OCI (the OCI option).

Once chosen, the accounting policy will need to be applied consistently at the level of a portfolio of insurance contracts.

The amount included in OCI is the difference between the total insurance finance income or expense and the amount included in profit or loss.

IFRS 17.B129, IAS 8.13

Under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, an entity selects and applies consistent accounting policies for similar portfolios of insurance contracts. In assessing whether portfolios of insurance contracts are similar, the entity considers for each portfolio the assets that it holds and how it accounts for them.

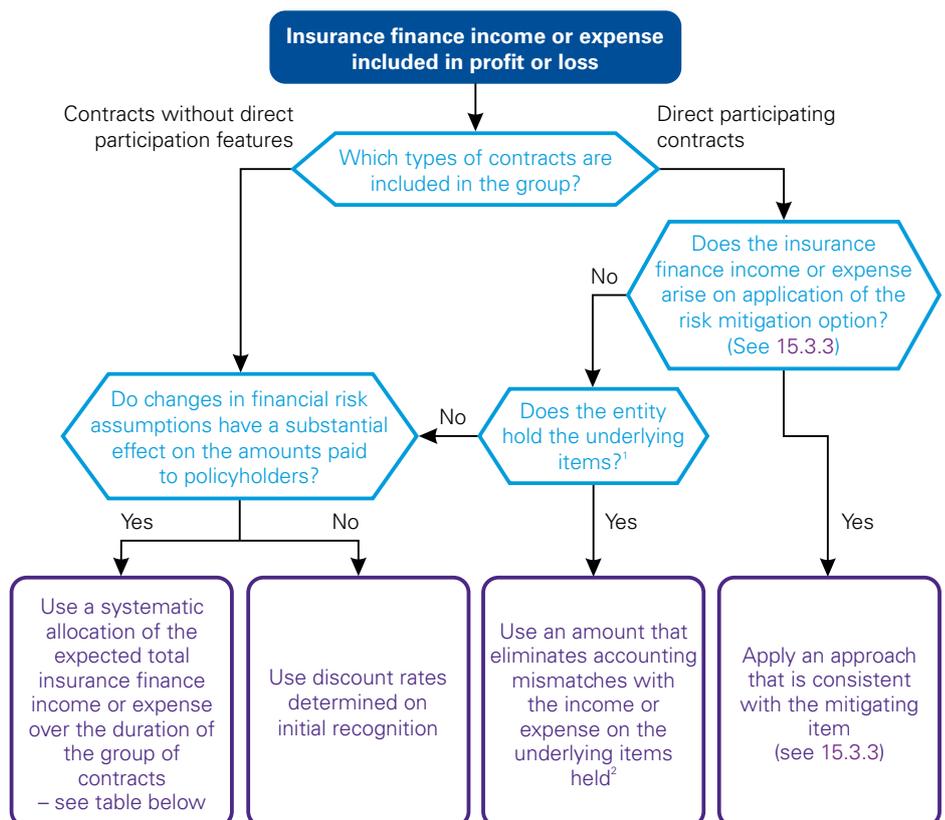
IFRS 17.88–90

When an entity applies the OCI option, the insurance finance income or expense that is recognised in profit or loss is determined depending on whether the group is a group of direct participating contracts for which the entity holds the underlying items and, if not, whether changes in financial risk assumptions would have a substantial effect on the amounts paid to policyholders. If the risk mitigation option is applied (see [15.3.3](#)) this will also impact how insurance finance income or expense is presented in profit or loss.

These presentation requirements do not change the total amount of insurance finance income or expense under IFRS 17, but specify only how to allocate this total amount to different parts of the statement(s) of financial performance when the OCI option is applied.

The following flowchart demonstrates how an entity determines the amount of insurance finance income and expense that is presented in profit or loss.

IFRS 17.88–89, B117A, B130–B135



A systematic allocation³ of the expected total insurance finance income or expense is applied as follows.

Systematic allocation of finance income and expense arising from:	Contracts without direct participation features	Direct participating contracts
Fulfilment cash flows⁴	Use a rate that allocates the remaining revised expected finance income or expense over the remaining duration of the group of contracts at a constant rate (the effective yield approach). For contracts that use a crediting rate to determine amounts due to policyholders, use an allocation that is based on the amounts credited in the period and expected to be credited in future periods to the policyholders (the projected crediting rate approach).	

Systematic allocation of finance income and expense arising from:	Contracts without direct participation features	Direct participating contracts
CSM	Use the discount rate determined on initial recognition.	Allocation consistent with that applied for the fulfilment cash flows.

Notes

IFRS 17B135–B136

- Whether an entity holds the underlying items (either by choice or requirement) may change over time. If there is a change, then the accounting policy choice available to the entity may change and the entity may be required to change the way that it determines the amount of insurance finance income or expense included in profit or loss. In this case, the entity applies its former OCI option accounting policy choice up to the date of the change, reclassifies the amount accumulated in OCI to profit or loss as a reclassification adjustment in the period of the change and future periods, and applies its new OCI option accounting policy choice prospectively without restating prior-period comparatives.

IFRS 17B134

- The insurance finance income or expense included in profit or loss is the amount that exactly matches the expenses or income included in profit or loss for the underlying items.

IFRS 1791(b)

When the entity transfers a group of contracts or derecognises a contract on modification, any amounts previously recognised in OCI are not reclassified to profit or loss.

IFRS 1788(b), B130

- A systematic allocation of the expected total insurance finance income or expenses over the duration of the group of contracts is based on the characteristics of the contracts without reference to factors that do not affect the cash flows of the contracts – e.g. the expected returns on assets when those returns do not affect the cash flows of the contracts. This allocation results in the amounts accumulated in OCI over the duration of the groups of contracts totalling zero.

IFRS 1791(a)

When the entity transfers a group of contracts or derecognises a contract on modification, any remaining amounts previously recognised in OCI are reclassified to profit or loss as a reclassification adjustment.

IFRS 17B132(b)

- A consistent allocation is applied for finance income or expense arising from the risk adjustment for non-financial risk, if it is disaggregated from other changes in the risk adjustment for non-financial risk (see 13.2.3.1).

IFRS 1730, 92

Because insurance contracts are treated as monetary items under IAS 21 (see 10.2.3), exchange differences on changes in groups of insurance contracts are recognised in profit or loss unless they relate to changes recognised in OCI, in which case they are also recognised in OCI.

IFRS 17BC275

IFRS 17 requires the CSM to be adjusted for changes in estimates of expected cash flows related to future service. When measuring the fulfilment cash flows, these changes in estimates are measured using a current discount rate. However, the CSM for insurance contracts without direct participation features is measured using a discount rate determined on initial recognition.

The application of two different discount rates causes a difference between the change in the fulfilment cash flows and the adjustment to the CSM (related to the change in the fulfilment cash flows). This difference gives rise to a gain or loss that is recognised as part of insurance finance income or expense and, therefore, is subject to the OCI option, if that accounting policy choice is made.

 **Example 10 – Disaggregating insurance finance income or expense: The mechanics**

Entity E issues a group of insurance contracts with a coverage period of four years. The contracts have no participation features or investment components. At inception, E receives total premiums of 1,000 from the group.

E expects claims and expenses of 800 to be incurred at the end of the fourth year of coverage. No lapses are expected.

For simplicity, this example assumes that the risk adjustment for non-financial risk is negligible. There are no acquisition cash flows that are directly attributable to the portfolio of insurance contracts that this group is a part of.

Over the coverage period, all events happen as expected and E does not change any assumptions relating to future periods.

The discount rate determined for measuring the fulfilment cash flows on initial recognition is 5%. At the end of Year 1, that discount rate is 5% and at the end of Years 2, 3 and 4 it is 3%.

Changes in financial risk assumptions do not have a substantial effect on the amounts paid to policyholders. The entity decides to apply the OCI option to disaggregate insurance finance income or expense and includes in profit or loss an amount determined by a systematic allocation of the expected total insurance finance income or expense over the duration of the group of contracts, using the discount rate determined on initial recognition.

E measures the insurance contract liability on initial recognition and at the end of each year as follows.

	Initial recognition	Year 1	Year 2	Year 3	Year 4
Estimates of the present value of cash inflows	1,000	-	-	-	-
Estimates of the present value of cash outflows	(658) ¹	(691)	(754) ²	(777)	-
Fulfilment cash flows	342	(691)	(754)	(777)	-
CSM	(342)	(269)	(188)	(98)	-
Insurance contract liability	-	(960)	(942)	(875)	-

Notes

1. Calculated as $800 / 1.05^4 = 658$.
2. Calculated as $800 / 1.03^2 = 754$.

On initial recognition, E estimates that the CSM will be released to profit or loss at each subsequent reporting date, as follows.

	Year 1	Year 2	Year 3	Year 4
Opening balance	342	269	188	98
Interest accretion	17 ¹	13	9	5
Release to profit or loss	(90) ²	(94)	(99)	(103)
Closing balance	269	188	98	-

Notes

1. Calculated as $342 \times 0.05 = 17$. The same interest rate is used for the subsequent periods.
2. Calculated as $(342 + 17) / 4 = 90$.

The following table includes the change in the liability for remaining coverage for each period.

	Year 1	Year 2	Year 3	Year 4
Opening balance	-	(960)	(942)	(875)
Premiums received	(1,000)	-	-	-
Insurance finance income/ (expense) in profit or loss	(50) ¹	(48) ²	(45) ⁴	(43)
Insurance finance income/ (expense) in OCI	-	(28) ³	14 ⁵	15
Expected claims	-	-	-	800
CSM allocation	90	94	99	103
Closing balance	(960)	(942)	(874)	-

Notes

1. The expense of 50 comprises the time value of money for the fulfilment cash flows of (658×0.05) and for the CSM of 17.
2. The expense of 48 comprises the time value of money for the fulfilment cash flows of (691×0.05) and for the CSM of 13.
3. The amount recognised in OCI of 28 is the difference between the total insurance finance income or expense of 76 and the amount recognised in profit or loss of 48. The total insurance finance income or expense of 76 is the difference between the estimates of the present value of expected cash flows (754) and the corresponding amount at the end of Year 1 (691), plus interest on the CSM (13).
4. The expense of 46 comprises the time value of money for the fulfilment cash flows of $(800 / 1.05^2) \times (0.05)$ and for the CSM of 9.
5. The amount recognised in OCI of 14 is the difference between the total insurance finance income or expense of 32 $(777 - 754 + 9)$ and the amount recognised in profit or loss of 46.

Changes in assumptions

If at the end of Year 3 E changes its assumptions so that it now expects insurance claims of only 450 at the end of Year 4, then the fulfilment cash flows would decrease by 340, being the change of 350 discounted at the current rate of 3%. This change would increase the CSM by 333, being the change of 350 discounted using the original discount rate of 5%. The difference of 7, which represents a reduction in the carrying amount of the group of contracts due to discount rate changes, would be recognised as insurance finance income in OCI.



Disaggregating insurance finance income or expense – Operational complexities

When applying the OCI option to contracts without direct participation features, entities will need to retain historical and current data to track discount rates determined on initial recognition and compute and present the effects of changes from those rates at each reporting date.

Although an entity may choose to recognise the effect of changes in discount rates and other market variables in profit or loss, it still needs to maintain records of the discount rates that applied on initial recognition of its insurance contracts without direct participation features. This is because this information will be needed to calculate the insurance finance expense accreted on the CSM, and to determine the amount by which the CSM is adjusted when there are changes in the estimates of expected cash flows related to future service.



Policy choices available in IFRS 17 and IFRS 9 to reduce accounting mismatches

When determining whether to apply the OCI option, entities will probably want to consider the expected accounting mismatches that may arise and the potential ways to mitigate them. This is a choice that is made on a portfolio level, which is defined by contracts with similar risks and whether they are managed together.

Entities will also want to consider how they will apply the designation options under IFRS 9 (see [Chapter 20](#) for further details). This is likely to be a significant exercise because entities should consider:

- the expected classification and measurement of financial assets under IFRS 9;
- all available options under each standard;
- the entity's approach to accounting mismatches and volatility in the financial statements; and
- the resources necessary for changes to systems to arrive at the desired solution.

Entities that prefer *less volatility* in profit or loss that arises between the insurance liability and the assets that support it are likely to consider options that allow this volatility to be presented in OCI, such as:

- applying the OCI option, such that insurance finance income or expense is disaggregated between profit or loss and OCI; and
- not electing to designate debt financial assets under the fair value option in IFRS 9 (FVTPL).

For direct participating contracts for which the entity holds the underlying items, IFRS 17 already reduces accounting mismatches because the insurance finance income or expense included in profit or loss is an amount that eliminates accounting mismatches with the finance income or expense arising on the underlying items held.

For direct participating contracts where the risk mitigation option is applied, an entity presents insurance finance income or expense in profit or loss or OCI depending on the assets held to mitigate changes in financial risk.

Entities that prefer *all changes to be in profit or loss* for the insurance liability and the assets that support it are likely to consider the following options:

- not applying the OCI option, such that all insurance finance income or expense is recognised in profit or loss;
- designating financial assets as at FVTPL to eliminate or significantly reduce an accounting mismatch that would otherwise arise from measuring assets or liabilities, or recognising the gains and losses on them, on different bases (IFRS 9 choice); and
- not electing to present in OCI any changes in the fair value of investments in equity instruments (IFRS 9 choice).

13.2.3.1

IFRS 17.B124(b)

Disaggregating changes in the risk adjustment for non-financial risk

Generally, insurance revenue recognised in a reporting period includes the changes in the liability for remaining coverage that result from changes in the risk adjustment for non-financial risk, excluding:

- changes that adjust the CSM because they relate to future service; and
- amounts allocated to the loss component of the liability for remaining coverage.

IFRS 17.81

The risk adjustment for non-financial risk might include a financial risk component – e.g. the effect of a change in discount rate on the risk adjustment. However, entities are not required to disaggregate the change in risk adjustment between the insurance service result and insurance finance income or expense. If an entity does not disaggregate the change in the risk adjustment for non-financial risk between these two, then the entire change in the risk adjustment for non-financial risk is included in the insurance service result.

IFRS 17.B124(b)(i)

If an entity decides to disaggregate the changes in the risk adjustment for non-financial risk between the insurance service result and insurance finance income or expense, then insurance revenue excludes the finance income or expense related to the change in the risk adjustment for non-financial risk.

14

Premium allocation approach

Entities with contracts eligible for a simplified model – the PAA – will still face new challenges when applying IFRS 17.

14.1

IFRS 17.40, A

A simplified model

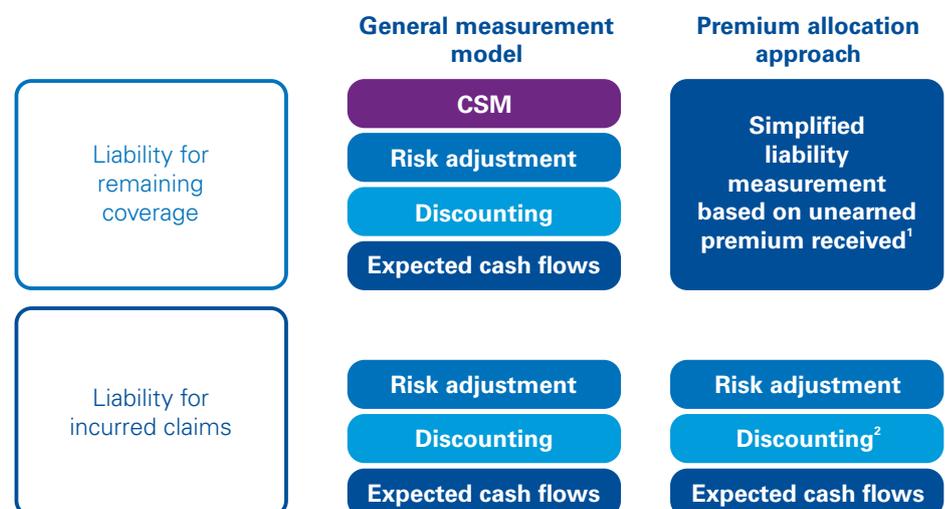
As outlined in [Section 5.2](#), the total carrying amount of a group of insurance contracts is made up of:

- a liability for remaining coverage, which represents the fulfilment cash flows relating to future service that will be provided under the contract in future periods and the CSM; and
- a liability for incurred claims, which represents the fulfilment cash flows related to past service for claims and expenses already incurred.

Under the PAA, the general measurement model may be simplified for certain contracts to measure the liability for remaining coverage.

Generally, the PAA measures the liability for remaining coverage as the amount of premiums received net of acquisition cash flows paid, less the net amount of premiums and acquisition cash flows that have been recognised in profit or loss over the expired portion of the coverage period based on the passage of time.

The PAA assumes that recognising the contract’s premium over the coverage period provides similar information and profit patterns to those provided by recognising insurance contract revenue measured using the general measurement model.



Notes

1. Unless the group of contracts is onerous. See further discussion at [14.3.2](#).
2. Unless the entity is permitted and chooses not to adjust the expected cash flows for the time value of money. See [Section 14.4](#).



PAA – New practices and challenges

Generally, the PAA shares some similarities with the current accounting model for short-duration contracts under US GAAP, and to models used by many entities under IFRS 4.

However, the specific guidance in IFRS 17 introduces new practices and challenges, even for entities that currently use a similar methodology. These mainly relate to the following issues, which are discussed in more detail below:

- level of aggregation (see [Chapter 6](#));
- PAA eligibility criteria (see [Section 14.2](#));
- onerous contracts: level of measurement and measurement method (see [14.3.2](#) and [14.3.3](#));
- interest accretion and discounting (see [14.3.4](#) and [Section 14.4](#));
- explicit risk adjustment in the liability for incurred claims (see [Section 14.4](#));
- pattern of revenue recognition over the coverage period (see [14.3.4](#)); and
- revenue presentation in the statement of profit or loss (see [Chapter 13](#)).

In addition to determining whether the PAA can be applied, there are various other simplifications within the PAA that an entity may apply:

- whether to adjust for the effect of the time value of money in the measurement of the liability for remaining coverage, if certain criteria are met (see [14.3.4](#));
- whether to expense insurance acquisition cash flows when they are incurred, if certain criteria are met (see [14.3.1](#));
- whether to discount liabilities for incurred claims and onerous contracts, if certain criteria are met (see [Section 14.4](#) and [14.3.2](#)); and
- whether to apply the OCI option for the liability for incurred claims and the liability for remaining coverage (see [Section 14.4](#) and [14.3.4](#)).

14.2

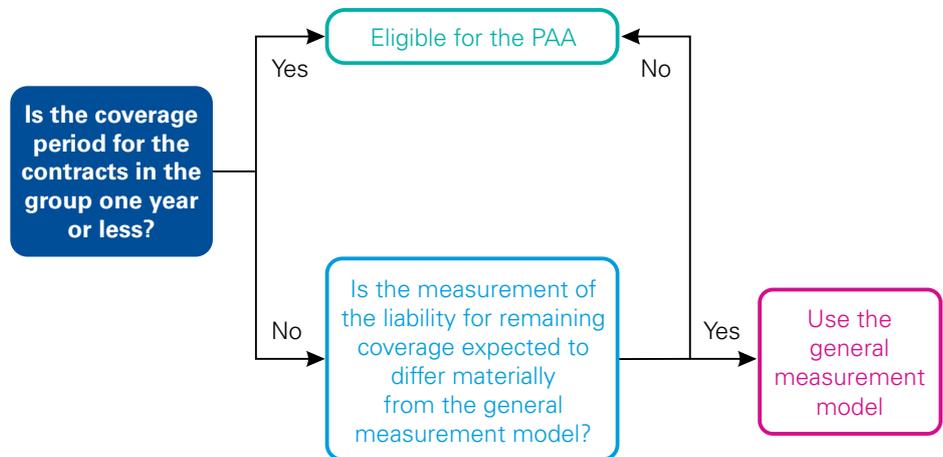
IFRS 17.53

Eligibility

An entity is permitted to apply the PAA to measure a group of insurance contracts if, at inception of the group:

- the coverage period of each contract in the group of insurance contracts⁴ is one year or less; or
- the entity reasonably expects that the PAA would produce a measurement of the liability for remaining coverage for a group of insurance contracts that would not differ materially from the measurement that would be achieved by applying the general measurement requirements.

4. The coverage period includes insurance contract services within the boundary of the contract (see [7.3.1](#)).



IFRS 17.54

If, at inception of the group, an entity expects significant variability in the fulfilment cash flows during the period before a claim is incurred, then the entity cannot reasonably expect that the PAA would produce a measurement of the liability for remaining coverage for a group of insurance contracts that would not differ materially from the one that would be produced by applying the general measurement requirements.

Variability in the fulfilment cash flows increases, for example, with:

- the extent of expected cash flows relating to any embedded derivatives that exist in the contracts; and
- the length of the coverage period.



Impacts of variability in fulfilment cash flows

Under the general measurement model, estimates of expected cash flows are updated at each reporting date for current information. These changes in estimates can impact the CSM and so will affect the profitability of the contract for the current reporting period and in the future.

If a group of contracts is not expected to have significant variability in its fulfilment cash flows during the period before a claim is incurred, then the PAA may give a liability for remaining coverage that would not differ materially from that using the general measurement model.

This is deemed to be the case for groups of contracts that have a coverage period of one year or less; however, judgement will be required in all other cases. Because IFRS 17 does not provide a method for determining whether the PAA is expected to produce a liability for remaining coverage that would not differ materially from that under the general measurement model, management's judgement will be critical in assessing whether the fulfilment cash flows of contracts with a coverage period greater than one year vary significantly.

This assessment should involve consideration of the length of the coverage period and whether embedded derivatives exist. Entities may also consider key market and other risk factors that would create variability in the fulfilment cash flows – e.g. interest rates, adjustable premiums. Entities may be able to leverage some of the information used in contract pricing, since this is expected to vary based on similar factors.

This assessment could be performed by creating a sensitivity analysis to compare groups of insurance contracts' liability for remaining coverage under the general measurement model and the PAA. This would also mean determining an acceptable margin of difference that results in a liability for remaining coverage that does not differ materially from that determined using the general measurement model. Entities are also expected to apply judgement over how often to refresh this analysis for the purpose of analysing the PAA eligibility of new business. For example, the more unstable the current interest rate environment, the more frequent a refresh of the analysis may be necessary.

Entities should consider how they will document this assessment and how they will implement controls over the process.



Assessing eligibility for the PAA

General insurance contracts

Groups of contracts with a coverage period of one year or less automatically meet the PAA eligibility criteria, even if the claims settlement period is longer than one year. For example, personal car insurance contracts for one year are eligible for the PAA, even if bodily injury claims are expected to be settled over a number of years.

A group containing contracts with a coverage period longer than one year could still be eligible for the PAA based on an assessment of the expected variability of cash flows.

It is likely that many general insurance contracts – e.g. property and casualty contracts – will meet the PAA eligibility criteria, mainly based on their short duration and because they usually do not include embedded derivatives. Many insurers will probably seek to apply the PAA for these types of contracts to simplify their transition to IFRS 17.

Life insurance contracts

Whole-life insurance contracts or annuity contracts are not expected to meet the PAA eligibility criteria, mainly due to the length of the period they cover. A one-year term life insurance contract will automatically meet the PAA eligibility criteria provided the application of the contract boundary requirements does not extend the coverage period beyond one year (see 7.3.1). In addition, certain group life contracts may meet the PAA eligibility criteria depending on the specific terms and conditions.

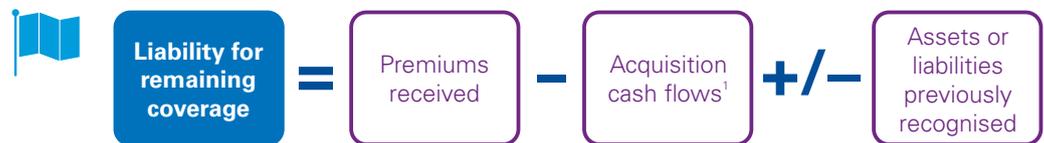
As noted, many life contracts will probably not meet the PAA eligibility criteria, because their coverage periods are significantly greater than one year. Some insurers may choose to account for all life insurance products under the general measurement model, even if some meet the PAA eligibility criteria, because they will be handled using similar processes and systems.

14.3

IFRS 1755(a)

Liability for remaining coverage

Under the PAA, the liability for remaining coverage is measured as follows on initial recognition (unless it is onerous – see 14.3.2).



Note

1. Unless the entity chooses – when applicable – to recognise insurance acquisition cash flows as expenses as they are incurred (see 14.3.1).

IFRS 1757, BC289

The initial measurement of the liability for remaining coverage does not explicitly identify the present value of expected cash flows, the effects of risk and the time value of money. Consequently, the subsequent measurement does not involve an analysis of the variations in those components before a claim is incurred because the rationale for applying the PAA is that there are unlikely to be significant changes in them. However, when facts and circumstances indicate that a group of contracts is onerous, the entity calculates the liability for remaining coverage using the general measurement model's fulfilment cash flow requirements, with a simplification if certain conditions are met (see 14.3.2).

14.3.1

IFRS 1755(a), B125



Insurance acquisition cash flows

Acquisition cash flows are deferred (by reducing the liability recognised on initial recognition) and are recognised as an expense over time in a systematic way. An entity recognises an asset for insurance acquisition cash flows relating to a group of existing or future insurance contracts that it pays before the group is recognised, consistent with the requirements in 7.3.4.

IFRS 1759(a)

However, if the coverage period of each contract in the group on initial recognition is one year or less, then an entity may choose to recognise insurance acquisition cash flows as an expense when they are incurred (see Section 4.2).



A policy choice not to defer insurance acquisition cash flows

The accounting policy choice for recognising acquisition cash flows is intended to be a simplification of the general measurement model. Therefore, it is designed to generate results that do not differ materially from the general measurement model.

This choice applies only for groups when the coverage period of each contract in the group on initial recognition is one year or less, and not necessarily for all groups of contracts applying the PAA, which may include contracts with longer coverage periods.

Entities that already have a policy of expensing acquisition cash flows over the coverage period could be able to continue to do so and their systems and processes may not need significant adjustment. However, they will still have to assess whether the costs previously deferred align with the definition of insurance acquisition cash flows under IFRS 17 and related allocation requirements.

Other entities may consider recognising acquisition costs as they are incurred. They may experience more variability in profitability over reporting periods if the level and costs incurred for underwriting activities vary significantly during the year. In this case, disclosing an explanation of the seasonality might be necessary.

14.3.2

IFRS 17.57–58

IFRS 17.57–58

IFRS 17.57

Onerous contract liability

An entity recognises a loss and an increase in the liability for remaining coverage if facts and circumstances indicate, at any time during the coverage period, that a group of contracts is onerous.

If a group of contracts is deemed to be onerous, then the increase in the liability for remaining coverage and the loss recognised is equal to the difference between:

- the fulfilment cash flows that relate to remaining coverage of the group; and
- the carrying amount of the liability for remaining coverage determined when applying the PAA.

In other words, when the facts and circumstances indicate that the group of contracts is onerous, the entity calculates the liability for remaining coverage using the general model's fulfilment cash flow requirements. If this value is greater than the liability for remaining coverage under the PAA, then a loss is recognised for the difference.

However, when determining the fulfilment cash flows relating to the remaining coverage of the group, an entity does not include in the measurement an adjustment for the time value of money and the effect of financial risk if it does not reflect these in the measurement of its liability for incurred claims (see [Section 14.4](#)). If the entity adjusts the expected cash flows for the time value of money and the effect of financial risk, then it determines the discount rate consistently with the requirements of the general measurement model (see [Chapter 8](#)).



How does an entity assess whether a contract is onerous?

Entities are not required to perform a periodic measurement exercise to assess whether groups of contracts applying the PAA are onerous at inception or during the coverage period. However, they do need to be able to identify facts and circumstances and changes to them, in order to consider whether they indicate that a group of contracts is onerous.

Because IFRS 17 does not provide any specific guidance about which facts and circumstances should be considered, management needs to develop a methodology to assess and monitor whether facts and circumstances indicate that a group of contracts is onerous on initial recognition or subsequently.

This assessment may consider factors such as:

- the expected ratio of claims to premiums (or any other measurement of expected profitability) compared with the actual ratio over the coverage period;
- economic or regulatory changes that can cause significant revisions in the expected cash flows; or
- significant changes to the costs involved in fulfilling contracts: e.g. as a result of internal reorganisations or changes to the prices of services or products used to fulfil its insurance obligations.



Onerous contract measurement – Potentially significant changes in practice

The accounting for onerous contracts under the PAA might involve a significant change in current practice.

When facts and circumstances indicate that a group of contracts is onerous, an entity will have to calculate the fulfilment cash flows that relate to the remaining coverage for the group under the general measurement model with a simplification if certain conditions are met.

Currently, general insurers sometimes recognise a liability for onerous contracts using a measurement basis other than the present value of expected cash flows. For example, in some jurisdictions a loss ratio is applied to unearned premiums to arrive at the expected loss. In other jurisdictions, the loss provision is undiscounted or includes implicit risk attributes rather than an explicit risk adjustment.

Under IFRS 17, an explicit present value of expected cash flows calculation is required to calculate the loss on a group of onerous contracts. This requires estimating the expected cash flows, an explicit risk adjustment for non-financial risk and discounting, if applicable.

14.3.3

IFRS 17.14–24

Grouping requirements

The aggregation requirements that apply to contracts under the PAA are consistent with those under the general measurement model (see [Chapter 6](#)). However, for contracts that apply the PAA, entities:

- assume that no contracts in the portfolio are onerous on initial recognition, unless facts and circumstances indicate otherwise; and
- assess whether contracts have no significant possibility of becoming onerous subsequently by assessing the likelihood of changes in applicable facts and circumstances.



The level of aggregation assessment for contracts accounted for under the PAA

When applying the aggregation requirements, an entity considers whether facts and circumstances indicate that contracts are onerous, and the likelihood of changes in facts and circumstances in order to assess whether contracts have no significant possibility of becoming onerous in the future.

In applying the aggregation criteria, entities consider the following.

- Assessing the likelihood of changes in applicable facts and circumstances by identifying the key estimates that would have been used had a detailed cash flow projection been used, and assessing the possibility of changes in them. This could be done, for example, by analysing the pricing model for those contracts and its underlying assumptions.
- Analysing the current profit margins and what impact a change in estimates would have on them. Clearly, the magnitude of these margins will be an important consideration. For example, entities could develop ranges of profitability – one range that includes contracts with no significant possibility of becoming onerous, and another for the other contracts in the portfolio.



The level at which contracts are grouped – Practice implications

Some general insurers currently manage their business by evaluating their results at a broadly aggregated level – e.g. portfolio, line of business or contract pricing level. Some also offset expectations of gains and losses on contracts. No additional liability is currently recognised for the loss on a contract that would be viewed as onerous on a stand-alone basis if it is subsumed in the expected profits of other contracts within the same measurement group.

Under IFRS 17, the level of aggregation, and therefore the level for offsetting gains and losses, may be more granular. Given the likelihood of a lower level of assessment, there will probably be groups of contracts that were accounted for together under IFRS 4 that, on transition to IFRS 17, may have to be assessed at a more disaggregated level, which may result in recognising higher liabilities for onerous contracts. After transition to IFRS 17, this will also mean that losses will be recognised in profit or loss immediately for groups of onerous contracts, whereas expected gains on contracts that are not onerous will be deferred in the form of a liability for remaining coverage.

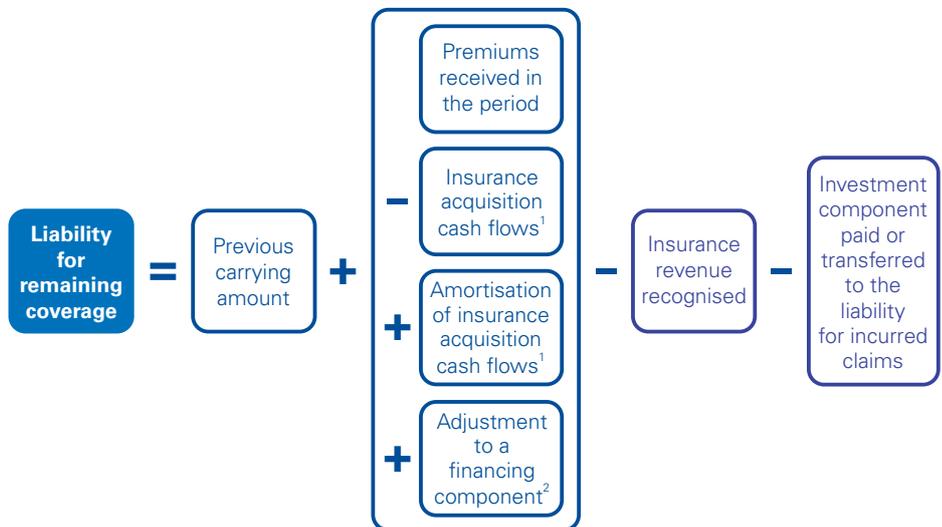
Given the inherent asymmetry between recognising losses immediately in profit or loss and deferring gains, it is critical that entities assess the effect that this may have on their financial reporting and on the information used to manage their business.

14.3.4

IFRS 17.55(b)

Subsequent measurement

Under the PAA, the liability for remaining coverage is measured at each subsequent reporting date as follows.



Notes

1. Unless the entity chooses to recognise the insurance acquisition cash flows as expenses as they are incurred, when applicable. These cash flows may arise from derecognising assets for insurance acquisition cash flows paid in advance of recognition of the group.
2. Unless this adjustment is not applied.

IFRS 17.B126–B127

Insurance contract revenue for the period is the amount of expected premium receipts allocated to the period (excluding the investment components and adjusted to reflect the time value of money and the effect of financial risk, if applicable). The allocation to each period of insurance contract services is based on the passage of time. However, if the pattern of the release of risk during the coverage period differs significantly from the passage of time, then the expected premium receipts are allocated to periods of coverage on the basis of the expected timing of incurred insurance service expenses. The basis of allocation is changed if facts and circumstances change over the coverage period.

IFRS 17.56

If insurance contracts in a group have a significant financing component, then the carrying amount of the liability for the remaining coverage is adjusted to reflect the time value of money and the effect of financial risk using a discount rate determined on initial recognition.

However, if on initial recognition the entity expects the time between providing each part of the services and the related premium due date to be one year or less, then the entity may elect not to adjust the liability for the time value of money and the effect of financial risk.

**Example 11 – Revenue recognition under the PAA**

Entity E issues insurance contracts on 30 June 2023 with the following terms:

- coverage period of 12 months;
- premiums of 1,200: all received at inception;
- the applicable discount rate on initial recognition is 5%; and
- the expected pattern of release of risk is not significantly different from the passage of time.

E's accounting policy is to adjust the liability for remaining coverage to reflect the time value of money and the effect of financial risk.

E's annual reporting date is 31 December, at which date there are no incurred claims.

For simplicity, this example assumes that the acquisition cash flows are insignificant.

At inception

The liability for remaining coverage is the premiums received of 1,200.

At 31 December 2023

The time value of money increases the liability for remaining coverage as follows (for simplicity, a simple interest calculation is applied to the opening balance of the liability).

$$1,200 \times (1 + (0.05 \times 6 / 12)) = 1,230$$

The insurance contract revenue is the amount of expected premium receipts, adjusted to reflect the time value of money, allocated to the period.

$$1,230 \times 6 / 12 = 615$$

The liability for remaining coverage is the sum of the previous carrying amount plus the adjustment for the time value of money less the amount recognised as insurance contract revenue during the period.

$$1,230 - 615 = 615$$

Statement of profit or loss and OCI for the six months ended 31 December 2023

Insurance contract revenue	615
Insurance finance expense	(30)
Profit	585

Facts and circumstances changed since inception

At 31 December 2023, facts and circumstances indicate that the group of contracts is onerous. E calculates the fulfilment cash flows under the general measurement model as 800.

In this case, E recognises a loss and an increase in the liability for remaining coverage as the difference between the liability for remaining coverage calculated above (615) and the fulfilment cash flows (800).

This results in a liability for remaining coverage of 800 and a loss of 185 that is recognised in profit or loss on 31 December 2023.



Significant financing components

Many entities that apply the PAA will be considering for the first time whether advance premiums include a significant financing component and whether:

- they are required to adjust the carrying amount of the liability for remaining coverage for the time value of money and the effect of financial risk; or
- they meet the criteria for the simplification option to avoid this adjustment.

Coverage period is a key factor

Groups of contracts with a coverage period of one year or less are expected to be automatically eligible for the simplification option because the time between providing each part of the coverage and the related premium due date is unlikely to exceed one year.

When identifying whether a group of contracts has a significant financing component, entities should consider groups that are eligible for the PAA and have a coverage period of more than one year.

Making the assessment

IFRS 17 does not include specific guidance on how to assess whether a significant financing component exists. However, IFRS 15 has a similar concept and provides some guidance. Under IFRS 15, an entity considers all facts and circumstances, including:

- the difference, if any, between the consideration and the cash selling price;
- the combined effect of the expected length of time between providing services and receiving payments from customers; and
- the prevailing interest rates in the relevant market.

IFRS 15.60–65

Implications for consideration

Under the PAA, reflecting the time value of money and the effect of financial risk when measuring the liability for remaining coverage could have several implications.

- Entities that are required or choose to reflect adjustments for the time value of money and the effect of financial risk will need to ensure that their systems and processes are capable of tracking historical interest rates (on initial recognition of the group of contracts) and delivering this information to the valuation systems for use in modelling the liability for remaining coverage. This will be a more significant cost and concern for entities that do not currently accrete interest on their liabilities.
- Because many premiums are received at the beginning of the coverage period, the profit (underwriting and financial results) at the beginning of the coverage period is lower than it would otherwise have been without accounting for the effect of the time value of money and the effect of financial risk, assuming that the discount rate is positive. This is because the interest expense is calculated on a higher balance in the earlier periods. In [Example 11](#) above, the result of 585 for the first six months of the contract would have been 600 had E not adjusted the liability for remaining coverage for the time value of money.
- Financing affects the amount of revenue recognised. For example, the amount of revenue recognised for the contract will be higher than the premiums received if the liability for remaining coverage is adjusted for the time value of money and the effect of financial risk, assuming that the discount rate is positive. In [Example 11](#) above, revenue of 615 is recognised for the first six months of coverage, compared with 600 that would have been recognised had E not adjusted the liability for remaining coverage for the time value of money and the effect of financial risk.



Pattern of release from risk

Under the PAA, revenue is recognised over the coverage period on the basis of the passage of time, unless the pattern of release of risk differs significantly. If it does, then the expected premium receipts are recognised as revenue on the basis of the expected timing of incurred insurance service expenses.

Entities will need to be able to determine the pattern of release of risk for their contracts and whether it represents a pattern that is significantly different from one based on the passage of time. An example of contracts with a significantly different pattern of release of risk from the passage of time is insurance contracts that cover losses resulting from low-frequency, high-severity events that are distinctly seasonal – e.g. insurance contracts covering hurricane or tornado damage.

Entities may demonstrate their analysis of the pattern of the release from risk based on past experience of how claims on similar contracts have actually been incurred over the coverage period, together with future expectations of how they might differ from past experience.



Insurance contract revenue – Change in practice

Similar to the general measurement model, the PAA will also introduce a major change in the practice of presenting insurance contract revenue for the period.

In many jurisdictions, entities currently present a reconciliation on the statement(s) of financial performance, which includes the gross underwritten premiums for contracts that begin during the reporting period. An adjustment for the unearned portion of these premiums is then presented to arrive at the net revenue recognised. This also means that the statement of financial position is grossed up for the premiums receivable throughout the contract.

Under the PAA, the amount of insurance revenue recognised in a period is the amount of expected premium receipts allocated to the period excluding any investment component and adjusted to reflect the time value of money and the effect of financial risk if applicable. Information about the gross underwritten premiums will be included in the disclosures (see [Chapter 19](#)). The statement of financial position will not be grossed up for premium receivables and pipeline premiums. Instead, the balance sheet will include the liability for remaining coverage representing the net position (asset or liability) for future coverage, any assets for insurance acquisition cash flows (see [7.3.4](#)) and the liability for incurred claims (see [Section 14.4](#)).

Investment components are not included in insurance revenue and insurance service expenses. A 'no-claims bonus/rebate' paid to the policyholder by way of return of premium if no claim has been made during the coverage period of the contract may be an example of an investment component that is excluded from insurance revenue and insurance service expenses, because there may be a payment to the policyholder in all circumstances, even if an insured event does not occur.

14.4

IFRS 17.59(b)

IFRS 17.B72(e)(iii), B133

Liability for incurred claims

The liability for incurred claims is measured for contracts under the PAA at the amount of the fulfilment cash flows relating to incurred claims, in accordance with the fulfilment cash flow requirements of the general measurement model. However, if the expected cash flows are expected to be paid or received within one year or less from when they are incurred, then an entity may choose not to adjust the expected cash flows for the time value of money.

When an entity discounts the liability for incurred claims (by requirement or choice) and chooses to apply the OCI option (see [13.2.3](#)), the interest rate used to recognise the insurance finance income or expense in profit or loss is a rate that applies to nominal cash flows that do not vary based on the returns on any underlying items, at the date of the incurred claim.

**Example 12 – Applying the PAA at inception and subsequently**

Entity E issues a group of insurance contracts with the following terms:

- coverage period of 12 months (assume that a contract does not lapse after a claim is made);
- premiums of 1,200: all received at inception;
- insurance acquisition cash flows of 24: all paid at inception;
- actual claims after one month of 60; and
- a risk adjustment for non-financial risk on the incurred claims of 10.

In this example, E presents financial statements at the end of the first month, the insurance acquisition cash flows are deferred and the discounting of expected cash flows and accretion of interest are ignored.

Also, this example assumes that insurance services are provided, and the insurance acquisition cash flows are expensed evenly over the coverage period.

At inception

The liability for remaining coverage is the sum of the premium received less payments related to insurance acquisition cash flows.

$$1,200 - 24 = 1,176$$

After one month

The amortisation of the insurance acquisition cash flows is as follows.

$$24 / 12 = 2$$

The insurance contract revenue is the amount of expected premium receipts allocated to the period.

$$1,200 / 12 = 100$$

The liability for remaining coverage is the sum of the previous carrying amount plus the amount of insurance acquisition cash flow amortisation for the period less the amount recognised as insurance contract revenue during the period.

$$1,176 + 2 - 100 = 1,078$$

The liability for incurred claims is the actual claims for the period including the risk adjustment for non-financial risk on incurred claims.

$$60 + 10 = 70$$

Profit or loss

Insurance contract revenue	100
Amortisation of insurance acquisition cash flows	(2)
Insurance service expense	(70)
Impact on profit or loss	28

IFRS 17.100(c)



IFRS 17 vs IFRS 4 – Reducing excessive prudence

Under IFRS 4, entities were permitted to change their accounting policies to eliminate excessive prudence. However, they were not required to eliminate that prudence if it existed within their current accounting policies when they adopted IFRS 4 for the first time.

Therefore, in certain jurisdictions where excessive prudence is currently either required or permitted, entities may currently develop conservative estimates of liabilities throughout the measurement process. Examples include measuring the liability for incurred claims on an undiscounted basis or determining the incurred but not reported claims based on an ultimate loss ratio technique and applying excessive prudence when developing ultimate loss ratios.

IFRS 17 is expected to remove excessive prudence, if it exists, and change such practices for measuring liabilities for incurred claims, even if excessive prudence does not exist, by:

- discounting the liability for incurred claims, if the effect is significant; and
- determining an unbiased estimate of expected cash flows and an explicit risk adjustment for non-financial risk.

This applies for all measurement models under IFRS 17.

In addition, entities are required to disclose, for the contracts to which the PAA has been applied, a reconciliation between the opening and closing balances for the liability for incurred claims separately for the estimates of the present value of the expected cash flows and the risk adjustment for non-financial risk (see [Chapter 19](#)). Therefore, this explicit measurement of the risk adjustment for non-financial risk is reflected in the disclosures as well as in the measurement.

15

Direct participating contracts

The variable fee approach modifies the treatment of the CSM under the general measurement model to accommodate direct participating contracts.

15.1

Understanding participation features

Many insurers issue contracts under IFRS 17 that include features that share returns on underlying items with the policyholder(s). However, IFRS 17 draws a distinction between contracts with direct participation features ('direct participating contracts') and other participating and non-participating insurance contracts ('contracts without direct participation features'), which is reflected in how the measurement model is applied in subsequent periods.

The distinction, and therefore the definition of direct participating contracts, assumes that significant investment-related service(s) are included in the contract when an entity promises an investment return based on underlying items. When these services are substantial, the contract meets the definition of a direct participating contract and so the accounting reflects the notion that these contracts create an obligation to pay policyholders an amount equal in value to specified underlying items, minus a variable fee for service. The underlying items can comprise any items as long as they are clearly identified by the contract. When a contract meets the requirements to be defined as a direct participating contract, the modifications to the general measurement model discussed throughout this chapter are applied to the group of contracts of which it forms part. This approach is called the 'variable fee approach', because the CSM is adjusted to reflect the variable nature of the fee. That fee is an amount equal to the entity's share of the fair value of the underlying items minus any expected cash flows that do not vary directly with the underlying items.

When the investment-related service(s) are not sufficiently substantial and the contract fails to meet the definition of a direct participating contract, any changes relating to these fees are recognised according to the general measurement model without any modifications.

The following table shows the primary measurement differences between the general measurement model and the variable fee approach, which are discussed further in this chapter.

	General measurement model	Variable fee approach
Changes in the fulfilment cash flows arising from the time value of money and financial risks	Recognised immediately in the statement(s) of financial performance as insurance finance income or expense	Insurer's share is regarded as part of the variability of the fee for future service and recognised in the CSM ¹
Interest rate accreted to the CSM	Interest rate determined on initial recognition	No explicit interest accretion is required since the CSM is effectively remeasured when it is adjusted for changes in financial risks

Note

1. Unless either the changes exceed the amount of the CSM or the entity applies the risk mitigation option and certain changes are recognised in profit or loss or OCI.

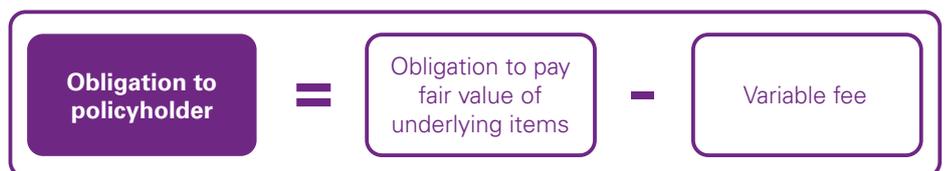
This chapter describes what direct participating contracts are and how the general measurement model is applied to them using the variable fee approach. It should be read in conjunction with Chapters 5–12, which outline the general measurement model.

15.2

IFRS 17B104, BC243

What are direct participating contracts?

Direct participating contracts create an obligation to pay the policyholder an amount equal to the fair value of the underlying items, less a variable fee for future service. The variable fee comprises the entity's share in the fair value of the underlying items less fulfilment cash flows – e.g. amounts payable to the policyholder – that do not vary based on the underlying items.



IFRS 17B101

An insurance contract is considered to be a direct participating contract when:

- the contractual terms (see 15.2.1) specify that the policyholder participates in a share of a clearly identified pool of underlying items (see 15.2.2);
- the entity expects to pay the policyholder an amount equal to a substantial share (see 15.2.3) of the fair value returns on the underlying items; and

- the entity expects a substantial proportion (see 15.2.3) of any change in the amounts to be paid to the policyholder to vary with the change in the fair value of the underlying items.

IFRS 17.B102

An entity assesses whether these conditions are met for each contract based on its expectations at inception of the contract, and this is not reassessed subsequently unless the contract is modified (see Section 12.2).

15.2.1

IFRS 17.B105

The contractual terms

As stated above, the *contractual terms have to specify* that the policyholder participates in a share of a clearly identified pool of underlying items. This does not preclude the existence of the entity's discretion to vary the amounts paid to the policyholder. However, the link to the underlying items has to be enforceable, and enforceability is a matter of law.

IFRS 17.2, B105, BC69



Enforceable link to the underlying items specified by the contract

IFRS 17 defines a contract as an agreement between two or more parties that creates enforceable rights and obligations. When applying IFRS 17, entities should consider their substantive rights and obligations, whether they arise from contract, law or regulation. Therefore, when referring to contractual terms the effects of law or regulation are also considered.

For a contract to be considered a direct participating contract, it needs to specify the link to the underlying items, and this link needs to be enforceable by law. The notion of a contract as defined in IFRS 17 is consistent with IFRS 15 and is applied when an entity considers how to classify a contract, and when assessing the boundary of a contract.

The agreement between two parties does not need to be in writing to be a contract. Whether the agreed-on terms are written, oral or otherwise evidenced – e.g. by electronic assent – a contract exists if the agreement creates rights and obligations that are enforceable against the parties. Determining whether a contractual right or obligation is enforceable is a question to be considered in the context of the relevant legal framework that exists to ensure that the parties' rights and obligations are upheld. There may be circumstances which a right or obligation is enforceable by a regulator or other body on behalf of the policyholder.

Similar types of contracts issued in different jurisdictions might give a different answer in terms of there being a link that is enforceable by law. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities and may vary within an entity, with different customers. An analysis of each different type of contract is essential to determine if each specifies an enforceable link to underlying items.

15.2.2

IFRS 17.B101, B106, BC245

Clearly identified pool of underlying items

The contractual terms should specify a determinable fee that can be expressed as a share of portfolio returns or portfolio asset values. This means that the contract specifies that *the policyholder participates in a share of a clearly identified pool of underlying items*. The pool of underlying items can comprise any items as long as they are clearly identified in the contract. For example, the pool of underlying items may include reference to a portfolio of assets, the net assets of the entity or a subsidiary within the group that is the reporting entity, or a specified subset of net assets of the entity. An entity is not required to hold the identified pool of underlying items and the underlying items do not need to exist for the entire duration of a contract – e.g. during the pay-out phase of a deferred annuity contract there are normally no underlying items.

A clearly identified pool of underlying items does not exist when:

- an entity can change the underlying items that determine the amount of the entity's obligation with retrospective effect; or
- there are no underlying items identified, even if the policyholder could be provided with a return that generally reflects the entity's overall performance and expectations, or the performance expectations of a subset of assets that the entity holds.

IFRS 17.B106(b)



Example 13 – Link to clearly identified pool of underlying items

Entity B issues two different types of life insurance contracts that provide death benefits for the whole life of the policyholder. The death benefit is determined as the higher of a guaranteed amount and the account balance.

- *Contract X*: The contract specifies that the policyholder's account balance is credited a 3% annual rate, but B has discretion to change the crediting rate.
- *Contract Y*: The contract specifies that the policyholder's account balance is credited with an annual rate that would leave the entity with a margin of 0.5% of the return from assets in a defined portfolio, Portfolio Z. B has discretion to change the crediting rate.

B holds assets in Portfolio Z to cover both types of contracts and the expected annual return of the portfolio is 3.5%.

Although B expects both contracts to initially credit a 3% return on the policyholder's account balance, only Contract Y creates a link between the policyholder's return and a clearly identified pool of underlying items.

Although the obligation to the policyholder under Contract X reflects a crediting rate set by B that generally reflects B's overall performance and expectations of the performance of the underlying assets that support the contract, it does not reflect clearly identified underlying items and therefore is not considered a direct participating contract.

Contract Y identifies a link to the assets in Portfolio Z and therefore could meet the definition of a direct participating contract, subject to meeting the other criteria described in 15.2.3.

15.2.3

IFRS 17.B101, B107–B108, BC245

What does ‘substantial’ mean?

The entity’s primary obligation is to pay the policyholder an amount equal to the fair value of the underlying items. For a contract to be considered a direct participating contract, the entity expects:

- to pay the policyholder an *amount equal to a substantial share* of the fair value returns from the underlying items; and
- a *substantial proportion* of any change in the amounts to be paid to the policyholder to vary with the change in the fair value of the underlying items.

The term ‘substantial’ is considered in the context of the objective of direct participating contracts, which is for an entity to provide investment-related services (i.e. to have an obligation to pay policyholders the fair value returns from specified underlying items) and to be compensated for those services by a fee that is determined with reference to the underlying items.

The variability in these amounts is considered over the duration of the insurance contract and on a present value, probability-weighted average basis.



Using an entity’s expectations

The assessment of whether the amount paid to the policyholder equals a substantial share of the fair value returns from the underlying items is based on the entity’s expectations. It includes, among other considerations, the entity’s expectations about any discretion that it will exercise when sharing the returns in future periods.

Therefore, an entity that is obliged to pay a policyholder 90% of the return on the underlying items will have similar expectations to those of an entity that is obliged to pay the policyholder 50% of the return on the underlying items, but expects, for commercial or other reasons, to exercise its discretion and pay the policyholder 90% of the return on the underlying items.

Entities’ expectations are also reflected in their assessment of whether a substantial proportion of any change in the amounts to be paid to the policyholder varies with the change in the fair value of the underlying items.

For example, if an entity expects to pay a substantial share of the fair value returns from underlying items, subject to a guarantee of a minimum return, then there will be scenarios in which the fair value returns will exceed the guaranteed minimum return (including any other cash flows that do not vary based on the returns on underlying items) and other scenarios in which the guaranteed minimum returns (including any other cash flows that do not vary based on the returns on underlying items) exceed the fair value returns. The entity’s assessment of the variability would reflect a present value, probability-weighted average of all of these scenarios.



Direct participating contract assessment – Practical impacts

There is a wide variety of contracts with different types of participation features. Under IFRS 17, analysis is required to conclude whether they meet the direct participating contract definition.

The following are examples of such contracts.

Insurance contracts that share with the policyholder the return on a specified pool of investments or net assets of a fund

It is common for these types of contracts to specify that the policyholder participates in a share of a clearly identified pool of underlying items. Moreover, in many cases the underlying investments are managed in a separate account or fund, for regulatory or practical reasons.

Therefore, it is likely that the assessment of whether these contracts are direct participating contracts will be focused on whether the policyholder is expected to receive a substantial share of the fair value returns on the underlying items, and whether a substantial proportion of any change in the amounts to be paid to the policyholder varies with the change in the fair value of the underlying items.

For certain types of contracts, sometimes referred to as 'unit-linked contracts', it is more likely that these criteria will be met due to the substantial share of the fair value returns on underlying items to which policyholders are typically entitled and the typically lower levels of minimum guarantees. However, the assessment will also be impacted by the variability in claim payments for insured events – including from insurance riders included in the contract. For other types of contracts, such as certain universal life contracts, meeting the criteria might not be as likely.

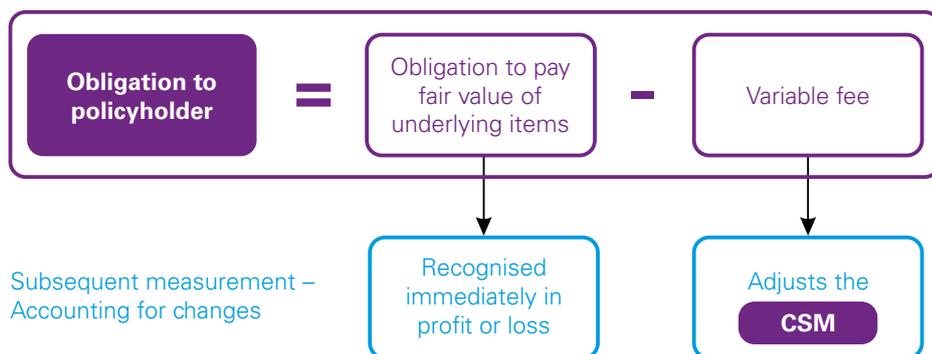
Investment contracts with DPFs

These contracts do not transfer significant insurance risk. However, they are in the scope of IFRS 17 if the entity also issues contracts that are in the scope of IFRS 17 (see [Section 3.2](#)). These contracts can be direct participating contracts. However, the definitions are not identical. Therefore, entities will have to assess the contract features to determine whether they meet the definition of a direct participating contract.

15.3

Subsequent measurement

The general measurement model is applied on initial recognition of direct participating contracts in the same way as it is applied for contracts without direct participation features. On subsequent measurement, differences arise within the treatment of the CSM, which includes modifications that reflect the specific nature of direct participating contracts.

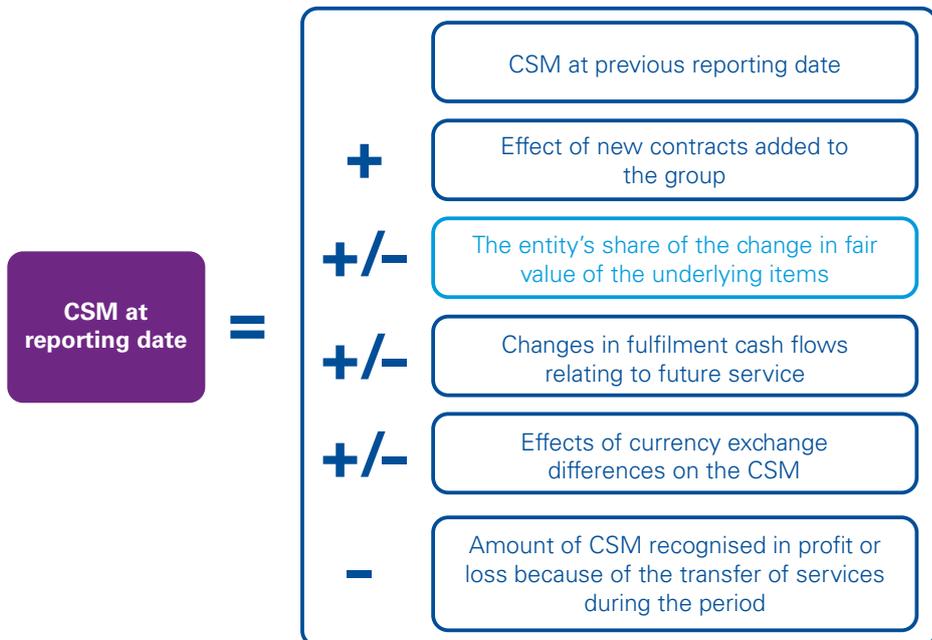


IFRS 17B101, B104(b)

The modifications to the general measurement model on subsequent measurement reflect the notion that the entity substantially provides investment-related services and is compensated for the services by a fee that is determined with reference to the underlying items.

IFRS 17.45

Therefore, under the modified model, the CSM at the reporting date equals:



IFRS 17B114

Entities need not identify the adjustments to the CSM for the changes in the entity's share of the change in the fair value of the underlying items separately from those related to changes in the fulfilment cash flows relating to future service (for further discussion on what these include, see 15.3.2). Therefore, they can adjust the CSM for an amount equal to the change in the fair value of underlying items, less the change in the fulfilment cash flows.

15.3.1

IFRS 17.45(b), B111–B112, B115, BC243, BC247

The entity's share of the change in the fair value of the underlying items

Changes in the obligation to pay the policyholder an amount equal to the fair value of the underlying items are recognised in profit or loss or OCI. However, changes related to the amount of the entity's share of the fair value of the underlying items – i.e. the variable fee – relate to future service and, therefore, adjust the CSM, except to the extent that:

- the amount of the entity's share of a decrease in the fair value of the underlying items exceeds the carrying amount of the CSM, resulting in a loss recognised as part of the insurance service result;
- the amount of the entity's share of an increase in the fair value of the underlying items reverses losses previously recognised; or
- the entity meets the conditions for the risk mitigation option and chooses not to reflect in the CSM some or all of the changes in the effect of financial risk on its share of the underlying items (see 15.3.3).

15.3.2

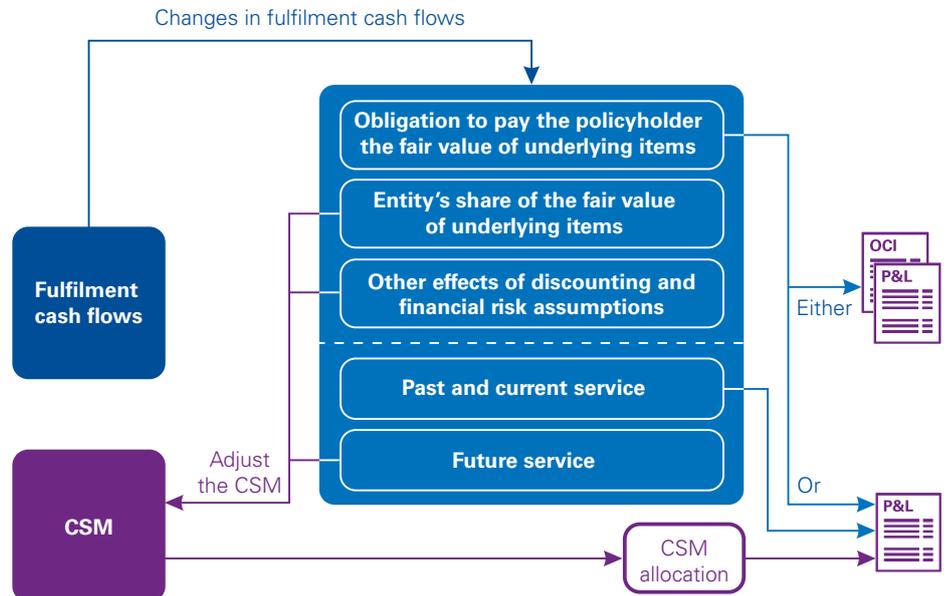
IFRS 17.45(c), B113, B115

Changes in fulfilment cash flows

The CSM is adjusted for changes in fulfilment cash flows relating to future service. These include:

- changes in estimates of the fulfilment cash flows, consistent with those for contracts without direct participation features (see 10.2.2); and
- changes in the effect of the time value of money and financial risks not arising from the underlying items – e.g. financial guarantees. These are considered to relate to future service and, therefore, adjust the CSM for direct participating contracts. However, to the extent that:
 - increases in the fulfilment cash flows exceed the carrying amount of the CSM (i.e. resulting in a loss);
 - decreases in fulfilment cash flows are allocated to the loss component of the liability; or
 - the entity meets the conditions for the risk mitigation option and chooses not to reflect in the CSM some or all of the changes in the effect of the time value of money and financial risks not arising from the underlying items (see 15.3.3),

these changes do not adjust the CSM.



IFRS 17:IE99–IE112



Example 14 – Mechanics of the variable fee approach

Entity X issues a group of unit-linked insurance contracts with a coverage period of three years that provides the policyholder with either:

- *on survival at the end of the coverage period*: the account balance; or
- *on death during the coverage period*: the higher of a guaranteed death benefit of 170 or the account balance.

The group consists of 100 contracts with an equal premium of 150 each, all of which was received immediately after initial recognition. On initial recognition, X expects that one policyholder will die at the end of each year.

The account balance is based on the premium paid and increases by the investment returns from a specified and clearly identified pool of assets. The account balance is reduced annually by 2% for a services charge at the end of each year. X expects the underlying fund to return 10% each year, has determined the risk-free interest rate to be 6% and has estimated a risk adjustment for non-financial risk of 25 (of which 12 is expected to be recognised in profit or loss in the first year).

The contracts meet the definition of direct participating contracts and X chooses to include all insurance finance income or expense for the period in profit or loss – i.e. it does not apply the OCI option. X purchases and holds the underlying items and measures them at FVTPL.

X measures the group of insurance contracts on initial recognition as follows.

	Initial recognition
Estimates of the present value of cash inflows	15,000
Estimates of the present value of cash outflows	(14,180) ¹
Risk adjustment	(25)
Fulfilment cash flows	795
CSM	(795)
Insurance contract liability	-
<p>Note</p> <p>1. The estimates of the present value of cash outflows reflect the use of current discount rates in discounting the future cash outflows and also include an estimate of the time value of the guarantee (TVOG) inherent in providing a minimum death benefit, measured consistently with observable market prices for the guarantee. The TVOG is a calculation that requires actuarial input.</p>	
<p>At the end of Year 1, X determines the fair value of the underlying items as follows.</p>	
	Year 1
Opening balance	-
Premiums received	15,000
Investment return	1,500 ¹
Annual charge	(330) ²
Payments for death	(162) ³
Closing balance	16,008
<p>Notes</p> <p>1. The investment return is derived as the beginning balance multiplied by the investment return in the period (15,000 x 0.10).</p> <p>2. The annual charge is derived as the net account balance after adjusting for the change in the investment return multiplied by the annual service charge of 2% [(15,000 + 1,500) x 0.02].</p> <p>3. The payment for death relates to the death claim paid out of the underlying items of the group based on the deaths in this period, after adjusting the current account balance for adjustments in the period [(15,000 + 1,500 - 330) x (1 / 100)].</p>	

At the end of Year 1, the movement of the liability is as follows.

	Estimates of the present value of expected cash flows	Risk adjustment for non- financial risk	CSM	Total liability
Opening balance	820	(25)	(795)	-
Premiums received	(15,000)	-	-	(15,000)
Death benefits paid	170 ¹	-	-	170
Change in the fair value of underlying items	-	-	(1,500) ³	(1,500)
Effect of the time value of money and other financial risks	(1,403) ²	-	1,403 ³	-
Release to the statement of profit or loss and OCI	-	12	300 ⁴	312
Closing balance	(15,413)	(13)	(592)	(16,018)
Notes				
<p>1. During the period, X incurred a claim of 170 on the death of one policyholder. Given that the account balance per policyholder of 162 is less than the minimum guaranteed death benefit of 170, the claim incurred is 170. The payment of the claim includes 162 paid from the policyholder's account balance (investment component) and 8 paid from X's account.</p> <p>2. The change in the effect of the time value of money and financial risks not arising from the underlying items relates to future service and, therefore, adjusts the CSM. This value includes the time value of the guarantee. This is not required to be specifically identified.</p> <p>3. The total CSM adjustment is determined as the difference between the change in the fair value of underlying items of 1,500 less the change in the fulfilment cash flows of 1,403.</p> <p>4. The CSM is recognised in profit or loss each period to reflect the services provided in that period. This release pattern is based on an allocation of the CSM at the reporting date (before recognising any amounts in profit or loss) equally to each coverage unit. In Year 1, the CSM immediately before recognition of the CSM in profit or loss is 892 (795 + 30 + 67). During Year 1, X provided 100 units of coverage (the death during the year occurred at the end of Year 1). X expects to provide coverage for 99 and 98 contracts in Years 2 and 3, respectively. So, the percentage of service provided in Year 1 is 34% [100 / (100 + 99 + 98)]. Applying this percentage of services provided in the period to the CSM immediately before recognition results in 300 (892 x 0.34) of the CSM being recognised in profit or loss during the period.</p>				

The following table analyses the insurance revenue and expense for Year 1, calculated using the direct approach.

	Year 1
Expected claims and other expenses	8
Changes to the risk adjustment for non-financial risk	12
CSM allocation during the period	300
Insurance revenue	320 ¹
Insurance service expenses	8 ²
Insurance service result	312
Investment income	1,500
Insurance finance expenses	(1,500) ³
Finance result	-
Profit	312

Notes

- Under the indirect approach, the insurance revenue provided is derived from the total change in the liability for remaining coverage of 16,018, excluding premiums received of 15,000, insurance finance expenses of 1,500 and the investment component – i.e. the payment for death from the policyholder's account balance – of 162.

Alternatively, under the direct approach the insurance revenue is derived as the sum of the change in the risk adjustment for non-financial risk (12), the CSM recognised in profit or loss during the period as services are provided (300) and the expected insurance claims, excluding the investment components (8 = 170 - 162).
- Insurance service expenses includes the amounts payable to the policyholder (170) less the investment component paid from the policyholder's account balance (162).
- The changes in the obligation to pay the policyholder an amount equal to the fair value of the underlying items do not relate to future service and, therefore, do not adjust the CSM. These changes are therefore recognised in insurance finance income or expense.



Profitability pattern

In many jurisdictions, entities that issue participating contracts usually recognise the income generated from investment-related fees as they are charged to policyholders. So, under these current accounting policies the revenue generated from these contracts generally increases over time. For example, if the pool of underlying items increases annually, then the fees charged to the policyholders that are based on the returns of the underlying items will increase over time, as more funds are managed over time.

In addition, the value of some participating contracts – e.g. unit-linked contracts and variable annuities with insurance guarantees – are closely correlated with the performance of some financial markets. For example, in periods of negative performance in equity markets, certain insurance liabilities may increase significantly as a result of the minimum guarantees becoming valuable. These changes in the liability are generally recognised immediately in profit or loss.

The variable fee approach introduces some changes that will impact current practice, which include the following.

- Expected cash flows are based on the contract’s boundaries. So, the expected profitability of the contract – i.e. the CSM – includes the entity’s share of the cash flow expectations related to funds that are expected to be received in the future. This means that the CSM reflects the expected investment-related fees for the funds that have not yet been received by the entity. Because the CSM is recognised in profit or loss as services are provided, this might result in a larger amount of expected fees being recognised in the early periods of the contract than under current practice. However, this will depend on the pattern in which investment-related services are provided.
- Generally, the effect of changes in the time value of money and financial risks that do not relate to the obligation to pay the policyholder the fair value of the underlying items (e.g. changes in the amount of the entity’s share of the underlying items or changes in the value of minimum guarantees) adjust the CSM. So, the volatility of reported profits that may currently result from these effects of changes in financial risks is reduced, because the effects of those changes may be included within the CSM and then recognised in profit or loss as services are provided over the coverage period. Therefore, the impact on profit or loss for groups of contracts arising from these changes is not as positively correlated with volatility in financial markets as under some current accounting models or the general measurement model, in which changes in financial risks are reflected in the statement(s) of financial performance as they are incurred. However, high market volatility will probably increase the value of the guarantees given to policyholders and declines in the value of the underlying items will lead to a reduction in the entity’s variable fee, both negatively affecting the CSM. Therefore, these changes may exceed the carrying amount of the CSM, giving rise to a loss that is immediately recognised in profit or loss.



Determining the fair value of the underlying items

The measurement of the fair value of the underlying items is required in order to apply the measurement model for direct participating contracts.

Although practice is well developed to measure the fair value of assets such as financial instruments and investment properties, underlying items such as insurance contracts issued are more complex to measure at fair value and this is likely to become a focus in the implementation of these requirements. Although determining the fair value of insurance contracts is currently required in business combination accounting under IFRS Standards, entities have less experience with performing it on an ongoing basis as part of their financial reporting process.

15.3.3

IFRS 17.BC250, 252

Financial risk mitigation

For direct participating contracts, changes in the effect of financial risks associated with the entity's share of the underlying items or that do not arise from the underlying items relate to future service and, therefore, adjust the CSM instead of being recognised immediately in the statement(s) of financial performance.



Some entities may use financial instruments measured at FVTPL, such as derivatives, or reinsurance contracts held in order to mitigate the effects of financial risk arising from direct participating contracts. When comparing the measurement of the mitigating instruments and the insurance liability, an accounting mismatch could arise because the impact of changes in financial risks on the fair value of the mitigating instruments or reinsurance contracts held is recognised in profit or loss (or in OCI for reinsurance contracts held for which the OCI option is applied), whereas the mitigated financial risk arising from the direct participating insurance contracts adjusts the CSM. IFRS 17 provides an option to help reduce such accounting mismatches for direct participating contracts.

IFRS 17.B113, B115–B116



An entity may choose to exclude from the CSM some or all of the changes in the effect of the time value of money and financial risk on:

- the fulfilment cash flows that do not vary with underlying items if the entity mitigates the effect of financial risk on those fulfilment cash flows with derivatives, non-derivative financial instruments measured at FVTPL or reinsurance contracts held; and
- the amount of the entity's share of the underlying items if the entity mitigates the effect of financial risk on that amount using derivatives or reinsurance contracts held.

To apply this option, the entity needs to meet the following criteria:

- it applies a previously documented risk management objective and strategy for mitigating financial risk as described above;
- an economic offset exists between the insurance contracts and the derivative, or non-derivative financial instrument measured at FVTPL or reinsurance contract held; and
- credit risk does not dominate the economic offset.

IFRS 17.B117

The fulfilment cash flows in a group to which this exception applies are determined in a consistent way at each reporting date.

IFRS 17.112

If an entity chooses not to adjust the CSM for some changes in the fulfilment cash flows, then it discloses the effect of that choice on the adjustment to the CSM that would otherwise have been made in the current period.

IFRS 17.B118

If, and only if, the entity no longer meets the conditions for using the option – e.g. an economic offset ceases to exist – then it:

- ceases to apply the option from that date; and
- does not make any adjustment for changes previously recognised in profit or loss.

IFRS 17B117A



If an entity applies both the OCI option (see 13.2.3) and the risk mitigation option to its direct participating contracts, then changes in the insurance liability that are mitigated by financial instruments held at FVTPL are presented in profit or loss. Changes in the insurance liability that are mitigated by reinsurance contracts held are presented by applying the same OCI option that the entity has chosen for the reinsurance contracts held.

IFRS 17BC251–BC252



Financial risk mitigation related to contracts that are not direct participating contracts

Under the general measurement model, without the modifications for direct participating contracts, changes in the time value of money and the effect of financial risk are considered not to relate to future service and so do not adjust the CSM. These changes are recognised immediately in the statement(s) of financial performance. Entities may use derivatives or non-derivative financial instruments measured at FVTPL or reinsurance contracts held (the ‘mitigating instruments’) to mitigate financial risks arising from insurance contracts. So, under the general measurement model both the change in the carrying amount of the fulfilment cash flows related to financial risks and the change in the value of the mitigating instruments are recognised in the statement(s) of financial performance as the changes occur.

Based on the subsequent measurement principles of the general measurement model, the accounting mismatch that exists for direct participating contracts measured using the variable fee approach does not exist for contracts without direct participation features. Rather, if an entity chooses to recognise all insurance finance income or expense in profit or loss, then there is no accounting mismatch due to the recognition principles applied to the change in the value of the mitigating instruments and the recognition of the change in the carrying amount of the insurance contracts related to the financial risks that the mitigating instruments are intended to alleviate. However, an accounting mismatch due to the measurement principles may still result. For example, this could be because the value of the mitigating instruments may be measured at FVTPL, whereas the change in the carrying amount of the insurance contracts related to the financial risks that the mitigating instruments are intended to mitigate is measured based on their current fulfilment value under the general measurement model.

Therefore, the option discussed in this section is only available for direct participating contracts. Entities with participating contracts that are not considered direct participating contracts and that manage a risk mitigation programme for these contracts should take into consideration these risk mitigation activities when determining whether to apply the OCI option.

15.3.4

Measuring certain underlying items

Some standards currently provide for fair value measurement of assets that are underlying items for different types of participating arrangements. These standards, and others, are amended by IFRS 17 to allow for more options to reduce mismatches between the measurements used for the assets held by the entity and the measurement of the liability that is supported by those assets.

IAS 16.29A–B, 28.18–19, 32.33A, 40.32A–B

The following table describes the options and related guidance available in certain instances, including when accounting for direct participating contracts.

Asset type	When does the fair value option apply?	Other relevant requirements
Investment properties	Option to apply the fair value model or the cost model for all investment properties backing liabilities that pay a return linked directly to the fair value of, or returns from, specified assets including that investment property – e.g. investment funds, direct participating contracts.	For investment properties that are held by a fund or as underlying items, the entity is not permitted to measure the property partly at cost and partly at fair value.
Investments in associates and joint ventures	Option to apply IFRS 9 FVTPL measurement for investments in an associate or a joint venture that are held by, or indirectly held through, an entity that is a venture capital organisation, a mutual fund, a unit trust or a similar entity, including investment-linked insurance funds – e.g. a fund held by an entity as the underlying items for a group of direct participating contracts.	These options are applied separately for each investment on initial recognition. Specific guidance is provided for circumstances in which only part of the investment is held in this way.
Owner-occupied property	Option to apply the fair value model of IAS 40 <i>Investment Property</i> to owner-occupied property held by an investment fund or as underlying items of direct participating contracts.	Owner-occupied property measured using the fair value model of IAS 40 is treated as a separate class of property, plant and equipment.

IFRS 17 also amends IFRS 9 and IAS 32 to address cases in which own financial liabilities and shares are held in investment funds operated by the entity and which provide their investors with benefits determined by the fund's units, or held as underlying items of a group of direct participating insurance contracts.

IFRS 9.3.3.5

When an entity holds its own financial liabilities – e.g. issued bonds – as underlying items for a group of direct participating contracts or in investment funds it operates, it may elect to continue to account for the instruments as financial liabilities and to account for the repurchased instruments as if they were financial assets, and measure them at FVTPL, instead of derecognising the liabilities.

IAS 32.33A

When an entity holds its own treasury shares as underlying items for a group of direct participating contracts or in such investment funds, it may elect to continue to account for them as equity and to account for the reacquired instruments as if they were financial assets, and measure them at FVTPL.

IFRS 7.8(a), IFRS 9.3.3.5, IAS 32.33A

The above choices are made when the repurchase of each instrument is made and are irrevocable. An entity discloses separately the fair value for the financial assets.



Accounting mismatches might still appear in equity

The presentation choice provided by IFRS 17 for insurance finance income and expense related to direct participating contracts, for which the entity holds the underlying items, is likely to remove any significant accounting mismatches from the statement of profit or loss. Together with the options to measure some underlying assets at fair value, significant mismatches are not expected to impact entities' equity for these types of underlying items.

However, some remaining accounting mismatches can still impact equity when entities issue direct participating contracts – e.g. if some of the underlying assets are measured at cost. This may be the case when underlying assets include intangible assets that are measured at cost but have a different fair value.

16

Investment contracts with DPFs

The general measurement model is modified for investment contracts with DPFs because they do not transfer significant insurance risk.

16.1

Modifications to the general measurement model

IFRS 17.3(c), 71

An investment contract with DPFs does not transfer significant insurance risk. However, it is still in the scope of IFRS 17 if it is issued by an entity that also issues insurance contracts. For further detail, including the definition of these types of contracts, see 3.1.2.

This chapter describes modifications that are made to the general measurement model for investment contracts with DPFs. It should be read with Chapters 5–12, which outline the general measurement model and Chapter 15, which outlines modifications to the general measurement model for direct participating contracts.

IFRS 17.71, BC86

The standard includes the following modifications for these contracts.

Area	Modification for investment contracts with DPFs
Recognition	The date of initial recognition is specified as that on which the entity becomes party to the contract (for the general requirements, see Chapter 4).
Contract boundary	<p>Cash flows are within the contract boundary if they result from a substantive obligation of the entity to deliver cash at a present or future date.</p> <p>The entity has no substantive obligation to deliver cash if it has the practical ability to set a price for the promise to deliver cash that fully reflects the amount of cash promised and related risks (for the general requirements, see Section 7.3).</p>
Allocation of the CSM	The CSM is recognised over the duration of the group of contracts in a systematic way that reflects the transfer of investment services under the contract (for the general requirements, see Chapter 10).

All other requirements of the standard apply unmodified to investment contracts with DPFs.

IFRS 4.34–35, 17.BC65(a), BC83



IFRS 17 vs IFRS 4 – Equity classification

Under IFRS 17, investment contracts with DPFs issued by entities that also issue insurance contracts are required to be measured using the measurement requirements of IFRS 17. Therefore, the measurement of investment contracts issued with DPFs by an entity that does not issue insurance contracts will not be comparable to that of an entity that does. However, given that most entities that issue these types of contracts also issue insurance contracts, these comparability issues are unlikely to be a significant concern.

Under IFRS 4, entities were able to account separately for a guaranteed benefit and the discretionary benefit, and sometimes equity instrument accounting might be applied to the latter. Under IFRS 17, expected cash flows are considered in fulfilment cash flows; therefore, both guaranteed and discretionary benefits are included in the measurement of the contract liability.

Those entities that may have previously separated the discretionary benefits from the guaranteed benefit will have to update their processes.

IFRS 17.BC86



Potential impacts

Investment contracts with DPFs that are not direct participating contracts

The definitions of an investment contract with DPFs and a direct participating contract are not identical. An investment contract with DPFs provides the investor with the contractual right to receive additional discretionary amounts contractually based on the underlying items and that are expected to be a significant portion of the total contractual benefits. Conversely, a direct participating contract requires the entity to expect to pay the policyholder *an amount equal to a substantial share* of the fair value returns on the underlying items and for a substantial portion of changes in the amounts paid to the policyholder to vary with changes in the fair value of the underlying items.

Therefore, entities will have to assess whether investment contracts with DPFs are also direct participating contracts. As a result, investment contracts with DPFs will often, but not always, be measured using the variable fee approach. Whether an investment contract with DPFs is measured by applying the general measurement model or the variable fee approach may give rise to significant measurement and presentation differences.

For instance, the future profitability of investment contracts with DPFs is generally earned from the expected asset management fees. If these contracts are classified as direct participating contracts, then the changes that relate to the entity's share in the fair value of the underlying items (in this case, the contract's asset management fees) adjust the CSM. However, if a contract is measured under the general measurement model, then the entity will have to identify the difference between the effect of changes in financial risk assumptions relating to its contractual commitment (do not adjust the CSM) and the other changes that relate to that commitment (adjust the CSM) (see 10.2.2.1).

Contract boundaries

The contract boundary includes cash flows that result from a substantive obligation of the entity to deliver cash at a present or future date.

Generally, expected future premiums and cash flows that make up the investment component of the contract will be included within the contract boundary, because the surrender value of these contracts is generally the account balance less a fee to recover acquisition costs. However, this substantive obligation ends, and therefore the contract boundary ends, when the entity has the practical ability to set a price for the promise to deliver the cash that fully reflects the amounts of cash promised and the related risks.

CSM allocation that reflects the transfer of investment services

The CSM is recognised in profit or loss over the duration of the group of contracts in a way that reflects the transfer of investment services under the contract. The provision of investment services is likely to reflect the entity's expectation of the amount of funds to be managed throughout the expected duration of the contract, if this amount of funds is consistent with the transfer of investment services under the contract.

17 Reinsurance contracts held

The general measurement model is modified for measuring reinsurance contracts held by an entity.

17.1

IFRS 17.A

What is a reinsurance contract?

A 'reinsurance contract' is a type of insurance contract that is issued by an entity (the reinsurer) to compensate another entity (the cedant) for claims arising from insurance contract(s) issued by the cedant.

This section describes the modifications to the general measurement model that are applied by the cedant to reinsurance contracts held. It should be read with [Chapters 5–12](#), which outline the general measurement model.

17.2

IFRS 17.BC296

Modifications to the general measurement model

The modifications introduced by IFRS 17 for reinsurance contracts are only relevant to reinsurance contracts *held* by an entity, the cedant. The modifications in this section do not apply to reinsurance contracts issued unless specified. An entity will apply the general requirements to reinsurance contracts issued, but also has an option to apply the PAA if the eligibility criteria are met.

Applying the general measurement model to reinsurance contracts

Reinsurance contracts issued

Apply the general measurement model

Reinsurance contracts held

Apply the general measurement model with certain modifications

IFRS 17.BC298

The cedant accounts for a group of reinsurance contracts held separately from the underlying contract(s) that it relates to because the cedant does not normally have the right to reduce the amounts that it owes to the underlying policyholder(s). The cedant's contractual obligations to the underlying policyholder(s) are not extinguished because the underlying contract(s) is (are) reinsured.

IFRS 17.29(b), 60–68, BC302

The cedant measures and accounts for groups of reinsurance contracts that it holds using the recognition and measurement requirements for issued insurance contracts, modified to reflect the following facts.

- Reinsurance contracts held are generally assets, rather than liabilities. They are separate from the underlying insurance contracts; however, they correspond with them.

- For reinsurance contracts held, the cedant pays a premium to a reinsurer and receives a reimbursement from the reinsurer if it pays valid claims arising from the underlying contracts. Generally, insurers do not make profits from reinsurance contracts held. Rather, they generally pay a margin to the reinsurer as an implicit part of the premium; but this is not necessarily always the case. The cedant can have a net cost or a net gain on purchasing the reinsurance – i.e. a CSM that can be positive or negative.

IFRS 17.29(b), B109

Reinsurance contracts issued or held cannot be direct participating contracts, for accounting purposes – i.e. an entity cannot apply the modifications described in Chapter 15 to reinsurance contracts issued or held.

IFRS 17.69–70, BC301

An entity may use the PAA to simplify the measurement of the remaining coverage component of a group of reinsurance contracts held if, on initial recognition of the group, it meets the eligibility criteria, adapted to reflect the features of reinsurance contracts held (see Chapter 14). Because the PAA eligibility assessment is performed separately for the underlying insurance contracts and the reinsurance contracts held, it might result in different outcomes.

IFRS 17.61

An entity applies the aggregation requirements to divide portfolios of reinsurance contracts into groups, adapted to reflect the features of reinsurance contracts held (see Chapter 6). Applying these requirements can result in groups that comprise a single contract.

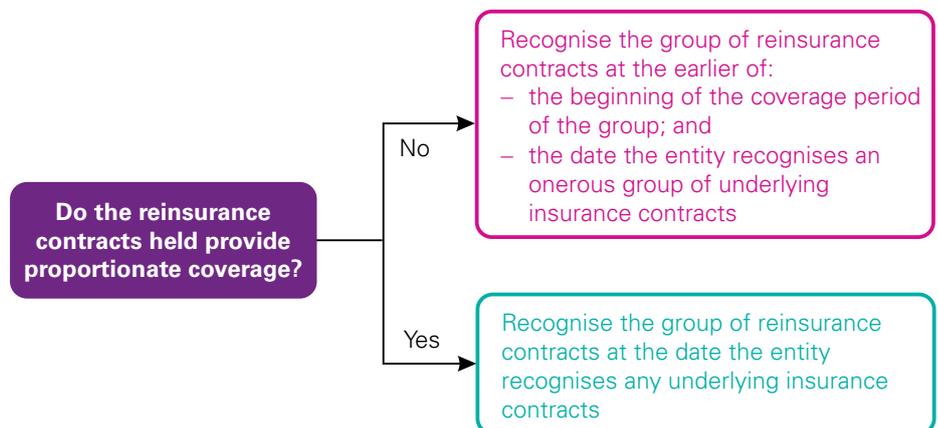
17.3

IFRS 17.62–62A

Recognition



An entity recognises a group of reinsurance contracts held as follows.



IFRS 17.BC304

Reinsurance contracts are designed to cover the claims incurred under underlying contracts written during a specified period. In some cases, the reinsurance contract covers the losses of individual contracts on a proportionate basis, and in others it covers the aggregated losses from a group of underlying contracts that exceed a specified amount.

IFRS 17.BC305(a)

If the group of reinsurance contracts held covers the loss of a group of contracts on a proportionate basis, then the treatment described above means that the entity does not recognise the group of reinsurance contracts held until it has recognised at least one of the underlying contracts.

IFRS 17.B119C, BC305(b)

If the group of reinsurance contracts held covers the aggregate losses from a group of underlying contracts that exceed a specified amount, then the entity benefits from coverage – in cases when the underlying losses exceed the threshold – from the beginning of the coverage period of the group of reinsurance contracts held as these losses accumulate throughout the coverage period. Therefore, a group of these reinsurance contracts held is recognised when its coverage period begins or, if it is earlier, when an onerous group of underlying contracts is recognised, if the entity entered into the related reinsurance contract at or before that date.



Contract boundary differences between reinsurance contracts held and the underlying direct contracts

Current practice generally tends to align the accounting for reinsurance contracts held with the accounting for the underlying insurance contracts issued, except for the impairment of reinsurance receivables.

IFRS 17 keeps the correlation between reinsurance contracts held and the underlying insurance contracts issued to some extent. However, it introduces some new requirements that reflect the fact that reinsurance contracts are separate from the underlying insurance contracts. Initial recognition is an example of this.

The initial recognition of excess of loss reinsurance contracts may differ from the underlying insurance contracts. The boundaries of these types of contracts may differ, as well. This can require additional data gathering and result in circumstances in which the PAA eligibility conclusion could be different for the reinsurance contracts held compared with the related underlying contracts, resulting in the application of a different model to each.

If an excess of loss reinsurance contract covers a period longer than a year and the underlying contracts are for one year of coverage, then an analysis of the PAA eligibility criteria for the reinsurance contract held would need to take into account the longer coverage period.

Typically, reinsurance contracts that provide coverage for short-term underlying contracts issued over an underwriting year would be considered to have a coverage period longer than a year, because the total coverage period is effectively longer. However, these reinsurance contracts might still meet the PAA eligibility criteria, due to the relatively short term of coverage. Other types of reinsurance contracts that provide coverage for multiple years might not meet the PAA eligibility criteria and would be subject to the general measurement model.

17.4

IFRS 17.63, BC300

IFRS 17.63, BC307–BC308

IFRS 17.63

Estimating expected cash flows

An entity uses consistent assumptions to measure the estimates of the present value of the expected cash flows for the group of reinsurance contracts held and the estimates of the present value of the expected cash flows for the group(s) of underlying insurance contracts. As a result, the cash flows used to measure the group of reinsurance contracts held reflect the extent to which those cash flows depend on cash flows of the contracts that they cover.

The effect of any risk of non-performance by the reinsurer, including the effects of collateral and losses from disputes, is considered when determining the estimates of the present value of expected cash flows for the group of reinsurance contracts held. Therefore, estimates of amounts and timing of cash flows related to this risk are based on probability-weighted outcomes after calculating the effect of non-performance risk.

For further detail on estimating expected cash flows, see [Chapter 7](#).



Expected cash flows for reinsurance contracts held

IFRS 17 requires an entity to estimate the present value of expected cash flows. This will result in current accounts or deposits being included in the insurance contract asset or liability. This may be a change from current accounting under IFRS 4.

17.5

IFRS 17.64

Risk adjustment for non-financial risk

The risk adjustment for a group of reinsurance contracts held represents the amount of risk being transferred by the cedant to the reinsurer.

For further discussion on determining the risk adjustment under the general measurement model, see [Chapter 9](#).

17.6

IFRS 17.65–65A

CSM on initial recognition

The CSM on initial recognition for a group of reinsurance contracts represents a net cost or net gain from purchasing reinsurance.

On initial recognition:

- if the coverage of the group of reinsurance contracts relates to events that occurred before the purchase of the group – e.g. coverage against an adverse development of claims incurred – then any net cost of purchasing reinsurance coverage is recognised immediately in profit or loss as an expense; and
- in all other cases, the CSM equals the inverse amount of the sum of:
 - the fulfilment cash flows;
 - the amount derecognised for assets or liabilities previously recognised for related cash flows;
 - any cash flows arising from the contracts in the group at the date of initial recognition of the group; and



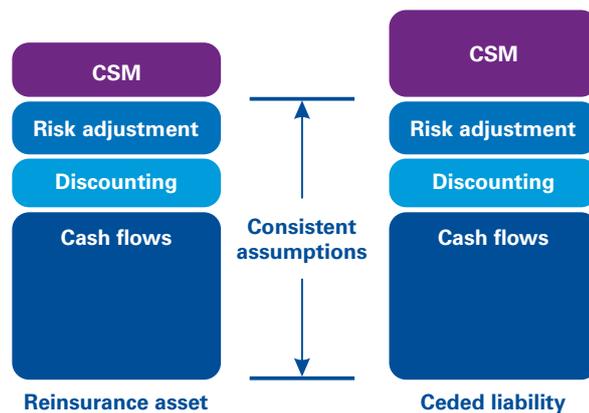
- any income recognised in profit or loss for recovery of losses recorded on initial recognition of onerous underlying contracts.

IFRS 17.BC310–BC311

The amount paid by a cedant typically exceeds the expected risk-adjusted present value of the cash flows generated by the reinsurance contracts held. Therefore, a debit CSM (net cash outflows) that represents a net cost of purchasing reinsurance is typically recognised on initial recognition of a group of reinsurance contracts held.

However, a credit CSM (net cash inflows) that represents a net gain on purchasing reinsurance can also occur, albeit in rare circumstances – e.g. favourable pricing by the reinsurer as a result of diversification benefits that are not available to the cedant.

This net gain, which represents a reduction in the cost of purchasing reinsurance, is not recognised immediately in profit or loss on initial recognition of the group, but is deferred. In these circumstances, entities review the measurement of the underlying insurance contracts to evaluate whether they are overstated.

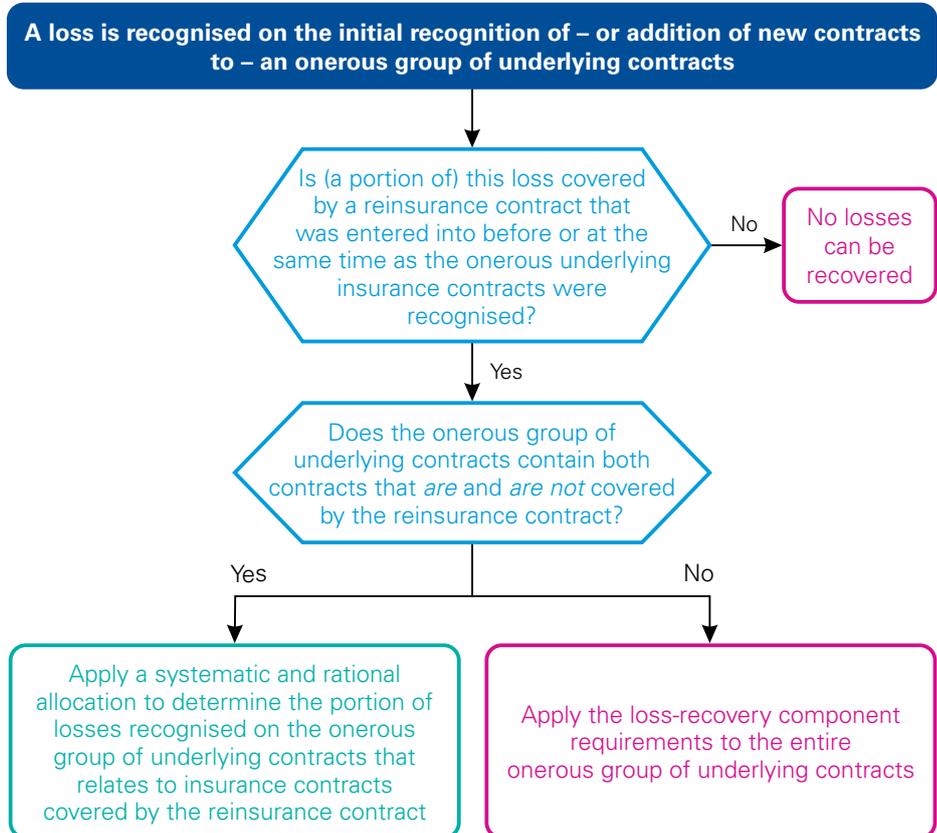


IFRS 17.66A–66B, B119D

When an entity recognises a loss on initial recognition of underlying contracts at the same time as or after entering into a reinsurance contract held, the entity adjusts the CSM of the reinsurance contracts held to compensate for all or some of that loss. It simultaneously recognises the corresponding amount in profit or loss and establishes a loss-recovery component of the asset for remaining coverage under the reinsurance contracts. The CSM adjustment is determined by multiplying:

- the loss recognised on the underlying insurance contracts; and
- the percentage of claims on the underlying insurance contracts that the entity expects to recover from the reinsurance contract held.

The process for initially recognising a loss-recovery component is as follows.



Example 15.1 – Reinsurance contracts held: Measurement on initial recognition

Entity X issues a group of insurance contracts with a coverage period of five years. It expects to receive total premiums of 1,000 on initial recognition and to pay claims of 900, on a present value basis, over the coverage period. The risk adjustment for non-financial risk is 60.

At the same time, X enters into a reinsurance contract that covers 30% of each claim arising from those contracts. In this example we consider two scenarios. In Scenario 1 the single reinsurance premium paid on initial recognition is 300, and in Scenario 2 the single premium paid on initial recognition is 260. In addition, the risk adjustment for non-financial risk is expected to be 18 for the reinsurance contract held.

X identifies a group comprising the single reinsurance contract held and recognises this group at the date on which the group of underlying insurance contracts is initially recognised.

The following table describes the measurement of the group of underlying insurance contracts and the measurement of the reinsurance contract held, under both scenarios. For simplicity, the risk of non-performance of the reinsurer is assumed to be negligible.

IFRS 17:IE124–IE129

	Group of insurance contracts issued	Reinsurance contract held – Scenario 1	Reinsurance contract held – Scenario 2
Estimates of present value of cash inflows (premium and claims recovery)	(1,000)	(270)	(270)
Estimates of present value of cash outflows (premium and claims recovery)	900	300	260
Risk adjustment for non-financial risk	60	(18)	(18)
Fulfilment cash flows	(40)	12	(28)
CSM	40	(12)	28

X recognises a CSM for the reinsurance contract held under both scenarios. In Scenario 1, the CSM reflects a net cost of purchasing reinsurance, and in Scenario 2, the CSM reflects a net gain. Both are recognised over the reinsurance coverage period.



Example 15.2 – Reinsurance contracts held: Measurement on initial recognition

Changing Example 15.1, X charges and expects to receive total premiums of 850 on initial recognition for the underlying group of insurance contracts.

The following table describes the measurement of the group of underlying insurance contracts and the measurement of the reinsurance contract held, under both scenarios.

	Group of insurance contracts issued	Reinsurance contract held – Scenario 1	Reinsurance contract held – Scenario 2
Estimates of the present value of cash inflows	(850)	(270)	(270)
Estimates of the present value of cash outflows	900	300	260
Risk adjustment for non-financial risk	60	(18)	(18)
Fulfilment cash flows	110	12	(28)
Loss component and loss recognised on initial recognition	110	N/A	N/A
Loss recovery component and gain recognised on initial recognition	N/A	33 ¹	33 ¹
CSM	-	45	5

Note

1. Calculated as the underlying loss of 110 x expected reinsurance coverage of 30%.

The group of underlying contracts is onerous on initial recognition. Therefore, X recognises a loss for the onerous group of underlying contracts in profit or loss. On initial recognition, X adjusts the CSM for the reinsurance contracts held for the expected recovery of part of this loss and recognises a corresponding gain in profit or loss.



Additional changes introduced for measuring reinsurance contracts held

The general measurement model introduces significant changes to current practice for insurance contracts issued, which are also relevant to reinsurance contracts held.

The modifications to the general measurement model for reinsurance contracts held add a number of potential practical impacts, including the following.

More independent fulfilment cash flow measurements

The assumptions used to determine the fulfilment cash flows of reinsurance contracts held are consistent with those used for the measurement of the underlying insurance contracts. However, the specific timing of cash flows expected under the reinsurance contracts held needs to be addressed separately if it departs from the timing of cash flows under the underlying insurance contracts. The current practice of recognising reinsurance deposits will no longer exist. The operational impact could be more significant for contracts when the reinsurer and cedant use a net settlement process whereby the transfer of cash occurs only on an agreed timescale – e.g. end of year.

Linkage between reinsurance contracts held and underlying insurance contracts

Unlike direct insurance, reinsurance contracts are likely to be much less standardised in regard to the terms and conditions. In many cases, entities will need to consider reinsurance contracts on an individual basis and it is possible that a group will include only a single reinsurance contract.

In addition, on initial recognition of onerous underlying insurance contracts, an entity is required to recognise the recovery of losses if the contracts are covered by a reinsurance contract. It is possible that the reinsurance contract covers only some of the insurance contracts within an onerous group. In these cases, the entity needs to determine what portion of the losses recognised on the onerous group of insurance contracts relates to the insurance contracts covered by the reinsurance contract. To determine the relevant portion, the entity uses a rational and systematic method; in many cases, judgement will need to be applied.

Reinsurance asset impairment included in the measurement model

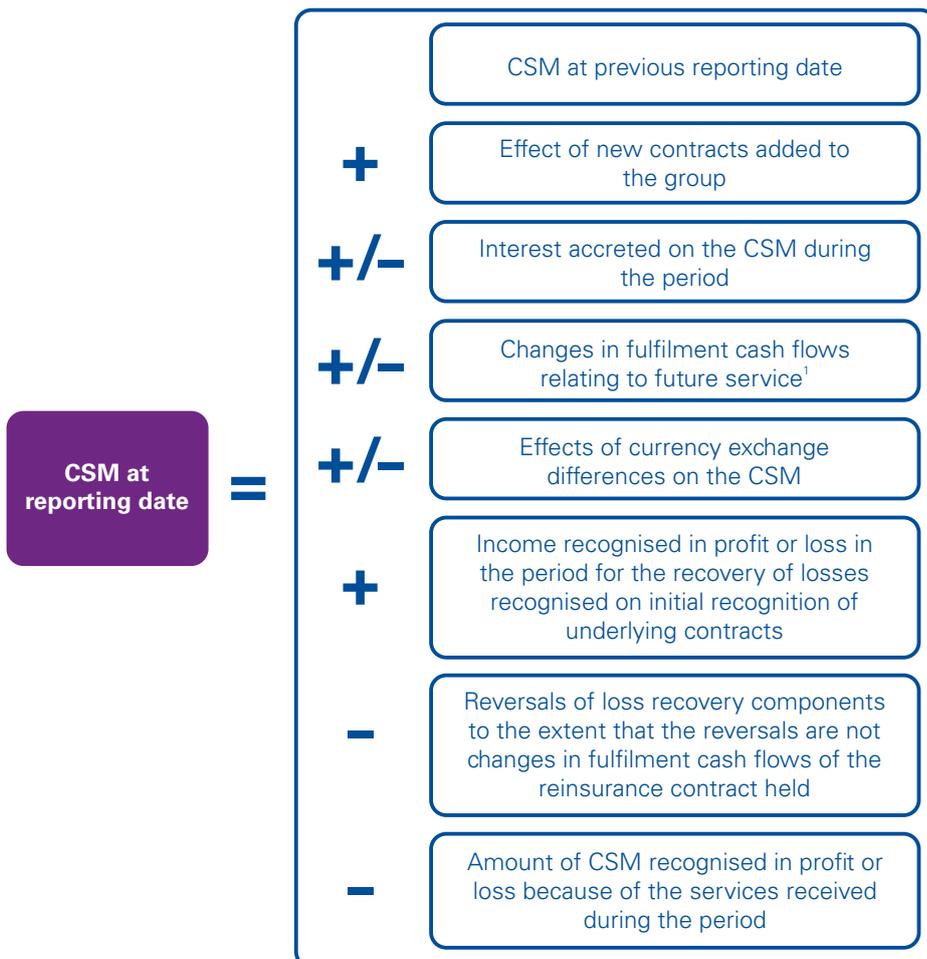
Current practice applies an impairment assessment to reinsurance contract assets (reinsurance receivables). This is no longer needed as a separate exercise under IFRS 17, because any non-performance risk is included in the measurement of the reinsurance contract held from its inception and throughout subsequent periods. 'Non-performance risk' is the risk that an entity will not fulfil an obligation. The estimation of this risk includes losses arising from disputes. This also means that impairment losses related to reinsurance contracts held are recognised on an expected basis, similar to the expected credit loss model for credit-impaired assets under IFRS 9.

17.7

IFRS 17.66

CSM subsequent to initial recognition

The CSM at each reporting date equals:



Note

1. Unless the change results from a change in the fulfilment cash flows allocated to a group of underlying insurance contracts that does not adjust its CSM or there is a remeasurement of the underlying PAA liability for remaining coverage (LRC) because the underlying PAA contract is or was onerous.

IFRS 17.66(c), 67, BC309, BC315, IE138

When a change in the fulfilment cash flows allocated to a group of underlying contracts that relates to future service does not adjust the CSM for the group of underlying contracts (or there is a remeasurement of the underlying PAA LRC because the underlying PAA contract is or was onerous), the corresponding changes in the fulfilment cash flows relating to future service of the reinsurance contracts held are also recognised in profit or loss. For example, this arises when a group of insurance contracts becomes onerous during the period, and so the losses on such onerous groups are recognised after initial recognition in profit or loss. In other words, to the extent that a change in the fulfilment cash flows of the group of underlying contracts is matched by a change in the fulfilment cash flows of the group of reinsurance contracts held, the effect on profit or loss is compensated. In addition to adjusting the CSM of the group of reinsurance contracts held this would also lead to the recognition of a loss recovery component for that group.

IFRS 17.66(ba)–(bb)



On subsequent measurement, the CSM will be adjusted for the recovery of losses on onerous underlying contracts that were initially recognised in the period. For existing loss recovery components, the CSM will be adjusted by any reversals of those components to the extent that those reversals are not changes in fulfilment cash flows of the group of reinsurance contracts held.

IFRS 17.67, BC309

Changes in the fulfilment cash flows that result from changes in the risk of non-performance of the reinsurer do not relate to future service and are recognised immediately in profit or loss.

For further discussion on changes in fulfilment cash flows, see [10.2.2](#).

IFRS 17.66(c)



Matching on subsequent measurement

Similar to initial recognition, there is a level of matching between the underlying group of contracts and the reinsurance contracts held on subsequent measurement.

The adjustment to the CSM of a group of reinsurance contracts to reflect changes in the fulfilment cash flows of the reinsurance contracts arising from changes in the fulfilment cash flows of the group of underlying contracts is limited to the reinsurer's share of those changes that adjust the underlying contracts' CSM (or there is a remeasurement of the underlying PAA LRC because the underlying PAA contract is or was onerous). Any changes outside this limit are recognised immediately in profit or loss as a gain or loss on the group of reinsurance contracts held.

17.8

IFRS 17.66(bb), B119F



Subsequent measurement of loss recovery components

Once an entity has established a loss recovery component, it will:

- adjust the loss recovery component to reflect changes in the loss component for the onerous group of underlying contracts;
- allocate subsequent changes in fulfilment cash flows, which arise from onerous groups of underlying insurance contracts, to that loss recovery component until it is reduced to zero; and
- ensure that the loss recovery component does not exceed the portion of the loss component of the underlying insurance contracts that is expected to be recovered from the reinsurance contract held.

17.9

IFRS 17.78

IFRS 17.82

IFRS 17.82, 86, BC346

Presentation of reinsurance contracts held

In the statement of financial position, portfolios of reinsurance contracts held are presented separately from portfolios of insurance contracts issued. Those held that are assets are presented separately from those that are liabilities.

Similarly, in the statement(s) of financial performance, income or expense from reinsurance contracts held is presented separately from income or expense from insurance contracts issued.

Amounts recognised in the statement(s) of financial performance are disaggregated between the insurance service result and insurance finance income or expense. The income or expense from reinsurance contracts held included in the insurance service result may be presented:

- as a single amount; or
- separately as the amounts recovered from the reinsurer and an allocation of the premiums paid, which together give a net amount equal to the single amount above. In particular:
 - cash flows that are contingent on the claims or benefit experience of the underlying contracts – e.g. profit commissions – are included as part of the expected claim reimbursement (unless they are considered an investment component);
 - any amounts that the entity expects to receive from the reinsurer that are not contingent on the claims experience of the underlying contracts – e.g. some types of ceding commissions – are treated as a reduction in the premiums to be paid to the reinsurer;
 - allocations of premiums paid are not presented as a reduction in revenue; and
 - amounts recognised related to a recovery of losses on underlying onerous insurance contracts are treated as amounts recovered from the reinsurer. The resulting loss-recovery component determines the amounts that are subsequently presented in profit or loss as reversals of recoveries of losses



IFRS 17.88

from reinsurance contracts held and are consequently excluded from the allocation of premiums paid to the reinsurer.

The insurance finance income or expense of reinsurance contracts held may be presented in profit or loss in its entirety, or disaggregated between profit or loss and OCI.

For further detail on the presentation requirements, see [Chapter 13](#).



Data and systems impacts

Some entities have less developed systems for reinsurance contracts held than for insurance contracts issued. So, entities that reinsure a significant amount of their business may find that the accounting requirements for reinsurance contracts held pose greater implementation challenges.

Entities should consider whether and how to leverage also for reinsurance contracts held upgrades or new systems, processes and controls that they are developing for insurance contracts that they issue.

18

Insurance contracts acquired

Insurance contracts acquired in a business combination or portfolio transfer are classified and measured as if they were newly written.

18.1

IFRS 17.39, B93–B95

Acquired insurance contracts

Insurance contracts issued and reinsurance contracts held that are acquired in a business combination in the scope of IFRS 3 or in a transfer of insurance contracts that do not form a business combination are treated as if they had been issued by the acquirer at the date of the transaction.

The entity identifies the groups of contracts acquired based on the level of aggregation requirements and determines the CSM for insurance contracts issued and reinsurance contracts held (unless the PAA applies) as if it entered into the contracts at the date of the transaction.

IFRS 17.B94

For measurement purposes, the consideration received or paid for the contracts is treated as a proxy for the premiums received. The consideration for the contracts excludes any consideration for other assets and liabilities acquired in the same transaction.

IFRS 13.47, IFRS 17.B94, BC166

For contracts acquired in a business combination in the scope of IFRS 3, this consideration is deemed to be the contracts' fair value at the date of the transaction. This fair value is determined using the requirements in IFRS 13, except for the requirement that the fair value of a financial liability with a demand feature cannot be less than the amount payable on demand.

IFRS 17.B95A

If the contracts acquired are onerous, then the difference between the consideration received or paid and the fulfilment cash flows is treated differently, depending on whether the transaction is a business combination in the scope of IFRS 3 or a transfer of insurance contracts.

IFRS 17.B95A

Type of transaction	Onerous contracts
Business combination in the scope of IFRS 3	Recognise the difference as a part of the goodwill or gain on a bargain purchase, and establish a loss component of the liability for remaining coverage.
Transfer of insurance contracts that do not form a business combination	Recognise the difference as a loss immediately in profit or loss, and establish a loss component of the liability for remaining coverage.

Once the newly acquired contracts have been initially recognised, an entity applies all of the other requirements of IFRS 17 in the same way as for any other group of insurance contracts.

IFRS 17.B95B



If the underlying contracts of a group of reinsurance contracts held are onerous, then the entity determines the loss-recovery component for the reinsurance contracts by multiplying:

- the loss component of the underlying insurance contracts at the date of the transaction; and
- the percentage of claims that the entity expects, at the date of the transaction, to recover from the (group of) reinsurance contract(s) held.

IFRS 17.B95C



The amount of the loss recovery component is recognised as a reduction in goodwill (or an increase in the gain on a bargain purchase) for reinsurance contracts held acquired in a business combination in the scope of IFRS 3, or as income in profit or loss for reinsurance contracts held acquired in a transfer.

IFRS 17.B95D



If a group of onerous insurance contracts includes some onerous underlying contracts covered by a group of reinsurance contracts held and other onerous contracts not covered by the group of reinsurance contracts held, then the entity allocates a portion of the loss component of the onerous group of insurance contracts to the underlying insurance contracts in that group.

IFRS 17.B95E



When an entity acquires insurance contracts in a business combination in the scope of IFRS 3 or in a transfer of insurance contracts that is not a business combination, at the date of the transaction the entity recognises an asset for insurance acquisition cash flows at fair value for the rights to obtain:

- future insurance contracts that are renewals of insurance contracts recognised at the date of the transaction; and
- other future insurance contracts after the date of the transaction without paying again insurance acquisition cash flows that the acquiree has already paid that are directly attributable to the related portfolio of insurance contracts.

IFRS 17.B95F



The amount of any asset for insurance acquisition cash flows is not included in the measurement of the insurance contracts acquired at the date of the transaction.

IFRS 17.BC326–BC327, IE139–IE151



Example 16 – Measuring insurance contracts acquired in a business combination

On 31 December 2023 Entity C completes a business combination transaction and acquires, among other assets and liabilities, a group of insurance contracts that have been in force for 10 years. The fair value of the liability for these contracts at the date of the transaction is 30. On the date of acquisition:

- under Scenario 1, C estimates that the fulfilment cash flows are 20; and
- under Scenario 2, C estimates that the fulfilment cash flows are 45.

Although the contracts have been in force for 10 years, C initially recognises and measures them as if they had been issued on 31 December 2023.

On initial recognition, C measures the insurance contract liability as follows.

	Scenario 1	Scenario 2
Fulfilment cash flows	20	45
CSM	10	-
Insurance contract liability on initial recognition	30	45

Scenario 1

The fair value exceeds the fulfilment cash flows. Therefore, the difference of 10 represents the CSM on initial recognition. C initially measures the contracts acquired at their fair value of 30.

Scenario 2

Because the fulfilment cash flows exceed the fair value, there is no CSM. Therefore, C initially measures the group at the fulfilment cash flows of 45.

The excess of the fulfilment cash flows over the contracts' fair value – i.e. $45 - 30 = 15$ – effectively increases the goodwill to be recognised and a loss component for the liability for remaining coverage would be established for the same amount. This might be the case if C agrees to receive a lower price (or pay more) because of other synergies that the contracts provide.

Had this transaction been a transfer of insurance contracts that was not a business combination – in which the consideration received was 30 and no goodwill was recognised – the difference of 15 would have been recognised in the statement of profit or loss as a loss on initial recognition.

IFRS 3.18, IFRS 4.31–33, IFRS 17C4, BC324



Recognition and measurement of contracts acquired in a business combination transaction

Normally, IFRS 3 requires all identifiable assets acquired and liabilities assumed in a business combination transaction to be measured at their fair values at the date of acquisition.

The approach used for business combinations under IFRS 17 – under which some contracts are initially recognised at their fulfilment cash flows if this amount exceeds their fair value – is an exception. The fulfilment cash flows are subject to the contract boundary requirements outlined in [Section 7.3](#). This approach affects the initial measurement of goodwill and avoids a loss being recognised under IFRS 17 immediately after the acquisition.

This also differs from current accounting under IFRS 4, which requires fair value measurement and allows an option to present the contract's fair value by splitting it into two components: an insurance liability (measured in accordance with the acquirer's accounting policies for insurance contracts) and an intangible asset.

This practice effectively means that intangible assets that are not in the scope of IAS 36 *Impairment of Assets* or IAS 38 are sometimes recognised under IFRS 4. These intangible assets are often described as the present value of in-force business, present value of future profits or value of business acquired.

The guidance in IFRS 17 means that all such intangible assets are eliminated, although an asset for insurance acquisition cash flows related to future contracts might be recognised. Also, any additional identifiable intangible assets reflecting a separate customer relationship under IAS 38 would continue to be recognised.

For more discussion on the transition requirements, see [Chapter 20](#).



Significant system and process complexities for portfolio acquisitions

Entities that have acquired insurance contract portfolios in the past may be presented with significant system and process complexities on implementation of IFRS 17.

Typically, when an insurance portfolio is acquired, the acquirer also inherits the existing valuation and administrative systems of the acquired insurance contract portfolios. This sometimes results in an insurer simultaneously running several different platforms to manage various portfolios of insurance contracts and their data.

Such legacy systems could become a source of significant complexity for some insurers on transition to IFRS 17. These entities should prioritise impact assessments and action plans to identify how to approach these data and systems complexities before transition.

IFRS 17.B3–B5



Contracts acquired

Contracts acquired in their claims settlement period – e.g. after the end of the coverage period originally agreed between the transferor and the customer – as a result of a business combination in the scope of IFRS 3 or a transfer of insurance contracts that does not form a business are treated as new contracts written by the acquiring entity on the date of acquisition.

Classification treatment

The contract classification of insurance contracts is considered by the acquirer based on the facts and circumstances that exist at the date of acquisition. Given that contracts acquired in their settlement period might have less insurance risk than when they were originally issued, or none – e.g. a contract for which a final settlement has been agreed but not yet paid – contracts that were considered insurance contracts during their original coverage period may no longer be considered as such. To determine this, entities will need to assess whether significant insurance risk still exists at the date of acquisition. See [20.2.2.1](#) and [20.2.3](#) for exceptions to this on transition.

The need to assess whether significant insurance risk exists at the date of acquisition is relevant not just to contracts acquired in their claims settlement period. For instance, modifications to insurance contracts in a transfer or business combination since their inception could also affect their classification.

Accounting treatment of contracts acquired in their settlement period

This approach may result in different accounting treatments for similar contracts, depending on whether they were originally issued by the entity or acquired.

The coverage period for contracts issued by the entity usually relates to the period over which an underlying loss event may occur. However, for contracts that are acquired after that period has passed, the discovery of such a loss, or an adverse development of claims, is deemed to be the insured event and the coverage period for these contracts is estimated on that basis.

For example, an entity has a group of one-year-coverage third party liability insurance contracts issued five years ago with long-tail claims, and it also acquires a group of similar non-onerous contracts that were issued five years ago. The coverage period for the contracts issued by the entity is one year. The coverage period for the contracts acquired is determined based on the claims development period starting from the date of acquisition.

This means that although the revenue related to contracts issued by the entity has been recognised in the past, the revenue related to the acquired contracts is recognised over a different period because the insured event is the adverse development of the acquired claims and the liability is classified as a liability for remaining coverage. The full amount allocated to the liability for remaining coverage will be recognised as revenue in the future in the acquirer's financial statements. Consequently, changes in estimates related to claims development will be recognised in profit or loss for the contracts issued by the entity, but may adjust future profitability for contracts acquired.

The different manner in which the coverage period is determined for contracts issued by the entity and those acquired by the entity could also impact the model applied for these contracts. In the example above, the entity would be able to apply the PAA for the contracts that it issued, because their coverage period is one year. However, considering the long settlement (=coverage) period of the acquired contracts, it is possible that these contracts may not be eligible for the PAA.

Transition relief is provided for insurance contracts acquired in their settlement period for acquisitions that occur before the date of transition; see [Chapter 20](#).

19

Disclosures

IFRS 17 contains specific disclosure requirements that aim to deliver clarity and transparency for users of financial statements.

19.1

IFRS 17.93

The general disclosure objective

The general disclosure objective is for an entity to disclose information that, together with information presented in the primary financial statements, provides a basis for users to assess the effects that insurance contracts have on its financial position, financial performance and cash flows. IFRS 17 contains specific disclosure requirements that focus on information about:

- amounts recognised in the financial statements;
- significant judgements and changes in those judgements; and
- the nature and extent of risks that arise from insurance contracts.

IFRS 17.94

If these specific disclosures are insufficient to meet this objective, then an entity discloses additional information.

19.2

IFRS 17.94–95

Level at which to disclose information

Entities consider the level of detail that is necessary to satisfy the general disclosure objective and how much emphasis to place on each of the disclosure requirements. The usefulness of the information cannot be obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics.

IFRS 17.96

Examples of aggregation bases that may be appropriate for disclosure purposes include the following.



**IFRS 17 vs IFRS 4 – Disclosures**

The level of detail that is necessary to enable users of the financial statements to assess the effects that insurance contracts have on the financial position, financial performance and cash flows of an entity will be an important judgement to make when presenting the disclosures.

Although entities currently provide some disclosures similar to those required by IFRS 17, many current disclosures – e.g. reconciliations of changes in insurance liabilities – are typically made only at a very high level, with little or no disaggregation, and the new requirements may represent a significant change in disclosures.

Entities will have to consider what level of disaggregation is appropriate to achieve the general disclosure objective. The conclusions reached may result in a significant difference in the level of detail currently disclosed by entities, which might require revisions to systems and processes to accommodate the new level of disaggregation.

19.3

IFRS 17.98–99, 102, BC350–BC353

Disclosures about recognised amounts

An entity discloses reconciliations that depict how the net carrying amounts of insurance contracts changed during the period arising from cash flows and amounts recognised in the statement(s) of financial performance.

Separate reconciliations are disclosed for insurance contracts issued and reinsurance contracts held. In each reconciliation, the opening and closing net carrying amounts are disclosed and disaggregated into a total for portfolios of contracts that are assets and a total for portfolios that are liabilities.

These reconciliations explain how the amounts in the statements of financial position and financial performance are linked and provide different types of information about the insurance service result.

IFRS 17.99–101, 103–105

An entity discloses the following reconciliations from the opening to the closing balances in tabular format.

Tabular information	What is separately included in the reconciliation?
Amounts related to insurance services	
Based on the components comprising the total asset or liability, which are: <ul style="list-style-type: none"> – the net liability (or asset) for remaining coverage, excluding any loss component; – any loss component; and 	These amounts include: <ul style="list-style-type: none"> – insurance revenue; – insurance service expenses, showing: <ul style="list-style-type: none"> - incurred claims and other expenses; - amortisation of insurance acquisition cash flows;



Tabular information	What is separately included in the reconciliation?
<ul style="list-style-type: none"> – the liability for incurred claims¹ 	<ul style="list-style-type: none"> – changes that relate to past service – i.e. changes in fulfilment cash flows relating to the liability for incurred claims; and – changes that relate to future service – i.e. losses on onerous groups of contracts and reversals of such losses; and – investment components and any refunds of premiums that are excluded from insurance revenue and insurance service expenses, unless these refunds of premiums are included in the amount of premiums received.
<p>Based on the general measurement model components comprising the total asset or liability¹, which are:</p> <ul style="list-style-type: none"> – the estimates of the present value of the expected cash flows; – the risk adjustment for non-financial risk; and – the CSM 	<p>These amounts include changes related to:</p> <ul style="list-style-type: none"> – future service, including the effects of contracts initially recognised; – current service; and – past service.
Amounts not related to insurance services	
<p>On either basis</p>	<p>These amounts include:</p> <ul style="list-style-type: none"> – cash flows in the period; – the effect of changes in the risk of non-performance by the reinsurer; – insurance finance income or expenses; and – additional information that may be needed to understand the change in the net carrying amount.
<p>Note</p> <p>1. For groups of contracts measured under the PAA, an entity is required to disclose separate reconciliations for the estimates of the present value of the expected cash flows and the risk adjustment for non-financial risk that comprise the liability for incurred claims.</p>	

The following table illustrates reconciliations from the opening balances to the closing balances for the net liabilities for remaining coverage and liabilities for incurred claims.

	Liabilities for remaining coverage		Liabilities for incurred claims	Total
	Excluding loss components	Loss components		
Net opening balance	161,938	15,859	1,021	178,818
Insurance revenue	(9,856)	-	-	(9,856)
Insurance service expenses	1,259	(623)	7,985	8,621
Claims and other insurance service expenses incurred	-	(840)	7,945	7,105
Amortisation of insurance acquisition cash flows	1,259	-	-	1,259
Losses and reversals of losses on onerous contracts	-	217	-	217
Changes to liabilities for incurred claims	-	-	40	40
Investment components	(6,465)	-	6,465	-
Insurance service result	(15,062)	(623)	(14,450)	(1,235)
Insurance finance expenses	8,393	860	55	9,308
Total changes in the statement(s) of financial performance	(6,669)	237	14,505	8,073
Cash flows				
Premiums received	33,570	-	-	33,570
Claims and other insurance service expenses paid, including investment components	-	-	(14,336)	(14,336)
Insurance acquisition cash flows	(401)	-	-	(401)
Total cash flows	33,169	-	(14,336)	18,833
Net closing balance	188,438	16,096	1,190	205,724

The following table illustrates reconciliations, for contracts to which the PAA has not been applied, from the opening balances to the closing balances of the estimates of the present value of expected cash flows, the risk adjustment for non-financial risk and the CSM.

	Estimates of the present value of expected cash flows	Risk adjustment for non- financial risk	CSM	Total
Net opening balance	163,962	5,998	8,858	178,818
Changes that relate to current service	35	(604)	(923)	(1,492)
CSM recognised for service provided	-	-	(923)	(923)
Expiry of the risk adjustment for non-financial risk	-	(604)	-	(604)
Experience adjustments	35	-	-	35
Changes that relate to future service	(784)	1,117	(116)	217
Contracts initially recognised in the period	(2,329)	1,077	1,375	123
Changes in estimates that adjust the CSM	1,452	39	(1,491)	-
Changes in estimates that result in losses and reversals of losses on onerous contracts	93	1	-	94
Changes that relate to past service	47	(7)	-	40
Adjustments to liabilities for incurred claims	47	(7)	-	40
Insurance service result	(702)	506	(1,039)	(1,235)
Insurance finance expenses	9,087	-	221	9,308
Total changes in the statement(s) of financial performance	8,385	506	(818)	8,073
Cash flows	18,833	-	-	18,833
Net closing balance	191,180	6,504	8,040	205,724

IFRS 17.105A–105B, 109A



An entity discloses the following related to assets for insurance acquisition cash flows recognised:

- a reconciliation from the opening balance to the closing balance, including separate line items for recognition of impairment losses and reversals of such losses; and
- quantitatively, in appropriate time bands, when it expects to derecognise the asset and include those cash flows in the measurement of the group of insurance contracts to which they are allocated.

IFRS 17.98, 106–109

An entity discloses the following, except for groups of contracts to which the PAA has been applied.

- An analysis of the insurance revenue recognised in the period.
- An analysis of the effect on the statement of financial position for contracts that are initially recognised in the period – based on the components of the general measurement model.



- When the entity expects to recognise the remaining CSM at the reporting date in profit or loss – this disclosure is made quantitatively in appropriate time bands.

IFRS 17.107–108



IFRS 17 vs IFRS 4 – New business issued and business in force comparison

The separate disclosure requirements for new contracts issued during the period provide insight, at the level of aggregation applied, into the profitability and attributes of these contracts, as well as whether an entity's insurance business is growing or contracting.

Similarly, the disclosure requirements regarding the entity's expectations with respect to CSM recognition in future periods provide insight into the profitability pattern expected in future periods.

It is not currently common practice for insurers to disclose this information in financial statements under IFRS Standards, although some similar information is often included in embedded value reporting – e.g. value of new business and value of in-force business – when it is used by analysts to assess value creation.

IFRS 17.97

For groups of contracts to which the PAA has been applied, an entity discloses:

- how it has satisfied the eligibility requirements for applying the PAA; and
- the accounting policy choices that it has made about:
 - whether to adjust the liability for remaining coverage and the loss component for the time value of money and the effect of financial risk; and
 - whether to recognise insurance acquisition cash flows as expenses when they are incurred.

IFRS 17.110–113

An entity also provides disclosures to enable users of its financial statements to evaluate the sources of finance income or expenses recognised in profit or loss and OCI. It does this by explaining the total amount of insurance finance income or expense in the period and the relationship between these amounts and the investment return on its assets. Additional disclosures are required for direct participating contracts – e.g. an entity describes the composition of the underlying items and their fair value.

19.4

Disclosures about significant judgements

IFRS 17.117

An entity discloses information about the significant judgements that it makes and changes in those judgements. These include:

- the methods used to measure insurance contracts and the processes for estimating the inputs into those methods. Information about the inputs includes quantitative information, unless this is impracticable; and
- any changes in the methods and processes for estimating inputs used to measure those contracts, the reason for each change and the type of contracts affected.

For example, an entity discloses the approaches used to:

- distinguish changes in estimates of expected cash flows arising from the exercise of discretion from other changes in estimates of expected cash flows for contracts without direct participation features;
- determine the risk adjustment for non-financial risk, including whether it disaggregates changes into an insurance finance component and an insurance service component;
- determine discount rates;
- determine investment components; and
- determine the relative weighting of the benefits provided by insurance coverage and investment-return service (for contracts under the general measurement model) or insurance coverage and investment-related service (for direct participating contracts).

*IFRS 17.118*

If the entity applies the OCI option (see [Section 13.2](#)), then it also explains how it determines the insurance finance income or expense recognised in profit or loss.

IFRS 17.119, B92

An entity discloses the confidence level used to determine the risk adjustment for non-financial risk. If it uses a technique other than the confidence level technique, then it discloses the technique used and the confidence level that corresponds to the results of that technique.

IFRS 17.120

An entity also discloses the yield curve (or range of yield curves) used to discount cash flows that do not vary based on the returns on underlying items. If an entity provides this information in aggregate for a number of groups of contracts, then it provides the disclosures in the form of weighted averages or relatively narrow ranges.

19.5

Disclosures about risks

IFRS 17.121–125

An entity discloses information that focuses on the insurance and financial risks (typically including credit risk, liquidity risk and market risk) that arise from insurance contracts and how they have been managed. The objective of disclosing this information is to enable users of its financial statements to evaluate the nature, amount, timing and uncertainty of expected cash flows that arise from contracts under IFRS 17.

IFRS 17.124–125

For each type of risk, an entity discloses:

- the exposure to risks, how they arise and changes in these from the previous period;
- the entity's objectives, policies and processes for measuring and managing risk, and changes in these from the previous period; and
- summary quantitative information about the exposure to the risk at the reporting date. This is based on information provided internally to key management personnel or, when this is not provided, based on specific disclosure requirements.

IFRS 17.127–132

The specific disclosure requirements about exposure to risk at the reporting date include:

- information about risk concentration;
- sensitivity analyses to changes in risk variables arising from insurance contracts (i.e. insurance and market risks);
- claims development (i.e. actual claims compared with previous estimates);
- maximum exposure to credit risk, and information about the credit quality of reinsurance contracts held that are assets; and
- information about liquidity risk.

IFRS 17.132

Specific disclosures for liquidity risks include separate maturity analyses for both portfolios of insurance contracts issued and portfolios of reinsurance contracts held that are liabilities, which show the net cash flows for each of the first five years after the reporting date and, in aggregate, for periods beyond that point. However, an entity is not required to include liabilities for remaining coverage measured using the PAA in these analyses. Any amounts payable on demand are disclosed separately.

IFRS 17.126

The disclosures also include information about the effect of the regulatory frameworks in which the entity operates – e.g. minimum capital requirements or required interest rate guarantees.

20

Effective date and transition



The effective date of IFRS 17 is 1 January 2023. The transition methods applied depend on whether retrospective application is impracticable.

20.1

IFRS 17.C1

IFRS 17.C2

IFRS 17.C34

IFRS 17.C29

Effective date



IFRS 17 is applied for annual reporting periods beginning on or after 1 January 2023. Earlier application is permitted for entities that apply IFRS 9 on or before the date of initial application of IFRS 17.

The transition requirements define the date of initial application as the start of the annual reporting period in which an entity first applies IFRS 17.

IFRS 17 supersedes IFRS 4, including the amendments to IFRS 4 introduced in 2016, which include:

- the temporary exemption from IFRS 9; and
- the overlay approach.

From the date of initial application of IFRS 17, these approaches are no longer available and IFRS 9 is applied, without delay or adjustment.

If an entity has already applied IFRS 9 before IFRS 17 (with or without the overlay approach), then IFRS 17 provides redesignation requirements and options (see [Section 20.4](#)).



Differing effective dates of IFRS 9 and IFRS 17

The differing effective dates of IFRS 9 and IFRS 17 meant that two major accounting changes would have needed to be implemented within a short period of time.

Entities would have been required to apply the IFRS 9 classification and measurement requirements before the adoption of IFRS 17. Changes in the classification of financial assets could have temporarily increased accounting mismatches and created volatility in profit or loss and OCI. This would have resulted in added costs and complexity for both preparers and users of insurers' financial statements.

The International Accounting Standards Board responded to these potential issues by issuing amendments to IFRS 4, allowing:

- temporary exemption from applying IFRS 9 for certain entities that issue contracts in the scope of IFRS 4; and
- exclusion from profit or loss of the difference between the amounts recognised under IFRS 9 and IAS 39 for specified assets relating to insurance activities (overlay approach).

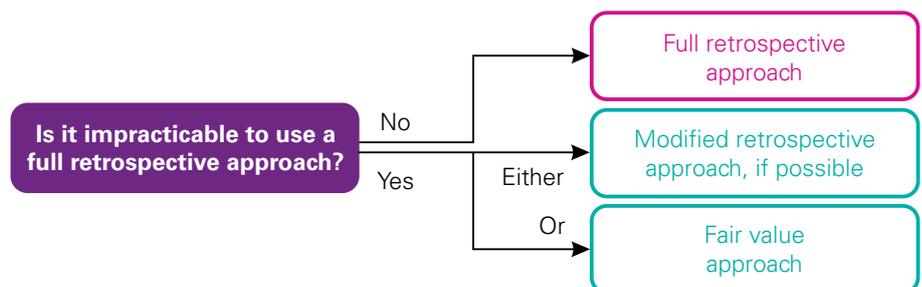
Our publication [First Impressions: Insurance amendments](#) provides an overview of the amendments and a discussion of their key elements.

20.2

IFRS 17.C3–C4, BC375–BC378

Transition to IFRS 17

IFRS 17 is applied retrospectively unless this is impracticable. To the extent that this is impracticable an entity applies the modified retrospective approach or the fair value approach. However, even if that is not impracticable, the fair value approach can be used when the risk mitigation option is applied as discussed in 20.2.1.



Note: An entity applies different transition approaches to different groups of contracts if appropriate.

The process of applying IFRS 17 retrospectively in an entity's financial statements starts with preparing the statement of financial position at the date of transition, which is the beginning of the period immediately preceding the date of initial application. For example, the date of transition will be 1 January 2022 for companies that have an annual reporting date of 31 December and implement IFRS 17 from 1 January 2023. The following two areas are particularly complex.

- **Determining the CSM or loss component:** The fulfilment cash flows component of the insurance contract liability or asset is based on current estimates that reflect circumstances at the measurement date. However, the CSM and loss component result from:

- estimating each component of the fulfilment cash flows on initial recognition and adjusting them in each subsequent period for changes in estimates that either adjust the CSM or are allocated to the loss component; and
- estimating the amount of CSM or loss component that would have been recognised in profit or loss over the previous years.

This estimation needs to be based on aggregating contracts into groups, which are determined on initial recognition. Measuring these components retrospectively might be subject to bias due to the use of hindsight, and is often impracticable.

- **Determining the cumulative effect of the difference between the insurance finance income or expense recognised in profit or loss and the total insurance finance income or expense:** The accumulated balance in OCI is the difference between the total insurance finance income or expense recognised and the amount of insurance finance income or expense that would have been presented in profit or loss since initial recognition of a group of contracts. Both amounts could be difficult to identify retrospectively, and might require the use of hindsight because they depend on historical rates not necessarily used or documented.

This chapter discusses IFRS 17's full retrospective approach (see 20.2.1), the modified retrospective approach (see 20.2.2) and the fair value approach (see 20.2.3), which were introduced to address these challenges.

20.2.1

IFRS 17.C4

Full retrospective application

At the date of transition, with corresponding differences recognised in equity, an entity:



- recognises and measures each group of insurance contracts and any assets for insurance acquisition cash flows as if IFRS 17 had always been applied; and
- derecognises any existing balances that would not exist if IFRS 17 had always been applied.

However, an entity is not required to apply the recoverability test for insurance acquisition cash flows retrospectively before the date of transition.

IFRS 17.C3(b)



Also, under the full retrospective approach, if an entity has used a derivative, non-derivative financial instrument measured at FVTPL or reinsurance contract held to mitigate financial risk arising from a group of direct participating insurance contracts, then the option to exclude some effects of the changes in the financial risk arising from the group of insurance contracts from the CSM is applied prospectively from the date of transition (see 15.3.3).

IAS 8.5



Full retrospective application

Full retrospective application will typically be a difficult exercise requiring significant time, effort and resources and a large amount of high-quality historical data.

Entities might encounter difficulties in the following areas.

- Identifying direct participating contracts based on information available on initial recognition: this might involve identifying the entity's expectations about the policyholder's share of underlying items at contract inception.
- Applying the aggregation requirements based on the original expectations about the contract's profitability and risks of becoming onerous.
- Determining the fulfilment cash flows on a contract's initial recognition in order to determine the CSM or loss component, and identifying all changes since initial recognition that would have adjusted the CSM or have been allocated to the loss component.
- Determining the cumulative amount of insurance finance income or expense that would have been recognised in OCI.

Groups of contracts accounted for under the general measurement model

These difficulties arise particularly for groups of long-duration contracts that are accounted for under the general measurement model (including applying modifications for direct participating contracts). It is likely that for many long-duration contracts, entities will apply at least some of the modifications permitted under the modified retrospective approach or the fair value approach. An exception to this might be groups of long-duration contracts that were recently issued, for which relevant historical information is more likely to be more readily available.

The use of an approach other than full retrospective application may result in less comparability between different generations of similar contracts and profit recognition patterns that are different from those that would apply under a full retrospective approach.

For groups of shorter-duration contracts, these difficulties will be less significant, because their recognition is more recent and there may be less risk of using hindsight.



Groups of contracts accounted for under the PAA

Retrospective application for contracts accounted for under the PAA poses a lesser challenge because these contracts usually have short coverage periods, and the challenges around determining the CSM do not arise. However, the new requirements for allocating insurance acquisition cash flows to different groups, including renewals, may cause complexities for some entities.

IFRS 17.C5–C6

Only when it is impracticable for an entity to complete a full retrospective application for a group of contracts or for an asset for insurance acquisition cash flows, can an entity choose between applying a modified retrospective approach and the fair value approach. This choice is relevant for a group of contracts or for an asset for insurance acquisition cash flows only if reasonable and supportable information can be obtained to apply the modified retrospective approach; otherwise, the fair value approach is applied. An entity assesses and applies the requirements to the assets for insurance acquisition cash flows separately from the group of insurance contracts.

IFRS 17.C5A



However, an entity may choose to apply the fair value approach to a group of insurance contracts with direct participation features even if it could apply the full retrospective approach if the entity:

- chooses to apply the risk mitigation option prospectively to the group of insurance contracts from the date of transition; and
- has used derivatives, reinsurance contracts held or non-derivative financial instruments measured at FVTPL to mitigate financial risk arising from the group of insurance contracts before the date of transition.

IAS 8.5

The use of hindsight is not allowed under the full retrospective approach, which may make retrospective application impracticable. For example, full retrospective application is considered impracticable if it:

- requires significant estimates of amounts; and
- is impossible to objectively distinguish from other information, information about those estimates that:
 - provides objective evidence of circumstances that existed on the dates at which the amounts are to be recognised, measured or disclosed; and
 - would have been available when the financial statements for that prior period were authorised for issue.

20.2.2

IFRS 17.C6

Modified retrospective approach

The objective of the modified retrospective approach is to use reasonable and supportable information that is available without undue cost or effort to achieve the closest possible outcome to full retrospective application. If an entity cannot obtain reasonable and supportable information, then it applies the fair value approach (see 20.2.3).

IFRS 17.C6(b), C8

When applying the modified retrospective approach, an entity maximises the use of information that is available without undue cost or effort that would have been used to apply a full retrospective approach. Therefore, an entity uses each of the permitted modifications discussed in this section only to the extent that it does not have reasonable and supportable information to apply a full retrospective approach.

20.2.2.1

IFRS 17.C9–C10

Assessments at inception or initial recognition

To the extent that an entity is not able to identify groups of contracts or their classification based on information available at inception or initial recognition, an entity determines, using information available at the date of transition:

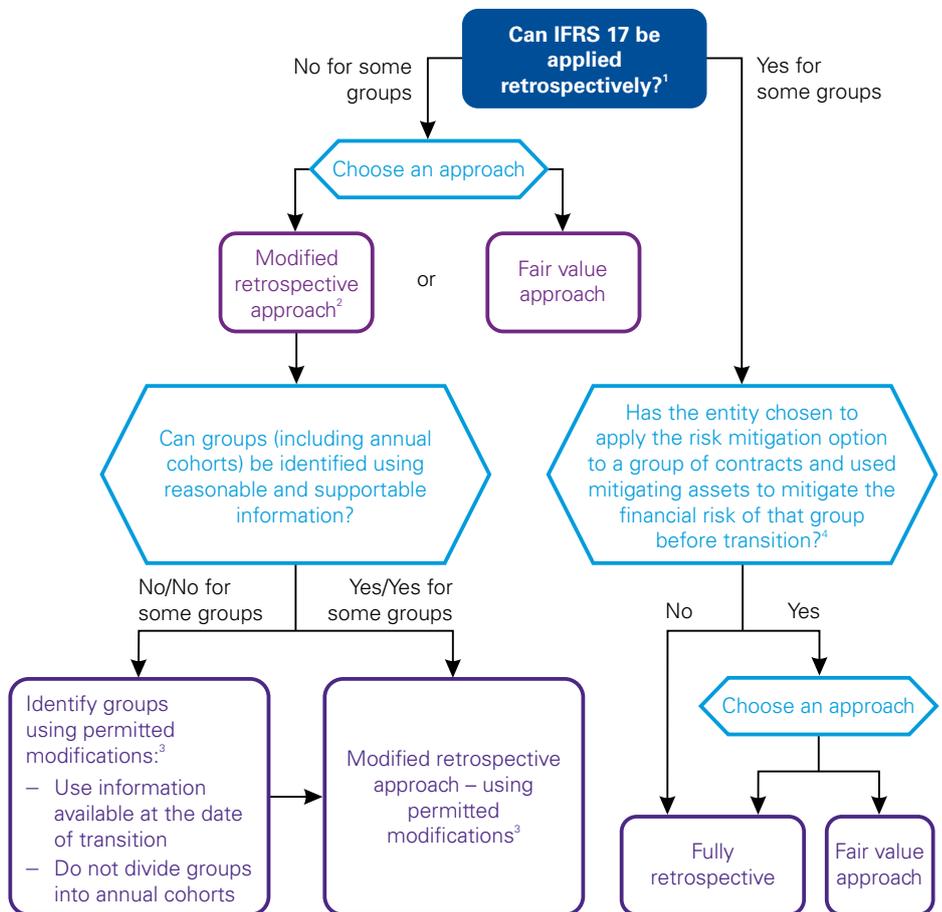
- how to identify groups of insurance contracts: when completing this assessment, an entity may group contracts issued more than one year apart, if necessary (see Chapter 6);

- whether a contract is considered a direct participating contract (see Section 15.2);
- how to identify discretionary cash flows for contracts without direct participation features (see 10.2.2.1); and
- whether an investment contract meets the definition of an investment contract with DPFs.

IFRS 17.C9A



To the extent that an entity does not have reasonable and supportable information to apply the full retrospective approach, an entity classifies as a liability for incurred claims a liability for settlement of claims incurred before an insurance contract was acquired in a transfer of insurance contracts that do not form a business or in a business combination in the scope of IFRS 3.



Notes

1. Retrospective application of IFRS 17 is generally required, unless it is impracticable.
2. If an entity cannot obtain reasonable and supportable information to apply the modified retrospective approach, then it applies the fair value approach.
3. Using permitted modifications only to the extent that reasonable and supportable information is not available to apply a retrospective approach.
4. See 15.3.3. Mitigating assets include derivatives, non-derivative assets measured at FVTPL and reinsurance contracts held.

20.2.2.2

IFRS 17.C14A, C19A



Interim reporting

To the extent that an entity does not have reasonable and supportable information to apply the requirements of the full retrospective approach, if an entity elects not to change the treatment of accounting estimates made in previous interim financial statements, then it determines the contractual service margin or the loss component at the date of transition as if it had not prepared any interim financial statements before the date of transition.



Interim reporting before transition

IFRS 17 was amended to provide operational relief on transition for entities that make an accounting policy choice not to change the treatment of past accounting estimates made in previous interim financial statements (see 10.2.5).

This is especially relevant for entities that did not apply such an approach before implementing IFRS 17, because in most of these cases a retrospective approach would probably not be practicable.

20.2.2.3

IFRS 17.C16A–C16C



Reinsurance contracts held

For a group of reinsurance contracts held that provides coverage for an onerous group of insurance contracts and was entered into before or at the same time as the insurance contracts were issued, a loss recovery component of the asset for remaining coverage is determined at transition. An entity determines the loss recovery component by multiplying:

- the loss component of the liability for remaining coverage for the underlying insurance contracts at the date of transition; and
- the percentage of claims for the underlying insurance contracts that the entity expects to recover from the group of reinsurance contracts held.

The onerous underlying insurance contracts might be included in a group of insurance contracts with other onerous contracts that are not covered by the group of reinsurance contracts held. If they are, then the entity uses a systematic and rational basis to allocate a portion of the loss component of the group of insurance contracts to the underlying insurance contracts in that group and then applies the guidance above.

To the extent that an entity does not have reasonable and supportable information to apply the guidance above, it does not identify a loss recovery component for the group of reinsurance contracts held.

IFRS 17.C16A–C16C, BC315A

**Reinsurance contracts held on transition**

IFRS 17 was amended to require companies to recognise recoveries from reinsurance contracts held for losses on initial recognition of onerous underlying contracts. In some cases, these reinsurance contracts may cover losses on some, but not all, of the onerous contracts in a group of insurance contracts. Given that the group of insurance contracts is the unit of account, IFRS 17 does not require initial losses and subsequent measurement of the onerous contracts to be tracked at a contract level. Accordingly, for both the modified retrospective approach and the fair value approach, a further amendment was made to require a company to use a systematic and rational method of allocation to determine the portion of losses recognised that relate to the reinsured insurance contracts in an onerous group. This will provide operational relief on transition.

20.2.2.4

IFRS 17.C9, C10–C14, C14B–C16

Determining the CSM or loss component for groups of contracts without direct participation features

The permitted modifications for the measurement of groups of insurance contracts without direct participation features focus on determining the CSM or loss component at transition, by estimating the CSM or loss component on initial recognition and rolling it forward to determine the liability for remaining coverage at the date of transition. In addition, the table includes the treatment of insurance acquisition cash flows.

Amount to be determined for a group of contracts	As of date	Permitted modification
Expected cash flows	Initial recognition	<p>Estimated as the amount of the expected cash flows at the date of transition, adjusted for the cash flows that are known to have occurred between the date of initial recognition of the group and the date of transition.</p> <p>If the amount of the expected cash flows can be determined retrospectively for an earlier date than the date of transition, then that amount is used instead.</p>



Amount to be determined for a group of contracts	As of date	Permitted modification
Discount rates	Initial recognition or subsequently	<p>Estimated using an observable yield curve that approximates the yield curve determined under IFRS 17 for at least three years before the date of transition.</p> <p>If such an observable yield curve does not exist, then the entity applies a spread (averaged over at least three years before the date of transition) to an observable yield curve. The spread adjusts the observable yield curve to approximate a yield curve determined under the standard.</p>
Risk adjustment for non-financial risk	Initial recognition or subsequently	<p>Determined as the risk adjustment for non-financial risk at the date of transition adjusted for the expected release of risk before that date. The expected release of the risk adjustment is determined with reference to the release of risk for similar insurance contracts that the entity issues at the date of transition.</p>
Insurance acquisition cash flows	Date of transition	<p>Insurance acquisition cash flows are measured by:</p> <ul style="list-style-type: none"> – identifying the amount of insurance acquisition cash flows that occurred before the date of transition (excluding the amount relating to contracts that ceased to exist before the date of transition); and – allocating this amount – using the same systematic and rational allocation method that the entity will apply to: <ul style="list-style-type: none"> - groups of insurance contracts that are already recognised at the date of transition; and - groups of insurance contracts that are expected to be recognised after the date of transition. <p>If an entity does not have reasonable and supportable information to apply the above, then both amounts are nil.</p>

Amount to be determined for a group of contracts	As of date	Permitted modification
CSM	Initial recognition and the date of transition	<p>The permitted modifications described above are applied as necessary to determine the CSM on initial recognition.</p> <p>The amount of CSM at the date of initial recognition is then adjusted to:</p> <ul style="list-style-type: none"> – accrete interest based on the discount rates that were determined to apply on initial recognition; and – reflect the transfer of services before the date of transition by determining the amount recognised in profit or loss, by comparing the remaining coverage units with the coverage units provided under the group of contracts before the date of transition.
Loss component	Initial recognition and date of transition	The same requirements and permitted modifications are applied to determine any loss component on initial recognition and amounts subsequently allocated to it.

The carrying amount of the liability for remaining coverage of a group of insurance contracts at the date of transition is the sum of the fulfilment cash flows and the CSM at this date. For onerous groups of contracts, a loss component at the date of transition is identified. These amounts form the basis for revenue recognition in subsequent periods.

IFRS 17:IE186–IE171



Example 17 – Measuring a group of contracts without direct participation features at transition

Fact pattern

Entity E has an annual reporting date of 31 December and initially applies IFRS 17 on 1 January 2023 – i.e. the date of initial application. The beginning of the earliest period presented is 1 January 2022 – i.e. the date of transition.

E has a portfolio of non-participating term life contracts. It concludes that it can apply a full retrospective approach at the date of transition to some groups of contracts in the portfolio.

However, it is impracticable to apply a full retrospective approach at the date of transition for the other groups of contracts included in the portfolio. For these groups, E chooses to apply a modified retrospective approach using available reasonable and supportable information.

Applying the permitted modifications to these groups, E identifies several groups of insurance contracts within the portfolio, based on information that is available on the date of transition. E has reasonable and supportable information to include contracts that were issued no more than one year apart in each group, and therefore identifies the groups on this basis. One of these groups is Group A.

The estimates of fulfilment cash flows for Group A at the date of transition are as follows.

Expected cash flows (outflows)	770
Discounting effect	(150)
Risk adjustment	100
Fulfilment cash flows estimated at transition (outflows)	720

Analysis

Under the modified retrospective approach, E estimates the CSM of Group A on initial recognition based on the following.

Permitted modifications applied	Estimates on initial recognition
Net expected cash inflows	(30)
The expected cash outflows at transition of 770 are adjusted for the cash inflows that are known to have occurred between initial recognition and the date of transition of 800.	
Time value of money	(200)
Adjusted by 50 for the effect of discounting on initial recognition applying an observable yield curve that approximates the yield curve determined under IFRS 17 for at least three years before the date of transition, to the expected cash flows above.	
Risk adjustment for non-financial risk	120
The estimated risk adjustment at transition is grossed up by 20 for the release of non-financial risk between initial recognition and the date of transition with reference to release patterns for similar contracts issued at the date of transition.	
Fulfilment cash flows on initial recognition	(110)
CSM on initial recognition	110

Analysis

To determine the CSM at transition, E adjusts the CSM on initial recognition of 110 for the estimate of the CSM that would have been recognised in profit or loss before the date of transition of 90, and arrives at a CSM of 20.

As a result, the carrying amount of the insurance contract liability of Group A at the date of transition is as follows.

Fulfilment cash flows	720
CSM	20
Insurance contract liability at date of transition	740

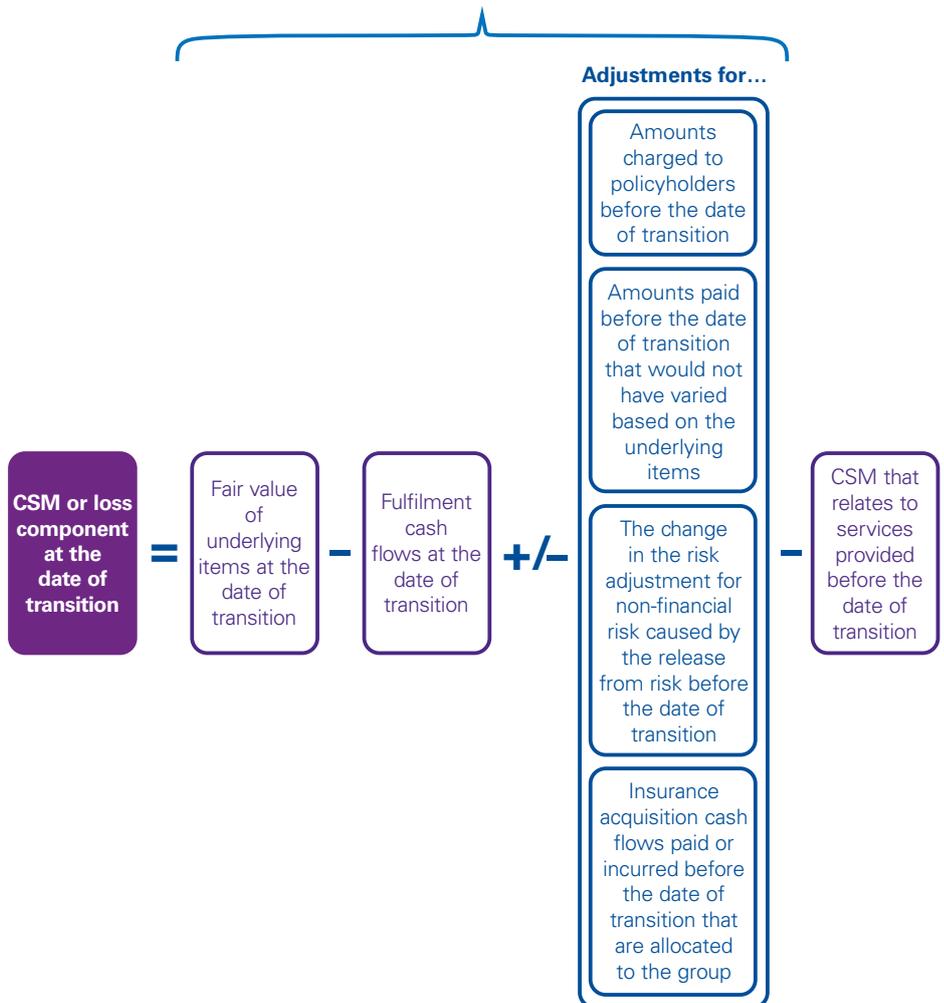
20.2.2.5

IFRS 17C17–C17A

Determining the CSM or loss component for groups of direct participating contracts

Under the modified retrospective approach, the CSM or loss component for a group of direct participating contracts at the date of transition is calculated as follows.

Proxy for the total CSM for all services (past and future) provided under the contracts



The calculation that reflects a proxy for the total CSM for all services (past and future) provided under the contracts is reduced by the CSM that relates to services

provided before the date of transition. This is based on the ratio between the remaining coverage units at the date of transition and the coverage units provided under the groups of contracts before the date of transition.

If the above calculation results in a loss component, then the loss component is adjusted to zero, with a corresponding increase in the liability for remaining coverage, excluding the loss component.

The requirements regarding insurance acquisition cash flows described in 20.2.2.4 apply equally to insurance contracts with direct participating features.

IFRS 17/IE192–IE199



Example 18 – Measuring a group of contracts with direct participation features at transition

Fact pattern

Entity E has an annual reporting date of 31 December and initially applies IFRS 17 on 1 January 2023 – i.e. the date of initial application. The beginning of the earliest period presented is 1 January 2022 – i.e. the date of transition.

E has a portfolio of participating contracts. It determines that it is impracticable to apply a full retrospective approach at the date of transition for the groups of contracts included in this portfolio and, applying a modified retrospective approach, it identifies Group B as a group of direct participating contracts.

The total fair value of the underlying items of Group B at the date of transition is determined as follows.

Premium received at inception	1,000
Changes in fair value of underlying items	219
Charges deducted from underlying items	(55)
Deduction for death benefits and other expenses	(216)
E paid an additional amount of 23 that does not vary based on the returns on underlying items according to a minimum death benefit – i.e. it was not deducted from the account balance.	
Fair value of the underlying items at the date of transition	948

E estimates the fulfilment cash flows at the date of transition to be 922, and the changes in the risk adjustment for non-financial risk caused by the release from risk before the date of transition at 14. It also determines that 60% of the total coverage units have been provided before that date.

E estimates the CSM at the date of transition as follows.

Fair value of underlying items at the date of transition	948
Fulfilment cash flows at the date of transition	(922)
Charges deducted from underlying items	55
Amounts paid that do not vary based on returns on underlying items	(23)
Change in risk adjustment for non-financial risk	(14)
Subtotal of CSM before allocation to periods	44
Allocation of CSM to past periods	(26)
CSM at the date of transition	18

20.2.2.6

IFRS 17.C18–C19

Determining insurance finance income or expense

To determine insurance finance income or expense for periods subsequent to the date of transition, an entity determines the discount rate on initial recognition, based on the following.

Do the groups of insurance contracts include contracts issued more than one year apart?	Discount rates that an entity determines
Yes	Discount rates at the date of transition
No	The rate that was determined to apply on initial recognition – i.e. retrospectively identified or determined using the permitted modification for discount rates

Applying the OCI option for insurance finance income or expense, the amount accumulated in OCI impacts insurance finance income or expense for periods subsequent to the date of transition. Therefore, the amounts accumulated in OCI on the date of transition are determined as follows.

Characteristics of the groups of insurance contracts	Amounts accumulated in OCI
Groups of direct participating contracts for which the entity holds the underlying items	The amount accumulated in OCI for the underlying items
Groups of other contracts for which changes in financial assumptions have a substantial effect on the amounts paid to policyholders	Zero
All other groups	The amount calculated using the discount rate that was used to arrive at the CSM on initial recognition – i.e. retrospectively identified or determined using the permitted modification for discount rates. For such groups of contracts that include contracts issued more than one year apart, the accumulated amount in OCI may be determined at zero.

To determine the insurance finance income or expense recognised in profit or loss for periods subsequent to the date of transition for groups of insurance contracts that apply the PAA and apply the OCI option for insurance finance income or expense, an entity determines the following.

Do the groups of insurance contracts include contracts issued more than one year apart?	An entity determines...
Yes	<p>The amount accumulated in OCI may be:</p> <ul style="list-style-type: none"> – calculated using discount rates determined to apply at the date of incurred claims – i.e. retrospectively identified or determined using the permitted modification for discount rates; or – zero.
No	<p>The amount accumulated in OCI is calculated using discount rates determined to apply at the date of incurred claims – i.e. retrospectively identified or determined using the permitted modification for discount rates.</p>

IFRS 17.C19A



To the extent that an entity does not have reasonable and supportable information to apply the requirements of the full retrospective approach, an entity that makes an accounting policy choice not to change the treatment of accounting estimates made in previous interim financial statements (see 20.2.2.2) determines amounts related to insurance finance income or expenses at the date of transition as if it had not prepared interim financial statements before the date of transition.

20.2.3

IFRS 17.C20

Fair value approach

Under this approach, an entity determines the CSM or loss component at the date of transition for a group of contracts based on the difference between the fair value of the group and the fulfilment cash flows of the group at that date. This fair value is determined using the requirements in IFRS 13, except for the requirement that the fair value of a financial liability with a demand feature cannot be less than the amount payable on demand.

IFRS 17.C21–C23

When the fair value approach is applied, an entity uses reasonable and supportable information for what it would have determined given the terms of the contract and the market conditions at the date of inception or initial recognition, as appropriate, or it uses reasonable and supportable information that is available at the date of transition. It uses this information to determine:

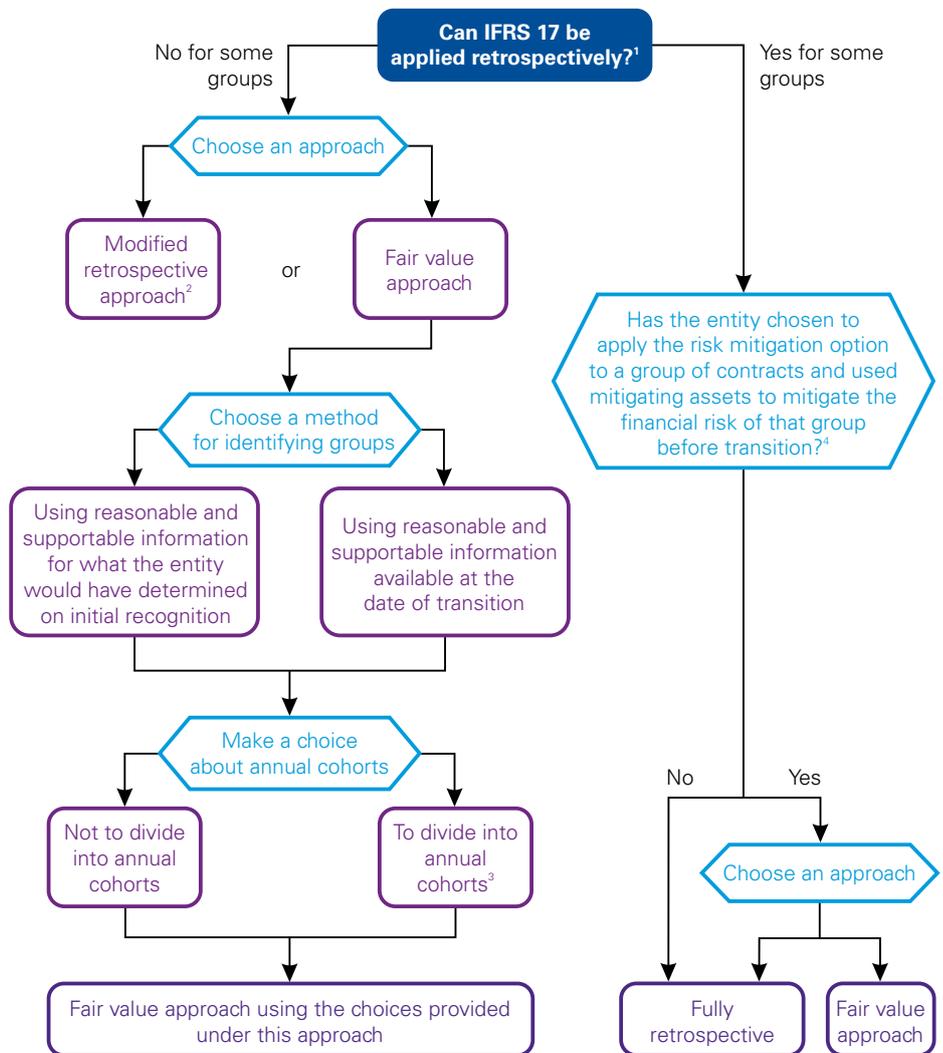
- how to identify groups of insurance contracts (see Chapter 6);
- whether a contract meets the definition of a direct participating contract (see Section 15.2);

- how to identify discretionary cash flows for insurance contracts without direct participation features (see 10.2.2.1); and
- whether an investment contract meets the definition of an investment contract with DPFs.



An entity may choose to classify as a liability for incurred claims a liability for settlement of claims incurred before an insurance contract was acquired in a business combination in the scope of IFRS 3 or in a transfer of insurance contracts that do not form a business.

In applying the fair value approach, when identifying groups of insurance contracts, an entity may group contracts issued more than one year apart. However, it may divide groups into those issued within a year if it has reasonable and supportable information to make the division.



Notes

1. Retrospective application of IFRS 17 is generally required, unless it is impracticable.
2. If an entity cannot obtain reasonable and supportable information to apply the modified retrospective approach, then it applies the fair value approach.

3. Only if reasonable and supportable information is available to do so.
4. See 15.3.3. Mitigating assets include derivatives, non-derivative assets measured at FVTPL and reinsurance contracts held.

20.2.3.1

IFRS 17.C24A



Insurance acquisition cash flows

Applying the fair value approach for an asset for insurance acquisition cash flows, at the date of transition the asset is measured at an amount equal to the amount of insurance acquisition cash flows that the entity would incur at the date of transition to obtain rights to:

- recover insurance acquisition cash flows from premiums of insurance contracts issued before the date of transition but not yet recognised at the date of transition;
- future insurance contracts that are renewals of contracts issued or recognised at the date of transition; and
- other future insurance contracts without paying again insurance acquisition cash flows that the entity has already paid that are directly attributable to the related portfolio of insurance contracts.

IFRS 17.C24B, BC184E

The amount of any asset for insurance acquisition cash flows is not included in the measurement of any groups of insurance contracts recognised at the date of transition because these assets relate to groups that will be recognised at a future date.

20.2.3.2

IFRS 17.C23

Insurance finance income and expense

To determine insurance finance income or expense for periods subsequent to the date of transition, an entity needs to determine the discount rate at the date of initial recognition. However, under the fair value approach it can instead determine the discount rate at the date of transition. This could also be applied for determining the discount rates at the dates of the incurred claims for groups of insurance contracts that apply the PAA and apply the OCI option for insurance finance income or expense.

IFRS 17.C24

If an entity applies the OCI option for insurance finance income or expense, then it is permitted to determine the amount accumulated in OCI on the date of transition as follows:

- retrospectively – if reasonable and supportable information is available;
- as being equal to the amount accumulated in OCI for underlying items held for direct participating contracts, for which the entity holds the underlying items; and
- for other groups of contracts, as zero.

20.2.3.3

IFRS 17.C20A



Reinsurance contracts held that provide coverage for onerous contracts

For a group of reinsurance contracts held that provides coverage for an onerous group of insurance contracts, a loss recovery component of the asset for remaining coverage is determined at transition. An entity determines the loss recovery component by multiplying:

- the loss component of the liability for remaining coverage for the underlying insurance contracts at the date of transition; and
- the percentage of claims for the underlying insurance contracts that the entity expects to recover from the group of reinsurance contracts held.

Relief is provided on transition from the usual requirement for the reinsurance contract to have been entered into before or at the same time as the underlying onerous insurance contracts were recognised.

IFRS 17.C20B

The onerous underlying insurance contracts might be included in a group of insurance contracts with other onerous contracts that are not covered by the group of reinsurance contracts held. To determine the loss recovery component, an entity uses a systematic and rational approach to determine the portion of the loss component of the group of insurance contracts that relates to the underlying insurance contracts covered by the reinsurance contract held.



Determining the fair value of insurance contracts

Under the fair value approach, entities will probably need to focus their efforts on determining the fair values of groups of contracts. Although the fair value of insurance contracts would have been measured for business combination transactions under IFRS 3, the infrequency of such transactions, the relatively small proportion of the in-force business that has been subject to such transactions, the variety of transactions for transfers of contracts and a shortage of observable market inputs are expected to pose challenges in this area.

Entities will have to be able to identify the differences in the measurements that will arise between the fair value and the fulfilment cash flows of the group to establish the CSM. Entities are likely to consider items such as a market participant vs an entity perspective when determining the risk adjustment for non-financial risk and how to accommodate non-performance risk in the fair value measurement.



Practical implementation of the transition requirements

Applying the transition requirements is expected to be a challenging exercise. Entities will first need to determine whether and to what extent full retrospective application is impracticable. If it is, then they will need to go through the different requirements and choices available for each transition approach to decide on the approach to apply for each relevant group of contracts.

The availability of relevant information is key to these assessments.

If an entity has no record of its assumptions at the date of initial recognition, then it is likely to apply either the modified retrospective approach or the fair value approach.

Some entities maintain some level of information about the assumptions used at the date of initial recognition, but may still encounter some difficulties in applying a full retrospective approach, including the following.

- Some reasonable and supportable information about actual historical cash flows may be available from the entity's systems. However, significant challenges may arise when this information is available only at a higher level of aggregation than that necessary to measure groups of insurance contracts applying the usual grouping requirements (see [Chapter 6](#)).
- Difficulties in retrieving relevant and reliable information could arise if assumptions at the date of initial recognition were not developed in a manner consistent with the requirements in IFRS 17. Determining an explicit risk adjustment for non-financial risk might be an example of this, because entities in some jurisdictions apply different methods to reflect this risk in the measurement of insurance liabilities.
- Difficulties in retrieving relevant information for each period between initial recognition and the date of transition could arise, because changes in assumptions have not been documented on an ongoing basis.

These difficulties might be less substantial for groups of recently issued contracts, resulting in some groups of contracts being subject to full retrospective application. However, the older the in-force contracts are on transition, the more likely that other approaches for transition will need to be applied. This could result in a mix of approaches applied at transition, which would make comparisons between entities adopting IFRS 17 more challenging.

Applying the modified retrospective approach and the fair value approach could also be challenging. Under the modified retrospective approach, entities are likely to focus their efforts on the assessment of what reasonable and supportable historical information they have, because only in its absence can the permitted modifications be applied.

20.3

IFRS 17.114

Transition disclosures

An entity provides disclosures in subsequent periods about the CSM and insurance revenue separately for insurance contracts that existed at the date of transition and to which it applies the:

- modified retrospective approach; and
- fair value approach.

IFRS 17.115

If an entity applies a modified retrospective approach or the fair value approach at transition, then it includes disclosures to help users understand the nature and significance of the methods used and judgements applied in determining the amounts on transition. The entity is required to explain how it determined the measurement of insurance contracts at the date of transition.

IFRS 17.116

When an entity applies the OCI option to insurance finance income or expense, and the specific transition requirements to determine the amount accumulated in OCI on the date of transition, an additional reconciliation is required to reflect the amounts recognised in OCI for related financial assets.

IAS 8.30–31



Disclosures before IFRS 17 is adopted

During the periods before IFRS 17 is initially applied, an entity discloses known or reasonably estimable information relevant to assessing the possible impact that applying IFRS 17 would have on the entity's financial statements in the period of initial application. The closer to the effective date, the more robust such disclosures are expected to be as more information is expected to be available about the impact of IFRS 17.

20.4

Redesignation of financial assets

The interaction between the classification of financial assets and the presentation of changes in insurance contract liabilities could impact whether accounting mismatches arise.

IFRS 17.C29–C30

Entities applying IFRS 9 before IFRS 17 are permitted – and in some cases are required – to change their previously applied classification and designation of financial assets. These redesignations are based on facts and circumstances that exist at the date of initial application of IFRS 17 and are applied retrospectively using IFRS 9's transition requirements. When applying the IFRS 9 transition requirements, the date of initial application is considered to be the date of initial application of IFRS 17.

These requirements and choices are as follows.

Business model assessment

- An entity may reassess whether a financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows, or within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. This reassessment is relevant only to assets that are not held in respect of an activity that is unconnected with contracts in the scope of IFRS 17. For example, financial

assets held in funds relating to investment contracts that are outside the scope of IFRS 17 are not eligible for reassessment and reclassification.

Fair value option

- An entity may newly designate financial assets under the fair value option as measured at FVTPL if this would eliminate or significantly reduce an accounting mismatch.
- An entity is required to revoke previous designations of financial assets as measured at FVTPL if the designation no longer eliminates or significantly reduces an accounting mismatch as a result of applying IFRS 17.

OCI option for investments in equity instruments

- An entity may newly elect to present in OCI any changes in the fair value of an investment in an equity instrument that is not held for trading and revoke previous elections to that effect.

IFRS 17.C32–C33

When an entity applies these redesignation permissions and requirements, it provides certain qualitative disclosures and, in some cases, quantitative disclosures.

20.5

IFRS 17.C25–C27

Comparative financial information

An entity is required to present comparative financial information for the annual period immediately preceding the date of initial application of IFRS 17. It may also present adjusted comparative information for any earlier periods. In this case, the date of transition is the beginning of that adjusted comparative period.

If an entity presents unadjusted comparative information for earlier periods, then it is required to clearly identify the information as not having been adjusted, stating that it has been prepared on a different basis and explaining that basis.

IFRS 17.C28

Entities are not required to disclose previously unpublished information about claims development that occurred earlier than five years before the end of the annual reporting period in which IFRS 17 is applied for the first time. Entities not disclosing this information disclose this fact.

IFRS 17.C31

An entity that had initially applied IFRS 9 before IFRS 17 and applies any of the transition requirements and choices for the reclassification or redesignation of financial assets is permitted to restate comparative information about these financial assets, but only if doing so is possible without the use of hindsight. If an entity does not restate prior periods, then the difference between the carrying amounts previously reported and at the date of initial application is recognised in the opening balance of retained earnings or another component of equity. However, if previous periods are restated then all relevant IFRS 9 requirements apply.



Comparative information for financial assets

Many insurers will initially apply IFRS 9 in 2023 at the same time as they initially apply IFRS 17. The transition requirements of IFRS 9 do not require comparative financial information to be restated, but require a cumulative effect adjustment at the start of the year in which it is adopted. The reclassification and redesignation requirements that are relevant for entities that have already applied IFRS 9 before applying IFRS 17 also do not require restatement. Therefore, entities will restate comparative information for their insurance liabilities but not necessarily for the financial assets that support those liabilities.

There may appear to be little or no merit in an entity not restating comparative information for its financial assets on implementation of IFRS 9. However, entities will have to consider the various costs and benefits of restating their financial information for financial assets that relate to insurance contracts, if applicable without the use of hindsight.

Entities should also consider the reduction in comparability between reporting periods, and how they will communicate changes in their financial position to their stakeholders if they do not restate comparative information.

IAS 1.40A



Impact of other standards on comparative information

IAS 1 *Presentation of Financial Statements* requires an entity to present a third statement of financial position at the beginning of the earliest period presented in addition to the minimum comparative financial information requirements in IFRS 17 if it applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements. So, if an entity initially applies IFRS 17 on 1 January 2023, then it presents restated statements of financial position at 31 December 2023 and 2022, and 1 January 2022.

20.6

IFRS 1.B1, B13

First-time adopters of IFRS

IFRS 17 amends IFRS 1 *First-time Adoption of International Financial Reporting Standards* to refer to the IFRS 17 transition requirements as an exemption from the general requirements of IFRS 1 for retrospective application.

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The text of this publication refers to IFRS 17 and to selected other current standards in issue at 1 July 2020.

Further analysis and interpretation will be needed for a company to consider the impact of IFRS 17 in light of its own facts, circumstances and individual transactions. The information contained in this publication is based on initial observations developed by the KPMG International Standards Group and these observations may change. Accordingly, neither this publication nor any of our other publications should be used as a substitute for referring to the standards and interpretations themselves.

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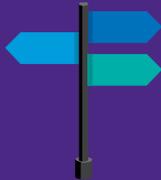
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